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Russian Stabilization Policy and the Banking Sector, as Reflected in the Portfolios of Moscow Banks in 1995–97

Abstract

The study analyses developments in the structure of Moscow banks' balance sheets, returns and costs of their different banking operations, as well as the banks' profitability, liquidity and capital adequacy. The analysis covers the years 1995-1997 when Russia was attempting to pursue a macroeconomic policy aimed at monetary stabilisation. An assessment is also given of the problems which were evolving in the Russian banking system before banks were hit by Russia's financial crisis in summer 1998.

The analysis itself presents rather detailed data on the balance sheets and banking operations of a large sample of banks registered in Moscow; at the peak, the sample consisted of 688 banks.

Keywords: Russian banks, bank credit, Treasury bills, deposits, interest rates, bank regulation

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1 Introduction to the study

During the past few years a lot of discussion has taken place both in Russia and other countries on the future development of the Russian banking system, one particular topic being the possibility of a banking crisis. While rather general assessments of the state of affairs in the Russian banking sector have been in circulation, systematic and concrete information on the operations of the entire sector or any meaningful part of it has hardly been available. In order to fill part of this gap, this study analyses changes in the operations of Moscow banks after stabilization policy was launched in Russia in 1995.

The article has been organized into two parts:

- We start out with an assessment of the problems that were evolving in the Russian banking system before the federal government's default on its Treasury bills in August 1998 triggered a financial crisis (chapter 2); this assessment draws partly on our analysis of the data on the Moscow banks.
- The rest of the article consists of the analysis itself which presents balance sheet information on a group of 688 banks based in Moscow, covering a three-year period from the beginning of 1995 to the beginning of 1998. The analysis mainly focuses on the banks' portfolio structure and returns on their banking operations.

In general, the problems of the Russian banking sector were already reflected in how the mere number of banks developed over time. During 1996 the number of credit organizations registered in Russia reached more than 2600[3], but at the same time less new banks were being set up than the Central Bank of Russia was cancelling bank licenses. During 1996 the rights for banking operations were withdrawn from 260 banks and in 1997 from more than 300 banks (Table 1). The number of functioning credit organizations continued to decline, from about 2300 on 1 January 1996 to little over 2150 on 1 July 1996 and about 2030 by 1 January 1997; their number fell further to about 1700 by 1 January 1998 and about 1600 by 1 July 1998.

Table 1 **Registration of banks and withdrawal of bank licenses in Russia in 1993-98**

Date	Cumulative number of credit organizations registered	Licenses withdraw* Cumulative number	Per cent of all licenses granted
1 Jan. 1993	1713	1	0.1
1 Jan. 1994	2019	20	1.0
1 Jan. 1995	2517	85	3.4
1 Jan. 1996	2578	310	12.0
1 July 1996	2605	448	17.2
1 Jan. 1997	2589	570	21.9
1 July 1997	2576	743	28.8
1 Jan. 1998	2552	852	33.4
1 July 1998	2525	927	36.7

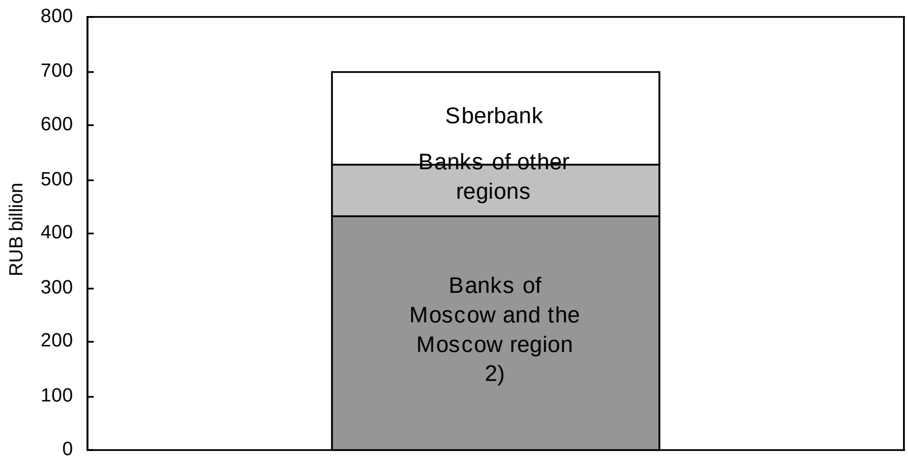
* Licenses withdrawn for breaking the rules of banking legislation
Source: Byulleten' bankovskoi statistiki, Vestnik Banka Rossii, various issues.

The Russian banking sector has been characterized by concentration in Moscow where 993 banks had been registered at the beginning of 1996. About 900 of them were functioning in early 1996. By 1 July 1996 the number of functioning credit organizations in Moscow had decreased to 845 and by 1 January 1997 to 823, and their number dropped further to 706 by 1 January 1998 and about 680 by 1 July 1998.

In terms of assets, Russian banks have been even more concentrated in Moscow as Moscow banks have accounted for more than 60% of total assets of all Russian banks (figure 1).

[3] The number of all credit organizations consists of commercial banks and other credit organizations, for example clearing centres, which have limited bank licenses. The number of such credit organizations varied between 21 and 29 during 1996-97.

Figure 1 **Total assets of Russian banks on 1 January 1998**[1)*]



1) data for 1691 banks; Vneshekonombank is not included
2) including Agroprombank
[*] Everything expressed in roubles in this article is in redenominated roubles (the redenomination was effected on 1 January 1998); thus 1 million roubles equals 1 billion pre-redenominated roubles. Source: calculations of the authors.

2 Evolving problems in the Russian banking system

The peculiar nature of the current Russian banking system has been linked inseparably with the very rapid growth of banks that took place during 1987-95. The special features that emerged during those years distinguish Russia from most other countries at a similar level of social and economic development. The factors behind the unique developments are many. Initially the supply of payment services to enterprises was extremely scarce and at the same time demand for them by small and medium-sized business was already growing. Lack of banking services allowed the banks to pay low or zero interest rates on transaction accounts and other current liabilities. Interest rates on such liabilities were tiny compared to the speed of inflation and to interest rates on short-term loans granted by banks to firms.

The Russian society was unprepared for living in conditions of high inflation, and therefore mechanisms for the indexation of banks' liabilities did not become widespread. This created unique opportunities for the banks to reap benefits from the inflation tax.

Regulations concerning the establishment of new banks were extremely liberal. Up to the beginning of 1994 the requirements for minimum capital were low, mainly because their size in real terms had diminished due to high inflation in 1992-93. Other requirements were simple and applications for bank registration were examined quickly. These circumstances favoured the swift growth of the number of banks that occurred at the beginning of the 1990s.

Under the liberal banking regime there were no direct controls of interest rates nor quotas on granting commercial loans to different industries. In the 1990s the banking sector in Russia has developed under conditions of high inflation that was also characteristic to other post-socialist countries as well as developing countries in the 1980s and 1990s. But nowhere else did high inflation lead to such a heyday of banking as in Russia. Russian-style high returns on banking during the past half a decade have been a very rare phenomenon in other countries where they have lasted only for short periods, often a few months.

It was because of the afore-mentioned features that Russian banks were able to obtain the significant gains from the inflation tax, amounting to 10 per cent of GDP in some periods. Thus the banks took advantage of the crisis in the real economy and deepened the fall of production. Orientation to speculative inflationary income resulted in a serious deformation of the balance sheets of most Russian banks. In assets this was reflected in the large share of correspondent accounts and short-term interest-earning assets and in liabilities in the high share of current liabilities.

Thanks to a considerable tightening of fiscal and monetary policy in 1995, by the middle of 1996 inflation decelerated to a level akin to financial stabilization. The exchange rate band brought down sharply the high returns on banking operations in foreign currency as early as the middle of 1995. Nevertheless, due to political uncertainty related to the Presidential election in summer 1996 interest rates on rouble instruments did not follow the decline of inflation and climbed extremely high (on certain instruments real interest rates went up to 500% per annum). This allowed Russian banks to maintain very large interest rate spreads and high returns on most loans and investment operations in roubles.

But even in these relatively favourable conditions financial difficulties of banks started to mount with a considerable tempo. The number of banks that had their licenses cancelled exceeded 10% of all banks both in 1996 and 1997, and thereafter more and more banks were facing withdrawal of their licenses. Bankruptcies and incidents of insolvency among medium-sized and large banks, which were practically missing before 1995, also became much more frequent.

As an unavoidable consequence of excessively high real interest rates on rouble loans in the first half of 1996, the financial situation of debtors in the non-financial sector deteriorated. That increased essentially the risks of banks related to operations in rouble loans. But as our data on the structure of balance sheets of 600 to 700 Moscow banks (depending on the date of cross-cut) shows, the share of rouble loans in all loans granted as well as in total assets tended to rise during the past couple of years. First of all this was due to the situation where, with the exchange rate band in place, returns on rouble loans were higher than on foreign currency loans.

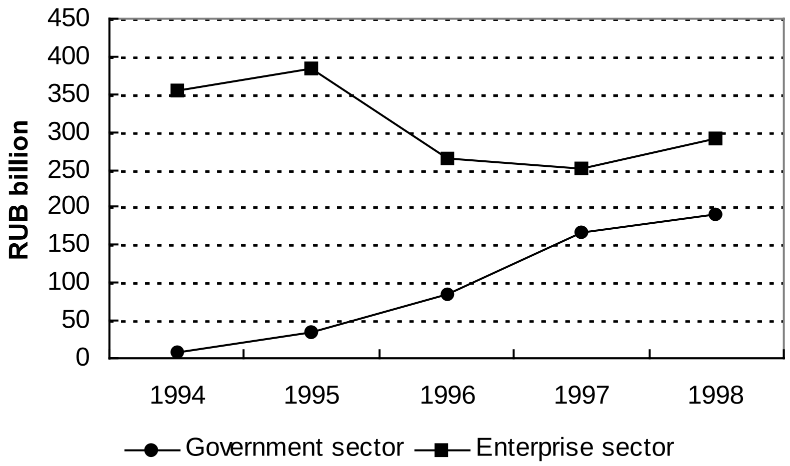
The developments inevitably increased the difficulties of getting rouble loans repaid and raised the share of problem loans in the banks' loan portfolios. This was also reflected in balance sheet information released by commercial banks.

Successful financial stabilization lead to a general decrease of interest rates on rouble loans, Treasury bills and other rouble assets of banks, during 1997 to the level of 20 to 50% per annum. To Russian banks this meant a decline of income from interest on rouble assets. Therefore, taking into account the increased weight of bad rouble loans and other non-performing assets as well as high operating costs, some banks faced falling income that did not cover their current expenses and losses, which would have ultimately made many of them bankrupt. Thus the menace of a systemic banking crisis became real.

However, there were special features of the monetary stabilization process in Russia which lowered the probability that that menace would materialize. The reduced rate of inflation was to a great extent achieved using instruments of monetary policy. Monetary stabilization went ahead of stabilization of the real economy and evolved against a continuing recession in the economy. As the crisis in the economy was structural, lower inflation did not lead to growth of investments and, consequently, did not create greater demand for loans in the real sector. In fact, in 1996 fixed investments declined by 18% and in 1997 as well as during 1998 still by 5 to 6%.

