



National Bank
of Ukraine

Financial Stability Report

28 June 2023

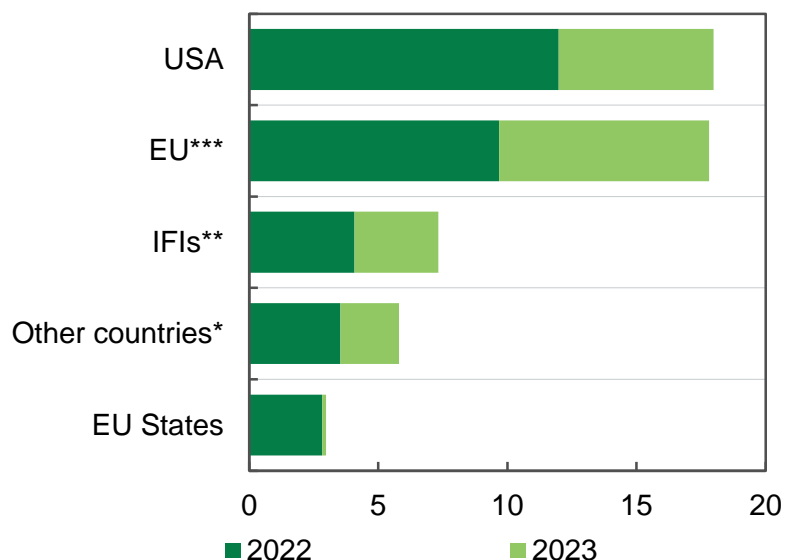


Summary

- Despite war challenges, the banks show high efficiency indicators and build up capital.
- Ukrainian economy is further supported by substantial international financial assistance, which became more systemic thanks to IMF program.
- The business has partially adjusted to working in crisis environment, companies' profitability recovers, debt burden on borrowers remains acceptable.
- Real estate market is out of balance, there is no market-based mortgage lending now.
- The banks remain highly liquid despite deceleration of retail deposits inflow, term composition of hryvnia funding improves.
- Loan demand from businesses is weak, the banks tend to lend under state support programs.
- Decline in retail loan portfolio has halted thanks to credit card lending.
- Banks' credit losses are most likely to be in line with the last year's expectations, around 20% of their portfolio. This estimates are to be verified after the resilience assessment of top-20 banks.
- Thanks to high net interest margin, the banks are profitable and have a comfortable margin while entering the interest rate decline phase.
- The banks will use the accumulated capital for complying with requirements that the NBU has previously postponed and to build capital buffers.

Systematic international assistance supports financial stability

External financing of State budget as of 14 June 2023, USD billions

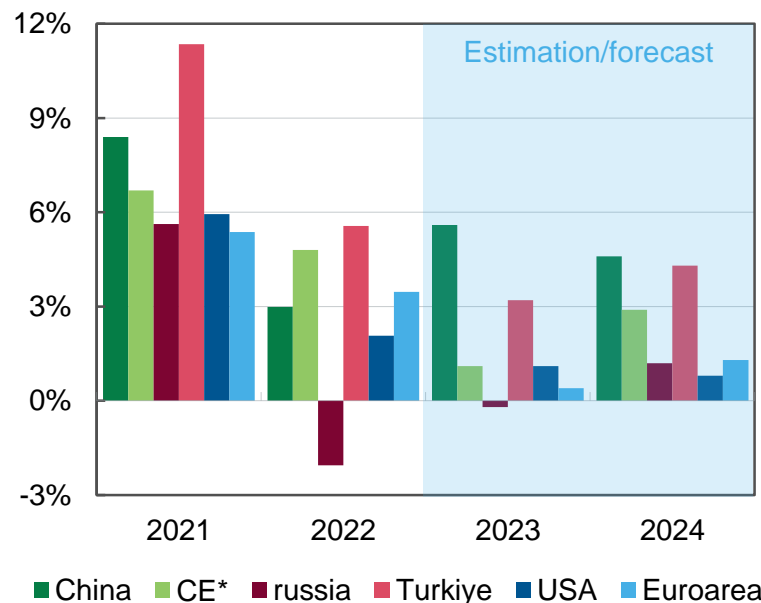


* Canada, UK, Japan, Switzerland, Norway, Iceland, Albania.

** IMF, World Bank. *** EU institutions including EIB.

Source: Ministry of Finance of Ukraine.

Change of GDP of Ukraine's major trading partners and Russia



■ China ■ CE* ■ Russia ■ Turkiye ■ USA ■ Euroarea

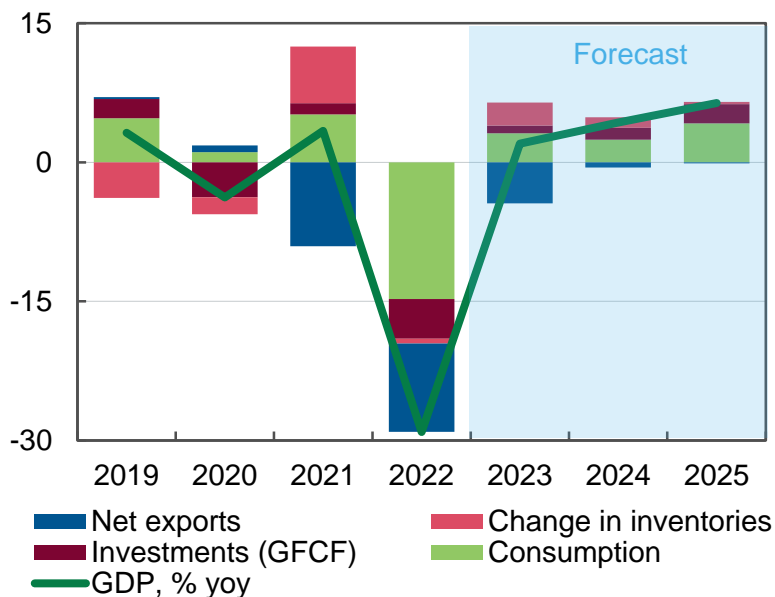
* Central Europe including Bulgaria, Hungary, Poland, and Romania.

