



EBCI

Vienna Initiative



UA financial sector reform: Professionally sailing through turbulent waters

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Warsaw, 18 November 2015



KEY MESSAGES TO RETAIN

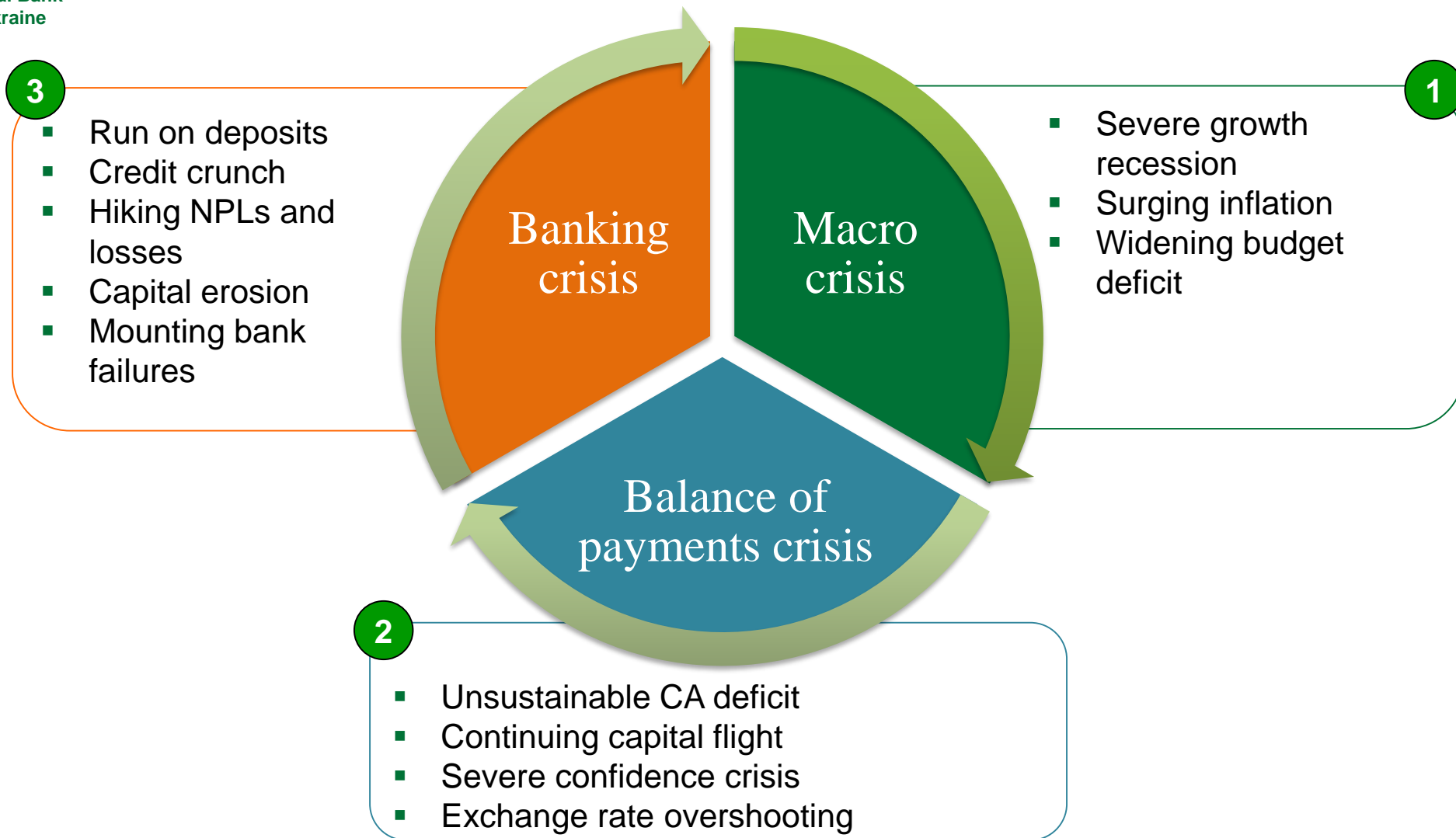
- 1. Ukraine has successfully overcome the Perfect storm in the financial sector:**
 - Macro environment is stabilizing
 - Deposit run has stopped
 - Payment crisis avoided
 - Cleaning of the banking sector almost completed w/o any disruption to the real sector

- 2. NBU knows Where and How to drive the financial sector in the long run:**
 - Financial sector strategy is supported by the market, other regulators and donors
 - NBU policy efforts in 2015-2016 are centered on the banking system consolidation, revamp of the supervisory framework, FX regime change, gradual transition to inflation targeting regime
 - NBU became a role model for other government institutions in undertaking reforms; strong reform efforts are now seen in a number of areas

- 3. Ukraine needs further support along this path:**
 - From IFIs and donors
 - From foreign regulators
 - From foreign banking groups



Ukraine was plagued by the textbook “triple crisis” in 2014-2015



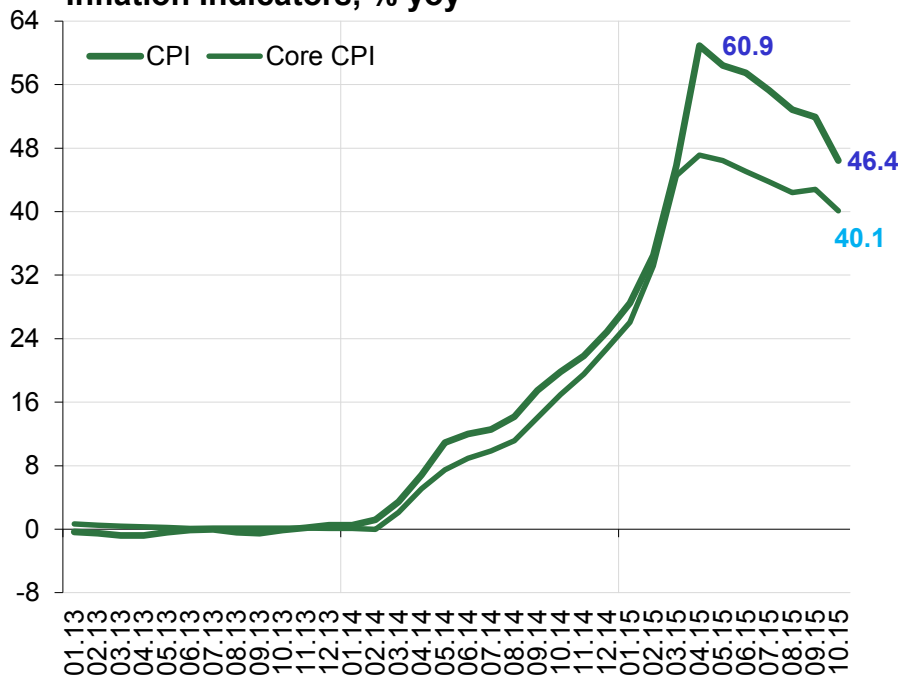
The situation in Ukraine is not unique:

- Mexico (1994/95), Argentina (1994/95);
- Thailand (1997), Indonesia(1997), Malaysia (1997), Philippines (1997);
- Russia (1998); Turkey (2001); Ukraine (2009).



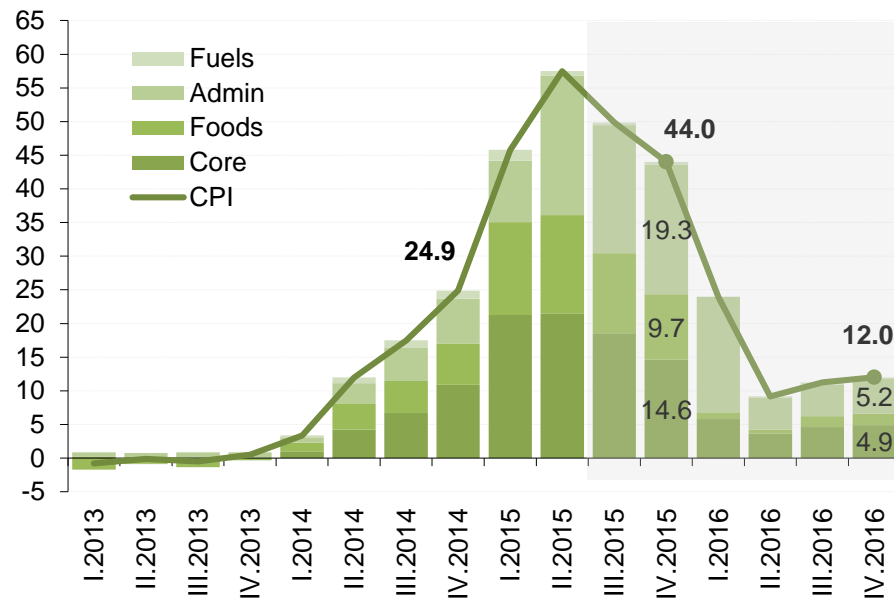
We passed over the inflation peak and currently see the strong disinflation signs

Inflation Indicators, % yoy



Source: State Statistics Service of Ukraine

Contribution to Annual Growth of CPI, p. p.



