

ANNUAL REPORT  
ON ACTIVITIES AND RESULTS



National Bank of Serbia

2017

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ON ACTIVITIES AND RESULTS

2017

**NATIONAL BANK OF SERBIA**

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## **Introductory note**

The National Bank of Serbia submits its Annual Report on Activities and Results to the National Assembly by no later than 30 June of the following year.<sup>1</sup>

As stipulated by the Statute of the National Bank of Serbia<sup>2</sup>, the Annual Report on Activities and Results presents data on the achievement of the National Bank of Serbia's objectives and the performance of its tasks relating to monetary and foreign exchange policies, foreign exchange reserves management, measures and activities aiming to safeguard and strengthen financial stability, the supervision of banks and insurance undertakings, voluntary pension fund management companies and leasing providers, including supervision of payment services and electronic money issuance, as well as of the issuance of banknotes and coins, cash management and the payment system.

The Report also contains financial statements of the National Bank of Serbia, disclosing the most important items within revenue and expenditure, as well as assets, liabilities and capital. The Report further presents data on the National Bank of Serbia's institutional framework, its legislative/legal activity, international cooperation, financial services consumer protection, payment cards, internal audit and information technology, internal organisation and staff policy, human resources, operations of the Bank's branches and the Institute for Manufacturing Banknotes and Coins – Topčider, including data on other activities of the National Bank of Serbia.

The Annual Report on Activities and Results for 2017 was reviewed and adopted by the National Bank of Serbia's Executive Board on 14 June 2018.

Executive Board of the National Bank of Serbia:

Jorgovanka Tabaković, PhD, Governor

Veselin Pješčić, MA, Vice-Governor

Diana Dragutinović, PhD, Vice-Governor

Željko Jović, PhD, Vice-Governor

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<sup>1</sup> Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 – Constitutional Court decision and 44/2018).

<sup>2</sup> RS Official Gazette, Nos 12/2013, 18/2015 and 72/2015.



## *Foreword by the Governor*



*Behind us is another year replete with challenges, notably in terms of uncertainties and turmoil in the international environment. We will also remember it by the responsible decisions made and objectives achieved.*

*In 2017, the National Bank of Serbia maintained price and financial stability, mindful of the interests of our citizens and economy.*

*The continuity of our results commits us to persevere each following year. Our gaze is therefore set on the future. As so far, we will work in the interest of our citizens and economy so as to efficiently respond to new challenges as well.*

*Despite the challenges from the international environment which marked 2017, Serbia's macroeconomic performances remained excellent. Uncertainties in the international commodity and financial markets were generated by global oil prices and divergent monetary policies of the Federal Reserve System and the European Central Bank. Nonetheless, the National Bank of Serbia remained the Government's equal partner in ensuring the continuity of the positive results of economic policy – we delivered low inflation, maintained a relatively stable exchange rate and contributed to sustainable economic growth. Furthermore, through joint efforts, we reduced the needs for external financing and increased the resilience of our economy to potential negative effects of global factors. This helped boost the growth outlook and increase confidence in our economy's prospects. Owing to the results achieved, the eighth, final review of the precautionary arrangement with the International Monetary Fund was successfully completed by the end of 2017. The Fund concluded that our achievements exceeded significantly the defined criteria in a number of fields. The success on the macroeconomic front was reflected in the country risk premium falling to its historical low – below 100 basis points in December, and was acknowledged by credit rating upgrades by all three rating agencies. This opened the room to use both domestic and foreign sources of finance at more favourable terms, ensuring faster progress going forward.*

*The National Bank of Serbia is committed to serving Serbian citizens, and this is best illustrated by the results achieved. In 2017, we fulfilled our main objective – for the fifth year in a row, we maintained inflation at a low level. Starting from 2017, we lowered the inflation target by one percentage point, to 3±1.5%. Inflation moved within the new target band throughout the year. The fact that both end-December and annual average inflation stood at the 3.0% target shows that we were realistic in setting the target and consistent in its implementation. That inflationary pressures remained low was also indicated by low and stable core inflation, which stood at 1.3% year-on-year in December, its lowest level since measured by the Consumer Price Index. Inflation expectations of financial and corporate sectors, anchored within the target tolerance band for a longer time, are another confirmation of the persistently low inflationary pressures. According to the Global Competitiveness Report 2017–2018 published by the World Economic Forum, as in the past two years, in terms of inflation, Serbia kept the first position, shared by other 35 countries. This, together with excellent fiscal results, also reflected in a sharp reduction of the share of public debt in gross domestic product, helped Serbia achieve the strongest progress in the macroeconomic environment field – it climbed by 31 places.*

*Muted inflationary pressures and low projected inflation enabled further lowering of the key policy rate. In making monetary policy decisions, we were guided by the effects of past monetary policy easing and uncertainties emanating from the international environment. Against such backdrop, the key policy rate was cut twice in 2017, by total 50 basis points – to 3.5%, its lowest level in the inflation targeting regime. Since May 2013, when the monetary policy easing cycle began, the key policy rate was cut by total 825 basis points, ensuring significant savings for the corporate and household sectors. Its further lowering created conditions for a further drop in interest rates on new and current dinar loans. Interest rates on all types of corporate dinar loans were not only reduced, but also fell to new lows in December. In addition, monetary policy easing and a falling country risk premium led to lower government interest expenses, ensuring better fiscal results. This is, at the same time, a confirmation of the responsible conduct of monetary and fiscal policies, and their full coordination.*

*Lending activity accelerated on account of falling interest rates on dinar loans, stepped-up interbank competition, economic growth accompanied with labour market recovery, a falling risk premium and low euro area rates. Despite the write-offs of non-performing loans, which were more intensive than in 2016, year-on-year growth in total loans (excluding the exchange rate effect) accelerated to 7.3% in December. Owing to lending growth, notably efficient regulatory measures of the National Bank*

*of Serbia, as well as banks' continued efforts to resolve non-performing loans, the share of these loans in total loans declined by 7.2 percentage points to 9.8%, which is lower than before the crisis and the lowest level on record. Given their high coverage by reserves for estimated losses, non-performing loans do not jeopardise the operation of the banking sector, or financial stability.*

*Despite uncertainties emanating from the international environment, relative stability of the exchange rate was preserved. The dinar strengthened in the major part of the year, primarily owing to solid macroeconomic performances of the domestic economy, a high inflow of foreign direct investment and continued vibrant exports. The National Bank of Serbia ended 2017 as a net buyer in the foreign exchange market, buying EUR 1,355.0 million and selling EUR 630.0 million. We preserved foreign exchange reserves of the National Bank of Serbia at an adequate level. At the end of the year, they stood at EUR 10.0 billion. Net foreign exchange reserves, excluding obligations to banks in respect of foreign currency required reserves, were EUR 8.3 billion. In 2017, they stayed above the level defined under the arrangement with the International Monetary Fund. In accordance with the principles of safety and liquidity, the National Bank of Serbia continued to invest foreign exchange reserves in first-class institutions and high-liquid securities of first-class issuers. Consistent in our commitment to lower risks, we increased further the share of gold, to 6.8% in 2017.*

*In addition to preserving price stability, the National Bank of Serbia worked to preserve financial stability as well. In 2017, the domestic banking system remained exceptionally liquid and the capital adequacy ratio continued up – to 22.6% by the end of the year, remaining far above the 8% threshold prescribed by the international and domestic regulatory framework. Capital buffers are an important novelty introduced by Basel III standards and applied as of June 2017. Their aim is to increase banking sector resilience, limit excessive or underestimated exposure and improve the quality of bank capital. Despite numerous challenges that the Serbian banking sector was exposed to during and after the crisis, it remained stable and resilient to shocks from the domestic and international environment, as also confirmed by stress tests, regularly implemented in 2017 as well.*

*The rising use of the dinar in the domestic financial system was one of our strategic priorities. Our efforts yielded results as the majority of financial system dinarisation indicators posted growth in 2017. In December, the degree of dinarisation of corporate and household loans reached its highest level since May 2011, reflecting the continued stepped-up dinar household lending. At the end of 2017, the shares of dinar deposits*

*in total corporate and household deposits reached their historical highs since 2008, when these data became available. Thanks to the Government's focus on dinar borrowing and considerable foreign currency debt repayment, the degree of dinarisation of public debt went up.*

*By maintaining low and stable inflation and a stable financial system, the National Bank of Serbia contributed significantly to the implementation of the precautionary arrangement with the International Monetary Fund. Assessing the monetary policy framework as adequate, the Fund concluded that the National Bank of Serbia kept inflation firmly at bay by pursuing well-calibrated monetary policy, while at the same time supporting the country's economic recovery. The International Monetary Fund praised the National Bank of Serbia for preserving financial stability, particularly progress in resolving non-performing loans. The National Bank of Serbia continued with successful cooperation with other international institutions as well – the World Bank, European Bank for Reconstruction and Development, particularly the European Central Bank and the European Commission, with which we held regular high-level dialogue and exchanged macroeconomic projections and perceptions of key issues concerning Serbia's sustainable growth and development. In the course of the year, the National Bank of Serbia continued to actively participate in the process of Serbia's accession to the European Union, by drafting negotiation positions for individual chapters and holding intensive consultations with the European Commission concerning plans to transpose European Union regulations.*

*Significant effort was invested last year to develop state-of-the-art payment methods. To promote cashless payments in the country, the National Bank of Serbia prepared the Draft Law on Multilateral Interchange Fees and Special Operating Rules for Card-Based Payment Transactions. In keeping with contemporary tendencies in payment methods, we continued to develop the payment services market, i.e. to increase the number of remittance service providers in Serbia and further enlarge the network of agents.*

*In 2017, the National Bank of Serbia signed the Memorandum of Understanding with the world's largest payment card system – China UnionPay, defining the basis for cooperation with the Serbian national card system DinaCard. Given Turkey's share in foreign trade with Serbia and potentials to strengthen and improve economic cooperation between the two countries, the National Bank of Serbia made the decision to introduce the Turkish lira in the list of currencies traded in the foreign exchange market.*

*In 2017, we continued to transparently and timely inform the public about our operation by cooperating with the media, publishing information on social networks, our official website and its subdomains. We continued to provide assistance to financial service consumers and carried out a number of educational activities. We remained committed to socially responsible, most notably humanitarian activities, promoting the well-being of our entire society. We continued to organise research seminars, gathering the leading world experts from European and United States universities and other central banks. We believe research seminars of such kind are highly important for raising the standard of economic research and developing economic science in Serbia. Their quality makes the National Bank of Serbia recognisable in European terms.*

*The results that we have achieved motivate us to continue to actively contribute to sustainable economic growth, improve the country's prospects and ensure a better standard of living. Aware of the importance of our activities, we will continue to act in a responsible, efficient and transparent manner, in the interest of all citizens of Serbia.*

A handwritten signature in black ink, appearing to read 'J. Tabaković', with a stylized flourish at the end.

Governor Jorgovanka Tabaković, PhD

## **ABBREVIATIONS**

**BIS** – Bank for International Settlements  
**bn** – billion  
**bp** – basis point  
**CAR** – capital adequacy ratio  
**CPI** – Consumer Price Index  
**ECB** – European Central Bank  
**EBRD** – European Bank for Reconstruction and Development  
**EIB** – European Investment Bank  
**EU** – European Union  
**FED** – Federal Reserve System  
**GDP** – gross domestic product  
**H** – half year  
**HHI** – Herfindahl-Hirschman Index  
**IFEM** – interbank FX market  
**IMF** – International Monetary Fund  
**mn** – million  
**NPL** – non-performing loan  
**OPEC** – Organisation of the Petroleum Exporting Countries  
**pp** – percentage point  
**Q** – quarter  
**RTGS** – Real Time Gross Settlement  
**SDR** – Special Drawing Rights  
**y-o-y** – year-on-year

Other generally accepted abbreviations are not cited.

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# I INSTITUTIONAL FRAMEWORK AND ORGANISATION OF THE NATIONAL BANK OF SERBIA

## **I.1 Constitutional position and Law on the National Bank of Serbia**

The institutional position of the National Bank of Serbia (NBS) is defined by the Constitution of the Republic of Serbia in its sections on the economic system and public finances. Article 95 of the Constitution sets out that the NBS is the central bank of the Republic of Serbia which is independent in its operations and subject to oversight by the National Assembly, to which it is accountable. It also sets out that the Governor manages its work and that the Law on the National Bank of Serbia is enacted.

Article 107, paragraph 2 of the Constitution further assures the autonomy of the NBS by providing for its right to propose laws within its remit.

### **Law on the National Bank of Serbia**

The Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015, 40/2015 – Constitutional Court decision and 44/2018) regulates the status, organisation, powers and tasks of the NBS, and its relations with bodies of the Republic of Serbia, international organisations and institutions.

#### *Objectives*

The primary objective of the NBS is to achieve and maintain price stability.

Without prejudice to its primary objective, the NBS contributes to the maintenance and strengthening of stability of the financial system.

Without prejudice to the above objectives, the NBS supports the implementation of the Government's economic policy, operating in accordance with principles of the market economy.

### *Tasks*

Tasks of the NBS are to:

- determine and implement monetary and foreign exchange (FX) policies;
- manage FX reserves;
- define and implement, within its remit, activities and measures aimed at maintaining and strengthening stability of the financial system;
- issue and revoke banks' operating licenses, carry out prudential supervision of bank operations and perform other activities, in accordance with the law governing banks;
- issue and revoke insurance licences, supervise the insurance business, issue and revoke licenses to perform specific insurance activities, and perform other activities, in accordance with the law governing insurance;
- issue and revoke financial leasing licenses, supervise the performance of financial leasing operations and perform other activities, in accordance with the law governing financial leasing;
- issue and revoke operating licenses of voluntary pension fund management companies, issue and revoke fund management licenses, supervise this activity and perform other activities, in accordance with the law governing voluntary pension funds;
- issue and revoke licenses to payment institutions to provide payment services, issue and revoke licenses to electronic money institutions to issue electronic money, supervise the provision of payment services and issuance of electronic money and perform other activities, in accordance with the law governing payment services;
- ascertain the fulfilment of conditions for the initiation of procedures for the resolution of banks and/or banking group members and implement these procedures; decide on instruments and measures to be taken in the resolution process and perform other activities regarding bank resolution, in accordance with the law governing banks;
- issue and revoke licenses to payment system operators and supervise their operations, and perform other activities, in accordance with the law governing payment services;
- perform activities of the protection of rights and interests of the consumers of services provided by banks, financial lessors, insurance companies and voluntary pension fund management companies, in accordance with law;
- issue banknotes and coins and manage cash flows;

- regulate, oversee and promote smooth performance of domestic and cross-border payment transactions, in accordance with the law governing payment services;
- perform statutory or contractual activities for the Republic of Serbia, without prejudice to its autonomy and independence.<sup>3</sup>

### *Position of the National Bank of Serbia*

The Law on the National Bank of Serbia regulates in detail, in compliance with international standards and rules, the constitutional principle of autonomy of the NBS, by stipulating that the NBS is autonomous and independent in carrying out its tasks as laid down by this and other laws, that NBS bodies and members of these bodies may neither seek nor take instructions from government bodies and institutions or other persons, and that government bodies and institutions and other persons may not threaten the autonomy and independence of the NBS nor seek to influence the NBS, its bodies or their members in carrying out their tasks.

