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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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Russia's Banking Sector in 2013

Main trends

For the banking system 2013 was marked by a slowdown of development in almost all directions. The previous year's forecast[1], which had predicted the slowdown of growth rates for key parameters of the banking sector, proved correct. The aggregate assets of the banking sector grew by 16% (previous year's forecast predicted 15-17%), corporate loans grew by 13% (forecast: 12-15%), loans to individuals by 28% (forecast: 25–30%) (*Fig. 63*).

The formation of the resource base of the banking sector in 2013 depended on funds of individuals and loans of the Bank of Russia to a larger extent than in the previous year. The funds of private clients accounted for one third of the growth of banking sector resources compared to 28% in the previous year, while funds of the regulator accounted for 24% compared to 18%. The role of the corporate sector in the formation of bank liabilities increased significantly, their contribution growing from 14 to 22%. At the same time, the inflow of foreign credits and loans to the banking sector almost stopped. Foreign liabilities accounted for only 3% of the banking sector resources (*Fig. 64*).

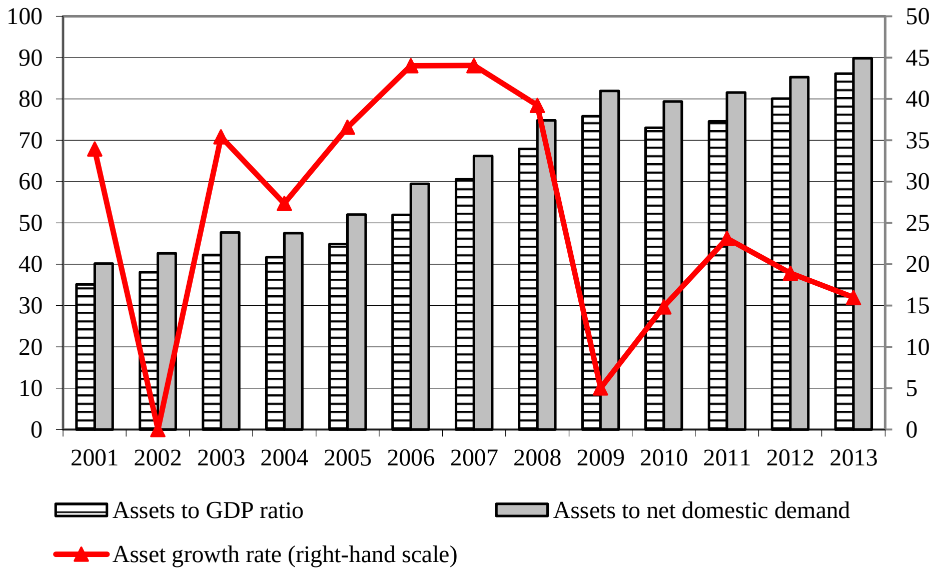
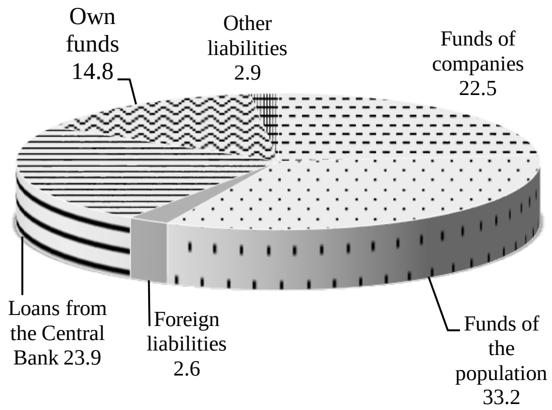


Fig. 63. Growth in bank' assets and the ratio to GDP and net domestic demand[2] (%)

[1] See review "Russian Economy in 2012. Trends and Prospects" (Issue 34), Moscow, the E.T.Gaidar IEP, 2013.

[2] Net domestic demand (NDD) is calculated as GDP without net export and constitutes a measure of domestic consumption in the economy.



