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The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 41th 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: global economic and political challenges and national responses, economic growth and economic crisis; 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.
By contrast to the previous publications the present issue includes also a short analysis of the first three months of 2020 from the perspective of the COVID-19 pandemic impact on the Russian economy development.

Reviewer: Faltsman V.K., Doctor of science (Economics), Professor, main researcher, Department of Institutional and Financial Markets Analysis, IAES RANEPA.

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Sergey Zubov

3.3. Russia's banking sector in 2019[1]

At 2019-end, Russian banking sector numbered 442 lending institutions. Over the year the number of operational lending institutions decreased by 42 (in 2018 – down by 77). Seven years ago in early 2013 the number of operational institutions exceeded one thousand (1094). Consequently, the Central Bank of Russia consistently has been conducting the bank resolution process (*Fig. 66*).

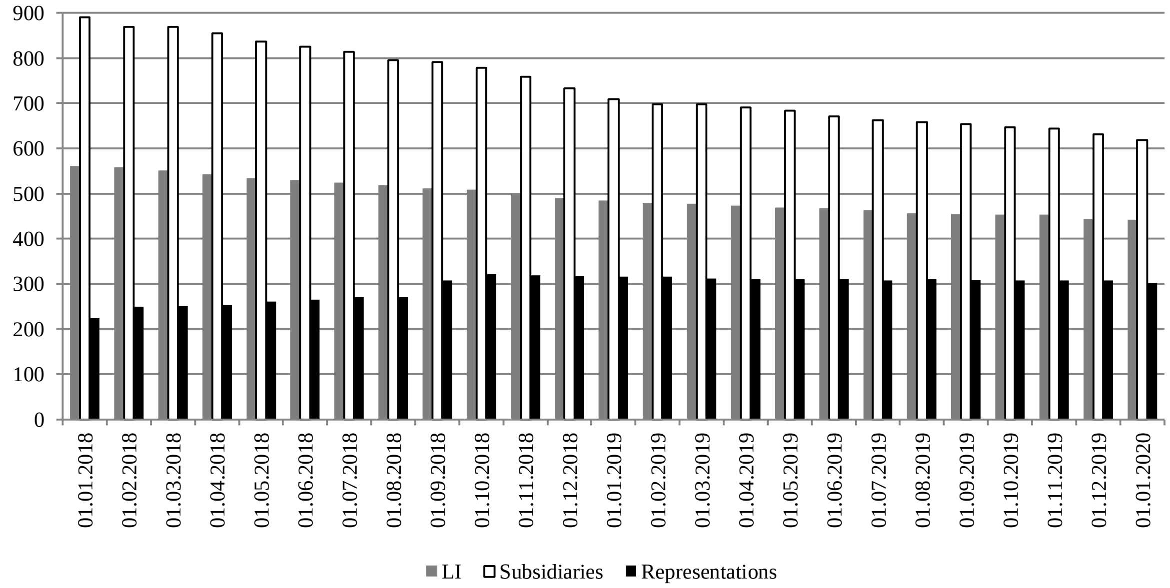

Fig. 66. Number of lending institutions, subsidiaries, and representations

Source: Bank of Russia.

As of January 1, 2020, 373 lending institutions' profit hit RUB 2,196.4 billion and losses of 69 banks amounted to RUB 159.6 billion. On the whole, the share of loss-making institutions over the year went down from 29 to 16 percent.

3.3.1. Financial results of the banking sector

Total assets of the lending institutions went up over 2019 by 2.7 percent (up by 10.4 percent over the previous year), and banks' own funds moved up by 7.6 percent (up by 3.8 a year earlier).

[1] This section was written by *Zubov S.A.*, Candidate of science (Economics), senior researcher, RANEPA.

In spite of a decline of interest rates on accounts and deposits, over 2019 banks managed to ramp up retail deposits volume by 7.3 percent down from 2018 (8.9 percent). Having said that growth was partially triggered by capitalization of the interest accrued on bank deposits. On the whole, the total growth of the deposits volume reduces the net interest earnings due to the relatively high cost of this type of bank liabilities. Over last year, the share pf deposits in the total volume of bank liabilities rose to 35.3 percent (at the end of 2018 – 33.6 percent).

