POLICY BRIEFING 05 | 2022

German Economic Team

UZBEKISTAN

Banking Sector Monitor Uzbekistan

Stanislav Dubko, Woldemar Walter, Robert Kirchner

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Summary (1/2)

- The Uzbek banking system has shown a remarkable level of resilience during the crisis caused by the COVID-19 pandemic and was supported by the overall positive macroeconomic situation of the country
- So far, the Uzbek banking system has also demonstrated a relative immunity to repercussions of Russia-Ukraine war and international sanctions imposed on the Russian financial sector
- The size of the Uzbek banking sector has remained rather stable over the last years, and is by share of GDP smaller than in Russia, but larger than in Kazakhstan or Ukraine
- The number of banks has increased in the last years to 33 banks, the sector continues to be dominated by state-owned banks, which control 81% of the assets
- Decreasing but still strong market concentration: Top 3 banks account for 44% of assets; 16 banks have a market share of less than 1%. Foreign banks play a limited role
- Government reinforces plans to privatise most of the state-owned banks until 2025 by selling state shares to strategic investors or through IPO, which, if successful, may change the structure and concentration in the banking sector
- However, so far only 1 relatively small bank (Asia Alliance Bank with an asset share of less than 1%) was privatised

Summary (2/2)

- Lending increased strongly by an average of 34% p.a. during 2017-2021 in real terms. Lending to the private sector increased even stronger, although from a low level
- The NPL ratio increased sharply in 1H2021 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
- Directed lending plays still an important role in the Uzbek economy. As the government is aiming at commercialisation of the banking sector, banks are less involved in directed lending and will replace it by lending out of own sources
- External debt of the banking sector increased strongly in the past years as banks started attracting new funding since 2019 on international markets, e.g. by issuing Eurobonds (including Eurobonds in local currency)
- High dollarisation remains an issue and poses risks for the banking sector
- The pandemic and instability caused by the Russia-Ukraine war might postpone the privatisation and commercialisation plans of the government. It is also questionable whether there will be enough foreign investment to privatise all state-owned banks planned for privatisation until 2025

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Key indicators

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10. External debt of banking sector

Selected issues

11. Directed lending
12. Dollarisation
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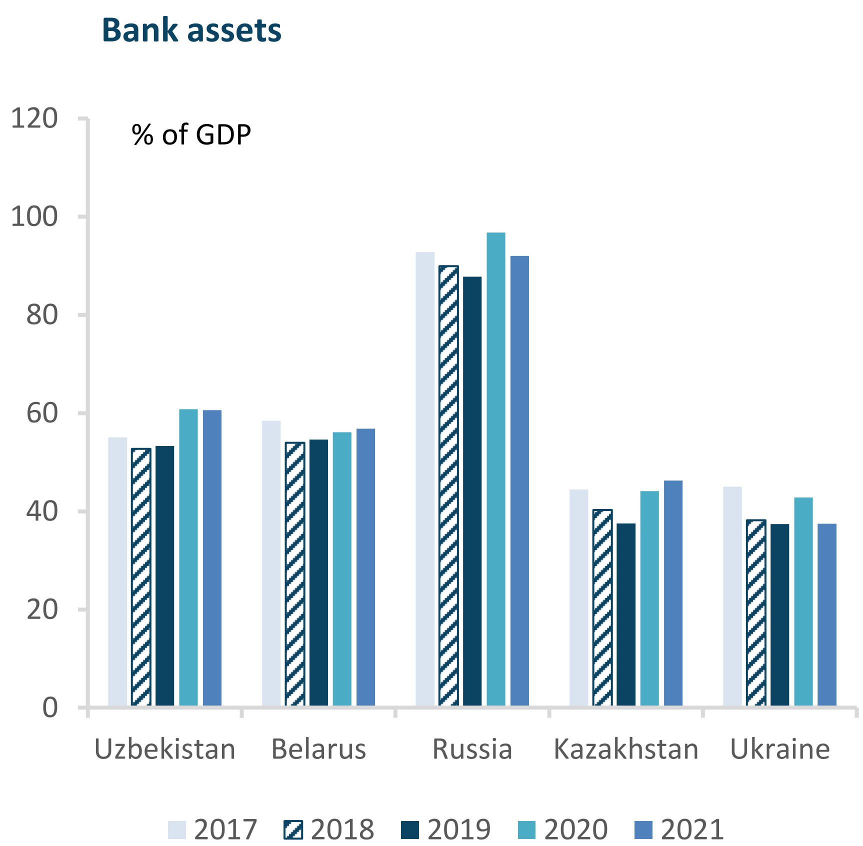
14. Impact of Russia-Ukraine war

