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PROBLEMS AND PRIORITIES OF THE UKRAINIAN BANKING SECTOR DEVELOPMENT IN THE CONDITIONS OF FINANCIAL MARKET TRANSFORMATION

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Abstract. The paper examines the place of the banking sector in the financial market of Ukraine. The main indicators characterizing the level of the Ukrainian banking sector development are presented. It is noted that the peculiarity of the banking sector of Ukraine is a significant reduction in the number of institutions and the predominance of the share of state-owned banks in the structure of the banking system assets. The paper considers the structure of the loan portfolio of Ukrainian banks, which is characterized by a significant share of non-performing loans. The financial result of the banking sector and the factors that have a significant impact on the banking efficiency in Ukraine are studied.

KEYWORDS: BANKING SECTOR, BANK ASSETS, BANK LOANS, NON-PERFORMING LOANS, FINANCIAL RESULT.

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INTRODUCTION

An immanent feature of modern social transformations is the intensification of the financial sector development, where banking institutions play a central role. In modern conditions, banks have become the leading institutions in the financial intermediation market, able to promote economic growth through the efficient allocation of financial resources for their productive use. The reliability and sustainability of the country's banking sector determine the level of its competitiveness, as well as the ability to maintain money turnover, create conditions for the transformation of savings into investment and provide the necessary level of loan financing of economic entities.

Herewith, in the event of a crisis in the real sector of the economy, where banks have invested their resources, the difficulties will easily spread to the banking sector. This will undoubtedly lead first to bank liquidity problems, the accumulation of non-performing loans forcing banks to accumulate reserves for their impairment increasing the costs, and eventually, some banks will become insolvent and cease operations.

At this stage, it is important to study the trends in the

banking sector of Ukraine and identify its potential advantages and significant disadvantages to address the negative economic consequences of the COVID-19 pandemic.

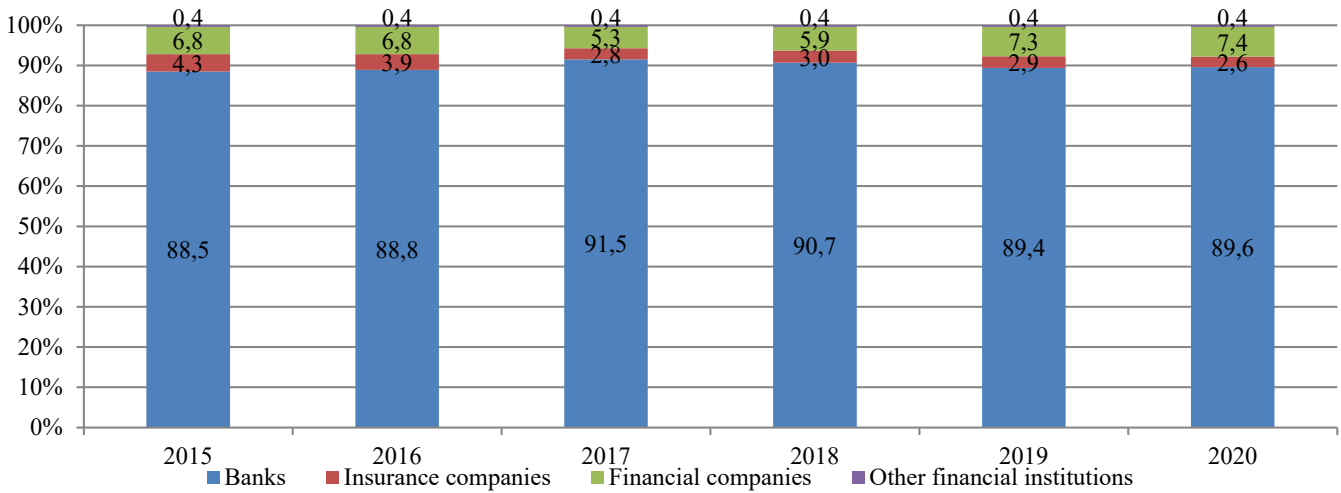
Results and discussion

The Ukrainian financial sector, as in many other countries, is bank-centric, therefore, approximately 90% of its assets belong to banks. It is through banking institutions that the major part of business savings is accumulated, transformed, and redistributed. (Fig. 1) (Supervision statistics of the..., 2021).

