“Modern tendencies of the Ukrainian banking system development”

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MODERN TENDENCIES OF THE UKRAINIAN BANKING SYSTEM DEVELOPMENT

Abstract

The article considers the main tendencies of financial globalization as an all-encompassing process of the world community transformation into an open integrated system of information-technological, financial-economic, socio-political, and socio-cultural interrelations and interdependencies, as well as dialectical interaction of national and global social processes. The main current trends of the Ukrainian banking system development for the period 2016–2017 were researched, which was expressed in accelerating lending to businesses and the population; a key interest rate cut by the National Bank of Ukraine, which creates positive conditions for improving the economy, reducing interest rates on deposits, increasing retail lending and portfolio growth loans to individuals. The Ukrainian banking system is gradually integrated into the international banking system and forms its development pattern in the way of integration processes, taking into account the complexities of the external financial environment.

Keywords financial globalization, banking system tendencies, inactive loans, loss-making banks

JEL Classification F36, G21

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INTRODUCTION

Nowadays, the research of modern trends in the Ukrainian banking system development is a topical issue in connection with political and economic, and social transformations, hryvnia's devaluation, loss of business by banks and large losses, and, consequently, investor confidence loss. All of the above causes the Ukrainian banks to lag behind foreign ones, especially in the innovation processes management, the quality of which does not match the world level and the needs for the Ukrainian banking system development. Ukrainian banks must constantly implement new development strategies that would provide competitive advantages and stability in a context of growing competition. In this context, it is essential to increase the role of foreign capital in the Ukrainian economy, which must be consistent not only with the domestic needs of the economy, but also with the global financial and economic markets, because today it is not the real sector of the economy that forms the financial sphere in the international market, but the financial markets determine the level of economies development in the world. Given the insignificant volumes of Ukraine's participation in the global financial markets and the low level of the domestic financial system integration into international financial centers, it is necessary to continue the Ukrainian banking system integration into the world financial space provided that transparency of banking activity is ensured, which should facilitate using foreign experience in banking business and establishing relations with foreign powers.

In the context of the world globalization processes, a major role belongs to the banking system, the effective functioning of which determines the economic development level. The banking system has its own distinctive features and current trends shaped by the impact of globalization. Esqueda et al. (2013) believe that globalization affects the global financial flows growth, the acceleration of capital flows between countries and the expansion of international credit and equity markets. According to Schmukler (2004), the development of modern information technologies leads to the evolving information systems, databases and global computer systems, which leads to an increase in the international transactions volume. At the current stage, SWIFT (payment system), CEDEL, EUROCLEAR, NASDAQ (securities trading), BLOOMBERG, DATA-STREAM, REUTER (information on the state of the world financial markets) and other systems are used. The rapid development of the latest technologies promotes the emergence of new information products and financial services, virtual banks creation, the concentration and centralization of capital in financial intermediation, increased competition, financial activities universalization. At the same time, the number of companies and financial groups operating outside the domestic financial systems is increasing. In this context, Saunders (2008) emphasizes that there is a gradual transition from an industrial to a post-industrial or informational society characterized by the growing role of information and knowledge that results in a global information space affecting the global financial space.

According to Martinez et al. (2004), a single financial space is gradually being formed through the liberalization of the capital movement, which leads to the unification of the financial systems of different countries. There are various approaches to financial globalization: Mauro at al. (2006) consider financial globalization as a process; McKenzie (2001) emphasizes the ideology based on the financial legislation liberalization; Mitton and Todd (2006) define it as a financial correlation between countries. Levine (2001) shows that financial globalization is objective and diverse in shape. Laneat al. (2008) interpret financial globalization as a complex phenomenon that collectively combines national financial markets to accelerate economic development with the help of state-of-the-art technologies, integration processes, and foreign capital.

In this context, Georgantopoulos and Filos (2017) confirm the positive effect of corporate governance mechanisms on the performance of Greek banks, which is characterized by high volatility and uncertainty in the market due to the significant debt crisis affecting Greece since the beginning of 2008. Also, the influence of a large number of corporate governance mechanisms on the Greek banks efficiency is being studied, using the widely accepted models of corporate governance in the economic model.

