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Transition of the Serbian Banking Sector and European Integration

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**TRANSITION OF THE SERBIAN BANKING SECTOR AND EUROPEAN
INTEGRATION**

Prof Dr Miroljub Hadžić¹

1. The experience of European Economies in transition

After decades of experiencing planned economy countries of Eastern and Central Europe have started transition toward fully market economy at the beginning of 1990s. Process of transition, among others, has included development of a strong and self sustained banking and more broadly defined financial sector.

The experience of Eastern and Central European countries pointed out that this task is neither easy nor short - term achievable. The establishment of a sound and strong banking sector and operational financial market has to be realized step by step. The sequence of measures is important, as well. It means for instance that Central bank has to have independent position from political factors, including government, from the beginning of transition. For stable monetary policy and introduction of a sound prudential control it is of central importance.

Central bank and government, as the main responsible bodies, usually face problems related to readiness of the banking sector to adopt the market “role of game”, to social sacrifices when it is necessary to close some of banks. Those problems can, from time to time, to relax, either postpone some measures or even hamper the whole transition process of the banking sector.

The main problem which monetary authorities have to solve is related to rehabilitation of existed banks and high costs of the rehabilitation. High costs are caused by cleaning of banking balance sheet and writing of dubious claims or their covering by state funds.

In countries in transition usually three lines of activity were performed:

- a) Restructuring of existed banks - threw process of selection, cleaning of their balance sheets of dubious claims and by introduction of tight financial discipline and prudential control, their number become smaller and by the time their efficiency is improved;

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- b) Opening room for foreign banks – integration of national banking sector into the global market includes possibility for foreign banks to start as green field investment or rather to merge some domestic bank through acquisition;
- c) Development of financial market – development of the market for money and securities is very important segment of transition toward market economy, as players on financial market are not only competitors to existed banks, but they strengthen the whole financial mechanism.

The starting point of transition and prerequisite for establishment of a strong banking and financial system, which was proved by experience of Eastern and Central European countries, is independent position of Central bank (World Bank, 1996, p. 99). The independent position of Central bank in monetary policy definition and its realization and prudential control are essentially important. However, prerequisite for independent position of Central bank is tight financial discipline in Budget balancing, which means that public consumption has to be in line with so – called hard budget constraint (Cornai J.1989).

For the monetary authorities the important dilemma is: to rehabilitate existed banks, which are with huge debt and dubious claims or to open the room for foreign banks. However, the experience of other transitory economies pointed out that the dilemma is false. Usually, Central banks in those countries introduced both strategies at the same time and not exclude some of them: they combined rehabilitation and openness. The openness, as the strategy included: penetration of several foreign banks to the market, privatization of state owned banks and liquidation of some of existed banks, which rehabilitation is too costly. Whether this strategy would be introduced depends firstly, on the facts how big the financial gap is and secondly, how developed financial institutions are. If the financial gap is too big or there are no sources to finance it then the strategy of opening banking sector for foreign banks is more plausible. Also, if financial institutions are not developed enough then the opening would give more chance for speedy growth of banking and financial sector. The rehabilitation of existed banks, as opposite strategy, has several important advantages: firstly, easier recovery of confidence into banking sector and secondly, easier transfer of informal activities into legal channels.

Privatization of existed banks was important part of process of rehabilitation and development of efficient banking sector. Privatization of huge state owned banks through sell of their shares faced with great difficulties related to underdeveloped financial market, on the one hand, caused by lack of financial sources and by underdeveloped financial institutions, on the other. Small banks, at the same time, were privatized through privatization of their

shareholders, usually companies in restructuring process. The problems with privatization of small banks arose, as restructuring process of those companies – shareholders of banks was time consuming and costly. The strategic partnership with foreign banks was seen as the third possibility for bank privatization. However, the experience of transitory economies pointed out that foreign banks preferred green field investment in comparison to merge domestic banks. The non transparent balance sheets and their inconsistency with International Auditing Standards were labeled as the main reason for this strategy of foreign bank.

