

Macroeconomic conditions were favorable for the banking sector in Q1. Retail bank deposits grew at a high and stable pace, and may increase further judging by the developments in nominal household incomes. Net retail loans (net of provisions) in hryvnia continued to increase at a rate of around 35% yoy. The size of the corporate loan portfolio remained almost unchanged as banks are still more focused on improving the portfolio's quality, rather than raising their market shares. A number of banks successfully restructured their NPLs, which allowed them to release provisions and increase profitability. Most banks expected an increase in lending to business. The cost of funding ceased declining and should not change significantly by the end of the year. The profitability of the banking sector was on the rise. In Q1, the major challenge for banks was transition to IFRS 9: they had to modify asset classification and switch to provisioning based on expected losses approach. However, the announced assessments of the effect the transition to IFRS 9 has had on banks' balance sheets and profitability are preliminary ones: some banks will continue the process of adopting the new standard in Q2–Q3.

**The structure of the sector.** The number of operating banks and their ownership structure have not changed since the start of 2018. Of 82 operating banks, two small banks decided to cease their banking activity – these banks will surrender their licenses after the legal procedures are completed. State-owned banks continue to dominate the market, accounting for 55.4% of the market share by net assets, and 62.8% by household deposits. The sector's concentration has not changed: the top-20 banks hold 90.8% of net assets.

**Assets.** In Q1, the banks' net assets decreased by 3.0% to UAH 1.296 trillion<sup>1</sup>, mainly driven by the revaluation of government securities in line with IFRS 9 and a decline in corporate loans.

Net corporate loans outstanding lost 4.0%<sup>1</sup> in the hryvnia equivalent, to reach UAH 438 billion. This was a result of the hryvnia's appreciation and the seasonal reduction in lending (1.3 pp at the exchange rate fixed at the start of the year).

The banks continued active lending to households. During the quarter, the net amount of the hryvnia household loan portfolio increased by 5.6% to UAH 83.8 billion, or by over 37.4% yoy. As in 2017, consumer loans grew the fastest: these were loans for purchase home appliances, car loans, etc.

Since the start of the year, the NPL ratio has grown by 1.8 pp, to 56.4%. This was primarily due to a change in the methodology for accounting for financial instruments: in particular, a portion of accrued but not paid interest income was transferred to provisions, which resulted in a one-time increase in the total assets and non-performing exposures, while net assets remained unchanged. In Q1, the provision coverage of NPLs grew by 2.4 pp, to 83.6%, which is an acceptable level.

**Funding.** In Q1, the banks' liabilities decreased by 3.1%, to UAH 1.136 trillion<sup>1</sup>. Corporate deposits saw a seasonal outflow (by 4.8% at the fixed exchange rate). On the other hand, the funds of local budgets showed an increase. Household deposits grew by 2.0% at the fixed exchange rate, to reach UAH 475 billion (hryvnia deposits gained 3.2%). The hryvnia appreciation and growth in hryvnia household deposits led to a moderate de-dollarization. The share of foreign currency deposits declined by 2.0 pp, to 48.9%. The share of the NBU's funds in the liabilities of banks decreased by 0.4 pp, to 1.2%.

**Interest rates.** The NBU raised the key policy rate twice in Q1, increasing it from 14.5% to 17% per annum. In response to this, the banks stopped decreasing interest rates on retail deposits: the rate for 12-month hryvnia retail deposits has remained at 14.2% over the last five months. Interest rates on FX deposits continue to decline slowly, having hit new record lows.

Interest rates on hryvnia corporate loans edged higher by 1.1 pp, to 15.5% per annum. Rates on retail loans grew as well.

**Financial results and capital.** In Q1, banks received net profits of UAH 8.7 billion, which is 2.7 times increase yoy. The main factor was a significant drop in provisioning, which accounted for UAH 1.1 billion, versus UAH 8.1 billion in Q1 2017. The sector's operational income increased by 6% yoy, while operating expenses grew by 25.2%. As a result, operating profit before provisioning dropped by 13.3% yoy, to UAH 10.8 billion. A decline in equity, which was associated with the transition to IFRS 9, was largely offset by the profits of the banking sector in Q1.

**Prospects and risks.** The banking system's profitability will continue to increase on the back of improved operating results and a decline in provisioning. The funding base will grow. Competition for high-quality borrowers will remain fierce among the banks. The NBU's April [survey](#) shows that the vast majority of banks expect a pickup in corporate lending. The uncertainty over further cooperation with the IMF remains the key risk to the sector.

The transition to IFRS 9 will last until the end of the year. For that reason, banks' financials reported for Q1 can be deemed preliminary ones, and they will be revised later. In June, banks will start calculating LCR, the new liquidity ratio, in testing mode. The ratio will become a requirement starting from December 2018. In May, the NBU started to stress test the 25 banks accounting combined for around 95% of the banking sector's assets. The banks that are found to require additional capital will be ordered to draw up recapitalization programs by 10 August.

<sup>1</sup> At banks that were solvent as of the end of March 2018.

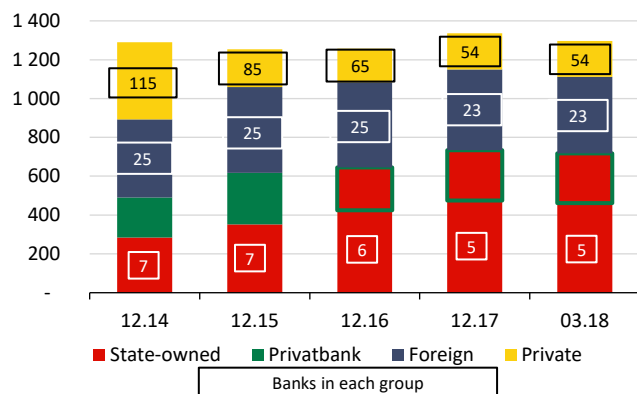
<sup>2</sup> At all reporting banks.

<sup>3</sup> Based on the Ukrainian Index of Retail Deposit Rates.

## Sector structure

The net assets of the banking sector declined by 3.0% in Q1 2018, to UAH 1.296 trillion. This was due to a reduction in the portfolios of domestic government bonds and certificates of deposit at state- and foreign-owned banks, as well as a drop in corporate loans inter alia due to a stronger hryvnia. The number of solvent banks remained unchanged.

