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The review provides a detailed analysis of main trends in Russian economy in 2016. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and budget spheres; financial markets; 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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3.9. Russia's banking sector[1]

3.9.1. Banking sector's main trends

Asset-holding dynamics and quantity of banks in business

In 2016, Russian banks' total asset holdings contracted by 3.5% in nominal terms – from Rb 83.0 trillion as of January 1, 2016 to Rb 80.0 trillion as of January 1, 2017. In 2015, Russian banks' total asset holdings increased 6.9%. The decline in the nominal value of banks' asset holdings in 2016 was recorded for the first time since asset-holding data began to be published in 1998. An appreciating ruble had a substantial adverse effect on the asset-holding dynamics. In 2016, the ruble gained 16.8% and 19.9% against the US dollar and the euro respectively, and therefore the ruble equivalent of assets held in foreign currency dropped considerably during the year. Banks' asset holdings, as adjusted for the revaluation of assets held in foreign currency, increased slightly by 2.1% in 2016 after a 1.5% fall in 2015. Thus, the value of banking sector's asset holdings was steady over the past two years.

Relative to the size of the Russian economy, the value of banks' asset holdings was down from 100% in 2015 to 93% in 2016 (*Fig. 43*) due to the fact that the 2016 decline in the nominal value of asset holdings was coupled with growth from Rb 83.2 trillion to Rb 85.9 trillion in the nominal value of GDP. The nominal value of GDP was on a steady rise over the past few years despite the contraction in volume terms in 2015/2016.

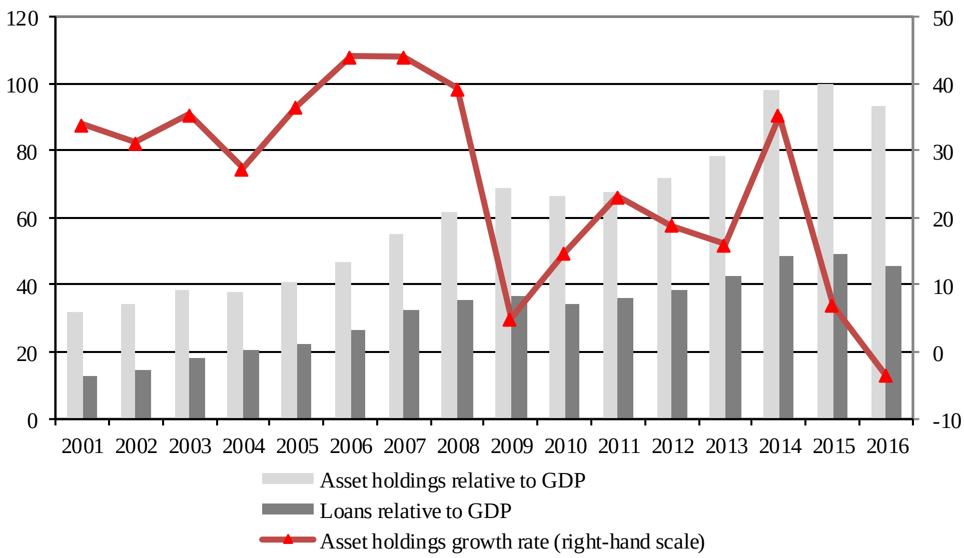


Fig. 43. Banks' asset holdings growth rate and banking sector size relative to Russian economy size, %

Source: Bank of Russia, Rosstat, own estimates.

[1] Author of chapter: M. Khromov – Gaidar Institute, IAES RANEPA.

The process whereby some of the credit institutions were forced out of the market on grounds of failing to meet the regulator's requirements continued in 2016. Ninety seven banking licenses were revoked during the year. While the number of revoked banking licenses was much the same over the past three years (86 in 2014 and 93 in 2015), most of the revocations were observed in 2016. More than 300 banks had their banking license revoked since Elvira Nabiullina took over as Governor of the Bank of Russia. The total number of banks in business decreased by more than one third, from 956 as of January 1, 2013 to 623 as of January 1, 2017.

The size of asset holdings of banks which had their license revoked in 2016 reached Rb 1.2 trillion, hitting a 3-year high and accounting for 1.4% of the total Russian banking sector's asset holdings recorded earlier in the year. Given slow growth rates in the banking sector's asset holdings, banking license revocations had a strong effect on the asset-holding dynamics as a whole. In 2015/2016, for instance, banks' asset holdings, as adjusted for the exchange rate revaluation, increased Rb 0.5 trillion, while those of banks which had their license revoked were 4.5 times this amount, reaching Rb 2.3 trillion.

