

## THE RUSSIAN BANKS AFTER SANCTIONS OF 2014

### LOS BANCOS DE RUSIA DESPUÉS DE LAS SANCIONES DE 2014



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#### RESUMEN

El objetivo del trabajo es el análisis de los bancos de Rusia después de la sanción de 2014 desde la perspectiva de la teoría del comportamiento económico. El documento describe el sistema bancario de Rusia utilizando métodos analíticos para las nuevas estadísticas bancarias. El documento encontró que las circunstancias de crisis requerían acciones enérgicas por parte de las instituciones bancarias y que la suma de los fondos recaudados tiene una tendencia estable. Este documento demuestra la idea de Vernikov (2009) que la concentración bancaria en Rusia PF y el sistema bancario de Rusia se convirtió en una Institución de mercado madura.

Palabras clave: Ruso, bancario, sistema, sanciones, activos.

#### ABSTRACT

The aim of the paper is the analysis of the banks in Russia after sanction of 2014 from the view of the economic behavior theory. The paper describe the banking system of Russia using analytical methods for new banking statistics. The paper found that crisis circumstances required vigorous actions for the banking institutions and the sum of funds raised have a stable up trend. This paper prove the idea of Vernikov (2009) that banking concentration in Russia decreased and the banking system of Russia became a mature market institution.

**Keywords:** Russia, banking, system, sanctions, assets.

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## INTRODUCTION

The main role of banks is to stimulate economic growth. However, there are increasing difficulties in implementing this task in Russia emerging due to the complexity of sectoral sanctions from western countries. Absolutely and relatively sectoral sanctions effect along with a complex mechanism of Russian banks make it necessary to search for ways to address the contradictions in bank assets consolidation.

The general objective is analysis of the statistics of banks in Russia after sanction of 2014 from the view of the economic behavior theory to prove idea of sanction effect. The declining in economic growth for 2014 and the ensuing rapid ruble devaluation in 2014 made worse excellent characteristics for the Russian financial systems like written before (Karas & Vernikov, 2016).

Today, Russian sanction problem cannot be compared with previous systemic crises, in which foreign economic factors were of leading importance. In modern conditions, the decisive role was played by domestic economic problems in the form of a slowdown in economic growth, coupled with higher inflation and lower investment, which led to the leveling of increased labor productivity. There was no the approximate stability of the balance of payments and exchange rate in the period 2011-2013. This situation led to real exchange rate growth, and the external sanctions impact was only an impetus to the emergence of a currency crisis (Abramov, Radygin & Chernova, 2017). Today, in the wake of financial and economic sanctions, exacerbated by political contradictions in relations with Western countries, the question of the future economic of banks in Russia is significant one (Karagiannis, 2014; Klinova & Sidorova, 2014). The Russian banks are forced to take responsibility on its own for global risks. Thus, global financial risks are determining factor in the stability and effective development of the Russian banking system.

This study result supports the previous research of Vernikov (2009) that Russian bank assets concentration decreased in the public sector of the industry, with the top five state controlled banking groups in possession of over 49% of assets. Several of the largest state-owned banks now constitute a de facto intermediate tier at the core of the banking system.

This study also supports previous research which finds that Russian banks after sanctions are a mature market institution by Mamonov and Vernikov (2017). In line with this finding bank asset performance decreased through response to increasingly dynamic sanctions.

International sanctions and financial crises affect both the Russian economy and its banking system with their negative impact; it often turned out to be shaky and weak. The Russian banking sector in 2014 is overcoming such significant events as the

financial crises of 1998 and 2008 (Mamonov & Vernikov, 2017). In this connection, the Russian banks for the second time in the last decade has come to the need to confront external shocks. In the beginning of sanctions situation in 2014, it was necessary to pay debts for a relatively short period and it was not realistic to carry out the restructuring of debts like found in last research (Abramov et al., 2017). In 2014 competition in the Russian banking sector should be fair, and household deposits should be kept in reliable banks. In this connection, decisions on the provision measures for banking institutions are made by the Bank of Russia (Rock & Solodkov, 2001).

## **LITERATURE REVIEW**

Sectoral sanctions significantly affect the local banking system. The analysis of the banks in Russia after sanction of 2014 from the view of the economic behavior theory involves identifying and evaluating economic parameters about Russian banks. It is a process which involves selecting main parameters and so should be done with utmost care, as not following the correct process may results in selection. The paper major concept is that main characteristic of banking sector is net assets (Belousova & Kozyr, 2016; Mamonov & Vernikov, 2017).

