NATIONAL BANK OF SERBIA

TRENDS IN LENDING

First Quarter Report 2018

Belgrade, June 2018

Introductory note

Trends in Lending is an in-depth analysis of the latest trends in lending, which aims to ensure better understanding of the conditions prevailing in the domestic lending market. It looks into lending developments, cost of borrowing by households and corporates and lending market conditions, by examining factors behind loan supply and demand.

Credit aggregates, as a quantified expression of movements in the lending market, are calculated based on banking sector balance sheet statistics as a source of data on the balance of domestic banks' loan receivables. Given the relatively high share of foreign currency-indexed loans in loan portfolios, the increment and growth rates are calculated excluding the effect of changes in the dinar exchange rate against other currencies in the loan portfolio.

The report also draws on the results of the bank lending survey conducted by the National Bank of Serbia since early 2014. Participation in the survey is voluntary. This survey has greatly improved the understanding of developments in the domestic lending market, allowing insight into bankers' perceptions of actual and expected changes with regard to loan supply and private sector loan demand.

The report also relies on the results of the survey developed by the European Investment Bank in the context of the Vienna Initiative 2 to monitor deleveraging by cross-border banking groups and the resultant constraints on lending activity. This survey, conducted since October 2012 on a semi-annual basis, monitors subsidiaries of international banking groups in Central and South-Eastern Europe, focusing on their strategies, market conditions and expectations. The purpose of the survey is to observe the effects of movement in supply and demand on lending activity, and to gauge the impact of domestic and international factors on supply and demand conditions. Ten Serbian banks participate in this survey, their assets making up around 50% of total assets of the Serbian banking sector.

ABBREVIATIONS

bn – billion
GDP – gross domestic product
H – half-year
LHS – left-hand scale
M – month
mn – million
NPL – non-performing loan
pp – percentage point
Q – quarter
RHS right-hand scale
y-o-y – year-on-year

Other generally accepted abbreviations are not cited.

Contents

Overview

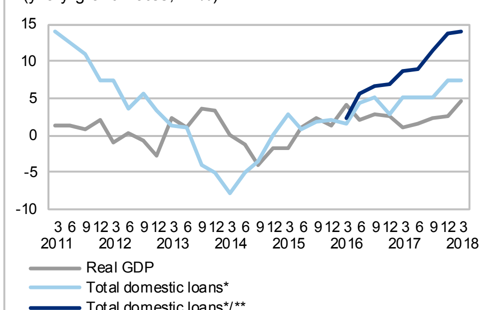
Lending activity continues to recover, bolstered by economic growth and positive labour market trends. It is also supported by favourable financing conditions on account of monetary policy easing, lower country risk premium, low interest rates in the euro area and intensified interbank competition. Y-o-y lending growth additionally accelerated in 2018 despite the fact that banks continued to clean up their balance sheets from distressed assets. The y-o-y rise in domestic loans, excluding the exchange rate effect,[1] stood at 7.5% in March. The growth rates were similar to those from end-2011, which was one of the years of subsidised lending schemes. In terms of sectors, growth in household lending slightly decelerated to 10.9%, while growth in corporate lending accelerated to 5.1%. If the effect of NPL write-off and sale is excluded,[2] the upward trend is even more evident – the y-o-y increase in total lending was 14.0% in March, while household lending rose by 14.4% and and corporate lending by 13.9%. However, the share of loans in GDP is below its long-term trend. Therefore, the accelerated growth in lending does not pose a threat to financial stability.

Despite the seasonal decline in lending at the beginning of the year, corporate lending recorded growth in Q1 2018, for the first time since 2012. In Q1, the amount of new corporate loans was slightly higher than in the same period last year, and by 16.6%, if the effect of loan refinancing with the same bank is excluded. Current assets loans kept their dominant position, accounting for the half of new corporate loans, while the share of investment loans reached 28.0% indicating that more intense investment activity was also boosted by bank loans. The bank lending survey results indicate that banks did not change credit standards for all types of corporates, though they were eased for loans to SMEs. As expected, corporate loan demand continued up, largely driven by investment and current assets financing.

The bank lending survey indicates that household lending growth was spurred by additional credit standard easing and a further rise in household loan demand. Use of all types of loans expanded, and of cash loans (including refinancing loans) and housing loans the most. In Q1 the volume of new household loans was up by 10.9% relative to the same period the year before, and the most dominant, dinar cash loans accounted for around 57% of these loans. Y-o-y growth in housing loans accelerated to 6.1% in March, bolstered by the recovery of labour market and real estate market. This was a result of the 7% rise in new housing loans (28.8% if refinancing loans with the same bank are excluded) in Q1 2018 relative to Q1 2017.