Retail deposits in banks who had their license revoked in 2016 reached Rb 478bn, with about 87% of the amount being eligible for reimbursement by the Deposit Insurance Agency (*Fig. 44*). The ratio remained stable in 2014–2016 mainly due to a double increase in the upper limit for reimbursement late in 2014.

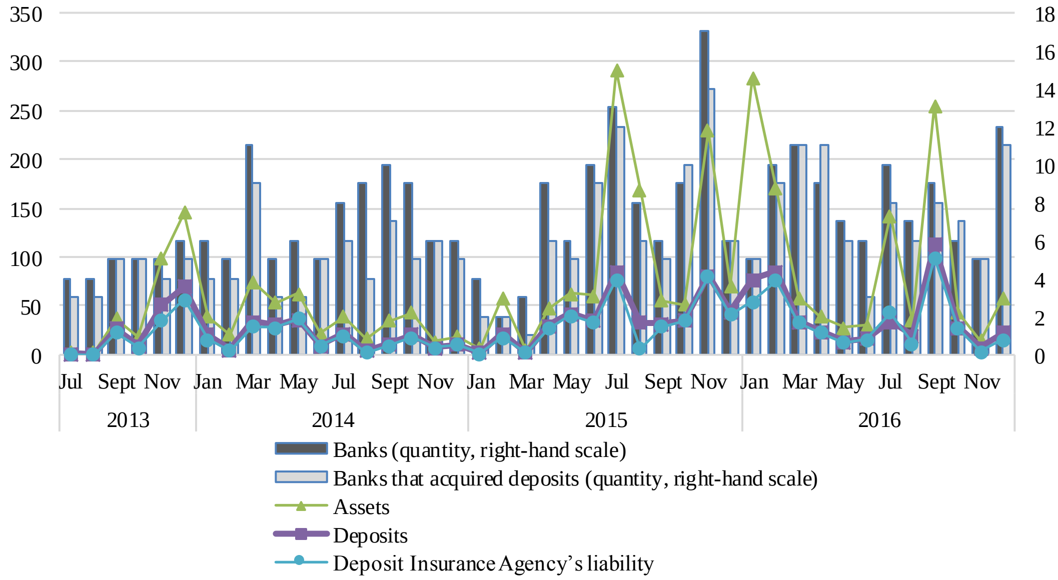


Fig. 44. Main performance figures for banks which had their license revoked

Sources: Bank of Russia, Deposit Insurance Agency, own calculations.

Profit and capital

The banking sector' financial performance figures are still moderate. In 2016, the year-over-year ROE reached 13% after a sharp plunge in profits in 2014/2015 when the year-over-year ROE dropped to 9% and 3% respectively. However, the indicator is considerably lower than that recorded in the period between 2011 and 2013 when it reached 17–20%, not to mention the period of 2005–2007 when it was more than 25% a year. The foregoing is responsible for Russian banks' low investment appeal to both existing holders and new investors.

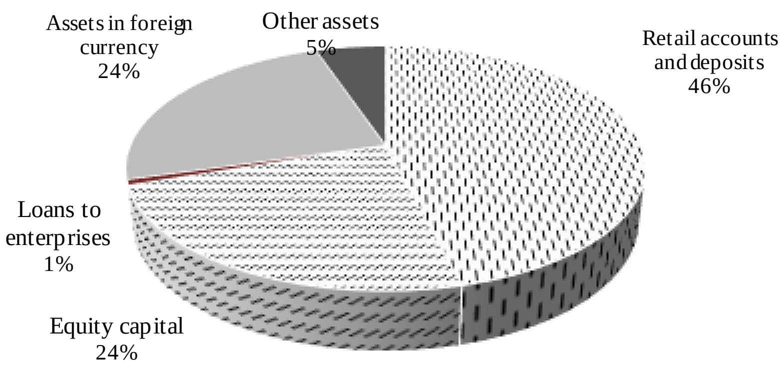
At the same time, the nominal volume of bank profits reached Rb 930bn in 2016. Banks generated bigger profits only in the banner years of 2012–2013 (Rb 1012bn and Rb 994bn respectively). The key growth factor for profits in 2016 was a sudden deceleration in the growth of allowances for loan loss provisions which increased only Rb 188bn in 2016 vs. Rb 1202bn and Rb 1352bn in 2014 and in 2015 respectively. The volume of profits, save for operations with such provisions, decreased for two straight years from Rb 1.8 trillion in 2014 to Rb 1.1 trillion in 2016. This gives evidence that banks continued to see their actual earnings decline despite technical growth of nominal profits and ROE.

