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Analysis of Effects of Foreign Bank Entry on Credit Interest Rate Behavior in Serbia

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Summary: Following foreign bank entry, credit interest rates have been extremely high in Serbia compared with a reference group of countries: Croatia, Bulgaria and Romania. This is connected with monetary authorities' poor predictions regarding the behavior of those banks in setting interest rates, creating an illusion that competition, per se, would rapidly result in decreasing interest rates; as well as undertaking monetary policy measures--such as an extreme increase in the reserve requirements rate--that contributed to unchanged or increased credit interest rates. The final outcome of poor predictions and measures undertaken by the National Bank of Serbia is limited to periodical appeals by its highest officials to citizens to consider the conditions under which they borrow from banks. However, under conditions of fully inelastic demand for bank credit and a cartel presence in the banking sector, such appeals are ineffective, merely reflecting an attempt to avoid responsibility for a possible wave of bankruptcies in the household sector. Only increasing competition among banks can lead to a significant decrease in credit interest rates in Serbia in the medium term. Empirical analysis shows that competition should be most intensive on the mortgage loan market.

Key words: Interest rate, Foreign banks, Serbia

JEL: G20, G21, G28

Introduction

Critical judgement on unfounded announcements of the highest officials of National Bank of Serbia and the Ministry of Finance of the Republic of Serbia of a rapid decrease in bank credit interest rates that I passed in June 2005, has been unambiguously confirmed by the results of my latest empirical analysis.

The problem stems from bad predictions of monetary authorities concerning the behaviour of foreign banks with regard to credit interest rate formation, creating an illusion that the competition among banks would rapidly result in a reduction in interest rates in Serbia, as well as monetary policy measures,

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such as an extreme increase in reserve requirements, which contributed to credit interest rates remaining unchanged, or increasing in certain periods.

It all happened in conditions of non-existance of thoroughly worked out mechanisms for the protection of banking sector competition, which would protect the users of bank services even with a predominant cartel in the banking sector, i.e. the tacit agreement between the largest banks concerning the interest rate levels.

This paper deals, firstly, with bank ownership structure and the behaviour of bank credit interest rates in the EU candidate countries; secondly, with bank ownership structure and the behaviour of interest rates in Serbia; thirdly, with implications of high interest rate mark-ups in the banking sector in Serbia; and fourthly, with prospects for bank credit interest rate reduction in Serbia.

1. Bank Ownership Structure and the Behavior of Bank Credit Interest Rates in the EU Candidate Countries

A thorough discussion of the behaviour of bank credit interest rates in different stages of transition is not possible without taking into consideration the pace of the banking sector privatisation process in the relevant group of countries comparable to Serbia. Figure 1 shows a summary of bank privatisation results in three EU candidate countries – Croatia, Bulgaria and Romania.[1] Since Serbia is yet to be given the EU candidate status, it makes sense to compare these three countries.

Figure 1. *The ownership structure of the banking sector in Croatia, Bulgaria and Romania*

Country	Description
Croatia	In the late 2000, about 84% of the banking sector assets was foreign owned, whereas in 1995 there was no foreign ownership. At the end of 2000, all ten major banks were foreign owned. The concentration is extremely high: in 2000, Zagrebačka banka a.d. and Privredna banka Zagreb a.d. accounted for 47.2% of the balance sum total of the banking sector.
Bulgaria	In the late 2000, foreigners became majority owners of 8 out of 10 largest banks.
Romania	Compared to the previous two countries, Romania lagged behind in bank privatisation. In 2000, foreigners owned less that 50% of the banking sector assets. Two out of three largest banks remained state-owned until 2003. The government decided to sell the controlling stake of the largest bank, Banca Comerciala Romana (BCR), to foreigners, the transaction with the buyer (Erste Bank) was to be finalised by the end of October 2006.*

Source: Factiva, Reuters, September 22, 2006.

[1] In September 2006, the European Commission announced that Bulgaria and Romania would become EU members as of 1st January 2007.