1. Bank assets in a regional context



Source: Central Banks, own calculations

Bank assets

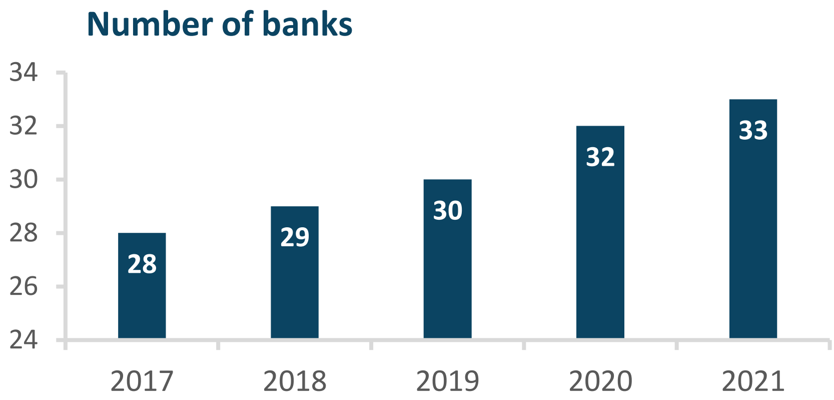
- Strong growth started in 2020 (nominal 34% yoy) and continued in 2021 (nominal 22% yoy)
- Asset growth was able to support real GDP growth at 7.4% yoy in 2021
- 2021: 60.6 % of GDP; about the same level as in 2020 (60.8%), supported by strong GDP growth

Regional comparison

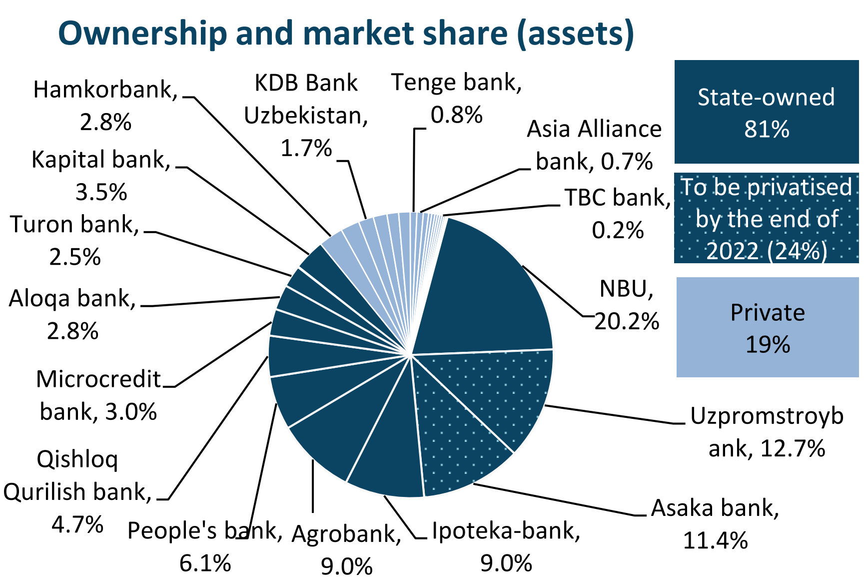
- UZB banking system comparable in size to BLR, larger than KAZ and UKR, but much smaller than RUS
- Similar trends in peer group, recent increase in UZB more dynamic

➢ **Level of bank assets relatively high in the peer group but no sharp increase expected in the short-term**

2. Number of banks and ownership



Source: Central Bank of Uzbekistan, end of period



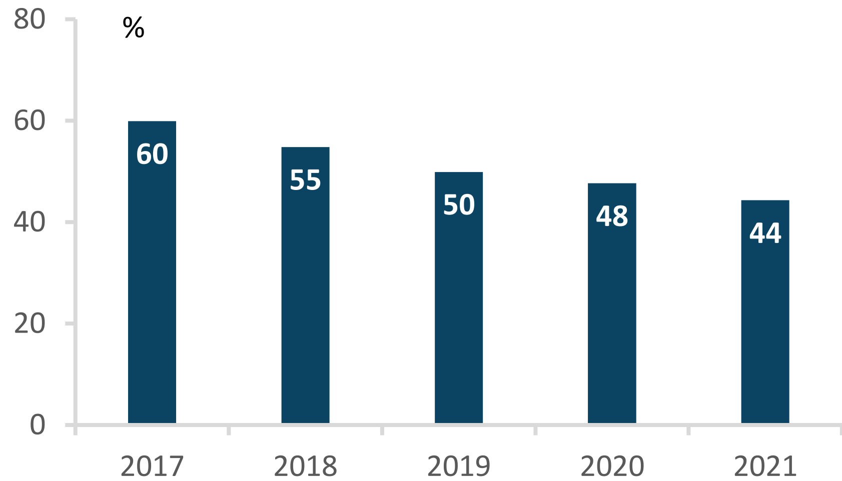
Source: Central Bank of Uzbekistan, as of 01/01/2022

- Since 2017 increase of number of banks, from 28 to 33
- State-owned banks still dominant: 81% of assets, 86% of loans and 67% of deposits
- Foreign-owned banks play very limited role (controlling 7% of assets)
  - Hamkorbank minority ownership of IFC and Dutch Development Bank FMO
  - JSC KDB Bank Uzbekistan owned by Korea Development Bank
  - 5 other banks with foreign ownership
- Asia Alliance Bank privatized in 2021
- Plans to privatise several other state-owned banks by end of 2025 (details on slide 18)
- IFIs very active in cooperation with Uzbek Banks, play important role for privatisation

➢ **Dominance of state-owned banks gradually decreasing (from 85% in 2020 to 81% end of 2021), may decease more drastically provided privatisation plans are successful**

3. Market concentration

Share of Top 3 banks (assets)



