NATIONAL BANK OF SERBIA

BANK SUPERVISION DEPARTMENT

BANKING SECTOR IN SERBIA

Fourth Quarter Report 2019

Contents:

1. BASIC INFORMATION ON SERBIAN BANKING SECTOR

1.1 Selected parameters of the Serbian banking sector[1]

At end-December 2019, the Serbian banking sector numbered 26 banks, which is unchanged relative to end-September 2019. The organisational network consisted of 1,598 business units and employed a total of 23,087 persons.

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

(in RSD bn, in %)

	Number of banks	Assets		Capital		Network		Employment	
		Amount	Share	Amount	Share	Number of business units [1)]	Share	Number of employees	Share
Banks in domestic ownership	7	991	24.3%	181	25.6%	558	34.9%	6,666	28.9%
State-owned	4	686	16.8%	109	15.4%	445	27.8%	5,219	22.6%
Privately-owned	3	305	7.5%	72	10.2%	113	7.1%	1,447	6.3%
Banks in foreign ownership	19	3,093	75.7%	525	74.4%	1,040	65.1%	16,421	71.1%
Italy	2	1,094	26.8%	186	26.3%	235	14.7%	4,385	19.0%
Austria	2	550	13.5%	90	12.7%	186	11.6%	2,749	11.9%
France	1	119	2.9%	12	1.8%	82	5.1%	933	4.0%
Hungary	2	551	13.5%	82	11.6%	239	15.0%	3,284	14.2%
Other	12	779	19.1%	155	22.0%	298	18.6%	5,070	22.0%
Total banking sector	**26**	**4,084**	**100.0%**	**706**	**100.0%**	**1,598**	**100.0%**	**23,087**	**100.0%**

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

Source: NBS.

Q4 2019 saw a contraction in banking employment and the number of business units. At end-Q4, banking sector employment went down by 85 persons compared to end-Q3 2019 as a consequence of a simultaneous increase in the number of employees by 85 in 13 banks and downsizing the workforce by 170 in 9 banks. Within the business network, the number of business units decreased by 12 in four banks, and increased by five in three banks, meaning that it decreased by seven business units net during the quarter.

At end-December 2019, the total net balance sheet assets of the Serbian banking sector equalled RSD 4,084.1 bn (up by 2.6% from end-September 2019), and the total balance sheet capital RSD 705.7 bn (up by 1.3% from end-September 2019).

[1] All data in the *Report* are based on the reports that banks are required to submit to the NBS. These reports have not been audited by external auditors or verified by NBS on-site supervisors.

In the quarter observed, banks in majority ownership of domestic entities (private entities and the Republic of Serbia) increased their market share in banking sector balance sheet total (from 23.4% to 24.3%), as well as their share in total banking sector capital (24.5% to 25.6%). Consequently, the share of banks in majority ownership of foreign entities decreased slightly (from 76.6% to 75.7%) relative to the balance sheet total, i.e. from 75.5% to 74.4% relative to the capital.

Banks from Italy, Hungary and Austria (six banks in total) accounted for the dominant share in total banking sector balance sheet assets – 53.7%.

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] value indicates the absence of concentration in all observed categories.

Table 1.2.1 **Concentration and competition indicators**

(Share %)

	Top 5 banks	Top 10 banks	HHI[1)]
Assets	53.4	79.7	800
Lending (total)	52.0	78.8	789
Household loans	53.3	83.0	838
Corporate loans	54.5	83.2	840
Deposits (total)	54.9	81.2	840
Household deposits	58.5	82.9	968
Income (total)	54.7	80.5	818
Interest	50.8	78.1	755
Fees and commissions	58.8	82.3	930

[1)] Herfindahl Hirschman Index of concentration.

Source: NBS.

For a long time now, the highest values of the index were observed in household deposits and income from fees and commissions, while the lowest figures were noted for interest income and total loans.

If the five biggest banks are observed in terms of balance sheet assets, gross loans and deposits, it is evident that they account for more than a half of the Serbian banking sector in these segments given their share in the net balance sheet assets (53.4%), gross loans (52.0%) and deposits (54.9%).

[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 end-Q4 2019, in terms of balance sheet total, the five largest banks maintained their positions relative to the previous quarter as well as the same period last year.

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

(in RSD bn, in %)

	31. 12. 2018			30. 09. 2018			31. 12. 2019			Δ Г	Δ T
	Amount	Share	Ranking	Amount	Share	Ranking	Amount	Share	Ranking		
Banca Intesa A.D.- Beograd	571	0.2	1	633	0.2	1	653	0.2	1	–	–
Unicredit Bank Srbija A.D.- Beograd	437	0.1	2	458	0.1	2	442	0.1	2	–	–
Komercijalna banka A.D.- Beograd	401	0.1	3	420	0.1	3	432	0.1	3	–	–
OTP Banka Srbija a.d. Beograd*	316	0.1	4	331	0.1	4	336	0.1	4	–	–
Raiffeisen Banka A.D.- Beograd	292	0.1	5	314	0.1	5	319	0.1	5	–	–
Erste Bank A.D.- Novi Sad	203	0.1	8	228	0.1	6	231	0.1	6	↑	–
Banka Poštanska štedionica A.D.- Beograd	220	0.1	6	203	0.1	9	228	0.1	7	↓	↑
Agroindustrijsko komercijalna banka AIK banka akcionarsko društvo, Beograd	207	0.1	7	208	0.1	8	224	0.1	8	↓	–
Vojvođanska banka a.d. Novi Sad	88	0.0	15	214	0.1	7	215	0.1	9	↑	↓
Eurobank A.D.- Beograd	170	0.0	9	175	0.0	10	177	0.0	10	↓	–

Source: NBS.

*ex Societe Generale banka Srbija A.D.- Beograd

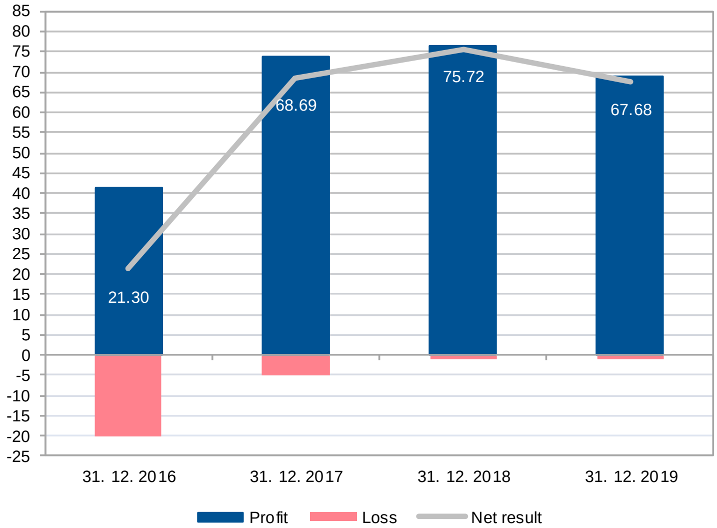
In terms of balance sheet assets, Banca Intesa a.d. Beograd remains the leading bank in Serbia; its market share edged up 0.1 pp from the previous quarter and 0.9 pp from the same period last year. In addition to Banca Intesa a.d. Beograd, the following banks had market shares above 10% as at 31 December 2019: Unicredit Bank Srbija a.d. Beograd (10.8%) and Komercijalna Banka a.d. Beograd (10.6%).

2. PROFITABILITY

2.1 Profitability indicators

The banking sector's net profit before tax in 2019 equalled RSD 67.7 bn, down by 10.6% compared to the result achieved at the end of 2018.

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

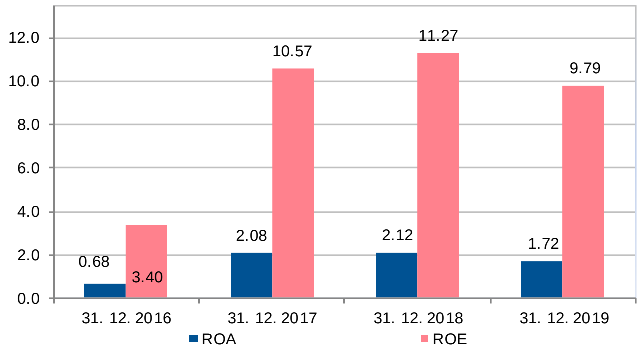


Source: NBS.

The structure of the net profit is as follows: 22 banks operated at a total profit of RSD 68.9 bn, while four banks accounting for 1.3% of the market share posted a negative financial result totalling RSD 1.2 bn. The profit and loss generating items of the banking sector were somewhat more concentrated than the balance sheet total: seven banks with the highest net profit together made up 84.5% of the total sector's profit, while two banks with the highest net losses accounted for almost 60% of the total losses.

Preserved profitability of the banking sector at end-2019 resulted in the following profitability indicators: ROA equalled 1.72% (2.12% at end-2018) and ROE 9.79% (11.27% at end-2018).

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



Source: NBS.