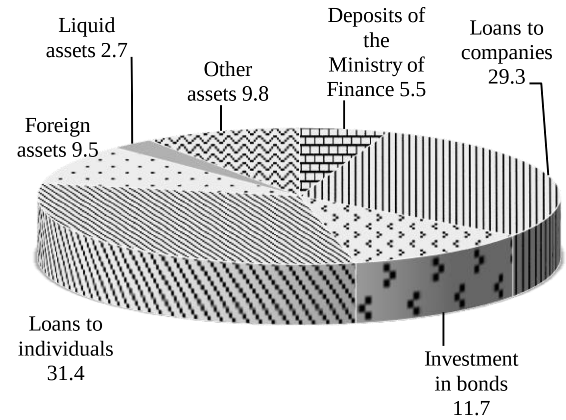


Fig. 64. Structure of banking sector resources (growth in liabilities and decrease in assets) in 2013, as % of the total

Fig. 65. Structure of the use of banking sector resources (growth in assets and decrease in liabilities) in 2013, as % of the total

The previous year's trend in the lending sector, towards displacement of lending to corporate borrowers by retail lending, continued. As a result, in 2013 the growth in loans to individuals exceeded the growth in corporate lending in absolute terms for the first time. Of banks' financial resources, 31% were provided as loans to individuals while 29% went as loans to business (*Fig. 65*).

Banks and households

The following key trends, which in many respects continued the tendencies of the previous year, dominated in the relationship between banks and individuals in 2013:

1. Consumption by households continued to become increasingly dependent on bank loans.
2. The load on household available income, related to the servicing of bank debt, continued to grow.
3. By the end of 2013 a sharp slowdown in the growth in deposits occurred, with their simultaneous redistribution in favour of the state-owned banks.

Growth of credit dependency of the population

There was a decline in growth of the retail segment of bank lending in 2013, after the record (post crisis) levels of 2012 (*Fig. 66*). The volume of individual indebtedness under consumer loans showed the fastest growth (as in previous years), with a 31.3% growth rate. Indebtedness under loans for the purchase of residential property, including mortgage loans, grew by 29.8% during the year, while car loans grew by 22.3%.

The volume of loans to individuals increased by 21.5% in 2013, totaling Rb 8.8 trillion, out of which Rb 1.4 trillion accrued to mortgage loans while Rb 7.4 trillion went to other loans (consumer loans, including car loans). The ratio of provided consumer loans in proportion to household consumer expenditure grew from 21.7% in 2012 to 23.5% in 2013. This means that almost every fourth ruble spent on the purchase of goods and services was loaned by Russian banks.

The greatest concern in respect of risks relating to the insolvency of borrowers and, hence, the stability of banks is not the rate of growth of the loan portfolio itself — in certain periods before the crisis, loan volumes grew even faster — but the increased level of debt burden on the income and assets of households. For example, the ratio of total debt under bank loans to the income of households has already exceeded the crisis maximum (17.8% in September 2008), having reached 24.7% by the end of the year.

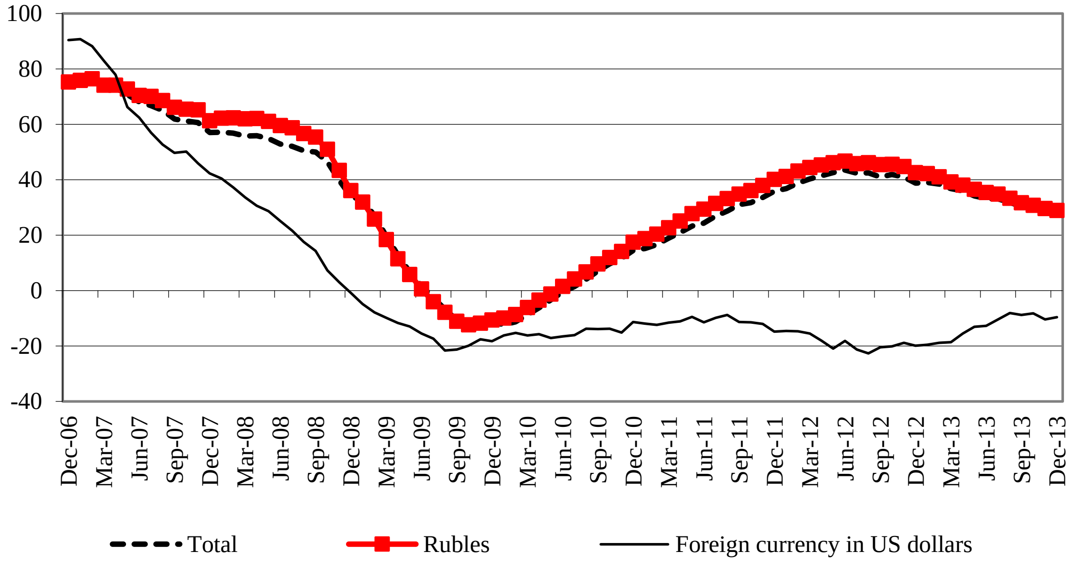


Fig. 66. Rates of growth of lending to individuals for 12 months (%)

