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Russian Banking Sector

In October, the only source of growth of banks' fund raising were government agencies, including the Central Bank. All other sectors acted as net beneficiaries. As a result, banking sector own liquidity (liquid assets less funds of monetary authorities) reached the minimum level in both, absolute terms and as a percentage of the total assets of the banking sector.

In the autumn months the growth rate of bank assets[1] has stabilized at the level around 2% per month. Annual growth rates remain in the range of 20-21%. Stability of October growth rate against September (2.3% vs. 1.9%) was accompanied with a fairly sharp segmentation by individual groups of banks. The greatest consistency was noted in the group of medium and small banks[2], which assets growth rate remained practically unchanged (2.9% in September, 2.7% in October). Among the major banks, the highest growth rates of assets were noted in Sberbank, accelerated from 0.4% in September to 4.2% in October, which allowed the growth rate of assets of the largest state-owned banks to grow in general from 1.2% to 2.8%. On the contrary, growth rates in assets of foreign and large private banks in October have slowed down. The growth rates of assets of the first group of banks decreased from 1.1% to 0.2%, and of the second group - from 2.5% to 0.9%.

Overall, in the banking sector the growth rate of raised funds in October reached 2.6%. The balance value of capital net worth has increased only by 1.5%. As a result, capital adequacy continued a gradual decline (from 13.1% to 13.0%), due to an advanced growth of operating assets over the capital net worth dynamics[3]. Herewith, the Russian second largest bank VTB was able to increase its regulatory capital and improve capital adequacy from 12.1 to 13.2% as a result of placement its subordinated Eurobond loan. Therefore, at the background of the Sberbank capital adequacy sustainability, the decline of capital adequacy in other banks was more noticeable.

The aggregate profit of the banking sector in October made Rb 84bn, which corresponds to the return on total assets of 2.2% in annual terms, and equity - 18%, roughly equal to the values of the last 12 months. The positive trend observed in October was a marked growth in profit before provisions for possible losses up to Rb 106bn, which exceeds the average monthly level in the current year.

Raised funds

The inflow of funds to the *deposits of individuals* with the banks remains low. The increase in deposits of individuals with the bank accounts in October made only Rb 81bn or 0.6%. The annual growth rate remained at 19.1%. The leaders in terms of the deposit base growth within several consecutive months are small and medium banks. In October they were able to extend the amount of raised funds of individuals by 1.9% or Rb 67bn. That is, making only 27% of the deposits market, small and medium banks in October ensured over 80% of the

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[1] Estimated under Form No.0409134.
[2] With the exception of 30 largest banks in terms of capital net worth .
[3] Estimated under Form No.0409134.

growth. The growth rate of deposits with the 30 largest banks in terms of capital net worth amounted to only 0.1% for the month. Since the beginning of the year the growth rate of funds of individuals with the small and medium banks has exceeded the relevant indicator of 30 largest banks (16.2% vs. 8.5%). This is the result of differences in interest rate policy of the large and small banks. Thus, the average actual yield of deposits of individuals with Sberbank for three quarters of 2012 made 4.5% per annum, 6.7% with other banks among the top 30, and 8.2% with other banks. Herewith, the small and medium banks' interest on deposits is greater than in Sberbank, although the volume of deposits with the first ones is less than 60% of total deposits with Sberbank.

The rate of household savings in bank deposits in October amounted to 3.9% of incomes, which is less than since the year beginning (4.3%). However, it is early to talk about a steady decline in savings growth rate: in 2012, the individuals are placing with the banks a larger share of income than in the corresponding period of 2011.

More alarming, in our view, can be considered the fact that this year the growth of deposits of individuals with the banks was steadily giving way to the growth of the outstanding liabilities on loans. Over 10 months, net household savings in the banking system have declined by Rb 691bn, including Rb 137bn in October. A larger redistribution of banks assets in nominal terms in favor of population over 10 months was observed only during the 2008 crisis (Rb 845bn),but then it was due to the outflow of clients, who were scared of the large-scale banking crisis. Only in September-October 2008, clients have withdrawn from the banks more than Rb 540bn. In 2012, the transition to a net borrowing of individuals from the banks took place in a more favorable financial market situation with no signs of panic among bank clients. This indicates a change in the savings behavior of households and the transition to a new credit consumption pattern, much more pronounced than in the boom of retail lending in 2006-2008.

