13 June 2024

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, 67/2022, 137/2022, 48/2023 and 110/2023, hereinafter: Decision on Capital Adequacy), the NBS Executive Board, at its meeting of 13 June 2024, decided to keep the countercyclical capital buffer (CCyB) rate for the Republic of Serbia at 0%, having in mind that the share of real lending activity in real GDP is below its long-term trend. By keeping the CCyB at 0%, the NBS continues to support the lending market.

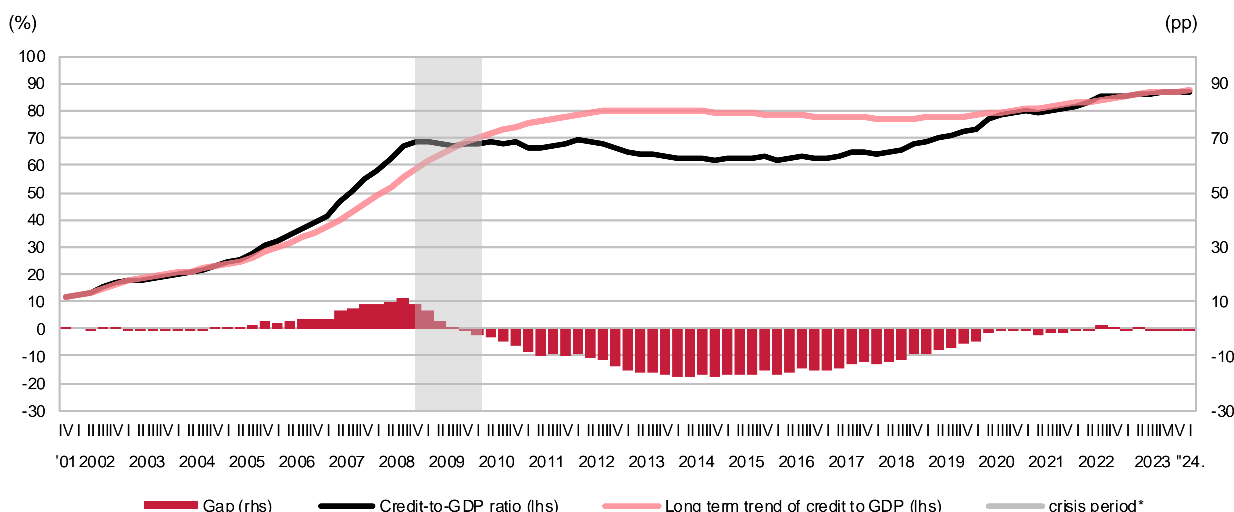
The CCyB is additional Common Equity Tier 1 capital that banks are required to maintain above the prescribed regulatory minimum in the amount equal to their risk-weighted assets multiplied by the specific countercyclical buffer rate. This instrument mitigates the cyclical dimension of systemic risk,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

The 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 between 2000 and 2008, in late 2009 the credit-to-GDP gap entered the negative territory. Lending growth in place since 2014 brought the share of total loans in GDP close to its long-term trend. Since 2000, the share has oscillated around its long-term trend. According to March 2024 data, the credit-to-GDP ratio is below its long-term trend, with a gap of -0.8 pp. The gap value declined both y-o-y and q-o-q. The estimated gap value is also below the

threshold of 2 pp, which is the reference value which can indicate excessive lending activity.

Chart 1 **Credit-to-GDP ratio and its long run trend**



Source: NBS
*Based on SSI

In addition to the credit-to-GDP gap, other optional indicators were also taken into account when 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 used relate to the real estate market, external imbalance and banking sector developments.

Real estate market

The latest available data of the Republic Geodetic Authority and the Apartment Price Index indicate that flat prices in the Republic of Serbia in Q4 2023 continued up, but at a slower pace relative to the prior period. The annual growth rate of flat prices equalled 5.75%[1] in Q4 2023, while relative to the previous quarter the prices of flats rose 0.8%.[2]

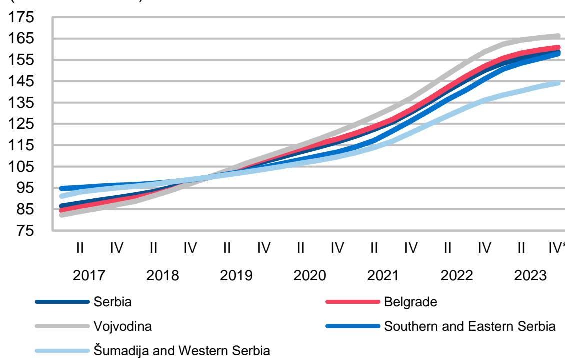
In Q1 2024, the total number of issued permits for new construction declined by 16.2% y-o-y.

The LtV ratio, measured by the ratio of mortgage-backed housing loans for which a flat was mortgaged and the estimated value of the flats, posted a mild q-o-q increase in Q1 2024 and measured 59.5% (58.9% in Q4 2023).[3]

[1] Preliminary data.
[2] Republic Geodetic Authority – Report on the Apartment Price Index for Q4 2023.
[3] Source: NBS Real Estate Database.

