NATIONAL BANK OF SERBIA

BANK SUPERVISION DEPARTMENT

BANKING SECTOR IN SERBIA

Fourth Quarter Report 2014

June 2015

Contents:

1. BASIC INFORMATION

1.1. Selected parameters of the Serbian banking sector[1]

At end-Q4, the Serbian banking sector numbered 29 banks, the same as last quarter, while the network of organisational units continued contracting. At end-December, the banking sector operated through 1.787 business units (down by 52 from end-September 2014) and employed 25,106 people (quarterly decline by 308 employees).

In Q4, only one bank expanded its organisational network (by two business units), while 10 banks recorded a contraction (by a total of 54 business units). At the same time, seven banks increased the number of employees (by a total of 62 persons), 20 banks reduced employment (by a total of 370 persons), while the number of employees of two banks stayed the same.

Table 1.1.1. Selected parameters of the Serbian banking sector

	Number of banks	Assets	Share (%)	Capital	Share (%)	Network	Share (%)	Employment	Share (%)
		RSD bln		RSD bln		Number of business units*		No. of employees	
Banks in domestic ownership	**8**	**758**	**25.6%**	**155**	**25.2%**	**526**	**29.4%**	**6,383**	**25.4%**
State-owned	6	571	19.3%	97	15.7%	465	26.0%	5,621	22.4%
Privately-owned	2	187	6.3%	58	9.5%	61	3.4%	762	3.0%
Banks in foreign ownership	**21**	**2,210**	**74.4%**	**459**	**74.8%**	**1,261**	**70.6%**	**18,723**	**74.6%**
Italy	2	738	24.9%	160	26.1%	255	14.3%	4,114	16.4%
Austria	3	440	14.8%	98	16.0%	210	11.8%	3,396	13.5%
Greece	4	418	14.1%	92	14.9%	322	18.0%	4,894	19.5%
France	3	304	10.2%	46	7.5%	215	12.0%	2,596	10.4%
Other	9	310	10.4%	63	10.3%	259	14.5%	3,723	14.8%
Total banking sector	**29**	**2,968**	**100%**	**614**	**100%**	**1,787**	**100%**	**25,106**	**100%**

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

Source: NBS.

[1] All data in the Report are based on financial reports that banks are required to submit to the NBS. These reports, however, have not been audited by external auditors nor verified by NBS on-site supervisors.

At end-Q4 2014, total banking sector assets stood at RSD 2,968 bln, up by RSD 13 bln q-o-q, while capital amounted to RSD 614 bln (down by RSD 2 bln from September 2014).

Banking sector structure changed slightly in terms of origin of ownership, in favour of banks in domestic ownership, as a consequence of the growth in net balance sheet assets and capital of banks in domestic ownership by RSD 29 bln and 6 bln respectively. At the same time, net balance sheet assets and capital of banks in foreign ownership fell by RSD 17 bln and 8 bln, respectively.

Foreign-owned banks have a dominant share in the Serbian banking sector, primarily banks from Italy, Austria and Greece. These nine banks together account for over 50% of the Serbian banking sector.

1.2. Concentration and competition

The Serbian banking sector remained competitively segmented in all key categories. The Herfindahl Hirschman Index – HHI[2] indicates the absence of concentration as the HHI values in all key categories were below 1,000.

Table 1.2.1. **Concentration and competition indicators**

	Top 5 banks	Top 10 banks	HHI*
	Share (%)		
Assets	53.6	76.3	794
Lending (total)	53.9	75.4	771
Household loans	49.0	75.7	715
Corporate loans	55.4	76.1	779
Deposits (total)	52.5	77.5	818
Household deposits	55.4	80.5	903
Income (total)	49.9	75.5	719
Interest	51.1	74.4	736
Fees and commissions	56.3	79.1	849

* Herfindahl Hirschman Index of concentration

Source: NBS.

The highest level of concentration was still observed in regard to deposits (chiefly household deposits) and income from fees and commissions.

In terms of net balance sheet assets, the top ten banks accounted for 76.3% of total banking sector net assets, 75.4% of total loans and 77.5% of total deposits.

[2] 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.

There were no changes in the ranking of top banks in Serbia in Q4 2014. The largest bank in Serbia is Banca Intesa a.d.- Beograd with a 15.9% share in total balance sheet assets.

Table 1.2.2. **Top ten banks according to the total assets criterion**

	31/12/2013			30/09/2014			31/12/2014				
	RSD bln RSD	%	Ranking	RSD bln RSD	%	Ranking	RSD bln RSD	%	Ranking	△ Г	△ T
Banca Intesa a.d.- Beograd	427	15.0%	1	478	16.2%	1	473	15.9%	1	–	–
Komercijalna banka a.d.- Beograd	364	12.8%	2	380	12.9%	2	406	13.7%	2	–	–
Unicredit Bank Srbija a.d.- Beograd	252	8.9%	3	266	9.0%	3	265	8.9%	3	–	–
Raiffeisen Banka a.d.- Beograd	205	7.2%	5	230	7.8%	4	224	7.5%	4	↑	–
Societe Generale banka Srbija a.d.- Beograd	221	7.8%	4	230	7.8%	5	222	7.5%	5	↓	–
Agroindustrijska komercijalna banka "AIK banka" a.d.- Niš	152	5.4%	7	162	5.5%	6	173	5.8%	6	↑	–
Eurobank a.d.- Beograd	158	5.6%	6	155	5.2%	7	146	4.9%	7	↓	–
Vojvođanska banka a.d.- Novi Sad	109	3.8%	9	124	4.2%	8	123	4.1%	8	↑	–
Hypo Alpe-Adria-Bank a.d.- Beograd	125	4.4%	8	118	4.0%	9	119	4.0%	9	↓	–
Banka Poštanska štedionica a.d.- Beograd	100	3.5%	10	111	3.8%	10	113	3.8%	10	–	–

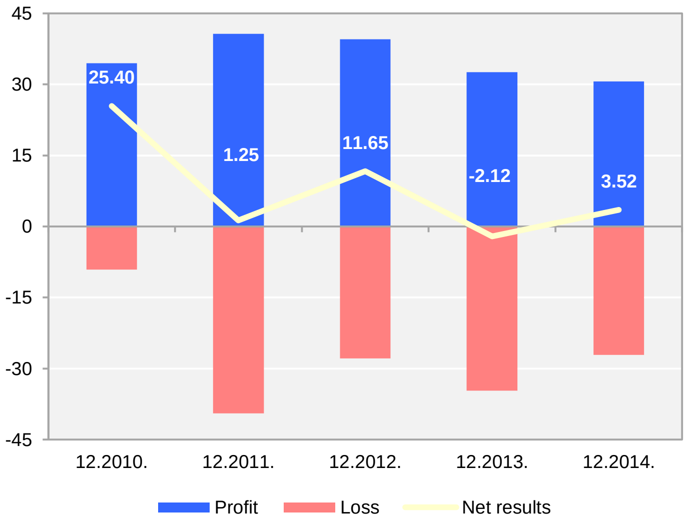
Source: NBS.

2. PROFITABILITY

2.1. Profitability indicators

The results of the Serbian banking sector at end-Q4 2014 indicate that the recovery in bank profitability still continues along a moderate path. Net result before tax at end-December 2014 stood at RSD 3.5 bln, which is a year-on-year improvement. Banks operating with profit achieved a poorer performance than the year before (cumulatively, profitable banks recorded a 5.9% lower profit than a year earlier). Still, the decline in profits of profitable banks was smaller than the cut in losses of banks recording losses (banks operating with losses recorded 21.8% smaller losses relative to the same period of 2013).

Chart 2.1.1. **Pre tax results**
RSD bln



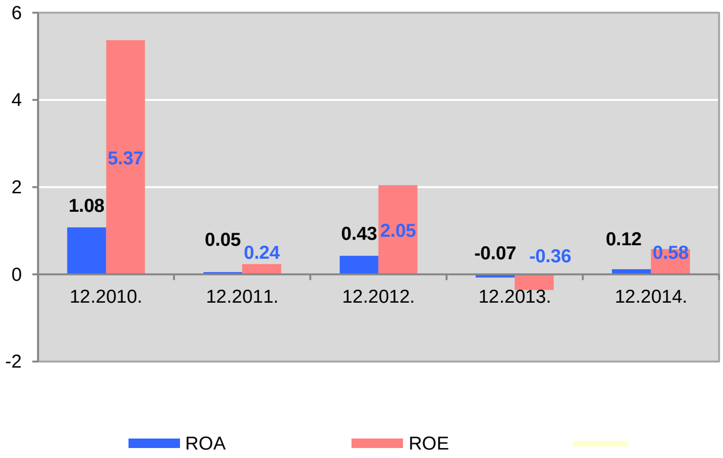
Source: National Bank of Serbia.

At end-2014, 17 banks posted a positive net result in the total amount of RSD 30.6 bln, while 12 banks operated with losses in the total amount of RSD 27.1 bln.

At end-Q4 2014, profitability indicators ROA[3] and ROE[4] stood at 0.12% and 0.58% respectively.

[3] Return on assets
[4] Return on equity

Chart 2.1.2. **Banking sector profitability indicators**
in %



Source: National Bank of Serbia.

