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Overview of Russia's SME lending market

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Macroeconomic situation and the banking sector

The summer of 2017 was very hot not only in terms of weather but also in terms of economic forecasts. The June statistics gave many grounds for optimism. Industrial output increased by 1.7% (year-on-year, according to Rosstat), inflation stood at only 3.3% in the period from January to June (compared to 8.5% for the same period last year), while the last week of July was even marked by deflation, according to Rosstat. Government officials and experts rushed to make optimistic claims, while information agency headlines trumpeted the end of recession and the forthcoming growth of Russia's economy. German Greff, President of Sberbank, also indicated that there were signs of stabilisation. He said that in the second half of 2016 we could expect some GDP growth. Bloomberg also felt the pulse rate increase: they made their conclusion based on growing entrepreneurial activity, which, according to analysts, was confirmed by higher electricity demand and volumes of freight services. July was also positive for the Bank of Russia. The news headlines read: "The Central Bank believes that recession in Russia is over", with reference to the CBR bulletin "What do the Trends Say?", which stated: "The index estimate of Russia's GDP shows that recession has been left behind, and slow economic growth is expected."[1]

In October, this rhetoric was reaffirmed by the World Bank, which reported that, spurred on by higher oil prices and macro stabilisation, the Russian economy returned to growth in 2017, albeit at a modest pace. Domestic demand rebounded, expanding by 1.7 percent in Q1 2017 after a contraction of 12.2 percent in 2014-2016 caused by a drastic terms-of-trade shock and economic sanctions. Supported by growth in real wages, the rouble's appreciation, and improving consumer credit, consumer demand became the main driver of this growth. Fixed capital investment also expanded, especially in Q2 2017, supported by public investment—both direct and of large state companies in the energy sector. Tradable sectors and the

[1]Online edition of Expert magazine, "Between stabilization and stagnation", http://expert.ru/ural/2016/38/mezhdu-stabilizatsiej-i-stagnatsiej/

accompanying non-tradable sectors, such as transportation, led GDP growth in the first Q1 2017. A rebound in wholesale trade, real estate and construction positively contributed to the GDP growth from Q2 2017. The monetary policy remained prudent and consistent with the inflation-targeting framework. In August 2017, the CPI inflation undershot the end-year target, reaching 3.3 percent y/y. Inflation expectations remained elevated, but they were on a downward trend. On September 15, the Central Bank lowered the key rate from 9 to 8.5 percent. The key rate has been reduced by 350 bp since the beginning of the year. The banking sector's performance improved with the economic recovery; preserving its stability remains key. Corporate lending growth experienced a low single-digit increase, while retail lending accelerated slightly faster. The key credit risk and performance indicators remained stable, while the banks' profitability continued to increase in the first half of 2017. Preserving the stability of the banking system will be key, given the recent failures of the largest private banks – Otkrytie and B&N Bank. Although there should be no direct implications for the budget, resolving these failures will be the first test of the new resolution mechanism, whereby funds from the Central Bank's Banking Sector Consolidation Fund will be injected as additional capital into these banks.[2]

At the same time, the structural vulnerability of the economy still persists, which can be attributed to the structural limitations of the industrial sector. Large corporations remain dominant in the structure of Russia's economy, with a high degree of concentration in traditional heavy-industry sectors, in the oil and gas sector, with a limited SME sector. Similarly, oil and gas companies and their connected entities account for two thirds of the stock market capitalisation, which increased the impact of external oil shocks on the internal economy. The public sector retains its dominant role in many industries, which undermines competition. In the financial sphere, three major government banks account for more than half of all assets of the banking sector, thus suppressing competition and hindering financial services development.[3]

The Russian banking sector and its players have found themselves in a challenging situation. It is not only the financial crisis, but also the technological revolution which may soon dramatically change the banking market. "If we think of an area for investment of our efforts and capital, banks will be the last to be considered. I don't know any other business today that is so obscure and complicated," said German Greff, President of Sberbank, when giving an overview of the banking industry at the International Financial Congress. The basis for this assessment can be traced to the facts of the economic crisis and the campaign for the revocation of banking licences. At the same time, the very structure of the financial services market is undergoing a global transformation in which new high-tech competitors create a challenge for traditional banks.

