Specifics of the Banking Sectors in the Countries of Former Yugoslavia

Liběna Černohorská
University of Pardubice
Faculty of Economics and Administration, Institute of Economics Science
Studentská 95
Pardubice, 532 10
Czech Republic
e-mail: libena.cernohorska@upce.cz

Filip Honza
University of Pardubice
Faculty of Economics and Administration, Institute of Economics Science
Studentská 95
Pardubice, 532 10
Czech Republic
e-mail: filip.honza@centrum.cz

Abstract
The paper deals about a comparison of the banking systems of the countries of the former Yugoslavia with the banking system of the Czech Republic. The aim of this paper is to analyze the specifics individual banking sectors in Slovenia, Croatia, Macedonia, Bosnia and Hercegovina, Serbia, The Republic of The Republic of Kosovo and Montenegro and use of monetary policy instruments of all former members of the Socialist Federal Republic of Yugoslavia. In comparison the Czech Republic and Slovenia - Slovenia suffered the greatest losses coming after the financial crisis in 2008 and had to take difficult measures in order to help meet capital requirements set(but both in the 90th years did not affect any crisis). Countries like Serbia, Bosnia and Herzegovina, The Republic of The Republic of Kosovo and Montenegro are highly dependent on economic developments in the European Union.

Keywords: banking system, central bank, monetary policy
JEL codes: E52, E58, G21

1. Introduction

Banking system has become an inherent part of national economy of each country. As well as other sectors, the banking sector has its own characteristic features and specifics affected by the interaction of internal and external effects within the economic sector. Each country needs a reliable and stable banking system, since the problems of banking sector may affect/have impact not only the financial industry, but also a country's economy.

Each banking system of individual countries has its own characteristic features that are being influenced by world-wide globalization and bank regulation as discussed by Matěješák et al. (2009) or Šútorová and Teplý (2013). It affects the banking systems all over the world. However, each country takes it differently. Some countries are more likely to preserve their traditional features of banking which were established in the development of the system, whereas some countries take over elements of globalised economy.

The aim of the work is to specify the banking sectors in former Yugoslavia countries and in the Czech Republic, and, subsequently, perform their mutual comparison. A number of changes has been introduced into the observed banking sectors in past years (in particular in the implementation of monetary policy by the central banks and for the privatization of commercial banks).

2. History of selected banking systems

2.1 History of the banking system of former Yugoslavia countries

Unlike other former Eastern bloc countries, the countries of the former Yugoslavia had implemented a two-tier banking system. This was seen in a Yugoslavian study (Radzic and Yuce (2008)) that until 1960 the central system had been responsible for planning and implementation of monetary policy. This year there have been reforms during which banks gained autonomy and foreign experience. The banks have participated in the financial and commercial activities for businesses and entrepreneurs. The banking market in the Socialist Federal Republic of Yugoslavia (SFRY) was at that time one of the most advanced systems in the territory of Central and Eastern Europe (CEE)[1]. The problem was that the banking market operated in rigid market environment. Free activity of banks, however, did not last very long, since they were denied the right to generate profit. The National Bank of Yugoslavia began to set the upper limit of the credit disbursement options with special interest rate for a particular part of the economy.

1980 found the Socialist Federal Republic of Yugoslavia facing several crises caused by high fiscal deficit, exchange rate, etc. The dinar national currency depreciated, and therefore, it was difficult to repay foreign credits obtained with the support of Governments in the years 1970 to 1980. This resulted in a negative impact on the banks portfolio as well as on the increasing debt of the states, the repayment of which to foreign creditors was successfully postponed by means of the agreement with the Paris and London Club. Persistent debt problems resulted in the adoption of a new law on banks in 1989. Another objective was to regain the economic stability with the help of the Markovicprogram.

However, in 1990 all the reforms failed due to the beginning of disintegration of the Socialist Federal Republic of Yugoslavia. Even before the breakup, nearly thirty percent of the bank assets were in bad shape. The Central Bank of Yugoslavia took over all of the foreign exchange reserves, which brought about substantial material damage to some of the banks following the breakup.

