



BANKING SECTOR REVIEW

Issue 4
August 2017

Retail banking activity picked up in Q2. Retail lending continued to grow and the pace of growth of retail deposits accelerated. Deposit interest rates decreased at a slower rate in Q2 but the pace picked up in Q3, primarily as state-owned banks revised their interest rates. This has the potential to bring down loan rates for businesses and households. The high credit risk of the corporate sector remains the main barrier to a faster lending recovery. Bank operating profits are on the rise and the banking sector is expected to generate a profit for the year (excluding PrivatBank).

The structure of the sector The banking sector's concentration has not changed much since Q1: the 20 largest banks hold more than 90% of the sector's net assets. Since early April, four banks have been removed from the market, one of them failing to meet the authorized capital requirement of UAH 200 million.

State-owned banks continue to increase their market share. In Q2, their share grew 0.5 pp to 55.6% by net assets and 1.3 pp to 62.3% by retail deposits.

Assets Bank lending to households is on the rise: in Q1, hryvnia retail loans grew 13.4%¹ (including the incorporation of P2P operations onto PrivatBank's balance sheet). The pick-up in retail lending improved the quality of the retail loan portfolio: in Q2, the share of NPLs decreased 2.3 pp to 57.9%².

New corporate lending was weak in Q2 across the banking sector. Hryvnia loans grew 2.2% over the quarter (+UAH 9.1 billion). Borrowings by some state-owned monopolies in June accounted for the majority of the growth. Corporate loan portfolios increased at some large foreign-owned banks, but the growth came mainly in short-term working capital loans.

In total, the gross corporate loan portfolio shrank 2.3% (-UAH 19.2 billion) in H1 on FX loan write-offs and repayments. At the same time, net corporate loans decreased 7.9% after additional provisioning by several large banks. In Q2, the share of NPLs increased 2.6 pp to 57.7%².

In Q2, the total share of government securities (mostly domestic government bonds) in banking net assets decreased 0.5 pp to 25.7%. State-owned banks carry a large volume of government securities on their balance sheets after receiving additional capital via domestic government bonds.

Funding In Q2, hryvnia retail deposits (deposits and deposit certificates) at banks grew by UAH 16 billion¹ (compared with +UAH 9 billion in Q1, a significant share of which were P2P operations incorporated onto PrivatBank's balance sheet). State-owned banks were most active in attracting retail deposits.

On the other hand, there was an outflow of corporate deposits. Two factors were driving it: the confiscation of ex-officials' funds held on accounts at state-owned banks and dividend payments by state-owned monopolies. However, the liquidity of the banking system has not deteriorated as growth in budget funds (including the confiscated funds) offset the outflows. The banking system is predominantly funded by deposits, which account for almost three-quarters of bank liabilities.

Banks continued repaying their debt to the NBU; in Q2, total liabilities owed to the NBU declined 0.4 pp to a 1.2% share. Some Russian-owned banks capitalized debt from their parent companies. As a result, the share of subordinated debt in total liabilities decreased to 1.4%.

Interest rates The decrease in deposit rates has slowed: the interest rate on annual hryvnia retail deposits fell 0.8 pp to 15.6% in Q2³ compared to a 1.4 pp decline in Q1. Interest rates on USD deposits fell further to 4.0% per annum due to weak demand from banks. There is a significant interest rate spread between deposit rates offered by foreign banks (excluding Russian banks), whose rates are below the market average, and state-owned and private banks.

In H1, interest rates on corporate loans fell, although at a slower pace than for household loans. Thus, corporate loan rates may potentially drop further. Over two-thirds of managers polled by the National Bank in Q2 believed high interest rates to be the main obstacle for new borrowings. The high interest rates are mainly the result of high credit risks counted into costs of loans by banks.

Profit or loss and capital Some large banks, including Privatbank and Russian-owned banks reported losses in Q2 as they made provisions and sold NPLs. As a result, the banking system reported net losses of UAH 5.1 billion. Other banks generated a total net profit of UAH 3.9 billion in Q2 and UAH 6.9 billion in H1. Operating performance improved substantially over last year - net operating profit before provisioning nearly doubled yoy.

Prospects and risks Banking sector participants remain optimistic. The last Lending Survey by the NBU showed that most banks intend to boost corporate and retail lending.

The key policy rate cut from 14.0% to 12.5% in Q2 has filtered through to other interest rates. In August, state-owned banks decreased retail deposit rates. Private banks are also likely to adjust their interest rates in response. Retail lending is expected to pick up further, driven by increased household income and robust consumer confidence.

The lending appetite of banks has recovered after a long break, as shown by the growth of the retail loan portfolio. Lower rates are expected to significantly improve the loan price conditions by the end of this year. However, the insufficient protection of creditor rights will continue to restrain corporate lending, forcing banks to tighten non-price lending conditions such as collateral, transparency, and reporting requirements.

¹Banks that were solvent as of end-June 2017.

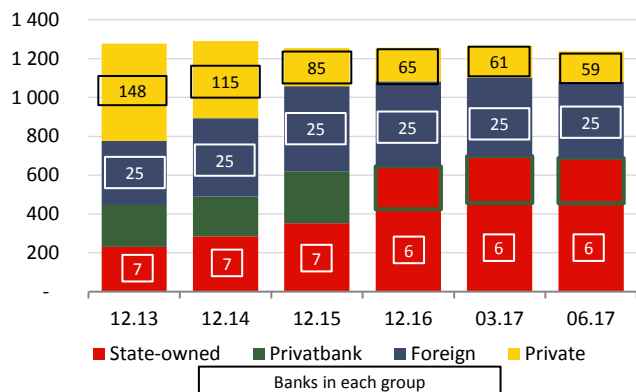
²Of all reporting banks.

³Based on the Ukrainian Index of Retail Deposit Rates.

The Structure of the Sector

In H1 2017, banks' net assets shrank 1.5% as corporate loans were repaid or re-sold at a discount, large banks made additional provisions, and banks were removed from the market.

Banks' net assets, UAH billion*



Number of banks*

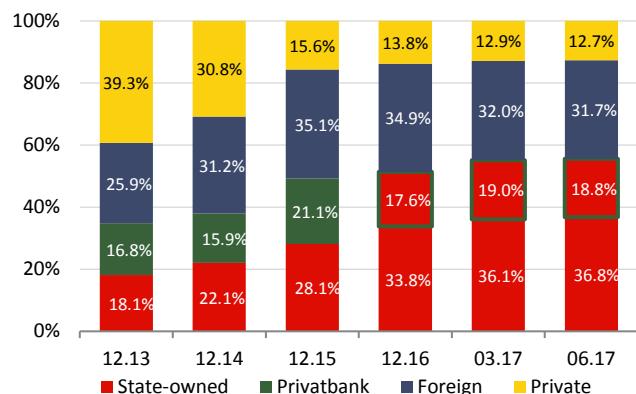
	2014	2015	2016	Mar-17	Jun-17
Solvent	147	117	96	92	90
- change	-33	-30	-21	-4	-2
State-owned	7	7	6	6	6
- change	0	0	-1	0	0
Foreign	25	25	25	25	25
- change	0	0	0	0	0
Private	115	85	65	61	59
- change	-33	-30	-20	-4	-2
Insolvent	16	3	4	3	3
- change	16	-13	1	-1	0
Under liquidation	21	64	84	89	91
- change	19	43	20	5	2

