RUSSIA'S BANKING SECTOR IN DECEMBER 2014

M.Khromov

Late in 2014, Russia's banking sector was driven by the ruble's devaluation and mounting crisis-related developments in the economy, firstly the decline in real disposable household income. Banks sustained big losses for the first time since 2009, and the money market regulator strengthened its support to banks.

The banking sector's assets increased 5.2%[1] in December 2014, 18.6% in 2014. In nominal terms, banks' assets grew at a much faster rates due to the revaluation of foreign exchange assets as a result of the ruble's depreciation[2]. The nominal volume of assets saw an increase of 9.1% monthly, overall 35.2% annually. Banks' assets grew in 2014 at a faster rate than that in 2013 both in nominal terms and after correction for changes in foreign exchange rates (16.0% at par, 14.2% after correction for changes in foreign exchange rates). However, in 2014, banks relied much more on the financial support from the Bank of Russia and the Ministry of Finance. Net of the debt owed to the regulators, banks' assets would have increased only 9.3% in 2014 as compared to 11.5% in 2013.

In December 2014, the banking sector sustained big losses of Rb 192bn or almost one fourth of the profit generated within the first 11 months of the year. In December, ROA and ROE figures were -3.1% and -34.4% respectively, on an annualized basis. As a result, banks' annual profit dropped to Rb 589bn, 41% less than that in 2013, while annual ROA and ROE figures dropped to 0.9% and 9.0% respectively, nearing very close to the lows of 2009 (0.7% and 6.3% respectively).

Like in the previous months, it is the increase in contributions to the provisions for possible bad loans and other assets that was the key factor of banks' profit crunch. The provisions increased by Rb 263bn during the month. However, banks' current profit plummeted in December. Net of the provisions formation and the revaluation of foreign exchange assets, banks earned only Rb 9bn in December, not an average of Rb 129bn they made during the previous 11 months.

More than 220 banks made losses as of the month-end in December, their negative financial performance result was more than Rb 300bn. First of all, loss-making banks included banks undertaking financial rehabilitation headed by the Deposit Insurance Agency (DIA), including Trust Bank which was put under such a regime on 12/22/2014. There were 14 such banks in December[4], their total losses amounted to Rb 160bn.

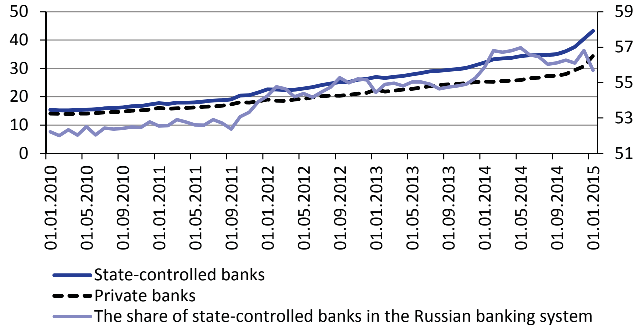

Fig. 1. Dynamics of assets in state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the assets (%, right-hand scale)

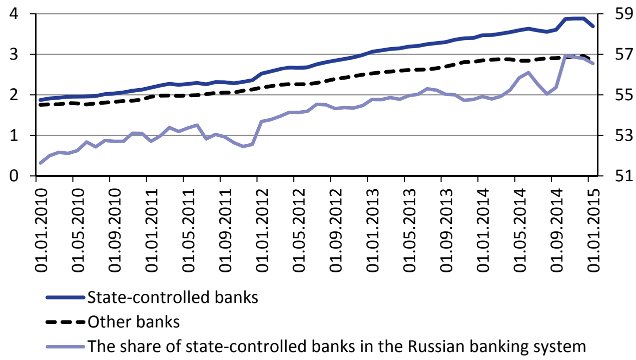

Fig. 2. Dynamics of equity[3] in state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the capital (%, right-hand scale)

Another group of loss-making banks in December was made up of banks controlled by the state or by large state-run companies, namely the banks of VTB Group, Gazprombank and Russian Agricultural Bank. Their monthly loss totaled Rb 90bn, including Rb 66bn of losses sustained by the VTB Group's banks. Both groups of the banks appeared to make losses even

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 In November 2014, the ruble weakened against US dollar, the Euro, and the dual-currency basket by 14.0%, 11.3%, and 12.7% respectively.

