



BANKING SECTOR REVIEW

Issue 5
November 2017

In Q3, bank lending to both households and the corporate sector reinvigorated. Inflows of retail deposits slowed, while the growth of corporate deposit accelerated, mainly on the back of higher export revenues. Banks, primarily state-owned ones, cut rates on hryvnia-denominated retail deposits, but that trend may slow down in Q4 after the National Bank of Ukraine (NBU) hiked its key interest rate. Loan rates stayed mostly flat. A pick-up in demand for banking services, lower funding costs, and lower provisioning enabled banks turn profitable and offset the losses of the first half of the year. The NBU sees the banking sector posting a full-year profit this year and next, in spite of possible losses in Q1 2018 related to transition to provisioning in line with the IFRS 9 standard.

Structure of the Sector Concentration in the banking sector remained unchanged for two consecutive quarters, with 20 largest financial institutions accounting for 91.1% of net assets. State-owned banks were gradually strengthening their positions. Their share in assets increased by 0.4 pp in Q3 owing to the re-capitalization of PrivatBank. Their share in retail deposits also grew by 0.4 pp as Oschadbank brought in substantial inflows. The NBU withdrew two banks over their failure to meet minimum regulatory capital and share capital requirements.

Assets The banking sector's net assets grew 3.5% qoq in Q3. Net retail and corporate loans grew at the fastest pace, by 5.1% yoy or UAH 26.1 billion.

Corporate loans were mostly provided by state-owned banks, which focused on strategic enterprises, but also by foreign-capital financial institutions that were lending more actively to companies with foreign investment. In Q3, banks wrote off or restructured more than UAH 10 billion in non-performing FX loans.

Bank were increasingly lending to households: in Q3, hryvnia-denominated retail loans grew 9.5%¹, or 25.2% yoy.

The quality of the banking sector's loan portfolio improved, with the NPL rate down 1.3 pp to 56.4%².

The ratio of government securities in banks' net assets remained flat in Q3 at 26.2% (included accrued income). The increase in the share of domestic government bonds in banks' assets was offset by a decrease in share of NBU certificates of deposit by UAH 16.8 billion, or 31.4% qoq.

Funding Inflows of hryvnia retail deposits to banks slowed from UAH 9.0 billion in Q1 and UAH 16.1 billion in Q2 to just UAH 0.7 billion in Q3. FX deposits grew 0.5%, or by USD 45.6 million (FX equivalent). State-owned Oschadbank saw the greatest inflow of retail deposits.

Inflows of corporate deposits to banks accelerated to UAH 16.8 billion in Q3, underpinned by FX account balances of exporting companies.

The share of interbank loans and deposits in total system's liabilities decreased by 0.6 pp to 14.3%. The share of NBU funds in the liabilities of financial institutions fell to 1.1%.

Retail and corporate deposits further dominated in funding of the banking system. Their share increased through the quarter to 76.2%.

Interest rates In Q3, interest rates on hryvnia deposits declined at a faster pace. That was driven by a 1.0-1.5 pp interest rate cut by state-owned banks over the quarter. For the banking system in general, interest rates on new 12-month hryvnia retail deposits decreased 0.9 pp to 14.6% per annum³. Interest rates on US dollar-denominated deposits hit a new historic minimum at 3.9% per annum³ on 12-month deposits, but the pace of the decline slowed. The potential for a further decline in rates on FX deposits has been gradually exhausting.

Interest rates on corporate loans remained virtually unchanged. However, the average interest rate on retail loans declined 0.9 pp to 29.5% per annum. With loan rates remaining relatively flat over the quarter, there is a room for a future decline in rates even if funding costs remain at current rates.

Financials and Capital A widening spread between loan and deposit interest rates allowed banks to grow net interest income, particularly from the household segment. Commission income from cash and settlement transactions grew, driven by stronger demand for banking services. These two factors, alongside a significant reduction in provisioning, enabled banks to make profits in Q3, offsetting the losses of the H1. The banking sector's net earnings totaled UAH 3.3 billion in Q3 and UAH 1.4 billion for 9M 2017. Bank operating efficiency as measured by the cost-to-income ratio (CIR) improved to 56.1% from 60.3% in 9M 2016.

Prospects and Risks In late October 2017, the NBU raised its key policy rate 1 pp to 13.5% to mitigate inflation risks for 2018. The decision will have no effect on the long-term trend towards lower interest rates, but it may lead to a temporary increase in the cost of short-term funding.

The NBU expects that banks will increase lending to businesses and households, provided there are no negative shocks. The outcome of the latest Lending Survey (October 2017) showed that banks have not changed their plans to ramp up lending to the corporate and household sectors.

As macroeconomic risks have subsided and banks have increased capital, the NBU expects banks to expand their balance sheets and to remain profitable next year. In Q1 2018, the banking sector may post losses resulting from the introduction of the new provisioning rules under IFRS 9 from the beginning of the next year.

¹ Banks that were solvent as of the end of September 2017.

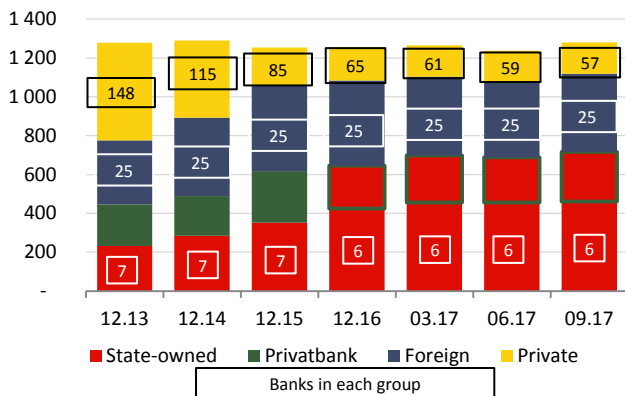
² Of all reporting banks.

³ Based on the Ukrainian Index of Retail Deposit Rates.

The Structure of the Sector

In Q3, the banking sector's net assets grew 3.5% to UAH 1281 million on the back of lending revival and additional capitalization of PrivatBank. Over the quarter, two small banks were declared insolvent.