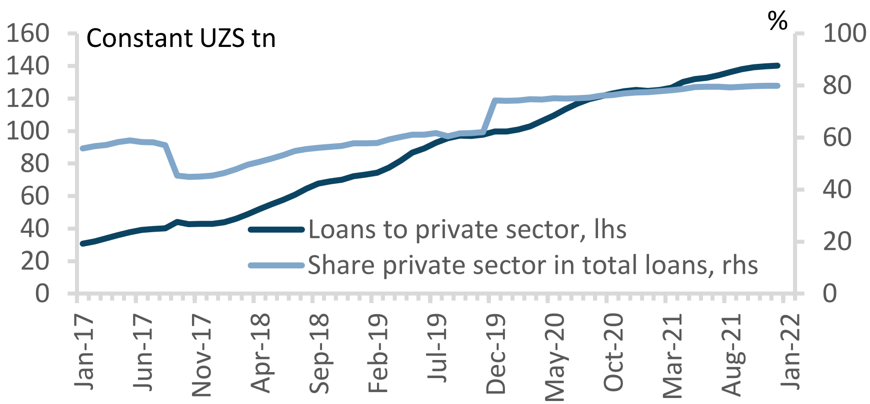
Source: Central Bank of Uzbekistan, own calculations, end of period

- NBU (National Bank for Foreign Economic Activity of Uzbekistan) is the biggest bank and the only systemic bank according to the Central Bank of Uzbekistan
- Still strong, but decreasing concentration of bank assets among Top 3 banks (44% share)
  - Main reason: decrease of size of NBU from 31% to 20% between 2017 and 2021 following restructuring
- 16 banks with market share below 1%
  - 2 banks with state ownership
  - 14 private banks

➢ **Concentration likely to change in the future due to privatisation and liberalisation, which should stimulate competition**

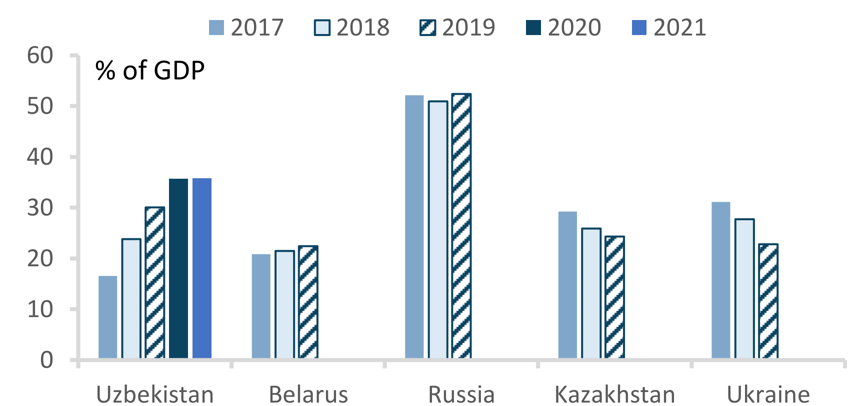
4. Lending to the private sector

Loans to private sector



Source: IMF IFS, CBU, FX loans at corresponding exchange rate

Loans to private sector in international comparison



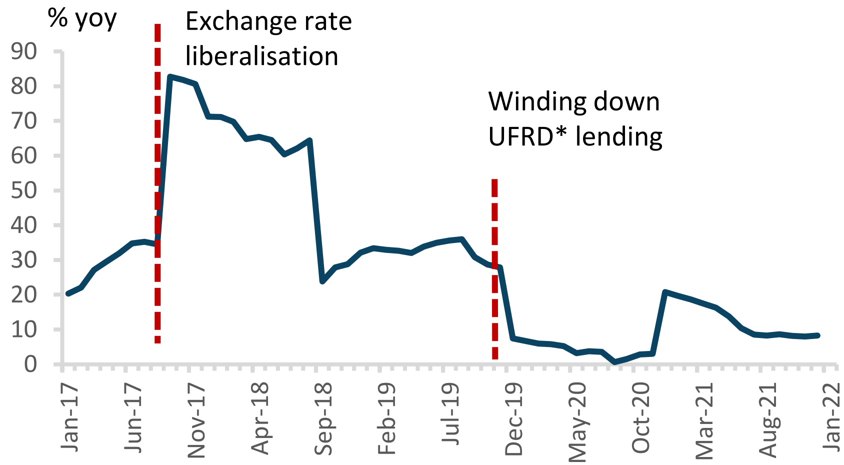
Source: Word Bank, IMF, own calculations

- Lending to private sector difficult to assess due to data limitations and no formal definition of SOEs
- Available IMF data most likely include SOEs which are not 100% state-owned
- Level of lending to private sector therefore overestimated but conclusions on developments over time possible:
  - Lending to private sector increased by ca. 37% p.a. since in 2017-2021 in real terms
  - Share in total loans increased at the same time from 56% to 80%
  - Share in GDP mirrors strong growth
  - Loans to private sector as share in GDP more than doubled: from 17% in 2017 to 36% in 2021
  - UZB in peer group now only second to RUS

➢ **Available data indicate remarkable growth of lending to private sector in recent years and illustrate the transformation of the economy**

