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## State and Trends in the Banking System Development in the Context of Structural Reform of the National Economy of Ukraine

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**Abstract.** The relevance of the study was conditioned by the fact that the fulfillment of the banking system potential can ensure positive structural changes in the Ukrainian economy. The purpose of the study was to analyse the state and trends in the development of the banking system of Ukraine in terms of its impact on the structural reform of the national economy. In the course of this study, statistical analysis methods were used (to analyse the state and dynamics of the country's banking system development) and an analogue method (to identify the degree of influence of the banking system development on structural changes in the economy). It was proved that the effective functioning of the banking system is the key to successful economic development of the national economy, namely its reform. It was demonstrated that a mechanism for redistributing financial resources and funds operates through the banking system, so they are mobilised and attracted to economic circulation in those sectors of the economy that need it most. The study summarised the state and trends in the banking system development as prerequisites for fulfilling its potential in the structural reform of the national economy. As a result of analysing the state and trends in the banking system development, both positive and negative features were identified. It was proved that in Ukraine, at the current stage of the national economy development, the banking system has been cleared of low-liquid and conditionally fictitious banking structures, the volume of assets, namely highly liquid ones, is growing, as well as the loan portfolio of banks is improving along with their financial results, liquidity, and solvency, resistance to currency shocks are increasing, and bank lending to the economy is reviving. It was demonstrated that the Ukrainian banking system is described by certain systemic shortcomings, primarily a high level of concentration of bank capital and deposits in the largest banks, as well as state-owned banks in a number of segments of the banking sector in terms of the number of structural divisions, ATMs, terminals, active payment cards. There is a tendency to weaken the penetration of the banking sector into the economy, especially in terms of affordable lending to individuals and strategic sectors of the economy. The practical value of the study lies in the fact that the identified shortcomings in the development of the banking system and its impact on structural reforms allowed determining the strategic areas for improving state regulation in this area

**Keywords:** economic development, performance indicators of banks, volume of financial resources, lending to the economy, systemic shortcomings



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## INTRODUCTION

The institutional elements of the banking system of Ukraine were developed and functioned as part of the financial system of the USSR, and in late 1991 – early 1992, Ukrainian commercial banks were re-registered, which, in fact, marked the beginning of the banking system development of the young state. At the present stage of development of independent Ukraine, the banking system has undergone numerous evolutionary changes, both qualitative and quantitative. It is natural that at each of these stages, the impact of the development of the banking system on the functioning and development of the national economy, its real sector, and the formation of changes in basic structural characteristics was different both in areas and nature. At first, it was to support business entities in the transition to a market-based management system by providing them with a set of banking services, capital placement and insurance, and business lending.

In accordance with the strengthening of the banking system, the supply of banking products and services, as well as its role in the national economy, has also evolved. The crises of 2008-2009 and 2014-2015 became pivotal for both banking and the Ukrainian economy. When both the financial and real sectors of the economy failed, which, among other things, confirmed the yet insufficient maturity, power, and development of the banking sector and its inability to perform functions relating to the stabilisation of the national economy, the development of its financial and economic stability, resistance to external and internal risks and threats, financial and economic shocks.

Thus, the National Bank of Ukraine introduced the policy of increasing transparency, activity of operations with derivatives, reducing the share of borrowed funds in the structure of bank capital and at the same time the introduction of a stimulating soft monetary policy of activation and dynamic development of lending by banks to enterprises and their innovation and investment projects, the development of microlending for small and medium-sized businesses as a necessary condition for structural reforms of sectors of the Ukrainian economy. These steps became critical for the development of the modern Ukrainian banking system.

In general, in recent years, more and more studies of Ukrainian researchers have appeared in the economic literature, using various standpoints to cover the issues of structural reform of the Ukrainian economy in general and the banking sector in particular. Thus, I. Ivashchuk and A. Ivashchuk noted the areas of transformation of the banking system in their research [1], ways to improve the efficiency and competitiveness of the banking sector

became the subject of research by Ya.I. Tchaikovsky [2], G.T. Karcheva [3], promising vectors of development of banking credit activity and its impact on the real sector of the economy were investigated by O.V. Gasi and V.I. Klimenko [4], O.S. Irshak and I.Ya. Leshchuk [5]. Relevant issues of the banking system functioning and ensuring banking security of the state in the context of the information economy development, its digitalisation and development of non-cash payment infrastructure, the cryptocurrency market and electronic credit platforms were covered in the studies by S.A. Kuznietsova, T.M. Bolhar, Z.S. Pestovskaya [6], V.V. Glushchenko, D.M. Soloviov [7], M.I. Zveriyakov, L.V. Zherdetska [8], A.I. Hulei [9], D.M. Hladkykh [10], V.A. Kornovska [11], O.I. Tkachenko [12], M.M. Bil, O.P. Mulska [13], T.H. Vasyltsiv, V.V. Boyko, S.S. Hrynkevych [14-15]. In general, these studies justified the role and place of the banking system of Ukraine in the implementation of national economic interests at a high scientific level, but the issue of evaluating the potential of the banking sector in the context of systemic reform of the Ukrainian economy remains understudied.

*The purpose of this study* was to generalise the state and trends in the development of the modern banking system of Ukraine as prerequisites for fulfilling its potential in the structural reform of the national economy.

## MATERIALS AND METHODS

The theoretical and methodological framework of this study included fundamental and applied studies of Ukrainian researchers concerning the investigation of the state and trends in the development of the banking system of Ukraine, considering its elements, functions, and potential in ensuring economic growth. A set of general scientific and special methods and techniques was used to solve the analytical problems of this study, namely:

1) analysis, synthesis, comparison, structural analysis – upon identifying the main trends of generalising indicators of the banking system development in Ukraine regarding the quantitative and structural composition of the banking system; the network of banks, financial organisations and their institutions; internal, attracted funds of banks; participation of foreign capital in the bank's activities; financial results (income, expenses, and profit of banks; balance of credit resources and their use, etc.;

2) graphical and tabular – for compelling representation of the study results, evaluation and analysis of processes in the banking system of Ukraine;

3) generalisation and abstraction – upon forming conclusions about the positive and negative aspects of the current state of the banking system development and determining its possible impact on the structural reform of the economy.

The information basis of the study included statistical data of the National Bank of Ukraine, monographic and fundamental studies of Ukrainian researchers, as well as analytical calculations performed during the study.

