**NATIONAL BANK OF SERBIA**

# Press release about the publication of the *Annual Financial Stability Report for 2021*

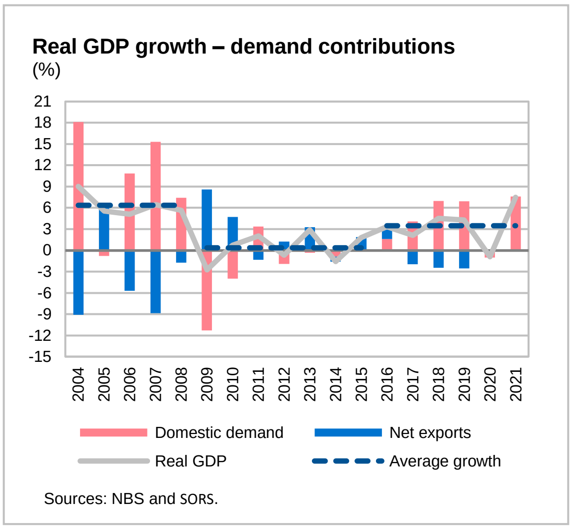
# *NBS publishes Annual Financial Stability Report for 2021*

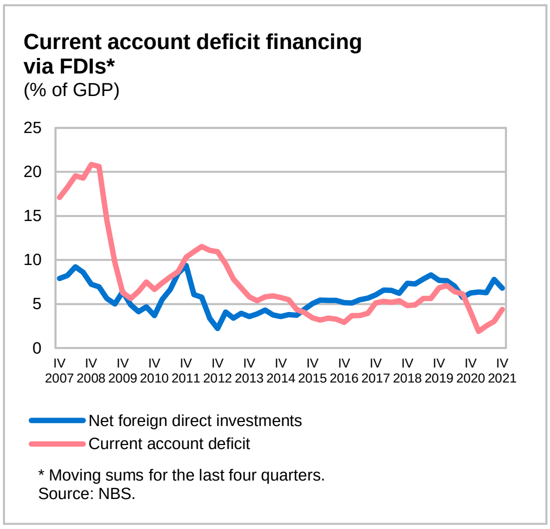
Committed to transparent communication with the public, the National Bank of Serbia (NBS) publishes the *Annual Financial Stability Report.* The aim is to provide information about the situation and risks in the financial system and to timely alert to potential systemic risks. To this end, this *Report* gives an overview of key systemic risks from the domestic and international environment, and regulatory measures undertaken to mitigate or eliminate them, or prevent their materialisation. The text boxes contained in the *Report* elaborate on the most topical issues globally and at home in the field of financial stability and macroprudential policy.

The year 2021 was marked by uncertainty associated with global economic recovery, trends in international financial and commodity markets, including the emergence of new coronavirus strains, the availability of vaccines and the pace of their rollout. However, compared to 2020, which saw a global downturn of 3.1%, the global economy picked up 6.1% in 2021. The growth in the euro area, with which Serbia fosters the most important financial and trade links, amounted to 5.4% in 2021 (vs. a 6.4% drop in 2020). As the global prices of energy and primary agricultural commodities touched their multiple-year highs and supply chains were disrupted, inflation surged globally in 2021. These global developments did not bypass Serbia either. Nonetheless, the earlier achieved macroeconomic and financial stability, the created fiscal room, and the application of a timely and large-scale package of economic measures to support businesses and citizens, helped Serbia face the above challenges better than most European countries.

- ✓ ***Despite the ongoing pandemic and mounting geopolitical tensions in 2021, Serbia preserved and reinforced macroeconomic stability.***

Serbia achieved one of the best results in Europe in terms of the GDP growth rate, which came at 7.4% in 2021, owing primarily to the expansion of the service sector, as well as the sectors of construction, manufacturing and mining. Despite the pandemic, net FDI inflow reached EUR 3.6 bn in 2021, exceeding the record level from 2019. For the seventh year in a row, the current account deficit was fully covered by FDI – 2021 saw a record coverage of 154.7%, which also contributes to the sustainability of the country’s external position.



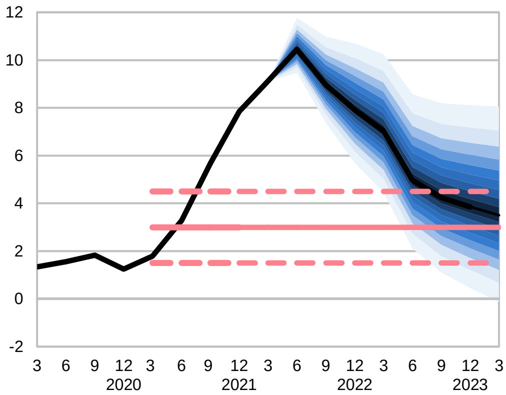

In recognition of the adequate running of the economy before and during the pandemic-related crisis, in 2021 Moody's upgraded Serbia's credit rating (March 2021), Fitch kept it unchanged (March and September 2021), and Standard & Poor's revised up the outlook from stable to positive (December 2021).

