Analysis of Recent Developments in the Russian Banking Sector

Vladimir NOSOV
K.G. Razumovsky Moscow State University of technologies and management, Moscow, Russia,
Moscow Academy of the Investigative Committee of the Russian Federation, Moscow, Russia,
novlavla875@gmail.com

Nadezhda KISELEVA
Financial University under the Government of the Russian Federation, Moscow, Russia,
kiseleva@list.ru

Olga TRETYAKOVA
Financial University under the Government of the Russian Federation, Moscow, Russia,
tretyakova@list.ru

Halin AYDINOV
K.G. Razumovsky Moscow State University of technologies and management, Moscow, Russia,
aydinov@list.ru

Marina MIRGORODSKAYA
K.G. Razumovsky Moscow State University of technologies and management, Moscow, Russia,
mirgorodskaya@list.ru

Abstract

The purpose of this paper is to review the status of the banking sector of the Russian Federation by analyzing trends in key development indicators. Special attention is paid to the study of trends in bank assets, loans, interest rates, number of credit institutions. Research results show that along with the absolute increase in key indicators of the Russian banking sector from 2014 to 2018 there has been an deceleration in their growth and assets reduction. It is noted that reasons for negative growth of assets are their decrease in foreign currency assets and ruble appreciation. The analysis of banking sector performance indicators in GDP of Russia is generally consistent with developing countries indicators, though it is still behind the developed countries figures. During the research special features and challenges of the Russian banking sector development were highlighted. Results obtained can be used for providing information to management systems in order to form a strategy on financial and credit system development, monetary fiscal policy intervention for economically feasible decisions.

Keywords: banking sector, trend data, liability structure, concentration ratios.

Introduction

Russian banking sector has undergone numerous changes and developments. At present it is market oriented and in adheres to generally accepted principles, methods and criteria established by the international banking community.

It is known that the state of the banking system is derived from the macroeconomic situation. However, banks should not be market takers - the banking sector should be a driver for economic development and further growth. In this regard, there is a need for an analysis on the compatibility of the state and structure of the banking sector with the needs of the economy.

Review and analysis of the financial market state are a basic stage of creating a strategy for the financial and credit system development. In the current situation where system risks of separate financial and credit institutions, and the whole financial institutions sector keep escalating, financial and credit regulatory authorities of the Russian Federation need a consistent study and resolution of financial market and its segments' problems at the methodological and practical levels. In this regard, it is essential and relevant to conduct a statistical study of structure, trends and relationships in the banking sector.

Methods of Research

Ministry of Finance of the Russian Federation, Federal Treasury, Moscow exchange and the National Settlement Depository are the largest providers of information on credit institutions activities. The Bank of Russia is a storage of information on the financial status of credit institutions. To date, the Bank of Russia has developed a system of macroeconomic indicators which makes it possible to identify the general proportions of the banking sector, its development trends, capacity, liquidity and concentration.

The analysis on development of the Russian banking sector was conducted basing on three groups of indicators, describing credit institutions activities. The first group reflects the banking system structure, it includes quantity indicators of registered and operating banks and their branches in Russia, and credit institutions grouping by the total or paid-up capital value. The second group consists of the capital adequacy ratios, assets values and liquidity indicators. The third group includes indicators of structure of the banking system loan portfolio.

Based on banking system development indicators time series were obtained and statistical indicators selected for time series processing were calculated. Amongst them are the following indicators: relative dynamic indices, structure indices, middle time series levels, average growth, etc.

To assess the competitiveness of the Russian banking sector it is proposed to used the Gini concentration ratio (GR).

Research Results and Discussion

Key indicators describing the state of the Russian banking sector are presented in Table 1.

Table 1: Banking sector indicators (at the beginning of the year)

Indicator	2014	2015	2016	2017	2018
Number of registered credit institutions	1071	1049	1021	975	923
Operating credit institutions/banks	1051	1024	987	623	561
Banking system assets, billion rubles	57423	77653.0	82999	80063	85192
% of GDP	78.5	98.0	99.7	93.2	92.6
Equity fund, billion rubles	7064	7928	9008	9387	9397
% of GDP	10.5	10.2	10.9	11.7	11.0
Loans and other invested assets, granted to non-financial institutions and individuals, billion rubles	32456	40865	43985	40938	42366
% of GDP	44.4	51.6	52.8	47.7	46.0
% of banking system assets	56.5	52.6	53.0	51.1	49.7
Loans and other funds	9957	11329	10684	10803	12311

granted to individuals, billion rubles					
% of GDP	13.6	14.3	12.8	12.5	13.2
% of banking system assets	17.3	14.6	12.9	13.5	14.3
Retail deposits, billion rubles	16957	18552	23219	24200	25987
% of GDP	23.2	23.4	27.8	28.1	28.0
% of banking system liabilities	29.5	23.9	28.0	30.2	30.5
Deposits and funds in accounts of non-financial and financial (except credit) institutions, billion rubles	16900	23419	27064	24321	24843
% of GDP	23.1	29.6	32.5	28..2	27.0
% of banking system liabilities	29.4	30.2	32.6	30.4	29.2