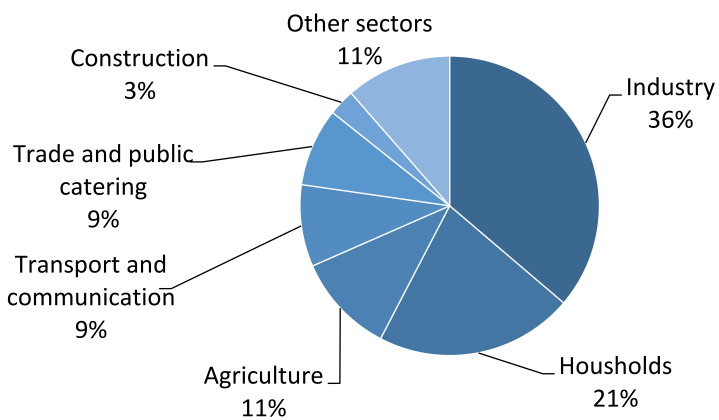
5. Loan growth

Outstanding real loans



Source: IMF, CBU, own calc., FX loans at corresponding exchange rate

Outstanding loans by sector

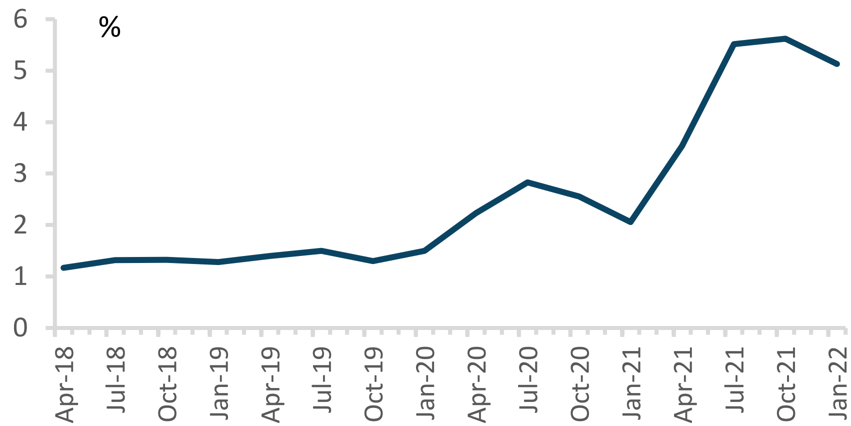


Source: Word Bank, IMF, own calculations
**Uzbekistan Fund for Reconstruction and Development*

- Bank lending increased strongly by 34% p.a. on average in 2017-2021 in real terms
- Breaks in time series explainable by:
  - Exchange rate liberalisation in 2017; FX denominated loans increased in UZS terms
  - Winding down of UFRD* funding through banks at the end of 2019
- Most lending goes to industry
- Household lending with above average growth rate in line with increasing role of private sector
- ➢ **Loan growth to continue in 2022 due to stronger lending from own sources**
- ➢ **Further growing role of households in lending in coming years**

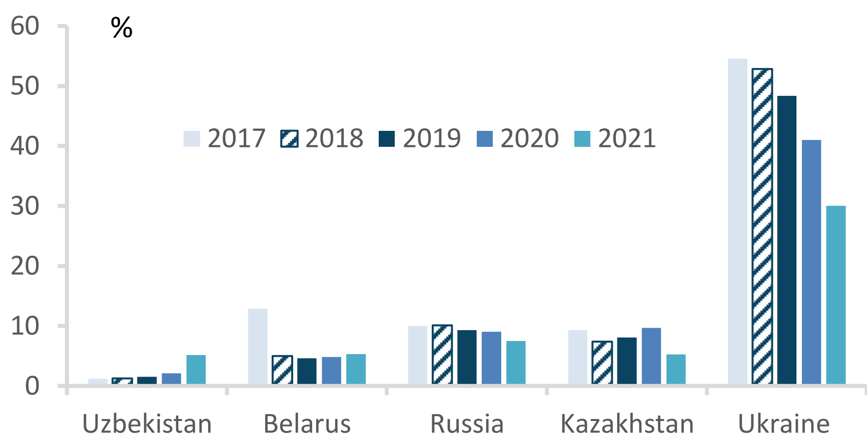
6. Non-performing loans (NPL)

NPLs as share of total loans



Source: Central Bank of Uzbekistan, end of period

NPLs to total gross loans



Source: Word Bank, IMF, own calculations

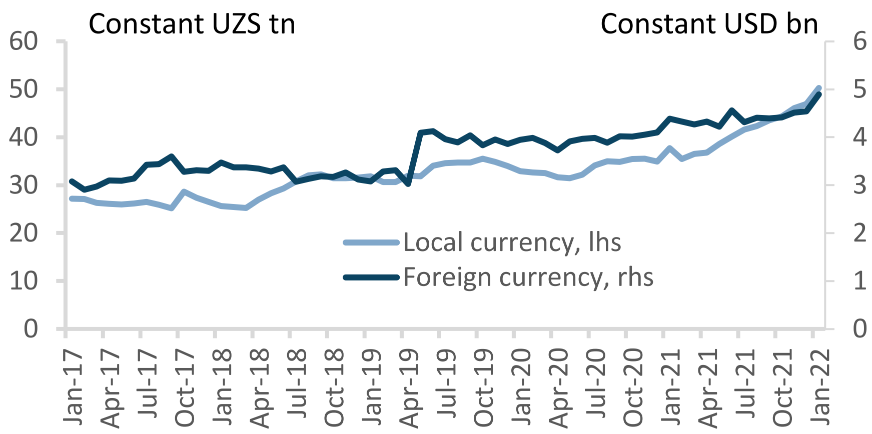
- NPL ratio low but increasing over time since 2018
- Significant increase of NPLs in 1H2020 followed by another sharper increase in 1H2021
- Assessment of asset quality by rating agencies is similar to reported data (S&P: NPL 4-6%)
- In regional comparison, NPL ratio lower than in peer group

