National Bank of Ukraine

Financial Stability Report

23 December 2024

Summary

- Economic conditions are still favorable for operations of the financial institutions. The banking system is stable, liquid, and increases its lending to businesses and households.
- The war remains the key challenge, but international assistance enables Ukraine to stay resilient and smooth out existing macroeconomic imbalances.
- The business sees its incomes increasing and retains sufficient operating returns, therefore the banks are able to build portfolios of loans to ‘star’ clients.
- Loans to businesses and households increase thanks to stronger demand; given moderate lending penetration rates, room for further portfolio expansion is considerable.
- The role of *5-7-9%* in lending to businesses declines further, while guarantees are becoming an important instrument for business lending support.
- Mortgage lending slowed down, also due to change in *eOSelia* program design and lack of funding for its implementation. Approaches to mortgage lending support need to be revised, and Ukrfinzhytlo should update its strategy.
- Despite lower interest rates, the banks retained high interest rate margin thanks to changes in asset composition: they stepped up investing and lending.
- The banks have successfully transitioned to the new capital structure, retained capital to cover the key risks, and are building up their loan portfolios. ICAAP proved capital adequacy.
- Non-bank financial sector transformation continues, resulting in higher resilience of the institutions.

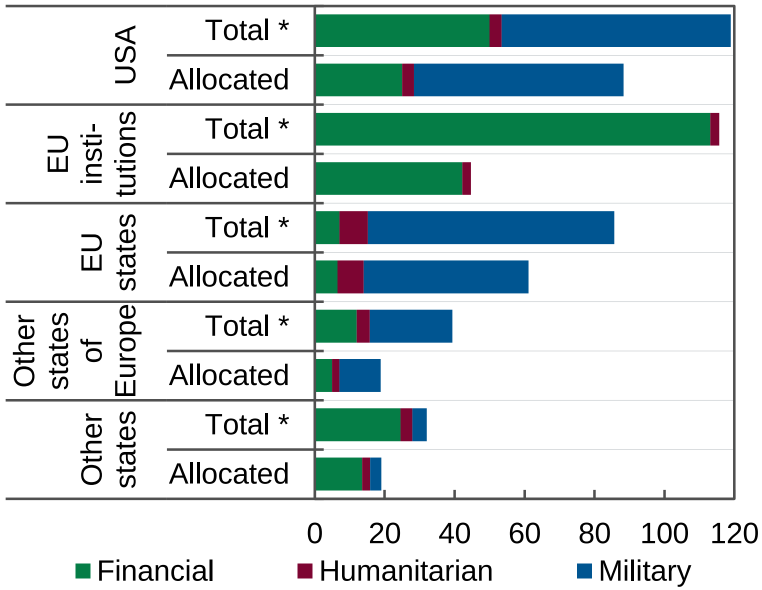
Financial stress index decreased substantially in H2

Source: NBU.

- The FSI decreased in September primarily due to a decrease in Eurobond yields after the external public debt reprofiling, as well as a decrease in hryvnia government bond rates.
- The banking sub-index remains at the lowest level among the sub-indices despite some deterioration in the LCR ratio after the increase in reserve requirements.

International support will continue to ensure economic stability

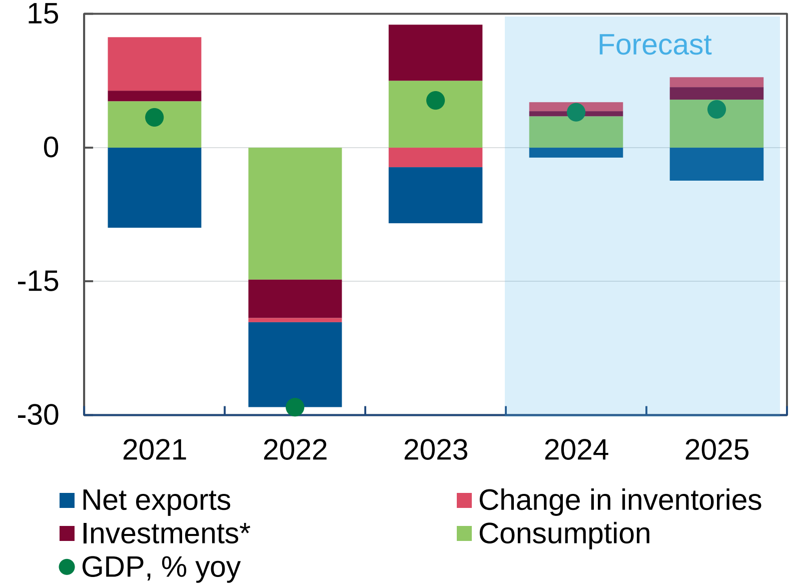
Committed official assistance for Ukraine from January 2022 through October 2024, euro billions



* Announced and provided. The rest of notes in line with Chapter 1.1. External Developments of the FSR.

