National Bank of Ukraine

Banking Sector Review

October 2018

Retail lending remained buoyant in Q3. There was also a seasonal revival in corporate lending. Deposit rates were on the rise, reflecting the NBU's tight monetary policy. The banking sector generated a net profit both in Q3 and in the first nine months of 2018. The expected resumption of cooperation with the IMF will promote macroeconomic stability in Q4, ensuring continued deposit inflows, and a pick-up in retail lending. As a result, the sector should end the current year in profit. The NBU completed stress tests of the 24 major banks in Q3: 8 of them potentially lacked UAH 6.1 billion in capital. Therefore, they drew up capitalization programs, which are either being implemented, or already have been. On 1 December 2018, the NBU will introduce the liquidity coverage ratio, LCR. Minimum LCR requirement will gradually reach the 100% target.

Sector Structure. As of 31 October, there were 79 operating banks. In Q3, one small bank received permission from the NBU to terminate banking operations. There were two bank mergers. Another bank plans to leave the market by the end of the year. The sector's concentration has not changed: the top-20 banks hold 90.9% of net assets. State-owned banks account for 54.3% of total net assets and 63.6% of total household deposits.

Assets. The total and net assets of the banking sector increased by 5.1% and 4.3% respectively[1], thanks to a pick-up in household and corporate lending, and the revaluation of foreign currency loans in the hryvnia equivalent to reflect the weakening of the hryvnia. The percentage of loans and interbank assets grew, while that of certificates of deposit declined by 2.8 pp, to 2.1% of net assets, the lowest since 2014.

The growth in hryvnia corporate lending sped up to 8.3% qoq, up by 1.6% yoy in net terms, mainly secured by foreign- and state-owned banks. The total corporate loan portfolio was little changed during the quarter, due to the repayment and writing-off of foreign currency loans.

Net hryvnia retail loans grew by 10.6% qoq, or by 38.0% yoy, with all bank groups reporting similar growth.

The share of NPLs dropped by 1.4 pp, to 54.3%[2], on the back of the pick-up in lending. The dollarization level of net household loans was low, at 8.4% in late September.

Funding. In Q3, the banks' liabilities increased by 4.7%, to UAH 1.211 trillion. Practically all liability components were on the rise, with the largest absolute increases reported for corporate and household deposits, mainly due to a change in the exchange rate. In contrast to previous quarters, hryvnia household deposits decreased by 2.0%, while foreign currency ones grew by 2.1%. The deposit dollarization level rose by 2.6 pp, to 44.9%.

The share of NBU refinancing loans edged up by 1.2% of total liabilities in Q3, as three banks received refinancing loans for over 30 days (up by UAH 4.2 billion).

Interest Rates. In Q3, the NBU raised the key policy rate from 17% to 18% per annum. The NBU's tight monetary policy pushed up interest rates. Stronger competition for corporate deposits reflected in higher interest rates on corporate and household deposits. The average interest rate on 12-month hryvnia household deposits edged up by 0.9 pp, to 15% per annum, while that on US dollar ones grew by 0.2 pp, to 3.5% per annum[3]. There was practically no difference between interest rates on 6-, 9- and 12-month deposits.

Interest rates on new corporate loans edged up by 0.5 pp, to 17.5% per annum, while rates on retail loans dropped by 0.6 pp, to 29.7% per annum.

Profit or Loss, and Capital. In the first nine months, the banking sector made a profit of UAH 10.9 billion, including UAH 2.7 billion in Q3. Operating income was up by 20.3% in January-September, driven by an increase in net interest and fee and commission income, with expenditures rising by 24.5% yoy. Operating income before provisioning grew by 13.5% yoy. Meanwhile, operating performance deteriorated, as the cost-to-income ratio rose to 58.0% compared to 56.1% in the first nine months of 2017. Two state-owned banks reported operating losses in Q3, in the wake of trading losses and large operating expenses. However, these banks ended the first nine months in profit, due to cancelling provisions. In Q3, PrivatBank, an operationally profitable bank, made provisions of about UAH 6 billion for outstanding loans to ten foreign companies, and incurred losses of UAH 1.8 billion. Since the start of the year, PrivatBank has made a profit of UAH 5.1 billion. During the first nine months of 2018, the banking sector's made provisions of UAH 19.9 billion, or 24.2% less yoy.

Prospects and Risks. The macroeconomic environment will be benign until the end of the year, on the back of expected resumption of cooperation with the IMF. The latest Lending Survey shows that the banks projected further pick-up in retail lending, and that the quality of such loans will improve. The sector will end the current year in profit, thanks to, among other things, an increase in operating income and moderate provisioning. Possible further rises in deposit rates pose a risk to profitability.

On 1 December 2018, the LCR will become binding. The banks will gradually bring up the ratio to the 100% minimum requirement.

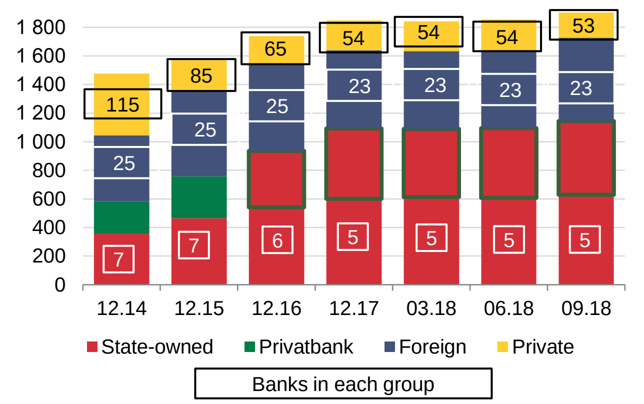
The NBU's stress tests of the 24 major banks held in Q2 and Q3 revealed that 8 of them required additional capital of UAH 6.1 billion under the baseline scenario. These banks prepared capitalization programs, which they have either implemented or will implement by the end of the year. Under an adverse scenario, 13 banks will require UAH 24.3 billion in additional capital. They drew up restructuring programs, which are to be implemented by the end of 2019. Banks with large percentages of FX assets and high concentrations of borrowers performed worst of all. In Q4, the NBU will publish its 2019 stress testing approaches, with a special focus on consumer lending.

[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

In Q3, one small bank terminated banking operations, with the prior NBU endorsement. In late October, the NBU revoked licenses from two other banks, as these banks merged with other banks. Thus, 79 banks were operating as of 31 October. Another bank plans to leave the market by the end of the year (while remaining a going concern). Total assets edged up by 5.1%, to UAH 1.949 trillion, mainly due to exchange rate moves and a revival in lending.