2.2 Structure of the results

In an environment of lending expansion, despite the downward trend in average interest rates and with the customary reliance of domestic banks on traditional credit-deposit business models, the main drivers behind the rising net profit were net interest and fee income.

Net interest income at end-2019 stood at RSD 128.8 bn, up 1.4% from 2018. This increase stems from the higher interest income (by RSD 3.7 bn) and the rise in interest expenses (by RSD 1.9 bn). At end-December 2019, the structure of interest income at banking sector level was diversified: 79.7% of interest income came from loans, 15.8% from securities and 1.9% from deposits. On the expense side, interest expenses from deposits had the highest share (76.1%), followed by those from loans (16.6%) and securities (2.7%).

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

(in RSD mn)

	Result	Net interest	Net fees	Net credit losses	Exchange rate effect
31. 12. 2019	67,684	128,785	42,084	-7,057	8,830
31. 12. 2018	75,716	126,960	40,375	-9,082	7,988
Change:	**-11%**	**1%**	**4%**	**-22%**	**11%**

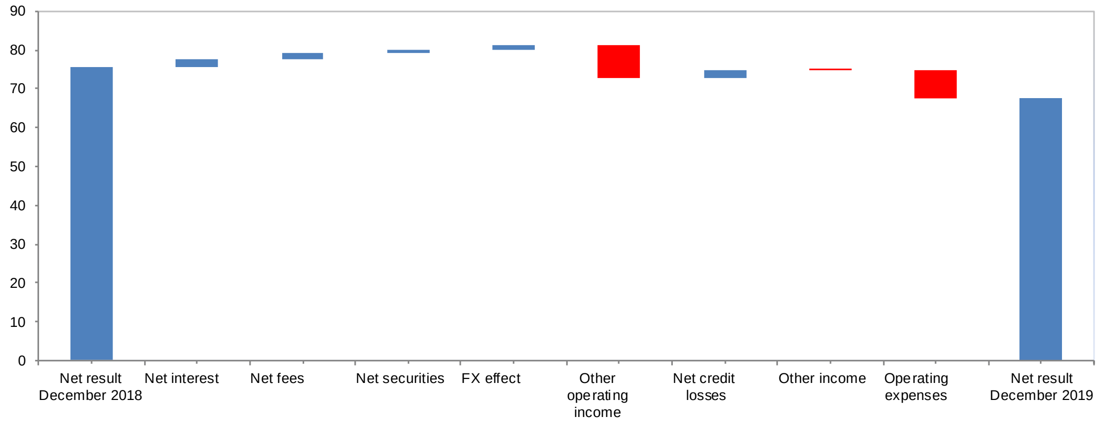
Source: NBS.

* Data for 30 September 2018 were changed compared to the previous report because one bank resubmitted its reports.

In the quarter observed, net fee and commission income increased by 4.2% or RSD 1.7 bn relative to 31 December 2018 due to the RSD 2.1 bn rise in the fee and commission income, while expenses on this account edged up slightly (RSD 0.4 bn). The most significant types of fee and commission income are those from: carrying out payment transactions (31.7%), payment cards (20.7%) and deposits (14.8%), whereas on the expense side, expenses from payment cards had the highest share (45.6%), followed by expenses from carrying out payment transactions (12.6%).

The net losses from the impairment of financial assets not carried at fair value through the income statement declined during 2019 and stood at RSD 7.1 bn, compared to RSD 9.1 bn in 2018.

Chart 2.2. **The structure of results**
(in RSD bn)



Source: NBS..

The decline in net losses on this account is mostly attributable to the fact that banks increased their net income due to the collection of previously written-off receivables to RSD 2.6 bn, while in 2018 net income on this account equalled RSD 1.1 bn. Net income was also recorded on account of the elimination of provisioning for off-balance sheet items in the amount of RSD 0.7 bn (in 2018 net expenses on this account measured RSD 0.2 bn). The indirect write-off of financial assets measured at amortised cost generated net expenses of RSD 10.5 bn, whereas in 2018 net expenses on this account equalled RSD 10.0 bn.

At end-2019, net income from securities rose RSD 1.0 bn from the year before and equalled RSD 3.5 bn.

The net effect of the dinar exchange rate fluctuations on the Serbian banking sector result at end-2019 was positive, resulting in net foreign exchange gains and currency clause effects of RSD 8.8 bn. Net exchange rate gains on FX receivables and liabilities equalled RSD 15.0 bn, while net exchange rate losses associated with the agreed FX currency clause came at RSD 6.2 bn.

Other operating income declined RSD 8.2 bn during 2019, mostly due to losses from the derecognition of financial instruments measured at amortised cost.

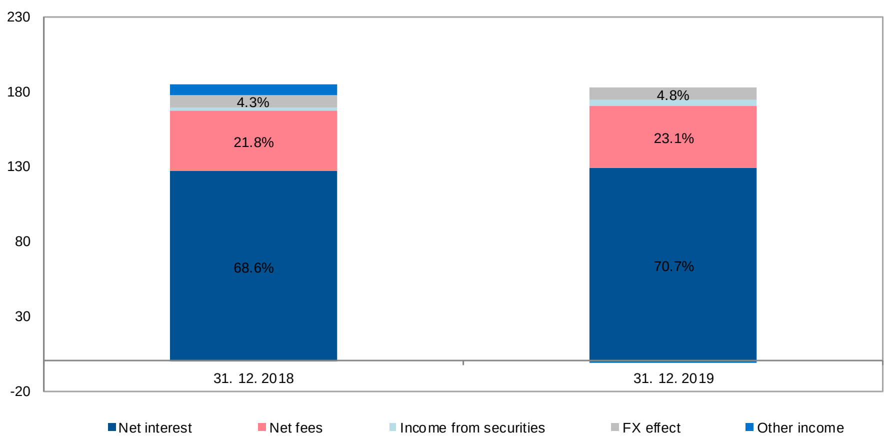
2.3 Operating income

During 2019, the banking sector's total net operating income stood at RSD 182.1 bn, down by 1.5% compared to the operating income in 2018.

The decrease was mostly the result of the implementation of the Law on the Conversion of Housing Loans Indexed to Swiss Francs.

The effect of the conversion of CHF-indexed housing loans into EUR-indexed loans was recorded with 15 banks. More than 50% of the conversion net effect pertains to four banks.

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

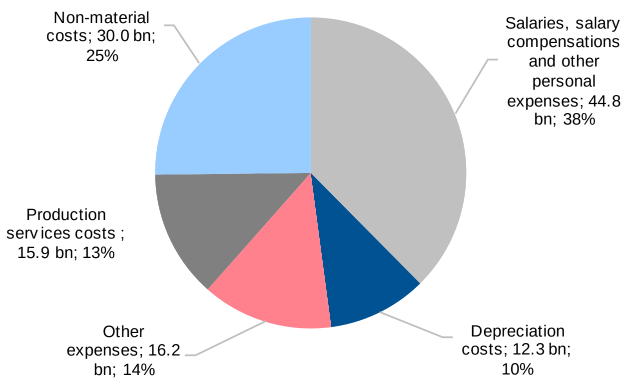


Source: NBS.

2.4 Operating expenses

The operating expenses of the Serbian banking sector in 2019 equalled RSD 119.2 bn, up by 6.4% relative to 2018. Operating expenses were recorded in all categories, mostly in depreciation expenses (by 73.3%) which account for 10.3% of operating expenses. Item Other expenses (accounting for 52.1% of operating expenses) increased 2.1% relative to the same period in 2018, while expenses relating to salaries, compensations and other personal expenses rose 1.5%, accounting for 37.6% of operating expenses.

Chart 2.4 **Structure of operating expenses**
31 December 2019



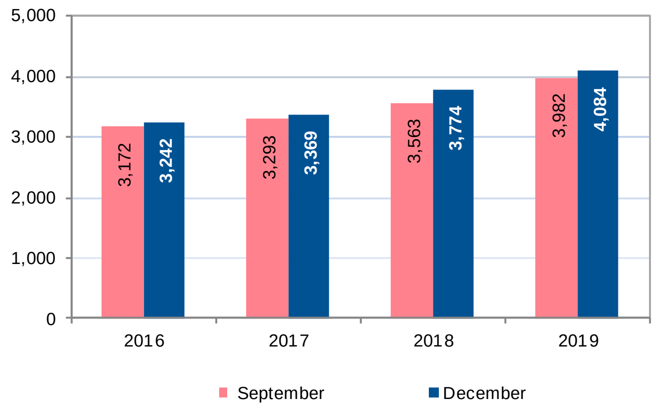
Source: NBS.

3. BANKING SECTOR ASSETS

3.1 Level and structure

Total net balance sheet assets of the Serbian banking sector at end-December 2019 equalled RSD 4,084.1 bn, indicating a q-o-q increase of RSD 102.2 bn or 2.6%.

Chart 3.1.1 **Banking sector's total net assets**
(in RSD bn)



Source: NBS.

