

BasisBank Research

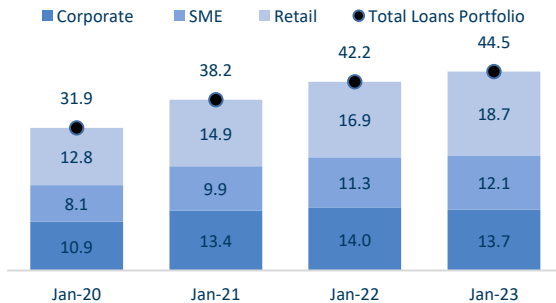
Banking Sector Review

January 2023

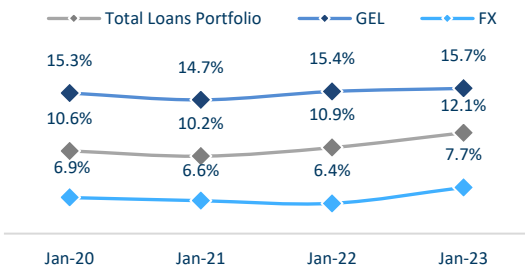
February

2022

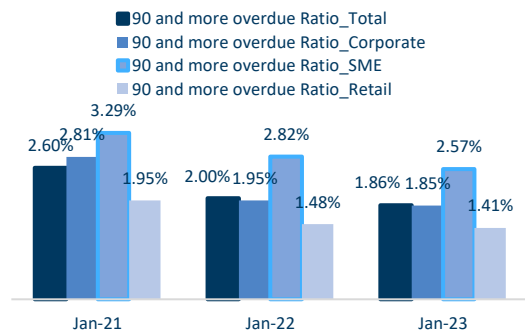
Loans Portfolio of the Banking System



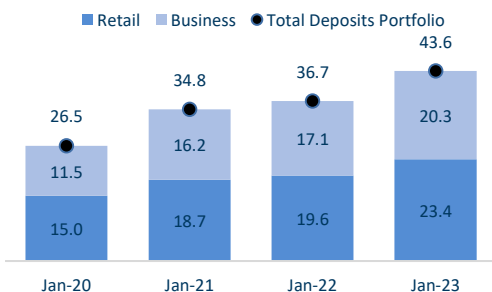
Weighted Average Interest Rate



90 and More Overdue Loans Ratio



Deposits Portfolio of the Banking System



Loans Portfolio

As of January 2023, the loans portfolio issued by the Georgian banking sector increased by 5.45% y/y (+12.8% excluding fx effect), to GEL 44.45 bln. The corporate loans portfolio decreased by 2.16% y/y (+7.84% excluding fx effect), to GEL 13.68 bln, the SME loans portfolio increased by 6.59% y/y (+14.67% excluding fx effect), to GEL 12.05 bln, while the retail loans portfolio increased by 11.00% y/y (+15.74% excluding fx effect) to GEL 18.72 bln. The annual growth of the retail portfolio was primarily related to the growth of consumer loans by 17.68% y/y (+20.33% excluding fx effect), to GEL 9.93 bln and increase of mortgage loans by 4.32% y/y (+3.94% excluding fx effect), to GEL 8.80 bln.

In January 2023, the share of 90 and more overdue loans in the total loans portfolio decreased by 0.14 pp and amounted to 1.86%, in y/y terms. The share of 90 and more overdue loans decreased by 0.10 pp y/y to 1.85% for corporate loans. While, the share of SME loans amounted to 2.57% (-0.25 pp y/y), and the share of retail loans portfolio equaled 1.41% (-0.07 pp y/y).

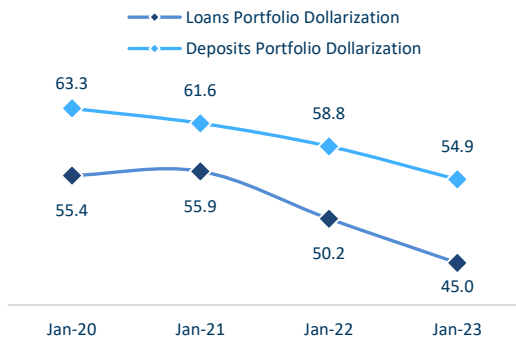
As for the shares on 90 and more overdue loans in total loans broken down by sectors, the share of 90 and more overdue loans in trade sector increased by 1.31 pp y/y to 10.48%, while the share of overdue loans in production of consumer foods and goods decreased by 4.13 pp in y/y and amounted to 1.75%. The shares of 90 and more overdue loans are decreased in construction, real estate and tourism sectors (construction down by 0.46 pp y/y to 3.23%, real estate sector down by 0.83 pp y/y to 1.84% and hotels and tourism sector decreased by 0.38 pp y/y to 2.46%, respectively). Increase is observed in production and trade of construction materials (+0.67 pp y/y to 2.74%) and health sectors (+0.54 pp y/y to 0.75%).