Source: World Bank, Global Economic Prospects, June 2023.

- The war increases risks further, but international financial and military assistance to Ukraine becomes more systemic. Ukraine has to meet its commitments to international partners in order to secure further support.
- Global economy avoided recession risks. That facilitates ongoing support to Ukraine. However, economic growth of some major partners will be slow.

The economy remains vulnerable to risks, particularly security ones

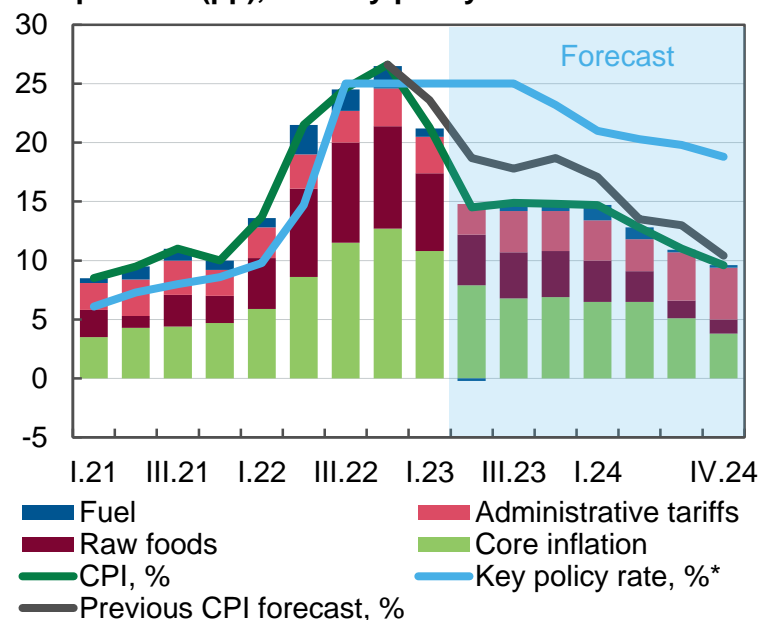
Contributions to GDP growth by final use, pp



Forecast for the 2023–2025 will be updated in July. * GFCF – gross fixed capital formation.

Source: SSSU, NBU calculations.

Contributions to the annual change of the CPI by components (pp), and key policy rate



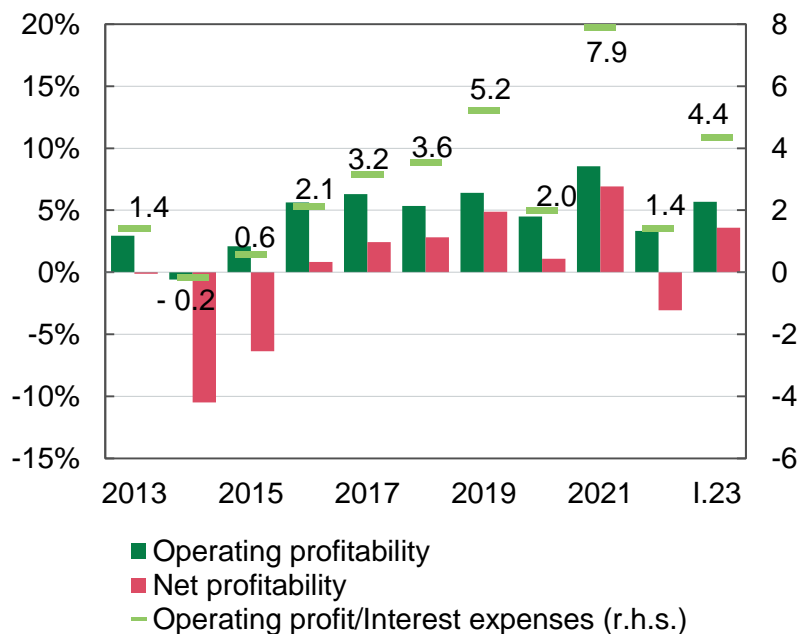
Since 2Q2023 – NBU's forecast as of April 2023. * On the forecast horizon – the middle of the confidence interval.

Source: SSSU, NBU calculations.

- The economy is gradually recovering but remains vulnerable. Weaker inflation will make it possible to cut rates earlier.
- International aid covers gaps in the balance of payments and helps build up reserves. The comfortable level of reserves improves FX expectations of households and businesses.
- The steady inflow of funds from donors ensures the government's liquidity. This makes it possible to increase the horizon of spending planning and fulfill obligations in a timely manner.

