

## THE BANKING SECTOR IN OCTOBER 2014

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*It is monetary authorities' resources that became the principal source of growth in banks' assets in October 2014. Still high frequency of banking license revocations and the ruble devaluation could hardly recover depositors' confidence in the banking system – growth in the deposit base was close to zero at an annualized rate. Retail lending slowed down amid the deterioration of the credit portfolio quality. Banks' return on assets kept declining in response to both the resource base appreciation and growth in contributions to the provisions for possible bad loans and other assets.*

The frequency of banking license revocations remained at a high level in October. Nine credit organizations lost their banking license during the same month. The total volume of assets of these institutions amounted to Rb 44bn<sup>1</sup>, of which Rb 35bn were accounted for by a single bank, Narodny Kredit Bank, the 2<sup>nd</sup> largest bank which lost its banking license in 2014 and the 4<sup>th</sup> of those covered by the intensive “sweeping” process in the banking sector launched in in the summer of 2013. Five out of 9 of these credit institutions lost their retail deposit banking license. The total volume of deposits in these banks amounted to Rb 20bn, of which Rb 17bn were accounted for by Narodny Kredit Bank. Deposit Insurance Agency (DIA) total liability to the depositors of the foregoing banks amounted to Rb 17bn in October 2014.

A total of 74 banking licenses were revoked since the beginning of 2014 up to and inclusive October, including 50 retail deposit banking licenses, and 103 credit institutions lost the right to run this business since July 2013, including 75 institutions which provided retail deposit banking services. DIA's total liability in the period between January 2014 and October 2014 increased Rb 170bn, reaching nearly Rb 300bn since mid-2013. As of November 1, 2014, the compulsory insurance fund contracted to Rb 94,2bn and, net of the provision for insured events, to Rb 74,9bn.

The banking sector's total assets increased 2.9%<sup>2</sup> in October 2014. The 12-month growth in banks' assets, reaching nearly four-year local lows of 12.8% as of the end of September, increased to 14.6% in October. It is the monetary authorities' resources that became the principal source of growth in banks' assets in October. Additionally, banks reduced their investment in ruble-denominated liquid assets. Banks began to invest their

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.

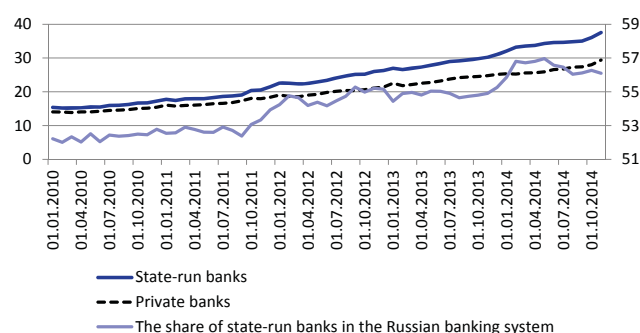


Fig. 1. Dynamics of assets in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the assets (% , right-hand scale)

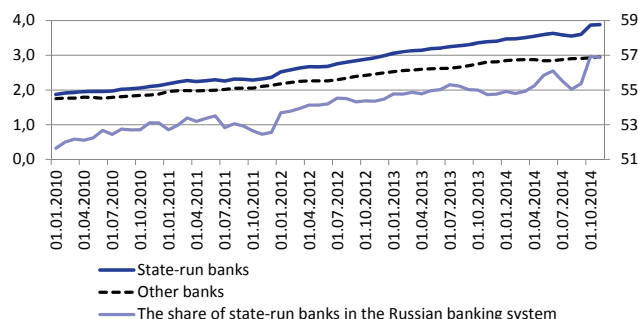


Fig. 2. Dynamics of equity<sup>3</sup> in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the capital (% , right-hand scale)

assets mainly in foreign assets, with slowing credit portfolio growth. Furthermore, bank operations with derivatives increased by 1.5 times both in assets and liabilities in October.

The book value of the equity in the banking sector in October remained unchanged at a level of Rb 6,8 trillion<sup>3</sup>.

Banks' profit in October 2014 amounted to Rb 47bn, nearly 40% lower than the average within the first three quarters of 2014 (Rb 76bn). The reason for this

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

is the same as before, i.e. drastic growth in contributions to the provisions for possible bad loans and other assets. In October they increased Rb 155bn against a monthly average growth of Rb 72bn within the previous nine months.

The fact that banks benefit from the ruble devaluation couldn't save the situation. The profit from the revaluation of bank accounts denominated in foreign currencies in October amounted to Rb 94bn, insufficient to cover losses from deterioration of banks' asset quality.

As a result of the foregoing processes, return on assets (ROA) in the banking sector in October dropped to 0.9% p.a. while return on equity (ROE) fell to 8.2% p.a. This is for the second time since May this year when ROA and ROE fell below 1.0% and 10% respectively, in May ROA stood at 0.9% and ROE at 8.5%. This was for the first time since mid-2010 when ROA in the banking sector dropped so low.

