NATIONAL BANK OF SERBIA

BANK SUPERVISION DEPARTMENT

BANKING SECTOR IN SERBIA

First Quarter Report 2018

September 2018

Contents:

1 BASIC INFORMATION ON SERBIAN BANKING SECTOR

1.1 Selected parameters of the Serbian banking sector[1]

At end-March 2018, the Serbian banking sector numbered 29 banks, which is unchanged relative to end-2017. The organisational network consisted of 1,633 business units and employed a total of 23,095 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 [1)]	Share	Number	Share
Banks in domestic ownership	8	775	22.9%	157	23.3%	548	33.6%	6,503	28.2%
State-owned	6	546	16.1%	91	13.5%	445	27.3%	5,312	23.0%
Privately-owned	2	228	6.7%	66	9.8%	103	6.3%	1,191	5.2%
Foreign banks	21	2,612	77.1%	516	76.7%	1,085	66.4%	16,592	71.8%
Italy	2	949	28.0%	190	28.2%	236	14.5%	4,187	18.1%
Austria	2	433	12.8%	81	12.1%	182	11.1%	2,649	11.5%
Greece	2	214	6.3%	59	8.7%	108	6.6%	1,878	8.1%
France	2	375	11.1%	52	7.8%	180	11.0%	2,318	10.0%
Other	13	642	18.9%	134	19.9%	379	23.2%	5,560	24.1%
Total banking sector	**29**	**3,387**	**100.0%**	**673**	**100.0%**	**1,633**	**100.0%**	**23,095**	**100.0%**

[1)] Business units include all business network forms: headquarters, branches, branch offices, bank counters and other business units.

Source: National Bank of Serbia

In Q1 2018, the total number of banking sector employees and business units in Serbia rose. At end-Q1 2018, banking sector employment went up by a total of 40 persons compared to their number at end-December 2017, as a consequence of a simultaneous increase in the number of employees by 153 in 15 banks and downsizing employment by 113 in 11 banks. Within the business network the number of business units increased by six, as a result of five banks expanding their networks by a total of eight units and one bank downsizing its network by two business units. Despite what was mentioned on the increase in the number of employees, a trend of downsizing employment in the banking sector is generally present – for example, in January 2009, the banking sector employed over 32 thousand people.

At end-March 2018, total net balance sheet assets of the Serbian banking sector equalled RSD 3,386.6 bn (rising by 0.5% relative to December 2017) and total balance sheet capital RSD 673.0 bn (up by 0.9% relative to December 2017).

[1] 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.

The market share of banks in majority ownership of domestic entities (private entities and the Republic of Serbia) decreased (from 23.1% to 22.9%), while their share in total banking sector capital edged up from 23.0% to 23.3%). Consequently, the share of banks in majority ownership of foreign entities increased (from 76.9% to 77.1%) as regards the balance sheet total, i.e. decreased (from 77.0% to 76.7%) as regards capital. The only nominal fall was recorded in the balance sheet of banks in majority ownership of domestic private entities (by 3.3%).

Banks from Italy, Austria, France and Greece (eight banks in total) continued to account for the dominant share in total banking sector balance sheet assets – 58.2%, (expanding by 0.7 pp from the quarter before).

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[2] values indicate the absence of concentration in all observed categories. For a long time now, the highest values of the index were observed in deposits (chiefly household deposits) and income from fees and commissions, while the lowest figures were noted for total income and interest income, as well as for total gross loans.

Table 1.2.1 **Concentration and competition indicators**

(Share %)

	Top 5 banks	Top 10 banks	HHI [1)]
Assets	55.5	78.8	816
Lending (total)	53.5	77.7	788
Household loans	53.6	79.7	810
Corporate loans	53.8	80.8	822
Deposits (total)	56.4	80.1	834
Household deposits	59.4	82.7	976
Income (total)	49.8	75.2	717
Interest income	51.7	77.5	761
Fees and commissions	58.5	81.5	922

[1)] Herfindahl Hirschman Index of concentration.
Source: National Bank of Serbia

In terms of balance sheet assets, the share of the ten biggest banks in Serbia changed in Q1 2018. The aforementioned changes are much more notable in the share of the first five banks observed on a quarterly and annual level.

[2] 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; 1,000–1800 indicates moderate concentration; above 1,800 indicates high concentration.

At the same time, if the first five biggest banks are observed in terms of balance sheet assets, gross loans and deposits, it is evident that they account for more than half of the Serbia's banking sector in the mentioned segments given their share in the net balance sheet assets (55.5%), gross loans (53.5%) and deposits (56.4%).

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

(RSD bn, %)

	31/03/2017			31/12/2017			31/03/2018			Δ Γ	Δ T
	Amount	Share	Ranking	Amount	Share	Ranking	Amount	Share	Ranking		
Banca Intesa A.D.- Beograd	550	17,1	1	565	16,8	1	559	16,5	1	–	–
Unicredit Bank Srbija A.D.- Beograd	317	9,9	3	363	10,8	3	390	11,5	2	↑	↑
Komercijalna banka A.D.- Beograd	382	11,9	2	369	11,0	2	367	10,8	3	↓	↓
Societe Generale banka Srbija A.D.- Beograd	245	7,6	5	288	8,5	4	290	8,6	4	↑	–
Raiffeisen Banka A.D.- Beograd	260	8,1	4	265	7,9	5	272	8,0	5	↓	–
Agroindustrijsko komercijalna banka AIK banka akcionarsko društvo, Beograd	187	5,8	6	209	6,2	6	201	5,9	6	–	–
Eurobank A.D.- Beograd	150	4,7	7	158	4,7	8	163	4,8	7	–	↑
Erste Bank A.D.- Novi Sad	145	4,5	8	162	4,8	7	161	4,8	8	–	↓
Banka Poštanska štedionica A.D.- Beograd	132	4,1	9	140	4,2	9	146	4,3	9	–	–
Vojvođanska banka A.D.- Novi Sa	126	3,9	10	123	3,6	10	118	3,5	10	–	–

Source: NBS

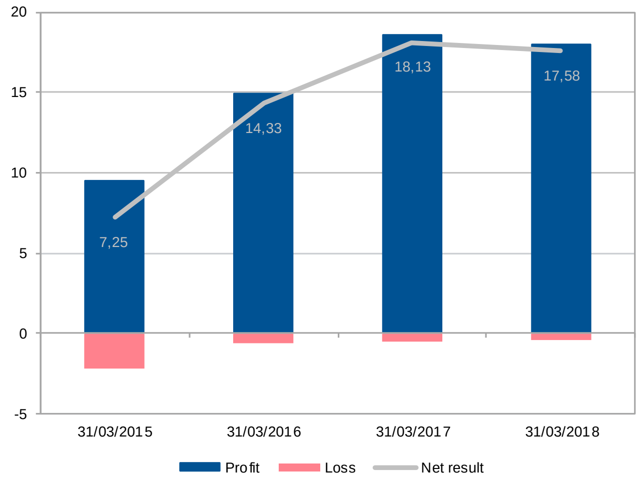
In terms of balance sheet assets, Banca Intesa A.D. Beograd remains the leading bank in Serbia; its market share edged down slightly (by 0.3 pp) from the previous quarter and by 0.6 pp from the same period last year. In addition to Banca Intesa A.D. Beograd, the following banks had market shares above 10% as at 31 March 2018: UniCredit Bank Srbija A.D. Beograd (11.5%) and Komercijalna Bank A.D. Beograd (10.8%).

2 PROFITABILITY

2.1 Profitability indicators

The banking sector's net profit before tax in the first three months of 2018 equalled RSD 17.6 bn, which is close to the result from the same period last year.[3]

Chart 2.1.1 **Pre tax result**
(in RSD bn)



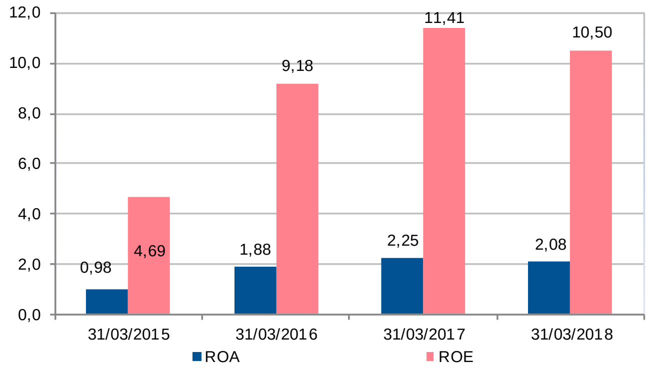
Source: National Bank of Serbia.

The structure of the net profit is as follows: twenty-four banks operated with a profit of RSD 18.0 bn, while five banks posted a negative financial result totalling RSD 0.4 bn. The market share of five banks with a negative financial result is insignificant (around 1%). The profit and loss generating items of the banking sector were somewhat more concentrated than the balance sheet total: six banks with the highest net profits together made up 72% of the total sector's profit, while three banks with the highest net losses accounted for 88% of the total losses.

[3] A new Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks entered into force on 1 January 2018 due to simultaneous coming into force and applying the new International Financial Reporting Standards 9 – Financial instruments (hereinafter: IFRS 9), which changed the valuing and disclosing of certain categories of the balance sheet and income statement, which to a certain extent influenced the comparability of categories before and after that date.