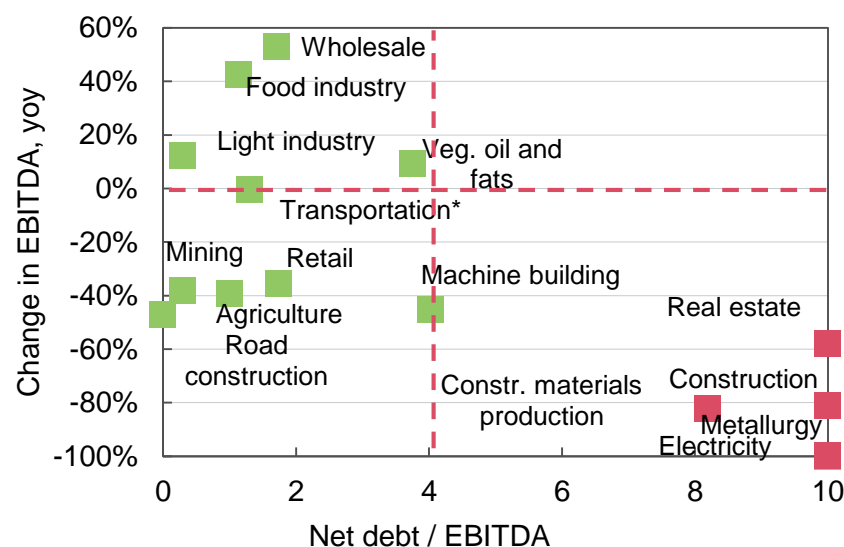
Business adjusts to crisis conditions

Profitability and debt burden of the real sector



Source: data.gov.ua, SSSU, NBU estimates.

Debt burden for 2022 and change in EBITDA between 2021 and 2022 by industry



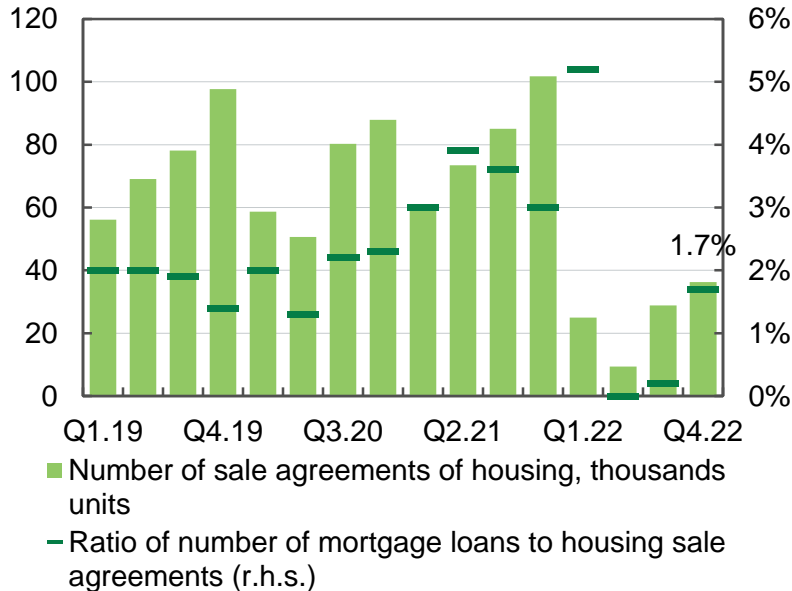
* Except for pipeline transport.

Source: data.gov.ua, NBU estimates.

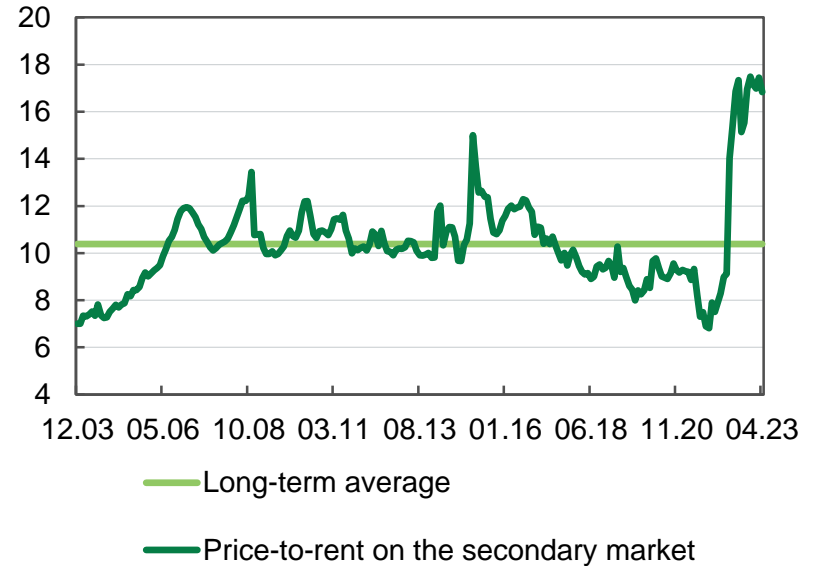
- In 12 months ending March 2023, the income of real sector enterprises decreased by 14%, in real terms - even more significantly. Yet the decline was uneven across industries.
- Since the beginning of 2023, the performance indicators of real sector companies have improved significantly: operating and net profitability are 6% and 4%, respectively.
- Most industries have maintained an acceptable debt burden, except for metallurgy and construction.

Housing market remains in disequilibrium

Housing market activity



Price-to-rent ratio



Number of new mortgage agreements – the results of banks’ survey. Data since the beginning of 2022 – a sample of banks, gross mortgage portfolio of which was over 90% of sector’s portfolio as of the end of 2021.

