



**NATIONAL BANK OF SERBIA**

ADMINISTRATION FOR SUPERVISION OF FINANCIAL INSTITUTIONS  
BANK SUPERVISION DEPARTMENT

# **BANKING SECTOR IN SERBIA**

## **Fourth Quarter Report 2017**

June 2018

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## 1 BASIC INFORMATION ON SERBIAN BANKING SECTOR

### 1.1 Selected parameters of the Serbian banking sector<sup>1</sup>

At end-December 2017, the Serbian banking sector numbered 29 banks, i.e. one bank less than at end-September 2017. The organisational network consisted of 1,627 business units and employed a total of 23,055 persons.

Table 1.1. **Selected parameters of the Serbian banking sector**

(RSD bn, %)

	Number of banks	Assets		Capital		Network		Employment	
		Amount	Share	Amount	Share	Number of business units <sup>1)</sup>	Share	Number	Share
Banks in domestic ownership	8	780	23.1%	153	23.0%	546	33.6%	6,488	28.1%
State-owned	6	544	16.1%	88	13.2%	443	27.2%	5,279	22.9%
Privately-owned	2	236	7.0%	65	9.8%	103	6.3%	1,209	5.2%
Banks in foreign ownership	21	2,589	76.9%	514	77.0%	1,081	66.4%	16,567	71.9%
Italy	2	928	27.5%	188	28.2%	236	14.5%	4,188	18.2%
Austria	2	426	12.7%	78	11.7%	180	11.1%	2,630	11.4%
Greece	2	209	6.2%	64	9.6%	108	6.6%	1,896	8.2%
France	2	375	11.1%	50	7.4%	179	11.0%	2,322	10.1%
Other	13	651	19.3%	134	20.1%	378	23.2%	5,531	24.0%
<b>Total banking sector</b>	<b>29</b>	<b>3,369</b>	<b>100.0%</b>	<b>667</b>	<b>100.0%</b>	<b>1,627</b>	<b>100.0%</b>	<b>23,055</b>	<b>100.0%</b>

<sup>1)</sup> Business units include all business network forms: headquarters, branches, branch offices, bank counters and other business units.

Source: NBS.

The fourth quarter of 2017 has seen a continuation of the downward trend in banking sector employment in Serbia and also a contraction in the number of business units. Compared to end-September 2017, employment fell by a total of 287 persons, as 14 banks downsized their employment by 437, while 13 banks hired 150 new people. Within the business network, the number of business units decreased by 44, as a net result of five banks downsizing their networks by a total of 54 units and five banks expanding their networks by 10 business units. The key driver of these movements was the winding up of operation of one bank, due to merger by acquisition<sup>2</sup>.

At end-December 2017, total net balance sheet assets of the Serbian banking sector equalled RSD 3,369.4 bn (rising by 2.3% relative to September 2017) and total balance sheet capital RSD 667.1 bn (up by 0.7% from September 2017).

The market share of banks in majority ownership of domestic entities (private entities and the Republic of Serbia) decreased a bit (from 24.2% to 23.1%), while their share in total banking sector capital edged down from 23.4% to 23.0%. Consequently, the share of

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

<sup>2</sup> Jubanka A.D. Beograd was merged by acquisition with the AIK banka A.D. Beograd on 22 December 2017.

banks in majority ownership of foreign entities increased (from 75.8% to 76.9% as regards the balance sheet total and from 76.6% to 77.0% as regards capital), which was accompanied by a nominal rise in the balance sheet of these banks by 3.7% and in capital by 1.3%.

Banks from Italy, Austria, France and Greece (8 banks) continued to account for the dominant share in total banking sector balance sheet assets – 57.5%, (contracting by 3.5 pp from the quarter before, mainly due to the change in the ownership structure of one bank<sup>3</sup>).

## 1.2 Concentration and competition

The Serbian banking sector is characterised by an acceptable level of competition and low concentration of activities. The Herfindahl-Hirschman index<sup>4</sup> values indicate the absence of concentration in all observed categories. For a long time now, the highest values of the index have been observed in deposits (chiefly household deposits) and income from fees and commissions, while the lowest figures have been noted for total income and interest income, as well as gross loans (both total loans and household loans).

Table 1.2.1 **Concentration and competition indicators**

(Share %)			
	Top 5 banks	Top 10 banks	HHI <sup>1)</sup>
Assets	54.9	78.4	813
Lending (total)	53.6	77.7	788
Household loans	53.7	79.6	810
Corporate loans	53.7	80.8	812
Deposits (total)	55.6	79.5	827
Household deposits	59.6	83.1	977
Income (total)	49.5	77.4	720
Interest income	52.1	77.3	767
Fees and commissions	57.8	81.3	911

<sup>1)</sup> Herfindahl Hirschman Index of concentration.  
Source: NBS.

The share of the ten biggest banks in Serbia changed slightly in the fourth quarter of 2017, thus they now accounted for 78.4% of net balance sheet assets, 79.5% of deposits and 77.7% of gross loans.

<sup>3</sup> OTP banka Srbija A.D. Novi Sad became the 100% owner of Vojvodjanska banka A.D. Novi Sad at end-2017 (the market share of Vojvodjanska banka on 31 December 2017 was 3.6%).

<sup>4</sup> The Herfindahl Hirschman Index (HHI) is calculated as the sum of square values of individual bank shares in the category observed (assets, loans, deposits, etc.). HHI up to 1,000 indicates that there is no market concentration; 1,000–1,800 indicates moderate concentration; above 1,800 indicates high concentration.

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

(RSD bln, %)

	31/12/2016			30/09/2017			31/12/2017			Δ Γ	Δ T
	Amount	Share	Ranking	Amount	Share	Ranking	Amount	Share	Ranking		
Banca Intesa A.D.- Beograd	551	17,0	1	560	17,0	1	565	16,8	1	—	—
Komercijalna banka A.D.- Beograd	400	12,3	2	374	11,4	2	369	11,0	2	—	—
Unicredit Bank Srbija A.D.- Beograd	332	10,2	3	359	10,9	3	363	10,8	3	—	—
Societe Generale banka Srbija A.D.- Beograd	236	7,3	5	265	8,1	4	288	8,5	4	↑	—
Raiffeisen Banka A.D.- Beograd	254	7,8	4	262	8,0	5	265	7,9	5	↓	—
Agroindustrijska komercijalna banka AIK banka akcionarsko društvo, Beograd	184	5,7	6	172	5,2	6	209	6,2	6	—	—
Erste Bank A.D.- Novi Sad	143	4,4	8	149	4,5	8	162	4,8	7	↑	↑
Eurobank A.D.- Beograd	151	4,6	7	149	4,5	7	158	4,7	8	↓	↓
Banka Poštanska štedionica A.D.- Beograd	133	4,1	9	134	4,1	9	140	4,2	9	—	—
Vojvođanska banka A.D.- Novi Sa	126	3,9	10	125	3,8	10	123	3,6	10	—	—

Source: NBS

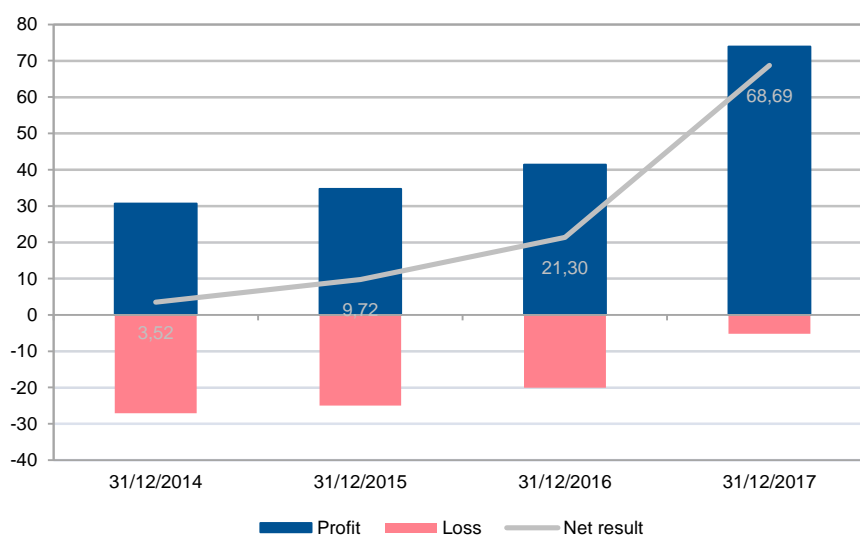
In terms of balance sheet assets, Banca Intesa A.D. Beograd remained the leading bank in Serbia; its market share edged down slightly (by 0.2 pp) from the previous quarter, as well as from the same period last year. In addition to Banca Intesa A.D. Beograd, the following banks had market shares above 10% as at 31/12/2017: Komercijalna banka A.D. – Beograd and Unicredit Bank Srbija A.D. – Beograd with market shares of 11.0%, and 10.8% respectively. In terms of balance sheet assets, the six leading banks have an aggregate market share of around 60%.

## 2 PROFITABILITY

### 2.1 Profitability indicators

Banking sector profitability remained on an upward path in Q4 2017, again mostly owing to a reduction in credit risk losses and other income item. In annual terms, net profit before tax equalled RSD 68.7 bn, rising significantly compared to previous years.

Chart 2.1.1. **Pre tax result**  
(in RSD bln)

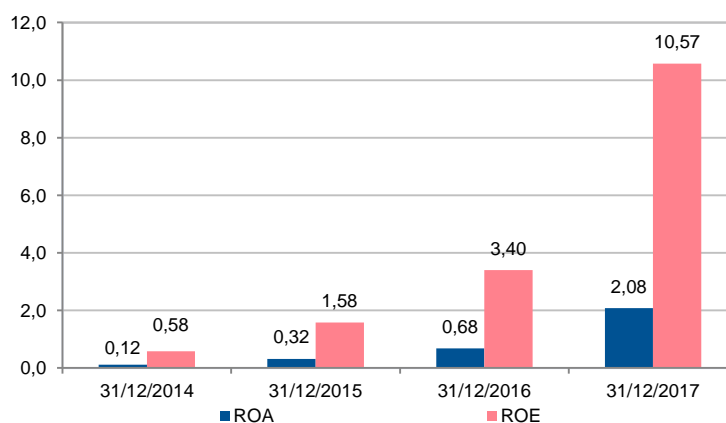


Source: National Bank of Serbia.

