8 December 2022

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

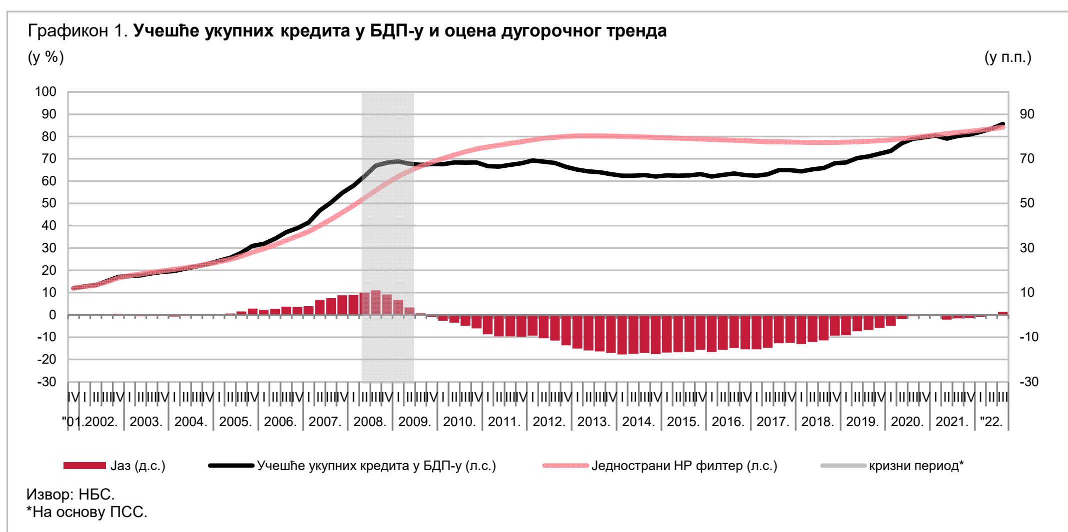
Pursuant to Article 14, paragraph 1, item 11) of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015 – CC decision and 44/2018) and Section 436 of the Decision on Capital Adequacy of Banks (RS Official Gazette, Nos 103/2016, 103/2018, 88/2019, 67/2020, 98/2020, 137/2020, 59/2021 and 67/2022, hereinafter: Decision on Capital Adequacy), the NBS Executive Board, at its meeting of 8 December 2022, decided to keep the countercyclical capital buffer rate for the Republic of Serbia at 0% having in mind that the estimated deviation of the real credit-to-GDP ratio from its long-term trend (credit-to-GDP gap) is below the lower bound of 2 pp needed for the introduction of the countercyclical capital buffer (hereinafter: CCyB). The National Bank of Serbia (NBS) has kept the countercyclical capital buffer rate at 0% in order to support financing conditions for corporates and households.

The CCyB is additional Common Equity Tier 1 capital that banks are obliged 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, 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. Continued credit activity growth since 2014, with a slowdown in 2022, contributed to the share of total loans in GDP exceeding

its long-term trend at end-Q3 2022 for the first time since 2009. According to September 2022 data, the credit-to-GDP gap is 1.5 pp. At end-Q3 2022, the gap widened by 19.0 pp relative to end-2014 and by 3.0 pp y-o-y, while in q-o-q terms it widened by 1.4 pp. In Q3 2022 the CCyB rate was kept at 0% bearing in mind that the estimated credit-to-GDP gap of 1.5 pp is below the lower bound of 2 pp needed for the introduction of this capital buffer. Dampened global growth prospects and prolonged conflict in Ukraine could contribute to the widening of the gap going forward.

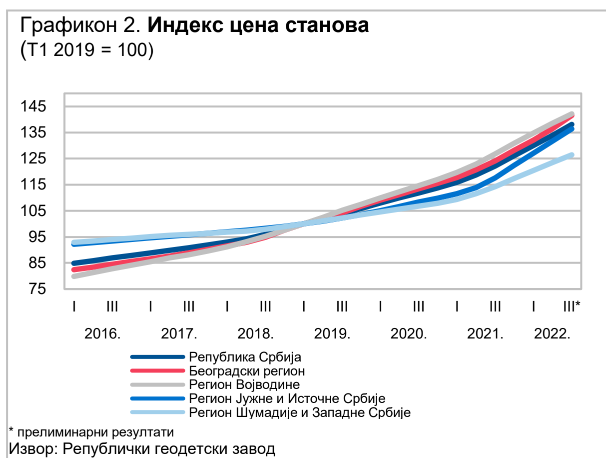


Графикон 1. **Учешће укупних кредита у БДП-у и оцена дугорочног тренда**
Извор: НБС.
*На основу ПСС.