In turn, Henry Blair (2007) notes that financial globalization is an important trend in the development of a modern world economy that takes innovation into account. Dorrucci at al. (2009) believe that financial globalization stimulates creating flexible labor markets, goods, capital, and balances the negative imbalances of economic globalization. According to Urionabarrenetxea at al. (2009), influenced by financial globalization, institutional boundaries disappear between different types of banking activity, which creates conditions for the competitiveness of the financial market under the strengthening intergovernmental interdependence and mutual influence in terms of financial relations. It should be noted that in a context of financial globalization, the openness of national economies increases, which gives rise not only to the formation of a system for supranational regulation of international finance, but also to the implementing global financial strategies of transnational corporations and transnational banks.

Slav'yuk at al. (2017) believe that financial imbalance causes macroeconomic instability, financial markets imbalance and a low level of confidence in the national banking system. The authors claim that the competitiveness of the Ukrainian financial market remains low in the limited financial services range, and it can be considered attractive for potential foreign investors.

We emphasize that mergers and acquisitions of banks are the key trend in the international banking system development. Sherman at al. (2011) believe that the emergence of banking insurance groups and transnational banks, as a result of bank mergers and acquisitions, is the basis for creating a single financial space that helps to reduce the sensitivity to market conditions and increase banks' resilience to risks. We emphasize that this tendency extends the structure of geographical presence.

Kalinichenko (2013) believes that the globalization of banking operations can be considered as the unification of banking systems in different countries on the basis of the implementing international standards of banking activities, with the subsequent transformation into a single world banking space. Dzubluk (2012) believes that banking globalization is a process of expanding the scope of transnational banks beyond national boundaries, which is accompanied by creating a network of foreign affiliates, on the one hand, and an increase in the number of foreign banks on the other. In this context, we emphasize that there are objective processes of Ukraine's integration into the global financial system, although there are many obstacles due to the political and economic crisis. Therefore, researching modern tendencies of the Ukrainian banking system will allow new strategic perspective steps towards the gradient of financial globalization.

1. METHODOLOGY

Since most innovative products are developed in banks, it is expedient to consider further methodology for organizing the process of banking innovations. The development of a methodology for innovation in the field of creating new financial products and modern trends in the development of the Ukrainian banking system in a globalizing environment is an actual issue. The processes of Ukraine's integration into the world economic space require to solve the problem of ensuring its economy development based on the forming fundamentally new methodological approaches and substantiating practical measures for the scientific results implementation.

2. RESEARCH FINDINGS

We will analyze the main tendencies of the Ukrainian banking system development in 2016–2017 years. The main trend in 2016 is a significant increase in corporate deposits in banks liabilities. Improving the finances of state-owned enterprises and restoring the activity of exporters in the second half of the year have led to an increase in deposits of foreign currency business. Its rate for the first three quarters was 12%, exceeding the hryvnia deposits, which increased by 8% (Dzubluk, 2012).

However, the population prefers hryvnia deposits. At the beginning of October 2016, the share of funds of non-financial corporations in depos-