➢ **Significant increase of NPL rate comparing to previous years, however it started to decline slightly since August 2021**

➢ **NPL still quite low but might deteriorate due to continued lending growth and expiration of loan moratoria (granted in 2020 to alleviate pressure on borrowers caused by the pandemic)**

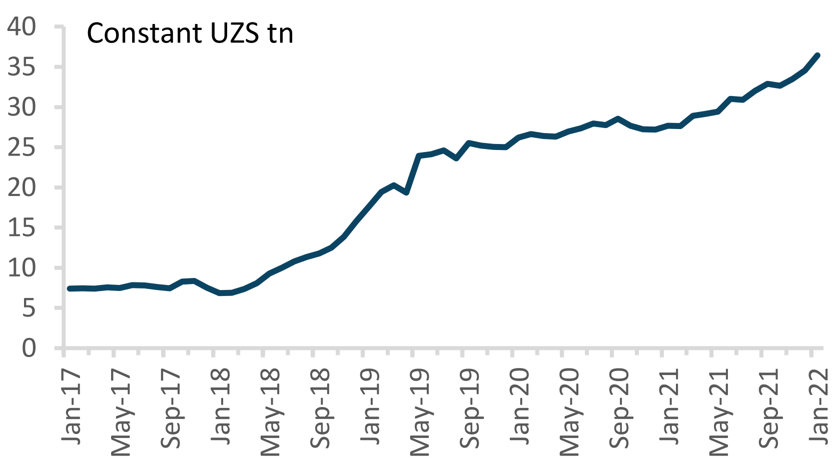
7. Deposits

Bank deposits



Source: Central Bank of Uzbekistan, own calculations

Long-term bank deposits (maturity >1 year)



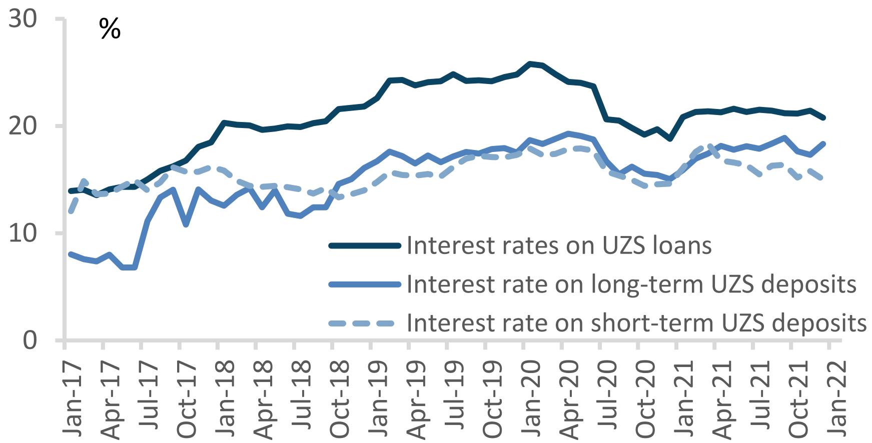
Source: Central Bank of Uzbekistan, own calculations

- Slow but steady growth of deposits in local currency by around 13% and FX by around 12% p.a. (2019-2021)
- No withdrawals of deposits during pandemic show confidence in Government's anticrisis policy
- Strong increase in long-term deposits by around 54% p.a. (2019-2021) allows banks to provide more long-term lending
- Deposit growth expected to continue and play a more important role as source of lending

➢ **Deposit development show confidence in banking system**

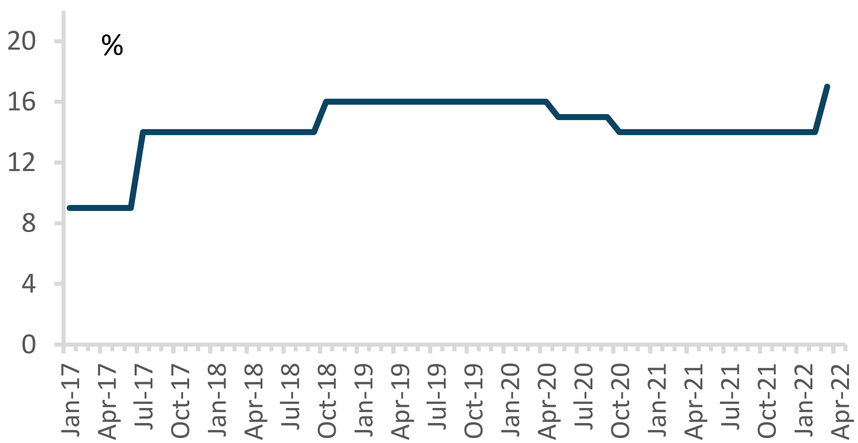
8. Interest rates

Interest rates on loans and deposits



Source: Central Bank of Uzbekistan

CBU policy rate



Source: Central Bank of Uzbekistan

- After a steady increase of interest rates since 2017, decline in 2020 with slight rebound in 2021
- Ratio of net interest income to total assets stands at 3.7 pp
- Decrease in inflation allowed to cut policy rate from 16% in 2019 to 14% in Sep 2020
- However: on 17 March 2022, CBU raised its policy rate to 17% from 14% to mitigate the short-term negative effects of the turmoil on Russian financial markets caused by Russia-Ukraine war

