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### **BANK LENDING TO BUSINESS ENTITIES: 2021-2024**

*The current situation in the country is characterized by a high degree of uncertainty, which prompts banks to invest resources not in the development of the real sector of the economy, but in risk-free and low-risk assets, which primarily include domestic government loan bonds (DGLB) and certificates of deposit (CD) of the NBU. This situation led to the fact that lending to corporate clients on market terms was not widely distributed and largely led to the implementation of the state credit program "5-7-9", according to which the state does not fulfill its obligations to banks in a timely manner to compensate the difference between market and preferential interest rates. The aim of the research is to develop a comprehensive approach to bank lending to business entities, which involves the implementation of radical measures to stimulate it on a market basis in a harmonious combination with state support. A set of methods of scientific knowledge were used: comparison, analysis and synthesis, grouping, abstraction, observation, etc. Ukrainian banks are currently weakly motivated or unable to provide business lending on a market basis. This is due to the presence of the state credit program "5-7-9", which provides a number of preferences to its participants. An inhibiting factor in the development of market lending to enterprises is also the attractiveness for banks of risk-free*

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### **БАНКІВСЬКЕ КРЕДИТУВАННЯ СУБ'ЄКТІВ ГОСПОДАРЮВАННЯ: 2021-2024**

*Поточна ситуація в країні характеризується високим ступенем невизначеності, що спонукає банки вкладати ресурси не в розвиток реального сектору економіки, а у безризикові та низькоризикові активи, до яких належать передусім облигації внутрішньої державної позики (ОВДП) та депозитні сертифікати (ДС) НБУ. Це призвело до того, що кредитування корпоративних клієнтів на ринкових умовах не отримало широкого розповсюдження та звелось здебільшого до реалізації державної кредитної програми "5-7-9", по якій держава не виконує своєчасно свої зобов'язання перед банками щодо компенсації різниці між ринковою та пільговою процентними ставками. Метою дослідження є формування комплексного підходу до банківського кредитування суб'єктів господарювання, що передбачає здійснення радикальних заходів щодо його стимулювання на ринкових засадах у гармонічному поєднанні з державною підтримкою. Використано сукупність методів наукового пізнання: порівняння, аналізу та синтезу, групування, абстрагування, спостереження тощо. Банки України нині слабо мотивовані або неспроможні здійснювати кредитування бізнесу на ринкових засадах через наявність державної кредитної програми "5-7-9", яка надає ряд преференцій її учасникам. Гальмуючим чинником розвитку ринкового*



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*investments in DGLB and CD NBU, for which interest rates are higher than for loans granted to corporate clients. In addition, the latter generate a high level of risks for banks during the war. A set of measures aimed at the development of business lending on a market basis is proposed, which include: the use of risk diversification tools by providing guarantees from the state and international financial organizations, in particular the EBRD, the EIB; the implementation of military risk insurance, as well as the transformation of the state credit program according to the outlined directions.*

*Keywords:* credit service, corporate clients, state credit program, NBU deposit certificates, domestic state loan bonds, credit development strategy.

*кредитування підприємств є також привабливістю для банків безризикових вкладень у ОВДП та ДС НБУ, за якими процентні ставки є вищими, ніж за кредитами, наданими корпоративним клієнтам. До того ж останні генерують для банків під час війни високий рівень ризиків. Запропоновано комплекс заходів, спрямованих на розвиток кредитування бізнесу на ринкових засадах, до яких віднесено: використання інструментів диверсифікації ризиків шляхом надання гарантій з боку держави та міжнародних фінансових організацій, зокрема ЄБРР, ЄІБ; страхування військових ризиків, а також трансформація державної кредитної програми за окресленими напрямками.*

*Ключові слова:* кредитне обслуговування, корпоративні клієнти, державна кредитна програма, депозитні сертифікати НБУ, облигації внутрішньої державної позики, стратегія з розвитку кредитування.

**JEL Classification:** E40, E44, G21.

### **Introduction**

The recovery of Ukraine's economy is only possible if, on the one hand, a favorable macroeconomic climate is created for the development of business activity of business entities, and, on the other hand, banks are encouraged to lend to them. The current situation in the country is characterized by a high degree of uncertainty, which encourages banks to invest in risk-free and low-risk assets, such as domestic government bonds (DGB) and NBU certificates of deposit (CD), rather than in the development of the real economy. In 2022-June 2024 alone, Ukrainian banks increased their investments in these assets by UAH 409 billion to more than UAH 1 trillion, which is 16% of last year's nominal GDP, according to the authors' calculations based on NBU statistics (NBU, n. d.). At the same time, the volume of lending to business entities is declining relative to GDP. To boost lending to the real economy, the Government implemented the 5-7-9 state loan program, which proved to be insufficiently effective, leaving both banks and their clients with little motivation to develop their businesses on a market basis.