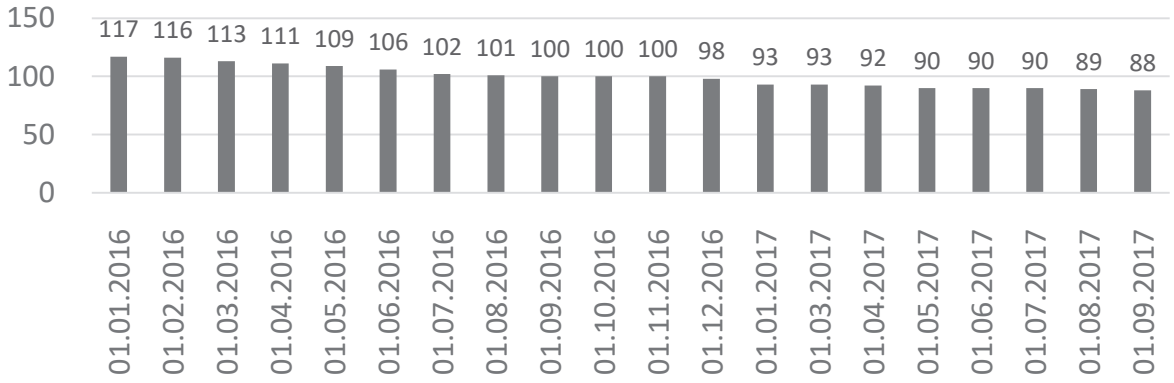

Figure 1. Number of operating banks of Ukraine in 2016–September 2017

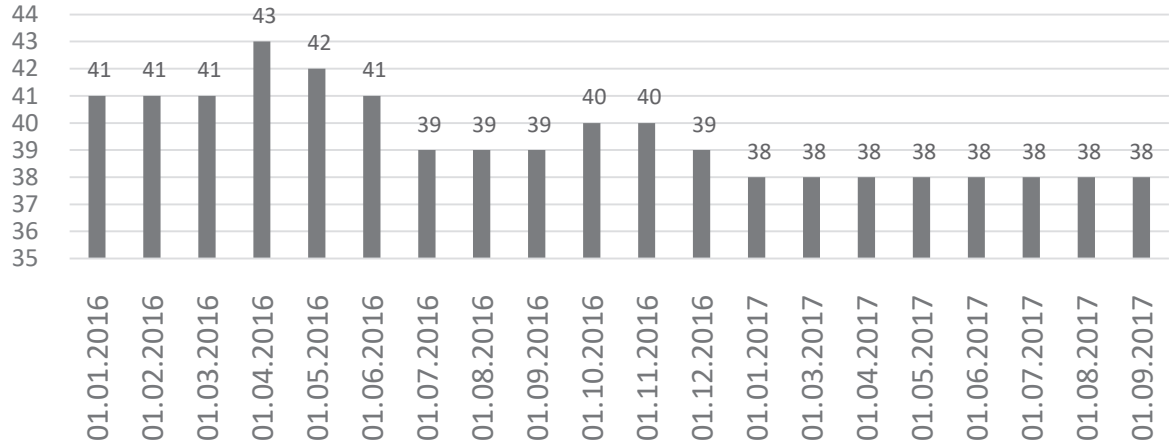

Figure 2. Number of operating banks with foreign capital in Ukraine in 2016 – September 2017

its with Ukrainian banks was the highest among European countries. The shares of economic entities and individuals in liabilities almost equaled.

We would like to emphasize that external financing loans should be the essential factor in the Ukrainian banks financing. The largest financial institutions that needed to recapitalize, during the 2015–2016 period, often converted into a capital lia ability to parent structures, namely subordinated debt and interbank loans. As of the beginning of 2016, the banks' gross external debt declined by $ 2.3 billion. $ 10.5 billion in the United States, the share of subordinated debt in banks' liabilities decreased almost twice to 3%.

From January 2016 to September 2017, the number of banks decreased from 117 to 88 (Figure 1). Currently, 38 banks with foreign capital operate in Ukraine, including 17 with 100% foreign capital (Figure 2), while in one and a half year their number decreased by 3 banks.

Due to the withdrawal of banks from the market significant losses were received by legal entities and the population, resulting in a significant deterioration in the financial position of many enterprises, some of them went bankrupt, and the state did not receive tax revenues. The prospect for the returning of funds held in the enterprises' accounts in banks for which it was decided to impose a temporary administration or liquidation is practically absent since the estimated value of such banks assets is several times lower than their book value. The active withdrawal of banks from the market has led to a sharp increase in financial burden on the Deposit Guarantee Fund over the past three years, 81 billion UAH were paid to bankrupt banks depositors (Kalinichenko, 2013). It takes a long time to revive the banking sector, as the system has to undergo testing again. Restoring the enterprises' trust to the banking system will be possible only if the NBU reconsider the understanding of the function of protecting the interests of depositors and creditors, which involves restructuring the ideology.

As to concentration in the banking sector from the first quarter of 2017, the 20 largest banks account for more than 90% of net assets. Since the beginning of April 4, 2017, banks have been withdrawn from the market. State banks continue to increase their market presence. During the 2nd quarter of 2017, the share of state-owned banks in net assets increased to 55.6%, while deposits of the population amounted to 62.3% (Dzubluk, 2012).

Note that the bank losses in 2016 increased, despite the reduction in operating profit (Figure 3). The main factor in increasing losses of banks is the reducing deductions in reserves for problem assets. The main trend of the year is that the banking system has increased profits, but with the unsustainable result. As a whole, by the end of 2016, out of 96 solvent banks as of January 1, 2017, 63 banks received a profit of UAH 10.8 billion, while 33 banks had a loss of UAH 170.2 billion (Dzubluk, 2012).

