Banking Sector Monitoring Ukraine

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Currently, there are **71 banks** operating in Ukraine, 3 less than a year before.

**State-owned banks** dominate the sector, but are losing gradually market share to domestic private institutions.

In parallel, the **market concentration decreases**, with the TOP-5 banks owning 54% of assets (after 59% in 2020).

**Loan growth** has picked up after the crisis and runs currently at 6% yoy.

**Non-performing loans** are still high (33%), but have reduced significantly over the last years, especially at state banks.

The **banking system is profitable**, with return on assets (ROA) in the 3%-4% range.

This helped to boost capital, with a current **capital adequacy ratio** (CAR) of 21%.

Due to high inflation, the National Bank of Ukraine has started a **new policy rate cycle**, which will eventually impact bank interest rates.

- Overall, Ukraine’s banking sector has weathered the COVID pandemic rather well, with no significant damage detectable.
- Still, the sector is still rather small in a regional perspective, limiting its potential to support the real economy via lending to corporates and households.
Content

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Annex: Banking Sector Statistics
1. Bank assets in a regional context

- Bank assets in Ukraine have increased over the last years, but grew only slightly faster than nominal GDP, resulting in a gradually higher asset-to-GDP penetration ratio.

- In 2020, bank assets increased strongly in all countries, while nominal GDP lagged due to the crisis, resulting in a jump in penetration.

- Still, following the clean-up of the banking sector, Ukraine’s sector remains much smaller than that of peers.

Bank assets-to-GDP continue to increase in Ukraine, but no convergence with peers in sight.

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

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2. Number of banks

- Three banks failed since Nov-20, with “Zemelny Capital” being the most recent failure
- Number of active banks decreased to 71
  - Three failed banks accounted for 0.2% of bank assets
  - No recent new entrance on the market
- Liquidation proceedings for over 30 banks are ongoing for longer than 5 years

➢ Number of banks relatively stable but legacy of 2014-2015 banking crisis is still felt
3. Market shares

- State-owned banks retain high market share in the banking sector
  - But down to 48% in Sep-2021 from 53% beginning this year
  - Reduced government bond holdings
  - Some losses in market share for loans (36% vs 39% in 2019)

- Private owned-banks expanded market share
  - Invested in government bonds
  - Expanded market share in consumer loans (30% vs 22% in 2019) primarily from foreign-owned banks

- Increased competition in the sector due to increasing market share of private banks

➢ Domestic private banks expanded market share in consumer lending and government bond investment

Source: NBU, September 2021; note: assets net of provisions

Source: Own calculations based on NBU data RZB; note: assets net of provisions
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4. Concentration

- Concentration decreased as large state-owned banks lost market share to smaller private banks
- Higher share of private banks in the Ukrainian market increases competition
- Market concentration is at low end for similar countries
  - In Belarus and Russia, markets are concentrated and dominated by state-owned banks (>60% of assets)
  - In Poland, competition is far advanced with a lower share of state-owned banks (ca. 40%) than in the mentioned peer countries

➢ Concentration has dropped in Ukraine
➢ Declining share of state-owned and increasing share of private banks increase competition
5. Lending to the real sector

Loans to households and nonfinancial corporates, 2020

- Loans to households and non-financial corporates in Ukraine are much lower than in peer countries
  - Conservative lending policies following bank “clean-up” in 2015-2017
  - Crowding-out effect of government bond holdings
- As a result, loans to the real sector remain relatively small compared to neighbouring countries
  - If we exclude NPLs, this amount is even smaller

➢ Low level of lending (and therefore support) to real sector

Sources: Own calculation based on IMF and NBU data; * Loans net of NPLs
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6. Loan growth

- Bank loan portfolio returned to nominal growth during 2021
  - Still lagging inflation
  - More loans to corporate borrowers
  - Write-downs of legacy loans continues offsetting increases in new loans

- Consumer lending grew slower in 2021 than in 2019 but remained focused on high-yielding short-term loans