An important aspect that characterizes the degree of development of the country's banking sector is the number of banking institutions. As of October 1, 2021, 71 banking institutions are operating in Ukraine (Fig. 2).

During 2014-2021, the number of banks decreased by 109, most banks ceased operations in 2014-2016 as a result of the economic crisis in the country due to the military-political conflict with the Russian Federation and forced measures taken by the National Bank of Ukraine, aimed at closing problem institutions.

Fig. 1. Assets structure of the Ukrainian financial sector in 2015-2020, %



Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

At the same time, the level of development of the banking sector of Ukraine remains relatively weak. Thus, in neighboring Poland at the end of 2019, there were 30 commercial banks, 538 cooperative banks, and 32 branches of credit institutions, and the concentration of bank assets in the gross domestic product was 88.3%. The Hungarian banking sector consists of 41 institutions, the sector’s total assets were 92.6% of annual GDP [3]. In Ukraine, the share of bank assets in GDP in 2013-2020 fell sharply from 280.8% to 34.5%, which means a significant reduction in the financial depth of the economy (Fig. 3).

Thus, the banking sector loses the function of financial intermediation, there is a contraction in lending, and, consequently, reduced opportunities for financing the real sector of the economy.

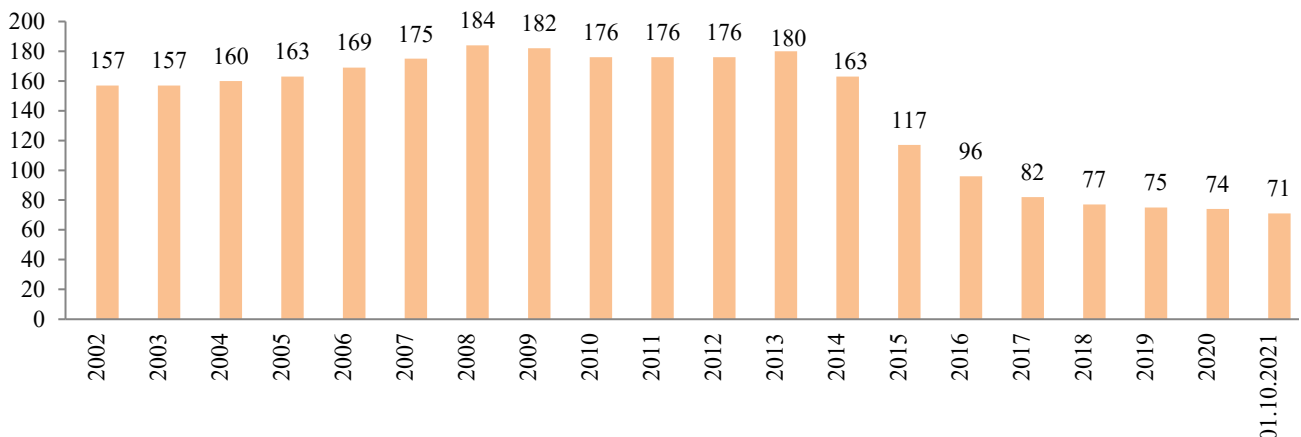
In 2016, the ownership structure of the banking system of Ukraine underwent significant regrouping, as of January 1, 2017, the ownership structure of assets of the banking system of Ukraine was as follows: banks with Ukrainian private capital accounted for about 13%, banks of foreign banking groups - 35%, government-owned banks - 52% (Fig. 4).

As a result of the transition of JSC CB PrivatBank to state ownership, the share of government-owned banks in the structure of assets of the domestic banking system has increased significantly. In general, the ownership structure of bank assets in Ukraine has not changed significantly over the last four years.

