



National Bank of Serbia

# Macroeconomic Developments in Serbia

February 2020

# Sustained Macroeconomic Stability

- In six years, Serbia has transformed to a low inflation and stable growing economy, with fiscal surplus, declining public debt, significantly reduced external imbalances and labour market recovery.
- Following strong economic expansion in 2018. (4.4%), we estimate that GDP growth in 2019 continued at similar a pace, reaching a rate of 4.2%, high above our initial projection of 3.6%, as a result of faster growth of investment.
- After averaging 2.0% in 2018, inflation finished the 2019 at 1.9%, in line with NBS forecast. Inflation expectations are anchored within the target tolerance band (3±1.5%).
- After a surplus in 2017 and 2018 government budget recorded deficit of 0.2% of GDP in 2019, maintaining primary balance in surplus (1.8% of GDP). Public debt share in 2019 stood at 52.0% of GDP, declining by 18 pp of GDP since 2015, with an improved currency composition.
- Macroeconomic stabilization and improvements to the business environment contributed to high FDI inflows of EUR 7.3 bn in 2018 and 2019.
- Exports of goods and services retained their growth momentum in 2019 (growth of 10.5%), driven by exports of manufactured goods, services and agriculture.
- Results were acknowledged by improved credit ratings in 2019 (Fitch and S&P) and additionally improved outlook (Moody's) and a continued decline in the country risk premium (minimum in December 2019). In 2018 a Policy Coordination Instrument with the IMF has been approved, with successfully completed third review.
- The key policy rate at 2.25% is at the lowest level in inflation targeting regime. Past monetary policy easing reflected in a further reduction in interest rate on dinar loans.
- Credit activity extended its steady and sustainable growth in 2019 which in December equaled 9.8% y-o-y.
- Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 4.10% at end-December 2019. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.

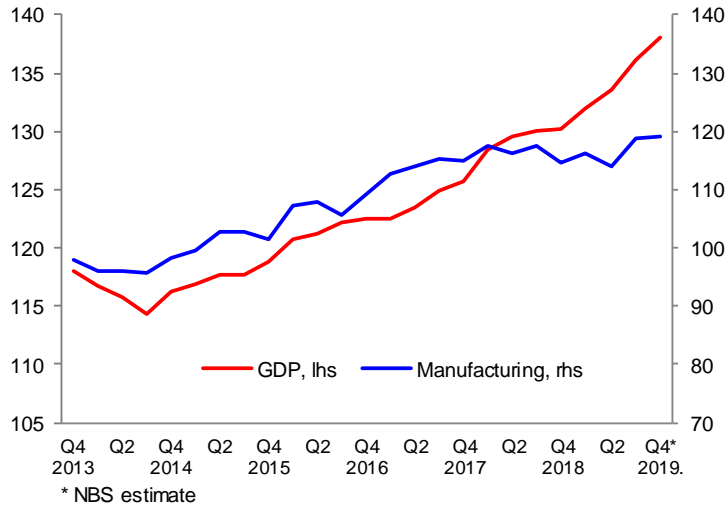




# Strong GDP Growth on the Back of Robust Investment Activity, Exports and Labour Market Recovery

## GDP growth in 2019 surpassed expectations despite external challenges

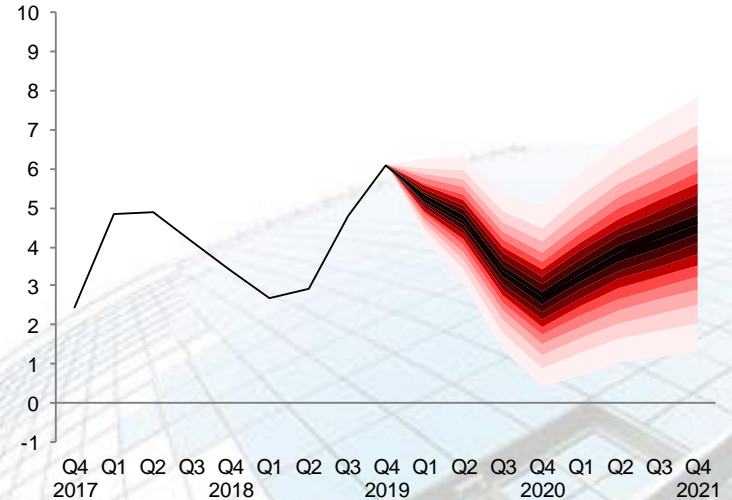
Chart 5 GDP developments  
(seasonally adjusted, 2008=100)



- Despite momentum loss across much of the Eurozone, and negative contribution of one-off effects, GDP growth in 2019 is estimated to be at a rate of 4.2%, primarily driven by faster growth of investment.
- GDP growth in Q4 accelerated even more compared to Q3, and stood at 6.1% y/y, led by further expansion of construction, investment in equipment, industrial production recovery and acceleration of service growth.
- After temporary decline in H1, manufacturing recovered in H2, providing positive contribution to GDP growth in 2019.

## In the coming years Serbia will maintain a strong, sustainable and broad-based growth

Chart 6 GDP growth projection (from February 2020 IR)  
(y/y rates, in %)



- In 2020, same as in the medium-term, GDP growth should be around 4%, supported by macroeconomic stability, improved business environment, strong private and public investment and effects of past monetary easing.
- Risks to GDP growth are assessed as symmetrical. Those arising from international environment are judged to be skewed to the downside and primarily related to the pace of euro area growth and in the short-term effects of the coronavirus. On the other hand, the domestic factors, primarily related to the potential faster growth of investment, are tilted to the upside.

# The New Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015...

...in both private and government sector

Chart 7 Fixed investment dynamics

(growth rates in %, share in %)

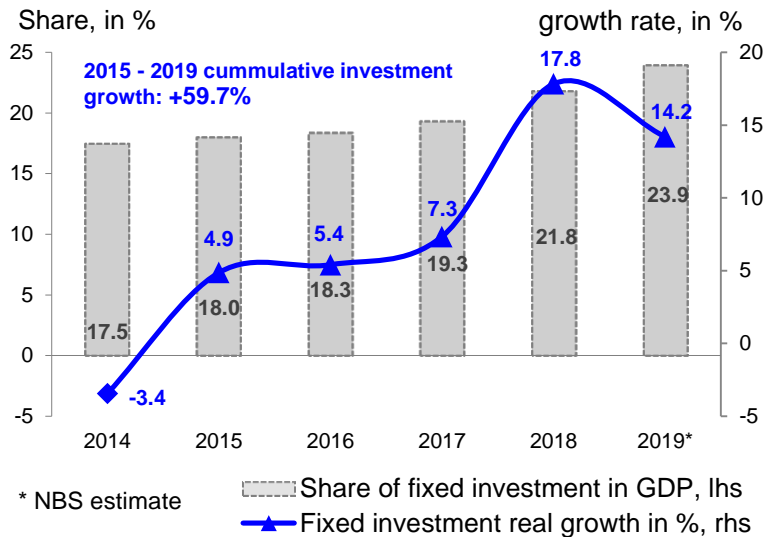
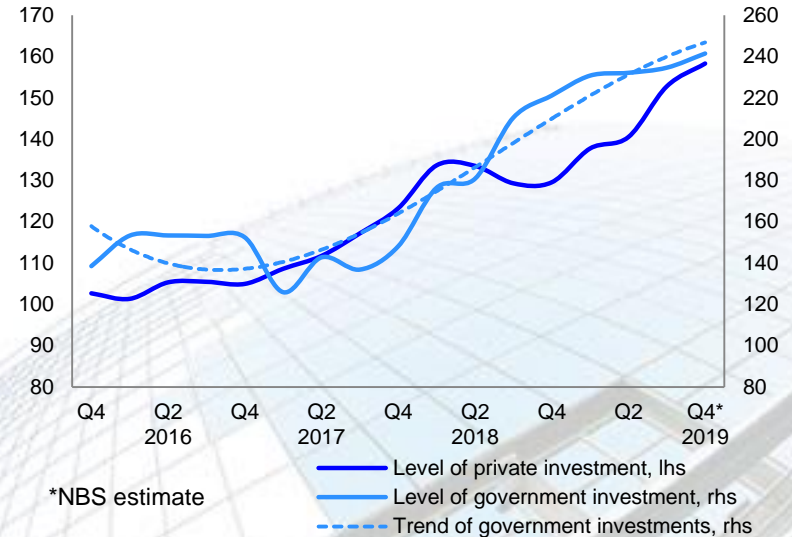


Chart 8 Private and government investment dynamics

(seasonally adjusted data, indices 2014=100)



- In 2015-2019, fixed investments grew at an average annual rate of about 10%, while their cumulative growth was about 60%.
- The biggest advancement were made in 2018 and 2019, when fixed investments increased in real terms by 17.8% and 14.2%.
- The share of fixed investment in real GDP increased from 17.5% in 2014 to 23.9% in 2019, with the expected continuation of growth in the medium term.
- In the medium-run, investments will contribute to further rebalancing of the economy.