The resumption of market-based lending to business entities seems to be possible through a set of measures at the level of the government, the central bank, and banks.

Lending to businesses by banks in times of war largely depends on the monetary policy of the central bank. In this regard, it is worth mentioning the article by Peterson et al. (2024), which discusses various instruments of the central bank's monetary policy, including changes in the discount rate, reserve requirements for banks on correspondent accounts, and liquidity ratios. At the same time, in times of war, the government can sell government securities and use such an unpopular and least appropriate option to increase the money supply as issuing money into circulation.

Betz & Pond (2023) emphasize that, despite the mobility of financial assets and restrictions on global markets, governments retain the freedom to regulate domestic markets for their own financial benefit.

The enormous need for funds in times of war exacerbates the problem of government credibility, and central banks increase its ability to borrow. In his paper, Poast (2015) examines the interaction between the central bank and the country's leadership over a long period of time. The author concludes that in the presence of interaction between the government and the central bank management, the cost of government borrowing can be reduced.

The work of Moosa (2019) notes that, in addition to direct lending to the government, banks make a profit during wartime through other channels: commissions by helping the government sell military bonds; financing military suppliers who sell goods and provide services to the military; financing economic recovery after the end of hostilities.

The analysis of the domestic scholars' works has shown that the issue of lending to business entities is mainly considered from the following perspectives: description of the loan granting process; disclosure of the methodology for assessing the creditworthiness of legal entities; management of the credit risk of an individual borrower or a loan portfolio, which are not directly related to the topic under study. Instead, only a few scholarly works are devoted to defining the peculiarities of lending to business entities during the war, the content of the state program of business lending "5-7-9" and the participation of banks in its implementation, generalizing approaches to the formation of the central bank's monetary policy in times of war and substantiating relevant recommendations for Ukraine (Danylyshyn, 2023; Khymych et al., 2023; Shpanel-Yukhta, 2022; Kornyluk A., & Kornyluk R., 2024).

The specifics and trends of lending to business entities operating in the difficult economic situation caused by the war are mainly disclosed in short journalistic reviews.

At present the issue of lending to Ukrainian enterprises in the context of war remains under-researched, which requires scientific approach to address it.

The aim of the research is to formulate a comprehensive approach to bank lending to business entities, which involves the implementation of radical measures to stimulate it on a market basis in harmony with state support.

The research puts forward the *first hypothesis* that banks prefer investing in NBU domestic government bonds and state securities to lending to the real economy. To substantiate this hypothesis, the NBU compared the volume of lending to corporate clients and the resources allocated by banks to purchase NBU domestic government bonds and government securities, and analyzed the ratio of interest income earned by banks from loans and investments in NBU domestic government bonds and government securities.

In order to intensify the business activity of banks in the credit market, the Government and the NBU have developed a Strategy for the development of lending, which necessitated the generation of the *second hypothesis* on the formation of a favorable macroeconomic "credit field" for the introduction

of an effective mechanism for lending to enterprises. It is proved that the government and the NBU are taking certain measures that would help to launch a credit lever for the development of the country's economy, in particular by implementing the State lending program "5-7-9". The study identifies the advantages and disadvantages of this program and formulates proposals for its transformation.

The article is based on the NBU's regulations, state statistics and the Regulator's data, and scientific articles by foreign and domestic scholars.

The article consists of three interrelated sections. The first of them analyzes current trends in lending by banks to corporate clients and factors that hinder its development; the second analyzes the SWOT analysis of the State Credit Program "5-7-9", reveals the purpose and principles of the Strategy for the Development of Lending approved by the Financial Stability Council; the third identifies the problems of lending to enterprises by Ukrainian banks, outlines possible ways to solve them, and suggests areas for improving the State Credit Program "5-7-9".

### 1. Current trends in bank lending to corporate clients and factors that hinder its development

The results of the analysis of the dynamics of net loans granted by Ukrainian banks to business entities between February 2022 and May 2024 show an undulating trend and a significant decrease in dollar terms (*Figure 1*). Since the beginning of 2024, bank loans to business entities in national currency have increased by 12% year-on-year, and by only 1% compared to February 2022. At the same time, net loans measured in US dollars decreased by 28% during the analyzed period, which is a clear illustration of the fact that the real sector of the country's economy did not receive sufficient credit support.