Banks' net assets, UAH billion\*



\* Solvent banks were grouped under the relevant classification over the years specified

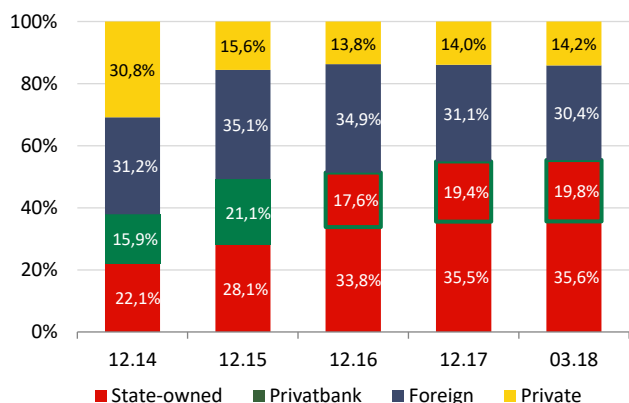
Number of banks\*

	2014	2015	2016	2017	Mar-18
<b>Solvent</b>	<b>147</b>	<b>117</b>	<b>96</b>	<b>82</b>	<b>82</b>
- change	-33	-30	-21	-14	0
<b>State-owned</b>	<b>7</b>	<b>7</b>	<b>6</b>	<b>5</b>	<b>5</b>
- change	0	0	-1	-1	0
<b>Foreign</b>	<b>25</b>	<b>25</b>	<b>25</b>	<b>23</b>	<b>23</b>
- change	0	0	0	-2	0
<b>Private</b>	<b>115</b>	<b>85</b>	<b>65</b>	<b>54</b>	<b>54</b>
- change	-33	-30	-20	-11	0
<b>Insolvent</b>	<b>16</b>	<b>3</b>	<b>4</b>	<b>2</b>	<b>2</b>
- change	16	-13	1	-2	0
<b>Under liquidation</b>	<b>21</b>	<b>64</b>	<b>84</b>	<b>95</b>	<b>95</b>
- change	19	43	20	11	0

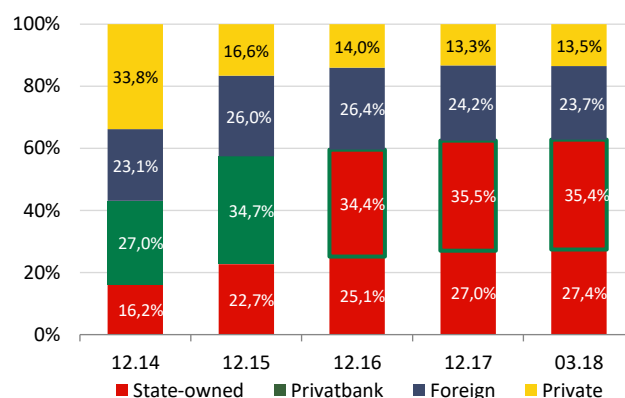
\* As of end of period

At the end of Q1, state-owned banks accounted for 55.4% of total assets and 62.8% of household deposits. The share of domestic private banks has been rising moderately for two quarters running, both in terms of assets and retail deposits.

Net assets by groups of banks

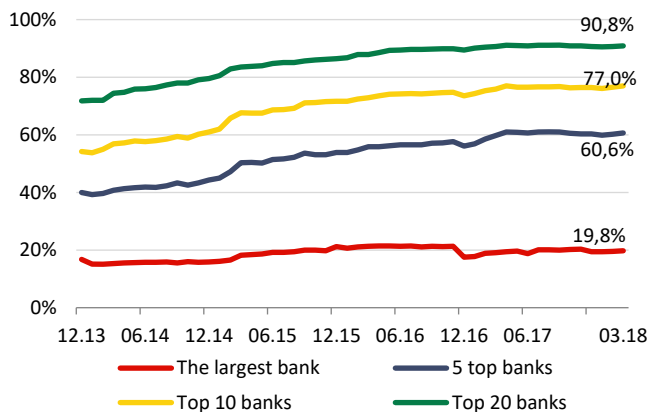


Retail deposits by groups of banks

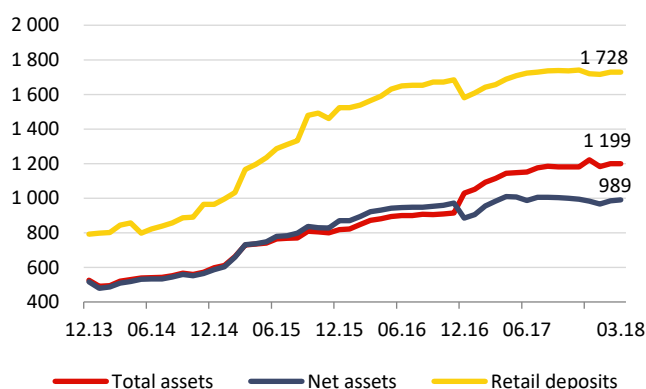


In March, the 20 largest banks accounted for 90.8% of total net assets, with the concentration level being unchanged since Q2 2017.

Shares of the largest banks by net sector assets



Concentration rate in the banking sector, HHI\*

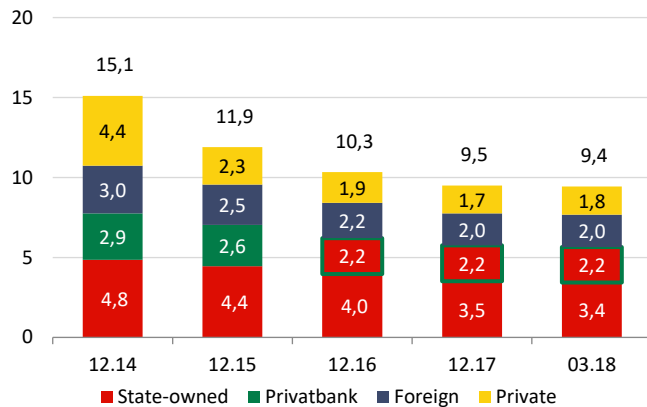


\* The Herfindahl-Hirschman Index (HHI) is an indicator of banking sector concentration. It is calculated as the sum of the banks' squared market shares. The index ranges from 0 to 10,000 – values below 1,000 indicate a low degree of market concentration.

## Banking infrastructure

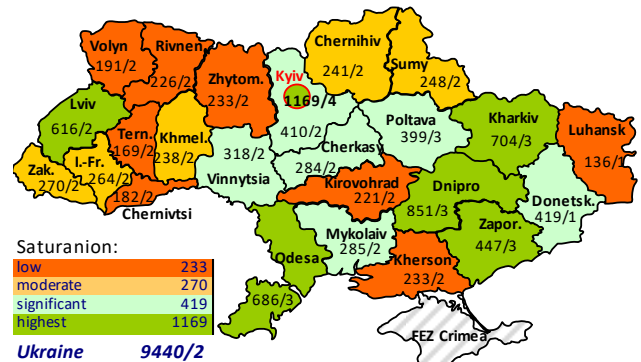
In Q1, state-owned banks continued to streamline their networks by shutting down 108 branches. Meanwhile, private and foreign-owned banks opened 20 and 39 new branches respectively.

