

Russia

Less supportive macroeconomic conditions limit recovery in net wealth accumulation

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- Following years of dynamic growth in household disposable income, the outlook appears much gloomier, with economic growth estimates rapidly revised down as the oil price keeps falling. It is anticipated that the less supportive macro conditions combined with the persistently volatile environment will bring only a marginal recovery in the accumulation of financial wealth, stabilising around 22/23% of GDP.
- Owing to the tense world economic situation a sharp drop in household mutual funds' investments was recorded in the second half of last year. The unstable situation in the financial markets and fears of rouble devaluation are expected to encourage an increasing shift into USD cash and bank deposits. Government support to stimulate pension funds should keep investment into these saving schemes lively.
- The tightening of credit market conditions, visible since last September, is expected to further depress lending activity in 2009 with most of the banks mainly focusing on short-term and unsecured loans. This will enable some stabilisation in the accumulation of net financial wealth as a share of GDP to around 11%, while growth in corrected net wealth is anticipated to cool down as mortgages lose their momentum.

Table 1: Household Financial Indicators (S.14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	23 %	24 %	22 %	22 %	23 %
Financial Liabilities (% of GDP)	8 %	10 %	10 %	11 %	12 %
Net Wealth (% of GDP)	15 %	14 %	11 %	11 %	11 %
Corrected Net Wealth (% of GDP)	17 %	16 %	14 %	13 %	14 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Sources: Bank of Russia, Rosstat, UCBR, UniCredit Group CEE Research Network

After almost six years of around 25 % growth p.a. in household disposable income (in USD terms), some signs of moderation started to emerge in 2008 on the back of poorer market conditions. Accordingly, growth in household real disposable income decelerated to 7.8 % yoy in the first 9 m compared to 10.4 % yoy for the same period of 2007, with wage growth also slowing down to 12.8 % yoy from 16.2 % yoy in 2007.

Despite the observed softening in income dynamics, the accumulation of financial wealth was sustained in H1 with investments into bank deposits and especially mutual funds still making a positive contribution. The market mood, however, changed drastically from then on, with both equity and investment fund markets recording dramatic sell-offs after the summer, when first of all due to political concerns over the Russian invasion of Georgia and then worries about the health of its banks prompted investors to flee the market. The result was a drop of more than 40 percent in Russia's equity markets and net redemptions of mutual funds hitting a record EUR 0.2 bn in Q3.

Volatility and uncertainty in financial markets are expected to hold at least in the short term, strongly influencing household preferences in favour of long-term saving instruments and deposits with larger banks, together with some evidence of a re-dollarisation process backed by recent CB decisions to speed up the deprecia-

tion of the rouble. Overall we anticipate the growth rate of household financial assets to have decreased to 15 % in 2008 as opposed to 27.1 % in 2007. However, a whole range of macro indicators seem to show worrisome trends ahead with growth estimates being rapidly revised down for 2009 as the oil price keeps falling. As a result of the gloomier outlook we envisage there will be only marginal room for recovery in the accumulation of financial wealth next year, with growth in financial assets projected to be 16.2 % yoy. The tightening of credit market conditions, visible since last September, is expected to further depress lending activity in 2009 with most of the banks mainly focusing on short-term and unsecured loans. The deleveraging of households might support some stabilisation in the accumulation of net financial wealth to around 11 % of GDP, while corrected net wealth should shrink as a percentage of GDP with mortgages losing their momentum.

Despite some outflows registered following the financial turmoil since September, bank deposits remain the key household saving vehicle and are expected to increase by 20 % yoy to reach EUR 172 bn by end of 2008. In 2008 the population continued to neglect cash savings in favour of the more profitable retail deposits at banks. Looking ahead, the share of bank deposits in total wealth is projected to increase further from an anticipated 69 % in 2008 to 72 % by 2010.

Table 2: Financial Wealth

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Currency	14,647	6.7%	-37.9%	-6.2%	-2.0%	4.4%
Bank deposit retail	145,032	66.6%	35.7%	20.2%	18.0%	24.0%
LC currency	126,492	58.1%	41.6%	24.0%	20.6%	26.6%
FX currency	18,540	8.5%	5.8%	-6.0%	-5.6%	-7.0%
Securities other than shares	-	-	-	-	-	-
Listed shares	-	-	-	-	-	-
Mutual funds	21,291	9.8%	81.9%	-10.0%	13.0%	20.0%
Open-end	3,785	1.7%	49.2%	-31.7%	17.2%	37.1%
Close-end	16,337	7.5%	117.6%	-2.6%	14.4%	17.1%
Interval	1,169	0.5%	-29.6%	-42.6%	-35.4%	20.0%
Insurance technical reserves	12,525	5.7%	25.4%	15.7%	14.6%	16.3%
Life insurance	-	-	-	-	-	-
Non-life insurance	-	-	-	-	-	-
Pension funds' assets	24,345	11.2%	26.5%	21.0%	17.0%	15.0%
Total	217,841	-	27.1%	15.3%	16.2%	21.3%

Sources: Bank of Russia, Rosstat, Analytical Center Investfunds, Federal Service of Insurance Survey, Vnesheconombank statistics, UCBR, UniCredit Group CEE Research Network

The Russian mutual funds industry also recorded stable inflows of funds until Q2 last year. However, the market mood and perceptions changed dramatically from the summer with a huge sell-off wave recorded in the July–September period and net sales topping out at 6.0 bn roubles (EUR 0.2 bn). With risk aversion dominating, stock markets in Russia tumbled by more than 40% in Q3 resulting in a drop of net assets of almost EUR 2.0 bn to 20.2 bn at the end of September. In the months to come, some stabilisation on the financial markets and depressed quotations could stimulate just a gradual recovery in accumulation into investment funds with growth expected to accelerate again to 13.0% this year.

