



Народна банка Србије

Annual Financial Stability Report for 2015

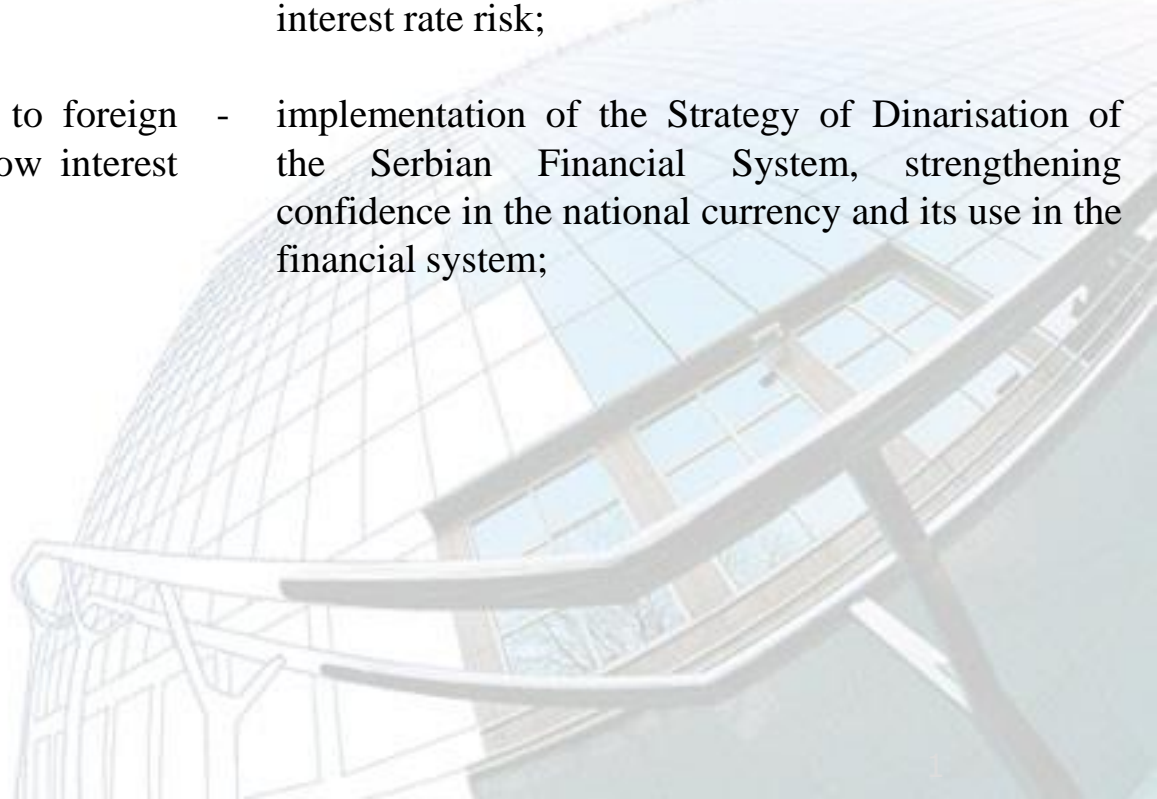
Belgrade, 27 July 2016





External risks and measures

- uncertainty in emerging markets due to the Fed's further monetary tightening;
- slower than expected recovery of the euro area and Serbia's other important foreign trade partners;
- reduced cross-border exposure of European banks in the medium run could hinder domestic credit and economic growth;
- higher interest rates on loans indexed to foreign currency after a period of extremely low interest rates of leading central banks;
- cooperation with European and international financial institutions to ensure the highest possible financial support to the domestic banking sector;
- cooperation with home supervisors to timely assess the effects of measures to be implemented;
- interest rate risk simulation of annuity plans for new variable-rate loans, in order to alert clients to the interest rate risk;
- implementation of the Strategy of Dinarisation of the Serbian Financial System, strengthening confidence in the national currency and its use in the financial system;





