NATIONAL BANK OF SERBIA

BANK SUPERVISION DEPARTMENT

BANKING SECTOR IN SERBIA

Third Quarter Report 2018

2019

Contents:

1. BASIC INFORMATION ON SERBIAN BANKING SECTOR

1.1 Selected parameters of the Serbian banking sector[1]

At end-September 2018, the Serbian banking sector numbered 28 banks, which is unchanged relative to end-June 2018. The organisational network consisted of 1,610 business units and employed a total of 23,067 persons.

Table 1.1 **Selected parameters of the Serbian banking sector**
(RSD bn, %)

	Number of banks	Assets		Capital		Network		Employment	
		Amount	Share	Amount	Share	Number of business units 1)	Share	Number of employees	Share
Banks in domestic ownership	8	843	23.7%	167	24.5%	554	34.4%	6,760	29.3%
State-owned	5	585	16.5%	94	13.8%	430	26.7%	5,268	22.8%
Privately-owned	3	258	7.2%	73	10.7%	124	7.7%	1,492	6.5%
Banks in foreign ownership	20	2,720	76.3%	515	75.5%	1,056	65.6%	16,307	70.7%
Italy	2	991	27.8%	189	27.7%	235	14.6%	4,286	18.6%
Austria	2	477	13.4%	80	11.7%	183	11.4%	2,671	11.6%
France	2	395	11.1%	55	8.0%	178	11.0%	2,293	9.9%
Hungary	2	204	5.7%	43	6.4%	161	10.0%	2,092	9.1%
Other	12	653	18.3%	148	21.7%	299	18.6%	4,965	21.5%
Total banking sector	**28**	**3,563**	**100.0%**	**682**	**100.0%**	**1,610**	**100.0%**	**23,067**	**100.0%**

1) Business units include all business network forms: headquarters, branches, branch offices, teller units and other business units.

Source: National Bank of Serbia.

Q3 2018 saw a contraction in banking employment and the number of business units in Serbia. At end-Q3, banking sector employment went down by 71 persons compared to end-June 2018 as a consequence of a simultaneous increase in the number of employees by 123 in 13 banks and downsizing employment by 194 in 12 banks. Within the business network, the number of business units decreased by six as a result of six banks downsizing their network by a total of 10 units and three banks expanding their network by four business units.

At end-September 2018, total net balance sheet assets of the Serbian banking sector equalled RSD 3,563.3 bn (rising by 2.5% relative to June 2018) and total balance sheet capital RSD 681.6 bn (up by 2.7% relative to June 2018).

[1] All data in this Report are based on the reports that banks are required to submit to the NBS. These reports have not necessarily been audited by external auditors or verified by NBS on-site supervisors.

The market share of banks in majority ownership of domestic entities (private entities and the Republic of Serbia) decreased (from 24.1% to 23.67%), however, their share in total banking sector capital slightly edged up (from 24.4% to 24.5%). Consequently, the share of banks in majority ownership of foreign entities increased (from 75.9% to 76.3%) relative to the balance sheet total and decreased (from 75.6% to 75.5%) relative to the capital. The nominal fall was recorded only in the balance sheet total of banks in majority ownership of domestic private entities (by 3.6%).

Banks from Italy, Austria, France and Hungary (eight banks in total) accounted for the dominant share in total banking sector balance sheet assets – 58.0%.

1.2 Concentration and competition

The Serbian banking sector is characterised by an acceptable level of competition and low concentration of activities. The Herfindahl Hirschman index[2] values indicate the absence of concentration in all observed categories. For a long time now, the highest values of the index were observed in deposits (chiefly household deposits) and income from fees and commissions, while the lowest figures were noted for total income and interest income, as well as for total gross loans.

Table 1.2.1 **Concentration and competition indicators**
(Share %)

	Top 5 banks	Top 10 banks	HHI [1)]
Assets	55.2	78.6	809
Lending (total)	53.5	77.3	790
Household loans	53.1	79.8	808
Corporate loans	52.9	80.4	818
Deposits (total)	56.0	79.8	827
Household deposits	59.3	82.4	975
Income (total)	47.6	73.7	678
Interest	51.9	77.5	763
Fees and commissions	58.9	81.5	929

[1)] Herfindahl Hirschman Index of concentration.
Source: National Bank of Serbia.

In terms of balance sheet assets, the ranking of the ten biggest banks in Serbia changed at end-Q3 2018.

[2] The Herfindahl Hirschman Index (HHI) is calculated as the sum of square values of individual bank shares in the category observed (assets, loans, deposits, etc.). HHI up to 1,000 indicates that there is no market concentration; 1,000–1800 indicates moderate concentration; above 1,800 indicates high concentration.

At the same time, if the five biggest banks are observed in terms of balance sheet assets, gross loans and deposits, it is evident that they account for more than half of the Serbian banking sector in these segments given their share in the net balance sheet assets (55.2%), gross loans (53.5%) and deposits (56.0%).

Table 1.2.2 **Top ten banks according to the total assets criterion**
(RSD bn, %)

	30. 9. 2017			30. 6. 2018			30. 9. 2018			Δ Γ	Δ T
	Amount	Share	Ranking	Amount	Share	Ranking	Amount	Share	Ranking		
Banca Intesa A.D.- Beograd	560	17.0	1	550	15.8	1	574	16.1	1	–	–
Unicredit Bank Srbija A.D.- Beograd	359	10.9	3	412	11.9	2	417	11.7	2	↑	–
Komercijalna banka A.D.- Beograd	374	11.4	2	381	10.9	3	390	10.9	3	↓	–
Societe Generale banka Srbija A.D.- Beograd	265	8.1	4	292	8.4	4	301	8.4	4	–	–
Raiffeisen Banka A.D.- Beograd	262	8.0	5	278	8.0	5	284	8.0	5	–	–
Agroindustrijsko komercijalna banka AIK banka akcionarsko društvo, Beograd	172	5.2	6	201	5.8	6	193	5.4	6	–	–
Erste Bank A.D.- Novi Sad	149	4.5	8	179	5.2	7	193	5.4	7	↑	–
Eurobank A.D.- Beograd	149	4.5	7	164	4.7	8	163	4.6	8	↓	–
Banka Poštanska štedionica A.D.- Beograd	134	4.1	9	157	4.5	9	163	4.6	9	–	–
Vojvođanska banka A.D.- Novi Sa	125	3.8	10	123	3.5	10	125	3.5	10	–	–

Source: National Bank of Serbia.

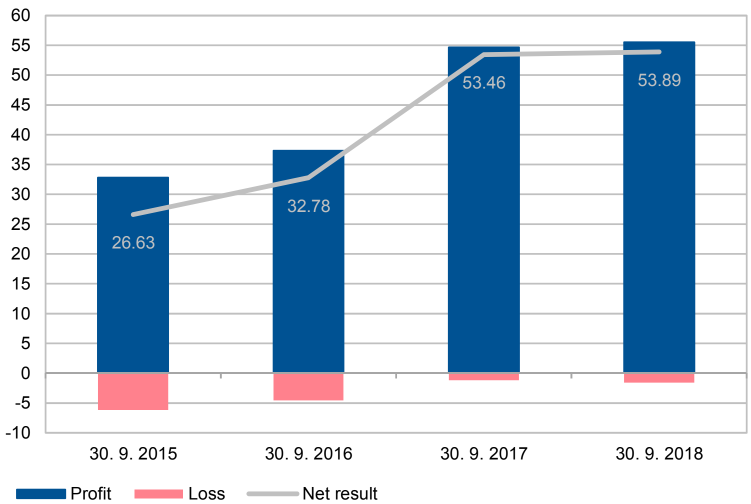
In terms of balance sheet assets, *Banca Intesa A.D. Beograd* remained the leading bank in Serbia; its market share edged up (by 0.3 pp) from the previous quarter, but decreased from the same period last year (by 0.9 pp). In addition to *Banca Intesa A.D. Beograd*, the following banks had market shares above 10% as at 30 September 2018: *UniCredit bank Srbija a.d. – Belgrade* (11.7%) and *Komercijalna banka a.d. – Belgrade* (10.9%).

2. PROFITABILITY

2.1 Profitability indicators

The banking sector's net profit before tax in the first nine months of 2018 equalled RSD 53.9 bn, up by 0.8% compared to the result achieved in the same period last year.[3]

Chart 2.1.1 **Pre-tax result**
(RSD bn)



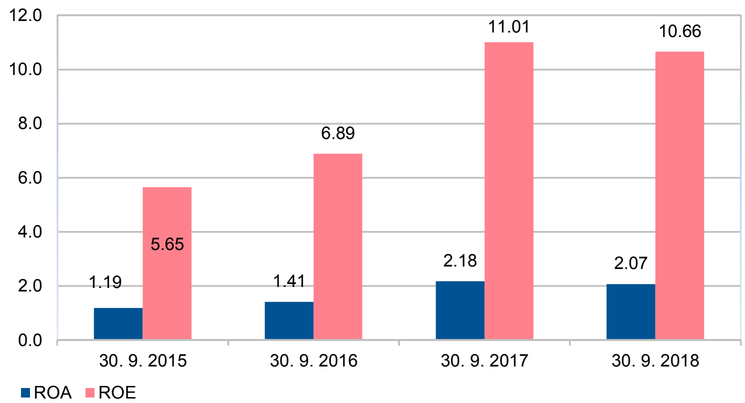
Source: National Bank of Serbia.