The situation with attracted funds from legal entities was somewhat different. The growth rate of the aggregate volume of deposits and funds on accounts opened by the corporate clients over 2019 rose by mere 4.6 percent, which is substantially below the corresponding index of 2018 (up by 29.3 percent).

Regarding the active bank operations, the rise of the corporate lending constituted 1.2 percent against 10.5 percent seen in 2018. The growth rate of the retail lending in the past year also somewhat slowed down: from 22.4 percent in 2018 to 18.5 percent in 2019.

Over 2019, past-due payment on credits extended to non-financial organizations rose by 25.1 percent, however that was due to technical factors: in 2019 this index engulfed outstanding account receivable and overdue acquired receivables (operations on acquiring and assignment of receivables). With respect to retail credits growth of past due payments came to 0.5 percent of the total volume of extended credits, in other words somewhat decreased on the back of the credit portfolio increase. Despite the absolute growth of past due debt, its proportion in the credit portfolio declined as of January 1, 2020 to 4.3 percent (5.1 percent a year earlier).

Important factor impacting the financial results of the Russian financial sector was putting in place the new procedure for reflecting in accounting and reporting of reserves for potential losses which entered into force from January 1, 2019 in compliance with the Instructions issued by the Bank of Russia No. 4555-Y and 2556-Y of October 2, 2017. The new procedure envisages implementation of IFRS 9 standard. According to the new accounting rules received additional balance accounts and symbols "Report on financial results" which reflect reserves adjustments. The changes have also related to the methodology of the interest income accounting.

Decisions taken by the bank of Russia have contributed to the profitability of Russian banks. It has increased even in the context of the pressure brought to bear on the sector's profitability by the interest margin reduction, triggered by the cut in the key rate. At the end of 2019, ROA profitability stood at 2.1% and ROE profitability – at 20.3%. At 2018-end, these indicators constituted 1.4 and 12.4 percent, respectively. Most likely, in the near future bank analysts will include in their practice reserves adjusted profit calculation according to International Accounting Standards.[1] To date this index demonstrates stagnation of the banking profitability (as of January 1, 2018, it stood at 13.8 percent and in 2019 – at 13.1 percent).

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

Shrinkage of bank margin triggered by the reduction of inflation and the key rate, forces banks to ramp up the fee-based income. In 2019, the fee-based income from private corporate loans increased by 72.1 percent and from the retail loans by 227.3 percent. The net income from operations with securities over the past year increased notably (up by RUB 164.7 billion or by 115.4 percent) which to a large extent was due to the growth of the stock exchange last year.

At the same time, banks are forced to more carefully plan their expenses linked to ensuring activities of credit institution including spending on personnel, on operations with fixed capital

[1] International financial accounting standards.

and non-material assets, organizational and managerial expenses. Operational effectiveness of the Russian lending institutions on average across sector went up: cost-to-income ratio, CIR over 2019 declined to 41 percent which demonstrates increased effectiveness of these expenses management (in the majority of EU countries this index is below 50 percent).

For the first time in recent years, the interest income generated from retail lending has exceeded that from the corporate clients. This is due to the growth of retail and corporate lending which rates are significantly higher than the crediting rates for legal entities.

3.3.2. Corporate lending

The total volume of loans issued to Russian enterprises of all form of ownership in non-financial and financial (minus banks) sectors and legal entities – non-residents (minus banks) over 2019 rose by RUB 992.7 billion or by 2.6 percent. Over the previous year, the rise was fundamentally higher and came to RUB 4,191.1 billion or 12.4 percent.

Growth of the aggregate corporate loans portfolio to a large extent was due to the increase of the loan volume denominated in the national currency – by 8.2 percent (in 2018 – up by 12.8 percent), meanwhile lending in foreign currency has fallen by 12.0 percent (over the previous year up by 11.4 percent). As a result, the amount of ruble loans as of end of October came to 76.3 percent in the total corporate loans portfolio.

