National Bank of Ukraine

The emergence of macroprudential policy in Ukraine

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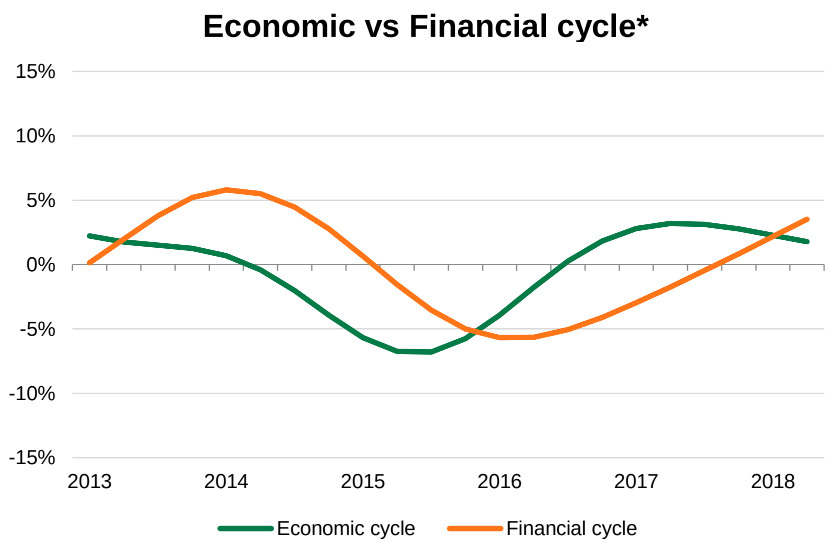
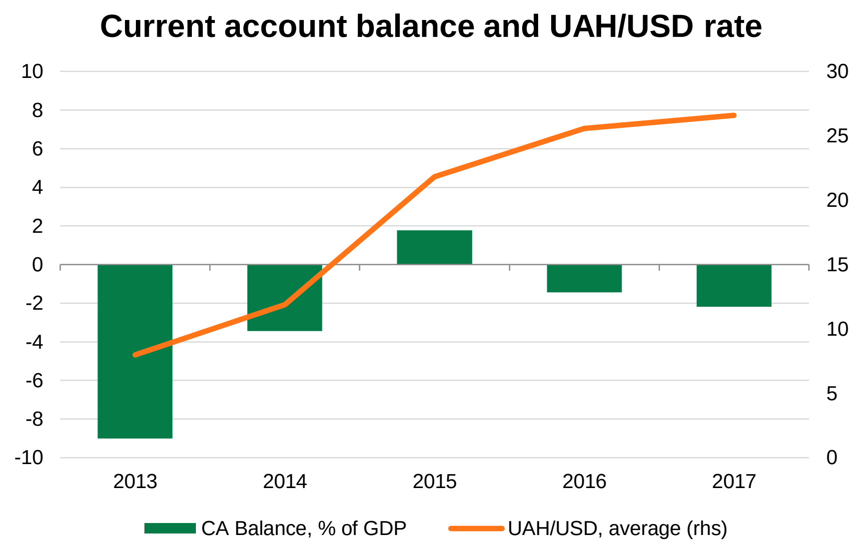
Summary

- Without established macroprudential policy framework, NBU was not able to contain the build-up of systemic risks. Moreover, microprudential supervision was often formalistic and fragmentary which made financial institutions vulnerable.
- In 2014, the crisis driven by external misbalances and a war in the east of Ukraine rapidly spread to the vulnerable banking sector as liquidity, credit and profitability risks materialized.
- Economic crisis of 2014-16 had long-lasting consequences, required a decisive NBU and government intervention, including funds injection into Privatbank, and led to huge fiscal and economic losses.
- NBU cleaned up the banking sector by resolving more than half of all banks, the banking sector is now liquid and solvent.
- However, NBU is aware that local banks continue to face certain challenges (albeit on a much lower scale) and a comprehensive approach is needed to prevent accumulation of systemic risks in the future.
- NBU is close to publishing its strategy of macroprudential policy that provides clarity on its approach to monitoring of systemic risk and crisis prevention.

