

THE RUSSIAN BANKING SECTOR IN Q1 2015

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In Q1 2015, there emerged the first signs of two negative trends approaching a break point: the inflow of individual funds into bank accounts and deposits finally reappeared, and after several months of negative financial results the banking sector managed to finish March 2015 in the black. At the same time, the quality of bank assets continued to decline. All the quality indices of loans issued both to individuals and legal entities were also on the decline.

The banking sector's assets were dwindling throughout Q1 2015. Over the course of March they dropped by 0.6%¹, while during the first three months of 2015 they shrank by 4.9%. The growth rate of bank assets expressed in annual terms decreased from 18.6% as of 1 January 2015 to 10.3% as of 1 April 2015.

The decline in the growth rate of bank assets clearly revealed the banking sector's strong dependence on financing provided by the Bank of Russia and the RF Ministry of Finance. In the absence of state support, the growth rate of bank assets would have been almost twice lower – 5.3% over the course of 12 months instead of 10.3%.

March 2015 was the first month since November 2014 for which the banking sector reported a positive financial result (+ Rb 42bn before profits tax). The profit gained in March was so large that it more than compensated the banking sector for the loss incurred by it during the two previous months. Consequently, the financial result of Q1 2015, however modest it may be, was positive (+Rb 6bn).

After the payment of profits tax by profit-making credit institutions, the banking sector's aggregate financial result of Q1 2015 became negative. As the banking sector paid Rb 38bn in profits tax for Q1 2015, its final financial result after tax amounted to -Rb 32bn. For reference: in Q1 2014, the banking sector's aggregate profit amounted to Rb 232bn; from that amount it paid Rb 46bn in taxes. Thus, in Q1 2014, the banking sector's aggregate profit after taxes amounted to Rb 186bn.

The main factor responsible for losses in the banking sector was the formation, on a massive scale, of target-

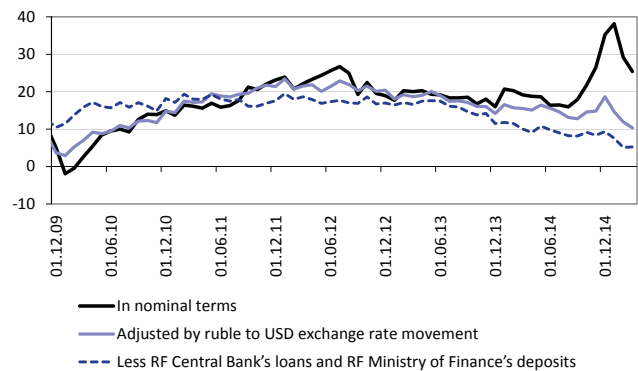


Fig. 1. The Movement of Assets of the Banking Sector (As % of Amount as of Corresponding Date of Previous Year)

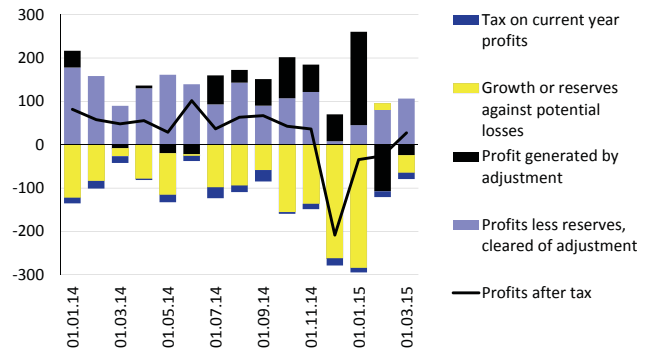


Fig. 2. The Main Components of the Banking Sector's Monthly Profits, Rb bn

ed bank reserves against potential losses on loans and other types of assets. Over the course of Q1 2015, the book value of the accumulated reserves increased by Rb 308bn, including by Rb 39bn in March. The sharp decline in transfers to reserves observed in February and March of the current year was apparently caused by the strengthening of the ruble and the decline in the ruble value of risky assets denominated in foreign exchange. During February, the volume of assets even dropped by Rb 15bn. In Q1 2015, a considerable proportion of losses was accounted for by big state banks². Of the

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.

2 Banks of the VTB Group (VTB, VTB24, Bank of Moscow), Gazprombank, Rosselkhozbank.

Table 1

THE STRUCTURE OF FINANCIAL RESULT IN Q1 2015, BILLION RUBLES

	Number of banks	Profit after taxes	Profits tax	Net transfers to reserves	Net profit from revaluation	Profit before taxes, transfers to reserves and revaluation
Credit institutions	824	-32.1	-38.1	-308.3	82.5	231.8
RF Savings Bank	1	26.3	-19.9	-68.4	52.7	62.0
Big state banks	5	-63.2	-1.5	-90.7	8.2	20.9
Other banks	818	4.8	-16.7	-149.1	21.7	148.9
For reference						
Profit-making banks (from sample*, except for RF Savings Bank)	593	96.9	-10.1	-61.7	21.4	147.3
Loss-making banks (from sample, except for state banks)	201	-94.8	-5.8	-119.9	-1.9	32.8

* The sample is composed of those credit institutions that post their reports to the website of the Bank of Russia (800 out of the total amount of 824, which accounts for 93.3% of the aggregate assets of credit institutions as of 1 April 2015).

