

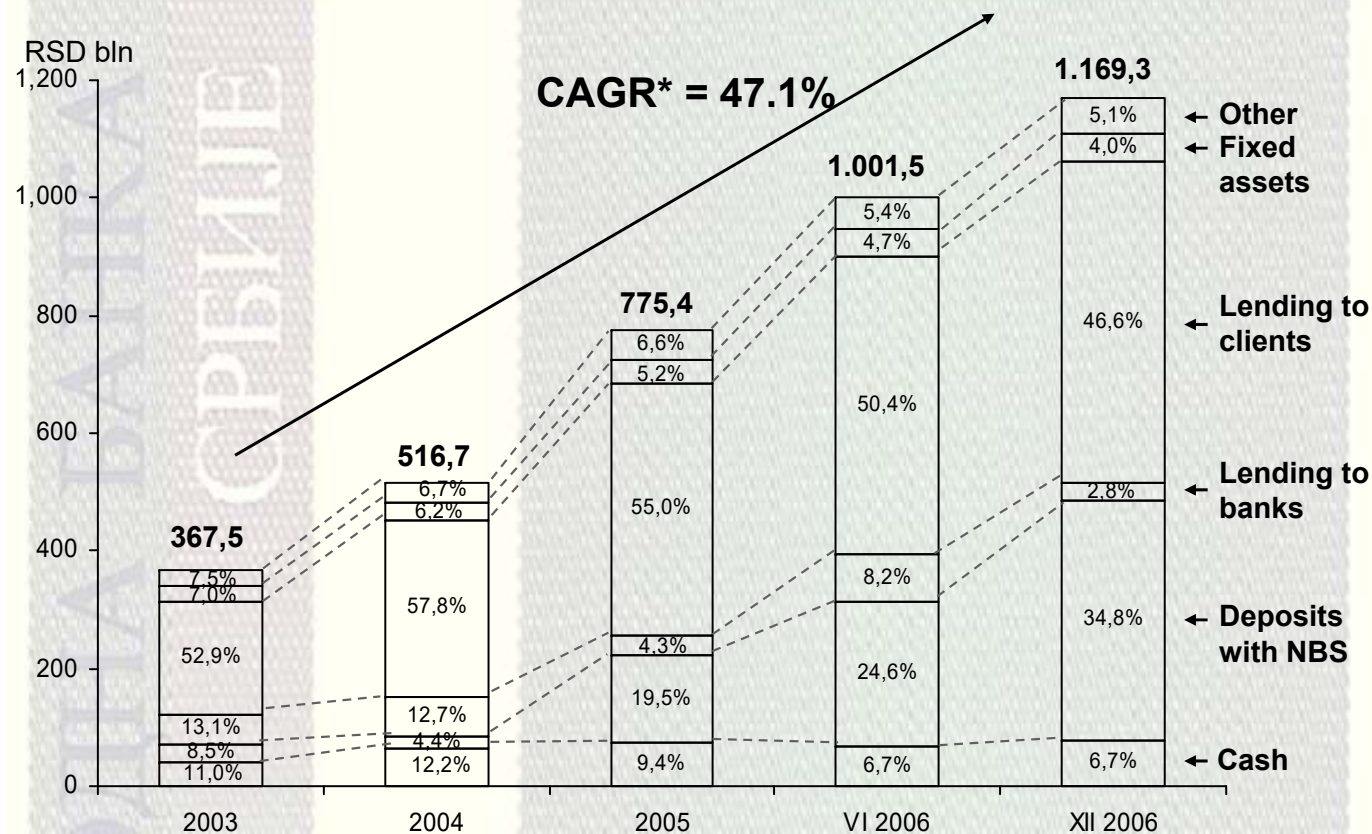


## Financial sector of Serbia in 2006 and monetary policy

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**Radovan Jelašić – Governor,  
Belgrade, 27 April 2007**

## Banking sector assets rose substantially...



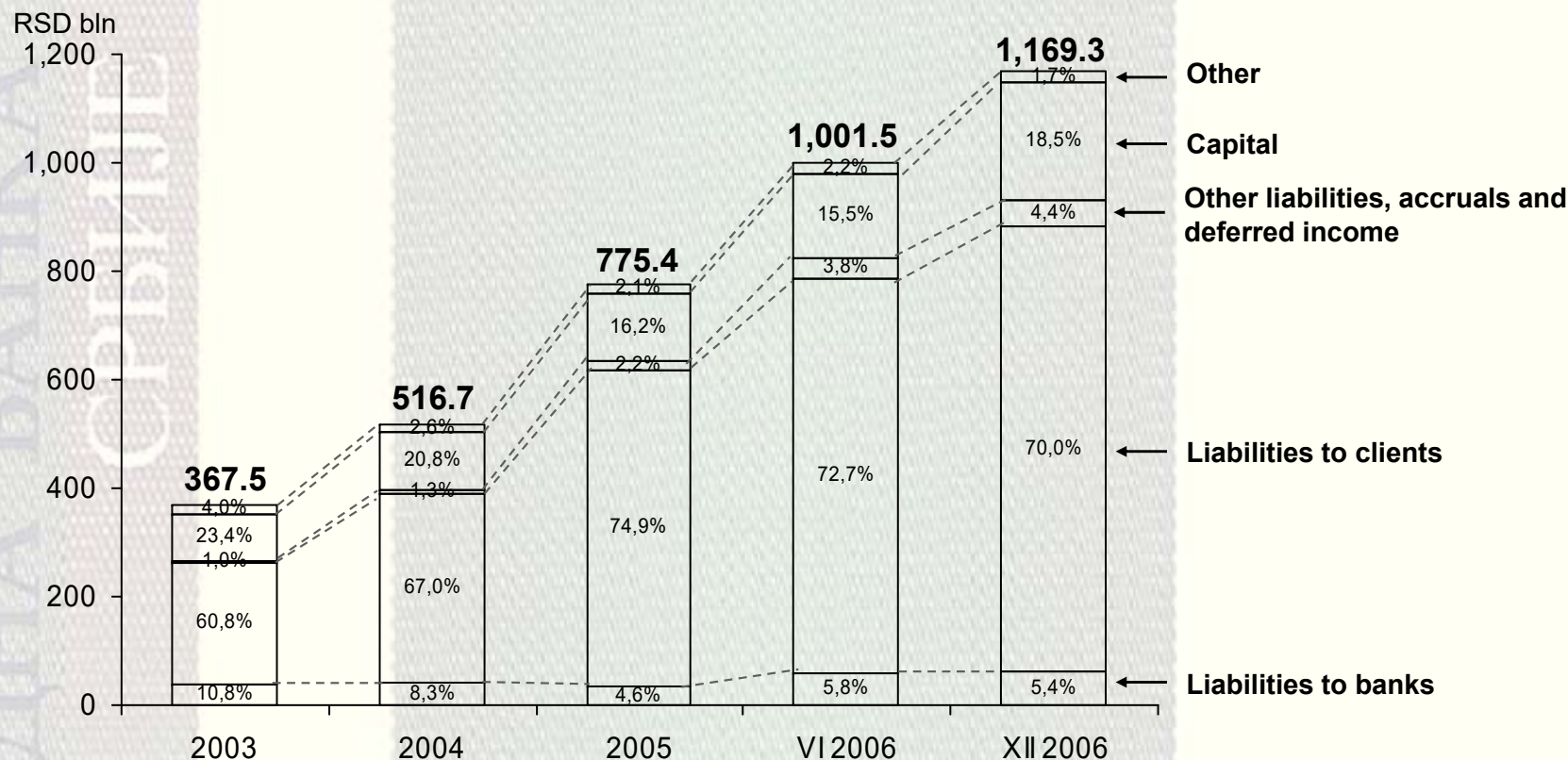
- Banking sector balance sheet total grew by an annual average of 47.1% over the past three years; its 2006 growth (RSD 393.9 billion or 51%) exceeded the overall balance sheet total at end-2003;

