



Народна банка Србије

Stability as Imperative of Sustainable Growth

– learn from the past, commit to the future

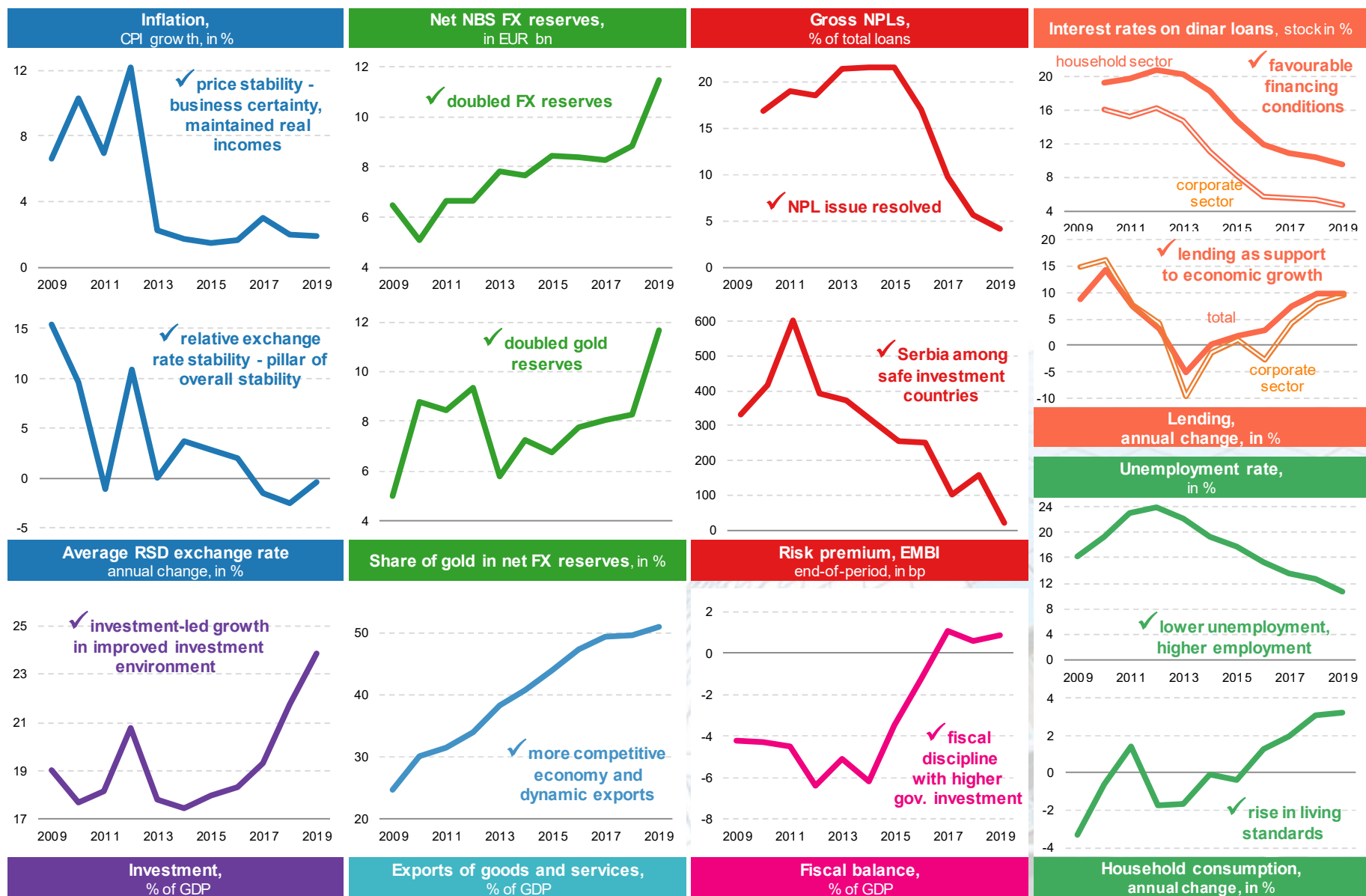
Dr Jorgovanka Tabaković,
Governor of the National Bank of Serbia

Kopaonik Business Forum, March 2020



Narodna banka Srbije

We adopted and implemented many measures strengthening our economy

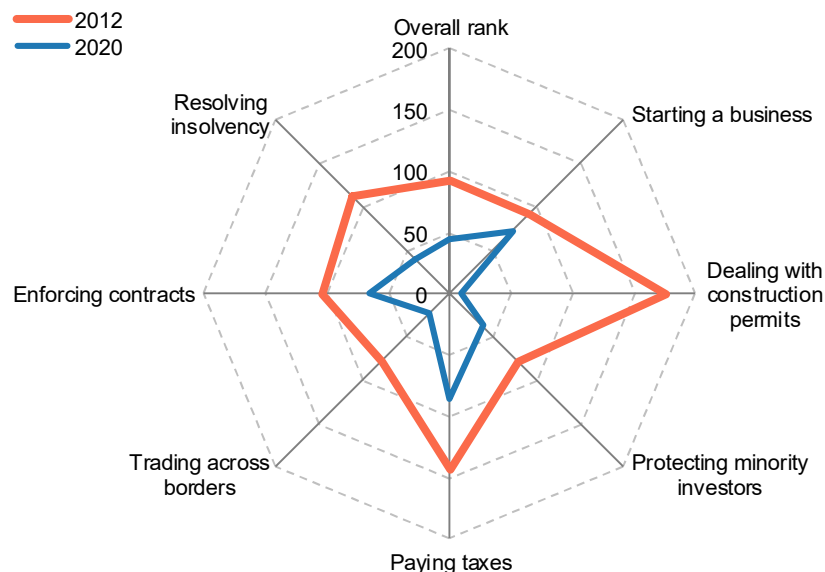




Narodna banka Srbije

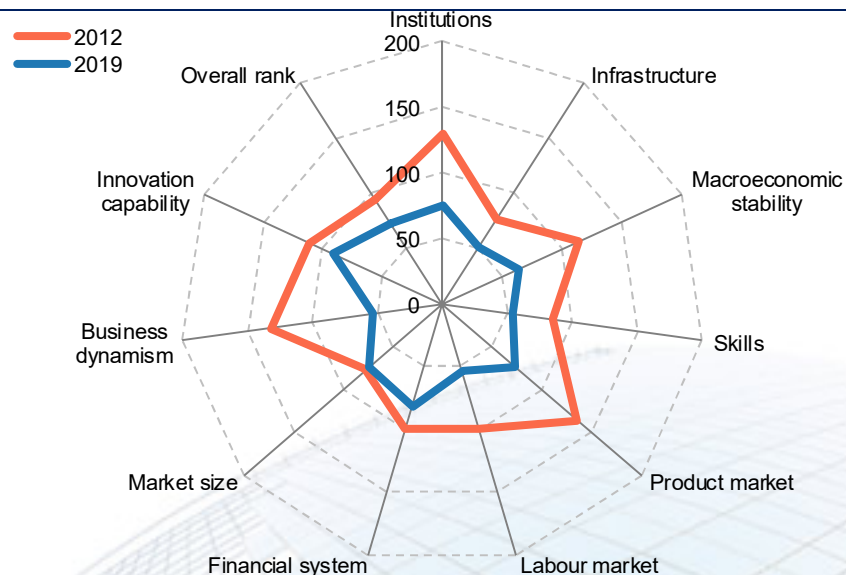
Structural competitiveness has been enhanced

Business environment indicators according to Doing Business list
(ranking, lower ranking indicates improvement)



Source: World Bank, Doing Business Report.

Business environment indicators according to WEF
(ranking, lower ranking indicates improvement)



Source: World Economic Forum.

– A number of reform areas:

- ☐ labour market,
- ☐ financial sector,
- ☐ construction sector,
- ☐ tax administration,
- ☐ contract implementation and bankruptcy proceedings ...

... accompanied with robust growth in the number of issued construction permits, rise in private sector employment by around 20%, increase in the share of tax revenues in GDP, improved efficiency of VAT collection (c-efficiency), sharp fall in NPL ratio by around 80%...

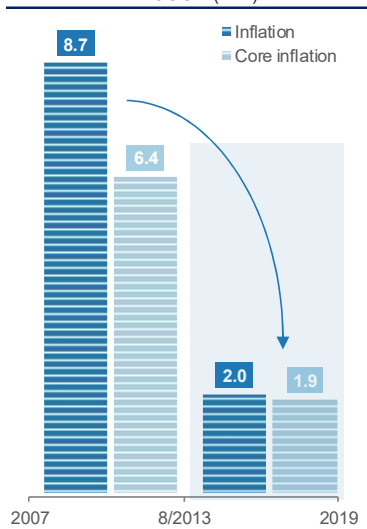
❖ *The economy's structural competitiveness has been enhanced, macroeconomic environment improved, infrastructure is better, institutions are stronger ...*

❖ *A lot has been done, and reforms will continue in the period ahead.*

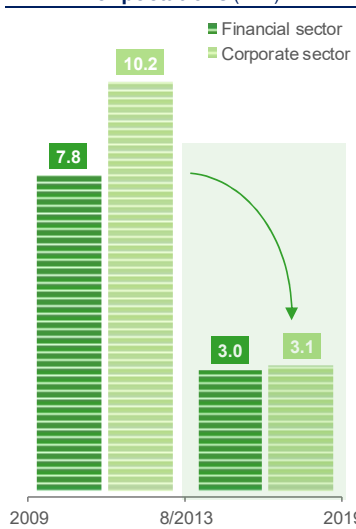
NBS results are one of the pillars of stability of the overall business environment



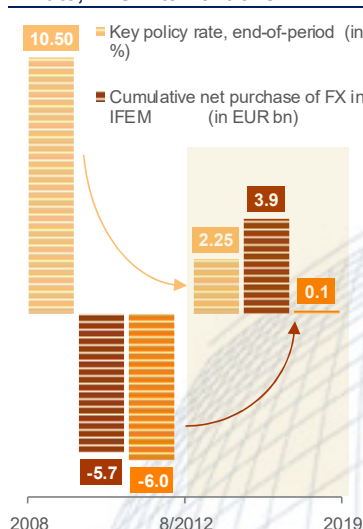
Average annual inflation and core inflation (in %)



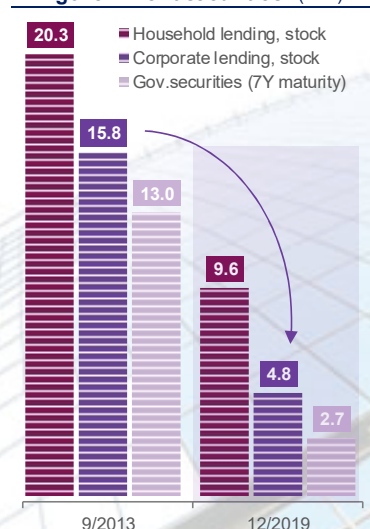
Average annual inflation expectations (in %)



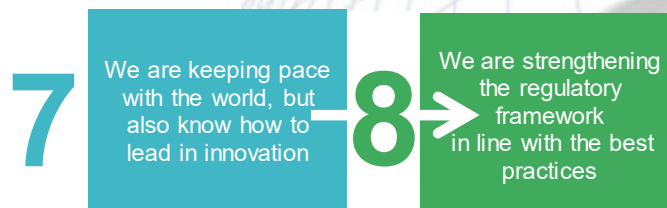
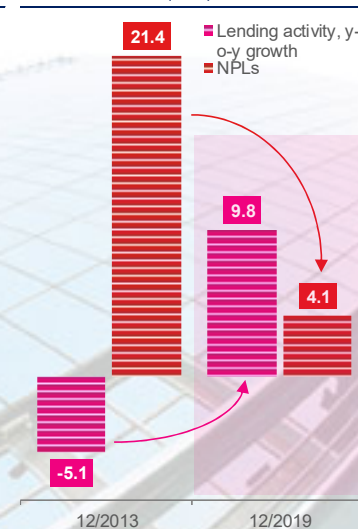
Key policy rate, RSD exchange rate, NBS interventions in IFEM