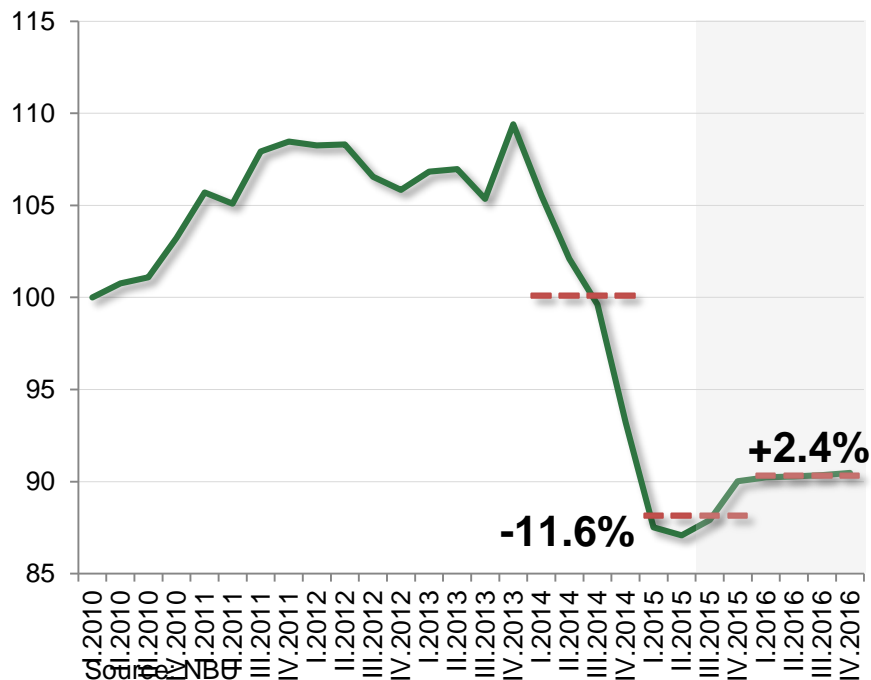
Source: State Statistics Service of Ukraine; NBU staff estimates

- After a prolonged acceleration since early 2014, **annual inflation** peaked at 60.9% yoy in April 2015 and **has been on a firm descending trend** since then thanks to
 - Hryvnia appreciation against US Dollar by 24.1% during Mar-May and stabilization of the FX market thereafter that weakened delayed pass-through effects of February’s sharp devaluation and caused a decrease in prices that quickly respond to exchange rate fluctuations (cars, some fuels, household appliances and pharmaceutical products)
 - A completion of the main phase of utility tariff adjustment (tariffs on select utilities are to be raised further – e.g., electricity and heating in September and October respectively, but the paces of adjustment will be moderate)
 - And tight monetary and fiscal policies
- **CPI growth slowed to 46.4% yoy in October** and is forecast to decline to around **12% yoy in 2016**

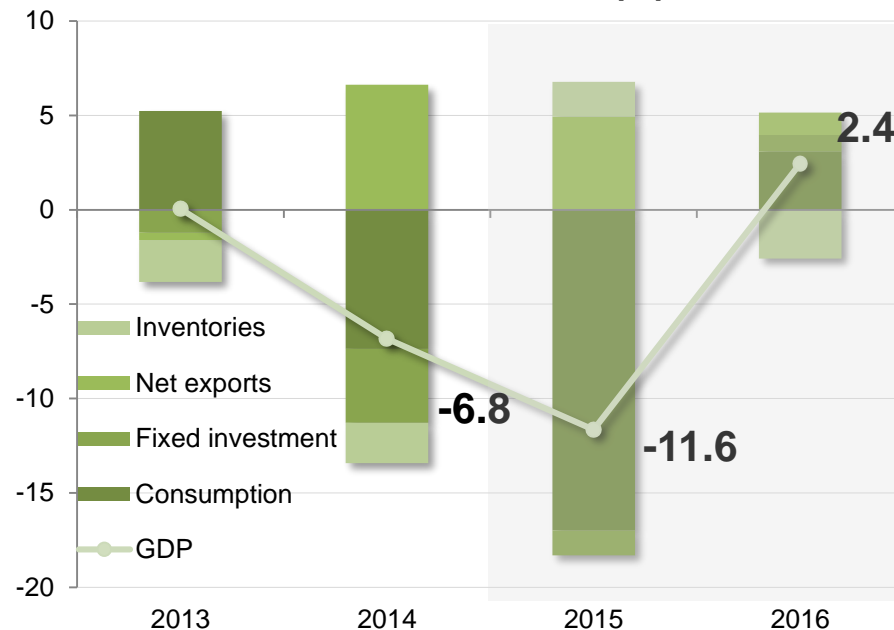


Gradual recovery on the horizon: +0.7% GDP qoq change in Q3'2015 and positive forecast further driven by net exports and consumption

Real GDP, QI 2010=100 (sa)



Contributions to Real GDP Growth, p. p.



Source: NBU

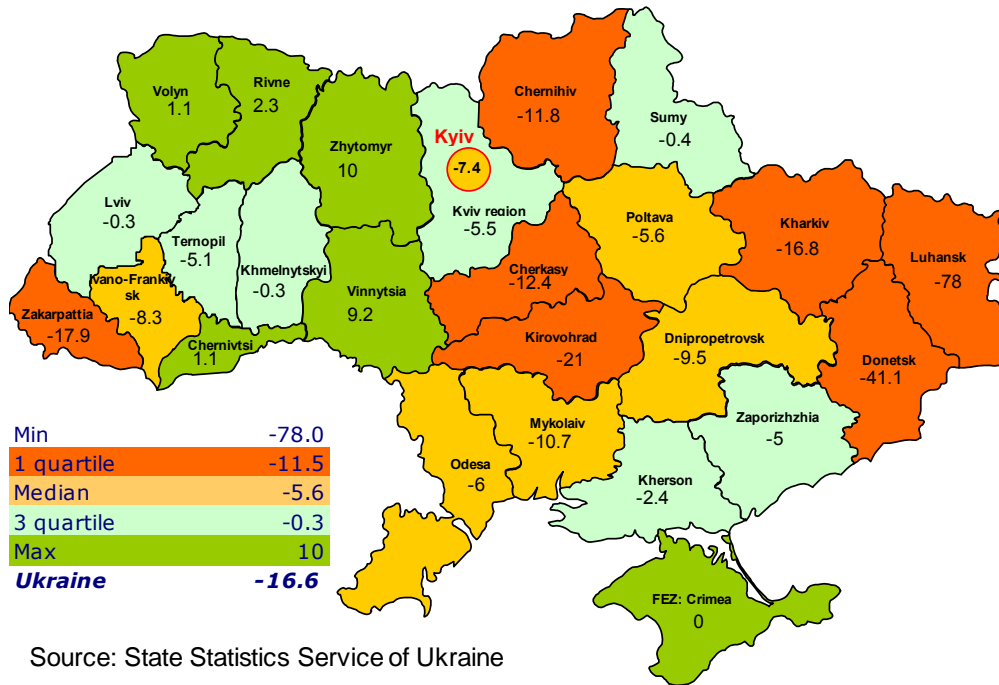
- Real GDP is forecast to fall by 11.6% in 2015, before returning to growth next year
- But we observe the end of 2-year stagnation followed by severe recession, which started in Q1 2014:
- Gradual recovery: +0.7% GDP qoq change in Q3'2015 and positive forecast further driven by net exports and consumption
- Investment growth is also to recover from the second half of 2015