The rise in profitability was differently distributed across the sector: twenty-two banks operated with a profit of RSD 73.9 bn, while seven banks accounting for a 6.8% market share posted a negative financial result totalling RSD 5.2 bn. The profit and loss generating items of the banking sector were somewhat more concentrated than the balance sheet total: five banks with the highest net profits together made up 66% of the total sector's profit, while three banks with the highest net losses accounted for 78% of the total losses.

The increase in banking sector's profitability at end-2017 was accompanied by a y-o-y improvement in profitability indicators: primarily the return on assets ratio and the return on equity ratio. At end-2017, ROA equalled 2.08% (rising by 1.40 pp y-o-y), and ROE 10.57% (rising by 7.17 pp y-o-y).

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



Source: National Bank of Serbia.

## 2.2 Structure of the result

The strongest contributor to the growth in net profit in 2017 (adding over RSD 33 bn) was a decrease in net credit losses, which came at RSD 7.4 bn at the annual level or only 18% of the net credit losses in 2016.

Such a sizeable decrease in losses under this item resulted from favourable macroeconomic movements in the economy on the one hand and the losses which the banks already carried in previous years, on the other. Banks recorded additional net income on account of provisioning for credit risk-weighted off-balance sheet items in the amount of RSD 387 mn, which is a decrease of 22.1% compared to 2016. The write-off of uncollectible receivables generated net expenses in both 2016 and 2017. Net expenses in 2017 equalled RSD 4.1 bn (rising by RSD 2.1 bn from 2016).

The second largest profitability driver in 2017 was the increase in other operating income, which stood at RSD 20.5 bn at end-2017, going up by RSD 14.3 bn from end-2016. The major part of this growth referred to a one-off increase in other income of RSD 12.3 bn due to the change in ownership structure and merger by acquisition of some banks.

The rise in bank lending did not lead to a rise in net interest income at banking sector level, as the declining trend of average interest rates continued. Further monetary policy easing through the key policy rate in October (reduction by 0.25 pp to 3.50%) drove down the average repo rate and interest rates in the interbank market and market of dinar loans and securities.

Net interest income in 2017 stood at RSD 120.9 bn, or 2.4% less than in the same period in 2016. The reduction stems from the fact that interest income fell more sharply than interest expenses (by RSD 8.7 bn vs. RSD 5.8 bn) in y-o-y terms. At end-2017, 75.7% of total banking sector interest income came from loans, 19.3% from securities and 2.2% from deposits.

On the expense side, interest expenses from deposits had the highest share (71.9%), followed by those from loans (19.5%) and securities (7.0%). The greatest nominal reduction was recorded in interest income in dinars from loans – by 4.9% (or RSD 5.5 bn). In the structure of total interest expenses, expenses arising from FX deposits lost the most (RSD 4.5 bn or 42.5%).

Table 2.2. **Changes in key elements of bank profitability**

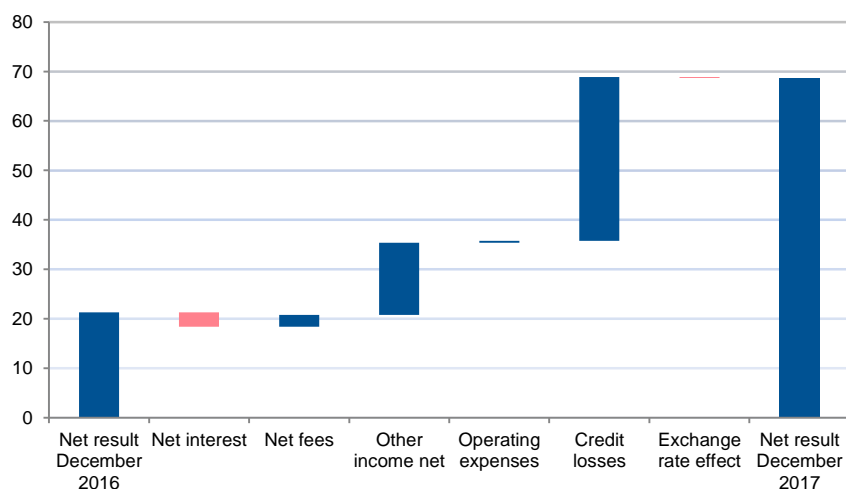
(in RSD mln)

	Result	Net interest	Net fees	Credit losses	Exchange rate effect
31/12/2017	68.690	120.924	37.637	-7.441	8.124
31/12/2016	21.302	123.847	35.272	-40.598	8.320
<b>Change:</b>		<b>-2%</b>	<b>7%</b>	<b>-82%</b>	<b>-2%</b>
		↓	↑	↑	↓

Source: NBS

Unlike net interest income, which was lower than in 2016, net commission and fees income rose by 6.7% or RSD 2.4 bn. At end-2017, net gains from securities increased by RSD 0.2 bn from the year before, reaching RSD 2.4 bn. This increase resulted mainly from higher net gains from financial assets available for sale (by RSD 233 mn). Financial assets held for trading and those initially recognised at fair value through income statement saw no major changes, while hedging derivatives recorded RSD 110 mn higher net loss compared to 2016. Within financial assets held for trading, revaluation income and expenses on derivatives held for trading were the most significant, accounting for over 94% and 97% respectively, and generating a net income of RSD 1.4 bn.

Chart 2.2. **Structure of net result**  
(in RSD bln)



Source: National Bank of Serbia.

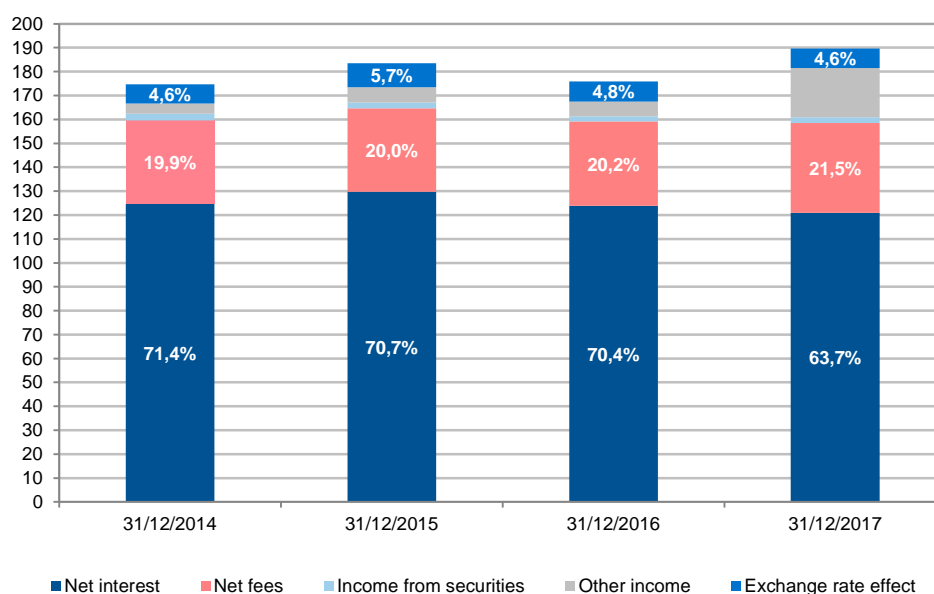


Net effect of the dinar exchange rate fluctuations on the banking sector result in 2017 was positive, resulting in net income of RSD 8.1 bn. The effect of the RSD/EUR exchange rate appreciation in 2017 and frequent appreciation pressures during the year reflected on the dinar equivalent of FX-denominated balance sheet items. Net exchange rate gains on FX receivables and liabilities equalled RSD 63.5 bn (vs. net exchange rate losses of RSD 9.8 bn in 2016), while net exchange rate losses associated with the agreed currency clause came at RSD 55.4 bn (vs. net gains of RSD 18.1 bn on this account in 2016).

## 2.3 Operating income

In 2017, the banking sector's total operating income stood at RSD 189.7 bn, up by 7.9% from the year before. The major drivers of this increase were other income and other operating income earned during the process of acquisition.

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

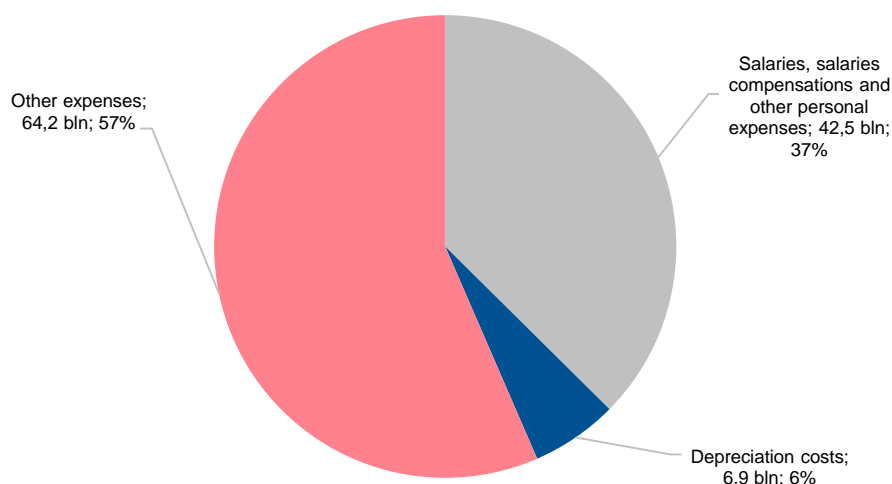


Source: National Bank of Serbia

## 2.4 Operating expenses

At end-2017, operating expenses<sup>5</sup> of the Serbian banking sector equalled RSD 113.6 bn, falling slightly (by 0.3%) y-o-y. Within operating expenses, salaries, salary compensations and other personal expenses (which make up 37.4% of total operating expenses) edged down by 1.2%<sup>6</sup>, and depreciation costs (accounting for 6.1% of operating expenses) decreased by 5.3%. Only the item other expenses rose by 0.8% relative to 2016 (making up 56.5% of operating expenses).

Chart 2.4. **Structure of operating expenses**  
(December 31, 2017)



Source: National Bank of Serbia

<sup>5</sup> Operating expenses include: salaries, salary compensations and other personal expenses, depreciation costs and other expenses (costs of material, production services, non-material costs...), in accordance with the amended methodology.