Interest rates on dinar loans and government securities (in %)



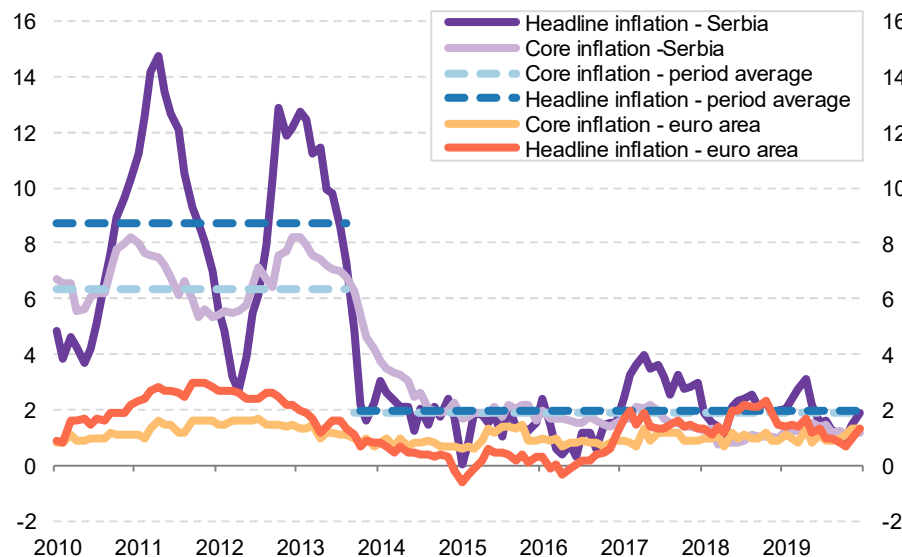
Lending activity and NPLs (in %)



The NBS is keeping inflation low and stable for the seventh year in a row

Inflation in Serbia and euro area

(y-o-y rates, in %)

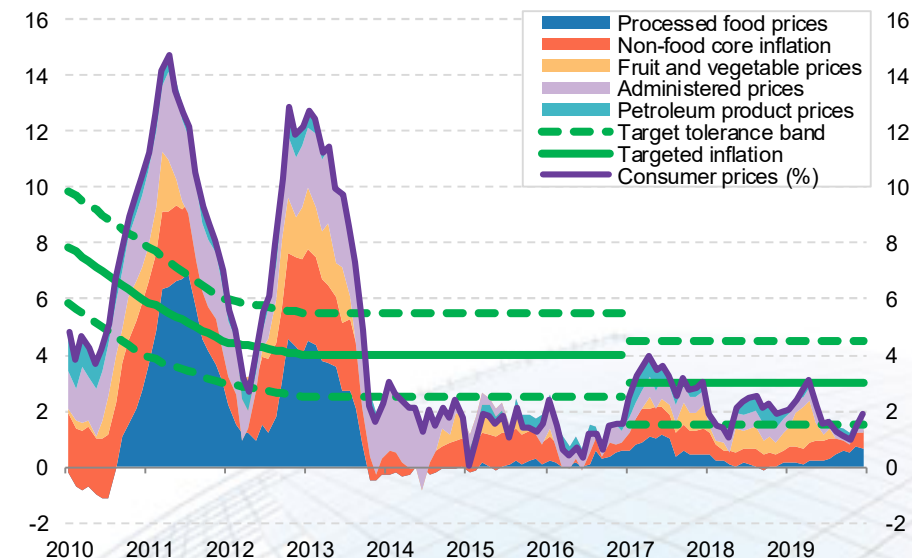


Source: SORS and NBS calculation.

- Significant dinar depreciation often resulted in two-digit inflation. The exchange rate volatility translated into inflation volatility.
- Since October 2013, headline and core inflation in Serbia have averaged around 2%, which is one of the key pillars of macroeconomic stability.
- *Inflationary pressures have been curbed on a durable basis, and for the first time inflation in Serbia is comparable to that in advanced economies.*

Contribution of CPI components to y-o-y inflation

(in pp)



Source: SORS and NBS calculation.

- In 2019 as well, the NBS kept inflation at a low level - 1.9% on average.
- When it comes to the volatile components of headline inflation, the pace of y-o-y inflation in 2019 was determined by the prices of unprocessed food (primarily vegetables) and the prices of petroleum products.
- Low inflationary pressures are also indicated by core inflation that averaged 1.3% in 2019.

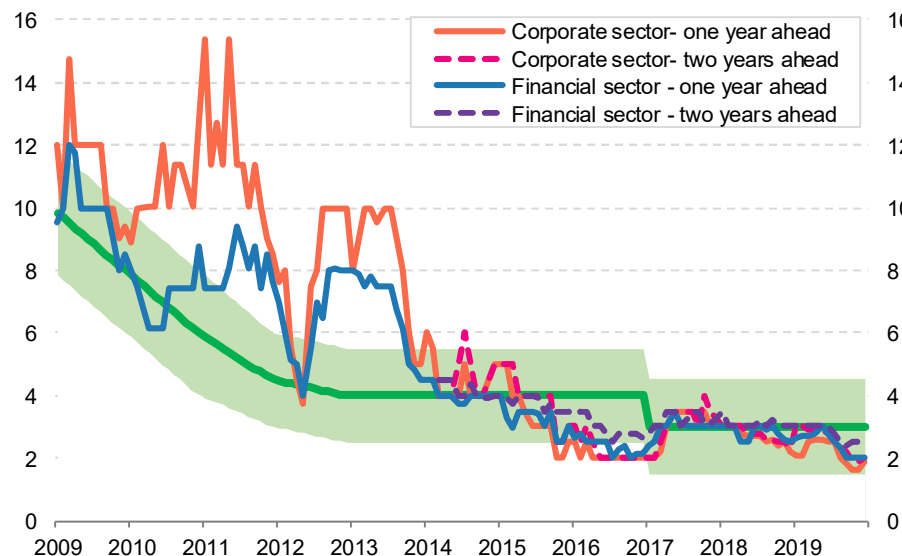


Narodna banka Srbije

Price stability is buttressed by the anchored inflation expectations ...

Anchored inflation expectations

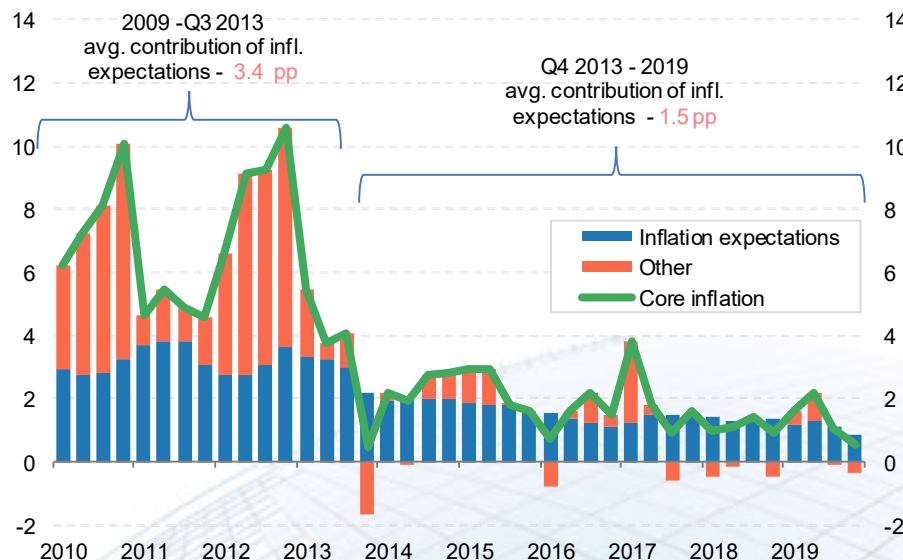
(y-o-y rates, in %)



Sources: Gallup, Ninamedia and Ipsos

Core inflation decomposition by factor

(in pp)



Source: NBS estimate.

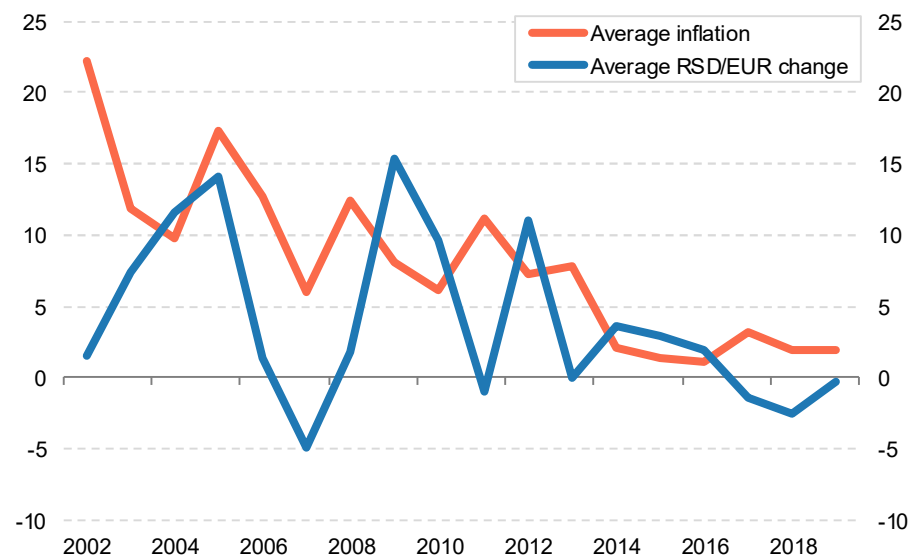
- Price stability is one of the key indicators of the achieved macroeconomic stability.
- The achievement and preservation of price stability has anchored inflation expectations of corporates and banks, which have moved within the target tolerance band since 2014.
- *Anchored inflation expectations are one of the important factors of bringing inflation down to the desired level.*



- The achieved and preserved low inflation underlies the anchoring of expectations ⇔ anchored expectations facilitate the maintenance of low inflation.
- Keeping inflation expectations within the target tolerance band boosts the credibility of the NBS and paints the picture of economic agents' trust in the measures we take.
- Anchored inflation expectations boost the resilience of the domestic economy to shocks from the international environment.

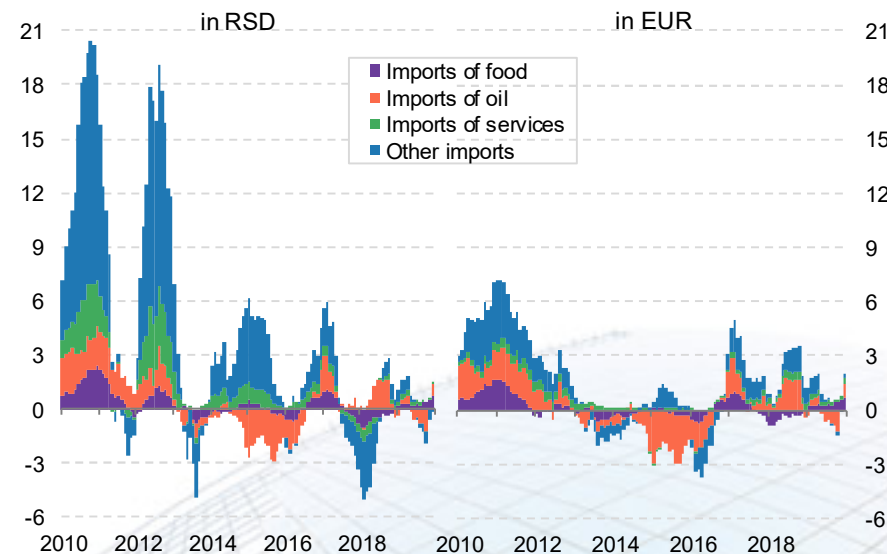
... and relative stability of the exchange rate of the dinar against the euro

Reduced exchange rate and inflation volatility
(growth rates in %)



Sources: SORS and NBS.