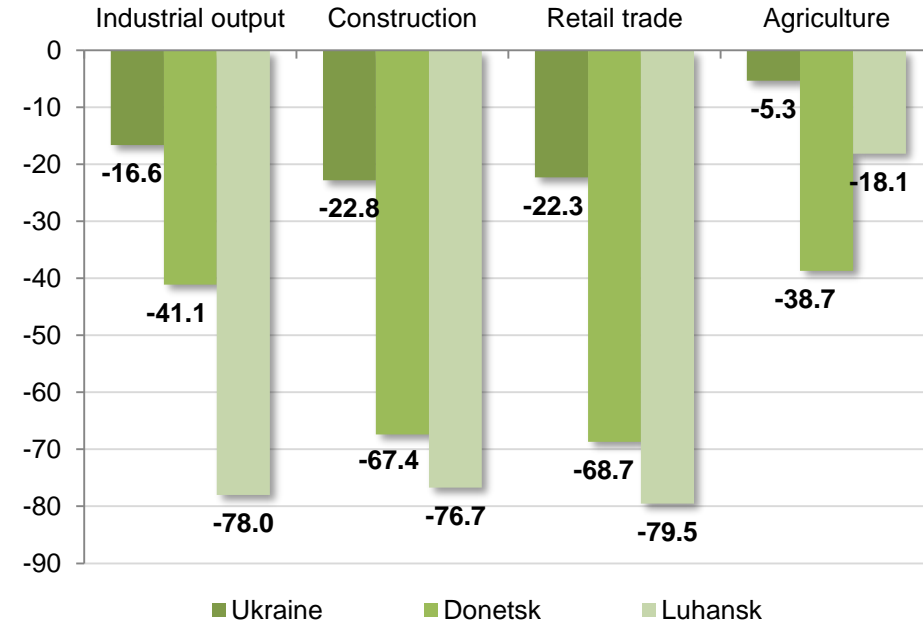
But divergence across regions of Ukraine still remains: Donbas reports deep declines, Western regions show resilience

National Bank of Ukraine

Industrial Output by Regions, Jan-Sep 2015, % yoy



Economic Indicators, Jan - Sep 2015, % yoy



- The escalation of military conflict at the beginning of 2015 caused further significant damage to infrastructure and termination of production activities by many enterprises in Donetsk and Luhansk regions
- Economic activity in South and Central regions kept declining amid falling consumer demand and destruction of industrial links with Russia
- In contrast, most Western regions (Chernivtsi, Zhytomyr, Volyn, Vinnytsia, Rivne) reported growth



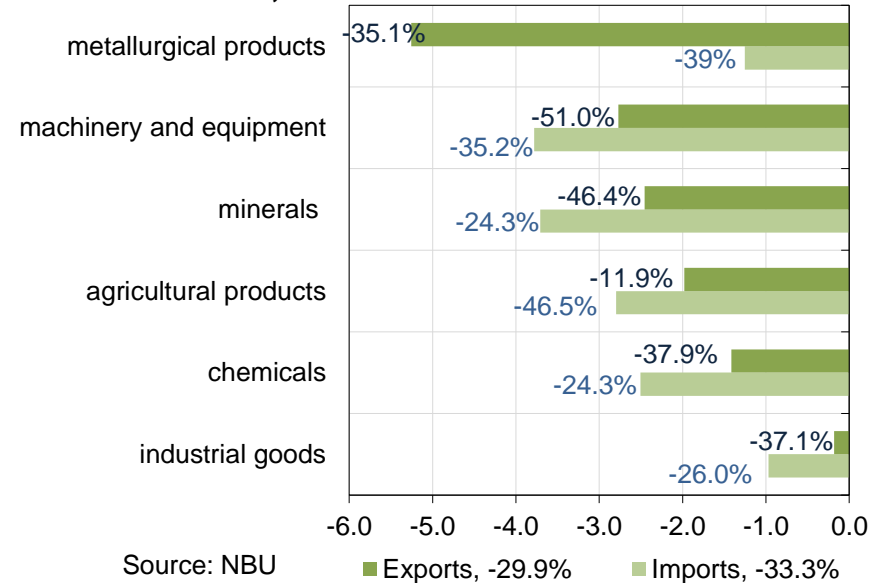
CA balance forecasted to continue improving in 2015 amid further drop in imports and a gradual recovery in exports in 2H 2015

Current Account Balance, USD bn



Source: NBU

Merchandise Exports and Imports, 2015, USD bn, %

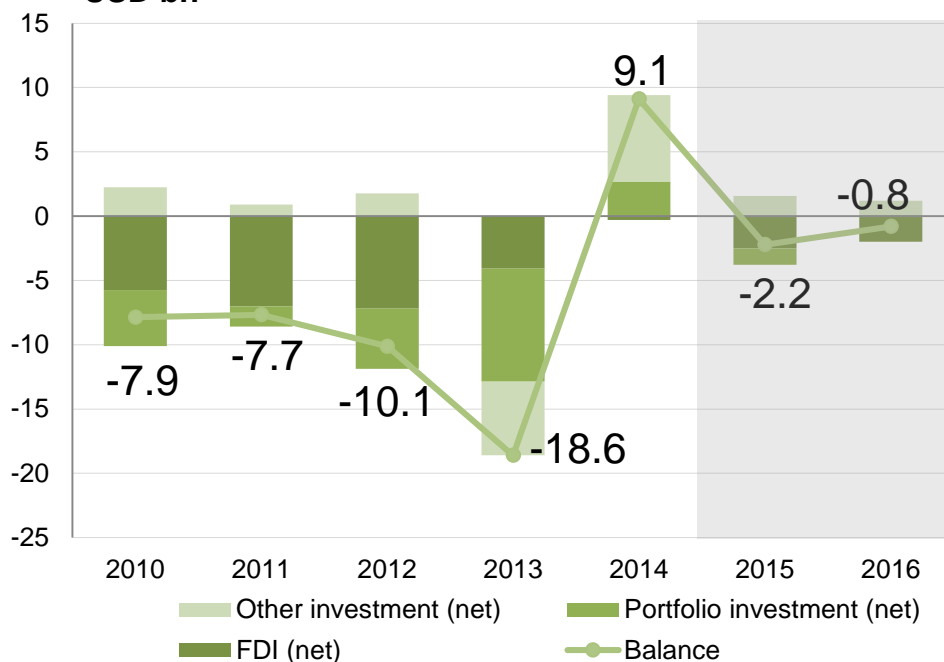


- **In 2014-2015, the adjustment in CA balance was achieved on the import side** as export performance was dampened by the military conflict in Donbas, worsened trade relations with Russia, falling global commodity prices and rising cost of imported inputs as a result of Hryvnia depreciation
- A sharp drop in imported energy prices and subdued domestic demand will keep imports subdued this year
- At the same time, **export recovery is key for FX market stabilization** as more Hryvnia depreciation is unlikely to tangibly contribute to further import compression



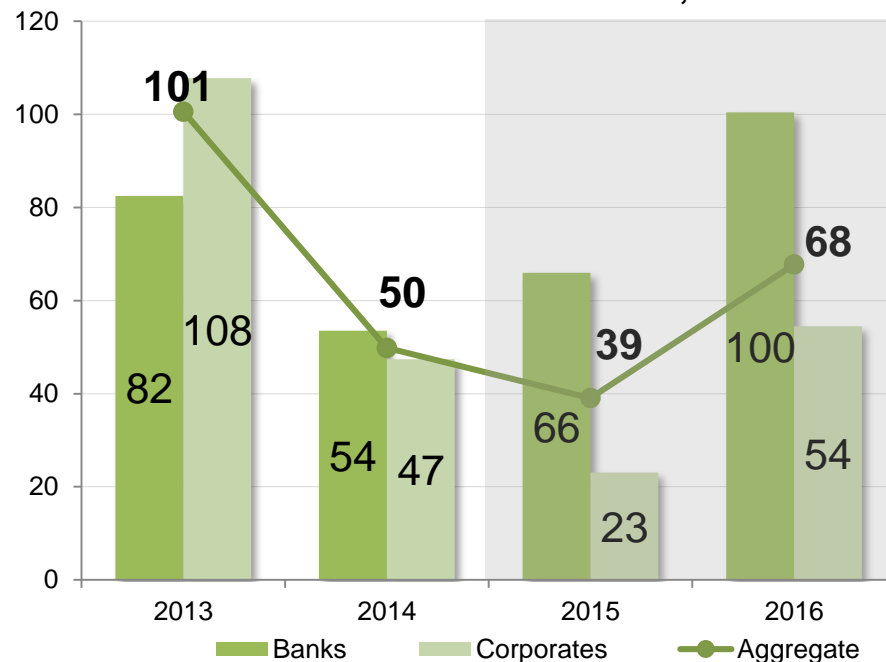
Financial account returns to surplus due to high official external financing

