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FINANCIAL STABILITY OF BANKS AND ITS MONITORING IN UKRAINE

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Introduction. The banking system of Ukraine plays an important role in the improvement of market relations, structural changes, and economic growth of the country. It largely determines the speed, quality and scale of economic development. The stable functioning of the banking sector ensures the overall macroeconomic stability of a market economy. However, in Ukraine over the past ten to fifteen years, banking crises caused by various reasons have become commonplace, accompanied by capital losses, destabilization of the functioning of economic entities and households, and a decline in general welfare.

Addressing the problem of ensuring the financial stability of banks requires a comprehensive, systematic approach and involves the development of relevant recommendations for the use of tools for identifying and assessing threats and responding to them in a timely manner. At the same time, today every bank must not only adapt to changing environmental conditions, counteract the impact of negative factors, but also actively develop, implementing innovation products and technologies and appropriate methods and tools of risk management. This highlights the importance of studying the theoretical and applied foundations of the banks' financial stability.

Overview of recent researches and publications. For a rather long time financial stability has been the subject for scientific discussions by both foreign and Ukrainian scholars who are trying to find methods of forecasting, preventing and neutralizing the crisis in the banking sector in the early stages. It is worth mentioning the works by G. Afonso, S. Cecchetti, A. Crockett, A. Demirguc-Kunt, O. Issing, K. Reinhart, G. Schinasi, and X. Vives. However, their researches are mainly concerned with economic processes in countries with developed market economy and effectively functioning institutional mechanisms to ensure financial stability, and therefore require some rethinking for countries with transformational economy.

Among domestic scholars who have made a significant contribution to the development of theory and methods of assessing and ensuring the financial stability of the banking sector as a whole and individual banks in Ukraine, it is necessary to mention O. Baranovsky, I. Bielova, I. Chmutova, Zh. Dovhan, O. Holovko, M. Khutorna, O. Kolodiziev, V. Kovalenko, V. Mishchenko, N. Pohorelenko, O. Vovchak, and others. Appreciating their contribution to substantiating the foundations of banking stability, it should be emphasized that the constant emergence of new problems in this area requires in-depth research on both the content of the concept of financial stability of banks and applied aspects of its monitoring to prevent crises.

The aim of the article is to develop approaches to determining the financial stability of banks and to

identify opportunities for its monitoring in Ukraine on the basis of publicly available statistical data of the National Bank of Ukraine.

Basic material and results. The content of the concept of financial stability is undoubtedly complex and multifaceted in terms of its internal components and external factors. Historically, the path to understanding it was through the awareness of the inevitability of periodic financial instability (the works of J. Keynes, I. Fisher, H. Minsky, J. Stiglitz [1], A. Demirguc-Kunt [2] and others), which could have, according to the scholars, both endogenous and exogenous nature. Further attempts to explain financial stability only through its opposite (the so-called reverse approach) have been thoroughly criticized, and currently the direct approach to the conceptualization of financial stability, which involves the disclosure of its economic content, specific features, properties and factors of influence, is predominant.

Modern scientific literature contains different scientific approaches to the typification of financial stability depending on the types of objects studied. Within the framework of the system approach the financial stability of the economic system [3], the financial system [4], the banking system is considered [5; 6]; from the point of view of the institutional approach – financial stability of business entities, commercial banks, households. At the same time, the scientific interpretation of the concept of financial stability of the bank is still insufficiently studied, and its theoretical investigation is fragmentary. Thus, H. Azarenkova and O. Holovko interpret it as the ability of the banking institution to maintain equilibrium for a certain period of time in terms of individual areas of financial relations; it can manifest itself through a permissible deviation from the trend line of the selected indicator over time [7].

M. Khutorna notes that the financial stability of a credit institution, first of all, is ensuring proper coverage of actual and potential negative consequences of internal imbalances and preventing their transfer to the real economy, as well as maintaining long-term resistance to negative changes in the environment. Regarding the bank, the author claims that this is a continuum of states in which the bank retains its ability to operate smoothly and efficiently for future development [8, p. 56, 69].

