10 June 2021

# EXPLANATION OF THE COUNTERCYCLICAL CAPITAL BUFFER RATE FOR THE REPUBLIC OF SERBIA

Pursuant to Article 14, paragraph 1, item 11) of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015 – CC decision and 44/2018) and Section 436 of the Decision on Capital Adequacy of Banks (RS Official Gazette, Nos 103/2016, 103/2018, 88/2019, 67/2020, 98/2020, 137/2020 and 59/2021, hereinafter: Decision on Capital Adequacy), the NBS Executive Board, at its meeting of 10 June 2021, decided to keep the countercyclical capital buffer rate for the Republic of Serbia at 0% having in mind that the estimated real credit-to-GDP ratio is mildly below its long-term trend and that global uncertainty caused by the spread of the coronavirus persists.

The countercyclical capital buffer (hereinafter: CCyB) is additional Common Equity Tier 1 capital that banks are obligated to maintain above the prescribed regulatory minimum in the amount equal to their risk-weighted assets multiplied by the specific countercyclical buffer rate. This instrument mitigates the cyclical dimension of systemic risk, given that it creates an additional buffer of Common Equity Tier 1 capital during periods of excessive credit growth, which can be released when systemic risks materialise.

The National Bank of Serbia (NBS) sets the CCyB rate for the Republic of Serbia on a quarterly basis, taking into account the reference guide, applicable guidelines and recommendations of the European Systemic Risk Board and other variables it considers relevant for monitoring the cyclical dimension of systemic risk. In accordance with Section 436, paragraphs 2 and 3 of the Decision on Capital Adequacy, the guide for setting the CCyB rate is the deviation of the share of loans in GDP from long-term trend (credit-to-GDP gap). The CCyB rate for the Republic of Serbia is set in line with the recommendation for setting the CCyB rate of the European Systemic Risk Board (ESRB/2014/1).

Chart 1 shows the share of credit to the non-government sector in GDP[1], the long-term trend and the estimated credit-to-GDP gap. After a period of credit expansion from 2000 to 2008, in late 2009 credit-to-GDP gap entered the negative territory. The data for March 2021 show that the share of real credit activity in real GDP was slightly below its long-term trend (gap value of

[1]The Statistical Office of the Republic of Serbia has revised the GDP data series starting from 2005 and uses 2015 as the benchmark year for the purposes of calculating the real GDP deflator.

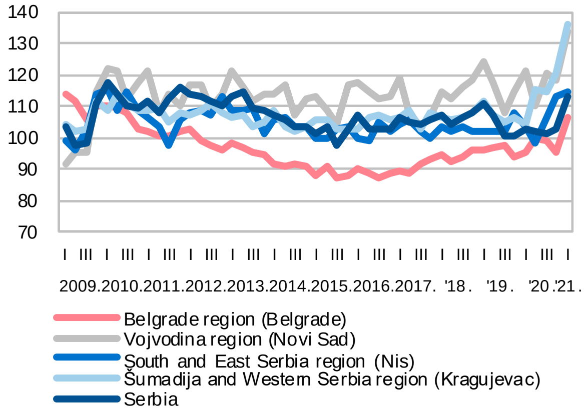
-0.3 pp), while the total credit-to-GDP ratio equalled 80.5%. Credit activity has been on the rise since 2014 and, as a result, in Q1 2021 the share of total loans in GDP came closer to its long-term trend. The change in the gap relative to end-2014 equals 17.2 pp, or 4.6 pp y-o-y. Having in mind that the gap is slightly below its long-term trend, as well as persisting global uncertainty caused by the spread of the coronavirus, setting the CCyB rate above 0% at this point in time could affect the potential future growth in lending.

In the prior period the NBS adopted a number of measures in response to the pandemic–induced crisis, including two moratoria available to all users of bank loans and financial leasing, as well as measures encouraging banks to offer to borrowers loan refinancing by extending the repayment term by two years. In December 2020, the NBS adopted, inter alia, a decision on additional facilities, obligating banks and financial lessors to approve debt repayment facilities to borrowers who are unable or likely to be unable to settle their obligations due to pandemic-related circumstances, at such borrowers' request. The NBS's well-timed and adequate measures supplied additional dinar and FX liquidity to the domestic financial sector, ensuring continued smooth lending to domestic businesses and citizens.