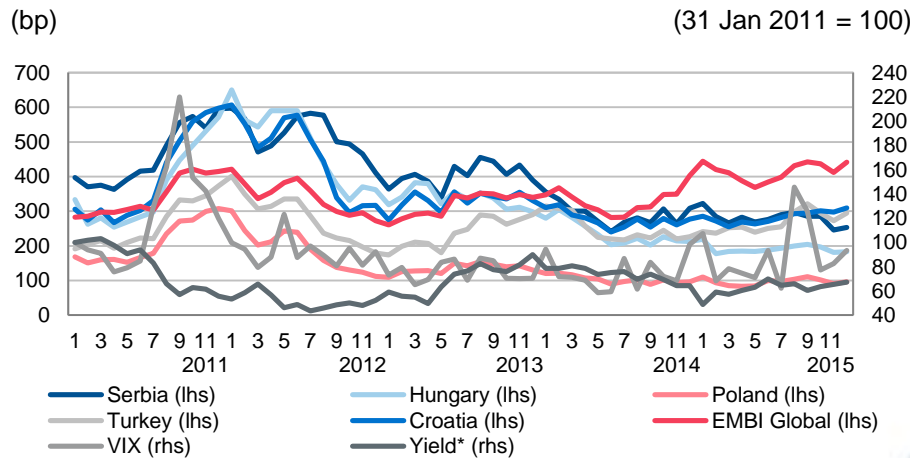
Internal risks and measures

- high degree of financial system euroisation increases exposure to FX-credit risk;
- a high share of NPLs negatively affects banks' risk propensity and credit growth, jeopardising banking sector profitability;
- muted lending activity;
- increased procyclicality risk as a systemic risk;
- consistent implementation of the Dinarisation Strategy by all relevant stakeholders: the National Bank of Serbia, government and banks, with the support of IFIs;
- further promotion of dinar financial instruments – from dinar savings to government securities in the domestic currency;
- full implementation of the NPL Resolution Strategy and Action Plans of the Government of the Republic of Serbia and the National Bank of Serbia for the implementation of the Strategy;
 - National Bank of Serbia's measures conducive to lower interest rates and banks' credit expansion, which encourages lending activity;
 - National Bank of Serbia's activities related to the implementation of Basel III Standards in Serbia in order to improve the quality of capital and mitigate procyclicality;

Poorer global growth prospects, sharp fall in prices of primary commodities and heightened uncertainty in the international financial market

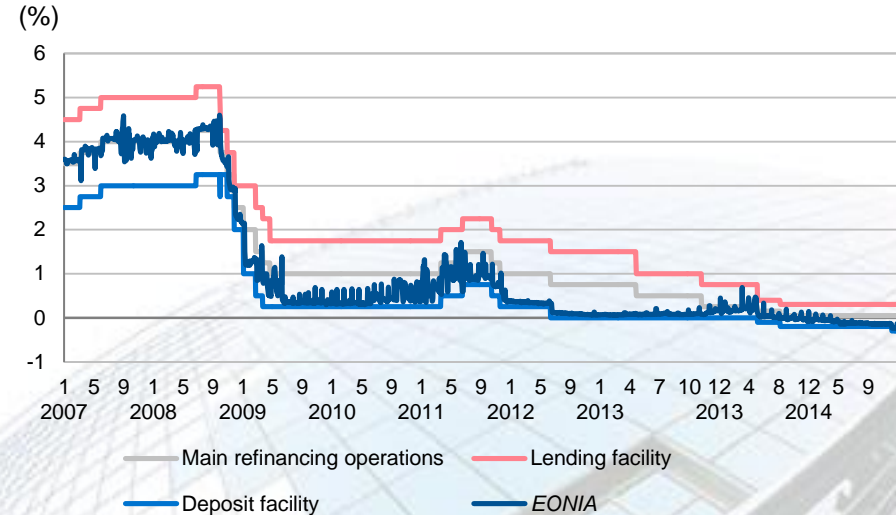
ECB's further monetary easing and domestic factors have helped mitigate negative impacts on Serbia

EMBI for Serbia and other regional peers, VIX and yields on US bonds



* On derived ten-year US bonds.
Sources: J.P. Morgan and Bloomberg.

