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R95 **Russian Economy in 2018. Trends and Outlooks. (Issue 40**) / [V. Mau at al; ed. Editors – Alexei Kudrin, doctor of sciences (economics), Alexander Radygin, doctor of sciences (economics), doctor of sciences Sergey Sinelnikov-Murylev, doctor of sciences (economics)]; Moscow: Gaidar Institute Publishers 2019. – 616 pp. – ISBN 978-5-93255-556-9

The review "Russian Economy. Trends and Outlooks" has been published by the Gaidar Institute since 1991. This is the 40th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: the socio-political issues and challenges; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

Reviewer: Lev Yakobson, Doctor of sciences (economics), professor, first pro-rector, NRU-HSE.

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3.9. Russia's banking sector in 2018[1]

3.9.1. Dynamics of the number of credit organizations

As of January 1, 2019, the Russian banking system numbered 484 credit organizations. A year earlier then number stood at 542. During the year the number decreased by 58 organizations. Six years ago at the beginning of 2013, the number of credit organizations exceeded one thousand (1094).

The Bank of Russia policy aimed at clearing the banking sector has triggered a reduction of the number of banks in operation. Over this period, the Bank of Russia withdrew more than 400 banking licenses. From late 2014 the policy aimed at withdrawing from the market those credit organizations which do not satisfy the requirements of the regulator coincided with the deterioration of the situation in the Russian economy and the imposition of international sanctions on major Russian banks. Correspondingly, already from 2014 the rate of banking license revocation has increased. When in 2013, around 4–5 banks on average per month lost their licenses then in 2014 the rate of banking license revocation increased to 7 lending organizations per month, and during the time of peak manifestations of crisis in the Russian economy and financial system seen in 2015–2016 on average 8 credit organizations per month lost the right to continue their banking activity. The number of revoked banking licenses peaked in 2016: the number of revoked licenses during that year hit 97. Moreover, 2016 saw the peak on the aggregate amount of the bank assets of the banks which lost their banking licenses: RUB 1.7 trillion or 2.0 percent of the overall volume of the banking sector assets.

At the same time, the regulator withdrew small banks from the market. For example, even when the number of revoked licensed peaked in 2015–2016, the average size of bank assets did not exceed RUB 19 billion at the moment of license revocation.

In 2017, when looking at the dynamics of banking license revocation one can assume that the situation in the banking sector was improving. The Bank of Russia phased down only of fifty-one lending organizations during the year – half of what was seen in 2016 (*Table 28*). Average assets of a bank with revoked license in 2017 went up notably (RUB 19.1 billion against RUB 11.9 billion a year earlier). However, total assets of banks which lost licenses contracted to RUB 974 billion or 1.2 percent of the overall volume of banking sector assets.

Table 28

Отзывы банковских лицензий в 2013–2018 гг.

	2013	2014	2015	2016	2017	2018
Number of banks with revokes licenses.	29	86	93	97	51	60
Average volume of assets of banks with revoked license, RUB bn.	10.5	5.1	11.9	11.9	19.1	7.4
Total amount of assets of banks with revoked licenses, RUB bn.	304.8	441.2	1108.4	1159.1	974.0	445.3

[1] This section was written by M. Khromov, Gaidar Institute, RANEPA.

Decline of the number of revoked licenses registered in 2017 most likely was due to other circumstances mainly to the burden of the system of deposit insurance. Already from mid-2015, payments to depositors of banks that lost licenses was financed mainly from the Bank of Russia credit line allocated to the Deposit Insurance Agency.

In 2018, the Bank of Russia somewhat increased the rate of banking licenses revocation. During the year, already 60 banking licenses were withdrawn. At the same time, the size of a bank loosing in 2018 the right to exercise the banking activity dropped to RUB 7.4 billion. Total volume of assets of such banks came to RUB 445 billion or 0.52 percent of the overall volume of assets of the banking sector (*Fig. 64*).