The NBS has a legal entity status *ex lege* and is not registered in the register of legal entities. The NBS has its Statute which is published in the Official Gazette of the Republic of Serbia.

In the performance of its tasks, the NBS works together with the Government and other state institutions and, without prejudice to the achievement of its objectives, undertakes measures within its scope of authority to promote that cooperation.

For the purpose of pursuing its primary objective and performing its tasks, the NBS may take up membership in international financial organisations and institutions and engage in cooperation with foreign central banks, regulatory bodies and financial and credit institutions, of which it regularly informs the National Assembly through semi-annual reports, or more frequently if required. Without prejudice to the achievement of its objectives, the NBS may, with the Government's consent, act for and on behalf of the Republic of Serbia in international financial organisations and institutions and engage in other forms of international cooperation.

The NBS may not extend credits, loans, overdraft facilities or other forms of credit facilities to the Republic of Serbia, autonomous province or local government unit, public enterprises and other legal entities whose founder is the Republic of Serbia, autonomous province or local government unit in which the Republic of Serbia, autonomous province or local government unit have a controlling stake, nor may it issue guarantees for the settlement of obligations of these entities or otherwise ensure the settlement of their obligations, or buy

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<sup>3</sup> The Law Amending the Law on Foreign Exchange Operations (RS Official Gazette, No 30/2018) and Law Amending the Law on the National Bank of Serbia (RS Official Gazette, No 44/2018) stipulate that as of 1 January 2019 the NBS shall assume from the Ministry of Finance – Tax Administration the issuance and revocation of authorisations to perform exchange operations and the supervision of exchange and foreign exchange operations.

securities directly from those entities. Exemptions from the monetary financing ban are daily loans and loans extended for the purpose of settling liabilities in respect of IMF membership. Banks in which the Republic of Serbia, an autonomous province or a local government unit have a controlling stake, have access to loans and lending facilities of the NBS on equal terms as other banks.

## I.2 Bodies of the National Bank of Serbia

NBS bodies are:

- Executive Board;
- Governor;
- Council of the Governor.

The Executive Board, Governor and Director of the Administration for Supervision of Financial Institutions<sup>4</sup> are responsible for achieving the NBS objectives, within their remit as defined by the Law on the National Bank of Serbia.

### I.2.1 Executive Board

The Executive Board consists of the Governor, Director of the Administration for Supervision of Financial Institutions<sup>5</sup> and Vice-Governors.

The Executive Board determines monetary and FX policies, as well as activities aimed at maintaining and strengthening stability of the financial system, and in particular:

- NBS monetary policy programme;
- manner of setting NBS interest rates and the manner of calculation, collection and payment of interest on loans and other receivables of the NBS and on the funds the NBS pays interest on;
- terms and conditions of issuing NBS securities;
- terms and conditions under which the NBS conducts open market operations and performs discount activities;
- short-term loan policy;
- dinar exchange rate policy;
- required reserves base and ratio, as well as terms, conditions and timelines for the allocation and use of banks' required reserves;
- FX reserve management policy and guidelines;
- other monetary and FX policy instruments and measures;

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<sup>4</sup> Under the Law Amending the Law on the National Bank of Serbia (RS Official Gazette, No 44/2018), the Administration for Supervision of Financial Institutions ceased to exist. Its activities will continue to be performed by the organisational units previously operating within the Administration.

<sup>5</sup> Ibid.

- measures for maintaining bank liquidity;
- measures and activities, within the NBS remit, aimed at maintaining and strengthening stability of the financial system.

The Executive Board sets the key policy rate and other interest rates applied by the NBS in the conduct of monetary policy.

In addition, the Executive Board exercises substantial powers in the field of supervision of financial institutions. On proposal of the Administration for Supervision of Financial Institutions<sup>6</sup>, the Executive Board enacts regulations of the NBS relating to its supervisory tasks, and in accordance with law decides on the licensing and delicensing of financial institutions (banks, insurance companies, financial leasing companies, and voluntary pension fund management companies, payment and electronic money institutions).

The Executive Board enacts regulations and other general and individual acts in the field of bank resolution, in accordance with the law governing banks.

The Executive Board determines the uniform fees charged for services provided by the NBS.

Executive Board meetings are held as often as necessary, but no less than once a month. Meetings are held if at least three members of the Executive Board are present. Meetings are chaired by the Governor. The Executive Board makes decisions by the majority vote of all members. In the event of a tie, the Governor has the casting vote. No member of the Executive Board may abstain from voting. The minister in charge of finance is invited to attend meetings of the Executive Board and participate in deliberations without the right to vote. The Executive Board adopts its Rules of Procedure, regulating in particular the manner of convening and holding a meeting, matters to be discussed at a meeting, and other issues relating to work of the Executive Board.

## I.2.2 Governor and Vice-Governors

Governor:

- represents and acts on behalf of the NBS;
- manages operations of the NBS and organises its work;
- implements decisions of the Executive Board and of the Council of the Governor;
- enacts regulations, general and individual acts under the NBS remit, which are not assigned by law to the authority of the Executive Board, Council of the Governor and Administration for Supervision of Financial Institutions<sup>7</sup>;
- proposes regulations, general and individual acts to be adopted by the Executive Board and the Council of the Governor, unless provided otherwise by the Law on the National Bank of Serbia;

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<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

- regulates the NBS internal organisation and job classification, as well as labour relations of NBS employees;
- appoints and dismisses employees who manage NBS organisational units;
- performs other tasks defined by law in a manner that does not conflict with the objectives stipulated by the Law on the National Bank of Serbia.

The Governor is appointed by the National Assembly on proposal of the President of the Republic of Serbia. The Governor is appointed for a six-year renewable term of office.

Pursuant to the Law on the National Bank of Serbia, the NBS has between two and four Vice-Governors. They are appointed by the National Assembly, on proposal of the Governor, for a six-year renewable term of office. The provisions of the Law governing the appointment, incompatibility of office and conflict of interest regarding the Governor's position apply accordingly to Vice-Governors. Specific tasks that the Governor may confer upon Vice-Governors are regulated in detail by the Statute of the National Bank of Serbia.

### I.2.3 Council of the Governor

The Council of the Governor consists of five members, including the President, appointed by the National Assembly on proposal of the National Assembly's Finance Committee. Members of the Council are appointed for a five-year renewable term of office. Members of the Council are not NBS employees. Provisions of the Law governing the appointment, incompatibility of office and conflict of interest regarding the Governor's position apply accordingly to the Council members. At least one member of the Council must have minimum ten years of work experience in accounting or auditing.

The Council of the Governor:

- adopts the Statute of the National Bank of Serbia, on proposal of the Executive Board;
- determines the exchange rate regime of the dinar, on proposal of the Executive Board and with the Government's consent;
- adopts the FX reserves management strategy, on proposal of the Executive Board;
- decides on membership in international organisations and institutions;
- adopts the NBS financial plan;
- adopts annual financial statements of the NBS;
- selects the external auditor, considers the external auditor's report and monitors the implementation of audit recommendations in the NBS;
- oversees the system of financial reporting, risk management and internal controls in the NBS;
- evaluates the adequacy of accounting policies and procedures adopted in the NBS;

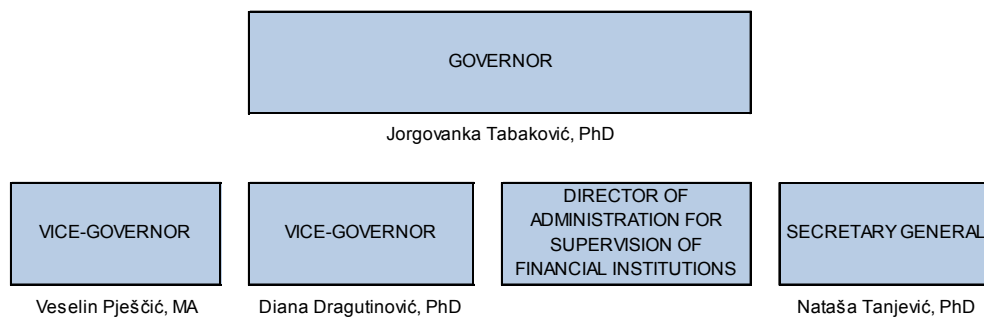
- adopts an annual plan of internal audit in the NBS and periodically reviews internal audit reports;
- oversees the performance of internal audit and compliance of operations in the NBS;
- adopts a strategy of NBS development, proposed by the Executive Board, and monitors its implementation.

The Council submits a report on its work to the National Assembly as often as necessary, but no less than twice a year.

Meetings of the Council are held as often as necessary, but at least once every two months. Meetings are held if at least three Council members are present. The Council takes decisions by a majority vote of all members. No member of the Council may abstain from voting. The Council adopts its Rules of Procedure, regulating in particular the manner of convening and holding a meeting, matters to be discussed at a meeting and other issues relating to the work of the Council.

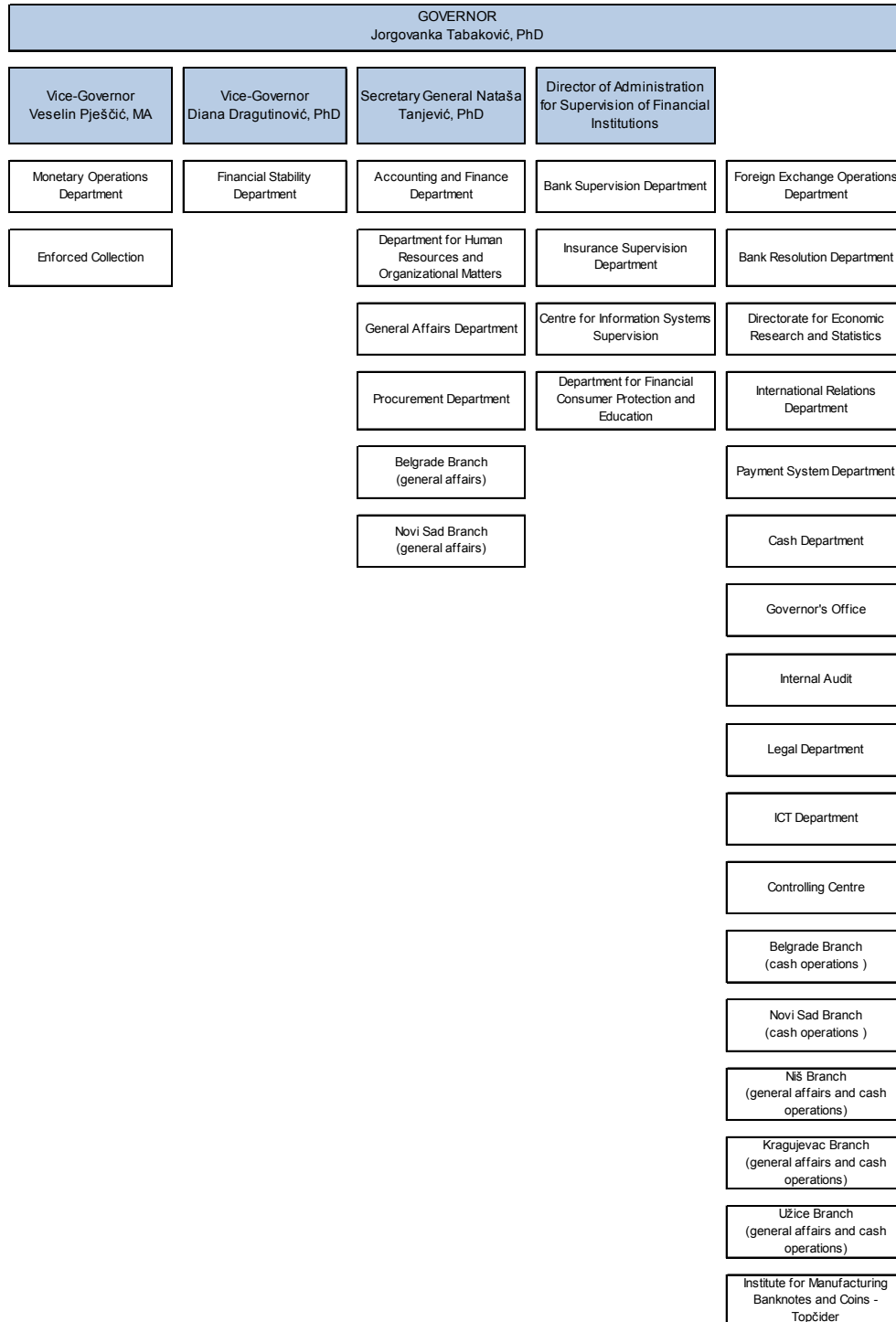
### I.3 Organisation

## MANAGEMENT OF THE NATIONAL BANK OF SERBIA (as at 31 December 2017)



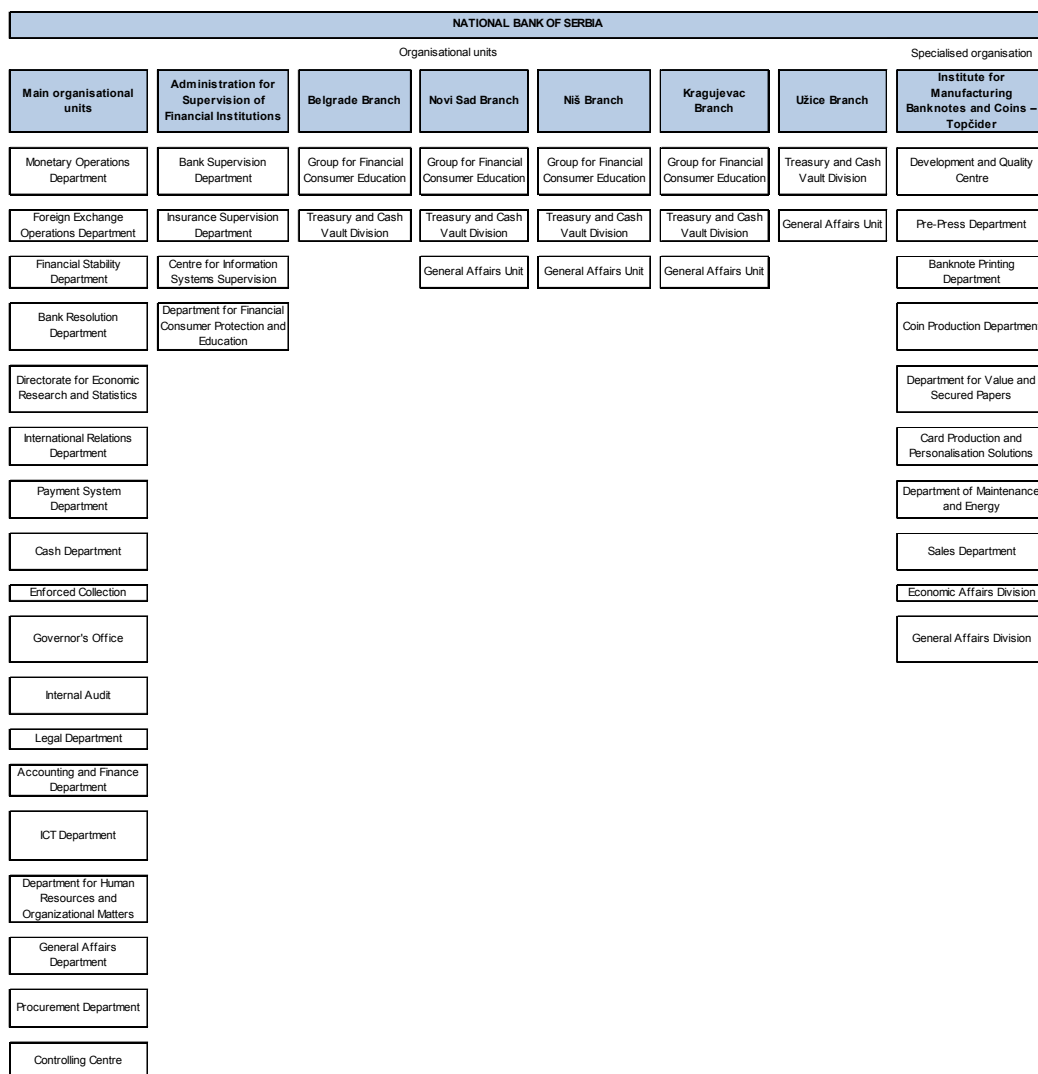
# COORDINATION OF THE NATIONAL BANK OF SERBIA

