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BasisBank Research

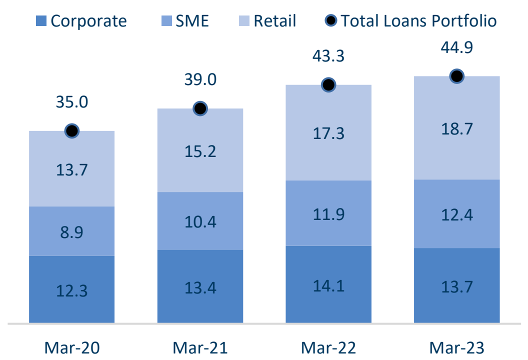
Banking Sector Review

March 2023

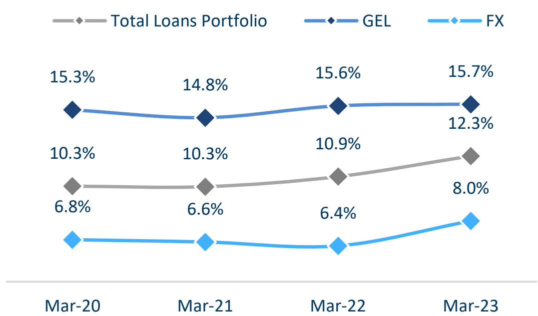
April

2023

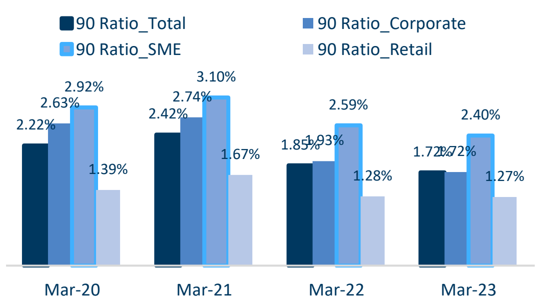
Loans Portfolio of the Banking System



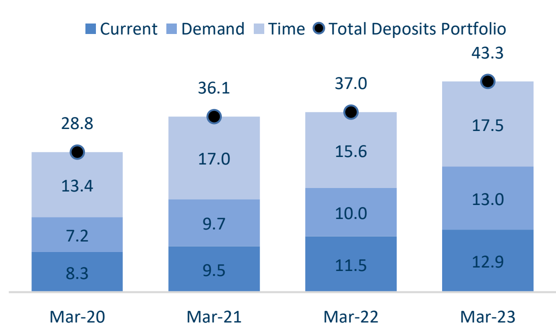
Weighted Average Interest Rate



90 and More Overdue Loans Ratio



Deposits Portfolio of the Banking System



Loans Portfolio

As of March 2023, the loans portfolio issued by the Georgian banking sector increased by 3.6% y/y (+13.3% excluding FX effect), to GEL 44.86 bln. The corporate loans portfolio decreased by 2.9% y/y (+10.7% excluding FX effect) to GEL 13.71 bln, the SME loans portfolio increased by 4.7% y/y (+15.17% excluding FX effect) to GEL 12.44 bln, while the retail loans portfolio increased by 8.1% y/y (+13.75% excluding FX effect) to GEL 18.54 bln. The retail loans portfolio increased by 8.1% y/y (+14.2% excluding FX effect) to GEL 18.72 bln. (Consumer loans increased by 12.5% y/y (+25.0% excluding FX effect), to GEL 9.77 bln. and mortgage loans increased by 3.6% y/y (+13.2% excluding FX effect), to GEL 8.94 bln.).

During 2023 the loans portfolio quality has been improved. More precisely, as of March 2023, the share of 90 and more overdue loans in the total loans portfolio decreased by 0.1 pp and amounted to 1.72%, in y/y terms. The share of 90 and more overdue loans decreased by 0.2 pp y/y to 1.72% for corporate loans. While, the share of SME loans amounted to 2.40% (-0.2 pp y/y), and the share of retail loans portfolio equaled 1.27% (-0.01 pp y/y).