- Because of the need to conduct a restrictive monetary policy, deposits with the NBS (required reserves + repo securities) reached RSD 406.7 billion or 34.8% of banking sector balance sheet total!
- In 2006, the level of deposits with the NBS slightly “compressed” lending to clients (from 55.0% in 2005 to 46.6% in 2006).

\* CAGR – compound annual growth rate

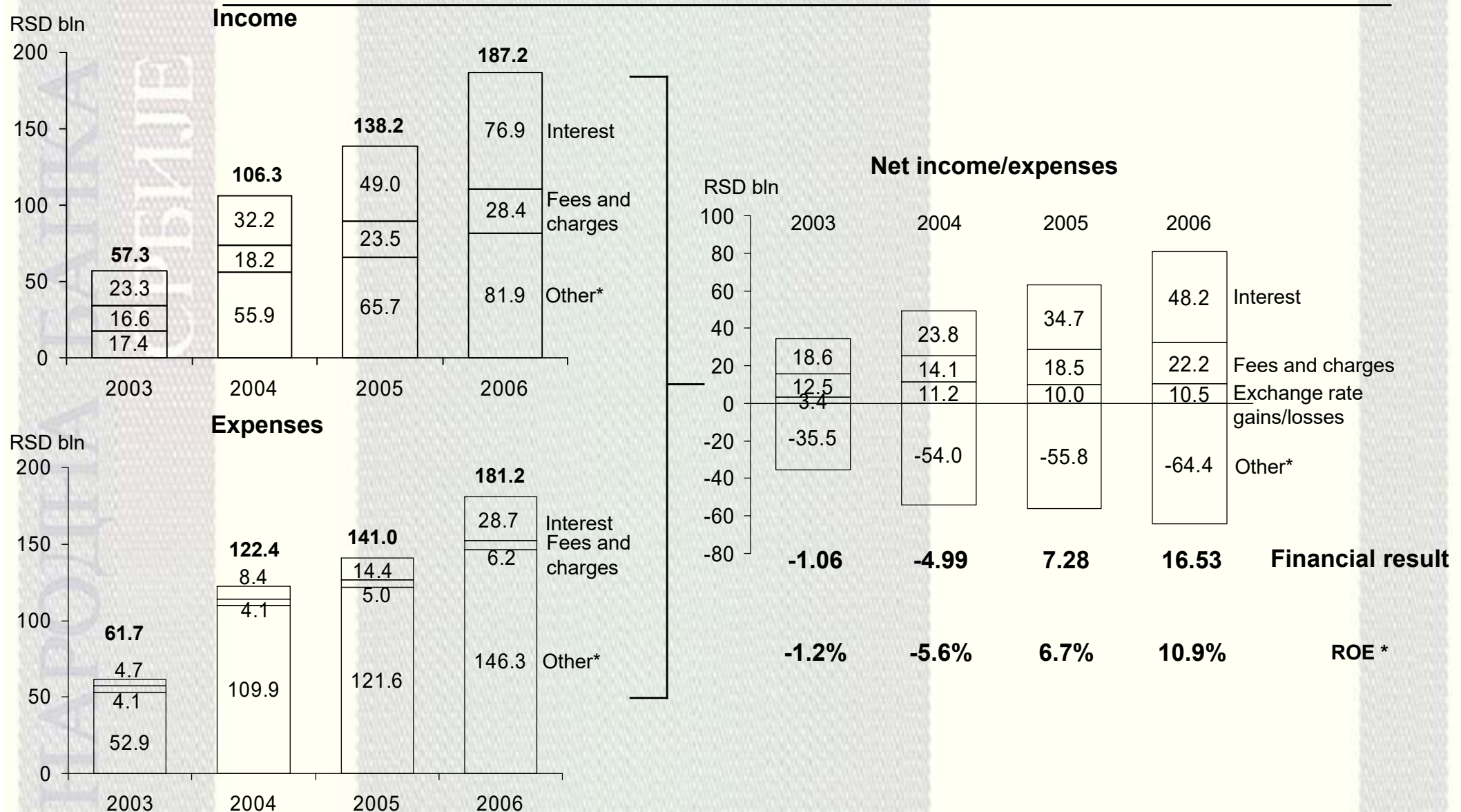


## ... with composition of liabilities also changing notably!



- During 2006, banks increased their capital substantially (+72% or RSD 90.5 billion), in order to meet the prescribed ratio of capital/lending to households – 1:2;
- Liabilities to clients rose notably, especially liabilities to households (by around 350% compared to end-2003).

# Banks' income statement is positive despite restrictive monetary policy!



Includes: profit/loss from sale of securities, income from dividends and stakes, expenses in respect of indirect write-off of lending and provisioning, other operating and extraordinary income/expenses and income/expenses from change in the value of assets and liabilities.

\* Return on equity.

