Ukrainian Banking Sector 2021 Outlook: Clean-Up And Renewed Growth

March 15, 2021

Annette Ess
Natalia Yalovskaya

S&P Global Ratings
Key Takeaways

- Ukrainian banks are well equipped to fight the economic shock of 2020-2021 thanks to the National Bank of Ukraine's (NBU) system clean-up, increased capital and liquidity cushions, and strengthened banking regulation and supervision.

- Main 2021-2022 challenges for four state-owned banks:
  - Cleaning up nonperforming loans (NPLs) from balance sheets;
  - Implementing viable new business strategies; and
  - Strengthening corporate governance to prepare them for partial or full privatization.

- Foreign- and privately-owned Ukrainian banks should remain resilient to the pandemic and resume growth in retail and corporate segments.

- Bank earnings in 2021 should remain in line with 2020: we expect growth in retail and corporate loans but pressure on net interest margin due to record low interest rates.

- Cost of risk will remain elevated at about 2.3% in 2021, compared to about 3.0% in 2020.

- Following write-offs, NPLs will reduce to about 30% by end-2021 from 41% at end-2020.
Strengthened Regulation Supports Ukrainian Banking Sector Development

- We note material improvements in regulation and supervision in the Ukrainian banking sector over the past six years.
- The NBU aims to be independent despite political pressure.
- Its regulatory actions are predictable and consistent.
- It has provided adequate and timely responses to support the banking system during the COVID-19 crisis.
- Upcoming 2021 regulatory initiatives:
  - Harmonize banking regulation with EU standards;
  - Increase risk weights for unsecured consumer loans to 125% by mid-2021 and 150% by January 2022 from 100% currently;
  - Tighten corporate governance requirements and strengthen board responsibility; and
  - Increase banking system digitalization.
More Severe GDP Contraction And More Pronounced Recovery In Ukraine Compared To Peer Average

- Ukraine's GDP growth and public finances outperformed our expectations in 2020 thanks to a strong rebound in domestic demand.
- GDP contraction in Ukraine was about 4.2% in 2020, which was less severe than the 9.8% reported in 2014.
- Estimated GDP growth of about 4% in 2021 should support the growth and recovery of the banking sector.
- However, epidemiological considerations pose an important risk to our growth projections.

Real GDP Growth

S&P Global Ratings
We expect:
- Net retail loans to increase by 10%-15% per year in 2021-2022, capitalizing on low key policy rate of 6.5% currently.
- Net corporate loans to increase by 5%-10% per year thanks to economic revival and government stimulus to increase lending.
- Gross corporate loans to reduce by about 10% annually due to write-offs of legacy NPLs.

Leverage Reduction Versus Growth

Leverage Reduction: Ukrainian State Banks
PrivatBank, Oschadbank, Ukreximbank, Ukrgazbank

Growth: Foreign-Owned Banks
18 banks excluding two Russian state banks

Growth: Private Ukrainian Banks
48 banks

---

We expect the rehabilitation of state-owned banks to continue in order to reduce the share of government ownership of the Ukrainian banking system to 25%. This will involve the full sale of PrivatBank, and the sale of minority stakes in Oschadbank, Ukreximbank, and Ukrgazbank.

In January 2021, International Finance Corporation provided Ukrgazbank with a €30 million loan convertible into a stake in the bank’s capital.

The banks have installed independent supervisory boards and introduced plans to reduce legacy NPLs. They continue to develop their growth strategies.
In summer 2020, the Financial Stability Council approved plans by four state-owned banks to reduce their NPLs by UAH305 billion over 2020-2022.

In 2020, these state-owned banks reduced NPLs by more than UAH110 billion.

The main reduction was at PrivatBank, by more than UAH70 billion.

We forecast NPLs in the system to reduce to about 20% by end-2022. We expect writeoffs of legacy fully provisioned NPLs will outweigh asset quality deterioration due to COVID-19 and seasoning of loans.
Dollarization of Loans And Deposits In Ukraine To Remain At Elevated Levels

Dollarization of loans and deposits in Ukraine is high in a global context but is in the middle of the range of CIS members. We expect the Ukrainian hryvnia to depreciate moderately in 2021 on top of 16% depreciation in 2020 – one of the highest depreciation rates in the region. We do not expect currency depreciation to materially harm Ukrainian banking system stability because:

- Regulation does not allow retail loans in FX in Ukraine. Net retail loans in FX were 3% at end-2020 and are progressively reducing through repayments.
- The majority of corporate loans in FX are to exporters. We expect dollarization of net corporate loans to slightly reduce to about 46% in 2021 from 48% at end-2020, reflecting reduced rates on UAH loans following the reduction of a key policy rate.
- De-dollarization of deposits is likely to slowly continue, largely depending on currency stability.
- FX mismatches at the majority of Ukrainian banks are moderate.