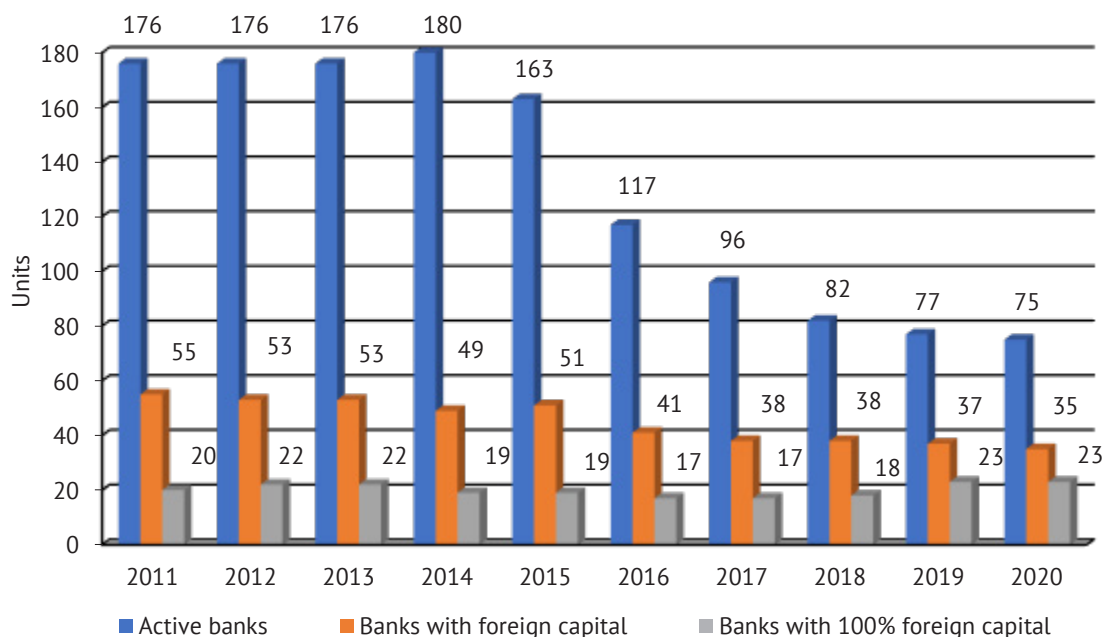
In this study, the authors developed an original methodology for analysing the impact of the functioning and development of certain segments of the national economy on stimulating structural changes and reforms. In particular, the authors' methodology makes provision for the implementation of economic and analytical calculations, as a result of which, using the method of strategic management, a matrix is built, the left part of which is built in accordance with the method of SWOT analysis, but is based on positive and negative aspects of, on the one hand, the state of development, and, on

the other hand, the trends in the country's banking system development. The right-hand part of the matrix projects the results obtained on the conclusions in the context of their impact on the structural reform of the national economy of the country. It is this approach that allows justifying the most accurate and balanced management decisions in the context of not only stimulating the growth and improving the efficiency of the banking system, but also the most complete use of the potential of these processes for structural reform of the country's national economy.

## RESULTS AND DISCUSSION

### *Dynamics of institutional and organisational elements of the banking system of Ukraine*

Researchers monitoring and analysing the state and trends in the development of the banking system of Ukraine tend to identify several stages in the evolution of the banking system of Ukraine (Fig. 1).



**Figure 1.** Number of operating banks in Ukraine as of January 1, 2011–2020

*Source:* compiled by the authors based on [16]

At first glance, a decrease in the total number of banks from 180 units as of January 1, 2014 up to 75 units as of January 1, 2020 appears to have weakened the potential of the banking system of Ukraine. Since the positive consequences of the so-called “great cleansing” are to strengthen the confidence of depositors in the preservation of their funds, the direction of financial resources by banks to lend to the real sector of the economy, in particular in the segment of small and medium-sized businesses, the growth of the volume of available credit resources, the localisation of capital

in the internal market as opposed to its withdrawal abroad, increasing the level of stability of banks to financial and macroeconomic shocks, the growth of the overall effectiveness of monetary policy, which is implemented by the National Bank of Ukraine.

In 2020, there were 75 operating banks in Ukraine, including 35 banks with foreign capital, of which 23 units with one hundred percent foreign capital. If during 2011–2020 the total number of banks in Ukraine decreased by 2.3 times, the number of banks with foreign capital decreased by 36.4%, and with one hundred

percent foreign capital increased by 15.0%. Notably, between 2016 and 2020, the number and the share of banks with one hundred percent foreign capital in Ukraine increased (by 6 units and 35.3%, respectively). This, against the background of a certain stabilisation of the number of operating Ukrainian banks, is evidence of increased sustainability, as well as an increase in the transparency of capital and the banking system, which closely correlates with the further development of the potential of the country's banking sector.

This is also confirmed by decline in the rate of reduction in the number of solvent banks. For example, if in 2014 there were 16 insolvent banks in the country (10.9% of their total number), and in 2015-2014 the number of solvent banks decreased by 30 units or by 20.4%, then in 2020-2019 is decreased only by 1 unit. The number of state-owned banks – 5 units – has remained unchanged over the past four years, and their share in the total number of banking structures in 2014-2020 increased by 2%. At the same time, state-owned banks remain one of the largest on the market and, accordingly, have a fairly significant influence on the activities of enterprises and economic processes that take place in the country, in its production complex, and in the internal consumer market.

In 2014-2020, the structural ratios relative to the number of foreign and private banks changed to a certain extent. Thus, the share of foreign banks in 2014-2020 increased by 10.02%, while the share of private banks decreased by 12.01%. This indicates a higher sustainability and stability of foreign banks' activities against the background of relatively weak viability of Ukrainian private banks. Consequently, the growth in the number and share of more financially capable banking structures, on the one hand, can be considered a positive trend. However, on the other hand, an increase in the share of foreign capital in the banking system can threaten banking security, undermining the foundations of the country's financial and economic security.

In this regard, special attention and status are given to monitoring the level and structure of foreign capital in the country's banking system to ensure timely monitoring of the negative trends and processes associated with the dependence of the banking system on large non-resident banks, possible withdrawal of capital abroad, and monopolisation of certain segments of banking services.

