

RESULTS OF BANK SURVEYS IN 2003

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2003 can be defined as the year of radical turn in the domestic banking sector. Although in a quantitative sense, the changes may look not so significant in many of their measurements at first sight, their qualitative content cannot be overlooked.

In the first place, at last we can say that banks have started to fulfill their function of inter-sectoral redistribution of funds: household savings are the most important source of liabilities of the majority of banks in our sample; and lending to trade intermediaries and to industrial enterprises are the main items of their assets.

In the second place, substantial reduction in risks is observed in the banking sector. Individuals are less afraid of entrusting their monies to banks (shortage of supply of personal deposits has considerably eased, and competition with the Sberbank has visibly diminished), while banks are less afraid of losing money on lending to trade and industrial firms.

In the third place, we observe an outbreak of intense competition on the market of bank services, while competition with the Sberbank is becoming relatively weaker.

Finally, in the fourth place, securities market has begun to gradually revive (or even having a second birth). The revival is rather slow, but it takes several directions at once: banks have beefed up their activities on the market of government borrowings and in placement of private securities, and also increased their investments in equities.

SOURCES OF EXTERNAL FUNDS

In 2003, there were no significant changes in the methods used by commercial banks for procurement of new financial resources. Ranking of main items of liabilities has remained more or less the same as in 2002. Meanwhile, variety of ways used for mobilization of financial resources has narrowed. It has lowered" roughly to the level of 2001.

The major change has occurred in deposits of juridical persons. Ranking of this liability item among main sources of external funds has declined by 11 points (see Table 1). A comparable decline (-9 points) was shown by such liability item as deposits of individuals. Ranking of settlement accounts of juridical persons has gone 6 points down. Nevertheless, despite the recorded decline, all the above mentioned items are still the leaders: deposits of individuals and settlement accounts remain the key liability items at 81% of the surveyed banks, and deposits of juridical persons, at 55%.

Nevertheless, the rise in ranking of interbank lending (+7 points) against this background is a source of worry. This is the only item to have increased its weight in our rating. Although it plays a lesser role among other sources of funds (it was one of the three key items only at 16% of the surveyed banks), a sign that the banking sector is getting locked in itself leaves an impression that in 2003, the situation in this sector has somewhat receded from where it had been in 2002.

Table 1

Rating of Sources of External Funds (shares of banks having mentioned each Item as one of three major ones, %)

	1997	1998	1999	2000	2001	2002	2003	(8)=(7)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Personal deposits	80	76	61	81	75	90	81	-9
Settlement accounts of juridical persons	82	86	79	94	84	87	81	-6
Deposits of juridical persons	32	34	36	51	49	66	55	-11
Interbank lending	28	15	7	12	15	9	16	+7
Other	7	8	15	17	13	7	6	-1
Targeted Central Bank lending	2	0	3	0	0	0	0	0
The sum of shares	231	219	201	255	236	259	239	-20

* Respondents were asked to point out no more than three items.

FACTORS LIMITING INFLOW OF PERSONAL SAVINGS

Leading position of personal deposits as one of the main sources of external funds calls special attention to the factors that limit their inflow. Only 27% of the surveyed banks responded that nothing limited their drawing of personal savings (see Table 2). This is the absolute maximum in seven years of our observation, which gives another confirmation of steady improvement in this segment of banking.

Ranking of the factors underwent substantial changes against this steadily positive development.

Firstly, shortage of supply of personal savings has substantially weakened (and reached its lowest level in seven years). This point was singled out by only 18% of the surveyed banks in 2003. In 2002, their share was 33%.

Secondly, the impact of competition with the Sberbank has declined by about the same rate (-13 points). Nevertheless, this is still the main factor among those that limit attraction of individual deposits.

In the meantime, the banks with increasing frequency complained about lack of adequate conditions to service small depositors (+14 points) and about competition with other banks (+13 points).