As in the previous period, the largest banks in Serbia (peer 1 group[5]) were those with the highest net result before tax. The highest losses were generally posted by small banks.

As in the previous year, losses of the Serbian banking sector were highly concentrated. At end-Q4 2014, as much as 60% of banking sector losses were incurred by a single bank – Srpska banka a.d.- Beograd, which at the time was undergoing reorganisation and a business model revision, resulting in the recognition of an extremely high level of allowances for impairment. Thus, for the third year in a row, the banking sector result was significantly affected by banks facing specific situations[6]. Excluding the effects of Srpska banka a.d. Beograd, profitability indicators ROA and ROE stood at 0.68% and 3.26% respectively.

[5] Banks holding over 5% of banking sector net balance sheet assets
[6] From 2011 to 2013, banking sector profitability was affected predominantly by delicensed banks and banks withdrawing from the market.

Table 2.1.1. **Banks posting highest profit and loss**
RSD mln

	31/12/2014
Banks posting highest net profit	
Banca Intesa a.d.- Beograd	7,096
Raiffeisen Banka a.d.- Beograd	5,839
Unicredit Bank Srbija a.d.- Beograd	5,680
Komercijalna banka a.d.- Beograd	4,758
ProCredit Bank a.d.- Beograd	2,388
Banks posting highest net loss	
Srpska banka a.d.- Beograd	-16,030
Eurobank a.d.- Beograd	-2,657
NLB banka a.d.- Beograd	-2,170
Dunav banka a.d.- Beograd	-1,375
Piraeus Bank a.d.- Beograd	-1,340

Source: NBS.

2.2. Structure of the result

The increase in net interest income and net other income gave the most significant contribution to the growth in banking sector income in 2014, while net operating expenses and the effect of exchange rate differentials had the highest negative contribution to total result.

Table 2.2.1. **Changes in key elements of bank profitability**[7]

RSD mln	Result	Net interest	Net fees	Credit losses	Exchange rate effect
31/12/2013	-2,118	118,910	34,797	60,504	10,842
31/12/2014	3,516	124,719	34,825	58,484	8,081
		5%	0%	-3%	-25%
Change	↑	↑		↓	↓

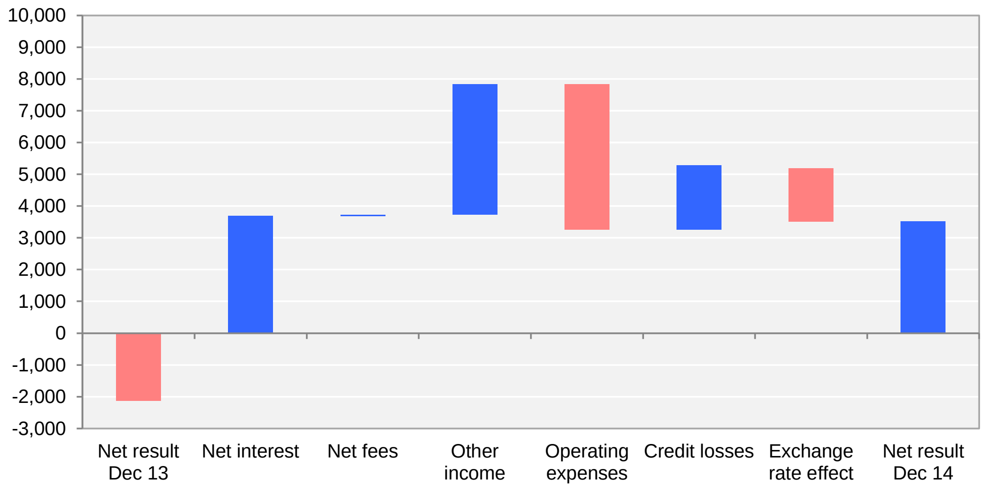
Net interest income rose from 2013 primarily on account of a significant drop in interest expenses (by RSD 18.7 bln) relative to the fall in interest income (of RSD 12.9

[7] As the chart of accounts was changed, credit losses and exchange rate effects are not fully comparable to those in the previous periods.

bln). Net value of other operating income increased on account of falling costs of sale of receivables[8].

An increase in losses on account of operating expenses was chiefly caused by additional expenses incurred for non-material costs (excluding taxes and contributions) – RSD 4.0 bln and other expenses by RSD 3.4 bln.

Chart 2.2.1. **Structure of results**
RSD bln



Source: National Bank of Serbia.

Net credit losses went down by 3% relative to end-2013.

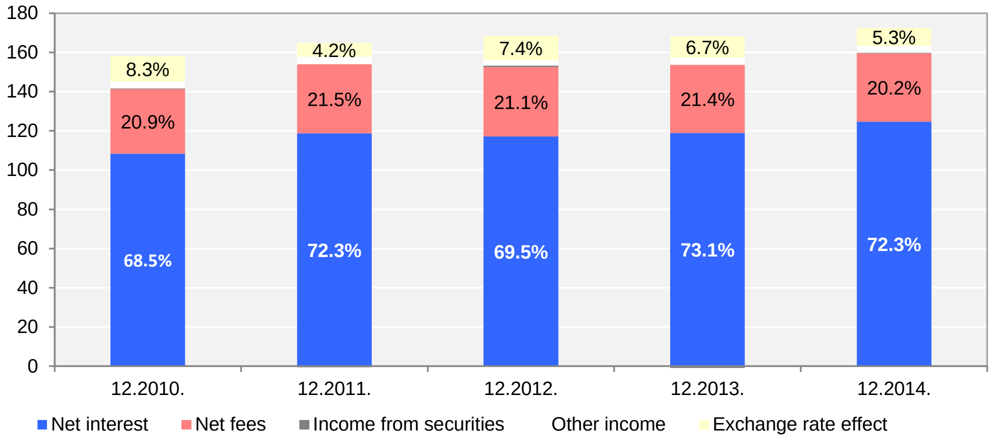
2.3. Operating income

At end-2014, total operating income increased by RSD 9.78 bln y-o-y and amounted to RSD 172.5 bln. Operating income rose primarily on account of net interest income, up by RSD 5.81 bln from the same period of 2013 (2013: RSD 118.9 bln, 2014: RSD 124.7 bln), net gains from securities, net result from securities and the sale of other lending products which rose y-o-y by RSD 5.8 bln (2013: RSD - 5.5 bln[9], 2014: RSD 0.3 bln).

[8] In 2013, notable expenses arising from the sale of receivables were posted by a single bank, which was undergoing a sale process, while transferring a part of its portfolio to another bank.
[9] Negative net result from securities and the sale of other receivables at end-2013 was mainly caused by the sale of one bank and the transfer of its receivables to another bank and/or the expenses registered by that bank on this account in the amount of RSD 5,724 bln.

The greatest negative contribution to the growth in operating profit was registered on account of exchange rate effects. At end-2014, net gains from exchange rate effects were down by RSD 1.68 bln from 2013.

Chart 2.3.1. **Operating income structure**
RSD bln

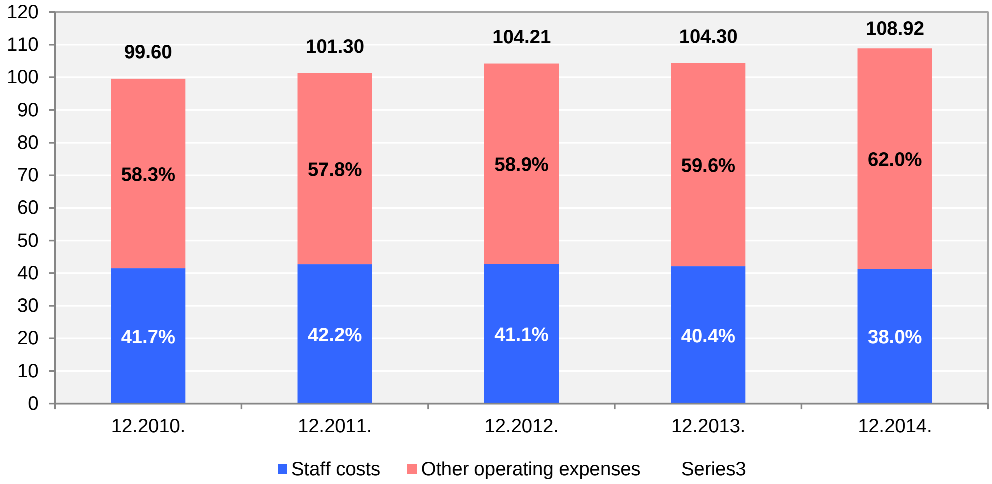


Source: National Bank of Serbia.

2.4. Operating expenses

At end-2014, operating expenses of the Serbian banking sector amounted to RSD 108.9 bln, up by RSD 4.62 bln y-o-y. The increase was chiefly due to the increase in other operating expenses by RSD 5.4 bln, while costs of salaries, compensations and other expenses related to employees and other hired staff went down by RSD 0.8 bln.

