Macroeconomic Developments in Serbia

March 2022
Sustained Macroeconomic Stability

- COVID-19 and global slowdown, according to available data, had a less severe impact on Serbia compared to most European countries, due to achieved macroeconomic and financial stability, growth momentum, fiscal space created in previous years, large and timely monetary and fiscal package, and structure of the economy.
- GDP recovery to pre-crisis level was accomplished already in Q1 2021, while according to the SORS data real GDP growth in 2021 stood at 7.4%. Such developments are the result of growing activity in industry, construction and the service sectors.
- Having in mind new investment cycle, and planned infrastructure projects in following ten years, our projection of real GDP growth for 2022 and the medium term is in the range from 4%-5%.
- According to NBS projection, real GDP growth in Q1 2022 should stand around 4.3% y/y, which includes the materialization of part of the risks related to the emerging crisis due to the Russia-Ukraine conflict..
- The adopted economic policy measures (EUR 5.8 bn, about 13% of GDP in 2020) minimized the decline in GDP in 2020, while an additional package of EUR 2.2 bn (4.2% of GDP) in 2021 contributed to further GDP growth and its return to the path of sustainable growth in the medium term.
- According to our February projection, inflation will be on a declining path throughout 2022. The conflict in Ukraine creates significant upside risks in energy, commodities and food prices.
- In 2021, current account deficit of EUR 2.34 bn (-4.4% of GDP) was recorded, with the record inflow of FDI (EUR 3.9 bn).
- Owing to product and geographic diversification and export oriented investments, goods exports in 2021 increased by as much as 29.1% y/y.
- According to LFS unemployment rate stood at 9.8% in Q4 2021, followed by the high participation rate (71.0%) and the employment rate at the level of 50.0% for the second consecutive quarter.
- Moody’s has upgraded Serbia’s credit rating (March 2021), while S&P revised upwards the outlook for obtaining an investment rating from stable to positive (December 2021) and Fitch confirmed credit rating in conditions of intensified geopolitical tensions (February 2022), while acknowledging the maintained macroeconomic stability and favourable outlook, as well as adequate economic policy response before and during the pandemic.
- As of June 30, 2021, RSD bonds of the Republic of Serbia have been included in the renowned bonds index - J.P. Morgan GBI-EM index. In January 2022 public debt of central government stood at the level of 51.8% of GDP.
- In March 2022, the NBS decided to keep the key policy rate unchanged at 1.0%, but to further raise average repo rate at reverse repo auction, to 0.90% in the latest auction (March 9th).
- Banking sector stability has been preserved and further reinforced. The share of NPLs stood at 3.49% in December 2021.
Inflation is Driven by Food and Energy Prices; Core Inflation Twice Lower than Headline

Increase of inflation was led by supply-side factors which is also indicated by…

- In the past eight years inflation was moving at level of around 2.0% on average.
- Higher inflation from H2 2021 is a consequence of rising food and global oil prices, as well as the exceptionally low base from the 2020.
- Average inflation in 2021 stood at 4.0%.
- In February overall inflation stood at 8.8%. Almost 3/4 of y-o-y inflation was determined by factors that monetary policy cannot influence to a large degree – the prices of food and energy.

...twice y lower level of core inflation compared to the headline

- On the other hand, owing to preserved FX and macroeconomic stability, core inflation remained stable.
- For the past eight years core inflation averaged 1.8%.
- Core inflation in February 2022 was twice lower than total inflation and amounted to 4.4%.
- According to the February Ipsos survey, short-term inflation expectations of the financial sector amounted 4.5%.
- Two and three years ahead inflation expectations of financial sector moved between 3.0%-3.5%.
Inflation on a Downward Trajectory During 2022

After it reaches its peak in the current quarter, inflation should gradually decline throughout 2022...

...and move towards the midpoint until the end of the projection horizon.

- Inflation has been moving above the target band as of September 2021, mostly driven by the growth in the global energy and food prices and supply chain bottlenecks.
- According to our February projection, inflation would gradually decline as of Q2.
- Due to the ongoing conflict in Ukraine, additional inflationary pressures from energy, food and industrial products prices, due to intensifying cost pressures, can be expected in the short term.
- Measures to ban exports of cereals and reduce excises on fuels should limit the spillovers on domestic inflation.

