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## Russian Banking Sector

*In September, the growth rate of the banking sector assets remained low. At the same time, the trend of slowing lending to the economy was observed not only in the corporate segment, but in the retail segment of the credit market as well.*

Growth rate of total banking sector assets in Q3 2012 was 5.0%<sup>1</sup>, including 1.9% in September, and the annual growth rates remain in the range of 20-22%.

Capital net worth of the banking sector<sup>2</sup> in September remained virtually unchanged. Herewith, there was a noticeable decrease in capital net worth of Sberbank, the largest Russian bank, whose capital fell over the month by 5%. The reason was the purchase of a subsidiary in Turkey that led to the deduction of the corresponding value from regulatory capital. Due to the lack of capital net worth growth, capital adequacy of own funds standard reduction was continued. H1 standard for the banking sector in general has declined over the last month from 13.3 to 13.0%. The capital adequacy ratio of Sberbank has decreased much more: from 12.8 to 12.0%, whereas this indicator of other banks remained at around 13.5%.

The aggregate profit of the banking sector in September was minimal over 2012 and amounted to Rb 72.3bn. As a result, the return on assets in the banking sector in September has reduced to 1.9% in annual terms, while for the total period since the year beginning its values remains at the level of 2.3%.

### **Raised funds**

The main source of funds of banks - *funds in the accounts and deposits of individuals* - in recent months continues to grow more slowly than the total assets of the banking sector. For Q3 2012, the volume of funds in the accounts and deposits of individuals increased by 2.5%, including 1.0% in September. The annual growth rate of the individual assets, however, has returned to the level of Q1 2012 (19.1%), i.e., total growth of deposits in Q2 and Q3 was comparable to the relevant period of the last year, while in Q3 it was even somewhat higher.

The rate of household savings in bank deposits for the period of January-September 2012 amounted to 4.3%, that is, found to be higher than in the corresponding period in 2011. However, with the cash (domestic and foreign currency) in 2012 the individuals allocate a smaller part of their income for savings (4.8% against 5.0% a year earlier). Accordingly, the relative increase in deposit growth in 2012 is due to the redistribution of household assets from cash income. A significant contribution to the increase of individuals' funds in the banking sector is the accrual of interest on deposits. The average yield of deposits (regardless current accounts) in Q3 reached 6.2%, having increased against Q1 by 0.3 p.p. The total amount of

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<sup>1</sup> Hereinafter growth rates of balance sheet are already adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

<sup>2</sup> Estimated under Form No.0409134.

income from bank accounts and deposits in Q3 was about Rb 170bn, which is equivalent to more than 50% increase in the funds of individuals with the banks.

The currency structure of deposits continues to shift in favor of foreign currencies. In Q3 ruble accounts and deposits grew by 1.3%, and remained virtually unchanged in September. At the same time, the deposits denominated in \$ increased by 7.7% over the quarter including 3.7% in September.

*Funds in accounts and deposits of legal entities* increased over Q3 by 1.7%, including 2.3% in September. Herewith, the annual growth rate has decreased to 14.9% from 19.1% a month earlier. The reason for such dynamics was the so-called "base effect": in September 2011, the Bank of Moscow has attracted a long-term loan from the Deposit Insurance Agency (DIA) worth Rb 295bn in the framework of government program of financial recovery. According to the Russian accounting standards, these funds are accounted for as a nonbank institution deposit. Less the amount of DIA assets with the Bank of Moscow, the annual growth rate of corporate funds with the banks in September of this year would be reduced from 15.7% to 15.4%.

Currency structure of corporate clients is similar to that of individual accounts, with the difference that foreign currency predominance in the assets of enterprises and organizations was even stronger. Thus, in Q3 ruble funds of legal entities with the banks increased only by 0.4%, while foreign currency ones - by 13.8% in dollar terms. In September the ratio remained similar: 1.1% - in ruble accounts versus 7.9% in foreign currency.

The ratio of current accounts versus term deposits is sustained at less than one. That is, for current activities businesses and organizations need only a half of their funds allocated with the Russian banks, and major share part of their funds is kept on term deposits. In September, this ratio has shifted a little in favor of current accounts, the share of which has increased from 45% to 47%.

The balance sheet value of the Russian banks' *foreign liabilities*<sup>3</sup> has increased during Q3 2012 to Rb 10.9bn, including \$3.8bn in September. Along with the growth of foreign liabilities, banks were increasing investments in foreign assets (by \$15.7bn for the quarter and \$10.2bn in September). As a result, in recent months, the external market served not as a source of fund raising for the Russian banks, but vice versa, the way of assets outflow.

