RUSSIAN BANKS IN JULY 2014

M.Khromov

In July, revocations of banking licenses continued. Asset growth was significantly slowed down as a result of shrinkage of their principal sources – corporate funds and foreign liabilities, as well as a very slow movement of individual deposits. Growth of interest rates has so far produced little positive effect on changes in the banking sector's resource base, but it is nevertheless a factor that further pushes down the level of current lending activity.

In July 2014, 8 credit institutions had their banking licenses revoked – including 6 entities licensed to attract the population's private funds. The average size of assets held by each of these institutions amounted to[1] Rb 4.9bn, where the share of the population's private funds amounted to Rb 3.7bn. Since the onset of the banking sector's cleanup in July 2013, the licenses of a total of 75 credit institutions were revoked by the Bank of Russia under its new leadership, including 46 licenses over the period of January–July 2014. Of these, 60 credit institutions had been granted the right to attract the population's funds (34 among those whore licenses were revoked in 2014).

The banking sector's assets increased by 0.1%[2] in July 2014 and by 14.6% over the period of 12 months from August 2013 through July 2014 (in 2012 and the first half of 2013, the annual growth rate of bank assets amounted to 19–23%). The slowdown in the growth rate of bank assets in July occurred due to shrinkage of the size of interbank loans (by 7%, or by more than Rb 200bn), as well as shrinkage of the funds held on bank accounts by corporate clients and external loans. In spite of the continuing growth of banks' debt to the money market regulators, July saw a decline both in bank liquidity and the volume of foreign assets.

Over the course of July, state-owned banks (*Sberbank* including) and biggest foreign banks decreased their assets by 0.7 and 0.8% respectively. At the same time, the assets of big private banks increased by 2.0%, and those held by medium- and small-sized banks – by 1.2%. As a result, the share of state-owned banks in the total volume of bank assets has been on the decline for as third month in a row – from its record high of 57% achieved as of 1 May 2014 to 56% as of 1 August 2014. Nevertheless, this is still higher that the same index for the first half year of 2013, when state-owned banks held 54.5–55.0% of total bank assets.

1 As of the last reporting date preceding the date of license revocation.

2 Hereinafter, if not otherwise specified, the growth rates of balance-sheet indices are adjusted by changes in the value of their components denominated in foreign currencies.

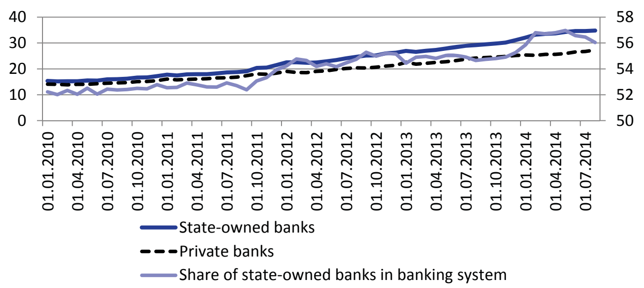

Fig. 1. The Movement of Bank Assets (State Banks vs Other Banks, Trillion Rb) and State Banks' Share in Aggregate Assets (%, Right-hand Side Scale)

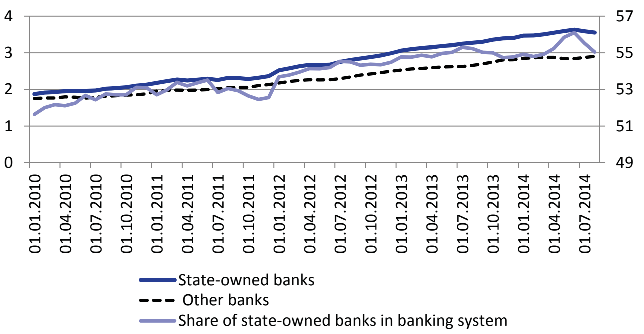

Fig. 2. The Movement of Equity[3] of State and Other Banks (Trillion Rb) State Banks' Share in Equity (%, Right-hand Side Scale)

In July 2014, the banking sector's profit amounted to Rb 62bn, which is somewhat lower than the average monthly profit received over the first half-year (Rb 75bn).The total banks' profit for the period since 1 January 2014 amounts to Rb 513bn, which is 10% below the corresponding index for the same period of 2013. The profitability of the banking sector's equity in July dwindled to 1.2% per annum, and the profitability of the banking sector's equity – to 11.5%.

As before, the main factor responsible for profit decline is the deteriorating quality of bank assets. In July alone, banks allocated to their reserves against possible loan losses a total of Rb 98bn, which is nearly

3 Calculated on the basis of balance-sheet accounts (Form No 101).

1.5 times more than the amount of similar allocations made in the first half year of 2014.