The share of dinar lending in total corporate and household lending (dinarisation of loans) stood at 32.5% at end-March. Since the largest portion of new loans to citizens was in dinars (around 71%), dinarisation of household loans additionally rose in 2018, to 51.9% in March. Dinarisation of corporate loans was reduced to 16.2% partly due to the write-off of dinar receivables.

Lending and economic activity growth additionally accelerated in Q1 2018
(y-o-y growth rates, in %)



Sources: NBS and SORS.
* Excluding the exchange rate effect.
** Excluding the effect of NPL write-off and sale since early 2016.

Intense NPL resolution activities, on the one hand, and the rise in lending activity, on the other, pushed down the share of NPLs in total lending to 9,2% in March. In slightly more than two and a half years since the adoption of the NPL

[1] Calculated at the dinar exchange rate against the euro, Swiss franc and US dollar as at 30 September 2014 (the so-called programme exchange rate used for monitoring the performance under the arrangement with the IMF), taking into account the currency structure of loan receivables.

[2] Excluding the NPL write-off and sale effect since the beginning of 2016. By March 2018, banks wrote off RSD 154.0 bn of NPLs, (of which RSD 117.1 bn pertained to corporates, and RSD 32.5 bn to households) and sold RSD 54.9 bn of NPLs that were in their balance sheets at the time.

Resolution Strategy, this share has been lowered by 13.2 pp, while the stock of NPLs has more than halved (the 55% fall), unambiguously pointing to the past success in solving this issue. The share of both corporate and household NPLs went down below the pre-crisis level and is at its lowest level since these indicators are monitored.

Further improvement of NPL indicators was also underlined in the EIB's CESEE Bank Lending Survey[3] from June. According to the survey results, past improvement was faster than the region's average and is expected to remain so in the coming period, too.

[3] Ten banks from Serbia, whose assets make up somewhat less than a half of total banking sector assets, participated in this survey: http://www.eib.org/infocentre/publications/all/cesee-bls-2017-h2.htm.

I. Corporate sector

1. Corporate loans

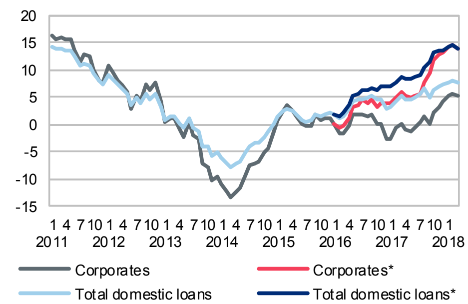
Y-o-y increase in corporate loans continued to accelerate in 2018, amounting to 5.1% in March, excluding the exchange rate effect. The increase occurred amid banks' continued efforts to resolve NPLs, confirming that lending activity is recovering fast. Excluding the effect of NPL write-off and sale since the beginning of 2016, the y-o-y rise in corporate loans stood at 13.9% in March.[4]

More favourable tendencies in corporate lending are also indicated by the fact that corporate loans recorded growth in Q1, for the first time since 2012, despite the seasonal decline in lending at the beginning of the year. Excluding the exchange rate effect, they rose by 0.4% or by RSD 3.7 bn in Q1. Growth related to companies, while public enterprise borrowing contracted additionally compared to end-2017. In nominal terms, corporate loans went up by RSD 2.6 bn to RSD 1,062.4 bn in Q1, while their share in estimated annual GDP stood at 23.5%[5] in March.

In Q1, the amount of new corporate loans (RSD 182.9 bn) was up by 1.3% relative to the same period last year and by 16.6% excluding the effect of loan refinancing with the same bank. As so far, current assets loans were dominant, accounting for the half of new corporate loans (50.4%), while the share of investment loans went up to 28.0% (average for 2017 was 23.3%). At the same time, the amount of new investment loans was higher by one fifth compared to the same period the year before, indicating that investment growth was supported by bank loans as well. The share of new import loans declined to 3.1%, as greater performance was recorded only in January.

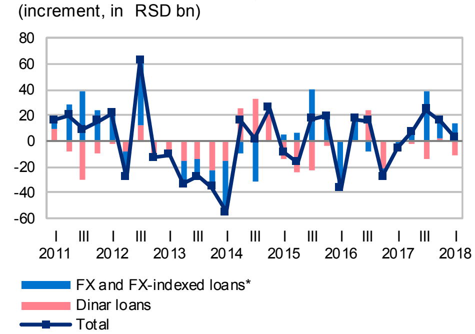
The composition of new loans reflects on the composition of the stock of loan receivables from corporates. Thus, owing to a greater amount of new investment loans, their share in total loans rose by 0.3 pp to 31.8% in March. Current assets loans again accounted for the largest portion of bank receivables from corporates, their share (48.8%) unchanged from December 2017. By sector, loans to companies operating in the areas of trade, construction, energy

