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NEWSLETTER

German Economic Team

UKRAINE

The Ukrainian banking sector in times of COVID-19

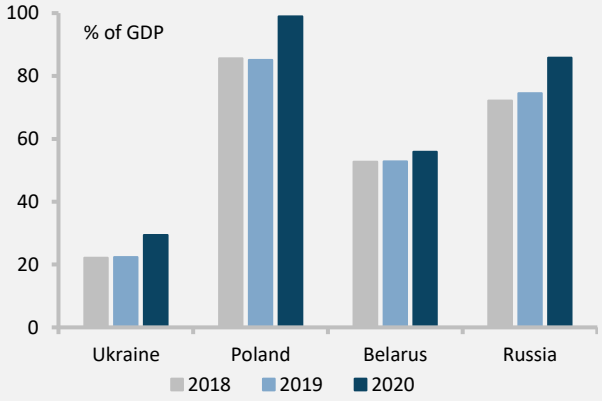
Ukraine's banking sector reforms, which started in 2015, clearly paid off during COVID-19. The increased resilience ensured that the economic crisis related to the pandemic has not spilled over to the financial sector. As a result, banking penetration increased in Ukraine, but remains far below that of peers. Assets are mainly concentrated in state-owned banks which account for four of the Top-5 banks. Currently, they hold less than half of net assets compared to 55% in 2019 indicating a much-welcome decline in the state share within the sector.

The pandemic did not put pressure on NPLs, as many observers expected. On the contrary, a strong decline of the non-performing loan (NPL) share in the sector from 58% in June 2017 to 33% in September 2021 was recorded. After stress tests were postponed in 2020 due to the pandemic, the recent one conducted in autumn 2021 showed that the sector is overall stable, with a solid and rising capital adequacy ratio, which is high even in international comparison. Beyond the pandemic, increasing demand and international competition in digital finance is a challenge for the sector. Successful forerunners demonstrate how to deal with the transformation.

Small sector size in international comparison

Since 2015, Ukraine has made huge progress in reforming the banking sector. The number of banks has halved to 71 during this painful process, with the recent insolvency of Zemelny Capital in August 2021. These reforms have supported the resilience of the sector and have been supporting its stability during the ongoing pandemic. While real GDP declined by 4% in 2020, net banking assets further increased such that the assets-to-GDP ratio increased to 29% (22% in 2019).

International comparison of bank assets



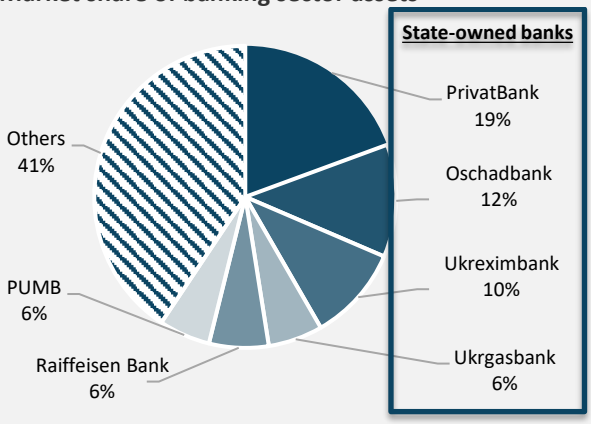
Source: Own calculations based on IMF data; Note: Bank assets are net of provisions on NPLs

Nevertheless, despite this increase, penetration remains much lower than in peer countries.

Some progress in state-owned banks

Another outcome of the reform process is that assets are mainly concentrated in state-owned banks, as four of the Top-5 banks are state-owned.