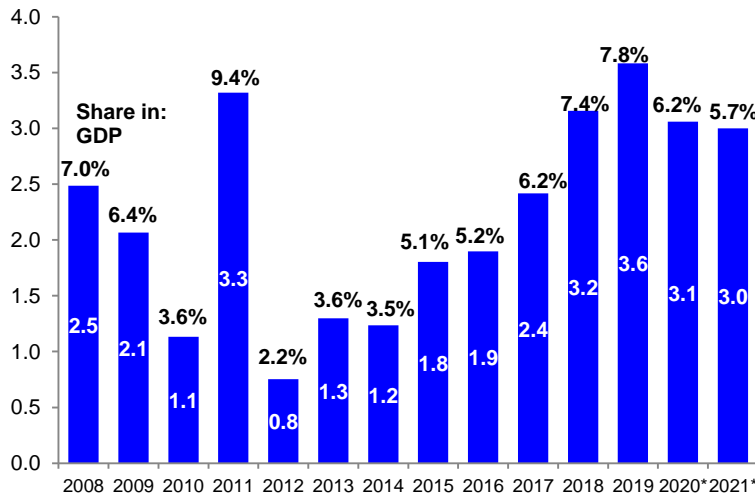
- Sustained macroeconomic stability, improvement in the overall business environment, rising profitability and EU accession process will work in favour of private investments in the coming years.
- Aside from private investments, public sector investments recovered as of 2015 and picked up particularly in 2018.
- A growing economy, combined with improved tax collection and responsible public spending policies, will enable the government to increase investment activity and further develop the country's infrastructure.

# Improved Business Environment Supporting High FDI Inflow

Macroeconomic stability combined with structural reforms has created a more favourable climate for FDIs...

...which are well-diversified and contributing to the country's export potential

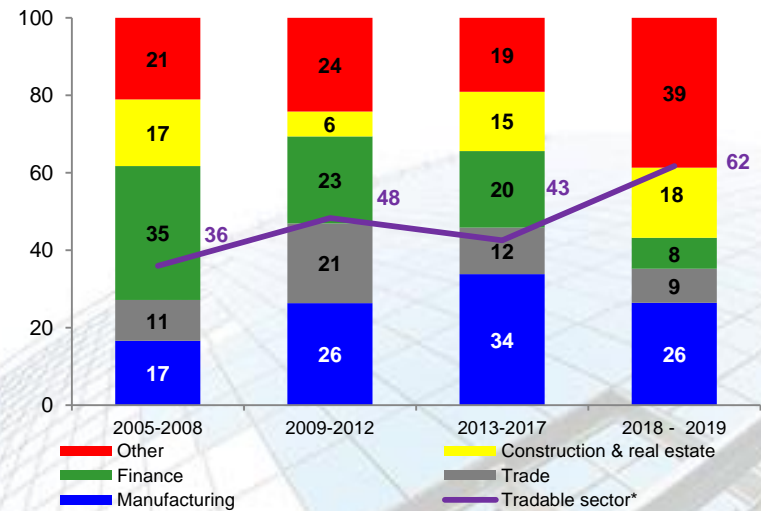
Chart 9 Net FDI (EUR bn)



\*NBS projection

- Gross FDI inflows equaled EUR 7.3 bn in the previous two years, while net inflows equaled EUR 6.7 bn and fully covered the current account deficit.
- More than half of FDI are small projects, indicating diversification and resistance to external shocks.
- Serbia ranked first on Financial Times Greenfield FDI Performance Index for 2019, which looks at greenfield FDI inflows compared to the size of the economy.

Chart 10 FDI composition by sector (% of inflow)



\*industry, agriculture, transport & storage, accommodation and food svc.

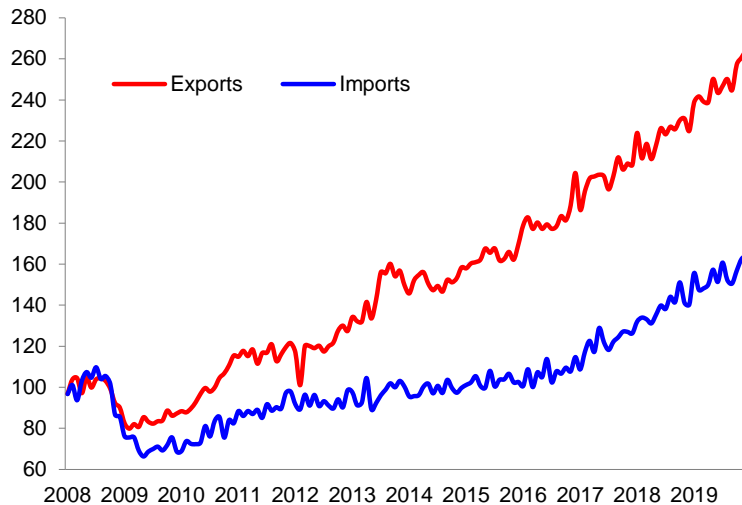
- Out of total inflow of EUR 7.3 bn in the last two years, EUR 4.5 bn was directed into the tradable sectors, most notably manufacturing (EUR 1.9 bn).
- Within manufacturing, most FDI inflows are directed to the metals, motor vehicles, food/beverage and rubber industries. This resulted in high growth of manufacturing employment, output and exports.
- FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia's major investment partner - the European Union.

# High Investment Growth Reflected in Current Account Deficit in 2019

**Export growth continues despite Eurozone slowdown...**

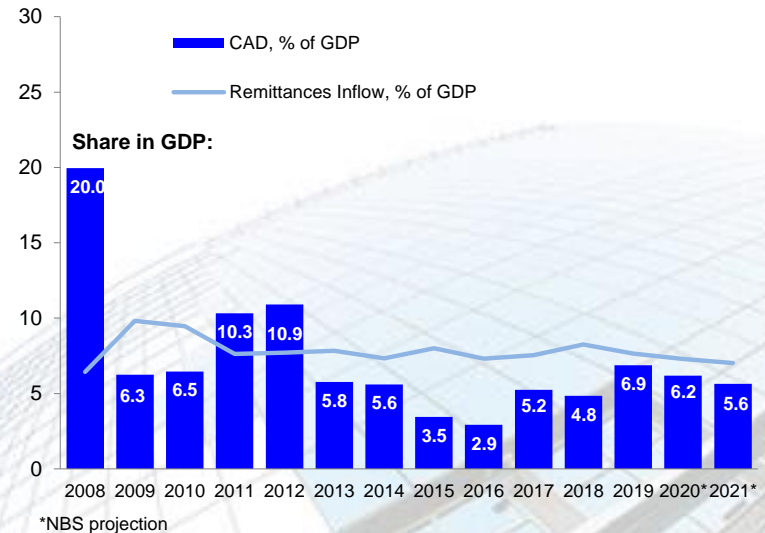
**...but investment related imports temporarily raised the deficit**

Chart 11 Trade in goods and services  
(seasonally adjusted, 2008=100)



- During 2019 goods and services exports continued to post strong growth (10.5%) despite external pressures, driven by exports of manufactured goods, services and agricultural products.
- Eurozone demand moderation was compensated by increasing exports to other markets and new productive capacities on the supply side.
- Imports of goods and services grew 10.7% y/y in the same period, on account of higher imports of capital, intermediate as well as consumption goods.

Chart 12 Current account deficit and remittances  
(% share in GDP)



- The CAD has increased to 6.9% of GDP in 2019, whereby the overall increase is a result of an increase in the share of investment in GDP.
- In addition, one-off effects on the CAD growth were also around 2% of GDP.
- Since 2015 Serbia's current account deficit has been fully financed by net FDI, which we expect to be continued in the coming period.
- As a result of high FDI inflow, we expect double-digit growth in exports of goods and services in the coming years.

# Favourable Fiscal Performance Continues

**Strong fiscal adjustment since 2015 of around 8 pp of GDP...**

**...resulted in a decline in the public debt-to-GDP ratio and its sustainability**

Chart 13 Fiscal revenues, expenditures and outcome (% share in GDP)

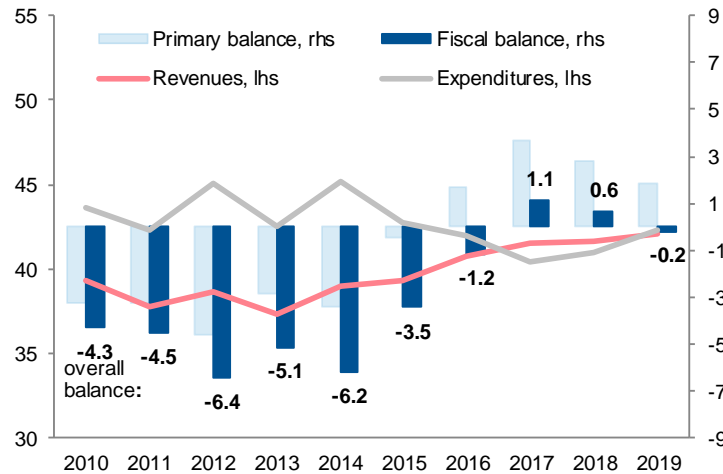
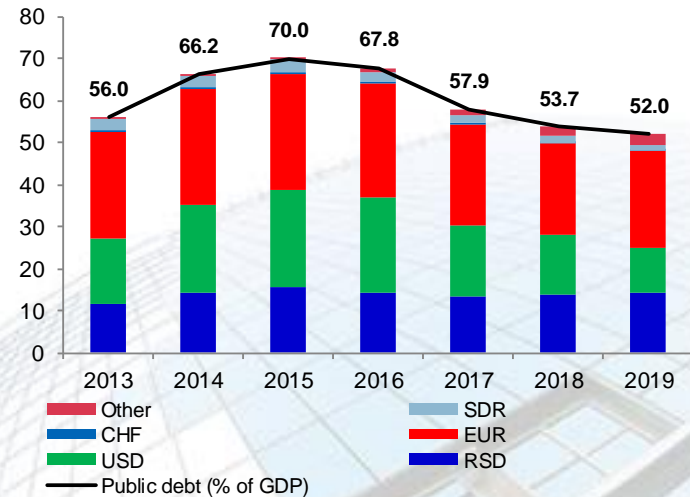


