

UDC 336.77:339.37(497.11)  
336.77:339.37(497.5)  
336.77:339.37(497.7)  
Original scientific paper

Evica DELOVA JOLEVSKA <sup>1)</sup>  
Ilija ANDOVSKI

**RETAIL LOANS IN THE BANKING SYSTEMS OF SERBIA,  
CROATIA AND MACEDONIA WITH SPECIAL EMPHASIS OF  
RETAIL PORTFOLIO OF MACEDONIAN BANKS**

**Abstract**

The aim of this paper is to evaluate the movements and quality of retail loan portfolio in banking systems of three sample Balkan countries. The quality of retail credit portfolio is important because is determinant of future credit growth and at the end influences on consumption in the economy. Another important aspect is the growth in past crisis years, at which products is achieved and is there trend in accumulation of future risks. The analysis will be focused to compare data for trends of growth and quality of retail portfolio in Macedonia, Serbia and Croatia. The comparative analysis will give answers for the different share structure of products in retail portfolio, different trends of movements and quality of portfolio measured through NPL ratios by products. Also the analysis should give answers for drivers that are key factors of vulnerability of retail portfolio which can be input for further strategies of development in retail segment. The retail portfolios in sample countries that are chosen, had similar rates of growth before the financial crisis, the banking systems are dominantly owned by foreign countries and the economies were influenced by the financial crisis. Still, Macedonian retail portfolio has trend of growth in the past 3-4 years, opposite of Serbian and Croatian portfolios and the quality of the portfolio is much better. Special

---

<sup>1)</sup> Evica Delova Jolevska PhD, University American College, Skopje,  
e-mail:evicadj@uacs.edu.mk  
Ilija Andovski, PhD., e-mail:iandovski@yahoo.com

emphasis will be given on future risks in Macedonian retail portfolio, given the opposite trends from the sample countries.

**Keywords:** Retail portfolio, NPL, banking systems, growth rate

**JEL classification:** G21, G01

### **Introduction**

The last fifteen years have witnessed many significant developments in the banking sector in Central Europe and South Eastern Europe (CESEE). This also influenced the banking systems of Balkan countries. Large number of international banks entered in Balkan countries banking system and significantly changed banking practices and contributed to high credit growth in corporate and retail loan portfolio. The retail loan portfolio had two digits rate of growth, and there was trend of debiting in circumstances where the risk management of this portfolio was not on the highest level and not all risk was anticipated. This fast credit growth led to a build-up of imbalances and risks (EIB, 2014). Even without financial crisis effects following the fast credit growth, this kind of growth is factor itself for deterioration in the portfolio in future (Espinoza and & Prasad, 2010). The banking sectors of three sample countries were caught by the financial crises still in high credit growth because of the time lag on the financial crisis effects. The effects from the financial crisis were felt at the end of 2008 and the beginning of 2009. Most of the studies make empirically proven link between GDP movement and the quality of the portfolio (ECB, 2013) which can easily be confirmed in the sample countries. This led to deterioration in retail loan portfolio quality in two ways: worsening of the credit ability of households and very low or negative growth, which in combination with the materialization of the past portfolio deteriorated all indicators for quality. Still the differences in the product structure of retail portfolios and the impact of financial crises was different in each of the sample countries which led to different movements and quality of the portfolio.

While there is still evidence of a financial penetration gap, a new banking model is emerging (EIB, 2014), with international banks calling for greater independence for their subsidiaries and a more balanced funding model, based on domestic resources. At the same time the recovery in lending has been slow, reflecting a mixture of demand and

supply factors. Moreover, the international banks operating in the region have started to be more selective with regard to their CESEE strategies, clearly discriminating between countries and committing only to those markets that clearly offer long-term opportunities. This trend also affects the retail credit strategy and appetite for risk of Balkan banking sectors.

Finally, among the other goals, one of the main goals of all banks is to produce adequate return for its shareholders. So the return which can be gained is one of the main drivers that can influence on future retail portfolio developments in sample Balkan countries. So the quality of portfolio, which through impairment affects the return of a portfolio, has impact on the future credit growth. This affects the economic development through the credit activity which influence on the consumption. Thus creating a spiral and deterioration in portfolio quality create low economic growth and low growth creates further deterioration in the portfolio.

