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## Russian Banking Sector

*Annual growth of budget expenditures, observed in December, has resulted in the funds extension of households and corporate clients with the bank accounts. This has urged a traditional growth of bank liquidity, which, however, has only slightly exceeded the refinancing rate of the Bank of Russia and the Ministry of Finance of Russia. The downward trend in the growth rate of bank assets and lending was maintained in H2 2012.*

In December 2012 the growth rate of bank assets traditionally accelerated<sup>1</sup>. In a month total assets increased by 4.2%. Nevertheless, the annual growth rate remained stable at about 20%. However, in 2012, for the first time after the crisis of 2008-2009, the growth rate of bank assets was recorded at a lower level than in the preceding year. In 2011 they were increased by 21.4%.

The Bank of Russia refinancing contribution in the growth of banking assets has been increased. In 2012, the regulator's support ensured 3.6 p.p. of the growth (about Rb 1.5 trillion), while in 2011, Rb 0.9 trillion, received by the banks, covered only 2.6 p.p. of the total banks' assets growth.

At the end of 2012 the banks' equity growth rate has increased. If in 2011 it has grown by 11%, in 2012 this indicator reached 14%. The rate of return on the banking authorized capital and the capital surplus more than doubled from 4.6% in 2011 to 10.7% in 2012, but the main source of banks' own funds growth is profit. As a result, in 2012 capitalization of earnings has ensured two thirds of the banks' own funds growth.

The volume of the banks' profit in 2012 has reached a record value in nominal terms - more than Rb 1 trillion. Herewith, in December financial performance of the banking sector (Rb 82bn) was close to the average monthly profit in 2012 (Rb 84bn). However, in the last month of the year a significant contribution to the final financial performance was made at the expense of provisions for possible loan losses. Regardless transactions with the provisions, the December profit could be far less – Rb 35bn.

Profitability of the banking sector for the year reached 2.3% in return on assets (ROA) and 19.8% in return on equity (ROE). These figures remain stable for nearly eighteen months. Therefore, it means that the record return on assets in nominal terms reflects only the expansion of banking business transactions.

### **Raised funds**

In December the inflow of funds growth rate to the *deposits of individuals* with the banking sector made 6% or Rb 829bn. In general, as of the year end, the growth rate of the individual funds has not changed, having made 19.4% vs. 19.5% a year earlier.

In the choice between the deposits in national and foreign currencies, in December bank clients preferred accounts in rubles. Ruble funds of individuals with the banks have grown over

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<sup>1</sup> Hereinafter growth rates of balance sheet are adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

the month by 7.1%, while foreign currency accounts in US dollar equivalent increased only by 1.8%. In this regard December is different from preceding months, when individuals were more actively accumulating deposits in foreign currencies. This situation is clearly based on seasonal factor and is associated with an increase in household incomes in December. As a result, if in the first 11 months of the year the growth rate on the funds with the banks in national and foreign currencies accounted for 11.1% and 19.5% with an obvious preference for FX deposits, by the year result, the dynamics of the two components of organized individual savings was more balanced: 19.0% and 19.5%, respectively.

The rate of household savings in cash and bank deposits in 2012, according to tentative estimates, amounted to 7.0%, that is, somewhat less than in 2011 (7.4%). At the same time, the banking sector has got some more of the individuals' income than in the preceding year: 5.6% instead of 5.3%. It means that in 2012 the sustained inflow of funds to the banks at the level comparable to 2011 was largely due to a decline in demand for cash.

The volume of *corporate clients' assets* with the banks in December increased by 8.9% or Rb 970bn. The December upsurge has not changed the trend of this type of bank liabilities growth rate in annual terms. As per the year result, the growth rate of the bank accounts of enterprises and organizations made only 10.7%, having decreased more than twice within the year (vs. 23.4 in 2011).

Herewith, in contrast to household savings, there was noted a clear shift in favor of the national currency in the dynamics of corporate clients' funds. Over the year ruble funds have grown by 13.0%, while foreign currency assets – only by 4.3%.

In December three fourths of the corporate return on assets were allocated on fixed-term deposits, rather than on settlement and current accounts. As of the year end, corporate sector has accumulated in the fixed-term bank deposits 54% of the total amount of funds allocated with banks by enterprises and organizations. This is the maximum value of this ratio for the entire period of comparable bank reporting.

Based on the banking reporting, their FX liabilities in December have grown by \$7bn, and all in all by \$31bn over the year. Due to the differences in accounting methods, this information is different from the balance of payments (39.5bn in 2012), but both of them evidence a significant gross inflow of non-residents funds to the Russian banking sector.

