Народна банка Србије

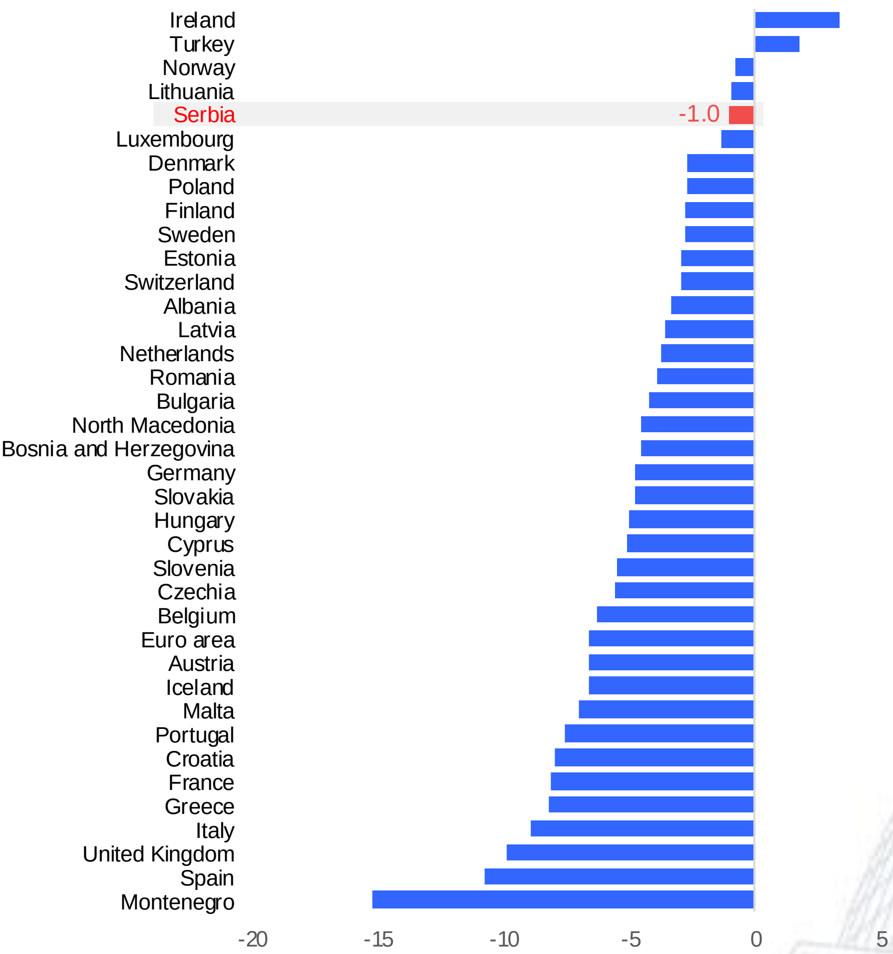
How we entered the COVID-19 crisis
What have we done and achieved
What lies ahead

Jorgovanka Tabaković, PhD
Governor of the National Bank of Serbia

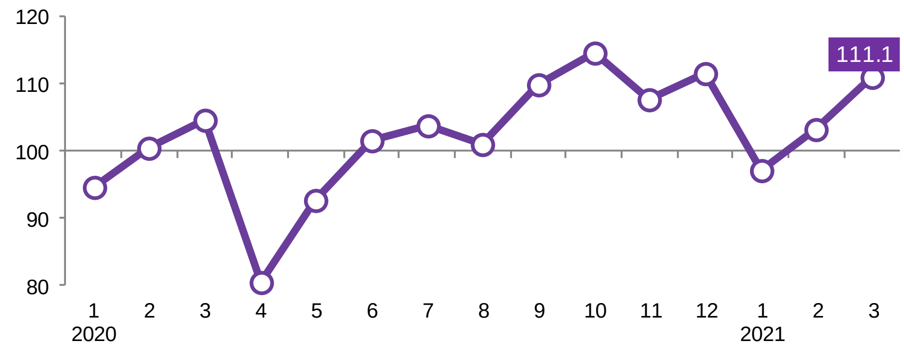
Kopaonik Business Forum, May 2021

Serbia has achieved one of the best economic results in Europe in 2020

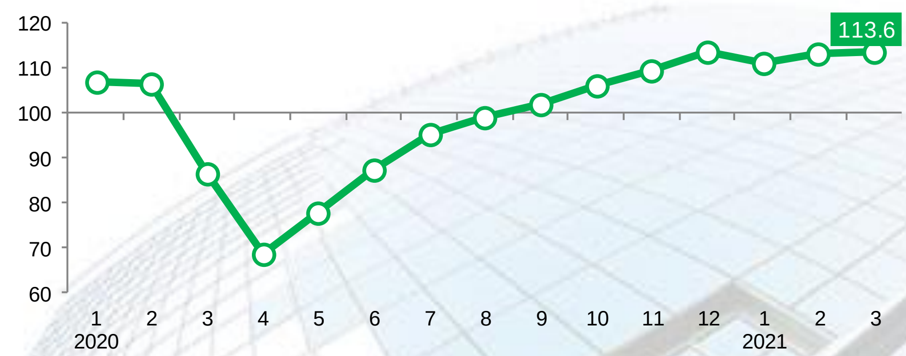
Real GDP growth in 2020 (in %)



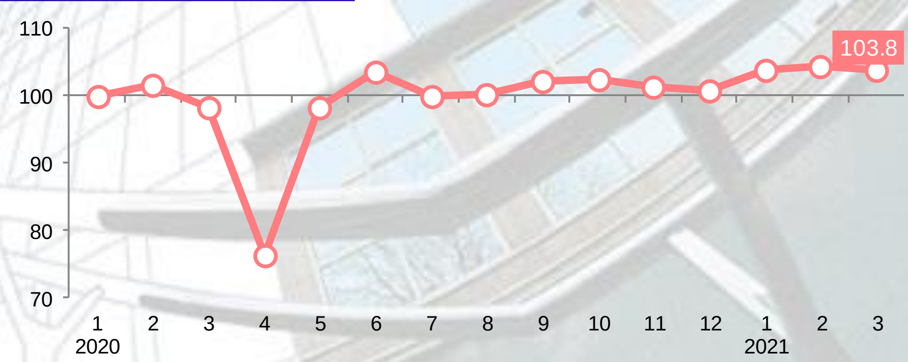
Industrial production (s-a, q1 2020 = 100)



Goods export (s-a, Q1 2020 = 100)



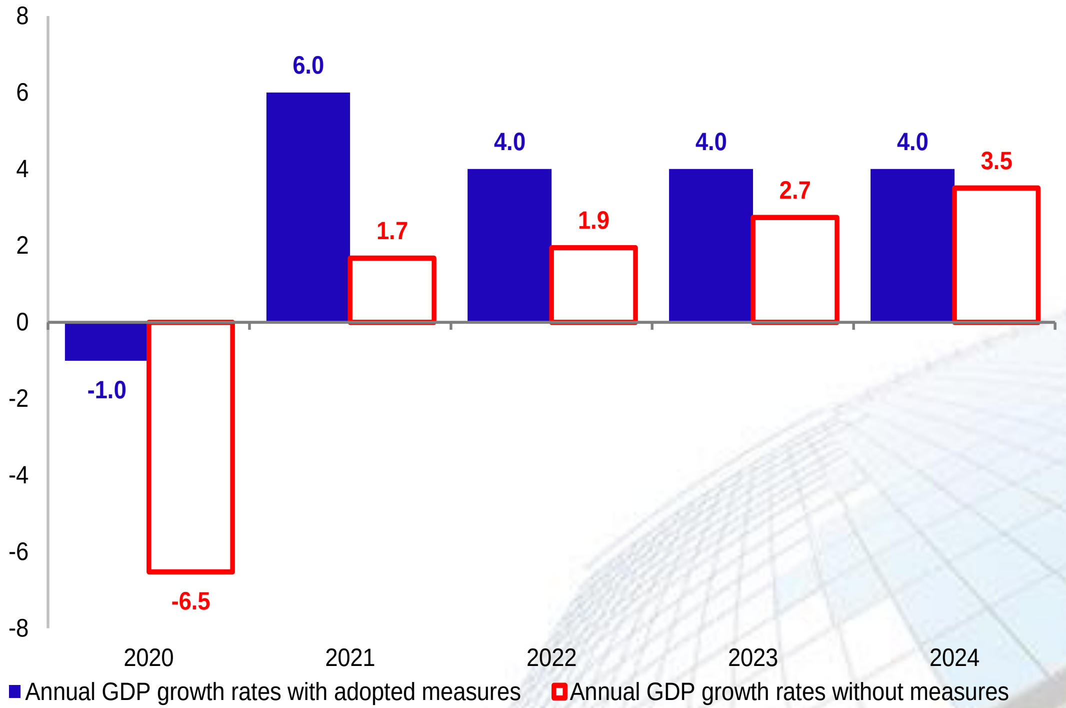
Retail trade (s-a, Q1 2020 = 100)



Results of the domestic economy at the start of 2021 are again above expectations. Serbia reached its pre-crisis level of economic activity sooner than many world economies – already in Q1 this year.

Government and NBS measures greatly mitigated the negative effects of the crisis, saved jobs and production capacity

GDP growth, 2020–2024, with and without measures (in %)

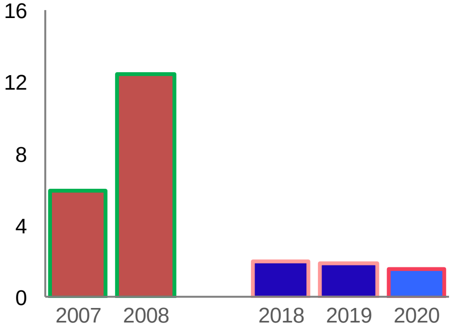


Source: SORS and NBS projection.