Preserved profitability of the banking sector at end-March 2018 resulted in the following profitability indicators: ROA equalled 2.08% (2.25% at end-March 2017), and ROE 10.50% (11.41% at end-March 2017).

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



Source: National Bank of Serbia.

2.2 Structure of the result

A mild drop in net profit recorded in Q1 2018 relative to the same period previous year stemmed from a decrease in other operating income (by RSD 2.1 bn), due to the one-off income recoded in Q1 2017 arising from changes in the ownership structure of certain banks.

Net credit losses equalled RSD 0.5 bn at end-Q1 2018, or 45% of net credit losses in the same quarter 2017. Such a sizeable decrease in losses under this item resulted from further favourable macroeconomic and economic movements and the losses which the banks already carried in previous years. In addition, banks recorded additional net income from provisioning for credit risk-weighted off-balance sheet items in the amount of RSD 300 mn, which is almost doubled compared to the same period in 2017. The indirect write-off of financial assets measured at amortised cost generated net expenses in both 2017 and 2018, whereas net expenses generated in 2018 equalled RSD 1.0 bn (falling by RSD 0.7 bn from 2017).

Amid increased bank lending and despite the declining trend of average interest rates[4], at end-Q1 2018, there was a rise in net interest income in each of the observed months individually, and collectively for all three months, relative to the same period in 2017.

[4] Further monetary policy easing through the key policy rate in March 2018 (reduction by 0.25 pp to 3.25%) drove down the average repo rate and interest rates in the interbank market and market of dinar loans and securities.

Net interest income in Q1 2018 stood at RSD 30.9 bn, or 1.3% more than in the same period in 2017. This increase stems from a somewhat more intensive decline in interest expenses (reduction by RSD 524 bn) compared to the decline in interest income (reduction by RSD 123 bn). At end-March 2018, the structure of interest income at banking sector level was diversified: 77.0% of interest income came from loans, 18.1% from securities and 2.0% from deposits. On the expense side, interest expenses from deposits had the highest share (71.7%), followed by those from loans (18.8%) and securities (7.5%).

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

(RSD mn)

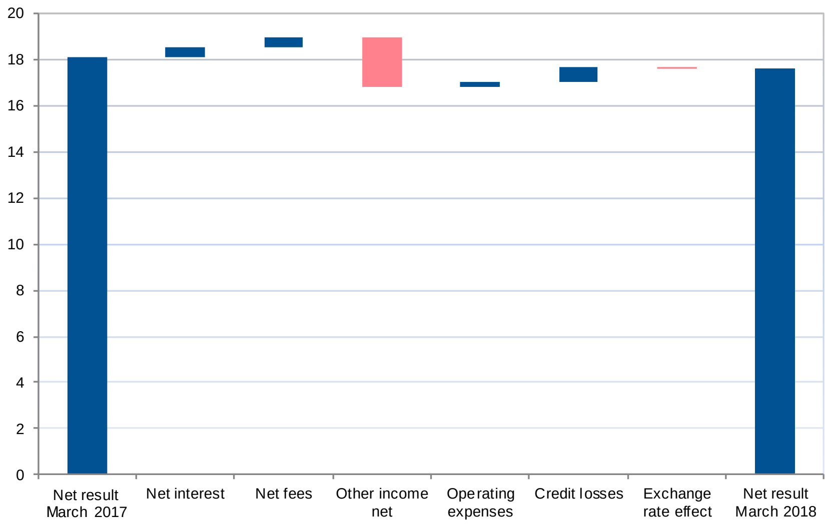
	Result	Net interest	Net fees	Credit losses	Exchange rate effect
31/03/2018	17.585	30.885	9.168	-538	1.427
31/03/2017	18.131	30.484	8.759	-1.197	1.555
Change:	**-3%**	**1%**	**5%**	**-55%**	**-8%**

Source: NBS

In the quarter observed, net fee and commission income increased by 4.7% or RSD 0.4 bn.

At end-Q1 2018, net gains from securities remained at the last-year level and equalled RSD 1.4 bn[5], mostly from revaluation of other derivatives (RSD 0.8 bn).

Chart 2.2 **Structure of net result**
(in RSD bn)



Source: National Bank of Serbia.

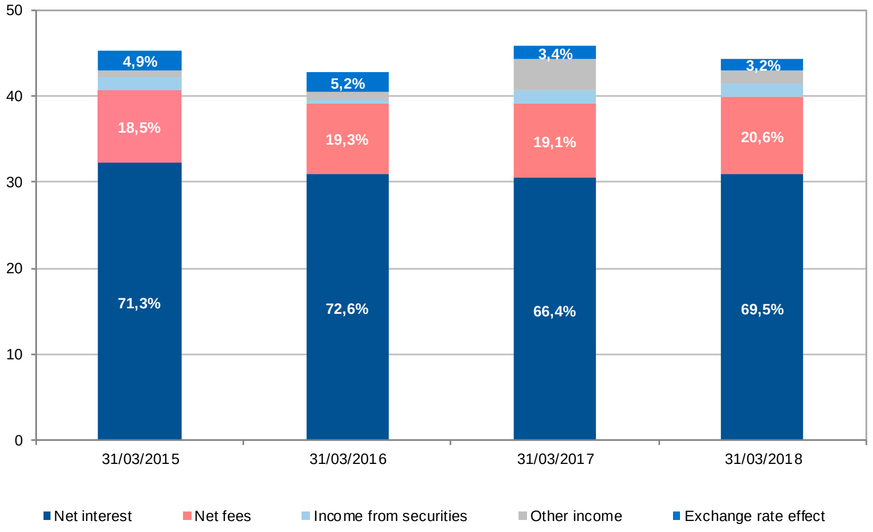
[5] A new Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks entered into force on 1 January 2018 due to simultaneous coming into force and applying the IFRS 9, which changed the valuing and disclosing of certain categories of the balance sheet and income statement, which to a certain extent influenced the comparability of categories before and after that date.

Net effect of the dinar exchange rate fluctuations on the Serbian banking sector result in Q1 2018 was positive, resulting in net foreign exchange gains and currency clause effects of RSD 1.4 bn. The effect of the RSD/EUR exchange rate appreciation in 2017 and to a lesser extent in the first months of 2018, and frequent appreciation pressures reflected on the dinar equivalent of FX-denominated balance sheet items. Net exchange rate gains on FX receivables and liabilities equalled RSD 2.6 bn (vs. net exchange rate losses of RSD 3.3 bn in 2017), while net exchange rate losses associated with the agreed FX currency clause came at RSD 1.2 bn (vs. net gains of RSD 4.9 bn on this account in Q1 2017).

2.3 Operating income

In Q1 2018, the banking sector's total operating income stood at RSD 44.5 bn, down by 3.1% compared to the total operating income from the same period in 2017. The decrease in operating income was mostly a result of lowered other operating income, i.e. income due to a reduction in liabilities, generated in 2017 in the acquisitions/mergers of certain banks.

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

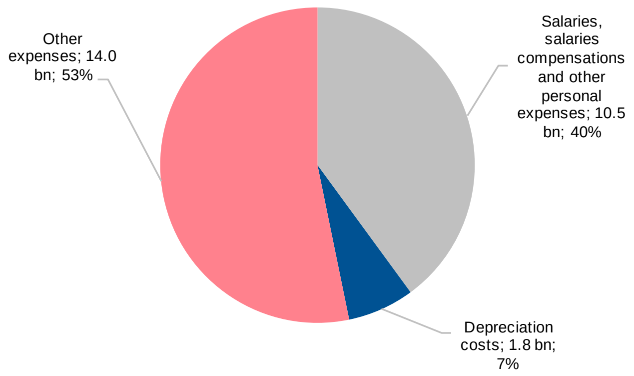


Source: National Bank of Serbia

2.4 Operating expenses

At end-Q1 2018, operating expenses[6] of the Serbian banking sector equalled RSD 26.3 bn, falling by 0.9% y-o-y. Within operating expenses, a reduction was recorded in all categories except those relating to Salaries, compensations and other personal expenses regarding employees. These expenses edged up by 0.8% (accounting for 40.0% of total operating expenses).[7] Depreciation costs (accounting for 6.8% of operating expenses) decreased by 0.9%, and item Other expenses by 2.1% relative to the costs generated in Q1 2017 (this item accounts for 53.3% of operating expenses).

Chart 2.4 **Structure of operating expenses**
31 March 2018



Source: National Bank of Serbia

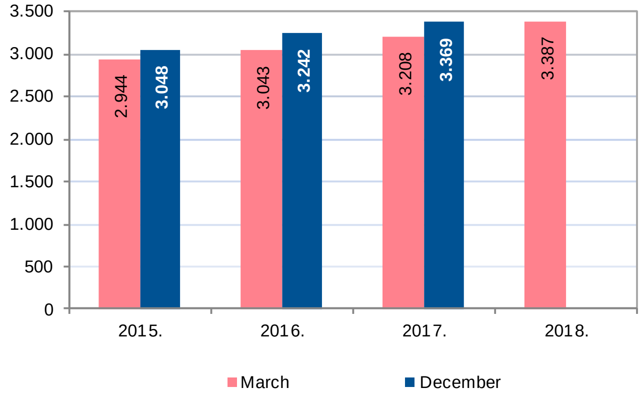
[6] Operating expenses include: salaries, salary compensations and other personal expenses, depreciation costs and other expenses (costs of material, production services, non-material costs…), in accordance with the amended methodology.
[7] At end-March 2018, there were 703 less employees in the banking sector than at end-March 2016.