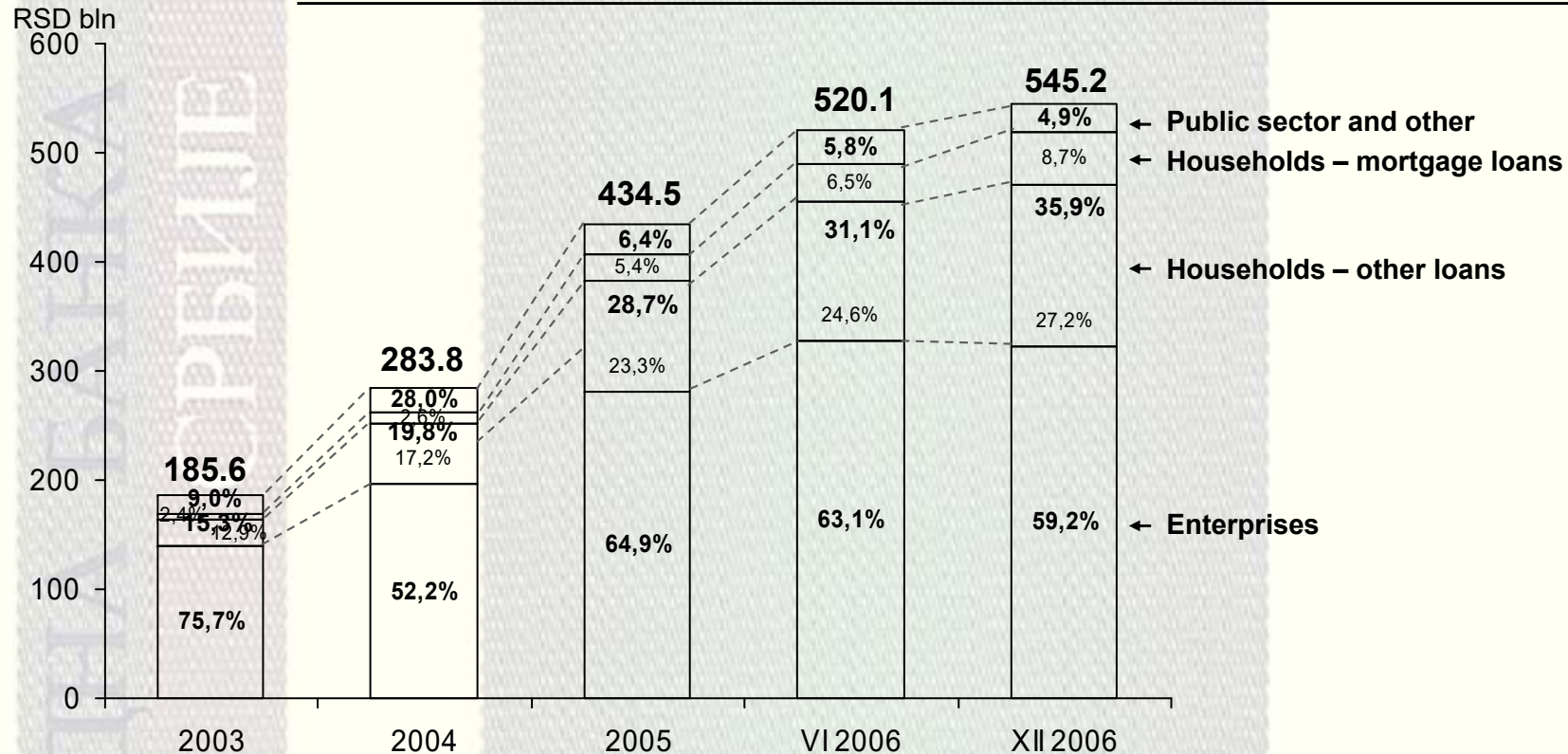


## Banking sector income statement increasingly resembles that of real banks!

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- Out of a total of 37 banks, 28 banks ended the year 2006 with a positive income statement.
- And while fees rose by only 71% over the past three years, from RSD 16.6 to RSD 28.4 billion, interest income has been growing three times faster (+230%), from RSD 23.3 billion to RSD 76.9 billion;
- Banks pay higher interest to their clients; in 2006, in which inflation declined from 17.7% to only 6.6%, clients received RSD 28.7 billion from banks on account of interest instead of RSD 14.4 billion in 2005.

## Lending activity about to enter the third stage of development



- The share of the public sector declined notably over the past four years;
- The share of households rose from 15.3% to 35.9% in three years, and from 28.7% to 35.9% during 2006;
- In 2006, growth in lending to households for the first time exceeded growth in lending to enterprises!

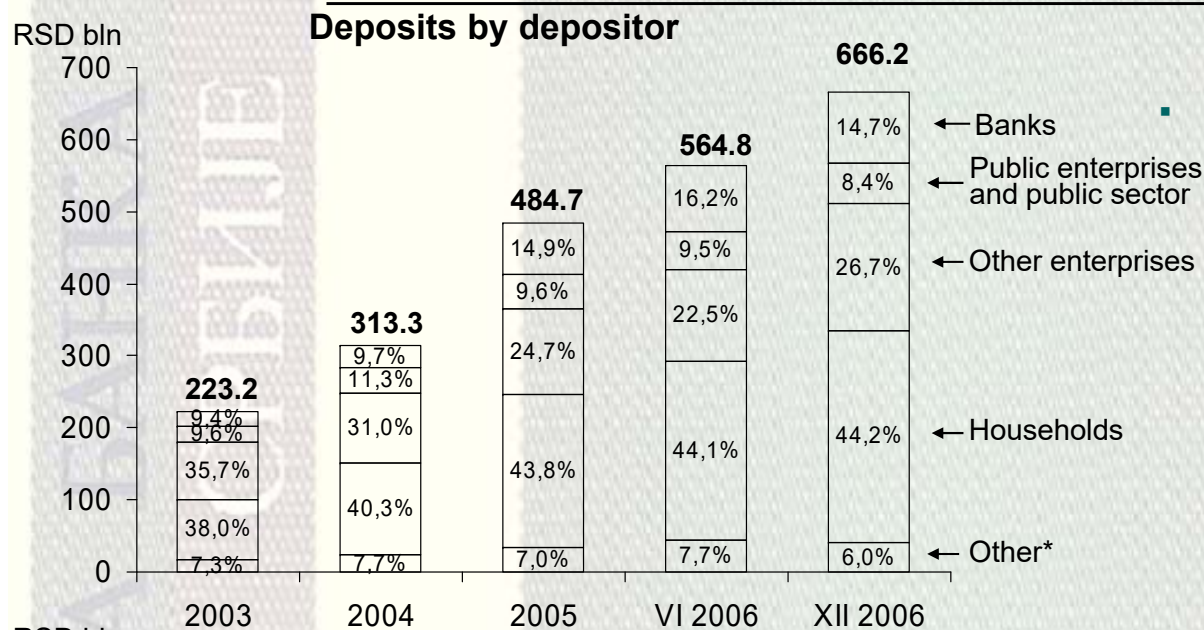


## **NBS macroeconomic policy is far more restrictive than optimal, but it is at present the only buffer against the overheating of domestic demand!**