The structure of the net profit is as follows: twenty-four banks operated with a total profit of RSD 55.5 bn, while four banks accounting for 2.9% of the market share posted a negative financial result totalling RSD 1.6 bn. The profit and loss generating items of the banking sector were somewhat more concentrated than the balance sheet total: five banks with the highest net profit together made up 68% of the total sector's profit, while two banks with the highest net losses accounted for 66% of the total losses.

The preserved profitability of the banking sector at end-September 2018 resulted in the following profitability indicators: ROA equalled 2.07% (2.18% at end-September 2017) and ROE 10.66% (11.01% at end-September 2017).

[3] A new Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks entered into force on 1 January 2018, due to the simultaneous coming into force and application of the new International Financial Reporting Standard 9 – Financial instruments (hereinafter: IFRS 9), which changed the valuing and disclosing of certain categories of the balance sheet and income statement, thereby influencing to a certain extent the comparability of categories before and after that date.

Chart 2.1.2 **Banking sector profitability indicators**
(in %)



Source: National Bank of Serbia.

2.2 Structure of the results

The level of net profit recorded at end-Q3 2018 was mainly influenced by a decrease in other operating income (by RSD 6.5 bn), which was primarily a consequence of banking sector consolidation process.

The net result from the impairment of financial assets not carried at fair value through income statement was positive at end-Q3 2018 and stood at RSD 0.1 bn, compared to RSD 2.2 bn of net loan losses in the same quarter of 2017. The reduction in net loan losses of banks is a result of favourable macroeconomic and economic developments and losses already carried in the previous years. Banks recorded net expenses under indirect write-off of financial assets measured at amortised cost in the amount of RSD 1.2 bn (RSD 1.4 bn of net income on this account in the same period 2017). The write-off of uncollectible receivables generated net revenues of RSD 1.0 bn, while net expenses in 2017 equalled RSD 3.6 bn.[4]

Net interest income at end-Q3 2018 stood at RSD 95.4 bn, up4.0% from the same period in 2017. This increase stems from the higher interest income (by RSD 2.4 bn) and, at the same time, the decline in interest expenses (reduction by RSD 1.3 bn). At end-September 2018, the structure of interest income at banking sector level was diversified: 77.5% of interest income came from loans, 18.0% from securities and 1.7% from deposits. On the expense side, interest expenses from deposits had the highest share (72.8%), followed by those from loans (18.5%) and securities (6.5%).

In the quarter observed, net fee and commission income increased by 3.9% or RSD 1.1 bn relative to 30 September 2017 due to the RSD 2.6 bn rise in the fee and

[4] The implementation of IFRS 9 as of 1 January 2018 rendered the complete comparability of all observed categories impossible.

commission income (6.4%), while expenses on this account rose RSD 1.5 bn (11.9%). The most significant types of fee and commission income are those from: carrying out payment transactions (a 32.4% share in total fee and commission income), payment cards (22.6%) and deposits (14.2%), whereas on the expense side, total expenses from payment cards had the highest share (49.1%), followed by expenses from carrying out payment transactions (12.5%).

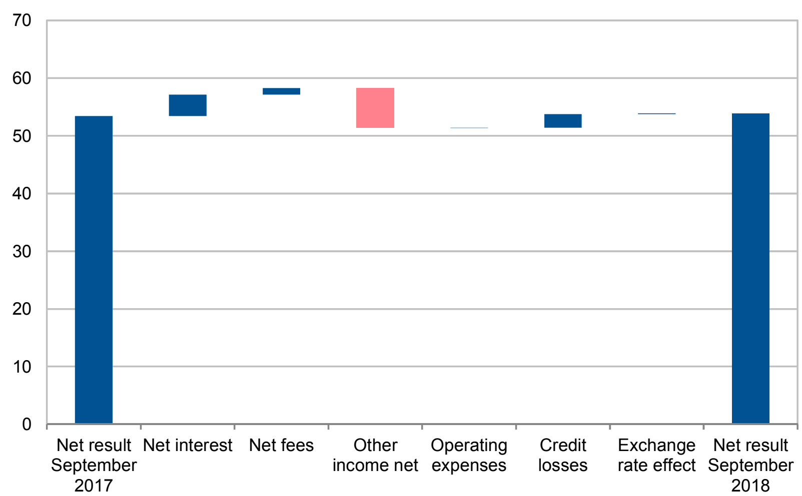
Table 2.2 **Changes in key elements of bank profitability**
(RSD mn)

	Result	Net interest	Net fees	Net credit losses	Exchange rate effect
30. 9. 2018	53,893	95,420	29,294	148	5,905
30. 9. 2017	53,458	91,713	28,193	-2,159	5,750
Change:	**1%** ⇧	**4%** ⇧	**4%** ⇧	⇩	**3%** ⇧

Source: National Bank of Serbia.

At end-Q3 2018, net gains from securities decreased by 18.3% relative to last year (and equalled RSD 2.0 bn),5 mostly owing to the revaluation of other derivatives (RSD 0.6 bn).

Chart 2.2 **Structure of net result**
(RSD bn)



Source: National Bank of Serbia.

The net effect of the dinar exchange rate fluctuations on the Serbian banking sector's result at end-Q3 2018 was positive, resulting in net exchange rate gains and

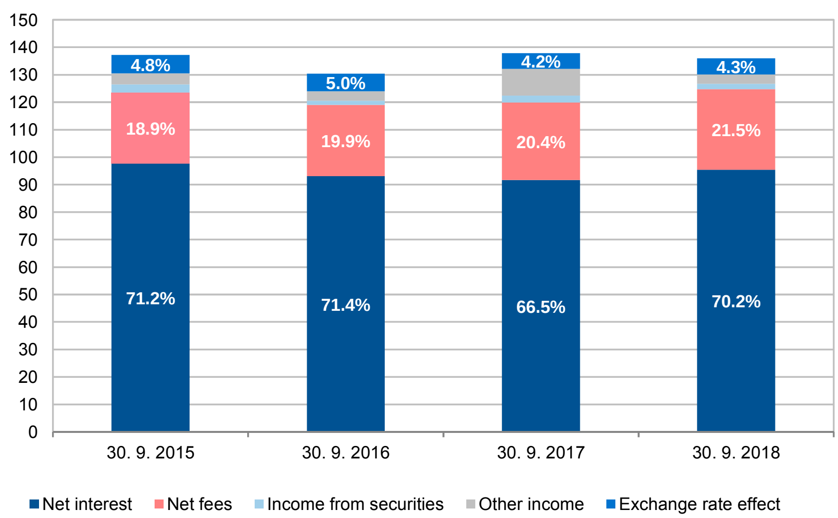
[5] A new Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks entered into force on 1 January 2018 due to the simultaneous coming into force and application of IFRS 9, which changed the valuing and disclosing of certain categories of the balance sheet and income statement, thereby influencing to a certain extent the comparability of categories before and after that date.

gains from the agreed currency clause of RSD 5.9 bn. Exchange rate gains on FX receivables and liabilities generated a net income of RSD 4.6 bn, while exchange rate gains on receivables and liabilities with the agreed FX currency clause came at RSD 1.3 bn.

2.3 Operating income

At the end of the third quarter of 2018, the banking sector's total operating income stood at RSD 136.0 bn, down by 1.4% compared to the total operating income from the same period in 2017. The decrease in operating income was mostly a result of the decrease in other operating income, i.e. income from decreased liabilities generated in 2017 in the acquisitions/mergers of certain banks.

Chart 2.3 **Operating income structure**
(RSD bn, in %)



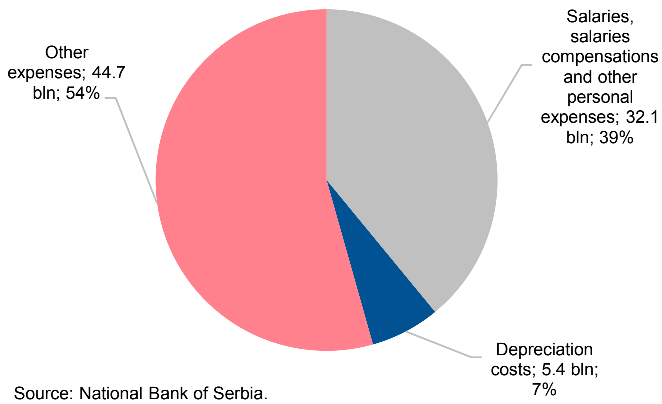
Source: National Bank of Serbia.

2.4 Operating expenses

At end-Q3 2018 operating expenses of the Serbian banking sector equalled RSD 82.2 bn, down by 0.1% from the same period a year earlier. Within operating expenses, item Other expenses posted a decline by 1.3% relative to the same expenses generated in Q3 2017 (this item accounts for 54.4% of operating expenses). Expenses relating to salaries, compensations and other personal expenses increased by 1.4% (making up

39.1% of total operating expenses).[6] Depreciation costs were slightly higher and made up 6.5% of operating expenses.

Chart 2.4 **Structure of operating expenses**
30 September 2018



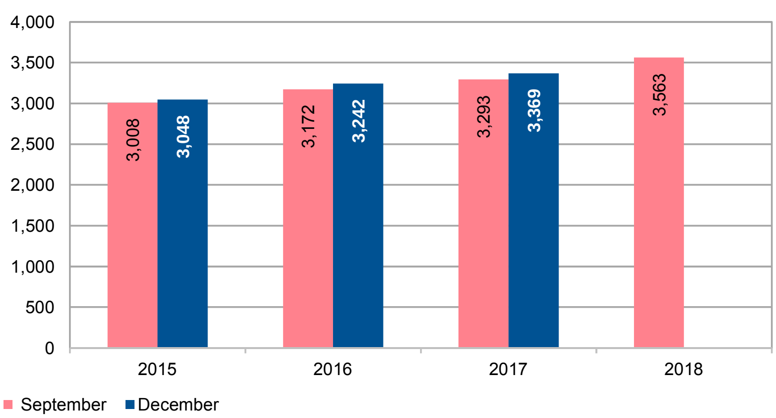
Source: National Bank of Serbia.