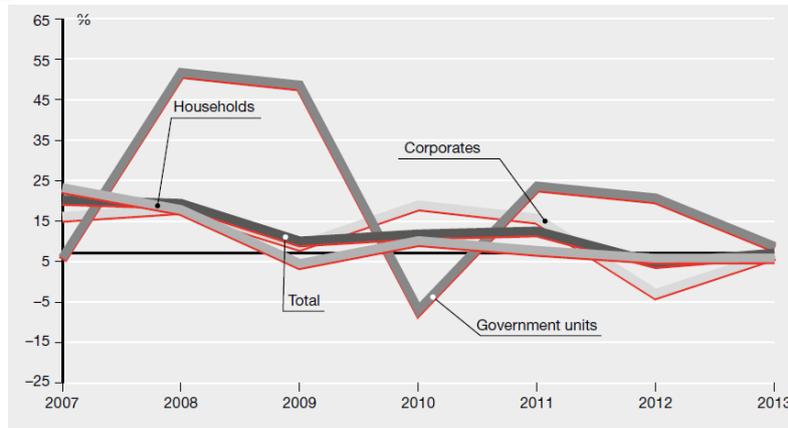
The aim of the analysis will be to reveal the differences in retail portfolio trends and quality in the sample countries. Special focus will be given on the credit growth in retail segment after the financial crises and the quality of the portfolio. Also, the retail portfolio will be analyzed by product in order to determine if there is different behavior regarding product portfolio quality.

### **Retail portfolio developments after the financial crisis in sample countries**

What is common for the retail loan portfolio in the sample countries is the two digits growth in the period before 2008. That was period after the ownership transition was finished and in all sample countries western foreign banks are dominant owners in the banking system. Also, what is common for the sample countries banking systems was the low level of debt of the households. So the financial crisis found the banking systems of sample countries in high growth and the effects of the crisis influenced on the growth rates with 12-18 months delay.

As can be seen from Figure 1, in Croatia the retail loan portfolio registered growth rates until 2009. After 2009 the growth rates are close to 0 or negative. The deleveraging strategy of banks in this segment caused decrease of seven percentage points in the five-year period of household loans in total structure, to 43.1% of total loans at the end of 2013.

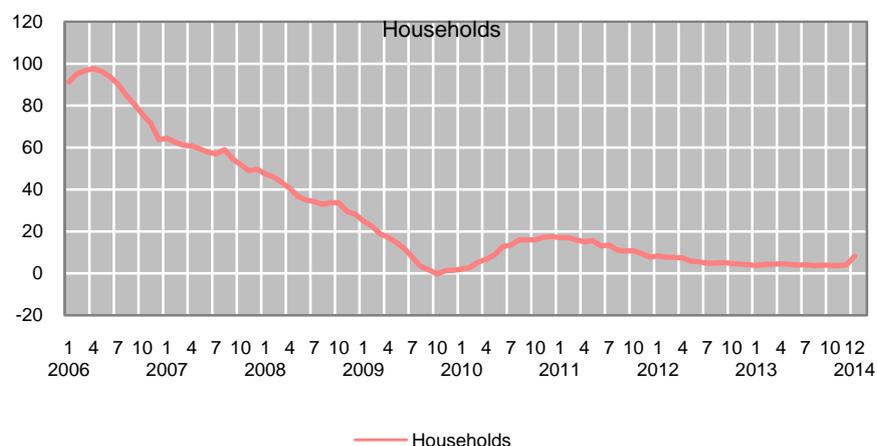
**Figure 1:** Rates of change of retail loan portfolio in Croatian banking system



Source: Banksbulletin 27, Central Bank of Croatia

According to Croatian Central Bank (Croatian Central Bank, 2014) lending to the private sector especially households was still weak, as a result of the increased bank cautiousness, but also of the suppressed demand of the private sector, especially of households. Also the deleveraging in retail portfolio is due of the trend of slight changes in the structure of loans to that sector and the strengthening of the share of loans used for servicing various other liabilities to creditors which is explanation why only consumer loans have growth. This trend (Croatian Central Bank, 2015) of deleveraging continued in 2014 also, and contributed for decreased share in total credit exposure. The trend of retail portfolio growth in Serbian banking sector was similar as in Croatia (Figure 2). Still, the effects from the financial crisis had impact on retail portfolio growth 10 months later, in the four quarter of 2009.

**Figure 2:** Rates of change of retail loan portfolio in Serbian banking system

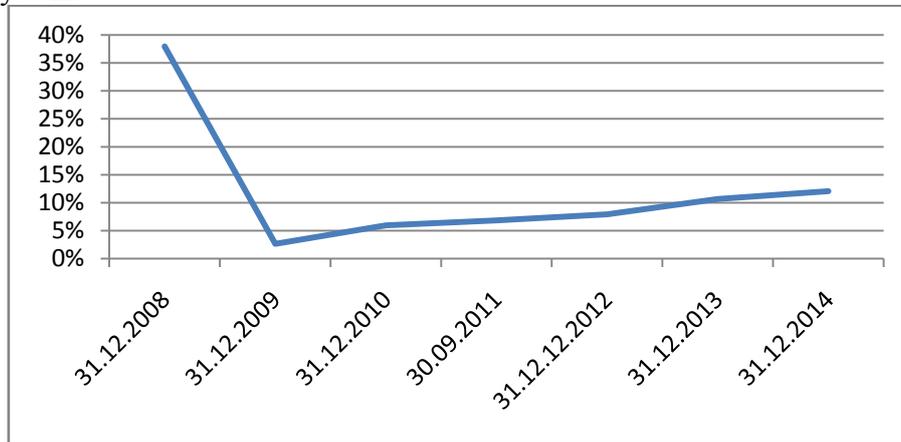


Source: Banking sector of Serbia, Fourth Quarter Report 2014, Central Bank of Serbia