Attracted Funds

In July 2014, the bank accounts and deposits of the population increased by only 0.4% (Rb 68bn). Their per annum rate of growth dropped to 6.7%. And the growth rate of individual bank deposits for the entire period since 1 January 2014 still remains negative – the outflow of funds in Q1 2014 has not yet been compensated for by the subsequent money inflow.

The ruble-denominated component of individual bank deposits over that month increased by 0.6%, while deposits denominated in US dollars over the same period shrank 0.6%. Nevertheless, when the ruble's exchange rate resumed its downward movement in July,[1] the share of individual bank deposits denominated in foreign currencies decreased from 19.0% to 19.6%.

The grow rate of individual bank deposits remains low in spite of rising interest rates. The rates for ruble-denominated deposits[2] for a term of more than one year in July reached the level of 8.8% per annum vs. 8.4% per annum in January, and those for a term under one year – to 8.06% vs. 7,54%. The maximum interest rate offered by 10 biggest banks on the individual deposit market in July jumped to 9.0% per annum, having risen from 8.3% per annum in early 2014.

Over the course of July 2014, the monies of corporate clients kept on bank accounts dwindled by 1.9%, or by Rb 273bn. The per annum growth rate displayed by bank liabilities of this type as of the end of July amounted to 11.0%. In July, enterprises decreased the volumes of both theuir ruble-denominated deposits (-1.1%) and deposits denominated in foreign currency (-4.3% in US dollar terms).

The outflow of corporate clients' funds from banks was observed only in their current and settlement accounts, which shrank over that month by 6.1% (Rb 382bn). At the same time, the volume of funds kept as term deposits increased by 1.3% (Rb 98bn). As a result, the share of term deposits in the total volume of corporate clients' monies kept with banks hit yet another record high, amounting as of 1 August 2014 to 56.6%, or Rb 7.7 trillion. Thus, companies withrew from their turnover a sum equivalent to 11% of GDP, and froze it in the form of term deposits placed with Russian banks.

The banking sector's foreign liabilities have been on the decline for a fourth month in a row. Since 1 April 2014, when it had been at the level of $ 176bn, they shrank by 5.4%, or by nearly $ 10bn. The share of foreign liabilities in the total volume of bank liabilities declined over that period from 10.6 to 9.5%.

July 2014 saw continual growth of the banking sector's debt to Russia's financial regulatory bodies – the Bank of Russia and the RF Ministry of Finance. The total amount of funds lent by the Bank of Russia to credit institutions as of 1 August 2014 was Rb 5.59 trillion, having increased over that month by Rb 223bn. The amount of funds deposited Размер by the RF Ministry of Finance with Russian banks rose to Rb 635bn. The aggregate debt owed to monetary authorities as of the end of July

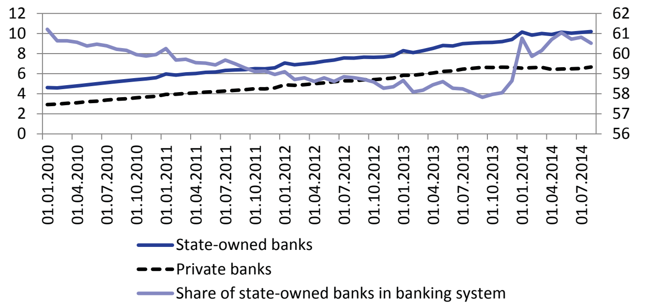

Fig. 3. The Movement of Individual Deposits with State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Physical Persons' Deposits (%, Right-hand Side Scale)

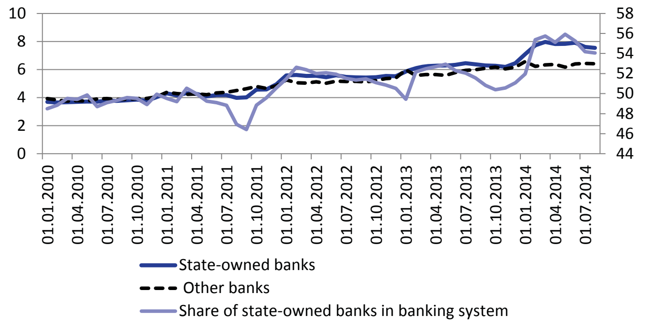

Fig. 4. The Movement of Corporate Clients' Deposits with State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Corporate Clients' Accounts (%, Right-hand Side Scale)