Nearly all the assets and savings of former Yugoslavia countries were managed and kept in banks or in the form of dinar cash or as a foreign currency. Financial institutions fell under the central banking system, which consisted of the National Bank of Yugoslavia, the central banks of the six Member States and two autonomous provinces. Further, there were other financial institutions such as in-house banks and the Yugoslav Bank for International Economic Cooperation (YBIEC). Commercial part of the system comprised not only a hundred and sixty six primary banks, but also nine associated banks (Baumler (2011)).

2.2 History of the banking system of the Czech Republic

Initial period of transformation of Czech economy was characterized by a high risk business, where, due to the general lack of capital in Czech economy, the transformation as well as the associated privatisation procedure was managed by means of credits. Thus the banks stared to be heavily dependent on developments in economy and on the success of transformation processes. In that period, however, these banks represented a significant stimulus for the development of economy and the privatisation process and their problems were in a sense a kind of payoff for the fast progress of the economic reform. The new risk environment has manifested in full in subsequent years, especially in the poor quality of the credit portfolio[2]. Above all, it was the question of small banks which had limited space for absorption of such a high risk as a result of not fully developed activities, which led to a threat to their further existence.

As states Czech National Bank (2003-2013), Czech National Bank (further referred to as CNB) is the central bank of the Czech Republic which was established as of 1 January 1993 through a division of the State Bank of Czechoslovakia into the Czech National Bank and the Slovak National Bank. The existence of the CNB as the central bank of the state is established under the Constitution of the Czech Republic. Its position is governed by the Act on the Czech National Bank.

[1] See Černohorská et al. (2012) or Rippel et al. (2012) dealing with bank risk management in CEE.

[2] Risk management practices of financial institutions in the Czech Republic are discussed, for instance, by Jakubík and Teplý, Rippel and Teplý (2011) or Horváth and Teplý (2013).

3. Comparison of banking systems

3.1 Comparison of monetary policies in the Czech Republic and in former Yugoslavia countries

A great landmark in the development of banking itself is associated with the creation and development of central banks. However, the existence of such an institution does not necessarily mean the existence of a two-tier banking system. The position of the central bank ranges from significant to irreplaceable, especially in the monetary area and in regulation of each modern banking system. Its objectives, functions and position are in many ways different from other banks.

Central banking in the Czech Republic goes back historically until the early 19th century. Czech National Bank (2003-2013) mentioned that independent Czech National Bank was established only in 1993. We can find information about Yugoslavian banking sector in Mongabay´s study (1990) and Baumler (2011). In the former Yugoslavian countries the oldest historical facts about the Central Bank of Montenegro date back to 1905 until 1931, when it became a part of the National Bank of Kingdom of Serbs, Croats and Slovenes. Countries such as Slovenia and Croatia established their own central banks before the Czech Republic, in 1991 and 1990 respectively. These were followed by countries such as Bosnia and Herzegovina in 1997, Montenegro in 2011, Serbia in 2003 and latest The Republic of Kosovo in 2008.

The main managing authority of central banks is the bank board. Filip (2013) states that the bank board of the Czech National Bank (CNB) has 7 board members, as well as the Central Bank of The Republic of Kosovo (CBK) and the Central Bank of Montenegro (CBCG). The bank board of the Slovenian National Bank (SNB) has 5 members, the National Bank of the Republic of Macedonia (NBRM) 9 members, the Central Bank of Bosnia and Herzegovina (CBBH) 5 members, the National Bank of Serbia (NBS) 5 members and the Croatian National Bank (HNB) has 6 members plus 8 external members of the bank board.

3.1.1 Objectives of monetary policies

The only country that as a member of the euro area carries out the common monetary policy of the European Central Bank (ECB) is Slovenia. In 2006, the SNB was fully implemented among the members of the European System of Central banks (ESCB).