Chart 2.4.1. **Operating expenses structure**
RSD bln



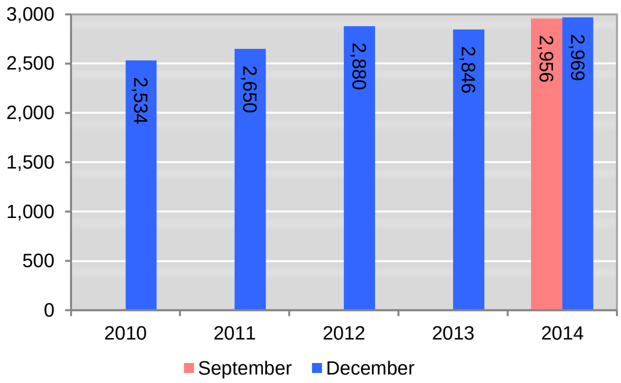
Source: National Bank of Serbia.

3. BANKING SECTOR ASSETS

3.1. Level and structure

Total net assets of the Serbian banking sector at end-Q4 equalled RSD 2,968.9 bln, indicating a quarterly growth of RSD 12.6 bln or 0.4%.

Chart 3.1.1. **Total banking sector assets**
RSD bln



Source: National Bank of Serbia

Starting from 31 December 2014, reporting requirements of banks must be fulfilled in accordance with the amended Decision on the Chart of Accounts and Contents of Accounts in the Chart of Accounts for Banks (RS Official Gazette, Nos 71/2014 and 135/2014) and the Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks (RS Official Gazette, Nos 71/2014 and 135/2014). The above amendments significantly affected the structure of assets, particularly in the section pertaining to cash and loans.

until 31/12/2014	**from 31/12/2014**
Group of accounts according to the old balance sheet structure	**Group of accounts according to the new balance sheet structure**
Cash	
Cash and cash equivalents	Cash and balances with the central bank
- without foreign currency required reserves and excess liquidity deposits	- includes foreign currency required reserves and excess liquidity deposits
- includes foreign currency accounts and cheques	- without foreign currency accounts and cheques
- without receivables for the calculated interest, fees and commissions arising from cash and balances with the central bank and prepayments and accrued income on account of cash and balances with the central bank	- includes receivables for the calculated interest, fees and commissions arising from cash and balances with the central bank, as well as prepayments and accrued income on account of cash and balances with the central bank
Securities	
Securities without own shares	Financial assets recognised at fair value through the income statement and held for trading
	Financial assets initially recognised at fair value through the income statement
	Financial assets available for sale
	Financial assets held to maturity
	Changes in the fair value of items subject to hedging
	Receivables arising from hedging derivatives
	Pledged financial assets – the group of pledged financial assets includes pledged securities
Loans	
Callable loans and deposits, accounts 010 - 013 and 060 - 063	Loans and receivables: Loans (Accounts 10 and 20) Callable deposits and loans (Accounts 01 without 010 and 06 without 060) - do not include excess liquidity deposits and foreign currency required reserves Foreign currency accounts and cheques (Accounts 050 and 052) Deposits (Accounts 11 and 21) Other lending (Accounts 16 and 26)
Loans, advances and deposits, accounts 10,11 and 20,21	

	Interest and fee receivables (Accounts 020, 028, 080 and 088) Accrued receivables from interest and other income (Accounts 190, 191, 290, 291) Deduction: Accrued income from receivables at amortised value (Accounts 493,593)
Fixed assets	
Property, plant and equipment and investment property	Property, plant and equipment Investment property

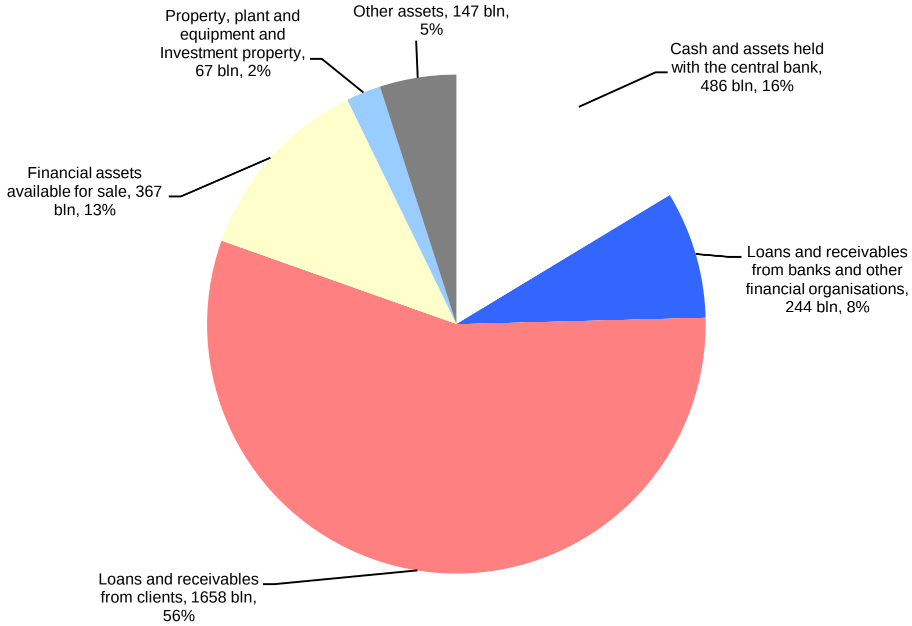
Table 3.1.1. **Key asset positions of the banking sector**

(RSD mln)	Amount 31/12/2014	share %
Cash and balances with the central bank	485,548	16.4%
Loans and receivables	1,902,155	64.1%
from banks and OFO	*244,494*	*8.2%*
from customers	*1,657,662*	*55.8%*
Financial assets	455,539	15.3%
at fair value through the income statement and held for trading	*10,383*	*0.3%*
initially recognised at fair value through the income statement	*1,717*	*0.1%*
available for sale	*367,208*	*12.4%*
held to maturity	*76,231*	*2.6%*
Property, plant and equipment	51,464	1.7%
Investment property	15,367	0.5%
Other	58,828	2.0%
Banking sector balance sheet total	**2,968,901**	**100.0%**

Source: NBS.

At 64.1% at end-2014, the item "loans and receivables" accounted for the largest share of assets of Serbian banks. During Q4, investments in securities rose by an additional RSD 17.6 bln, reaching RSD 455.5 at end-2014 or 15.3% of total assets.

Chart 3.1.2. **Banking sector assets structure**
December 2014



Source: National Bank of Serbia.

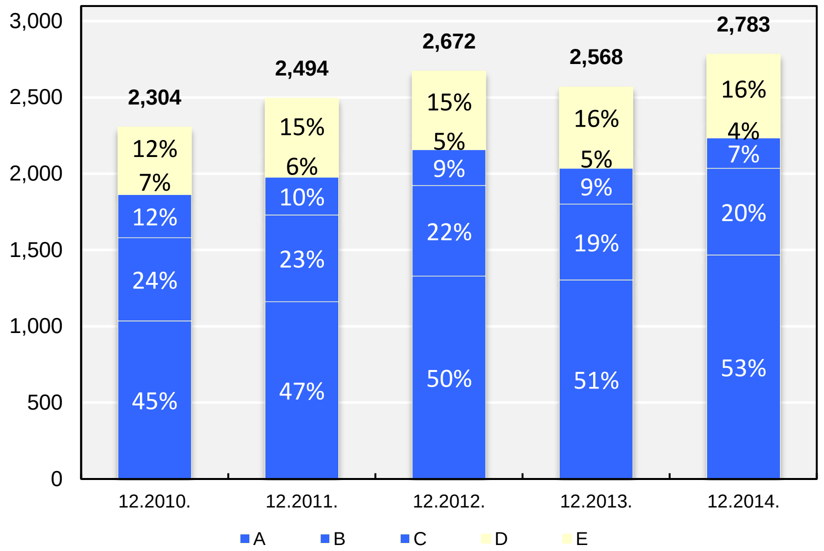
3.2. Classified assets

Total classified assets of the banking sector rose by RSD 112.9 bln in Q4-2014, of which RSD 83.5 bln related to an increase in balance sheet classified assets and RSD 29.4 bln to an increase in off-balance sheet classified items.

The level of classified balance sheet assets changed most significantly in categories A (up by RSD 44.6 bln), B (up by RSD 63.7 bln) and E (down by RSD 20.5 bln). Off-balance sheet items rose the most in categories B (by RSD 36.2 bln) and C (by RSD 14.7 bln), while the level of assets in categories A and D declined by RSD 20.7 bln and 2.5 bln, respectively.

Total calculated reserve under classified balance sheet items (2014: RSD 482.3 bln) was reduced by RSD 20.6 bln q-o-q, primarily due to the reduction in classified assets in category E which accounts for the highest share of allocations, whereas calculated reserve for losses under off-balance sheet items, rising by RSD 1.4 bln, amounted to RSD 16.3 bln at end-2014.

Chart 3.2.1. **Total classified assets**
RSD bln



Source: National Bank of Serbia.

3.3. Loans[10]

Net loans of the Serbian banking sector nominally increased by RSD 11.9 bln in Q4 2014, reaching RSD 1,653.2 bln at end-December, which is an 0.7% increase.

The greatest contribution to lending came from growth in household loans (by RSD 15.6 bln), primarily housing loans (by RSD 4.8 bln), which was partly due to the depreciation of the dinar exchange rate of 1.8% in Q4. Changes in the volume of loans to the finance and insurance sectors, the public sector and companies were chiefly due to the change in sectoral structure pursuant to the instructions of the NBS[11]. The decline in lending primarily related to loans from repo transactions with the NBS, which fell by RSD 36.6 bln in the observed quarter.

