National Bank of Ukraine

Banking Sector Review

August 2018

In Q2, the banks focused on the retail segment, which was evidenced by sustained robust growth in household deposits and retail lending. There was a seasonal reduction in corporate loans, on the back of repayments of loans by large state-owned companies and short-term loans by private companies. A seasonal revival of corporate lending is expected in Q3. In spite of incurring moderate losses in Q2 due to a Russian-owned bank's large additional provisioning, the banking sector ended H1 in profit. Although macroeconomic conditions were benign for the banking sector, further delays in resuming cooperation with the IMF could worsen the sentiment of banks and their customers, resulting in slower deposit and loan growth. In Q3, the NBU plans to complete stress-testing of the 25 most important banks in the system. NBU expects that most of these banks will not require any additional capital.

Sector Structure. As of 1 August, 82 banks were operating, with the number of banks on the market remaining unchanged since the start of 2018. Two of these banks received permission from the NBU to terminate banking operations and become financial companies. Two other banks were authorized to merge. Once these plans are realized, the number of banks will drop to 78.

The overall sector's concentration has not changed: the top-20 banks still hold 90.7% of net assets. State-owned banks continue to dominate the market, accounting for 55.1% of total net assets and 63.5% of total household deposits.

Assets. The net and total assets of the banking sector were practically unchanged in Q2 (up by 0.3% and 0.7% respectively). Most of the decline came from a fall in net corporate loans (by UAH 16.6 billion or 3.8%), due to seasonal repayments of loans made by some state-owned monopolies to state-owned banks, as well as repayments of loans made by tobacco and agricultural companies to foreign-owned banks. In addition, two banks (one state-owned and one Russian-owned) made additional provisions for impaired loans. This pushed up provisions for NPLs by 3.0 pp, to 86.6%.

The banks further intensified retail lending. In Q2, hryvnia household loans rose by 7.4% qoq or by 39.2% yoy[1]. This resulted in a statistical improvement in the loan portfolio quality – the percentage of NPLs came in at 55.7% in late June, down from 56.4% in early April[2].

The percentage of domestic government bonds held by banks increased by 1.5 pp, due to one state-owned bank consolidating its derivatives (based on FX-indexed securities) with domestic government bonds after transitioning to IFRS 9.

Funding. The growth in hryvnia retail deposits remained high in Q2, at 8.7% qoq or 21.4% yoy. Over two thirds of new hryvnia deposits had maturities of up to six months. In contrast, foreign currency deposits declined by 0.4% qoq, with the share of these deposits shrinking by 2.5 pp, to 46.4%.

After the seasonal outflow seen early in 2018, corporate deposits started to return to banks – hryvnia deposits were up by 0.9% qoq, while FX ones grew by 4.2% qoq in the US dollar equivalent. Two Russian state-owned banks converted interbank loans into capital, pushing down the share of loans issued by international financial institutions and interbank loans by 1.1 pp, to 12.9% of the sector's total funding. The share of NBU loans fell to 0.9%.

Interest Rates. The NBU continued its monetary policy tightening cycle in H1 by raising its key policy rate by a total of 2.5 pp, to 17%. Therefore, there was no incentive for the banks to cut hryvnia deposit rates further.

The average interest rate on 12-month retail deposits ranged between 14.1% and 14.3% per annum[3]. Banks still do not practically differentiate deposit rates depending on maturity. Indeed, at the beginning of May interest rates on 6-month deposits were still higher than those on 12-month deposits, with the interest rates becoming equal only at the end of Q2. This discourages households from making long-term hryvnia deposits. US dollar deposit rates were at a historic low – 3.3% per annum.

Interest rates on new hryvnia corporate loans edged up by 0.6 pp, to 16.1% per annum, with rates on retail loans being unchanged, at about 30% per annum.

Profit or Loss and Capital. In Q2, the banking sector suffered losses (UAH 400 million) mostly because of significant provisions made by a large bank (that makes operating profits). Operating performance deteriorated, as the cost-to-income ratio rose to 63.1% compared to 57.9% in Q1 2018 and 62.9% in Q2 2017. The banking sector's total profit for H1 was UAH 8.3 billion.

Due to the transition to IFRS 9, one large bank increased its losses from previous years by UAH 16.6 billion in Q2, mainly by making additional provisions for impaired loans. Although affecting the bank's net worth, this had no impact on its regulatory capital and capital adequacy ratio, as the bank's credit risk (prudential provisions) were significantly higher than the provisions made under the IFRS.

Prospects and Risks. Q3 will continue to witness steady deposit inflows and household lending growth. A seasonal pick-up in corporate lending is also expected. According to the lending survey, most banks anticipate growth in both retail and corporate loan portfolios. Operating performance will continue to be driven by retail lending and fee and commission income. Since no large provisioning is expected in H2, the sector should end the current year in profit.

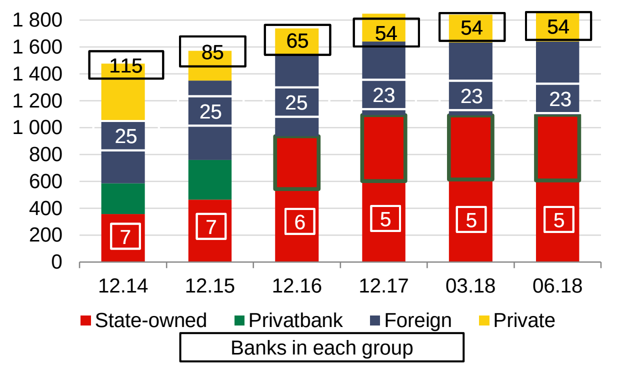
Delay in resuming cooperation with the IMF is the key risk to the banking sector's performance. The absence of clear signals on the IMF program resumption could significantly undermine the banks' appetite for lending and slow down growth in deposits, in particular hryvnia deposits. That said, today the banking sector is resilient to external shocks. It should therefore sustainably operate under any macroeconomic scenario.

[1] *Issued by banks that were solvent as of end-June 2018.*
[2] *At all reporting banks.*
[3] *Based on the Ukrainian index of retail deposit rates.*

Sector structure

The number of banks remained unchanged in H1. Two banks declared their intention to surrender their banking licenses and turn into financial companies. One bank will merge with another bank that has the same owner. Two other banks have also received the NBU's authorization for merger. Once these plans are realized, the number of banks will drop to 78.