3 BANKING SECTOR ASSETS

3.1 Level and structure

Total net balance sheet assets of the Serbian banking sector at end-March 2018 equalled RSD 3,386.6 bn, indicating a q-o-q increase of RSD 17.2 bn or 0.5%.

Chart 3.1.1 **Total banking sector assets**
(in RSD bn)

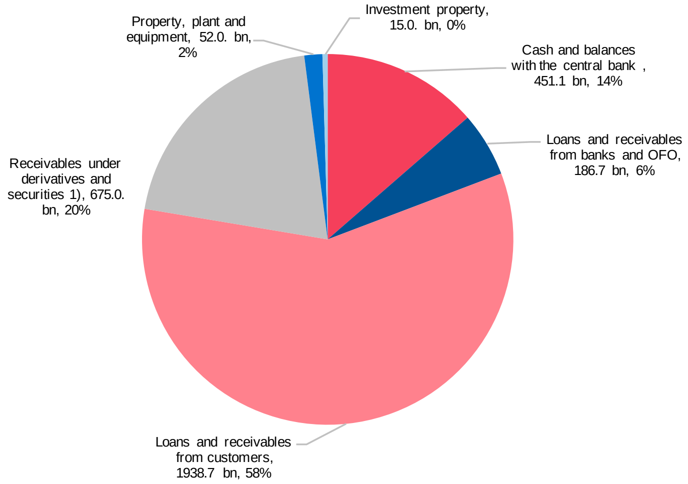


Source: National Bank of Serbia

Loans and receivables (to banks and other clients) held a dominant share in banking sector assets of 62.7% (as a result of banks' orientation towards traditional banking activities), rising up by 0.2 pp q-o-q. Also, Securities held a significant share (19.9%) and Cash and balances with the central bank (13.3%).[8] Banks' investment in securities mostly related to investment in securities issued by the Republic of Serbia, making this segment of banking sector investment highly secure.

[8] A new Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks entered into force on 1 January 2018 due to simultaneous coming into force and applying the IFRS 9, which changed the valuing and disclosing of certain categories of the balance sheet and income statement, which to a certain extent influenced the comparability of categories before and after that date.

Chart 3.1.2 **Banking sector assets structure**



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	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Cash and balances with the central bank	451,110	-22,735	24,200	-4.8%	5.7%
Loans and receivables	2,125,415	21,513	140,533	1.0%	7.1%
from banks and OFO	186,675	9,338	-31,512	5.3%	-14.4%
from clients	1,938,739	12,174	172,045	0.6%	9.7%
Receivables under derivatives and securities [1)]	674,959	28,154	1,318	4.3%	0.2%
Property, plant and equipment	52,007	-306	241	-0.6%	0.5%
Investment property	15,009	-282	-1,140	-1.8%	-7.1%
Other	68,124	-9,113	13,504	-11.8%	24.7%
Banking sector balance sheet total	**3,386,624**	**17,232**	**178,656**	**0.5%**	**5.6%**

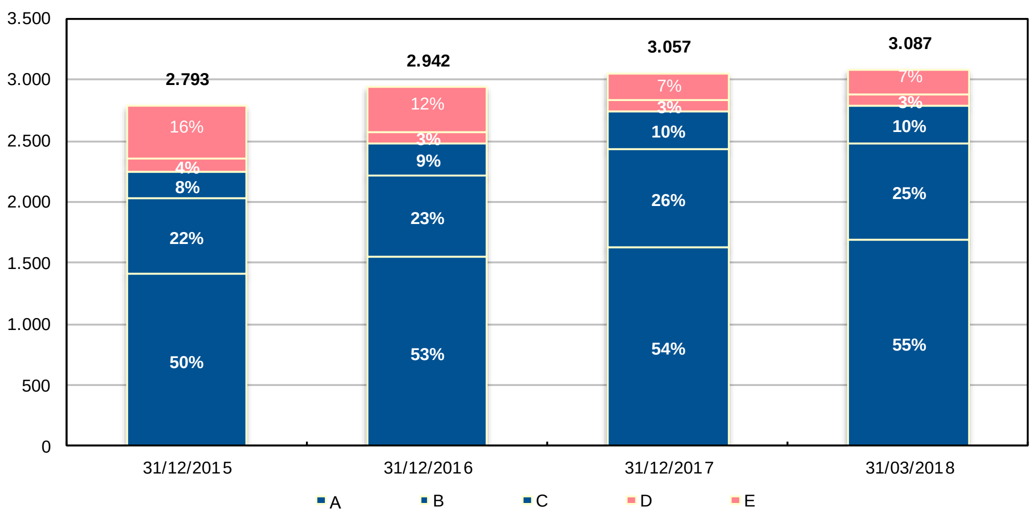
[1)] Until 2018 this included the following financial assets in balance sheet at fair value through income statement held for trading, available for sale, held to maturity and initially recognised at fair value through income statement.

Source: National Bank of Serbia

3.2 Classified assets

At end-March 2018, total classified assets (on- and off-balance sheet) equalled RSD 3,087.3 bn, up by RSD 30.4 bn or 1.0% q-o-q. Balance sheet assets subject to classification rose by RSD 27.8 bn and off-balance sheet items subject to classification by RSD 2.6 bn. Within balance sheet assets subject to classification, the most significant changes were recorded for deposits with banks and long-term loans, which rose by RSD 32.8 and RSD 27.2 bn respectively, while other receivables went down by RSD 9.3 bn (decreasing their share in total classified balance sheet assets subject to classification from 6.0% to 5.5%). Within off-balance sheet items, the largest absolute increase was recorded in contingent liabilities (by RSD 10.0 bn), which remain the dominant off-balance sheet item subject to classification with RSD 489.5 bn at end-March 2018 (59.9% share in total classified off-balance sheet items). The largest decrease was recorded in performance guarantees (by RSD 8.6 bn).

Chart 3.2 Total classified assets
(in RSD bn, in %)



The most significant change in balance sheet assets subject to classification relative to a quarter earlier was an increase in balance sheet items from category A by RSD 54.1 bn (mostly deposits with banks and long-term loans) and decrease in categories B and C by RSD 13.7 bn (decline in short-term loans) and RSD 11.7 bn (in receivables due and long-term loans). The key reason for the reduction of bas assets is the application of the Decision on the Accounting Write-off of Bank Balance Sheet Assets. Consequently, the assets quality improved, as the share of the two worst categories shrank by 0.4 pp, so bad assets accounted for 11.9% of total classified balance sheet assets.

A slight increase in total classified off-balance sheet items by RSD 2.6 bn resulted from a rise in A and B categories by RSD 7.7 bn and RSD 3.5 bn, mostly under contingent liabilities, while there was a decline in other classified bad assets C, D and E categories by RSD 8.7 bn, mainly under contingent liabilities and payable guarantees and performance guarantees. The share of off-balance sheet bas assets changed slightly (decreasing from 4.0% to 3.8% in total classified off-balance sheet items).

As a result of the above movements, the calculated balance sheet regulatory provisions dropped by RSD 11.3 bn or 4.1% in Q1 and equalled RSD 261.7 bn, and calculated balance sheet provisions by 3.7% to RSD 15.1 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 9.6 bn or 6.6% in the same period, amounting to RSD 136.9 bn.

During Q1 2018, total assigned receivables equalled RSD 1.9 bn (almost 4.5 times less than in the same period 2017), and all assignments went to persons outside the banking sector. For the sake of comparison, after Q1 2017, of total assigned RSD 8.2 bn, 37% were assigned within the banking sector, while the remaining 63% of receivables went to persons outside the banking sector.

3.3 Loans [9]

During Q1 2018, gross loans of Serbia's banking sector increased slightly in nominal terms by RSD 3.0 bn and equalled RSD 2,056.6 bn, representing a nominal quarterly growth of 0.1%. Observed in real terms, these loans in Q1, excluding the exchange rate effect, rose by 1.0%, primarily on account of rise in household lending.

Gross lending growth was the most pronounced in the household sector – an increase by RSD 16.4 bn (or 2.1% compared to the end of the previous quarter), and in the corporates by RSD 9.0 bn (increasing by 1.0% compared to the end of the previous quarter). Growth in household lending was mostly due to the expansion of dinar cash loans and FX-indexed housing loans. In corporate lending, there was a rise in investment loans, loans under transaction accounts and liquidity and current assets accounts. The most pronounced gross lending decline in nominal terms was recorded in the sector of foreign persons, and finance and insurance – by RSD 9.1 bn and RSD 7.1 bn respectively. Gross loans to legal persons in bankruptcy (except banks) lost RSD 2.4 bn or 7.0% relative to the end of previous quarter. The corporate and household sectors remained the most prevalent, with shares of 45.9% and 39.8% respectively.

