CHAPTER 29.

DEVELOPMENT OF SERBIAN BANKING SECTOR: A COMPARISON WITH THE WESTERN BALKAN COUNTRIES[1]

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Abstract

Serbian banking sector in last decade faces rapid expansion followed by capacity, productivity and profitability increases. Foreign direct investments inflow, strenghtening of depository and capital basis, rapid credit activity expansion, decreasing number of banks and more efficient management are the main characteristics of domestic banking after performed financial system regulatory reform. Powerfull strikes of economic crises on domestic banking sector and high reputational risk in previous period required active role of central bank that is, by set of measures, maintained sector stability.

Considering turbulent environment domestic banks operate and risks they face, this paper analyze sector performances with simultaneous comparison with relevant indicators in Western Balkan and EU countries. Comprehensive analysis is performed to present current domestic banking sector conditions and evaluate potential directions of future development.

Key words: *banking sector, Serbia, Western Balkan countries, capacity, profitability, economic crisis*

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INTRODUCTION

At the beginning of the new millennium, national banking was faced with major obstacles that have been accumulated in the former years. Illiquidity, insolvency and low profitability were the basic characteristics of the national banking sector during this period. The majority of banks had problems of insufficient capital and lack of reserves for absorbing the risk, along with the inadequate system of risk management. It was more than obvious that the banking and overall financial system in the country required radical changes. The National Bank and entire society faced with a difficult task of restoring the citizens' lost trust in the national financial system.

Since 2001, the banking sector had gone under visible structural changes with the aim of increasing the efficiency and competitiveness of national banks. Adoption of the legislation that supports the structural changes and defining competent institutions for monitoring and control of business in banking and non-banking financial institutions was a part of the restructuring strategy. Privatisation of banks, inflow of foreign capital, sophisticated technologies and efficient methods of corporative management are some of the key characteristics of Serbian banking in the first years of the new millennium.

Transforming the remaining segments of financial system of Serbia have been undergoing along with the restructuring of the banking institutions. The expansion of non-banking financial institutions and financial markets were the result of the regulatory reforms in the country financial system. Although in the first year of 21st century we have witnessed high rates of growth for leasing and insurance companies, voluntary pension and investment funds, the dominant role of banks was also visible. With a share of more than 90%, the banking sector represents the most important segment in the structure of the financial sector of Serbia.

LEGAL FRAMEWORK OF SERBIAN BANKING SECTOR

In Serbia today, the legal framework of the banking sector on a larger scale is regulated by two fundamental laws, *Law on banks* adopted in 2005 and *Law on NBS* adopted in 2003. In a broader sense, legal framework is at the same time comprised of *Deposit insurance law*, *Law on bank bankruptcy and liquidation*, *Law on securities market and instruments*, *Law on foreign exchange*, *Law on payment instructions* and *Company law* (Vukovic, 2009). In the last decade, payment system operations switched to private banks. Government resolved the problem of old foreign currency savings by issuing state bonds and accepted Strategy for Basel II implementation. In 2011, National Bank of Serbia (NBS) finally adopted *Law on protection of financial services users*. By adopting mentioned regulatory measures, National Bank of Serbia and the Government created solid basis for development and stability of banking sector. However, we need to emphasise that Serbia is still at the beginning of the process of creating competitive and stimulating banking environment. Legislators will face many challenges in the future and need to continue with the practice of dynamic regulatory activities. Brief analysis of the current regulatory and main regulative challenges for the future period is given below.

Law on Banks. Before 2005, the banks operated under the law which entered in force in 1993 and was amended several times before finally repealed in 2005. New Law on banks provided good framework for risk management in banks, harmonised with the EU legislative. Bank operations and formal organization as well as acquiring the licence are now more strictly monitored. Acquiring ownership share that is greater than 5% is regulated by very strict set of measures: "If a person/legal entity without NBS permission acquires direct or indirect ownership rights from 5% to 20%, from 20% to 33%, from 33% to 50% or more than 50%, NBS will instruct that person to sell its ownership rights immediately and block its power to influence the bank operations" (*Law on banks*, Chapter 5, Article 99). Moreover, new measures suggested that the bank exposure to one person/entity or group of related entities should not be greater than 25% of ban capital. Bank exposure to its related person/entity should not exceed more than 5% of its capital.

