



RECENT DEVELOPMENTS IN THE UKRAINIAN BANKING SECTOR

Political upheavals in Ukraine that started in 2014 have caused a severe deterioration of the country's economic situation, combined with the decline in the socio-economic well-being of Ukrainian citizens. The Euro-maidan protests resulted in the ouster of President Yanukovich, which led to Russia's annexation of Crimea and the armed conflict in the Donbass region. These dramatic events have seriously affected Ukraine's economy triggering sharp GDP fluctuations. In fact, the country's GDP fell by 6.6% and 9.8% in 2014 and 2015, respectively, and grew by 2.3% and 2.0% in 2016 and 2017, respectively. Moreover, the country's national currency, hryvnia, depreciated from around 8 hryvnia per \$1 at the beginning of 2014 to about 29 hryvnia per \$1 at the beginning of 2018, which is nearly a 250% depreciation. Meanwhile, inflation grew by 24.9%, 43.3%, 12.4% and 13.7% in 2014, 2015, 2016 and 2017, respectively. These unfavorable conditions have significantly reduced the stability of the country's banking sector, which seriously depends on the level of political and economic volatility.

According to the National Bank of Ukraine (NBU), at the beginning of 2014, when a relatively stable period in the country was coming to an end, the total assets of its banking sector were 1,277.51 billion hryvnia (\$159.6 billion). Subsequent financial-economic difficulties, such as the liquidity shortage and a high level of bad loans led to the closure of 22 banks reducing the number of banks in the country to 158. Despite a smaller number of banks, the nominal value of the sector's total assets grew by 3.07% to 1,316.72 billion hryvnia (\$81.4 billion). However, it is worth mentioning that the growth was due to the revaluation of banks assets in foreign currency because of the national currency's depreciation. Thus, the real growth of assets (excluding inflation) was negative reaching 17.48%. In 2015, the crisis in the banking sector deepened, and the number of banks plunged to 117, while the nominal amount of the sector's total assets fell by 4.7% decreasing by 33.52% in real terms. In 2016-2017, the situation in the banking sector still had a downward trend. In 2016, the number of banks fell to 96, further decreasing to 83 in 2017.

The deposit outflow and the growth of non-performing loans (NPLs) were among other main reasons for the decline of bank assets.

The sharp depreciation of hryvnia and high inflation decreased the population's confidence both in the national currency and in the banking system. Because of reduced confidence, the population started withdrawing their savings from the banks. For example, according to the NBU, the deposits in the national currency fell by 28.21% from 365.96 billion hryvnia (\$45.74 billion) in 2013 to 262.71 billion hryvnia (\$16.24 billion) in 2014. At the same time, the regulator shows that the foreign currency deposits calculated in hryvnia grew by 35.81% from 336.95 billion hryvnia in 2013 to 455.49 billion hryvnia in 2014. However, it is important to note that the growth in the foreign currency deposits was mainly due to the depreciation of hryvnia, while the same deposits calculated in the U.S. dollar actually had a negative growth rate, falling by 32.41% from \$42.19 billion in 2013 to \$28.24 billion in 2014. After a significant decrease in 2014, the deposits in the local currency were relatively stable in the next two years. In 2015, the deposits in the local currency grew by 0.23%, while in 2016 there was a 1.07% decrease. Meanwhile, the foreign currency deposits calculated in the U.S. dollar fell by 71.83% to \$20.71 billion in 2015 and grew by 6.17% to \$21.98 billion in 2016.

It is worth mentioning that the deposit base decreased despite the fact that the government introduced some restrictions to halt the withdrawal of deposits. For instance, in July 2014, the NBU introduced a regulation introducing the daily withdrawal limits of 150,000 hryvnia (\$9,317) in the national currency and 20,000 hryvnia (\$1,250) in the foreign currency per individual. Later, the limits were increased several times to reach 500,000 hryvnia (\$19,230) in the national currency and 50,000 hryvnia (\$1,923) in the foreign currency in March 2016. In July 2016, the limit for withdrawing deposits in the national currency was abolished, while the limit for withdrawing deposits in the foreign currency was increased to 250,000 hryvnia (\$9,615) in September 2016 only to be eventually removed in August 2017. During that time, the NBU tried to decrease the deposit outflow not only by introducing the withdrawal limits but also by supporting the national currency. For instance, in August 2014, the regulator introduced a prudential norm for the mandatory sale of foreign exchange proceeds, obliging all exporters to

sell 100% of their foreign exchange earnings in the Ukrainian foreign exchange market. The requirement was reduced to 75% and 65% in September 2014 and May 2016, respectively.