At the same time the large deficit of the state budget and the refusal of the government from taking direct Central Bank credit turned the government into the main borrower in the financial market and created a new market to the banks. Before monetary stabilization the government was in no great need of bank loans and its share in the claims of Russian banks on both the government and the enterprise sector was only 2% (figure 2). Restraint on money emission by the Central Bank for covering the budget deficit was bound to increase the role of banks as a creditor to the government and the budgetary crisis strengthened the effect significantly. Growing demand for credit by different levels of government naturally affected the decisions of banks to lend, leading into a rapid growth of government debt to banks (the afore-mentioned share had grown to 40% at the beginning of 1998). The effect of how the government as a borrower crowds out enterprises (both private and state enterprises) in bank lending could be clearly seen in the development of bank credit to the government sector (not only in the form of purchase of government securities but also as loans to the government sector). The development of government securities market played an important shock-absorbing role when banks had to start adjusting to the new financial conditions (the nominal volume of Treasury bills (GKOs and OFZs) issued increased more than 20-fold during 1995-96). The rapid growth of government borrowing protracted the fall of interest rates and softened the effects of the banking crisis of August 1995 and dedollarization of banks' balance sheets. The government attracted funds which were earlier invested in liquid foreign currency assets, i.e. in assets whose yield fell sharply with the stabilization of the rouble exchange rate.

Figure 2 **Claims of all Russian banks on the government sector and the enterprise sector in 1994-98 (at the beginning of year), real volumes in billion January 1998 roubles**[1)]



[1)]Includes claims of Sberbank and Vneshekonombank. The government sector consists of the federal government, local governments and off-budgetary funds. Real volumes were derived by deflating nominal figures with the consumer price index.
Source: Byulleten' bankovskoi statistiki.

3 While this sample of 688 Moscow banks suffered from withdrawal of licenses, it still represented a sizeable share of Russian banking capital

Since it is not possible to examine developments in the aggregate balance sheet of all Russian banks accurately enough, we used data on a sample of banks registered in Moscow (Table 2).[4] [5] The share of the banks in the sample of all banks registered in Moscow was 69% on 1 January 1996 and over 80% of all operating Moscow banks through 1996-97, and their share of all banks operating in Russia was 30% on 1 January 1996 and 35% on 1 January 1998. The sample does not include some of the largest Russian banks such as the Savings Bank of the Russian Federation (Sberbank), Vneshekonombank, Vneshtorgbank, Agroprombank of the Russian Federation and certain other "old" banks that originate in the Soviet era. The banks in the sample were roughly the average Russian size. Their share of the total balance sheet of Russian banks, excluding Vne shekonombank, was 24% on 1 July 1996 (31% excluding Vneshekonombank and Sberbank) and 39% on 1 January 1998 (excluding Vneshekonombank).

[4] "The unchanged group" in the sample consisted of 528 banks whose assets represented 77% of assets of the maximum sample of 688 banks on 1 July 1996. During 1995 to 1997, the Central Bank withdrew licenses of operation from about one hundred banks in the sample, so that at the end of 1997, 596 of the 688 banks continued to function (a separate analysis of the balance sheets of banks whose licenses were withdrawn is contained in chapter 8).

[5] For a more in-depth analysis of the balance sheets of 627 Moscow banks as per 1 January 1995 and for detailed descriptions of the various balance sheet items and other indicators employed in the analysis, see Rossiiskiye banki nakanune finansovoy stabilizatsii (published by Norma, St.Petersburg 1996), which is an earlier study by the four authors together with Yevgeny Timofeyev and Andrew Warner.

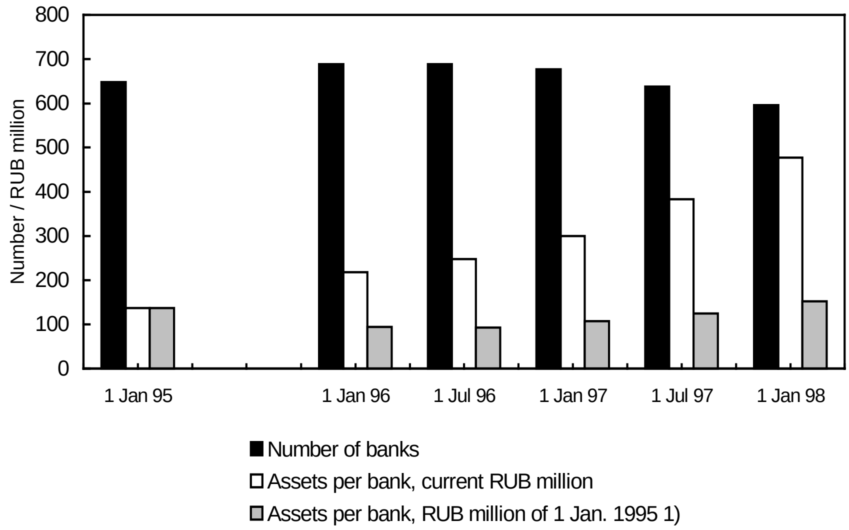
The consolidated balance sheet[6] of the Moscow banks in the sample and of all Russian banks grew in a similar way in nominal terms (by about 15%) in the first half of 1996 but remained unchanged in real terms (deflated by the consumer price index). Since mid-1996, the total balance sheet of the Moscow banks grew in real terms, at the same time when licenses were withdrawn from smaller banks in the sample, and the balance sheet of the Moscow banks also grew more rapidly than the balances of banks outside Moscow. Different balance sheet items of all Russian banks as well as the Moscow banks developed quite unstably over 1995-97. For example, in our sample of Moscow banks the growth of assets on correspondent accounts in other banks and interbank loans slowed down in the second half of 1995 to the extent that their total assets grew "only" by 60% in nominal terms in 1995 and shrunk by 30% in real terms.

4 The role of profitable assets and costly liabilities in the Moscow banks' portfolios became more important, with less reliance on foreign currency operations

In the following, we briefly examine the development of broad categories of more and less profitable assets as well as more and less costly liabilities as they appear on the balance sheets of our sample of Moscow banks. An important additional angle to the analysis arises from the fact that the decline of the rouble exchange rate, especially until late spring 1995, helped the banks profit (in rouble terms) from foreign currency assets that otherwise give a low income, and respectively, made them pay more (in rouble terms) for foreign currency liabilities that otherwise incur a low cost. As such, operations in foreign currency continued to play an important role in the business of Moscow banks (Figure 4). However, since early 1995 the share of foreign

[6] See Annex 1 for details of calculating the value of the consolidated balance sheet of all Russian banks.

Figure 3 **The development of the number of banks in the sample and their total assets in nominal and real terms in 1995-98 (at the beginning of year)**



1) The nominal value of assets was deflated by the consumer price index.

currency assets in the total assets decreased markedly, to below 40% in mid-1997, and the share of foreign currency liabilities declined in a similar manner.[7] Thus, a dedollarization of the balance sheets took place during a period when the introduction of stabilization policy in Russia slowed down the decline of the rouble exchange rate and made operations in foreign currency less profitable.

We also divided the Moscow banks into three groups according to the share of foreign currency assets in their total assets,[8] which provides some further evidence of decreased reliance on foreign currency operations during the stabilization of the rouble exchange rate. In our sample, the number of banks with a high share (over 75%) of foreign currency assets dropped during 1995 from 40 to 26, and to 10 during 1996; their share of the assets of the entire sample fell from 37% to 18% in 1995 and to 3% by the end of 1997; and their average size (in terms of assets) compared to the average of the entire sample declined and this ratio then remained below its level of early 1995.

But the process of dedollarization turned and during the second half of 1997 the shares of both foreign currency assets and liabilities grew. The largest banks in the sample (alongside the federal government) attracted finance from non-residents in different forms (e.g. syndicated loans and eurobond issues). The growth of foreign currency assets was less rapid. Dedollarization

7 Operations in foreign currency denote operations in convertible currencies, mainly the US dollar. The share of balance sheet items in currencies with limited convertibility (some of the currencies of the former Soviet republics) has been extremely low in the balance sheets of the Moscow banks.

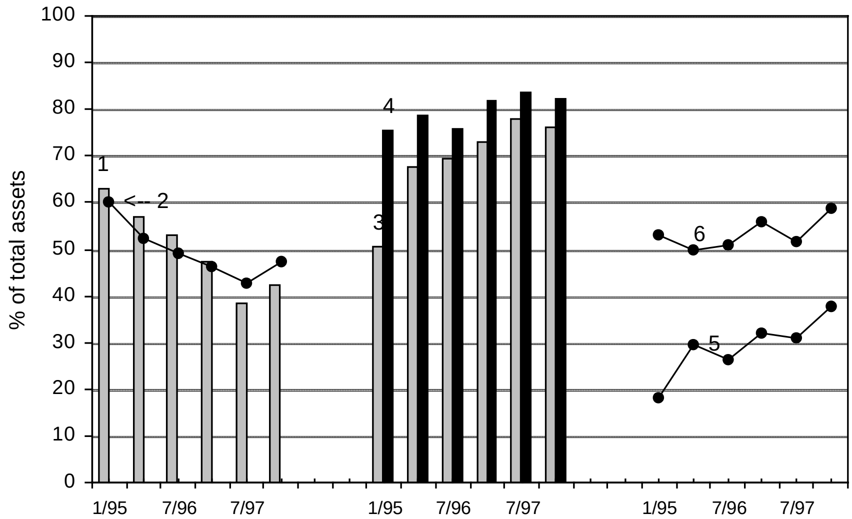
In the balance sheets of the Moscow banks the share of foreign currency items as of 1 January 1995 was 2.5 times as large as among the regional banks on which we had data (203 banks) and 2.6 times as large on 1 January 1996 (when our data covered 217 regional banks). The data on all the banks apparently underestimates the real situation, since it was not possible to separate foreign currency items under each balance sheet item, for example, to divide time deposits into foreign currency deposits and rouble deposits.

8 Balance sheet data on the three groups is presented in Annex 2.

and the turn to the opposite on the Moscow banks' balance sheets happened in a manner that turned their net foreign exchange position from strongly positive to strongly negative, mainly from mid-1996 to mid-1997 (Figure 5).

With regard to profitable assets and costly liabilities, the structure of the balance sheet of the Moscow banks underwent major changes, especially in 1995. As a major development, the share of interest-earning assets (assets that provide high interest income and consist mainly of loans to the non-financial sector, interbank loans and government securities) increased considerably in 1995, climbing further in 1996-97 to around 75% (Figure 4).

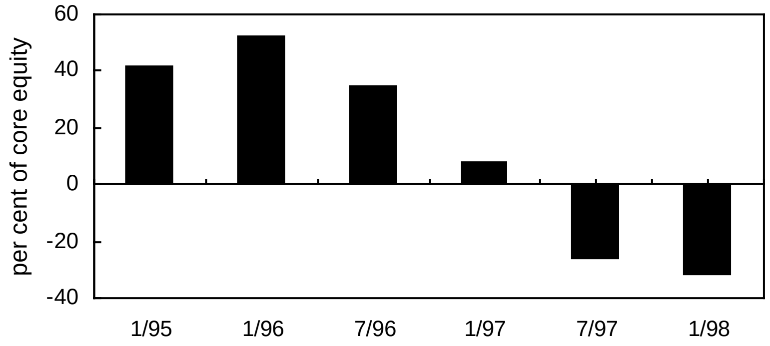
Figure 4 **Foreign currency assets and liabilities, profitable assets and costly liabilities in the total balance sheet of the sample of Moscow banks in 1995-98 (at the beginning of month), in per cent of total assets**



1 Foreign currency assets
2 Foreign currency liabilities
3 Interest-earning assets[1)]
4 Assets earning financial income (item 3 plus liquid assets in foreign currency)[2)]
5 Interest-bearing liabilities (liabilities with high interest rates)[1)]
6 Liabilities incurring financial expenditure (item 5 plus non-interest bearing liabilities in foreign currency)[2)]

[1)] For the full composition of these categories of assets and liabilities, see Annex 3.
[2)] Excluding settlements for transactions in foreign currency

Figure 5 **Net foreign exchange position of the sample of Moscow banks in 1995-98, in per cent of core equity (Tier One Capital)**



In addition, due to the decline of the rouble exchange rate the banks were earlier also able to profit (in rouble terms) from liquid foreign currency assets. When these assets are added to interest-earning assets, the share of this broader category, here called assets earning financial income, amounted to more than 75% of total assets in 1995-96 and also grew somewhat (to over 80%) since mid-1996. By implication, the share of liquid foreign currency assets in the balance sheets decreased significantly in 1995 and early 1996 when they became less profitable with the stabilization of the rouble exchange rate (balances held on correspondent accounts in foreign currency in other banks were drawn down drastically). After the shift, the share notably stabilized (at 6 to 9%).

