Ukraine: Macroeconomic and Banking Sector Outlook

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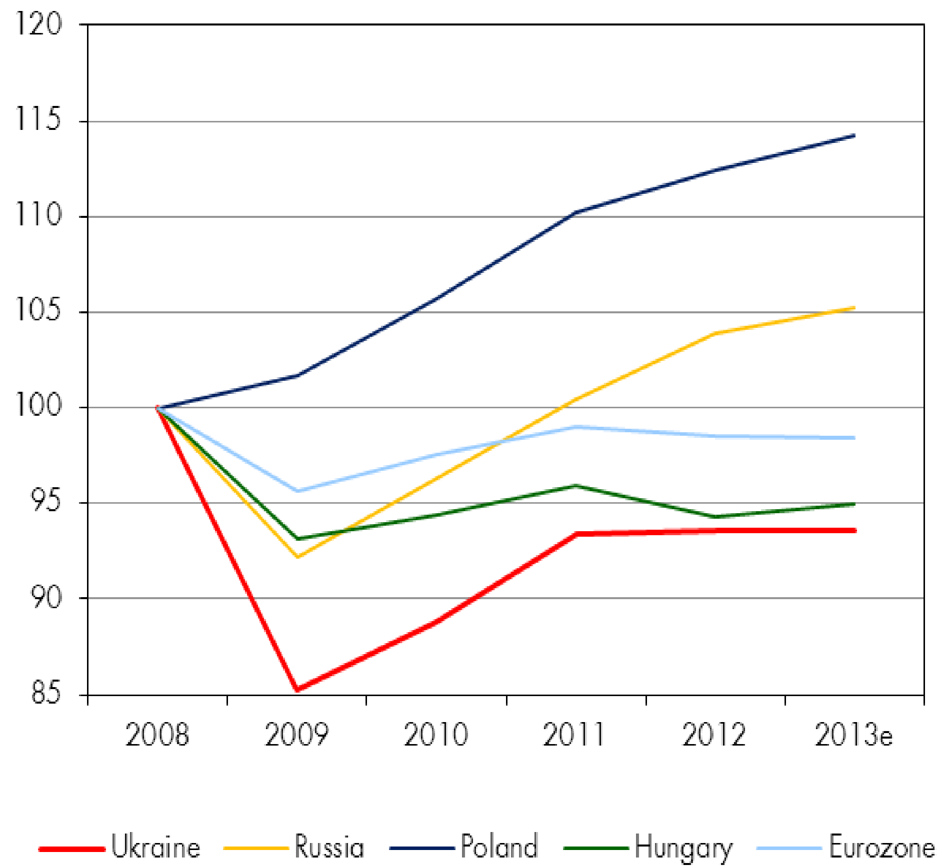
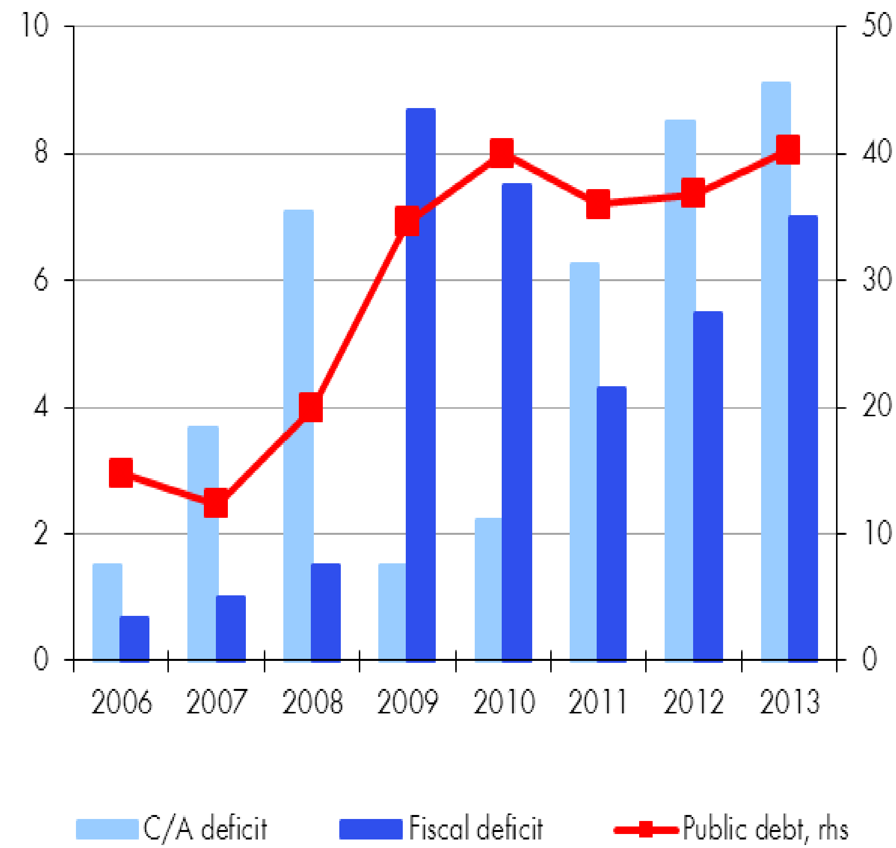
Economy: Looming vulnerabilities on the back of policy failures

- The economy has been stagnating for the last two years amid subdued external demand and weak domestic investment activity.
- Also, the country has been plagued by the twin deficits, stemming from populist fiscal policy, inflexible exchange regime and deteriorating terms of trade.

