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COVER NOTE

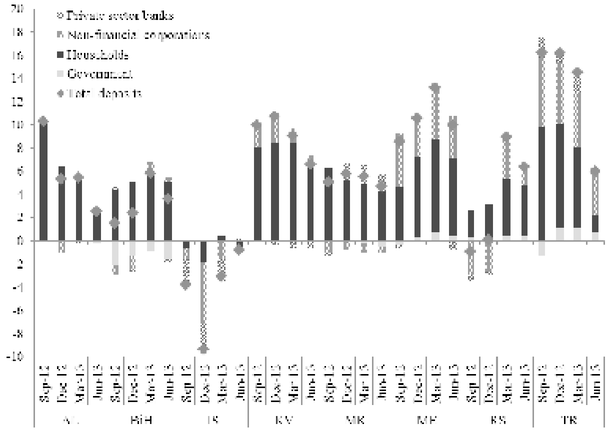
From:	General Secretariat of the Council
To:	Delegations
Subject:	Report on Financial Stability Challenges in EU candidate and potential candidate countries

In view of the ministerial dialogue lunch between the economic and finance ministers of the EU and the Candidate Countries of 6 May 2014, delegations will find attached

" Report on Financial Stability Challenges in EU candidate and potential candidate countries"

endorsed by the members of the EFC and representatives of the former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey on 24 April 2014 as a background document.

Chart 3.3: Contributions to overall deposit growth
(annual percentage change)



Sources: National central banks, Haver Analytics and ECB staff calculations.
Notes: Time series are converted into euro and fx-adjusted with the difference in the exchange rate compared to the same month the previous year.

Reference deposit rates in EU candidate and potential candidate country banking systems have remained broadly stable or declined in a context of some monetary policy easing by central banks both 'at home' and 'abroad'. Notwithstanding this overall trend, reference deposit rates vary widely among EU candidate and potential candidate country banking systems, reflecting both diverging monetary and exchange rate policy regimes as well as different underlying perceptions of 'country risk' (see table 3.7).

Table 3.7: Reference deposit rates

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Albania	3.4	3.3	3.5	3.4	3.4	2.8
Bosnia and Herzegovina	0.2	0.3	0.2	0.2	n.a.	n.a.
Iceland	0.2	0.9	0.9	1.0	1.1	1.1
Kosovo	3.3	3.6	3.7	3.7	3.5	3.5
FYR Macedonia	3.6	3.5	3.4	3.3	3.1	3.1
Montenegro	3.4	3.3	3.2	3.2	3.1	3.0
Serbia	6.5	6.2	6.7	6.3	6.9	5.9
Turkey	7.6	7.8	6.5	5.9	5.2	5.3

Sources: National central banks and ECB staff calculations.
Notes: Reference deposit rates refer to weighted averages of short- and long-term deposit rates to households and non-financial corporations, in domestic or foreign currency (as applied in the relevant quarter).

Relative reliance on interbank funding has remained broadly stable and thus of limited importance for most banking systems concerned. The share of interbank funding (both domestic and foreign banks) in total liabilities of banking systems in Western Balkan EU candidate and potential candidate countries ranged from 5.2% (Serbia) to 16.4% (Montenegro) in 2013Q2. In a longer term perspective, the share of interbank funding has decreased in Montenegro and Serbia, remained broadly unchanged in Albania and Kosovo and increased slightly in the former Yugoslav Republic of Macedonia since 2011 (although it remains still marginal in banks overall funding). In the first half of 2013, it was the second most important funding source in Turkey. Overall, these figures indicate that there is room to improve the functioning of the interbank market to channel funding from banks with a funding surplus to those with a funding deficit.

3.3 Dynamics in underlying profitability

Pressure on bank profitability has continued amid an often difficult business environment. Banks' returns on assets (RoA) have remained subdued in all EU candidate and potential candidate countries except for Iceland, Turkey, and to a lesser extent Kosovo (see chart 3.4). Tentative signs of improvement of such indicators seem to occur in Serbia and Montenegro. In 2013Q2, RoA of the banks in EU candidate and potential candidate countries ranged from 0.2% in the former Yugoslav Republic of Macedonia to 2.3% in Iceland. Compared to the pre-crisis period, the returns generated from banks' assets decreased in all countries except for Bosnia and Herzegovina (+0.1pp) and Montenegro (+0.98pp).

Chart 3.4: Return on assets
(in percent)

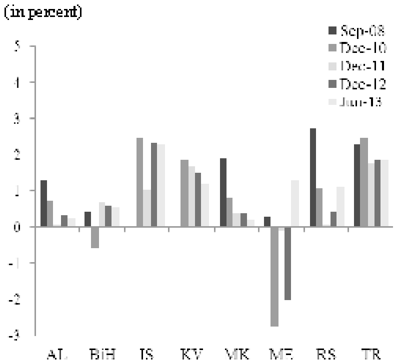
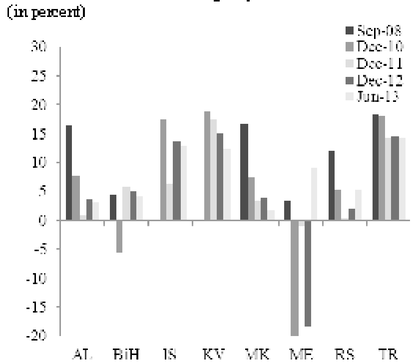


Chart 3.5: Return on equity
(in percent)



Sources: National central banks.

In the case of Montenegro profitability turned around in the beginning of 2013 due to some sell-off of NPLs. The on-going adjustment in bank balance sheets has generally brought down the leverage ratio of banks, ranging from 11.8% in Albania to 4.8% in Serbia in 2013Q2 (see country annexes). Lower leverage has in turn been often associated with a downtrend in returns on equity in some cases, including in Albania, where return on equity came down from 16.3% (2008Q3) to

2.9% (2013Q2, see chart 3.5). Overall, returns on equity ratios have remained consistently robust in the cases of Turkey, Kosovo as well as in Iceland. In case of Iceland, this is mainly related to reductions in expenses costs and net increase in loan values in the corporate sector.

Banks' net income has generally been dampened by increased provisioning for rising NPLs. Provisions rose in most EU candidate and potential candidate countries, primarily reflecting stubborn challenges to asset quality but also regulatory changes in some cases. The latter was the case in Turkey, where the Basel II.5 framework became operative. However, net income increased in 2012 compared to 2011 in all countries except in Kosovo, while it was still negative in Montenegro (see also table 3.8).

Table 3.8: Net income in 2012

	Albania		Bosnia and Herzegovina		Iceland		Kosovo		FYR Macedonia		Montenegro		Serbia		Turkey	
end 2012	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)	million EUR	y-o-y change (%)
Gross interest income	551.9	5.6	591.6	-2.9	1,089.1	14.6	200.5	2.7	726.7	1.0	189.5	-1.1	1,775.8	-10.0	47,461.9	25.7
- Total interest expenses	165.8	10.7	202.9	-6.0	525.8	21.2	61.1	8.0	142.0	44.1	81.5	-7.0	759.9	-8.6	24,896.0	19.0
Net interest income	386.0	1.1	388.7	-1.8	563.5	9.1	117.4	0.5	184.8	9.1	106.0	-0.1	1,016.0	-11.0	22,567.9	14.0
- Provisions for loan losses	111.7	-0.6	121.1	1.2	145.7	-11.1	n.a.	0.0	81.7	25.4	110.5	1.6	404.0	-17.2	1,782.1	0.8
+ Non-interest income	401.6	-16.8	221.9	-0.9	501.4	-11.7	46.6	1.5	101.6	8.0	96.7	-27.4	8,811.5	-5.1	11,117.6	9.7
- Non-interest expenses	1455	-19.1	411.8	-1.7	621.6	40.1	161.5	15.0	181.8	1.1	179.9	8.5	9,164.7	-5.1	18,499.1	19.2
+ Gain (losses) on securities	9.0	4.4	n.a.	n.a.	151.8	1.7	-0.6	57.8	1.2	-10.2	2.2	-47.1	5.1	56.9	-1,015.6	251.4
Pre-tax earnings	77.1	110.2	77.4	-7.1	441.1	212.2	21.8	45.7	24.4	21.5	-66.6	-2,997.5	101.1	719.5	17,604.5	18.5
Net income	37.1	418.5	64.4	-9.7	190.0	115.0	18.5	48.7	21.8	21.5	-66.5	-4,666.5	74.7	511.5	10,159.1	19.5

Sources: National central banks and ECB staff calculations.
Notes: For Albania, provisions for loan losses cover provisions for loans and other assets. In the case of FYR Macedonia, impairment losses of non-financial assets are also included in provisions for loan losses, and gain (losses) on securities refer to net-income from assets and liabilities held for trading.

Interest-related income remains the most important source of revenue for banks in EU candidate and potential candidate countries. Although the low interest rates currently prevailing at a global level reduce banks' funding costs, they also put pressure on margins and thus ultimately on profitability as well. Revenues generated from lending are the most important income source in EU candidate and potential candidate countries. Gains from trading with securities and derivatives have a minor importance in overall net income except in the case of Turkey. Operating costs seem to dent significantly into profits. Non-interest expenses as a share of gross income range from 52.2% in Turkey to 89.4% in Iceland. However, in order to improve their income, some banks are cutting operational cost (mostly staff-related through lay-offs and re-adjusting the remuneration structures) as well as utilising economies of scale and innovations.

The scope to increase interest rate margins appears limited to the extent that the credit environment remains sluggish and global interest rates remain low, especially in the fx lending segment which is dominant in many cases. Interest rate spreads between reference lending and deposit rates have remained broadly stable in the period under review, ranging from 4.6pp in the former Yugoslav Republic of Macedonia to 8.5pp in Kosovo in 2013 Q2. Looking into the currency denomination, the spread between lending and deposit rates in domestic currency ranged from 4.1pp to 8.5pp in 2013Q2 and thus remained above that for loans and deposits in fx, which ranged between 4.2pp and 5.0pp. The narrower dispersion of fx-denominated interest rate margins relative to domestic ones appears to provide limited room for significant increases in the former segment, especially to the extent that the global credit and interest rate environment remains sluggish.

3.4 Conclusions

Overall, the magnitude of the challenge to reach a 'new banking normal' for banking systems in EU candidate and potential candidate countries appears to remain sizeable. On the lending side, challenges to asset quality through high NPL burdens in some cases hamper effective balance sheet repair and increased financial intermediation. Survey-based indicators show that demand for credit also remains weak in many cases, especially in the corporate sector. Concerning funding, the substitution of external for domestic sources of finance has been encouraging, with banks' successfully capturing household deposits, although the evidence on loan-to-deposits provided in chapter 2 illustrates that the stability of domestic bank funding bases has yet to be cemented in many cases. Moreover, the potential of domestic deposits to fully offset the reduction in foreign funding when credit demand picks up again remains questionable, suggesting that the development of alternative sources of funding in local capital markets would be key. Concerning profitability, pressure has generally remained high in the period under review, with provisioning for NPLs denting banks' net income. Banks in several countries have tried to make-up for this shortfall by increasing their exposure to the public sector, but the impact on bank profitability (as well as on overall credit growth more generally) has been limited.

4. Potential implications of the Single Supervisory Mechanism for banking systems in EU candidate and potential candidate countries

The establishment of a 'banking union' in the euro area is set to have a number of implications for banking systems in EU candidate and potential candidate countries. The regulatory and supervisory environment of most euro area-headquartered banks with a strong presence in EU candidate and potential candidate countries will fundamentally change once a key element of the banking union – the Single Supervisory Mechanism (SSM) – becomes fully operational in November 2014. This implies that the relationship between 'home' (euro area) and 'host' (EU candidate/potential candidate) supervisory and regulatory authorities will be altered soon.

The environment in which euro-area headquartered banks operate will continue to evolve as further progress is made towards the completion of the banking union project. This will include the establishment of a Single Resolution Mechanism (SRM) as well as a system of harmonised

Deposit Guarantee Schemes (DGS). EU candidate and potential candidate countries will also be impacted by these changes as the legal and regulatory environment which they must comply with as prospective EU members will be modified. Changes in the business strategies of parent banks operating in non-SSM countries resulting from banking union in the euro area appear more uncertain, but cannot be ruled out.

The remainder of this chapter provides an overview of the prospective role of the SSM as the home supervisor of banks where parent-subsidiary relations are most prominent (i.e. EU candidate and potential candidate countries in the Western Balkans, Section 4.1). It then takes a closer look at the potential benefits and challenges for EU candidate and potential candidate countries associated with the establishment of the SSM (and the introduction of macro-prudential competencies at the euro area level, Sections 4.2 and 4.3) and outlines the need to establish appropriate 'home-host' supervisor communication channels in the new system (Section 4.4).