Contribution of individual components to the y-o-y growth in import prices (in pp)



Sources: Destatis, FAO, Bloomberg, Eurostat, SORS and NBS calculation.

– In conditions of the inherited relatively high euroisation and high pass-through effect of the exchange rate on prices, putting inflation under control would not have been possible without the stabilisation of movements in the FX market.

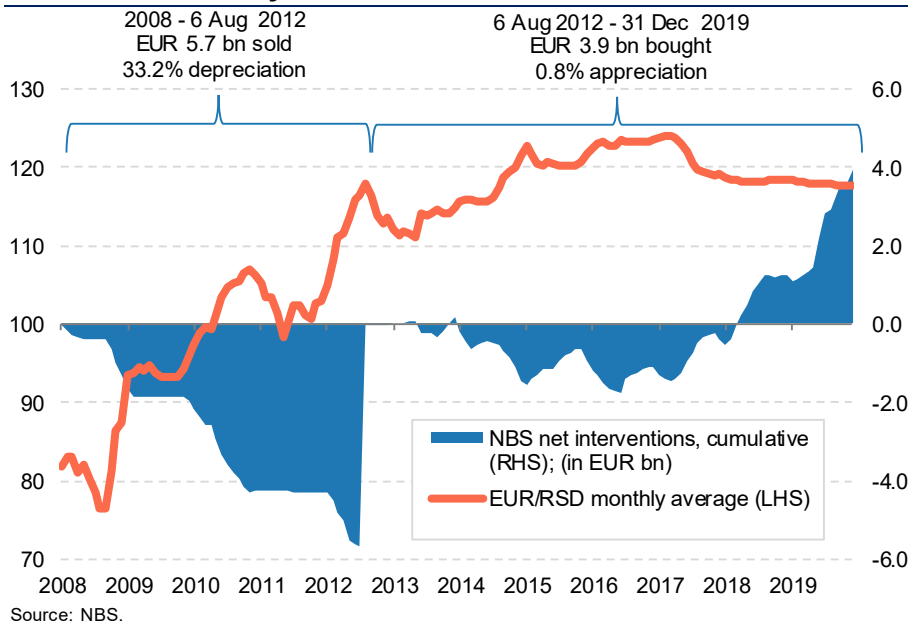


– The impact of volatile global prices of primary commodities on inflation at home in the period before 2012 was intensified by the effects of significant dinar depreciation, resulting in high and volatile inflation rates.

– *Relative stability of the dinar exchange rate since 2013 reduced the volatility of import inflation, and thus its impact on the domestic inflation and inflation expectations.*

We respond to short-term external shocks without affecting the exchange rate

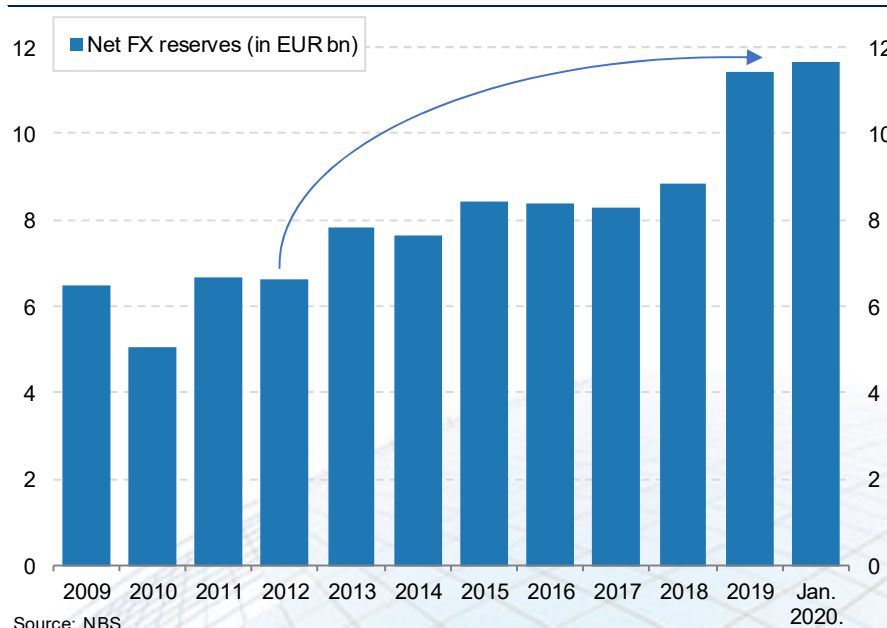
Maintained stability of the FX market



– FX market interventions in case of short-term external shocks do not affect the exchange rate trend:

- from August 2012 until end-2019 we net purchased EUR 3.9 bn, with the dinar nominally appreciating 0.8%;
- in the period before that, the dinar lost 33.2% despite the sale of EUR 5.7 bn.
- Without NBS interventions (purchase of foreign currency) from April 2017, the dinar would have appreciated more significantly in real terms.

Increased FX reserves as a guarantee of stability



– Net FX reserves almost doubled from 2012.

- *Gross and net FX reserves of the NBS (EUR 13.7 bn and EUR 11.64 bn at end-January 2020) reached new peaks, since 2000 when we started monitoring the data in this way.*
- J.P. Morgan assessed the Serbian dinar as realistically valued, neither undervalued nor overvalued. The assessment is based on the model taking into account the real effective exchange rate, productivity, terms of trade, interest rate differences, indicators of external and fiscal balance ...

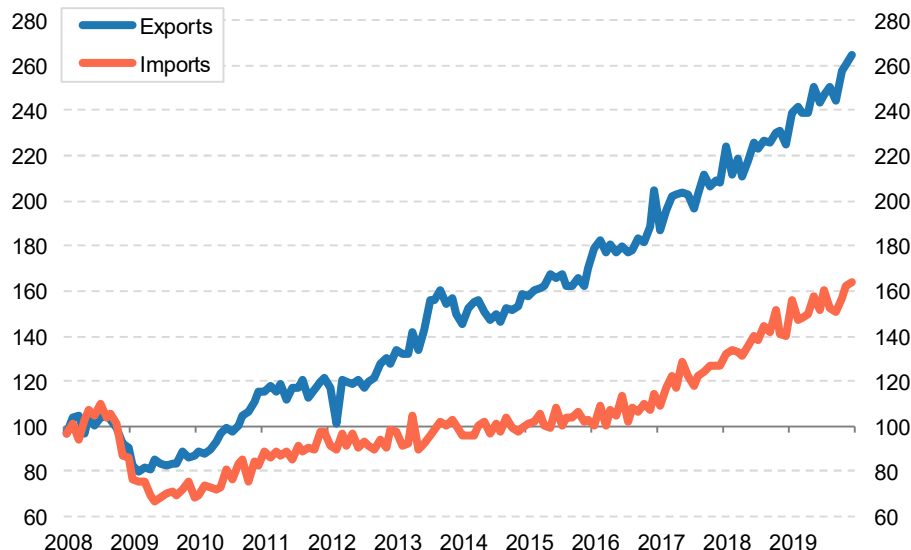


Narodna banka Srbije

FX market stability ⇔ predictability of business and investment climate ...

Trade in goods and services

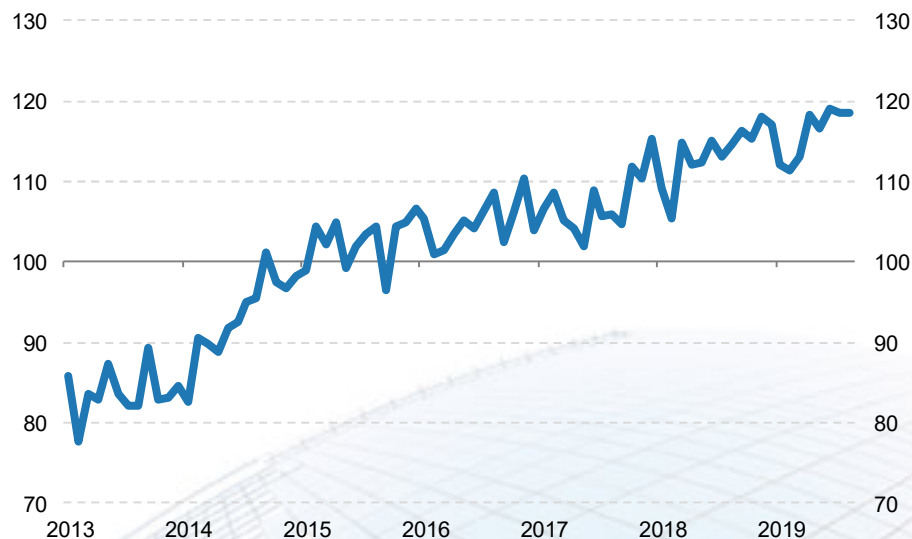
(s-a data, 2008 = 100)



Source: SORS and NBS calculation.

Economic Sentiment Indicator for Serbia

(index, long-term average = 100)



Source: European Commission.

Note: Above 100 index values indicate above-average expectations.

– By contributing to the predictability of the business climate, the relative stability of the exchange rate boosts investments, which are dominantly oriented towards tradable sectors, which in turn leads to a rise in export inflows and FX market stabilisation.

– Positive effects of the preserved stability in the FX market are best illustrated by data. In 2019 compared to 2012:

- the export of goods and services/GDP rose from 34% to 51%;
- export/import of goods and services increased from 67% to 84%.

– Economic Sentiment Indicator for Serbia (ESI) produced by the European Commission also confirms continuous improvement of corporate expectations and economic environment in Serbia in general as of 2014.

- In the period from 2013, the export of goods and services has been rising at the average rate of about 11% annually.



Narodna banka Srbije

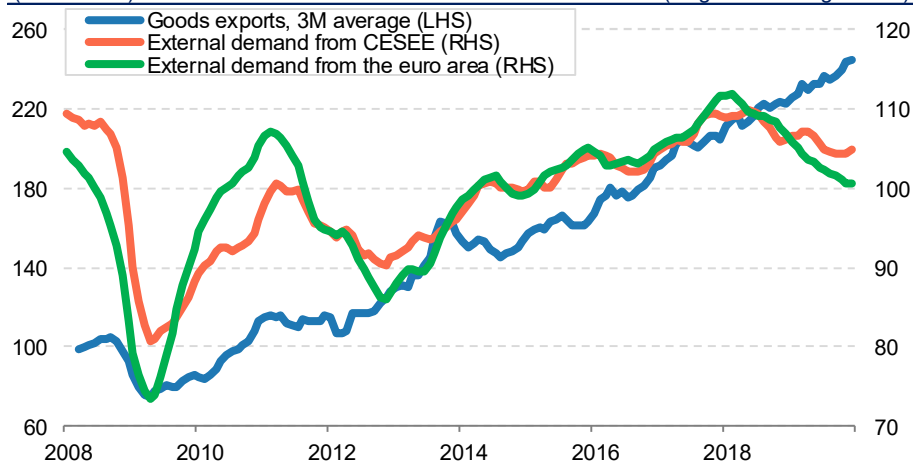
...underpin Serbia's robust exports ...