*For 2014-2016, solvent banks are broken down into groups according to the classification of 1 January 2016 and for 2017 based on the new breakdown

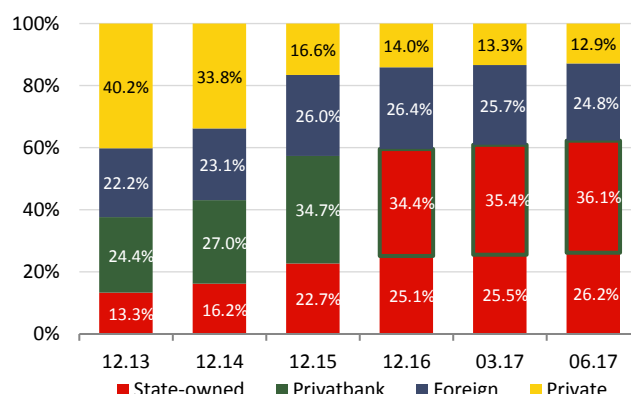
*The number of banks as of period-end

State-owned banks grew their market presence: their share grew 0.5 pp to 55.6% by net assets and 1.3 pp to 62.3% by retail deposits as of the end of Q2 2017.

Net assets by groups of banks

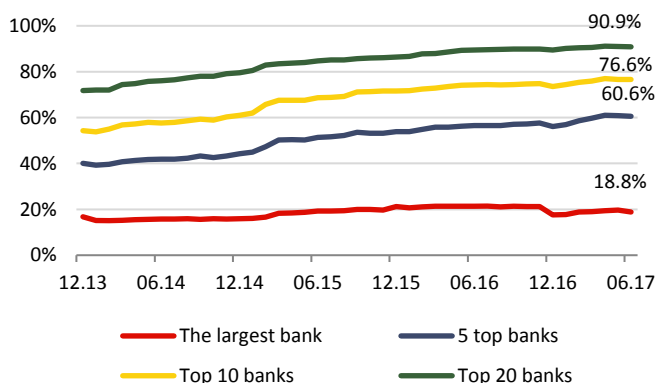


Retail deposits by groups of banks

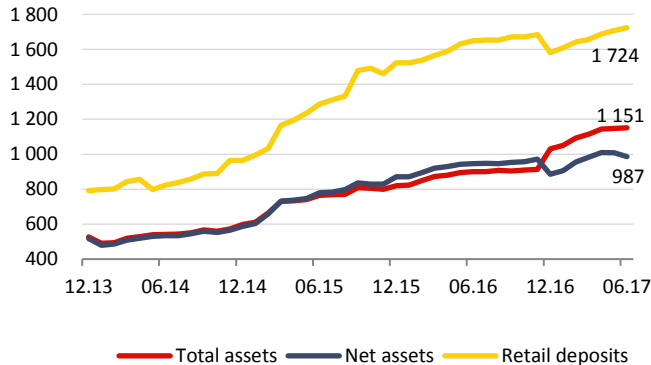


The concentration of net assets stopped growing in Q2. The top-20 largest banks account for 90.9% of the sector's net assets. However, the concentration of retail deposits continues to grow as state-owned banks attract funds, especially PrivatBank.

Shares of the largest banks by net sector assets



Concentration rate in the banking sector, HHI*

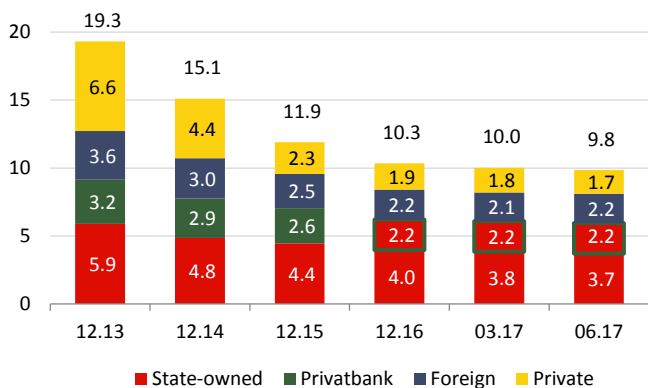


*The Herfindahl-Hirschman Index (HHI) is an indicator of banking sector concentration. It is calculated as the sum of the banks' squared market shares. The index ranges from 0 to 10,000 – values below 1,000 indicate a low degree of market concentration.

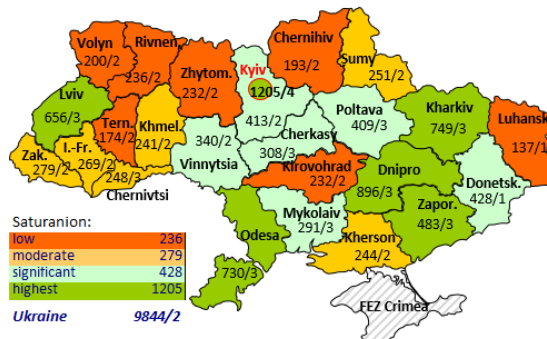
Banking Infrastructure

In H1, the number of operating banking units decreased by nearly 500 branches. The decrease was largely caused by the exit of banks from the market and an optimization of networks by some state-owned banks.

Number of structural units of banks, thousands*



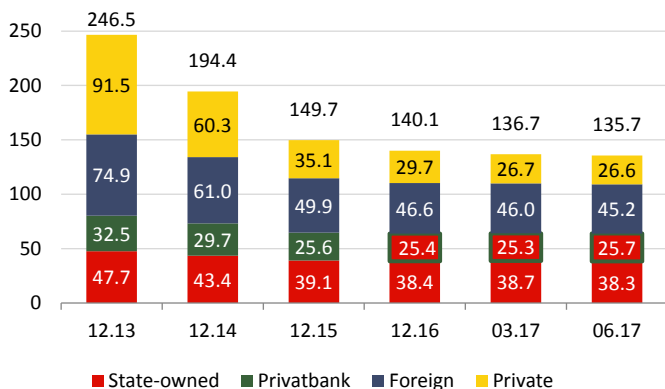
Operating banking units by regions as of 1 July 2017, units per 10,000 individuals



* branches and head-offices

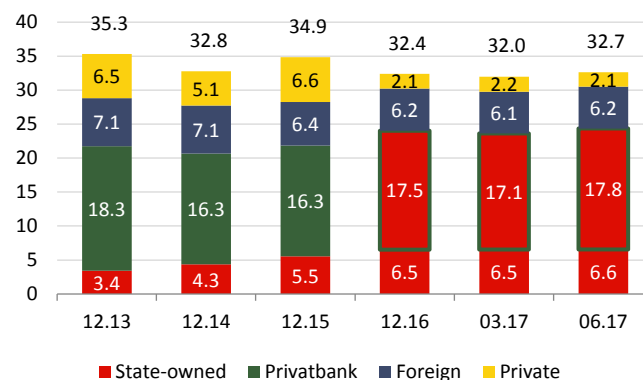
In Q2, bank staff numbers declined by 1,000 employees.

Headcount at banks, thousand employees



PrivatBank and Oschadbank actively issued new payment cards in Q2.