In world practice, for the statistical study of the development of the banking sector, the ratio between the number of bank branches and the amount of adult population is used (Fig. 5).

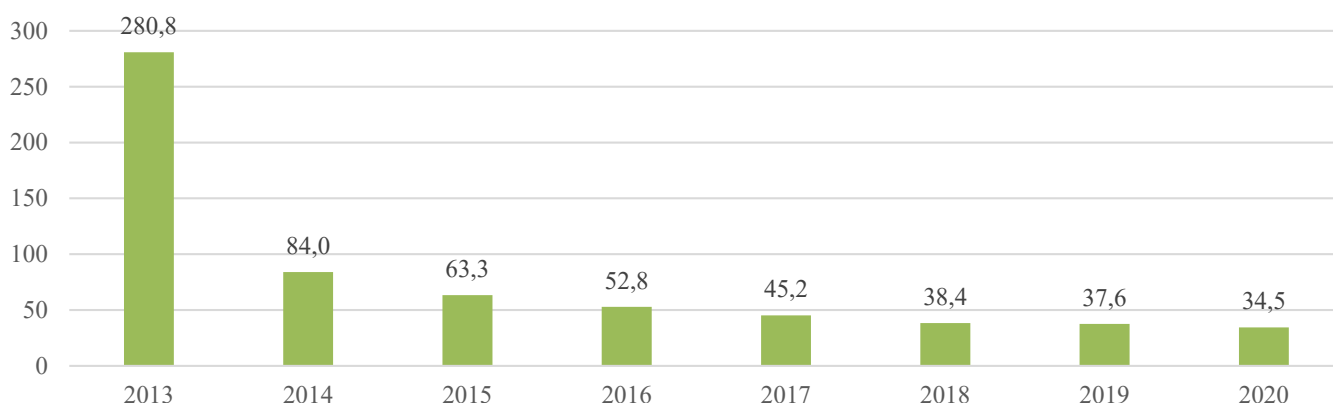
Since 2004, the number of bank branches per 100,000 adults in Ukraine has grown rapidly to 61 branches in 2008 and then dropped significantly to 17 in 2020. At the same time, the dynamics of reducing the number of structural divisions of banks is typical for other Eastern European countries as well. The main reasons for this situation in the domestic banking market, first, include the development of Internet banking, which is due to the growing development of online payment services and the expansion of the Internet. Secondly, the level of economic activity has a significant impact on

Fig. 2. Dynamics of the number of banks operating in Ukraine in 2013-2020, units



Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

Fig. 3. Dynamics of the share of net banking assets in GDP in Ukraine in 2013-2020, %



Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

the number of operating structural divisions of banks, which determines the general condition of the banking system.

Due to a significant reduction in the number of functioning banks, their capital also decreased during 2015-2016, but in 2017-2020 Ukrainian banks finally managed to achieve positive changes in equity (Fig. 6).

One of the most significant obstacles to the development of the Ukrainian banking sector is the very low level of public confidence in it. Recent domestic opinion polls conducted by the Razumkov Center have shown that 71% of the population does not trust banking institutions, and the level of distrust in the National Bank of Ukraine accounts for 60% (Trust in the institutions..., 2021). Thus, according to the American Institute of Public Opinion, only 28% of Ukrainians trust domestic banking and financial institutions, 61% of respondents distrust the entire banking system of the country, the remaining 11% are undecided. With this indicator, Ukraine ranks ninth among the countries with the lowest level of confidence in banks (Chernychko, Pelekhach, 2017, p.186). Distrust of banking institutions will further limit the main function of banks - the transformation of savings into investment.

The most considerable consequences of any crisis for

the banking sector are an increase in the volume and share of non-performing assets and, above all, loans. Let us assess the quality of the loan portfolio of Ukrainian banks (Table 1).