Table 2

Factors Limiting Inflow of Personal Savings (Shares of banks having mentioned each Item, %)

	1997	1998	1999	2000	2001	2002	2003	(8)=(7)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Competition with Sberbank	24	23	35	33	38	54	41	-13
Regulations set by Central Bank	48	35	28	38	44	30	28	-2
Lack of adequate conditions for retail banking	8	3	6	4	10	10	24	+14
Competition with other banks	12	10	6	12	8	10	23	+13
Lack of supply of personal savings	28	33	24	20	23	33	18	-15
High cost of retail banking	4	13	16	30	21	7	13	+6
Other	13	10	10	12	4	2	3	+1
No limitations	25	25	19	11	21	24	27	+3

COMPOSITION OF ASSETS

Rating of various items of assets remains relatively stable over recent years, in spite of some fluctuations.

Lending to trade intermediaries is the top item for the sixth year in a row. Although the ranking of this item has declined by 9 points in 2003, it is still one of the two key items for 67% of the surveyed banks (see Table 3).

Lending to industrial enterprises was always the second item during these six years. However, its ranking remains very unstable: it declined in 2002 (-16 points) and then rose in 2002 (+23). And in 2003, another decline has come (-20). As a result, less than a half (47%) of the surveyed banks placed lending to industrial enterprises among their main asset items.

The rising rating of lending to other banks looks rather worrisome: +9 percentage points on the year. As a result, it has become one of the two main items for 22% of the banks in 2003. This is the highest value in the seven years time span.

Other types of transactions are clearly of secondary importance. Foreign exchange is considered to be one of the main assets only by 6% of the banks, leasing, by 7%, and investments in real estate, by 4%.

Table 3

Rating of Main Asset Items (Shares of banks having mentioned each item among the two major ones, %)*

	1997	1998	1999	2000	2001	2002	2003	(8)=(7)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Lending to trade intermediaries	60	54	56	71	71	76	67	-9
Lending to industrial enterprises	70	52	56	60	44	67	47	-20
Lending to individuals	10	5	7	12	29	27	29	+2
Lending to other banks	10	8	10	9	15	13	22	+9
Foreign currency assets	7	15	25	17	15	9	6	-3
Other	18	28	16	19	13	7	17	+10
Of which:								
Leasing	0	0	0	0	0	2	7	
Investments in real estate	0	5	2	0	2	0	4	

* Respondents were asked to point out no more than two items out of nine offered in the questionnaire.

EFFICIENCY OF OPERATIONS

In the REB surveys, respondent banks are offered to evaluate efficiency of various operations on a scale of "profitable - neutral - unprofitable".

In 2003, the ranking of major types of operations by the rate of profitability for the banks remained unchanged. "Lending to trade intermediaries" has been the leading item for the last six years: in 2003, 98% of the respondents have assessed it as profitable for their banks (see Table 4).

Despite a slight decline in the ranking in 2003 (-1 point), "lending to industrial enterprises" is the second item for the fourth (I) consequent year: 81% of the banks assessed this operation as profitable.

"Keeping of settlement accounts" steadily occupies the third place.

"Lending to other" banks has suffered the greatest decline (from 66% in 2002 to 55% in 2003). Interestingly, this type of transactions, as we

have already mentioned above, has risen in importance as a means of formation of both liabilities and assets. However, decline in its profitability may indicate that the respondent banks are compelled to use it.

The growth leaders in 2003 were transactions of marginal ranking: "trading in government bonds" (+16 percentage points), "placement of securities issued by other juridical persons" and "equity investments" (+10 points each). In general, this fact can be considered positive, firstly, because it indicates that the number of effective operations has increased to a certain extent, and secondly, because it is a demonstration of gradual establishment of the securities market (which had been artificial in many respects before 1998 and practically collapsed immediately after the crisis).

Table 4

Rating of Various Banking Operations (Shares of banks considering the relevant operation profitable, %)

	1997	1998	1999	2000	2001	2002	2003	(8)=(7)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Lending to trade intermediaries	70	97	92	95	95	100	98	-2
Lending to industrial enterprises	39	50	64	77	86	82	81	-1
Keeping of settlement accounts	52	66	78	51	66	79	77	-2
Lending to individuals	31	49	45	60	60	72	72	0
Foreign exchange operations	67	67	91	75	64	69	66	-3
Lending to other banks	60	67	48	67	71	66	55	-11
Placement of securities issued by other juridical persons	17	5	3	0	10	14	24	+10
Trading in government bonds	63	23	12	36	20	7	23	+16
Equity investments	48	0	3	23	11	6	16	+10

INDICATORS OF CREDIT ACTIVITY

After brisk development of bank lending activities in 1999-2001, the credit market reached certain stability in 2002-2003 at the level it had achieved earlier. Certain improvement of the situation can be traced in

the increase in the share of loan portfolio in the assets of the surveyed banks, and also in slight extension of the term of lending.

