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SERBIAN BANKING SECTOR: RISING OPPORTUNITIES ON THE HORIZON

Bankarski sektor u Srbiji: na horizontu perspektiva

Abstract

After the first wave of the global crisis, in 2010 and 2011, the Serbian banking sector remained stable, largely owing to the preserved vitality of the real sector of the economy due to a moderate recovery of FDI inflow, as well as the Government's program for mitigating the adverse effects of the global economic crisis, aimed at stimulating domestic demand (the GDP growth rate amounted to 1% and 1.6%, respectively). During 2012, the election year, the economy went into recession (the GDP growth rate was -1.7%), i.e. economic activity, FDI and the overall performance of the real sector of the economy declined, which, combined, had an impact on a decline in banking sector performance. Data indicate that banks' credit activity in post-crisis years has recorded a trend of deceleration, both in terms of scale and in terms of risk or conservatism in their approach, all of which is a result of economic recession. However, if banking sector performance is viewed from another perspective, although profitability exhibited a downward trend over the observed period, capitalization of the banking sector is more than adequate and the current share of banking sector assets in the GDP (about 82%) indicates that there is room for further growth. As yet, there is no threat to banks' liquidity and solvency, and confidence in the banking system is stable. However, the main risk to banking sector stability and the influence of the monetary policy on the economy lies in the vitality, or recovery, of the real sector of the economy, i.e. in the economic policy makers' activities/measures aimed at reviving economic activity in the forthcoming period.

Key words: *real sector of the economy, recession, solvency, liquidity, capitalization of the banking sector, economic recovery, economic policy makers*

Sažetak

Nakon prvog talasa globalne krize, tokom 2010. i 2011, domaći bankarski sektor se stabilno održao, zahvaljujući, dobrim delom, održavanju vitalnosti realnog sektora privrede usled blagog oporavka priliva SDI-a, kao i programa Vlade za ublažavanje negativnih efekata globalne ekonomske krize, usmerenog ka stimulisanju domaće tražnje (stopa rasta BDP-a je iznosila 1% i 1,6% respektivno). Tokom 2012, izborne godine, privreda ulazi u recesiju (stopa rasta BDP-a je -1.7%), tj. dolazi do pada privredne aktivnosti, SDI-a, kao i opštih performansi realnog sektora privrede, što sve zajedno ima uticaja i na pad performansi bankarskog sektora. Podaci pokazuju da u postkriznim godinama kreditna aktivnost banaka beleži trend usporavanja, kako u pogledu obima aktivnosti, tako i u pogledu rizičnosti, tj. konzervativnosti u pristupu, a sve kao posledica ulaska privrede u recesiju. Međutim, sagledavajući sa druge strane performanse bankarskog sektora, iako profitabilnost tokom posmatranog perioda beleži opadajući trend, kapitalizovanost bankarskog sektora je više nego adekvatna, a trenutni udeo aktive bankarskog sektora u BDP-u (oko 82%) ukazuje da postoji prostor za dalji rast. Još ne preti opasnost po likvidnost i solventnost banaka, a i poverenje u bankarski sistem je stabilno. Međutim, osnovni rizik po stabilnost bankarskog sektora i uticaj monetarne politike na ekonomiju leži u vitalnosti, tj. oporavku realnog sektora privrede, odnosno aktivnostima/merama kreatora ekonomske politike usmerenim ka oživljavanju privredne aktivnosti u narednom periodu.

Ključne reči: *realni sektor privrede, recesija, solventnost, likvidnost, kapitalizovanost bankarskog sektora, ekonomski oporavak, kreatori ekonomske politike*

Introduction

The global financial crisis, which was not expected to reach such proportions, has led developed market economies into recession. Considering that Serbia is a small economy with a significant share of foreign trade in its GDP, it was only a matter of time when global developments would be reflected in the local economy ("time lag").

Owing to good capitalization of the Serbian banking system, the first blow of the global crisis, in the last quarter of 2008, was fended off successfully. During 2009, the banking sector was faced with a lower availability of funds for investment ("cross-border" arrangements declined significantly, and the domestic deposit base was not

additionally strengthened), which made borrowing more expensive (higher interest rates essentially mean a lower level of investment activity, and expected consequences include lower liquidity of the real sector and difficulties in servicing the existing loans). The trend continued in 2010 and 2011; thus, at the end of 2012, the economy faced a shortage of liquid assets and high liabilities, which significantly affected the preservation of banking sector stability.

Crisis effects are primarily manifested in *a lower foreign direct investment (FDI) inflow and, accordingly, a lower foreign currency inflow,* which, combined with growing inflationary expectations, affected domestic currency weakening, despite NBS interventions. In addition, *international borrowing became more expensive* for the banking sector and *available funds lower.* Funds borrowed abroad constituted one of the key sources of credit expansion until 2008; hence, the lowered availability of funds significantly affected:

- *higher lending interest rates,* which meant more expensive loans, as well as a rise in annuities due for those who borrowed at variable interest rates (after the rise of lending interest rates to over 12% in 2008 and 2009, they stabilized at 9-10% in the period 2010-Q3/2012);
- *higher borrowing interest rates,* whereby banks tried to attract available funds with a view to enhancing their credit potential (a rise in borrowing interest rates is frequently a signal of jeopardized liquidity – after an increase in borrowing interest rates to over 6% in 2008 and 2009, they stabilized at about 4% in the period 2010-Q3/2012);
- *lower credit supply,* resulting in difficulties in financing production and jeopardized liquidity of the economy;
- *growth of low-quality assets,* as a number of enterprises was not able to repay their loans owing to considerably deteriorated operating conditions;
- *withdrawals of deposits* due to banks' jeopardized liquidity or bankruptcy of major banks globally (as a result of the first blow of the global economic crisis, retail banking customers in Serbia withdrew about one billion euros of savings in 2008 and 2009).

Overview of the business climate in Serbia

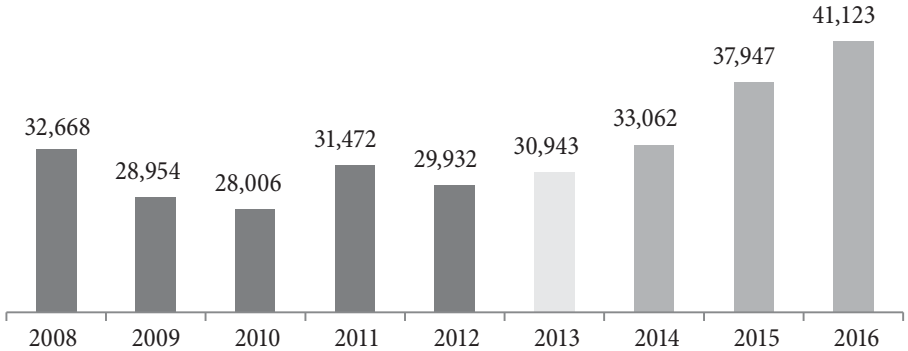
Gross domestic product

In the past 10 years, Serbia was one of the fastest-growing economies in Europe due to large FDI inflows and high growth of the services sector, especially wholesale and retail, which eventually resulted in high imports increase.

However, in 2009, the economy was severely hit by the global financial crisis, which resulted in 3.5% decrease in its GDP compared to the previous year. After a slight recovery in 2010 and 2011, in 2012 Serbia had an election year and slipped back into recession again (see Figure 1 and Figure 2).

