NATIONAL BANK OF SERBIA

Speech at the presentation of the Annual Financial Stability Report for 2016

Dr Jorgovanka Tabaković, Governor

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

Welcome to the presentation of the Annual Financial Stability Report for 2016. Consistent with best international practice, for the third year in a row, we have been presenting to you our analyses aimed at assessing the resilience of the financial system to shocks, and the measures that we adopt in order to make the system even more resilient.

Serbia is a small and open economy, which is why the developments in the international environment, notably in the euro area, may impact the domestic financial system. Last year saw a slowdown in global economic growth, the UK's decision to withdraw from the EU, and soaring oil prices following the decision of the major producers to cap oil production for the first time since 2008. Coupled with this, the divergence of monetary policies of the leading central banks still remains the key factor of uncertainty in the international financial market given that the ECB decided to extend the quantitative easing programme at least until late 2017, while the Fed continued with monetary policy normalisation. These decisions of the leading central banks may affect capital flows to emerging economies, including Serbia.

Carefully following the developments in the domestic and international markets, we responded in a timely fashion, which, along with full coordination with fiscal policy, helped further narrow the internal and external imbalances in 2016. This buttressed the resilience of our economy to influences from the international environment.

At the same time, we achieved economic growth, low inflation, a relatively stable exchange rate, and earned the trust of foreign investors in the domestic economy. The cycle of key policy rate cuts, launched in May 2013, continued into 2016. Still, we exercised due caution over uncertainties in the international commodity and financial markets. The key policy rate was cut to 4% – its lowest level in the inflation targeting regime. As a result, and given the falling risk premium of the country, interest rates on corporate and household loans declined, whilst government borrowing costs fell to their lowest.

A reduction in average dinar and foreign currency borrowing costs was certainly one of the factors leading to a better financial result of the corporate sector. In 2016, economic agents achieved three and a half times higher positive net financial result compared to 2015. I presented concrete data at the presentation of the May *Inflation Report*. The share of corporate NPLs in total NPLs declined significantly, as well as the number of economic agents with blocked accounts in enforced collection.

Inflation running low for three years, strengthening of macroeconomic fundamentals and better prospects going forward opened room to make the decision, in November last year, to lower the inflation target to

3%±1.5 pp starting from 2017. That this decision was justified is indicated by inflation moving within the new, lower target band as of early this year, as well as by anchored inflation expectations of the financial and corporate sectors. This serves as the best confirmation of credibility of National Bank of Serbia's monetary policy.

Significant progress in the fiscal policy field continued in 2016. The general government deficit equalled 1.3% of GDP, this being the most favourable fiscal result in the past ten years. The public debt share in GDP headed down, for the first time since 2008.

When it comes to Serbia's financial sector, all facts testify to its stability, as my colleagues will also corroborate. Given that the financial sector is bank-centric, the financial health of banks and their capacity to perform their core function of financial intermediation is key for maintaining financial stability. In this context, it is important that banks operating in Serbia largely rely on domestic, stable sources of funding. This reduces banks' exposure to risks stemming from the international environment, and mitigates the risk of sudden withdrawal of funds by parent banks, which was one of the challenges facing the countries in the region in the crisis period. In 2016, Serbia's banking sector remained well-capitalised and highly liquid, with higher profitability compared to the same period last year. Quarterly macroprudential stress tests confirm high resilience of the banking sector to different macroeconomic shocks – namely, the banking sector would remain adequately capitalised and liquid even if the worst-case macroeconomic scenario materialised.

The extension of household loans stepped up further in 2016. Acceleration of economic activity, favourable trends in the labour market and a further decline in interest rates on loans impacted the growth in loan demand. As a consequence of higher demand and the supply of loans, the volume of new household loans was by 33% higher in 2016 compared to 2015, with close to 75% pertaining to dinar loans.

The achieved results of overall economic policy have been confirmed by the IMF, credit rating agencies, foreign investors and the EBRD, which was the first international financial institution to issue dinar securities in the Serbian market. The issue of these securities gave a contribution to the process of dinarisation, which is one of our priorities. The results have also been confirmed by Serbia's progress on the Doing Business list, with the country ranking among ten countries that achieved the strongest progress.

We are satisfied with the fact that by achieving the main objectives of the National Bank of Serbia – preservation of price and financial stability, we contribute to the improvement of the position of our country in the international context.

The National Bank of Serbia's efforts in the past period focused also on resolving the NPL issue. I can say with great pleasure that the National Bank of Serbia's Action Plan for implementation of the NPL Resolution Strategy has been fully implemented, within the envisaged deadlines. Banks' capacities have been strengthened, with improvements made in the field of application of accounting standards, transparency of bank operation, practice of forbearance and the development of the NPL market. The results of these activities are more than obvious. In May 2017, the share of NPLs in total banking sector loans equalled 16.1%, this being its lowest level since 2010. Let me remind you that in August 2015, when the Strategy was adopted, this share stood at 22.2%. This implies a drop of over 6 percentage points, which confirms that the systemic, interinstitutional and coordinated approach of the National Bank of Serbia, the Government and market participants is yielding the desired results.

By analysing the risks that may jeopardise financial stability, we always aim to act pre-emptively, among other things by enhancing the regulatory framework in accordance with the EU *acquis* and the Strategy for Introduction of Basel III Standards in Serbia. The regulations transposing these standards in the domestic legislation were adopted in December 2016, with the start of application on 30 June 2017. We may freely say that as of that date, the operation of Serbian banks is regulated in the same way as in EU countries. The introduction of Basel III standards will further increase the already high resilience of the banking sector, by enhancing the quality of capital, better monitoring and control of risks, strengthening market discipline and transparency of bank operations. An important novelty are the capital buffers which increase the quality of bank capital and further limit systemic risks, thereby contributing to the preservation and strengthening of the stability of Serbia's financial system.

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

Behind us is the year in which, owing to efficient coordination of monetary, fiscal, microprudential and macroprudential policy, macroeconomic stability of the country has been preserved and the resilience of the domestic financial system strengthened. The National Bank of Serbia will remain committed to long-term stability of our financial system, in the general interest of all participants, this being a precondition for long-term sustainability of economic growth.

Thank you for your attention. I now give the floor to Vice Governor Diana Dragutinović.