Table 1: The main objective of monetary policy

Country	The mainobjectiveofmonetarypolicy
Slovenia (ECB)	Maintainigprice stability
Croatia	Maintainigprice stability
Macedonia	Maintainigprice stability
Bosnia and Hercegovina	Maintainigmonetary stability
Serbia	Maintainigprice stability
The Republic of Kosovo	Maintaining the stability of the financial system
Montenegro	Maintaining the stability of the financial system
Czech Republic	Maintainigprice stability

Source: Croation National Bank, Central Bank of Bosnia and Herzegovina, Central Bank of Montenegro, European Central Bank, National Bank of Serbia, National Bank of the Republic of Macedonia

Each country or its central bank respectively, determines different objectives of monetary policy (Table 1). For a majority of referred countries it is the question of maintaining price stability. The main objective of The Republic of Kosovo and Montenegro monetary policy is to maintain stability of the financial system. Bosnia and Herzegovina concentrated on maintaining monetary stability.

3.1.2 Monetary policy tools

Central banks conduct their monetary policies with particular use of indirect tools in the form of open market operations, automated facilities and minimum reserves requirements.

The structure of monetary policy tools of the monitored central banks is very similar. All institutions are used to control liquidity by repo transactions. The central banks of the Czech Republic, Serbia and Montenegro do not use the tools of structural operations. As far as a longer-term liquidity control is considered, the NBRM, unlike most central banks, uses auctions of treasury bills.

The central banks of individual countries use virtually the same automatic facilities. States of the former Socialist Federal Republic of Yugoslavia (SFRY), except for Slovenia, additionally make use of intraday credit tools. The Central Bank of Montenegro has the most distinct policy of these built-in stabilisers, since it does not use any deposit facilities.

Monetary policies that most differ from other policies are CBBH and CBK. Central Bank of Bosnia and Herzegovina (2012) states that the only tool used by the CBBH are minimum reserves requirements, which is the reason why this central bank is criticized by the International Monetary Fund for its passive monetary policy. With the adoption of the convertible euro, CBBH had to give up its autonomy in the performance of monetary policy and its condition is determined by the course of economy in the European Union. Similarly, monetary tools are not used in The Republic of Kosovo, where the adoption of the euro has created stable macroeconomic environment and a stable inflation rate.

Table 2: Basic tools used by central banks and their rates to 31. 12.2012 (in %)

	2Wreporate	**1Wreporate**	**Deposit facility**	**Lombard loan**	**MMR**
CNB	2Wreporate		Discountfacility	Lombard rate	
	0.05		0.05	0.25	2.00
ECB		Fixedrate	Deposit facility	Lendingfacility	
		0.75	0.00	1.50	1.00
CHNB		Reporate	Deposit facility	Lombard rate	
		-	0.25	6.25	13.50
NBRM		Base rate	Deposit facility	Lendingfacility	
		3.50	0.75	3.98	10.00
NBS		Keyrate	Deposit facility	Lendingfacility	
		11.25	8.75	13.75	5.00
CBCG		Reporate		Lendingfacility	
		9.38		10.38	9.50
CBBH					
					10.00

Source: Central Bank of Bosnia and Herzegovina, The World Bank, National Bank of Serbia, Czech National Bank, Central Bank of the Republic of Kosovo, National Bank of Macedonia, European Central Bank, Croatian National Bank

When comparing the basic tools of monetary policy (Table 2), it can be seen that the CNB uses two-week repo transactions (2W repo transactions), while other countries have this tool set up for a period of one week (1W repo transactions). The CNB repo rate, with the exclusion of the HNB repo rate that currently does not use this tool due to good liquidity, operates with the lowest rate of this tool. 2W repo rate has been fixed at 0.05%. The highest rate in repo transactions is reported by the NBS, where the key rate of the NBS is set at 11.25%.

For deposit facilities that are not used by the CBCG, the lowest rate is that of the ECB which does not offer any remuneration of deposits. The second lowest rate is the discount rate of the CNB amounting to 0.05%. Best evaluation of banks' funds is at NBS which has a deposit rate of 8.75%.

