

The Role of Bank Credit in Financing of the Economic Growth in Russia

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Abstract

The aim of the study is to identify solutions of the problems of the real sector of Russian economy, associated with its financing and lending for economic growth. These include low growth of industrial production, irrational structure of exports and imports, high degree of depreciation of fixed assets, lack of volumes and growth rate of investments in their renovation. According to the materials of the official bodies of state power of Russia, the analysis of the main declared objectives and methods of achieving high rates of economic growth was carried out. Based on the study of relevant statistical information, there were identified the main sources for financing of economic development and the necessity of their extension. Special attention was paid to trends in bank lending of the real sector.

Keywords: real sector of the economy, industrial policy, investments, bank loans, syndicated loan

1. Introduction

The development of Russian economy can be currently characterized by insufficient growth rate of gross domestic product and structural imbalances that negatively affects the prospects for economic growth. Thus, the increase of GDP year to year in the first half of 2014 has not reached 1% (0.8%), and was lower than in the first half of the previous year, when this figure was 0.9%. According to the interim figures of the Federal State Statistics Service (Rosstat), the index of industrial production in January-September 2014 compared with the corresponding period of 2013 was 101.5%; increase in production of manufacturing industries respectively 102.7%.

At the same time in separate industries volumes of engineering production continue to decline. Thus, the volume of production of tractors for agriculture and forestry in January-September 2014 amounted to only 82.7% of the corresponding period of 2013, forging presses—73.0%, electric motors—84.0%, passenger cars—93.8%, and trucks—78.5% respectively (Operational information of Rosstat, 2014).

In accordance with the results of a survey of industrialists in September 2014, conducted by market research experts at the Center of the Institute of Statistical Studies Higher school of Economics (HSE), more than a third (38%) of respondents rated the demand for the products of their enterprises “below normal” level (the worst figure since April 2010) and the situation with its own financial resources and profitability improved for only 11% and 14% of enterprises. With 21 and 25% of respondents reported deterioration.

High rates of depreciation of fixed assets are continuing: in the whole economy level of depreciation reached 46.3% in 2013, increased comparing with 2008 by 3 percentage points, and in the medium technology high-level activities, to which Rosstat relates basic engineering industry—45.9%. Thus investment in fixed capital gradually declined in 2014, so their value in the first half of the year made up 97.2% of the corresponding period of 2013, while the share of loans in the sources of their funding barely exceeds 10% (Operational information of Rosstat).

If in 2011 the share of investments aimed at the reconstruction and modernization in the total investment in fixed assets in the sector “machinery and equipment” was 34.3, then in 2013 it fell almost doubled and amounted to 17.2%.

Virtually there were no changes in the structure of Russian exports. The major share (71.4%) in the total amount of it for the period January-August 2014 amounted to export energy products, and the share of exports of machinery,

equipment and vehicles remained negligible and even decreased from 5.9% in January-August 2013 to 4.6% in the corresponding period of 2014.

In the structure of imports, despite the introduction of economic sanctions against Russia, still almost half (47.9%) is engineering products, due to the insufficient development of own capacities for the production of process equipment. Thus, none of the Russian machine-building factories is able to ensure fully the cement plant modern technological equipment. Domestic manufacturers have put only 4% of the equipment for the maintaining of existing facilities, creating a power reserve of 1.2 million tons of cement per year (Portal engineering). According to News agency REGNUM, 85% of the equipment in the domestic shipbuilding industry is not Russian.

Obviously, it becomes actual to identify possible solutions of these complex problems.

2. Review of Official Documents to Stimulate Economic Growth

Russian authorities recognize the need to promote economic growth through the development of the real sector of the economy and reduce dependence on imports of foreign products. Thus, in an interview with “the Newspaper” in early November 2014, First Deputy Minister of Industry and Trade Gleb Nikitin noted that increased attention to the real sector is one of the main trends of modern economic policy in developed countries in recent years. There industry is the main investor in innovation. For example, in Germany and South Korea 89% of the total cost of private business on innovation are made in the industrial sector accounted, in China and Japan—87%, USA—67%. The role of industry is great in the creation of jobs, including those in related industries—it provides nearly 25% of jobs in Europe in the private sector, and every new job in industry creates 0.5-2 new jobs in other sectors of the economy (Gazety, 2014).

Given the urgent needs of the economy in economic growth, in December 2012 Government decree No. 2539-r approved state program “The development of industry and increase its competitiveness”, which included the implementation of 17 sub-programs in virtually all major branches of Russian industry.