Source: real estate agencies, NBU estimates.

Source: Ministry of Justice, banks’ data.

- Housing demand remains very low, the signs of recovery are weak.
- Demand will stay depressed for a long time due to security risks, lower income of most of the population groups and significant emigration.
- Record-high values of the price-to-rent ratio point towards substantial market imbalances.

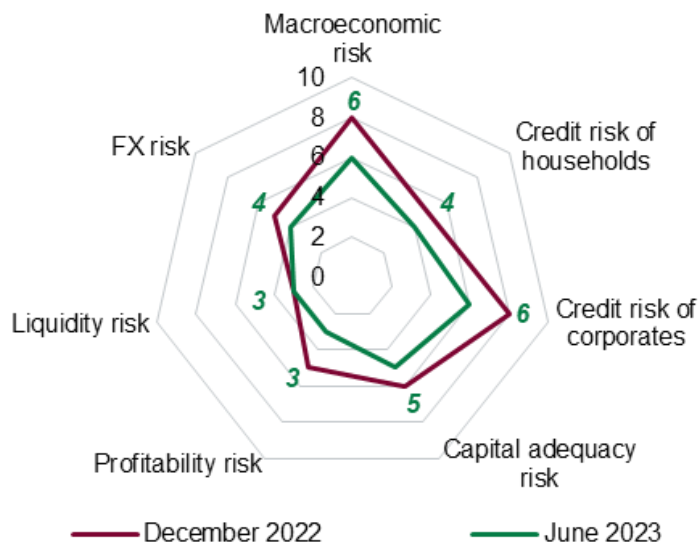
The financial stress index (FSI) remains volatile



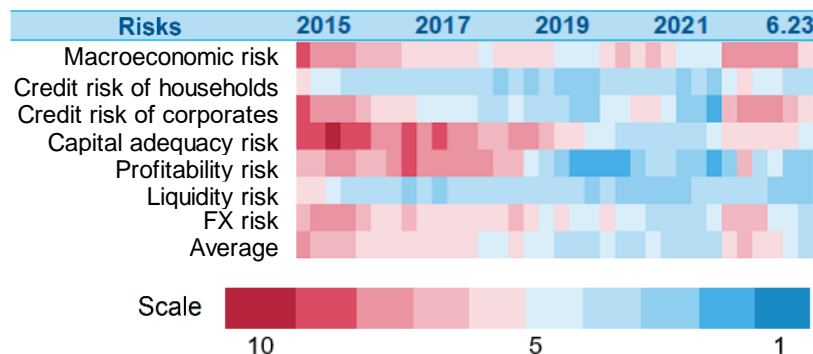
Source: NBU

- The FSI remained highly volatile during the first half of the year. It increased recently due to the simultaneous upward movement of several components of the index.
- The household sub-index grew steadily due to the increase in deposit rates, while the banking sub-index increase was caused by a slight deterioration in liquidity indicators.
- The government sub-index remains high due to the high yields of sovereign Eurobonds.
- The spread reduction between the official and cash foreign exchange rates and the decrease of interventions by NBU led to the decline of the currency sub-index.

Financial sector risk map



Financial sector heatmap



Macroeconomic risk has decreased (-2) due to the energy system resilience and revived domestic demand. However, the ratios of the state budget deficit, state and external debt to GDP will remain high.

Credit risk of households has eased (-1) because of better loan portfolio quality and more optimistic expectations.

Credit risk of corporates has declined (-2) along with business debt burden. The economic expectations of enterprises have improved. However, rates of loan migration to the NPL remain high.

Capital adequacy risk has declined (-1) owing to bank profits.

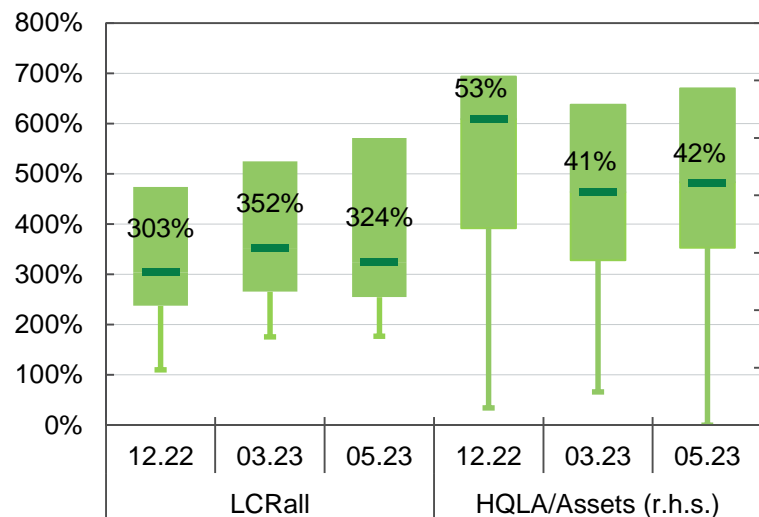
Profitability risk has decreased (-2) due to rising interest income from investments in securities and limited provisioning.

Liquidity risk has not changed. Banks maintained high liquidity and increased client deposits.

FX risk has eased (-1). The cash exchange rate approached the non-cash one. Due to significant international financial assistance, international reserves have grown. FX rate expectations have improved.

