

# TOPIC OF THE ISSUE

## Bank placements in Serbia - main findings

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Lending activities in the banking sector decelerate. The first eight months of this year are characterized by two important facts:

- Higher increase in loan repayment than in the level of placements;
- Y-o-y decrease in private sector placements was recorded

Total bank placements in August 2013 reached the level of RSD 2.213,9 bn. The first eight months of the current year reported a nominal decline of RSD 32,2 bn, i.e. 1.4%. The realized decline was not caused by the effect of the dinar exchange rate changes relative to foreign currencies. During the period under review, the dinar depreciated against the euro by only 0.62% and appreciated against the Swiss franc by 0.47%, so placement decline of 1.3% is thus real. The achieved result is much worse compared to the same period in 2012 when a relatively high level of activity was recorded. Therefore, the indices showing trends in 2013 total placements are the worst in recent years.

**Banking sector placements**  
(in RSD bn, end of the period)

|                                     | 2011           | 2012           | August 2013    |
|-------------------------------------|----------------|----------------|----------------|
| <b>Total placements</b>             | <b>1.987,2</b> | <b>2.246,1</b> | <b>2.213,9</b> |
| Government sector                   | 200,1          | 290,4          | 302,8          |
| Corporate sector                    | 1.058,7        | 1.161,8        | 1.100,8        |
| Retail sector                       | 560,1          | 608,7          | 631,8          |
| Public sector                       | 98,1           | 106,3          | 102,5          |
| Other sectors                       | 70,2           | 78,9           | 76,0           |
| <b>Placements to private sector</b> | <b>1.618,8</b> | <b>1.770,5</b> | <b>1.732,6</b> |
| Nominal annual growth (%)           | 7,5            | 9,4            | -4,1*          |
| Real annual growth (%)              | 7,5            | 4,5            | -0,8*          |
| Share in total placements (%)       | 81,5           | 78,8           | 78,2           |

\* Compared to August 2012

Source: NBS, Statistical Bulletin 08/13

The structure of placements has remained almost unchanged compared to the previous year. The trend of a strong turnaround in lending policy, in which the commercial banks channeled their activities towards the government instead of the private sector, was mitigated. Placements to the government sector reached the level of RSD 302,8 bn and accounted for 13.6% of total placements. After a significant decrease in the level of placements in the first quarter, due to the government focus on fundraising in foreign markets, the second quarter reported issuing of securities in the national market, resulting in a new record level of placements to the government sector. However, these trends can not be characterized as "crowding" private sector out of the banks' focus because there are almost no alternative options for placements or banks do not use them.

Placements to private companies and entrepreneurs in the amount of RSD 1.000,8 bn are dominant in the structure of total placements. However, due to nominal decline, in the amount of RSD 61,0 bn, the share thereof decreased by 2,0 p.p. and they accounted for only 49.7% of total placements in late August. Placements to the corporate sector have been for years characterized by banks' high activity during the Government Programme of support to economic activity through subsidies to interest rate on loans, and far lower lending activity in other periods of the year. Due to the fact that the fund of subsidy resources was the lowest since this concept was introduced into practice, the programme was completed in March. This directly reflected on the recorded result. Negative net effect of placement and repayment process was observed with this group of clients for the sixth consecutive month, which indicates placement stagnation.

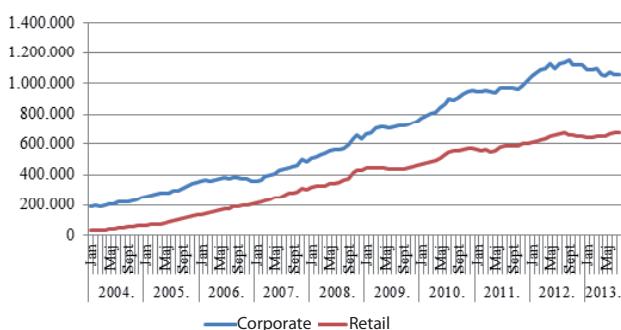
On the other hand, placements to the retail sector recorded a nominal increase in the period under review, standing at RSD 23,1 bn, i.e. 3.9%. At the end of August, they reached the level of RSD 631,8 bn accounted for 28.5% of total placements of the sector. The low level of non-performing loans, the need for diversification of the overall portfolio combined with a high level of demand for cash loans, are the main factors of achieved growth.