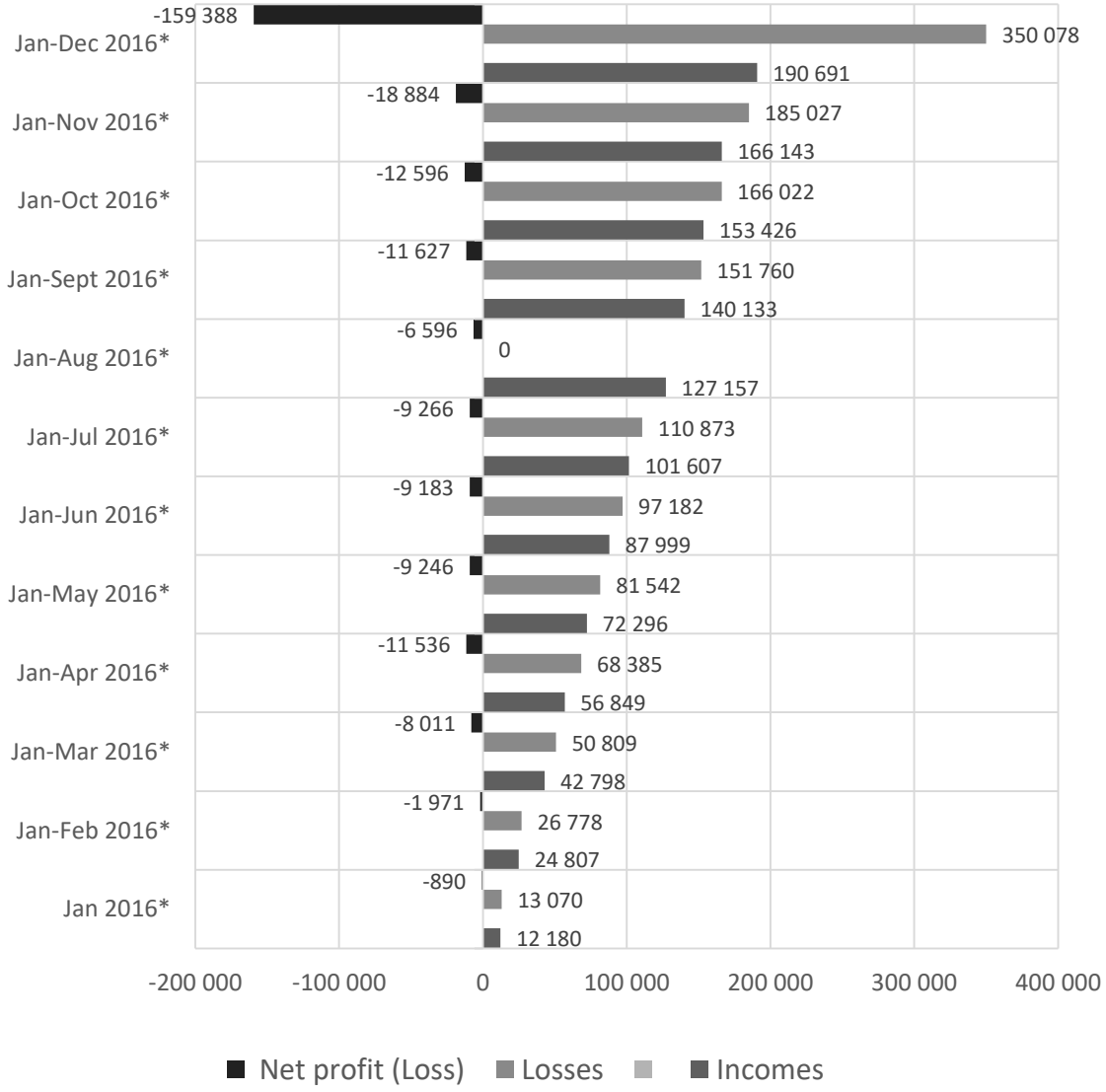

Figure 3. Incomes, expenses and profits of Ukrainian banks in 2016

This can be explained by the fact that there was a process of forming reserves for problem loans in large banks, with the volume of reserves cut in September, which can be linked to the fact that in 9 months the banks received losses amounting to 11.6 billion UAH. According to the results of 9 months of the current year, 35 out of 100 solvent banks were unprofitable. In 2015, there were 46 such banks out of 117. The number of banks that received operational loss before the reserves formation was halved. The number of banks that showed a negative net interest income decreased from 7 to 4 during the year (Dzubluk, 2012).