According to the International Monetary Fund, the share of NPLs in Ukraine has been gradually increasing since 2013, when it was equal to 12.9% of the total assets of the banking system. The NPLs share grew to 19.0%, 28.0% and 30.5% in 2014, 2015 and 2016, respectively. At the end of 2017, the share of NPLs reached 54.5% of the total assets, which was the record high rate of NPLs in the world. This number indicates a high probability that more than a half of the total loans of the banking sector will not be returned, putting a serious pressure on the sector's profitability and stability. The reason for the increase in NPLs was a serious decline of the population's income due to high inflation, the depreciation of the national currency, and the fall in the total output of the country. It is worth mentioning that in 2016 the Ukrainian authorities adopted the Law on Financial Restructuring, which aims to decrease the number of NPLs. However, in the end of 2017 the amount of restructured NPLs was only 8 billion hryvnia (\$307 million) out of about 500 billion hryvnia (\$19 billion) of total NPLs. Hence, the steps that the government has taken are not enough to decrease the number and amount of NPLs.

Overall, it is clear that the problems of the Ukrainian banking sector will not be solved in the near future. However, it can be expected that the sector will perform better in 2018 than in the previous years because of a better macroeconomic situation in the country. It is expected that the economy will grow by 3.4% in 2018, which is significantly higher than in 2014-2017, meaning that more intensive economic activity will increase demand for loans. A higher GDP will increase the average household income, which in its turn will allow people to return some of their bad loans. In addition, the NBU expects that inflation will be about 8.9% in 2018. A lower inflation will allow the Ukrainian banks to set their interests on loans lower, which will also increase demand for deposits. Thus, provided there are no more serious external and internal political and economic disturbances, the country can gradually stabilize its banking sector.

Politics, Foreign Affairs and Security

- During the trilateral meeting between Defense Minister of Azerbaijan Colonel General Zakir Hasanov, Minister of National Defense of Turkey Nurettin Canikli and Minister of Defense of Georgia Levan Izoria held in the Turkish city of Giresun, the parties discussed prospects of military cooperation, including activities aimed at ensuring peace, stability and economic development in the region.
- During the high-level international conference on Afghanistan titled “Peace Process, Cooperation in the Sphere of Security and Regional Interaction” held in Tashkent, the representatives from 25 countries, the European Union, the UN and NATO discussed possible ways to find a peaceful solution to the Afghan civil war. On the sidelines of the conference, the foreign ministers of Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, and the deputy foreign minister of Turkmenistan met with High Representative of the European Union for Foreign Affairs and Security Policy Federica Mogherini to discuss relevant topics of mutual interest, including prospects of economic development and regional cooperation in the fields of trade, investment and technologies.
- During his official two-day visit to Ashgabat and Baku, President of Iran Hassan Rouhani met with his Turkmen and Azeri counterparts Gurbanguly Berdimuhamedov and Ilham Aliyev. The Iranian and Turkmen presidents discussed a range of bilateral and regional issues. The parties signed 13 memoranda of understanding on culture, art, science and education, trade cooperation, agriculture, industry, air transport, and political cooperation. The Iranian and Azeri presidents discussed prospects for further boosting economic cooperation and signed a document on oil and gas projects in the Caspian Sea.
- During talks in Tashkent, Kyrgyz Foreign Minister Erlan Abdyldaev and his Uzbek counterpart Abdulaziz Kamilov signed the Cooperation Program for 2018-2019 between the foreign ministries of the two countries. The sides also discussed actual topics of the bilateral and regional agendas.
- During his official visit to Dushanbe, President of Poland Andrzej Sebastian Duda met with President of Tajikistan Emomali Rahmon to discuss bilateral relations and exchanged views on certain topical issues of regional and international importance.