Table 1

### Structure of the Russian banking system liabilities (end of month), as % of total

|                             | 12.07        | 12.08        | 12.09        | 12.10        | 06.11        | 12.11        | 03.12        | 05.12        | 06.12        | 07.12        | 08.12        | 09.12        |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Liabilities, Rb bn</b>   | <b>20125</b> | <b>28022</b> | <b>29430</b> | <b>33805</b> | <b>35237</b> | <b>41628</b> | <b>41533</b> | <b>43225</b> | <b>44266</b> | <b>45090</b> | <b>45523</b> | <b>45861</b> |
| Own assets                  | 15.3         | 14.1         | 19.3         | 18.7         | 18.5         | 16.9         | 17.5         | 17.0         | 16.8         | 16.8         | 16.9         | 16.9         |
| Loans of the Bank of Russia | 0.2          | 12.0         | 4.8          | 1.0          | 0.9          | 2.9          | 3.5          | 3.9          | 5.1          | 5.7          | 5.3          | 5.1          |
| Interbank operations        | 4.1          | 4.4          | 4.8          | 5.5          | 5.2          | 5.7          | 5.1          | 4.7          | 4.8          | 4.8          | 5.0          | 5.1          |
| Foreign liabilities         | 18.1         | 16.4         | 12.1         | 11.8         | 10.9         | 11.1         | 10.2         | 11.0         | 11.3         | 11.4         | 11.4         | 11.0         |
| Private deposits            | 26.2         | 21.5         | 25.9         | 29.6         | 30.4         | 29.1         | 29.4         | 29.4         | 29.4         | 28.8         | 28.9         | 28.7         |
| Corporate deposits          | 25.8         | 23.6         | 25.9         | 25.7         | 24.3         | 26.0         | 25.7         | 24.9         | 24.0         | 23.5         | 23.1         | 23.3         |

<sup>3</sup> Dynamics of the balance sheet indicators of foreign assets and liabilities of the banking sector may be different from the balance of payments due to differences in the methods for calculating these indicators.

|                                                               |     |     |     |     |     |     |     |     |     |     |     |     |
|---------------------------------------------------------------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Accounts and deposits of state agencies and local authorities | 1.5 | 1.0 | 1.0 | 1.5 | 3.5 | 2.3 | 1.4 | 1.7 | 1.5 | 1.7 | 2.3 | 2.5 |
| Securities issued                                             | 5.8 | 4.1 | 4.1 | 4.0 | 4.0 | 3.7 | 4.8 | 4.6 | 4.5 | 4.5 | 4.6 | 4.8 |

Source: Central Bank of Russia, IEP estimates

## Investments

Retail lending in Q3 started to slow down. Growth rate for the quarter was by 1.5 p.p. lower than in Q2 (9.3% vs. 10.8%), the growth of individuals' indebtedness was the lowest since March of the current year (2.7%), and the annual values decreased to 41% after 42-43% in the summer months. The share of new loans in the final consumption of households has also slightly decreased from the maximum 28% in May to 26% in September. Since the beginning of the year (over January-September 2012), the volume of new bank loans to individuals amounted to more than a quarter of the final consumption of households.

The quality of the retail loan portfolio of the banking sector continued to improve gradually due to faster growth of the indebtedness. Overdue loans to individuals in September did not change, and the value of provisions for losses on loans to individuals grew over the month by 1.4%. As a result, both, the share of overdue debt, and the ratio of provisions to outstanding loans decreased during the month by 0.1 p.p. to 4.5 and 6.3%, respectively.

One of the factors slowing lending could be a gradual rise in the cost of loans to retail borrowers. Thus, if in Q1 2012 the average cost of loans to individuals (calculated as the ratio of interest income received by banks to the average debt for the period) was 16.5% per annum, in the third quarter it increased by almost 1 p.p., to 17.4% per annum. The achieved level of bank credit cost for individuals is the highest since 2006, when the year-end yield on lending made 17.6%. In subsequent years (2007-2011), its value was varying in the range of 15.5 to 16.6% per annum.

The growth of the credit cost for the population leads to an increase in the debt burden on disposable household income. In Q3 2012, according to Ye.T. Gaidar, households spent on service of their accounts payable to banks (the amount of interest and repayment of basic debt in accordance with payment schedule), 10.4% of disposable income. For comparison, the previous maximum recorded in Q1 2009, amounted to 9.7%.