- The key uncertainties of the projection stem from the ongoing conflict in Ukraine and its potential effect on prices of energy and cereals. Risks also arise from its impact on global economic recovery and duration of disruptions in global supply chains, and the normalisation of monetary policies of leading central banks.
- Risks are also associated with the domestic market – the agricultural season and movement in administered prices.
GDP Growth in 2021 Exceeds Expectations; Medium Term Growth Projection Retained Between 4%-5%

Economic recovery in 2021 is driven by domestic and external demand

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

- Thanks to the preserved macroeconomic and financial stability and the timely and comprehensive package of economic measures adopted by the National Bank of Serbia and the RS Government, Serbia recorded a cumulative growth of real GDP of 6.4% in two pandemic years.
- According to the SORS data, in 2021, Serbia achieved a real GDP growth of 7.4% driven by recovery in service sectors, as well as growth in construction and industrial production.
- NBS project growth in Q1 2022 of 4.3% y/y, whereby the projection includes effect of the conflict between Russia and Ukraine, which led to disturbance in production and trade of goods and services worldwide.

- GDP reached the pre-crisis level in 2021 Q1, and, according to our estimate, in Q4 it is more than 5% above the pre-crisis level.
- For 2022 and the medium term we expect growth to be in a range between 4%-5%, as a result of new investment cycle.
- This year, we expect growth to be predominantly driven by further development in service sectors, as well as construction and industrial production.
- In light of the conflict between Russia and Ukraine, risks to the projection form international environment particularly those related to supply chain disruption, energy crisis and prices of primary products are asymmetrical to the downside. Since geopolitical situation is changing constantly, and new sanctions are being introduced, it is impossible to determine the economic effects of the conflict.
# NBS Response to Covid-19

## Monetary Policy Measures

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<td>I-III 2021</td>
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<td>I-III 2021</td>
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<td>December 2022</td>
<td>Cut by 0.25 pp, to -7.00%</td>
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<td>I-III 2023</td>
<td>Cut by 0.25 pp, to -7.25%</td>
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<td>Cut by 0.25 pp, to -7.50%</td>
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**Notes:**
- Monetary policy measures include cuts in key policy rates, narrowing of rate corridors, lower interest rates on FX swaps, additional swap auctions, auctions of repo purchase of government securities, and outright purchase of government securities in the secondary market.
- Additional measures include approval of dinar loans under the Guarantee Scheme, extension of repayment terms for housing loans, and reduction of mandatory downpayment for first-time home buyers.
- Source: NBS.
Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy in 2020 and 2021

- Total value of economic measures in 2020 is estimated at around 13% of GDP, and additional package in the amount of 4.2% of GDP has been implemented in 2021.

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<th>Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy</th>
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<td><strong>I Group – Tax policy measures</strong></td>
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<td>1. Deferred payment of payroll taxes and contributions in the private sector (during the state of emergency) with subsequent repayment of liabilities in instalments (starting from 2021 at the earliest)</td>
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<tr>
<td>2. Deferred payment on taxes and contributions on salaries for one month</td>
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<td>3. Exemption of donors from the obligation to pay VAT</td>
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<td><strong>II Group – Direct assistance to the private sector</strong></td>
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<td>4. Payment of three minimum wages to entrepreneurs that are subject to the flat rate tax and pay tax on actual income, and to micro, small and medium-sized enterprises in the private sector</td>
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<tr>
<td>5. Payment of assistance to large private sector enterprises in the amount of 50% of net minimum wage for employees on paid temporary leave on employer’s decision</td>
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<tr>
<td><strong>III Group – Measures to preserve liquidity</strong></td>
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<tr>
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<td><strong>IV Group – Other measures</strong></td>
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<td>8. Moratorium on dividend payments until the end of 2020, except for public companies</td>
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<td>9. Wage increase measures and other direct financial assistance</td>
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<td>10. Direct assistance to all adult Serbian citizens in the dinar equivalent of EUR 100</td>
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<tr>
<td><strong>V Group – Additional package of measures (July/August 2020)</strong></td>
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<tr>
<td>1. Payment of 60% of minimal wages to entrepreneurs, and to micro-, small- and medium-sized enterprises in the private sector</td>
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<tr>
<td>2. Deferred payment of income tax advances for one month</td>
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<tr>
<td>3. Direct support to the hotel sector - 350 € per bed, 150 € per room</td>
</tr>
<tr>
<td><strong>Additional package of measures in 2021</strong></td>
</tr>
<tr>
<td>1. Direct support to private sector - 3 months 50% minimal wage to all entrepreneurs, micro, small and medium enterprises</td>
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<tr>
<td>2. Targeted support for sectors that suffered the most (hotels, restaurants, passenger transport companies, tourist agencies artists etc.)</td>
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<tr>
<td>3. Measures to preserve liquidity (extension of previous and introduction of a new guarantee scheme)</td>
</tr>
<tr>
<td>4. Fiscal stimulus measures (direct payment to all adult citizen, and additional to pensioners and unemployed)</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance.
The Beginning of New Strong Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015…

In 2015-2019, fixed investments grew at an average annual rate of about 10%, while their cumulative growth was about 64%. The share of fixed investment in GDP increased to 22.5% in 2019.

