



OESTERREICHISCHE NATIONALBANK  
EUROSYSTEM

*Ukraine: Struggling banking sector  
amid substantial political and  
economic uncertainty*

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# *Introduction: Main findings in a nutshell*

- Deep depression + plunge of hryvnia (2014-15)

+ geopolitical tensions & uncertainty

pushed banking sector again deeply into the red

However: Major economic policy anchor: IMF and international support

Fragile macroeconomic stabilization succeeded in H2/2015

Successful NBU intervention to remove smaller problem banks

- Main shortcomings/risks plaguing banking sector:

- High credit risk
- Chronic lack of profitability
- Exchange rate risk
- Weak rule of law, endemic corruption

↔ Financial intermediation very weak, trough probably reached

Continuing substantial recapitalization needs

Recovery of banking sector/lending will lag recovery of real sector

# *Overview*

- Banking developments from crisis 2008/09 to
- Crisis 2014/15/16 (focus)
- Most significant risks, shock-absorbing factors
- Outlook

## *Banking sector development since global financial crisis*

2 phases dominated by asset growth and decline/ credit cycles

- **Increasingly fragile post-crisis stabilization (2009 to early 2014)**
  - Share of forex loans has traditionally been high in UA (40-50%)
  - Temporary credit spurt to enterprises (2013, connected lending?)
- **Crisis-triggered collapse of fin. intermediation (from early 2014)**
  - Lenders, depositors shocked by deep macroeconomic instability, political uncertainty
  - Delicate re-stabilization tendencies on low level from Q3/2015

## Ukraine: Main banking sector stability indicators

	end-09	end-11	end-13	end-14	end-Jun 15	end-15
<b>Commercial banks (number holding banking license)</b>	<b>182</b>	<b>176</b>	<b>179</b>	<b>162</b>	<b>138</b>	<b>119</b>
number of banks not complying with selected banking regulations <sup>1)</sup> :	49	18	14	82	93 <sup>2)</sup>	.
<b>Total deposits (from resident sectors, excl. interbank, ratio to GDP in %)</b>	<b>36.7</b>	<b>37.8</b>	<b>45.7</b>	<b>43.1</b>	<b>40.9</b>	<b>37.1*</b>
- annual growth (in real terms, exchange rate-adjusted, %)	.	<b>12.8</b>	<b>16.5</b>	<b>-37.6</b>	<b>-47.1</b>	<b>-37.4</b>
- share of forex deposits in total deposits (%)	48.3	43.0	37.0	45.9	48.1	45.3
<b>Total loans (to resident sectors, excl. interbank, ratio to GDP in %)</b>	<b>79.2</b>	<b>61.6</b>	<b>62.2</b>	<b>65.1</b>	<b>61.3</b>	<b>54.4*</b>
- annual growth (in real terms, exchange rate-adjusted, %)	.	<b>4.6</b>	<b>11.2</b>	<b>-30.8</b>	<b>-48.2</b>	<b>-45.7</b>
- share of forex loans in total loans (%)	<b>50.9</b>	<b>40.3</b>	<b>33.8</b>	<b>46.3</b>	<b>52.6</b>	<b>55.8</b>
<b>NPLs (% of total loans, broader definition)<sup>3)</sup></b>	.	.	<b>23.5</b>	<b>32.0</b>	<b>44.3<sup>4)</sup></b>	.
<b>NPLs (% of total loans, NBU definition)<sup>5)</sup></b>	<b>13.7</b>	<b>14.7</b>	<b>12.9</b>	<b>19.0</b>	<b>24.3</b>	<b>25.6*</b>
Ratio of large exposures to capital (%)	169.2	164.5	172.1	250.0	573.2	820.0
<b>Capital adequacy ratio (%)</b>	<b>18.1</b>	<b>18.9</b>	<b>18.3</b>	<b>15.6</b>	<b>9.0</b>	<b>7.1*</b>
<b>Regulatory Tier 1 capital to risk-weighted assets (%)</b>	<b>14.2</b>	<b>14.0</b>	<b>13.9</b>	<b>11.2</b>	<b>5.5</b>	<b>3.5*</b>
<b>Return on assets (ROA, %)</b>	<b>-4.4</b>	<b>-0.7</b>	<b>0.3</b>	<b>-4.2</b>	<b>-12.1</b>	<b>-6.9*</b>
<b>Return on equity (ROE, %)</b>	<b>-33.7</b>	<b>-4.4</b>	<b>1.7</b>	<b>-32.0</b>	<b>-147.3</b>	<b>-80.3*</b>

