

Quarterly Bank Survey

№ 2 (7)

December 2009

- Business climate estimates continue to be negative but the expectations for its changes are improving.
- Banks still assess their business situation as negative, yet the expectations indicators continue to rise.
- The tendency of demand reduction has stopped, actual and expected indicators rose above zero again.
- Demand from corporate clients significantly increased compared to the beginning of 2009; further growth is expected.
- Actual and expected demand from private clients considerably increased compared to the beginning of the year.
- The tendency of decreasing of the loan volumes for private and corporate clients decelerates.
- In the next quarter, the banks are going to keep interest rates for loans at the current level, some part of them planning to reduce the rates for deposits.
- Unfavorable political situation and unfavorable regulatory climate are the main obstacles for the development of banking.
- Food industry is most likely to increase real output in 2010, according to the estimations of the banks.

Mail survey of banks for monitoring of assessments and expectations of managers about changes in general business climate and performance. Response rate is 15.6%.

In this issue: results of a survey conducted during October 20th-30th 2009

Indexes: Oct' 09 to Jul' 09

Expectations: Dec' 09 to Oct' 09

Business climate: index October 08, expectations for 6 months

GENERAL INDICATORS

Business Climate

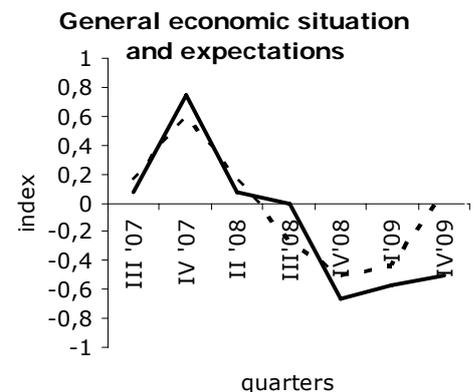
According to the banks, business climate showed no significant changes during 2009. *The index of business climate assessment* remains at -0.5, close to that of -0.57 for the results of the previous poll. Again, none of the banks evaluates business climate positively. Half of the banks judges it as satisfactory, the other half, as negative. Compared with the 1st quarter of 2009, the balance shifted towards neutral assessments. At the beginning of this year, 42.9% of the banks evaluated business climate as satisfactory and 57.1% as bad. Similarly to the current survey, no banks assessed it positively.

Expectations index as to the change of business climate stopped descending in the second quarter of 2009. In the end of the year, it grew significantly. This happened because a considerably smaller proportion of the banks predict worsening of business climate today (25% compared to 57.1% in the beginning of the year). The number of banks which expect improvement of business climate increased twofold (33% compared to 14.3%). But the majority of the surveyed banks (41.7%) did not expect changes in business climate.

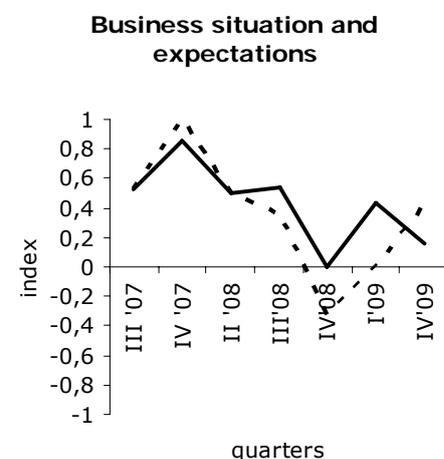
Business Situation at Bank

The indicators of the assessment of the banks' own business situation have declined compared to the beginning of this year. While in the 1st quarter of 2009 42.9% of the banks reported its improvement, only 25% of respondents give such an account in October-November of 2009. 66.7% of the banks considered their business conditions satisfactory. 57.1% assessed it in such a way in the beginning of the year. However, a particular share of the banks (8.3%) rated it as unsatisfactory. Hence, the corresponding *index* dropped from 0.43 to 0.16.

The *index* of expected changes of business situation continued growing. It rose to the mark of 0.42 from zero in the beginning of this year. Now, exactly half of the banks, compared to 28.6% in the 1st



— Current - - - - Expected



— Current - - - - Expected

Authors:
Oksana Kuziakiv
Iryna Fedets

Institute for Economic Research and Policy Consulting
Reytarska 8/5-A, 01034 Kyiv
Tel. (+38044) 278-6342
Fax (+38044) 278-6336
E-mail: institute@ier.kiev.ua
http://www.ier.kiev.ua



quarter of 2009, expect to improve their business situation. 8.3% predict its deterioration, and 41.7% do not expect it to change.