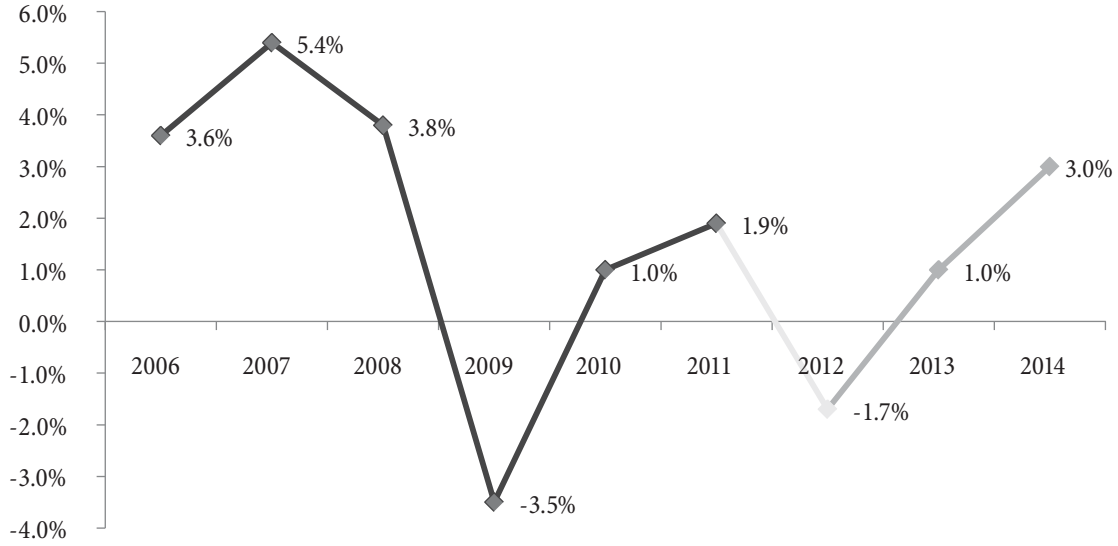
Despite fragile economic performance in the past couple of years, it is expected that the economy will return on the path of strong growth (GDP growth is forecast to pick up in 2013-16, to an annual average of 3.5%), if it manages to gain the official status of candidate for accession to the EU, which should secure stable foreign capital inflows in the upcoming years.

Figure 1: Gross domestic product (mil. EUR)



Note: GDP growth 2012-2016 is forecasted by the Economist Intelligence Unit
Source: NBS, Economist Intelligence Unit

Figure 2: GDP growth trends from 2006 to 2014 (%)



Note: GDP growth 2012-2014 is forecasted by the Economist Intelligence Unit
Source: Statistical Office of the Republic of Serbia, Ministry of Finance and Economy, NBS

Industrial production and service industry

The GDP structure has not changed significantly in the previous 10 years (see Figure 3); however, the relative contribution of the individual sectors has endured substantial shifts. The most obvious have been the relative deterioration of the agricultural sector and the slight decline of the industry sector – all in favor of an overall increase of the already dominant service sector.

In 2011, nearly 85% of the GDP consists of the service and industry sectors. In the service sector, real estate business is the single largest with an 11.9% share in the overall GDP, followed by wholesale and retail trade with 10.7%. In the industry sector, manufacturing was the single largest component with 16% of the GDP, followed by electricity, gas and steam supply with 3.7%.

Estimations are that economic growth will lead to an increased demand for loans by the business sector, with special emphasis on agriculture, which is expected to have a sharp growth in the upcoming years, as well as in the corporate sector, where growth should be boosted as a result of increased production of the investments from previous year (Fiat, Michelin, Yura Corporation, Benetton, Falke, Cooper Tires etc.) and entry of new foreign investors to the market.

Figure 3: Changes in the structure of the GDP from 2001 to 2011 (%)

Source: Statistical Office of the Republic of Serbia

Employment

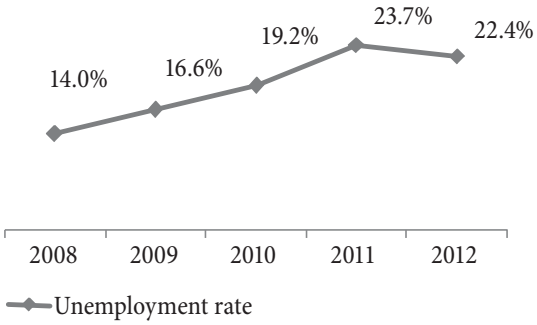
The population of the Republic of Serbia has been constantly decreasing in the past decade. According to the official population censuses of 2002 and 2011, the population decreased by 4.15%. Another important trend is that Serbian population is ageing. The 2011 census indicated that 14.9% of the population were below the age of 15, and 16.6% were aged 65 or above. However, fertility rates are constantly declining, which eventually results in the rise of the old-age dependency ratio (the ratio of people aged above 60 to the working-age population), which has significant implications for the fragile Serbian state pension system.

On the other hand, the most pressing issue for the Serbian economy is a rising trend of unemployment (see Figure 4). In the period from 2008 to 2012, unemployment rate rose from 14% to 22.4%. This rapid increase was a direct result of the international economic crisis, unsuccessful privatization process and slowdown of foreign direct investments. The unemployment issue is especially problematic in smaller provincial towns, where there is a serious shortage of professional work, meaning that many young people are either unemployed or under-utilized, and consequently seek work in other places. As a consequence, unemployment will have direct influence on the weakening private consumption in the upcoming years.

Inflation rate

Serbia has recently experienced one of the highest inflations (see Figure 5) in the region as a result of rapid increases in the price of food, administrative price increases and a sharp rise in public sector wages and pensions. Furthermore, continued uncertainty related to the euro zone economic situation had a negative impact on exchange rate developments and capital inflows, and eventually on the inflation.

Figure 4: Unemployment rate (in %)

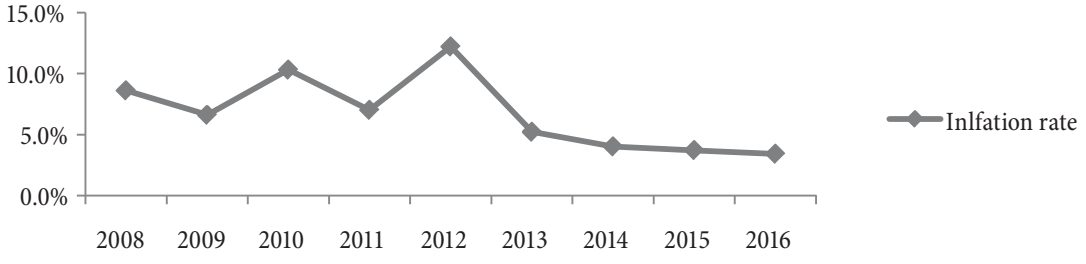


Source: Ministry of Finance and Economy of Serbia

However, in the second half of 2012 and the first half of 2013, the strengthening of the dinar and tight monetary policy have resulted in a disinflationary impact. In the upcoming years, the National Bank of Serbia expects the inflation rate to lower and approach the tolerance threshold of 4.0±1.5%.

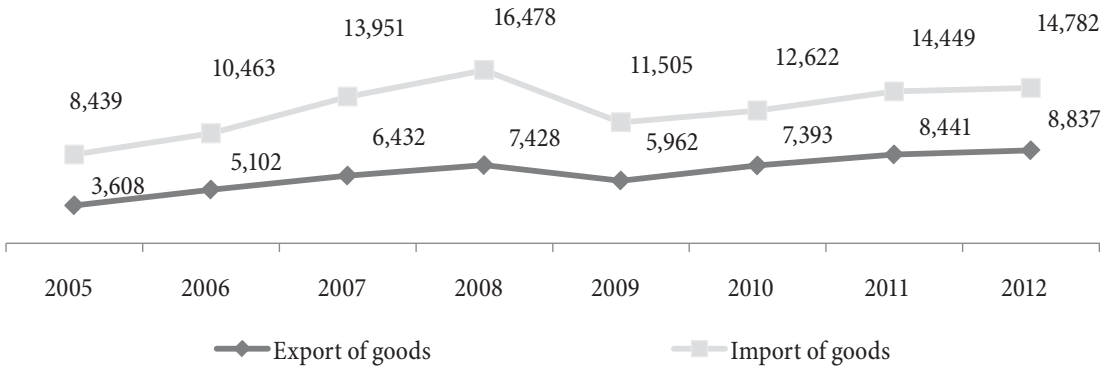
The National Bank of Serbia (NBS) uses monetary policy to target annual inflation based on the consumer price index with the two-week repo rate as the main policy instrument. The projected inflation target of 2.5-5.5% by end-2012 turned to be unattainable and annual inflation in 2012 finished at 12.2%. The NBS raised the two-week repo rate, the main policy instrument, by 25 basis points in both January and February 2013, to 11.75%, in order to reduce strong inflationary expectations. Future prospects for monetary easing will depend on developments in the international financial markets and domestic budget execution. Over the medium term, interest rates should decline gradually, in line with decelerating inflation.