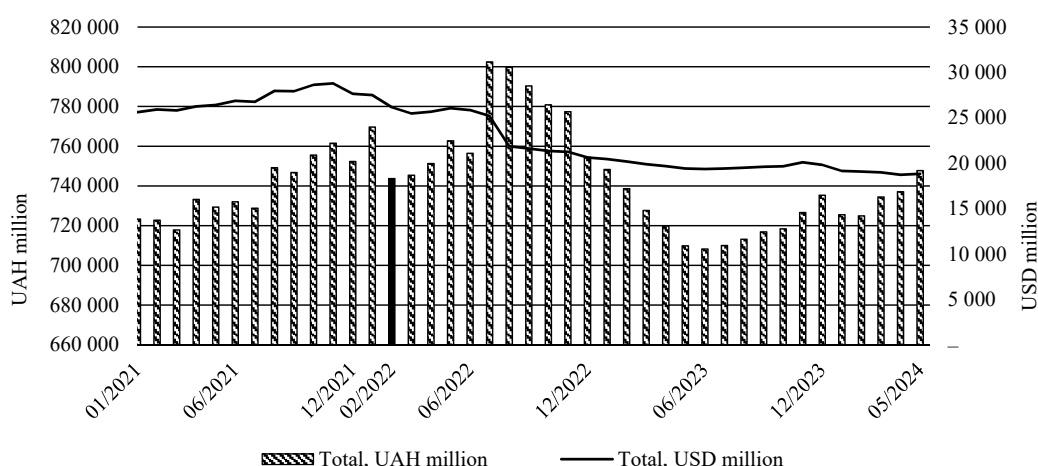


Figure 1. Dynamics of net business loans granted by Ukrainian banks in January 2021 – May 2024, UAH million and USD equivalent

Source: compiled by the authors based on financial sector statistics of the National Bank of Ukraine (NBU, n. d.).

The full-scale invasion of Ukraine has led to a significant reduction in the volume of loans relative to GDP. By the end of 2023, the share of loans to business entities amounted to only 11% of nominal GDP, while in 2017 it reached 28% (*Figure 2*).

The data in Figure 2 shows that the volume:

- of nominal GDP – by 2.2 times, which was largely influenced by inflation;
- of investments in the NBU's DS – by more than 8 times;
- domestic government bonds – by 1.8 times.

Accordingly, the share of investments in the NBU's CD in relation to GDP increased from 2% to 8%, while the share of investments in domestic government bonds remained roughly the same at 10–12% of GDP. At the same time, over the same period, the volume of net loans to business entities declined to 11%, and their ratio to nominal GDP fell by 2.6 times.