De-dollarization policy alongside the appreciation of national currency against the US dollar by 12.0% in y/y terms reduced the dollarization of the loans portfolio by 5.69 pp y/y and amounted to 44.9%. In the same period, the dollarization of corporate loans decreased by 3.29 pp y/y to 65.91%, the dollarization of SME loans decreased by 5.22 pp y/y to 48.36%, while the dollarization of retail loans decreased by 5.60 pp y/y to 27.29% (consumer loans -1.04 pp y/y to 10.34% and mortgage loans -8.10 pp y/y to 45.92%).

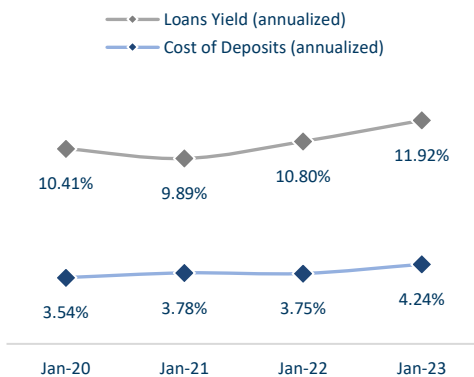
Annual inflation in Georgia has already passed the peak and follows a downward trend, mainly driven by the gradual neutralization of the external factors. Despite the positive tendencies, high inflationary expectations remain in Georgia because of current uncertain geological situation. Due to Russia-Ukraine war, migration flows into Georgia are increased that stimulated economic activity. Consequently, demand-driven inflationary risks have increased, although this is partly offset by the strengthening of the GEL exchange rate because of foreign exchange inflows. Furthermore, increased FED rates by 0.25 bps to 4.75 and announced future growth gives commercial banks incentives to raise the rate they charge for loans.

The loans portfolio pricing (wair) in the local currency increased by 0.25 pp y/y to 15.67% in January 2023. The increase of monetary policy rate since January 2022 by 0.5 pp up to 11% stimulate the wair growth for the GEL portfolio. In the same period, GEL wair on the corporate loans portfolio increased by 0.62 pp y/y to 14.47%, wair on the SME loans portfolio increased by 0.43 pp y/y to 14.89%, while wair on the retail loans portfolio decreased by 0.14 pp y/y to 16.40% (Mortgage +0.39 pp to 12.65% and consumer -0.23 pp to 18.23%).

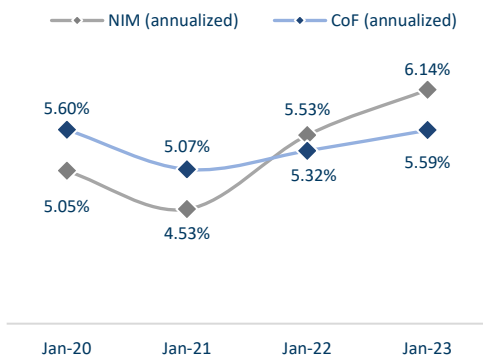
Portfolio Dollarization



Portfolio Yields



Net Interest Margin and CoF



The wair on the local currency loans in January 2023 increased for all sectors with respect to previous year. The wair on local currency loans in real estate industry increased by 1.13 pp y/y and amounted to 14.29%. The wair in production of consumer foods and goods sector increased by 0.95 pp y/y equaled 14.54%. The wair growth is observed in trade, restaurants and agro sectors (trade up by 0.75 pp y/y to 14.57%, restaurants increased by 0.18 pp y/y to 14.50%, agro sector wair growth is 0.42 pp y/y to 15.86%).

The wair of loans portfolio in foreign currency increased by 1.28 pp y/y and amounted to 7.71% as of January 2023. The wair on corporate loans increased by 2.00 pp y/y to 9.19%, the wair on SME loans increased by 1.05 pp y/y to 7.08% and the wair on retail loans increased by 0.32 pp y/y to 5.85% (Mortgage +0.39 pp y/y to 5.73% and consumer -0.30 pp y/y to 5.89%).

