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Global financial crisis: impact on Ukraine's banking sector

By the end of September 2008 the global financial crisis has severely hit Ukraine's banking sector through folding of external financing. It immediately revealed key foibles of the Ukrainian banks, namely the significant share of foreign currency credits unmatched with foreign currency revenues of credit-holders, and the dependence on external financing. The impact of the crisis was further amplified by the loss of confidence in the banking system due to problems in Prominvestbank.

In October, a swift withdrawal of deposits in hryvnya, when banks lost UAH 21.6 bn or approximately 10% of hryvnia stock during the month, shook banking stability and credibility. Total amount of deposits, including both deposits in national and foreign currencies, shrank by 2.7% mom or UAH 9.1 bn. In November, that tendency continued, and the national currency deposits withdrawals constituted UAH 10.9 bn (5.2% mom). However, total deposits rose by UAH 7.9 bn due to devaluation effect as it pushed up the amount of foreign currency deposits measured in hryvnya.

Interestingly, households' deposits withdrawals did not lead to equivalent increase in cash outside banks that grew by only UAH 12.7 bn in October. Probably, withdrawn funds were used for payments on credits in foreign currency as respective obligations increased due to national currency devaluation. Also, people might convert hryvnya into foreign currency deposits or use it for durable goods purchases. For example, passenger cars sales accelerated by 14% in October compared to previous month.

Banks reacted on shaken stability by increase in deposits interest rates. The average deposit rate grew by 0.7 p.p. to 9.5% p.a. in October, e.g. interest rates on term deposits increased by 1.6 p.p. to 11.4% p.a., and on foreign currency deposits by 1.0 p.p. to 7.4% p.a. The latter signals about the particular interest of banks in foreign currency, likely needed to meet external credit obligations.

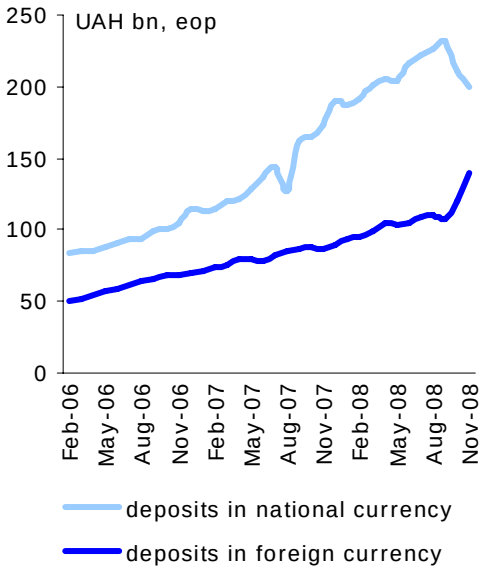
On the credit side, real sector problems and population incomes deceleration along with increased likelihood of being unemployed in face of production folding seriously restricted possibilities of active bank operations. Moreover, crediting was legislatively restricted almost for two months by the NBU Resolution #319. As a result, significant slowdown of crediting in national currency from UAH 6.6 bn in September to UAH 1.7 bn in October and UAH 3.3 bn in November occurred. In face of deposit rates increase financial resources have become even more expensive: interest rate of credits increased by 1.9 p.p. to 17.1% p.a. in October, limiting possibilities for assets widening. Central bank revised its policy towards crediting in early December. The NBU Resolution #413 abolished Resolution #319 meaning credit restrictions' cancellation. Moreover, due to high risks of non-payoffs on credits the NBU recommended to revise interest rates on given credits towards their reduction taking into account history of loan servicing.

Problems of bank runs and restricted crediting were further aggravated by hryvnya devaluation. Raised hryvnya supply after deposit withdrawals added to increased demand for foreign currency in the country as foreign capital flew and exports receipts decelerated. Currency weakening raises risk of future non-payments on domestic credits in foreign currency.

Besides exchange rate risk, another potential threat for Ukrainian banks is concerned with high share of external financing in their foreign currency liabilities. In current terms of credit crunch and low credit ratings of the country and domestic banks, the probability of non-refinancing increases. As maturities of credits and liabilities in Ukrainian banks are highly mismatched, the latter imposes significant risks for serving external obligations.

