

THE RUSSIAN BANKING SECTOR IN JANUARY 2015

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In early 2015, Russia's banking sector was operating under an increasing impact from several negative trends that had first become prominent towards the end of 2014. January 2015 became the second-in-a-row loss-making month for banks, the second-in-a-row month of declining debt against retail loans issued by banks, and the third-in-a-row month of individual bank deposit outflow.

The growth rate of the banking sector's assets has dramatically increased over the past few months. According to data reported as of the end of January 2015, the volume of bank assets had increased by 4.0% over that month and by 38.2% over the past 12 months, although in the autumn of 2014 the per annum growth rate of bank assets had been no higher than 20%. This rapid growth had been triggered by the ruble's depreciation and the adjustment of bank asset value denominated in foreign currency. Over January alone, the USD to ruble exchange rate rose by 22.6% (see the section on monetary policy), and over the previous 4 months it had jumped up by 75.0%. Over the same 4-month period, the value of foreign currency bank assets in terms of the Russian ruble increased by 80.7%, and their share in total bank assets increased from 24.2% to 34.7%. When adjusted by this foreign currency component, the banking sector's assets in January shrank by 2.7%¹, and over the 12-month period from 1 February 2014 through 1 February 2015 their amount increased by 14.7%.

January 2015 became the second month in a row for which banking sector reported negative financial results (- Rb 24bn), although this time the loss was less spectacular than in December 2014. The profitability of the banking sector's assets in January was -0.4% per annum, and the profitability of the banking sector's equity amounted to -4.4%. Over the 12-month period from February 2014 through January 2015, the banking sector's profit shrank to Rb 471bn (for reference: in 2014 – Rb 589bn, in 2013 – Rb 994bn). At the same time, the banking sector's profitability index for that

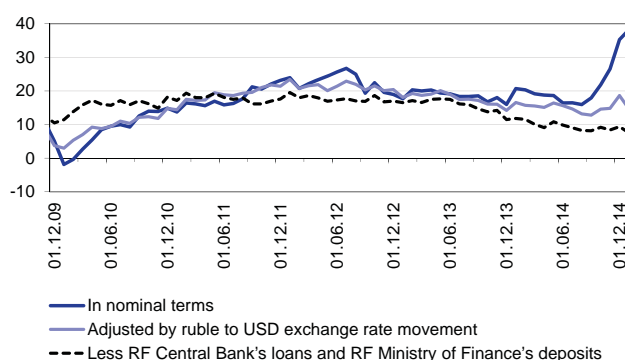


Fig. 1. The Movement of Assets of the Banking Sector (As % of Amount as of Corresponding Date of Previous Year)

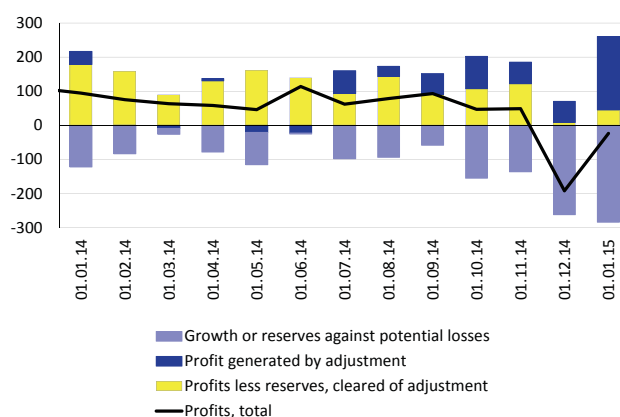


Fig. 2. The Main Components of the Banking Sector's Monthly Profits, Rb bn

period (asset profitability – 0.7%, equity profitability – 7.2%) is still above the corresponding indices for the crisis year 2009 (0.3 and 2.2% respectively).

As in the course of the previous month, the main factor responsible for losses in the banking sector was the formation, on a massive scale, of targeted bank reserves against potential losses on loans and other types of assets. Over the month of January, the volume of bank reserves increased by the record-breaking amount of Rb 284bn. The losses of the banking sector could have been much greater but for the additional income generated by the recalculation of their

¹ 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, but without the adjustment by the data for banks whose licenses have been revoked. To eliminate the effects of the ruble exchange rate movement, all the components of the banking sector's balance sheet denominated in foreign currencies are recalculated in terms of US dollar's exchange rate as of a given date, all changes are recalculated in terms of USD, and the ruble-denominated component's changes are estimated by applying the monthly average ruble to USD exchange rate.

accounts denominated in foreign currencies. The positive foreign exchange component (the excess of the banking sector's assets denominated in foreign currencies over liabilities denominated in foreign currencies) yielded to banks an additional sum of Rb 215bn.

In January 2015, similarly to the situation in December 2014, the banking sector's losses were limited in the main to only two groups of banks. The banks undergoing financial recovery procedures sustained losses in the amount of Rb 21bn, and big state banks¹ – in the amount of Rb 43bn.