The total volume of lending operations of Ukrainian banks over the past 5 years increased by only UAH 20.6 billion. Banking institutions began to significantly reduce the size of their loan portfolios in 2019, due to a significant increase in investment in Ukraine's domestic government bonds as a low-risk and high-yield asset. In 2019, hryvnia DGBs were placed at 12-19% per annum.

The share of non-performing loans, starting in 2016, gradually began to decline after reaching a record high. Table 1 shows that in 2020 this figure was 41.0% of the total loan portfolio. For comparison, in the second/third quarters of 2017, the share of non-performing loans in Belarus was 13.7%, in Poland - 4.1% (Banking sector reform ...). Problems in the domain of bank lending did not arise with the crisis in early 2020 but accumulated over a long period of time (Dzubylyuk, 2020, p.39).

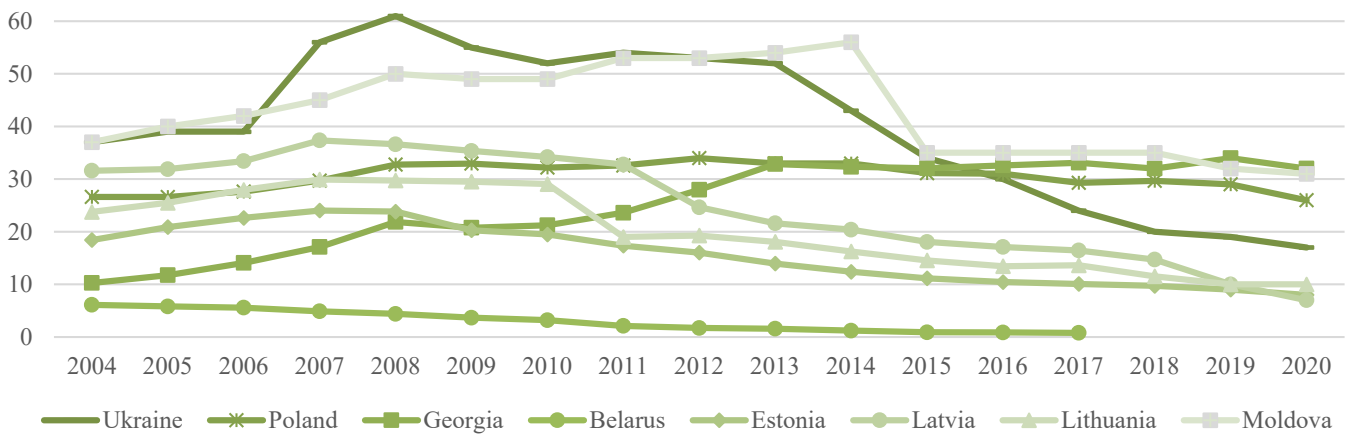
The quality of loans to individuals improved the most due to the deployment of new lending. With regard to loans to the corporate sector, the servicing of most non-performing loans will never resume, and banks must speed up

Fig. 4. The ownership structure of assets of the banking system of Ukraine in 2013-2020, %



Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

Fig. 5. The number of structural divisions of banks in individual countries per 100 thousand adults in 2004-2020, units



Source: The World Bank (World Bank Open Data)

the ‘cleansing’ of balance sheets by selling and writing off non-performing loans.

The vast majority of experts attributed the prospects of improving the credit portfolio of Ukrainian banks to further economic growth and credit expansion, but the quarantine measures taken by the Ukrainian government call into question this scenario of the banking sector. Moreover, the level of credit expansion in Ukraine is extremely low (Fig. 7).

