



The Banking Sector in Ukraine

- Trends and Selected Issues -

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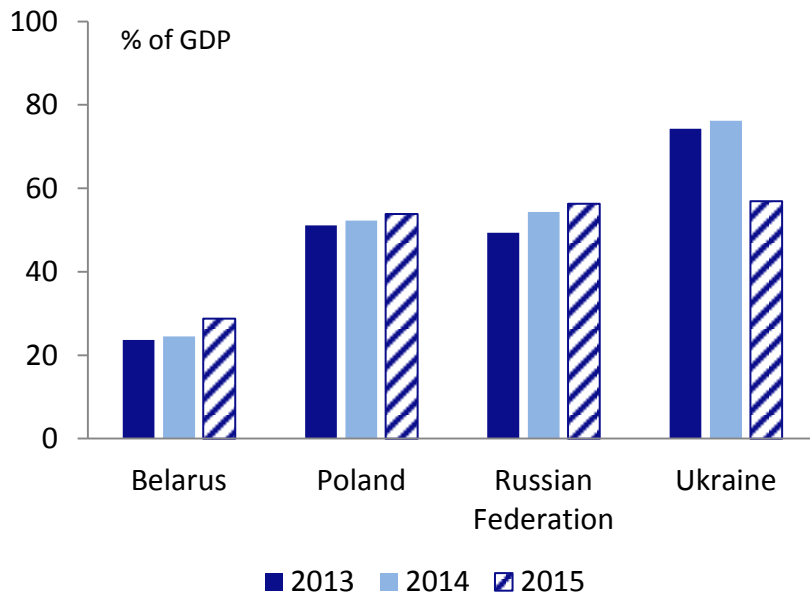
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1. Regional comparison

Domestic credit to private sector



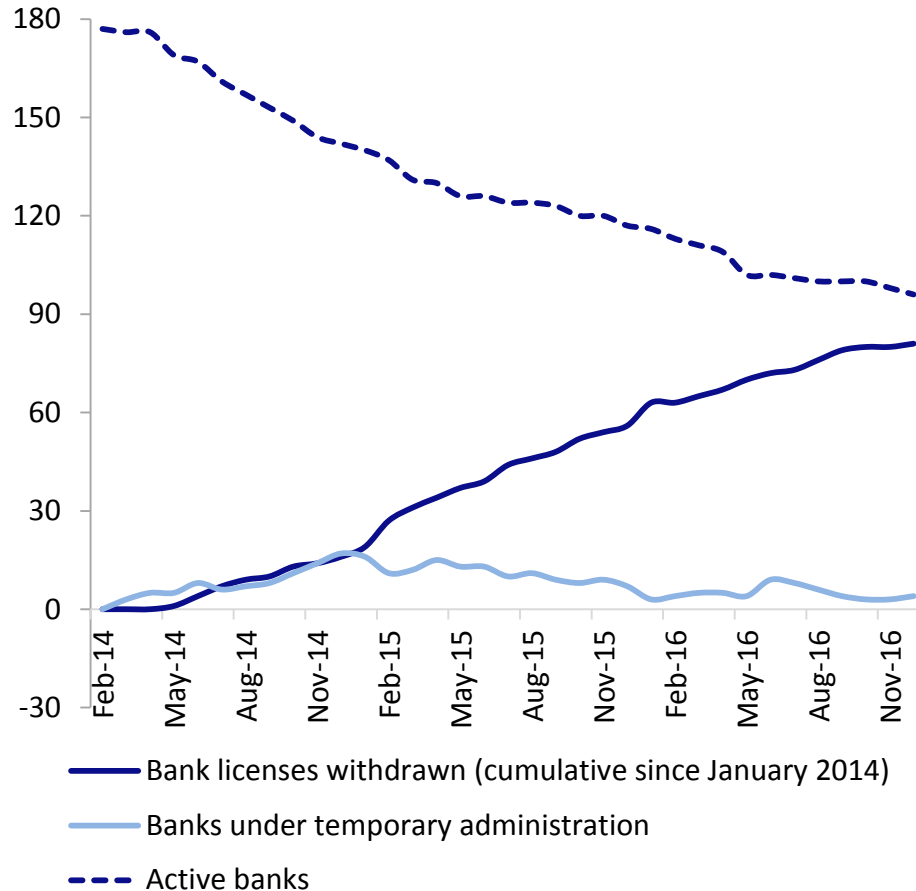
Source: World Bank

- Size of Ukraine's banking sector in 2013 and 2014 was larger than in neighbouring countries if measured by domestic credit to the private sector as % of GDP
 - However, these loans included wide-spread related party lending
- In 2014 and 2015 bank closures and deleveraging of banks led to significantly lower domestic credit as % of GDP in Ukraine
 - Now on par with Russia and Poland, still higher than Belarus
- Technical factors, i.e. low nominal growth of GDP and depreciation kept the credit-to-GDP ratio from falling even more in the short term