As for the wair on foreign currency loans, it is increased for all the sectors. The highest increase during the January of 2023 is observed in energy sector by 2.84 pp y/y to 10.06%. 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 0.89 pp y/y to 6.99%, agro sector wair increased by 1.24 pp y/y to 8.28%, restaurants sector wair growth is 1.64 pp y/y to 7.61% and construction industry wair growth reached 2.02 pp y/y to 9.69%).

Deposits Portfolio

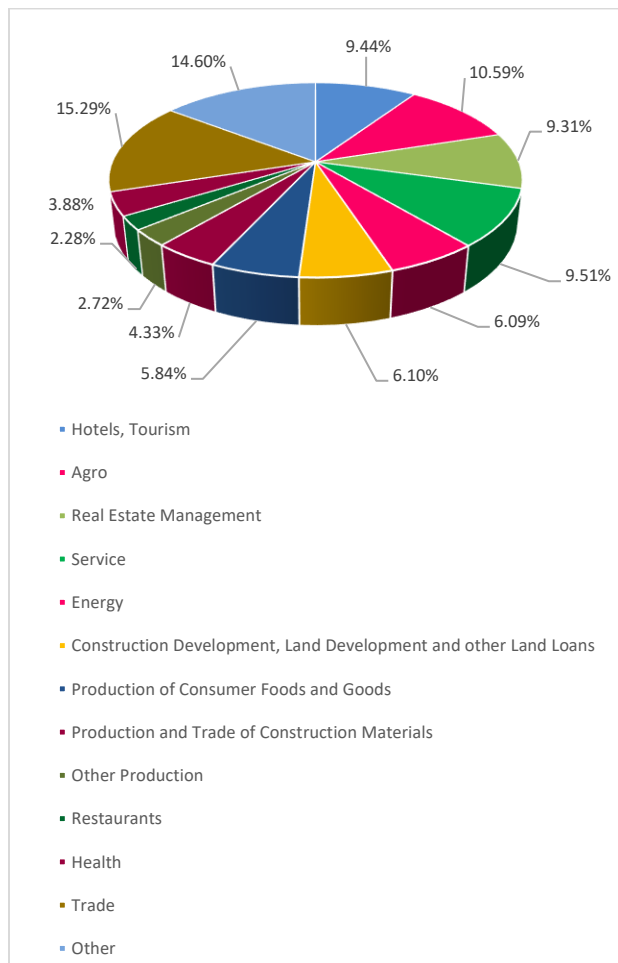
In January 2023, total deposits portfolio of the banking sector increased by 18.88% (+18.35% excluding fx effect), to GEL 43.64 bln.

Retail deposits portfolio increased by 19.20% (-0.03% excluding fx effect) to GEL 23.36 bln, while the business deposits portfolio increased by 18.51% (+20.40% excluding fx effect) to GEL 20.28 bln.

The dollarization of deposits portfolio decreased by 3.93 pp y/y to 54.9%. The dollarization of retail deposits decreased by 1.57 pp y/y to 71.77%, while the dollarization of business deposits decreased by 6.76 pp y/y to 35.46%. Recent appreciation of national currency 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 January 2023 amounted to 11.51% (-0.55 pp m/m, +0.67 pp y/y). While, the wair on the foreign currency term deposits attracted in January 2023 amounted to 1.07% (-0.14 pp m/m, +0.18 pp y/y). While replacing resources of induced funds from international financial institutions, resources in foreign currency becomes expensive for banks. As a response, the rates of deposits in foreign currency increased.

Shares of Sectors in Total Loans as of January 2023



Interest Margins

As of January 2023, the loan portfolio yield in annualized terms amounted to 11.92% up by 0.60 pp y/y. While the average cost of deposits amounted to 4.24% up by 0.38 pp y/y. Due to the presence of the tight monetary policy that is followed in 2023 coupled with the growth of FED reserve rate, the loans' yield and the cost of deposits in national and foreign currency have increased.