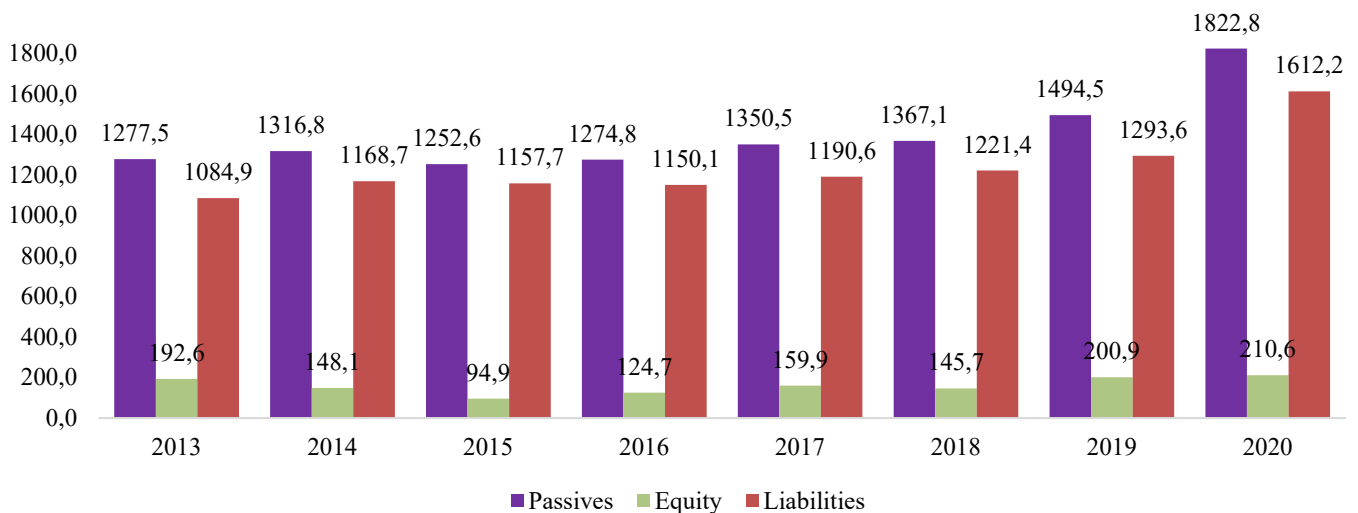
In the current situation, known as the ‘Corona crisis’, banks cannot provide full lending to the economy, as the uncertainty of the economic situation, restrictive government quarantine measures, falling world markets, and the threat of mass bankruptcies pose additional risks to the banking system. Under such conditions, competition in the banking market of Ukraine will intensify, and banks with an impeccable reputation will be able to attract more resources. The suspension of lending will create additional threats to the activities of small and medium-sized banks, which will find it increasingly difficult to maintain an acceptable level of liquidity and comply with regulatory requirements.

The financial result of banking sector activities, profit or loss, allows assessing its performance. Profit is one of the most important indicators, which is the material basis for the further operation and determination of the rating in the banking market. Maintaining it at a sufficient level is necessary for banking institutions to attract new capital and allows increasing the volume and improving the quality of services offered, stimulates the improvement of operations, reducing costs, and the development of banking technologies (Matvienko, 2014, 169).

The dynamics of net profit (loss) of Ukrainian banks is shown in Fig. 8.

In 2019, the banking sector received a record-breaking profit of UAH 58.4 billion, of which UAH 32.6 billion is the profit of the largest government-owned bank in Ukraine - JSC CB PrivatBank. Thus, out of 75 solvent banks at the end of 2019, only 6 institutions were unprofitable, the total amount of their losses amounted to UAH 0.2 billion. Contributions to reserves for the year decreased to UAH 12.5 billion, which was the lowest value in the last 10 years. Among the banks

Fig. 6. Changes in equity (passives) of Ukrainian banks in 2013-2020, billion UAH.



Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

Table 1. Dynamics of lending operations and the share of non-performing loans of Ukrainian banks in 2016-2020

Indicator	2016	2017	2018	2019	2020	Change in 5 years
Lending operations, UAH billion:	1029.0	1090.9	1193.6	1097.6	1049.6	+20.6
non-performing loans, UAH billion	572.5	595.1	630.8	530.8	430.4	-142.1
share of non-performing loans,%	55.6	54.6	52.8	48.4	41.0	-14.6 g.p.
Loans to the corporate sector, UAH billion	847.1	892.9	959.6	847.3	795.4	-51.7
non-performing loans, UAH billion	472.7	500.3	535.8	456.1	371.2	-101.5
share of non-performing loans,%	55.8	56.0	55.8	53.8	46.7	-9.1 g.p.
Loans to individuals (including individual entrepreneurs), UAH billion	157.4	174.4	202.2	214.3	208.4	+51.0
non-performing loans, UAH billion	98.5	93.4	93.1	73.1	58.2	-40.3
share of non-performing loans,%	62.6	53.5	46.0	34.1	27.9	-34.7 g.p.
Interbank loans, deposits (excluding correspondent accounts), UAH billion	23.1	22.0	28.9	31.4	34.0	+10.9
non-performing loans, UAH billion	1.3	1.4	1.1	0.9	1.0	-0.3
share of non-performing loans,%	5.6	6.2	3.7	3.0	2.9	-2.7 g.p.
Loans to public authorities and local government bodies, UAH billion	1.4	1.5	2.9	4.7	11.7	+10.3
non-performing loans, UAH billion	0.01	0.01	0.8	0.7	0.0	-0.01
share of non-performing loans,%	0.7	0.7	29.2	14.5	0.0	-0.7 g.p.

Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

with significant contributions to the reserves were two government-owned banks and one bank with Russian capital (Overview of the..., 2021).

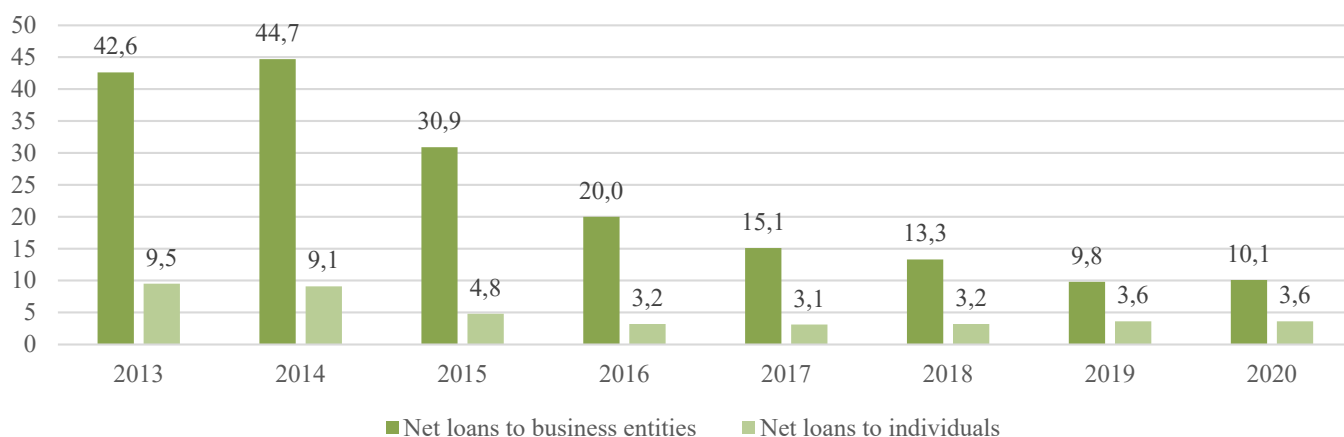
In 2020, banks received UAH 41.3 billion net profit, which is 29% less than for the same period last year. And out of 73 solvent banks, 65 banks were profitable and received a net profit of UAH 47.7 billion, which covered the losses of 8 banks totaling UAH 6.4 billion. At the same time, the profits of the banking sector are very concentrated: JSC CB PrivatBank generated 61% of total profits (UAH 25.3 billion), and the five most profitable banks - 89% of profits (Profit of the..., 2021).

It should be noted that a significant increase in the profitability of the banking system was made possible by reducing contributions to reserves with a steady increase in interest and commission income (Overview of the..., 2021).