The share of credits in the assets of the surveyed banks in 2003 was 54%, which is the absolute maximum in a seven-year period. Meanwhile, the share of lending to industrial enterprises remained at the 2001-2002 level - 16% (see Table 5).

Average term of loans granted in 2003 was about 5.6 months. This was 0.8 month longer than in 2002. The term of lending to industrial enterprises has also get longer - from 5.1 to 6.1 months.

The share of banks not engaged in long-term credit in 2003 was 16%. This was less than a half (!) of their share in 1997.

The volume of overdue debt is declining for the last six years. It accounted for 19% of total credit outstanding in 1997, 8-9% in 1998-1999; 4-5% in 2000-2002, and just 3% in 2003. To all appearances, its "quality is not getting worse. Expectations of bankers about their chance to recover their debts remain at the level of 2002, when they looked forward to have as much as 45% of total "bad" debts repaid (within six months). The frequency of cases, which the banks took to courts of arbitrage against their persistent defaulters, in 1999-2003 was roughly stable: one or two applications in a half-year.

In recent years, the share of banks free from overdue debt has significantly declined. In 2001, their share was 15%, but in 2003, only 8%.

Table 5
Indicators of Credit Activity of Commercial Banks

	1997	1998	1999	2000	2001	2002	2003
Share of credits in assets of banks, %	38	42	40	43	50	49	54
Share of credits to industrial enterprises in assets of banks, %	15	17	14	13	15	16	16
Share of long-term (over 1 year) credits in total credits, %	2	9	13	10	10	11	11
Share of banks granting no long-term loans, % of all banks	34	31	21	21	16	12 ^{*)}	16
Average term of lending, months	3,1	4,2	4,6	5,0	5,4	4,8	5,6
Average term of lending to industrial enterprises, months	3,5	4,9	4,7	5,3	5,4	5,1	6,1
Share of overdue debt in total debt, %	19	9	8	5	4	4	3
Share of banks having no overdue debts in their loan portfolios, %	5	8	5	13	15	10	8
Share of overdue debt repayable within a half-year in total overdue debt, %	32	32	38	30	40	45	45
Number of recourses to arbitration on overdue debt in a half-year	3,6	2,3	1,6	1,0	1,5	1,3	1,7

^{*)} *Corrected.*

FINANCIAL CONDITION OF BORROWERS

Banks are fairly optimistic in their assessment of financial condition of their borrowers. Financial condition of enterprise borrowers was assessed as normal by only a half of all respondent banks in 1997-98, by 70% of them in 1999, and by as many as about 95% in 2001-2003.

These assessments are probably not unfounded, because only just about 13% of the total outstanding loans accounted for new borrowers, in other words, for those the banks had been dealing with over less than a year. And 56% of all loans were taken by enterprises, which had been dealing with relevant banks for more than three years (see Table 6).

Notice that entry of new borrowers into the credit market, however slow so far, accelerated a little in 2003. Those enterprises that the banks had been dealing with for less than a year accounted for as much as

13% of the total outstanding loans (against 7% in 2001-2002). And only 30% was granted to those that the banks had been dealing with for over five years (38-50% in 2001-2002).

Table 6

Distribution of Outstanding Loans by Term of Dealing with an Enterprise, % of total lending

Term of dealing with an enterprise	1997	1998	1999	2000	2001	2002	2003
Less than 1 year	8	3	8	9	7	7	13
1-3 years	4	4	15	19	20	28	31
3-5 years	13	10	24	20	23	27	26
More than 5 years	75	83	53	52	50	38	30
TOTAL	100	100	100	100	100	100	100

This is also evident from direct assessment of changes in the number of borrowers: in 2003, the range of borrowers widened at 40% of the surveyed banks. This is the maximum indicator in seven years of our observation (see Table 7).