*Banks' total assets, UAH billion**



** Solvent banks were grouped under the relevant classification for the given years*

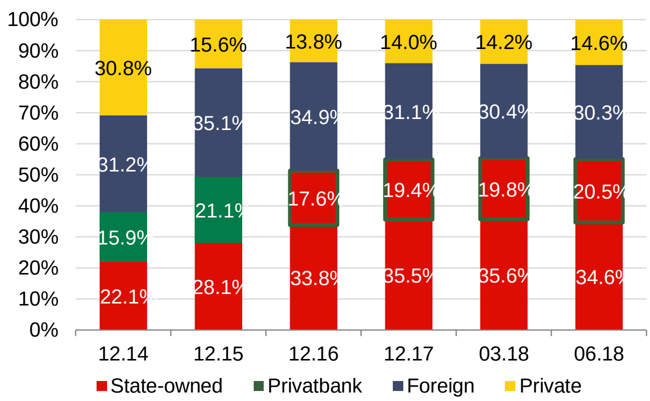
*Number of banks**

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

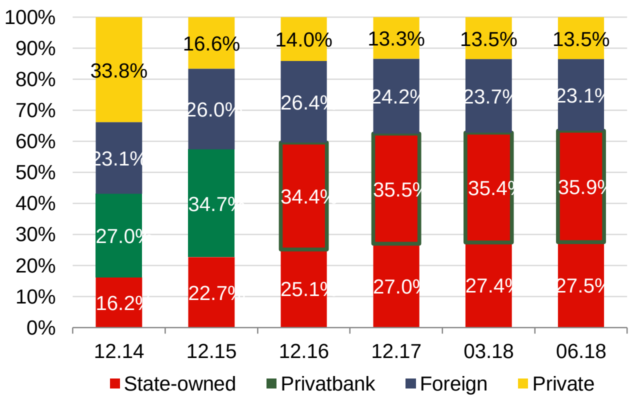
** As of end of period*
*** Including PrivatBank*

In Q2, PrivatBank and domestic private banks increased their shares of net assets through intensive lending to households. The share of state-owned banks, not including PrivatBank, edged down by 1.0 pp, to 34.6% of net assets. PrivatBank and other state-owned banks actively attracted retail deposits. As a result, their combined in total household deposits share edged up by 0.7 pp qoq, to 63.5%. .

Net assets by groups of banks

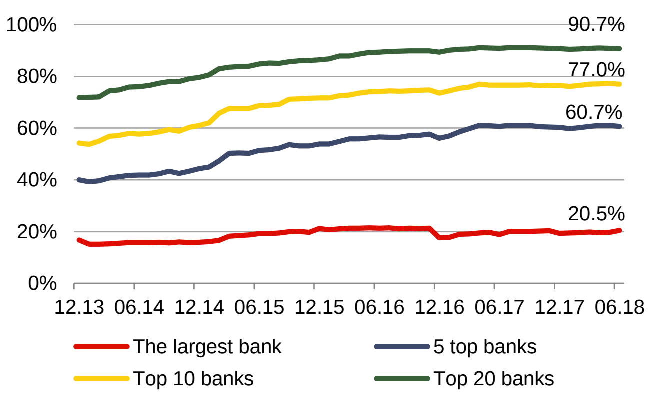


Retail deposits by groups of banks

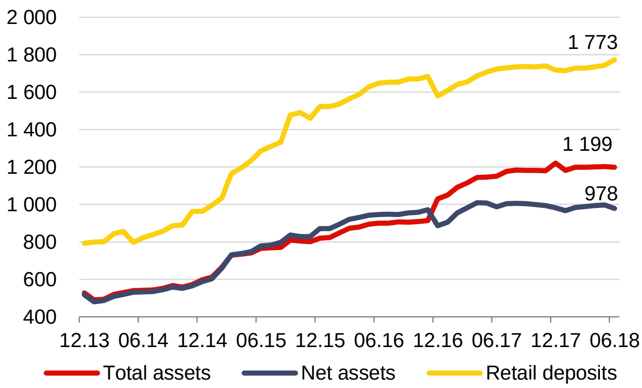


The concentration level remained practically unchanged in Q2, with the 20 largest banks accounting for 90.7% of total net assets. There was a slight increase in the PrivatBank's share in household deposits.

Shares of the largest banks by net sector assets



*Concentration rate in the banking sector, HHI**

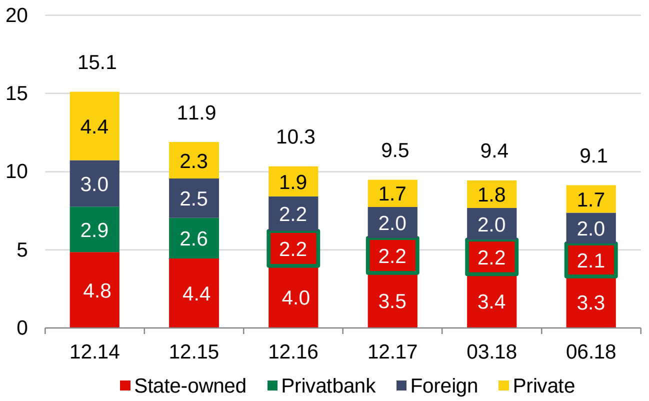


** The Herfindahl-Hirschman Index (HHI) is an indicator of banking sector concentration. It is calculated as the sum of the banks' squared market shares. The index ranges from 0 to 10,000 – values below 1,000 indicate a low degree of market concentration.*

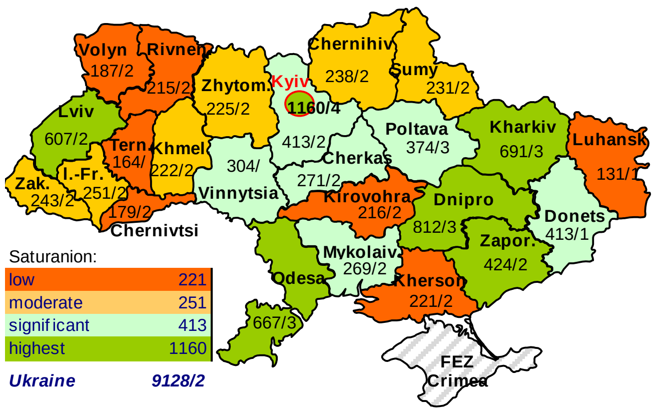
Banking infrastructure

In Q2, the bank groups, apart from foreign-owned ones, decreased the number of their branches by 312, to 9,128 branches. State-owned banks shut down the largest number of branches – 253.

*Number of structural units of banks, thousands**



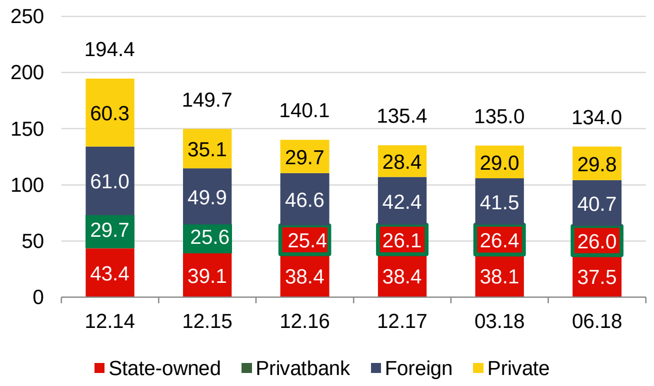
Operating banking units by regions as of 1 July 2018, units per 10,000 individuals



** Branches and head-offices*

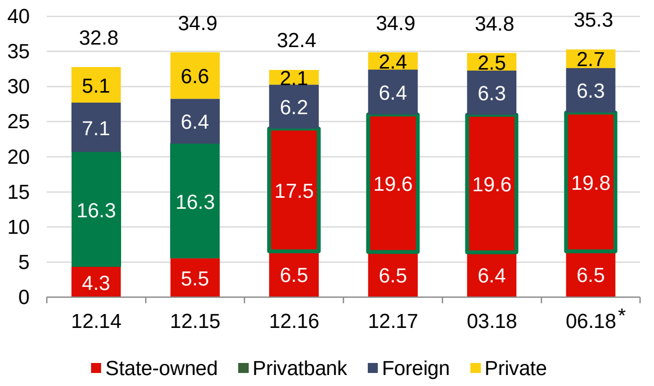
While foreign- and state-owned banks cut their workforce in Q2, private banks hired more staff. Overall, the banking sector reduced its payroll by 1,000 persons.