Corporate lending growth accelerated despite continued NPL write-off
(y-o-y growth rates at programme exchange rate, in %)



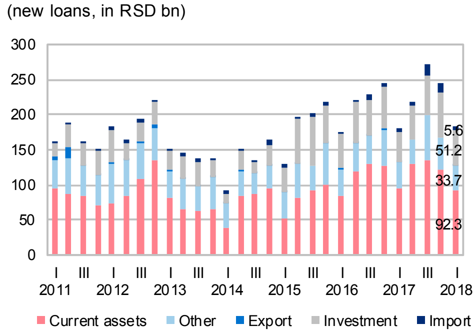
Source: NBS.
* Excluding the effect of NPL write-off and sale since early 2016.

Corporate lending growth in Q1, despite seasonally lower lending
(increment, in RSD bn)



Source: NBS.
* Excluding the exchange rate effect.

Investment growth boosted by higher new invetsment loans
(new loans, in RSD bn)



Source: NBS.

[4] From the beginning of 2016 until March 2018, banks wrote off RSD 117.1 bn of corporate NPLs and sold RSD 52.8 bn of NPLs that were in their balance sheets at the time.

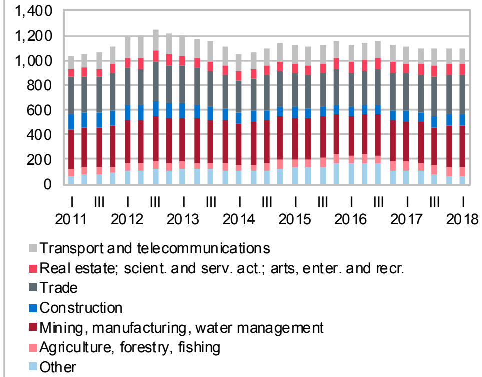
[5] GDP in the past four quarters.

and manufacturing continued to go up, while loans to transport and agriculture companies largely went down. The share of dinar corporate loans decreased in Q1, to 16.2% in March, under the impact of greater borrowing in foreign currency and partly due to the write-off of dinar receivables.[6] Euro-indexed and euro-denominated loans still made up the bulk of corporate loans (82.3%), while the share of US dollar- and Swiss franc-denominated loans is constantly declining – in March, these loans made up 1.1% and 0.3% of the loan portfolio, respectively.

The implementation of the NPL Resolution Strategy[7], supported by the application of the Decision on the Accounting Write-off of Bank Balance Sheet Assets as of September 2017, continues to yield good results in 2018. NPLs additionally declined in Q1, still on account of bank efforts regarding collection, restructuring, write-off and sale of NPLs, facilitated by the NBS measures. This and the rise in lending activity were the reasons why the share of NPLs in total corporate loans went down in Q1 by 0.7 pp to 9.7% in March. The share of NPLs of companies decreased by the same amount and stood at 10.1% in March. The NPL share decreased in all sectors and is currently at its multi-year lows. The greatest drop is recorded in sectors that were most severely hit by the crisis (construction, manufacturing, real estate). The results achieved in this area are also pointed out by the IMF and rating agencies in their estimates.

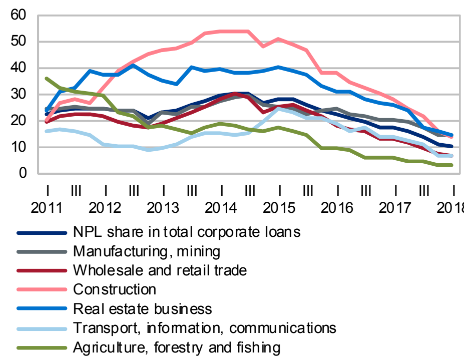
From the standpoint of financial stability, it is important to note that even when they were at a higher level, the NPLs did not threaten the stability of the financial sector. Allowances for impairment of total loans to gross NPLs stood at 73.2%, and regulatory provisions for balance sheet exposure continued to fully cover gross NPLs, at 135.7% in March. Also, after the introduction of Basel III standards,[8] the capital adequacy ratio rose further, to 22.7% in March, indicating the high capitalisation of the domestic banking sector.

Lending to manufacturing and trade sectors account for the bulk of receivables from corporates
(stocks, in RSD bn)



Source: NBS.

NPL shares are at their lowest points in years, in all sectors
(gross principle, in %)



Source: NBS.

[6] On 30 September 2017 the Decision on the Accounting Write-off of Bank Balance Sheet Assets started to apply. According to this Decision, banks are required to write off all loans whose allowances for impairment equal 100% of their gross book value.