Table 3.1 **Change in key asset items of the banking sector**

(in RSD mn)

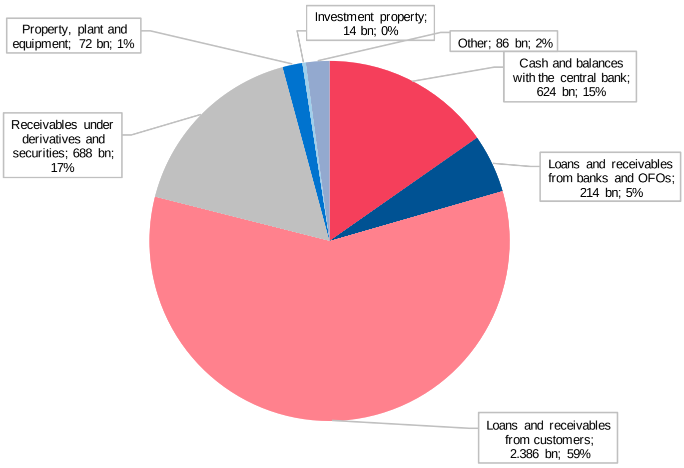
	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Cash and balances with the central bank	623,951	35,615	27,129	6.1%	4.5%
Loans and receivables	2,600,464	60,591	231,384	2.4%	9.8%
from banks and OFOs	214,345	-22,747	6,300	-9.6%	3.0%
from customers	2,386,118	83,337	225,084	3.6%	10.4%
Receivables under derivatives and securities [1)]	688,462	13,519	22,995	2.0%	3.5%
Property, plant and equipment	72,089	570	20,570	0.8%	39.9%
Investment property	13,624	-48	-23	-0.4%	-0.2%
Other	85,546	-8,093	7,983	-8.6%	10.3%
Total balance sheet	**4,084,136**	**102,153**	**310,038**	**2.6%**	**8.2%**

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

Source: NBS.

Loans and receivables (to banks and other clients) held a dominant share of 63.6% in banking sector net assets (as a result of banks' orientation towards traditional banking activities), and remained mostly unchanged q-o-q (63.8%). Other significant shares were that of item Securities (16.8%) and item Cash and balances with the central bank (15.3%). Banks' investments in securities were still mostly related to investment in government securities issued by the Republic of Serbia, which made this segment of banking sector investment highly secure.

Chart 3.1.2 **Structure of banking sector assets**
31 December 2019



Source: NBS.

Table 3.2 **Change in key balance and off-balance sheet asset items of the banking sector**

(in RSD mn, in%)

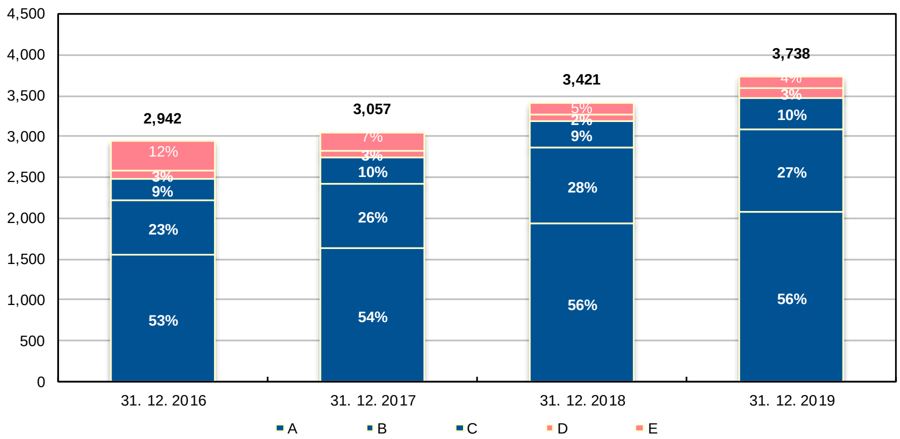
	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Balance sheet assets subject to classification	**2,675,506**	**46,548**	**175,236**	**1.8%**	**7.0%**
Short-term loans	352,755	9,202	6,803	2.7%	2.0%
Long-term loans	2,048,918	71,127	199,131	3.6%	10.8%
Receivables due	60,676	-8,418	-16,475	-12.2%	-21.4%
Deposits with banks	82,062	-4,366	-30,188	-5.1%	-26.9%
Off-balance sheet items subject to classification	**1,062,362**	**48,809**	**141,922**	**4.8%**	**15.4%**
Payable guarantees	117,827	893	3,997	0.8%	3.5%
Performance guarantees	259,772	22,428	42,145	9.4%	19.4%
Contingent liabilities	627,791	22,779	79,237	3.8%	14.4%

Source: NBS.

3.2 Classified assets

At end-December 2019, total classified assets (on- and off-balance sheet) equalled RSD 3,737.9 bn, up by RSD 95.4 bn or 2.6% q-o-q. Balance sheet assets subject to classification rose by RSD 46.5 bn and off-balance sheet items subject to classification by RSD 48.8 bn. Within balance sheet assets subject to classification, the most significant changes were recorded for long-term and short-term loans, which rose by RSD 71.1 bn and RSD 9.2 bn, respectively. When it comes to off-balance sheet items, the largest absolute increase was recorded in item Contingent liabilities – by RSD 22.8 bn. Long-term loans in balance sheet assets and contingent liabilities remained the most important items subject to classification (share of 76.6% and 59.1% in total classified balance / off-balance sheet items).

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



Source: NBS.

The most significant change in balance sheet assets subject to classification relative to a quarter earlier was an increase in balance sheet items from categories A and B by RSD 30.9 bn and RSD 15.2 bn respectively, primarily in long-term loans. The "worst" category E contracted by RSD 18.2 bn. Consequently, the share of the two worst categories declined by 0.3 pp, hence bad assets accounted for 8.1% of total classified balance sheet assets.

Table 3.2 **Change in key balance and off-balance sheet asset items of the banking sector**

(in RSD mn, in%)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Balance sheet assets subject to classification	**2,675,506**	**46,548**	**175,236**	**1.8%**	**7.0%**
Short-term loans	352,755	9,202	6,803	2.7%	2.0%
Long-term loans	2,048,918	71,127	199,131	3.6%	10.8%
Receivables due	60,676	-8,418	-16,475	-12.2%	-21.4%
Deposits with banks	82,062	-4,366	-30,188	-5.1%	-26.9%
Off-balance sheet items subject to classification	**1,062,362**	**48,809**	**141,922**	**4.8%**	**15.4%**
Payable guarantees	117,827	893	3,997	0.8%	3.5%
Performance guarantees	259,772	22,428	42,145	9.4%	19.4%
Contingent liabilities	627,791	22,779	79,237	3.8%	14.4%

Source: NBS.

Increase in total off-balance sheet items subject to classification was recorded for categories B and C (by RSD 22.60 bn and RSD 17.2 bn, respectively). The rise in the share of off-balance bad assets in total classified off-balance sheet assets from 3.6% to 4.0% is mainly attributable to increase in category D.

Assigned receivables amounted to RSD 6.4 bn in Q4 2019, down by RSD 4.8 bn than in Q3 2019, but also RSD 2.2 bn higher y-o-y (in Q4 2018 assigned receivables equalled RSD 4.2 bn). All RSD 6.4 bn worth of receivables in Q4 2019 were assigned to non-banking sector entities.

3.3 Loans[3]

In Q4 2019, gross loans of the Serbian banking sector recorded a nominal quarterly increase of RSD 66.9 bn or 2.9%, reaching RSD 2,456.9 bn.

[3] 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.

Table 3.3. **Change in the level of net loans**

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Finance and insurance	26,162	2,151	-1,244	9.0%	-4.5%
Public non-financial sector	115,174	10,532	17,192	10.1%	17.5%
Corporates	1,109,941	34,721	92,134	2.8%	9.1%
General government sector	39,220	4,102	14,568	11.7%	59.1%
Households	988,267	27,932	86,067	2.9%	9.5%
Foreign entities and foreign banks	38,162	-7,177	-20,544	-15.8%	-35.0%
Other sectors	139,958	-2,357	1,549	-1.7%	1.1%
Total loans	**2,456,884**	**69,904**	**189,722**	**2.9%**	**8.4%**

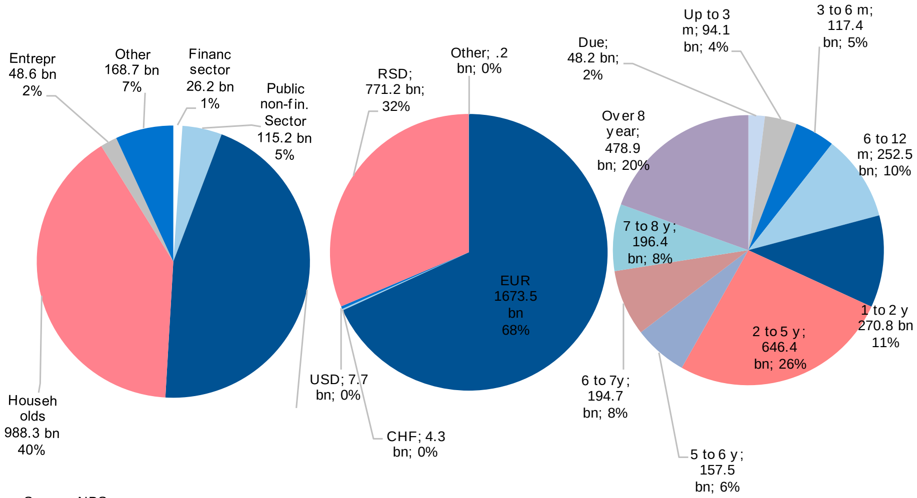
Source: NBS.