Despite pandemic, fixed investments cumulatively increased during 2020 and 2021 for around 12%.

Thanks to the new investment cycle, the share of fixed investments in nominal GDP should reach the level of around 26% as early as 2024 and move around that level in the medium term.

Government investments reached level of over 7% of GDP and should remain around that level in the medium term.

…supported by diversified financing sources

In earlier years, investments have largely relied on FDI.

Owing to maintained macroeconomic and financial stability, exchange rate stability, as well as fiscal consolidation, in recent years three more strong pillars for financing investments have been established: multiplied profitability of the economy, investment loans and doubled government investments.

On top of that, FDI inflow reached record levels of around 8% of GDP.
Macroeconomic and financial stability combined with structural reforms has created a favourable climate for FDIs...

...which are diversified by sector and origin and contributing to the employment growth and country’s export potential

- Out of an inflow of EUR 13.6 bn in past three years (2019-2021), EUR 7.8 bn has been directed into tradable sectors, most notably manufacturing (EUR 3.5 bn).
- Manufacturing sectors with the highest FDI inflows (metals, autos, food, tyres) recorded a high growth in employment, output and exports.
- Serbia has attracted about 60% of total FDI to the Western Balkans region.
- In 2021, FDI inflow amounted to record high amount of EUR 3.9 bn (net inflow EUR 3.6 bn).

• FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific, alongside Serbia's major investment partner - the European Union.
• During 2019 – 2021, the bulk of FDI inflows still came from EU countries (57%), but with an increasing share of Asian countries such as China/HK (15%), as well as USA and non-EU countries, such as Russia, Turkey and Switzerland.

*industry, agriculture, transport & storage, accommodation and food svc.
Medium Term CAD Under the Influence of the New Investment Cycle

Midterm current account deficit projection is at a range from -4.0% to -5.0% GDP

Chart 11 Current account balance by component (EUR bn)

Chart 12 Savings and investment balance (% of GDP)

- In 2021, a CAD of -4.4% of GDP was recorded. Current account deficit amounted to EUR 2.3 bn, driven by an increase in the trade deficit in goods, despite faster export than import growth, and the primary income deficit.
- On the other hand, an increase in the trade surplus in services and the secondary income surplus was recorded.
- Since 2015 Serbia’s current account deficit has been fully financed by FDI which is expected in the following years as well (projected net FDI inflow of around 5% of GDP).
- In January of 2022, CAD amounted to EUR 141.7 mn and was driven by higher energy imports.

From a S-I perspective temporary CAD increase in medium term will be driven by higher investments due to investment cycle

- In 2020 the decline in the S-I gap was driven by a faster reduction of private gap than public SI gap.
- Private sector savings increased in 2020 due to reduced domestic demand and lower energy prices.
- During 2020, the share of gross domestic investment in GDP decreased only slightly compared to 2019, due to the growing share of gross public sector investment.
- In 2021, there was no deepening of the S-I gap, despite the increase in the share of public sector investments due to recovery of domestic demand, but also domestic savings.
Demonstrated Exports Resilience in 2020 and Strong Growth in 2021

New investments and continued expansion of the export capacities will ensure high growth of exports in the medium term

The projection takes into account that the new investment cycle will reflect on the increased imports of equipment and intermediate good

- In 2021, there was an intensive growth of exports of goods of 29.1%, driven by the recovery of exports of the manufacturing industry, which would have been even faster if there were no disruptions in global chains.

- The growth of exports of services in 2021 amounted to 26.0% and was driven by exports of ICT services, as well as tourism services, which fully recovered in 2021.