Banks' net assets, UAH billion*



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

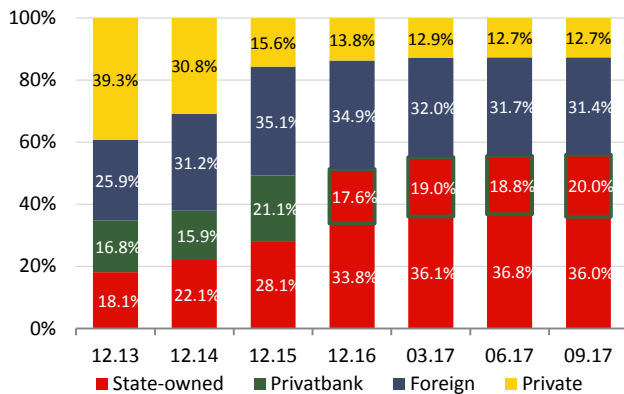
Number of banks*

	2014	2015	2016	Mar-17	Jun-17	Sep-17
Solvent	147	117	96	92	90	88
- change	-33	-30	-21	-4	-2	-2
State-owned	7	7	6	6	6	6
- change	0	0	-1	0	0	0
Foreign	25	25	25	25	25	25
- change	0	0	0	0	0	0
Private	115	85	65	61	59	57
- change	-33	-30	-20	-4	-2	-2
Insolvent	16	3	4	3	3	4
- change	16	-13	1	-1	0	1
Under liquidation	21	64	84	89	91	92
- change	19	43	20	5	2	1

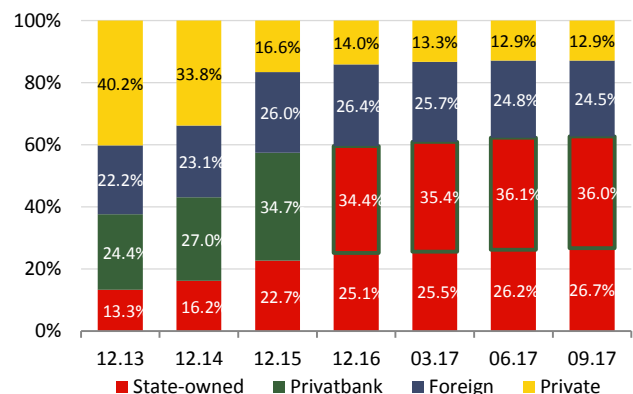
*The number of banks as of period-end

In Q3, state-owned banks increased their share of assets by 0.4 pp to 56%. Their share of retail deposits grew 0.4 pp to 62.7%. Oschadbank saw substantial deposit inflows, share of other state-owned banks in deposits declined.

Net assets by groups of banks

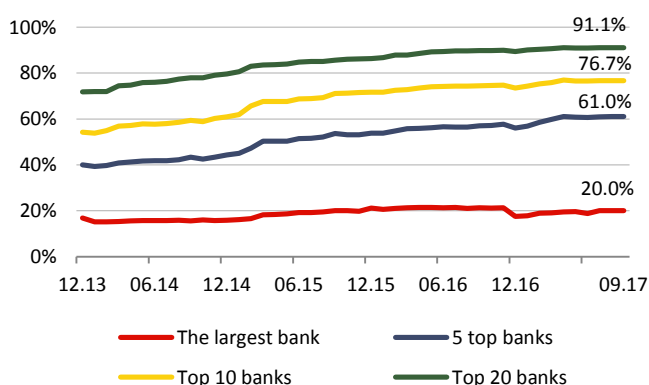


Retail deposits by groups of banks

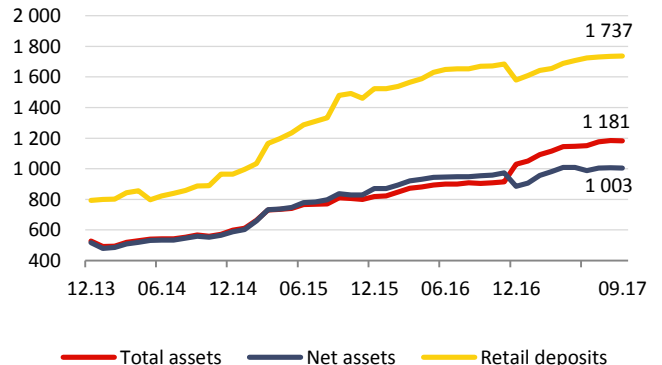


In Q3, concentration of net assets remained virtually unchanged. The 20 largest financial institutions account for 91.1% of the banking sector assets. Concentration of retail deposits is on the rise.

Shares of the largest banks by net sector assets



Concentration rate in the banking sector, HHI*

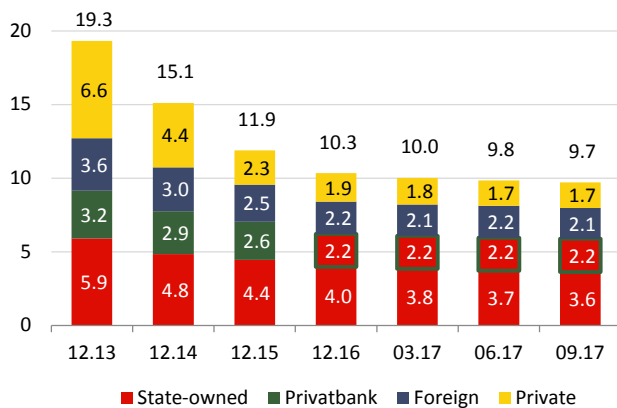


*The Herfindahl-Hirschman Index (HHI) is an indicator of banking sector concentration. It is calculated as the sum of the banks' squared market shares. The index ranges from 0 to 10,000 – values below 1,000 indicate a low degree of market concentration.

Banking Infrastructure

In Q3, banks proceeded with restructuring of their networks. Some 129 structural units were shut down, mostly within the structure of state-owned and foreign banks.

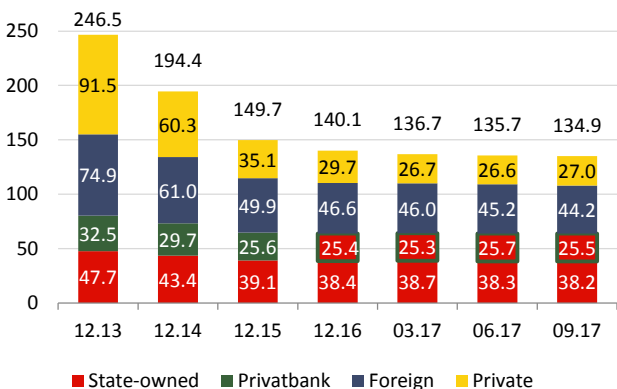
Number of structural units of banks, thousands*



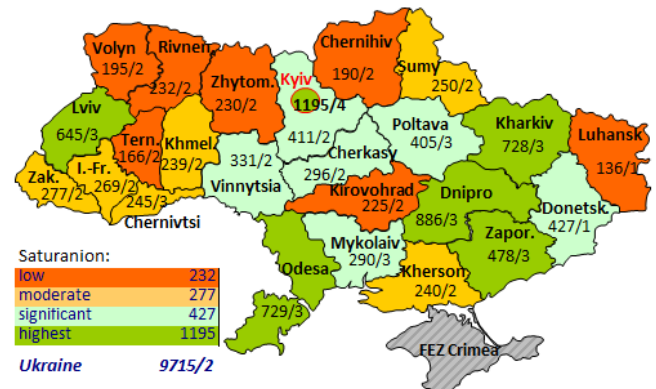
* branches and head-offices

The number of employees in foreign banks reduced by 800 individuals during the quarter, while private banks expanded their workforce.