Real credit growth started slowing down in early 2008. According to Central Bank of Serbia the credit growth picked up temporarily in 2010 as a result of interest subsidies for liquidity loans, consumer loans and investment loans, subject to Government Decree. So after 2011 when the retail credit growth was driven from consumer loans, in 2012 and 2013, the retail portfolio stagnates with growth rates close to 0. In 2014 there was slightly increase in retail portfolio, which was due primarily for housing loans mostly as a result of depreciation of the dinar exchange rate of 1.8% in Q4. So the increase was not a result of real credit activity.

Macedonia is outlier regarding the retail growth. Macedonian banking system felt the impact from the financial crisis in 2009 when the retail portfolio growth was decreased to 3% after 38% in 2008. This was year for stabilization of the banking system after rapid growth. After 2009, opposite from trend in Serbia and Croatia, the retail portfolio in Macedonian banking system has growth rates between 6-11%. In 2013 and 2014, especially in 2013, the growth in non financial loans was driven mainly from retail loans.

**Figure 3:** Rates of change of retail loan portfolio in Macedonian banking system



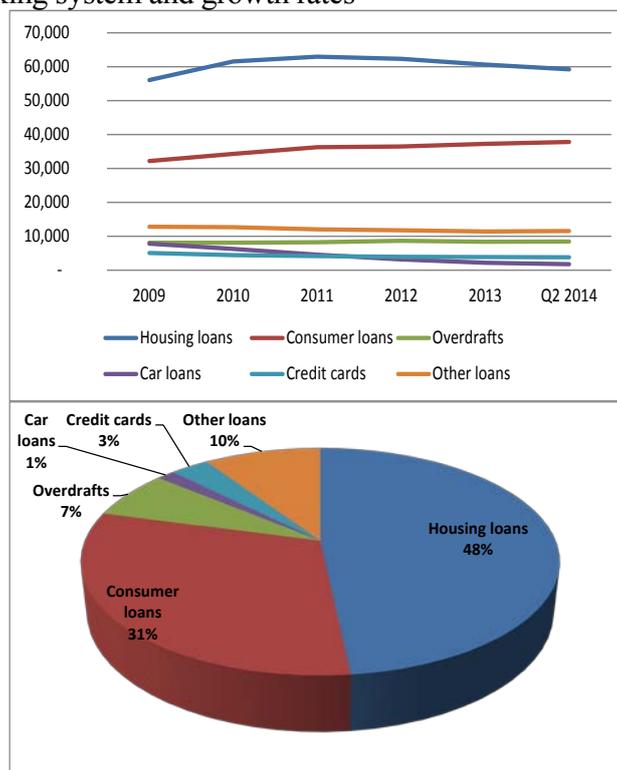
Source: Report on risks in the banking system of the Republic of Macedonia for quarters, Central Bank of R.Macedonia

The reasons for the opposite trend of retail portfolio in the banking system of Macedonia will be analyzed from few aspects: structure of retail portfolio by product, level of NPL, unemployment rate in sample countries and exposure per capita. The structure of retail portfolio by product and the growth of exposure by product should give hint for the quality of growth. Deterioration of loan portfolio quality (Moinescu&Codirlaşu, 2013) increases the capital requirements and erodes credit institutions' own funds, compressing capital adequacy ratio. Under threat of recapitalization, bank loans supply is adjusted by strengthening credit standards. But a lower credit flow in the economy affect consumption and investment, which then causes changes in production through a multiplier effects. Feedback effect from the real economy to credit markets will further worsen the quality of bank portfolios, prolonging the persistence of macroeconomic shocks. So the NPL ratio is important predictor of portfolio growth. The macroeconomic variables unemployment rate and exposure per capita have direct influence of the movements in retail portfolios.

### Structure of retail loan portfolio in sample countries by product

The analysis of the retail portfolio structure in Croatian banking system at Q2 2014 shows dominant share of housing loans with 48% share and consumer loans with 31% share (Figure 4). Still, the trend in the last 2 years is upward only for consumer loans and all the other products have opposite trend. This is mainly due to the effects from the financial crisis and slow recovery process in the aftermath which influenced with deleveraging in housing loan portfolio. The growth of consumer loans can be interpreted as a way banks to stop further retail portfolio decline and to undertake diversify portfolio. Taking into account their purpose, the banking system is financing current consumption of the population and the portfolio is fragile of movement of unemployment rate, life expenses and interest rates.