In the late 1990s, the process of the banking sector privatisation was intensive in two out of three observed countries (Figure 1). At the end of 2002, 75% of the total banking sector assets was foreign controlled in Croatia and Bulgaria. The bank privatisation process was slower only in Romania. In addition, the process of selling the largest Romanian bank, BCR, to Erste Bank, a transaction worth EUR 3.75b, was hotly disputed, so that the sale was expected to be finalised during October 2006 at best.

In order to understand the effects of foreign bank entry on consumer and corporate credit interest rates in three relevant countries comparable to Serbia, it is necessary to show the dynamics of relevant interest rates. When comparing the level of interest rates in Croatia, Bulgaria and Romania, official data were used referring to euro and/or foreign currency credit interest rates, which is the only way to provide an objective picture.[2]

Table 1. Bank interest rates on kuna credits with foreign currency clause in Croatia (December, %)

Year	Short-term credits		Long-term credits		
	Corporate	Consumer	Corporate	Consumer Total average	Consumer Housing
1995.	21.09	18.10	15.79	10.48	-
1999	13.54	17.21	10.46	11.65	-
2000	11.10	13.59	9.41	11.64	-
2001	9.54	11.30	7.52	10.79	-
2002	8.72	11.37	6.37	9.50	7.42
2003	7.00	8.66	5.76	8.04	6.02
2004	7.09	8.47	5.55	7.73	5.71
2005	6.34	7.65	5.18	6.95	5.00
2006	6.29	8.33	6.21	6.22	4.75
2007 August	6.96	6.19	6.28	6.46	4.92

Source: Hrvatska narodna banka (HNB), www.hnb.hr

Note: In 2003, Erste Bank offered 30-year long-term housing credits at the annual interest rate of 4.99% with a CHF clause.

It is important to stress that interest rates on kuna credits with foreign currency clause in Croatia, as a predominant form of credit, were much higher in the late 2004 (Table 1) compared with the interest rates of the EMU countries (Table 2), despite the fact that inflation rate was somewhat higher than in the

[2] Latest available monthly data are used, the end of August 2007.

EMU countries. Annual increase in retail prices in Croatia in October 2004 was 2.7% per cent, only by 0.3 percentage points higher relative to a retail price increase in Eurozone.[3] It took Croatia five years to halve the level of the shown interest rates. Banking competition in Croatia was most fierce in consumer mortgage credit market, which results from the fact that in mid-2006, five and a half years after the domination of foreign banks in Croatian market, interest rates on these credits were not significantly above the average of the EMU countries.

Table 2. Interest rates of the EMU credit institutions (December, %)

Consumer credits, %

Year	Bank overdrafts	Consumer credits (up to 12 months)	Housing credits (over 10 years)
2003	9.69	7.64	4.89
2004	9.51	7.24	4.41
2005	9.67	6.75	4.03
2006	10.03	7.56	4.49
2007			
Sep.	10.56	8.47	4.98

Non-finance corporation credits, %

Year	Bank overdrafts	Other credits up to EUR 1m. (up to 12 months)	Other credits over EUR 1m. (up to 12 months)
2003	5.58	4.03	3.12
2004	5.26	3.97	3.05
2005	5.12	3.98	3.22
2006	5.80	5.08	4.50
2007			
Sep.	6.49	5.93	5.20

Source: European Central Bank (ECB), www.ecb.int
Note: Weighted average interest rates, referring to all new client-credit institution transactions.

As can be seen from Table 3, interest rates on new euro credits that were applied by credit institutions in Bulgaria, were extremely high in the period 2003-2005, not only compared to EMU, but also to Croatia. There were no significant changes in the observed months in 2006. Obviously, even when a coun-

[3] *Source*: HNB, Bilten 102, March 2005, p. 18.

try has had a currency board regime for a number of years, there is no guarantee that the level of bank credit interest rates will decrease quickly and approximate the level of the country or the zone whose currency the credit is tied to. In Bulgaria in December 2004, natural persons were charged an annual interest rate of 9.79% on short-term euro credits, whereas companies were charged 7.47%, despite the fact that the average annual inflation rate in the previous year was only 2.3%.[4] In September 2007, these interest rates were not only reduced relative to those of December 2004, but they increased, especially those charged on short-term corporate credits, which rose even more substantially.