The results of the NBS bank lending survey carried out in April show that in Q1, for the first time since the outbreak of the pandemic, banks eased their corporate credit standards. The standards were eased somewhat more for dinar than for FX-indexed loans, and more for SMEs than for large enterprises, reflecting in part the NBS monetary policy easing and approval of loans under the Guarantee Scheme. Having eased in the previous quarter, overall household credit standards remained unchanged in Q1.

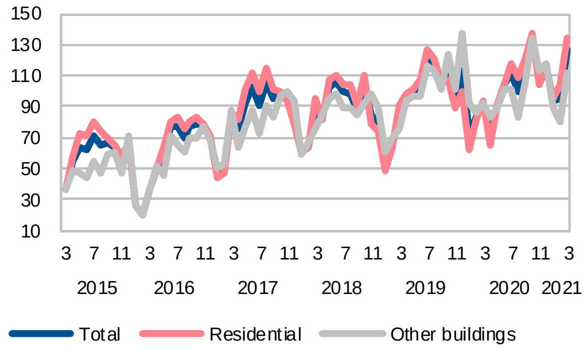
To set the CCyB rate for the Republic of Serbia, in addition to the credit-to-GDP gap, other optional indicators are also taken into account in accordance with Section 436, paragraph 4 of the Decision on Capital Adequacy. The optional indicators for monitoring lending activity illustrate the characteristics of the domestic financial system, and relate to the real estate market, external imbalance and banking sector developments.

Chart 2 **Real estate index DOMex**
(index, average 2002 - 2010 = 100)




Source: National Mortgage Insurance Corporation.

Chart 3. **Indices of the number of newly issued building permits**
(index, 2020 = 100)




Source: Statistical Office of the Republic of Serbia.

## Real estate market

According to data of the Republic Geodetic Authority, in 2020 the average price of old flats in the Republic of Serbia measured EUR 1,000 per m$^2$, while that of new flats was EUR 1,335 per m$^2$. According to the National Mortgage Insurance Corporation data, the average estimated value of residential real estate in the Republic of Serbia measured EUR 866 per m$^2$ in Q4 2020. Q1 2021 saw an increase in the total number of issued permits for new construction by 27.1% y-o-y. The average LTV ratio of newly approved housing loans is slightly above the regulatory maximum of 80%,[2] amounting to 80.65% in Q1 2021.[3]

According to the April bank lending survey, household demand for loans, particularly for FX-indexed housing loans, increased in Q1. Real estate purchases were among the key drivers of elevated loan demand of households.

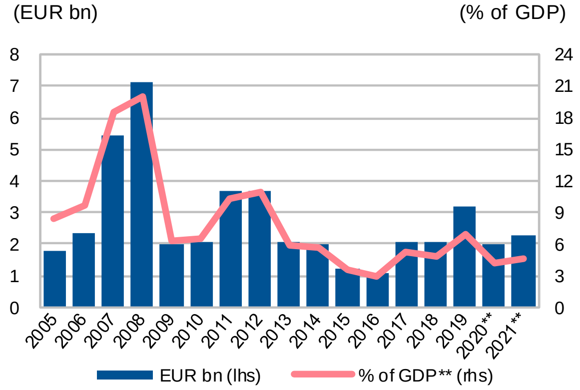
[2] In accordance with the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System (RS Official Gazette, Nos 34/2011 and 114/2017), a mortgage loan may be approved to a natural person if the loan amount does not exceed 80% of the value of the property mortgaged. By way of exception, a bank may approve a mortgage loan to a natural person provided that the amount of such loan does not exceed 90% of the value of the property mortgaged as determined by a certified valuer and reduced by the amount of other receivables secured by first-rank mortgage over the same property, if the loan is approved as a government-support measure for certain groups of natural persons. The Decision Amending the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System (RS Official Gazette, No 84/2020) allowed for a reduced downpayment required for the approval of housing loans to first-time home buyers. Under this regulation, for the purchase of the first residential property, a bank may approve a mortgage-backed housing loan to a natural person provided that the amount of such loan does not exceed 90% of the value of such mortgaged property.