Thus, depending on the objectives of the program various tasks and tools to implement them were formulated. For example, to create new industries and markets innovation infrastructure for the development of new industries; removal of regulatory barriers and creation of conditions for bringing to market innovative products and services are required. For the development of industries, whose activities are focused on domestic consumption, incentives to increase the share of non-budgetary sources of financing, gradual reduction in the volume of direct public sector financing, focusing instruments of state support to stimulate demand must be provided. (Burakov, 2014a)

To support the industries, oriented to meet investor demand, there provided the need to update the technological base of relevant industries; promotion of research and development to create new technologies and materials; ensuring for Russian companies equal conditions of competition in the domestic and international market; promotion of exports of products with high added value; development of competition; coordination of programs of technological development of the industry with the trends in demand for products in the consuming sectors of the energy and commodity sectors.

To achieve these goals until 2020Y funding in the amount of 3.5137 trillion rubles is provided, including: the federal budget—228.2 billion rubles, budgetary funds—207.5 billion rubles, private investments—3078.0 billion rubles.

In addition, the state program and a number of other industries, aviation, electronics and electronic, pharmaceutical and medical industry for the period 2013-2025 years, Shipbuilding (2013-2030 gg.) were developed. The main instruments of industrial policy included such as subsidizing part of the interest on loans, subsidies for research and development (R & D) costs, and other costs (investment projects, pilot projects in the field of engineering and industrial design, grants to strategic organizations of the defense industry, etc.), property contributions, state contracts under Federal Law-44 to perform R & D, subsidies for the implementation of state assignment by the Federal budgetary institutions (FBI), state guarantees on bonds, providing budgetary investments, provision of budget financing of R & D, public capital investment.

In mid-2014 a draft law “On industrial policy” was developed, which aims to achieve three main objectives: to determine the role of the state in the area of industrial policy, establish a framework for the application of new tools to support industrial activities, resolve conflicts of interpretation of sectoral legislation in the application of measures to support industrial activities.

Developers mentioned, that the major objective—not the definition of the leading role of the state in support of the industry, but the definition of priority sectors and a set of tools for their development.

As new instruments to support industrial activities bill defines a special investment contract, exemption from certain taxes for a certain term, the creation of the state information system of industry.

It is also envisaged the development of industrial parks, project finance and Fund of Industrial Development.

Project financing mechanism includes banks preferential loans for projects that have been selected under the state guarantees (up to 25% of the loan amount), and the Bank of Russia refinancing. Banks will be refinanced in the Bank of Russia under the formula “key rate minus 1.5%” (as a result of banks’ margin of 2.5%), while the interest rate shall not exceed the level of the key rate plus 1%. Term of refinancing—three years with the possibility of extension.

Fund of Industrial Development aims to support technology projects at the stage of completion of the R & D and facilitate private investment. Soft loan with collateral from the borrower’s side will be tool of support. The size of the loans will be determined by the Supervisory Board of Fund, based on the demand and opportunities of companies. Rate of 5%, available for most companies, but sufficient to cover operating expenses of the Fund in the amount of 1.2-1.6% and an allowance for partial risk coverage is assumed. At the same time the fund is not profit-oriented, designed to ensure the development of a large-scale bank financing of industrial and technological projects.

It is assumed that in a single project, private investment will exceed the amount of support from Fund 3-5 times. Thus, the mechanism will be launched to stimulate production and technology large manufacturing companies to invest in projects on import substitution and market launch of new industrial products.

3. Analysis of the Financial Opportunities to Achieve Goals

However, under the current trends achieving the necessary private funding to achieve these objectives is constrained by a number of reasons. First of all, funding opportunities of investment for its own account private corporates are limited. Thus, the proportion of unprofitable enterprises in the manufacturing sector in January-August 2014 increased to 31.1% compared with 30.7% for the corresponding period of 2013, while growth in the volume of losses amounted to 117.0%, including in manufacturing industry in general 122.2%, and in the sub-sectors “fabricated metal products” and “machinery and equipment”—196.9 and 123.7 respectively.

Profitability of products and assets in key manufacturing industries and construction is extremely low and is not comparable with the level of weighted average interest rates on bank loans.

Table 1. Profitability of production in basic industries

	<i>I half 2014</i>		<i>I half of 2013</i>	
	Profitability of			
	products	assets	products	assets
manufacture of machinery and equipment	5.5	1.1	6.3	1.3
manufacture of electrical equipment, electronic and optical equipment	7.1	1.6	6.7	1.6
manufacture of transport equipment	4.2	0.6	6.5	0.8
construction	2.0	0.5	2.7	0.3

Reference: According to the Bank of Russia, the weighted average rate on loans to non-financial companies for a period of 1 year to 3 years old in August 2014 amounted to 11.96% over 3 years—11.66%.