ECB's interest rates and EONIA

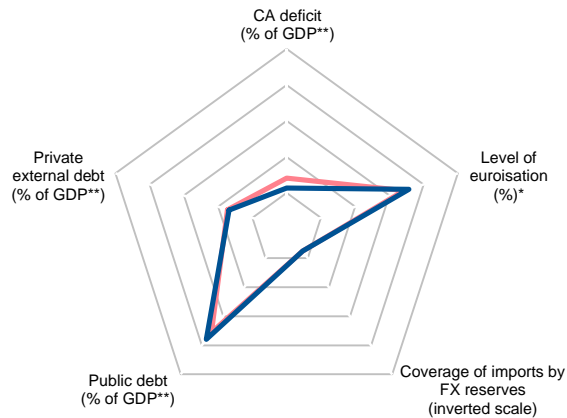


Sources: ECB and Bloomberg.

- Economic activity in the euro area rallied moderately and low inflationary pressures continued.
- In anticipation of the Fed's decision to start raising its policy rate, volatility in the global financial market increased, as indicated by movements in the volatility index – S&P 500 VIX.
- The divergence between the ECB's and the Fed's monetary policies increased in late 2015 and early 2016.
- Falling oil prices and low inflation, in addition to expansionary measures of the ECB, enabled central banks of CESEE countries to continue to ease their monetary policies during 2015.

The resilience of the domestic system increased in 2015 relative to 2014

Key macroeconomic risks



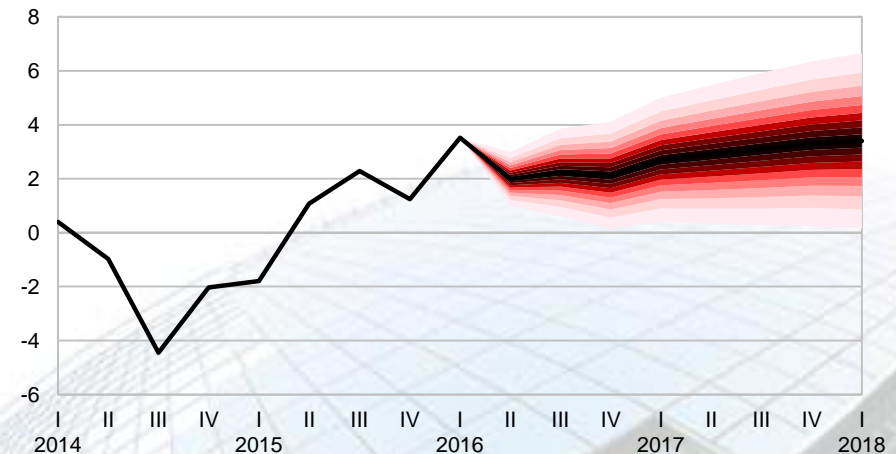
* Share of FX and FX-indexed loans in total loans of households and corporates.

**GDP is compliant with ESA 2010 methodology.

Source: NBS.

Economic recovery in 2015 was led by a powerful upswing in investment and net exports

Projection* of real GDP growth (y-o-y growth rates, %)



* May 2016.

Source: NBS.

- Substantial narrowing of external imbalances due to reduced share of private external debt in GDP and lower BoP deficit.
- Upward pressure on financial system vulnerability came from increased share of public debt in GDP.
- Economic activity is expected to rally at a faster pace and GDP to pick up to 2.5% y-o-y in 2016 on account of a further rise in investment.
- Period of low and stable inflation and relatively stable exchange rate.

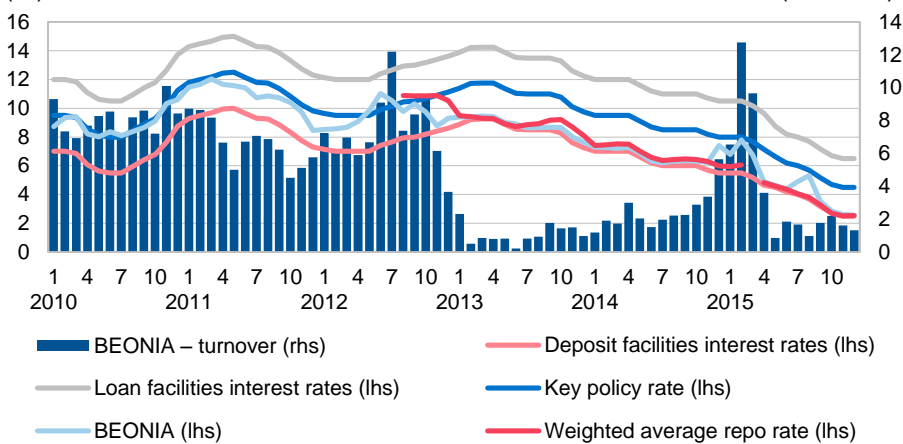
NBS's decisions were aimed at preserving monetary and financial stability