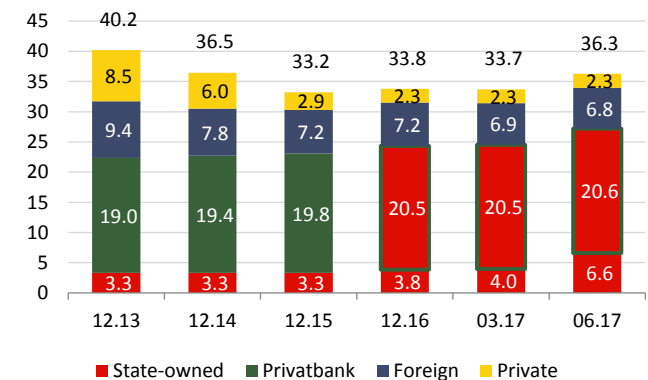
Number of active bank cards by bank groups, million pcs



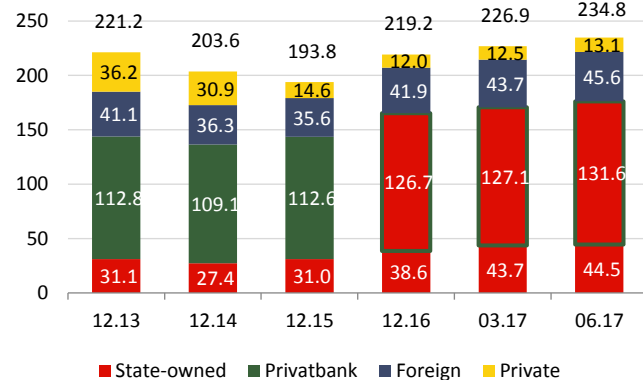
* data could be updated

In H1, the number of ATMs* grew by 2,500 as Oschadbank started including self-service kiosks into its total count.

Number of ATMs*, thousand units



Number of banks' POSs, thousand units



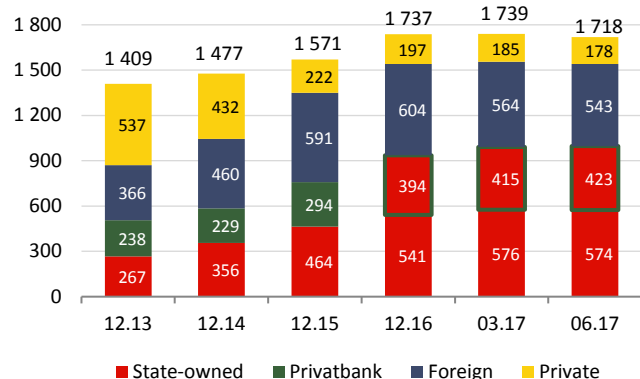
*Number of self-service bank machines (ATMs, deposit ATMs, Self-Service Kiosks)

**Data may be updated

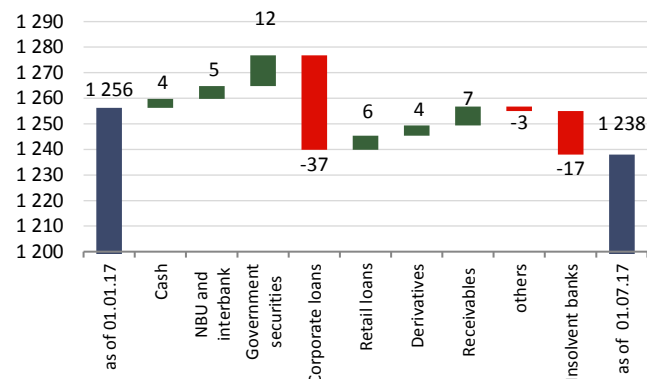
Assets

In H1, net loans issued to businesses by active banks decreased 7.9% while the gross amount of loans decreased by just 2.3%. The additional recognition of non-performing loans accounted for the difference.

Total assets by bank groups, UAH billion



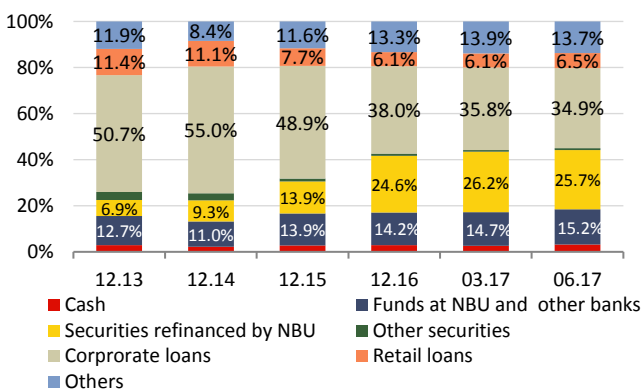
Change in net assets by components*, UAH billion



*Adjusted by the amount of provisions for active banking operations; government securities include NBU certificates of deposit

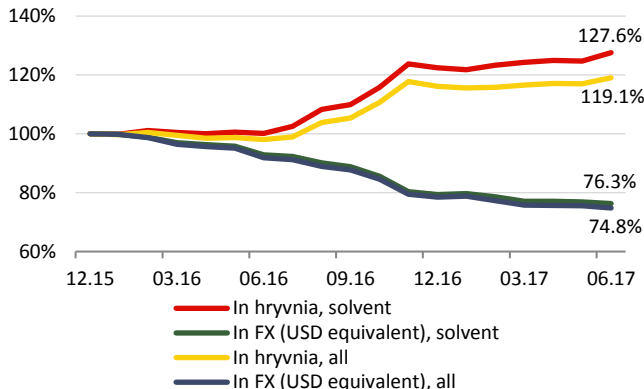
The share of corporate loans in total net assets decreased, while retail loans and funds held at the NBU grew in Q2.

Net assets by components



In Q2, the FX loan portfolio remained almost unchanged. Hryvnia loans grew significantly in June.

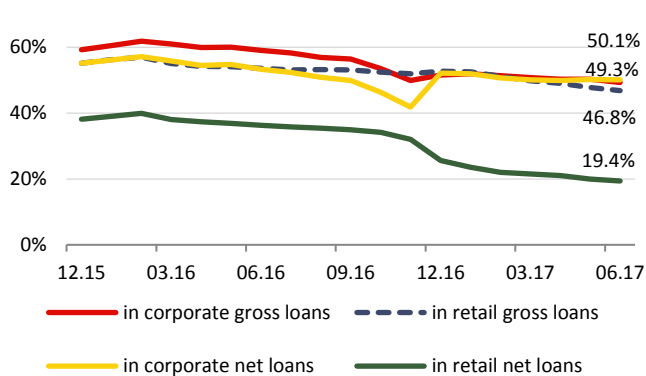
Gross corporate and retail loans, 2015=100%*



* At banks solvent as of 1 July 2017

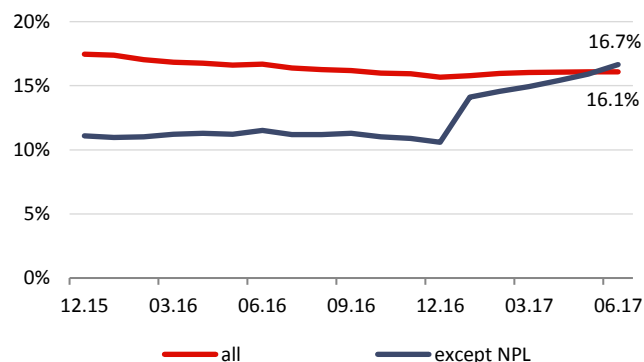
Given the stable exchange rate, the dollarization of loans decreased to below 50%.