Undoubted awareness of the basic need to ensure the financial stability of a modern bank should be integrated at all levels of its management, and the tools carefully selected and adapted to the specifics of the bank should be used in all its business processes. The main features of ensuring the optimal level of financial stability of the bank in a dynamic macro environment are: its ability to maintain long-term equilibrium as a result of resistance to internal and external threats; ensuring the continuity of activities in terms of performing the basic functions as a financial intermediary; the ability to absorb the effects of the negative impacts of internal and external factors; ability to ensure sustainable targeted financial development of the bank, based on innovative principles.

Therefore, we can talk about the need to clarify the concept of financial stability of the bank, formed under the influence of modern operational, functional, institutional, technological features of its performance [9]. In our opinion, it should be understood as the ability to:

- ensure equilibrium in the long run by counteracting / adapting / absorbing internal and external shocks based on the use of a proactive approach to identifying and managing threats to the functioning of the bank over time;

- maintain the continuity, efficiency and financial effectiveness of operation;

- ensure sustainable targeted financial development through early adaptation to the objective transformations of the economic environment by comprehensive integration of risk-oriented approach and the use of the newest methods to manage the bank in terms of all its business processes.

In the context of monitoring the financial stability of the Ukrainian banks, it is necessary, first of all, to analyze the dynamics of the main indicators of their activities' scale (Figure 1).

The data in Figure 1 show that the number of banking institutions in Ukraine has continued to decrease over the last five years. "Cleaning of the banking sector", according to the National Bank of Ukraine (NBU), started as far as in 2014-2015. Thus, as of 01.01.2014, there were 180 banks in Ukraine, and at the beginning of 2020 there were 75 banks, i.e. 105 banks were withdrawn from the market in six years. However, it is important to note that the reduction in the number of banking institutions did not significantly affect the amounts of banking capital, assets and liabilities. During the analysis period, the number of banks decreased by 42, but the assets, the liabilities and the capital increased by UAH 239.0 billion, UAH 142.7 billion, UAH 96.2 billion, respectively. So, the banking sector, despite the quantitative reduction, improved its performance including due to the need to meet the requirements of the NBU to increase the minimum amount of regulatory capital that, of course, affected its financial stability.

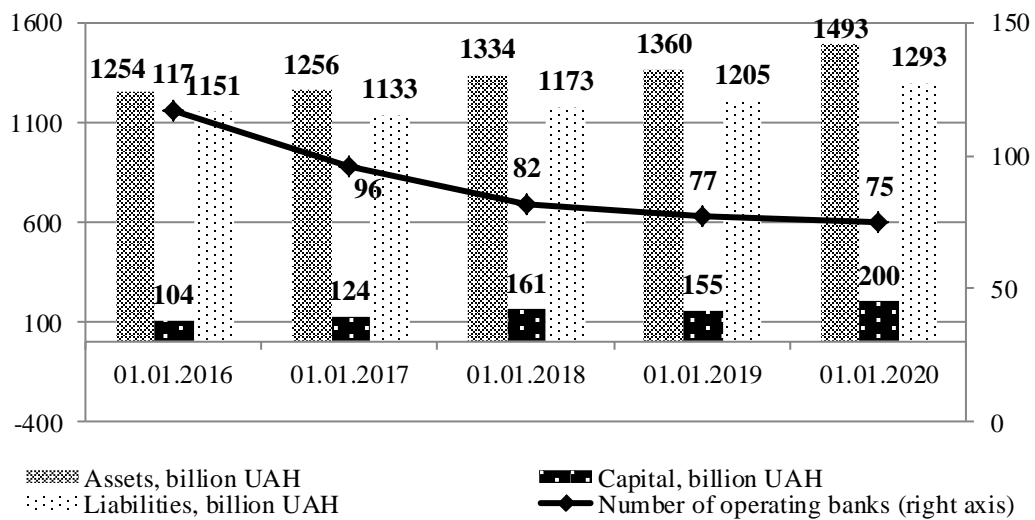


Fig. 1. Dynamics of the main indicators of the Ukrainian banks

**Complied according to the National Bank of Ukraine [10].*

The dynamics of the Bank Z-score indicator for Ukraine, which is calculated by the World Bank [11], can be a certain confirmation for this conclusion. Z-score compares the stability buffer of the banking sector – capitalization and profitability – with the volatility of these indicators. It reflects the probability of default of the banking system and allows comparing the situation in different countries. The increasing of the Bank Z-score means positive dynamics, the critical value is less than 2 [12].