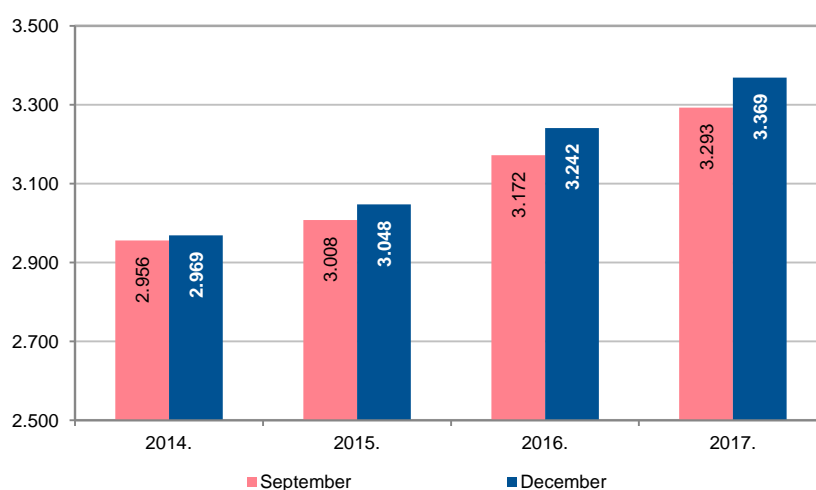
<sup>6</sup> At end-2017, there were fewer employees in the banking sector than at end-2016 (down by 3.3%).

### 3 BANKING SECTOR ASSETS

#### 3.1 Level and structure

Total net balance sheet assets of the Serbian banking sector at end-December 2017 equalled RSD 3,369.4 bn, which is a rise of RSD 76.1 bn or 2.3% compared to September 2017.

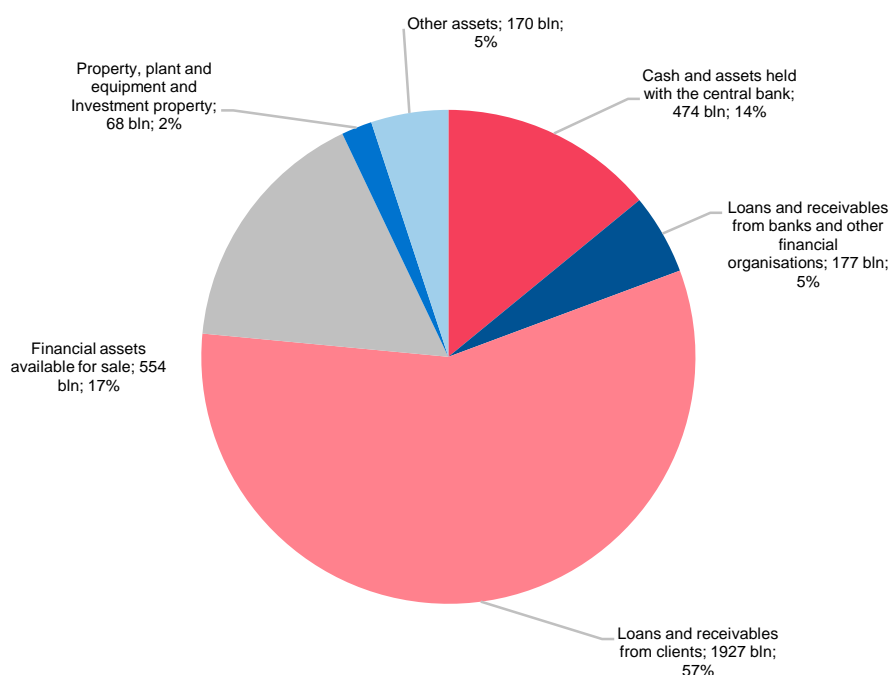
Chart 3.1.1. **Total banking sector assets**  
(in RSD bln)



Source: National Bank of Serbia

Loans and receivables held a dominant share in banking sector assets of 62.5% (as a result of banks' orientation towards traditional banking activities), though they shrunk by 0.7 pp from the quarter before. Other prominent items were financial assets available for sale (16.4%) and cash and balances with the central bank (14.1%), which dropped by 0.2 pp and rose by 0.7 pp, respectively in the quarter observed. Investment in financial assets mostly related to investment in securities issued by the Republic of Serbia, making this segment of banking sector investment highly secure and liquid.

**Chart 3.1.2. Banking sector assets structure**  
(December 31, 2017)



Source: National Bank of Serbia.

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

	Amount	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Cash and balances with the central bank	473,844	33,366	-10,271	7.6%	-2.1%
Loans and receivables	2,103,902	22,760	145,665	1.1%	7.4%
<i>from banks and OFO</i>	177,337	-30,980	-33,022	-14.9%	-15.7%
<i>from customers</i>	1,926,565	53,740	178,687	2.9%	10.2%
Financial assets	646,805	8,446	-27,325	1.3%	-4.1%
<i>at fair value through the income statement and held for trading</i>	26,244	2,057	4,958	8.5%	23.3%
<i>Initially recognised at fair value through income statement</i>	7,270	4,635	839	175.8%	13.0%
<i>available for sale</i>	553,816	7,807	-1,099	1.4%	-0.2%
<i>held to maturity</i>	59,474	-6,053	-32,023	-9.2%	-35.0%
Property, plant and equipment	52,312	1,742	-118	3.4%	-0.2%
Investment property	15,291	-253	-1,608	-1.6%	-9.5%
Other	77,237	10,032	21,543	14.9%	38.7%
<b>Banking sector balance sheet total</b>	<b>3,369,392</b>	<b>76,092</b>	<b>127,887</b>	<b>2.3%</b>	<b>3.9%</b>

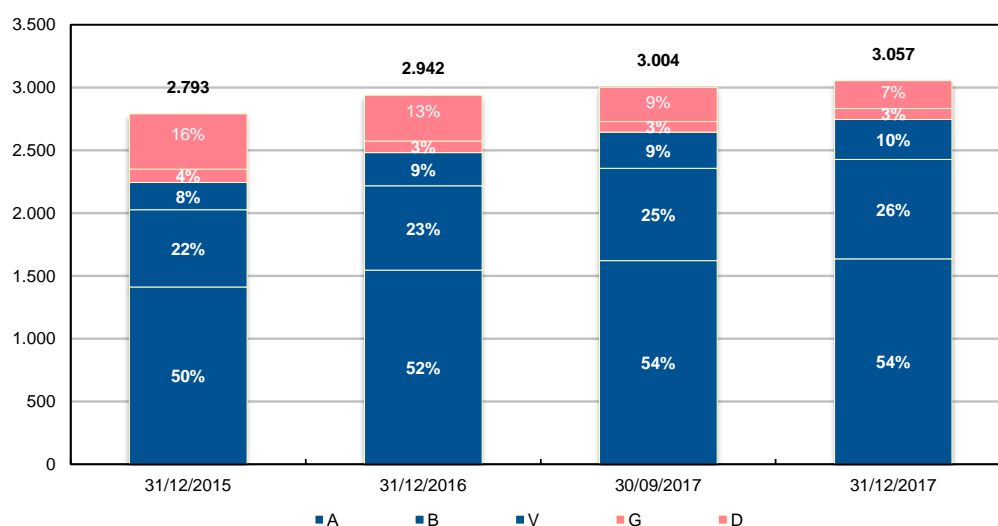
Source: NBS.

### 3.2 Classified assets

At end-December 2017, total classified assets (on- and off-balance sheet) equalled RSD 3,056.9 bn, up by RSD 52.7 bn or 1.8% from a quarter earlier. Balance sheet assets subject to classification rose by RSD 26.1 bn and off-balance sheet items subject to classification by RSD 26.6 bn. Within balance sheet assets subject to classification, the most significant changes were recorded for receivables due, which shrunk by RSD 28.2 bn (decreasing their share in total classified balance sheet assets from 7.3% to 6.0%), and for long-term and short-term loans, which increased by RSD 27.5 bn and RSD 19.2 bn, respectively. As regards off-balance sheet items, the largest absolute increase was recorded in performance guarantees – by RSD 15.6 bn. The most significant off-balance sheet item subject to classification (making up 58.8 % of the total) were contingent liabilities.

**Chart 3.2. Total classified assets**

( in RSD bin , in % )



Source: National Bank of Serbia

A major change in the structure of classified balance sheet assets compared to the quarter before is reflected in the increase in balance sheet items from categories B and C by RSD 66.1 bn and RSD 16.9 bn, respectively (mostly short-term and long-term loans), and a decline in the worst category – E by RSD 50.0 bn (mainly receivables due and long-term loans). The key reason for the reduction in bad assets is the coming into force and application of the Decision on the Accounting Write-off of Bank Balance Sheet Assets.<sup>7</sup> Consequently, the overall structure improved, as the share of the two worst categories shrank by 2.5 pp, so bad assets accounted for 12.3% of total classified balance sheet assets.

<sup>7</sup> In accordance with the Decision on the Accounting Write-off of Bank Balance Sheet Assets, banks were required to carry out the accounting write-off (transfer of balance sheet assets to off-balance sheet records) of balance sheet assets of a low degree of collectibility (a non-performing loan whose allowances for impairment equal 100% of its gross book value).

An increase in total classified off-balance sheet items by RSD 26.6 bn resulted from a rise in A category by RSD 20.8 bn, mostly under performance guarantees and other classified off-balance sheet items, as well as in C category by RSD 14.6 bn, mainly under contingent liabilities. Despite the rise in off-balance sheet items classified in these two categories, due to the shrinking of B category by RSD 9.1 bn, the share of off-balance sheet bad assets in total classified off-balance sheet items did not change significantly (dropped from 4.1% to 4.0%).

As a result of the above movements, the calculated balance sheet regulatory provisions decreased by RSD 46.6 bn or 14.6% in Q4 and came at RSD 273.1 bn. On the other hand, calculated off-balance sheet regulatory provisions rose by 12.0% to RSD 15.7 bn.

Accordingly, total required reserve for estimated losses arising from credit risk (which for each borrower represents a positive difference between the amount of regulatory provisions and the sum of allowances for impairment of balance sheet assets and provisions for losses on off-balance sheet items) decreased by RSD 1.8 bn or 1.2% in the same period, amounting to RSD 146.6 bn.

In 2017, assigned receivables amounted to RSD 88.3 bn, which is, historically speaking, the highest level of assignments recorded in a calendar year. It should be noted that the highest amount of these assignments was realised in Q4 2017 – RSD 68.9 bn (78% of total assigned receivables in 2017), which is by as much as 19% more than the amount of receivables assigned during the whole 2016.

### 3.3 Loans<sup>8</sup>

In Q4 2017, gross loans of the Serbian banking sector recorded a nominal quarterly increase of RSD 25.0 bn or 1.2%, reaching RSD 2,053.6 bn. Credit activity increased, despite that fact that, in accordance with the Decision on the Accounting Write-off of Bank Balance Sheet Assets, banks transferred the fully impaired non-performing loans to their off-balance sheet records. Excluding the exchange rate effect, write-off and sale to entities outside the banking sector, y-o-y lending growth accelerated to almost 14% (13.7%).