Impediments to business development

Unfavorable regulatory climate reached the second position in the rank of the factors that hinder the growth in banks operations volume. With 66.7% of the votes of respondents, this factor proved to be more influential than those grouped under the category of "Other", by which economic recession is usually meant. Such impediments were noted by 33.3% of the respondents. 25% of banks believe tax pressure to be a barrier, and 16.7%, competition in the sector. None of the banks has reported low demand as an obstacle to doing business, but 8.3% inform about the lack of skilled workers. Another 8.3% of respondents do not see any barriers. At the same time, it has been a year that unfavorable political situation ranks first in the list of the obstacles for banks.

DEMAND

In the beginning of 2009, the rates of growth of demand as well as expectations of changes in demand reached a minimum level for the entire period of study of business tendencies in the banking sector. *Index of changes* in demand fell to -0.67, and the related *index of expected changes*, to -0.6. In the end of the year, the situation notably improved. Demand increased for 62.5% of banks and remained unchanged for 12.5%. It deteriorated for 25% of the banks. *Index of changes* in demand rose to the point of 0.38. For the next three months, 40% of banks expect further growth in demand, and another 40% predict that it will remain at the current levels. Still, 20% of the respondents expect the deterioration of demand. As a result, the *index of expected changes* of demand for the 1st quarter of 2010 equals 0.2.

Demand from corporative clients. Demand from corporate clients increased significantly compared to the beginning of this year. *Index of demand* equals zero in the 4th quarter of 2009, while it was on the point of -0.82 in the 1st quarter. *The index of expected changes* reached 0.33, thus breaking the tendency of deterioration in expectations.

Demand from private clients. *Index of changes* in demand from private clients rises to the level of 0.4, after dropping to -0.33 in the beginning of the year. The expected reduction in demand in the 1st quarter of 2009 resulted in the *index* value of -0.4. In the 4th quarter of this year, the *index of expected changes* rose to in 0.3.

FINANCIAL INDICATORS

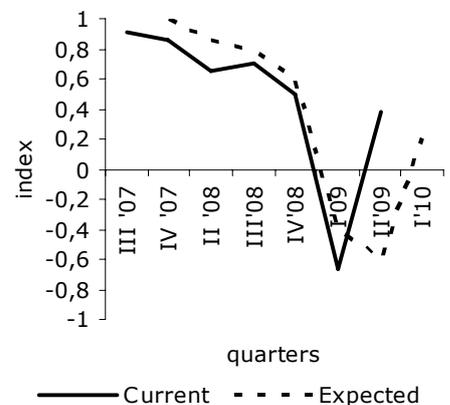
Net Profit. Only 9.1% of Ukrainian banks report growth of net profit in the previous three months. For 27.3% it remained unchanged, and for 63.6%, decreased. Hence *the index of net profit change* remained at the point of -0.55, close to the mark of -0.67 in the first quarter of 2009. *Index of expected changes* rises to zero from the previous level of -0.4 because in the current quarter, the same share of banks, both equaling 36.4%, expected increase and decrease of net income. The remaining 27.3% believe that it will remain unchanged.

Gross Operating Income (GOI). Income indicators displayed improvement compared to the beginning of the year. *Index of changes* of income rose to -0.09 from -0.33. 27.3% of the banks report income growth in the previous quarter, 36.6% inform about its decline, and another 36.6% report that income remained unchanged. Dynamics of the *index of expected changes* in income proved to be more rapid. It rose to the level of -0.18 from that of -0.8, at which it was in the beginning of the year. Now, 18.2% of banks expect growth of income in the next quarter. 45.5% believe that level of income will not change, while 36.6% still expect lower incomes. Let us note that

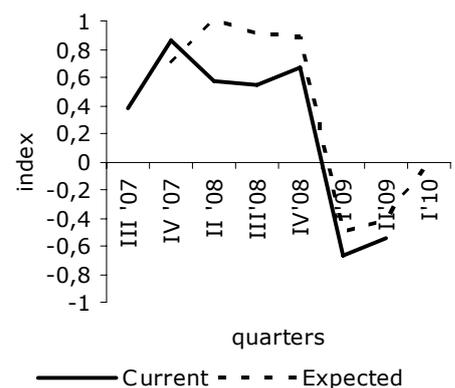
Impediments to business development



Demand



Net profit





earlier this year, expectations of the absolute majority of banks were negative: all predicted that income will decline.

Net Interest Income. In 2009, the pessimistic forecasts of the banks about the reduction of growth of net interest income proved true. However, expectations for the next quarter improved slightly.