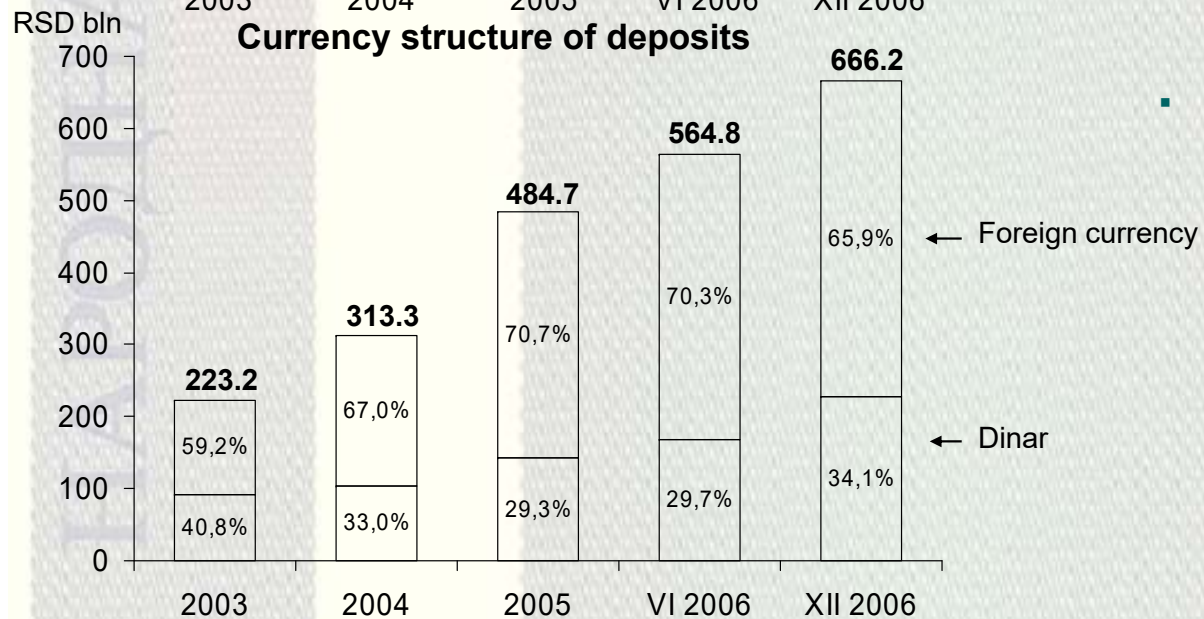
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- Notably higher domestic demand contributed to the widening of the trade deficit which in the first two months of this year came to USD 1,050.2 million (+ 38.7%), compared to USD 757.0 million in the same period a year earlier;
- High level of required reserves makes direct foreign borrowing more attractive – the NBS is aware of both this and the fact that it is almost exclusively enterprises that resort to this option;
- So as to prevent Serbian banks from turning into institutions for retail operations only, the NBS enacted a decision prescribing that lending to households must not exceed twice the value of capital;
- The above two measures are compatible and needed primarily on account of:
  - ✓ Overheated domestic demand which further widens the current account deficit;
  - ✓ Lack of budget for 2007;
  - ✓ Appreciation recorded during 2006;
- Reserve requirement ratio can only be lowered once a restrictive budget is adopted!

## Almost one half of all deposits are household deposits – the share of dinars is on the rise!



The share of household deposits rose from 43.8% to 44.2%, with balance sheet total rising by 51%;



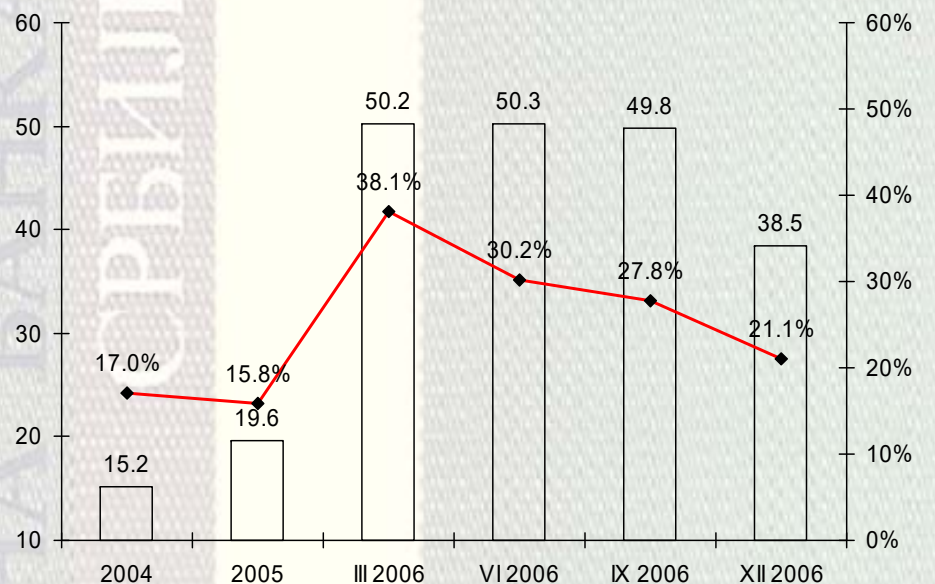
The share of dinars is rising notably again, having climbed from 29.3% to 34.1% in the second half of 2006 alone.

\* Other includes the following categories: other clients, foreign legal entities and natural persons, other (current maturities and long-term investments).



## Risks in the banking sector declined in 2006

Open foreign exchange position (RSD bln)



### Foreign exchange risk

- After recording a considerable rise in early 2006, foreign exchange risk declined throughout the year (open foreign exchange position);
- It is up to banks to decide with which part they wish to “gamble” and to what extent, as long as they stay within the prescribed 30% limit.