The current load on the disposable income of households relating to servicing bank debt (the amount of obligatory payments of the principal amount and of interest) has continued to grow. While in 2012 individuals had to pay 9.5% of their available income to banks, in 2013 this figure increased to 11.3%.

Savings rate of households

The growth rates of the deposit base have remained stable for almost two years. As early as late October 2013 the annual growth rate of the funds of individuals in banks was around 20%. However, based on the results of 2013, private deposits had grown by only 17% at the year end, and in January 2014 the slowdown continued.

The main factor causing increased public distrust of the banks was, oddly enough, the policy of the Bank of Russia aimed at putting the banking sector in order. In summer 2013 the licenses of a number of banks were revoked, including the fairly large Master Bank and Investbank, which were in the top 100 in terms of the size of their assets. In total, the Bank of Russia revoked the licenses of 32 banks, with two more banks subjected to reorganisation. Of them, 26 banks held licenses for transactions with individuals and the deposits with these banks were insured through the Deposit Insurance Agency (DIA). The banks that lost their licenses in 2013 held private deposits of over Rb 170bn and the DIA liability under these insured events was Rb 125bn (*Fig. 67*).

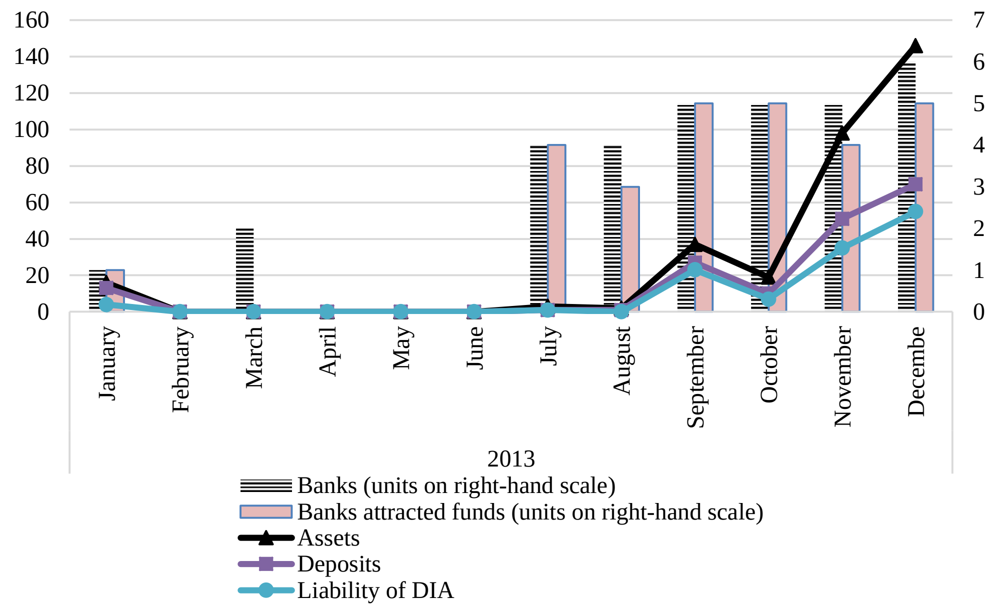


Fig. 67. Range of indicators for banks whose licenses were revoked in 2013

Firstly, this caused a general slowdown of the inflow of funds of private individuals to banks and, secondly, the floating of funds from small and medium-sized banks to large, mainly state-owned, banks. Household savings in banks in November-December 2013 grew by 5.2% (RUR 820bn), while in the corresponding period of 2012 the growth in deposits was 8.3% (RUR 1,088bn) (*Fig. 68*). At the same time, the deposit growth rate of the 30 largest banks remained almost unchanged (8.6% in November-December 2013 against 8.9% in November-December 2012) and the deposit growth rates of state-owned banks, taking into account Sberbank, increased from 8.7% at the end of 2012 to 10.9% at the end of 2013. In the medium-sized and small banks during November-December 2013 the funds of individuals decreased by Rb 208bn (5.3%), as compared to the increase by Rb 214bn (6.5%) in the corresponding period of 2012.

