12 September 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 12 September 2024, decided to keep the countercyclical capital buffer (CCyB) rate for the Republic of Serbia at 0%, having in mind that the estimated deviation of the credit-to-GDP ratio from its long-term trend is below the threshold for introducing a 2 pp CCyB. By keeping the CCyB rate at 0%, the NBS continues to support the lending market amid the still tightened global financial conditions.

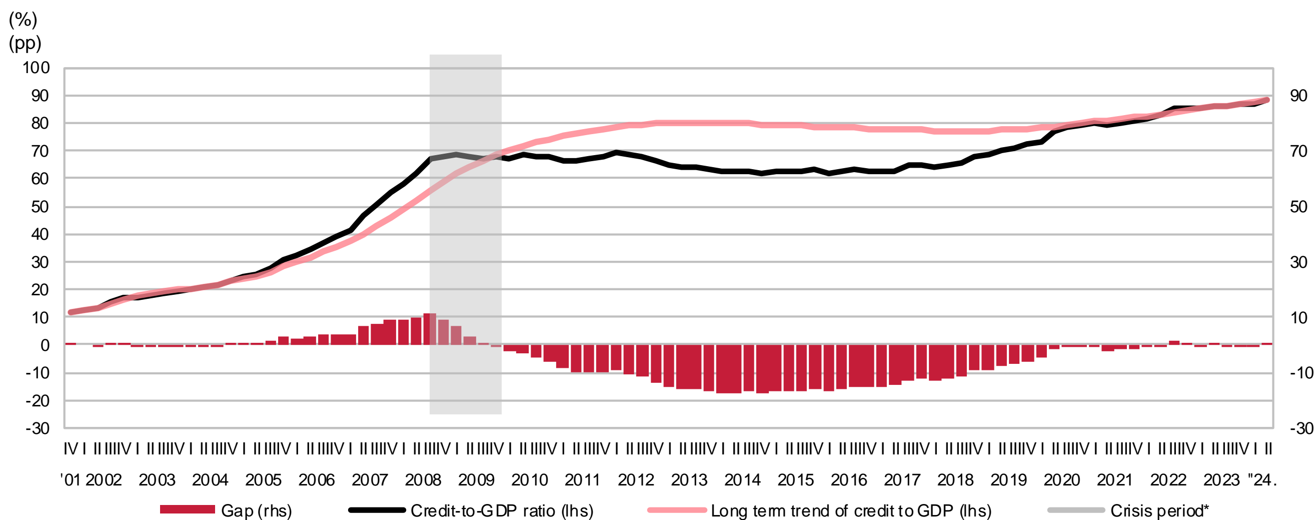
The CCyB is additional Common Equity Tier 1 capital that banks are required to maintain above the prescribed regulatory minimum in the amount equal to their risk-weighted assets multiplied by the specific countercyclical buffer rate. This instrument mitigates the cyclical dimension of systemic risk, 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 2020, the share has oscillated around its long-term trend. According to June 2024 data, the credit-to-GDP ratio is slightly above its long-term trend, with a gap of 0.2 pp. The gap value declined by 0.2 pp y-o-y, while rising by 0.9 pp q-o-q. The

estimated gap value is below the threshold of 2 pp, which is the reference value potentially indicating 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

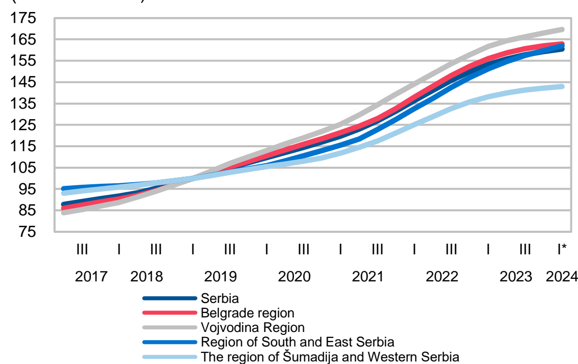
The latest available data of the Republic Geodetic Authority and the Apartment Price Index indicate that flat prices in the Republic of Serbia in Q1 2024 continued up, but at a slower pace relative to the prior period. The annual growth rate of flat prices equalled 4.7% in Q1 2024, while relative to the previous quarter the prices of flats rose 0.8%.[1]

In Q2 2024, the total number of issued permits for new construction increased 7.8% 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 in Q2 2024, posted a mild q-o-q increase and measured 60.9% (59.7% in Q1 2024).[2]