(as at 31 December 2017)



# ORGANISATIONAL CHART OF THE NATIONAL BANK OF SERBIA

(as at 31 December 2017)



## II PRICE AND FINANCIAL SYSTEM STABILITY

### II.1 Monetary policy

#### II.1.1 Monetary policy in 2017

In 2017, monetary policy was pursued in accordance with the **Monetary Policy Programme of the National Bank of Serbia in 2017**.<sup>8</sup> As envisaged by the Programme, the NBS achieved the inflation target of  $3.0\pm 1.5\%$ , closely monitoring the developments in the domestic and international environment. The NBS remained flexible when using monetary policy instruments, taking into account the expected effects of past monetary easing on inflation movements and acknowledging uncertainties in the global market.

The main monetary policy instrument of the NBS – the key policy rate – **was kept unchanged (4.0%) from January to September 2017**. The Executive Board made decisions to keep the key policy rate on hold in this period taking into consideration the medium-term inflation outlook and key factors of inflation, effects of past monetary easing, and the lowering of the inflation target.

In this period the Executive Board underscored that inflation would stay low and stable, moving within the target band of  $3.0\pm 1.5\%$  throughout 2017 and thereafter. It expected that the movement of inflation by end-2017 would be driven by the low base effect of fruit and vegetable prices, and the gradual increase in aggregate demand at home and inflation abroad. It also assessed that low costs of raw materials in food production would remain a drag for some time, as would the high base of petroleum product prices starting from March. As assessed by the Executive Board, inflation would slow down from early 2018 on account of still low inflationary pressures reflecting the majority of factors from the domestic and international environment, along with the high base effect of products and services that saw one-off price hikes in early 2017. Inflationary pressures remained

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<sup>8</sup> RS Official Gazette, No 98/2016.

subdued, as confirmed by stable core inflation, which moved around 2% y-o-y. Low inflationary pressures were also indicated by anchored inflation expectations – the financial and corporate sectors expected that price stability would be preserved both in the short and medium term.

A good agricultural season in 2016 drove down the prices of fruit and vegetables, which is why they were expected to rise in 2017, assuming an average agricultural season. However, owing to particularly cold weather early in the year, the prices grew more than usual for the season. Also, drought in the summer months gave rise to expectations that the prices of primary commodities and fruit and vegetables could be higher than expected for the season until the end of the year, which could have certain second-round effects on other prices as well.

The Executive Board assessed that domestic demand could gradually recover on the back of the rise in private sector wages and employment, and past monetary policy easing. Interest rates in the domestic market continued down, while considerably more favourable financing conditions pushed up lending activity and investment growth.

Besides the recovery of domestic demand, the Executive Board assessed that external demand would recover as well. Following a slow global economic recovery in previous years, most economies and international trade showed visible signs of growth. Better outlook for euro area economic growth would reflect positively on other countries in the region, which are our important trade partners as well. Also, after rising early in the year due to the increase in energy and food prices, euro area inflation stabilised at a somewhat higher level than last year, though still below the inflation target (below, but close to 2%).

Monetary policy caution in the period observed was also mandated by uncertainty in the international financial market due to increased divergence of monetary policies of leading central banks. The Fed continued to raise the federal funds rate and announced that as of October 2017 it would start cutting down its balance sheet, i.e. cease to reinvest repayments of principal on securities purchased in quantitative easing. Caution was required mainly because of the possibility for such global conditions to cause sudden shifts in the capital flows towards emerging economies, including Serbia. On the other hand, the ECB continued to implement the quantitative easing programme, which mitigated the adverse effects of the Fed's policy normalisation. The ECB's moves are of particular importance for Serbia, given our financial links with the euro area, and the fact that the euro area is our most important trade partner. However, despite global economic recovery, there were no signals of rising inflationary pressures on the demand side or that monetary policy tightening of leading central banks could come faster than announced.

Considering new information on economic developments at home and abroad, the NBS Executive Board **lowered the key policy rate by 25 bp in both September and October, to 3.5%**, which was its lowest level in the inflation targeting regime. The NBS thus provided additional support to credit activity and economic growth.

As the Executive Board had expected, y-o-y inflation slowed down in the summer, as did core inflation, which fell to 1.5% y-o-y in August and remained unchanged in September.

However, headline inflation decelerated more than expected, given that the effects of the drought on the prices of fruit and vegetables and primary agricultural commodities were weaker than anticipated, thus second-round effects on inflation never occurred. This was indicated by the prices of processed food which remained almost unchanged, while both one- and two-year ahead inflation expectations were additionally lowered.

Another drag on inflation were lower import prices expressed in dinars, including the prices of primary agricultural commodities and oil. In addition, the country risk premium, in conditions of improved fundamentals at home and under the impact of global factors, was brought down to its lowest level on record for Serbia. The Executive Board decisions to cut the key policy rate in September and October were also supported by fiscal trends. They were more favourable than expected, which was best confirmed by the achieved budget surplus. This reduced the need of the government for borrowing and, among other things, helped further lower the share of public debt in GDP. The Executive Board expected that the fiscal efforts made, along with achieved economic growth, would allow the tendency of falling public debt to continue in the coming period.

Bearing in mind past monetary policy easing as well as the new, November inflation projection, movement of its key factors, better economic performance and prospects for the coming period, the Executive Board **did not change the key policy rate in November and December (3.5%)**. It assessed that inflation would move within the target band in the next two years, though it would decline in H1 2018 as a result of the base effect of food and energy prices. Another drag on inflation would be low cost-push pressures on account of import prices expressed in dinars, prices of primary agricultural commodities in the domestic market, and the continued decline in the country risk premium. The expected rise in domestic demand would work in the opposite direction, aided by wage and employment growth and the effects of past monetary policy easing.

Monetary policy caution was still mandated by developments in the international environment. However, the Executive Board emphasised that, owing to improved macroeconomic fundamentals and a favourable outlook in the period ahead, Serbia was now more resilient to potentially adverse effects from the international environment. Standard & Poor's and Fitch raised Serbia's credit rating in December, which is another confirmation of further improvement in Serbia's macroeconomic outlook and the results achieved in terms of implementing structural reforms. Further improvement of macroeconomic outlook was also noted by the IMF during reviews under the stand-by arrangement.

In the coming period, the Executive Board will continue to implement a carefully calibrated and combined set of monetary policy measures aimed at maintaining low and stable inflation, while preserving financial system stability and supporting economic growth.

## Monetary policy instruments

The main monetary policy instrument of the NBS is the key policy rate, i.e. the interest rate on the main open market operations.

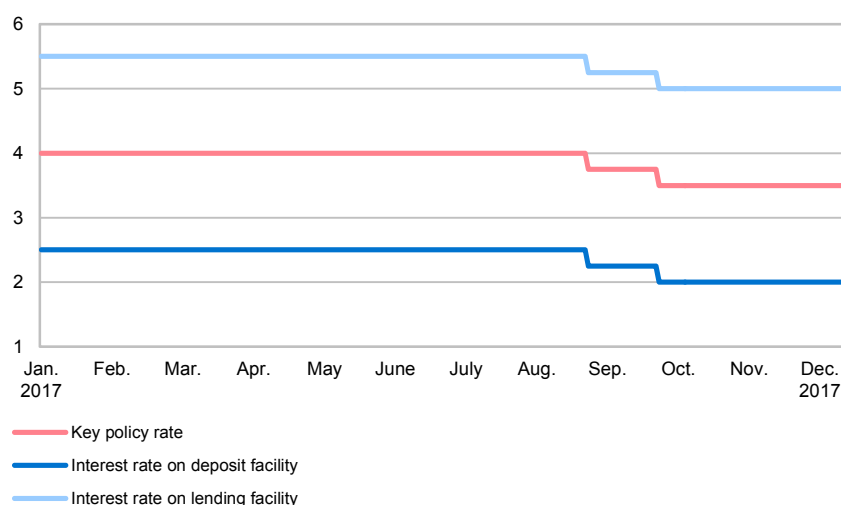
The role of the key policy rate is supported by the corridor of interest rates on deposit and lending facilities and by other open market operations. In addition to the key policy rate, the NBS uses other instruments of monetary regulation, notably reserve requirements and operations in the FX market.

### *Open market operations*

The main open market operations of the NBS in 2017 were again **one-week reverse repo transactions**, i.e. repo sale of securities (liquidity absorbing).

The NBS implemented repo transactions through own securities. For the purposes of repo sale, in 2017 the NBS issued one series of T-bills in the total nominal amount of RSD 500.0 bn. The issuing of one series of high nominal value is consistent with the practice in earlier years which enables more adequate management of securities within the same series and facilitates liquidity management for banks.

Chart II.1.1 **Key policy rate and interest rate corridor**  
(daily data, p.a., in %)



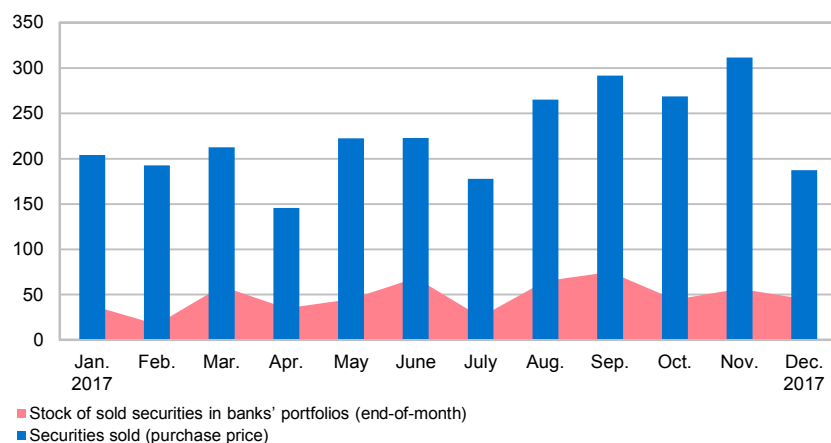
Source: NBS.

In 2017, fifty-two repo sale auctions were organised once a week **modelled on the variable multiple interest rate**. Total securities sales amounted to RSD 2,701.7 bn, which was somewhat higher than in 2016 (RSD 2,343.4 bn).

The stock of NBS bills in banks' portfolios averaged RSD 51.8 bn in 2017, up by RSD 6.8 bn from 2016. Relative to end-2016, the stock of these bills increased by RSD 11.3 bn, to RSD 45.1 bn at end-December.

The sales volume was gradually increasing in 2017. Total securities sales amounted to RSD 1,199.9 bn in H1 and RSD 1,501.8 bn in H2.

**Chart II.1.2 Repo sale and stock of sold securities**  
(in RSD bn)



Source: NBS.

### *Deposit and lending facilities*

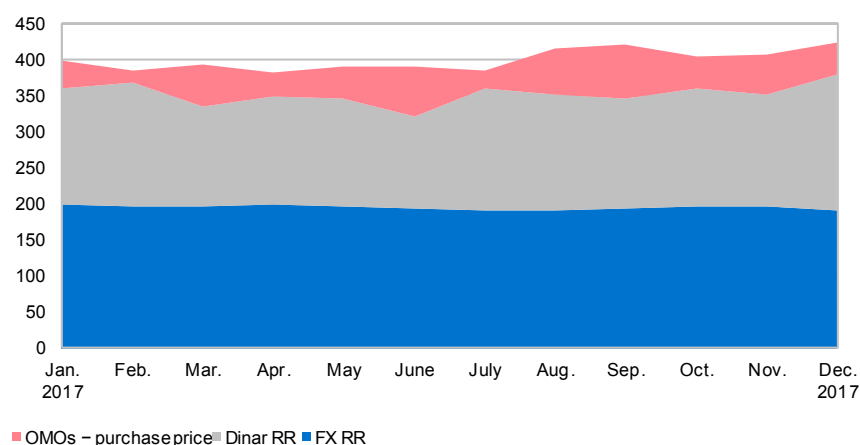
In 2017 banks continued to place overnight deposits with the NBS. The average daily stock of bank deposits with the NBS in 2017 came at RSD 14.8 bn, which is RSD 13.1 bn less than in 2016. The highest average monthly stock was recorded in January (RSD 22.3 bn) and the lowest in July (RSD 8.7 bn).

In 2017, banks rarely used lending facilities, mainly as intraday loans (eight banks), and less as overnight loans (one bank). Intraday loans were worth a total of RSD 61.1 bn, with the peak recorded in Q3 (RSD 23.4 bn). Overnight loans were used on several occasions in smaller amounts, totalling RSD 12.6 bn. They were used only in H2, the most of which related to July (RSD 6.2 bn).

### *Reserve requirements*

The rates and manner of required reserve allocation were not changed in 2017.

**Chart II.1.3 Volume of sterilisation by monetary policy instrument**  
(in RSD bn)



Source: NBS.

At end-2017, calculated required reserves allocated in dinars increased by RSD 8.5 bn relative to end-2016, to RSD 155.8 bn. Of that amount, RSD 1.9 bn related to dinar required reserves and RSD 6.6 bn to dinar allocations of foreign currency required reserves.