Table 7

Changes in the Range of Borrowers (Shares of banks whose range of borrowers expanded - remained unchanged - narrowed in two months before survey, %)

	1997	1998	1999	2000	2001	2002	2003
Expanded	15	12	29	32	39	29	40
Remained unchanged	79	82	64	64	56	67	56
Narrowed	6	6	7	4	5	4	4

FACTORS TO LIMIT LENDING ACTIVITIES OF BANKS

Gradual improvement in the economic situation and the further, however slow, development of the credit market affect the factors that are limiting the lending activities of banks. These factors have lost much of their acuteness.

In the first place, this refers to such limitation of lending activities as insolvency of borrowers. In 2003, only 18% of the surveyed banks singled out this factor among those that limited their lending activities (see Table 8). This is the absolute minimum in seven years of observation. Let us remind that in 1997-1998 the same indicator was 73-85%; in 1999-2000, 51-56%, and in 2001-2002, 40-42%. In other words, it has declined by the factor of 4.5 (!) in seven years.

Such limiting factor as toughness of the Central Bank policy has declined at a relatively similar rate: it was singled out as a limitation by 16% of the banks in 2003, while in 1997, their share had been 42%.

Although the problem of shortage of credit resources has been gradually relaxed in the last three years (declined in order of importance from 52% in 2001 to 40% in 2003), this is still the major factor to impede the development of lending activities of the banks.

Among other noteworthy obstacles to the development of lending, 26% of the surveyed banks mentioned deficient demand for loans from sound and promising borrowers.

No more than 6% of the respondent banks have mentioned other factors.

Let us notice that after a long period of increase in the share of the banks that saw no factors to constrain their credit activities (from 8% in 1998 to 20% in 2002), this indicator has declined to 14% in 2003. This decline may perhaps be attributed to the fact that the growing number of banks are trying to operate more actively in the credit market, but are facing real difficulties, while earlier their inactivity in this segment was, indeed, never limited by anything.

Table 8**Main Factors to Limit Lending Activities of Banks (Shares of banks considering the relevant factors, %)**

	1997	1998	1999	2000	2001	2002	2003	(8)=(7)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
No limiting factors	9	8	10	12	13	20	14	-6
Lack of credit resources	52	32	25	37	52	51	40	-11
Lack of demand for credit (from sound and promising borrowers)	25	32	33	32	19	27	26	-1
Insolvency of borrowers	85	73	56	51	40	42	18	-24
Tough policy of Central Bank	42	42	35	37	39	29	16	-13
Lack of offices, equipment etc.	0	0	0	2	4	0	4	+4
Price surge	0	7	0	2	4	2	2	0
Taxes	7	8	7	7	7	3	0	-3
Shift to other types of operation	10	0	5	7	0	0	0	0
Inadequate skills of personnel	0	0	0	2	2	0	0	0
Other	0	3	3	3	4	0	6	+6

INDUSTRY-WISE PRIORITIES OF LONG-TERM LENDING

In recent years, industrial sectors have got quite a clear ranking by credit attractiveness. Food is the undeniable leader in the ranking. In 2003, 54% of the surveyed banks believed it to be the most preferable object for long-term financing (see Table 9). This was 7 percentage points less than in 2002, but the gap between food and other industries still remains quite substantial.

The second echelon are the industries, which 1/5 to 1/3 of all banks are ready to lend money to. They are electric power, fuel, building materials and machinery, which has ascended to such a high rank for the first time in the whole period of our observation.

The third echelon are the industries, which 1/10 to 1/5 of the banks reported to be ready to lend money to. They are chemicals, which went to a lower rank in 2003 from the second to the third echelon, iron and steel, non-ferrous metals, light industry, and agriculture.

Finally, about 7% of the banks in 2003 believed that all industries were bad for lending.