Gross lending growth was the most pronounced in the corporate segment – an increase by RSD 22.0 bn (or 2.4% q-o-q), and in the segment foreign persons and households – by RSD 11.8 bn and RSD 11.3 bn, respectively (or 38.9% and 1.4% q-o-q). Growth in the corporate segment was mostly due to the expansion of FX-indexed loans, primarily liquidity and current assets loans. Gross lending declined in nominal terms in the sector of finance and insurance, public enterprises, entrepreneurs, public sector and

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<sup>8</sup> In accordance with the Guidelines on the Obligation and Method of Collection, Processing and Submission of Data on the Stock and Structure of Bank Loans, Receivables and Liabilities, loans include the following loans in dinars and foreign currency: recalls, under transaction accounts, overnight, consumer, liquidity and current assets, export, investment, housing, cash, for the payment of imports of goods and services from abroad, for the purchase of real estate in the country for a natural person, and other loans.

other clients. Relative to end-Q3, gross loans to non-financial sector in bankruptcy lost RSD 7.5 bn or 18.0%. The corporate and household sectors remained the most prevalent, with shares of 45.5% and 39.0% respectively. The currency structure of the banking sector's loan portfolio is still dominated by foreign currency. At end-Q4 2017, FX and FX-indexed loans accounted for 68.9%. The prevalent currency of loan indexation in Serbia was the euro, with EUR loans making up 64.5% (93.5% of total gross FX and FX-indexed loans), followed by CHF loans and USD loans at 3.5% and 1.2% (5.1% and 0.8% of total gross FX and FX-indexed loans, respectively). Compared to September 2017, gross CHF and USD loans continued to fall both in nominal and relative terms.

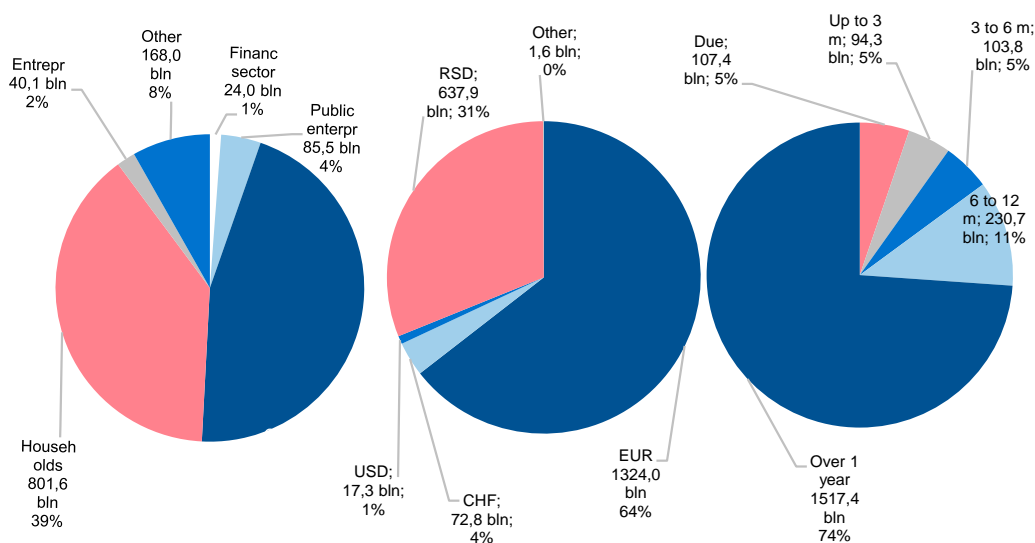
**Table 3.3 Change in the level of gross loans**  
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Finance and insurance	24,000	-5,113	-658	-17.6%	-2.7%
Public sector	26,830	-2,920	-3,973	-9.8%	-12.9%
Public enterprises	85,442	-5,737	-18,323	-6.3%	-17.7%
Households	801,629	11,327	60,973	1.4%	8.2%
Companies	934,405	22,018	53,028	2.4%	6.0%
Foreign persons and foreign banks	42,118	11,791	14,074	38.9%	50.2%
Other sectors	139,225	-6,364	-24,287	-4.4%	-14.9%
<b>Total loans</b>	<b>2,053,649</b>	<b>25,002</b>	<b>80,835</b>	<b>1.2%</b>	<b>4.1%</b>

Source: NBS.

At end-Q4 2017, dinar loans made up 31.1% of total gross loans, which is a mild increase from the quarter before. The rise in cash loans continued in the quarter observed – at end-2017, their share in total loans measured 16.9%, with dinar cash loans making up 99% of all cash loans. Among loans with FX-clause, growth was recorded only in liquidity and current assets loans (by RSD 14.3 bn) and housing loans (by RSD 0.7 bn), while other types of loans declined in nominal terms. These movements were significantly affected by the dinar's appreciation of 0.7% relative to Q3.

Chart 3.3. **Banking sector gross loan portfolio structure**  
(in RSD bln)  
(December 31, 2017)



Source: National Bank of Serbia

The structure of gross loans by remaining maturity remained broadly the same: the share of short-term and long-term gross loans increased (from 19.3% and 73.0% to 19.5% and 73.9%, respectively), matured loans fell from 6.4% to 5.2%, while overnight loans remained almost the same (rising from 1.3% to 1.4%).

### 3.4 Non-performing loans

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

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

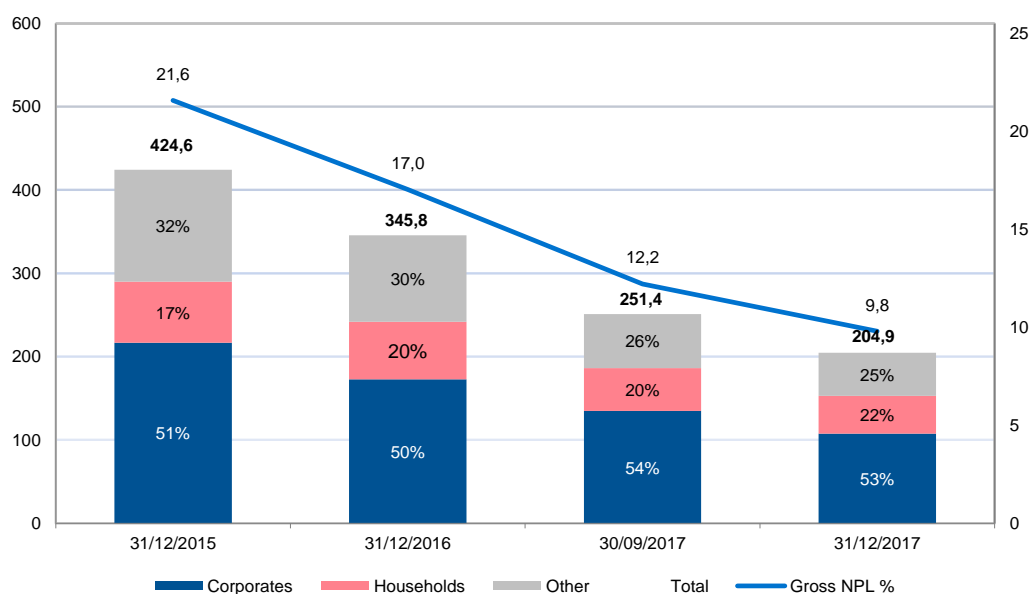
- where the payment of principal or interest is past due (within the meaning of the decision on classification of balance sheet assets and off-balance sheet items) over 90 days;
- where at least 90 days of interest payments have been added to the loan balance, capitalized, refinanced or delayed by agreement;
- where payments are less than 90 days overdue, but the bank has assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full.



### Gross NPLs

In Q4 2017, the banking sector's total gross NPLs decreased by RSD 46.5 bn to RSD 204.9 bn at end-December. The reduction in gross NPLs<sup>9</sup> due to write-offs amounted to RSD 33.6 bn, and due to assignment of balance sheet receivables – RSD 13.0 bn. A high quarterly decline was again driven mainly by the application of the Decision on the Accounting Write-off of Bank Balance Sheet Assets, which drove down the amount of NPLs through direct write-offs by RSD 21.1 bn in December 2017 alone.

Chart 3.4.1. **Gross non performing loans (NPL)**  
(in RSD bln)



Source: National Bank of Serbia.

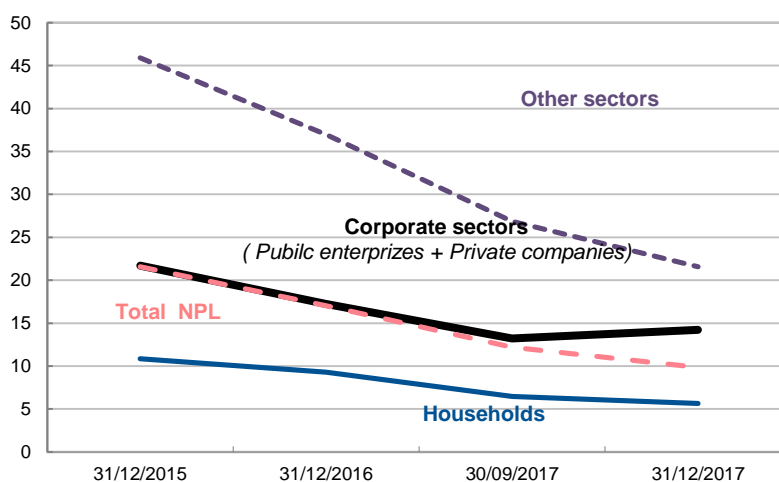
The fall in gross NPLs by 18.5%, along with a slight rise in total loans by 1.1%, pushed the share of NPLs in total gross loans further down by 2.4 pp relative to end-Q3, to 9.8%, which is the lowest figure recorded since the introduction of the uniform definition of a non-performing loan and mandatory reporting in 2008.

Despite a decline of RSD 21.9 bn, the major part of gross NPLs are still in the corporate segment (RSD 102.4 bn at end-December 2017). NPLs of non-financial legal persons in bankruptcy stood at RSD 39.5 bn (RSD 47.9 bn at end-September 2017).

<sup>9</sup> Calculated based on the NPL 3 report which banks submit to the NBS.

In the household segment, gross NPLs amounted to RSD 45.4 bn, which is 22.2% of total gross NPLs and an increase compared to the 20.4% share at the end of the previous quarter.

