NATIONAL BANK OF SERBIA

Press release about the publication of the *Annual Financial Stability Report* for 2019

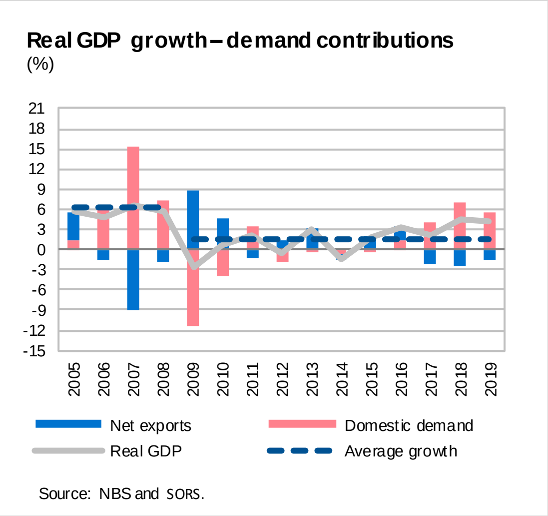
NBS Publishes Annual Financial Stability Report for 2019

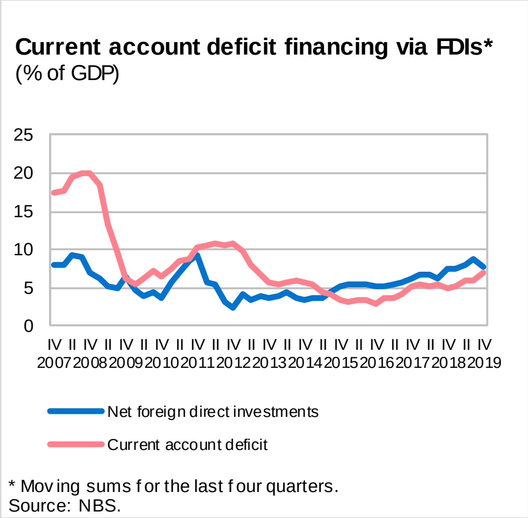
The *Annual Financial Stability Report* gives an overview of developments in the financial sector, and describes trends and key risks arising from the domestic and international environments, as well as regulatory measures undertaken to mitigate those risks and prevent their occurrence. Developments in the banking and non-banking sectors are also presented, as well as movements in different segments of the financial market. In addition, the text boxes in the *Report* cover in particular the most important current topics in the areas of financial stability and macroprudential policy at home and abroad.

In the prior year, global economic growth posted the slowest rate since the global economic crisis of 2007/2008 amid subdued production and trade activities, as well as the trade tensions between the USA and the rest of the world. Growth decelerated in both developed and emerging countries. As for the euro area, Serbia's key financial and trade partner, growth slowed down to 1.2% in 2019 (1.9% in 2018). Around the end of the year, there were indications of the biggest world economies returning to the path of recovery, which was then cut short due to the sudden and unexpected outbreak of the coronavirus pandemic. International institutions estimated that the spread of the coronavirus pushed the global economy into recession and significantly deteriorated its chances of growth, while recovery is not expected until 2022.

- ✓ ***Macroeconomic stability was achieved and preserved***

Despite challenges arising from the international environment, Serbia's GDP rose 4.2% in 2019, largely driven by a strong increase in fixed investments, notably in transport and energy infrastructure, as well as investments in machines and equipment. The achieved and preserved macroeconomic stability was conducive to a further rise in investor confidence and their appetite for longer-term investments in Serbia, as attested by the record-high inflow of foreign direct investment, the country risk premium falling to the lowest level on record, and credit rating upgrade to a notch away from investment grade. The country's external position has been fortified, and for five years straight the current account deficit has been fully covered by foreign direct investment, which measured EUR 3.6 bn in 2019, up by 13.5% from 2018.





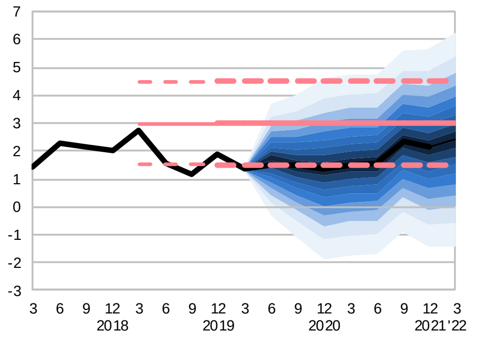
The achieved price and financial stability, as well as ordered public finances, were confirmed by Moody's improving Serbia's credit rating outlook from "stable" to "positive", and Fitch and Standard &Poor's improving the rating from BB to BB+.