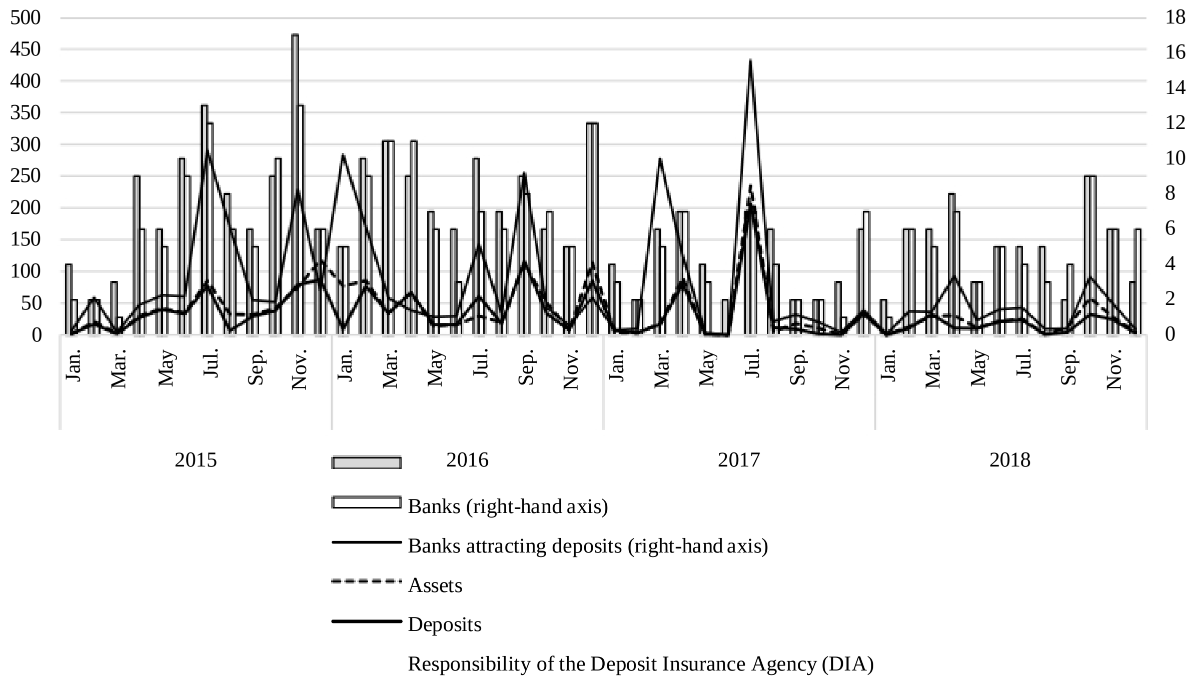

Fig. 64. Main indicators of the banks whose licenses were withdrawn

Source: Bank of Russia

Another type of regulation – bank resolution procedures – practically were not exercised in 2018. Following the bank resolution procedures applied towards a number of large banks in 2017 (Bank Otkrytie FC, Binbank, and Promsvyazbank) the Bank of Russia took some time off and in 2018 this mechanism of regulation was applied solely once regarding Asia-Pacific Bank.

Thus, in 2018, the Bank of Russia paid attention to smaller banks. This is attested to by the average amount of assets of the lending organizations which lost licenses last year. Lack of new cases of the bank resolution procedures demonstrates adequate state of the large banks.

3.9.2. Banking sector financial performance

Bank profit in 2018 notably improved against 2017. Growth of net interest profit and the yield of regular bank operations was a positive factor. In 2018 as a whole, balance–

1.5 percent, and the return of equity profit of Russia's banking sector amounted to RUB 1,345 billion, return on assets (ROA) (ROE) came to 15.8 percent in annual terms.

Compared to 2017, banking income went up by RUB 600 billion. The banking sector profitability has also moved up notably. A year earlier, ROA stood at 1.0 percent, and ROE at 9.4 percent.