*Banks' total assets, UAH billion**



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

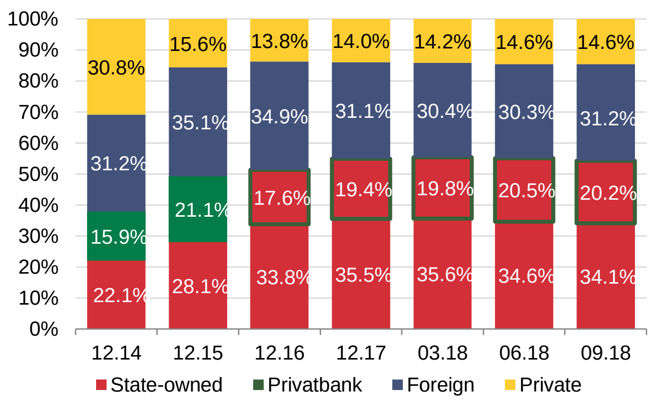
*Number of banks**

	2014	2015	2016	2017	Mar-18	Jun-18	Sep-18
Solvent	**147**	**117**	**96**	**82**	**82**	**82**	**81**
- change	-33	-30	-21	-14	0	0	-1
State-owned**	**7**	**7**	**6**	**5**	**5**	**5**	**5**
- change	0	0	-1	-1	0	0	0
Foreign	**25**	**25**	**25**	**23**	**23**	**23**	**23**
- change	0	0	0	-2	0	0	0
Private	**115**	**85**	**65**	**54**	**54**	**54**	**53**
- change	-33	-30	-20	-11	0	0	-1
Insolvent	**16**	**3**	**4**	**2**	**2**	**1**	**1**
- change	16	-13	1	-2	0	-1	0
Under liquidation	21	64	84	95	95	96	96
- change	19	43	20	11	0	1	0

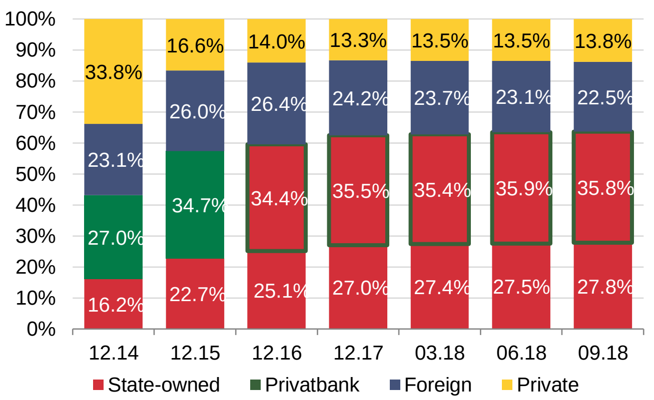
** As of end of period*
*** Including PrivatBank*

All state-owned banks, apart from PrivatBank, increased their shares of household deposits. Together with PrivatBank, these banks account for 54.3% and 63.6% of the sector's net assets and total household deposits respectively. Private banks have increased their shares of assets and deposits for four quarters running.

Distribution of net assets by bank groups

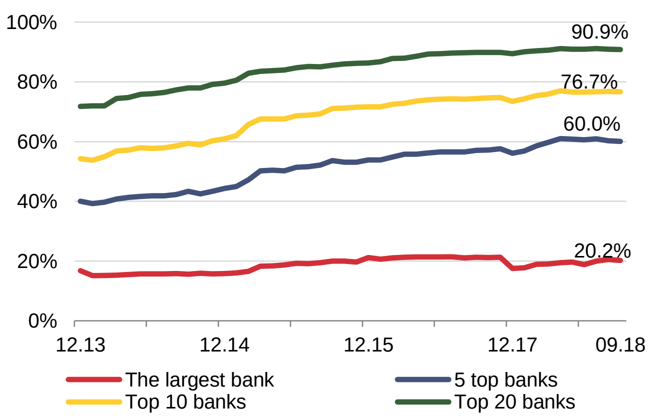


Distribution of retail deposits by bank groups

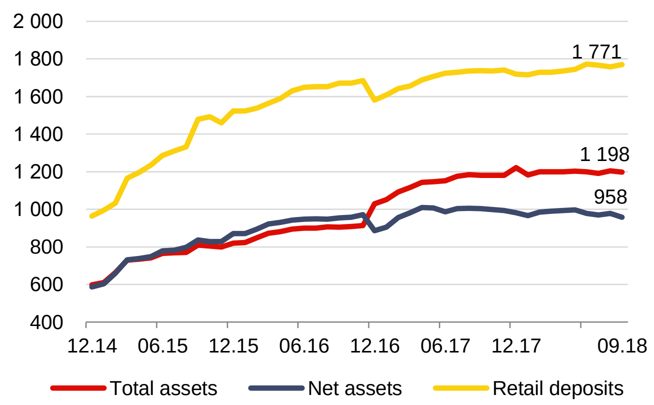


Concentration in the sector has been unchanged over the past two years, with the 20 largest banks accounting for 90.9% at the end of Q3.

The largest banks' share of the sector's net assets



*Concentration as defined by the HHI indicator**

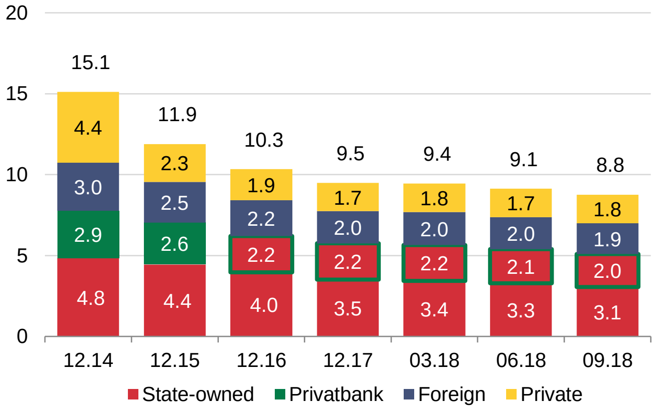


** The Herfindahl-Hirschman Index (HHI) is an indicator of banking sector concentration. It is calculated as the sum of the banks' squared market shares. The index ranges from 0 to 10,000 – values below 1,000 indicate a low degree of market concentration.*

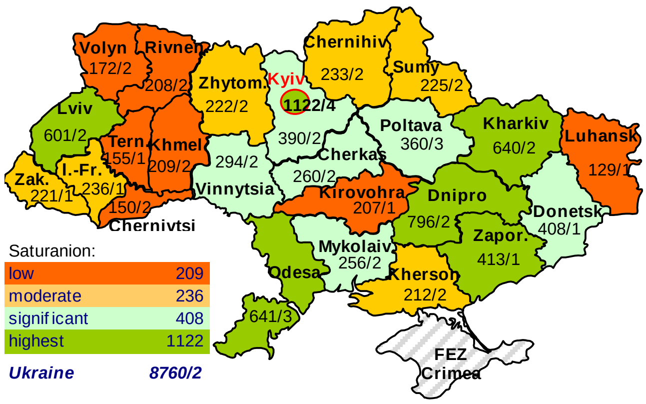
Banking infrastructure

In Q3, state- and foreign-owned banks streamlined their networks. The total number of structural units decreased by 368, to 8,760. Oschadbank led the trend, closing 236 units over three months. Private banks increased their network by 12 structural units.

*Number of banking units, thousand**



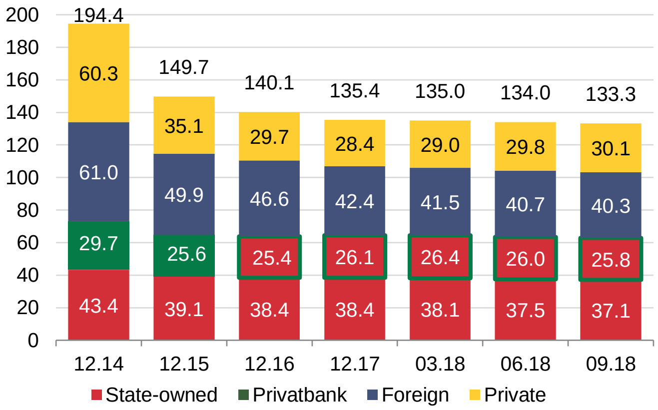
Operating banking units by regions as of 1 October 2018, units per 10,000 individuals



* standalone structural units and head offices

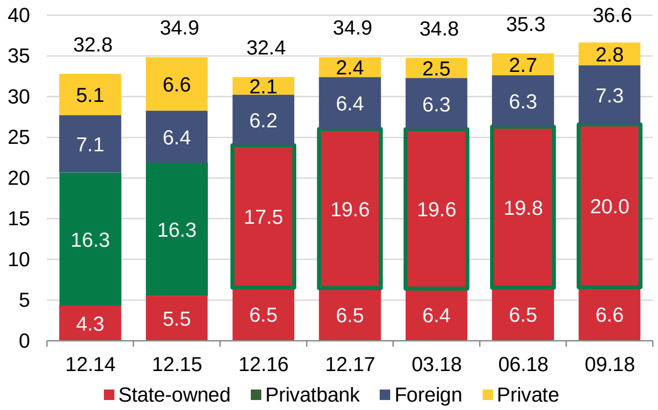
While foreign- and state-owned banks cut their workforce, private banks hired more staff. Overall, the banking sector reduced its labor force by 700 employees.