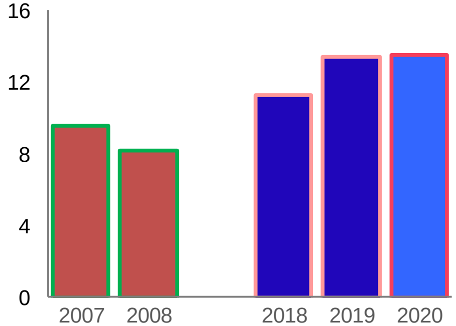
If we had not passed a number of measures immediately, and then continued to react with additional measures, the fall in economic activity in 2020 would have been at least 6%, while recovery and return of GDP to the pre-crisis level would have taken several years. This would have meant the loss of billions of euros, the loss of jobs and endangered stability. The price of not reacting would have been too high.

Serbia was better prepared for the COVID-19 crisis than the global economic crisis of 2008-2009

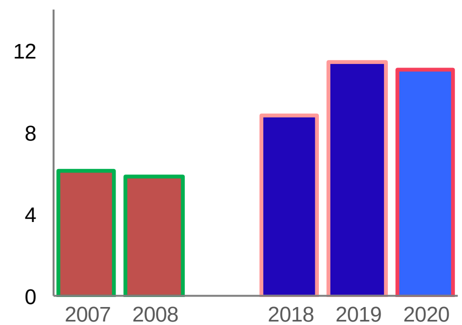
Inflation
(in %, average)



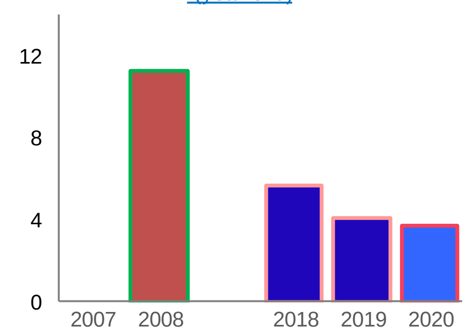
FX reserves, gross
(in EUR bn)



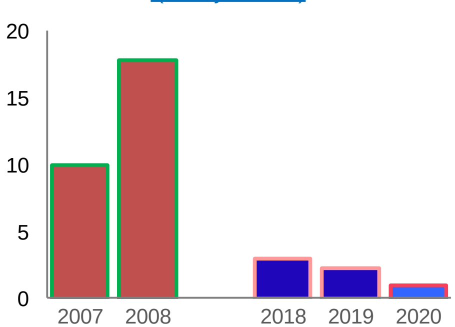
FX reserves, net
(in EUR bn)



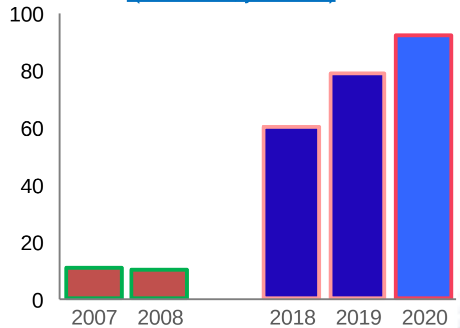
NPL %
(year-end)



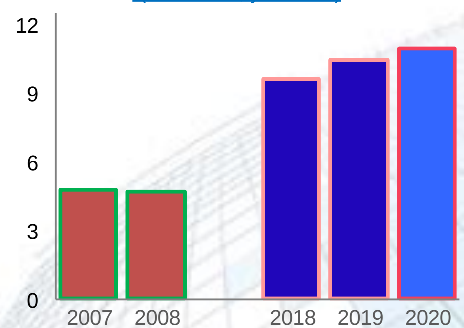
Key policy rate
(in %, year-end)



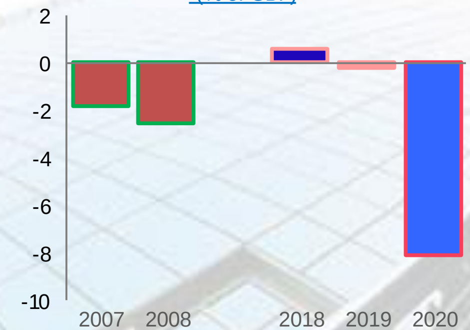
Dinar savings
(in RSD bn, year-end)



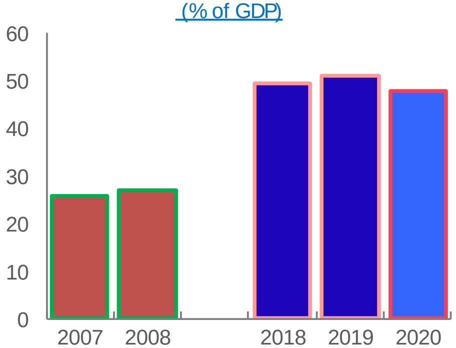
Euro savings
(in EUR bn, year-end)



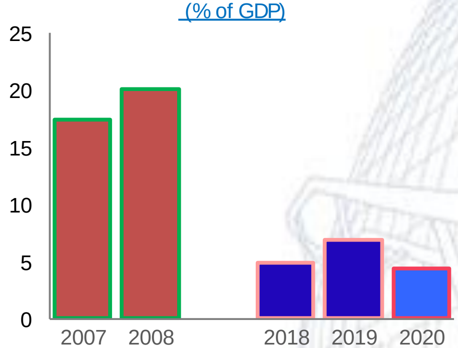
Fiscal result
(% of GDP)



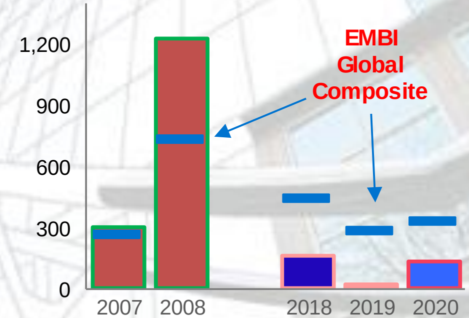
Export fo goods and services
(% of GDP)



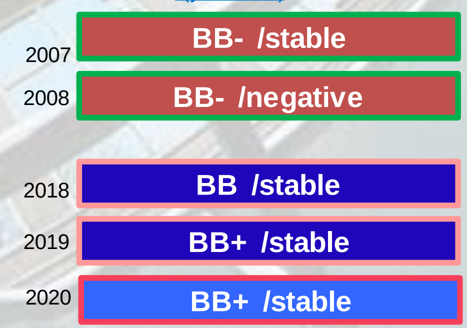
Current account deficit
(% of GDP)



Serbia's risk premium
(in bp, year-end)



Serbia's credit rating
(year-end)



NBS's response to the COVID-19 crisis

	2020										2021			
	March	April	May	June	July	August	September	October	November	December	January	February	March	April
Monetary policy measures														
Key policy rate														
	Cut by 0.5 pp, to 1.75%	Cut by 0.25 pp, to 1.5%		Cut by 0.25 pp, to 1.25%						Cut by 0.25 pp, to 1.0%				
	Rate corridor narrowed from ±1.25 pp to ±1.0 pp									Rate corridor narrowed from ±1.0 pp to ±0.9 pp				
Support to dinar liquidity														
	Additional swap auctions, 3M maturity								Additional swap auctions on a weekly basis (Mondays), 3M maturity					
		Lower interest rate on FX												
	Auctions of repo purchase of government securities, 7D maturity													
	Auctions of repo								Additional auctions of repo purchase of government securities on a weekly basis (Thursdays), 3M maturity					
		Outright purchase of government securities in the secondary market												
			Corporate bonds included in the list of eligible collateral in NBS monetary operations											
More favourable conditions for Guarantee Scheme loans														
					Approval of dinar loans under the Guarantee Scheme at lower interest rates – minimum 50 bp reduction is compensated by the NBS through the higher remuneration rate on allocated required reserves									
Additional NBS measures														
Moratorium														
		Moratorium on debt payments				Moratorium on debt payments				Moratorium on debt payments for debtors unable to settle their liabilities due to the pandemic, with the extension of the repayment period so that the debtor's monthly liabilities are not higher than before the approval of facilities				
Housing loans														
				Reduction of mandatory downpayment for first-time home buyers from 20% to 10%										
						Reduction of the minimum degree of completion of a building eligible for financing via bank housing loans								
						Extension of repayment term for housing loans by up to five years								
Other loans														
					Extension of repayment term for household loans (except housing) by up to eight years									
						Until end-2021 banks allowed to extend household dinar loans (up to 90,000 dinars) only based on signed statement on employment/pension								
Precautionary repo line with the ECB														
					Precautionary repo line with the ECB established to supply additional euro liquiduty to local banks in case of need									

Source: NBS.