Cost Of Risk To Remain Elevated But **Lower Than Peer Average**

- We expect Ukrainian banks’ cost of risk (COR) to be about 2.3% in 2021, one of the lowest among international peers, reflecting very high COR in 2016-2018 and limited growth hereafter.
- At about 3% in 2020, COR in Ukraine was in line with the peer average.

### COR For Ukrainian Banks And Peers

- **Greece**: 8%
- **Kazakhstan**: 7%
- **Belarus**: 6%
- **Azerbaijan**: 6%
- **Turkey**: 6%
- **Georgia**: 4%
- **Uzbekistan**: 4%
- **Armenia**: 4%
- **Kenya**: 3%
- **Ukraine**: 3%
- **Nigeria**: 3%
- **Egypt**: 3%
- **Russia**: 3%
- **Tunisia**: 3%

**COR**—Cost of risk. Source: Central Banks, S&P Global Ratings.

**S&P Global Ratings**
We Expect The Pandemic To **Moderately Harm** 2021 Profitability

**Revenue And Expenses For Ukrainian Banks**

<table>
<thead>
<tr>
<th>Year</th>
<th>Net interest income</th>
<th>Fees</th>
<th>Other income</th>
<th>Loan loss provisions</th>
<th>Administrative expenses</th>
<th>Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020e</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2021f</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Expectations for 2021:**

- Stable net interest margin. This will reflect an increasing share of retail and SME lending, and increasing share of performing versus nonperforming loans, but low key policy rate.
- Volume growth to spur an approximate 10% increase in fees.
- Investment in digitalization and IT to spur an approximate 10% increase in expenses.
- Provisions will remain above 2019 levels.
- ROA of about 2% in 2021, in line with 2.3% in 2020.

---

PrivatBank And Foreign Banks Will Remain **Main Profit Generators**

**ROA In 2020**

<table>
<thead>
<tr>
<th>Bank Type</th>
<th>ROA (2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PrivatBank</td>
<td>6.5%</td>
</tr>
<tr>
<td>Foreign-owned banks*</td>
<td>2.3%</td>
</tr>
<tr>
<td>Private Ukrainian banks</td>
<td>1.8%</td>
</tr>
<tr>
<td>Oschadbank and Ukrgazbank</td>
<td>0.9%</td>
</tr>
<tr>
<td>All banks</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

**Breakdown Of Net Income In 2020**

<table>
<thead>
<tr>
<th>Bank Type</th>
<th>Net Income (2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PrivatBank</td>
<td>61%</td>
</tr>
<tr>
<td>Oschadbank, Ukrgazbank, Ukreximbank</td>
<td>(5)%</td>
</tr>
<tr>
<td>Foreign-owned</td>
<td>31%</td>
</tr>
<tr>
<td>Private Ukrainian</td>
<td>14%</td>
</tr>
</tbody>
</table>


Source: National Bank of Ukraine.
Deposits Remain Main Funding Source And **Liquidity Is Ample**

- We expect deposits to remain the main funding source for Ukrainian banks, accounting for 80%-90% of total liabilities in 2021-2022.
- We do not expect any material local or foreign debt issuance by Ukrainian banks in 2021-2022 due to ample liquidity. Outstanding gross external debt was about $4 billion at end-2020.
- Banks remain very liquid with cash equivalents and securities accounting for about 45% of total assets.
- We expect deposit growth to somewhat slowdown in 2021 to about 15% from 27% in 2020.

Source: S&P Global Ratings, National Bank of Ukraine
Ukrainian Banks' Funding And Liquidity Are Stronger Than Peers'

Funding Metrics For Ukrainian Banks And Peers
At end-2020e

We define core deposits as 100% of retail and 50% of corporate deposits. e--Estimate. Source: S&P Global Ratings, Central Banks.

S&P Global Ratings
Analytical Contacts

Annette Ess
Associate Director
annette.ess@spglobal.com
+49 69 33 999 157

Natalia Yalovskaya
Director
natalia.yalovskaya@spglobal.com
+44 20 7176 3470