

# RUSSIAN BANKING SYSTEM – KEY 2009 TRENDS

2009 was extremely challenging for the national banking system. Persisting global economic crisis, trailing issues in the Russian economy related to its overdependence on commodities, foreign capital markets and technologies, coupled with low domestic solvent demand created the most unfavorable conditions for Russia's banking sector development in the last 10 years. The economic downturn drove down corporate profitability and the population's living standards, which, in turn, negatively affected borrowers' ability to service their debt. Higher unemployment and lower household disposable incomes depressed domestic demand. As international sources of long money dried out, the cost of funding soared.

As a result, the Russian banking sector faced the following challenges:

- ◆ A sharp increase in corporate overdue debt and defaults, as well as reduced solvency of retail borrowers
- ◆ Escalated competition for funding in the domestic market and the resulting increase in the cost of capital. Interest rates on deposits offered by many banks were for the first time in many years above the expected inflation level
- ◆ Lack of quality borrowers considerably limited opportunities for lending activity expansion and interest income growth.

However, the recession proved to be less pervasive than had been expected in the fall of 2008 and it can now be assumed that the worst of the crisis is behind us. By mid-2009, recovery trends emerged in the economy and the banking sector, including positive GDP dynamics, industrial production index growth, stabilization of the rouble, inflation growth slowdown, household disposable income growth and stock market recovery.

Global commodity market recovery was an important driver behind the positive trends in the Russian economy. The role of government support of the national economy and the country's banks cannot be overestimated. Specifically, the government lowered the base rate, provided loans, softened regulatory requirements, and bailed out troubled banks. However, not all measures implemented by the government and the Bank of Russia were timely.

A more than 20% increase in the banking sector capitalization in 2009 was a positive development. However, the increase was mainly driven by government capital injections into state-owned banks.

Attractive interest rate levels and aggressive deposit promotion campaigns coupled with recovering trust of the population in the banking system drove a 28% growth in retail deposits in 2009. Inflow of non-financial institution funding was up 10% in the same period.

At the same time, lending activity, in particular at privately owned banks, was down due to the lack of funding, high cost of capital and tighter lending criteria caused by higher credit risk.

Retail loan portfolio in 2009 contracted by 11%. Massive support for state-owned banks prevented contraction of corporate lending volumes: the total banking system corporate loan portfolio remained at the 2008 level.

The Russian banking sector appears to have passed the test. However, some repercussions of the crisis have yet to be addressed: the federal budget deficit is growing, unemployment remains high and the quality of bank system loan portfolio continues to deteriorate. The ability of Russian banks to withstand the challenges will determine to a great extent the timeline for Russia's return to sustainable growth.