As for advances, the lowest rates are again those of the CNB and the ECB in the respective amounts of 0.25% and 1.5%. At the NBS and the CBCG the rates of advances reach values exceeding 10% limit.

Differences also arise in minimum reserves requirements (MRR) not only in the level of rates, but also in the length of maturity, or the difference between the foreign and domestic currencies. The CNB, the ECB, and the HNB require mandatory minimum reserves for deposits of up to two years. NBRM has established minimum reserves requirements at the rates of 10% for domestic currency and 13% for foreign currency. Minimum reserves requirements of the NBS include the rate of 5% for domestic currency, 29% for foreign currency with a maturity of up to two years and 22% for foreign currency with a maturity over two years. The CBCG sets two rates of MMR (9.5% for deposits with a maturity of up to one year and 8.5% over one year). The same principle of minimum reserve requirements is used by the CBBH, the rates of which are 10% for foreign exchange liabilities with a maturity of up to one year and 7% in case of a maturity over one year.

Table 3: The development of repo transaction rates 2007 - 2012 (in %)

	2007	2008	2009	2010	2011	2012	Rate
CNB	3.50	2.25	1.00	0.75	0.75	0.05	**2Wreporate**
ECB	4.00	2.50	1.00	1.00	1.00	0.75	**Fixedrate**
CHNB	4.06	6.00	-	-	-	-	**Reporate**
NBRM	4.77	7.00	8.50	4.11	4.00	3.73	**Basicrate**
NBS	10.00	17.75	9.50	11.50	9.75	11.25	**Keyrate**
CBCG	9.09	9.36	9.38	9.63	9.64	9.38	**Reporate**

Source: The World Bank, Czech Statistical Office, Central Bank of the Republic of Kosovo, National Bank of Macedonia, European Central Bank

The development of repo transaction rates is similar also for the CNB and the ECB (Table 3). Both institutions recorded a downward trend in their rates. The remaining central banks, except for the NBS, have been decreasing their rates of repo transactions since 2009. The lowest values were achieved by the NBRM, which had the base rate of 3.73% in 2012. The key rate of the NBS since 2009 has varied within 9-11.5%. The rate helps the NBS regulate inflationary pressures as well as it should help get inflation values that are the highest in Serbia too, into the specified inflation band. Therefore, the NBS must take advantage of the higher interest rates than other central banks. The amount of the NBS key rate also affects the amounts of deposit and advance rate, which are determined by the key rate ± 2.5%. The HNB due to good liquidity in the banking sector in 2009 ceased to use the repo transactions tool.

Table 4: The development of the deposit facility rate compared central banks 2007 - 2012 (in %)*

	2007	2008	2009	2010	2011	2012	Rate
CNB	2.50	1.25	0.25	0.25	0.25	0.05	**Discountrate**
ECB	3.00	2.00	0.25	0.25	0.25	0.00	**Deposit facility**
CHNB	0.50	0.50	0.50	0.50	0.25	0.25	**Deposit facility**
NBS	7.50	15.25	7.00	9.00	7.25	8.75	**Deposit facility**

*Does not include data for the deposit facility NBRM for lack of information andCBCG which are not used

Source: European Central Bank, Central Bank of the Republic of Kosovo,Czech Statistical Office,National Bank of Macedonia

The development of rates of deposit facilities (Table 4) had a declining trend at the CNB and the ECB from 2007 to 2009. Then in 2011, the rates were kept at the same level. For 2012, the CNB decreased the discount rate to 0.05% and the ECB decreased its deposit rate to 0%. The HNB holds virtually all its deposit rates unchanged. In 2011, at HNM this rate was at the same level as at the ECB and the CNB. The last institution, where the development of the deposit facility rates was monitored is the NBS that sets its deposit rate by 2.5% lower than its key rate. Its rate is much higher than the rates of deposit facilities established by other central banks.