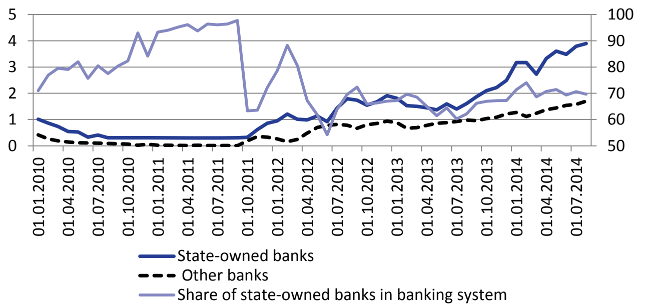

Fig. 5. The Movement of the Bank of Russia's Loans to State and Other Banks (Trillion Rb), and State Banks' Share in the Loans Issued by the Bank of Russia (%, Right-hand Side Scale)

1 Over the course of June, the ruble lost 4.7% in its value against the US dollar, and 2.8% against the euro.

2 Without taking in account *Sberbank*'s rates.

Table 1

THE STRUCTURE OF RUSSIA'S BANKING SYSTEM'S LIABILITIES (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	3.14	04.14	05.14	06.14	07.14
Liabilities, bn Rb	28,022	29,430	33,805	41,628	49,510	52,744	57,423	59,377	60,208	61,196	61,385	62,127
Equity	14.1	19.3	18.7	16.9	16.2	16.3	16.0	16.0	15.9	15.9	15.8	15.8
Credits allotted by Bank of Russia	12.0	4.8	1.0	2.9	5.4	4.4	7.7	7.9	8.4	8.2	8.7	9.0
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.2	5.1	4.7	4.8	5.6	5.9	5.5
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	10.8	9.9	10.6	10.3	9.8	9.4	9.5
Physical persons' monies	21.5	25.9	29.6	29.1	28.9	29.6	29.4	27.8	27.9	27.3	27.4	27.5
Enterprises and organizations' monies	23.6	25.9	25.7	26.0	24	23.5	23.8	23.9	23.3	23.4	22.9	22.4
Accounts and deposits of state administrative bodies and local governments	1.0	1.0	1.5	2.3	1.6	2.4	0.9	1.8	2.2	2.5	2.3	2.5
Securities issued	4.1	4.1	4.0	3.7	4.9	5.1	4.5	4.2	4.1	4.0	3.9	3.9

Source: RF Central Bank; the IEP's estimates

(Rb 6.23 trillion) accounted for 10.0% of aggregate bank assets, which is near the record highs observed in the crisis year 2009 (12.3% as of 1 February 2009).

Invested Monies

The rate of lending to physical persons is continuing its decline. Over the course of July 2013, the amount of outstanding debt of physical persons against bank loans issued to them increased by 1.5%, while its per annum growth rate dropped to 18.8%, thus having returned to its February 2011 level.

The quality of the retail credit portfolio is steadily worsening. The growth rate of the number of credits with repayment in arrears over that month was 4.2%, while the amount of reserves against potential loss of monies lent to physical persons in the form of credits increased by 3.1%. As a result, the share of outstanding debt in the total amount of debt owed by physical persons amounted to 5.5%, and the ratio of reserves against potential losses to payables – to 8.5%.

The slowdown in the credit portfolio's growth rate means that the credit market no longer represents a source of additional funding to the population, and so it has ceased to sustain consumer demand. In 2014, the population has been paying interest on credits in amounts higher than the relative growth of consumer loans. While prior to 2014 the cost of servicing the previously taken bank loans was compensated by the inflow of newly borrowed funds, now new loans are no longer capable of providing the population with resources sufficient for covering the cost of servicing their old debt. Thus, over the first half year of 2014, interest payments on consumer bank loans amounted to Rb 889bn, while the aggregate debt increased by only Rb 671bn. So, in the first half year, the necessity to repay bank loans resulted in shrinkage of disposable household income by Rb 218bn.

If we set aside housing loans, which are taken in order to invest in housing and not to cover current household consumption costs, the other types of (consumer) credits will turn out to be even more expensive in terms of household budgets. As estimated by the Gaidar Institute's Center for Structural Research, interest payments on consumer bank loans over the first half year of 2014 rose to Rb 707bn, thus implying that the average cost of such loans is 19.4% per annum. However, debt growth amounted to only Rb 303bn. The resulting difference of Rb 404bn corresponds to 2.5% of household consumption expenditure over that period. This is the sum depleted from the total amount of money that could have been spent on household consumption but for the need to service the debt owed to banks against consumer loans.

