NATIONAL BANK OF SERBIA

Speech at the presentation of the Annual Financial Stability Report for 2017

Dr Jorgovanka Tabaković, Governor

Belgrade, 30 July 2018

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

Welcome to the presentation of the Annual Financial Stability Report for 2017. Today we have the pleasure to present a report about a year marked by exceptionally positive developments, in Serbia and the international environment alike, as well as by the results we have achieved. Owing to this, financial stability has not only been maintained, but also reinforced, which is reflected in a financial system that is to a large degree resilient to any potential future shocks.

Global economic growth stepped up in 2017, which reflected positively on the growth prospects of Central, Eastern and South-Eastern European countries and pushed their risk premiums down. On the other hand, risks in the international commodity and financial markets persisted, primarily those associated with volatile movements in global oil prices and divergent monetary policies of the ECB and Fed.

Thanks to improved structural characteristics and favourable growth prospects, coupled with the enactment of well-timed measures and regulations and full coordination between monetary and fiscal policies, Serbia is now more resilient to potentially adverse effects from the international environment. This was confirmed in 2017 by credit rating upgrades by all three rating agencies, successful completion of the three-year stand-by arrangement with the International Monetary Fund and a decline in the country risk premium to its historic low.

The National Bank of Serbia remained cautious in the conduct of monetary policy in 2017 due to uncertainties in the international financial and commodity markets. As inflationary pressures were running low, the key policy rate was cut by 0.25 pp on two occasions, feeding through into lower cost of borrowing for the government, corporate and household sectors. Favourable interest rates are one of the key drivers of credit growth, which means that by easing its monetary policy the National Bank of Serbia encouraged the increase in investment and private consumption and supported sustainable economic growth.

In 2017 the National Bank of Serbia achieved its key objectives – it ensured monetary and financial stability. Throughout the year inflation was low and stable, moving within the new target band, which was lowered from 4%±1.5 pp to 3%±1.5 pp as of early 2017. The fact that inflation stood at the 3.0% target in December only confirms that the decision to lower the inflation target was correct. At the same time, inflation expectations of the financial and corporate sectors have been anchored within the target band for quite some time already, indicating confidence in the National Bank of Serbia's monetary policy.

Owing to better export performance, high FDI inflows and greater interest of foreign investors in long-term government securities, the dinar strengthened vis-à-vis the euro by 4.2% in 2017. The central bank's interventions in the foreign exchange market aimed at preventing excessive appreciation of the dinar provided an additional boost to the country's foreign exchange reserves, whose level, judging by all relevant indicators, is more than adequate.

Last year was also very successful in terms of fiscal policy results. For the first time since 2005 a fiscal surplus was recorded (around 1.2% of GDP), while the share of public debt in GDP was slashed by more than 10 pp in 2017 alone. NBS's monetary policy easing, better positioning of the country in the international financial market, stronger investor confidence, credit rating upgrades and a sharp fall in the country risk premium ensure cheaper sources of funding and reinforce Serbia's fiscal position.

Against the backdrop of GDP recovery, low and stable inflation, a relatively stable exchange rate and vigorous fiscal consolidation, positive tendencies were recorded both in the corporate and household sectors. A fall in the unemployment rate and rising wages were accompanied with growth in household loans and rising savings. The volume of new household loans increased by 21.7% compared to 2016, with almost 71% concerning dinar loans, which reflects households' confidence in the domestic currency. Households were also offered a new form of safe investment after the Republic of Serbia issued a new financial instrument – savings bonds. The issuance of savings bonds enables citizens to invest in the safest financing instruments and encourages further development of the government securities market.

The financial position of corporates improved, as reflected in their almost two and a half times higher positive net financial result compared to 2016. In addition, the lowering of interest rates led to acceleration of credit activity in the corporate sector. Excluding the exchange rate effect, total corporate loans (domestic and foreign) went up by 5.7%, despite considerable clean-ups of bank balance sheets owing to NPL write-offs, assignment and restructuring.

The Serbian financial sector remained stable in 2017 as well, as signalled by all key indicators. Given the bank-centric nature of the financial sector, banks' financial soundness and ability to perform their main, financial intermediation function is key to maintaining financial stability. Banks operating in Serbia rely predominantly on domestic, stable sources of funding, which reduces their exposure to risks from the international environment. The banking sector remained adequately capitalised, highly liquid and profitable in 2017. Our quarterly macroprudential stress tests show that the domestic banking sector, as a whole, would remain resilient to shocks even if the worst-case scenario materialised.

I wish to particularly highlight the exceptional results achieved in reducing NPLs owing to measures undertaken in the context of the NPL Resolution Strategy and other regulatory measures of the National Bank of Serbia. After the National Bank of Serbia passed the Decision on the Accounting Write-off of Bank Balance Sheet Assets in August 2017, gross NPLs worth RSD 100 bn were written off in 2017, much more than in the earlier years, while RSD 24.5 bn was assigned to non-banking sector entities. The NPL share in total loans declined sharply, by almost 14 pp from the start of implementation of the Strategy. In May 2018, this share stood at 8.6%, meaning that NPLs fell below their pre-crisis level. Such a significant reduction in NPLs is indicative of considerable efforts invested in their resolution and the success achieved. It also reflects the great commitment of the National Bank of Serbia, Government and market participants. At the same time, this will further support future credit and economic activity.

In 2017, the National Bank of Serbia also adopted a set of regulations transposing the International Financial Reporting Standard 9. These regulations reflect the National Bank of Serbia's commitment to encouraging adequate implementation of international standards, increasing the transparency of financial reports in terms of the manner of valuation of balance sheet items, and strengthening confidence in the banks' financial position.

By regulating the banking area in the way it is done in the European Union and upgrading the regulatory framework, the National Bank of Serbia strengthened further the already high resilience of the banking sector. In accordance with the Strategy for Implementation of Basel III Standards in the Republic of Serbia, in December 2016 a set of regulations were adopted, in effect as of 30 June 2017. Among other things, Basel III standards introduce new capital buffers, which are some of the most important macroprudential policy tools. This helps increase the quality of capital and improve the resilience of the domestic banking sector to systemic risks, contributing to the preservation and strengthening of financial stability in the Republic of Serbia.

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

Behind us is a very successful year, as we can see in the results achieved, as well as in attained and improved macroeconomic stability. As so far, the National Bank of Serbia will remain committed to achieving its objectives, contributing to the resilience and stability of the domestic financial system.

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