State bailouts not enough for banks

It is not uncommon when governments bail out their banking systems by issuing subordinated loans (it is the last thing to grant such loans in case of bankruptcy). At present, around one hundred banks are awaiting unsecured loans from the Central Bank. Government backups like this are widely practiced in the financial sector. Specifics of funding banks under crisis conditions in Russia lie in the fact that substantial aid is given to state-owned banks (the largest portion of funds is allocated to the three largest government banks). State banks enjoy this privilege because they hold a large share of the domestic market (namely, personal deposits, corporate loans, trade finance, etc.). Obviously, if state-run banks face any problems in settlements or fulfillment of their obligations the reaction of the market can be catastrophic.

The Bank of Russia's role of a creditor of a final resort has a number of negative implications. The 1998 experience of issuing stabilization loans showed that banks are not required to repay government money. Seemingly, there is no need in that because the banks belong to the state. But state-orchestrated institutions' privileged position does not help enhance the development of market relations within the economy and, moreover, aggravates problems that exist in the country's financial system.

On the one hand, sizeable financial injections into the economy under the circumstances of instability ease the liquidity market tensions; on the other, they have an appreciable implication on inflation rates. October 7, the state-owned banks received subordinated loans worth 950 billion rubles; this amount is comparable to the banks' debts due to be repaid within a month and totals one-third of Russia's banking system capital. Also, the Bank of Russia continues to support the national currency on the foreign exchange market, which partially compensates fund inflows into the economy. In this situation, the Ministry of Finance will be forced to reconsider their 2009 inflation projections of 7–8,5%.

Giving interest-free loans to banks might turn out a parlous tendency. This policy reduces both the banks' and their customers' responsibility thus heightening the risks. The Central Bank contributes to the problems Russian banks are facing under the conditions of negative dynamics of the capital market. It is not about restrictions on banks' international activities. The Central Bank's inability to create a mature financial market meeting credit issuers' liquidity needs causes them to borrow funds from external financial institutions. The Central Bank's attempt to stabilize the market through fund injections only can solve the banking problems for a short time. Without enhancement of the financial instrument, public debt and refinancing markets, the Russian banking will remain utterly unstable.

By Galina Kovalishina