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## Economic turbulence brings new clients to microlenders, but growth slowdown persists

### Russian microfinance market outlook

Macroeconomic ills are not obstructing portfolio growth in the microfinance universe, although the upward trend here has moderated from 25% in 2014 to 14% in 2015. That said, the neighboring banking segments – SME and retail lending – saw their portfolios shrink 6% each. This trend is related to market immaturity, a growing number of loan denials in the banking sector on the back of the crisis as well as an increasing volume of bad debt and restructured loans in microfinance sector.

In 2016-2017, the microloan market is to expand 12-14% each year. Increasing share of defaulted loans in microloan portfolios and new provisioning requirements will adversely affect microlenders' income and equity, which will limit their ability to bring growth rates back to the 2014 level (+25%). The market is to benefit from an increase of the limit for microloans provided to businesses up to RUB 3 mn coupled with an anticipated growth of state support of microlenders working with businesses.

Most microlenders are to see their credit quality wane in 2016, with the highest risk run by companies combining a growing share of defaulted loans in their portfolios with low capital and weak diversification of the resource base. We expect the most pronounced credit quality slump in the segments of payday and consumer loans.

Deteriorating credit quality combined with regulatory requirement toughening will result in perceptible reduction of minor microlenders in 2016-2017 and in increase of major players' market share. According to ACRA estimates, the market share of TOP-20 microlenders can show an increase from current 40% to 50% by the end of 2017.

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Table 1. Russian microloan market dynamics in 2013–2020

Indicators	Unit	Actual			Forecast	Forecast			
		2013	2014	2015	2016E	2017E	2018E	2019E	2020E
Microloan portfolio, total	RUB bln	45.6	57.0	65.0	72.5	82.4	95.4	110.9	129.5
growth rate	%	-	25%	14%	12%	14%	16%	16%	17%
Including microloans to businesses	RUB bln	19.1	22.2	24.7	26.4	29.1	32.6	36.8	41.9
growth rate	%	-	16%	11%	7%	10%	12%	13%	14%
Payday loans*	RUB bln	7.3	10.3	11.7	12.9	14.2	15.9	17.8	19.9
growth rate	%	-	40%	14%	10%	10%	12%	12%	12%
Consumer loans	RUB bln	18.7	23.9	28.6	33.2	39.1	47.0	56.4	67.6
growth rate	%	-	28%	19%	16%	18%	20%	20%	20%

