THE BANKING SECTOR UNDER RUBLE FREE FLOATING EXCHANGE RATE REGIME IN NOVEMBER 2014

M.Khromov

The Russian banking sector in November was affected by the same key adverse trends that have been prevailing over the recent months. The monetary authority's resources still served as the principal source of funding for banks, which is indicative of a systemic shortage of traditional types of liabilities. This resulted in slower growth in retail and corporate lending. The credit portfolio's quality was deteriorating mainly in the retail segment of the lending market, however, increased contributions to the provisions remained the key factor reducing the return on assets in the banking business.

The Bank of Russia slowed down the rate of revoking banking licenses in November 2014. Six organizations ceased to be entitled to provide banking services, whereas nine banking licenses were revoked on average per month in the preceding four months. Additionally, all of the banking licenses revoked in November were held by retail banks and, perhaps, the Deposit Insurance Agency's (DIA) organizational capabilities turned out to be exhausted in that month. Furthermore, the compulsory insurance fund has steadily been shrinking in volume. As of the 1st of December, the fund amounted to Rb 88,5bn, which is Rb 74,3bn less the built up provision for insured events. The depositors of the shut-down banks were reimbursed Rb 192bn since the beginning of the current year. One hundred and nine banking licenses, including 81 retail banking licenses, were revoked till the 1st of December 2014 since Elvira Nabiullina was appointed the head of the Bank of Russia. DIA's insurance liability amounted to Rb 297bn during that period.

Besides license revocations, turnaround management was applied against five banks in November. There were eight of such banks in the period between January and October, one of which lost subsequently its banking license. The mounting popularity of this policy, on the one hand, supports the thesis of the regulator's managers that banking license revocation is the last resort, on the other hand, it may be indicative of the diminished possibility to reimburse depositors via the deposit insurance system.

The banking sector's assets increased 1.7%[1] in November and 14.8% during 12 months. At the same time, the accelerating in November[2] depreciation of the ruble exchange rate pushed up the nominal volume growth rate of assets to 6.2% per month through the revaluation of foreign exchange accounts. The share of foreign exchange assets in the banking sector reached 27.6%. To compare, this share reached a maximum of 37.0% in 2009.[3]

At the same time, banks maintain a positive on-balance sheet foreign exchange position. As of the 1st of December, banks' foreign exchange assets exceeded foreign exchange liabilities by $21bn or

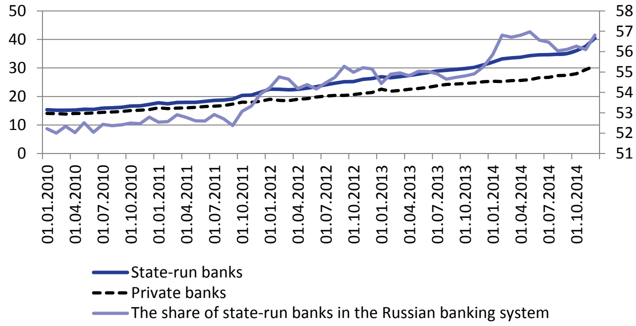

Fig. 1. The Dynamics of assets in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the assets (%, right-hand scale)

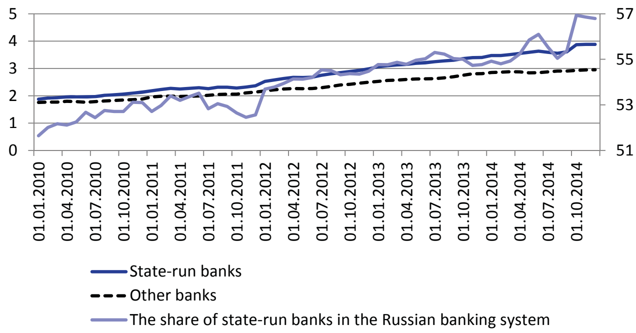

Fig. 2. The dynamics of equity[3] in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the capital (%, right-hand scale)

1 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.