2. Transition of Serbian banking sector

Serbia has started transition toward market oriented economy after political changes in October 2000, which caused lifting overall sanctions of International community and return into International (financial) organizations. The starting point of Serbian banking sector and whole financial sector, after a decade of deep political and economic crisis, was very weak, even worse if compare to real economy. One could see that total amount of credit lines was 14% only in comparison to amount a decade earlier, while the fall of real economy was somewhat 45-50% considering GDP (Živković B., 2001, p.1). This bad position of the banking sector was caused by several important factors, as follows: firstly, total debts toward foreign creditors, mainly London and Paris club of creditors, EBRD and IFC were estimated to USD 3.4 billion, secondly, debts toward citizens related to the non operating foreign currency deposits were estimated on USD 3.3 billion, thirdly, the total losses of the banking sector related to hyper inflation during 1992-93² were calculated on USD 8-10 billion and fourthly, a very weak position of National bank toward political authorities.

The analysis of the Serbian banking sector was prepared in several months and pointed out the main shortcomings of banking praxis (KPMG and Ernst & Young 2001), as follows: a) potential losses of so - called big four banks were higher than ½ of their total assets; b) capital census fulfilled only 20 of 83 operating banks³; c) there was a wide discrimination of different clients in banking practice, especially of credit approval; d) audit and control functions were very weak and audit not in line with international auditing standards; e) legal

² It was 25 months long hyper inflation episode and the second highest according to price increase in economic history and obviously was related to introduction of sanction toward FR Yugoslavia and caused by the wrong assumption of political authorities that it would not be long lasting, so it can be overcome through budget deficit financing with money supply.

³ Capital census acquired for the license was USD 5 million of cash or equivalent, as part of total capital of bank.

misusing was not so rare and f) there were weaknesses in bank governance and human sources management.

The bad situation asked for urgent and heavy measures of monetary authorities and the Government. Neither the Government prepared transition strategy nor National Bank prepared strategy of recovery and development of broadly defined financial sector (Hadžić M. 2005, p.6/7)⁴. So, legal framework was changed and different measures realized through time step by step, without any sequencing in advance. The measures introduced were as follows:

- a) Introduction of sound prudential control - National bank became more independent toward the Government and other political influences and more important introduced tight financial discipline in the banking sector;
- b) Selection of banks – The Monetary authorities in short period of time – six months, asked all banks to fulfill capital census required (USD 5 million) or to lose the license. As result 23 banks - all those without cash or equivalent required lost license;
- c) Forced merging – Banks without readiness or capital strength to fulfill census requirement were forced to merge with other small banks in order to survive on the market. Those banks – 19 of them – were merged with other;
- d) Rehabilitation of the biggest banks – For 6 banks estimated as insolvent, but important for national banking system National bank introduced process of rehabilitation with responsibility of the Agency for Deposit Insurance and Bank Rehabilitation and Liquidation (BRA). The rehabilitation depended on sources available to finance it. Unfortunately, according to estimation the rehabilitation of the biggest four only asked for amount similar to national GDP (92% or USD 21 billion) (Živković B., 2001, p.4/5). Consequently, without such huge amount the Monetary authorities decided to withdraw licenses for all of them, at the same time, at the beginning of 2002.
- e) Opening room for foreign banks - After years of absence from Serbian market several foreign banks got license to start “green field investment” in 2001, as follows: Reiffesenbank, Hipovereinsbank, National Bank of Greece, Alpha bank and Micro Credit bank (now Pro Credit bank)⁵. However, without clear “role of game” National Bank stopped issuing of licenses shortly after that, at then end of 2001.

⁴ It was argued that the lack of overall developemnt strategy including transition strategy for banking sector was not usefull for economic agents, as they could not be prepared well for measures introduced and, more important, some of measures were missed or measures intruduced by different authorities were opposite by effects.

⁵ Socite Generale was present from the early 1990s with low profile.

- f) Solving the problem of frozen foreign currency deposits – After years of debate how to overcome problem of claims of citizens on the basis of non performing foreign currency deposits of citizens the Law was enacted at the mid 2002, which was of essential importance if one wanted to recover confidence into the banking system⁶;
- g) Transfer of payment operation into the banking sector – Payment operations from a legal entity to other entity and household payment, as well, for decades were practised through state agency – so called Agency for payment and settlement (ZOP). From the beginning of 2003 all payment operations were started to perform within banking sector, like in other market economies;
- h) Introduction of International Financial Standards – From January 1st 2004 there is obligation for all economic subjects, including banks, to prepare their financial reports in line with International Financial Reporting Standards - IFRS.

