

# Russia Macro View

## How sustainable is credit growth?

- **Temporary factors allowed retail lending to accelerate to 45%** – In terms of the average loans-to-wages ratio, retail lending only reached pre-crisis levels in early 2012. The increase in the average payback period was coupled with the massive budget spending on wages which resulted in the high loans growth.
- **Across the regions, growth looks 95% sustainable** – In our view, sustainable growth is the inverse relation between lending growth rate and indebtedness levels. Only 5% of the loans are allocated in regions that have an average payback period of more than 5 months and where growth rises with indebtedness.
- **Most of the factors point to a slowdown in lending** – The post-crisis recovery is over, wages are decelerating, savings are at their historical lows, and lending is coming under increased regulatory scrutiny. However, the average payback period has the scope to increase from the current 3.5 months. On balance, we think retail lending is likely to taper off to 15-20% in 2013.

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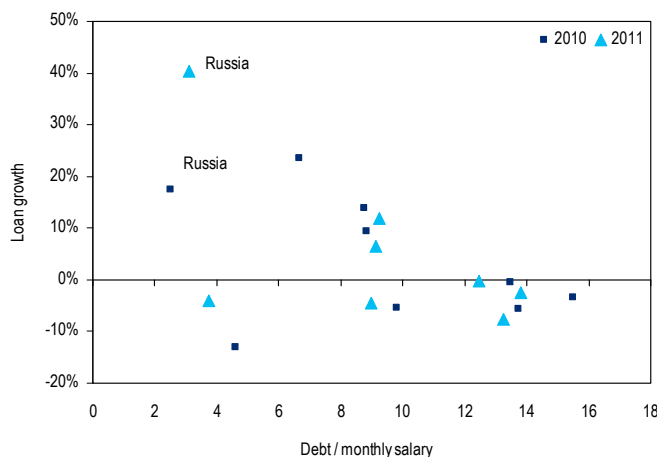
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## How sustainable is credit growth?

**The 40-45%YoY growth in loans to households caused concerns for the Central bank.** The credit expansion might have been one of the reasons to hike policy rates in September by 25bps. Furthermore, the CBR is implementing regulatory measures to restrain loans growth by increasing provision requirements on uncollateralised retail loans. **However, in our view, even without the regulatory measures, credit growth would significantly lose momentum.**

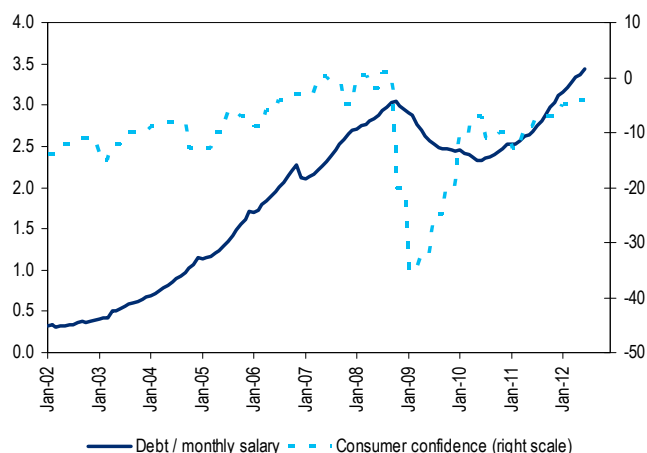
**Russia has very low levels of debt.** As we wrote in [Household consumption strong, but running out of support?](#), despite the credit expansion, new loans have little effect on consumer spending. The main reason behind this is the low overall level of debt. Compared to countries in Eastern Europe, Russia has in fact the lowest loans-to-salary ratio. The spread in the ratio is too high, in our view, to be explained by a different income structure in the other countries, or a lower share of wages and higher share of rents or entrepreneurial earnings.

Figure 1. Russian households have less debt than Eastern Europeans



Source: Haver, Citi Research

Figure 2. Post-deleveraging recovery and wages were driving lending\*



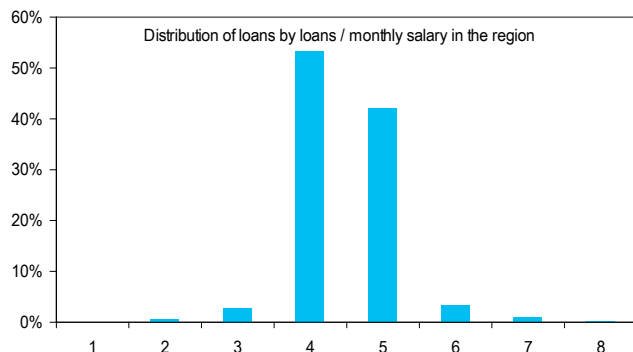
Source: CBR, Haver, Citi Research

\*We divided the outstanding loans by the working population and by the average wage to get the debt/monthly salary ratio (payback period)

**In our view, credit growth is mostly driven by recovery.** 2009 was a period of significant deleveraging by households, and only in early 2012 did the loans-to-salary ratio reach its pre-crisis levels of 3 months (Figure 2). This also coincided with the significant pre-election increase in budget wages. Another driver is the expansion to the regions. Those regions that have a loans-to-salary ratio below three months are growing fastest (Figure 4) aiming at the Russia-average of 3-4 months. Still, these regions are only 5% of the loan portfolio in banks.

