7 December 2023

EXPLANATION FOR THE COUNTERCYCLICAL CAPITAL BUFFER RATE FOR THE REPUBLIC OF SERBIA

Pursuant to Article 14, paragraph 1, item 11) of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015 – CC decision and 44/2018) and Section 436 of the Decision on Capital Adequacy of Banks (RS Official Gazette, Nos 103/2016, 103/2018, 88/2019, 67/2020, 98/2020, 137/2020, 59/2021, 67/2022, 137/2022 and 48/2023, hereinafter: Decision on Capital Adequacy), the NBS Executive Board, at its meeting of 7 December 2023, decided to keep the countercyclical capital buffer rate for the Republic of Serbia at 0% having in mind that the estimated deviation of the real credit-to-GDP ratio from its long-term trend (credit-to-GDP gap) is below the lower bound of 2 pp needed for the introduction of the countercyclical capital buffer (hereinafter: CCyB). By keeping the countercyclical capital buffer rate at 0%, the National Bank of Serbia (NBS) continues to support the lending market.

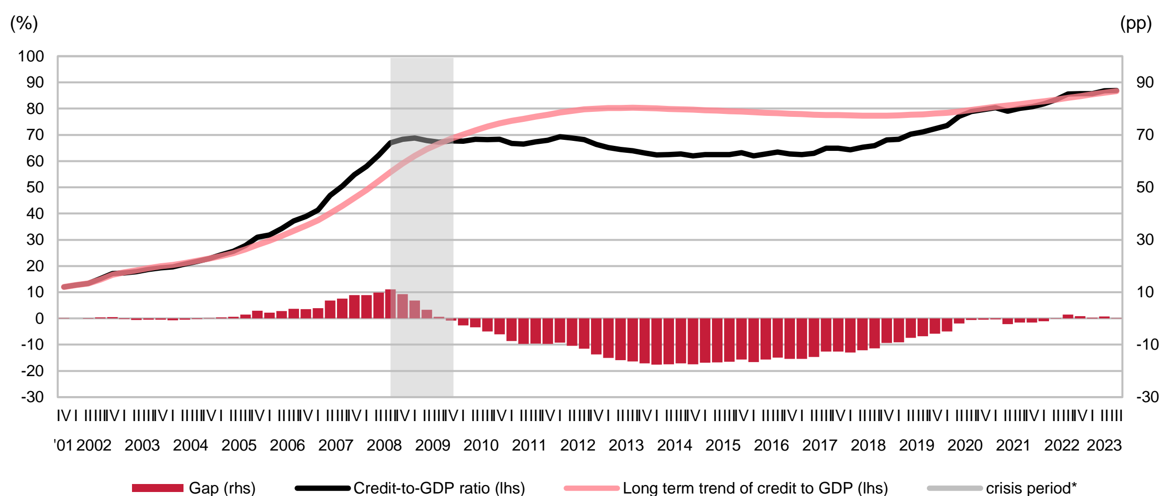
The CCyB is additional Common Equity Tier 1 capital that banks are required to maintain above the prescribed regulatory minimum in the amount equal to their risk-weighted assets multiplied by the specific countercyclical buffer rate. This instrument mitigates the cyclical dimension of systemic risk, creating an additional buffer of Common Equity Tier 1 capital during periods of pronounced credit growth, which can be released when systemic risks materialise.

The NBS sets the CCyB rate for the Republic of Serbia on a quarterly basis, taking into account the reference guide, applicable guidelines and recommendations of the European Systemic Risk Board and other variables it considers relevant for monitoring the cyclical dimension of systemic risk. In accordance with Section 436, paragraphs 2 and 3 of the Decision on Capital Adequacy, the guide for setting the CCyB rate is the deviation of the share of loans in GDP from long-term trend (credit-to-GDP gap). The CCyB rate for the Republic of Serbia is set in line with the recommendation for setting the CCyB rate of the European Systemic Risk Board (ESRB/2014/1).