Financial Account Balance: Net External Assets, USD bn



Source: NBU

Rollover Rates of Private External Debt, %



Source: NBU

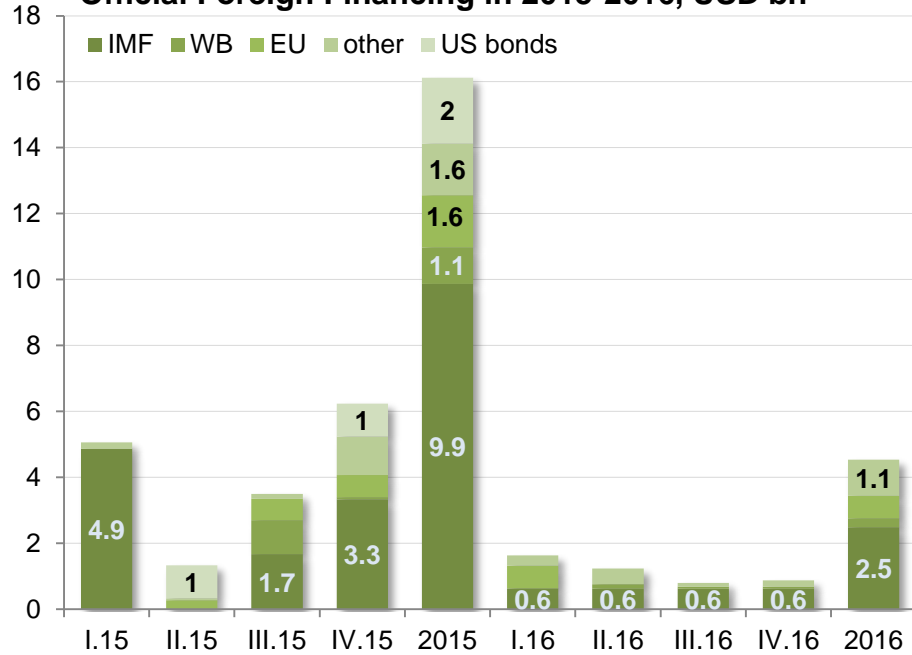
- In 2015, financial account will turn into the net borrowings amid hefty official financing inflows and lower debt repayments following the wave corporate restructuring and completion of sovereign debt operation
- Private capital inflows might gradually take off starting from H2 2015. Rollover ratio on external liabilities of the private sector is expected to increase in 2016



Official financing and economic recovery will help to bring FX reserves back to the sustainable level

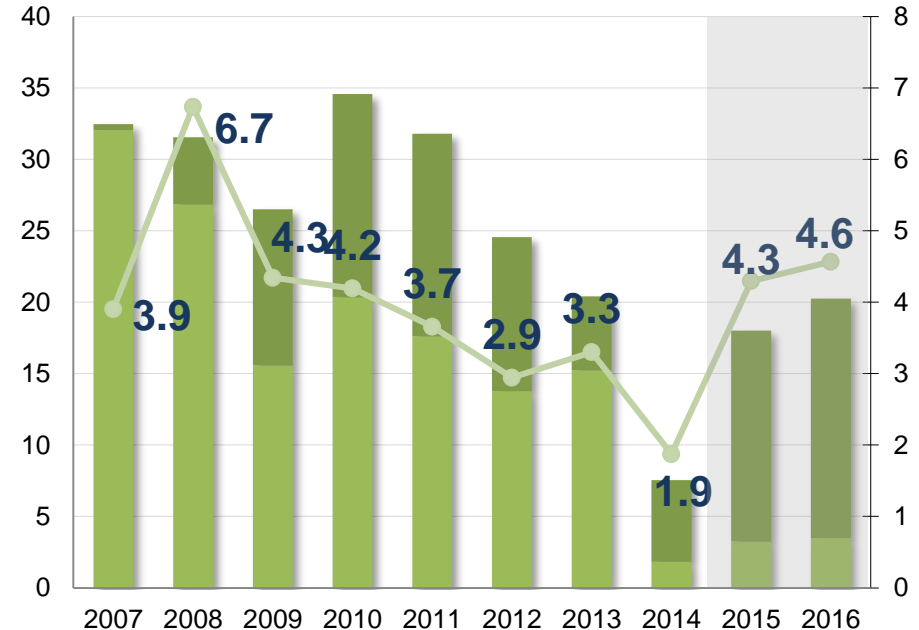
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Official Foreign Financing in 2015-2016, USD bn



Source: NBU; IMF

International Fx Reserves



Source: NBU

■ IMF loan, USD bn (LHS)
■ NIR, USD bn (LHS)
● Months of Future Imports (RHS)

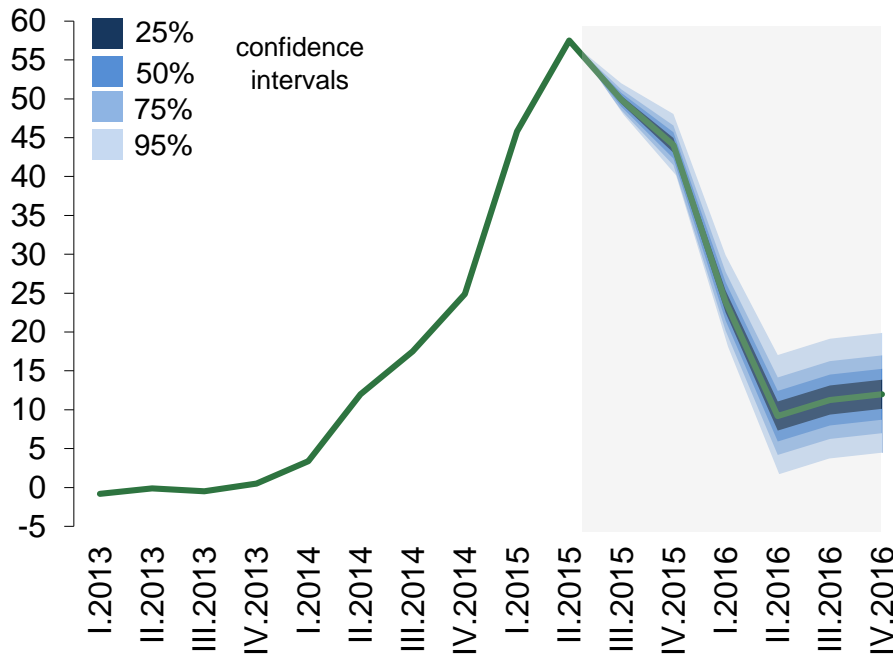
- Official financing is projected to be USD 16.5 bn in 2015 with the major share (USD 9.9 bn) attributed to IMF EFF programme
- USD 4.5 bn of official financing is committed for 2016, including: IMF (EFF) – USD 2.5 bn, EU – EUR 0.6 bn, other financing – USD 0.8 bn, funds for gas support – USD 0.5 bn from WB
- Consequently, **gross FX reserves are expected to grow to 20.2 bn** by the end of 2016



Baseline scenario forecast Y2016 is considerably optimistic with CPI = 12% and +2.4% GDP growth

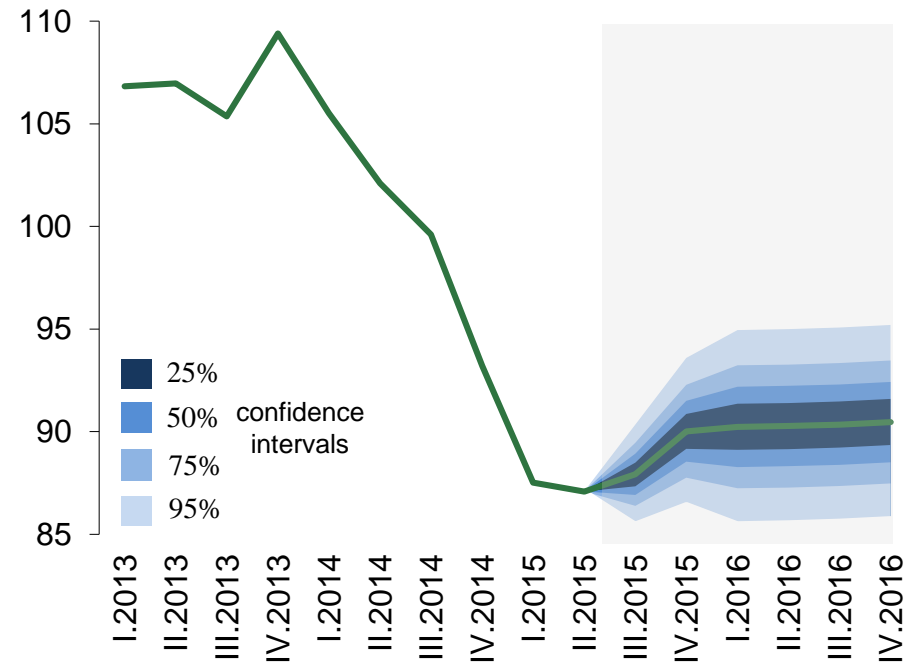
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CPI Growth, % yoy