Source: Kiel Institute for World Economy (Germany)

Contributions of components to GDP growth, pp



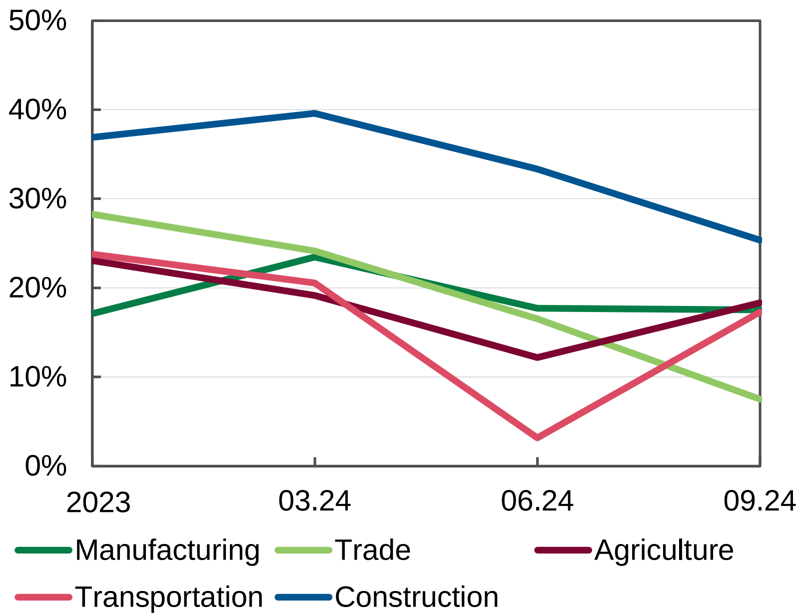
* Gross fixed capital formation.

Source: SSSU, NBU estimates.

- The war remains the key risk to financial stability in Ukraine.
- International support is expanding through the use of income from immobilized Russian assets.
- Sustained domestic and external demand will support GDP growth in 2025.
- The current acceleration in inflation will be short-lived. Tightening monetary conditions will balance expectations and halt the decline in bank commercial rates.

Business revenues are growing, but at a slower pace

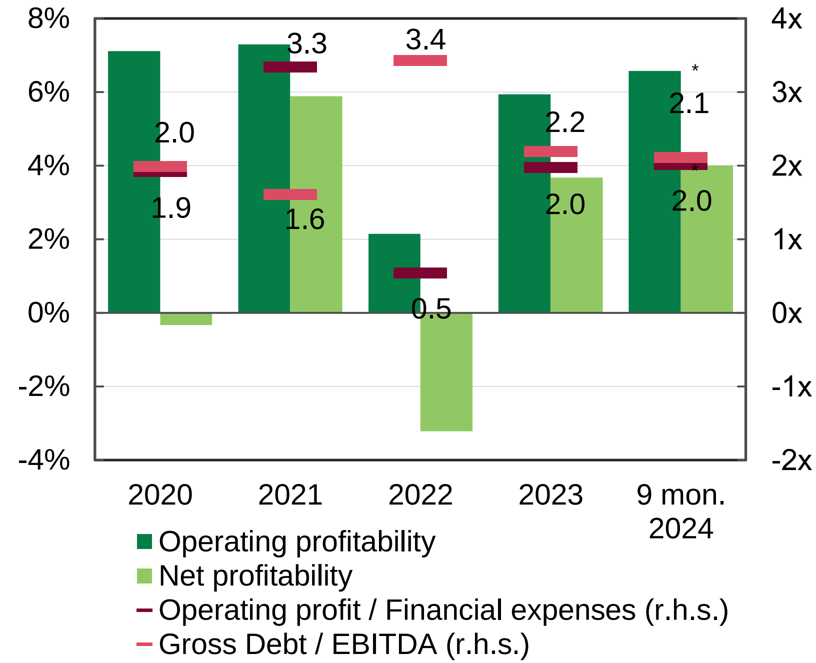
Change in annual* income of businesses by sector, yoy



* 12-month trailing.

Source: Open data portal, NBU estimates.

Profitability and debt burden



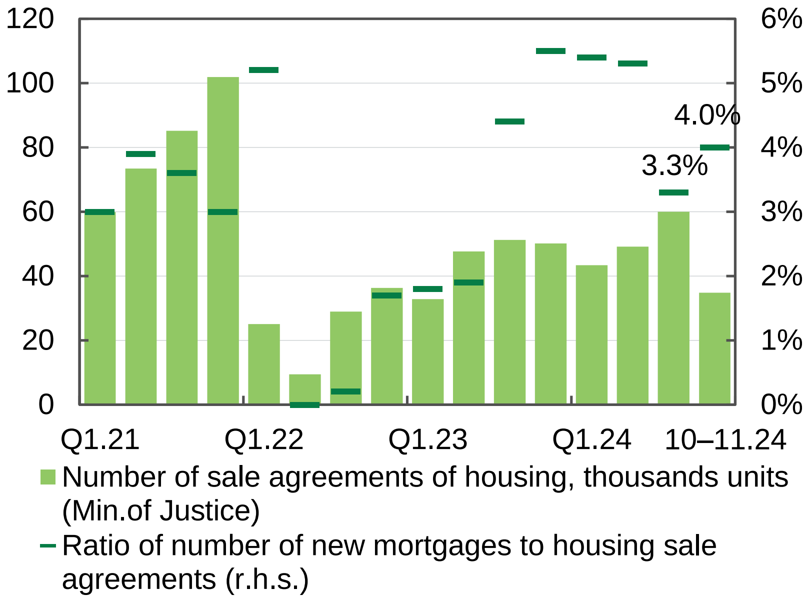
* Calculated for the 12 months ending September 2024.

Source: Open data portal, NBU estimates.

- Revenues and returns of businesses continue to grow slowly.
- The business maintains financial stability and good debt burden indicators, close to 2020 levels.
- Surveys of business activity indicate expected production growth, but business investment activity is subdued.