In the period 2008-2017, among the neighboring countries of Ukraine – Poland, Belarus and Russia – the banking system of Poland (with a rate of 8.98 in 2017) has the highest level of financial stability, although in 2008 the banking system of the Russian Federation was the most stable (8.08). In 2009, the domestic banking system was the least financially stable, as the Bank Z-score was only 3.27. The lowest probability of default for Ukraine during this period was in 2012, when the Bank Z-score was 5.56, because this year the financial result of the Ukrainian banks, in the end, became positive after three years of their unprofitable performance. In 2017, this indicator for Ukraine began to rise after the crisis fall in 2015-2016 and reached the level of 4.57 (which, at the same time, was almost twice less than the Polish one).

The study of indicators that assess the performing banking basic functions at the macroeconomic level (the ratios of banking capital, assets, loans and deposits to GDP) is an important area of analysis of the financial stability of the Ukrainian banks [13] (Figure 2). It should be noted that from 2016 the Bank for International Settlements began publishing statistics on one of these indicators, namely, the bank assets to GDP ratio, which reflects the depth of banking intermediation (financial depth), and recommended that central banks use it to monitor banking sector’s financial stability.

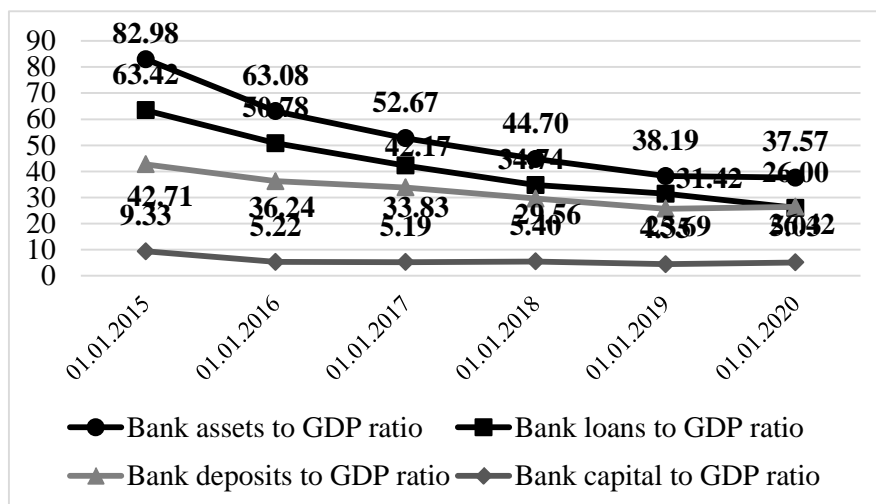


Fig. 2. Dynamics of the financial stability indicators of the Ukrainian banks in relation to the performance of their main functions at the macroeconomic level, %

**Complied according to the State Statistics Service of Ukraine and the National Bank of Ukraine [14; 10].*

The data shown in Figure 2, indicate that the penetration of banks into the economy had a steady downward trend in almost all indicators. All indicators decreased from 1.5 to 2.5 times during the analysis period, and only at the end of 2019 the ratios of deposits and of capital increased slightly compared to the previous year. Thus, the development of the banking sector “does not keep up” with the development and needs of the economy, so its financial stability determined by other approaches is quite relative.

Assessing the growth rates of the indicators that are primary for the calculation of the above mentioned indexes of financial stability allows for a more in-depth analysis of the processes under study (Table 1).

Table 1

Growth rates of GDP and assets, loans, deposits and capital of the Ukrainian banks, %

Indicators*	01.01.2016	01.01.2017	01.01.2018	01.01.2019	01.01.2020
GDP growth rate	25.3	20.0	25.1	19.3	11.6
Bank assets growth rate	-4.7	0.2	6.2	1.9	9.8
Bank loans growth rate	0.3	-0.4	3.1	7.9	-7.6
Bank deposits growth rate	6.3	12.0	9.3	3.7	14.8
Bank capital growth rate	-29.9	19.4	30.2	-3.8	29.0

* Chain growth rates.