From the cost point of view, the structure of liabilities of the Moscow banks developed in a way similar to assets during 1995-97. As the evolution of the Russian banking system coincided with high inflation, the share of interest-bearing liabilities (composed mainly of interbank loans and time deposits) was rather small in most banks, a notable exception being the Savings Bank (Sberbank) where the share of household deposits was high from the Soviet era and which (unlike other banks) enjoys state guarantees for deposits. In our sample of Moscow banks their share increased remarkably in 1995 and grew further in 1996-97 approaching the 40% level. However, with the falling rouble exchange rate, non-interest bearing liabilities in foreign currency were earlier also costly to the banks in rouble terms. Adding them to interest-bearing liabilities raises the share of costly liabilities (here called liabilities incurring financial expenditure) to roughly 50% throughout 1995-97. Thus, the share of non-interest bearing liabilities in foreign currency fell in 1995 at the same time when their cost diminished due to a more stable rouble exchange rate. Since early 1996 the share remained rather stable (at roughly one fifth to one quarter).

5 Portfolios of the Moscow banks shifted towards enterprises and the government

Claims of the Moscow banks in our sample on the banking sector decreased significantly as a share of their total assets during 1995-97 (figure 6). First and foremost, the amounts kept by the banks on correspondent accounts in other banks were reduced from early 1995 until mid-1997. A similar change took place, as a strong drawdown in 1995, with funds held by other banks on correspondent accounts in the Moscow banks. In both directions, the relative use of foreign currency accounts fell, primarily in 1997.

The second factor were the ups and downs of the Moscow interbank loan market. The banking crisis of August 1995 was reflected in our balance sheet data in the shrinking share of interbank rouble loans. In 1996-97 the role of loans given to banks was on the decline, and 65 to 70% of them were extended in foreign currency, most of which to non-resident banks. On the other hand, the share of loans received from banks was on the rise and their revival actually pushed up the share of liabilities to banks in our sample. In 1996-97, as much as 75 to 88% of liabilities on interbank loans received were in foreign currency, and mainly from non-resident banks.

In turn, the share of claims on the non-financial sector grew strongly in the banks' assets since 1995, reaching two thirds in 1997 (Figure 6). The share of liabilities to the non-financial sector also increased until mid-1996, staying at around 45% thereafter. Interdependence between the Moscow banks and the non-financial sector increased through 1995-97 because of growing portfolios of federal and municipal securities and discounted enterprise bills of exchange as well as corporate securities. The stock of loans granted, almost all of it short-term, also remained large.

In the banks' liabilities to the non-financial sector, negotiable instruments (most of them in roubles and with a maturity of over 90 days) increased their share. The role of transaction accounts, which were increasingly in roubles but mostly still in foreign currency, gained somewhat in importance. Deposits, which mainly had a maturity of over 90 days, lost their share slightly in the banks' balance sheet since summer 1997.

As for other balance sheet items, settlements for transactions lost their share, especially as a funding device, during 1995-97. Close to all balances on settlement accounts, both in assets and liabilities, were continuously in foreign currency. Equity capital gained some more weight in the Moscow banks' balance sheet until early 1997, as did bank premises et al. until summer 1996.

Past-due loans have been a specific issue in the Russian banking sector. When adjusting to the high returns on rouble loans the banks ran into the problem that the high interest rates made it difficult for clients to repay. In our sample of Moscow banks, the share of past-due loans in the assets increased until mid-1996 (Figure 7), as did their share of loans given, but then declined. These figures must be interpreted with caution, particularly as the sample did not include some of the largest banks such as Vneshekonombank, Sberbank, Agroprombank of the Russian Federation, and some other banks originating in the Soviet era. Therefore the figures were essentially lower than for all Russian banks whose books, according to data published by the Central Bank, showed that the share of past due loans of loans given was 8% on 1 January 1996, 10% on 1 July 1996, 9% on 1 January 1997, over 10% on 1 July 1997 and 7.5% on 1 December 1997, and interest arrears made up another 10% in late 1997.[9] In banks outside Moscow the situation is apparently worse.[10] In our sample, the declining share of past-due loans after mid-1996 may reflect various background developments ranging from better bank management to increased reluctance of banks to announce past-due claims but rather to roll them over as if they were normal credit.

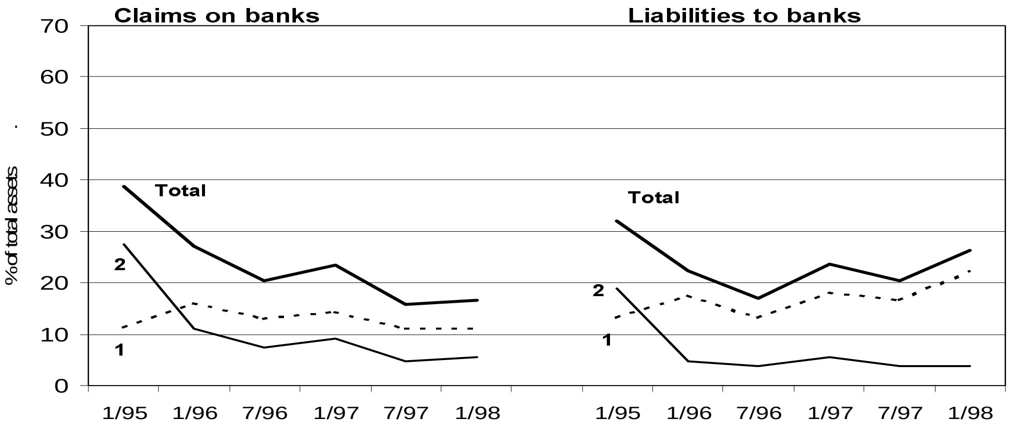
In the banks' activities vis-à-vis the non-financial sector, a central phenomenon were

[9] Calculated from data in Byulleten´ bankovskoi statistiki, various issues. Two banks, Sberbank and Vneshekonombank, accounted for 44% of all past-due loans on 1 January 1996 and for 40% from 1 July 1996 through 1 July 1997; the third bank having large amounts of past-due loans, Agroprombank, accounted for about 4% on 1 January 1996. If Vneshekonombank, which has a special position in the Russian banking system, is excluded, the share of past-due loans of loans given was down to 6.2% on 1 January 1996, 7.9% on 1 July 1996 but remained at 7.5% on 1 December 1997. Thus, the decline of past-due loans of all Russian banks in autumn 1997 was almost fully accounted for by Vneshekonombank´s falling past-due claims.

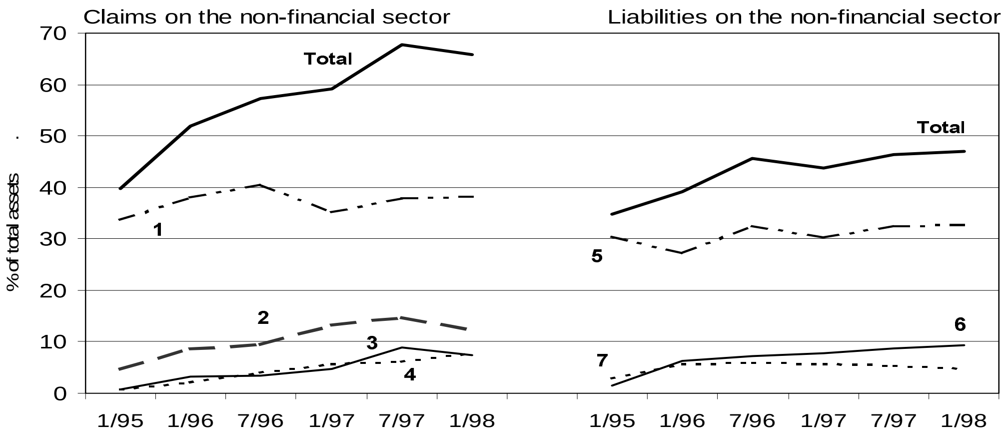
[10] Our partial data indicate that the share of past-due loans in the assets of a group of 362 regional banks was 4.4% on 1 January 1995 (0.8% in our sample of Moscow banks) and 4.5% on 1 January 1996 in a group of 359 regional banks (1.6% in our sample). Also, different rules of book-keeping caused a difference in the structure of past-due loans in Moscow banks and regional banks. In Moscow banks, which mainly grant foreign currency loans, past-due loans were dominated by unpaid principal, 0.8% of assets on 1 January 1995 and 2.44% on 1 July 1996; unpaid interest stood for 0.5% and 0.8%, respectively. In regional banks, which mainly grant rouble loans, past-due loans were dominated by unpaid interest, 10.3% of assets on 1 January 1995 and 7.2% on 1 January 1996; unpaid principal stood for 4.4% and 4.5%, respectively.

investments in government securities (which here consist of federal and municipal securities), in particular since they played an important role in the profitability of banking operations. Their share in the assets of the Moscow banks nearly doubled in 1995 and grew further until mid-1997

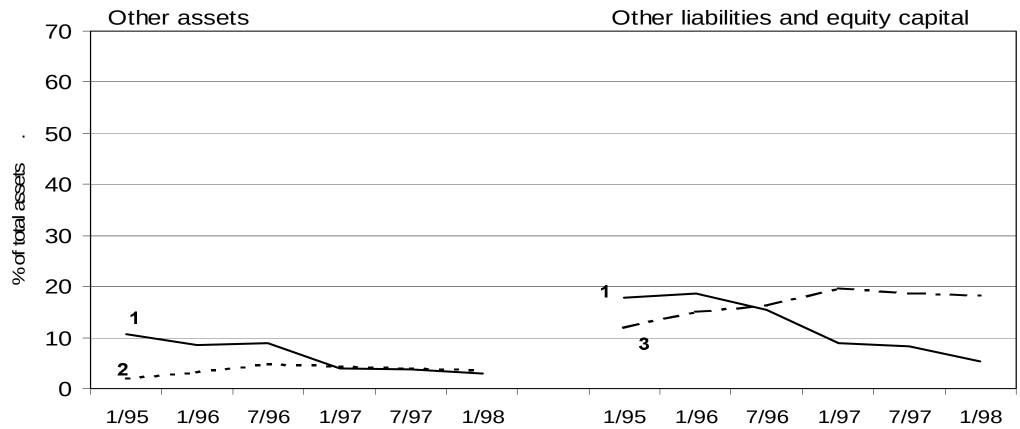
Figure 6 **Structure of the Moscow banks' balance sheet in 1995-98 (at the beginning of month), in per cent of total assets**