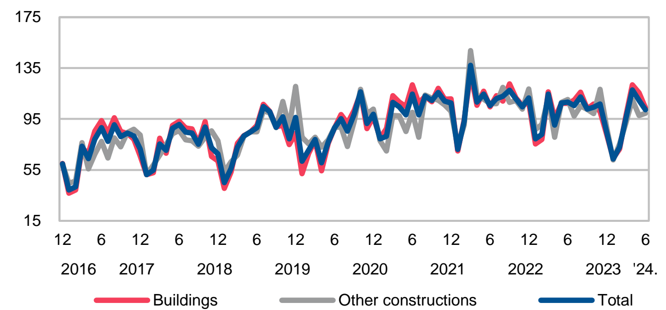
[1] Republic Geodetic Authority – Report on the Apartment Price Index for Q1 2024.
[2] Source: NBS Real Estate Database.

Chart 2 **Housing price index**
(Q1 2019 = 100)



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

Chart 3 **Indices of the number of newly issued building permits**
(index, 2023 = 100)



Source: Statistical Office of the Republic of Serbia.

The July NBS bank lending survey shows that in Q2 2024, banks further relaxed credit standards for dinar corporate and household loans, while mildly tightening standards for FX-indexed corporate loans and keeping unchanged those for FX-indexed household loans. Standard easing in household lending was driven by the lower costs of the sources of funding and banking sector competition. Loan demand expanded in both sectors and banks expect its further growth in Q3 2024. Corporate loan demand expanded after three consecutive months of contraction and mostly referred to small and medium-sized enterprises. Households upped demand for dinar cash and refinancing loans, as well as for FX-indexed housing and consumer loans. In banks' view, demand growth was driven by the need to refinance the current loans and purchase durable consumer goods, with a positive impetus of higher wages. [3]

Indicators of external imbalance

H1 2024 saw a current account deficit of EUR 1.2 bn (3.4% of GDP), which was more than fully covered by the net FDI inflow. In view of the expected acceleration of the investment cycle, which will be reflected in higher import of equipment and intermediate goods, the share of the current account deficit is expected to be around 4% of GDP in 2024 and around 5% of GDP going forward.[4]

[3] Report on the Bank Lending Survey, Q2 2024.
[4] *Inflation Report*, August 2024.

FDI inflow to Serbia in H1 2024 measured EUR 2.3 bn (2.0 bn net) or 6.7% more than in the same period a year earlier. The bulk of FDIs were in the form of 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 5–6% of GDP and to maintain the high diversification by geographies and projects, with the bulk of it remaining channelled to export-oriented sectors.[5]

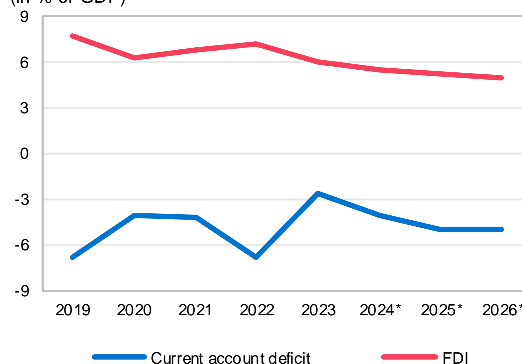


Chart 4 **Current account deficit and FDI**

Main banking sector indicators

The banking sector is adequately capitalised and highly liquid. At end-Q2 2024, the capital adequacy ratio at the banking sector level equalled 21.8%, well above the regulatory minimum.[6]

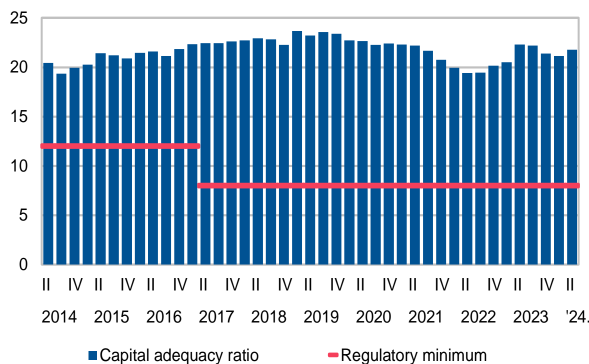


Chart 5 **Capital adequacy ratio**

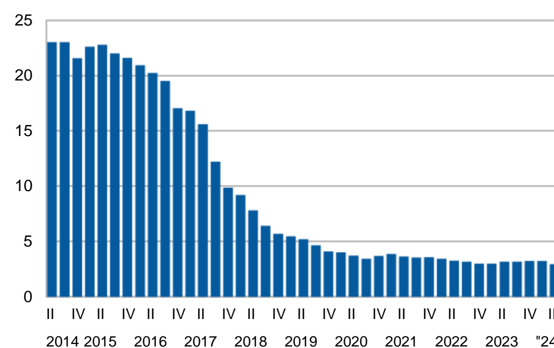


Chart 6 **Non-performing loans**

Source: NBS.

