

EFFECT OF CRISIS 2014-2015 ON COMMERCIAL BANKS

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ВЛИЯНИЕ КРИЗИСА 2014-2015 ГОДА НА КОММЕРЧЕСКИЕ БАНКИ

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Abstract: *Year 2014 was one the most difficult years for the whole banking system in modern Russia. We can observe not only a lot of economic reasons and preconditions, but also political impact on the situation in banking system. As we can see, commercial banks were not ready for such a situation and suffered many losses, mostly because of sanctions and low oil prices. Central bank is trying to help through force reserves and sanations of most important banks. At the same, the CB prevents unfair activities of commercial banks on market. Central Bank even started to recall licenses in order to stabilise and improve banking sector. However, banks already have ways and methods for refining conditions by their own, like mergers and acquisitions.*

Keywords: *crisis 2014-15; commercial banks; banking system; effect; liquidity; reserves; exchange rate; assets; sanation; mergers and acquisitions.*

JEL O1, C01

Аннотация: *2014 год был одним из самых тяжелых для всей банковской системы в истории современной России. Можно наблюдать не только большое количество экономических причин и предпосылок, но и большое влияние политики на состояние банковской системы. Как мы можем видеть в данный момент, коммерческие банки оказались не готовы к такой ситуации и понесли большие убытки, большей частью в связи с санкциями и падением цен на нефть. Центральный Банк прилагает все усилия чтобы помочь банкам, вводя обязательные резервы и проводя санации наиболее важных банков. В то же время ЦБ старается не допустить проведения нечестных операций коммерческих банков на рынке. Центральный банк был вынужден начать отзыв лицензий для стабилизации банковского сектора и его совершенствования. В то же время, банки самостоятельно ищут методы и пути улучшения ситуации, например, с помощью слияний и поглощений.*

Ключевые слова: *кризис 2014-2015 года, коммерческий банки; банковская система; влияние; ликвидность; резервы; обменный курс; активы; санация; слияния и поглощения.*

In the first half of 2014 there was stagnation in the Russian economy. The slowdown in growth observed since mid-2012, initially according to the Ministry of Economic Development, has been associated with an investment pause caused by the growth of the debt crisis in the eurozone. As the economic slowdown deepened, more and more clearly structural problems became apparent, caused by outrunning growth of costs, primarily related to human resources.

As a result, there was a reduction in gross profit share in the structure of GDP, which resulted in a decrease in resources for investment growth. Due to this, the investment pause dragged on, and in 2014 new factors limiting economic growth had been added to this.

The currency crisis in Russia, which began in 2014 - a sharp weakening of the ruble against foreign currencies caused by the rapid decline in world oil prices from the export of which the income part of the budget of Russia depends largely on, as well as due to the introduction of economic sanctions against Russia in connection with the events in Ukraine.

Since the 2000s, the Russian economy was marked by the so-called "Groningen effect" ("Dutch disease") - the negative effect exerted by the strengthening of the national currency (caused by rising prices for exported oil) on the economic development of the country and leads to the priority development of the raw materials sector at the expense of production sector. Strong growth in oil prices during this period (from \$ 25 - \$ 30 to \$ 100 per barrel) resulted in a greater dependence of the Russian economy on this factor and an increase in the contribution of energy producing sectors in the economy (40-50% of the Russian budget was formed at the expense of oil and gas revenues). Thus, the dependence of the federal budget revenues from foreign economic situation increased. Structure of export of goods from Russia in 2012 did not change significantly by 2015: the share of fuel continued to be 70%. If in 2015 in Western Europe, the share of the knowledge economy in the GDP was 35% in the US - 45%, in Russia - only 15% (in the USSR, this share was 20%).