2 The ruble depreciated by 17.5% against the US dollar in November, which is approximately equal to what the ruble lost within the three previous months: 18.3% in the period between August and October

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

Rb 1037bn. This provides additional profit to the banking sector amid the devaluation of the national currency. For instance, since the beginning of the year the banking sector gained Rb 308bn, including Rb 63bn in November, from the revaluation of foreign exchange accounts.

The banking sector's comprehensive income in November remained as low as in October, Rb 49bn and Rb 47bn respectively, against an average of Rb 76bn during the period between January and September of 2014. Substantial volume of contributions to the provisions for possible losses, which increased Rb 136bn in November, still remains the key factor decreasing the income. The average monthly growth in the provisions was almost half as much, Rb 72bn, within the first three quarters of the current year.

The return on assets (ROA) in the banking sector in November stood at 0.8% p.a. while the return on equity (ROE) was 8.6%.

Fundraising

Retain deposits and accounts with banks contracted by 1.6% in November 2014. This is already the fourth consecutive month in the current year when banks have been seeing net outflow of retail deposits. Banks previously encountered a retail deposit outflow in January, March, and September. Annual growth rate in bank deposits contracted to 1.9% (Rb 301bn), much higher than the interest paid, about 5% p.a. or almost Rb 900bn. This implies that not only did retail customers bring more money to banks during the last year, but they also claimed a part of the interest accrued.

The dynamics of retail accounts and deposits in November was characterized by that depositors withdrew their money from accounts and deposits denominated both in rubles and foreign exchange, except that it is foreign exchange accounts and deposits that saw most of cash outflow. For instance, ruble-denominated accounts shrank in volume by 0.5% or Rb 69bn while foreign exchange accounts contracted by 5.1% or $4,7bn. Nonetheless, the share of foreign exchange retail accounts increased during the month to 24.0% from 22.0% through the revaluation of the foreign exchange component of retail deposits.

Corporate customers' deposits and accounts with banks also showed contraction in November. They decreased in volume by 0.2% (Rb 37bn) while annual growth rate of this type of bank resources stood at 11.2% and was closer to the lower boundary of fluctuations in the current year. Local minimum was recored at 10.0% on September 1, 2014.

Corporate custormers, like retail customers, reduced their foreign exchange deposits and accounts with banks in November. Объем foreign exchange current accounts contracted in volume by $3,1bn during the month, while foreign exchange deposits fell by $1,3bn. Non-bank organizations' deposits and accounts with banks saw a total contraction of $4,5bn or 4.1% during the month, whereas ruble-denominated accounts and deposits increased 1.7% in volume. However, the share of corporate customers' accounts and deposits, like that of retail customers, incrased and reached 34.3% as of the end of November.

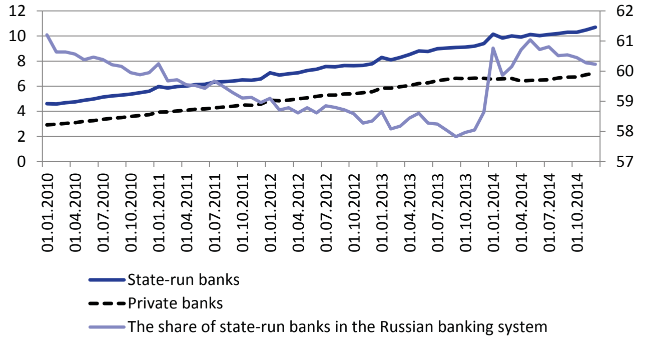

Fig. 3. Dynamics of retail deposits in state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail deposit market (%, right-hand scale)

