12 December 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 December 2024, decided to keep the countercyclical capital buffer (CCyB) rate for the Republic of Serbia at 0%, having in mind that the credit-to-GDP ratio is below its long-term trend. By keeping the CCyB at 0%, the NBS continues to support the lending market amid the still tight global financial conditions and uncertain global circumstances.

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.

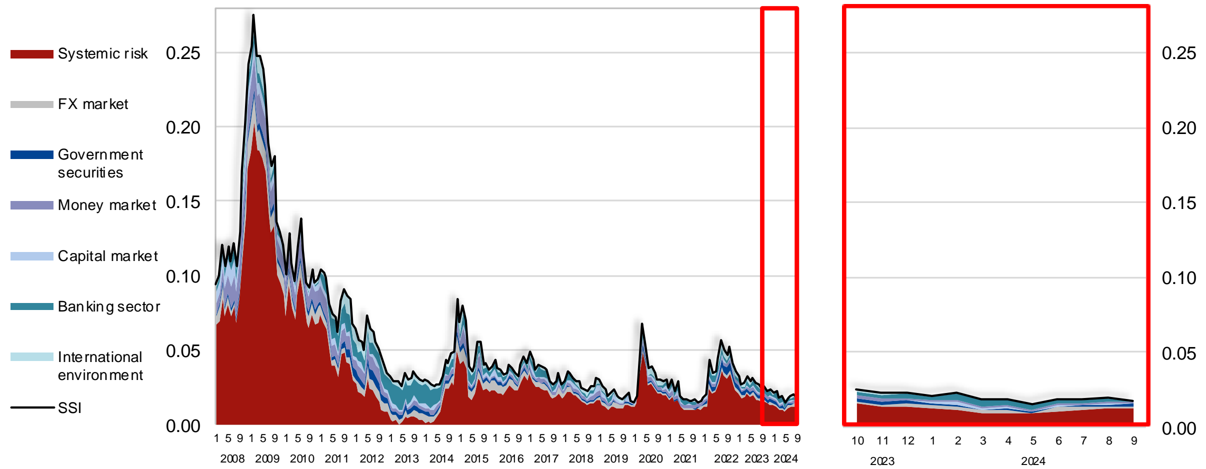
The NBS sets the CCyB rate for the Republic of Serbia on a quarterly basis, taking into account the reference guide, applicable guidelines and recommendations of the European Systemic Risk Board and other variables it considers relevant for monitoring the cyclical dimension of systemic risk. In accordance 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,[1] 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 credit in GDP close to its long-term trend. Since 2020, the share has

[1] https://www.stat.gov.rs/en-US/vesti/statisticalrelease/?p=15314

oscillated around its long-term trend. According to September 2024 data, the credit-to-GDP ratio is slightly below its long-term trend, with a negative gap of -0.1 pp.[2] Relative to the quarter before, and the same quarter a year earlier, the real credit-to-GDP ratio came closer to its long-term trend. The estimated gap value is also below the threshold of 2 pp, which is the reference value potentially indicating excessive lending activity.

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



Source: NBS.

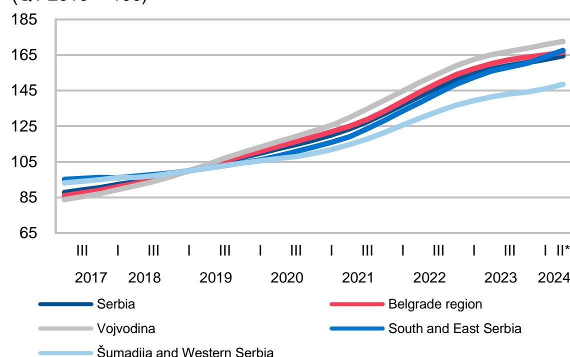
In addition to the credit-to-GDP gap, other optional indicators were also taken into account when setting the CCyB rate for the Republic of Serbia, in accordance with Section 436, paragraph 4 of the Decision on Capital Adequacy. The optional indicators used relate to the real estate market, external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

[2] The Statistical Office of the Republic of Serbia (SORS) revised in late 2024 its GDP data series starting from 1995. Also, for the purpose of calculating GDP deflator, SORS uses 2021 as the reference year.

Real estate market

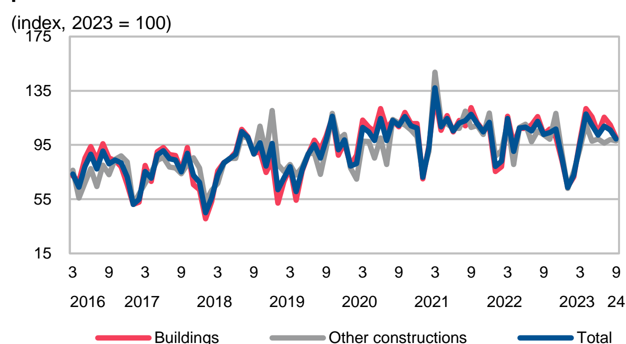
The latest available data of the Republic Geodetic Authority and the Apartment Price Index indicate that flat prices in Q2 2024 continued up, but at a slower pace relative to the prior period. The annual growth rate of flat prices in Serbia equalled 4.7% in Q2 2024, while relative to the previous quarter the prices of flats rose 1.3%.[3]

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, 2023 = 100)



Source: Statistical Office of the Republic of Serbia.