Banking system retains high liquidity

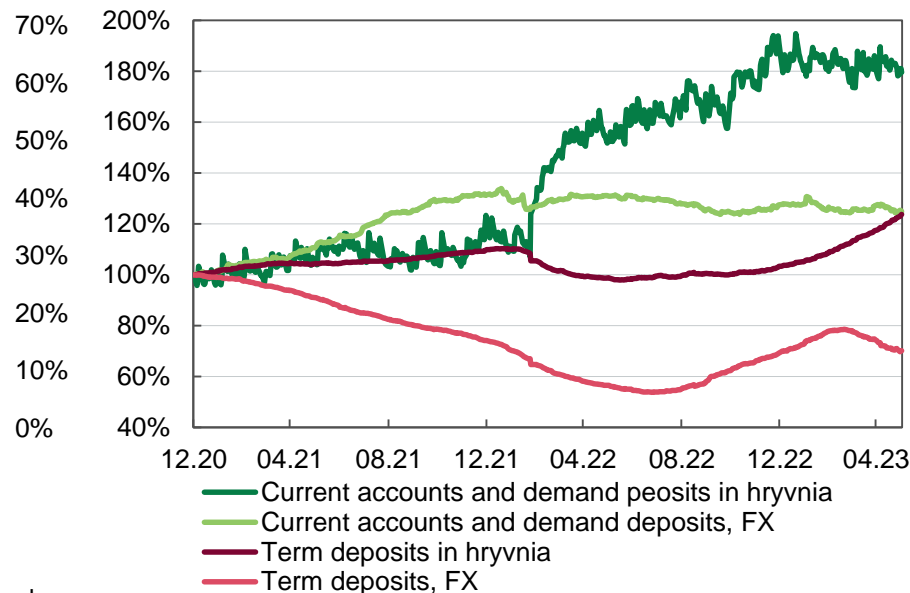
Distribution of LCR in all currencies and HQLA to net assets*



* Upper and lower edges of the green rectangles represent the first and the third quartiles of the indicator distribution across the banks for the date. Dashes inside the rectangle show the median. Lower dashes outside the rectangle show the minimum.

Source: NBU

Retail deposits, 2020 = 100%



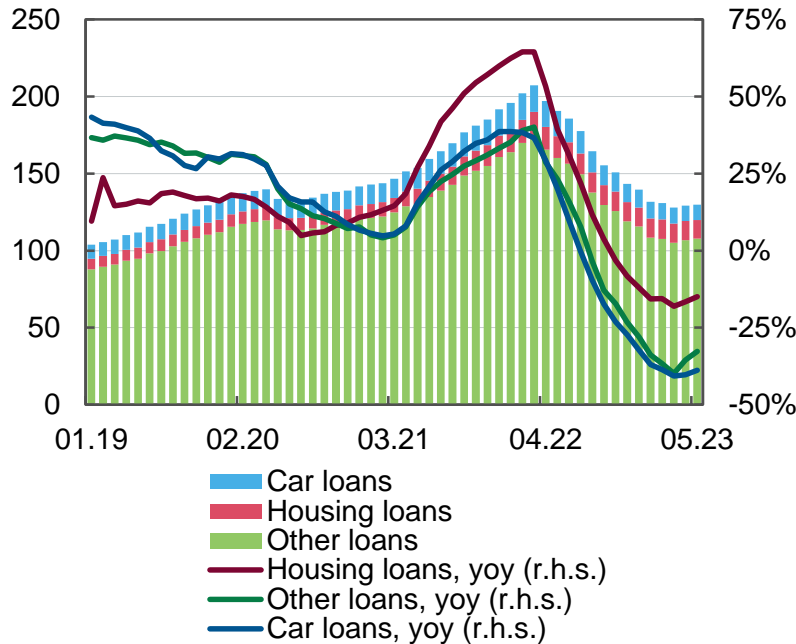
* At solvent banks as of 1 June 2023.

Source: NBU, daily data.

- Liquidity risks for banks remains moderate, the sector retains high liquidity despite a certain decrease in the volume of highly liquid assets under the influence of NBU measures.
- The growth of hryvnia deposits from the population decelerated. However, hryvnia term deposits have been growing since the beginning of the year due to higher interest rates on deposits.
- Banks receive significant inflows of funds from business.

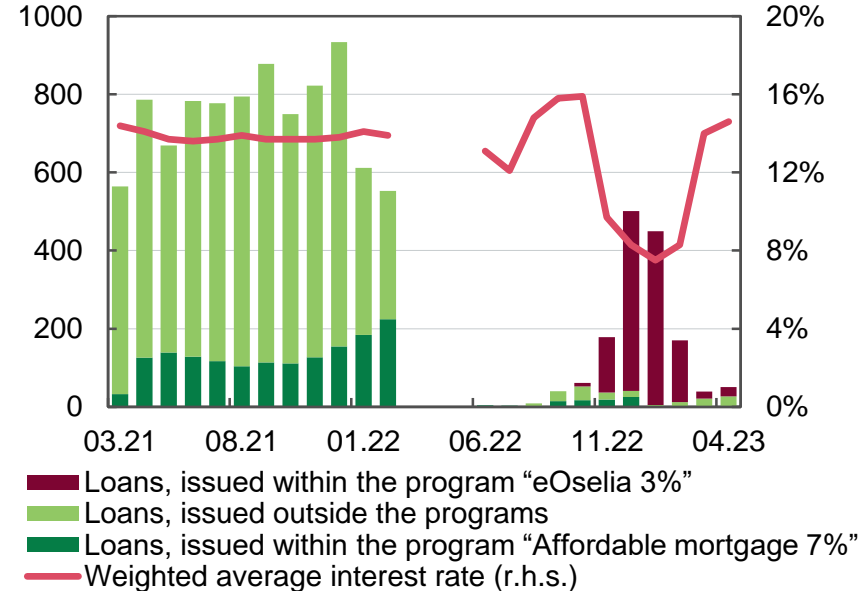
Retail loan portfolio contraction has halted