Source: NBU

Real GDP, seasonally adjusted, Q1 2010=100



Source: NBU

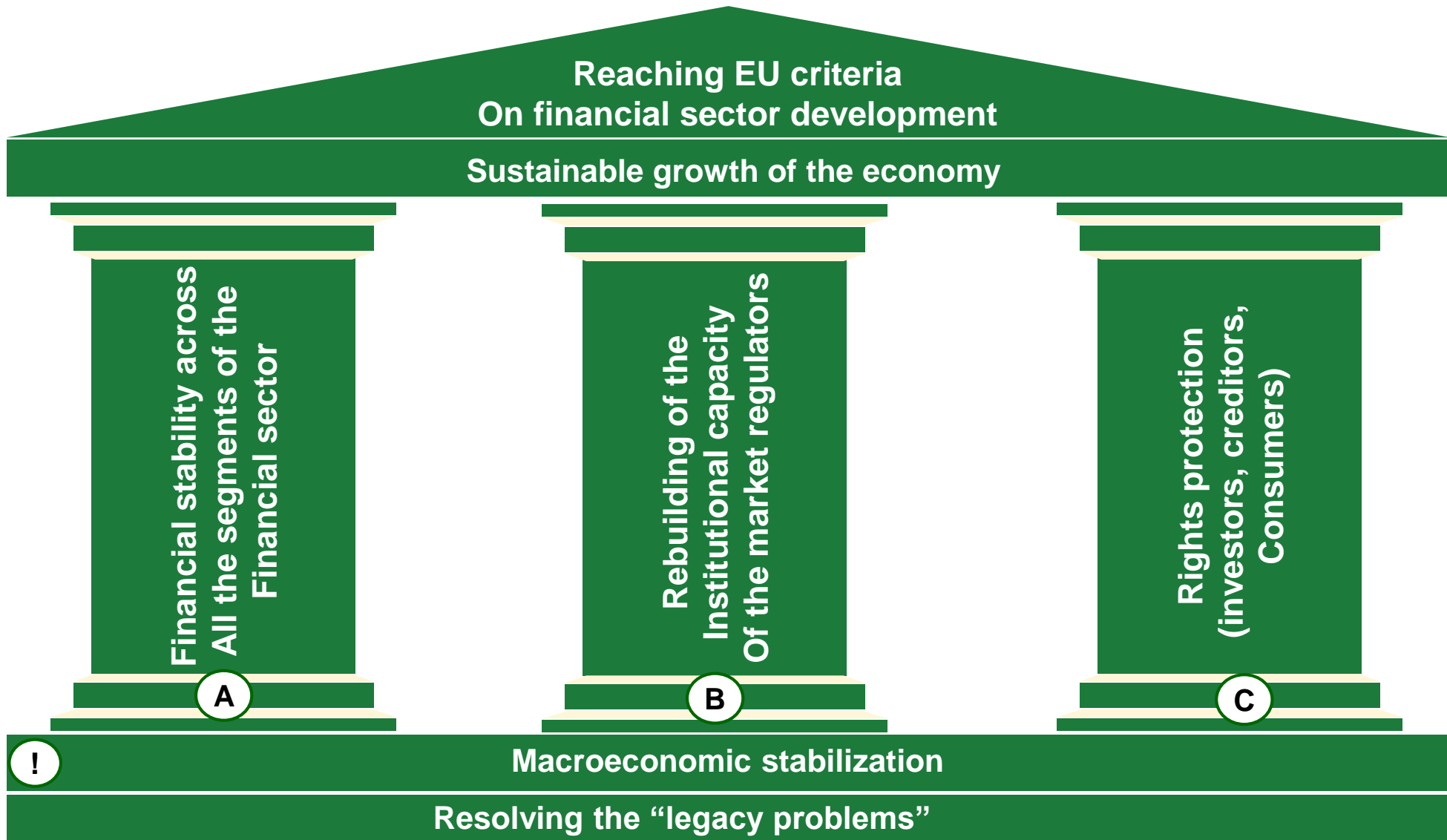
But Ukraine still faces risks related to:

- **Escalation of the military conflict in the Eastern Ukraine**
- **Rising turbulences on external financial and commodity markets** (high volatility on China's stock market, falling world commodity prices, depreciation pressures on EM currencies, etc.)



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Financial sector strategy program has a clear framework