*Number of structural units of banks, thousands\**



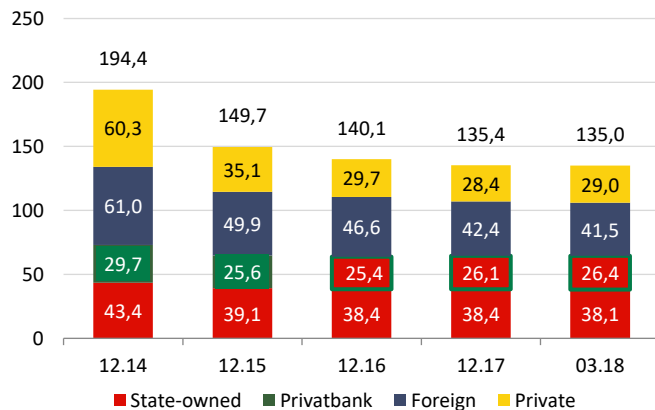
\* Branches and head-offices

*Operating banking units by regions as of 1 January 2018, units per 10,000 individuals*



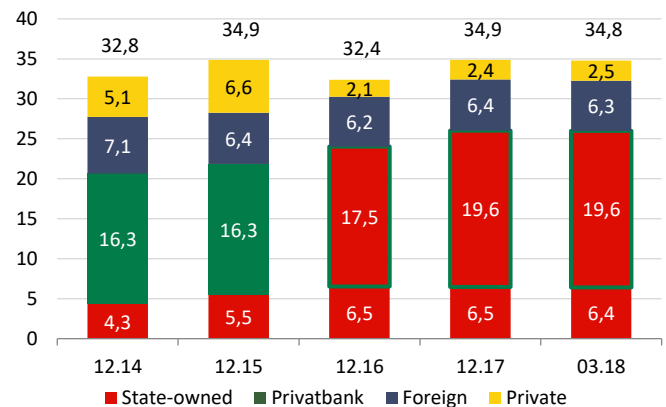
In Q1, foreign-owned banks laid off 1,000 employees, while private banks hired 600 persons.

*Headcount at banks, thousand employees*



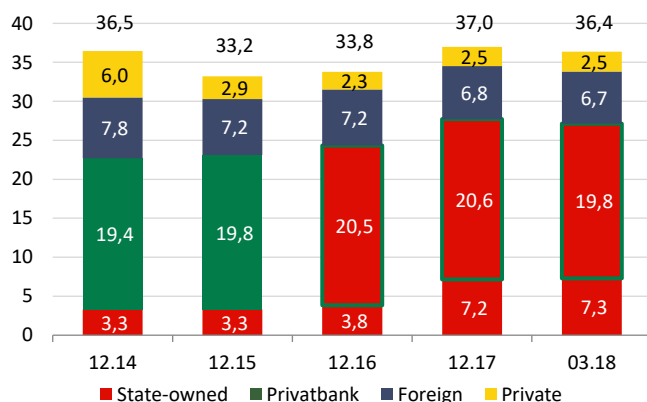
Q1 saw no significant changes in the payment card market.

*Number of active bank cards by bank groups, million pcs*

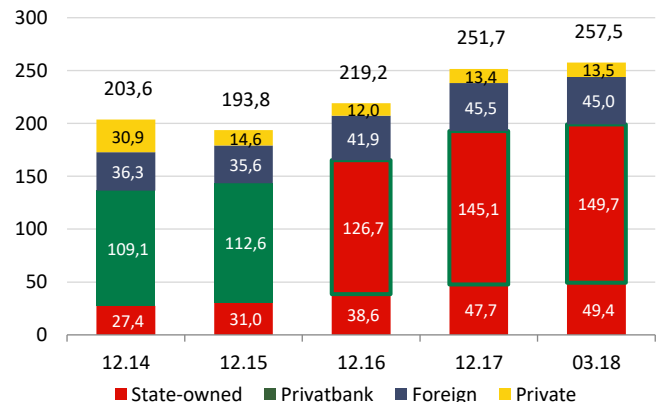


In Q1, the number of self-service payment kiosks\* decreased by 633 units, while the network of POS terminals grew by 5,900 units. PrivatBank led the growth increasing the number of its POS terminals to a record 149,700 units.

*Number of ATMs\*, thousand units*



*Number of banks' POSs, thousand units*

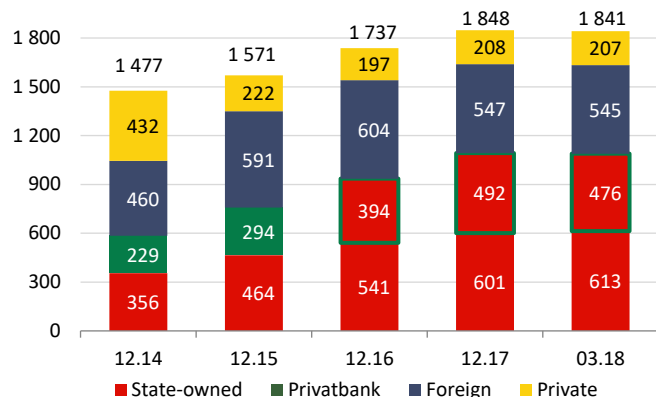


\* Number of self-service bank machines (ATMs, deposit ATMs, Self-Service Kiosks)

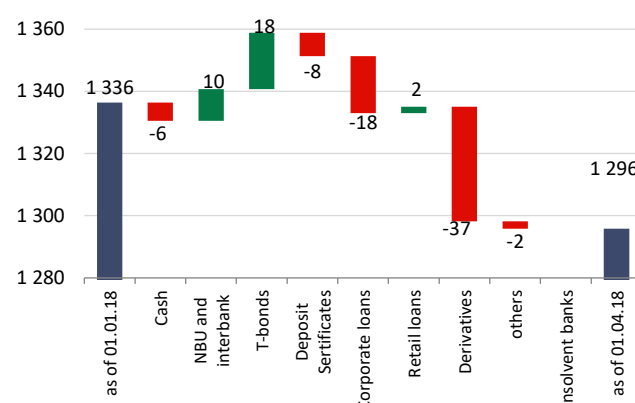
## Assets

In Q1 2018, the banks' total assets, at UAH 1.8541 trillion, were little changed. Accrued interest grew on the introduction of IFRS9, while corporate loans recorded a seasonal decline.

Total assets by bank groups, UAH billion



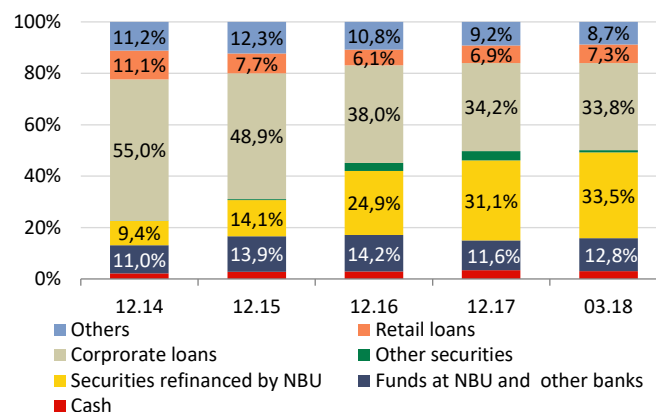
Change in net assets by components\*, UAH billion



\* Adjusted by the amount of provisions for active banking operations

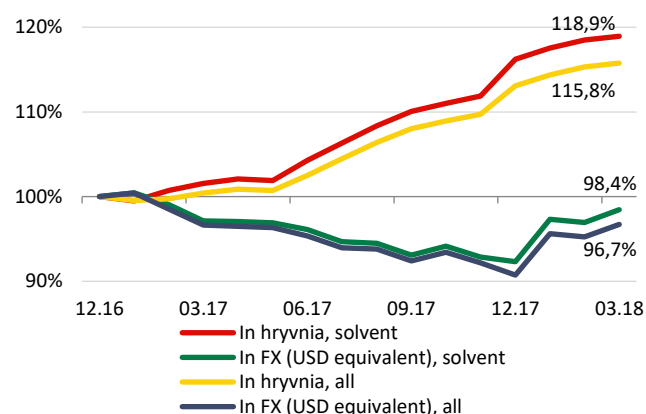
The percentage of domestic government bonds in the banks' total assets grew, due to derivative financial assets (indexed government securities) being reclassified as domestic government bonds, as required by IFRS9.