Rb 158bn in losses sustained by loss-making banks, Rb 63bn was accounted for by 5 state banks. It is noteworthy that the loss-making banks are characterized not only by a high volume of transfers to reserves, but also by an extremely low relative volume of net operating income – profit before taxes and without taking into account transactions in reserves and revaluation of bank accounts denominated in foreign exchange. Thus, while the net operating income gained by the profit-making banks (except for the RF Savings Bank) in Q1 2015 accounted for 2.9% of the volume of their assets expressed in annual terms, the net operating income of the loss-making banks amounted to just 0.6%, and to a negligible 0.4% in case of loss-making state banks.

Attracted Funds

Over the course of Q1 2015, the volume of funds attracted from physical persons and placed on their bank accounts and deposits increased by 2.1%, including by 1.7% in March 2015. For the first time since November 2014, their annual growth rate returned to positive zone. As of 1 April 2015, the volume of individual funds increased by 2.5% on 1 April 2014.

The resumption of the inflow of individual funds into the banking sector was reflected both on ruble and foreign currency bank accounts. In Q1, the volume of ruble-denominated deposits grew by 2.4%. Since the beginning of the current year, bank accounts and deposits denominated in foreign exchange have displayed growth by 1.0%, and by 2.8% in US dollar terms in March.

Having plummeted in the disastrous 2014, in Q1 2015, the savings rate of households (bank accounts and deposits) practically returned to the level of previous years. In Q1 2015, Russia's population transferred

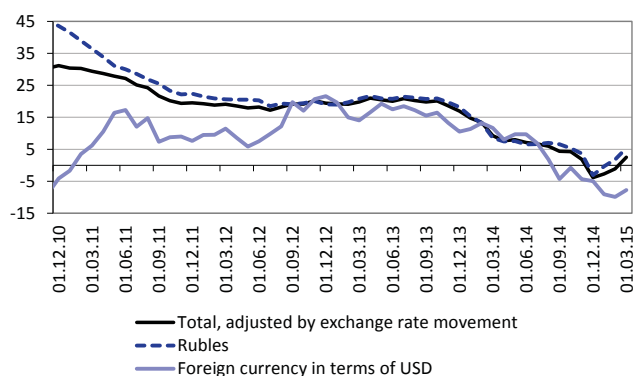


Fig. 3. The Movement of Individual Deposits (As % of Amount as of Corresponding Date of Previous Year)

to the banking sector 3.4% of their aggregate money income, which almost exactly corresponds to the level of 2012 (3.7%); while in Q1 2014, depositors had withdrawn from banks 6.6% of the money incomes of their households.

Over the course of Q1 2015, the volume of funds kept by corporate clients in their bank accounts increased only by 0.3% because of a 1.8% drop in corporate funds registered in March. The annual growth rate of corporate funds amounted to 14.5%, which approximately corresponds to their average growth rate during the past one-and-a-half or two-year period.

In Q1 2015, the share of FX funds kept by corporate clients in their bank accounts and on bank deposits gradually increased at the expense of ruble funds. Since the beginning of the current year, the amount of ruble funds kept in corporate bank accounts and on bank deposits has dropped by 1.6%, including by 0.1% in March. At the same time, over the course of Q1 2015 the amount of funds kept in bank accounts denominated in foreign currencies increased by 7.1%

in US dollar terms, including by 0.7% in March. As of 1 April 2015, the volume of FX funds kept in the bank accounts of enterprises and organizations amounted to \$ 117bn, an all-time high.

The share of accounts denominated in foreign currencies in the total volume of corporate funds placed with banks as of 1 April 2015 amounted to 36.2%, having increased since the beginning of the current year by almost 3 p.p. (from 33.3%).

In Q1 2015, the amount of the banking sector's debt to Russia's financial regulatory bodies (the Bank of Russia and the RF Ministry of Finance) declined from Rb 9.9 trillion as of 1 January 2015 to Rb 8.1 trillion as of 1 April 2015. Most of this decline took place in January, when the banking sector was getting rid of the redundant liquidity stashed by it at the end of the past year. In February and March 2015, the level of the banking sector's debt to Russia's financial regulatory bodies remained relatively stable.