Despite the fact that this summer the Central Bank revoked fewer licences than ever during the entire period, the Russian banking sector's "clean-up" is far from being completed yet. According to the experts of Fitch Ratings, there are still many problem banks in the system. At the same time, financiers refuse to give more accurate forecasts, as they do not have a full understanding of the true licence revocation or restructuring criteria. Nobody can tell at what stage the banking sector's clean-up process is today.

[2] WORLD BANK, Europe and Central Asia - ECONOMIC UPDATE, OCTOBER 2017
https://openknowledge.worldbank.org/bitstream/handle/10986/28534/9781464812194.pdf
[3] WORLD BANK, Systematic Country Diagnostic for the Russian Federation "Pathways to Inclusive Growth",
http://pubdocs.worldbank.org/en/235471484167009780/Dec27-SCD-paper-rus.pdf

Official statements promise another year or two of active withdrawal of banks from the market. The number of licence revocations is most likely to decline in the near future from the 2014-2016 maximums due to a decrease in the total number of banks and, accordingly, the number of candidates for revocation, and also due to the overall profitability growth in the banking sector, which helped a large number of vulnerable banks to improve their financial standing. However, the information cited by the head of the Central Bank, Elvira Nabiullina, on the net profit of the banking sector in the first half of the year (which more than doubled year-on-year to RUB 770 billion)should not be misleading – the lion's share of these profits was earned by several major banks, primarily with state capital. As for the remaining bulk of Russian banks, they have to fight for survival. Since the beginning of the active phase of the banking sector clean-up in 2013, a total of 346 licences have been revoked and 35 banks have been bailed out.[4]According to expert assessments, the key reason for revoking licences is associated with the aggressive lending policies and falsification of balance sheets by banks.

Apart from support provided to active banks, the government has spent huge amounts on bailing out the banking sector – RUB 2.7 trillion, or 3.2% of the GDP, according to Fitch Ratings. It is not clear so far how much more the government intends to spend on banking sector support. According to earlier assumptions of the economists of the Centre for Macroeconomic Analysis and Short-term Projections, one half of all active credit institutions in Russia may have evidence of a negative balance. RUB 5 trillion may be needed to close this gap.[5] A source in the Ministry of Finance said that up to RUB 0.75 trillion may be required for closing the capitalisation gap of the banks Otkrytie and B&N alone.

At the same time, according to analysts from the Fitch Ratings Group for Financial Institutions Analysis headed by Alexander Danilov, the financial rehabilitation of banks has resulted in a loss for the government which is at least RUB 500 billion higher than the government would have incurred had these banks gone bankrupt. In their opinion, bailout decisions are often unobvious. The group's report on the situation in the banking sector, presented by Danilov at the Fitch conference in Moscow, states that10 of the recent 30 bailout cases resulted in the rescuers themselves going bankrupt or requiring their own subsequent bailouts.[6]

Meanwhile, the Central Bank proposes to solve the problems of the banking sector by transferring credit institutions in need of rehabilitation to the Banking Sector Consolidation Fund. Earlier, the same proposal was voiced in the media by Dmitry Tulin, First Deputy Chairman of the Central Bank. The idea of setting up such a fund was discussed by the Central Bank back in July. And by the end of October, the Finance Ministry had already reported about its work on drafting a bill on the creation of a banking sector consolidation fund and a management company through which the Central Bank would be able to independently invest in the capital of banks under restructuring for their subsequent sale.

The scope of financial imbalances in the banking sector is impressive. It was the consequence of an active and overly risky policy of cheap corporate lending funded by proceeds from

[4] Central Bank of the Russian Federation, Department of Banking Supervision, Review of the Banking Sector of the Russian Federation (This issue corresponds to the "Methodological comments to the tables in the Review, Issue 20") (an online edition), Analytical Indexes, No. 179, September 2017 https://www.cbr.ru/analytics/bank_system/obs_179.pdf

[5]Online Edition of NezavisimayaGazeta, "Banks lost about 5 trillion roubles", http://www.ng.ru/economics/2016-11-18/1_banks.html

[6]Fitch and CBR discussed the "unobvious" character of decisions made by the Bank of Russia regarding the clean-up of banks, http://www.banki.ru/news/lenta/?id=10028690

expensive private deposits. This policy plants a delayed-action mine under the banks' balance sheets, says Alla Dvoretskaya, Head of the Chair of Economics and Finance of the Russian Presidential Academy of National Economy and Public Administration. This phenomenon in the banking sector has already been dubbed the "Yugra syndrome", as the practices of Yugra Bank triggered one of the biggest financial scandals of recent times. This example is very indicative of how the Russian banking market has changed in just a few years.

