

РАЗВИТИЕ КРЕДИТНОГО РЫНКА УКРАИНЫ В ПОСЛЕКРИЗИСНЫЙ ПЕРИОД

TRENDS IN THE UKRAINIAN LOAN MARKET IN THE POST-CRISIS PERIOD

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Abstract. The purpose of the paper is to systematize the data of the credit market of Ukraine in the period of economic and political turmoil and the beginning of military confrontation with Russia. The method of extended studies allow to trace the changes that have occurred not only in the banking system, but also in the whole of the economy. **Methodology.** The study is based on a comparison of data on a number of indicators that were taken as a basis and allow fully analyze the credit market as a component of the capital market in the period from 2000 to 2013. **Results** of the survey allowed to clearly identify the problems that impede the stable development of the banking system of Ukraine, among which are the following: high cost of banking products, the marriage of skilled personnel and lack of confidence in banks, low level of culture of users of financial products, low income, high yield deposit operations increases the cost of credit products, slowing of economic development, lack of reforms, social and political tensions, armed conflict with a neighboring state. **Practical implications.** A clear definition of the problems in the credit market as a component of the banking system helped identify a number of areas that allow us to solve the situation. Among them, first of all, we should highlight the following: the bank regulator (the National Bank of Ukraine), must take a great responsibility as the authority of last resort in the refinancing of a bank, on a continuous basis to implement the stress testing of banks in Ukraine, to stabilize inflation and return confidence in the national currency, to set up a mechanism of mortgage lending by state banks. **Value / originality.** The data obtained as a result of thorough calculations possible not only to identify problems but also to identify their solutions that will enable the Ukrainian banking system to reach a new stage in its development, and the credit market to make an essential source of economic development.

Key words: lending market, economic growth, economic development, financial soundness, banking system.

JEL Classification: G01, G21, E51.

1. Introduction

Risk management enhancement is a priority objective in lending activities of banks. Effective risk management is supposed to enhance financial soundness in individual banks and the banking system as a whole. The Law of Ukraine “On Banks and Banking Activities”, enforced in November 2006, opened up access of foreign capital to the national financial market. The increasing share of foreign (European) capital in the Ukrainian banking system enabled for essential increase in the credit portfolio of Ukrainian banks. Yet, inadequate management of lending policies in individual banks and the National Bank of Ukraine (NBU) as a regulator is still a pressing problem faced by the Ukrainian banking system. Small and medium enterprises in Ukraine, which are supposed to be central to economic development, a priori have no access to long-term (five years long) loans required in times of structural reforms in the national economy.

Another debatable and unresolved problem is access to loans by physical persons, either in national or foreign currencies. Although contributions of Ukrainian work migrants to national GDP are estimated by national experts as nearly 8%, Ukrainian population do not receive salaries and wages in foreign currencies. Imperfect regulation of relations between lenders and borrowers and

unstable operation of national enterprises cause additional risks for the banks, hampering economic development due to shortage of lending resources.

Issues of lending stimuli have been in focus of many Ukrainian researchers: V. D. Bazelevich, O. I. Baranoski, G. M. Gritsenko, O. V. Dzyublyuka, V. V. Kovalenko, V. I. Mischenko, A. M. Moroz, S. V. Naumenkova, L. O. Primostkin, to mention just a few. However, a range of issues related with creating stimuli for effective and balanced policies in epy post-crisis period in Ukraine are yet to be studied.