The previous year was marked by the growth of placements to public enterprises while the placements to this sector, in the period under the review, remained at almost the same level with minor fluctuations from month to month. Placements in this category amounted to RSD 102,5 bn in August, i.e. 4.6% of total placements.

### The level of placements to corporate and retail sectors

(in RSD bn, end of the period)

Source: NBS, Statistical Bulletin 08/13



Placements to private sector, as to the main driver of economic activity, reported a nominal decrease of RSD 39,9 bn in the first eight months, i.e. 2.1%. However, looking at trends over the past 12 months, there has been y-o-y nominal drop of 4.1%, but due to appreciation of the dinar in the period under the review (5.8% against the Swiss franc and 3.4% against the euro) y-o-y drop was only 0.8% in real terms. With the total amount of placements of RSD 1.732,6 bn, the share of private sector placements in total placements is 78.2%, meaning that trend of share decrease continued but was mitigated. Over the last 10 years, this is the worst period for the private sector placements.<sup>1</sup>

Such market signal must not be underestimated given the importance of the private sector activity for the entire economy, as well as the fact that there is a positive correlation between the level of banks' lending activity to private sector and economic activity in general, as well as the value of gross domestic product of a country. This especially applies to the segment of companies. The need for deleverage comes both from banks and from private sector due to the still ongoing consequences of previous mistakes made by all stakeholders - careless placements and borrowings.

In recent months, the banking sector problems, as regards placements, have clearly profiled in Serbia on both the demand side and on supply side. Loan demand certainly exists but its level is much lower compared to last year. There are two reasons for said:

1. High level of uncertainty in business operations, caused by slow economic recovery, as well as relatively high interest rates, affect companies in terms of more cautious borrowing; making major decision as regards investments and expansion of business scope is "on hold";

2. High unemployment and a large number of employees without a clear long-term perspective influence the lower level of loan demand for capital investments (purchase, construction and renovation of housing, as

well as schooling).

The following reasons for reduced level of activities on the supply side are of importance:

1. Reducing the sources of placements in the past three years directly reflected on the reduced capacity of the co-called foreign banks for new loans. Restrictions which parent banks forced on their subsidiaries in Serbia (ratio: loan/deposits) and a low potential of local resources, directly contribute to a negative trend;

2. High level of non-performing loans and, as a consequence, low profitability, resulted in significant tightening of credit approval procedures.

These findings are not specific for the Serbian banking sector only, but also for banking sectors of almost all European countries, regardless of the region. The only difference is on the supply side, where an additional limiting factor for the placements growth is banks' need to adjust to this new regulation, in both regulatory and in financial terms. Based on the European Central Bank's data, published recently, there are clear indications of the euro zone banks recovery in terms of resources and liquidity, but the positive trends are not yet reflected in placements to private sector. Loans to households has stabilized in the last two quarters and reported low but positive growth rates, while loans to corporate sector have further declined.

Finally, when making the analysis of trends in the field of the private sector placements, one should have in mind several important facts that characterize this type of market signals. Firstly, the fact is that the financial cycle is always longer than the economic cycle. This could be observed in practice in the situation when, apart from the clear solvency problem and the problem with business concept of a large number of companies, the level of lending activity was still high. Secondly, due to the specific segments of the economy and the population, there are distinctive differences in the interpretation of placement trends. Due to a number of factors, banks' activity, i.e. financial cycle, in the segment of population is followed by the business cycle trends. The growth of economic activity that results in increasing number of employees, including the salary levels, affect the bank's decision to increase the level of retail loans as soon as possible. The results may be shown with no time lag. In the segment of companies, the situation is more complex and lagging of banks' activities behind business cycle can be three or four quarters. The experience gained in times of crisis, but also the fact that the economy has a surplus of own resources due to higher business volume, are the main arguments that affect the creation of the aforementioned lag.

The main macroeconomic consequence of reducing private sector placements is deceleration of the process of economic activity renewal. Another major problem that can cause this trend is radical tightening of liquidity problems in the real sector. Therefore, the regulatory and governing bodies should address this negative trend thoroughly.

1 The fact that NBS official data exclude placements of two state-owned banks, whose license was revoked, has to be taken into account as well. However, it does not change the general assessment of trend.