Indicator of external demand for Serbian exports

(quarterly moving average s-a)

(2008 = 100)

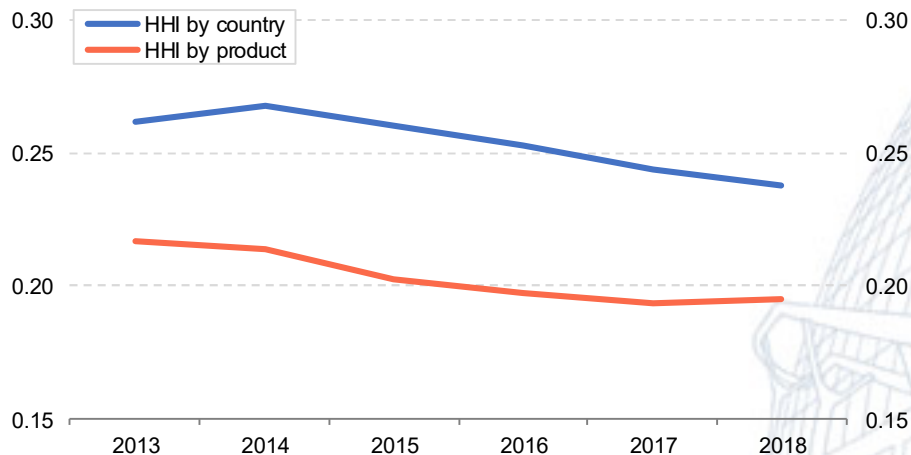
(long-term average = 100)



Sources: European Commission, SORS and NBS.

Indicator of exports concentration

(Herfindahl-Hirschman Index, HHI*)

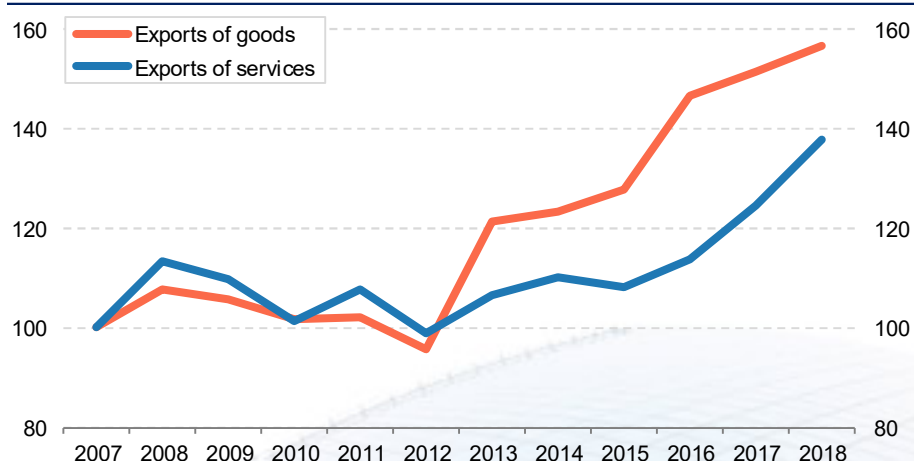


Source: SORS and NBS calculation.

* The lower the index, the lesser the concentration of country exports.

Share of Serbian exports in the global market

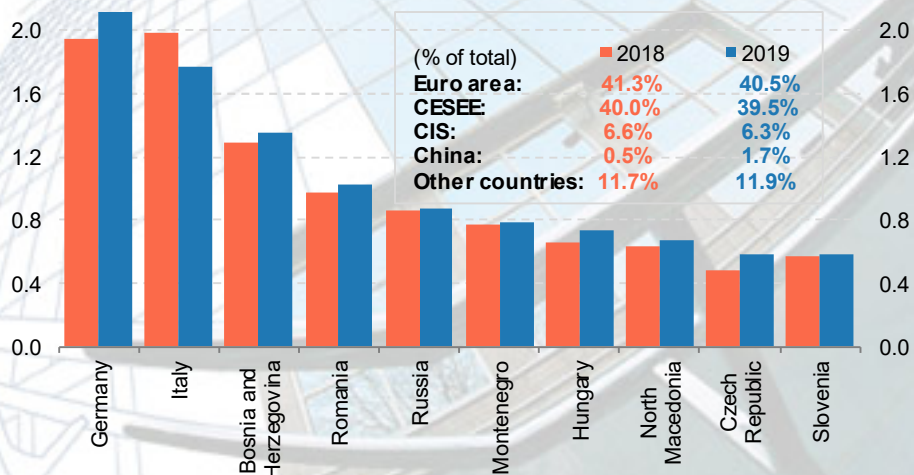
(index, 2007 = 100)



Source: International Trade Centre.

Serbia's top ten export markets

(in EUR bn)



Source: SORS.

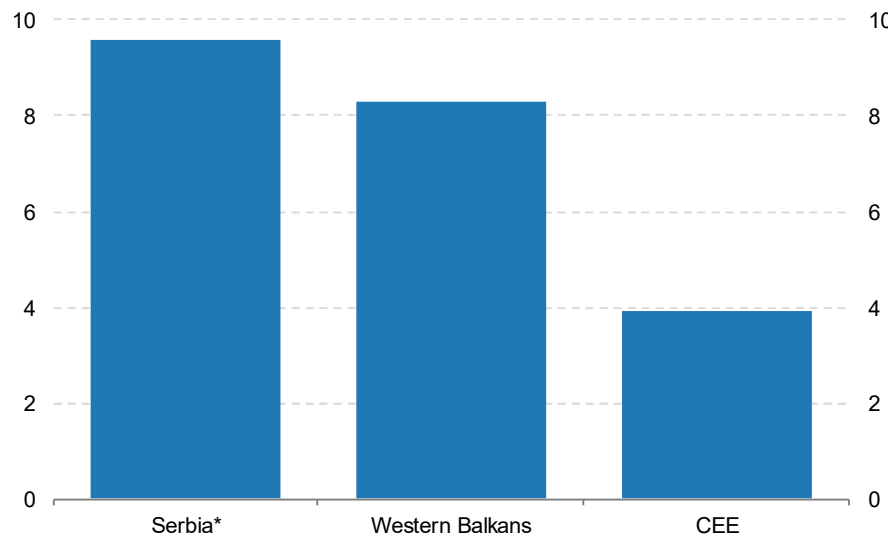


Narodna banka Srbije

... accelerating their growth in 2019 compared to 2018 despite slackened global demand

Real growth in goods and services exports, Q1-Q3 2019

(in %)

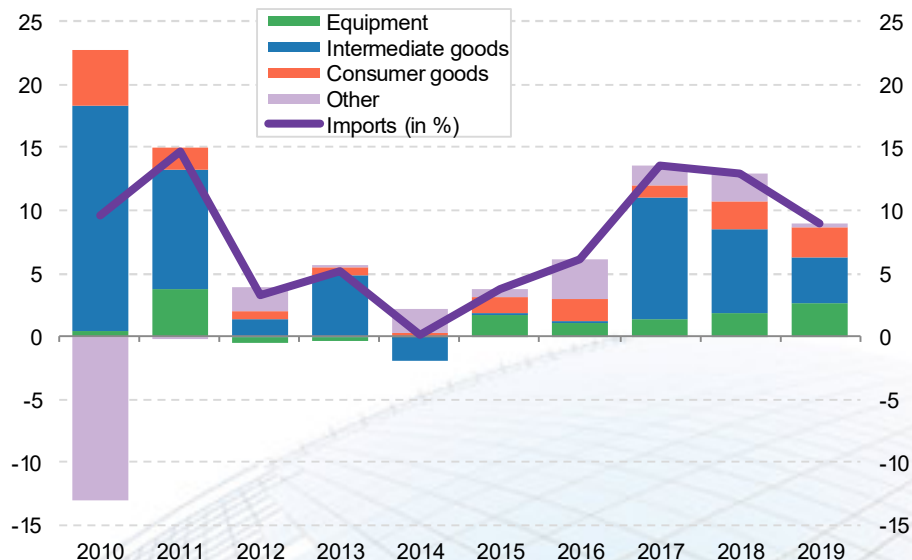


Source: Eurostat.

* Data for Serbia for 2019 covers nine months.

Movement of key import components

(contributions to y-o-y growth, in pp)



Source: SORS and NBS calculation.

– Despite the euro area slowdown, the export of goods and services of Serbia accelerated in 2019 compared to 2018.

– Exports acceleration resulted from the activation of new investments, and from product and geographic diversification of exports. In addition to exports to euro area, exports to Central European countries, China, USA, UK, Turkey and other countries also recorded a rise.

– *Expansion of export capacities and diversification are expected to bring exports share to 60% of GDP in the next few years.*

– Imports are also increasing, in line with the investment cycle and higher import of intermediate goods and equipment on that account (around three quarters of the rise in imports is attributable to these two categories), while the import of consumer goods rises in line with the rising living standard.

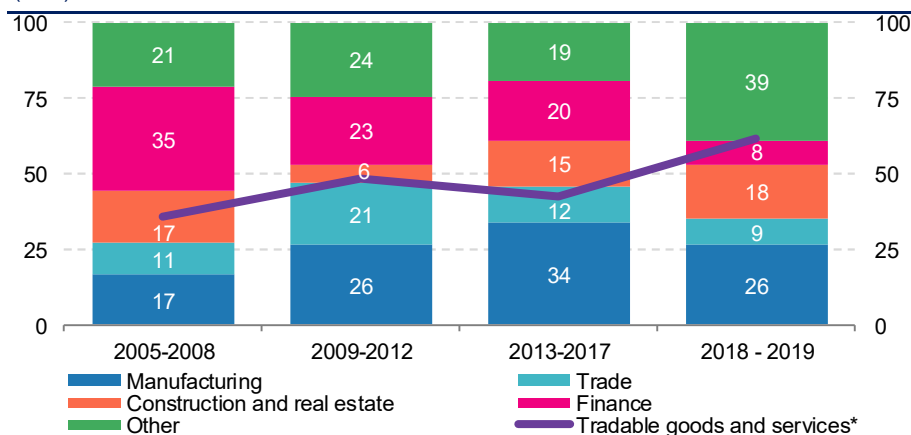


Narodna banka Srbije

The rise in exports is supported by diversified FDIs in export-oriented sectors

FDI by sector

(in %)



Source: NBS

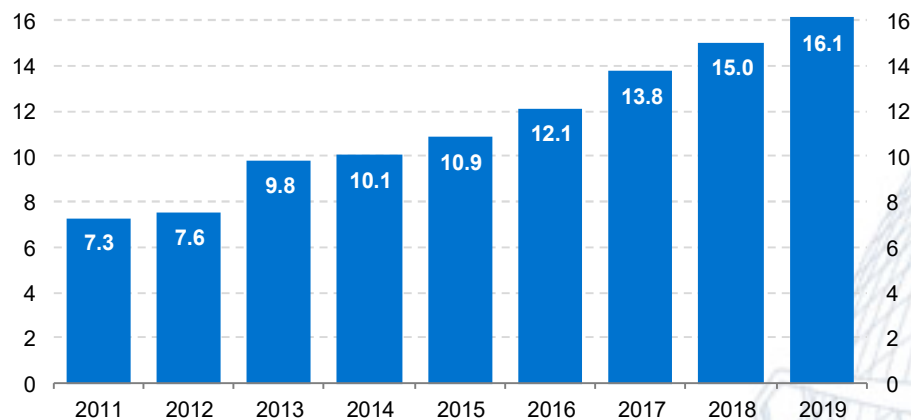
* Agriculture, industry, mining, transport, catering.