Attracted Funds

The movement of funds attracted from physical persons² in January 2014 – similarly to the situation observed over several previous months – retained its positive vector only due to the fact that the value of bank accounts and deposits denominated in foreign currencies was being adjusted by the exchange rate movement. The volume of individual funds in nominal terms over that month increased by 4.2%, while ruble-denominated accounts and deposits dwindled by 1.5%, and the value of accounts and deposits denominated in foreign currencies shrank in terms of USD by 2.2%. The overall outflow of individual funds in January 2015, according to our estimations, amounts to Rb 317bn, or 1.7% of the total volume of individual funds as of the month's beginning.

The per annum rate of growth displayed by individual funds remains negative, its month-end index for January 2015 being -2.7%. In this the saving behavior of Russia's population differs from the situation observed during the crisis period 2008–2009. Then, the 10-percent outflow of funds from ruble-denominated bank accounts and deposits had been compensated by the twofold growth, in terms of USD, of bank accounts and deposits denominated in foreign currencies. As a result, the cumulative growth rate of individual funds held by banks had never dropped below 6% over a 12-month period.

Now, an outflow of individual funds from bank accounts and deposits – both ruble-denominated and denominated in foreign currencies – can also be observed in per annum terms. While the amount of ruble-denominated individual funds in per annum terms decreased by only Rb 45bn (or 0.3%), the shrinkage of bank accounts and deposits denominated in foreign currencies was much more substantial: over the

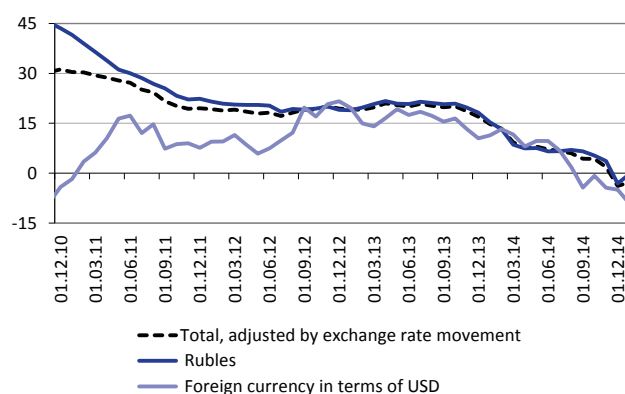


Fig. 3. The Movement of Individual Deposits (As % of Amount as of Corresponding Date of Previous Year)

12-month period their amount decreased by \$ 8.5bn³ (or 9.1%). Nevertheless, the share of individual funds kept on bank accounts denominated in foreign currencies continued to expand. As of 1 February 2015, it increased to 30.5% vs. 26.5% as of 1 January 2015 and 19.7% as of 1 February 2014.

In January 2015, the monies of corporate clients kept on bank accounts⁴ demonstrated growth by 9.2% in nominal terms. As in the case of individual funds, the input of exchange-rate recalculations was substantial. However, the January inflow of corporate funds turned out to be positive even when adjusted by the ruble exchange rate movement: the resulting growth amounted to Rb 275bn, or 1.5%. The per annum growth rate of corporate funds had been on the rise for several months in a row, amounting at the end of January 2014 to 17.8%.

The share of accounts denominated in foreign currencies in the total volume of corporate funds placed with banks as of 1 February 2015 was at a level above the crisis-period historic high achieved in 2008–2009 (36.9%), having risen to 39.2%. In this connection it should be

3 For the sake of comparability, in order to eliminate the effects of the ruble exchange rate movement, we apply a single procedure for estimating all the bank balance sheet indices; due to absence of any additional information, we assume that all the deposits denominated in foreign currencies are denominated in USD. This procedure evidently does not account for the movement of the US dollar's exchange rate in terms of other foreign currencies. Thus, over the past year, the USD-to-euro exchange rate rose significantly. Besides, our estimations based on the structure of cash transactions carried on in foreign currencies demonstrate that up to 30% of individual funds placed with banks may be denominated in euro. With due regard for these factors, the estimated deposit outflow denominated in foreign currencies may be adjusted to -0.2% for January 2015 and to -4.8% for a 12-month period; however, the general conclusion as to the negative movement of this index remains unchanged.

4 This index describes the bank accounts and deposits placed by legal entities, less the funds placed by individual entrepreneurs and non-residents, as well as interest charged to accounts and deposits of legal entities.