From 2012 to June 2014, the price of oil was in the range of \$ 100 - \$ 115 by the end of December 2014 it had fallen to \$ 56.5, reaching minimum indicators in spring 2009. During the first half of January 2015 the price of oil declined from \$ 55.27 to \$ 45.13 per barrel, but in mid-February, the price rose to \$ 60 and stayed all the first six months stable at \$ 55 - \$ 60 per barrel. In mid-July, prices fall resumed, reaching \$ 35.98 per barrel on 23 December. Thus, in 2015, prices fell by more than 35%.

The current drop in oil prices was due to supply was in excess of demand, the cause of which were: slower growth in oil demand, an increase in oil and gas production in the US domestic market as a result of shale gas revolution as well as the refusal of the OPEC countries cut production. The fall led to a reduction in revenue from energy exports, constituting about 70% of the volume of Russian exports. Thus, according to OPEC analysts, the drop in oil prices on every \$ 1 per barrel reduces the Russian oil export revenues to \$ 3 billion and, according to former Minister of Economic Development and Trade of the Russian Federation Mr. Gref, falling prices of \$ 10 per barrel It leads to a reduction of Russia's GDP by 2%.

After a sharp collapse the ruble regained some positions, completing the courses of the year 56.24 and 68.37 rubles to the dollar and the euro. At the end of 2014 the ruble, according to the «Bloomberg» agency was the worst the currency, which lost 58% of its value against the US dollar, while it fell by only 17.7% in 2008.

Rather complicated situation can be observed in modern Russian banking system, caused by both internal and external reasons. Internal reasons - its own policies, the scale of activity, degree of independence, types of activity, etc. The external causes of the crisis in the banking sector can be attributed to an unstable state of the economy as a whole.

The main reasons for bank crisis were:

- Loss of Russian banks the possibility of taking foreign loans, which are known as "low-cost and long-term" western money, due to the introduction of international sanctions. Countries such as the USA, Canada, European Union countries, Norway and Australia have announced sanctions aimed at slowing down the Russian economy. Due to the fact that the loans

of the Central Bank of the Russian Federation may not be available to all commercial banks, this has led to such an internal problem, as the lack of the necessary resources for Russian banks.

- The stagnation in the real sector of the Russian economy, which is why foreign investors ceased to invest not only in production but also in Russian banks.
- In 2014 there was a serious macroeconomic shock - the decline of the Russian ruble.
- Mass recall of licenses of commercial banks has undermined public confidence in the deposits and the banks, which is why many people prefer to keep savings at home in 2014.



Pic. 1 Exchange rate USD/Russian Ruble

Source: Russia's central bank [1]

All these factors has led to following:

- The lack of capital needed to ensure an adequate level of liquidity operations;
- Banks stopped payments of their clients;
- A sharp decline in the solvency of the banks, unable to meet its obligations to the Russian and foreign partners;
- Arrest of correspondent accounts of some Russian banks abroad, resulting in decreased inflow of export earnings, decreased liquid assets expressed in foreign currency;
- A sharp decline in the level of mutual trust intra-community and stop inter-bank money market.

First, that should be mentioned, even in 2013 there was a wave of withdrawal of licenses, and in 2014 the total number of credit institutions which have lost their licenses were up to 80, accounting for 10% of the market. Also, legal entities, that had previously placed in commercial banks significant amounts of money had prematurely terminated their contracts. Many people have transfered their deposits from commercial banks to state banks. Therefore, the liquidity of commercial banks declined, which led to a wave of revocation of licenses. The mass withdrawal of licenses greatly complicated the activity of the Agency for Deposit Insurance, which does not cope with the assigned load. So, in 2014 the State Duma adopted a law that allows for additional capitalization of banks in a trillion rubles, in addition, decisions on 12 banks sanation.

Forced-scale recapitalization of banks by state is also evidence of the difficult situation in which turned out to even the largest banks.

In addition, there is a number of measures taken by the banks during the crisis. For example, the implementation of certain transactions. The most popular type of deals is a the deal of bank mergers and acquisitions.

During the crisis, there were special, so-called deal-sanation of problematic banks with subsequent addition to the bank-sanator. In other words, the bank, which had a problem, was put up for sale for a very modest cost, or handed down to the private commercial bank for the implementation of sanation. These deals were carried out with the support and participation of the state.