⇒ **Over the last years, size of sector more in line with regional peers**

2. Number of banks

Number of banks



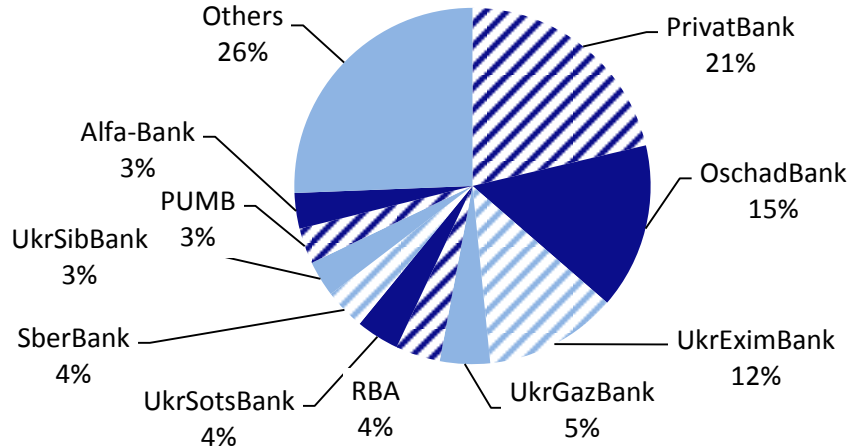
Source: Own calculations based on NBU data

- The number of banks in Ukraine has shrunk dramatically
- Out of 180 banks operating in the beginning of 2014, 86 were declared insolvent or liquidated by the NBU
 - Out of temporary administration, 1 bank was sold and 2 banks were created as bridge banks
 - 5 remain under administration
 - 4 banks were liquidated or reorganized voluntarily and 1 was registered in Feb 2014
 - Privatbank was sold to the Government in a publicly funded bail-out in late 2016
- Liquidity, solvency and related-party lending, as well as involvement in illegal activities (e.g. money laundering) were the key reasons for the decrease
- Thus, almost 50% of banks failed during 2014-2016
- At end-2016, 96 active banks remain

⇒ **Massive reduction in number of banks operating in Ukraine**

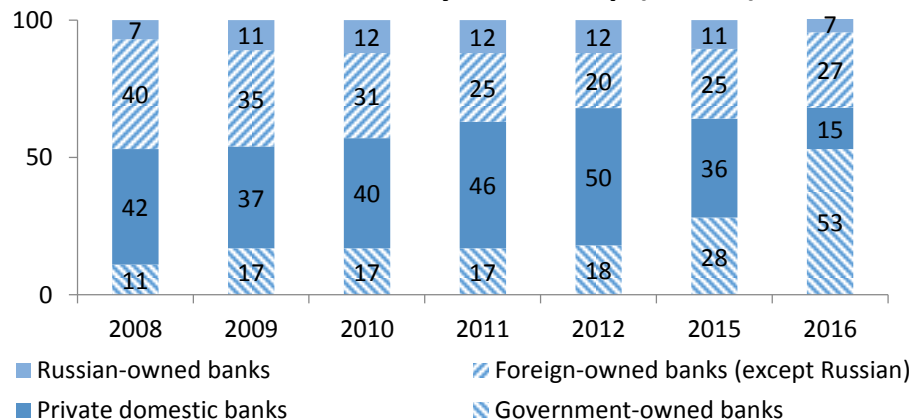
3. Market shares

Banking sector assets



Source: Own calculations based on NBU data (September 2016)

Market share by ownership (Assets)