Law on NBS. Law on NBS provides framework for NBS activities, organization and responsibilities, monetary policy and efficient banks supervisory. With this law, NBS has complete autonomy to implement all necessary measures to enable banks to operate in a prudent and responsible way.

NBS by-laws and measures to cope with the financial crisis. NBS adopted several by-law acts, particularly in order to regulate risk management in banks. The most important acts in force are *Act on risk management*, *Act on capital adequacy* and *Act on way and terms of identification and monitoring risk of compliance of bank operations and risk management*. In the light of financial crisis, NBS was determined to take preventive actions in order to minimize crisis effects. As a result of this, in 2008 and 2009 NBS adopted several temporary measures to improve banking sector liquidity and maintain financial system stability in the period of crisis[4]. In addition to, when it was evident that confidence in banking sector has decreased, Government decided to accept NBS suggestion to increase insured amount of deposit up to 50.000 EUR per account.

[4] http://www.nbs.rs, Control of banks, Quarterly reports for 2008 and 2009

That decision stopped rapid cash disbursement from banks as a consequence of economic crisis. (*Deposit insurance law changes*, NBS 2010)

Legal framework in other Western Balkan countries. Legal framework in other WB countries is very similar to Serbia. In Montenegro, the following laws are in force: *Law on Central Bank*, *The Banking law*, *Law on Bank bankruptcy and liquidation*, *Law on national payment operations* and *Deposit protection law*[5].

In Bosnia and Herzegovina, Dayton Peace Agreement established the Central Bank of Bosnia and Herzegovina as a sole authority for issuing currency and monetary policy throughout Bosnia and Herzegovina. The establishment of banks, management and supervision is regulated by the entity laws on banks, which are mostly in accordance with the EU legislation[6].

In Albania, the National Bank's activity is conducted in compliance with the *Law on the Bank of Albania*. The banking system activity is conducted in compliance with the *Law on banks in the Republic of Albania*. The Law on banks in the Republic of Albania defines the core principles of banking activity in the Republic of Albania, the main procedures and rules of licensing and supervision in the Albanian banking system[7].

Macedonian Government adopted laws which regulate banking sector similarly to other WB countries did by adopting *Law on the National Bank of the Republic of Macedonia*, *Banking Law*, *Law on foreign exchange operations*, *Law on payment operations*. What is particular for Macedonia is that in 2009 Macedonian Government decided to establish the state bank for development by adopting the *Law on the Macedonian Bank for Development Promotion*. The primary objective of the Macedonian Bank for Development Promotion shall be to support and initiate the development of the Macedonian economy in compliance with the strategic policies, objectives and priorities of the Republic of Macedonia[8].

Likewise, Croatia has similar legislation. Considering the fact that Croatia will eventually become EU member in 2013, its legislation is completely harmonised with the EU directives. Along with the Law on National Bank of Croatia and Law on banks, Croatia also adopted the *Law on credit institutions* that covers establishing, operation and liquidation of credit institutions and their supervision. This law defines conditions for provision of services of legal entities headquartered outside the territory of the Republic of Croatia. Some articles of

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[5] http://www.cb-mn.org
[6] http://www.cbbh.ba
[7] http://www.bankofalbania.org
8 http://www.nbrm.mk

this law will enter into force on 1st July 2013, when Croatia becomes an EU member[9].

Basel II. Finally, Serbia along with the rest of the Western Balkan countries plans to adopt Basel II standard in the process of banking sector reform and harmonization with the EU regulations. According to NBS, the main goals of introducing Basel II are the following[10]:

- Further strengthening of stability of the banking sector and financial system;
- Improvement of risk management process in banks and risk-based supervision;
- Enhancement of transparency and market discipline;
- Alignment with operating conditions in the international financial market;
- Harmonization with the EU regulations - EU Directives 48/2006 and 49/2006;
- Strengthening the link between capital requirements and risk exposure in banks.

It was the initial plan for the full implementation of Basel II standard on 1st January 2011. However, it was clear that banks did not have enough time to adapt to this since the implementation of Basel II requires significant resources. For that reason, complete implementation is delayed until 1st January 2012. Among Western Balkan countries it was only Croatia, forced by the EU, which has implemented Basel II standard. Croatian experience teaches us that early adoption could lead to many problems such as lack of human resources and technological capacities for new rules implementation (Kraft, Urosevic, Zivkovic, 2007.). Republika Srpska is planning to fully implement Basel II until 2018[11], and other Western Balkan countries are just preparing and have not defined the date for the complete implementation of new rules.