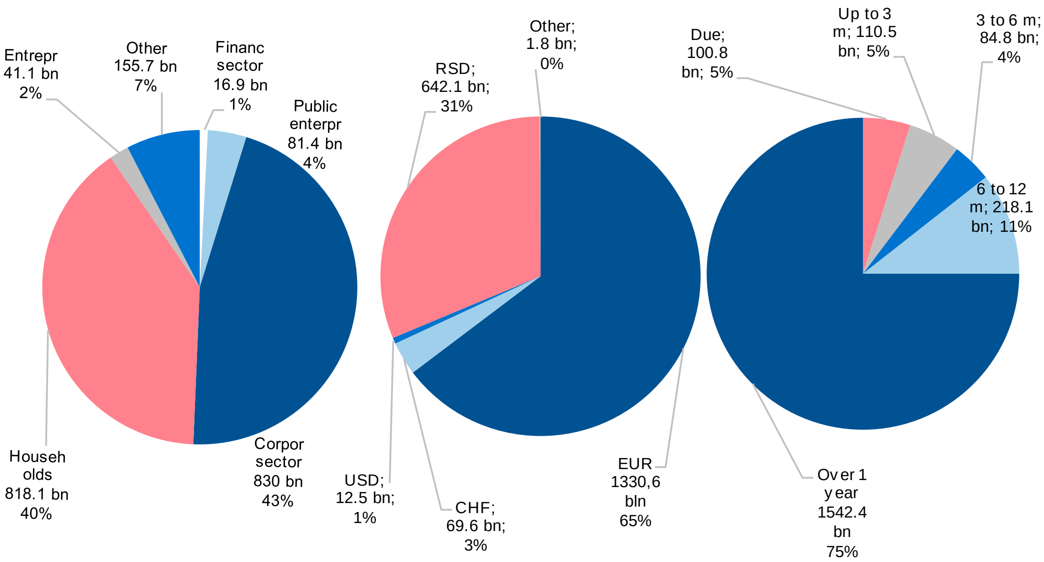
[9] In accordance with the Guidelines on the Obligation and Method of Collection, Processing and Submission of Data on the Stock and Structure of Bank Loans, Receivables and Liabilities, loans include the following loans in dinars and foreign currency: recalls, under transaction accounts, overnight, 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.

The currency structure of the Serbian banking sector's loan portfolio is still dominated by foreign currency. At end-Q1 2018, FX and FX-indexed loans accounted for 68.8%. The prevalent currency of loan indexation in Serbia was the euro, with EUR loans making up 64.7% (or 94.1% of total gross FX and FX-indexed loans)[10], followed by CHF loans and USD loans at 3.4% and 0.6% (4.9% and 0.9% of total gross FX and FX-indexed loans, respectively). Compared to December 2017, gross CHF and USD loans continued to fall both in nominal and relative terms.

At end-Q1 2018, dinar loans made up 31.2% of total gross loans, which is unchanged relative to the previous quarter (increase by 0.01 pp). The rise in cash loans continued in the quarter observed – at end-March 2018, their share in total loans measured 17.3%, with dinar cash loans making up almost 99% of all cash loans.

Among loans with FX clause, the greatest growth was recorded in investment and housing loans (by RSD 10.3 bn and RSD 4.6 bn respectively).

Chart 3.3 **Banking sector gross loan portfolio structure**
(in RSD bn)
(31 March 2018)



Source: National Bank of Serbia

Observed by the remaining maturity, the structure of gross loans did not change significantly – the share of long-term gross loans increased (from 73.9% to 75.0%), while short-term loans fell (from 19.5% to 19.2%), as well as matured loans (from 5.2% to 4.9%) and overnight loans (from 1.4% to 0.9%).

[10] A new Decision on Collection, Processing and Submission of Data on the Balance and Structure of Accounts in the Chart of Accounts entered into force on 1 January 2018, as well as a new currency structure of accounts.

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, a 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, capitalised, refinanced or delayed by agreement;

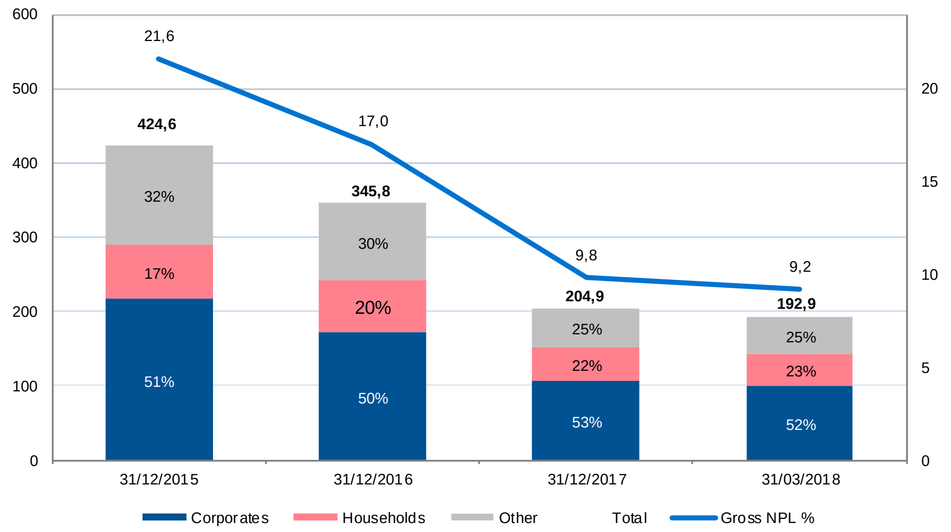
- where payments are less than 90 days overdue, but the bank has assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full.

Gross NPLs

In Q1 2018, the banking sector's total gross NPLs decreased by RSD 12.0 bn to RSD 192.9 bn at end-March. The reduction in gross NPLs[11] due to collection amounted to RSD 13.6 bn, and due to write-off – it fell by additional RSD 7.7 bn.

[11] Calculated based on the NPL 3 report which banks submit to the NBS.

Chart 3.4.1 **Gross non-performing loans (NPLs)**
(in RSD bn)

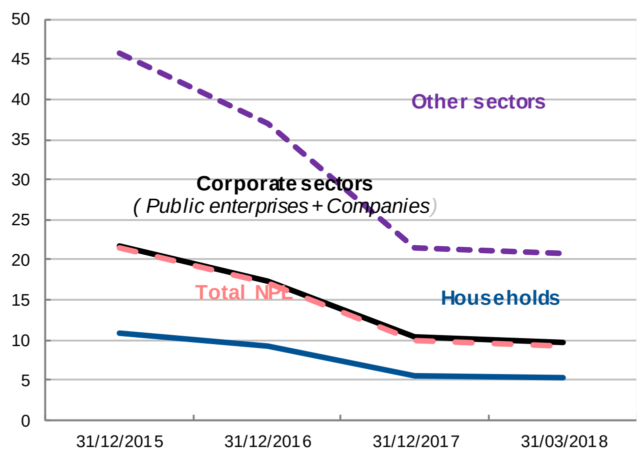


Source: National Bank of Serbia.

The fall in gross NPLs by 5.9%, along with a slight rise in total loans by 0.7%, pushed the share of NPLs in total gross loans further down by 0.6 pp q-o-q, to 9.2%, which is their new historic low since the introduction of the uniform definition of a non-performing loan and mandatory reporting in 2008.

Despite a decline of RSD 5.6 bn, the major part of gross NPLs are still in the corporate segment (RSD 96.8 bn at end-March 2018). Besides, NPLs of Companies and other legal persons in bankruptcy stood at RSD 36.4 bn.

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



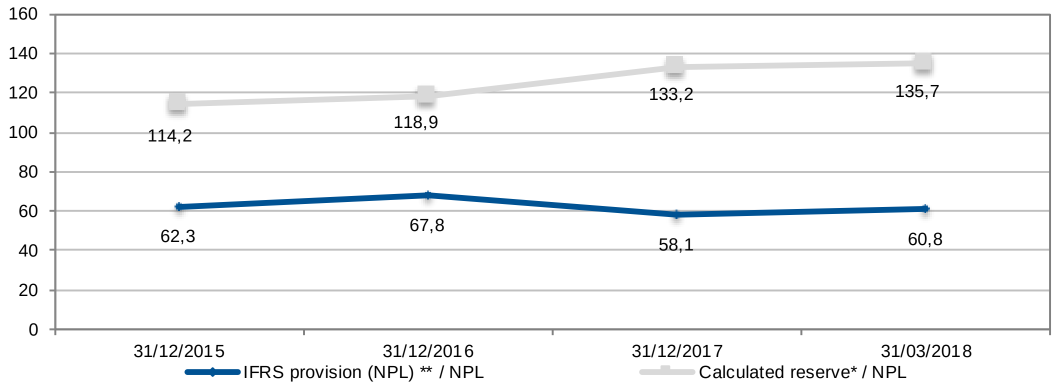
Source: National Bank of Serbia.

In the household segment, gross NPLs amounted to RSD 43.1 bn, which is 22.4% of total gross NPLs and a slight increase compared to 22.2% share at the end of the previous quarter.