Source: Natsionalny Bank Ukraini, IMF

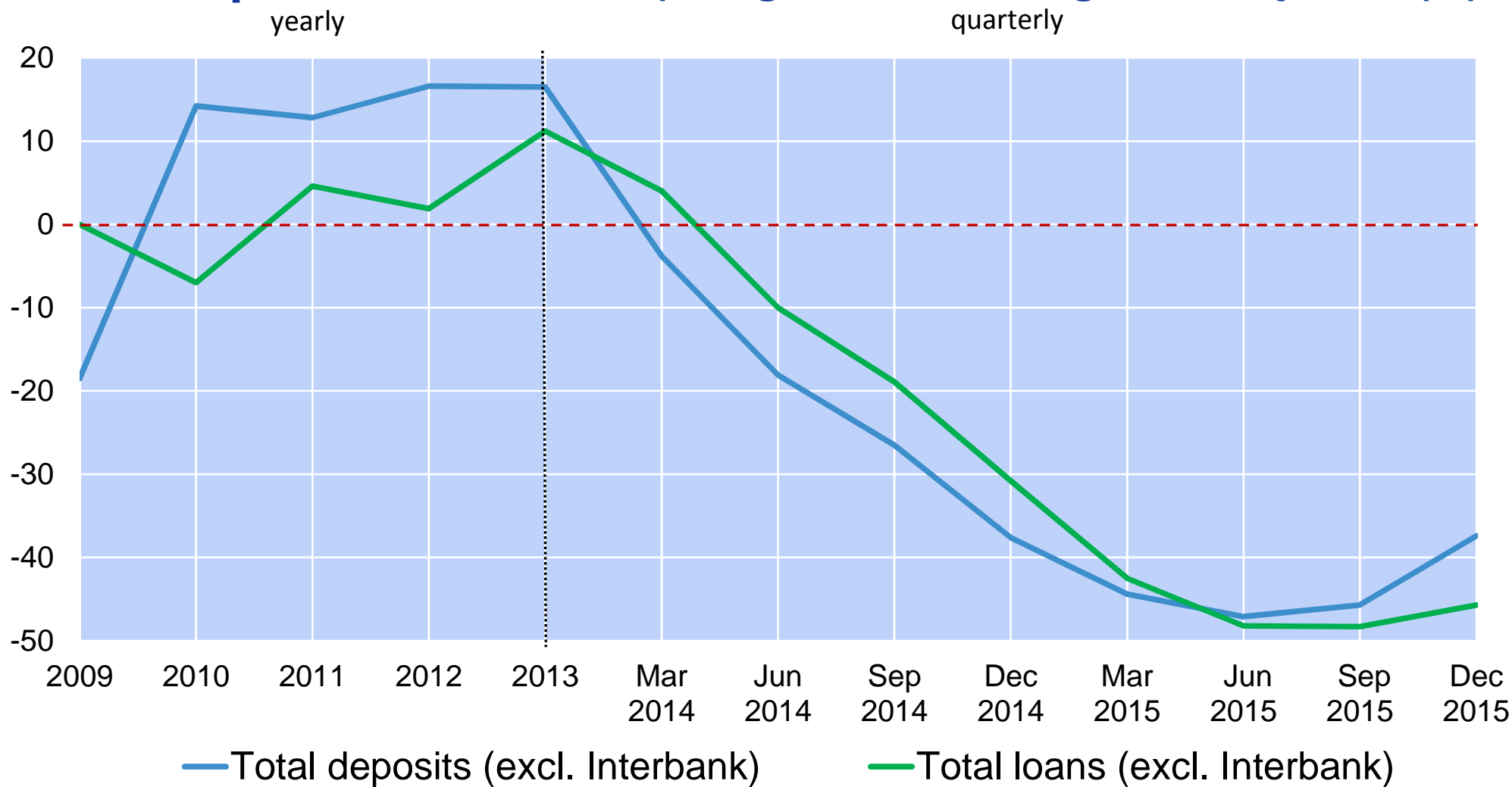
\* end-September 2015

<sup>1)</sup> Refers to all banks not meeting capital adequacy requirements for Tier 1 capital, prudential regulations and/or reserve regulations. <sup>2)</sup> end-April; <sup>3)</sup> Includes NPLs that are classified as substandard, doubtful and loss. <sup>4)</sup> end-May; <sup>5)</sup> Includes NPLs that are classified as doubtful and loss. From Dec 2012, loan classification adjusted, which results in series break.