In Q3 2024, the total number of issued permits for new construction declined by 1.9% 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 an increase in Q3 2024 and measured 61.9% (60.9% in Q2 2024).[4]

The October NBS bank lending survey shows that in Q3 2024 banks further relaxed credit standards for corporate and household loans. Standard easing was driven by the lower costs of the sources of funding associated with the NBS and ECB rate cut cycle. In case of households, this was also aided by the positive real estate market outlook. At the same time, household loan demand increased. Banks estimate that a rise in demand was driven by the need for refinancing of existing loans, purchase of real estate, and procurement of durable consumer goods, with the positive impact of higher wages. Banks expect further standard easing and a rise in loan demand in Q4 2024 as well.[5]

[3] Republic Geodetic Authority – Report on the Apartment Price Index for Q2 2024 (latest available data).
[4] Source: NBS Real Estate Database.
[5] Report on the Bank Lending Survey, Q3 2024.

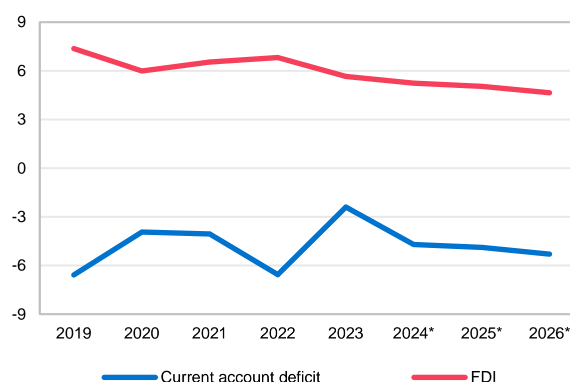
Indicators of external imbalance

The first three quarters of 2024 saw a current account deficit of EUR 3.3 bn, which was more than fully covered by the net FDI inflow. In view of the higher import of goods and services, particularly of equipment supporting the continuation of the investment cycle, the share of the current account deficit is expected to reach 4.7% of GDP in 2024 and around 5% of GDP going forward, owing to higher expenditures for the implementation of the EXPO 2027 programme.[6]

FDI inflow to Serbia in the first three quarters of 2024 measured EUR 3.6 bn (3.2 bn net) or 12.4% more than in the same period a year earlier. Around three quarters of these inflows were in the form of equity capital and reinvested earnings, which confirms the unwavering trust of foreign investors in the economic ambience of Serbia and their willingness to continue investing.

FDI inflow is expected to maintain the high diversification by geographies and projects, with the bulk of it remaining channelled to export-oriented sectors. Also, the current account deficit should stay fully covered by the net FDI inflow (estimated at close to 5% of GDP) this and the next year as it was in the past nine years, ensuring external sustainability of the country.[7]

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



* NBS projection, November 2024
Source: NBS.

Main banking sector indicators

The banking sector is adequately capitalised and highly liquid. At end-Q3 2024, the capital adequacy ratio at the banking sector level equalled 21.9%, well above the regulatory minimum.[8]

At end-Q3 2024, the loan-to-deposit ratio (LtD) measured 0.85. Keeping this indicator at levels below 1 means that banks largely rely on domestic, stable sources of funding, such as deposits.

[6] *Inflation Report – November 2024.*

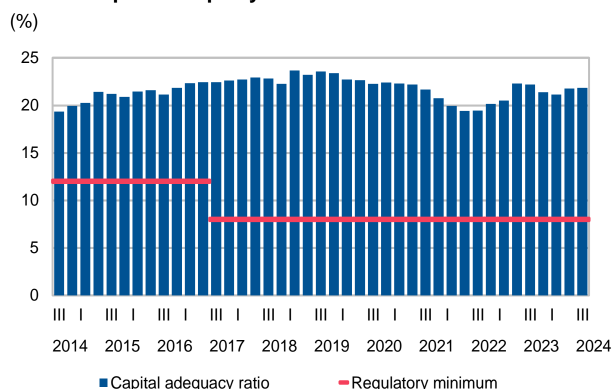
[7] *Inflation Report – November 2024.*

[8] 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 in the prior period, 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-Q3 2024, the NPL ratio equalled 2.7%, or 0.2 pp lower than in Q2, indicating that the tightening of financial conditions in the prior period did not have any major adverse consequences on the quality of banks' assets.

