

USAID's Response to Ukraine's Financial Crisis

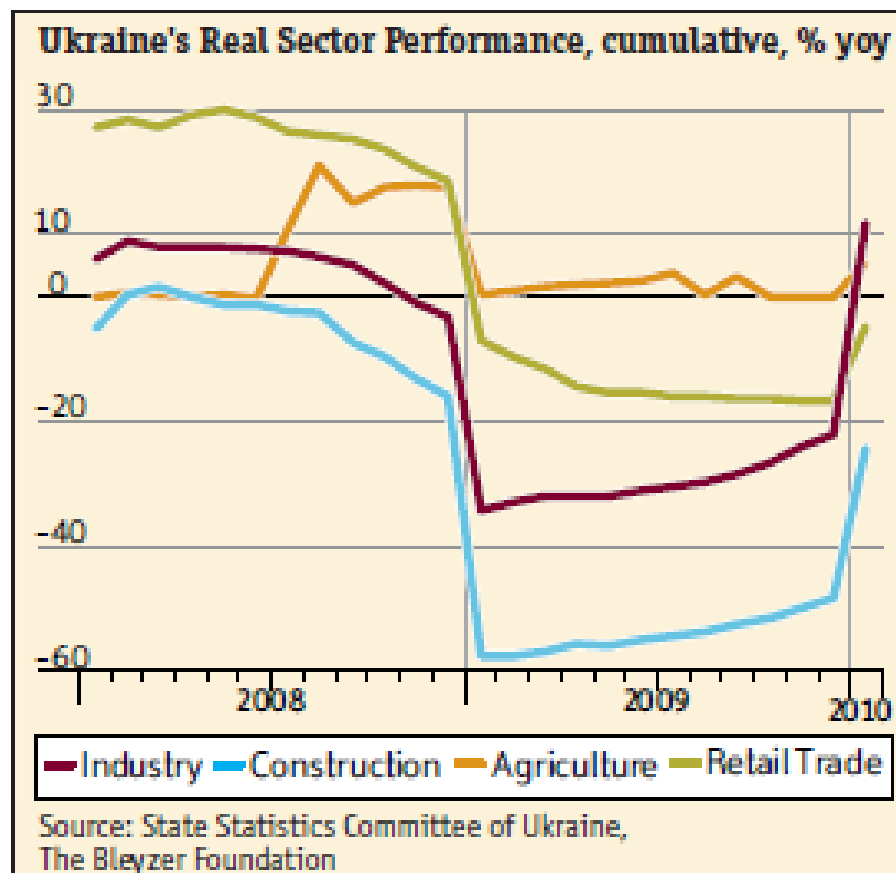
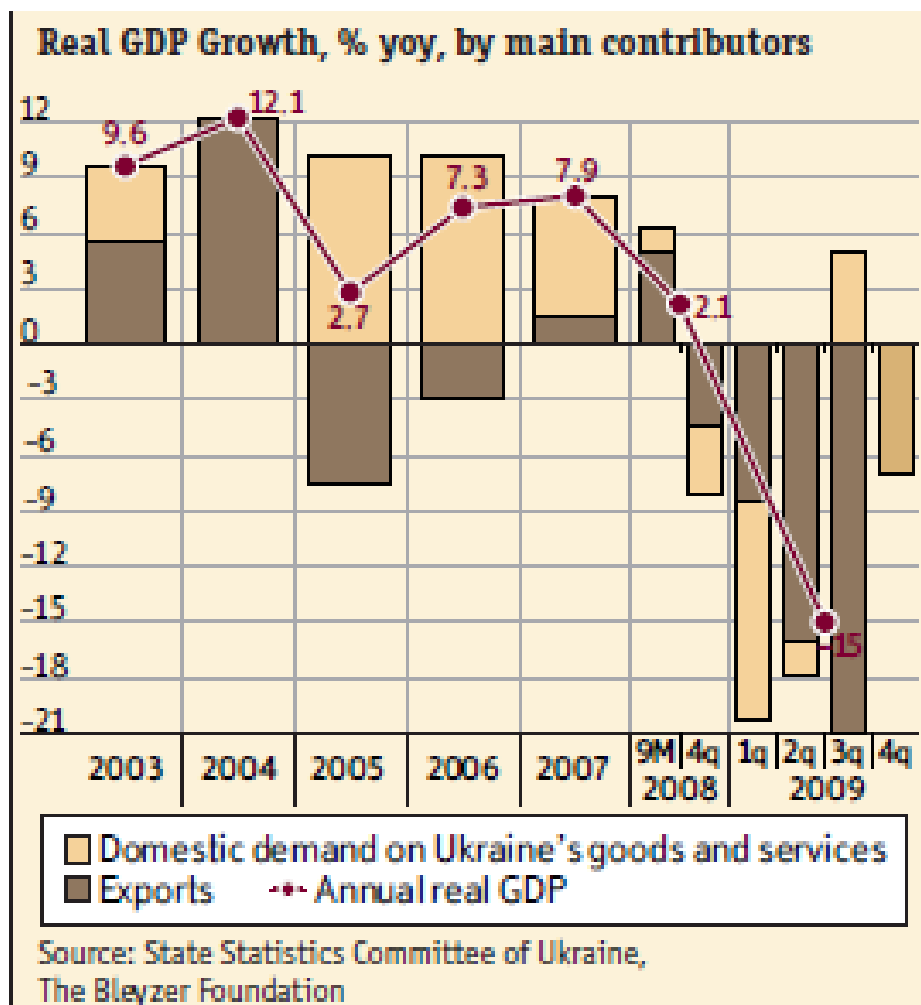
**Ryder Rogers
Office of Economic Growth**