Source: ACRA estimates

\* Ultra short-term loans

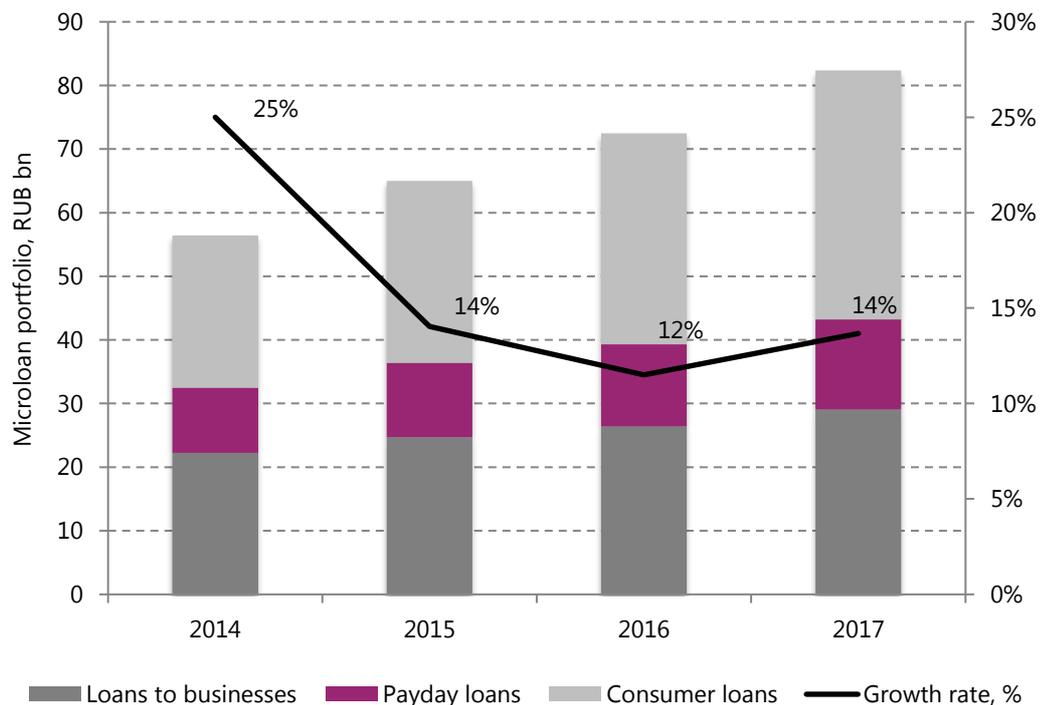
## Market trends: onward and upward

Last year, the microfinance market in Russia showed a much weaker correlation with the macro environment compared to the banking sector. Indeed, while microloan portfolios posted only a slowdown in growth from 25% in 2014 to 14% in 2015, the neighboring banking segments of SME and retail lending saw their portfolios shed 6% each. By our estimates, the total amount of microloans provided in 2015 remained flat y-o-y, running into some RUB 130 bln, while the banking sector lent a 10-40% lower amount depending on segment.

High growth rates in microlending may be explained not only by relative immaturity of the market but also by an increased frequency of loan denials in the banking sector on the back of the crisis resulting in client base expansion for microlenders. On the other hand, given a fast turnover of microloans, portfolio growth surpassing loan disbursement can implicitly indicate an increase of bad debt and restructured loans in microfinance sector. That said, by ACRA estimates the dynamics of microlenders' portfolio is to remain positive even without reference to the increase of problem microloans.

ACRA expects the cumulative microloan portfolio to grow 12% in 2016 to RUB 73 bln. The further slowdown is related to difficulties with market funding, an outpacing growth of defaulted loans in microlenders' portfolios and new provisioning requirements.

**Figure 1. The microfinancing market to grow 12% in 2016 and 14% in 2017**



Source: ACRA estimates

The microfinancing market may accelerate its growth to 14% in 2017, backed mainly by an anticipated slash in lending rates coupled with a less pronounced economic downturn and a slower decline of real household incomes (see Table 1). We expect this trend to be noticeable already in 2H16, although its most tangible impact should be seen next year. The market could benefit from an increase of the limit on microloans provided to businesses to RUB 3 mln coupled with an anticipated growth of state support of microlenders that provide loans to entities and individual entrepreneurs.

**Table 2. Key microeconomic indicators to show further improvement in 2017**

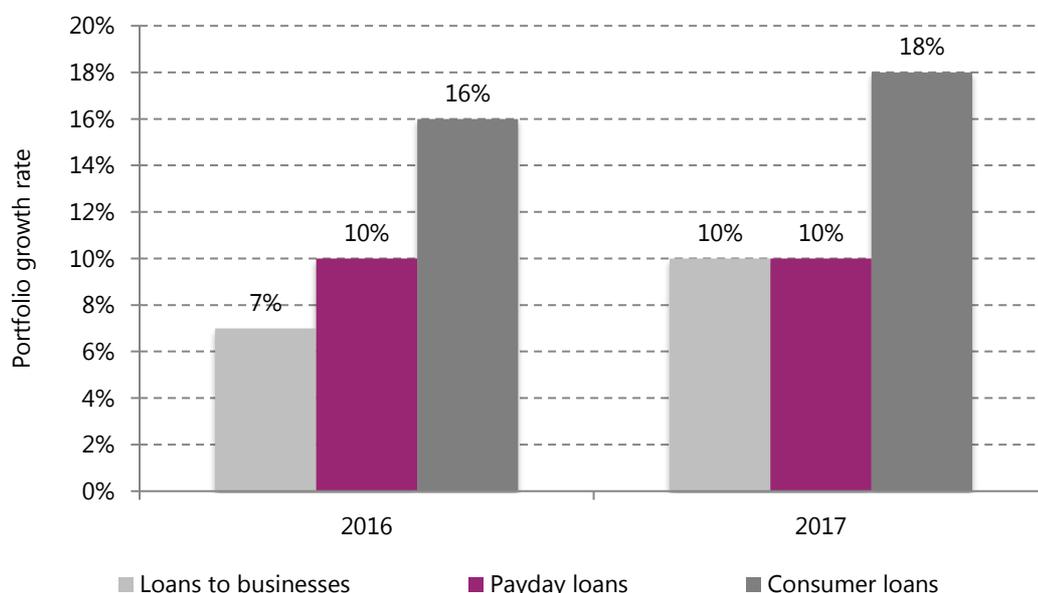
Indicator	2015	2016E	2017E
CBR's key interest rate	12.5	9.6	7.3
Real GDP growth	-3.8	-1.8	-0.4
Inflation	12.9	7.2	6.0
Real disposable household income	-4.0	-3.5	-1.1

Source: [Russia: Economic Outlook 2020](#)

### Market structure: a promising set

ACRA projects some setback in growth across all microloan segments in 2016: microloans provided to businesses should ease their upward drive from 11% to 7%, while payday and consumer loans are to see their growth rates decline from 14% to 10% and from 19% to 16% respectively. By the end of 2016, almost half (46%) of the cumulative microloan portfolio is expected to be made up by consumer loans, while loans provided to businesses and payday loans should see their shares at 36% and 18% respectively.