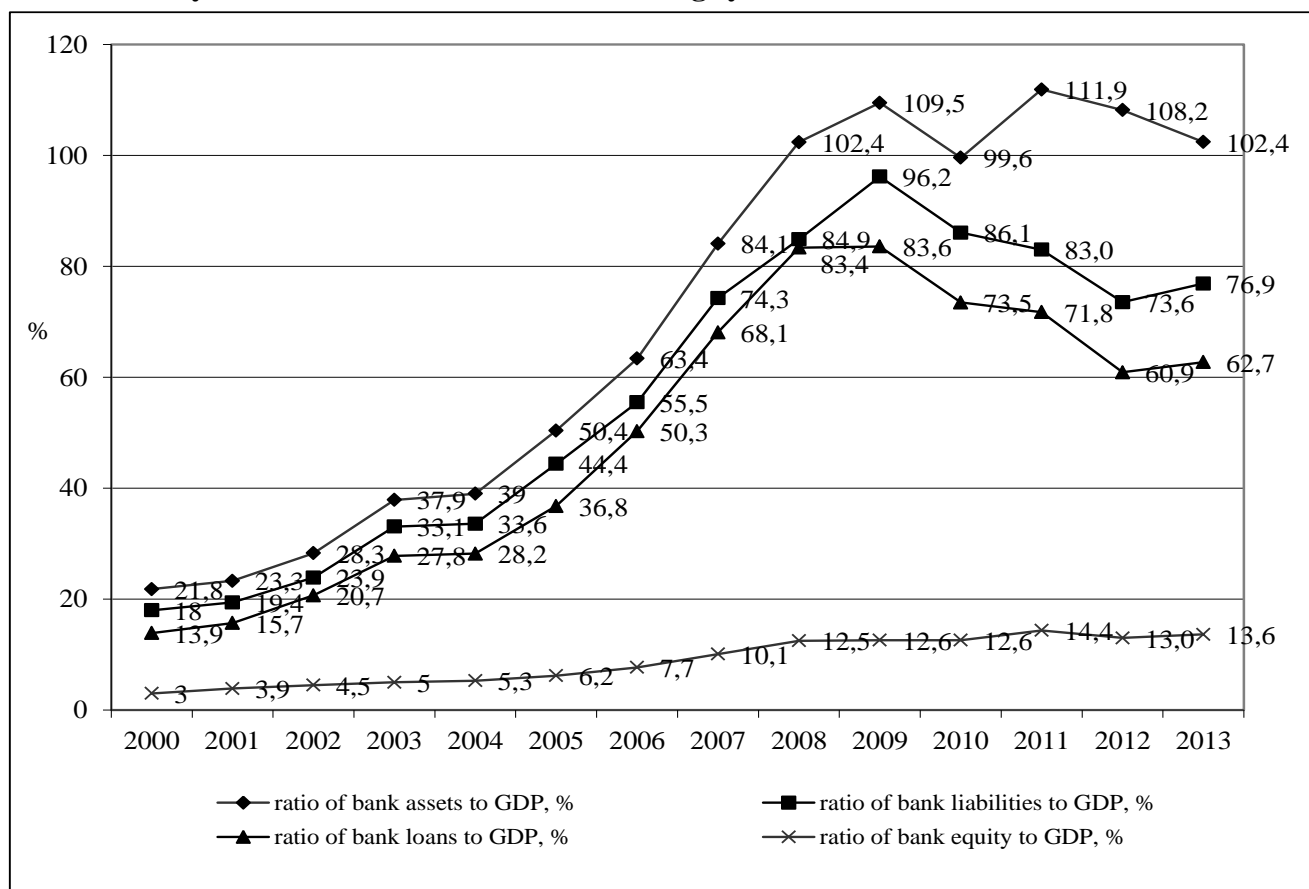
In view of the above, the study aims at analysis of recent trends in the Ukrainian lending market and its efficiency enhancement perspectives.

2.Results

The Ukrainian lending markets has been under permanent transformations, with lending-specific issues being subject of concern by not only researchers or financial experts, but all the population groups. Being dependent on the economic model, lending market has heavy implications for it. As a component of capital market, lending market has implications not only for the regulation of monetary circulation, but for flows, re-distributions and effective use of financial resources.

The Ukrainian banking system as a whole and the lending market in particular has demonstrated rapid expansion in the latest years, with notable quantitative and qualitative change in 2000–2013 (see Chart 1). The banking system showed recovery in 2011, along with signs of stabilization in the national economy. Yet, instability at the global financial market and lack of vivid positive change in the Ukrainian economy slowed down development of the national banking system. A menacing trend has been the increasing ratio of bank liabilities to GDP after 2008, which signals the occurrence of problems with return of bank deposits in future. The problem per se occurred in August-September 2014. A good number of banks with debts to deposit clients are incapable to reimburse the debt at call, as specified in the deposit agreement.

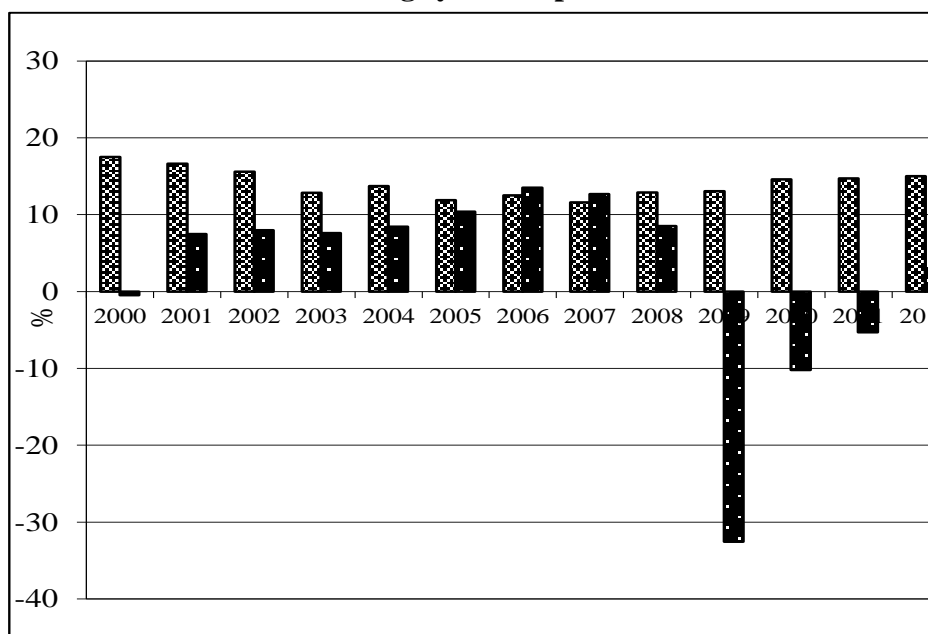
Chart E.1: Key indicators of the Ukrainian banking system



Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

The sufficiency of regulatory capital, slightly grown in 2000–2013 from 15.53% to 18.26%, indicates on inadequate capitalization in the Ukrainian banking system. Also, the gradually declining share of equity in the structure of liabilities is an evidence of risk policies pursued by banks with respect to liabilities and lending transactions. This weakens financial stability of the banking system, with negative effects for the financial security of the state. Rapid decline in the profit rate of capital in 2009 and its negative value in 2010–2011 pushed bank managers to revise both organizing structure and client policies (see Chart 2). Yet, more rapid decline in profitability rate in 2013 than in the previous period shows that the problems faced by banks and the government as early as in the crisis year of 2008 have still been overlooked.

Chart 2: Indicators of banking system capitalization



Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

The essential problems for bank managers are:

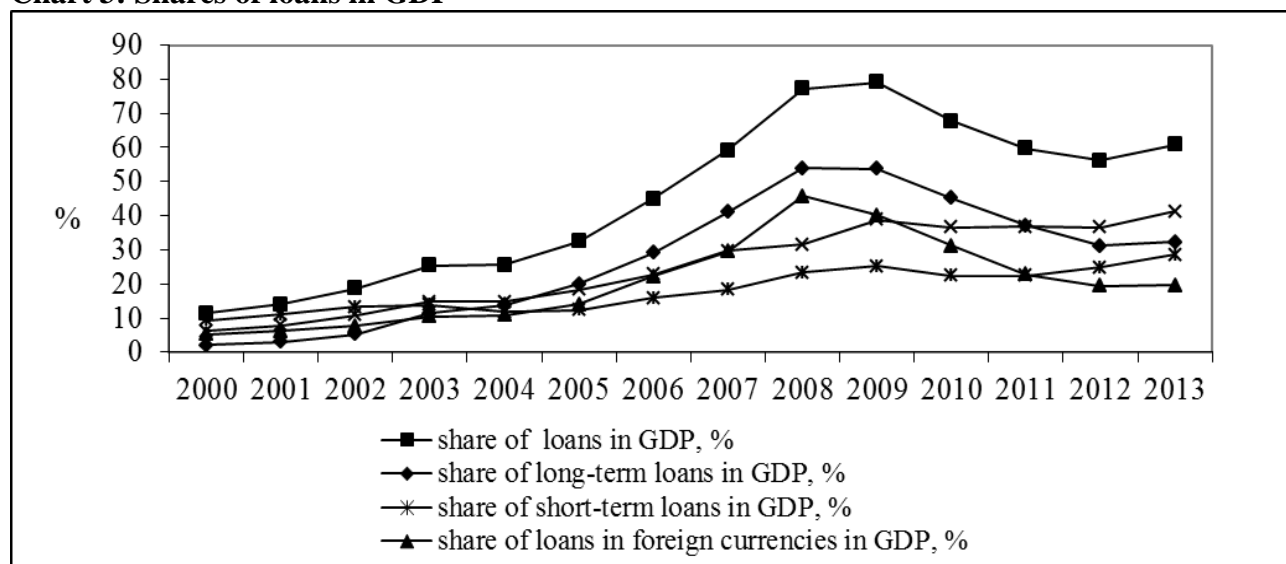
1. High spending on introduction of new programs and services.
2. Shortage of skilled personnel capable to effectively contact and communicate with clients.
3. Population's distrust in banks.
4. Poor competencies and awareness of the public regarding use of bank services.
5. Poor population's income, hampering deposit strategies of banks.
6. High interest rates on deposits (20–23% on deposits in national currency), increasing the price of loans (25–27%), repress lending capacities of banks.
7. Bad condition of the national economy.
8. Social and political instability.
9. Military conflict.

With consideration to the above, a more detailed analysis of the lending market as a capital market component is going to be made. In 2000–2013, the share of loans in GDP rapidly grew from 12% to 61%. This tendency may well be referred to as a positive one in the Ukrainian economy, but the low quality of credit portfolio and the rates of lending expansion, apart from destabilizing effects for the capital market and the financial system, had negative implications for the overall social and economic conditions in Ukraine. It should be born in mind that the share of loans in national GDP was rapidly growing in 2005–2009 due to “lending fever” of national economies.