Russian banks' equity capital[1] increased Rb 403bn, or by 4.5%, in 2016. In nominal terms, it was the smallest amount on record since 2010 when bank's capital increased Rb 110bn. In the period between 2014 and 2015, banks' capital increased Rb 864bn and Rb 1080bn, respectively. Nonetheless, the capital adequacy standard (H1) in 2016 showed positive dynamics by increasing from 12.7 to 13.1% due to stable risk-weighted asset holdings. The 2016 decline in total banks' asset holdings resulted in slowing of overall growth in risk-weighted asset holdings. Risks relating to balance-sheet accounts lowered, too. However, the increase in the volume of operations exposed to a higher-than-normal risk, as well as the mounting transaction risk in the banking sector, compensated for the reduction of the balance-sheet accounts risk, and therefore risk-weighted asset holdings increased 0.5% in 2016.

The increase in banks' ploughed-back profits as a result of recovered balance-sheet profits became the predominant source of banks' equity capital in 2016. In 2016, banks' charter capital and additional paid-in capital increased only Rb 59bn, reaching the lowest volume on record since 2004. This reflects an extremely low investment appeal of the banking sector to holders and outside investors.

Cash flow transformation by the banking sector

In 2016, retail accounts and deposits (*Fig. 45*) became the predominant source of financial resources in banks' balance sheet, accounting for almost a half, or Rb 2.2 trillion, of the total cash flows redistributed by the banking sector. Banks' equity capital constituted to one fourth of the resources. In addition, banks reduced their assets held in foreign currency by a comparable value over the year, thus providing for another one fourth of the banking sector's disposable resources. It is worth noting that a small reduction of the corporate credit portfolio was responsible for corporate loans making no contribution to the real economy financing in 2016.



[1] Calculated using reporting form No. 123.

Fig. 45. Banking sector's resources accumulation pattern (growing liabilities and declining assets) in 2016, as % of total

Sources: Bank of Russia, own calculations.

The banking sector's resources utilization pattern gives evidence that banks failed to perform their macroeconomic function as financial intermediaries in 2016, but they instead focused on their internal objectives of optimizing banking finance instruments. For instance, the principal way of utilizing financial resources in 2016 was repayment of debts owed to the Bank of Russia. More than a half of the disposable financial resources were spent for the purpose (*Fig. 46*). Another more than one third of the resources were spent on reducing bank liabilities, including overseas debts. Only a little more than 10% of the reallocated bank financial resources were spent on asset accumulation, most of which were spent on building up the portfolio of Russian residents' debt instruments, primarily MinFin bonds.

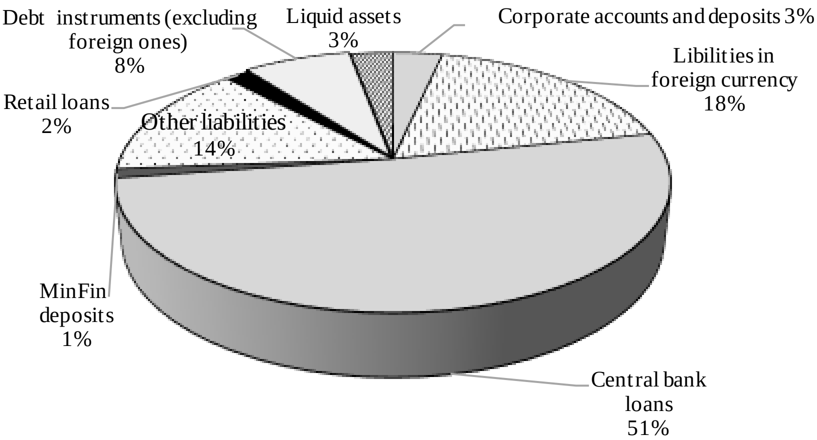


Fig. 46. Banking sector's resources spending pattern (growing assets and declining liabilities) in 2016, as % of total

Sources: Bank of Russia, own calculations.

3.9.2. Banks and corporate sector

The balance of balance-sheet operations of banks and corporate customers tended to zero in 2016. A curious result of the past year was that corporate customers stopped accumulating both their financial resources on bank accounts and deposits and their outstanding loans from banks. However, close-to-zero figures for both banks' asset- and liabilities-side operations with corporate customers resulted from mixed trends of certain components thereof.