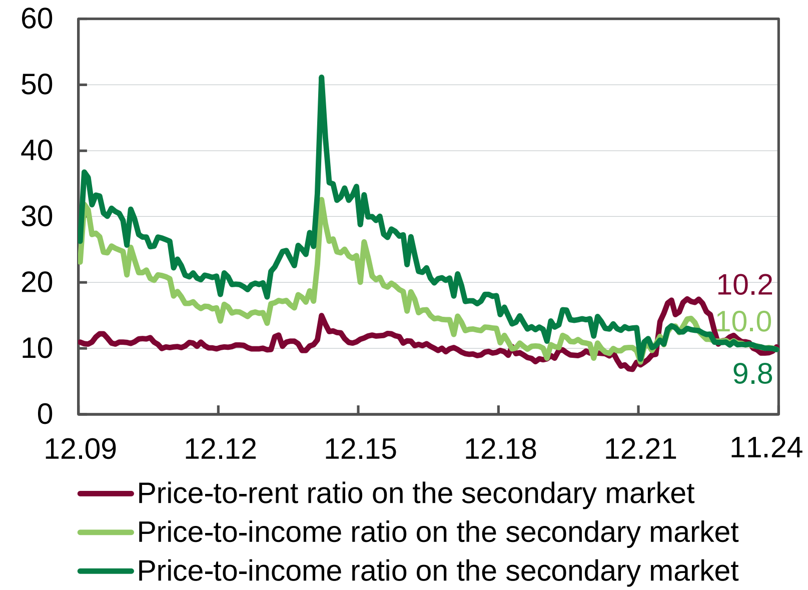
Price conditions for housing purchase are good, but demand is weak

Housing market activity



Source : Ministry of Justice, State Property Fund of Ukraine, banks' data.

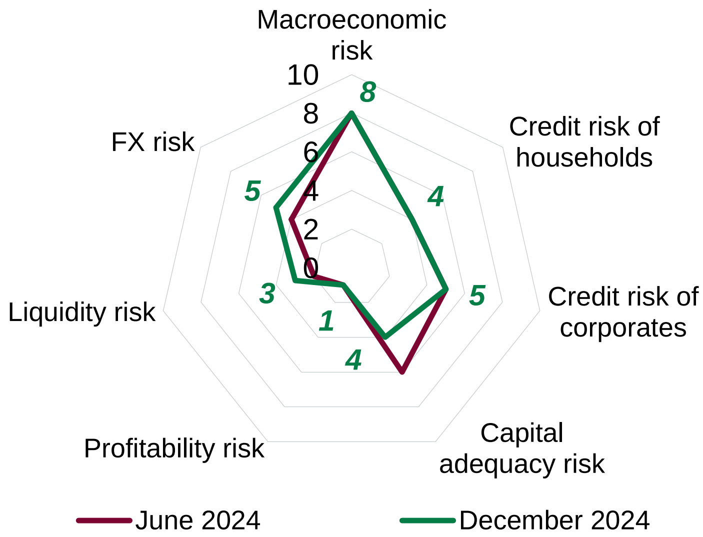
Price-to-rent and price-to-income ratios in Kyiv



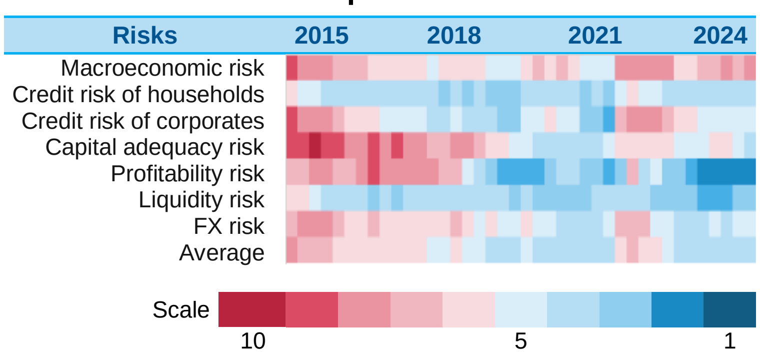
Source: SSSU, websites of real estate agencies, websites of job aggregators, NBU estimates.

- Demand for housing is still lower than before the full-scale invasion, but is getting more brisk, especially on the secondary market.
- Prices on the secondary market are barely rising, mostly following the exchange rate change.
- Price-to-rent is at its long-term average of 10x, and price-to-income raio is at its historical minimum, which indicates the acceptability of price conditions for housing purchase.
- However, the housing market is recovering slowly: security risks deter from purchases, and there are significant discrepancies between demand and supply.

Financial sector risk map



Financial sector heatmap



Source: NBU

Macroeconomic risk has not changed. Economic recovery continues. The state budget and current account deficit, public and gross external debt are high. International financial assistance offsets these risks.

Household credit risk has not changed. Retail portfolio quality is improving, but banks expect some deterioration. Economic expectations of households have somewhat deteriorated.

Corporate credit risk has not changed. The level of defaults is further decreasing. However, banks point to a possible deterioration in the portfolio quality. Business estimates of business activity outlook are subdued.

Capital risk decreased (-2). Banks' capital adequacy increased after the change in its structure.