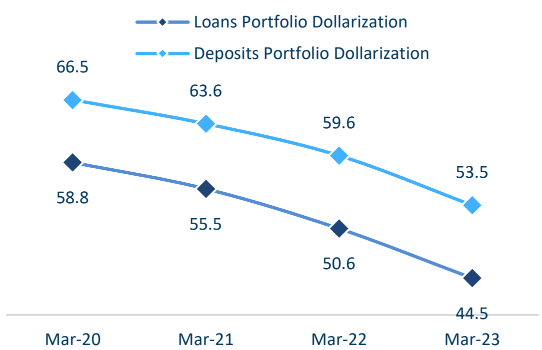
De-dollarization policy alongside the appreciation of national currency against the US dollar by 17.5% in y/y terms reduced the dollarization of the loans portfolio by 6.1 pp y/y and amounted to 44.5%. In the same period, the dollarization of corporate loans decreased by 4.20 pp y/y to 66.35%, the dollarization of SME loans decreased by 6.03 pp y/y to 47.24%, while the dollarization of retail loans decreased by 5.85 pp y/y to 26.77% (consumer loans -0.09 pp y/y to 11.85% and mortgage loans -10.15 pp y/y to 43.39%).

High inflationary expectations remain in Georgia because of uncertain geopolitical situation. Possible pressures from the labor market are worth noting among the upward risks affecting inflation. In particular, productivity growth has been lagging behind the wage growth in recent periods. This trend is reflected in the growth of prices of domestic goods and services. Although, inflationary risks are partly offset by the strengthening of the GEL exchange rate because of foreign exchange inflows. Furthermore, increased FED rates to 5.25% and central European bank rate up to 3.25% gives commercial banks incentives to raise the rate they charge for loans.

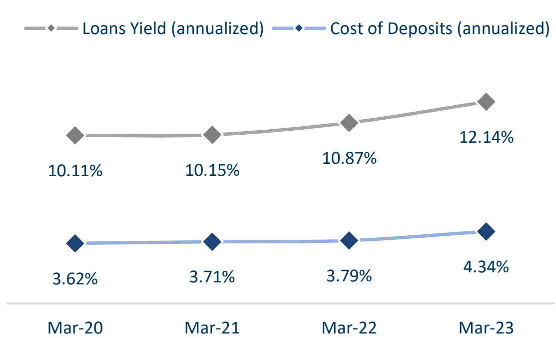
The loans portfolio pricing (wair) in the local currency increased by 0.11 pp, y/y to 15.69% in 2023. In the same period, GEL wair on the corporate loans portfolio increased by 0.38 pp y/y to 14.54%, the wair on the SME loans portfolio increased by 0.35 pp y/y to 14.98%, while the wair on the retail loans portfolio decreased by 0.22 pp y/y to 16.39%. The wair on the mortgage loans increased by 0.30 pp y/y to 12.75%, the wair on consumer loans decreased by 0.35 pp y/y to 18.12%.

The wair on the local currency loans in March 2023 increased for most sectors with respect to previous year. The wair on local currency loans in real estate industry increased by 0.85 pp y/y and amounted to 14.26%. The wair in production of consumer foods and goods sector increased by 0.61 pp y/y equaled 14.49%. The wair growth is observed in trade, energy and agro sectors (trade up by 0.49 pp y/y to 14.58%, energy increased by 0.34 pp y/y to 14.94%, agro sector wair growth is 0.21pp y/y to 15.85%.

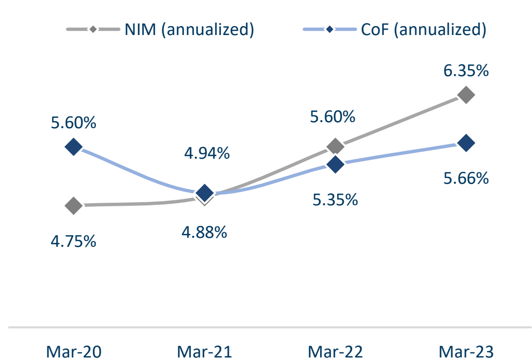
Portfolio Dollarization



Portfolio Yields



Net Interest Margin and CoF



The wair of loans portfolio in foreign currency increased by 1.64 pp y/y and amounted to 8.00% as of 2023. The wair on corporate loans increased by 2.49 pp, y/y to 9.54%, while the wair on SME loans increased by 1.25 pp, y/y to 7.31% and the wair on the retail loans increased by 0.55 pp y/y to 6.03%.