Fundraising from corporate customers

In 2016, the balance of corporate customers' accounts and deposits in banks decreased by 0.7% to Rb 20.5 trillion following a 10.6% growth in 2015, whereas the balance of ruble-denominated accounts and deposits continued growing in 2016 (+5.3%), albeit at a slower pace than that recorded a year earlier (8.1% in 2015). This was coupled with a decline of 12.1% in dollar terms in corporate customers' foreign currency holdings (a 11.8% increase in 2015). The share of foreign currency holdings in the total volume of corporate customers' non-cash holdings in banks fell from 40 to 31% in 2016.

There is a huge balance of corporate customers' time deposits in banks, thus indicating a lack of appealing options for investing in the real production sector. At the same time, a positive signal is that the upward trend toward growth in corporate customers' time deposits was over, according to the 2016 year-end figures. The share of time deposits in the total volume of corporate customers' money held in the banking system hit the highest level as at the end of 2014 (62.8%), whereas it remained almost unchanged (62.6%) in 2015, and then decreased to 60.0% in 2016.

In addition, the balance of corporate customers' time deposits was down relative to business activity in economy. The balance fell to 30 days of business turnover in 2016, whereas it was equivalent to 35 days in 2015. The balance of settlement accounts remained stable relative to the size of economy, being equivalent to 20–22 days of business turnover. At the same time, the above mentioned dollarization processes were observed in both corporate customers' current accounts and time deposits in 2016. In 2016, the share of foreign currency holdings in corporate customers' current accounts and time deposits shrank from 28 to 22% and from 46 to 37%, respectively.

All in all, corporate customers' time deposits totaled about Rb 12 trillion earlier in 2017. Given that bank deposits tend to gradually lose investment appeal in response to a stronger ruble and lower interest rates, the amount could be sufficient to boost fixed investment in 2017.

Corporate loans

In 2016, Russian banks extended Rb 35.6 trillion in corporate loans, which is 3.9% above the amount extended in the corresponding period of 2015. However, such a moderate growth was insufficient to compensate for the collapse of 2015 when lending dropped 11.1% in volume terms compared with 2014, a year of peak volumes in the lending market when banks extended Rb 38.5 trillion in loans to corporate customers. Corporate loans declined to a total of 7.7% over the past two years.

Lending in rubles saw a slightly faster growth rate. A total of Rb 32.4 trillion in ruble-denominated loans were extended in 2016, or by 8.0% more than a year earlier. The two-year fall has not been overcome to date. In 2016, the ruble segment of the lending market shrank by 2.5% compared with 2014.

Lending in foreign currency continued declining at a fast pace. In 2016, banks extended USD 48bn in foreign currency loans to corporate borrowers, which is 29.9% below the amount extended in the same period of 2015. In 2015, lending in foreign currency developed at even more faster, almost double, pace of 48.9%. In dollar terms, bank foreign currency loans dropped by almost two third, 64.1%, within just two years. The ruble equivalent of foreign currency lending decreased as well, showing a decline of 24.9% in 2016 compared with 2015 and of 39.8% compared with 2014.

Lending volumes fell not only in absolute terms but also relative to scales of economic activity. Russian banks' new loans to the economy were comparable with 30–31% of business turnover when credit activity hit peak levels (in 2013/H1 2014). The data available as at the end of 2015 show a 25% decline in the ratio mainly due to substantial downturn in the lending market earlier in 2015. In 2016, the volume of bank loans to corporate borrowers accounted for 24% of business turnover over the same period (*Fig. 17*).

Predictably, the deceleration in new loans growth resulted in slower credit portfolio growth rates in banks. In 2015, outstanding loans to corporate borrowers increased merely 5.0% following a 11.1% hike in 2014, and the growth rate of outstanding loans to corporate borrowers slowed to zero (-0.1% year-over-year) as at 2016 year end.

The large business segment remained the driving force in the lending market. In 2016, corporate customers that represented large businesses took up Rb 30.3 trillion in new bank loans, accounting for 85% of the total volume of new loans extended. The volume of loans to large businesses increased 5.2% over 2015, which was insufficient to compensate for the fall recorded in the preceding year, as was the case with the market as a whole. In 2016, the volume of new loans dropped by 2.1% compared with that recorded in 2014.