Macro background



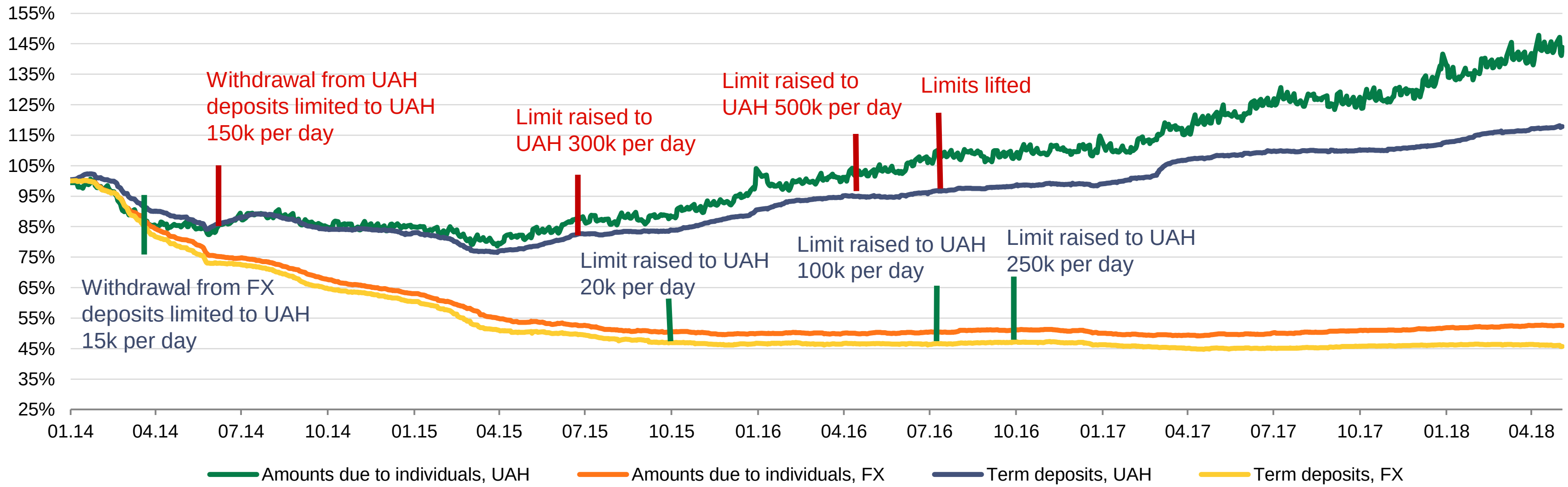


** Real GDP yoy (economic) and credit-to-GDP (financial) to HP filter trend*

- In 2014-16, Ukraine faced the most significant crisis since independence. Huge economic misbalances and a war in the east triggered the meltdown.
- GDP fell by c. 15% over 2014-15, undermining solvency of banks and its borrowers.
- Accumulated current account deficit resulted in a sharp hryvnia depreciation. This had a detrimental impact on local banks.

Ample deposit outflows triggered liquidity crisis

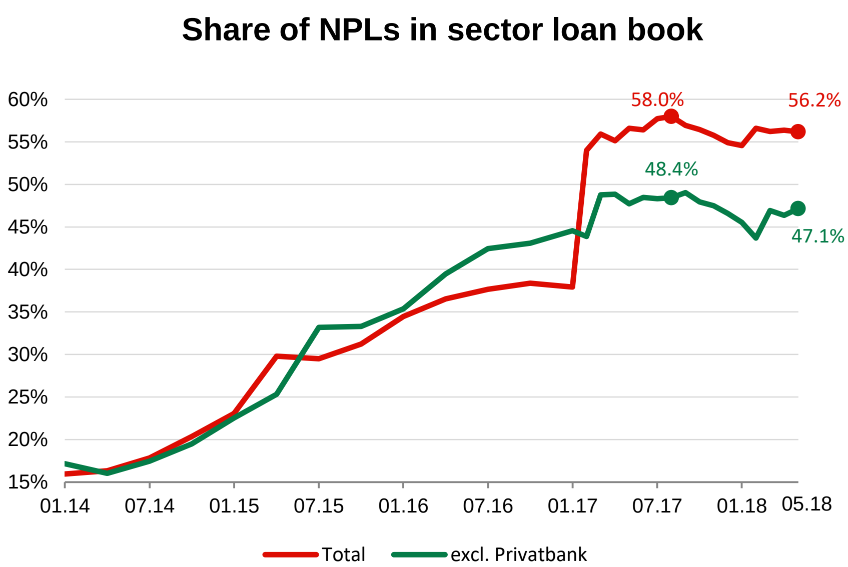
Deposits outflow and preventive measures, December 2013 = 100%*