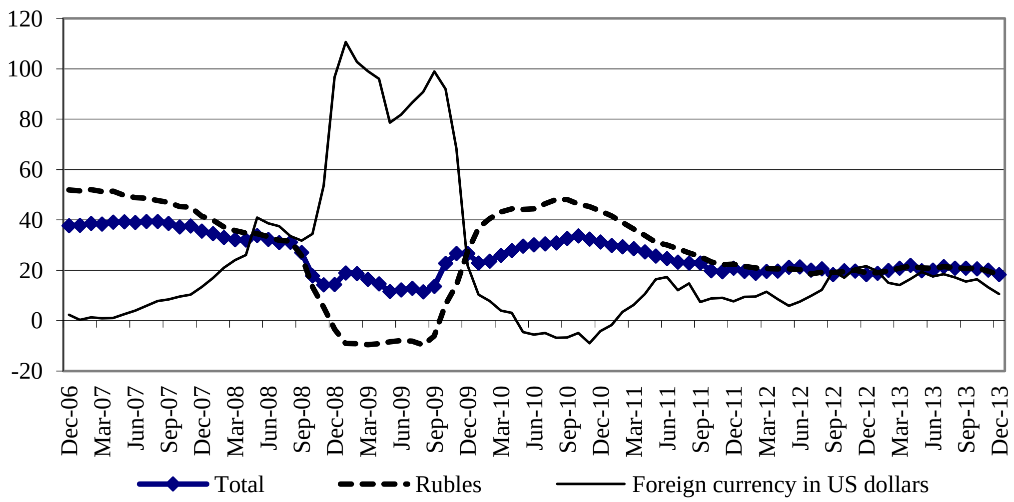


Fig. 68. Growth rates of deposits by individuals per 12 months (%)

Banks and the corporate sector

The relationship between banks and corporate clients in 2013 were characterised by the following trends:

1. Slowdown in the growth of lending to companies and organisations.
2. Increase in the growth of balances on the accounts of corporate clients;
3. Increase in "non-performing" assets in the corporate sector.

In 2013, there was a slowing of the rise in the level of debt of companies and organisations to banks under loans and credits. While the 2012 growth had been 16%, growth rates for the corporate segment of the credit market decreased to 13% (*Fig. 69*). Furthermore, the nominal volume of debt increase in 2013 for the retail segment overtook the corporate debt: company debt grew by Rb 2.4 trillion while individual debt grew by Rb 2.5 trillion.

However, the quality of the credit debt of corporate clients was gradually increasing during the year. The volume of reserves against possible loss grew only by 2.9%, while the value of arrears decreased by 0.4%. The yearly results also showed a decrease both in the share of overdue debt in the total debt (from 4.6 to 4.1%) and in the ratio of reserves to loan debt (from 7.5 to 6.8%). At the same time, these formal indicators of the quality of corporate customers' debt still remained much higher than the pre-crisis minimum values, when the share of overdue debt did not exceed 1% of the total debt and the volume of reserves was about 3% of the total volume of loans.

In 2013, the intensity of flow of the funds of corporations to bank accounts and deposits increased (*Fig. 70*). After a reduction to 10% in 2012, in 2013 the volume of corporate clients' funds grew by 16%. In absolute terms the annual inflow of funds from enterprises to banks increased by 1.5 times from Rb 1.07 trillion in 2012 to Rb 1.62 trillion in 2013.

In this respect, the total of funds placed on term deposits, constituting the "non-performing" assets of the corporate sector withdrawn from the current economic turnover, continued to dominate in the total funds of corporations in the banking sector. Throughout the year their share in the total funds of corporate customers exceeded 50%, at certain points reaching 55% of the total funds of corporations in banks. Moreover, a considerable part of the term deposits of legal entities was placed in banks for a term of over 1 year. For the term deposits of non-financial organisations their share slightly increased during the year from 38.2% as of 1 January 2013 to 39.6% as of 1 January 2014.

