

## RUSSIAN BANKS WITHIN THE FIRST THREE QUARTERS OF 2014

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*Over the past three quarters of 2014 the Russian banking sector encountered a constriction of growth in all of its key resource sources. Retail accounts and deposits and foreign liabilities contracted while growth in corporate customers dropped to low levels. Monetary authorities' resources, which contributed most to the growth of the banking sector's resource base during the foregoing period, were used as compensation. The banking sector's resources were used primarily for lending purposes, yet facing a downtrend. Nonetheless, it is only the retail segment of the lending market that has so far been facing deterioration of the quality of loans.*

The last year's record with regard to the number of banking license revocations was nearly repeated in September 2014: during the month the regulator revoked the banking license from 10 credit institutions, just one less than in March 2014 when 11 institutions lost their banking license. In September, however, institutions of smaller size (whose assets averaged Rb 3,6bn<sup>1</sup>) than in March (Rb 6,9bn) had to leave the market, making a total of Rb 5,6bn during the first nine months of 2014. Seven of these 10 institutions provided retail banking services. Their bank deposits totaled Rb 12bn (an average of Rb 1,7bn per bank). Nine billion rubles, or ¾ of the total retail deposits, were covered under the deposit insurance scheme.

Multiple revocations of banking licenses under the new management of the Bank of Russia have resulted in substantial contraction of the obligatory insurance fund. Deposit Insurance Agency's (DIA) liability to the depositors of the license-revoked banks increased Rb 278bn in the period of July 2013 to September 2014 inclusively. The obligatory insurance fund, net of the provision for insured events, saw a contraction of Rb 82,5bn as of October 1, 2014.

The banking sector's total assets increased 1.0%<sup>2</sup> in September, gaining 6.9% since the beginning of the year, and 12.8% during the 12 months. The latter indicator (annual growth rate) dropped to its lowest level since the end of 2010.

The book value of the equity in the banking sector increased 4.3% (Rb 280bn) in September 2014 which is associated with the rescheduling of VEB's subordinated loans to VTB bank funded with the resources of the National Wealth Fund (NWF) to directly increase the state participation in VTB by investing the NWF's re-

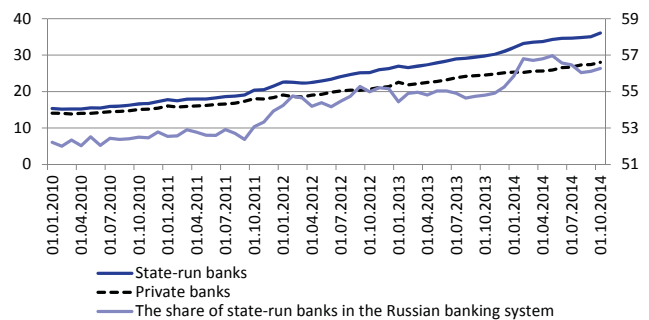


Fig. 1. Dynamics of assets in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the assets (% , right-hand scale)

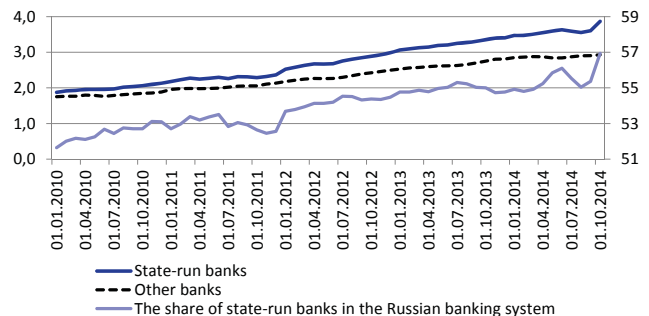


Fig. 2. Dynamics of equity<sup>3</sup> in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the capital (% , right-hand scale)

sources in VTB preferred shares, Rb 214bn. The regulatory capital of the banking sector remained unchanged after this operation, because the subordinated loan, a fundraising by nature, was previously accounted as tier 2 capital in VTB.

