

RUSSIAN BANKING SECTOR IN Q1 2013

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In Q1 2013 the trend of slowing growth in the credit portfolio of banks was sustained. In the retail segment of credit market there was started deterioration of the Bank's loan portfolio quality. Profitability of the banking business is getting reduced for the second consecutive quarter, which is driven by the growing deductions to reserves and higher cost of the resource base.

In March 2013 the assets of the banking sector increased by 0.9%, having only slightly (by Rb 300bn) surpassed the level of the beginning of the year. Annual growth rates remain close to the indicator of 19% (18.7% as of Q1 2013).

The dynamics of the state-owned banks in March was slightly weaker than in the other banks, but nevertheless, the share of the largest state-owned banks in the total bank assets (54.8%) remains higher than at the beginning of the year (54.4%), as well as the indicator of a year ago (54.2%).

In March the banks' own funds have grown by 1.0% and in the first quarter – by 3.4%. The main source of growth in equity were the banks' dividends (including the capitalization of the last year profit), which have grown in Q1 by 6.2%. The total statutory and surplus capital of the banking sector in the first quarter of this year remained virtually unchanged.

In Q1 2013 the return on banking assets made Rb 239bn, including Rb 88bn in March (the maximum result since the beginning of the year). Here-with, Rb 124bn were addressed to the formation of reserves for possible losses on loans and other assets. This is more than within the entire last year (Rb 123bn). Earnings excluding the reserves in Q1 2013 also reached the record level (Rb 363bn over three months). However, the earnings with regard to the banking business scope in Q1 2013 was rather modest. Profitability of the banking

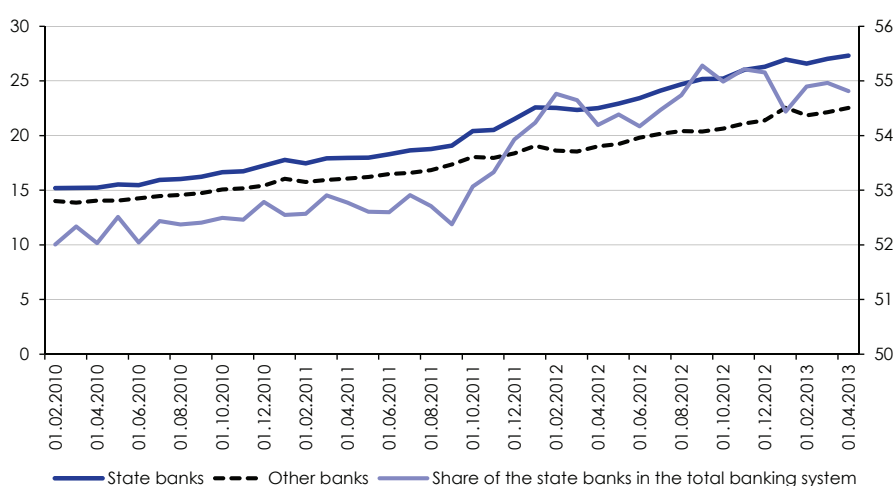


Fig. 1. Dynamics of the state-owned and other banks' equity (Rb trillion) and the share of the state-owned banks in the total assets (% , right scale)

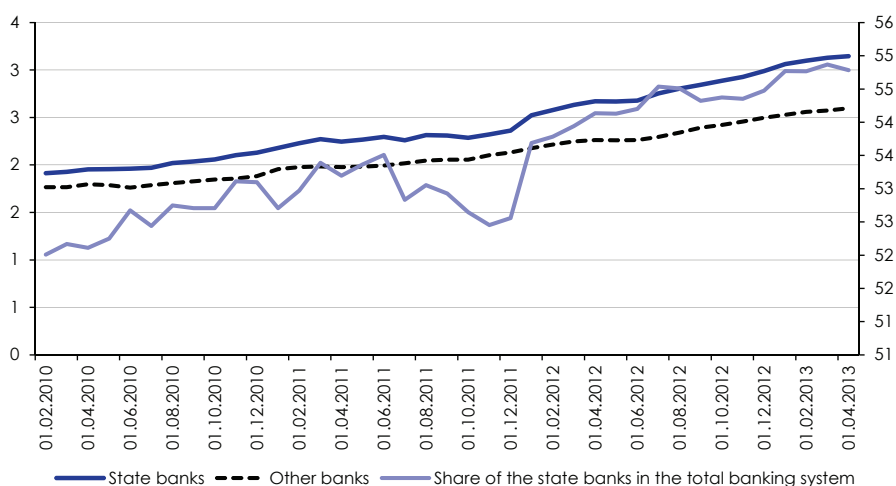


Fig. 2. Dynamics of the state-owned and other banks equity (Rb trillion) and the share of the state-owned banks in the total assets (% , right scale)

business is getting reduced. As of the end of Q1, the rate of returns made 1.9% , and that of the equity – 16.9% in annual terms.