Given the conflict between Russia and Ukraine, and the spillover of that crisis to the prices of energy and other primary commodities, the NBS revised down its GDP growth projection for 2022 from 4–5% to 3.5–4.5%, while not changing the medium-term growth projection of 4–5% p.a. It may be expected that the negative effects of external factors will be minimised since investment, business and consumer confidence was preserved during the pandemic, owing to the undertaken economic measures, with FDI inflows to the country continuing and the government investing record sums in infrastructure projects. Economic growth continued in Q1 2022, despite the fallout from the Ukraine conflict. According to Statistical Office data, real y-o-y GDP growth reached 4.4% in Q1 2022, led by service sectors and the industry, and was slightly above the preliminary estimate of 4.3%.

- ✓ ***Inflation is led by food and energy prices. In 2021, average annual inflation equalled 4.0% and average core inflation 2.3%.***

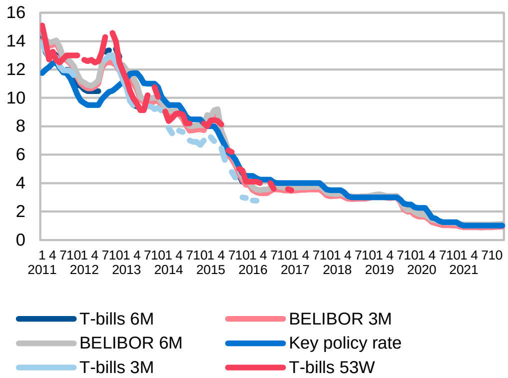
Inflation's upturn since April 2021 was led by rising prices of vegetables and global oil prices, and the exceptionally low base from the same period of 2020. As of September, inflation exceeded the upper bound of the target tolerance band. Its hike in 2021 was prompted by supply-side pressures, mainly from the international environment – higher prices of primary commodities, the European energy crisis and global supply chain bottlenecks. Namely, more than three quarters of domestic inflation was due to rising food and energy prices. Consistent with such an analysis of inflation factors, there was no need for a more aggressive monetary policy response in 2021. The NBS kept its key policy rate on hold in 2021 – at 1%. The rates on deposit (0.10%) and credit (1.90%) facilities also remained unchanged. As of October 2021, the NBS began to tighten monetary conditions, by gradually raising the weighted average repo rate at repo securities sale auctions, and discontinuing repo securities purchase auctions via which it had been providing dinar liquidity to banks in the prior period. As the main risks to inflation and other economic developments still emanate from the international environment, the NBS continues to monitor and analyse trends in the international commodity and financial markets, and assess their impact on the Serbian economy. Under the central projection from May 2022, y-o-y inflation is expected to decline as of H2 2022, and return within the target band in H2 2023.

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




* May 2022.
Source: NBS.

**Interest rates in the money market and auctions of dinar T-bills**
(monthly averages, %)



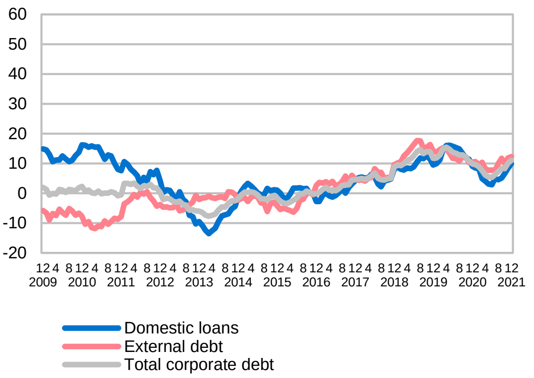

Sources: Ministry of Finance and NBS.

The relative stability of the dinar exchange rate against the euro was preserved in 2021 owing to adequate NBS interventions in the interbank FX market, despite the persisting global uncertainty and inflationary pressures from the international environment. In 2021, NBS FX reserves increased, further strengthening the resilience of the domestic system to external risks.

Lending continued up in 2021, reflecting both supply- and demand-side factors. At end-2021, total domestic loans rose 9.9% y-o-y, excluding the exchange rate effect. Loan supply was driven up by past monetary policy of the NBS, extension of the deadline and amount of loans approved under the guarantee scheme, favourable financing conditions in the domestic and international money markets, and interbank competition. On the other hand, loan demand increased on the back of elevated needs for liquidity provision, the restructuring of liabilities and real estate purchases.