Loan portfolio shows signs of recovery in 2021

Sources: Own calculations based on NBU and Ukrstat data; note: FX adjusted, gross loans. Real loan growth based on observed consumer inflation
7. Non-performing loans (NPLs)

- Rapid decrease in NPLs in 2020-2021 due to write-down of legacy loans (100% provisioned in previous years)
  - COVID effect notable in 2020, as bank expenses on loan loss provisions almost tripled from 2019 (from UAH 11 bn to UAH 31 bn) and more non-legacy/current loans became NPLs than in previous years
  - However, NPL share still decreased as write-downs were higher than new NPLs
  - No visible effect in 9M2021; provision expense lower than in 9M2019
  - NPLs in PrivatBank remain on balance sheet most likely due to ongoing court cases
  - Low level of NPLs in private banks

- Write-downs reduced NPL levels sharply
- (Small) COVID effect seems to be limited to 2020
8. Deposits

- Bank deposits grew during crisis
  - Slowdown in 2021 in response to lower interest rates
  - Decrease in term deposits
- FX deposits remained broadly stable
- Ubiquity of card and phone payments reduced demand for cash
  - This resulted in strong growth of demand deposits in 2020-2021
  - Cheap source of funding for banks, but vulnerability if preferences change

➢ Bank deposits expanded, providing banks with a stable funding base

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**Source:** NBU, own calculations from NBU data

**Source:** Own calculations based on NBU data

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9. External debt

- External debt continues to fall as new bank debt remains low
- Actually, bank deposits in foreign banks exceed external debt since 2019; implying a (growing) net external creditor position of USD 6.4 bn (2019: USD 4.1 bn)
  - In part due to limitations on domestic FX lending
- Debt service obligations of banks over the next quarters are minimal

➢ Banks are now net external creditors
10. Capital adequacy

- Significant improvements in capital adequacy, which contributed to financial stability, continued over the last years
  - Current CAR: 21% of RWA
  - October 2015: 7%
- So far, only limited COVID-19 impact observable (see slide “NPL“)
- Only two banks among the 14 banks deemed systemically important report a CAR below 15%
- CAR is higher than in peer countries

Positive developments in terms of capital adequacy

Source: IMF, data for Poland are for 3M2021
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11. Profitability

- Banks remained profitable during the pandemic (USD 1.5 bn after 9M2021)
- But high share of operating income comes from government bonds
- Return on assets (ROA) remain high in the 3%-4% range since 2019;
- 2021 slightly below the 2019 level
- ROA high in international comparison, indicating a profitable sector

➢ Sector profitability has held up during COVID-19
➢ Return on assets in Ukraine is above that of peers

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Source: NBU
Source: IMF, data for Poland are for 3M2021
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12. Interest rates

- In response to inflation pressures, NBU increased policy rate stepwise from 6% to 8.5% in 2021
  - Some COVID-related lending facilities were discontinued
  - Ex-post real rate turned negative in 2021, as inflation increased faster than policy rate
- Transmission of recent policy rate hikes into bank rates so far limited
  - Deposit rates stabilised and increased slightly over the last months
  - No sign of pick-up in deposit rates due to COVID-19
  - Interest rates on loans were increased as reaction of key policy rate hike, as loan interest rates are usually stickier during key policy rate cuts than during hikes

➢ In line with increasing inflation, new cycle of interest rate increases, but imperfect transmission mechanism

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Source: NBU, new loans/new deposits
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Banks have to adapt products to digital transformation due to increasing competition.