With regulatory measures, we endorsed citizens and corporates to more easily overcome the crisis in financial terms

March 2020: the first moratorium on the repayment of liabilities

- ✓ Included all citizens, farmers, entrepreneurs, and corporates
- ✓ Lasted 3 months and was accepted by around 90% (more than 3 million) debtors

June 2020: facilitated access to housing loans for first-time home buyers

- ✓ The amount of the housing loan that may be approved to a first-time home buyer was increased to 90% of the value of mortgaged real estate

July 2020: extended deadline for the repayment and refinancing of consumer, cash and other loans

- ✓ Available to citizens who took the loan before 18 March 2020
- ✓ Enabled the refinancing or the change of the date of maturity of the last instalment (up to 10 years for car loans, and up to 8 years for other consumer, cash and similar non-purpose loans)
- ✓ Temporary measures made it easier for banks to manage their credit risk in the conditions of the pandemic for the loans in question

July 2020: the second moratorium

- ✓ Included all liabilities of citizens and corporates maturing in August and September 2020, as well as unsettled liabilities maturing in July 2020
- ✓ Accepted by around 79% (almost 2.5 million) debtors

August 2020: facilitated access to housing loans and short-term dinar loans

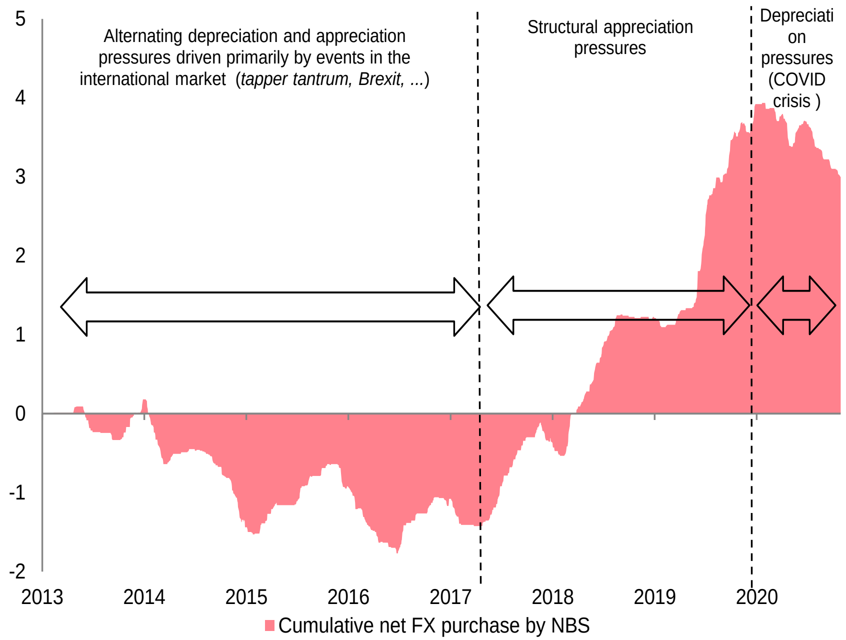
- ✓ Minimum degree of completion of a building financed by a housing loan was lowered
- ✓ Possibility of extending the deadline for the repayment of housing loans by five years
- ✓ Simplified procedure for approving short-term dinar loans up to 90,000 dinars
- ✓ Facilities are valid until end-2021

December 2020: new facilities in the repayment of liabilities of clients who are the most affected by the pandemic

- ✓ Includes debtors affected by the pandemic (inter alia: those in arrears more than 30 days, corporates – those recording a fall in business income or interrupted business due to the pandemic, citizens – unemployed and those whose average net income is below the average wage in the Republic of Serbia, etc.)
- ✓ Possibility of rescheduling or refinancing, with the approval of a six-month grace period and extended repayment term

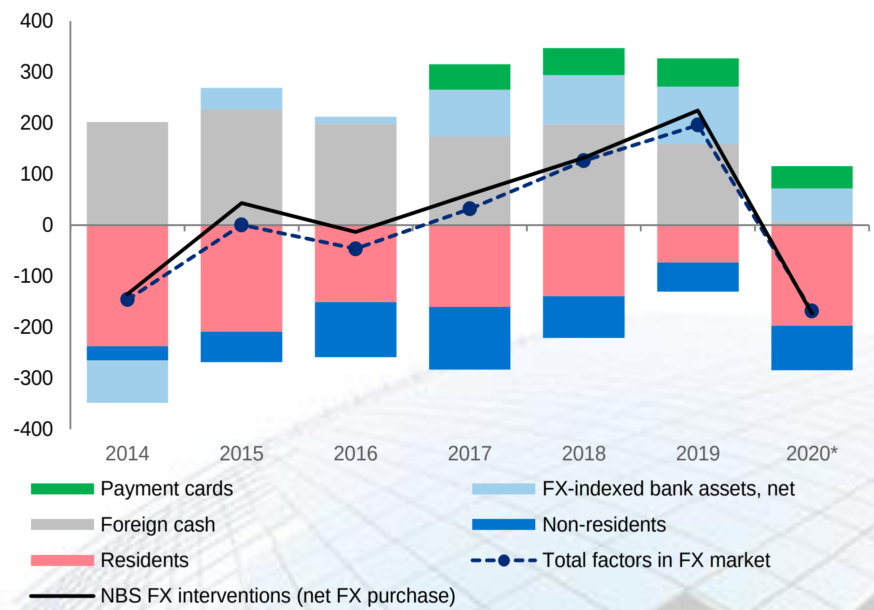
The COVID-19 crisis affected non-residents' behaviour in Serbia less than in comparable emerging markets

Cumulative amount of NBS FX interventions (in EUR bn)



Source: NBS.

Factors affecting developments in the FX market (in EUR mn, monthly averages by year)



* January–October 2020
Source: NBS.

Contribution of individual factors in the domestic FX market to explanations of the trend reversal in 2020 relative to 2019

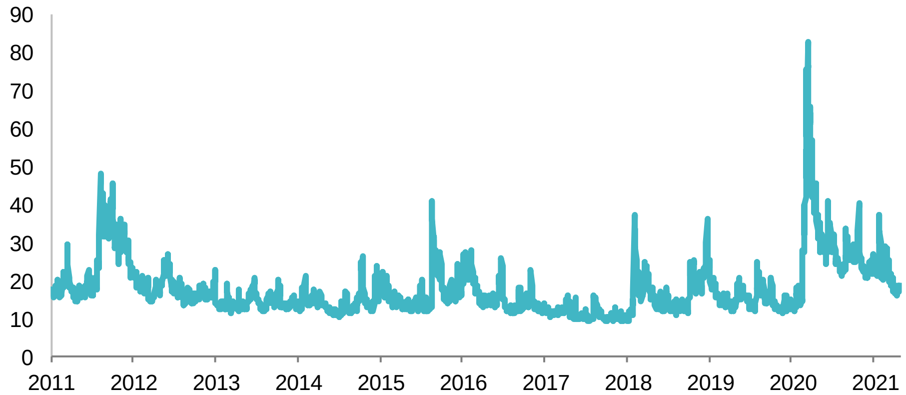
	Factors affecting trends in the domestic FX market				
	Residents	Non-residents	Foreign cash	FX-indexed bank assets, net	Payment cards
% Explanations of trend reversal in 2020 compared to 2019 (% explanations of the FX supply and demand gap in 2020 compared to 2019)	34%	8%	41%	13%	3%

Source: NBS.

An analysis of factors affecting developments in Serbia's FX market shows that the transmission of the COVID-19 crisis onto the exchange rate was carried out mainly via its influence on economic activity and citizen behaviour, and not through the outflow of capital from the country amid the withdrawal of foreign investors. This speaks in favour of our domestic economy's increased resilience to external shocks, as well as to volatility in global capital flows.

Despite rising uncertainty in the international financial market, stability was preserved in domestic markets

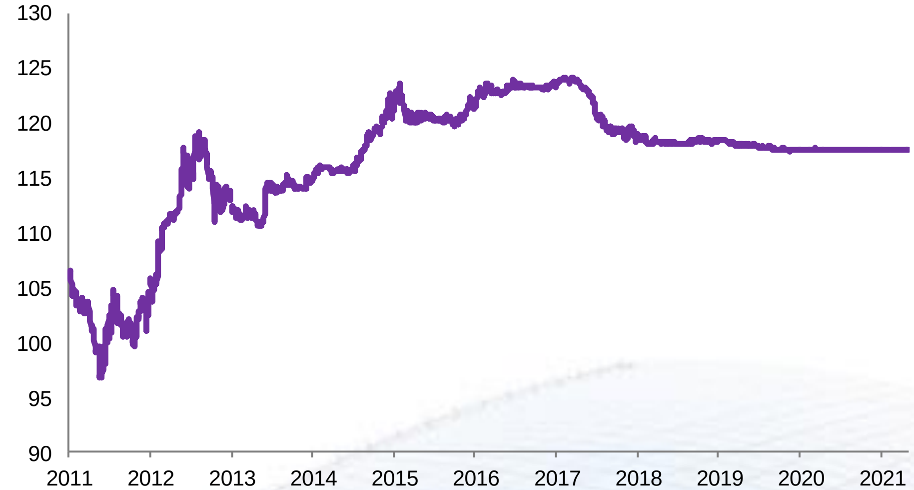
Implied volatility index – VIX*



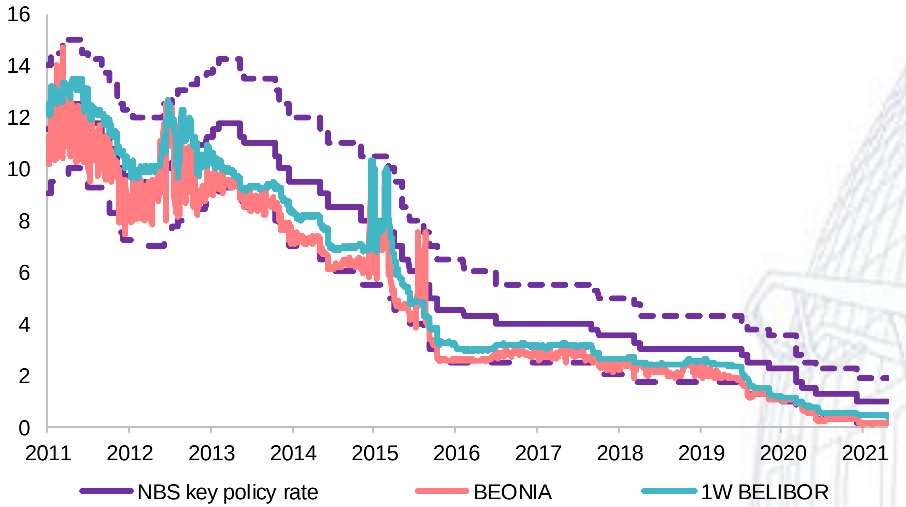
Source: Bloomberg.