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

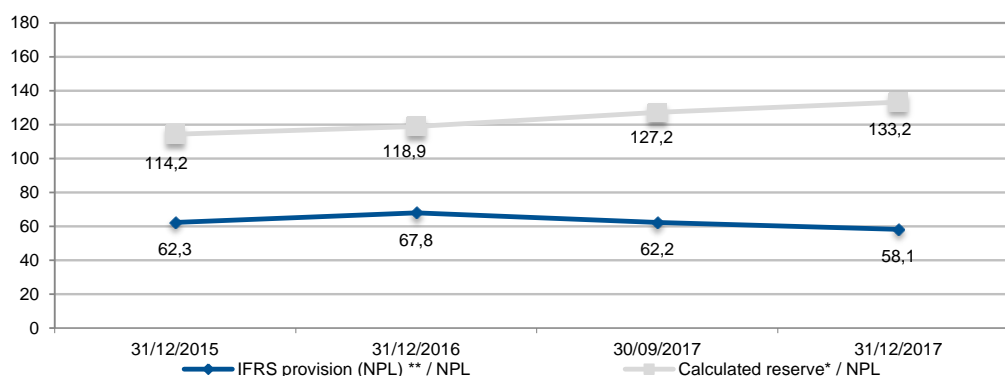


Source: National Bank of Serbia.

### NPL coverage

At end-Q4 2017, the coverage of total gross NPLs by loan loss reserves equalled 133.2%, while allowances for impairment remained relatively high, ensuring the coverage of 58.1%, despite the high amount of write-offs.

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



\* Calculated reserve for potential losses on balance-sheet lending (loan loss reserve);

\*\* Provision for non-performing loans;

Source: National Bank of Serbia.

*Corporate NPLs*

Amounting to RSD 102.4 bn at end-Q4 2017, gross corporate NPLs recorded a RSD 21.9 bn or 17.6% decrease relative to end-Q3, mainly due to: write-offs (RSD 17.4 bn), assignment (RSD 6.4 bn), collection (RSD 5.0 bn) and sectoral re-allocations (RSD 3.0 bn)<sup>10</sup>.

Table 3.4.1 **Changes in gross corporate NPLs by main economic sectors**

(RSD mn, %)

	Amount 31/12/20 17	Change relative to prior periods			
		Nominal		Relative	
		30/09/201 7	31/12/201 6	30/09/201 7	31/12/201 6
Manufacturing	46,457	-5,144	-14,182	-10.0%	-23.4%
Trade	21,650	-6,491	-16,501	-23.1%	-43.3%
Construction	13,125	-3,925	-11,369	-23.0%	-46.4%
Real estate	13,735	-3,042	-7,602	-18.1%	-35.6%
Agriculture	2,361	-622	-1,705	-20.8%	-41.9%
Transport, hotels/restaurants, communications	4,725	-2,671	-3,888	-36.1%	-45.1%

Source: NBS.

By sector, the biggest share in total corporate NPLs continued to be held by manufacturing (45.4%, with a 14.6% NPL gross ratio), followed by trade (21.1%, with a 7.1% gross NPL ratio) and real estate (13.4%, with a 16.0 % gross NPL ratio). In Q4, NPL ratio markedly declined in all sectors. The sharpest decline was recorded in: construction, transport and manufacturing (by 5.6 pp, 3.8 pp and 2.9 pp, respectively).

Table 3.4.2 **Corporate NPL ratio by sector**

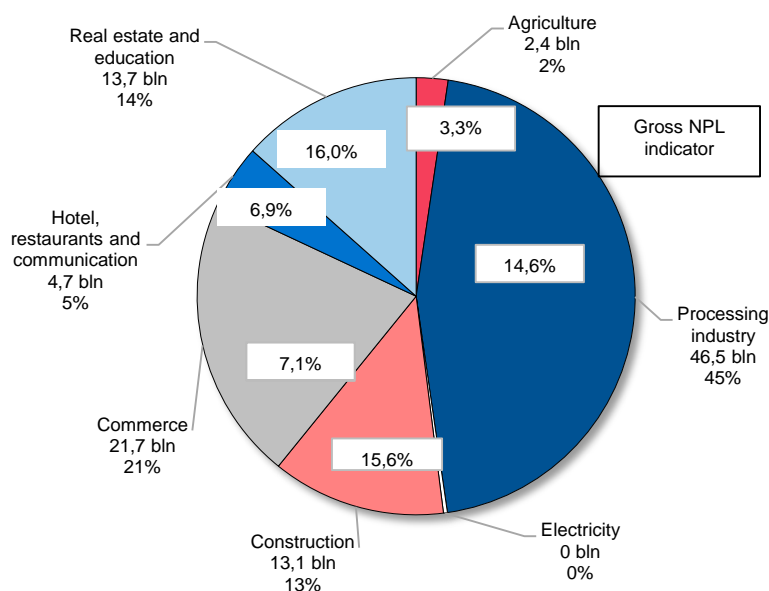
(%)

	31/12/2017	Change relative to prior periods (pp)	
		30/09/2017	31/12/2016
Construction	15.6%	-5.6	-14.6
Real estate	16.0%	-1.1	-10.4
Manufacturing	14.6%	-2.9	-5.6
Trade	7.1%	-2.2	-6.1
Agriculture	3.3%	-1.0	-2.5
Transport, hotels/restaurants, communications	6.9%	-3.8	-6.9

Source: NBS.

<sup>10</sup> Calculated based on the NPL 3 report which banks submit to the NBS.

Chart 3.4.4. **Private corporates NPL structure**  
(December 31, 2017)



Source: National Bank of Serbia.

### *Natural persons' NPLs<sup>11</sup>*

Measuring 5.9% at end-Q4 2017, the share of gross NPLs of natural persons stayed below the average of the total portfolio and 1.2 pp lower than a quarter earlier. At end-Q4 2017, natural persons' NPLs equalled RSD 53.0 bn, dropping by 15.8% from end-Q3 2017. All types of loans recorded a decrease, particularly consumer loans (by 65.8%).

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

	amount 31/12/2017	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Housing loans	21,832	-2,104	-9,259	-8.8%	-29.8%
Cash loans	15,293	-364	-5,837	-2.3%	-27.6%
Credit cards	2,699	-804	-1,770	-23.0%	-39.6%
Current account overdrafts	2,478	-725	-1,537	-22.6%	-38.3%
Consumer loans	612	-1,177	-3,269	-65.8%	-84.2%
Other	10,100	-4,806	-9,006	-32.2%	-47.1%
<b>Total</b>	<b>53,014</b>	<b>-9,979</b>	<b>-30,679</b>	<b>-15.8%</b>	<b>-36.7%</b>

<sup>11</sup> Households, entrepreneurs, private households with employed persons and registered farmers.

Source: NBS.

The category of housing construction loans accounted for a dominant share both in lending to natural persons (39.4%) and in gross NPLs of natural persons (41.2%). Cash loans came next with a 39.9% share in total loans of natural persons and a 28.8% share in total NPLs of natural persons.

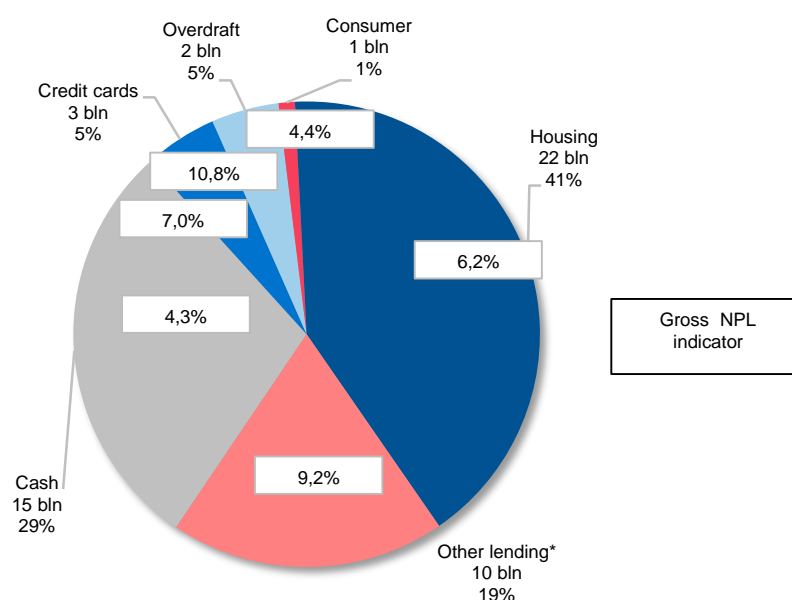
**Table 3.4.4 NPL ratio for natural persons by category**  
(%)

	31/12/2017	Change relative to prior periods (pp)	
		30/09/2017	31/12/2016
Housing construction	6.2%	-0.6	-2.5
Cash loans	4.3%	-0.4	-3.3
Credit cards	7.0%	-2.2	-5.5
Current account overdrafts	10.8%	-1.8	-5.4
Consumer loans	4.4%	-6.0	-17.3

Source: NBS

The highest gross NPL ratio in the natural persons' segment at end-December 2017 (10.8%) was recorded in the category of current account overdrafts (which accounted for 2.5% of total loans to natural persons and for 4.7% of total NPLs of natural persons). The next were credit cards, with the ratio of 7.0% (making up 4.3% of total loans to natural persons and 5.1% of NPLs of natural persons), housing loans with 6.2% and cash loans with 4.3%. Gross NPL ratio declined across all categories of natural persons' loans.

**Chart 3.4.5. Natural persons NPL structure**  
(December 31, 2017)



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

Source: National Bank of Serbia.

## 4 BANKING SECTOR LIABILITIES

### 4.1 Structure of the sources of funding

The primary source of funding of Serbian banks are deposits taken<sup>12</sup>, accounting for 70.1% of total liabilities. The next largest source are own sources of funding which at end-Q4 2017 made up 19.8% of liabilities, while loans taken made up 5.9%.