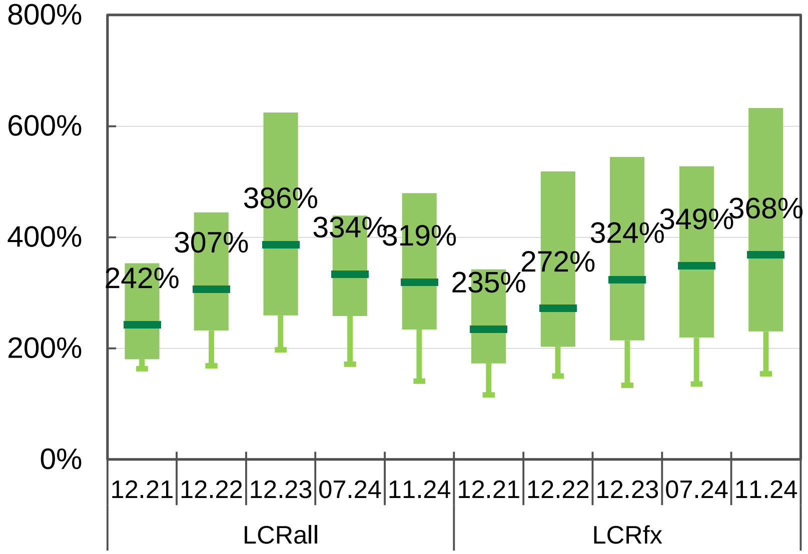
Profitability risk remained unchanged due to high interest margin, high operating efficiency, and low provisions.

Liquidity risk increased (+1). Client deposit inflows have slowed down. Banks expect this risk to increase. However, financial institutions are highly liquid going forward.

Currency risk increased (+1) to medium due to worse exchange rate expectations compared to the spring estimates However, exchange rate volatility remains low and international reserves are sufficient to smooth out exchange rate fluctuations.

Sector's liquidity is high, yet its structure evolves

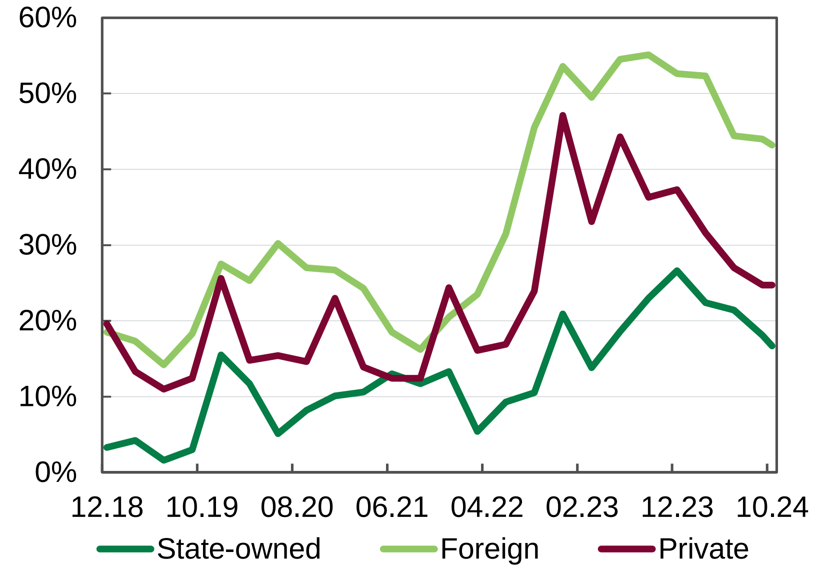
Liquidity coverage ratios in all currencies (LCRall) and FX (LCRfx)



Edges of rectangles represent the first and the third quartiles of the indicator distribution. Dashes inside the rectangle show the median. Lower dashes outside the rectangle show the minimum. Regulatory requirement is 100%.

Source: NBU.

Ratio of investment in certificates of deposit-to-hryvnia liabilities, by groups of banks

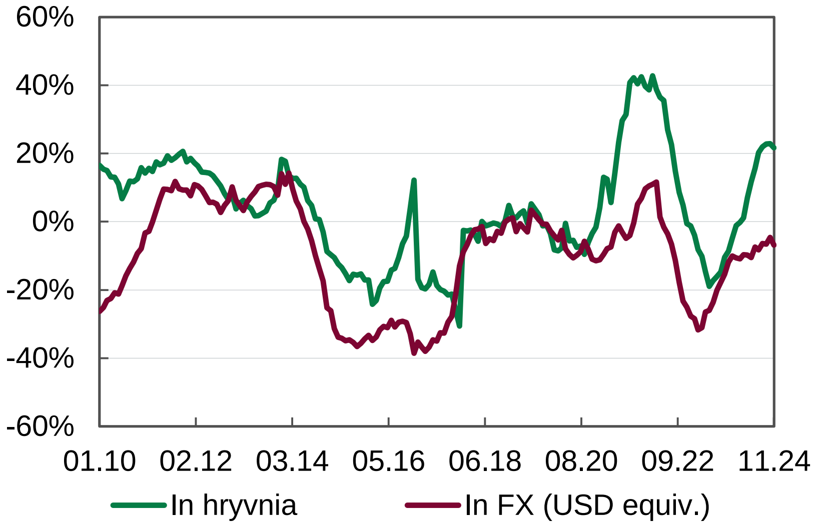


Source: NBU.

- Banking sector liquidity remains high, both LCR in all currencies and LCR in FX are more than triple the required minimum.
- Client deposits remain the major source of bank funding. Their steady inflows enable the financial institutions to lend and to invest into government debt securities comfortably.
- Higher reserve requirements and increased income tax rate, as well as future dividends of state-owned banks change the composition of liquid assets; this will require more active liquidity management on behalf of the banks.