1 Interbank loans
2 Correspondent accounts in/of commercial banks

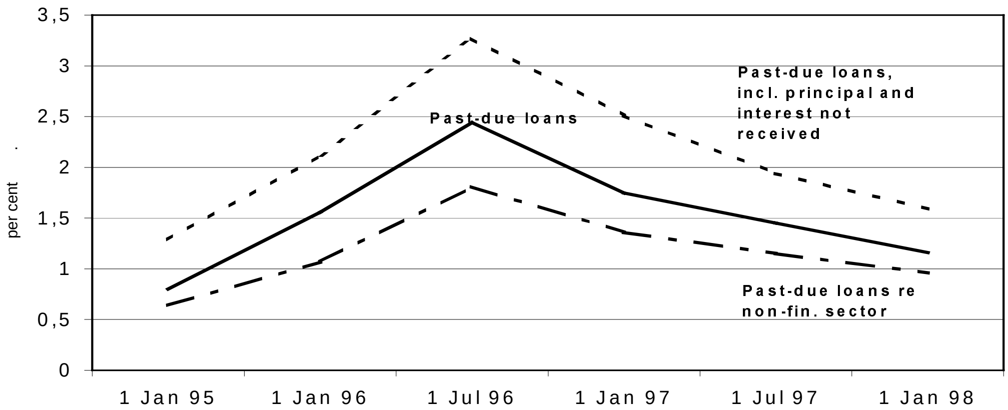


1 Loans, incl. past-due loans
2 Federal and municipal securities (in accordance with the Central Bank regulations, certain government securities, i.e. domestic foreign currency bonds (OVVZ), are accounted as non-government securities)
3 Discounted bills of exchange, incl. past-due bills
4 Corporate and other non-government securities, incl. domestic foreign currency bonds (OVVZ), and participating interest
5 Transaction accounts (incl. budgetary accounts and accounts for financing construction)
6 Negotiable instruments (CDs, promissory notes)
7 Term deposits by individuals and legal entities



1 Settlement for transactions
2 Bank premises, equipment and other tangibles
3 Equity capital

Figure 7 **Past-due loans (assets) of the Moscow banks in 1995-98, in per cent of total assets**



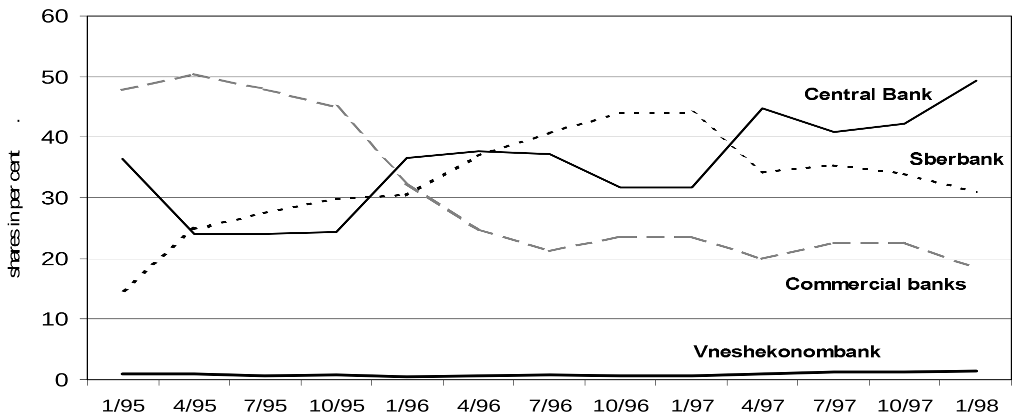
(Figure 6). Banks holding relatively large portfolios of government securities (more than 15% of assets) were rather small in terms of assets (between 10 and 100 million roubles) still in 1996, but by the end of 1997 the average size of assets of such banks had risen close to the average of the entire sample. Such banks enjoyed higher than average return on assets.

Although government securities gave a very high return, they were also subject to a high interest rate risk (as high volatility of prices made it difficult to forecast the return) and political risk. The risks had an especially strong effect on banks in spring and summer 1996 when massive borrowings by the government caused a collapse of prices and the market was in a state of fever until the Presidential election held in summer.[11] During autumn 1997 to summer 1998 the banks encountered both increasing interest rate volatilities and instances of falling liquidity in some segments of government securities markets; due to price declines of government securities, the share of government securities in the Moscow banks' portfolios already shrank in autumn 1997.

[11] In the balance sheets of our sample of Moscow banks the share of federal securities declined from 10.4% on 1 February 1996 to 8.9% on 1 May 1996, before rising to 9.5% on 1 July 1996.

To put the issue of government securities in a broader context, it must be noted that investments by Russian banks in them have increased less rapidly than the entire volume of state borrowing. As a whole, the market is characterized by high concentration, and data available indicate that most government securities were in the portfolios of Sberbank and the Central Bank of Russia (Figure 8 and Table 2).

Figure 8 **Federal government debt certificates in the Russian banking sector in 1995-98 (at the beginning of quarter), shares in per cent**



Source: Tekuchtchye tendentsii v denezhno-kredytnoi sfere, various issues.

Table 2 **Banks with largest portfolios of government rouble-denominated securities on 1 January 1996 and 1998 (rank on 1 January 1998), share of portfolio of the entire volume outstanding, in per cent *)**

	1 Jan 1996	1 Jan 1998
Sberbank	36.4	26.5
Inkombank	0.9	0.9
Vneshtorgbank	0.8	0.8
Avtobank	0.7	0.7
City Bank T/O	0.4	0.6
Menatep	n.a.	0.6
Bank Moskvy	n.a.	0.6
Republic National Bank of New York	0.4	0.5
Chase Manhattan Bank International	0.9	0.5
Natsionalnyi reservnyi bank	1.1	0.4
Rossiiskiy kredyt	0.5	n.a.
Mosbiznesbank	0.6	n.a.
Total for the ten largest portfolios	**42.6**	**32.1**

* Securities of the federal government include short-term Treasury bills (GKO), federal bonds (OFZ), state savings bonds (OGSZ), treasury obligations of the Ministry of Finance (KO), promissory notes of the Ministry of Finance and long-term state securities (GDO).

Sources: Central Bank of Russia, Finansovye Izvestija, Interfax - AiF, calculations by the authors.

6 Returns on the Moscow banks' operations in roubles became more stable and remained positive

In this chapter we briefly review, on the basis of our data on the Moscow banks, how the returns changed in 1995-97 on their most important banking operations, i.e. rouble loans and deposits, interbank loans and government Treasury bills. We further provide a comparison of the returns on banking operations in roubles and foreign currency.

In general, interest rates on rouble instruments used by Russian banks tended to follow the developments and expectations of inflation in 1995-97, although there were instances when other factors pushed them up. Thus, in 1995 nominal interest rates on rouble instruments still fluctuated strongly, jumping first to very high levels in early 1995 as inflation had accelerated in late 1994 and maintained expectations of further rapid inflation (Figures 9 and 10). With falling inflation in spring 1995, nominal rates declined and that tendency continued through most of 1996-97.

The trend of declining nominal interest rates became destabilized on two occasions in 1995-96. First, in summer 1995 a number of banks experienced serious financial difficulties (which was due to the tightening fiscal and monetary policies of the Government and the Central Bank, appreciation of the rouble exchange rate and risky lending policies). Interest rates in the interbank market started to rise and in August 1995 a liquidity crisis broke out leading to a steep decline of the interbank loan volume. The fall in interest rates on loans and deposits also came to a halt and in the aftermath the lending rates increased again. Secondly, in summer 1996 the political situation before the Presidential elections, the deepening government budget deficit and periodic apprehensions in the market of the liquidity of large market operators kept interest rates in the interbank market quite unstable and prevented lending and deposit rates from declining.

As an important feature of the Russian banking market in 1995-97, the decline of inflation lead to more established positive real interest rates on rouble instruments since early 1995. Real interest rates continued to rise rather fast until late summer 1996, largely because of the special circumstances, and only thereafter they were sliding downwards (Figures 9 and 10).

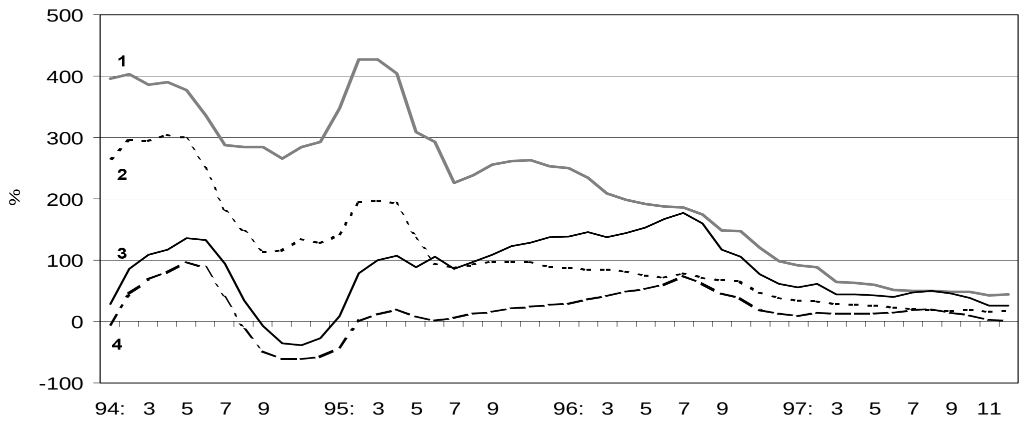
With regard to short-term Treasury bills of the Federal Government (GKOs), in 1995-96 interest rates on them reacted to the different factors earlier than interest rates on loans and deposits. In that comparison the interest rate on 3-month GKOs (in primary auctions) also varied considerably (Figure 11). Changes in interest rates on GKOs took place more closely with the developments in the interbank market, which in Moscow was dominated by one-day operations, and in fact the interconnection of these two segments of the money market had become well recognised.

Apart from the fluctuations that occurred in the different segments of the Russian money market in 1995, interest rates on GKOs varied quite strongly in 1996 as well. In spring 1996 massive borrowing by the Government pressed down the prices and interest rates on GKOs increased sharply. The second increase of GKO rates came in summer 1996 when the market was affected by a political risk stemming from the coming Presidential election.

Federal government securities played the major role in the Russian financial markets. In order to lower interest rates the Government and the Central Bank undertook a range of measures since summer 1996, including efforts to limit the federal government's domestic borrowing. Though not quite on target, nominal interest rates on GKOs came down during autumn 1996, and by autumn 1997 they reached the level of about 20%. But a withdrawal of foreign investors from the GKO market, which was at least partly a consequence of the financial crisis in East Asia, pushed the rates up in late 1997 and again early 1998.