4.1 The SSM as home supervisor of locally-systemic banks in EU candidate and potential candidate countries

The SSM will 'inherit' a banking structure in which subsidiaries of euro-area headquartered banks in EU candidate and potential candidate countries are dominant and hence systemically-important from a 'host' point of view. In end-2012, almost 70% of bank assets in the six Western Balkan economies which are EU candidates and potential candidates (i.e. Albania, Bosnia and Herzegovina, Kosovo, the former Yugoslav Republic of Macedonia, Montenegro and Serbia) were owned by euro area-headquartered banking groups, with Austrian, Greek, Italian, French and Slovenian subsidiaries dominating the market (see table 4.1).

Consolidated claims by such parent banking groups typically amount to around 50% of host country GDP, (see chart 4.1). Most of these cross-border banking groups are expected to be deemed 'significant'[13] entities and would thus fall under the direct supervision of the ECB once the SSM will assume its responsibilities in November 2014. Using the list of banks that has been released as part of the 'comprehensive assessment'[14] underway as a broad approximation to this

[13] The 'significance' of banking entities to fall under the direct auspices of the ECB from a consolidated supervision point of view will be established according to a number of different metrics. Banks will be deemed as significant if total asset size exceeds EUR 30 billion, or if they account for more than 20% of a participating members' GDP (except if total assets amount to less than EUR 5 billion). Banks which have received ESM/EFSF financial assistance as well as the three most significant banks in participating member states will also be directly supervised by the ECB. In addition, entities can be deemed as significant if there is agreement between national supervisors ('National Competent Authorities') and the ECB that this is the case; if the activities of the bank in question are important for the EU economy and/or the member state concerned; or if cross-border activities are sizeable. In addition, the SSM regulation confers the ECB the power to take-up the direct supervision of any individual entity which is deemed as 'less significant'. See http://www.ecb.europa.eu/ssm/html/index.en.html

[14] See "Comprehensive assessment in advance of the single supervisory mechanism", ECB publication, October 2013, www.ecb.europa.eu.

end, the ECB would be the 'home' supervisor for about 60% of total banking assets in EU candidate and potential candidate countries in the Western Balkans (see chart 4.2).

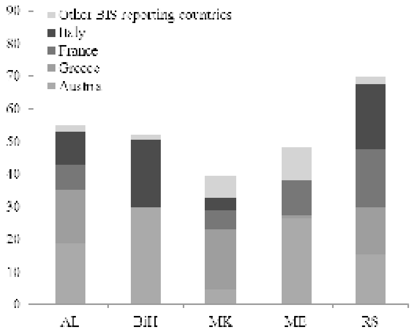
Table 4.1: Euro area headquartered banking groups in the Western Balkans

in percent, as of December 2012		Share of Western Balkan subsidiaries in group's assets	Share in total banking assets Western Balkans
Raiffeisen Landesbanken Holding	(AT)	4.5	12.1
Intesa Sanpaolo	(IT)	0.8	9.6
UniCredit Bank	(IT)	0.5	8.3
NLB	(SI)	22.7	6.0
Société Générale	(FR)	0.2	5.5
NBG	(GR)	2.3	4.5
Erste Group Bank *(incl. Sparkasse Bank)*	(AT)	0.8	3.3
Eurobank	(GR)	2.2	2.7
Alpha Bank	(GR)	2.5	2.7
Piraeus Bank	(GR)	1.8	2.3
Crédit Agricole	(FR)	0.0	1.5
KBC Group	(BE)	0.1	0.5
BNP Paribas	(FR)	0.0	0.3
Veneto Bank	(IT)	0.3	0.2
Hypo Alpe-Adria Bank	(AT)	9.4	5.8
ProCredit Bank	(DE)	36.5	3.9
KBM Bank	(SI)	2.4	0.2
Total			69.5

Sources: Bankscope and banks' financial and annual reports. The red box denotes those banks that are part of the ECB comprehensive assessment (October 2013).

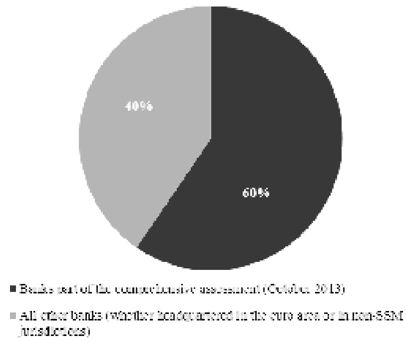
The key practical implication arising from the establishment of the SSM for EU candidate and potential candidate countries in the Western Balkans is that the ECB will become the 'home supervisor' for a large part of local banking systems. At the same time, a still significant part of individual banking systems will remain outside the supervisory realm of the SSM, on account of (i) subsidiaries of euro area-headquartered entities expected to be deemed 'less significant', (ii) subsidiaries from non-SSM jurisdictions (notably Turkey), and (iii) the remaining parts of the system that are domestically-owned. For EU candidate and potential candidate countries in the Western Balkans, this implies that of the top three banks operating in any given country (as measured by total asset size), one will still fall outside the supervisory remit of the SSM from a consolidated viewpoint.

Chart 4.1: Consolidated claims of Austrian, Greek, French and Italian banks on Western Balkans as a whole (September 2013)
(in percent of full-year nominal GDP)



Sources: BIS consolidated foreign banking statistics, IMF/WEO and ECB staff calculations.
Notes: The selection of countries was made based on the main presence in the region. Data on claims of Slovenian banks on Western Balkans are not available. Claims of euro area 12 on Western Balkans represent on average 94% of total BIS reporting banks' claims on the region.

Chart 4.2: Share of (presumably) directly ECB-supervised euro area-headquartered banks in total banking assets of EU CCs/PCCs in the Western Balkans
(in percent of total banking sector assets)



Sources: Bankscope, financial reports of individual banking groups and ECB staff calculations.
Note: Western Balkans includes Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro and Serbia.

Most euro area-headquartered banks operating in EU candidate and potential candidate countries in the Western Balkans are expected to be deemed as 'significant' by the SSM. However, the activities of local subsidiaries within any given country are unlikely to elicit much concern from the point of view of consolidated supervision as they tend to account for a very minor share of total group assets. The individual weight of the four largest subsidiaries of euro area-headquartered entities in any given country rarely exceeds 1% of total group assets (see table 4.2). Even from an aggregate perspective, the total share of subsidiaries of euro-area headquartered entities operating in the Western Balkans within any given banking group does not exceed 5% of total group assets, with the exception of NLB, Procredit and Hypo Alpe-Adria. However, the latter two banking groups are not expected to be deemed 'significant' by the SSM.

The relatively limited importance of local subsidiaries of euro area-headquartered banks for the group as a whole stands in contrast to the systemic nature of their activities for 'host' banking systems. Individual subsidiaries which typically only account for 1% or less of the respective total group assets tend to have a significant market share of banking activity in EU candidate and potential candidate countries in the Western Balkans, amounting for up to a quarter of total banking assets per country (see table 4.2). As a result, there is an asymmetry between the relevance of subsidiaries of euro area-headquartered banks for host countries in the Western

Balkans (and their respective supervisory authorities) on the one hand and for the parent banking group (and therefore the home supervisor) on the other.

Table 4.2: Presence of euro area headquartered banks in individual Western Balkan banking systems

In percent, as of December 2012	Subsidiary's share in group assets	Market share of total assets in host country
Albania		
Raiffeisen Bank	1.6	26.4
Intesa Sanpaolo Bank	0.1	10.7
Tirana Bank (Piraeus Bank)	1.0	8.1
Alpha Bank	1.0	6.6
Bosnia and Herzegovina		
Unicredit Group	0.3	23.5
Raiffeisen Bank	1.3	18.6
Hypo Alpe-Adria Group	4.2	14.1
NLB Group	6.8	9.6
Kosovo		
ProCredit Bank	14.0	30.2
Raiffeisen Bank	0.4	23.6
NLB Bank	3.0	15.9
FYR Macedonia		
Stopanska Banka (NBG)	1.2	22.5
NLB Bank	6.8	17.7
Ohridska Banka (Société Générale)	0.0	8.0
Sparkasse (Erste Bank)	0.1	4.9
Montenegro		
NLB Bank	3.6	19.6
Erste Bank	0.2	13.4
Société Générale	0.0	12.0
Hypo Alpe-Adria Bank	0.7	9.5
Serbia		
Intesa Sanpaolo Bank	0.5	14.6
Unicredit Bank	0.2	8.6
Société Générale	0.1	7.3
Raiffeisen Bank	1.2	7.1

Sources: Bankscope and banks' financial and annual reports.

4.2 Potential benefits of the SSM for EU candidate and potential candidate countries

The establishment of the SSM could bring a number of benefits to prospective EU members, especially to those countries in the Western Balkans whose banking systems are largely owned by euro area-headquartered parents.

First, EU candidate and potential candidate countries host to SSM-supervised banks should benefit from 'positive spillovers' stemming from increased financial stability at the core ('home' of parent banks) to the extent that the SSM leads to a sounder banking system and stronger supervision. The SSM is widely expected to be an important step to help reduce financial fragmentation and increase confidence in the banking sector, and thereby contribute to increased financial stability and better governance in the euro area. This is to materialise in particular through the centralisation of supervision under the aegis of the ECB, coupled with the adoption of a high-quality common supervisory approach, underpinned by a single rulebook and supervisory manual. Furthermore, the centralisation of supervision will address long-standing home-host coordination problems in a credible manner. Coupled with the SSM's supranational mandate, this should be associated with a reduction of both 'home bias' in the activities of cross-border banking groups and 'inaction bias' by national supervisors. The latter could be especially important where subsidiaries of SSM-supervised banks are significant local market players.

The adoption of a high-quality common supervisory approach/model should also be conducive to both the earlier detection and handling of problems in individual parent entities and a reduced risk of supervisory ring-fencing in crisis situations. Insofar as banking systems in prospective EU members are concerned, this coordinated approach could possibly also entail more likely consideration relative to the current status quo of (i) potential spillover effects of supervisory and macro-prudential measures to be taken at the level of the SSM on third parties; and (ii) possible cross-border circumvention by parent banking groups of supervisory and macro-prudential measures taken in prospective EU members, respectively.

As a result, provided that the SSM can deliver on the expectations which have been placed on it, countries whose banking systems have strong linkages to those of SSM member states are set to gain from more effective supervision at the core regardless of whether they participate in the system or not. However, it should be noted that the full benefits of the SSM in terms of enhanced financial stability can only be expected to unfold if the architecture of the banking union is completed. In particular an effective SRM complementing the SSM is necessary to break the sovereign/bank nexus in the euro area.

Second, EU candidate and potential candidate countries will benefit from simplified 'home-host' interactions following the establishment of the SSM, both bilaterally and through supervisory colleges, akin to the simplified interactions which countries that are party to the SSM may expect.[15] In bilateral terms, the SSM will lead to a streamlining of communication within existing cooperation agreements on consolidated supervision. For most euro-area headquartered banks operating in EU candidate and potential candidate countries (those to be deemed 'significant' entities by the SSM), host supervisors will interact with only one (the ECB) instead of multiple euro area home supervisors as is currently the case. As regards the supervisory colleges, the ECB will act as the 'home' supervisor for 'significant' banks from a consolidated point of view. Simplified communication will also be a benefit in this domain since the ECB will

[15] The SSM will bring simplification, efficiency and clarity by avoiding altogether the complicated arrangements between home and host supervisors currently in place as regards the consolidated supervision of cross-border banking groups operating in the euro-area.

become the counterparty to national supervisors, replacing several euro area supervisors. This will certainly be the case for non-SSM EU countries, but potentially also for non-EU countries which exhibit significant banking interconnections with SSM participating countries to the extent that host authorities are able to participate in such colleges.[16]

Third, EU candidate and potential candidate countries should also benefit from the establishment of a more level playing field for parent banks in home (SSM) countries as well as in an EU accession context. For parent entities the level playing field will consist of (i) a 'single rulebook' aiming at the consistent implementation of harmonised rules, on the basis of which the ECB (and national competent authorities for less significant entities) will supervise banks and which should be developed by the European Banking Authority (EBA) for the EU as a whole; (ii) a common supervisory manual laying down items such as the procedures for on-site inspections to be conducted in joint supervisory teams and the risk assessment systems to be used, which will apply to both 'significant' and 'less significant' entities; and (iii) the establishment of uniform data reporting templates. Once established, these common rules and procedures could be associated with a lower cost of doing business (regulatory compliance) for cross-border banking groups that are present in both EU and non-EU countries, thereby indirectly benefiting the latter as well. Moreover, to the extent that such rules and practices become the standard at an EU-wide level beyond that of SSM participants, EU candidate and potential candidate countries will have strong incentives to align themselves at an early stage to the legal and regulatory environment which will become binding upon EU accession.

Finally, to the extent that the banking union will help to reduce the sovereign/bank nexus and thus financial fragmentation in the euro area, it should also lead to more homogenous funding costs for euro area-headquartered parent banks that are active in EU candidate and potential candidate countries. This levelling of the playing field across borders would be an important development, since the crisis in the euro area has been associated with significant differences in funding costs depending on the nationality of the parent banks.