- According to the Deputy Commander of the Russian Aerospace Forces, Major General Andrei Prikhodko, the new Russian upgraded air defense missile has been successfully tested at the Sary Shagan range in Kazakhstan. The missile successfully accomplished its mission hitting a hypothetical target at the stated time.

Economy, Finance and Energy

- According to the Finance Ministry of Belarus, the country’s external debt totaled \$16.4 billion decreasing by \$278.8 million, or 1.7%, from the beginning of the year. In January-February 2018, the external state borrowings totaled \$742.8 million, including \$600 million in Eurobonds.
- According to the Central Bank of Azerbaijan, the current account surplus of the country’s balance of payments in 2017 amounted to \$1.7 billion compared to the current account deficit of \$1.36 billion in 2016. The current account surplus of Azerbaijan’s oil and gas sector stood at \$7.4 billion in 2017 compared to \$4.4 billion in 2016.
- According to the Government of Belarus, the country reduced the customs duties on oil and petroleum products, which are exported beyond the customs territory of the Eurasian Economic Union. The export duty on crude oil was reduced from \$119.5 to \$111.4 per ton. The export duty on straight-run gasoline was cut down from \$65.7 to \$61.2 per ton, with the export duty on commercial gasoline going down from \$35.8 to \$33.4 per ton.
- According to Managing Director of the North Caspian Operating Company Bruno Jardin, 1.5 million tons of sulfur has been extracted from oil produced at the Kashagan field since the start of production. It is also noted that the company has exported more than 250,000 tons of sulfur.
- According to the Government of Turkmenistan, President Gurbanguly Berdimuhamedov approved the program for the development of the economic, financial and banking systems for 2018-2024. The program focuses on the policy of gradual transition to market economy.
- According to the Exporters’ Assembly of Turkey, the country’s exports increased by 10.5% amounting to \$159.923 billion over the last 12 months. The exports for March 2018 increased by 11.5% to \$15.106 billion compared to the same period of 2017. This figure was the highest monthly one

during the entire history of the country’s exports. Turkey’s exports amounted to \$40.727 billion over the first three months of 2018, which is 10.4% more than in the same period of 2017.

- Prime Minister of Russia Dmitry Medvedev signed a decree to allocate funds for financing the priority activities of the “Digital Economy of Russia” program. According to the document, 3.04 billion rubles (\$53.14 million) would be allocated from the Reserve Fund for the implementation of planned program activities.

Society and Culture

- President of Russia Vladimir Putin has declared 28 March a day of mourning in honor of the victims who perished in a shopping mall fire in the Siberian city of Kemerovo. According to official accounts, the blaze claimed the lives of 64 people, including 41 children, with another 79 injured.
- During her official visit to Tashkent, Head of the United Nations Regional Center for Preventive Diplomacy for Central Asia (UNRCCA) Natalia Gherman met with Foreign Minister of Uzbekistan Abdulaziz Kamilov to discuss possible ways of overcoming transboundary water issues in Central Asia, as well as the UNRCCA projects on the use of water resources of the Amudarya and Syrdarya rivers.
- According to the Defense Ministry of Russia, the country’s Aerospace Force successfully launched the Soyuz-2.1V rocket from the Plesetsk space center in the northern Arkhangelsk region. The rocket is carrying into space a satellite, which will serve the needs of the Defense Ministry.
- The United Nations Development Program (UNDP) and the Women’s Committee of Uzbekistan launched a new project directed at empowering women to participate in public administration and socio-economic life of the country. The new project should assist the Government of Uzbekistan in implementing the state policy on supporting women and protecting their rights and legitimate interests.
- The Central Election Commission (CEC) of Azerbaijan registered 1,285 observers to monitor the April 11, 2018 presidential election. It is noted that the election process will be observed by representatives of 51 international organizations. In addition, the CEC registered 53,900 local observers.