Chart 14 Public debt (central government) (% share in GDP)



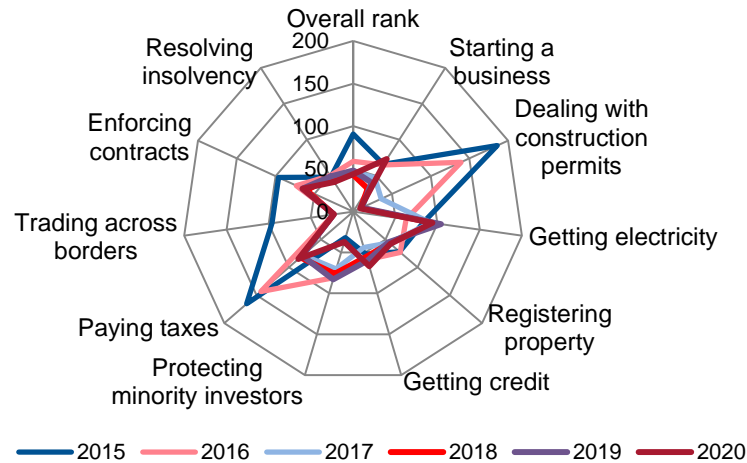
- Improvement of the fiscal outlook in last four years was led by fiscal consolidation on expenditure side, and robust growth in revenues on account of GDP growth and improved tax collection.
- After two years of surplus, fiscal balance recorded deficit of 0.2% of GDP in 2019 which is better result than projected in the Fiscal strategy.
- Deficit was a result of intensive government investment, which grew at rate of 33.6% in 2019, reaching 4.9% of GDP, well above projection.

- The declining trend of public debt continued in 2019 (52.0% of GDP, compared to 53.7% in 2018).
- The Fiscal Strategy entails a medium-term deficit target of 0.5% of GDP, consistent with steady debt to GDP reduction.
- Public debt dinarisation picked up from 20.9% (end-2016) to 27.7% in 2019.
- Serbia issued a 10y EUR 1bn Eurobond at 1.62% in June and an additional EUR 550mn at 1.25% in November, repaying USD-denominated bonds in the same amount, thereby further reducing exchange rate and rollover risk.

# Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

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Chart 15 **Indicators on business regulation**  
(rank, lower value means rank improvement)



Source: World Bank, *Doing Business Report*

• Key reform areas in the last four years:

- ❑ Construction sector;
- ❑ Labor market;
- ❑ Tax administration;
- ❑ Financial sector;
- ❑ Contract enforcement and resolving insolvency.

Key deliverables:

- ✓ Law on Planning and Construction (2014) and Law on Investment (2015) – streamlined construction permit procedures (one-stop-shop and electronic construction permits), doubling the number of construction permits and increasing the share of construction in GDP.
- ✓ New Labor Law (2014) – improved flexibility and job creation. On top of that, the National Employment Strategy & Reform Program improved job matching services and training and provided subsidies to disadvantaged people and self-employment. Reforms contributed to an increase in private sector employment by more than 230 thousand people (17.3%), of which 90 thousand in manufacturing.
- ✓ Efforts have been made in 2019 to include seasonal workers into employment registries more efficiently, by introducing an online platform for their registration, the effects of which will be evident in the following period.
- ✓ Tax Administration reform – led to a significant increase in revenue collection and better than planned fiscal results.
- ✓ NPL Resolution Strategy (NBS and government action plans) – the share of NPLs declined more than 70% (from 22.2% in August 2015 to 4.1 % in December 2019). Narrowing was most evident with corporates – the share of NPLs was reduced from 25.9% to 3.4% in the same period.
- ✓ Private bailiff system (2013) and New Bankruptcy Law (2014).

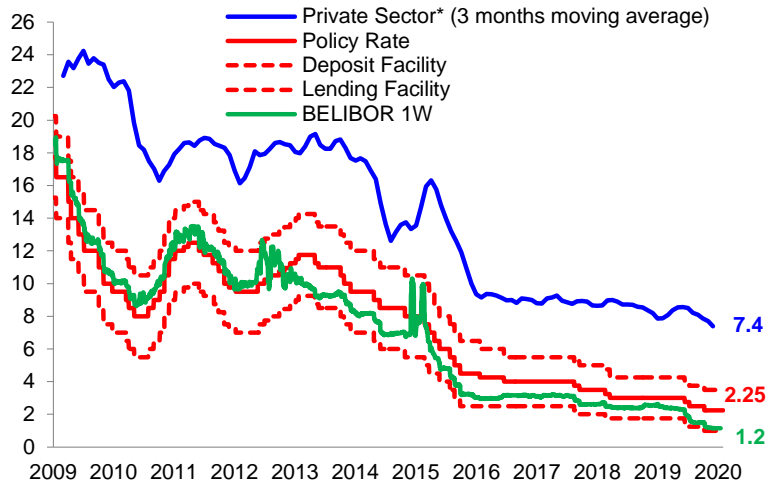
# Key Policy Rate kept at 2.25%, its' lowest level in the inflation targeting regime

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In February, the key policy rate kept unchanged at 2.25%

Chart 16 Interest rates

(y/y rates, in %)

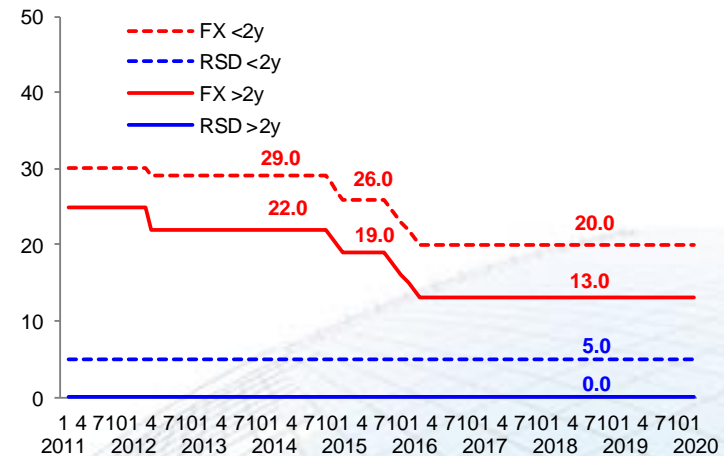


\*weighted interest rate on non-indexed RSD loans (up to September 2010 the data was exclusively used for research purposes of NBS)

FX required reserve ratio has remained unchanged since early 2016

Chart 17 Reserve requirement ratios

(in %)



## The decision takes into account the following factors:

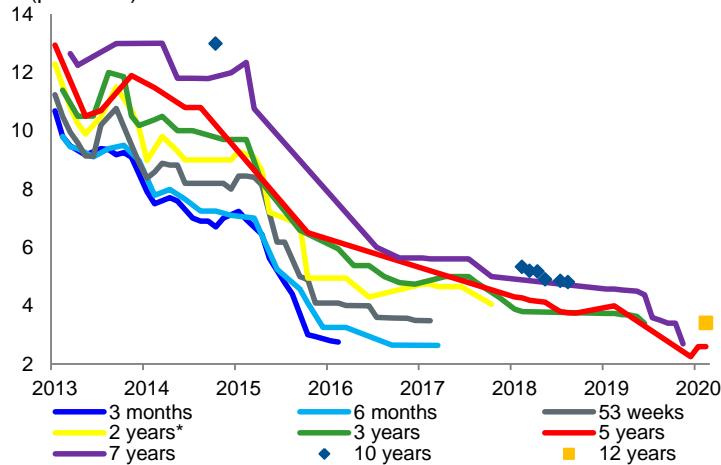
- expected movement in inflation and other macroeconomic indicators from the domestic and international environment going forward,
- effects of past monetary policy easing,
- uncertainties arising from international environment – as the future conditions in the international financial market will be largely determined by the decisions of leading central banks, and its deviation from market expectations, and volatility of prices of oil and primary agricultural commodities in the global market.

- Last time FX RR ratio was reduced in early 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).
- RR is an important monetary policy tool (in January 2020 RR amounted to EUR 2.1 bn and RSD 194.1 bn).
- NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration at higher rate on dinar RR vs FX RR (i.e. 0.75% on RSD RR, while no remuneration is applied on FX RR).

# The Effects of NBS Monetary Policy are Reflected in Lower Costs of Government and Private Sector Financing...

## Interest rates on dinar government securities have slid to new minimums ...

Chart 18 Interest rates in the primary market of government securities (p.a. in %)



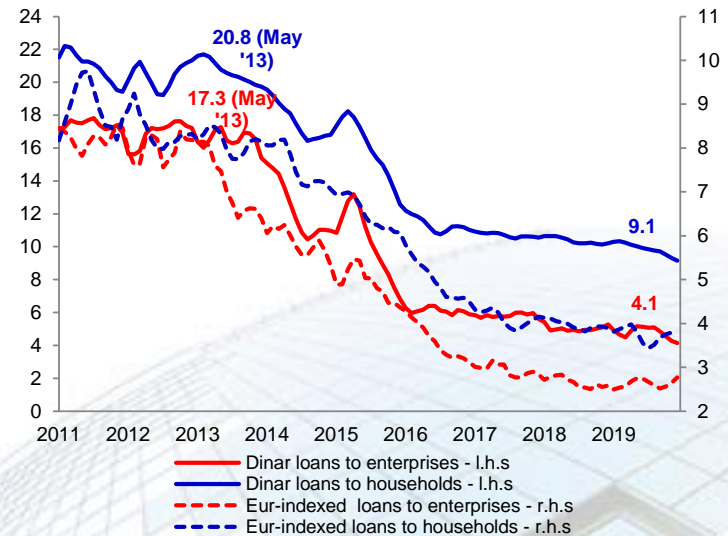
Source: Ministry of Finance.