Figure 4 shows the dynamics of the non-working bank loans share in percentage terms for the period of 01.02.2017–01.09.2017, which is followed by a significant upward trend. The share of non-performing loans in the system increased during the second quarter to 57.7% (Dzubluk, 2012).

The loan portfolio grew only in state banks by 2.0% since the beginning of the year, while in other groups there was a decline. Cheaper financial resources have led to lower credit rates. The large impact on the hryvnia loans value for business was large-scale restructuring, in which the new hryvnia rates were closer to the dollar than to the hryvnia. The reason is the slow recovery of the economy, a high level of business loans and high interest rates.

The main trend of the current year is the change of the currency of loans to the hryvnia in the process

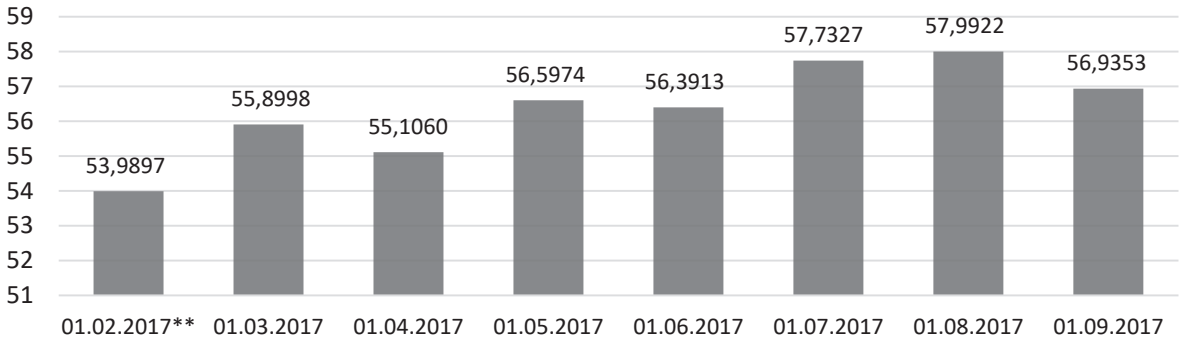

Figure 4. The share of non-working bank loans in 01.02.2017–01.09.2017 (in %)

of restructuring the obligations. During three quarters the hryvnia loans grew by 10%, especially in the third quarter. At the same time, foreign currency loans in the dollar equivalent decreased by 11%. The loans portfolio increases only in agriculture. For nine months, the overall growth of the industry at a fixed rate was 16%. Indicators of the industry give every reason to hope that the trend will continue.

Figure 5 shows the dynamics of the non-working loans share in PJSC CB "Privatbank" and without it for the period of 01.02.2017–01.09.2017. It is evident from Figure 5 that the non-performing loans share in PJSC CB "Privatbank" reached its maximum in July 2017 and amounted to about 89%, which exceeds all the norms in the last three years.

PJSC CB "Privatbank" showed losses due to the formation of reserves and the sale of bad loans. This resulted in a net loss of the system by UAH 5.1 billion. We would like to note that due to the bank nationalization there was a significant increase in deductions to its reserves, the amount of which in 2016 amounted to more than 144 billion UAH. At the same time, the bank's assets amounted to 220 billion UAH, that is, the amount of deductions was more than 65%. This led to the fact that the bank in one quarter, according to the financial statements, has been turned from a lucra-