Banking system is a set of different types of national banks and credit institutions operating within the framework of a common monetary mechanism. The banking system includes the Central Bank, a network of commercial banks and other credit and settlement centers. The Central Bank carries out the state issue and currency policy and is the core of the reserve system. Commercial banks carry out all types of banking operations (Mamonov & Vernikov, 2017).

Sanctions in the spring and summer of 2014 put the Russian banks in a dangerous situation. In this regard, Bank of Russia tried to increase stability of the Russian banking system and got the right to purchase preferred shares or subordinated bonds of banks in order to increase their fixed equity. Russian researchers (Belousova & Kozyr, 2016) estimated sanction effect. This paper can prove their findings.

Researchers found other factors to indicate that the Russian banking system will be stable despite the expected difficulties (Belousova & Kozyr, 2016).

The Russian researchers found any features of the functioning of the banking sector like the dominance of public banks, which found by Vernikov (2009, 2011). The major papers regarding the banking system of Russia are about the conditions for the return of Russian banking institutions to international financial markets like proposed by several Russian researchers (Vernikov, 2009; Lopatin, 2019; Meynkhard, 2019).

The global financial community has made active efforts to harmonize global universal banking rules and standards for the functioning of the global financial market and banks (N. Morozko, N. Morozko & Didenko, 2018a; Fungáčová, Solanko & Weill, 2010).

Any papers was annualized the establishment of the anti-sanction principles of banking regulation in Russia in accordance with international requirements and country committing to use the Basel standards of prudential supervision and regulation in accordance with the Basel 1,2 and 3 (Schoors, 2003; Speranskaya, 2009). Under the conditions prevailing in 2014, when Bank of Russia was not able to provide the most accurate assessment of the credit risks of the banking sector (Sprenger, 2010).

In practice, in 2014-2019 years, the Russian banking system continued to develop under rather difficult conditions associated with increased risks in the activities of banking institutions, which inevitably lead to a corresponding increase in the requirements of the regulator regarding bank reserves (N. Morozko, N. Morozko & Didenko, 2018b).

The transfer of subordinated loans to preferred shares strengthened the equity of banks. At the same time, this action entailed some inhibition of asset growth, i.e. led to a decrease in the availability of bank lending (N. Morozko, N. Morozko & Didenko, 2018c; Karminsky, Hainsworth & Solodkov, 2013).

According to the view of Bank of Russia, there is no objective data on a decrease in savings activity after 2014, despite the fact that at the beginning of last year there was a slight short-term decrease in the volume of deposits. The leading factor in a certain change in the growth rate of investments in the downward direction is the internal factor associated with a decrease in the growth rate of real incomes of the population (Manevich, 2017; Tatuev, Shash & Borodin, 2014).

## **MATERIALS AND METHODS**

The economic behavior theory gave the instruments for analysis of the situation in the banking system of Russia after sanctions implementations in 2014 because each round of international economic restrictions has impact on the banking system of Russia.

Using analytical methods for new banking statistics from Bank of Russia (2019, September), we can find effect on the banking system of Russia after sanction in the period from 2014 to 2018. There is new data about Russian bank, because of it there are not so many researches in this field.

We found the next information about Russian banking system after 2014:

Total assets (liabilities) of banking sectors [billion USD],

Total funds of banking sectors [billion USD],

Loans and other placed funds, provided by non-financial organizations and individuals, including overdue debt [billion USD],

Securities purchased by credit organizations [billion USD],

Deposits of individuals [billion USD],

Funds raised from organizations [billion USD].

Various general scientific methods (analysis and synthesis) and the methods of cognition (systemic, functional, and formal-logical approaches) were used for analysis of Russian banks after sanctions in 2014. The use of formal legal and comparative legal methods contributed to the development of conclusions. We use banking statistics from Bank of Russia (2019, September).

## RESULTS

Since the external debt of domestic banks in the process of overcoming the crisis tended to increase (Table 1). But the external debt of the banking sector at the beginning of 2013 amounted to 259 [billion dollars], and by 2018 already 659 [billion dollars] by Russian researchers (N. Morozko, N. Morozko & Didenko, 2018d). We are going to use Bank of Russia (2019, September) data as default.

During the financial and economic crisis of 2008-2009. Russian banks received additional funding from the state. At that time, Bank of Russia sold loans to Bank VEB, coupled with several leading Russian banks. Bank VEB placed subordinated loans in Russian banks, which essentially replenished their capital. After 2014 this mechanism can be used again.

