NATIONAL BANK OF SERBIA

Speech at the presentation of the Annual Financial Stability Report for 2018

Dr Jorgovanka Tabaković, Governor

Belgrade, 31 July 2019

Ladies and gentlemen, esteemed members of the press, dear colleagues,

Welcome to the presentation of the Annual Financial Stability Report for 2018. Before you is a report for the year in which Serbia achieved the highest growth rate in the last ten years, maintained low and stable inflation and additionally strengthened the domestic financial system. The year in which long-term investment in our country increased and the share of public debt in GDP contracted further. I have to say that such results were achieved in the face of challenges from the international environment we have all been witnesses to – such as global protectionism, geopolitical tensions, or uncertainties surrounding the UK's exit from the European Union.

The Financial Stability Report starts with the ever important conditions in the international environment, because they have a significant bearing on the conditions at home too. At the global level, 2018 was marked by an economic slowdown experienced in the second half of the year by advanced and, consequently, emerging economies. This put an upward pressure on the risk premia of countries in the region and prompted revisions to the growth outlook. Trade tensions between major world economies also fuelled uncertainty in international commodity and financial markets. In such an environment, the pace of normalisation of monetary policies of leading central banks, the European Central Bank and Federal Reserve System, was uncertain.

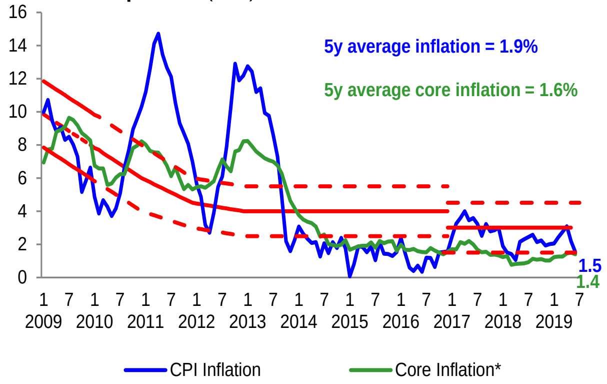
What is the best response of policy makers to growing uncertainties in the external environment? The best, and in fact the only response, is to strengthen the domestic economy. In coordination with other economic policy makers, the National Bank of Serbia has worked continuously towards further narrowing of internal and external imbalances. More stable conditions of doing business reflected in price and financial stability, sound public finance and better prospects were also "sealed" by the *Standard & Poor's* upgrade of Serbia's outlook from "stable" to "positive". As the reasons for its decision, the rating agency cited the country's strong economic growth, as well as the results of the National Bank of Serbia in maintaining price and financial stability.

- ***We have kept inflation under control for six consecutive years.***

Over the past six years inflation in Serbia has been kept firmly under control. Inflation averaged around 2% in 2018, while medium-term inflation expectations of the financial and corporate sectors remained anchored.

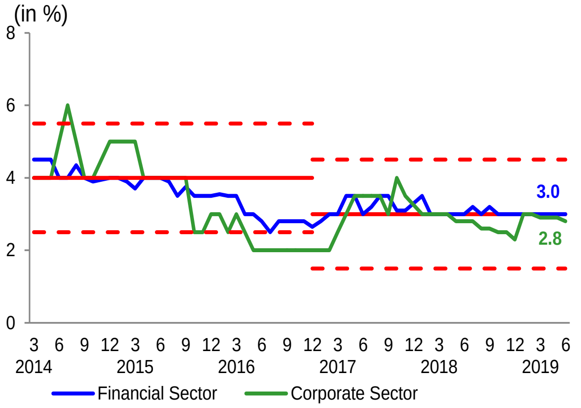
Against the background of low inflationary pressures, but also risks from the international environment, we maintained a cautious monetary policy stance and lowered our key policy rate in two 25 bp steps to the level of 3%. This way, we continued to support economic growth that reached 4.3% last year. **In July this year, we trimmed the key policy rate by another 25 bp, to 2.75%, which is its lowest level in the inflation targeting regime yet.** We expect that this impulse will soon pass through to all segments of the market, thereby extending our support to economic growth going forward.

CPI developments (in %)



*CPI excl. Food, Energy, Alcohol and Tobacco
Source: SORS, NBS and NBS caluculation.