Ukraine’s sector experienced a big push in early 2018:
- Fully-mobile Monobank started operations (now 4.5 m customers)
- PrivatBank introduced NFC (near-field communication to exchange data between e-wallet and reader) via Apple Pay
- Since then, 43 further banks followed

Since 2021: NBU publishes data for NFC and contactless card transactions separately:
- Transactions with contactless cards and NFC steadily increasing and further accelerated due to COVID effect
- NFC payments overtook payments with physical cards after 9M2021

- Digitalisation can reduce transaction costs for banks and customers
- Domestic market is increasing
14. Monetary policy transmission

Monetary policy transmission

<table>
<thead>
<tr>
<th>Deposits</th>
<th>Non-financial corporations (NFC)</th>
<th>Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term</td>
<td>0.98</td>
<td>0.93</td>
</tr>
<tr>
<td>Medium-term</td>
<td>0.91</td>
<td>0.97</td>
</tr>
<tr>
<td>Long-term</td>
<td>0.66</td>
<td>0.95</td>
</tr>
</tbody>
</table>

<table>
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<th>Loans</th>
<th>Non-financial corporations (NFC)</th>
<th>Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term</td>
<td>0.97</td>
<td>-0.53</td>
</tr>
<tr>
<td>Medium-term</td>
<td>0.94</td>
<td>0.62</td>
</tr>
<tr>
<td>Long-term</td>
<td>0.2</td>
<td>0.57</td>
</tr>
</tbody>
</table>

Source: NBU, own calculations *Correlation of respective rate (two lags) with the key policy rate, light blue shows a high positive correlation >0.6, grey shows a weak positive one with 0.2<X<0.6, white shows the case of no or the negative sign, period: Jan-18 to Aug-21, new loans/new deposits

How do bank interest rates react to changes in the policy rate („interest rate pass-through“)?

**Deposits:**
- Strong transmission for all maturities

**Lending:**
- Mixed picture for households
- Strong transmission for short/medium-term to Non-financial corporations (NFC)

What determines the interest rate spread?
- We consider main determinants of the spread (difference between lending and deposit rate) in a cross-country analysis
- Rule of Law is significant and has a negative sign
- Bank market concentration is significant and has a positive sign

➢ Transmission works well for deposits, much weaker for loans
➢ Rule of Law and market concentration influence the interest spread

Determinants of the interest rate spread

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rule of Law (RoL)</td>
<td>-13.98***</td>
<td>-6.90</td>
<td>-9.19</td>
<td>-13.59*</td>
</tr>
<tr>
<td>GDP per capita [in 1000]</td>
<td></td>
<td>-0.07</td>
<td>-0.06</td>
<td>-0.06</td>
</tr>
<tr>
<td>CPI</td>
<td></td>
<td>-0.07</td>
<td>-0.06</td>
<td></td>
</tr>
<tr>
<td>Market concentration [in %]</td>
<td></td>
<td></td>
<td>0.16***</td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td>0.10</td>
<td>0.12</td>
<td>0.12</td>
<td>0.26</td>
</tr>
</tbody>
</table>

Source: Own calculation, *significant at 10%, **significant at 5%, *** significant at 1%, variance inflation factor does not reveal a multicollinearity problem
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**Background:**
- Programme was established in Jan-20 to stimulate investment and create jobs.
- State Fund for Development of Entrepreneurship (FDE) compensates the difference between the base rate and the loan rate and provides partial credit guarantees.

**Current developments:**
- Programme retargeted from investment stimulus and job creation to working capital support at 0% interest due to COVID.
- Currently, agricultural businesses are the largest recipients, with 44% of all loans issued to them, even though most of these businesses are stable and do not need emergency support.
- Need to refocus the programme.
  - Programme supported SMEs during the pandemic.
  - Recovery should be used to refocus the programme, thereby limiting fiscal spending.

**Loans and participating banks (cumulative):**
- Loan volume (left axis)
- Number of banks (right axis)

**Loans by purpose and recipients:**
- Emergency working capital support
- Capital investment
- Debt refinancing

**Source:** MOF, MEU, as of October 2021
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16. Re-launch of Export Credit Agency?