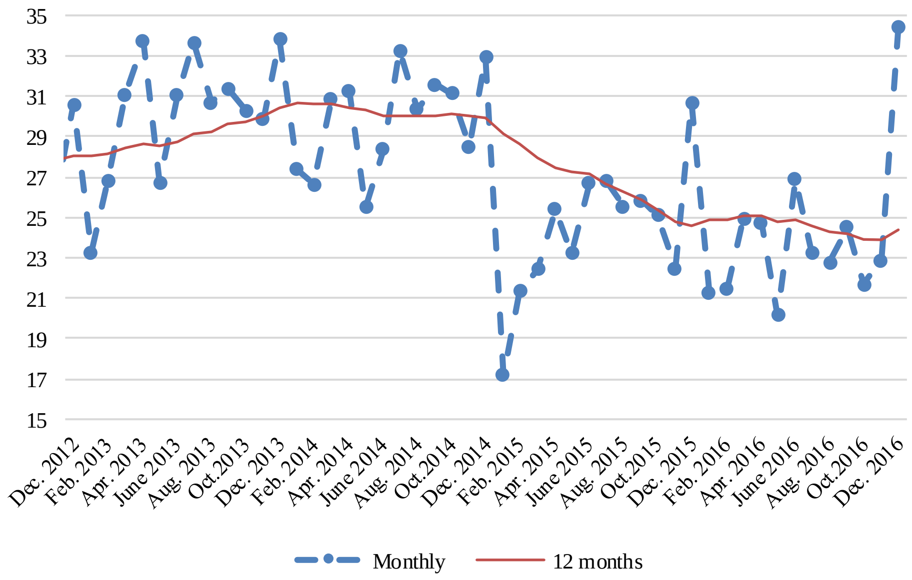


Fig. 47. The ratio of extended corporate loans
to business turnover, %

Sources: Bank of Russia, Rosstat, own calculations.

While the dynamics of loans to large businesses can be described as relatively stable, the lending volume for SMBs continued declining. New loans worth Rb 5.3 trillion were extended in this lending market segment in 2016, which is 2.9% less than that recorded in the corresponding period of 2015, and is nearly one third (30.3%) less than that of 2014.

The quality of loans to corporate borrowers almost stabilized in 2016. The 2016 year-end share of delinquencies in the total volume of outstanding bank loans to enterprises stood at 6.9%, which is slightly higher than 6.8% recorded at the beginning of the year, and most of the decline was seen in the second half of the year (a peak of 7.5% was recorded in August). The quality of ruble-denominated loans remained worse than that in the market as a whole. The 2016 year-end share of delinquencies in ruble-denominated loans dropped to 8.0% from a peak of 8.8% recorded in late August 2016. Foreign currency loans remained a safer lending option for banks. The share of delinquent foreign currency loans stood at only 3.1%, and the quality of loans of this type improved almost throughout the entire year since March when delinquent foreign currency loans hit a peak of 4.0%.

Foreign currency loans continued being driven by negative dynamics despite an improving quality in terms of delinquencies. Obviously it is mounting risks for banks that were responsible for the deceleration of lending. However, while credit risks were responsible most for the decline in the ruble-denominated loan segment, the fall in foreign currency loans was precisely due to exchange rate risks which became too high for banks because of a highly volatile ruble exchange rate.

In terms of borrower's business size, there was still a wide gap between the quality of credit portfolio and borrowers represented by large businesses and by SMBs. The quality of debt servicing for major customers was above the market average. The 2016 year-end share of delinquencies in the total volume of major corporate customers' accounts payable to banks stood at 5.5%, reaching a peak of 6.2% over the course of 2016. In the mid-2016, the share of delinquencies in the total volume of outstanding bank loans to SMBs reached a peak of 15.6%, but decreased to 14.2% over the past few months. Thus, in terms of borrower's business size, there was visible relationship between the dynamics of the given lending market segment and the quality of loans therein.

Interest rates on ruble-denominated corporate loans were cut throughout the entire 2016, mirroring largely, and even outrunning slightly, the trend toward a lower key rate (*Fig. 48*). The interest rate on ruble-denominated loans was lowered in October 2016 to 12.1% p.a. from 13.4% earlier in the year. The gap between the Bank of Russia key rate and the rate on ruble-denominated corporate loans narrowed to 2 percentage points, whereas it was more than 3.5 percentage points in 2015. This may be a circumstantial evidence of a higher-than-normal regulator key rate – the lending market is already prepared to further interest rate cuts.