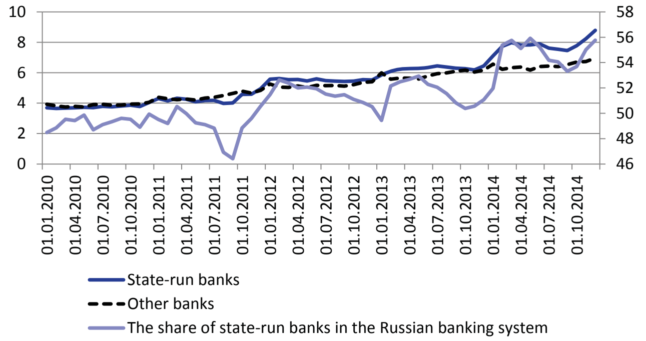

Fig. 4. The dynamics of corporate accounts with state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate account market (%, right-hand scale)

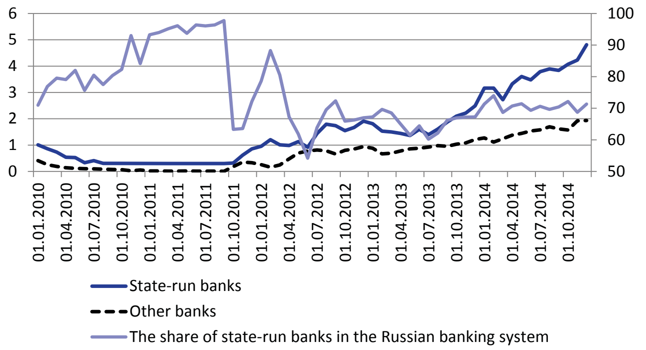

Fig. 5. The dynamics of Bank of Russia's loans extended to state-run banks and other banks (trillions of rubles), and the share of state-run banks in Bank of Russia's loans. (%, right-hand scale)

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	08.14	09.14	10.14	11.14
Liabilities, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	62464	64073	66 982	71163
Equity	14.1	19.3	18.7	16.9	16.2	16.3	16.0	16.0	15.8	15.9	16.1	15.6	14.9
Loans from the Bank of Russia	12.0	4.8	1.0	2.9	5.4	4.4	7.7	7.9	8.7	8.7	8.8	9.2	9.5
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.2	5.1	4.7	5.9	5.6	5.5	5.5	6.3
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	10.8	9.9	10.6	9.4	9.6	9.6	9.8	10.2
Retail accounts and deposits	21.5	25.9	29.6	29.1	28.9	29.6	29.4	27.8	27.4	27.6	26.9	26.3	25.3
Corporate accounts and deposits	23.6	25.9	25.7	26.0	24	23.5	23.8	23.9	22.9	22.4	22.6	22.4	22.1
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	2.9	2.9	3.1	3.1
Outstanding securities	4.1	4.1	4.0	3.7	4.9	5.1	4.5	4.2	3.9	3.9	3.8	3.7	3.5

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

The monetary authority's resources still remain the principal source of growth in banks' assets. In November, banks' total debt to the Bank of Russia and the Ministry of Finance of Russia (MinFin) increased Rb 735bn, of which Rb 586bn to the Bank of Russia and Rb 149bn on MinFin deposits. The monetary regulators deposited Rb 3,4 trillion in Russian banks since the beginning of the year, raising the total debt to Rb 7,95 trillion as of December 1, 2014.

The monetary authority's resources accounted for 11.2% of banking sector's total liabilities. Banks have just about Rb 800bn to borrow to reach again the highest level of January 2009.

