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## **REALITIES AND PROSPECTS OF UKRAINE BANKING SYSTEM**

**Abstract.** The article deals with the necessity of effective banking system functioning for successful economic development. The Ukrainian banking sector under the conditions of unstable financial, economic and political situation is analyzed. The basic problems, which the banks faced by in the course of their business, such as a low credit and investment ratings, total distrust of financial institutions, rapid devaluation of the hryvnia, are grounded. It is represented the dynamics of the changes in the number of banking institutions, dynamics of indices of their activities, changes in the discount rate for lending of the real economy sector by commercial banks. It is found that reducing the number of banks would mean increasing their reliability. The reasons of commercial banks liquidation are determined. The necessity of nationalization of JSC "Privatbank" is grounded. On the base of the analysis the recommendations of stabilization the banking system, the main of which are the start of lending and effective risk management are offered.

**Keywords:** banking system; bank; bankruptcy; solvency; credit; discount rate.

**JEL Classification:** G21

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## **РЕАЛІЇ ТА ПЕРСПЕКТИВИ РОЗВИТКУ БАНКІВСЬКОЇ СИСТЕМИ УКРАЇНИ**

**Анотація.** У статті здійснено аналіз банківського сектору України в умовах нестабільної економіки. Обґрунтовано основні проблеми, з якими стикаються банки у процесі своєї діяльності. Зображено динаміку зміни кількості банківських установ, динаміку показників їх діяльності, зміни облікової ставки на кредитування реального сектору економіки комерційними банками. На основі проведеного аналізу запропоновано рекомендації щодо стабілізації банківської системи.

**Ключові слова:** банківська система; банк; банкрутство; платоспроможність; кредитування; облікова ставка.

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## **РЕАЛИИ И ПЕРСПЕКТИВЫ РАЗВИТИЯ БАНКОВСКОЙ СИСТЕМЫ УКРАИНЫ**

**Аннотация.** В статье осуществлен анализ банковского сектора Украины в условиях нестабильной экономики. Обоснованы основные проблемы, с которыми сталкиваются банки в процессе своей деятельности. Представлена динамика изменения количества банковских учреждений, динамика показателей их деятельности, изменения учетной ставки на кредитование реального сектора экономики коммерческими банками. На основе проведенного анализа предложены рекомендации по стабилизации банковской системы.

**Ключевые слова:** банковская система; банк; банкротство; платежеспособность; кредитования; учетная ставка.

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**Introduction.** Economic development sufficiently depends on its historical development. This follows from the researches of economists. That is why on the state of the economy and the banking system in particular affect not only the economic but also the geographical, historical and other factors. Currently it is very relevant. After all, the result of historical development is the formation of the banking system structure with further reorganization and restructuring.

In recent years an active process of the Ukrainian banking system integration into the global financial system through its adaptation to international standards of banking systems operation and regulation begun. Therefore, in the present circumstances the strategic objective of the National Bank of Ukraine is to build a sustainable, efficient and competitive banking system that would facilitate long-term economic growth of the country, its financial security. The solution of this problem could be achieved through a combination of three interrelated areas: ensuring the stability of the banking system, transparency and a high level of competitiveness [1, p. 32–33].

**The analysis of researches and the tasks setting.** The researches of the theoretical and practical foundations of the banking system were engaged by foreign and domestic scientist, in particular A. Antoniuk, W. Wozniak, I. Granovskaya, R. Peak, D. Pirogov, N. Rudyk, T. Smovzhenko. Haunga S., Dzhou H. and Dzhi H. paid the special attention to the issue of bank lending during the crisis.

However, considering the many scientific achievements, still there is many questions requiring a more comprehensive research. The research goal is the analysis of the current state of the Ukrainian banking system and searching for ways of its further development.

**Research results.** The modern banking system can be characterized as an open system with many structural elements. It is characterized by constant development. Periodic recessions or regresses of this process caused by some changes in the economy. Economic development on the country depends on the state and prospects of the banking system.