**Table 1.** Indicators of the banking sector of Russian Federation.

Indicators	2013 year	2014 year	2015 year	2016 year	2017 year	2018 year
Total assets (liabilities) of banking sectors [billion USD]	474,677 4	545,235 5	671,411 3	798,541 9	926,179	1252,46 8
% to GDP	75,8	73,0	74,4	79,6	86,8	108,7
Total funds of banking sectors [billion USD]	74,5258 1	76,3274 2	84,55	98,5951 6	113,940 3	127,877 4
% to GDP	11,9	10,2	9,4	9,8	10,7	11,1
% of banking sector assets	15,7	14,0	12,6	12,3	12,3	10,2

Indicators	2013 year	2014 year	2015 year	2016 year	2017 year	2018 year
Loans and other placed funds, provided by non-financial organizations and individuals, including overdue debt [billion USD]	259,927 4	292,704 8	375,261 3	446,911 3	523,488 7	659,121
% to GDP	41,5	39,2	41,6	44,6	49,0	57,2
% of banking sector assets	54,8	53,7	55,9	56,0	56,5	52,6
Securities purchased by credit organizations [billion USD]	69,5064 5	94,0161 3	100,188 7	113,466 1	126,166 1	156,838 7
% to GDP	11,1	12,6	11,1	11,3	11,8	13,6
% of banking sector assets	14,6	17,2	14,9	14,2	13,6	12,5
Deposits of individuals [billion USD]	120,725 8	158,354 8	30,1838 7	229,854 8	273,508 1	299,237 1
% to GDP	19,3	21,2	21,2	22,9	25,6	26,0
In % to liabilities banking sector	25,4	29,0	28,5	28,8	29,5	23,9
In % of the cash income of the population	26,1	30,2	33,3	35,7	38,0	38,9
Funds raised from organizations [billion USD]	154,148 4	179,466 1	225,737 1	252,390 3	286,887 1	403,356 5
% of GDP	24,6	24,0	25,0	25,2	29,6	35,0
% to liabilities of banking sector	32,5	32,9	33,6	31,6	31,0	32,2

Source: Author calculation (2019), Bank of Russia (2019, September).

In addition, Bank of Russia had to carry out a number of foreign exchange interventions, as a result of which there was a more gradual depreciation of the ruble in the foreign exchange market. Approximately similar actions, however, on a much smaller scale, the Government of the Russian Federation and Bank of Russia implemented in December 2017 and January 2018, when they resorted to foreign

exchange interventions in the amount of 11.9 [billion dollars] and 2.34 [billion dollars], respectively.

The task of paying off external debt by the banking sector of Russia is all the more significant since the total external debt of Russia is a significant factor that has a significant impact on the macroeconomic stability of the Russian economy.

In general, during 2017-2018 Russian banks, companies and federal authorities had 227.7 [billion dollars] in foreign debt. In 2017, Russian banks and companies needed to pay 142.5 [billion dollars]. In particular, banks must repay 40.4 [billion dollars] on foreign debt (N. Morozko et al., 2018d).

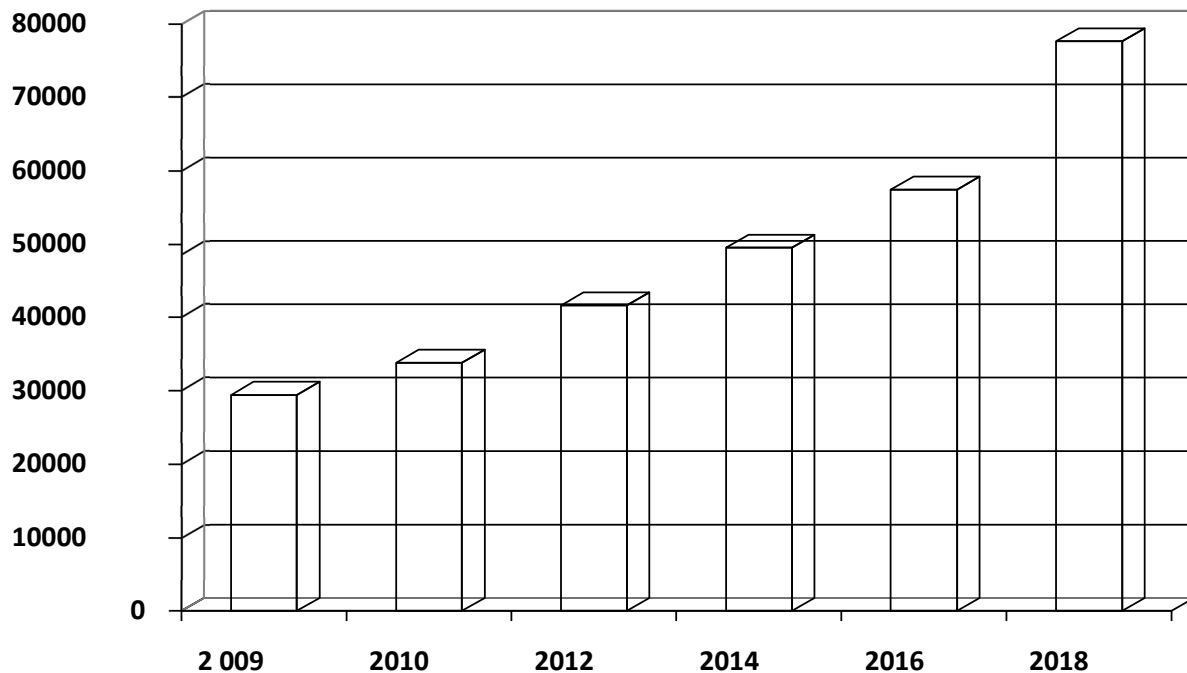
It's not only Russian banks that are directly exposed to the sectoral sanctions of the United States and the European Union. The risk assessment for all operations with all institutions of the domestic banking system is overestimated.