**Calculated according to the State Statistics Service of Ukraine and the National Bank of Ukraine [14;10].

The calculated annual growth rates suggest that the following aspects of strengthening the financial stability of domestic banks are being identified:

- negative growth rates of bank loans indicate the absence of excessive lending, therefore, this threat is not inherent in the current development of the banking sector of Ukraine. However, it should be noted that the reduction in the growth rate of banks’ loan portfolios may have negative consequences in terms of efficient use of borrowed funds;

- increasing the growth rate of bank deposits proves a sufficient level of depositors’ confidence in the national banking system;

- sizeable growth rate of equity indicates the growing capitalization of the banking sector, despite the considerable amounts of accumulated uncovered losses of domestic banks, which were formed in previous crisis periods. The constant increase in the banking capital is caused by the need to form an adequate “buffer of protection against risks” and allows improving the financial stability of the banking sector.

Thus, capital stability and capital adequacy are the most important financial stability indicators of the banks [15] (Figure 3).

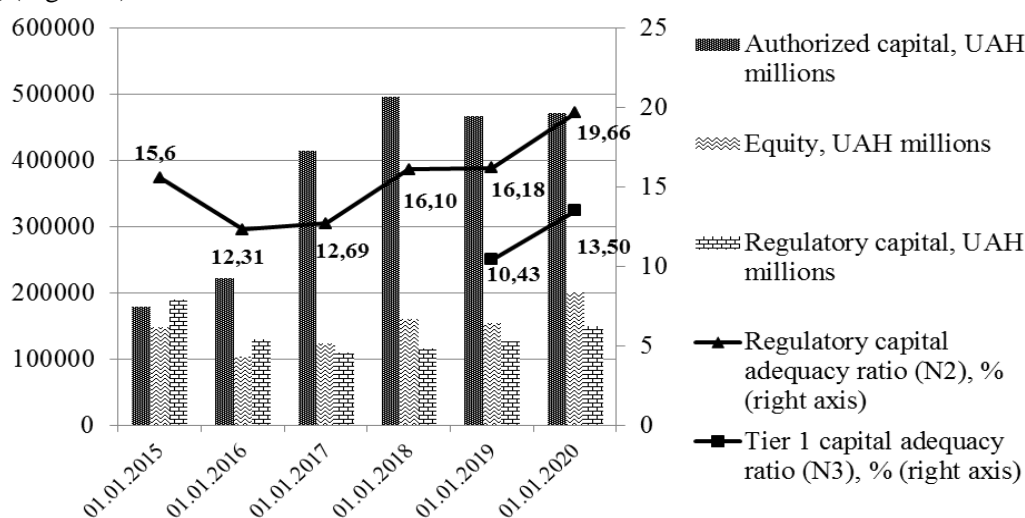


Fig. 3. Dynamics of the main indicators of the Ukrainian banks' capitalization

* Tier I capital adequacy ratio (N3) began to be calculated on February 1, 2019.

**Complied according to the National Bank of Ukraine [10;16].

It should be noted that at the beginning of the analysis period, almost all capital indicators of banks decreased significantly, which was due to the restructuring of the banking sector by the National Bank and the forced nationalization of CB "PrivatBank". In the future, all indicators gradually increased, but the constant excess of authorized capital over equity due to the uncovered losses in the capital structure of most Ukrainian banks is noteworthy, which, at the same time, is gradually declining.

Capital adequacy ratios are a kind of barometer of the financial strength margin as a prerequisite for the financial stability of the banks. In general, the amount of regulatory capital of the Ukrainian banks is gradually recovering after a considerable decrease in 2015-2016. The constant compliance by banks with the capital adequacy ratio N2, which at the beginning of 2020 almost doubled the minimum value (10%), is also a positive point. However, such a sizeable excess, in our opinion, is not, as a whole, a result of the strong capital base formation, but a consequence of the specific assets' structure of many banks, where government bonds account for a significant share. At the same time, as of July 1, 2020, in five of the fourteen systemically important banks of Ukraine, the excess of the N2 ratio was in the range of 3 pp. up to 5 pp. above the minimum value. In our opinion, this may not be enough to cover unexpected losses in terms of operational risk as well.

Thus, one of the priority areas for ensuring the financial stability of domestic banks is to overcome the problems of their capitalization in order to be able to withstand shocks that threaten the smooth realization of the banks' functions.

The level of non-performing loans (NPL), which characterizes the quality of loan portfolios, is one of the indicators that reflect the threat to the financial stability of both the individual bank and the banking sector as a whole. Statistics on non-performing loans is available from February 1, 2017 on the NBU website (Table 2).