It should be noted that although the share of long-term loans in Ukrainian GDP grew from 2 to 29% in 2000–2013, its peak (maximum) of 54% occurred in 2008 and 2009. The share of short-term loans grew from 9 to 32%, but, unlike long-term loans, it has been constantly up over the latest 14 years. Regarding the change in proportion between long-term and short-term loans, a turning

point occurred 2004, when the share of long-term loans in GDP exceeded first ever since, by 2%, the share of short-term loans in GDP. This trend followed up, with the gap between the two shares growing year-to-year; but in 2013 they were nearly equal. It is remarkable that it was in these years (2004 and 2013) when Ukraine witnessed two revolutions, “Orange revolution” and “Revolution of honor”. It should be noted that the share of loans, in national and in foreign currencies, in GDP was gradually increasing in the analyzed period. However, while the share of loans in foreign currencies in GDP shrank remarkably from 46% (in 2008) to 20% (in 2013), the share of loans in the national currency grew in this period from 32% to 41% (see Chart 3).

Chart 3: Shares of loans in GDP



Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

It is remarkable that the share of credit portfolio in the assets was higher than the allowed maximum of 65% in 2006–2011. Apart from the aggravating performance in the national banking sector, overburden with loans endangered financial security and stability of the national economy. It should be emphasized that while in 2000 the amount of loans given to legal entities exceeded the amount of loans with physical persons 19-fold, in 2013 this ratio fell to 3.5-fold, which is an evidence of eating up the capital rather than its investment in economic purposes (see Table 1).

Table 1: Loan given by Ukrainian banks in 2000–2013

year	Loans			Including					
	total	loans given to legal entities	loans given to physical persons	Long-term loans			Short-term loans		
				total	loans given to legal entities	loans given to physical persons	total	loans given to legal entities	loans given to physical persons
2000	19574	18594	980	3514	3072	442	16060	16060	538
2001	28373	26955	1418	6156	5652	504	22218	22218	914
2002	42035	38721	3313	11849	10202	1647	30185	30185	1666
2003	67835	58849	8986	30553	24466	6086	37282	37282	2900
2004	88579	73785	14794	48003	36722	11282	40575	40575	3513
2005	143418	109895	33523	88599	31088	27511	54819	54819	6012

2006	245226	166683	78543	159033	92231	66801	86193	86193	11742
2007	426683	271417	155446	295362	159444	135918	131501	131501	19528
2008	733919	460529	273390	507715	266204	241511	226204	226204	27803
2009	723295	481984	241311	492321	268247	215367	230974	207982	25944
2010	732823	523208	209615	490091	311013	179038	242772	215679	28795
2011	776769	575545	201224	484924	324247	160677	291845	251298	40547
2012	793054	605425	187629	441026	308878	132148	352028	296547	55481
2013	885432	691903	193529	468879	333091	135788	416553	358812	57741
Rate of growth, %									
2000	66	67	43	33	30	58	76	78	32
2001	45	45	45	75	84	14	38	38	70
2002	48	44	134	92	81	227	36	36	82
2003	61	52	171	158	140	270	24	24	74
2004	31	25	65	57	50	85	9	9	21
2005	62	49	127	85	-15	144	35	35	71
2006	71	52	134	79	197	143	57	57	95
2007	74	63	98	86	73	103	53	53	66
2008	72	70	76	72	67	78	72	72	42
2009	-1	5	-12	-3	1	-11	2	-8	-7
2010	1	9	-13	0	16	-17	5	4	11
2011	6	10	-4	-1	4	-10	20	17	41
2012	2	5	-7	-9	-5	-18	21	18	37
2013	12	14	3	6	8	3	18	21	4

Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

Regarding the ratio of long-term and short-term loans, the short-term loans had a larger share in the total loans in 2000–2013, whereas in 2004 the ratio changed in favor of long-term loans, which, we believe, was a positive sign for economic development in the years to come.

Also, it should be noted that the loans to legal entities had a larger share in the total long-term loans and in the total short-term loans, but both shares fell down at the end the analyzed period.

