7 March 2024

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

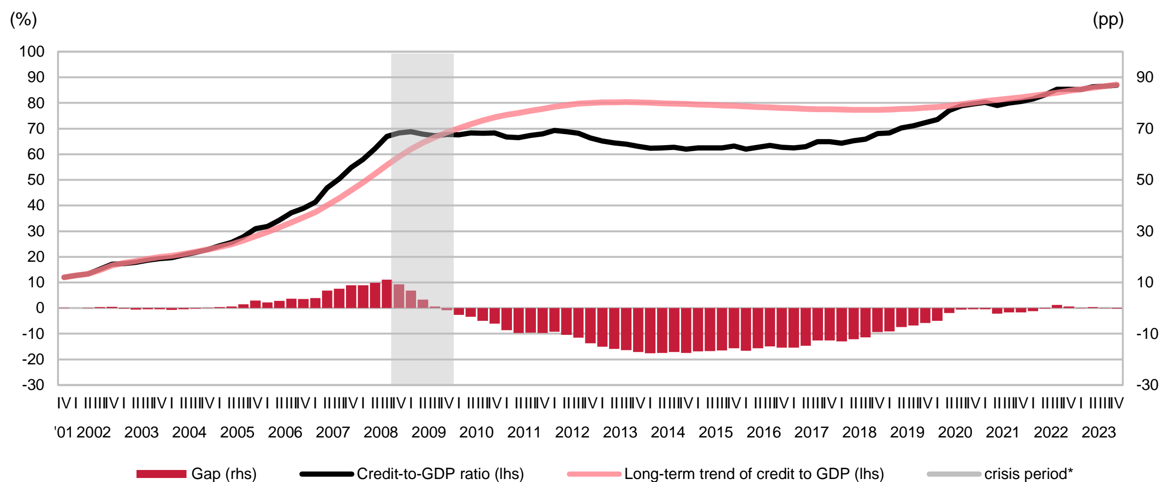
Pursuant to Article 14, paragraph 1, item 11) of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015 – CC decision and 44/2018) and Section 436 of the Decision on Capital Adequacy of Banks (RS Official Gazette, Nos 103/2016, 103/2018, 88/2019, 67/2020, 98/2020, 137/2020, 59/2021, 67/2022, 137/2022, 48/2023 and 110/2023, hereinafter: Decision on Capital Adequacy), the NBS Executive Board, at its meeting of 7 March 2024, decided to keep the countercyclical capital buffer (CCyB) rate for the Republic of Serbia at 0%, having in mind that the share of real lending activity in real GDP is slightly below its long-term trend. By keeping the CCyB at 0%, the 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 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 December 2023 data, the credit-to-GDP gap is slightly below its long-term trend, with a gap of -0.2 pp. The gap value declined both y-o-y and q-o-q. The estimated gap value is also below the threshold of 2 pp, which is the reference value which can indicate excessive lending activity.

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



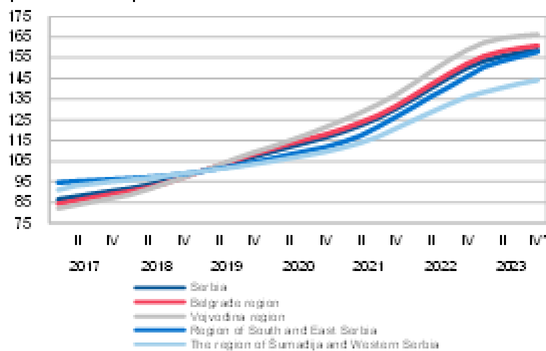
Source: NBS.
*Based on SSI.

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. The optional indicators used relate to the real estate market, external imbalance and banking sector developments.

Real estate market

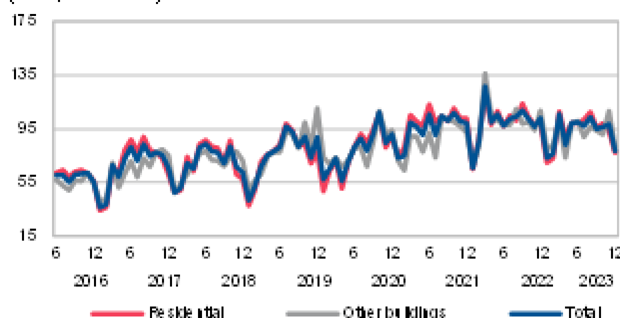
According to the data of the Republic Geodetic Authority, and based on the index of flat prices, the annual growth rate of flat prices in the Republic of Serbia in Q4 2023 continued up, but at a slower pace relative to the past period. According to preliminary data, in Q4 2023 the annual growth rate of flat prices stood at 5.75%, while relative to the previous quarter the prices of flats rose 0.8%.[1]

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.