Table 2

**Dynamics of the share of non-performing loans in the loan portfolio
of the Ukrainian banks, %**

Indicators	01.02.2017	01.01.2018	01.01.2019	01.01.2020	Absolute deviation	
					01.01.2020/ 01.01.2019	during the analysis period
Share of non-performing loans, total	53.99	54.54	52.85	48.36	-4.49	-5.63
including in banks:						
- with state share, among them:	77.23	71.12	67.92	63.52	-4.40	-13.71
CB «PrivatBank»	83.00	87.64	83.35	78.38	-4.97	-4.62
-with state share, except CB "PrivatBank"	29.37	55.75	54.96	49.33	-5.63	19.96
-of foreign bank groups	49.66	41.01	38.50	32.51	-5.99	-17.15
- with private capital	23.75	24.08	23.01	18.57	-4.44	-5.17
- insolvent banks	36.82	43.02	52.04	0.00	-52.04	-36.82

**Calculated according to the National Bank of Ukraine [17].*

The indicators in Table 2 show that the quality of assets of the Ukrainian banks is extremely unsatisfactory. In 2016-2017, a considerable increase in NPL was caused by: the new methodology for recognizing problem assets, taking into account international experience; recognizing a sizeable share of problem loans of CB "PrivatBank" after nationalization; objective deterioration of borrowers' creditworthiness due to declining real incomes; large amounts of insider lending. To strengthen the stability of banks, the National Bank insists on improving asset quality management by restructuring, selling or writing off non-performing loans [18]. As of January 1, 2020, the share of such loans decreased to less than 50% of assets for the first time since the beginning of the calculation and amounted to 48.36%, which is certainly a positive trend.

It should be noted that it is important for banks to form a sufficient reserves in case of non-repayment of credit debt to be able to "absorb" risks generated by active operations. In our opinion, the

security of loans (the ratio of provisions to total loans) is no less important than the level of their problem-causing (Figure 3).

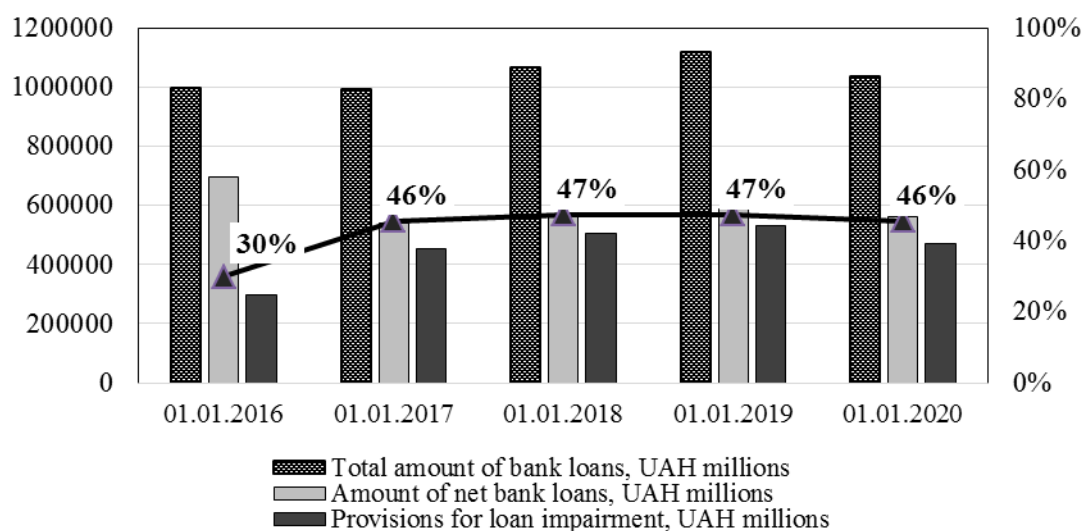


Fig. 3. Dynamics of the loans' quality of the Ukrainian banks

**Complied according to the National Bank of Ukraine [17].*

A considerable amount of provisions is directly related to the amount of non-performing loans of domestic banks. Over the last four years, loan protection has fluctuated between 46%-47%. It is important to emphasize that the concealment of non-performing loans and the insufficient level of provisions for loan impairment can crucially affect the stability of both a particular bank and the banking sector as a whole.