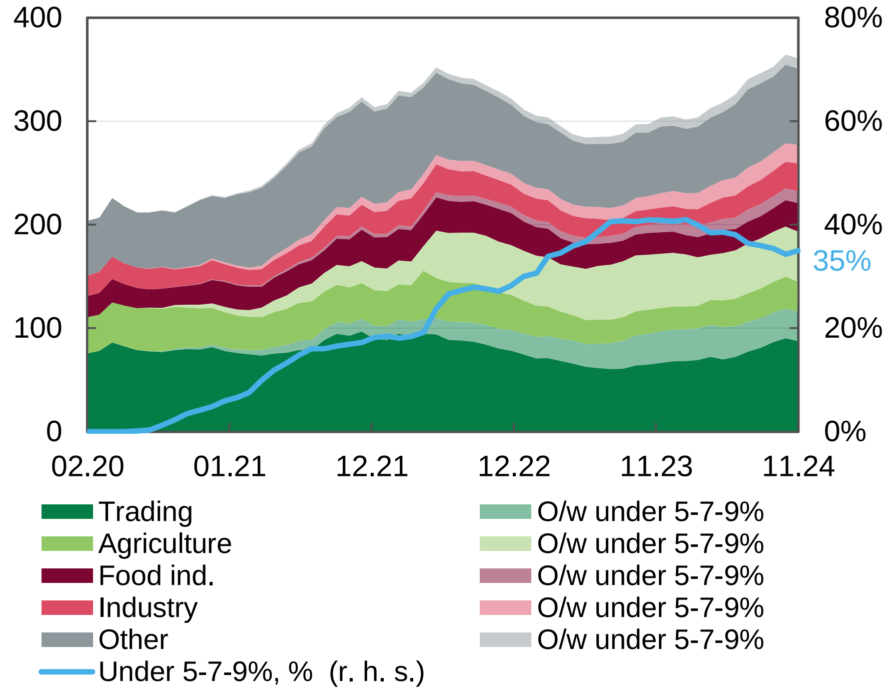
Corporate loans grow due to stronger demand

Annual change in net corporate loans, yoy



Source: NBU.

Net hryvnia corporate loans, UAH billions

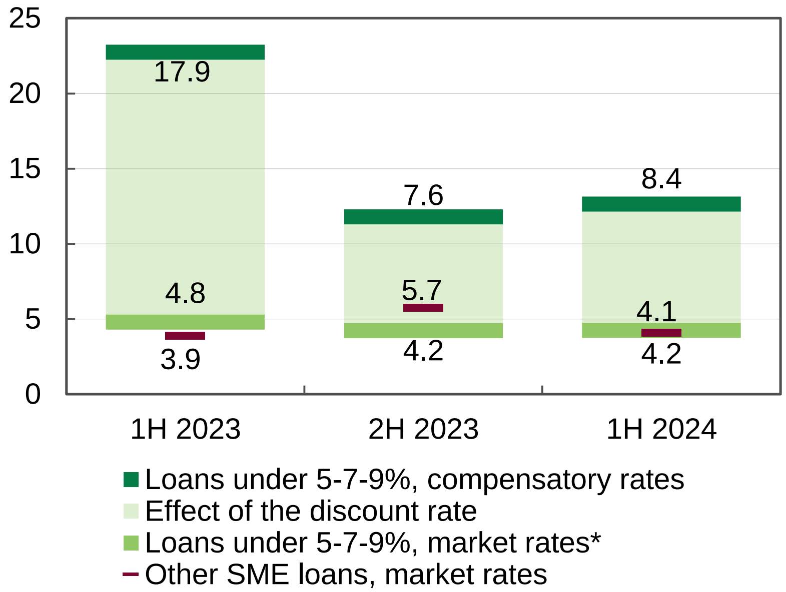


Source: NBU, BDF.

- The annual growth rate of net hryvnia corporate loans reached 22% in October, responding to stronger demand from enterprises.
- Enterprises of all sizes and banks of all groups are increasing hryvnia loans.
- Further implementation of the Lending Development Strategy will contribute to improving the lending infrastructure.
- Given the better lending conditions, the role of subsidies under the *Affordable Loans 5-7-9%* program is declining.

Role of guarantees is rising, that of *5-7-9%* program is weakening

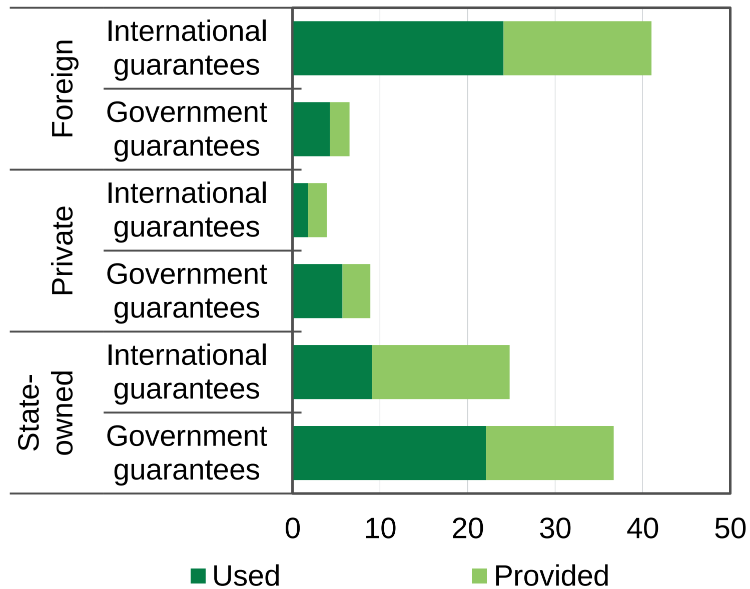
Distribution of the performing corporate portfolio by EBITDA interest coverage ratio



* Hypothetical coverage of financial costs of EBITDA of clients who received loans at “5-7-9%”, if they pay the average market rate.

Source: Open Data Portal, BDF, NBU.