3. Integration of Serbian banking sector into European one

Prior to process of transition (before 2001), unlike to other Eastern and Central European countries where banks have been 100% state owned, Serbian banks were of mixed ownership structure. On the one hand, majority of banks were, as joint stock companies, owned by state and social owned companies, practically state owned in essence. The main problem of those banks was related to the fact that those companies were at the same time the main debtors. On the other hand, there were a several dozen of small privately owned banks, established during the 1990s.

National Bank of Serbia instead to rehabilitate withdrew licenses of the biggest four banks considering that there were no sources to finance „cleaning” balance sheet of those banks of dubious claims. No one from economic experts could oppose that this was inevitable, but all criticized timing, as all those were closed at the same time. A serious social problem appeared, because as a consequence of the liquidation 8.000 officials lost job at the moment when foreign banks did not seriously start their business in Serbia. So, some economists could even conclude that monetary authorities closed those banks in attempt to open room for foreign one. If consider privatization then it can be pointed out that the biggest four banks were not privatized at all, but their very expensive assets were privatized through process of their liquidation.

⁶ Law on Regulation of the Public debts of the FR Yugoslavia based on Household Foreign Exchange savings, Official Gazette FRY No 36/02

As it was noted above, five foreign banks got license for green field investment during 2001. Those banks were not interested at all to acquire some of domestic banks, although National Bank of Serbia expected that they would be. It was explained that Serbian banks have no transparent balance sheet, that financial reports were not prepared in line with International Financial Auditing Standards, their ownership structure were not clear etc. Overnight monetary authorities decided to stop further issuing licenses for foreign banks and announced that exclusive possibility to penetrate Serbian market would be threw acquisition (merger) domestic banks. It was pressure for foreign banks to merge domestic one, because without pressure there was no results. Again, the lack of transition strategy was appeared as problem, because the “role of game” was changed.

At the beginning of 2002 the Law was adopted by which some banks were practically nationalized. The law on regulation of debts toward Paris and London club of creditors⁷ to which the Government assumed the mentioned commitments and banks issued the shares that are to be Government owned, by debt – equity swaps. Since substantial amount were in sight the Government became the shareholder of 13 banks and majority one in 8 cases. This step was criticized from several arguments. On the on hand, the Government in negotiation with London and Paris club of creditors achieved the best – so - called the Neapolitan conditions, under which 2/3 of total debts would be written of and rest repaid with certain grace period while, on the other hand, did not write of the debts of banks and companies. So, this was criticized from the point that Government regulated those external debts, but on the basis of those debts it became shareholders of banks. Moreover, claims of those banks to companies which used credit lines from abroad were not written of and became great problem in restructuring of companies and consequently harmed severely privatization process. It is worth noting that the Government, by the law was obliged to sell all those shares which belong to the state in the period of six months, which was unrealistic and was not possible to realize. As it was seen it would be possible rather in the period of four years.

Banks with state ownership

Banks with Government majority stake

No	Bank name	Share of State (%)	Share of banks in liquidation	Total share
1.	Vojvodjanska bank, N.Sad	98.65	0.01	98.66

⁷ Law on regulationn between FR Yugoslavia and Legal entities and banks from Territory of FR Yugoslavia who were the Original Debtor or Underwriters in relations to the Paris and London Club Creditors, Official Gazette of FRY No36/02.

2.	Privredna bank , Pančevo	92.42	3.02	95.44
3.	Continental bank, No. Sad	94.64	1.10	95.74
4.	Yubanka, Beograd	76.49	8.09	84.58
5.	Panonska bank, N. Sad	82.91	-	92.91
6.	Credy bank, Kragujevac	60.58	6.29	66.87
7.	Novosadska bank, N. Sad	67.27	0.36	67.63
8.	Niška bank, Niš	88.56	11.44	100.00