BEONIA oscillated closer to the lower bound of the interest rate corridor,

which led to a fall in interest rates on dinar loans

Key policy rate, BEONIA, and interest rates on deposit and loan facilities

(daily turnover, monthly averages)
(%)

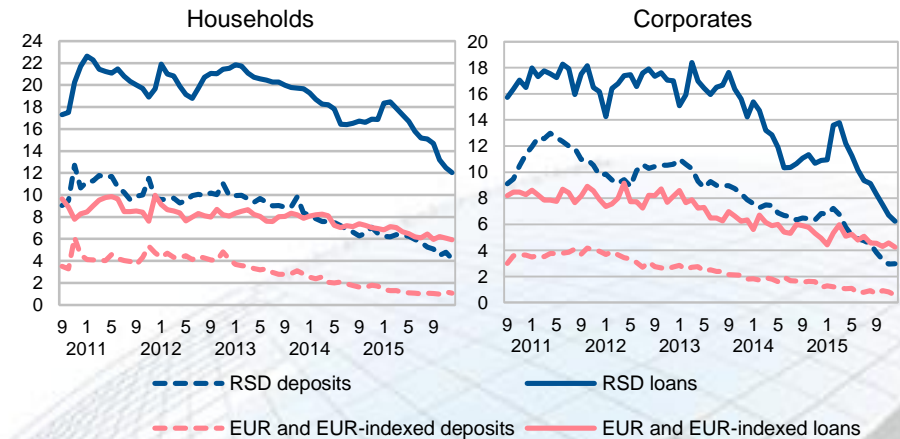


Source: NBS.

- The key policy rate was cut by 3.5 pp in 2015 (from 8.0% to 4.5%).
- In 2015, FX reserve requirement ratios were trimmed and dinar allocations increased.
- The narrowing of the interest rate corridor helped stabilise rates in the interbank money market.

Interest rates on household and corporate RSD, EUR and EUR-indexed loans and deposits – new business

(weighted average, %)



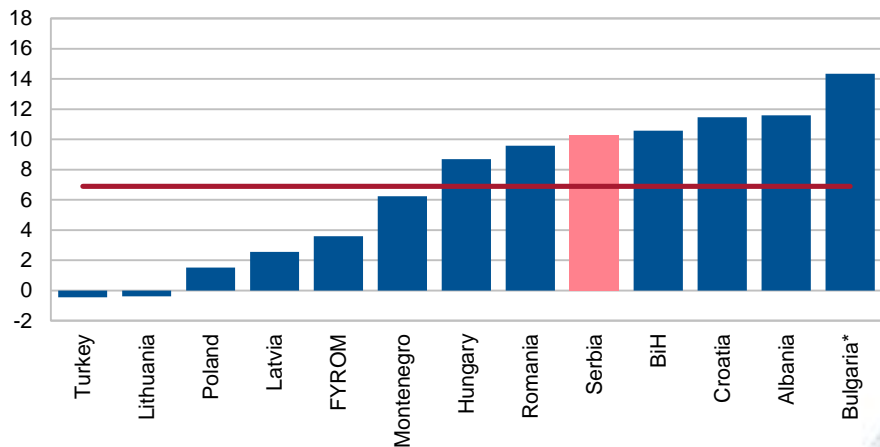
Source: NBS.

- Reflecting key policy rate cuts, average interest rates on new dinar loans to corporates and households decreased by 4.7 pp and 4.8 pp, respectively.
- BELIBOR rates decreased by around 5 pp.