The effective functioning of the banking system is a necessary condition for the development of market relations in Ukraine, which objectively determines the leading role of the central bank's banking regulation.

National Bank of Ukraine makes efforts to implement the main strategic goal – ensuring the stability of the national currency through targeted monetary policy aimed at macroeconomic stabilization and inflation control [2, p.5].

The banking system participates in performing the basic functions of the financial system, in particular by:

- providing ways to move the financial resources over time;
- the development and providing methods of risk management;
- providing a mechanism of combining financial resources and their distribution between different entities;
- ensuring the smooth functioning of payment systems;
- ensuring the market saturation with price information [3].

Banks are the most important financial intermediaries that provide liquidity and control the services among all financial firms and are the main markets channels [4, s.195]. This characteristic of banks as the driving element of the whole economy, is quite compelling.

On the 01.01.2017 there are 96 banking institutions (except insolvent) in Ukraine. 38 banks of them – are banks with a foreign capital. In this situation it is a positive phenomenon, because it contributes to the expansion the range of banking products and integrated approach to service different clients [5, p. 47].

At the October 2016 such banks as Megabank, Diamantbank, Bank East, Taksobank, International Investment Bank, Universal, Pravex–Bank, BIS, ViEs Bank and Marfin bank are referred to insolvent ones. That is the second dozen of banks that do not reach positive levels of capital adequacy.

It is advisable to show the dynamics of the number of banks in Ukraine (Figure 1).

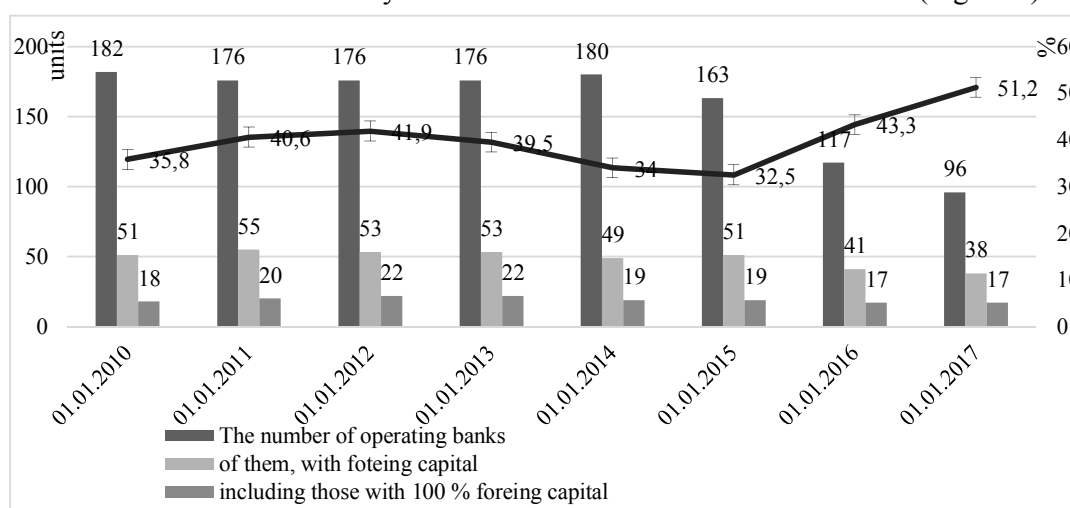


Fig. 1. Changes in the number of banks in Ukraine  
Source: 3

So, on January 1, 2017 the number of banks decreased by 21 units compared to 2016, and by 67 units compared to 2015. During the research period 86 banks were withdrawn from the market. During 2016 21 banks were liquidated. The reason was the failure of banking legislation, namely the abuse of financial monitoring and far "not transparent" ownership structure of banking organizations.

Also, 1.6.2016 p. The National Bank of Ukraine for the first time decided to grant consent to liquidation and revocation of license holders on the initiative of two banks (JSC "Finance Bank" and JSC "Investment and Trust Bank"). NBU led the work to bring ownership structures JSC "Finance Bank" and JSC "Investment and Trust Bank" with the requirements of transparency. The controller banks was set, but not expressed a desire to engage in activities and chose the path of self-destruction of financial institutions [6].