4.3 Potential challenges of the SSM for EU candidate / potential candidate countries

The establishment of the SSM might also bring about a number of challenges for prospective EU members. As is the case with its potential benefits, countries whose banking systems have strong interconnections to those in SSM jurisdictions would appear to be potentially more affected than others. In this context, some concerns as detailed below have been expressed by policy makers

[16] National supervisors ('National Competent Authorities') will continue to lead supervisory colleges for less significant SSM-headquartered entities as home supervisors, with the ECB retaining the option to participate in such arrangements.

from EU candidate and potential candidate countries[17] as well as in the context of the European Bank Coordination 'Vienna II' Initiative.[18]

First, prospective EU members appear to be concerned about voice and representation, as their banking systems are 'too small to matter' when discussing implications from SSM/ECB decisions for third parties. This follows from the asymmetric importance of individual subsidiaries of euro area-headquartered banks for 'home' and 'host' authorities outlined in section 4.1. In conceptual terms, the main concern is that the small significance of local entities in cross-border parent groups as a whole may not be conducive to the full internalisation of potential spillovers for third parties of micro-prudential decisions taken by the SSM from a consolidated point of view. In practical terms, the perception of this risk is also due to the fact that the channels of communication to voice such concerns ex ante vis-à-vis the ECB/SSM are not yet in place (see section 4.4). Furthermore, the voicing of such concerns ex ante by EU candidate and potential candidate country authorities vis-à-vis the ECB/SSM is also seen at risk of being 'diluted' in a supranational context compared to bilateral communication with national (euro area) supervisors. In a related concern, authorities in some prospective EU members apparently believe that the adjusted future composition of the supervisory colleges for significant cross-border banking groups (which will be chaired by the ECB) will be associated with a loss of influence on their part, stemming from the need to establish working relationships with new officials and the reduced relevance of established relationships with key national supervisors in the euro area.

The concern on the adequate internationalisation of spillovers for non-SSM parties is also voiced as regards macro-prudential policies, with EU candidate and potential candidate countries being possibly affected by decisions taken in a complex system by the ECB or national authorities.[19] While the duty of consultation between the ECB and national authorities would reduce the risk of potentially contradictory decisions affecting local banking systems in EU candidate and potential

[17] See for example the speech by Ardian Fullani, Governor of the Bank of Albania, at the technical meeting to promote regional cooperation in the framework of Vienna II Initiative, Tirana, 3 October 2013; or the address of Maja Kadievska-Vojnovik, Vice-Governor of the National Bank of the Republic of Macedonia, at the regional summit of Governors, Belgrade, 8 November 2013.

[18] See in particular the document "Working Group on the European Banking Union and Emerging Europe" convened under the Vienna II initiative, released 30 April 2013; and "Observations on the proposed directive for bank recovery and resolution and the single resolution mechanism", Vienna II Initiative document, 12 November 2013.

[19] Given the different credit cycles in member states, the SSM regulation allows participating member states either to act on their own initiative when applying macro-prudential tools or to request the ECB to act. In addition, the ECB will have the power to apply higher requirements for capital buffers and other prudential measures set out in Union Law (CRD IV/CRR) to address systemic or macro-prudential risks. The macro-prudential toolkit defined in the regulation contains a number of instruments such as higher levels of own funds, liquidity, large exposure and public disclosure requirements, risk weights for mortgage exposures and intra-financial sector exposures. However, macro-prudential instruments which are not regulated by EU law, such as loan-to-income and loan-to-value ratios, will remain the sole responsibility of national supervisors. The national authorities and the ECB must inform each other of their respective intentions before proceeding with any policy action and the ECB will not have the possibility to 'block' national measures.

candidate countries, authorities remain concerned about the possibility that their banking systems will be affected by 'coordinated' decisions from the core which may not be adequate for local circumstances, thus forcing host supervisors to act.

Second, there is a concern that centralised supervision from a consolidated point of view for only part but not the entire banking sector in EU candidate and potential candidate countries will lead to the emergence of a 'two-tiered' system, placing some entities at a competitive disadvantage. In this regard, the concern is that banks which are supervised by the SSM from a consolidated point of view could be perceived to be 'safer' on account of presumably more onerous oversight and the importing of credibility ex ante as well as the availability of financial backstops ex post. In this context, troubled banking parents which are party to the SSM would have the Single Resolution Mechanism/Single Resolution Fund as a prospective backstop as well as implicit access under certain conditions to direct recapitalisation through ESM resources, with neither option being available to banks headquartered in other jurisdictions, in particular domestically-owned banks.

The resulting competitive distortions introduced in domestic banking sectors would be primarily manifest though lower borrowing costs for some banks compared to others. According to this view, the fact that some banks would have implicit access to liquidity in euro provided by the ECB (through their parents) while others have not would further reinforce the competitive distortions in host banking systems. Such concerns on 'level playing field issues' are seen to be particularly relevant in the Western Balkans, where at least one of the top three banks per country would fall outside both the supervisory remit of the SSM and the liquidity providing operations of the ECB (see section 4.1).

The concerns mentioned above on the potential downsides to the establishment of the SSM need to be put into perspective and should also be assessed relative to the prevailing status quo. For example, the asymmetric importance of subsidiaries of euro-area headquartered banks for home and host authorities is a long-standing feature of banking systems in EU candidate and potential candidate countries and will not materially change as a result of the SSM. It does not necessarily follow that a perceived 'home bias' in supervision will increase (rather than decrease) on account of a broader pan-European supervisory mandate relative to a narrower 'national' one previously. Similar arguments apply as regards the new composition of the supervisory colleges. It is also not evident that the concerns of host authorities as regards macro-prudential spillovers would be more readily dismissed in a supranational context relative to the current set-up in which they must bring forward arguments bilaterally vis-à-vis home authorities.

Moreover, while the granting of macro-prudential powers to the ECB as well as to national competent authorities may add to complexity for EU candidate and potential candidate countries, the implicit need for coordination among home authorities may also be seen as an improvement compared to the current status quo in which hosts are exposed to uncoordinated, overlapping and potentially conflicting decisions from various (euro area) supervisors. Lastly, it is questionable whether as a result of the establishment of the SSM competitive distortions in domestic banking systems would increase relative to the current state of affairs in which (i) bank funding costs already differ significantly according to the nationality of the parent in question; and (ii) significant parts of the system have indirect access to ECB liquidity-providing operations through parent entities while non-euro area-headquartered banks do not have recourse to this option.

4.4 Establishing adequate 'home – host' communication channels in the new system

Adequate cooperation and communication between 'home' and 'host' authorities would help to address the concerns on the establishment of the SSM (and the wider project of banking union) as expressed by EU candidate and potential candidate countries, especially in the Western Balkans on account of strong banking interlinkages. This would appear all the more relevant since, as non-EU members, they do not have the possibility to 'opt in' into the SSM and are neither part of the ESRB nor EBA, and can only participate in supervisory colleges subject to the consent of the college itself.

Establishing a permanent mechanism for exchange of information and dialogue between the SSM/ECB and EU candidate and potential candidate countries thus appears warranted in both the supervisory and macro-prudential domain. Further convergence to the EU legal and regulatory standards by prospective EU members should be fostered in this context. For example, gaps with EU standards as regards data confidentiality in some EU candidate and potential candidate countries have been seen as a major obstacle to both participation in the supervisory colleges and to the completion of Memoranda of Understandings (MoUs) in the supervisory domain.[20]

In this context, it is foreseen that the ECB will build on the agreements/MoUs which have been concluded so far between home (euro area) and non-SSM host supervisors in the field of banking supervision. However, as shown in table 4.3, there remain large differences as regards bilateral agreements in the supervisory domain between individual euro area and EU candidate/potential candidate countries. For example, Bosnia and Herzegovina only has one agreement in place with a euro area home supervisor, while the Austrian supervisor has not formalised any general agreements in the bank supervisory domain with any individual country in the Western Balkans in spite of the fact that Austrian banks have a locally systemic presence in

[20] This would underline the importance of the EBA's role, including as regards its formal assessments of the national legislation frameworks of non-EU host countries in order to determine the level of compliance with EU confidentiality standards. In turn, this should open the way to the removal of barriers for the signing of MoUs and the participation in supervisory colleges, respectively.

these countries. Overall, the status quo as regards communication and cooperation between home and host supervisors in the euro area and the Western Balkans suggests that the establishment of the SSM provides an opportunity for further improvements in this regard.

Table 4.3: Bilateral agreements between euro area member states and EU CCs/PCCs in the bank supervisory domain

Bilateral agreements			
Host supervisor	Home supervisor	Nature of contract	Year
Albania	Germany (BaFin)	MoU	2012
	Greece	MoU	1999
	Italy	MoU	2011
Bosnia and Herzegovina	Slovenia	MoU	2001
Kosovo	Germany (BaFin)	MoU	2011
	Slovenia	MoU	2005
FYR Macedonia	Germany (BaFin)	MoU	2011
	Greece	Multilateral Cooperation and Coordination Agreement *(NBG and Alpha Group)*	2009
	Slovenia	MoU	2001
Montenegro	France (ACPR)	MoU	2008
	Slovenia	MoU	2003
Serbia	Belgium (CBFA)	MoU	2008
	Cyprus	MoU	2001 & 2006
	France (ACPR)	MoU	2013
	Germany (BaFin)	MoU	2011
	Greece	MoU	2002
	Italy	MoU	2007
	Slovenia	MoU	2004
Memorandum item			
Multilateral agreement			
Signing parties		Nature of contract	Year
Albania, Greece, FYR Macedonia, Romania, Bulgaria, Serbia, Cyprus, Montenegro, Central Bank of Bosnia and Herzegovina, Banking agencies of Republic of Srpska and Federation of Bosnia and Herzegovina		MoU on high-level principles of cooperation and coordination among banking supervisors of South-Eastern Europe	2007/2008

Sources: National central banks.

COUNTRY-SPECIFIC ANNEXES

A1. Albania

The banking sector, which is predominantly foreign-owned, has continued to grow in recent years, in contrast to developments in some peer countries (see table A1.1). Although there are 16 banks operating in the country, the system is relatively concentrated with over half of total banking assets in the hands of the three largest players and around a quarter of total assets controlled by a single entity (Raiffeisen). While some progress has been achieved in the restructuring of Greek subsidiaries – which account for just under a fifth of total banking assets – the Bank of Albania has applied more stringent capital and liquidity requirements to such entities and intensified coordination with Greek authorities in order to prevent undue spillovers.[21]

Table A1.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks		16	16	16	16	16	16
...of which foreign-owned		14	14	14	14	14	14
Total assets of banking sector	Percent of nominal GDP	76.6	77.2	81.0	86.1	88.0	86.1
Total assets of private banks	Million euro	6,792.5	6,711.5	7,189.6	7,982.3	8,544.2	8,542.3
....of which assets of foreign-owned banks	Percent of total assets	93.6	92.4	90.6	90.3	89.8	89.2
Total liabilities of private banks	Million euro	6,792.5	6,711.5	7,189.6	7,982.3	8,544.2	8,542.3
....of which external liabilities	Percent of total liabilities	10.1	6.7	4.9	6.8	6.7	7.1
.....of which external liabilities to other private banks	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Bank of Albania and IMF/WEO.

Notes: *As of June 2013. Nominal full-year GDP figures for 2013 are projections.

Local capital markets serve mainly government funding needs. Local bond markets consist only of government bonds, amounting to 34% of GDP, and thus being by far the largest among EU candidate and potential candidate countries in the Western Balkans relative to GDP (see table A1.2).

Credit risk and impairments to the bank lending channel are the largest financial stability challenges for the Albanian banking sector, with indirect market risks still latent. The quality of the loan portfolio deteriorated further during the period under review, with the ratio of NPLs to total gross loans edging up to 24.2% in mid-2013 (see table A1.3). This was mainly driven by developments in the corporate loan segment, which in turn suffers from a sluggish pace of liquidation of state arrears to businesses. Although provisions for impaired loans were stepped-up, NPLs net of provisions to capital still remained at 56.4% in 2013 Q2, and further efforts to foster workouts (particularly as regards collateral execution) thus appear necessary.[22]

[21] See IMF (2013), Albania – Article IV consultation, country report 13/7.
[22] See IMF (2013) Albania: Concluding Statement of the Staff Visit Tirana, September 27, 2013.

Table A1.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	34	33	34	32	33	34
...share of corporate bonds	in percent of total local bond market	0	0	0	0	0	0
...share of government bonds	in percent of total local bond market	100	100	100	100	100	100
Size of local stock market (amount outstanding)	Percent of GDP (eop)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Banks outstanding corporate bonds	Million euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Banks holding of government securities	Million euro	2,097	1,92[illegible]	1,94[illegible]	2,03[illegible]	2,155	2,0[illegible]1
Debt securities issued by corporations[1]	Percent of GDP (eop)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Banks credit to non-government residents[2]	Percent of GDP (eop)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Bank of Albania.