The structure of the main profit components in the banking sector in 2018 is presented in *Table 29.*

Table 29

Main profit components in banking sector, RUB billion

	2016	2017	2018
Profit, total	929	785	1345
Net interest income	1624	1669	2113
Net commission income	853	886	1078
Operation with loan loss provisions	-665	-1433	-1200
Organization costs	-1456	-1447	-1686
Other net income	573	1110	1040

Source: Bank of Russia.

The structure of the banking sector financial performance compared to the same period of the previous year has undergone the following changes.

Main positive trend – growth of income from the main banking operations. Net banking interest income went up in 2018 by RUB 444 billion in comparison with 2017 or by 27.0 percent and net commission income – by RUB 192 billion (up 22 percent).

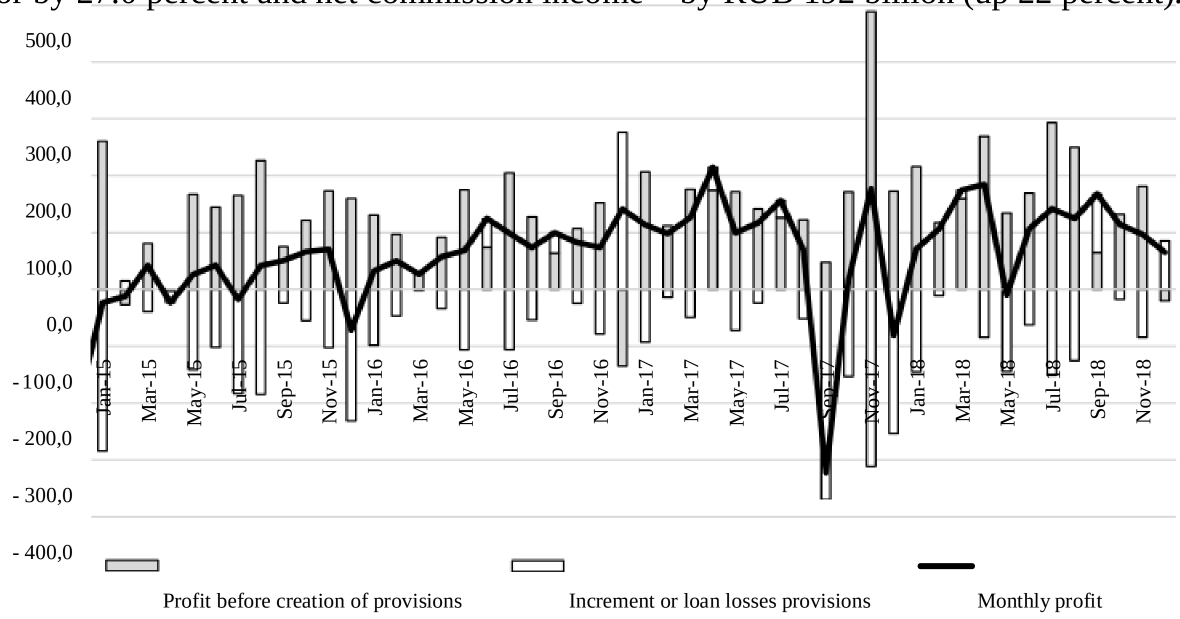

Fig. 65. Principal components of banking income, billions of roubles

Source: Bank of Russia.

Among other components of net interest income one should mention a rather dynamic growth (RUB 450 billion, nearly by 30 percent) of proceeds from retail lending which is a rather natural result of recovery growth of the retail lending portfolio (see below chapter 3.9.4).

Also notably increased fee-based income – by RUB 314 billion or by 27 percent.

Decrease of contributions for loan loss provisions, which raised banking income in 2018 by RUB 233 billion can be seen as a one-time factor. A significant volume of reserves registered in 2017 was due to the launch of the bank resolution procedures against three large private banks. This confirmed the fact that in 2017 issues related to the quality of the bank assets has rather local character. In 2018, the reserves growth against specified deposit liabilities and at the year end the ration of reserves to total bank assets somewhat decreased from 8.1 to 8.0 percent (*Fig. 65*).