[7] Activities envisaged in the NBS's Action Plan (http://www.nbs.rs/internet/latinica/55/npl/akcioni_plan.pdf), aimed at boosting banks' capacity for NPL resolution and providing a contribution to the development of the NPL market, were implemented in full, some of them even before the deadline. Their implementation was one of the important factors that led to the sharp fall in NPLs in 2016, 2017 and 2018. For more details on the measures undertaken and results achieved in terms of NPL resolution by the end of 2016 see Text box 2 in the *Inflation Report* from February 2017.

[8] Basel III regulatory framework is applied as of 30 June 2017 when the application of the Decision on Capital Adequacy of Banks (RS Official Gazette, No 103/2016) started, introducing this standard in the domestic legislation.

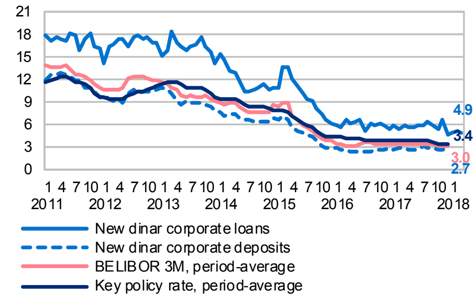
2. Cost of corporate borrowing

The downward trend in interest rates on new dinar corporate loans began in September 2013 (from 17.7%) after a cycle of NBS key policy rate cuts initiated in May that year. Since then, rates on dinar loans to corporates fell by 12.7 pp to 4.9% in March 2018.[9] Relative to September 2013, rates on euro-indexed corporate loans stood at 2.9% on average in March, down by 4.1 pp, reflecting lower rates in the euro money market, and, to a larger extent, a drop in the country risk premium, owing primarily to the strengthening of domestic macroeconomic fundamentals. Increased interbank competition in the lending market also worked towards a fall in interest rates on both dinar and euro-indexed loans.

Having reached new lows in December, interest rates on all types of dinar corporate loans remained favourable in Q1. At end-March, the average rate on new dinar corporate loans stood at 4.9%. The rate on investment loans stood at 6.9%, the rate on current assets loans was at 4.4%, up by 0.1 pp, and the rate on other loans at 5.2%, up by 0.2 pp.

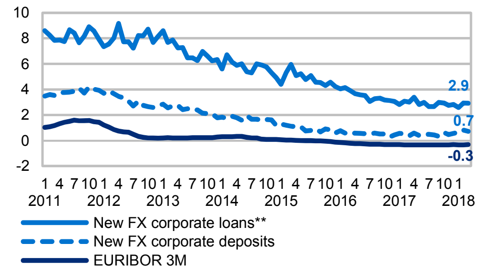
In Q1, the weighted average rate on new euro and euro-indexed corporate loans slightly rose (from 2.8% in December to 2.9% in March). The rates on current assets loans and euro-indexed loans for other purposes were adjusted by 0.2 pp each and in March they stood at 2.8% and 2.9% respectively. At the same time, interest rates on import loans (2.2%) remained almost unaltered compared to December, while the price of investment loans was down by 0.3 pp relative to end-2017 and equalled 3.0% in March.

Interest rates on dinar loans were close to December minimum in Q1*
(average weighted values, per annum, in %)



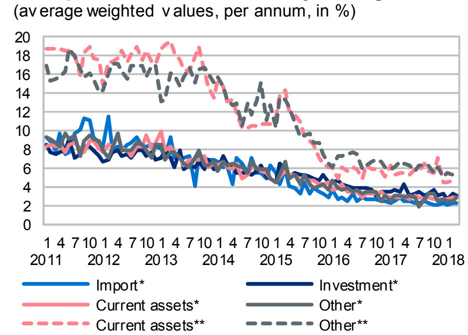
Source: NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

The price of FX corporate loans remained favourable in 2018.*
(average weigthed values, per annum, in %)



Sources: NBS and European Banking Federation.
* Excluding revolving loans, current account overdrafts and credit card debt.
** Euro and euro-indexed.

Interest rates on all types of corporate loans multiple times lower than five years ago
(average weighted values, per annum, in %)



Source: NBS.
* Euro and euro-indexed.
** Dinar.

---

[9] The lowest level of 4.7% was recorded in December 2017.