Headcount at banks, thousand employees



The number of active payment cards rose by 540,000 pieces in Q2. PrivatBank and private banks generated the strongest growth – 209,000 and 171,000 cards respectively.

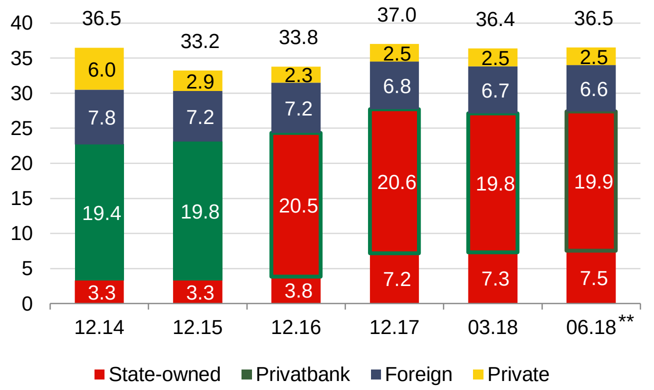
Number of active bank cards by bank groups, million pcs



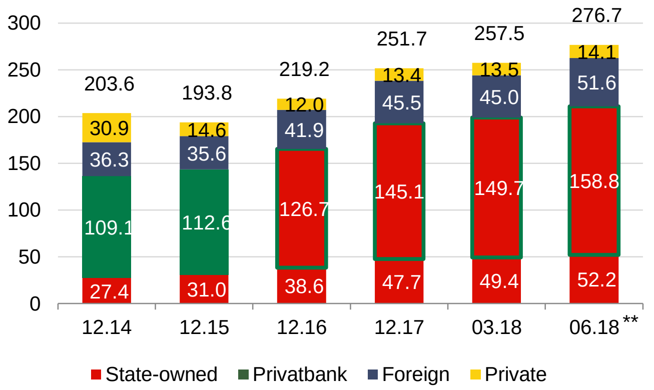
** Data might be updated*

The number of ATMs* grew by 125 units in Q2, with state-owned banks mainly responsible for the increase. The network of POS terminals is developing rapidly – it added 19,000 units over Q2, with state- and foreign-owned banks driving the growth.

Number of ATMs, thousand units*



Number of banks' POSs, thousand units

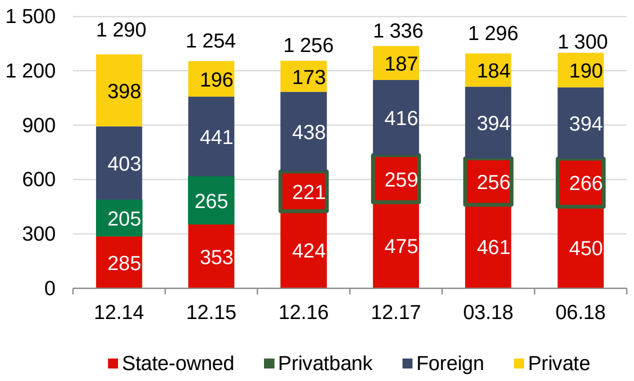


** Number of self-service bank machines (ATMs, deposit ATMs, Self-Service Kiosks)*
*** Data might be updated*

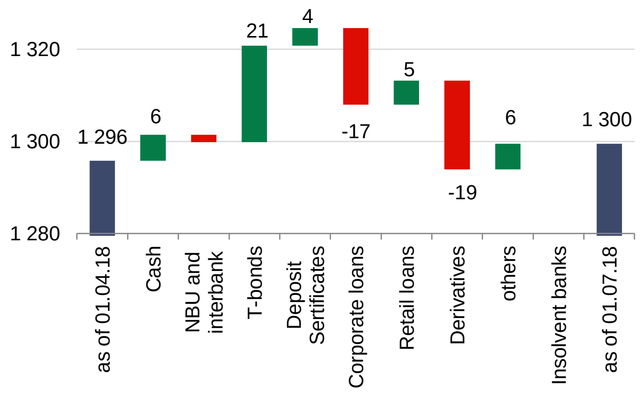
Assets

In Q2 2018, the banks' gross and net assets were little changed. The net corporate loan portfolio fell by UAH 16.6 billion, due to a seasonal drop in lending, and additional provisions made by two large banks. This was offset by a rise in cash, retail loans, and investment in certificates of deposit. The banks continued transition to IFRS 9, which also had a significant effect on the composition of their assets – one state-owned bank reclassified its derivatives as domestic government bonds that are accounted at fair value.

Net assets by bank groups, UAH billion



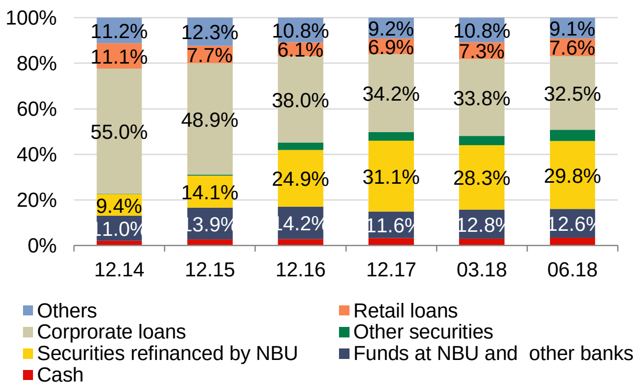
Change in net assets by components, UAH billion*



** Adjusted for provisions for assets-side exposures*

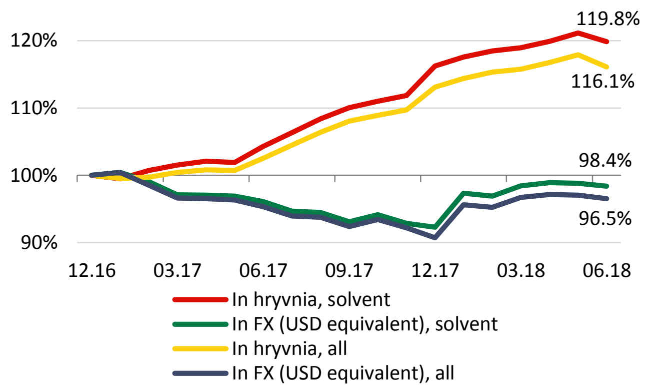
The structure of net assets saw an increase in the shares of domestic government bonds and retail loans, to 29.8% and 7.6% respectively.

Net assets by components



Gross loans dropped, mainly due to repayments by state-owned monopolies and some private companies (short-term loans).

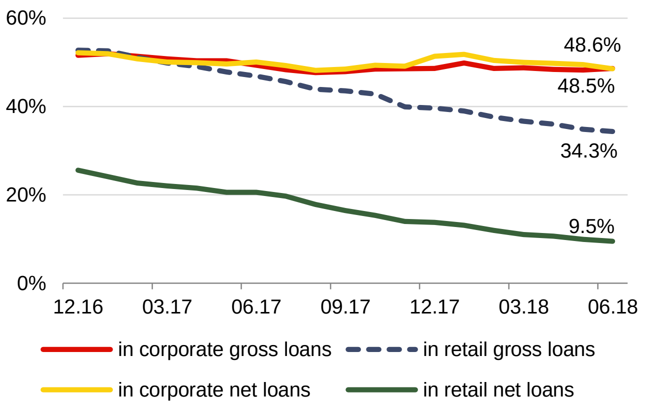
*Gross corporate and retail loans, 2016=100%**



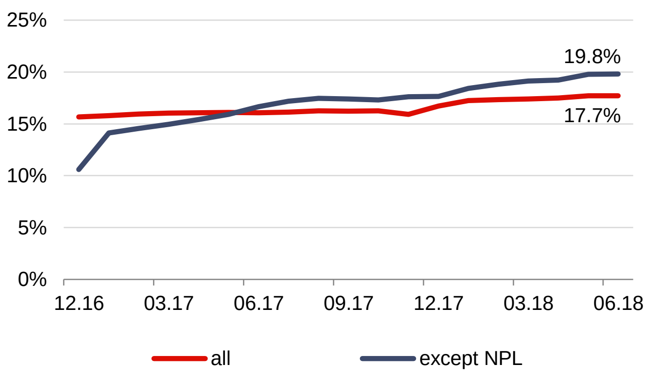
** At banks solvent as of 1 July 2018*

The percentage of retail loans rose by 1 pp ytd, to 17.7% of total bank loans. Active new household lending is helping to bring down the dollarization ratio of the retail loan portfolio.