GENERAL TRENDS IN DEVELOPMENT OF SERBIAN BANKING SECTOR

The key characteristic of national banking in the first years of implementation of reforms was the internationalisation of banks share capital. The significant increase of foreign banks share in the capital of Serbian banking system was achieved through recapitalisation or local banks takeover. Contemporary legal

[9] http://www.hnb.hr
[10] www.nbs.rs, the Strategy of implementing Basel II standard.
[11] Strategy for implementing the international Agreement on Capital Measurement and Capital Standards, Basel II, Banja Luka, 2009.

and institutional frameworks have created the favourable environment for the inflow of foreign capital and expansion of banking business. Foreign banks have gradually entered into the national banking market. In the period of 2002-2003 of the total number of 50, twelve banks were under the control of majority foreign shareholders. In the period 2006-2011 we have observed the domination of foreign banks in the structure of ownership. Foreign shareholders dominate not only by the number of banks where they have the majority of ownership, but also in the assets they manage.

Table 1. Ownership structure of Serbian banking sector

	2006	**2007**	**2008**	**2009**	**2010**	**2011***
Total domestic banks	15	14	14	14	12	12
State-owned	8	8	8	10	8	8
Privacy-owned	7	6	6	4	4	4
Total foreign banks	22	21	20	20	21	21
Total sector	**37**	**35**	**34**	**34**	**33**	**33**

** Data as of June 30, 2011*
Source: National Bank of Serbia

The period of transformation of the Serbian banking sector was marked with the decrease of the number of banks and its consolidation. According to the National Bank data, 86 banks were working in the national banking market by the beginning of 2001[12]. In the years that follow, we have witnessed the significant reduction of the number of banks – 33 banks are working in the market by the end of the second quarter of 2011. The trend of decreasing the number of banks was followed by the expansion of the organisational network until 2008 when the banking system faced with the implications of the world economic crisis. Quarterly reports of the National Bank of Serbia showed that in the last three years the number of organisational units has decreased.

The growing trend of employment was visible until the crisis year 2008, when the shattered financial stability of the sector caused a number of negative implications, and one of them was the decrease in a number of employees in 2009, when 3.58% of the decrease rate was registered. NBS report for the second quarter of 2011 has manifested an insignificant, but definitely encouraging rise of employability in banks.

[12] www.nbs.rs. Banking sector of SRY, 2002, p.1.

Table 2. Structural indicators of the Serbian banking sector (2006-2011)

	2006	**2007**	**2008**	**2009**	**2010**	**2011***
Number of banks	37	35	34	34	33	33
Number of organization units	2,158	2,435	2,711	2,635	2,487	2,471
Number of employees	28,092	30,246	32,342	31,182	29,877	29,925

** Data as of June 30, 2011, Source: National Bank of Serbia*

Capacity indicators. The national banking sector is undergoing a complete transformation followed by the increased growth of capacities. In the methodology of European Central Bank (ECB) the indicators relevant for the evaluation of capacities are the number of credit institutions, population per credit institution, population per branch and ATM and assets per employee.[13] *Table 3* contains the preview of key sector indicators for the countries of Western Balkans and the EU and countries of Eurozone (MU16).[14]

Table 3. Comparative indicators of banks activities (2010)

	Number of banks	**Population per bank**	**Number of business units**	**Population per business unit**	**Number of employees**
Serbia	33	220,491	2,487	2,926	29,877
Croatia	33	130,019	1,274	3,368	21,770
BIH	29	148,208	955	4,501	10,321
Macedonia	18	112,364	436	4,639	6,052
Albania	16	199,686	529	6,040	6,384
MU 16*	6,458	50,959	179,916	1,766	1,041,856
EU 27*	8,358	59,860	229,532	2,131	2,007,336

** The data is related to all credit institutions in the financial systems; Data for 2009*
Source: The data of WB countries Central Banks and ECB data

The important indicator of the banking sector development, in accordance to the ECB methodology, is population per credit institution and branch. By monitoring the listed indicators in time and in comparison to other countries, it is possible to evaluate the development of the banking sector capacities for each monitored country.