- In January 2022 an increase in goods exports of 35.2% y/y was recorded, driven by growth in exports of manufacturing and mining. Exports of services increased by 32.6% y/y.
Geographic Diversification Helped Foreign Trade Resilience During Pandemic

Exports to all significant partners increases in 2021 compared to 2020

Chart 15 Goods exports by country in 2020 / 2021 (EUR mn and % of total)

- Serbia’s exports are largely directed towards EU and countries of the region, and reliant on demand in those countries which were recovering during 2021. In 2020, most of Serbian exports went to the EU, followed by CEFTA and CIS.
- By country, the largest share of exports went to Germany (12.7%), followed by Italy (8.5%), Bosnia and Herzegovina (7.2%), Romania (5.5%), Hungary (5.0%) and Russia (3.9%).
- Exports to China in 2021 continued to grow compared to 2020, while recording growth even in 2020, so China is highly positioned on the list of Serbian export partners.

China catches up to Germany in 2020 as the most important import partner, and in 2021 imports from China continue to increase

Chart 16 Goods imports by country in 2020 / 2021 (EUR mn and % of total)

- Majority of imports (more than 58% in 2021) come from the EU, followed by CIS and CEFTA.
- In 2021, compared to 2020, imports (as well as exports) in absolute terms increased in most significant countries.
- By country, the largest shares of imports are from Germany (13.2%), whereas the share of imports from China increased from 9.0% in 2019 to 12.5% in 2020 and sits at 12.8% in 2021.
Positive Trends in the Labour Market in Q4 Accompanied by Productivity Growth

According to the LFS, high employment and participation rates and in Q4

Chart 17 Labour market indicators according to the LFS*, (in %)

- Employment rate
- Unemployment rate
- Participation rate

Source: Statistical Office Republic of Serbia.
* LFS data revised according to the new methodology from 2021.

Increasing contribution of total factor productivity to Serbian GDP growth

Chart 18 Contribution of factors of production to GDP*
(in pp, period average)

- TFP
- Capital
- Labour
- GDP

Sources: SORS, NBS calculation.
* NBS estimate.

- According to the Labour Force Survey, the unemployment rate is reduced by 0.7 p.p. compared to Q3 and amounted to 9.8%, so after five quarters returned to a single digit level.
- The employment rate in Q4 remained at a record level from Q3 and amounted to 50.0%, with a falling rate of informal employment from 14.8% to 13.7%.
- The participation rate (activity rate for the population from 15 to 64) was 71.0%, which continued to move above 70% in terms of slightly reduced compared to Q3 (71.7%).
- Economic growth acceleration in 2018-2019 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2017, compensated by a faster growth of the capital stock.
- In 2020, similar to other countries, there was a temporary decline in TFP and a negative contribution of labour due to a reduction in the participation rate due to the pandemic.
- In 2021 productivity recorded growth again and was a main driver of growth, together with strong investments.
- In the medium term, we expect that TFP and capital will be the main drivers of GDP growth, while labour will have positive but declining contribution.
Continuation of Favourable Trends in the Formal Segment of the Labour Market

According to SORS, the average wage in 2021 is nominally higher by 9.6%, and real 5.4%

- The average wage in December was y/y growth of 12.9% driven by faster growth of wages in the private sector of 17.3% y/y, as well as growth of wages in the public sector of 3.8% y/y.

- Y/y wage growth in December was recorded in all activities. The average net wage in the period January - December 2021 was 65,864 dinars and y/y higher by 9.6%, with growth present in almost all activities (except energy).

- The growth of average net wage in the mentioned period was driven by year-on-year growth of wages in both the private (11.2% y/y) and public sector (7.0% y/y).

Dominant contribution of industry in formal employment

- The total formal employment, after deceleration in December, accelerated in January 2022 y/y growth and increased by about 33 thousand persons (1.5%).

- The acceleration of growth is also present in the private sector (increase of about 30 thousand persons, i.e. 1.8% y/y) and in the public sector (higher employment for about 3 thousand persons, i.e. 0.6% y/y).

- Observed by activities, acceleration of y/y growth is noticeably for the ICT sector (about 9 thousand persons), manufacturing (about 6.5 thousand), construction (about 4 thousand), administrative and assistant service activities (about 8 thousand), as well as professional and scientific activities (around 5 thousand).
In 2021 the deficit is significantly lower than in 2020, despite the continuation of pandemic. Increase of public debt is one of the smallest in Europe due to support economic package.