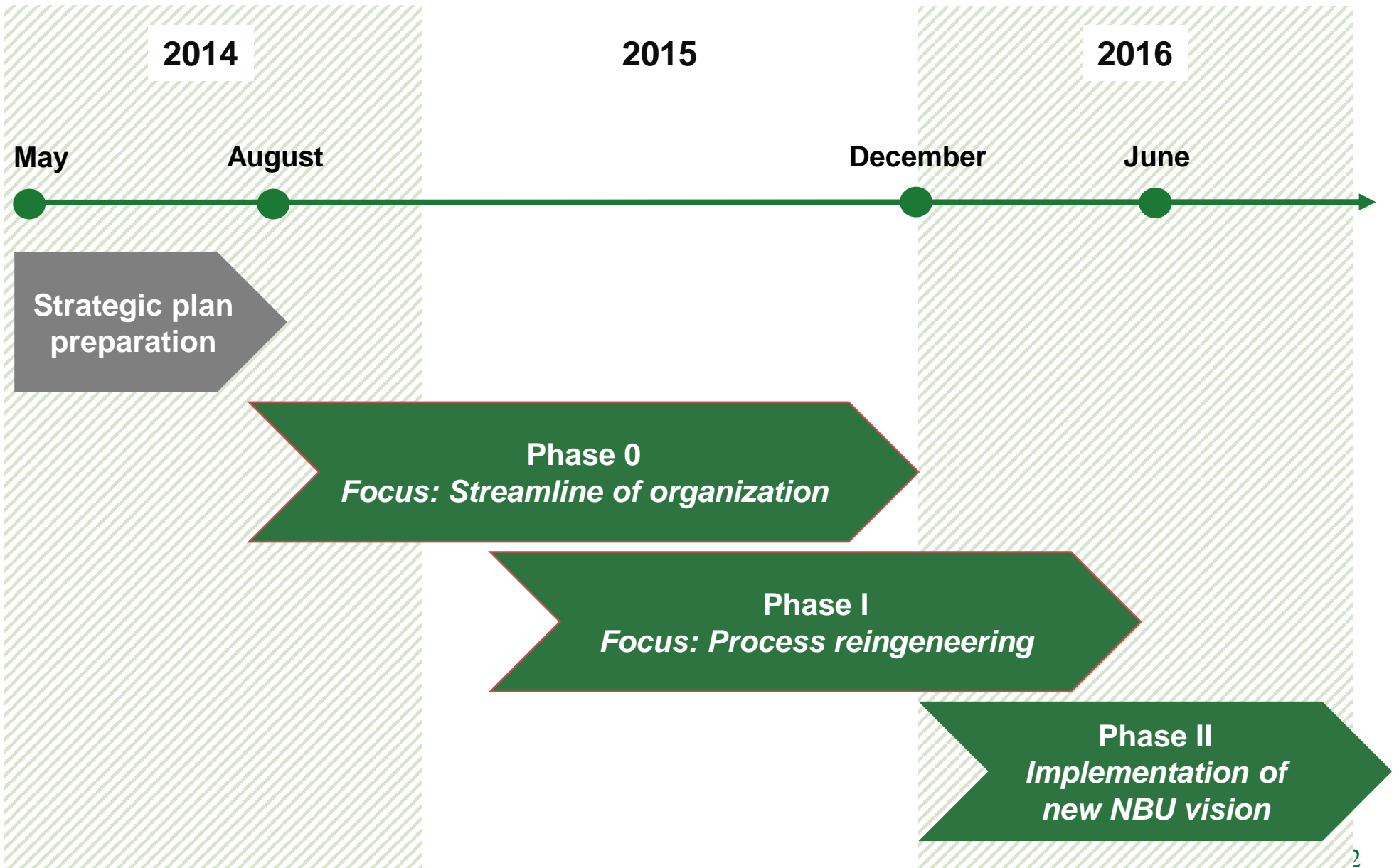




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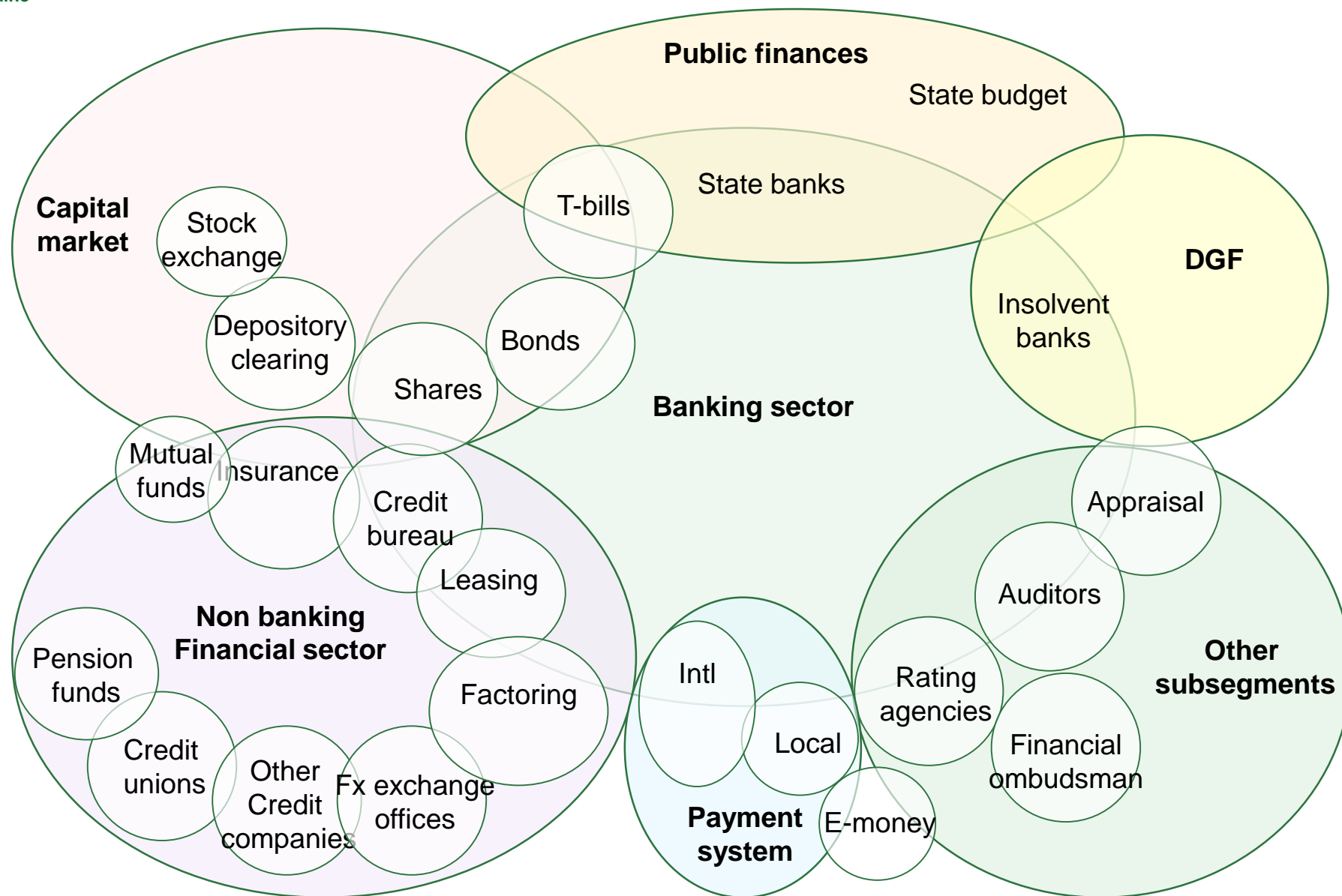
NBU transformation became a part of the financial sector strategy