Obviously, monetary stability is a necessary but not a sufficient condition for the achievement of low bank credit interest rates. Without a proper analysis of the market structure and the behaviour of demand for credits, i.e. the level of competition in the banking sector of a given country after foreign bank entry, it is not possible to objectively assess the behaviour of bank credit interest rates.

Table 3. Interest rates of credit institutions in Bulgaria (new loans in EUR, December, %)

Year	Natural persons			Non-finance corporations		
	Overdrafts	ST	LT	Overdrafts	ST	LT
2003	11.75	10.38	12.26	8.41	6.10	8.38
2004	12.60	9.79	10.01	6.04	7.47	8.02
2005	9.80	7.43	7.48	5.38	6.49	7.72
2006	9.49	8.30	7.89	7.07	8.39	8.23
2007 Sep.	9.64	12.58	7.53	7.41	8.32	8.15

Source: Bulgarian National Bank (BNB), www.bnb.bg

Abbreviations: ST- short-term credits; LT- long-term credits.

Note: Average interest rates on long-term housing credits in levs in this period ranged from the highest level of 12.62% in December 2003, to a record low of 6.88% in December 2005 and 8.50% in December 2006 and 8.37% in September 2007.

Although Romania never resorted to a currency board regime and despite the fact that the bank privatisation process was slower compared to that in Bulgaria, the level of short-term credit interest rates charged on new loans in euros was similar to that of interest rates charged to natural persons in Bulgaria, except in December 2005. However, for legal persons, the level of interest rates was substantually lower.

[4] *Source*: BNB, Macroeconomic Review, www.bnb.bg

Table 4. Interest rates of credit institutions in Romania (new loans in EUR, December, %)

Year	Natural persons				Legal persons			
	Average	≤ 1 m.	6-12months	> 5 years	Average	≤ 1 m.	6-12months*	> 5 years
2003	10.5	11.8	9.3	9.9	6.6	6.0	6.3	5.3
2004	9.9	8.6	8.7	9.5	6.3	5.2	6.2	7.5
2005	8.6	15.1	9.6	8.4	5.9	5.8	5.7	7.7
2006	8.6	-	10.1	8.4	6.8	-	6.3	8.2
2007 Sep.	7.8	-	6.2	7.8	7.2	-	6.9	7.6

Source: National Bank of Romania (RNB), www.bnro.ro
* For 2006 and 2007 up and including 12 months.

As can be seen from Table 4, in the period December 2003-September 2007, for example, natural persons were charged an interest rate of 8.7% to 10.1% on 6-12 month credits, whereas legal persons were charged 5.3% to 8.2% annual interest rate.

2. Bank Ownership Structure in Serbia and the Behavior of Credit Interest Rates

The changes in the banking sector ownership structure, in terms of a share of the ten largest banks in the balance sum total of the banking sector in Serbia in the period 30 September 2004 - 31 December 2005, are shown in Table 5.

Table 5. Percentage share of individual banks in the balance sum total of the banking sector in Serbia

Bank	Balance 30 Sept. 2004	Balance 31 March 2005	Balance 31 December 2005
Raiffeisenbank Jugoslavija a.d.	13.14	14.01	15.40
Delta bank a.d./ Banca Intesa A.D. Beograd	11.08	10.45	10.59
Komercijalna bank a.d. Beograd	9.87	10.32	9.64
Vojvodjanska bank a.d.*	8.13	6.96	4.89
Societe General Yugoslav Bank a.d.	4.69	4.79	4.36
Hypo Alpe-Adria-Bank	4.34	6.21	8.79
Jubanka a.d. Beograd	3.74	3.08	3.04
AIK bank a.d. Niš	2.99	3.25	2.86
HVB bank Serbia and Montenegro a.d. Beograd	2.93	3.39	5.84
ProCredit bank a.d.	2.49	2.69	2.90
TOTAL	63.40	65.15	68.31

Note: Calculated according to the Narodna banka Srbije (NBS) data base.
* This bank is privatised currently. National Bank of Greece is majority shareholder.