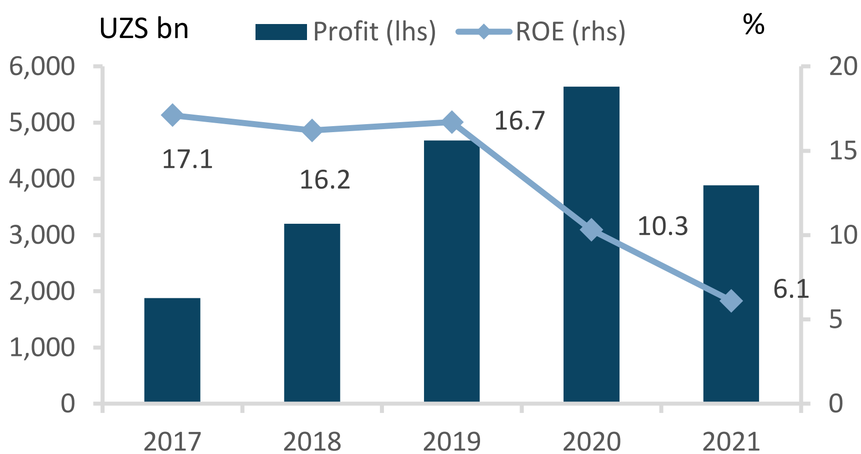
➢ **CBU may further intervene in the market by changing the policy rate in order to prevent sharp fluctuations in the national currency**

9. Capital adequacy and bank profits

Capital adequacy ratio (CAR)

Source: Central Bank of Uzbekistan

Banking sector performance



Source: Central Bank of Uzbekistan

Capital adequacy ratio (CAR)

- Still on a satisfactory level at 17.5% (01.01.22)
- Since beginning of 2020: decline by 6.0 pp as a result of strong asset growth (63.1%) without corresponding equity increase (39.0%)
- However, still comfortable capital buffers (CBU's prudential norm for CAR is 13.0%)

Banking sector profit

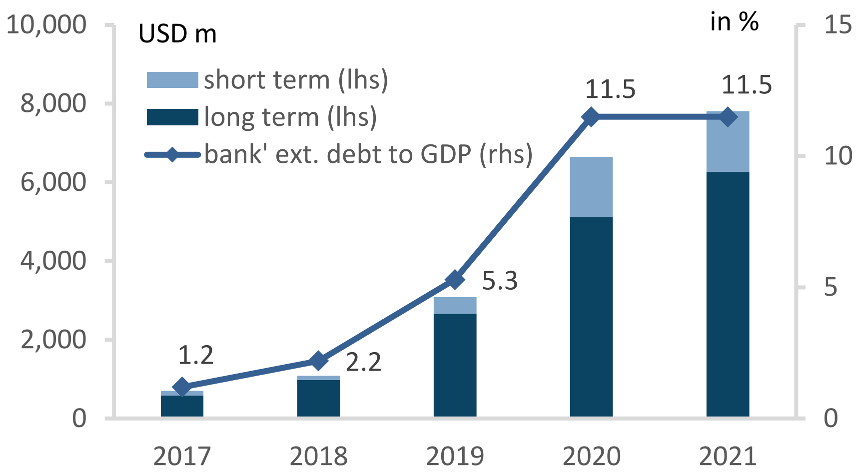
- Decreased in 2021 comparing to 2020
- Profitability (ROE) at 6% in 2021 but decreasing (ca. 10% in 2020 and 17% in 2019)
- Negative pandemic impact on corporate sector and shrinking interest margin with increase of NPLs reduced profitability of banks
- Decrease in profitability might also be caused by higher risk weighting measures by CBU