*Corporate borrowers' debt* to banks increased in Q3 2012 by 5.3%, including 1.7% in September. The annual growth rate declined to 18.6%, which is the lowest indicator since August 2011. This suggests an established trend to the slowing growth of bank crediting to the economy - from the peak of 22.8% at the beginning of 2012 the annual growth rate of corporate loan portfolio has decreased already by more than 4 p.p.

Indicators of credit portfolio quality of corporate borrowers has not changed in September 2012. The share of overdue debt was 4.9% and the ratio of provisions for loan loss versus credit debt reached 7.8%.

## Liquidity and government support

Liquidity of the banking sector (the ratio of liquid assets with the Bank of Russia and cash on hand versus total assets) in September remained unchanged at about 4.6%. The sustained

overall level of liquidity was accompanied with a volatile dynamics of this index in Sberbank and other groups of banks<sup>4</sup>. Liquidity of the largest bank has decreased in this month by nearly 1 p.p. from 5.0% to 4.1%, and for all other groups of banks an increase in this index was noted. Herewith, in the Sberbank, due to its size, a much lower level of liquidity is admitted than in other banks. Thus, over 2007-2008, this indicator value of the largest Russian bank was sinking even below 2%.

Currently, Sberbank liquidity roughly corresponds to the overall level of the banking sector. However, the national largest bank is the leader in terms of another indicator, i.e., the volume of the funds raised from the monetary authorities both, in absolute and in relative terms. The total overdue liabilities of Sberbank to the Bank of Russia and the Ministry of Finance deposits amounts to Rb 1.2 trillion or 9.1% of total assets, whereas to other banks - 5.2%. Herewith, in addition to Sberbank, the average level of state support is exceeded ( 6.3% of assets) is exceeded only by a group of other state-owned banks (6.8%). Thus, there remains a situation where government support of the banking sector is aimed mainly at the state-owned banks.

The total amount of monetary authorities' assets in the banking sector has increased over the month from Rb 115bn to Rb 2.7 trillion, which makes 6.2% of total banking sector assets and 4.8% of GDP. In September an increased government support to the banks was carried out mainly by the Ministry of Finance deposits, which total volume increased by Rb 167bn. Overdue liabilities of the banks to the Bank of Russia on the contrary has decreased due to reduced loans, secured by assets and guarantees.

Table 2

### Structure of the Russian banking system assets (end of month), as% of total

|                                  | 12.07        | 12.08        | 12.09        | 12.10        | 06.11        | 12.11        | 03.12        | 05.12        | 06.12        | 07.12        | 08.12        | 09.12        |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Assets, Rb bn</b>             | <b>20125</b> | <b>28022</b> | <b>29430</b> | <b>33805</b> | <b>35237</b> | <b>41628</b> | <b>41533</b> | <b>43225</b> | <b>44266</b> | <b>45090</b> | <b>45523</b> | <b>45861</b> |
| Cash and precious metals         | 2.5          | 3.0          | 2.7          | 2.7          | 2.2          | 2.9          | 2.4          | 2.4          | 2.5          | 2.5          | 2.5          | 2.6          |
| Deposits with the Bank of Russia | 6.9          | 7.5          | 6.9          | 7.1          | 4.5          | 4.2          | 3.2          | 2.6          | 3.0          | 3.2          | 2.9          | 2.8          |
| Interbank operations             | 5.4          | 5.2          | 5.4          | 6.5          | 6.4          | 6.4          | 6.2          | 5.7          | 5.8          | 5.7          | 5.9          | 5.8          |
| Foreign assets                   | 9.8          | 13.8         | 14.1         | 13.4         | 13.8         | 14.3         | 14.2         | 14.6         | 14.2         | 14.5         | 14.0         | 13.9         |
| Individuals                      | 16.1         | 15.5         | 13.1         | 13.0         | 14.0         | 14.4         | 15.3         | 15.8         | 16.0         | 16.1         | 16.5         | 16.8         |
| Corporate sector                 | 47.2         | 44.5         | 44.5         | 43.6         | 45.3         | 44.0         | 44.4         | 44.1         | 43.6         | 42.7         | 43.7         | 43.4         |
| Government                       | 4.1          | 2.0          | 4.2          | 5.1          | 5.8          | 5.0          | 4.9          | 4.5          | 3.8          | 3.4          | 3.4          | 3.3          |
| Property                         | 2.2          | 1.9          | 2.7          | 2.6          | 2.5          | 2.3          | 2.4          | 2.3          | 2.3          | 2.3          | 2.3          | 2.3          |

Source: Central Bank of Russia, IEP estimates

<sup>4</sup> Other state-owned banks, foreign banks, large private banks and small and medium-sized banks.