FX loans ratio

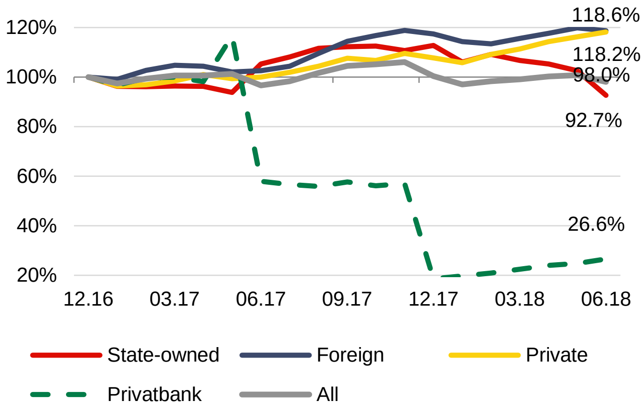


Retail loans in the total loan portfolio

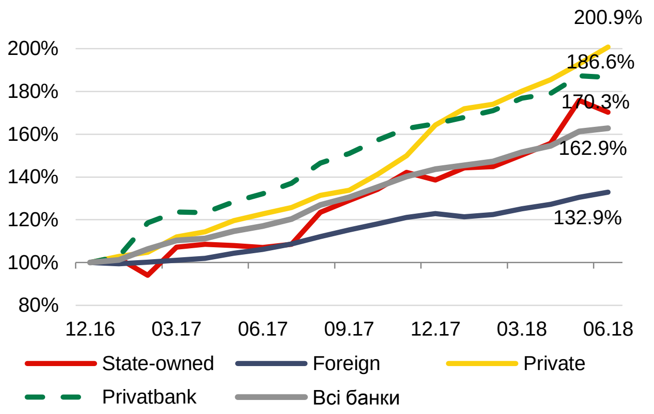


In Q2, net hryvnia retail loans increased most robustly at private and state-owned (not including PrivatBank) banks, up by 63.7% and 59.0% yoy respectively. Hryvnia corporate lending declined at state-owned banks but intensified at foreign-owned and private banks (total corporate loans declined over the sector by 1.1% in Q2).

*Net corporate loans in UAH, 2016=100%**



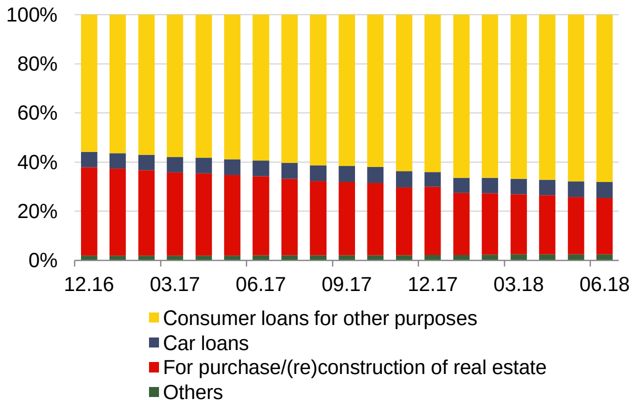
*Net retail loans in UAH, 2016=100%**



** At banks solvent as of 1 July 2018, including accrued interest*

In Q2, the share of consumer loans for current needs edged up by 1.2 pp to 68.1% of total household loans.

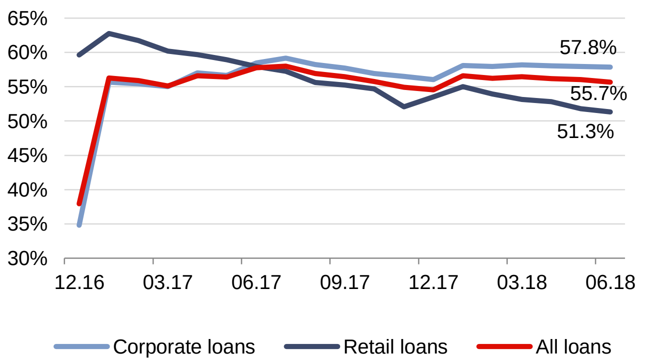
Gross retail loans by type*



** At all banks including insolvent ones*

New retail lending is statistically improving the quality of the total loan portfolio. In Q2, the NPL ratio shrank by 0.7 pp, to 55.7%.

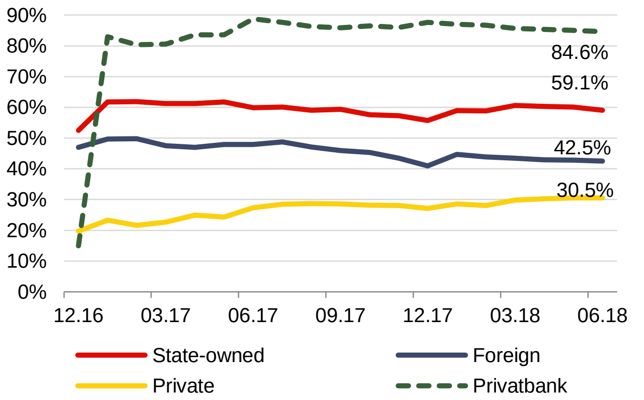
*Non-performing loans in the portfolios**



** At all banks including insolvent ones*

The NPL ratio is decreasing across all bank groups, with state-owned banks (not including PrivatBank) reporting the largest drop (by 1.5 pp, to 59.1%).

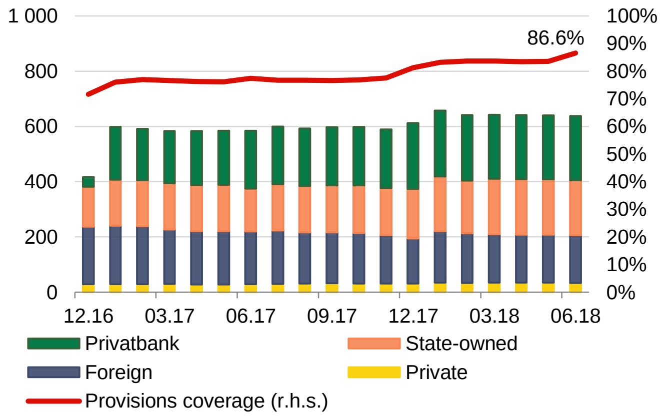
*Non-performing loans in loan portfolios by bank groups**



** Including interbank loans, all banks including insolvent ones*

In Q2, provisions coverage ratio rose by 3.0 pp, to 86.6%, after state-owned banks made additional provisions against FX loans.