Figure 5: Inflation rate (in %)



Source: NBS, Economist Intelligence Unit

Figure 6: Trade balance (mil. EUR)



Source: NBS

International Trade

The current account deficit was one of the key weaknesses of the macroeconomic environment before the 2009 crisis, reaching almost 23% of the GDP as a consequence of high domestic demand, strong dinar and low competitiveness of exports. The negative economic situation had some positive spillovers resulting in a decreased deficit from a fall in exports by an even greater fall in imports (see Figure 6). Furthermore, Serbian exports are heavily orientated towards the EU markets; therefore, the current recession in the euro zone means generally a less favorable outlook for export growth. However, there is still some cause for optimism due to a rise of production in the investments from the previous year, which should contribute significantly to exports increase. In addition, export-oriented services are expected to have a steady growth. The forecast of domestic demand remains moderate in the upcoming years, which will result in the current account deficit of about 7% of GDP on average in the 2013-2017 period.

Exchange rate

The dinar depreciated continuously from 2008 onward (see Table 1). In the period from 2011 to 2012, the dinar depreciated in nominal terms by 8.7% against the EUR, and by 6.6% against the USD. Depreciation was partly driven down by euro zone troubles, as with other regional currencies, but also by domestic uncertainties which made it vulnerable to depreciation pressures.

Regarding future trends (see Table 2), the exchange rate of the local currency is expected to remain turbulent throughout 2013, reflecting the situation on the financial markets caused by the Greek as well as wider euro zone crises, and due to concerns about domestic fiscal policy developments. However, in the following period, 2013-17, the dinar is forecast to strengthen modestly in real effective terms.

Table 2: Forecasts of RSD/EUR exchange rates (RSD)

	2013	2014	2015	2016
Exchange rate (RSD/EUR, end)	121.4	114.7	113.7	113.3

Source: Economist Intelligence Unit

Table 1: Historical exchange rates against the key foreign currencies (RSD)

	Dinar exchange rates against the foreign currencies - end of period					Dinar exchange rates against the foreign currencies - period average				
	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
EUR	88.6	95.89	105.5	104.64	113.72	81.44	93.95	103.04	101.95	113.13
USD	62.9	66.73	79.28	80.87	86.18	55.76	67.47	77.91	73.34	88.12
CHF	59.4	64.46	84.45	85.91	94.19	51.42	62.2	74.88	82.9	93.83
GBP	90.86	107.26	122.42	124.6	139.19	102.25	105.5	120.28	117.49	139.62
SEK	8.08	9.34	11.77	11.7	13.22	8.46	8.85	10.82	11.28	13
JPY	69.66	72.21	97.28	104.18	100.07	54.39	72.19	89.14	92.12	110.46

Source: NBS

Table 3: External debt of the Republic of Serbia, by type of debtor (mil. EUR)

	2008	2009	2010	2011	2012
STOCK OF EXTERNAL DEBT	21,088	22,487	23,786	24,125	25,721
LONG-TERM DEBT	18,945	20,483	21,956	23,477	25,228
Public sector	6,503	7,762	9,076	10,773	12,187
of which: NBS debt under IMF Standby arrangement		1,110	1,529	1,618	1,389
of which: Government obligation under IMF SDR allocation		422	449	459	452
Private sector	12,442	12,720	12,880	12,704	13,040
Banks	2,201	2,597	3,362	3,782	3,672
Enterprises	10,241	10,123	9,518	8,922	9,369
SHORT-TERM DEBT	2,143	2,005	1,830	648	493
Public sector	18	1	0	0	0
Private sector	2,126	2,003	1,830	648	493
Banks	1,323	1,713	1,731	582	428
Enterprises	803	290	100	66	65

Source: NBS

External debt

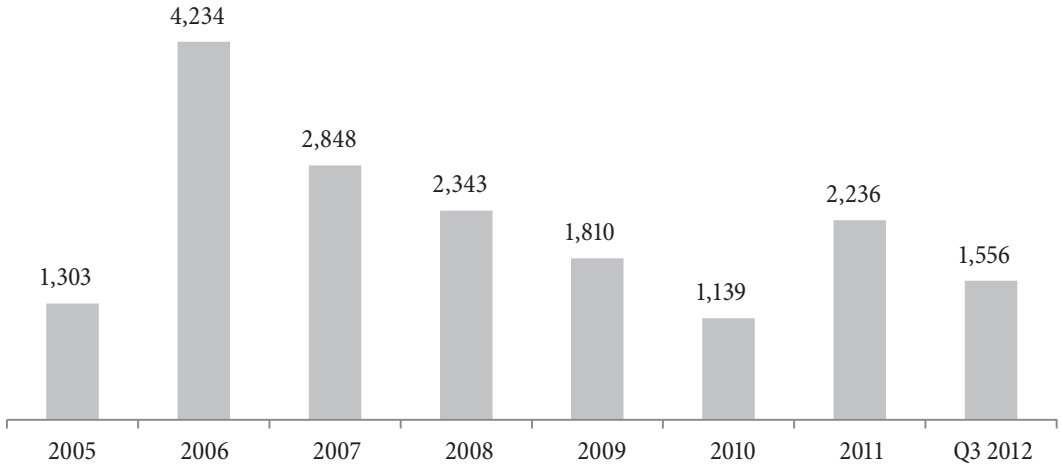
The external debt of the Republic of Serbia shows a constant upward trend (see Table 3), with the long-term debt accounting for the major part of it, with the private sector facing the greatest burden, especially enterprises. Although the private sector is the most indebted one, there is a clear and accelerating trend regarding the indebtedness of the public sector.

Direct foreign investments

In the previous years, Serbia was very active in attracting foreign direct investments (see Figure 7). From 2001 to 2011, the total value of FDI was around 19.5 billion EUR. Companies from Germany, Austria, Italy, Slovenia and other EU member states are most common investors in Serbia. Hence, economic development within the euro zone will influence future FDI inflows in Serbia. The largest investments were realized in the services sector, such as the financial industry, telecommunication and retail industry. On the other hand, in manufacturing, the highest stakes of investments were realized in the automotive and metallurgy sectors. Most of these investments were executed as privatizations of Serbian state-owned companies.

According to the national development plan, Serbia awaits future investments in the amount of 22.7 billion EUR until 2020, mainly in agriculture & food industry, energy, chemical industry and automotive industry, while the Government has the intention of providing strong support for the development of ICT and electronics industries, as well as textile. Obviously, trends for future

Figure 7: Foreign direct investments by years (mil. EUR)



Source: SIEPA, NBS, [11]

investments indicate that agriculture and labor-intensive industries might experience an increase in investments due to Government interest in lowering unemployment by providing attractive incentives to new investors.