According to experts, it is the aggressive credit policy that entails falsifying reporting, masking the actual situation with regard to delinquency, overstating the value of assets, and stripping assets via fictitious bankruptcy proceedings through deliberate disbursements of non-repayable loans to companies affiliated with the owners.

Nevertheless, the current banking clean-up has its positive aspects: the regulator has practically curbed capital flight from the country. "So, in 2008, capital outflow via doubtful transactions reached USD 50 billion (then about 30 banks lost their licences). In 2009 it was reduced to about USD 25 billion (the number of banks that lost their licences increased up to 50), and then in 2012 it grew up to USD 40 billion (the number of licence revocations was steadily decreasing to less than 30). Since 2013, when Elvira Nabiullina was appointed head of the Central Bank, the regulator has revoked more than 400 licences. Thus, the number of licence revocations has been increasing every year and reached its peak in 2016 (when almost 100 banks lost their licences). At the same time, capital flight declined to less than USD30 billion in 2013, and to less than USD10 billion in 2014, and almost stopped from 2015," points out Alexander Danilov, Senior Director of the Fitch Analytical Group on Financial Institutions. According to Danilov, had it not been for the restructuring measures in the banking sector during the 2014-2015crisis, the capital outflow would have been much higher.[7]

Confidence crisis. Financial literacy. Demand. During the past 12 months, the banking market has experienced a dramatic "information shock" – an unprecedented discussion in the media about licence revocations and the problematic environment in which major market players operate. This had its inevitable effect on consumers' attitudes, in particular, their confidence in financial institutions.

"Two steps forward, one step back" is exactly how one could characterise the population's level of confidence in the banking system. After two years of gradual growth, we can now observe a dramatic fall of this indicator. Since July 2016, the population's trust in banks, insurance companies and non-government pension funds has fallen sharply. The level of confidence in investment companies and microfinance organisations has not changed, as evidenced by the results of a survey conducted by the NAFI Analytical Centre in July 2017: to date, 60% of Russian citizens trust banks, which is 7% lower than last year. It is noteworthy that women are more inclined to trust banks than men are (62% vs. 58%), and young people aged 18-24 trust banks more than pensioners do (68% against 57%).[8]

"The current situation contributes to the development of a crisis of confidence in the economy – the population and businesses do not trust banks, fearing loss of their savings, while banks facing liquidity problems and, in turn, mistrusting businesses, will not perform their investment

[7] Online edition of Nezavisimaya Gazeta, "Banking sector in the manual mode", http://www.ng.ru/economics/2017-09-27/1_7082_banks.html

[8] NAFI All-Russia Survey Initiative, July 2017. Total number of respondents – 1,600 in 140 towns and cities of 42 Russian regions; ages – 18 years and older. Statistical error – within 3.4%, https://nafi.ru/analytics/doverie-bankam-strakhovym-kompaniyam-i-npf-zametno-snizilos/

function," says Vladislava Poletaeva, Senior Lecturer at the Plekhanov Russian University of Economics.[9]

This fact is supported by the results of the first research on financial literacy among entrepreneurs, conducted in Russia on the initiative of the Bank of Russia by the NAFI Analytical Centre in cooperation with the RF Chamber of Trade and Industry, OPORA of Russia, and the Russian Microfinance Centre. Over the past year, more than one third of small and medium-sized companies experienced cash gaps; the financial planning horizon of most companies is limited to 12 months, while a quarter of all companies do not keep electronic records of their income and expenses. The research showed that in most cases liquidity gaps are overcome by way of cutting costs (41% of the respondents), using bank loans (26%), or taking private loans from friends or relatives (24%). It should be pointed out that 9% of entrepreneurs solve their liquidity problems by selling assets. Only 5% of companies practice long-term planning. Entrepreneurs rarely use specialised financial products (factoring, leasing, etc.) designed for financial flow management and for closing liquidity gaps, as they find the related paperwork too complicated. SMEs use loans as the main source of financing, including bank loans (31%), partner loans (from founders, shareholders – 22%), or credit lines (13%). 22% of SMEs rely on loans from close friends and relatives. One in ten small businesses (10%) use leasing, 8% use overdrafts, and 6% use crowd funding. Every fifth SME manager does not use any sources of financing for business development purposes (22%).[10]