**Figure 4:** Structure of retail loan portfolio by product on 30.06.2014 in Croatian banking system and growth rates

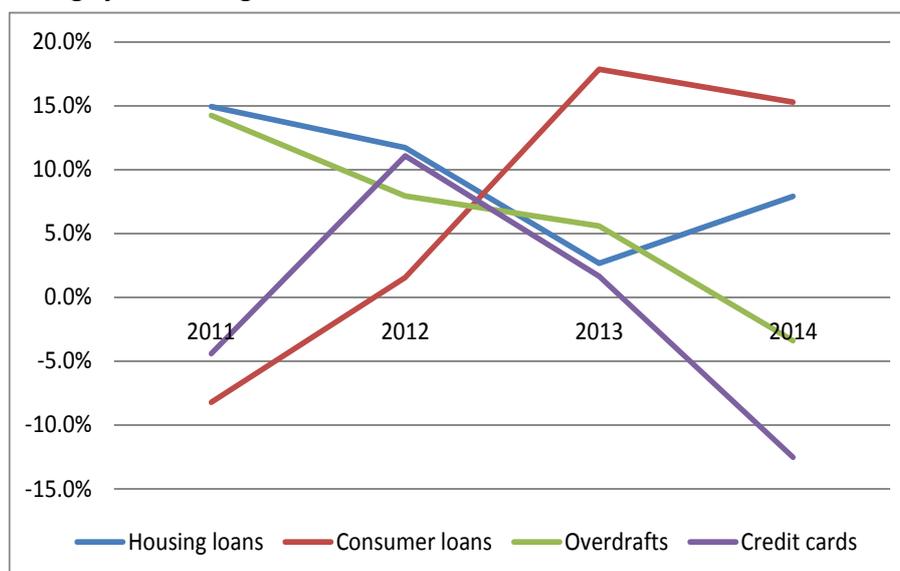


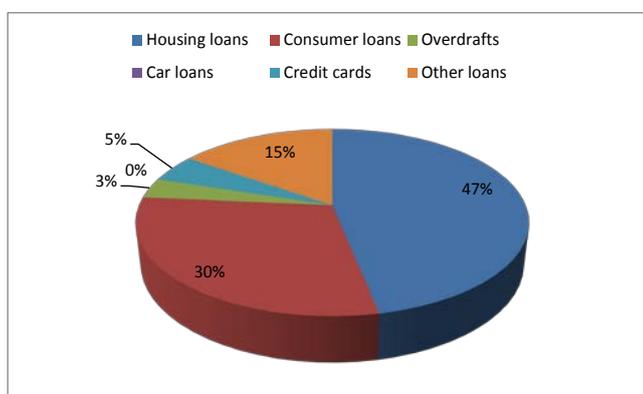
Source: Banks bulletins, Central Bank of Croatia

Although the level of NPL ratio is important determinant of future portfolio growth, in in circumstances where the demand for household loans is low, the consumer loans registered an increase besides the 25% NPL ratio. Still the new portfolio probably is created for new clients and the high NPL ratio is due to the effects from the financial crises and also from the fast growth before 2009.

The structure of retail portfolio and the trends in Serbian banking system are very similar to the one in Croatian banking system. Dominant portfolio is household loans with 47% share and the second largest are consumer loans with 30% share (Figure 5). In 2012 and 2013 only the consumer portfolio registered an increase while all the other portfolios stagnate. In 2014 the growth in retail segment was driven by housing loan portfolio increasement which was due on devaluation of the national currency in Q4 2014.