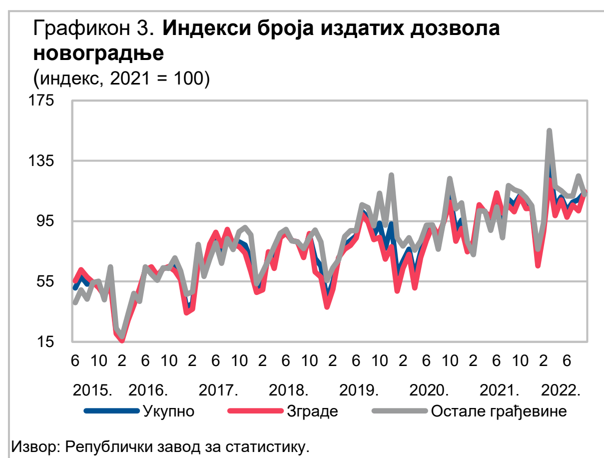
In addition to the credit-to-GDP gap, other optional indicators were also taken into account for setting the CCyB rate for the Republic of Serbia, in accordance with Section 436, paragraph 4 of the Decision on Capital Adequacy. The optional indicators for monitoring the lending activity illustrate the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

Real estate market

According to data of the Republic Geodetic Authority, and based on the index of prices of flats, the annual growth rate of flat prices in the Republic of Serbia at end-Q3 2022 stood at 13%, while relative to the previous quarter



Графикон 2. **Индекс цена станова**
* прелиминарни резултати
Извор: Републички геодетски завод



Графикон 3. **Индекси броја издатих дозвола новоградње**
Извор: Републички завод за статистику.

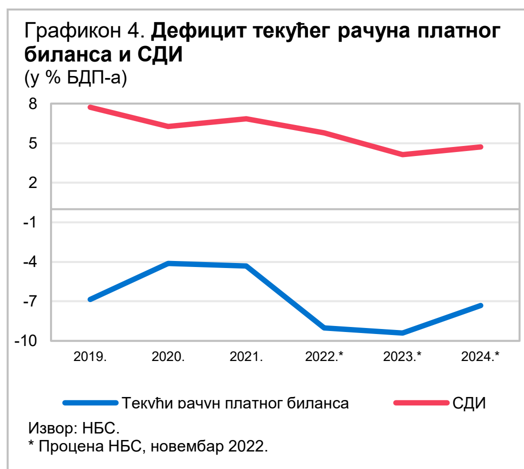
the prices of flats rose 3.1%.

In Q3 2022, the total number of issued permits for new construction increased by 6.5% y-o-y. The LTV ratio, measured by the ratio of mortgage-backed housing loans, for which a flat was mortgaged and the value of the flats estimated, posted a q-o-q decline in Q3 2022 and measured 63.55%[1] (64.59% in Q2 2022), which is significantly below the regulatory maximum of 80%.[2]

According to the results of the bank lending survey, in accordance with expectations, in Q3 2022 banks continued to tighten corporate credit standards. Also, they continued tightening household credit standards as well, which primarily concerned dinar cash and FX-indexed housing loans. The increased costs of funding sources and diminished risk propensity are the key factors behind the tightening of standards, which is something banks expect to continue in Q4 2022. According to banks' estimate, businesses slightly increased their loan demand during Q3 2022, while household loan demand was dampened due to the less favourable situation in the real estate market and reduced need for purchasing durable consumer goods.[3]

Indicators of external imbalance

FDI inflow to Serbia in Q3 2022 came at EUR 1.4 bn (EUR 1.3 bn net), whereby inflow on this account in the year to September reached EUR 3.0 bn (net FDI inflow – EUR 2.8 bn). According to the latest projection, FDI inflow this year will measure around EUR 3.8 bn (EUR 3.5 bn net),[4] surpassing the expectations from August. The current account deficit of EUR 2.8 bn in the first nine months of this year was doubled in y-o-y terms, mainly determined by the rising energy import due to the upswing in global energy prices. Unfavourable terms of trade on account of a considerable rise in energy prices in the global market will push



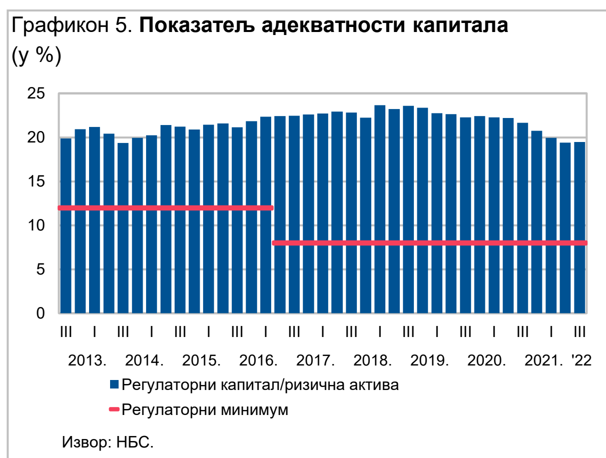
[1] According to NBS data.
[2] In accordance with the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System (RS Official Gazette, Nos 34/2011, 114/2017 and 84/2020), a mortgage loan may be approved to a natural person if the loan amount does not exceed 80% of the value 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, if the loan is approved as a government support measure for certain groups of natural persons or if the loan is approved to first-time home buyers.
[3] Report on the Results of the Bank Lending Survey for Q3 2022.
[4] Inflation Report, November 2022.