Serbian economy prospects

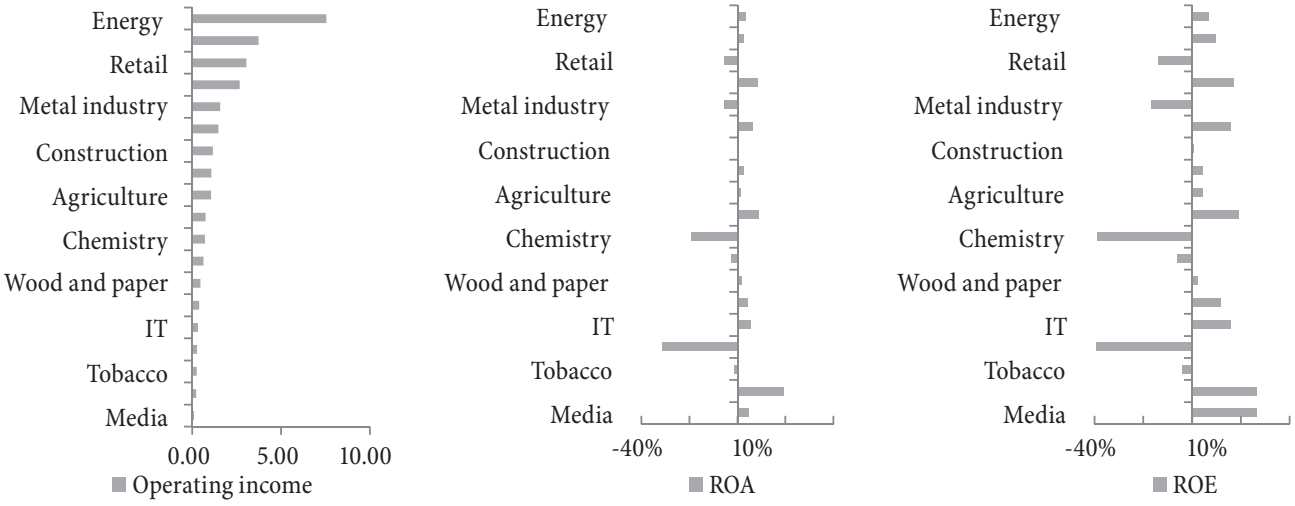
The total operating income of the top 300 Serbian companies was over 27 billion euros and the most profitable industries were construction materials, applied chemistry, food and beverage, telecommunication and IT (see Figure 8).

However, the Government strategy is to shift industry production from low value-added products to ones with higher value added. Also, its focus will be on support to export-oriented companies, further development of infrastructure and improvement of the climate for doing business in Serbia.

Despite this dedication to increasing the value added of domestic products, in the next decade, the Serbian economy will face the following challenges:

- *Dependency on FDI* – In order to ensure stable growth, Serbia will need to attract app. 2 bn EUR of FDI per year.
- *Promotion of export-related industries* – After a severe crisis in 2009, the Serbian Government realized that the GDP growth model based solely on services was not sustainable in the long run. Therefore, the Government focus should be on strong support to export-related manufacturing industries such as the automotive industry, ICT and electronics.
- *Growth of the SME sector* – In 2011, SMEs accounted for approximately 33% of the national GDP, which is much lower than in EU member states (SMEs contribute up to 60% of GDP). One of the key agendas for the Government should be further promotion and support to SMEs so that they can truly become the backbone of the country's economy.
- *Large infrastructure projects* – Despite the fact that large-scale infrastructure projects were planned for the past decade, Serbia is still lagging behind in terms of infrastructure development. Therefore, in order to further upgrade the country's road and railway networks, roughly 4 bn EUR should be invested in their modernization over the coming years.
- *Resolving the problem of unprofitable state-owned companies* – In the past decade, Serbia has privatized most of its state-owned companies; however, in this process, there are a couple of large companies (systems) still available for privatization, which currently receive support from the Government, either through subsidies or sovereign guarantees. Eventually, the Government should retain its interest in their privatization, directly or through strategic partnership, where it is possible.

Figure 8: Operating income (in bn EUR), ROA and ROE in 2011 (in %)



Source: Serbian Business Registers Agency

Banking sector overview

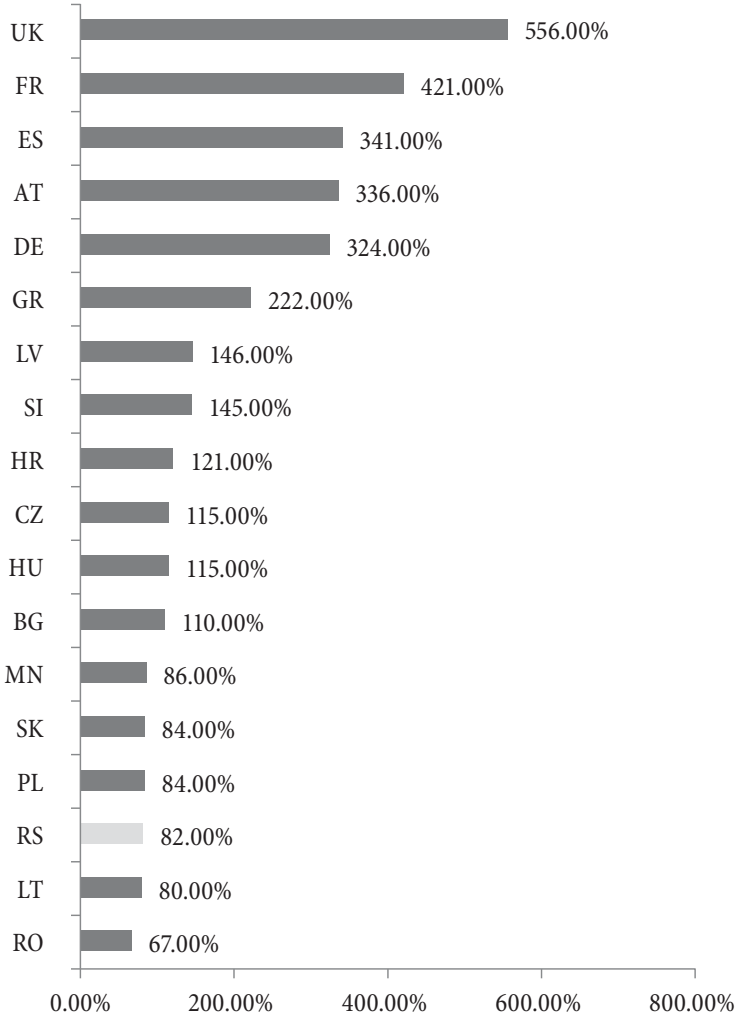
Growth potentials

Recent years have proved to be an exercise in crisis management for Serbian banks. Asset quality has been under assault due to a deteriorating macroeconomic situation, which has hit banks via rising impairment charges. Although adjustments have been apparent as the banks trimmed headcount and closed some branches, this has proved not to be enough as profits have plummeted due to higher impairment costs.

However, although profitability is reduced for the time being, the long-term picture looks more positive. The capitalization of the sector is more than adequate, while the growth rate of the market is another cause for optimism; however, everything still depends on the recovery of the real sector of the economy.

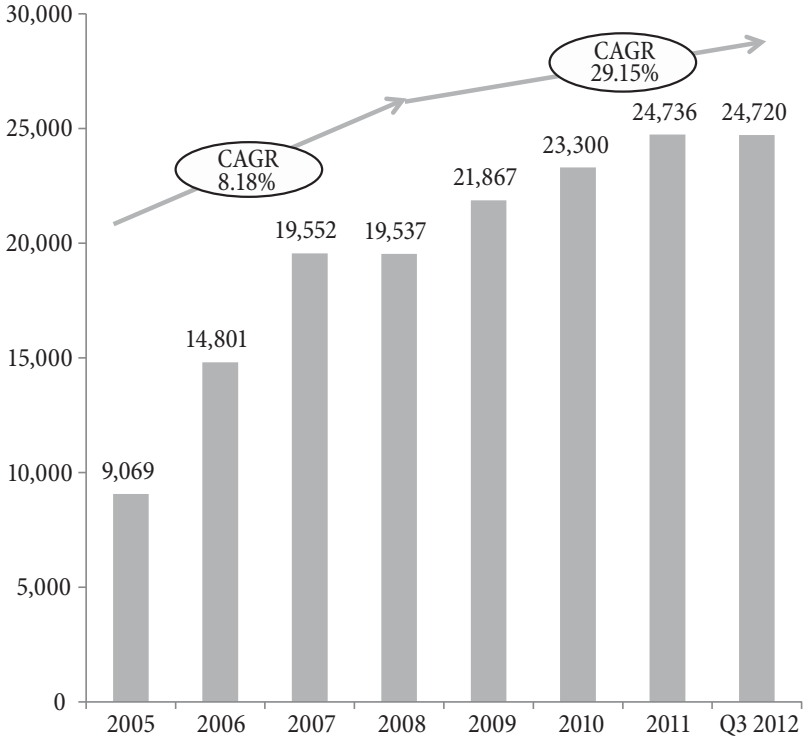
After immense growth from 2005 to 2008, the banking sector in Serbia continues to grow despite the financial crisis (see Figure 10). Contrary to the experience of most CE countries, where growth rates decelerated after the crisis, the pace of growth in Serbia continues to be brisk. Up to 2008, the assets of the banking sector expanded at an annual rate of over 29%. From 2009 to 2012, the assets grew, but at a slower pace (over 8% annually, on average). To some extent, this is a result of the sector's still relatively small size, especially when the regional perspective is taken into account. The assets of the Serbian banking sector total around 82% of the GDP, placing the country among the less developed in the region and suggesting that its long-term prospects are positive (see Figure 9).