Net assets by components



Gross FX loans increased thanks to the adoption of IFRS9.

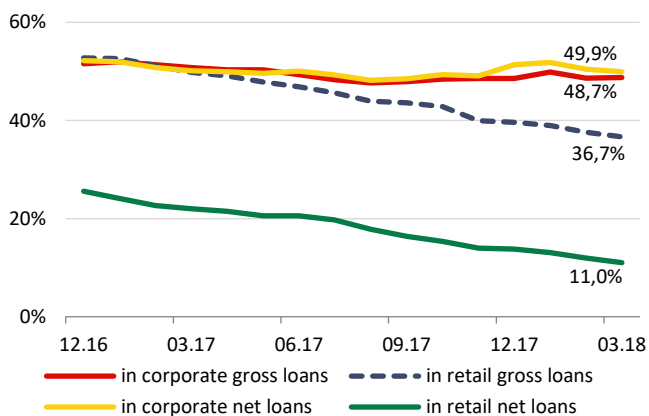
Gross corporate and retail loans, 2015=100%\*



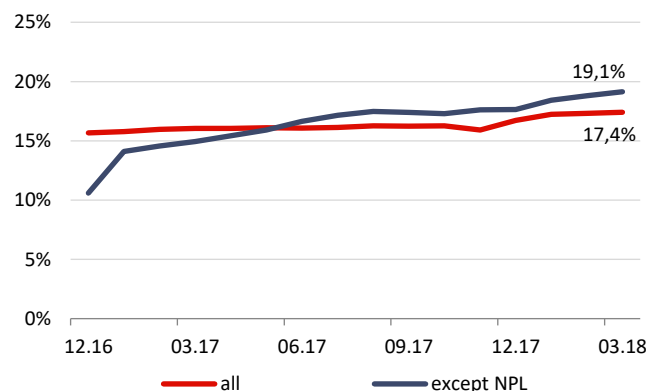
\* At banks solvent as of 1 April 2018

In Q1 2018, the dollarization of net retail loans decreased by 2.8 pp, to 11.0%, on the back of revived household lending.

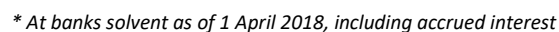
FX loans ratio



Retail loans in the total loan portfolio

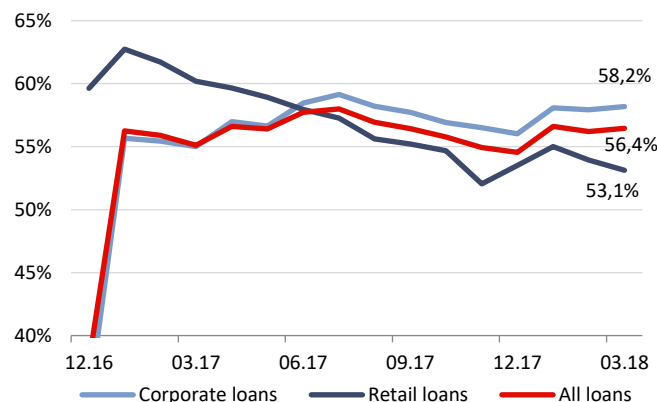


Net corporate loans in UAH, 2015=100%\*



**The NPL ratio was up by 1.8 pp, to 56.4%.**

*Non-performing loans in the portfolios\**

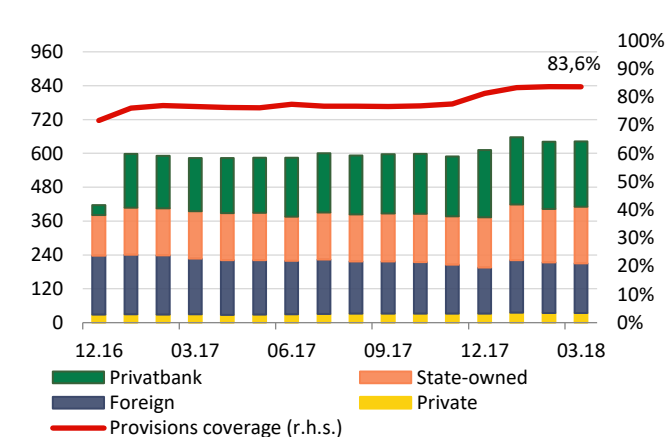


\* At all banks

\* Excluding off-balance sheet accounts, all banks

**By late March, provisions covered 83.6% of NPLs. This is an acceptable level.**

*Non-performing exposures and provisions, UAH billion*

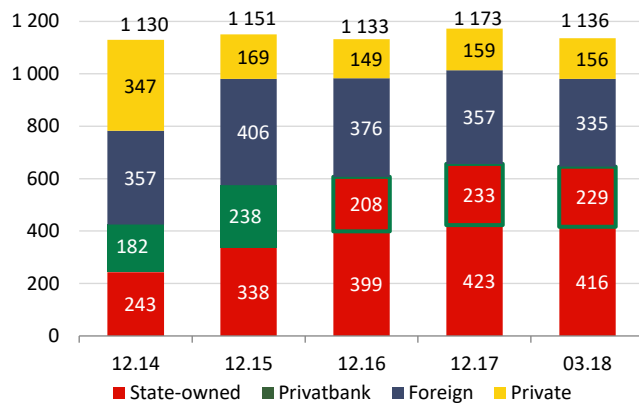


\* Excluding off-balance sheet accounts, including interbank loans, all banks

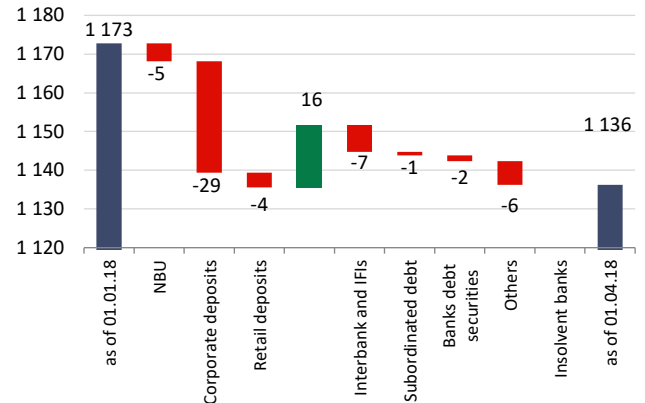
## Funding

In Q1, the banks' liabilities decreased by 3.1%, to UAH 1.136 trillion, driven by a seasonal outflow of corporate deposits and a stronger hryvnia. Budgetary funds were the only component rising.