- FDI's are oriented to tradable sectors, stimulating and expanding the export base.

- Financing relies on stable long-term sources, with the coverage of the current account deficit with net FDI inflows of around 140% for 5 years.

Manufacturing exports

(in EUR bn)

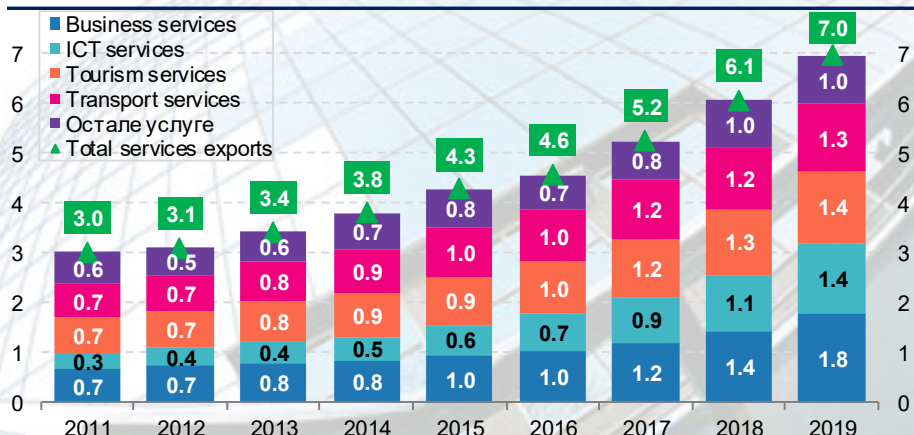


Source: SORS.

- In 2019 manufacturing exports more than doubled compared to 2012, and increased by 60% compared to 2014.

Services exports

(in EUR bn)



Source: NBS.

- In 2019 the export of services reached EUR 7.0 bn. The largest contribution came from ICT and business services, with tourist and transport services also recording robust growth.

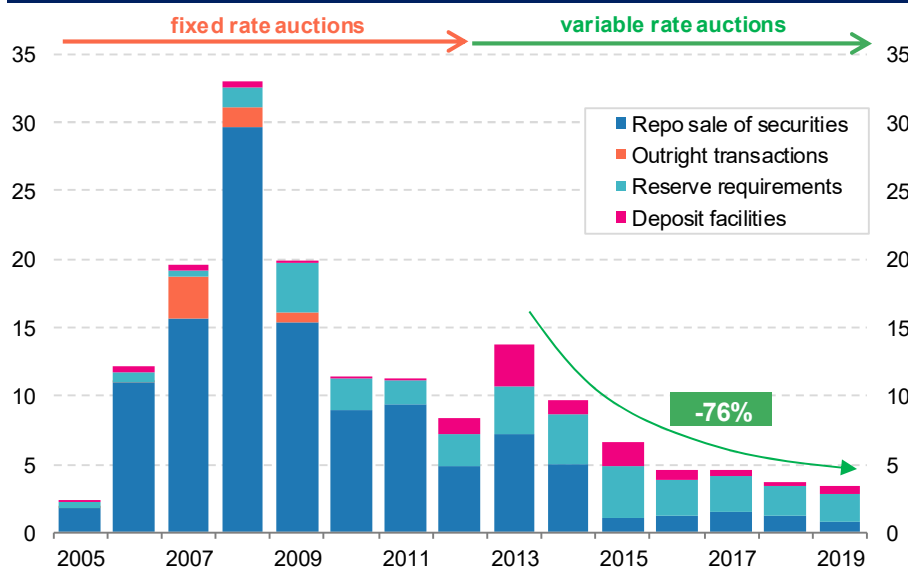


Narodna banka Srbije

We changed the approach to monetary policy conduct

Monetary operation expenses by year

(in RSD bn)

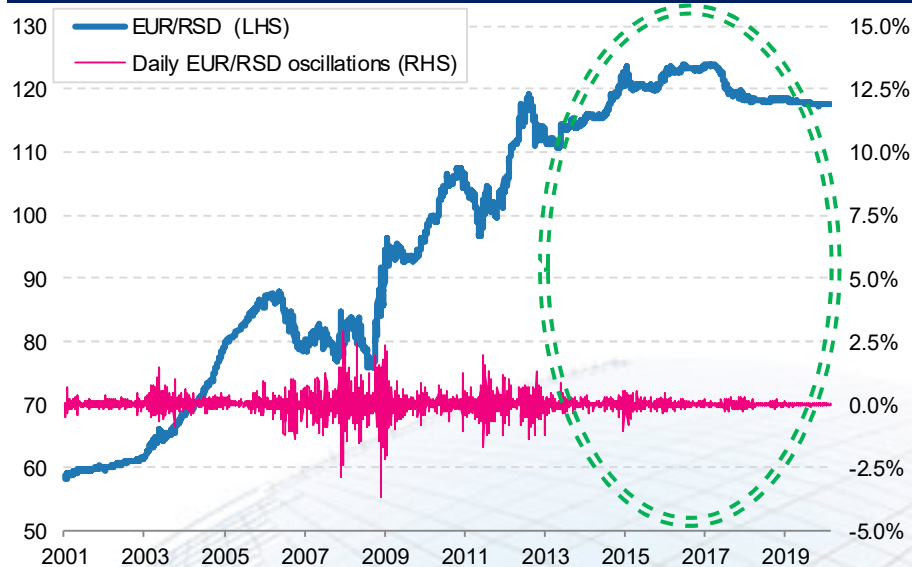


Source: NBS.

– As of 2013 expenses on account of monetary operations have been continuously falling due to:

- **Decrease in the main interest rates** (including the remuneration rate)
- **Change of approach to repo operations:**
 1. Repo auctions according to the model of multiple variable interest rate – an additional channel was also introduced for responding to temporary shocks, to ensure the necessary monetary policy flexibility in periods of volatile capital flows.
 2. The decision of the NBS not to withdraw the entire offered liquidity surplus at repo auctions through the competitive bids effect, created favourable financing conditions in the loan market and led to higher private sector borrowing.

EUR/RSD and daily oscillations



Source: NBS.

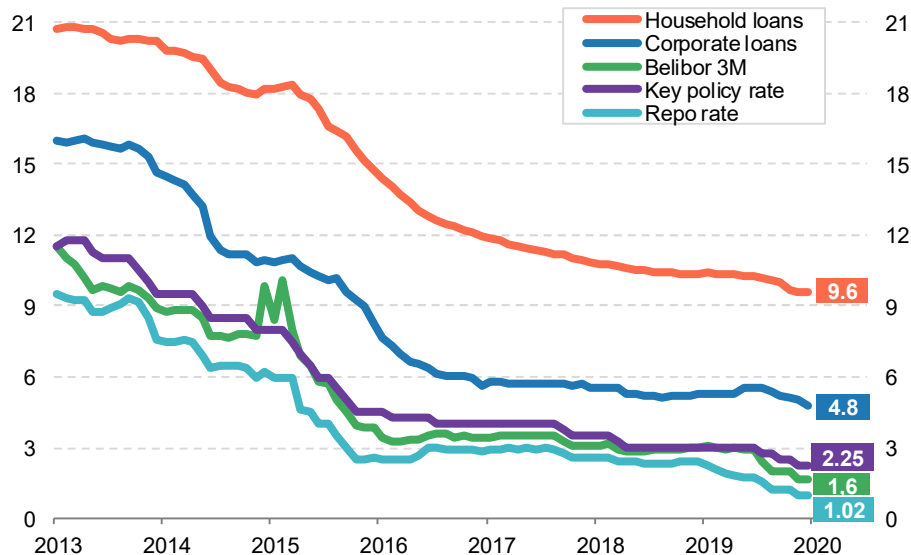
– Reduced daily exchange rate volatility induced a rise in relative exchange rate stability with a positive impact on:

- Achieving low and stable inflation,
- Certainty of the business environment,
- Halting NPL growth and creating room for solving the issue,
- Creating conditions for successful fiscal consolidation (as the rise in exchange rate and inflation as the costs of living was halted).

We have secured more favourable terms of financing...

Interest rates on dinar loans

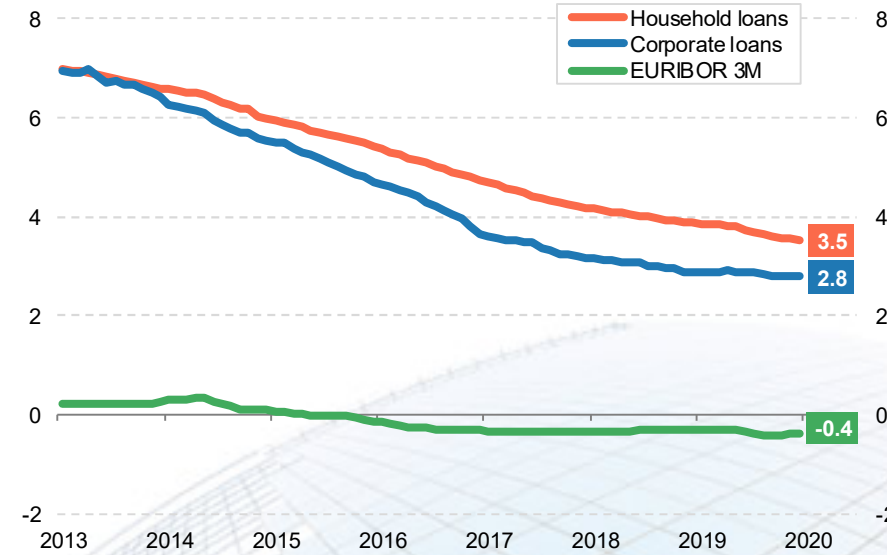
(outstanding amounts, in %)



Source: NBS.

Interest rates on euro-indexed and euro loans

(outstanding amounts, in %)



Source: NBS.

Since May 2013:

– the key policy rate was cut by 9.5 pp to 2.25%,
and, as at December 2019, interest rates on new dinar loans were cut:

- by around 12.5 pp for corporates,
- by around 11.5 pp for households.

Lower interest expenses increase disposable income, leading to the growth in credit and economic activity, higher investment and consumption, as well as rising employment.

A decline in Serbia's risk premium and higher interbank competition, with low interest rates in the international financial market, brought about a fall in interest rates on new euro-indexed loans:

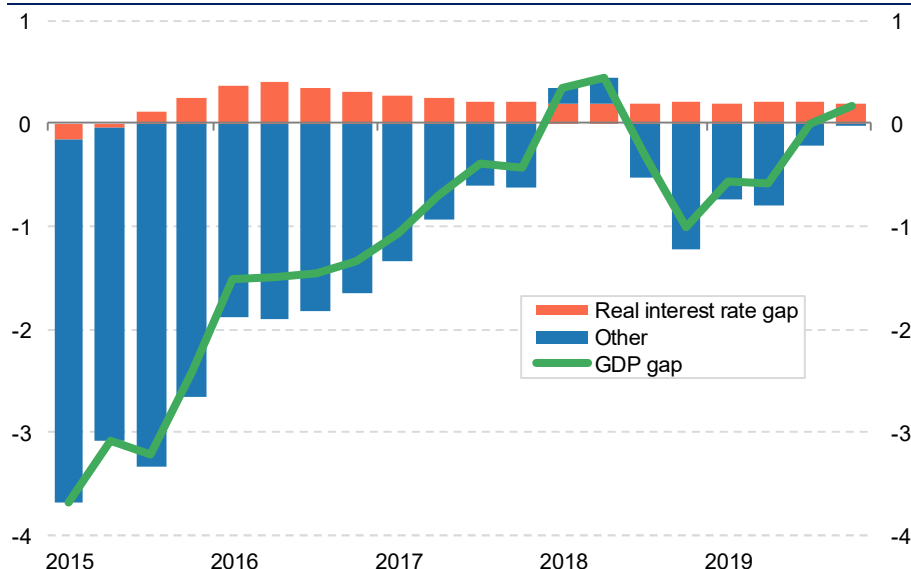
- by 4.3 pp for corporates,
- by over 4.2 pp for households.