The National Bank of Ukraine, which implements macroprudential policy, supervises banks (in particular, compliance with mandatory ratios), performs their stress testing and contributes to the financial health of banks, especially systemically important ones, plays an important role in ensuring the financial stability. The main indicators of the financial stability of the Ukrainian banks, which are used to assess the effectiveness of their performance, are calculated by the NBU on the basis of the IMF methodology. The main areas of analysis are: capital adequacy, asset quality, profit and profitability, liquidity, sensitivity to market risk (Table 3).

Table 3

The main financial stability indicators of the Ukrainian banks in 2016-2020 (as of the end of the period)

Indicators	2016	2017	2018	2019	2020*
I1 – Regulatory capital to risk-weighted assets ratio	12.69	16.10	16.18	19.66	21.91
I2 – Tier 1 regulatory capital to risk-weighted assets ratio	8.96	12.12	10.52	13.50	16.05
I3 – Non-performing loans excluding reserves to capital ratio	89.37	70.18	60.20	25.28	23.14
I4 – Non-performing loans to total gross loans ratio	30.47	54.54	52.85	48.36	45.62
I5 – Loans by sectors of the economy to total gross loans ratio (residents)	95.92	94.21	93.47	92.83	93.28
I6 – Return on assets rate	-12.47	-1.76	1.60	4.70	3.42
I7 – Return on capital rate	-122.2	-15.34	14.61	37.55	26.24
I8 – Interest margin to gross income ratio	45.94	50.20	52.02	47.39	44.27
I9 – Non-interest expenses to gross income ratio	60.91	76.14	61.92	55.58	56.67
I10 – Liquid assets to total assets ratio	48.53	53.94	51.14	72.28	71.71
I11 – Liquid assets to short-term liabilities ratio	92.09	98.37	93.52	94.35	89.68
I12 – Net open position in foreign currencies to capital ratio	57.07	43.31	46.99	47.44	35.58

** Data for 9 months of 2020.*

***Complied according to the National Bank of Ukraine [20].*

The dynamics of indicators I1 – I4, given in Table 3, confirms the conclusions made earlier on the gradual improvement of capital stability of the Ukrainian banks and the quality of their loan portfolios. A slight decrease in indicator I5 means an increase in the share of loans to non-residents, which necessitates particular attention of banks to monitoring their creditworthiness.

Indicators I6 and I7 show that in 2018-2020, the banking sector as a whole began to generate profits, which creates the preconditions for strengthening their financial stability. Indicator I8, despite some fluctuations over a period of time, has a positive trend, as it confirms the growing diversification of the income base of the Ukrainian banks. The trend of indicator I9 is also positive and indicates implementing the austerity policies in banks, which reflected in the increase in their profitability.

During the period 2016-2020, liquidity indicators (I10 and I11) significantly exceeded the normative values, which indicates not only the ability of banks to pay their obligations on time, but also the significant untapped opportunities to invest in profitable assets, the lack of banks' desire to take additional risks. It should be noted that since September, 2019 the calculation of liquidity ratios N4 and N5 was cancelled in Ukraine. Instead, banking institutions should calculate the liquidity coverage ratio (LCR) on a daily basis, which more effectively reflects the level of banks' resilience to short-term liquidity shocks. As of October 1, 2020, the normative values of both LCR_{ac} (liquidity coverage ratio for all currencies) and LCR_{fc} (liquidity coverage ratio for foreign currencies) were met by all banks of Ukraine [17], which created the basis for ensuring their financial stability.

Summarizing, currently the banking sector is the most financially stable in its history, according to the NBU [20, p. 21], despite the impact of the pandemic and quarantine restrictions.

Conclusion. The study led to the conclusion that the internal balance is the basic determinant of the financial stability of the bank. Given the modern transformation of banking, the meaning of this concept is significantly enriched. Along with the established attributes of the bank's financial stability (equilibrium, proactive threat management, maintenance of continuity, efficiency and financial effectiveness), it is now necessary to focus on early adaptation of the banking institution to objective transformations of the economic environment through integration of risk-oriented approach and use of advanced methods of bank management in all its business processes.

The dynamic context is a defining feature of assessing the financial stability of banks, which is embodied in the definition of certain indicators and the study of their trends. This helps to identify existing or possible problems in banks that can lead to financial fragility.