[10] Pursuant to the Guidelines on the Obligation and Manner of Collecting, Processing and Submission of Data on the Stock and Structure of Loans, Bank Receivables and Liabilities, loans in dinars or in a foreign currency include the following loans: callable, repo, transaction account, overnight, consumer, liquidity, current asset, export, investment, housing, and cash loans, loans for payment of imports of goods and services from abroad, personal loans for the purchase of real estate in the country, and other loans.

[11] The reclassification of institutional units was made in December 2014. Based on sector tables presented on the NBS webpage – http://www.nbs.rs/internet/cirilica/20/index_stat.html, division was made by institutional sector in accordance with the European System of National and Regional Accounts (ESA 2010).

Table 3.3.1. **Change in the level of net loans**

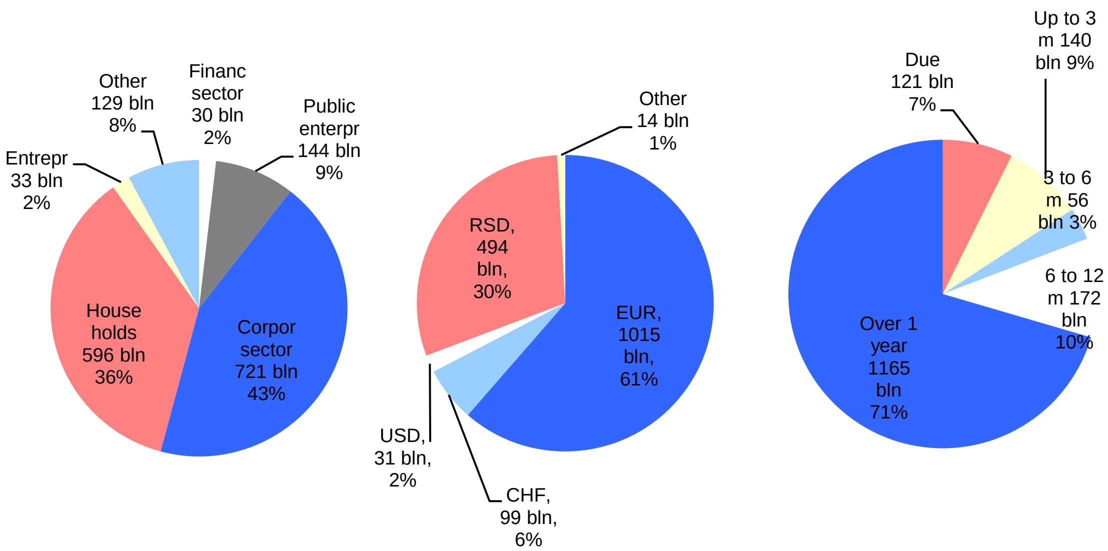
RSD mln	Amount 31/12/2014	Change relative to prior periods: Nominal 30/09/2014	Nominal 31/12/2013	Relative 30/09/2014	Relative 31/12/2013
Finance and insurance	30,428	-37,237	-112,223	-55.0%	-78.7%
Public sector	43,072	5,819	485	15.6%	1.1%
Public enterprises	144,222	63,210	50,172	78.0%	53.3%
Households	595,516	15,576	46,840	2.7%	8.5%
Companies	721,339	-28,639	-35,545	-3.8%	-4.7%
Foreign persons and foreign banks	25,143	-11,557	5,347	-31.5%	27.0%
Other sectors	93,495	4,712	12,070	5.3%	14.8%
Total loans	1,653,215	11,884	-32,854	0.7%	-1.9%

Source: NBS.

In terms of currency structure, loans in Serbia were still predominantly FX-indexed. At end-2014, the share of dinar loans was 29.9%, whereas the share of FX and FX-indexed loans was 70.1%. With a 61.4% share, EUR was dominant in the structure of FX-indexed loans (or 87.6% share in total FX and FX-indexed loans), followed by CHF and USD with 6.0% and 1.9%, respectively.

Relative to end-Q3, the share of long-term loans rose from 65.1% to 70.5%, whereby loans with maturity over 5 years accounted for 29.8% of the entire portfolio.

Chart 3.3.1. **Banking sector loan portfolio structure**
RSD bln
December 2014



Source: National Bank of Serbia.

3.3.1. Non-performing loans

Monitoring the level and trend of non-performing loans (NPLs) is vital for identifying possible problems in the collection of receivables and monitoring the 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. An additional analysis of the level of NPLs relative to allowances for impairment, regulatory reserves and capital provides insight into the banking sector's capacity to absorb losses arising from NPLs.

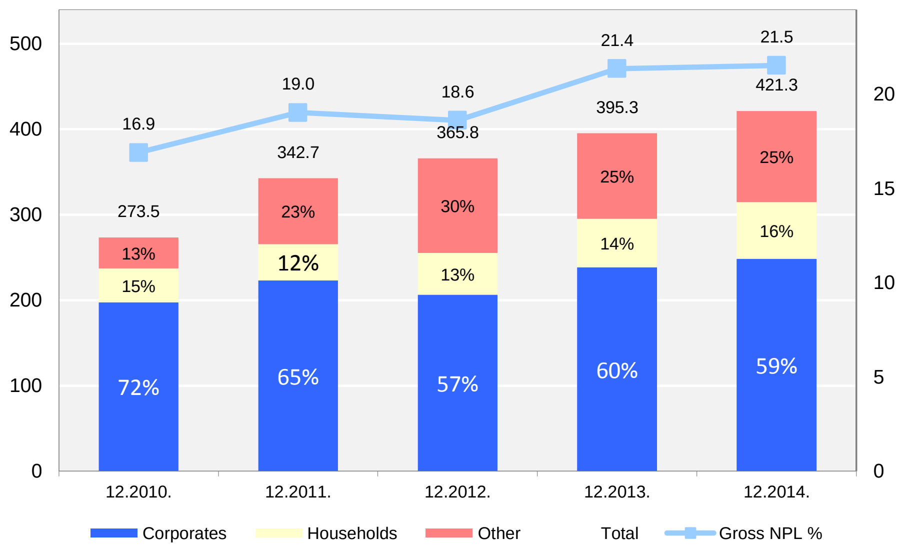
In accordance with the internationally accepted definition, an NPL implies the level of outstanding debt on individual loan balances (including the overdue amount):

- where the payment of principal and interest is 90 days or more past due its original maturity date;
- where interest at the quarterly level (and above) was ascribed to the loan balance, capitalised, refinanced or delayed;
- where payments are less than 90 days overdue, but the bank assessed that the borrower's repayment ability deteriorated, assuming that payments will not be made in full.

Gross NPLs

Relative to Q3, in Q4 2014 gross NPLs declined by 3.5% (RSD 15.4 bln) to RSD 421.3 bln, while gross carrying amount of total loans increased by RSD 58.2 bln (by 3.1%).

Chart 3.3.1.1. **Gross non performing loans - NPL**
RSD bln



Source: National Bank of Serbia.

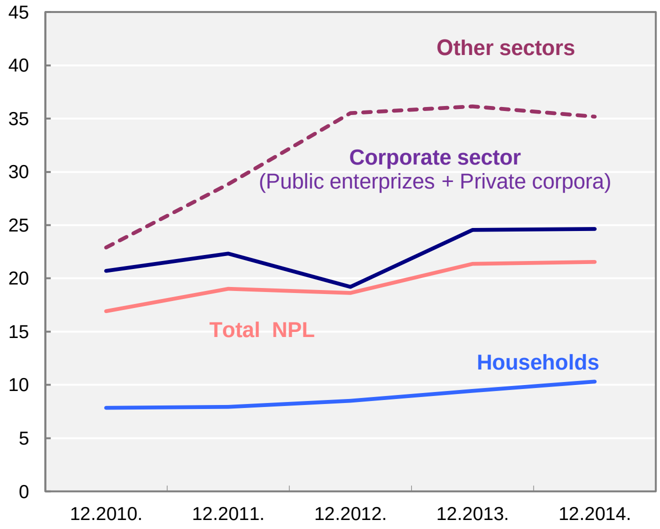
<u>The drop in the amount of gross NPLs resulted from:</u>

- <u>the increase in NPLs on account of new NPLs (RSD 39.0 bln) and exchange rate differences (RSD 5.5 bln),</u>
- <u>decrease in NPLs through collection (RSD 31.8 bln), assignment (RSD 5.9 bln), resolution (RSD 4.0 bln), write-off (RSD 3.0 bln) and other changes (RSD 15.2 bln).</u>

The most significant change in the structure of NPLs is by sector, as NPLs to public enterprises increased by RSD 20.0 bln in the last quarter (primarily due to the reclassification of public enterprises), while NPLs to companies fell by RSD 35.9 bln.

The gross NPL ratio for the dominant category – the corporate sector (companies and public enterprises) – declined, equalling 24.6% at end-2014 (down from 27.3% from the previous quarter), owing to the pick-up in lending (up by 4.2% or RSD 40.3 bln) and the drop in NPLs by RSD 16.0 bln (6.0%). The NPL ratio for the household sector remained well below average, at 10.3% (compared to 10.2% at end Q3 2014).

Chart 3.3.1.2. **NPL - sector distribution**
in %



Source: National Bank of Serbia.