the current account deficit to GDP ratio this year to around 9%.[5] This ratio is expected to remain at a similar level in 2023 and to gradually decline in the medium term to around 6%, supported by the more favourable terms of trade, which should preserve external sustainability.

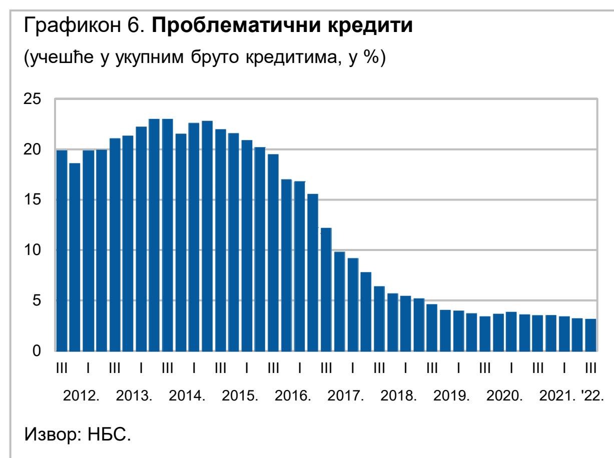
Main banking sector indicators

The banking sector stayed adequately capitalised and highly liquid and is expected to remain so going forward. At end-Q3 2022, capital adequacy ratio at the banking sector level equalled 19.5%, well above the regulatory minimum.[6]

At end-Q3, loan-to-deposit ratio (LtD) measured 0.84. This indicator at levels below 1 suggests that banks largely rely on domestic, stable sources of funding, such as deposits.



Графикон 5. **Показатељ адекватности капитала**
(у %)
Извор: НБС.



Графикон 6. **Проблематични кредити**
(учешће у укупним бруто кредитима, у %)
Извор: НБС.

The share of NPLs in total banking sector loans decreased significantly owing to the implementation of the NPL Resolution Strategy, as well as other regulatory activities of the NBS. The NPL ratio equalled 3.19% at end-Q3 2022, down by 0.4 pp relative to Q3 2021 and by 19.1 pp relative to August 2015, when the Strategy was adopted.

Assessment of systemic risk of the Serbian financial system

[5] Inflation Report, November 2022.

[6] 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%). Also, in addition to meeting these conditions, a bank shall maintain its capital at all times at the level necessary for the coverage of all risks to which the bank is or may be exposed in its operation, i.e. at least in the amount necessary for maintaining the increased capital adequacy ratios – if the National Bank of Serbia, in accordance with Section 5 of this Decision, has set capital adequacy ratios for a bank higher than the prescribed ones.

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.

In Q3 2022, the SSI recorded mild growth relative to end-June 2022. It turned upward in July 2022, mainly due to the movements in the government securities market and the risks stemming from the international environment.

The extraordinary health situation, geopolitical tensions and consequences of the conflict between Russia and Ukraine were the causes behind the newly emerging economic environment characterised by the energy crisis, high inflation and measures taken to tackle it. In such conditions, Q3 saw global recovery contracting more severely than previously

expected.

The NBS acted proactively, making timely decisions in view of the need to preserve and strengthen financial stability. A continuous improvement of regulatory measures implemented by the NBS and improvement in the domestic macroeconomic environment in the previous period helped to maintain a stable, adequately capitalised and highly liquid banking system, which is expected to remain so going forward. The capital adequacy ratio at end-September 2022 equalled 19.5%, while the average monthly liquidity ratio in September 2022 amounted to 2.0. The results of macroprudential

stress tests for June 2022 confirm that even in the case of the most adverse scenario, the capital adequacy ratio would have values well above the regulatory minimum.

In mid-August 2022, Fitch Ratings kept Serbia's rating at BB+, with the stable outlook, one notch away from investment grade. In its press release, the Agency pointed out that the maintained rating with the stable outlook reflects a credible macroeconomic policy framework, as well as a more robust governance, human capital and higher GDP per capita compared to other countries with the similar credit rating, as well as the availability of external sources of funding and FX reserves adequacy, which allows for the absorption of the pressures on country's balance of payment amid the extraordinary conditions in the global market.