\* Excluding coupon securities with the rate linked to the NBS key policy rate.

- The dinar yield rate curve is extended to 12 years – in auction held in February yield rate recorded 3.4% with 10 times higher demand, which reflects confidence of investors.
- In January and February the yield rates on 5y bond were 2.6%, which is 1.4 pp lower than a year ago.
- The share of long-term securities (5+ year maturity), increased from 2% in December 2012 to over 75% at the beginning of 2020.
- In auction held in January 2020, Serbia issued for the first time EUR bond with the maturity of 20 years (with yield rate of 3.0%).

## ... while interest rates on private sector loans are close to their lowest levels

Chart 19 Interest rates on loans – new business (3 months moving average, in %)

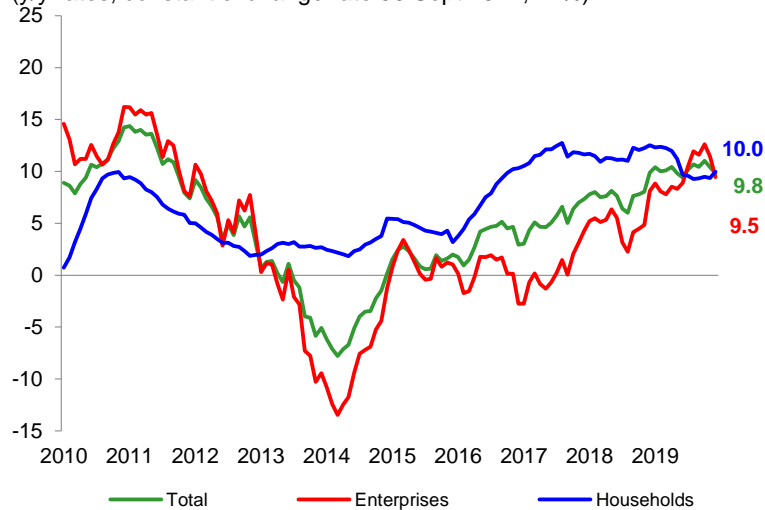


- Since the beginning of monetary policy relaxation cycle (May 2013), dinar lending interest rates fell sharply. In December 2019, dinar interest rate for corporate sector recorded new minimum of 4.0% (down by 12.4 pp), while households dinar interest rates were kept at lowest level of 9.1% (down by 11.4 pp).
- The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.
- In the observed period, a sharp fall in the country risk premium and the country's credit rating upgrade, as well as monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.

# ... as well as to Growth of Credit Activity

## Lower costs of financing and sustainable economic growth support domestic lending ...

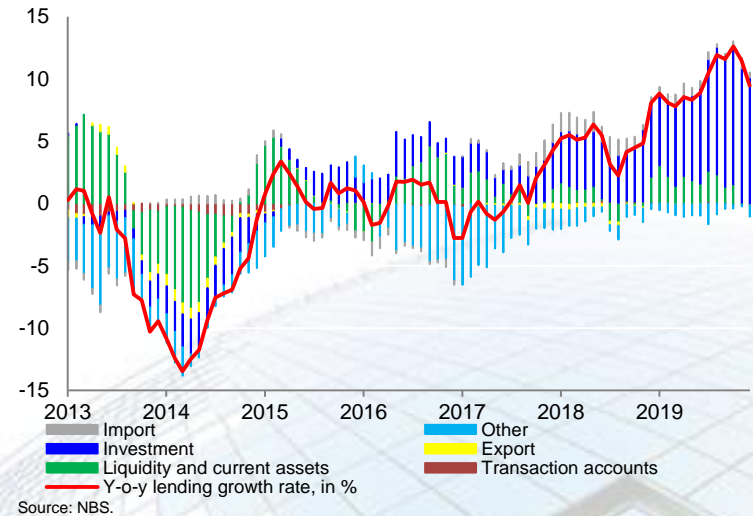
Chart 20. Bank lending to enterprises and households  
(y/y rates, constant exchange rate 30 Sept 2014, in %)



- Lending activity extended its steady and sustainable growth in 2019, which in December, excluding the exchange rate effect, equaled 9.8% y/y.
- The structure of lending is favorable in terms of support to sustainable economic growth, as evidenced by a significant rise in corporate investment loans and a rebound in housing loans.
- Further growth of lending activity is expected in the coming period, as a result of sustainable economic growth, improved conditions in the labor market, effects of monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

## ... and the positive tendencies are also reflected in corporate loans market

Chart 21. Contributions to y-o-y corporate lending growth  
(in pp, constant exchange rate 30 Sept 2014)



- Since the beginning of H2 2019, corporate loans are providing the biggest contribution to y/y growth rate of total credit activity (4.9 pp in December 2019) and significant support to acceleration of economic activity.
- The strong increase of investment loans is providing the biggest impetus to the y/y growth rate of corporate loans (9.5% in December 2019), which increased by almost EUR 1 bn.
- Since May 2019, investments loans have become the largest category of corporate loans (with the share of 45.2% in December 2019), followed by loans used to finance current assets (with share of 39.1% in December 2019).



# Serbia's Credit Rating Improvement and Investor Confidence Growth

After reaching all-time low, Serbia's risk premium stays among the lowest in the region

Appreciation pressures in previous years backed by strong domestic macroeconomic fundamentals

Chart 22 EMBI risk premium (basis points, daily values)

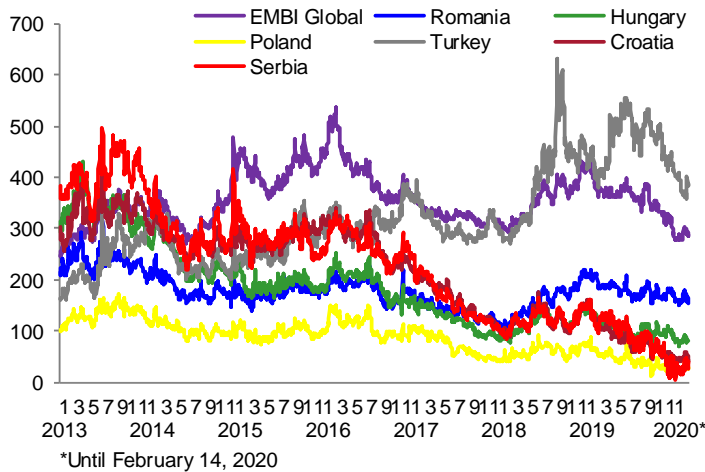
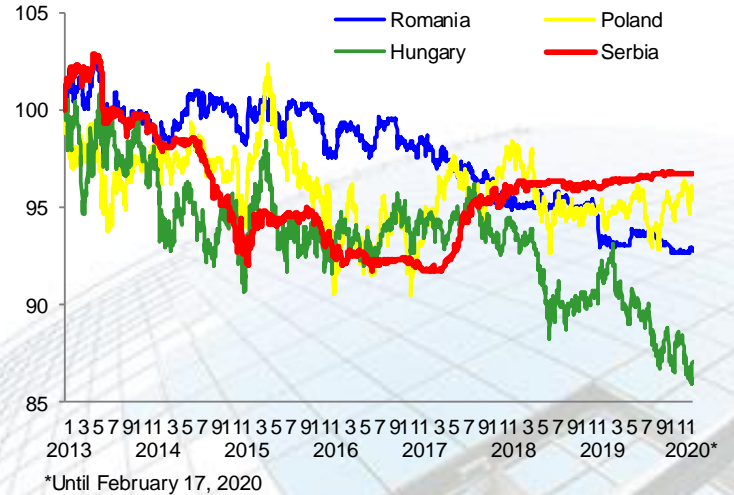


Chart 23 Exchange rate developments (31 December 2012 = 100)



- Serbia's risk premium reached its **historical low level in December**, and recorded the biggest fall in the region in 2019, indicating that it was also driven by domestic factors. The outbreak of the coronavirus in early 2020 triggered uncertainty in global financial markets and pushed the risk premia of emerging markets somewhat up.
- **Fitch improved Serbia's rating from BB to BB+, and Moody's upgraded the outlook for credit rating to 'positive' from 'stable' (Ba3) in September 2019.**
- **S&P also upgraded Serbia's credit rating from BB to BB+ in December, while at the same time assessing the outlook for further rating upgrade as positive, sending a positive signal to investors.**

- In the previous three years the dinar cumulatively appreciated by 5% against the euro in nominal terms. Strengthening of the dinar is stimulated by better Serbia's macroeconomic fundamentals, good performance and favorable growth prospects, which contributed to FX inflow on account of FDI and elevated non-resident investment in long-term dinar government securities. Since the beginning of 2020, the dinar stayed broadly unchanged against the euro.
- In order to maintain the relative stability of the dinar, the National Bank of Serbia was buying FX in periods of strong and concentrated appreciation pressures, acting proactively and bolstering the FX reserves, thus enhancing the resilience of the domestic financial system to external risks.