Net UAH loans to households, UAH billions



Source: NBU

New mortgage lending, UAH millions



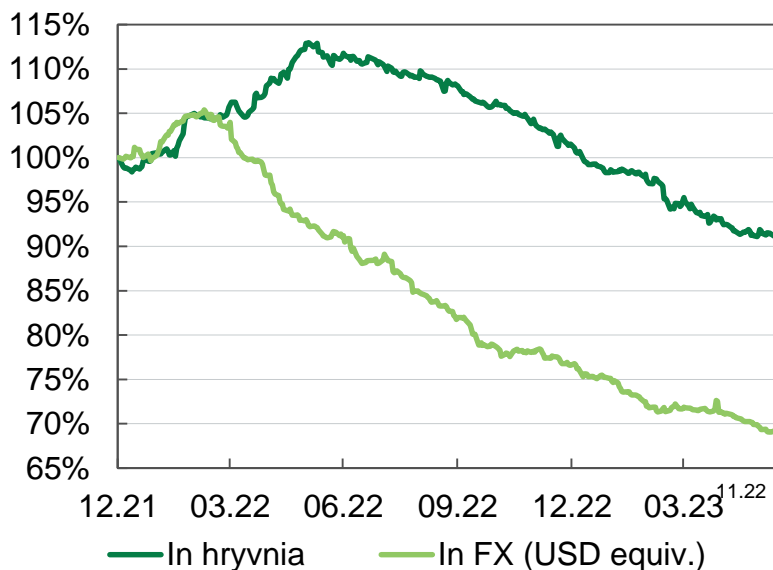
* Data on loans, issued within the program "eOselia" - an estimation based on the banks' survey results.

Source: banks' data, BDF, UFHC.

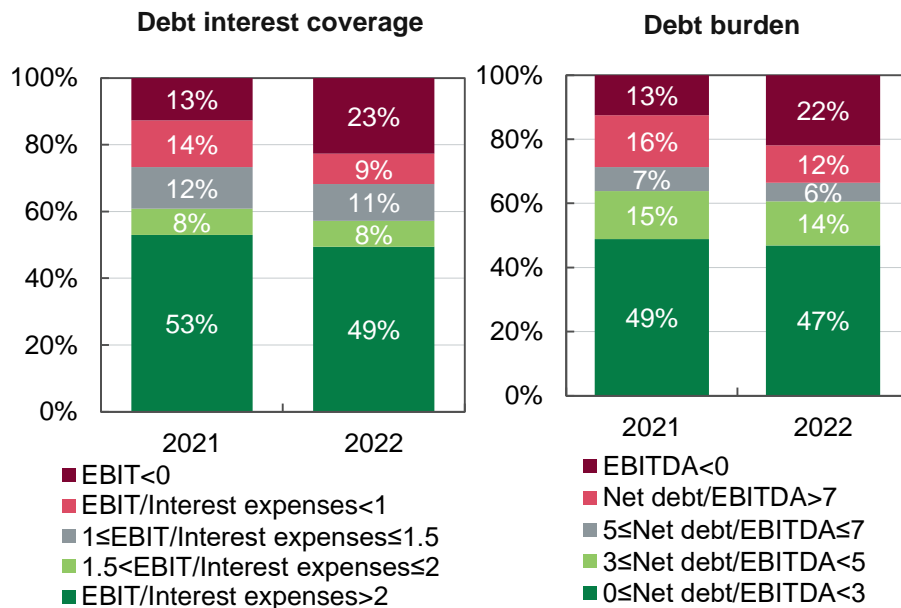
- Retail loan portfolio shrinkage has halted.
- Credit cards remain the main lending driver, banks with high-quality online applications recover lending faster than competitors.
- Market mortgage lending is almost absent, new loans issuance within the state program "eOselia" is not systematic.

Corporate loan portfolio continues to decline

Net corporate loans, Dec. 2021 = 100%



Distribution of performing corporate loans by debt metrics as of 1 June 2023



Loans over UAH 2 million. Except for state-owned enterprises.

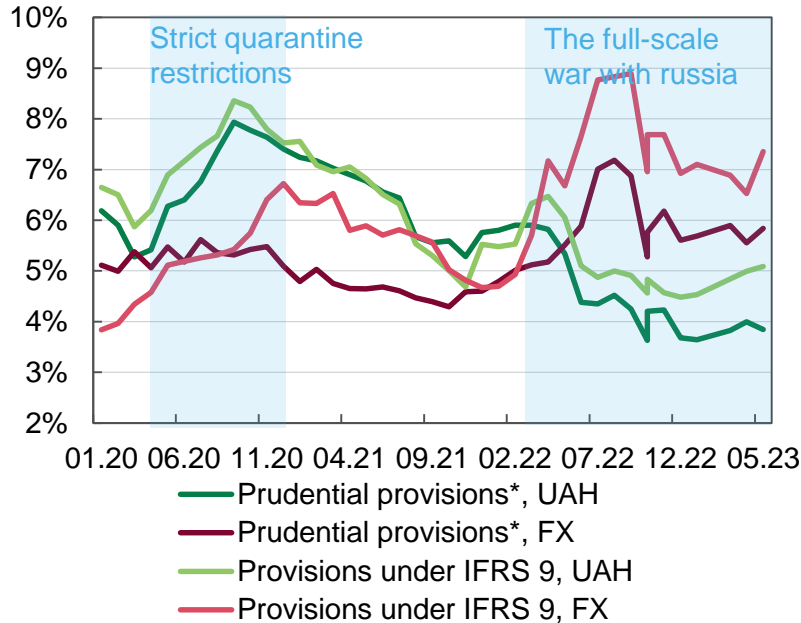
Source: NBU, data.gov.ua.