➢ **Lower net interest margin burdens bank profitability**

➢ **ROE and CAR decline, but still not critically**

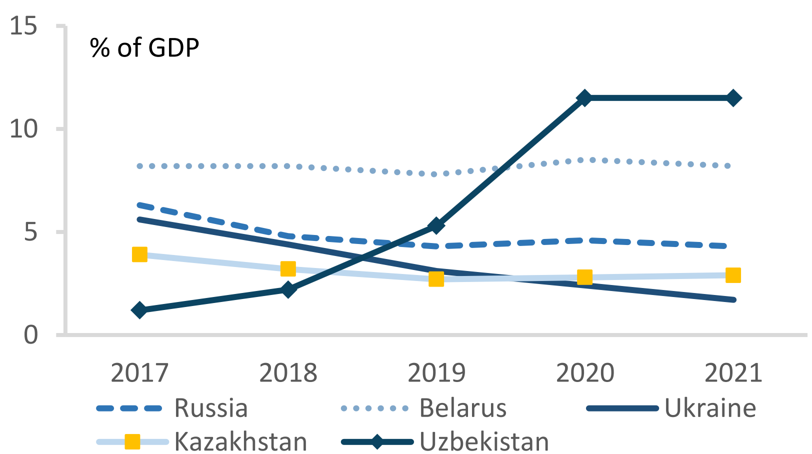
10. External debt of banking sector

External debt of Uzbek banks



Source: WB data, own calculation

Peer countries banks' external debt to GDP



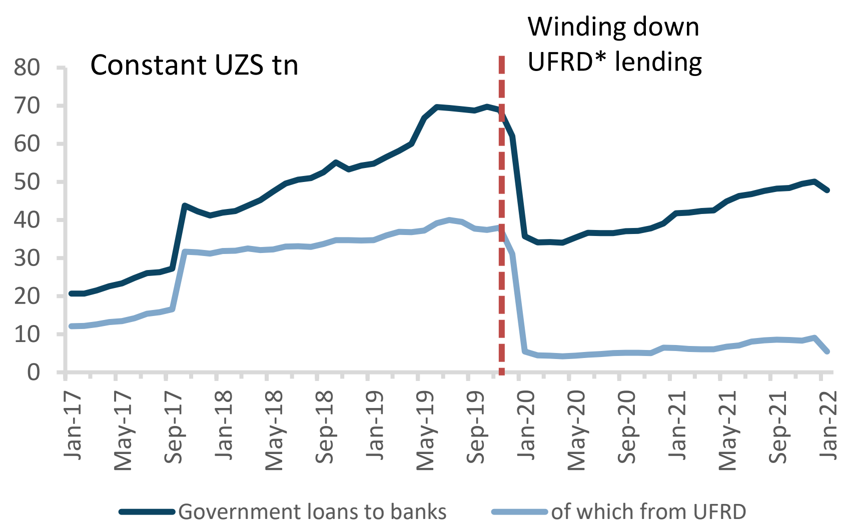
Source: WB data, own calculation

- External debt of banking sector rapidly grew since 2019, reaching 11.5% of GDP
- Due to reforms state funding is reduced and banks need to find new financing sources
- Recently banks issued Eurobonds to reduce reliance on state funding
  - Uzpromstroybank: USD 300 m 5 yr bond in 2019
  - NBU: USD 300 m 5 yr bond in 2020
  - Ipoteka Bank: USD 300 m 5 yr bond in 2020 and, a first of its kind in Uzbekistan, UZS nominated issue equal to ca. USD 70 m in 2021
- Spreads between bank and sovereign Eurobonds on average 200 bp in 2021 and increased to 400 bp since start of the war in UA

➢ **External debt of banks jumped to the highest level (relative to GDP) in peer group**

11. Directed lending

Government loans to banks



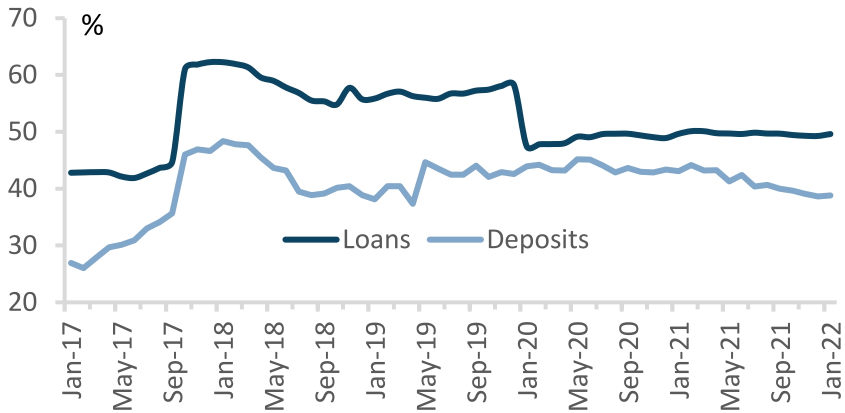
Source: Central Bank of Uzbekistan
** Uzbekistan Fund for Reconstruction and Development*

- Until Mid-2019: UFRD* used to provide loans to banks, which in turn channeled loans to SOEs and investment projects
- In 2H19, the government started to wind down UFRD loans aiming to commercialise business models of banks
- Starting from January 2021 directed lending only effected through 3 dedicated policy banks: Agrobank, Microcredit Bank and People’s Bank
- Decline in directed lending was compensated by increase in other government loans and capital increase
- In 2020-2021 direct loans were extended mainly to the households under the state Family entrepreneurship development programs

➢ **Government aims to change and commercialise business models of banks by reducing directed lending**

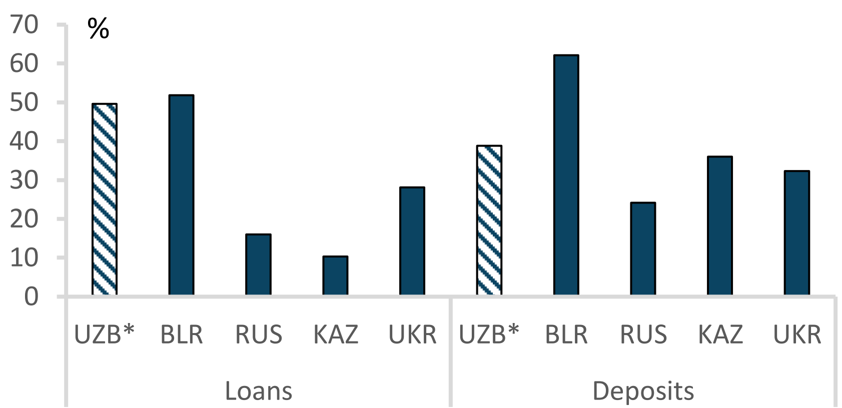
12. Dollarisation

Dollarisation of outstanding loans and deposits



Source: Central Bank of Uzbekistan

Dollarisation of outstanding loans and deposits



Source: Central Banks, own calculations

- After a peak in 2017 dollarisation has decreased in 2020, but since then stabilised on a still quite high level
  - Jan 2022, FX deposits at 39% of total deposits; FX loans at 50% of total loans (Jan 2021, FX deposits at 43% of total deposits; FX loans at 50% of total loans)
- Pandemic has not changed the currency structure of loans and deposits