Table 9

Rating of Industries (Shares of banks considering the relevant Industry attractive for long-term lending, %)*

	1997	1998	1999	2000	2001	2002	2003	(8)=(7H6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Food	32	45	50	56	57	61	54	-7
Electric power	33	29	25	22	30	24	27	+3
Fuel	34	25	25	26	25	33	26	-7
Machinery and metalworking	13	11	13	8	14	15	22	+7
Building materials	12	16	14	21	21	23	20	
Chemicals and petrochemicals	17	11	17	22	29	24	17	-7
Iron and steel and non-ferrous metals	14	8	9	13	19	12	17	+5
Light industry	4	6	5	8	9	19	12	-7
Agriculture	5	2	7	7	13	12	8	-4
Logging, woodworking, pulp-and-paper	8	6	10	7	9	7	8	+1
All industries are bad	19	25	16	13	7	5	7	+2

* Respondents were asked to point out three industries.

FINANCIAL CONDITION OF BANKS

Financial condition of banks was getting steadily better over the last seven years. The fastest pace of improvement was typical of the post-crisis years (1999 and 2000). By 2001, none of the banks any longer assessed its financial condition as poor. Nevertheless, in 2001-2003 the share of banks in good financial condition declined a little, and the share of those in normal condition increased (see Table 10). These changes practically by no means affected the distribution of the banks by performance. Their vast majority - 89% - made profit in 2003; 9% were at a break-even point, and only 2% of them made loss (see Table 11).

Table 10**Financial Condition of Banks (Shares of surveyed banks, %)**

	1997	1998	1999	2000	2001	2002	2003
Good	12	17	34	42	32	32	39
Normal	72	78	65	57	68	68	61
Poor	16	5	1	1	0	0	0

Table 11**Performance of Banks (Share of surveyed banks, %)**

	1997	1998	1999	2000	2001	2002	2003
Profits	74	80	83	91	92	90	89
Break-even	7	16	12	9	4	10	9
Losses	19	4	5	0	4	0	2

PROSPECTS FOR BANKRUPTCY OF BANKS

In the assessments by the bankers, the threat of bankruptcy has declined in recent four years: in 2003 70% of the banks believed it to be unreal (see Table 12). Meanwhile, the balance of factors to make the danger of bankruptcy closer changed, and their severity declined in recent years. For instance, while before 2000, the banks saw the major threat to their activities in insolvency of their borrowers and in tough policy conducted by the Central Bank, in 2001-2003, insolvency of borrowers went to the background, to be replaced by lack of external funds.

COMPETITION IN BANKING SECTOR

In spite of their relatively affluent appearance and good financial condition, banks are feeling a tougher pressure of competition. About 61% of all banks believed that the competition was strong (see Table 13). This was 24 points more than in 2002, and the highest assessment in seven years of the observation. Only 2% of the banks reported that they had no competition on their markets.

Table 12**Factors of Bankruptcies (Share of banks, %)***

	1997	1998	1999	2000	2001	2002	2003
No danger	38	43	43	70	61	61	70
Tough policy of the Central Bank	38	40	20	17	21	12	22
Lack of external funds	29	13	10	8	15	23	11
Insolvency of borrowers	57	33	24	17	15	13	5
Tax burden	28	18	13	10	14	6	4
Managerial errors	7	8	2	2	0	2	2
Other	2	18	9	4	4	5	3

* Respondents were offered to point out no more than three factors to make the danger of bankruptcy close.

Table 13**Level of Competition (Share of banks, %)**

	1997	1998	1999	2000	2001	2002	2003
Strong	24	28	26	36	26	38	61
Insignificant	61	51	65	62	74	60	37
Absent	15	21	9	2	0	2	2

Generally speaking, development of the banking sector in 2003 may have not been marked by essential changes in terms of quantitative indicators, but it gives an impression of a start of vital qualitative modification. The domestic banking system is beginning to perform the functions of redistribution that it has badly fulfilled before.

REB SAMPLE

Surveys of banks are conducted by REB bimonthly. As a rule, they cover from 20 to 40 banks. The sample is based on medium-scale regional banks with average workforce of about 180 employees and average salary about 7000 rubles (2003). About 34% of all banks in the sample are the former special banks, and about 54% are new commercial banks.