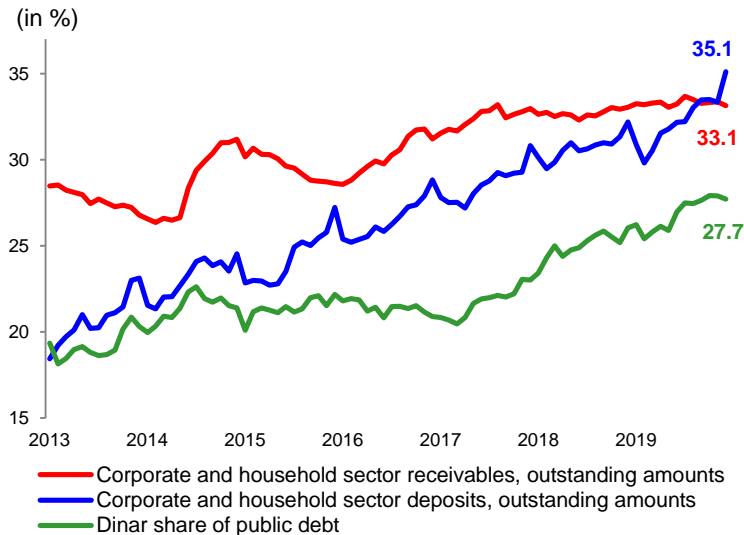
# After Fitch, S&P also upgrades Serbia's Credit Rating to BB+

- **Following the rating upgrade by Fitch in September, S&P has also upgraded Serbia's rating from BB to BB+ in December, while at the same time assessing the outlook for further rating upgrade as positive. The rating upgrades are the result of resilient economic growth in the face of the challenging external environment, strengthening of macroeconomic fundamentals, preserved fiscal discipline and adequate monetary and prudential policy measures.**
  - Agencies particularly emphasized the NBS's success in maintaining low and stable inflation. Inflation is expected to remain firmly under control, within the NBS target tolerance band. Agencies also stress positive trends in the banking sector, underlining the sharp reduction in the NPL share in total loans to below 5%, solid capitalisation of the banking sector, and two-digit lending growth which supports economic growth. S&P once again points out the NBS's operational independence and accomplished monetary policy credibility.
  - S&P revised the expected growth in 2019 upwards, to 3.6%, as decelerating growth in the eurozone appeared not to have undermined Serbia's economic performance due to the resilient double-digit export growth, as well as double-digit growth in investments and vigorous private consumption on the back of improvements on the labor market. Agency anticipates that economic growth will remain resilient in 2020 (around 4%) and 2021 as well.
  - S&P simultaneously assessed the rating outlook as positive on the back of strong prospects for continued inflows of productive foreign direct investments which could further widen and diversify Serbia's export base, strengthening its balance of payments' resilience to external shocks. Rating on Serbia also reflects educated workforce, lower public debt share, and commitment of Serbia's fiscal and monetary policy authorities to the maintenance of stability and further economic reforms.

# Indicators of Dinarisation are on the Rise

## Macroeconomic stability contributing to dinarisation process

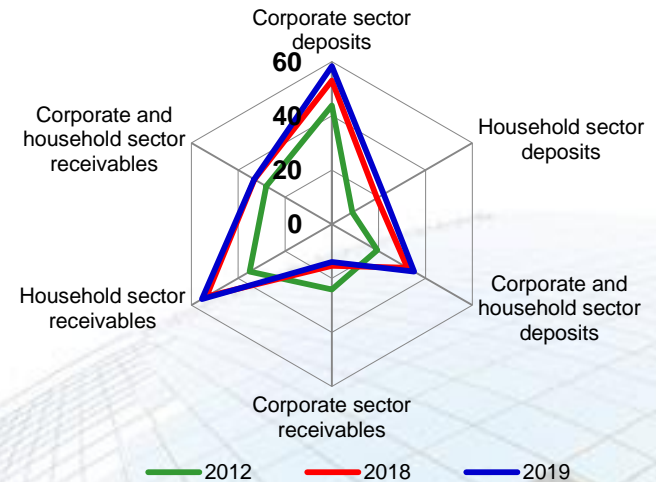
Chart 24 Dinarisation of the corporate and household sector receivables and deposits, and dinar share of public debt (in %)



- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.
- The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 27.7 % in December 2019).
- Dinarisation of corporate and household sector deposits rose by 15.8 pp compared to end-2012 and currently stands at 35.1% (December 2019), while dinarisation of corporate and household sector receivables rose by 5.1 pp to 33.1% (December 2019).

## The growth of dinar loans to households accompanied by higher dinar savings

Chart 25 Dinarisation of corporate and household sector (outstanding amounts, in %)

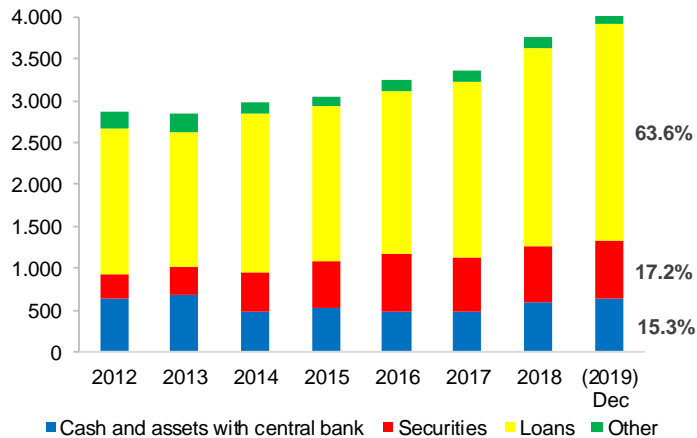


- Over the past years, dinarisation of household receivables had a firm upward trend – an upsurge from 35.1% (2012) to the maximum of 55.4% (Sept-Dec 2019). This positive trend is a result of a sharp drop in dinar interest rates, low and stable inflation, as well as NBS measures aimed to support dinarisation.
- Dinar savings of households (residents) recorded strong growth of 22.2% in 2018, which is also continued in 2019. In the 2019, household dinar savings increased by RSD 18.5 bn (over 30%), reaching the new maximum of RSD 79.0 bn in December (or RSD 79.6 bn including non residents).

# Traditional Banking Mostly Financed by Domestic Deposits

## Adequate structure of banking sector assets

Chart 26 Structure of banking sector assets  
(RSD bn)

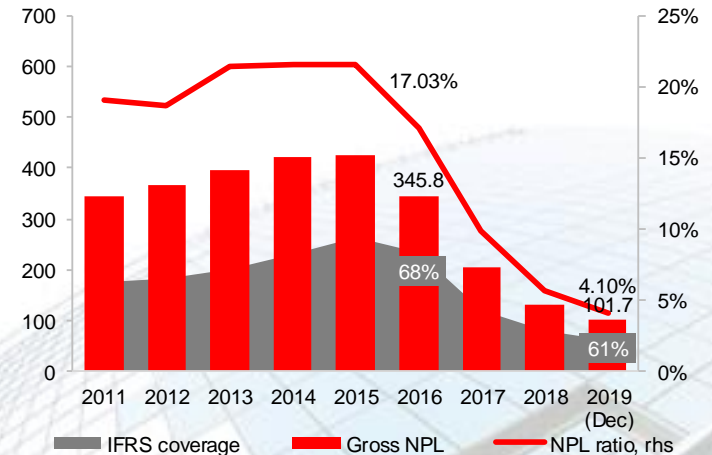


Source: NBS

- Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around of one-fifth of the total banking sector net assets (17.2% at the end of December 2019).
- Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 46% and 27%, respectively at the end of December 2019.
- Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 1.6% of regulatory capital at end of December 2019.

## Improving the quality of the banking sector assets

Chart 27 Asset quality – Non-performing loans (NPL)  
(RSD bn, %)



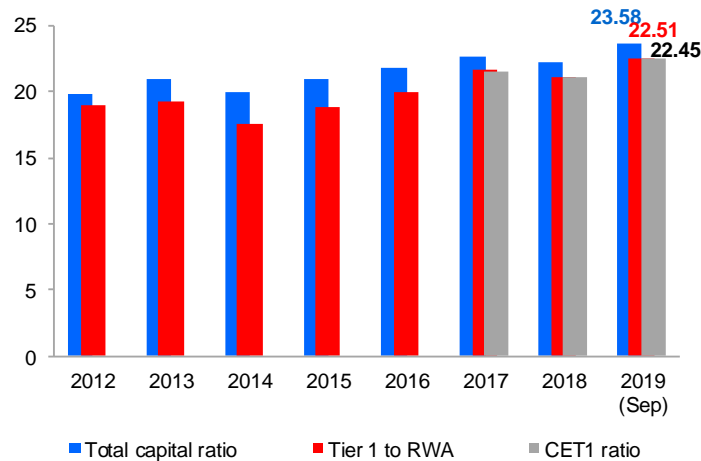
Source: NBS

- Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.
- At end-December 2019, the NPL ratio was 4.10%, with the maintenance of relatively high coverage by both, IFRS provisions (60.7%).
- The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.

# Conservative Framework Contributed to the Banking Sector Resilience to Shocks

## High banking sector capitalisation as a result of strong prudential measures

Chart 28 Capitalization of the Serbian banking sector (%)

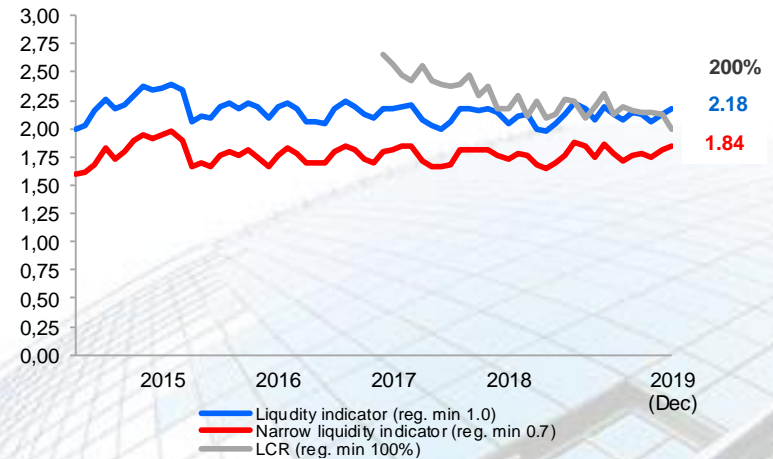


Source: NBS

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of September 2019 amounted to 13.7%.