## *From early 2014: New crisis-triggered severe banking contraction*

- Strong devaluation and rise of inflation → inflation-depreciation spiral
- Persistent uncertainty, falling real incomes → slide into recession
  - Mounting deposit withdrawals (-18% mid-2014, -47% Jun 15 y-o-y)
  - Share of forex loans rises to record level (56%)
  - Credit quality worsens again (NPLs grow to record 44% and swelling)
  - Capital adequacy plummets (from 18% at end-13 to 7% end-Sep 15)
  - Lending sharply contracts (-10% mid-14, -48% end-Sep 15 y-o-y)
  - Banks' profitability again deeply in the red
- IMF estimate (2014): fiscal cost of bank recapitalization: 9-10% of GDP
  - As of mid-2015, capital of 2.5% of GDP raised
- New diagnostic studies (2015) carried out to identify capital shortages from most recent losses

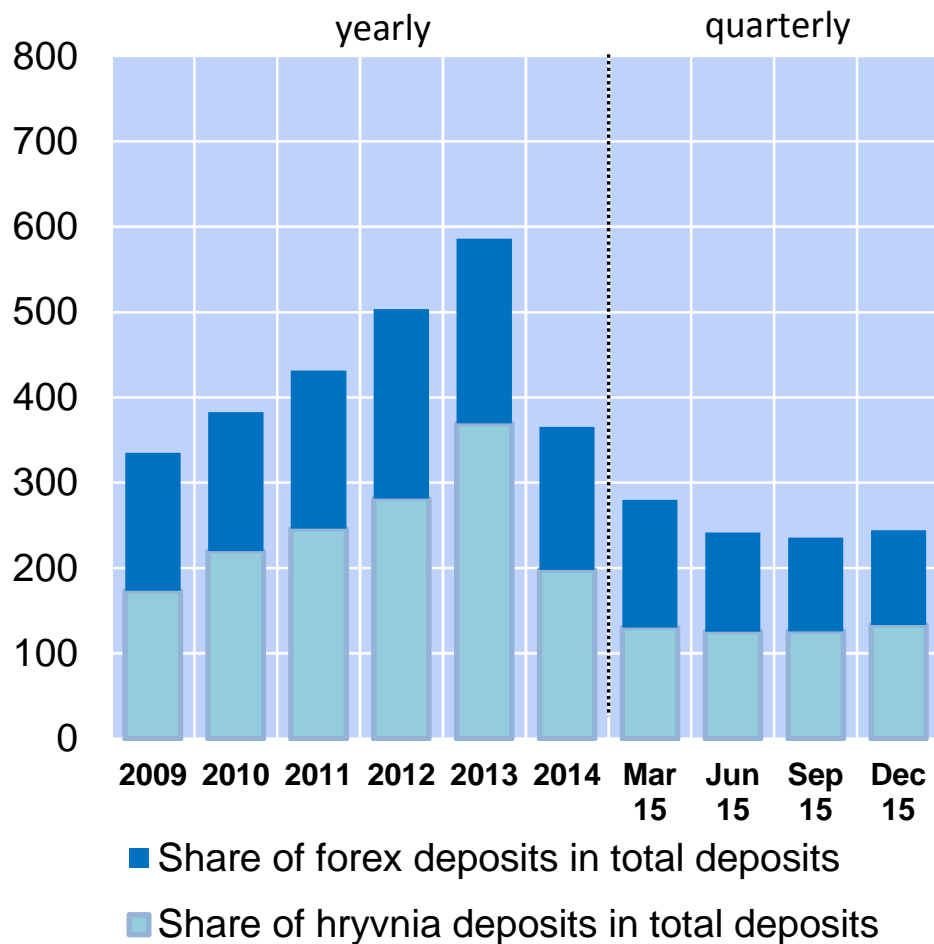
# Bank deposits and loans (real growth, exchange rate-adjusted (%))