NET INTEREST INCOME FROM PRIVATE CLIENTS dropped down to the value of -0.56 compared with -0.17 in the beginning of the year. In that time, all the banks expected decreasing of net interest income from loans to private clients, the value of corresponding expectations *index* falling to the lowest point of -1 as a result. In the end of 2009 such *index* amounts -0.33.

NET INTEREST INCOME FROM BANK SECURITIES accelerated their growth. Compared to the 1st quarter of 2009, when the value of the corresponding *index* equaled -0.4, the *index* remained near the point of zero in the 4th quarter. The *index of expected changes* for the next quarter reached 0.29, while the corresponding *index* fell to -0.75 in the previous survey.

Net Fee and Commission Income. Growth rates of commission income from banking transactions turned out to be negative, as was predicted in the beginning of the year. Value of the corresponding *index* continued to decline from -0.5 to -0.7. However, the value of the *index* of expected change increased to -0.2 from -0.8.

Also, banks regard the prospects of growth of the commission income from transactions with clients more optimistically. While in the end of the previous year the corresponding *index of expected changes* fell to -0.5, it rose to zero in current quarter. But the corresponding figure still equals -0.5 for the previous quarter.

Net Trading Income. The results of trading transactions have deteriorated compared to the beginning of the year, but future expectations became relatively better. *Index of changes* equals zero, while in the 1st quarter of 2009, it remained at 0.17. *Index of expected changes* for the 1st quarter of 2010 grew from -0.6 to -0.1.

LOANS AND DEPOSITS

Volume of Given Loans. In the end of 2009, a slowdown of the rate of decline of lending volumes compared to the beginning of the year could be observed, but the trend is continuing for private clients. For them, the value of corresponding *index* rose from 0.43 in January this year to 0.18 in October and November. For corporate clients, corresponding *index* turned positive again: 0.1 compared to -0.33 in the beginning of the year.

Loan Interest Rates

The tendency of raising interest rates for loans by the banks went down. In the next quarter, only 10% of banks plan to raise interest rates for short-term loans. 90% will keep them unchanged. Because of this, the *index of expected changes* amounts 0.1. In the beginning of the year, such *index* remained at the point of 0.5.

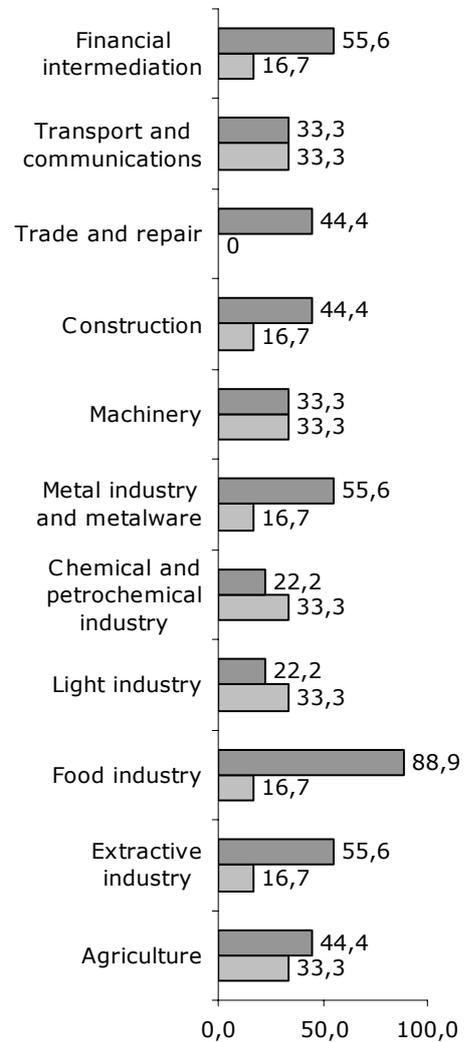
Index of changes of interest rates for long-term loans dropped to zero due to the fact that all surveyed banks plan to keep them unchanged. This *index* was 0.38 in January 2009 and reached the point of one in late 2008.

Deposit Interest Rates

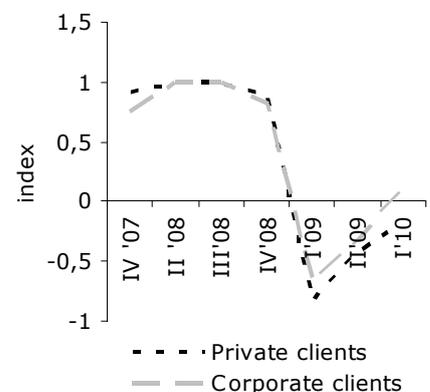
Instead, banks consider lowering interest rates for deposits. 27.3% of banks hold such plans for short-term deposits. 72.7% plan to keep them at the current level. Value of the corresponding *index* is -0.27, and it is the first negative value for the last two years.