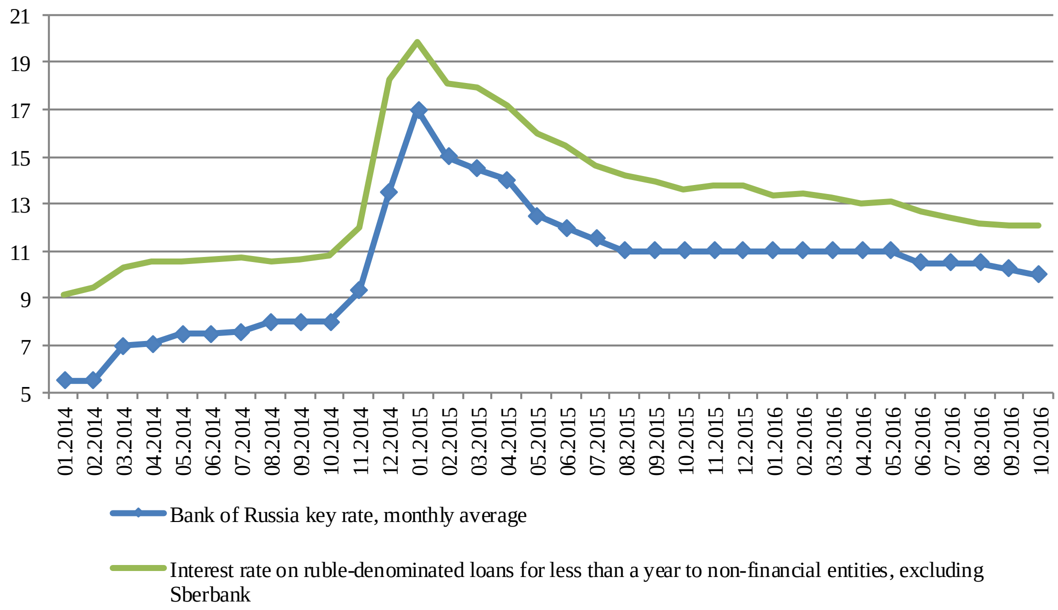


Fig. 48. Interest rate on ruble-denominated corporate loans and Bank of Russia key rate

Source: Bank of Russia.

3.9.3. Banks and households

Retail deposit acquisition

Retail bank accounts growth rates decelerated notably in 2016. The balance of retail accounts and deposits in banks increased 9.7% during the year, whereas it rose 16.9% in 2015. In absolute terms, the household saving inflow to the banking sector contracted by 28%, from Rb 3.1 trillion in 2015 to Rb 2.2 trillion in 2016. Nevertheless, as noted above, retail accounts and deposits became the predominant source for the banking sector resources.

The deceleration of retail resources inflow to the banking sector was not a result of slowing household saving rate. Individuals increased steadily their cash balance in hand in 2016 compared with 2015. For instance, the amount of cash outside of the banking sector increased Rb 476bn during 2016, whereas it was up only Rb 68bn in 2015. In addition, individuals' demand for foreign currency in cash increased. In 2016, individuals purchased from banks and withdrew from bank accounts a total of USD 15.9bn, which is three times less than that in 2015 (USD 5.5bn).

It is worth noting here that total foreign currency demand, including noncash holdings on foreign currency accounts and deposits in Russian banks, did not grow fast enough in 2016, from USD 14.7bn in 2015 to USD 17.5bn in 2016, which is due to the fact that foreign currency deposit inflows to banks almost stopped in 2016. In 2016, foreign currency deposits increased just USD 1.6bn following a growth of USD 9.2bn in 2015. Thus, individuals switched their preferences toward cash while retaining demand for foreign currency. A similar picture was observed in ruble savings, too. The deceleration in ruble deposits' nominal growth rate in 2016 compared with 2015 was compensated in full with growing cash holdings.

Such changes to the saving pattern could be caused by the following aspects. First, banks lowered steadily interest rates on retail deposits in 2016, especially on foreign currency deposits. The established level of interest rates on foreign currency deposits in 2016 was not appealing in terms of converting foreign currency in cash into noncash holdings.

Thus, the decline in the household saving rate on bank deposits in 2016 compared with 2015 did mean a decline in the saving rate as a whole. Including cash, the saving rate in 2016 increased to 6.0% of households cash income after the fall to 1.7% in 2014 and the recovery to 4.7% in 2015. However, it was still below the level seen in 2011/2013 when individuals increased annually the total volume of cash and noncash holdings by an average of 7.1% of their cash income.