*Liabilities by groups of banks, UAH billion*

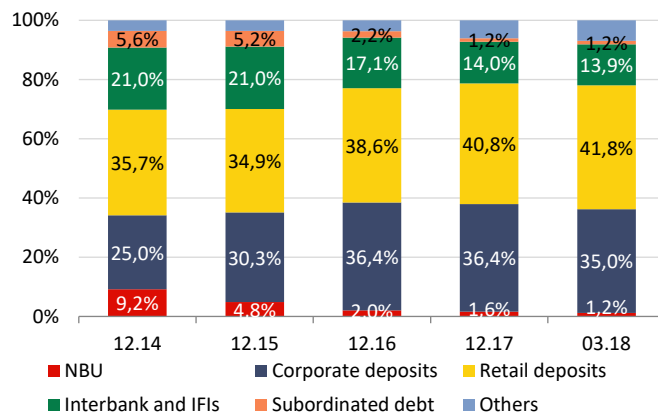


*Change in liabilities by items, UAH billion*



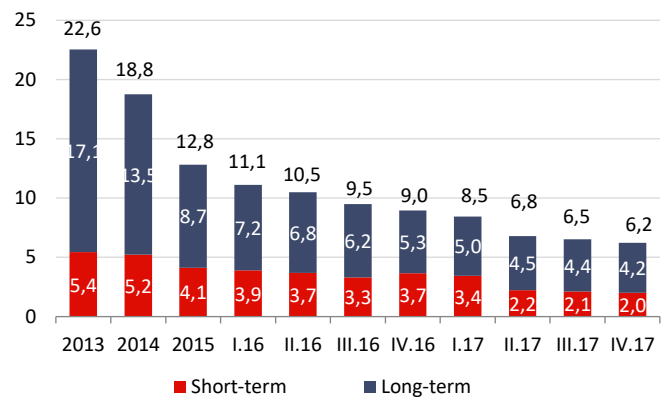
In Q1, the percentage of retail deposits in total liabilities rose by 1.0 pp. to 41.8%.

*The structure of liabilities*



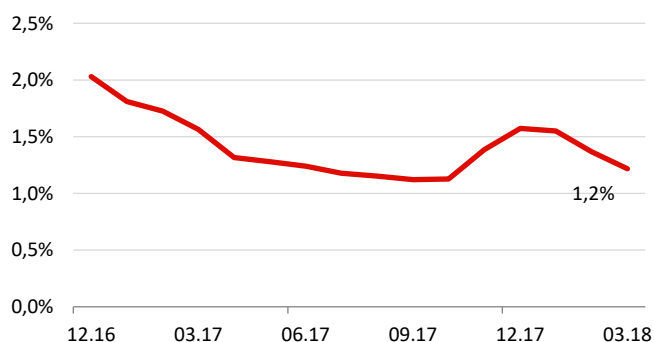
The decrease in gross external debt slowed, with the debt declining by USD 277 million, to USD 6.2 billion in Q4 2017.

*Banks' gross external debt, USD billion*



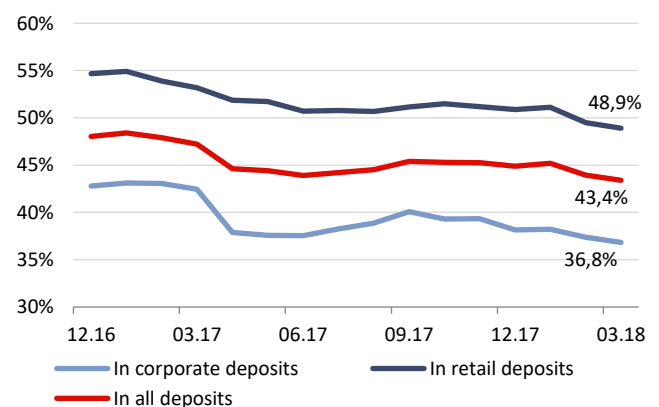
After surging in Q4 2017, the share of the NBU funds in total liabilities dropped to 1.2%.

*NBU funds in banks' liabilities*



In Q1, the dollarization of customer deposits fell by 1.5 pp, to 43.4%, with that of retail deposits decreasing by 2.0 pp, to 48.9%.

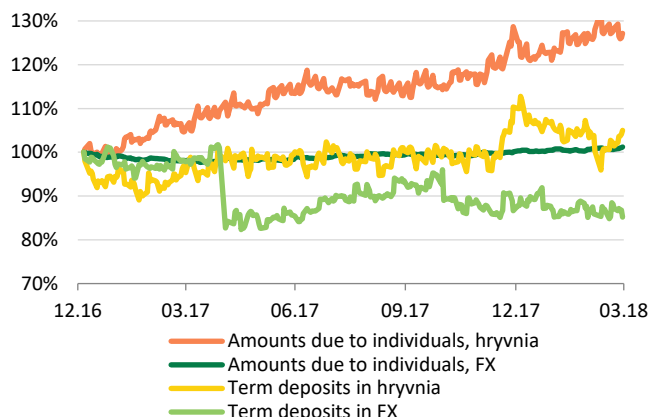
*FX deposits*





Retail deposits in hryvnia grew by 3.2% in Q1, while those in FX rose by 0.8% (in the USD equivalent).

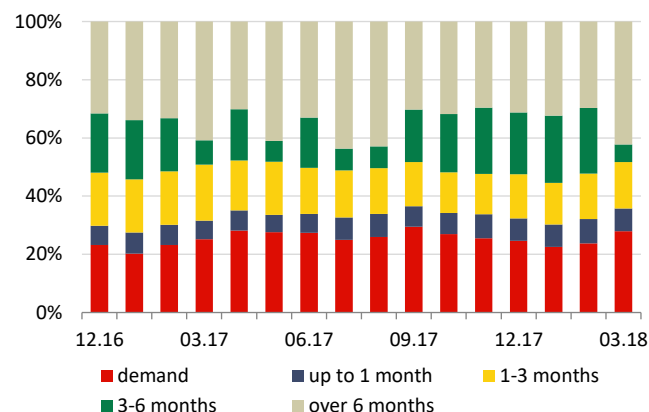
*Retail deposits, 2015=100%\**



\* At banks solvent as of 1 April 2018, including certificates of deposit

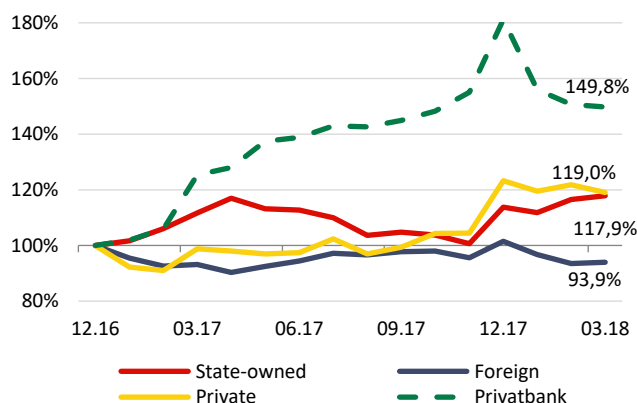
The share of deposits with maturities over six months among new deposits was 42.2% in March, up from 31.2% in December 2017.