Transformation phases



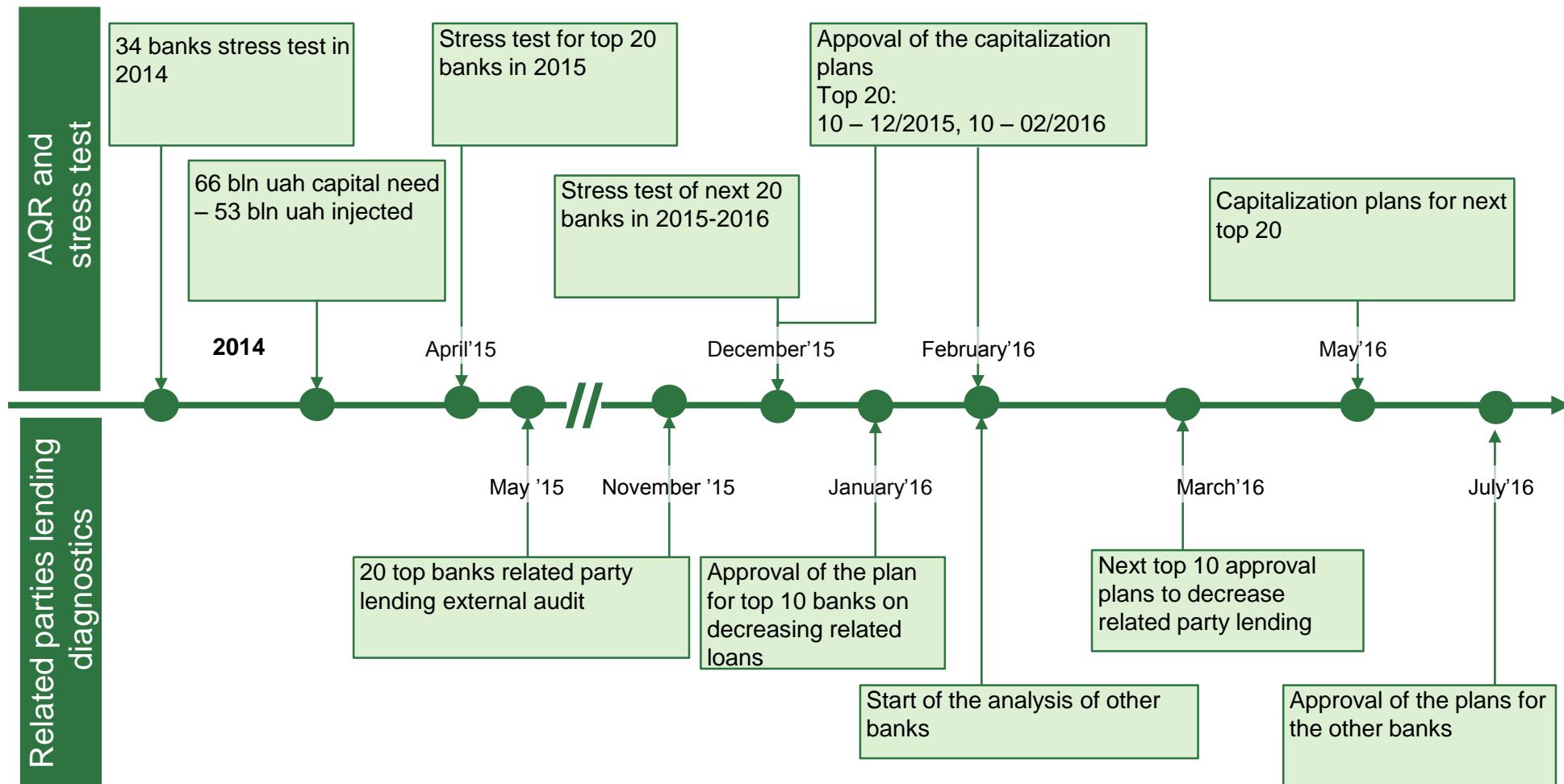


Reform strategy touches all the elements of the financial sector





Recapitalization of the banking sector is a prerequisite for the further growth

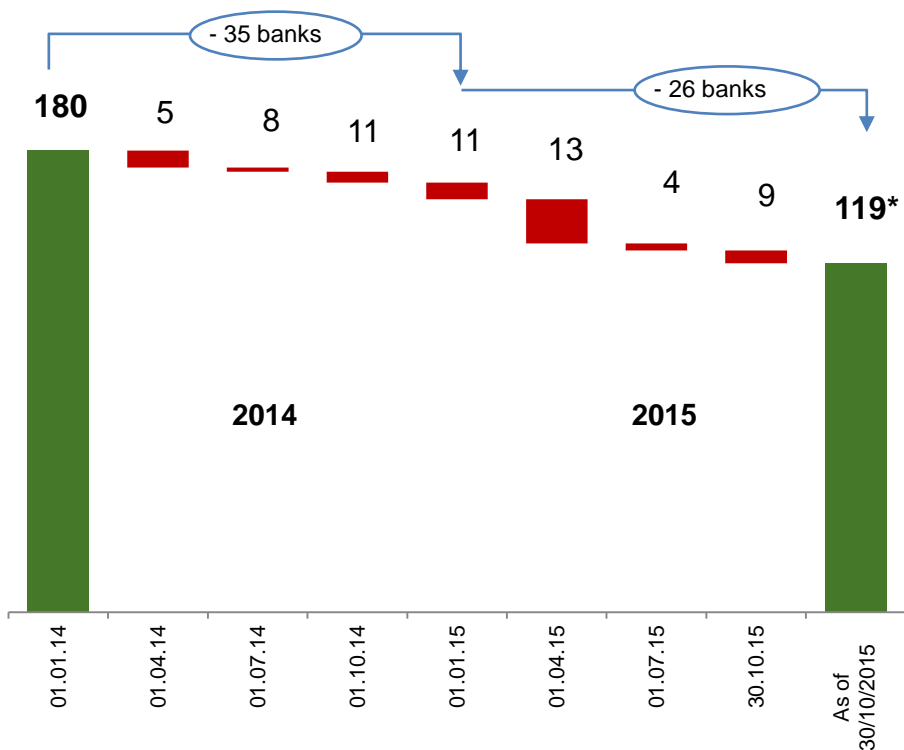


Following the commitments given in EFF program we are in the process of the completion of the banking sector recapitalization

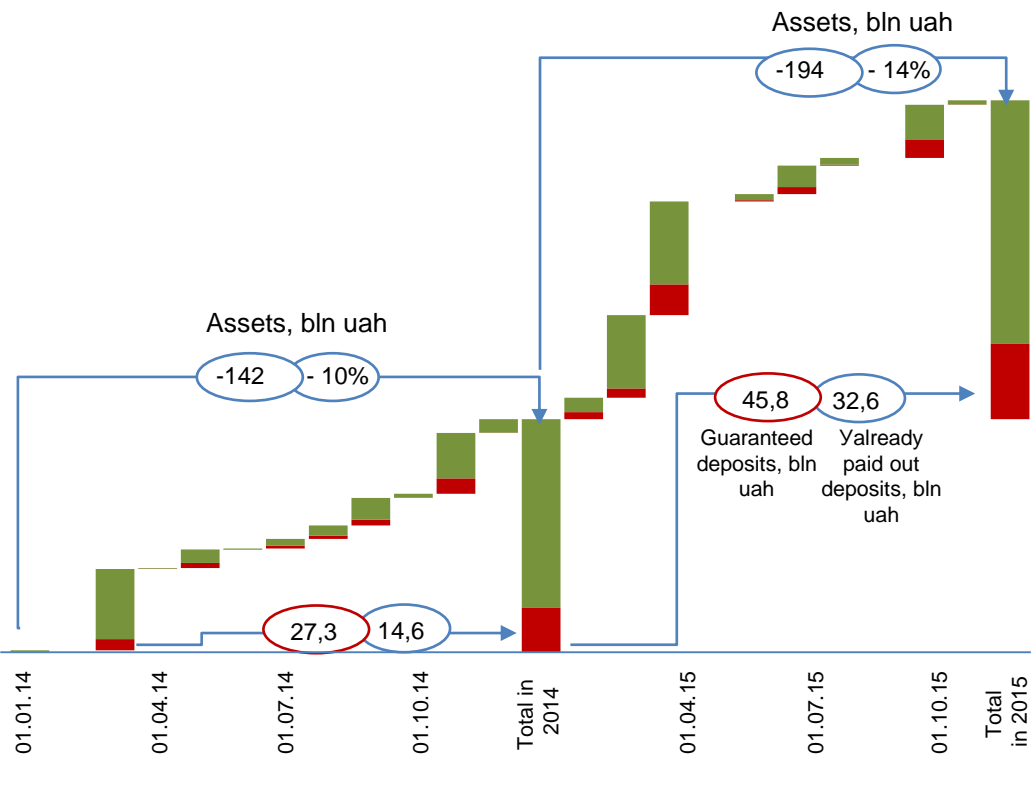


Cleaning up of the banking sector almost completed

Exit of the banks



Assets of the insolvent banks



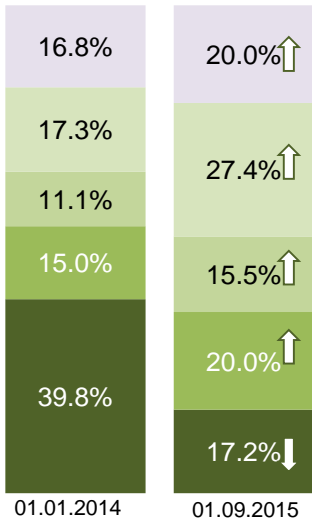
- Totally 61 banks left the market in 2014-2015 (+2 banks in Crimea)
- Totally 336 blyu assets in insolvent banks, incl 73.1 blyu uah of guaranteed deposits, 57.2 blyu uah already paid out to the depositors



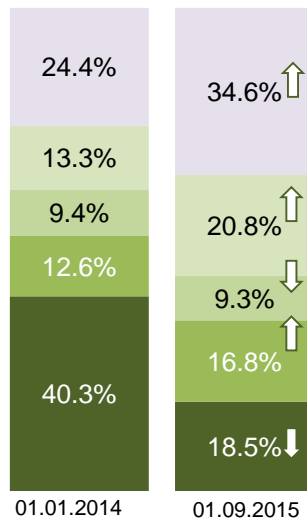
As a result of the cleaning efforts, 40 largest banks take 90% of the market share with Foreign banks MkS by assets increased from 15% to 20%

Banking market

By assets

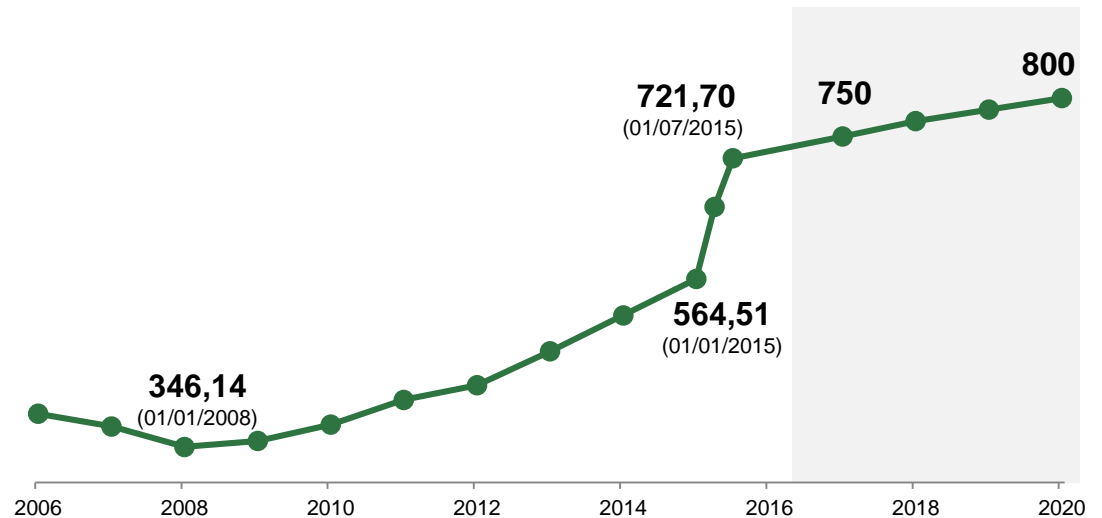


By deposits



- local private banks (w/o Privat)
- Foreign banks
- Russian banks
- State banks
- Privatbank