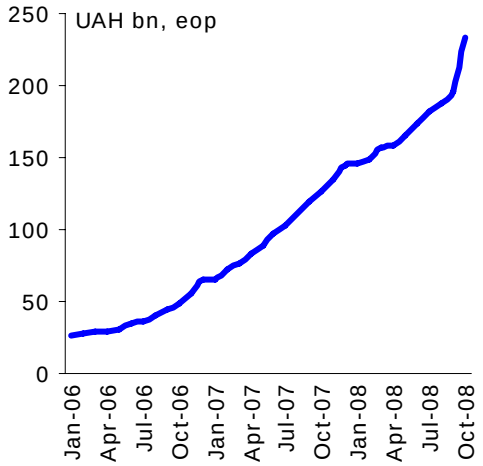
As for third quarter, net income and profit of banks continued to rise by 6.8% qoq and by 8.9% qoq respectively, though already decelerating as compared to the second quarter. Moreover, as on December 1 expenses' growth rates outweighed incomes' ones. In result, banking system seems to face significant worsening with problems exposure expected next year.

Deposits



Source: NBU

External debt of banks



Source: NBU

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Quarterly trends

National accounts		Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08
GDP	UAH bn	97.5	119.4	123.6	105.4	124.1	150.4	157.7	137.6	165.1	197.4	212.8	186.6	232.5
GDP (real)	% yoy	3.4	1.4	1.7	4.1	6.8	6.9	9.5	8.9	8.6	6.2	7.4	6.5	6.5
Household consumption (real)	% yoy	17.7	17.0	17.1	20.2	18.2	11.8	9.9	14.7	15.5	15.2	19.0	22.0	13.3
State consumption (real)	% yoy	0.0	1.0	4.0	9.6	5.8	5.8	1.0	0.8	6.2	4.4	2.4	1.0	1.5
Gross fixed capital formation (real)	% yoy	-0.5	0.2	0.3	19.9	19.3	17.9	18.3	24.4	23.5	18.9	23.8	14.7	6.3
Exports of goods and services (real)	% yoy	-14.0	-12.7	-15.5	-14.9	-9.6	3.2	1.0	4.9	5.2	0.1	5.6	0.9	8.9
Imports of goods and services (real)	% yoy	3.2	3.9	-0.9	10.7	0.9	8.3	6.4	12.9	19.6	13.7	27.2	20.2	25.6
Agriculture, hunting, forestry (real)*	% yoy	8.3	2.6	-7.2	3.8	2.8	-5.6	8.1	4.8	6.8	-9.3	7.1	0.4	-0.4
Manufacturing industry (real)*	% yoy	1.8	-1.1	2.0	-1.5	6.1	7.3	7.2	15.0	13.2	13.1	4.4	8.7	9.0
Construction (real)*	% yoy	-11.3	-8.5	-7.5	0.1	0.8	1.4	4.2	13.3	8.2	12.7	5.8	-1.5	-6.4
Trade, repair services (real)*	% yoy	-10.7	-11.7	-11.9	6.2	16.4	20.0	21.9	14.3	17.5	25.3	15.0	15.7	10.9
Transport (real)*	% yoy	5.7	2.8	7.8	4.9	7.7	9.4	5.3	7.0	5.6	8.0	10.2	10.1	10.6
Balance of payments														
Current account balance	USD bn	0.6	0.4	-0.1	-0.8	0.0	0.5	-1.4	1.2	-0.8	-0.5	-3.5	-3.6	-2.8
Current account balance	% of GDP	3.2	1.7	-0.4	-3.7	0.0	1.7	-4.3	4.4	-2.4	-1.2	-8.1	-9.6	-7.9
Trade balance in goods	USD m	-236	-1131	-788	-1353	-935	-884	-2022	-1735	-1701	-2684	-4452	-4321	-3562
Trade balance in services	USD m	392	1035	191	219	506	1054	347	103	512	1689	392	261	526
Current transfers	USD m	694	745	780	622	790	851	910	825	968	1099	1183	966	957
Direct investment (FDI)	USD m	365	477	6474	1053	1389	1636	1258	1709	1934	3927	1648	2387	3083
Portfolio investments	USD m	923	90	1347	4	-141	370	3350	1816	1477	517	1844	225	129
Gross international reserves	USD bn	13.1	14.3	19.4	17.3	17.6	19.1	22.3	23.5	25.6	30.6	32.5	33.2	35.5
Exchange rate(market), UAH/USD	aop	5.08	5.00	5.02	5.06	5.02	5.02	5.03	5.04	5.02	5.01	5.04	5.03	4.79