**May, 2010
USAID/Kyiv, Ukraine**

Presentation Outline

- **Financial Crisis Impact On Ukraine**
- **USG and Donor Response to the Crisis**
- **Current Situation**

Pre- and Post-Crisis: Real Sector Performance



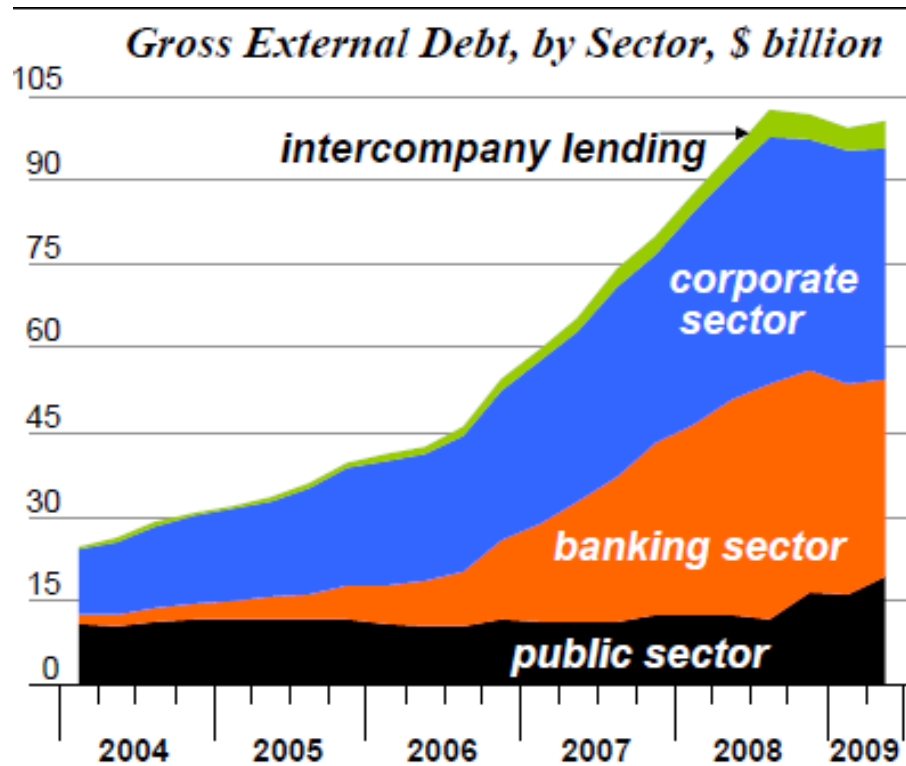
Financial Crisis Post-Mortem

- **GDP: 15% ↓ (2009)**
- **UAH/USD Exchange Rate: 60% ↓**
- **PFTS stock market index: 74% ↓ (2008)**
- **Export of goods: 40% ↓ (2009)**
- **Industrial production: 20% ↓ (2009)**
- **Fiscal Deficit: 11% of GDP (2009)**
- **Inflation: 13% (2009)**