Headcount at banks, thousand employees

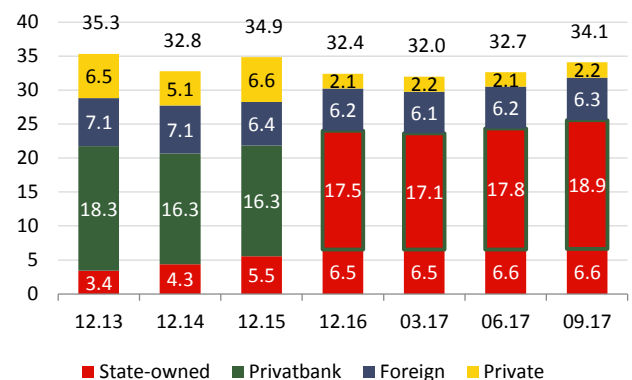


Operating banking units by regions as of 1 October 2017, units per 10,000 individuals



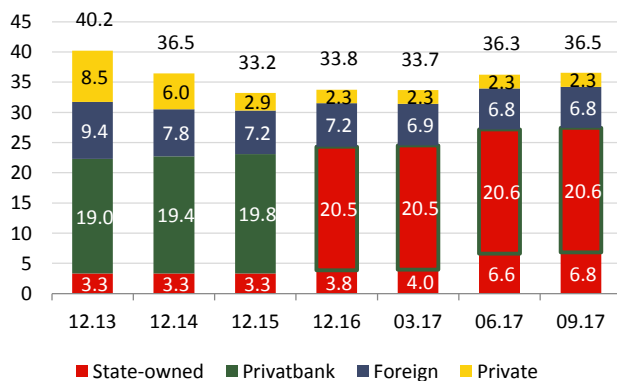
New payroll programs enabled PrivatBank to issue 1.1 million new payment cards during the quarter.

Number of active bank cards by bank groups, million pcs

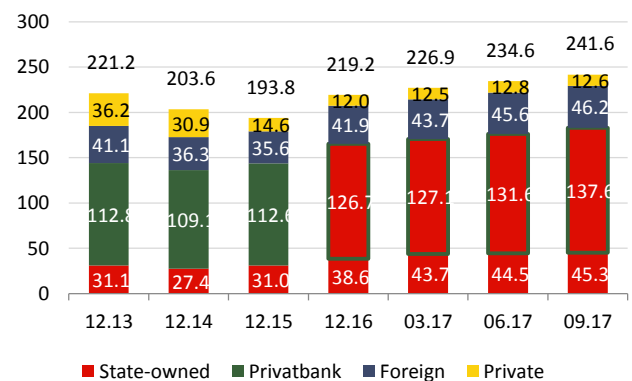


In Q3, the number of ATMs* and payment terminals increased by 245 and 7,000, accordingly. State-owned banks increased the number of ATMs, while PrivatBank produced the highest increase in POS-terminals.

Number of ATMs*, thousand units



Number of banks' POSs, thousand units

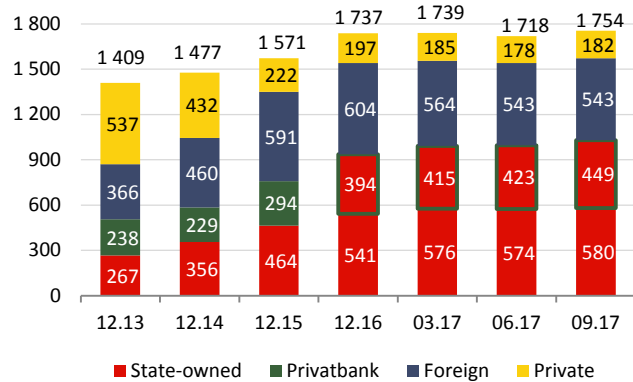


*Number of self-service bank machines (ATMs, deposit ATMs, Self-Service Kiosks)

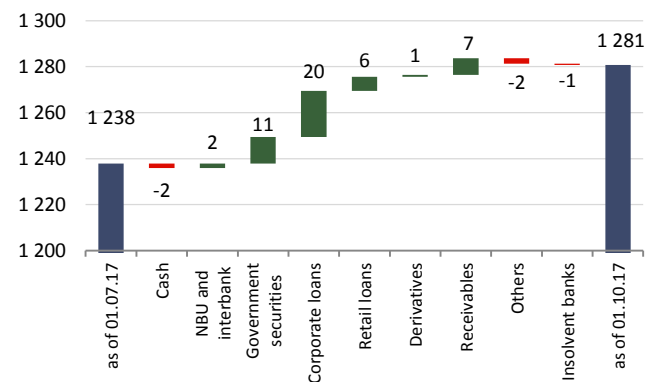
Assets

In Q3, net corporate loans grew by 4.7% (UAH 20.1 billion), mainly in state-owned (except for PrivatBank) and foreign banks. Some particularly large default exposures, fully provisioned, were written off or restructured - to the tune of over UAH 10 billion.

Total assets by bank groups, UAH billion



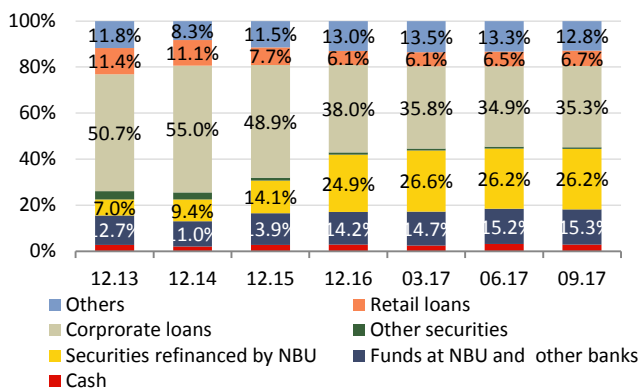
Change in net assets by components*, UAH billion



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

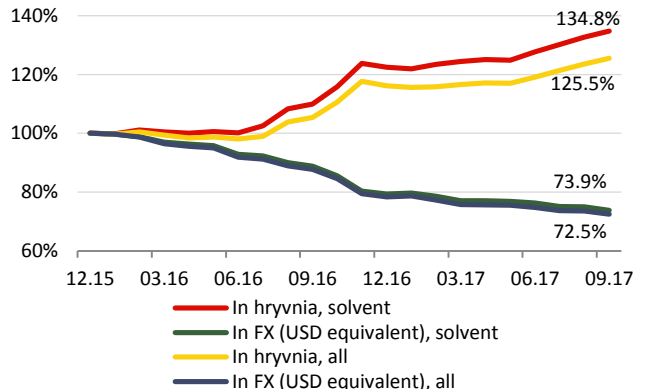
In the structure of net assets, corporate and retail loans grew by 0.4 pp and 0.3 pp respectively over the quarter.

Net assets by components



After restructuring or write-offs, the amount of FX loans decreased, while hryvnia loans increased.