Ukrainian banks have significantly increased their resilience to the crisis over the past five years. Thus, in the banking sector there is an increase in capitalization, a gradual decrease in non-performing loans in the loan portfolio, the implementation and compliance with new capital and liquidity ratios, which allows us to conclude that it improves its financial stability. Moreover, domestic banks are showing sufficient readiness for the crisis. Carrying out rapid diagnosis of financial stability of banks in the areas identified in the study allows identifying its deterioration in time, assessing the likelihood of a financial crisis and promptly taking appropriate measures to prevent critical consequences for the national economy.

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Фінансова стабільність банків та її моніторинг в Україні. Розвинуто поняття фінансової стабільності банків як комплексної та багатоаспектної категорії, зміст якої постійно збагачується. Розглянуто підходи до визначення фінансової стабільності в цілому й фінансової стабільності банків зокрема. Зазначено, що сучасні операційні, функціональні, інституційні, технологічні особливості діяльності банків не можуть не позначитися на змістовному наповненні їх фінансової стабільності та оновленні механізмів її забезпечення. Наголошено на необхідності завчасної адаптації банківських установ до об'єктивних трансформацій економічного середовища шляхом інтегрування ризик-орієнтованого підходу й використання передових методів управління банком у всіх його бізнес-процесах. Здійснено моніторинг рівня фінансової стабільності банків в Україні, для чого проаналізовано основні об'ємні показники їхньої діяльності та індикатор Bank Z-score, що розраховується Світовим банком. Аналіз показників проникнення банків в економіку засвідчив, що розвиток банківського сектора відстає від потреб реального сектора, тому їхня фінансова стабільність є відносною, хоча простежуються тенденції до її зміцнення. Особливо позитивним стає постійне нарощення капітальної бази українських банків і дотримання ними нормативів адекватності капіталу. Проте якість кредитних портфелів банків є незадовільною, що становить загрозу для їхньої фінансової стабільності, навіть із врахуванням великих обсягів сформованих резервів під

неповернення кредитів. Динаміка індикаторів фінансової стабільності, що розраховуються Національним банком України, підтвердила наявність передумов для її перспективного забезпечення, незважаючи на складні умови зовнішнього середовища. Запропоновані у статті напрями моніторингу фінансової стабільності дозволяють вчасно діагностувати її погіршення з метою недопущення критичних наслідків для національної економіки.

Ключові слова: банк, фінансова стабільність, рівновага, адаптація, моніторинг, достатність капіталу, якість кредитного портфеля.

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Yehorycheva Svitlana, D.Sc. (Economics), Professor. National University “Yuri Kondratyuk Poltava Polytechnic”. **Vovchenko Oksana**, Assistant. Higher Educational Establishment of Ukoopspilka “Poltava University of Economics and Trade”. **Financial Stability of Banks and Its Monitoring in Ukraine.** The concept of financial stability of banks as a complex and multifaceted category, the content of which is constantly enriched, has been developed. Approaches to determining the financial stability and financial stability of banks, in particular, are considered. It is noted that modern operational, functional, institutional, technological features of banks cannot but affect the content of their financial stability and update the mechanisms for its ensuring. Emphasis is placed on the need for early adaptation of banking institutions to objective transformations of the economic environment through the integration of risk-oriented approach and the use of advanced methods of bank management in all its business processes. The level of financial stability of banks in Ukraine is monitored, for which the main volume indicators of their activity and the Bank Z-score indicator calculated by the World Bank are analyzed. The analysis of indicators of banks' penetration into the economy shows that the development of the banking sector lags behind the needs of the real sector, so its financial stability is relative, although there are trends to strengthen it. The constant increase in the capital base of Ukrainian banks and their compliance with capital adequacy ratios is particularly positive. However, the quality of banks' loan portfolios is unsatisfactory, which poses a threat to their financial stability, even given the large amounts of formed provisions for loan impairment. The dynamics of financial stability indicators calculated by the National Bank of Ukraine confirms the existence of prerequisites for its long-term provision, despite the difficult environmental conditions. The directions of monitoring of financial stability offered in the article allow diagnosing its deterioration in time to prevent critical consequences for the national economy.

Key words: bank, financial stability, equilibrium, adaptation, monitoring, capital adequacy, loan portfolio quality.