Gross lending growth was the most pronounced in the corporate (by RSD 34.7 bn or 2.8% q-o-q) and household segments (by RSD 27.9 bn or 2.9% q-o-q). Increase in corporate lending was recorded mostly on account of investment loans. As was the case earlier, the increase in loans to households is largely attributable to the rise in cash loans (mainly dinar ones), which recorded the highest share in total household loans – 49.1%, with a 6.0% growth rate in Q4 2019. Housing loans (the bulk of them FX-indexed) recorded an increase of RSD 11.6 bn and the growth rate of 3.0% (with the share of 40.5% in total household loans). Gross lending declined in nominal terms in the sectors of foreign entities and other legal entities.

The currency structure of the Serbian banking sector's loan portfolio is still dominated by foreign currency. At end-Q4 2019, FX and FX-indexed loans accounted for 68.6%. The prevalent currency of loan indexation in Serbia was the euro, with euro loans making up 68.1% in total loans (99.3% of total gross FX and FX-indexed loans), followed by USD and CHF loans at 0.3% and 0.2% (0.5% and 0.3% of total gross FX and FX-indexed loans, respectively). Compared to September 2019, gross USD and CHF loans declined 20.4% and 13.2%, respectively, in nominal terms.

At end-Q4 2019, dinar loans made up 31.4% of total gross loans. Observed by sector, household loans accounted for the bulk of dinar loans (57.9%), while the share of the general government sector was the smallest (8.4%), with the exception of foreign entities (0.9%). By loan category, dinar loans accounted for the major portion of cash and consumer loans (99.4% and 41.3% respectively), and the smallest share of investment and housing loans (9.0% and 0.3% respectively). Due to the prolonged upward trend of dinar cash loans, the share of cash loans in total loans equalled 19.7% at end-December 2019 (19.2% in September 2019).

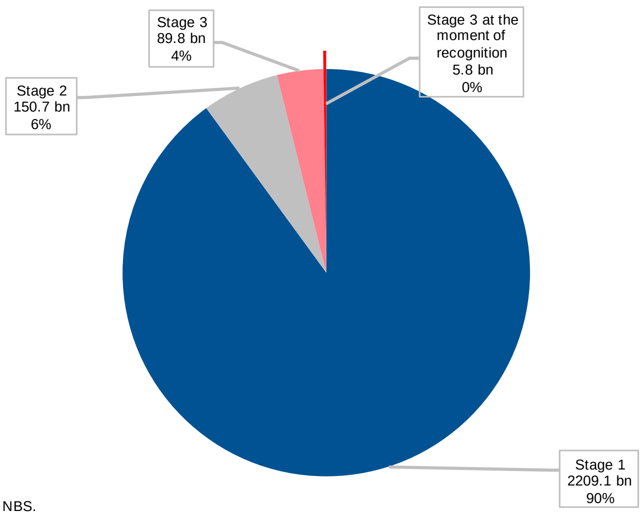
Chart 3.3 **Banking sector gross loan portfolio structure**
(in RSD bn)
(31 December 2019)



Source: NBS.

Observed by the remaining maturity, the structure of gross loans did not change significantly – the share of long-term gross loans increased (78.1% in September, 79.1% in December), while the shares of other categories declined. The share of short-term loans edged down (from 18.6% to 18.0%), as did the share of overnight loans (from 1.0% to 0.9%) and matured loans (from 2.3% to 2.0%).

Chart 3.3.1 **Gross loans structure by level of impairment**
(31 December 2019)



Source: NBS.

Since the start of implementation of IFRS 9 – Financial instruments on 1 January 2018 the NBS has been monitoring the effects of this standard in the area of classification, valuation and calculation method for impairment of financial instruments. According to data for Q4 2019, the prevailing share in the structure of gross loans is that of loans classified in Stage 1 (89.9%), while a significantly lower share was recorded for loans classified in Stage 2 and Stage 3 (6.1% and 3.7%, respectively).

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. Also, 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 the principal or interest is delayed 90 days or longer since the initial maturity;

- where 90 days of interest payments (or higher) have been attributed to the loan balance, capitalised, refinanced or delayed;

- 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.

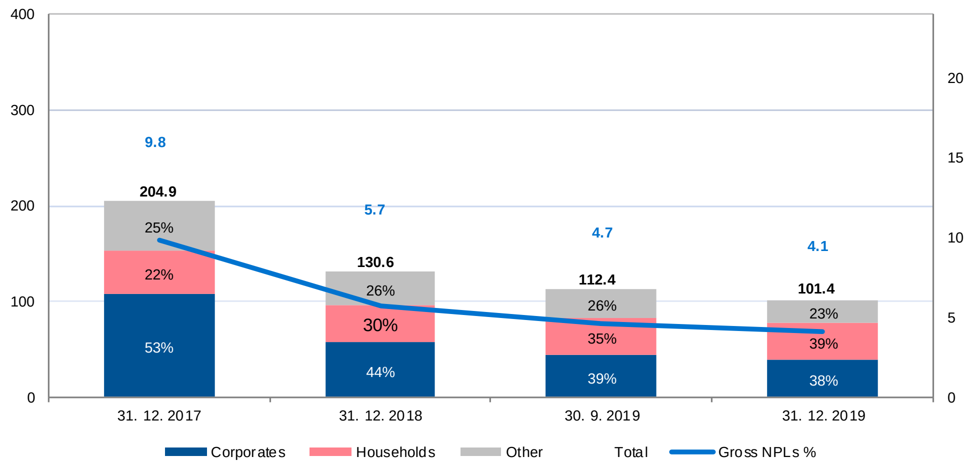
Gross NPLs

In Q4 2019, the banking sector's total gross NPLs decreased by RSD 11.0 bn to RSD 101.4 bn at end-December.

During this quarter, gross NPLs[4] saw a decline of RSD 1.7 bn on account of assignment and by RSD 10.3 bn on account of collection, while write-offs accounted for an additional reduction of RSD 9.9 bn. The banking sector's new gross NPLs in Q4 2019 amounted to RSD 11.8 bn.

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

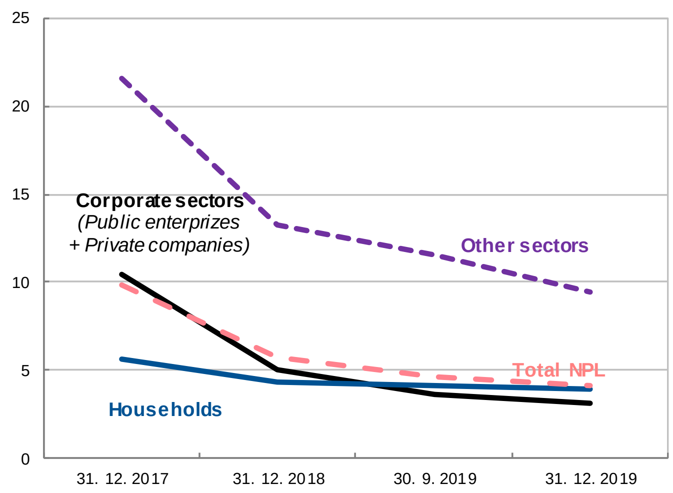
Chart 3.4.1 **Gross NPLs**
(in RSD bn)



Source: NBS.

The fall in gross NPLs by 9.7%, along with a rise in total loans by 3.0%, pushed the share of NPLs in total gross loans further down by 0.58 pp q-o-q, to 4.09%, which is their new historic low since the introduction of the uniform definition of a non-performing loan and mandatory reporting in 2008.

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



Source: NBS.

After declining by RSD 4.4 bn, the bulk of NPLs are still in the corporate segment (RSD 37.1 bn at end-December 2019). In addition to that, NPLs of companies in bankruptcy and other legal persons in bankruptcy stood at RSD 15.9 bn.