3. Assessment of loan supply and demand – based on the results of bank lending surveys

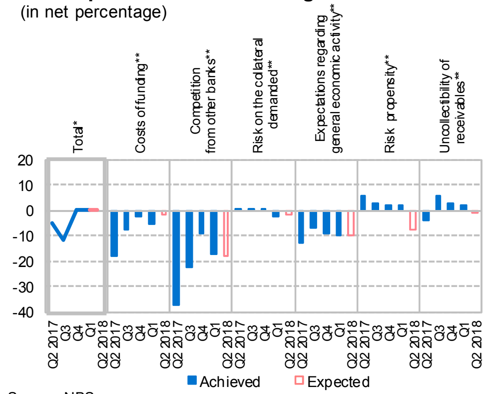
According to the results of the April NBS bank lending survey, in aggregate terms, credit standards were unchanged, and no change is expected in Q2 either. Under the criterion of company size, according to banks' estimate standards were slightly eased for SMEs and tightened for large enterprises. Standards were eased for foreign currency long-term loans, mostly affected by interbank competition and greater risk propensity, as well as lower costs of sources of funding and expected economic growth.

According to banks' estimates, terms of borrowing for enterprises were more favourable on account of lower interest margins and associated costs, increase in maturity and the maximum loan amount. Collateral requirements were also eased after a longer period of time, owing to greater bank participation in projects in which international financial institutions provide a portion of guarantee support.

As expected, loan demand of corporates continued up in Q1. Rising demand was led by the the need for financing capital investment and current assets and, to a lesser extent, debt restructuring. The same factors are likely to remain the main drivers of the rise in demand in Q2 as well.

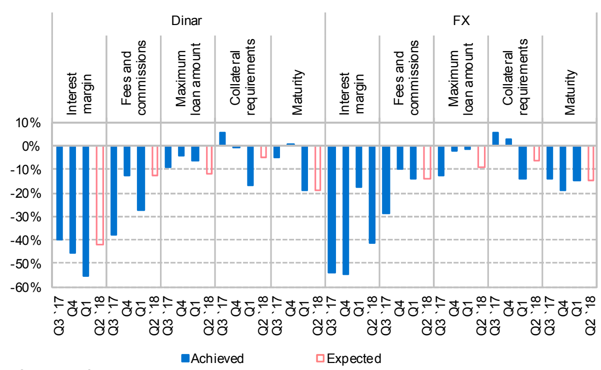
According to the EIB's CESEE Bank Lending Survey[10] published in June, corporate loan demand in Serbia was rising faster than the region's average and was led by the higher demand of SMEs. The surveyed banks estimated that the quality of loan applications, particularly of SMEs, improved significantly in the previous period.

Having been eased in mid-2017, credit standards for corporates were not changed
(in net percentage)



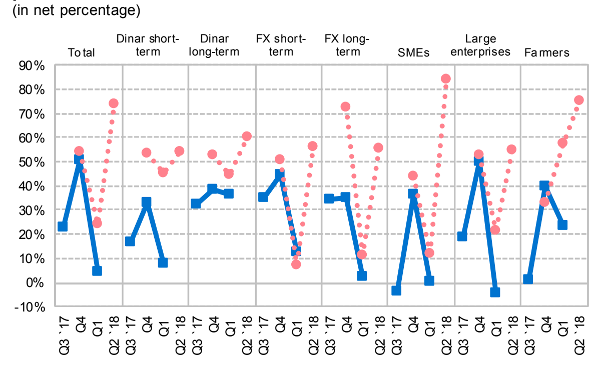
Source: NBS.
* Positive values indicate tightening of conditions and negative – easing, relative to the previous quarter.
** Positive values indicate the contribution of individual factors to tightening, and negative values indicate the contribution to easing of lending standards.

Collateral requirements eased after a longer period
(in net percentage)



Source: NBS.
* Positive value indicates tightening of conditions and negative – easing.
** The intensity of change is not shown.

Significant rise in SME demand for loans expected in the coming period
(in net percentage)



Source: NBS.
* Positive value indicates an increase in demand, and negative value indicates a decrease.
** The intensity of change is not shown.

[10] Ten banks from Serbia, whose assets make up somewhat less than a half of total Serbian banking sector assets, participated in this survey (http://www.eib.org/infocentre/publications/all/cesee-bls-2017-h2.htm).

II. Household Sector

1. Household loans

The y-o-y growth of household loans slightly decelerated since the beginning of 2018, and excluding the exchange rate effect it equalled 10.9% in March. Excluding the NPL write-off and sale effect, which continued into 2018, household lending recorded a 14.4% y-o-y increase in March.[11] The stock of household loans equalled RSD 917.6 bn in March, accounting for around 45% of bank loan receivables from the non-monetary sector. Their share in estimated annual GDP equalled 20.3% in March.

In the course of Q1, excluding the exchange rate effect, household loans rose by 2.2% or RSD 19.5 bn. Cash loans (including refinancing loans) and housing loans recorded the most significant growth. In Q1 they rose by RSD 10.4 bn and by RSD 5.3 bn, respectively.