3. BANKING SECTOR ASSETS

3.1 Level and structure

Total net balance sheet assets of the Serbian banking sector at end-September 2018 equalled RSD 3,563.3 bn, indicating a q-o-q increase of RSD 86.9 bn or 2.5%.

Chart 3.1.1 **Total banking sector assets**
(RSD bn)

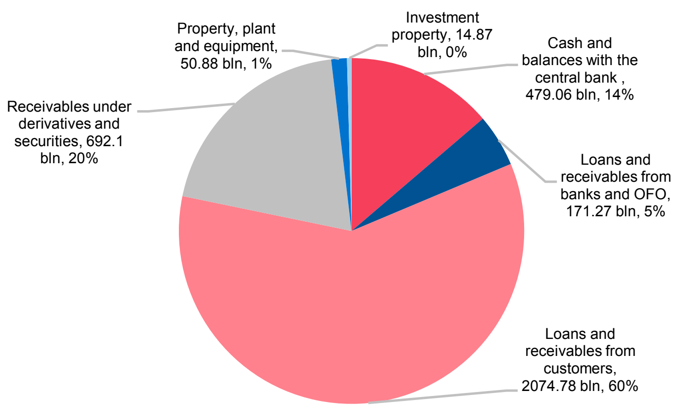


Source: National Bank of Serbia.

[6] At end-September 2018, the number of employees in the banking sector dropped by 275 persons from end-September 2017.

Loans and receivables (to banks and other clients) held a dominant share of 63.0% in banking sector net assets (as a result of banks' orientation towards traditional banking activities), rising up by 0.2 pp q-o-q. Also, item Securities held a significant share (19.4%) and item Cash and balances with the central bank (13.4%). Banks' investments in securities were mostly related to investment in securities issued by the Republic of Serbia, which made this segment of banking sector investment highly secure.

Chart 3.1.2 **Banking sector assets structure**
(30 September 2018)



Source: National Bank of Serbia.

Table 3.1 **Change in key asset items of the banking sector**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Cash and balances with the central bank	479,055	10,160	5,211	2.2%	1.1%
Loans and receivables	2,246,050	64,396	142,148	3.0%	6.8%
from banks and OFO	171,268	-4,985	-6,069	-2.8%	-3.4%
from customers	2,074,782	69,381	148,217	3.5%	7.7%
Receivables under derivatives and securities[1)]	692,086	9,852	45,281	1.4%	7.0%
Property, plant and equipment	50,880	-517	-1,432	-1.0%	-2.7%
Investment property	14,869	-34	-422	-0.2%	-2.8%
Other	80,394	3,056	3,157	4.0%	4.1%
Total balance sheet	**3,563,335**	**86,912**	**193,943**	**2.5%**	**5.8%**

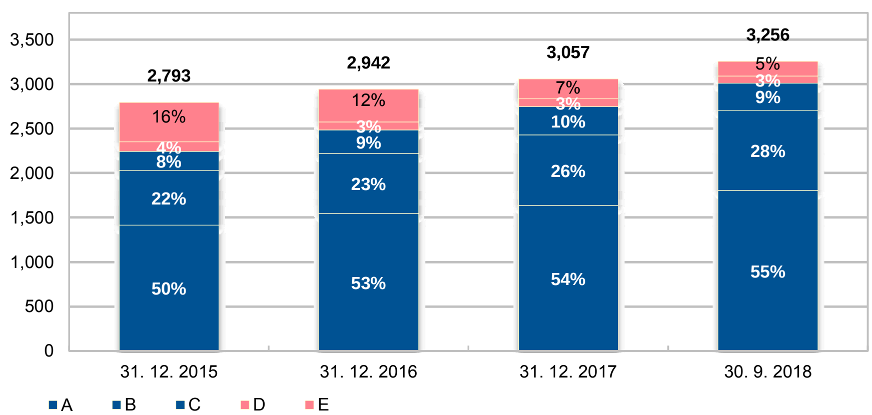
[1)] Until 2018 the following financial assets were included: recognised at fair value through income statement and held for trading, available for sale, held to maturity and initially recognised at fair value through income statement

Source: National Bank of Serbia.

3.2 Classified assets

At end-September 2018, total classified assets (on- and off-balance sheet) equalled RSD 3,256.1 bn, up by RSD 116.6 bn or 3.7% relative to a quarter earlier. Balance sheet assets subject to classification rose by RSD 75.3 bn and off-balance sheet items subject to classification by RSD 41.2 bn. Within balance sheet assets subject to classification, the most significant changes were recorded for long-term loans and due receivables, which rose by RSD 69.0 bn and went down by RSD 22.2 bn, respectively. Within off-balance sheet items, the largest absolute increase was recorded in contingent liabilities (by RSD 34.5 bn), which remain the dominant off-balance sheet item subject to classification with RSD 539.3 bn at end-September 2018 (60.6% share in total classified off-balance sheet items).

Chart 3.2 **Total classified assets**
(RSD bn, in %)



Source: National Bank of Serbia.

The most significant change in balance sheet assets subject to classification relative to a quarter earlier was an increase in balance sheet items from categories A and B by RSD 48.8 bn and RSD 52.0 bn, respectively (primarily in long-term loans), while categories D and E recorded a reduction by RSD 3.1 bn and RSD 26.4 bn, respectively (a reduction in receivables due). The downward trend displayed by bad assets is the result of the implementation of the Decision on the Accounting Write-off of Bank Balance Sheet Assets as of 30 September 2017. Consequently, the asset quality improved, as the share of the two worst categories shrank by 1.6 pp, hence bad assets accounted for 9.2% of total classified balance sheet assets.

An increase in total classified off-balance sheet items by RSD 41.2 bn resulted from an increase in category A by RSD 42.0 bn, mostly under Contingent liabilities, while categories C and D decreased (by RSD 3.4 bn and RSD 3.5 bn), hence the share of bad assets fell from 3.6% to 3.1% in total classified off-balance sheet items.

As a result of the above movements, the calculated balance sheet regulatory provisions dropped by RSD 25.8 bn (10.6%) in Q3 and equalled RSD 216.5 bn, while calculated off-balance sheet provisions fell 5.1% to RSD 14.5 bn.

Accordingly, total required reserve for estimated losses arising from credit risk (which for each borrower represents a positive difference between the amount of regulatory provisions and the sum of allowances for impairment of balance sheet assets and provisions for losses on off-balance sheet items) decreased by RSD 6.4 bn or 4.8% in the same period, amounting to RSD 126.8 bn.

Assigned receivables amounted to RSD 28.5 bn in Q3 2018, which is 3.5 times more than in Q2 2018. The third quarter had the highest activity on record in terms of assigned receivables given that 78% of all receivables in 2018 were realised in this period. Of the total generated receivables in the first nine months of 2018 (amounting to RSD 36.7 bn), the bulk (98%) was transferred to non-banking sector entities.

3.3 Loans[7]

In Q3 2018, gross loans of the Serbian banking sector recorded a nominal quarterly increase of RSD 57.7 bn or 2.7%, reaching RSD 2,178.2 bn. Relative to end-2017, the nominal increase in gross loans was RSD 124.5 bn or 6.1%.

Table 3.3 **Change in the level of net loans**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Finance and insurance	26,020	2,910	2,020	12.6%	8.4%
Public enterprises	76,216	344	-9,226	0.5%	-10.8%
Companies	980,501	14,781	46,096	1.5%	4.9%
Public sector	25,587	32	-1,243	0.1%	-4.6%
Households	883,640	32,660	82,011	3.8%	10.2%
Foreign persons and foreign banks	47,850	5,890	5,732	14.0%	13.6%
Other sectors	138,355	1,052	-870	0.8%	-0.6%
Total loans	**2,178,169**	**57,670**	**124,520**	**2.7%**	**6.1%**

Source: National Bank of Serbia.

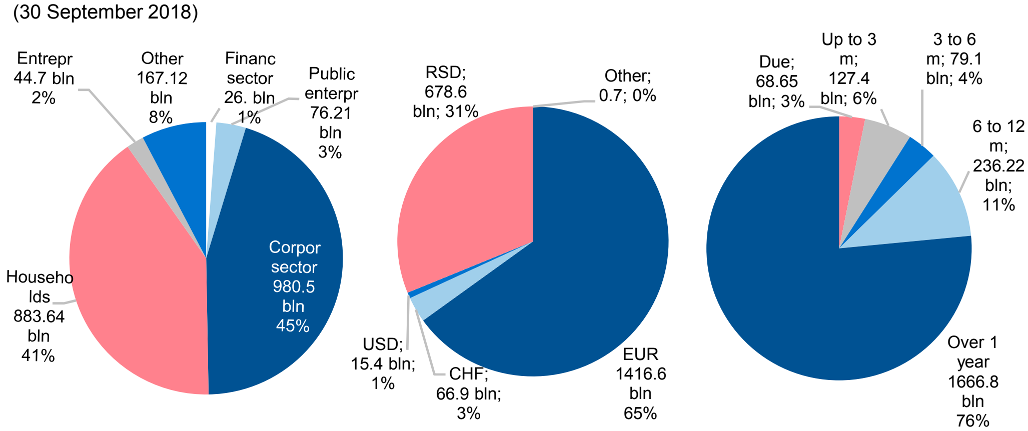
[7] In accordance with the Guidelines on the Obligation and Method of Collection, Processing and Submission of Data on the Stock and Structure of Bank Loans, Receivables and Liabilities, loans include the following loans in dinars and foreign currency: recalls, under transaction accounts, overnight, consumer, liquidity and current assets, export, investment, housing, cash, for the payment of imports of goods and services from abroad, for the purchase of real estate in the country for a natural person, and other loans.