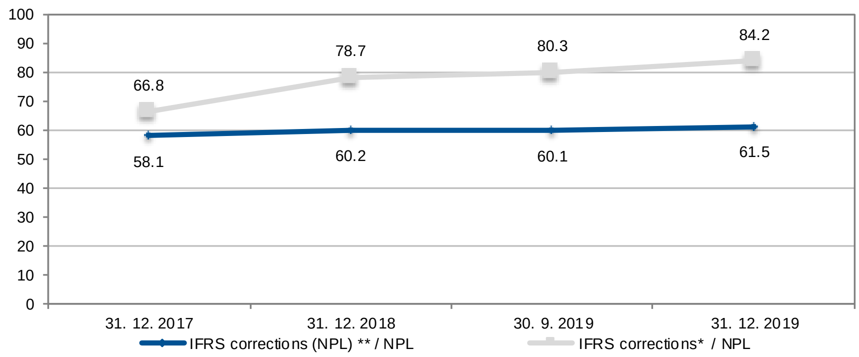
In the household sector, gross NPLs stood at RSD 39.0 bn, or 38.5% of total gross NPLs.

NPL coverage

At end-Q4 2019 the coverage of total gross NPLs with allowances for impairment, despite a high write-off amount, was kept relatively high at 61.5%.

The Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, among other things, repealed banks' obligation to calculate reserve for estimated losses which may be incurred on account of balance sheet assets and off-balance sheet items.

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



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

Source: NBS.

Corporate NPLs

At end-Q4 2019, gross corporate NPLs equalled RSD 37.1 bn, down by RSD 4.4 bn or 10.6% q-o-q, mainly due to: collection (RSD 3.4 bn), write-offs (RSD 1.1 bn), and assignment (RSD 1.1 bn).[5]

[5] 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**

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Agriculture	1,403	257	-484	22.4%	-25.7%
Manufacturing	15,085	-415	-4,416	-2.7%	-22.6%
Construction	4,471	-2,382	-5,302	-34.8%	-54.3%
Trade	6,444	-2,436	-3,141	-27.4%	-32.8%
Transport, hotels/restaurants, communications	3,438	587	268	20.6%	8.5%
Real estate	6,178	2	-2,967	0.0%	-32.4%

Source: NBS.

By sector, the biggest share in total corporate NPLs continued to be held by manufacturing (40.6%, with a 4.4% gross NPL ratio), followed by trade (17.4%, with a 1.9% gross NPL ratio), construction (12.0%, with a 3.8% gross NPL ratio) and real estate business (16.6%, with a 5.4% gross NPL ratio). During this quarter, the NPL ratio markedly declined in all sectors. The sharpest reduction was registered in construction (2.3 pp).

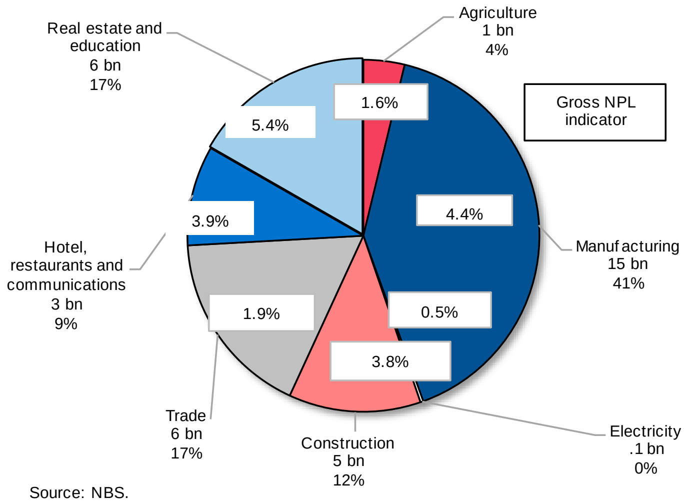
Table 3.4.2 **Gross corporate NPL ratio by sector**

(in %)

		Change relative to prior periods (pp)	
	31. 12. 2019	30. 09. 2019	31. 12. 2018
Agriculture	1.6%	0.2	-0.8
Manufacturing	4.4%	-0.1	-1.3
Construction	3.8%	-2.3	-6.6
Trade	1.9%	-0.8	-1.1
Transport, hotels/restaurants, communications	3.9%	0.5	-0.2
Real estate	5.4%	-0.5	-4.0

Source: NBS.

Chart 3.4.4 **Structure of corporate NPLs**
(31 December 2019)



Source: NBS.

Natural persons' NPLs[6]

Measuring 3.9% at end-Q4 2019, the share of gross NPLs of natural persons was continuously below the average of the total portfolio and 0.2 pp lower than at end-Q3.

At end-Q4 2019, natural persons' NPLs equalled RSD 43.7 bn, down by RSD 0.8 bn q-o-q. Cash loans recorded the most significant increase in NPLs (by 6.2%) at the rate of total cash loan growth of 4.0%. Their share in total gross loans to natural persons amounted to 46.2% at end-December 2019. At the same time, the share of cash loans in total NPLs to natural persons increased to 49.2% at end-December 2019 (45.5% in the previous quarter). The gross NPL ratio of cash loans stood at 4.2%, almost unchanged from 30 September 2019.

The category of housing construction loans accounted for 36.1% of total loans and 28.2% of total gross NPLs. The gross NPL ratio of these loans was 3.1%.

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

Table 3.4.3 **Changes in gross non-performing household loans by category**

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Housing loans	12,297	-1,968	-5,199	-13.8%	-29.7%
Cash loans	21,467	1,248	4,957	6.2%	30.0%
Credit cards	1,824	203	157	12.5%	9.4%
Current account overdrafts	1,715	0	-70	0.0%	-3.9%
Consumer loans	356	-32	-189	-8.3%	-34.7%
Other	5,996	-216	-911	-3.5%	-13.2%
Total	**43,655**	**-766**	**-1,256**	**-1.7%**	**-2.8%**

Source: NBS.

The highest gross NPL ratio in the natural persons' segment at end-December 2019 (7.8%) was recorded in the category of current account overdrafts (which accounted for 2.0% of total loans to natural persons and 3.9% of total NPLs of natural persons). The next were credit cards, with the ratio of 5.5% (making up 3.0% of total loans to natural persons and 4.2% of NPLs of natural persons), consumer loans with 4.7%, cash loans with 4.2% and housing loans with 3.1%.

Table 3.4.4 **Gross NPL ratio for households by category**

(in %)

		Change relative to prior periods (pp)	
	31. 12. 2019.	30. 09. 2019.	31. 12. 2018
Housing construction	3.1%	-0.6	-1.5
Cash loans	4.2%	0.1	0.4
Credit cards	5.5%	0.6	0.5
Current account overdrafts	7.8%	0.5	-0.1
Consumer loans	4.7%	0.8	1.4

Source: NBS.

When observing NPLs of natural persons in relation to allowances for their impairment, housing loans are a category with the lowest allowances for impairment (42.9% relative to gross NPLs), due to the generally much better collateral coverage. In current account overdrafts, consumer loans, credit cards and cash loans, allowances for impairment are much higher (70.8%, 68.2%, 66.5% and 66.1%, respectively).

Concentration risk

At end-2018, the NBS adopted regulatory measures aimed at preventing new NPLs and preserving financial stability as a response to unsecured non-purpose household loans with unreasonably long maturities. These measures cover cash, consumer and other household loans (with the exception of housing loans and current account overdrafts) with the repayment term of eight years or longer. In accordance with the Decision on Managing Concentration Risk Arising from Bank Exposure to Specific Products, concentration risk indicator was introduced as an additional regulatory and supervisory instrument of the NBS.

Concentration risk indicator is the ratio of household loans with contracted maturity longer than eight years (except for loans with top-class collateral, housing loans and current account overdrafts) and capital, increased by dinar liabilities whose remaining maturity is over five years. At end-Q4 2019, the concentration risk indicator of the Serbian banking sector was 15.67%, which is significantly below the prescribed 50% for the observed year and is a reduction of 2.5 pp compared to this indicator at end-September 2019. In the same period, the banking sector household credit exposure (loans with the maturity of more than eight years) was reduced by 12.3% (from RSD 117.6 bn to RSD 103.2 bn).

4. BANKING SECTOR LIABILITIES

4.1 Structure of the sources of funding

Deposits[7] were the primary source of bank funding in Serbia, making up 79.9% of total liabilities. This is followed by own funding sources which at end-Q4 2019 participated with 17.3% in liabilities, while loans received made up 6.0% of liabilities.