Table 4.1 **Change in key items of banking sector liabilities**

(RSD mn, %)

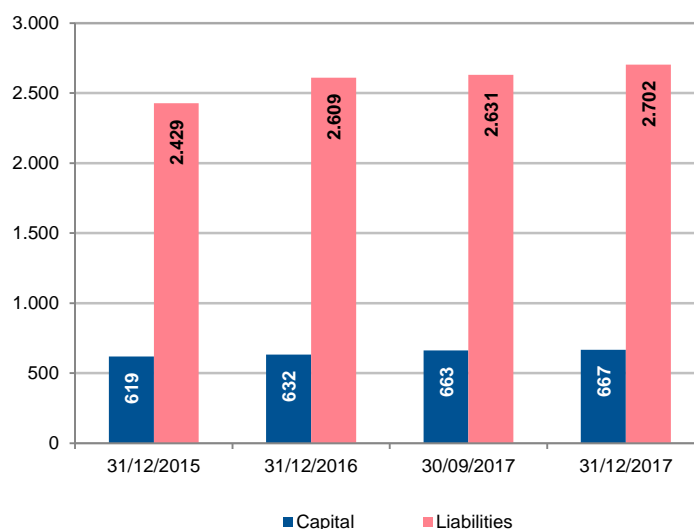
	Amount 31/12/2017	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Deposits and other liabilities	2,612,247	84,740	99,023	3.4%	3.9%
<i>to banks, OFO and the central bank</i>	379,451	33,992	68,207	9.8%	21.9%
<i>to other clients</i>	2,232,796	50,748	30,816	2.3%	1.4%
Own securities issued and other borrowings	0	-123	-123	-99.9%	-99.9%
Subordinated liabilities	33,290	-9,896	-12,281	-22.9%	-26.9%
Provisions	11,160	1,085	-601	10.8%	-5.1%
Share capital and other capital	404,546	3,636	3,033	0.9%	0.8%
Profit	100,739	3,597	21,637	3.7%	27.4%
Loss	34,505	3,842	-9,545	12.5%	-21.7%
Reserves and unrealised losses	196,336	979	414	0.5%	0.2%
Other	45,580	-4,082	7,241	-8.2%	18.9%
<b>Total banking sector liabilities</b>	<b>3,369,392</b>	<b>76,092</b>	<b>127,887</b>	<b>2.3%</b>	<b>3.9%</b>

Source: NBS.

Total liabilities of the banking sector rose by RSD 71.7 bn (or 2.7%) from end-Q3. The increase in liabilities is mainly a result of the increase under the item deposits and other liabilities to other clients by RSD 50.7 bn (or 2.3%) and item deposits and other liabilities to banks by RSD 34.0 bn (or 9.8%).

<sup>12</sup> Including transaction and other deposits as part of items: Deposits and other liabilities to banks, other financial organisations and the central bank and Deposits to other clients.

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



Source: National Bank of Serbia.

In Q4 total capital of the banking sector rose by RSD 4.4 bn in nominal terms (i.e. by 0.7%), while the share of capital in total balance sheet assets dropped slightly (from 20.1% to 19.8%). The nominal increase in capital is largely a result of the profit realised in Q4. Share capital rose by RSD 3.6 bn, primarily as a result of a new share issue (RSD 15.4 bn) and cancellation of shares in merger by acquisition (RSD 11.9 bn).

In terms of the currency structure, Q4 2017 saw an increase in dinar sources of funding (including capital), from 43.8% to 44.1%. As regards the FX and FX-indexed portion of liabilities, EUR-denominated liabilities remained dominant, making up 90.7% of total FX liabilities, while the rest were mostly liabilities in USD (5.6%) and CHF (2.9%).

## 4.2 Deposits

Total deposits with banks stood at RSD 2,360.4 bn at end-Q4 2017, up by RSD 74.4 bn or 3.3% relative to a quarter earlier. The increase stemmed mainly from a rise in transaction deposits of households (by RSD 27.3 bn), and transaction deposits of corporates (by RSD 16.1 bn).

At end-Q4 2017, dinar deposits grew by RSD 48.2 bn, while FX and FX-indexed deposits rose by RSD 26.2 bn in nominal terms. Despite the nominal increase, the share of FX and FX-indexed deposits in total deposits edged down from 69.1% to 68.0%. The EUR was the dominant currency, making up 90.0% of total FX and FX-indexed deposits. The rest of FX and FX-indexed deposits were mainly in USD (6.2%) and CHF (2.8%).

Short-term deposits<sup>13</sup> made up the bulk of bank deposits in Serbia. Demand deposits made up over a half of all deposits (61.6%), followed by deposits with the remaining maturity of up to one year with 30.9%, while deposits with the remaining maturity of over one year accounted for 7.5% of total deposits. The share of demand deposits increased relative to the previous quarter (1.0 pp) due to a rise in dinar transaction deposits of corporates, households and public enterprises.

In terms of initial (agreed) maturity, demand deposits were still dominant (61.4%), followed by deposits with the remaining maturity of up to one year (26.5%), while 12.1% of all deposits were agreed for over one year term.

At end-Q4 2017, total household deposits in foreign currency amounted to RSD 1,064.5 bn (rising by 0.5% q-o-q) and were made up mainly of savings deposits (65.5%).

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

	Amount 31/12/2017	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Finance and insurance	63,471	2,798	1,628	4.6%	2.6%
Public sector	33,115	1,586	-6,829	5.0%	-17.1%
Public enterprises	140,323	11,341	2,052	8.8%	1.5%
Households	1,222,967	20,669	13,183	1.7%	1.1%
Companies	553,906	20,538	38,897	3.9%	7.6%
Foreign persons and foreign banks	194,062	12,150	47,331	6.7%	32.3%
Other sectors	152,591	5,359	11,787	3.6%	8.4%
<b>Total deposits</b>	<b>2,360,435</b>	<b>74,442</b>	<b>108,048</b>	<b>3.3%</b>	<b>4.8%</b>

Source: NBS.

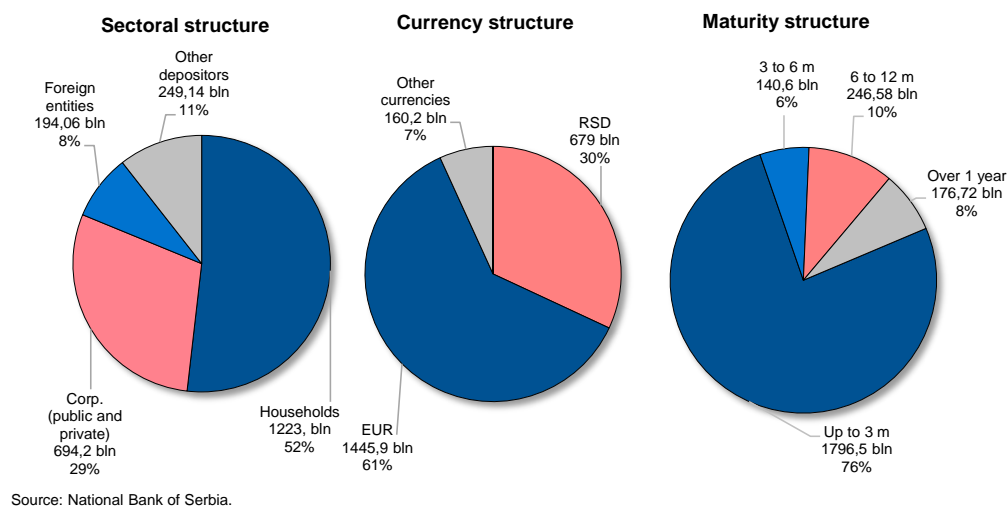
Compared to end-Q3, household savings deposits<sup>14</sup> decreased by RSD 8.1 bn (1.1%) to RSD 741.4 bn at end-Q4. The drop did not result from withdrawal, but, in part, from the maturing of savings and their transfer to FX transaction deposit accounts (which recorded a RSD 13.1 bn increase in the period observed), and in part from the dinar's appreciation by 0.7% in Q4 2017. At end-December 2017, FX savings were dominant in total household savings deposits, making up 94.0%, while dinar savings accounted for 6.0%. Relative to a quarter before, dinar savings went up by RSD 0.7 bn, while FX savings contracted by RSD 8.8 bn.

<sup>13</sup> At remaining maturity.

<sup>14</sup> Accounts 402 and 502 in the Chart of Accounts, sector 6 (domestic and foreign natural persons – residents)



Chart 4.2. **Banking sector deposits structure**  
(December 31, 2017)



### 4.3 Total borrowing of banks

At end-Q4 2017, total credit borrowing of the banking sector amounted to RSD 246.3 bn, an increase by RSD 11.5 bn or 4.9% relative to the previous quarter.

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

	Amount	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Overnight loans	36,367	-7,305	-14,116	-16.7%	-28.0%
Loans received	198,146	16,639	6,327	9.2%	3.3%
Other financial liabilities	11,752	2,167	535	22.6%	4.8%
<b>Total borrowing</b>	<b>246,265</b>	<b>11,501</b>	<b>-7,253</b>	<b>4.9%</b>	<b>-2.9%</b>

Source: NBS.

The largest individual item in total credit borrowing were loans received (primarily from parents and international financial institutions), making up 80.4% (end-Q3: 77.3%) and rising by 9.2% nominally from the quarter before. The next largest item were liabilities under overnight loans which accounted for 14.8% (end-Q3: 18.6%), after a decline of RSD 7.3 bn in Q4. Other financial liabilities made up 4.8% (end-Q3: 4.1%) rising by RSD 2.2 bn from the quarter before.

Banks that are majority foreign-owned accounted for 95.2% of total credit borrowing of the banking sector, 94.8% of overnight loans, 95.3% of loans received and 94.3% of other financial liabilities.

The dominant currency of borrowing was the euro, accounting for RSD 222.3 bn (end-Q3: RSD 205.0 bn) or 90.3% of total credit borrowing. Liabilities in dinars stood at RSD 17.8 bn (end-Q3: RSD 25.1 bn) or 7.2% of total credit borrowing, while banks owed RSD 3.4 bn and RSD 2.7 bn in USD and CHF, respectively (end-Q3: RSD 1.8 bn and RSD 2.8 bn), or 1.4 % and 1.1% of total credit borrowing.

#### 4.4 External liabilities

At end-Q4 2017, banks' total external liabilities under credit operations stood at RSD 169.9 bn, up by RSD 19.3 bn (12.8%) q-o-q. Borrowing increased only in the largest item – loans received (with a share of 93.3%), by RSD 22.5 bn, while overnight loans lost RSD 3.2 bn. External credit debt remained highly concentrated, given that of the 15 banks which borrowed externally, six banks accounted for 85.1% of the total debt. Also, four banks took overnight foreign loans, and 80.1% of that debt related to a single bank.

Long-term loans held a dominant 81.8% share in the maturity structure of external borrowing (end-Q3: 79.6%).

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

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31/12/2017	30/09/2017	31/12/2016	30/09/2017	31/12/2016
Overnight loans	9,609	-3,193	-7,727	-24.9%	-44.6%
Loans received	158,568	22,494	23,262	16.5%	17.2%
Other financial liabilities	1,723	-50	244	-2.8%	16.5%
<b>Total borrowing</b>	<b>169,900</b>	<b>19,251</b>	<b>15,779</b>	<b>12.8%</b>	<b>10.2%</b>

Source: NBS.