1 In this group we place the banks belonging to VTB Group, Gazprombank, and Russian Agricultural Bank (Rosselkhozbank).

2 We define individual funds as accounts opened by physical persons, including individual entrepreneurs, deposits placed with banks by physical persons, and interest charged to accounts and deposits of physical persons. Certificates of deposit are not included in these estimations.

borne in mind that corporate clients (unlike physical persons) had been actively increasing the amount of funds denominated in foreign currencies and held in their bank accounts and as deposits with Russian banks. The amount of monies accounts kept on bank accounts and as bank deposits denominated in foreign currencies had increased, in terms of US dollars, by \$ 14.3bn over the 12-month period since 1 February 2014, including growth by \$ 5.5bn in January 2015.

In January 2015, the amount of the banking sector's debt to Russia's financial regulatory bodies declined from Rb 9.87 trillion to Rb 8.71 trillion. More specifically, the shrinkage of the banking sector's debt to the Bank of Russia by Rb 1.56 trillion coincided with growth, by Rb 0.40 trillion, of the amount of deposits attracted by the RF Ministry of Finance¹. In December 2014, banks began to actively borrow funds denominated in foreign currencies from the monetary authorities. Over the course of January, the movement of banks' debt to the financial regulatory bodies generally reproduced the movement of the overall debt index. In January, the amount of funds denominated in foreign currencies borrowed from the Bank of Russia decreased by \$ 5.0bn – from \$ 22.8bn to \$ 17.8bn, while that of the time deposits placed by the RF Ministry of Finance with commercial banks, on the contrary, increased (although by a lesser amount) from \$ 3.0bn to \$ 3.6bn.

The January decline in the amount of banks' debt to the financial regulatory bodies does not reflect the fact that the problems with the availability of resources are becoming less acute. That process was evolving simultaneously with the reduction in the amount of redundant

1 Estimations based on banks' balance sheet data (the account of time deposits placed by the RF Federal Government).

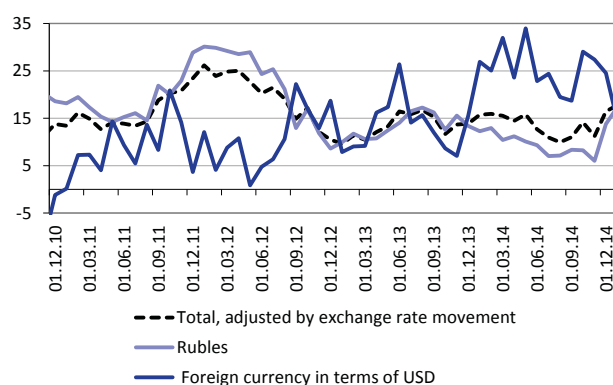


Fig. 4. The Movement of Corporate Clients' Deposits (As % of Amount as of Corresponding Date of Previous Year)

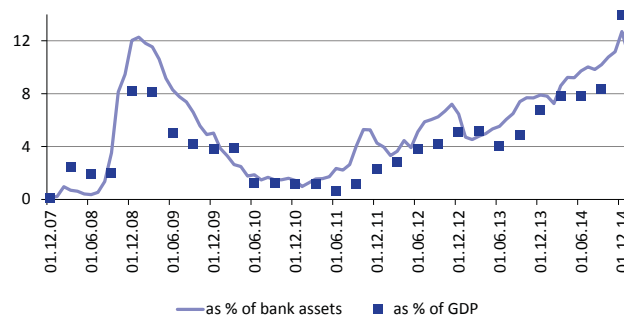


Fig. 5. The Movement of Banks' Total Debt to the Bank of Russia and the RF Ministry of Finance (As % of Bank Assets and GDP)

liquid assets accumulated at the year's beginning as an 'insurance' against potential additional shocks associated with the resource base. Thus, over the course of January, the volume of the banking sector's liquid assets shrank by Rb 1.8 trillion – that amount being much greater than the total outflow of the financial regulatory bodies' funds from the banking sector.

Table 1

THE STRUCTURE OF RUSSIA'S CREDIT INSTITUTIONS' LIABILITIES (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	03.14	06.14	09.14	11.14	12.14	01.15
Liabilities, bn Rb	28,022	29,430	33,805	41,628	49,510	52,744	57,423	59,377	61,385	64,073	71,163	77,663	80,753
Equity	14.1	19.3	18.7	16.9	16.2	16.3	16.0	16.0	15.8	16.1	14.9	13.6	13.3
Credits allotted by Bank of Russia	12.0	4.8	1.0	2.9	5.4	4.4	7.7	7.9	8.7	8.8	9.5	12.0	9.6
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.2	5.1	4.7	5.9	5.5	6.3	6.1	4.7
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	10.8	9.9	10.6	9.4	9.6	10.2	10.2	11.2
Physical persons' monies	21.5	25.9	29.6	29.1	28.9	29.6	29.4	27.8	27.4	26.9	25.3	23.7	23.7
Enterprises and organizations' monies	23.6	25.9	25.7	26.0	24	23.5	23.8	23.9	22.9	22.6	22.1	23.8	24.9
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	2.3	2.9	3.1	1.4	2.1
Securities issued	4.1	4.1	4.0	3.7	4.9	5.1	4.5	4.2	3.9	3.8	3.5	3.5	3.4

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

Invested Monies

Over the course of January, the amount of outstanding debt of physical persons against bank loans issued to them dropped by Rb 162bn (or by 1.3%), while its 12-month growth rate dropped to 10.1%. The movement of the total outstanding debt index is determined primarily by the rate of ruble-denominated lending, as the share of loans denominated in foreign currencies remains very modest (about 3%) in spite of the declining exchange rate of the ruble and the corresponding recalculation of the amount of loans denominated in foreign currencies.

