SUOMEN PANKKI FINLANDS BANK
EUROJÄRJESTELMÄ
EUROSYSTEMET

Focus/Opinion
Expert view
5/2008 • 26.9.2008

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 problems 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 requirements 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 practice, 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 maturity 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 obligations.

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 possible 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 banking 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 international capital movements and, as the international situation continues to be tight, the outward flow of capital will persist and liquidity will remain tight.

Zuzana Fungáčová and Laura Solanko are economists at BOFIT.