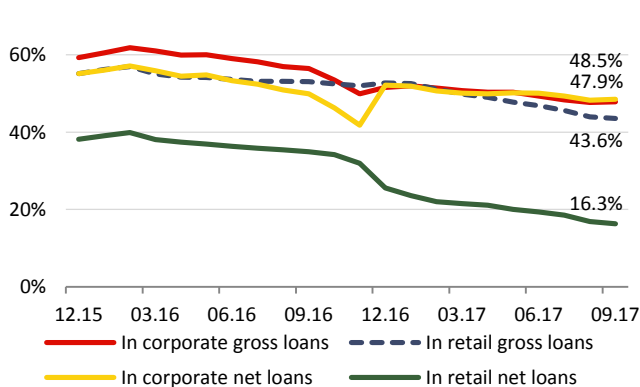
Gross corporate and retail loans, 2015=100%*



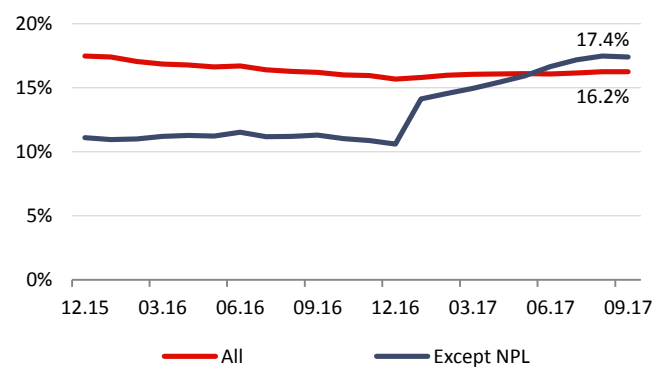
* At banks solvent as of 1 October 2017

The ratio of net retail loans in banks' portfolios grew by 0.7 pp to 17.4%. The ratio of FX corporate loans in the gross loan portfolio reduced to 47.9%.

FX loans ratio

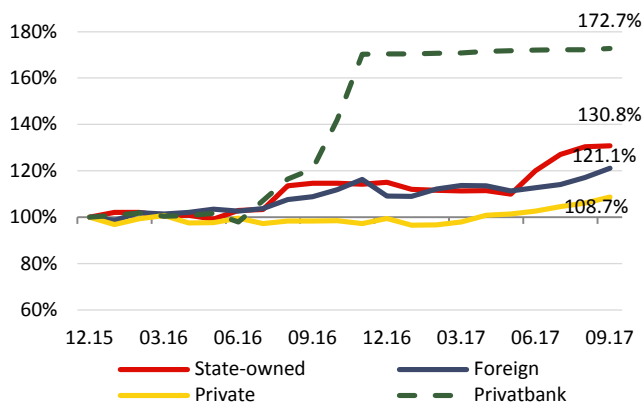


Retail loans in the total loan portfolio

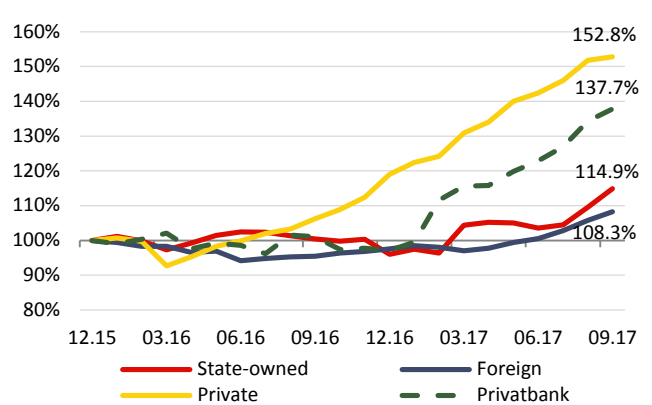


In Q3, gross retail loans in hryvnia increased by 9.5%, corporate loans were up by 4.8%. All banking groups, except PrivatBank, boosted lending to corporate sector; all banks, without exception increased retail lending.

Gross corporate loans in UAH, 2015=100%*



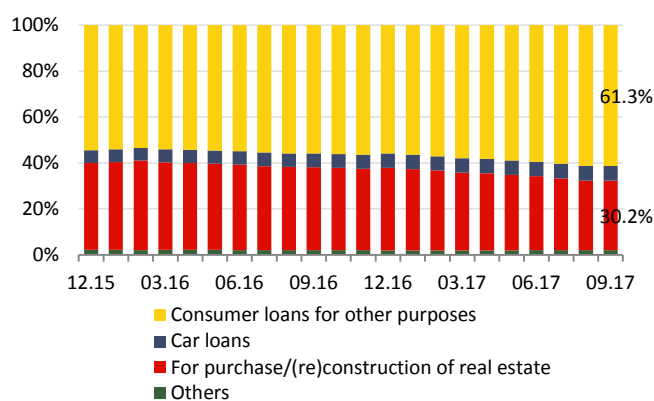
Gross retail loans in UAH, 2015=100%*



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

The share of consumer loans in retail loan portfolio grew 1.9 pp to 61.3%.

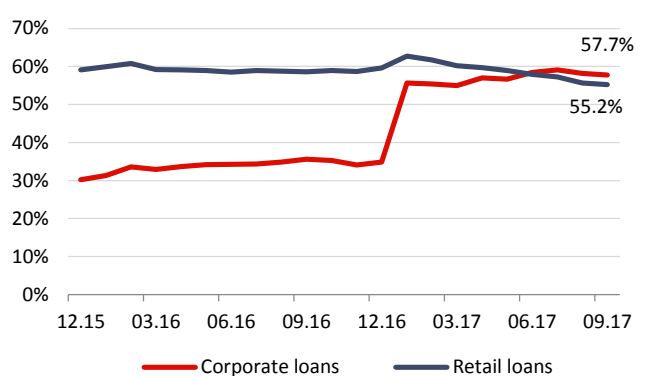
Gross retail loans* by type



* At all banks

The quality of bank's loan portfolio improved due to statistical effect from new loans.

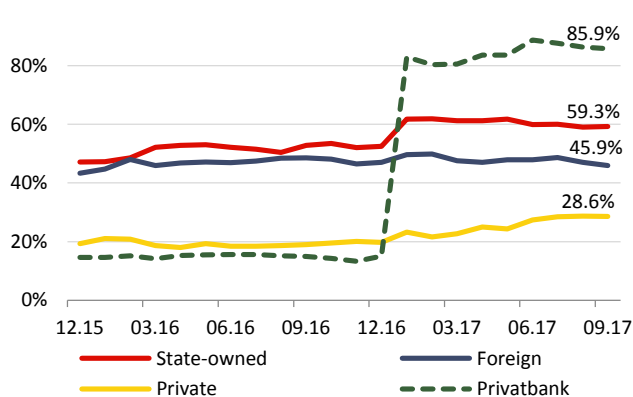
Non-performing loans in the portfolios of reporting banks*



*Excluding off-balance sheet accounts, all banks

The share of non-performing loans in portfolios of private banks has increased since the beginning of the year due to additional recognition of NPLs in accordance with new rules for credit risk assessment.

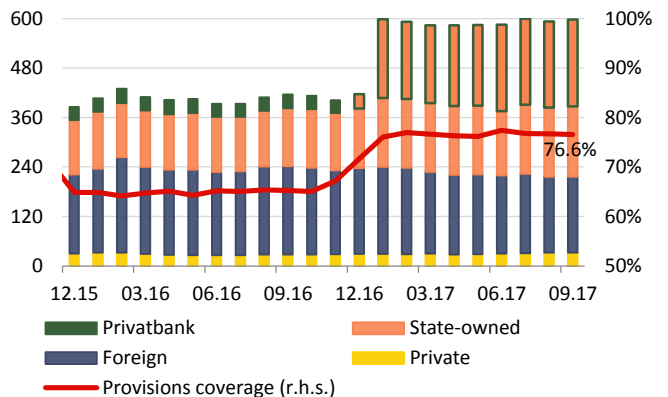
Non-performing loans in loan portfolios by bank groups*



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

The loan loss provision coverage ratio stayed at 76.6%.