FX loans



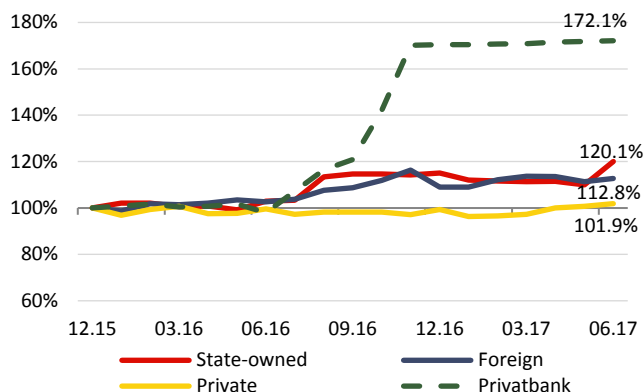
Household lending is picking up: since the start of the year, the share of net retail loans grew 6.1 pp to 16.7% of the banking loan portfolio.

Retail loans in the total loan portfolio

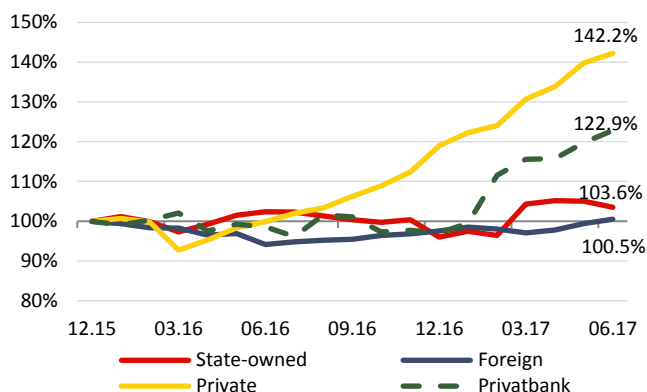


In H1, banks increased retail lending 13.4%. The inclusion of P2P operations on PrivatBank's balance sheet accounted for around one-third of the growth. Across bank groups, private banks showed the highest growth: +19.6% in H1. Corporate lending remains sluggish, with the exception of state-owned banks issuing loans to state monopolies.

Gross corporate loans in UAH, 2015=100%*



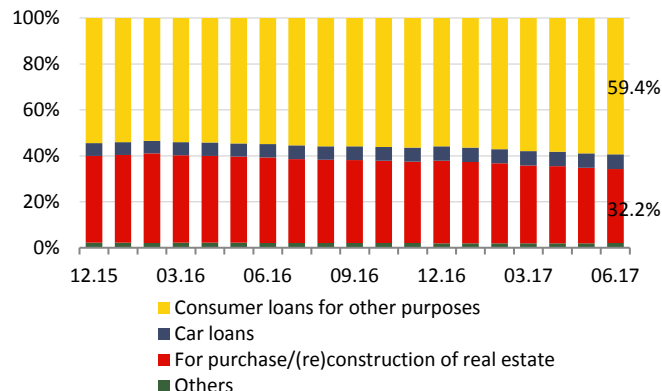
Gross retail loans in UAH, 2015=100%*



*At banks solvent as of 1 July 2017, including accrued interest

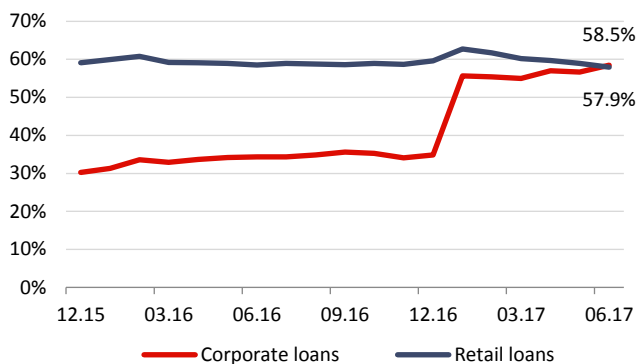
In H1, the share of consumer loans grew 3.6 pp to 59.4%.

Gross retail loans* by type



The quality of retail loans improved thanks to fresh lending.

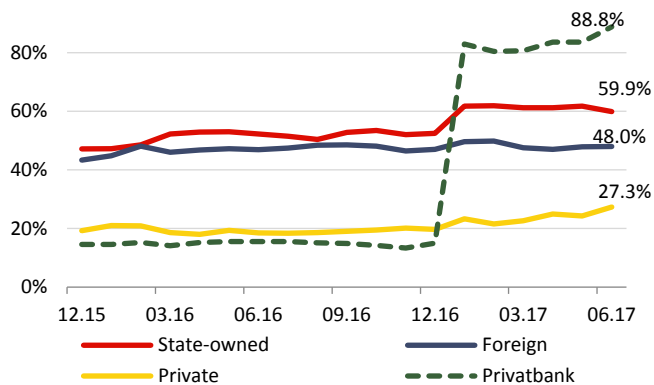
Non-performing loans in the portfolios of reporting banks*



*Excluding off-balance sheet accounts, all banks

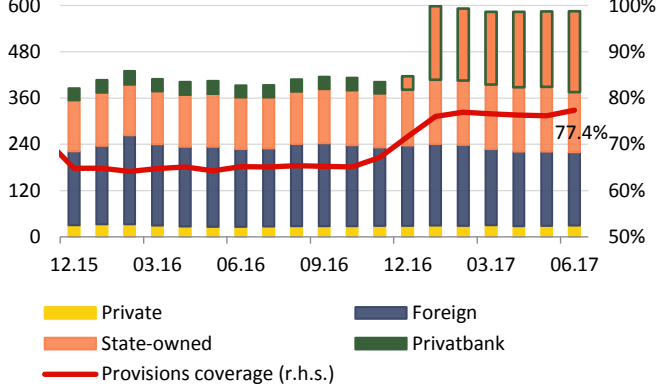
In Q2, loan quality deteriorated at PrivatBank and private banks. The share of non-performing loans in the banking sector increased to 57.7%.

Non-performing loans in loan portfolios by bank groups*



Provisions for non-performing loans grew 5.7 pp to 77.4%.

Non-performing loans and provisions, UAH billion

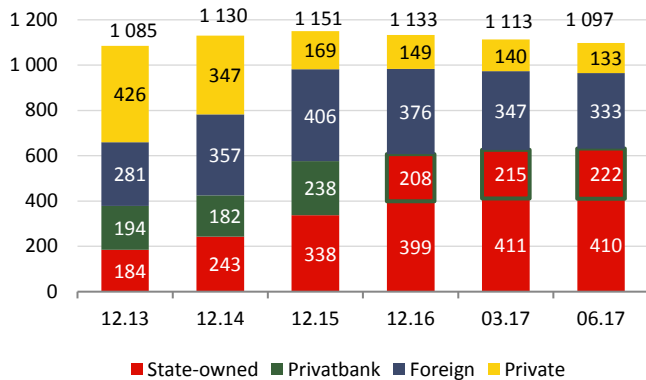


*Excluding off-balance sheet accounts, including interbank loans, all banks

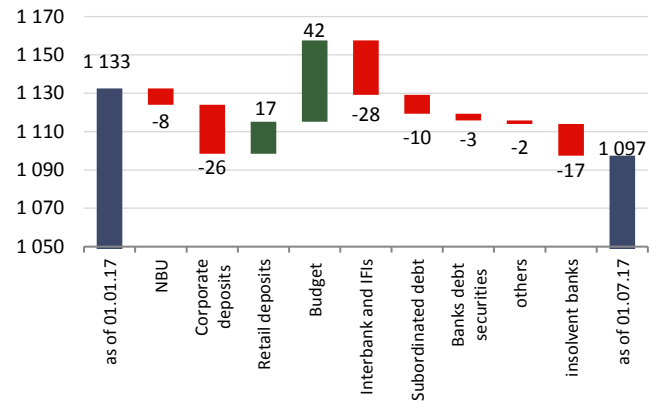
Funding

Banks' liabilities have decreased 3.1% since the start of the year. Budget and household deposits have increased significantly, while businesses have withdrawn funds. Interbank loans and subordinated debt also decreased (the latter through capitalization).

