

BANKS TO BENEFIT FROM FLEXIBLE RUBLE RATE

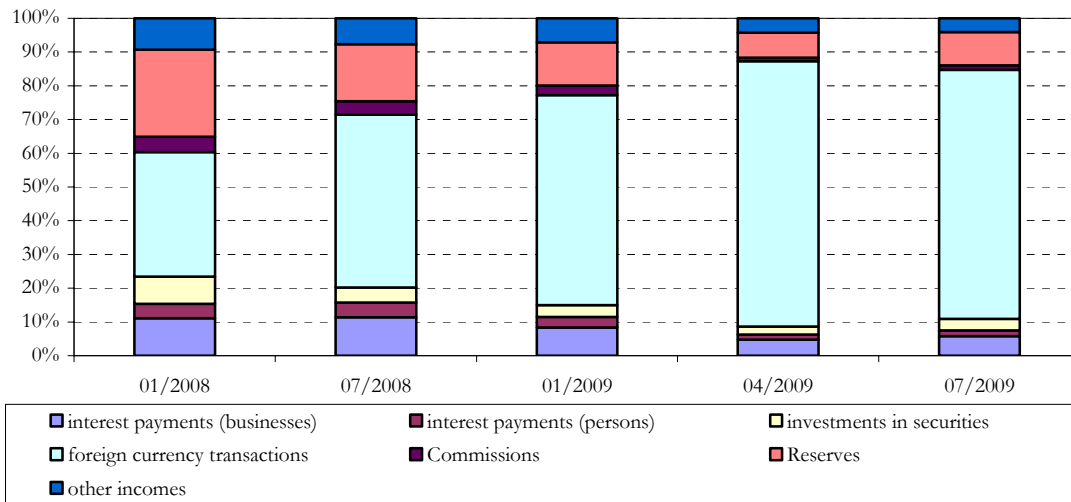
BY GALINA KOVALISHINA, HEAD OF THE CORPORATE FINANCE DEPARTMENT, 24 SEPTEMBER 2009

Under the Bank of Russia's draft project of the state monetary policy for 2010 and the period between 2011 and 2012, the Central Bank's primary task will be 'creation of conditions for the use of a monetary policy model based on inflation targeting by gradual reduction of direct influence on the ruble exchange rate'¹. The Bank of Russia retains the right to smoothen sharp rate fluctuations against the dual currency basket in the period of transiting to the flexible rate. It means that Central Bank will be less involved in the currency market processes and that the ruble exchange rate will be regulated by market mechanisms.

Analyzing possible consequences of this initiative for the country's financial sector, we may assume that a flexible rate will benefit Russian banks. According to the statistics, foreign exchange transactions were the main source of income for credit institutions (see the figure) in 2008 and 2009 amid heightening volatility in the currency market. As incomes from lending to persons and businesses decline, foreign exchange transactions have been Russian banks' most profitable activity in the past time. As the Central Bank is curtailing its activities in the currency market, volatility will be increasing, which may affect profits that banks derive from foreign exchange operations or lead to higher instability of foreign exchange operations profitability.

¹ <http://www.prime-tass.ru/news/0/%7BE111F944-F12C-4D3E-A90A-F6771763009C%7D.uif>

Banking income mix



Source: Bank of Russia

Efficient exchange rate regulation is only possible in developed markets, but this is not the case with the Russian market. Several dominating players (in Russia this group is mainly represented by exporters of raw materials) could manipulate the market pursuing their own interests. Large players also include banks that are interested in preserving high profitability of foreign exchange transactions. An increase in the funds placed with non-residents versus the total assets of the Russian banking sector (up from 9.8% in early 2008 to 15.7% in September 2009) is a guarantee of high profitability of foreign exchange transactions in case of the ruble depreciation.

Under the conditions of high market volatility and low predictability of the rate fluctuations, market players will have to be extremely careful about risk management and quickly respond to the changing conditions. These are the main factors that could prevent banks from generating stable profit in the currency market. Risk management procedures had been ‘ruined’ before they were started because of the state’s indulgences and anti-crisis injections into the banking sector. In these conditions, banks risk to make wrong decisions – either not optimal or threatening their balance stability. But anyway, Russian financial organizations will try to profit from this situation.