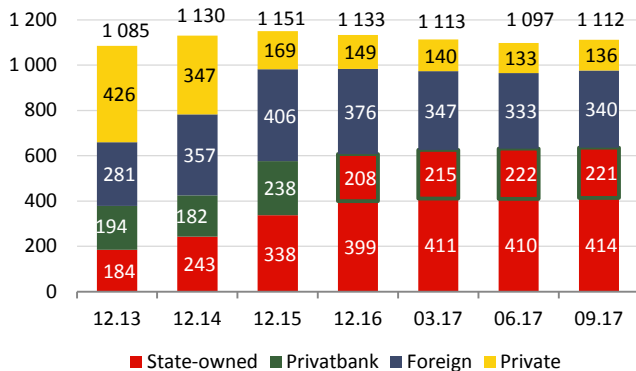
Non-performing exposures and provisions, UAH billion



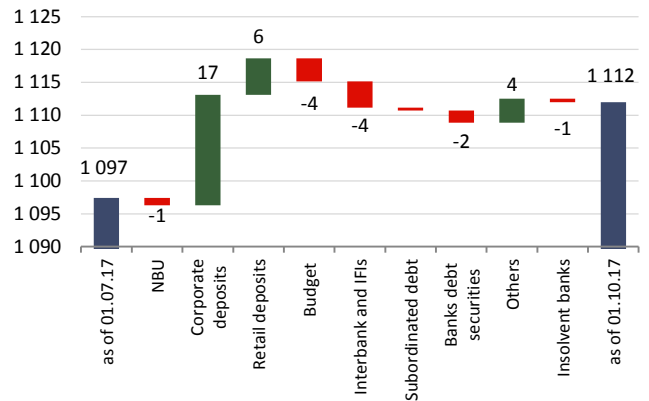
Funding

During the quarter, banks' liabilities rose by 1.3%, but decreased by 1.1% in annual terms. Over Q3, inflows of corporate and retail deposits continued (+UAH 16.8 and +UAH 5.6 billion respectively), other liabilities decreased.

Liabilities by groups of banks, UAH billion

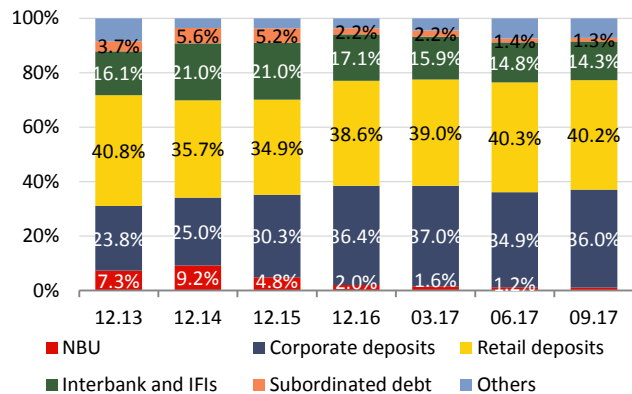


Change in liabilities by items, UAH billion



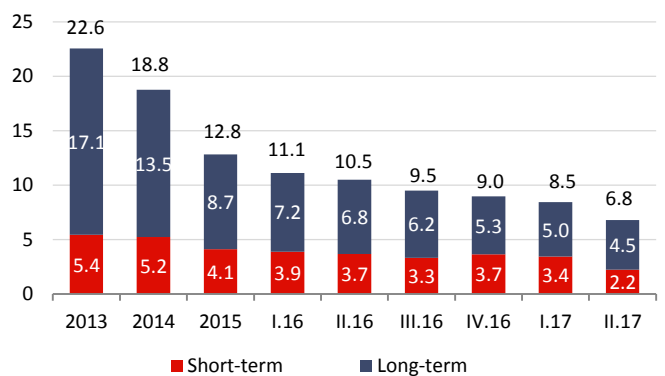
In Q3, the structure of liabilities showed increase in corporate and retail deposits by 1.0 pp to 76.2%.

The structure of liabilities



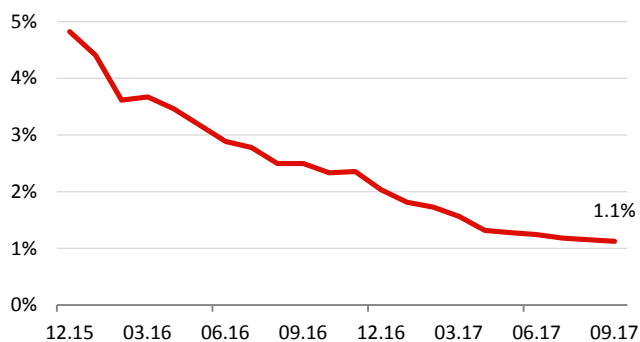
Due to conversion of interbank loans from parent banks into capital in Q2, gross external debt of banks decreased by USD 1.7 billion.

Banks' gross external debt, USD billion



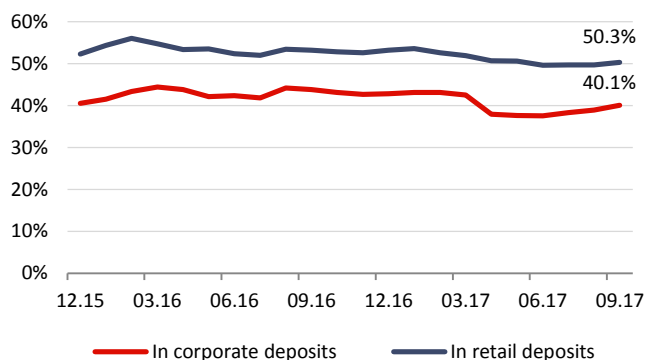
The share of NBU funds in banks' liabilities is insignificant, accounting for 1.1% of liabilities as of the end of Q3.

NBU funds in banks' liabilities



In Q3, banks reported inflows of funds in foreign currency from the corporate sector.

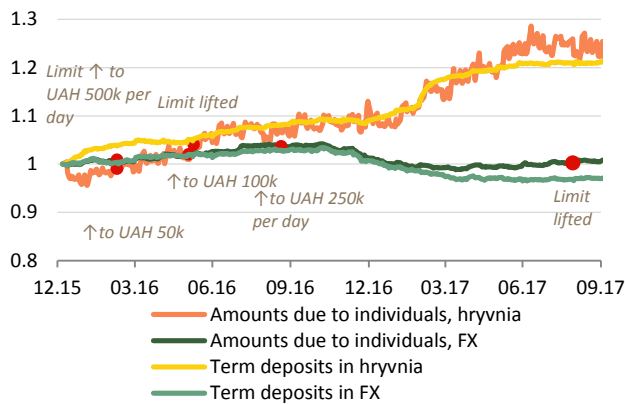
FX deposits



Since the start of 2017, hryvnia retail deposits have grown 16.4% while FX retail deposits have fallen by 3% (in USD equivalent). During the quarter, hryvnia deposits grew by 0.3% and FX deposits were up by 0.5%.