**Figure 5:** Structure of retail loan portfolio by producton 12.2014in Serbian banking system and growth rates

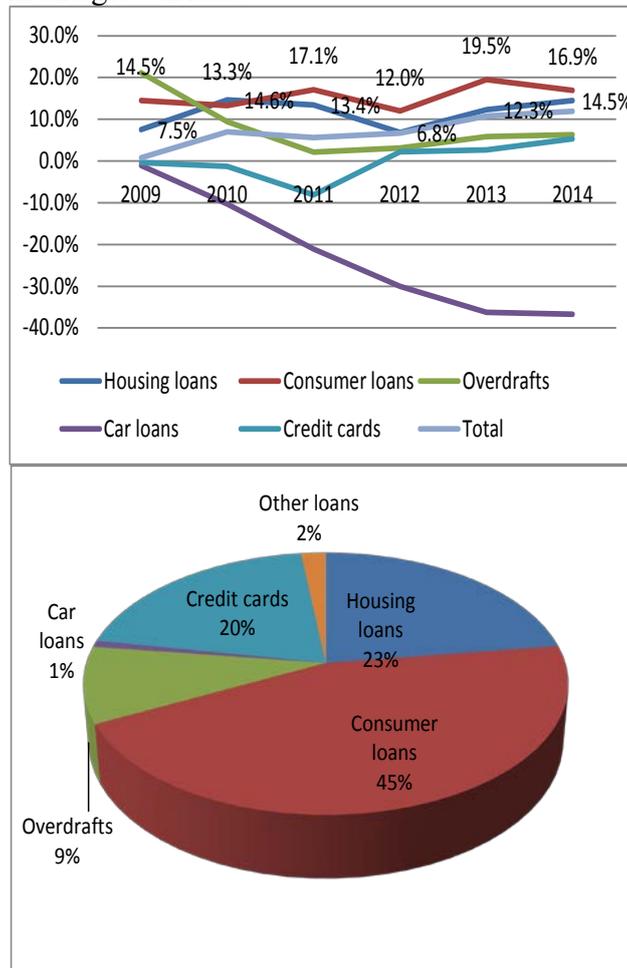




Source: Banking sector of Serbia, Fourth Quarter Report 2014, Central Bank of Serbia

In Macedonian banking sector the structure of the portfolio is totally different (Figure 6). The consumer loans are dominant ones with 44% share, and the second largest portfolio is the housing loans with 22% share. Also significant difference is the share of credit cards with 21% opposite to 3% and 5% in the other sample countries. The size of part of the credit cards has the features of consumer loan so the share of consumer loans is even bigger. The growth of retail portfolio in the last two years in Macedonian banking system was driven by consumer loans and housing loans. The growth of the housing loans, which is different from other sample countries, is due to few factors. Most important factors are the promotional low interest rates from 3-5 years which were quite different from the previous period and the decrease of prices of residential property. Also the housing portfolio is with the best quality and the share in total retail portfolio is still small. The growth of consumer loans, besides the low interest rates is due to the worst quality of corporate portfolio. In order to achieve growth with the same approval criteria and same clients, the maturity of corporate loans is continuously increasing and in the last 2 years the maturity is increased from 66 to 75 months average maturity. The analysis by clients' shows that in 2014, from the total growth, 57% is due to new clients. There are two possibilities that explain this kind of growth. Either the low interest rates attracted clients that didn't like to raise consumer loans before or the low rates with easing of approval criteria regarding maturity period, made clients that were not suitable for granting loan before as clients that meet the approval criteria.

**Figure 6:** Structure of retail loan portfolio by product on 09.2014 in Serbian banking system and growth rates



Source: Report on risks in the banking system of the Republic of Macedonia in 2014, Central Bank of R. Macedonia

### NPL ratios at retail portfolio in sample countries banking systems

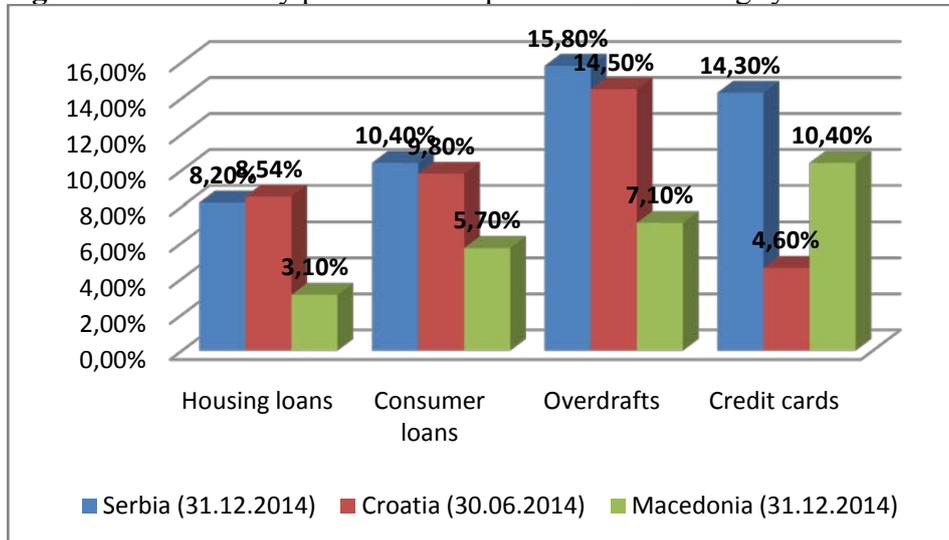
One of the main drivers that has influence on the future growth strategy of banks and the decision making process is the level of NPL loans. If the NPL ratio for certain product is increasing it can be expected the future growth of exposure toward that product to decrease. This phenomenon creates spiral, the worsening conditions in economy creates

bad loans, and the high NPL ratios reduce the credit activity and worsen the economy even further which feedbacks again with higher bad loans. This connection is empirically confirmed. According to Moinescu and Codirlaşu (Moinescu & Codirlaşu, 2013), large swings in credit flow (deleveraging or excessive financing) are associated with high levels of non-performing loans rate two years later, as the consequences of extreme values in both sides of the distribution of credit growth are similar in terms of risk level in the medium term. The feedback effects deepens recession through bank financing channel, as the credit elasticity dynamics to the change in non-performing loans ratio is slightly higher than one.