Even foreign subsidiaries of Russian banks are categorically instructed not to provide loans for more than 30 days to their own parent companies, which were on the sanction lists (Karagiannis, 2014). For example, It was happened with DenizBank AS, the Turkish subsidiary of Sberbank of Russia (N. Morozko et al., 2018d; Sprenger, 2010).

Despite the fact that the decrease in the nominal ruble exchange rate in the spring and autumn of last year amounted to about 40%, the effective real ruble exchange rate shows a much lower level of devaluation of the national currency. Given the increase in domestic inflation in the previous 2011-2013, it was possible to ascertain the growth of the effective real exchange rate of the ruble, which created the objective prerequisites for its decline in the present. At the same time, the acceleration of the pace of this process last fall was due to the direct impact of a combination of external - economic and political - events that preceded it.

As a result of the outstripping growth of bank assets relative to GDP growth, the ratio of bank assets to GDP grew from 86.8 to 108.7% (Figure 1).

**Figure 1.** Growth dynamics of total assets (liabilities) banking sector, bln. USD.



Source: Author calculation (2019), Bank of Russia (2019, September).

The actions of Bank of Russia aimed at stabilizing the foreign exchange market were quite effective. A sharp, up to 17%, increase in the key rate, coupled with the introduction of REPO transactions in foreign currency and the accelerated transition to a freely floating exchange rate of the ruble, created grounds for suspension of speculative currency transactions, which led, in the future, to stabilization of the ruble exchange rate.

In January 2014, the activity of many banks (about 70) in attracting household deposits was limited or directly prohibited by direct instructions of Bank of Russia. These measures were applied during the period of a thorough analysis of the financial condition of these banks, in order to stabilize and prevent accumulation of risks.

## DISCUSSION

Our study showed that main characteristics of banks (net assets) grew (Figure 1). The loans, securities purchased by credit organizations, deposits of individuals, funds raised from organizations were in uptrend in the period from 2014 to 2018 year.



The banks in Russia is going through a crisis period without serious loss. The contribution of the Russian banking sector to the economic growth balanced at the same level.

The paper highlighted that the sum of funds raised from organizations in national currency have a stable growth. The share the funds in GDP grows not so quickly.

At the same time, a law was passed on doubling the maximum amount of insurance payments, which should prevent the outflow of funds from accounts (Belousova & Kozyr, 2016). The law developed by the Government of the Russian Federation, Bank of Russia got the right to purchase preferred shares or subordinated bonds of banks in order to increase their fixed capital, or capital of the first level (Alkassim, 2005).

Sanctions measures in the spring and summer of 2014 put the Russian banking system in a dangerous situation. In this regard, certain steps have already been taken to increase the efficiency and stability of the Russian banking system on the back of oil and gas revenues and blockchain infrastructure developing (Mikhaylov, 2019; Denisova, 2019; Nyangarika, Mikhaylov & Tang, 2018).

The main features of the functioning of the banking sector are identified:

1. The growth of bank assets relative to GDP growth, the ratio of bank assets to GDP grew from 86.8 to 108.7%.
2. The banking system of Russia is a mature market institution, which over the twenty-plus years of advancing the Russian economy along the path to the market has gained considerable potential for independent development.

## **CONCLUSIONS**

Significant asset growth in the banking sector should not be expected, but they will not be realized in the worst-case scenario. The paper made original contributions in paper of Vernikov (2009).

The analysis of the situation in the banking system of Russia after sanction of 2014 from the view of the economic behavior theory showed that Russian banks are enough sustainable.

It is significant contribution in literature about problems in banking sector. The finding about vigorous actions for the Russian banking institutions and state regulators is significant for future researches in banking and finance.

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