Notes: *As of June 2013, [1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations.[2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

Nevertheless, the Albanian banking sector remains well capitalised with a ratio of regulatory capital to risk-weighted assets of 17.0% in 2013 Q2. The liquidity position of the banking system remained strong, in spite of a slight decline in the main liquidity indicators, with liquid assets amounting to 27% of total assets and 34% of short term liabilities in 2013 Q2.

The banking sector appears to be well-hedged against direct risk from adverse exchange rate and interest rate movements, but remains indirectly sensitive to potential changes on these variables. In this context, the exposure to indirect market risk from unhedged borrowing in fx remains relatively high, with fx loans accounting for 64.5% of total loans. Exposure to adverse developments in interest rates stemming from potential sovereign shocks is also relevant through still sizeable holdings of government debt securities (see also table 3.5 in chapter 3). Looking forward, capital adequacy needs to be monitored closely in light of the rapid deterioration of loan quality against a sluggish macroeconomic environment.

Table A1.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	15.4	14.8	14.6	15.1	15.6	15.9	15.7	15.9	16.2	16.8	17.0
Regulatory Tier-1 capital to risk-weighted	14.5	13.9	13.5	13.9	14.3	14.7	14.5	14.5	14.6	15.2	15.4
Nonperforming loans											
...net of provisions to capital	35.9	38.1	47.4	51.2	52.0	54.2	55.8	59.5	55.6	57.0	56.4
... to total gross loans	14.0	14.7	17.0	18.4	18.8	20.1	21.1	22.7	22.5	23.7	24.2
Households: NPLs to total gross loans	11.8	13.1	13.9	15.4	15.8	16.4	16.8	17.4	17.2	17.8	17.2
Non-financial corporations: NPLs to total gross loans	15.5	16.0	19.1	20.5	20.8	22.5	23.8	26.0	25.9	27.4	28.4
... of which in FX	13.8	14.7	17.1	18.8	19.6	21.3	22.6	24.4	24.7	26.0	26.5
..... of which in Euro	14.3	15.0	17.5	19.9	20.8	21.6	22.8	23.9	24.2	25.5	25.8
..... of which in USD	10.0	13.1	12.7	11.2	12.0	20.0	21.8	27.8	28.0	29.6	31.6
..... of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Return on assets	0.7	0.3	0.2	0.2	0.1	0.7	0.4	0.4	0.3	0.4	0.3
Return on equity	7.6	2.9	2.4	1.9	0.8	8.0	4.8	4.2	3.8	5.2	2.9
Liquid assets to total assets	25.9	26.6	25.5	26.3	26.5	29.0	29.0	29.0	29.4	29.1	27.4
Liquid assets to short-term liabilities	30.6	31.4	30.2	31.3	33.1	36.1	36.0	35.8	36.7	36.1	33.8
Net open position in foreign exchange to	5.0	2.8	3.7	-3.0	3.9	4.0	6.0	4.1	4.0	1.7	4.0
Capital to assets	9.4	9.1	8.6	8.7	8.7	8.7	8.6	8.5	8.6	8.6	8.5
Large exposures to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross asset position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross liability position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trading income to total income	1.2	0.9	1.6	1.6	1.5	1.4	1.3	1.4	1.5	2.4	2.2
Interest margins to gross income	118.9	137.2	146.6	147.6	147.7	119.7	129.5	130.6	130.4	123.6	131.2
Non-interest expenses to gross income	227.5	200.8	289.7	319.2	353.2	259.5	280.6	291.0	277.2	215.2	252.4
Foreign-currency-denominated loans to foreign-currency denominated deposits	86.0	88.1	87.4	82.9	83.3	83.5	79.7	74.2	74.1	75.4	75.9
Foreign-currency-denominated loans to total loans	69.8	69.4	68.7	68.8	67.9	68.2	67.1	66.5	64.5	64.8	64.5
Foreign-currency-denominated liabilities to total liabilities	51.0	50.2	50.2	50.3	51.9	52.1	52.3	53.7	52.6	52.4	51.8
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	12.1	11.5	11.8	11.9	11.4	11.2	11.1	11.3	11.2	11.1	11.2
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	5.0	0.9	-1.3	5.6	-6.2	2.5	4.8	-10.9	-5.7	1.3	4.8
Loan-to-deposit ratio	60.1	60.7	61.1	60.1	61.3	61.0	59.5	58.0	58.3	58.2	57.5
Loan-to-value ratios for housing loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ratio of external liabilities to total liabilities of banks	4.9	5.1	6.3	6.3	6.8	7.2	6.9	6.6	6.7	7.0	7.1

Source: Bank of Albania

Notes: NPL in FX refers to NPL in foreign currency to total loans in foreign currency. Due to lack of data, household debt to GDP refers to household loans to GDP. Non-performing loans cover those loans that are classified in the last three categories of credits classification: sub-standard, doubtful and loss. Their gross amount (principal + interest) is the total of non-performing loans.

A2. Bosnia and Herzegovina

The number of banks operating in Bosnia and Herzegovina remains remarkably high relative to peer countries.[23] Although the number of players active in the country as a whole fell to 27 in the period under review[24] (see table A2.1), there still appears to be room for further consolidation. Nevertheless the banking sector remains relatively concentrated, with the top three players in the system (i.e. Unicredit, Raiffeisen, and Hypo Alpe-Adria) holding a combined market share of just over half of total banking assets. The fact that the third- and fourth-largest banks (Hypo Alpe-Adria and NLB) are being restructured creates some uncertainty to the medium-term banking sector outlook in Bosnia and Herzegovina.

Table A2.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks		30	30	29	29	28	27
...of which foreign-owned		21	21	19	19	19	17
Total assets of banking sector	Percent of nominal GDP	83.6	85.2	82.4	81.8	80.4	76.2
Total assets of banking sector	Million euro	10,643	10,537	10,439	10,735	10,833	10,852
...of which assets of foreign-owned private banks	Percent of total assets	95.0	94.5	92.8	92.1	91.9	90.5
Total liabilities of banking sector	Million euro	10,643	10,537	10,439	10,735	10,833	10,852
...of which external liabilities	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
.....of which external liabilities to other private banks	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Central Bank of Bosnia and Herzegovina and IMF/WEO.
Notes: *As of June 2013. Nominal full-year GDP figures for 2013 are projections.

Local capital markets need to be further developed in order to reduce the dependency on external financing. The local stock market contracted in recent years on the back of sluggish economic growth (see table A2.2). The bond market is dominated by government bonds which are mainly held by the banking sector, whose exposure to entity government bonds (i.e. those of the Republic Srpska and the federation of Bosnia and Herzegovina) has increased.

The main challenges to financial stability are rising credit and market risks as well as improving the bank funding base, in an environment where the uncertainty related to the on-going restructuring of key parent entities is expected to prevail. The ratio of NPLs to gross loans rose to 14.3% in the period under review, suggesting that there is a need to undertake further clean-up of lending portfolios in the banking system as a whole. The banking system appears to be adequately capitalised at the aggregate level, with a ratio of regulatory capital to risk-weighted assets ratio of 17.2% in 2013 Q2, but NPLs net of provisions to capital amounted to

[23] This might be related to the complex structure of the country, in which each entity has its own banking supervision.
[24] One small domestic bank, Herzegovina Bank dd Mostar, got its license revoked in July 2012. Another small domestic bank (PostBank BH dd Sarajevo) was delicensed in late June 2013, falling just outside of the end of the period under review.

almost 32% in 2013 Q2, suggesting that the system's ability to cope with unexpected shocks may be compromised (see table A2.3). The banking system as a whole remains profitable, although the only moderate pick-up in credit growth expected going forward in view of a sluggish economic environment will continue to put pressure on standard indicators in this regard.

Table A2.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding, at market value)	Percent of GDP (eop)	0.8	1.1	2.1	2.7	3.0	4.0
...share of corporate bonds	Percent of total local bond market	8.5	8.2	2.2	1.0	1.1	1.6
...share of government bonds	Percent of total local bond market	91.5	91.8	97.8	99.0	98.9	98.4
Size of local stock market (amount outstanding)	Percent of GDP (eop)	46.6	45.2	43.9	29.4	29.3	n.a.
Banks outstanding corporate bonds	Million euro	5.0	4.7	12.5	12.9	7.8	6.5
Banks holding of government securities	Million euro	0.0	3.3	8.5	139.1	206.8	211.6
Debt securities issued by corporations[1]	Percent of GDP (eop)	0.1	0.1	0.0	0.0	0.0	n.a.
Banks credit to non-government residents[2]	Percent of GDP (eop)	56.6	55.9	56.2	56.4	57.6	n.a.

Source: Central Bank of Bosnia and Herzegovina.
Note: *As of June 2013. [1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations.[2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

The exposure to direct market risk – as measured by banks' net open position in fx to capital – increased to 11.1% in the period under review, while exposures to indirect market risks (in the form of fx loans to total loans, which amounted to 64% in 2013 Q2) remained high but stable. Looking forward, securing stability in the bank funding base will remain critical on account of the high level of the loan-to-deposit ratio (almost 119% in 2013 Q2). Closer coordination and cooperation with home country supervisors will also remain important given the ownership structure of the domestic banking system and the fact that key players (HAAG and NLB) are subject to restructuring plans.[25]

[25] BiH authorities have recently amended the respective legal frameworks related to the treatment of confidential information so as to align them with EU requirements. This had previously been seen as an important hurdle preventing the conclusion of MoUs with key home supervisors in the euro area.

Table A2.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	16.2	15.8	15.5	15.3	17.1	17.4	16.7	16.7	17.0	17.2	17.2
Regulatory Tier 1 capital to risk-weighted assets	12.6	12.8	12.5	12.4	13.6	14.2	14.1	14.1	14.1	14.6	14.9
Nonperforming loans											
...net of provisions to capital	42.0	42.5	43.1	46.9	25.9	25.8	28.4	28.6	30.0	30.2	31.6
... to total gross loans	11.4	11.7	11.8	12.6	11.8	12.1	12.7	12.7	13.5	13.8	14.3
Households: NPLs to total gross loans	7.2	7.1	7.3	8.0	11.0	11.2	11.0	10.9	11.2	11.1	10.9
Non-financial corporations: NPLs to total gross loans	14.9	15.3	15.3	16.3	12.5	12.9	14.0	14.1	15.3	15.9	16.9
... of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Return on assets	-0.6	0.2	0.4	0.4	0.7	0.2	0.5	0.8	0.6	0.3	0.5
Return on equity	-5.5	1.4	3.5	3.4	5.8	1.8	4.2	6.4	5.0	2.0	4.2
Liquid assets to total assets	29.0	27.9	26.2	27.2	27.2	24.7	24.7	24.8	25.4	24.1	24.2
Liquid assets to short-term liabilities	49.7	48.5	46.2	47.5	46.7	42.3	43.0	43.5	44.1	42.2	42.4
Net open position in foreign exchange to capital	4.4	11.6	11.2	11.8	16.0	6.4	8.3	6.4	5.4	6.5	11.1
Capital to assets	11.8	11.9	12.1	12.0	13.6	14.2	14.2	14.4	14.2	14.6	14.9
Large exposures to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross asset position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross liability position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trading income to total income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest margin to gross income	60.1	61.3	60.5	61.0	63.9	65.5	64.2	63.6	63.7	64.3	63.3
Non-interest expenses to gross income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign-currency-denominated loans to foreign-currency denominated deposits	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign-currency-denominated loans to total loans	70.0	68.5	68.1	67.8	66.9	63.0	63.5	63.7	63.1	63.2	63.7
Foreign-currency-denominated liabilities to total liabilities	67.0	66.7	66.4	66.5	66.2	65.1	67.0	66.5	65.2	65.1	65.1
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Loan-to-deposit ratio	115.9	118.0	119.5	118.0	117.8	121.5	120.9	121.1	118.5	118.1	118.7
Loan-to-value ratios for housing loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ratio of external liabilities to total liabilities of banks	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Central Bank of Bosnia and Herzegovina

Notes: Loan-to-deposit-ratio is calculated using total loans net of interbank loans and customer's deposit (excl. deposits from financial institutions). Non-performing loans cover the three last categories of the credit classification, i.e. sub-standard (principal or interest is between 90 and 180 days overdue), doubtful (principal or interest is between 180 and 270 days overdue) and loss (principal or interest is 270 days or more overdue).

A3. Iceland

The Icelandic banking sector has stabilised in recent years but remains highly concentrated and in public hands. The number of banks remained unchanged in 2013 (see table A3.1). The banking sector remains fully domestically owned, with the three biggest commercial banks owning 96% of total banking assets. After a protracted period of contraction in order to correct for past excesses, the total asset size of the banking system has been moderately on the rise since 2011, edging up to 168% of GDP in 2013 Q2.