Source: Report of the “Socio-Economic Situation in Russia”, January-July 2014, the Bank of Russia data “Weighted average interest rates on loans granted by credit institutions to non-financial institutions in rubles.”.

In the post-crisis period the structure of foreign investment as possible funding sources for economic growth has worsened, which is reflected in a sharp drop in the share of direct investment and growth in the share of other investments, primarily intended for service trade export and import operations.

Table 2. Structure of foreign investments in Russia, % of total

	2000	2005	2007	2010	2012	2013
Total investments	100	100	100	100	100	100
including:						
direct investments	40.4	24.4	23.0	38.7	12.1	15.4
portfolio investments	1.3	0.8	3.5	3.0	1.2	0.6
other investments	58.3	74.8	73.5	58.3	86.7	84.0

Resource: Compiled by the author according to: “Russia in Figures”, 2008, Foreign investments in 2010, the report “Social and Economic Situation in Russia”, January-August 2014.

Accumulation of households do not always translate into investments because:

- The relatively low share of savings (in 2014 slower growth in real incomes was an additional constraint of savings growth—in January-September, real income growth was 100.7%, while the same period of 2013—103.7%);

- Prevalence of speculative investments accumulated funds.

Thus, in September 2013, the share of savings in money incomes of the population was 7.1%, in September 2014—only 4.8%. In the structure of savings funds bank deposits constitute the main part (70%), the fifth part—balances of cash and only 11%—investments in securities (Socio-economic situation of Russia, 2014).

In addition, according to the survey of Research center “Demoscope” held in September-October 2013 and included more than 6,000 households in 32 regions of Russia, only 4.5% of citizens own shares of enterprises, 0.5%—shares of mutual funds, 0.2%—bonds (BBC, 2014), that don’t allow to consider the general population as mass investor.

Thus, the commercial banks are among the major private investors for industrial development. In the post-crisis period their resources and assets increased more than 2 times, but the share of loans for machinery remains extremely low.

Table 3. Loans to non-financial sector of Russian banks by industry

Indicator	1.01.2010	1.01.2011	1.01.2012	1.01.2013	1.01.2014	1.09.2014
Total assets bln. Rub.	29 430.0	33 804.6	41 627.5	49 509.6	57 423.1	62 464.1
Loans to non-financial sector	112	14 062.9	17 715.3	19	22 242.3	24 441.2
In % of the assets	541.7			971.4		
		41.6	42.6		38.7	39.1
	442.6			40.3		
Loans by industry “manufacture of machinery and equipment”	241.2	267.1	299.5	372.6	388.6	484.6
In % of total	1.9	1.96	1.7	1.9	1.7	2.0
Manufacture of machinery and equipment for agriculture and forestry	13.4	18.7	21.3	24.7	20.7	11.0
In % of total	0.1	0.13	0.12	0.13	0.09	0.04

manufacture of transport equipment	311.3	313.5	382.1	493.4	696.5	1027.5
in % of total	2.5	2.3	2.2	2.0	3.1	4.2

Resource: Calculated according to the Bank of Russia “Total outstanding loans to resident legal entities and individual entrepreneurs in rubles, foreign currency and precious metals of economic activity and the use of certain areas (of the Russian Federation)” for the respective years.

The value of bank lending to finance upgrade the technological base of enterprises gradually decreases, which is confirmed by data on the share of bank loans for investment in fixed assets.

Table 4. Proportion of bank loans for investment in fixed assets of enterprises

Indicator	2008	2009	2010	2011	2012	2013	January-September 2014
Bank loans for investment organizations of all ownership in fixed assets (excluding small businesses) (bn. Rub.)	791.9	621.5	595.8	725.7	806.3	1000.9	8223.2
As % of investment organizations of all ownership in fixed assets (excluding small businesses)	11.8	10.3	9.0	8.6	8.4	10.0	10.3

Source: Investments in fixed capital in Russia by funding source, Federal State Statistics Service.

A discrepancy of bank resources to areas of their investments is saving. This is confirmed, for example, a comparison of the volume of attracted and placed long-term funds.