Source: NBU.

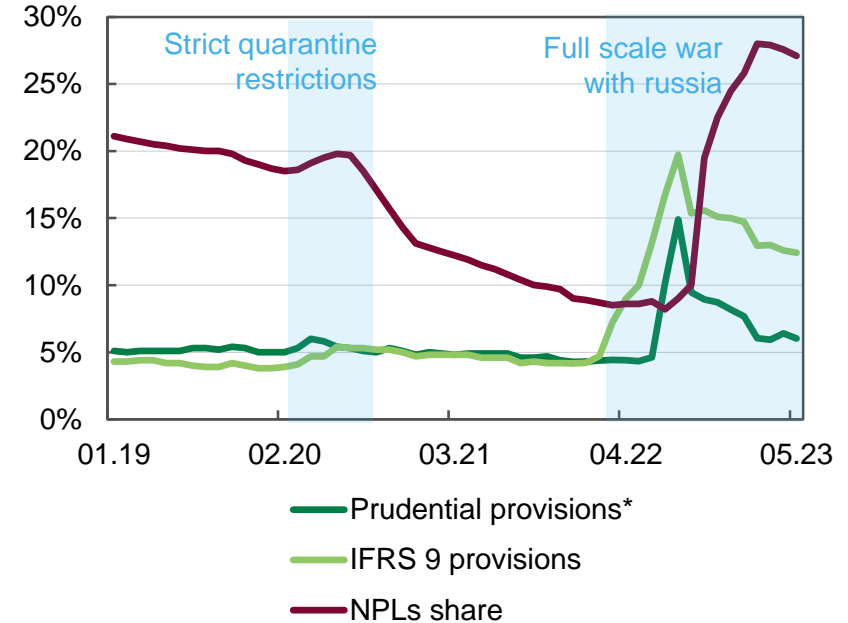
- The corporate loan portfolio is shrinking further: volumes of new lending do not cover repayments on earlier loans due to weak demand for loans.
- According to the survey results, banks plan to increase the gross loan portfolio in hryvnia by almost 10% in 2023, with a further commensurate increase in 2024.
- The main driver of lending is the Affordable Loans 5-7-9% program.
- Corporate borrowers retain the ability to service loans.

Credit losses of the corporate loan portfolio will increase

Provision coverage of corporates performing loans



Performing retail loan provisions and share of hryvnia retail NPLs



Provision coverage is equal to the ratio of provisions to gross loans. * Credit risk according to Regulation No. 351.

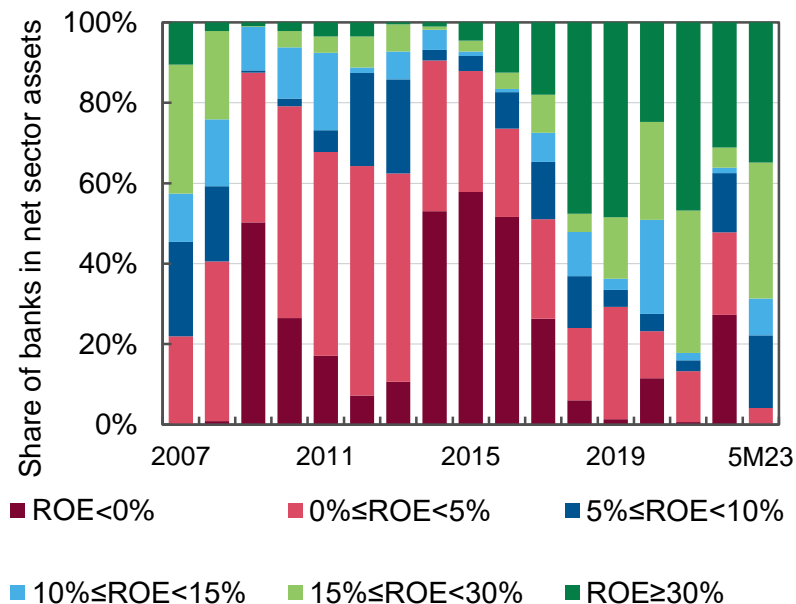
Source: NBU.

Source: NBU

- Since the start of full-scale invasion, the banks have recognized almost 15% of portfolio losses, less for corporate loans, and more for retail loans.
- Performing retail loans' quality is reaching its pre-war levels, the peak of losses is over. However, a proportion of restructured loans may still transform into non-performing.
- This year's resilience assessment will show the actual portfolio quality. The portfolio losses are expected to be close to NBU's last year estimations, around 20%.

