NEWSLETTER

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The Banking Sector in Ukraine: Trends and Developments

One of the main areas of economic reforms in Ukraine is the banking sector. Over the last 3 years, the number of institutions on the market has shrunk by 87 due to the decisions of the supervisor, the National Bank of Ukraine. As a result, the number of active banks declined from 180 to currently 93.

While this process of deleveraging was painful for many people in the short term, the long term economic benefits will certainly outweigh these costs. Recent developments in the sector give rise to the hope that a certain revival in lending is near, which would support the economic recovery.

Following the recent nationalisation of Privatbank, with a market share of 21% the biggest bank in the country, the state owns now more than 50% of the banking system. Together with a blanket guarantee for all household deposits at the major state banks, this creates new challenges on the path towards a primarily market driven, sustainable financial system.

Background

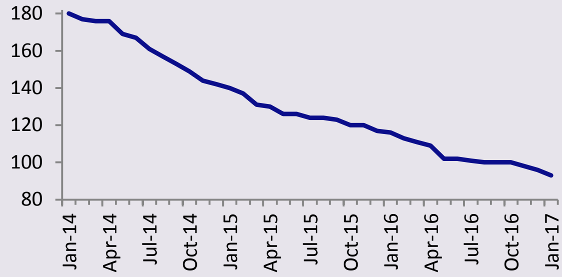
In Ukraine's programme with the IMF, the reform of the financial sector features prominently as a key reform area. The main objective is to restore public trust in the sector, which had deteriorated during the economic crisis of 2014/15, but which exhibited severe structural deficiencies already long before the crisis. One of these deficiencies is the so-called "old banking model" practised by some local owners, were fraudulent related party lending was customary. This created problems in the real sector, where well-connected companies flourished, but also for the depositors of those banks and ultimately for the taxpayer, who was called to pick up the pieces when such banks failed.

Main developments 2014-2016

Since the start of the economic crisis in 2014, the banking sector has shrunk dramatically, which is evidence of a completely new approach by the supervisor, the National Bank of Ukraine (NBU).

Due to problems relating to liquidity and solvency, related-party lending and involvement in illegal activities (e.g. money laundering) many banks failed. Thus, out of 180 banks operating in the beginning of 2014, only 93 continue to operate as of time of writing. This is a reduction of 52% over the course of only 3 years.

Number of active banks



Source: Own calculations based on NBU data

This severe consolidation process was one of the main reasons for the decrease of domestic credit as a share of GDP from 74% in 2013 to 57% in 2015. Thus, the sector´s size is now more in line with regional peers like Russia (56%) and Poland (54%).

Nationalisation of Privatbank

Privatbank, previously co-owned by the oligarch Igor Kolomoisky, is the country´s largest bank with 21% of total assets. Its systemic importance is reflected by the fact that it provides services to almost half of the Ukrainian population (about 20 million citizens). As the bank has the largest network of ATMs and payment terminals in the country, it accounts for 65% of settlements between individuals.

In December 2016, the stress tests conducted by the NBU among all the major banks had revealed higher than previously reported related-party lending and shortfalls in loan-loss provisions in the loan book of Privatbank. The Ministry of Finance estimated its total capital need between UAH 117-148 bn. As share-holders did not inject the necessary capital, the bank was declared insolvent and transferred to the Deposit Guarantee Fund on 18 December 2016. Due to the bank´s systemic importance, the fund sold it shortly after to the government for a symbolic price of 1 hryvnia. The government injected UAH 107 bn through government bonds in late December in order to recapitalise the bank, while the NBU provided liquidity assistance. In order to prevent a panic, the parliament introduced full guarantees for household deposits – a privilege that previously only Oschadbank enjoyed. The whole procedure was positively assessed by all major international partners, as the quick and smooth nationalisation of the country´s largest bank was an important step to safeguard financial stability.

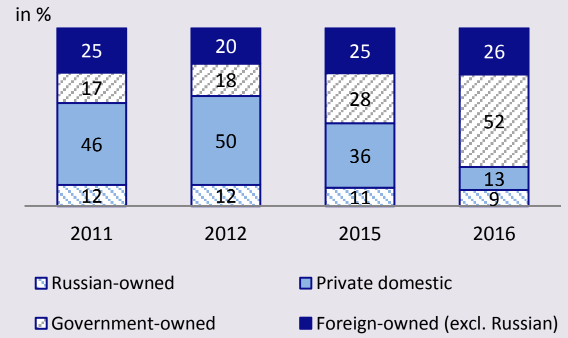
Market shares and concentration

Following the nationalisation of Privatbank, the share of state capital in the banking sector now exceeds 50%. Trailing Privatbank, the next three largest banks

(Oschadbank, Ukreximbank and Ukrgazbank) are also owned by the government. Together these three banks occupy 32% of the banking market. The remaining banks account for slightly less than 50% of the banking sector assets.

This expansion of state banks together with the failure of many other banks helped to increase the market share of the top-5 banks from 40% in 2013 to 57% in 2016. While the pace of consolidation in the banking sector gained speed significantly during the recent years, this process had not raised competition issues so far. The immense share of state capital involved in the sector might, however, have a serious negative impact on the banking sector´s competitiveness.

Market share by ownership



Source: Own calculations based on NBU data

Recovery in lending?

After the sharp decline in lending (both in nominal and real terms) during the crisis, there has been a gradual improvement during 2016. Loans denominated in national currency returned to year-on-year growth in October. While it is too early to speak of a recovery in lending, a gradual stabilisation of the loan book can clearly be observed.

A similar trend is taking place on the deposit side: Deposits denominated in hryvnia now exceed their pre-crisis level. Foreign currency deposits, on the other hand, stopped their fall and have stabilised at a level around half of that before the crisis.

After interests had risen sharply during the crisis (at times they amounted to 24% on new loans), they have decreased gradually since early 2015. Currently, interest rates on new loans are at 16%, those on new deposits at 10% (in Hryvnia).

Outlook

The fundamental changes in the banking sector had undoubtedly painful consequences in the short run (like e. g. lost deposits in the failed banks). However, there will be valuable gains in the long term: taxpayers will be protected from financial risks stemming from the banking sector and the real sector will benefit from a level playing field in terms of access to finance.

Still, it remains to be seen how the new challenges will be addressed: The very high share of state-owned banks accompanied by the promise to provide blanket deposit state guarantees to them is far from ideal. Thus, banking sector reforms in Ukraine are far from over – stay tuned.

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Note: A more comprehensive analysis of the topic is provided by the Policy Briefing PB/21/2016 „The Banking Sector in Ukraine – Trends and Selected Issues“.

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German Advisory Group

The German Advisory Group advises since 1994 the Government of Ukraine on a wide range of economic policy issues. The group is financed by the German Federal Ministry for Economic Affairs and Energy.

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