[3] According to the data of the National Mortgage Insurance Corporation for new loans insured with that Corporation.

### Indicators of external imbalance

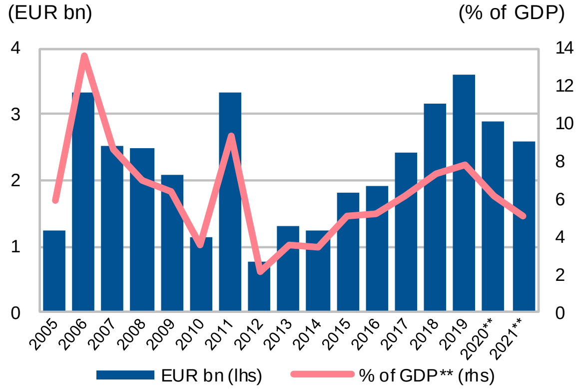
Despite the deteriorating epidemiological situation and extended containment measures at home and abroad, FDI inflows to Serbia measured EUR 959.7 mn in Q1, up by 18.7% y-o-y. Investments were mostly channelled into tradable sectors. A faster recovery in exports than imports resulted in a first-time quarterly current account surplus of EUR 159 mn in Q1.

Chart 4. **Current account deficit***




*Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM6.
** NBS estimate, May 2021
Source: Statistical Office of the Republic of Serbia and NBS.

Chart 5. **Net foreign direct investments***




*Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM6.
** NBS estimate, May 2021
Source: Statistical Office of the Republic of Serbia and NBS.

### Main banking sector indicators

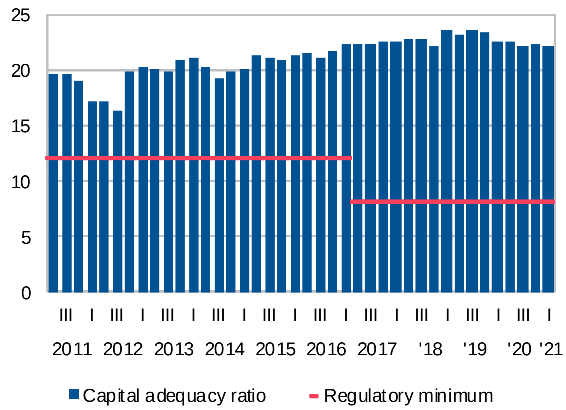
Despite the pandemic, the banking sector remained adequately capitalised and highly liquid, and is likely to remain so in the coming period.

At end-Q1 2021 CAR stood at 22.3%, significantly above the regulatory minimum.[4]

At end-Q1 2021, the loan-to-deposit (LTD) ratio measured 0.81. This indicator at levels below 1 suggests that banks largely rely on domestic, stable sources of funding, such as deposits.

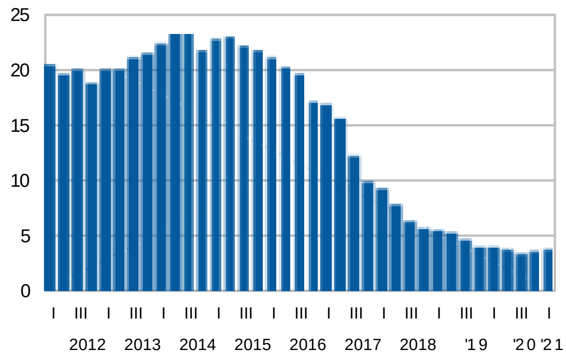
[4] Since 30 June 2017, the minimum CAR is 8% (minimum Tier 1 capital is 6% and minimum Common Equity Tier 1 capital is 4.5%).

Chart 6. **Capital adequacy ratio**
(y %)




Source: NBS.

Chart 7. **Non-performing loans**
(share in total gross loans, %)




Source: NBS.

The share of NPLs in total banking sector loans decreased significantly and displays an evident downward trend owing to the implementation of the NPL Resolution Strategy, adopted in August 2015, as well as other regulatory activities of the NBS. The NPL ratio equalled 3.9% at end-Q1 2021, down by 0.2 pp relative to Q1 2020, or by 18.4 pp relative to August 2015, when the Strategy was adopted.