The negative aspect of forming the potential of the banking sector in terms of structural reform of the national economy can be attributed to the reduction in the number of structural divisions of banks, which was typical for Ukraine during 2013-2020 and led to a

deterioration in banking coverage of the country, its territories, population, and business entities. In addition, the rate of decline in the number of structural divisions of banks has become almost commensurate with the rate of decline in the total number of banks in the country, which is evidence of a deterioration in the institutional and economic capabilities of banks, because with a decrease in their total number, the number of structural divisions should grow and in place of banking structures that went bankrupt or left the market for other reasons, branches of existing solvent banks should "come", but this did not happen. Thus, stagnant trends in the deformation of the network of banking structures at the present stage of the country's development still take place and this objectively worsens the ability of the system to properly serve both the population and businesses in terms of capital allocation and obtaining proper credit resources.

Thus, if in 2013 there were 19.3 thousand units in Ukraine, by 2020, this indicator decreased to the level of 7.3 thousand units, which was 2.6 times less [16]. In 2019-2020 alone, the number of structural divisions of banks decreased by about 700 units (by 8.7%). Notably, the reduction in the number of structural divisions of banks has become typical for both state-owned banks, and PJSC CB PrivatBank, foreign, and private banks. However, this is mainly due to a particularly active reduction in the number of structural divisions directly in the segment of private banks. In particular, in 2013-2020, the indicator here decreased by 8.0 thousand units, and in relative terms – 5.4 times, which is substantial. Consequently, the share of structural divisions of private banks, which in 2013 exceeded 50.0%, by 2020 decreased to 24.7% (the reduction was 26.1%). This, on the one hand, is a consequence of the "cleansing" processes in the Ukrainian banking system, but at the same time indicates a deterioration in the capabilities of the private bank segment to provide full system service for the national economy.

Another notable aspect is the presence of an extensive network of structural divisions of state-owned banks, which, together with a considerable share of structural divisions of PJSC CB PrivatBank, indicates a certain hidden monopolisation of the network of banking structures. After all, 5 state-owned banks (6.8% of the total number) as of 2020 accounted for 56.2% of the total number of structural divisions of banks [16].

Unfortunately, the tendency to reduce the number of structural divisions of banks has become inherent in all regions of Ukraine without exception, which has further complicated the issue of fulfilling the potential of the banking system in structural reform of the economy

at the regional and subregional levels. In particular, the highest rates of decline in 2016-2020 were typical for such regions of the country as Zakarpatska Oblast (35.7%), Kyivska Oblast (36.6%), and Cherkaska Oblast (34.2%) [16]. The functioning of structural divisions of banks in Donetsk, Zhytomyrska, Luhanska Oblasts and the city of Kyiv remained more stable. In these regions, the rate of decline did not exceed 20%. According to the largest number of structural divisions of banks per 100 thousand people, the authors can distinguish the cities of Kyiv, Odeska, Poltavska, Dnipropetrovska, Zaporizka, and Kharkivska Oblasts.

The presence of trends towards a certain monopolisation of the Ukrainian banking sector is also confirmed by data on the development of banking infrastructure, namely the number of ATMs and payment terminals. Thus, in 2013-2020, there was a clear tendency to increase the number of ATMs and terminals of state-owned banks (by 2.3 times) and the number of terminals of PJSC CB PrivatBank (by 70.9% in 2020-2016) [16].

As a result of these trends, as of 2020, a situation was formed when the share of PJSC CB PrivatBank in the total ATM network was 56.6%, and of state-owned banks – 21.8%; the corresponding indicators in the total network of terminals were 58.3% and 19.5% [16]. At the same time, the total share of foreign and private banks in the ATM system in 2020 dropped to 21.6%, and payment terminals – to 20.9%. On the other hand, the position of the private banking sector in the segment of active payment cards has also strengthened. Although the share of private banks in terms of the number of active payment cards issued in Ukraine in 2020 was only 13.0%, for 2016-2020 the indicator increased 2.4 times

(from 2.1 million units to 5.0 million units) [16]. Therewith, the share of private banks increased by 6.5%.

The position of state-owned banks remains stable in this segment of banking services. Thus, despite the fact that the share of this group of banks in terms of the number of active payment cards in 2016-2020 slightly decreased (by 3.1%), the number of active payment cards did not change and amounted to 6.5 million units. The authors also noted the growth of the positions of PJSC CB PrivatBank against the background of their weakening in the group of foreign banks. Thus, in 2020, the share of PJSC CB PrivatBank in the total number of active payment cards increased to 57.3%, while the share of foreign banks decreased (by 6.4%); the number of active payment cards issued by foreign banks decreased from 6.2 million units up to 4.9 million units (the reduction was 21.0%). It can be summarised that, on the one hand, the high quality of payment card service, as well as the innovation of consumer banking services in the system of PJSC CB PrivatBank, contributes to improving the level of quality of public service. However, monopolisation of any sphere in the short or long term leads to negative consequences and does not contribute to competition as one of the important and integral features of the structural reform of the national economy of the country and its financial system.

#### **Volumes, structure, and sources of formation of bank assets in Ukraine**

The possibilities of the banking sector in terms of raising capital, as well as lending to the national economy, are largely evidenced by trends in changes in the volume and structure of assets and liabilities of banks (Table 1).

**Table 1.** Assets of commercial banks of Ukraine as of January 1, 2011-2020

Indicators	Years							Growth rate, % / Absolute deviations (+/-)	
	2011	2013	2015	2017	2018	2019	2020*	2020/2011	2020/2019
Assets, billion UAH	942.1	1,127.2	1,316.7	1,256.3	1,336.4	1,360.8	1,494.5	158.6	109.8
Loans granted, billion UAH	755.0	815.3	1,006.4	1,005.9	1,042.8	1,118.6	1,033.5	136.9	92.4
Share of loans in assets, %	80.1	72.3	76.4	80.1	78.0	82.2	69.2	-10.9	-13.1
Loans granted to business entities, billion UAH	508.3	609.2	802.6	847.1	870.3	919.1	822.0	161.7	89.4
Share of loans granted to business entities, %	67.3	74.7	79.8	84.2	83.5	82.2	79.5	+12.2	-2.6
Loans granted to individuals, billion UAH	186.5	161.8	179.0	157.4	170.9	196.6	206.8	110.9	105.2