Figure 9: Bank assets to GDP in 2011 (%)



Source: Deloitte analysis, Eurostat, financial reports of banks

Figure 10: Total assets in mil. EUR



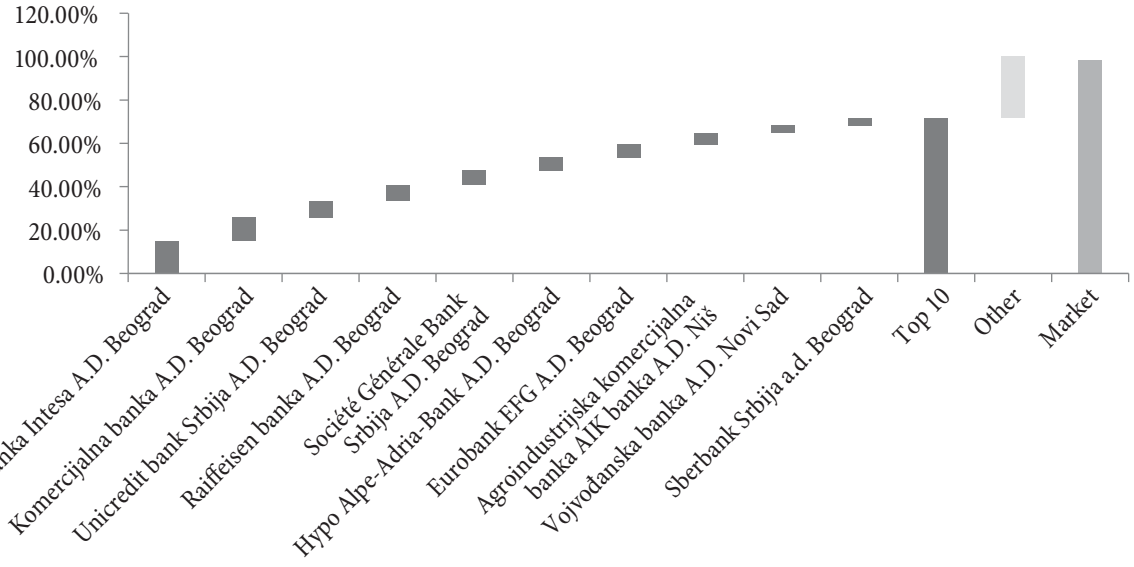
Source: Deloitte analysis, Eurostat, financial reports of banks

Banking sector assets distribution

One of the major reasons for the unsatisfactory level of operational efficiency within Serbian banks is the level of concentration of the banking sector (see Figure 11). The top 10 banks held around 72% of the total banking assets in Q3 2012. Another 20 banks held the remaining 30% of the market (individually, less than 3% of market share).

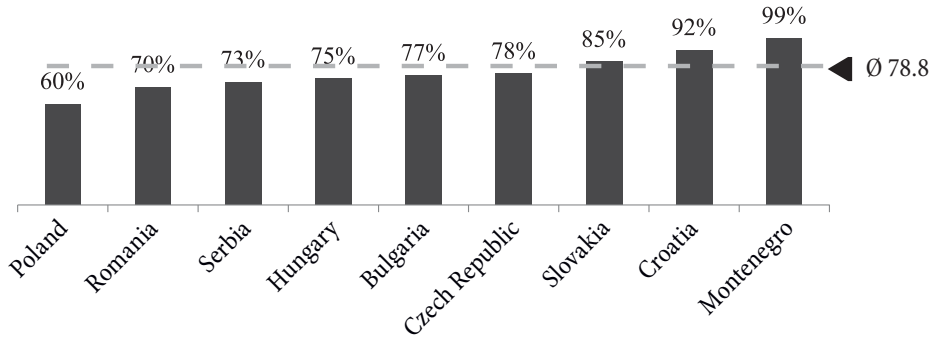
It is a shared feature of CE countries that their largest banks share a higher proportion of the market than the leaders in Western Europe. This strong market presence of the biggest players limits organic growth opportunities for smaller and new players, making mergers and acquisitions the primary route to gaining market share. Compared to other CE countries, the Serbian banking sector exhibits

Figure 11: Market share by assets – top 10 banks



Source: NBS, financial reports of banks

Figure 12: Assets of the top 10 banks in total assets, 2011



Source: NBS, ECB, Deloitte analysis, financial reports of banks

a lower level of concentration (see Figure 12). Hence, further market consolidation (mergers or acquisitions) can be expected in the upcoming years, especially taking into consideration merger trends of the parents' banks on the global market.

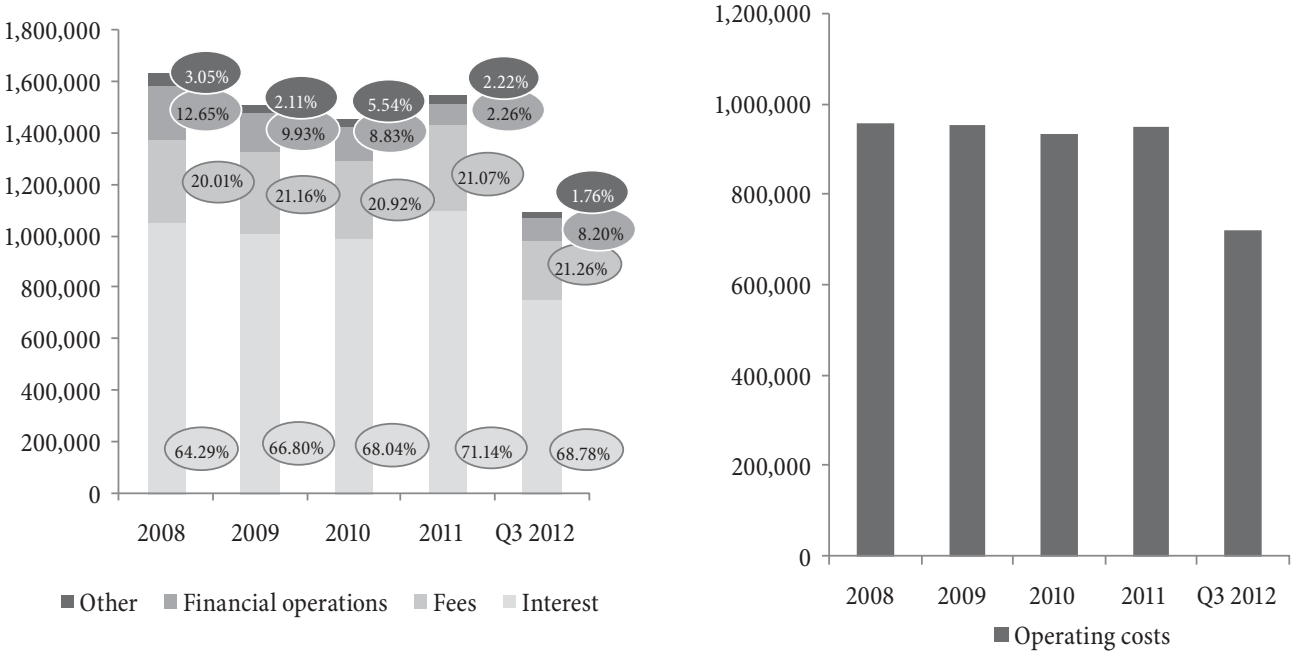
Funding

Deposits have been the cornerstone of Serbian banks' funding strategies over recent years (see Figure 13), contributing around 58% of liabilities (a slightly lower level than loans). After the initial hits of the global crisis, domestic banks were even more focused on further strengthening the deposit base (since they needed to repay credit lines which had been withdrawn from their parents' banks). The loan-to-deposit ratio, which in the past 5 years (2008-2012) was around 130%, illustrates the cautious approach to liquidity management within Serbian banks. It also shows a conservative approach to funding and emphasizes banks' ability to fund themselves. On the other side, the self-funding capacity of Serbian banks can determine their growth rates in the upcoming years.

