

# The Revival of Bank Crediting in the Wartime Economy of Ukraine

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## Summary

*In wartime, Ukraine could retain the banking system's stability. However, bank loans stagnated both in corporate and personal segments. Corporate crediting is driven mainly by subsidised credit programs, while market-based crediting is shrinking. The revival of large-scale crediting is crucial for businesses adapting to the challenges of the exhaustive war and for the fastest recovery of the economy. The accents in credit policy should be shifted to advancing the development of market-based loans, establishing the incentives for banks and recovery of borrowers' solvency and long-term sustainability.*

*In the paper, measures are suggested to redesign the existing subsidised credit programs and rearrange the banking system to unlock the impediments of market-based credit provision. The revival of market-based crediting should restore the mechanisms of monetary policy transmission and enable the NBU to be more effective in anti-inflationary control.*

## Problem

**In the period of the full-scale war, the prudent regulatory policy of the National Bank of Ukraine (NBU) has ensured that the banking system remained stable and capable of providing basic banking services. Key stability measures have been introduced via the 100% guarantees of bank deposits of physical persons, the active refinancing of banks, the adoption of regulatory norms on the realities of war, and the restrictions on currency markets to avoid speculation.**

*For the period of active war from March to November of 2022, [commercial banks' resources](#) increased at the expense of household deposits in hryvnia by 28,6 % (UAH 136 billion). The deposits of non-financial corporations declined by 10,9 % (UAH 43 billion).*

**However, at the same time, [bank loans in hryvnia stagnated](#) both in corporate (increased by UAH 18,0 billion) and in personal (declined by UAH 33,1 billion) segments. Corporate loans even grew from March to June by a total of 33,0 billion UAH, but since**

September started to stagnate, declining to November by UAH 14,9 bln. Generally, only about 60 % of deposits are redirected to the goals of crediting. Significant shares of money supplied to the economy, e.g. by fiscal channels, fail to reach the market and influence economic activity but are rather locked within the banking system. Despite its current stability, the banking system suffers from its functional insufficiency as the backbone of the national financial system.

The accumulated deposits overheat liquidity, remove the significant money mass from productive circulation in the economy, but simultaneously create a visible monetary overhang, endangering inflationary and devaluation expectations. This logically causes a more strict monetary policy of the NBU, which is reflected in the [key policy rate, which has increased to 25 % since June 3rd](#).

The "expensive money" policy pursued by the NBU is not the only reason for banks' crediting stagnation. **A prolonged war witnesses growing risks for banks due to the worsening solvency situation of debtors.** According to [statistical data](#), as of December 1st, the share of non-performing loans (NPL) totalled 36,7%. This indicator will probably be much higher following the cancellation of credit term reprieves announced for the martial law term.

Having met with high debtors' solvency risks, the banks restrain from crediting and prefer to invest the abundant liquidity primarily in short-term deposit certificates of the NBU, which provide a 23% annual yield. Banks' investments into these instruments [totalled at the end of December](#) in UAH 457 billion (compared to UAH 745,6 billion of credits in hryvnia, provided to all residents) and more than tripled since February.

**Corporate lending is mainly driven by subsidised credit programs ("[Accessible loans 5-7-9 %](#)").** Since the beginning of the full-scale war till the end of December, the banks involved in the program [have provided loans](#) amounting to UAH 72,2 billion. The subsidised credits compensate for the negative cor-

porate loans' dynamics and constitute more than 50% of the total working corporate loan portfolios. Delays in the disbursement of guaranteed part of interest payments due to the problems with budget revenues have largely explained the decline of loans' provision in the last months of 2022.

**In the near future, the track of subsidised crediting will also be supported by several internationally financed programs.** In particular, in December 2022, the IFC [approved the program](#) promoting bank crediting in agriculture and SMEs for USD 2 billion. Practically at the same time, another agreement [has been signed](#) on USD 150 million funding by German KfW bank loans for energy saving and energy resilience projects.