In the same period, the amount of calculated required reserves allocated in foreign currency increased by EUR 141.2 mn to EUR 1.7 bn. Such a development resulted from the increase in the foreign currency base by EUR 1.2 bn, which pertained to FX liabilities with maturity up to two years. The majority of the increase related to household FX savings and foreign FX liabilities of banks.

### *Foreign exchange market operations*

Under the 2017 Monetary Policy Programme, the NBS continued implementing the managed float exchange rate regime. Its interventions in the FX market aimed to ease excessive short-term volatility of the exchange rate, safeguard financial and price stability and maintain an adequate level of FX reserves.

In 2017, the dinar gained 4.2% against the euro in nominal terms, mostly as a result of:

- 1) improvement of Serbia's macroeconomic indicators and outlook of the domestic economy, which contributed to a net FDI inflow more than sufficient to cover the current account deficit;
- 2) higher interest of foreign portfolio investors to invest in long-term dinar government securities;
- 3) higher FX inflow during the tourist season; and
- 4) rise in net indexed bank assets.<sup>9</sup>

In 2017, the NBS intervened in the IFEM as a net buyer of EUR 725.0 mn (buying EUR 1,355.0 mn and selling EUR 630.0 mn). The NBS intervened as a price taker, strictly under market conditions.

Depreciation pressures were recorded in the domestic FX market early in the year, in January and the first ten days of February. They were mostly prompted by heightened uncertainty in the international environment due to diverging monetary policies of the Fed and ECB, especially following the Fed's decision to raise the federal funds rate in December 2016, and by seasonally higher FX demand of domestic energy importers. A period of relative stability in the FX market followed from mid-February. From April to mid-November, appreciation pressures were mainly recorded owing to favourable macroeconomic developments and the outlook of the domestic economy. The second half of November and most of December saw depreciation pressures, caused mostly by the seasonally higher FX demand of domestic energy importers.

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<sup>9</sup> Aiming to balance their long open foreign currency positions, thus reducing exposure to exchange rate risk, banks sell foreign currency, which results in the strengthening of the dinar.

In quarterly terms, in Q1 the dinar lost 0.4% against the euro in nominal terms, and the NBS exclusively sold foreign currency in the IFEM (EUR 345.0 mn). In Q2, the NBS intervened by buying foreign currency (EUR 505.0 mn), and the dinar strengthened against the euro by 2.6% in nominal terms. In Q3, the dinar's appreciation continued (by 1.2%), whereas the NBS intervened only by purchasing foreign currency (EUR 605.0 mn). Despite stronger depreciation pressures in mid-Q4, in this quarter the dinar gained 0.8%, with net sales in the IFEM amounting to EUR 40.0 mn (the NBS bought EUR 245.0 mn and sold EUR 285.0 mn).

### *Foreign exchange swaps*

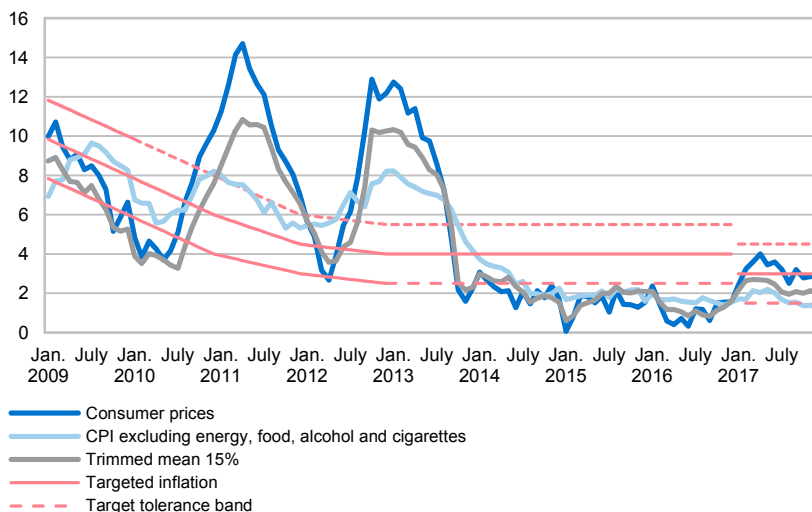
In 2017, the NBS continued to hold its regular three-month and two-week FX swap auctions of FX purchase and sale for dinars, in order to develop interbank swap trading and facilitate more efficient bank liquidity management. In 2017 the NBS organised 102 two-week FX swap actions, where it swap sold and swap bought EUR 363.0 mn each. Also, it organised 100 three-month FX swap auctions, where it swap sold and swap bought EUR 183.5 mn each. The highest performance was recorded in March, when the NBS swap sold and swap bought EUR 62.0 mn each. At end-2017, the stock of FX receivables and FX liabilities of the NBS in respect of three-month swap auctions equalled EUR 32.0 mn each. NBS FX receivables and FX liabilities to banks in respect of two-week swap auctions measured EUR 19.0 mn each.

## II.1.2 Achievement of inflation target in 2017

Inflation moved within the new, lower target band of  $3.0\pm 1.5\%$  throughout 2017. Its movement early in the year was driven by the recovery of global oil prices since H2 2016, and by the impact of extremely cold weather, which pushed up the prices of fruit, vegetables and firewood more than is usual for the season. Having reached 4% in April as a result of the above one-off hikes of a small number of products and services, y-o-y inflation started to decline in May, stabilising in H2 around the 3.0% target. The average inflation rate also equalled 3% in 2017. Low inflationary pressures were indicated by core inflation as well, which moved around the lower bound of the target tolerance band throughout 2017. In December, core inflation stood at 1.3%, its (then) lowest level since it has been measured by CPI.

Inflationary pressures remained low, and weather (extremely cold at the start of the year, followed by drought in the summer) was the dominant driver of inflation in 2017, which is indicated by the fact that 1.3 pp of 1.4 pp (the difference between inflation at end-2017 and end-2016) relates to the rise in the contribution of fruit and vegetables (from -0.4 pp at end-2016 to 0.9 pp at end-2017).

**Chart II.1.4 Price movements**  
(y-o-y growth, in %)



Sources: SORS and NBS calculation.

Overall, **food prices** picked up by 4.2% in 2017 (contributing 1.3 pp to inflation). **Unprocessed food prices** gained the most in 2017 (8.5%), particularly prices of fruit (22.4%) and vegetables (12.9%), mostly because of adverse weather conditions, but also because these prices were extremely low in H2 2016 following the previous excellent agricultural season.

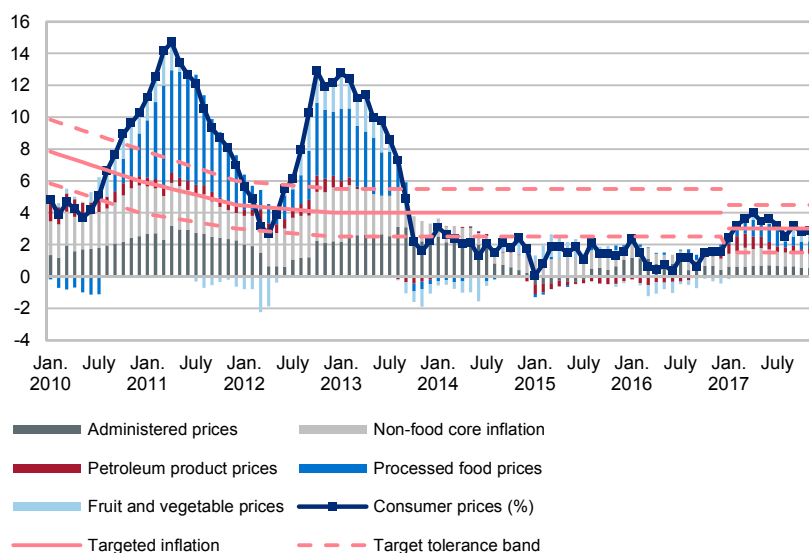
**Processed food prices** rose by 1.9% y-o-y in December, which is why their contribution to headline inflation in 2017 remained low (0.4 pp), primarily owing to the persistent low prices of primary agricultural commodities in the global market. The strongest boost was provided by the prices of non-alcoholic beverages, milk and dairy products, and processed meat products.

**Industrial product prices excluding food and energy** picked up by 2.0% y-o-y in December, contributing 0.6 pp to inflation. The price growth in this group was predominantly determined by the January and July cigarette price hikes totalling 8.9% (contribution to inflation: 0.4 pp). The dinar's strengthening during the year drove down the prices of imported goods expressed in dinars, as well as rents.

At the annual level, **prices of services** rose by 2.1% (contribution to inflation: 0.5 pp), chiefly due to the March increase in the prices of mobile telephony services of one mobile network operator by 12%, and to higher prices of travel packages by around 13%.

**Energy prices** gained 3.8% in 2017 (contribution to headline inflation: 0.6 pp in December). In this category, prices of petroleum products made the strongest positive contribution and were followed by the prices of firewood and electricity.

Chart II.1.5 **Contributions of CPI components to y-o-y inflation**  
(in pp)



Sources: SORS and NBS calculation.

Compared to end-2016, the contribution of electricity prices was lower (electricity prices picked up by 2.1% in 2017 as opposed to 3.8% in 2016), and that of firewood prices was higher (due to extremely cold weather in early 2017). As regards petroleum products, the largest contribution to y-o-y inflation came in February and March (by 0.9 pp in both months), resulting not only from the low base effect from the same period in 2016, but also from the recovery of global oil prices in late 2016 following the agreement between OPEC countries and Russia on curtailing oil production. As the year progressed, the contribution of petroleum products waned, standing at 0.3 pp at end-2017.

**Administered prices**, i.e. prices under direct or indirect impact of the Government, grew by 2.9% in 2017, contributing 0.6 pp to headline inflation. Growth in this price group was almost fully determined by hikes in cigarette and electricity prices. Lower prices of medicines worked in the opposite direction.

**Core inflation**,<sup>10</sup> as part of CPI under the strongest impact of monetary policy, remained low and stable in 2017. It moved around the lower bound of the target tolerance band, measuring 1.3% y-o-y in December, which is lower than its level a year earlier. Such movement of core inflation indicates that low inflationary pressures are of more durable character and largely a result of restrictive fiscal policy, relative stability of the dinar exchange rate, anchored inflation expectations and low inflation abroad. In terms of groups of products and services, the only major positive contribution to core inflation

<sup>10</sup> CPI excluding the prices of energy, food, alcohol and cigarettes, which is the most frequently used measure of core inflation.

in 2017 came from the prices of mobile telephony services (0.2 pp) and travel packages (0.1 pp).

## II.2 Regulation and supervision of financial institutions

### II.2.1 Banks

During 2017, the structure of the NBS-supervised segments of the financial sector remained largely unchanged. The banking sector still dominates the Serbian financial system and represents the key contributor to its stability. In the balance sheet total of the NBS-supervised segments of the financial sector, which measured around 84% of GDP in 2017, the banking sector participated with 90.7%.<sup>11</sup>

The trend of downsizing employment in the Serbian banking sector, which started back in 2009, continued into 2017. At year-end, the banking sector employed 23,055 persons, 792 fewer than at end-2016.

Table II.2.1.1 **Financial system structure**

	31 December 2016			31 December 2017		
	Number	Balance sheet total (RSD bn)	Share (%)	Number	Balance sheet total (RSD bn)	Share (%)
Banking sector	30	3,241.5	91.1	29	3,369.4	90.7
Lessors	16	66.3	1.9	16	75.3	2.0
Insurance undertakings	23	215.6	6.1	21	233.0	6.3
Voluntary pension funds	7	32.8	0.9	7	36.1	1.0
<b>Total</b>	<b>76</b>	<b>3,556.2</b>	<b>100.0</b>	<b>73</b>	<b>3,713.8</b>	<b>100.0</b>

Source: NBS.

### Banking sector structure

There were 29<sup>12</sup> banks operating in Serbia in 2017 – one less than in 2016. At year-end, 21 banks in the Serbian banking sector were majority foreign-owned, private domestic capital dominated in two banks, while six banks were in majority ownership of the Republic of Serbia.<sup>13</sup>

<sup>11</sup> All data in the Report are based on the reports that banks are required to submit to the NBS. These reports have not been audited by external auditors or verified by NBS on-site supervisors.

<sup>12</sup> Direktna banka a.d. Kragujevac acquired 100% of ownership in Findomestic banka a.d. Beograd on 1 July 2017, and AIK banka a.d. Beograd acquired Jubanka a.d. Beograd on 22 December 2017. Bank of China Srbija a.d. Beograd was licensed on 20 December 2016, and started its operations in 2017.

<sup>13</sup> The Republic of Serbia is the majority owner or the biggest individual shareholder.

Table II.2.1.2 Ownership structure of the banking sector in 2017

	Balance sheet total (RSD mn)	Share (%)	Capital (RSD mn)	Share (%)
Domestic banks:	779,826	23.1	153,195	23.0
- state-owned	543,596	16.1	88,084	13.2
- privately-owned	236,230	7.0	65,111	9.8
Foreign banks	2,589,566	76.9	513,921	77.0
<b>Total</b>	<b>3,369,392</b>	<b>100.0</b>	<b>667,116</b>	<b>100.0</b>

Source: NBS.

At end-2017, state-owned banks held a smaller share in total balance sheet assets of the banking sector, but a higher share in total capital (by 1.2 pp each) than at end-2016. Balance sheet total and capital of banks in foreign ownership increased by 4.2% and 2.4% in nominal terms, respectively.

The greatest change took place in privately-owned domestic banks, whose shares of balance sheet total and capital increased (by 1.0 pp and 1.2 pp respectively), while at the same time achieving the largest nominal increase (by 21.3% and 19.8% respectively) due to the takeover of 100% of the shares of Alpha Bank a.d. Beograd<sup>14</sup> by AIK banka a.d. Beograd and of Findomestic banka a.d. Beograd by Direktna banka a.d. Kragujevac.

Of the banks in foreign ownership, the highest share in total banking sector assets was held by banks from Italy (27.5%), Austria (12.7%) and France (11.1%), followed by banks from Greece (6.2%) and Hungary (5.8%), while other countries (eleven banks) jointly accounted for 13.6% of total assets.

## Concentration

At end-2017, balance sheet assets of the majority of banks exceeded RSD 100 bn. Together, they accounted for around 82% of total banking sector balance sheet assets, while the top three banks held almost 40% of the total.

Table II.2.1.3 Banks by balance sheet assets

	31 December 2016		31 December 2017	
	Number of banks	Balance sheet total (RSD mn)	Number of banks	Balance sheet total (RSD mn)
Over 100,000	11	2,617,911	11	2,758,372
50,000 to 100,000	5	390,807	5	402,050
10,000 to 50,000	10	208,528	9	192,967
Up to 10,000	4	24,259	4	16,003
<b>Total</b>	<b>30</b>	<b>3,241,505</b>	<b>29</b>	<b>3,369,392</b>

Source: NBS.