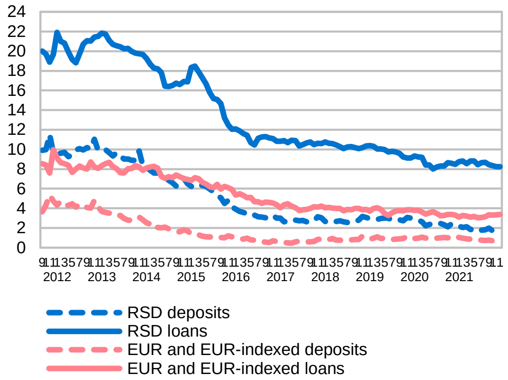
Favourable borrowing conditions in the domestic and international money market propped up investment loans, which indicates a favourable structure of lending activity from the aspect of support to sustainable economic growth. The share of NPLs in total corporate loans declined further.

**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.

The key labour market indicators displayed positive trends in 2021, despite the spread of new coronavirus strains and supply bottlenecks. At the same time, the real disposable income and domestic demand recovered. Dinar savings continued up as it was more profitable to save in dinars than in a foreign currency. At end-2021, dinar savings amounted to RSD 103.7 bn, up by RSD 11.2 bn from end-2020.

✓ ***Economic policy measures eased the negative consequences of the pandemic.***

Against the backdrop of a prolonged pandemic and the adoption of a large-scale package of measures supporting businesses and citizens, in 2021 the fiscal deficit measured 4.1% of GDP, which was much below the last year's figure of 8.0%. A significant portion of public expenditure concerned capital investment, which in 2021 reached record 7.4% of GDP, contributing further to sustainable economic growth.

Owing to vibrant economic growth, the public debt share in GDP fell to 56.5% at end-2021, down by 0.5 pp y-o-y. As the share continued down in 2022, central government public debt equalled 52.3% of GDP in May 2022. However, a high share of foreign currency public debt suggests the presence of the FX risk, including the risk of EUR/USD volatility. The share of

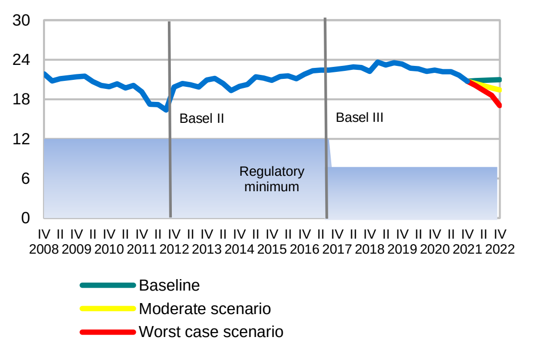
US dollar debt declined in 2021, while the share of euro debt went up, mainly owing to the issues of government eurobonds in the international market. In mid-September 2021, Serbia issued a green eurobond for the first time, thus becoming one of the few European countries and the first non-EU European country to have issued a green instrument. At the same time the 15-year conventional eurobond was also issued, at the longest maturity so far.

Fiscal policy remained sustainable even during the pandemic, as also confirmed by the IMF. In 2021, the IMF concluded regular Article IV consultation with Serbia and adopted decisions on the successful completion of the previous and approval of the new economic programme supported by the Policy Coordination Instrument. As the previous one, the new programme is of advisory nature and lasts until late 2023. In June 2022, the IMF concluded the second review of Serbia’s economic programme, stating that macrofinancial stability of the country has been maintained despite the uncertain environment, and that the medium-term growth outlook remains favourable, supported by the authorities’ commitment to structural reforms.

A great recognition of all the activities aimed at the development of the domestic financial market came from J.P. Morgan, which, on 30 June 2021, included dinar government bonds in its renowned GBI-EM Global Diversified index. The objectives and measures for the further development of the domestic financial market are defined by the Capital Market Development Strategy for 2021–2026, adopted in October 2021. The new Capital Market Law, adopted in December 2021, also contributes to the attractiveness of the domestic market and the investor appetite.

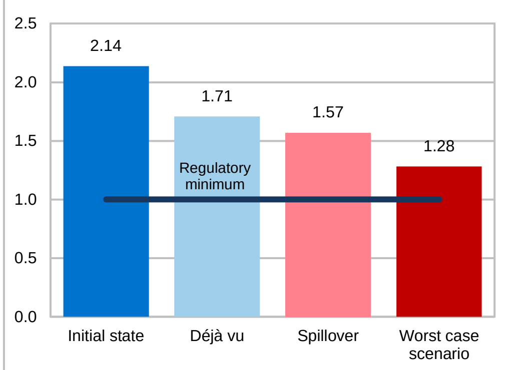
- ✓ ***The Serbian banking sector remained resilient to shocks, and has preserved its stability, high capitalisation and liquidity.***

The Serbian banking sector, making up around 91% of financial sector assets, remained stable owing to adequate capitalisation, high liquidity and profitability. Throughout 2021, capital adequacy and liquidity ratios were much above the prescribed thresholds. The achieved profitability of the banking sector in late 2021 resulted in a 1.2% ROA and a 7.8% ROE. Moreover, the results of macroprudential stress testing confirm that the banking sector as a whole would remain highly resilient even to the strongest of shocks, and that it has sufficient capacity to absorb the consequences of the risks it might be exposed to.