Banks with share of Government under 50%

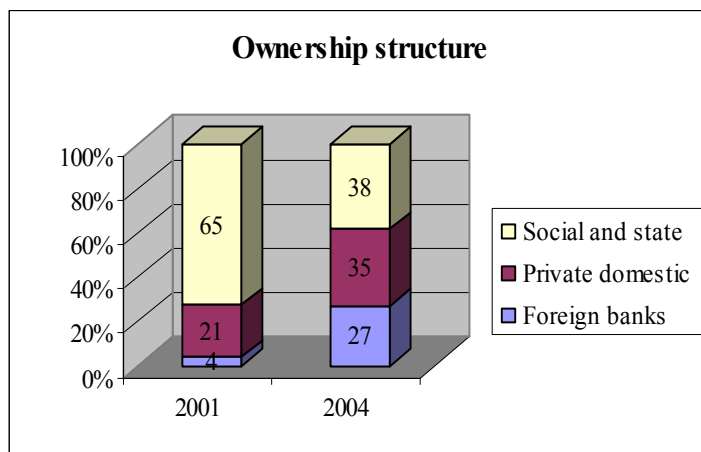
9.	Srpska regionalna bank, Beograd	46.10	12.68	58.78
10.	Čačanska bank, Čačak	33.06	8.17	41.23
11.	Komercijalna bank, Beograd	29.08	5.44	34.52
12.	Privredna bank, Beograd	16.36	-	16.36
13.	Agrobannk, Beograd	14.90	2.37	17.27

Bank in rehabilitation

14.	Pirotska bank, Pirot	97.27	1.29	98.56
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Source: Agency for bank rehabilitation and liquidation and deposits insurance

One can conclude that this measure was characterized as same as other transitory measures realized by National Bank of Serbia: firstly, it was not prepared in the broaden context of the process of rehabilitation of domestic banks and was not announced in advance; secondly, the state took on itself too strong discretion rights, as it practically nationalized ownership of state (not a problem), but ownership of socially owned companies, as well; thirdly, there was no a correct proportion between state obligations, on the one hand (written of by 2/3), and obligations of enterprises, on the other hand (has to be covered fully); fourthly, the Government obviously took some obligations which could not be realized in time (selling of those shares now belonging to the Government in the period of six months only).



As can be seen from the figure above until the end of 2004 noting was seriously happened regarding consolidation of ownership of Serbian banks, with the means of privatization. Some of banks (13) have become partially or completely controlled by

Government, as the results of swapping of debts to the Paris and London club of creditors for government shares. At the end of 2004 considering ownership structure domestic banks were prevailing. The share of foreign banks with total assets of CSD 179.310 million (EUR 2.3 billion) was 1/3 of total banking assets on the Serbian market. Those are banks which started from very beginning as green field investment (Alpha bank, EFG - Eurobank, HVB bank, Volks bank, LHB bank, NBG, Pro Credit bank, Reffeissen bank and Hypo – Alpe - Adria bank)⁸, except Societe Generale. The Government shares package would be sold by tender procedure and full responsibility was placed to the Agency for deposits insurance and bank rehabilitation and liquidation. In meantime foreign financial consultants were called to become financial advisor for privatization of those share packages, but no one process was finished. The first privatization of Yubank was happened at the beginning of 2005.

Recent / current transactions in Serbian banking sector

Date	Target	Buyer/country	% Stake	Mil EUR	Price/book ratio	Market share
Feb 05	Delta Bank, Belgrade	Banca Intesa – Italy	90%	333	3.3	10.6
May 05	Novosadska bank, Novi Sad	Erste bank - Austria	83.2%	73	2.7	1.6
Nov 05	Exim bank, Belgrade	Bank Austria-Austria	58.7%	43	1.9	5.6
Feb 05	Atlas bank, Belgrade	Pireus bank – Greece	80%	20	1.7	1.1
Jan 05	Jubanka, Belgrade	Alpha bank-Greece	88.6%	152	1.7	3.1
May 05	Continental bank, Nov Sad	Nova Ljub–Slovenia	98.4%	49	1.7	1.6
Nov 05	Niška bank, Niš	OTP - Hungary	89.4%	14	1.3	0.4
July 05	Meridian Bank, Novi Sad	Credit Agricole, France	71% cap.incr.	34.5		1.8
Nov 05	Nova bank, Belgrade	Findomestic, Italy	97%	22.5	1.8	0.5
Sep 05	National Saving bank, Belgrade	EFG Eurobank, Greece	52.5%	41	5.3	1.5
Nov 05	Centrobanka, Belgrade	Laikhi bank, Cyprus	90.4%	30		1.0

During 2005 the Republican Budget got revenues of EUR 288.91 million on the basis of acquisition of four banks with majority state ownership. Additionally by selling shares of six private banks their owners got EUR 490.5 million. According to origin the greatest interest was shown by Greek banks, which became owners of four Serbian

⁸ It has to be noted that Volks bank and Hypo Alpe Adria bank acquired banks, but practically those were banks without business and with license only.

banks, and Italian and Austrian banks which acquired two Serbian banks both. Those figures pointed out that Serbian financial market became great challenge and chance for foreign banks to penetrate it in time and at the same time to use potentials of the market and human sources, as well.