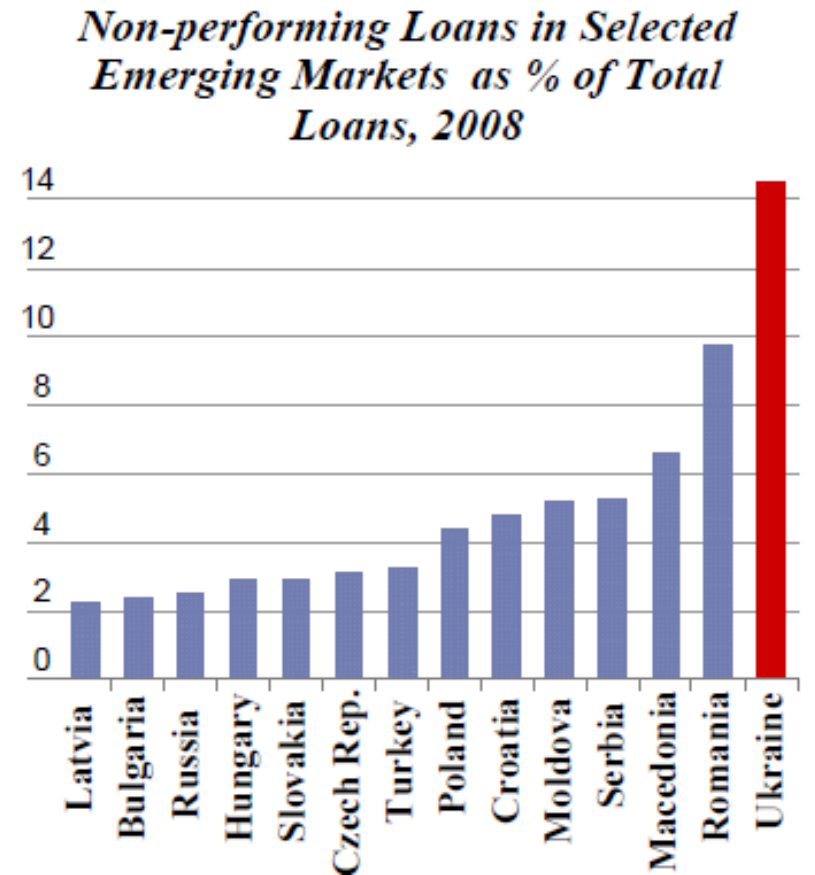
Banking Sector

- **Pre-crisis:** Loan portfolio grew by 70% per year on average from 2005-2008. This growth was supported by:
 - improved access to foreign capital
 - the entrance of foreign banks
 - loose domestic monetary policy.
- 50% of total loans were issued in foreign currency, including 80% of mortgages.
- **Post Crisis:** 60% depreciation of UAH to dollar
- severe deposit runs during October 2008-April 2009 reduced the resource base of the commercial banks