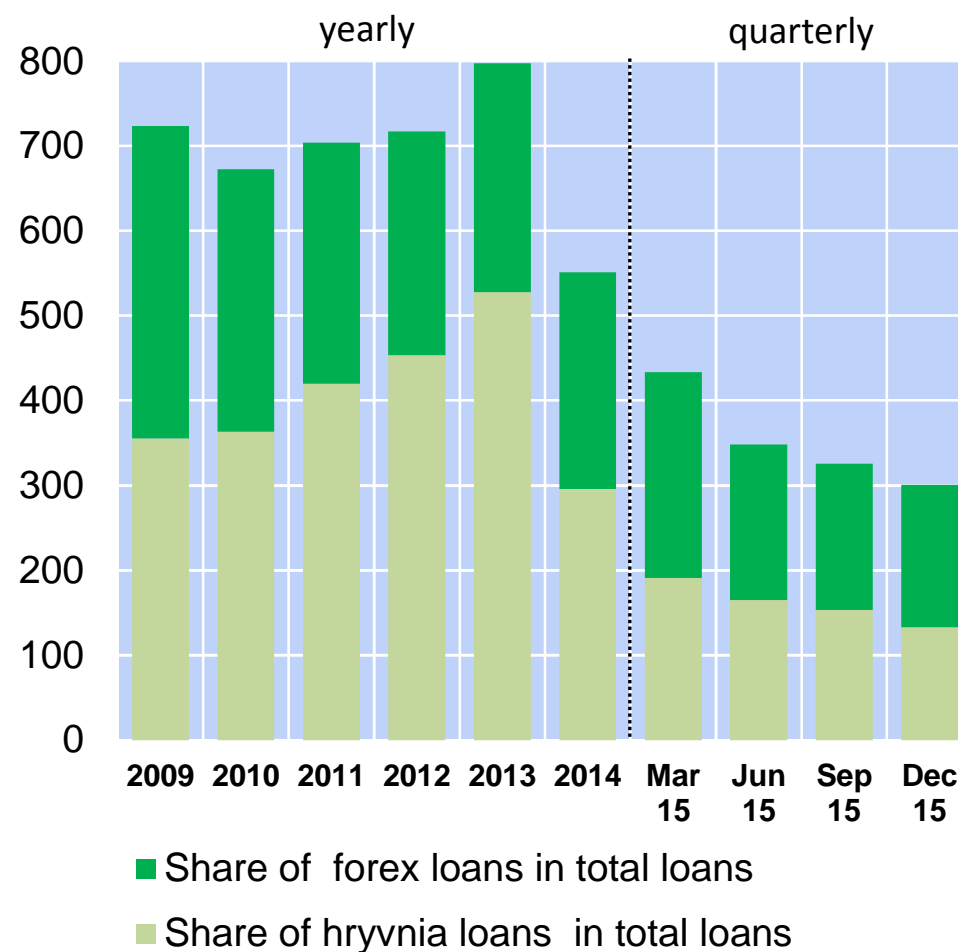
Source: Natsionalny bank Ukraini.