**Fundraising**

Retail deposits in banks increased 0.8% in volume in October, down 0.9% since the beginning of the year, only 4.3% of growth during 12 months, the lowest level since 1999. Deposits growth rate has been below 6.1% for three consecutive months, unlike in the crisis-hit period of 2008–2009, when the growth rate never fell below the foregoing value. Deposit inflow during 12 months is estimated Rb 685bn, whereas banks paid Rb 874bn of interest on retail accounts and deposits within four quarters. In other words, deposits growth appeared to be less than the capitalized interest.

In terms of foreign exchange structure of deposits, their inflow in October was totally secured by foreign exchange accounts. Their volume expressed in US dollars increased 5.8% or \$5bn to \$92,4bn from \$87,4bn. This is more than Rb 200bn at the average monthly exchange rate. Ruble accounts dropped 0.5% or by Rb 72bn. The share of foreign exchange deposits reached 22.0% as of the end of October. It is a gross exaggeration to say about deposit dollarization. Foreign exchange accounts are even smaller in volume than last year (Rb 93,2bn), while the share of foreign exchange deposits increased, compared to that observed as of the 1st of November 2013 (18.6%), exclusively in response to the weakening of the ruble exchange rate.

Corporate accounts and deposits with banks in October increased 1.4%, showing an annual growth of 14.2%, which is a bit higher than in the previous reporting dates when it varied within a range of 10.0–11.0%.

Total inflow of corporate customers (Rb 218bn) was driven by divisive trends of its different components. For instance, ruble-denominated accounts and deposits saw an outflow of Rb 211bn while foreign exchange

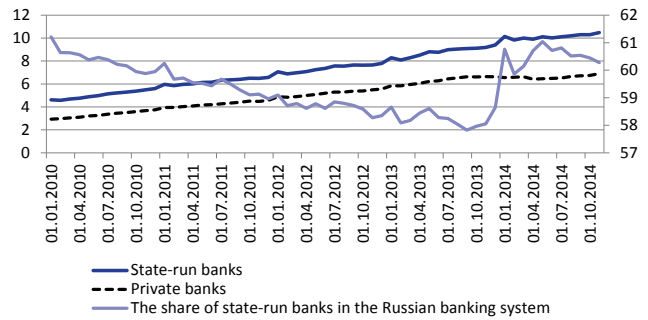


Fig. 3. Dynamics of retail deposits in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail deposit market (% , right-hand scale)

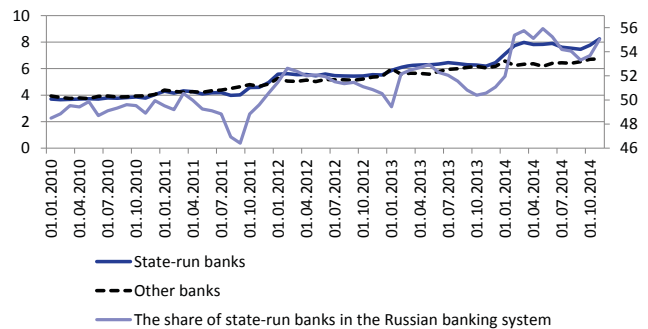


Fig. 4. Dynamics of corporate accounts with state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate account market (% , right-hand scale)

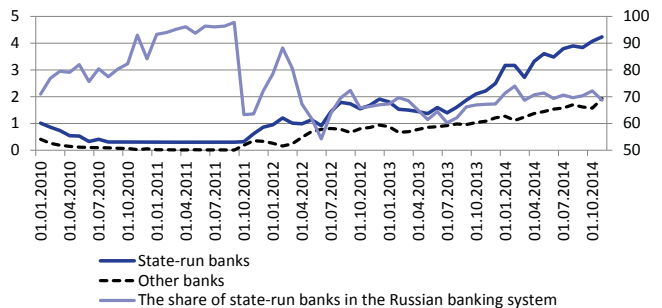


Fig. 5. Dynamics of Bank of Russia's loans extended to state-run banks and other banks (trillions of rubles), and the share of state-run banks in Bank of Russia's loans. (% , right-hand scale)

ones showed an inflow of \$10,5bn or Rb 429bn at the average monthly exchange rate.

The balance on corporate settlement and current accounts contracted in volume by Rb 306bn, whereas fixed-term deposits increased Rb 524bn. As a result, corporate fixed-term deposits saw a record growth of 60.7% of total funds. Corporate fixed-term deposits reached Rb 8,9 trillion in absolute terms as of the 1st of November.

Bank have to pay more interest due to the growth in corporate fixed-term deposits. Within three quarters of 2014, banks paid 34% more interest to coproate

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 | 10.14  |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Liabilities, billions of rubles   | 28022 | 29430 | 33805 | 41628 | 49510 | 52744 | 57423 | 59377 | 61385 | 62127 | 62464 | 64073 | 66 982 |
| 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  | 15.6   |
| 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   | 9.2    |
| 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   | 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   | 9.8    |
| 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  | 26.3   |
| 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  | 22.4   |
| 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   | 3.1    |
| 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   | 3.7    |

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

customers than they did in the corresponding period of 2013 (Rb 1127bn against Rb 839bn).