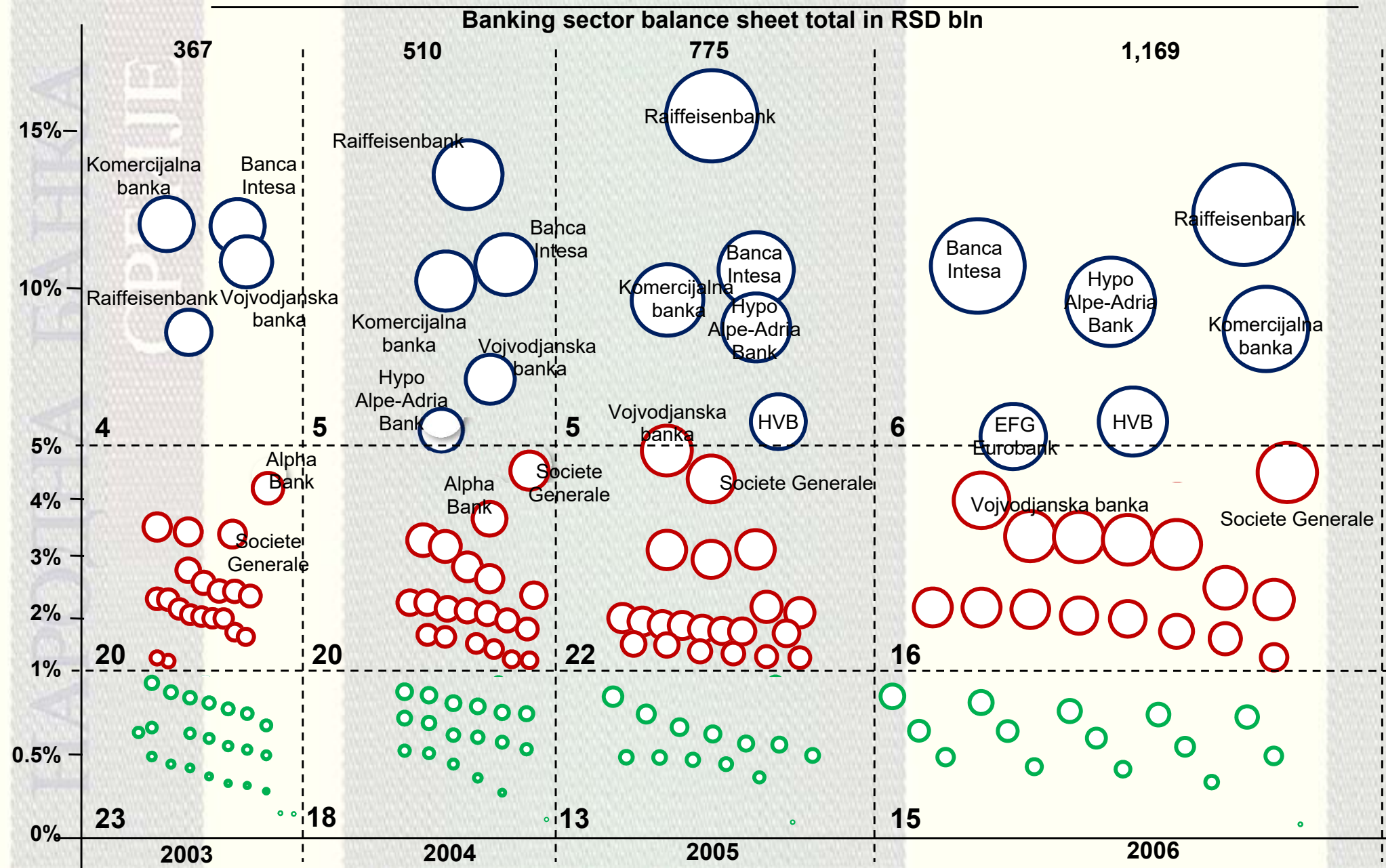
### Liquidity risk

- Banking sector is liquid;
- No banks resorted to liquidity loans.

### Operational risk

- IT needs to be substantially improved;
- Internal procedures are not fully observed;
- Insufficiently qualified personnel for keeping pace with accelerated development of products.

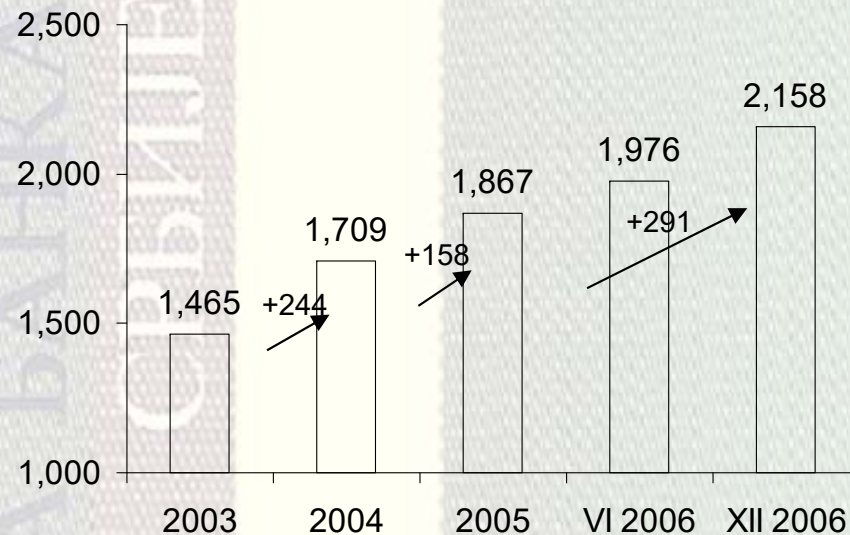
# Banking sector consolidation made significant headway in the 2003-2006 period



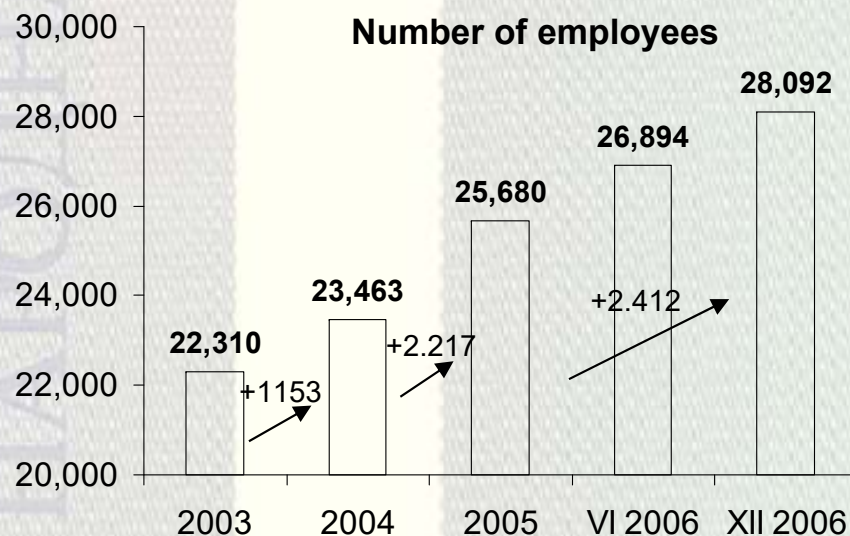


# Banking sector is one of the rare ones – if not the only – developing energetically and with a rising number of employees!