In the Russian money market the relationship between the rates of return on rouble instruments and foreign currency instruments changed a couple of times during the past few years, requiring from the banks flexibility in respect of operations in assets and liabilities. Due to high inflation and a quick depreciation of

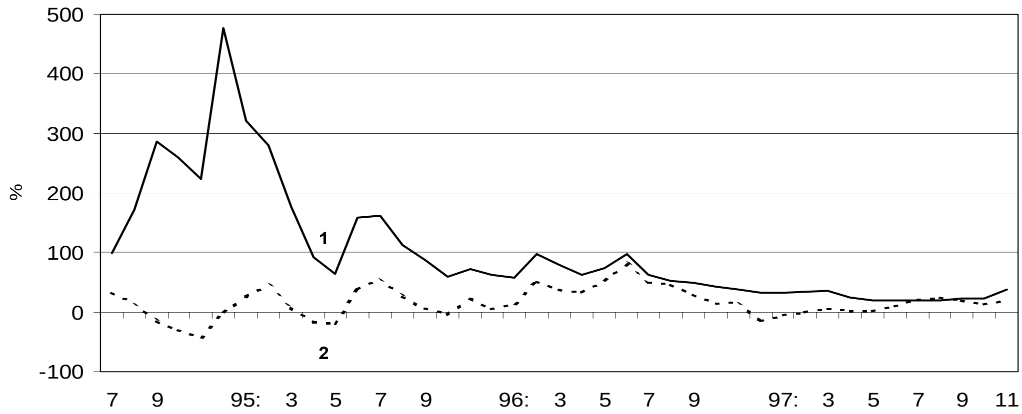
Figure 9 **Nominal and real interest rates (compounded) on 3-month rouble loans and deposits in 1994-97**



1 Nominal interest rate on rouble loans
2 Nominal interest rate on rouble deposits
3 Real interest rate on rouble loans
4 Real interest rate on rouble deposits

Note: The interest rates were calculated on the basis of interest rates announced by leading Moscow banks for loans to and deposits by legal entities. The compounded nominal rates were deflated using the consumer price index assuming reinvestment of funds at the beginning of each month. The rates are monthly averages compounded to annual level.

Figure 10 **Nominal and real interest rates on 7-day interbank loans in 1994-97**



1 Nominal interest rate (compounded)
2 Real interest rate

Figure 11 **Nominal interest rates (compounded) on 3-month Treasury bills (GKOs), rouble loans and rouble deposits in 1994-97**

1 Rouble loans
2 Rouble deposits
3 3-month Treasury bills (GKOs)

Note: The interest rate on GKOs is for GKOs sold in primary auctions and for their full maturity until the moment of repayment. The rates are monthly averages compounded to annual level.

Before January 1997 GKO issues were classified in maturities of 3, 6 and 12 months. From January 1997 maturities of new issues started to diverge from the earlier. For calculation, 3-month issues since January 1997 were defined as those with maturities of less than 135 days.

There were no primary auctions of 3-month GKOs in June 1996, November 1996 to January 1997, May 1997 and July 1997, and as a proxy, data on 6-month GKOs auctioned was used.

the rouble exchange rate, the highest returns (in rouble terms) to banks were, still in late 1994, accruing from foreign currency instruments such as loans to the non- financial sector, interbank loans and correspondent accounts, which in a stable economy only give a low return.

With financial stabilization in spring 1995, the situation changed when the depreciation of the rouble slowed down considerably. Thus, during 1995 rates of return on different rouble instruments became drastically higher than the returns on foreign currency instruments, and the same happened with the cost of most rouble liabilities (Table 3). The real rates of return on foreign currency instruments also remained negative until late 1995. The situation where nominal returns and cost on rouble items was higher than on foreign currency items persisted for most instruments in 1996, although the difference narrowed down. For example, the returns on foreign currency loans and deposits fell very sharply in spring 1995 and stayed below the returns on the respective rouble instruments (though the difference was shrinking) until autumn 1997 (Figure 12). In late 1997, returns on both types of loans and deposits were merging as returns on rouble loans and deposits continued to crawl down and returns on foreign currency loans and deposits were climbing up slowly since summer 1997.

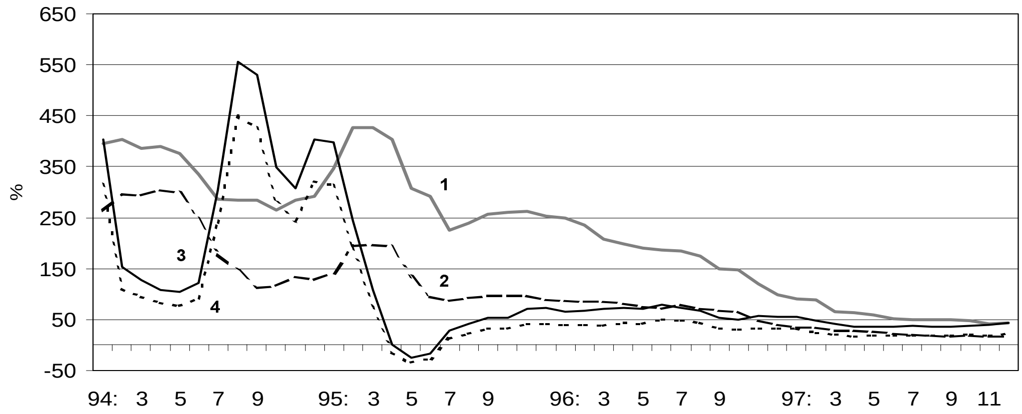
As a result of the developments, in early 1995 funding through foreign currency time deposits and lending in roubles became more advantageous to the banks. However, the Moscow banks improved the structure of their operations with a delay, increasing first the share of transaction accounts in foreign currency. Lending policies were not reoriented very actively either. The share of rouble loans given to the non-financial sector in the assets grew somewhat, but the share of the foreign currency loans was higher than the share of rouble loans still at the end of 1996. The situation changed in favour of rouble loans only by mid-1997.

Table 3 **Rates of return/cost on balance sheet items in large Moscow banks in rouble terms in 1994-97, per cent per annum**

	Uncompounded nominal rate of return (assets) / cost (liabilities)						Compounded nominal rate of return (assets) / cost (liabilities)					
	1994	1995	1996		1997		1994	1995	1996		1997	
	Dec	Dec	Jun	Dec	Jun	Dec	Dec	Dec	Jun	Dec	Jun	Dec
Assets:												
Loans and bills of exchange												
- in roubles	163	148	120	75	43	38	292	252	186	99	51	44
- in foreign currency	33	36	35	33	26	27	321	65	71	51	28	43
Federal and municipal securities	112	104	87	30	18	30	168	152	120	33	19	33
Cash												
- in roubles	0	0	0	0	0	0	0	0	0	0	0	0
- in foreign currency	0	0	0	0	0	0	206	17	23	10	-0.2	10
Due from the Central Bank	0	0	0	0	0	0	0	0	0	0	0	0
Compulsory reserves at the Central Bank	0	0	0	0	0	0	0	0	0	0	0	0
Liabilities:												
Liabilities to the Central Bank	180	160	120	48	30	28	435	349	214	60	34	32
Deposits and other debt instruments												
- in roubles	91	69	57	34	21	16	127	89	70	39	23	17
- in foreign currency	15	16	16	16	12	10	255	37	43	29	12	21
Transaction accounts												
- in roubles	20	20	20	3	3	3	22	22	22	3	3	3
- in foreign currency	3	3	3	2	2	2	215	20	26	12	2	12
Items appearing both as assets and liabilities:												
Interbank loans												
- in roubles	117	54	56	27	14	29	218	71	75	31	15	34
- in foreign currency	20	9	9	6	6	72	74	28	35	17	6	18
Due from/to banks												
- on rouble accounts	20	20	20	3	3	3	22	22	22	3	3	3
- on foreign currency accounts	3	3	3	2	2	22	15	20	26	12	2	12
Other assets and liabilities												
- in roubles	0	0	0	0	0	0	0	0	0	0	0	0
- in foreign currency	0	0	0	0	0	0	206	17	23	10	-0.2	10
Memo:												
Change of the US dollar against rouble (compounded to annual level), per cent							206	17	23	10	-0.2	10

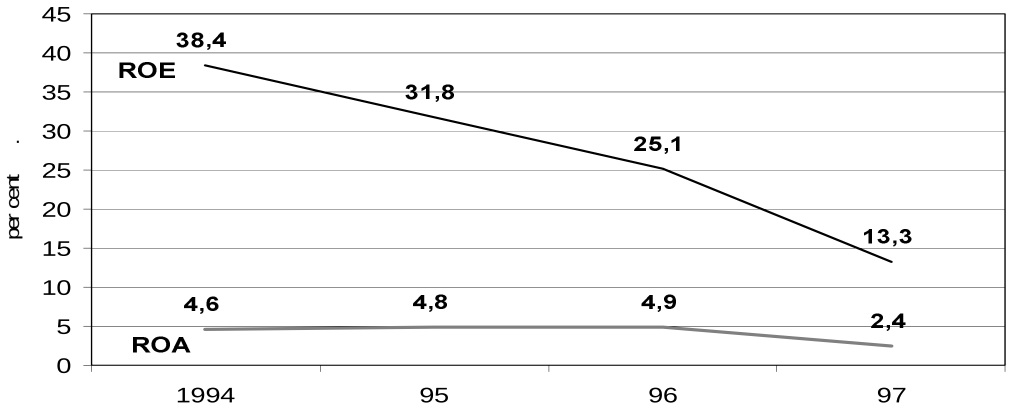
Note: The rates of return/cost were calculated using the interest rates announced by large banks in Moscow. The uncompounded rates were used to calculate the compounded rates of return, assuming reinvestment of funds and the duration of investment (the assumption was three months for credits and deposits and one week for interbank loans). The compounded rates of return on foreign currency instruments were calculated in rouble terms taking into account exchange rate changes.

Figure 12 **Nominal interest rates (compounded) on rouble loans and deposits, and foreign currency loans and deposits accounting for exchange rate changes, in 1994-97**



1 Rouble loans
2 Rouble deposits
3 Foreign currency loans
4 Foreign currency deposits

Figure 13 **Profits of the sample of Moscow banks, in per cent of assets (ROA) and balance sheet equity capital (ROE) in 1994-97**



7 The Moscow banks' profitability started to decrease, liquidity varied, and required reserves and capital adequacy were subject to developing regulations

The Moscow banks in our sample, as a whole, showed profit in 1995-96 at the level of 4-5% of assets but their profits fell to 2-3% in 1997. Compared to equity capital, the profits diminished markedly (Figure 13). However, a bank's profit as shown on the balance sheet has not reflected all sources of income in Russian conditions, as it has left out the income from currency revaluation, which formed the main part of income for many large Moscow banks when the rouble exchange rate was falling rapidly. This situation has stemmed from accounting rules that have provided for separate accounting of part of the income from the foreign currency position.

The price that the Moscow banks had to pay in 1995 for maintaining their profit/asset ratio at the level of 1994 by making structural changes in their balance sheets (besides a more risky structure of assets), was weakening liquidity. In 1995, the share of liquid assets in all assets declined and the share of current liabilities grew.[12] The share of liquid assets declined mainly due to the falling share of funds on correspondent accounts, which was only partly compensated for by growing portfolios of government securities. In the first half of 1996 this process continued, and thus the ratio of liquid assets to current liabilities (both excluding interbank loans) decreased until mid-1996 (Figure 14). However, since then the liquidity of the Moscow banks improved as a result of growing holdings of federal government securities.

When assessing the liquidity of Moscow banks in particular, it was also necessary to take into account loans granted in the interbank market where contracts were basically made for one day or a couple of days. With this refinement the decline of liquidity of the Moscow banks until mid-1996 appeared less steep, which entailed increased dependence of Moscow banks on the interbank market as a means of supporting liquidity. On the other hand, since mid-1996 the improvement of their liquidity relied more on other liquid assets than interbank loans.