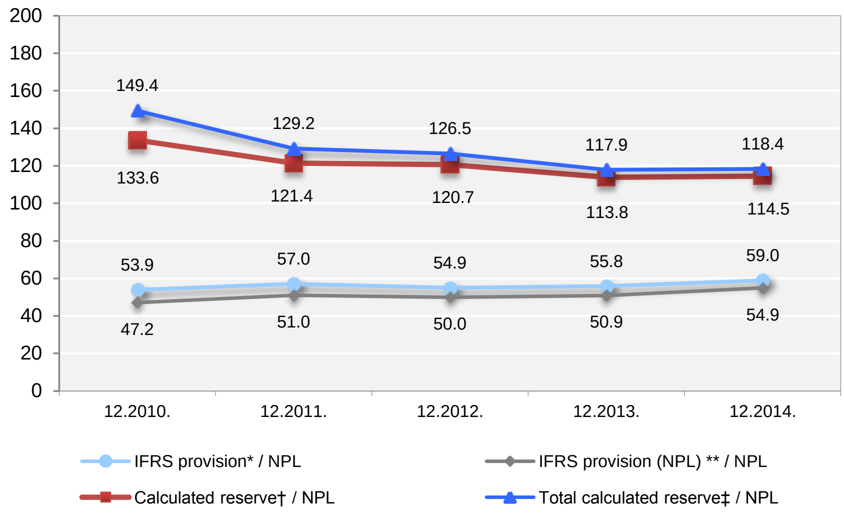
Other sectors, including all entities in bankruptcy, continued to record the highest level of NPLs with the gross NPL ratio of 35.2% (down from 36.5% at end-Q3).

The assignment of due bank receivables to non-financial sector entities in Q4 helped relocate additional RSD 1.0 bln, excluding interbank transfers.

NPL coverage

At the current level of NPLs, the banking sector's ability to absorb possible risks remained exceptionally stable in Q4. At end-2014, the coverage of gross NPLs by regulatory provisions for non-performing exposures equalled 114.5%, while the coverage under IFRS provisions came at 58.9%.

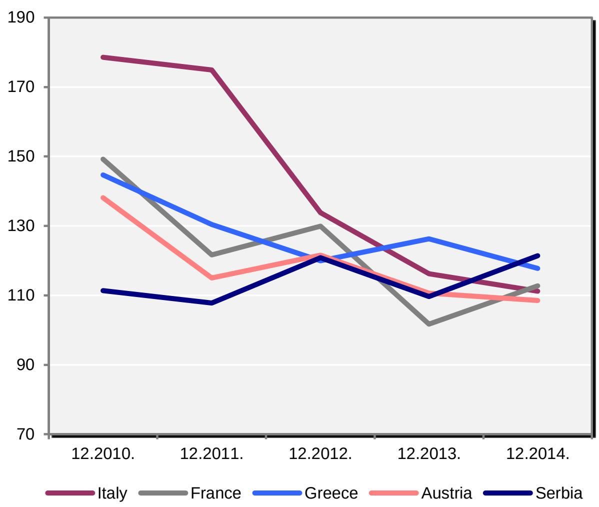
Chart 3.3.1.3. **NPL coverage**
in %



† Calculated reserve for potential losses on balance-sheet lending (loan loss reserve);
* Total loan provision;
** Provision for non-performing loans;
‡ Total calculated reserve for potential losses (on- and off-balance sheet).

Source: National Bank of Serbia.

Chart 3.3.1.4. **NPL coverage* across countries of origin of banks in Serbia**
in %



* provisions for balance sheet exposure

Corporate NPLs

Relative to both end-2013 and end-Q3 2014, the level of corporate gross NPLs decreased, by RSD 9.9 bln and RSD 35.9 bln, respectively, i.e. 4.2% and 13.6% respectively, equalling RSD 227.8 bln at end-2014.

Table 3.3.1.1. **Changes in gross NPLs by key sector**

		Change relative to prior periods			
	Amount	Nominal		Relative	
(RSD mln)	31/12/2014	30/09/2014	31/12/2013	30/09/2014	31/12/2013
Manufacturing	79,892	-17,539	-2,093	-18.0%	-2.6%
Trade	62,013	-11,573	-1,639	-15.7%	-2.6%
Construction	36,152	-7,929	-8,124	-18.0%	-18.3%
Education and real estate	29,030	2,432	2,920	9.1%	11.2%
Agriculture	9,852	190	719	2.0%	7.9%
Transport, hotels/restaurants, communications	10,726	-1,432	-1,714	-11.8%	-13.8%

Source: NBS.

The construction industry, which accounts for 8.8% of total gross corporate lending and 15.9% of total NPLs, recorded by far the highest NPL ratio – 48.3% (down by 5.1 percentage points from the quarter before).

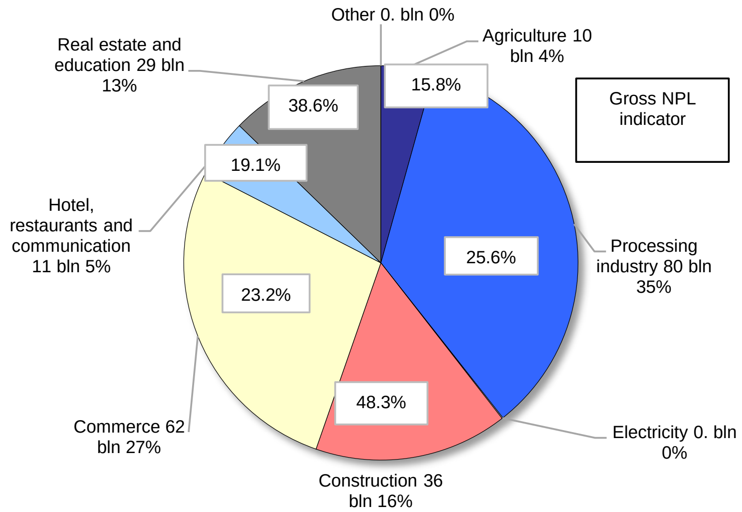
Table 3.3.1.2. **Corporate NPL ratio by sector**

		Change relative to prior periods (pp)	
(%)	31/12/2014	30/09/2014	31/12/2013
Construction	48.3%	-5.1	-4.4
Real estate and education	38.6%	0.7	-0.2
Manufacturing	25.6%	-4.0	0.6
Trade	23.2%	-5.2	-2.1
Agriculture	15.8%	-0.7	-1.8
Transport	19.1%	3.7	4.2

Source: NBS.

The key branches of the economy – manufacturing and retail and wholesale trade, accounting for 62.3% of total gross corporate NPLs, showed the NPL ratio of 25.6% and 23.2% respectively, representing a significant decrease relative to a quarter earlier (29.6% and 28.4%, respectively).

Chart 3.3.1.5. Private orporates NPL structure
December 2014



Source: National Bank of Serbia.

Non-performing personal loans

The ratio of non-performing personal loans stayed below the average for the overall portfolio. At end-2014, it equalled 11.4%, same as in the quarter before. Housing loans made the bulk of non-performing personal loans (33.6% at end-2014), accounting for 46.7% of gross lending to natural persons.

In addition to housing loans, cash loans also accounted for a significant share in total non-performing personal loans (25.1%). The cumulative share of these two types of loans in total non-performing personal loans was 58.7%, while gross NPL ratios for these two categories equalled 8.2% and 10.4% respectively.

Table 3.3.1.4. **Non-performing personal loans by category**

(%)	31/12/2014	Change relative to prior periods (pp)	
		30/09/2014	31/12/2013
Housing construction	8.2%	0.2	1.3
Cash loans	10.4%	-0.4	-0.1

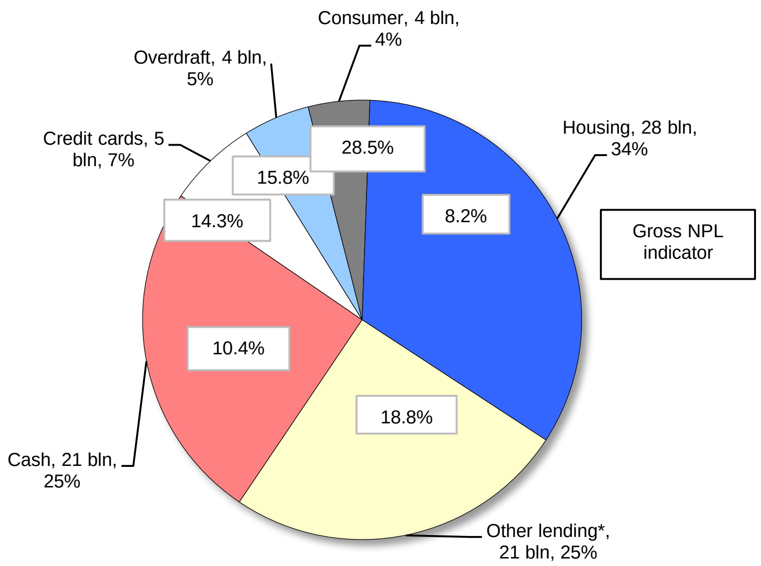
Source: NBS.

