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German Economic Team

NEWSLETTER

UKRAINE

Key trends in Ukraine's banking sector

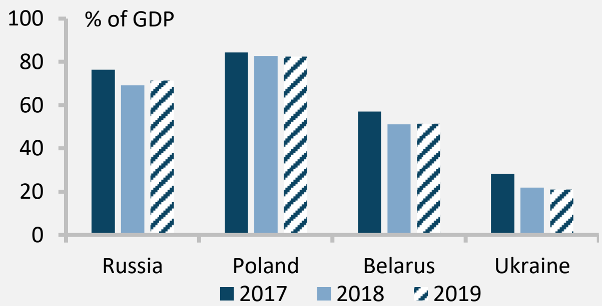
Ukraine's banking sector has undergone a process of deep and comprehensive reforms over the last few years. As a result, the number of banks dropped significantly to 74 currently, down from 180 in 2013. Bank assets have somewhat increased, but slower than Ukraine's nominal GDP. Therefore, the banking sector (21% of GDP) declined and remains small in regional comparison. The banking clean-up involved the nationalisation of Privatbank, the market leader with a 28% asset share, and led to the dominance of state-owned banks, representing 59% of the market. The reforms also contributed to improving the capital adequacy ratio, thereby strengthening resilience and supported profitability of the sector. As a result, Ukraine's banks are facing the negative economic consequences of the COVID-19 pandemic much better prepared than in the past.

Still, the amount of non-performing loans remains a risk. Though the share has gradually declined since 2017, it remains on a very high level compared to peers. Ensuring a significant reduction of the NPL stock and maintaining the independence of the National Bank are two key priorities within the current IMF Stand-By-Arrangement.

Stable number of banks, but lower penetration

As a result of massive banking sector reforms and clean-up, the number of active banks dropped from 180 in late 2013 to 75 in late 2019. There have been no further insolvencies between September 2018 and August 2020. Only very recently, in August 2020, this number dropped to 74 after the failure of Bank Arkada. At the same time, the liquidation of many banks closed during the previous years is still ongoing. Bank assets have somewhat increased over the last years, but slower than nominal GDP. As a result, Ukraine's banking sector has shrunk and remains much smaller (21% of GDP) than in neighbouring countries.

Bank assets in regional comparison

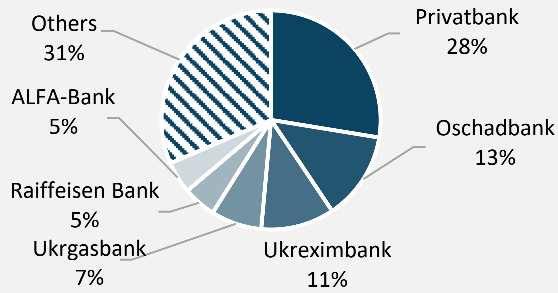


Source: Own calculations based on IMF data; Note: bank assets are net of provisions on NPLs

Market structure dominated by state-owned banks

The reforms also resulted in a dominance of state-owned banks in the sector. Privatbank is leading the market with a share of 28%, seven percentage points more than shortly before nationalisation at the end of 2016. All Top-4 banks are state-owned, representing together 59% of the banking sector assets.

Market share (assets)



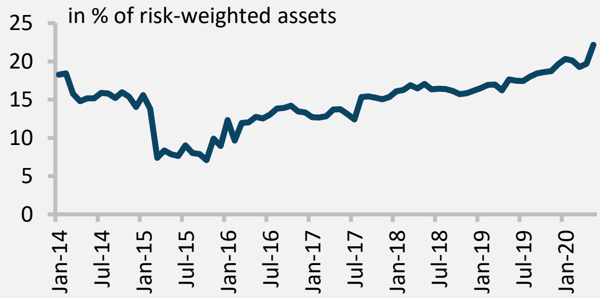
Source: NBU, June 2020

The remaining 41% are dominated by foreign-owned banks with almost a quarter. While private domestic banks hold more than 10% of total banking sector assets, Russian-owned state banks continue their exit from the market and play only a marginal role currently.

Drop in loans, but solid capitalisation

Government bonds are a considerable part of banking assets while loans to the real sector (25% of GDP) remain rather small in comparison to peer countries. Moreover, the (FX-adjusted) bank loan portfolio currently shrinks and is expected to experience a further drop due to the pandemic. However, the reforms contributed to improving the capital adequacy ratio and strengthened resilience. Therefore, the Ukrainian banking sector is facing the economic crisis resulting from the pandemic much better prepared than in the past.

Capital adequacy ratio (CAR)



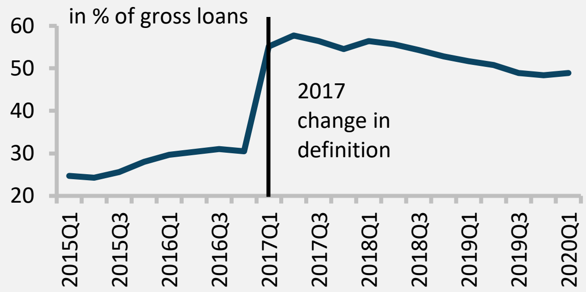
Source: NBU

Banks remained profitable in 2019 and in the current year, including the largest bank, Privatbank, which showed large profits of UAH 32.7 bn (USD 1.3 bn) in 2019. Banks are earning healthy interest margins in an environment of decreasing policy rates (currently 6% p.a.). In this framework, signs of pass-through are visible, as rates on household deposits in Hryvnia have reached single-digit figures for the first time for many years.

NPLs: Still an unresolved issue

During 2017, the share of non-performing loans (NPLs) reached a maximum of almost 60%, which is extremely high by international standards. Since then, a gradual decrease of this number has been observed, to currently less than 50%. This legacy NPL stock is largely provisioned for.

Non-performing loans



Source: NBU

Due to the pandemic, NPLs are expected to increase, as certain borrowers will face liquidity and solvency problems due to the crisis. So far, there are almost no visible effects on NPLs, but this can also be related to temporarily relaxed credit risk classifications by the NBU, which are part of a bigger package to deal with the crisis. According to NBU modelling, about 9% of all bank's corporate loan portfolio may go into default as a result of the crisis. As part of the IMF Stand-By Arrangement approved in June 2020, the authorities committed to specific NPL reduction strategies in state-owned banks.

Conclusion and outlook

Over the last year, the situation in Ukraine's banking sector has stabilised. The number of banks is now rather constant, their capital position sound and sufficient liquidity available; the sector also returned to profitability. At the same time, no recovery in lending was recorded, and the reforms and clean-up of the banking sector led to a high market share of state-owned banks, with significant legacy NPLs.

In this situation, the COVID-19 pandemic and the associated economic crisis poses new, but in our view manageable challenges to the sector. However, this requires a continuation of the close cooperation with the IMF and other IFIs. In this context, maintaining the legally guaranteed independence of the NBU must be a key priority for policy makers.

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