Table 1, Continued

Indicators	Years							Growth rate, % / Absolute deviations (+/-)	
	2011	2013	2015	2017	2018	2019	2020*	2020/ 2011	2020/ 2019
Share of loans granted to persons, %	24.7	19.9	17.8	15.7	16.4	17.6	20.5	-4.7	+2.4
Share of overdue loans in the total amount of loans, %	9.6	7.7	21.2	23.7	54.5	52.9	48.4	+38.8	-4.5
Reserves for active bank operations	148.8	141.3	204.9	484.3	516.9	555.9	492.1	3.3	88.5
Share of reserves in assets, %	15.79	12.54	15.56	38.55	38.68	40.85	32.93	+17.1	-7.9
Share of reserves in loans, %	19.71	17.33	20.36	48.15	49.57	49.70	47.61	+27.9	-2.1

**Note:** \* – data as of September 2020

**Source:** compiled by the authors according to the data from [17-18]

In particular, the growth of assets objectively expands the ability of banks to lend to business entities and the population. In this regard, it is positive that in all years of the 2011-2020 period (except 2015), an increase in the volume of banks' assets was considerable. In 2011-2020, the indicator increased by more than UAH 0.5 trillion, or by 58.6%. Notably, the growth of bank assets in 2016-2020 is mainly typical for private banks (by 52.8%) and PJSC CB PrivatBank (by 52.3%). The volume of assets of state-owned banks also increased (by 25.1%). While the total amount of assets of foreign banks for the analysed period of time remained virtually unchanged (UAH 612 billion against UAH 604 billion).

If the situation with PJSC CB PrivatBank concerned its artificial recapitalisation, then the increase in total assets of private banks can be considered as a positive phenomenon, which will help expand their capabilities in terms of increasing the volume of activities and increasing the level of its financial and economic and commercial efficiency. The increase in net assets in this segment of the banking system (in 2017-2020) ensured the preservation of the corresponding share of net assets of private banks. Thus, at first, after the nationalisation of PJSC CB PrivatBank, the share of net assets of private banks in 2016 decreased to 29.7%, but as of 2020 it increased to 35.9%.

The structure of net assets of the banking sector of Ukraine by components is also described by certain disadvantages. In 2016-2020, the weight of such a source of net asset formation as internal governmental bonds (hereinafter referred to as "the IGB") considerably increased – from 19.3% in 2016 to 29.0% in 2020. This has its advantages and disadvantages. As for the shortcomings from the standpoint of the state's macroeconomic policy, these are one hundred percent guarantee obligations of the state to repay them, and, consequently, the need to divert an extensive financial resource to these

purposes, in particular to cover financial risks, high maintenance costs (as compared with other sources of formation of net assets of banks), the lack of receipt of personal income tax to the budget, etc. Given the above, the tendency to reduce the share of loans of business entities in the structure of net assets of banks can be evaluated negatively. The indicator in 2016 was 38.0% and by 2020 it decreased to the level of 25.3%.

The positive trend is the growth of the share of funds of the NBU and other banks (from 14.2% in 2016 to 18.2% in 2020) and the share of loans to individuals (from 6.0% in 2016 to 8.4% in 2020). Raising funds from these and some other sources is more reliable and economical for the subjects of the country's banking system, and, consequently, allows forming a less cost-intensive and more competitive banking product for both businesses and the population, implement a number of programmes and projects concerning the support of the structural reform of the country's national economy. The authors summarised that the banking system of Ukraine generally operates with sufficient amounts of financial resources to provide financial and credit support to the economy, because considerable amounts of funds are in correspondent accounts of banks with the NBU and other banks, invested in interbank loans, IGB, NBU certificates of deposit. The lion's share of these funds could be used for long-term lending to investment and innovation projects of subjects of the real sector of the national economy, qualitative development of consumer lending, and expanding the capacity of the internal market.

The banking sector of Ukraine is monopolised at a fairly high level. This conclusion is confirmed by the considerable shares of the largest banks in the net assets of the country's banking sector. Thus, in 2020, the share of the largest bank was 20.6% and by 2016 this indicator increased by 3.0%. Evidently, this situation not only discourages proper competition, hinders the

complete fulfilment of the banking system's potential for economic growth, but the banking system itself requires structural reforms. The segments of deposits of individuals remained quite concentrated both as of 2020 and especially during 2017-2019 (with the value of the Herfindal-Hirschmann index up to 1,000, which corresponds to a weakly concentrated environment, the indicator value of total assets ranged from 1,581 to 1,738 in 2016-2020. At the same time, the value of the concentration indicator in the net asset segment is also approaching 1,000.

#### **Trends and problematic aspects of Ukrainian bank lending**

To a certain degree, the growth of bank assets has become one of the factors and prerequisites for increasing the volume of bank lending. However, its growth rate has not become equal and comparably stable. Thus, in 2011-2020, the volume of loans granted increased by 36.9%, and in certain years (2013, 2017, and 2020) was lower than in the previous year [16]. This led to a decrease in the level of lending (to the amount of bank assets) (by 10.9%) in 2020, when the indicator was 69.2%, compared to 2011 (81%).

Notably, the reduction in absolute values and growth rates of lending volumes was more typical for the individual segment. Thus, with the overall growth in the volume of loans granted to individuals (by 10.9% in 2020-2011), the share of such loans decreased (by 4.7%) [16]. While the share of loans granted to business entities for the same time period increased (by 12.2%). As of 2020, the ratio between the shares of lending to legal entities and individuals was 79.5% to 20.5%. Consequently, there are grounds to conclude on the deterioration of the banking system's contribution to structural changes relating to stimulating internal consumer demand, increasing the level of purchasing power of the population and improving its accessibility to goods and services, especially for investment purposes, and improving the quality of life.

Another negative aspect is related to the low volume of lending to the national economy, which was largely conditioned by the limited assets of banks, since the share of loans in assets remained quite high. Therewith, as of January 1, 2019, the assets of Ukrainian banks in foreign currency (USD) amounted to 36.4%, and as of January 1, 2020 – to 32.9% [16]. Thus, despite the reduction in the share of banks' assets in foreign currency, the level of this indicator is still quite high.