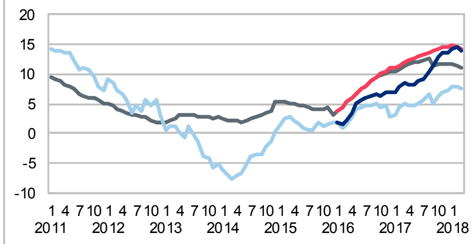
The volume of new household loans in Q1 (RSD 110.5 bn) was down by 2.8% relative to Q4 2017 and up by 10.9% relative to same period last year. In Q1 dinar cash loans and refinancing loans were the dominant household loans, which accounted for 57.1% of new household loans. Almost three quarters of those were approved for a period longer than five years. Housing loans continued to recover as confirmed by the amount of new housing loans of RSD 19.2 bn, which went up by 7.0% relative to Q1 of the previous year, and by 28.8% excluding the loans refinanced by the same bank.

By purpose, housing and cash loans were the dominant category of household loans – at 39.3% and 38.9%, respectively. The use and share of consumer loans edged up slightly and in March they accounted for 2.5% of household loans. They were mostly made up of dinar loans for purchase of mobile phones and household appliances, as well as FX-indexed loans for car purchase.

Households continued to borrow predominantly in dinars – on average, in Q1 2018 as in 2017, 71% of newly-approved household loans were in dinars. As a result, the dinarisation of household lending trended further up, reaching 51.9% in March (up by 0.1 pp relative to end-2017. The share of euro-indexed and euro-denominated loans rose to 40.8% as a result of the recovery of housing loans, whereas the share of Swiss franc loans went down to 7.3%.

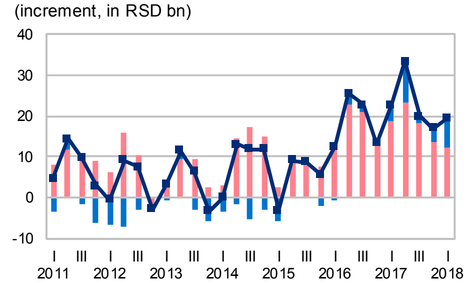
[11] Excluding the NPL write-off and sale effect since the beginning of 2016. By March 2018, banks wrote off RSD 32.5 bn worth of NPLs from households.

Y-o-y growth in household loans slightly decelerated, but still high
(y-o-y growth rates at programme exchange rate, in %)



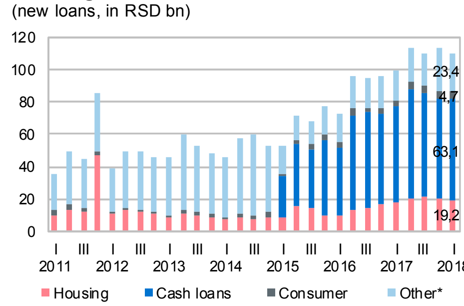
Source: NBS.
* Excluding the effect of NPL write-off and sale since early 2016.

As usual, housold lending growth driven by dinar lending
(increment, in RSD bn)



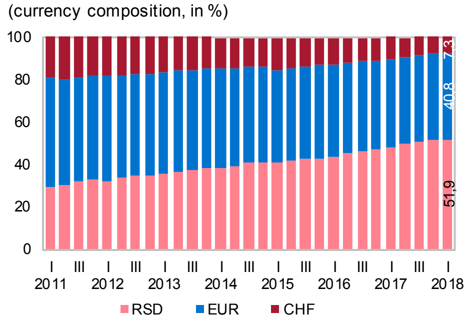
Source: NBS.
* Excluding the exchange rate effect.

Housing loans continue to rise
(new loans, in RSD bn)



Source. NBS.
* Until Dec. 2014, the 'other loans' category implied cash and other loans together.

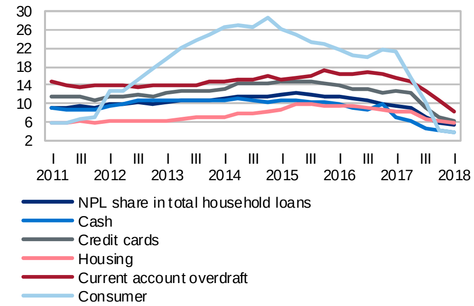
Rise in dinarisation of receivables from households continues
(currency composition, in %)



Source: NBS.