Chart 1 shows the share of credit to the non-government sector in GDP, the long-term trend and the estimated credit-to-GDP gap. After a period of credit expansion between 2000 and 2008, in late 2009 the real credit-to-GDP gap entered the negative territory. Lending growth in place since 2014 brought the share of total loans in GDP close to its long-term trend. According to the September 2023 data, the share of total loans in GDP is slightly above its long-term trend, the gap being 0.2 pp. The gap value declined both y-o-y and q-o-q.

The estimated gap value is below the lower bound of 2 pp, the benchmark value which, if exceeded, may point to excessive lending growth.

Chart 1 **Credit-to-GDP ratio and its long run trend**



Source: NBS
*Based on SSI

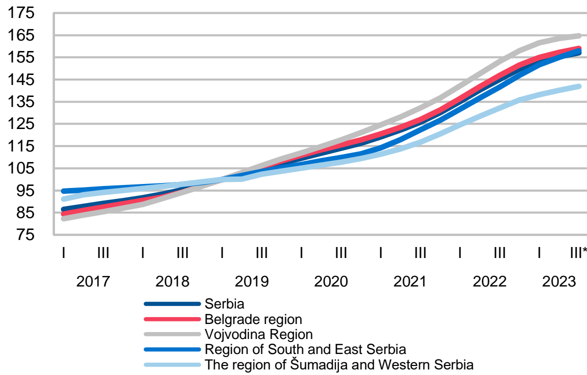
In addition to the credit-to-GDP gap, other optional indicators were also taken into account when setting the CCyB rate for the Republic of Serbia, in accordance with Section 436, paragraph 4 of the Decision on Capital Adequacy. Optional indicators relating to the real estate market, external imbalance and banking sector developments were used.

Real estate market

According to the data of the Republic Geodetic Authority, and based on the index of flat prices, the growth in flat prices continued, though at a somewhat slower pace compared to the previous period. According to preliminary data, the annual growth rate of flat prices in the Republic of Serbia in Q3 2023 stood at 8.2%, while relative to the previous quarter the prices of flats rose 1.1%.[1]

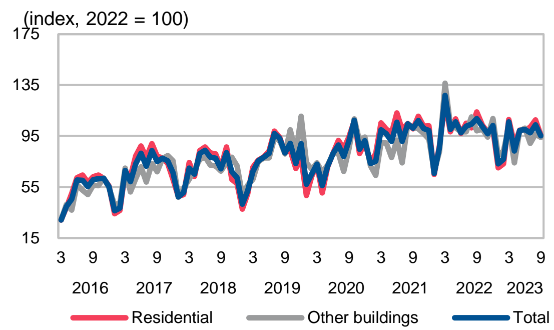
[1] Republic Geodetic Authority – Report on the index of flat prices for Q3 2023.

Chart 2 **Housing price index**
(Q1 2019 = 100)



* Preliminary data
Source: Republic Geodetic Authority

Chart 3 **Indices of the number of newly issued building permits**
(index, 2022 = 100)



Source: Statistical Office of the Republic of Serbia.

In Q3 2023, the total number of issued permits for new construction declined by 6.1% y-o-y.

The LTV ratio, as the ratio of mortgage-backed housing loans for which a flat was mortgaged and the estimated value of flats, posted a moderate q-o-q rise in Q3 2023 and measured 58.4% (57.4% in Q2 2023).[2]

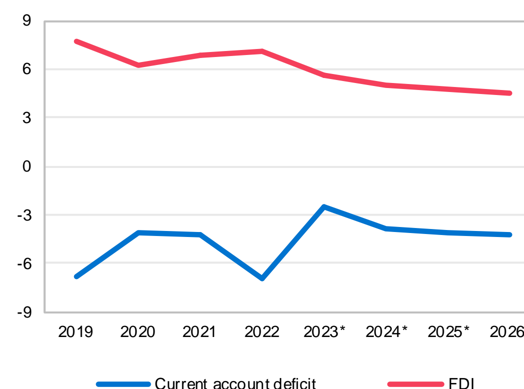
The October bank lending survey showed that corporate and household credit demand declined in Q3 2023. Q4 will likely witness a rise in credit demand, except for housing loans, where demand is expected to decline further. In Q3 2023, expectedly, banks continued to moderately tighten their corporate and household credit standards. Higher costs of funding, which reflect the monetary policy tightening by the NBS and the ECB, are the key factor behind stricter household credit standards. According to banks, household credit standards will remain unchanged, while housing credit standards are anticipated to be even slightly eased.[3] The expected easing of housing credit standards is associated with the temporary cap on the rates on these loans as the NBS temporarily capped the interest rate for first-time beneficiaries of variable-rate housing loans whose contracted amount does not exceed EUR 200,000 from October this year to end-2024.[4] It also capped interest rates on new housing loans and enabled early repayment of housing loans under more favourable terms.