**Figure 2. Growth rate of microloans provided to businesses and consumers should accelerate in 2017**



Sources: ACRA estimates

By ACRA estimates, microloans provided to businesses and consumers are to build up their growth pace to 10% and 18% respectively in 2017, while payday loans will show a flat performance compared to 2016.

## Growth factors: a triple impact

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There are three key factors affecting the microfinance market at present: persisting difficulties with market funding, an increasing share of defaulted loans in microloan portfolios and new CBR requirements for loan loss provisioning. The impact of the first two of these factors is expected to weaken in 2017.

The microloan business is still funded primarily by shareholder loans and bank credits. Few companies in the sector are ready to issue debt securities, while investor demand for such instruments is very low. Surging interest rates and declining risk appetites in the banking sector have dramatically limited opportunities for microlenders to raise debt in 2015.

In view of interest rate forecasts and persisting high macro risks, ACRA does not expect microlenders to enjoy a noticeable improvement in loan availability in 2016, while starting 2017 the situation is bound to improve.

We note that microlenders with state ownership may also face funding problems in 2016, as some regional budgets could be amended in a way that expenditures aimed at supporting small businesses will be curtailed, resulting in lower subsidies to the capital of local microlenders.

Another funding limitation is to come into force in March, 2016. It will deprive microlenders whose capital is under RUB 70 mln of the option to raise funds from private individuals, unless the latter are their founders or shareholders. Considering the extent of market concentration and funding specifics for small microlenders, ACRA believes that this factor will not seriously affect market performance.

By ACRA estimates, this year will see a surge in bad debt in the microfinance sector, due to an expected slowdown in loan disbursement and in view of existing borrowers showing no signs of improvement in their credit quality. This trend will be the most pronounced in the individual loan segment, as companies lending to businesses dramatically tightened borrower requirements as far back as early 2015 and started to limit the amount of loans given out.

The increasing share of defaulted microloans in company portfolios will negatively affect the ability of some microlenders retain their former rate of building up loan portfolios. While previously loan losses usually manifested themselves as a shortfall in interest income, a new factor emerged in 2015 to adversely affect incomes – microlenders are now obliged to create loan loss provisions.

ACRA believes that some microlenders may face losses and capital funds setback as a result of expenditure growth for loan loss provisioning in 2016. At that, microlenders can find it extremely difficult to substitute adequately a missing part of the capital via market funding. In these circumstances, microlenders shall require additional capital infusions from shareholders in order to avoid a dramatic upturn of risks to their financial stability.

Two factors are to bring support to the market in 2016-2017. On the one hand, state support of microlenders focusing on loans to businesses is anticipated to expand which shall have a positive impact on growth rates of the segment. The segment could also benefit from an increase of the limit on microloans provided to businesses to RUB 3 mln (in calculation of current and expected indicators loans from RUB 1 mln to RUB 3 mln given by microlenders up to March 2016 were not taken into account).

On the other hand, the segment of online consumer lending is going viral. Microlenders can noticeably decrease their operating expenses and at the same time avoid an increase of defaulted loans share in their portfolios by providing online loans. According to ACRA estimates, at present microlenders focusing on online consumer lending show the fastest growth of microloan disbursement.

### **Credit quality: constrained by defaulted loans growth**

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ACRA expects most microlenders to see their credit quality wane in 2016. A growing share of defaulted loans in microlenders' portfolios coupled with required loan loss provisioning are to put pressure on profitability and capital. As microlenders will have a limited potential for substituting the capital with market funding in 2016, some of them can face the slump in lending which can lead to losing their market shares and to the decrease of profitability. The highest risk shall be run by companies combining low capital and weak diversification of the resource base. ACRA expects the most pronounced credit quality slump in the segments of payday and consumer loans.

An anticipated deterioration of credit quality of some minor microlenders combined with regulatory requirement toughening will result in perceptible reduction of microlenders in 2016-2017 and to further concentration of the microfinance market on major players. ACRA expects major microlenders' shareholders to have sufficient capabilities and willingness to give support to the companies via an increase of share capital or long-term lending. Thus according to ACRA estimates, the market share of TOP-20 microlenders can show an increase from current 40% to 50% by the end of 2017.

The policy of the Bank of Russia aimed at microfinance market improvement, namely at uncovering the companies that are not engaged in the microfinance operations or that run fraudulent and/or dubious operations, which includes breaking the anti-money laundering legislation (115-FZ), also contributes to the consolidation of the market. ACRA expects the number of companies taken off the register for the foregoing reasons to upsurge.

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