Staffing level at banks, thousand employees



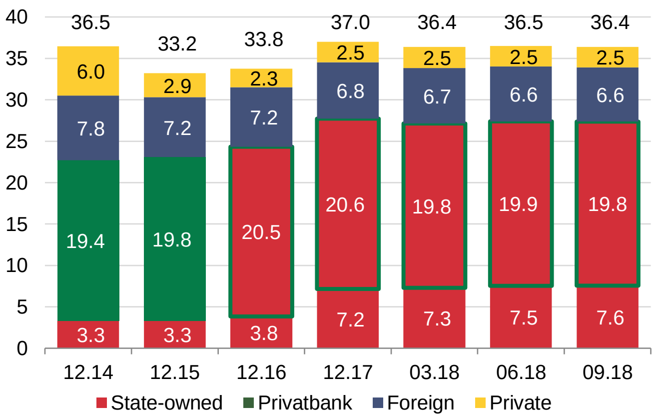
The number of active payment cards rose by 1.3 million in Q3, with the largest increases reported by foreign-owned banks (up by 928,000) and PrivatBank (up by 216,000).

Number of active payment cards by bank groups, million units

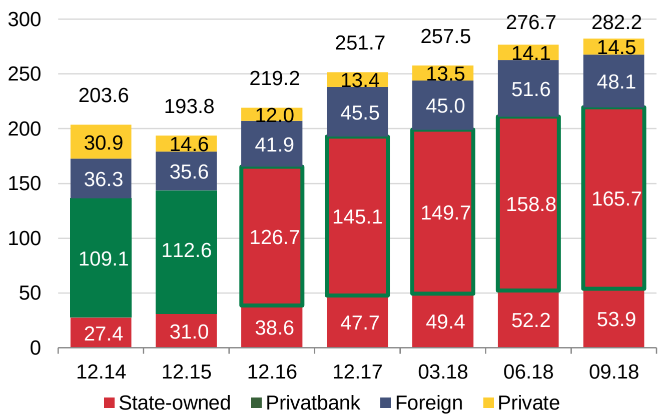


The total number of ATMs* dropped by 108 units in Q3, with foreign-owned banks and PrivatBank mainly responsible for the decrease. The network of POS terminals is expanding – in Q3 it added 5,500 units. Foreign-owned banks cut their networks by 3,500 units, while other bank groups expanded their networks.

Number of ATMs, thousand units*



Number of POS terminals, thousand units

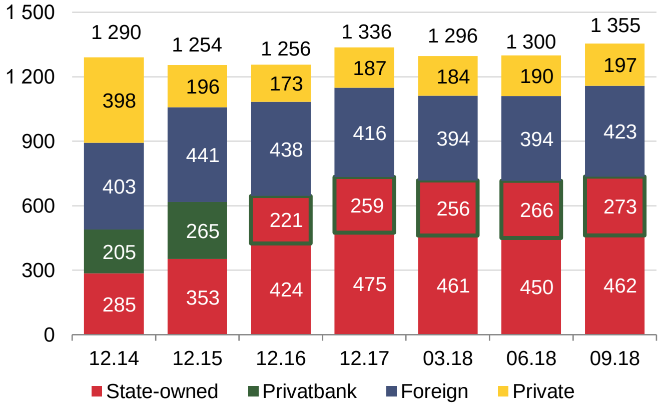


* number of self-service bank machines (ATMs, deposit ATMs, self-service kiosks)

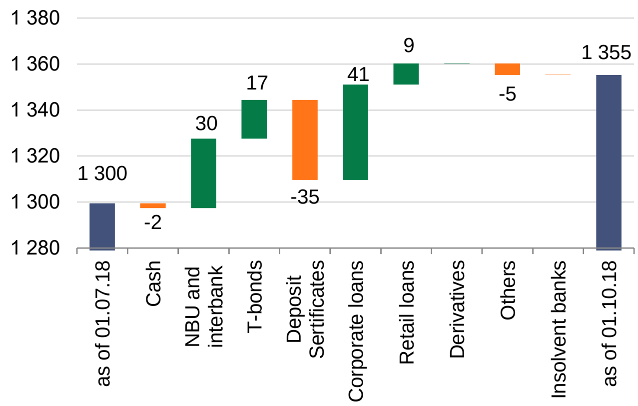
Assets

Total net assets grew by 4.3%, to UAH 1.355 trillion in Q3, mainly due to the exchange rate moves, a pick-up in lending by all groups of bank, and an increase in domestic government bond holdings by state-owned banks.

Net assets by bank groups, UAH billion



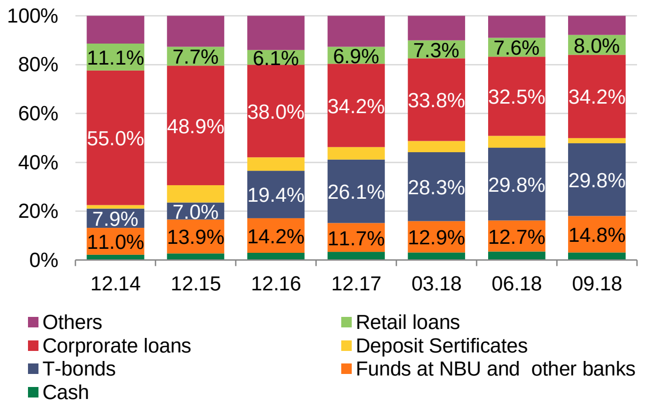
Change in net assets by components, UAH billion*



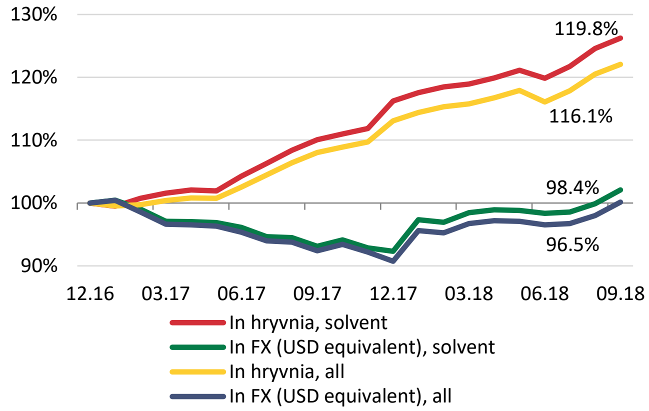
* adjusted by the amount of loan loss provisions

In Q3, loans and interbank funding grew by 2.1 pp each, to 42.2% and 14.8% respectively of the sector's net assets. Certificates of deposit decreased by 2.8 pp to 2.1%, a low not seen since 2014. Both FX and hryvnia loans were on the rise.