External borrowing was primarily euro-denominated – 97.4% and changed only slightly from the quarter before (-0.2 pp). CHF borrowing accounted for 1.6%.

#### 4.5 Subordinated liabilities

At end-Q4 2017, total subordinated liabilities of Serbian banks stood at RSD 33.2 bn, down by RSD 9.7 bn (22.5%) from end-Q3, which marked a continuation of a downward trend. In 2017 only, these liabilities shrunk by 27%.

Of subordinated liabilities, liabilities to foreign banks accounted for 75.2%, liabilities to foreign legal persons – 23.4% and liabilities to corporates –1.4%.

The share of subordinated liabilities in euros decreased to 78.7%, while liabilities in Swiss francs increased to 19.5%; liabilities in dinars made up 1.4%, and in other currencies – 0.4%.

Subordinated liabilities were highly concentrated – of the 14 banks with subordinated debt, one bank accounted for over 26% of all subordinated liabilities, and the top six banks made up over 76% of total subordinated liabilities.

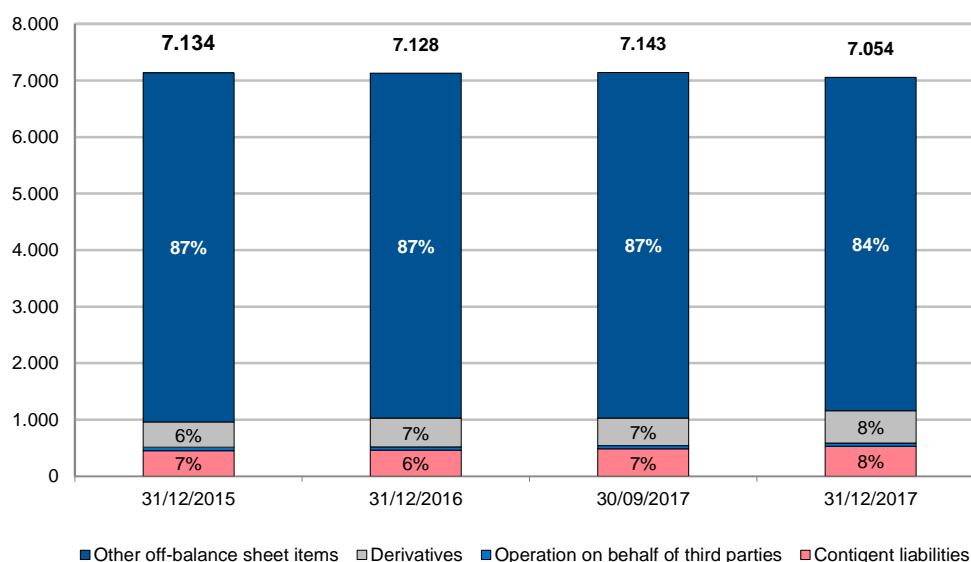
Given the regulatory restrictions on inclusion of subordinated liabilities in supplementary and/or regulatory capital, banks included 55.5% of total subordinated debt in supplementary capital.

## 5 OFF-BALANCE SHEET ITEMS

At end-Q4 2017, total off-balance sheet items of the banking sector stood at RSD 7,054.1 bn, dropping slightly (by 1.2%) from the end of the previous quarter, mostly on account of a decrease in other off-balance sheet assets (by RSD 193.9 bn). Within this item (accounting for 79.4% of total off-balance sheet), the sharpest fall of RSD 131.5 bn was recorded in guarantees received and other sureties for settling the obligations of bank debtors. Other significant off-balance sheet items were derivatives with 8.1% and issued guarantees and other sureties with 4.3%.

The off-balance sheet segment of the banking sector operations remained the most highly concentrated, given that at the end of the observed period, over one third of total banking sector off-balance sheet items were held by two banks and that the value of the HHI index for total off-balance sheet items exceeded 1,000 (standing at 1,036).

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



Source: National Bank of Serbia.

Risk-free items accounted for the bulk (88.4%) of off-balance sheet items: material collateral received, guarantees and other sureties accepted for the settlement of borrowers' liabilities, custody operations and other off-balance sheet assets.

At end-Q4 2017, the classified part of off-balance sheet items (i.e. which is considered risk-bearing) amounted to RSD 815.1 bn (an increase by RSD 26.6 bn or 3.4%).

At end-Q4 2017 contingent liabilities<sup>15</sup> equalled RSD 529.1 bn (rising by RSD 45.4 bn or 9.4% q-o-q) and made up 7.5% of total off-balance sheet items (end-Q3: 6.8%).

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

(RSD mn, %)

	Amount 31/12/2017	Change relative to prior periods			
		Nominal		Relative	
		30/09/2017	31/12/2016	30/09/2017	31/12/2016
Issued guarantees and other sureties	303,615	19,035	33,597	6.7%	12.4%
Receivables under derivatives	574,521	88,383	66,203	18.2%	13.0%
Contingent liabilities and other irrevocable commitments	225,455	26,363	36,402	13.2%	19.3%
Securities received as collateral	178,335	-13,032	-3,237	-6.8%	-1.8%
Sureties for liabilities	97,031	1,001	4,210	1.0%	4.5%
Other off-balance sheet assets	5,600,369	-193,863	-213,491	-3.3%	-3.7%
Other	74,790	-17,130	1,971	-18.6%	2.7%
<b>Total off-balance sheet assets</b>	<b>7,054,116</b>	<b>-89,243</b>	<b>-74,345</b>	<b>-1.2%</b>	<b>-1.0%</b>

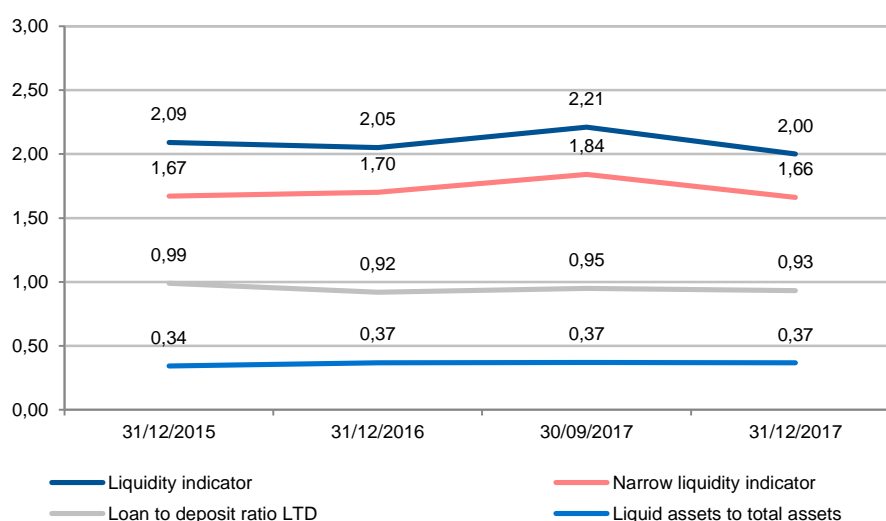
Source: NBS.

<sup>15</sup> Issued guarantees and other sureties, irrevocable commitments regarding undisbursed loans and placements, and other irrevocable commitments.

## 6 BANK LIQUIDITY

Based on reference values of liquidity indicators, Serbia's banking sector has been characterised by considerable excess liquidity for a long time now. At end-Q4 2017, the average monthly liquidity ratio was 2.00, twice higher than the regulatory floor of 1.0. The narrow liquidity ratio at banking sector level measured 1.66 (regulatory floor – 0.7). The share of liquid assets in total banking sector balance sheet assets is stable, reaching 36.7% at end-Q4 2017.

Chart 6.1. **Banking sector liquidity indicators**



Source: National Bank of Serbia.

At end-Q4 2017, banks' investments in NBS repo securities decreased relative to September 2017, from RSD 75.0 bn to RSD 45.1 bn. The number of banks which invested in repo securities declined (from 15 to 13). As for government securities, their portfolio was worth RSD 623.4 bn at end-2017, increasing by 1.7% from end-September.

To strengthen the resilience of the banking sector further,<sup>16</sup> the liquidity coverage ratio was introduced. This indicator is the ratio of the liquidity buffer (made up of high-quality liquid assets) and net outflow of a bank's liquid assets that would occur in the 30 days after the calculation of this ratio in assumed stress conditions.

Until 31 December 2017, banks were required to maintain this ratio at a level not lower than 80%, and from 1 January 2018 at a level not lower than 100% (prescribed floors are the same as in the European Union). As at 30 December 2017, the liquidity coverage ratio at the level of the banking sector measured 239.51%.

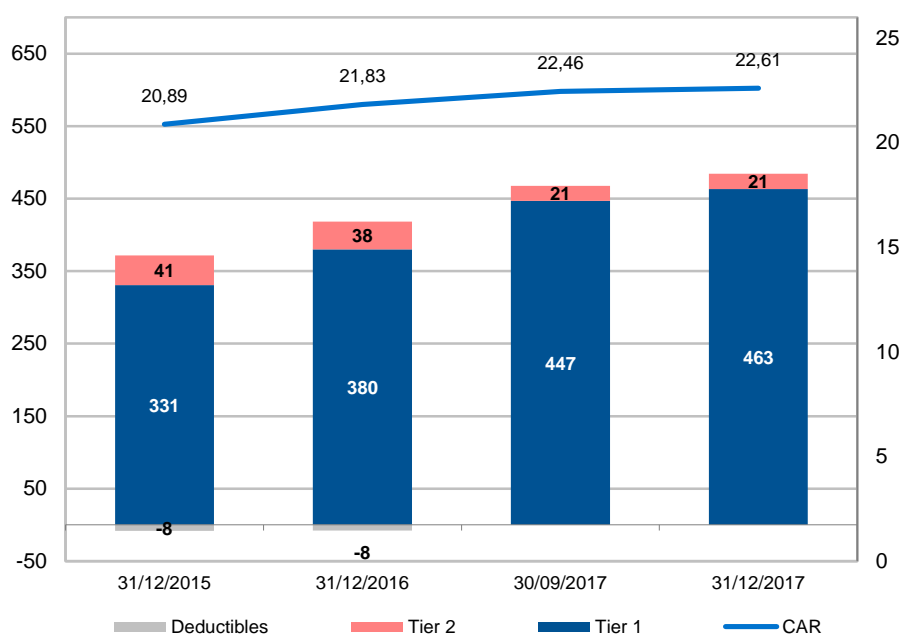
<sup>16</sup> The Decision on Liquidity Risk Management was adopted in December 2016 as part of the implementation of the Strategy for Introduction of Basel III Standards in Serbia.