NPL coverage

At end-Q1 2018, the coverage of total gross NPLs by loan loss reserves equalled 135.7%, while allowances for impairment remained relatively high, ensuring the coverage of 60.8%, 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);

Source: National Bank of Serbia.

Corporate NPLs

At end-Q1 2018, gross corporate NPLs equalled RSD 96.8 bn, down by RSD 5.6 bn or 5.5% q-o-q, mainly due to: collection (RSD 5.3 bn), write-offs (RSD 2.3 bn) and other changes, mostly NPL status cancellation (RSD 2.1 bn).[12]

[12] Calculated based on the NPL 3 report which banks submit to the NBS.

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

(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Agriculture	2,173	-189	-1,932	-8.0%	-47.1%
Manufacturing	45,388	-1,069	-14,098	-2.3%	-23.7%
Construction	11,842	-1,283	-11,475	-9.8%	-49.2%
Trade	19,683	-1,967	-19,430	-9.1%	-49.7%
Transport, hotels/restaurants, communications	4,745	20	-3,816	0.4%	-44.6%
Real estate	12,622	-1,114	-8,114	-8.1%	-39.1%

Source: National Bank of Serbia

By sector, the biggest share in total corporate NPLs continued to be held by manufacturing (46.9%, with a 14.3% NPL gross ratio), followed by trade (20.3%, with a 6.3% gross NPL ratio) and real estate (13.0%, with a 14.2% gross NPL ratio). In Q1, NPL ratio markedly declined in all sectors. The sharpest decline was recorded in: real estate and construction (by 1.8 pp and 1.7 pp, respectively).

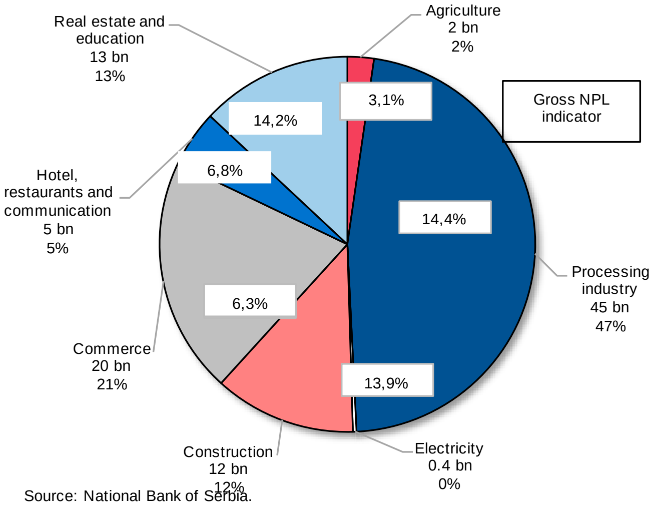
Table 3.4.2 **Corporate NPL ratio by sector**

(%)

		Change relative to prior periods (pp)	
	31/03/2018	31/12/2017	31/03/2017
Agriculture	3.1%	-0.2	-2.8
Manufacturing	14.3%	-0.2	-5.5
Construction	13.9%	-1.7	-14.4
Trade	6.3%	-0.8	-7.0
Transport, hotels/restaurants, communications	6.8%	0.0	-6.6
Real estate	14.2%	-1.8	-12.0

Source: National Bank of Serbia

Chart 3.4.4 **Private corporates NPL structure**
(31 March 2017)



Source: National Bank of Serbia.

Natural persons' NPLs[13]

Measuring 5.4% at end-Q1 2018, the share of gross NPLs of natural persons stayed below the average of the total portfolio and 0.5 pp lower q-o-q.

At end-Q1 2018, natural persons' NPLs equalled RSD 50.0 bn, dropping by 5.6% q-o-q. All types of loans recoded a decrease, in both nominal and relative terms, particularly credit cards (by RSD 0.7 bn and 26.2%, respectively).

The downward trend of NPL ratio of the natural persons sector was primarily determined by the lending growth due to the expansion of cash loans. Their share in total gross loans to natural persons was 40.4% at end-March 2018, indicating an increase relative to 39.9% at end-2017, and especially to 33.6% at end-2016. At the same time, their share in total NPLs to natural persons increased by 29.3% at end-March 2018. However, gross NPL ratio of these loans was at its lowest level (3.9% at end-March 2018).

[13] Households, entrepreneurs, private households with employed persons and registered farmers.

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

		Change relative to prior periods			
	Amount	Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Housing loans	21,603	-229	-8,526	-1.0%	-28.3%
Cash loans	14,652	-640	-6,611	-4.2%	-31.1%
Credit cards	1,991	-708	-2,425	-26.2%	-54.9%
Current account overdrafts	1,930	-549	-2,168	-22.1%	-52.9%
Consumer loans	527	-85	-3,253	-13.8%	-86.1%
Other	9,342	-758	-9,598	-7.5%	-50.7%
Total	**50,044**	**-2,969**	**-32,583**	**-5.6%**	**-39.4%**

Source: National Bank of Serbia

The category of housing construction loans does not hold a dominant share in lending to natural persons any longer, accounting for 39.2%, but remains dominant in total gross NPLs (43.2%).

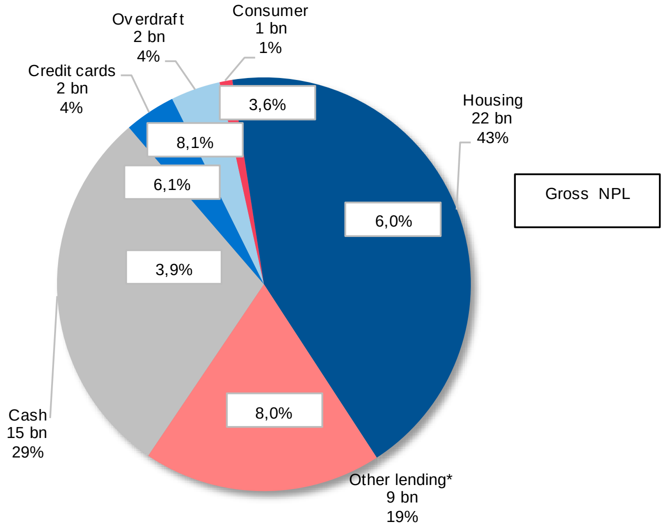
Table 3.4.4 **NPL ratio for natural persons by category**
(%)

		Change relative to prior periods (pp)	
	31/03/2018	31/12/2017	31/03/2017
Housing construction	6.0%	-0.2	-2.3
Cash loans	3.9%	-0.3	-3.2
Credit cards	6.1%	-0.9	-6.6
Current account overdrafts	8.1%	-2.7	-7.4
Consumer loans	3.6%	-0.8	-17.6

Source: NBS.

The highest gross NPL ratio in the natural persons' segment at end-March 2018 (8.1%) was recorded in the category of current account overdrafts (which accounted for 2.6% of total loans to natural persons and for 3.9% of total NPLs of natural persons). The next were credit cards, with the ratio of 6.1% (making up 3.6% of total loans to natural persons and 4.0% of NPLs of natural persons), housing loans with 6.0% and cash loans with 3.9%. Gross NPL ratio declined across all categories of natural persons’ loans.

Chart 3.4.5 **Natural persons NPL structure**
(31 March 2018)



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

Source: National Bank of Serbia.

When observing NPLs to natural persons in relation to allowances for their impairment, housing loans are a category with the lowest allowances for impairment (47.0% relative to gross NPLs), due to generally better collateral coverage. In current account overdrafts, credit cards and cash loans, allowances for impairment are much higher (77.9%, 71.5% and 63.1%, respectively).

4 BANKING SECTOR LIABILITIES

4.1 Structure of the sources of funding

Deposits[14] were the primary source of bank funding in Serbia, making up 70.1% of total liabilities. At end-Q1 2018, own sources of funding made up 19.9% and borrowing 5.6% of total liabilities.

Table 4.1 **Change in key items of banking sector liabilities**
(RSD mn, %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Deposits and other liabilities	2,622,045	9,798	151,693	0.4%	6.1%
to banks, OFO and the central bank	*391,983*	*12,532*	*125,767*	*3.3%*	*47.2%*
to other clients	*2,230,062*	*-2,734*	*25,926*	*-0.1%*	*1.2%*
Liabilities arising from hedging derivatives	572	-2	-77	-0.3%	-11.9%
Subordinated liabilities	33,287	-3	-11,982	0.0%	-26.5%
Provisions	10,469	-691	-1,089	-6.2%	-9.4%
Share capital	396,847	-7,700	-5,907	-1.9%	-1.5%
Profit	106,134	5,395	28,248	5.4%	36.3%
Loss	33,320	-1,186	-11,213	-3.4%	-25.2%
Reserves and unrealised losses	203,319	6,984	733	3.6%	0.4%
Other	47,269	2,264	5,824	5.0%	14.1%
Total banking sector liabilities	**3,386,624**	**17,232**	**178,656**	**0.5%**	**5.6%**

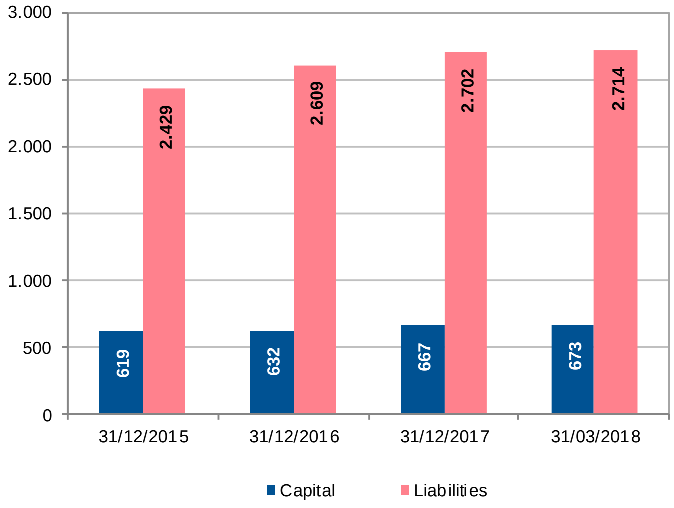
[1)] Until 2018 this included the following items in balance sheet: Financial liabilities in balance sheet initially recognised at fair value through income statement and Own securities issued and other borrowings

Source: National Bank of Serbia

Total liabilities of the banking sector rose by RSD 11.4 bn (or 0.4%) q-o-q. Increase in liabilities is mainly a result of the increase under the item Deposits and other liabilities to banks by RSD 12.5 bn (or 3.3%), and decrease under the item Deposits and other liabilities to other clients by RSD 2.7 bn (or 0.1%).