The first acquisition of Serbian bank (with majority state stake) was Yubanka, Belgrade in which the state offered its majority stake of 88.6% of total shares, which was finished successfully in January 2005. It became a part of Greek Alpha bank, which is already present on Serbian market.

Slovenian Nova Ljubljanska bank paid EUR 49.5 million to Republican Budget and became owner of 98.43% of total shares of Continental bank, Novi Sad.

Austrian Erste bank bought 83.28% of state ownership within Novosadska banka, Novi Sad for EUR 73.2 million.

The last, the fourth among banks with majority state ownership was Niška bank, Niš, which shares were bought by Hungarian OTP bank for amount of EUR 14.21 million. OTP now controls 89.39% of total capital of the bank.

The first private bank, among top three Serbian banks – Delta was reprivatized with Italian Bank Intesa at the beginning of 2005, as well. It was the highest amount paid for majority stake of 90% of total equity worthy EUR 277.5 million. At the same time it was high value of the multiple reached, measured as price to book value ratio (3.3).

Private shareholders of Atlas bank, Belgrade signed the contract about strategic partnership with Piraeus bank. Piraeus bank now controls 80% of total capital of the bank, for which EUR 19.5 million was paid.

HVB bank, which is already present at Serbian market, acquired Exim bank, Belgrade and paid EUR 43 million to the previous shareholders.

Among others it was interesting acquisition of Meridian bank, Novi Sad, as it was done by capital increase, by which the strongest among new comers – Credit Agricole came on Serbian market. It was EUR 34.5 million worthy acquisition.

In November 2005 the contract was signed by which majority shareholder of Centrobank, Belgrade became Laiki bank, Cyprus. The transaction was EUR 10 million worthy plus EUR 20 million additionally.

The highest value of the multiple (price to book value ratio) was reached for acquisition of majority stake of National Saving Bank. Greek EFG Eurobank Ergasias bought 52.5% of total equity of the bank for EUR 41 million after successful finalization of the Take Over Bid (TOB). The Group of EFG Eurobank now controls 62.3% of NSB

(9.77% as majority shareholders of Berberis Investment Ltd., which was also one of the shareholders of National Saving Bank before public offer announcement). It is worth noting that EFG is already presented few years on the Serbian market and did the transaction in order to strengthen its strategy toward retail banking business.

Italy's Findomestic Banca, which is equally owned by group Banca CR Firenze and Cetelem (a subsidiary of BNP Paribas), has completed the acquisition of 97% of the share capital of Nova Banka. The transaction was worth EUR 22.5 million, which represents a price - to - book value multiple 1.8. Findomestic Banca is the market leader in consumer finance in Italy.

At the end of 2005 Agency for bank rehabilitation and deposit insurance (BRA) launched tender procedure for Vojvodjanska bank and Panonska bank (both established in Novi Sad). For those two tender is still under way at the beginning of 2006, as potential investors sent their financial proposals. The finalization of those transactions can be expected in the third quart of 2006.

At the beginning of 2006 also BRA started procedure for acquisition of Credy bank, Kragujevac and at the first quart potential investors sent their letters of interest.

One can expect that the Government would stay majority shareholder in Commercial bank, Belgrade and Post Saving Bank, Belgrade, as well. It is worth noting that EBRD invested in Commercial bank at the beginning of 2006 and by increase in shares it became shareholder of 25% of total capital of the bank.

4. What are the effect – the current situation in the Serbian banking sector

The banking sector in Serbia is in the process of restructuring. The number of banks has been decreasing continuously over the past few years, as from more than 100 banks in 2000 dropped to less than 50. At the end of 2004 43 banks had a license, while during 2005 number of banks decreased to 40. The banks in Republic of Serbia are of general and universal nature.