## 7 CAPITAL ADEQUACY

The Serbian banking sector is well-capitalised, both from the aspect of compliance with the prescribed capital adequacy ratio<sup>17</sup>, and in terms of the structure of regulatory capital. At end-December 2017, the capital adequacy ratio of the Serbian banking sector averaged 22.61% (vs. 22.46% in September 2017). This is well above the NBS regulatory minimum (8%).

At end-December 2017 the Tier 1 capital ratio of the Serbian banking sector averaged 21.62% (vs. 21.46% in September), and Common Equity Tier 1 capital ratio – 21.54% (vs. 21.39% in September).

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



\* CAR = Regulatory capital adequacy ratio

Source: National Bank of Serbia.

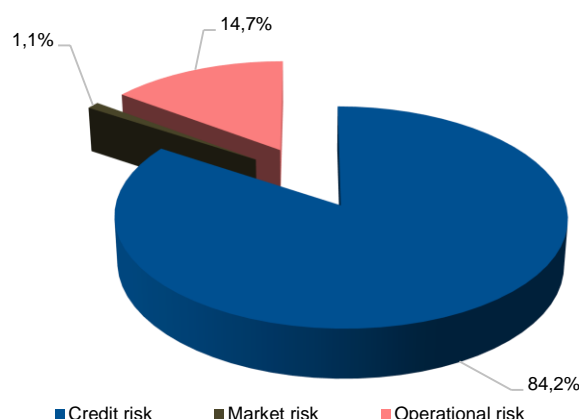
As risk-weighted assets grew slower than capital in Q4 2017 (2.9% vs. 3.6%, respectively), capital adequacy ratio slightly increased (by 0.15 pp).

<sup>17</sup> For the purposes of harmonisation with the relevant EU legislation in the field of banking, and to strengthen banking sector resilience, the NBS adopted new regulations in line with the requirements of Basel III standards, coming into effect as of 30 June 2017. The prescribed minimum capital adequacy ratio was lowered from 12% to 8%. In parallel, capital buffers were introduced (capital conservation buffer, countercyclical capital buffer, systemic risk buffer, capital buffer for a systemically important bank).

The increase in risk-weighted assets by RSD 60.8 bn stemmed from a rise in credit risk-weighted assets by RSD 75.5 bn (mainly in the part of exposure to companies). At the same time, operational risk-weighted assets decreased by RSD 10.4 bn to RSD 315.3 bn. Market-risk weighted assets also declined (by RSD 4.5 bn), primarily with regard to foreign exchange risk exposure.

In the structure of risk-weighted assets, the dominant share referred to credit risk (84.2%), taking into account banks' traditional business models relying on lending to corporates and households. Next was operational risk with a share of 14.7%, while the shares of market risks and credit valuation adjustment risk were negligibly low – at 1.1% and 0.05%, respectively.

Chart 7.2. RWA by risk type  
(y %)  
(December 31, 2017)



Source: National Bank of Serbia.

The growth of regulatory capital in Q4 2017, as well as throughout the whole 2017, can be attributed primarily to a decrease in required reserve. The quarter observed saw a 3.6% increase (in absolute amount: RSD 16.9 bn), while the whole of 2017 recorded growth of 18.0%. Regulatory capital of the banking sector at end-Q4 2017 equalled RSD 484.4 bn.

Regulatory capital consists of: Tier 1 capital, which remained at 95.6% and Tier 2 capital, measuring 4.4%. Tier 1 capital, which is the highest quality segment, is made up of Common Equity Tier 1 capital (99.7%) and Additional Tier 1 capital (0.3%).



At end-Q4 2017<sup>18</sup>, Tier 1 capital of the banking sector stood at RSD 463.2 bn, up by 3.7% (RSD 16.3 bn) from September 2017. The banking sector's Tier 1 capital increased mostly as a result of the release of RSD 23.8 bn of required reserves for estimated losses arising from credit risk. The paid in amount of Common Equity Tier 1 capital instruments increased by RSD 3.6 bn, as a result of recapitalisation worth RSD 15.4 bn in three banks and a decrease in equity worth RSD 11.9 bn due to one merger by acquisition. Tier 2 capital of the banking sector also rose relative to end-Q3, by RSD 0.6 bn (2.6%) to RSD 21.2 bn, due to a decrease by RSD 3.2 bn of direct, indirect and synthetic holdings by a bank of Tier 2 instruments and subordinated liabilities of financial sector entities where the bank has a significant investment in those entities (deductible). Cumulative preference shares stayed practically the same (RSD 2.6 bn).

Amendments to the Decision on Reporting Requirements for Banks adopted in December 2016 as part of the implementation of the Strategy for Introduction of Basel III Standards in Serbia set up a regulatory framework for monitoring the leverage ratio at banks.

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

On 31 December 2017, the leverage ratio at banking sector level equalled 11.09%.<sup>19</sup>

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<sup>18</sup> According to Basel III regulations, among other things, Tier 1 and Tier 2 capital are not reduced by the appropriate part of deductibles from regulatory capital, rather each of them has its own deductibles.

<sup>19</sup> According to Basel III standards, the leverage ratio floor was set at 3%.

## 8 FOREIGN EXCHANGE RISK

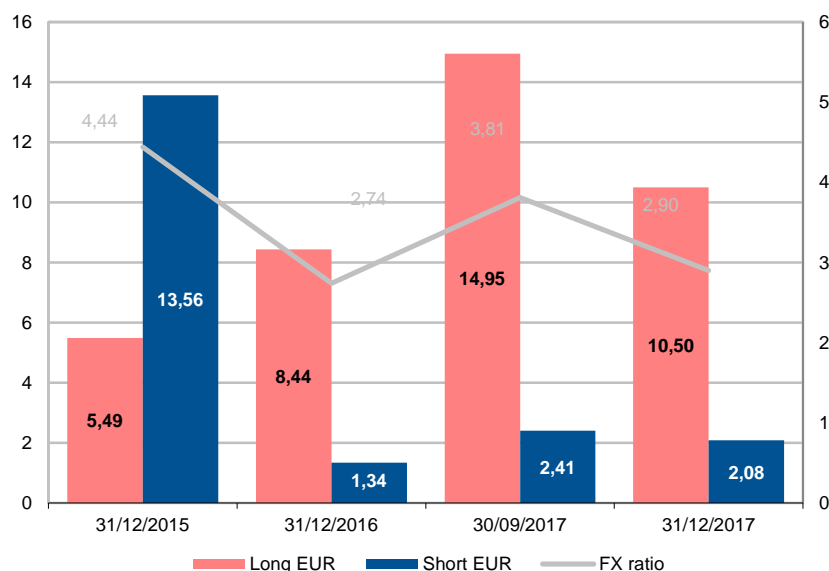
At end-Q4 2017, Serbia's banking sector posted a long open FX position worth RSD 14.0 bn (excluding the position in gold). Twenty banks ended December 2017 with a net long open FX position, while the remaining nine banks showed a net short open FX position.

On 31 December 2017, banks in Serbia operated at net long open positions in euros, US dollars and Swiss francs (RSD 10.50 bn, RSD 1.39 bn and RSD 0.9 bn, respectively).

At end-December 2017, the foreign exchange risk ratio for the banking sector equalled 2.90%, again indicating relatively low foreign exchange risk compared to the regulatory cap (20% of banks' capital).

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

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



Source: National Bank of Serbia

Banks conclude forward agreements most often with companies, enabling them thus to regularly service monetary obligations to third persons at the agreed exchange rate on a fixed future date. At end-Q4 2017,<sup>20</sup> in currency forward agreements, banks most often took the net short position in US dollars (50%), while committing to an almost the same extent to the sale of the dinar (26%) and the euro (24%) at an agreed future date. Of the total amount of active forward agreements in US dollars, around 70% were forward agreements of a company in energy sector which faced a strong FX risk in its operations and needed to hedge against exchange rate volatility.

<sup>20</sup> Calculated based on the FINDER report which banks submit to the NBS.

Currency swap agreements held a dominant share in derivative transactions in the Serbian banking sector. Banks usually conclude currency swap agreements with foreign financial institutions, including majority foreign owners and other financial institutions from parent banking groups. In swap agreements, commercial banks held a long position in the following currencies: the euro (77% of all active swap transactions) and the Swiss franc (14% of active swap transactions). Long positions in other currencies accounted for 9% of all active swap transactions, and the majority were concluded in dinars (8% of total swap transactions). The most frequently used currency pair exchanged in swap agreements was the euro/dinar, accounting for 52% of active swap transactions, followed by euro/US dollar (20%) and euro/Swiss franc (19%) as at 31/12/2017.

## 9 NBS REGULATORY ACTIVITY

Exercising its regulatory competences in the area of bank supervision, the NBS issued the following regulations in Q4 2017:

Having in mind the statutory obligation of banks to apply International Financial Reporting Standards (IFRS) when preparing their annual financial statements as of the date specified by the responsible international authority as the date of start of their implementation (1 January 2018), in November 2017 the Governor of the National Bank of Serbia adopted the following regulations in the area of accounting and financial reporting to enable the implementation of the new IFRS 9 – Financial Instruments as of 1 January 2018: Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks, Decision Amending the Decision on the Chart of Accounts and Contents of Accounts in the Chart of Accounts for Banks, and Decision on Collection, Processing and Submission of Data on the Balance and Structure of Accounts in the Chart of Accounts (all these decisions were published in the RS Official Gazette, No 101/2017).

With the same objective, taking into account the provisions of the above regulations, in November 2017 the NBS Executive Board adopted the Decision Amending the Decision on Reporting Requirements for Banks and Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items. These two decisions were published in the RS Official Gazette No 101/2017. Apart from the amendments aimed at the application of IFRS 9, certain provisions were changed in response to issues which emerged in the banking practice.

In December 2017 the NBS Executive Board adopted the Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (RS Official Gazette 114/2017) with a view to limiting the risk of bringing back to the banking sector those NPLs that were previously removed from it.

In December 2017 the NBS Executive Board adopted the Decision Amending the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System (RS Official Gazette, No 114/2017) which differentiates between the upper LTV limits (ratio of loan amount and the property mortgaged), so that the LTV ratio is 90% for housing loans approved as a government-support measure for certain groups of natural persons. In December 2017 the NBS Executive Board also adopted the Decision Amending the Decision on Risk Management by Banks (RS Official Gazette, No 119/2017) to improve the internal capital adequacy assessment process (ICAAP) and its monitoring, and to concretise and closely define some concepts from the Decision on Risk Management by Banks and the bank's conduct in the risk management process, which was found to be needed in practice.