**However, there are some regions in Russia that look unsustainable.** What concerns us is the U-shape of the curve in Figure 2. It shows that the heavily indebted regions (with a debt level at or above 5-6 months) increase their borrowing more than Russia does on average. On the other hand, these loans in the overall banks' portfolio represent 5%. In contrast to these, the richest Central and North-Western regions are growing at the slowest pace, and this is also supported by the dynamics of retail sales that show the lowest YoY growth in Russia.

Figure 3. Most of the regions have the payback period of 3-5 months



Source: CBR, Rosstat, Citi Research

Figure 4. Lending growth is highest in the least and most leveraged regions



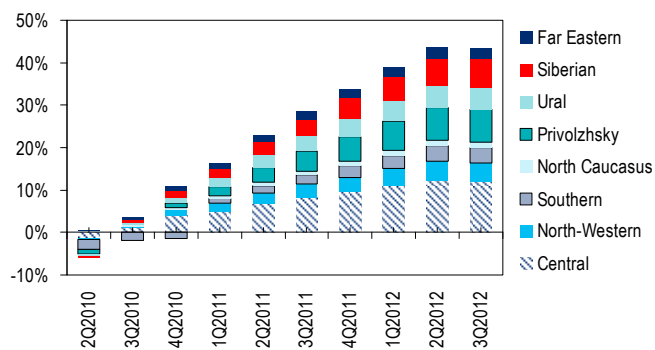
Source: CBR, Rosstat, Citi Research

**We expect 15-20% growth of retail lending next year.** In our view, there are five main factors influencing credit growth. First, higher wages make it easier for banks to lend and for consumers to borrow as risks seem to decrease. Second, propensity to save may change spending behaviour. Third, the loans-to-wages ratio reflects banks' risk management as well as risk taking by households. Fourth, interest rates on loans show their affordability. And finally, the CBR's policy may impose constraints on banks.

- **Wages** – in our view, overall wage growth will be subdued compared to this year. As we noted in [Emerging Markets Economics Today](#), corporate profits do not suggest a robust increase in compensation. In our base case, we expect nominal wages to slow down to around inflation rate next year, weighing on consumer lending as well.
- **Savings** – the savings ratio is fluctuating at its historical lows, and it is unlikely to further decrease – unless there is a dramatic rise in unemployment. However, during 2009, the households used their savings to deleverage. Overall, the savings factor should be marginally negative for loans growth.
- **Loans-to-wages ratio** – more than half of the overall retail loan portfolio is in those regions, where average loan to average wage is between 3 and 4 months. On the other hand, close to 45% of loans have a longer regional-average payback period of 4 to 5 months. In our view, this indicates the average indebtedness has a potential to increase closer towards 4 from 3.5 months.
- **Interest rates** – are likely to increase as liquidity in the banking sector remains tight. Still, when the average retail loan rate is above 20%, an additional 1pp makes little difference. We mark this factor as neutral.
- **CBR's policy** – the regulator is constraining risky lending through high provision requirements that might weigh on credit expansion.

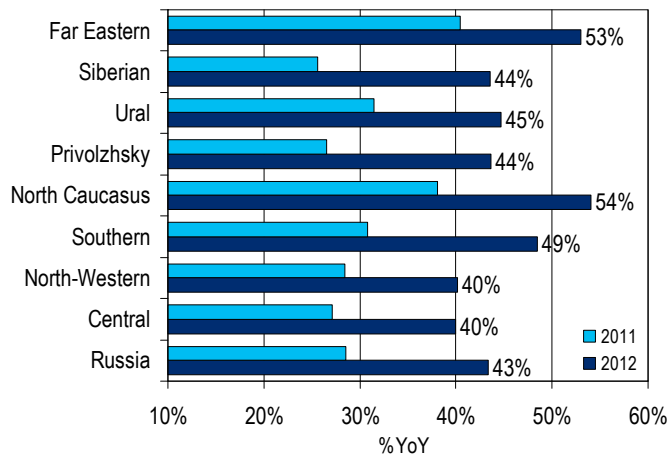
Most of the factors point to a cooling in the consumer lending segment. Moreover, the after-crisis recovery seems to be over and, due to the overall economic situation and the CBR's policy, lending growth will likely go down. In our base case, we set the loans-to-wages ratio to be 0.3 months higher than current levels (at around 3.8) and, with 6-7%YoY nominal wages, the average growth rate of retail loans should slow down to 15-20% in 2013.

Figure 5. Contribution to lending growth by regions



Source: CBR, Citi Research

Figure 6. YoY lending growth in 1H by regions



Source: CBR, Citi Research

## Appendix A-1

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