Liabilities by groups of banks, UAH billion

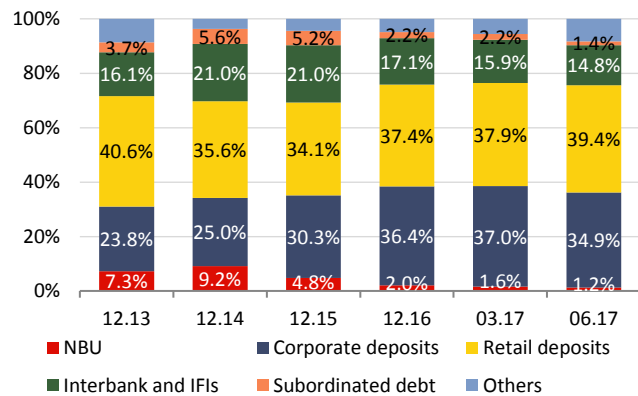


Change in liabilities by items, UAH billion



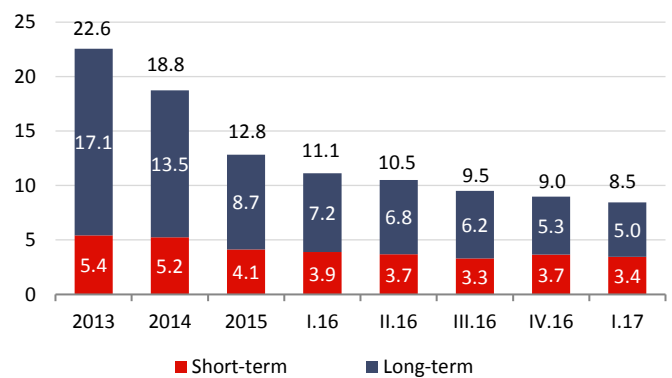
Customer funds continue to dominate liabilities, accounting for 74.3%. Retail deposits grew their share of total funding 2 pp in H1.

The structure of liabilities



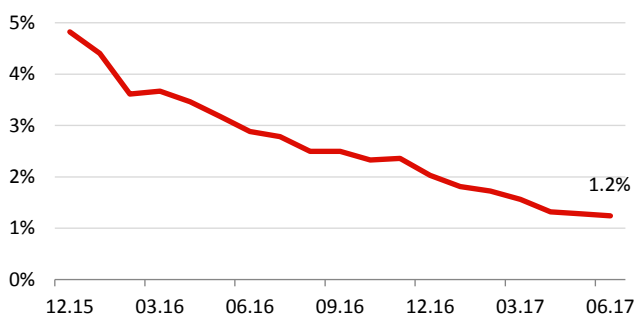
In Q1, banks' gross external debt decreased by USD 0.5 billion to USD 8.5 billion.

Banks' gross external debt, USD billion



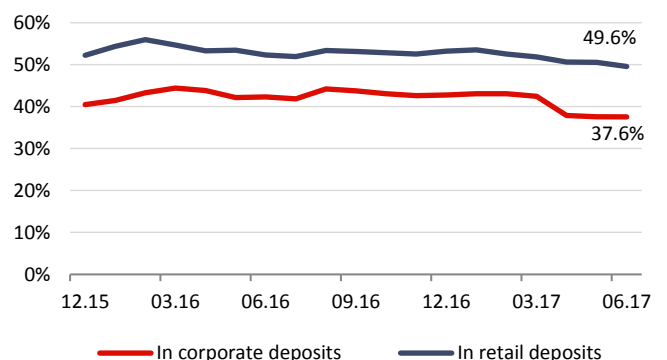
The share of NBU deposits in funding has fallen further to 1.2% of total liabilities in Q2.

NBU funds in banks' liabilities



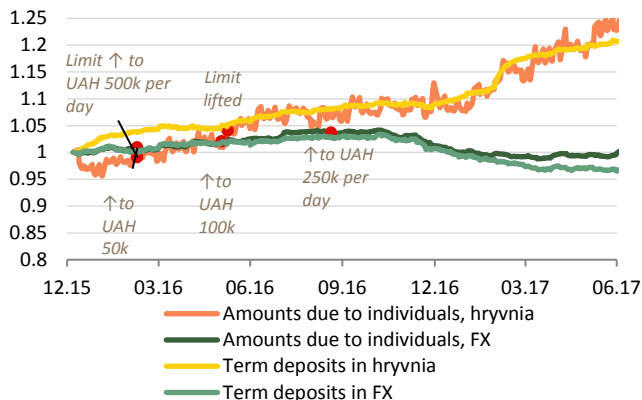
The share of FX corporate deposits declined as state monopolies withdrew funds from state-owned banks in Q2.

FX deposits



Since the start of 2017, hryvnia retail deposits have grown 13% while FX retail deposits have decreased 1% (in USD equivalent).

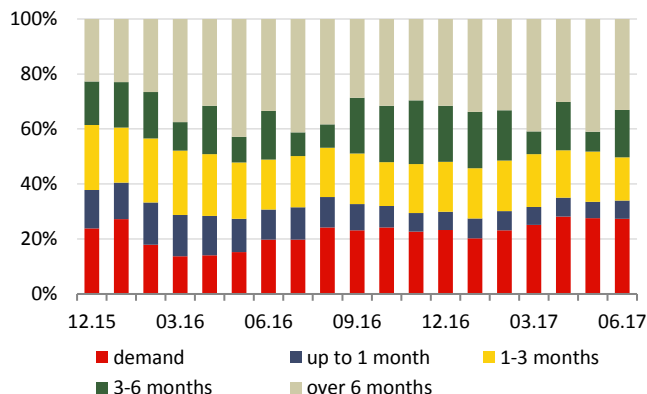
Retail deposits, 2015=100%*



*At banks solvent as of 1 July 2017, including certificates of deposit

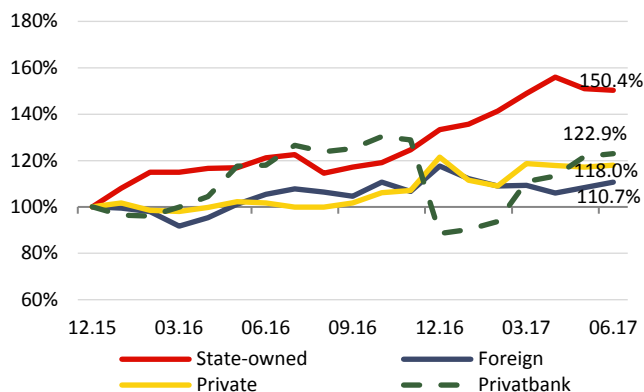
The share of demand deposits in new retail deposits grew compared with 2016.