Operational efficiency

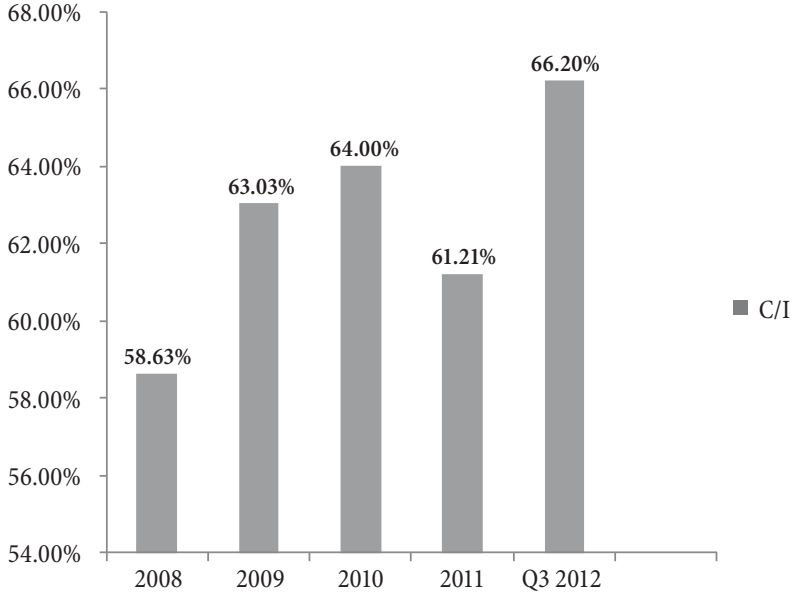
The efficiency of the banking sector has decreased in recent years. The cost-to-income ratio deteriorated from cca 59% to 64% between 2008 and 2010, as a result of sluggish income levels (see Figure 14). The short recovery seen in 2011 helped to improve the ratio, which fell back to 61%, while in 2012 the ratio worsened again, reaching 66%. Such development underlines the challenging banking

Figure 13: Income structure and operating costs (in 000 EUR)



Source: NBS, financial reports of banks

Figure 14: Cost to income ratio (%)



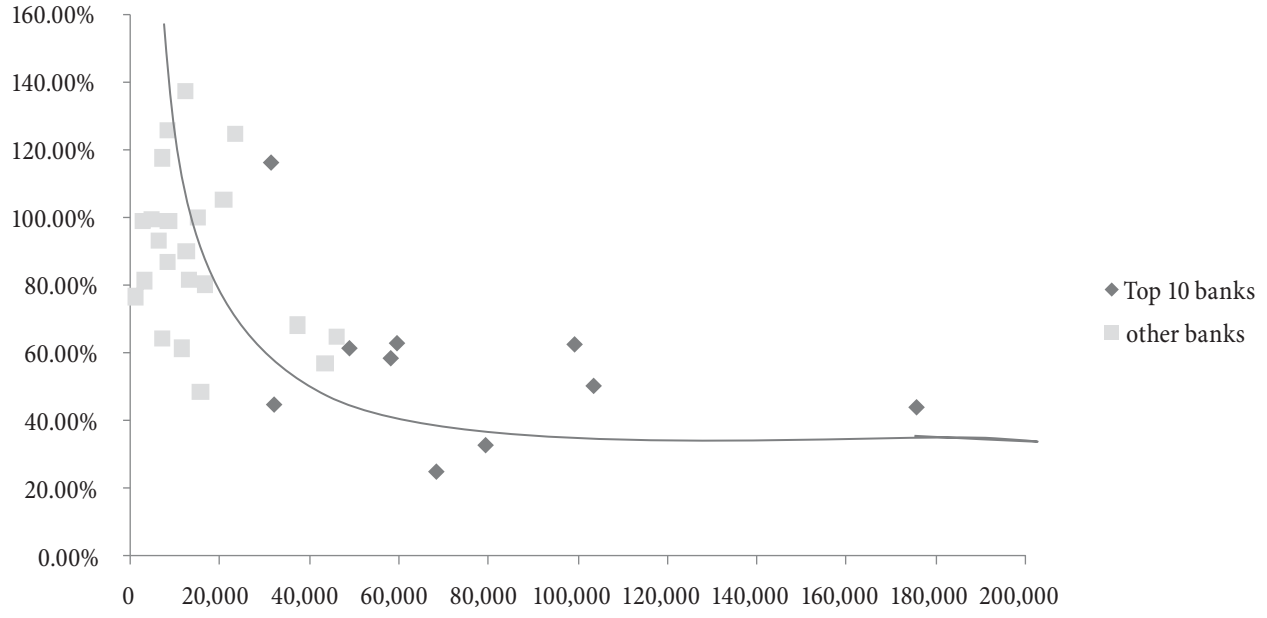
Source: NBS, financial reports of banks

environment, which is limiting the sector's ability to grow its top line.

A comparative analysis with other CE countries reveals inferior productivity of the Serbian banking sector: assets per employee and net revenues per employee, amounting to EUR 889K and EUR 56K, respectively, are below the average for the region. The gap between Serbia's personnel costs per head (EUR 14K) and the regional average (EUR 20K) is smaller than the corresponding gap in revenues (in Romania and Hungary, net revenues per employee are EUR 68K and EUR 122K, respectively).

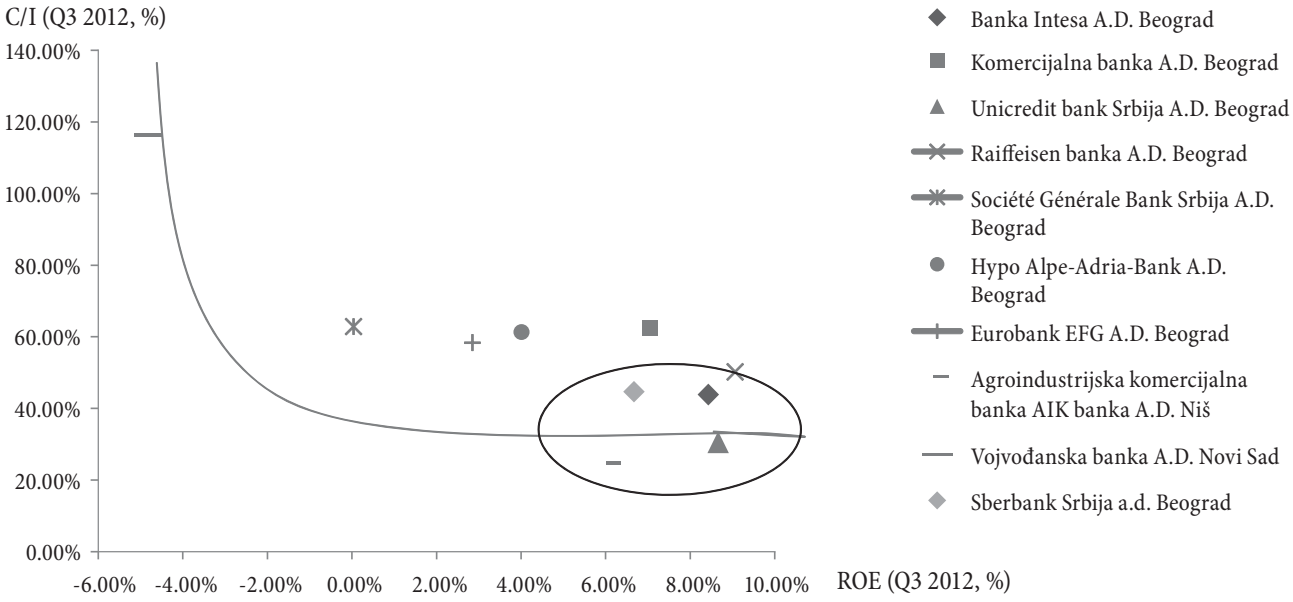
This highlights weak Serbian banking sector productivity, even despite the sector's decreasing number of employees. Bank by bank analysis shows that substantial benefits arise from a larger scale of operations (see Figure 15). Banca Intesa, the Serbian market leader, takes the top spot of the economies of scale. Yet, in general, the conclusion is that the rising trend of C/I ratio is mainly influenced by the drop in operating income – the chief driver of decline was the weaker contribution of financial operations, while net interest income and fees also contracted,