**Background:**
- Ukraine’s ECA couldn’t serve as a risk transfer counterparty for banks due to various reasons:
  - Low capitalisation until recently (UAH 200 m); thus, the NBU does not recognise guarantees as a loan collateral
  - There is no additional sovereign guarantee

**Current developments:**
- ECA is not yet regulated by any supervision institution (like the NBU)
- In Aug-21, the Cabinet of Ministers approved a capital increase to UAH 2 bn
- ECA’s Supervisory Board members were dismissed in Nov-21, the ECA’s head dismissed and then reinstated again

- Clear and transparent regulation, established and trustworthy corporate governance and external financial control is needed
- Risk assessment of deals to be shared between ECA and commercial banks to prevent abuse
- ECA should try to set up a first-class panel of reinsurers

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**Companies facing obstacles in export transactions**

- No answer: 33%
- Companies reporting obstacles: 43%

**Source:** Own survey

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**Buyer’s credit guarantee with 3 parties (plus ECA)**

- Exporter
- Export contract
- Export credit guarantee
- Buyer/Borrower
- Buyer’ credit contract
- Loan repayment
- Loan disbursement
- Bank
- ECA

**Source:** Own illustration © Berlin Economics
17. Challenges for state-owned banks

**Background:**
- SOBs hold 48% of banking net assets:
  - Profitable, but high share of operating income comes from government bonds
  - Only PrivatBank remains profitable if excluding government bonds income
  - Legacy NPLs declining steadily, but still high share

**Current challenges:**
- Oschadbank to become a member of the Deposit Guarantee Fund as a structural benchmark under the IMF programme
- Numerous court decisions outstanding on nationalisation of PrivatBank
- Convertible loans by IFIs to Oschadbank and Ukrgazbank support pre-privatisation phase

- Privatisation roadmaps and corporate governance policy to be implemented as conditionality in the IMF programme
- Further progress in NPL resolution should be a joint focus for the government and IFIs

**Reform status in state-owned banks**

<table>
<thead>
<tr>
<th>Supervisory Board</th>
<th>PrivatBank</th>
<th>Oschadbank</th>
<th>Ukreximbank</th>
<th>Ukrgazbank</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 out of 9 members are independent</td>
<td>5 out of 7 members are independent</td>
<td>5 out of 7 members are independent</td>
<td>5 out of 7 members are independent</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategy</th>
<th>2018-2022 approved</th>
<th>2021-2024 approved</th>
<th>2020-2024 approved</th>
<th>2019-2021 approved, newer yet to come</th>
</tr>
</thead>
</table>

| Pre-privatisation phase | Numerous court proceedings still on as a nationalisation legacy | EBRD is to provide EUR100M convertible loan | No agreements yet | IFC provided EUR30M convertible loan (up to 20% stake) |

Source: NBU, preliminary data for 10M2021, all periods: profits after taxes
About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

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## Annex: Banking Sector Statistics

