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Focus Turns to Domestic Liquidity Crunch

15 September 2008 By [Tatiana Adelajda](#) / Staff Writer The Central Bank loaned a record 345 billion rubles (\$13.8 billion) to banks on Friday at its twice-daily auctions for one-day funds as concerns over an oncoming domestic liquidity crisis began overshadowing the ongoing international credit crunch.

The issue has drawn attention in recent days from central bankers as well as comments from President Dmitry Medvedev and Prime Minister Vladimir Putin aimed at reassuring fleeing investors, who have withdrawn tens of billions of dollars since the outbreak of last month's war with Georgia. The Central Bank has also been trying to prop up the falling ruble by selling off dollars, which has further contributed to the dearth of rubles.

"The liquidity crunch is a very serious issue for the stock market and for the underlying economy as well," said Peter Halloran, CEO of Pharos Financial Group.

"You would see a marginal slowdown in economic growth as the crisis deepens," Halloran said. "This will also lead to forced selling in the market."

The record volumes at Friday's repo auctions came after Medvedev said Thursday that "the government and Central Bank must do everything possible to ensure the flow of additional funds into the financial market."

Putin also acknowledged the problems, saying capital inflows might dip by 45 percent to \$45 billion, from a high of \$80 billion last year. He characterized the outflow as a result of "speculative" dealings by Western financial institutions withdrawing funds because of the mortgage crisis in the United States and Europe.

The same day, Central Bank Chairman Sergei Ignatyev conceded that there was "some [liquidity] shortfall in the banking sector," although he and other Central Bank officials have said they are confident that they have the resources to deal with the crisis.

The growing chorus acknowledging the crunch has also stoked fears that Russia may soon be facing bankruptcies and bailouts in its financial sector.

"I expect some second- and third-tier banks to pack up," said Vladimir Matias, managing partner at Asset Capital Partners. "Other players may need to sell off their assets, such as so-called distress assets, in order to handle their financial woes."

Ronald Smith, chief strategist at Alfa Bank, said that while the current liquidity problems were a consequence of the global credit crunch, they have been exacerbated by the capital flight caused by the recent deterioration of ties with the West and the quarterly tax season.

"Many [small banks] are undercapitalized, and few, if any, have real risk controls," Smith said.

Adding to the trouble, he said, is a minor liquidity faced by the economy every quarter when tax payments come due.

"However, the shortfall of liquidity in the system is reported to be ... roughly twice the shortfall seen in the spring," he said.

The shortage has also led to rising borrowing costs, with the cost of money rising across the market.

"First-tier banks and corporates can still borrow money today in rubles at around 9 to 10 percent," Troika Dialog said in a note Friday. Second-tier institutions can borrow at 12 to 13 percent, but the market is "largely shut" to third-tier banks, the note said.

The problems -- while serious for smaller companies and those already carrying debts -- are not likely to have a major effect on overall economic growth, Troika said, maintaining its forecast of 6 percent growth for the economy this year and 7 percent in 2009.

And while the markets saw a bump Friday after a week of losses, it was unclear whether the government's urgency in dealing with the liquidity shortfall would bring back longer-term investors.

"Many big companies would see Medvedev's appeal as an opportunity to go in and buy back shares," said Halloran, of Pharos. "They realize that this would be a liquidity-driven sell-off and that the economy is not poised to slow dramatically yet."

After smaller banks, the biggest concern remained in the real estate and construction sector, with half-finished projects languishing and proposed developments stuck on the drawing board or being sold off to cover internal costs.

"The liquidity problem puts many construction companies under tremendous pressure to sell their projects or declare insolvency because of restricted access to financing," said Matias, of Asset Capital Partners. "The construction sector will soon be akin to the Spanish experience, with many developers and real estate brokers seeking bankruptcy protection."



Ria-novosti / AP
Medvedev being greeted by Klaus Schwab, CEO of the World Economic Forum, at a Valdai club meeting on Friday.