Figure 15: Cost-to-income ratio vs operating income



Source: NBS, financial reports of banks

Figure 16: Cost-to-income ratio vs ROE



Source: NBS, financial reports of banks

but to a lesser degree. Overall, the top line of the Serbian banking sector has recovered and remains driven by net interest income and fees on the back of growing assets.

Profitability

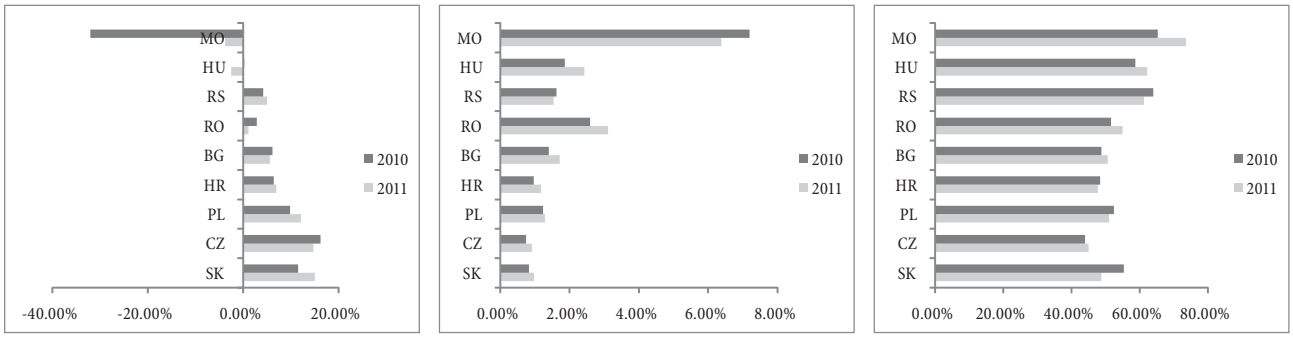
Lower cost to income appears to be directly correlated with higher profitability (see Figure 16).

On the other hand, among CE countries (see Figure 17), Serbia is slightly below average in terms of the level of profitability, costs and risk.

Recent years have been demanding for Serbian banks as the negative impact of depreciating assets has hit profitability (see Figure 18). While there was a clear deterioration in the sector's ability to generate net profit in the years immediately following 2008, banks still managed to deliver low, single-digit profitability. The final blow from rising provisions came in 2011 and 2012, which wrecked the profitability of the banking sector. As a result, ROA and ROE both fell in Q3/2012, to 0.4% and 2.1%, respectively.

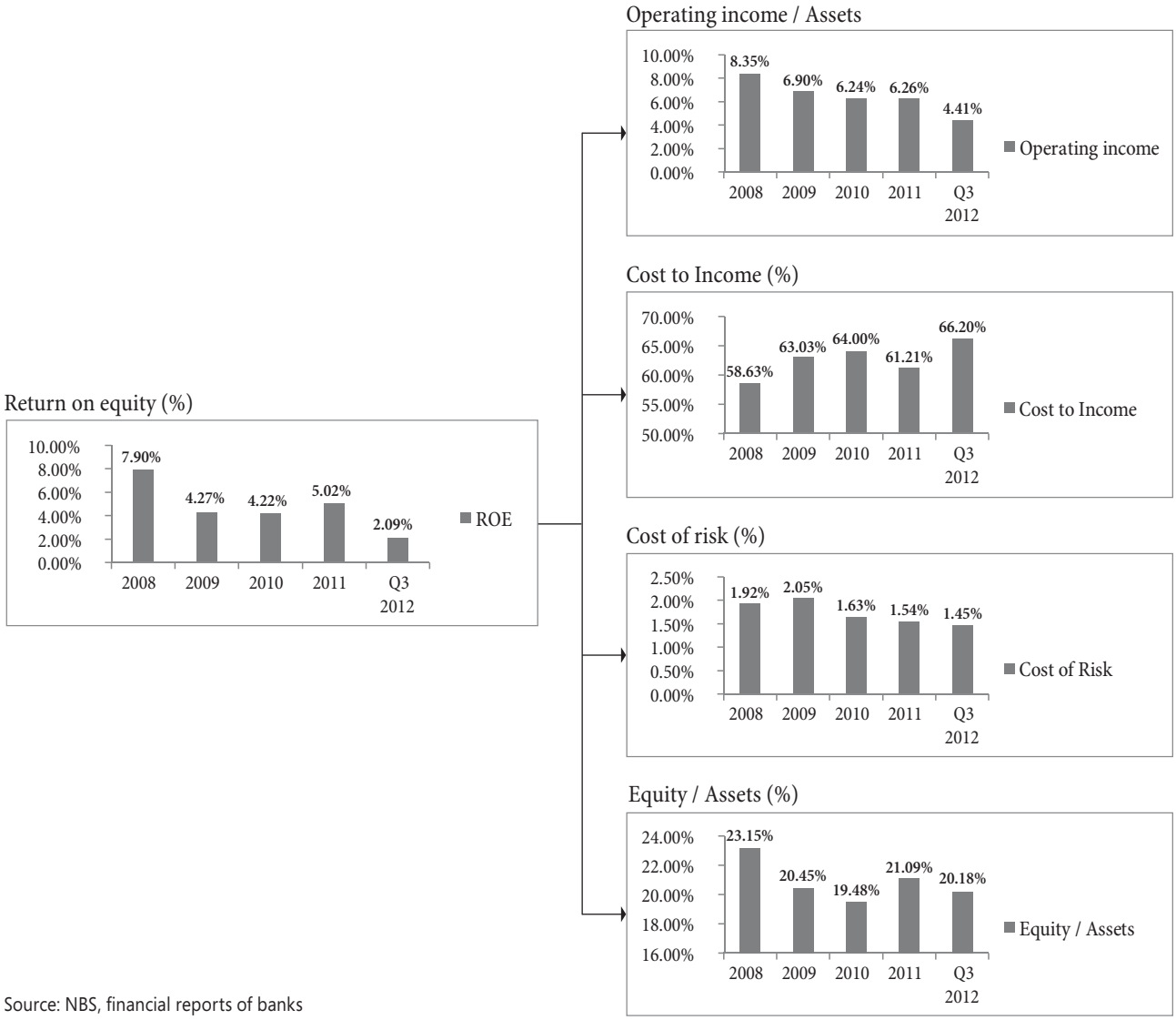
A comprehensive profitability analysis illustrates two negative trends: a) the cost of risk rose sharply, especially in 2011 and 2012 (a weak macroeconomic backdrop and slower loan book growth resulted in a strong increase in loan-loss provisions in 2011 and 2012, placing Serbia among those countries with the highest levels of provisions in the CE region, 2.5% CAGR from 2008 to 2011 – the deterioration is particularly evident when 2008 is taken as the base year: loan-loss provisions in 2011 were almost twice the 2008 level); b) revenue relative to assets contracted throughout the period at an annual rate of 8%. At the same time, cost-to-income ratio in the past 4 years was balancing around 62%, remained the same, causing profitability to fall.