Raised funds

Savings of households in the bank accounts of individuals have grown in March made according to the tentative estimates 4.1%, which is somewhat more than the last year level (3.7%). Moreover, the inflow of deposits at the beginning of 2013 has equaled the amount of the growth in the individuals' credit indebtedness, unlike the last year, when in Q1 the growth of the debt on bank loans to individuals was exceeding the inflow of deposits by one third. As of the end of one quarter, it is too early to talk about the turn in the savings behavior of the population, but there are preconditions for the trend change.

The average effective interest rate on deposits in banks in Q1 2013 reached 6.6%. This is significantly higher than the previous year indicator (5.9%) and the average for 2013 (6.1%). Growth rates offered by the banks, was aimed at increasing the attractiveness of bank deposits and the stabilization of the resource base. For the banks, this meant a significant increase in costs (interest paid to the depositors on deposits in Q1 2013 has exceeded the indicator of the last year by 34%).

The amount of funds in the accounts and deposits of corporate clients with the banks since the beginning of the year remains virtually unchanged. In March it has been decreased by 0.1%, and overall for the quarter increased by 0.2%. The annual growth rates have stabilized since the beginning of the year near the level of 10%.

Fixed-term deposits are prevailing in the structure of corporate funds. Although their share has declined in Q1 from 54.4% to 52.7%, but still they make more than a half of the total funds of corporate clients deposits in the banking system.

One of the reasons for the prevalence of fixed-term deposits, apparently, is the growing interest rate. Average actual value of the fixed-term deposits of corporate clients in the banking

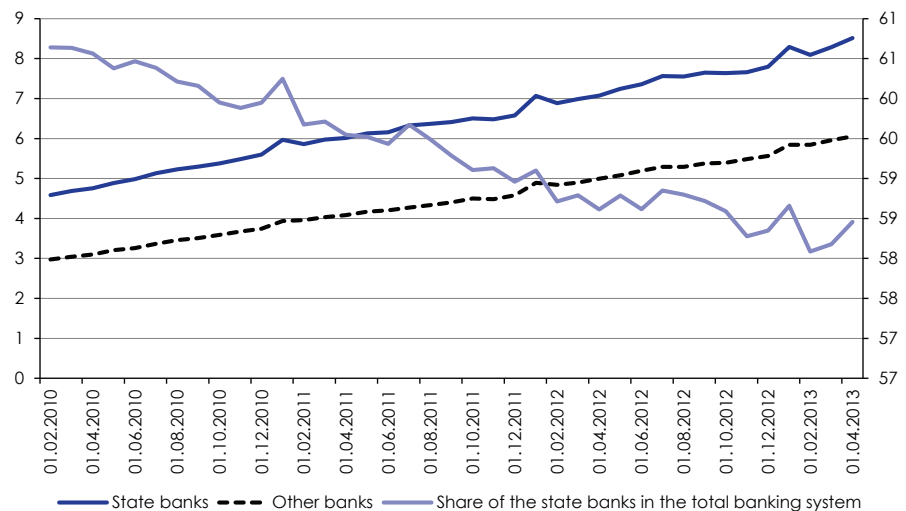


Fig. 3. Dynamics of individual deposits in the state-owned and other banks (Rb trillion) and the share of state-owned banks in the market of physical entities deposits (% , right scale)