* *VIX (Chicago Board Options Exchange Market Volatility Index) is a measure of implied volatility on S&P 500 index options; EM–VXY (J.P. Morgan emerging markets implied volatility index) is a measure of aggregate volatility of emerging economies' currencies on the basis of quarterly forward options.*

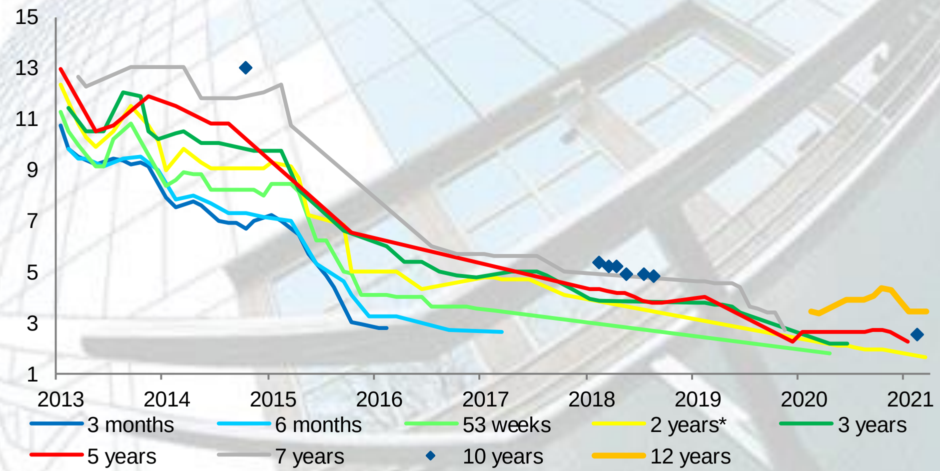
Movements in the dinar exchange rate (EUR/RSD)



NBS key policy rate and interest rates in the interbank money market (in%)



Effective rates at auctions of dinar government securities (in%)



Source: Ministry of Finance.

* Excluding coupon securities whose interest rate is linked to NBS key policy rate.

Efficiency of the interest rates channel in Serbia; fall in risk premium due to domestic factors

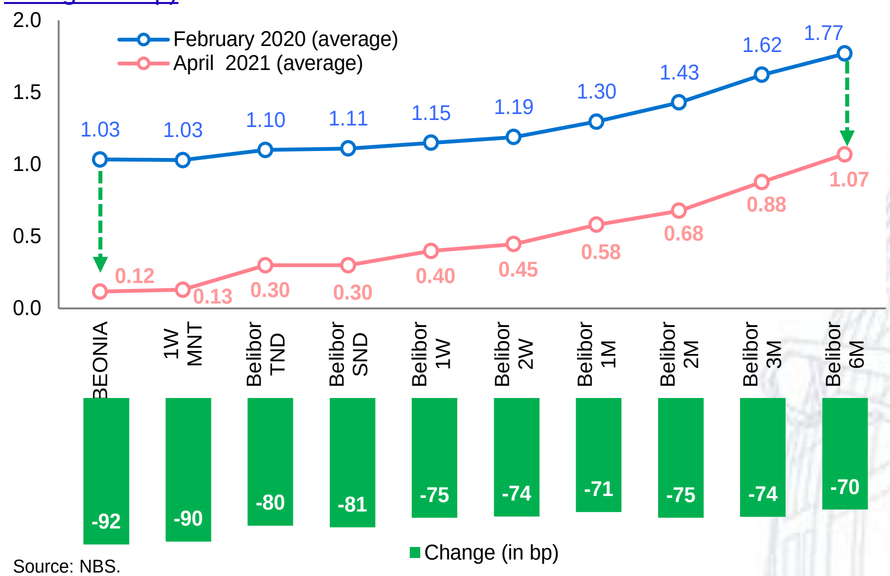
Estimated coefficients of models for loans to households, corporates and for BELIBOR

BELIBOR maturity	1W	2W	1M	3M	6M
Long-term equation for interest rates on household loans					
BELIBOR (β1)	1.10***	1.10***	1.09***	1.06***	1.04***
EMBI (β2)	0.6**	0.56**	0.55**	0.58**	0.57**
Constant (β0)	5.06***	5.16***	5.1***	4.71***	4.62***
R2	0.95	0.95	0.95	0.95	0.95
Long-term equation for interest rates on total corporate loans					
BELIBOR (β1)	1.25***	1.25***	1.23***	1.2***	1.18***
EMBI (β2)	0.7***	0.67***	0.66***	0.72***	0.71***
Constant (β0)	-1.14	-1.11	-1.18	-1.72	-1.83*
R2	0.96	0.96	0.96	0.96	0.96
Long-term equation for *BELIBOR*					
Repo rate (β_1)	1.03***	1.04***	1.05***	1.07***	1.09***
Constant (β_0)	0.24***	0.31***	0.4***	0.63***	0.78***
R^2	0.99	0.99	0.99	0.99	0.98

Source: NBS calculation.

***Means the highest statistical significance, i.e. p-value < 0.01; ** p-value < 0.05; and * p-value < 0.1.

Interest rates in Serbia's money money market (rates in %, changes in bp)



Source: NBS.

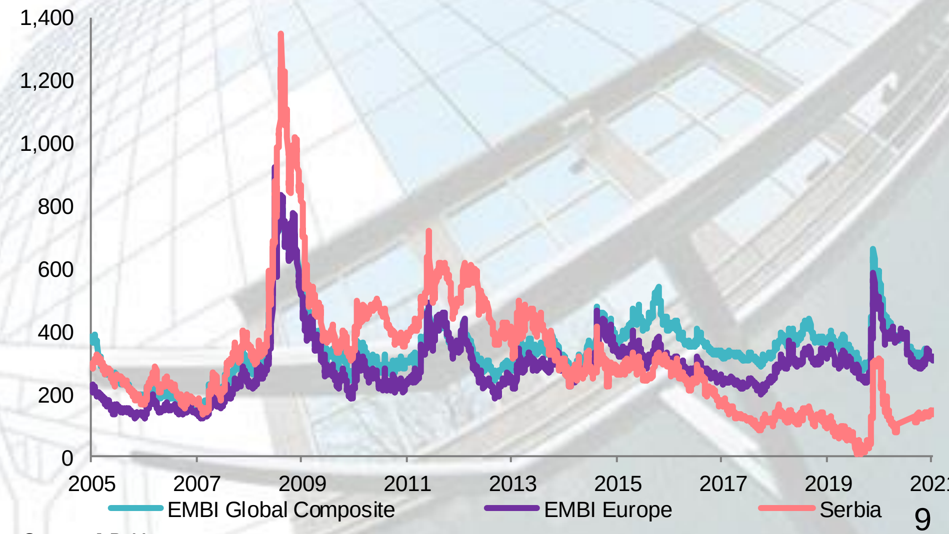
Determinants of Serbia's risk premium

	Model 1	Model 2	Model 3
Dependent variable: *DEMBI (log)*			
Long-term link:			
GDP per capita (log)	-12.163***	-2.958***	
GDP (y-o-y growth rates, %)			-0.068**
Current account balance / GDP (%)	-0.128***		
CPI (log)	6.012***		
Inflation (y-o-y growth rates, %)		0.111***	0.059***
Public debt / GDP (%)		0.043***	0.011**
NPL ratio			0.066***
LIBOR (%)	0.390***		
Global oil price (*log*)		0.548***	0.439***
C	59.793	21.713	1.957
Error adjustment toward equilibri	-0.138***	-0.264***	-0.254***
Exogenous variable: VIX (log)	0.456***	0.504***	0.328***
R^2	0.68	0.67	0.62
Adjusted R^2	0.62	0.61	0.53
JB Normality test	1.08	0.47	0.17
Analysed period:	Q2 2008 – Q3 2019	Q1 2007 – Q3 2019	Q1 2009 – Q3 2019

Source: NBS calculation.

*** Means statistical significance at 1% significance level, ** at 5% significance level.

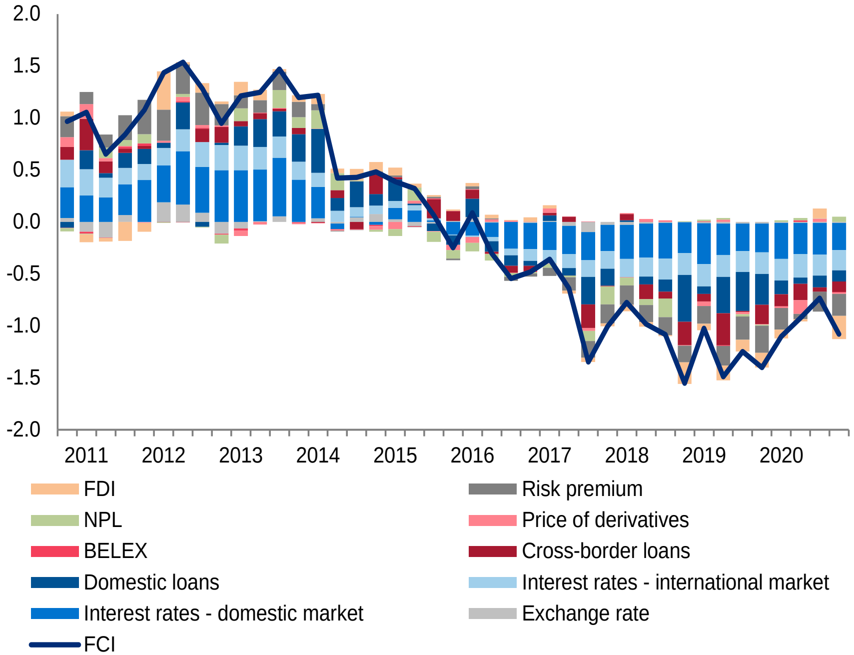
Risk premium indicator – EMBI Composite, EMBI Europe and EMBI for Serbia (in bp)



Source: J.P. Morgan.