At the same time, according to the rating agency Expert RA, there is a rising demand for investment financing in the SME sector against the background of a falling share of short-term loans. From July 2016 through June 2017, about 15% of monthly disbursements to SMEs had maturities exceeding three years, against only 11% during the same period in 2015-2016.At the peak of the crisis, small and medium-sized entrepreneurs focused their demand on working capital loans. Due to the expansion of concessional financing programmes in 2016-2017, the cost of long-term loans to SMEs was decreasing faster than that of short-term loans up to 12 months, which contributed to the improvement of the investment climate for this category of borrowers. As a result, the number of SME loan applications received by banks in the first half of 2017 was 1.8 times higher than in the first half of 2016, along with an accelerated increase in the number of loan applications from small businesses.[11]

Officials from the financial industry are increasingly supportive of the idea of introducing insurance funds for sole proprietors and small legal entities. The alleged motivation behind this initiative is to support small business, as in recent years, due to the vast clean-up of the banking sector, the estimated losses borne by entrepreneurs due to bankrupt banks reached hundreds of billions of roubles. However, in the opinion of experts from RIA Rating, this type of insurance is likely to be introduced not because anyone cares about the entrepreneurs' pockets, but because they would like to help small banks and thus stimulate competition.

[9] Online edition of Nezavisimaya Gazeta, Article "About 5 trillion roubles were lost in banks", http://www.ng.ru/economics/2016-11-18/1_banks.html

[10] Entrepreneurs' financial literacy research conducted on the initiative of the Bank of Russia by NAFI in conjunction with the Chamber of Commerce and Industry, OPORA of Russia, and Russia Microfinance Centre, https://nafi.ru/analytics/tret-predprinimateley-stalkivayutsya-s-kassovymi-razryvami/

[11] Expert RA Rating Agency, SME lending in Russia: Results of the first six months of 2017, http://raexpert.ru/researches/banks/msb_1h2017

Population's over-indebtedness. In the spring of 2017, the discussion on regulating the level of the population's over-indebtedness resumed. Elaboration of this initiative continues but, as before, appropriate assessment of a borrower's income is a stumbling block. On the one hand, swindlers come to banks with forged statements indicating a huge income, which allows them to receive large loans. On the other hand, a large part of the Russian population receives their salaries "in envelopes", i.e. in cash and off the books. Thus, they cannot be eligible for banking services based on their formal income. In most developed countries, it is common practice to assess a borrower's level of indebtedness, and the Russian system will move towards the Western model. The question is how fast this shift will take place. The government's reasoning not only includes the idea of providing social protection for "unreasonable" borrowers, who, due to their financial illiteracy, get into credit bondage, but also the idea of protecting banks from excessive risks, and, most importantly, stimulating formalization of the population's personal income in order to increase income tax collection. Another idea is to standardize retail loans, meaning that the borrower selection criteria that are common for all banks, should, in theory, stimulate securitisation. Given that in recent years retail lending has been regulated quite well, one cannot expect a quick resolution of this issue in the near future. It is more likely that a serious discussion will be triggered by a new wave in retail lending, which may already begin at the end of 2017. In general, the problem of over-indebtedness of a significant part of the population may become apparent only in the second half of 2018, and then we can expect an appropriate solution.[12]

With regard to over-indebtedness, it should be pointed out that in spite of the falling subjective assessment of their own financial literacy, the financial behaviour of Russian citizens has objectively changed for the better. For example, since 2015, the share of families that keep track of their income and expenditures is gradually increasing (20% in 2015, 25% in 2016 and 42% in 2017). The improved practices vis-à-vis family budget management is a sign of rising financial literacy, as evidenced by the results of the all-Russia survey conducted by the NAFI Analytical Centre in May 2017.[13]

Bank lending. The growth of the economy and investment has so far had a relatively low impact on bank lending. Consumer lending is in a relatively better position, while corporate lending is more likely to be stagnant. It is not entirely clear now to what extent the new wave of economic growth will be capital-intensive, and to what extent demand for capital will be satisfied at the expense of the stock market and external borrowing, and what will be financed by bank loans. In general, we can expect a noticeable increase in the growth rates of consumer lending and an exit of corporate lending into a stable green zone. Nevertheless, no new credit boom is expected to materialise in the foreseeable future.