Elimination of insolvent banks from the market gave way to rapid development of payment subsystem operating commercial banks, this happened because the resale of network technology.

The share of foreign capital in the statutory capital of existing commercial banks in Ukraine from 01.01.2010 to 01.01.2017 increased by 17.5 percentage points, and during 2016 – by 10.0 percentage points. On the 01.01.2017 38 banks with 100% foreign capital acts in Ukraine. It is less than 3 units from the beginning of 2016.

Acquisitions and mergers will be typical for Ukrainian banks. This will be the main requirement to stay on the market of financial services. Reducing the number of banks for the citizens of the state would mean increasing their reliability and thereby the risk of deposits will decrease. It is possible that only about forty banks will remain from such a large number. This information is already takes place in the media.

Another sharp fluctuations was the government's decision on 18.12. 2016 according to which JSC "Privatbank" moved to the 100-% state ownership. More than 20 mln. Ukrainian had deposits in this banking institution that in this situation has caused a panic fair. The result – a massive queues at ATMs that notified of the lack of money by the middle of the day.

The nationalization of JSC "Privatbank" was caused by a lack of capital. On the 1 of December 2015 it was 113 billion USD., and in December 2016 reached the level of 148 billion USD. Shareholders of the bank appealed to the state, which in turn made the decision of entering the state in bank capital. Currently JSC "Privatbank" works continuously and in normal mode to its customers.

Medium and small banks are at the highest risk. It is predicted that in a short time the NBU will output such banks from the market. However, in our view, it involves converting and circuit banks (for example PJSC CB "Premium") that are not engaged in banking business. The main problem is that the National Bank as the regulator does not publish the criteria and characteristics for which banks will get into this list. It is advisable to consider the dynamics of the indexes of the financial performance of banks (Fig. 2).

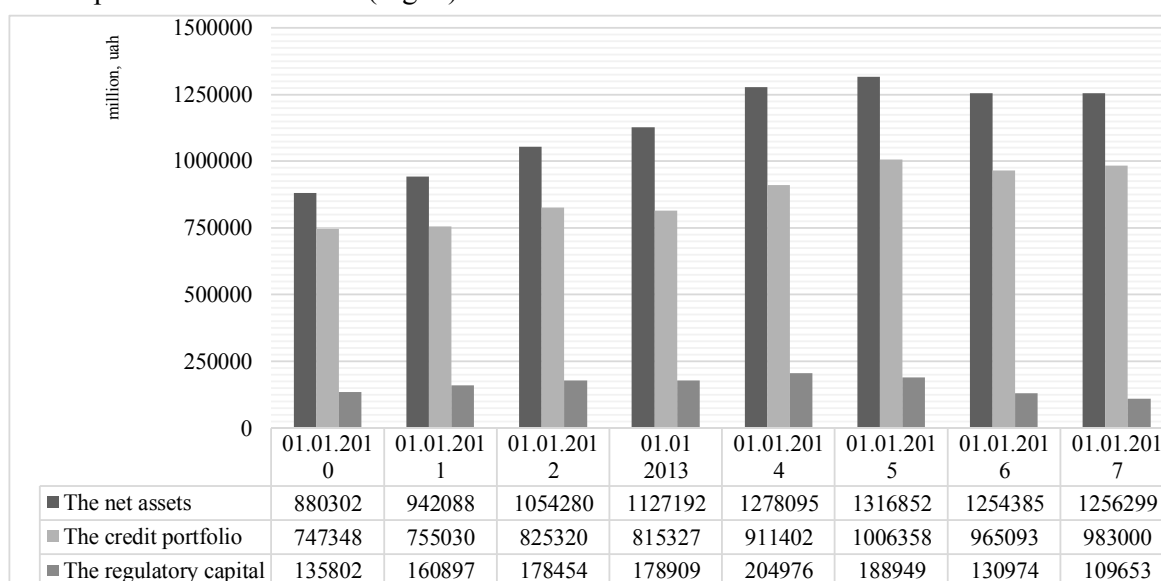


Fig. 2. The dynamics of the financial performance indexes of Ukrainian banks  
Source: 3

During 2016 the amount of assets increased by 1.0% (1914 mln. UAH), however we can observe assets decline against 2015, namely 60.553 billion UAH. Quite an important aspects of fluctuations in the assets of the banking system in researched period were the dynamics of the national currency, removing of commercial banks from the market outflow of client funds and a significant decrease in loan portfolios.