It is worth paying attention to the increase in the level of overdue debt on loans in the total amount of loans, which is evidence of insufficient solvency of borrowers, on the one hand, and a certain discrepancy

between the credit conditions and the capabilities of business entities regarding timely repayment of the loan body and servicing interest on loans, on the other hand. Thus, as of January 1, 2019, the share of overdue loan debt in the total amount of loans increased to more than half – 52.9%. In 2020, the indicator, although it decreased to 48.9%, further signalled the preservation of a critically high level of overdue credit debt [16]. State-owned banks continued to predominate in terms of problem loans (49.3%), while private banks continued to have a moderate level of problem loans (18.6%). The share of overdue debt on loans from foreign banks was considerably higher – 32.5%.

The deterioration of the quality structure of bank lending is also evidenced by an increase in the level of reserves in both assets (by 17.1 percentage points in 2011-2020) and loans (by 27.9 percentage points) of banks. Thus, starting from 2020, there has been a definite tendency towards an improvement in the situation and a gradual decrease in the level of provisioning of credit operations by banks. Thus, the share of problem loans in the banking system of Ukraine remains substantial, but does not generate critical risks and threats, since the level of coverage of such loans by reserves exceeds 95%.

#### **State and structure of bank liabilities in Ukraine**

As for a factor of weakening the potential of the banking system in ensuring economic growth and structural reforms, the authors considered it to be the structure of liabilities, namely with an emphasis on the financial stability of banks in Ukraine. As of 2020, the structure of banks' liabilities continued to occupy a fairly high share of such a source of financial resource formation as funds of individuals – 36.9% or UAH 552.6 billion. At the same time, in recent years, banks' attraction of funds from business entities has also been actively increasing. If the share of this source of liability formation in 2011 was 15.3%, then in 2020 it was 33.3%; the total amount of capital raised by banks from business entities for the analysed time period increased 3.5 times.

In general, this trend is positive, but it should be supplemented and developed towards improving the structure of funds of the population and business entities attracted by banks, because today there is a meagre share of funds that are distributed for a long time, for example, more than 2 years. Accordingly, this makes it impossible for banks to fully develop long-term lending programmes for enterprises in the real sector of the national economy. Thus, the most important task for the Ukrainian authorities is to restore the deposit market, especially in terms of attracting long-term financial resources in the national currency.

The structure of liabilities in the banking system of Ukraine is dominated by the share of state-owned banks, which, on the one hand, indicates a high level of ability of these structures to attract financial resources, and, on the other hand, can serve as a factor of a lower level of their financial stability, growing dependence

on debt obligations, increasing potential threat of a general destabilising impact on the country's financial system. In 2013-2020, the share of state-owned banks in the liabilities of banks in Ukraine increased from 16.96% to 34.33%, and in absolute terms, the amount of liabilities increased 2.8 times (Table 2).

**Table 2. Volumes and structure of liabilities by bank groups in Ukraine in 2013-2020**

Indicators	Years								Growth rate, % / Absolute deviations (+/-)	
	2013	2014	2015	2016	2017	2018	2019	2020*	2020/ 2013	2020/ 2019
Total, billion UAH	1,085	1,130	1,151	1,133	1,173	1,205	1,293	1,500	138.3	116.01
State-owned banks, UAH billion	184	243	338	399	423	430	474	515	2.8	108.7
Share of state-owned banks, %	16.96	21.50	29.37	35.22	36.06	35.68	36.66	34.33	+17.4	-2.3
PrivatBank, UAH billion	n/a	n/a	n/a	206	234	171	188	240	116.5	127.7
PrivatBank's share, %	n/a	n/a	n/a	18.18	19.95	14.19	14.54	16.00	-2.2	+1.5
Foreign banks, UAH billion	231	357	406	376	357	353	372	442	191.3	118.8
Share of foreign banks, %	21.29	31.59	35.27	33.19	30.43	29.29	28.77	29.47	+8.2	0.7
Private banks, UAH billion	670	530	407	149	150	251	260	302	45.1	116.2
Share of private banks, %	61.75	46.90	35.36	13.15	12.79	20.83	20.11	20.13	-41.6	+0.03

**Note:** \* – data as of September 2020

**Note:** \*\* – until 2016

**Source:** compiled by the authors according to the data from [17-18]

At the same time, against the background of growing obligations of state-owned banks, they do not perform their inherent functions and tasks regarding financial support for the implementation of structural reforms that are strategically important for the national economy (in particular, in terms of public-private partnership projects, strategically important industries, modernisation of the public sector, etc.). Notably, the volume of liabilities of foreign banks increased quite significantly (by 91.3% in 2020-2013). Due to this, their share in the structure of liabilities increased by 8.2%. A certain increase was also inherent in the obligations of PJSC CB PrivatBank, which in 2016-2020 increased by 16.5%, but at the same time the share of PJSC CB PrivatBank even decreased by 2.2%.

Thus, there was an evident decrease in the participation of private banks in the formation of obligations of the Ukrainian banking system, when the volume of such banks in 2013-2020 more than halved, and their share decreased by 41.6%. Again, this trend has both positive (a decrease in the level of financial dependence of private banks) and negative (a shortage of financial

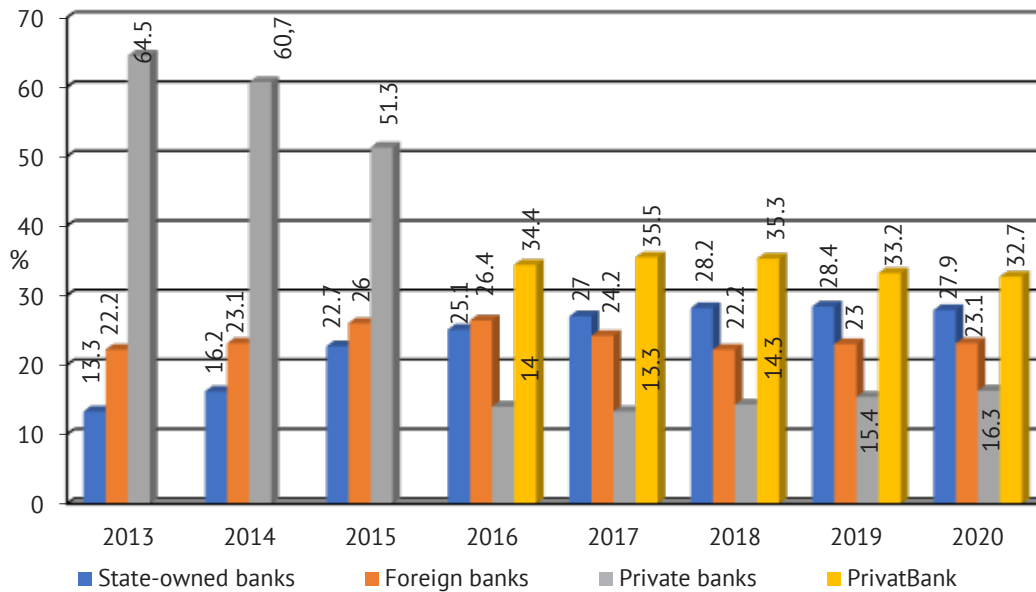
resources for resuming long-term lending projects to the economy) aspects.