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

4 This analysis considers Bank of Moscow, which is currently undertaking financial restructuring, as part of the VTB Group.

if provision operations were excluded. The monthly loss of the banks undertaking financial rehabilitation reached Rb 12bn, while the foregoing state-controlled banks saw losses of Rb 18bn.

Fundraising

In December 2014, retail customers didn't reestablish credibility in Russia's banking system and kept withdrawing their funds from banks. Retail customers' accounts and deposits contracted by 1.1% during the month and by 3.7% during the year. Therefore, the year of 2014 became the first after 1998 when retail customers stopped building up their savings in the banking sector.

Both ruble and foreign exchange bank deposits saw outflow in December and throughout the entire year. Ruble-denominated accounts and deposits contracted by 1.0% (Rb 130bn) during the month and by 3.0% (Rb 413bn) throughout the entire year. Retail foreign exchange accounts contracted by 1.2% ($1,1bn) in December and by 4.9% ($4,5bn) in 2014.

In December 2014, the deposits outflow accounted for 3.2% of the household cash income, as compared to an inflow of 12.7% in December 2013 and 16.1% in December 2012. In December 2014, banks fell short of Rb 938bn in retail deposits compared with the savings rate in December 2013 and Rb 1137bn compared with that in December 2012. In December 2014, retail customers preferred higher consumption costs and investment in foreign exchange to bank savings.

Corporate accounts and deposits with banks in December increased considerably by 12.9% (or more than Rb 2 trillion). The growth in December contributed to the most of the annual increase in this type of liabilities: 15.3% or Rb 2,4 trillion

In December, enterprises increased predominately ruble balances in bank accounts which grew up 19% (Rb 1,97 trillion) while foreign exchange balances increased only 1.1% ($1,2bn). At the same time, corporate customers preferred foreing exchange accounts which increased 26% ($23bn) during the year while ruble accounts increased only 14% (Rb 1,52 trillion).

In December 2014, banks' total debt owed to the Bank of Russia and the Ministry of Finance increased by Rb 266bn. Additionally, in December, banks borrowed foreign exchange from the regulators. For instance, according to the preliminary estimates, as of January 1, 2015, banks' FX repo debt was more than $20bn and another $3bn as MinFin (Ministry of Finance) deposits. Overall, the debt owed to the monetary authority reached Rb 9,9 trillion at 2014 year-end, accounting for 12.7% of the total assets or 13.4% of GDP.

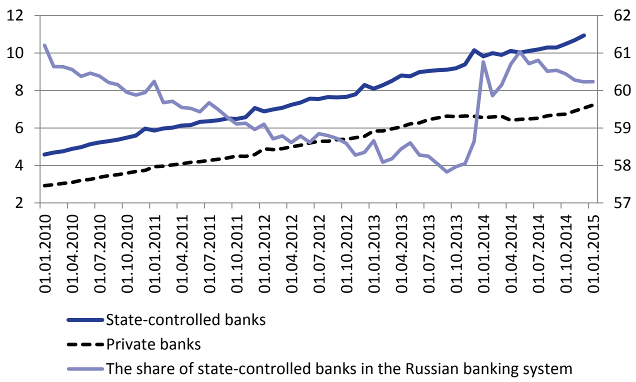

Fig. 3. Dynamics of retail deposits in state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the retail deposit market (%, right-hand scale)