# Deposits and loan dollarization in Ukraine

**Deposits in UAH billion (exch. rate-adj., deflated)**



**Loans in UAH billion (exch. rate-adj., deflated)**



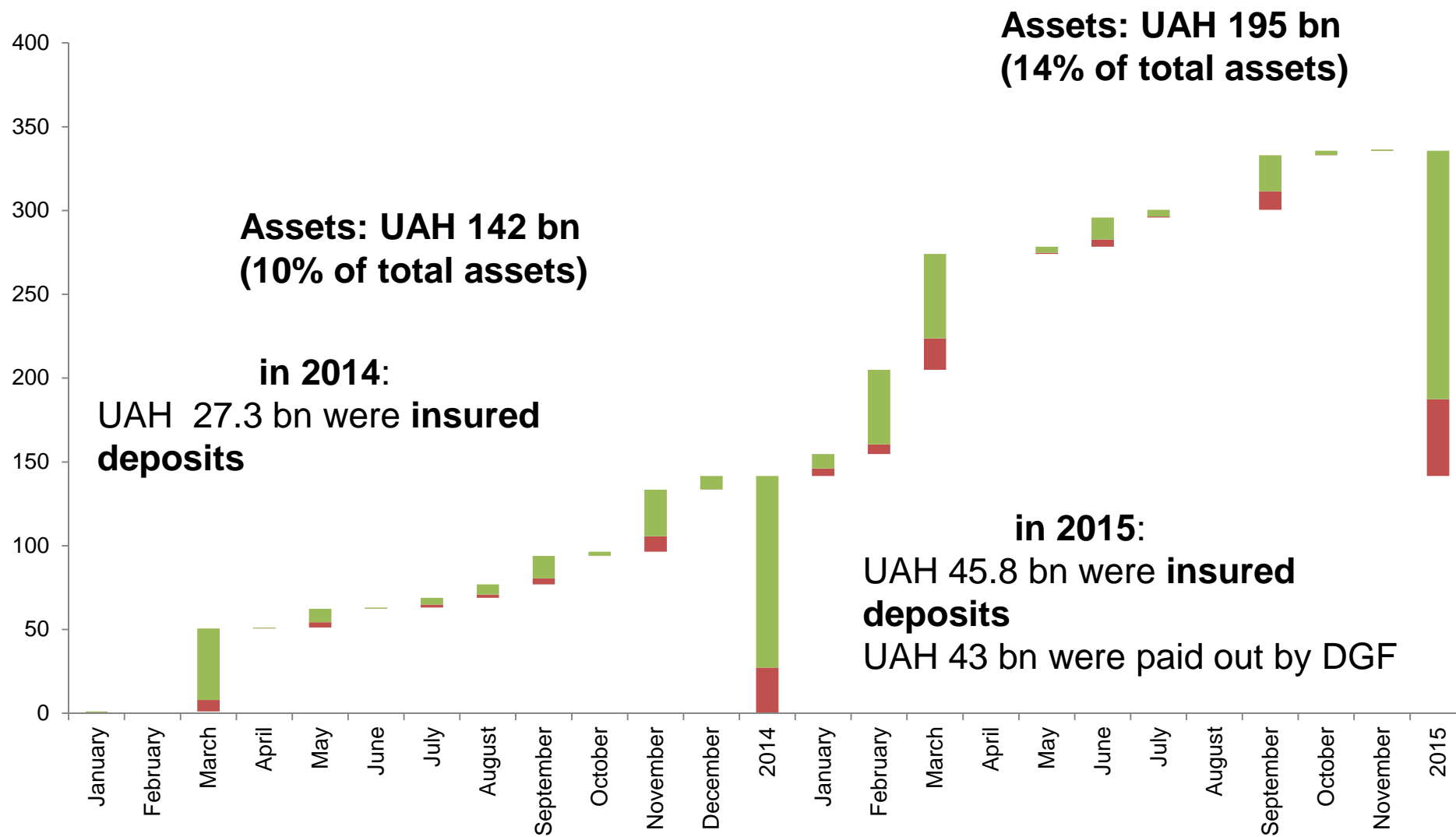
Source: Natsionalny bank Ukraini.



## H2/2015: some signs of stabilization at low level

- GDP Q3/15: Slower contraction (y-o-y) and return to weak growth (q-o-q)
- Current account deficit 2015 all but eliminated (ca. 0.2% of GDP)
- From mid-15: Monthly inflation low, considerable slowdown of depreciation
- Therefore: inflation-depreciation spiral interrupted/ stopped
- Deposit withdrawals have slowed down (-37% at end-15 y-o-y)
- Recent distressed debt restructuring agreements for some of largest banks
- NBU: successful cleansing of sector of insolvent pocket banks  
effort to rein in connected lending
- **On the other hand:**
  - further deterioration of low credit quality, further swelling losses, eroding capital
  - Serious problems with unhedged borrower-companies