Exchange rate(official), UAH/USD	aop	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	4.96
Fiscal indicators														
Consolidated fiscal revenues	% of GDP	35.1	31.5	31.0	31.2	31.7	31.9	32.8	33.3	32.8	30.8	31.1	32.5	42.7
Personal income tax	% of GDP	4.4	3.9	4.2	4.4	4.6	4.1	4.1	5.1	5.3	4.9	4.8	5.1	6.9
Enterprise profits tax	% of GDP	5.9	5.3	6.3	3.4	4.6	4.3	6.7	3.8	4.1	4.1	6.4	4.1	5.2
Value-added tax	% of GDP	9.2	7.9	7.3	9.2	9.2	9.7	9.3	10.4	9.8	8.7	7.6	10.5	14.9
Excise tax	% of GDP	2.0	2.0	1.7	1.8	1.7	1.5	1.5	1.8	1.7	1.6	1.3	1.5	1.8
Consolidated fiscal expenditures	% of GDP	36.4	28.1	41.7	30.9	32.8	29.4	36.6	28.4	31.0	29.6	36.7	29.5	42.2
Current expenditures	% of GDP	33.6	24.0	34.2	28.9	29.7	24.9	29.2	26.9	28.4	25.9	27.3	28.6	37.3
Capital expenditures	% of GDP	2.7	4.1	7.5	1.9	3.2	4.5	7.4	1.6	2.6	3.7	9.4	0.9	5.0
Consolidated fiscal balance	% of GDP	1.0	-5.0	6.2	-0.4	1.1	-2.4	4.0	4.7	1.7	1.2	-6.2	3.0	0.5
Privatisation receipts	% of GDP	0.6	0.6	16.0	0.1	0.1	0.1	0.1	0.5	0.5	0.3	0.4	0.1	0.1
Labour market														
Average wage (real)	% yoy	19.0	19.6	26.4	23.8	22.6	18.8	11.3	14.7	13.9	14.9	15.7	13.8	7.1
Household income (real)	% yoy	28.0	19.4	18.9	22.1	18.6	20.3	16.3	17.5	17.4	14.9	16.4	19.0	10.1
Unemployment rate (ILO methodology)	% cum	7.1	5.2	7.8	7.9	6.8	6.4	6.8	7.4	6.6	6.2	6.4	7.1	6.2
Banking system														
Monetary aggregate M0	% yoy cum	39.1	31.1	42.2	36.2	25.3	23.7	24.5	22.9	30.4	36.4	48.2	48.4	48.8
Monetary aggregate M2	% yoy cum	37.4	31.3	53.9	39.2	36.6	36.7	34.3	38.6	40.7	47.8	50.8	52.7	48.8
Household deposits in national currency	% yoy cum	31.6	30.4	90.8	54.6	41.1	39.7	37.3	50.7	56.3	64.8	71.9	68.8	68.2
Household deposits in foreign currency	% yoy cum	45.4	46.4	59.1	54.5	66.2	64.3	57.5	52.3	43.8	38.4	32.5	35.2	32.9
Com. bank credits in national currency	% yoy cum	32.6	43.4	58.7	59.8	53.7	49.0	52.3	52.4	57.2	60.7	72.7	81.2	70.7
Com. bank credits in foreign currency	% yoy cum	36.8	47.1	66.3	72.0	82.1	90.4	95.4	98.9	97.4	91.0	75.4	71.3	57.9
Long-term com. bank credits	% yoy cum	53.0	70.1	84.6	87.6	86.7	76.6	79.5	84.1	86.5	87.9	85.7	84.8	67.2
Long-term com. bank credits	% of total	56.1	59.7	61.8	63.1	63.4	63.5	64.9	65.8	67.3	68.2	69.2	69.1	68.6
Average lending rate on national cur. credits	% p.a.	15.4	15.4	16.4	15.8	15.5	14.6	15.1	14.0	13.9	13.7	14.0	14.6	17.3
Average lending rate on foreign cur. credits	% p.a.	11.0	11.3	11.7	11.5	11.3	11.3	11.5	11.5	11.4	11.3	11.1	10.8	11.4

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters, IER estimates

* change in value added

Notes:

yoy year on year change **p.a.** per annum