Sector's net assets by components



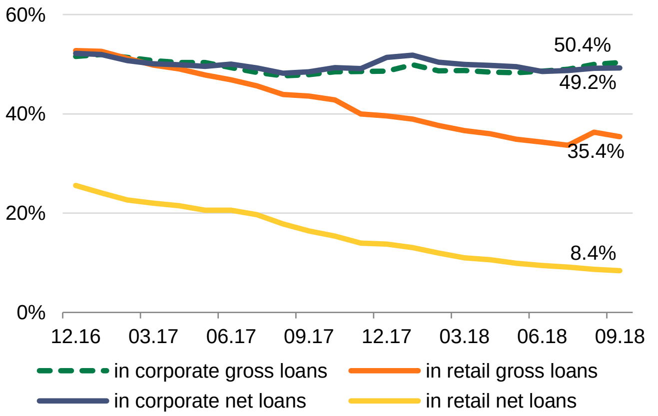
*Gross corporate and retail loans, 2016=100%**



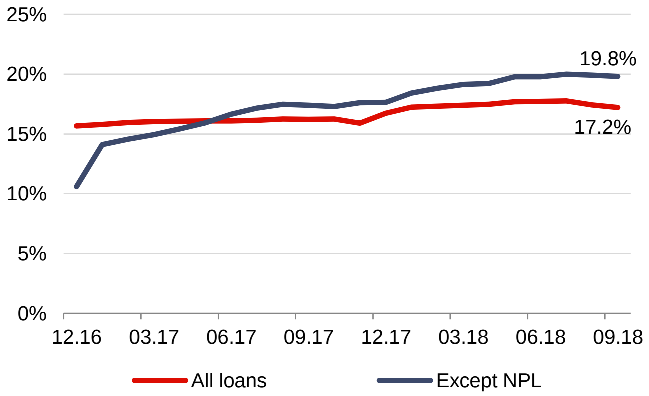
* issued by banks that were solvent as of 1 October 2018

The dollarization level of gross loans increased due to a change in the exchange rate, while that of net loans was flat. Retail lending remains buoyant, pushing up the share of household loans in total and net loans, while decreasing the dollarization of such loans.

FX loans ratio

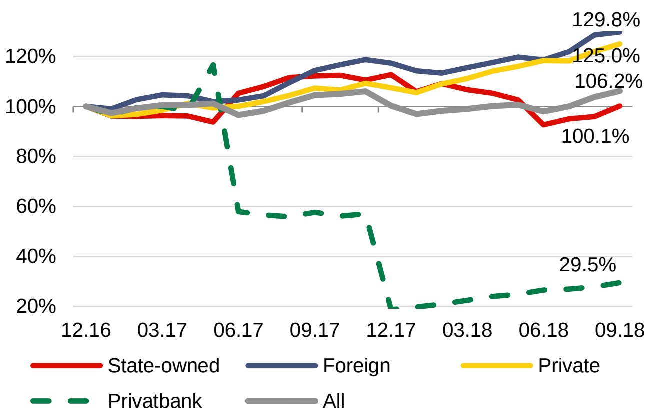


Retail loans in the total loan portfolio

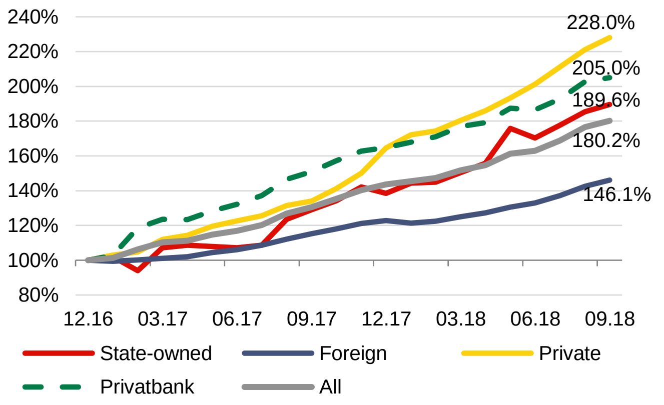


Net hryvnia household loans grew by 10.6% in Q3 or by 38.0% yoy*, with all groups of banks reporting similar growth. There was a seasonal rebound in hryvnia corporate lending, by 8.3% qoq or by 1.6% yoy, mainly due to lending by foreign- and state-owned banks.

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



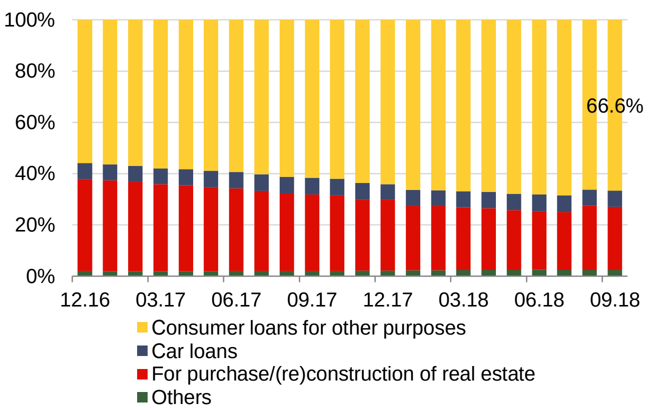
*Net retail loans in UAH, 2016=100%**



** issued by banks that were solvent as of 1 October 2018, including accrued interest*

In Q3, the share of real estate loans edged up by 1.6 pp to 24.6% of total household loans, thanks to a change in the exchange rate.

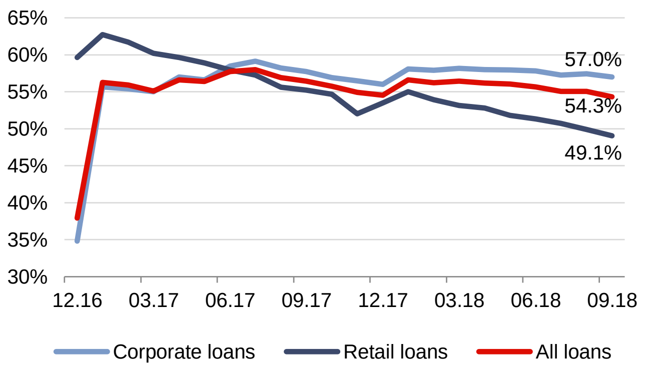
Gross retail loans by purpose*



** all banks, including insolvent ones*

The NPL ratio fell by 1.4 pp, to 54.3% in Q3 on the pick-up in lending.

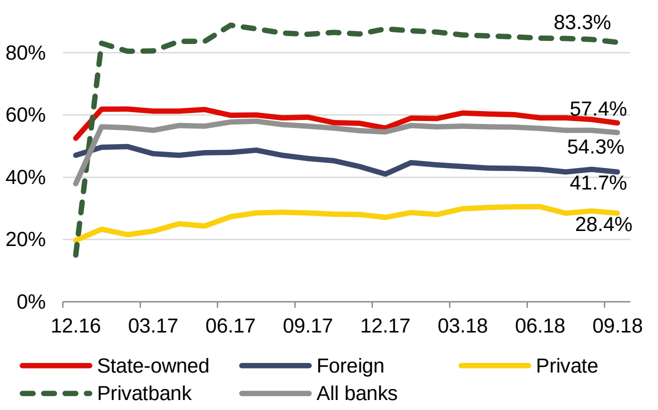
*NPL ratio in bank portfolios **



** all banks, including insolvent ones*

Q3 saw a moderate improvement in the quality of loans at all bank groups, apart from at Russian-owned banks.