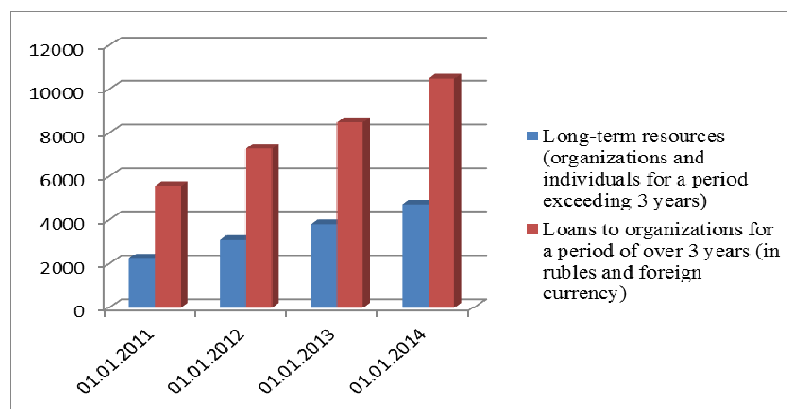


Figure 1. The ratio of attracted and placed long-term resources in the Russian banking system

Source: Calculated according to the Bulletin of Banking Statistics, 2011, No. 12, 2013, No. 9.

As shown above the data, although the volume of long-term resources is gradually growing, only less than half of long-term loans are secured by the underlying long-term resources. This means that while for the provision of long-term loans medium- and short-term funds are used, what results in a high level of interest rate risk associated with the need to refinance loans granted. Thus, the rate of interest rate risk since the beginning of 2013 to the beginning of 2014 increased from 36.0 to 37.8% of the total capital.

4. The Main Directions of the Provision of Financial and Credit Support for Economic Development

In view of limited resources, especially banking, which can be used to finance economic growth, it is necessary:

- Identify the main priorities of state support as a benchmark for private investment;
- To stimulate the activity of commercial banks aimed at lending support of priority sectors and projects.

The need to define the strategic priorities was noted in October 2014 at a meeting of the Russian President with members of the government. In particular, it was noted that the priority of the industry is the basic condition for the provision of financial support in the amount of 1 to 20 billion. Rub., the provision of budget guarantee in the amount of 25% of the project cost. The role of the agent for the account of the safeguards is proposed for the Vnesheconombank (Izvestiya, 2014).

However, it is obvious that under the shortage of financial resources it should be formed a hierarchy of such priorities, among which it's necessary to select the object for priority support, the development of which would be an incentive for expansion in related industries or sectors of the economy. It appears that at present the most serious problem that requires immediate solution—is to ensure food security by upgrading the technological base and the development of modern infrastructure for the agricultural sector.

In turn, providing the technological basis of agriculture requires the investment of resources in the development of tractor and agricultural machinery, where production tractors decreased to 200 times the level of 1990, even with taking into account the screwdriver assembly of foreign tractors—to 22 times. And although in November 2010 it was decided by the government to achieve the share of domestic appliances by 2020 in total sales of agricultural tractors up to 60%, in 2013 it achieved only 10%, and the actual amount of their production reached only half of the planned for this period. As a result, if in the world of 1,000 hectares of arable land for average 21 tractors are used, in Russia—only 4. (Burakov, 2014b)

Given the importance of bank lending as a major source of financing for economic growth in accordance with the allocation of priorities of state policy, a set of measures to promote the participation of the Russian banking system in the process is required. In particular, the credit policy of the Russian banks should provide focus of lending to meet the actual needs of the economy in credit resources (Ternovska & Grebenik, 2014).

For banks whose loan portfolio involves the bank in the implementation of priority programs for the development of the country or region it may be used simplified access to refinancing instruments, reduction of reserve requirements. A special role in this process the system-forming banks are playing, including state-owned banks, the share of which, according to the “Expert” RA for the period from 2009 to 2014 increased from 40.6 to 52%.

Since 2013, the Bank of Russia has stepped up its oversight of systemically important credit organizations (SZKO). The Department of supervision of systemically important credit organizations was created, comprehensive quarterly survey of their financial condition is assumed, including those on the basis of inspections, requirements for intra-control procedures are increased. In three banks (Gazprombank, Raiffeisenbank, PSB) an experiment on the application of the new model of supervision was started. At the same time ensuring the sustainability of such banks should be accompanied by a strengthening of their role in the financial support of the real economy, as these banks have sufficient resources to do so and receive state support, including indirect. In particular, the head of Russia's state-owned bank VTB A. Kostin suggested that the bank will be funded through the program, which the government wants to fund through the National Welfare Fund.

For expansion of credit support for development of priority sectors and projects in the regions it's necessary to overcome the problem of unequal access to liquidity in the form of funds the Bank of Russia for small and medium-sized regional banks.