Outstanding debt take-off has somewhat accelerated. Over 2019, total past-due corporate debt rose by 27.0 percent, a year earlier the increment constituted 6.0 percent. At the year-end, past-due debt amounts to 7.1 percent of the credit portfolio, in 2018 this index stood at 5.7 percent.

The government adopts measures aimed at stimulating corporate lending. In late 2018, the RF government adopted Resolution No. 1764 "On the Adoption of Rules for Granting Subsidies from the Federal Budget to the Russian Lending institutions to Offset Shortfall of Income from Loans Extended in 2019–2024 to Small and Medium-sized Businesses at Reduced Rate." In early 2019 the implementation of the program of preferential loans was launched in the framework of the national project "MSE and support of individual entrepreneurial initiative." The RF Ministry of Economic Development has approved a list of 70 banks in 29 regions for preferential loans extended to small and medium-sized businesses at the rate of 8.5 percent (the 2018 program included 15 authorized banks, reduced rate of 6.5 percent).

Owing to programs of preferential loans the amounts of credits extended to small and medium-sized businesses have gone up by 14.5 percent (to RUB 4,695.5 billion). Loans to individual entrepreneurs over 2019 were moving up faster than in the previous year: the increment came to 12.2 percent (a year earlier – 7.1 percent). As of January 1, 2020, the total preferential loans portfolio for MSE totaled RUB 527.0 billion or 11.7 percent of the overall volume of SME credit portfolio. The debt volume on the currency loans extended to individual entrepreneurs is insignificant (below 0.5 percent) and contracted over the year by 21.1 percent (over 2018 reduction came to 16.2 percent).

The rise of the inflationary expectations and the real inflation rate in early 2019 culminated in the nominal interest rates on the ruble loans on average in 2019 somewhat took-of against the previous year. Rates on dollar and euro loans declined following the cut in the FRS rate and zero rate of ECB (*Fig. 67*).

From January 1, 2020, ceased to be in force: the Instruction of the RF Central Bank No. 180-И "On Mandatory Statutory Ratios of Banks" and the Instruction No. 112-И "On Mandatory Statutory Ratios of Lending institutions Listing Mortgage-backed Securities." Instead from

2020 was put in force Instruction of the Bank of Russia No. 199-И "On Mandatory Statutory Ratios and Premiums to Statutory Ratios of Sufficiency of Capital of Banks with Universal License." The new approach envisages calculation of compulsory normative across counterparties' classes and allows to release capital for provision of additional resources for lending to the real sector of the economy.