Table A3.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks[1]		22	16	16	14	13	13
...of which foreign-owned[1]		0	0	0	0	0	0
Total assets of banking sector	Percent of nominal GDP	282.7	197.4	179.9	179.9	173.3	168.0
Total assets of banking sector	Million euro	32,840	17,137	17,041	18,183	18,392	18,725
...of which assets of foreign-owned banks	Percent of total assets	0.0	0.0	0.0	0.0	0.0	0.0
Total liabilities of banking sector	Million euro	32,840	17,137	17,041	18,183	18,392	18,725
...of which external liabilities	Percent of total liabilities	17.5	10.5	7.6	5.3	4.2	4.5
.....of which external liabilities to other private banks	Percent of total liabilities	4.9	6.1	5.8	3.7	2.1	2.1

Sources: Central Bank of Iceland and IMF/WEO.
Notes: *As of June 2013. Nominal full-year GDP figures for 2013 are projections.
[1] Deposit Money Bank.

With capital controls in place, the relative importance of the domestic bond market for bank funding has increased (see table A3.2). Domestic sight deposits have also become a key funding source for this reason.

Table A3.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	114.2	90.9	110.2	112.2	109.9	110.4
..share of corporate bonds	in percent of total local bond market	19.7	15.0	8.5	7.8	7.1	7.2
..share of government bonds	in percent of total local bond market	13.2	28.8	43.3	43.1	45.8	44.3
Size of local stock market (amount outstanding)	Percent of GDP (eop)	15.7	12.9	14.6	15.6	21.5	26.0
Banks outstanding corporate bonds	Million euro	98.7	78.7	36.4	150.8	123.2	222.8
Banks holding of government securities	Million euro	350.7	1463.4	1447.8	1359.1	1330.6	1322.3
Debt securities issued by corporations[1]	Percent of GDP (eop)	22.5	13.7	9.3	8.8	7.8	7.9
Banks credit to non-government residents[2]	Percent of GDP (eop)	154.5	128.9	124.9	117.1	113.9	109.3

Source: Central Bank of Iceland.
Notes: *Market Cap information as of September 2013, GDP estimates for 2013. All other figures are as of August 2013.
[1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

Iceland's new banks are well capitalised and profitable, but risks to financial stability stemming from the legacy of the 2008 financial bust remain. The three largest commercial banks have further strengthened their capital base so that the sector's total capital adequacy ratio rose to 25.2% in 2013 Q2, from 20.9% in end-2011 (see table A3.3). Bank profitability is also high compared to other peer Nordic countries reaching a return on equity of 13% in 2013 Q2. Moreover, considerable progress has been made as regards corporate NPL reduction, with the sector-wide ratio to gross loans edging down to 5.1% in 2013 Q2. Banks' exposure to direct market risk has also continued to contract from its post-crisis peak, with the net open position in foreign exchange dropping to 3.6% at the end of the period under review. However, in spite of these improvements, a number of legacy issues from the sharp financial bust of 2008 will continue to challenge financial stability going forward.

First, household indebtedness remains high, at 108% of GDP in 2013 Q2. Authorities have recently presented a plan to reduce mortgage indebtedness, largely financed by an increase in the levy on financial institutions including from failed estates. However, this could aggravate negotiations over the final settlement of the estates of failed banks and thereby lead to a more protracted lifting of capital controls than would otherwise be the case. This is because the foreseen bank levy will reduce the value of the assets that will ultimately accrue to the (mostly foreign) creditors of the estates. Second, while banks' liquidity buffers are very high (with liquid assets to total assets and short-term liabilities at 23% and 178% respectively), but these partly depend on a degree of domestic financial repression, including captive funds locked-in by capital controls. Third, the lifting of capital controls could lead to capital outflows and heightened exchange rate volatility given the still substantial stock of liquid offshore króna.

Overall, the lifting of capital controls thus remains a major challenge both for the banking sector and for the wider economy as a whole, given the inherent costs for allocative efficiency associated with the maintenance of such restrictions in a small open economy such as the Icelandic one.

Table A3.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	19.7	21.2	22.1	22.7	20.9	20.9	22.4	22.7	24.3	24.8	25.2
Regulatory Tier 1 capital to risk-weighted assets	18.0	19.5	20.2	20.9	19.3	19.1	20.7	21.0	22.3	22.9	23.3
Nonperforming loans											
...net of provisions to capital	40.2	n.a.	25.2	27.2	22.6	22.9	9.8	3.4	-2.8	-2.6	-7.5
... to total gross loans	18.3	n.a.	13.9	14.2	11.6	11.6	9.5	7.9	6.4	5.8	5.1
Households: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-financial corporations: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
... of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
..... of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Return on assets	2.5	2.9	3.0	2.5	1.0	2.5	2.5	2.1	2.3	2.0	2.3
Return on equity	17.5	18.8	18.9	15.1	6.2	16.4	15.4	12.7	13.7	11.5	13.0
Liquid assets to total assets	22.2	21.5	20.1	23.6	20.5	20.8	20.6	23.3	23.4	23.3	22.9
Liquid assets to short-term liabilities	159.3	196.2	201.6	231.9	205.8	205.4	225.9	199.9	180.1	192.4	178.0
Net open position in foreign exchange to capital	102.4	68.1	61.1	29.1	22.6	25.9	18.2	18.4	7.7	3.7	3.6
Capital to assets	14.0	16.3	16.5	16.7	16.4	15.8	16.4	16.7	17.0	18.1	18.0
Large exposures to capital	39.8	39.3	54.5	52.5	47.3	47.5	44.8	38.0	34.8	33.9	28.0
Gross asset position in financial derivatives to capital	0.012	0.020	0.018	0.031	0.035	0.024	0.019	0.023	0.021	0.025	0.021
Gross liability position in financial derivatives to capital	0.012	0.020	0.018	0.031	0.036	0.023	0.018	0.024	0.020	0.025	0.021
Trading income to total income	1.0	3.1	-3.5	-0.7	11.6	5.5	5.8	6.3	5.7	4.9	4.3
Interest margins to gross income	102.1	388.2	219.2	148.6	257.1	454.8	245.2	192.1	128.1	488.1	164.2
Non-interest expenses to gross income	64.3	63.6	63.8	69.9	171.0	81.1	83.9	101.0	93.3	111.8	89.4
Foreign-currency-denominated loans to foreign-currency denominated deposits	563.0	519.0	455.0	269.0	227.0	224.0	228.0	212.0	200.0	185.0	176.0
Foreign-currency-denominated loans to total loans	47.9	45.5	40.3	34.3	28.1	28.7	26.2	25.3	24.6	22.8	22.4
Foreign-currency-denominated liabilities to total liabilities	6.1	6.1	5.9	8.9	9.0	8.8	8.4	8.7	8.8	9.2	9.3
Net open position in equities to capital	9.9	n.a.	13.8	n.a.	14.0	n.a.	11.6	n.a.	7.7	n.a.	7.7
Household debt to gross domestic product	123.3	119.2	115.5	112.9	113.6	110.6	113.7	110.5	110.5	108.9	108.3
Household debt service and principal payments to income	30.6	22.0	20.2	20.3	20.3	18.6	18.4	19.6	19.8	18.6	18.8
Residential real estate prices (Percentage change/last 12 months)	0.2	1.9	4.7	7.3	9.9	8.7	6.3	6.0	5.8	4.6	6.9
Loan-to-deposit ratio	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Loan-to-value ratios for housing loans	51.0	n.a.	n.a.	n.a.	46.0	n.a.	n.a.	n.a.	43.0	n.a.	n.a.
Ratio of external liabilities to total liabilities of banks	9.0	8.3	7.8	7.1	6.3	6.3	5.7	5.8	5.1	5.3	5.5

Source: Central Bank of Iceland.

Note: Non-performing loans in the table are calculated as DMB's loan portfolios by three largest commercial banks, parent companies. Past due items (COREP exposure).

A4. Kosovo

The banking sector in Kosovo has remained broadly stable in the period under review, with asset growth of 1.1% in 2013 Q2 with respect to end-2012, as compared with a 6.8% annual increase for 2012 as a whole (see table A4.1). The entry of Türkiye İş Bankası into the system brought the total number of players up to 9 in 2013, of which 7 are foreign-owned entities. As is the case in many peer economies in the Western Balkans, the banking sector is relatively concentrated with close to two-thirds of total banking assets in the hands of the top three entities operating in the country (all of them euro area-headquartered, i.e. ProCredit, Raiffeisen and NLB). The presence of Turkish-owned banks in the system is also notable, with a combined market share of around 13% of total banking assets. Kosovo is defined as one of the strategic markets for the NLB group in its restructuring plan, but uncertainties related to this process going forward cannot be ruled out.

Table A4.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks		8	8	8	8	8	9
...of which foreign-owned		6	6	6	6	6	7
Total assets of banking sector	Percent of nominal GDP	45.9	55.0	57.2	55.5	56.4	54.4
Total assets of private banks	Million euro	1,808	2,205	2,455	2,650	2,829	2,860
....of which assets of foreign-owned banks	Percent of total assets	91.7	91.4	90.4	89.2	89.5	89.6
Total liabilities of private banks	Million euro	1,808	2,205	2,455	2,650	2,829	2,860
....of which external liabilities	Percent of total liabilities	4.2	6.4	8.2	5.9	5.0	6.3
......of which external liabilities to other private banks	Percent of total liabilities	2.0	3.4	3.8	2.3	1.1	2.1

Sources: Central Bank of Kosovo and IMF/WEO
Notes: As of July 2013. Nominal full-year GDP figures for 2013 are projections.

As is also the case in other peer economies, local capital markets in Kosovo are in an early stage of development, so that the availability of longer-term funding for credit institutions to help avoid maturity mismatches remains limited. In 2012, the government started issuing T-bills via the central bank, which serves as its fiscal agent. Domestic banks are the main investors in government debt securities, which together with foreign debt obligations amounted to just below 9% of total bank assets in end-July 2013.

Near-term challenges to financial stability stemming from the banking system appear contained, with a sector characterised by high capitalisation and liquidity buffers and low exposure to credit and market risks, although vulnerability to external spillovers remains. The ratio of regulatory capital to risk-weighted assets was 16.5% in 2013 Q2, down by 2 percentage points since 2010 but still well above the minimum required ratio of 12% set by domestic supervisory authorities (see table A4.3).[26]

Table A4.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	n.a.	n.a.	n.a.	n.a.		
...share of corporate bonds	in percent of total local bond market	n.a.	n.a.	n.a.	n.a.		
...share of government bonds	in percent of total local bond market	n.a.	n.a.	n.a.	n.a.		
Size of local stock market (amount outstanding)	Percent of GDP (eop)			n.a.	n.a.	n.a.	n.a.
Banks outstanding corporate bonds	Million euro			7.8	0.5	0.0	0.0
Banks holding of government securities	Million euro			165.6	201.5	256.5	249.8
Debt securities issued by corporations[1]	Percent of GDP (eop)			n.a.	n.a.	n.a.	n.a.
Banks credit to non-government residents[2]	Percent of GDP (eop)						

Source: Central Bank of Kosovo.

Notes: [1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

Moreover, banks seem to be rather well provisioned given the still low share of NPL net of provisions to capital (7.3% in 2013 Q2), in spite of the up-tick in this ratio during the period under review. Banks' liquid assets amounted to 29.3% of total assets or 37.3% of short-term liabilities in 2013 Q2. As almost half of liquid assets are mainly sovereign bonds from euro area countries or placements in euro area banks, the banking sector remains exposed to negative spillovers from abroad, including through interest rate risk. The fact that banking sector development remains constrained by the limited absorption capacity of the domestic economy, resulting in a perceived shortage of fundable projects[27], would exacerbate this vulnerability to external factors in the event of adverse developments abroad.

[26] The drop in capital adequacy ratios is mainly attributable to changes in the Regulation on Bank Capital Adequacy, effective as of December 2013, which enforced more conservative measures on regulatory capital calculation. For more information see www.bqk-kos.org/?cid=2,53,527 and www.bqk-kos.org/?cid=2,53,576.

[27] See IMF (2012) Republic of Kosovo, Financial Stability Assessment.