Two year ahead inflation expectations (in %)



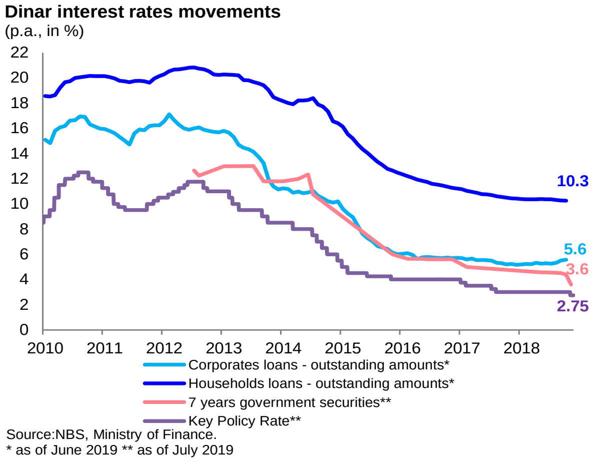
Surce: Ipsos/Ninamedia and NBS.

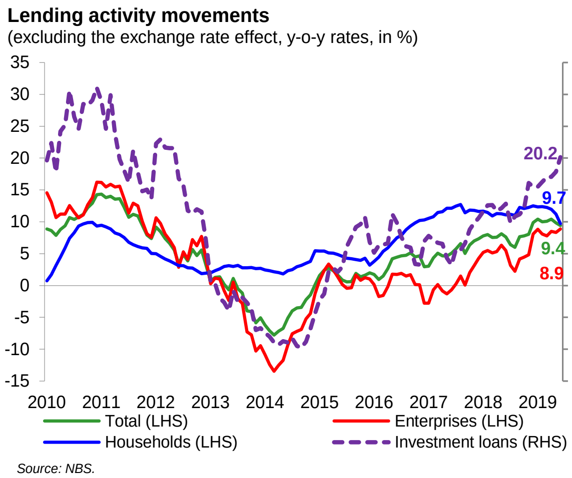
❖ ***The cost of financing declined, while disposable income of corporates and households increased.***

Continued monetary policy easing contributed to a further reduction in the cost of financing for households and corporates, as well as for the government. This is evident from the fact that compared to May 2013 when we embarked on a monetary policy easing cycle, **interest rates on dinar loans for households are now twice lower,** while those for **corporates are even three times lower.** In the case of the government, an evident example is that of **seven-year dinar securities** where the interest rate fell **from 13% at end-2013 to 3.59% this July**. **And this is exactly where the effect of full coordination of our policies and the progress Serbia made on the macroeconomic front is best seen.**

Considerably lower interest rates and the consequently higher disposable income, as well as economic growth accompanied with a rise in wages and the lowest unemployment rate, were the key drivers of lending activity. The y-o-y growth in loans to the private sector was almost two-digit in 2018, measuring 9.9%, and the loan structure was favourable. **In 2018 alone,**

over RSD 240 bn worth of new investment loans was disbursed, which is the highest level so far. This supported the profitability of corporates, which has been on a constant rise since 2015. **The corporate sector** ended **2018 with a net profit of RSD 500 bn**, which is **by RSD 126 bn or by one third more than the year before**. If we look at company size, we will see that profitability was in the positive zone in all categories – from micro to large enterprises.





Positive fiscal trends extended into 2018 – Serbia recorded a fiscal surplus of around 0.6% of GDP. The share of public debt in GDP dropped by 4.1 pp y-o-y to 53.8% in 2018, and went further down to 51.8% in May 2019.

In the context of financial stability, particularly important is the **reduction in the dollar share of public debt** in the previous two and a half years, **from around one third to around one fifth** of total public debt in June this year.

Also, the country's external position is sustainable. For four years in a row the current account deficit was fully covered by the inflow of foreign direct investment, which in 2018 reached EUR 3.5 bn or 8.2% of GDP. Full coverage of the current account deficit continues in 2019.