- In the years before pandemic, Serbia eliminated fiscal deficit, with government investments reaching near 5% of GDP. Higher deficit in 2020 (8.0% of GDP) was a consequence of high expenditures for support measures and purchase of medical equipment.
- In 2021 a fiscal deficit was RSD 259.4 bn (4.1% of GDP), which is significantly lower than the level projected in Fiscal strategy (4.9% of GDP).
- The deficit in 2021 was mostly influenced by the new stimulus package in the amount of EUR 2.2 bn (4.2% of GDP). In addition, CAPEX amounted to 7.4% in 2021 and are expected to remain at a similar level in the coming years.
- In 2022 a deficit of 3.0% of GDP is projected, and its return to 1.0% of GDP in the medium run.

- In 2021 public debt was reduced to 56.5% of GDP, despite the issuance of three Eurobonds worth of total EUR 2.75 bn during the year, which were intended to cover the growing financial needs due to the pandemic. Also, it is significantly lower than the level projected by the Fiscal strategy (57.3%).
- At the end of January 2022, the share of public debt in GDP was 51.8% and thus further reduced compared to December 2021, due to the higher projected nominal GDP for 2022.
- Despite the crisis, public debt is expected to return to a downward trajectory in the coming years (53.8% of GDP in 2024), with further reliance on RSD and EUR denominated debt and reduction of currency risk.
The current monetary framework allows tightening monetary conditions even without changing the key interest rates.

In March 2022, the key policy rate remained unchanged at the level of 1.0%, but average repo rate was further increased to 0.90% (in auction on March 9th).

The decision takes into account the following factors:

- That current monetary framework allows tightening monetary conditions even without changing the main interest rates,
- The heightened cost-push pressures at home and abroad, and the need to influence inflation expectations of market agents and contain the second-round effects on the prices of other products and services,
- That developments in the international environment call for special caution, additionally fueled by geopolitical tensions and the crisis in Ukraine.

FX required reserve ratio has remained unchanged since early 2016.

- Last time FX RR ratio was cut in 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).
- RR is an important monetary policy tool (in January 2022 RR amounted to EUR 2.5 bn and RSD 252.6 bn), as well as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration on dinar RR (i.e. "standard" rate 0.10% and "beneficial" rate of 0.60% under predefined conditions, on amount on dinar lending in line with State Loan Guarantee Scheme), while no remuneration is applied on FX RR.
Financing Conditions of Government and Private Sector Remained Favorable...

Interest rates on dinar government securities are still close to their minimum levels...

Chart 25 Interest rates in the primary market of government securities (p.a. in %)

- The share of long-term securities (5+ year maturity) increased from 2% in 2012 to over 80% in beginning of 2022, supported by the extension of the dinar yield rate curve up to 12 years in February 2020.

- Interest rates on dinar securities are around the lowest values (3.24% for a period of 12 years).

- Serbia’s dinar-denominated bonds are included in renowned J.P. Morgan GBI-EM family of indices as of 30 June 2021, which contribute to even greater recognition of Serbia as a safe and favorable investment destination.

... as well as interest rates on private sector loans

Chart 26 Interest rates on loans – new business (p.a. in %)

- The key policy rate reduction is fully reflected in dinar lending interest rates which fell sharply since the beginning of monetary policy relaxation cycle (May 2013), and in January 2022 they amounted to:
  - 2.7% for corporates (down by 13.7 pp),
  - 8.5% for households (down by 12.0 pp).

- The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

- In the observed period, a sharp fall in the country risk premium and the country’s credit rating upgrade, as well as monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
Lower costs of financing support domestic lending ...

... which supports the recovery of the economy from crisis caused by COVID-19 pandemic

- In 2021, credit activity posted an almost double-digit growth rate for the fourth consecutive year. Its structure remained a favourable in terms of the contribution to economic recovery, as growth was led by liquidity and current assets and investment loans within corporate loans, and housing loans within household loans.

- Credit activity continued its strong growth in 2022, as total domestic loans recorded y/y growth rate of 10.3% in January.

- The accelerated growth of domestic lending stemmed from the rise in economic activity and favourable terms of financing, which reflected on higher lending, especially to the corporate sector.

- A larger contribution to the total lending activity in the begging of 2022 came from corporate loans compared to household loans.

- In January, investment loans amounted to 41.3% of total corporate loans, while the share of liquidity and current assets loans equaled to 46.2%, supported by Guarantee Scheme loans.