[14] 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 bn)



Source: National Bank of Sebia.

In Q1 2018 total capital of the banking sector rose by RSD 5.9 bn in nominal terms (by 0.9%), which is why the share of capital in total balance sheet liabilities edged up slightly (from 19.8% to 19.9%). Within capital structure, the most significant changes were recorded for share capital (a decrease by RSD 7.7 bn) and reserves (an increase by RSD 7.0 bn). Share capital was decreased primarily as a result of a decrease in one bank which covered its loss and withdrew and cancelled its shares, before the process of acquisition.

In terms of the currency structure, Q1 2018 saw a decrease in dinar sources of funding (including capital), from 44.1% to 43.8%. As regards the FX and FX-indexed portion of liabilities, EUR-denominated liabilities remained dominant, making up 91.5% of total FX liabilities, while the rest were mostly liabilities in USD (4.8%) and CHF (2.9%).

4.2 Deposits

Total deposits with banks stood at RSD 2,374.7 bn at end-Q1 2018, up by RSD 14.2 bn or 0.6% q-o-q. The increase stemmed mainly from a rise in household deposits (by RSD 22.7 bn), and foreign persons (by RSD 21.0 bn).

At end-Q1 2018, dinar deposits fell by RSD 19.1 bn, while FX and FX-indexed deposits rose by RSD 33.3 bn in nominal terms. Due to the nominal increase, the share of FX and FX-indexed deposits in total deposits edged up from 68.0% to 69.0%. The EUR was the dominant currency, making up 91.0% of total FX and FX-indexed deposits. The rest of FX and FX-indexed deposits were mainly in USD (5.4%) and CHF (2.7%).

In terms of initial (agreed) maturity, demand deposits were still dominant (60.7%), followed by deposits with the remaining maturity of up to one year (26.0%), while 13.3% of all deposits were agreed for over one year term.

Short-term deposits (observed by the remaining maturity) made up the bulk of bank deposits in Serbia. Demand deposits made up over a half of all deposits (60.8%), followed by deposits with the remaining maturity of up to one year with 31.1%, while deposits with the remaining maturity of over one year accounted for 8.1% of total deposits. A quarterly increase is notable in long-term deposits (0.6 pp) due to a rise in FX deposits received from foreign persons for a period of 2 to 5 years.

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

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Finance and insurance	62,305	-1,166	2,873	-1.8%	4.8%
Public non-financial sector	130,259	-10,064	-10,281	-7.2%	-7.3%
Corporate sector	539,352	-14,553	44,319	-2.6%	9.0%
General government	40,367	7,253	1,297	21.9%	3.3%
Household sector	1,245,630	22,664	20,694	1.9%	1.7%
Foreign persons and foreign banks	215,109	21,046	79,723	10.8%	58.9%
Other sectors	141,634	-10,958	1,975	-7.2%	1.4%
Total deposits	**2,374,656**	**14,221**	**140,600**	**0.6%**	**6.3%**

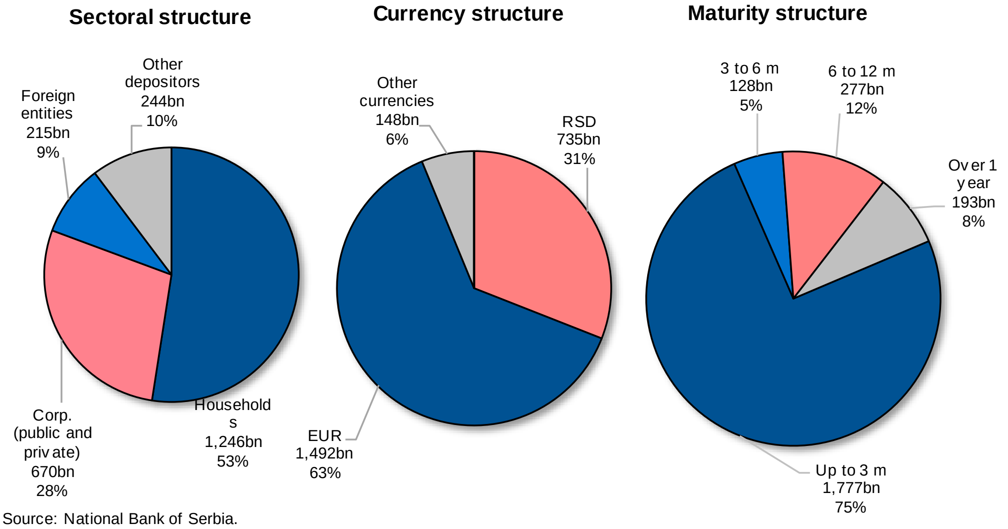
Source: NBS.

At end-Q1 2018, total household deposits in foreign currency amounted to RSD 1,084.8 bn (rising by 1.9% q-o-q) and were made up mainly of savings deposits (64.6%).

Compared to end of the previous quarter, household savings deposits[15] increased by RSD 5.3 bn (0.7%) to RSD 746.7 bn at end-Q1 2018. This growth resulted from the increase in savings in foreign currency (by RSD 3.3 bn) due to the effect of insignificant dinar appreciation of 0.07%, and from the increase in dinar savings (by RSD 2.0 bn). At end-March 2018, FX savings were dominant in total household savings deposits, making up 93.8%, while dinar savings accounted for 6.2%.

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

Chart 4.2 **Banking sector deposits structure**
(31 March 2018)



Source: National Bank of Serbia.

4.3 Total borrowing of banks

At end-Q1 2018, total credit borrowing of the banking sector amounted to RSD 241.9 bn, a decrease by RSD 4.4 bn or 1.8% q-o-q.

Table 4.3 **Changes in the level of bank borrowing**

(RSD mn, %)

		Change relative to prior periods			
	Amount	Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Overnight loans	34,964	-1,403	-6,252	-3.9%	-15.2%
Borrowings	190,827	-7,319	10,097	-3.7%	5.6%
Other financial liabilities	16,093	4,341	9,099	36.9%	130.1%
Total borrowing	**241,884**	**-4,381**	**12,945**	**-1.8%**	**5.7%**

Source: NBS.

The largest individual item in total credit borrowing were loans taken (primarily from parents and international financial institutions), making up 78.9% (end of the previous quarter: 80.4%) and falling by RSD 7.3 bn nominally q-o-q. The next largest item were liabilities under overnight loans which accounted for 14.5% (end of the previous quarter: 14.8%), after a decline of RSD 1.4 bn in Q1. Other financial liabilities made up 6.7% (end of the previous quarter: 4.8%) rising by RSD 4.3 bn.

In this segment, the biggest creditors of banks were foreign persons with 69.6% (primarily foreign banks) and general government sector with 18.6% (primarily government bodies and organisations).

The dominant currency of borrowing was the euro, accounting for RSD 209.3 bn (end of the previous quarter: RSD 222.3 bn) or 86.5% of total credit borrowing. Liabilities in dinars stood at RSD 28.2 bn (end of the previous quarter: RSD 17.8 bn) or 11.6% of total credit borrowing, while banks owed RSD 2.5 bn and RSD 1.8 bn in CHF and USD, respectively (end of the previous quarter: RSD 2.7 bn and RSD 3.4 bn, respectively), or 1.0 % and 0.7% of total credit borrowing.

4.4 External liabilities

At end-Q1 2018, banks' total external liabilities under credit operations stood at RSD 168.4 bn, down by RSD 1.5 bn (0.9%) q-o-q. Borrowing increased only in the item – Other financial liabilities (with a share of 4.1%), by RSD 5.3 bn, while liabilities under loans taken (with a share of 91.2%) declined by RSD 5.1 bn, and under overnight loans by RSD 1.7 bn. This segment remained highly concentrated, given that of the 14 banks which borrowed externally, five banks accounted for 79.1% of the total debt. Also, three banks took overnight foreign loans, and 95.5% of that debt related to a single bank.

