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Banks' Profitability Falls as Consumer Loans Turn Bad

By Alexander Panin

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Banks that have been profusely lending money to Russians will have to pump up reserves to offset growing losses, according to a banking forecast for 2014.

After a borrowing binge, people's ability to service their debts are being squeezed as the economy continues to flounder. Meanwhile, banks' profitability is falling and the share of unsecured debt on their books is growing, said the forecast, released by Standard and Poor's on Thursday.

And good news is not on the horizon — Thursday also saw reports of negative economic growth in January and a steep fall in capital investment.

The consumer loan market boomed in 2012 and 2013, growing 30 to 40 percent annually. This year it will begin to cool, increasing by a still considerable 20 to 25 percent, S&P analysts said.

At first glance, the debt burden in the economy is moderate — loans to individuals constitute only 14 percent of gross domestic product. This figure is 21 percent in Turkey, 34 percent in Poland and 30 percent in China.

"But the number does not fully represent all the potential risks," said Sergei Voronenko, senior analyst at S&P. "If we subtract secured debt from this value we would be left with 8 percent of GDP, which are unsecured loans. This means the majority of loans taken out by individuals are unsecured."

Another factor alarming the analysts is the concentration of risk in few institutions. Four major banks — Russky Standart, Vostochny Express, OTP Bank and Home Credit Bank — which specialize in individual loans have more than tripled their combined portfolio in the last three years. These banks now account for 10 percent of all individual loans in the country. They also hold almost a quarter of all overdue private debt in the banking system.

"We estimate that all banks will have to increase their reserves to cover possible bad loan losses," Voronenko said.

The four banks mentioned in the report that specialize in individual loans have already had to allocate half of their operational revenue to cover possible losses because of overdue loans, up from only 6 percent in 2011 and 26 percent in 2012, the analyst said.

S&P estimates that the banking system on average will have to hold reserves high enough to cover possible losses worth 30 to 35 percent of their operational revenue, up from 8 percent in 2012.

This would put a burden on the profit margins, lowering the average return on equity to 13 to 15 percent, down from about 18 percent in 2011, the analysts said.

Banks will have lower profit margins not only because of ballooning overdue loans, but also due to falling demand for their services and tightening fiscal policy by the Central Bank, said Egor Dvinyanin, head of the East + West = Invest financial conference's analytical center.

Banks could cope with the flagging economy and the overdue loans, he said, but the "cleaning" of the banking sector that has been aggressively pursued by the regulator since the fall last year is severing the trust people had in financial institutions.

Over 30 mid- and small-size banks had their licenses revoked last year, and eight more have been shut down in 2014.

The febrile atmosphere generated will lead to a redistribution of funds toward safe, state-controlled banks, Dvinyanin said.

This is already happening. According to S&P, in 2007 state banks accounted for 43 percent of all assets in the banking sector. Last year this figure rose to 57 percent.

The Central Bank's latest data on the movement of individual deposits shows that December saw the weakest growth in deposits for 13 years. Of the fewer funds deposited in the banking system, over 90 percent went to the country's biggest lender — the state-owned Sberbank.

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