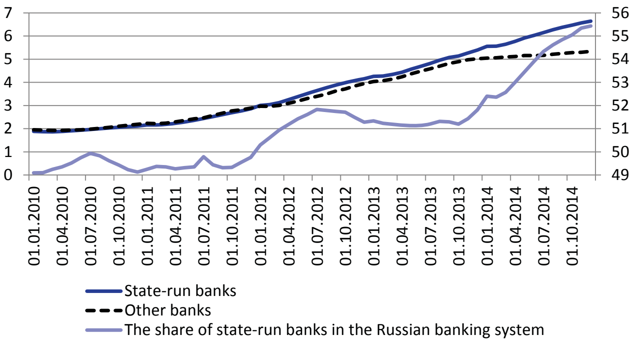

Fig. 6. The dynamics of retail loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the retail loan market (%, right-hand scale)

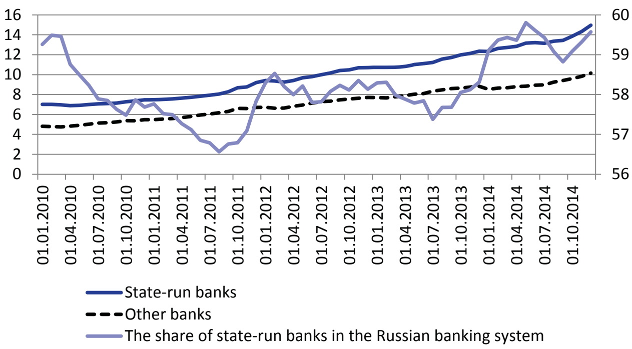

Fig. 7. The dynamics of corporate loans issued by state-run banks and other banks (trillions of rubles), and the share of state-run banks in the corporate loan market (%, right-hand scale)

Loans issued

Growth rates in household debt owed to credit institutions kept slowing down in November. It increased just 0.6% in the same month, while it dropped to 14.1% within 12 months (it was 15.1% on an annualized basis in the previous month). Lending increased only Rb 70bn in absolute terms. No detailed data by type of loans in November were available on the date of this review. However, consumer loan debt stopped growing as early as in October, and it is residential loans that were responsible for the total increase in debt. In November, the ratio of consumer and residential loans remained most probably the same. It is reasonable to expect that consumer debt kept shrinking.

The credit portfolio's quality kept deteriorating. The share of overdue loans in November increased to 6.1% from 5.9% while the ratio of such provisions to the total volume of debt increased to 9.0% from 8.9%.

In absolute terms, households owed Rb 12,0 trillion to banks as of December 1, 2014, of which Rb 727bn accrued to overdue debt. Provisions for possible bad retail loans amounted to Rb 1075bn.

Loans to corporate customers in November increased at extremely slow rates. The volume of total

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	08.14	09.14	10.14	11.14
Assets, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	62464	64073	66982	71163
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	2.4	2.2
Deposits with the Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.3	3.9	3.5	3.3	2.8	3.4	2.8	3.2
Interbank operations	5.2	5.4	6.5	6.4	6.8	6.0	5.7	5.3	6.9	7.2	7.4	7.3	7.9
Foreign assets	13.8	14.1	13.4	14.3	13.0	15.1	13.3	14.4	14.1	13.5	13.1	13.8	13.8
Retail sector	15.5	13.1	13.0	14.4	16.8	17.9	18.5	18.4	18.5	18.7	18.4	17.8	16.9
Corporate sector	44.5	44.5	43.6	44.0	41.3	40.8	39.3	39.6	38.8	39.3	39.3	38.4	37.4
State	2.0	4.2	5.1	5.0	3.2	3.2	3.1	3.0	3.4	3.6	3.2	3.1	2.8
Property	1.9	2.7	2.6	2.3	2.2	2.2	2.0	1.9	1.9	1.9	1.9	1.8	1.7

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

debt to banks increased only 0.2%. Annual growth rates dropped to 9.3%, the lowest since 2010.

Curiously enough, the credit portfolio's quality is not affected by slower growth rates of its volume. Slower growth rates in loan debt tend to reveal the accumulated problems, which is reflected by over trend growth in overdue loans as against the growth in total debt and provisions for loans. Nonetheless, in November the share of corporate customers' overdue debt in the loan debt contracted from 4.1% to 4.0%, the lowest value in the current value. The ratio of provisions for possible losses to the total corporate customers' debt remained unchanged during the month, contracting at a level of 6.6%.