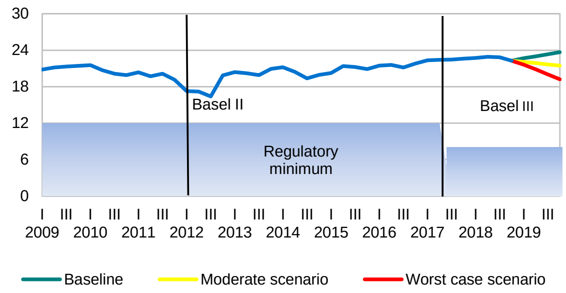
❖ ***We have preserved financial stability.***

In such an environment, appreciation pressures prevailed in 2018 as well. The dinar strengthened against the euro owing to good macroeconomic indicators, greater interest in long-term investment in Serbia and rising exports of goods and services. To prevent excessive short-term volatility of the dinar exchange rate, we intervened in the interbank foreign exchange market on both sides – by buying and selling foreign currency. We bought EUR 1.58 bn net. This also gave an additional boost to the country's FX reserves which at end-

December 2018 came at EUR 11.3 bn. **At end-June this year, FX reserves** reached **EUR 12.1 bn in gross terms**, or **over EUR 10 bn in net terms**, which is **the highest level** on record. Such a high level of FX reserves **ensures security not only in conditions of stability, but also in case of potential external shocks.**

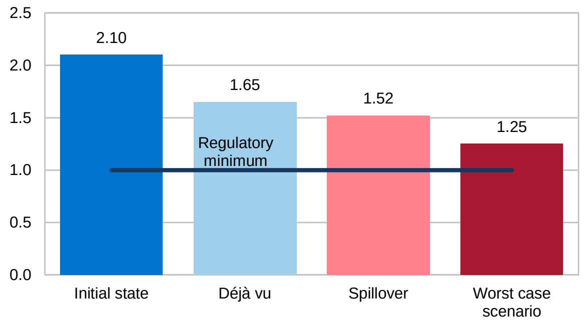
Serbia's banking sector was adequately capitalised, highly liquid and profitable throughout 2018 as well, with indicators standing high above the regulatory minimums. The dominant role among the sources of funding was that of domestic deposits, which reduces banks' dependence on external sources of funding and their exposure to risks from the international environment. In addition, the results of macroprudential stress tests, which we continued to regularly conduct in 2018, confirm that banking sector capitalisation and liquidity would not be jeopardised even in case of extremely negative developments.

Expected capital adequacy ratio by stress scenario*
(%)



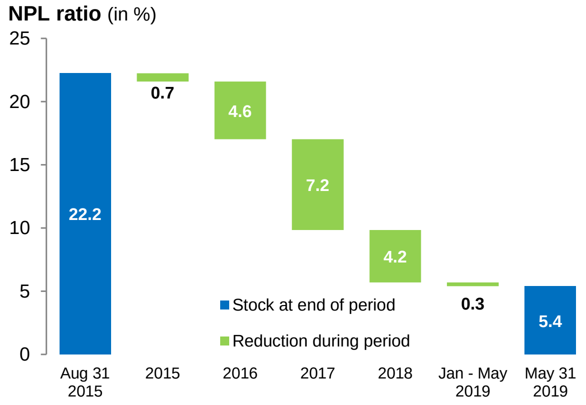
* NBS estimation.
Source: NBS.

Expected liquidity ratio for the banking sector by stress scenario*

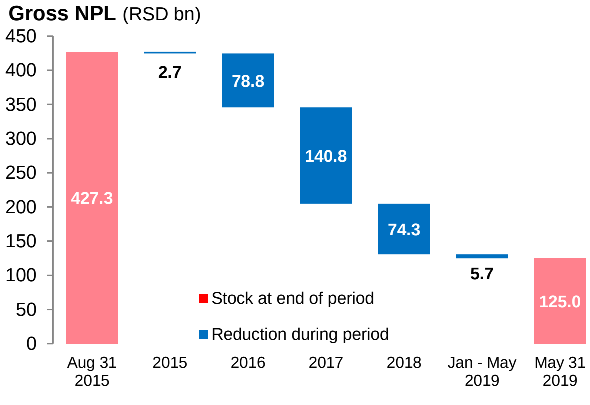


* NBS estimation.
Source: NBS.

At our previous presentations of the Annual Financial Stability Report, we underscored the share of non-performing loans as a systemic risk. **This is also how we tackled the issue – in a systemic way**. As a result, the share of non-performing loans in total banking sector loans was lowered to 5.7% at end-2018 and to 5.21% in June this year. The ratio of non-performing loans is smaller by around 17 pp and their stock by around 70% compared to the period when the Serbian Government and the National Bank of Serbia adopted the NPL Resolution Strategy. At the same time, the current ratio of non-performing loans is the lowest on record. Being proactive, last year we also adopted regulatory measures to curb risks potentially arising from unsecured non-purpose lending to households at unreasonably long maturities.