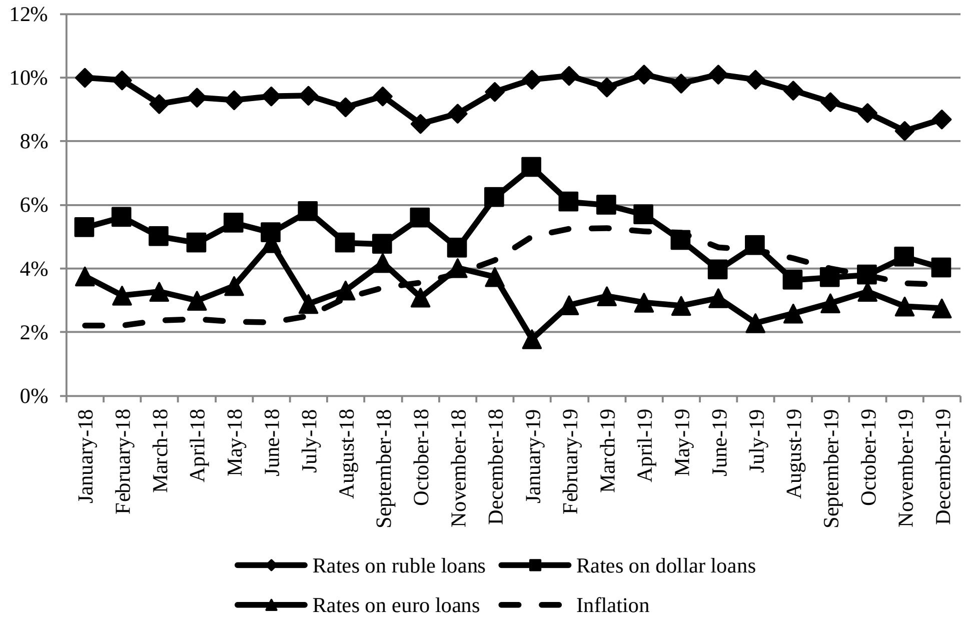

Fig. 67. Corporate lending rates

Source: Bank of Russia.

The Instruction No. 199-И sets aside a category of borrowers "investment class" with a reduced risk ratio – 65 percent (to date–100 percent) when identifying them as I and II quality categories to create provisions and admission of the borrower's securities to listing. This decision should contribute to raise attractiveness of the corporate lending sector for banks. It also set a reduced risk rate of 85 percent regarding requirements applied to small and medium-sized businesses evaluated individually (previously risk ration of 100 percent was applied) where the borrowers' financial situation corresponds to the high quality standards (evaluated by banks according to their methodologies in compliance with the Bank of Russia instructions).

According to the requirements applied to small and medium sized businesses evaluated on the portfolio basis corresponding to criteria set by the Instruction a reduced ration of 75 percent is retained.

3.3.3. Retail lending

Analysis of the aggregate retail credit portfolio for 2019 demonstrates run-up of the household debt load: monthly rates of credits advance originated by banks to households vary in the range of 1–2 percent, the total retail loaning debt from the onset of 2019 has moved up by 18.4 percent and as of January 1, 2020 amounted to RUB 17.6 trillion. At the same time, according the Bank of Russia[1] the upsurge of unsecure consumer lending positively affects the consumer dynamic and GDP, without this factor the economic growth would have been significantly lower. However, the issue of reducing risks for ensuring financial sustainability remains in the years to come.

In 2019, households' budgets following their multiyear contraction were in stagnation: cash income (average per capita) amounted to RUB 40.9 thousand per month and went up compared to 2018 by 6.1 percent meanwhile the real disposable income of the population have risen by merely 0.8 percent. Against this backdrop, the positive role of consumer lending consisted both in maintaining the spending volume of the population on final consumption and in sustainability of the households' savings.

A number of factors mark a somewhat improvement of the credit environment in 2019. For example, at Q2 – end 2019, FICO registered the credit health index growth calculated on the data released by the National Bureau of Credit Histories (NBCH). At the year-end 2019 the index hit 96 points and thus to values reported prior to December crisis of 2014, when amid the plunge of the oil prices and collapse of the ruble exchange rate the regulator raised the key rate to 17 percent annualized.[2] The index envisages identification of bad debts with 60 days past due over last six months.

According to the Bank of Russia, as of mid-2019 the number of complaints received by the central bank related to "Consumer lending" declined compared to 2018 by 5.4 percent and came to 28.2 thousand. Nevertheless, retail lending remains one of the most acute issues in the banks' activities with clients: the share of consumer and mortgage leans account for 38.1 and 10.2 percent of the total number of complaints (40.5 and 16.7 percent in 2018). Most often citizens' appeals dealt with credit repayment including refusals for their restructuring and refinancing (24.5 percent), with obtrusive automatic notification (14.4 percent), and violation of the rights of citizens on repayment of the past due debt (11.1 percent).

Assessments made by representatives of the banking community regarding the state of the consumer lending market in Russia vary notably. Many see serious risks in the spike of the consumer lending volumes, others speak about the lack of the universal credit overhang of the Russian borrowers. That said, the latter consider that there are no any grounds for the inception of the lending 'bubble' in the near future. Nominal wages growth and reduction of the interest rates serve as arguments in justification of the credit demand rise and simultaneously it is emphasized that the clients' solvency is substantiated by a high level of early payments.