**However, any special credit program does not solve the fundamental imbalances in the financial sector of Ukraine.** Subsidised credits create an additional burden for the public debt – either domestic or foreign, while banks continue accumulating liquidity and are subject to restrictive monetary policy. Administrative, not market criteria for adopting loan provision decisions distort the business landscape, making it less transparent and predictable for foreign partners and potential investors.

## Purpose

The revival of large-scale crediting is crucial for businesses adapting to the challenges of exhaustive war and for the fastest recovery of assets destroyed during the fighting and Russian missile attacks.

**The importance of subsidised crediting will still be high** as the optimal way to deliver credit resources to finance the most urgent needs of businesses' resilience and recovery. In the state budget for 2023, more than UAH 9 billion was assigned to the "5-7-9 %" program compared to UAH 3 billion in 2022. Meanwhile, the corresponding programs [should be redesigned](#) to widen the spectrum of financial instruments subject to subsidisation, differentiate the residual interest paid by the borrower, and specify the targeting of supported loans to the projects, which can serve as accelerators for economic recovery and business development.

**However, the accents in credit policy should be shifted to advancing the development of market-based loans** via the establishment of incentives for banks and recovery of borrowers' solvency and long-term sustainability.

For this reason, **complementary institutional changes should be undertaken to rearrange the banking system to best meet the challenges of prolonged war and recovery imperatives.** The revival of market-based crediting should restore the mechanisms of monetary policy transmission and enable the NBU to be more effective in anti-inflationary control, and eliminate the self-supporting scheme of excess liquidity sterilisation with precious deposit certificates step-by-step. Researchers of emerging economies [argue](#) that the proper quality of institutes allows central banks to minimise the recessionary risks of inflationary targeting.

## Recommendations

- **The subsidised credit programs** should be oriented towards sequentially diminishing the share of loans for operational needs and concentrating largely on financing investment projects centred around recovery and structural changes. **It is recommended to specify the priority spheres for subsidised credits**, including particularly the restoration of destroyed business assets, the rearrangement of relocated enterprises, and the creation of employment opportunities. Thus, regional differentiation in subsidy provision is strongly recommended, giving the preferences to regions and local communities with the strongest needs in recovery.
- Likely, based on the experience of IFC and KfW, the share of foreign aid in credit subsidies will spread. This eases the task of subsidised credits' redesign, as the donors in their programs will follow the considerations mentioned above. Possible risk can be associated with an extremely high basic interest rate, making subsidies much more expensive. Reducing key policy rates or any steps to reduce the basic rate of bank credit should encourage the donors' credit-support programs.
- **Implementing a differentiated rate of refinancing depending on the structure of the credit folders of banks (the longer the credits, the cheaper the refinancing)** can serve to reduce the rate for long-term investment credits. The instrument will not work in the short run in the situation of excess liquidity, but in the medium and long run, cheaper long-term financing should be recalled to finance the demand for investments in recovery. The experience of the European Central Bank in the form of its [Targeted Longer](#)

[Term Refinancing Operations](#) (TLTROs), used in the EU since 2014, should be adapted.

- **The specialisation of banks provides the opportunity to tailor regulatory frameworks taking into account the specific features of the lending objective.** The more sophisticated regulations should consider different natures of collateral (export goods, future agriproducts, mortgage, etc.), different business models and terms of turnover, different risks, and the like. Preferably, the differentiation could be realised by the designation of special banks, concentrated on specific borrowers, or, in a much worse option, by the selection of specialised pools of credits which can be subject to misuse.