Table 20

Dynamics of basic components of household savings

	Average in 2011/2013	2014	2015	2016
Rubles in billions				
Money held in bank accounts and deposits	2203	-595	3021	2265
Foreign currency in cash	-21	1227	-579	520
Rubles in cash	641	186	68	476
Total	2823	817	2509	3260
As % of income				
Money held in bank accounts and deposits	5,5	-1,2	5,6	4,2
Foreign currency in cash	-0,1	2,6	-1,1	1,0
Rubles in cash	1,6	0,4	0,1	0,9
Total	7,1	1,7	4,7	6,0

Retail loans

According to the data for 2016 year end, bank outstanding loans to households increased 0.7% after a 7.3% fall in 2015. In terms of borrowing currency, growth was observed exclusively in ruble-denominated loans, with a 1.6% increase in outstanding ruble-denominated loans (a 6.8% decline was recorded in 2015). Outstanding retail foreign currency loans continued to fall steadily for a long period. Positive growth in outstanding retail foreign currency loans was last recorded in 2007 when it was up 42% in dollar terms. This retail lending segment stopped growing as late as 2008. Outstanding bank foreign currency loans to retail customers never increased since then. In 2016, the amount of foreign currency loans dropped to USD 2.7bn, or by 33%.

The 2016 recovery of positive growth rates of banks' credit portfolio was driven up exclusively by housing mortgage loans. Outstanding retail housing mortgage loans never declined throughout the entire period since 2011, although this market segment growth rates also decelerated considerably in 2015 – from a peak of 33% year-over-year in the fall of 2014 to a 9.7% low as at 2015 year end. In 2016, outstanding retail housing mortgage loans increased 12.9%.

As to consumer loans, the picture was completely different. Outstanding loans continued to fall for two consecutive years despite slowing growth rate deceleration – from 14% in 2015 to 5% in 2016 – in this lending market segment. Although some months of 2016 saw insignificant growth in outstanding consumer loans, there was no return to a steady growth yet.

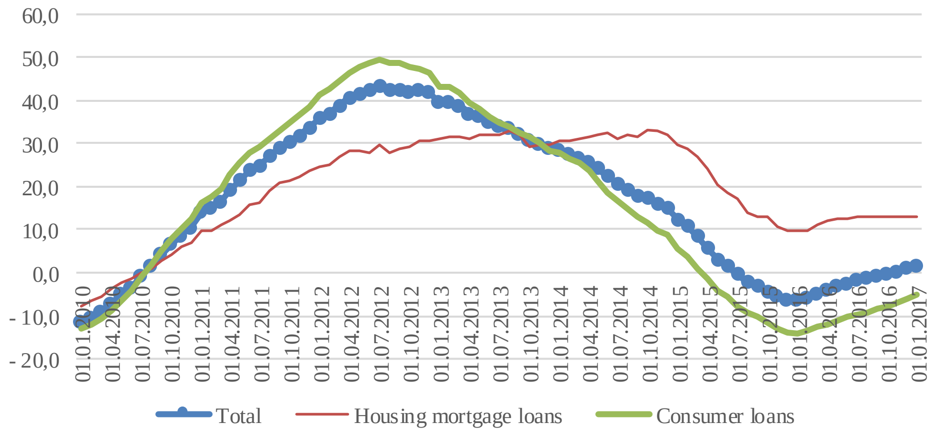


Fig. 49. Growth rates of outstanding loans to households, % change 12 months

Sources: Bank of Russia, own calculations.

As a result, the structure of outstanding retail loans switched toward longer and cheaper housing mortgage loans. As of January 1, 2017, the share of housing mortgage loans in total outstanding retail loans reached an all-time high of 42%, gaining 4 percentage points in 2016 alone (from 38% as of January 1, 2016). The lowest share of housing mortgage loans stood at 27% late in 2013 following the consumer lending boom of 2011/2013 when outstanding consumer loans growth rates reached 50% year-over-year.

The change in the outstanding loans structure can be regarded as favorable factor for households' financial status. This has direct relevance to the level of debt burden on households' disposable income. The increase in the share of housing mortgage loans in the total amount of outstanding retail loans leads to, all other things being equal, longer average maturities and a lower cost of outstanding loan servicing. Longer maturities of outstanding loans requires less regular payments, with the outstanding amount being the same.

However, the retail credit portfolio average weighted maturities fell from 48 to 45 months at 2016 year end. The consumer loan maturities saw a deeper fall from 37 to 32 months at 2016 year end, whereas housing mortgage loan maturities remained almost unchanged, at the 12-year level, in 2016, thus being a constraining factor for shorter maturities of banks' aggregate retail credit portfolio.