On 30 September 2004, five domestic banks with domestic capital accounted for 35.02% of the balance sum total of the Serbian banking sector, whereas five domestic banks with foreign capital accounted for 28.38%. The situation significantly changed in the late 2005. In the meantime, the state sold its majority stake of Jubanka, a.d. Belgrade to Greek Alpha Bank, A.E., whereas Delta banka, a.d.. Beograd, second largest bank in Serbia, was bought by Banca Intesa from Italy. This inevitably resulted in a dominant position of foreign-controlled banks in domestic market, measured by their balance sum as a share of balance sum total of five, as well as ten, largest banks in Serbia.

On 31 December 2005, five largest banks accounted for 49.31% of the balance sum total of the banking sector in Serbia. The degree of concentration in the banking sector in Serbia did not significantly change relative to the end of September 2004. In addition, at the end of 2005, a share of the balance sum of foreign-controlled banks within five largest banks increased to 68.61%. The only two banks in this group with a majority of domestic capital - Komercijalna banka a.d. Beograd and Vojvođanska banka a.d. – accounted for 31.39% of the balance sum total of this group.

That the entry of foreign banks into the domestic market did not result in a rapid fall in bank credit interest rates, as was predicted by highest-ranked officials of the NBS and the Serbian Ministry of Finance, is confirmed by the data shown in Table 6. In December 2003, citizens were charged an average interest rate of 24.66% on short-term credits, whereas in December 2005, the average annual interest rate was 25.24%. In September 2007, interest rates rose to 30.47%. In December 2003, consumer credit interest rates were 20.27%, while in December 2005 they were 19.71%. They increased in September 2007 to 21.89%, after significant reduction in December 2006.

Although reduced to the level of 6.30% annually, housing credit interest rates were in December 2005 in Serbia substantially higher relative to those in Croatia. Housing credits in Serbia involve government-subsidised credits with the effective interest rate of 5.18 to 5.33%. Due to this, the average interest rate on these credits decreased to 6.30% in late 2005. However, commercial housing credit interest rates are still high compared to those in Croatia, where they were reduced to under 5% in May. In this way, out of all mentioned countries, Croatia most closely approached the level of housing credit interest rates in the EMU countries (Table 2). Therefore, during the last five years, the competition among foreign banks has had the greatest impact on the mortgage credit market, which will also happen in Serbia.

In July 2005, these interest rates increased in Serbia to an annual level of 6.67%, making the difference relative to Croatia even greater. The situation is unchanged in September 2007.

Table 6. Bank interest rates in Serbia (December, %)

Consumer credits:

	Short-term credits	Consumer credits	Housing credits
2003	24.66	20.27	7.67
2004	23.88	27.37	8.08
2005	25.24	19.71	6.30
2006	29.50	14.54	6.80
2007			
Sep.	30.47	21.89	6.64

Corporate credits:

	Short-term export credits	Short-term agricultural and stock credits	Long-term credits for buying and selling locally produced equipment
2003	16.83	19.58	11.13
2004	16.75	14.19	10.38
2005	13.09	13.22	8.43
2006	11.13	19.16	8.56
2007			
Sep.	13.55	12.06	10.31

Source: NBS, Statistički bilten, Septembar 2007, www.nbs.yu
Note: Weighted average interest rates on credits approved in a given month. The NBS does not implement the methodology of presenting foreign currency clause credit interest rates, despite the predominance of this credit type.