3.9.3. Corporate lending

In 2018, Russian banks issued new corporate loans worth RUB 38.4 trillion up 17 percent from the previous year (*Fig. 66*). Large corporate lending segment was growing faster. This category of borrowers in 2018 received new loans to the tune of RUB 38.2 trillion. Small and medium-size business received in 2018 new loans to the tune of RUB 6.8 trillion, which exceeds the 2017 level by 11 percent. Volume of large business lending have already notably exceeded pre-crisis maximum seen in 2014 when the large business received corporate loans to the tune of RUB 30.9 trillion. At the same time, small and medium-size business lending volumes seen in 2013 amounting to RUB 8.1 trillion have not been reached yet. The share of small and medium-size corporate borrowers in the lending market decreased from 22 percent in 2013 to 15 percent at the year-end 2018.

Growing volumes of new corporate loans resulted in the increased growth of the total amount of corporate debt to bank. In 2018, the debt volume went up by RUB 2.3 trillion or by 7.8 percent. In terms of nominal volume this is comparable with the increment of the bank debt for three previous years (RUB 2.6 trillion).

At the same time, increment of loan debt concentrates in the segment of large business. Debt of small and medium-size business before banks was falling for four years in a row starting from 2014. In 2018 for the first time since 2013, the volume of small and medium-size debt did not fall but increased by 1 percent.

Thus, the bank lending market exhibits clear trend of large corporate predominance in recent years. This is owing to the quality of credit portfolio in the corresponding market segments. Lending to small and medium-size business remains a much risker business than corporate lending to large business. The share of outstanding debt of large borrowers at the year-end 2018 constituted 5.6 percent of the total volume of extended loans to the large business. The share of outstanding debt of small and medium-size business remained at 12.4 percent at the year-end 2018.