**CAR by stress scenario***
(%)

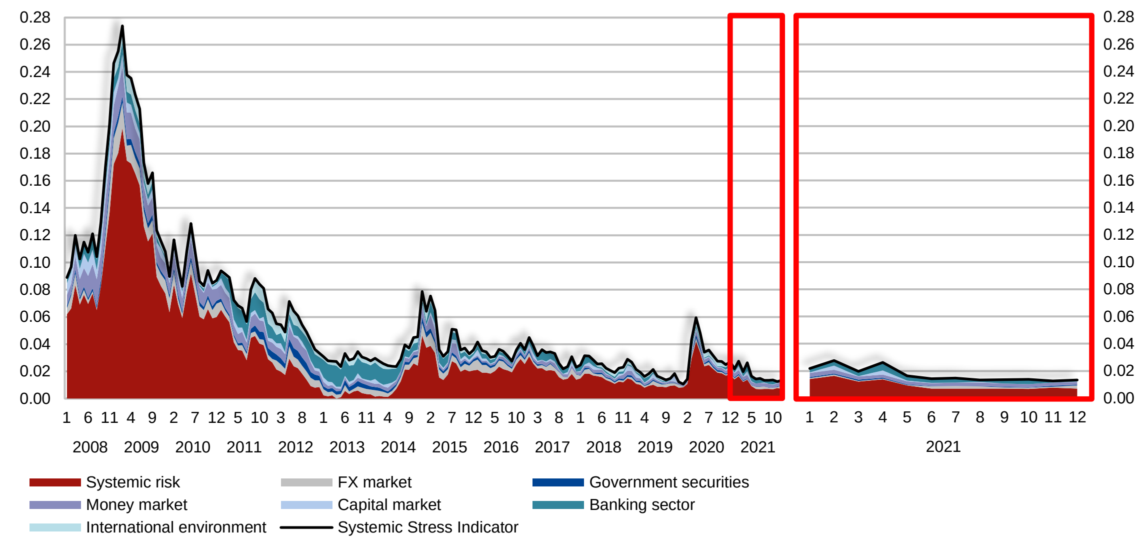
* NBS estimate.
Source: NBS.




**Liquidity ratio for the banking sector by stress scenario***

* NBS estimate.
Source: NBS.

Owing to stepped-up lending, systemic resolution of NPLs, and the measures to mitigate the pandemic fallout, the NPL share continued down, to 3.6% at end-2021, down by 0.1 pp y-o-y, and by as much as 18.7 pp compared to August 2015, when the NPL Resolution Strategy was adopted. The NPL share in total loans continued down, reaching a historical low of 3.3% at end-May 2022.




**Systemic Stress Indicator dynamics**

Source: NBS.

The overall financial stability was assessed based on the composite systemic stress indicator and other financial soundness indicators. The systemic stress indicator was at a low level in 2021, recording a stable systemic component, and pointing to the resilience and preserved stability of the overall financial system. The systemic stress indicator suggests that the pandemic effects that materialised in 2020 were neutralised owing to the implemented fiscal, monetary and macroprudential measures, which helped preserve the stability of the Republic of Serbia's financial system.

- ✓ ***During the pandemic 2021, the NBS continued to apply numerous measures geared at maintaining financial stability.***

In 2021, amid the prolonged pandemic, the NBS remained proactive and undertook numerous steps to support businesses and households. It prescribed measures to preserve the achieved level of stability and further strengthen the financial system in an environment of risks triggered by the extraordinary health situation and mounting geopolitical tensions.

Among other things, the NBS extended the application of measures aimed at adequate credit risk management amid the pandemic for banks and financial lessors. These measures ensured timely recognition of potential difficulties of debtors and the undertaking of appropriate steps. The application of measures facilitating natural persons' access to financing was also extended. To facilitate access to dinar sources of funding, the NBS supported dinar corporate lending by making the dinar loans approved by banks under the government guarantee schemes even more favourable compared to the initial conditions from 2020.

By extending the validity and increasing the volume of corporate loans, approved with the government guarantee under the first guarantee scheme, and by adopting the second guarantee scheme, additional liquidity to the corporate sector was provided.

All decisions and measures were adopted in a timely manner and are of limited duration. They make the financial position of debtors less difficult and ensure favourable conditions of financing for the government, banks and the private sector.

Maintaining financial stability, particularly amid heightened global uncertainty, remains the priority of the NBS, which, as so far, will be undertaking all measures under its remit and thus contribute to coordinated efforts aimed at strengthening overall macroeconomic stability.