As for the wair on foreign currency loans, it is increased for all the sectors. The highest increase during the March 2023 is observed in energy sector by 2.75 pp y/y to 10.25%. As for the rest of the sectors, the wair on loans in foreign currency in trade, agro, restaurants and construction industries are increased as well (trade sector wair increased by 1.22 pp y/y to 7.35%, agro sector wair increased by 1.51 pp y/y to 8.55%, restaurants sector wair growth is 1.82 pp y/y to 7.84% and construction industry wair growth reached 2.39 pp y/y to 9.97%.

Deposits Portfolio

The total deposits portfolio of the banking sector increased by 17.01% y/y (+16.5% excluding FX effect) to GEL 43.33 bln. in March 2023.

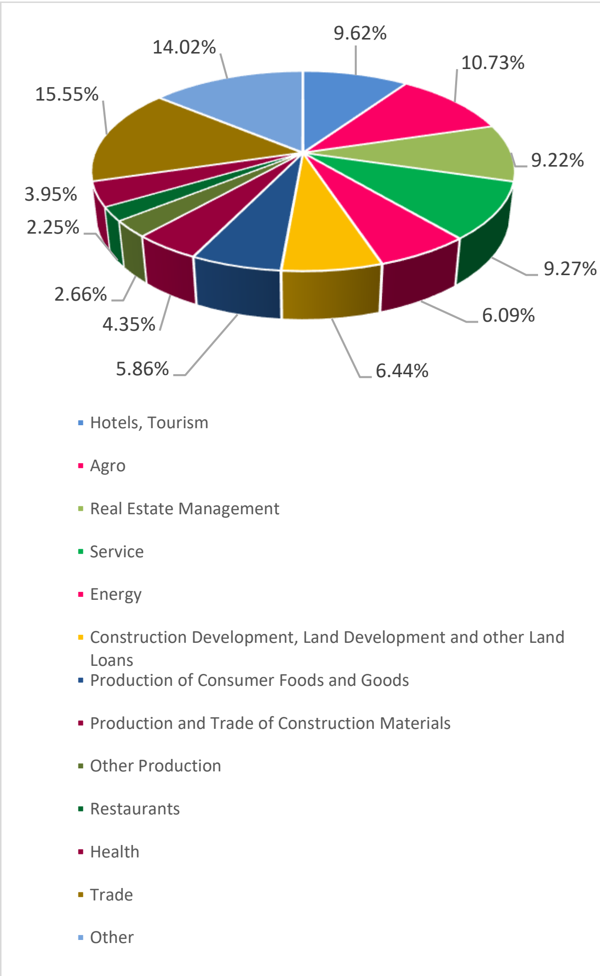
Retail deposits increased by 17.3% y/y (+4.3% excluding FX effect) to GEL 23.19 bln, while business deposits increased by 16.7% y/y (+28.8% excluding FX effect) to GEL 20.14 bln.

The dollarization of deposits portfolio decreased by 6.10 pp y/y to 53.53% in March 2023. While, excluding the pension agency funds deposits dollarization amounted to 55.7% (+0.1 pp y/y). The dollarization of retail deposits decreased by 3.45 pp y/y to 69.53%, while the dollarization of business deposits decreased by 9.24 pp y/y to 35.10%. Recent appreciation of national currency and increased interest rate differential between the lari and the US dollar funds improved return from deposits denominated in lari. Subsequently, it declined the dollarization rate on deposits side.

The wair on the local currency term deposits attracted in March 2023 amounted to 11.56% (+0.05 pp, m/m, +0.50 pp y/y). While, the wair on the foreign currency term deposits attracted in March 2023 amounted to 1.08% (-0.04 pp, m/m, +0.32 pp y/y). Despite the relatively low interest rates on foreign currency deposits, the level of dollarization, especially for deposits of individuals, remains at a high level. In order to encourage the de-dollarization of deposits, from July 2021, a new rule for determining the minimum reserve requirement for funds raised in foreign currency came into force. According to the mentioned rule, the norm of the minimum reserve requirement for each commercial bank was determined according to the dollarization of deposits. By reducing dollarization in loans, other factors remaining unchanged, banks will have the opportunity to increase leverage and lending.