Owing to consistent monetary policy pursuit and full coordination with the fiscal policy, the National Bank of Serbia has made a significant contribution to the achievement of good economic results, thus strengthening the foundations for future sustainable growth. It was these results that were reflected on a considerable fall in the risk premium on the dollar debt, measured by the EMBI, which fell to its historical minimum of 5 bp in the second half of December 2019. At end-2019, the risk premium on the dollar debt stood at 19 bp and was among the lowest in the region. Thus, by preserving stability and transforming its economy, for the first time in history Serbia came a step away from investment grade, which is characteristic of economies with high investment safety.

✓ ***For seven years in a row, inflation was kept low and stable***

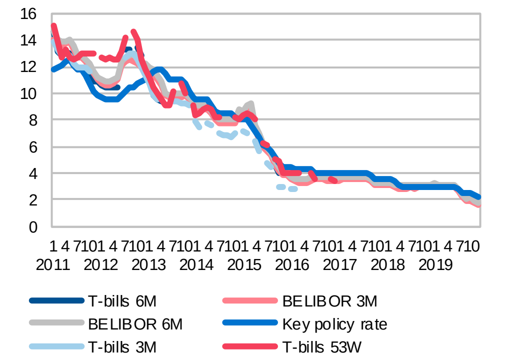
For seven years in a row inflation remained low and stable, and in December 2019 it measured 1.9% y-o-y. Low inflationary pressures are anticipated going forward as well, as indicated by short-term inflation expectations, which continue to move within the bounds of the target tolerance band (3±1.5%). Against the backdrop of low inflationary pressures, as well as risks emanating from the international environment, during 2019 the National Bank continued to pursue a cautious monetary policy, and trimmed its key policy rate three times – in July, August and November, each time by 0.25 pp, to 2.25%, its then lowest level in the inflation targeting regime. This way the National Bank offered additional support to credit and economic growth, and directly contributed to more favourable financing conditions and a higher disposable income for households and corporates. During the year, lending activity continued to increase due to factors on both the supply and demand sides, which means that it was not excessive and did not pose a risk to financial system stability.

Inflation projection*
(y-o-y growth rates, %)



* May 2020.
Source: NBS.

Interest rates in the money market and auctions of government bills
(monthly averages, %)



Sources: Ministry of Finance and NBS.

✓ ***In 2019 responsible fiscal policy was fully coordinated with monetary policy***

In 2019, the IMF Executive Board adopted a decision on the successful second and third review of Serbia’s economic performance supported by the Policy Coordination Instrument, which is advisory and does not envisage the use of funds. The share of the central government debt in GDP equalled 52.0% at end-2019, down by 1.7 pp from end-2018. The share of the general government debt amounted to 52.9% of GDP in the same period. In addition to its lower share in GDP, 2019 also saw a significant improvement in the currency composition of public debt, as its share in US dollars was as much as 6.4 pp lower than in 2018 and the dinar share 1.7 pp higher.

In June 2019 the Public Debt Administration successfully issued the first euro-denominated government bond in the international capital market, in the total amount of EUR 1.0 bn, which matures in 2029, and in November it reopened the issue in the amount of EUR 550 mn. The funds obtained through these issues were used for the early buyback of a portion of the more costly dollar eurobond issued in 2011 and 2013. Another confirmation of the successful results achieved in terms of developing the Serbian economy and continuing the development of its financial market is the fact that at end-January 2020, J.P. Morgan officially announced that Serbia’s dinar bonds were placed on Index Watch Positive for potential inclusion into the J.P. Morgan Government Bond Index – Emerging Markets (GBI-EM) series.

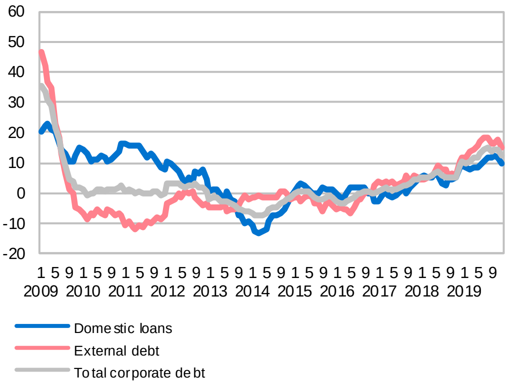
✓ ***Corporates continued to operate at a profit and the household sector continued to record positive tendencies***

The economic policy makers’ best response to the rising uncertainty from the international environment is the strengthening of the domestic economy. In 2019, corporates continued to operate at a profit, owing to the preserved macroeconomic stability and implemented structural reforms, including robust domestic demand and a stimulating business and investment environment. Domestic corporate loans, excluding the exchange rate effect, increased by 9.5% y-o-y in 2019. Corporates recorded a positive net financial result of RSD 387 bn.