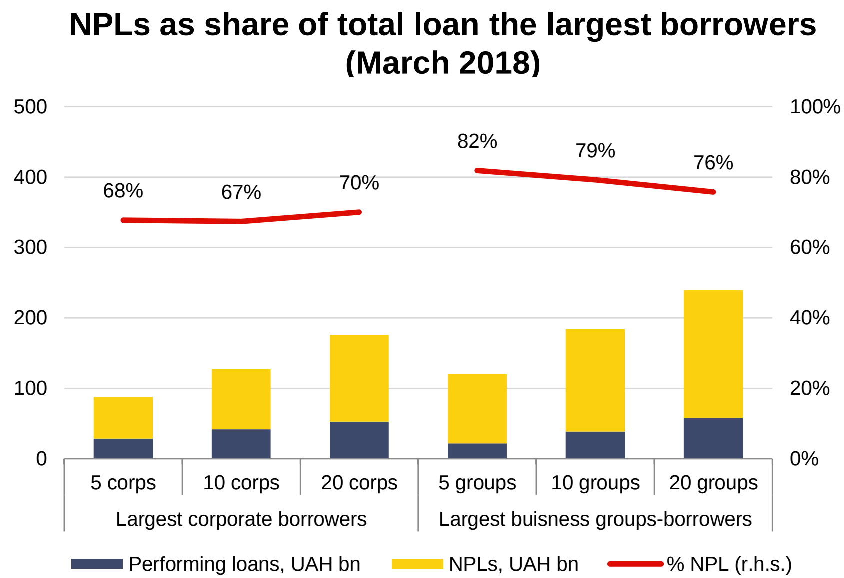


** Chart is based on data of banks that were solvent as of 1 July 2017.*

- Over 50 % of total FX deposits were withdrawn and never returned to banks
- Ukraine was one of the few countries that set limits on deposits withdrawal to contain liquidity crisis.