- Micro, small and medium-size enterprises loans amounted to 65% of total corporate loans in January.
Increased Resilience of the Serbian Economy Confirmed by Rating Agencies

Serbia's risk premium remained low and relatively stable risk premium during covid crisis

- In addition to optimism regarding vaccines, the adopted economic policy measures in response to the crisis, as well as the recovery of domestic economic activity contributed to the low and relatively stable risk premium of Serbia during covid crisis.
- Latest movements of risk premium, i.e. its growth at the international level was crucially determined by the escalation of geopolitical tensions.
- In December 2021, S&P confirmed Serbia rating at BB+, with changed outlook for further rating upgrade from stable to positive. In February 2022, Fitch confirmed Serbia's rating at BB+. As the last decision was made in the conditions of intensified geopolitical tensions, it additionally confirms the adequacy of economic policies in Serbia.

The stability of the exchange rate is maintained, while FX reserves are at the adequate level

- The dinar remained broadly unchanged against the euro in 2021 and in 2022.
- For most of 2021 appreciation pressures prevailed due to favorable balance of payments movements. The NBS was a net buyer of foreign currency in 2021, in the amount of EUR 645 million, despite reacting mostly by selling FX around year-end,.
- Depreciation pressures extended into 2022, mostly due to FX purchases for energy imports in January, while in February they were fueled by Ukrainian crisis. Regardless of that, FX reserves remained high (EUR 15.6 bn at the end-February), well above FX reserves adequacy standards.
Indicators of Dinarisation have rising trend

Macroeconomic stability contributing to dinarisation process

The growth of dinar loans to households accompanied by higher dinar savings

- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.
- The Government contributes to dinarisation through tax policy, by developing the dinar securities market - dinar debt share rose from 2.5% in 2008 to 26.6% in January 2022.
- Dinarisation of corporate and household sector deposits rose by 19.6 pp compared to end-2012 to 38.9% (January 2022). Dinarisation of corporate and household sector claims amounted to 38.0% in January 2022 (up by 10.0 pp compared to end-2012).
- Over the past years, dinarisation of household receivables had a firm upward trend as a result of a sharp drop in dinar interest rates, low and stable inflation as well as NBS measures aimed to support dinarisation – an upsurge from 35.1% (2012) to 54.4% (January 2022).
- Dinar savings of households (residents) recorded strong growth in past four years (22% in 2018, 31% in 2019, 17% in 2020, and 12.0% in 2021), which continued in January 2022, when it increased by 0.6 billion dinars to 104.3 billion dinars.
- This reflects citizens’ confidence in financial and price stability.

Chart 31 Dinarisation of the corporate and household sector receivables and deposits, and dinar share of public debt

Chart 32 Dinarisation of corporate and household sector (outstanding amounts, in %)
Traditional Banking
Mostly Financed by Domestic Deposits

Adequate structure of banking sector assets

- Risk aversion during the crisis led to intensified banks’ investments in securities (predominantly low-risk government securities), the share of which stabilized since 2015 and amounts 16.6% of the total net banking sector assets at the end of December 2021.
- Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 46% and 30%, respectively at the end of December 2021.
- Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 1.0% of regulatory capital at end of December 2021.

Improving the quality of the banking sector assets

- Successful implementation of NPLs resolution activities, supported by strong credit growth led to a record low level of NPL ratio in 2020. The data for the first quarter of 2021 show a slight increase in NPL ratio, but still well below its pre-crisis level.
- At the end of December 2021, the NPL ratio was 3.5%, with the maintenance of relatively high coverage by IFRS provisions (57.6%).
- The main channels for the NPLs reduction were repayments, write-offs, and transfer (sale) to third parties.

Source: NBS
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a good structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of September 2021 amounted to 11.5%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 37.3% of the total assets of the banking sector in December 2021.
- The loan to deposit ratio that at the end of December 2021 amounted 83.5%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

Key reform areas in the last four years:

- Construction sector;
- Labor market;
- Tax administration;
- Financial sector;
- Contract enforcement and resolving insolvency.


In response to the COVID-19 pandemic, the NBS provided numerous relief to citizens and the economy

March 2020: first delay in repayment of liabilities (moratorium)
✓ included all debtors (households, farmers, entrepreneurs and corporates)
✓ lasted three months and was accepted by ca. 90% (more than 3 million) debtors

June 2020: Facilitated access to housing loans for first-home buyers
✓ the amount of housing loan that can be granted to first-home buyer increased to 90% of the value of the mortgaged real estate

July 2020: Extending the repayment and refinancing of consumer, cash and other non-purpose loans
✓ available to citizens who entered into loan contracts until 18 March 2020
✓ encouraged refinancing, i.e. change of the due date of the last installment (up to 10 years for car loans and 8 years for other consumer, cash and similar non-purpose loans)
✓ temporary measures facilitate banks' credit risk management during a pandemic for the loans in question