High level of NPLs and rising profitability of the banking sector

The share of NPLs in total loans has stagnated for the past two years, equalling **21.6% at end-2015**

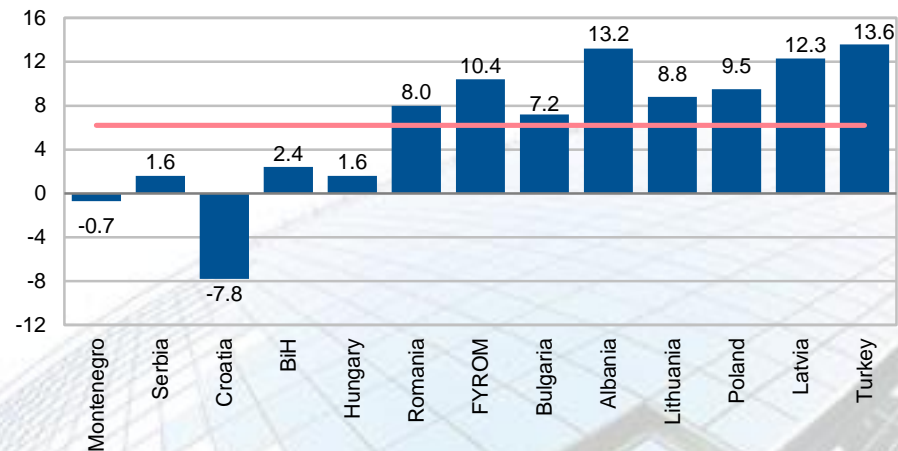
NPL ratio across countries of the region
(2015 relative to 2008, pp)



* Latest available data for 2014.
Sources: NBS and IMF: GFSR.

Banking sector profitability is in positive territory

Return on equity, countries of the region
(2015, latest available data, %)



Sources: NBS and IMF: GFSR.

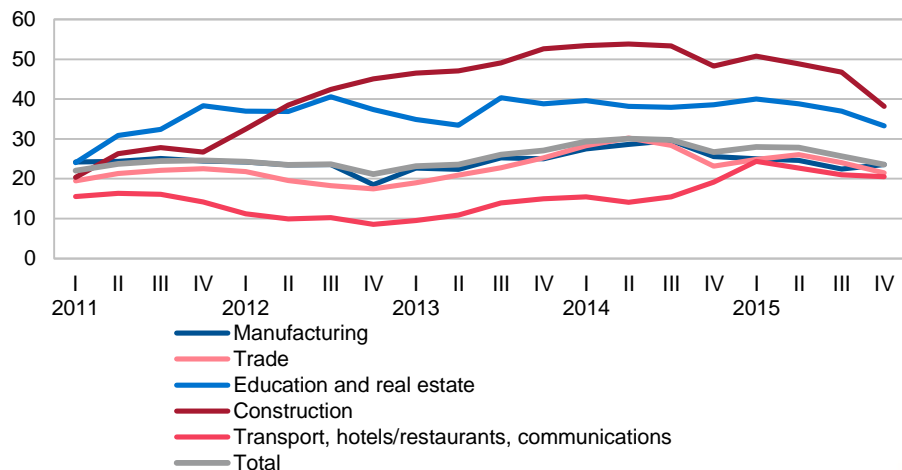
- Loan loss provisions are still sufficiently high to ensure that NPLs do not threaten financial stability.
- SDS results have enabled enhanced transparency and better insight into bank assets.

- The profitability of the banking sector increased mostly on account of income from interest, fees and commissions, whereas expenses on account of indirect write-offs of balance sheet items limited the final profit of the banking sector.