#### **Deposits in the banking system: Trends and causes of instability**

It has already been noted that both the volume and growth rate of deposits of individuals in the banking system of Ukraine are insufficient and constitute of the main factors in the development of a shortage of financial resources of banks, which could be used to expand and increase the quality of bank lending programmes for the population and the real sector of the national economy.

Therewith, the structure of deposits of individuals by bank groups in Ukraine did not change much during 2013-2020. If at the beginning of the analysed period 64.5% of individual deposits were attracted by private banks, then in 2020 the total share of private banks and PJSC CB PrivatBank was 49.0% (Fig. 2). If the indicator for PJSC CB PrivatBank remained mostly constant during 2016-2020, then, accordingly, the share of private banks for the analysed period decreased by about 15%.





**Figure 2.** Structure of individual deposits by bank groups in Ukraine as of December 31, 2013-2020\*

**Note:** \* – data as of September 2020

**Source:** compiled by the authors based on [17-18]

From 2013 to 2020, the share of state-owned banks in the structure of deposits of individuals considerably increased, namely by 24.6% (from 3.3% to 27.9%). The share of foreign banks in the structure of deposits of individuals changed insignificantly, which fluctuated at the level of 22-26% on average. Thus, among the guidelines of national policy, it is important to single out the incentivisation of the restoration of household confidence in making deposits in the country's banking system, especially in terms of developing deposit programmes of private and foreign banks.

#### **The role of bank lending in the Ukrainian economy**

Despite the presence of numerous critically negative aspects of functioning and crisis phenomena in the Ukrainian banking system, which hinder the fulfilment of its potential in restoring economic growth and improving certain basic structural features of the national economy, the key parameters of the state of banking security in Ukraine are threatening, but still not critical, which indicates the available opportunities to improve the situation in the area under study. But in recent years,

the situation has substantially worsened according to the indicator “share of gross loans to business entities in GDP”. This indicator is a stimulant and is considered acceptable when its limit value is at least 30%. Until 2016, the indicator value was in an acceptable range and, starting from 2017, the level of bank lending coverage of the corporate sector of the economy began to decline rapidly, reaching 20.5% in 2020, which is negative and indicates the extremely low role of bank lending in the formation of financial support for the functioning and, more importantly, the development of the national economy.

The conclusions drawn absolutely correlate with data and trends concerning the level of penetration of the banking sector in the national economy of Ukraine. Notably, the values of all of the indicators presented in Table 3, in 2013-2020 worsened, and the role of bank capital in the economy, respectively, weakened. For example, the level of net loans of business entities in the country's GDP decreased to 11.0% in 2020, when in 2013 the figure was 42.6% (Table 3).

**Table 3.** Indicators of the level of penetration of the banking sector in the national economy in Ukraine in 2013-2020

Indicators	Years									Absolute deviations (+/-)	
	2013	2014	2015	2016	2017	2018	2019	2020*	2020/2013	2020/2019	
Gross loans to business entities / GDP, %	47.7	51.7	41.8	35.5	29.0	25.8	20.7	20.5	-27.2	-0.2	

Table 3, Continued

Indicators	Years								Absolute deviations (+/-)	
	2013	2014	2015	2016	2017	2018	2019	2020*	2020/2013	2020/2019
Net loans to business entities / GDP, %	42.6	44.7	30.9	20.0	15.1	13.3	10.4	11.0	-31.6	+0.6
Gross loans to individuals / GDP, %	12.4	13.1	8.8	6.6	5.7	5.5	5.2	5.5	-6.9	+0.3
Net loans to individuals / GDP, %	9.5	9.1	4.8	3.2	3.1	3.2	3.6	3.7	-5.8	+0.1
Funds of business entities / GDP, %	17.0	17.8	17.6	17.3	14.3	12.1	13.2	16.0	-1.0	+2.8
Funds of individuals / GDP, %	29.1	25.4	20.2	18.3	16.0	14.3	13.9	16.6	-12.5	+2.7

**Note:** \* – data as of September 2020

**Source:** compiled by the authors based on [18]

The level of penetration of the Ukrainian banking sector in lending to individuals has decreased even more. Thus, in 2013-2020, the level of gross loans to individuals to GDP decreased by 6.9%, falling to 5.5%. Similar indicators for the level of net loans to individuals to GDP were 5.8% and 3.7%. That is why it is not necessary to assert a sufficient contribution of banks to financial support for both the population and businesses, and this should be considered an obstacle to fulfilling the potential of the banking system in ensuring structural changes and shifts in the national economy. As a result, banks did not provide an increase in the capital used by Ukrainian business entities. If in 2013 the share of business entities' funds to GDP was 17.0%, then by 2020 it has not considerably changed, having decreased by 1.0% – to 16.0%. But the level (to GDP) of individual funds experienced a substantial reduction: from 2013 to 2019, there was an annual decrease in this indicator as a whole by more than half (from 29.1% in 2013 to 13.9% in 2019). In 2020, there was an increase in the level of funds of individuals to the country's GDP. However, the value of the indicator was 12.5% less than at the beginning of the analysed period.

Notably, these trends were to a large extent due to the high cost of servicing bank lending, which led to a decrease in the demand of both the population and businesses for bank loans. Conversely, the result of the active policy of the NBU, focused on reducing the discount rate, was a revival in demand for bank loans and a return to the trend towards increasing the volume of bank lending to the national economy. Thus, the weighted average annual rate on NBU refinancing operations in 2011-2019 (with some exceptions typical for 2012-2013) was mostly unstable and excessively high, for example, in 2015 it amounted to 25.22%, while in 2020 it dropped to 6.21%.