At the same time, the share of FX debt in the total volume of the banking sector's debt to the Bank of Russia was notably increasing. The amount of FX liquidity provided to the banking sector by the RF CB grew from \$ 22.9bn as of 1 January 2015 to \$ 31bn as of 1 April 2015. At the same time, the volume of ruble instruments was on the decrease (dropping to Rb 5.8 trillion as of 1 April 2015).

The FX funds received by banks from the Bank of Russia were spent on repaying their external debts and on increasing the number and the volume of FX loans issued to their corporate borrowers for the purpose of servicing their external debts.

Invested Monies

The issuance of bank loans to physical persons has been on the decline since December 2014. In Q1 2015, the amount of debt of physical persons against bank loans issued to them shrank by 3.7%, including by 1.2%

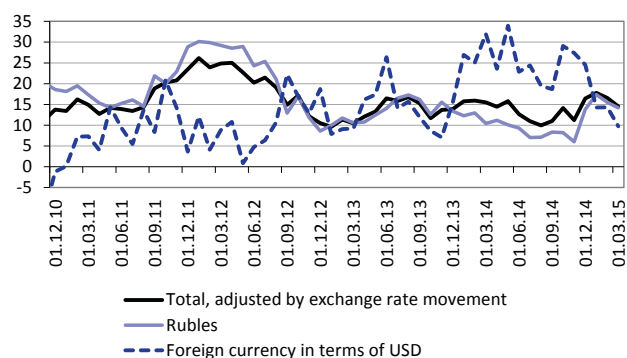


Fig. 4. The Movement of Corporate Clients' Deposits (As % of Amount as of Corresponding Date of Previous Year)

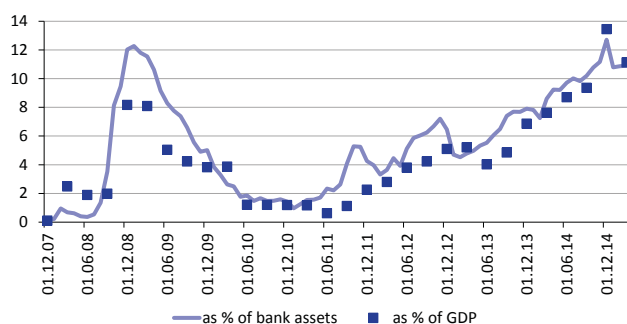


Fig. 5. The Movement of Banks' Total Debt to the Bank of Russia and the RF Ministry of Finance (As % of Bank Assets and GDP)

in March (when its 12-month growth rate dropped to 10.1%). The decline in the amount of physical persons' debt to banks was caused by a sharp drop in the number of new loans issued to the population, as well as in the amount borrowed thereby. Thus, over the course of January and February 2015, the amount borrowed from banks by physical persons dropped by 40% on the same period of the previous year: Rb 693bn vs. Rb 1,185bn.

Table 2

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	12.13	03.14	06.14	09.14	12.14	01.15	02.15	03.15
Liabilities, bn Rb	28,022	29,430	33,805	41,628	49,510	57,423	59,377	61,385	64,073	77,663	80,753	76,378	74,447
Equity	14.1	19.3	18.7	16.9	16.2	16.0	16.0	15.8	16.1	13.6	13.3	14.2	14.8
Credits allotted by Bank of Russia	12.0	4.8	1.0	2.9	5.4	7.7	7.9	8.7	8.8	12.0	9.6	10.1	10.2
Interbank operations	4.4	4.8	5.5	5.7	5.6	5.1	4.7	5.9	5.5	6.1	4.7	4.6	4.5
Foreign liabilities	16.4	12.1	11.8	11.1	10.8	9.9	10.6	9.4	9.6	10.2	11.2	10.2	9.5
Physical persons' monies	21.5	25.9	29.6	29.1	28.9	29.4	27.8	27.4	26.9	23.7	23.7	24.7	25.4
Enterprises and organizations' monies	23.6	25.9	25.7	26.0	24	23.8	23.9	22.9	22.6	23.8	24.9	25.4	25.0
Accounts and deposits of state administrative bodies and local governments	1.0	1.0	1.5	2.3	1.6	0.9	1.8	2.3	2.9	1.4	2.1	1.8	1.8
Securities issued	4.1	4.1	4.0	3.7	4.9	4.5	4.2	3.9	3.8	3.5	3.4	3.4	3.5

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

The quality of the retail credit portfolio continues to deteriorate. Since the beginning of the current year, the share of debt in arrears in the total amount of physical persons' debt against bank loans issued to them has increased by more than 1 p.p., from 6.0% to 7.1%. Since the beginning of 2015, the ratio of reserves against potential losses to payables has increased from 8.9% to 10%.