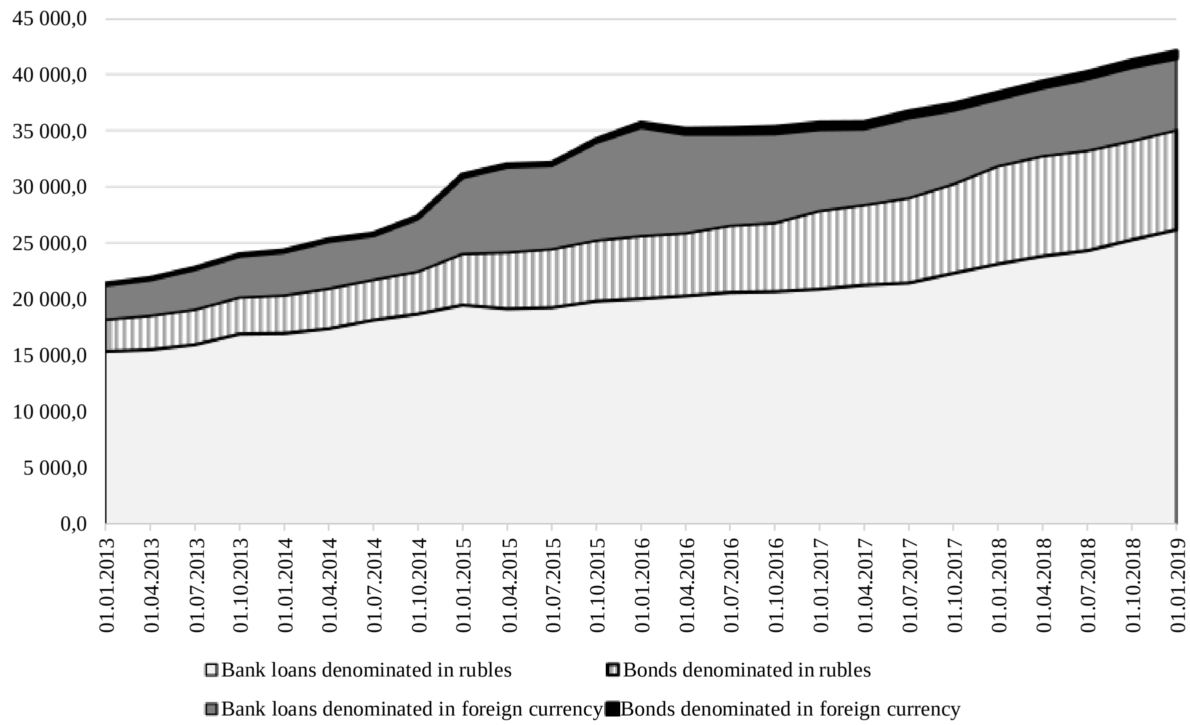

Fig. 66. Main elements of corporate debt in the domestic market, RUB billion

Source: Bank of Russia

3.9.4. Retail lending

Retail bank lending again becomes an incentive instrument for economic growth. In 2018, the retail bank lending market has been developing quite dynamically. All major segments of the lending market have been affected by it. Nominal debt indicators and loans issuance have hit new peaks. Reduction of interest rates and growth of new loans extension have determined a positive net contribution of the bank lending in the disposable household income.

During the year, retail debt on bank loans moved up by RUB 2.74 trillion, which amounts to 21.7 percent of the overall debt as of the beginning of 2018. This is a two-fold increase on the relevant period of the previous year. Then the growth of the households' loan debt to banks amounted to merely RUB 1.39 trillion or 12.3 percent of its value as of the beginning of 2017. As a result, households' overall debt volume to banks amounted to a new record-high value and was equal to RUB 15.4 trillion as of January 1, 2019.

In 2018, the retail bank lending market has also grown markedly regarding new loans extension in comparison with the previous year. During the year, banks extended new retail loans totaling RUB 12.4 trillion up 35 percent against 2017 (RUB 9.1 trillion). It is obvious that in the entire period of existence of the Russian banking market, 2018 saw the new maximum attained as regards the volume of new loans. The previous maximum was hit precisely in 2017.

The pattern of retail loans extended to individuals keeps shifting towards residential loans. For example, in 2018, banks extended to individuals RUB 3.0 trillion worth of housing loans, a 49% increase against 2017. In 2018, the share of new housing loans amounted to 24% in the overall volume of bank loans extended to households, while in 2017 it did not exceed 22%.

Due to the fact that housing loans have a longer period of repayment as compared to other loans to individuals, their share in the total debt volume is higher than in the newly extended loans. Based on the results of 2018, housing loans accounted for 43% (RUB 6.4 trillion) of the total debt volume (RUB 14.8 trillion). A year before, this index was equal to 42%.

Based on the results of 2018, annual growth rates of the loan debt (on the relevant period of the previous year) amounted to 22.3 percent and 23.1 percent for the overall volume of loans and housing loans, respectively. Higher growth rates of the loan debt have affected all the market segments. In 2017, growth rates of retail lending were more moderate: the debt on housing loans and consumer loans rose by 15.1 percent, and 11.0 percent, respectively (*Fig. 67*).