SME lending.[14] According to the Expert RA rating agency, in the first half of 2017, the trends in the SME lending segment changed from negative to positive: the volume of disbursements increased by 20%, and the portfolio increased by 3.7% from 01.07.2016 to 01.07.2017. The increase in the total outstanding loans due from SMEs was primarily attributed to Sberbank (without Sberbank, the SME portfolio would have decreased by 1.7%), which led to a record concentration of the segment on the largest players. The future level of competition in the

[12] RIA Rating Agency: Overview of banking trends in Q2 2017, http://riarating.ru/banks/20170705/630067184.html
[13] NAFI Analytical Centre, https://nafi.ru/analytics/rossiyane-stali-bolee-tshchatelno-vesti-semeynyy-byudzhet/
[14] Expert RA Rating Agency, SME lending in Russia: Results of the first six months of 2017, http://raexpert.ru/researches/banks/msb_1h2017

market will primarily depend on the banks' participation in state SME support programmes and the introduction of new technologies. According to the agency's forecast, a decrease in the rate of defaults and an increase in demand for investment loans in the run-up to the high season will contribute to growth of the SME loan portfolio that may reach RUB 5 trillion by year-end.

In Q2 2017, the volume of loan disbursements to SMEs showed a 25% increase, reaching RUB 1.6 trillion. The current indicators are significantly better than the trends of the previous years (+0.8% in Q2 2016 and -35.5% in Q2 2015). However, in absolute terms, the volumes of disbursements are still far behind the pre-crisis level (RUB 2 trillion in Q2 2014). The SME loan portfolio demonstrated positive annual growth rates for the first time since 2014, having reached RUB 4.8 trillion as of July 1, 2017 (+3.7% compared to July 1, 2016). The trends in the outstanding loan portfolio volume are more modest compared to disbursements, which is attributed to the dominance of short-term loans in the SME portfolio, as well as the rollovers of older loans that were disbursed at higher interest rates. The SME loan portfolio is growing somewhat more slowly than the retail loan portfolio (the portfolio of loans to individuals increased by 5.8% during the period from 01.07.2016 to 01.07.2017), while the portfolio of loans to large businesses has been declining since Q3 2016 (-5.2% for the same period).

In recent years, the degree of the segment concentration has increased to a record level: the share of the top 30 banks in total outstanding SME loans reached 65% as of 1 July 2017. Since mid-2016, large banks have been actively expanding their market shares: +11 ppts from 01.07.2016 to 01.07.2017. In the first six months of 2017, the volume of loans extended by large banks to SMEs grew by 45.7% compared to the same period last year, while banks outside the top 30 showed a 10% decrease. So, about 43% of the banks included in the ranking demonstrated growth in their SME loan portfolios over the period under review, while disbursements increased in 57% of the surveyed banks. In many respects, it was Sberbank who set the trends in the SME segment by increasing the volume of SME lending by 83.9% in the first half of 2017, and the volume of the portfolio by 24.4% for the period from 01.07.2016 to 01.07.2017 (excluding the market leader, the total SME loan portfolio would have decreased by 2%, and the volume of disbursements would have increased by only 14.3%).

