

# The Russian banking sector in 2000

Vladimir Goryunov

## 1. Macroeconomic background

Russia's economy recorded its strongest growth for many years in 2000; real GDP expanded by almost 8%, over twice the growth rate of 1999, which had itself been a strong year. Industrial production expanded by 9% and there was a surge in investment, which increased by 18% compared with only 5% in 1999.

Notwithstanding the rapid growth in domestic demand, the balance of payments continued to strengthen, aided by higher oil prices. The trade balance over January-September 2000 was US\$ 45 billion, compared with US\$ 23 billion in 1999.

While inflation remained high, it also showed an improving trend. The consumer price index decelerated from 37% in 1999 to 20% in 2000 and the producer price index from 67% to 32%.

## 2. Development of the banking sector

This relatively healthy macroeconomic background facilitated the decision in 2000 to clean up the banking system.

The banking system expanded rapidly in 2000, with aggregate assets growing by 47%. This was quite widely spread, with assets rising in three quarters of active banks. In real terms assets were back to 90% of pre-crisis levels and now represent 34% of GDP, a slightly larger proportion than before the crisis. Funds raised by banks increased by 55% as public confidence in the banking system increased. Within this total, the proportion raised from enterprises increased slightly to 39%, while that from households was steady at around 23% (Table 2).

The proportion of loans in the balance sheet rose but they still account for less than half of assets (Table 2). Increasingly loans are being made to corporations (Table 1) and carry 100% risk weights (Table 3).

Table 1  
Banks' loan portfolio (%)

	End-1998	End-1999	End-2000
Government	4.6	4.8	1.6
Banks	13.2	14.3	10.8
Households	4.4	4.2	4.5
Corporates	76.4	74.8	81.9
Other	1.5	1.8	1.2

Table 2  
Composition of assets, liabilities and capital (%)

	End-1998	End-1999	End-2000
<b>Assets<sup>1</sup></b>			
Deposits with central bank	0.5	0.2	0.9
Interbank deposits and loans	9.3	11.1	9.0
Total loans	38.2	38.7	42.1
Government securities	17.5	14.0	13.9
Total securities	20.6	17.2	16.4
Other assets	31.5	32.8	31.6
<b>Liabilities</b>			
Liabilities to central bank	0.9	1.1	0.6
Interbank liabilities	21.7	13.2	9.1
Household deposits	22.4	22.8	22.9
Enterprise deposits	33.9	37.6	39.0
Other liabilities	21.1	25.4	28.4
<b>Capital</b>			
Registered (statutory) capital	65.8	79.1	79.3
Reserves and funds	62.8	40.0	32.7
Accumulated profits	- 28.5	- 19.1	- 12.0

<sup>1</sup> After deduction of reserves.

Table 3  
Banks' risk-weighted assets

	End-1998	End-1998	End-1999	End-2000
Total:	371.4	710.0	856.0	1,340.9
<i>of which:</i>				
• with 2% risk weight	0.2	0.4	0.9	0.9
• with 10% risk weight	0.8	17.2	23.1	30.8
• with 20% risk weight	9.4	29.4	59.5	73.1
• with 70% risk weight	21.4	21.6	48.0	76.0
• with 100% risk weight	381.3	547.9	724.5	1,160.1

There was a further contraction in the volume of interbank loans taken by Russian banks in the international financial market. The share of foreign currency denominated assets declined from 49% to 42% during the course of the year, reflecting the continued slowdown in inflation and the rate of rouble devaluation.

Table 4  
**Banks' foreign assets and liabilities**

	End-1998	End-1999	End-2000
Foreign assets as a percentage of total assets	56	49	42
Foreign liabilities as a percentage of total liabilities	47	38	33
Difference (percentage points)	9	11	9

As banks concentrated more on lending, the relative importance of their operations in the foreign exchange market declined (Table 5).