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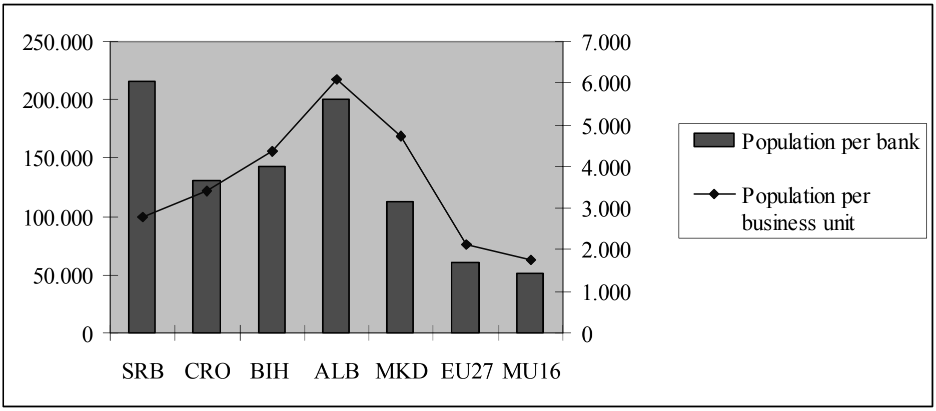
[13] www.ecb.int *EU Banking Structures*, ECB (2010), p. 19.
[14] MU16 was an indication for the countries members of Monetary Union (Eurozone), by 31 December 2009.

Graph 1. Population per bank and population per business unit (2009)



Source: The data of WB countries Central Banks and ECB data

According to the data of ECB for 2009, the countries of EU27 had population of 59,860 per credit institution, and the countries of Monetary union (MU16) 50,959.[15] For the same year, Serbia has registered the population of 215,318 per bank[16] which indicates that Serbia is significantly behind in comparison to the capacity of banking sector in developed countries. Such state is a result of rapid decrease in number of banks. It is obvious that, according to the capacity indicator observed, Serbia is on the last place in comparison to the rest of the Western Balkans countries, and among these the Republic of Macedonia had the best position, with population of 112,364 per bank. The register of observed WB countries for population per bank indicator remained the same in 2010 – Serbia was registered with population of 220,491 per bank which would again be the final position in this register.

The second indicator of capacities, population per branch, monitored in the same year (2009), provided us with a different conclusion for the structure of Western Balkan countries. According to this indicator, WB countries are visibly behind the EU and Eurozone countries. This indicator of banking sector development in 2009 in Serbia was 2,778, as in EU countries and MU16 it was 2,131 and 1,766, respectively. At the same time, Serbia is the best rated in comparison to other countries in the neighbourhood. Better indicator of capacities in comparison to WB countries can be explained by the widespread organisational network of Serbian banks and population decrease. Serbia has the most developed branch

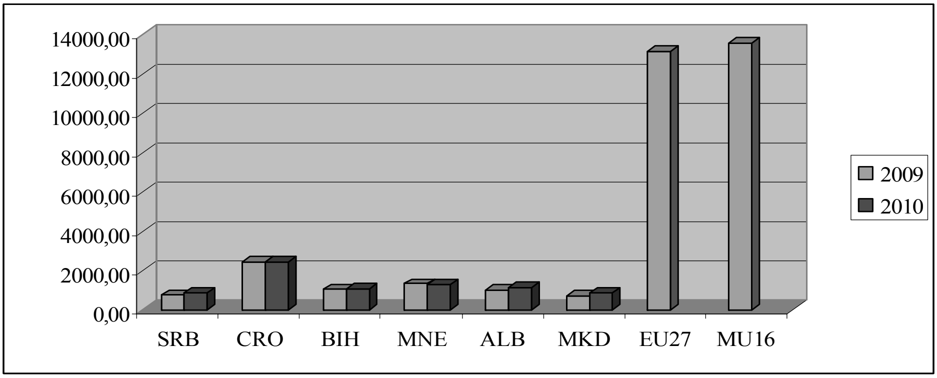
[15] www.ecb.int EU Banking Structures, (ECB 2010), p. 19.

