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BANKING SYSTEM OF UKRAINE IN THE WARTIME ECONOMY

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Annotation: the problems the Ukrainian banking system functioning in conditions of the national economy deepening recession caused by the effects of the previous and the current crisis of the economy and the anti–terrorist operation in the east of the country are regarded.

Keywords: financial crisis, the banking system, the National Bank of Ukraine, military tax, refinancing, liquidity.

The financial stability of the state is the necessary foundation for the real economy development. But the financial and economic crisis that Ukraine has experienced during 24 years of its independence, and especially in the last years of 2014–2015, drained its financial

system and led to a significant weakening of the national currency, high inflation, almost bankruptcy of the banking system, loss of public confidence practically to all state institutions.

Over the past two years, because of the annexation of the Crimea and military operations in the East, there has been the redirection of the government spending on the country's defense, reinforcement of army, overcoming the consequences of the Russian aggression, supporting more than one million of temporary displaced persons. It is well known that the defense spending and economic development are closely interrelated. The critical limit of the defense spending, which could have negative impact on the national economy as a share of GDP is 6% [2, p.3]. That is why the acceptable level of military spending in peacetime for the developed countries has not to be above 4–5% of GDP. Ukraine, which previously spent on defense about 1% of GDP, the amount that is 170 times smaller than the amount of Russia's military budget during last year allocated from the state treasury nearly 58 billion hryvnas. For additional government revenue from the third quarter of 2014 there has been introduced a new income tax – military tax (1.5%) that is received from individuals and brings to the budget additional 9 billion hryvnas each year. In the 2016 defense budget will rise to 4.2 billion USA dollars (92 bln. hrn.) and will be 5% of GDP [1, p.79]. But, despite all these measures, the state budget still has not enough of incomes to help the families of armed conflict victims, to compensate the enterprisers' expense on the average wages to growing number of employees called up for military service.

Prolonged anti-terrorist operation (ATO) that requires a significant increase in the defense financing is transforming the Ukrainian economy into the wartime economy. And a deep financial crisis can be demonstrated by analyzing the negative dynamics of macroeconomic indicators (Table 1).

During last 3 years we observe constant trend in GDP declining. Nominal GDP per capita is 2.8 times less than in Belarus, by 3.4 times less than in Romania, by 4.8 times less than in Poland and 12.1 times less than in other EU countries [1, p. 199].

Moreover, the exchange rate of hryvna to US dollar in March 2016 reached 27 UAH per 1 USD, foreign investors derive funds from the country and the economy is deep in the recession.

Table 1 – Macroeconomic indicators of Ukraine from 2013 to the end of 2015.

Indicators	2013	2014	2015
GDP growth (% from the previous period)	0%	– 6,8%	– 10,5%
Nominal GDP per capita (USD)	4030,3	3014,6	2 001,6
State budget deficit (bln. USD)	64,708	72	199,2
Country's export (% from the previous period)	– 8,7%	– 14,6%	– 16,3%
Country's import (% from the previous period)	– 10%	– 28%	– 21,8%
Capital investment (% from the previous period)	+ 11,1 %	– 24,1%	– 6%
Foreign direct investment into Ukraine (mln. USD)	53 679,3	57 056,4	43 371,4
The consumer price index (CPI) (%)	99,7	112,1	148,7
Hryvnia's exchange rate to 1 USD (UAH).	8,1	16,1	23,5

* Compiled by the authors on the base of [4].

Economic activity in uncontrolled Ukrainian territories decreased by 5 times, the overall decline in the industrial production in 2014 was 10.1%, the industrial output decreased in 16 regions of the country, the financial result of large and medium enterprises in Ukraine amounted to 168.0 bln. UAH of losses. [1, p. 214].

Along with macroeconomic imbalances and political and military shocks in the country the destruction of the financial and banking system has began (Table 2).

Table 2 – Indicators of banks activity in Ukraine

Indicators	1.01.2013	1.01.2014	1.01.2015	1.01.2016
Number of banks	176	180	163	117
Assets (bln.UAH)	1127,192	1278,095	1316,852	1254,385
The share of foreign capital in the authorized banks' capital (%)	39,5	34,0	43,3	42,8
The amount of credits granted to business entities (bln. UAH)	609,202	698,777	802,582	785,918
The share of overdue loans (%)	8,9	7,7	13,5	22,1
Liabilities (bln. UAH)	957,872	1085,496	1168,829	1150,672
Deposits of individuals (bln. UAH)	364,003	433,726	416,371	389,060
Regulatory capital (bln. UAH)	178,909	204,976	188,949	130,974
The regulatory capital adequacy (%)	18,06	18,36	15,60	12,74
Banks gains / losses (bln. UAH)	+4,899	+1,436	-52,966	-66,600

* Compiled by the authors on the base of [3].