Regional comparison:

- Loan side: equal to BLR on significantly higher than RUS and KAZ
- Deposit side: equal to KAZ, higher than RUS and UKR, lower than in BLR

➢ **High dollarisation of banking system remains a challenge**

13. Overview of banking reforms – main goals

Goals of the roadmap until 2025 and interim results

Indicators	2019 Fact	2021 Fact	2025 Goal
Share of assets of private banks	15%	19%	60%
Share of private sector in total banks' liabilities	28%	no info	70%
Attracted strategic foreign investors into banking sector	0	no info	3
Share of deposits in liabilities of banks	41%	42%	50-60%
Share of foreign currency in total liabilities	58%	58%	40-45%
Bank assets to GDP ratio	53%	61%	> 55%
Bank deposits to GDP ratio	18%	21%	25-27%

Source: Presidential Decree 5992 from 12/05/2020, CBU

- **In the past:** role of state-owned banks defined as agents of gov. programmes to provide lending mainly to SOEs
- Funding and lending provided on subcommercial terms
- Heavy reliance on collateral and state support in lending decisions and loan quality assessment
- **Now:** government committed to transform and develop the sector by
  - Strengthening private sector in banking system and banks balance sheets
  - Enhancing quality of banks balance sheets
  - Decreasing foreign currency share in banks liabilities

➢ **Very ambitious reform programme**

➢ **However: little progress achieved during 2 years, goals yet far from being reached**

13. Overview of banking reforms – privatisation

Privatisation Goals for 2020-2025

Banks	Market share (%)	Through IPO / sale to strategic investors
NBU	20.2	Public offering
UzPSB	12.7	IFC/EBRD/ADB
Asaka Bank	11.4	IFC/EBRD/ADB
Ipoteka Bank	9.0	IFC/foreign investor
Agro Bank	9.0	Public offering
People's Bank	6.1	Public offering
QQB	4.7	Public offering
Microcredit Bank	3.0	Public offering
Aloqa Bank	2.8	Public offering
Turon Bank	2.5	merger with QQB

Source: Presidential Decrees 5992 from 12/05/2020 and PP-168 from 18/02/2022, CBU

- Large-scale privatisation programme of the banking sector started in May 2020 with the Presidential decree No. 5992
- **So far only one bank (Asia Alliance Bank) was fully privatised (in 2021)**
- On 18 March 2022 the President signed another decree (no.168) to include 3 more banks for privatisation (NBU, Agrobank and Mikrokreditbank) and to shift focus from finding strategic investors to offering state shares through IPO:
  - by 01 October 2022, selling of the state share in QQB through IPO
  - by the end of 2022, selling of the state share in UzPSB and Asaka Bank
  - by 01 July 2023, selling of the state share in People's Bank, Mikrokreditbank, Aloqa Bank, Agro Bank and National Bank through IPO

➢ **Decision to privatize the largest state owned bank, if successfully implemented, is a significant step to increase competition**

13. Overview of banking reforms – Islamic banking

- Since early 2000s, Uzbekistan is a member of the IDB (Islamic Development Bank), ICD (Islamic Corporation for the Development of the Private Sector), ISFD (Islamic Solidarity Fund for Development) and IRTI (Islamic Research and Training Institute)
- Despite the long-time cooperation, the share of Islamic loans in total bank lending is insignificant:
  - total number of IDB projects in Uzbekistan is 103 (active - 54) with funding of USD 2.4 bn or ca. 8% of total loan portfolio of Uzbek banks as of 01 January 2022
- In October 2020, Uzbekistan has drafted regulations on Islamic bonds (Sukuks), including green Islamic bonds but no issuance has happened yet

➢ **Islamic Banking has potential to provide Uzbek banks with access to new and additional funding and widen their product range**

14. Impact of Russia-Ukraine war

- The Uzbek banking system exposure to foreign markets is compared to Kazakhstan, Kyrgyzstan or even Ukraine rather negligible (ca. 0.03% of total bank loans)
- Uzbek banks engage with Russian banks mainly in payment settlements, clearing guarantees and trade finance
- Impact of SWIFT ban on selected Russian banks
  - Settlements between Russia and Uzbekistan have significantly shifted from USD to RUB, payment settlements now done via Russian system of interbank payments (SPFS)
  - Likely migration of clients from sanctioned to non-sanctioned Russian banks
- No Uzbek bank has Russian capital; two potential transactions (purchase of Poytakht bank and Uzagroexportbank) with Russian capital are now put on hold
- Decline of remittances from Russia (around 50% in 2022 – GET estimate) may lead to a decrease in solvency of the population and cause an increase in NPLs in banks
- Local market for RUB to UZS exchange remains liquid and balanced

➢ **So far, the Uzbek banking system demonstrated a relative immunity to repercussions of the Russia-Ukraine war and international sanctions imposed on the Russian financial sector**

About the German Economic Team

German Economic Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, 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.
**Advisory activities in Belarus are currently suspended.*

CONTACT

Woldemar Walter, Project Manager Uzbekistan
walter@berlin-economics.com

German Economic Team
c/o BE Berlin Economics GmbH
Schillerstraße 59
10627 Berlin

Tel: +49 30 / 20 61 34 64 0
info@german-economic-team.com
www.german-economic-team.com

Implemented by

Berlin Economics