The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Quantitative Easing May Sow Trouble

By The Moscow Times

December 13, 2012

It has been dubbed quantitative easing, Russian-style.

A surge in Central Bank lending to banks is sustaining rapid loan growth but also risks fueling inflation and a potential credit bubble.

On the face of it, the Central Bank has been acting tough. To crack down on inflation, it recently hiked interest rates, in stark contrast with the ultraloose monetary policies seen in Western economies.

But while Russia has tightened the monetary screws with one hand, it has opened the flood gates with the other.

"They are sending conflicting signals," said Natalya Orlova, chief economist at Alfa Bank. "They are raising interest rates ... and at the same time they continue to fund loan growth."

Total credit extended by the central bank mushroomed from negligible levels in mid-2011 to 2.5 trillion rubles ($80 billion) as of Nov. 1. And it is approaching levels seen at the height of the 2008-09 financial shock.

And the Central Bank's role in financing banks looks set to keep growing, as authorities endeavor to stave off the possibility of a slide in bank lending, which would deepen an economic slowdown and undermine support for President Vladimir Putin.

At least in theory, more Central Bank funding for banks is a way to prop up the economy by encouraging banks to lend, supporting spending by companies and consumers.

Funding Squeeze

At the root of the Central Bank's growing lending is an intensifying squeeze on banks' market funding. Overnight interbank lending rates have risen steadily from below 3 percent at the start of 2011 to around 6 percent today.

Many bankers blame the Central Bank. Last month, German Gref, the head of Sberbank, criticized

its September rate hike, saying higher borrowing costs would crimp lending and damage economic growth.

But the deeper roots of the funding shortage lie in Russian banks' own behavior.

"The cause of the problem is that the banks have deployed more liquidity than they have attracted in the form of customer funding," said Yaroslav Sovgyra, associate managing director at credit rating agency Moody's in Moscow.

In the first 10 months of this year, lending by Russian banks grew 15 percent, outpacing the 9.4 percent increase in client deposits, according to the Central Bank's monthly banking sector review.

The shortfall means banks are turning to the Central Bank to fill the gap. Moody's predicts that the share of Central Bank funding in banks' liabilities, now about 6 percent, will reach 15 percent by the end of next year.

Under pressure from banks, the Central Bank has promised to accept a wider range of collateral in the future and extend the maximum duration of refinancing operations from three months to up to one year.

That raises concerns that what began as an emergency measure is rapidly becoming the new norm.

"Banks generally should resort to central bank funding in a difficult situation, when you need liquidity as a matter of extraordinary support, but not during the normal course of business to finance loans," Sovgyra said.

Inflation Underestimate

The Central Bank's monetary injections may help explain disconcertingly high inflation, which is set to surpass the bank's 6 percent inflation target for the year.

"Without these injections, core inflation would be much lower. It's quite obvious," Orlova said, predicting that the Central Bank would also miss its 6 percent target next year due to political and economic pressure to support banks.

Analysts are also worried that the expansion in Central Bank credits will dilute asset quality, both of the Central Bank and of the banks to which it lends.

They point out that growth in retail lending, the riskiest segment of the market, has accelerated to over 40 percent, notwithstanding the recent hike in Central Bank rates.

Concerned by the rapid increase, the Central Bank is now tightening regulations to tamp down the riskiest retail lending.

But it seems less inclined to rein in corporate lending, the main cause of Russian banks' troubles in the 2008-09 crunch.

Leading bankers see the situation differently.

"If you look at penetration of loans in the economy, it still significantly lags emerging market peers and is obviously far away from the developed economies," said Herbert Moos, chief financial officer of VTB, Russia's No. 2 lender.

The ratio of loans to GDP is about 45 percent. That compares with 55 percent in Poland and 150 percent in the European Union, suggesting that Russia is a long way from the kind of debt crisis now plaguing Western economies. Retail loans represent just 10 percent of GDP.

But some bankers paint a less reassuring picture.

"A lot of banks are involved in speculation because the Central Bank provides a big volume of resources," said Andrei Larkin, deputy chairman of the midsized Absolut Bank. "Banks take a big risk of a liquidity gap. In general, the money is short term, and the assets are long term."

Leading bankers acknowledge the latter problem but say the solution is for Russia to go even further in copying the quantitative easing policies seen in the West by providing multiyear financing.

"It's not only about inflation and monetary stability," Moos said. "If Russia wants to support growth of its own economy, it needs to provide improved longer-term financing."

Skeptics say Russia can hardly be compared to Western countries, which are resorting to highly unorthodox measures to revive stagnant lending and avert a deflationary debt spiral.

"Obviously, that might be necessary if you have a problem effectively with loan growth like you have in the U.S. or eurozone. But that's not a problem here," said Clemens Grafe, chief economist at Goldman Sachs in Moscow.

"You can't fund your loan growth with short-term repos [central bank loans]," he added. "And you shouldn't fund it with long-term repos either because that is essentially printing money."