July 2020: second moratorium
✓ included all obligations of households and businesses due in August and September 2020, as well as outstanding liabilities due in July 2020
✓ accepted by ca. 79% (nearly 2.5 million) debtors

August 2020: Facilitated access to housing loans and short-term dinar loans
✓ reduced minimal level of completion for a building to be financed by a housing loan
✓ the possibility of extending the repayment period for five years
✓ simplified procedure for approving short-term dinar loans up to RSD 90,000
✓ valid until the end of 2021

December 2020: new reliefs in repayment of obligations to debtors affected by pandemic
✓ targets the debtors affected by the pandemic (among other things: more than 30 days past-due; businesses – those who recorded a drop in operating income/turnover or a business interruption due to a pandemic; natural persons – unemployed or whose average monthly net income fell below average net earnings in the RS; etc.)
✓ possibility to reprogram or refinance the debt with a six-month grace period and an extension of the repayment period
The Amendment of NPL Resolution Strategy by Adoption of NPL Program for Period 2018 - 2020

Effect of strategy on NPL stock

- Aggregate decrease of NPL level in August 2015 – December 2021 amounts to RSD 320.7bn, while the effect of the NPL Strategy is mostly reflected through the lowest level of NPL ratio of 3.5% at end-December 2021. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 18.76 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th, 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As an integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it’s upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.
• Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
• These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
• The following capital buffers are used in the Republic of Serbia:
  – Capital conservation buffer;
  – Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  – Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  – Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
• The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
• Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

• NPL development after the adoption of the NPL Resolution Strategy, especially in 2017, 2018 and 2019, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

• After record low values of NPL ratio recorded in 2020, COVID-19 pandemic let to deceleration of this downwards trend, so in the first quarter of 2021 this ratio was slightly increased, but it is still well below its pre-crisis level.

• It is expected that further credit growth and anticipated economic recovery, supported by the measures taken by the NBS, will contribute to the continuation of the NPL ratio downwards trend.

### NPL data, December 2021

<table>
<thead>
<tr>
<th></th>
<th>Gross loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
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<tr>
<td>Corporates</td>
<td>11.2</td>
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<tr>
<td>Natural persons</td>
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<td>of which:</td>
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<tr>
<td>households</td>
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<td>0.1</td>
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<tr>
<td>Other</td>
<td>2.9</td>
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<tr>
<td>Total</td>
<td>25.9</td>
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NPL data,
December 2021
### Serbia’s Economic Outlook

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<td>Real GDP, y-o-y %</td>
<td>5.7</td>
<td>-2.7</td>
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<td>Private consumption, in %</td>
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<td>2.2</td>
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<td>-1.9</td>
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<td>4.3</td>
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<td>Private investment,¹ in %</td>
<td>13.2</td>
<td>-23.4</td>
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<td>14.9</td>
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<td>12.3</td>
<td>13.9</td>
<td>-5.5</td>
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<td>12.9</td>
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<td>Government consumption, in %</td>
<td>3.5</td>
<td>-1.7</td>
<td>-0.1</td>
<td>1.6</td>
<td>0.4</td>
<td>-2.1</td>
<td>0.9</td>
<td>-3.7</td>
<td>0.0</td>
<td>2.9</td>
<td>3.8</td>
<td>2.0</td>
<td>2.9</td>
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<td>Government investment, in %</td>
<td>-16.4</td>
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<td>7.6</td>
<td>-35.8</td>
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<td>Exports, in %</td>
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<td>-11.5</td>
<td>16.9</td>
<td>5.6</td>
<td>2.9</td>
<td>18.0</td>
<td>4.3</td>
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<td>12.0</td>
<td>8.2</td>
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<td>7.7</td>
<td>-4.2</td>
<td>19.4</td>
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<td>7.2</td>
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<td>5.1</td>
<td>4.0</td>
<td>7.0</td>
<td>11.1</td>
<td>10.8</td>
<td>10.7</td>
<td>-3.6</td>
<td>19.3</td>
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<td>Unemployment Rate, in %⁴</td>
<td>-</td>
<td>-</td>
<td>20.9</td>
<td>24.9</td>
<td>25.9</td>
<td>24.0</td>
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<td>18.9</td>
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<td>Nominal Wages, in %⁵</td>
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<td>3.7</td>
<td>3.9</td>
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<td>9.4</td>
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<tr>
<td>Money Supply (M3), in %</td>
<td>9.8</td>
<td>21.5</td>
<td>12.9</td>
<td>10.3</td>
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<td>8.4</td>
<td>18.1</td>
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<tr>
<td>CPI,² in %</td>
<td>12.5</td>
<td>8.1</td>
<td>6.1</td>
<td>11.2</td>
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<td>7.9</td>
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<td>1.4</td>
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<tr>
<td>National Bank of Serbia Key Policy Rate,³ in %</td>
<td>17.8</td>
<td>9.5</td>
<td>11.5</td>
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<tr>
<td>Current Account Deficit BPM-6 (% of GDP)</td>
<td>20.0</td>
<td>6.3</td>
<td>6.5</td>
<td>10.3</td>
<td>10.9</td>
<td>5.8</td>
<td>5.6</td>
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<td>6.9</td>
<td>4.1</td>
<td>4.4</td>
<td>4.7</td>
</tr>
</tbody>
</table>

