WAYS OF IMPROVING CREDIT PORTFOLIO QUALITY UNDER THE TRANSFORMATION OF BANKS: EVIDENCE FROM UZBEKISTAN

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https://doi.org/10.5281/zenodo.21886429

Abstract. The paper examines the quality of the credit portfolio of Uzbek commercial banks under the ongoing transformation of the banking system. Drawing on the open monthly statistics of the Central Bank of Uzbekistan for 2025–2026, the study identifies two patterns that a single-indicator analysis conceals: the officially reported non-performing loan (NPL) ratio falls sharply at each year-end and rebounds within one or two quarters, and the burden of problem assets is concentrated in state-owned banks. The 2.5–3 fold divergence between the prudential NPL ratio (3.7 % as of 1 June 2026) and rating agency estimates under IFRS 9 (9–10 % expected in 2026) is interpreted as a recognition problem rather than an asset quality problem as such. An integral index of credit portfolio quality composed of six sub-indices is proposed, and five policy recommendations are formulated.

Keywords: *bank transformation, credit portfolio, non-performing loans, IFRS 9, privatisation, directed lending, financial stability.*

1. Introduction

The active phase of banking reform in Uzbekistan acquired a systemic form with Presidential Decree PF-5992 of 12 May 2020, which approved the Strategy of Reforming the Banking System for 2020–2025. At the moment of its adoption, 13 of 31 banks had state participation, controlling over 87 % of aggregate capital and over 85 % of assets, while directed and subsidised loans exceeded 60 % of the total credit portfolio. This ownership structure is the root of the credit quality problem: a portfolio formed on administrative rather than market criteria accumulates credit risk by construction.

Six years into the reform, the system has expanded in quantitative terms. As of 1 July 2026, total banking assets reached 1,005.8 trln UZS (+18 % year-on-year), gross loans 642.8 trln UZS (+12 %), and aggregate capital 148.9 trln UZS (+19 %). Expansion, however, is not equivalent to improvement in quality. Fitch Ratings expects Stage 3 loans under IFRS 9 to peak at 9–10 % of gross loans in 2026, against a prudential figure of 3–4 % reported nationally. The purpose of this study is to identify the structural determinants of credit portfolio quality under bank transformation and to substantiate practical ways of improving it.

2. Data and methods

The empirical base comprises the monthly NPL releases of the Central Bank of the Republic of Uzbekistan (January 2025 – June 2026), the Central Bank's aggregate banking indicators, Decree PF-5992 with subsequent amendments, the results of the IMF–World Bank Financial Sector Assessment Program conducted in 2024–2025, Fitch Ratings sector reviews, and Central Bank Board Resolution No. 21/6 of 2 October 2025 on capital adequacy requirements. The methods applied are comparative statistical analysis of target versus actual indicators, time-series analysis of monthly NPL data, structural analysis by ownership form and borrower type, ratio analysis, and expert weighting for the construction of the composite index. Two limitations should be noted: national prudential NPL (loans overdue by more than 90 days) and IFRS 9 Stage 3 are not directly comparable, and bank-level data on restructured and written-off loans are not publicly disclosed. Values marked with an asterisk in Table 1 are the author's estimates derived from published ratios.

3. Results and discussion

Table 1 summarises the dynamics of the credit portfolio and non-performing loans.

Table 1. Credit portfolio and non-performing loans in the banking system of Uzbekistan

Date	Credit portfolio, trln UZS	NPL volume, trln UZS	NPL ratio, %	NPL ratio, state banks, %
01.01.2025	533.1*	21.3*	4.0	3.9
01.03.2025	541.1*	24.3	4.5	4.6
01.11.2025	588.7*	22.4	3.8	n/a
01.01.2026	604.0	18.1*	3.0	3.2
01.05.2026	628.9*	21.9*	3.5	3.6
01.06.2026	636.0	23.6	3.7	4.0
01.07.2026	642.8	not published	—	—

** author's estimates based on published ratios. Source: compiled by the author from Central Bank of Uzbekistan monthly statistics.*

First, the decline in the NPL ratio is cyclical rather than sustained. The ratio stood at 3.8 % on 1 November 2025, fell to 3.0 % by the year-end, and returned to 3.7 % within five months. The absolute figures confirm that this is not a genuine improvement: in May 2026 alone the stock of problem loans grew by 7.7 %, or roughly 1.7 trln UZS. The year-end drop is explained by concentrated write-offs, restructuring and maturity extensions rather than by portfolio recovery, which means that annual reporting dates systematically understate the true level of credit risk.