Drafted by authors using data from review of the banking sector of the Russian Federation: online edition, 2017 № 172; 2018 № 192

During the period under review, all key indicators of the Russian banking sector have increased in absolute terms, except the number of credit institutions. At the beginning of 2018, the increase of macroeconomic indicators in assets was 148.3% in comparison with 01/01/2014, in capital - 133.0%, in retail deposits - 153.2%, in deposits - 147.0%. At the same time there has been a deceleration in sector indicators' growth in 2015-2017, and volumes of assets, loans and deposits in 2016 have reduced by 3.5%, 6.9% and 10.1% respectively.

Since 2008 there has also been a decreasing trend in a number of banks in Russia.

The ratio between key banking sector activity indicators and GDP is a basic development index. During the period under review the proportion of this index in GDP remained generally on one level. A decline in proportion of assets and loans in GDP was also noted in 2017. As noted by the Bank of Russia, without consideration of the foreign currency revaluation impact, banking sectors assets would have been 98% of GDP at the end of 2017.

In the structure of banking assets, loans and debt securities have the largest share. At 01/01/2018 the proportion of loans was 68.2% and the proportion of debt securities - 14.5%. International comparisons presented in Table 2 show that the structure of assets of Russian banks corresponds to the equivalent figures of euro area countries.

Table 2: Banking assets structure in 2016

Country	Proportion of loans, %	Proportion of debt securities, %
Russia	70	12
The euro area:	55	21
France	31	28
Germany	62	18
The Netherlands	73	16
Sweden	77	11
Great Britain	52	19

Drafted by authors using data from the CGFS report

The main sources of banking sector liabilities are retail deposits, deposits and corporate funds in accounts. The proportion of retail deposits in banking liabilities has increased over the period under

review from 29.5% at the beginning of 2014 to 30.5% at 01/01/2018. The proportion of deposits and funds in corporate accounts is only 30% of liabilities. With this, the growth of personal savings occurred under conditions of a decline in real disposable household income and volume of retail trade turnover.

Non-financial institutions form the bulk of the structure of the banking sector loan portfolio - 51.9% at 01/01/2018, while loans to individuals form 20.9%, which is below international practice, where volumes of loans to companies and individuals are nearly the same.

In recent years the loan portfolio structure has experienced a decline in the proportion of foreign currency loans to individuals and non-financial institutions. A decline in dollarization of loans to individuals and non-financial institutions was the consequence of increased regulatory requirements from the Bank of Russia on foreign currency credit operations, introduction of higher coefficients of risk and reserve requirements for foreign currency obligations.

The levels of economy lending are an important indicator of the banking system development. This indicator can be described as the proportion of bank loans in the number of sources of investments to the fixed capital. During the period under review this share was insignificant - 8-11%. For purposes of comparison, it should be noted that in developed countries this indicator is 30-40%.

The banking sector development analysis assumes an assessment of levels of competition, which contributes to the effectiveness of banking, investment of money to the real economy and accessibility of lending resources. The Bank of Russia surveys the banking sector concentration ratio basing on calculation of the proportion of 200 banks and 5 banks largest by the number of assets in the number of total assets of the banking sector. The survey is presented in Table 3.

Table 3: Russian banking sector assets concentration, %

Distribution of credit institutions ranked by asset value (in descending order)	At 01/01/2015	At 01/01/2016	At 01/01/2017	At 01/01/2018
1-5	53.6	54.2	55.3	55.8
6-20	21.5	21.7	22.8	23.5
21-50	10.6	11.4	10.6	10.8
51-200	10.8	10.2	9.4	8.4
201-500	3.0	2.5	1.9	1.5
More than 501	0.5	0.0	0.1	0.0
Total	100.0	100.0	100.0	100.0

Drafted by authors using data provided by the Bank of Russia

The proportion of assets of the 5 largest banks in total assets of the sector exceeds 50% and at the beginning of 2018 compared to 01/01/2015 there has been an increase from 53.6% to 55.8%. Policy of the Bank of Russia on withdrawal of unsustainable banks from the market has influenced the growing concentration of the banking sector.

When comparing assets concentration ratios in Russia basing on equivalent indicators in the euro area, Russia holds positions of the middle of the list. Besides, according to the Committee on the Global Financial System (2018), euro area countries and USA had experienced an increase in concentration of the banking sector in recent years. With this, it should be noted that an increase in concentration leads to a loss of competitiveness of the banking sector and does not enhance the national economic growth.

Results from the analysis of banking sector development trends show deceleration in growth of key sector indicators. Note that reduction in growth is not a specific trait of the Russian banking sector.