NPLs spiked close to 60% in corporate and retail segments

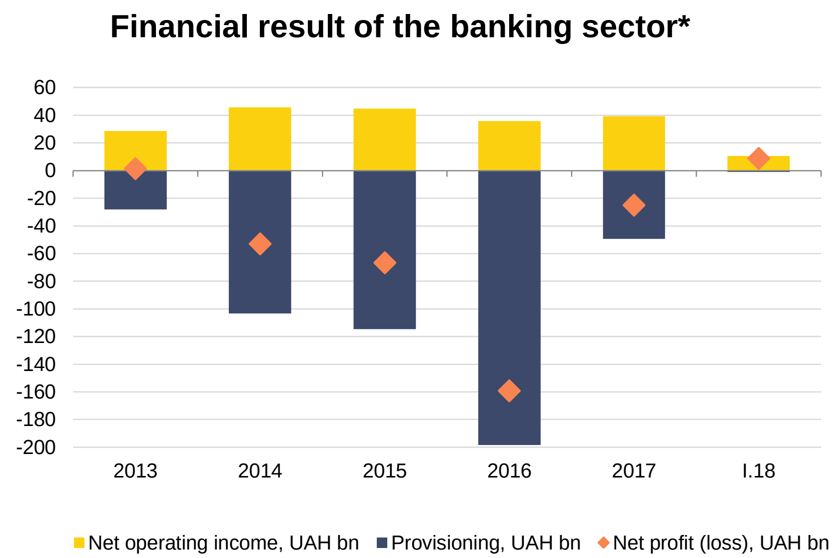


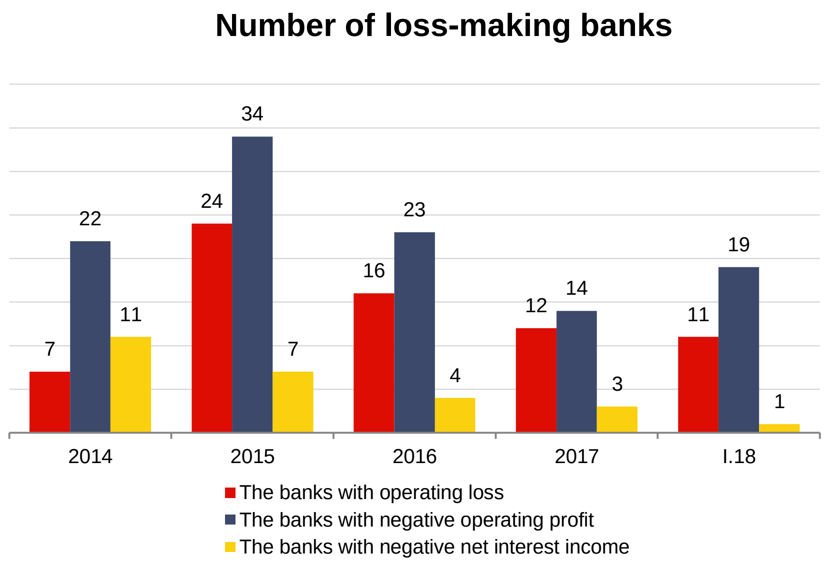


** Banks that were solvent as of 1 April 2018 (excluding Privatbank).*

- Loans quality worsened significantly due to 2 factors:
  - NBU forced banks to reveal the true quality of their loan book following sector-wide AQR
  - Many borrowers failed to service debts due to solvency / liquidity problems
- The largest business groups were the least diligent borrowers (NPLs exceeded 70% of their debts).
- NPLs in Ukraine are close to 55% - the largest share globally

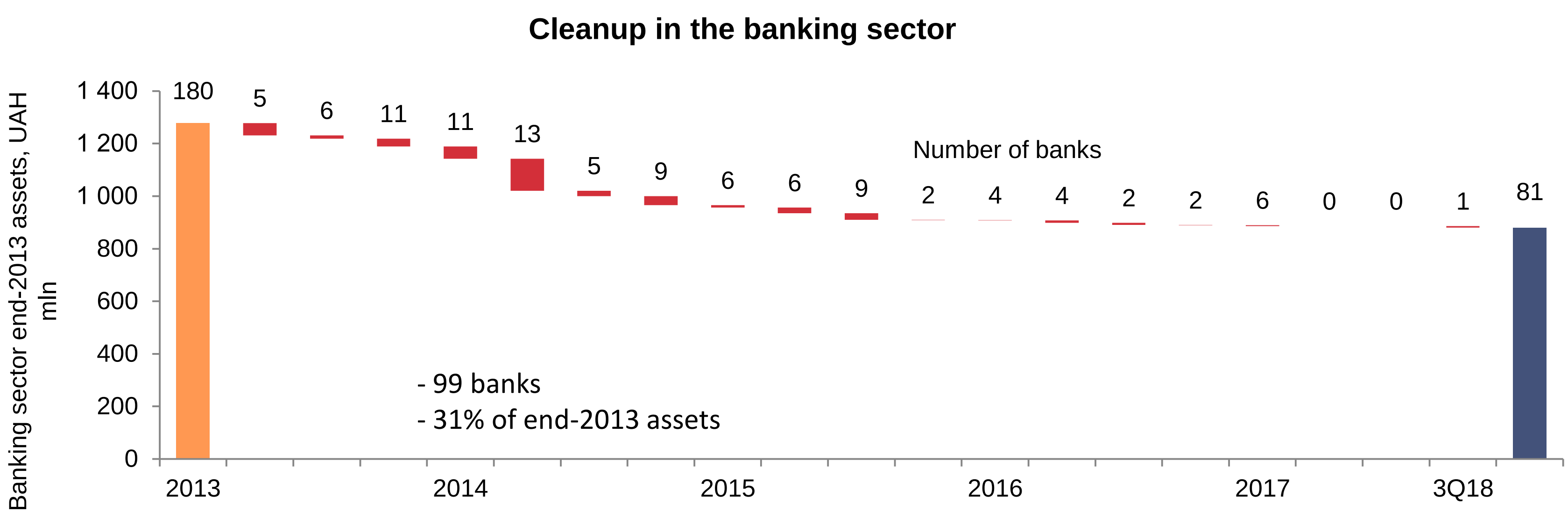
Banks losses were huge driven by provisions





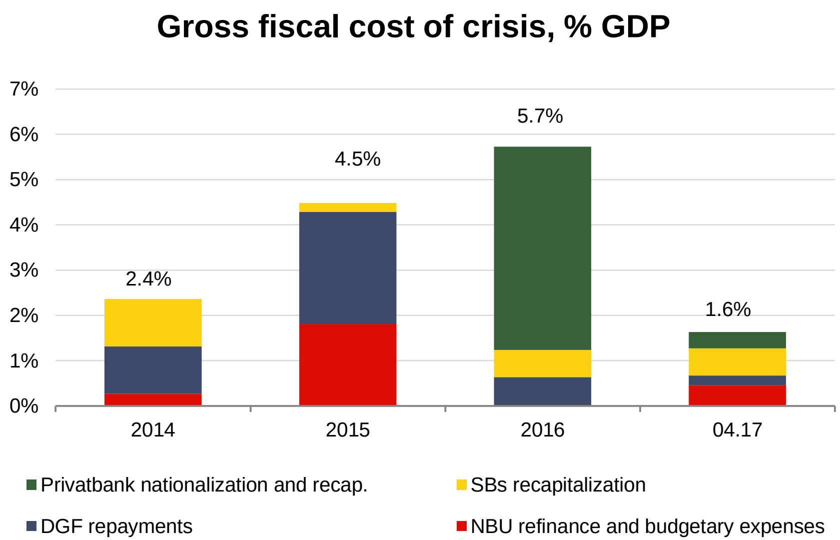
- Since 2013 banks remained loss-making. Total accumulated loss exceeded equiv. of USD 15 bn.
- The sector will report its first post-crisis profit in 2018.
- Some banks are still loss-making