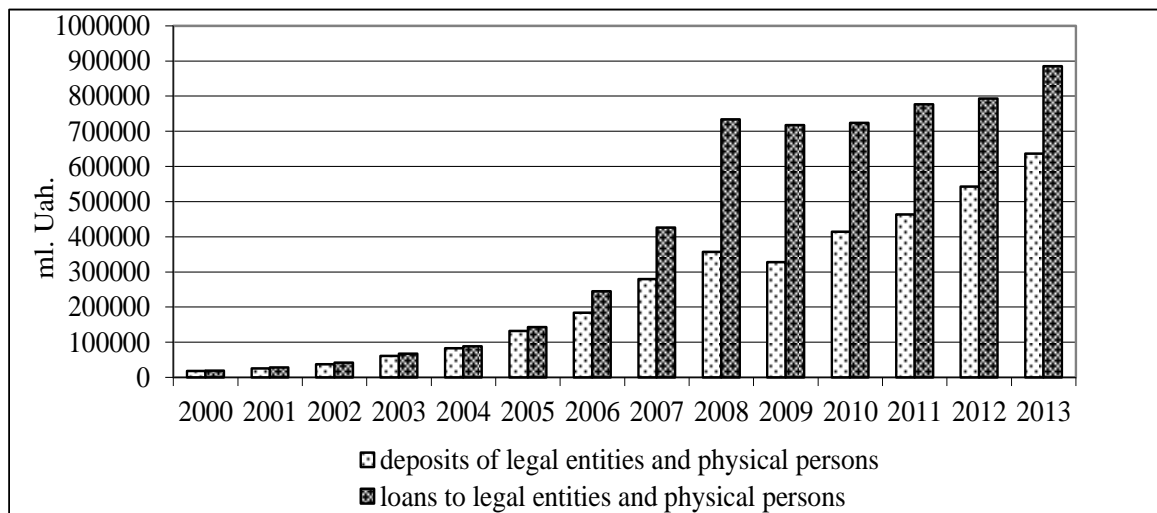
The indicator “rate of growth in loans given to legal entities” demonstrated insignificant variations (10% in average), whereas the indicator “rate of growth in loans given to physical persons” featured strong variations, especially in 2004, 2009 and 2013. Regarding the rates of growth in loans to enterprises and population, both trends were far worse than before the crisis.

Also, higher rates of growth in loans given to physical persons compared with ones to legal entities, except in 2009–2010, should be emphasized, meaning more rapid growth in consumer lending compared with lending for real economy purposes. In circumstances like this, all the external (foreign) loans taken by Ukrainian banks are forwarded to lending of consumer expenditures (mainly purchase of imported household appliances or cars) and mortgage. Yet, easy access to mortgage pushed up construction sector in Ukraine, on the one hand, and construction materials producers in other countries, on the other (as most part of construction materials are imports). Therefore, through external loans commercial banks in Ukraine tended to support foreign

producers. However, the prevailing share of loans to enterprises in the total long-term loans may be regarded as an evidence of the increasing support to investment activities through lending. Reconstruction and modernization of production facilities has been increasingly greater concern for national producers, enhancing in this way production capacities of the national economy.

Imbalances of assets and liabilities in the Ukrainian banking system are illustrated in Charts 4 and 5.

Chart 4: Deposits and Loans, by legal entity and physical person

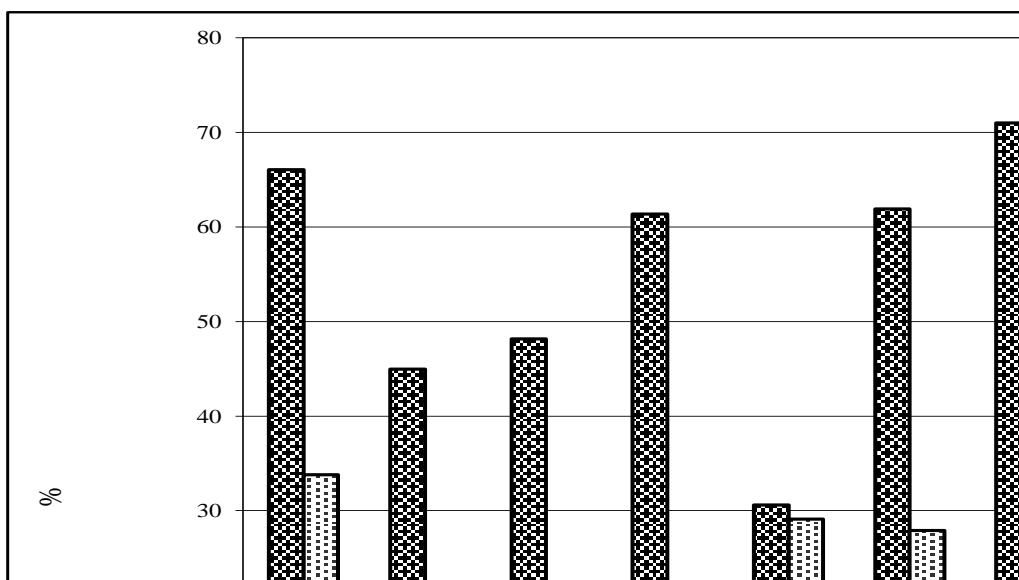


Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

Graph (Chart 4) demonstrates prevalence of loans over deposits in 2007–2013, in spite of explicit signs of crisis at the Ukrainian financial market, which is an evidence of the excessive credit expansion trend in the Ukrainian banking system in this period. A reverse side of this trend is the degrading quality of credit portfolio. Besides that, rapidly growing scopes of loans complicate monitoring of the credit portfolio quality by regulatory bodies, on account of its too high volatility