Growth in gross lending was the most pronounced in the household sector – by RSD 32.7 bn (or 3.8% compared to the end of the previous quarter), and in the corporates by RSD 14.8 bn (up by 1.5% compared to the previous quarter). As was the case earlier, the increase in loans to households is largely attributable to the rise in dinar cash loans and housing loans with an FX clause. As of April 2018, cash loans posted the highest increase in total loans to households, rising at 5.1% in Q3 2018 or by 15.0% in the nine months of 2018. As for loans to corporates, the rise is mostly evident with liquidity and current assets loans with an FX clause. The only gross lending decline in nominal terms was recorded in the sector of Other legal persons, within which the most pronounced decrease is that of Companies in bankruptcy. The corporate and household sectors are still the most prevalent, accounting for 45.0% and 40.6% respectively of total gross loans.

The currency structure of the Serbian banking sector's loan portfolio is still dominated by foreign currency. At end-Q3 2018, FX and FX-indexed loans accounted for 68.8%. The prevalent currency of loan indexation in Serbia was the euro, with EUR loans making up 65.0% in total loans (94.5% of total gross FX and FX-indexed loans), followed by CHF and USD loans with 3.1% and 0.7% (4.5% and 1.0% of total gross FX and FX-indexed loans, respectively). Compared to June 2018, gross CHF and USD loans fell both in nominal and relative terms.

At end-Q3 2018, dinar loans made up 31.2% of total gross loans. Observed by sector, households accounted for the bulk of dinar loans (55.6%), while the share of the public non-financial sector was the smallest (7.8%), with the exception of foreign entities (0.4%). By loan category, dinar loans accounted for the major portion of cash and consumer loans (99.1% and 64.2% respectively), and the smallest share of housing and investment loans (0.3% and 10.0% respectively). Due to the prolonged upward trend of dinar cash loans, the share of cash loans in total loans equalled 18.3% at end-September 2018 (17.9% in June 2018).

Chart 3.3 **Banking sector gross loan portfolio structure**
(RSD bn)
(30 September 2018)



Source: National Bank of Serbia.

Observed by the remaining maturity, the structure of gross loans did not change significantly – the share of long-term gross loans increased (from 75.7% to 76.5%), as did the share of overnight loans (from 1.2% to 1.3%), short-term loans were unchanged at 19.0%, while matured loans trended down (from 4.1% to 3.2%).

3.4 Non-performing loans

Monitoring the level and trend of non-performing loans (NPLs) is vital for identifying potential problems in the collection of receivables and monitoring of credit risk, as these loans and the indicators associated with them may signal deterioration in the quality of the loan portfolio of the banking sector. Further analysis of NPLs in relation to allowances for their impairment, regulatory provisions and capital provides insight into the banking sector's capacity to absorb losses arising from NPLs.

According to the methodology applied by the NBS, an NPL means the total outstanding debt under an individual loan (including the amount of arrears):

- where the payment of principal or interest is past due (within the meaning of the decision governing the classification of balance sheet assets and off-balance sheet items) over 90 days;

- where at least 90 days of interest payments have been added to the loan balance, capitalised, refinanced or delayed by agreement;

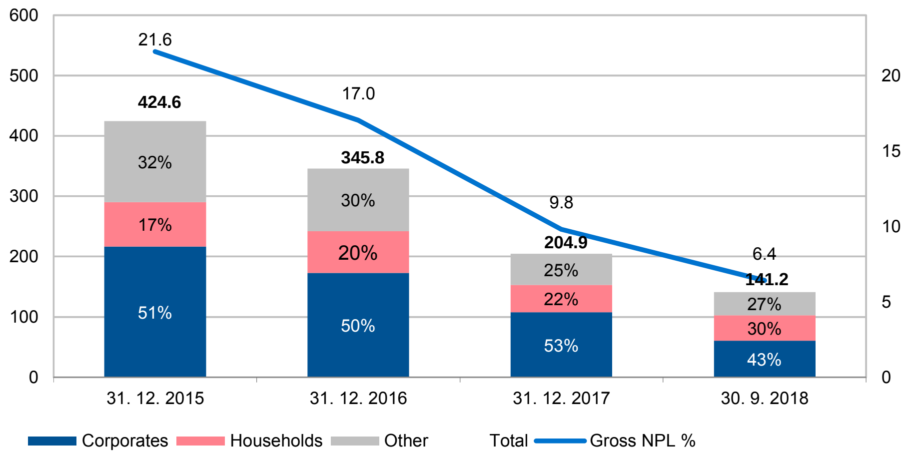
- where payments are less than 90 days overdue, but the bank has assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full.

Gross NPLs

In Q3 2018, the banking sector's total gross NPLs decreased by RSD 26.7 bn to RSD 141.2 bn at end-September. During this quarter, gross NPLs[8] saw a decline by RSD 22.2 bn on account of assignment and by RSD 12.9 bn on account of collection, while write-offs accounted for an additional reduction of RSD 3.9 bn. The banking sector's new gross NPLs in Q3 2018 amounted to RSD 13.3 bn.

[8] Calculated based on the NPL 3 report which banks submit to the NBS.

Chart 3.4.1 **Gross non performing loans (NPL)**
(RSD bn)



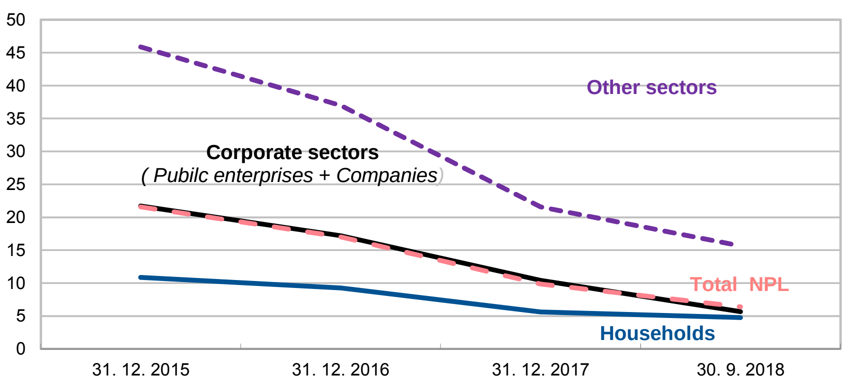
Source: National Bank of Serbia.

The fall in gross NPLs by 15.9%, along with a rise in total loans by 2.4%, pushed the share of NPLs in total gross loans further down by 1.4 pp q-o-q, to 6.4%, which is their new historic low since the introduction of the uniform definition of a non-performing loan and mandatory reporting in 2008.

Despite a decline of RSD 26.7 bn, the bulk of gross NPLs is still in the corporate segment (RSD 57.0 bn at end-September 2018). In addition to that, NPLs of Companies in bankruptcy and other legal persons in bankruptcy stood at RSD 28.8 bn.

In the household sector, gross NPLs stood at RSD 42.2 bn, or 29.9% of total gross NPLs.

Chart 3.4.2 **NPL ratio for main sectors**
(in %)

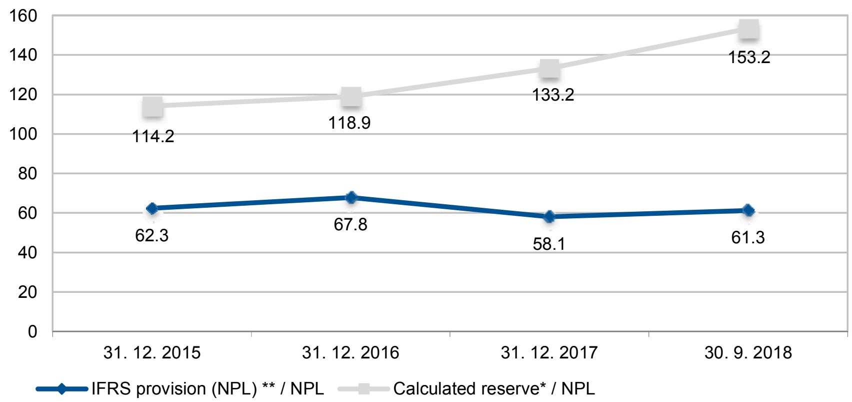


Source: National Bank of Serbia.

NPL coverage

At end-Q3 2018, the coverage of total gross NPLs by loan loss reserves equalled 153.3%, while allowances for impairment remained relatively high, ensuring the coverage of 61.3%, despite the high amount of write-offs.

Chart 3.4.3 **NPL coverage**
(in %)



* Calculated reserve for potential losses on balance-sheet lending (loan loss reserve)
** Provision for non-performing loans

Source: National Bank of Serbia.

Corporate NPLs

At end-Q3 2018, gross corporate NPLs equalled RSD 57.0 bn, down by RSD 24.6 bn or 30.2% q-o-q, mainly due to: assignment (RSD 21.6 bn), collection (RSD 6.4 bn) and write-offs (RSD 1.7 bn).[9]

Table 3.4.1 **Changes in gross NPLs by main economic sectors**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Agriculture	1,822	-130	-540	-6.7%	-22.9%
Manufacturing	21,863	-20,157	-24,594	-48.0%	-52.9%
Construction	9,880	1,401	-3,245	16.5%	-24.7%
Trade	10,339	-4,656	-11,311	-31.1%	-52.2%
Transport, hotels/restaurants, communications	3,175	-997	-1,550	-23.9%	-32.8%
Real estate	9,621	-118	-4,115	-1.2%	-30.0%

Source: National Bank of Serbia.