Table A4.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	18.8	18.1	17.2	17.1	17.6	18.0	17.2	17.7	18.1	15.1	16.5
Regulatory Tier-1 capital to risk-weighted assets	15.8	15.1	14.4	14.3	14.8	15.2	14.4	14.8	15.2	12.5	13.4
Nonperforming loans											
…net of provisions to capital	5.4	5.7	5.7	5.2	4.4	4.4	5.2	5.6	2.9	6.7	7.3
…to total gross loans	5.9	6.2	5.9	6.0	5.8	6.0	6.5	7.0	4.3	7.6	7.8
Households: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-financial corporations: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
…of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
…..of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
…..of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
…..of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Return on assets	1.8	1.0	1.4	1.5	1.7	1.3	1.0	1.0	1.5	1.0	1.2
Return on equity	18.8	10.2	14.2	15.8	17.4	13.6	9.7	10.7	15.0	10.0	12.3
Liquid assets to total assets	36.8	33.9	29.8	32.1	31.3	30.4	28.9	30.3	37.3	31.1	29.3
Liquid assets to short-term liabilities	46.2	43.2	38.1	40.5	39.6	38.6	36.2	37.9	47.0	39.2	37.3
Net open position in foreign exchange to capital	-0.1	1.1	1.3	-1.3	2.5	-0.3	-2.4	3.1	12.4	0.3	0.3
Capital to assets	10.1	10.1	10.2	9.8	10.2	10.6	10.3	10.1	9.8	10.5	10.5
Large exposures to capital	72.4	73.3	82.7	77.3	77.8	76.7	80.9	88.0	64.6	69.2	78.5
Gross asset position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross liability position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trading income to total income	-0.3	-0.5	-0.1	-0.5	-0.2	-1.1	-0.5	-0.7	-0.4	0.3	0.9
Interest margin to gross income	74.5	76.1	75.9	75.6	75.2	75.4	75.4	74.7	74.7	73.8	74.0
Non-interest expenses to gross income	74.3	84.8	79.9	78.7	76.8	80.9	86.6	85.0	87.8	84.6	82.0
Foreign-currency-denominated loans to foreign-currency denominated deposits	2.2	2.0	1.9	5.3	5.5	5.3	6.3	6.3	5.7	5.3	5.5
Foreign-currency-denominated loans to total loans	0.2	0.2	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Foreign-currency-denominated liabilities to total liabilities	4.6	5.0	5.2	5.1	5.0	5.0	4.7	4.5	4.3	4.6	4.6
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Loan-to-deposit ratio	75.3	78.8	83.0	78.9	80.7	82.3	84.2	79.7	77.4	78.6	82.9
Loan-to-value ratios for housing loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ratio of external liabilities to total liabilities of banks	8.2	8.3	8.5	7.2	5.9	6.0	5.5	5.5	5.0	5.4	5.4

Source: Central Bank of Kosovo.

Note: Non-performing loans cover loans categorised as doubtful (90-180 days late) or as loss (over 180 days late).

A5. Former Yugoslav Republic of Macedonia

The banking sector in the former Yugoslav Republic of Macedonia has continued to grow over the period under review, albeit at a more moderate pace than before. As is also the case in peer economies in the region, the banking sector remains relatively concentrated with the three largest entities (Komercijalna Banka, Stopanska Banka / NBG and NLB) accounting for over 60% of total assets, notwithstanding the fact that there is a total of 16 players operating in the system (see table A5.1). As parent groups controlling two of the three largest entities are in the midst of restructuring (following state-aid cases pursued by the EC) the domestic banking system is more exposed to uncertainty relative to peers.

Table A5.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012
Number of banks		18	18	18	17	16
…of which foreign-owned		14	14	14	13	12
Total assets of banking sector	Percent of nominal GDP	60.9	65.4	70.3	72.0	76.6
Total assets of private banks	Million euro	4,043	4,322	4,849	5,217	5,536
… of which assets of foreign-owned banks	Percent of total assets	94.3	94.6	95.1	95.4	95.5
Total liabilities of private banks	Million euro	4,043	4,322	4,849	5,217	5,536
… of which external liabilities	Percent of total liabilities	9.1	10.1	10.2	8.2	8.2
…..of which external liabilities to other private banks	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: National Bank of the Republic of Macedonia and IMF/WEO.

Local capital markets are underdeveloped, although the relative exposure of the banking sector to its sovereign has grown. The size of the local bond market, which consists exclusively of government bonds, has declined further to 1.6 % of GDP in 2012, from 4.4% in 2008 (see table A5.2). However, bank holdings of government bonds have almost doubled from 2011 to 2012, which could partly reflect the attempt by banks to improve profitability and maintain liquidity buffers against the backdrop of limited bankable projects in a sluggish macroeconomic environment.

The banking sector exhibits robust capital and liquidity buffers and is largely reliant on a domestic funding base, but risks to financial stability remain through indirect exposures to currency risk and bank uncertainty stemming from the restructuring of key parent entities. Notwithstanding the change in the methodology for determining capital adequacy in 2012 Q3, regulatory (Tier-1) capital to risk-weighted assets has remained stable over the period under review, standing at 14.7% in 2013 Q2 (see table A5.3) and thereby well-above the 8% regulatory minimum set by domestic supervisory authorities. Bank liquidity also remains comfortable in the system as a whole, with liquid assets amounting to 32% of total assets and 55% of short-term liabilities in 2013Q2.

Table A5.2: Local capital markets

	Unit	2008	2009	2010	2011	2012
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	4.4	3.6	2.9	1.9	1.6
...share of corporate bonds	in percent of total local bond market	0.0	0.0	0.0	0.0	0.0
...share of government bonds	in percent of total local bond market	100.0	100.0	100.0	100.0	100.0
Size of local stock market (amount outstanding)	Percent of GDP (eop)	25.8	29.7	28.2	25.9	24.5
Banks outstanding corporate bonds	Million euro	0.0	0.0	0.0	0.0	0.0
Banks holding of government securities	Million euro	149.6	209.4	290.3	267.3	486.9
Debt securities issued by corporations[1]	Percent of GDP (eop)	0.0	0.0	0.0	0.0	0.0
Banks credit to non-government residents[2]	Percent of GDP (eop)	40.7	42.3	42.9	44.0	46.3

Source: National Bank of the Republic of Macedonia.

Notes: [1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

The ratio of NPLs to gross loans rose to 11.8% in the period under review, partly reflecting worsened corporate sector performance. NPLs net of provisions to capital also rose to 15.4% in 2013 Q2, but provisioning appears ample. The banking sector remains exposed to currency risks of both direct and indirect nature. This pertains to the net open position in fx to capital, which rose to 12.1% in 2013 Q2 (though still well below the 30% ceiling set by domestic regulatory authorities), but especially to the share of fx-denominated and fx-indexed loans to total loans, amounting to 51.7% in 2013 Q2. The share of fx loans in total loans has been steadily declining in recent years, in part due to efforts pursued by the central bank, and is the lowest among those regional peers which have a domestic currency. Latent tail risks to the banking system in this regard remain through unhedged borrowers in the event of an unexpected devaluation of the currency, as well as through currency mismatches since fx loans exceed (by a small margin) fx-denominated deposits. Uncertainty related to the impact of restructuring plans in key parent banking groups whose subsidiaries are locally systemic constitutes a further downside risk to the system in the medium-term.

Table A5.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	16.1	16.8	16.5	16.7	16.8	17.5	17.4	17.1	17.1	17.3	17.3
Regulatory Tier 1 capital to risk-weighted assets	13.4	14.1	14.0	14.0	14.1	14.7	14.7	14.4	14.5	14.7	14.7
Nonperforming loans											
...net of provisions to capital	11.9	10.9	11.0	11.6	10.8	10.7	11.5	12.9	10.7	14.1	15.4
...to total gross loans	9.0	9.1	8.9	9.5	9.5	9.9	9.7	10.6	10.1	11.4	11.8
Households: NPLs to total gross loans	81	8.1	7.8	79	75	7.6	77	75	7.1	70	70
Non-financial corporations: NPLs to total gross loans	93	9.4	9.3	98	99	10.2	10.0	10.9	10.5	11.9	123
...of which in FX	72	7.5	7.6	85	84	91	87	10.2	9.7	10.8	11.4
.....of which in Euro	72	7.5	8.2	85	92	91	87	103	10.0	11.1	11.7
.....of which in USD	13.2	10.8	10.9	93	6.4	6.3	6.6	4.9	3.9	33	3.4
.....of which in CHF	2.7	3.6	3.9	4.6	4.6	9.2	101	17.9	17.3	17.1	181
Return on assets	0.8	-0.1	0.2	0.1	0.4	-0.3	0.4	0.3	0.4	-0.1	0.2
Return on equity	73	-1.0	2.1	1.0	3.4	-2.5	3.2	2.3	3.8	-0.4	1.8
Liquid assets to total assets	30.9	30.2	29.7	29.9	31.2	31.5	30.2	30.2	32.4	33.1	32.0
Liquid assets to short-term liabilities	46.9	46.7	46.1	46.6	48.9	50.2	48.6	49.3	53.0	54.9	54.6
Net open position in foreign exchange to capital	18.9	11.9	10.0	17.9	21.3	12.5	8.7	12.3	11.4	73	12.1
Capital to assets	10.6	11.0	11.0	11.1	11.0	11.4	11.6	11.5	11.2	11.1	11.2
Large exposures to capital	200.4	182.1	199.6	186.1	189.6	183.8	188.7	181.3	205.1	208.0	194.3
Gross asset position in financial derivatives to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross liability position in financial derivatives to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trading income to total income	0.5	0.5	0.5	0.5	0.5	1.1	0.7	0.5	0.4	0.2	0.4
Interest margin to gross income	61.8	63.5	62.7	62.5	60.0	64.2	64.0	64.3	60.7	62.5	62.9
Non-interest expenses to gross income	68.2	73.7	70.8	70.7	69.7	67.7	70.6	68.6	65.3	62.9	62.2
Foreign-currency-denominated loans to foreign-currency denominated deposits	92.7	92.0	95.8	95.4	97.2	99.2	103.4	102.1	101.0	99.9	106.7
Foreign-currency-denominated loans to total loans	56.6	55.9	55.4	56.5	56.2	55.3	54.0	53.0	52.4	51.9	51.7
Foreign-currency-denominated liabilities to total liabilities	59.4	59.2	58.7	58.7	56.6	55.0	53.4	52.8	52.8	52.5	51.5
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	18.2	n.a.	n.a.	n.a.	18.4	n.a.	n.a.	n.a.	19.3	n.a.	n.a.
Household debt service and principal payments to income	10.8	n.a.	n.a.	n.a.	11.2	n.a.	n.a.	n.a.	10.9	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	0.9	n.a.	n.a.	n.a.	-3.8	n.a.	n.a.	n.a.	-0.4	n.a.	n.a.
Loan-to-deposit ratio	87.5	88.2	89.3	88.2	86.4	87.0	89.4	89.4	88.1	87.5	90.3
Loan-to-value ratios for housing loans	53.1	64.2	52.8	56.7	56.9	57.4	58.4	65.3	66.6	68.6	68.6
Ratio of external liabilities to total liabilities of banks	13.1	12.8	13.5	12.3	11.8	11.7	11.8	11.6	12.2	12.2	13.1

Source: National Bank of the Republic of Macedonia.

Notes: For the ratio foreign-currency-denominated liabilities to total liabilities, foreign currency denominated liabilities refer to liabilities with contractual maturity while total liabilities refer to all liabilities excluding equity and reserves and current profit. Total gross loans cover loans to the financial and nonfinancial sector.

Non-performing loans are loans classified in D and E risk category (doubtful and loss) or loans that are pass-due for more than 90 days. NPLs net of provision to capital refer to NPLs (and corresponding provisions) to the nonfinancial sector, which includes domestic and foreign households, enterprises, non-profit institutions serving households, and government (State). It does not include any type of financial institution or company.

A6. Montenegro

The Montenegrin banking system is showing signs of incipient recovery after a protracted period of correction from the excesses in the run-up to the 2008 financial crisis. Total banking assets increased by 3.8% in the year to 2013Q2, after remaining virtually unchanged from 2011 to 2012 and contracting by 15% from pre-crisis peak (2008) to post-crisis trough (2012, see table A6.1). The number of banks operating in the country (11) may be seen as high relative to domestic economic size. Although just over half of total banking assets remain in the hands of the three largest entities (i.e. OTP [Hungary], NLB [Slovenia], and Erste Bank [Austria]), the system comprises a number of other banks with non-negligible market shares. Besides domestic risks, the banking sector remains vulnerable to externally-induced uncertainty stemming from the on-going restructuring of Hypo Alpe-Adria and NLB (which together hold just over a quarter of total banking assets), as is also the case in some other peer economies.

Table A6.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks		11	11	11	11	11	11
...of which foreign-owned		9	9	9	9	9	9
Total assets of banking sector	Percent of nominal GDP	107.3	101.5	94.8	84.9	85.7	85.8
Total assets of private banks	Million euro	3309.7	3025.2	2943.7	2809.7	2808.3	2915.0
...of which assets of foreign-owned banks	Percent of total assets	84.6	87.1	88.4	89.7	90.0	90.0
Total liabilities of private banks	Million euro	3309.7	3025.2	2943.7	2809.7	2808.3	2915.0
...of which external liabilities	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
.....of which external liabilities to other private banks	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Central Bank of Montenegro and IMF/WEO.
Notes: * As of June 2013. Nominal full-year GDP figures for 2013 are projections.

Local capital markets play a minor role in the funding of the economy and the banking sector, although the latter's exposure to its sovereign is rising rapidly from a low base. Local bond markets – amounting to just over 8% of GDP in 2013 Q2 – are dominated by government securities (94% of the total). However, banks' total holdings of government securities (foreign as well as domestic) has more than doubled in the period under review (see table A6.2), although these still comprise for a modest share of bank assets.