This is one of the channels through which we have contributed to economic growth and to the gradual reduction of the negative output gap.

... and our monetary policy easing fully supported sustainable economic growth

Output gap decomposition

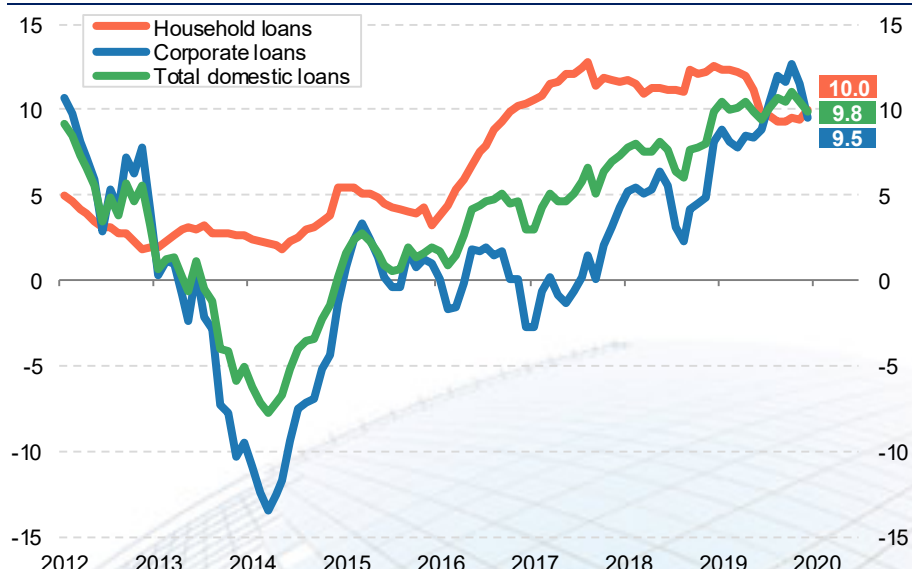
(in pp)



Source: NBS estimate.

Lending growth

(y-o-y growth rates in %, excluding the exchange rate effect)



Source: NBS.

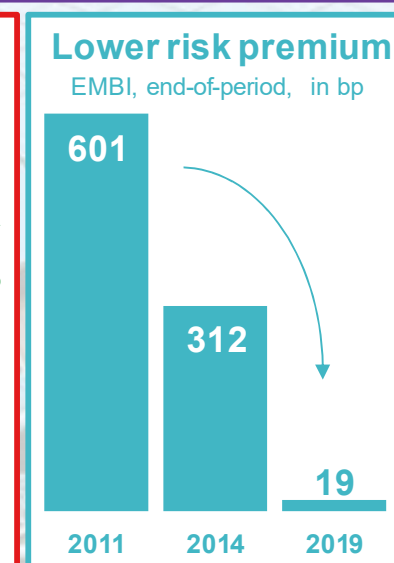
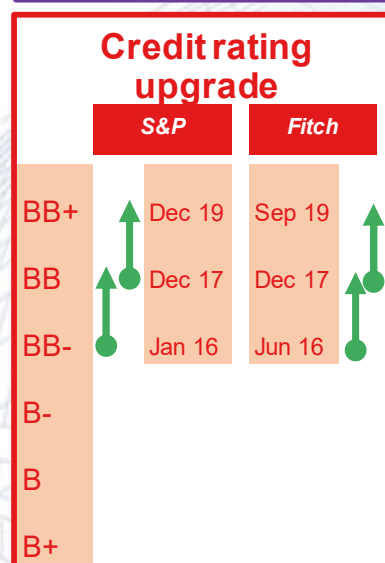
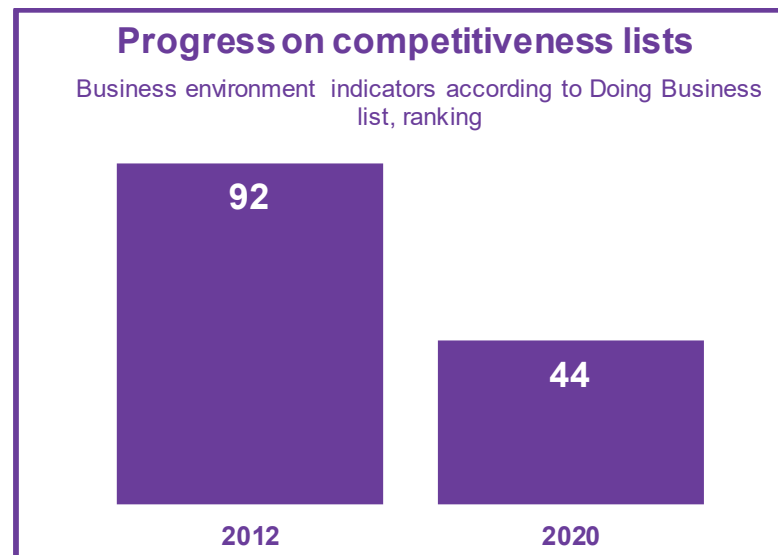
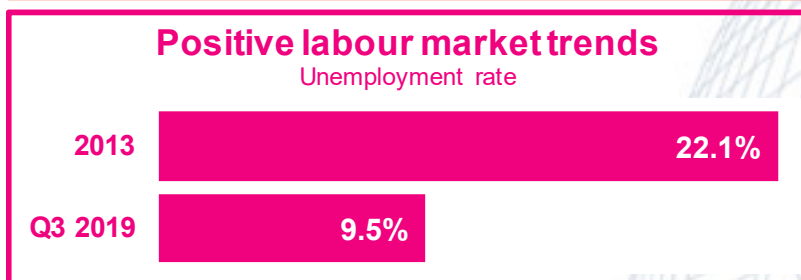
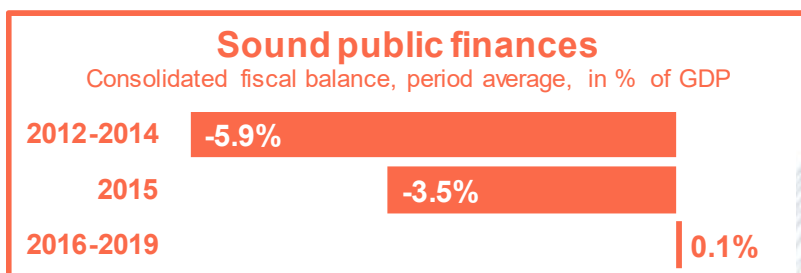
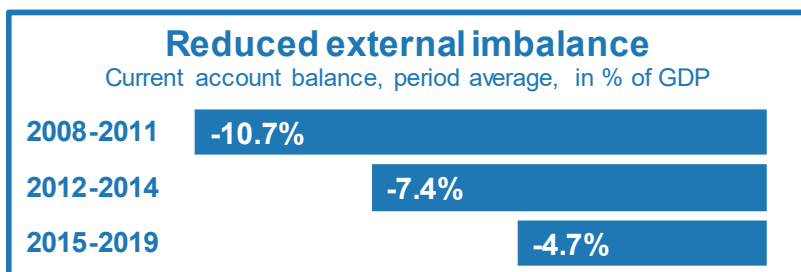
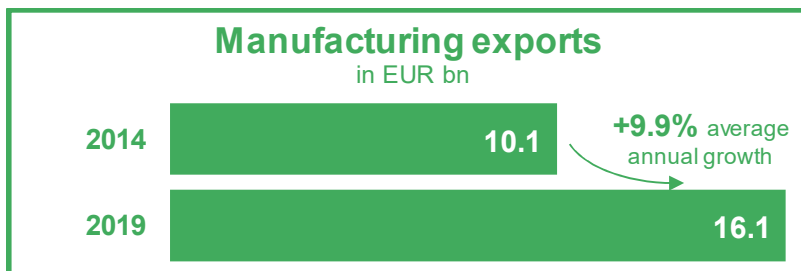
– NBS monetary policy easing since mid-2015 contributes to the closing of the negative output gap.

– Y-o-y growth in credit activity is among the highest in the region, and since mid-last year, it has been more oriented toward corporates, most notably SMEs and entrepreneurs.

– The structure of lending is conducive to sustainable economic growth — a significant rise in investment loans to corporates and housing loans to households.



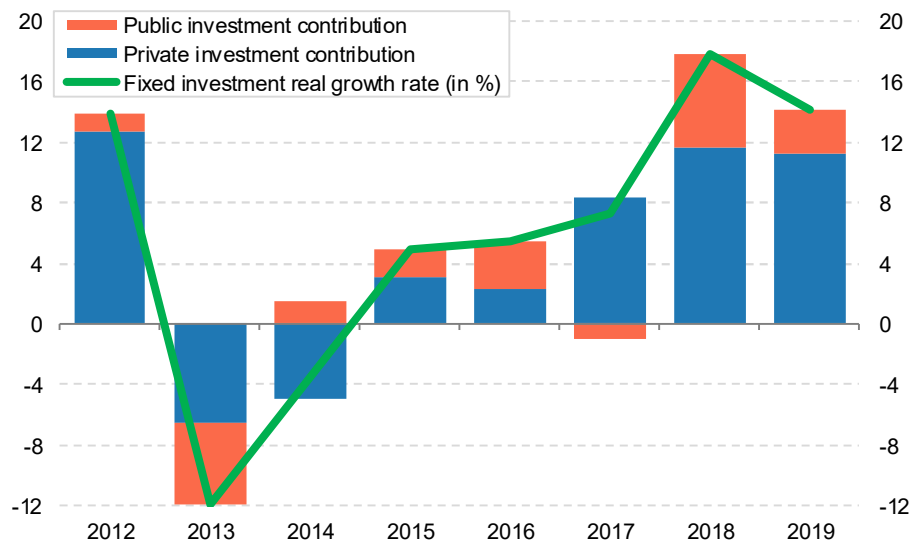
Sound economic policy and better prospects for the period ahead



Increased share of investment in GDP is supported by investment lending

Investment - real growth and contributions

(in pp)



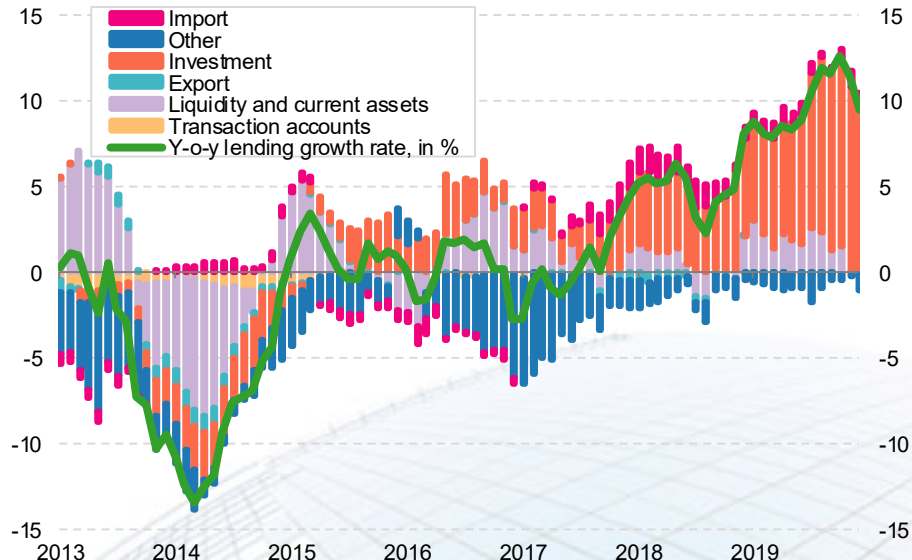
Source: SORS and NBS calculation.