Disturbed population had lost confidence in banks and only in 2014 withdrew from the banking system around 53 billion hryvnas and 9 billion US dollars, and during 4 months of 2015 another 80 billion hryvnas [5, p.14], foreign investors quickly had taken out their money abroad too. Therefore banks lost their liquidity and stood in a queue to obtain refinancing from the National Bank of Ukraine (NBU). The leader of the banking market "Privatbank", which had been the most affected by the annexation of the Crimea received a stabilization loan of 30 bln. UAH. Furthermore, during these two years only 4 out of 180 banks did not apply for refinancing.

However, the NBU could not meet all resource needs of Ukrainian banks and that strongly unbalanced the banking system of the country. Over the last two years the regulatory capital of banks decreased almost twice, the losses of the banking system reached nearly 120 bln. UAH, because of the foreign exchange intervention of the NBU foreign reserves reduced significantly. The National Bank of Ukraine raised the discount rate from 6.5% to 30%, and in August 2015 dropped to 22%, introducing in the country regime of market exchange rate [3, p. 66].

The sharp depreciation of the currency led to the dollarization of the Ukrainian economy, its population transferred savings into foreign currency, the share of overdue loans increased. Because of currency component the National Bank of Ukraine lost control over the emission mechanism, and the currency restrictions introduced by the NBU to clients activated shadow foreign exchange market, as a result, the amount of money that is now outside the legal economy and the banking system is about 10 times larger than the country's foreign exchange reserves, and compose more than 90 bln. USD and almost 300 bln. UAH. [5, p. 18]. Loss of liquidity by every third bank led to their insolvency. The real "banks fall" had begun. For two years, the National Bank of Ukraine withdrew from the financial market more than 60 domestic banks (30% of the banking system). The Individuals Deposit Guarantee Fund (IDGF) lacked resources to return the deposits of population from failed banks. The NBU was forced to provide loans to the IDGF, by issuing more than \$ 300 bln. UAH within two years. Small and medium size businesses were the most affected by the closure of banks since the refund of deposits of legal entities by Deposit Guarantee Fund is not provided.

Despite the fact that in these difficult economic and financial conditions for the NBU it was very difficult to carry out adequate monetary policy, the management of the central bank, according to the memorandum of the IMF, began a comprehensive two levels reform: inside the National Bank of Ukraine and in the banking system.

Organizational transformation of the NBU, the purpose of which is a preparation for new challenges in a rapidly changing environment is carried out at three levels in seven key areas:

- closure of non-core functions;
- change of the NBU organizational structure for decision-making;
- reduction of hierarchical structure to 4 levels;

- introduction of divisions by implementing matrix structure subordination system;
- centralization of functions at the central apparatus – the transition from 25 regional offices to 4 macro–regional;
- optimization of the employees number that will allow to withdraw from the state more than 6 thousand employees;
- reengineering of processes [3, p.74].

Completion of the NBU's organizational reform in 2016 as part of a strategic comprehensive reform of the banking system of Ukraine, will increase the effectiveness of regulatory, supervisory, monetary and other functions of the Central Bank.

Today the Regulator works in difficult conditions and takes important decisions every week to overcome the crisis. Thus, from the beginning of the year it increased requirements for capitalization of banks and disclosure of the information about bank's owners, defined three systemically important banks ("Oschadbank" "Ukreximbank", "Privatbank"), liberalized foreign exchange restrictions on withdrawals, simplified terms of consolidation of banks, and so on. In order to detect violations and achieve transparency in banking activity, the National Bank of Ukraine conducts stress testing of banks and makes rankings, sets requirements for capitalization, establishes owners responsibility for the results of the bank's activity. Filtering of the banking system from the insolvent banks led to a partial recovery of the banking system, but it was very painful shock for small and medium businesses.

Lending activity in the country practically stopped. Nowadays to cope with the financial crisis Ukraine most of all needs peace in the east of the country, solution of political and social conflicts, a clear program of reforms in all sectors of the economy, where an important place belongs to reforming of the financial – credit sector. To overcome the banking crisis, we believe the National Bank of Ukraine should take a number of priority actions:

- to ensure accountability, stable support and adequate capitalization of state banks that will promote the gradual return of confidence to the banking system;
- to optimize monetary policy and take responsibility for price and currency stability, temporarily abandoning the practice of inflation targeting to the time when this monetary mechanism will be effective again;
- to increase the transparency of financial transactions and counteract the money laundering by hounding criminals who violate banking legislation, contribute to the development of the shadow foreign exchange market;
- to boost lending to the economy, along with protection of the rights of creditors and borrowers through significant reduce of the discount rate;
- to create a mechanism to compensate financial losses to small and medium–sized businesses in case of the bank bankruptcy etc.

Many of these strategic objectives can not be accomplished without the correct support from the Ukrainian Parliament which creates the legal framework for economy transformation. Thus, to overcome the financial and economic crisis all state institutions should start to cooperate despite any political conflicts of interest.

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