

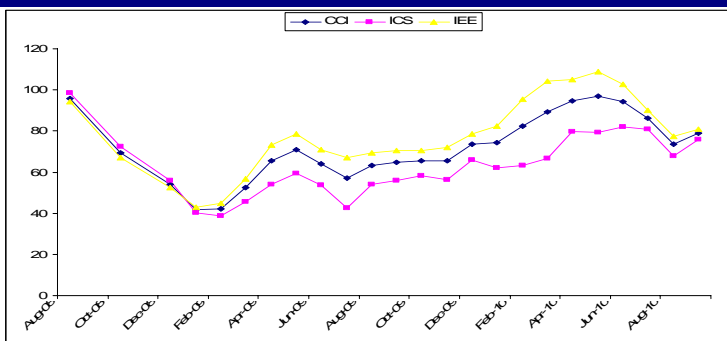
## Quarterly / Consumer Banking Snapshot

Q3 2010

According to market research firm GfK Ukraine, in September the Consumer Confidence Index (CCI) began to improve after declining for the three summer months, adding 5.1pp to end at 78.8. Among the reasons for the summer decline in confidence, GfK points to the Government's plans to institute a series of unpopular reforms, especially to raise rates for energy and increase the pension age, which were received rather coldly by most Ukrainians. In addition, a slowdown in the economic revival coupled with a heat wave that was threatening this year's grain harvest caused Ukrainian consumers to feel more pessimistic about economic prospects. Plus, in August there was a sudden surge in prices for foodstuffs, which forced Ukrainian consumers to downgrade their assessments of their own financial standing.

The consumer mood improved in September, as assessments of the current situation improved and, to a lesser degree, economic expectations among Ukrainians. The Index of the Current Situation (ICS) jumped 8.0pp to 75.9 from 67.9 the previous month, while the Index of Economic Expectations (IEE) rose a more modest 3.2pp to 80.8 (Chart 1).

Chart 1: Consumer Sentiment Indexes



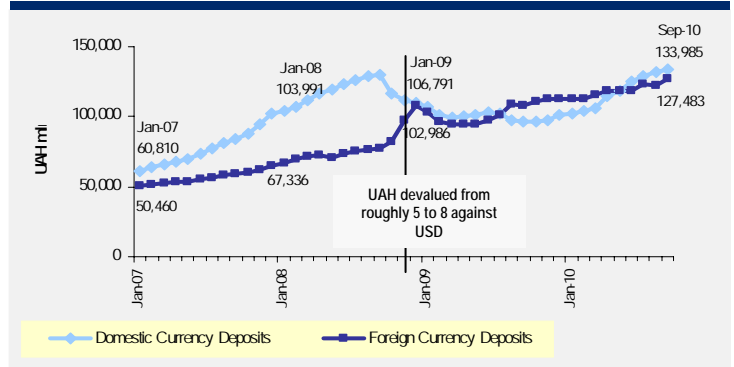
CCI- Consumer Confidence Index; ICS – Index of the Current Situation; IEE – Index of Economic Expectations.

Source: GfK Ukraine, International Center for Policy Studies

The upward trend in bank deposits continued throughout the summer months and into September (Chart 2). Foreign currency denominated deposits rose by UAH 8.6 billion since June to UAH 127.483

billion at September 30, 2010. hryvnia denominated deposits grew by UAH 9.2 billion to UAH 113.985 billion. Thus, the pace of growth in hryvnia and foreign currency deposits had almost equalized in contrast to previous periods where UAH deposits had been going up much faster than FX deposits. This change of tendency may be explained by a weakening confidence in the domestic currency, caused by both psychological factors (history of UAH devaluation in the fall period) and fundamental factors like rising inflation.

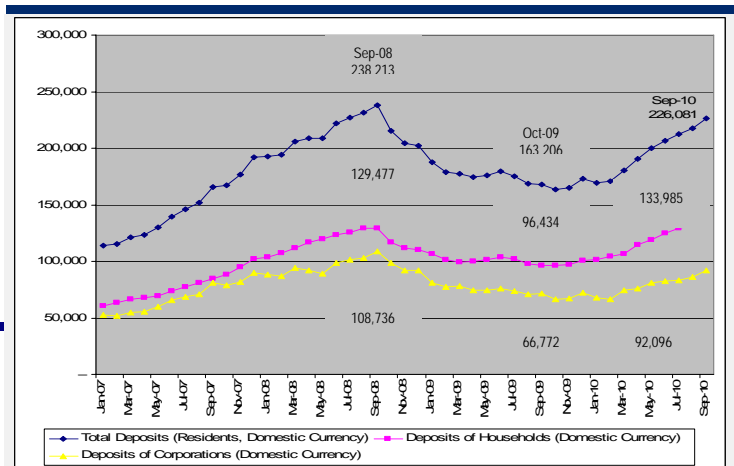
Chart 2: Foreign Currency Denominated Deposits and Domestic Currency Denominated Deposits of Households



Source: National Bank of Ukraine

The increase in consumer deposits took place in line with the general tendency of money retuning to the banking system, as deposits of corporations had risen as well (Chart 3).