Table 3.3.1.3. **Changes in gross non-performing personal loans by category**

(RSD mln)	Amount 31/12/2014	Change relative to prior periods: Nominal 30/09/2014	Nominal 31/12/2013	Relative 30/09/2014	Relative 31/12/2013
Housing loans	27,629	1,044	5,827	3.9%	26.7%
Cash loans	20,615	99	2,284	0.5%	12.5%
Credit cards	5,428	-79	340	-1.4%	6.7%
Current account overdrafts	4,012	-186	162	-4.4%	4.2%
Consumer loans	3,714	107	234	3.0%	6.7%

Source: NBS.

Chart 3.3.1.6. **Individuals gross NPL structure**
December 2014



*Other lending = agriculture, other activities, vehicle purchase loans and other loans

Source: National Bank of Serbia.

4. BANKING SECTOR LIABILITIES

4.1. Level and structure

Banking sector liabilities were favourably structured. The primary source of bank funding were deposits[12], making up 63.7% of bank liabilities. At end-2014, own sources of funding made up 20.7% and borrowing 10.8% of total liabilities.

Table 4.1.1. **Key items of banking sector liabilities**

(RSD mln)	Amount 31/12/2014	share %
Deposits and other liabilities	2,224,937	74.9%
to banks, OFO and the central bank	*353,240*	*11.9%*
to other customers	*1,871,697*	*63.0%*
Securities issued and other borrowings	1,869	0.1%
Subordinated liabilities	72,439	2.4%
Provisions	12,324	0.4%
Share capital and other capital	424,811	14.3%
Profit	54,779	1.8%
Loss	-53,747	-1.8%
Reserves and unrealised losses	187,956	6.3%
Other	43,533	1.5%
Total banking sector liabilities	**2,968,901**	**100.0%**

Source: NBS.

Total liabilities of the banking sector increased by RSD 103.4 bln (by 4.6%) from end-2013, or by RSD 14.7 bln (0.6%) from end-Q3. The increase in liabilities primarily stems from growth in deposits by RSD 164.2 bln (9.5%) in 2014, or by RSD 84.1 bln (4.7%) in the final quarter of the year. Other liabilities generally remained unchanged.

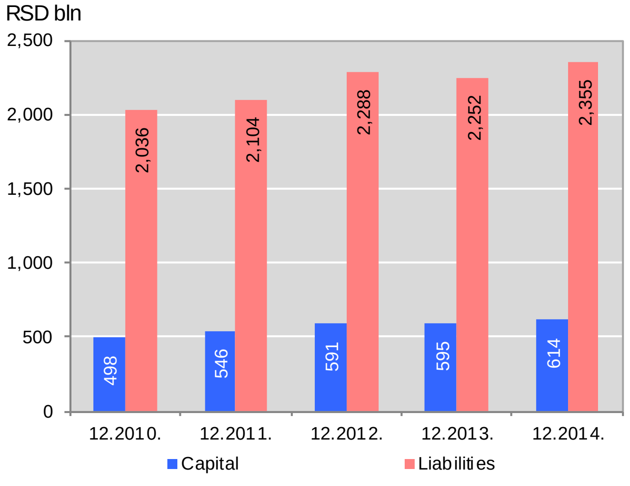
The maturity structure of total liabilities remained unchanged. Liabilities with the maturity of over one year (capital included) accounted for 36.7% of total liabilities at end-Q4, compared to 37.4% in Q3 2014.

The currency structure showed no significant changes in Q4 2014. At end-2014, dinar liabilities (capital included) accounted for 40.7% (Q3: 40.0%) and FX and FX-indexed liabilities for 59.3% of total liabilities. As regards the FX portion of liabilities, the dominant currency of denomination was the euro, accounting for 91.7%, whilst the rest of FX liabilities were denominated predominantly in USD (4.2%) and CHF (3.6%).

[12] 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 customers

Chart 4.1.1.

Banking sector capital and liabilities of the banking sector



Source: National Bank of Serbia.

Greater use of own sources of funding during Q4 (increase in share capital) was sufficient to keep the share of capital at 20.7%, which is a mild decline from Q3 (20.8%), despite the fact that two banks covered losses in the total amount of RSD 4.2 bln during the observed quarter.

4.2. Deposits

Total deposits of the Serbian banking sector rose by RSD 164.2 bln from end-2013 to RSD 1,891.5 bln, which is an increase of RSD 84.1 bln, q-o-q. The increase was mainly due to the rise in household and public enterprise deposits.

At end-2014, the share of FX and FX-indexed deposits stood at 72.1%, with the euro accounting for a dominant 91.6% share of the portfolio. The rest of the FX portfolio was mainly in US dollars (5.3%) and Swiss francs (2.4%).

Short-term deposits accounted for the prevalent share of the deposit portfolio of banks in Serbia, which, in addition to demand deposits (with a 43.9% share in total deposits), made up 46.6% of all deposits (six-month and one-year deposits being the most significant – over 40% of all short-term deposits). Over-one-year deposits accounted for 9.1% of total deposits.

Household savings[13] contracted by RSD 9.5 bln (by over RSD 11 bln with a single bank) to RSD 849.3 bln at end-2014. Due to the depreciation in the observed period, the fall is even greater for deposits in euros (2.8%). Despite the strengthening of the euro against the dinar by 1.8%, foreign currency savings declined by RSD 7.6 bln (0.9%) in Q4. The share of dinar household savings remained relatively low at 4,0%.

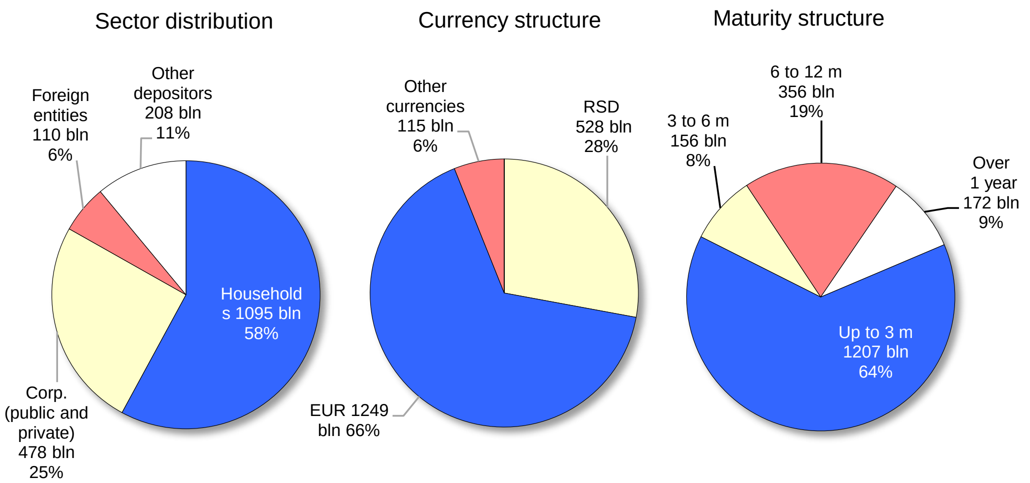
Table 4.2.1. **Changes in deposit levels**

	Amount	Change relative to prior periods			
		Nominal change		Relative change	
(RSD mln)	31/12/2014	30/09/2014	31/12/2013	30/09/2014	31/12/2013
Finance and insurance sector	58,894	536	-14,683	0.9%	-20.0%
Public sector	40,268	19,706	20,793	95.8%	106.8%
Public enterprises	93,338	36,677	38,865	64.7%	71.3%
Household sector	1,095,452	26,175	72,440	2.4%	7.1%
Companies	384,650	-21,239	26,272	-5.2%	7.3%
Foreign entities and foreign banks	109,651	19,776	6,303	22.0%	6.1%
Other sectors	109,216	2,439	14,199	2.3%	14.9%
Total deposits	1,891,469	84,070	164,189	4.7%	9.5%

Source: NBS.

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

Chart 4.2. **Banking sector deposits structure**
December 2014



Source: National Bank of Serbia.

4.3. Borrowing

Total borrowing of the banking sector amounted to RSD 321.8 bln at end-2014, down by RSD 44.6 bln (12.2%) relative to the previous quarter. The decline mostly referred to the reduction in borrowing of three banks.

Table 4.3.1. **Changes in the level of bank borrowing**

		Change relative to prior periods			
	Amount	Nominal		Relative	
(RSD mln)	31/12/2014	30/09/2014	31/12/2013	30/09/2014	31/12/2013
Repo transactions	-	-	-	-	-
Overnight loans	40,703	-4,398	9,633	-9.8%	31.0%
Loans received	273,305	-41,952	-49,743	-13.3%	-15.4%
Other financial liabilities	7,789	1,780	2,660	29.6%	51.9%
Total borrowing	321,797	-44,570	-37,450	-12.2%	-10.4%

Source: NBS.

Loans maturing in over one year (73.5%) held the dominant share in the banking sector's borrowing, with the greatest number of those loans maturing in two to five years (43.0% of long-term loans).

The dominant currency of borrowing was the euro, accounting for RSD 265.0 bln (Q3 2014: RSD 298.1 bln), followed by the Swiss franc with RSD 24.0 bln (Q3: RSD 23.9 bln). Bank debt in dinars arising from borrowing totalled RSD 31.0 bln (Q3: RSD 37.0 bln).

The key item in total borrowing were the loans received, accounting for 84.9% (Q3: 86.1%).