# Assets and insured deposits of insolvent banks as of end-2015



Source: National Bank of Ukraine

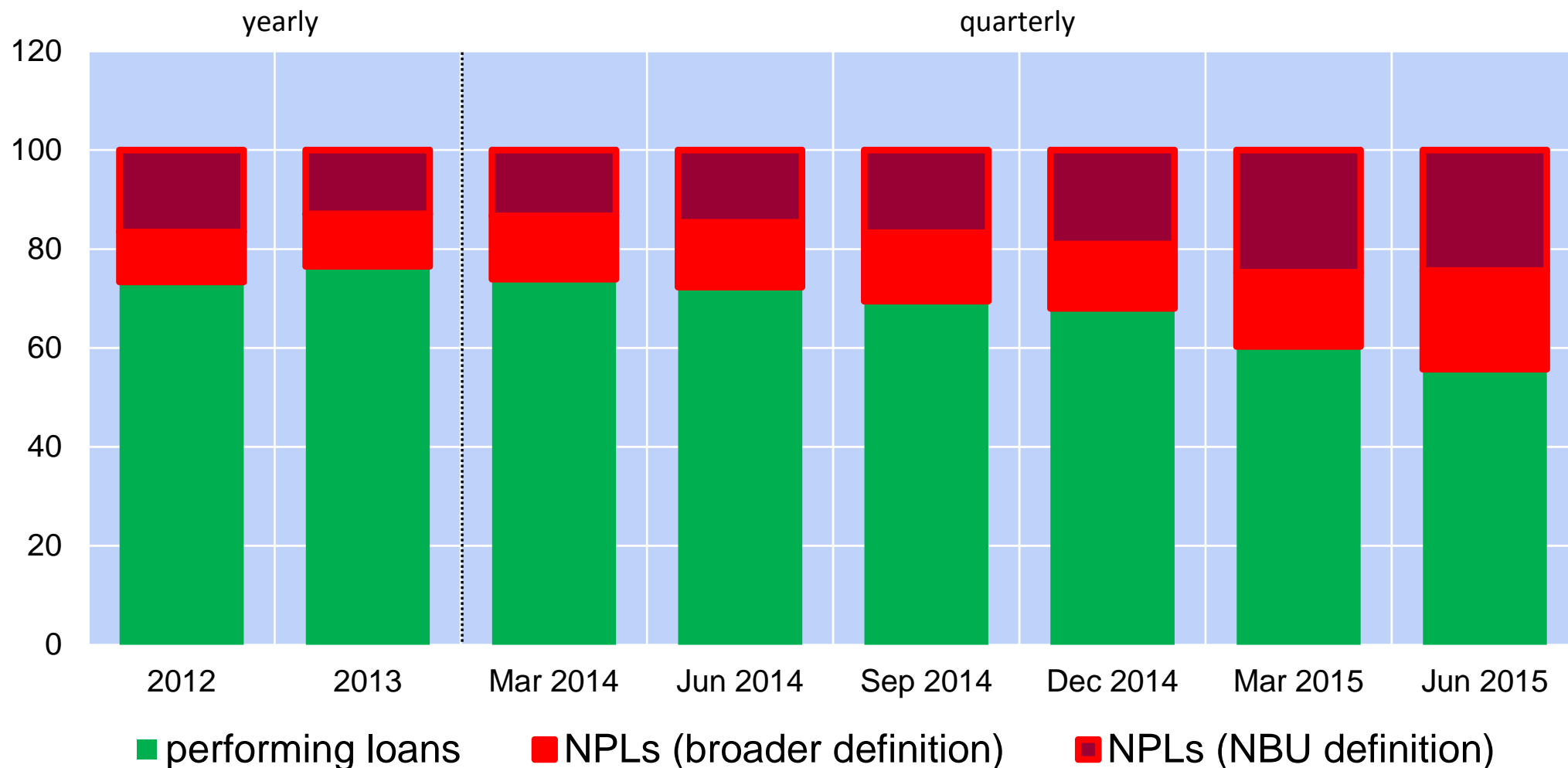
## *Current Ukrainian banking risks*

- **High credit risk**
  - ← Very high NPLs, weakness of economy and hryvnia
- **Persisting negative profitability**
  - ← High provisioning, continued credit crunch
- **Exchange rate risk**
  - ← unstable expectations, capital controls extended, still high infl., high external debt, modest forex reserves
- **Still substantial related-party lending**
  - Largely identified, to be wound down
- **Weak rule of law and creditor rights, endemic corruption**