<sup>14</sup>In April 2017 the bank changed its name to Jubanka a.d. Beograd.

In 2017, market concentration rose slightly only for loans, but the HHI<sup>15</sup> remained well below 1,000, as in the case of balance sheet assets and deposits. Thus, the Serbian banking sector is concentration-free.

**Table II.2.1.4 Concentration – the shares of top banks in banking sector balance sheet assets, loans and deposits**

(%)	31 December 2016	31 December 2017
<b>Share in balance sheet assets</b>		
Top bank	17.0	16.8
Top five banks	54.7	54.9
Top ten banks	77.4	78.4
<b>Share in gross loans</b>		
Top bank	14.8	15.3
Top five banks	51.2	53.6
Top ten banks	74.7	77.7
<b>Share in deposit potential</b>		
Top bank	16.9	16.7
Top five banks	54.3	55.6
Top ten banks	77.9	79.5

Source: NBS.

**Table II.2.1.5 HHI concentration**

	Balance sheet total	Gross loans	Deposit potential
31 December 2016	813	736	827
31 December 2017	813	788	827

Source: NBS.

## Structure of banking sector assets and liabilities

### *Structure of assets*

At end-2017, the Serbian banking sector's balance sheet assets equalled RSD 3,369.4 bn, up by 3.9% from end-2016. As banks focus on traditional credit-deposit activities, loans and receivables accounted for a dominant share of banking sector net assets<sup>16</sup> – around 62.5% at end-2017, and are therefore the most

<sup>15</sup> HHI (Herfindahl-Hirschman Index) is calculated as the sum of square values of individual bank shares in the category observed (assets, loans, deposits, etc.). HHI up to 1,000 indicates that there is no market concentration; 1,000–1,800 indicates moderate concentration; above 1,800 indicates high concentration.

<sup>16</sup> In addition to loans and deposits, this balance sheet item also includes FX accounts abroad, receivables from interest, fees and commissions and other receivables (factoring, forfeiting, sureties, letters of credit and other sureties), and excludes foreign currency required reserves and excess liquidity deposited with the NBS.

important determinant of asset quality. The remainder of net assets was mostly made up of financial assets available for sale (16.4%) and cash and balances with the central bank (14.1%).

Table II.2.1.6 **Structure of banks' assets as at 31 December 2017**

	Amount (RSD mn)	Share (%)
Cash and balances with the central bank	473,844	14.1
Pledged financial assets	5,334	0.2
Financial assets at fair value through the income statement and held for trading	26,244	0.8
Financial assets initially recognised at fair value through the income statement	7,270	0.2
Financial assets available for sale	553,816	16.4
Financial assets held to maturity	59,474	1.8
Loans and receivables from banks and other financial organisations	177,337	5.3
Loans and receivables from clients	1,926,565	57.2
Change in fair value of hedged items	194	0.0
Receivables arising from hedging derivatives	91	0.0
Investment in associated undertakings and joint ventures	2,752	0.1
Investment in subsidiaries	19,791	0.6
Intangible investment	11,496	0.3
Property, plant and equipment	52,312	1.5
Investment property	15,291	0.4
Current tax assets	74	0.0
Deferred tax assets	2,446	0.1
Non-current assets held for sale and discontinued operations	3,066	0.1
Other assets	31,995	0.9
<b>Total assets</b>	<b>3,369,392</b>	<b>100.0</b>

Source: NBS.

The majority of loans and receivables (91.6%) related to clients, and the rest to banks and other financial organisations. Net loans only gained 10.2% in 2017, coming at RSD 1,927.3 bn at year-end. They rose mostly owing to the increase in cash loans (by RSD 72.2 bn) and liquidity and current assets loans (by RSD 60.9 bn). By sector, corporate and household loans rose the most (12.0% and 11.1% respectively), making up 45.2% and 40.0% of total net loans respectively at end-2017.

### *Structure of liabilities*

Banks are increasingly relying on stable domestic sources of funding. At end-2017, deposits and other liabilities<sup>17</sup> made up the largest portion of overall sources

<sup>17</sup> Pursuant to new balance sheet structures, the item 'Deposits and other liabilities', besides deposits, also includes received loans and liabilities in respect of interest, fees and commissions.

of funding – 77.6% (where 66.3% of total liabilities were deposits and other liabilities to other clients, except for banks, other financial organisations and the central bank), with capital at 19.8%.

Banks' deposit potential was RSD 2,360.4 bn. In 2017, it went up by 4.8%, driven primarily by the rise in transaction deposits (9.9%), mostly of households and corporates. At end-2017, deposits of households accounted for 51.8%, and those of corporates for 23.5% of total banking sector deposits, indicating a rise in the share of corporate deposits and a fall in the share of household deposits compared to 2016.

The currency structure of funding sources did not change much in the course of 2017 either. FX deposits, mainly denominated in euros, remained a dominant source of bank funding. Nevertheless, some progress was achieved, as seen in the further rise in the share of dinar deposits in total deposits by 1.3 pp to 32.0% at the end of the year.

Table II.2.1.7 Structure of banks' liabilities as at 31 December 2017

	Amount (RSD mn)	Share (%)
Financial liabilities at fair value through the income statement held for trading	456	0.0
Financial liabilities initially recognised at fair value through the income statement	0	0.0
Liabilities arising from hedging derivatives	573	0.0
Deposits and other liabilities to banks, other financial organisations and the central bank	379,451	11.3
Deposits and other liabilities to other clients	2,232,796	66.3
Changes in fair value of hedged items	0	0.0
Securities issued and other borrowings	0	0.0
Subordinated liabilities	33,290	1.0
Provisions	11,160	0.3
Liabilities in respect of assets held for sale and discontinued operations	0	0.0
Current tax liabilities	1,483	0.0
Deferred tax liabilities	797	0.0
Other liabilities	42,270	1.3
<b>Total liabilities</b>	<b>2,702,276</b>	<b>80.2</b>
Capital	<b>667,116</b>	<b>19.8</b>
<b>Total liabilities</b>	<b>3,369,392</b>	<b>100.0</b>

Source: NBS.

Banking sector capital reached RSD 667.1 bn at end-2017, up by 5.5% from end-2016. Capital increased primarily on account of higher banking sector profitability in 2017. Share capital increased mainly as a result of recapitalisation amounting to RSD 18.7 bn, along with a RSD 16.1 bn decline due to two banks' mergers.

**Table II.2.1.8 Structure of bank capital**  
(RSD mn)

	31 December 2016	31 December 2017
Share capital and other capital	401,513	404,547
Own shares	0	1
Reserves*	195,921	196,336
Profit of the current and previous years	79,102	100,739
Loss of the current and previous years	44,050	34,505
<b>Total</b>	<b>632,486</b>	<b>667,116</b>

Source: NBS.

\* And unrealised losses.

### *Off-balance sheet items*

Off-balance sheet items of the banking sector totalled RSD 7,054.1 bn at end-2017, slightly lower than at end-2016 (by 1.0%).

**Table II.2.1.9 Banks by off-balance sheet total**

	31 December 2016		31 December 2017	
	Number of banks	Off-balance sheet total (RSD mn)	Number of banks	Off-balance sheet total (RSD mn)
Over 1,000,000	1	1,728,947	1	1,610,838
500,000 to 1,000,000	5	2,982,402	5	3,119,500
100,000 to 500,000	9	2,033,741	8	1,906,025
50,000 to 100,000	3	189,568	4	253,632
10,000 to 50,000	6	160,644	6	148,924
1,000 to 10,000	5	32,424	4	15,197
Below 1,000	1	735	1	0
<b>Total</b>	<b>30</b>	<b>7,128,461</b>	<b>29</b>	<b>7,054,116</b>

Source: NBS.

The breakdown of banking sector off-balance sheet items shows that the majority of banks (eight) recorded off-balance sheet total ranging from RSD 100 bn to RSD 500 bn, accounting for 27.0% of total off-balance sheet items of the banking sector. Six banks held more than RSD 500 bn, making up more than 67% of off-balance sheet items of the total banking sector, where a single bank held over a third of the total. The most significant off-balance sheet items were other off-balance sheet assets<sup>18</sup> (79.4% of total off-balance sheet items), which are credit risk-free, i.e. in respect of which no payments can be made. The most significant credit risk-bearing off-balance sheet items were receivables under derivatives (8.1%) and issued guarantees and other sureties (4.3%).

<sup>18</sup> Received material collateral, received guarantees and other collateral, funds from depo and custody operations, approved framework loans and credit lines, accepted callable liabilities and other off-balance sheet assets.

### Foreign currency sub-balance sheet

The currency structure of the Serbian banking sector's balance sheet improved in 2017, i.e. the share of dinar assets and liabilities rose.

Table II.2.1.10 **Currency structure of bank balance sheets**  
(%)

	Assets		Liabilities	
	2016	2017	2016	2017
Balance				
Dinars and other hedging	39.5	41.6	42.8	44.1
Foreign currency and foreign currency clause	60.5	58.4	57.2	55.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: NBS.

At end-2017, the banking sector's total open FX position equalled RSD 14.0 bn and exposure to FX risk (expressed as the FX risk ratio) 2.9%, which is significantly below the prescribed 20% cap.

Table II.2.1.11 **Banks' exposure to FX risk as at 31 December 2017**  
(RSD mn)

Open position in EUR		Open position in USD		Open position in CHF		Open position in other currencies		Open position in gold		Total open position		Total net open FX position
Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	
10,496	2,081	1,389	98	919	252	1,154	46	90	-	13,958	2,477	<b>13,958</b>

Source: NBS.

### Asset quality

Adoption of the NPL Resolution Strategy in August 2015 and the implementation of all activities envisaged by the Action Plan in the specified deadline, along with the adoption of the Decision on the Accounting Write-off of Bank Balance Sheet Assets in 2017 are the key stages in the process of resolving the issue of NPLs in the Serbian banking sector. Efficient regulatory measures introduced by the NBS and the banks' commitment to continue resolving NPLs led to record results in terms of reducing the gross NPL ratio in 2017. According to data as at end-December 2017, during the year this ratio fell by 7.2 pp to 9.8%, the lowest recorded level of NPLs.<sup>19</sup> Gross NPLs fell to RSD 204.9 bn, or by 40.7% compared to end-2016.

Sector-wise, the share of NPLs in total loans in the corporate sector fell from 17.2% at end-2016 to 10.4%, the lowest level since the start of the global financial crisis. Non-financial sector entities in bankruptcy decreased their share in total NPLs, coming at 19.3% at the end of the year.

<sup>19</sup> Available data on the NPL ratio reach back to September 2008.

The share of NPLs of natural persons also dropped significantly in 2017 – their NPL ratio lost 4.1 pp over one year, falling to 5.9% at end-December. The movement of the ratio of NPLs of natural persons was, on the one hand, driven by banks' efforts to reduce the amount of NPLs through write-offs and collection, and on the other, by the rise in lending activity.

Table II.2.1.12 NPL composition

(RSD mn)

	31 December 2016	31 December 2017
Total gross NPL		
amount	345,779	204,930
ratio	17.0%	9.8%
Corporates <sup>1)</sup>		
amount	172,787	107,603
ratio	17.2%	10.4%
Natural persons <sup>2)</sup>		
amount	83,692	53,014
ratio	10.0%	5.9%
Other legal persons – non-financial sector in bankruptcy		
amount	81,106	39,452
ratio	99.9%	99.1%
Other		
amount	8,194	4,861
ratio	7.4%	4.5%

<sup>1)</sup> Public enterprises and companies.

<sup>2)</sup> Households, entrepreneurs, private households with employed persons and registered farmers.

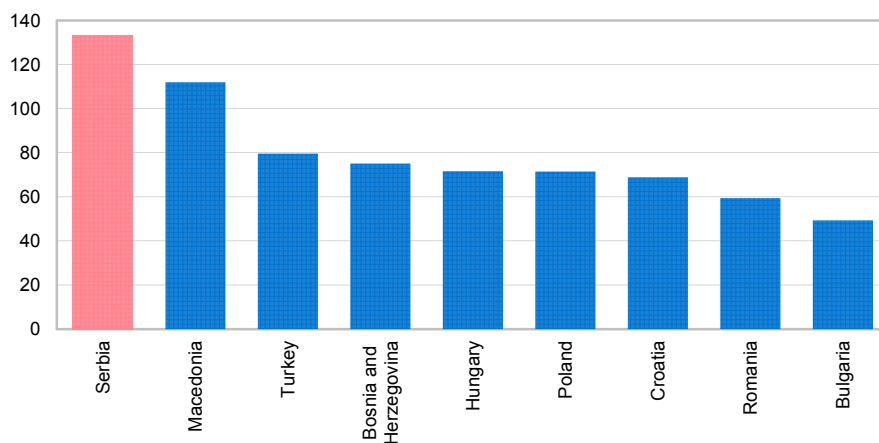
Source: NBS.

The current level of NPLs poses no threat to the operation of the banking sector and, by extension, to financial stability, owing to the high level of reserves for estimated losses. In order to maintain financial stability and protect the interests of depositors and other creditors, the NBS requires, in addition to the reserves prescribed by international standards, the creation of regulatory reserves, i.e. reserves for estimated losses. At end-2017, allowances for impairment (calculated according to the International Accounting Standards) covered 58.1% of total gross NPLs, while the calculated reserve for estimated balance sheet losses in accordance with the regulatory requirements equalled 133.2% of total gross NPLs.

The quality of the banking sector assets, measured by the share of the most adversely classified assets (categories D and E) in total classified assets fell from 15.6% to 10.1%, signalling a significant improvement in 2017.

Total calculated required reserves for estimated losses on classified balance sheet assets and off-balance sheet items equalled RSD 288.8 bn at end-2017, while allowances for impairment and provisions in respect of classified balance sheet assets and off-balance sheet items came at RSD 156.1 bn (a fall of 32.2% and 43.8% respectively, relative to end-2016).

**Chart II.2.1.1 Coverage of gross NPLs by loan loss provisions, countries of the region**  
(2017, latest available data, in %)



Sources: NBS, IMF.

## Banking sector liquidity

The Serbian banking sector remains exceptionally liquid. Of all the risks in the system, liquidity risk is the least pronounced.

In December 2017, the average monthly banking sector liquidity ratio was two times higher than the prescribed minimum (1.0), equalling 2.0. In 2017 the ratio was even above 2, suggesting that liquid assets (first-degree liquid receivables and other receivables due in the next month) were double the sum of liabilities without a set maturity date and liabilities due in the next month. Liquid assets made up 36.7% of total balance sheet assets and 53.1% of short-term liabilities as at 31 December 2017.

The average monthly narrow liquidity ratio of 1.7 in the same period was also significantly above the regulatory minimum (0.7). To further strengthen the banking sector's resilience to shocks, a new regulatory liquidity ratio was introduced and started to apply in June 2017 – the liquidity coverage ratio. This ratio, whose definition is in line with EU regulations, was introduced as part of the Strategy for Implementation of Basel III Standards in Serbia. Banks are required to maintain this ratio at or above 80% until end-2017, and at or above 100% thereafter (same minimum values as in the EU). At end-2017, the liquidity coverage ratio at the level of the banking sector measured 239.5%.