*New retail deposits by maturity*



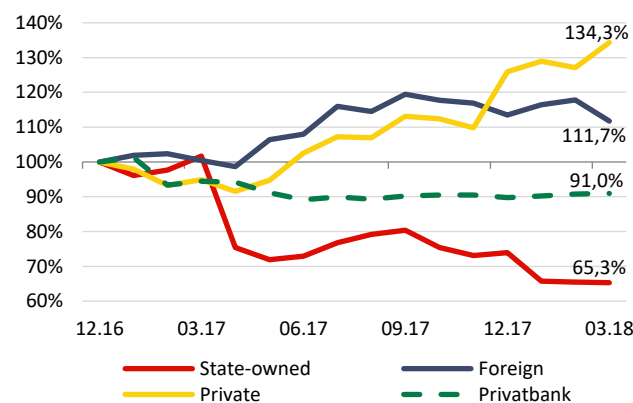
Corporate deposits decreased by 4.8% in Q1. Growth in hryvnia corporate deposits (by 3.6% qoq) was only reported by state-owned banks (apart from PrivatBank), while the growth in FX deposits was generated by private banks and PrivatBank (by 6.7% and 1.3% qoq respectively in the USD equivalent).

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



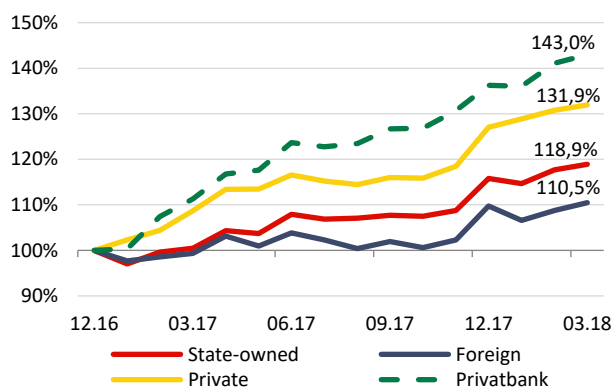
\* At banks solvent as of 1 April 2018

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



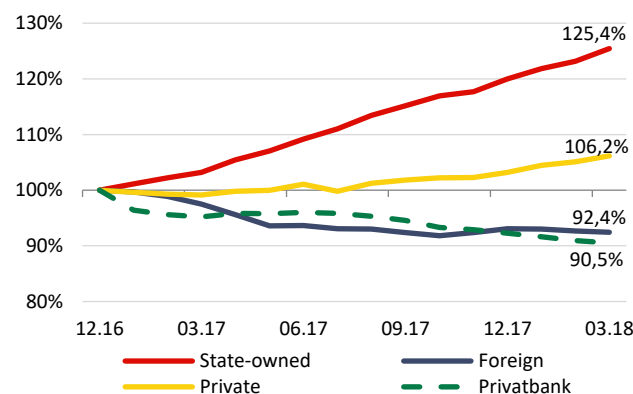
Hryvnia retail deposits increased in Q1 across all groups of banks, most robustly at private banks and PrivatBank (by 4.9% and 3.9% qoq respectively). The growth in FX retail deposits was generated by state-owned and private banks.

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



\* At banks solvent as of 1 April 2018, including certificates of deposit

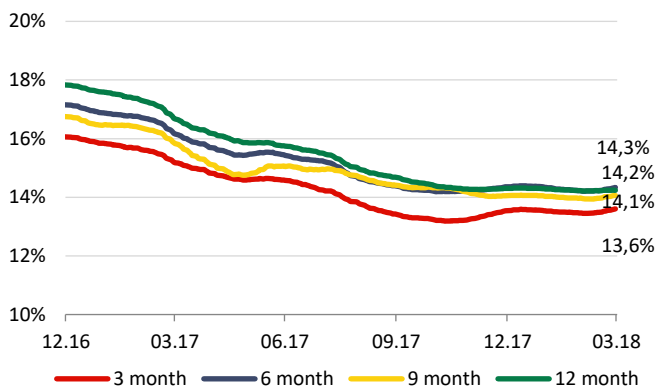
*Corporate deposits in FX (USD equivalent) by bank groups, 2013 = 100%\**



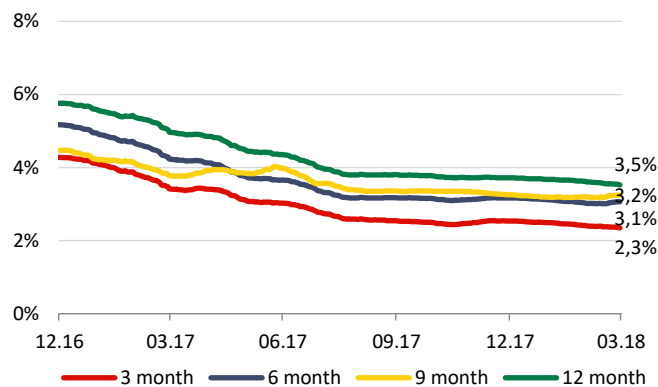
## Interest rates

In Q1, hryvnia deposit rates were stable and almost the same across maturities. Interest rates on FX deposits were at historical lows, as the interest rate on 12-month US dollar deposits fell by 0.3 pp, to 3.3% per annum.

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



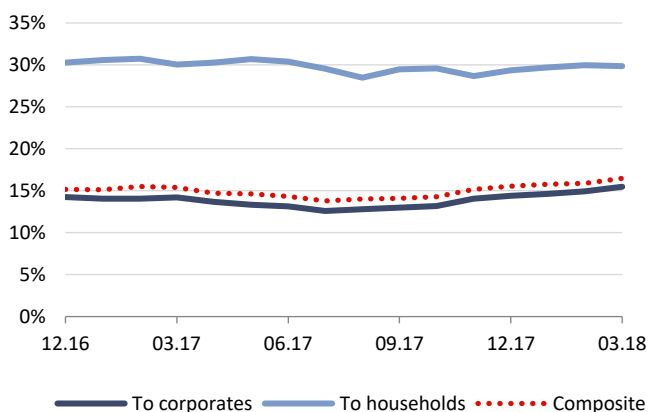
*Ukrainian Index of Retail Deposit rates in USD, % per annum\**



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

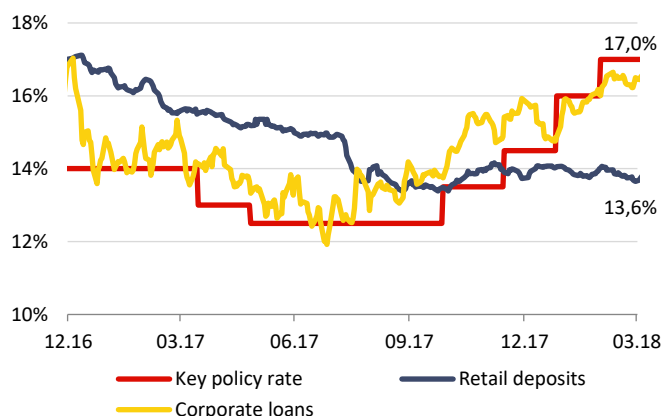
Loan rates increased further in Q1 on the back of the NBU key policy rate hikes (by 1.1 pp on corporate loans and by 0.4 pp on retail loans).