4.4. External relations

The downward tendency in banking sector's external borrowing, in place as of Q3 2013, continued in the quarter observed. At end-2014, banks' total external liabilities arising from credit operations stood at RSD 226.5 bln, down by RSD 48.9 bln (17.8%) in Q4. Credit exposure remained highly concentrated, with four banks accounting for over 58% of total debt.

Long-term loans held a dominant share in foreign borrowing – 83.8%, a decrease relative to 88.4% recorded in Q3.

Table 4.4.1. **Changes in bank external borrowing**

		Change relative to prior periods			
	Amount	Nominal		Relative	
(RSD mln)	31/12/2014	30/09/2014	31/12/2013	30/09/2014	31/12/2013
Overnight loans	0	-246	-618	-100.0%	-100.0%
Loans received	225,113	-48,738	-70,141	-17.8%	-23.8%
Other financial liabilities	1,381	90	239	7.0%	20.9%
Total borrowing	226,494	-48,894	-70,520	-17.8%	-23.7%

Source: NBS.

The currency composition of external borrowing remained almost unchanged relative to the previous quarter, given that 89.7% of loans were granted in euros and 10.2% in Swiss francs (Q3 2014: 89.2% and 8.7%).

4.5. Subordinated liabilities

Total subordinated liabilities of Serbian banks reached RSD 72.4 bln at end-2014, down by RSD 0.6 bln or 0.8% q-o-q, with the bulk maturing within one to two years (40.9%) and within two to five years (32.0%). Liabilities denominated in euros made up 92.8% of total liabilities, followed by those in Swiss francs (6.5%) and dinars (0.7%). The exposure remained highly concentrated in Q4 as well, since two banks held 45.7% of all subordinated liabilities, and four banks as much as 63.3%.

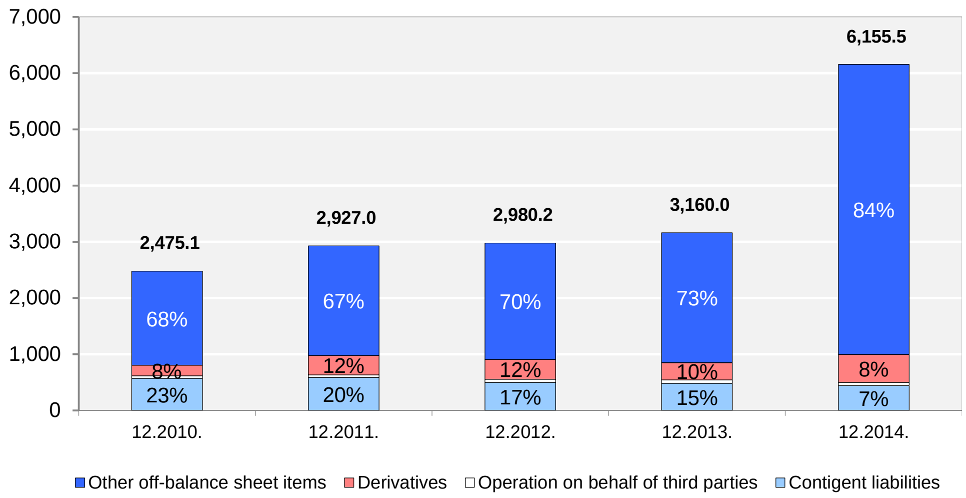
Of total subordinated liabilities with RSD 73.0 bln, banks included RSD 33.8 bln in supplementary capital.

5. OFF-BALANCE SHEET ITEMS

Off-balance sheet items surged in Q4 2014 (by 84.8%), primarily on account of an increase in other off-balance sheet items (by 129.9% or RSD 2,746.2 bln) and derivatives receivables (by 33.3%). At end-2014, total off-balance sheet items amounted to RSD 6,155.5 bln.

Pursuant to the newly-adopted Chart of Accounts and Contents of Accounts in the Chart of Accounts for Banks and the Decision on Collection, Processing and Submission of Data on the Balance and Structure of Accounts from the Chart of Accounts, banks have an obligation to include received material collateral within other off-balance sheet assets.

Chart 5.1. **Off-balance sheet items**
RSD bln



Source: National Bank of Serbia.

The off-balance sheet segment of the banking sector is most highly concentrated, not only in aggregate terms (at end-2014, 26.3% of total off-balance sheet items was held by a single bank, 59.9% was concentrated in five banks, and 83.5% in ten banks), but also in terms of individual items (over 72% of total derivatives receivables was held by four banks, and four banks accounted for over a half of other off-balance sheet items and guarantees).

The majority of off-balance sheet items (90.2%) were risk-free[14] items (guarantees and other sureties accepted, custody operations and other off-balance sheet assets). The portion of off-balance sheet items subject to classification (considered risk-bearing) amounted to RSD 602.0 bln at end-2014, up by RSD 29.5 bln or 5.1% q-o-q.

At end-2014, contingent liabilities[15] equalled RSD 442.5 bln, down by RSD 2.5 bln (0.6%) q-o-q, making up 7.2% of total off-balance sheet items[16] (13.4% at end-Q3).

Table 5.1 **Changes in off-balance sheet items in the Serbian banking sector**

	Amount	Change relative to prior periods			
		Nominal		Relative	
(RSD mln)	31/12/2014	30/09/2014	31/12/2013	30/09/2014	31/12/2013
Issued guarantees and other sureties	267,718	7,750	8,061	3.0%	3.1%
Receivables under derivatives	493,028	122,243	184,056	33.0%	59.6%
Contingent liabilities and other irrevocable commitments	174,734	-10,235	-45,613	-5.5%	-20.7%
Receivab. from susp. rates and repo agreements	0	-77,381	-63,425	-100.0%	-100.0%
Sureties for liabilities	83,885	-146,242	-143,070	-63.5%	-63.0%
Other off-balance sheet assets	4,860,424	2,746,169	2,860,549	129.9%	143.0%

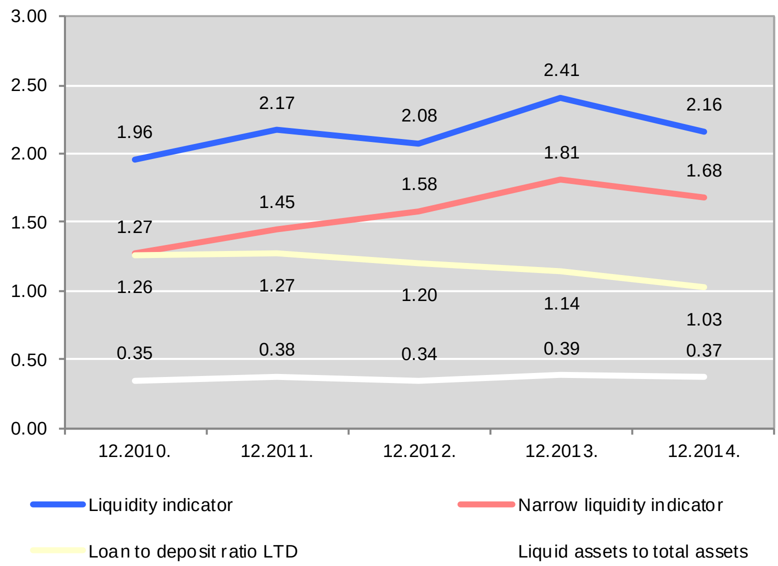
Source: NBS.

[14] Risk-free positions are positions under which a bank is not exposed to credit risk. Off-balance sheet assets considered risk-bearing in terms of credit risk exposure are subject to classification under which banks are required to calculate reserves for estimated losses.
[15] Guarantees and other sureties (RSD 267.7 bln), irrevocable commitments regarding undisbursed loans and placements (RSD 114.9 bln) and other irrevocable commitments (RSD 59.8 bln).
[16] The share was mostly reduced due to the increase in total off-balance sheet assets on account of changes to the Chart of Accounts and the Decision on Collection, Processing and Submission of Data on the Balance and Structure of Accounts from the Chart of Accounts.

6. LIQUIDITY

Serbia's banking sector featured exceptionally high liquidity levels according to all relevant criteria. At end-2014, the average monthly liquidity ratio equalled 2.16 and the narrow liquidity ratio 1.68 (vs. regulatory floors of 1.0 and 0.7 respectively).