The inflow of funds of *corporate clients* to the bank accounts for the second consecutive month exceeds the relevant indicator of deposits of individuals in absolute terms. In October 2012 the accounts of corporate clients increased by 1.9% (Rb 203bn), while the annual growth rate for October made 17.1%.

For the fourth consecutive month businesses and organizations prefer to accumulate funds in foreign currency accounts. Thus, over July-October 2012 the volume of ruble corporate accounts decreased by 0.3%, having increased by 1.2% in October, while the amount of foreign currency accounts in dollars rose in four months to 18.6 %, including 4.2% in October. The most rapid rate in October were noted in corporate funds on time deposits in foreign currency, namely by 5.5% in dollar terms.

The maximum growth rate of corporate clients' funds as broken down by major groups of banks in October were reached by Sberbank (5.3%) and small and medium banks (4.8%)

Foreign liabilities of the banking sector grew in October by \$3.3bn. The total growth of foreign loans was made solely by large state-owned banks. Sberbank foreign liabilities increased over the month by \$2.8bn, and those of other major state banks - by \$1.4bn. Respectively, private banks have reduced the amount of foreign loans nearly by \$1bn.

Investments in foreign assets for the second consecutive month exceeded the growth of foreign liabilities, amounting to \$7.7bn in October. Here the state banks also play the key role.

Sberbank and other major state-owned banks ensured $7.2bn of foreign assets increase. This means that banks act as net creditors to the external market ($4.4bn in October, $ 2.9bn of which were ensured by state-owned banks).

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	06.12	07.12	08.12	09.12	10.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	41628	41533	44266	45090	45523	45861	47096
Own assets	15.3	14.1	19.3	18.7	18.5	16.9	17.5	16.8	16.8	16.9	16.9	16.7
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	2.9	3.5	5.1	5.7	5.3	5.1	5.4
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.7	5.1	4.8	4.8	5.0	5.1	5.1
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.1	10.2	11.3	11.4	11.4	11.0	11.1
Private deposits	26.2	21.5	25.9	29.6	30.4	29.1	29.4	29.4	28.8	28.9	28.7	28.2
Corporate deposits	25.8	23.6	25.9	25.7	24.3	26.0	25.7	24.0	23.5	23.1	23.3	23.2
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	3.5	2.3	1.4	1.5	1.7	2.3	2.5	2.7
Securities issued	5.8	4.1	4.1	4.0	4.0	3.7	4.8	4.5	4.5	4.6	4.8	5.0

Source: Central Bank of Russia, IEP estimates

Investments

Bank's *retail lending* growth rates remain at maximum post-crisis levels. In October, the volume of outstanding liabilities on loans to individuals increased by 2.8%, and within 12 months – by 41.7%. Accordingly, if in the previous review we noted the slowdown in retail lending, given the results of October, it makes sense to talk about stabilization of growth. The annual growth rate after the June peak of 42.5%, in the next 4 months remained in the range of 41.2-41.7%.

The quality of retail loan portfolio indicators of the banking sector remained unchanged in October. Currently the share of overdue debt makes 4.5%, and the ratio of provisions for outstanding liabilities on loans – 6.3%.

Among the market segments of lending to individuals the fastest growth rate are noted in the outstanding liabilities on unsecured loans. Thus, over the 12 months from October 2011 to September 2012[4], the outstanding liabilities of individuals on unsecured bank loans increased by 58%, while the growth rates of secured loans are much lower: 30% on housing purchase (including mortgage), 24% on car loans.

The latter circumstance causes understandable concern of regulatory authorities. The Bank of Russia plans to adopt a number of measures aimed at limiting the growth rates of portfolios of unsecured loans to individuals. Thus, from March 1, 2013 it is planned to double the rate of provisions for unsecured consumer loans, and from July 1 to increase the risk factors on consumer credits for assessment of the banks' capital adequacy of own funds standard (H1).