GDP growth index (2008=100)



Fiscal and external indicators (% of GDP)

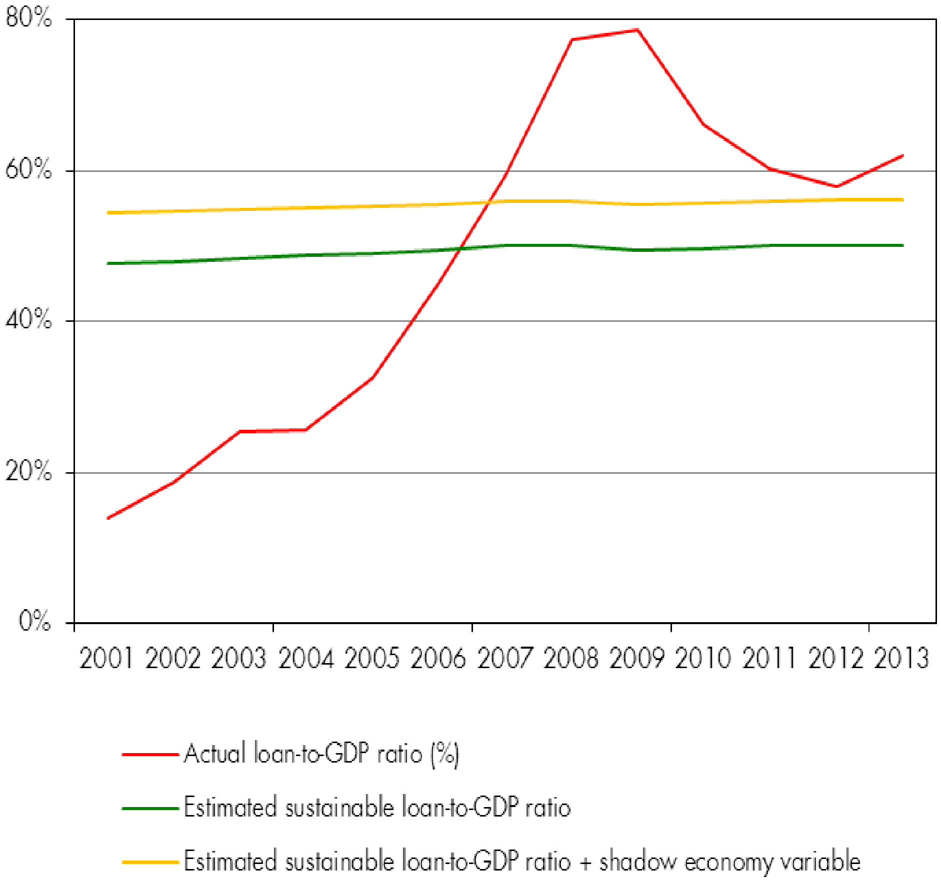


Source: National statistics, Thomson Reuters, Raiffeisen RESEARCH

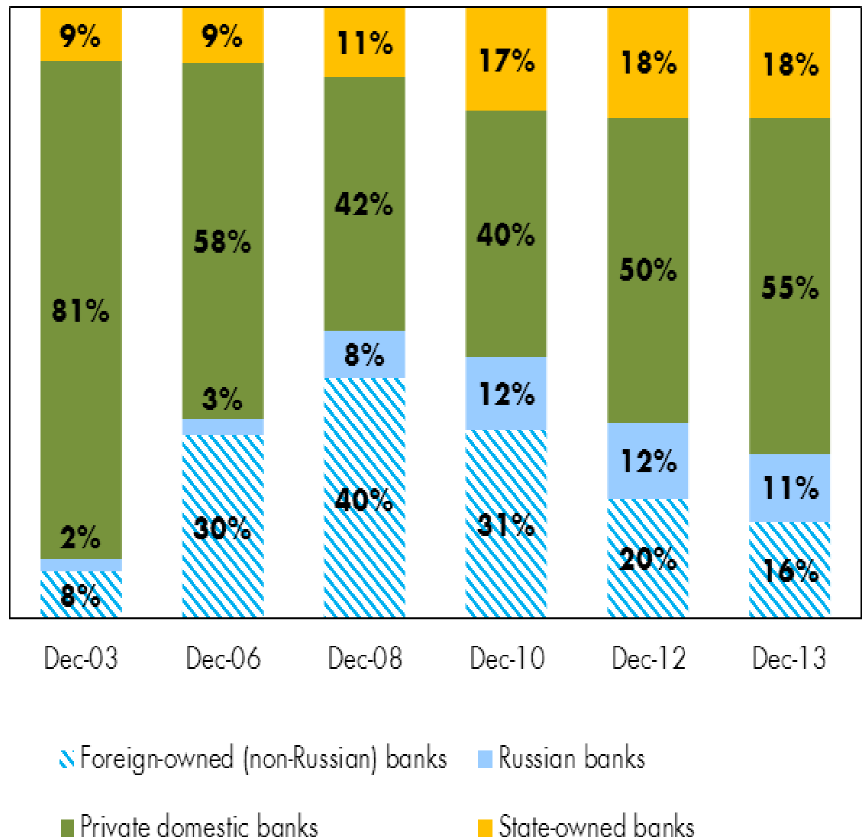
Banking sector: Weak lending activity, exodus of foreign banks