Therefore, observing the dynamics of bank credit interest rates at the end of 2005 and during 2006 and 2007, we can conclude that consumer bank credit interest rates in Serbia are still extremely high compared to those in Croatia, Bulgaria and Romania, i.e. the group of countries comparable with Serbia. The only exception are housing credit interest rates. As can be seen from Table 6, corporate credit interest rates in Serbia are drastically higher compated to those in the three observed countries.

3. Implications of High Interest Rate Spread in Banking Sector of Serbia

By purchasing domestic banks in Serbia, foreign banks did not buy their share capital, but a part of domestic market. If they buy a share of the market, foreign banks want to pay off as soon as possible the costly "entrance ticket" through extremely high difference between interest payable and interest receivable, especially in retail banking. They regarded Serbia as an atractive region in which they could make extremely high profits relative to the neighbouring countries, which is their legitimate goal. The tacit agreement between the leading banks controlling the prevailing consumer banking service market share in Serbia only made this goal easier to achieve. The undisputable proof of the presence of that cartel is the fact that interest rate spread is not decreasing. It has been more or less unchanged for years.

As can be seen from Table 7, in the period December 2005 – September 2007 also, interest rate spread in the banking sector of Serbia ranged from 10.82 to 7.83 percentage poins. It reached a record low in December 2005, only to be increased in July 2006 to 11.27 percentage points and to 10.82 in December

2006. For comparison, according to most recent available data, the interest rate spread of the overall banking sector in Croatia decreased to 6.7 percentage points in November 2005, whereas in the EU countries it was four to five times lower than that in Serbia.

Table 7. Interest rate spread in the banking sector of Serbia (December, %)

Year	Interest receivable on total credits (1)	Interest payable on total deposits (2)	Interest spread (1-2)
2003	14.81	2.74	12.07
2004	14.59	3.60	10.99
2005	14.41	3.71	10.70
2006	15.88	5.06	10.82
2007			
Sep.	11.79	3.96	7.83

Source: NBS.
Note: Weighted average interest rates.

The illusion of a rapid fall in bank interest rates is best confirmed by movements in the interest rate spread in the banking sector of Serbia (Table 7). From a record high of 12.07 percentage points in the late 2003, it somewhat decreased in late 2005 – to 10.70 percentage points. In December 2006, it rose to as much as 10.82 percentage points. This only shows that after their entry on Serbian market, foreign banks have made use of a double advantage of making large profits in the domestic market:

- imposing low interest payable on deposits, when DEM was exchanged for EUR, in conditions of a total loss of confidence in domestic banks with domestic capital;
- imposing high interest receivable due to insufficient competition in the domestic market, especially in retail banking, with consumers, trying to solve their basic problems, ignore the cost of credit.

High interest rate spread was the main reason for entering of foreign banks into the Croatian[5] market, just like the Serbian one. The movements of interest rate spread in Croatia are shown in Table 8. If the interest rate spread of kuna credits and foreign currency clause credits is observed, we may conclude that it was substantially reduced in December 2005 relative to the same month in 2003 – from 3.59 to 2.18 percentage points.

[5] Haan de J. and I. Naaborg, *ibid*, p. 189.

Interest rate spread in the banking sector of Serbia was 7.83 percentage points in September 2007, which is still sigfnificantly higher than in Croatia.

Tabela 8. Interest rate spread in the banking sector of Croatia (December, %)

Year	Interest rates on kuna credits with foreign currency clause (total average) (1)	Interest rates on kuna deposits with foreign currency clause (total average) (2)	Interest rate spread (1-2)
2003	7.07	3.48	3.59
2004	6.89	4.17	2.72
2005	6.17	3.99	2.18
2006	6.30	3.67	2.63
2007			
August	6.46	3.96	2.50

Source: HNB.