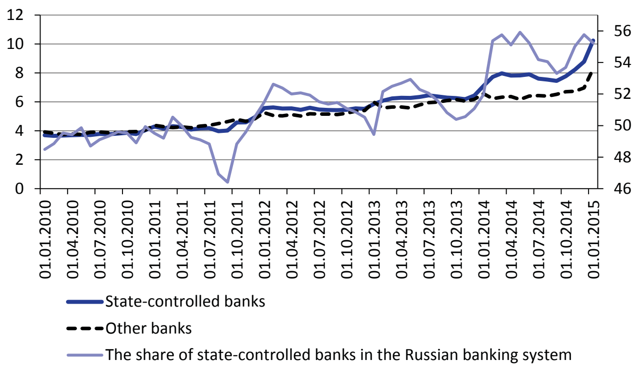

Fig. 4. Dynamics of corporate accounts with state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the corporate account market (%, right-hand scale)

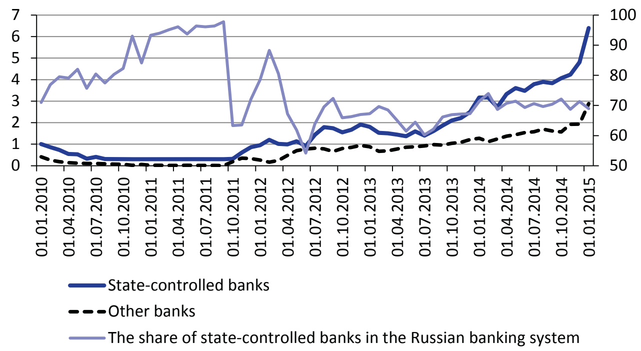

Fig. 5. Dynamics of Bank of Russia's loans extended to state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in Bank of Russia's loans. (%, right-hand scale)

The mounting debt owed by banks to the monetary regulators reflects that those groups of customers (foreign creditors and retail customers) who used to contribute a considerable share to banks' liabilities have lowered their degree of confidence in domestic banks. State support to banks has a positive effect on banks in the short run, mitigating the effects of the

Table 1

RUSSIAN CREDIT INSTITUTIONS' 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	09.14	10.14	11.14	12.14
Liabilities, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	64073	66 982	71163	77 663
Equity	14.1	19.3	18.7	16.9	16.2	16.3	16.0	16.0	15.8	16.1	15.6	14.9	13.6
Loans from the Bank of Russia	12.0	4.8	1.0	2.9	5.4	4.4	7.7	7.9	8.7	8.8	9.2	9.5	12.0
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.2	5.1	4.7	5.9	5.5	5.5	6.3	6.1
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	10.8	9.9	10.6	9.4	9.6	9.8	10.2	10.2
Retail accounts and deposits	21.5	25.9	29.6	29.1	28.9	29.6	29.4	27.8	27.4	26.9	26.3	25.3	23.7
Corporate accounts and deposits	23.6	25.9	25.7	26.0	24	23.5	23.8	23.9	22.9	22.6	22.4	22.1	23.8
Accounts and deposits of government administration 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	3.1	3.1	1.4
Outstanding securities	4.1	4.1	4.0	3.7	4.9	5.1	4.5	4.2	3.9	3.8	3.7	3.5	3.5

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

crisis. In the medium term, however, state support implies that the banking sector is unable to adapt to the market conditions, hiding the acuteness of the liquidity and resources issue.

Investment

Household debt to banks in December 2014 decreased 0.3% (by Rb 37bn). Overall, annual growth rate in the retail segment of the lending market slowed down to 11.6% compared with 27.7% in the preceding year.

Traditionally, the quality of retail loans stopped deteriorating at the end of the year. Overdue debt contracted by 1.0% during the month, while its share in the household total debt decreased to 6.0% from 6.1% during the same month. Provisions for possible bad retail loans shrank by 1.2% in December while the provisions/total debt ratio decreased to 8.9% from 9.0%. However, during the year the share of overdue loans in the household total debt increased by 1.5 p.p. while the provisions/loans payable ratio went up 1.8 p.p.

Corporate customers' debt increased 1.6% in December and 12.8% during the entire year. Despite the ruble's devaluation and growth in foreign exchange risks, foreign exchange loans in December were growing faster than ruble loans (2.4% against 1.3%). Overall, in 2014, a big share of corporate loans payable was secured by ruble loans which increased by 14.9% while foreign exchange loans went up only 2.4%.