**Number of organizational units**



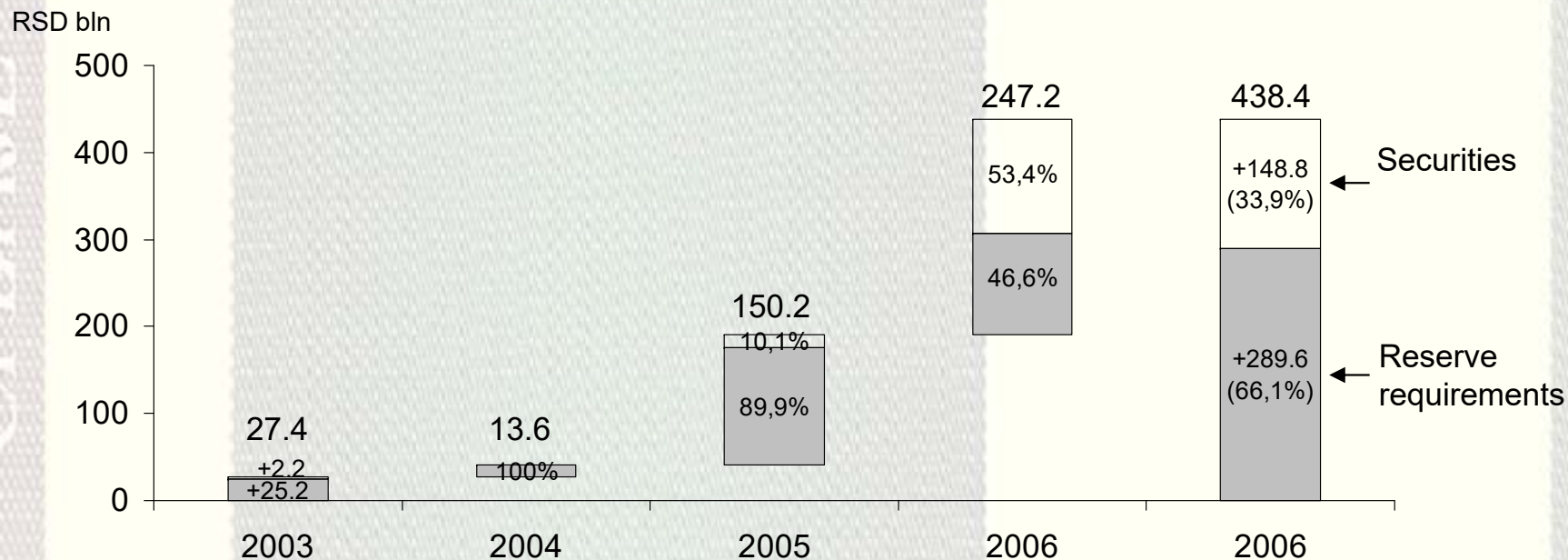
- Number of bank organizational units\* increased at a record pace , +291;
- In three years, the number of organizational units rose by 56%;



- ... whereas the number of people employed in the banking sector experienced record growth in 2006 - +2,412 (9,4%);
- At end-2000, number of banking sector employees stood at mere 23,986;
- Average gross wage in the banking sector came to RSD 70,626 in 2006!

\* Organizational units: business units, branches, branch offices, counters

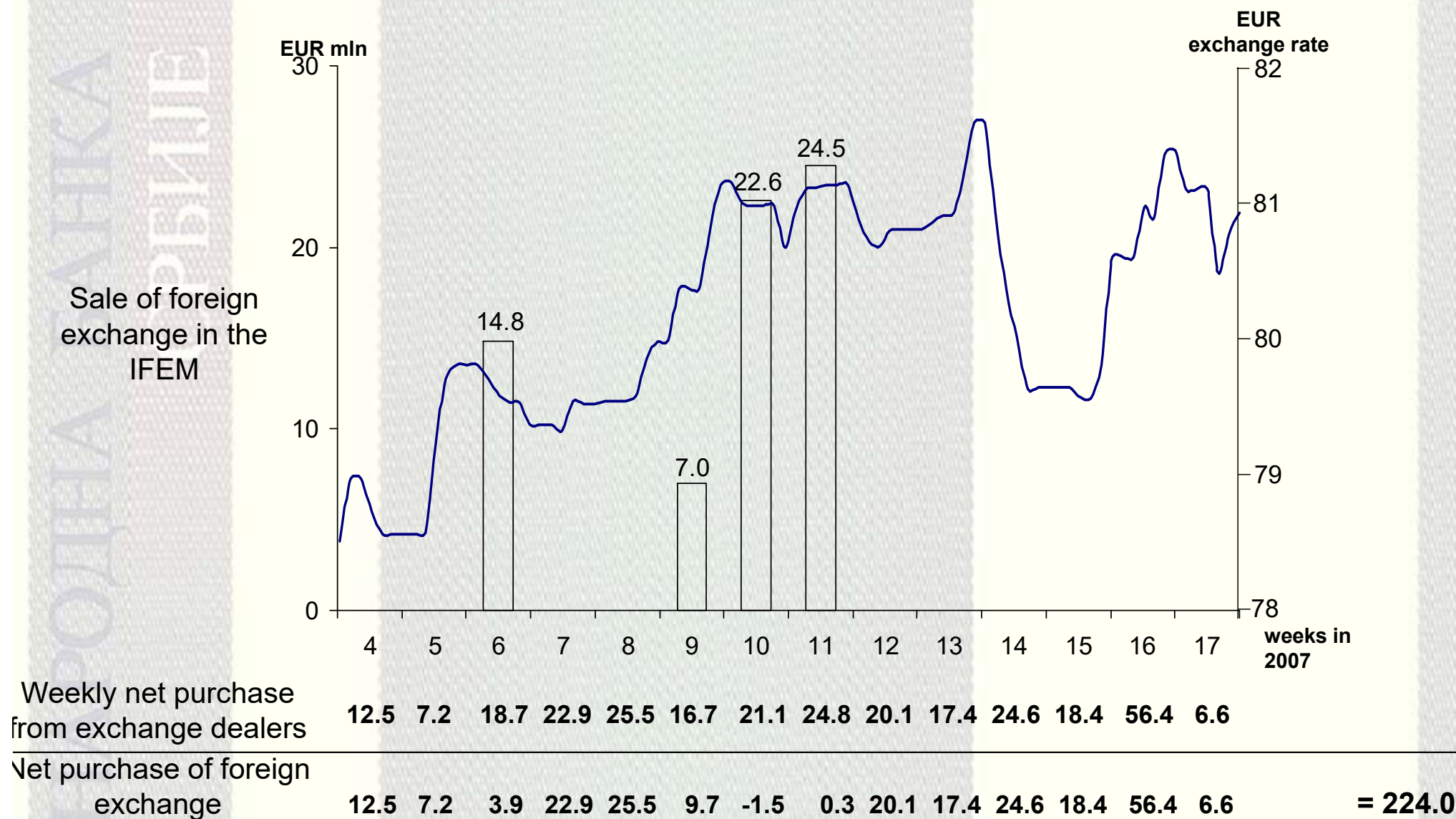
## In 2006, major portion of excess liquidity was sterilized through market mechanisms