The actual value of retail credit portfolio stood at 16.6% p.a., with a meager change, at 2016 year end. It is however worth noting that the 2-year trend toward depreciation of outstanding retail loans stopped (the debt value reached 18% p.a. in 2013). The dynamics of banks' retail credit portfolio value is first of all determined by the cost of consumer loans. The average weighted interest rate on housing mortgage loans remained at a stable level of about 12.5–12.7% p.a. At the same time, the consumer credit portfolio value rose from 18.7% p.a. in 2015 to 19.2% p.a. in 2016. Thus, the stable cost of outstanding loans for borrowers was secured by growth in the share of cheaper mortgage loans in the retail lending structure.

The debt burden relative to households' disposable income was 9.6% in 2016, like in 2015. In nominal terms, households' disposable income amounted to Rb 50.0 trillion in 2016, which is 0.5% higher than that of 2015. The amount of compulsory payments on bank loans (the amount of scheduled repayment and interest payments) was Rb 4.6 trillion, which corresponds to the level of 2015. It is of interest that a small growth in the principal repayment amount within the bank loan servicing structure was almost completely offset by a decline of Rb 32bn in interest payments in 2016 compared with Rb 33bn in 2015. With the foregoing debt structure and value, this gives evidence that it was the growth in the share of cheaper housing mortgage loans that secured a stable debt burden on households' income in 2016.

The contribution of bank loans to households' finances remained negative despite recovering positive growth rates of banks' outstanding retail loans in 2016. This resulted from substantial interest payments which outran considerably the growth in outstanding loans. For instance, households' interest payments on bank loans were worth Rb 1.8 trillion in 2016. And outstanding loans increased merely Rb 0.2 trillion, as noted above. Thus, bank loans were responsible for a Rb 1.6 trillion decline in households' total budget in 2016 (-Rb 2.5 trillion in 2015), or by 4.2% (6.9% in 2015) of the 2016 total households' consumer spending, including retail turnover, payments for paid services and foodservice costs. During the 2014/2016 period of lending market's negative contribution to households' budget, the contribution can be assessed an average of 4.3% of households' consumer spending, whereas bank loans' positive contribution accounted for only 2.8% of households' consumer spending during the lending booms of 2011/2013.

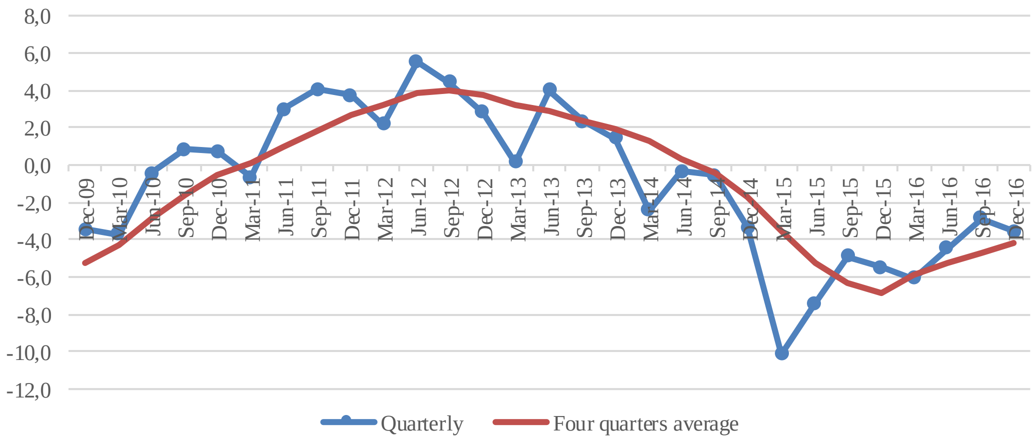


Fig. 50. Contribution of loans to households' disposable resources, as % of consumer spending

Sources: Rosstat, Bank of Russia, own calculations.

The quality of credit portfolio in 2016 can be described as bad debts ceasing to rise. The share of overdue retail loans in the total volume of retail loans fell by only 0.1 percentage points, from 8.4 to 8.3%. However, given that this indicator reached 9% in the middle of the year, the trend changed indeed. A similar situation was observed with regard to the ratio of retail loan loss provisions to the amount of banks' outstanding retail loans. The ratio fell from 11.2% to 10.8% during the year, reaching 11.6% in the spring of 2016. The quality of retail credit portfolio improved in 2016 mainly because banks shifted from more risky consumer loans to less risky housing mortgage loans that tend to exhibit a lower level of overdue loans.