[2] Source: NBS Real Estate Database.
[3] Inflation Report – November 2023 and the Bank Lending Survey for Q3 2023.
[4] Decision on Temporary Measures for Banks Relating to Natural Persons' Housing Loans (RS Official Gazette, No 78/2023).

Indicators of external imbalance

Positive balance of payment trends extended into Q3 2023. In the month to September, the current account deficit amounted to a record low level of close to EUR 0.8 bn, down by as much as EUR 2.5 bn y-o-y. Given the significantly lower current account deficit in the year to date, the deficit is likely to measure around or even below 2.5% of GDP in 2023.[5]

Chart 4 **Current account deficit and FDI**
(in % of GDP)



Source: NBS.
* NBS projection, November 2023.

Capital inflow under FDI exceeded EUR 3.2 bn in the first nine months of 2023, up by 8% y-o-y. More than four fifths of FDI were in the form of equity and reinvested earnings, confirming the foreign investors' commitment to continuing to invest in Serbia.[6] Foreign capital inflow exceeded the current account deficit multiple times.

Net FDI inflow is expected to measure around 5% of GDP in the years to come and continues to fully cover the current account deficit in the medium run, thus contributing to the sustainability of Serbia's external position. FDI is expected to remain highly diversified in terms of geography and project, and to be mainly channelled to export-oriented sectors.[7]

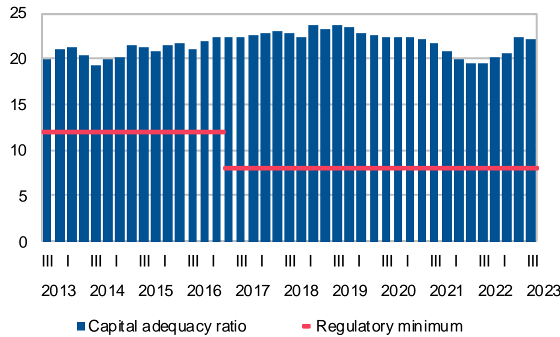
Main banking sector indicators

The banking sector is adequately capitalised and highly liquid. At end-Q3 2023, the capital adequacy ratio at the banking sector level equalled 22.2%, well above the regulatory minimum.[8]

At end-Q3 2023, the loan-to-deposit ratio (LtD) measured 0.86. Keeping this indicator at levels below 1 means that banks largely rely on domestic, stable sources of funding, such as deposits.

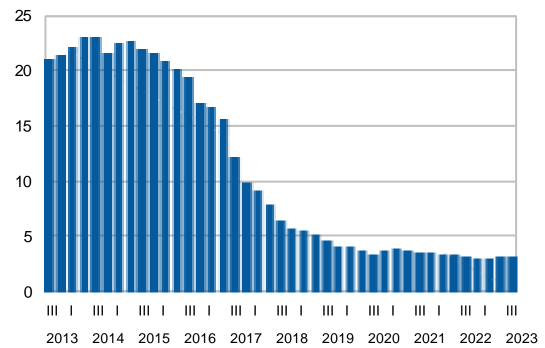
[5] Inflation Report – November 2023.
[6] Inflation Report – November 2023.
[7] Inflation Report – November 2023.
[8] Since 30 June 2017, the minimum CAR is 8% (minimum Tier 1 capital is 6% and minimum Common Equity Tier 1 capital is 4.5%). Also, in addition to meeting these conditions, a bank shall maintain its capital at all times at the level necessary for the coverage of all risks to which the bank is or may be exposed in its operation, i.e. at least in the amount necessary for maintaining the increased capital adequacy ratios – if the National Bank of Serbia, in accordance with Section 5 of this Decision, has set capital adequacy ratios for a bank higher than the prescribed ones).