* NBS estimate

- As a result of five years of continuous growth – 17.8% in 2018 and 14.2% in 2019 – the share of investment in real GDP is growing rapidly (at around 24% in 2019). Three quarters of growth during this period was driven by investments.
- Owing to positive trends in the labour market, private consumption is also growing, whereas its share in GDP is falling because its growth is slower than total GDP growth.
- We expect a similar growth structure in the coming years.

Contributions to the y-o-y growth in corporate lending

(in pp, excluding the exchange rate effect)



Source: NBS.

- Companies are increasingly relying on favourable financing conditions for investment growth, as evidenced by the rise in investment loans of 25% in the previous year, with the balance of these loans higher by RSD 115 bn than in 2018.
- At the level of the year, almost entire growth in lending activity was due to investment loans which, as far back as in 2015, emerged as one of the major sources for financing investment (over 45% share in total corporate loans).

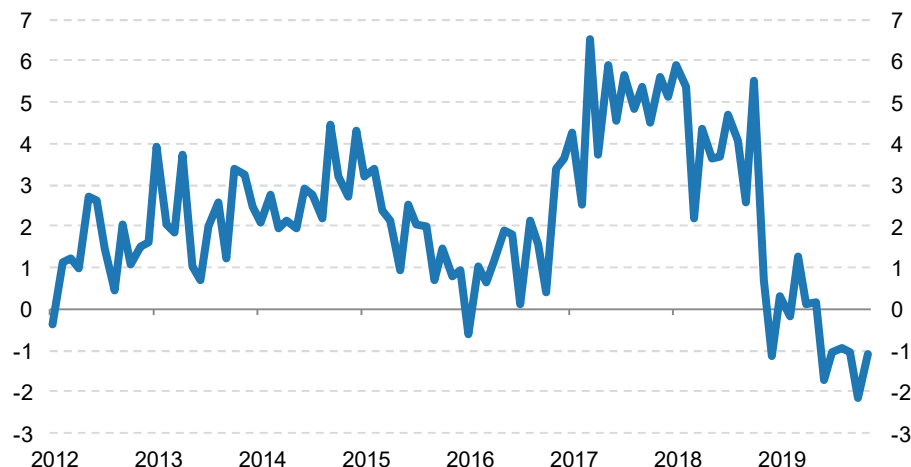


Narodna banka Srbije

We continue to monitor closely movements in the international environment and to react...

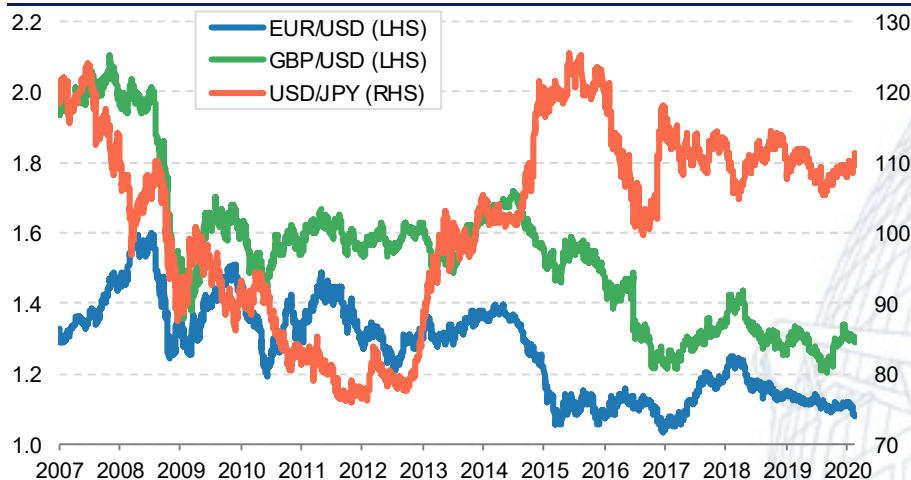
World merchandise trade

(y-o-y growth rates, constant prices 2010=100)



Source: CBP World Trade Monitor.

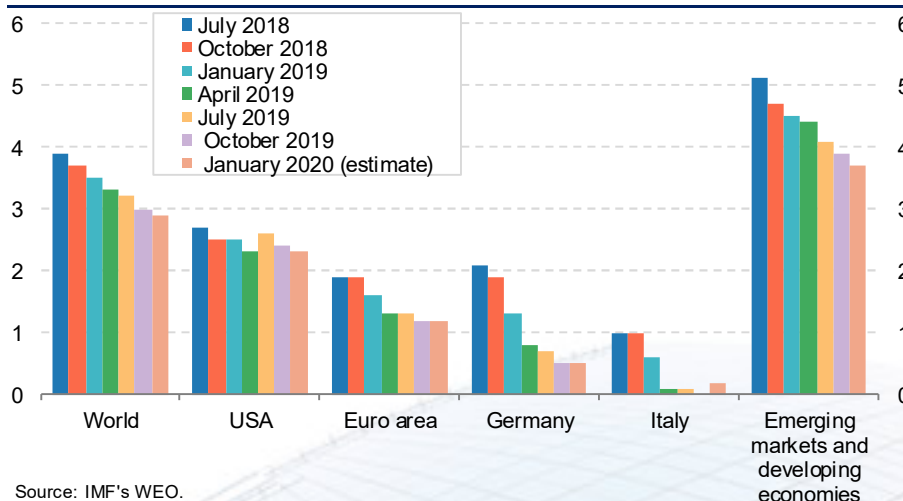
Exchange rates of major world currencies



Source: IMF.

Revisions to IMF's real GDP growth forecasts for 2019

(in %)

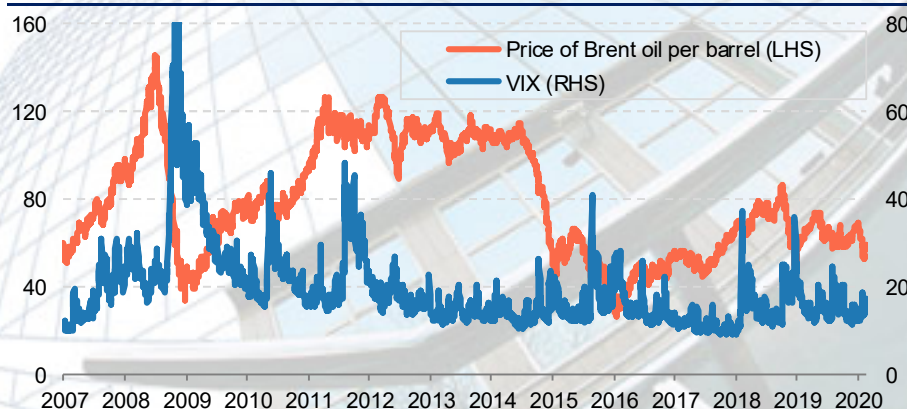


Source: IMF's WEO.

Oil price movements and VIX*

(USD)

(in %)

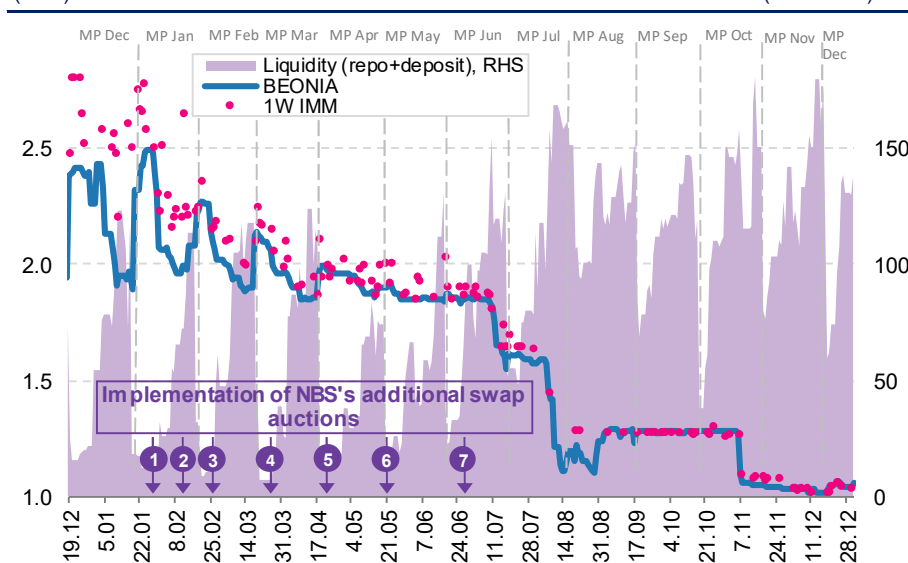


* VIX (Chicago Board Options Exchange Market Volatility Index) measures implied volatility of the S&P 500 index; EM-VIX (J.P.Morgan emerging markets implied volatility index) measures aggregate volatility of emerging market currencies based on three-month forward options

Source: Bloomberg.

... by using all available instruments

Impact of swap auctions on liquidity and interbank money market rates
(in %)



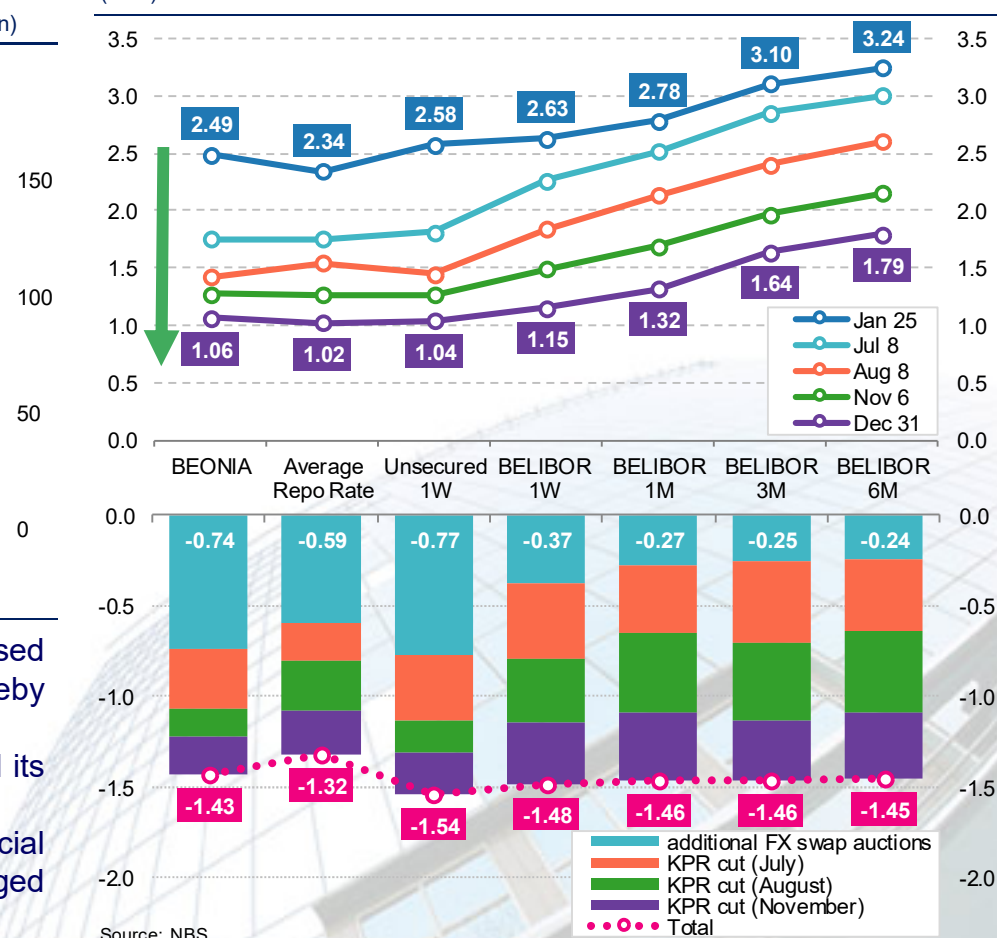
– In conditions of reduced excess liquidity, the NBS organised **seven additional FX swap auctions** in H1 2019, thereby securing:

- Stable interest rates in the interbank money market and its smooth functioning,
- Full transmission of monetary policy effects to the financial sector (joint impact of swap auctions and the changed approach to repo operations).