Financial conditions are supporting economic activity

FCI decomposition, 13 variables (in pp)



Source: NBS.

Movement of FCI and GDP

Source: NBS and SORS.

Movements of the financial conditions index of corporates over a longer period show that all components that reflect the economic policy gave a significant contribution to favourable financing conditions.

NBS's monetary policy measures provided the major boost to such movements.

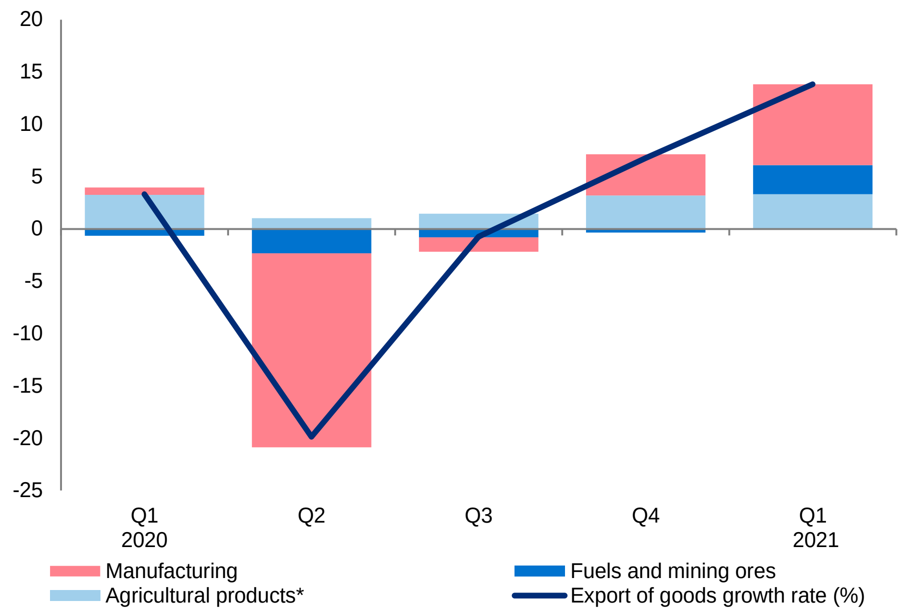
Increase in Serbia's credit rating, as well as decrease in its country risk premium, allowed corporates to seek financing in the international market as well, under favourable terms.

FDI inflows broaden the spectrum of corporate financing.

Even during 2020, most of these factors continued to exert a positive effect on corporate financing conditions, most notably favourable financing conditions in the domestic lending market, as well as preserved lending activity, thanks to the NBS's and Government's anti-crisis measures.

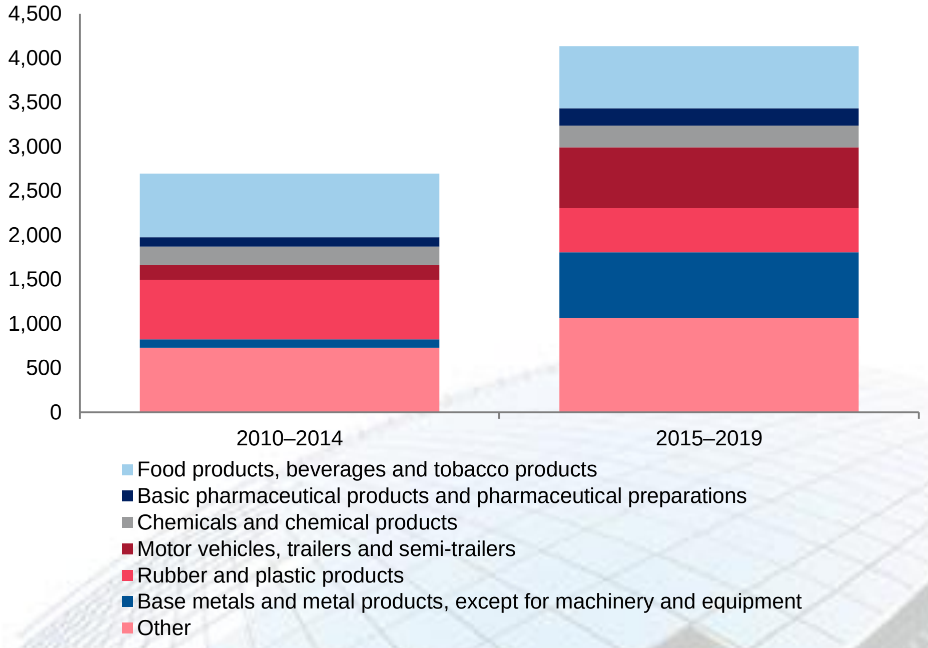
Serbia's goods export reached pre-crisis levels already at the end of summer

Contributions to y-o-y growth rate of Serbia's goods export (in pp)



* Including food production.
Source: SORS, NBS calculation.

FDI in manufacturing industry by branch (in EUR mn)



Source: NBS.

Observed **by country**, the indicator of the concentration of export has declined continuously since 2015 and **in 2020 it reached the value that suggests the largest geographic diversification of exports to date.** This means that **even in pandemic conditions, Serbia additionally increased the degree of the geographic distribution of export, which contributed to its greater resilience to disruptions in external demand.**

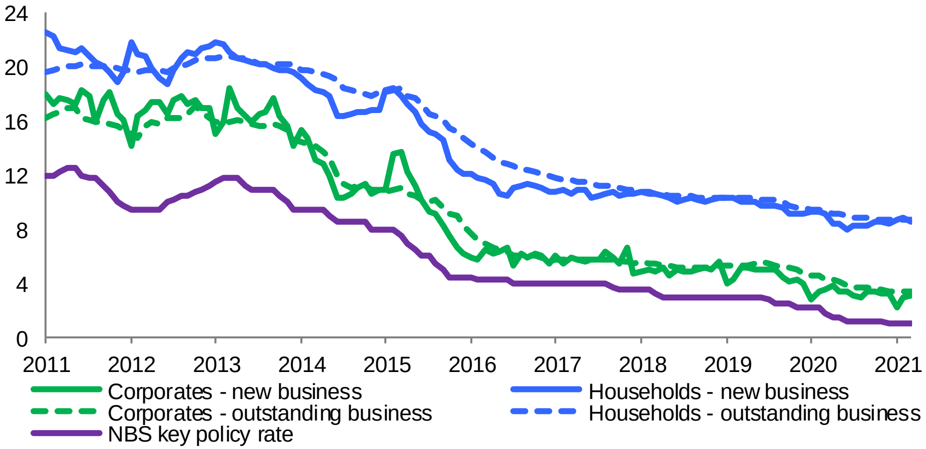
We come to similar conclusions when we take a look at the degree of concentration of exports measured **by product**, which in 2020 was lower than in 2019, meaning that the export distribution by product increased even further.

Serbia's goods export returned to the pre-crisis level already in the summer of 2020, and in Q4 it was 6.8% higher y-o-y.

Also, Serbia's comparative advantages in the production of agricultural products and food, with the development of agricultural capacities and above-average agricultural season, contributed to the resilience of Serbia's export.

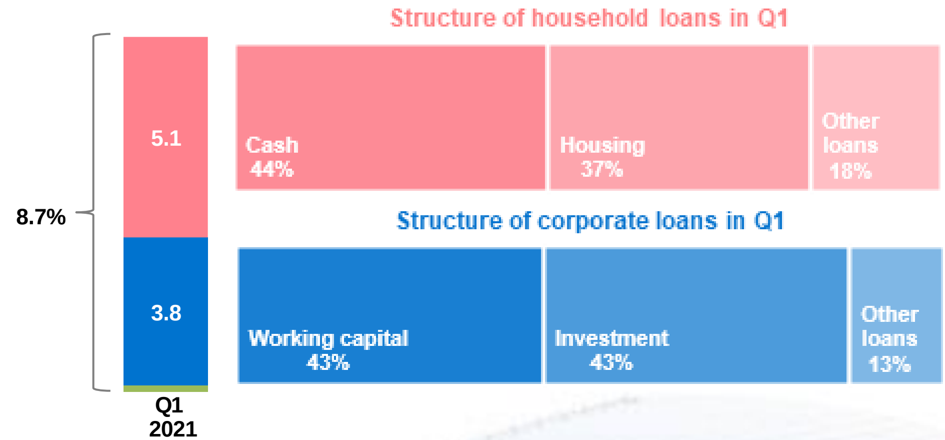
Lending activity contributes to balanced recovery of investments and consumption

Interest rates on dinar loans (in %)

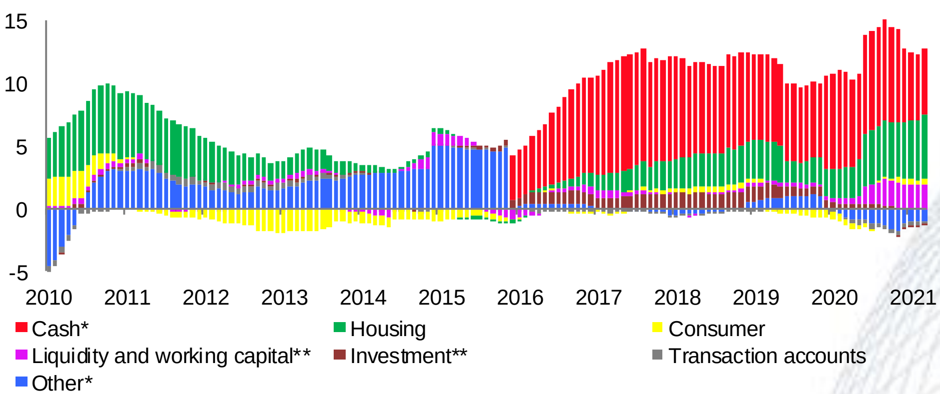


Source: NBS.