Lower share of corporate NPLs and higher corporate sector profitability in 2015

Credit portfolio quality improved in the majority of sectors

Private corporates' NPL ratios by sector (%)

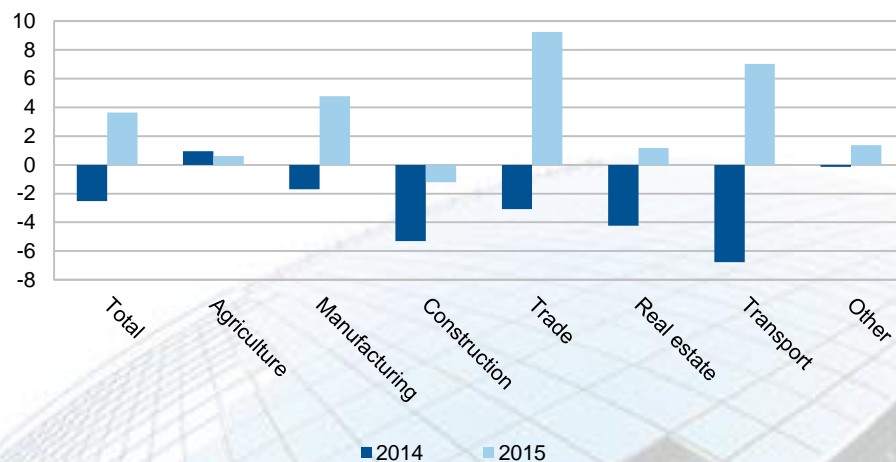


Source: NBS.

- The share of NPLs in total corporate loans in 2015 was 21.7%, down by 2.9 pp from end-2015.
- Gross NPLs declined most in the construction, trade and manufacturing industries.

Corporates left the loss territory

Corporates' return on equity (post-tax) by selected sectors (y %)



Source: Serbian Business Registers Agency.

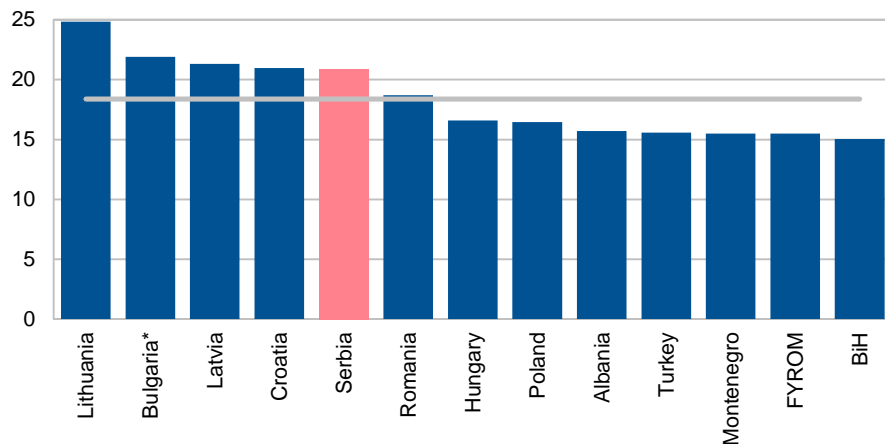
- Thanks to the recovery in economic activity, corporates recorded a positive net financial result in 2015.
- All sectors which recorded losses in 2014 operated at a profit in 2015, except for the construction sector.



Banking sector is adequately capitalised

CAR is high, reliance on domestic sources of funding lowers the deleveraging risk

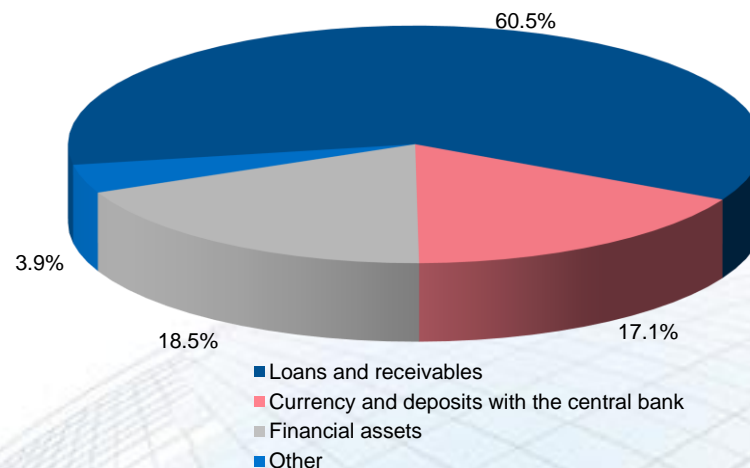
Regulatory capital to risk-weighted assets, countries of the region (2015, latest available data, %)



* Latest available data for 2014. Sources: NBS and IMF: GFSR.