- Alternative to market-based withdrawal of excess liquidity was upward revision of reserve requirement – had the NBS opted for this type of instrument, instead of the present 35.2%, average reserve requirement ratio would level off at around 50.5% and would also entail the following:
  - additional substantial losses for the banking sector coming to around RSD 16 billion and/or;
  - more costly loans for enterprises and households;
- Monetary policy has its price, and the NBS is not a profit-making institution!



## In 2007, the National Bank considerably reduced its role in the formation of exchange rate...



In EUR mln

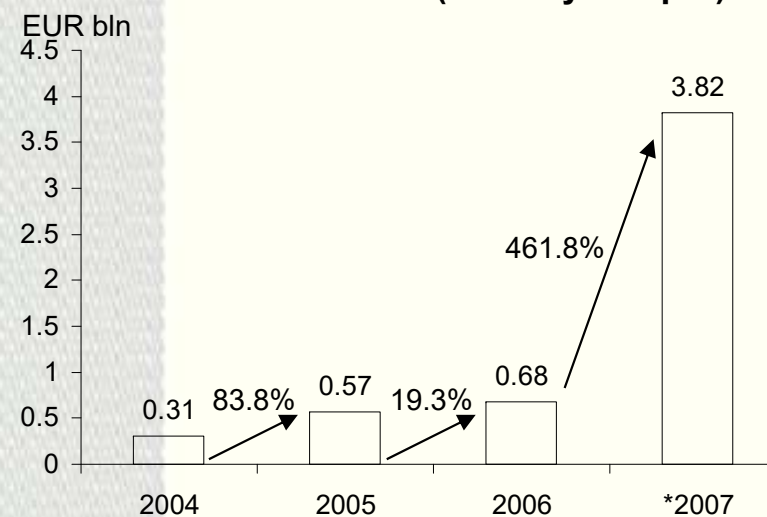
From 21 January to 25 April 2007, the NBS intervened four times in the IFEM.

## ...which is floating more and more freely

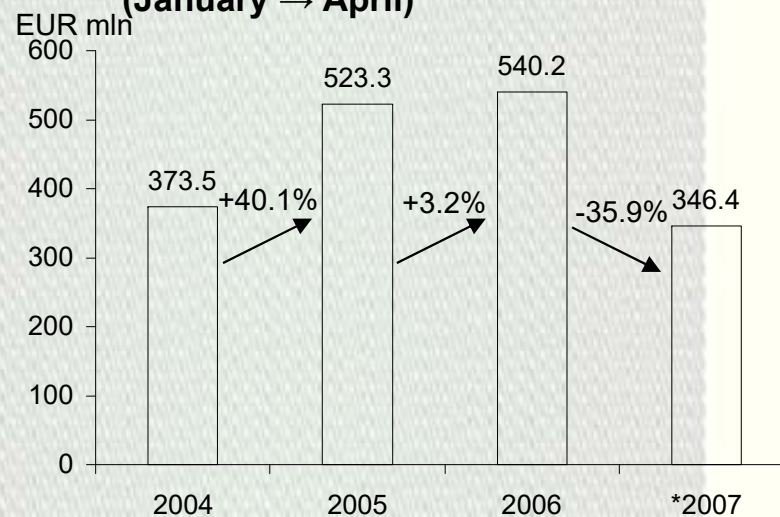
**Number of days of NBS interventions**



**Trade in the IFEM (January → April)**



**Purchase from exchange dealers  
(January → April)**



\* Until 25 April 2007





Народна Банка Србије

## Insurance supervision introduced in 2004 contributed to faster development of the Serbian insurance market which continues ...

	2004	2005	2006	trend
<b>Total premium</b>	22.6	34.7	38.3	↑ 10.4%
<b>Life insurance premium in Σ premium</b>	1.7 (7.5%)	3.3 (9.5%)	4 (11%)	↑ 23%
<b>Non-life insurance premium in Σ premium</b>	20.9	31.4	34.3	↑ 9.2%
<b>Premium per capita</b>	€ 38	€ 54	€ 65	↑
<b>Life insurance premium per capita</b>	€ 2.9	€ 5.1	€ 6.8	↑
<b>Premium share in GDP</b>	1.7%	2%	2.1%	↑
<b>Total assets</b>	30.8	46.4	56	↑
<b>Capital</b>	15.6	18.6	20.7	↑
<b>Technical reserves</b>	11.5	22.9	28.9	↑ 26%
<b>Number of insurance companies</b>	40	19	17	↓
<b>Number of employees</b>	5,407	7,283	7,880	↑

# Share in total premium from 2004 to 2006

Classification criteria according to the share in total premium:

2006

peer1 >15%

peer 1	63.4
Dunav	34.2
DDOR	29.1

3%<= peer2 <+15%

peer 2	21.6
Delta	11.4
Wiener	6.4
Takovo	3.8

peer3 < 3%

peer 3	15.1
Zepter (Uniqa)	2.8
Kopaonik	2.4
Grawe	2.4
AMC	2.2
Polis	1.8
Milenijum	1.3
Dunav TBI	1.0
Globos	0.6
Energoprojekt	0.5

Prizma	0.0
Morava	0.0

2005

peer 1	64.9
Dunav	33.5
DDOR	31.4

peer 2	21.5
Delta	9.5
Wiener	4.6
Zepter (Uniqa)	4.1
Takovo	3.3

peer 3	13.6
Kopaonik	2.7
AMC	2.2
SIM	1.9
Polis	1.7
Grawe	1.6
Milenijum	1.1
Dunav TBI	0.7
Globos	0.7
Prizma	0.6
Energoprojekt	0.3
Morava	0.2