The quality of the corporate segment loans payable deteriorated. The volume of overdue loans increased 6.4% while their share in the corporate sector's debt increased to 4.1% from 4.0%. Provisions for possible bad corporate loans saw a bigger increase of 11.0% during the month, thereby increasing the provisions/debt ratio to 6.9% from 6.6%.

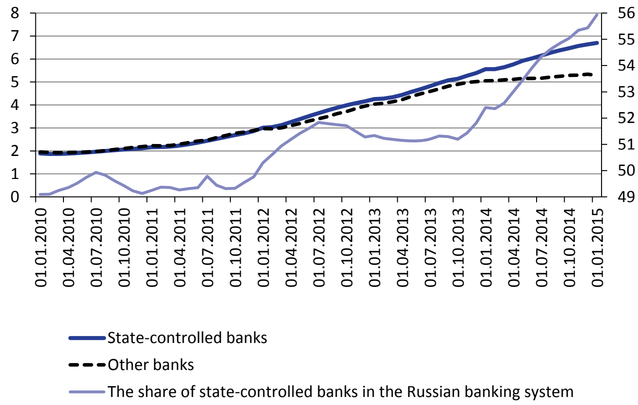

Fig. 6. Dynamics of retail loans issued by state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the retail loan market (%, right-hand scale)

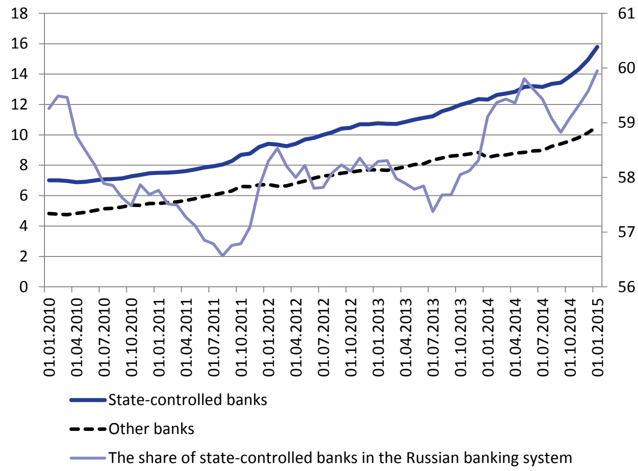

Fig. 7. Dynamics of corporate loans issued by state-controlled banks and other banks (trillions of rubles), and the share of state-controlled banks in the corporate loan market (%, right-hand scale)

Table 2

RUSSIAN CREDIT INSTITUTIONS' 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	09.14	10.14	11.14	12.14
Assets, billions of rubles	28022	29430	33805	41628	49510	52744	57423	59377	61385	64073	66982	71163	77 663
Cash and precious metals	3.0	2.7	2.7	2.9	3.1	2.4	2.8	2.8	2.4	2.3	2.4	2.2	3.5
Deposits with the Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.3	3.9	3.5	3.3	3.4	2.8	3.2	4.2
Interbank operations	5.2	5.4	6.5	6.4	6.8	6.0	5.7	5.3	6.9	7.4	7.3	7.9	7.5
Foreign assets	13.8	14.1	13.4	14.3	13.0	15.1	13.3	14.4	14.1	13.1	13.8	13.8	13.8
Retail sector	15.5	13.1	13.0	14.4	16.8	17.9	18.5	18.4	18.5	18.4	17.8	16.9	15.5
Corporate sector	44.5	44.5	43.6	44.0	41.3	40.8	39.3	39.6	38.8	39.3	38.4	37.4	35.9
State	2.0	4.2	5.1	5.0	3.2	3.2	3.1	3.0	3.4	3.2	3.1	2.8	3.1
Property	1.9	2.7	2.6	2.3	2.2	2.2	2.0	1.9	1.9	1.9	1.8	1.7	1.6

Source: Central Bank of Russia's Review of the Banking Sector of the Russian Federation, credit institutions financial statements, Gaidar Institute's estimates.