Long-term loans held a dominant 80.8% share in the maturity structure of external borrowing (end of the previous quarter: 81.8%).

Table 4.4 **Changes in bank external borrowing**

(RSD mn, %)

		Change relative to prior periods			
	Amount	Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Overnight loans	7,902	-1,707	-3,379	-17.8%	-30.0%
Borrowings	153,478	-5,090	26,006	-3.2%	20.4%
Other financial liabilities	6,981	5,259	5,806	305.2%	493.9%
Total borrowing	**168,362**	**-1,538**	**28,433**	**-0.9%**	**20.3%**

Source: NBS.

External borrowing was primarily euro-denominated – 94.0% and changed from the quarter before (reduction by 3.4 pp). CHF borrowing accounted for 1.5%.

4.5 Subordinated liabilities

At end-Q1 2018, total subordinated liabilities of Serbian banks stood at RSD 33.1 bn, which is a slight decrease (by 0.4%) q-o-q, continuing their downward trend. In 2017 only, these liabilities stood at 27%.

In terms of creditors, total subordinated liabilities were structured in the following manner: liabilities to foreign banks accounted for 75.1%, liabilities to foreign legal persons – 23.5% and liabilities to corporates –1.4%.

Currency structure was unchanged: The share of subordinated liabilities in euros stood at 78.7%, liabilities in Swiss francs increased to 19.5%; liabilities in dinars made up 1.4%, and in other currencies – 0.4%.

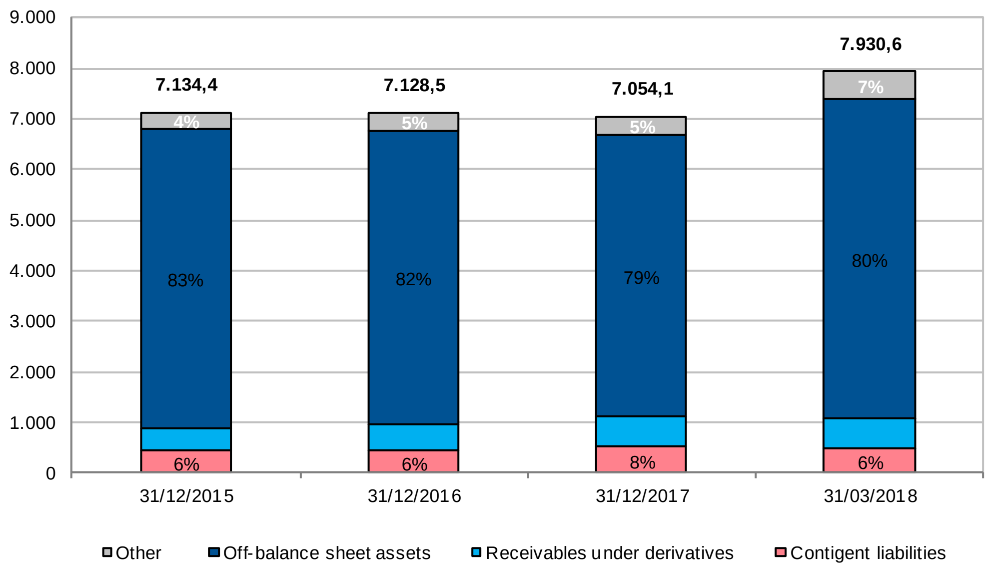
Subordinated liabilities were highly concentrated – of the 14 banks with subordinated debt, one bank accounted for 27% of all subordinated liabilities, and the top four banks made up over 61% of total subordinated liabilities.

Given the regulatory restrictions on inclusion of subordinated liabilities in supplementary and/or regulatory capital, banks included 52.9% of total subordinated debt in supplementary capital.

5 OFF-BALANCE SHEET ITEMS

At end-Q1 2018, total off-balance sheet items of the banking sector stood at RSD 7,930.6 bn, rising significantly (by 12.4%) q-o-q, mostly on account of an increase in Other off-balance sheet assets (by RSD 723.8 bn). Within this item (accounting for 79.7% of total off-balance sheet), the strongest growth of RSD 801.3 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 7.2% and Issued guarantees and other sureties with 3.7%.

Chart 5.1 **Off-balance sheet items**
(in RSD bn, in %)



Source: National Bank of Serbia.

Following its implementation on 1 January 2018, amendments and supplements to the Chart of Accounts introduced two new accounts for disclosing written-off financial assets, which were transferred to off-balance sheet records (in dinars and foreign currency) for the purpose of reporting in accordance with the Decision on the Accounting Write-off of Bank Balance Sheet Assets. At end-Q1 2018, banking sector disclosed RSD 192.9 bn on these accounts, which is the amount for which other off-balance sheet assets was reduced within the item Other off-balance sheet assets[16].

[16] Before 1 January 2018, written-off financial assets were disclosed within the item Other off-balance sheet assets.

Risk-free items still accounted for the bulk (89.7%) 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-Q1 2018, the classified part of off-balance sheet items (i.e. which is considered risk-bearing) amounted to RSD 817.7 bn (an increase by RSD 2.6 bn or 0.3%).

At end-Q1 2018, contingent liabilities[17] equalled RSD 501.8 bn (falling by RSD 27.3 bn or 5.2% q-o-q) and made up 6.3% of total off-balance sheet items (7.5% at end of the previous quarter).

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

(RSD mn, %)

		Change relative to prior periods			
	Amount	Nominal		Relative	
	31/03/2018	31/12/2017	31/03/2017	31/12/2017	31/03/2017
Issued guarantees and other sureties	294,684	-8,931	30,384	-2.9%	11.5%
Receivables under derivatives	573,993	-528	54,996	-0.1%	10.6%
Contingent liabilities and other irrevocable commitments	207,127	-18,328	31,073	-8.1%	17.6%
Securities received as collateral	183,222	4,887	3,415	2.7%	1.9%
Sureties for liabilities	96,825	-206	4,302	-0.2%	4.6%
Other off-balance sheet assets	6,324,147	723,777	576,594	12.9%	10.0%
Other	250,652	175,862	161,097	235.1%	179.9%
Total off-balance sheet assets	**7,930,649**	**876,533**	**861,861**	**12.4%**	**12.2%**

Source: NBS.

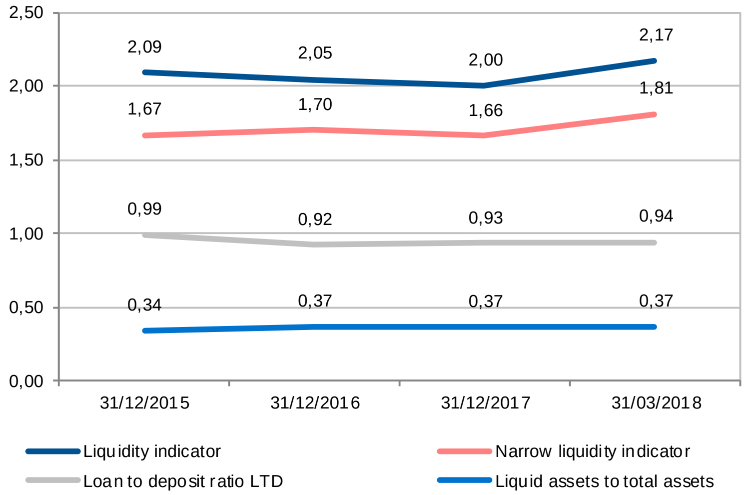
[17] Issued guarantees and other sureties, irrevocable commitments regarding undisbursed loans and placements, and other irrevocable commitments.

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-Q1 2018, the average monthly liquidity ratio was 2.17, twice higher than the regulatory floor of 1.0. The narrow liquidity ratio at banking sector level measured 1.81 (regulatory floor – 0.7). The share of liquid assets in total banking sector balance sheet assets is stable, reaching 36.9%at end-Q1 2018.

Atend-Q1 2018 , banks' investments in NBS repo securities decreased relative to December 2017, from RSD 45.1 bn to RSD 40.0 bn. The number of banks which invested in repo securities rose (from 13 to 16). As for government securities, their portfolio was worth RSD 648.9 bn at end-March 2018, increasing by 4.1% from end-December.

Chart 6.1 **Banking sector liquidity indicators**



Source: National Bank of Serbia.

To further strengthen the resilience of the banking sector,[18] the liquidity coverage ratio was introduced. This indicator is the ratio of the liquidity buffer (made up by 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.

As of 1 January 2018, banks are required to maintain this ratio at a level not lower than 100% (prescribed floors are the same as in the European Union). As at 31 March 2018, the liquidity coverage ratio at the level of the banking sector measured 247.78%.