Banking Sector: Large External Debt and Non-Performing Loans



Source: NBU, The Bleyzer Foundation

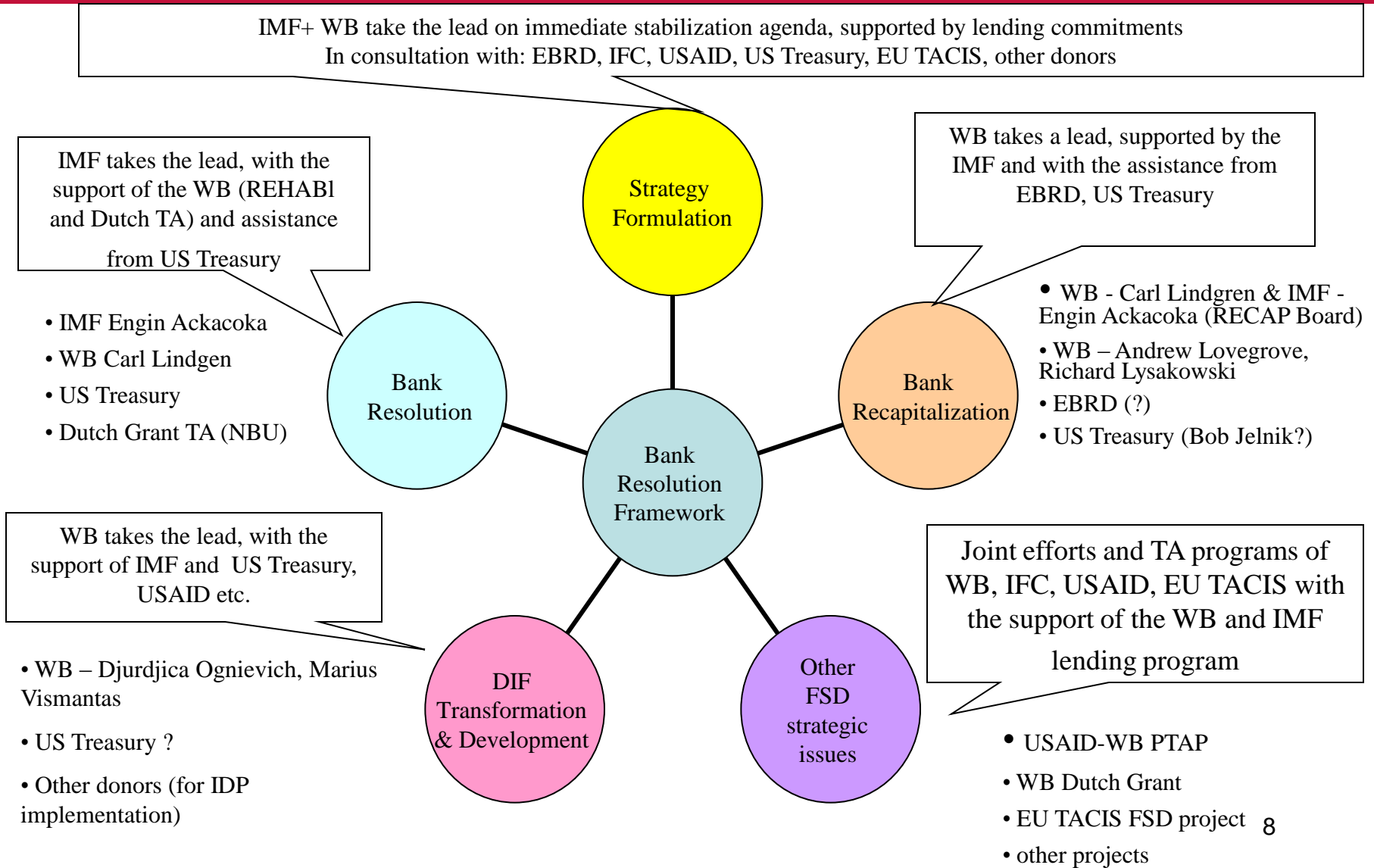


Source: IMF GFS Report, Apr. 2009

Donor Response to Crisis

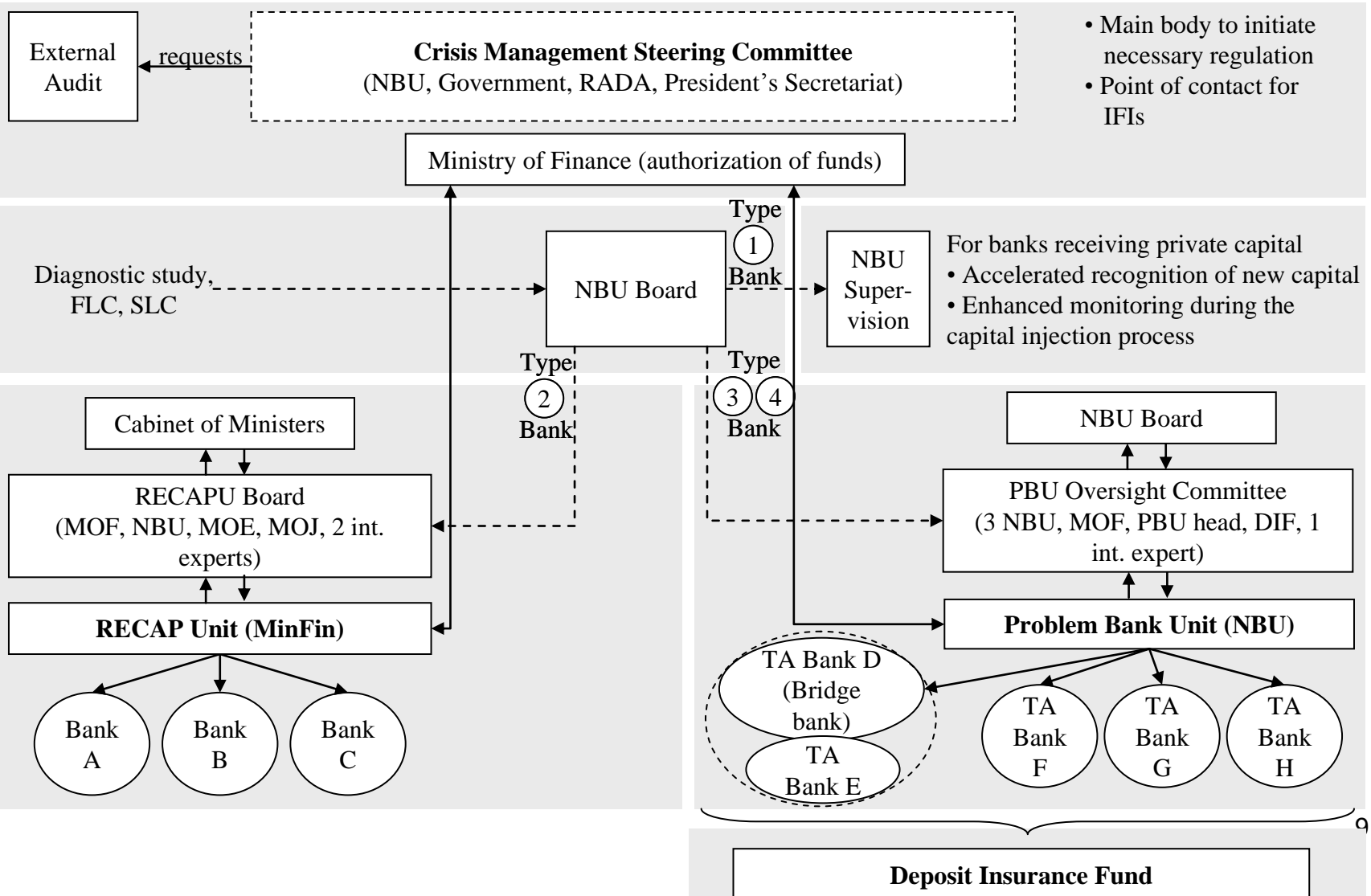
- IMF, World Bank and EBRD pledge \$20bn in financing
- Conditions for those loans require extensive technical assistance
- USAID, Treasury, and EU initiate TA programs to support IFI loans and TA.
 - USAID also adjusts existing programs to address the crisis