Measures proposed by the Bank of Russia focus mainly on slowing growth in the segment of unsecured loans with high interest rates on loans. Provisions for consumer loans, unsecured by dwellings or vehicles now account for about 7% of the debt on these loans or Rb

[4] At the time of this review preparation, the data on certain types of retail loans for October are not published yet.

280bn. However, it is planned to increase only the provisions for loans free from overdue liabilities or those with overdue liabilities not exceeding 30 days. The amount of provisions for such loans, formed by banks on all types of loans, is now Rb 43bn, wherein the share of unsecured accounts, according to our estimates, makes about 80%. Besides, the new provisions requirements should be applied only to the new loans, credited from January 2013. Provisions rate increase will make from 1 to 3 percentage points, and the banks can increase lending rates on unsecured loans for the same amount to compensate for increasing provisions. With the average annual interest rate on short-term loans at 25% it will be noticeable, but will be hardly critical for the outstanding liabilities dynamics. Therefore, this measure is unlikely to radically change the retail loan market.

Another measure is aimed at limiting the interest rates on loans. From July 1, 2013 loans to individuals at higher rates will be included with increased coefficients in the formula for calculating capital adequacy standards. Thus, for ruble loans higher rates will be regarded the annual rates exceeding 25%. Up to the level of 35% per annum the mark-up factor will be equal to 1.1 (that is, the risk for this loan will be 10% higher than for the "cheap" loans), from 35% to 45% the mark-up factor will be 1.4, from 45 to 60% - 1.7, and for more than 60% - 2. That is, those banks will have to apply double rate in the assessment of capital adequacy for the most expensive loans. To make an overall assessment of the effect of this measure on the banking sector, more detailed information is required on individual banks, than that disclosed by the Bank of Russia. Based on the open forms of the bank statements for Q3 2012, the average yield on loans to individuals exceeded 25% per annum in 43 banks. That is, these banks will have either to reduce the capital, or review their interest rate policy. In reality, the number of banks, which have at least one expensive loan in its assets is much more, so this measure, of course, will affect a wide range of banks, which will have either to reduce the retail lending yield, or to look for additional sources of revenue for their capital.

Corporate segment of the credit market in terms of growth rates falls behind the retail credit market. In October loans to nonbank enterprises and organizations grew by 1.5%, and over 12 months by 18.5%. Indicators of corporate lending quality has improved slightly over the last month. The share of overdue loans decreased from 4.9 to 4.8%, and the ratio of provisions formed for possible losses to the loan portfolio - from 7.8 to 7.7%.

Liquidity and government support

Liquidity of the banking sector (the ratio of liquid assets in the total assets) in October has reduced by 1 p.p. to 4.5%. This is the minimal level over the past five months, but it is higher than the historical minimum of 4.1%, which was recorded at the end of May this year.

Herewith, the own liquidity of banks, with the exception of loans from the Bank of Russia and the Ministry of Finance of Russia deposits continues to decline. Thus, based on the end of October results, the amount of funds received by banks from the RF Central Bank and the Ministry of Finance of Russia, exceeded the value of the liquid assets by more than Rb 1 trillion. Within the month the scope of government support to the banking sector increased by Rb 280bn, Rb 174bn of which were the assets of the Bank of Russia, and the balance (Rb 106bn) were deposits of the Ministry of Finance of Russia.

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	06.12	07.12	08.12	09.12	10.12
Assets, Rb bn	**20125**	**28022**	**29430**	**33805**	**35237**	**41628**	**41533**	**44266**	**45090**	**45523**	**45861**	**47096**
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.9	2.4	2.5	2.5	2.5	2.6	2.6
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	4.2	3.2	3.0	3.2	2.9	2.8	2.7
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.4	6.2	5.8	5.7	5.9	5.8	6.1
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.3	14.2	14.2	14.5	14.0	13.9	14.3
Individuals	16.1	15.5	13.1	13.0	14.0	14.4	15.3	16.0	16.1	16.5	16.8	16.8
Corporate sector	47.2	44.5	44.5	43.6	45.3	44.0	44.4	43.6	42.7	43.7	43.4	42.9
Government	4.1	2.0	4.2	5.1	5.8	5.0	4.9	3.8	3.4	3.4	3.3	3.2
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.