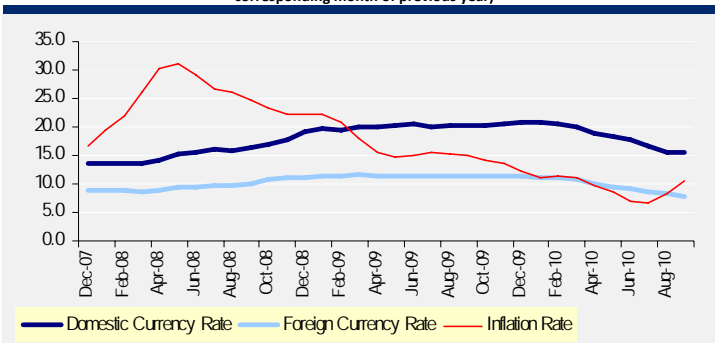
Chart 3: Deposits of Households and Corporations, UAH mln



Source: National Bank of Ukraine

After a period of continuous decline, the weighted average interest rate on domestic currency deposits stabilized in August (15.5%) and September (15.6%), while the foreign currency rate continued to go down (Chart 4). Again, this is an indication that UAH deposits became less popular because of devaluation apprehensions. The banks had to stop reducing interest rates to attract hryvnia resources, while they were able to attract FX resources even at lower rates. The formation of a rising trend in inflation may lead to a situation where at least the FX nominal interest rate will be lower than the inflation rate, with the real interest rate being in the negative.

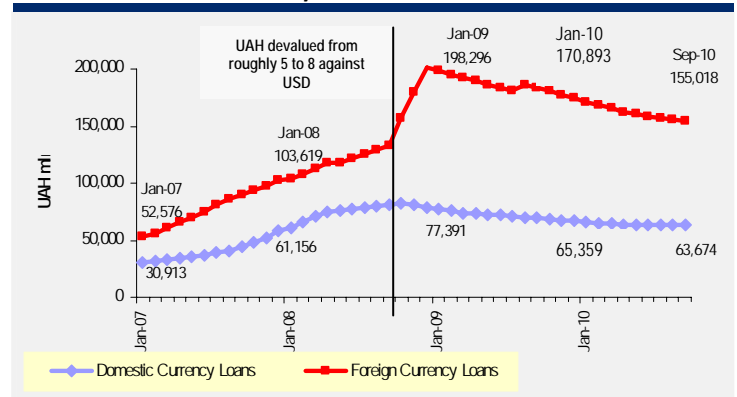
**Chart 4: Interest Rates on Deposits of Households, Inflation Rate (to corresponding month of previous year)**



Source: National Bank of Ukraine, State Statistics Committee of Ukraine

Although the banks were active in the quarter in expanding their deposit base, the increased resources were not used to boost lending, with the total loans to households continuing to contract. However, some signs of flattening trend appeared in September, as Consumer Loans and Mortgage Loans grew by UAH 470 mln and 118 mln, respectively, as compared to August figures. Total outstanding loans continued to be dominated by FX-denominated loans, but their proportion has been narrowing continuously to stand at 70.88% in September down from 71.14% in August and 72.34% in January (Chart 5).

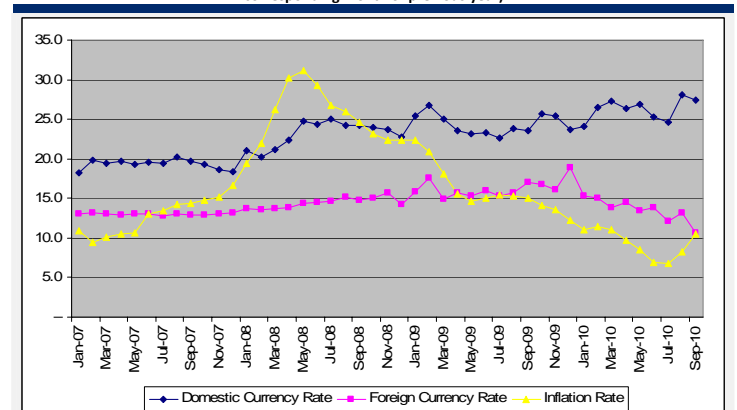
**Chart 5: Foreign Currency Denominated Loans and Domestic Currency Loans to Households**



Source: National Bank of Ukraine

Interest rates on domestic currency loans moved almost in line with changes in inflation pressure and increased to average levels of 28.1% in August and 27.5% in September in comparison to 24.6% in July (Chart 6). Foreign currency loan rates continued to go down on the background of no new lending activity because of the almost complete ban on extending FX-denominated loans under Law of Ukraine # 1533-VI dated June 23, 2009\*.

**Chart 6: Interest Rates on Loans to Households, Inflation Rate (to corresponding month of previous year)**



Source: National Bank of Ukraine, State Statistics Committee of Ukraine

\* "Financial institutions have the right to extend foreign currency denominated credits, loans to private individuals – residents and nonresidents, who are not engaged in entrepreneurial activities, only to pay to nonresidents for medical treatment and educational services abroad.

**About the FINREP Consumer Banking Snapshot**

The FINREP Consumer Banking Snapshot is a quarterly covering issues related to the Ukrainian financial sector, with a focus on developments in consumer banking. For more information about FINREP, its projects or this or any other publication of FINREP please visit the project website at <http://www.finrep.kiev.ua/> or contact the project via e-mail at [office@finrep.kiev.ua](mailto:office@finrep.kiev.ua)