Chart 6.1.
Liquidity indicators for the Serbian banking sector



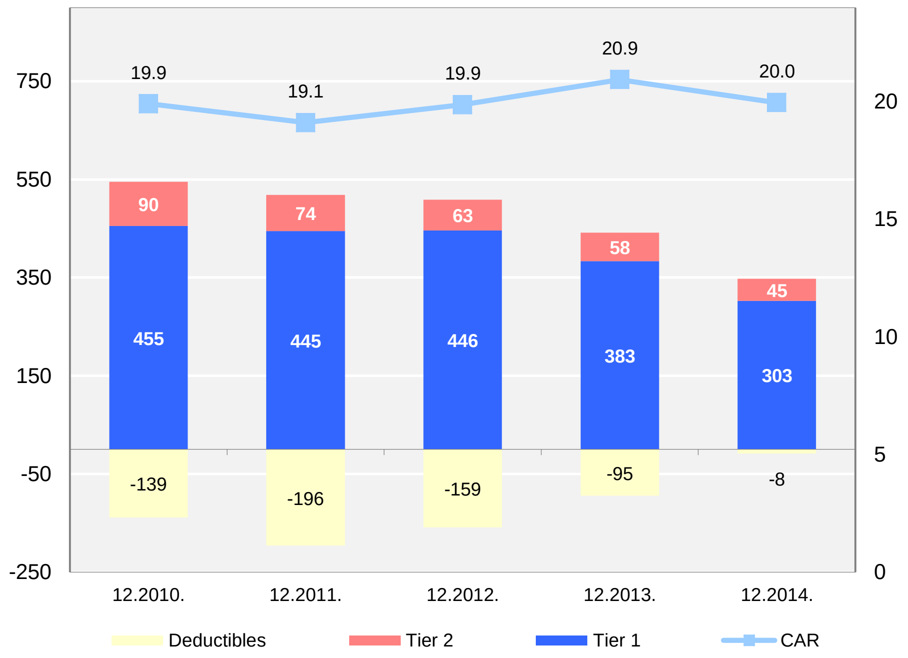
The share of liquid assets did not change in Q4, amounting to 37.1% at end-December (vs. 37.3% at end-September). The value of total liquid receivables did not change in the observed period compared to a quarter earlier, but their structure did, in terms of an increase in cash and balances in gyro and foreign currency accounts and a decrease in foreign currency required reserves. The value of liquid liabilities rose by over RSD 76 bln, particularly the liabilities with agreed maturity and which are due in the following month.

The value of the portfolio of NBS repo securities fell by RSD 36.5 bln in Q4, reaching RSD 7.5 bln at end-December. At the same, the portfolio of government securities expanded by RSD 19.1 bln to RSD 444.0 bln. The share of dinar securities amounted to 61.3% in late September.

7. CAPITAL ADEQUACY

In terms of the fulfilment of regulatory requirements concerning the capital adequacy ratio, the Serbian banking sector may well be considered well-capitalised. At end-2014, the average capital adequacy ratio for Serbia's banking sector was 19.96%, which is far above the regulatory minimum, both according to domestic regulations (12%) and Basel standards (8%).

Chart 7.1. **Regulatory capital and CAR***
RSD bln, CAR in

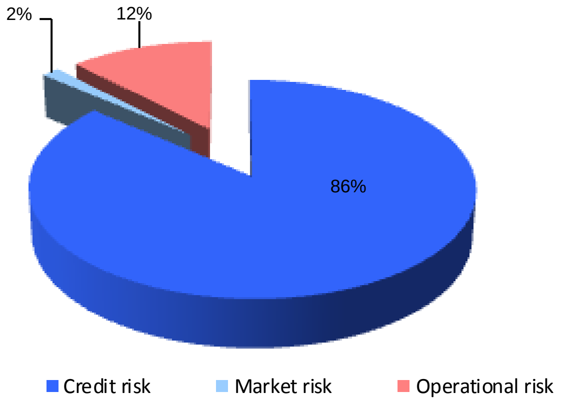


* CAR = Regulatory capital adequacy ratio

Source: National Bank of Serbia.

At end-2014, prior to reduction for the deductibles from total regulatory capital, banking sector core capital stood at RSD 303.0 bln, up by RSD 26.5 bln q-o-q. The greatest contribution to the increase in banking sector core capital in Q4 came from a decline in regulatory reserves for estimated losses under balance sheet assets and off-balance sheet items (by RSD 21.5 bln q-o-q) due to the relocation of bad assets from one bank’s balance sheet.

Chart 7.2
Capital requirements
In percentages



Source: National Bank of Serbia.

In addition, Q4 recorded a decline in supplementary capital by RSD 3.4 bln, primarily on the back of a decline in subordinated liabilities of banks eligible for inclusion in supplementary capital, whereas the amount of deductibles from regulatory capital remained broadly unchanged relative to the previous quarter. Given the above, total regulatory capital, after reduction for deductibles, rose by RSD 23.2 bln in Q4 2014.

Q4 saw an increase in the capital adequacy ratio (CAR) due to higher regulatory capital (in the segment of core capital), which surpassed the increase in capital requirements (primarily for credit risk) by RSD 8.1 bln or 4.2%.

In Q4, seven banks carried out recapitalisation in the total amount of EUR 230.3 mln (RSD 27.9 bln).

The leverage[17] ratio was highly favourable. At end-2014, capital accounted for 20.7% of balance sheet assets, with top-quality equity capital (69.2%) making up the bulk of balance sheet capital.

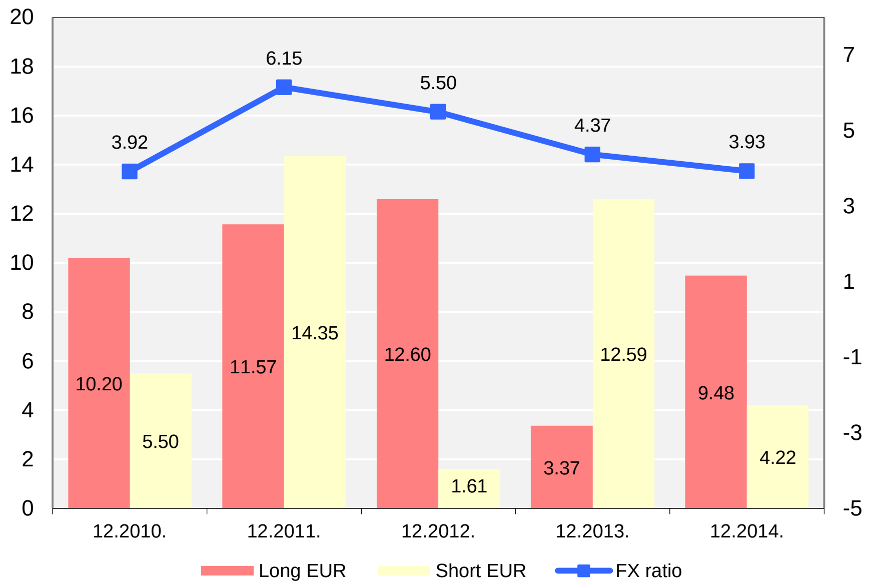
[17] Capital to balance sheet assets ratio.

8. FOREIGN EXCHANGE RISK

At end-2014, Serbia's banking sector featured a long open FX position worth RSD 13.2 bln, whereas the FX indicator stood at 3.93%.

Banks operated at net long open positions in euros (RSD 9.48 bln) and US dollars (RSD 2.91 bln), while at the same time featuring a net short open position in Swiss francs (RSD 1.29 bln).

Chart 7.3 **Quarterly breakdown of the sector's long and short FX position (in EUR) and foreign exchange risk ratio**
RSD bln



Source: National Bank of Serbia

9. NBS REGULATORY ACTIVITY

In Q4 2014, the NBS adopted the following by-laws pertaining to bank supervision:
In its meeting on 13 November 2014, the Executive Board of the National Bank of Serbia adopted the **Decision on Reporting Requirements for Banks** (RS Official Gazette, No 125/2014) in order to harmonise the reports prescribed by the decision with a set of accounting regulations published in the RS Official Gazette, No 71/2014, as well as to upgrade some of the reports that banks submit to the NBS. The new Decision repealed the Decision on Reporting Requirements for Banks (RS Official Gazette, Nos 45/2011, 94/2011 and 87/2012) and came into force on 31 December 2014, except for reports which banks are obligated to submit on a daily basis in accordance with the provisions of the new decision as of its effective date.
At the same meeting, the Executive Board adopted the **Decision on Disclosure of Data and Information by Banks** (RS Official Gazette, No 125/2014), which introduced four standard forms to be completed by banks in order to disclose data on their capital and main features of financial instruments included in the calculation of capital, data on reconciliation of all regulatory capital elements back to the balance sheet, as well as data on capital adequacy. New elements in the Decision should ensure greater transparency in bank operations, and provide the public at large with a set of simple, comparable and easily accessible data and information on bank capital, which should facilitate business decision making and bank risk profile assessment.
At its meeting on 12 December 2014, the Executive Board of the National Bank of Serbia adopted the **Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items** (RS Official Gazette, No 135/2014). The decision marks an improvement on the current provisions regulating the recognition of prime and adequate collateral. Furthermore, receivables from a natural person borrower on whom the bank does not have an updated credit file, instead as currently in the E category, are now classified one category below the category where they would otherwise be classified. This should preclude unjustified provisioning for reserves by banks in respect of accounts of clients who regularly settle their obligations. This however would not diminish the bank’s obligation to adequately assess the creditworthiness of these persons and thereby ensure adequate credit risk management. In addition, provisions on credit files of debtors – farmers and entrepreneurs have been aligned with amended regulations on taxation of income from independent business activities.
At the same meeting, the NBS Executive Board made the decision to postpone the deadlines for the second phase of the Strategy for Implementation of Basel III Standards in the Republic of Serbia (assessment of effects and determination of the implementation dynamics) until the end of 2015. Given that the Strategy is implemented in parallel with other activities relating to the improvement of the regulatory framework for bank operation, the phased implementation of the

quantitative impact study and the phased drafting of regulations in accordance with Basel III standards are in fact an appropriate way of introducing these standards in the Serbian banking sector, in order to ensure shorter lapse of time between the assessment of effects and the implementation through regulations.