It should be noted that lending expansion preceded bank crises in many countries (Japan or countries Latin America) in 80s and in countries of South-East Asia in 90s. In the Southern Korea, on the eve of the crisis in 1997, absolute Charts of problematic and bad debts grew from 12.3 trillion to 22.6 trillion USD, with their share in credit portfolio grown from 3.9 to 6%. So, economic boost in countries of South-East Asia had hid for years the vulnerability of banking system, with the demand for loans stable as long as the economy growing. The latest crisis revealed low quality of credit portfolios of banks in many countries, which is essentially the fault of governments and central banks. Experiences of the abovementioned countries show: when the rate of growth in loans is more than twice higher than that of GDP, this should be seen as a sign of potential occurrence of banking crisis [1].

Chart 5: Rates of growth in loans and GDP



Source: constructed by the author by data from NBU and State Statistics Service of Ukraine

Graph shown in Chart 5 confirms the above thesis that top managers and administrations in Ukrainian banks have drawn no lessons from the crisis of 2008. While purification of the Ukrainian banking system by the crisis of 2009–2010 led to stabilization and healthy economic development as early as 2010, trends of 2012 and 2013 show that non-productive model of banking system was launched anew.

It should be mentioned that the year of 2004 was rather difficult for the national banking system, and the year of 2008 marked the beginning of financial crisis, triggered by the shrinking global demand for domestically produced machinery and equipment, chemicals and basic metals. This, accordingly, aggravated the financial condition of enterprising entities (not to mention the default of some), resulting in failure of legal entities and physical persons to return bank loans. National currency devaluation resulted in shrinking capacities of borrowers (mainly physical persons) to repay bank loans, especially loans in foreign currencies, which triggered growth in problematic (overdue) loans of physical persons.

This is a grave problem, because a limit exists, which, if passed over, will make the capital available in Ukraine incapable to cover losses incurred by bank loans. When the losses exceed the capital, this may cause bankruptcies, which will require recapitalization.

It is the reason why banks seek for prolongation of loans and various forms of credit portfolio restructuring, with the only purpose to pay interests (depending on the amount of bank's capitalization or income). Part of the banks started to sell their loans to collector firms in 2007 and 2008 [4]. As of 2010, banks transferred problematic loans on 2 to 5 billion USD to collector firms, which were mainly consumer loans. To enhance the quality of credit portfolio in commercial banks, the NBU enforced the Resolution from 13.09.2010 No 424 "Procedure for Formation of Reserves by Banks on Loans and Interests Charged on Loans, and Writing off Bad Debts".

Nearly 30-fold growth in the amount of problematic (overdue) loans in 2000–2013 is an evidence of low quality of bank assets. Yet, the share of overdue loans in credit portfolio has not been significant. While their lowest share was registered in 2008 as 1.3%, it grew up to 9.4% in 2010, and over seven months of 2014 it continued to grow, to reach 10.8%.

There are several reasons behind this. First, devaluation of the Ukrainian currency (hryvnya, UAH) led to not only nominal revaluation of overdue loans in foreign currencies, but also to worsening of financial conditions of the borrowers. Second, banks had losses due to annexation of Crimea and legal prohibition to do business on the temporarily occupied territory. Third, military actions forced the regulator to ban the conventional transactions with the credit portfolio across the area of Antiterrorist Operation (part of Donetsk and Lugansk regions in the Eastern Ukraine). Forth, enforcement of the Law of Ukraine "On Moratorium on Expropriation of Properties of Ukrainian

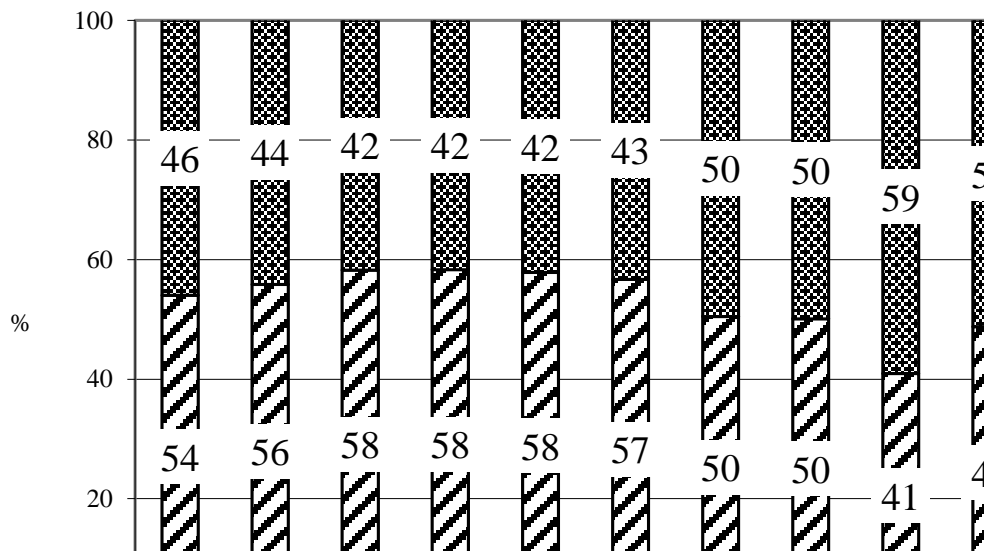
Citizens, Given as Backing of Loans in Foreign Currencies”; the Law had to be enforced largely due to economic problems encountered by Ukraine, especially the high volatility of the national currency exchange rate. In 2013, there were 968679 lawsuits in courts of general jurisdiction in the first instance, of which 184989 were about credit disputes, or 19% of the total number of cases. Of these, claims were met in 137431 cases, or in 74% of the total number of lawsuits on credit disputes. Fifth, weak system for protection of lenders’ rights, significant problems with sales of mortgaged property and court proceedings expenses.