Chart 5 **Capital adequacy ratio**

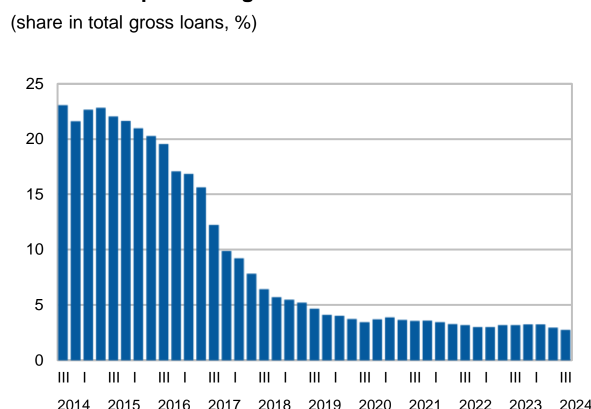
(%)



Source: NBS.

Chart 6 **Non-performing loans**

(share in total gross loans, %)



Source: NBS.

Assessment of systemic risk of the Serbian financial system

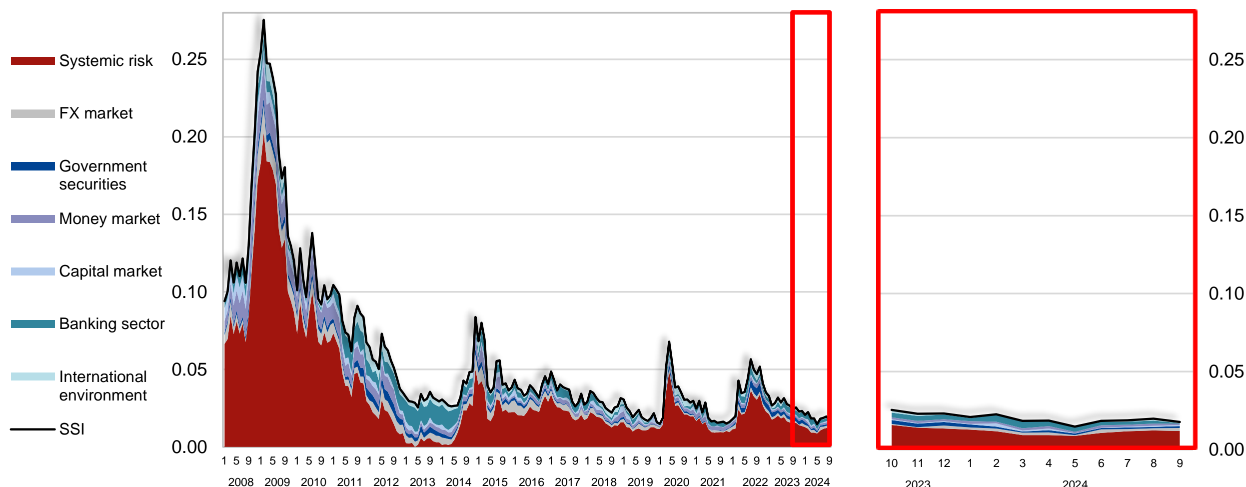
The Systemic Stress Indicator (hereinafter: SSI) was developed with a view to identifying periods of elevated stress and the level of systemic risk in the financial system of the Republic of Serbia. The SSI covers a series of indicators which capture the level of financial stress in six key segments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

At end-Q3 2024, the SSI recorded a slightly lower value relative to the quarter before, largely owing to movements in the FX market amid the preserved stability of the EUR/RSD exchange rate.

Against the backdrop of pronounced geopolitical risks and the increasingly pervasive geoeconomic fragmentation, the NBS will continue to act cautiously as well as proactively, making timely decisions so as to preserve and strengthen the achieved financial system stability. Such economic circumstances continue to affect the persistency of core inflation and bring into question the direction of future economic policies. Therefore, the NBS will continue to monitor all movements, both globally and at home, in order to preserve the achieved macroeconomic 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 and liquidity stress tests carried out on data from June 2024 also confirm the stability of our banking system.

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



Source: NBS.

Favourable macroeconomic developments and very positive prospects for the coming period were confirmed by the world's three leading rating agencies.

In early August 2024, Fitch Ratings increased Serbia's outlook from stable to positive, affirming the rating at BB+, while by the end of the same month Moody's 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, the strengthening of public finances, a well-capitalised and liquid banking sector and the maintained financial stability.

As an outstanding confirmation of the stability of Serbia's economic policy, in early October 2024 Standard & Poor's raised Serbia's credit rating to BBB- thus ranking Serbia among investment grade countries for the first time in its history. The decision reflects Serbia's favourable macroeconomic prospects and boosted resilience to external shocks. It was made primarily thanks to the government's responsible economic policy pursuit which is expected to continue in the coming years, as well as expectations that risks to financial stability in Serbia will remain low, supported by a well-capitalised, profitable and liquid banking system.