The profit of the banking sector in September 2014 amounted to Rb 93bn, corresponding a 1.8% return on assets and 16.8% return on equity on an annualized basis. Within the first nine months of 2014 the profitability of the banking sector reached Rb 927bn, down 8.5% compared to the same period of 2013. The

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

2 Growth rates in balance-sheet indicators are hereinafter presented with allowance for revaluation in foreign currency, but without taking account of banks whose banking license was revoked, unless otherwise stated.

3 Calculated according to balance sheet accounts (form No. 101).

return on bank assets in the period of January 2014 and September 2014 stood at 1.5% on an annualized basis (2.0% within the first nine months of 2013), while the equity was 14.1% on an annualized basis (17.2% in 2013).

### Fundraising

Within the elapsed nine months of 2014 the banking sector totally lost two of its primary sources of the resource base, while the third source showed a minimum growth: Retail accounts and deposits and foreign liabilities contracted since the beginning of the year, whereas corporate accounts and deposits increased insignificantly. Accordingly, in the same period the banking sector relied primarily upon public resources, namely Bank of Russia loans and Minfin (Ministry of Finance) deposits. Furthermore, the contraction of liquid ruble-denominated assets and investment in foreign assets served as additional source of resources.

Retail bank deposits contracted 1.1% (by Rb 189bn) in September and 1.7% (by Rb 289bn) since beginning of the year. The annual growth of retail accounts and deposits in banks dropped to 4.4% as of the end of September, the slowest growth rates in retail deposits after the recovery from the 1998 crisis.

It's worth noting that the September contraction of retail bank accounts had an effect on the assets denominated both in rubles and foreign currencies. Despite the ongoing devaluation of the national currency in September<sup>1</sup>, the volume of resources denominated in foreign currencies contracted even more than that of ruble-denominated resources: 4.0% against 0.4%. As a result, the dollar equivalent of retail accounts and deposits in banks dropped to the level observed in the summer of 2013, amounting to \$87,4bn as of October 1, 2014.

Corporate accounts and deposits with banks in September increased 1.8%, including ruble-denominated ones (up 1.0%), while the dollar equivalent of those denominated in foreign currencies gained 3.8%. The share of corporate accounts and deposits denominated in foreign currencies reached 28.2% of their total volume as of October 1, 2014.

Fixed-term deposits denominated in foreign currencies saw the fastest growth, up 5.4% in dollar terms, in September. Overall, the share of fixed-term deposits in the total volume of corporate accounts and deposits reached another highest value of 57.7%.

Annual growth of corporate accounts and deposits was 11.0% as of the end of September, 13.9% less than the value observed as of the end of 2013 and 15.3% less than in 2012.

<sup>1</sup> During the month the ruble weakened against the US dollar and the Euro by 6.6% and 2.8% respectively.

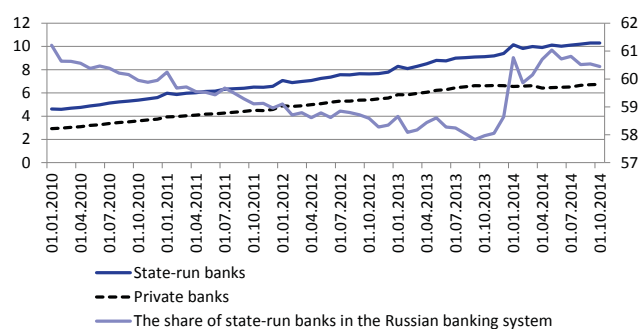


Fig. 3. Dynamics of retail deposits in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail deposit market (% , right-hand scale)

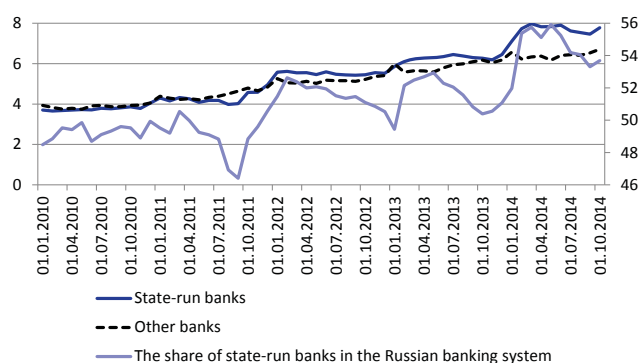


Fig. 4. Dynamics of corporate accounts with state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate account market (% , right-hand scale)