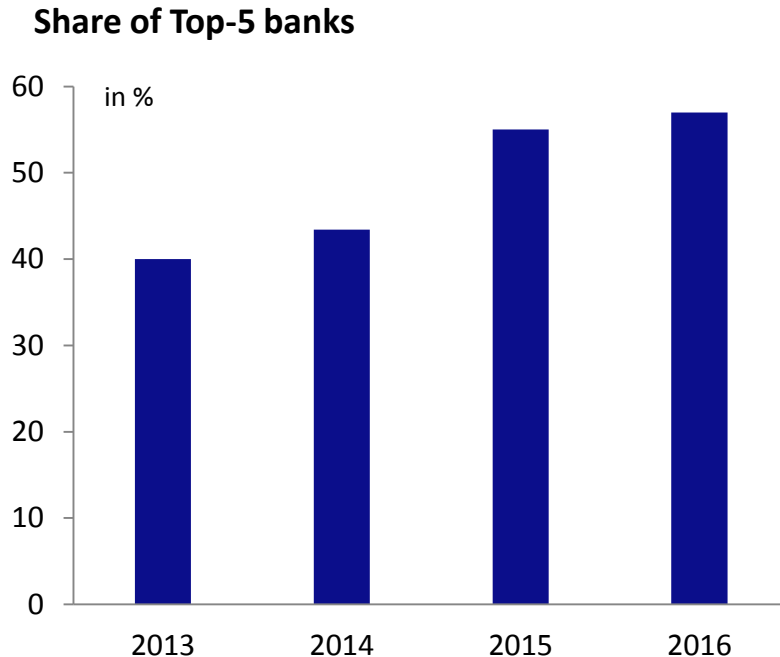
Source: Own calculations based on NBU data

Note: Russian-owned banks exclude Alfa group banks. If we include Alfabank and its recent acquisition UkrSotsbank, the total share of Russian banks rises to 14%.

- Recently nationalized Privatbank is Ukraine's largest bank with over 21% market share
- Trailing Privatbank are three other state banks (OschadBank, UkrEximBank, UkrGazBank), whose combined market share of 32% is significantly higher than that of the market leader
- The remaining banks account for slightly less than 50% of banking sector assets
- Over time, state banks increased their market share, while Western banks reduced their market share

⇒ **After the recent nationalisation of Privatbank, the four biggest banks are state-owned; the share of state capital in the banking sector exceeds 50%**

4. Concentration



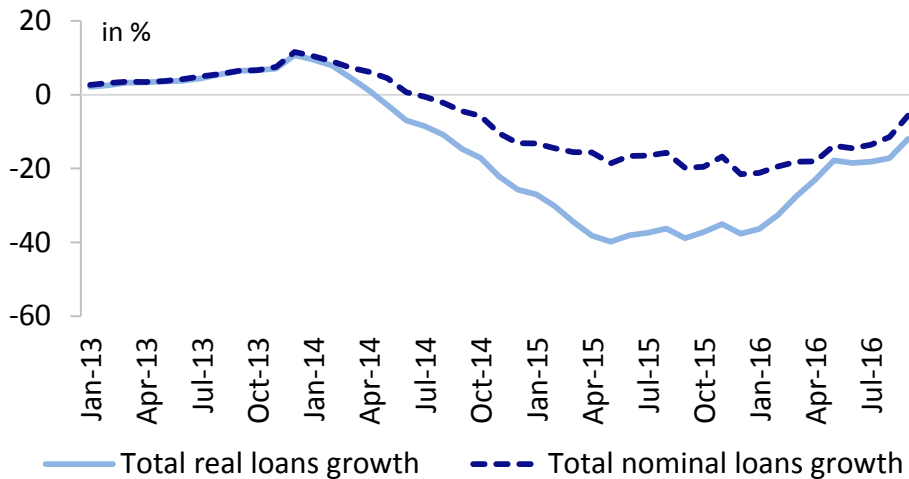
Source: Own calculations based on the NBU data (total assets)

- Bank failures as well as the expansion of state banks helped to increase the market share of Top-5 banks from 40% in 2013 to 57% in 2016
 - Only one bank from the Top-5 in 2013 failed, but 13 banks from the Top-30 failed, but 13 banks from the Top-30
 - Privatbank was declared insolvent in December 2016 but emerged from administration after public bail-out
- The increase of the concentration ratio of 17 percentage points within 3 years is much higher than in previous periods
 - The ratio was 32% in 2008, i.e. it increased by only 8 percentage points until 2013 (5 years)

⇒ **During the recent years, the pace of consolidation in the banking sector gained speed, without raising competition issues**