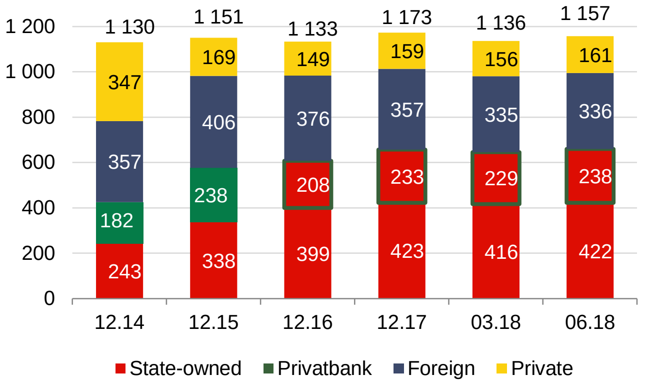
Non-performing exposures and provisions, UAH billion



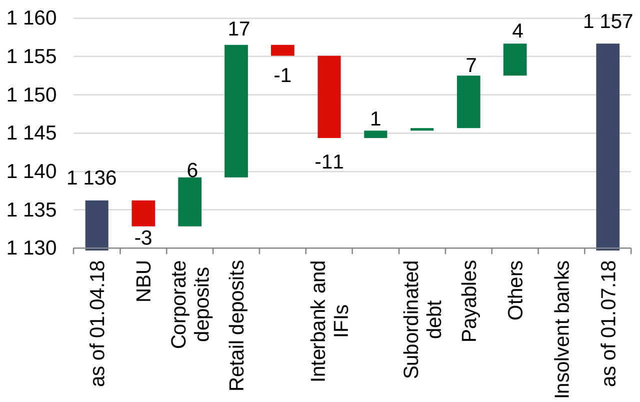
Funding

In Q2, retail deposits increased by 3.6% or UAH 17.2 billion, while corporate deposits grew by 1.6% or UAH 6.4 billion. Two Russian state-owned banks converted interbank loans worth about UAH 11 billion into capital.

Liabilities by groups of banks, UAH billion

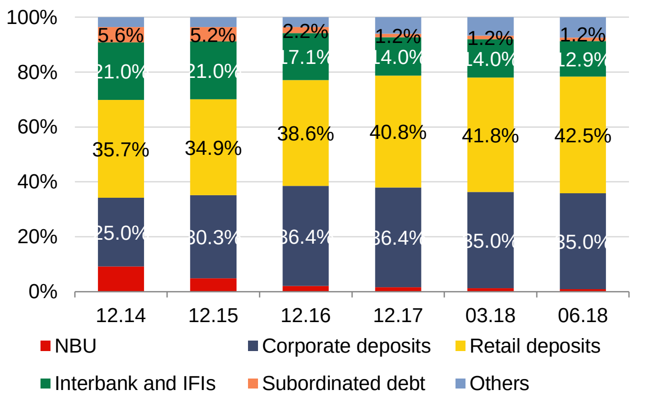


Change in liabilities by items, UAH billion



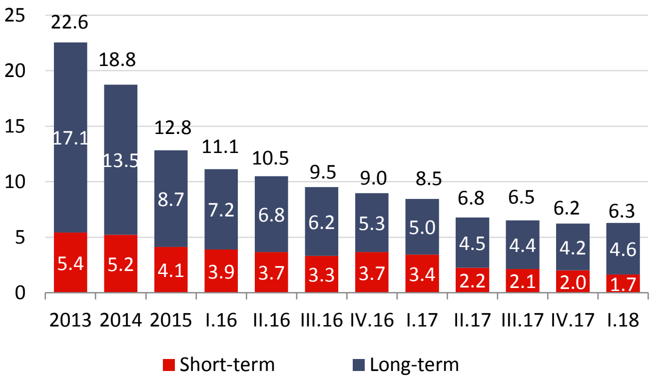
The percentage of household deposits continues to rise as a share of total liabilities – in Q2 it edged up by 0.8 pp, to 42.5%.

The structure of liabilities



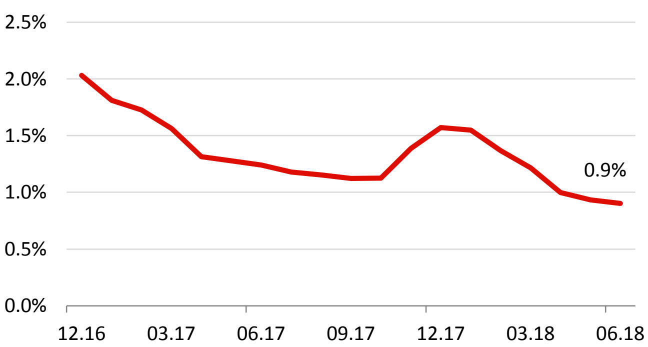
In Q1, the banks' gross external debt grew quarter-over-quarter for the first time since early 2014.

Banks' gross external debt, USD billion



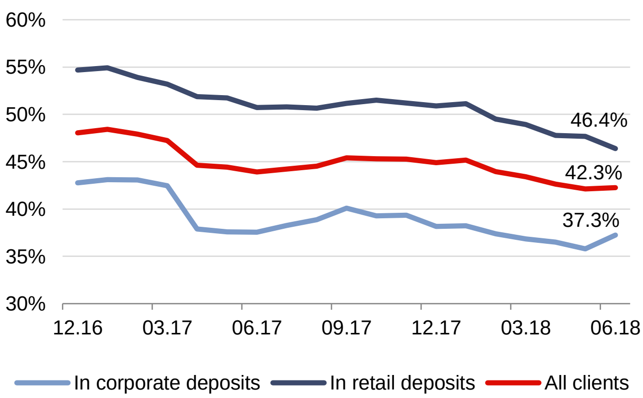
The share of NBU funds in banks' funding fell to a historic low of 0.9%.

NBU funds in banks' liabilities



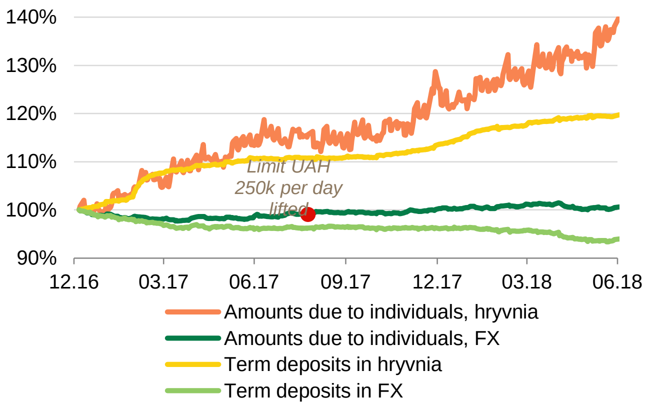
In Q2, the dollarization of household deposits decreased by 2.5 pp, to 46.4%, due to inflows of hryvnia deposits.

FX deposits



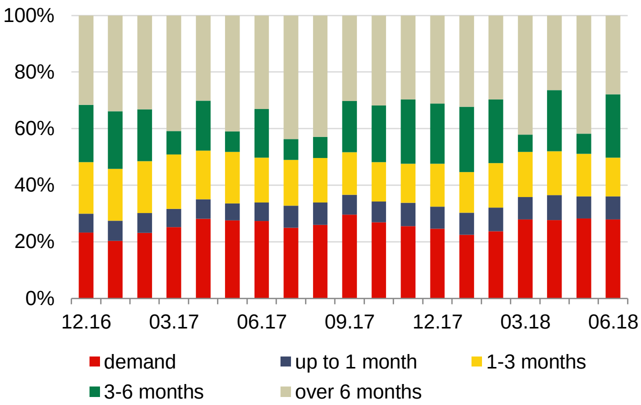
In Q2, hryvnia retail deposits grew by 8.7% qoq or by 21.4% yoy.