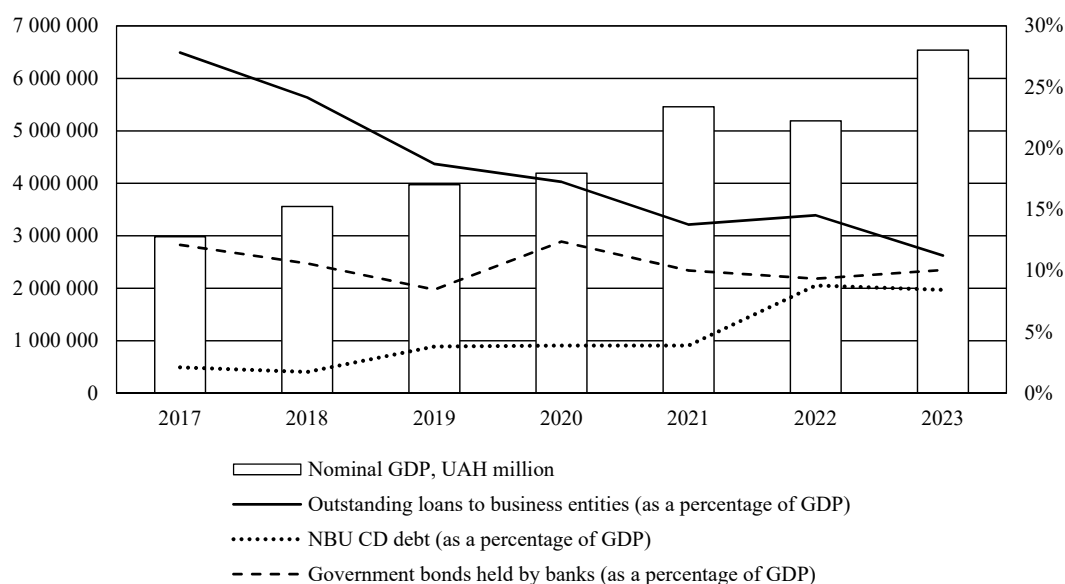


Figure 2. Nominal GDP, debt on NBU CD and loans to lending entities, and bank-owned domestic government bonds, % of GDP in 2017–2023

*Source:* compiled by the authors based on NBU data on financial sector statistics and State Statistics Service of Ukraine data on national accounts (NBU, n.d.; State Statistics Service of Ukraine, n. d.).

Numerous factors contribute to the low level of lending to the real economy.

*First*, the NBU stimulated banks' investments in domestic government bonds and NBU securities through various monetary levers (*Figure 3*). Starting from January 10, 2023, the NBU allowed banks to cover up to 50% of their total required reserves with domestic government bonds. According to the NBU, this step will facilitate more active participation of banks in the primary market for domestic government bonds, avoiding the need for emission financing of the budget deficit in 2023, and absorbing part of the banking system's free liquidity (NBU, 2023, January 6).