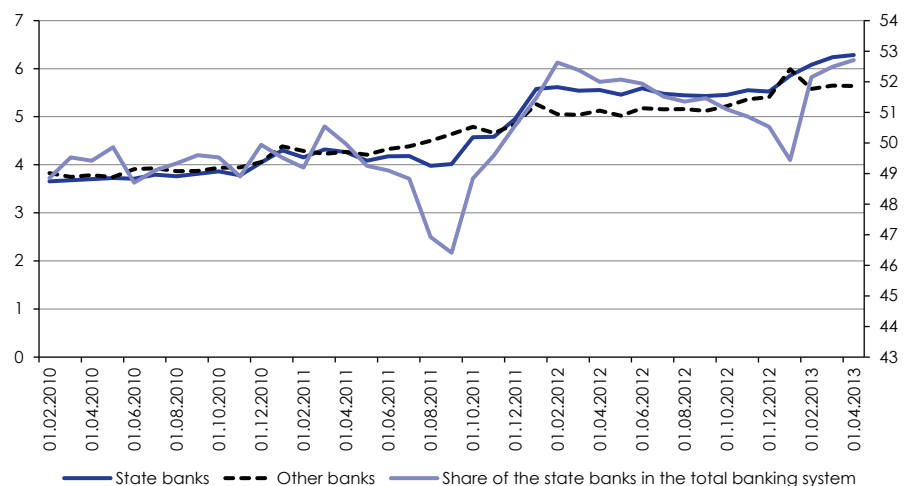


Fig. 4. The dynamics of corporate accounts in the state-owned and other banks (Rb trillion) and the share of the state-owned banks in the market of corporate accounts (% , right scale)

sector made at the end of Q1 2013 6.2% per annum, having increased by 0.6 p.p. (5.6% in Q1 2012).

There is no doubt that interest rates growth on the main types of the banks' raised funds has led to the decline in profitability of the banking business.

Table 1

STRUCTURE OF THE RUSSIAN BANKING SYSTEM LIABILITIES
(END OF MONTH), AS % OF TOTAL

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	12.12	01.13	02.13	03.13
Liabilities, Rb bn	20125	28022	29430	33805	41628	41533	44266	45861	49510	48429	49165	49839
Own assets	15.3	14.1	19.3	18.7	16.9	17.5	16.8	16.9	16.2	16.8	16.7	16.7
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	2.9	3.5	5.1	5.1	5.4	4.5	4.5	4.5
Interbank operations	4.1	4.4	4.8	5.5	5.7	5.1	4.8	5.1	5.6	5.4	5.4	5.4
Foreign liabilities	18.1	16.4	12.1	11.8	11.1	10.2	11.3	11.0	10.8	10.5	10.6	10.4
Individual deposits	26.2	21.5	25.9	29.6	29.1	29.4	29.4	28.7	28.9	29.1	29.3	29.6
Corporate deposits	25.8	23.6	25.9	25.7	26.0	25.7	24.0	23.3	24	24.1	24.2	23.9
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	2.3	1.4	1.5	2.5	1.6	1.1	1.0	1.4
Securities issued	5.8	4.1	4.1	4.0	3.7	4.8	4.5	4.8	4.9	5.2	5.3	5.2

Source: Central Bank of Russia, IEP estimates.

Investments

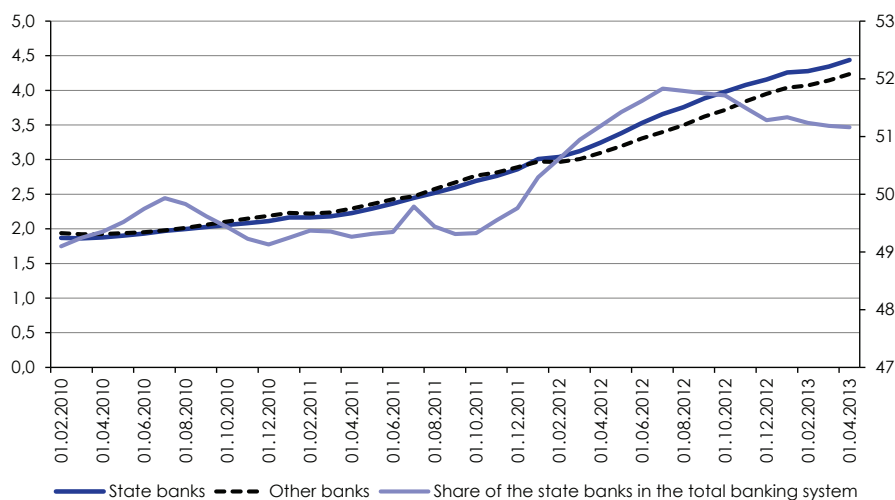


Fig. 5. Dynamics of loans to individuals in the state and other banks (Rb trillion) and the share of the state banks' loans to population (%; right scale)

The volume of public debt to the banks has increased since the beginning of the year by 4.5%, including, 2.2% in March. The annual growth rate fell down below the level of a year ago, amounting to 36.5% on April 1, 2013.

The main indicators of quality of retail loan portfolio have worsened as of Q1 2013 results. The volume of overdue debt increased from 4.1% to 4.3% within three months, while the share of overdue loans in the total debt portfolio increased from 6.1 to 6.5%.