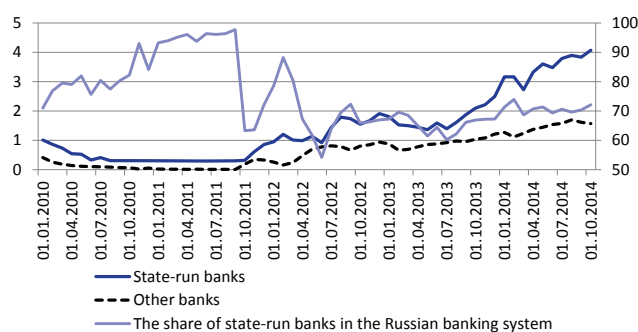


Fig. 5. Dynamics of Bank of Russia's loans extended to state-run banks and other banks (trillions of rubles), and the share of state-run banks in Bank of Russia's loans. (% , right-hand scale)

The state accelerated its support to the banking sector in September 2014. The debt owed to the Bank of Russia grew up to Rb 191bn during the month and Rb 1,2 trillion since the beginning of the year. Minfin deposits in commercial banks increased Rb 205bn during the month and Rb 790bn since the beginning of the year. Banks' total debt to the monetary authorities increased Rb 2,0 trillion since the beginning of the year, reaching Rb 6,5 trillion as of October 1, 2014. This accounts for 10.2% of the to-

Table 1

**RUSSIAN BANKING SYSTEM'S STRUCTURE OF LIABILITIES (AT MONTH END), AS A PERCENTAGE OF TOTAL**

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	03.14	06.14	07.14	08.14	09.14
Liabilities, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	62127	62464	64073
Equity	14.1	19.3	18.7	16.9	16.2	16.3	16.0	16.0	15.8	15.8	15.9	16.1
Loans from the Bank of Russia	12.0	4.8	1.0	2.9	5.4	4.4	7.7	7.9	8.7	9.0	8.7	8.8
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.2	5.1	4.7	5.9	5.5	5.6	5.5
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	10.8	9.9	10.6	9.4	9.5	9.6	9.6
Retail accounts and deposits	21.5	25.9	29.6	29.1	28.9	29.6	29.4	27.8	27.4	27.5	27.6	26.9
Corporate accounts and deposits	23.6	25.9	25.7	26.0	24	23.5	23.8	23.9	22.9	22.4	22.4	22.6
Accounts and deposits of government agencies and local government authorities	1.0	1.0	1.5	2.3	1.6	2.4	0.9	1.8	2.3	2.5	2.9	2.9
Outstanding securities	4.1	4.1	4.0	3.7	4.9	5.1	4.5	4.2	3.9	3.9	3.9	3.8

Source: Central Bank of Russia, Gaidar Institute's estimates.

tal assets in the banking sector, including the equity, and 9.1% of GDP. The state support to banks already exceeded as a percentage of GDP the crisis value of 8.2% in Q4 2008.

**Loans issued**

Despite the fundamental changes in the structure of fundraising in 2014, on-lending to corporate and retail customers continued, although at slower rates. The increase in the credit portfolio in the period of January to September 2014 accounted for 75% of the growth in the total bank assets during the same period.

In September, retail customers' debt owed to banks increased 1.0% (Rb 120bn) and 10.4% (Rb 1,11 trillion) since the beginning of the year. The annual growth as of the end of September was 16.8%, indicating that the downtrend towards growth in banks' retail credit portfolio was still there.

At the same time, according to Gaidar Institute's preliminary estimates, within the first nine months of the year retail customers paid Rb 1,36 trillion of interest on loans. This suggests that this year bank lending has begun to deteriorate the financial situation of households – growth in debt has begun to fall behind the amount of interest payments. Therefore, consumer lending has begun to weaken the final demand instead of encouraging the consumer demand, shrinking by Rb 250bn the disposed financial resources of households since the beginning of the year.

The quality of the credit portfolio kept deteriorating at the backdrop of the foregoing. The share of delinquent loans increased to 5.8% in September against 5.7% in the preceding month and 4.5% earlier in the year. As of October 1, 2014, the volume of provisions for losses reached 8.8% of the volume of retail debt on loans against 8.6% in the preceding month and 7.1% earlier in the year.