State banks were the only group whose share in total assets increased from the beginning of the year (2.7 percentage points).

Regulatory capital also declined in 2016. This was due to repayment of NBU loans, conversion of subordinated debt and interbank parent of capital.

The study of the status and trend analysis of the domestic banking system give reason to affirm that overall it complies with modern requirements, including the recommendations of the Basel Committee on Banking Supervision, the WTO requirements and other international documents [1]. However, at present it has a number of unresolved issues.

The banking system of Ukraine is faced with problems such as poor credit and investment rating, reducing confidence in the national currency (UAH), high corruption and with imperfect and not adapted legislation that lead to negative consequences in the work of National Bank of Ukraine and commercial banks in particular.

Rather low is the credit activity of banks caused by a narrow range of reliable borrowers high level of uncertainty of the economy and excessive cost of credit.

During 2016 the volume of customer loan portfolio increased (by 1.8% or 17.907 billion UAH) and on the 01.01.2017 reached 983.0 billion UAH. This happened due increase in the volume of loans to entities (Fig. 3).

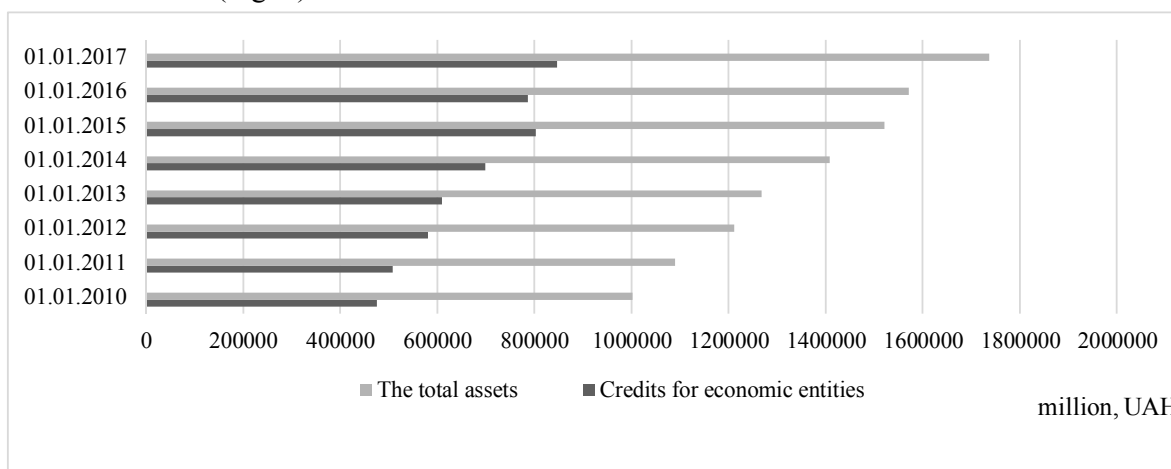


Fig. 3. Trends in lending to the real sector by commercial banks during the 2010–2017  
Source: 3

The volume of credits granted to business entities for 2015 increased, but since 01.01.2016, their size was reduced to 2.08%, and on the 01.01.2017 was increased again by 7.3%. Such fluctuations of loans depends on several factors, including: a limited number of reliable borrowers, uncertainty regarding the further development of Ukraine's economy and the high cost of credit. Quite an important element in the loan portfolio is the discount rate (Figure 4). The average discount rate for all agricultural loans in the EU amounted to 4.2%. The highest rate was in Bulgaria (7.3%) and the lowest – in the Czech Republic (2.4%) [7].