Overstated concerns related to debt overburden of the households are also supported by the ratio between the consumer loans volume and deposits volume, which at the year-end 2019 constituted 57 percent while the acceptable ratio stands at 80–90 percent (as in EU countries) that demonstrates an ongoing potential for the retail lending growth.

Banks are interested in ramping up consumer lending in order to raise their income amid a reduction of the interest margin. Steady growth (and in Q3 2019 – even outstripping) of interest income generated by retail lending compared to corporate lending is a fundamental incentive for the expansion of the credit proposal to the population but carries the risk of subsequent market 'overheating' (*Fig. 68*).

[1] Evaluation of the contribution of the unsecure consumer lending and auto credits in the consumption growth and GSP. Report of the Bank of Russia "Accelerated growth of consumer loans in the structure of bank lending: reasons, risks and measures of the Bank of Russia" June 2019.
[2] URL: https://www.nbki.ru/company/news/?id=27458.

The central bank, the Ministry of Economic Development and Finance Ministry of Russia time and again expressed their preoccupation with the extension of the consumer lending, and are taking concrete steps in an effort to restrict it.

One of the factors, which had to impact banks' policy was the introduction by the Bank of Russia from October 1, 2019 in regulatory documents debt burden indicator (DBI) designed to introduce premiums on the risk rates depending on the state of the credit portfolio. DBI is calculated as a ratio of monthly average payments across all credits of a borrower to his monthly average income and is taken into account on extending a loan in excess of RUB 10 thousand at the credit limit discretion on the credit card at prolongation of credit contract life or at the debt restructuring. Previously, credit institutions used this indicator for the similar purposes. This is designed to restrict banks' expansion on the consumer lending market – the majority of lending institutions will have to adjust their procedures to the Bank of Russia requirements and be more inventive in approaching lending in highly risky segments.

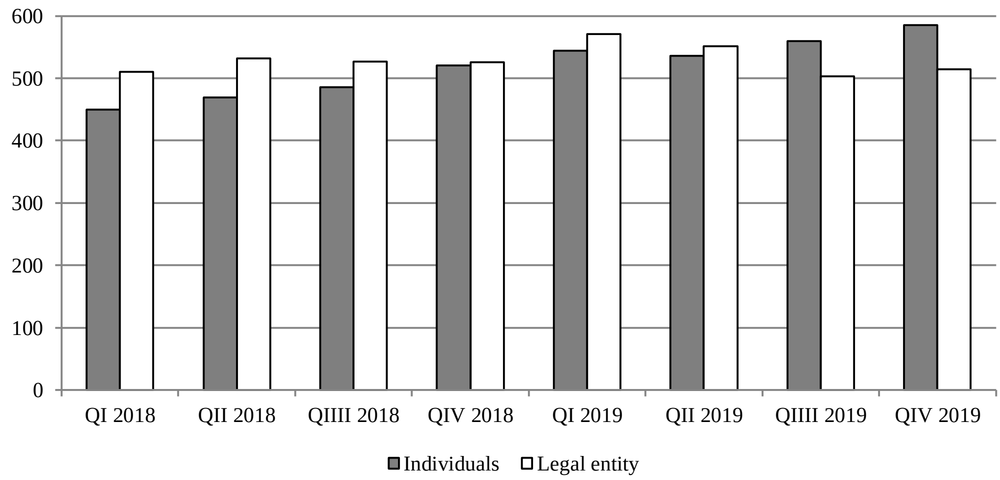

Fig. 68. Interest income generated from retail and corporate loans, Rb billion

Sources: Bank of Russia. URL: http://www.cbr.ru/credit/forms/.

Besides, from January 31, 2019, amendments to the Federal Law "On Credits Histories" entered into force according to which Russians get personal credit rating which is a score constructed on the basis of personal history. The value of the rating is affected by loan delinquencies, level of debt burden, number of requests for credit history inspection and other indicators. Introduction of the personal credit rating should assist banks in proactively take decisions on extending a loan, reduce operational costs. This being said, accessibility of loans for citizens with low rating will be falling, which, in its turn, can affect the divergence of the interest rates and slowdown of growth of the aggregate credit portfolio volume.