Donor Coordination: Policy & TA Framework



Re-capitalization and Resolution Framework

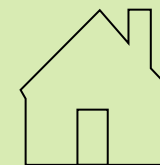
Ukraine Bank Recapitalization and Resolution Framework



Donor Coordination: Modalities

Monthly Meetings

- ✓ General donor coordination
- ✓ Progress reports
- ✓ Discussion of strategic issues & next steps



**WB
office**

Bi-weekly technical meetings

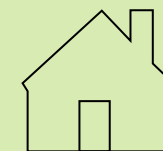
- ✓ Thematic meetings on bank resolution, bank recapitalization, DIF, capital markets, legal reform and harmonization of legislation with EU /FTA etc



**Other
donors**

Quarterly meetings

- ✓ Meetings with the broader donor community (including Embassies) to discuss longer term strategic issues, FSD reform agenda and additional TA needs



tbd

USAID/USG Response and Technical Assistance



- 1. USAID (pre-crisis): Access to Credit Initiative (2004-2009) and Capital Markets Project (2005-2010)**
- 2. USAID (post-crisis): FINREP begin in late 2009 and includes banking, capital markets and pension reform components.**
- 3. US Treasury Advisors: Banking Sector and Governmental Debt.**

Financial Sector Reform Goals

- ✓ **Immediate priorities: banking crisis and pension reform**
- ✓ **Reform must be based on international standards of transparency, and be enforced by strong and independent regulators.**

Financial Sector Reform Key Activities

▶ **BANKING SECTOR**

- ▶ Liquidate insolvent banks promptly and sell assets/deposits to the private sector.
- ▶ Strengthen the Deposit Guarantee Fund to protect deposits of citizens.
- ▶ Require international standards of transparency and disclosure.

▶ **PENSION REFORM**

- ▶ Implement pension reform that helps eliminate continuing budget deficits.
- ▶ Protect future pensioners with a strong and independent regulator, international disclosure standards, and severe penalties for violations of participants rights.

▶ **INSTITUTIONAL STRENGTHENING**

- ▶ Regulators must be politically and financially independent
- ▶ Regulators must require consistent and reliable business and financial data, financial statements based on international accounting and auditing standards, and the identity of real owners of banks and public companies including identification of all affiliated companies and relationships
- ▶ Institutions must be able to enforce provisions with meaningful penalties for violation, including criminal sanctions.

Reform Technical Assistance:

▶ **BANKING SECTOR**

- ▶ **Problem Banks – Work with U.S. Treasury**
- ▶ **Nationalized Banks – Support Ministry of Finance bank recap (also with US Treasury)**
- ▶ **Deposit Guarantee Fund – With World Bank, Institutional Strengthening, Implement Liquidation of Banks Program**
- ▶ **Mortgage Modification Program – Commercial Banks**
- ▶ **Communications and Crisis Management Response- National Bank of Ukraine**
- ▶ **Public Education Program – Consumer Protection, Truth-in-Lending, Financial Literacy**

Reform Technical Assistance:

▶ **CAPITAL MARKETS**

- ▶ **Securities and Stock Market State Commission- Developed and Implementing Internationally Compliant Transparency and Disclosure System for public companies including banks**
- ▶ **Financial Services Regulator- Legal and Regulatory Drafting of Enhanced Provisions for Protection of Pension Assets and regulatory oversight of Non-State Pension Funds. Web-based disclosure system based on international standards of disclosure.**
- ▶ **All Ukrainian Securities Depository- Provides for clearance and settlement of transactions in securities on the Ukrainian Exchange and the PFTS Exchange. Maintains ownership records for approximately 99% of the Ukrainian securities market, except government debt (NBU).**

Reform Technical Assistance:

▶ **PENSION REFORM**

- ▶ **Provide Ministry of Labor and Social Policy support in developing Pension Reform Program and Concepts.**
 - **Increase Retirement Age**
 - **Address Privilege Pensions**
 - **Develop Pillar II Accumulation System**
- ▶ **Provide Legal Draft and Public and Rada Roundtables on Pension Reform Issues**
- ▶ **Public Education and Outreach to the Most Vulnerable with Pension Hotline and Regional Programs**

Coordination with International Donor Community:

- ✓ **Coordinate with World Bank, IMF, European Union, on Programs for Financial Sector Stabilization.**
 - **IMF:** Ultimate Controllers legislation, VAT Bonds, Government Securities Market Development
 - **World Bank:** Deposit Guarantee Fund, MinFin re-capitalization work, NBU
 - FINREP/CMP's activities often support IMF and WB loan conditionalities, and sometimes become conditionalities.
 - **Treasury:** Re-capitalization, Debt Market, NBU
 - EU Financial Services Project; non-bank financial services Commission (pension)
 - Monthly coordination meetings at World Bank

What Success Looks Like

- ▶ **PUBLIC FINANCES STABILIZED**
 - ▶ Pension Reform Program Addresses Balanced Budget Concerns
 - ▶ Implementation of International Accounting Standards leads to effective tax collection and realistic budget
 - ▶ Work for Independence of National Bank of Ukraine and other regulators – mitigate problems of corruption, inappropriate political influence, and lack of international standards
 - ▶ Support Ministry of Finance Government Debt Program for realistic budget support

What Success Looks Like

▶ **FINANCIAL SECTOR RESTRUCTURED**

▶ **Strengthen Banking System**

- Closing insolvent banks/eliminate nationalization
- Deposit Guarantee Fund operating in accordance with international standards – protection of most vulnerable
- NBU operates in accordance of international standards free of corruption and inappropriate political influence
- International Accounting Implemented

▶ **Strengthen Non-Bank Financial Sector**

- Regulators operating independently and in accordance with international standards
- Investor rights protection
- Strong legal framework and pension regulator with mission to protect pension contributions
- Market infrastructure operates in line with international standards

What Success Looks Like

- ▶ **STIMULATE PRIVATE INVESTMENT**
 - ▶ **Implementation of Joint Stock Company Law in accordance with international standards**
 - ▶ **Clear and effective regulation of business environment**
 - ▶ **Modernize tax regime based on international accounting standards for all enterprises**