Table 5  
**Banks' income and expenses (%)**

	1998	1999	2000
<b>Income</b>			
Interest received on loans	11.7	9.1	11.4
Interest on securities	11.1	6.7	8.0
Income from foreign exchange operations	64.6	63.8	40.1
Dividends	0.6	0.0	0.0
Fines, penalties and forfeits	0.4	0.3	0.2
Other income	11.6	20.0	40.2
<i>of which:</i>			
<i>Transfers from reserves</i>	7.2	13.3	33.5
<i>Commissions received</i>	2.3	2.4	2.9
<b>Expenses</b>			
Interest paid on loans	2.2	1.2	0.9
Interest paid to legal entities	3.5	1.8	2.2
Interest paid to persons	6.5	6.5	6.0
Expenses on operations in securities	10.4	2.9	2.7
Expenses on operations in foreign exchange	54.1	59.9	39.8
Operating expenses	2.5	2.3	3.3
Fines, penalties and forfeits	0.2	0.1	0.1
Other expenses	20.6	25.2	45.1
<i>of which:</i>			
<i>Transfers to reserves</i>	12.2	17.9	37.6
<i>Commissions paid</i>	0.4	0.3	0.3

At the same time, the banks became better capitalised. Almost all banks were profitable, with the sector as a whole making a profit of 17 billion roubles, compared with a loss of 4 billion in 1999. This reduced the accumulated losses in the banking sector (Table 2) and helped the banking sector's aggregate capital to increase by 71% to 287 billion roubles during 2000. In real terms this brought capital back to 85% of its pre-crisis level. For the sector as a whole, the capital adequacy ratio is well in excess of the required 8%. The share of overdue loans declined from 6.5% to under 4% over the course of the year (Table 6).

Table 6  
**Structure of the loan portfolio**

	End-1998	End-1999	End-2000
Standard	75.4	78.8	87.2
Substandard	7.2	7.8	5.1
Doubtful	6.0	2.7	2.5
Irrecoverable	11.3	10.7	5.2

Since the crisis, 250 bank licences have been revoked, although only 33 of these were revoked in 2000. Financially stable banks now account for 88% of financial institutions. Personal loans continue to account for only a small share of banking assets (about 2%). Despite a small reduction in the number of bank branches, due to licence revocations, the provision of banking services to outlying regions has improved markedly.

### 3. Factors relevant to systemic instability

There remain many risks in the Russian banking system. Some of these arise from factors outside the banking system such as the slow pace of restructuring in the economy, low incomes, high taxes and the low creditworthiness of many borrowers. They are exacerbated by weak management within banks, including poor risk assessment and a reliance on short-term liabilities. The banks are not very transparent and are not trusted by much of the population. The state infrastructure has not helped. There are big risks caused by the legal system, which has shown weak support for creditors. Legal environments of banking supervision should be improved.

There remain many small banks (Table 7). About 80% of banks have less than US\$ 5 million in capital and half of them have less than US\$ 1 million. The quality of this capital is also questionable.

Table 7  
**Number of financial institutions**

	1998	1999	2000
Active credit institutions	1,476	1,349	1,311
<i>of which:</i>			
<i>Banks</i>	1,447	1,315	1,274
<i>Non-banks</i>	29	34	37

### 4. State and foreign-owned banks

The government has a majority holding in 23 credit institutions, which together account for about a third of total assets. The main state-owned banks are Sberbank, which alone accounts for a quarter of banking assets and has three quarters of household deposits, and Vneshtorgbank. Many of the state-owned banks cannot make loans of over US\$ 100,000. It has proved very hard to sell these banks to either domestic investors or foreign banks. Many are likely to remain state-owned for a considerable period. (In part this reflects Russia's history; it had a command economy for five generations whereas central Europe had one for only two generations.)

In the cities foreign banks have an increasing influence. Their overall market share is now approaching 10%. There are no obstacles to the entry of major foreign banks as it is realised they can bring significant benefits, such as introducing new technology and sophisticated financial instruments and techniques, helping train domestic bankers and increasing competitive pressures. However, it is realised that further improvements to the legal system will be needed to attract more foreign banks to Russia.