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

(in RSD mn, in %)

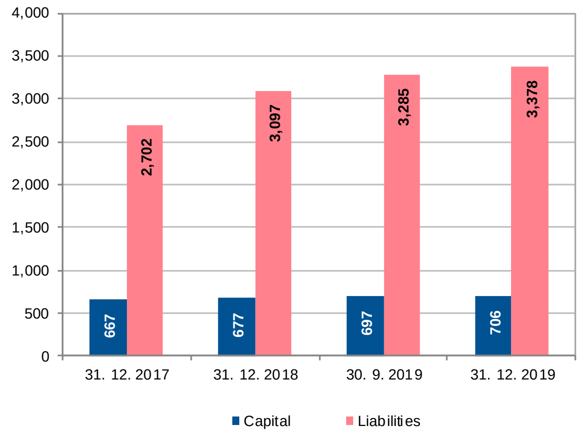
	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Deposits and other liabilities	3,262,112	107,197	252,602	3.4%	8.4%
to banks, OFOs and the central bank	*531,003*	*25,211*	*51,244*	*5.0%*	*10.7%*
to other clients	*2,731,109*	*81,986*	*201,358*	*3.1%*	*8.0%*
Liabilities arising from hedging derivatives	395	58	-165	17.1%	-29.5%
Subordinated liabilities	29,096	-1,990	-5,852	-6.4%	-16.7%
Provisions	13,199	2,133	1,731	19.3%	15.1%
Common Equity Tier 1 capital	388,919	3,000	-4,311	0.8%	-1.1%
Profit	101,542	1,850	3,402	1.9%	3.5%
Loss	24,743	-475	939	-1.9%	3.9%
Reserves and unrealised losses	240,025	3,780	30,885	1.6%	14.8%
Other	73,590	-14,350	32,685	-16.3%	79.9%
Total liabilities	**4,084,136**	**102,153**	**310,038**	**2.6%**	**8.2%**

Source: NBS.

Total liabilities of the banking sector rose by RSD 93.0 bn (or 2.8%) q-o-q. Increase in liabilities is mostly a result of the rise in item Deposits and other financial liabilities towards other clients by RSD 82.0 bn (3.1%) and in item Deposits and other financial liabilities towards banks, other financial organisations and the central bank by RSD 25.2 bn (5.0%).

[7] 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: NBS.

In Q4 2019, the total capital of the banking sector rose RSD 9.1 bn in nominal terms (1.3%), with a slight decrease in the share of capital in total balance sheet liabilities (from 17.5% to 17.3%). Within capital structure, the most significant changes were recorded for: reserves (up by RSD 3.8 bn), Common Equity Tier 1 capital (up by RSD 3.0 bn – on account bank recapitalisation) and profit (up by RSD 1.9 bn – mainly from the ongoing year).

In terms of the currency structure, Q4 2019 saw an increase in the share of dinar sources of funding (including capital), from 44.5% to 44.9%. As regards the FX and FX-indexed portion of liabilities, EUR-denominated liabilities remained dominant, making up 92.5% of total FX liabilities, while the rest were mostly liabilities in USD (4.6%) and CHF (2.1%).

4.2 Deposits

Total deposits with banks stood at RSD 2,963.0 bn at end-Q4 2019, up by RSD 114.4 bn (4.0%) q-o-q. The increase is mainly attributable to the rise in transaction deposits (by RSD 78.3 bn), mostly in the household (by RSD 37.2 bn) and corporate sectors (by RSD 36.0 bn). The main depositors are the household sector with 50.0% and the corporate sector with 26.8%.

At end-Q4 2019, dinar deposits rose RSD 72.0 bn, while FX deposits declined by RSD 42.4 bn. The share of FX and FX-indexed deposits in total deposits edged down from 65.9% to 64.8%. The EUR was the dominant currency, making up 91.5% of total FX and FX-indexed deposits. The rest of FX and FX-indexed deposits were mainly in USD (5.1%) and CHF (2.5%).

In terms of initial (agreed) maturity, demand deposits were still dominant (63.5%), followed by deposits maturing in up to one year (21.5%), while 15.0% 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 more than one half of all deposits (63.6%), followed by deposits with the remaining maturity of up to one year with 29.2%, while deposits with the remaining maturity of more than one year accounted for 7.0% of total deposits. Matured deposits made up 0.1% at end-Q4 2019.

Table 4.2 **Changes in deposit levels**

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Finance and insurance sector	86,612	1,827	7,816	2.2%	9.9%
Public non-financial sector	90,239	-6,485	-99,390	-6.7%	-52.4%
Corporate sector	794,051	58,086	110,405	7.9%	16.1%
General government sector	72,475	-2,841	32,918	-3.8%	83.2%
Households	1,481,211	55,898	152,122	3.9%	11.4%
Foreign entities and foreign banks	278,669	8,031	31,571	3.0%	12.8%
Other sectors	159,761	-133	-4,469	-0.1%	-2.7%
Total deposits	**2,963,018**	**114,384**	**230,974**	**4.0%**	**8.5%**

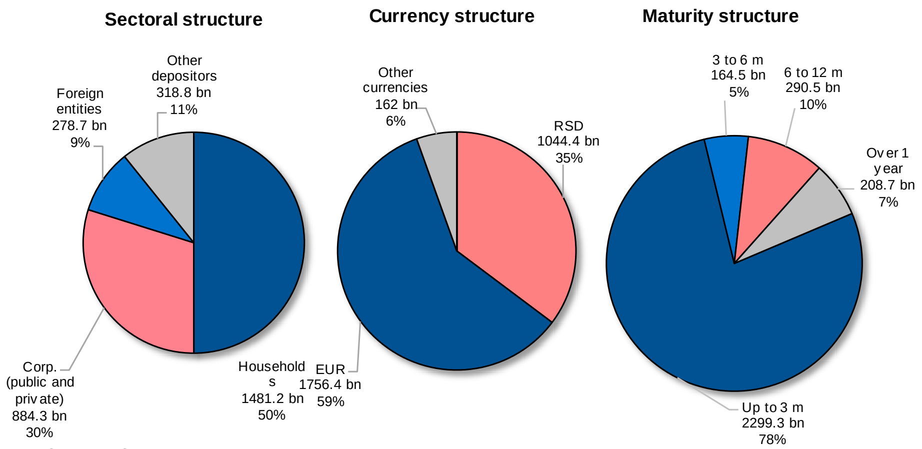
Source: NBS.

At end-Q4 2019, total household deposits in foreign currency equalled RSD 1,217.6 bn (up by 2.0% from end-Q3) and consisted mainly of savings deposits (60%) and transaction deposits (37.7%).

Compared to the end of the previous quarter, household savings deposits[8] went up RSD 16.4 bn (2.1%), coming at RSD 802.9 bn at end-Q4 2019. This increase is mostly attributed to the rise in savings deposits in FX (by RSD 11.0 bn), hence FX savings remained dominant in total household savings deposits, accounting for 91.1%. On the other hand, with an 8.9% share in total savings deposits of households, dinar savings maintained extremely dynamic growth and record-high levels, posting an increase of RSD 5.5 bn during the quarter. Compared to end-2018, growth in dinar savings equalled RSD 18.5 bn (30.3%), which is the most vibrant growth since 2013.

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

Chart 4.2 **Structure of banking sector deposits**
(31 December 2019)



Source: NBS.

4.3 Total borrowing of banks

Total credit borrowing of the banking sector stood at RSD 293.1 bn at end-Q4 2019, down by RSD 6.4 bn (2.2%) q-o-q.

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

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
REPO	2,103	1,145			
Overnight loans	34,207	-17,720	-13,801	-34.1%	-28.7%
Loans received	245,095	10,610	31,839	4.5%	14.9%
Other financial liabilities	11,658	-478	1,018	-3.9%	9.6%
Total borrowing	**293,063**	**-6,443**	**21,159**	**-2.2%**	**7.8%**

Source: NBS.

The largest individual item in total credit borrowing were loans taken (primarily from international financial institutions and foreign entities), making up 83.6% (end of the previous quarter: 78.3%) and rising RSD 10.6 bn q-o-q in nominal terms. The next largest item were liabilities under overnight loans which accounted for 11.7% (end of the previous quarter: 17.3%), after a decline of RSD 17.7 bn in Q4. Other financial liabilities made up 4.0% (end of the previous quarter: 4.1%), having decreased by RSD 0.5 bn.

In this segment, the biggest creditors of banks were foreign persons with 78.7% (primarily extraterritorial organisations and bodies) and the general government sector with 12.8% (primarily government bodies and organisations). The dominant currency of borrowing was the euro, accounting for RSD 266.2 bn (end of the previous quarter: RSD 262.8 bn) or 90.8% of total credit borrowing. Liabilities in dinars stood at RSD 22.1 bn (end of the previous quarter: RSD 34.3 bn) or 7.5% of total credit borrowing, while banks owed RSD 3.9 bn and RSD 0.5 bn in USD and CHF, respectively (end of the previous quarter: RSD 1.9 bn and RSD 0.3 bn, respectively), or 1.3% and 0.2% of total credit borrowing, respectively.

4.4 External liabilities

At end-Q4 2019, banks' total external liabilities under credit operations stood at RSD 230.8 bn, up by RSD 11.8 bn (5.4%) q-o-q. The increase was recorded with loans received (by RSD 13.0 bn) and other financial liabilities (RSD 1.2 bn), while liabilities under overnight loans declined RSD 2.4 bn.

Table 4.4 **Changes in bank external borrowing**

(in RSD mn, in %)

		Change relative to prior periods			
	Amount	Nominal		Relative	
	30. 09. 2019	30. 06. 2019	31. 12. 2018	30. 06. 2019	31. 12. 2018
Overnight loans	12,285	-2,364	-15,110	-16.1%	-55.2%
Loans received	214,377	12,953	33,119	6.4%	18.3%
Other financial liabilities	4,124	1,171	1,531	39.6%	59.1%
Total borrowing	**230,786**	**11,761**	**19,540**	**5.4%**	**9.2%**

Source: NBS.