Contributions to y-o-y growth rate of total loans in Q1 (in pp)

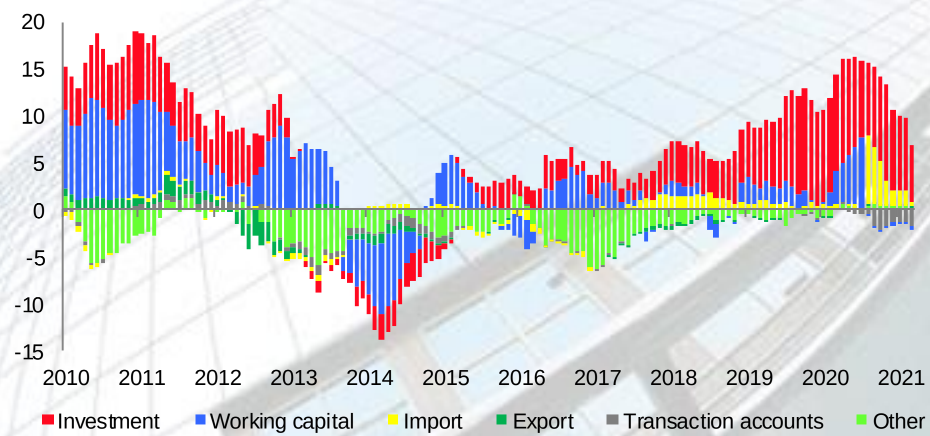


Contributions to y-o-y growth of household loans
(in pp, excluding the effect of exchange rate changes)



* Contribution of cash loans until December 2015 is shown as a part of contributions of other loans.
** Loans granted to entrepreneurs.
Source: NBS.

Contributions to y-o-y growth of corporate loans
(in pp, excluding the effect of exchange rate changes)



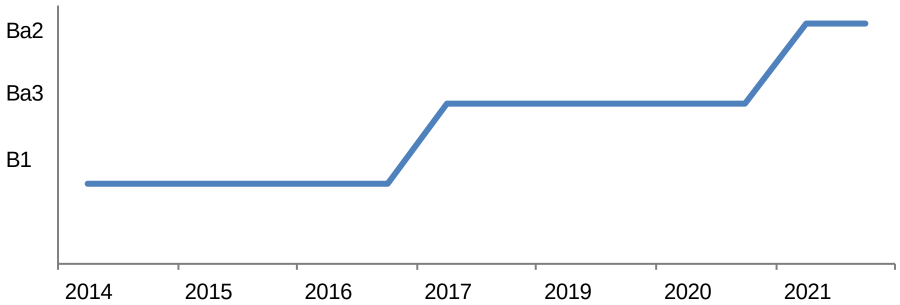
Source: NBS.

Lending activity remained not only a stable source of private sector financing, but its structure – both in terms of currency, and sector and purpose – was also well-balanced, which contributed to an even recovery of investments and consumption.

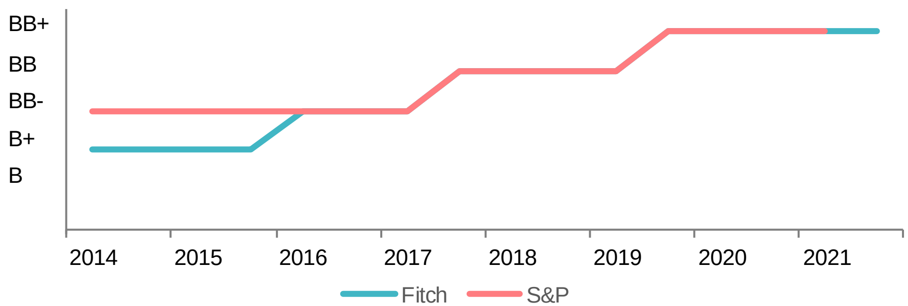
The structure of lending growth remained favourable this year as well, because within corporate loans, the highest growth since the start of the year was recorded by investment loans, and within household loans – by housing loans.

Even during the COVID-19 crisis, Serbia kept its credit rating (Fitch and S&P) and raised it in March 2021 (Moody’s)

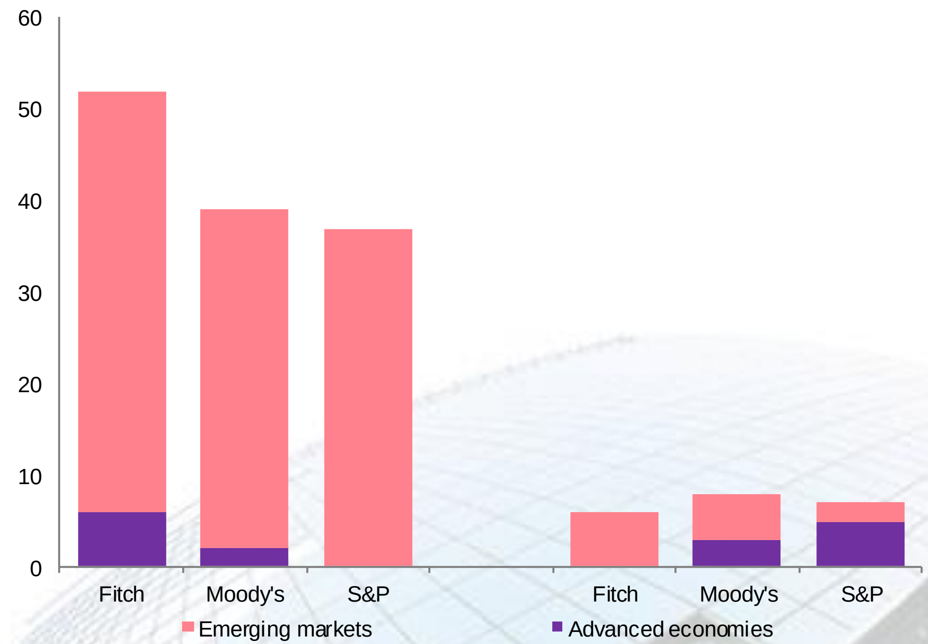
Serbia’s credit rating with Moody's



Serbia’s credit rating with Fitch and S&P



Number of sovereign downgrades and upgrades
(cumulatively, February 2020 – April 2021)



Source: Rating agencies' websites.

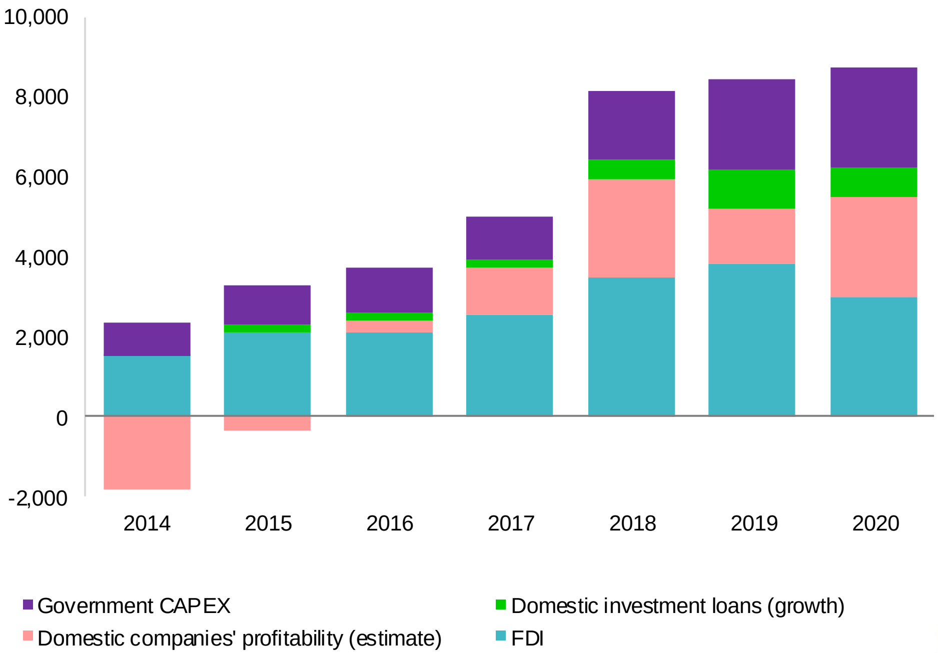
Improvements from ten years ago, which the rating agencies emphasize, pertain to the **achieved and preserved low and stable inflation, relative stability of the exchange rate, adequate level of FX reserves, stronger fiscal position, as well as greater diversification of investment and export by sector and geography, which enables a more balanced economic growth.**

They also cite the full coverage of the current account deficit by FDI inflows, unlike in the period before the global financial crisis of 2008, when portfolio investments, as the most volatile category of inflows, were a dominant source of financing deficit of the then twin deficit.

They assess that responsible economic policy conduct created room for the adoption of comprehensive monetary and fiscal measures which mitigated the effects of the pandemic and created conditions for economic growth. They conclude that political stability, with the majority support to the politics of President Vučić, is a guarantee of the continuity of sound economic policies, which is among the key factors that bring Serbia closer to investment grade.

Broad sources of investment financing, with FDI growth, based on macroeconomic stability

Key sources of investment financing (in EUR mn)



Sectoral structure of FDI (in %)

Source: NBS.