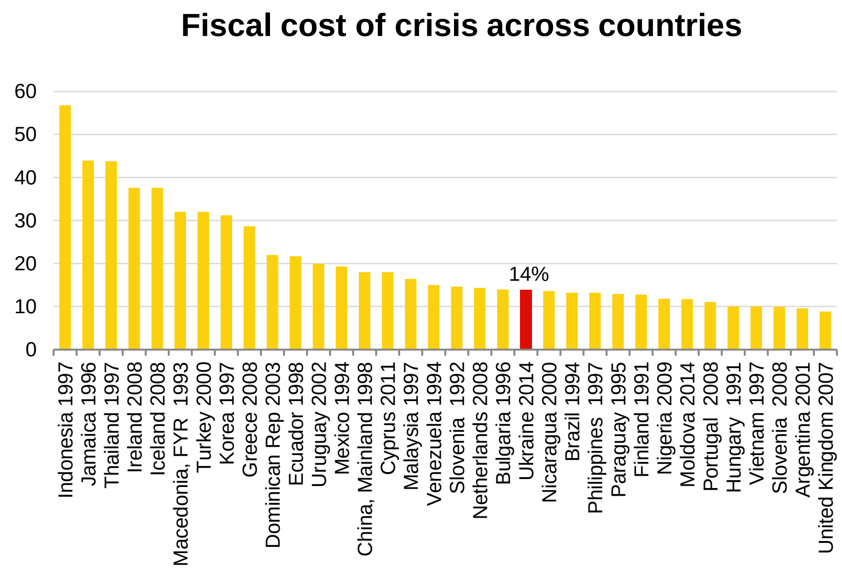
Sector clean-up was extensive



- More than half of all banks representing 1/3 of the total sector assets were resolved during the crisis.
- Additionally, Privatbank, Ukraine's largest bank (c. 21% of total assets and 32% of retail deposits), was nationalized in late 2016 as former shareholders failed to provide capital. Government injected an equivalent of c. USD 6 bn to keep it afloat.
- Today the banking sector is liquid and solvent.

Crisis had a long-lasting impact on economy





- Total fiscal cost of the crisis amounted to 14% of GDP of the respective years.
- Meanwhile, the direct loss of the economy totaled 38% of GDP.

History of macroprudential regulation

- Before the crisis NBU did not have an established macroprudential policy framework. Preventive macroprudential instrument were not used to contain the build-up of systemic risks.
- Moreover, the micro supervision was also ineffective.
- NBU’s response to the crisis was reactive.
- By the end of 2018 NBU plans to finalize and publish macroprudential strategy.

Existing macroprudential measures

- ✓ Moratorium on lending to households in foreign currency (was implemented since 2009 as a response to the crisis of 2008-09)
- ✓ Limits on open currency position
- ✓ Obligatory use of an NBU-set floors on PD and LGD parameters
- ✓ Limits on large exposures
- ✓ Limits on related-party lending

Current focus of macroprudential regulation

Key challenges (systemic risks) faced by local banks:

- Short funding maturity and a related liquidity risk
- High dollarization in the banking sector
- Dominant role of state-owned banks in the sector
- Rapid expansion of consumer lending
- High concentration of credit risk in certain economy sectors and at the largest business groups
- High volumes of related-party lending
- High NPL ratio

Strategy of macroprudential regulation

Additionally to the existing measures the NBU plans to implement macroprudential instruments to prevent future crises.

Instrument	2018	2019	2020
Capital instruments			
Capital conservation buffer			gradual phase-in from 0.625 to 2.5% in 2023
Countercyclical buffer			up to 2,5 % depending on the economic cycle phase
Systemically importance buffer			1 to 2 % depending on the importance of the bank
Leverage ratio			
Liquidity instruments			
Liquidity coverage ratio		gradual implementation from 80 to 100%	
Net stable funding ratio			
Other instruments			
Detailed information disclosure			
Monitoring of the IFRS/prudential provisions			
Sectoral instruments			

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