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NEWSLETTER

German Economic Team

UZBEKISTAN

Key trends in Uzbekistan's banking sector

The banking system of Uzbekistan has shown a remarkable level of resilience during the COVID-19 pandemic but was also supported by the overall positive macroeconomic situation of the country. So far, the banking system has also demonstrated a relative immunity to repercussions of the Russia-Ukraine war.

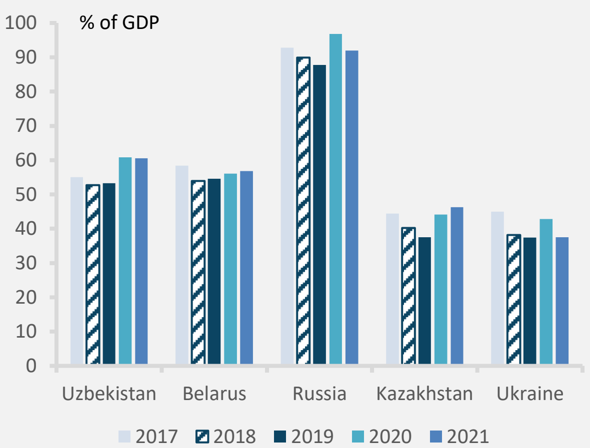
The banking sector has grown strongly over the last years and has a smaller share of GDP than in Russia, but a larger one than in Kazakhstan or Ukraine. The sector continues to be dominated by state-owned banks which control 81% of the assets. However, the government plans to privatise most of the state-owned banks until 2025 through IPOs or by selling state shares to strategic investors.

Lending increased strongly by an average of 34% p.a. during 2017-2021 in real terms with lending to the private sector increasing even stronger, albeit from a low level. The NPL ratio increased sharply due to repercussions of the COVID-19 pandemic but is still low in regional comparison. Capitalisation and profitability of the sector are on a relatively comfortable level, but have been declining recently.

Strong growth of the banking sector

Uzbekistan's banking sector experienced very strong growth in 2020 with a nominal increase of assets by 34% yoy (21% in real terms), followed by a further 22% increase in 2021 (11% in real terms). As a result, banks' assets have exceeded 60% of GDP, supporting strong GDP growth (7.4% yoy in 2021 in real terms). Uzbekistan's banking sector is the second largest in size in the peer group of Belarus, Kazakhstan, Russia and Ukraine.

International comparison of bank assets



Sources: Central Banks, own calculations

Share of state-owned banks to decrease

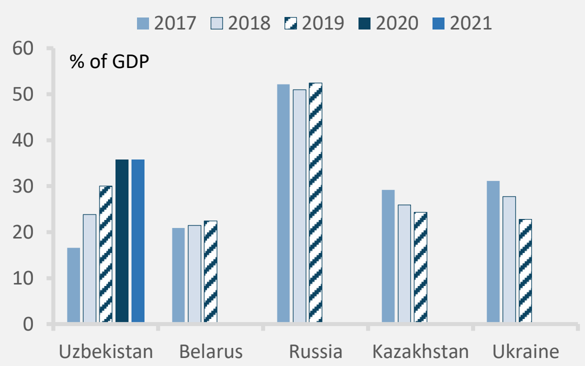
State-owned banks are still dominant with 81% of assets, 86% of loans and 67% of deposits. However, the large-scale reform programme of the banking sector started in May 2020 is aimed at privatising several state-owned banks by end of 2025 through IPOs or sale of banks' shares to strategic investors (including the National Bank of Uzbekistan – the largest state-owned bank with a market share of around 20%).

If privatisation plans are successful, they will drastically reduce the share of state ownership in the banking sector, potentially in favour of foreign investors, who currently play a limited role, controlling just 7% of assets. This will not only significantly increase competition but also ensure banks' development towards lending to the private sector as compared to the previous longstanding practice of directed lending to state companies.

Lending to the private sector on the rise

The transformation of Uzbekistan's economy is best illustrated by trends of banks' loan portfolios. Over the last five years, lending to the private sector increased by an average of 37% annually in real terms, with its share in total loans reaching 80% (from 56% in 2017). Uzbekistan compares favourably to most peer group countries with loans to the private sector at 36% to GDP (more than doubling from 17% in 2017).