By increasing reserve requirements, the NBS only caused commercial banks to increase their interest rates, or, at best, to maintain them at the same level, without giving up space for extreme profit-making during the observed period, due to high demand for consumer and corporate credits. In the first quarter of 2006 only, relative to the end of 2005, foreign indebtedness of Serbian banks increased by about EUR 330m, which fully confirms the thesis of exceptional profit-making possibilities compared to domicile countries. For example, Raiffeisen International, a member of RZB Group, recorded an increase in profits (after tax) of 83% in 2005 compared to that in 2004, thanks to its operations in Central and Eastern Europe countries such as Croatia and Serbia. It is expected that this bank will record a return on equity after tax of more than 25%.[6]

It can be seen from Table 9 that the total amount of consumer credits until July 2006 inclusive recorded a continuously high increase, despite the NBS measures undertaken to substantially slow down a rise in these aggregates. In December 2005, compared to the same month in 2004, the total amount of consumer credits almost doubled, whereas in July 2006, it increased by 33.35% compared to December 2005. The fastest increase was recorded in long-term (housing) consumer credits. At the end of 2005, compared to the late 2004, the total amount of these credits increased 2.11 times. In September 2007 compared to the December 2005, the total amount of consumer credits more then doubled.

[6] *Source*: Annual Report RI 2005, www.rzbgroup.com

Tabela 9. The amount of bank consumer credits in Serbia (December, mil. dinars)

Period	Short-term credits	Long-term credits	Interest and commission income	TOTAL (1+2+3)
	1	2	3	4
2003	11,264	17,274	105	28,643
2004	15,278	49,006	157	64,441
2005	20,985	103,513	439	124,937
2006	38,827	163,631	827	203,285
2007				
Sep.	49,955	233,990	1,487	285,432

Source: NBS.

A majority of Serbian citizens ignores the cost of short-term credits, which is partly connected with the necessity of solving basic household problems. Credit refinancing is becoming increasingly frequent, thus creating a vicious circle in which the highest price is paid by the poorest layers of population. The debt is exponentially increasing, which can be seen from Table 10. While at the end of December 2004, debt per employed person was EUR 398, in September 2007 it rose to EUR 1,826. It is obviously a dramatic rise in citizen indebtedness, those who are employed, which is best confirmed by a statistic that the total indebtedness per employed person in Serbia rose at the end of September 2007 to 5.11 average net salaries.

Tabela 10. Consumer indebtedness in Serbia (December)

Year	Indebtedness per employed person (in EUR)	The ratio of indebteness per employed person to average net salary
2004	398	2.23
2005	714	2.75
2007		
Sep	1.826	5.11

Note: The author's calculation according to the NBS and the Republic Bureau of Statistics data.

4. Prospects for Decreasing Bank Credit Interest Rates in Serbia

Starting from rough measures the NBS have undetaken in the previous period in the form of increasing reserve requirements rate, the assessment that in the period to come nothing will substantially change in this regard, as well as the undisputable thesis that the cartel is still dominant in the banking sector in Serbia, we can conclude that the competition among banks will not result in a considerable fall in consumer credit interest rates in the next year. There will be some partial positive shifts in this regard, especially concerning housing credits, although interest rates charged on commercial housing credits (without government subsidies) will be substantially higher than those in Croatia.

The National Bank of Serbia manifested its incapacity when it increased the rate of reserve requirements on external borrowing and deposits from abroad with maturity of up to 2 years from 40% to 60% as of 10 May 2006. It happened after it withdrew 11.5 billion dinars at two securities auctions in order to curb inflation which in April was 15.6%, as opposed to a forecast annual rate of 9.8%. At the auction held on the day when the decision about a hike in reserve requirements was announced (May 8, 2006), the NBS withdrew additional 6 billion dinars.[7]

If at the beginning of May 2006 banks could buy non-risk securities from the NBS at an average annual weighted repo rate of 23.89% for securities with 61 day maturity, or at the rate of 20.90% for securities with 14 day maturity, which is substantially higher relative to the end of 2005, then it wasn't justified to expect banks to reduce their interest rates charged on new consumer and corporate credits. Just the opposite, it was logical to expect banks to increase them in the period to come, which is exactly what actually happened. Average interest rate applied to the securities subject to open market operations of the National bank of Serbia in period January-July 2006 ranged from the highest 22.26% at the end of April to the lowest 20.51% at the end of July.