[9] Calculated based on the NPL 3 report which banks submit to the NBS.

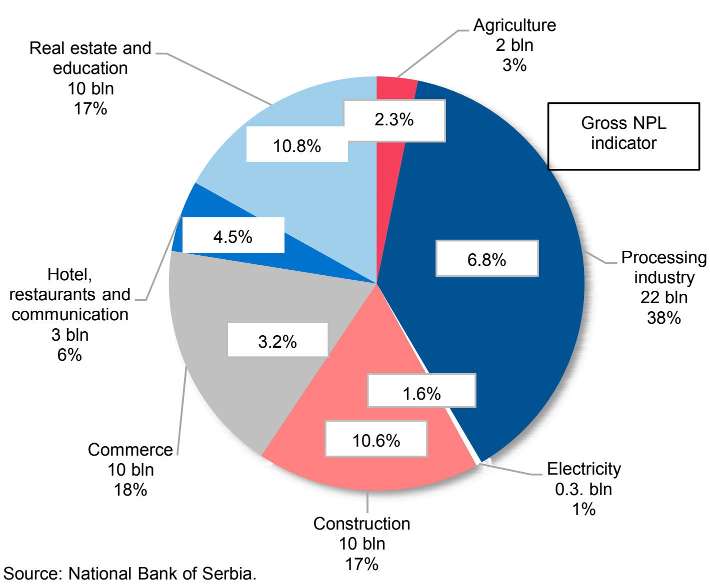
By sector, the biggest share in total corporate NPLs continued to be held by manufacturing (38.4%, with a 6.8% gross NPL ratio), followed by trade (18.2%, with a 3.2% gross NPL ratio), real estate (16.9%, with a 10.8% gross NPL ratio) and construction (17.3%, with a 10.6% gross NPL ratio). During this quarter, the NPL ratio markedly declined in all sectors. The sharpest decline was recorded in: manufacturing and trade (by 6.0 pp and 1.6 pp, respectively).

Table 3.4.2 **Corporate NPL ratio by sector**
(in %)

		Change relative to prior periods (pp)	
	30. 9. 2018	30. 6. 2018	31. 12. 2017
Agriculture	2.3%	-0.3	-0.9
Manufacturing	6.8%	-6.0	-7.8
Construction	10.6%	1.1	-5.0
Trade	3.2%	-1.6	-3.8
Transport, hotels/restaurants, communications	4.5%	-1.1	-2.3
Real estate	10.8%	-0.3	-5.2

Source: National Bank of Serbia.

Chart 3.4.4. **Private corporates NPL structure**
(30 September 2017)



Source: National Bank of Serbia.

Natural persons' NPLs[10]

Measuring 4.9% at end-Q3 2018, the share of gross NPLs of natural persons is still below the average of the total portfolio and 0.2 pp lower than a quarter earlier.

At end-Q3 2018, natural persons' NPLs equalled RSD 48.4 bn, having dipped by 0.1% q-o-q. The NPL share is decreasing in all loan categories. The greatest relative reduction was recorded in current account overdrafts (2.9%) and consumer loans (2.6%), except cash loans, which recorded a rise of RSD 0.7 bn or 4.7%.

The downward trend of the NPL ratio of the natural persons sector was primarily determined by growth in lending triggered by the expansion of cash loans. Their share in gross loans to natural persons equalled 42.4% at end-September 2018, up by RSD 21.3 bn or 5.3% from the previous quarter. At the same time, the share of cash loans in total NPLs to natural persons increased to 32.5% at end-September 2018. On the other hand, the gross NPL ratio of cash loans recorded relatively low values (3.7% at end-September 2018).

Table 3.4.3 **Changes in gross non-performing household loans by category**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Housing loans	20,703	-295	-1,129	-1.4%	-5.2%
Cash loans	15,762	714	469	4.7%	3.1%
Credit cards	1,726	-30	-974	-1.7%	-36.1%
Current account overdrafts	1,727	-52	-751	-2.9%	-30.3%
Consumer loans	504	-14	-108	-2.6%	-17.6%
Other	8,023	-386	-2,077	-4.6%	-20.6%
Total	**48,445**	**-63**	**-4,569**	**-0.1%**	**-8.6%**

Source: National Bank of Serbia.

The category of housing construction loans accounted for 38.1% and 42.7% in total gross NPLs.

Table 3.4.4 **Gross NPL ratio for households by category**
(in %)

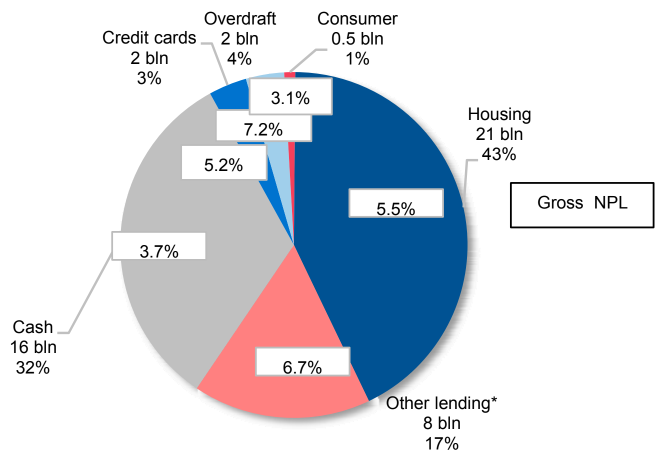
		Change relative to prior periods (pp)	
	30. 9. 2018	30. 6. 2018	31. 12. 2017
Housing construction	5.5%	-0.2	-0.7
Cash loans	3.7%	0.0	-0.5
Credit cards	5.2%	-0.1	-1.8
Current account overdrafts	7.2%	-0.3	-3.6
Consumer loans	3.1%	-0.2	-1.3

Source: National Bank of Serbia.

[10] Households, entrepreneurs, private households with employed persons and registered farmers.

The highest gross NPL ratio in the natural persons' segment at end-September 2018 (7.2%) was recorded in the category of current account overdrafts (which accounted for 2.4% of total loans to natural persons and for 3.6% of total NPLs of natural persons). The next were housing loans, with the ratio of 5.5%, credit cards with the ratio of 5.2% (making up 3.3% of total loans to natural persons and 3.6% of NPLs of natural persons), and cash loans with 3.7%. The gross NPL ratio declined across all categories of natural persons' loans.

Chart 3.4.5. **Natural persons NPL structure**
(30 September 2018)



* Other lending = agriculture, other activities, vehicle purchase loans and other loans
Source: National Bank of Serbia.

When observing NPLs to natural persons in relation to allowances for their impairment, housing loans are a category with the lowest allowances for impairment (46.5% relative to gross NPLs), due to generally better collateral coverage. In current account overdrafts, credit cards and cash loans, allowances for impairment are much higher (76.3%, 67.3% and 64.7%, respectively).

4. BANKING SECTOR LIABILITIES

4.1 Structure of the sources of funding

Deposits[11] were the primary source of bank funding in Serbia, making up 70.2% of total liabilities. At end-Q3 2018, own sources of funding made up 19.1% and borrowing 5.8% of total liabilities.

Table 4.1 **Change in key items of banking sector liabilities**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Deposits and other liabilities	2,772,290	54,361	160,043	2.0%	6.1%
to banks, OFO and the central bank	*415,146*	*14,036*	*35,694*	*3.5%*	*9.4%*
to other customers	*2,357,145*	*40,325*	*124,348*	*17%*	*5.6%*
Liabilities under securities 1)	473	-13	-101	-2.7%	-17.5%
Subordinated liabilities	31,722	2,625	-1,568	9.0%	-4.7%
Provisions	9,546	-513	-1,615	-5.1%	-14.5%
Share capital and other capital	400,181	4,131	-4,365	1.0%	-1.1%
Profit	95,627	14,272	-5,111	17.5%	-5.1%
Loss	24,666	-2,001	-9,839	-7.5%	-28.5%
Reserves and unrealised losses	210,460	-2,166	14,125	-1.0%	7.2%
Other	67,702	12,214	22,696	22.0%	50.4%
Total liabilities	**3,563,335**	**86,912**	**193,943**	**2.5%**	**5.8%**

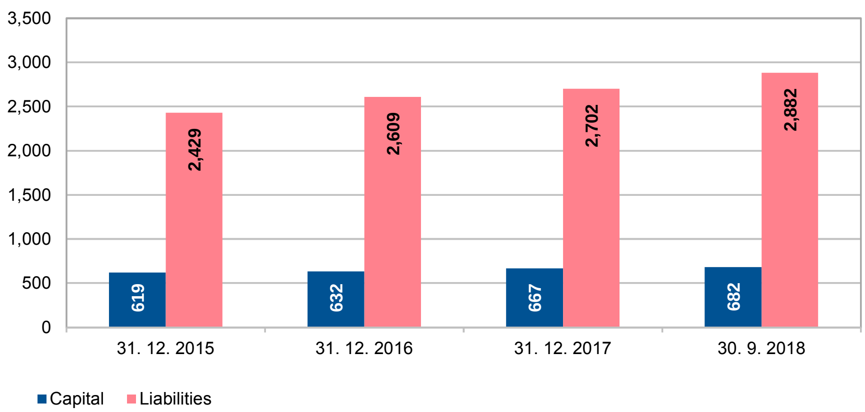
1) Until 2018 this included the following items in balance sheet: Financial liabilities in balance sheet initially recognised at fair value through income statement and Own securities issued and other borrowings.