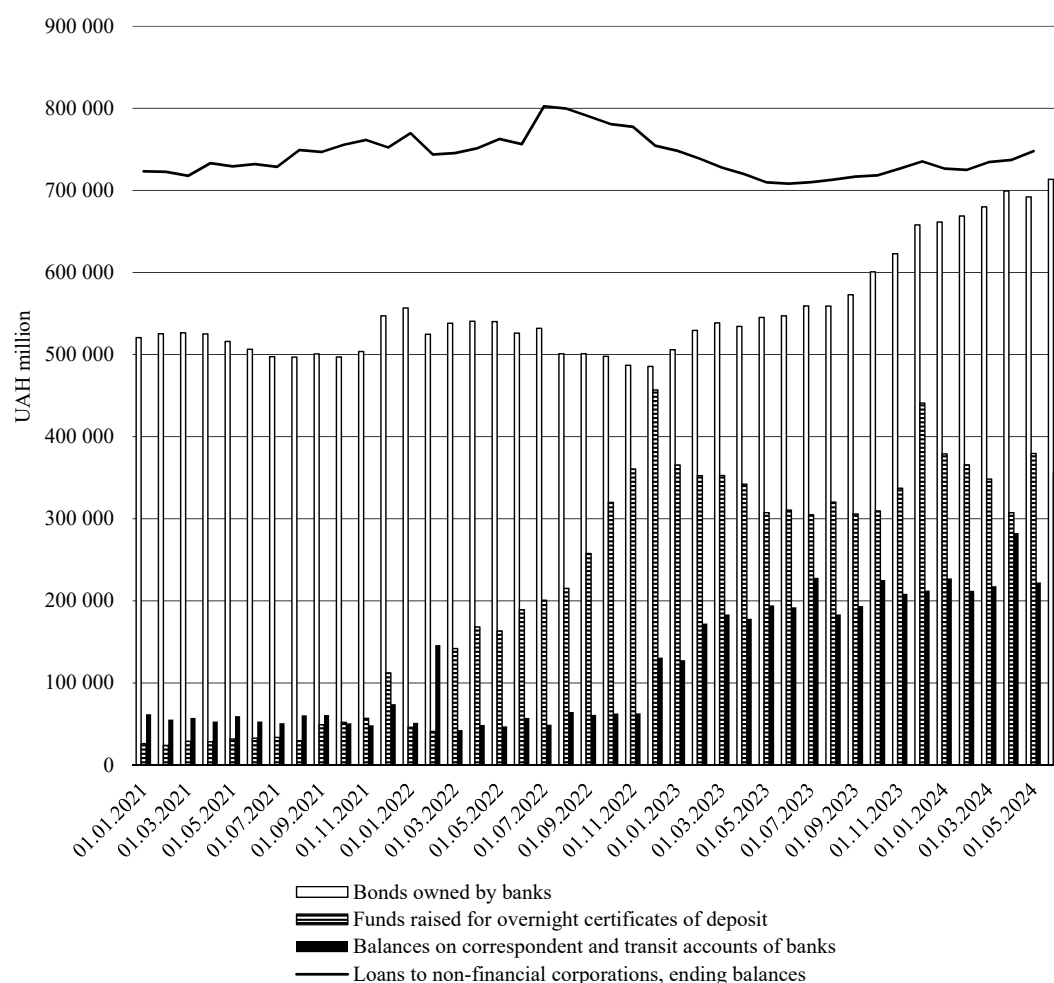


Figure 3. Comparison of lending to business entities by banks with their investments in NBU domestic government bonds and securities and balances on correspondent accounts during the period (January 2021 – May 2024, UAH million)  
*Source:* compiled by the authors based on NBU data on financial sector statistics (NBU, n. d.).

According to *Figure 3*, the amount of domestic government bonds held in banks’ portfolios has been steadily increasing since December 2022. Banks also allocated significant resources to purchasing NBU securities, which fluctuated over the period under review, due to the NBU’s liquidity regulation of the banking sector.

*Second*, this process was facilitated not only by monetary leverage but also by the high yields on these assets. It has been established that the yield on NBU CD reached its highest level from June 2022 to June 2023, with some months reaching 23–23.4% per annum, while the maximum yield on loans to business entities was only 15.8–16.2% per annum in July-December 2023 (NBU. Financial Sector Statistics, b. d.).

The significant difference between the yield on the NBU’s securities and the yield on loans to business entities has significantly affected the structure of banks’ interest income (*Table*).

While in 2021, Ukrainian banks received 34.3% of their interest income from lending to business entities, and 30.3% from financing domestic government bonds and NBU securities, in April 2024 this ratio was 22.8% and 52.5%, respectively, which confirms the thesis that they are not interested in lending to businesses, but primarily in investing their free funds in domestic government bonds and NBU securities, which is facilitated by the Government’s and the Regulator’s policies.

*Table*

Components of interest income of Ukrainian banks for 2021 – April 2024, %

Period	In total	Credits		DGLB	NBU certificates of deposit	Other interest income
		business entities	natural persons			
31.12.2021	100	34.3	33.3	24.2	6.1	2.1
31.03.2022	100	33.3	30	27.8	6.7	2.2
30.06.2022	100	28.7	25.7	23.8	18.8	3
30.09.2022	100	31.5	24.3	18.1	22.5	3.6
31.12.2022	100	27.9	15.6	17.2	34.4	4.9
31.03.2023	100	26.4	17.1	21.4	29.1	6
30.06.2023	100	23.9	15.4	21.4	32.5	6.8
30.09.2023	100	23.5	16.8	22.7	30.3	6.7
31.12.2023	100	23.8	17.2	25.4	27	6.6
31.03.2024	100	22.9	17.8	27.1	25.4	6.8
30.04.2024	100	22.8	18.4	27.2	24.6	7

*Source:* compiled by the authors based on the NBU Financial Stability Report for June 2024 (NBU, 2024, June).

*Third,* the increase in the NBU discount rate in June 2022 from 10 to 25% per annum was one of the reasons for the decrease in the volume of new loans by banks (*Figure 4*).

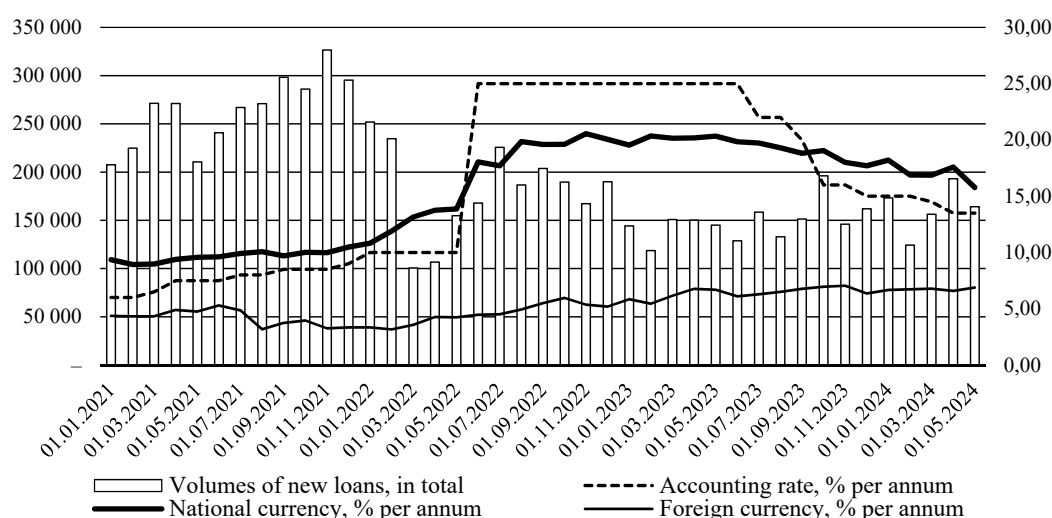


Figure 4. The NBU discount rate, lending rates, and the volume of new loans to business entities granted by Ukrainian banks in January 2021 – May 2024