According to the Bank of Russia over 2019, the volume of ruble mortgage loans originated to individuals-residents moved up by 17.0% hitting RUB 7.5 trillion. This was driven by systematic reduction of the key rate, which the Bank of Russia carried out 5 times in the course of 2019. Demand hike for mortgage loans in the context of record-low mortgage interest rates was due to the households' demand for the resolution of the residential problem. A certain role in the mortgage demand growth today was also played by a transition to the new procedure of housing purchase by way of application of project financing and escrow accounts according.

According to this scheme the developers had to borrow from banks for the construction which will trigger price hikes in newly erected buildings.

In early 2019 the microloan market was affected by the Law No. 554-FZ adopted in late 2018 and envisaging a significant restriction regarding a very expensive type of lending as ‘pay day loans.’ Putting in place of the new regulation triggered a reduction of the annual interest rate on this type of financial services. Main restrictions were: reduction of the maximum rate on microloan from 1.5 to 1 percent per day and reduction of the maximum asking amount from 2.5-fold of the originally borrowed amount to 2-fold. Owing to those measures at the year-end 2019 the highest annual interest rate on microloans considerably declined to 365 percent against 842 percent seen over the previous year.

Despite this novation, in Q2 2019 the microloan market demonstrated an upward trend of key indexes: microloan portfolio increased by 16 percent, quarterly origination of loans was up by 11 percent. At the same time, past due debt went on growing: NPL indicator 90+ (90+ days past due) hit an all-time high of 27.3 percent in late June, which probably, demonstrates aggressive strategy in an effort to “capture market” to the detriment of its quality ahead of a new round of restrictions which will come into force in 2020 as well as well as the impact of digitalization and expansion of online origination of PDL loans (Pay Day Loans – short-term loans of up to 30 days).

‘Business as usual’ scenario regarding the situation on the consumer lending market and microloan market in 2020 envisages selected deceleration of the volumes growth rates due to the influence of macro prudential and monetary policies conducted by the Bank of Russia. Forced contraction of supply on the retail lending will tell on the pricing policy of the commercial banks, which can trigger a reduction of rates on accounts and deposits and growth of commissions and tariffs. In the event measures adopted by the government and the Bank of Russia aimed at the cooling of the retail lending market will be materialized then we can expect an increase in corporate lending.

In the event of growing crisis developments in the economy on the back of negative factors (plunge of crude oil prices, inflation rise, and ruble’s devaluation), a reduction of lending volumes, growth of interest rates, and decline of banks’ income will be conceivable. The outbreak of recession in financial and banking sector can trigger risks of non-payments, which, in its turn, can result in a serious revaluation of banks’ credit portfolios, spending growth on reserves build up and capital loss by credit institutions. Under this scenario the situation will depend on the stabilization measures undertaken by the government and the central bank, on their inclusiveness and timeliness.

3.3.4. Banking sector resources

Among the most significant components of the banking sector resources still remain retail deposits (31.6 percent of all bank liabilities), deposits of legal entities minus lending institutions (19.1 percent), organizations’ current accounts (11.4 percent), and raised funds from banks including Bank of Russia (11.0 percent).

Retail deposits on ruble and currency bank accounts at 2019-end hit RUB 30.5 trillion, increase over past year amounted by RUB 2.1 trillion or 7.3 percent (in 2018, retail bank accounts grew by 8.9 percent). Slowdown of the retail bank accounts growth over last two years was due to the transition from the savings to consumption and investment models of behavior. Consumption growth rates amid real income stagnation were ensured by an increase of bank loan debt. Meanwhile, moderate revival of interest of the population towards investments in real estate and operations on the stock market has been observed.