Another thing that is important in NPL ratio analysis is the growth rate. If the growth rate is low, because of the natural rate of aging, the NPL ratio will be higher over time. As it was mention in the previous section, there was trend of deleveraging in retail portfolios in Croatia and Serbia. Only retail portfolio in Macedonian banking system had above 10% growth in the last two years.

The analysis of NPL ratio shows that Macedonian banking system has retail portfolio with better quality. The differences in the housing and consumer loans, which are dominant retail products, are evident (Figure 7). The NPL ratio in housing loans is highest in Croatia, and is three times larger than NPL ratio for the same product in Macedonia. Serbian NPL ratio for this product is somewhere in the middle. Higher NPL ratio in Serbian and Croatian banking system compared to Macedonian can be explained by few factors: more growth in this product in the past, rise of unemployment rate, more exposure per capita which in combination with the previous factor contributed for higher NPL ratio and off course the negative or close to zero growth rate.

**Figure 7:** NPL ratio by product in sample countries banking systems



Source: Reports on Central banks on sample countries

Housing portfolio in Macedonia with NPL ratio of 3% is the product with best quality. In the last two years this is the portfolio with second highest rates of growth. This is due on favorable conditions of lending with low “promotional” fixed interest rates in the first 3-5 years which allowed access for clients that were not suitable for lending previously. The low interest rates were due of changes in banks strategies and redirecting of the credit activity towards retail because of the higher NPL ratios in corporate portfolio. The competition in retail segment and the excess of liquidity contributed for low interest rates for retail loans and growth in this segment. This growth is not risk free. When the period of fixed interest rate will pass, and the rate will be increased especially if in that period there is interest growth environment, it can be expected NPL ratio to increase.

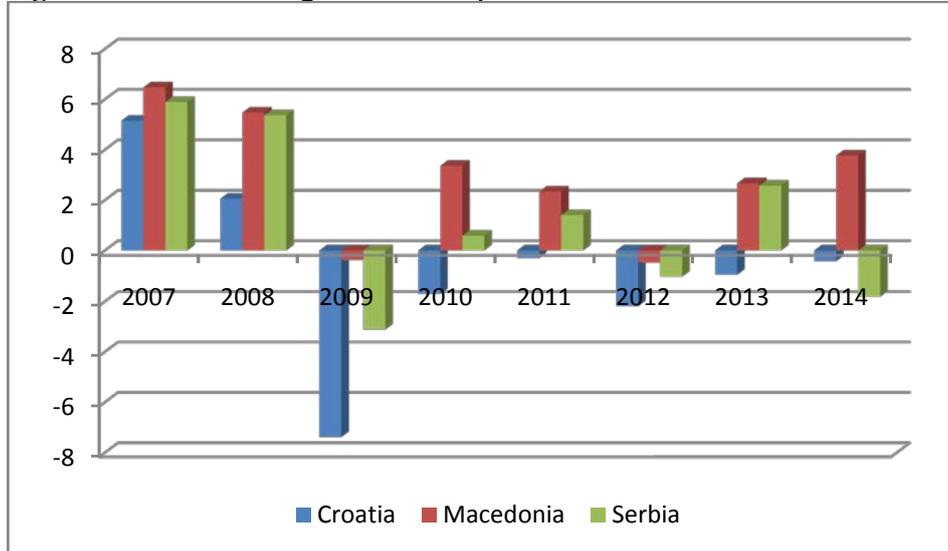
The difference in NPL ratio at consumer loans is not as great as housing loans. Still, the NPL ratio for consumer loans in Macedonian banking system is 4.7 and 4.1 pp below the other two sample countries. The main reasons are: the high growth in exposure towards consumer loans in Macedonia which absorbs the natural rate of aging, the growth in maturity which contributes to lower monthly burden and maintaining the unemployment rate against the increase in the other two sample countries.

### **Determinants of quality of retail portfolio**

The literature identifies two sets of factors to explain the evolution of NPLs over time (Klein, 2013). One group focuses on external events such as the overall macroeconomic conditions, which are likely to affect the borrowers' capacity to repay their loans, while the second group, which looks more at the variability of NPLs across banks, attributes the level of non-performing loans to bank-level factors. If we focus on macroeconomic factors, most of the economists identify GDP movement as key one (Rajan & Dhal, 2003). Also, the unemployment rate (Klein, 2013) is another factor that influence on NPL loans. Finally of course the level of NPL is influenced by the indebtedness of the population. Higher exposure toward population makes the banking system less resilient of macroeconomic shocks.

As can be seen from figure 8, the financial crisis had different impact in the sample countries. Croatian economy felt the crisis in 2008 and the impact in 2009 on GDP was much greater than in the other two sample countries. Also if we compare the GDP growth in the years 2008-2013, when the effects from the financial crisis and the EU debt crisis were felt, Macedonian economy was more resistant than the sample countries. This is explanation of the better quality of the total portfolio on banking system and also on the retail portfolio. Also, the GDP growth can explain the growth of the retail portfolio, opposite of the deleveraging trend in other sample countries.