Changes in the NBU discount rate were described by almost similar trends: with relative stability

in 2011-2013, in 2014-2015, it increased mainly due to the need to contain the negative consequences of the political and economic crisis of 2014-2015, in particular, to curb the growing inflation. Starting in 2019, after a certain stabilisation of the political and economic situation, the NBU launched a policy focused on reducing the discount rate to revive economic development, which the authors of this study regarded positively in the context of stimulating structural changes in the national economy of Ukraine. Accordingly, in 2019 alone the NBU reduced the discount rate five times, which allowed lowering its level from 18.0% to 13.5%, and in 2020 there were four further stages of rate reduction, while as of June 12, 2020 it was fixed at 6.0%.

Further effective reduction of the NBU discount rate is impossible without systemic reforms primarily in the areas of the judicial system and proper protection of creditors' rights, shadowing, and de-offshoring of the economy, increasing the level of capital transparency and solvency of the corporate sector, the development of the mortgage and real estate market, which would considerably minimise the financial risks of bank lending and the financial system of the country in general. In 2011-2020 there was a fairly close correlation between the direction and dynamics of changes in the NBU discount rate and the average monthly interest rate on loans and deposits. As a result, the average rates on loans of business entities (in national currency) as of October 2020 decreased to 9.6% per annum (for foreign currency loans – to about 5.0% per annum), and for loans to individuals – to 30.9% per annum. Thus, the cost of bank credit resources, especially for the population, remains excessively high. But it is also high for businesses, when, for example, in the EU countries, subjects of the real sector of the economy can receive long-term investment loans at 1.5-1.6% per annum.

The transition from the crisis to gradual financial and economic development, as well as building up the

potential of the banking system of Ukraine, gives grounds to assert an improvement in the financial results of banks, typical for 2018-2020, which became especially relevant after the crisis of 2014-2015, the consequences of which were especially noticeable in 2015, when the total loss of banks was estimated at UAH 159.4 billion. In the same year, a critically negative decline in the quality of the banks' loan portfolio led to almost the largest deductions to reserves in the recent history of Ukraine (UAH 198.3 billion).

In fact, 2015 was also described by the lowest value of net interest income of banks – UAH 39.1 billion. In the following years, the difference between total interest income from credit operations, operations with securities and derivatives and the total amount of expenses for paying interest on deposits and borrowed funds of banks began to grow, reaching UAH 78.9 billion in 2019, which was 60.7% more than in 2013 and 8.1% more than in 2018. Notably, the situation with net commission income of banks in Ukraine during the analysed period was more stable and the difference between the commissions and fees received by banks, as well as the commissions and fees paid by them for services received, improved in almost all years of the period under study. From 2013 to 2019, the indicator increased from UAH 21.0 billion to UAH 44.0 billion (by UAH 23.0 billion or 2.1 times).

By 2019, banks' contributions to reserves substantially decreased, which is evidence of a gradual increase in the quality of the banks' loan portfolio and an increase in the financial and economic efficiency of the country's banking sector in general. As a result, the growth of banks' net profit was natural, which was typical for 2018 and 2019 and continued in 2020, although with a lower growth rate compared to 2019. In particular, the profit of banks in the third quarter of 2020 exceeded the same indicator in the second quarter of this year, but was about 20% less than in the corresponding

quarter of the previous year. Thus, the recovery and growth of the revenue-generating capacity and profitability indicators of the banking sector of Ukraine is a direct evidence of the strengthening of its potential in ensuring both structural changes and economic growth in general. But this requires the implementation of a balanced incentivising national policy that would coordinate the economic interests of banks regarding their further development and the state in terms of the positive impact of the functioning of the banking sector on structural changes.

Thus, it is necessary to address the fact that there are certain structural flaws directly in the processes of growth of financial and economic efficiency in the analysed sector of the economy, which also require their elimination or settlement. This refers, for example, to the fact that in 2020, more than half (52.2%) of banks' profits were received by only one bank – PJSC CB PrivatBank. The value of the indicator was UAH 7.2 billion, while the total profit of all other banks was only UAH 6.6 billion. The positive aspect can be attributed to the increase in the bank adequacy ratio during 2016-2020. If the standard value of this indicator was not lower than 10% in 2020, its actual value in the banking system of Ukraine was 21.9%. This is evidence of the high level of ability of banks to fully and timely perform their obligations and assume the main part of the risk specifically by banks, and not by their creditors or depositors.

#### ***Impact of banking system development on structural reform of the national economy of Ukraine: Conclusions for national policy***

Thus, at the current stage of socio-economic development of Ukraine, the banking system is described by both positive and negative aspects of the state and development trends, which can be regarded as both positive and negative prerequisites for fulfilling its potential in the structural reform of the national economy (Table 4).

**Table 4.** Summary results for the state and trends in the banking system development as prerequisites for fulfilling its potential in the structural reform of the national economy

Aspects of the development <i>state</i>		Conclusions in the context of <i>impact on structural reform</i> of economy
Positive	Negative	
<ul style="list-style-type: none"> <li>▪ Retention of a group of relatively financially stable, liquid, and solvent banks with a transparent capital structure;</li> <li>▪ availability of potential reserves of financial resources for lending to the economy and the population;</li> <li>▪ small proportion of banks at risk;</li> <li>▪ high quality of banking supervision in the country;</li> <li>▪ sufficiency of banking sector reserves;</li> <li>▪ stability of banking infrastructure functioning, activation of digital interaction and online services;</li> </ul>	<ul style="list-style-type: none"> <li>▪ high level of concentration of bank capital and deposits in the largest banks;</li> <li>▪ concentration of certain banking sector segments according to the number of structural divisions, ATMs, terminals, and active payment cards;</li> <li>▪ high level of IGB and insufficiently rational structure of the banking system's net assets;</li> <li>▪ predominance of state-owned banks' liabilities in the structure;</li> <li>▪ high maintenance costs and the level of problem bank loans;</li> <li>▪ low return on capital, limited net assets of the banking system;</li> </ul>	<ul style="list-style-type: none"> <li>➤ Development of financial potential for the implementation of investment projects for technological modernisation of production as a result of stabilisation and strengthening of the banking system;</li> <li>➤ limiting the possibilities of financial support for economic diversification programmes, especially in the areas of small and medium enterprises, research and development, innovation, smart technologies, high-tech exports, etc.;</li> <li>➤ deformation of the structure of social capital and conditions of its reproduction;</li> <li>➤ incentivisation of shadow forms of capital formation</li> </ul>