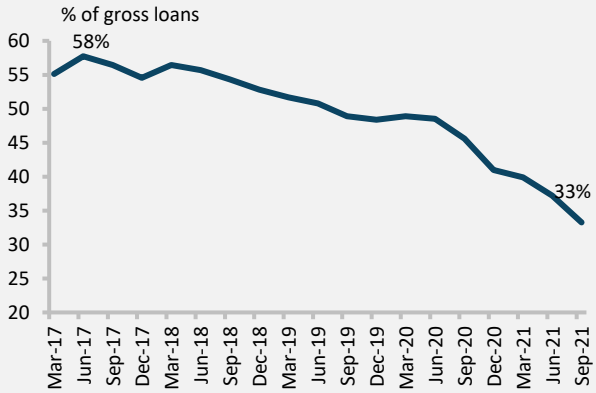
Market share of banking sector assets



Source: NBU, data for Sep-2021, assets net of provisions

The nationalised PrivatBank leads the market with 19% of net assets. However, the share of state-owned banks keeps slowly declining. Currently, they account for less than half of net assets, compared to 55% in 2019, while the share of domestic private banks grew to 21% (15% in 2019), which is an encouraging sign. Some further progress can be observed in the reduction of NPLs in state-owned banks. Since January 2020, the share of NPLs has declined significantly, from 48% to 33% of total assets, despite the pandemic. State-owned banks contribute 80%, amounting of UAH 108 bn (ca. USD 4 bn), to the decline. The market leader, PrivatBank, was been able to reduce its NPL ratio by 7 pp during this period.

NPLs



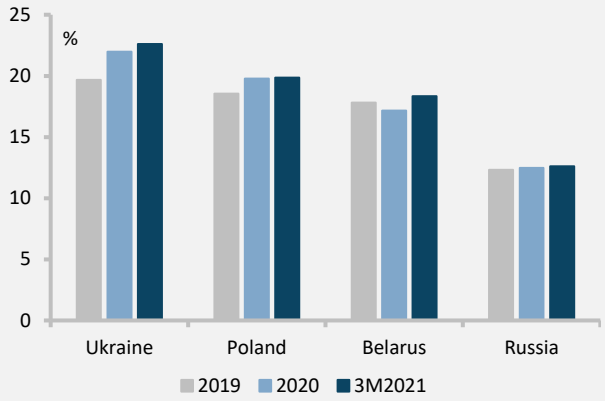
Source: NBU

Nevertheless, the ratio remains still very high (71% in Jun-21) and so is the ratio in the whole sector. As Ukraine has committed to reducing NPLs in state-owned banks under the current Stand-By Arrangement with the IMF, further effort is needed.

Solid capital and profitability despite pandemic

Widespread expectations of an increase of business insolvencies as result of lockdown measures and the decline in GDP in 2020 have not been visible in the data on non-performing corporate loans. Since the beginning of the pandemic in March 2020, the share has even further declined by 11 pp to 44% in June 2021. Overall, the recent banking stress test conducted in autumn 2021 indicates a stable and resilient sector, as the capital adequacy ratio (CAR) has been steadily increased as part of the reform agenda.

Banking sector CAR in international comparison



Source: IMF

While the CAR in Ukraine was 13% in January 2017, it has gradually increased to 23% in March 2021 and remains there now. Currently, the ratio is higher than in peer countries.

Banking sector profits of UAH 39.7 bn (ca. USD 1.5 bn) were recorded in 2020, showing once again that the pandemic-related economic crisis has not spilled over to the banking sector. Return on assets continues to fluctuate between 3% and 4%, which is higher than in Russia and Belarus (ca. 2%).

Monetary policy back to normal

During the pandemic, the NBU quickly introduced different instruments to support the stability of the banking sector; these emergency measures have been gradually phased out since spring 2021. Operations of long-term refinancing rates and interest rate swaps have been reduced and then finally suspended in October 2021. These decisions by the NBU draw the line to a normalisation of its activities in the banking sector. In addition, deep policy rate cuts also helped to cushion the economic impact of the crisis. Things have changed here as well as the policy rate has been gradually hiked to currently 8.5% as a result of high inflation pressures.

Outlook

Ukraine`s banking sector has proven resilient against the COVID crisis due to past reforms and adequate policy support. Therefore, a continuation of the reform agenda, which is also a key cornerstone of the recently prolonged IMF programme, is of high importance.

A general heritage of the crisis is the accelerated development of digital finance. In Ukraine, with its vibrant and successful IT-sector, such trends are already clearly observable. In early 2018, Ukraine had experienced a great push when market-leader PrivatBank introduced NFC payment technology via Apple Pay. At the same time, fully mobile Monobank started its operations and recorded about 4.5 m customers this autumn. Ukraine has now rapidly converged to its peers in terms of digital lending and digital capital raising. This development will intensify due to increasing domestic as well as international demand for digital finance products and increasing competition.

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This newsletter is based on the forthcoming Banking Sector Monitor.

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