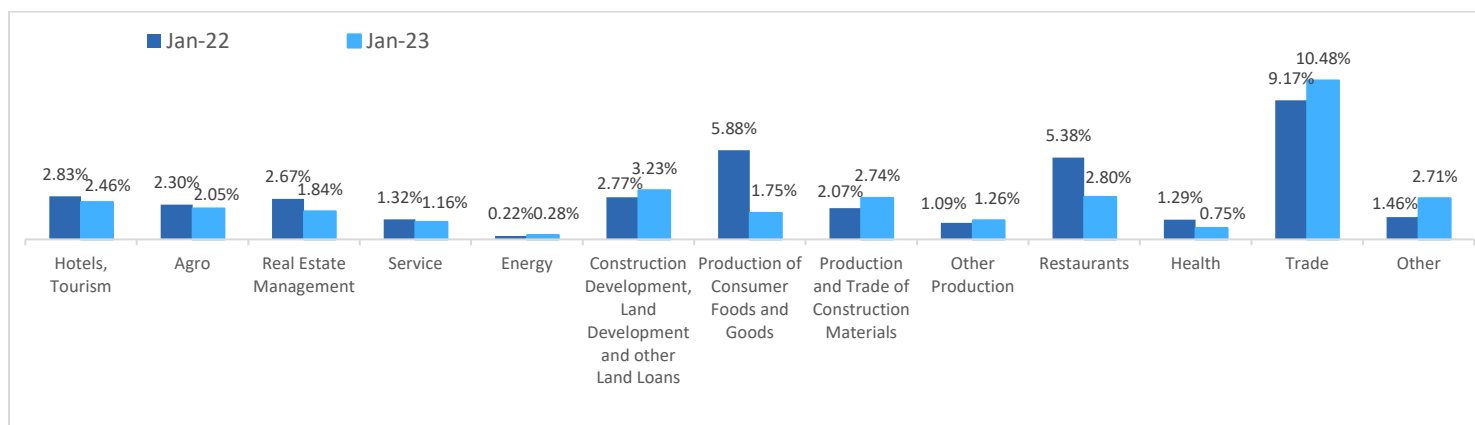
On aggregate, the average cost of funds of the banking system increased by 0.14 pp y/y and equaled to 5.59% as of January 2023. Despite the increase of cost of fund, the growth of loans portfolio yield still improved the value of interest margins. The net interest margin amounted to 6.14%, up by 0.37 pp in y/y terms. In the increased interest rates environment improvement of interest margins is further expected.

Profitability

The cost to income ratio decreased by 4.57 pp y/y to 37.96%. The Non-interest expenses increased by 25.03% y/y terms. The growth of total non-interest expenses in annual terms is primarily related to increased personnel expenses by 28.15% y/y.

The share of non-interest income in total revenues increased by 4.61 pp y/y to 30.8%.* Total non-interest income increased by 53.12% in annual terms. The non-interest revenues were improved by the increased fee and commission revenues (+25.53% y/y) related to the stimulated economic activity and increase of fx operations (+27.88% y/y) related to increased export/import and currency conversion operations initiated by the migrated individuals. Net operating income in January 2023 amounted to GEL 2.47 bln, which is 35.71% higher than the 2021 level and 68.48% higher than the 2020 level.

90 and More Overdue Loans Portfolio Shares by Sectors



* The non-interest income to revenues are free from discount effect of buying VTB portfolio by Basis Bank.

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.

Despite the tight monetary policy followed worldwide, the demand on consumer loans was still high during 2022. The Federal Reserve raised the target range for the fed funds rate 8 times in 2022 and rate was increased by 4.50 pp from 0.25% to 4.75%. The main aim is to maintain the price stability and slow down the inflation but is also boosted the cost of borrowing that gave commercial banks incentives to raise the rate they charge for loans. Thus, the increase slowed down the credit activity for the economy. Like FED, European banking system also increased rates during 2022 up to 2.50%. The growth of European banking system was moderate rather than FED considering the recession threats emerged from the ongoing war. It is expected that, central banks will follow the tight monetary policies throughout the 2023 until the inflation risks will be sufficiently mitigated.

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.

During the 2020-2022, the National Bank of Georgia developed the concept and changes for the transition to IFRS. The Regulation on Identifying Risk Categories of Financial Instruments and Expected Credit Losses was approved, and changes were made to the relevant decrees, to come into force on January 1, 2023. Commercial banks are expected to comply with supervisory regulations with IFRS-based numbers and approaches while transitioning to IFRS. Other things being equal, a neutral approach to the cost of regulatory capital should be maintained. The capital adequacy framework has been amended for this purpose. A credit risk adjustment (CRA) buffer and an updated procedure for its calculation were introduced. The aim of establishing a credit risk adjustment buffer is to reduce the credit risk caused by insufficient expected credit losses and to determine an adequate capital buffer.

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 macroprudential 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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