Figure 17: ROE, cost of risk, cost to income in CE, 2011



Source: NBS, financial reports of banks, Deloitte analysis

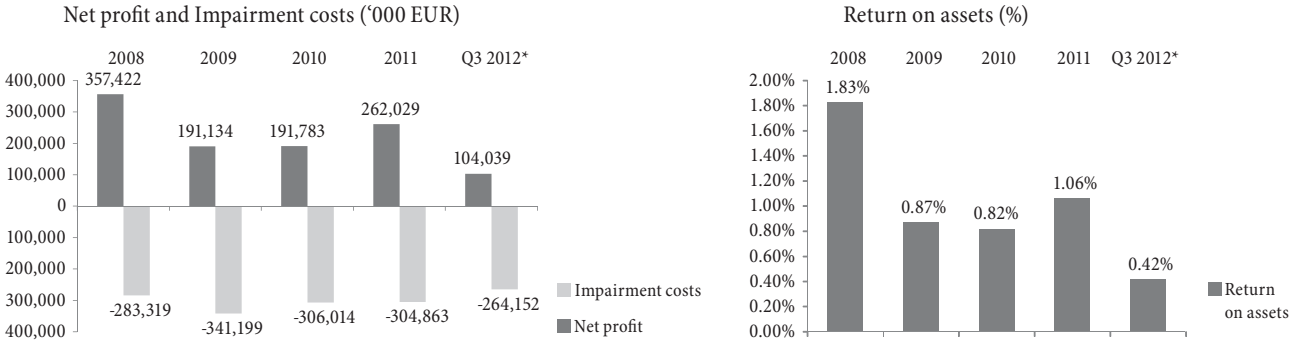
Figure 18: ROE trend, in 2008-Q3/2012



Source: NBS, financial reports of banks

Decreasing revenues and risk of impairment costs increase (see Figure 19) are the main threats to profitability in the upcoming years. However, on the other hand, equity-to-asset ratio at cca 20% enables a higher level of safety and demonstrates the above-average capitalization of Serbian banks. Recovery of the economy, and consequently, the reduction in impairment costs should provide recovery in profitability of the Serbian banking sector.

Figure 19: Net profit and Impairment costs ('000 EUR) and ROA, in 2008-Q3/2012



Source: NBS, financial reports of banks

Conclusion

After the first wave of the global crisis, in 2010 and 2011, the Serbian banking sector remained stable, largely owing to maintained vitality of the real sector of the economy due to a moderate recovery of FDI inflow, as well as the Government's program for mitigating the adverse effects of the global economic crisis, aimed at stimulating domestic demand (the GDP growth rate amounted to 1% and 1.6%, respectively). During 2012, the election year, the economy went into recession (the GDP growth rate was -1.7%), i.e. economic activity, FDI and the overall performance of the real sector of the economy declined, which, combined, had an impact on the banking sector as well:

a) total banking assets growth decelerated (in the period 2005-2008, the average annual growth rate, in cumulative terms, amounted to 29.2%, while in the period 2009-2012, it was 8.2%);
b) the loan-to-deposit ratio exhibited a downward tendency (from 137% and 141% in 2010 and 2011, respectively, to 128% in 2012), which indicates a deceleration in credit activity, while, on the other hand, it also testifies to local banks' conservative approach in financing the credit portfolio (predominantly from the deposit base);
c) total deposits recorded a growth in the period 2010-2012 (11.7% in Q3 2012 against Q3 2011) and accounted for about 58% of total liabilities – retail deposits account for the highest proportion (about 58%); as regards the currency structure, foreign currency deposits prevail (about 77%); as regards the term structure, short-term deposits up to one year are dominant (about 94%), while retail savings account for about 49% of the total banking sector deposits;
d) total loans recorded a decelerating tendency in the period 2010-2012 (the total loans growth rate amounted to 2.3% in Q3/2012 against 2011 and -0.8% in 2011 against 2010, while in 2010 against 2009 it was about 32%, and in 2009 against 2008 – about 24%) – loans to enterprises account for the highest proportion (about 1/2), followed by retail loans (about 31%) and those to the public sector (about 9%); as regards the currency structure, foreign currency loans prevail (about 75%), while, as regards the term structure, long-term loans over one year are dominant (about 62%);
e) the cost-to-income ratio is on the increase (from about 58% in 2008 to about 66% in 2012), but owing to a decline in operating income (income from interests and charges), rather than an increase in costs;
f) the amount of non-performing assets ("non-performing loans"/NPL), as a percentage of total loans, grew significantly – from 5.3% in 2008 to 19.9% in 2012; the business sector accounts for the highest share of NPL (59.5% of the total NPL in 2012), while the retail and public sectors account for 38.5% and 1.8%, respectively, of the total NPL in 2012 – the NPL coverage ratio worsened and amounted to 122% in Q3/2012, while it had been 128% in Q3/2011;
g) return on equity (ROE), as well as return on assets (ROA), is on the constant decline (ROE from 7.9% in 2008 to 2.7% in Q3/2012, and ROA from 1.8% in 2008 to 0.6% in Q3/2012), and factors affecting such outcome are: increase in other operating expenditures on account of bad debt write-off, decline in net interest income, as well as increase in net expenditures on account of write-off of investments and provisions;
h) the average monthly liquidity indicator for the overall banking sector was 2.10 in Q3/2012, which is considered satisfactory, in view of the regulatory minimum of 1, and the ratio of liquid assets to total short-term deposits indicates that term deposits with a term longer than one year still do not represent an attractive option for the existing and potential depositors;
i) finally, conditionally speaking, a comprehensive indicator of banking sector portfolio quality or, better, a measure of the risk to security is capital adequacy. The banking sector capital adequacy ratio, which amounted to 16.40%[1] in Q3/2012 (it was

1 From December 31, 2011, banks compute the indicator pursuant to the Decision on Bank Capital Adequacy, Official Gazette of the Republic of Serbia No. 46/2011.

19.9% in 2010 and 19.1% in 2011), as well as the proportion of equity (share) capital of about 21% in the total assets confirm the above-average capitalization of banks in the local market, i.e. the fact that, in the event of credit portfolio deterioration, solvency remains at a satisfactory level.

Notwithstanding all this, market concentration is high, but still lower than the average for CE countries – the top 10 banks hold about 72% of the market, in terms of total assets, which supports the position that the Serbian banking market is concentrated, i.e. that the number of banks currently operating is too great (32 banks), and that, in near future, further consolidation within the banking sector must be expected.

Earlier data indicate that banks' credit activity in post-crisis years has recorded a trend of deceleration, both in terms of scale and in terms of risk or conservatism in their approach, all of which is a result of economic recession. However, if banking sector performance is viewed from another perspective, although profitability exhibited a downward trend over the observed period, the long-term prospects are more positive. More specifically, capitalization of the banking sector is more than adequate, and the current share of banking sector assets in the GDP (about 82%) indicates that there is room for further growth (in Central Europe, this indicator amounts to about 140%, while in Western Europe it is higher than 300%, and in the UK it exceeds 500%).

All of the above gives rise to the conclusion that the banking sector has successfully absorbed the shocks of the global financial crisis so far and that there is no threat to banks' liquidity and solvency. Also, confidence in the banking system is stable. However, the main risk to banking sector financial stability and the influence of the monetary policy on the economy lies in the vitality of the real sector of the economy, i.e. in the economic policy makers' activities/measures aimed at reviving economic activity in the forthcoming period.

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