The volume of corporate debt against bank loans over July 2014 increased by 1.3% (Rb 287bn). Over the period of 12 months from August 2013 through July 2014, the per annum growth rate amounted to 11.4%, thus plummeting to its record low since January 2011. Ruble-denominated loans and loans denominated in foreign currencies in July increased almost at an equal rate – by 1.3% and 1.4% respectively. However, the

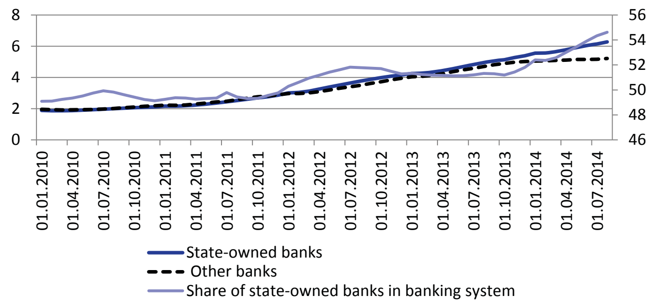

Fig. 6. The Movement of Retail Loans Issued by State and Other Banks (Trillion Rb), and State Banks' Share in Retail Lending (%, Right-hand Side Scale)

Table 2

STRUCTURE OF RUSSIA'S BANKING SYSTEM'S ASSETS (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	3.14	04.14	05.14	06.14	07.14
Assets, bn Rb	28,022	29,430	33,805	41,628	49,510	52,744	57,423	59,377	60,208	61,196	61,385	62,127
Cash and precious metals	3.0	2.7	2.7	2.9	3.1	2.4	2.8	2.8	2.7	2.4	2.4	2.3
Monies placed with Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.3	3.9	3.5	3.4	2.9	3.3	3.1
Interbank operations	5.2	5.4	6.5	6.4	6.8	6.0	5.7	5.3	5.7	6.5	6.9	6.5
Foreign assets	13.8	14.1	13.4	14.3	13.0	15.1	13.3	14.4	15.1	14.6	14.1	14.2
Population	15.5	13.1	13.0	14.4	16.8	17.9	18.5	18.4	18.4	18.3	18.5	18.5
Corporate sector	44.5	44.5	43.6	44.0	41.3	40.8	39.3	39.6	39.0	38.8	38.8	39.0
State	2.0	4.2	5.1	5.0	3.2	3.2	3.1	3.0	2.7	3.2	3.4	3.4
Property	1.9	2.7	2.6	2.3	2.2	2.2	2.0	1.9	1.9	1.9	1.9	1.9

Source: RF Central Bank; the IEP's estimates.

share of loans denominated in foreign currencies increased from 18.0% to 18.7% due to the downward movement of the ruble's exchange rate.

The credit portfolio quality in the market's corporate segment in July 2014 remained relatively stable. The volume of outstanding debt in nominal terms in July was displaying a faster growth rate than did the aggregate lending volume, but in fact it only returned to its level of two months before – Rb 968bn as of 1 August 2014 vs. Rb 967bn as of 1 June 2013. The share of outstanding debt in the total debt volume over the course of July increased by 0.1 pp. to 4.3%, while still being below its index as of 1 June 2014 (4.4%). The volume of reserves against possible corporate loan losses increased over that month by 1.9%, while the ratio of reserves to the size of credit portfolio remained at the level of 6.6%.

One of the factors responsible for the slower credit portfolio growth has evidently been the rising cost of loans. The interest rates on ruble-denominated loans issued to non-financial organizations[1] for a term up to one year in July reached the level of 11.0% per annum, thus having risen since the year's beginning by 1.4 p.p. Cost growth was less noticeable with regard to long-term loans: in July, the interest rates on loans issued for a term of more than one year amounted to 12.3% per annum, which is 0.9 p.p. above their January level. However, the movement of the interest rates on long-term loans was lagging behind that of the interest rates on short-term loans even back in 2009.

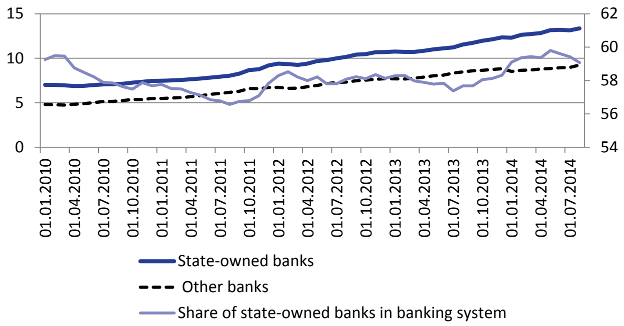

Fig. 7. The Movement of Loans Issued to Enterprises and Organizations by State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Loans to Enterprises and Organizations (%, Right-hand Side Scale)

1 Without taking in account Sberbank's rates.