Loans to the private sector in international comparison



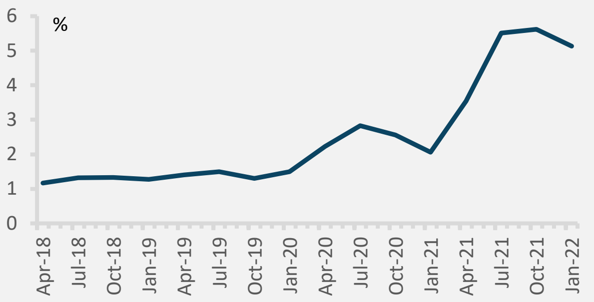
Sources: World Bank, IMF, own calculations (data for 2020-2021 available only for Uzbekistan)

Loan growth is expected to continue in 2022, with lending to households playing an increasingly important role.

Non-performing loans (NPLs)

NPL levels have been remarkably low (also in regional comparison) but started to increase since 2018. Significant increases took place in 1H2020 and 1H2021, mainly attributed to COVID-related shocks. NPL ratios might further deteriorate due to continued lending growth and the expiration of loan moratoria (granted in 2020 to alleviate pressure on borrowers caused by the COVID pandemic).

NPLs as share of total loans



Source: Central Bank of Uzbekistan, end of period

Current assessments of asset quality by rating agencies are similar to the reported data (S&P: NPL ratio of 4-6%).

Deposits

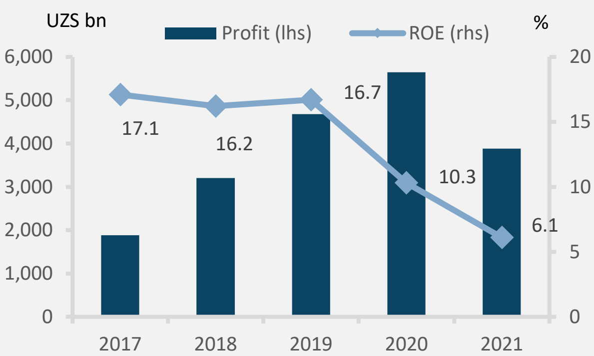
A slow but steady growth of deposits was recorded for the last 3 years both in local currency (by around 13% p.a.) and in foreign currency (by around 12% p.a.). Notably, there is a strong increase in long-term deposits by an average of 54% annually for the same period which shows confidence in the banking system and allows banks to provide more long-term lending.

Capital adequacy and bank profits

The capital adequacy ratio (CAR) was at a satisfactory level at 17.5% (end of 2021) even though it declined by 6 p.p. for the last 2 years as a result of strong asset growth (63%) without a corresponding equity increase (39%).

Bank profitability (ROE) was at 6% in 2021 but decreasing compared to previous years (around 10% in 2020 and 17% in 2019).

Banking sector performance



Source: Central Bank of Uzbekistan

The profitability of banks is burdened by the negative impact of the COVID pandemic on the corporate sector and shrinking interest margins. Other contributing factors are increasing NPLs and higher risk weighting measures imposed by the Central Bank of Uzbekistan.

External debt

The external debt of the banking sector grew rapidly since 2019, reaching 11.5% of GDP in 2021 (the highest level in the peer group), caused by a significant reduction of state funding. This led to the need to find new financing sources.

Summary and outlook

Uzbekistan's banking sector has proven resilient to the COVID crisis due to adequate policy support. So far, it has also demonstrated a relative immunity to the repercussions of the Russia-Ukraine war and international sanctions imposed on the Russian financial sector. Uzbekistan's banks have a low dependence on Russian banks, mainly dealing with them in payment settlements, clearing guarantees and trade finance. However, a possible decline of remittances from Russia (by around 50% in 2022 according to a GET estimate) may deteriorate the solvency of the population and cause an increase in NPLs.

A continuation of the reform agenda aimed at drastically reducing the share of state ownership in banks is of high importance to ensure further changes of the market structure and increase competition in the sector.

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A more comprehensive analysis is provided by our Policy Briefing: Banking Sector Monitor Uzbekistan.

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**Advisory activities in Belarus are currently suspended.*