*Retail deposits, 2016=100%**



The maturity composition of new retail deposits remained unchanged – deposits with maturities of up to three months and demand deposits accounted for over half of all deposits.

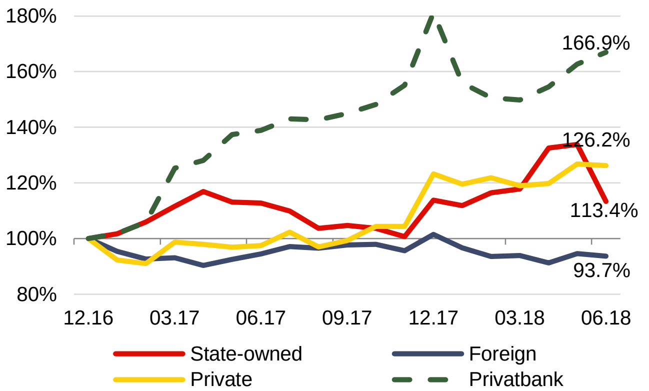
New retail deposits by maturity



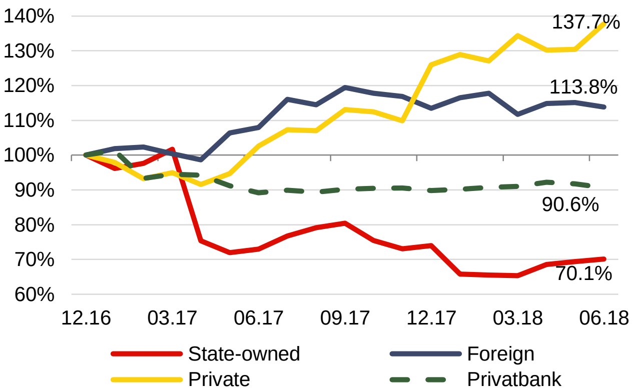
** At banks solvent as of 1 July 2018, including certificates of deposit*

Total hryvnia corporate deposits changed only marginally in Q2 (up by 0.9%), with the strongest increases generated by PrivatBank and privately owned banks (by 11.4% and 6.1% respectively). State-owned monopolies were mainly behind a 4.2% rise in FX corporate deposits (in the US dollar equivalent).

*Corporate deposits in hryvnia by groups of banks, 2016 = 100%**



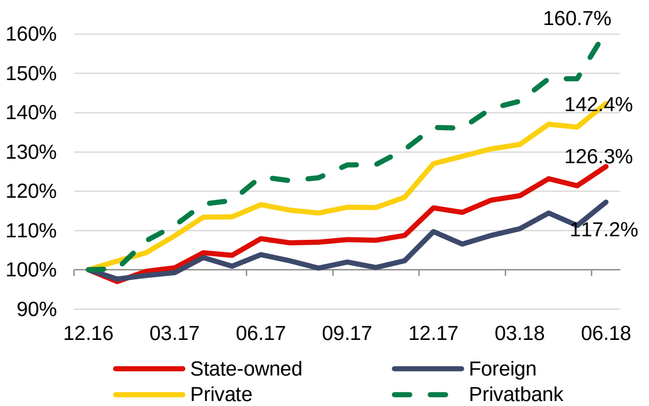
*Corporate deposits in FX (in USD equivalent) by groups of banks, 2016 = 100%**



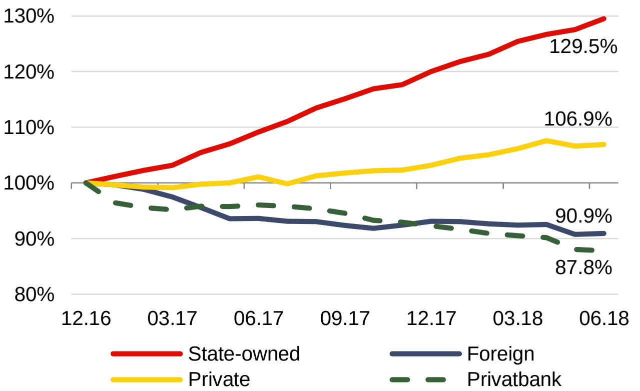
** At banks solvent as of 1 July 2018, including certificates of deposit*

Q2 witnesses rapid growth in hryvnia retail deposits across all groups of banks, and most of all at PrivatBank (by 12.4%). Only state-owned banks (apart from PrivatBank) reported growth in FX household deposits (by 3.2%).

*Corporate deposits in UAH by bank groups, 2016 = 100%**



*Corporate deposits in FX (USD equivalent) by bank groups, 2016 = 100%**

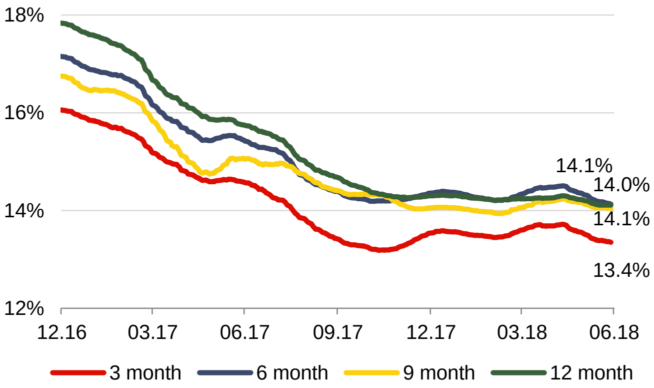


** At banks solvent as of 1 July 2018, including certificates of deposit*

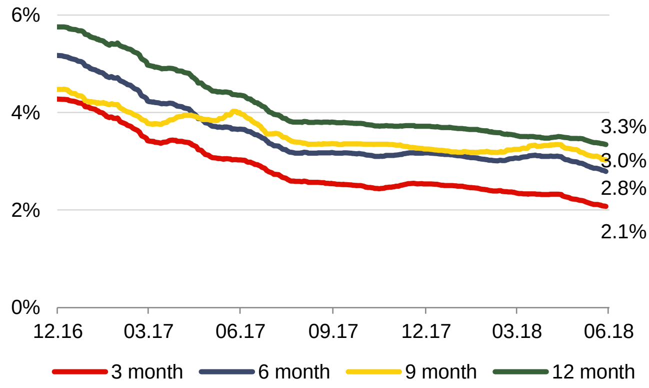
Interest rates

Hryvnia retail deposit rates changed little in Q2. The rates on hryvnia 6-, 9- and 12-month deposits hovered at around 14.1% per annum, with the difference between the rates being minimal. The rate on US dollar 12-month deposits was 3.3% per annum.