5. Loan growth and currency structure

Loan growth



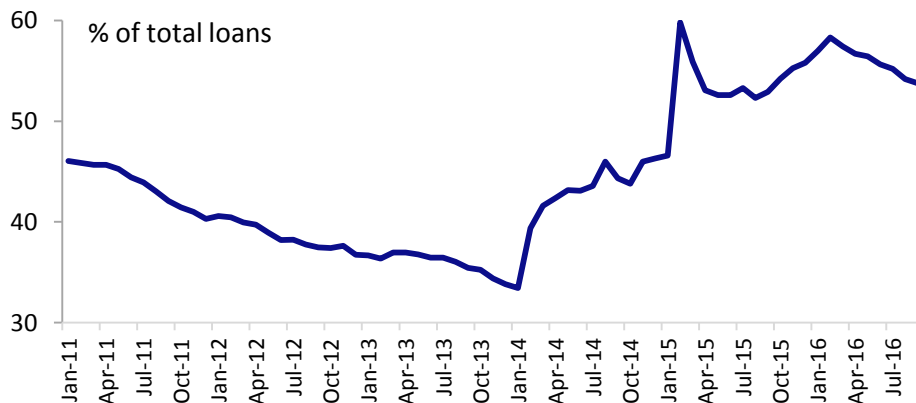
Source: Ukrstat

Note: FX adjusted

Loan growth

- Sharp decline in loans both in nominal and real terms during the crisis 2014/15
- Decline reflects low demand, undercapitalisation and bank failures
- Gradual improvement during 2016, hryvnia loans returned to growth in October

Share of foreign currency loans



Source: Ukrstat

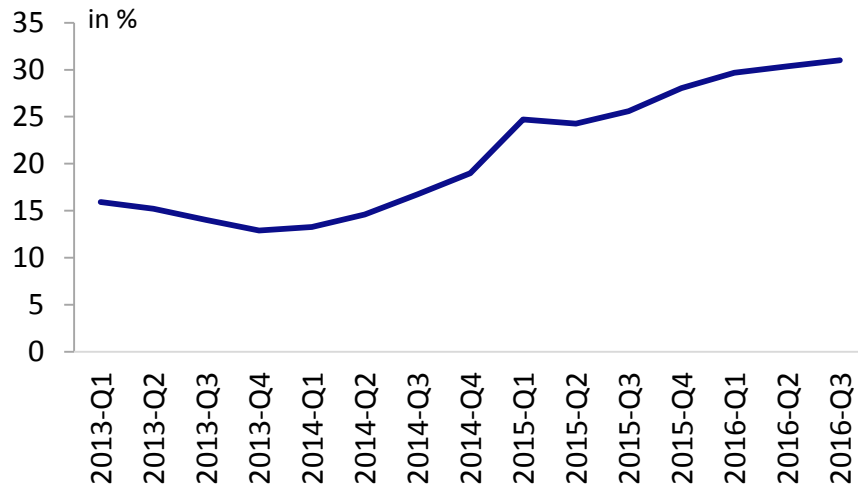
Currency structure

- The share of FX loans in banks' portfolios increased during the crisis due to UAH depreciation, as well as their generally longer maturities
 - Also, FX loans were often restructured, which further increased their maturity

⇒ **So far, no recovery in lending, but gradual stabilisation of the loan book**

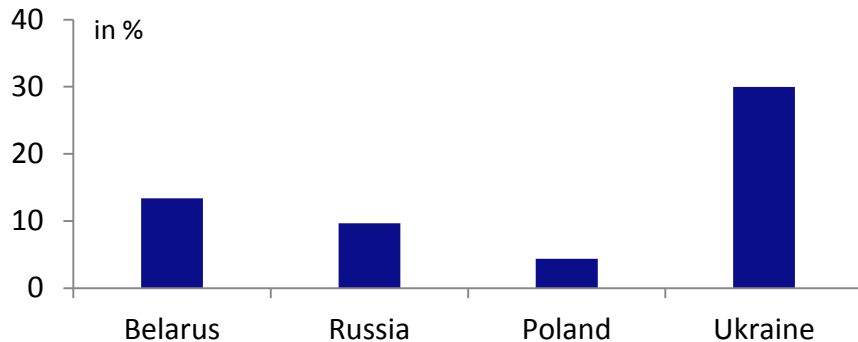
6. Non-performing loans (NPL)

NPLs as a share of gross loans



Source: NBU

NPL in a regional comparison



Source: IMF Financial Soundness Indicators, NBRB

Note: NPLs as a share of gross loans, Q2 2016

NPL dynamics

- Sharp increase in NPLs reflects impact of UAH depreciation, decline in cash flows of borrowers and reduction in under-reporting of problem loans
- NPL surge continues even as most problem banks are removed from the system
- Furthermore, while 31% of loans are classified as NPLs in Ukraine (NBU category IV and V), an additional 15% are substandard (category III)