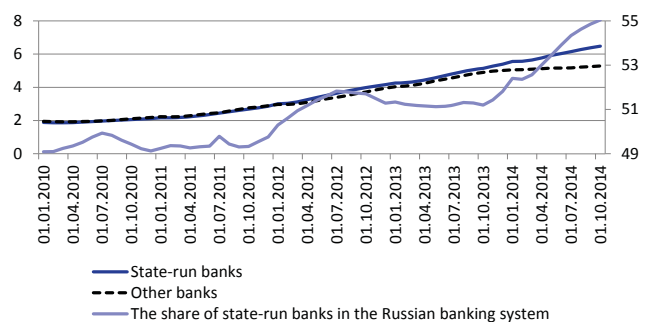


Fig. 6. Dynamics of retail loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail loan market (% , right-hand scale)

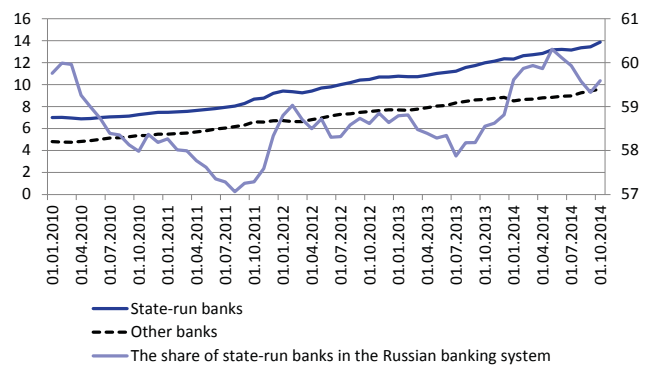


Fig. 7. Dynamics of corporate loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate loan market (% , right-hand scale)

Corporate customers' debt on loans increased 1.4% (by Rb 315bn) in September and 8.7% (by Rb 1,82 trillion) since the beginning of the year. The annual growth was 9.7% as of the end of September, the lowest level over the period since the beginning of 2011.

At the same time, slowdown in the corporate credit portfolio's growth rates had, incredible as it may seem,

Table 2

## RUSSIAN BANKING SYSTEM'S STRUCTURE OF ASSETS (AT MONTH END), AS A PERCENTAGE OF TOTAL

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	03.14	06.14	07.14	08.14	09.14
Assets, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	62127	62464	64073
Cash and precious metals	3.0	2.7	2.7	2.9	3.1	2.4	2.8	2.8	2.4	2.3	2.3	2.3
Deposits with the Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.3	3.9	3.5	3.3	3.1	2.8	3.4
Interbank operations	5.2	5.4	6.5	6.4	6.8	6.0	5.7	5.3	6.9	6.5	7.2	7.4
Foreign assets	13.8	14.1	13.4	14.3	13.0	15.1	13.3	14.4	14.1	14.2	13.5	13.1
Retail sector	15.5	13.1	13.0	14.4	16.8	17.9	18.5	18.4	18.5	18.5	18.7	18.4
Corporate sector	44.5	44.5	43.6	44.0	41.3	40.8	39.3	39.6	38.8	39.0	39.3	39.3
State	2.0	4.2	5.1	5.0	3.2	3.2	3.1	3.0	3.4	3.4	3.6	3.2
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: Central Bank of Russia, Gaidar Institute's estimates.

no effect on the quality of the same. Due to a time lag between the issue of loans and suspension of servicing a part thereof in periods of slowdown in growth in the total volume of loans, the overdue debt tends to keep growing at faster rates corresponding to the growth in the credit portfolio a few months (or quarters) earlier.

In 2014, growth rates in corporate customers' overdue debt corresponds approximately to the growth in

the total volume of the credit portfolio. As a result, the share of overdue debt in the total debt on loans remained the same as of the end of September as it was earlier in the year, 4.1%, while the ratio of provisions for losses to corporate customers' total debt on loans even improved to 6.5% as of October 1, 2014 from 6.7% as of January 1, 2014. ●