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets UAH bn</td>
<td>1840.0</td>
<td>1910.6</td>
<td>1981.6</td>
<td>2205.9</td>
<td>2261.7</td>
</tr>
<tr>
<td>Net assets in UAH bn</td>
<td>1333.8</td>
<td>1359.7</td>
<td>1493.3</td>
<td>1822.8</td>
<td>1931.9</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>6.2</td>
<td>1.9</td>
<td>9.8</td>
<td>22.1</td>
<td>13.1</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>26.7</td>
<td>27.2</td>
<td>29.5</td>
<td>36.5</td>
<td>38.7</td>
</tr>
<tr>
<td>Total loans UAH bn</td>
<td>1035.2</td>
<td>1116.0</td>
<td>1028.6</td>
<td>948.9</td>
<td>1015.1</td>
</tr>
<tr>
<td>Net loans in UAH bn</td>
<td>542.7</td>
<td>586.4</td>
<td>557.6</td>
<td>581.1</td>
<td>697.8</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>-1.9</td>
<td>8.1</td>
<td>-4.5</td>
<td>4.2</td>
<td>20.1</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>18.2</td>
<td>16.5</td>
<td>14.0</td>
<td>13.9</td>
<td>14.0</td>
</tr>
<tr>
<td>Loans to legal entities in UAH bn</td>
<td>450.8</td>
<td>471.9</td>
<td>415.0</td>
<td>432.5</td>
<td>511.7</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>-5.5</td>
<td>-4.7</td>
<td>-12.1</td>
<td>4.2</td>
<td>18.3</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>15.1</td>
<td>13.3</td>
<td>10.4</td>
<td>10.3</td>
<td>10.2</td>
</tr>
<tr>
<td>Loans to households in UAH bn</td>
<td>91.9</td>
<td>114.5</td>
<td>142.6</td>
<td>148.6</td>
<td>186.0</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>20.3</td>
<td>24.6</td>
<td>24.5</td>
<td>4.2</td>
<td>25.2</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>3.1</td>
<td>3.2</td>
<td>3.6</td>
<td>3.5</td>
<td>3.7</td>
</tr>
<tr>
<td>Loans in foreign currency in UAH bn</td>
<td>490.4</td>
<td>520.9</td>
<td>418.5</td>
<td>363.0</td>
<td>308.2</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>-5.7</td>
<td>6.2</td>
<td>-19.7</td>
<td>-13.3</td>
<td>-15.1</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>16.4</td>
<td>14.6</td>
<td>10.5</td>
<td>8.7</td>
<td>6.2</td>
</tr>
<tr>
<td>Loans in foreign currency (% of total loans)</td>
<td>47.4</td>
<td>46.7</td>
<td>40.7</td>
<td>38.3</td>
<td>30.4</td>
</tr>
<tr>
<td>Total deposits UAH bn</td>
<td>905.0</td>
<td>938.7</td>
<td>1077.1</td>
<td>1363.1</td>
<td>1417.6</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>6.5</td>
<td>3.7</td>
<td>14.7</td>
<td>26.6</td>
<td>4.0</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>30.3</td>
<td>26.4</td>
<td>27.1</td>
<td>32.5</td>
<td>28.4</td>
</tr>
<tr>
<td>Total deposits from legal entities in UAH bn</td>
<td>426.9</td>
<td>430.2</td>
<td>525.0</td>
<td>681.2</td>
<td>729.1</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>3.4</td>
<td>0.8</td>
<td>22.0</td>
<td>29.8</td>
<td>7.0</td>
</tr>
<tr>
<td>in % of GDP</td>
<td>14.3</td>
<td>12.1</td>
<td>13.2</td>
<td>16.2</td>
<td>14.6</td>
</tr>
<tr>
<td>Total deposits from households in UAH bn</td>
<td>478.1</td>
<td>508.5</td>
<td>552.1</td>
<td>681.9</td>
<td>688.5</td>
</tr>
<tr>
<td>growth in % yoy</td>
<td>9.4</td>
<td>6.4</td>
<td>8.6</td>
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<td>14.3</td>
<td>13.9</td>
<td>16.3</td>
<td>13.8</td>
</tr>
<tr>
<td>Total loans % of total deposits</td>
<td>114.4</td>
<td>118.9</td>
<td>95.5</td>
<td>69.6</td>
<td>71.6</td>
</tr>
</tbody>
</table>

### Structural information

| Number of banks                                         | 82.0     | 77.0     | 75.0     | 73.0     | 71.0     |
| Market share of state-owned banks (% of net assets)     | 54.9     | 54.7     | 55.2     | 52.6     | 47.5     |
| Market share of domestic private banks (% of net assets)| 14.0     | 14.8     | 15.0     | 17.2     | 21.3     |
| Market share of foreign-owned banks (% of net assets)   | 31.1     | 30.4     | 29.8     | 30.2     | 31.2     |

### Profitability and efficiency

| Net profits/losses in UAH bn                            | -26.5    | 22.3     | 58.4     | 39.7     | 21.3     |
| Return on assets                                       | -1.9     | 1.7      | 4.7      | 2.8      | 4.0      |
| Capital adequacy ratio (% of risk-weighted assets)      | 16.1     | 16.2     | 19.7     | 22.0     | 21.6     |
| NPLs (% of total loans)                                | 54.5     | 52.8     | 48.4     | 41.0     | 33.3     |

Source: NBU
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