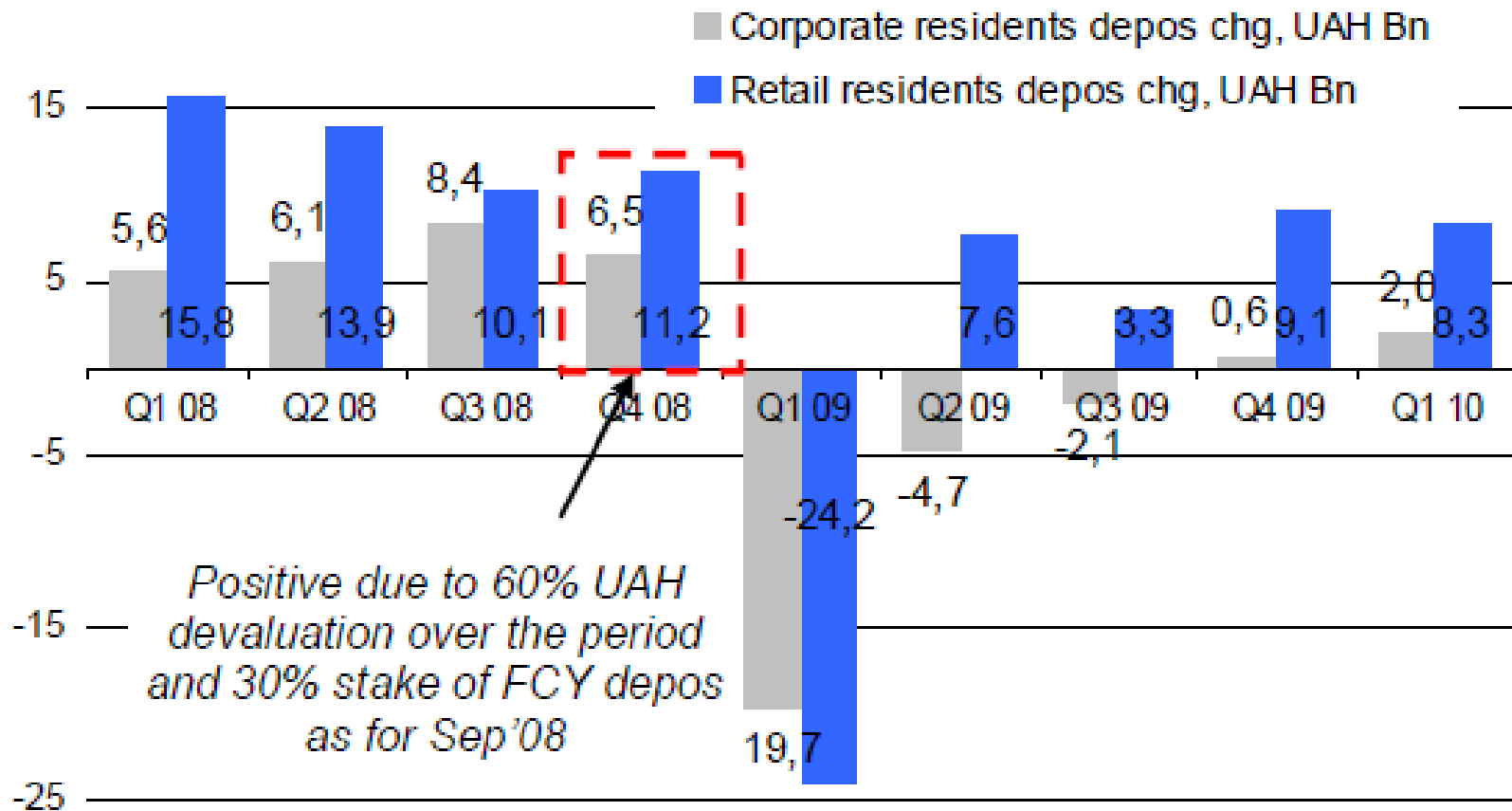
The Situation Today

- Second round of stress tests have been completed and results are due soon- more capital may be required for banks. World Bank wants this to come from private owners rather than state- need least cost option. Liquidation may be best option for many (to the dismay of creditors). Liquidation of banks must proceed more rapidly.
- Credibility and confidence in the banking sector must be restored!
- PFTS has risen by 53% in 2010 (as of March 23), and up 273% since March
- April 16) Reduction in risk, cost of borrowing: Government securities: CDS spread down to 5%- down from 43%
- Overall debt to GDP ration remains manageable, considering most debt issued in 2009 was IMF and NBU. (April- Ukrissbank)
- Being a very open economy, with exports accounting for about 50% of GDP, Ukraine is forecast to benefit from the expected stronger rebound of external demand in 2010. Real sector data for the first month of 2010 supported the forecast. Industrial production grew by 11.8% yoy in January 2010, driven by export-oriented metallurgy (+26.6% yoy), chemicals (+29.5% yoy) and machinery (+22.3% yoy). Nevertheless due to sluggish domestic demand, GDP growth in 2010 forecast to be 3%.
- Politics: economic reform agenda is slow process. It was promised for the beginning of May, but not likely until June or later. Many working groups have been announced. Tigipko has lions share of responsibility.