### *Shock-absorbing factors*

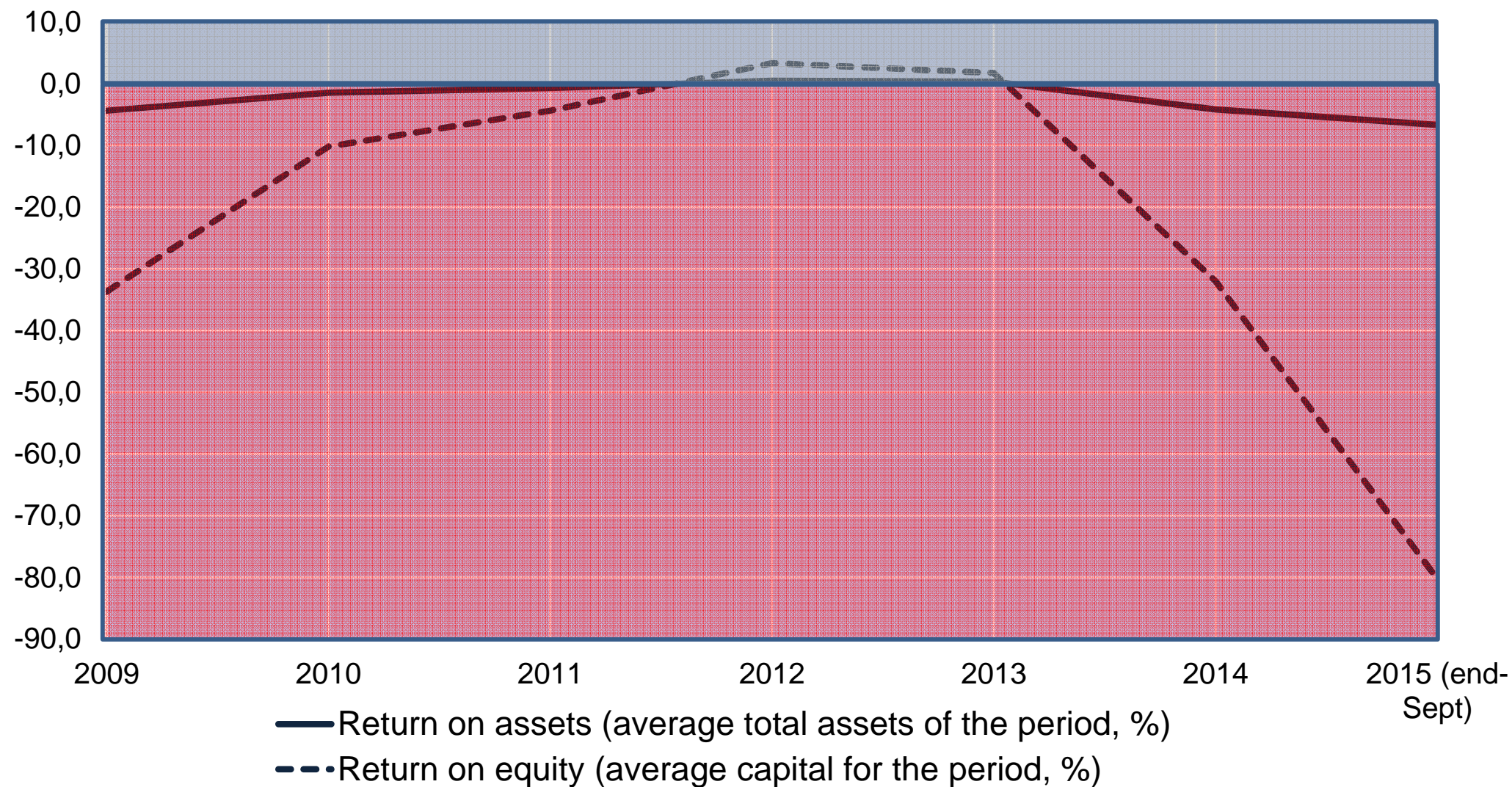
- **Forex reserves** (if still modest: 15% of GDP, 3 import months)
- **Intact IMF financial support (?)** and Western commitment

## Non-performing loans (% of total loans)



Source: *Natsionalny bank Ukraini*

## Profitability



Source: Natsionalny bank Ukraini

# Outlook

- **Fragile recovery of Ukrainian eco. expected from 2016**
- **Recovery strongly influenced by pol. and security factors**
  - Extended domestic political instability/re-escalating geopolitical tensions could put pressure on hryvnia and deposits
- **Turnaround of banking activity will lag real economic recovery**
  - ← Drag of dismal credit quality, lingering uncertainty
  - ↔ Losses probably continuing for some years
- **Authorities grant banks up to end-2018 (forbearance) to fulfill substantial and partly still growing re-capitalization needs**

*Danke!*