Table II.2.1.13 **Classification of bank assets**  
(RSD mn)

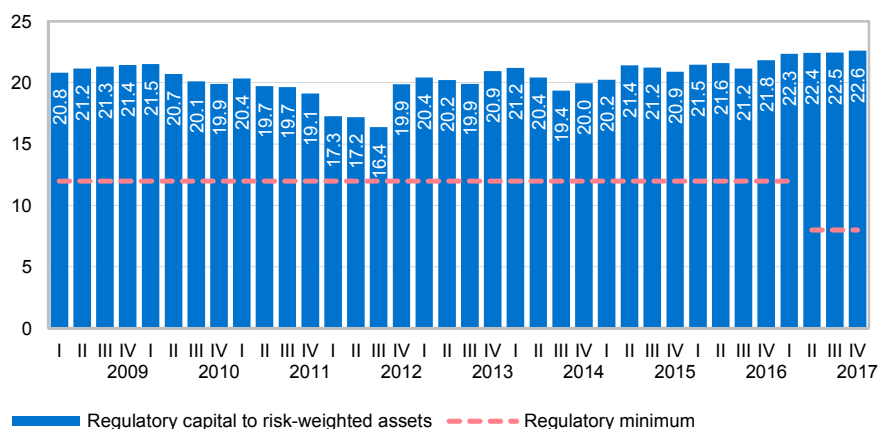
	Gross amount	Total classified assets	Classified assets		Share of assets classified in categories D and E in total classified assets (%)
			A + B + C	D + E	
<b>31 December 2017</b>					
Balance sheet assets	3,589,378	2,241,755	1,965,275	276,480	12.3
Off-balance sheet items	7,054,116	815,112	782,526	32,586	4.0
<b>Total</b>	<b>10,643,494</b>	<b>3,056,867</b>	<b>2,747,801</b>	<b>309,066</b>	<b>10.1</b>
<b>31 December 2016</b>					
Balance sheet assets	3,585,392	2,221,428	1,795,002	426,426	19.2
Off-balance sheet items	7,128,461	720,428	688,337	32,091	4.5
<b>Total</b>	<b>10,713,853</b>	<b>2,941,856</b>	<b>2,483,339</b>	<b>458,517</b>	<b>15.6</b>

Source: NBS.

## Capital adequacy ratio of the banking sector

In 2017 the Serbian banking sector was adequately capitalised, with the CAR of 22.6% at year-end. This is well above the new regulatory floor of 8%, which has applied since June 2017. According to the new capital adequacy standards harmonised with Basel III standards, narrow definitions of capital are also monitored, such as Tier 1 and Common Equity Tier 1 capital, in relation to the set regulatory floors. Owing to the high capital position and good quality of regulatory capital, the banking sector Tier 1 capital ratio measured 21.6%, and Common Equity Tier 1 capital ratio – 21.5%. These indicators are also considerably above the prescribed minimums of 6% for the Tier 1 capital ratio and 4.5% for the Common Equity Tier 1 capital ratio.

Chart II.2.1.2 **Capital adequacy of the banking sector**  
(in %)



Source: NBS.

Also, according to amendments to regulations, banks are required to allocate a part of Common Equity Tier 1 capital in the form of the combined capital buffer. At end-2017, banks allocated RSD 115.1 bn of Common Equity Tier 1 capital (5.4% of their risk-weighted assets) to the combined capital buffer.

The share of accounting equity in total liabilities at end-2017 measured 19.8%. As of June 2017, banks in Serbia are required to calculate and report to the NBS the leverage ratio (definition – Tier 1 capital relative to total on- and off-balance exposure of a bank – same as in the EU), which equalled 11.1% at end-2017.

## Performance indicators

Twenty-seven out of twenty-nine banks fully complied with the prescribed indicators at end-2017. One bank failed to comply with three indicators, and another bank with two indicators. One bank failed to meet the requirement under Article 22 of the Law on Banks.<sup>20</sup>

Table II.2.1.14 **Performance indicators**

	31 December 2017	Number of non-complying banks
Capital adequacy ratio (min. 12%)	22.6%	1
Fixed investment ratio (max. 60%)	14.2%	2
Liquidity ratio*	2.00	0
FX risk ratio (max. 20%)	2.9%	2

\* Average monthly indicator.

Source: NBS.

## Profitability

In 2017 the Serbian banking sector again posted a positive pre-tax net financial result in the amount of RSD 68.7 bn, significantly higher than in 2016 (by RSD 47.4 bn). With a 2.08% ROA and a 10.57% ROE, the Serbian banking sector was more profitable than in 2016, and more profitable than the regional average in terms of ROA. The structure of profit indicates that the business model of domestic banks is still focused on traditional banking services.

Table II.2.1.15 **Bank financial result**

	31 December 2016		31 December 2017	
	Amount (RSD mn)	Number of banks	Amount (RSD mn)	Number of banks
1. Profit	41,398	19	73,892	22
2. Loss	20,096	11	5,202	7
<b>Financial result (1–2)</b>	<b>21,302</b>	<b>30</b>	<b>68,690</b>	<b>29</b>

Source: NBS.

<sup>20</sup> In conducting its operations, each bank is required to maintain its capital at no less than the dinar equivalent of EUR 10.0 mn, calculated at the official middle exchange rate.

Growth in net profit in 2017 was triggered by a drop in net expenses in respect of impairment of financial assets and credit risk-bearing off-balance sheet items (by RSD 33.2 bn), mostly in indirect write-offs of balance-sheet items.

On the other hand, as the downward trend in lending and deposit interest rates continued, net interest income was lower by RSD 2.9 bn (caused by a drop in income and expenses by RSD 8.7 bn and RSD 5.8 bn respectively). Compared to last year, net gains from fees increased by RSD 2.4 bn.

In 2017, 22 banks operated at a profit, while seven banks recorded a negative financial result. A concentration trend was noted in total profits and losses; hence 66% of the banking sector's total profit was generated by the five banks with the highest net profit, while the losses of three banks with the highest net losses accounted for 78% of the sector's total losses.

Table II.2.1.16 **Banking sector's profitability indicators**

(%)

	2016	2017
ROA	0.68	2.08
ROE	3.40	10.57
Interest margin / average balance sheet assets	3.9	3.7
Interest margin / total operating income	70.4	63.7
Operating expenses / total operating income	64.8	59.9
Salary expenses / operating expenses	37.7	37.4

Source: NBS.

## Bank supervision activities

### *Regulatory activity*

In June 2017 the NBS adopted the Decision Amending the Decision on Consolidated Supervision of a Banking Group (RS Official Gazette, No 58/2017), enabling the introduction of Basel III standards in the Republic of Serbia also at the level of the banking group supervised by the NBS on a consolidated basis, along with harmonisation with the provisions of by-laws introducing Basel III standards applicable at the level of an individual bank, in order for the entire set of regulations to be smoothly implemented as of 30 June 2017. Provisions of the past Decision relating to the structure of the bank's capital were amended, new capital adequacy ratios were introduced at the level of the banking group and their levels were specified. The minimum prescribed level of the (total) capital adequacy ratio of the banking group was reduced from 12% to 8%, equal to the requirement for individual banks. In relation to the manner of calculating risk-weighted assets – the provisions of the Decision on Consolidated Supervision of a Banking Group relating to the capital requirement for credit risk were adjusted, and a capital requirement for other risks was introduced. This entails the capital requirement for credit valuation adjustment (CVA) risk and capital requirement for large exposures for each member of the banking group. As regards risk management at banking

group level, the ultimate parent company is now required to set up a liquidity risk management system at the level of the banking group, to calculate the liquidity coverage ratio and to implement the relevant limits pertaining to the bank's exposure to liquidity risk, in accordance with the provisions of the Decision governing bank liquidity risk management.

In July 2017, the NBS adopted the Guidelines for the Identification of Default so as to comply with the relevant provisions of the Decision on Capital Adequacy of Banks and further align the domestic regulatory framework with the relevant European regulations. To specify the triggers for default, it was prescribed that a bank considers a receivable due if any amount of principal, interest or fee was not paid at the maturity date. It was also prescribed that the number of days past due for receivables with changed terms of repayment is based on the changed repayment schedule within the meaning of the Decision on Capital Adequacy of Banks. The Guidelines also prescribe: the manner of calculating a materially significant amount, indications of unlikelihood to pay, conditions for return to a non-defaulted status and the new occurrence of default, application of the definition of default, monitoring the fulfilment of conditions for classification into non-defaulted status, requirements in relation to the principles of management for banks applying the IRB Approach, and documentation and the risk management process. These Guidelines will apply as of 1 January 2021, and some of its provisions as of 1 January 2019.

In August 2017, the NBS adopted the Decision on the Accounting Write-off of Bank Balance Sheet Assets (RS Official Gazette, No 77/2017), which prescribes that banks are required to directly write off NPLs that are fully impaired by debiting expenses, if the calculated amount of impairment of that loan recorded by the bank to the credit of allowances for impairment equals 100% of its gross book value. Accounting write-off, within the meaning of this Decision, is the transfer of NPLs to a bank's off-balance sheet records. The Decision came into effect on 30 September 2017. This regulation was adopted to provide incentive to banks to continue efforts to resolve NPLs by introducing the mandatory transfer of the poorest part of NPLs to off-balance sheet records, further "cleaning" bad assets from banks' balance sheets, freeing up their resources for new lending and further growth in lending and economic activity in Serbia.

In September 2017, the NBS Executive Board adopted the Guidelines for the Implementation of Specific Provisions of the Decision on Capital Adequacy of Banks Relating to Bank Capital (RS Official Gazette, No 82/2017), so as to achieve alignment with delegated EU regulations and create an additional regulatory assumption for the fulfilment of one of the primary goals of Basel III standards – increasing banking sector resilience by improving the quality of regulatory capital of banks. The Guidelines introduced innovations relating to detailed conditions for including certain elements in the calculation of capital, and to defining in detail the manner of calculating deductibles from capital, including the calculation of certain regulatory adjustments.

Given the obligation of banks prescribed by law to apply International Financial Reporting Standards (IFRS) when preparing their annual financial statements as of the date set by the competent international authority as the start of their implementation, aiming to enable the implementation of the new IFRS 9 – Financial Instruments by banks as of 1 January 2018, in November 2017 the Governor of the NBS adopted the following regulations in the area of accounting and financial reporting, for the purposes of reporting, collecting, processing and submitting certain data to the NBS: the Decision on Forms and Content of Items in Financial Statement Forms to Be Completed by Banks, Decision Amending the Decision on the Chart of Accounts and Contents of Accounts in the Chart of Accounts for Banks, and Decision on Collection, Processing and Submission of Data on the Balance and Structure of Accounts in the Chart of Accounts. With the same objective, taking into account the provisions of the above regulations, at the meeting held on 9 November 2017 the NBS Executive Board also adopted the Decision Amending the Decision on Reporting Requirements for Banks and Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items. All the above by-laws were published in the RS Official Gazette, No 101/2017 of 10 November 2017. In addition to the amendments made to enable the implementation of IFRS 9, the adopted decisions contain some innovations resulting from the needs recognised in practice, and adjustments of some provisions to regulations in force in the Republic of Serbia.

As a responsible regulator, the NBS adopted the Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (RS Official Gazette, No 114/2017) in December 2017. This Decision was adopted to address certain NPL purchases by a bank using that bank's funds, to approve loans used by the bank's debtors to directly or indirectly settle NPLs approved by that bank, and to ensure appropriate regulatory treatment of a receivable from a debtor – newly founded company considered a person related to the debtor within the meaning of the Law on Banks, to which the bank has approved a loan considered to be non-performing. The adoption of this regulation reflects the commitment of the NBS to address the resolution of the complex issue of banking sector NPLs in a way that ensures the maintenance and strengthening of the stability of the banking sector and the financial system as a whole.

In December 2017 the NBS Executive Board adopted the Decision Amending the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System (RS Official Gazette, No 114/2017) so as to relax the maximum ratio of the amount of a mortgage loan to the value of real estate serving as collateral (LTV limit) in relation to a housing loan portfolio (LTV limit equals 90% in case of housing loans approved as a government-support measure for certain groups of natural persons), and to align the definition of a certified valuer with the Law on Real Estate Valuers (RS Official Gazette, No 108/2016). The Decision entered into force on 1 January 2018.

In December 2017 the NBS Executive Board also adopted the Decision Amending the Decision on Risk Management by Banks (RS Official Gazette, No

119/2017) to improve the internal capital adequacy assessment process (ICAAP) and its monitoring, and to specify and closely define some concepts from the Decision on Risk Management by Banks and the bank's conduct in the risk management process, which was found to be needed in practice. This Decision came into force on the day following its publication in the Official Gazette of the Republic of Serbia, while banks were given a deadline to align their internal acts with the provisions of the Decision by 31 March 2018 at the latest.

### *Off-site supervision*

Off-site supervision means supervision and analysis of reports and other documents banks are obliged to submit pursuant to NBS laws and regulations, as well as of other data on bank operations available to the NBS (data collected through on-/off-site supervision and from other NBS organisational units) and data obtained from external sources (including foreign regulatory bodies with which the NBS has signed multilateral or bilateral agreements on cooperation, exchange of information and coordination of supervisory activities).

To identify key operational risks and draw up risk profiles of banks, regular monthly information papers and annual supervisory evaluations were prepared. These entail the analysis of banks' business models, quality of corporate governance and system of internal controls, analysis of risks affecting a bank's solvency and liquidity, and the assessment of capital adequacy and liquid assets of a bank.

In addition to the above comprehensive supervisory evaluations, detailed annual assessments of updated individual recovery plans and banking group recovery plans were conducted, and their compliance with the regulatory framework was assessed. Recommendations relating to identified deficiencies or deviations from best practices were sent.

A detailed analysis of the assessment of further potential for reducing the level of NPLs in the banking sector was conducted, based on which banks were sent recommendations in late 2017 relating to the improvement of the framework for bad asset management, and to activities related to the reduction of the level of bad assets.

In 2017, off-site bank supervision carried out a horizontal analysis<sup>21</sup> of bank conduct in the processes of outsourcing and launch of new products, based on the results of relevant surveys conducted in the fourth quarter of 2016. Based on the conclusions of the analysis, regulations relating to outsourcing and launch of new products in banks were amended.