At end-Q2 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.

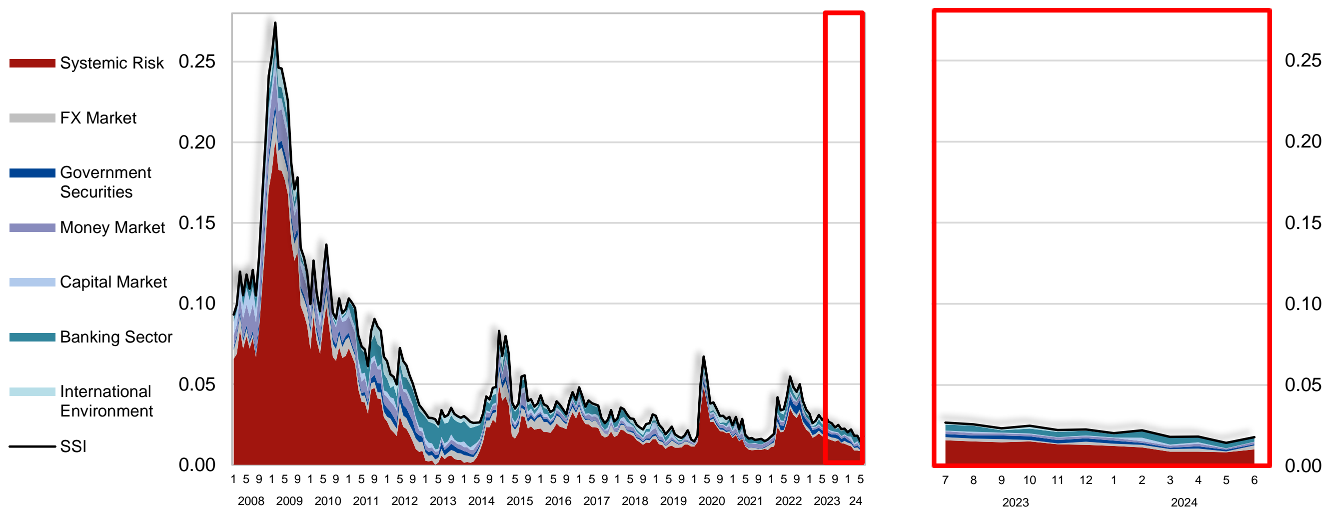
[5] *Inflation Report*, August 2024.
[6] Since 30 June 2017, the minimum CAR is 8% (minimum Tier 1 capital is 6% and minimum Common Equity Tier 1 capital is 4.5%). Also, in addition to meeting these conditions, a bank shall maintain its capital at all times at the level necessary for the coverage of 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 the Decision on Capital Adequacy, 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-Q2 2024, the NPL ratio equalled 2.9%, 0.3 pp lower than in Q1. Based on the latest results from July 2024, the share of NPLs in total loans declined further to 2.8%, its new record low, indicating that the tightening of financial conditions in the past period did not have any major adverse effects on the quality of bank 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 factors to the szstemic stress indicator**



Source: NBS.

In Q2 2024, the SSI stayed broadly unchanged relative to the quarter before. 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, as well as by developments in the FX market.

Amid sluggish global growth, pronounced geopolitical tensions, elevated inflation and tight global financial conditions, the NBS worked proactively, making timely decisions so as to preserve and strengthen the achieved financial system stability. The strengthening of domestic macroeconomic fundamentals in the prior 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 carried out in March 2024 also confirm the stability of our banking system.

Favourable macroeconomic developments and positive prospects for the coming period were confirmed by the world's three leading rating agencies, which improved Serbia's rating outlook in recent months. In early April, Standard & Poor's affirmed Serbia's long-term credit rating at BB+ and raised the outlook from stable to positive, indicating that it might award investment grade to Serbia in the period ahead. The decision reflects Serbia's robust macroeconomic outturns, demonstrated resilience in the preceding years, and the improved fiscal performance and external position. In early August 2024, Fitch Ratings increased the outlook from stable to positive, affirming the rating at BB+, while by the end of that month Moody's also raised the outlook from stable to positive, maintaining the rating at Ba2. In their press releases, the agencies noted that the decision on rating outlook was underpinned by favourable medium-term growth prospects, the economy's reinforced resilience to potential new shocks from the international environment, inflation's return within the target band and its expected further decline, the strengthening of public finances, a well-capitalised and liquid banking sector and the maintained financial stability.