[16] In Serbia, banks are the only credit institutions. Vukovic V, *Structural changes and banking performance in Serbia 2002-2008,* Institute of economic sciences, Belgrade, 2009, p.77.

network in comparison to WB countries. However, reducing the number of branches continued in 2010, and therefore influenced the decrease of indicator to 2,926.

One of the fundamental indicators in evaluation of performance of the banking system is the efficiency of employees, rendered as a ratio between assets and number of employees in the banking sector. Higher ratio is an indicator of better efficiency of bank business and complete banking sector. NBS evaluates the productivity of banking sector on the basis of the previous indicator. Selected capacity indicator for Serbia, WB countries and EU member countries can be found in *Graph 2*.

Graph 2. Assets per employee in 000 EUR (2009-2010)



Source: The data of WB countries Central Banks and ECB data

Although in last decade, the banking sector in Serbia and countries in the region underwent deep structural changes, *Graph 2* indicates the major gap between Western Balkan countries and EU and Eurozone member countries. Balance sum rate in EUR to number of employees in banking sector ratio in Serbia in 2009 was 722.5 thousand EUR, that is eighteen times lower in comparison to developed countries of EU and Eurozone (13,156 thousand EUR in EU27 and 13,616 thousand EUR in MU16). Significant increase of capacity indicators in EU banking sector in period 2007-2009 can be explained by ad hoc measures taken in the time of global economic crisis, concerning the reduction of the number of employees in banking sector. Therefore, in interpretation and comparative analysis of balance sum per employee, it is important to consider the last observation. In the group of countries that belong to the European Union, different level of capacity indicators is noticeable. The rate of balance sum and number of employees in 2009 was the highest in Ireland, almost 34,669 thousand EUR, whereas Bulgaria and Romania occupy the last position (1,102 and 1,272 thousand EUR).

Graph 2 indicates that, according to the fundamental capacity indicator, in 2009 the banking sector is Serbia was behind the countries in the region as well – Macedonia scored approximate rate, whereas the balance sum per employee in Croatia was three times bigger compared to Serbia. In 2010, in Serbia the assets per employee increased (803.9 thousand EUR) which is an indicator of growing capacities of banking sector. Growing trend of capacity indicators continued in 2010 in other WB countries as well, except for Montenegro where the balance sum per employee decreased notably.

Concentration and competition. Banking sector in Serbia is fragmented to a great extent in all the segments of banking activity. Business of a large number of banks with a small share in assets, loans and deposits influenced Herfindahl–Hirschman Index (HHI) to drop below the level of 1000.[17] HHI assets, loans and deposits in 2010 were 629, 649 and 720 index points, respectively, which indicates the lack of concentration in the national banking market. Apart from the higher competition in the banking sector, the low level of concentration for the abovementioned categories was influenced by the occurrence of crisis in the economy in the last quarter of 2008, which significantly reduced the deposit potential of banks, damaged the quality and reduced the scope of banks loan portfolio.

Table 4 shows the concentration in banking sector of WB countries, members of EU27 and Eurozone, measured by Herfindahl-Hirschman Index and ratio of assets concentration for five largest banks.

Table 4. Concentracion and competition indicators (2010)

	SRB	CRO	BIH*	MNE	ALB	MKD	MU16*	EU 27*
HH index (assets)	629	1,362	999	1,467	1,400	1,578	663	632
C5 (assets)	45.0%	65.0%**	59.2%	76.9%	-	77.2%	44.6%	44.3%

** Data for 2009, ** Participation of four banks.*
Source: The data of WB countries Central Banks and ECB data

In 2010 HH Index in Croatia, Macedonia and Montenegro indicates that the market concentration concerning assets and loans is moderate. The data of central bank of Macedonia indicated a high concentration of loans for population – 2,050 index points in 2010 which is three times more than in Serbia, whereas the

[17] HH Index is used to evaluate the degree of concentration for the banking sector. Herfindahl-Hirschman Index under 1,000 indicates the low level of concentration in the sector, whereas the values over 1,800 indicate prominent concentration. The values between 1,000 and 1,800 indicate moderate concentration.

concentration of population deposits was 2.6 times higher. The indicators of concentration in Albania measured in HH Index are at the similar level in the last three years, but still not close enough to the optimal level of concentration. HH Index of assets concentration in 2009 in EU27 countries is 632 index points, whereas in the Eurozone countries it was 663 index points (EU banking structures, ECB 2009). By observing single member countries one can notice the difference, very fragmented markets such as Germany, Great Britain, Austria and Italy, and markets with a prominent concentration such as Estonia, Finland and Belgium where the highest HH Index of assets concentration were registered – 4,039, 2,730, 2,112 index points, respectively.