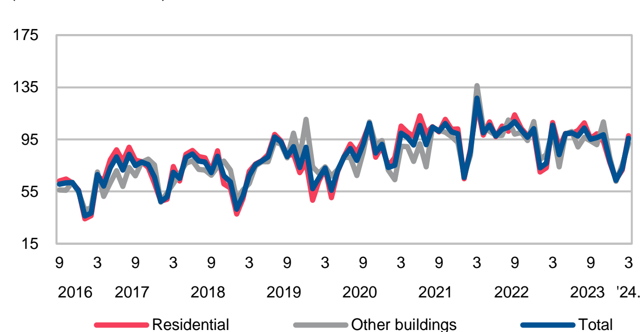
The April NBS bank lending survey shows that in Q1 2024, banks relaxed standards for the approval of household loans and for the first time in almost three years they also eased their standards for the approval of corporate loans. Standard easing was driven by the lower costs of the sources of funding, banking sector competition, lower bank risk aversion and positive expectations regarding economic activity. Banks anticipate the standard easing to continue into Q2 2024. Corporate demand for dinar loans increased in Q1 2024, while the demand for FX loans declined. In Q1, household loan demand went up, including for FX-indexed housing loans in which case the demand increased for the first time in a year and a half. The rise in household demand was led by the need to refinance current loans and purchase durable consumer goods, with higher wages also lending an impetus. The situation in the real estate market, featuring high prices of flats, worked in the opposite direction. Banks expect both sectors to step up loan demand in Q2 2024.[4]

Chart 2 **Apartment Price Index**
(Q1 2019 = 100)



* The latest data available (preliminary data)
Source: Republic Geodetic Authority

Chart 3 **Indices of the number of newly issued construction permits**
(index, 2022 = 100)



Source: Statistical Office of the Republic of Serbia.

Indicators of external imbalance

Q1 2024 saw a current account deficit of EUR 395 mn (2.3% of GDP), which was covered by net FDI inflow many times over. In view of the expected acceleration of the investment cycle, the share of the current account deficit is expected to be close to 4% of GDP in 2024 and around 5% of GDP going forward.[5]

FDI inflow to Serbia in Q1 2024 measured EUR 1.3 bn (1.1 bn net) or 53.4% up from the same period a year earlier. The bulk of FDIs were in the form of

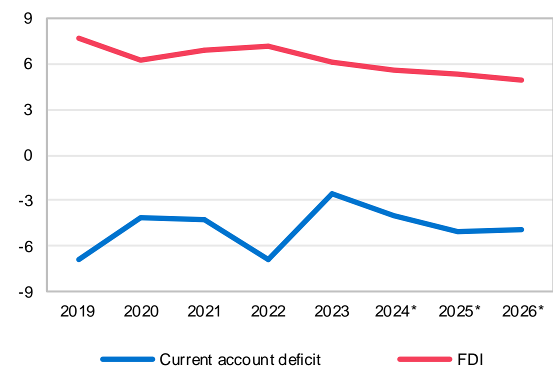
[4] Report on the Bank Lending Survey, Q1 2024.

[5] *Inflation Report*, May 2024.

equity capital and reinvested earnings, which confirms the determination of foreign investors to continue investing in Serbia.

Looking ahead, net FDI inflow is expected to measure around 5% of GDP and to maintain the high diversification by geographies and projects, as well as to remain channelled to export-oriented sectors. Also, the current account deficit is expected to stay fully covered by net FDI inflow, as was the case in the past nine years.[6]

Chart 4 **Current account deficit and FDI**
(in % of GDP)

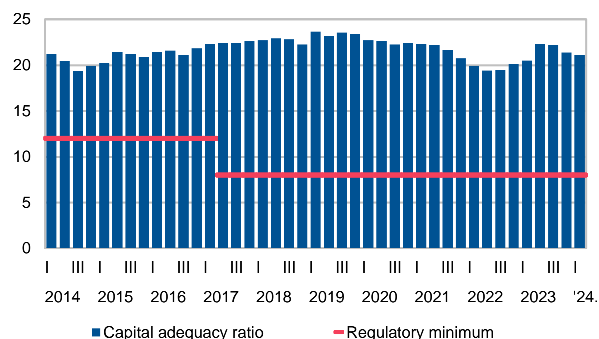


* NBS projection, May 2024
Source: NBS.

Main banking sector indicators

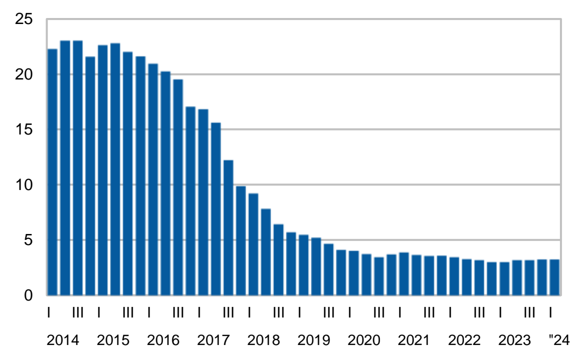
The banking sector is adequately capitalised and highly liquid. At end-Q1 2024, the capital adequacy ratio at the banking sector level equalled 21.2%, well above the regulatory minimum.[7]

Chart 5 **Capital adequacy ratio**
(%)



*Latest data available
Source: NBS.