The outburst of financial crisis in 2008 showed failure of the banking system to transform savings into investment. Insufficiency of loans for investment projects due to low capitalization of Ukrainian banks pressed harder than anything else on the competitiveness of the Ukrainian economy. Given considerable wear of fixed assets across the economy, no visible change in resource and energy saving in production sector can be expected, which will further decline the global competitiveness of the Ukrainian economy. However, the situation can improve if production enterprises seek for more efficient use of lending market tools.

A large problem for domestic banks is that two thirds of the loans given to physical persons are loans in foreign currencies, with 70% of currency loans given by the largest Ukrainian banks. Commercial banks did not care that most part of borrowers did not earn income in foreign currencies and that if devaluation would occur repayment of interest and return of loans would be problematic, which would have negative effects for the banking system. Borrowers are not always capable to have a good sense or awareness of the effects of inflation, currency fluctuations, price growth, reduced or lost earnings.

Unfortunately, there have been no mechanisms in Ukraine to prevent (i) excessive lending at the global market by the domestic corporate sector, and (ii) lending in foreign currencies at the domestic market. In 2006, the NBU made the initial steps to prevent a growth in the deposits in USD by increasing two-fold the target for obligatory reserves on deposits in foreign currencies. In fact, it was one of a few successful measures to recover the Ukrainian banking system (see Chart 6).

Chart 6: Measures of amounts of loans in foreign currencies



By the IMF classification, the level of dollarization in a country can be regarded as reasonable if it amounts to less than 30%. Ukraine, therefore, has fallen under the category of countries with high dollarization level. It is a very negative tendency, as a foreign currency (USD or euro) has become a means of circulation, payment and savings along with the domestic currency. In view of this, dual-currency system is a problem to the NBU; if it is not dealt with, an effective monetary policy will be impossible.

A large share of loans in foreign currencies, sometimes even a larger one than in the national currency (as was in 2008 and 2009, see Chart 5) caused heavy pressures on the national currency exchange rate.

The existence of a large share of loans in foreign currencies sustains a large demand for it at the internal interbank market. Shrinking returns from exports cause currency deficit, which triggers devaluation of the Ukrainian hryvnya. The situation is aggravated by the demand for foreign currencies from commercial banks that need to repay foreign debts, and by other tendencies referred to above.

Lending used to provide for a major share of income to Ukrainian commercial banks prior to the financial crisis. Once the lending shrank, the banks had to re-orient on the currency market where the transactions with currency purchase and sale became very profitable. Also, in October – November 2008, the NBU carried out refinancing of the banking system, to rescue it from the liquidity deficit. The banks received 74 703.3 million UAH in this period. Because the control over use of this money is not perfect, experts say that a large share of this money was forwarded to the currency market, which opened wider currency speculation opportunities for banks [12]. It is paradoxical that, on the one hand, banks carry out speculative transactions and have extra profits; on the other hand, their actions cause devaluation of their capital due to rapidly falling exchange rate of Ukrainian hryvnya.

Hence, restructuring of credit investment in the national economy in favor of loans in foreign currencies was due to the following reasons: (i) lower level of interest rates on loans in foreign currencies compared with ones in national currency, with the stability of the national currency exchange rate to USD; (ii) the accelerating growth in deposits in foreign currencies at the domestic market and vigorous lending by domestic banks at the global financial market, expansion of importers who boosted the demand for loans in foreign currencies; (iii) the on-going inflation expectations; and (iv) the increasing numbers of banks with foreign capital.

Therefore, due to the rapidly growing lending, not balanced with the internal financial capacities of banks, and the resort of banks to the NBU for liquidity support, the NBU had to abandon any support of bank liquidity by the instruments of refinancing, if a bank had chronic imbalances between the terms of loans repayment and amounts of loans.