*Source:* compiled by the authors based on NBU data on financial sector statistics (NBU, n. d.).

Starting in March 2023, banks gradually reduced interest rates on business loans without waiting for the official reduction of the discount rate by 3% in July 2023, which led to a decrease in the cost of new loans.

The emergence of new borrowers was an important factor in the revival of lending. In May 2024, about 35% of all bank debtors were companies that had not used loans at all a year ago. The new clients are mainly SME, 3/4 of which applied to financial institutions for soft loans under the program (NBU, n. d.).

The loan portfolio of medium-sized businesses, according to the authors' calculations based on NBU financial sector statistics, increased by UAH 50 billion or 25% from February 2022 to May 2024, while lending to large businesses decreased by 10% and to small and microbusinesses by 3%<sup>1</sup> (NBU, n. d.).

Despite the fact that the loan portfolio to business entities has only begun to grow in recent months, the yield on the banking system's investments in government bonds and NBU securities remains high, which hinders the further development of lending to businesses on market terms. In addition, a major threat to bank lending to business entities remains the decline in their creditworthiness due to problems with energy supply, disruption of logistics chains, and military attacks by the aggressor on Ukraine's critical infrastructure, which causes business disruption.

## **2. SWOT-analysis of the State Credit Program "5-7-9" and the strategy for credit development developed by the Government and the NBU**

The SWOT analysis of the State Loan Program "5-7-9" identified several important factors.

The advantage of the program after the start of the full-scale invasion in 2022 was the credit support for enterprises. Despite the deep economic crisis, lending was carried out thanks to the state program. Some banks have built up to 50% of their hryvnia loan portfolio with loans from the state program.

Along with its advantages, the implementation of the State Loan Program "5-7-9" has also revealed some disadvantages. In particular, the state program has increased competition between banks, which has led to a slight decrease in the standard of creditworthiness assessment of borrowing companies. Increased competition prompted banks to simplify the procedures for approving loans under this program, which led to an increase in NPL in servicing banks.

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<sup>1</sup> Under the Article 55 of the Economic Code of Ukraine, medium-sized enterprises include economic entities of any organizational and legal form and form of ownership, in which the average number of employees for the reporting period (calendar year) does not exceed 250 people and the annual income from any activity does not exceed the amount equivalent to EUR 50 million, determined at the average annual exchange rate of the National Bank of Ukraine.



A disadvantage of the state loan program is the significant debt of the state to banks to compensate interest rates. Periodic delays in financing the program have created uncertainty for banks and borrowers participating in it. Banks are in no hurry to lend under the program because of the state's existing debts to them. Borrowers are reluctant to enter into loan agreements with banks outside the program, hoping to take advantage of its preferential terms. As a result, the conclusion of new agreements and the prolongation of old ones have been suspended, and lending have slowed down (*Figure 5*).