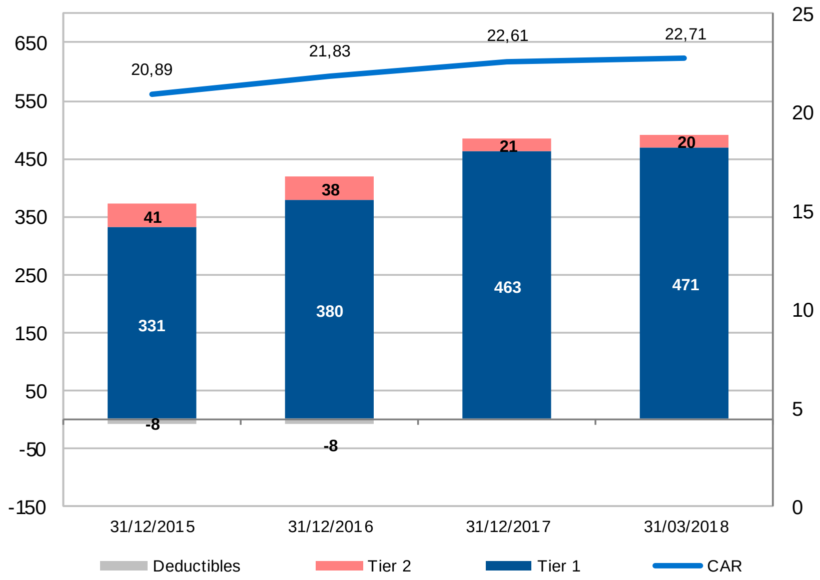
[18] The Decision on Liquidity Risk Management was adopted in December 2016 as part of the implementation of the Strategy for Introduction of Basel III Standards in Serbia.

7 CAPITAL ADEQUACY

The Serbian banking sector is well-capitalised, both from the aspect of compliance with the prescribed capital adequacy ratio[19], and in terms of the structure of regulatory capital. At end-March 2018 2018, the capital adequacy ratio of the Serbian banking sector averaged 22.71% (22.61% in December 2017). This is well above the NBS regulatory minimum (8%).

At end-March2018 , the Tier 1 capital ratio of the Serbian banking sector averaged 21.78% (vs. 21.62% in December 2017), and Common Equity Tier 1 capital ratio – 21.71% (vs. 21.54% in December 2017).

Chart 7.1 **Regulatory capital and CAR***
(in RSD bn, CAR in %)



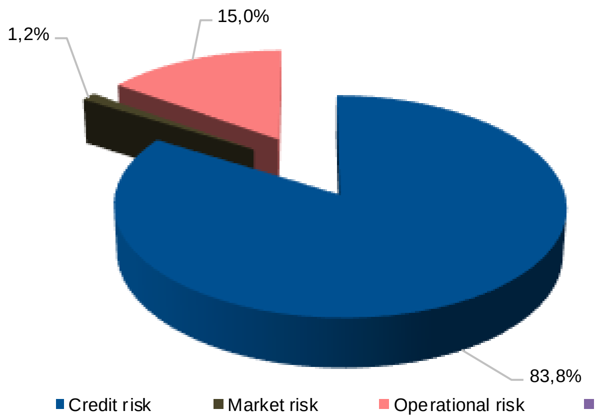
* CAR = Regulatory capital adequacy ratio

Source: National Bank of Serbia.

[19] 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).

As risk-weighted assets grew slower than capital in Q1 2018 (0.8% vs. 1.3%, respectively), capital adequacy ratio slightly increased (by 0.10 pp). The increase in risk-weighted assets by RSD 17.7 bn stemmed from a rise in credit risk-weighted assets by RSD 7.8 bn. The increase in risk-weighted assets on account of its exposure to credit risk by RSD 6.8 bn was primarily with regard to exposure to natural persons. Market-risk weighted assets also increased (by RSD 3.3 bn), primarily with regard to foreign exchange risk exposure. The only reduction was recorded in risk-weighted assets with regard to exposure to credit valuation adjustment risk (by RSD 0.2 bn).

Chart 7.2 **RWA by risk type**
(y %)
(31 March 2018)



Source: National Bank of Serbia.

In the structure of risk-weighted assets, the dominant share referred to credit risk (83.8%), taking into account banks' traditional business models relying on lending to corporates and households. Next was operational risk with a share of 15.0%, while the shares of market risks and credit valuation adjustment risk were negligibly low – at 1.2% and 0.04%, respectively.

The growth of regulatory capital in Q1 2018, as well as throughout the whole 2017, can be primarily attributed to a decrease in required reserve. In Q1 2018, a growth of regulatory capital was recorded by 1.3% (in absolute amount: RSD 6.3 bn), while the whole of 2017 recorded growth of 18.0%. Regulatory capital of the banking sector at end of the reporting quarter in 2018 equalled RSD 490.7 bn.

Regulatory capital consists of: Tier 1 capital, which remained at 95.9% and Tier 2 capital, measuring 4.1%. 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-Q1 2018,[20] Tier 1 capital of the banking sector stood at RSD 470.5 bn, up by 1.6% (or RSD 7.3 bn) from December 2017. The banking sector's Tier 1 capital increased mostly as a result of the release of RSD 8.8 bn of required reserves for estimated losses arising from credit risk. The paid amount of Common Equity Tier 1 capital instruments was reduced by RSD 7.1 bn, as a result of a decline in share capital by RSD 9.8 bn due to one bank's coverage of losses and withdrawal and cancellation of shares, and recapitalisation in the amount of RSD 2.7 bn recorded in two banks. Tier 2 capital of the banking sector fell relative to the end of the previous quarter, by RSD 1.0 bn (4.5%) and stood at RSD 20.2 bn on account of a RSD 1.0 bn reduction in subordinated liabilities included in Tier 2 capital. Cumulative preference shares remained relatively unchanged (RSD 2.6 bn).

In accordance with the Amendments to the Decision on Reporting Requirements for Banks, adopted in December 2016 and implemented as of 30 June 2017, 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.

As at 31 March 2018, the leverage ratio at banking sector level measured 11.13%[21] , while simultaneously maintaining the stable movements of this ratio, since its introduction.

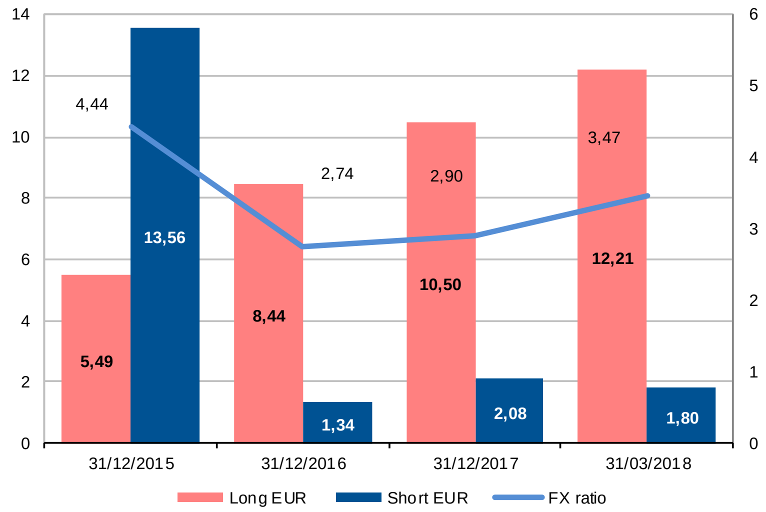
[20] According to Basel III regulations, among other things, Tier 1 and Tier 2 capital are not reduced by the appropriate part of deductibles from regulatory capital, rather each of them has its own deductibles.
[21] According to Basel III standards, the leverage ratio floor was set at 3%.

8 FOREIGN EXCHANGE RISK

Atend-Q1 2018, Serbia's banking sector posted a long open FX position worth RSD 16.9 bn (excluding the position in gold). Twenty three banks ended March 2018 with a net long open FX position, while the remaining six banks showed a net short open FX position.

On 31 March 2018, banks in Serbia operated at net long open positions in euros, US dollars and at net short open FX position in Swiss francs (RSD 12.21 bn, RSD 2.98 bn and RSD 0.46 bn, respectively).

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



Source: National Bank of Serbia

At end-March 2018, the foreign exchange risk ratio for the banking sector equalled 3.47%, 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.

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 future fixed date. At end-Q1 2018[22], in currency forward agreements, banks took the net short position in euros (43%) and dinars (42%), while taking to an almost the same extent the net short position in US dollars (15%) at an agreed future date.

[22] 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 (75% of all active swap transactions) and the Swiss franc (19% of active swap transactions). Long positions in other currencies accounted for 6% of all active swap transactions, and the majority were concluded in dinars (4.5% of total swap transactions). The most frequently used currency pair exchanged in swap agreements was the euro/dinar, accounting for 47% of active swap transactions, followed by euro/US dollar (22%) and euro/Swiss franc (16%) of agreed and active swap transactions as at 31 March 2018.

9 NBS REGULATORY ACTIVITY

Exercising its regulatory competences in the area of bank supervision, the NBS issued the following regulation in Q1 2018:

In February 2018, the Executive Board adopted the Decision on the Guidance for the implementation of the provisions of the Law on the Prevention of Money Laundering and Terrorism Financing for obligors supervised by the National Bank of Serbia (RS Official Gazette, No 13/2018), applied as of 1 April 2018**.** Adopting these guidelines improved the regulatory framework for obligors supervised by the NBS, especially in the part relating to AML/CFT risk. The guidelines regulate the manner in which the obliger supervised by the National Bank of Serbia prepares AML/CFT risk analysis, the procedure which determines whether the client or the beneficial owner of the client is a public official, as well as the manner of implementing other provisions of the law regulating AML/CFT.