Chart 5 **Capital adequacy ratio**
(y %)



Source: NBS.

Chart 6 **Non-performing loans**
(share in total gross loans, %)



Source: NBS.

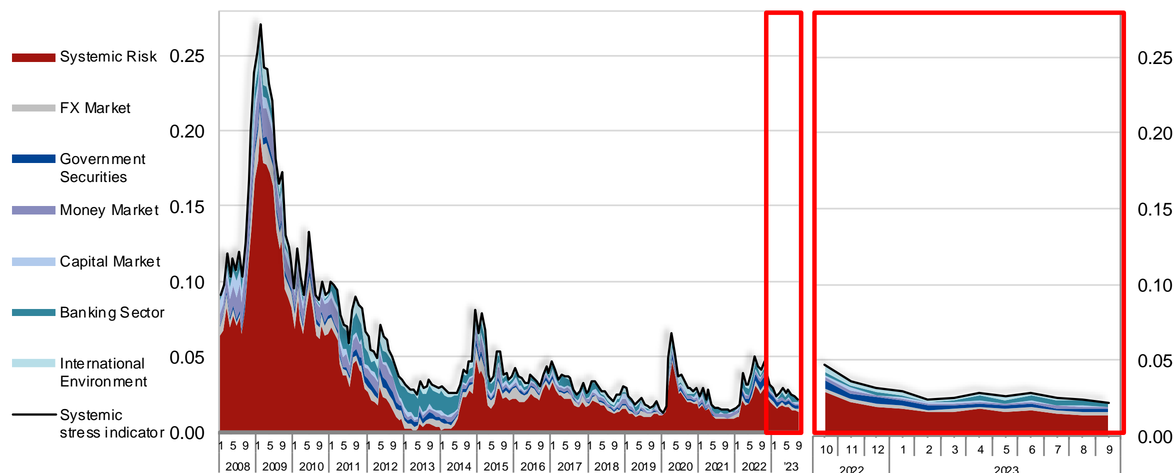
Owing to the implementation of the NPL Resolution Strategy since 2015 and other regulatory activities of the NBS, the share of NPLs in total banking sector loans decreased significantly and remained at a record-low level despite the multidimensional crisis we have faced in the past three years. At end-Q3 2023, the NPL ratio equalled 3.2%, almost unchanged q-o-q and y-o-y, meaning that the tightening of financial conditions did not negatively affect the bank asset quality.

Assessment of systemic risk in the Serbian financial system

The Systemic Stress Indicator (hereinafter: SSI) was developed with a view to identifying periods of elevated stress and the level of systemic risk in the financial system of the Republic of Serbia. The SSI covers a series of indicators which capture the level of financial stress in six key segments of the Serbian financial system: FX market, government securities market, money market, capital market, banking sector and the international environment.

During Q3 2023, the SSI declined q-o-q and y-o-y. The SSI value was mostly affected by movements in the government securities market and the banking sector.

Chart 7. **Systemic stress indicator dynamics and contrabution of the most important factors to the systemic stress indicator**



Source: NBS.

Amid the expected global slowdown, heightened geopolitical tensions, relatively high inflation and tightened global financial conditions, the NBS acted proactively, making timely decisions with a view to preserving and strengthening financial stability. Continuous improvement of the NBS's regulatory measures, as well as the enhancement of the domestic macroeconomic environment in the previous period helped maintain a stable, adequately capitalised and highly liquid banking system in Serbia. The results of macroprudential stress tests for June 2023 confirm banking sector stability.

Fitch Ratings and Standard & Poor's recently affirmed Serbia's credit ratings at BB+, and Moody's at Ba2, with a stable outlook, which is a notch away from investment grade. The key drivers include a credible economic policy framework, the economy's resilience to negative external developments, diversified FDI inflow, higher GDP per capita, favourable medium-term prospects, orderly public finance, ample fiscal room to respond to potential shocks, improved governance, and a higher level of human development compared to rating peers. Despite elevated uncertainties in the domestic environment, as stated by the agencies, Serbia is managing to offset the external challenges with favourable trends at home and adequate economic policies.