This segment remained highly concentrated, given that of the 14 banks which borrowed externally (the largest item with the 92.9% share in total external debt), five banks accounted for over 77.0% of the total debt. Also, overnight foreign loans were recorded for two banks only, with one bank having around 94%.

Long-term loans held a dominant 79.0% share in the maturity structure of external borrowing (at the end of the previous quarter: 79.6%), i.e. 40.9% of all borrowings were extended with the maturity of over five years.

External borrowing was primarily euro-denominated – 97.3%, unchanged from the quarter before (97.7%), while RSD and USD borrowing accounted for 2.4% and 0.1% respectively.

4.5 Subordinated liabilities

Total subordinated liabilities of banks in Serbia reached RSD 29.0 bn at end-Q4 2019, posting a RSD 1.8 bn decrease relative to end-Q3.

In terms of creditors, total subordinated liabilities were structured in the following manner: liabilities to foreign banks accounted for 48.3%, liabilities to foreign legal persons – 49.6% and liabilities to corporates – 2.1%.

The currency structure was as follows: the share of subordinated liabilities in euros increased to 97.9%, liabilities in Swiss francs were none, liabilities in dinars made up 1.6%, and the remaining 0.5% were in roubles.

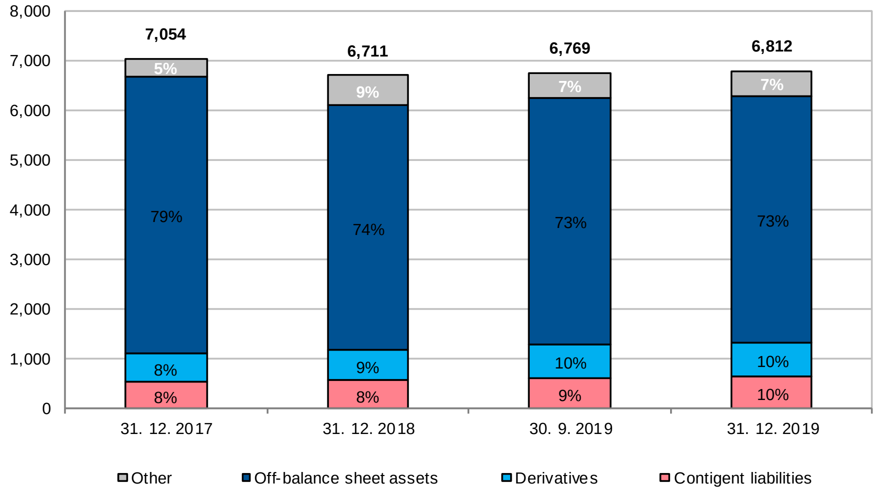
Subordinated liabilities were highly concentrated – of the 12 banks with subordinated debt, one bank accounted for over 32% of all subordinated liabilities, and the top four banks made up around 69% of total subordinated liabilities.

Given the regulatory restrictions on the inclusion of subordinated liabilities in Tier 2 and/or regulatory capital, banks included 82.9% of stated subordinated debt in their Tier 2 capital.

5. OFF-BALANCE SHEET ITEMS

At end-Q4 2019, total off-balance sheet items of the banking sector stood at RSD 6,811.7 bn, rising by 0.6% from the end of the previous quarter, mostly on account of an increase in Issued guarantees and other sureties (by RSD 23.5 bn) and Irrevocable commitments regarding undisbursed loans and placements (RSD 22.9 bn). Within item Other off-balance sheet assets, whose 73.1% made up the bulk of total off-balance sheet, the biggest increase was recorded in Other off-balance sheet assets (RSD 55.1 bn). Other important off-balance sheet items are Derivatives with a 9.8% share, and Issued guarantees and other sureties with a 5.7% share, and a 6.2% increase in the observed period.

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



Source: NBS.

As of 1 January 2018, the amendments and supplements to the Chart of Accounts introduced two new accounts for disclosing written-off financial assets, which were carried over 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-Q4 2019, the banking sector disclosed RSD 209.0 bn on these accounts, down by RSD 0.8 bn or 0.4% q-o-q.

Risk-free items still accounted for the bulk (84.4%) 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 2019, the classified part of off-balance sheet items (i.e. which is considered risk-bearing) amounted to RSD 1,062.3 bn (an increase by RSD 48.9 bn or 4.8%).

At end-Q4 2019, contingent liabilities equalled RSD 656.7 bn (up by RSD 46.2 bn or 7.6% q-o-q), making up 9.6% of total off-balance sheet items (9.0% at end-September 2019).

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

(in RSD mn, in %)

	Amount	Change relative to prior periods			
		Nominal		Relative	
	31. 12. 2019	30. 09. 2019	31. 12. 2018	30. 09. 2019	31. 12. 2018
Issued guarantees and other sureties	389,968	23,545	46,559	6.4%	13.6%
Receivables from derivatives	670,853	-23,359	52,975	-3.4%	8.6%
Contingent liabilities and other irrevocable comn	266,731	22,546	51,606	9.2%	24.0%
Securities received as collateral	53,079	2,833	-153,220	5.6%	-74.3%
Sureties for liabilities	126,511	-2,342	17,229	-1.8%	15.8%
Written-off financial assets	209,034	-789	910	-0.4%	0.4%
Other off-balance sheet assets	4,978,609	11,619	37,807	0.2%	0.8%
Other	116,921	8,274	46,664	7.6%	66.4%
Total off-balance assets	**6,811,706**	**42,328**	**100,531**	**0.6%**	**1.5%**

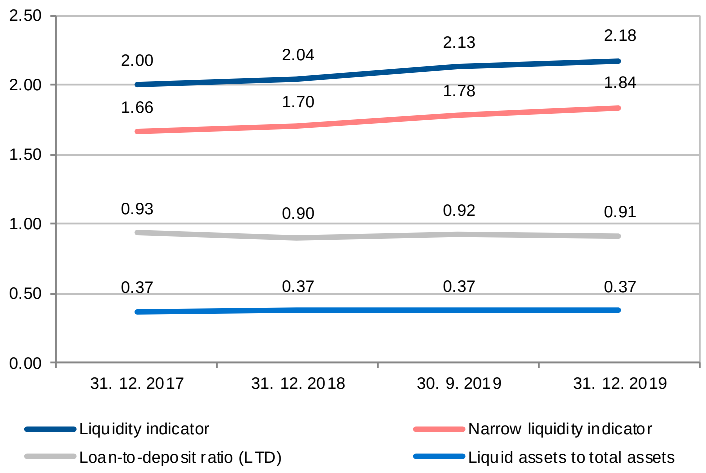
Source: NBS.

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 2019, the average monthly liquidity ratio was 2.18, twice higher than the regulatory floor of 1.0. The narrow liquidity ratio at banking sector level measured 1.84 (regulatory floor – 0.7). The share of liquid assets in total banking sector balance sheet assets is stable, reaching 37.3% at end-Q4 2019.

At end-Q4 2019, banks' investments in NBS repo transactions remained unchanged relative to September 2019 (RSD 70.0 bn), while the number of banks which invested in repo transactions decreased (eight banks). As for government securities, their portfolio increased to RSD 665.0 bn at end-December 2019, up by 3.2% from end-September.

Chart 6.1 **Banking sector liquidity indicators**



Source: NBS.

To further strengthen the resilience of the banking sector,[9] 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 December 2019, the liquidity coverage ratio at the banking sector level measured 199.3%.

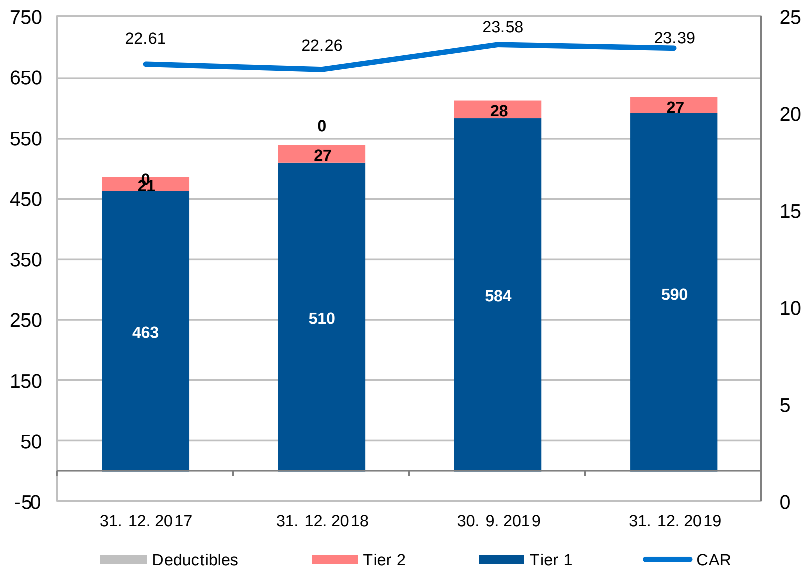
[9] The Decision on Liquidity Risk Management was adopted in December 2016 as part of the implementation of the Strategy for Introduction of Basel III Standards in Serbia.