**Assessment of systemic risk of the Serbian financial system**

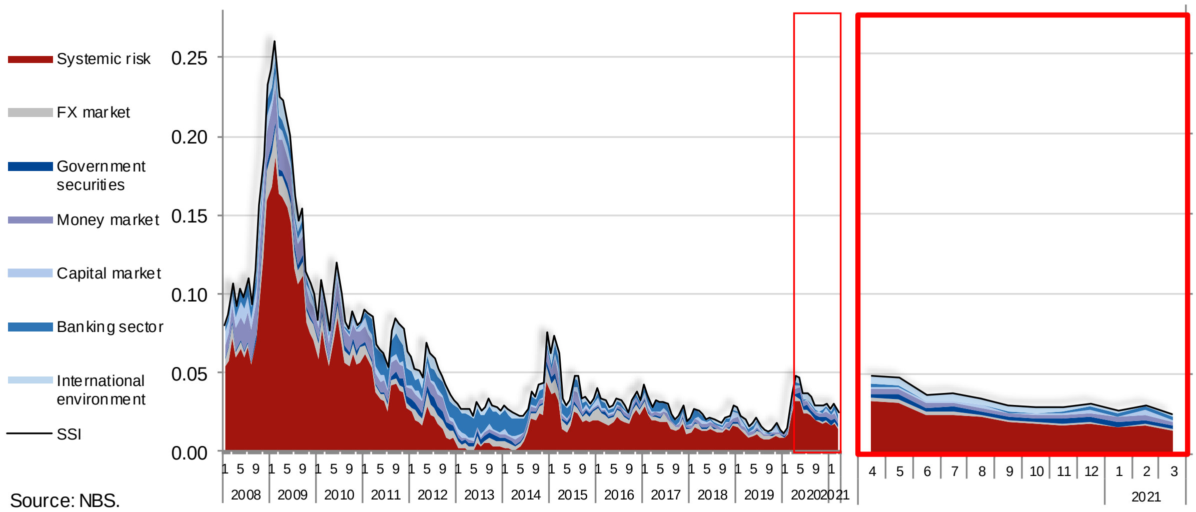
The Systemic Stress Indicator (hereinafter: SSI) was developed with a view to identifying periods of elevated stress and the level of systemic risk in the financial system of the Republic of Serbia. The SSI covers a series of indicators which capture the level of financial stress in six key segments of the Serbian financial system: FX market, government securities market, money market, capital market, banking sector and the international environment.

After recording higher values, particularly in April and May 2020 due to the pandemic, SSI decreased in Q1 2021 and recorded a stable systemic component.

At end-Q1 2021, SSI was lower than at end-2020, mostly on account of a reduction in the systemic risk component, as well as movements in the capital market, FX market and the international environment.

In Q1 2021, average risk premium of Serbia for euro debt (EURO EMBIG) equalled 148 bp (180 bp in Q4 2020). At end-Q1 2021, EURO EMBIG for Serbia equalled 163 bp and was lower than in the majority of countries in the region (Montenegro 374 bp, Albania 249 bp, Romania and North Macedonia 204 bp, Hungary 89 bp and Croatia 86 bp, Bulgaria 69 bp).

Chart 8. **Systemic stress indicator dynamics and contribution of the most important risk factors to the Systemic stress indicator**




Source: NBS.

The banking sector is adequately capitalised and highly liquid, and is likely to remain so in the coming period. At end-Q1 2021, banking sector capital adequacy ratio stood at 22.3%, significantly above the regulatory minimum. The results of macroprudential stress tests for December 2020 confirm banking sector stability, as CAR would remain significantly above the regulatory minimum even in the worst-case scenario.

Despite global circumstances marked by the COVID-19 pandemic, Moody's upgraded Serbia's credit rating in March 2021 from Ba3 to Ba2. According to Moody's, the key drivers of the decision to upgrade Serbia's rating were low and stable inflation, relative stability of the exchange rate, limited external vulnerability and a current account deficit fully covered by FDI. Also noted was the adequate level of foreign exchange reserves, increased economic diversification and lower fiscal risks. Serbia's outlook was defined as stable. In March 2021, Fitch Ratings affirmed Serbia's long-term foreign currency issuer default rating at BB+, with a stable outlook, highlighting a stable macroeconomic policy, maintained inflation and the economy's resilience to shocks.