The deterioration of the loan portfolio quality may further to provoke a limiting credit growth. Moreover, the increase of interest rates, designated to compensate the appreciation of the resource base, is shifting lending to riskier segments of the market in terms of the borrowers' quality: higher interest rates are accepted mostly by the compliant clients, who are not so responsibly for personal financial planning and therefore, there is a higher risk in their failure to repay their debt on time.

The average actual cost of retail loans in Q1 2013 was 17.7% per annum, which is more than by 1 p.p. exceeds the last year indicator (16.5%). In addition, the burden on servicing the banks' debt to disposable income continues to grow. As of the end of the last 4 quarters, the population was paying to the banks (for loans repayment schedule and interest) about 10% of the disposable income, and for Q1 2013, when there happens a seasonal decline in household income, that indicator reached 12%.

The volume of corporate clients' debt on loans to the banks have grown in March by 1.0%, and for the quarter – by 1.2%. Annual growth rates of corporate clients' debt have decreased to its lowest level of the past two years to 14.5%. For the last time such indicators were observed in spring of 2011, at the beginning of the post-crisis credit market recovery.

The quality of loans to corporate borrowers in Q1 2013 remained at the same level. The share of overdue debt as of April 1 made 4.6%, and the ratio of provisions for tentative losses to the total credit debt made 7.5%

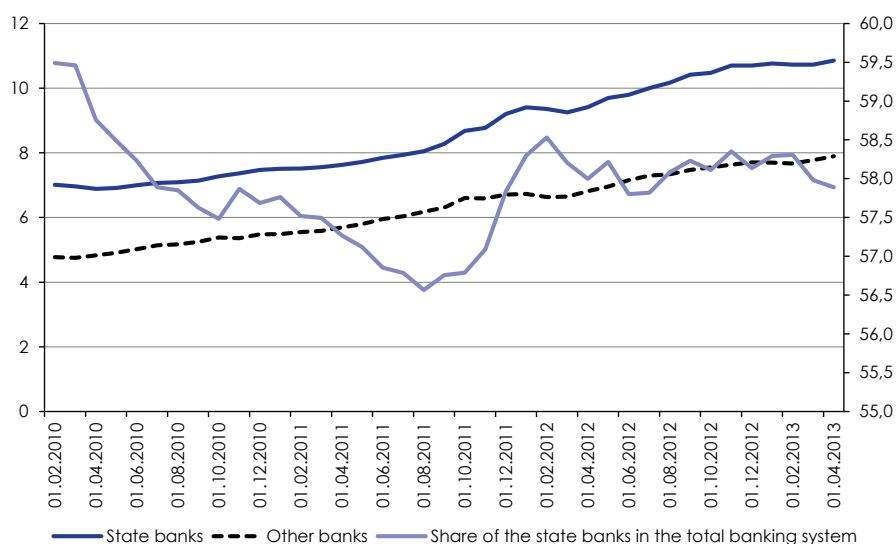


Fig. 6. Dynamics of loans to companies and organizations with the state-owned and other banks (Rb trillion), and the share of the state-owned banks in the market of corporate borrowers, (%), (right scale)

Table 2

STRUCTURE OF THE RUSSIAN BANKING SYSTEM ASSETS
(END OF MONTH), AS% OF TOTAL

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	10.12	01.13	02.13	03.13
Assets, Rb bn	20125	28022	29430	33805	41628	41533	44266	45861	47096	48429	49165	49839
Cash and precious metals	2.5	3.0	2.7	2.7	2.9	2.4	2.5	2.6	2.6	2.6	2.5	2.5
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.2	3.2	3.0	2.8	2.7	2.9	3.1	3.3
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	5.8	5.8	6.1	6.7	6.6	6.4
Foreign assets	9.8	13.8	14.1	13.4	14.3	14.2	14.2	13.9	14.3	14.0	14.6	14.5
Individuals	16.1	15.5	13.1	13.0	14.4	15.3	16.0	16.8	16.8	17.3	17.3	17.4
Corporate sector	47.2	44.5	44.5	43.6	44.0	44.4	43.6	43.4	42.9	42.3	42.1	41.9
Government	4.1	2.0	4.2	5.1	5.0	4.9	3.8	3.3	3.2	3.7	3.3	3.2
Property	2.2	1.9	2.7	2.6	2.3	2.4	2.3	2.3	2.3	2.3	2.3	2.2

Source: Central Bank of Russia, IEP estimates.