In addition to the above, in 2017 there were nine off-site bank supervision activities; three of them pertained to the implementation of the Law on the Protection of Financial Service Consumers and six concerned the opening and

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<sup>21</sup> A horizontal analysis entails firstly an analysis of each individual bank, followed by an analysis among banks, i.e. group analysis of similar banks, and the banking sector analysis.

keeping non-resident accounts, one off-site follow up of a Decision on early intervention measures, and one off-site follow up of orders and measures under a Decision on temporary measures. Further, in 2017 the NBS conducted continuous off-site supervision of all financial transactions of one bank, focusing on inflows and/or outflows on accounts of business entities related to that bank. Also, acting pre-emptively and aiming to prevent negative effects from spilling over to the banking sector and the real economy in the Republic of Serbia, activities of groups of related persons and the liquidity positions of some banks were monitored more intensely. As in the previous period, financial status and trends in state-owned domestic banks (where the state is the largest individual or majority owner) were monitored with greater intensity.

Also, the implementation of IFRS 9 was monitored more closely, meetings were held with managing bodies and external auditors of banks, and some aspects of banks' operations were analysed.

All these analyses and information were used in the preparation of a draft on-site supervision plan and a plan of supervisory activities for 2018.

The NBS continued its cooperation with the ECB, IMF and foreign supervisors of banking groups operating in the Republic of Serbia.

### *Prevention of money laundering and terrorism financing*

In 2017 the NBS continued to actively participate in the operations of Moneyval, a committee of the Council of Europe gathering experts on the evaluation of anti-money laundering measures and the financing of terrorism. Moneyval aims to ensure that all member states have systems in place to efficiently prevent money laundering and terrorism financing in accordance with relevant standards in that field, particularly with FATF<sup>22</sup> Recommendations and international conventions. Moneyval reports contain recommendations for improving the efficiency of the system for anti-money laundering and terrorism financing in individual countries, and recommendations on boosting the capacity for international cooperation.

Together with other relevant Serbian bodies, the NBS participated in the preparation of the Action Plan for implementing Moneyval recommendations, adopted by the Government of the Republic of Serbia, and in the implementation of the planned activities. In addition to the above, it continued to regularly report to Moneyval on the activities conducted in the area of prevention of money laundering and terrorism financing, and to report about the progress made in that field by the ICRG,<sup>23</sup> a special working group in the FATF.

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<sup>22</sup> Financial Action Task Force.

<sup>23</sup> International Cooperation Review Group.

### *On-site supervision*

On-site supervision of banks is supervision carried out on site, by inspecting the business books and other documents of the bank, in accordance with the annual on-site supervision plan. Thirty-three on-site examinations were conducted in 2017: six targeted prudential supervision activities of bank operations in accordance with the Law on Banks, nine examinations of the lawfulness of bank operations in accordance with other laws under which the NBS is responsible for bank supervision, 16 follow-ups of measures pronounced by the NBS and two diagnostic tests. An overview of on-site supervision conducted in 2017 by supervision subject is shown below:

**Table III.2.1.17 Overview of on-site supervision in 2017**

<b>Type of on-site supervision</b>	<b>Subject of on-site supervision</b>	<b>Number of banks subject to on-site supervision</b>
Targeted prudential supervision of bank operations in accordance with the Law on Banks	Supervision of bank management	1
	Supervision of credit risk management, supervision of the capital adequacy ratio, and supervision of bank management	1
	Supervision of credit risk management and supervision of the capital adequacy ratio	1
	Supervision of the loan approval process, supervision of bank management and supervision of the bank merger process	1
	Supervision of operational risk management and supervision of bank management	1
	Supervision of management of outsourcing risks and supervision of management of risks arising from the launch of new products/services	1
Supervision of lawfulness of bank operations in accordance with other laws under which the NBS is responsible for bank supervision	Supervision of management of money laundering and terrorism financing risk and supervision of payment transactions	4
	Supervision of management of money laundering and terrorism financing risk in non-resident operations	2
	Supervision of management of money laundering and terrorism financing risk, supervision of payment transactions and supervision of the implementation of provisions of laws governing the protection of financial service consumers	1
	Supervision of the implementation of provisions of laws governing the protection of financial service consumers	2
Supervision of bank compliance with measures pronounced by the NBS	Related to prudential supervision of bank operations in accordance with the Law on Banks	11
	Related to supervision of lawfulness of bank operations in accordance with other laws under which the NBS is responsible for bank supervision	5
Diagnostic testing	Diagnostic testing of the internal capital adequacy assessment process and stress tests	1
	Diagnostic testing of the internal capital adequacy assessment process	1
<b>Total on-site supervision activities in 2017</b>		<b>33</b>

Source: NBS.

### *Measures against banks*

Following the bank supervision procedures, in the course of 2017 the NBS took the following measures: issued 13 written warnings to banks; adopted six decisions imposing orders and measures and 32 decisions on temporary measures; filed eight requests for initiating offence proceedings and six reports for economic

offence against banks and their responsible persons. Seventeen supervision procedures were cancelled in 2017.

*Acting upon requests for consent*

Acting upon requests for issuing operating licences and various consents and approvals in 2017, pursuant to the Law on Banks, the NBS conducted the following: 35 procedures for granting consent to the articles of association, and/or amendments to the founding act and/or articles of association (of which 34 were resolved positively and one was cancelled); 93 procedures for granting prior consent to the appointment of members of the bank's managing and executive boards (of which 91 were resolved positively, one was cancelled and one was dismissed); three procedures for granting prior consent to the distribution of profit through payment of dividends to shareholders (of which two were resolved positively and one was cancelled); two procedures for granting prior consent for changing the conditions under which subordinated liabilities were created (of which one was resolved positively and one was cancelled); three procedures for granting prior consent for including elements of capital in the calculation of Common Equity Tier 1 capital by increasing Common Equity Tier 1 capital, while reducing the value of Tier 2 capital instruments; two procedures for granting consent to a bank to exclude a subordinated company from the consolidated financial statement, which were resolved positively; four procedures for granting prior consent to reduce the value of Tier 1 capital elements (of which three were resolved positively and one was cancelled); four procedures for granting prior consent to include profit of the current year in Common Equity Tier 1 capital, which were resolved positively; two procedures for granting consent to a bank for merger by acquisition of a bank that is a subordinated company, which were resolved positively; five procedures for granting prior consent to acquire direct ownership in a bank, which were resolved positively; four procedures for granting consent to acquire a bank as a subordinated company, which were resolved positively; one procedure for granting consent to acquire a financial lessor as a subordinated company, which was resolved positively; one procedure for granting prior consent to acquire own shares, which was resolved positively; one procedure for granting consent to exclude elements of capital from Tier 2 capital and include them in Common Equity Tier 1 capital, which was resolved positively; one procedure for revoking a final decision, granting a bank consent to acquire a subordinated company.

The NBS also acted in response to two notifications from banks of their intention to add annexes to a subordinated loan agreement and extend the deadline for changing the terms under which the subordinated liability was created, as well as to 235 notifications from banks on outsourcing.

### *NBS Action Plan for Implementation of the NPL Resolution Strategy*

The NPL Resolution Strategy, adopted by the Serbian Government in August 2015, was drawn up by the NBS in cooperation with relevant ministries. The Strategy aims to provide incentives and eliminate obstacles identified in the system, which prevent timely resolution of NPLs, and to establish a system that would prevent NPLs from accumulating to a level that can adversely affect financial stability and economic growth. The NBS Executive Board adopted the NBS Action Plan for Implementation of the NPL Resolution Strategy, in line with NBS competencies.

The NBS carried out all activities envisaged by the Action Plan within the set deadline. The accomplished objectives focus on: improving banks' capacity to resolve NPLs, improving the practice of restructuring receivables and accounting practices, analysing the possibility to improve the NPL market, improving transparency of banks with regard to asset quality, improving collateral management in banks and the system of reporting about the NPL structure to the regulator.

Even though the Action Plan was implemented, the NBS is taking additional regulatory steps to encourage banks to resolve NPLs more efficiently and set up a system which will prevent them from accumulating. In this context, mandatory write-off of NPLs that are fully impaired was introduced, and regulatory treatment of some undesirable NPL-related transactions was prescribed.

The adoption and implementation of the National NPL Resolution Strategy and the implementation of the Decision on the Accounting Write-off of Bank Balance Sheet Assets as of 30 September 2017 yielded positive results, as seen in the apparent reduction in total NPLs. Competent institutions are unequivocally committed to the resolution of the NPL issue, which is confirmed by the fact that potential adverse tax effects related to the implementation of the Decision on the Accounting Write-off of Bank Balance Sheet Assets were negated by adopting amendments to the Law on Corporate Income Tax and Law on Personal Income Tax in December 2017.

The data indicate that the systemic, inter-institutional and coordinated approach that the NPL Strategy envisages has a positive impact on relevant stakeholders in resolving NPLs. In almost two and a half years, the market-based approach to NPL resolution envisaged by the Strategy, along with the implementation of the Decision on the Accounting Write-off of Bank Balance Sheet Assets, significantly reduced the level of total NPLs to 9.8% at end-2017, which was down by 12.4 pp compared to the time of the Strategy adoption. Further steps towards reducing NPLs in the Serbian banking sector may certainly be expected both on the side of competent institutions and of banks. Relevant institutions, in accordance with their responsibilities, undertake activities planned by the Strategy, whose effects are still not fully exhausted, while the NBS, as a regulator and supervisor, guides banks to commit to resolving this issue, by setting up instruments and mechanisms for supervising their operations. It should be borne in mind that the Republic of Serbia

opted for an NPL resolution model based on market-oriented solutions. This does not merely mean that state funds will not be used for one-off solutions to the problem, but it is also indicative of the readiness of the responsible institutions to set up a system and an environment which will prevent NPLs from accumulating and ensure a solution sustainable in the long run. Taking into account the specificities of the domestic market, and carefully considering the activities of EU bodies and institutions in this field, the NBS will continue its regulatory efforts aimed at further resolution of the complex issue of NPLs in the Serbian banking sector, within its responsibilities, to preserve and strengthen the stability of the financial system.

### *Application of Basel III standards*

The domestic regulatory bank supervision framework is based on Basel III standards. Namely, as part of its efforts to continuously improve the legal framework for bank supervision in accordance with international standards and EU regulations, the NBS has successfully completed the final phase of the Strategy for Implementation of Basel III Standards in Serbia, by adopting a set of by-laws introducing these standards in the Republic of Serbia at the individual level and the level of a banking group supervised by the NBS on a consolidated basis. These regulations specify that, as at the date of start of introduction of Basel III standards (30 June 2017), the prescribed minimum CAR is reduced from 12% to 8%, and that capital buffers are established in parallel (capital conservation buffer, countercyclical capital buffer, systemic risk buffer, capital buffer for a systemically important bank). The new regulations are in compliance with the requirements of Regulation (EU) No 575/2013. They introduced all three capital adequacy ratios (Common Equity Tier 1 capital ratio, Tier 1 capital ratio, CAR), new standards for calculating capital requirements for credit, market, operational and credit risk associated with securitised exposures, more favourable risk weight for exposures secured by commercial real estate, and new capital requirement for items from the correlation trading portfolio; use of the stressed VAR (Value-at-Risk) parameter was made mandatory in the calculation of capital requirements for market risks, a capital requirement for excess over the limit of exposures in the bank's trading book was introduced, and leverage ratio and liquidity coverage ratio were prescribed.

The main objectives of implementing these standards were: to strengthen the resilience of the banking sector by raising the quality of capital and introducing capital buffers; to improve monitoring and supervision of a bank's exposure to liquidity risk; to further strengthen market discipline and transparency of bank operations in the Republic of Serbia by publishing all relevant information on the bank's operations; and to align the reporting system with new regulatory solutions.

Starting from July 2017, further steps were taken to harmonise the domestic legal framework with Basel III standards by taking regulatory activities to apply the technical standards adopted by the European Commission. In this context,

Guidelines for the Identification of Default were adopted in July 2017, and Guidelines for the Implementation of Specific Provisions of the Decision on Capital Adequacy of Banks Relating to Bank Capital in September.

*Monitoring banks' preparations for the implementation of IFRS 9 and publishing the necessary amendments to regulations*

In view of the banks' obligation to implement the new International Financial Reporting Standard – IFRS 9 – Financial Instruments as of 1 January 2018, in 2017 the NBS monitored the preparations of banks for the start of implementation. The significance of the commencement of implementation of IFRS 9 stems from changes to the method of classification, measurement and calculation of impairment of financial instruments. It is an important turning point for banks in terms of recognising and reporting credit losses, since the concept of incurred credit losses was replaced with the concept of expected credit losses.

To ensure a transparent dialogue, timely include all stakeholders and provide the required information on the implementation of IFRS 9 in practice, a Working Group monitored banks' preparations for the implementation of IFRS 9 and identified the necessary amendments to regulations. The Working Group consisted of representatives of banks, Association of Serbian Banks and external auditors, in addition to NBS representatives.

Analyses covered the qualitative capability of individual banks and the entire banking sector for IFRS 9 implementation, the models banks plan to use to calculate impairment under the new standard, and the assessment of the impact of the start of implementation of IFRS 9 on the amount of impairment of financial instruments and on bank capital. The key conclusions of the analyses show that the capital adequacy ratio is expected to lose around 0.39 pp owing to IFRS 9 implementation, which does not affect the ability of the banking sector to absorb all potential losses, given that capital adequacy remains considerably above the prescribed minimum even after the expected drop.

After a public debate, a set of regulations in the field of accounting, financial and regulatory reporting of banks was introduced (published in RS Official Gazette, No 101/2017 of 10 November 2017), enabling the implementation of IFRS 9 in banks as of 1 January 2018.

## Plans for 2018

In 2018, the NBS plans to carry out the following activities in the area of bank supervision:

- further enhancement and alignment of the domestic legal framework with the EU acquis in the field of banking, international standards and best practices, in a manner that ensures the maintenance and strengthening of banking and financial system stability, while acknowledging the specificities of domestic legislation and the market;

- implementing the plan of supervisory activities for 2018;
- in off-site supervision particular attention will be paid to the horizontal analysis of bank business models, the quality of managing bodies' work and system of internal controls, monitoring of banks' further activities towards reducing the level of bad assets and improving their management, and implementation of IFRS 9 in practice;
- implementing a plan of on-site prudential supervision of bank operations, supervision of money laundering and terrorism financing risk management, and supervision of the implementation of provisions of laws governing the protection of financial service consumers in 2018;
- further strengthening of cooperation with relevant government bodies and supervised obligors in the field of prevention of money laundering and terrorism financing in order to implement the recommendations from the Moneyval Evaluation Report, as well as aligning with amendments to regulations in the field of prevention of money laundering and terrorism financing.

## II.2.2 Insurance sector

The insurance sector has a significant impact on the development of the overall economy in every country and plays an important role in terms of stability of the financial system. Judging by the development indicators, such as the total premium to GDP ratio and per capita premium, the Serbian insurance market is less developed than insurance markets of the EU member countries. In 2017 the share of premium in GDP equalled 2.1%, unchanged from 2016, while per capita premium amounted to EUR 112, up by EUR 10 relative to the year before.<sup>24</sup>

The share of balance sheet total of the insurance sector in balance sheet total of the financial sector supervised by the NBS (banks, financial lessors, insurance undertakings and voluntary pension funds)<sup>25</sup> was 6.3%, indicating slight increase compared to 6.1% from the previous year.