– Monetary policy easing in 2019 was reflected fully in money market movements – **interest rates at their all-time lows:**

- ▼ **BEONIA** rate declined by **143 bp**.
- ▼ Rates on **one-week** loans were cut by **132 bp**.
- ▼ **BELIBOR** rates of all maturities were cut by **145-154 bp**.

Interest rates in IMM in 2019
(in %)

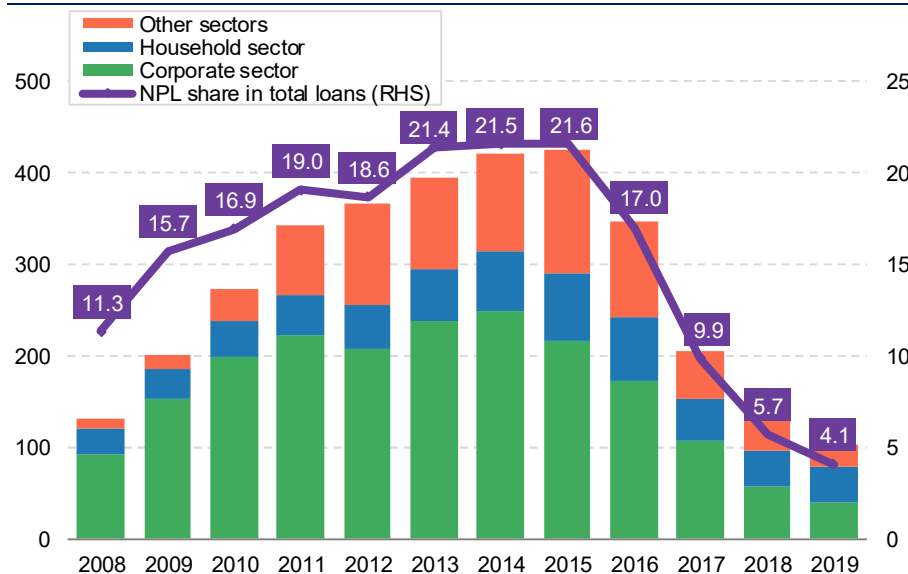




Narodna banka Srbije

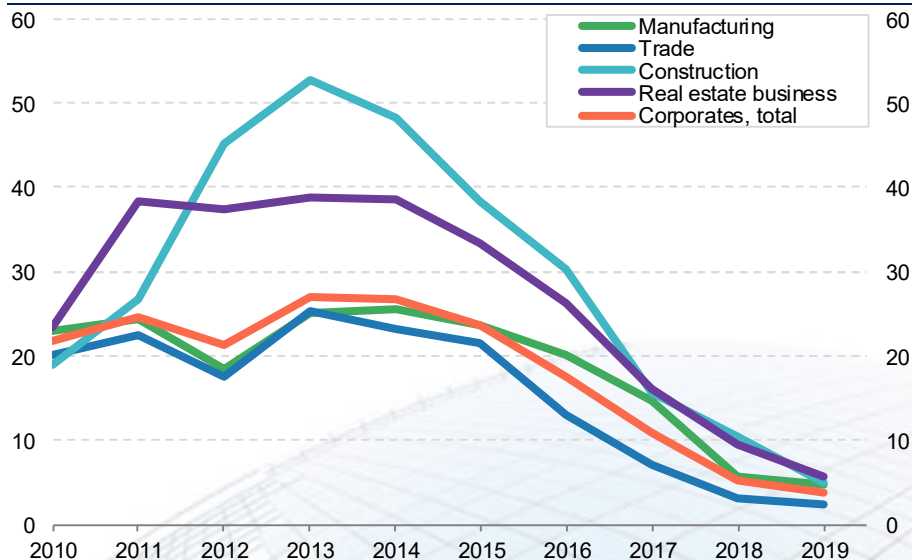
Preserved financial stability and NPL resolution as a support to economic growth

NPL structure, gross principle
(in RSD bn)



Source: NBS.

NPLs, corporate sector
(%)



Source: NBS.

- Key assumptions for resolving the NPL legacy were created by stabilising the overall environment, notably the FX market. The NPL Resolution Strategy followed as a logical step forward.
- Since the Strategy was adopted, the NPL ratio was cut to 4.1% in December 2019, which is its lowest level so far (by around 80% lower).

- The sharpest decrease in NPLs was recorded in construction, where the share of NPLs was the highest.



Народна банка Србије

Safer, faster and cheaper transactions


National Bank of Serbia



DinaCard is
the national payment card of
the Republic of Serbia



Serbia National
Retail
Payments Strategy
2019-2024



**The NBS IPS system
processed 1,501,739
payments in
December 2019.**

**The average daily
number of payments
was 48,443, with the
average time of
transaction execution of
0.99 seconds.**



**The value of turnover
was RSD 13.9 bn and
the daily average RSD
447.0 mn.**



Chapter
4
Free movement
of capital



Chapter
9
Financial services



Financial
services



**10 million
instant payments**
Total value over **RSD 123 billion**

 **0.95** seconds



IPS QR code



QR code

is a trademark for a type
of two-dimensional matrix
that allows us to read data
through a specific device.



1.536.783 payments
processed in the **NBS IPS system**,
which operates 24/7/365,
during the 31 days of
January.



49.574

Was the average daily number of payments
with the average time
of transaction execution of

0,95 seconds.



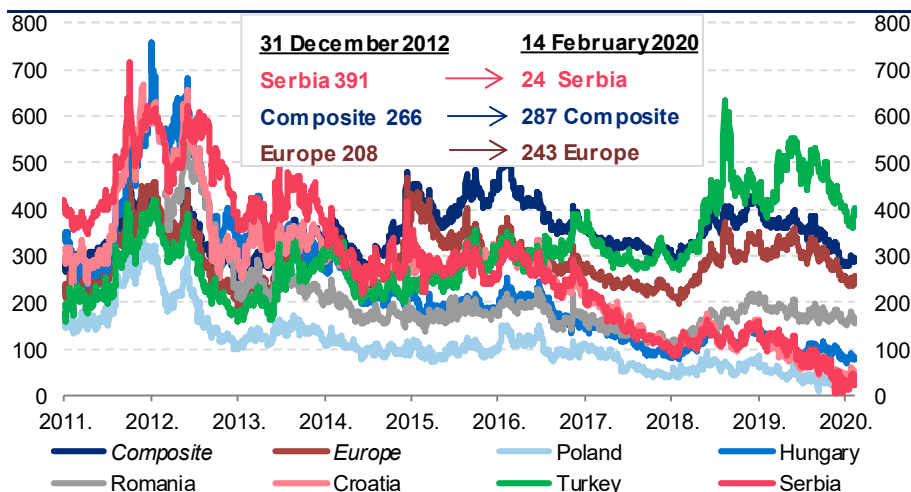


Narodna banka Srbije

We continue to strengthen Serbia's economic outlook

Country risk premium – EMBI

(in bp)



Source: J. P. Morgan.

Credit rating (change of rating and outlook)

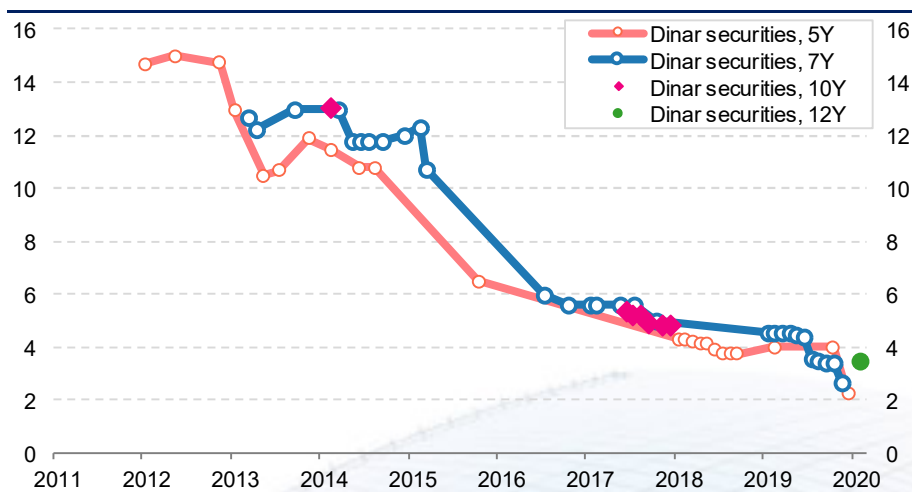
	2015	2016	2017	2018	2019
S&P		BB- /stable ¹⁾ /positive ⁵⁾	BB /stable ⁵⁾	BB /positive ⁵⁾	BB+ /positive ⁵⁾
Fitch	B+ /positive ⁵⁾	BB- /stable ³⁾	BB /stable ⁵⁾		BB+ /stable ⁴⁾
Moody's		B1 /positive ²⁾	Ba3 /stable ²⁾		Ba3 /positive ⁴⁾

Source: NBS.

¹⁾January, ²⁾March, ³⁾June, ⁴⁾September, ⁵⁾December.

Interest rates in the primary market of dinar government securities

(per annum, in %)



Source: Ministry of Finance.

– As confirmed by the analysis from February, Serbia's risk premium dropped since end-2012 owing to lower inflation, NPL resolution, accelerated economic growth, reduced fiscal and external imbalances (as measured by the share of public debt and current account balances in GDP). (National Bank of Serbia, Inflation Report, February 2020).

- In 2019, Serbia came, for the first time, only one step away from investment grade!
- While EMBI Composite rose relative to end-2012, EMBI Serbia recorded the sharpest fall to the level which is among the lowest in the region – as a result of domestic factors.
- Today, Serbia also has a 12-year dinar bond and we will work actively on lengthening the dinar yield curve. The demand for the 12-year dinar bonds of the Republic of Serbia was more than 10 times higher than the planned volume of sale and the effective rate was 3.4%, whereas in late 2012 the interest rate on one-year government bonds was 11.9%.
- It is this difference between interest rates and the maturity of dinar government bonds that all the results and Serbia's significantly improved reputation worldwide are reflected in.