Assets concentration ratio for top five banks is a more precise measure for evaluating the market domination although it has the widest use at the same time. In 2010, C5 ratio in Serbia is 45%, which is approximately at the same level in the last five years. Ratio C5 in 2009 in EU countries is approximately 44.3%. On a case by case basis, countries that have high value of assets concentration ratio for top five banks noticeably have a high HH Index of concentration.[18]

THE ANALYSIS OF BUSINESS PERFORMANCE OF BANKING SECTOR IN SERBIA

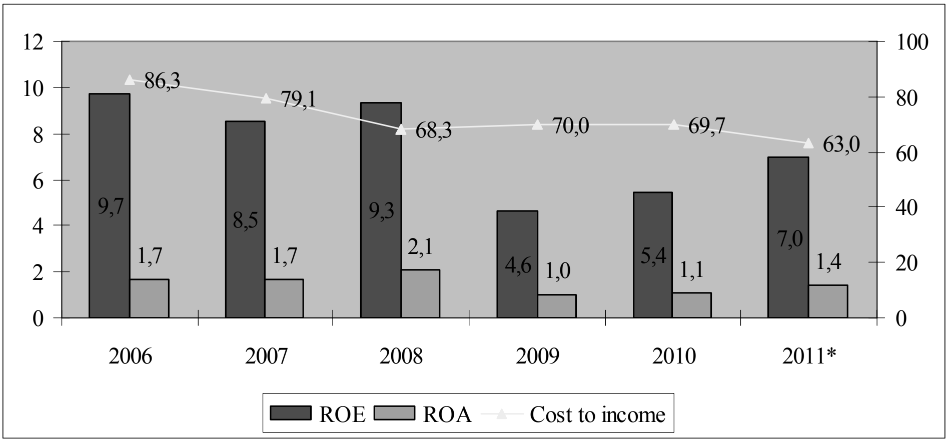
Before the spillover of the economic crisis to the banking sector of Serbia, the banks had an increasing trend of profitability. High rates of growth in sector income were interrupted in 2009 when the income was 42.3% lower in comparison to 2008 (20 billion dinars, 34.7 billion dinars, respectively). As a result of the appropriate support from central bank and the state in the conditions of a crisis there was a growth of profitability in 2010 (realized sector profit was 25.4 billion dinars, i.e. 240.7 million EUR). Eleven banks from the total number of 33, with a share of 17% of banking sector assets, recorded loss.

The effects of aggravation of portfolio quality on the income statement, with the slow loan activity, were already visible in the middle of 2009. Return on assets, by which the efficiency of bank property management is measured, has dropped from 2.1% in 2008 to 1.0% in 2009. Return on equity, which demonstrates the level of return on equity invested by the owner, was 4.6%, in December 2009, which is a decrease in the rate of 50.5% compared to the end of 2008. However, the national banking system, with the support of NBS, resisted the blows of crisis successfully and in 2010 the growth or ROA and ROE indicators was visible. Operating costs to net income from interest and fees ratio in 2010 was insignificantly better compared to the same period in the previous year (2009).

[18] See more in EU banking structures, ECB (2010), p. 36.

Graph 3 indicates the movement of key indicators of profitability in the period of 2006-2011.

Graph 3. Profitability of the Serbian banking sector (2006-2011)



* *Data for the first six months of 2011,*
Source: National Bank of Serbia

Sector profitability of Western Balkan countries, measured in return on assets, had ascending trend until 2008, when the success in business dropped. Return on equity in countries of the region had the tendency of decreasing, and the biggest decrease occurred in 2008, the year of crisis *(Vukovic, 2009). Table 5* demonstrates the values of key indicators of profitability of banking sector of Serbia and WB countries, for the period of 2009-2010.

