Blog: The Russian banking sector – where to next?

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After a long recession, the Russian economy is finally showing signs of moderate growth. The economy is expected to expand by 1.5 % this year, and most analysts forecast roughly similar growth rates in the coming years, too. There is a wide consensus among both Russian and foreign researchers that without major structural reforms Russia's potential growth rate will remain at around those levels. This implies that Russian growth rates will remain well below the global average for the foreseeable future.

Structural reforms are notoriously difficult to implement anywhere, and Russia's track record during the last 15 years leaves much to be desired. There are, however, two sectors of the Russian economy where a lot of progress has been made recently: the military and the banking sector. Whereas analysis of the reforms in the armed forces and the military-industrial complex is seriously hampered by the lack of open access data, information on the Russian banking sector is becoming increasingly transparent. Several reforms improving banking and financial market regulation as well as supervision have been put through since summer 2013. The visible outcome of these has been an increasing number of licence withdrawals both from banks and from non-bank financial institutions as well as micro lenders and other financial market participants.

Since the summer of 2014 the Bank of Russia has also overseen implementation of various initiatives aimed at creating a new financial market infrastructure. These initiatives have their origins in the import-substitution policies undertaken in many sectors of the Russian economy, but progress in payments systems, national payment cards and the national system of rating agencies has been remarkable. These ideas were not completely new in spring 2014, but a real push came with the perceived threat of tightening Western sanctions on the Russian financial markets.

At the same time, the clean-up of the banking sector has reduced the number of operating banks from 922 at the end of 2013 to below 589 in August 2017. Even if the large majority of the banks that have lost their licences were very small, the very large number of bank closures underlines how dramatic the change in banking supervision has been. Moreover, a non-trivial number of banks among the largest one hundred have also lost their licences. Last year, six of the top 100 banks were closed and at least two ended up in restructuring. By early September this year, 38 banks had lost their licences, four of which were among the top 100. By far the most significant of those was Yugra Bank, originally a regional bank from Khanty-Mansiysk, that had grown very rapidly into one of the largest 40 commercial banks in Russia. Whereas Yugra's banking licence was swiftly removed, Otkritie Bank, which ran into serious troubles during the summer, was deemed too big to fail. Otkritie, the second largest private bank in Russia, was directly taken over by the Central Bank in early September.

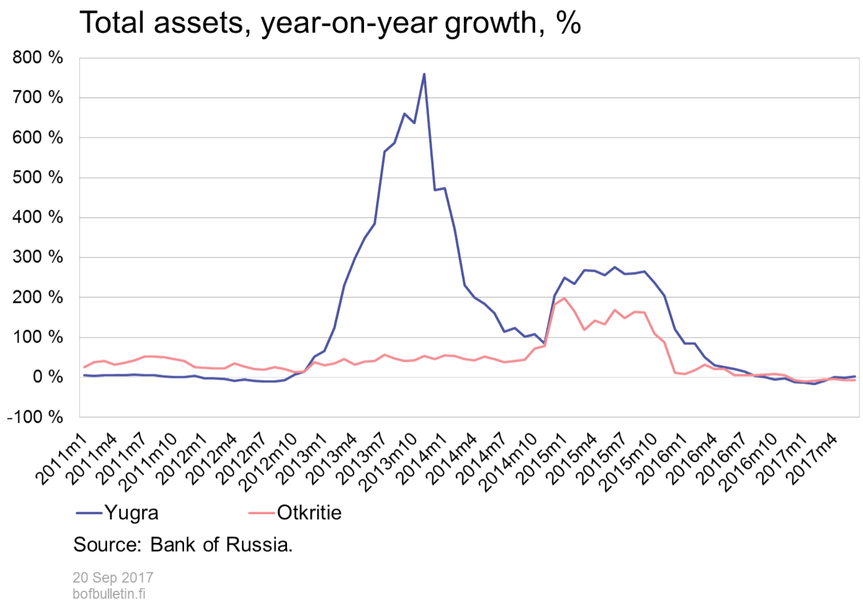
What has been common to many closed banks in Russia is that the origins of their troubles have been in the business models chosen, not in the economic downturn or non-performing loans per se. Many of the smallest banks have had troubles with anti-money laundering regulations, and several mid-sized banks have had extremely high exposure to related party lending. Both of these features are a legacy of the fact that most banks in Russia were initially pocket banks of a single enterprise or of a small group of wealthy individuals. Some of the recently closed banks apparently had greatly inflated their assets, resulting in huge holes in bank capital being revealed at the special audits that are conducted after licence withdrawal.

Another recurring feature of the closed banks has been very rapid asset growth in the past. The examples of Yugra and Otkritie are illustrative of this phenomenon (see Figure 1 below). The periods of rapid growth have typically been linked to attracting customer deposits with very high interest rates or to major acquisition activities. For example, Otkritie took over Trust Bank at the end of 2014, when the latter was close to failing.

The pick-up in economic growth in Russia has been reflected in a slow increase in bank lending and clearly improving bank performance over the past year. But, as the recent bank closures have shown, better-looking balance sheets are not enough to calm expectations of future closures.

The Russian banking sector is heavily dominated by five large state-owned banks, with the central bank directly owning a majority in the country's largest bank, Sberbank. Moreover, large state-owned corporations are among the largest depositors in the banking system. The heavy role of the state in the banking sector may not be beneficial for fostering competition, innovation or economic growth. But it will help in maintaining stability. If necessary, the Russian authorities can go a long way to encourage large depositors, rating agencies or state-owned banks to support the smooth functioning of the banking system.

Chart



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