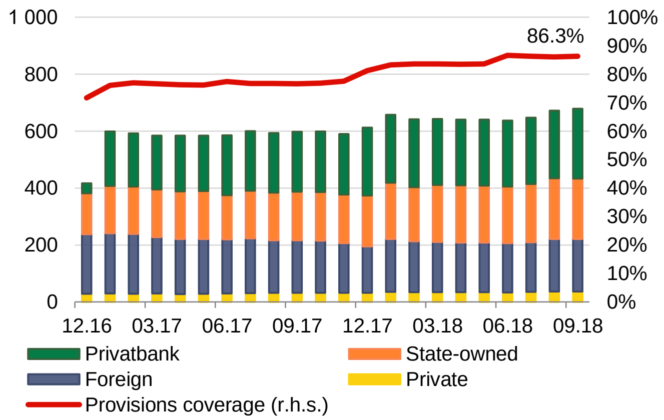
*NPLs in loan portfolios by groups of banks**



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

Provision coverage ratio changed little during the quarter, at 86.3%.

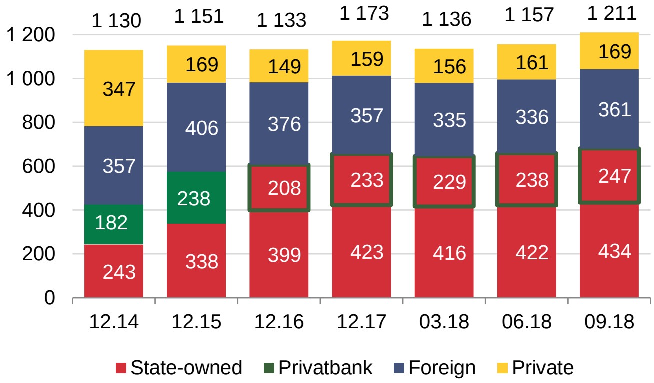
Non-performing exposures and provisions, UAH billion



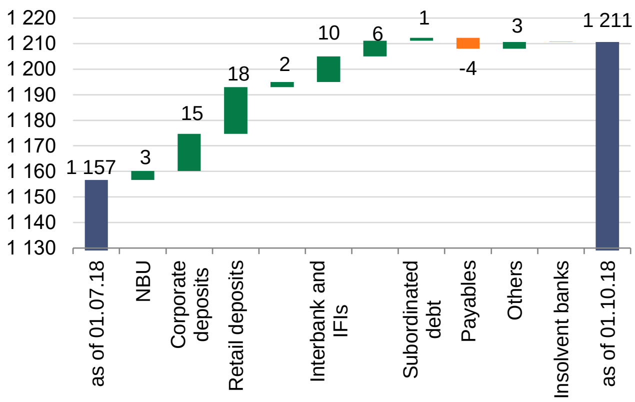
Funding

In Q3, liabilities increased by 4.7%, to UAH 1.211 trillion. Retail and corporate deposits generated the largest nominal growth. Loans issued by international financial institutions and interbank liabilities grew at the fastest rate.

Liabilities by bank groups, UAH billion

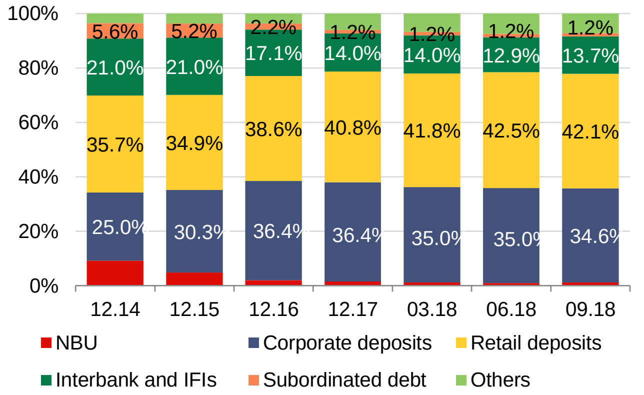


Change in liabilities by components, UAH billion



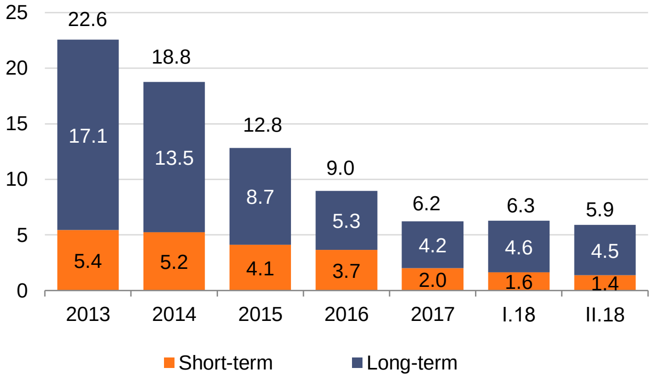
In late September, the percentage of household and corporate deposits came in at 76.8%.

The structure of liabilities



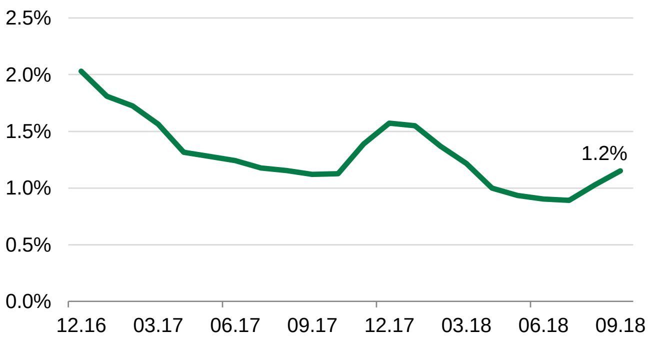
The banks' external debt shrank by 5.9% in Q2, to USD 5.9 billion.

Banks' gross external debt, USD billion



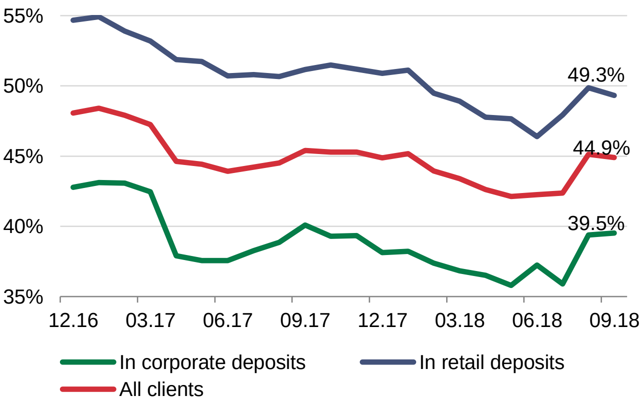
The share of NBU refinancing loans edged up, because of three banks receiving refinancing loans with maturities of over 30 days (up by UAH 4.2 billion).

NBU funds in banks' liabilities



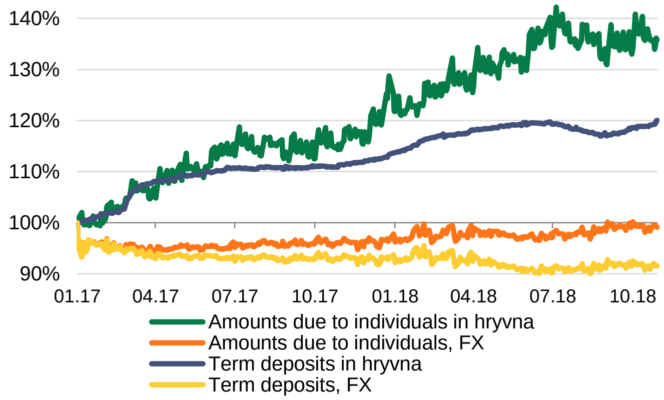
The deposit dollarization level rose by 2.6 pp, to 44.9% in Q3, due to a change in the exchange rate and customers shifting to FX deposits.

Percentage of FX deposits



Hryvnia retail deposits* shrank by 2.0% in Q3 (rose by 18.6% yoy), while FX ones grew by 2.1% qoq or by 3.2% yoy in the dollar equivalent.