In addition, 36.6% of the banks intend to reduce interest rates for long-term deposits. 45.5% will not change them, and 18.2% plan to

Key sectors that may demonstrate the rise of real production volume in 2010 and reach pre-recession level



Expected volume of given loans





raise them. Value of the corresponding *index* fell to -0.18 compared to 0.63 at the beginning of the year.

Personnel

Number of the frontoffice personnel in banks is close to optimal one, but the surplus of the labor force in the back office is felt again. *Index* of the assessment of the frontoffice staff fell to 0.1 from 0.57 in the first quarter of 2009. The corresponding *index* for backoffice personnel equaled 0.13 before. Today, it rose to 0.36. Thus, it can be concluded that the trend of excess of bank personnel still continues.

Competitive Position

The banks' assessment of their competitive position on the market of private and corporate clients is similar, but their dynamics are quite different. While the fluctuation of competitive position on the market of private clients was less dramatic, the trend for competitive position on the market of corporate entities changed its direction. *Index* of assessment of competitive position on the market of private clients (0.46) remained practically unchanged compared to the beginning of the year when it amounted 0.43. 45.5% of banks reported its improvement, and 54.5% consider it to be the same as in the previous quarter. The distribution of estimates of competitive position on the market of corporate clients is similar. For 54.5% of respondents, it remained the same, and 45.5% felt some improvement. However, unlike early in 2009, no bank reports its deterioration today. Therefore, the corresponding *index* rose from 0.17 to 0.46.

Special Questions

Real sector. Banks moderately assess the chances of key economic sectors to demonstrate the growth of real output volumes in 2010. They are most optimistic about the food industry: 88.9% of the banks believe it to be able to increase production in 2010. Two equal shares of 55.6% of banks expect the results to improve in such sectors as extractive industry, metal industry and metal ware, and financial intermediation. 44.4% of banks hold positive expectations towards trade and repair, construction and agriculture. 33.3% of respondents point to a possible increase of production in the sectors of machinery, as well as in transport and communications. Only 22.2% expect such developments regarding light and chemical industries.

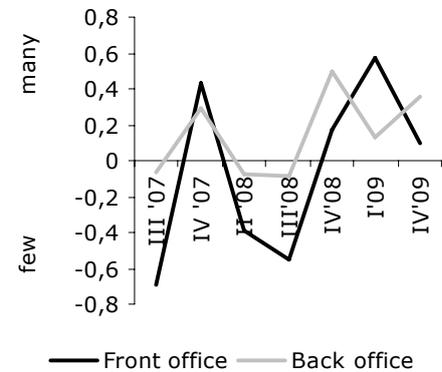
Even smaller share of the banks believes in the likelihood of any of the sectors to reach the pre-recession level of output volume next year. 33.3% assume it for such sectors as transport and communications, engineering, chemical and petrochemical industry, light industry and agriculture.

16.7% of respondents informed about such expectations towards financial intermediation, construction, metal industry and metal ware, food, and extractive industry. None of the banks forecasts reaching the pre-crisis level of output for trade and repair.

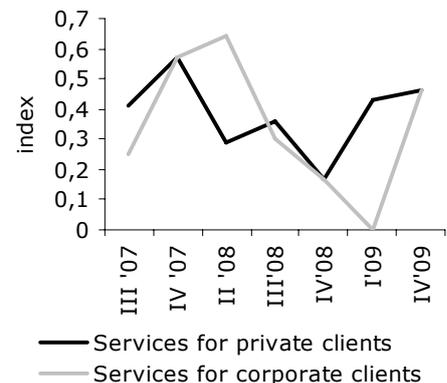
Assessment of the NBU Activity. The assessment of the NBU activity in 2009 lacks consent among the banks. 50% of them evaluated the monetary policy of the NBU positively. 33.3 % assessed it negatively. Two equal shares of 41.7% of respondents assess the exchange rate policy positively and negatively. Another 16.7% of banks do not have a clear position on the assessment of either of the NBU policies.

Bottom of the recession. Most of the banks are still experiencing difficulties caused by the economic crisis. 66.6% of the respondents admit not having yet gone through the worst times associated with the recession. 33.3% believe that such days for their bank have already passed.