Over the course of Q1 2015, the volume of corporate debt due to banks grew by 1.5%, including by 0.9% in March. At the same time, by the month-end results of March 2015, the per annum growth rate of corporate debt to banks amounted to 12.0%.

At the same time, since the beginning of 2015, the share of loans denominated in foreign currencies has been notably increasing at the expense of the share of ruble loans. Thus, over the course of Q1 2015, the amount of corporate ruble-denominated debt due to banks dwindled by 1.6%, including by 0.1% in March. In contrast, the amount of corporate FX debt due to banks significantly increased – by 9.3% over the course of Q1 2015, including by 3.2% in March. As of 1 April 2015, the aggregate amount of corporate debt was \$ 133bn – a historic high.

Apparently, these phenomena represent two different processes. The amount of ruble debt decreases because of the recent hike in interest rates. Also, the quality of ruble loans is significantly worse than that of FX loans. It should be noted that, as of 1 April 2015, the share of outstanding debt against ruble loans in the total volume of debt due to banks amounted to 6.0% (vs. 5.0 at the beginning of the current year), while this index for FX loans amounted to a mere 1.4%, having remained almost unchanged since 1 January 2015, when it amounted to 1.3%.

At the same time, the increase in the amount of FX borrowing is caused by the necessity of servicing exter-

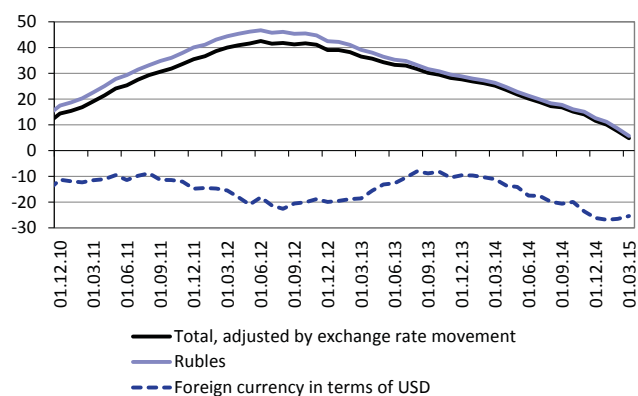


Fig. 6. The Movement of Retail Loans
(As % of Amount as of Corresponding Date of Previous Year)

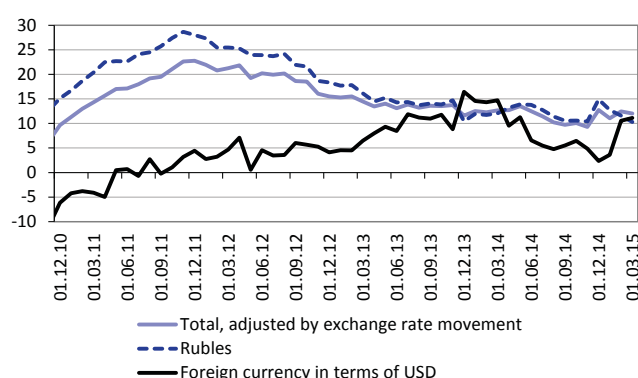


Fig. 7. The Movement of Loans Issued to Enterprises and Organizations
(As % of Amount as of Corresponding Date of Previous Year)

nal corporate debt. Therefore such loans are issued to reliable borrowers (i.e. those who could previously borrow on foreign financial markets). As a result, the quality of such loans has so far remained much better than that of ruble loans.

Table 3

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	12.13	03.14	06.14	09.14	12.14	01.15	02.15	03.15
Assets, bn Rb	28,022	29,430	33,805	41,628	49,510	57,423	59,377	61,385	64,073	77,663	80,753	76,378	74,447
Cash and precious metals	3.0	2.7	2.7	2.9	3.1	2.8	2.8	2.4	2.3	3.5	2.7	2.5	2.3
Monies placed with Bank of Russia	7.5	6.9	7.1	4.2	4.4	3.9	3.5	3.3	3.4	4.2	3.0	2.8	3.2
Interbank operations	5.2	5.4	6.5	6.4	6.8	5.7	5.3	6.9	7.4	7.5	6.7	6.7	6.6
Foreign assets	13.8	14.1	13.4	14.3	13.0	13.3	14.4	14.1	13.1	13.8	16.6	15.7	15.1
Population	15.5	13.1	13.0	14.4	16.8	18.5	18.4	18.5	18.4	15.5	14.8	15.4	15.5
Corporate sector	44.5	44.5	43.6	44.0	41.3	39.3	39.6	38.8	39.3	35.9	36.5	38.0	38.6
State	2.0	4.2	5.1	5.0	3.2	3.1	3.0	3.4	3.2	3.1	3.5	4.0	3.9
Property	1.9	2.7	2.6	2.3	2.2	2.0	1.9	1.9	1.9	1.6	1.5	1.6	1.6

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