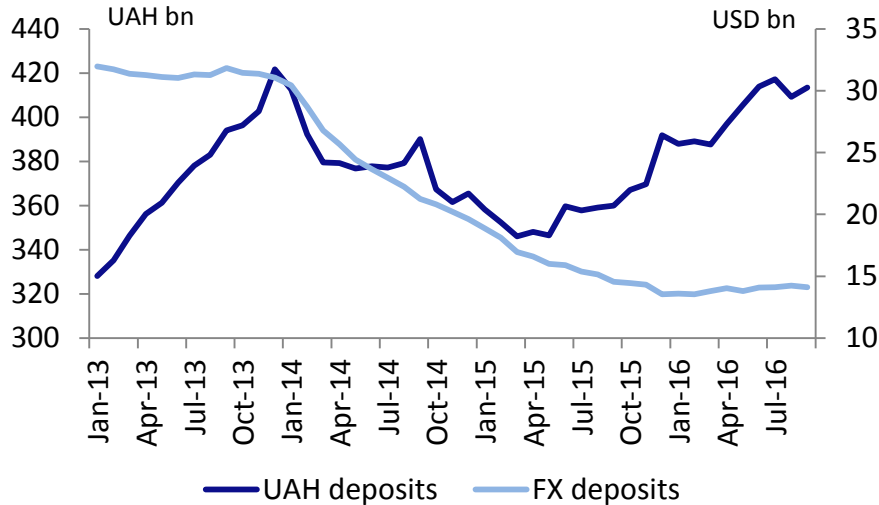
Regional comparison

- NPLs are on the rise in Russia and Belarus as well, but the scale of the problem is much larger in Ukraine

⇒ **High and rising NPLs still an important issue that needs to be addressed**

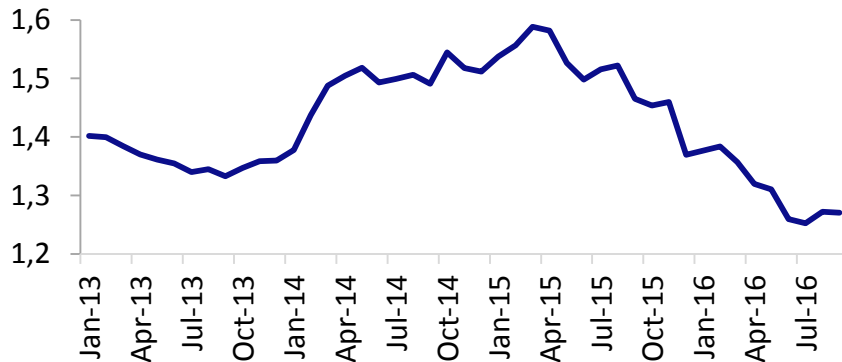
7. Deposits

Bank deposits



Source: NBU, own calculations based on NBU data

Loan to deposit ratio



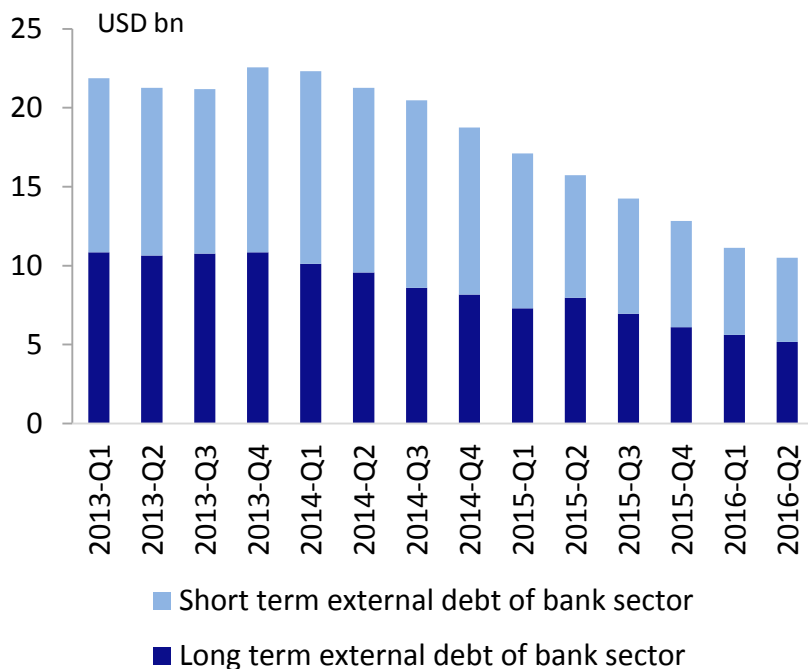
Source: NBU, own calculations based on NBU data