The low rate on foreign currency deposits in Georgia and a high rate (from 5.00% to 5.50% depends on the maturity) on USA treasury bonds creates incentives to place deposits on foreign market, that increases the risk of capital outflow from the country.

Shares of Sectors in Total Loans as of March 2023



Interest Margins

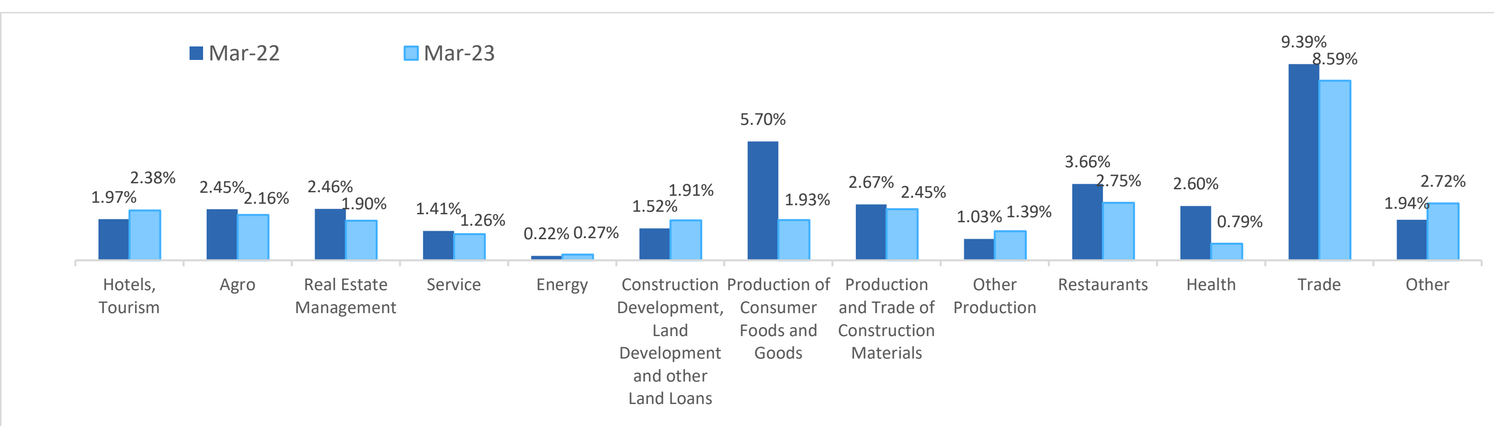
As of March 2023, the loan portfolio yield in annualized terms amounted to 12.14% up by 1.26 pp y/y. While the average cost of deposits amounted to 4.34% up by 0.55the pp y/y. Due to the presence of the tight monetary policy that is followed in the first quarter of 2023 coupled with the announced growth of FED reserve rate, the loans' yield and the cost of deposits in national and foreign currency have increased.

On aggregate, the average cost of funds of the banking system increased by 0.31 pp y/y and equaled to 5.66% as of March 2023. Despite the increase of cost of fund, the growth of loans portfolio yield still improved the value of interest margins. The net interest margin amounted to 6.35%, up by 0.75 pp in y/y terms. In the increased interest rates environment improvement of interest margins is further expected.

Profitability

As of March 2023, net interest income increased by 23.38% up to 0.83 bln. Total non-interest income increased by 15.01% in annual terms. The non-interest revenues were improved by the increased fee and commission revenues (+20.46% y/y) related to the stimulated economic activity and increase of FX operations (+42.54% y/y) related to increased export/import and currency conversion operations initiated by the migrated individuals. Net income amounted to 0.59 bln. GEL that is 42.18% higher than the 2021 level and 42.76% higher than the 2020 level.

90 and More Overdue Loans Portfolio Shares by Sectors



Regulatory Updates

Within the inflation targeting and de-dollarization policies framework, the national bank of Georgia implemented a number of macro prudential instruments throughout the year to mitigate inflationary expectations and support financial stability.