According to the Resolution of the NBU Board from 21.04.2008 No 107, entered into force in April 22, 2008, when a bank needs refinancing from the NBU for liquidity support, it shall be required to submit information about its lending policy, specified by terms and amounts of the loans; the decision on refinancing shall be taken with account to this information [3]. According to experts, measures like this are quite expedient. As shown by research, in the years of 2007 and 2008 currency imbalances and repayment term imbalances were rapidly increasing in the Ukrainian banking system, which means the increasing gaps between the amounts of deposits and loans by repayment term and currency of repayment. Risks amassing in the Ukrainian banking system due to the increasing orientation on foreign loans, stroke heavy blow on the banking system in autumn 2008, when domestic banks faced limited access to external lending sources, due to liquidity problems at global financial markets and outflow of capital, which worsened their liquidity and increased devaluation pressures on the national currency. Also, the increasingly important role of lending in the financial capacities of banks, especially foreign loans, increases the dependency of banks on foreign financial institutions, shocks at global capital markets and systemic risks threatening the financial soundness of the Ukrainian banking system. Yet, the causally related domestic problems of Ukraine are no less vital: unstable financial condition and weakness of domestic banks and overall economic slackness.

The main factors hampering the lending market in Ukraine are the following:

1. The falling rates of economic growth (economic recession) due to military conflict, loss of control over a part of Ukrainian territories and rapid shrinkage (if not closure in some sectors) of the Russian market.

2. Political instability, social tensions, inflation, rapid devaluation of the Ukrainian hryvnya and shrinking populations' incomes, which represses consumption and solvency of borrowers .
3. Limited access of enterprises and population to loans as a consequence of the increasing government borrowing.
4. Limited financial resources for potential borrowers, because the banks are legally required to increase reserves to secure stability.
5. Shortage of lending resources due to weak domestic monetary capacities along with limited external resources, disabling long-term capital formation.
6. The degrading quality of assets and the increasing arrears, resulting from high credit risks, imperfect methods of risk management, absence of clear mechanisms for return of loans by insolvent borrowers.
7. Inadequate legal protection of borrowers and lenders alike, low level of financial literacy with the population.

3. Conclusions

Recovery from the monetary crisis is an imperative for economic development. Practices of many countries show the efficiency of measures given below:

- Improve the system of regulation and supervision of bank equities, in parallel with a relief from administrative pressures, creating conditions for long-term capital formation;
- Improve the refinancing system, strengthen the function of central bank as the lender of the final instance;
- Carry out stress-tests of banks, to evaluate their capital sufficiency and capacities to encounter internal and external shocks;
- Sale of banks recapitalized by the government to effective owners;
- Improve the mortgage mechanism through engaging state-owned banks;
- Stabilize inflation and fix reasonable interest rates;
- Foster the attitude of trust to the national currency and banking system.

The above measures, when taken coherently, can enhance banks' efficiency and competencies, and their role as vital and vigorous contributors in economic recovery.

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Аннотация. Целью работы является систематизация данных развития кредитного рынка Украина в период экономических, политических потрясений и начала военного противостояния с Россией. Метод продолжительного исследования позволяет проследить изменения, которые происходили не только в банковской системе, но и в целом в экономике.

Методика. Исследование основано на сравнении данных по ряду показателей, которые были взяты за основу и позволили в полном объеме провести анализ кредитного рынка как составляющей рынка капитала за период с 2000 по 2013 год. **Результаты работы** позволили четко определить проблемы, которые препятствуют стабильному развитию банковской системы Украины, среди которых можно выделить следующие: высокий уровень себестоимости банковских продуктов; брак квалифицированного персонала; недоверие населения к банкам; низкий уровень культуры пользователей финансовыми продуктами; низкий уровень доходов населения; высокая доходность по депозитным операциям увеличивает стоимость кредитных продуктов; замедление развития экономики, отсутствие реформ; социально-политическая напряженность; военный конфликт с соседним государством.

Практическое значение. Четкое определение существующих проблем на кредитном рынке как составляющем элементе банковской системы позволило определить ряд направлений которые позволяют решить сложившуюся ситуацию. Среди них прежде всего следует выделить следующие: банк регулятор (Национальный банк Украины) должен брать на себя большую ответственность, как органа последней инстанции при рефинансировании того или иного банка; на постоянной основе внедрить проведения стресс-тестирования для банков Украины; стабилизировать уровень инфляции и вернуть доверие к национальной валюте; настроить механизм ипотечного кредитования государственными банками.

Значение / оригинальность. Полученные данные в результате основательных расчетов позволили не только определить проблемы, но и выявить пути их решения, что даст возможность украинской банковской системе выйти на новый этап своего развития, а кредитный рынок сделать неотъемлемой источником развития экономики.