New retail deposits by maturity



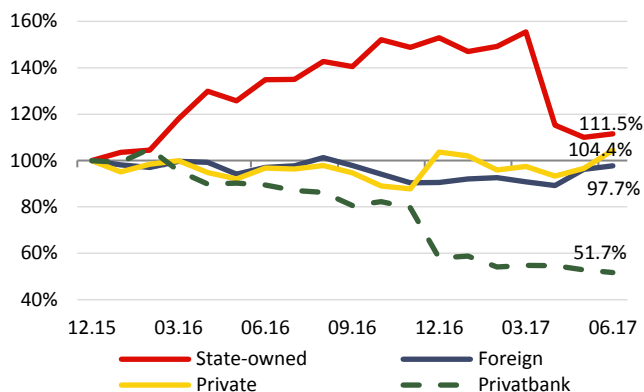
In Q2, businesses withdrew FX deposits from state-owned banks (-28.3%). The deposit outflow was caused by the confiscation of the previous government's funds and by scheduled payments by state monopolies. Hryvnia corporate deposits grew 1.6%.

Corporate deposits in hryvnia by groups of banks, 2015 = 100%*



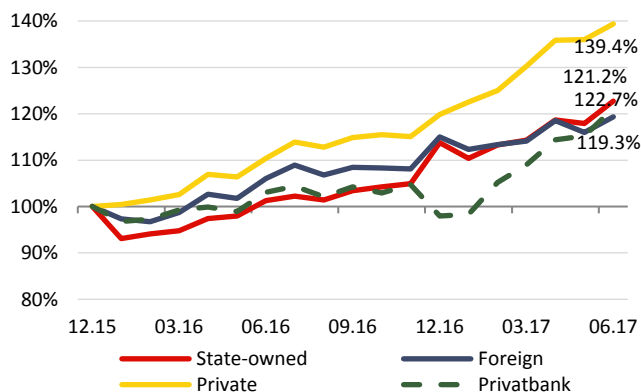
* At banks solvent as of 1 July 2017, including certificates of deposit

Corporate deposits in FX (in USD equivalent) by groups of banks, 2015 = 100%*



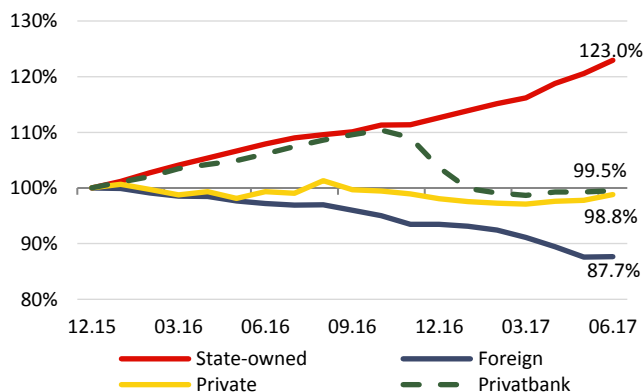
Hryvnia retail deposits grew 8% in Q2 and 13% YTD. PrivatBank and other state-owned banks showed the highest growth rates.

Corporate deposits in UAH by bank groups, 2013 = 100%*



* At banks solvent as of 1 July 2017, including certificates of deposit

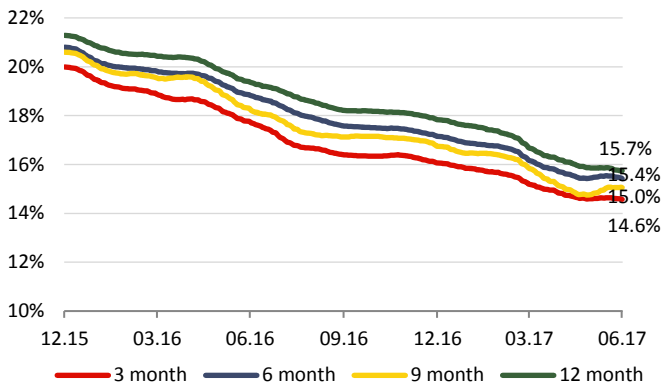
Corporate deposits in FX (USD equivalent) by bank groups, 2013 = 100%*



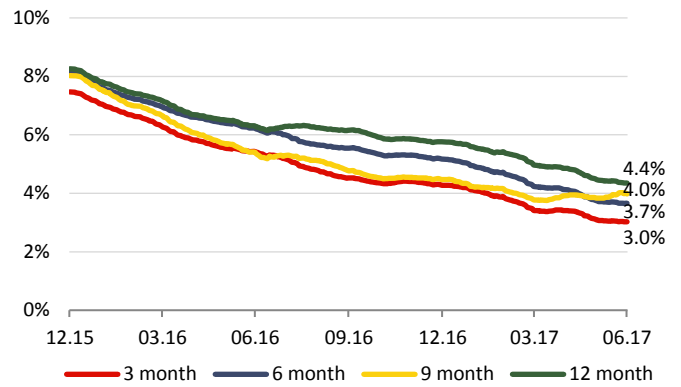
Interest Rates

Interest rates on 12-month household deposits dropped by 0.8 pp to 15.6% per annum in UAH and to 4.0% per annum in USD.

Ukrainian Index of Retail Deposit rates in UAH, % per annum*



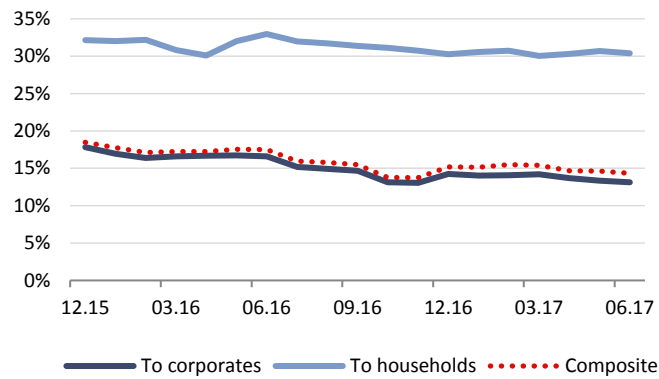
Ukrainian Index of Retail Deposit rates in USD, % per annum*



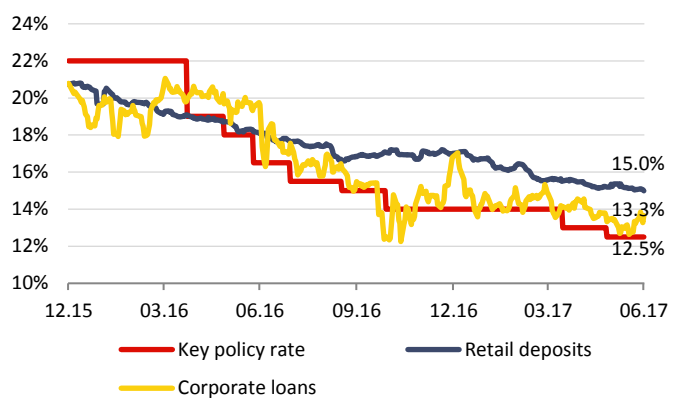
*Based on data from Thomson Reuters, 20-day moving average

Interest rates on new corporate loans fell in Q2, although by less than retail deposit rates.