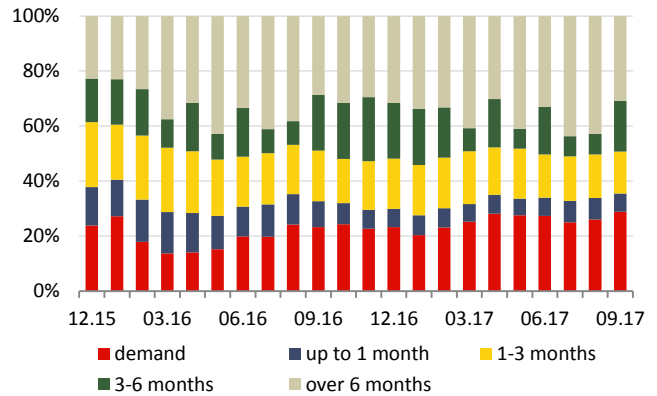
In Q3, the maturity structure of new retail deposits did not change, with short-term deposits (up to 3 months) accounting for almost a half of all deposits.

Retail deposits, 2015=100%*



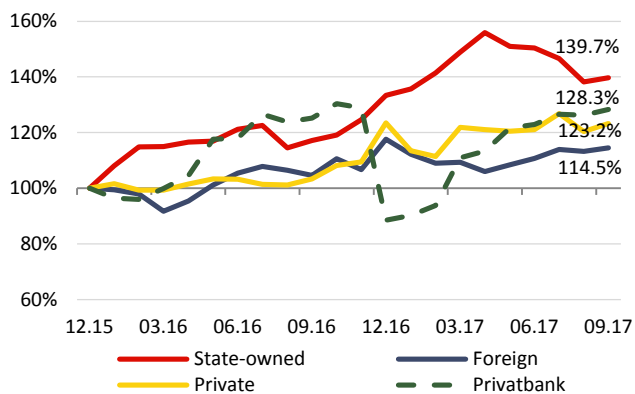
*At banks solvent as of 1 October 2017, including certificates of deposit

New retail deposits by maturity



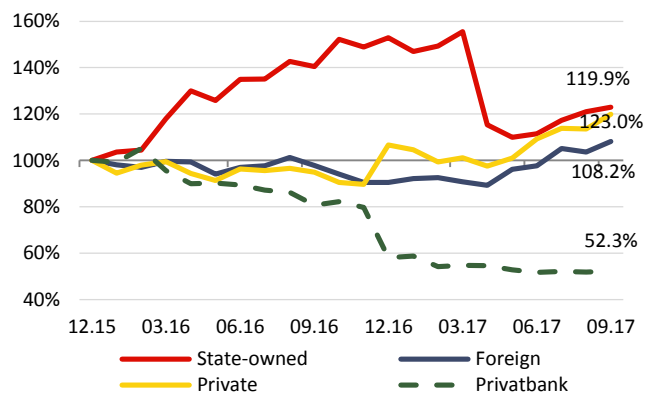
In Q3, the volume of hryvnia corporate deposits stayed largely unchanged; the growth of corporate deposits at foreign banks and Privatbank (+3.5% and +4.4% respectively) offset the outflow of state-owned enterprises' deposits from state-owned banks. Corporate deposits in FX surged by 9.6% thanks to exporters and certain natural monopolies.

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



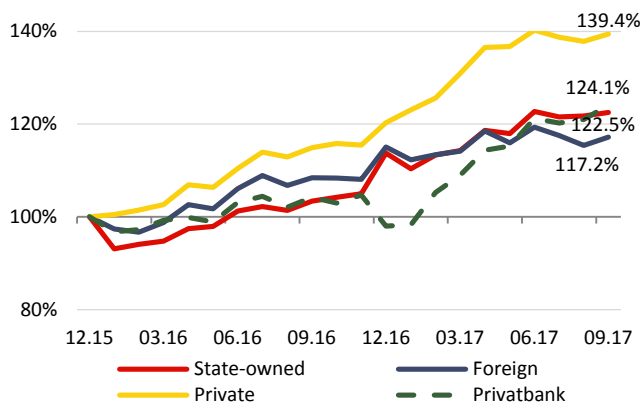
* At banks solvent as of 1 October 2017, including certificates of deposit

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



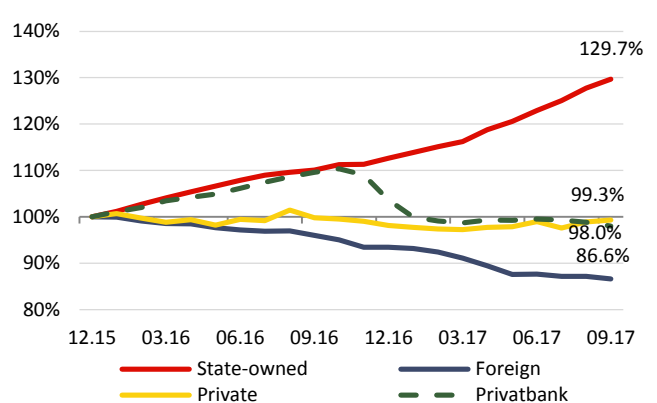
In Q3, state-owned banks experienced a significant growth of 5.5% in retail FX deposits, or 17.8% in annual terms. The highest growth in hryvnia deposits was reported by PrivatBank - 2.4% over the quarter.

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



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

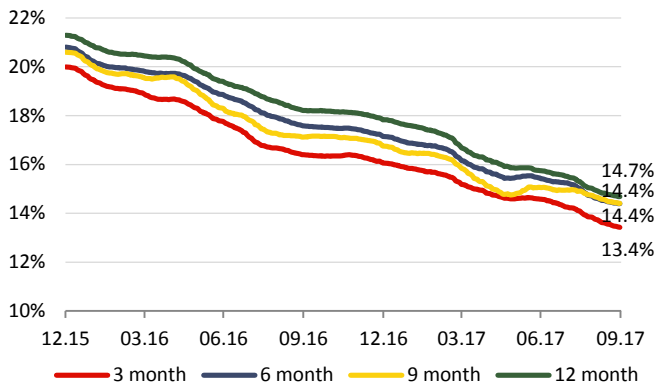
Corporate deposits in FX (USD equivalent) by bank groups, 2013 = 100%*



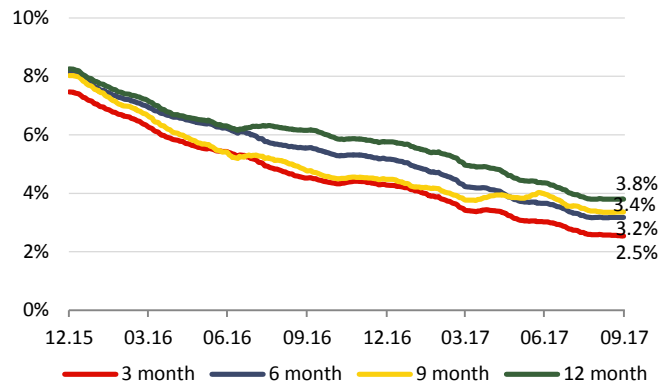
Interest Rates

In Q3, the reduction of interest rates on retail deposits was prompted by state-owned banks, including PrivatBank. The most significant decrease in interest rates was on 12-month retail hryvnia deposits, down by 0.9 pp to 14.6% per annum. Interest rates on FX deposits decreased by 0.2 pp to 3.9% per annum in US dollar.