*Interest rates on new loans\*, % per annum*



\* No loan rescheduling or any other amendments to lending terms

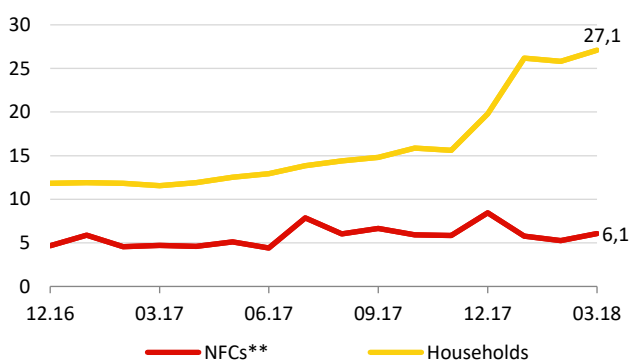
*The NBU's key policy rate, price\* of new loans and deposits in hryvnia, % per annum*



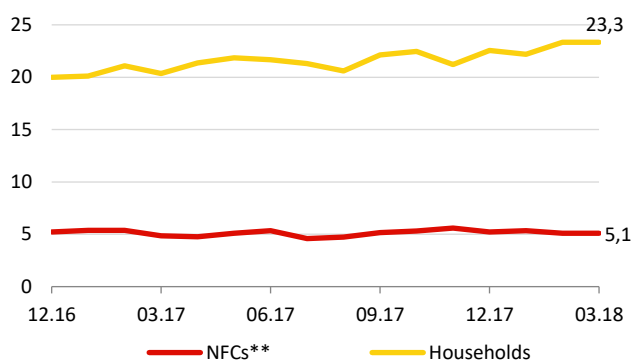
\* Daily rates, 5-day moving average

The spread between corporate loan and deposit rates narrowed due to rising interest rates on corporate time and demand deposits.

*Spread between interest rates on loans and deposits, pps\**



*Interest rate spread, pps\**



\* All banks

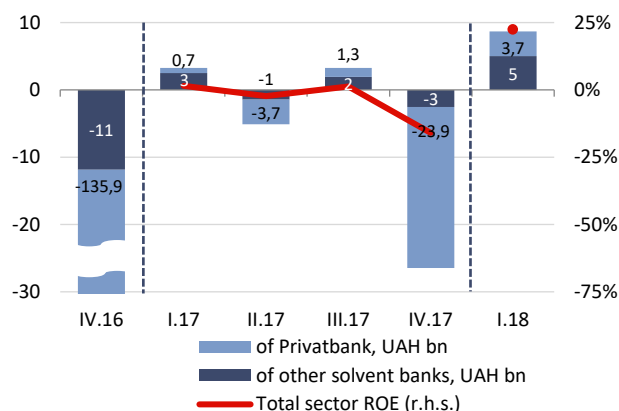
\*\* Non-financial corporations



## Financial Results and Capital

In Q1, the banking sector generated UAH 8.7 billion of net profit.

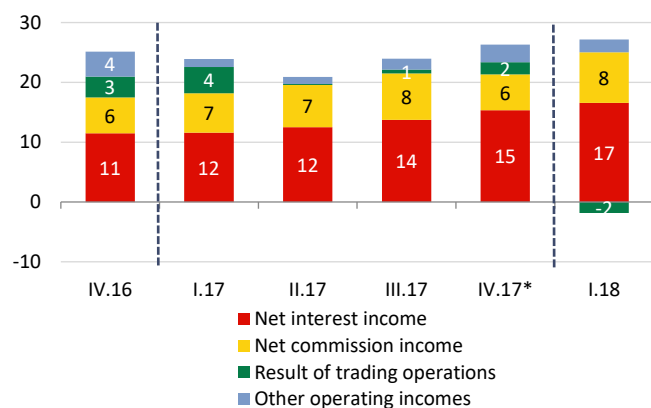
### Profit/loss\* and return on equity



\* For the quarter here and below adjusted data are used

In Q1, operating income was up by 6% yoy.

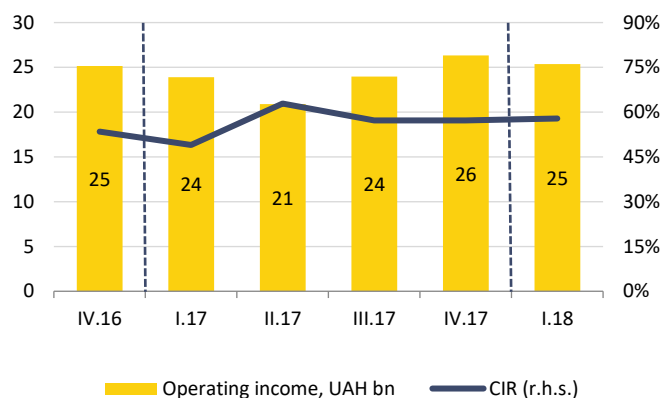
### Operating income components for the period, UAH billion



\* data for 2017 are adjusted

The banks' operating performance\* was weaker in Q1 2018 than in Q1 last year, due to a significant rise in operating expenses – by 57% compared to 49.0% in Q1 2017.

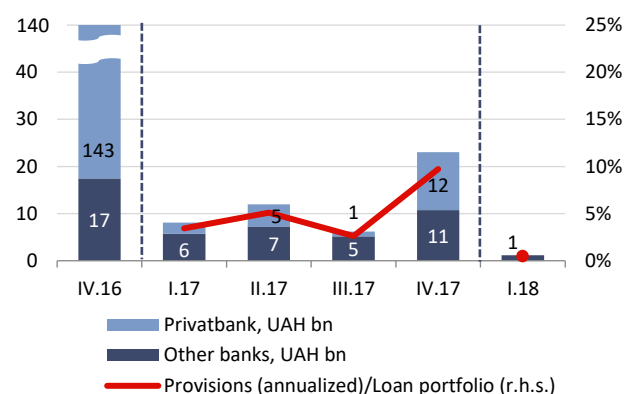
### Operating income and operating efficiency of banks



\* The CIR (cost-to-income ratio) measures the ratio of operating expenses to operating income

Provisioning decreased to UAH 1.1 billion in Q1, down from UAH 8.1 billion in Q1 2017.