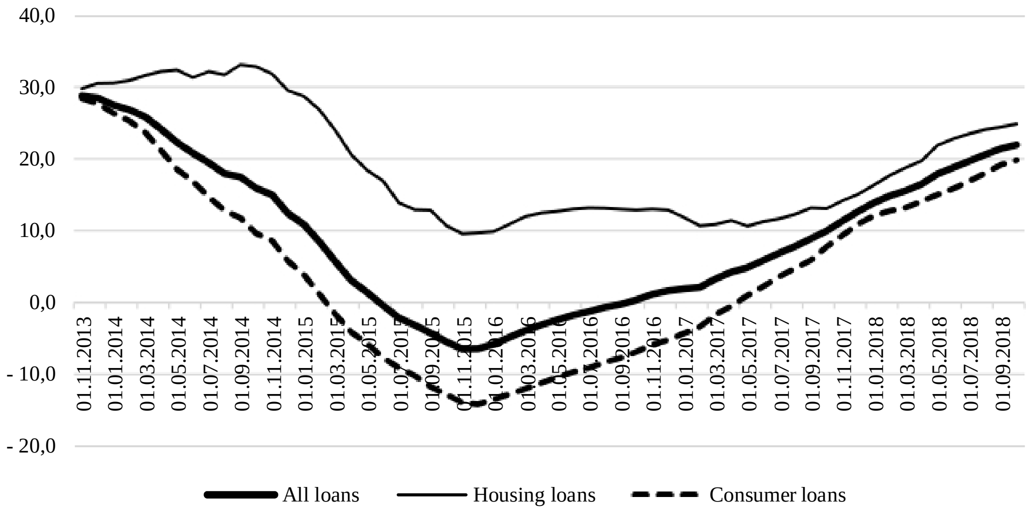

Fig. 67. Growth rates of retail bank loans, percent change compared with the corresponding date of the previous year

Sources: Bank of Russia, own calculations.

The recovery of the retail lending market is evident not only in the nominal terms, but also in terms of comparison with the value of households' cash income.

At 2018 year-end, the overall loan debt exceeded 26.7 percent of the annual amount of households' cash income. This indicator is also an all-time high. the overall loan debt exceeded 25% of the volume of households' cash income. A similar phenomenon was observed only for a few months late in 2014.

The volume of new loans relative to the volume of cash income has also exceeded the previous maximums. As in 2013 when the volume of new loans amounted to 20% of the value of cash income. At 2018 year-end, this indicator amounted to a bit over 21 percent.

In 2018, the debt growth lags slightly behind the level of 2012–2013 when the correlation between the loan debt and cash income was at the level of 5.0%–5.5%, while in 2018 this indicator exceeded 4.7% of the annual volume of households' cash income. This can be explained by the fact that a substantial reduction of interest rates on retail loans stimulates refinancing of previous loans. Consequently, loan debt growth is lagging behind the rate of extension of new loans.

A return to the positive net contribution of a bank loan to households' disposable cash income has become a key result of the loan market development in 2018. This indicator is determined as the difference between growth in households' loan debt to banks and the volume of interest payments on loans. In a situation where growth in the loan debt exceeds the value of interest payments, households receive additional funds from the banking sector, thus gaining more disposable cash resources (*Fig. 68*).

During the past three years (from 2015 to 2017), households paid more interest to banks than received new loans, less the repaid ones, from them. In such a situation, fewer financial resources became available to households and the extent of consumer spending decreased.

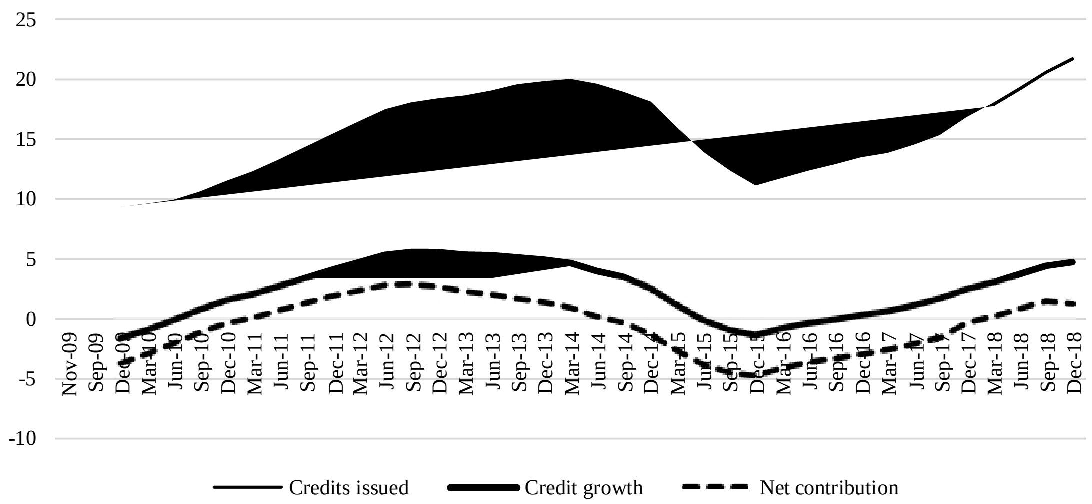

Fig. 68. Lending to households, percent change on cash income for four quarters

Sources: Bank of Russia, the Federal State Statistics Service, and own calculations.