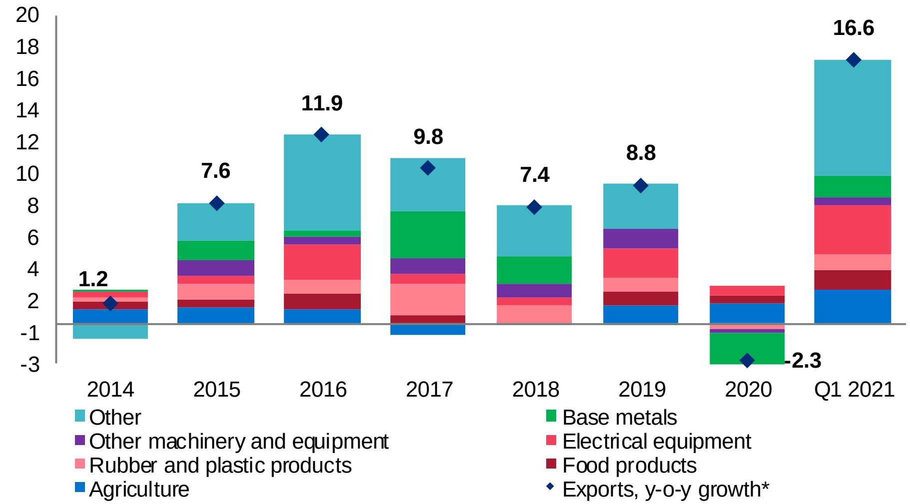
* Agriculture, industry, mining, transport, catering.

Corporate sources of financing are drastically better than in the period before 2015, when the investment cycle in Serbia began.

Given the significant degree of correlation between the corporate financial conditions index and GDP movements, this index can also be used as one of the indicators of economic activity. The dynamics of its movements during 2020, indicating that the extremely favourable conditions for financing corporates were maintained, also suggests that **even in the coming period, we can expect a further positive contribution to economic recovery on the grounds of financing conditions.**

Strong export growth in Q1 is attributed to growth in manufacturing exports

Movement in main components of the goods export (contributions to y-o-y growth, in pp)

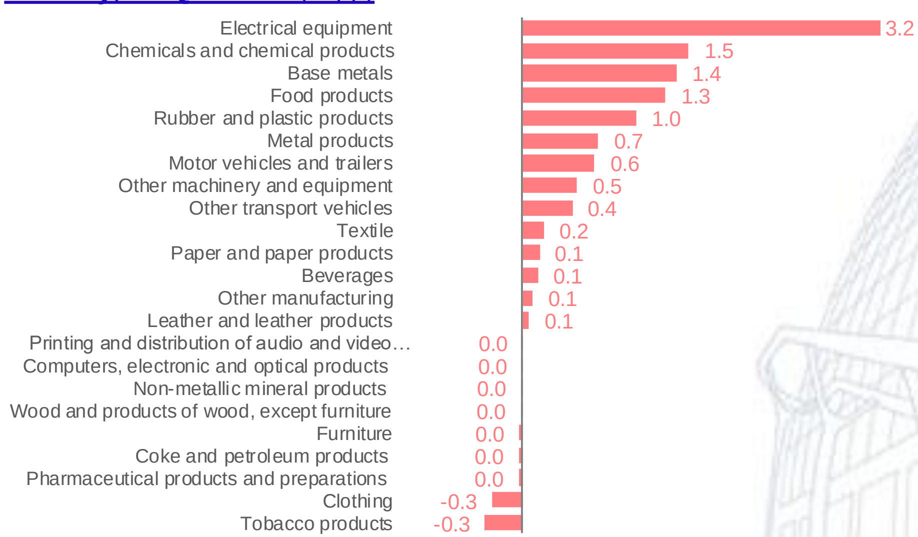


Source: SORS and NBS calculation. * Revised data for 2018 and 2019.

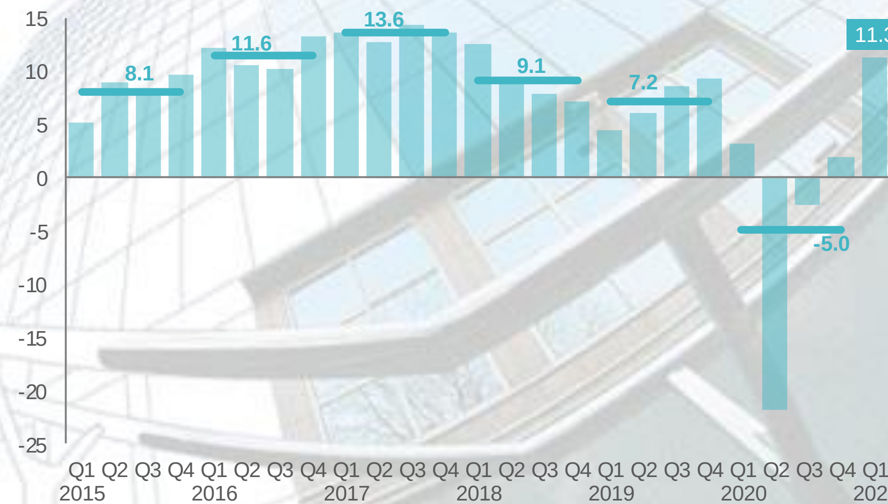
In 2021, we expect two-digit growth rate of Serbia's goods export, owing to contributions of both factors on the supply side – i.e. further investment growth in export-oriented sectors – and of the recovery of external demand, with the expected successful vaccine rollout across the world.

In Q1 this year in Serbia there was a current account surplus (of almost EUR 160 mn), which is the result of the improvement in all of its components, mostly in the goods trade, with y-o-y export growth of 16.6% and a 0.2% fall in import.

Contribution to y-o-y growth in manufacturing export, by activity, in Q1 2020 (in pp)

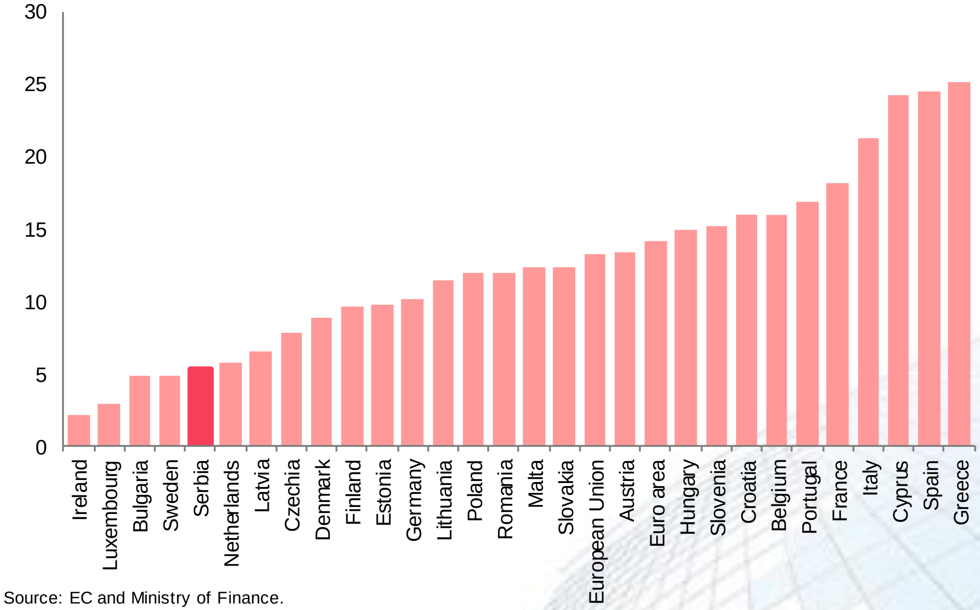


Export of the manufacturing industry (y-o-y, in%)



Orderly public finances created room for a strong fiscal policy response, which was efficiently used, without jeopardising the principle of sustainability of public finance

Change in general government public debt in EU countries and Serbia in 2020 (in % of GDP)



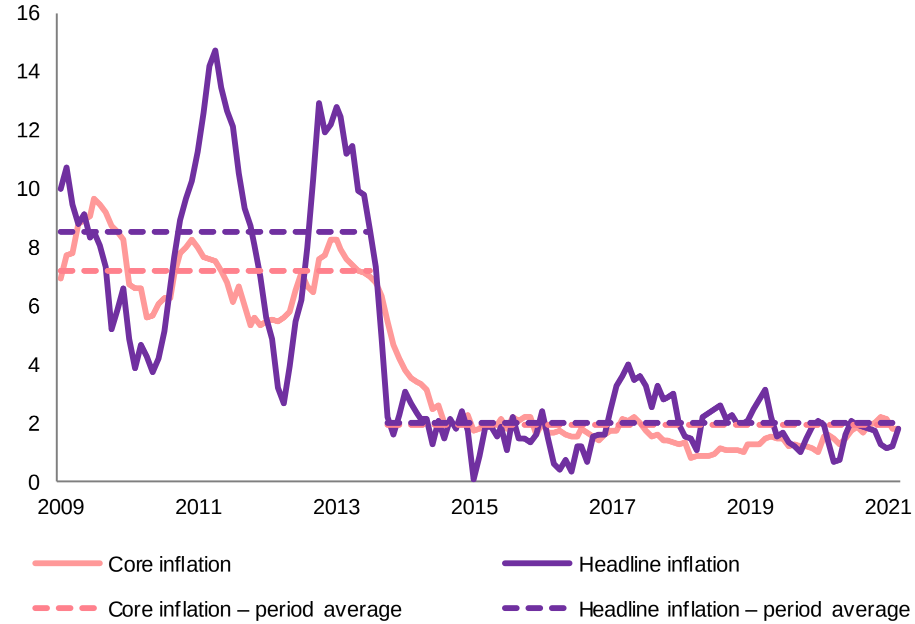
Source: EC and Ministry of Finance.

Finding an optimal measure during the pandemic between short-term support to people's health and the economy, and ensuring medium-term sustainability of public finances was one of the biggest challenges for policy makers across the world. Such measure was established in Serbia.