- Slowing inflation, better deposit guarantees and higher interest rates helped UAH deposits to exceed their pre-crisis levels in 2016 (excluding a Dec 2013 seasonal spike)
 - However, household deposits are still below pre-crisis levels
- This development offsets opposing effects of a savings drain, deposit flight and bank failures during the last years
- FX deposits had less deposit protection (paid in UAH at an FX rate fixed at date of bank insolvency) and were subject to withdrawal restrictions. As a result, they stabilized in 2016 but didn't recover
- Higher share of FX loans than FX deposits and deposit flight pushed the loan to deposit ratio up when the crisis started, but faster recovery of deposits than loans from 2015 onwards brought the ratio down again

⇒ **Recovery of local currency deposits underway, while FX deposits stabilised**

8. External debt

External debt of the banking sector



Source: NBU

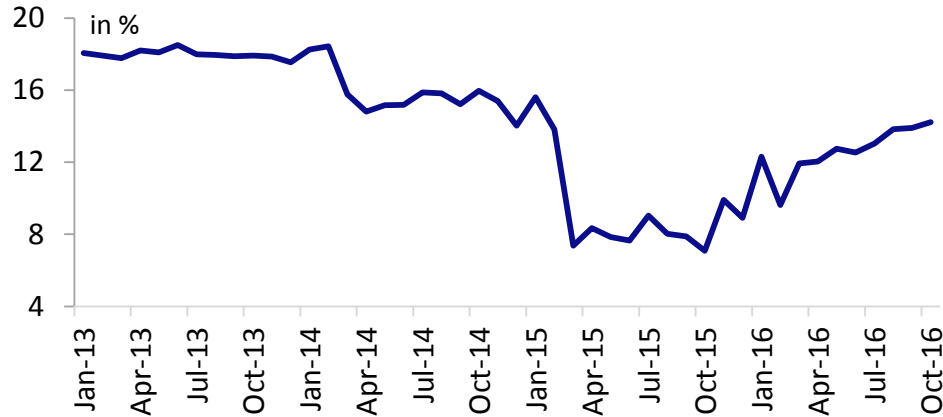
Note: short-term debt at remaining maturity

- One important funding source apart from household and corporate deposits is external debt attracted by banks
- The level of external debt went down from USD 22.5 bn (Q42013) to USD 10.5 bn (Q22016) as banks were closed, non-resident deposits were withdrawn and some of the debt (e.g. subordinated loans) was converted into capital during the process of recapitalisation
- The share of short-term external debt (e.g. under 1 year of remaining maturity) has not changed significantly during the crisis and amounts to about 50%

⇒ **External deleveraging during the crisis still continues**

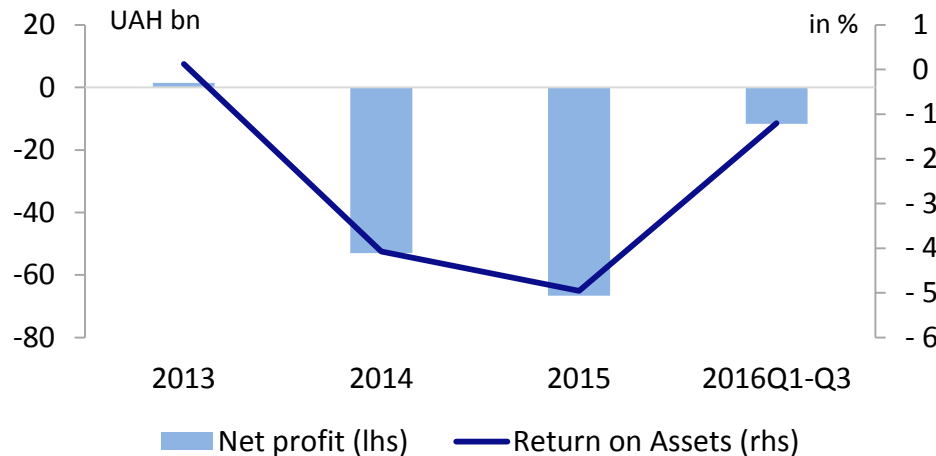
9. Capital

Banking sector capital adequacy ratio



Source: NBU

Banking sector profit



Source: NBU, own calculations based on NBU data

Capital adequacy ratio (CAR)

