Russian Banks After the Crisis

Natalia Orlova
Chief Economist
Alfa-Bank
Russia 2007: Unaffected by subprime turmoil

- Russia was not affected by the subprime crisis, as mortgages represented only 5% of banks’ assets versus 35% in the US.
- Russian mortgage market was a small 1.8% of GDP in 2007.
- The RTS and Russia’s sovereign CDS continued to perform well until mid-2008.

RTS and Russia’s CDS remained unchanged in 2007

Sources: CBR, Bloomberg, Alfa Research
Drop in oil prices triggered capital outflow

Sudden decline in commodity prices triggered reconsideration of Russia’s growth story

Russia’s RTS market fell 74% in 2008, one of the largest drops in the world

CBR reserves declined from $597 bln in summer 2008 to $427 bln as of the end of 2008; 4Q08 capital outflow totaled $131 bln

Sources: Bloomberg, CBR, Alfa Research
Banks became vulnerable in 2H08

Ruble depreciated against the basket and USD

- Ruble exchange rate came under pressure in 2H08 and fuelled run on deposits

- Retail deposits became more dollarized: the share of foreign-currency deposits jumped from 13% to 33% in 2H08 in the Russian banking system and from 30% to 65% at Alfa Bank

Sources: Bloomberg, CBR, Alfa Research
Liquidity crisis successfully resolved

Banking liquidity and overnight rates

State money in total banking liabilities went up from 2% at the beginning of 2008 to 9%

Banking sector liabilities, % of total

<table>
<thead>
<tr>
<th></th>
<th>2Q08</th>
<th>4Q08</th>
<th>7M09</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ bln</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total state money:</td>
<td>24</td>
<td>123</td>
<td>78</td>
</tr>
<tr>
<td>CBR</td>
<td>2</td>
<td>115</td>
<td>61</td>
</tr>
<tr>
<td>Finance Ministry</td>
<td>22</td>
<td>8</td>
<td>17</td>
</tr>
<tr>
<td>Retail deposits</td>
<td>246</td>
<td>201</td>
<td>208</td>
</tr>
<tr>
<td>Corporate accounts</td>
<td>352</td>
<td>297</td>
<td>285</td>
</tr>
</tbody>
</table>

Sources: CBR, Reuters, Alfa Research
Macrou trends affected retail loan quality

Unemployment stabilized at 7.6% in September, but wage arrears still pose a serious threat to loan-payment discipline.

Retail loans are down 10% YTD; NPLs were reported at 6.4% of loan books as of September 2009, double their level of last summer.

Sources: CBR, Rosstat, Alfa Research
Corporate NPLs jumped from 1.1% to 5.6%

Decline in asset prices hit local borrowers hard

Real sector net profits fell 62% y-o-y in 1H09 ($51 bln vs. $134 bln in 1H08)

Corporate profits will cover only 30% of debt payments over the next 12 months

Corporate NPLs are a major threat, rising from 1.1% to 5.6% over the last 12 months

Sources: CBR, Bloomberg, Rosstat, Alfa Research
Banks’ response to the crisis

Banks are rolling over bad loans to avoid losing equity capital

Bank’s are unable to increase lending exposure, so they are compelled to increase retail and corporate accounts in order to reduce exposure to the CBR

Building a position in financial instruments is another way to avoid lending

Sources: CBR, Bloomberg, Alfa Research
**State liquidity helping to keep loan/deposit ratio high**

Even though Russia’s loan-to-deposit ratio declined to 105% in September 2009 from 115% in December 2008, it is still well above those of the other BRICs, suggesting a lack of local funding.

After a long period of strong growth, both retail and corporate loans declined in 9M09.

**Corporate and retail loan book growth, % y-o-y**

*Calculated based on figures in dollar terms

Sources: CBR, Reuters, BIS, Alfa Research
The top 200 banks in Russia control 90-95% of all key banking markets.

Banking sector concentration in Russia

In many countries, a period of economic slowdown has been used to consolidate the banking sector and reduce the number of banks.

Number of banks at the beginning of the crisis (T) and two years later (T+2)*

*Data collected for 1990s

Sources: CBR, IMF, Alfa Research
**Capital injections crucial to boosting growth**

**Economic trends stabilized in 2Q09**

Industrial output began to show signs of recovery in June-July, and loan books stabilized.

**Countries’ financial rescue packages as % GDP**

Russia’s entire financial rescue package is only 7% of GDP, well below developed economies.

In developed economies, capital injections equaled up to 3-6% of GDP; Russia lags behind, with 1% of GDP allocated for direct recapitalization.

Sources: CBR, Rosstat, BIS, Alfa Research