Due to the pandemic, the creditworthiness of households has deteriorated, which was reflected in increased share of 90 and more overdue loans (2.31% in 2020, 1.90% in 2021, respectively). As the economic conditions have been improved, the loans portfolio quality was enhanced as well. Although, within the positive tendencies and economic recovery, inflation growth is noteworthy that is negatively impacted on households' disposable income. Furthermore, household debt burden is also hampered by globally increased interest rates.

In order to improve borrowers' creditworthiness, the NBG implemented a number of policies. The NBG made a decision to reduce the maximum maturity of foreign currency mortgage loans from 15 to 10 years at the end of 2021. Decreased maturity in combination with tightened limits on PTI ratios enhanced households' creditworthiness and mitigated currency-induced credit risks through reduced portfolio dollarization.

During 2022, the financial stability committee kept the countercyclical capital buffer at 0%. Due to the uncertain geopolitical situation caused by the Russia-Ukraine War, economic growth could be at risk. Credit to GDP ratio for the Georgian banking sector was high compared to peer countries. If the credit to GDP ratio increases such that financial stability will be at risk, the NBG will likely increase the buffer to reduce credit activities and support financial sector stability. This will help the banking system to avoid the possible impairment of loans portfolio quality. The Financial Stability Committee decided to revise the framework for setting the countercyclical capital buffer based on the suggestion of the Basel Committee. Meaning that the buffer could be activated regardless of the economic cycle.

To support the larization policy the NBG prohibited commercial banks from charging customers a prepayment fee if the foreign currency loan is converted into GEL. The mentioned regulation can create a slight pressure on the exchange rate. However, considering the strength of lari supported by the migrant individuals the timing of this policy can be appropriate. It will mitigate upside pressure on the lari exchange rates and reduce the uncertainty for the businesses.

The Financial Stability Committee of the NBG decided to leave the countercyclical capital buffer unchanged, at its base rate (1%). Currently, credit activity remains at a sustainable level, banks maintain healthy capital and liquidity requirements, while asset quality has improved compared to the previous year. According to the Committee's assessment, if the existing tendency of credit activity continues, the growth of credit portfolio is expected to be in line with nominal economic growth in the current year. Therefore, currently, there is no need to change countercyclical capital buffer.

Financial Stability Committee made a decision to raise liquidity requirement for non-residents' foreign currency deposits. After Russia-Ukraine war, Russian residents' currency deposit placements in Georgia increased materially, which creates concentration risk and adversely affects liquidity position of the system. In addition, it should be noted, that previously banks directed these funds in liquid assets and from 2023 there is a noticeable trend of replacing high cost funding with the below-mentioned table about structure of foreign currency funding. Therefore, as inflows of above-mentioned funds may be temporary it is reasonable to place them in liquid assets. Financial stability Committee decided to raise liquidity requirement (outflow rate) up to 80% for foreign currency deposits of Russian residents. Outflow rate previously ranged between 30-40%. Above-mentioned change is effective from first of September 2023.

Structure of Foreign Currency Funding

	Dec-2021	Apr-2023
Borrowed Funds	24%	19%
Resident Deposits	57%	53%
Non-resident Deposits	15%	22%
Other Liabilities	4%	6%

The National Bank of Georgia sets the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) for systemically important commercial banks to further support financial stability. The recommendation to establish this requirement was given in 2021 with the joint Financial Sector Assessment Program of Georgia by the International Monetary Fund and the World Bank. The purpose of the MREL is to ex-ante create such a structure of balance sheets by commercial banks, which will contribute to the stability of the bank through recapitalization in a stressed situation.

Based on the decision of the government of Georgia, Banks and the financial sector are no longer moving to the Estonian model of corporate income tax. The profit tax for banks will increase to 20% from 15% and banks will pay profit tax according to international financial accounting reporting standards, which was not the case before. The regulation will be effective from 2023.

As a result of the above-mentioned macro prudential policies, the financial sector maintains stability and faces potential threats arising from the uncertain geopolitical situation in the region with solid capital buffers. The banking sector has enough resources to ensure that lending to the economy continues smoothly.

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