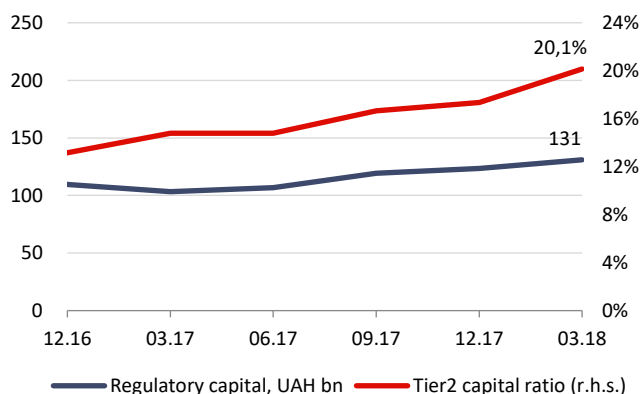
### Loan loss provisions\*



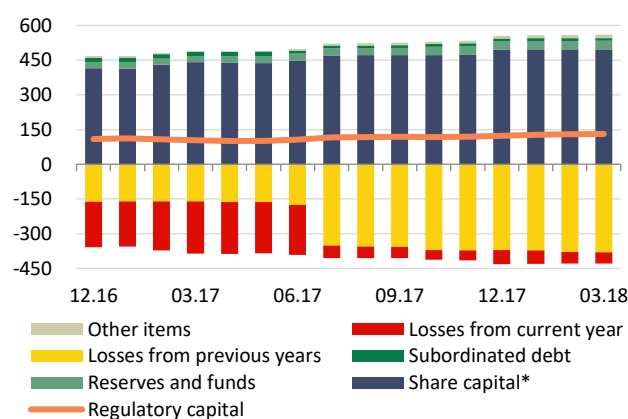
\* Ratio of provisions to bank loan portfolios

The regulatory capital of the banking sector was up by 6.2% ytd, or by UAH 7.6 billion. Overall, capital adequacy improved across all banks. There were no significant contributions to share capital (it was up by only UAH 200 million).

### Regulatory capital and regulatory capital adequacy levels



### Banks' regulatory capital, UAH billion



\* Registered and unregistered share capital

**Key indicators of Ukraine's banking sector<sup>1</sup>**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	I.18
<b>Number of operating banks</b>	180	175	175	174	180	145	117	96	82	82
<b>General balance sheet ratios (UAH billion)<sup>2</sup></b>										
Total assets	1 002	1 090	1 212	1 264	1 409	1 477	1 571	1 737	1 848	1 841
<i>including in foreign currency</i>	489	476	492	503	513	667	800	788	755	749
Net assets	880	942	1 054	1 125	1 278	1 290	1 254	1 256	1 336	1 296
<i>including in foreign currency</i>	426	395	416	450	470	565	582	519	507	478
Gross corporate loans <sup>3</sup>	498	537	608	634	727	820	831	847	870	883
<i>including in foreign currency</i>	212	212	221	227	252	400	492	437	423	430
Net corporate loans <sup>3</sup>	434	463	530	553	648	710	614	477	457	438
Gross retail loans	236	205	197	184	189	208	176	157	171	175
<i>including in foreign currency</i>	172	143	113	84	67	101	97	83	68	64
Net retail loans	203	168	158	133	145	144	96	76	92	94
Corporate deposits <sup>3</sup>	128	160	205	221	258	283	349	413	427	398
<i>including in foreign currency</i>	53	56	70	80	81	114	141	177	163	146
Retail deposits <sup>4</sup>	214	276	312	368	443	403	402	437	479	475
<i>including in foreign currency</i>	116	136	154	187	189	214	215	239	243	232
<b>Change (yoy, %)</b>										
Total assets	3.5%	8.8%	11.1%	4.3%	11.4%	4.8%	6.4%	10.6%	6.4%	5.9%
Net assets	-4%	7.0%	11.9%	6.7%	13.7%	1.0%	-2.8%	0.2%	6.4%	2.4%
Gross corporate loans <sup>3</sup>	4.6%	7.8%	13.3%	4.2%	14.7%	12.8%	1.3%	2.0%	2.7%	6.5%
Gross retail loans	-13%	-13%	-4.0%	-6.7%	3.0%	10.3%	-15.7%	-10.4%	8.6%	12.9%
Corporate deposits <sup>3</sup>	-21%	25%	27.7%	7.9%	16.8%	9.5%	23.5%	18.2%	3.4%	-3.4%
Retail deposits <sup>4</sup>	-2.3%	28.7%	13.2%	18.1%	20.2%	-8.9%	-0.3%	8.7%	9.6%	9.6%
<b>Penetration<sup>5</sup> (%)</b>										
Gross corporate loans <sup>3</sup> / GDP	52.6%	47.9%	45.1%	43.4%	47.7%	51.7%	41.8%	35.5%	29.2%	28.7%
Net corporate loans <sup>3</sup> / GDP	45.9%	41.3%	39.3%	37.9%	42.6%	44.7%	30.9%	20.0%	15.3%	14.2%
Gross retail loans/ GDP	24.9%	18.3%	14.6%	12.6%	12.4%	13.1%	8.8%	6.6%	5.7%	5.7%
Net retail loans/ GDP	21.4%	15.0%	11.7%	9.1%	9.5%	9.1%	4.8%	3.2%	3.1%	3.1%
Corporate deposits <sup>3</sup> / GDP	13.5%	14.3%	15.2%	15.1%	17.0%	17.8%	17.6%	17.3%	14.3%	12.9%
Retail deposits/ GDP	22.6%	24.6%	23.1%	25.2%	29.1%	25.4%	20.2%	18.3%	16.1%	15.4%
<b>Profit or loss<sup>6</sup> (UAH billion)</b>										
Net interest income	54.5	51.9	53.8	49.2	49.1	52.2	39.1	44.2	53.1	16.6
Net commission income	13.2	12.6	15.4	18.1	21.0	23.1	22.6	24.2	27.5	8.5
Provisions	75.4	46.2	36.5	22.3	28.0	84.4	114.5	198.3	49.3	1.1
Net profit/loss	-38.4	-13.0	-7.7	6.0	1.4	-33.1	-66.6	-159.4	-26.5	8.7
<b>Memo items:</b>										
UAH/USD (period average)	7.79	7.94	7.97	7.99	7.99	11.89	21.84	25.55	26.60	27.32
UAH/USD (end-of-period)	7.99	7.96	7.99	7.99	7.99	15.77	24.00	27.2	28.07	26.54
UAH/EUR (period average)	10.87	10.53	11.09	10.27	10.61	15.72	24.23	28.29	30.00	33.56
UAH/EUR (end-of-period)	11.45	10.57	10.30	10.54	11.04	19.23	26.22	28.42	33.50	32.70

<sup>1</sup> Data for solvent banks for each reporting date

<sup>2</sup> Including accrued income/expenses

<sup>3</sup> Including non-banking financial institutions

<sup>4</sup> Including certificates of deposits

<sup>5</sup> 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 2017 it excludes data for the temporarily occupied Republic of Crimea and City of Sevastopol and a part of the ATO zone; As for Q1 2018 - last twelve months (LTM)

<sup>6</sup> Data as of 2017 and Q1 2018, taking into consideration adjustment entries.

## 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.

All data in the Review are based on the monthly balance sheet report, while banks' financial performance indicators are based on adjusted data from quarterly balance sheet.

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

Change at a fixed exchange rate means that value of a financial instrument in FX is calculated at the exchange rate fixed at the beginning of the period.

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