Table 5: The development of the lombard rate compared central banks 2007 - 2012 (in %)

	2007	2008	2009	2010	2011	2012	Rate
CNB	4.50	3.25	2.00	1.75	1.75	0.25	**Lombard rate**
ECB	5.00	3.00	1.75	1.75	1.75	1.50	**Výpůjční rate**
CHNB	7.50	9.00	9.00	9.00	9.00	6.25	**Lombard rate**
NBRM	7.50	8.50	10.00	5.50	4.23	3.98	**Borrowing rate**
NBS	12.50	20.25	12.00	14.00	12.25	13.75	**Borrowing rate**
CBCG	8.50	9.50	11.00	6.50	5.23	4.98	**Borrowing rate**

Source: The World Bank,European Central Bank, Central Bank of the Republic of Kosovo, National Bank of Macedonia, National Bank of Serbia

The rates on advances (Table 5) are again very similar in case of the CNB and the ECB. Both these institutions had the rate set at the same amount of 1.75% in 2010 and 2011. Next year, the CNB decreased it by 1.5%, while the ECB decreased the rate only by 0.25%. Advance rate determined by the HNB was kept at the level of 9% during the majority of monitored years. Practically the same trend of development of the borrowing rate can be seen in the NBRM and the CBCG, where the only difference was that the CBCG rates are 1% higher. The highest values of borrowing rates are again at the NBS, ranging over 10% and being 2.5% higher than its own key rate. The ECB and the CNB keep their advance rates at least 2% lower than other central banks.

3.2 Development of inflation in the Czech Republic and in former Yugoslavia countries

3.2.1 Inflation targets of monitored central banks

Among the main targets in the majority of monitored countries belongs the maintenance of price stability. Only three of the national banks use the process of inflation targeting to achieve this goal. These are the CNB, the SNB and the NBS.

Table 6: Inflation targets on monitored central banks

CNB		ECB (SNB)		NBS	
Year	**Target level**	**Rok**	**Target level**	**Year**	**Target level**
2007	3 % ± 1 %	**2007**	2 %	**2007**	4 - 8 %
2008	3 % ± 1 %	**2008**	2 %	**2008**	3 - 6 %
2009	3 % ± 1 %	**2009**	2 %	**2009**	8 % ± 2 %
2010	2 % ± 1 %	**2010**	2 %	**2010**	6 % ± 2 %
2011	2 % ± 1 %	**2011**	2 %	**2011**	4,5 % ± 1,5 %

Source: National Bank of Serbia, Czech National Bank, European Central Bank

The ECB'S inflation target is to keep inflation within 2% (Table 6). Since 2010, the CNB has a similar target which is set at 2 ± 1%. The NBS has set an inflation target which should not deviate by more than 1.5% from the 4.5% limit in 2011.

3.2.2 Development of inflation in the monitored countries

The SNB as well as the CNB have fulfilled their inflation targets in the past two years, while the NBS deviated a lot from the established target in 2011. The lowest values of inflation rates are manifested by Slovenia, Croatia and the Czech Republic. Overall, the majority of countries reported the lowest rate of inflation in 2009 (after the outbreak of the global financial crisis). Some countries achieved even deflation in that year. Consistently, the highest rate of inflation is kept by Serbia which failed to meet its inflation target from 2011, and in 2010 it had the lowest consumer price index at the level of 6.1% (Table 7).

Table 7: Development of inflation in the monitored countries2007 – 2011 (v %)

	2007	2008	2009	2010	2011
Slovenia	3.8	5.5	0.9	2.1	2.1
Croatia	2.9	6.1	2.4	1.1	2.3
Macedonia	2.3	8.3	-0.8	1.6	3.9
Bosnia and Hercegovina	1.5	7.4	-0.4	2.1	3.7
Serbia	6.4	12.4	8.1	6.1	11.1
The Republic of Kosovo	4.4	9.3	-2.4	3.5	7.3
Montenegro	4.3	8.8	3.5	0.7	3.2
Czech Republic	3	6.3	0.6	1.2	2.1

Source: Central Bank of Bosnia and Herzegovina, Eurostat, http://www.inflation.eu/inflation-rates/slovenia/historic-inflation/cpi-inflation-slovenia.aspx

As the greatest factor affecting inflation in the countries of the former Yugoslavia and in the Czech Republic we can mark the development of food prices, energy prices, particularly oil, and, in some countries, also changes in administered prices.