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



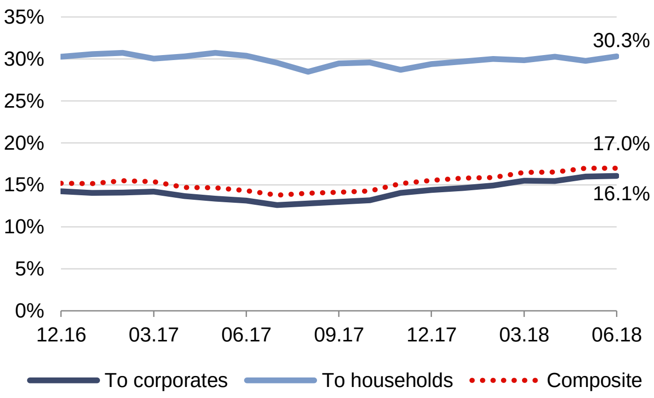
*Ukrainian Index of Retail Deposit rates in USD, % per annum**



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

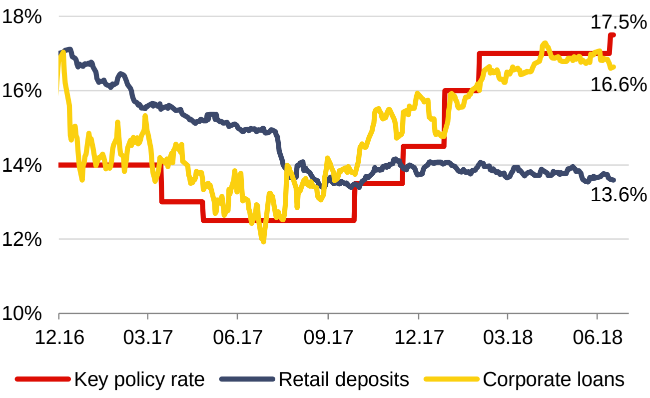
In Q2, the rate on new corporate loans edged up by 0.6 pp, to 16.1% per annum, while that on retail loans remained at 30.3% per annum.

Interest rates on new loans, % per annum*



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

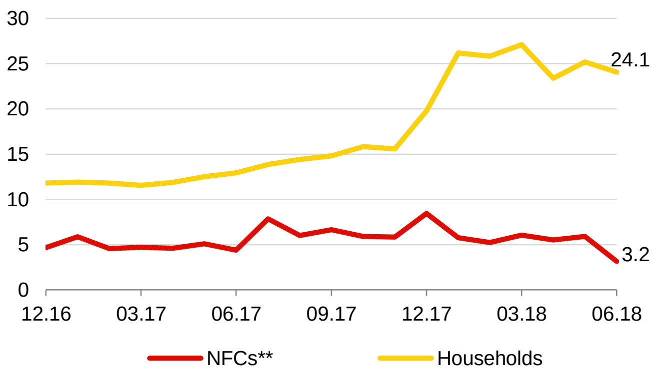
The NBU's key policy rate, price of new loans and deposits in hryvnia, % per annum*



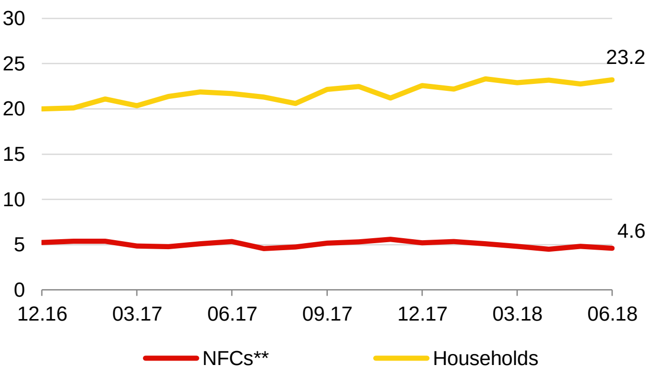
** Daily rates, 5-day moving average*

The spread between new loans and deposits has little changed. However, the spread between outstanding loans and deposits decreased, due to several restructurings that entailed interest rate reduction.

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



*Interest rate spread on outstanding loans and deposits, pps**

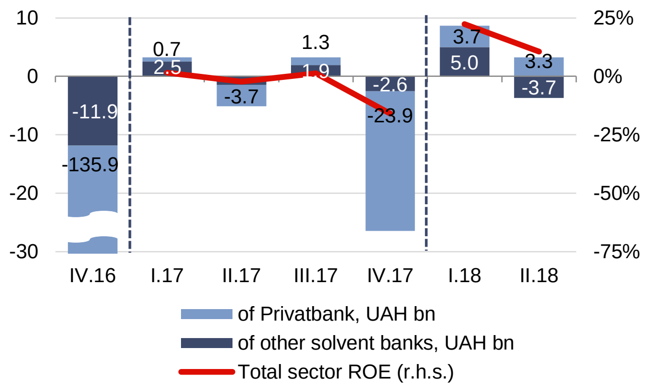


** Including insolvent banks*
*** Non-financial corporations*
**** New loans and deposits comprise those originated in the reporting period as well as additional agreements, for which loan amount, interest rate or both were revised*

Financial Results and Capital

In Q2, the banking sector sustained losses of UAH 0.4 billion, because of losses recorded by several Russian-owned banks. However, in H1 the sector recorded a profit of UAH 8.3 billion.

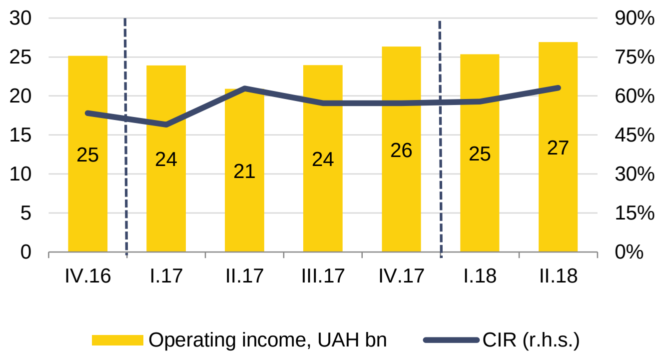
Profit/loss and return on equity*



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

Operating performance slightly deteriorated in Q2, as the cost-to-income ratio rose to 63.1% compared to 57.9% in Q1.

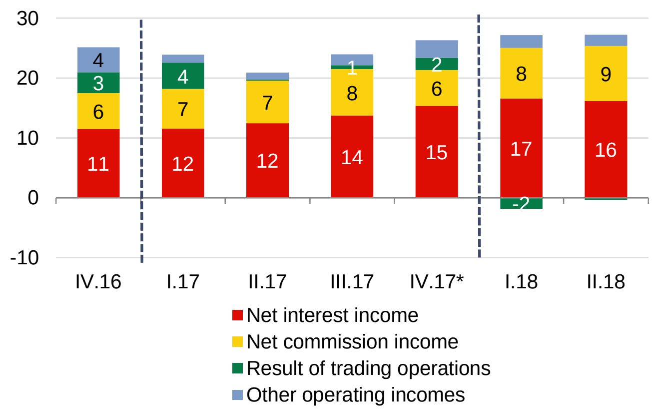
Operating income and operating efficiency of banks



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

The sector's operating income grew by 6.1% qoq thanks to an increase in fee and commission income and improved trading results.

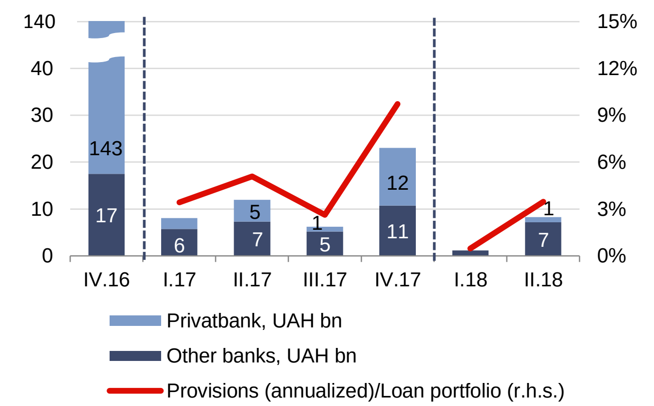
Operating income components for the period, UAH billion



** Data for 2017 are adjusted*

In Q2, provisions increased mostly because of one large banks. However, provisioning was still lower than last year.