The rate of defaults in the SME segment has decreased: the share of past-due loans decreased to 13.2% (-2 ppts for the period from 01.07.2016 to 01.07.2017). In absolute terms, the volume of past-due SME loans amounted to RUB 636 billion, which is 10% less than it was as at 01.07.2016. At the same time, there is a growing gap in the percentage of defaulted loans in banks of different sizes: at large players, the share of past-due SME loans amounted to 9.6% (-4.7 ppts from 01.07.2016 to 01.07.2017), while at banks outside the top 30 the share was 19.9% (+3.7 ppts from 01.07.2016 to 01.07.2017). The overall payment discipline in the SME segment is lower than in other lending segments: the default rate on retail loans accounts for 7.8% of the retail portfolio and the rate of defaults on large corporate loans accounts for 5.3% of the portfolio of loans to large businesses. This difference is partly attributed to the uneven distribution of defaults among retail loan products due to the dominance of a high-quality mortgage portfolio and incomplete reflection of bad loans to large businesses due to their restructuring.

The reduction of competition has become the main limitation for SME market development. Further trends in the segment will be largely determined by the state policy. Small and medium-sized banks have been forced to reduce their presence in the segment for a number of reasons,

including an increase in default rates to a level that is beyond the owner's financial capacity to absorb toxic assets.

In addition to expansion of the "6.5 Program" and development of the National Guarantee System, relaxation of loan-loss provisioning requirements and broader access for banks to federal programmes can help banks outside the top 30 by assets to reverse the negative portfolio trends. Establishing a uniform database for information support of SMEs could also stimulate borrowers' demand for financial resources. With regard to individual banks, both the introduction of new risk management technologies and the higher overall level of digitalisation (development of online banking, smart lending), which reduce the time of loan application processing, may have a significant impact on disbursement volumes.

According to the basic scenario prepared by Expert RA, the volume of the SME loan portfolio will approach RUB 5 trillion by the end of 2017, showing an increase of 11-13%. The agency's projections are based on the assumption that demand for SME loans will go up due to a seasonal increase in sales in Q4 2017. This forecast is most likely to materialise if the following conditions are met: no new macroeconomic shocks occur, the key rate remains around 8-8.5% until the end of 2017, the average annual price of Brent crude oil stays at about USD 52 per barrel, and an official inflation rate of 4% exists at year-end. In its baseline scenario, the agency envisages that interest rates on long-term SME loans will decrease to 12-13% and the share of overdue loans will remain at12-13% of the portfolio as of 01.01.2018. The negative scenario of Expert RA is based on the assumptions that the annual average oil price will be USD 40 per barrel, the inflation rate will stand at 6-7%, and the key rate will be9.5% or higher. Under this scenario, SME market growth will slow to 5%, and the portfolio will stand at about RUB 4.7 trillion by the end of 2017.

The role of MFIs in SME financing. It should be pointed out that the growth of portfolios of state-owned MFIs focused on supporting SMEs continues (up 8% from the beginning of the year to 01.07.2017). However, in order to maintain high rates, more infusions from budgets are needed. Microbusinesses are supported primarily by tender microloans. According to assessments of Expert RA, over the first six months of 2017, the total portfolio of microloans grew by 17% (compared to 13% a year earlier) and amounted to RUB 103 billion. Due to further expansion of "bank" MFIs, the dumping policy of certain companies, and the decrease in the number of cessions (assignments), the microfinance market may grow by a quarter by the end of 2017, reaching RUB 120 billion. However, in the coming years, market growth will be limited by tougher regulatory requirements. The increase in regulatory costs and the introduction of SRO (self-regulating organisations) requirements to risk management will put excessive pressure on profitability within the industry. As a result, at least 800 companies will leave the market by mid-2018, which will lead to further concentration in the industry, focusing on the 100 largest MFIs.[15]

Automation of banking services. Another trend, and at the same time a challenge, has been the automation of banking services. This has led to staff reduction policies, and this affects not just ordinary tellers, but also more qualified staff. For example, Sberbank plans to discharge about three thousand employees after the introduction of a special robot lawyer. And by the year 2025, it will be possible to reduce the number of bank employees worldwide from the current 325,000 to 280,000. "We shall keep reducing staff further. And if we change our

[15]Expert RA Rating Agency, Microfinance market: results of the first six months 2017.

legislation accordingly, then personal visits to a bank will become history," announced German Greff.

The project manager of the Expert Analytical Center, Sergei Selyanin, attributes this staff optimisation trend not only to the progress of online technologies, but also to the overall economic situation. He points out that in many banks the peak number of branches/offices was in 2013 – at the end of the consumer lending boom, growth which he believes was totally unjustified. Therefore, what we see now is just a natural reversal of this process.