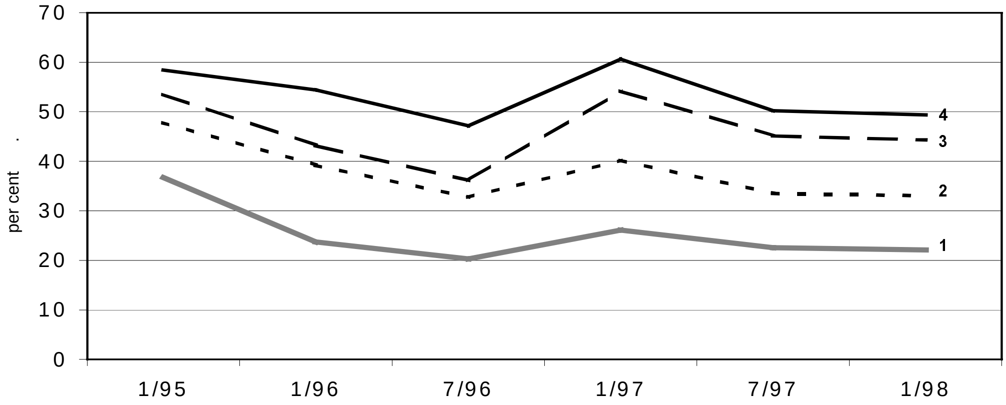
During the past few years, Russian banks were affected by various changes in the normative base of banking. The changes came both from new and amended legislation (for example, the entry into force of the Civil Code and the Law on securities market as well as amendments to the Law on banks and banking) and amendments made by the Central Bank in regulatory norms.

Among the changes, to regulate liquidity in banks, reserve requirements on commercial banks' liabilities as well as the rules of calculating the reserves were adjusted in the course of 1995-98. In total assets of our Moscow banks, decreases of the requirements on rouble liabilities brought down somewhat the share of required reserves deposited in roubles at the Central Bank (Figure 15). However, a rising reserve requirement on foreign currency liabilities since summer 1996 clearly pushed up the share of required foreign currency reserves and had a tightening effect on the Moscow banks' liquidity.

Turning to capital adequacy, we face the fact that the measurement of capital adequacy of banks changed considerably in Russia in 1996-97 due to amendments in regulatory norms. The changes were launched in several steps. The amendment of rules at the end of 1995 had only

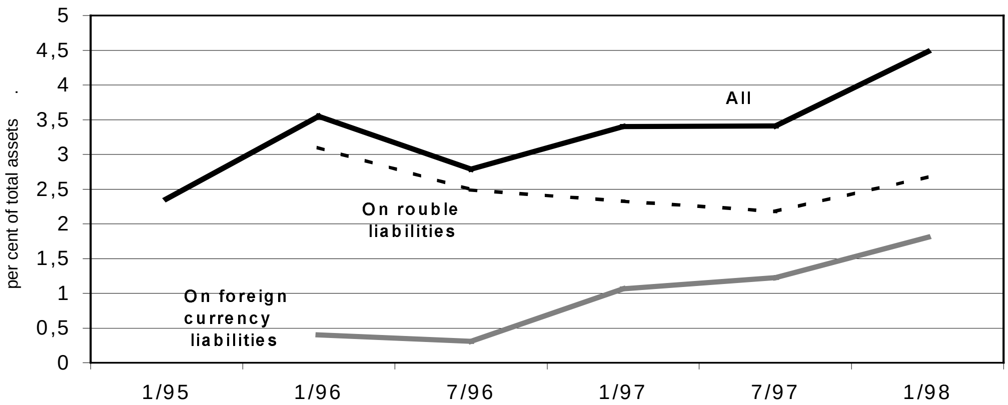
[12] For the analysis we used some indicators that characterize the liquidity of banks. The liquidity of assets was analyzed with two indicators, LA1 and LA3. LA1 is composed of assets that are most liquid, i.e. cash, the correspondent account at the Central Bank, correspondent accounts in commercial banks, precious metals and federal government debt certificates. LA3 consists of LA1 and interbank loans given (as the Moscow interbank market works mainly on one-day basis). Current liabilities were analyzed with two indicators as well, ODV2 and ODV3. ODV2 consists of liabilities whose maturity is not laid down in the contract, i.e. transaction accounts and current accounts, demand deposits of budgetary institutions (including off-budgetary funds), funds for capital construction and settlement for transactions. OVD3 consists of ODV2 and interbank loans received (which are of a very short-term nature).

Figure 14 **Indicators of liquidity in the sample of Moscow banks in 1995-98 (at the beginning of month), per cent**



1 Liquid assets excluding interbank loans / assets
2 Liquid assets including interbank loans / assets
3 Liquid assets excluding interbank loans / current liabilities excluding interbank loans
4 Liquid assets including interbank loans / current liabilities including interbank loans

Figure 15 **Required reserves deposited by the Moscow banks at the Central Bank in 1995-98 (at the beginning of month), per cent of total assets**



a small impact on the measured values of capital and risk-weighted assets. The new rules of 1 April 1996 had a very big effect, tightening the norms essentially (Table 4).

By our estimates, the methodological change reduced the capital adequacy ratio from over 50% to about 20% in our sample of Moscow banks and brought it much closer to the ratio calculated by applying the recommendations of the Basle Committee, e.g. the Cooke coefficient.

The Cooke coefficient obtained very high values for the capital adequacy of the sample of Moscow banks, around 20% in 1996, and indicated a notable increase in the banks' capital adequacy in 1996 (though the figures for different dates in 1996 are not fully comparable). The ratio calculated according to the new rules of the Central Bank showed a similar increase. In addition, in 1996 the number of banks with a Cooke coefficient below the recommended norm (8%) decreased, their average size declined and their share of consolidated assets of the sample fell considerably (from 17% to 8%).[13]

The most significant changes on 1 April 1996 concerned the appraisal of the riskiness of assets, thus affecting the value of assets which is used as the denominator of capital adequacy ratio. The new rules increased the value of risk-weighted assets drastically as risk coefficients were raised and flaws in the earlier regulations were eliminated (due to the flaws a considerable part of assets had not been subject to risk appraisal). The new rules of 1 April 1996 applied the methodological principles of the Basle Committee but imposed on Russian banks requirements that were stricter than international standards.

The new rules of April 1996 also contained features that were characteristic to Russian banking practice. For example, risk coefficients for funds held on correspondent accounts in other banks were differentiated according to the home country of the correspondent bank (20% for the OECD countries and 70% for Russian banks and 100% for other countries). A stricter approach to defining coefficients of riskiness of different types of assets provided some counterweight to the orientation of the new rules to a rather low requirement for the capital adequacy ratio (8% at that time). In October 1997 rules of calculating risk-weighted assets were changed further in accordance with the Basle Committee recommendations by raising the risk weight for investments in fixed assets from 70 to 100%.

The rules of April 1996 had opposite effects on calculating the value of capital. The Central Bank stopped the practice where investments made in shares and other similar assets were deducted from capital, but at the same time new deductions from assets were introduced.[14] Anyhow, these changes did not have a big effect on the value of regulatory capital. In October 1997 some further changes were introduced, such as the requirement to subtract from capital those loans which were given to shareholders and insiders in excess of regulatory limits, and redefined limits on investments in fixed assets not subtracted from capital.

8 The Moscow banks which lost their licenses of operation had their balance sheets concentrated more in claims on the non-financial sector

In 1996, licenses of operation were withdrawn from almost 30 banks in our sample of Moscow banks, and the pace accelerated to 76 during 1997, bringing the total number of withdrawals in our data to over 100. In the following, we compare the balance sheets of the problem banks and the entire sample (Table 5; a full presentation of balance sheets of the two groups is contained in Annex 3).

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[13] Due to the special technical features of calculating the capital adequacy ratio according to the Central Bank methodology (see footnote 15) it was not possible to use the capital adequacy ratio for assessing changes in the reliability of the banks in the first half of 1996.

[14] For example, a part of funds on the account "Other operations in foreign currency" was deducted from equity capital.

Table 4 **Indicators of capital adequacy and riskiness of assets in the sample of Moscow banks in 1995-98, in per cent of assets (except capital adequacy ratios)[*]**

	1995 1 Jan	1996 1 Jan	1 Mar	1 Apr	1 Jul	1 Oct	1997 1 Jan	1 Jul	1 Sep	1 Oct	1998 1 Jan
Equity capital	12	15	18	16	17	19	20	19	19	17	18
As defined by Instructions Nr. 1 valid on the respective date:											
Capital	11	12	15	14	15	16	17	16	16	15	17
Risk-wighted assets	23	26	27	70	71	68	67	69	71	74	73
Capital adequacy ratio15	47	49	54	20	21	24	26	23	22	20	22
According to the methodology of the Basel Committee:											
Core capital (Tier One Capital)	7	9	11	10	10	12	13	16	16	15	16
Capital base	9	11	14	13	13	15	16	16	16	15	16
Risk-weighted assets	58	62	66	63	64	63	58	70	72	67	66
Capital adequacy ratios for core capital	11	14	17	16	16	19	23	23	22	22	24
Cooke coefficient	15	18	21	20	20	23	28	23	22	22	24

[*]664 banks on which there was data for 1996 and 566 banks for 1997.

Notes:
1. Supplements to the balance sheets were used for calculation where possible.
2. Data for January and March 1996 are not fully comparable with the data for April 1996 and thereafter because a majority of the supplements could be used only since April. The Basel Committee ratios are not fully comparable before and after 1 July 1997. In 1997 the Central Bank changed the rules of foreign currency revaluation, and therefore most capital previously accounted as Tier Two Capital is shown as core capital from 1 July 1997.

[15] It was not possible to compare capital adequacy ratios based on the old and new Central Bank methodology on the same dates (i.e. to assess quantitatively the impact of the changes made in the Instruction), since having only balance sheet data, it was impossible to precisely calculate the value of capital and risk-weighted assets. By our estimates, the error in calculating the value of capital was about 5 % before the latest edition of the Instruction. The error increased considerably due to the new rules and it became impossible to make even a rough estimate of capital adequacy without the supplementary information which was necessary for calculating the norms concerned. The supplements also changed with the new editions of the Instruction. Therefore, two close dates were chosen to compare capital adequacy ratios based on the old and new methodology, the last day when the old supplements were effective (1 march 1996) and the first day for which we had data on the new supplements (1April 1996). Supplements also facilitated more precise calculations of capital adequacy according to the Basle methodology. For example, it was possible to avoid overstating Tier One Capital to some extent, which occurred when balance sheet information on statutory funds was used. Actual payments in the statutory fund appeared a little smaller than the fund announced and recorded in the balance sheets of non-joint stock banks; in the sample of 664 banks the ratio of payments in the fund to the fund's balance sheet value ranged between 79 % (on 1 March 1996) and 91 % (on 1 April and 1 July 1996).

Compared to the entire sample, non-interest-earning assets showed no clear dominance in the balance sheets of the problem banks over 1996-97. However, the share of settlements for transactions was much higher in the problem banks until mid-1997. Their fixed assets (bank premises et al.) also accounted for a higher share of total assets in 1996-97. In the problem banks, low liquidity associated with fewer operations with other banks and in foreign currency, which was reflected in a far lower share of funds kept on correspondent accounts in other banks, especially foreign currency accounts.

The structure of interest-earning assets in the problem banks was also essentially different from the sample. They had granted proportionately more rouble loans to the non-financial sector (but not loans in foreign currency), and they had a much higher stake of their portfolios in discounted bills of exchange. The problem banks had invested much less of their assets in government and corporate securities, and the difference was especially pronounced for government securities. They also had a lower involvement in extending both rouble loans and foreign currency loans to other banks. The share of past-due loans vis-à-vis the non-financial sector in the assets of the problem banks was considerably higher than in the sample through 1996-97.