- High CAR pre-crisis reflected under-reporting of problem loans and recapitalization of state banks
- In 2015, asset quality went down sharply and banks were forced to disclose more problem loans
- Closure of the most problematic banks and recapitalization of the surviving banks helped to lift CAR

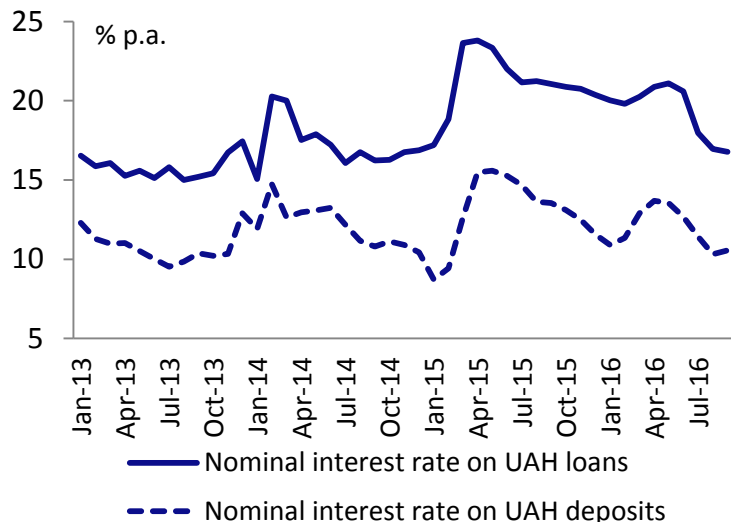
Profitability

- In 2014/2015, the sector had large losses, which were a constant drain on capital
- In 2016, these losses reduced significantly

⇒ **After very problematic years 2014/15, some stabilisation is on the way**

10. Interest rates

Interest rates on loans and deposits



Source: NBU, own calculations based on NBU and Ukrstat data

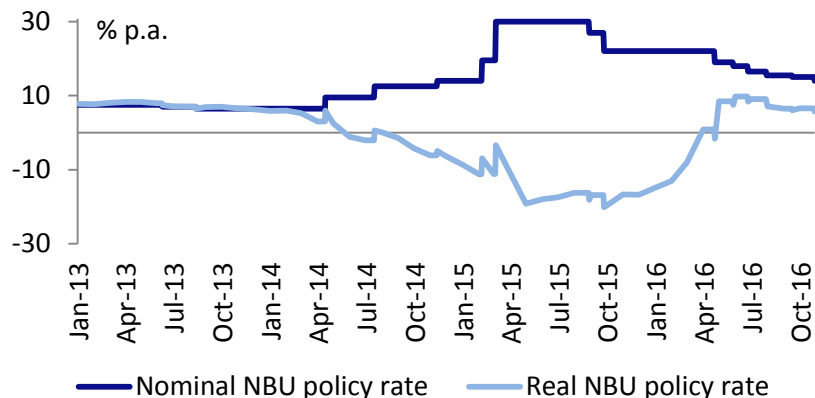
Loan and deposit rates

- Nominal interest rates on UAH loans and deposits moved higher during the crisis, reaching almost 24% on loans
- Since early 2015, gradual reduction in interest rates observable, currently 17% on loans and 11% on deposits

Monetary policy rate

- In the first quarter of 2015, the NBU was forced to increase the monetary policy rate significantly to 30%; due to high inflation this rate was highly negative in real terms (ex-post)
- In line with slowing inflation, NBU decreased interest rates to a level of 14% currently
- This level is now firmly in positive territory in real terms

NBU key policy rate



Source: NBU, own calculations based on NBU and Ukrstat data

⇒ **Clear trend of declining interest rates**

11. Priorities under the IMF programme

Bank
recapitalization

Unwinding
related loans

Better bank
supervision

Reform of DGF
and state-
owned banks

Better
resolution of
NPLs

Reforming
securities
markets

- In Ukraine's programme with the IMF, the reform of the financial sector features prominently as a key reform area
- The main objective is the rehabilitation of the banking sector and the rebuilding of public trust in banks
- Only a transparent, stable and sound banking system can finance the sustainable growth that Ukraine ultimately needs
- This has important implications for the real sector, where an efficient banking sector supports a level playing field among enterprises in terms of access to finance

⇒ The banking sector is a key reform area under the IMF programme, with 5 main reform priorities; securities market reform is another reform area

12. Bank recapitalisation

Recapitalisation schedule

	Top-19	Next-21
Nov-16	0% Tier 1	Program approval
Feb-17	5% CAR	0% Tier 1
May-17		5% CAR
Jun-17	Complete evaluation for all banks	