In 2018, the bank loan has regained its role in stimulating growth in households' expenditures. Based on the results of the three quarters of 2018, the net contribution of bank lending to households' disposable cash resources could be estimated at 1.2% of their cash income. Those additional financial resources were spent by households both on underpinning ultimate consumption and investments in housing taking into account the fact that the importance of housing loans in the overall volume of the loan market has greatly increased. In either case, it can be stated that a bank loan has a stimulating role to play in promotion of economic growth.

3.9.5. Banking passives

In 2018, retail accounts and deposits increased RUB 1,782 billion, or by 6.8 percent. Retail ruble accounts and deposits in Russian banks saw an increase of nearly Rb 2 trillion year to date. At the same time, deposits held in foreign currencies decreased in dollar terms by USD 4.8bn during the same period

The period since 2018 has seen slow pace of growth in retail bank deposits: excluding deposit outflows during the same period of 2014, 2018 saw the slowest dynamics over the entire period of monitoring (*Fig. 69*).

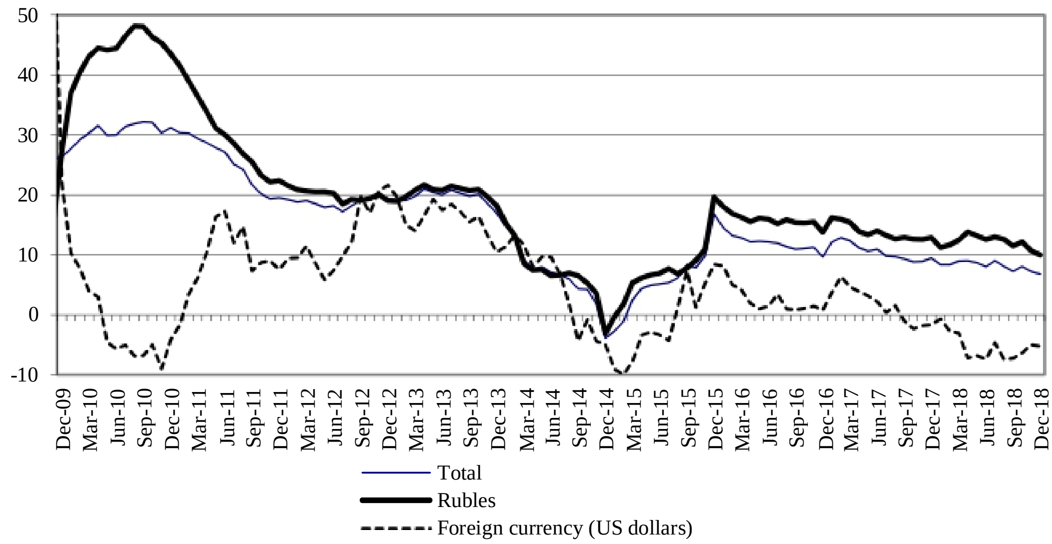

Fig. 69. Growth rates in bank deposits over 12 months, percent

Sources: Bank of Russia, own estimates.

Thus, the primary source of bank liabilities – retail accounts and deposits – has since 2018 been exhibiting an extremely sluggish dynamics. Russian households have accelerated their savings against the backdrop of active growth in credit liability to banks for maintaining an acceptable level of consumption amid stagnating real income.

Another critical component of the resource base of Russian banks – corporate accounts and deposits – increased during 2018 by RUB 2.0 trillion, or by 9.4 percent. This is a bit more against the previous year (RUB 1.7 trillion, or 8.3 percent) (*Fig. 70*).