It is monetary authorities' resources that became the principal source of growth in banks' assets in October. The debt owed to the Bank of Russia and the Ministry of Finance increased Rb 514bn and Rb 168bn respectively. As of the end of October, banks' total debt to the Bank of Russia and the Finance Ministry reached Rb 7,2 trillion or 10.8% of banking sector's total liabilities.

### Loans issued

In October 2014, growth rate of banks' retail credit portfolio slowed down to 0.8% monthly and 15.1% within 12 months. The credit portfolio gained only Rb 91bn monthly, whereas it saw an average monthly growth of Rb 123bn within the first nine months of the current year.

Retail customers' debt owed to banks increased 0.8% too. At the same time, the balance of outstanding debt on foreign exchange loans stopped decreasing for the first time over a long period. Their volume in US dollar terms remained at \$6,3bn and they increased at a bit faster rate than the debt on ruble-denominated loans, 0.9%. The most likely cause for the foregoing dynamics was the growth in overdue debt in response to the devaluation of the ruble and the appreciation of foreign exchange loan servicing. For instance, total volume of overdue debt on retail loans increased 3.0% or Rb 20bn (not adjusted for the revaluation of overdue debt on foreign exchange loans) during the month. As a result, the share of overdue debt in the total debt increased to 5.9% from 5.8%. Overdue debt on foreign exchange loans increased 6.4% in US dollar terms or

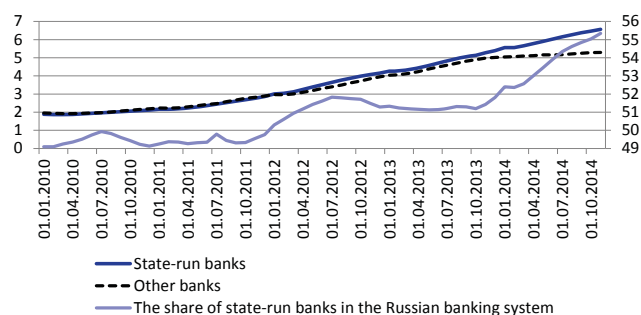


Fig. 6. Dynamics of retail loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail loan market (%), right-hand scale

\$60m. The total volume of debt on foreign exchange loans saw the same growth. The share of overdue debt on foreign exchange loans increased to 17.1% from 16.2% during the month.

Provisions for possible bad retail loans grew up by 1.8% (Rb 19bn) during the month, while the ratio of such provisions to the total volume of debt increased 8.9% from 8.8%.

Corporate customers' debt on bank loans 2014 increased 1.7% in October. Annual growth remained near 10% for three consecutive months, 10.1% as of the end of October.

The corporate segment quality of the credit portfolio was much better compared to the retail portfolio. The share of overdue debt in the total debt remained at 4.1% in October, the lowest since mid-2009. The ratio of provisions for possible bad corporate loans to the total volume of debt increased to 6.6% from 6.5% during the same month, being, however, less than

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 | 10.14 |
|----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Assets, billions of rubles       | 28022 | 29430 | 33805 | 41628 | 49510 | 52744 | 57423 | 59377 | 61385 | 62127 | 62464 | 64073 | 66982 |
| 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   | 2.4   |
| 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   | 2.8   |
| 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   | 7.3   |
| 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  | 13.8  |
| 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  | 17.8  |
| 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  | 38.4  |
| 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   | 3.1   |
| 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   | 1.8   |

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

the value observed during the most part of the year, when the ratio was beyond 6.7%.

Interest rates on ruble-denominated loans to non-financial institutions (net of Sberbank loans) hit new maximum values in October this year. Loans, up to 1 year maturity and more than 1 year maturity were provided at an average rate of 11.3% and 12.87% respectively, during the same month. "Short" and long corporate loans increased in value by 1.7 p.p. and 1.5 p.p. respectively since the beginning of the year.

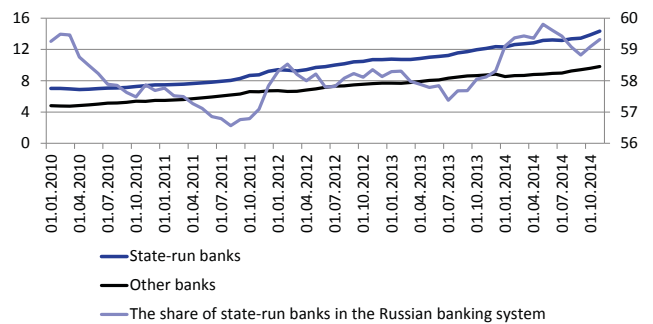


Fig. 7. Dynamics of corporate loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate loan market (% , right-hand scale)