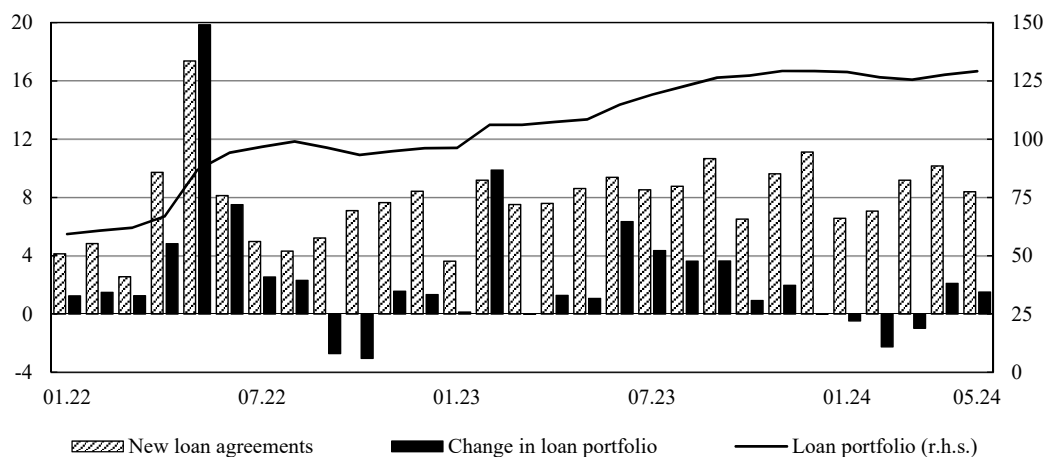


Figure 5. Loans under the program "Affordable Loans 5-7-9%", UAH billion  
*Source:* (NBU, 2024, June).

Starting in January 2024, the volume of lending under the 5-7-9 program has been gradually decreasing, both in terms of the limits of signed agreements and net loan growth, which is a result of delays in interest rate compensation by the government and, accordingly, a decrease in bank interest.

In 2022–2023, the government amended the program 16 times, mostly by raising credit limits and expanding the list of lending areas. Since then, a wide range of borrowers have been able to receive government support, regardless of their actual need for credit assistance. The loan portfolio has more than doubled since the beginning of the full-scale invasion and amounted to UAH 129 billion in early June 2024. The compensation budget of the program was not designed for such dynamics. The state's debt to banks amounted to UAH 5.8 billion at the beginning of June (NBU, n. d.).

In order to reduce the pressure on the budget in terms of rate compensation payments to banks, the government restricted working capital lending in April 2024, with limits for non-priority areas reduced from UAH 60 million to UAH 5 million. The NBU also reduced the banks' margin above the UIRD (Ukrainian Index of Retail Deposit Rates) by 3–5 percentage points. These changes will reduce the burden on the budget in the long run, but will not solve all the problems (Resolution of the Cabinet of Ministers of Ukraine No. 473 (2024, April 30)).

Due to the recent changes in the program's rules, bankers admit that the total amount of funding will be reduced by "5-7-9%" and are confident

that the Cabinet of Ministers will be able to save budget funds on compensation of interest rates and slightly reduce the state debt under the program. Although it does not mean that concessional lending will stop completely (Lysenko, 2024).

The preferential regime of lending to enterprises under the state loan program "5-7-9" poses threats to its further functioning. After all, low or zero compensation rates for loans under the program and the right to extend the principal amount of loans allow banks to mask the insolvency of a number of their clients for a long time. Under the terms of the program, the bank ceases to receive interest compensation if the client breaches the terms of the loan agreement. Therefore, banks are not interested in recognizing a loan as problematic as long as possible (Kornyliuk A., & Kornyliuk R., 2024).

The capabilities of the State Credit Program "5-7-9" are subject to change in light of the Lending Development Strategy approved by the Financial Stability Council on June 6, 2024, which aims to ensure effective lending to the economy, especially to critical sectors (NBU, 2024). These include energy, the military-industrial complex (or MIC), manufacturing, agriculture, and businesses in the de-occupied territories and those close to the front line.

The strategy stipulates that state subsidies for loans under the 5-7-9 program will remain available for businesses that implement investment projects that are critical to maintaining infrastructure or operate in high-risk areas. However, for businesses that do not fall into these categories, the amount of subsidized loans will be reduced.

The strategy is based on eight fundamental principles: win-win lending and its accessibility, reducing credit risks, improving the quality of the loan portfolio, environmental responsibility, developing infrastructure for SME, financial responsibility, innovations in financial services, and implementing modern solutions to facilitate access to financial services and improve customer service (NBU, 2024).

The approval of the Lending Development Strategy by the Financial Stability Council is a positive step. However, the list of measures outlined in this strategy looks more like a declaration of intent than a plan of practical measures to achieve the goal, as the financial mechanism for its implementation is not disclosed.

### **3. Problem identification of corporate lending by Ukrainian banks and possible ways to solve them**

The diagnosis of the corporate lending market by Ukrainian banks has revealed that there are currently no prerequisites for its active growth on a market basis without increasing the level of credit risk. This is due to the fact that the number of solvent companies is currently limited, and new ones are hardly being created. Some companies from cities and regions near the combat zone are relocating to the central and western regions of Ukraine, and, in our opinion, an increase in lending is only possible due to the growth of banks' risk

appetite, which may lead to an increase in the share of non-performing loans. Solvent demand in Ukraine has declined significantly, exports have become difficult due to logistical issues, and prices do not fully cover costs. In addition, borrowers in most sectors of the economy have a significant debt burden and are cautious and careful about borrowing from banks.