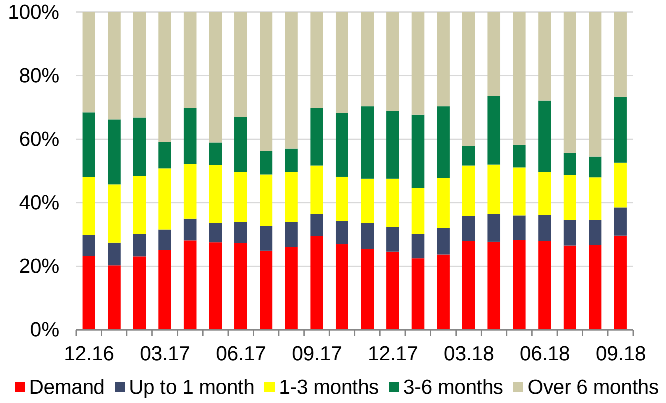
*Retail deposits, 2016=100%**



** at banks that were solvent as of 1 October 2018, including savings certificates*

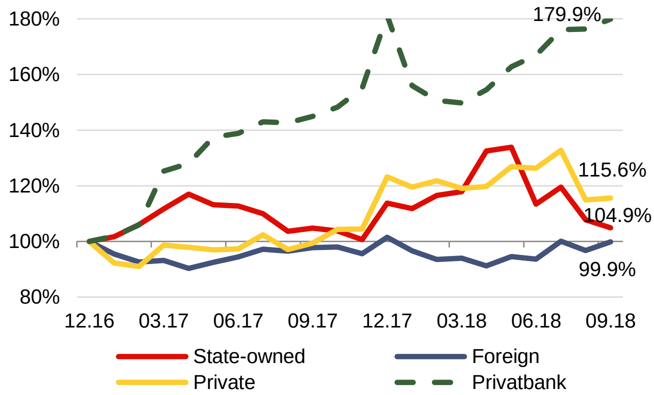
In Q3, the percentage of deposits with maturities over three months edged up by 1.2 pp qoq, to 50.3%.

New retail deposits by maturity

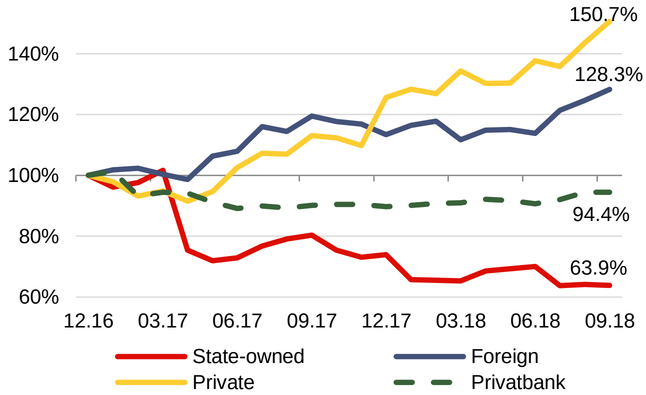


Hryvnia corporate deposits were little changed qoq (dropped by 0.2%), while increasing by 6.0% yoy. FX deposits grew by 1.7% qoq, while decreasing by 3.1% yoy. Foreign-owned banks and PrivatBank reported an increase in both hryvnia and FX corporate deposits.

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



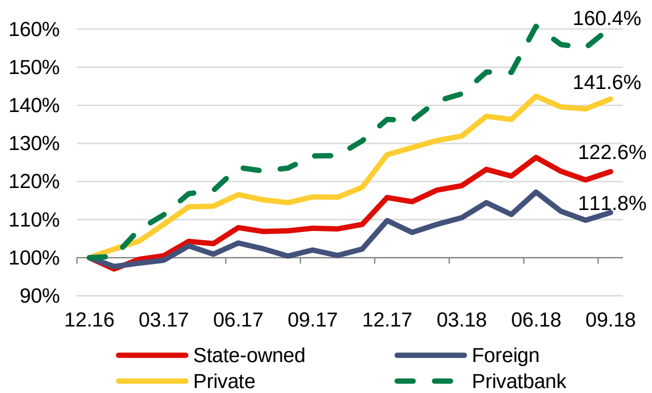
*FX corporate deposits (in the US dollar equivalent) by groups of banks, 2016 = 100%**



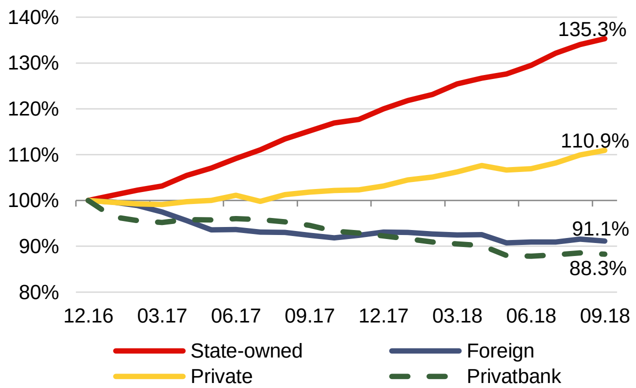
** at banks that were solvent as of 1 October 2018, including savings certificates*

Although declining in July and August, hryvnia retail deposits at private banks and at PrivatBank almost recovered in September (down by 0.5% and 0.2% in Q3, respectively). Foreign-owned banks reported the largest loss – 4.6% over the quarter. All bank groups generated an increase in FX retail deposits, with state-owned banks (apart from PrivatBank) and private banks accounting for the largest growth (up by 4.5% and 3.8% respectively).

*Hryvnia retail deposits by bank groups, 2016 = 100%**



*FX retail deposits (in the US dollar equivalent) by bank groups, 2016 = 100%**

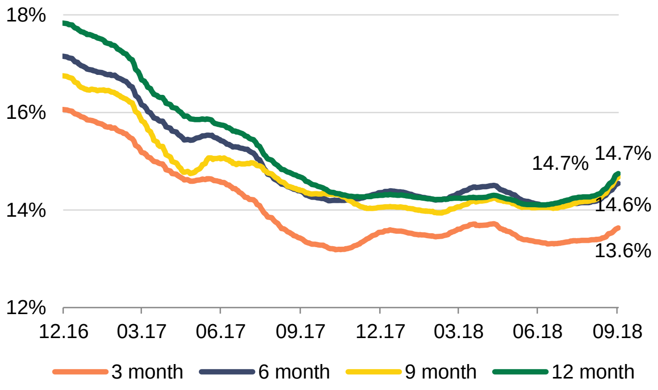


** at banks that were solvent as of 1 October 2018, including savings certificates*

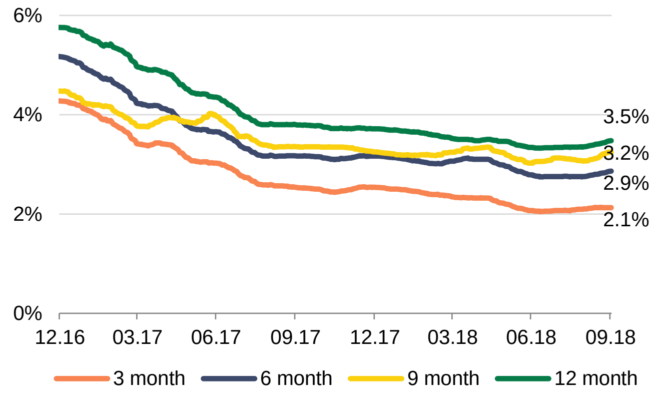
Interest rates

Q3 witnessed growth in hryvnia retail deposit rates on all maturities, and most of all in 12-month deposit rates – by 0.9 pp. The difference between 6-, 9- and 12-month deposit rates remained insignificant. The rates on US dollar 12-month deposits edged up by 0.2 pp, to 3.5% per annum.