The quality of the retail credit portfolio, after a short pause in December, continued to steadily worsen. The volume of outstanding debt over the month increased by Rb 44bn, and the amount of reserves against potential retail lending losses – by Rb 38bn. As a result, as of 1 February 2015, the share of outstanding debt in the total amount of debt owed by physical persons amounted to 6.4%, and the ratio of reserves against potential losses to payables – to 9.3%.

The corporate segment of the lending market in January 2015 was also marked by negative developments. The volume of corporate outstanding debt over that month shrank by Rb 167bn (0.6%). At the same time, the per annum growth rate had stayed, for a rather long time already, in the interval of 10–13%. The month-end results of January 2015 place it at 11.1%

The credit portfolio quality in the market's corporate segment in January continued its downward trend that had emerged in December. The volume of outstanding debt increased by Rb 110bn, or from 4.1 to 4.3 % of the

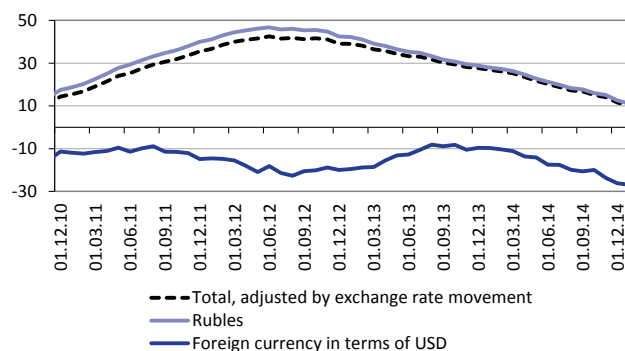


Fig. 6. The Movement of Retail Loans (As % of Amount as of Corresponding Date of Previous Year)

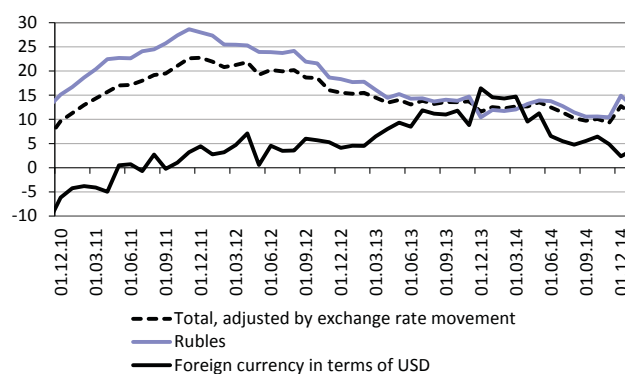


Fig. 7. The Movement of Loans Issued to Enterprises and Organizations (As % of Amount as of Corresponding Date of Previous Year)

total outstanding debt of corporate clients. The volume of reserves against possible corporate loan losses increased over that month by Rb 126bn, thus amounting to 7.0% of the total amount of corporate debt.

Table 2

STRUCTURE OF RUSSIA'S CREDIT INSTITUTIONS' ASSETS (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	12.12	06.13	12.13	03.14	06.14	09.14	11.14	12.14	01.15
Assets, bn Rb	28,022	29,430	33,805	41,628	49,510	52,744	57,423	59,377	61,385	64,073	71,163	77,663	80,753
Cash and precious metals	3.0	2.7	2.7	2.9	3.1	2.4	2.8	2.8	2.4	2.3	2.2	3.5	2.7
Monies placed with Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.3	3.9	3.5	3.3	3.4	3.2	4.2	3.0
Interbank operations	5.2	5.4	6.5	6.4	6.8	6.0	5.7	5.3	6.9	7.4	7.9	7.5	6.7
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	16.6
Population	15.5	13.1	13.0	14.4	16.8	17.9	18.5	18.4	18.5	18.4	16.9	15.5	14.8
Corporate sector	44.5	44.5	43.6	44.0	41.3	40.8	39.3	39.6	38.8	39.3	37.4	35.9	36.5
State	2.0	4.2	5.1	5.0	3.2	3.2	3.1	3.0	3.4	3.2	2.8	3.1	3.5
Property	1.9	2.7	2.6	2.3	2.2	2.2	2.0	1.9	1.9	1.9	1.7	1.6	1.5

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