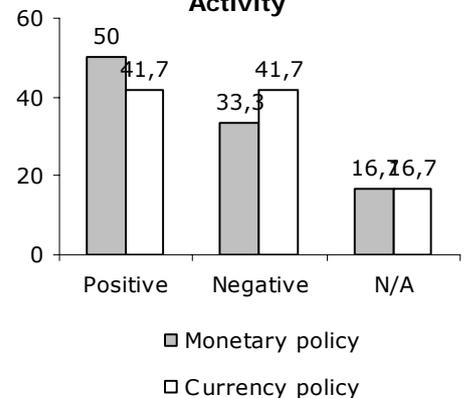
Current staff number assessment



Competitive position



Assessment of the NBU Activity





Methodology of research

The survey was conducted on the base of the standard questionnaire, which contains questions concerning overall economic conditions in the country, business situation in the bank, impediments to business activity, expectations about interest rates for loans and deposits. Total universe of banks contains 156 entities, which are constantly present on a market.

All the indexes are calculated by the unified methodology. We count answers as +1 when a bank answers that an indicator increased, 0 - if it did not change and -1 - if decreased. For example, if out of 100 respondents 20 noted the growth of profits, 50 respondents reported their reduction, and 30 marked that situation had remained without changes, the proper value of index will be -0.30. The positive (negative) value of index means that a part of banks whose profits have grown is more than (less than) a part of those, whose profits have reduced. Every index bigger than +0.09 or smaller than -0.09 is statistically significant and differs from a zero with 5% probability of error. For details please contact Oksana Kuziakiv (Kuziakiv@ier.kiev.ua).


Appendix 1. Numerical Results

PERFORMANCE AND EXPECTATIONS:	IV quarter 2008 (November-December)		I quarter 2009 (January-February)		IV quarter 2009 (October-November)	
	<i>Index of changes</i>	<i>Index of expected changes</i>	<i>Index of changes</i>	<i>Index of expected changes</i>	<i>Index of changes</i>	<i>Index of expected changes</i>
1. Overall Indicators:	Indicators	Expectations (1 st half of 2009)	Indicators	Expectations (1 st half of 2009)	Indicators	Expectations (1 st half of 2010)
Business situation is /will be favourable (+) / unfavourable (-)	0.00	-0.33	0.43	0	0.16	0.41
Overall economic situation is /will be favourable (+) / unfavourable (-)	-0.67	-0.50	-0.57	-0.43	-0.5	0.08
2. Performance Indicators: will increase(+)/ will decrease (-)	Indicators	Expectations (I Q 2009)	Indicators	Expectations (II Q 2009)	Indicators	Expectations (I Q 2010)
Demand	0.50	-0.40	-0.67	-0.6	0.38	0.2
Demand from corporative clients	0.17	-0.17	-0.83	-0.4	0	0.33
Demand from private clients	0.67	0.17	-0.33	-0.4	0.44	0.33
Net profit	0.67	-0.50	-0.67	-0.4	-0.55	0
Net interest income from loan for private clients	0.67	-0.33	-0.17	-1	-0.56	-0.33
Net interest income from bank securities	0.33	0.00	-0.4	-0.75	0	0.29
Net fee and commission income from banking transactions	0.17	0.17	-0.5	-0.8	-0.7	-0.2
Net fee and commission income from transactions with clients	0.33	0.50	-0.4	-0.5	-0.5	0
Net trading income	0.17	0.40	0.17	-0.6	0	-0.1
Gross Operating Income (GOI)	0.67	-0.40	-0.33	-0.8	-0.09	-0.18
Personnel expenses/(GOI)	-0.17	-0.60	-0.67	-0.8	-0.6	-0.09
Number of employees	-0.33	-0.40	-0.83	-0.8	-0.75	-0.33
Loans to private clients		-0.83		-0.43		-0.18
Loans to corporate clients		-0.67		-0.33		0.1
3. Interest rates will decrease (-) / will increase (+) for...		Expectations (I Q 2008)		Expectations (II Q 2008)		Expectations (I Q 2010)
Short-term loans		1.00		0.5		1
Long-term loans		1.00		0.38		0
Short-term deposits		0.80		0.5		-0.27
Long-term deposits		1.00		0.63		-0.18
4. Staff Number: more needed (+) / less needed (-)	Indicators		Indicators		Indicators	
Front office	0.17		0.57		0.1	
Back office	0.50		0.13		0.36	
5. Competitive Position: improved (+)/worsened (-)	Indicators		Indicators		Indicators	
- Services for private clients	0.17		0.43		0.46	
- Services for corporate clients	0.17		0		0.46	