HHI by assets



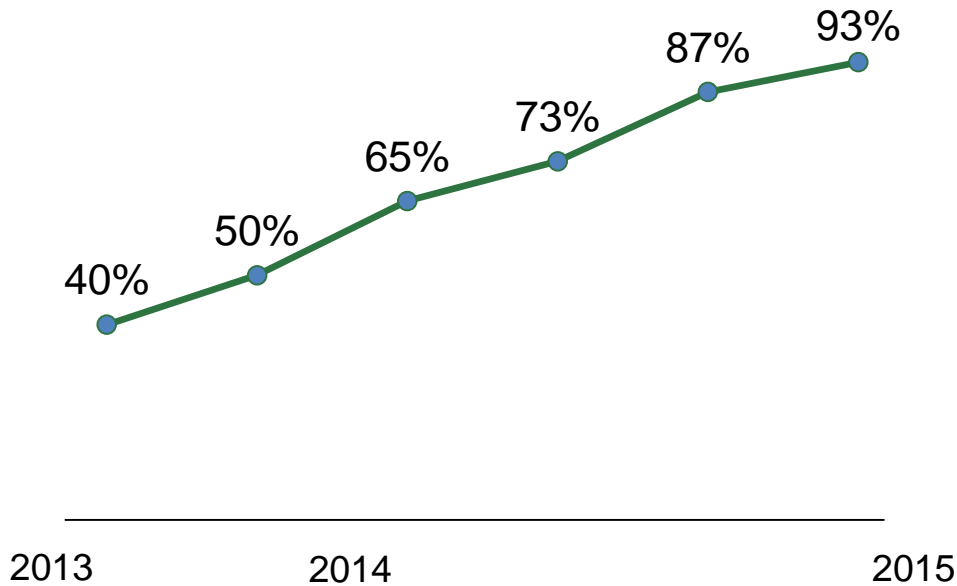
We target foreign banks to become a pillar for the rebuilding the banking sector



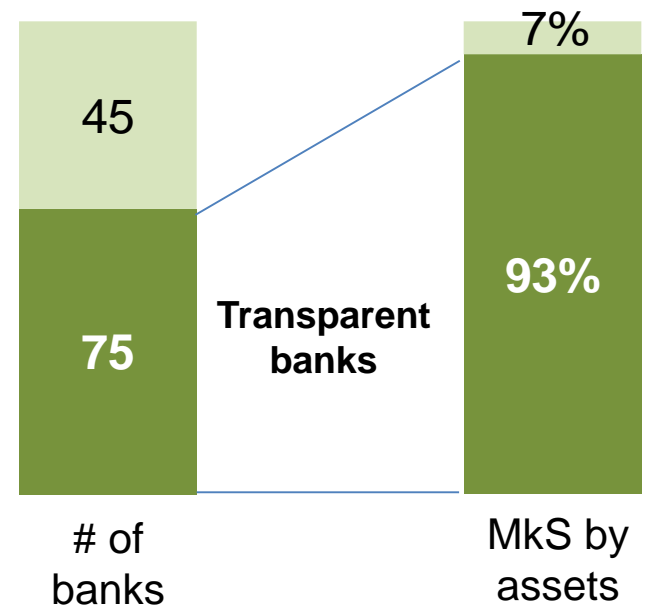
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NBU takes seriously the issue of the banking sector transparency working on the disclosure of the ultimate beneficiary owners of the banks (UBO)

Banking sector transparency index



Transparency of UBO by banks

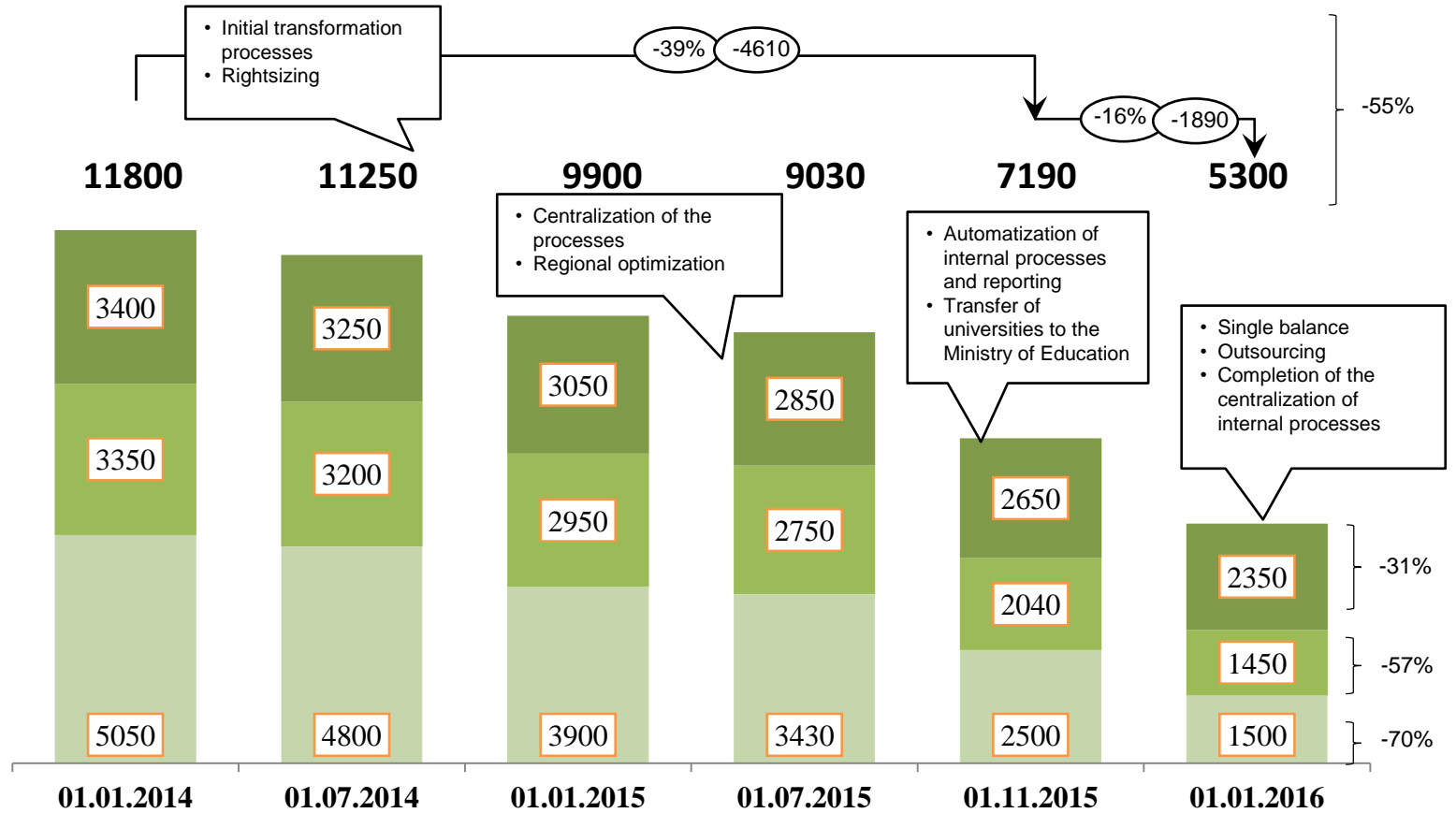


- By Q1'2016 NBU targets to have banking sector Transparency index equal to 100%



NBU decreased its staff by 4610 employees (39%) since 2014, ~1900 to go until the year end (totally -55%)

NBU staff



Key functions	29%	29%	31%	31%	37%	44%
Support	28%	28%	30%	30%	28%	27%
Non-core	43%	43%	39%	39%	35%	28%

■ We have a new Central Bank, which is ready to re-establish the relations both the foreign regulators and foreign banking groups



INVITATION FROM UKRAINE:

1. To organize the specific session of the Vienna Initiative in Kyiv in start of 2016 focusing on:
 - NPL resolution
 - Restart lending
 - Consolidation of the sector

2. To sign the new **commitment roadmap** for the Regulators – IFIs – Foreign financial institutions **for Ukraine** (Vienna Initiative 1 concept + elements of Vienna Initiative 2 concept):
 - Committing on reforms by Ukrainian regulators
 - Committing on support by IFIs
 - Increasing cooperation with foreign regulators (via signing of MoU with EBA)
 - Committing on investments to Ukraine by the foreign banking groups