Portfolio guarantees as of October 2024, UAH billion



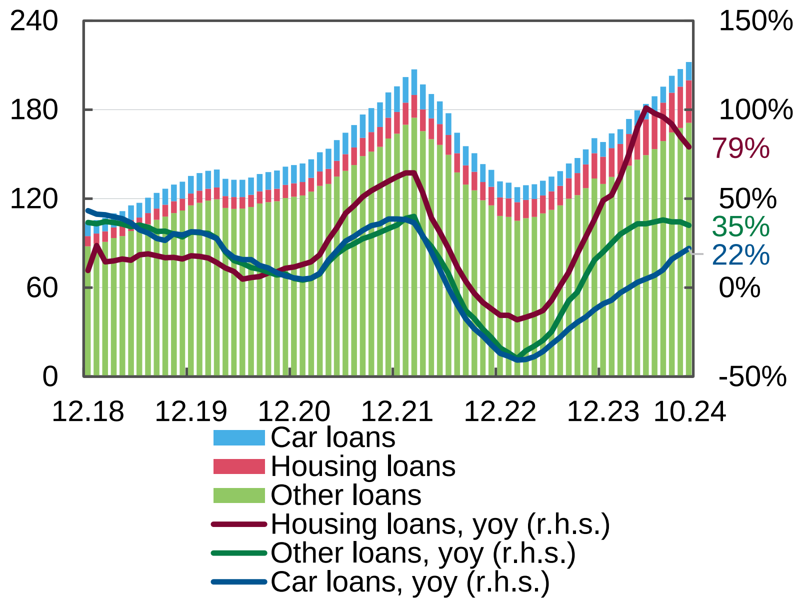
* In UAH equivalent as of October 1, 2024.

Source: Bank data, Ministry of Finance, NBU calculations.

- The April revision of the terms of the *5-7-9%* program did not cut its costs much. Since October, its budget for this year has been exhausted, and the debt to banks will grow to UAH 10 billion by the end of this year.
- Many program participants could have received and serviced loans on market terms, so there is a need to focus the program on clients who need support.
- The potential for supporting lending through guarantees is significant, about a quarter of the working hryvnia portfolio is already secured by portfolio guarantees, and banks have used only a little more than half of the available limit.

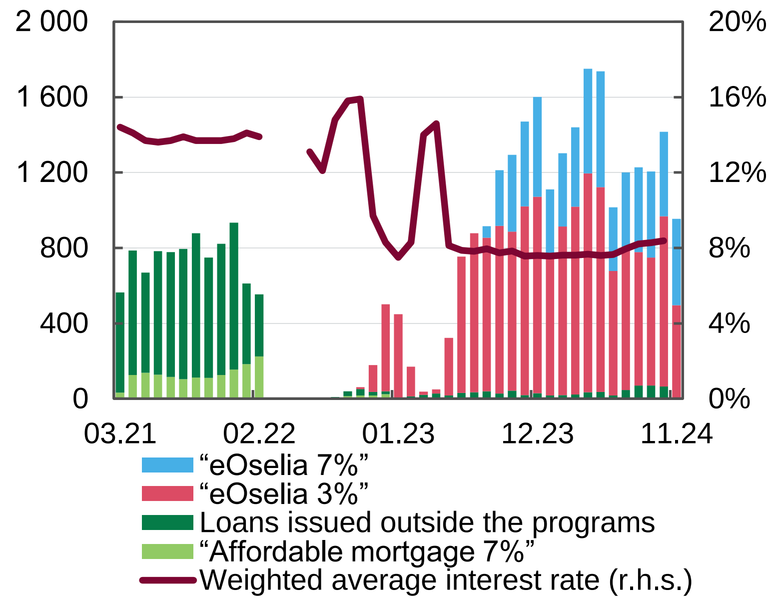
Retail loan portfolio growth has stabilized

Net UAH loans to households, UAH billions



Source: NBU.

New mortgage lending, UAH millions



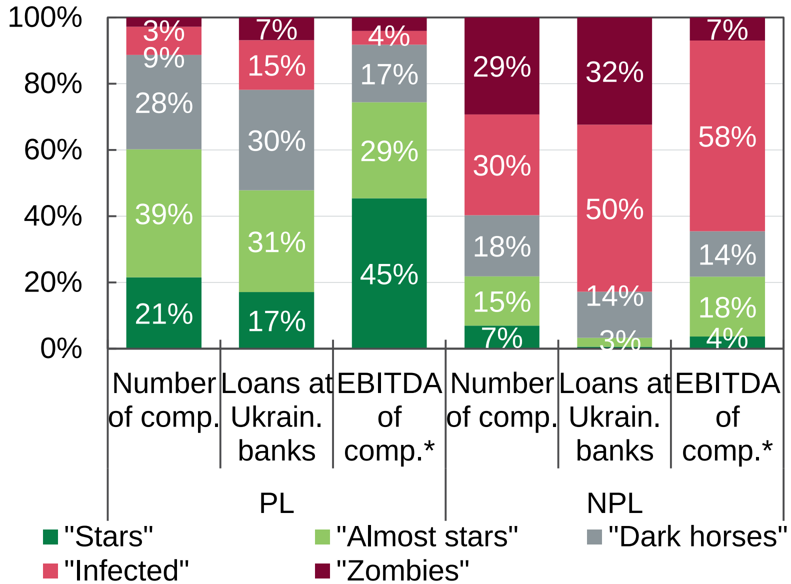
"eOselia 7%" program covers loans to broad categories of households. Data on mortgages issued outside the program are not yet available for November.

Source: banks' data, BDF, UFHC..