[1] Republic Geodetic Authority – Report on the index of flat prices for Q4 2023.

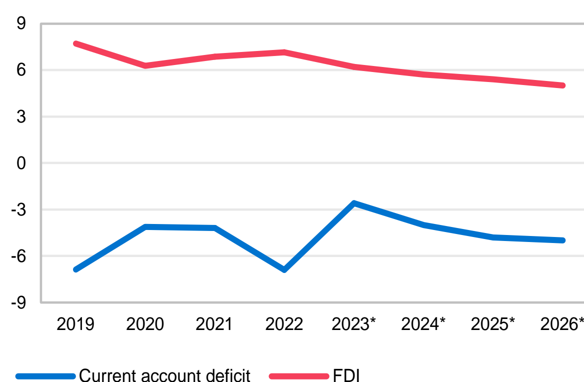
In Q4 2023, the total number of issued permits for new construction declined by 9.4% y-o-y. The LTV ratio, measured by the ratio of mortgage-backed housing loans for which a flat was mortgaged and the estimated value of the flats, posted a q-o-q decline in Q4 2023 and measured 54.2% (58.8% in Q3 2023).[2]

The January bank lending survey showed that, according to banks' estimate, corporate and household demand for dinar loans increased, while the demand for FX loans declined. Corporate loan demand was encouraged by the financing of working capital and investment. The rise in household demand was led by the need to refinance current loans and procure durable consumer goods, with higher wages also lending an impetus. The situation in the real estate market, featuring high prices of flats, worked in the opposite direction. Banks expect both sectors to step up loan demand in Q1 2024. Consistent with expectations, in Q4 2023, banks tightened corporate lending standards, with household standards remaining broadly unchanged.[3] Banks expect the easing of housing loan standards in the household sector in Q1 2024, which is associated with the temporary cap on interest rates on these loans. 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 2023 to end-2024. It also temporarily capped the rates on new housing loans and enabled early repayment of housing loans under more favourable conditions.[4]

Indicators of external imbalance

Positive balance of payment movements continued in Q4 2023. In 2023 the current account deficit measured EUR 1.8 bn, which is as much as EUR 2.4 bn below the 2022 figure. The share of the current account deficit in GDP is estimated at 2.6%, the lowest on record. The current account deficit in 2024 is expected to be close to 4% of GDP and range between 4% and 5% of GDP in the medium term.[5]

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



* NBS projection, February 2024
Source: NBS.

FDI inflow to Serbia in 2023 reached a new record level, amounting to EUR 4.5

[2] Source: NBS Real Estate Database.
[3] *Inflation Report*, February 2024.
[4] Decision on Temporary Measures for Banks Relating to Natural Persons' Housing Loans (RS Official Gazette, No 78/2023).
[5] *Inflation Report*, February 2024.

bn or 6.1% of GDP and exceeding the achieved current account deficit several times over. The bulk of FDIs were in the form of equity capital and reinvested earnings, which confirms the determination of foreign investors to continue investing in Serbia.

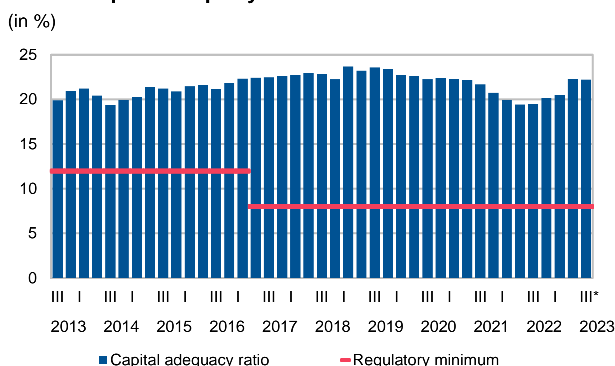
FDI inflow is expected to measure around 5% of GDP in the medium term and to maintain the high diversification by geographies and projects, as well as to remain channelled to export-oriented sectors. The current account deficit will stay fully covered by net FDI inflow in the medium term as well, as was the case in the past nine years.[6]

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.[7]

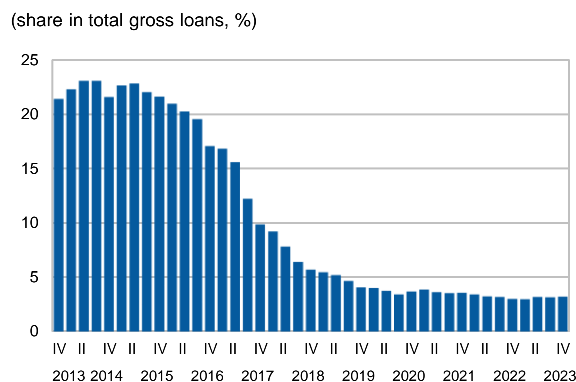
At end-Q4 2023, the loan-to-deposit ratio (LtD) measured 0.83. Keeping this indicator at levels below 1 means that banks largely rely on domestic, stable sources of funding, such as deposits.