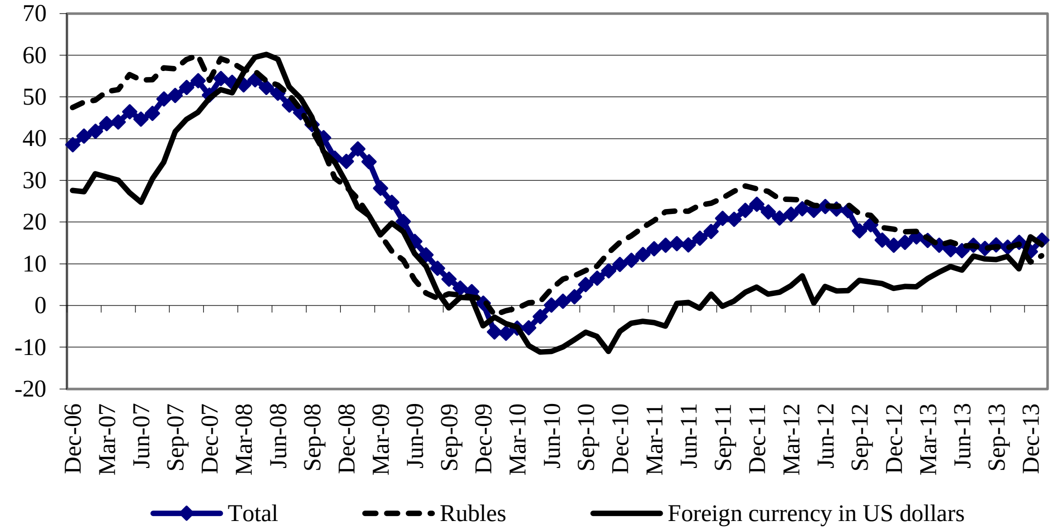


Fig. 69. Rates of growth in lending to companies per 12 months (%)

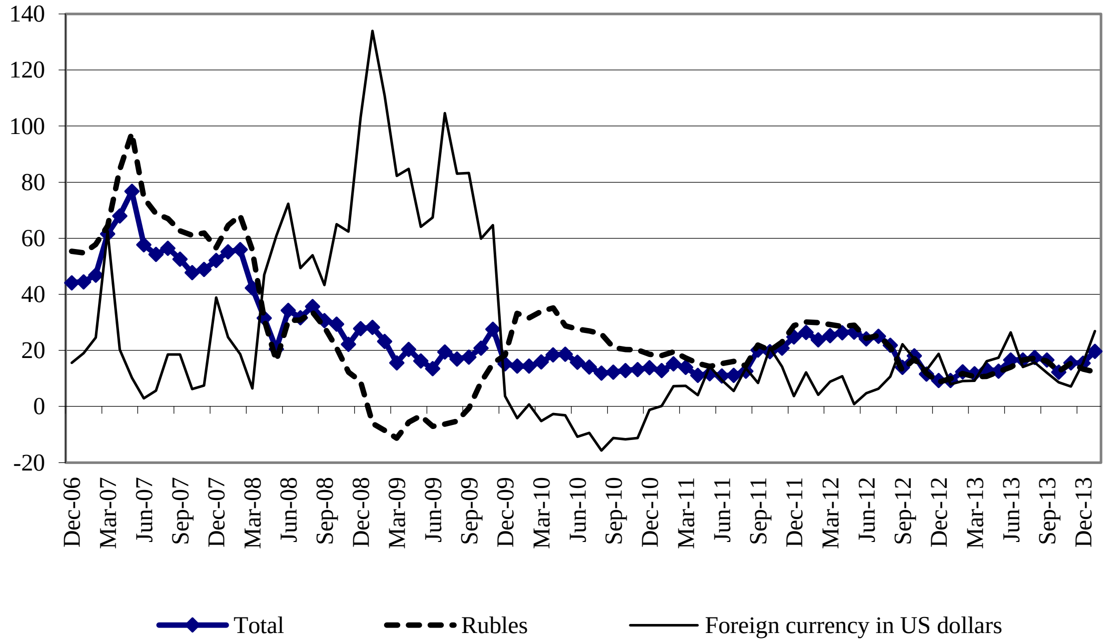


Fig. 70. Rates of growth of company funds per 12 months, %

Banks and the outside world

Based on the results of 2013 the balance of transactions of the banking sector with non-residents continued to change in favour of the net placement of foreign assets. The volume of foreign liabilities grew by only Rb 4bn and foreign assets grew by Rb 21bn. The net investments of banks in foreign assets, thus, grew by Rb 16bn during the year, reaching Rb 58bn (*Fig. 71*).