Interest rates on new loans*, % per annum



The NBU's key policy rate, price* of new loans and deposits in hryvnia, % per annum

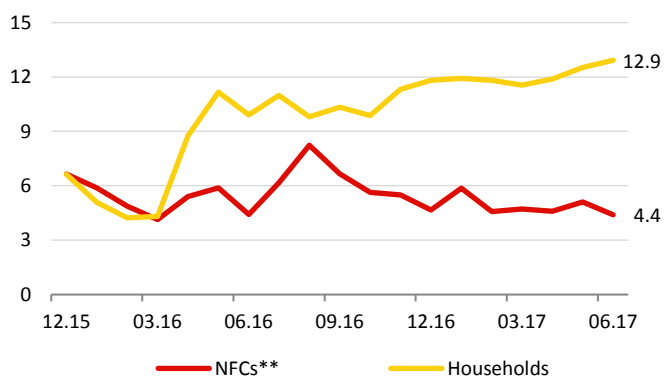


* No loan rescheduling or any other amendments to lending terms

*Daily rates, 5-day moving average

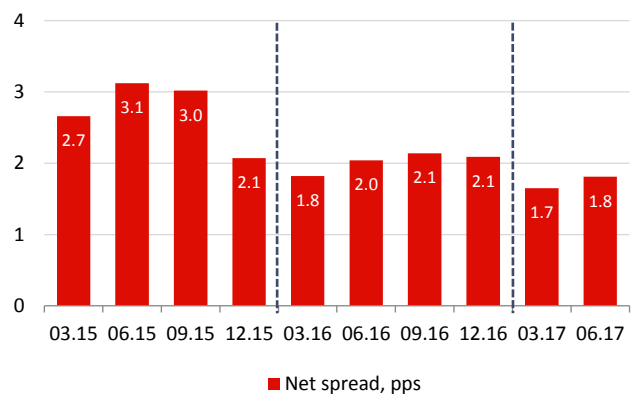
A decrease in the interest rate spread in the corporate sector was offset by growth in the retail spread.

Spread between interest rates on loans and deposits, pps*



Return on assets rose slightly in Q2.

Interest rate spread, pps*



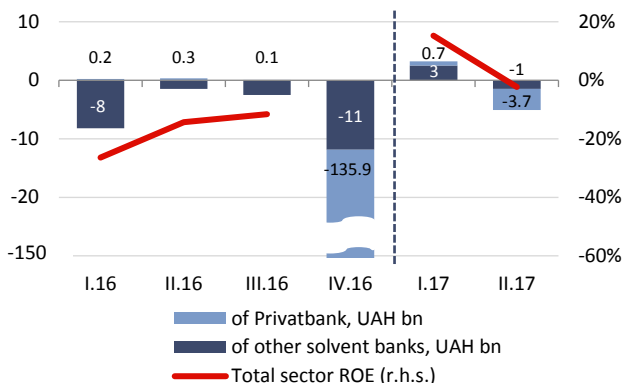
*On outstanding loans and deposits, including at insolvent banks
** non-financial corporations

*In a given month, including insolvent banks

Financial Results and Capital

New loan loss provisions at Privatbank and Russian-owned banks caused the banking sector to generate a total loss of UAH 1.8 billion* in H1.

Profit/loss** and return on equity

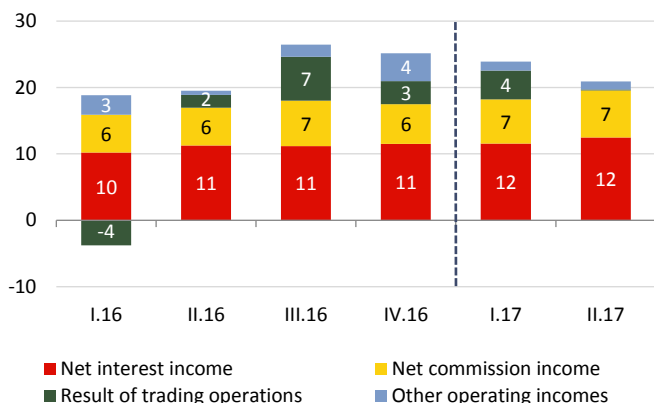


*The adjusted data for Q1 2017 hereinafter

**in respective quarter

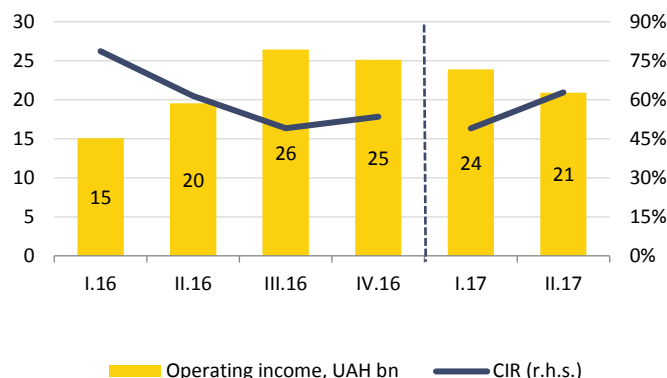
Operating income decreased in Q2 as banks generated no income from trade operations after the revaluation of domestic government bonds held by Privatbank.

Operating income components for the period, UAH billion



Operating efficiency* improved in H1 2017: The cost-to-income ratio (CIR) fell to 55% from 69% in H1 2016.

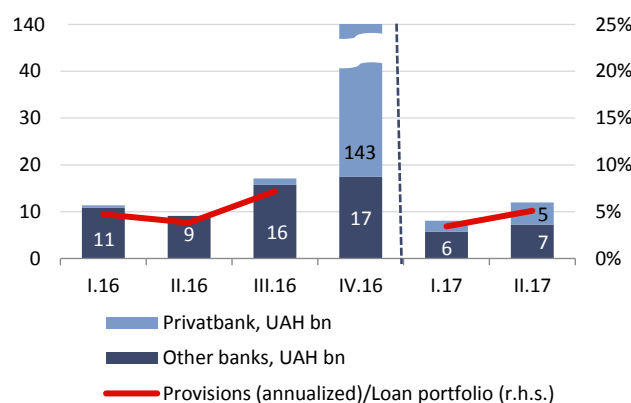
Operating income and operating efficiency of banks



* CIR (Cost-to-Income Ratio) – ratio of operating costs to operating income

Most large banks, except PrivatBank and Russian-owned banks, provisioned* significantly lower amounts in H1

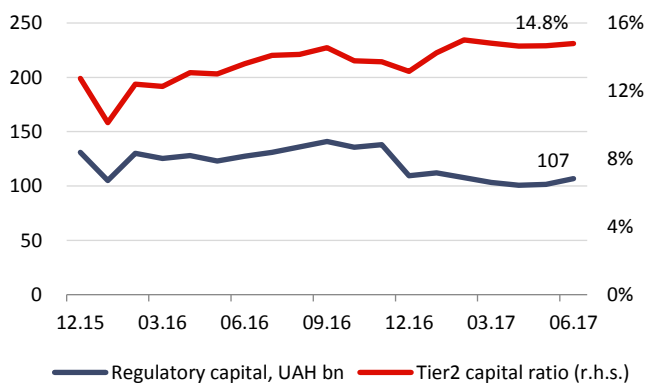
Loan loss provisions



*Adjusted Q1 data, **Ratio of provisions to bank loan portfolios, ***Annualized

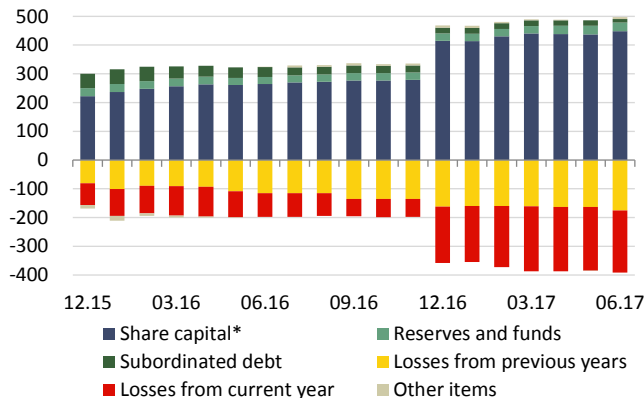
Capital adequacy ratios were little-changed in Q2, but still higher than the minimum level required.