The value of collateral has declined and is not increasing much even with the hryvnia devaluation, and collateral coverage ratios for credit exposures are also declining, so new loans will be partly form-based. In order to avoid this situation, we believe it is necessary to use such risk-sharing instruments as government guarantees on a portfolio basis, risk-sharing programs from international financial organizations, including the EBRD, EIB, etc.

It seems important to insure military risks, especially for companies located in close proximity to the war zone or near the border with Russia and Belarus, as well as for companies that have a significant impact on the economy (energy, logistics, fuel complex, which are potential targets for enemy shelling).

It also seems appropriate to reorient from lending under the state loan program "5-7-9" to lending at market rates, which, although decreasing, are higher than the rates in the program.

Summarizing the above, it can be argued that banks are currently not ready to provide "long" financing without government participation, as they are not sure that the borrowing company will be able to repay the loan. After all, at any moment its production may be damaged or destroyed as a result of an enemy attack.

Neither Ukrainian banks nor international financial organizations will agree to lend to large investment projects with a 3-5-year horizon (whether in the defense industry, energy, or agriculture) unless there are clear guarantees of compensation for war damage and confidence in the ability to collect the debt from the borrower, and this process will not take years.

A number of radical measures have been developed to improve the State Loan Program "5-7-9", in particular:

- to conduct a comprehensive diagnosis of the asset quality and achieved socio-economic effects of the existing 5-7-9 loan portfolio (in particular, in terms of job creation, innovation, increased contribution to food and energy security, etc;)

- to focus state funds on credit support for SME that cannot obtain loans on market conditions from banks and to distinguish between large businesses and small/medium-sized businesses when groups of large companies consist of several small and medium-sized enterprises;

- to regularly assess the compliance of clients with the conditions of access to the program, including increased attention to the actual location of the business, avoiding schemes of fictitious re-registration in the high military risk zone, paying more attention to assessing the solvency of clients during prolongation (Kornyliuk A., & Kornyliuk R., 2024).

In our opinion, it is advisable to improve the state credit program "5-7-9" in the following areas:

- diversify lending by economic sectors to prevent "distortions" of program funding in favor of certain sectors (lending to the agricultural sector accounts for 50% of all loans in the program) and state-owned banks;
- support investment projects focused on energy independence and energy efficiency;
- develop and launch a war risk insurance mechanism, which will contribute to strengthening the role of investment lending in the structure of the state program and reducing borrowers' credit risks;
- consider the possibility of limiting the total portfolio of loans under the program, taking into account the budget allocated to it.

Thus, a set of measures for the formation of a market mechanism for providing bank loans to enterprises, together with their state support, will activate the participants of the credit market to expand the scale of business lending in the conditions of martial law, which is the key to the revival of the Ukrainian economy.

### Conclusions

Based on the results of the research, it was established that Ukrainian banks and their clients are currently weakly motivated in business lending on a market basis. Inhibiting factors for the development of market lending to enterprises are the attractiveness for banks of risk-free investments in DGLB and CD NBU, for which interest rates are higher than for loans granted to corporate clients; a limited number of solvent enterprises, a significant debt burden of borrowers in most sectors of the economy and a decrease in the value of mortgaged property, even taking into account the devaluation of the hryvnia; lack of military risk insurance, deficiencies in the State Credit Program "5-7-9", etc.

In order to form a comprehensive approach to bank lending to business entities, which involves the implementation of radical measures to stimulate it on a market basis in a harmonious combination with state support, we suggest to use risk distribution tools (state guarantees on a portfolio basis, guarantees of international financial organizations, in particular EBRD, EIB, etc.); to form an effective system of military risk insurance and a financial mechanism for its provision. At the same time, it is appropriate to transform the State credit program "5-7-9". The adoption of these measures during the war can provide an impetus both for expanding the participation of banks in financing enterprises, and for increasing the effectiveness of their state credit support, which will contribute to the relaxation of the domestic economy.

Future directions of research may be the development of a financial mechanism of the Strategy for the Development of Lending, which will

provide for a harmonious combination of various sources of credit support for enterprises at the expense of the state, international financial institutions and banks, as well as the introduction of effective tools of the central bank's monetary policy aimed at stimulating the activation of market lending to businesses in Ukraine.

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