Source: National Bank of Serbia.

Total liabilities of the banking sector rose by RSD 68.7 bn (or 2.4%) q-o-q. The increase in liabilities is mainly a result of the increase under item Deposits and other liabilities to other clients and Deposits and other liabilities to banks by RSD 40.3 bn (1.7%) and RSD 14.0 bn (3.5%), respectively.

[11] Including transaction and other deposits as part of items: Deposits and other liabilities to banks, other financial organisations and the central bank and Deposits to other clients.

Chart 4.1. **Banking sector capital and liabilities**
(in RSD bn)



Source: National Bank of Sebia.

In Q3, the total capital of the banking sector rose by RSD 18.2 bn in nominal terms (by 2.7%), while its share in total balance sheet liabilities remained unchanged (19.1%). Within capital structure, the most significant changes were recorded for profit of the current year (increase by RSD 19.3 bn), profit from previous years (decrease by RSD 5.1 bn – primarily envisaged for payment of dividends), share capital (up by RSD 4.1 bn – capital increase in two banks) and losses from previous years (down by RSD 2.8 bn – provisioning).

The currency structure showed that dinar sources of funding (capital included) increased from 43.5% to 43.9% in Q3. As regards the FX and FX-indexed portion of liabilities, EUR-denominated liabilities remained dominant, making up 91.7% of total FX liabilities, while the rest were mostly liabilities in USD (4.6%) and CHF (2.9%).

4.2 Deposits

Total deposits with banks stood at RSD 2,501.9 bn at end-Q3 2018, up by RSD 51.9 bn (2.1%) q-o-q. The increase stemmed mainly from a rise in deposits of foreign persons, namely foreign banks and households (by RSD 28.6 bn and RSD 23.6 bn, respectively).

At end-Q3 2018, dinar deposits grew by RSD 13.2 bn and FX deposits by RSD 42.7 bn, while FX-indexed deposits went down by RSD 4.0 bn. The share of FX and FX-indexed deposits in total deposits remained unchanged at 68.5%. The EUR was the dominant currency, making up 91.1% of total FX and FX-indexed deposits. The rest of FX and FX-indexed deposits were mainly in USD (5.1%) and CHF (2.8%).

In terms of initial (agreed) maturity, demand deposits were still dominant (62.1%), followed by deposits maturing in up to one year (25.5%), while 12.4% of all deposits were agreed for over one year term.

Short-term deposits (observed by the remaining maturity) made up the bulk of bank deposits in Serbia. Demand deposits made up over a half of all deposits (62.2%), followed by deposits with the remaining maturity of up to one year with 30.3%, while deposits with the remaining maturity of over one year accounted for 7.3% of total deposits. There were no major changes in the shares relative to a quarter earlier.

Table 4.2 **Changes in deposits levels**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Finance and insurance sector	67,148	670	3,676	1.0%	5.8%
Public enterprises	125,225	-4,243	-15,098	-3.3%	-10.8%
Companies	584,054	-4,517	30,149	-0.8%	5.4%
Public sector	42,816	-536	9,701	-1.2%	29.3%
Households	1,289,111	23,566	66,144	1.9%	5.4%
Foreign entities and foreign banks	236,441	28,615	42,378	13.8%	21.8%
Other sectors	157,100	8,312	4,509	5.6%	3.0%
Total deposits	**2,501,895**	**51,868**	**141,460**	**2.1%**	**6.0%**

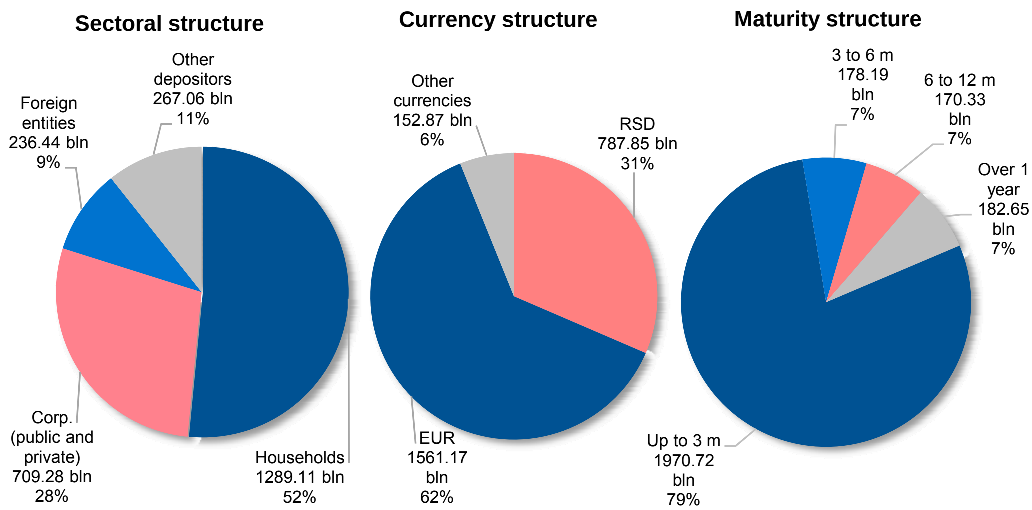
Source: National Bank of Serbia.

At end-Q3 2018, total household deposits in foreign currency amounted to RSD 1,109.5 bn (rising by 1.3% q-o-q) and were made up mainly of savings deposits (63.1%).

Compared to the end of the previous quarter, household savings deposits12 increased by RSD 4.9 bn (0.7%) to RSD 750.2 bn at end-Q3 2018. This increase resulted from higher savings in foreign currency (by RSD 2.7 bn) due to the dinar depreciating by 0.3%, and the rise in dinar savings (by RSD 2.2 bn). At end-September 2018, FX savings were dominant in total household savings deposits, making up 93.3%, while dinar savings accounted for 6.7%.

[12] Accounts 402 and 502 in the Chart of Accounts, sector 6 (domestic and foreign natural persons – residents).

Chart 4.2. **Banking sector deposits structure**
(30 September 2018)



Source: National Bank of Serbia.

4.3 Total borrowing of banks

At end-Q3 2018, the total credit borrowing of the banking sector amounted to RSD 264.0 bn, an increase by RSD 1.8 bn or 0.7% relative to the previous quarter.

Table 4.3 **Changes in the level of bank borrowing**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Overnight loans	46,414	-9,732	10,047	-17.3%	27.6%
Loans received	206,906	12,492	8,760	6.4%	4.4%
Other financial liabilities	10,646	-962	-1,107	-8.3%	-9.4%
Total borrowing	**263,966**	**1,798**	**17,701**	**0.7%**	**7.2%**

Source: National Bank of Serbia.

The largest individual item in total credit borrowing were loans taken (primarily from parent banks, banks related within the same group and international financial institutions), making up 78.4% (end of the previous quarter: 74.2%) and rising by RSD 12.5 bn nominally q-o-q. The next largest item were liabilities under overnight loans which accounted for 17.6% (end of the previous quarter: 21.4%), after a decline of

RSD 9.7 bn in Q3. Other financial liabilities made up 4.0% (end of the previous quarter: 4.4%), falling by RSD 1.0 bn.

In this segment, the biggest creditors of banks were foreign persons with 72.9% (primarily foreign banks) and the general government sector with 15.3% (primarily government bodies and organisations).

The dominant currency of borrowing was the euro, accounting for RSD 233.1 bn (end of the previous quarter: RSD 230.5 bn) or 88.3% of total credit borrowing. Liabilities in dinars stood at RSD 26.5 bn (end of the previous quarter: RSD 25.8 bn) or 10.0% of total credit borrowing, while banks owed RSD 1.7 bn and RSD 2.5 bn in USD and CHF, respectively (end-Q2: RSD 2.8 bn and RSD 2.6 bn, respectively), or 0.6 % and 0.9% of total credit borrowing.

4.4 External liabilities

At end-Q3 2018, banks' total external liabilities under credit operations stood at RSD 192.3 bn, up by RSD 7.3 bn (4.0%) q-o-q. An increase was recorded only for borrowings – by RSD 11.1 bn (from international financial organisations). This segment remained highly concentrated, given that of the 13 banks which borrowed externally, four banks accounted for 70.6% of the total debt. Also, five banks took overnight foreign loans, and 79.8% of that debt related to a single bank.

Long-term loans held a dominant 80.8% share in the maturity structure of external borrowing (end-Q2: 79.1%).

Table 4.4 **Changes in bank external borrowing**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Overnight loans	17,288	-2,281	7,679	-11.7%	79.9%
Loans received	173,043	11,073	14,475	6.8%	9.1%
Other financial liabilities	1,982	-1,471	259	-42.6%	15.0%
Total borrowing	**192,314**	**7,322**	**22,414**	**4.0%**	**13.2%**

Source: National Bank of Serbia.

External borrowing was primarily euro-denominated – 97.4%, unchanged from the quarter before (97.3%). CHF borrowing accounted for 1.2%.

4.5 Subordinated liabilities

At end-Q3 2018, total subordinated liabilities of Serbian banks stood at RSD 31.5 bn, which is an increase by 8.5% q-o-q, whereby the prior downward trend was discontinued. In 2017 alone, subordinated liabilities decreased by 27%.

In terms of creditors, total subordinated liabilities were structured in the following manner: liabilities to foreign banks accounted for 77.3%, liabilities to foreign legal persons – 20.8% and liabilities to corporates –1.9%.