Source: IMF Country Report 16/319, September 2016

- Bank recapitalisation is a top priority under the IMF programme
- Bank diagnostics in form of stress tests are the instrument to determine capital needs
- In case capital needs are identified, banks must agree with the NBU a recapitalisation schedule to bring their capital up to the required norm
- Banks need first to reach a Tier 1 capital of zero (e.g. reach a positive capital level), and then meet a CAR of 5%; the respective deadline depends on the size of the bank
- Banks that don't meet those deadlines will be resolved promptly (nationalisation in case of Privatbank)
- By June 2017, the process will be completed

⇒ Implementation of bank recapitalisation schedule is on track

13. Nationalisation of Privatbank

- Stress-testing revealed higher than previously reported related-party lending and shortfalls in loan-loss provisions and thus capital
- Total capital needs were estimated between UAH 117-148 bn, according to the Ministry of Finance
- Shareholders did not provide sufficient capital support, therefore, on December 18, 2016 Privatbank was declared insolvent and transferred to the Deposit Guarantee Fund (DGF)
- On December 21, the bank was sold to the Government by the DGF for UAH 1 due to its systemic importance
- As part of the recapitalisation efforts, bail-in of certain liabilities (e.g. Eurobonds)
- The Government authorized the issuance of up to UAH 117 bn in government bonds to recapitalise Privatbank; UAH 108 bn were issued in late Dec 2016
- NBU provided UAH 25 bn in refinancing to Privatbank and purchased UAH 26 bn in government bonds from Privat (mostly to cover previous debt)
- The Parliament introduced full insurance of household deposits similar to Oschadbank (and including also another state bank, UkrEximBank) to prevent a panic

⇒ Quick and smooth nationalisation of Privatbank is an important step to safeguard financial stability; welcomed by all major international partners

Annex: Banking sector statistics

Balance sheet data	2011	2012	2013	2014	2015
Total assets (EUR m)	101,373	106,239	112,607	68,801	48,061
growth in % yoy	177.3	4.8	6.0	(38.9)	(30.1)
in % of GDP	81.0	79.9	87.8	83.0	63.4
Total loans (EUR m)	73,488	73,260	76,929	51,543	37,610
growth in % yoy	169.2	(0.3)	5.0	(33.0)	(27.0)
in % of GDP	58.7	55.1	60.0	62.2	49.6
Loans to private enterprises (EUR m)	56,695	58,013	62,148	42,189	30,936
growth in % yoy	182.5	2.3	7.1	(32.1)	(26.7)
in % of GDP	45.3	43.6	48.5	50.9	40.8
Loans to households (EUR m)	16,793	15,247	14,782	9,354	6,545
growth in % yoy	132.0	(9.2)	(3.1)	(36.7)	(30.0)
in % of GDP	13.4	11.5	11.5	11.3	8.6
Loans in foreign currency (EUR m)	29,829	27,103	26,098	24,200	20,989
growth in % yoy	132.4	(9.1)	(3.7)	(7.3)	(13.3)
in % of GDP	23.8	20.4	20.4	29.2	27.7
Loans in foreign currency (% of total loans)	41	37	34	47	56
Total deposits (EUR m)	53,419	58,926	65,391	42,302	27,461
growth in % yoy	187.7	10.3	11.0	(35.3)	(35.1)
in % of GDP	42.7	44.3	51.0	51.0	36.2
Deposits from households (EUR m)	29,822	34,593	38,656	22,001	15,258
growth in % yoy	180.3	16.0	11.7	(43.1)	(30.6)
in % of GDP	23.8	26.0	30.2	26.5	20.1
Total loans (% of total deposits)	138	124	118	122	137
Structural information					
Number of banks*	175	175	180	158	117
Market share of state-owned banks (% of total assets)*	17	18			28
Market share of foreign-owned banks (% of total assets)*	37	32			36
Market share of Western foreign-owned banks (% of total assets)*	25	20			25
Profitability and efficiency					
Return on Assets (RoA)*	(0.8)	0.4	0.1	(4.1)	-1.2
Capital adequacy (% of risk weighted assets)	18.2	18.1	18.3	15.6	8.6
Non-performing loans (% of total loans)	9.6	8.9	12.9*	19.0*	28.0*
Non-performing loans (% of total loans)**	40.0	37.0	35.0	30.0	28.0

Source: NBU, Raiffeisen Research; *NBU, **IMF



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