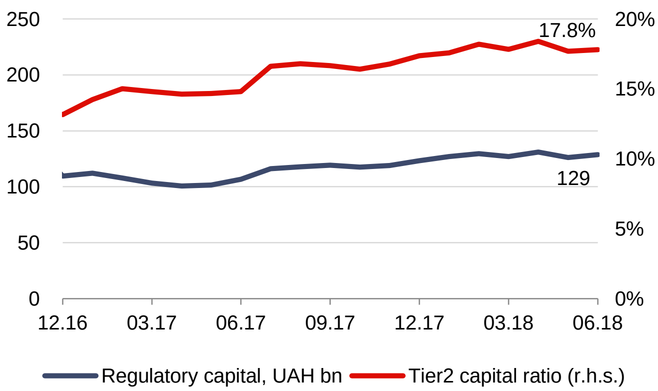
*Loan loss provisions**



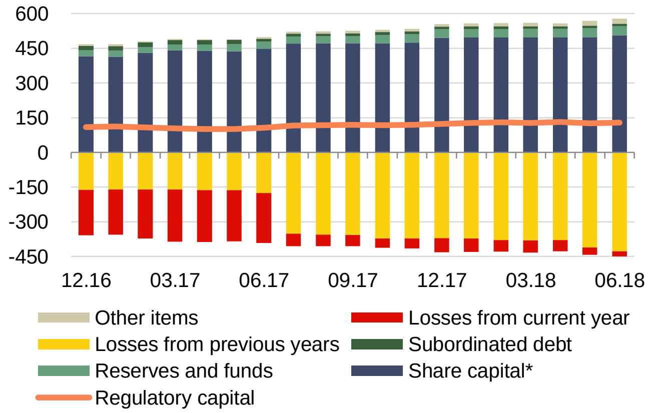
** Ratio of provisions to bank loan portfolios*

Overall capital adequacy across the sector remained higher than the minimum required level. The share capital of the banking sector increased by 2.2% ytd, or by UAH 10.9 billion, with regulatory capital rising by 4.3%.

Regulatory capital and regulatory capital adequacy levels



Banks' regulatory capital, UAH billion



** Registered and unregistered share capital*

***Key indicators of Ukraine's banking sector*[1]**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	Q1.18	Q2.18
Number of operating banks	180	175	175	174	180	145	117	96	82	82	82
General balance sheet indicators (UAH billion)[2]											
Total assets	1 002	1 090	1 212	1 264	1 409	1 477	1 571	1 737	1 848	1 841	1 854
of which in foreign currency	489	476	492	503	513	667	800	788	755	749	746
Net assets	880	942	1 054	1 125	1 278	1 290	1 254	1 256	1 336	1 296	1 300
of which in foreign currency	426	395	416	450	470	565	582	519	507	478	468
Gross corporate loans[3]	498	537	608	634	727	820	831	847	870	883	876
of which in foreign currency	212	212	221	227	252	400	492	437	423	430	426
Net corporate loans[3]	434	463	530	553	648	710	614	477	457	438	422
Gross retail loans	236	205	197	184	189	208	176	157	171	175	180
of which in foreign currency	172	143	113	84	67	101	97	83	68	64	62
Net retail loans	203	168	158	133	145	144	96	76	92	94	99
Corporate deposits[3]	128	160	205	221	258	283	349	413	427	398	404
of which in foreign currency	53	56	70	80	81	114	141	177	163	146	151
Retail deposits[4]	214	276	312	368	443	403	402	437	479	475	492
of which in foreign currency	116	136	154	187	189	214	215	239	243	232	228
Change (yoy, %)											
Total assets	3.5%	8.8%	11.1%	4.3%	11.4%	4.8%	6.4%	10.6%	6.4%	5.9%	7.9%
Net assets	-4%	7.0%	11.9%	6.7%	13.7%	1.0%	-2.8%	0.2%	6.4%	2.4%	5.0%
Gross corporate loans[3]	4.6%	7.8%	13.3%	4.2%	14.7%	12.8%	1.3%	2.0%	2.7%	6.5%	7.1%
Gross retail loans	-13%	-13%	-4.0%	-6.7%	3.0%	10.3%	-15.7%	-10.4%	8.6%	12.9%	16.9%
Corporate deposits[3]	-21%	25%	27.7%	7.9%	16.8%	9.5%	23.5%	18.2%	3.4%	-3.4%	5.5%
Retail deposits[4]	-2.3%	28.7%	13.2%	18.1%	20.2%	-8.9%	-0.3%	8.7%	9.6%	9.6%	11.3%
Penetration[5] (%)											
Gross corporate loans[3]/ GDP	52.6%	47.9%	45.1%	43.4%	47.7%	51.7%	41.8%	35.5%	29.2%	28.7%	27.4%
Net corporate loans[3]/ GDP	45.9%	41.3%	39.3%	37.9%	42.6%	44.7%	30.9%	20.0%	15.3%	14.2%	13.2%
Gross retail loans/ GDP	24.9%	18.3%	14.6%	12.6%	12.4%	13.1%	8.8%	6.6%	5.7%	5.7%	5.6%
Net retail loans/ GDP	21.4%	15.0%	11.7%	9.1%	9.5%	9.1%	4.8%	3.2%	3.1%	3.1%	3.1%
Corporate deposits[3]/ GDP	13.5%	14.3%	15.2%	15.1%	17.0%	17.8%	17.6%	17.3%	14.3%	12.9%	12.6%
Retail deposits/ GDP	22.6%	24.6%	23.1%	25.2%	29.1%	25.4%	20.2%	18.3%	16.1%	15.4%	15.4%
Profit or loss[6] (UAH billion)											
Net interest income	54.5	51.9	53.8	49.2	49.1	52.2	39.1	44.2	53.1	16.6	16.2
Net commission income	13.2	12.6	15.4	18.1	21.0	23.1	22.6	24.2	27.5	8.5	9.2
Provisions	75.4	46.2	36.5	22.3	28.0	84.4	114.5	198.3	49.3	1.1	8.3
Net profit/loss	-38.4	-13.0	-7.7	6.0	1.4	-33.1	-66.6	-159.4	-26.5	8.7	-0.4
Memo items:											
UAH/USD (period average)	7.79	7.94	7.97	7.99	7.99	11.89	21.84	25.55	26.60	27.32	26.18
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	26.19
UAH/EUR (period average)	10.87	10.53	11.09	10.27	10.61	15.72	24.23	28.29	30.00	33.56	31.27
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	30.57

[1] Data for solvent banks for each reporting date

[2] Including accrued income/expenses

[3] Including non-banking financial institutions

[4] Including certificates of deposits

[5] 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 and Q2 2018 - last twelve months with regard to NBU projections (UAH 3092 billion and UAH 3199 billion)

[6] Data as of Q1 2017 takes 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 compiled in accordance with decision No.76-D by the NBU Board dated 10 February 2017. 2018 data is compiled in line with the decision № 444 of 29 December 2017 of the NBU Committee for banking supervision and regulation. 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*
NFC	*non-financial corporation*
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*