The Situation Today: Banking Sector

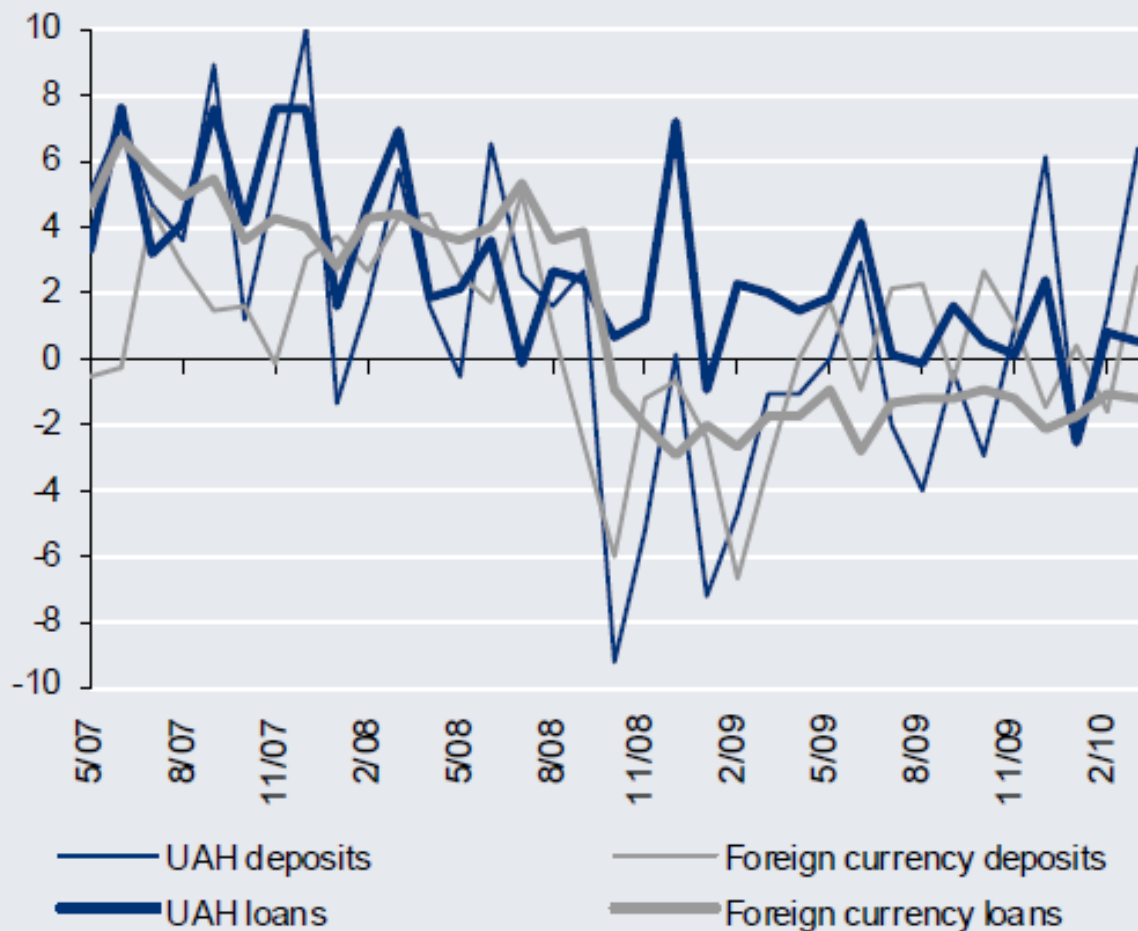
- As of May 7, there are 175 banks in Ukraine. Seven licenses were revoked in 1Q2010, and 8 revoked in 2009. 19 banks are undergoing liquidation. 5 banks are under state ownership, including three problem banks re-capitalized.
- 16,300 bank employees were laid off in 1Q2010. 25% of all branches have been closed.
- Non-performing loans remain a huge problem, and if foreign banks start to pull out (there are rumors) the banking sector could be in for another catastrophe. 80% of mortgage loans are FX-denominated.
- As long as risks remain high among Ukraine's potential borrowers, the banks' increased resources do not translate into loans (the overall amount of loans decreased 2.7% since the start of the year, despite a small 0.2% rise in April), but are rather invested in the government's bonds; banks held UAH26.85bn (US\$3.39bn) in government bonds as of 15 May, which is a 37% increase since 1 March, when it stood at UAH19.54bn.
- **Nevertheless, it could have been worse:** considering capital flows drying up, non-performing loans approaching 35%, and a loss of 25% of the deposit base by April 2009. Refinancing has been civilized, so outlook is positive.
- Increasing deposits and liquidity in the banking system indicate that the general state of the economy is gradually improving, from the monetary and financial point of view, and lowering interest rates point out to gradual diminishing of risk.
- **NBU:** On the monetary side, loosening of the previously tight policy will help economic recovery.

Some Positive Signs: confidence returns to banking sector



Deposits vs. Loans: confidence returns to banking sector

Fig 3 Deposits are on a growth path



Source: NBU, ING

Re-capitalization and Resolution Process Update

- **NBU:** 5 banks are under state ownership, including three problem banks re-capitalized. Opaque re-financing deals, with little accounting for the IMF funds that came in to support the banking sector. Conflicts of interest continue.
- **Ministry of Finance:** re-capitalized banks continue to limp along in temporary administration. Many still have no business plans, and dubious management. Asset stripping has likely occurred, so that there might be nothing left to sell.
- **NBU and Deposit Guarantee Fund** unable to effectively and efficiently liquidate insolvent banks.

DONORS: Program Updates

- **IMF:** Budget is passed, and with 6% GDP deficit target, but IMF has not yet approved loan. Pension and wage increases, as well as gas price increases, that tripped up previous loan disbursement are still there. IMF delegation expected this week. In particular, UAH30bn (US\$3.8bn) will be allocated for the recapitalisation of banks. In January-February 2010, the budget deficit equaled UAH4.778bn (US\$602.8m), which is 5.2% of the GDP in 2009.
- **World Bank:** threaten to scuttle the second \$350mn DPL if Nadra Bank plan goes forward (splitting the cost of re-capitalization between the state and Firtash). WB Mission in Kyiv this week, along with IMF.
- EU Twinning Project at NBU
- Treasury: MinFin Advisor (debt) will stay, ReCap and NBU advisor are leaving.

Donor Coordination at the National Bank: Complex!

- Insert Complex NBU Donor TA Matrix!

Parliamentary Negotiations





USAID
FROM THE AMERICAN PEOPLE

Question and Answers

April 19, 2010
USAID/Kyiv, Ukraine