Table 8: Development of historical inflation in selected countries*

	1991	1992	1993	1994	1995
Slovenia	109.33	237.96	33.95	21.00	21.00
Croatia	99.30	594.85	1466.79	111.76	23.54
Macedonia		250.00	338.68	126.40	15.80
Czech Republic	56.60	11.10	20.80	10.00	9.10

*Rest of the country could not be included for lack of information

Source: Eurostat, Czech National Bank, http://www.inflation.eu/inflation-rates/slovenia/historic-inflation/cpi-inflation-slovenia.aspx, http://economic-outlook.realclearworld.com/l/3383/Former-Yugoslav-Republic-of-Macedonia

The origins of the banking systems in the countries of Slovenia, Croatia and Macedonia were accompanied by hyperinflation, which had gradually shifted into the range of runaway inflation until 1995 (Table 8). The Czech Republic, unlike these countries, has not achieved the hyperinflation values since its establishment, and in 1995, already fell to 9.1% value of normal inflation.

4. Conclusion

Currently, the banking sector is an integral part of any advanced country. As well as in the Czech Republic and in the countries of the former SFRY, the banking system began to shape into its present form until after 1990, when there was the breakup of the Eastern bloc countries. The banking sectors of the Balkan countries were restored with the contribution of participating Banks Rehability Agency, which started the privatisation of the banking entities in these countries. This agency was established by individual countries to maintain a stable banking system and to conduct supervision of the banking sector.

Each country or its central bank respectively, determines different objectives of monetary policy. For a majority of referred countries it is the question of maintaining price stability. Central banks conduct their monetary policies with particular use of indirect tools in the form of open market operations, automated facilities and minimum reserves requirements. The structure of monetary policy tools of the monitored central banks is very similar. All institutions are used to control liquidity by repo transactions. The central banks of the Czech Republic, Serbia and Montenegro do not use the tools of structural operations. As far as a longer-term liquidity control is considered, the NBRM, unlike most central banks, uses auctions of treasury bills. The central banks of individual countries use virtually the same automatic facilities. States of the former Socialist Federal Republic of Yugoslavia (SFRY), except for Slovenia, additionally make use of intraday credit tools. The Central Bank of Montenegro has the most distinct policy of these built-in stabilisers, since it does not use any deposit facilities.

Among the main targets in the majority of monitored countries belongs the maintenance of price stability. Only three of the national banks use the process of inflation targeting to achieve this goal. These are the CNB, the SNB and the NBS. The ECB'S inflation target is to keep inflation within 2%. Since 2010, the CNB has a similar target which is set at 2 ± 1%. The NBS has set an inflation target which should not deviate by more than 1.5% from the 4.5% limit in 2011.

The banks in the countries of the former SFRY offer new investment opportunities, which is the reason why global bank groups are beginning to open their affiliates here. All countries struggle to join the European Union. Their accession would lead to further expansion of banking institutions in the framework of the so-called principle of a single passport. Two of these countries, The Republic of Kosovo and Montenegro, already use the euro as their national currency, which greatly affects their monetary policy. For this reason, The Republic of Kosovo does not have its own monetary policy. These markets are mostly conquered by investors from Austria, Germany, France, Italy, but also by investors from countries such as Greece or Turkey. Within these countries, a large number of affiliates can be seen in Slovenia, too.

The most similar banking environment to that of the Czech Republic is in Slovenia, which has also become a member of the European Union, as well as in Croatia, where banks (as well as the banks in the Czech Republic) had to be for the most part privatized by foreign owners.

The banking sector has become an important component of individual economies affecting the affairs of the entire national economy. Its decline in individual countries at present may have considerable impact not only on the economy of the respective country, where the banking sector found itself in crisis, but also on the economies of other countries.

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