Table 5. ROA i ROE indicators in 2009-2010 (%)

	2009		**2010**	
	ROA	**ROE**	**ROA**	**ROE**
Serbia	1.0	4.6	1.1	5.4
Croatia	1.1	6.4	1.2	7.0
BIH	0.1	0.8	-0.6	-5.5
Montenegro	-0.7	-8.0	-2.8	-27.0
Albania	0.6	5.6	0.8	7.3
Macedonia	0.4	4.6	0.7	7.6

Source: The data of WB countries Central Banks

By the comparative analysis we draw a conclusion that the banks in Serbia realized high rate of efficiency in management of assets in comparison to the countries in the region – highest values of ROA indicators were demonstrated in Croatia and Serbia, whereas the return on assets of Montenegro banking system was negative. Rate of ROA in 2010 was positive in the countries of the region, except for the Montenegro and Bosnia and Herzegovina. If we observe the return on equity in 2009 the highest profitability was realized by the banking system of Croatia, and then Albania, Serbia, Macedonia and Bosnia and Herzegovina, whilst only Montenegro system suffered loss and had negative return on equity (-7.98%). In 2010, the majority of Western Balkan countries demonstrate a moderate growth in sector profitability, apart from Montenegro and Bosnia and Herzegovina that demonstrated negative rates of ROA and ROE indicators.

The crisis in developed markets caused the aggravation of assets quality and increase of non-performing loans in assets of EU banks, which influenced the negative indicators of profitability for the majority of member countries in 2008. ECB data indicate that the banking profitability in EU27 countries improved moderately in 2009, with a moderate positive value of ROE indicators in comparison to the previous year. The return on equity for domestic banks was 0.3%, and for foreign banks 2.7%. (EU Banking sector stability, ECB, 2010). Profitability of large banks in EU has improved in 2009 and in the first half of 2010, as the returns demonstrated the gradual recovery.

CHALLENGES OF BANKING BUSINESS IN CONDITIONS OF FINANCIAL CRISIS

The crisis originated in the developed markets spilled over in the last quarter of 2008 to the countries of WB region. It manifested the first consequences in 2009 in the form of a rapid decrease of capital inflow, increase of investors distrust, costs of capital rise and decrease in export demand. Both real and financial sector were affected by the crisis effects.

Serbia. In the conditions of the drop of economic activity, devaluation of national currency and high level of banks resistance to risk, it was expected that the lending activity of banks will slow down. The growth of non-performing loans and slowing down the growth of capital did not put in danger the solvency of the sector, due to the strong capitalisation that took place in the first years of 21st century. As a result of special measures that NBS introduced was the return of the total amount of deposits population withdrew in 2009. Dinar short term loans for liquidity and foreign currency swap transactions in the foreign currency interbank market influenced the improvement of indicators of solvency for 2009 and 2010 and gradual stabilisation of the sector. In 2009 the banks focused on the strengthening of deposit base, trying to decrease the level of foreign borrowing as the conditions for it were highly unfavourable. Moreover, capital adequacy rate in

2010 was 19.91% which is above the legally defined minimum of 12% and at the same time the highest value in the region. By signing the Financial Sector Support Program – FSSP, also known as Vienna Initiative, foreign parent banks whose subsidiaries run business in Serbia have committed themselves to keep the level of liquidity and solvency above the prescribed minimum, accepting the obligation to perform subsequent recapitalisation if the stress tests indicate the need for that. (Annual Financial Stability Report, National Bank of Serbia, 2010).

Croatia. The aggravation of loan-portfolio quality and slow lending activity were the characteristics of Croatian banks in 2010. The share of non-performing loans in total number of loans increased to 11.2% in 2010 in comparison to 2009 when the registered rate was 7.8%. These movements influenced the reduction of interest income and increase of costs for loan provision. However, sector profitability was not in danger. Due to the improvement of expenditure efficiency, decrease of interest expenses and improvement of other income categories, the indicators of profitability were among the highest in the region in 2010. Although the growth of loss in loan portfolio was obvious, the stability of banking sector was influenced by the favourable liquidity and high capitalisation of the largest number of banks (Annual Report, Croation National Bank, 2010).