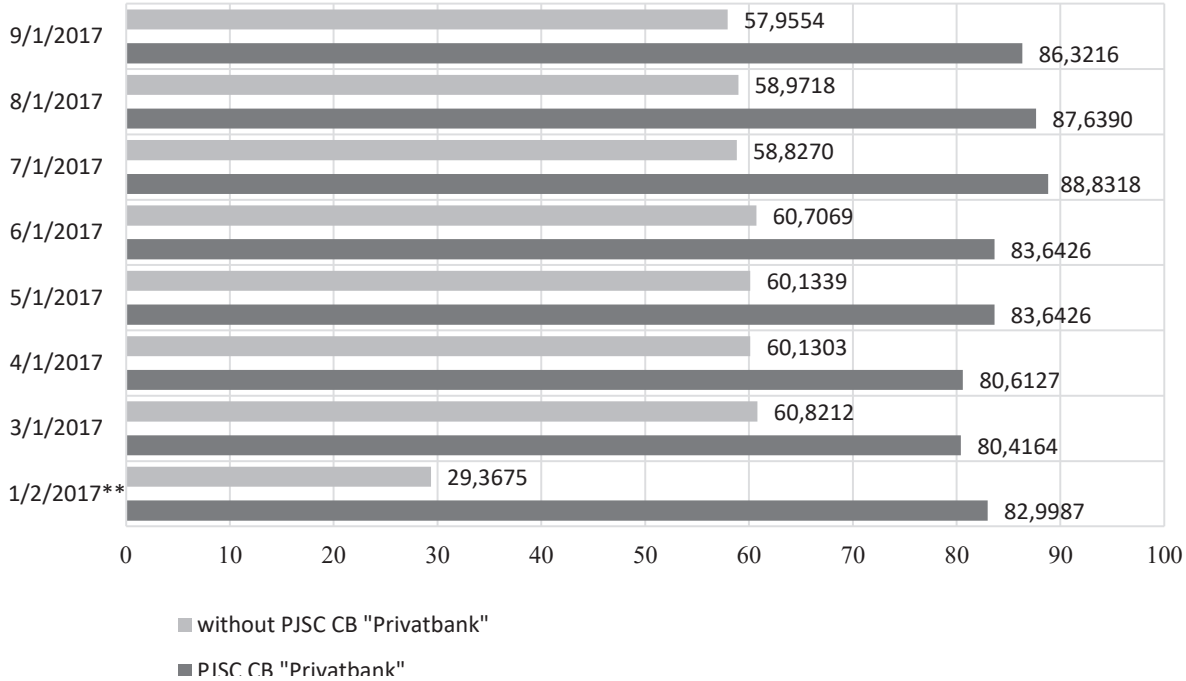

Figure 5. The share of non-working loans in PJSC CB "Privatbank" and without it in 01.02.2017–01.09.2017

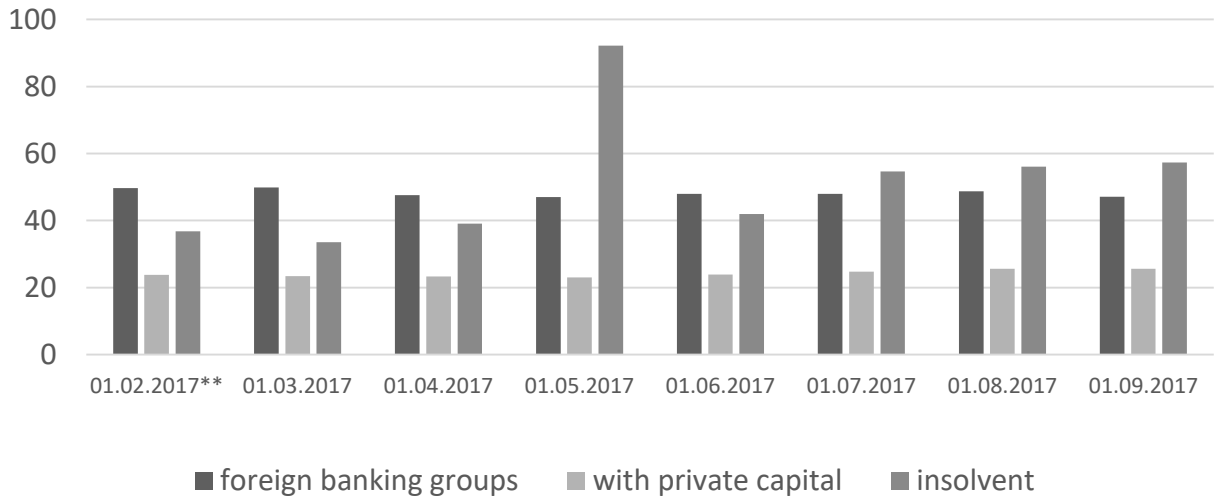

Figure 6. The share of non-working loans of foreign banking groups, banks with private capital and insolvent banks in 01.02.2017–01.09.2017

tive banking institution to the most unprofitable financial institution in the banking system. The Eurobond owners can appeal to this fact. Further changes in the Bank's indicators will most likely depend on how the state-owned "Privatbank" will be managed already, as well as on the population. Since "Privatbank" is a truly "popular bank", the mood of the population significantly impacts both the resource base of the bank and its volume lending activity.