Loans dominate the assets side of the banking sector

Structure of assets of the Republic of Serbia's banking sector (%)



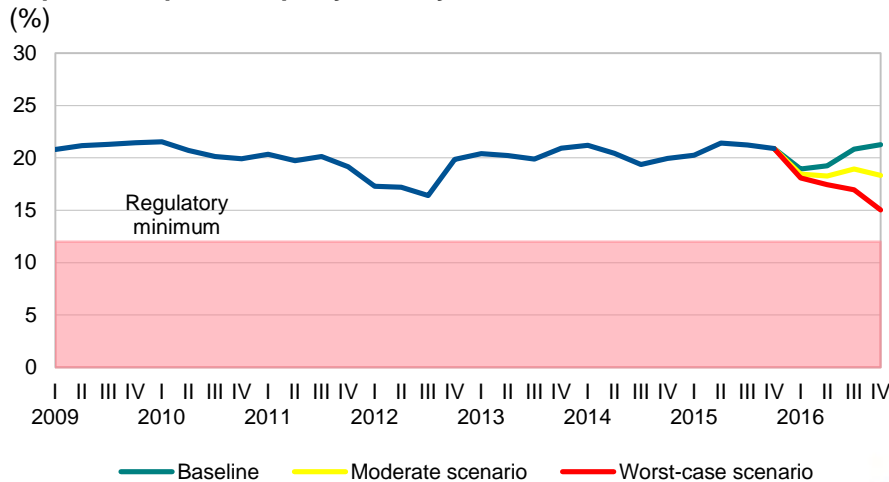
Source: NBS.

- CAR of the domestic banking sector is higher than the average across the region.
- Domestic deposits accounted for a dominant share of liabilities, lowering banking sector's exposure to external risks, including the risk of cross-border deleveraging.
- Credit portfolio recorded growth, despite the maturing of around 80% of loans approved as part of the subsidised lending scheme.
- The bulk of financial assets related to investment in RS securities, reflecting banks' preference for safer investments.

Despite conservative stress scenario assumptions, banking sector is resilient to solvency and liquidity shocks

The banking sector remains adequately capitalised ...

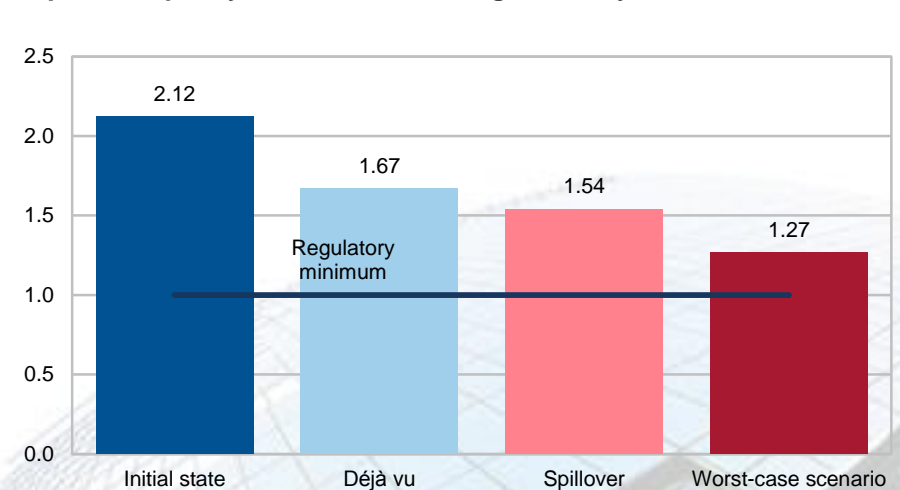
Expected capital adequacy ratio by stress scenario*



* NBS estimate.
Source: NBS.

...and highly liquid.

Expected liquidity ratio for the banking sector by stress scenario*



* NBS estimate.
Source: NBS.

- Under **baseline, moderate, and worst-case** scenarios, CAR of the banking sector is 21.28%, 18.32% and 15.04%, respectively.