Such a setting resulted in further external borrowing of banks, which must be treated as a part of the total Serbia's debt. Due to an extremely high interest rate spread possible to achieve in Serbia, all measures undertaken by the NBS to stop further external borrowing of banks proved to be futile, which could have have been predicted from the experience of Croatia. In December 2006, total external debt of banks amounted to about EUR 3.89 b. Relative to December 2005, it rose by 74 %. Bad predictions of monetary authorities undoubtedly suggest incompetence of individuals in the NBS bodies.[8]

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[7] *Source*: www.nbs.yu

[8] It can be seen from the biographies presented to the members of the Serbian Parliament that out of five elected members of the National Bank of Serbia Council in its first term, four of them have

Consequently, the final outcome of bad predictions and measures undertaken by the NBS is that banks were required as of 15 March 2004, to uniformly calculate and disclose effective interest rates on loans and deposits, so that bank clients are fully aware of the cost of credit, as well as occasional appeals of the highest NBS officials to the citizens to be fully informed about the borrowing conditions (interest rate level, commissions, etc.). At the end of August 2006, the NBS announced a list of banks which calculated a foreign currency clause credit instalment using the unfavouranle (higher) exchange rate of the euro, despite the appreciation of the dinar against the euro. However, in conditions of fully inelastic demand for consumer credits, these appeals were eventually useless and present an attempt to avoid responsibility for a possible wave of bankruptcies in the household sector, already experienced in the Czech Republic, Slovakia, Croatia, etc.

Therefore, an increasing competition among banks is the only factor that could lead to a considerable reduction in lending interest rates in medium term. The fact that supports this point is that Banca Intesa announced an agressive behaviour in the domestic market and focusing on rendering services to citizenship in order to increase its share from the current 12% to 20%. Giovanni Boccolini, Head of International Subsidiary Banks of Banca Intesa, explicitly said that their aim is to outperform their main competitor, Raiffeisenbank.[9] Until September 2006 inclusive, however, this aggressive behaviour of Banca Intesa in practice, with regard to dictating lower interest rates on consumer credits, haven't been noticed.

Foreign owned banks will start to implement internal credit risk models (Bazel II) as advanced risk management technique, as their parent companies will do that, adjusting to the EU requirements in the form of Bazel II. Therefore, it is logical to expect that foreign banks (daughters) will lead in client classification according to credit risk exposure in such a way that first-class clients will pay a lower cost of credit.

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never engaged in monetary and banking issues. In addition, according to the National Bank of Serbia Act, they are authorised, at the Governor's suggestion, to elect vice-governors, who, being the Monetary Board members, make key decisions in the monetary and banking area, as well as to supervise the governor's work. Therefore, incompetent members of Monetary Board elect the most responsible people in the Central Bank and supervise the Governor! What effective control of distribution of power in the public interest can we talk about if, according to the coalition agreement, one party (G17 plus) is allowed not only to control the NBS (through proposing candidates for Governor), but also all other key financial institutions in Serbia - Ministry of Finance, Securities Commission, Agency for Deposit Insurance, Rehabilitation, Bankruptcy and Liquidation of Banks, etc?! According to new Constitution, when defining the NBS decision-making bodies, it is possible to establish mechanisms which will thwart manipulations by individuals or coalitions. The proposal of how to define the position of the NBS in the new Constitution was sent by the author to authorised institutions in March 2005. (See Đukić, Đ, 2006, pp. 198-202).

[9] See "Foreign banks target Serbia", Dow Jones & Reuters, Factiva, 28 March 2005.

Considering the fact that the banks's implementation of internal risk ratings models should result in smaller risk-based capital requirements for mortgage loans, it is logical to expect these banks to be the first to offer housing credits in Serbia at a lower effective interest rate, using this as their comparative advantage over majority domestic capital banks. To what extent this will foster competition in mortgage credit market is yet to be seen. In any case, this will serve as another test of the exsistence of tacit agreement between the largest banks in Serbia.

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