Thus, in the report of the Committee on the Global Financial System (2018), it is mentioned that after the global financial crisis of 2008, certain developed and developing countries are going through the period of deceleration in the banking sector growth as well. Besides, negative indicators of assets growth in Russia were related to their decrease in foreign currency and appreciation of the ruble. According to the Bank of Russia, without consideration of the 2016 foreign currency revaluation impact, there would have been a growth in assets by 1.9%.

The main reason for reduction in the number of banking institutions was the licenses revocation by the Bank of Russia. In this, most liquidated banks were declared bankrupt. Reduction in the number of banking institutions can be seen in other countries as well. In studies by Udell (2014), Wyjcik and MacDonald-Korth (2015), the emergence and spread of new information technologies is mentioned as one of the major causes of reduction in the number of banks. In the banking sector development of information technologies contributes to cost reduction, primarily through process automation and branches virtualization.

Indicators of percentage of banking assets to GDP of Russia are generally consistent with ratios of developing countries, though are still behind developed countries indicators. The proportion of assets in GDP of France and Great Britain exceeds the same indicator for Russia in 4.2 times. Indicators for Sweden and Germany exceed Russian figures in 3.1 and 2.7 times respectively.

The primary sources of the Russian banking sector liabilities are retail deposits, deposits and corporate funds in accounts. With this, the proportion of loans and deposits granted by the Bank of Russia is reducing when at the same time the proportion of loans and deposits granted by other credit institutions is growing. Thus, in the liabilities structure assets of the Bank of Russia are replaced by other market sources.

During the period under review, the level of economy lending remained low. Analysis of researches, conducted by economists for the effectiveness of banking crediting expansion in terms of economic growth, does not provide a clear answer. For example, in the paper by Bezemer et al (2014), a conclusion was made about the existence of strong correlation between loan growth rates and GDP rates, on the one part, and the lack of significant positive influence of the total volume of loans to non-financial institutions on GDP growth, on the other part. In papers by Arcand et al (2012), Cecchetti, Kharroubi (2012) and Easterly et al (2000), it is also established that the threshold of the ratio between loans and GDP, which warns of negative consequences for economic growth, can be clearly identified. According to Shen and Lee (2006), after banking lending reaches the 80-100% of GDP level, the further expansion of credit market does not longer contribute to acceleration of the long-term economic growth and leads to deceleration and volatility of economic growth.

Despite the average banking sector concentration ratio, its growth trend is negative. The ongoing process of concentration in the banking sector and quantitative reductions of credit institutions were not justifies, and can also result in loss of control over the national financial system, as the bank consolidation policy leads to mass mergers and takeovers in the banking sector with transitions of banks to nonresident holders. Monopolization and loss of competition do not contribute to improvement of the national economy climate.

Conclusions

During the period under review, the downward trend in the number of banks, which has been observed since 2008, still continues. The major cause of this reduction are the increased demands on credit institutions established by the Bank of Russia. The proportion of banking assets in GDP of Russia indicator is generally consistent with developing countries indicators, though is still behind figures of developed countries. Thus, the proportion of assets in GDP of France and Great Britain exceeds the same indicator for Russia in 4.2 times, and indicators for Sweden and Germany exceed Russian figures in 3.1 and 2.7 times respectively.

The major use of banking assets is economy lending. At 01/01/2018 the proportion of loans and other credits in the structure of assets was 68.2%.

The main sources of banking sector liabilities are retail deposits, deposits and corporate funds in accounts. The proportion of retail deposits in banking liabilities has increased over the period under review from 29.5% at the beginning of 2014 to 30.5% at 01/01/2018. The proportion of deposits and funds in corporate accounts is only 30% of liabilities.

Non-financial institutions form the bulk of the structure of the banking sector loan portfolio - 51.9% at 01/01/2018, while loans to individuals form 20.9%, which is below international practice, where volumes of loans to companies and individuals are nearly the same. Besides, resulting from the policy of the Bank of Russia, there has been a decline in the proportion of foreign currency loans to individuals and non-financial institutions.

During the period under review the share of bank loans in the number of sources of investments to the fixed capital was insignificant - 8-11%, when in developed countries this indicator is 30-40%.

In 2015-2016 concentration of banking sector has continued to grow. Concentration ratio, measured by the proportion of assets of the 5 largest banks in total assets of the sector, has increased from 53.6% at 01/01/2015 to 55.8% at the beginning of 2018. When comparing assets concentration ratios in Russia basing on equivalent indicators in the euro area, Russia holds positions of the middle of the list. It also should be noted that an increase in concentration leads to a loss of competitiveness of the banking sector and does not enhance the national economic growth.

The research allows to define real economic conditions for the banking system functioning. Obtained results can be used for providing information to management systems in order to form a strategy on financial and credit system development, and monetary fiscal policy intervention for economically feasible decisions.

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