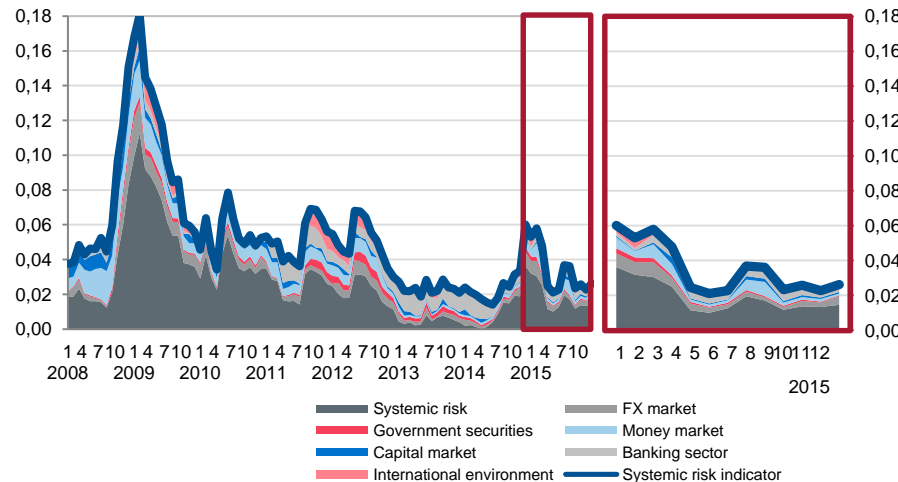
- The banking sector liquidity ratio ranges from 2.12 it actually measured at end-2015 to 1.27 in the **worst-case scenario**.

Comprehensive assessment of financial stability in 2015

Early 2015 was marked by developments in the money market

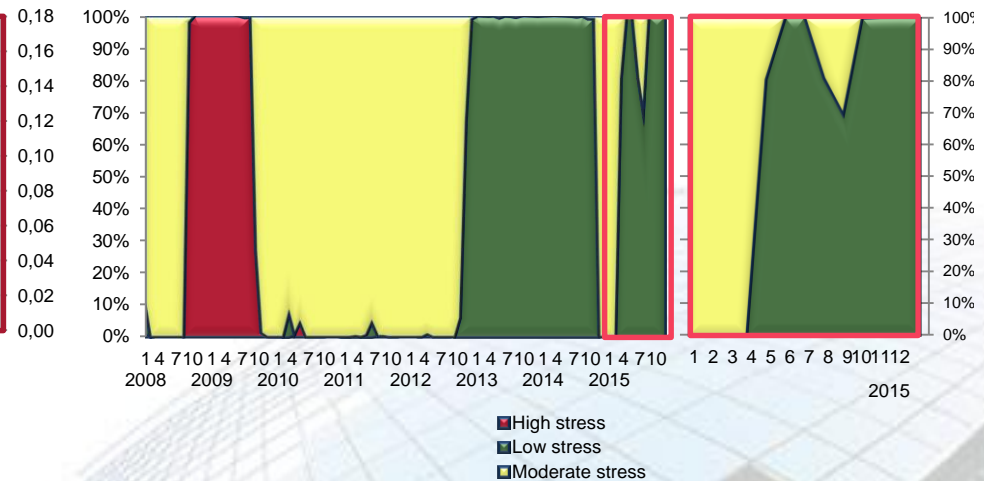
The latter half of 2015 was a period of low systemic stress

Systemic stress indicator



Source: NBS.

Identified stress periods



Source: NBS.

- Q1 2015 saw increased volatility in the money market and a rise in Serbia's risk premium.
- Mid-2015 was marked by risks from the international environment and the Greek crisis.

- After a period of heightened stress in the first half of 2015, a period of low stress followed in the latter half of the year.



1. Start of the Fed's monetary policy normalisation
2. Special diagnostic studies
3. NPL determinants
4. Network modelling
5. Database on real estate collateral valuations and loans secured by such collateral
6. Use of the hedonic method to calculate the real estate price index
7. Capital buffers
8. Systemic stress indicator of the Republic of Serbia's financial system



THANK YOU FOR YOUR ATTENTION!