With this in mind, the Bank of Russia developed new forms of refinancing: under secured claims under credit agreements secured by insurance contracts of “EXIAR”, and under secured claims under loan agreements between banks which are focused on lending to small and medium businesses. For the further development of the system it is advisable to extend the refinancing opportunity for small and medium-sized banks to obtain loans secured by non-marketable assets, including a list of persons liable for assets enterprises, strategically important for the development of the region.

Finally, the provisioning of syndicated loans by banks should be expanded, given the fact that in developed countries near 80% of large investment projects are credited on syndicated basis and the syndicated loan market was viable even in a crisis, as it is accessible for a wide range of borrowers, in contrast from the stock market public borrowing.

Using syndicated lending for engineering enterprises will allow to accumulate the necessary loans for major long-term investments in project finance, investment lending, issuance of bank guarantees, ensuring their financial needs by several small banks with the support of resources of banks with state participation and separation of risks.

As studies of experts show, Russian syndicated loans are mainly used for short- and medium-term credit of export-import and trading firms, speculative trading on the Russian stock market and very insignificantly for investments in the real economy, mainly to cover the needs of an investment nature. The major share of loans is available for general corporate purposes of the borrower, working capital and trade finance.

In addition, most of the loans are granted in foreign currency, and a leading position in this segment is occupied by foreign banks. This is due to the high capitalization of foreign financial institutions, many years of experience conducting operations on syndicated lending, positive reputation of foreign organizations. This position is confirmed by the analysis of the practices of the Russian banks. So, in 2010 PSB received the syndicated loan of 250 million US dollars, which was attended by the EBRD and 11 international banks (Commerzbank AG, CREDIT SUISSE AG, HSBC BANK PLC, ING BANK NV, Oversea-Chinese Banking Corporation Limited, The Royal Bank of Scotland NV, Raiffeisen Zentralbank Österreich AG, Standard Chartered Bank and others). The funds were used to finance the loan portfolio of PSB, including the financing of foreign trade contracts of bank customers (OJSC “Promsvyazbank”).

The company “Uralkali” in October 2013 was granted by a syndicated loan in the order of project financing for the construction of two mines Ust Yaivinsky mine, implemented by “Daylmann-Haniel Shakhtostroy”, a subsidiary of the German Mine Construction Company “DEILMANN-HANIEL SHAFT SINKING GmbH”. Guarantor of political and commercial risks of the loan is the German export credit agency Euler Hermes. At the same time, in May 2013 a similar loan was provided for general corporate purposes, and in June 2014—to refinance (<http://loans.cbonds.info/loan/2335>).

It should be noted that the number of transactions involving Russian banks is gradually increasing. For example, the largest private bank in Russia “Alfa-Bank” participates in syndicated lending for companies operating in various sectors of the Russian economy by implementing in projects worth more than \$ 1 billion. (Burakov, 2014c)

Funds raised under the syndicated loans are used for such purposes as financing general corporate purposes, the implementation of structural projects, mergers and acquisitions, refinancing of the loan portfolio. And loans to banks are dominated. Thus, in June 2014 “Belarusbank” was granted by the syndicated loan in the amount of 85 000 mln. Dollars., with Alfa-Bank as Arranger and Bookrunner, and CJSC “NOVIKOMBANK”, ZAO KB “Globex”, “MDM Bank” JSC “CREDIT BANK OF MOSCOW”, Eurasian Development Bank, JSC “Bank Zenit”, Baltikumus Bank AS. OAO “Gazprombank”, Amsterdam Trade Bank, JSC “Bank Finservice”, Baltic International Bank as joint organizers. At the same time an agreement was signed on bringing another syndicated loan of 100 million euros. This syndicated loan was second syndicate attracted by Belarusbank based on legislation of the Russian Federation, with Novikombank as the agent bank.

According to the results of the past year Novikombank became the leader among Russian banks in syndicated loans, was the organizer of 10 transactions to raise resources for the largest banks in The Commonwealth of Independent States (CNG), totaling more than 540 million US dollars.

This experience could be used for lending of priority investment projects of a strategic nature, which require substantial financial resources.

5. Conclusions

Achieving high and sustainable economic growth is impossible without adequate financial support. Given the trends in financing and lending to the real sector, the system of measures for its expansion is necessary. With this purpose, there were suggested such ways as: the necessity of identifying strategic priorities for economic development, methods of stimulating lending to industrial enterprises, commercial banks, improving the system of refinancing of the banking sector, the development of the syndicated loan by pooling the resources of several commercial banks for sectors and projects which are strategically important for the economy.

Such complex of proposed measures could significantly improve the efficiency of the Russian economy and create a solid foundation for further growth and development.

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