Dijamant	
Jugins	
Osiguranje Plus	

2004

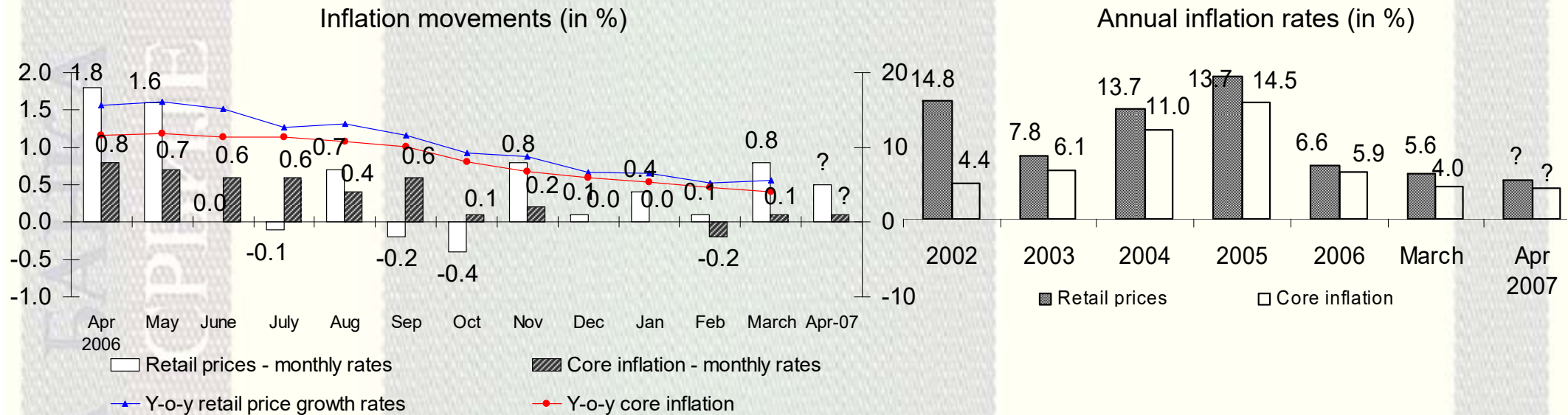
peer 1	74.2
Dunav	38.8
DDOR	35.5

peer 2	11.8
Delta	5.2
Zepter (Uniqa)	3.5
Wiener	3.1

peer 3	14.0
AMC	2.7
SIM	1.9
Kopaonik	1.9
Takovo	1.8
Grawe	1.3
Polis	1.1
Dunav TBI	0.6
Prizma	0.5
Jugins	0.4
Globos	0.4
Osiguranje Plus	0.4
Energoprojekt	0.3
Dijamant	0.3
Milenijum	0.2
Morava	0.2



# After the first four months, core inflation will most probably fall below the targeted level, and headline inflation below 5%!



- Targeted core inflation corridor for 2007 - 4 - 8%;
- Although retail price growth in April is expected to be somewhat stronger due to the rise in prices of petroleum products and seasonally-induced growth in the prices of agricultural products,
  - core inflation is expected to continue low;
  - while headline inflation is expected to continue downwards;
- In the first three months of 2007, core inflation stood at -0.1% and retail price growth came to 1.2% (mainly influenced by changes in administered prices – petroleum products and utilities).

## MPC decision of 27 April 2007!

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### Rate cut

- Core inflation already below the planned range of 4-8%;
- Exchange rate stable, regardless of key policy rate cuts (13.0% at the beginning of the year);

### Risks

- Inflation expectations partly above actual inflation;
- High wage growth;
- Public finances have run a deficit since November 2006;
- Political uncertainty.

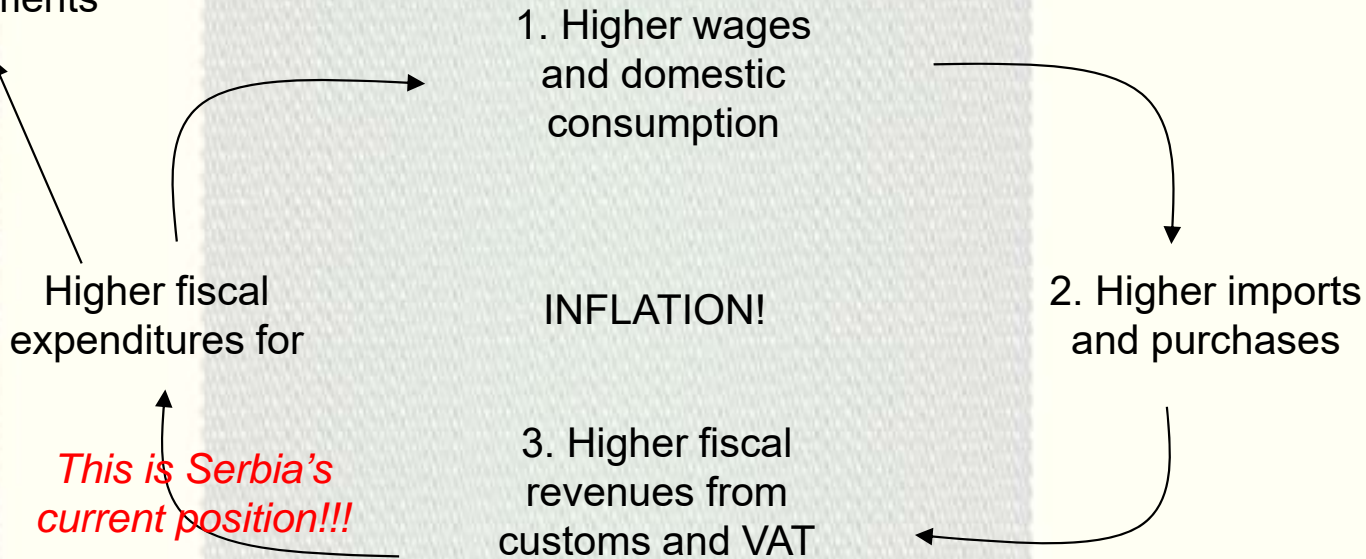
**Key policy rate cut from 10.5% down to 10%**



# Inflation levels are determined primarily by budget expenditure and public spending!

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Investments



Excess revenue should be used primarily for:

- Infrastructural investment;
- Pension system reform;
- Early repayment of foreign debt;
- (Cut in taxes for the enterprise sector).