In 2013, simultaneously with the growth of net foreign assets, the net balance foreign exchange position of the banking sector, i.e. the excess of foreign exchange assets over foreign exchange liabilities, grew. It grew by Rb 14bn during the year.

The fact that the dynamics of the foreign exchange position followed that of net foreign assets shows that the foreign exchange balance, in bank transactions with the internal economy sectors, was preserved. Almost the entire increase in foreign currency accounts and the deposits of residents (Rb 25bn) was placed in internal foreign exchange assets, which increased by Rb 23bn. The growth in the foreign exchange position of banks was due to the accumulation of currency liquidity of foreign banks, and the major part of the increase in foreign assets accounted for loans to foreign banks. This strategy was justified under the conditions of depreciation of the national currency in 2013. During the year the ruble lost 7.5% against the US dollar and 12% against the euro, which brought Rb 50bn of net income from the revaluation of accounts in foreign currencies.

The Bank of Russia's gradual exit from the foreign exchange market continued in 2013 and the increased uncertainty in the medium-term dynamics of the ruble exchange rate discouraged banks from assuming additional foreign exchange risks. It makes it pointless to undergo a possible repeat of the banking sector growth strategy that prevailed before the crisis: growth of credit expansion in the country by attracting cheap (in foreign currency terms) resources from foreign financial markets.

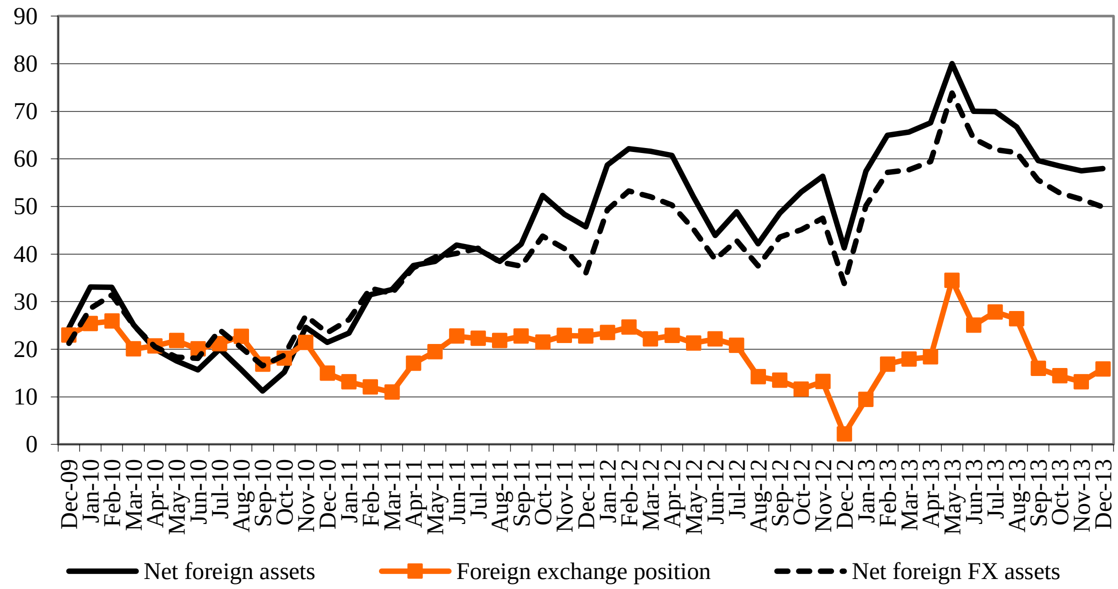


Fig. 71. Net foreign assets and foreign exchange position of the banking sector, billion USD

Banks and the state

Starting from 2011 the main factor in the formation of money supply in the Russian economy has been the refinancing of the banking sector by the Bank of Russia. The scale of growth of the debts of commercial banks to the regulator, today, considerably exceeds the increase in the broad definition monetary base (as an indicator of the dynamics of the money supply) due to the substantial outflow of liquidity through other channels, principally as a result of the sterilisation of the funds of enlarged government accounts in the Bank of Russia.