"The banking market has long been growing, absorbing the best resources, the most qualified staff, lured by higher levels of income. And now this level is gradually levelling off, and in some segments, the income of bank employees is not higher than the national average, especially in the regions," reiterates Pavel Samiev, Managing Director of the National Rating Agency. "In investment banking, financial technology, analytical segments, salaries will remain above average, as these areas require highly qualified staff, but people working in other banking areas will have to retrain and go to other industries. The popularity of the profession of a banker has fallen dramatically, including due to massive licence revocations. But this can also be regarded as a stage of a cycle, when the banking profession is at its historical minimum."

The development of online technologies in the financial services industry has another important, but not yet fully understandable, aspect in terms of its consequences – the emergence of alternative providers of such services. But it is already clear now that one of the aspects of this process – the boom in the crypto currency market – undermines the government's monopoly in money emission, and various Internet payment platforms are actively poaching clientele from traditional banks. In addition to convenience and functionality, they have another advantage, such as freedom from regulatory supervision.

Some of the services traditionally provided by banks have largely moved to structures based on IT and financial technologies which are aimed at a completely new generation of consumers of financial products – the so-called "millennials". Telecom operators have followed suit and have already gobbled up a large portion of the market previously controlled by banks. Social networks and various other platforms that allow the provision of services online can probably take away an even larger segment.

Thus, the transfer of a significant portion of banking operations to the area of online services is just the tip of the iceberg with regard to a deeper transformation of the financial services market. And the process is global. According to a survey published in 2016 by PWC, an international audit and consulting group, 83% of respondents from companies providing traditional financial services and 95% of respondents representing banks believe that there is a high likelihood of losing part of their business in the niche occupied by fintech providers. So the main question is whether banks will remain banks in the conventional sense – institutions that take deposits, disburse loans, and conduct various other transactions for a fee.

Alternative financial tools. Against the background of decreasing interest rates paid by banks on deposits, alternative financial instruments have been playing an increasingly important role in the financial system. This trend is most noticeable in the market of investment and savings life insurance plans. In recent years, life insurance has become a true flagship of the insurance market, with turnovers reaching several hundred billion roubles a year. This year, the popularity of this type of saving continued to grow. In Q1 2017, life insurance premiums

increased almost 1.5 times up to RUB 59 billion, as compared to the same period last year. It should be pointed out that this growth is not only attributed to the difference between the profitability of insurance products and deposits (the difference is not very high so far; besides, there are risks), but, above all, to tax incentives envisaged by the government. Tax deductions are envisaged for long-term life insurance contracts and make such products very attractive for the population. In addition to life insurance, tax deductions are also envisaged for stock market investments via individual investment accounts (IIA) and pension programmes. In general, the state actively stimulates alternative saving schemes, while interest earned on bank deposits may become subject to income tax, an issue which has been under discussion recently. Up to now, the Russian financial system has been developing according to the European model, where the market is dominated by banks. However, taking into account the government's intention to support the non-banking financial sector, there is likelihood that it could lean more towards the American model, where the stock market plays a dominant role.

Expectations. World Bank experts expect that consumer demand and exports will be the main drivers of GDP growth in 2017, supported to a great extent by investment demand. The low Total Factor Productivity (TFP) and labour force reduction are limiting the growth in the medium term. In order to offset these factors, it will be necessary to deepen and accelerate structural reforms. The priority policy objectives include reducing the role of the state in the economy, protecting property rights, improving the institutional and regulatory framework and promoting fair competition.

According to World Bank estimates, the growth rate of the Russian economy will reach 1.7% in each of 2017 and 2018, and 1.8% in 2019. It is pointed out in the report that the medium-term growth forecast for Russia was slightly corrected upwards after a faster-than-expected recovery in domestic demand and higher exports. Experts emphasise that high oil prices and the subsequent high demand in the domestic market created opportunities in Russia for workers from neighbouring countries. According to the World Bank, Russia needs structural reforms to improve long-term growth of the country's economy.[16]

[16] Online edition of Kommersant, "The World Bank announced recovery of Russia's economy from recession", 19.10.2017, https://www.kommersant.ru/doc/3442662?from=hotnews