The total assets of commercial banks amounted on 31 of December 2005 EUR 9.14 billion, which represent an increase of even 41.4 % compared to year earlier (increase 21.6%, 3.3% and 5.4% respectively in previous years). At the end of 2004 the total assets were EUR 6.74 billion. It is worth noting that this increase is the highest in transitory economies. This is the reason for pressure from respectable banks from the region to penetrate Serbian market.

Share of top ten banks in total balance sheet sum of the banking sector is 67.9%. The share of the three largest banks in total balance sheet sum amounts 45.4%. The first ten banks have a balance sheet sum above EUR 200 million, while 15 banks have a balance sum above EUR 100 million and 14 above EUR 30 million.

Top 10 banks in Serbia according to balance sheet

Name	000 EUR
1.Reffeisen Bank Yugoslavia, Beograd	1.396.756
2.Banka Intesa, Beograd	960.614
3.Komercijalna banka, Beograd	874.846
4.Hypo – Alpe - Adria ,Beograd	796.975
5.HVB Yugoslavia, Beograd	529.908
6.Vojvodjanska bank, N.Sad	443.559
7.Societe General Yugoslav bank, Beograd	395.497
8.Jubanka, Beograd	276.191
9.Pro Credit bank, Beograd	275.173
10.AIK Bank, Niš	259.246
Total	9.141.630

From the table below one can see changes of the banking sector in Serbia during last few years. While number of banks was decreasing and total balance sum increasing the share of banks with dominant state ownership dropped especially in 2005 from near to one half to 25.5%. At the same time ownership structure was changing toward foreign shareholders, as the share of banks with prevailing foreign capital increased from 27% in 2002 to 64.3% in 2005.

The structure of the banking sector in Serbia

	Banks number	State ownership		Private domestic		Private dominant foreign	
		Number	% in balance	Number	% in balance	Number	% in balance
2002	50	23	49.4	15	23.6	12	27
2003	47	15	34.1	16	27.5	16	38.4
2004	43	14	36.1	18	26.2	11	37.7
2005	40	11	25.5	12	10.2	17	64.3

Source: National Bank of Serbia

The effects of opening the market are of the twofold sort, positive, but negative, as well. Positive effects are (Jelašić R. 2002,p. 99-100), as follows: a) transfer of know - how – all banks new comers are from European Union and consequently are transferring knowledge, technology and international standards of banking business; b) entrance of foreign banks

caused increase in competition; c) the supply of products and services to clients is dispersed, including plastic cards and e – banking, as well; d) the confidence into domestic banking sector is recovering now, which can be proved by increasing domestic saving (mainly in foreign currency); e) the prudential control executing by National Bank of Serbia is now easier, as foreign banks introduce international banking standards and procedure, which they practisize in their countries of origin.

However, one has to be aware of negative effects of opening at the same time (Filipović M, Hadžić M. 2002, p.123): a) business policy of affiliates or banks established with foreign capital usually is rigid and not in line with current needs and situation on the market; b) those banks are very conservative in crediting domestic companies and citizens (although repayment is very high – 90%) and consequently they are overcapitalized; c) monetary authorities created unequal competition between domestic small banks, harmed after a decade of financial and economic crisis, and foreign banks, which penetrated the market easy (USD 5 million for census was exclusive condition, although NBS increased census on EUR 10 million, but after issuing several licenses) d) after a few year of operating on the market foreign banks increased their assets for several times on average and by acquisition of domestic banks they reinvest here what they generated.

Organizational Banking network

	2003	2004	2005
Organizational units	97	124	114
Branches	292	300	327
Sub branches	774	1.010	1.162
Outlets	302	275	264
Total	1.465	1.709	1.867

Source: National Bank of Serbia

From the table above one can see that in spite of decreasing number of banks on the market number of organizational units is increasing. Banks opened in 2005 on the territory of Serbia 158 new different organizational units in attempt to have better approach to the clients. The biggest number of organizational units opened those banks oriented mainly toward retail business.

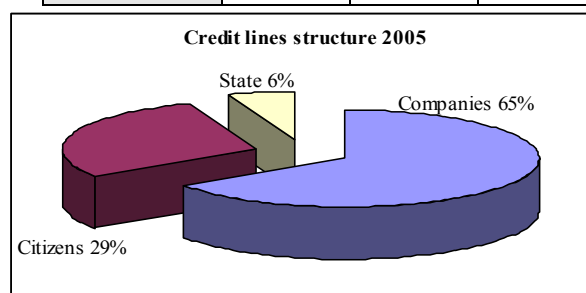
Total number of employees in Serbian banking sector increased considerably during last several years. In 2005 total number is higher for 2.217 (increase 9.4%) then year earlier (from 23.463 to 25.680).