Credit risk remains the main near-term challenge to financial stability, while uncertainty as regards the domestic impact of parent bank restructuring remains a concern in the medium-term. The ratio of non-performing to gross loans edged down significantly in 2011H2, at a time when some subsidiaries sold-off troubled loans to parent banks, including to factoring companies set-up by the latter. However, the trend-up in NPLs resumed in 2012 and the ratio to gross loans has since remained at a level which, though lower than before, still gives cause for concern (19% in 2013 Q2). Further progress in NPL treatment by banks appears to partly depend on the improvement of the legal and regulatory environment underpinning this process, including the enforcement of procedures for collateral execution.[28]

Table A6.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	6.7	6.1	4.6	3.6	7.4	8.3
...share of corporate bonds	in percent of total local bond market			4.9	17.1	8.1	6.5
...share of government bonds	in percent of total local bond market	100.0	100.0	95.1	83.0	91.9	93.5
Size of local stock market (amount outstanding)	Percent of GDP (eop)	155.7	159.3	160.8	151.9	148.4	160.8
Banks outstanding corporate bonds	Million euro			7.0	19.0	19.0	19.0
Banks holdings of government securities	Million euro					42.9	99.3
Debt securities issued by corporations[1]	Percent of GDP (eop)						
Banks credit to non-government residents[2]	Percent of GDP (eop)	n.a.	77.4	68.1	55.8	51.6	53.2

Source: Central Bank of Montenegro.
Notes: * As of June 2013.
[1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

Looking forward, the banking sector appears to exhibit adequate capital buffers to deal with the continued challenge to asset quality expected in the near-term, with the regulatory capital to risk-weighted assets ratio standing at 15.5% in 2013 Q2 (see table A6.3). However, NPLs net of provisions to capital amounted to almost 73%, implying that the system's ability to withstand further unexpected losses remains compromised. Should this negative scenario materialise, it would be reminiscent of the situation in 2012 when three banks in the system needed to be recapitalised in following stress-tests conducted by the central bank.

Banks' liquidity buffers remain high but have dropped significantly during the period under review (as measured by total assets to both liquid assets and short-term liabilities), although methodological changes undertaken by the central bank in the calculation of liquid assets mean that pre- and post-2013 figures are not directly comparable. The banking system's incipient recovery in profitability (as measured by return on equity) is encouraging but still needs to be durably ascertained in the period ahead. In the medium-term, uncertainty on the potential domestic impact of the on-going restructuring of parent banking groups whose subsidiaries are locally systemic (i.e. HAAG and NLB) remains a matter of concern.

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[28] See IMF (2013), Montenegro: Concluding Statement of the 2013 Article IV Consultation Mission Podgorica, May 20, 2013.

Table A6.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	15.9	15.4	15.3	15.1	16.5	15.9	14.5	13.6	14.7	14.4	15.5
Regulatory Tier 1 capital to risk-weighted assets	15.5	15.6	15.8	15.9	15.1	16.9	15.2	14.7	15.8	13.2	13.8
Nonperforming loans											
...net of provisions to capital	102.8	122.3	129.1	92.4	66.9	65.2	77.8	82.2	68.0	71.7	68.6
...to total gross loans	21.0	23.2	25.3	19.7	15.5	15.5	17.1	18.5	17.6	19.4	18.8
Households: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	11.5	9.6	7.9	11.91	11.79
Non-financial corporations: NPLs to total gross loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	22.9	27.3	25.6	32.7	31.2
...of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.5	0.8
.....of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
.....of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.0	0.0
.....of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.5	0.8
Return on assets	-2.8	-2.4	-0.6	-1.0	-0.1	-0.9	-1.3	-2.3	-2.0	1.4	1.3
Return on equity	-27.3	-23.4	-6.3	-10.1	-1.1	-8.8	-11.9	-21.7	-18.3	10.0	9.2
Liquid assets to total assets	19.1	19.4	19.9	23.0	19.9	18.2	19.5	25.2	24.0	13.2	14.5
Liquid assets to short-term liabilities	32.9	33.5	33.9	39.2	32.8	30.0	31.1	41.8	40.1	21.3	23.5
Net open position in foreign exchange to capital	0.8	-2.0	0.6	0.8	1.0	-0.3	-0.5	-0.6	-0.8	-0.6	0.4
Capital to assets	9.6	10.4	10.6	10.1	10.9	11.0	10.5	9.3	10.3	13.7	13.9
Large exposures to capital	112.1	106.5	107.0	99.9	100.8	95.5	123.3	162.8	125.9	87.4	60.2
Gross asset position in financial derivatives to capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross liability position in financial derivatives to capital	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Trading income to total income	1.1	0.5	3.6	1.9	2.6	1.9	1.2	1.3	1.7	1.3	1.6
Interest margin to gross income	71.6	75.7	71.8	74.3	70.5	75.3	71.3	69.7	73.1	69.5	71.0
Non-interest expenses to gross income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign-currency-denominated loans to foreign-currency-denominated deposits	150.3	179.7	92.3	88.1	72.5	65.9	52.9	48.7	44.3	101.2	102.7
Foreign-currency-denominated loans to total loans	4.1	3.7	2.8	2.8	2.3	2.2	2.2	2.1	1.9	4.0	3.8
Foreign-currency-denominated liabilities to total liabilities	6.4	5.2	5.1	4.9	4.3	4.1	4.5	4.8	4.7	5.2	4.9
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	27.8	25.9	26.5	26.1	25.8	24.9	25.0	24.8	24.3	24.6	25.0
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	-30.2	-31.0	-31.5	-30.8	-32.2	-31.0	-30.5	-30.9	-31.0	-31.1	-36.9
Loan-to-deposit ratio	122.9	117.3	111.3	104.2	107.6	109.6	106.2	94.5	94.0	114.8	113.4
Loan-to-value ratios for housing loans	39.3	40.1	41.8	43.1	42.6	42.2	42.5	43.6	43.5	21.0	21.4
Ratio of external liabilities to total liabilities of banks	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Central Bank of Montenegro.

Notes: Non-performing loans cover loans and matured receivables classified in C, D and E category (sub-standard, doubtful and loss respectively). As of 1 January 2013, loans and receivables classified under category E (written off) have been transferred from off-balance sheet records into the balance sheet, which is also reflected in the rise of NPL on an aggregated level.

Due to the implementation of IAS 39 from 1 January 2013, time series of several core financial stability indicators have changed and data ratio calculated prior to 2013 are therefore not necessarily comparable with indicators calculated in 2013. Receivables classified under category E has been transferred from off-balance sheet records into the balance sheet. These methodological changes resulted in an increase in total loans and in NPLs, and thus also in the loan-to-deposit and NPL ratios. Symmetrically, since funds and deposits with banks are part of loans and other receivables since 2013, the ratio liquid assets to total assets declined over the same period and according to national authorities the ratios calculated for previous periods are not comparable with 2013 data. Return on assets (equity) here comprises net profits in percentage of average assets (equity).

A7. Serbia

The banking sector has experienced some adjustments in the period under review. Total banking assets of private banks (which are dominant in the system) have dropped by just under 1% in the year to 2013 Q2. However, total assets of the banking system as a whole relative to GDP have dropped moderately, in part due to the de-licensing of several (mostly public) entities by the central bank in recent years.[29] In spite of the latter, the system continues to exhibit a high number of banks in operation (31, see table A7.1). In the case of Serbia, contrary to most peer economies, the large number of players in the system amounts to a relatively low degree of concentration, with the combined market share of the three largest entities amounting to just over 35% of total assets. Relative to peer economies in the region, the Serbian banking system also appears to be relatively less exposed to uncertainty resulting from the on-going restructuring of troubled parent banking groups, with the combined market share of the respective Hypo Alpe-Adria and NBG subsidiaries amounting to just over 9% of total banking assets.[30]

Table A7.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013 *
Number of banks		34	34	33	33	32	31
...of which foreign-owned		20	20	21	21	21	21
Total assets of banking sector	Percent of nominal GDP	66.8	79.4	87.9	82.6	83.0	76.9
Total assets of private banks	Million euro	18,327.4	18,975.2	20,210.9	21,360.0	20,864.0	20,674.1
...of which assets of foreign-owned banks	Percent of total assets	89.7	90.0	89.6	90.2	91.8	91.6
Total liabilities of private banks	Million euro	18,327.4	18,975.2	20,210.9	21,360.0	20,864.0	20,674.2
...of which external liabilities	Percent of total liabilities	23.0	27.3	28.4	23.9	23.1	21.0
.....of which external liabilities to other private banks	Percent of total liabilities	12.9	14.4	16.2	11.9	10.8	9.9

Sources: National Bank of Serbia and IMF/WEO.
Notes: * As of July 2013. Nominal full-year GDP figures for 2013 are projections.

Local bond markets have grown significantly in size in recent years backed inter alia by increased government funding needs. Both dinar-denominated and euro-denominated bond issuance have been stepped-up, with domestic currency denominated bonds accounting for more than 75% of the total bond market. The share of corporate bonds remains negligible. Banks' holding of government securities have been on an upward trend over the last few years, edging up to 9% of total bank assets in 2013 Q2 (see table A7.2 and also chapter 3).

The main challenges to financial stability continue to stem from persistent credit and indirect market risks, though capital and liquidity buffers appear sufficient and the funding

[29] Nova Agrobanka was delicenced in 2012 and Razvojna banka Vojvodine in April 2013. Privredna banka and Univerzal banka a.d had their licences revoked after the period under review (October 2013 and January 2014 respectively), bringing the total number of banks operating in the economy to 29.
[30] See National Bank of Serbia (2012), Banking Sector in Serbia – Fourth Quarter Report 2012.

base is showing signs of stabilisation. The ratio of non-performing to gross loans has remained at just under 20% in the period under review. While several measures to foster NPL clean-up have been taken, further efforts are needed in the restructuring of corporate debt in particular, including as regards collateral execution or out-of-court procedures.[31] However, the system appears relatively well-positioned to deal with the continued challenges to asset quality in the period ahead, with the ratio of regulatory capital to risk-weighted assets at 20% in 2013 Q2. NPLs net of provisions to capital remain high at 33% in 2013 Q2 (see table A7.3), but provisioning for total loans (including both IFRS and regulatory provisions) remains ample. The liquidity of the banking sector also remains high even by regional standards

Table A7.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	9.3	8.9	9.7	14.0	17.4	18.3
...share of corporate bonds	in percent of total local bond market	1.3	0.3	0.4	0.3	0.7	0.2
...share of government bonds	in percent of total local bond market	98.7	99.7	99.6	99.7	99.3	99.8
Size of local stock market (amount outstanding)	Percent of GDP (eop)	28.8	28.3	26.7	21.3	19.0	18.3
Banks outstanding corporate bonds	Million euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Banks holding of government securities	Million euro	22.0	950.5	1432.7	1500.3	2224.0	2702.3
Debt securities issued by corporations[1]	Percent of GDP (eop)	0.0	0.0	0.0	0.0	n.a.	n.a.
Banks credit to non-government residents[2]	Percent of GDP (eop)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: National Bank of Serbia

Notes: [1]Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [2] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities. Banks' holdings of government securities do not include banks' holdings of frozen foreign currency savings bonds.

However, notwithstanding this aggregate picture for the system as a whole, stress tests conducted by the central bank in 2012 revealed that on an individual level some banks might need additional capital in an adverse scenario.[32] Concerning market risks, the indirect exposure of the banking system to adverse developments related to nominal exchange rate depreciation for unhedged borrowers remains high, with the ratio of fx loans to total loans at 73% in 2013Q2. Risks in this regard appear to be compounded by the high volatility of the domestic currency (the dinar) relative to the euro. The moderate downtrend of the loan-to-deposit ratio (to 104% in 2013 Q2) and the further reduction in the share of banks' external liabilities in total liabilities (21% in 2013 Q2) indicate some improvement in the funding base, though both figures remain high and the durability of these trends amid a more dynamic credit environment still needs to be ascertained.

[31] See IMF (2013c) 2013 Article IV Consultation – Serbia.

[32] One bank had been recapitalised in 2013 Q1 (see National Bank of Serbia (2013), Banking Sector in Serbia – First Quarter Report 2013). Four other banks were recapitalised later in 2013H1.