The problem banks had considerably more of their liabilities concentrated in interest-bearing items than the other Moscow banks in 1996. But in 1997 the share of short-term interbank loans received (especially foreign currency loans) was drastically smaller in the problem banks' liabilities**.** The share of term deposits made by individuals and legal entities in the problem banks was mostly smaller than in the entire sample during 1996-97.

The dominance of non-interest bearing liabilities in the problem banks increased over 1996-97 due to increasing “other liabilities”, which were mostly liabilities reported by the banks as received from other creditors. However, there were two major items that worked to the other direction. First, the problem banks had very small balances on the accounts of budgetary institutions compared to the other banks through 1996-97. Secondly, transaction accounts accounted for considerably less in the problem banks' balance sheets during the two years. Also, the share of funds held by other banks on their correspondent accounts in the problem banks was smaller than in the entire sample through 1996-97.

The equity capital of the banks whose licenses were withdrawn was negative in 1996, due to big losses made in 1995 and the first half of 1996. In 1997, such banks made only small losses and were able to keep their equity capital technically positive but this was primarily due to growing unearned income of future periods. The value of capital, calculated both following the Central Bank methodology (of 1 January 1996) and the methodology of the Basle Committee, was negative in the problem banks in 1996 as well as in the banks analyzed with regard to 1997.[16]

[16] Supplements to the balance sheets were available for less than half of the banks which had their licenses revoked in 1997. See chapter 7 for the methodology.

Table 5 Balance sheet structure of banks that had their licenses withdrawn (within half a year after the day of reporting) and of the entire sample of Moscow banks, in 1996-97

	1996 1 January		1 July		1997 1 January		1 July	
	Lic. drawn	All	Lic. drawn	All	Lic. drawn	All	Lic. drawn	All
Number of banks	17	688	11	688	35	677	41	638
Assets per bank, million roubles	84	219	412	248	138	300	172	383
ASSETS:								
1) Non-interest-earning assets	45.6	32.3	24.6	30.5	36.9	27.1	11.3	22.2
- settlement for transactions	21.5	8.5	17.2	8.9	5.2	4.0	0.7	3.8
- bank premises, equipment and materials	10.1	3.2	1.9	4.8	5.6	4.4	4.8	3.9
- correspondent accounts, due from banks	0.7	11.1	0.7	7.5	15.1	9.1	0.9	4.8
2) Interest-earning assets	54.4	67.7	75.4	69.5	63.2	72.9	88.7	77.8
- loans to the non-financial sector (incl. discounted bills), incl. past-due loans	45.3	41.2	49.1	43.9	50.6	39.9	92.0	46.8
- short-term loans, excl. past-due loans								
- in roubles	21.8	13.9	3.1	15.7	12.1	14.6	5.4	18.9
- in foreign currency	18.3	22.4	11.5	22.3	14.3	18.6	1.9	17.2
- discounted bills of exchange, incl. unpaid	2.5	3.2	26.0	3.4	14.2	4.8	77.4	9.0
- investments in securities, net	1.3	10.8	0.8	13.4	1.4	19.2	1.6	20.8
- federal and municipal securities	0.8	8.8	0.0	9.5	0.2	13.4	1.0	14.9
- corporate securities	0.8	2.1	1.4	4.1	1.4	6.0	0.6	6.2
- interbank loans, incl. past-due loans	7.6	16.1	36.0	12.9	3.4	14.3	2.5	11.1
- interbank loans, excl. past-due loans								
- in roubles	7.2	4.3	1.7	3.6	0.6	4.0	0.4	3.8
- in foreign currency	0.1	11.4	29.0	8.8	1.5	10.0	0.4	7.1
- past-due loans to the non-financial sector	2.5	1.1	8.3	1.8	9.0	1.4	7.2	1.2
- past-due interbank loans	0.3	0.4	0.5	0.5	1.3	0.3	1.6	0.2
LIABILITIES:	101.5	85.0	102.2	83.7	83.4	80.3	85.1	81.4
1) Interest-bearing liabilities	44.2	29.7	51.2	26.5	26.3	32.1	7.2	30.8
- deposits by legal entities and individuals	7.9	5.8	0.6	5.9	2.6	5.7	1.9	5.3
- short-term interbank borrowings	26.4	17.5	26.9	13.1	11.3	18.1	1.4	16.6
- in roubles	16.2	4.6	5.3	3.5	4.3	4.1	1.3	3.5
- in foreign currency	10.2	13.0	21.6	9.6	7.6	14.0	0.2	13.1
2) Non-interest-bearing liabilities	57.3	55.4	51.0	57.2	57.1	48.2	77.9	50.6
- transaction accounts	21.7	24.3	15.6	29.6	19.0	27.6	5.4	27.9
- in roubles	13.4	9.6	3.7	8.5	11.5	9.1	3.5	10.8
- in foreign currency	8.3	14.7	11.9	21.1	7.5	18.5	1.9	17.1
- settlement for transactions	15.4	18.6	26.7	15.4	18.8	8.9	3.4	8.3
- demand deposits of budgetary institutions (incl. off-budgetary funds)	2.6	2.7	0.3	2.9	1.5	2.4	0.6	4.5
- revenues of budgetary institutions	2.6	14.7	0.3	10.9	1.5	13.8	0.6	11.5
- expenditure of budgetary institutions	0.0	12.0	0.0	8.0	0.0	11.4	0.0	7.0
- correspondent accounts, due to banks	3.0	4.8	1.2	3.8	1.3	5.5	0.9	3.8
3) Equity capital	-1.5	15.0	-2.2	16.3	16.6	19.7	14.9	18.6
- statutory fund	12.5	5.1	4.3	5.2	8.5	7.0	4.6	7.3
- profit (loss) of the current year	-19.5	4.8	-12.7	2.1	-2.4	4.9	-3.1	1.7

Annex 1 **Calculation of the consolidated balance sheet of Russian banks**

Data published on the balance sheets of Russian banks contains elements of double counting. For eliminating double counting, calculations can only be made with a varying degree of incompleteness, and estimates by different analytical institutions can differ. The methodology used in this study for analysing balance sheet data removed elements of double counting as follows:

Only the balance of the respective items in assets and liabilities was taken into account for
- the banks' inter-branch settlements
- the accounts of budgetary and extra-budgetary funds
- the funds for financing construction
- unearned income and prepaid expenses
- revaluation of foreign currency items
- revaluation of securities
- the banks' income and expenses.

Overdue interest on credits was excluded.

Capital items were taken into account according to the residual value.

Profits were reduced by the sum of distributed profits and equity capital was reduced by the value of losses.

Nominal value of shares bought back from shareholders was deducted from equity capital.

Reserves for possible losses on loans and securities were deducted from the respective items in assets.

Annex 2.

Table Main items in the consolidated balance sheet for three groups of banks in the sample of Moscow banks, grouped according to the share of foreign currency assets in total assets, in 1995-97

	1995 1 January				1996 1 January		1 July		
Share of foreign currency assets, per cent of total assets	<25	25-75	>75	<25	25-75	>75	<25	25-75	>75
Number of banks in the sample	468	140	40	494	168	26	506	153	27
Assets (average per bank), million roubles	19	339	814	44	605	1040	53	814	612
				in per cent of total assets:					
Foreign currency assets	9.0	57.3	85.6	9.3	60.3	82.8	8.6	57.6	80.4
Foreign currency liabilities	10.5	56.7	78.3	12.0	54.5	75.4	10.5	52.9	75.4
Foreign exchange position (net of assets and liabilities)	-1.5	0.6	7.3	-2.6	5.8	7.4	-1.9	4.7	5.0
Interest-earning assets 1)	60.5	56.3	39.7	70.2	65.8	72.6	68.4	69.5	68.9
Non-interest-earning assets 1)	39.5	43.7	60.3	29.8	34.2	27.4	31.6	30.5	31.1
Interest-bearing liabilities 1)	23.0	21.8	12.1	29.5	28.1	35.9	28.0	24.8	31.3
Non-interest-bearing liabilities 1)	57.8	68.1	75.6	43.6	59.3	49.9	44.6	60.1	56.5
Loans to the non-financial sector, including past-due loans	37.6	37.6	28.8	42.0	40.9	41.5	46.3	42.6	50.2
Time deposits	7.3	3.5	0.7	8.7	6.5	0.8	10.4	5.8	0.5
Interbank loans given	14.8	13.4	7.1	11.2	14.9	24.6	6.8	13.7	9.9
Interbank loans received	10.0	15.2	11.0	9.5	15.6	31.2	5.3	12.6	27.8
Securities	7.9	6.1	3.9	17.9	10.4	7.2	16.1	14.0	9.2
- of which federal and municipal securities	6.4	5.5	3.0	17.2	8.1	4.6	15.2	8.8	7.4
Loans past due, including principal and interest not received (claims on both the non-financial sector and banks)	3.3	1.7	0.2	2.8	2.3	1.1	4.7	2.9	0.8
- of which past-due loans	1.6	1.1	0.1	1.7	1.7	0.8	2.5	2.3	0.7
Equity capital	19.2	10.1	12.4	26.8	12.7	14.1	27.4	15.0	12.2
Profit	10.4	4.9	2.5	9.8	4.4	2.3	4.1	2.0	3.1
Foreign currency adjustments	0.6	3.2	7.0	0.4	4.1	7.7	0.4	5.0	2.9
Profit, in per cent of equity capital	54.0	48.3	20.0	36.6	34.3	16.0	14.9	13.6	25.0
Net foreign currency assets, in per cent of core equity (Tier One Capital)	-9.3	9.8	148.7	-12.9	74.7	123.4	-8.5	49.9	58.2

(table continued)

	1997 1 January			1 July			1998 1 January		
Share of foreign currency assets, per cent of total assets	<25	25-75	>75	<25	25-75	>75	<25	25-75	>75
Number of banks in the sample	530	135	10	518	113	6	488	103	5
Assets (average per bank), million roubles	87	1073	1252	110	1644	254	106	2165	1844
				in per cent of total assets:					
Foreign currency assets	10.4	56.2	81.9	10.0	47.0	81.8	9.7	48.4	78.3
Foreign currency liabilities	17.2	53.6	70.7	14.9	51.1	54.3	17.2	52.7	87.5
Foreign exchange position (net of assets and liabilities)	-6.8	2.6	11.2	-4.9	-4.1	27.5	-7.5	-4.3	-9.2
Interest-earning assets 1)	71.9	73.2	73.7	75.3	78.6	67.4	70.7	76.8	88.2
Non-interest-earning assets 1)	28.1	26.8	26.3	24.7	21.4	32.6	29.3	23.2	11.8
Interest-bearing liabilities 1)	32.1	32.7	25.4	26.4	32.3	7.5	28.0	38.4	72.7
Non-interest-bearing liabilities 1)	39.2	50.2	57.6	47.1	51.4	83.1	42.2	45.5	21.1
Loans to the non-financial sector, including past-due loans	41.5	39.7	36.0	49.1	45.9	66.4	47.2	44.7	61.6
Time deposits	9.5	4.9	0.8	8.2	4.5	1.8	6.4	4.5	0.1
Interbank loans given	7.2	15.3	29.6	6.9	12.3	22.4	6.9	12.4	2.1
Interbank loans received	11.6	19.7	22.8	9.6	18.9	1.7	10.3	23.3	68.8
Securities	24.2	18.7	9.6	20.4	21.4	2.4	17.7	21.1	24.8
- of which federal and municipal securities	23.0	11.1	5.5	19.0	13.7	0.4	15.4	11.6	14.0
Loans past due, including principal and interest not received (claims on both the non-financial sector and banks)	4.7	1.8	1.9	3.2	1.3	23.8	2.2	1.5	0.6
- of which past-due loans	2.5	1.4	1.8	2.1	1.0	21.8	1.4	1.1	0.3
Equity capital	28.7	17.0	17.0	26.5	16.3	9.4	29.8	16.1	6.3
Profit	8.5	4.0	3.3	2.4	1.6	-10.8	3.7	2.2	0.5
Foreign currency adjustments	0.5	4.6	9.8	0.0*	0.0*	0.0*	-0.0*	0.0*	0.0*
Profit, in per cent of equity capital	29.6	23.4	19.2	8.9	9.8	-114.6	12.5	13.7	8.1
Net foreign currency assets, in per cent of core equity (Tier One Capital)	-28.1	26.3	158.4	-22.3	-29.6	419.6	-28.3	-30.4	-160.4