The possible specialised banks or pools of credits can be as follows:

- **Export** – taking into consideration specific risks, such as political, infrastructure-related, and currency. The risks can also be covered by the mechanisms of the [Export Credit Agency](#);
- **Innovation** – with special emphasis on the expertise of financed projects, compensation of the higher risks of venture projects;
- **Small businesses** – emphasis on small-sized credits and startups, with small or unavailable collateral, providing technical support for preparing project proposals;
- **Mortgage** – affected by prolonged terms of credit in conditions of high uncertainty, volatility of the market price of collateral, and uncertain long-term solvency of borrowers;
- **Agricultural** – with season-dependent capital turnover and increased climate risks. In addressing small-sized entities, namely farmers, technical support in the preparation of projects and small-sized credits are needed;
- **Municipal** – considering the small scale and localisation of such banks, less orientation for profit-seeking, at the same time – a high potential role in local infrastructure recovery that can be addressed through public-private partnerships.
- **State-owned banks can serve as leaders in re-arranging the provision of banking services in wartime.** This touches upon the development of networks of branches and bank terminals, the

introduction of modern digital services, the tight networking between state-owned banks or with other Ukrainian banks, the implementation of the proper methodology of client solvency assessment in wartime, the supply of competitive deposit rates and programs, the provision of credits to the priority sectors, and the goals of recovery. As the state-owned banks now [constitute the foundation of the national banking system](#), their pilot projects of adapting to wartime challenges could be shared with the entire banking system of Ukraine. State-owned banks, consequently, require special management provided by the Ministry of Finance. The policy concerning state-owned banks should be one of the subjects of international support for the recovery process. As soon as, in the long run, [the major shares of state-owned banks are supposed to be privatised](#), the investments in their modernisation will be refunded due to the increase in their market value.

- **The systemic measures to unload banks from the burden of NPL can significantly reduce their risks, improve the capacity to attract deposits and investments, and reduce the risk premium in the composition of credit rate.** The issue is that an enormously high level of NPL caused by the war does not allow the standard sanitation (rehabilitation) procedures to apply. Thus, it is recommended to:
  - implement differentiated programs of restructuring for *pre-war debtors* that suffered no war damage, thus, can be responsible for debts with their assets;
  - redeem the NPL of the *debtors affected by war damages* to business assets, which are focused on recovering their businesses;
  - determine the regimes of compensation of credits lost by banks in the cases when *debtors cancelled their activities* due to war-generated reasons;
  - create a special agency of bad assets' management to *treat the redeemed loans*.
- **Special instruments should be implemented to finance the recovery of destroyed assets and individual property and dwellings.** As crediting these goals is problematic due to the lack of appropriate collateral, one possible way is to issue compensational certificates, which should be accepted as collateral for crediting recov-

ery. The certificates could be used as reserves of banks, circulate in the securities market and have guaranteed delayed coverage by means of international aid to Ukraine. In the medium run, the option can be foreseen for the owners of the certificates to claim part of Russia's reparations in the post-war period.

- **The revival of bank crediting requires the resilient availability of physical access to banking services for businesses and physical persons.** Thus, offices of key banks should be restored in the centre of each hromada (Ukrainian administrative divisions), either as constantly acting units or as mobile offices. Electronic banking services for users should be guaranteed across the entire country, even in periods of temporary electricity blackouts due to Russian missile attacks (the NBU suggests the "[PowerBanking](#)" initiative as the appropriate one).

## Conclusion

The successful recovery of a full-scale spectrum of credit services of Ukrainian banks is crucial in ensuring the country's resilience in wartime and the efficient transition to post-war recovery. The NBU is quite successful in the promotion of the current stability of the banking sector. Meanwhile, the restart of productive crediting requires additional complementary steps.

Technical assistance should be suggested to the NBU and leading commercial banks in solving the number of primordial problems necessary for the recovery of their functionality in wartime. In particular:

- investment crediting in the period of high uncertainty;
- crediting the recovery;
- managing the NPL;
- targeted refinancing implementation;
- institutional arrangements of specialised commercial banks;
- functioning of the municipal banks;
- proper communications between the Central bank and the Government concerning the goals of macroeconomic stability and revival of the crediting of the economy.

Due to the unprecedented challenges the Ukrainian economy now faces, the standard financial instruments, compliant with conventional institutional practices, should be complemented with some innovative tools. The composition of the latter requires additional studies.