7. CAPITAL ADEQUACY

The Serbian banking sector is well-capitalised, both from the aspect of compliance with the prescribed capital adequacy ratio,[10] and in terms of the structure of regulatory capital. At end-December 2019, the capital adequacy ratio of the Serbian banking sector averaged 23.39% (23.58% in September 2019). This is well above the NBS regulatory minimum (8%).

At end-December 2019, the Tier 1 capital ratio of the Serbian banking sector averaged 22.37% (vs. 22.51% in September 2019), and Common Equity Tier 1 capital ratio – 22.31% (vs. 22.45% in September 2019).

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



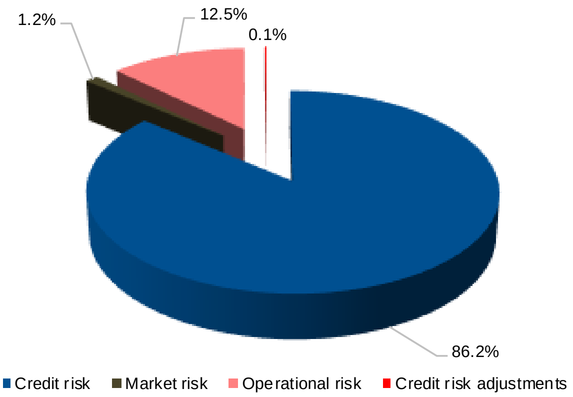
* CAR = Regulatory capital adequacy ratio

Source: NBS.

[10] 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 minimum prescribed capital adequacy ratio was reduced 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 faster than capital in Q4 2019 (1.7% vs. 0.9%, respectively), capital adequacy ratio decreased slightly (by 0.19 pp). The RSD 44.2 bn increase in risk-weighted assets was due to credit risk-weighted assets rising by RSD 35.0 bn. The rise in credit risk-weighted assets was primarily attributable to mortgage-backed exposures. Market-risk weighted assets increased (by RSD 2.2 bn), primarily with regard to the pricing risk in debt securities (by RSD 1.7 bn), whereas in terms of operational risk exposure and exposure to the credit valuation adjustment risk it rose by RSD 6.3 bn and RSD 0.7 bn, respectively.

Chart 7.2 **RWA by risk type**
(in %)
(31 December 2019)



Source: NBS.

In the structure of risk-weighted assets, the dominant share referred to credit risk (86.2%), taking into account banks' traditional business models which include reliance on lending to corporates and households. Next was operational risk with a share of 12.5%, while the shares of market risks and credit valuation adjustment risk were negligibly low – 1.2% and 0.1%, respectively.

In Q4 2019, the share of regulatory capital increased by 0.9% (in absolute amount: RSD 5.3 bn), while a growth rate of 14.8% was recorded for the whole of 2019. Regulatory capital of the banking sector at the end of the reporting quarter in 2019 equalled RSD 616.7 bn.

The increase in regulatory capital is mainly attributable to a rise in revaluation reserves. This item increased RSD 3.4 bn.

At end-Q4 2019, Tier 1 capital of the banking sector[11] stood at RSD 590.0 bn, up

[11] 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.

by 1.1% (or RSD 6.2 bn) from September 2019. Tier 2 capital of the banking sector edged down by RSD 0.9 bn (3.2%) relative to end-Q3 and equalled RSD 26.7 bn on account of a RSD 0.9 bn decrease in subordinated liabilities included in Tier 2 capital.

Regulatory capital consists of: Tier 1 capital, which made up 95.7%, and Tier 2 capital, measuring 4.3%. 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%).

The package of regulations which the NBS adopted at end-2018 also prescribed an obligation to maintain a certain level of capital depending on household credit risk[12] in terms of purpose, availability of collateral, ability for repayment bearing in mind total indebtedness and justifiability of payment term depending on loan purpose or lack of specific purpose. Amendments to the Decision on Capital Adequacy of Banks prescribed new deductibles from Common Equity Tier 1 capital in the event: that 60% debt-to-income ratio has been exceeded, loan with payment term of eight years or longer has been approved (for 2019, or seven years for 2020 and six years for 2021) and in the event of granting a consumer loan for the purchase of motor vehicles whose contracted payment term is eight years or longer. As of 31 December 2019, banks disclosed an amount of RSD 9.3 bn as a deductible from Common Equity Tier 1 on this account.

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. As at 31 December 2019, the leverage ratio at banking sector level measured 13.55%, reflecting the stable upward trend of this ratio since its introduction.

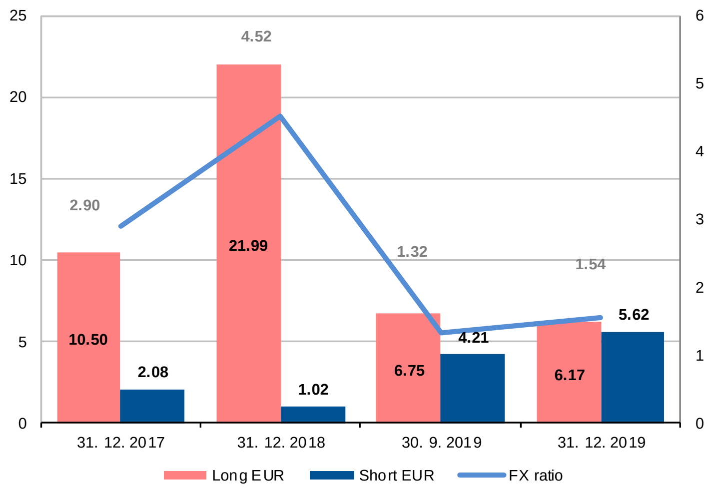
8. FOREIGN EXCHANGE RISK

At end-Q4 2019, Serbia's banking sector posted a long open FX position worth RSD 9.4 bn (excluding the position in gold). Thirteen banks ended December 2019 with a net long open FX position, while the remaining thirteen banks showed a net short open FX position.

On 31 December 2019, banks in Serbia operated at net long open positions in euros and US dollars (RSD 6.17 bn and RSD 0.84 bn, respectively), and a net short open position in Swiss francs (RSD 0.35 bn).

[12] Consumer, cash or other loan (which is not a housing loan, or current account overdraft).

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: NBS.

At end-December 2019, the foreign exchange risk ratio for the banking sector equalled 1.54%, indicating a relatively low foreign exchange risk compared to the regulatory cap (20% of banks' capital).

9. NBS REGULATORY ACTIVITY

In December 2019, the NBS Executive Board adopted amendments to the Decision on Capital Adequacy of Banks and to the Decision on Risk Management by Banks. These decisions established new rules for banks, aimed at changing the currency structure of lending by increasing the share of dinar in total loans and creating an environment conducive to more favourable corporate lending in dinars, especially to SMEs.

The novelty introduced by the Decision Amending the Decision on Capital Adequacy by Banks is the incentive to banks for dinar lending (without a currency clause) and all other dinar exposures to micro, small and medium-sized enterprises, entrepreneurs and farmers. As soon as 1 January 2020, banks may utilise this incentive for dinar lending and all other exposures to micro, small and medium-sized enterprises, entrepreneurs and farmers (which implies that the amount of credit risk-weighted assets under dinar exposure to an SME, an entrepreneur or a farmer, is multiplied by a deduction factor of 0.7619 if the prescribed conditions have been met).

An additional novelty introduced by these amendments aims to encourage dinar lending by introducing measures to discourage the approval of new non-purpose and non-investment FX-indexed and FX loans to companies, entrepreneurs and farmers. Namely, the maximum percentages of these loans have been introduced, and if a bank exceeds these maximum levels, it will be subject to capital reduction. Apart from gradualness, this measure is also characterised by the absence of any form of lending prohibition, given that there are still no obstacles for a bank to approve a non-purpose and non-investment loan with the agreed currency clause or a loan in foreign currency to any client, provided that it maintains an appropriate level of capital after that, i.e. that at any point it has sufficient own funds to meet all regulatory requirements.

The Decision Amending the Decision on Risk Management by Banks specifies the supervisor's requirements from banks in the context of the management of risks arising from a bank's exposure in dinars with a currency clause and exposure in a foreign currency, from the level of the risk management strategy, through risk management policies to the procedure level. Among other, the amendments envisage a bank's obligation to have a strategy defining acceptable and target levels of these exposures in terms of both total exposures and by exposure type. They also defined hedging against exchange rate risk resulting from the currency mismatch between the currency of the borrower's income and the currency of his obligations under the loan, and introduced provisions whose implementation would obligate banks to continually undertake activities towards lowering the share of exposures without the natural and financial hedge.

Both regulations were published in the RS Official Gazette, No 88/2019.