Table A7.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	19.9	20.4	19.7	19.7	191	17.3	17.2	16.4	19.9	20.4	20.2
Regulatory Tier-1 capital to risk-weighted assets	15.9	16.5	16.1	16.1	181	16.3	16.3	15.6	19.0	19.2	191
Nonperforming loans											
...net of provisions to capital	29.0	29.4	33.2	33.2	30.8	35.5	35.5	36.4	31.0	32.2	33.4
...to total gross loans	16.9	17.1	18.6	18.8	19.0	20.4	19.5	19.9	18.6	19.9	19.9
Households: NPLs to total gross loans	8.8	9.1	9.2	9.5	91	9.9	9.9	10.1	10.1	10.3	10.7
Non-financial corporations: NPLs to total gross loans	20.7	20.5	22.0	22.4	22.3	22.6	21.3	21.7	19.2	20.8	21.3
... of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	17.6	17.7	18.3	17.9	19.4	19.4
..... of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	17.8	17.9	18.7	17.8	19.3	19.4
..... of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	15.3	11.0	8.3	9.5	15.1	9.8
..... of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	17.9	17.6	18.0	20.8	20.9	21.3
Return on assets	1.1	1.6	1.4	1.4	0.0	1.4	0.7	0.6	0.4	1.5	1.1
Return on equity	5.3	7.6	7.0	6.5	0.2	6.9	3.6	2.8	2.0	7.2	5.3
Liquid assets to total assets	27.2	25.7	26.9	25.5	25.4	24.3	22.9	22.7	23.9	25.1	24.0
Liquid assets to short-term liabilities	58.4	56.5	60.8	57.3	60.4	57.8	54.8	55.1	57.2	59.5	58.0
Net open position in foreign exchange to capital	1.3	0.7	0.9	0.9	2.5	0.9	1.3	1.9	2.7	1.9	1.1
Capital to assets	19.7	20.9	21.0	21.1	20.6	20.6	20.2	20.2	20.5	21.2	21.0
Large exposures to capital	39.6	45.0	42.7	40.8	65.0	74.4	79.3	72.0	61.9	50.7	53.2
Gross asset position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross liability position in financial derivatives to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trading income to total income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest margin to gross income	65.7	71.4	69.5	68.8	69.0	65.8	65.3	65.1	65.6	67.0	66.8
Non-interest expenses to gross income	67.1	64.9	63.0	63.7	65.9	63.2	71.8	69.6	69.8	68.8	65.7
Foreign-currency-denominated loans to foreign-currency denominated deposits	98.1	96.6	99.4	100.1	99.8	102.6	100.5	103.6	98.2	97.1	97.5
Foreign-currency-denominated loans to total loans	76.8	69.7	69.2	69.7	69.8	71.1	75.3	75.5	74.1	72.3	72.8
Foreign-currency-denominated liabilities to total liabilities	81.8	81.2	79.9	79.9	79.0	80.8	80.9	79.7	80.1	79.4	79.3
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	19.8	19.0	19.0	18.7	18.8	19.5	20.1	19.9	19.3	18.7	18.8
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	-1.2	-4.7	-5.5	2.1	6.0	1.9	5.5	-0.7	-5.2	-0.5	1.1
Loan-to-deposit ratio	115.3	117.1	117.2	113.5	109.0	113.5	109.9	112.2	107.3	105.3	103.6
Loan-to-value ratios for housing loans	65.4	66.9	67.7	64.7	64.3	62.7	65.8	65.0	65.5	66.3	67.1
Ratio of external liabilities to total liabilities of banks	30.0	27.8	26.9	25.8	26.0	27.1	25.3	24.8	25.4	23.6	23.6

Source: National Bank of Serbia.

Notes: Non-performing loans cover the total outstanding debt under an individual loan (including the amount of arrears) under the following conditions: (i) where the payment of principal or interest is past due (within the meaning of the decision on classification of balance sheet assets and off-balance sheet items) over 90 days, (ii) where at least 90 days of interest payments have been added to the loan balance, capitalized, refinanced or delayed by agreement, (iii) where payments are less than 90 days overdue, but the bank has assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full.

In table A7.3, NPL net of provisions to capital in Serbia are based on IFRS provisions only. NPLs net of total provisions (statutory and IFRS provisions) to capital are 0%, i.e. NPLs are fully provisioned for according to national authorities.

A8. Turkey

The Turkish banking system has continued to grow at a brisk pace over the period under review, with total banking assets increasing by 11.5% in the year to 2013 Q2. Banks play an important role in the financial system, accounting for almost 90% of total financial system assets in spite of the relatively large number of non-bank financial entities. A key difference with banking systems in EU candidate and potential candidate countries in the Western Balkans is that parent-subsidiary dynamics are very limited, with domestic banks controlling around three-quarters of total assets and foreign-owned banks making up for less than half of the total number of entities operating in the country. Bank concentration in Turkey is also lower than the Western Balkan average but remains comparable to some countries (such as Serbia), with the three largest market players in the system accounting for just over 33% of total assets.

Table A8.1: Structure of the banking sector

	Description	2008	2009	2010	2011	2012	2013*
Number of banks		49	49	49	48	49	49
...of which foreign-owned		24	24	24	23	24	23
Total assets of banking sector	Percent of nominal GDP	77.1	87.6	91.6	93.8	96.8	97.2
Total assets of private banks	Millions euro	266,924.2	261,661.5	344,325.6	363,695.9	413,939.1	428,795.0
...of which assets of foreign-owned banks	Percent of total assets	24.4	23.3	24.2	23.6	24.1	25.1
Total liabilities of private banks	Millions euro	266,924.2	261,661.5	344,325.6	363,695.9	413,939.1	428,795.0
...of which external liabilities	Percent of total liabilities	17.5	16.1	16.0	20.4	18.6	20.6
.....of which external liabilities to other private banks	Percent of total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Central Bank of the Republic of Turkey and IMF/WEO.
Notes: * As of June 2013. Nominal full-year GDP figures for 2013 are projections.

While the total size of local capital markets has remained stable, their relative importance in bank funding has grown. The size of local bond markets has remained stable at around 29% of GDP, with over 90% of this accounted by government bonds. Banks remain dependent on domestic deposits as their main funding source, but the relative importance of securities' issuances has grown as can be seen from the pick-up in banks' outstanding corporate bonds in the period under review (see table A8.2). Banks' holdings of government debt securities have dropped, though this largely reflects valuation effects in holdings of foreign debt obligations.

With risks to financial stability in Turkey remaining largely contained on account of strong fundamentals for the banking system as a whole, the main challenge going forward is to achieve a 'soft landing' as regards the pace of credit extension while containing funding risks. The Turkish banking system exhibits few of the vulnerabilities which afflict peer EU candidate and potential candidate countries in the Western Balkan region. Credit risks appear broadly in-check, with the ratio of NPLs to gross loans at only 2.8% in 2013 Q2. At the same time, developments in this regard have also been influenced by a pace of credit extension which, though exhibiting a somewhat volatile pattern, has remained brisk. Exposure to indirect market risks also remains low in comparison to Western Balkan peers, with fx loans amounting to just over 25% of total loans. Potential vulnerabilities by fx lending to those parties deemed to be most at risk of being unhedged (i.e. households) have been safeguarded by law. However, holdings of government bonds account for a significant share of total bank assets, including relative to peer countries, implying that the banking system remains indirectly exposed to potential sovereign shocks.

Table A8.2: Local capital markets

	Unit	2008	2009	2010	2011	2012	2013*
Size of local bond market (amount outstanding at market value)	Percent of GDP (eop)	29.0	34.7	32.4	29.5	29.4	28.7
...share of corporate bonds	in percent of total local bond market	0.2	0.2	0.8	3.8	7.1	7.7
...share of government bonds	in percent of total local bond market	99.8	99.8	99.2	96.2	92.9	92.3
Size of local stock market (amount outstanding)[1]	Percent of GDP (eop)	6.7	7.4	7.4	6.9	6.9	6.6
Banks outstanding corporate bonds	Million euro	2,468.5	2,197.8	3,584.2	3,422.5	3,067.3	3,309.2
Banks holding of government securities	Million euro	98,880.8	118,517.6	139,287.8	117,771.5	112,798.2	105,476.2
Debt securities issued by corporations[2]	Percent of GDP (eop)	0.1	0.1	0.3	1.1	2.0	2.1
Banks credit to non-government residents[3]	Percent of GDP (eop)	34.7	36.7	43.1	47.6	50.9	56.6

Source: Central Bank of the Republic of Turkey.

Notes: * As of Q2 2013.

[1] Figures does not indicate market capitilization amounts but nominal outstanding securities. [2] Outstanding amount of debt securities issued by resident non-financial corporations, MFIs and other financial corporations. [3] MFI (excluding NCB) credit to domestic non-MFI residents other than government. Credit includes outstanding amounts of loans and debt securities.

The system's relative ability to withstand negative shocks appears high on account of both the considerable capital buffers of banks, notwithstanding their mild decline in the period under review (with regulatory capital to risk-weighted assets at 16.3% in 2013 Q2, see table A8.3) and the results of central bank stress tests.[33] Bank profitability also remains high, with return on equity at 14.3% in 2013 Q2. The main challenge going forward will be to achieve a 'soft landing' as regards the pace of credit extension, both as regards the headline rate as well as in the specific segment of fx lending to the corporate sector (with an average annual increase of 15% in the year to July 2013). This is important since some Turkish corporates tend to have sizeable open positions in fx, albeit mostly at longer-dated maturities.[34] It will be key to limit the vulnerabilities associated with potential shifts in market sentiment and the related shifts in external funding, whose share in total liabilities has increased to just over a fifth in the period under review for private banks. This is also warranted by the rising loan-to-deposit ratio, which has trended up to a high of 106% in the period under review.

[33] See Central Bank of Turkey (2013), Financial Stability Report, May 2013.

[34] It should be noted that corporates which do not have fx income can also borrow in fx but only if the loan amount is higher than USD 5 million and the maturity is longer than 1 year. This implies that fx borrowing is de facto restricted to larger firms which presumably have a greater ability to manage their fx exposures relative to smaller peers.

Table A8.3: Financial stability indicators

(percentages)	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2
Regulatory capital to risk-weighted assets	19.0	18.0	17.2	16.4	16.6	16.6	16.5	16.5	17.9	17.4	16.3
Regulatory Tier 1 capital to risk-weighted assets	17.0	16.4	15.6	14.9	14.9	14.9	14.7	14.5	15.1	14.7	14.0
Nonperforming loans											
…net of provisions to capital	2.6	2.4	2.3	2.6	3.0	2.9	2.9	3.7	3.5	3.7	3.9
… to total gross loans	3.7	3.3	3.0	2.7	2.7	2.8	2.7	3.0	2.9	3.0	2.8
Households: NPLs to total gross loans	4.1	3.7	3.3	3.1	2.9	3.0	2.9	3.1	2.9	3.0	2.7
Non-financial corporations: NPLs to total gross loans	3.5	3.1	2.8	2.6	2.7	2.7	2.6	3.0	2.9	3.0	2.9
… of which in FX	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
….. of which in Euro	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
….. of which in USD	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
….. of which in CHF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Return on assets	2.5	2.2	2.0	1.8	1.7	1.7	1.7	1.8	1.8	1.8	1.9
Return on equity	18.1	16.7	15.4	14.6	14.3	14.2	14.2	14.5	14.5	14.3	14.3
Liquid assets to total assets	28.7	26.6	22.6	21.3	19.8	19.2	18.5	17.4	17.5	16.0	13.9
Liquid assets to short-term liabilities	42.7	41.3	36.6	34.3	31.7	30.5	29.1	27.7	28.2	26.3	22.8
Net open position in foreign exchange to capital	0.0	1.2	1.2	-0.7	0.4	0.6	0.2	1.7	1.6	2.3	-0.7
Capital to assets	13.7	13.4	12.7	12.4	13.0	13.4	13.4	13.7	14.3	14.2	13.6
Large exposures to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross asset position in financial derivatives to capital	155.7	179.6	195.7	215.2	199.1	209.7	213.0	199.2	196.4	243.5	n.a.
Gross liability position in financial derivatives to capital	155.7	180.9	196.5	215.2	197.9	209.3	212.5	199.0	196.9	243.5	n.a.
Trading income to total income	0.5	1.1	0.5	-0.8	-0.3	-1.4	-1.2	0.5	2.0	2.9	4.2
Interest margin to gross income	62.5	55.4	57.5	61.0	65.2	63.7	64.7	65.6	64.4	63.4	60.4
Non-interest expenses to gross income	48.0	50.0	52.6	54.3	55.2	55.2	55.2	53.8	53.0	52.8	52.2
Foreign-currency-denominated loans to foreign-currency denominated deposits	86.9	91.8	96.3	94.7	92.6	88.9	86.9	88.7	89.8	91.1	99.2
Foreign-currency-denominated loans to total loans	26.7	27.2	27.2	28.9	28.4	27.0	25.9	25.3	24.9	24.7	25.7
Foreign-currency-denominated liabilities to total liabilities	30.4	31.2	31.7	34.5	35.9	35.4	36.2	35.5	35.1	35.6	36.8
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt to gross domestic product	17.8	17.8	18.8	18.9	19.4	19.3	19.9	20.4	21.2	21.8	n.a.
Household debt service and principal payments to income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Residential real estate prices (Percentage change/last 12 months)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Loan-to-deposit ratio	82.6	86.9	91.3	93.7	94.9	96.7	98.7	98.4	99.0	101.6	105.7
Loan-to-value ratios for housing loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ratio of external liabilities to total liabilities of banks	15.1	16.6	17.3	18.6	19.2	18.6	20.1	19.7	19.6	21.0	21.8

Source: Central Bank of the Republic of Turkey.

Note: Non-performing loans are all loans and other receivables classified as with limited recovery means, suspicious recovery or having the nature of loss, according to the *regulation on procedures and principles for determination of qualifications of loans and other receivables by banks and provisions to be set aside*.