For example, Vnesheconombank acquired the following banks: Globex and Svyaz-Bank, that had serious problems. Globex and Svyaz-Bank are continuing its activities and now, but the main shareholder is Vnesheconombank. There are several banks in the leaders in the number of mergers and acquisitions during the crisis: Bank VTB, Vnesheconombank, Gazprombank and Nomos-Bank. Most mergers and acquisitions should be attributed to the horizontal type, i.e. the banks combined with the banks, which are in the same market segment. Preference is given to this type, because it gave the opportunity to quickly and cost-effectively expand the regions of presence. [2]

The rate of growth of the Russian banking sector is currently decreasing. This is due not only to reduce the economic activity of the banks, but also changes in regulation. Another way to increase capital may be to sell non-core assets, i.e., the bank needs to sell stakes in the companies of manufacturing or construction sectors. For instance, the largest deal for the sale of non-core assets held by subsidiary banks belonging to the "Sberbank" and "VTB", since June 2014 they significantly reduced their share in more than 10 companies.

It is worth noting indicators of bank profitability and capital assets in the previous year.

“Among the top-200 on the results of 2015 55 banks (27.5%) had a loss, which is significantly worse than in the previous year, when there were 33 such banks, and in 2013 there were only seven large credit institutions were characterized by a negative financial result. Among the top 100 banks in terms of assets the share of loss-making was even greater - 34%, and among the ten largest banks four credit institutions got losses for the end of year.” [3]

Talking about profitability, we can see, that return on assets in the past year decreased as much as the income of banks. ROA for the end of 2015 reached 0.25% (0.9% and 1.9% in 2014 and 2013 respectively). Last time, when the result was worse, was in 1999, when Russian banks even were unprofitable for the end of the year results. Banks Return on equity also decreased markedly in 2015, which is connected not only to the low profitability of the banking sector, but also with respect to the rapid growth of capital by credit institutions (equity in 2015 increased by 13% and assets of only 6.9%). Return on equity decreased from 7.4% in 2014 to 2.3% in 2015. [4]

Such low return on equity calls into question the feasibility of conducting banking business for many owners. In general, low return on equity in the medium term will limit investment in the banking sector and low profitability does not allow banks to increase capital through the capitalization of profits.

According to statistics of the Central Bank, due to results of 2015, Russian banks managed to earn only 192 billion rubles. For comparison, in 2014 and 2013, the banks made a profit of 589 and 994 billion rubles, respectively. Such low profitability on the year end results were observed last time in the 2005, when the banks were able to earn only 178 billion rubles. [5]

It is important to note, that the ROA and ROE indicate how effectively the bank attracts resources and allocates them. Low profitability index may indicate insufficient value of customer base or an outdated investment policy of the bank. Thus, when such an important indicator of banks' activities as profitability fell rapidly, it demonstrated the ineffectiveness of the investment policy of banks.

Another influential part is a significant burden on the Russian banks associated with large forced reserves. Banks reserved over a trillion rubles for possible losses, which is 3 times bigger than in 2013. Reserves decreased temporarily free funds of banks and it noticeable affected the profits of the banking sector.

Moreover, banks have received huge blow on the capital and reserves due to the revaluation of foreign currency loans, the debts of banks to foreign creditors has significantly increased - it has caused such a problem as a lack of funds of banks, which is why commercial banks took on debt from the Central Bank, as a result, it has significantly increased debts of banks. [6]

In addition to the loss of foreign creditors, the banks have lost and part of the funds of Russian investors. The outflow of deposits took place in January-March, September-December and has been associated with a confidence factor not only in the national currency, but also to the entire banking system. In 2014 there was a significant reduction not only ruble, but foreign currency deposits. Compared with the crisis of 2008, when there was a multiple increase in foreign currency deposits in 2014 as a currency and ruble deposits lost more than 10%. [7]

For example, we can see how deposits have changed during October, 2015.