Using the composite indicator of fiscal sustainability for Serbia, in February we estimated that additional fiscal measures that were announced back then, do not endanger the sustainability of public finances. **Based on the decomposition of factors that affect the movement of the share of public debt in GDP, we estimated that the key role in the dynamics of this indicator will be that of dynamic economic growth and favourable financing conditions, which will ensure that the share of public debt in GDP moves at around 60% this year and steadily declines in the medium term.**

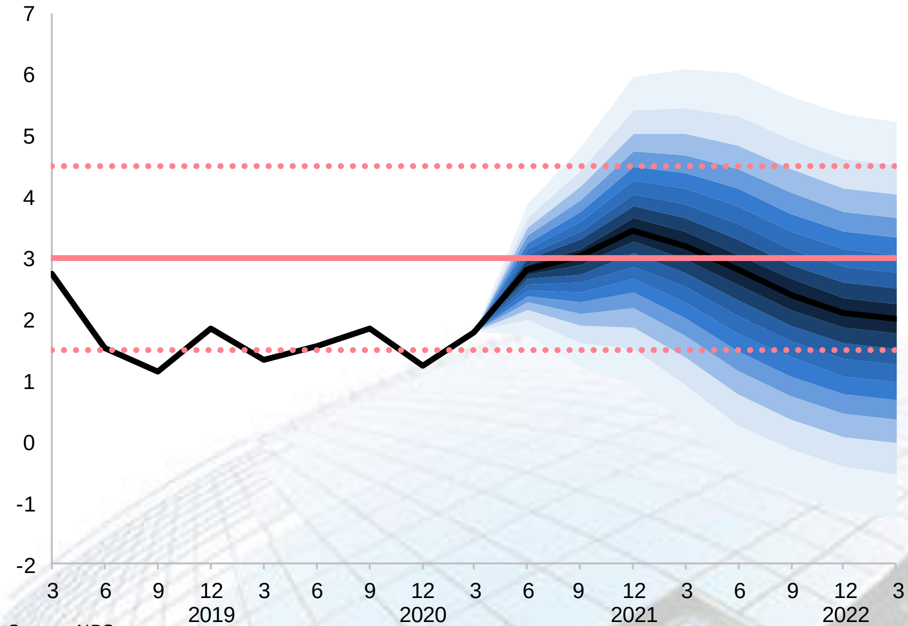
Inflation trending around target midpoint over the next year

Headline and core inflation (y-o-y rates, in %)



Source: SORS and NBS calculation.

Inflation projection (y-o-y rates, in %)



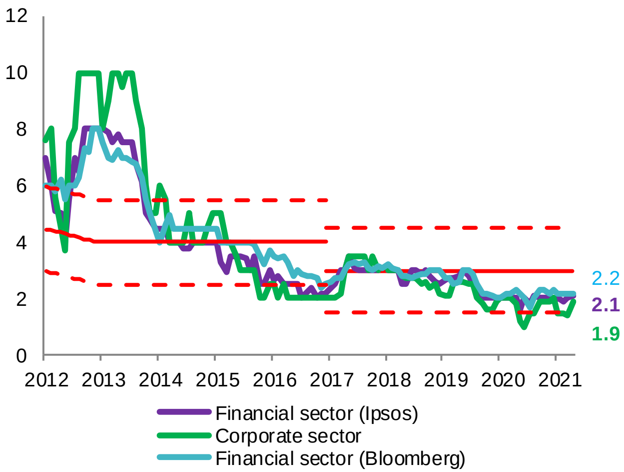
Source: NBS.

Our inflation projection indicates that going forward, inflation will remain low and stable, under the following assumptions – relatively stable exchange rate, anchored inflation expectations, moderate wage growth and low euro area inflation. Nothing comes on its own; rather, it is people who make policies and measures to ensure such conditions.

At the same time, there is a global discussion as to the possible tightening of financial conditions and further capital flows to emerging countries. Then, the prices of primary commodities, which are on the rise and mainly driven by optimism over the acceleration of global economic growth, also reflect on the rise of global inflation. Still, the prevailing view is that such inflation growth is temporary, and leading central banks continue to stimulate favourable financing conditions with their monetary policies.

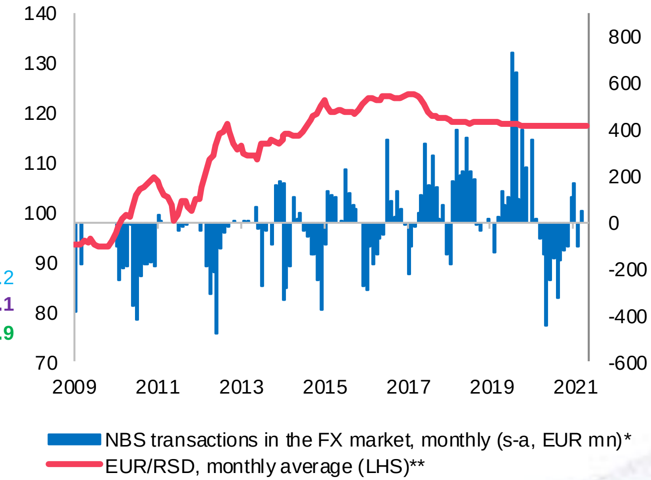
Dynamic economic recovery in conditions of preserved stability and improved investment environment

One-year ahead inflation expectations (in %)



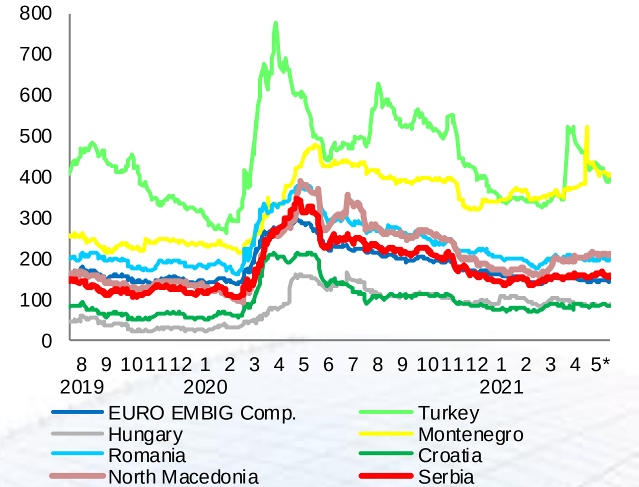
Source: Galup, Ipsos/Ninamedia, Bloomberg and NBS.
* Ipsos and Galup until December 2014, Ninamedia since December 2014 and Ipsos since January 2018.

Dinar exchange rate movements and NBS transactions in the FX market



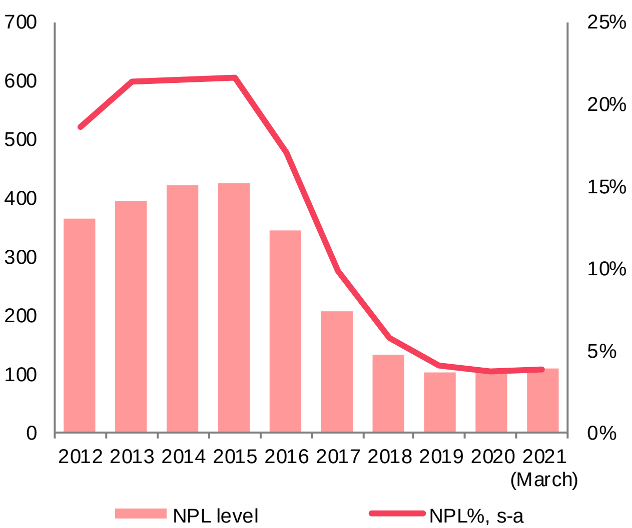
* + net purchase; - net sale.
** EUR 1 in RSD.

Risk premium indicator for debt in euros – EURO EMBIG (in bp)

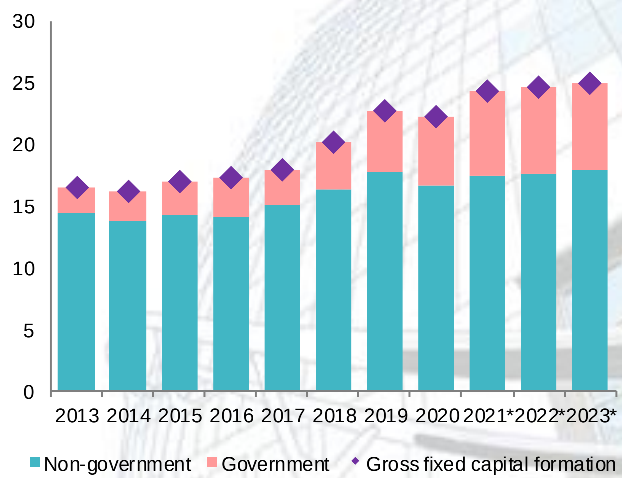


*As at 13 May 2021.

Asset quality – NPLs (in RSD bn and %)

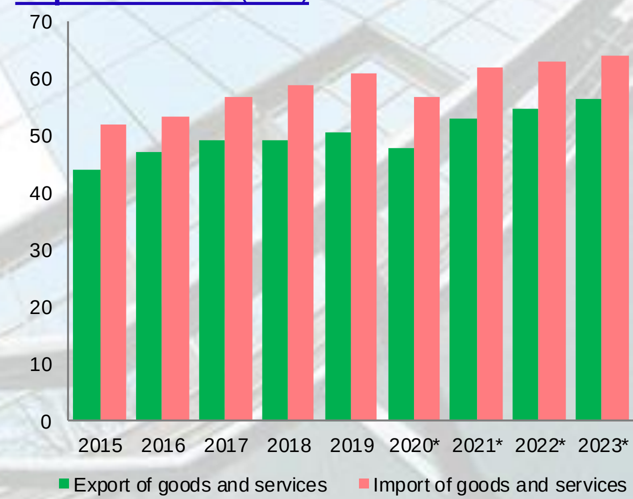


Investments in fixed funds (in % of GDP)



Source: SORS and NBS calculation.
* NBS estimate.

Share of goods and services export and import in GDP (in %)



Source: NBS.
* NBS estimate.