- Pre-crisis lending boom has been followed by sharp deleveraging as loan-to-GDP ratio is largely back to fundamentally justified level.
- Deteriorating macro picture, huge loan losses, incurred during the last crisis and poor investment climate prompted the exodus of foreign banks from the sector.

Loan-to-GDP ratio



Market structure by ownership*



*In total assets

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Source: National Bank of Ukraine, Raiffeisen RESEARCH

Political and economic crisis is in the full swing

- The sudden turnaround in the foreign policy and the subsequent crackdown on the peaceful protests spurred the massive public uprising in Ukraine.
- The political turmoil reverberated the economic turbulences, triggering the forceful breakdown of exchange rate peg and massive deposit outflow, and bringing country on the brink of economic collapse.
- The domestic political transformation goes relatively smoothly so far as the new government is fully functioning and has a strong mandate for implementing painful reforms.
- The new administration has a strong backing of the foreign donors, who are committed to provide massive financial support to restore economic stability and facilitate the implementation of structural reforms.
- As a result, the local financial markets got some respite with hryvnia strengthening against USD and deposit outflows decelerating.
- However, the political and economic situation remains extremely fragile amid aggressive stance of Russia, enormous challenges faced by the new government and looming economic vulnerabilities.

Economic outlook: Tough times ahead, comprehensive reforms needed

- The economic outlook very much depends on the political developments.
- In the baseline scenario we assume some de-escalation of the political conflict between Ukraine and Russia.
- The Ukrainian economy faces a substantial adjustment this year via nominal depreciation and fiscal tightening.
- As a result, GDP is to fall by 5% in 2004, while inflation rate will go up.
- In the longer-term, the fight with corruption and structural reforms may untap country's enormous potential.
- Risks to this scenario stem from negative external political developments and failure of the new administration to clean up the country.

Key macroeconomic indicators

	2012	2013	2014e	2015f
Real GDP, % yoy change	0,2	0,0	-5,0	1,5
Domestic demand, % yoy change	5,3	1,1	-5,8	0,3
CPI avg, % yoy	0,6	-0,2	6,0	7,5
Exchange rate to USD avg	8,12	8,15	10,75	11,00
Exchange rate to EUR, avg	10,47	10,84	14,30	14,30
Current Account in % of GDP	-8,5	-9,1	-5,9	-4,2
FDI, USD bn	6,6	3,3	5,0	7,0
Fiscal balance in % of GDP	-5,5	-7,0	-5,0	-3,5
Public debt in % GDP	36,8	40,3	52,0	53,0

Source: Raiffeisen RESEARCH

Banking sector outlook: Contingent on the macro outcomes

- The banks are facing strong headwinds this year, stemming from economic slump, exchange rate adjustment and increasing liquidity risk.
- The new NBU management seems determined to clean up the sector and overhaul banking supervision framework.
- Thus, we see a high chance of structural changes in the Ukrainian banking sector going forward.
- Lending activity will remain subdued in the short-run on the back of economic tensions.
- In the longer-run, the banking sector might vastly benefit from deshadowing of the economy, which will promote lending activity, especially in such areas as SME financing.

CEE: Banking growth outlook 2013-17 (EUR- vs. LCY-terms) *

Country	Loan stock growth (EUR bn)	Avg. annual growth (yoy, EUR)	Avg. annual growth (yoy, LCY)
Russia	577	13%	14.4%
Poland	129	10.5%	8.9%
Albania	2	9.9%	9.7%
Serbia	9	8.9%	8.3%
Slovakia	20	8.8%	8.8%
Romania	25	8.4%	7.9%
Belarus	17	7.8%	19.4%
Czech Rep.	38	7.1%	6.1%
Hungary	13	4.6%	4.5%
Bosnia a.H.	2	4%	4%
Bulgaria	6	3.6%	3.6%
Ukraine	12	3.3%	7.8%
Croatia	2	1.2%	1.2%
Slovenia	2	1.1%	1.1%
Regions			
CE	201	7.1%	7.3%
SEE	45	6.4%	6.1%
CIS	607	12.1%	14%

** Countries sorted by average annual 2013-2017 expected yoy-growth rate in EUR-terms*
Source: Raiffeisen RESEARCH

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