Regulatory capital and regulatory capital adequacy levels



Authorized capital grew by UAH 7.1 billion in Q2 and by UAH 32.6 billion in H1, mainly on additional capital injections into state-owned banks.

Banks' regulatory capital, UAH billion



* Includes registered and non-registered share capital

Key indicators of Ukraine's banking sector¹

	2008	2009	2010	2011	2012	2013	2014	2015	2016	Q1.17	Q2.17
Number of operating banks	181	180	175	175	174	180	145	117	96	92	90
<i>including 100% foreign-owned banks</i>	17	18	20	22	22	19	19	17	17	17	17
General balance sheet ratios (UAH billion)²											
Total assets	967	1 002	1 090	1 212	1 264	1 409	1 477	1 571	1 737	1 739	1 718
<i>including in foreign currency</i>	528	489	476	492	503	513	667	197	788	757	730
Net assets	921	880	942	1 054	1 125	1 278	1 290	1 254	1 256	1 266	1 238
<i>including in foreign currency</i>	500	426	395	416	450	470	565	582	519	497	481
Gross corporate loans ³	476	498	537	608	634	727	820	831	847	829	818
<i>including in foreign currency</i>	252	212	212	221	227	252	400	492	437	421	403
Net corporate loans ³	453	434	463	530	553	648	710	614	477	452	432
Gross retail loans ³	273	236	205	197	184	189	208	176	157	155	154
<i>including in foreign currency</i>	198	172	143	113	84	67	101	97	83	77	72
Net retail loans	254	203	168	158	133	145	144	96	76	78	80
Corporate deposits ³	162	128	160	205	221	258	283	349	413	412	383
<i>including in foreign currency</i>	69	53	56	70	80	81	114	141	177	175	144
Retail deposits ⁴	219	214	276	312	368	443	403	402	437	434	442
<i>including in foreign currency</i>	111	116	136	154	187	189	214	215	239	231	224
Change (yoy, %)											
Total assets		3.5%	8.8%	11.1%	4.3%	11.4%	4.8%	6.4%	10.6%	7.1%	9.3%
Net assets		-4.4%	7.0%	11.9%	6.7%	13.7%	1.0%	-2.8%	0.2%	-2.5%	-1.8%
Gross corporate loans ³		4.6%	7.8%	13.3%	4.2%	14.7%	12.8%	1.3%	2.0%	-3.2%	2.4%
Gross retail loans ³		-13.4%	-13.1%	-4.0%	-6.7%	3.0%	10.3%	15.7%	10.4%	-10.4%	-3.9%
Corporate deposits ³		-20.8%	25.1%	27.7%	7.9%	16.8%	9.5%	23.5%	18.2%	12.9%	1.8%
Retail deposits ⁴		-2.3%	28.7%	13.2%	18.1%	20.2%	-8.9%	-0.3%	8.7%	3.2%	7.1%
Penetration⁵ (%)											
Gross corporate loans ³ /GDP	48.0%	52.6%	47.9%	45.1%	43.4%	47.7%	51.7%	41.8%	35.5%	29.1%	28.7%
Net corporate loans ³ /GDP	45.7%	45.9%	41.3%	39.3%	37.9%	42.6%	44.7%	30.9%	20.0%	15.9%	15.1%
Gross retail loans/GDP	27.5%	24.9%	18.3%	14.6%	12.6%	12.4%	13.1%	8.8%	6.6%	5.5%	5.4%
Net retail loans/GDP	25.6%	21.4%	15.0%	11.7%	9.1%	9.5%	9.1%	4.8%	3.2%	2.7%	2.8%
Corporate deposits ³ /GDP	16.4%	13.5%	14.3%	15.2%	15.1%	17.0%	17.8%	17.6%	17.3%	14.4%	13.5%
Retail deposits/GDP	22.1%	22.6%	24.6%	23.1%	25.2%	29.1%	25.4%	20.2%	18.3%	15.2%	15.5%
Profit or loss⁶ (UAH billion)											
Net interest income	37.2	54.5	51.9	53.8	49.2	49.1	52.2	39.1	44.2	11.6	12.5
Net commission income	17.7	13.2	12.6	15.4	18.1	21.0	23.1	22.6	24.2	6.6	7.1
Provisions	24.0	75.4	46.2	36.5	22.3	28.0	84.4	114.5	198.3	8.1	12.0
Net profit/loss	7.2	-38.4	-13.0	-7.7	6.0	1.4	-33.1	-66.6	-159.4	3.3	-5.1
Memo items:											
UAH/USD (period average)	5.27	7.79	7.94	7.97	7.99	7.99	11.89	21.84	25.55	27.00	26.11
UAH/USD (end-of-period)	7.70	7.99	7.96	7.99	7.99	7.99	15.77	24.00	27.19	26.98	26.10
UAH/EUR (period average)	7.71	10.87	10.53	11.09	10.27	10.61	15.72	24.23	28.29	28.82	29.26
UAH/EUR (end-of-period)	10.86	11.45	10.57	10.30	10.54	11.04	19.23	26.22	28.42	28.96	29.79

¹Data for solvent banks for each reporting date²Including accrued income/expenses³Including non-banking financial institutions⁴ including certificates of deposits⁵GDP is calculated as defined in the 2008 national accounts system methodology. From 2008 through 2013 it includes data for the temporarily occupied Republic of Crimea and City of Sevastopol; from 2014 through 2016 it excludes data for the temporarily occupied Republic of Crimea and City of Sevastopol and a part of the ATO zone.

2017 – NBU estimates (Inflation Report, July)

⁶Data for Q1 2017 include adjustments

Notes:

Source: National Bank of Ukraine (unless otherwise stated)

The sample of banks consists of banks solvent as of each reporting date unless otherwise stated.

Banking groups up to 2016 were based on decision No.657 by [the Committee on Banking Regulation and Supervision and Oversight of Payment Systems dated 31 December 2015](#). 2017 data is prepared in accordance with [decision No.76-D by the NBU Board dated 10 February 2017](#);

The data includes accrued interest as of the end of the period (month, quarter, year) unless otherwise stated.

Gross loans are loans not adjusted by provisions for active banking operations.

Rounding may cause the sum of components to differ from the total.

Terms and Abbreviations:

ATM	Automated teller machine
ATO	Anti-terrorist operation
CIR	Cost-to-Income Ratio
FX	Foreign currency/exchange
GDP	Gross domestic product
IFI	International Financial Institution
NBU	National Bank of Ukraine
NPL	Non-performing loan
P2P	Peer-to-peer lending, direct lending between non-related parties
POS	Point of sale
ROE	Return on equity
UIRD	Ukrainian Index of Retail Deposit Rates
pp	percentage point
UAH	hryvnia
USD	US dollar
eq.	equivalent
Q	quarter
H	half of year
k	thousand
bn	billion
r.h.s.	right-hand scale
yoy	year-on-year
YTD	year-to-date