Table 4, Continued

Aspects of the development <i>trends</i>		Conclusions in the context of <i>impact on structural reform of economy</i>
Positive	Negative	
<ul style="list-style-type: none"> <li>▪ Cleansing of the banking system from low-liquid and conditionally fictitious banking structures;</li> <li>▪ growth of banks' assets and loan portfolio, improvement of its quality;</li> <li>▪ growth in the volume and share in the structure of liabilities of banks of equity and funds raised from enterprises and individuals;</li> <li>▪ increase in highly liquid assets of banks;</li> <li>▪ improvement of financial results and improving banks' liquidity and solvency;</li> <li>▪ strengthening the banking system's resilience to currency shocks;</li> <li>▪ reduction of the NBU discount rate and interest rates on loans, revival of bank lending to the economy</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reduction of private and foreign-capital banks, their infrastructure elements, reduction of structural divisions of banks, which weakens competition and the ability to service remote territories;</li> <li>▪ growth of the share of IGB in the structure of formation of net assets of banks;</li> <li>▪ reduction of the share of loans of business entities in the structure of net assets of banks;</li> <li>▪ growth in the level of overdue loans;</li> <li>▪ strengthening differentiations in interest and commission income, profitability between large and other banks;</li> <li>▪ weakening of banking sector penetration in the national economy;</li> <li>▪ deterioration of basic indicators of national banking security</li> </ul>	<ul style="list-style-type: none"> <li>➤ Partial de-shadowing of the country's financial and economic system as a result of the withdrawal of quasi-legitimate, affiliated, insolvent banks from the market;</li> <li>➤ limiting the impact on the sectoral structure of the economy due to the weakening of specialised banks' capabilities;</li> <li>➤ deterioration of the ratio in the "domestic production – import" system due to a decrease in the level of lending to local producers;</li> <li>➤ growth of the share of unprofitable enterprises, activation of fictitious mutual settlements and bankruptcies;</li> <li>➤ growing imbalances in the balance sheet: intellectual and human resources resource of the economy-external migration of the population due to restrictions on lending programmes to individuals, especially young people, intellectual, and specialised personnel</li> </ul>

*Source: compiled by the authors*

## CONCLUSIONS

Thus, the evolution of the Ukrainian banking system has had both a positive and negative impact on the development of some critical structural correlations in the national economy of Ukraine. On the positive side, it is the stabilisation and development of banks, improvement of their performance indicators, withdrawal of "dishonest" banks from the market, which resulted in lending to important investment projects of business structures, as well as the de-shadowing of the country's financial and economic system.

At the same time, until now, there still have been more manifestations of negative influence (or at least "non-interference" of the NBU and commercial banks in changing the situation in numerous structural correlations). This refers to the limited supply practices (due to the weakening of positions in the market of specialised banks) of high-quality affordable bank lending programmes and support for business projects in the areas of strategic development (which can act as growth drivers, focused on the production of products with a high content of added value, are new to the global environment)

of economic activities, the creation, attraction, and implementation of modern advanced technologies, activating and improving the efficiency of research and technical work, innovative activity of enterprises, etc.

This also refers to the active use of the government bonds instrument, which violates the proportions in the system of capital placement and its further redistribution, demotivates the growth of deposits and the development of other segments of the stock market. The high cost-intensity of bank lending encourages businesses to search for and apply shadow capital raising schemes, transition from a production form of entrepreneurship to a trade one, which further complicates the problems of import substitution of the internal market. The weakening of the banking sector's penetration into the economy, especially in terms of affordable lending to individuals, is one of the factors complicating the self-fulfilment of the young and intellectual part of the population in Ukraine, the growth of foreign educational, labour, and even stationary migration abroad.

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## Стан і тенденції розвитку банківської системи в контексті структурного реформування національної економіки України

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**Анотація.** Актуальність теми дослідження полягає в тому, що реалізація потенціалу банківської системи спроможна забезпечити позитивні структурні зрушення в економіці України. Метою дослідження є аналіз стану і тенденцій розвитку банківської системи України у фокусі його впливу на структурне реформування національного господарства. У процесі дослідження використано методи статистичного аналізу (для аналізу стану та динаміки розвитку банківської системи країни) та аналоговий метод (для ідентифікації міри впливу розвитку банківської системи на структурні зміни в економіці). Обґрунтовано, що ефективне функціонування банківської системи – запорука успішного економічного розвитку національної економіки, зокрема її реформування. Показано, що через банківську систему діє механізм перерозподілу фінансових ресурсів і грошових коштів, відтак відбувається їх мобілізація та залучення в економічний обіг у тих галузях економіки, які найбільше цього потребують. Узагальнено стан і тенденції розвитку банківської системи як передумови реалізації її потенціалу в структурному реформуванні національної економіки. У підсумку аналізування стану і тенденцій розвитку банківської системи виявлено їх як позитивні, так і негативні характеристики. Доведено, що в Україні на сучасному етапі розвитку національної економіки відбулося очищення банківської системи від низьколіквідних та умовно фіктивних банківських структур, зростають обсяги активів, зокрема високоліквідних, а також покращується кредитний портфель банків, підвищуються їх фінансові результати, ліквідність і платоспроможність, стійкість до валютних шоків, поживляється банківське кредитування економіки. Показано, що для банківської системи країни характерними залишаються низка системних недоліків передусім високого рівня концентрації банківського капіталу та депозитів у найбільших банках, а також державних банків у низці сегментах банківського сектора за чисельністю структурних підрозділів, банкоматів, терміналів, активних платіжних карток. Виявлено тенденцію до послаблення проникнення банківського сектора в економіку, особливо в частині доступного кредитування фізичних осіб і стратегічних галузей економіки. Практична цінність дослідження полягає в тому, що на основі виявлених недоліків розвитку банківської системи і її впливу на структурні реформи визначені стратегічні напрями удосконалення державного регулювання у цій сфері

**Ключові слова:** економічний розвиток, показники діяльності банків, обсяги фінансових ресурсів, кредитування економіки, системні недоліки