Overall we expect high volatility conditions to persist in the coming years, stimulating a re-dollarisation process in line with trends prevailing in recent months. In October, Russians withdrew 9.2% of their retail deposits from the 32 largest banks, with outflows speeding up compared to September when net retail deposits de-

creased by 1%. At the same time, deposits in foreign currencies rose by 18.2%, while rouble deposits fell by 22.6%. The outflows from local currency deposits show that confidence in the rouble is falling, fuelled by recent CB decisions to speed up its depreciation. As a result, demand for dollars in October also reached a record high with banks selling over USD 6 bn. Restored confidence in the banking sector should facilitate some stabilisation in the outflows from bank deposits, while demand for cash dollars will remain high in the short term.

The share of insurance in household financial assets has remained quite stable over the last 3 years. This trend is expected to persist resulting in a share in total financial assets of around 5.5% by 2010. The Russian pension system has undergone a deep reform since 2002. As of 2008 the pension system is still far from being efficient. For some time, the Pension Fund of the Russian Federation has been running at a deficit and has been subsidised by the state. Nevertheless, the government was able to

Table 3: Financial Liabilities

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Housing loans	21,083	23.4%	116.3%	45.0%	28.0%	33.0%
Consumer loans	68,945	76.6%	44.9%	32.1%	21.0%	22.7%
Financial leasing	-	-	-	-	-	-
Total	90,028	-	57.1%	35.1%	22.8%	25.4%

Source: Bank of Russia, UCBR, UniCredit Group CEE Research Network

avoid taking unpopular action. Government support to stimulate investment into pension funds is anticipated to remain strong in the years to come as well, resulting in average yearly growth of around 18% in the 2008–2010 period.

The volume of retail loans has grown exponentially in recent years. Retail demand was driven by improving household financial conditions, especially among the middle classes. Growth rates remained strong throughout last year until September when signs of a rapid squeeze in credit became more evident following the mounting liquidity problems.

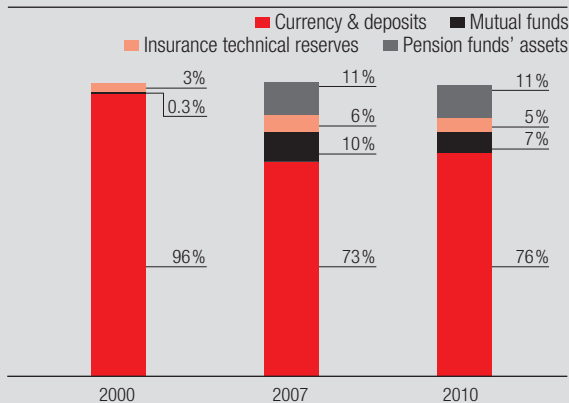
The mortgage market was hit particularly hard – only high quality collateral accepted and based on low LTV and on already finished projects – and banks increasingly switched their focus toward short-term and unsecured lending. As a result, the yearly growth rate for mortgages is expected to dive from 116.3% in 2007 to 45.0% in 2008. Looking ahead, the mortgage market may receive some relief from the government injection of funds into the AHML (Agency for Home Mortgage Lending – joint stock company owned by the Russian Government) equivalent to USD 2.5 bn.

Government support will also be crucial for property developers as it might help to unfreeze some important projects, partially avoiding a bust in the real estate market. However, the full recovery in the housing market will very much depend on improved macro conditions and restored confidence. Longer term potential in the segment still remains intact with mortgages representing only 2% of GDP at the end of 2007, below the regional average of 9%.

The ongoing crisis and credit squeeze at global level are also badly affecting the car loan business. The financing of household appliances is also anticipated to slow down (most purchases of white goods are still made on a cash basis). Despite a less supportive scenario in the short term, opportunities in the car loan segment remain healthy and bank loans may still play an important role in influencing sales given car affordability, which is still relatively low.

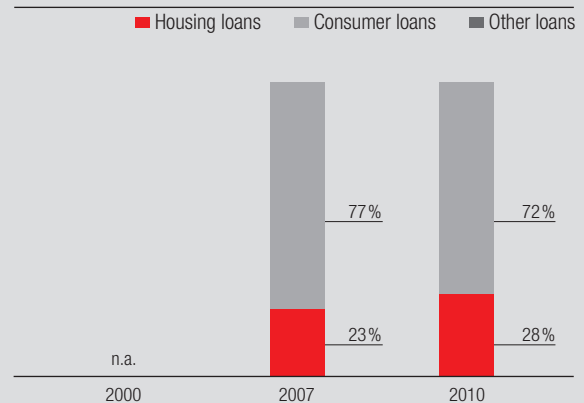
Overall, total retail loan growth is projected to slow down significantly from an estimated 35% yoy in 2008 to 23% in 2009, reaching 12% of GDP by 2010.

Household Financial Assets (% of total)



Sources: Bank of Russia, UCBR, UniCredit Group CEE Research Network

Household Financial Liabilities (% of total)*



*) Consumer credits include also credit cards, overdrafts and car loans as they are not split by the Bank of Russia
Sources: Bank of Russia, UCBR, UniCredit Group CEE Research Network