Second, the problem is concentrated in state-owned banks. Over the first five months of 2026 their NPL stock rose from 15.0 to 16.7 trln UZS and the ratio from 3.6 % to 4.0 %, whereas in private and other commercial banks the ratio remained unchanged at 3.2 %. State banks perform the directed lending function and therefore absorb the most difficult segment of the portfolio. As of 1 July 2026, 422.2 trln UZS, or about 65 % of the system-wide portfolio, was still held by state banks, and only one of the three large banks scheduled for sale — Ipoteka-bank, acquired by OTP Bank in 2023 — has actually been privatised.

Third, the divergence between measurement frameworks is the decisive finding. A prudential ratio of 3.7 % against an expected IFRS 9 Stage 3 level of 9–10 % implies that problem assets exist in the system but are not recognised in reporting on time. The most convincing evidence is provided by banks that changed ownership or governance: during 2025 the NPL ratio fell from 10.2 % to 3.5 % at Ipoteka-bank, from 14.8 % to 4.9 % at Garant Bank, and from 8.5 % to 4.5 % at the Business Development Bank. These banks first recognised hidden losses and then cleaned the portfolio, which indicates that the effect of transformation on measured credit quality is negative in the short run and positive in the medium run.

Additional structural pressures reinforce this picture. Seven systemically important banks controlled 64 % of system assets as of 1 October 2025, so the deterioration of any single large portfolio becomes systemic by definition; the new capital adequacy regulation effective from 1 January 2026 (minimum K1 of 13 %, Tier 1 ratio of 10 % and leverage ratio of 6 %) is the supervisory response to this concentration. At the same time the portfolio mix is shifting rapidly towards retail: household loans grew by almost 40 trln UZS over the year to 235.9 trln UZS, against an increase of only 28.6 trln UZS in corporate exposures, which requires behavioural scoring and debt-service-to-income limits rather than collateral-based appraisal. Finally, the return on equity of the sector fell from 14.2 % in 2023 to 6.6 % in 2024 against official inflation of 9.8 %, meaning that capital was eroded in real terms by at least 2.2 percentage points and that the capacity to absorb credit losses out of profit has narrowed.

To overcome the limitations of single-indicator monitoring, an integral index of credit portfolio quality (CPQI) is proposed: $CPQI = \Sigma (w_i \times I_i)$, where the six sub-indices are the NPL ratio (w = 0.25), the loan loss reserve coverage of NPL (0.20), the share of directed and subsidised loans (0.20), portfolio concentration measured as the exposure of the ten largest borrowers to Tier 1 capital (0.15), the share of foreign currency loans (0.10) and the ratio of credit growth to nominal GDP growth (0.10). Since all components are inversely related to quality, they are normalised as $I_i = (x_{max} - x_i) / (x_{max} - x_{min})$. Values above 0.80 indicate high quality, 0.60–0.80 satisfactory, 0.40–0.60 average, and below 0.40 low quality requiring a capital add-on. Notably, only three of the six components are publicly available, which makes disclosure itself a precondition for managing portfolio quality.

4. Conclusions and recommendations

The quantitative targets of the transformation strategy have been met, while its structural targets — reducing the state share and abandoning directed lending — have not. Officially reported credit quality improves artificially at year-end and deteriorates again in subsequent quarters, and the gap between national and international measurement frameworks is the principal obstacle to managing credit risk. The following measures are proposed:

1) publish the IFRS 9 Stage 3 ratio alongside the prudential NPL ratio together with a reconciliation of the two, and use quarterly average rather than period-end NPL for supervisory purposes in order to neutralise the year-end effect;

2) complete the privatisation of Uzsanoatqurilishbank and Asakabank within the announced deadlines, since the Ipoteka-bank case demonstrates that a change of owner and governance is the most effective instrument of portfolio clean-up;

3) remove directed lending from commercial bank balance sheets by channelling state programmes through a specialised development institution, compensating the cost of non-commercial operations from the budget on a transparent basis, and imposing a moratorium on new subsidised portfolios;

4) introduce the integral index of credit portfolio quality into supervisory practice and use it as a criterion for Pillar 2 capital add-ons, and develop a secondary market for distressed assets, including a legal framework for NPL sale and an asset management company;

5) link the remuneration of state bank management to risk-adjusted return on capital, the NPL ratio and reserve coverage rather than to loan volume targets, and publish stress-test results regularly in line with the FSAP recommendations.

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