1) For the full composition of these items see Annex 3.
*) Due to regulatory changes on 1 July 1997 the accrued revaluation of equity in foreign currency was, from that date, transferred to “Retained earnings of previous years”

Annex 3

Table Full balance sheet structure of banks which had their licenses withdrawn (within half a year after the day of reporting) and of the entire sample of Moscow banks, in 1996-97

	1996 1 January		1 July		1997 1 January		1 July	
	Lic. drawn	All	Lic. drawn	All	Lic. drawn	All	Lic. drawn	All
Number of banks	17	688	11	688	35	677	41	638
Assets per bank, million roubles	84	219	412	248	138	300	172	383
In per cent of total assets:								
1. Cash	0.7	1.4	0.0	1.7	0.2	1.6	0.5	1.6
2. Correspondent accounts	1.6	13.5	0.9	9.3	18.5	11.4	1.2	6.8
due from the Central Bank	0.9	2.4	0.3	1.9	3.4	2.3	0.3	2.0
due from banks	0.7	11.1	0.6	7.4	15.1	9.1	0.9	4.8
in roubles	0.4	0.9	0.6	1.8	5.7	1.6	0.5	1.6
in foreign currency	0.2	10.2	0.1	5.7	9.4	7.5	0.4	3.2
3. Required reserves at the Central Bank	6.0	3.6	1.6	2.8	3.5	3.4	1.1	3.4
4. Settlement for transactions	21.5	8.5	17.2	8.9	5.2	4.0	0.7	3.8
other foreign operations	21.5	8.4	17.2	8.8	5.2	3.2	0.6	1.9
5. Uncollected sums	0.3	0.0	1.4	0.2	0.1	0.0	0.2	0.0
6. Bank premises, equipment and other tangibles	10.1	3.2	1.9	4.8	5.6	4.4	4.8	3.9
7. Intangible assets	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.2
8. Other assets	5.2	2.0	1.3	2.7	3.5	2.1	2.7	2.5
Non-interest-earning assets (items 1 to 8)	45.6	32.3	24.6	30.5	36.9	27.1	11.3	22.2
Total loans given (incl. interbank loans and discounted bills of exchange), incl. past-due loans (i)	52.8	57.3	85.0	56.9	54.0	54.2	94.4	58.0
past-due loans	2.9	1.6	13.9	2.4	10.3	1.8	8.9	1.5
(-) reserve for possible loan losses (ii)	1.3	1.1	11.9	1.7	2.2	1.8	7.4	1.6
1. Total loans given, net (i minus ii)	51.6	56.2	73.1	55.2	51.8	52.5	87.0	56.4
Loans to the non-financial sector, incl. discounted bills of exchange	45.3	41.2	49.1	43.9	50.6	39.9	92.0	46.8
loans, incl. past-due loans	42.7	38.0	23.0	40.5	36.4	35.1	14.6	37.8
loans, excl. past-due loans	40.2	36.9	14.7	38.7	27.4	33.7	7.4	36.7
short-term loans	40.1	36.3	14.6	38.0	26.4	33.2	7.3	36.1
in roubles	21.8	13.9	3.1	15.7	12.1	14.6	5.4	18.9
in foreign currency	18.3	22.4	11.5	22.3	14.3	18.6	1.9	17.2
long-term loans	0.1	0.6	0.1	0.7	1.0	0.6	0.1	0.6
past-due loans	2.5	1.1	8.3	1.8	9.0	1.4	7.2	1.2
discounted bills of exchange, incl. unpaid	2.5	3.2	26.0	3.4	14.2	4.8	77.4	9.0
discounted bills of exchange, excl.unpaid	2.4	3.1	25.7	3.4	14.2	4.7	77.3	8.9
discounted bills of exchange past due	0.1	0.1	0.4	0.1	0.0	0.1	0.1	0.1
Interbank loans, incl. past-due loans	7.6	16.1	36.0	12.9	3.4	14.3	2.4	11.1
interbank loans, excl. past-due loans	7.3	15.7	30.8	12.4	2.1	14.0	0.8	10.9
in roubles	7.2	4.3	1.7	3.6	0.6	4.0	0.4	3.8
in foreign currency	0.1	11.4	29.0	8.8	1.5	10.0	0.4	7.1
past-due interbank loans	0.3	0.4	5.2	0.5	1.3	0.3	1.6	0.2
2. Investments	2.2	11.2	2.3	14.0	1.9	20.2	1.7	21.3
Participating interest (voting rights in non-consolidated companies)	0.9	0.5	1.5	0.5	0.6	0.9	0.1	0.5
Securities	1.6	10.9	1.4	13.6	1.6	19.4	1.6	21.0
(-) reserve for possible securities losses	0.3	0.2	0.6	0.2	0.2	0.2	0.1	0.2

(table continued)

	1996 1 Jan Lic. lost	All	1 Jul Lic. lost	All	1997 1 Jan Lic. lost	All	1 Jul Lic. lost	All
Securities, net	1.3	10.8	0.8	13.4	1.4	19.2	1.6	20.8
federal and municipal securities	0.8	8.8	0.0	9.5	0.2	13.4	1.0	14.9
corporate securities	0.8	2.1	1.4	4.1	1.4	6.0	0.6	6.2
shares	0.5	0.9	1.4	0.8	0.9	1.0	0.2	1.3
debt certificates (incl. domestic foreign currency bonds)	0.3	1.3	0.0	3.3	0.5	5.0	0.5	4.8
3. Other interest-earning assets	0.6	0.2	0.0	0.3	9.4	0.3	0.0	0.1
Interest-earning assets (items 1 to 3)	54.4	67.7	75.4	69.5	63.2	72.9	88.7	77.8
1. Deposits	7.9	5.8	0.6	5.9	2.6	5.6	1.9	5.3
deposits by legal entities	1.8	2.4	0.1	1.9	0.4	1.3	0.2	1.2
deposits by individuals	6.1	3.4	0.5	4.0	2.2	4.3	1.7	4.1
2. Short-term borrowings	26.4	17.6	26.9	13.1	11.3	18.5	1.4	16.7
borrowings from the Central Bank	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.1
interbank borrowings	26.4	17.6	26.9	13.1	11.3	18.1	1.4	16.6
in roubles	16.2	4.6	5.3	3.5	4.3	4.1	1.2	3.5
in foreign currency	10.2	13.0	21.6	9.6	7.0	14.0	0.2	13.1
3. Negotiable instruments	9.8	6.2	23.7	7.3	5.9	7.8	3.6	8.7
4. Other interest-bearing liabilities	0.0	0.2	0.0	0.2	6.4	0.2	0.3	0.0
Interest-bearing liabilities (items 1 to 4)	44.2	29.7	51.2	26.5	26.3	32.1	7.2	30.8
1. Transaction accounts	21.7	24.3	15.6	29.6	19.0	27.6	5.4	27.9
in roubles	13.4	9.6	3.7	8.5	11.5	9.1	3.5	10.8
in foreign currency	8.3	14.7	11.9	21.1	7.5	18.5	1.9	17.1
2. Accounts for capital construction	0.0	0.1	0.4	0.1	1.0	0.2	0.0	0.1
(+) funds for capital construction	3.4	2.5	0.6	1.9	3.0	2.3	0.2	1.8
(-) financing of capital construction	3.4	2.4	0.2	1.8	2.0	2.1	0.2	1.7
3. Demand deposits of budgetary institutions (including off-budgetary funds)	2.6	2.8	0.3	2.8	1.5	2.4	0.6	4.5
(+) revenues of budgetary institutions	2.6	14.8	0.3	10.9	1.5	13.8	0.6	11.5
(-) expenditure of budgetary institutions	0.0	12.0	0.0	8.1	0.0	11.4	0.0	7.0
4. Correspondent accounts (due to depository institutions)	3.0	4.8	1.2	3.8	1.3	5.5	0.9	3.8
in roubles	3.0	0.8	0.5	2.2	1.1	1.7	0.8	1.8
in foreign currency	0.0	4.0	0.7	1.6	0.2	3.8	0.1	2.0
5. Settlement for transactions	15.4	18.6	26.7	15.4	18.8	8.9	3.4	8.3
other foreign operations	15.4	17.4	24.2	13.7	4.9	6.3	1.3	5.9
6. Other liabilities	14.6	4.7	6.9	5.5	15.4	3.7	67.6	6.0
Non-interest-bearing liabilities (items 1 to 6)	57.3	55.4	51.0	57.2	57.1	48.2	77.9	50.6
1. Statutory fund	12.5	5.1	4.3	5.2	8.5	7.0	4.6	7.3
(-) treasury stock (own shares acquired)	0.0	0.0	0.0	0.1	0.3	0.0	0.1	0.0
2. Reserve fund	0.8	1.7	0.7	1.9	1.6	1.6	0.7	1.8
3. Retained earnings of previous years	4.9	3.0	0.7	4.7	6.7	4.8	0.7	8.2
4. Undistributed profit of the current year	-20.7	1.2	-13.1	0.8	-3.2	2.0	-4.0	0.9
(+) profit (loss) of the current year	-19.5	4.8	-12.7	2.1	-2.4	4.9	-3.1	1.7
(-) distributed profit of the current year	1.2	3.6	0.4	1.4	0.8	2.9	0.9	0.7
5. Foreign currency adjustments	1.3	4.3	5.7	4.1	1.2	4.0	0.1*	0.0*
(+) appreciation of assets in foreign curr.	1.3	4.7	5.9	5.9	1.3	4.0	0.1	0.0
(-) appreciation of liabilities in foreign currencies	0.0	0.4	0.2	1.8	0.1	0.0	0.0	0.0
6. Income/loss of future periods	-0.2	-0.2	-0.5	-0.1	2.2	0.3	14.5	0.4
(+) unearned income of future periods	1.3	0.9	1.6	1.5	9.2	1.6	16.2	1.4
(-) unreceived interest on loans	1.0	0.6	1.6	0.8	6.2	0.8	1.6	0.5
(-) prepaid expenses	0.5	0.5	0.5	0.8	0.8	0.5	0.1	0.5
Equity capital (items 1 to 6)	-1.5	15.0	-2.2	16.3	16.6	19.7	14.9	18.6

Total liabilities	101.5	85.0	102.2	83.7	83.4	80.3	85.1	81.4

*) Due to regulatory changes on 1 July 1997 the accrued revaluation of equity in foreign currency is, from that date, shown in "Retained earnings of previous years"

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