As in the case of the corporate sector, the share of NPLs in total household loans kept decreasing in 2018. This was due not only to increased household lending, but also stepped-up NPL write-offs. A significant improvement in NPL indicators is also highlighted in the latest EIB's CESEE Bank Lending Survey and the trend is expected to continue in the coming period. The share of NPLs in household loans came at 5.2% in March, down by 0.4 pp from end-2017.[12] The NPL share is decreasing in all loan categories. In Q1 the share of NPLs in cash loans went down by 0.3 pp, to 4.0%, in housing loans by 0.2 pp, to 6.0%, and in consumer loans by 0.8 pp, to 3.6%.

NPL share in total household loans at its lowest level
(gross principle, in %)

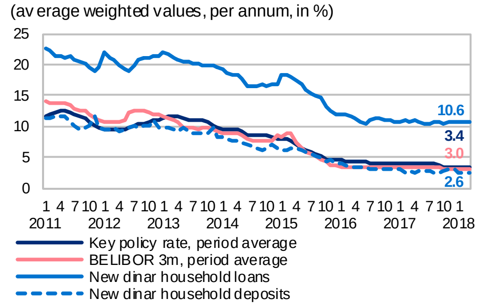


Source: NBS.

2. Cost of household borrowing

Owing to significant monetary policy easing by the NBS, a fall in the country risk premium, low rates in the international money market and increased interbank competition in the lending market, the cost of household borrowing halved in comparison to 2013. Relative to May 2013, when the cycle of monetary policy easing by the NBS began, rates on new dinar loans contracted by 10.0 pp and on euro-indexed loans by 4.0 pp. At the same time, the costs of the repayment of existing loans were also reduced, which reflects positively on the households' disposable income.

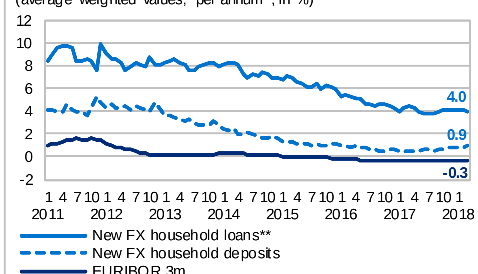
Costs of dinar household borrowing down by 10 pp relative to 2013*
(average weighted values, per annum, in %)



Source: NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

The average weighted rate on dinar household loans was 10.6% in March, which is at the December level. The rates on cash loans went down (by 0.2 pp to 10.9%), and March saw disbursements of housing loans, approved at the lowest average rate so far (4.7%). The rates on consumer loans (8.3%) were unchanged from end-2017, while the rates on other loans went up (to 9.9%).

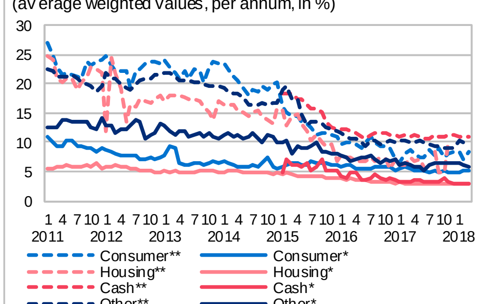
The cost of FX borrowing is also two times lower relative to 2013*
(average weighted values, per annum , in %)



Sources: NBS and European Banking Federation.
* Excluding revolving loans, current account overdrafts and credit card debt.
** Euro and euro-indexed.

The average rate on euro and dinar euro-indexed household loans slid by 0.2 pp in Q1 to 4.0% in March. This was a result of lowered interest rates on housing loans (by 0.2 pp), which sank to the lowest level so far in February and March (2.8%), and of decreased interest rates on other loans, that went down by 0.6 pp, to 5.9%. On the other hand, rates on cash and consumer loans went up by 0.1 pp each relative to end-2017 and in March they stood at 3.0% and 5.1%, respectively.

Interest rates on new housing loans lowered to new lows in Q1
(average weighted values, per annum, in %)



Source: NBS.
* Euro and euro-indexed.
** Dinar.

[12] If we include entrepreneurs and private households, that share also decreased from the beginning of 2018, by 0.4 pp to 5.4% in March.

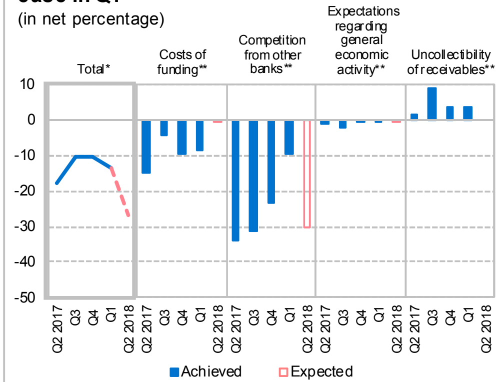
3. Assessment of loan supply and demand – based on the results of bank lending surveys

According to banks' estimates, growth in household lending in Q1 reflects the continued positive effect of factors on both the demand and supply side. According to the results of the April NBS lending survey, as it was expected, banks eased their household credit standards further in Q1. The easing concerned primarily dinar cash loans and refinancing loans, as well as FX housing and consumer loans, and was under the strongest impact of interbank competition and cheaper costs of funding. The easing of credit standards is expected to continue in Q2, primarily in response to interbank competition and economic growth.