So, for 2011–2013 the volume of the broad definition monetary base increased by Rb 2.3 trillion; refinancing of the banking sector grew by Rb 4.1 trillion; Rb 3.2 trillion were received to the budgetary accounts in the Bank of Russia; and operations with reserve assets provided a ruble issue in the amount of Rb 0.6 trillion (with an additional Rb 0.8 trillion through loans by the Central Bank of the Russian Federation to the Deposit Insurance Agency, a decrease in the balances of the accounts of organisations in the Central Bank of the Russian Federation and other factors).

The same situation will continue in the medium term. The dynamics of the key elements of the balance of payments, coupled with the declared policy of the Bank of Russia for minimisation of its presence in the internal foreign exchange market, will lead to minor changes in the size of the reserve assets of the Bank of Russia in absolute terms. In some years, they could be both positive and negative, but in any event their amount will be insufficient to provide the banking sector with the required volume of liquid assets.

The budgetary factor will keep its sterilising influence on the money market. In accordance with the Law on the Federal Budget for 2014 and the Planning Period of 2015 and 2016 it is planned to reduce the federal budget deficit to 1% of GDP. According to estimates by the Ministry of Economic Development, as laid out in the forecast of long-term social and economic development of the Russian Federation for the period until 2030, the balance of the budget system in general for this period will be close to zero. At the same time, it is planned that internal state debt will continue to grow to 10.8% of GDP by 2016. Together, these factors will determine the continuation of the sterilising effect of the budget system on the dynamics of money supply until 2016.

Thus, the refinancing of the banking sector by the Bank of Russia will remain the only stable source of growth of money supply in the future, at least until 2016. According to our estimates, in the period from 2014 to 2016 the amounts owed by credit institutions to the regulator will increase by more than Rb 6 trillion, reaching 14% of the total assets of the banking sector.

At the same time, the level of dependency of the banking sector on monetary regulators continues to grow. In nominal terms, state support for the banking sector has already exceeded the crisis values of early 2009 and its relative level (although it has not returned to the crisis maximum) is still quite high. Based on the results for 2013, the aggregate volume of bank debt to the regulators has reached 8% of assets and 7% of GDP (*Fig. 72*).

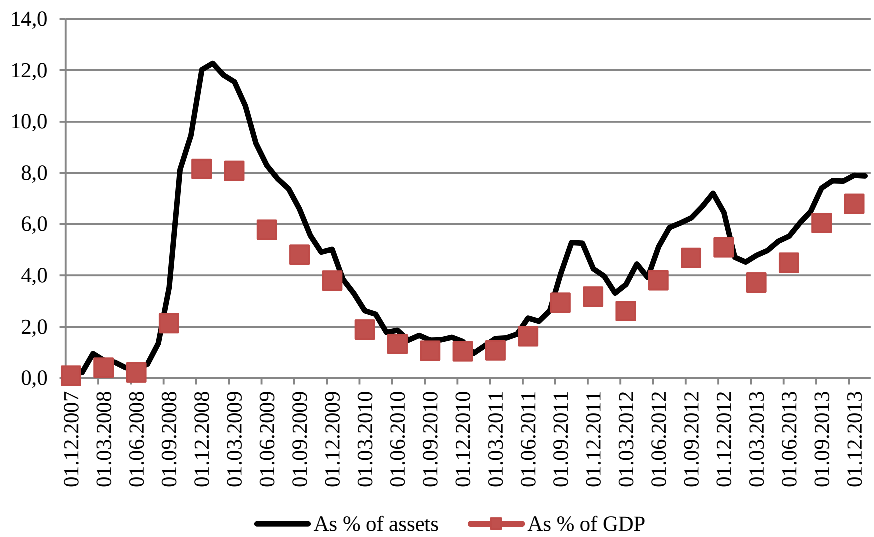


Fig. 72. Funds of the Bank of Russia and the Ministry of Finance of Russia, attracted by banks