## Serbian banking sector is highly liquid

Chart 29 Liquidity indicators of the Serbian banking sector

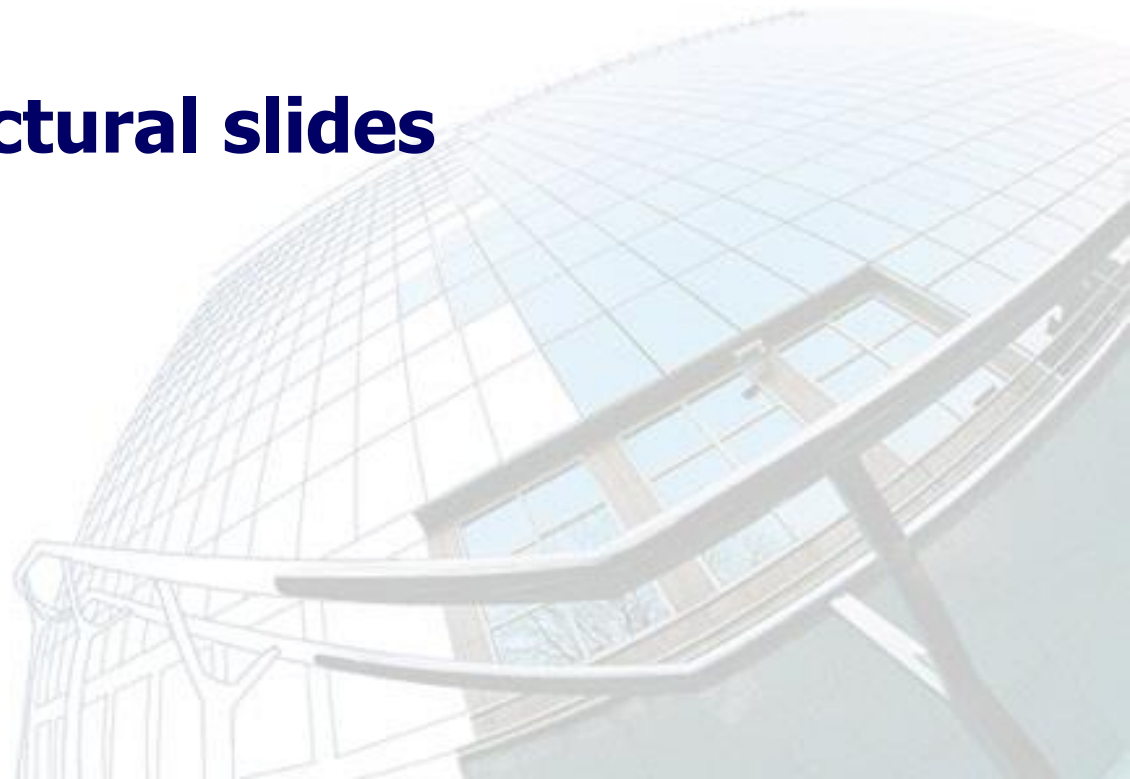


Source: NBS

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 37.2% of the total assets of the banking sector in December 2019.
- The loan to deposit ratio that at the end of December 2019 amounted 91.2%, indicates stability of funding and in general the liquidity of the banking sector.

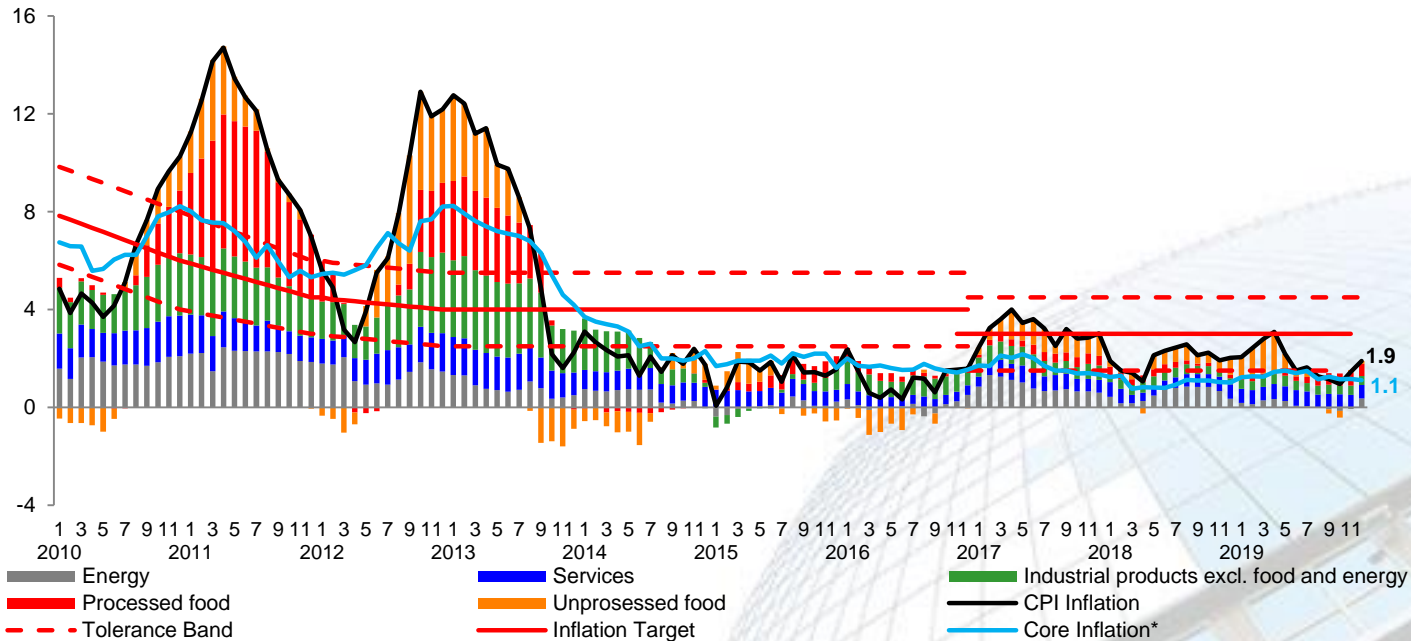


# Structural slides



# Reduced Food Price Volatility Contributing to Low and Stable Inflation

Chart 30 Contributions of CPI components to y/y inflation  
(y/y rates, pp)

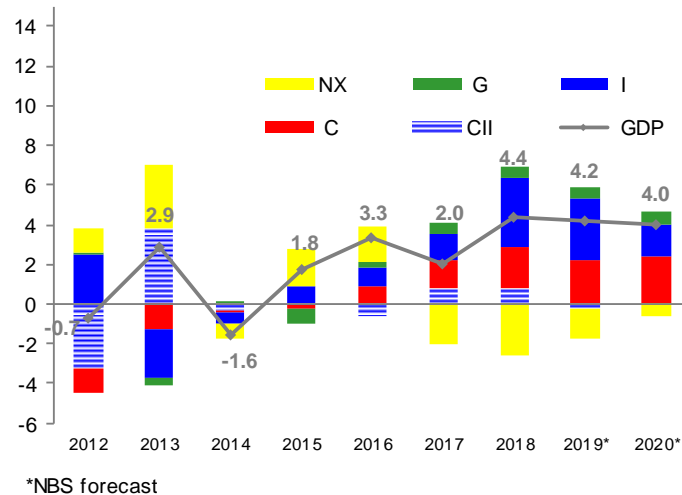


- Historically, short-term volatility of headline inflation was mainly driven by food prices.
- Core inflation remained low and stable, confirming low inflationary pressures (end of 2019 1.1%).

# Growth Structure more Favourable than Pre-Crisis

Pre-crisis GDP growth was driven by consumption, the trend reversed after the crisis in favour of investments and exports

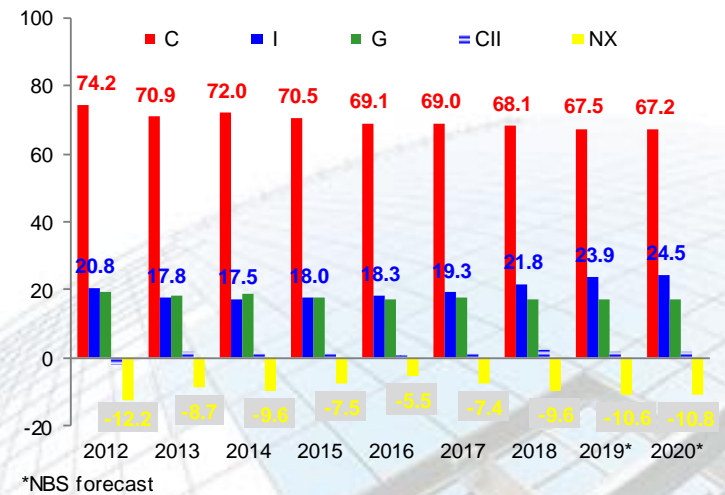
Chart 31 Contributions to real GDP growth  
(y/y rates, pp)



- Prior to the crisis, high capital inflows led to consumption-based growth which resulted in increased external imbalances. With the first wave of the crisis, this trend reversed. Growth was slower, but more sustainable and driven by net exports and investments.
- Large-scale investments in the automobile and oil industries (2011–2012) have helped the economy to rebalance.
- The new investment cycle that began in 2015 is more diversified, and is leading to further rebalancing of the economy and sustainable growth.