- The retail loan portfolio has exceeded recently the level of February 2022. After that, the growth rate has stabilized at around 38% per year.
- High returns encourage the banks to increase their portfolios, so they are competing in the unsecured retail segment.
- There is room for credit growth, as the households' debt burden is low.
- Mortgage lending has slowed down due to changes in the eOselia design and limited resources of the program.

Loans to clients with good metrics dominate banks' portfolios

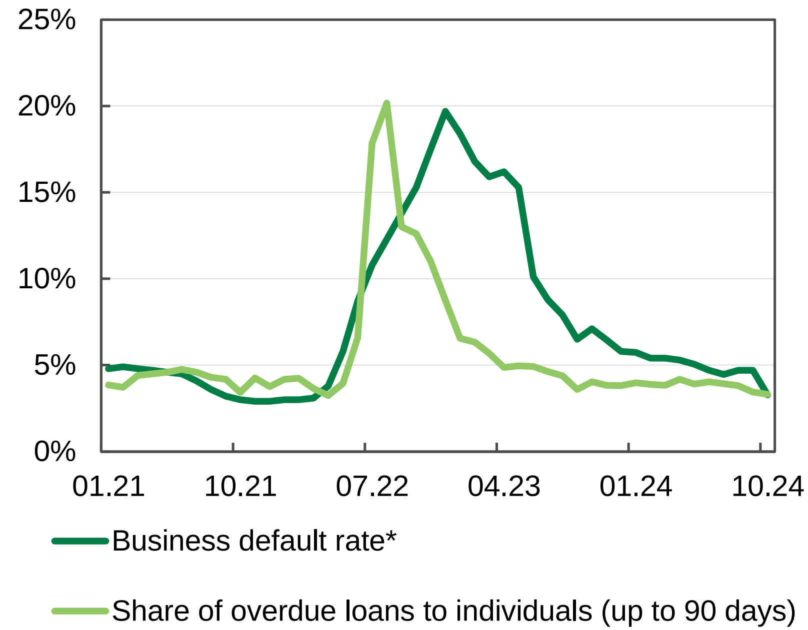
Borrower indicators by quality groups in terms of performing (PLs) and non-performing loans (NPLs)



The distribution methodology is described in the FSR Box 2. “Stars” and “zombies”.

Source: Open data portal, NBU estimates.

Corporate and retail loan portfolio quality indicators



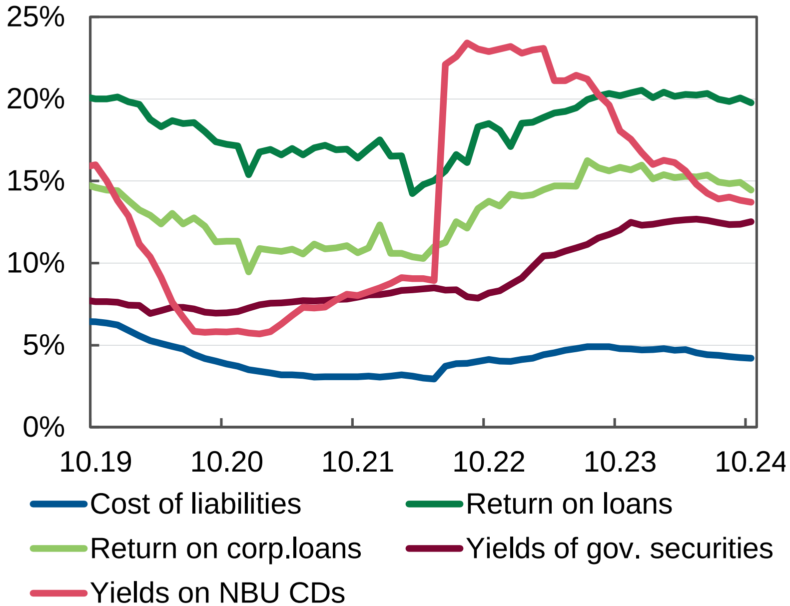
* Share of defaults of borrowers with loans exceeding UAH 2 million over a 12-month horizon, smoothed figures.

Source: NBU.

- Default ratio of businesses and overdue loans of households are at the 2021 level.
- The financial standing of corporate borrowers is good, 48% of the performing portfolio are enterprises with excellent financial indicators.
- Moderately conservative approaches to risk assessment by banks ensure good portfolio quality and the ability to continue active lending.

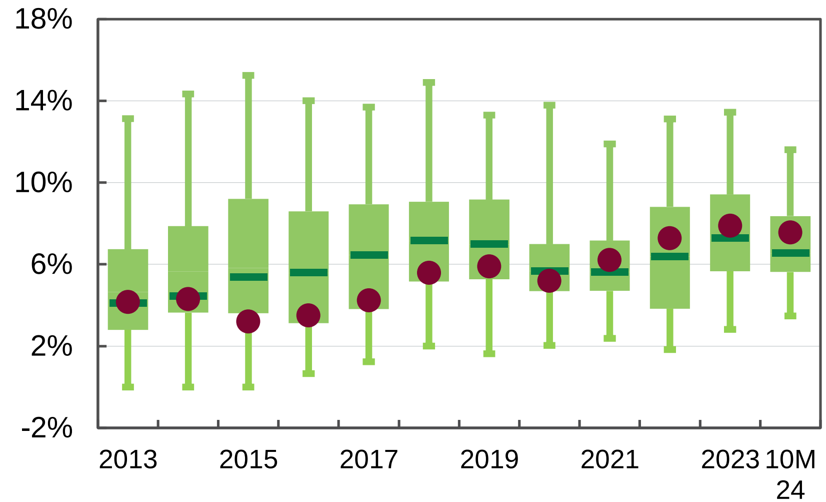
Banks adjusted assets to lower rates and retained their margin

Return on assets and cost of labilities



Source: NBU.