Table 1

### Structure of the Russian banking system liabilities (end of month), as % of total

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	10.12	11.12	12.12
<b>Liabilities, Rb bn</b>	<b>20125</b>	<b>28022</b>	<b>29430</b>	<b>33805</b>	<b>41628</b>	<b>41533</b>	<b>44266</b>	<b>45861</b>	<b>47096</b>	<b>47669</b>	<b>49510</b>
Own assets	15.3	14.1	19.3	18.7	16.9	17.5	16.8	16.9	16.7	16.7	16.2
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	2.9	3.5	5.1	5.1	5.4	6.0	5.4
Interbank operations	4.1	4.4	4.8	5.5	5.7	5.1	4.8	5.1	5.1	5.1	5.6
Foreign liabilities	18.1	16.4	12.1	11.8	11.1	10.2	11.3	11.0	11.1	10.9	10.8
Private deposits	26.2	21.5	25.9	29.6	29.1	29.4	29.4	28.7	28.2	28.4	28.9
Corporate deposits	25.8	23.6	25.9	25.7	26.0	25.7	24.0	23.3	23.2	22.9	24
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	2.3	1.4	1.5	2.5	2.7	2.4	1.6
Securities issued	5.8	4.1	4.1	4.0	3.7	4.8	4.5	4.8	5.0	5.0	4.9

Source: Central Bank of Russia, IEP estimates.

## **Investments**

In December 2012 the bank's *retail lending* growth rate amounted to 2.4%. In total for the year the volume of outstanding liabilities on loans of individuals to the banks increased by 39.1%. This is certainly more than in 2011, when the growth rate of loans to individuals made 35.7%, but lower than the mid-2012 maximum peak. In H2 2012 lending growth rate was slowing down. As of 2012 end, bank lending has provided about 25% of retail turnover and household spending on commercial services.

The quality of retail loan portfolio indicators of the banking sector in the credit market in December has improved. The value of overdue debt has declined within the month by 5%, and its share in the loans to individuals made 4.1% against 5.3% a year earlier. The volume of provisions for possible losses over the last month remained virtually unchanged, but against the background of the total loan debt the ratio of provisions/loans decreased in December by 0.2 p.p.

A marked improvement in the quality of the loan portfolio is apparently caused by write-off of bad debts or its selling to collection agencies. This also may be the reason of low growth rate of total debt of individuals to the banks in December. This strategy of the banks was urged by more stringent requirements of the Bank of Russia to the quality of loan portfolio, which makes it more profitable for the banks to transfer bad debts to collection agencies in the earlier periods of overdue arrears.

Corporate lending in December 2012 also demonstrated low rates of growth. The amount of overdue loans increased by 0.6% over the month and in total by 15.5% in annual terms. It is noteworthy that the increase of arrears in corporate clients segment has virtually matched the growth of retail loans. Outstanding liabilities of enterprises and organizations to domestic banks have grown over the year by Rb 2.50 trillion, while those of individuals – by Rb 2.34 trillion.

The quality of corporate credit debt in December continued to improve. Overdue loans decreased from 4.8 to 4.6%, and the ratio of provisions for loans - from 7.6 to 7.5%

## **Liquidity and government support**

In December the federal budget is traditionally executed with a significant deficit, which results in replenishment of financial sector with surplus liquidity. Thus, the account balances of budgets of all levels with the Bank of Russia have been decreased by Rb 1.6 trillion in December. This indicator virtually matches the total growth of funds in the individual and corporate accounts with the banks (Rb 1.8 trillion).

The growth of funds in clients' accounts allowed the banks partially, and apparently temporarily, to reduce the volume of their arrears to the monetary authorities, but this reduction was much less than the increase in liquidity growth from budget resources. Thus, the amount of deposits of the Ministry of Finance of Russia with commercial banks has declined over the month by Rb 153bn, arrears of the banks to the Bank of Russia – by Rb 162bn, which makes in total about 20% of the budget funds, addressed to the economy in December.

Liquidity of the banking sector, i.e., the share of liquid assets in the aggregate banking assets made 6.7% as of January 1, 2013. This is by 0.4 p.p. higher than a year earlier (6.3% as of January 1, 2012). But on the basis of 2012, nearly total amount of the banks' liquidity was formed at the expense of the funds of monetary authorities. The banking sector own liquidity,

excluding loans from the Bank of Russia and the deposits of the Ministry of Finance of Russia at the end of December has barely exceeded the zero indicator (0.2%), vs. 2.0% a year earlier. Therefore, as a natural result, in the first months of 2013 the banks' arrears to monetary market regulators will again exceed the value of liquid assets.

Table 2

**Structure of the Russian banking system assets (end of month), as% of total**

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	09.12	10.12	11.12	12.12
<b>Assets, Rb bn</b>	<b>20125</b>	<b>28022</b>	<b>29430</b>	<b>33805</b>	<b>41628</b>	<b>41533</b>	<b>44266</b>	<b>45861</b>	<b>47096</b>	<b>47669</b>	<b>49510</b>
Cash and precious metals	2.5	3.0	2.7	2.7	2.9	2.4	2.5	2.6	2.6	2.6	3.1
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.2	3.2	3.0	2.8	2.7	2.9	4.4
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	5.8	5.8	6.1	6.1	6.8
Foreign assets	9.8	13.8	14.1	13.4	14.3	14.2	14.2	13.9	14.3	14.2	13.0
Individuals	16.1	15.5	13.1	13.0	14.4	15.3	16.0	16.8	16.8	17.0	16.8
Corporate sector	47.2	44.5	44.5	43.6	44.0	44.4	43.6	43.4	42.9	42.5	41.3
Government	4.1	2.0	4.2	5.1	5.0	4.9	3.8	3.3	3.2	3.0	3.2
Property	2.2	1.9	2.7	2.6	2.3	2.4	2.3	2.3	2.3	2.2	2.2

Source: Central Bank of Russia, IEP estimates.