As suggested by survey results, in Q1 banks continued to offer more favourable terms for both dinar and FX-indexed loans. Citizens were offered extended payment terms, collateral requirements were eased and interest rates went further down.

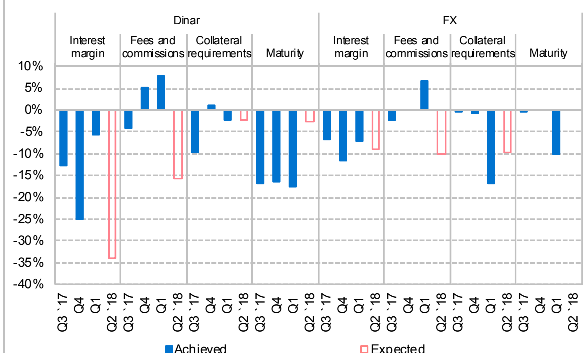
As expected, loan demand continued to grow in Q1. As usual, there was a rise in the demand for dinar cash loans and refinancing loans, as well as for FX-indexed housing loans. The demand for FX-indexed consumer car purchase loans also recorded a pronounced growth in Q1. The main factors contributing to the rising demand were the refinancing of current liabilities, wage growth and purchase of real estate. The survey suggests that banks expect the same factors to continue affecting the rise in demand in Q2 with additional positive impact of employment growth.

Credit standards for households continued to ease in Q1
(in net percentage)



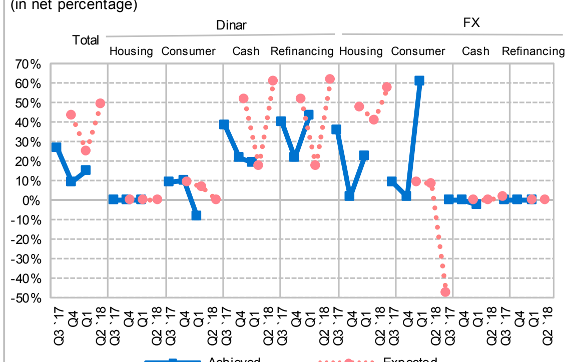
Source: NBS.
* Positive values indicate tightening of conditions and negative – easing, relative to the previous quarter.
** Positive values indicate the contribution of individual factors to tightening, and negative values indicate the contribution to easing of lending standards.

In Q1 margins were lowered additionally, maturity extended and colalteral requirements eased
(in net percentage)



Source: NBS.
* Positive value indicates tightening of conditions and negative – easing.
** The intensity of change is not shown.

Demand for FX consumer loans significantly exceeded expectations in Q1
(in net percentage)



Source: NBS.
* Positive value indicates an increase in demand, and negative value indicates a decrease.
** The intensity of change is not shown.

Methodological notes

- Loans imply bank receivables under the loan principal.
- Placements imply receivables under loans, interests and charges, paid deposits, securities and shares of companies.
- All types of receivables are expressed according to the gross principle, i.e. not reduced by allowances for impairment.
- Dinar loans are loans extended in dinars without an FX-clause. The FX clause implies a currency clause that defines hedging against changes in the dinar exchange rate.
- When excluding the exchange rate effect, the calculation is based on the original currency composition and the exchange rate of the dinar against the euro, the US dollar and the Swiss franc as at 30 September 2014.
- New business includes all financial arrangements (credits and deposits) the terms of which are agreed for the first time during the reporting month, as well as all existing contracts the terms of which were re-agreed (through annexes), with the active participation of the client.
- The sectoral classification of monetary statistics is used. The corporate sector includes public enterprises, companies and the non-financial sector in bankruptcy, while the household sector includes citizens, entrepreneurs, private households with employed persons and registered farmers. By way of exception:
  - with newly-approved loans, the household sector includes non-profit institutions serving households (in accordance with the ECB methodology);
  - with non-performing loans, the sectors are presented separately, but are aggregated for the sake of comparison with the monetary statistics data.
- The term non-performing loans implies the stock of the total outstanding debt under individual loans (including the amount of arrears):
  - where the payment of principal or interest is past due (within the meaning of the decision on classification of balance sheet assets and off-balance sheet items) over 90 days,
  - where 90 days of interest payments have been attributed to the loan balance, capitalized, refinanced or delayed,
    where payments are less than 90 days overdue, but the bank assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full.