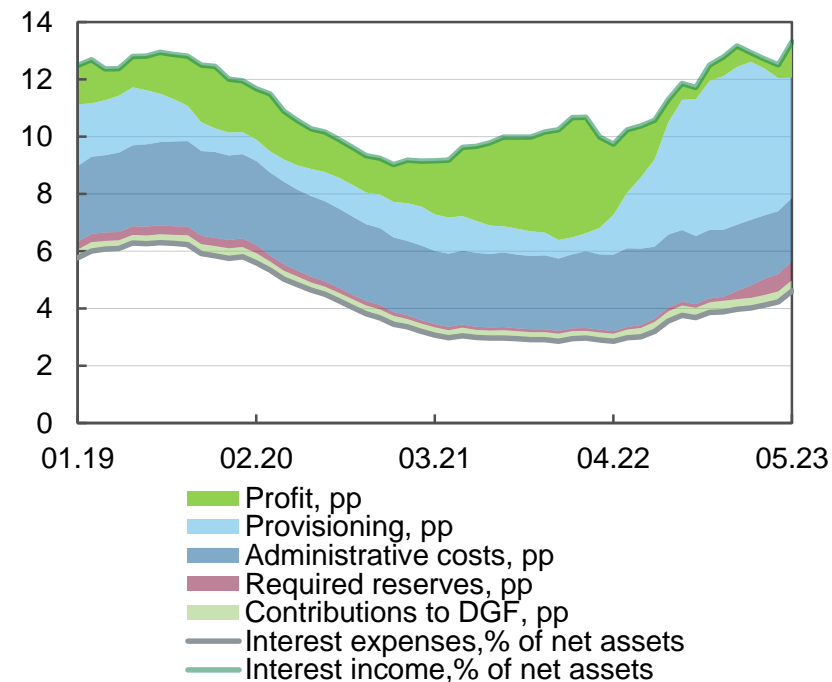
Material interest income underpins high sector profitability

Distribution of ROE by banks' share in assets



Source: NBU.

Decomposition of net interest margin of banks*



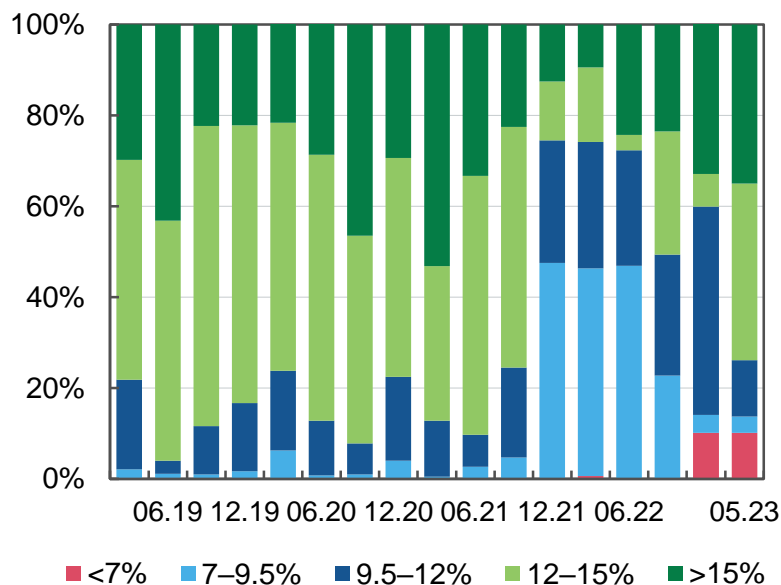
* For calculation methodology, see December-2020 Financial Stability Report, page 37.

Source: NBU.

- Growing interest income from riskless assets and persisting incomes from business loans helped the banks to secure high net interest margin.
- It persists despite rising cost funding, faster for corporate and somewhat slower for retail one.
- High interest margin supports high operating efficiency and returns, and gives the banks substantial comfort during transition to lower interest rate environment.

Banks have capital above minimum requirements

Distribution of core capital adequacy ratios by banks' share in assets



Source: NBU.

Priorities for use of banks' accumulated capital

Order of priority:

- 1 **Covering unexpected losses from risks that materialize during the war**
- 2 **Complying with postponed requirement to cover risks with capital:**
 - Operational risk in full (currently the banks hold capital to cover 50% of the risk)
 - Market risk (implementation of requirement is expected after the test period)
 - 100% of risk weights for FX-denominated domestic government debt securities (with adjusting ratios, the weight is 50% now)
- 3 **Complying with new requirements scheduled for 2023-2024:**
 - Updated regulatory capital structure
 - Updated credit risk weights for certain asset categories
 - Leverage ratio
- 4 **Building up capital buffers**
- 5 **Dividend distribution**

- Banks' capital stock is growing, mainly thanks to high profitability.
- The NBU prioritizes implementation of new requirements to capital adequacy, re-imposition of previously postponed measures, and building capital buffer requirements.

NBU's recommendations

Recommendations to financial institutions

- To restore lending to businesses and households.
- To remain conservative in assessment of credit risks.
- To prepare for calculation of market risk and complying with requirement to cover it with capital.
- To focus more on managing information security and ICT risks.
- Insurers have to comply with new regulatory requirements.

Recommendations to state authorities

- To ensure further meeting of obligations under IMF program and commitments to other donors.
- To ensure further development of domestic debt market.
- To facilitate implementation of Strategy for financial sector development.
- To maintain access of wider range of SMEs and banks to government business support programs.

NBU plans

- To complete resilience assessment of banks and banking system of Ukraine.
- To restore gradually its regulatory requirements on credit risk assessment.
- To harmonize further its regulations with the EU acquis.