The currency structure was as follows: the share of subordinated liabilities in euros increased to 76.9%, liabilities in Swiss francs amounted to 21.2%, liabilities in dinars made up 1.5%, and in other currencies – 0.4%.

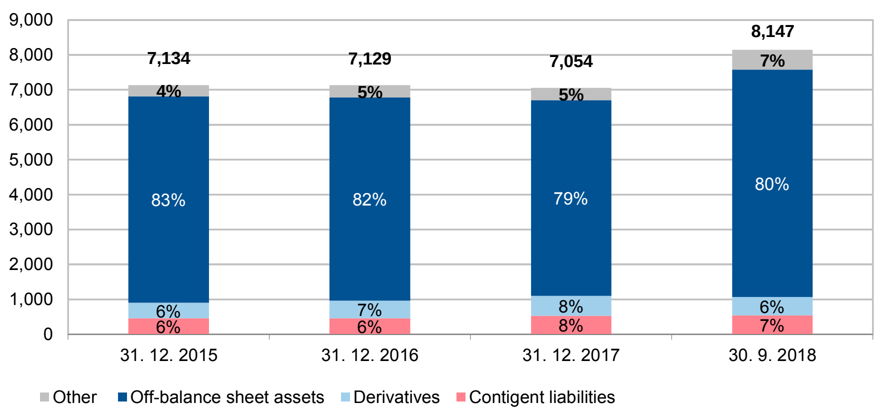
Subordinated liabilities were highly concentrated – of the 12 banks with subordinated debt, one bank accounted for over 28% of all subordinated liabilities, and the top four banks made up over 67% of total subordinated liabilities.

Given the regulatory restrictions on inclusion of subordinated liabilities in Tier 2 and/or regulatory capital, banks included 60.4% of stated subordinated debt in their Tier 2 capital.

5. OFF-BALANCE SHEET ITEMS

At end-Q3 2018, total off-balance sheet items of the banking sector stood at RSD 8,147.0 bn, rising by 6.1% from the end of the previous quarter, mostly on account of an increase in Other off-balance sheet assets (by RSD 398.8 bn) and Derivatives (by RSD 63.4 bn). Within item Other off-balance sheet assets (with a dominant 79.9% of total off-balance sheet), the sharpest growth of RSD 184.4 bn was recorded in Guarantees received and other sureties for settling the obligations of bank debtors. Other significant off-balance sheet items were Derivatives with 6.5% and Issued guarantees and other sureties with 4.0%.

Chart 5.1. **Off-balance sheet items**
(in RSD bn, in %)



Source: National Bank of Serbia.

Following its implementation on 1 January 2018, amendments and supplements to the Chart of Accounts introduced two new accounts for disclosing written-off financial assets, which were transferred to off-balance sheet records (in dinars and foreign currency) for the purpose of reporting in accordance with the Decision on the Accounting Write-off of Bank Balance Sheet Assets. At end-Q3 2018, the banking sector disclosed RSD 209.7 bn on these accounts, up by RSD 1.9 bn or 0.9% q-o-q.

Risk-free items still accounted for the bulk (89.1%) of off-balance sheet items: material collateral received, guarantees and other sureties accepted for the settlement of borrowers' liabilities, custody operations and other off-balance sheet assets.

At end-Q3 2018, the classified part of off-balance sheet items (i.e. which is considered risk-bearing) amounted to RSD 890.3 bn (an increase by RSD 41.2 bn or 4.9%).

At end-Q3 2018, contingent liabilities13 equalled RSD 539.9 bn (rising by RSD 4.3 bn or 0.8% q-o-q) and made up 6.6% of total off-balance sheet items (7.0% at the end of the previous quarter).

Table 5.1 **Changes in off-balance sheet items in the Serbian banking sector**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	30. 9. 2018	30. 6. 2018	31. 12. 2017	30. 6. 2018	31. 12. 2017
Issued guarantees and other sureties	322,955	9,530	19,340	3.0%	6.4%
Receivables from derivatives	528,569	63,426	-45,952	13.6%	-8.0%
Contingent liabilities and other irrevocable commitmei	216,958	-5,208	-8,497	-2.3%	-3.8%
Securities received as collateral	197,835	8,506	19,500	4.5%	10.9%
Sureties for liabilities	97,647	1,541	616	1.6%	0.6%
Written off financial assets*	209,652	1,937	209,652	0.9%	
Other off-balance sheet assets	6,510,526	398,806	910,157	6.5%	16.3%
Other	62,872	-13,546	-11,918	-17.7%	-15.9%
Total off-balance assets	**8,147,015**	**464,992**	**1,092,899**	**6.1%**	**15.5%**

* Off-balance sheet items applies as of January 2018.
Source: National Bank of Serbia.

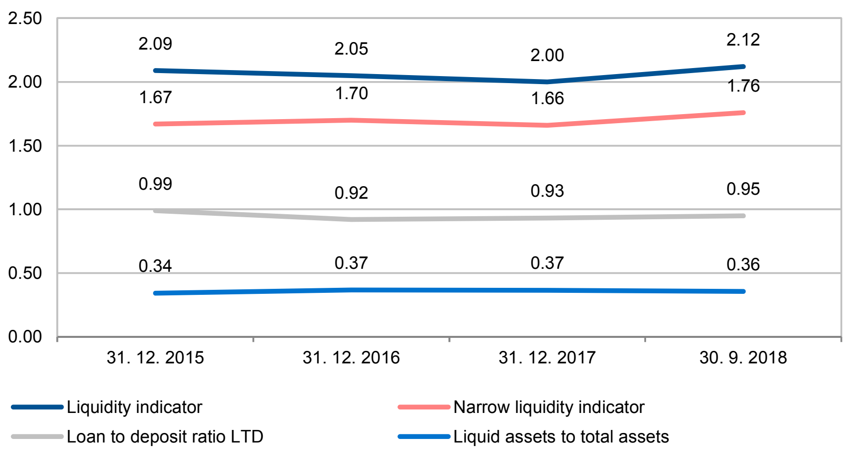
[13] Issued guarantees and other sureties, irrevocable commitments regarding undisbursed loans and placements, and other irrevocable commitments.

6. BANK LIQUIDITY

Based on reference values of liquidity indicators, Serbia's banking sector has been characterised by considerable excess liquidity for a long time now. At end-Q3 2018, the average monthly liquidity ratio was 2.12, twice higher than the regulatory floor of 1.0. The narrow liquidity ratio at banking sector level measured 1.76 (regulatory floor – 0.7). The share of liquid assets in total banking sector balance sheet assets is stable, having reached 35.7% at end-Q3 2018.

At end-Q3 2018, banks' investments in NBS repo securities decreased relative to June 2018, from RSD 65.0 bn to RSD 40.0 bn. The number of banks which invested in repo securities increased (15 banks). As for government securities, their portfolio was worth RSD 668.9 bn at end-September, having increased by 1.8% from end-June.

Chart 6.1. **Banking sector liquidity indicators**



Source: National Bank of Serbia.

To further strengthen the resilience of the banking sector,14 the liquidity coverage ratio was introduced. This indicator is the ratio of the liquidity buffer (made up by high-quality liquid assets) and net outflow of a bank's liquid assets that would occur in the 30 days after the calculation of this ratio in assumed stress conditions.

As of 1 January 2018, banks are required to maintain this ratio at a level not lower than 100% (prescribed floors are the same as in the European Union). As at 30 September 2018 the liquidity coverage ratio at the level of the banking sector measured 210.73%.

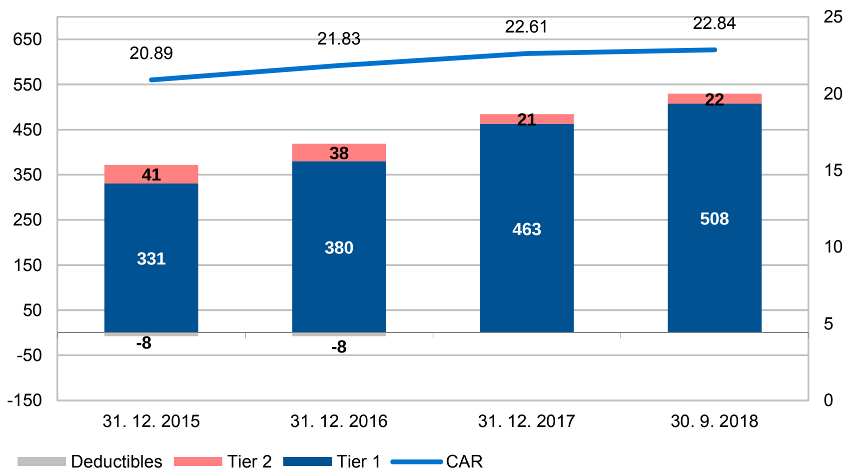
[14] The Decision on Liquidity Risk Management was adopted in December 2016 as part of the implementation of the Strategy for Introduction of Basel III Standards in Serbia.

7. CAPITAL ADEQUACY

The Serbian banking sector is well-capitalised, both from the aspect of compliance with the prescribed capital adequacy ratio,[15] and in terms of the structure of regulatory capital. At end-September 2018, the capital adequacy ratio of the Serbian banking sector averaged 22.84% (22.93% in June 2018). This is well above the NBS regulatory minimum (8%).

At end-September 2018, the Tier 1 capital ratio of the Serbian banking sector averaged 21.90% (vs. 22.07% in June 2018), and Common Equity Tier 1 capital ratio – 21.84% (vs. 22.00% in June 2018).