Considering total assets and liabilities of banks operating on Serbian market the nominal increase in CSD in 2005 was impressive (52% and 39% in 2004). The credit to clients had highest share in structure of total assets (55% in 2005 and 57% in year before), then cash and equivalent (9.4% and 12.3% respectively). The liabilities to clients had the highest share in total liabilities (74.9% in 2005 and 67.8% in 2004), while capital had approximately 1/5 (16.2% and 19.5% respectively).

Credit lines

CSD million

	2003	2004	2005
Companies	140.420	197.022	281.885
Citizens	28.439	64.283	124.651
State	13.551	20.130	23.812
Total	185.591	283.832	434.527



Although monetary policy of National Bank was very restrictive the increase in credit lines in CSD was impressive (53% and 53% respectively), especially to citizens. Total amount of credit lines given to citizens were more than doubled in 2004 and increased slightly less in 2005 (126% and 94% increase respectively). In the structure of total credit lines crediting to companies covered 2/3 and to citizens less than 1/3.

Total deposits of the banking sector increased in 2005 for CSD 171 billion (EUR 2 billion) or 54.7% in comparison to year earlier. In the structure of total deposits the highest share were deposits of citizens (43.8%), deposits of companies (31.2%) and deposits of banks (14.9%). In the total amount of deposits the share of foreign exchange deposits was 70.7% and 29.3% deposits in dinars. Considering time frame 51.8% were sight deposits and 43.5% short term deposits.

Indicators of profitability of Serbian banking sector

	Revenues/ assets	Revenues from interest/ assets	Operating costs/ assets	Irregular revenues/ assets	Operating costs/ Interest revenue	Financial Result CSD mill (EUR mill)
2003	29.78	5.06	6.83	0.01	80.81	-1.055 (-16,2)
2004	37.72	4.66	6.27	0.02	84.52	-4.990 (-68,8)

2005	33.63	4.47	5.55	0	80.95	7.272 (87,7)
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The financial business results on the level of all banks in the period under consideration are a reflection of problems that were present in the banking system for a number of years. The loss which the banking sector as a whole recorded until 2005 was the result of operations of several banks which were either under administration BRA or were undergoing privatization.

5. The future development of the Serbian banking sector

The Serbian banking sector has a great growth potential, especially taking into account that total banking assets make some 40% of GDP only. Some segments of business such as mortgage lending, consumer finance and corporate loans have a very good growth prospects, considering the low basis and the expectations for further recovery of Serbian economy. Leasing, private pension insurance products and bonds are very perspective, also. However, in meantime lending and deposits business will continue to dominate for a while. In Serbian banking market one can expect following tendencies in next few years: firstly, continuation of privatization process; secondly, further opening of the market for entrance of foreign banks and thirdly, further consolidation of the market through concentration. It means that there are still many small banks active in the market with their share less than 1% without any specialization, servicing mainly local market.

Before starting real transition of the financial sector in Serbia in 2001 the ownership structure of the banks was dominant by socially and state owned capital, as main shareholders of banks were socially and state owned companies. After entrance of a few foreign banks and after debt – to equity swaps made by Republican Government in order to solve problems related to London and Paris club of creditors, ownership structure of banking sector was changed considerably. The Serbian banking sector experiencing at the same time privatization of state owned banks and reprivatization of privately owned banks. It is very important to bear in mind that National Bank of Serbia has halted issuing licenses for green field investment in banking sector and the only possible way to penetrate the market is through acquisition of state or private banks.

A further increase in total assets of Serbian banks in next few years is expected, as results of the continuing robust credit activity, although at slightly moderate rate. The

penetration of foreign banks, which have easy access to cheaper financing and rising competition will be dominant factors of expanding banking market in Serbia. Possible and inevitable declining margins, as increasing price stability will lower market interest rates and competition will strengthen, can be offset by efficiency gains and still considerable rationalization potential. One can expect positive outcome to profitability and banking system stability.

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