Zuzana Fungáčová and Laura Solanko: Current situation in the Russian banking sector

In terms of GDP, the past eight years have seen the Russian economy grow at an annual rate of over 7%. Economic growth, increasing export revenue, fiscal surpluses, the structural reforms of earlier in the decade and developments in international financial markets have all served to enhance the extraordinarily rapid growth in recent years in the Russian financial sector. Over the last few years, lending stock has increased by about 50% and deposits by a good 40%, annually.

Rapid growth
Despite this recent brisk growth, the Russian banking sector remains relatively small. At the beginning of 2000, the banking sector’s assets accounted for only 35% of GDP. This has already grown to 60%, but still remains notably below the level in many new EU member states. Regardless of the brisk rate of growth, the role of banks (and stock markets) in the financing of investments and consumption has been small. Bank financing accounts only for 10% of companies’ fixed investments. As domestic banks are still fairly small, large Russian companies have increasingly relied on international capital markets to finance their investments.

Household consumer credit and housing loans have only become more commonly used in recent years and still only account for approximately 25% of banks’ lending stock. The explosive growth experienced in the housing loan market has boosted housing construction in the largest cities, but overall these loans remain relatively insignificant. On average, throughout Russia, less than 10% of housing purchases are financed using mortgage credit, with housing loans representing only 15% of all loans taken out by households.

Extensive state ownership
The state owns or indirectly controls a considerable proportion of the Russian banking system. State-controlled banks account for almost half of the domestic loan market. Of the ten largest banks in the country, six are state controlled, two are foreign owned and the remaining two are under private domestic ownership. Overall, foreign ownership is not particularly extensive, accounting for approximately a quarter of the Russian banking sector’s assets.

Russia’s banking sector is dominated by three large, state-controlled banks: Sberbank, VTB and Gazprombank, accounting for as much as 40% of the sector’s assets. Of these, Sberbank is clearly the country’s largest bank, having the most extensive network of branches and, due to its de facto state guarantee, it accounts for half of all household deposits. VTB and Gazprombank are mainly corporate sector banks. All three of these large banks are profitable and have increased their lending considerably recently.

Two thirds of the country’s banking balance sheets are accounted for by the twenty largest banks which handle 70% of household deposits, 70% of corporate loans and 64% of household lending stock. In all, there are 1,125 banks operating in the Russian banking sector, of which the majority are insignificant from the systemic point of view. There are 215 banks with foreign ownership and 70 of them are fully foreign owned.

Core of the sector is sound
On average, the Russian banking sector is in sound condition. The ratio of equity to assets is over 12%, loans relative to deposits (excluding Sberbank) is fairly reasonable at 125% and the banks have returned very good profits in recent years. Additionally, it is widely believed that the government would not allow any of the country’s larger banks to get into difficulties. At present Russia (including the central bank) has a budgetary surplus and, due to its having the world’s third largest foreign reserves, is in a strong enough position to support its banking and financial sectors. As, indeed, it has done lately (See BOFIT Weekly Reviews 38-41).

Problems springing from the sector’s structure and lack of confidence…
However, one of the more worrying characteristics of the Russia banking sector is the lack of confidence between the participants in the sector which makes interbank markets the more vulnerable and prone to the effects of rumours and external shocks. Save for the biggest banks, confidence in counterparties is weak and interbank markets do not efficiently redistribute liquidity between banks. As was observed in the last weeks, external shocks can bring a market
that normally operates poorly to a complete halt. The
small and medium-sized banks have been effectively
cut off interbank markets and the largest banks
hoarding liquidity.

In an atmosphere prone to rumour the difficulties
experienced by a few small banks can cause prob-
lems to the entire sector and, at worst, cause a run on
banks. For this reason, authorities have been reluctant
to allow even the smallest bank to go under and, for
example, have not raised minimum capital require-
ments for banks in recent years.

...as well as the rapid growth in lending stock in
recent years
Over the last few years the domestic lending stock
has expanded faster than domestic deposits, leading
to banks increasingly looking abroad for financing.
The share of foreign liabilities in the banks’ assets
has grown slightly, to as much as 20%. In current
market conditions, banks’ opportunities to acquire
favourably priced financing from abroad are, in prac-
tice, non-existent which has effectively halted the
growth of the domestic lending stock.

The lending periods on loans granted by banks
have continued to grow during recent years. This can
be a particular problem for medium-sized banks,
whose funding has been reliant on taking short-term
foreign loans. There have been concerns on this ma-
turity mismatch even before the current crisis, but the
tightening of liquidity to the extreme degree has only
served to highlight the problem. Russian banks will
have hard times in refinancing their foreign obliga-
tions.

There are always risks associated with rapid
growth. Lending to households is a new concept in
Russia; there is no long-term customer history or
credit history to fall back on and banks have shown
notable lacks in their risk management in this matter.
As some of the most significantly rapid growth has
been in household lending in recent years it is possi-
ble that, in retrospect, there have also been some
highly questionable lending decisions made at times.
Should there be a notable slowing of growth in the
Russian economy due to a crash in the price of oil or
from a deepening of the international financial crisis,
some difficulties in loan servicing might emerge.
Although for the moment Russian banks' loan losses
have been few.

Outlook
For the moment, it is likely that the measures taken
by the Russian central bank and the government will
be adequate to calm the situation and raise the bank-
ing sector’s liquidity to tolerable levels. However,
growth in the lending stock is expected to slow down
for a longer period. The occasional bank merger will
probably be seen, but it is yet unlikely that we shall
see a larger consolidation of the banking sector.
However, Russia cannot isolate itself from interna-
tional capital movements and, as the international
situation continues to be tight, the outward flow of
capital will persist and liquidity will remain tight.

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