Chart 6 **Non-performing loans**
(share in total gross loans, %)



Source: NBS.

At end-Q1 2024, the loan-to-deposit ratio (LtD) measured 0.83. Keeping this indicator at levels below 1 means that banks largely rely on domestic, stable sources of funding, such as deposits.

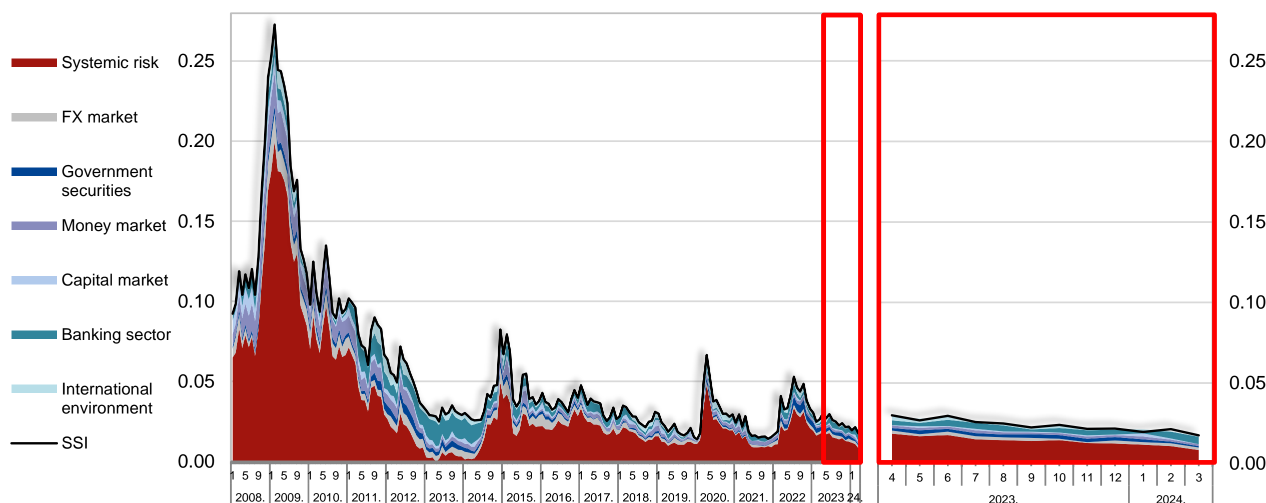
[6] *Inflation Report*, May 2024.
[7] Since 30 June 2017, the minimum CAR is 8% (minimum Tier 1 capital is 6% and minimum Common Equity Tier 1 capital is 4.5%). Also, in addition to meeting these conditions, a bank shall maintain its capital at all times at the level necessary for the coverage of all 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).

Owing to the implementation of the NPL Resolution Strategy as of 2015 and other regulatory activities of the NBS, the share of NPLs in total banking sector loans decreased significantly and remained at record-low levels despite the multidimensional crisis we have faced in the past four years. At end-Q1 2024, the NPL ratio equalled 3.2%, unchanged y-o-y, indicating that the tightening of financial conditions and other global uncertainties in the past period did not have any major adverse effect on the quality of banks' assets.

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.

Chart 7 **Systemic stress indicator dynamics and contribution of the most important risk factors to the systemic stress indicator**



Source: NBS.

During Q1 2024, the SSI recorded a lower value relative to end-2023 and to Q1 2023. The SSI value in the previous period was mostly affected by developments in the banking sector where the deposit base expanded and lending activity rose slightly.

In the conditions of slower global growth, pronounced geopolitical tensions, elevated inflation and tight global financial conditions, the NBS acted

proactively, making timely decisions in view of the need to preserve and strengthen the achieved financial stability. The enhancement of the domestic macroeconomic environment in the previous period and the continuous improvement of the regulatory framework for banks helped to maintain a stable, well-capitalised and highly liquid banking sector in Serbia. The results of macroprudential solvency stress tests for December 2023 also confirm the stability of our banking system.

In early February 2024, Fitch Ratings affirmed Serbia's credit rating at BB+, with a stable outlook, a notch away from investment grade.

In early April, Standard & Poor's affirmed Serbia's long-term credit rating at BB+, and raised the outlook from stable to positive, which indicates that it could award investment grade to Serbia in the coming period. The decision reflects Serbia's robust macroeconomic indicators in 2023, our economy's demonstrated resilience in the preceding, turbulent years, and the improved fiscal performance and external position.

In their press releases, the agencies noted that Serbia's rating is underpinned by a credible monetary policy framework, moderate level of public debt and a well-capitalised, profitable and liquid banking sector.