¹ Excluding the effect of change in inventories
² Average inflation in corresponding year.
³ Latest data
⁴ Labour Force Survey. Data are revised according to the new LFS methodology from 2021. Data for 2021 are average of four quarters.
⁵ Since 2018, nominal wages published according to the new methodology. For 2021 are data for the period January - December.
## Banking Sector Overview

**December 2021**

**Number of banks**: 132, 30, 29, 30, 31, 29, 27, 26, 26, 23

**Employees**: 28,394, 26,380, 25,106, 24,257, 23,847, 23,055, 22,830, 23,087, 22,823, 22,550

**Branches**: 2,243, 1,989, 1,787, 1,730, 1,719, 1,627, 1,598, 1,598, 1,576, 1,515

**HHI**: 678, 741, 794, 813, 813, 779, 800, 786, 867

**Assets (net), EUR m**: 25,322, 24,827, 24,545, 25,059, 26,253, 28,440, 31,931, 34,731, 39,177, 42,943

**Capital, EUR m**: 5,198, 5,186, 5,074, 5,090, 5,122, 5,631, 5,725, 6,002, 6,098, 6,128

**Loans (gross), EUR m**: 17,273, 16,140, 16,170, 16,175, 16,442, 17,565, 19,406, 21,111, 23,439, 25,939

**Of which gross NPL, EUR m**: 3,217, 3,448, 3,483, 3,491, 2,800, 1,730, 1,105, 862, 906, 1,105

**Gross NPL ratio, %**: 18.6, 21.4, 21.5, 21.6, 17.0, 9.8, 5.7, 4.1, 3.7, 3.5

**IFRS impairment of NPLs**: 50.0, 50.9, 54.9, 62.3, 67.8, 58.1, 60.2, 61.5, 59.0, 57.6

**Deposits, EUR m**: 14,936, 15,067, 15,637, 16,523, 18,242, 19,926, 23,115, 25,197, 28,984, 32,483

**Pretax Income**, EUR m: 102.5, -18.0, 29.0, 80.0, 172.0, 579.8, 640.6, 575.5, 391.9, 445.2

**CAR**, %: 19.9, 20.9, 20.0, 20.9, 21.8, 22.6, 22.3, 23.4, 22.4, 21.7

**CET1 ratio**, %: - - - - 21.5, 21.1, 22.3, 21.6, 20.6

**Leverage**, %: - - - - 11.1, 12.6, 13.6, 12.4, 11.5

**Liquidity ratio**: 2.1, 2.4, 2.2, 2.1, 2.1, 2.0, 2.0, 2.2, 2.2, 2.1

**Net interest margin**, %: 4.3, 4.2, 4.3, 4.3, 3.9, 3.7, 3.6, 3.3, 3.0, 2.7

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1. The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodine on 6 April 2013, from Prvi redna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to A&K bank on 23 December, 2017. Pireaus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska bank was merged to OTP bank 25. April, 2019 (consolidated under Vojvodanska brand). OTP bank was merged into Vojvodanska banka 29. April, 2021 (consolidated under OTP brand). mts bank was merged to Banka Poštanska Štedionica on 30 Jun 2021. Direktna bank was merged into Eurobank Direktna on 10 December 2021.

2. Without Novoajrobanka Vojvodina at the end of 2012: Pretax profit € 230m; ROA 1.0; ROE 4.7

3. The last available data of 30.09.2021

4. Introduced by the implementation of Basel 3 and monitored from 30 June 2017

5. Net interest margin to average total asset