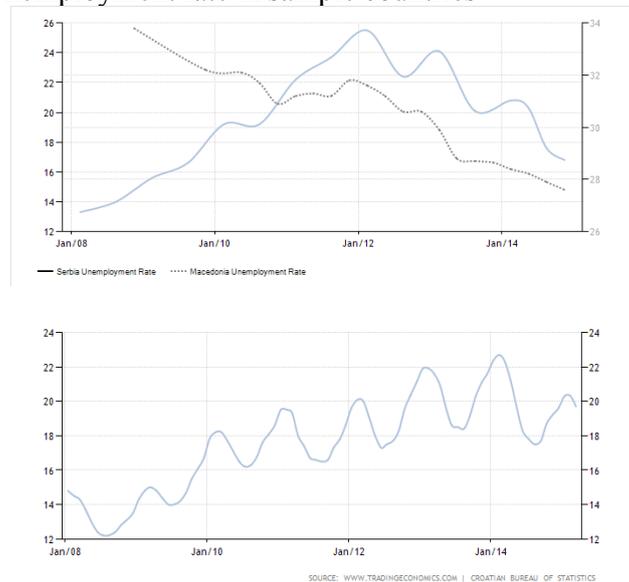
**Figure 8:** Annual GDP growth in sample countries



Source: World Bank database

The second important macroeconomic indicator that can influence the quality of the portfolio is the unemployment rate. The trend of unemployment rate is different in all sample countries (Figure 9).

**Figure 9:** Unemployment rate in sample countries



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

The unemployment rate in Macedonia is decreasing. Even if the movement is not completely real and partially is due on the manner on the records of unemployed persons, still the unemployment is not increasing. If we have in mind that only employed persons are eligible for exposure, the general conclusion is that this is one of the main reasons for preserving the good quality of the portfolio. In Serbia, the unemployment rate had increasing trend till 2013 which explains the deterioration in quality of portfolio. There is decreasing in unemployment rate in 2014 which will have positive impact on the quality of the portfolio. Upward trend, although cyclical depending from the season and tourist season, has the unemployment rate in Croatia. The upward trend of unemployment rate in Croatia and Serbia till 2014 explains the deterioration in quality of retail portfolios in their banking systems.

The retail exposure toward GDP and per capita are indicators for indebtness of the population and can indicate for future risks especially if movements in GDP and unemployment rate are expected. As can be seen from table 1, most vulnerable of unexpected movements and most indebteted is the population in Croatia. The financial crisis confirmed that fact and Croatia has highest level of retail NPL. Another factor that contributed to this fact were the loans in Swiss frank, and after the appreciation of the frank toward the euro, the monthly burden of this clients was increased.

**Table 1:** Retail exposure to GDP and per capita in sample countries

<b>Country</b>	<b>retail exposure/GDP</b>	<b>retail exposure per capita</b>	<b>retail exposure per capita/average salary</b>
Croatia (06.2014)	38.94%	5,245 USD	6.54
Serbia (12.2014)	17.60%	760 USD	1.92
Macedonia (12.2014)	21.10%	1,106 USD	2.53

Source: World Bank database

The indebtness of population in Serbia is lower than Macedonian population, still the quality of retail portfolio is better in Macedonian banking system. This can be explained by the fact that the impact from financial and EU debt crisis, measured through GDP movement and unemployment, was much higher in Serbia than Macedonia. Also, the NPL ratios for retail portfolio in 2009-2010 in Serbia were higher which

was due on the higher growth in portfolio in the previous period and weak credit standards.

Still, at a time when the standard of living of the citizens is endangered because of the deepening economic crisis, the data shows that Macedonian citizens borrowing more unsecured retail loans (Mahmudi, 2013). If total citizens borrowing achieve almost 1.8 billion euro, almost 45 percent off total structure of retail portfolio belongs to consumer loans. Moreover, the credit cards portfolio at the end of September 2014 reached to 378 million euro which is third predominant required and predominate weight in entire retail structure if to this adds portfolio of 176million in overdrafts it is clear that two third of the Macedonian retail structure is consisted from unsecured loans. This data show that citizens of Macedonia had borrowed from banks in order to fulfill the general needs respectively purchasing durable and non durable goods as well as to pay the current bills. Although the current quality of the retail portfolio is good, still the banking sector is especially vulnerable in movements in employment rate, life expenses and wages. Any bigger movements in these three categories can materialize the credit risk that banks in Macedonia have taken in retail segment in the last 3-4 years.