Bosnia and Herzegovina. The implications of crisis in the neighbouring B&H were manifested by withdrawing deposits and conversion of cash in national currency to the cash in foreign currency. Central bank of B&H reacted by decreasing the rate of required reserve from 18% to 14% in 2008 which caused the development of additional liquid assets and increase of loan potentials of the banks (Annual Report, Central Bank of Bosnia and Herzegovina, 2009). In 2009 this trend of decreasing the level of lending activity and increasing the participation of non-performing assets continued. The rate of capital adequacy in the end of 2009 was 16.1%, and that is still above the legal minimum of 12%. By signing the Vienna Initiative, foreign banks have committed to loan activity, adequate capitalisation and stress tests for banks business in the aim of monitoring the condition of the banking sector.

Montenegro. During 2009, Central bank adopted a set of measures in the aim of alleviating the rapid fall of assets performance, improving the lending activity and attracting foreign investors. The participation of non-performing loans in total loans increased from 13.5% in 2009 to 21.0% in 2010, which is a problem that the banks will be "facing" for a longer period of time. Although the majority of banks had recapitalisation in 2009 and 2010, thus increasing the solvency and resistance of Montenegro banking sector, the level of capitalisation was the lowest in the region (15.75% in 2010). Montenegro banking system demonstrated negative sector profitability – in 2010 the realized loss was 81.7 million EUR, which is predominantly concerned with two banks (Financial Stability Report, Central bank of Montenegro, 2010).

Macedonia. Due to the accumulated liquid assets, increased caution of banks in taking risks and timely measures of Central bank, the banking system of Macedonia in 2010 was considered safe. Stable environment influenced the increase of activity of banks that was dominantly supported by the growth in deposits, especially in household sector. After two years of decrease in loan-portfolio quality, the decrease of loan risk was obvious in the end of 2010. Although in 2010 the banking sector of Macedonia demonstrated high safety, one should not disregard the risks in the view of future trends in global and national macroeconomic environment, along with the increase of inflation pressure that could influence the profitability and the level of capital in national banks.

Albania. The events in international financial market manifested in terms of public loss of trust in the banking system and outflow of deposits. At the same time, the growth of non-performing loans made the loan risk dominant. However, total level of risk was moderate, due to the satisfying level of capital adequacy. With the timely reaction of the Central bank the growth of business performance was demonstrated – indicators of profitability of banking sector of Albania demonstrate growth in 2010 in comparison to 2009. By the realised return on equity in 2010, the banking sector of Albania was leading in the group of WB countries.

European Union. The majority of great world economies started the gradual recovery in the middle of 2009. Global economy started to demonstrate moderate growth again, and financial conditions in the market indicated the first signs of stabilisation. Along with the simultaneous activities in the field of fiscal and monetary policy there was a rapid turn in trends of economic activity development and a beginning of banks loan activities. In 2009 the decrease in ratio loans/deposits was obvious, due to the increase of loan activities of banks, increase of deposits and willing efforts to limit the risk of liquidity. High solvency in 2009 was supported with the increase of capital from private sector and reduction of risk weighted assets. Moreover, sector profitability of EU countries indicated the tendency of growth in 2009 and movement from negative to positive values.

CONCLUSION

Global financial crisis implication on WB countries banking sector resulted with sudden deposits outflow, investors confidence decrease, cost of capital increase and credit quality deterioration. Governments and Central Banks of Western

Balkan countries have shown high responsibility reacting timely by adopting series of measures in order to save sector stability and neutralize reputational risk.

Serbian banking sector remained resistent on external shocks and risks due to NBS restrictive measures in pre crisis period. High capitalization conducted in 2004-2008. period proved to be a key factor of neutralizing crisis effects. Rise of doubtful loans and slow credit activity inflenced sector profitability that still remained one of the highest in the region.

NBS measures, combined with state subsidies, prevented credit activity to collapse. Required rate of reserves, short term liquidity loans in domestic currency and especially Wienna Initiative have shown remarkable effects in relatively short period of time. Stress tests performed, according to the methodology supported by IMF, have shown that Serbian banks are highly liquid and adequately capitalized, with performances above legally required and among the highest in the region. These peformances of Serbian banks indicate a remarkable resilience to the negative impacts, even if the pesimistic macroeconomic scenario to happen. Although Serbian banking sector, as well as other WB countries, shown high stability and resistance on crisis effects it would be wrong to ignore potential risks related to future macroeconomic trends in global envirinment. Therefore, it is expected that the Central Banks will continue with their consistent and responsible monetary policy.

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