In the next five years, Serbia will gradually converge towards more developed countries in terms of GDP composition

Chart 32 GDP composition  
(share in GDP)

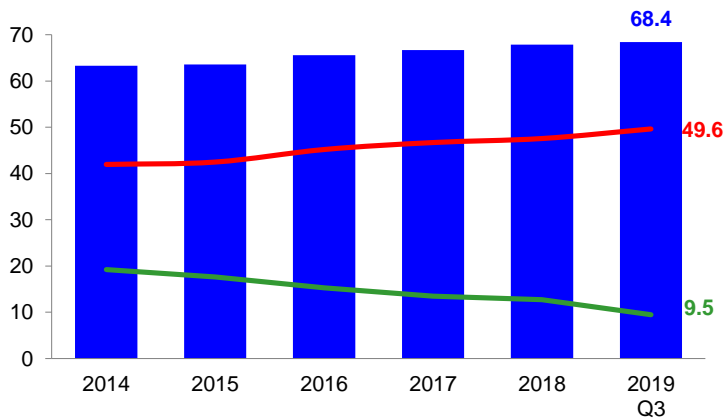


- As a result of adequate policy mix, GDP growth will remain broad-based and sustainable.
- Consumption will continue to grow, but slower than the total GDP, creating space for more investment.
- In the medium-run, fixed investments will increase their share in GDP, while exports of goods and services are likely to approach 70% of GDP.
- Implementation of structural reforms, improvement in the investment climate and the EU accession process created a foundation for healthy growth.

# Labour Market Recovery and Productivity Growth

## The unemployment rate for the first time at single-digit level in Q3 2019

Chart 33 Labour market indicators according to the Labour Force Survey, (in %)



Source: Statistical Office Republic of Serbia.

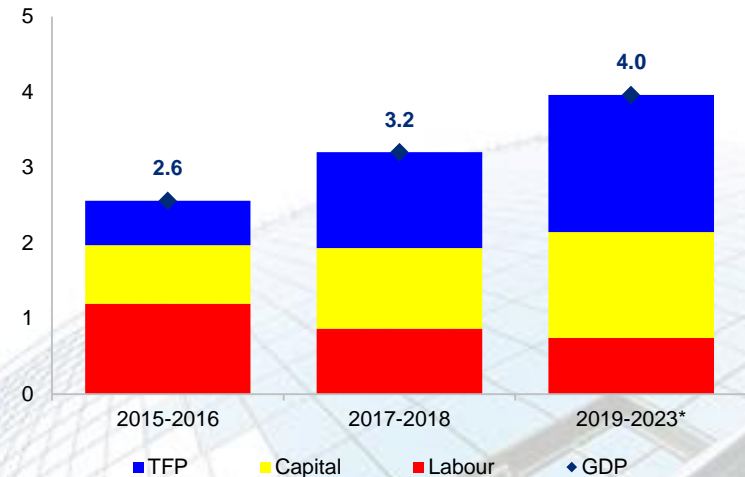
\* Since 2014, LFS data published according to the new methodology.

■ Participation rate    — Employment rate    — Unemployment rate

- The unemployment rate in Q3 2019 is for the first time at the single-digit level and amounted to 9.5%. This represents a decrease of 1.8 p.p. compared to the same period of the previous year.
- Favourable trends in the formal labour market come from the private sector, where employment increased by 18.4% (December 2019/December 2014) - mainly in manufacturing, private sector services and construction.

## Increasing contribution of total factor productivity to Serbian GDP growth

Chart 34 Contribution of factors of production to GDP (in pp, period average)



Sources: SORS, NBS calculation.

\* NBS estimate.

- In the period as of 2015, a positive contribution to GDP growth came from capital, labour and TFP.
- Growth acceleration in 2017-2018 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2016, compensated by a faster growth of the capital stock.
- In the medium term, we expect still lower contribution from labour, a higher capital contribution due to structural reforms, while TFP contribution will increase further to 2 pp supporting income convergence to developed countries.

# Trading Partners and External Demand

Chart 35 Goods imports by country in 2018/ 2019  
(EUR mn and % of total )

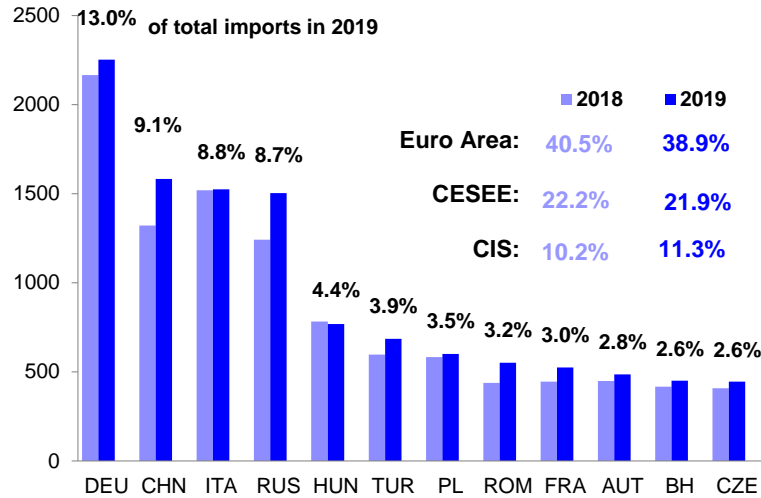


Chart 36 Goods exports by country in 2018/ 2019  
(EUR mn and % of total )

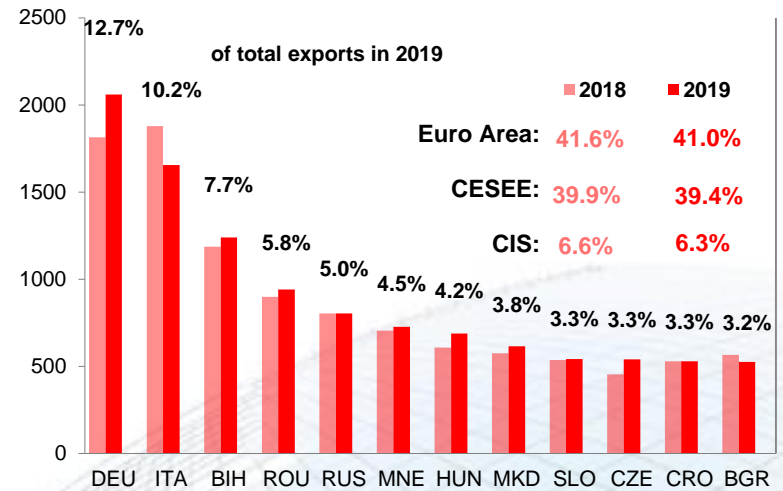
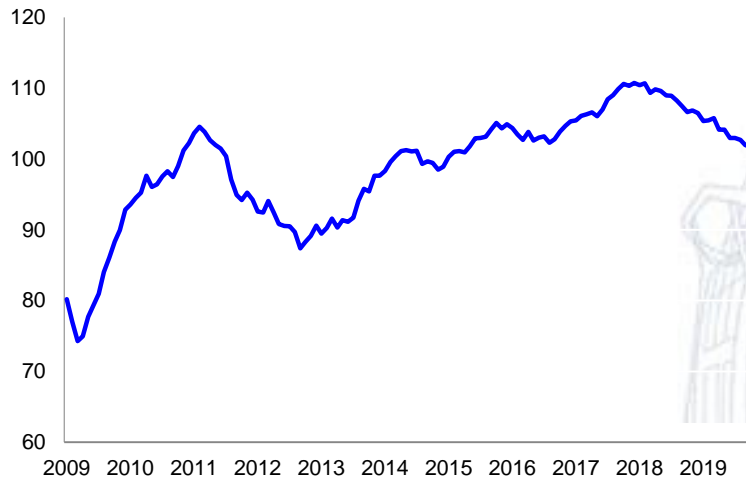


Chart 37 External Demand Indicator  
(long-term average = 100)



Source: European Commission, NBS

Chart 38 Real Effective Exchange Rate Development  
(2005=100)



\*Growth indicates appreciation.

# Legal Framework for Banking Supervision

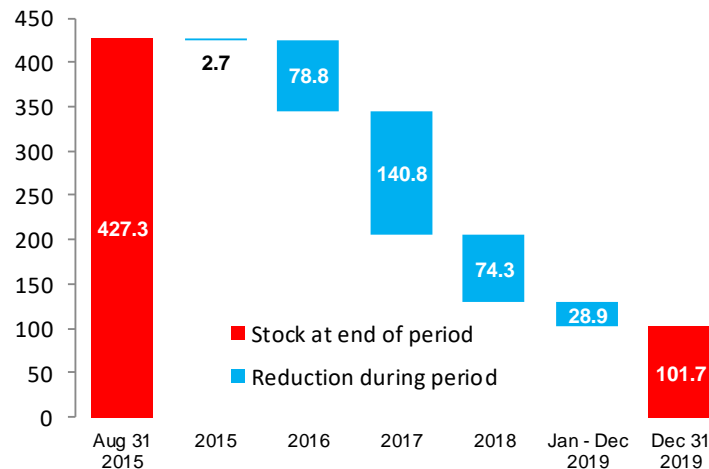
- **Domestic regulatory framework for banking supervision is based on Basel III standards:**
  - ✓ Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
  - ✓ Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
  - ✓ The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks' exposure to liquidity risk, further strengthening of the market discipline and transparency of banks' operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
  - ✓ So far no issues have been identified in the application of Basel III standards;
  - ✓ NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.
  