In 2019, the volume of new household loans was by 13.1% higher than in 2018, reflecting favourable labour market trends and falling interest rates. Dinar household savings recorded an exceptionally vibrant growth trend in 2019, standing at record RSD 79.0 bn at the year-end, up by RSD 18.5 bn from late last year. Dinar savings have been on a continuous rise for a longer period already, suggesting that citizens’ trust in the domestic currency is constantly rising.

Corporate credit activity*

(y-o-y growth rates, in %)

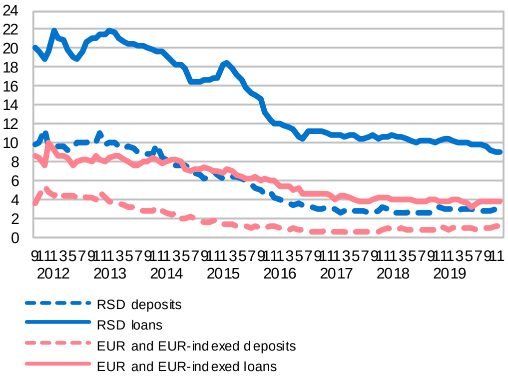


* Excluding the exchange rate effect.

Source: NBS.

Interest rates on RSD, EUR and EUR-indexed household loans and deposits – new business

(weighted average, %)

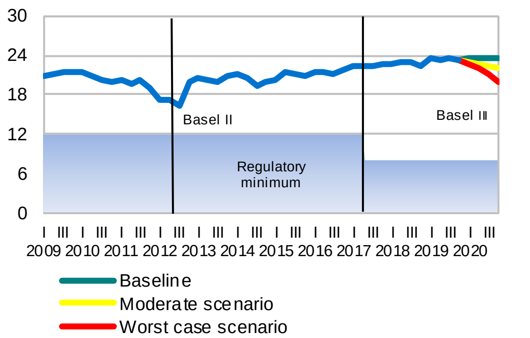


Source: NBS.

✓ ***Strong and stable banking sector and preserved financial stability***

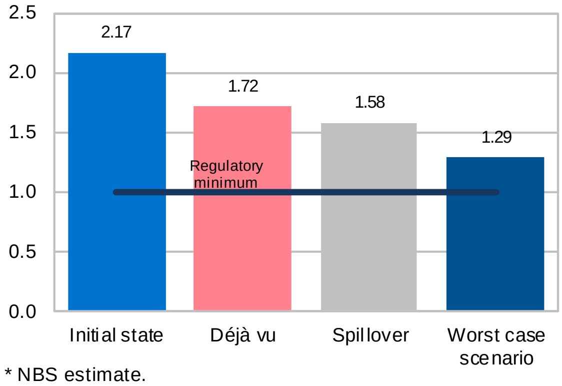
Serbia's banking sector, making up over 90% of financial sector assets, was stable in 2019 owing to adequate capitalisation, high liquidity and profitability. Throughout the year, banking sector adequacy and liquidity ratios were significantly above the prescribed thresholds. At year-end, banking sector profitability resulted in the ROA of 1.8% and ROE of 9.8%. In addition, the results of macroprudential stress-tests, which we continued to regularly implement in 2019, confirm that banking sector capitalisation and liquidity would not be jeopardised even in the case of extremely negative developments.

CAR by stress scenario*
(%)



* NBS estimate.
Source: NBS.