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



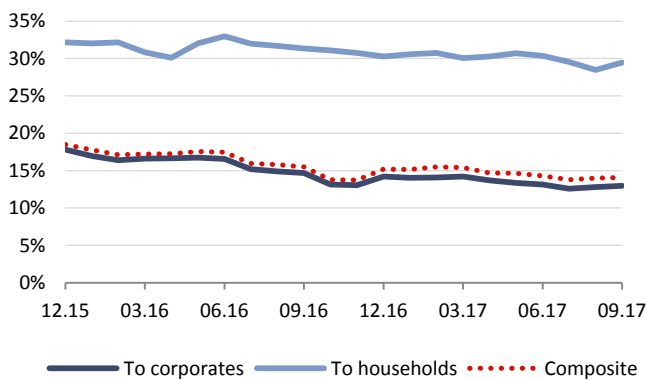
Ukrainian Index of Retail Deposit rates in USD, % per annum*



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

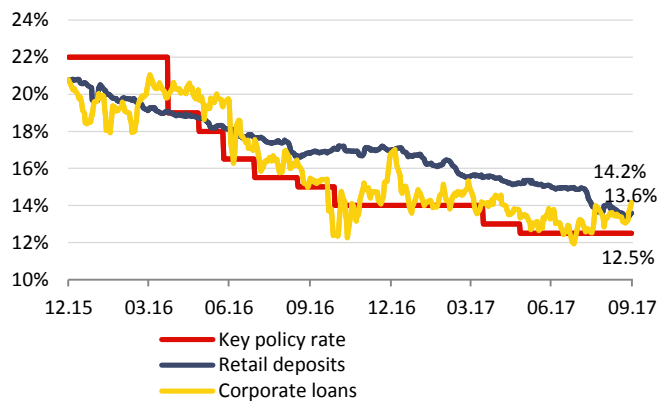
Interest rates on corporate loans stayed virtually unchanged during the quarter. Interest rates on retail loans decreased by 0.9 pp to 29.5% per annum.

Interest rates on new loans*, % per annum



* No loan rescheduling or any other amendments to lending terms

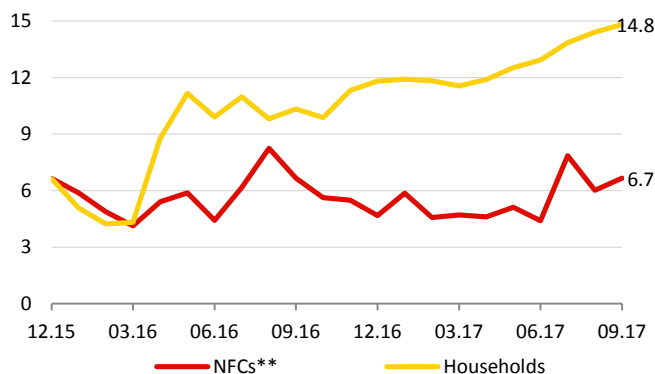
The NBU's key policy rate, price* of new loans and deposits in hryvnia, % per annum



*Daily rates, 5-day moving average

In Q3, spreads were expanding in both corporate and retail segments because of falling deposit rates.

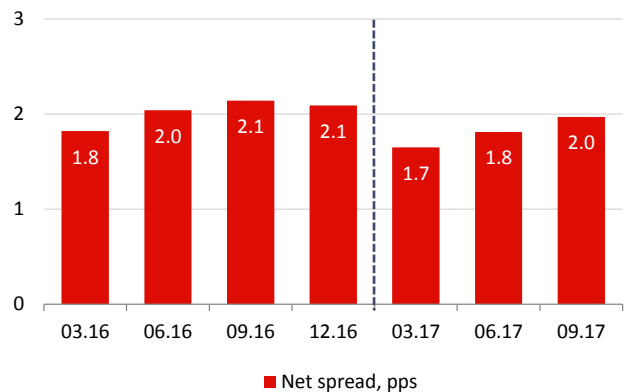
Spread between interest rates on loans and deposits, pps*



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

In Q3, return on bank assets rose in the quarter under review.

Interest rate spread, pps*

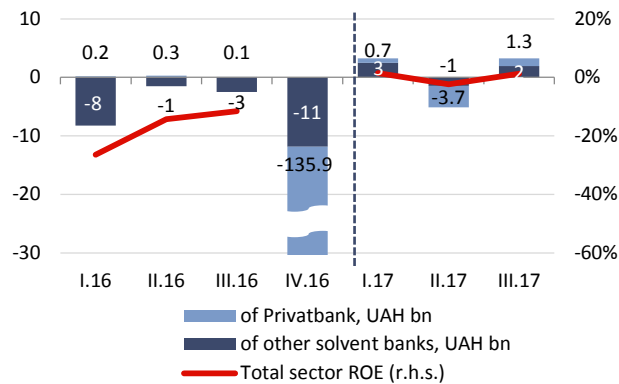


*In a given month, including insolvent banks

Financial Results and Capital

In Q3, banks were able to earn profits again. Net earnings in nine months totaled UAH 1.4 billion*.

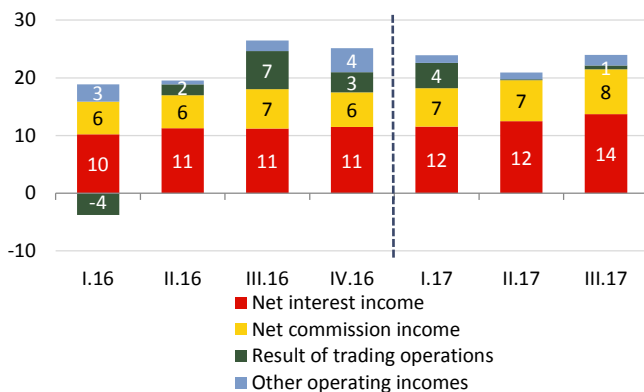
Profit/loss** and return on equity



*The adjusted data for 2017 in this section
**in respective quarter

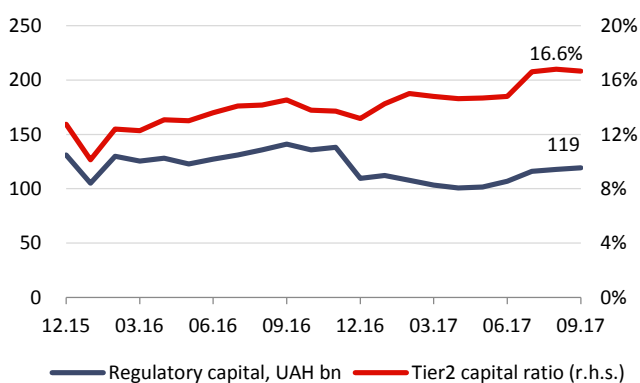
In Q3, the banking system operating income grew due to higher net interest income in the household segment and net commission income from cash and settlement transactions.