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



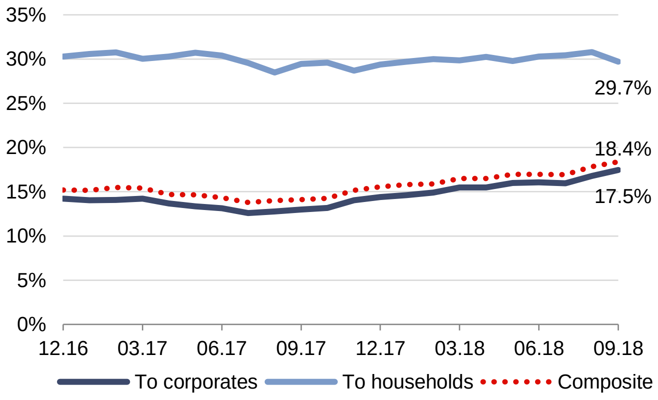
*Ukrainian Index of USD Retail Deposit rates, % per annum**



** Thomson Reuters data, 20-day moving average*

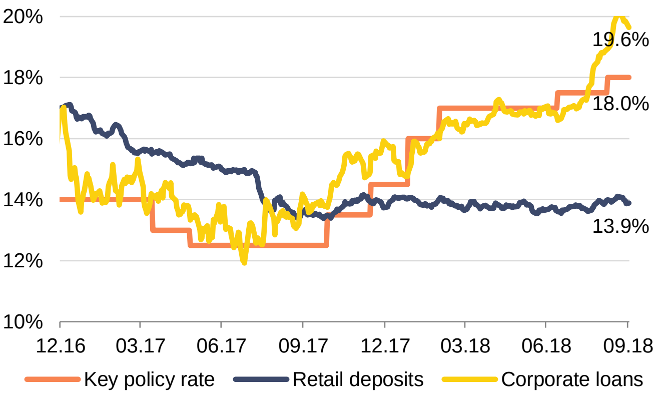
The NBU's tight monetary policy drove up rates on new corporate loans from 17.0% in June to 17.5% per annum in September. In contrast, the rate on household loans dropped by 0.6 pp, to 29.7% per annum.

Interest rates on new loans, % per annum*



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

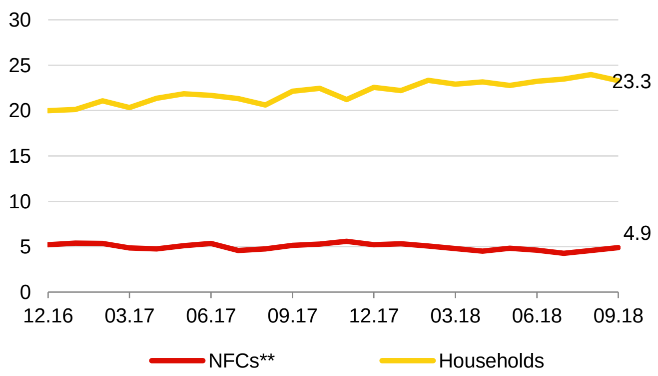
NBU key policy rate and interest rates on new hryvnia deposits and loans, % per annum*



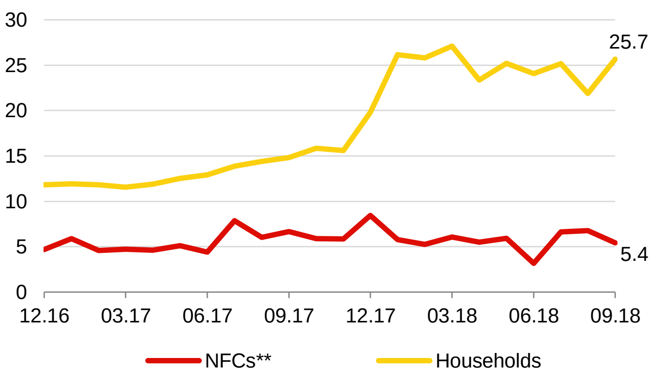
** daily rates, 5-day moving average*

In Q3, the spread between new loan and deposit rates remained practically the same, due to simultaneous rises in market rates. However, the ultimate yield of operations with households and business was on the rise.

*Spread between new*** loan rates and deposit rates, pp**



*Spread between rates on outstanding loans and deposits, pp**

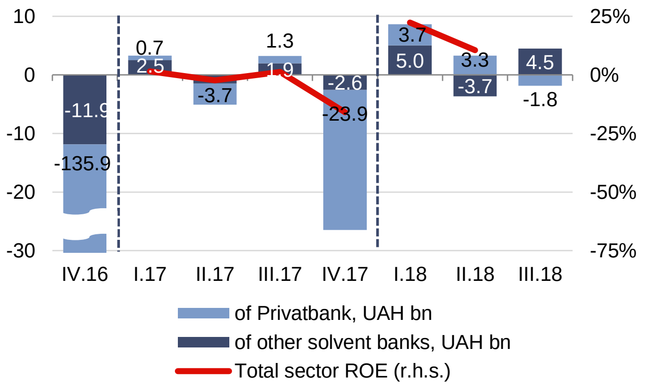


** including insolvent banks*
*** non-financial corporations*
**** new loans and deposits are loans and deposits issued or obtained under primary agreements that were entered into in the reporting period, as well as those under additional agreements, with changes in the amount, interest rate, or both*

Financial Results and Capital

In the first nine months, the banking sector made a profit of UAH 10.9 billion, including UAH 2.7 billion in Q3*.

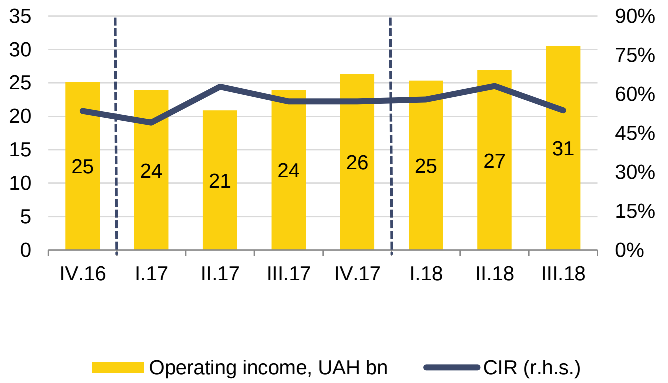
Profit/loss and return on equity*



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

Operating efficiency decreased – the CIR* was 58.0%, up from 56.1% a year ago.

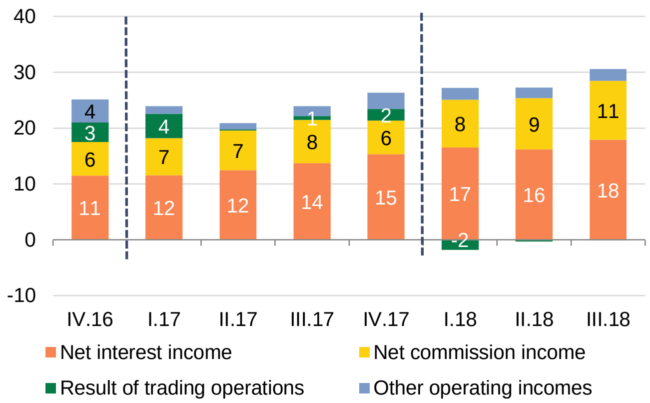
Operating income and operating efficiency



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

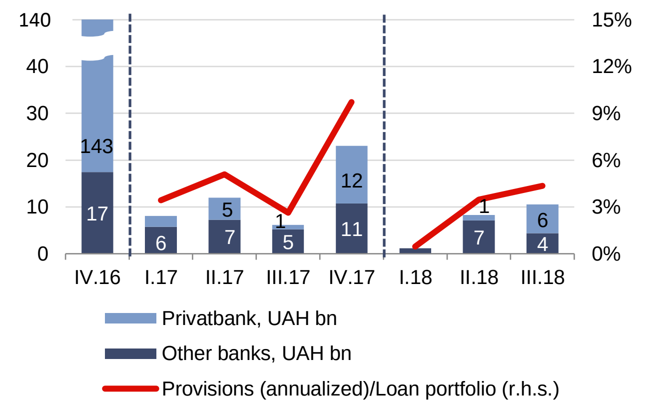
Operating income rose by 13.4% qoq, driven by an increase in net interest, and fee and commission income.