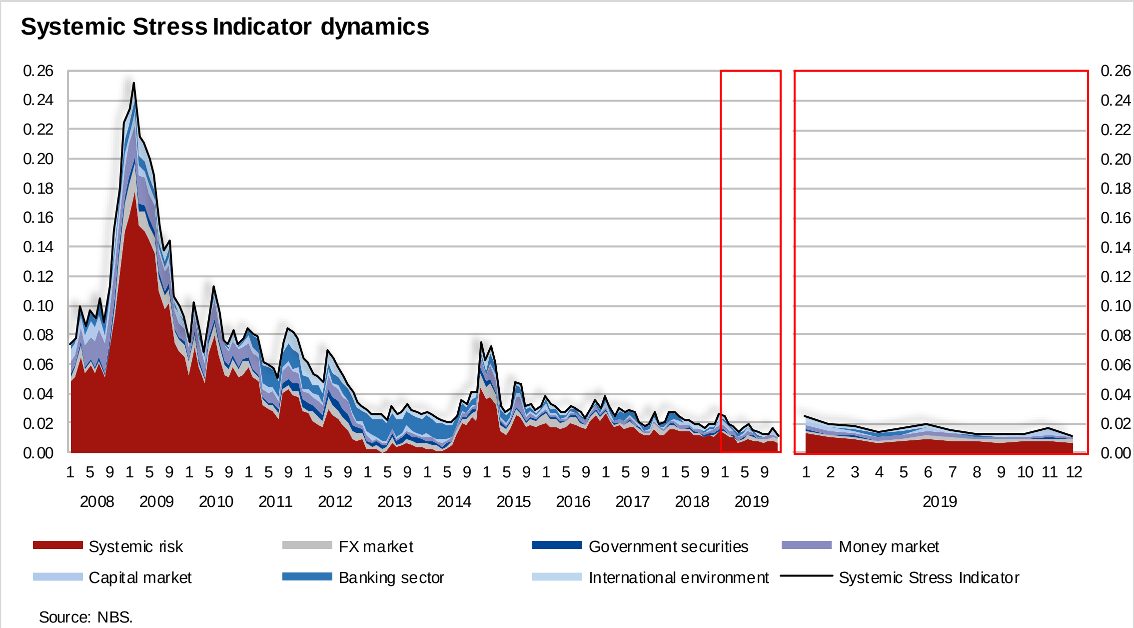
Liquidity ratio for the banking sector by stress scenario*



* NBS estimate.
Source: NBS.

At end-2019, the share of NPLs in total banking sector loans stood at 4.1%, the then lowest level on record. The NPL share dropped by 18.3 pp compared to July 2015, i.e. the period before the adoption of the NPL Resolution Strategy.

Overall financial stability was assessed based on the composite systemic stress indicator and other financial soundness indicators. In 2019, the systemic stress indicator touched its historically lowest level, indicating a period of an extremely low risk, with a low and stable systemic component. The measures of monetary, microprudential and macroprudential policy of the National Bank of Serbia, along with positive macroeconomic developments, contributed to the lowering of the level of systemic risk and further strengthening of the resilience and stability of the financial system of the Republic of Serbia.



✓ ***Effects of the coronavirus pandemic (COVID-19) and the National Bank of Serbia's response***

One text box in the *Annual Financial Stability Report* for 2019 analyses the impact of the pandemic on global financial stability. The fast spread of the virus in almost all countries in the world and the introduction of containment measures triggered a sharp rise in uncertainty in the international commodity and financial markets. The coronavirus pandemic did not bypass Serbia either, which readily faced the crisis, by responding in a timely manner and implementing adequate monetary and fiscal policy measures.

The National Bank of Serbia was the first institution in the country and one of the first central banks in the region which responded to the pandemic by adopting concrete measures in order to ensure support to the domestic economy and citizens. By cutting the key policy rate, the National Bank supported credit and economic growth, i.e. the Programme of Economic Measures adopted by the Government.

The possibility for the National Bank of Serbia to respond with these measures and to contribute, in full coordination with the Government, to the reduction in the negative effects of the pandemic, was created in the previous period. Serbia faced this crisis in a much better position, with an economic growth rate of over 4.3% on average in the past two years, low and stable inflation for the seventh year in a row, eliminated fiscal imbalances and significantly reduced external imbalances, and the country's FX reserves at the highest level on record.

Despite the crisis caused by the coronavirus pandemic, in March 2020 Fitch Ratings kept Serbia's credit rating at BB+, with a stable outlook. In May and June 2020, Standard & Poor's made the same decision. Both agencies emphasized Serbia's increased resilience to external shocks owing to significantly reinforced FX reserves and a created fiscal space, which enabled economic policy makers to respond quickly when the pandemic broke out.

Going forward, the National Bank of Serbia will continue to respond in a timely manner with all available measures and instruments in order to preserve financial stability and thus facilitate the position of citizens and corporates in the current extraordinary circumstances.