Chart 7.1. **Regulatory capital and CAR***
(in RSD bn, CAR in %)



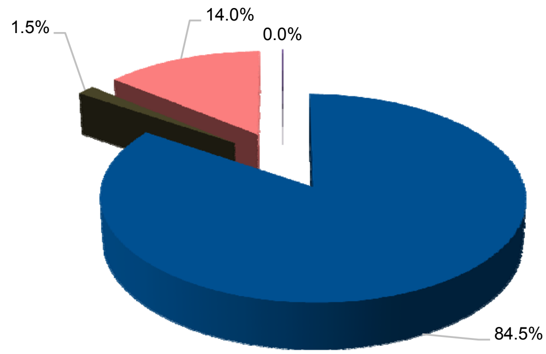
* CAR = Regulatory capital adequacy ratio

Source: National Bank of Serbia.

As capital grew slower than risk-weighted assets in Q3 2018 (2.8% vs. 3.2%, respectively), capital adequacy ratio slightly declined (by 0.09 pp). The increase in risk-weighted assets by RSD 71.2 bn stemmed from a rise in credit risk-weighted assets by RSD 64.4 bn (mainly in the part of exposure to companies and natural persons). Market-risk weighted assets also increased (by RSD 7.3 bn), primarily with regard to foreign exchange risk exposure (by RSD 5.6 bn).

[15] For the purposes of harmonisation with the relevant EU legislation in the field of banking, and to strengthen banking sector resilience, the NBS adopted new regulations in line with the requirements of Basel III standards, coming into effect as of 30 June 2017. The minimum prescribed capital adequacy ratio was reduced from 12% to 8%. In parallel, capital buffers were introduced (capital conservation buffer, countercyclical capital buffer, systemic risk buffer, capital buffer for a systemically important bank).

Chart 7.2. **RWA by risk type**
(in %)
(30 September 2018)



Source: National Bank of Serbia.

In the structure of risk-weighted assets, the dominant share referred to credit risk (84.5%), taking into account banks' traditional business models relying on lending to corporates and households. Next was operational risk with a share of 13.9%, while the shares of market risks and credit valuation adjustment risk were negligibly low – at 1.5% and 0.03%, respectively.

The growth of regulatory capital in Q3 2018, as well as throughout the whole 2017, can be primarily attributed to a decrease in required reserve. In Q3 2018, regulatory capital went up by 2.8% (in absolute amount: RSD 14.4 bn), and in the nine months of 2018 – by 9.3%. Regulatory capital of the banking sector at the end of the reporting quarter in 2018 equalled RSD 529.4 bn.

Regulatory capital consists of: Tier 1 capital, which made up 95.9%, and Tier 2 capital, measuring 4.1%. Tier 1 capital, which is the highest quality segment, is made up of Common Equity Tier 1 capital (99.7%) and Additional Tier 1 capital (0.3%).

At end-Q3 2018, Tier 1 capital[16] of the banking sector stood at RSD 507.6 bn, up by 2.4% (or RSD 11.8 bn) from June 2018. The banking sector's Tier 1 capital increased mostly as a result of the release of RSD 6.6 bn of required reserves for estimated losses arising from credit risk. Tier 2 capital of the banking sector increased relative to the end of the previous quarter by RSD 2.6 bn (13.4%) and stood at RSD 21.8 bn on account of an increase in subordinated liabilities included in Tier 2 capital in the same amount. Cumulative preference shares remained unchanged (RSD 2.6 bn).

In accordance with the Amendments to the Decision on Reporting Requirements for Banks, adopted in December 2016 and implemented as of 30 June 2017, the

[16] According to Basel III regulations, among other things, Tier 1 and Tier 2 capital are not reduced by the appropriate part of deductibles from regulatory capital, rather each of them has its own deductibles.

leverage ratio is calculated as a ratio of Tier 1 capital and a bank's total exposure amount. Total exposure is the sum of on- and off-balance sheet exposures, exposure based on derivatives, increases for counterparty credit risk with respect to repo and reverse repo transactions, margin lending transactions, agreements on securities or commodities lending or borrowing transactions and long-settlement transactions.

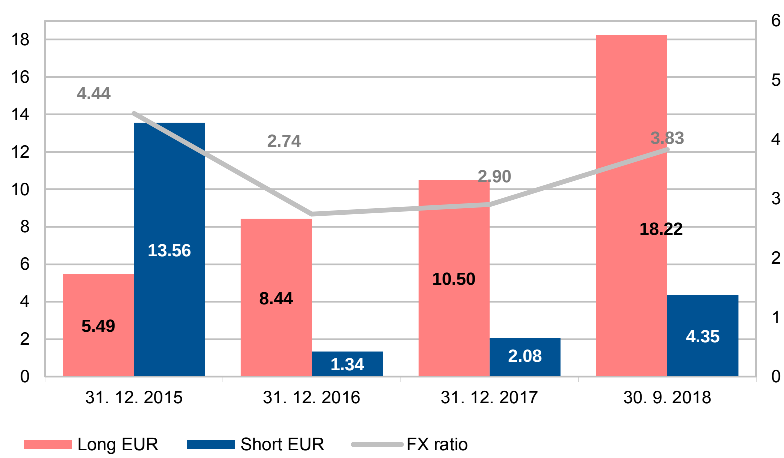
As at 30 September 2018, the leverage ratio at banking sector level measured 12.42%.[17] Stable movements of this ratio have been recorded since its introduction.

8. FOREIGN EXCHANGE RISK

At end-Q3 2018, Serbia's banking sector posted a long open FX position worth RSD 20.2 bn (excluding the position in gold). Eighteen banks ended September 2018 with a net long open FX position, while the remaining ten banks showed a net short open FX position.

On 30 September 2018, banks in Serbia operated at net long open positions in euros and US dollars (RSD 18.22 bn and RSD 1.26 bn, respectively), while at the same time posting a net short position in Swiss francs (RSD 0.30 bn).

Chart 8.1. **Quarterly breakdown of the sector's long and short FX position (in EUR) and foreign exchange risk ratio**
(in RSD bn)



Source: National Bank of Serbia.

At end-September 2018, the foreign exchange risk ratio for the banking sector equalled 3.83%, indicating a relatively low foreign exchange risk compared to the regulatory cap (20% of a banks' capital).

[17] According to Basel III standards, the leverage ratio floor was set at 3%.

In the structure of derivative financial instruments used by banks to manage foreign exchange risk, the most frequently used are currency forward and swap agreements.

Banks conclude forward agreements most often with companies, enabling them thus to regularly service monetary obligations to third persons at the agreed exchange rate on a future fixed date. At end-Q3 2018,[18] in currency forward agreements, banks mostly took the net short position in euros and dinars (53% and 42%, respectively), while taking to the lesser extent the net short position in US dollars (5%) at an agreed future date.

Currency swap agreements held a dominant share in derivative transactions in the Serbian banking sector. Banks usually conclude currency swap agreements with foreign financial institutions, including majority foreign owners and other financial institutions from parent banking groups. In swap agreements, commercial banks mostly held a long position in the following currencies: the euro (86.7% of all active swap transactions) and the Swiss franc (12% of active swap transactions). The long position in other currencies accounted for only 1.3% of the value of all active swap transactions. The most frequently used currency pair exchanged in swap agreements was the euro/dinar, accounting for 49% of active swap transactions, followed by euro/US dollar (25%) and euro/Swiss franc (13%) as at 30 September 2018.

9. NBS REGULATORY ACTIVITY

Exercising its regulatory competences in the area of bank supervision, the NBS issued the following regulations in Q3 2018.

In July 2018, the NBS Executive Board adopted the Decision Amending the Decision on Consolidated Supervision of a Banking Group (RS Official Gazette No 54/2018). The Decision aims to regulate the manner of calculation and conditions for inclusion of minority interests and Additional Tier 1 capital instruments and Tier 2 capital instruments issued by subsidiary companies in the capital of the banking group and to allow for offsetting of positions between members of the banking group for the purpose of calculating net positions and the capital requirement for market risks on a consolidated basis. The Decision is applied as of 21 July 2018.

In August 2018, the NBS Executive Board adopted the Decision Amending the Decision on Terms and Method of Calculating the Effective Interest Rate and on the Layout and Content of Forms Handed out to Consumers (RS Official Gazette No 62/2018). Taking into account the high risk of loans with variable interest rate and loans approved in foreign currency or with the contracted currency clause, this Decision was adopted in order to ensure appropriate risk management and removal of causes than might lead to unexpected losses, as well as in order to raise consumer

[18] Calculated based on the FINDER report which banks submit to the NBS.

awareness on borrowing risks. This Decision is yet another step forward in financial consumer protection. Amendments to the Decision prescribe, among other, the obligation for a bank (and lessor) – in case the consumer required that he be offered a loan/lease contract at a variable nominal interest rate and/or in a foreign currency or by contracting a currency clause – to inform the consumer, using the prescribed forms, about the risks of borrowing at a variable nominal interest rate and risks of borrowing in a foreign currency or by contracting a currency clause; about the risks of borrowing at a variable nominal interest rate (borrowing in dinars); about the risks of borrowing in a foreign currency or by contracting a currency clause. The Decision is applied as of 1 January 2019.

In September 2018 the NBS adopted the Decision on the Content, Deadlines and Manner of Submitting Data on Multilateral Interchange Fees (RS Official Gazette No 69/2018). This Decision regulates in more detail payment service providers' reporting to the NBS about multilateral interchange fees, based on the Law on Multilateral Interchange Fees and Special Operating Rules for Card-based Payment Transactions (RS Official Gazette No 44/2018), which prescribes the obligation for the NBS to regulate these issues in more detail. The Decision is applied as of 17 December 2018.