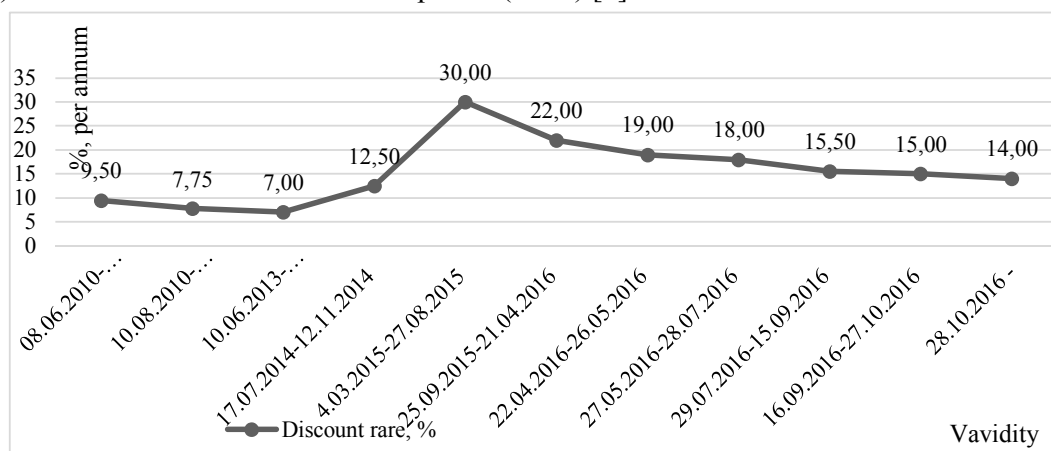


Fig. 4. Dynamics of change the NBU discount rate  
Source: 8

During the research period it occurred as increase and decrease in the National Bank of Ukraine discount rate. At the 28.10.2016, the discount rate is 14.00% per annum.

Reducing the rates on deposits in foreign currency caused by low banks demand for funding in foreign currency. Currently, rates on foreign currency deposits are at a minimum. It is saved a significant differential for rates for local and foreign currencies, more than 10 percentage points. Reducing the rates has provided banks to partially reduce pricing lending terms of business, which in turn led to a moderate increase in corporate loan portfolio. [9] It is necessary to continue to reduce interest rates, it will give banks an opportunity to perform one of its basic function – to lend the economy, because, to develop the business under the condition of the "expensive" credit resources is impossible.

It is expedient to note that as a result of a stabilization of the exchange rate and a gradual decrease in the discount rate, a significant number of banks launched a loan program, thereby attracted new customers both corporate and small and medium businesses.

According to the National Bank of Ukraine, after years of loss-making activities the banking sector became profitable. It took place in May 2016. Thus, in May–August 2016 the net profit of solvent banks amounted to 4.9 bln. USD [9].

Although marginal profitability of the banking sector, the quality of the resource base and assets is still quite low and operating environment – weak that enhances sensitivity of banks to major individual risks [10].

The particular attention of banking institutions should be paid to increase the level of risk management. According to the results of 2010–2016, many Ukrainian banks did not pay enough attention to the management of credit risk and liquidity risk, which in turn contributed to growth the number of insolvent banks that were liquidated.

**Conclusions and prospects of further research.** According to the study we should state the fact that the economy still carried out restructuring, which requires a reliable and well-developed banking system.

In order to stabilize the banking sector first of all it is necessary to:

- reduce foreign exchange restrictions that will lead to the liberalization of the foreign exchange market and reduce the outflow of foreign currency deposits. Therefore banks will receive funds that are currently in circulation on the "black market";
- capitalize banks. Since January 2016 it is implemented the decapitalization of state banks – Oschadbank and Ukreximbank for 15 bln. UAH;
- reduce the discount rate that will enable to reduce the cost of credit;
- stabilize the situation on the currency market and thus restore confidence in the banking sector;
- The transition of NBU to inflation targeting, which will allow to predict the price of loans.

The Ukraine's economy out of stagnation, start of lending and effective risk management can bring the banking system of the crisis.

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