### **Conclusion**

The analysis in the three sample countries on trends and quality of retail portfolio shows different movements. All three sample banking systems faced with high credit growth in retail portfolio until 2008-2009 when effects from financial crisis were felt. Still, although the trend of deterioration is present in all sample countries the intensity and effects are quite different. This is due to macroeconomic performances during the crisis regarding GDP movement and unemployment rate. GDP reduction off course is connected to macroeconomic policy. Macedonia before the crisis was low indebted country which was used by economic policy makers to increase the debt in crisis in order to overcome the negative impact of the crisis. Also Macedonian economy didn't face with increased unemployment which contributed the quality of retail portfolio to remain stable. This is the main reason why Macedonian retail portfolio, measured through NPL ratio, is with much better quality than the other sample countries. The other reason is the growth in retail segment that is

present in retail portfolio in Macedonian banking system in the last 4 years which contributes for better NPL ratio. Also, in Macedonian banking sector the structure of the portfolio is totally different. The consumer loans are dominant ones with 44% share, and the second largest portfolio is the housing loans with 22% share. Also significant difference is the share of credit cards with 21% opposite to 3% and 5% in the other sample countries. The size of part of the credit cards has the features of consumer loan so the share of consumer loans is even bigger. The growth of retail portfolio in the last two years in Macedonian banking system was driven by consumer loans and housing loans. The growth of the housing loans, which is different from other sample countries, is due to few factors. Most important factors are the promotional low interest rates from 3-5 years which were quite different from the previous period and the decrease of prices of residential property. Also the housing portfolio is with the best quality and the share in total retail portfolio is still small. The growth of consumer loans, besides the low interest rates is due on the worst quality of corporate portfolio. In order to achieve growth the maturity of consumer loans is continuously increasing and in the last 2 years the maturity is increased from 66 to 75 months average maturity. The analysis by clients' shows that in 2014, from the total growth, 57% is due on new clients. There are two possibilities that explain this kind of growth. Either the low interest rates attracted clients that didn't like to have consumer loans before or the low rates with easing of approval criteria regarding maturity period, made clients that were not suitable for granting loan before as clients that meet the approval criteria. Still, two third of the Macedonian retail structure is consisted from unsecured loans. This data show that citizens of Macedonia had borrowed from banks in order to fulfill the general needs respectively purchasing durable and non durable goods as well as to pay the current bills. Although the current quality of the retail portfolio is good, still the banking sector is especially vulnerable in movements in employment rate, life expenses and wages. Any bigger movements in these three categories can materialize the credit risk that banks in Macedonia have taken in retail segment in the last 3-4 years.

The real problem in all sample countries is how to revive the real sector. Without recovery in the real sector, the credit growth in retail segment could be a strategy for a short period of time. When growth opportunities will be exhausted, after same time gap, this portfolio will face with deteriorating quality as a result of low or negative growth and nature rate of aging.

## References

1. Central Bank of Croatia.(2013). *Financial stability report for 2012*.(No.11, VII 2013). Zagreb:Publishing Department.
2. Central Bank of Croatia.(2014). *Banks Bulletin for 2013*.(No.26, VIII 2014). Zagreb:Publishing Department.
3. Central Bank of Croatia.(2014). *Financial stability report for 2013*.(No.13, VII 2014).Zagreb:Publishing Department.
4. Central Bank of Croatia.(2014). *Financial stability report for 2014*.(No.14, II 2015).Zagreb:Publishing Department.
5. Central Bank of Serbia.(2014). *Annual Financial Stability Report – 2013*.(ISSN 2217-6942). Belgrade:Publishing Department.
6. Central Bank of Serbia. (2014). *Banking sector of Serbia, Fourth Quarter Report 2013*. Belgrade:Publishing Department.
7. Central Bank of Serbia. (2015). *Banking sector of Serbia, Fourth Quarter Report 2014*. Belgrade:Publishing Department.
8. ECB. (2013). *Non-performing loans - What matters in addition to the economic cycle?*(No.1515). Frankfurt am Main.
9. EIB.(2014). *CESEE Bank Lending Survey*.Vienna.
10. Espinoza, R. A., & Prasad, A. (2010). Nonperforming loans in the GCC banking system and their macroeconomic effects. *IMF Working Papers*, 1-24.
11. Klein N,. (2013). Non-Performing Loans in CESEE: Determinants and Impact on Macroeconomic Performance. *IMF Working Paper, European Department*.
12. Mahmudi C. (2013). Comparison between Macedonian and Albanian Retail Banking Sector. *International Journal of Academic Research in Accounting, Finance and Management Sciences, Vol. 3, No.3, July 2013, pp. 171–179*.
13. Moinescu B.G.,&Codirlaşu A. (2013). Lending, economic growth and nonperforming loans: empirical evidences from the new EU member states. *Working Paper, Project "PN-II-ID-PCE-2011-3-1054 - Uncertainty, Complexity and Financial Stability*.
14. Rajan R. and Dahl S.C. (2003). Non-performing Loans and Terms of Credit of Public Sector Banks in India: An Empirical Assessment. *Occasional Papers, 24:3 Reserve Bank of India*.