Net interest margin of banks



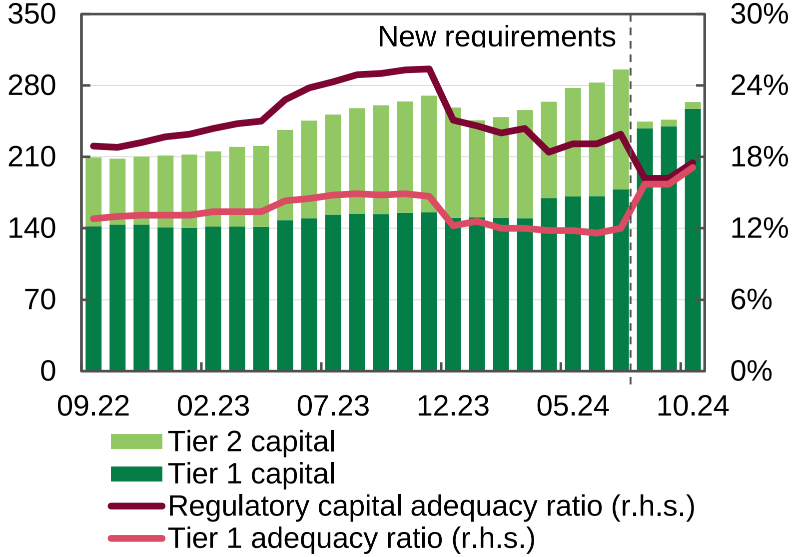
Upper and lower edges of the rectangles show the first and the third quartiles of the indicator distribution across the banks. Dashes inside the rectangle show the median. Dots are average. Dashes outside the rectangle show the minimum and maximum.

Source: NBU.

- Throughout the year, the banks responded to cuts in key policy and commercial interest rates by increasing investment into longer and more profitable assets, like government debt securities and loans.
- Therefore, return on assets has been stable throughout the whole easing cycle, while the cost of funding gradually declined, and so the interest rate margin remained high.
- High interest rate margin and rising fee income puts the banks into the position to cover their higher administrative costs.

Banks’ capital adequacy has increased and enables them to lend

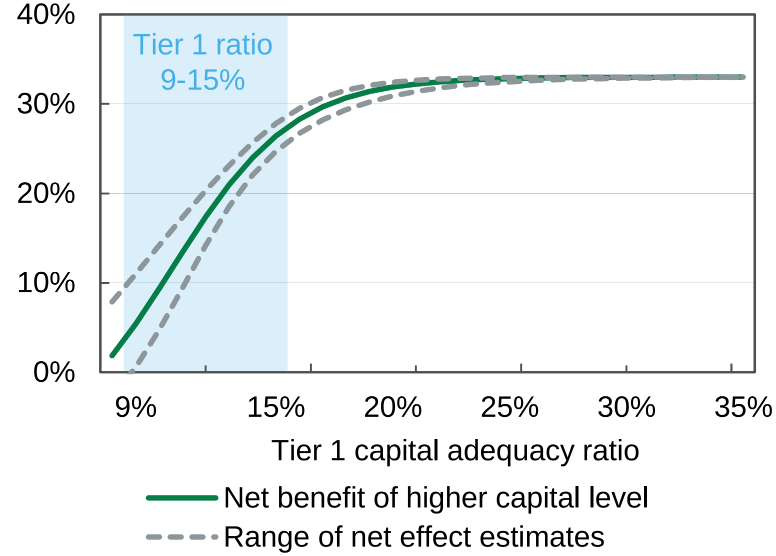
Components of regulatory capital and regulatory capital adequacy ratio



Until 5 August 2024, instead of Tier 1 and Tier 2 capital, the figure shows core and additional capital, respectively. Instead of Tier1 and regulatory capital ratios it shows core and former regulatory capital adequacy ratios.

Source: NBU.

Net benefit of higher capital levels for Ukraine, % GDP



The range of net effect estimates is calculated based on 95% confidence intervals for the probability of a crisis occurring, Estimated on a sample of Ukraine’s peer countries.

Source: NBU.

- After transition to the new capital structure and covering all key risks with capital, the banks retained sufficient capital. This allows them to build up lending.
- An NBU’s research showed that maintaining bank Tier 1 capital adequacy at above 15% has significant positive effect for the economy.
- Higher income tax will entail to lower bank activity going ahead.
- Based on the results of 2025 bank resilience assessment, the NBU will make decisions on introduction of further capital requirements.

Recommendations of the National Bank

Recommendations to financial institutions

- The banks have to adopt to new regulatory requirements:
  - To calculate leverage ratio in a test mode, to report on ICAAP and ILAAP.
  - To comply with required regulatory capital adequacy ratio, which is to grow (to 9.25% and 10%).
  - To take into account the hike in 2024 income tax in their business plans for the next year. To update restructuring programs if necessary.
- For the banks, to implement appropriate system of environmental and social management.
- For non-bank financial service providers, to comply with provisions of updated legislation.

Recommendations to public authorities

- To keep up the pace of reforms under programs with the EU, the IMF, and other partners.
- To implement further the Lending Development Strategy, including measures supporting lending in “resilience territories” and improving lending infrastructure.
- To optimize the design of state support programs, including *eOselia*, and to update strategies of operators of state support programs.

NBU’s priorities

- To conduct banking resilience assessment next year.
- To implement further the EU regulatory standards, including enhanced requirements on assessment of third-party risks.