Operating income components for the period, UAH billion



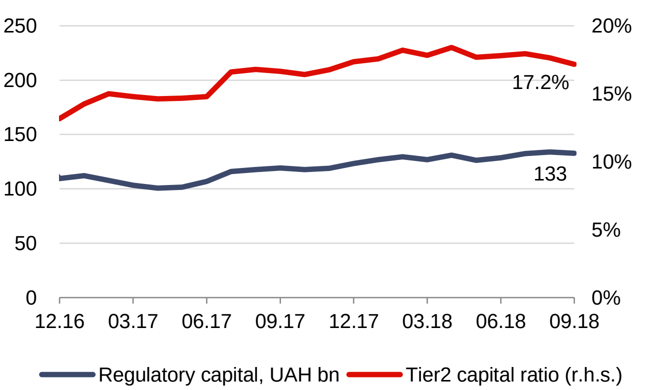
The growth in provisioning recorded in Q3 was largely due to PrivatBank. However, in the first nine months, overall provisioning was lower than a year ago.

Loan loss provisions

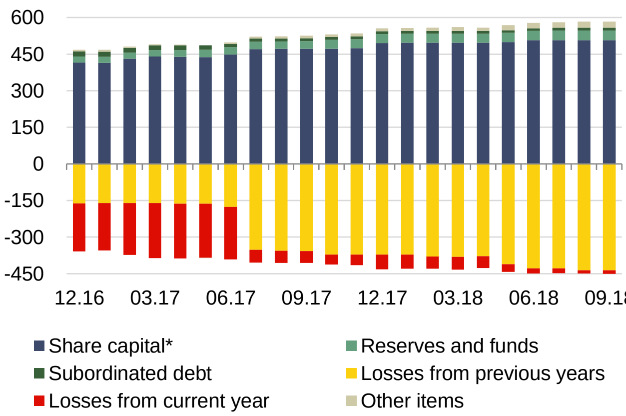


Overall capital adequacy across the sector was significantly higher than the minimum required level. The share capital of the banking sector increased by 0.2% in Q3, or by UAH 900 million, with regulatory capital rising by 3.1%.

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]

	2011	2012	2013	2014	2015	2016	2017	Q1.18	Q2.18	Q3.18
Number of operating banks	175	174	180	145	117	96	82	82	82	81
General balance sheet indicators (UAH billion)[2]										
Total assets	1 212	1 264	1 409	1 477	1 571	1 737	1 848	1 841	1 854	1 949
of which in foreign currency	492	503	513	667	800	788	755	749	746	831
Net assets	1 054	1 125	1 278	1 290	1 254	1 256	1 336	1 296	1 300	1 355
of which in foreign currency	416	450	470	565	582	519	507	478	468	516
Gross corporate loans[3]	608	634	727	820	831	847	870	883	876	945
of which in foreign currency	221	227	252	400	492	437	423	430	426	476
Net corporate loans[3]	530	553	648	710	614	477	457	438	422	485
Gross retail loans	197	184	189	208	176	157	171	175	180	199
of which in foreign currency	113	84	67	101	97	83	68	64	62	71
Net retail loans	158	133	145	144	96	76	92	94	99	119
Corporate deposits[3]	205	221	258	283	349	413	427	398	404	419
of which in foreign currency	70	80	81	114	141	177	163	146	151	166
Retail deposits[4]	312	368	443	403	402	437	479	475	492	510
of which in foreign currency	154	187	189	214	215	239	243	232	228	252
Change (yoy, %)										
Total assets	11.1%	4.3%	11.4%	4.8%	6.4%	10.6%	6.4%	5.9%	7.9%	11.1%
Net assets	11.9%	6.7%	13.7%	1.0%	-2.8%	0.2%	6.4%	2.4%	5.0%	5.8%
Gross corporate loans[3]	13.3%	4.2%	14.7%	12.8%	1.3%	2.0%	2.7%	6.5%	7.1%	13.6%
Gross retail loans	-4.0%	-6.7%	3.0%	10.3%	-15.7%	-10.4%	8.6%	12.9%	16.9%	25.9%
Corporate deposits[3]	27.7%	7.9%	16.8%	9.5%	23.5%	18.2%	3.4%	-3.4%	5.5%	4.8%
Retail deposits[4]	13.2%	18.1%	20.2%	-8.9%	-0.3%	8.7%	9.6%	9.6%	11.3%	14.1%
Penetration[5] (%)										
Gross corporate loans[3]/ GDP	45.1%	43.4%	47.7%	51.7%	41.8%	35.5%	29.2%	28.5%	27.1%	27.8%
Net corporate loans[3]/ GDP	39.3%	37.9%	42.6%	44.7%	30.9%	20.0%	15.3%	14.2%	13.0%	14.3%
Gross retail loans/ GDP	14.6%	12.6%	12.4%	13.1%	8.8%	6.6%	5.7%	5.7%	5.6%	5.9%
Net retail loans/ GDP	11.7%	9.1%	9.5%	9.1%	4.8%	3.2%	3.1%	3.0%	3.1%	3.5%
Corporate deposits[3]/ GDP	15.2%	15.1%	17.0%	17.8%	17.6%	17.3%	14.3%	12.9%	12.5%	12.3%
Retail deposits/ GDP	23.1%	25.2%	29.1%	25.4%	20.2%	18.3%	16.1%	15.4%	15.2%	15.0%
Profit or loss[6] (UAH billion)										
Net interest income	53.8	49.2	49.1	52.2	39.1	44.2	53.1	16.6	16.2	17.9
Net commission income	15.4	18.1	21.0	23.1	22.6	24.2	27.5	8.5	9.2	10.5
Provisions	36.5	22.3	28.0	84.4	114.5	198.3	49.3	1.1	8.3	10.5
Net profit/loss	-7.7	6.0	1.4	-33.1	-66.6	-159.4	-26.5	8.7	-0.4	2.7
Memo items:										
UAH/USD (period average)	7.97	7.99	7.99	11.89	21.84	25.55	26.60	27.32	26.18	27.36
UAH/USD (end-of-period)	7.99	7.99	7.99	15.77	24.00	27.2	28.07	26.54	26.19	28.27
UAH/EUR (period average)	11.09	10.27	10.61	15.72	24.23	28.29	30.00	33.56	31.27	31.82
UAH/EUR (end-of-period)	10.30	10.54	11.04	19.23	26.22	28.42	33.50	32.70	30.57	32.73

[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 2018 it excludes data for the temporarily occupied Republic of Crimea and City of Sevastopol and a part of the ATO zone; As for Q1, Q2, Q3 2018 – last twelve months according to NBU's estimation (3092, 3235 and 3396 UAH bn)

[6] 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 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*