Operating income components for the period, UAH billion



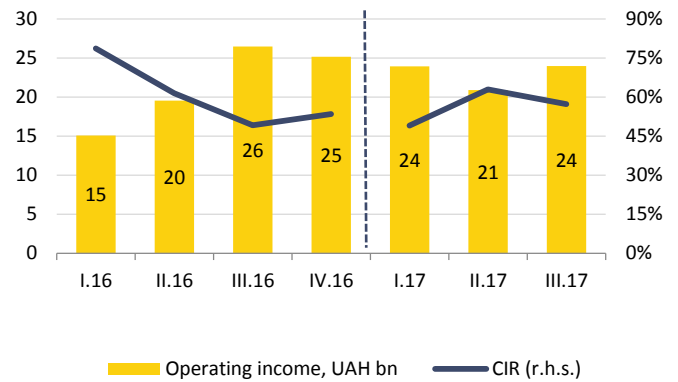
Capital adequacy ratios were higher than the minimum level required.

Regulatory capital and regulatory capital adequacy levels



Operating performance improved: CIR* decreased from 60.3% in 9M 2016 to 56.1% in 9M 2017.

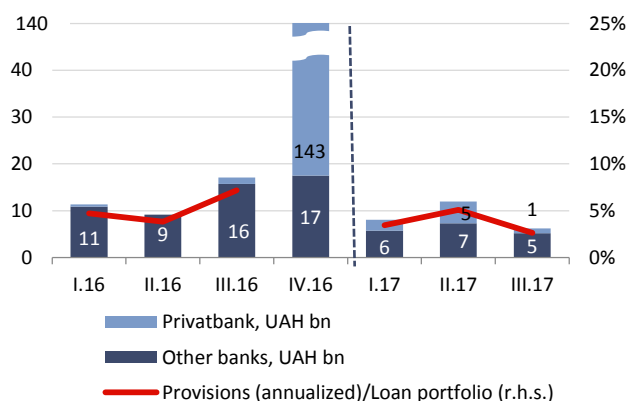
Operating income and operating efficiency of banks



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

In Q3, bank provisions* totaled UAH 6.2 billion, down by 48.4% from the previous period.

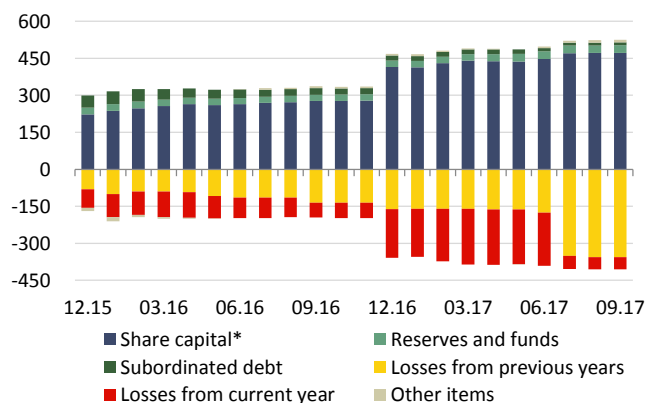
Loan loss provisions**



*Adjusted data
**Ratio of provisions to bank loan portfolios

Over the quarter, the share capital grew by UAH 24.2 billion, or up by 5.4%, mostly as the result of additional capitalization of PrivatBank.

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	Q3.17
Number of operating banks	181	180	175	175	174	180	145	117	96	92	90	88
<i>including 100% foreign-owned banks</i>	17	18	20	22	22	19	19	17	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	1 754
<i>including in foreign currency</i>	528	489	476	492	503	513	667	197	788	757	730	738
Net assets	921	880	942	1 054	1 125	1 278	1 290	1 254	1 256	1 266	1 238	1 281
<i>including in foreign currency</i>	500	426	395	416	450	470	565	582	519	497	481	498
Gross corporate loans ³	476	498	537	608	634	727	820	831	847	829	818	833
<i>including in foreign currency</i>	252	212	212	221	227	252	400	492	437	421	403	399
Net corporate loans ³	453	434	463	530	553	648	710	614	477	452	432	451
Gross retail loans	273	236	205	197	184	189	208	176	157	155	154	158
<i>including in foreign currency</i>	198	172	143	113	84	67	101	97	83	77	72	69
Net retail loans	254	203	168	158	133	145	144	96	76	78	80	86
Corporate deposits ³	162	128	160	205	221	258	283	349	413	412	383	400
<i>including in foreign currency</i>	69	53	56	70	80	81	114	141	177	175	144	160
Retail deposits ⁴	219	214	276	312	368	443	403	402	437	434	442	447
<i>including in foreign currency</i>	111	116	136	154	187	189	214	215	239	231	224	229
Change (yoy, %)												
Total assets		3.5%	8.8%	11.1%	4.3%	11.4%	4.8%	6.4%	10.6%	7.1%	9.3%	9.4%
Net assets		-4.4%	7.0%	11.9%	6.7%	13.7%	1.0%	-2.8%	0.2%	-2.5%	-1.8%	0.4%
Gross corporate loans ³		4.6%	7.8%	13.3%	4.2%	14.7%	12.8%	1.3%	2.0%	-3.2%	2.4%	0.0%
Gross retail loans		-13.4%	-13.1%	-4.0%	-6.7%	3.0%	10.3%	-15.7%	-10.4%	-10.4%	-3.9%	-1.5%
Corporate deposits ³		-20.8%	25.1%	27.7%	7.9%	16.8%	9.5%	23.5%	18.2%	12.9%	1.8%	4.3%
Retail deposits ⁴		-2.3%	28.7%	13.2%	18.1%	20.2%	-8.9%	-0.3%	8.7%	3.2%	7.1%	4.5%
Penetration⁵ (%)												
Gross corporate loans ³ / BBП	48.0%	52.6%	47.9%	45.1%	43.4%	47.7%	51.7%	41.8%	35.5%	29.1%	28.7%	29.2%
Net corporate loans ³ / BBП	45.7%	45.9%	41.3%	39.3%	37.9%	42.6%	44.7%	30.9%	20.0%	15.9%	15.1%	15.8%
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%	5.6%
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%	3.0%
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%	14.0%
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%	15.7%
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	13.7
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	7.8
Provisions	24.0	75.4	46.2	36.5	22.3	28.0	84.4	114.5	198.3	8.1	12.0	6.2
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	3.3
Memo items:												
UAH/USD (period average)	5.27	7.79	7.94	7.97	7.99	7.99	11.89	21.84	25.55	27.06	26.46	25.90
UAH/USD (end-of-period)	7.70	7.99	7.96	7.99	7.99	7.99	15.77	24.00	27.2	26.98	26.10	26.52
UAH/EUR (period average)	7.71	10.87	10.53	11.09	10.27	10.61	15.72	24.23	28.29	28.81	29.06	30.39
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	31.24

¹ Data for solvent banks for each reporting date² Including accrued income/expenses³ Including non-banking financial institutions⁴ Including certificates of deposits⁵ GDP 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)

⁶ Data for 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