Increased growth of corporate resources in the banking sector in 2018 was due to the growth of time deposits growth in contrast to current accounts.

For instance, in balances on corporate current and settlement accounts in banks increased by RUB 216 billion, or by 2.7% percent, practically the same was seen a year earlier (RUB 204 billion, or 2.5 percent).

Corporate fixed deposits volume increased at a higher pace – by RUB 1.788 billion, or by 13.5 percent. Meanwhile, I 2017 the increment of this component corporate resources moved up by RUB 1,406 billion, or by 11.6 percent.

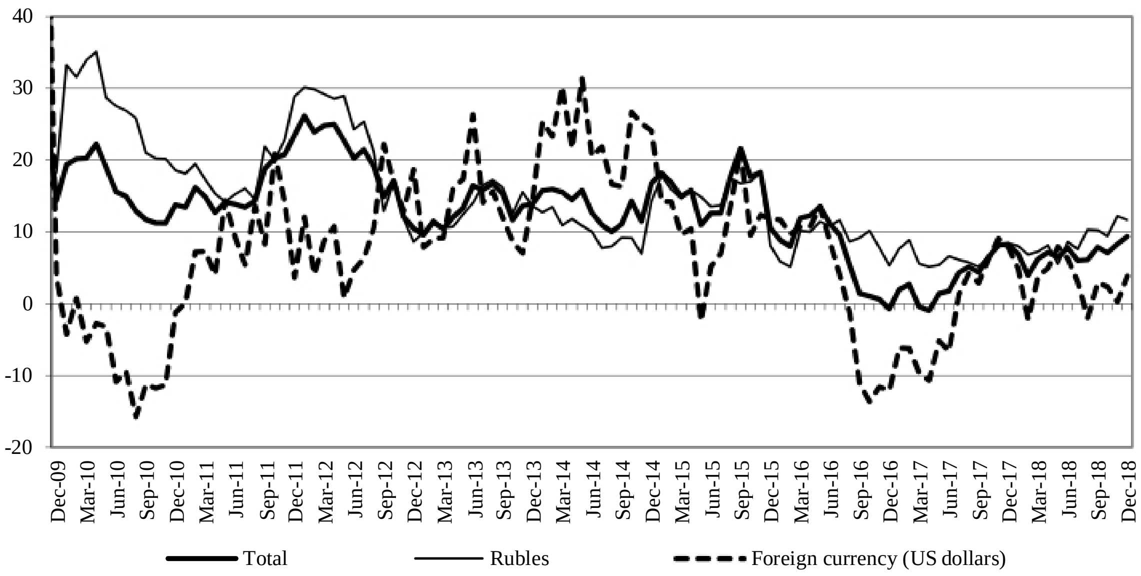

Fig. 70. Growth rates of non-bank organizations over 12 months, percent

Sources: Bank of Russia, own calculations.

Such combination in the dynamics of certain elements of corporate resources seems negative.

The recovery, since 2017, of growth in Russian corporations' term deposits with banks is indicative of a lack of sufficient number of attractive investment projects. The stagnation of current accounts is an economic activity indicator reflecting that the economy is faced with an overall unstable dynamics

An extra adverse factor for the dynamics of the resource base of Russian banks was the ongoing reduction of liabilities to non-residents. Over 2018, foreign liabilities of the Russian banking sector were reduced by nearly by RUB 733 billion, or by USD 13 billion. However, the reduction of foreign liabilities of Russian banks was overall offset by repayment of their foreign assets. During 2018, foreign assets of the banking sector contracted by nearly USD14 billion.

Therefore, in 2018 the Russian banking sector so far can count on only two principal domestic sources – households and legal entities in approximately equal proportions. In comparison with 2017, there was a small shift in favor of corporate resources.

The increase in banks' debt to the central bank (+RUB 591 billion year to date) amid structural liquidity surplus appears to be the result of regulator's efforts to rescue a few big credit institutions and can hardly become a firm basis for the provision of lending to bank customers.