



Ukrainian banks: Stable now, slow to recover

Conference call notes

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Yesterday Concorde Capital hosted a conference call with the NBU's Poroshenko and several top bankers on the state of the banking system in Ukraine...

- ...the hryvnya's fluctuations are being held in check by the NBU, but faith has not been restored
- ...banks are seeing a resumption in deposit inflows, increases in margins (before provisions)
- ...growth prospects hinge on lending in hryvnyas, with cheap and long funding sources scarce

Call participants

Petro Poroshenko, head of the NBU's supervisory board
Sergey Naumov, CEO of Ukrsibbank
Olena Zhukova, CEO of Megabank
Vitaliy Masyura, first deputy CEO of Delta Bank
Andrey Bobyshev, deputy CEO of Alfa Bank Ukraine

Hryvnya: Significant swings over, but uncertainty remains

Poroshenko said the UAH exchange rate is in check and the NBU tightened monetary policy further in September to stabilize the FX market. At the same time, Poroshenko acknowledged that this might hinder real economic growth and said the NBU would partially rollback controls in the next year.

Poroshenko also stressed that the NBU is assisting in the timely servicing and repayment of FX obligations by banks and that all sovereign and quasi-sovereign debts are being repaid on time. The only exception is Naftogaz, though the government has pledged to guarantee its debt after restructuring.

Exchange rate UAH/USD



Source: www.finance.com.ua

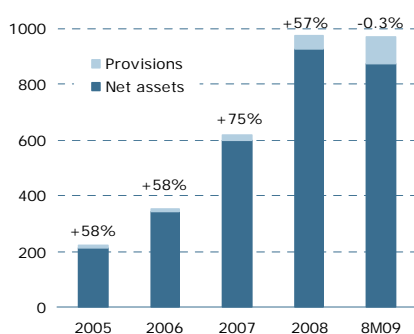
Masyura agreed that the panic is over, but said market participants remain cautious as trust in the national currency and the banking system has not been restored. **Bobyshev** added that the current calm on the domestic FX market is still fragile and that more time would be needed for normalization.

Banks learn to live in difficult times

Bankers said financial institutions have adjusted to the market volatility and most (especially large banks) have no liquidity problems. **Naumov** said banks have learned to deal with bad loans. He also said the recovery in deposit inflows resumed in September, after temporary deterioration in August.

Importantly, Naumov confirmed that many foreign majority owners of local banks have remained committed to their businesses in Eastern Europe, such as BNP Paribas to subsidiary Ukrsibbank.

Banks total assets, UAH bln



Source: NBU

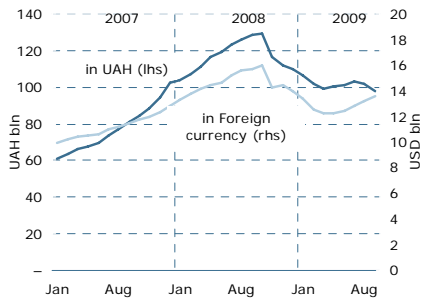
Masyura pointed out that certain banks have an opportunity now to expand market share. He said margins (before provisions) are also going up.

Bobyshev also stressed the NBU did a good job in stress testing of the system and stimulating banks to increase their capital, which contributed to overall situation stabilization.

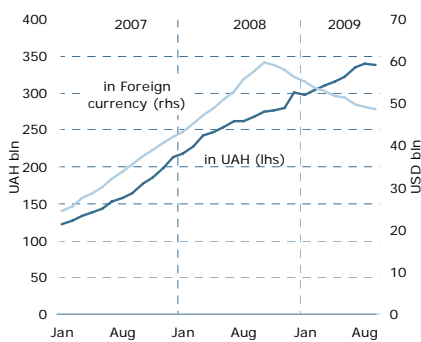
Growth prospects questionable

All call participants were cool on growth prospects for local banks: with the brakes on lending in foreign currency, banks have insufficient resources to expand lending in hryvnyas. **Naumov** said that banks have no cheap and long UAH funding. Available resources in foreign currency can only be used for lending to clients with FX revenues (i.e. exporters). **Masyura** confirmed that the average maturity of retail deposits, which are viewed as the chief source for funding loan portfolio expansion) is going down now.

Bobyshev called for new refinancing rules from the NBU. **Zhukova**, in turn, said that some banks have accumulated foreign currency and that the NBU should provide instruments (e.g. swaps) to help banks convert these resources into hryvnyas.

Retail deposits


Source: NBU, Concorde Capital calculations

Loans issued


Source: NBU, Concorde Capital calculations

Our view: Situation is indeed stabilized but...

In mid-September, the hryvnya exchange rate stabilized at UAH 8.5 per US dollar. In our view, downward pressure, although weakened, will linger as Ukraine is still running a current account deficit (USD -0.4 bln in July and USD -1.2 bln during 1-7M09): there is a significant capital account deficit (USD -0.6 bln in July and USD -7.0 bln over 7M09). Although the NBU is pursuing a tight monetary policy (the monetary base shrank 1.8% over 8M09), fiscal policy remains quite loose due to social expenditures, which increased 12% yoy in 7M09 while capital expenditures declined by 46% yoy (the consolidated budget deficit was 3.5% of GDP over 7M09). These factors create additional pressure on the exchange rate, on top of the low confidence in the hryvnya. We expect depreciation forces to remain in play at least until the presidential election in January 2010.

Ukraine redeemed its Eurobonds on time this year (USD 513 mln in August and CHF 768 mln in September); its next principal payment is scheduled for December 2010 (JPY 35 bln).

In terms of banks, all of those that have had the opportunity (mostly large banks with foreign owners) to solve their liquidity problems have done so. Deposit inflows have resumed: retail deposits in foreign currency went up 11.2% in April-August while deposits in hryvnyas declined 1.7% over the same period (overall nominal value in UAH of all deposits went up by 6.6% in April-August). Subsequently, interbank interest rates dropped in the recent months, accompanied by a 2.6x drop in transaction volumes (average daily volumes dropped from UAH 4 bln in January-February to UAH 1.5 bln in August-September). There is also an increase in banks' capitalization levels as the system's average capital adequacy ratio (regulatory capital to RWA) rose from 14.0 as of January 1, 2009 to 15.2 as of September 1, 2009. Thus, we do not expect any significant problems with large banks. Small banks, though, will experience further liquidity and capital problems and some of them may be liquidated.

...banks lack the resources to renew rapid growth

Ukrainian banks' rapid growth in recent years was partly driven by attracting cheap financing from abroad and lending domestically in foreign currency. However, the NBU is frowning on this practice and banks have thus far not been able to find similar resources to lend in hryvnyas.

Stabilization on the domestic FX market, and a recovery in the real economy are prerequisites for inflows in hryvnyas into the system via retail deposits. We do not expect these conditions to surface until at least until late-1Q10.

We expect growth in banks' assets in 2010 to not exceed 10%. Furthermore, in the near term, banks will be concentrating mostly on shorter-term products and limit funding long-term corporate investment projects and mortgages.

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