Bank deposits growth was ensured, first of all, by the increment of ruble deposits by 9.9 percent (in 2018 – by 7.6 percent). Currency accounts volume in ruble equivalent decreased during the last year by 2.2 percent (the previous year demonstrated growth by 13.7 percent). However, taking into consideration USD exchange rate dynamics (ruble's depreciation in 2018 and its appreciation in 2019) seen over the last year, an increment of the dollar equivalent of currency accounts by 9.8 percent was observed, meanwhile in 2018 the same indicator fell by 5.7 percent (*Fig. 69*).

The level of deposits' dollarization[1] of the population remains modest: over the year, the share of funds on currency deposits in ruble equivalent in the overall deposits volume decreased from 21.5 to 19.6 percent, which is due to the ruble appreciation in the first place.

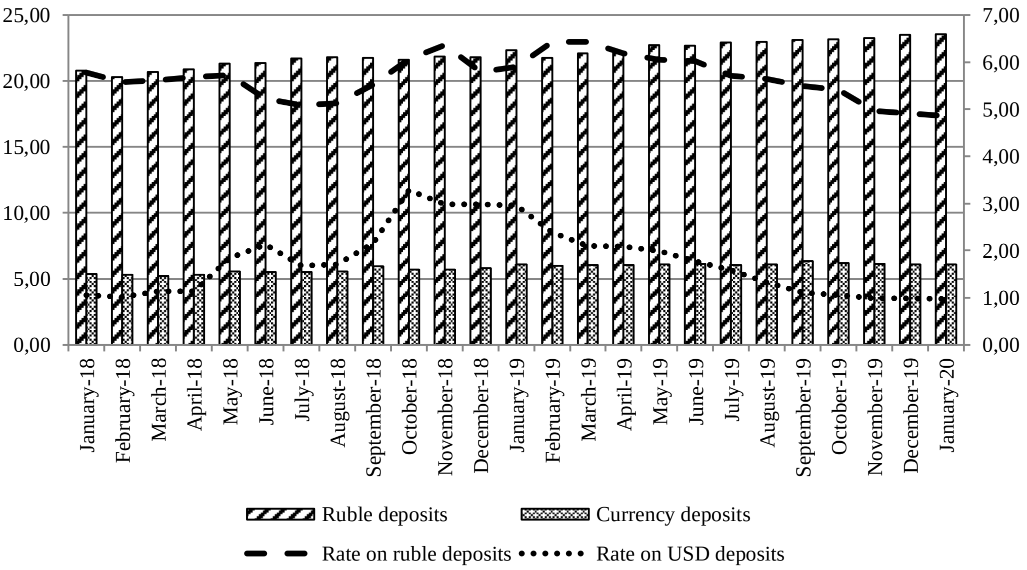

Fig. 69. Volumes of raised funds to retail deposits (trillion rubles) and interest rates on deposits (percent)

Source: Bank of Russia.

Another important component of the Russian banks' resource base are corporate deposits, which went up during 2019 by RUB 0.14 trillion or by 4.6 percent hitting RUB 18.5 trillion. Compared to the last year, growth rates of such deposits have significantly contracted (in 2018 growth amounted to 29.3 percent). This is primarily due to the contraction of currency deposits. However, taking into account the dollar exchange rate, the decline of dollar equivalent of currency deposits slowed down by 1.2 percent in 2019 against 5.8 percent in 2018 (*Fig. 70*).

Interest rates on ruble deposits declined by 15.8 percent (in 2018 up by 7.1 percent), contraction on dollar deposits was much more significant – 64.7 percent, meanwhile in 2018, growth hit 102.1 percent. At year-end 2019, many banks put an end to accepting euros on corporate deposits due to the fact that interest rates on deposits in the EU were in the red.

[1] Deposits in all currencies are taken into consideration.

Transaction interest-free deposits[1] demonstrated last year a sustainable growth: total amount of such accounts during last year went up by 5.7 percent (over 2018 by 7.9 percent) hitting RUB 11 trillion.