- In December 2017 **regulation governing risk management by banks was amended** with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).
  
- Accounting and prudential regulations were timely adjusted in order to **enable the implementation of IFRS 9 in banks from 1<sup>st</sup> of January 2018.**
  
- Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.

# The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

## Effect of strategy on NPL stock

Chart 39 Gross NPL

(RSD bn)

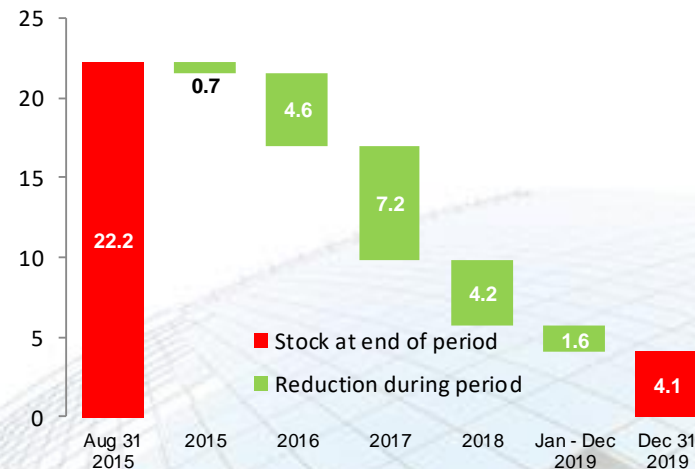


Source: NBS

## Effect of strategy on NPL ratio

Chart 40 NPL Ratio

(in %)



Source: NBS

- Aggregate decrease of NPL level in August 2015 – November 2019 amounts to RSD 325.6 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 4.10% at end-December 2019. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 18.15 p.p.
- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27<sup>th</sup> 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).
- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it's upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.

# Capital Buffers – Implementation of Macroprudential Policy Measures

- Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
- These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
- The following capital buffers are used in the Republic of Serbia:
  - Capital conservation buffer;
  - Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  - Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  - Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
- The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
- Capital buffers apply as of 30 June 2017.

# NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

## NPL data, December 2019

	Gross loans (EUR bn)	Gross NPL (EUR bn)	NPL ratio (%)
Corporates	9.5	0.3	3.4
Natural persons	9.4	0.4	4.0
<i>of which: households</i>	8.5	0.3	3.9
Corporates in bankruptcy proceedings	0.1	0.1	98.3
Other	2.1	0.1	4.8
Total	21.1	0.9	4.1

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017 and 2018, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.
- After 2018 drop in share of NPLs of 4.15 pp, noticeable downward trend continued in 2019, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.
- Fall was widespread and recorded in all sectors, of which most prominent was within construction.
- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

Serbia													*NBS forecast	
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020*	
<b>Real GDP, y-o-y %</b>	5.7	-2.7	0.7	2.0	-0.7	2.9	-1.6	1.8	3.3	2.0	4.4	4,2*	4.0	
<b>Private consumption, in %</b>	4.5	-3.3	-0.6	1.4	-1.7	-1.7	-0.1	-0.3	1.3	1.9	3.1	3,3*	3.6	
<b>Private investment,<sup>1</sup> in %</b>	14.4	-23.6	-7.9	7.5	15.1	-7.7	-5.6	3.5	2.7	10.1	13.6	10,5*	6.2	
<b>Government consumption, in %</b>	3.5	-1.7	0.0	1.6	0.4	-2.1	0.9	-3.8	1.3	3.3	3.7	3,5*	3.5	
<b>Government investment, in %</b>	-16.4	-16.6	0.0	-7.8	7.6	-35.8	13.6	14.0	22.0	-6.4	43.1	31.8	8.0	
<b>Exports, in %</b>	12.6	-11.5	16.9	5.6	2.9	18.0	4.3	9.4	11.9	8.2	8.3	9,9*	10.2	
<b>Imports, in %</b>	10.1	-21.9	-0.1	7.2	-0.6	6.5	5.1	4.0	6.7	11.1	11.6	10,7*	9.6	
<b>Unemployment Rate, in %<sup>4</sup></b>	13.6	16.1	19.2	23.0	23.9	22.1	19.2	17.7	15.3	13.5	12.7	10.6	n/a	
<b>Nominal Wages, in %<sup>5</sup></b>	18.0	9.0	7.6	11.2	9.0	6.2	1.4	-0.2	3.7	3.9	6.5	10.3	n/a	
<b>Money Supply (M3), in %</b>	9.8	21.5	12.9	10.3	9.4	4.6	7.6	6.6	11.6	3.6	14.5	8,5 <sup>6</sup>	7.6	
<b>CPI,<sup>2</sup> in %</b>	8.6	6.6	10.3	7	12.2	2.2	1.7	1.5	1.6	3.0	2.0	1.9	chart 2	
<b>National Bank of Serbia Key Policy Rate,<sup>3</sup> in %</b>	17.8	9.5	11.5	9.8	11.3	9.5	8.0	4.5	4.0	3.5	3.0	2.25	2.25	
<b>Current Account Deficit BPM-6 (% of GDP)</b>	20.0	6.3	6.5	10.3	10.9	5.8	5.6	3.5	2.9	5.2	4.8	6.9	6.2	

<sup>1</sup> Excluding the effect of change in inventories

<sup>2</sup> Inflation figures in the table represent Dec on Dec inflation:  $(Pt/Pt-12)*100-100$

<sup>3</sup> Latest data

<sup>4</sup> Labour Force Survey. Since 2014, data are revised according to the new LFS methodology. Q1-Q3 2019

<sup>5</sup> Since 2017, nominal wages published according to the new methodology. Jan-Nov 2019

<sup>6</sup> Preliminary data



# Banking Sector Overview

Serbia	2010	2011	2012	2013	2014	2015	2016	2017	2018	December 2019
<b>Number of banks<sup>1</sup></b>	33	33	32	30	29	30	31	29	27	26
<b>Employees</b>	29,887	29,228	28,394	26,380	25,106	24,257	23,847	23,055	22,830	23,087
<b>Branches</b>	2,487	2,383	2,243	1,989	1,787	1,730	1,719	1,627	1,598	1,598
<b>HHI Assets</b>	629	664	678	741	794	796	813	813	779	801
<b>Share of foreign banks, %</b>	73.5	74.1	75.2	74.3	74.5	76.1	76.7	76.9	75.4	75.7
<b>Assets (net), EUR m</b>	24,015	25,211	25,322	24,827	24,545	25,059	26,253	28,440	31,931	34,769
<b>Capital, EUR m</b>	4,720	5,104	5,198	5,186	5,074	5,090	5,122	5,631	5,725	6,024
<b>Loans (gross), EUR m</b>	15,324	17,204	17,273	16,140	16,170	16,175	16,442	17,565	19,406	21,110
<b>Of which gross NPL, EUR m</b>	2,592	3,275	3,217	3,448	3,483	3,491	2,800	1,730	1,105	865
<b>Gross NPL ratio, %</b>	16.9	19.0	18.6	21.4	21.5	21.6	17.0	9.8	5.7	4.1
<b>IFRS impairment of NPLs</b>	47.2	51.0	50.0	50.9	54.9	62.3	67.8	58.1	60.2	60.7
<b>Deposits, EUR m</b>	14,263	14,584	14,936	15,067	15,637	16,523	18,242	19,926	23,115	25,197
<b>Pretax Income<sup>2</sup>, EUR m</b>	241.0	12.0	102.5	-18.0	29.0	80.0	172.0	579.8	640.6	574.5
<b>CAR<sup>3</sup>, %</b>	19.9	19.1	19.9	20.9	20.0	20.9	21.8	22.6	22.3	23.6
<b>CET1 ratio %<sup>3,4</sup></b>	-	-	-	-	-	-	-	21.5	21.1	22.5
<b>Leverage%<sup>3,4</sup></b>	-	-	-	-	-	-	-	11.1	12.6	13.7
<b>Liquidity ratio</b>	1.0	2.2	2.1	2.4	2.2	2.1	2.1	2.0	2.0	2.2
<b>Liquidity coverage ratio<sup>4</sup>, %</b>	-	-	-	-	-	-	-	239.5	213.3	199.7
<b>FX ratio, %</b>	3.9	6.2	5.5	4.4	3.9	4.4	2.7	2.9	4.5	1.6
<b>ROA<sup>2</sup>, %</b>	1.1	0.0	0.4	-0.1	0.1	0.3	0.7	2.1	2.1	1.7
<b>ROE<sup>2</sup>, %</b>	5.4	0.2	2.0	-0.4	0.6	1.6	3.4	10.6	11.3	9.8
<b>Net interest margin<sup>5</sup>, %</b>	4.6	4.6	4.3	4.2	4.3	4.3	3.9	3.7	3.6	3.3

<sup>1</sup> The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodine on 6 April 2013, from Privredna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK bank on 23 December, 2017. Preaus bank was merged to Direktna bank on 26 October, 2018. Vojvođanska bank was merged to OTP bank 25. April 2019 (consolidated under Vojvođanska brand).

<sup>2</sup> Without Agrobanka at the end of 2011: Pretax profit € 296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit € 230m; ROA 1.0; ROE 4.7

<sup>3</sup> The last available data of 30.09.2019

<sup>4</sup> Introduced by the implementation of Basel 3 and monitored from 30 June 2017

<sup>5</sup> Net interest margin to average total asset