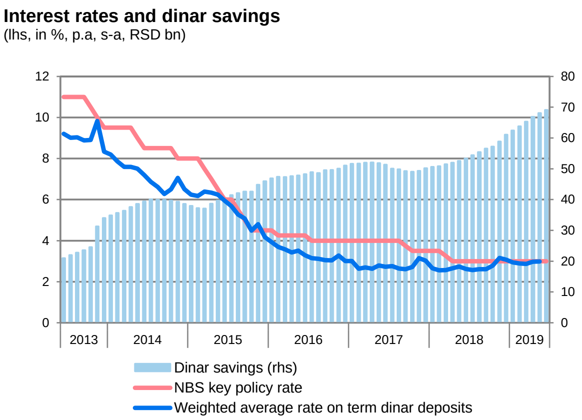


Source: NBS.

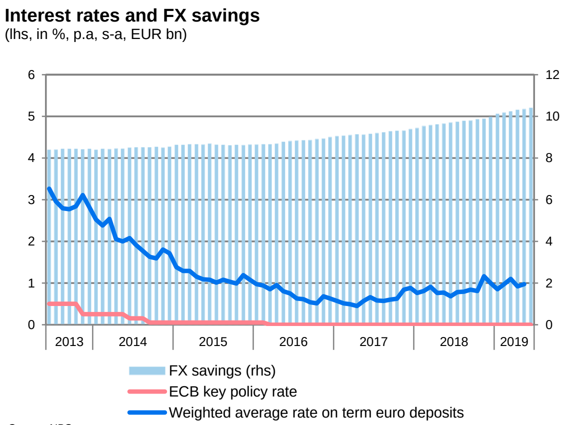


Source: NBS.

Late last year, we signed with the Serbian Government the new Memorandum on the Dinarisation Strategy, outlining additional measures and activities which aim to encourage further dinarisation and reduce FX risk in the financial system. We are particularly happy about the **rise in dinar savings**, which are today **almost four times higher than at end-2012, exceeding RSD 70 bn in July this year. This truly reflects citizens' increased trust in the domestic currency**.



Source: NBS.



Source NBS.

❖ ***In following the latest trends, we strive to meet consumer needs.***

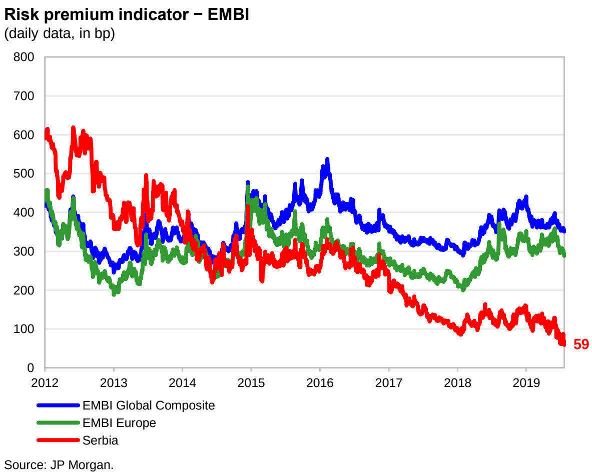
Last year as well, we showed that besides being traditional, we always support the development of cutting-edge technologies, while ensuring safety and protecting financial service consumers. In this regard, one of the key projects of the National Bank of Serbia in 2018 was the launch of the instant payments system in the Republic of Serbia. The system is an important step towards the digitalisation of payment services, enabling instant payments 24 hours a day, seven days a week, 365 days a year.

Ladies and gentlemen, esteemed members of the press, dear colleagues,

Low and stable inflation, a cautious monetary policy stance, a stable banking system and favourable fiscal trends have provided a positive contribution to maintaining and strengthening the resilience of the domestic financial system and macroeconomic stability of the country in 2018 as well.

Despite all challenges from the international environment, which were not few, last year saw the lowest unemployment rate on record and an increase in employment and wages, which shows that sound economic policy was pursued in Serbia and that the resilience of the domestic economy to potential risks was strengthened.

By consistent implementation of monetary policy and full coordination with fiscal policy, the National Bank of Serbia significantly contributed to the country's solid economic performance, which strengthened the basis for sustainable growth. **We are therefore able to talk today about the lowest risk premium, which in July, for the first time since records are available for our country, fell below 60 bp**.



Thank you for your attention. Please allow me now to pass the floor to General Manager of the Financial Stability Department Mr Darko Kovačević.