Table 1 Deposit changes in Russian banks, October 2015 [8]

	Deposit portfolio as of October 1, bln. Rubles	Change for month, bln rubles.	Change for month, %.
Alfa-bank	571,4	-0,1	-0,02
Gazprombank	536,8	-3,3	-0,62
Raiffeisenbank	325,9	-4,4	-1,32
Bank FC Otkritie	237,7	-2,9	-1,21
Khanty-Mansiysk Bank Otkritie	207,6	-0,6	-0,31
Bank Home Credit	173,5	-0,6	-0,36
Rosbank	172,2	-0,9	-0,53
Russian Standard	167,9	-5,5	-3,19
Uralsib	161,1	-3,5	-2,12
MDM Bank	160,5	-5,2	-3,17
Bank Saint-Petersburg	160,0	-0,2	-0,13
Moscow Industrial Bank	136,2	-2,0	-1,43
Vostochniy	116,4	-3,2	-2,66
Vozrozhdenie	114,2	-1,7	-1,46

In 2015, there was a marked increase in the volume of overdue debts on loans - for the last 5 years the rate of growth of overdue debts increased by 18 times, which can be explained by the decline in real incomes and less strict requirements of banks to borrowers.

Russian bankers recognize the problem with the growth overdue debt, but argue that loans may not remain unclaimed. In 2016, observed deceleration of consumer loans. In aggregate terms, the volume of loans has grown, however, lending growth slowed to 2% -5%, which is less by almost 5 times compared to the previous data of 2013.

As demonstrated by the crisis situation, commercial banks are often not able to perform the function of mobilizing savings of the population to create an investment resource. Effective demand of the population was and remains low, according to analysts of the largest banks of the country; in Russia there is no enough demand with the available number of banks. Banks are difficult to ensure the necessary level of resources for long-term lending institutions.

Particularly acute is the problem of short-sightedness of the policy of the supervisory body and members of the banking system. There is a number of credit institutions with the hidden

internal problems or implementing too risky policy. Before the critical moment for external actors is usually imperceptible, and at approach - it has a negative impact on the whole system. [9]

It is therefore necessary to create such a monitoring control system and rapid identification of problematic aspects of banking system, which will prevent possible negative consequences. Of course, revocation of licenses of the bank exercising the riskiest activities and violating the law is a necessary measure, however, it is possible to consider the need to create new legislation in the area of licensing.

Another feature of the Russian banking sector is also an imbalance in the distribution of assets of the banking sector: approximately 20 largest banks are the owners of 60% of total assets. Concentration of assets is huge, moreover, in connection with the crisis, this disparity has increased, leaving all the banks in terms of assets on the position of 200 and lower, only 3% of the market. [10]

Provided that dealing with all the problems of banks that have arisen today, it is expected sufficiently rapid normalization of the credit market and the banking system as a whole due to, firstly, the anticipated significant improvement in the trade balance due to the current weakening of the ruble. Even in the case if in subsequent years low oil prices remain, it is expected massive excess of the incoming foreign exchange earnings from exports over the demand for currency.

The trend of appreciation of the ruble, combined with a weak post-crisis dynamics of consumer demand will lead to a rapid decline in inflation and output in the scheduled four percent benchmark of the Central bank. This, in turn, will cause a downward trend in interest rates on loans and an increase in the availability of the latter.

An additional factor in improving the conditions of lending to enterprises will be the reduction of competition from the population for the credit resources of banks; expected market of a short credit correction would free up significant resources for the expansion of lending to enterprises.

Thus, the problems in the banking sector in 2014 affected all spheres of activity of the banks, but the development of the banking sector in 2015 clearly indicates the beginning of recovery. So, the key rate of the Central Bank today is 12.5% in comparison with previous 17%. However, it is important to understand that the banking sector looks in 2016 with fear. It will be a difficult time, after which the Russian banks will come even more efficient and find new ways of development, become more competitive.

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