

BANKS SURVIVE OWING TO STATE BAIL-OUTS AND CUSTOMERS' FUNDS

BY GALINA KOVALISHINA, HEAD OF THE CORPORATE FINANCE DEPARTMENT,
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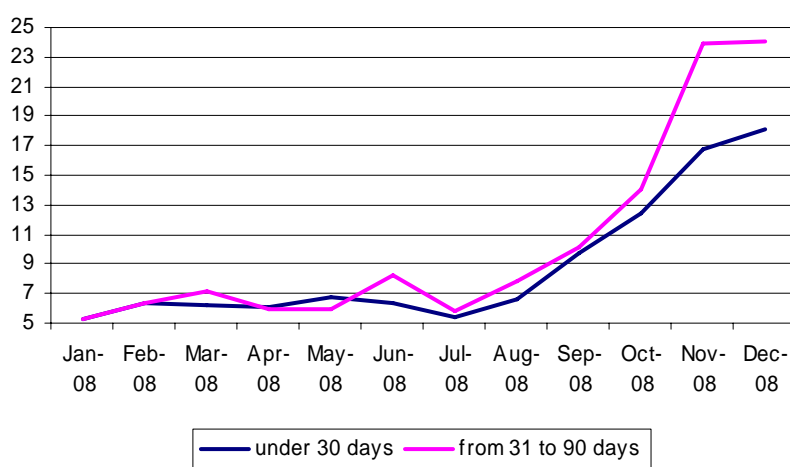
Banks' primary activity is participation in the capital market. In other words, credit institutions borrow and lend money at different interest, and the difference between the cost of borrowing and lending makes their profits. The year 2008 was difficult for the Russian economy, including the banking sector that faced problems with fund raising, both domestically and internationally.

In autumn 2008, the government bailed out the banking system, and those injections in a large part prevented a liquidity crisis and enabled banks to continue operation.

All seriousness of the financial turbulence becomes more evident as the interbank rate grows: between September and December 2008, MIACR¹ increased three times to reach 24%² (see Figure 1).

Interbank market turmoil illustrates the problem of fund sufficiency in the market. Russian banks did not see mass withdrawals of personal and corporate funds – contrary to analysts' predictions in early autumn 2008.

Figure 1: MIACR growth



Source: the Bank of Russia

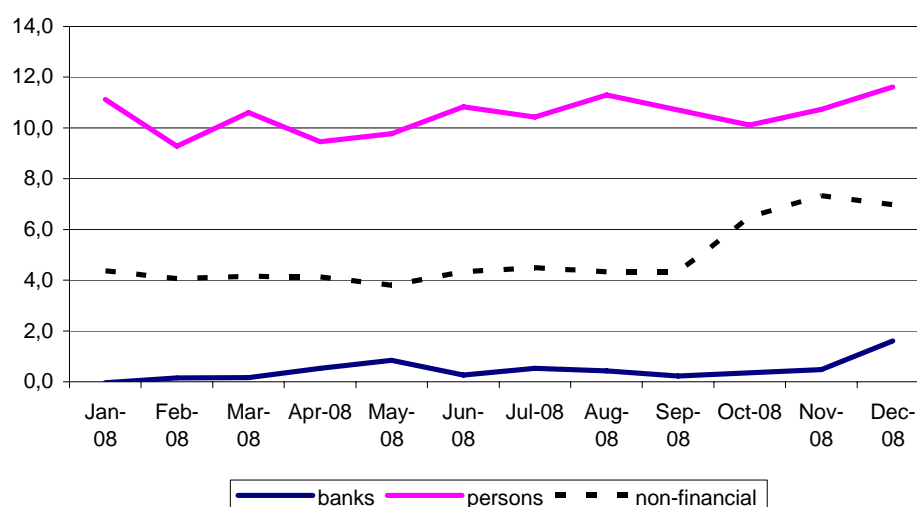
Analysis of the margins that banks make by keeping and lending money reveals that personal banking is the biggest source of income (personal banking margin³ averaged 10.5% in 2008) (see Figure 2). It is followed by corporate business (profit is 4.9%). Transactions with credit institutions are least profitable for banks (the margin is just 0.5%). These banking activities were affected by a confidence crisis, a consequence of the global financial crisis.

¹ Moscow InterBank Actual Credit Rate

² 31 to 90-day loans

³ The difference between interest accrued and paid

Figure 2: Bank margin from operations with different types of customers, %



Source: the Bank of Russia

Meanwhile, businesses remain core customers for banks as the business savings are three times the personal savings kept at banks. This resulted from very tough conditions applied to personal bank accounts (last year, average interest rate for personal 31 to 90-day ruble deposits averaged 5.65% per annum while inflation climbed to 13.3%).

Fairly speaking, none category of bank customers saw a positive real rate applied to their deposits. Nonetheless, parking money with banks remains the most profitable investment because allocating funds to other sectors brings more losses to investors.

According to our estimates, the banking system had a net interest income of 820 billion rubles in 2008. This is only a bit more than the government's bail-out to banks. According to finance minister Alexey Kudrin, a 950 billion rubles bail-out was given to support credit institutions in 2008. The total amount given to banks accounts for about 10% of all banking assets, or 30% of all personal deposits, or 50% of corporate funds on settlement accounts. As we can see, the state and credit institutions support banking on the 'parity' principle. The state pays for stability of the banking system while the latter does not undertake any measures to review its business strategies. As we can see from Figure 1, faced with a liquidity crunch, banks did not decrease the size of their margins. As a result, banks receive the previous level of income, personal funds continue to depreciate and the state does not dare to clear the banking system from inefficient institutions.