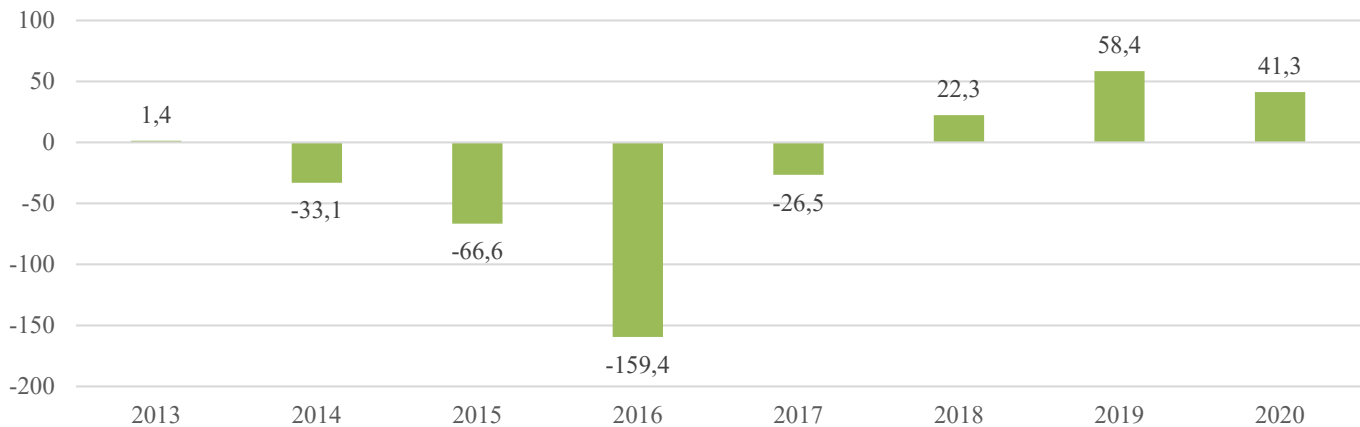
Despite the positive dynamics of the majority of indicators of the banking sector development in Ukraine, current challenges can nullify all previous achievements. The continuation of quarantine measures together with the further decline of world markets may destabilize the domestic economy, including the banking sector, especially in the terms of legislative consolidation of some concessions for borrowers.

CONCLUSIONS

In the conditions of instability of the economic and political environment, each bank is forced to operate under fierce competition, low trust of potential and existing customers, and increasing risks of liquidity and solvency. The experience

Fig. 7. Dynamics of loans to business entities and individuals in Ukraine in 2013-2020, % of GDP

Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

Fig. 8. Dynamics of the financial result of the Ukrainian banks in 2013-2020, UAH billion.

Source: The National Bank of Ukraine (Supervision statistics of the..., 2021)

of 2014-2016 has shown that external threats do not contribute to the development of banking institutions in response to challenges, but, on the contrary, create barriers to the efficient operation of banks and generate risks for the real sector of the economy.

Thus, the main direction of preventing an unfavorable scenario for the banking sector of Ukraine should be the creation of the Stabilization Fund, which will be used to support the solvency of businesses and individuals, including partial compensation of borrowers' loans, state-guaranteed lending for strategically important projects. In turn, this will enable to avoid the collapse of the banking system and additional costs to maintain the solvency of systemically important banks.

It is also important to prevent further decline in the trust of economic entities in the activities of banking institutions, as the outflow of time deposits from the banking

system and a significant concentration of demand deposits will significantly affect bank liquidity. Therefore, the main efforts of banks should be aimed at attracting long-term funds from customers, both by providing customers with favorable conditions and by using modern marketing techniques. Strategic guidelines for ensuring a sufficient level of liquidity of the banking system by the state are the introduction of long-term targeted refinancing under government development programs and further reduction of interest rates on certificates of deposit, which will direct free bank funds into the economy.

It should be noted that solving the problems of the banking sector is possible only in combination with macro-financial stabilization measures related to balancing budget indicators, limiting inflation, and fluctuations in the hryvnia exchange rate.

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