This situation led to an increase in the non-performing assets share from insolvent banks in July 2017 (Figure 5). In August 2017, the inflow of private deposits accelerated and the situation with non-working loans was leveled out. During the first half of 2017, it is necessary to note the high level of credit risks, especially in the corporate sector.

It should be noted that although statistics on credit portfolios of business in some large banks with foreign capital have increased, they are short-term and therefore, the gross corporate loan portfolio decreased by 2.3% (–19.2 billion) (Dzubluk, 2012).

On the one hand, the attraction of state-owned funds to individuals is tracked, and, on the other hand, the funds outflow at the expense of corporations is detected. This was due to two reasons: the confiscation of funds from the former government on accounts with state banks and the payment of dividends by certain state monopolies. The growth of budget funds in the banks' accounts compensated for this outflow, so the overall system's liquidity did not deteriorate. Customer deposits remain the main source of funding for the system, with a share of almost three quarters of the banks' liabilities.

Dollar deposits are further easing due to the lack of demand for currency among banks. There is a significant difference between the deposit rates of foreign banks offering rates below the average market, both in public and private banks. In the first half of the year, business lending became cheaper, but rates on corporate loans declined more slowly than on population's deposits. This indicates the potential for further lowering rates on business loans. We note that high interest rates due to high credit risks are the most significant obstacle for attracting new loans from the borrowers' perspective.

According to the NBU statistics, the TOP-10 most unprofitable banks in the three quarters of 2016 included: VTB Bank (–5.6 billion USD); Prominvestbank (–4.1 billion USD); Sberbank (–2.96 billion USD); Ukrsotsbank (–2.8 billion UAH); Ukrsibbank (–978 million UAH); Diamantbank (–529 million USD); Alfa–Bank (–493 million USD); BM Bank (–464 million USD); Ukreximbank (–410 million USD); and Platinum Bank (–334 million UAH) (Dzubluk, 2012).

At the same time, the TOP-10 most profitable banks are: "Raiffeisen Bank Aval" (2.53 billion

USD); Citibank (UAH 1.11 billion); OTP Bank (874 million USD); ING Bank (UAH 651 million); PrivatBank (UAH 591 million); CreditAgricol (561 million USD); Oschadbank (411 million USD); FUIB (UAH 276 million); Kredobank (225 million USD); Promocredit Bank (220 million UAH) (Dzubluk, 2012).

In 2016, the highest ever loss of the banking sector was recorded – 159.4 billion UAH. PrivatBank was created 135.3 billion USD damage, generated by reserves formation for credit operations. The NBU also notes that for other solvent banks, the deduction in reserves in 2016 compared with the previous year significantly decreased. This positive trend led to a reduction in their total losses by 2.8 times – up to 24 billion UAH with 66.9 billion UAH in 2015 year. In particular, it significantly reduced the scale of losses for 2016 group of state-owned banks – by 21.5 billion UAH (Dzubluk, 2012).

Among other positive tendencies for the entire banking system is the growth of net interest income by 15% compared to 2015. The main reason is the interest income growth (by UAH 4.6 billion) against the background of a decrease in interest expenses (by UAH 1.2 billion) (Dzubluk, 2012).

According to the results of 2015, out of 117 solvent banks as of January 1, 2016, 71 banks were profitable for a total of UAH 5.2 billion, while 46 banks suffered losses totaling 71.8 billion UAH (Dzubluk, 2012).

CONCLUSION

Thus, for the period of 2016 and the first half of 2017, it is possible to distinguish the following tendencies of the Ukrainian banking system:

- acceleration of business and population lending;
- reduction in the NBU key rate, which creates favorable conditions for the economy improvement;
- lower rates on deposits of the population;
- retail lending growth;
- portfolio of loans to individuals growth.

At the same time, these trends contribute to the fact that banks will more closely approach borrowers' reporting in terms of requirements for their providing.

Today, improving the quantitative and qualitative characteristics of the financial sector development is an important task of the state regulation of the domestic financial system, which leads to the adoption of effective and adequate managerial decisions in order to find approaches and correct methods on the path of integration processes taking into account the complexities of the external financial environment. The Ukrainian banking system is gradually integrating into the international banking system and shaping its development model, which must fully exploit Ukraine's potential opportunities for financial globalization.

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