Banks' debt commitments remain not too attractive financial instruments for the clients: compared to interest-bearing deposits their issuance volume is insignificant. Total volume of bonds at 2019-end hit RUB 1.9 trillion (in 2018 – RUB 1.3 trillion) up by 41.1 percent during the year (up by 9.7 percent over past year). The volume of issued promissory notes came to RUB 0.38 trillion down by 12.8 percent (over 2018 – up by 2.5 percent). The total volume of issued debt securities and savings certificates contracted by 75.8 percent (down by 61.0% percent during 2018) and stays at a low level – RUB 0.04 trillion

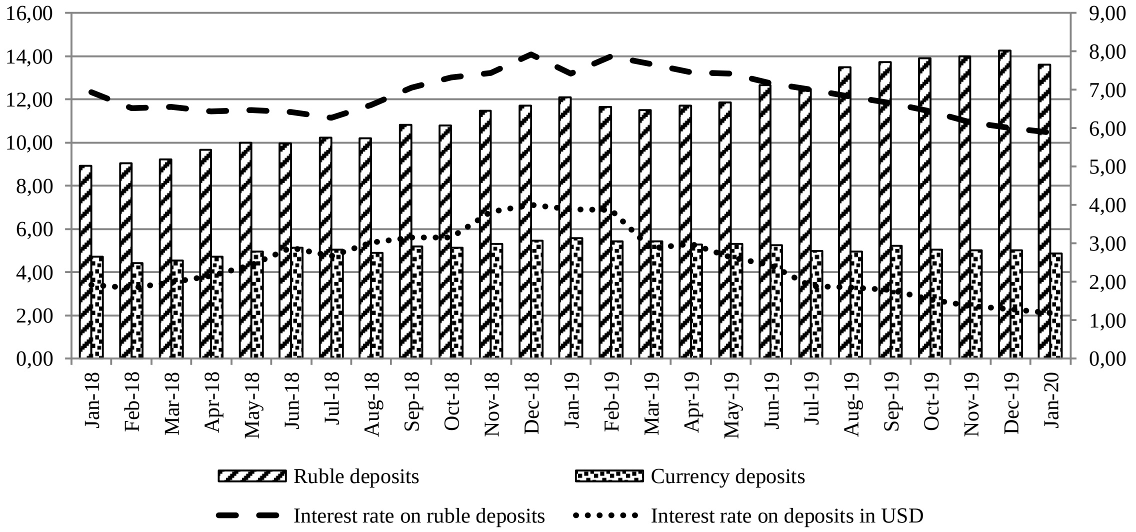

Fig. 70. Volumes of funds raised on corporate deposits (trillion rubles) and interests on deposits (percent)

Source: Bank of Russia.

Decrease of borrowing on the interbank market demonstrates a reduction of dependence on the most volatile sources of funding. During the year, the volume of loans and deposits originated by the resident banks went down by 8.3 percent (down by 3.3 percent in 2018).

Alongside this, the volume of funds raised from the non-resident banks continued a downward trend, over the year it decreased by 32.3 percent in the ruble equivalent (up by 20.7 percent in 2018).

As far as borrowings from the Bank of Russia go, they decreased over the past year by 6.0 percent, meanwhile in 2018 a significant growth was observed – by 29.3 percent. Taking into consideration the short term of borrowings, one can draw a conclusion on the improvement of the bank liquidity.

The level of the bank resources concentration remains high. The share of five major banks as for the size of assets of lending organizations account for 65.5 percent of retail deposits (in 2018, this indicator stood at 65.1 percent), and 59.2 percent of corporate deposits (61.2 percent).

[1] Funds of legal entities and retail operating and current accounts, resources in settlements, factoring and forfaiting transactions.

The share of raised funds by way of credits from the Bank of Russia decreased slightly – by 24.7 percent (in 2018 – 32.9 percent).

In 2020, under the escalation of the crisis developments related to the oil prices and the outbreak of the coronavirus pandemic, surge of inflation and ruble's devaluation are feasible, which will lead to an increased demand for foreign currencies and contraction of ruble savings. In case of this scenario implementation the stability of the banks' resource base will be dependent of the timeline of the crisis development and measures undertaken by the government and the Bank of Russia.