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



*Latest data available.
Source: NBS.

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



Source: NBS.

Owing to the implementation of the NPL Resolution Strategy as of 2015 and other regulatory activities of the NBS, the share of NPLs in total banking sector loans decreased significantly and remained at record-low levels despite the multidimensional crisis we have faced in the past four years. At end-Q4 2023, the NPL ratio equalled 3.2%, almost unchanged y-o-y, indicating that the

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[6] *Inflation Report*, February 2024.

[7] 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).

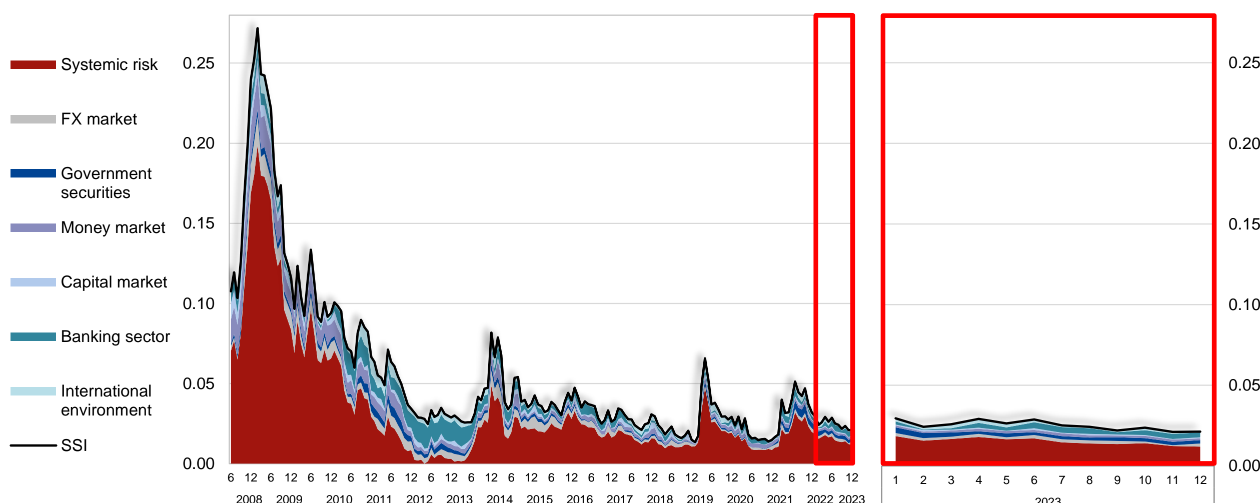
tightening of financial conditions did not have major adverse consequences on the quality of banks' assets.

Assessment of systemic risk of 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 Q4 2023, the SSI recorded and a lower value relative to the quarter before and to end-2022. The SSI value in the previous period was mostly affected by movements in the government securities market and the banking sector.

Chart 7 **Systemic Stress Indicator dynamics and contribution of the most important risk factors**



Source: NBS.

Amid the expected global slowdown, pronounced geopolitical tensions, elevated inflation and tight global financial conditions, the NBS acted proactively, making timely decisions in view of the need to preserve and strengthen the achieved financial stability. A continuous improvement of regulatory measures implemented by the NBS, as well as the enhancement of the domestic macroeconomic environment in the previous period helped to maintain a stable, adequately capitalised and highly liquid banking sector in Serbia. The results of macroprudential stress tests for September 2023 also confirm the stability of our banking system.

In early October 2023, Standard & Poor's affirmed Serbia's credit rating at BB+ with a stable outlook. Also, in early February 2024, Fitch Ratings affirmed Serbia's rating at BB+, i.e. a step away from investment grade, with a stable outlook. In their press releases, the agencies noted the following key rating drivers underpinning their decisions: a credible monetary policy framework, ordered public finances and a moderate level of public debt, as well as a stable banking sector. The agencies also stressed that uncertainties emanating from the international environment are still high, but that Serbia is managing to buffer the external challenges with favourable developments at home and adequate economic policies.