At end-2017, 21 insurance undertakings operated in the Republic of Serbia, two undertakings less than in the previous year.<sup>26</sup> Seventeen undertakings engaged in insurance activities and four in reinsurance activities. Of the insurance undertakings, four were exclusive life-insurers, seven exclusive non-life insurers, while six provided both life and non-life insurance. The breakdown by capital ownership shows that 15 insurance undertakings were in majority foreign ownership. Beside insurance undertakings, the sales network included: 20 banks, seven financial lessors and one public postal operator, which are licensed for agency operations, 88 legal persons (insurance brokerage and agency services), 90

<sup>24</sup> For comparison's sake, according to Swiss Re data for 2016, published in July 2017, the share of premium in GDP for EU member countries stood at 7.4%, and in the group of developing countries – 3.2%. The per capita premium stood at USD 2,383 and USD 149, respectively.

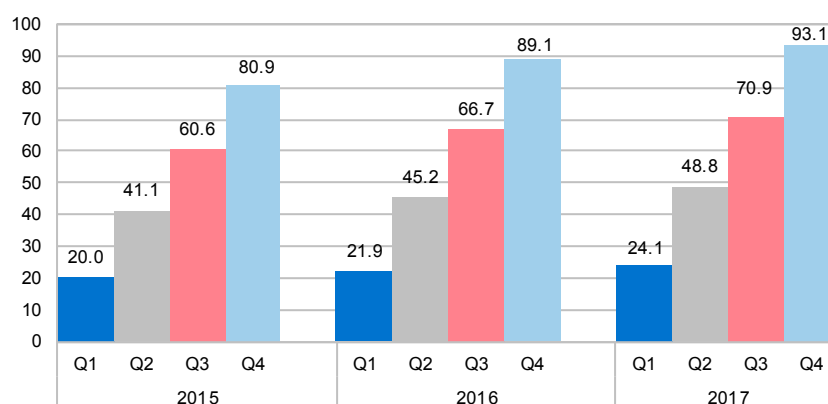
<sup>25</sup> Excluding payment institutions and electronic money institutions.

<sup>26</sup> One non-life insurer and one life insurer merged with an insurance undertaking dealing with both life and non-life insurance in Q3 2017.

insurance agents (natural persons-entrepreneurs) and 6,428<sup>27</sup> certified agents/brokers in insurance.

In 2017, total insurance premium amounted to RSD 93.1 bn, up by 4.4% from 2016. The share of non-life insurance accounted for 75.6% and life insurance for 24.4% of the total premium. Life insurance premium fell by 1.6% relative to 2016.

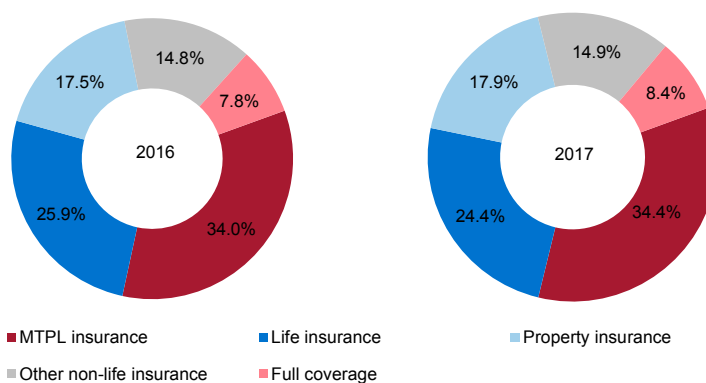
Chart II.2.2.1. **Quarterly movements in total premium**  
(RSD bn)



Source: NBS.

By type of insurance, in 2017 motor third party liability insurance (MTPL) accounted for the largest share in the total premium (34.4%), followed by life insurance (24.4%), property insurance (17.9%) and full coverage motor vehicle insurance (8.4%).

Chart II.2.2.2 **Total premium by type of insurance**



Source: NBS.

The balance sheet total of insurance and reinsurance undertakings at end-2017 equalled RSD 233.0 bn, up by 8.1% from a year earlier. The largest portion of insurance undertakings' assets at end-2017 pertained to debt securities available for sale (49.6%), fixed-yield debt securities (11.5%), property, plant and equipment

<sup>27</sup> Active authorised persons.

(7.8%), receivables (6.2%) and debt securities measured at fair value through profit or loss (2.5%).

Technical reserves (69.0%) and capital and reserves (23.2%) accounted for the largest share of insurance undertakings' liabilities. In 2017, capital rose by 6.3% (to RSD 54.0 bn) and technical reserves by 8.2% (to RSD 160.6 bn). Mathematical reserves, which rose by 7.4% in 2017, accounted for the largest share of technical reserves.

Measured by the HHI, market concentration slightly increased in 2017 relative to the year before, but is still moderate at 1,302.<sup>28</sup>

## Performance indicators

Core CAR<sup>29</sup> equalled 208.4% for predominantly non-life insurance undertakings and 241.5% for life insurance undertakings.

As an indicator of price policy and adequacy, i.e. sufficiency of premiums for the settlement of liabilities arising from non-life insurance contracts and adequacy of risk transfer to reinsurance and coinsurance, the combined ratio<sup>30</sup> was satisfactory (88.9%) in 2017 and better than in 2016 (89.1%), which can be explained by somewhat faster growth in self-retained premium earned compared to growth in incurred losses and insurance administration costs.

As an indicator of life-insurance premium adequacy, the benefit ratio<sup>31</sup> measured 71.0% in 2017, which is lower compared to the previous year when it stood at 90.1%. That is a result of a faster drop in self-retained settled claims and changes in technical provisions compared to the self-retained earned premium.

## Business result

The insurance sector ended 2017 with a positive net result of RSD 6.7 bn pre-tax and RSD 6.4 bn after tax and the distribution of a portion of the profit. Total income of insurance undertakings amounted to RSD 140.1 bn, up by 1.7% from a year earlier. The largest share in income was made up of technical premium income (56.1%), expense loading income (15.0%), and other operating (functional) income (13.9%). The sector's total expenses equalled RSD 133.4 bn in 2017, up by 1.5% relative to 2016. Other operating (functional) expenses made up the greatest share of total expenses (37.0%), followed by damages and sums insured (30.0%) and acquisition costs (16.6%).

<sup>28</sup> The HHI is calculated based on the balance sheet totals of insurance undertakings.

<sup>29</sup> The ratio of available to required solvency margin.

<sup>30</sup> Ratio of the sum of incurred losses and insurance administration costs relative to the self-retained premium earned.

<sup>31</sup> Ratio of self-retained settled claims and changes in technical provisions compared to the self-retained earned premium. In interpretation one needs to take into account the long-term character of life insurance and a significant impact of changes in technical provisions on this indicator.

## Results of insurance supervision

There were 20 on-site supervision activities in the field of insurance in 2017 – five insurance undertakings, six insurance agency/brokerage undertakings, seven insurance agents and two banks. All on-site supervision activities were initiated and conducted within the planned time line. Seven supervisory measures to supervised entities were issued and 12 entities were fined. One member of an insurance undertaking management board was dismissed, and a report for economic offence was filed against one insurance undertaking and its responsible person. Supervision cases which did not reveal illegalities and irregularities in operations were discontinued (five in total).

In supervision activities, particular attention was paid to insurance sales and market behaviour of supervised entities, providing information to insurance beneficiaries and whether insurance is sold by persons authorised to do it under the Insurance Law. Significant omissions were established in this very segment, primarily with the sales network of agents who hired persons not employed by them and not trained to sell insurance in order to make sale easier and cheaper.

Insurance agents are expected to make sure that beneficiaries are informed about their rights and obligations pertaining to the use of a particular insurance service – before, during and after the term of the contractual relation. As a certain number of supervised entities failed to present information in a way stipulated by the Insurance Law, the first fines were imposed under this Law.

Supervision of insurance agents revealed irregular reporting to the NBS, preparation of financial statements contrary to accounting regulations and as well as failure to maintain the required amount of core capital. A certain number of agents used the so-called concept of business associations, that is, their name, brand and reputation, through which they promoted and offered insurance services.

Supervision of insurance undertakings also revealed omissions in the management system – system of internal controls and actuarial function, irregular process of business planning, as well as omissions in monitoring of their implementation, in the area of keeping records of invested assets of an undertaking contrary to International Accounting Standards, etc. Omissions in actuarial operations in one insurance undertaking, primarily in calculations and keeping records of technical provisions in business books, resulted in incorrect financial reporting.

In the supervision of life insurance sales, which marked 2017, radical supervisory measures were imposed in the case of one insurance undertaking, along with the dismissal of one member of the management on account of established illegal activities in the sale process.

Illegal activities identified in on-site supervision related to the disclosure of insurance administration costs which resulted in repeated fines under the Law on Compulsory Traffic Insurance. Supervision of handling claims for damages in motor third party liability insurance was carried out after imposing supervisory measures in that area.

The NBS limited the assumption of insurance risk (both life and non-life insurance) in two insurance undertakings through supervisory measures.

Activities on the prevention of money laundering and terrorism financing were supervised in insurance undertakings engaged in life insurance, as well as in their agents and brokers. Since all supervised entities have mostly established this process no significant irregularities were identified, except in the case of organisation of thematic trainings of employees in insurance sale.

Supervision of the banking sales channel, which in recent years indirectly influenced the growth of premium volume, in particular the life insurance premium, was also carried out, in the segment in which insurance is used as collateral for lending to natural persons. It has been noticed that in certain cases a bank is registered as an insurance beneficiary although, in general, this is not unambiguously stipulated in the bank's internal acts. Omissions were also identified in delivering the conditions of insurance which are integral to an insurance contract, disclosing information on the purpose of an insurance contract and insurance expenses borne by the bank's client. It was also noticed that banks and insurance undertakings have a practice of concluding cooperation agreements contrary to regulations governing contracts and torts, in which the bank has a double role in the same business – both as a policyholder and as an insurance agent, and in doing so, earns a commission.

Apart from the planned on-site supervision activities, the reports on implementation of supervisory measures were also examined, in some cases even in on-site supervision, based on the supervisory measures issued in the previous period.

Four off-site supervision activities of insurance undertakings were carried out, three of which ended in 2017, based on which supervisory measures were imposed. Off-site supervision yielded significant effects, the most prominent being the improvement of financial reporting by type of insurance, cooperation with utility companies, and above all, building the quality of insurance of primary and secondary school pupils, as well as of hotels and related facilities.

In addition to the above, based on collected data on complaints and other relevant indicators of market behaviour, a remedial factor was established for assessing market behaviour risks in insurance undertakings and other insurance market participants, which adjusts risk assessments determined in terms of prudential supervision. These indicators and identified problematic segments of operations were used in preparing the “Guidelines on minimum standards of behaviour and good business practice of insurance market participants”, in order to ensure fair and transparent activities of those participants in relation to insurance beneficiaries, as well as higher protection of their rights and interests.

In 2017, off-site supervision was initiated for insurance undertakings licenced for life insurance in the area of managing risk of money laundering and terrorism financing. Also, a Questionnaire on AML/CFT Activities was prepared. It is disseminated to undertakings once a year for the purpose of indirectly monitoring the system for detecting and preventing money laundering

and terrorism financing, and analysing the implementation of regulations governing this field. Based on the results of the analysis of responses to the questionnaire, the degree of risk in operations of insurance undertakings is adjusted, if needed, for the purpose of planning on-site examinations for the following year.

In 2017, the NBS successfully carried out the second micro stress testing of the Serbian insurance sector with a view to identifying the risk exposure of individual insurance undertakings and their ability to manage risks. The stress test covered the following five mutually unrelated extreme-case scenarios: (1) “less marketable investments” scenario – loss is due to impaired value of real estate and write-off of premium receivables; (2) “retrocession” scenario – loss due to retrocessionaire’s default; (3) “actuarial” scenario – loss due to increased mortality as a consequence of a pandemic and insufficient claims provisions; (4) “natural disaster – earthquake” scenario – loss due to catastrophic damage as a consequence of an earthquake and (5) “natural disaster – flood” scenario – loss due to a catastrophic damage as a consequence of flood.<sup>32</sup> After the analysis, the NBS issued a public statement about the stability of the insurance industry even in case of extreme shocks, while individual undertakings, in which a higher level of risk was detected, received recommendations for improvement of risk management.

Methodology of early warning indicators was improved by adding new indicators.

## Regulatory activity

The NBS gradually adjusts insurance regulations to EU *acquis communautaire*, first and foremost taking care of the protection of rights and interests of insurance service beneficiaries, and/or insured persons. New Insurance Law and its by-laws adopted in late 2014 and first half of 2015 are almost entirely aligned with EU Solvency I Directive, and with certain elements of the EU Solvency II Directive (Solvency II).

In line with the adopted Strategy for Implementation of Solvency II in the Republic of Serbia and planned phased implementation, a comparative analysis of compliance of the Insurance Law and its by-laws with Solvency II was carried out. It is envisaged to carry out analyses for judging the readiness of insurance and reinsurance undertakings to meet the regulatory requirements prescribed by Solvency II in the period from 2018 to 2021. Completion of the preparation of drafts and proposals of regulations necessary for establishing the new regulatory framework for insurance and reinsurance operations is envisaged for 2021.

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<sup>32</sup> The greatest effect on capital adequacy would come from the first scenario, mainly due to write-off of premium receivables, followed by the third scenario, mainly due to insufficient technical provisions and finally the fourth and fifth scenario, in case maximum possible retained claims were realised. The second scenario would not have a significant effect.

In June 2017 the Ministry of Finance established a working group for the preparation of the new Law on Compulsory Traffic Insurance to further align it with EU *acquis communautaire* in this area. NBS representatives participate in the mentioned working group. New provisions of the Law on Compulsory Traffic Insurance are currently being drafted.

The Plan for gradual alignment of domestic legislation in the areas of insurance and voluntary pension funds with EU *acquis communautaire* in the area of foreign investment of institutional investors and the Plan for implementation of regulations were adopted in October 2017.

Amendments to the Decision on Implementing Provisions of the Insurance Law relating to the Issuance of License to Carry on Insurance/Reinsurance Activities and Specific Approvals of the National Bank of Serbia to allow lawyers to be members of the management of the insurance/reinsurance undertaking. The amendments to the following were also adopted: Decision on Investment of Insurance Funds, Decision on Technical Provisions, and Decision on Actuary Certification and Further Professional Education.

## Plans for 2018

In 2018, the NBS will continue to focus on maintaining the stability of the insurance sector and improving the supervisory function, and hence providing the protection of the insured, insurance beneficiaries and injured parties.

Maintenance of the stability of the insurance sector also entails implementation of the plan for on-site examination of insurance/reinsurance undertakings and other entities. On-site examinations will continue to be aimed at thematic controls, primarily in the area of market behaviour (such as the quality of direct sale of insurance undertakings, pre-contractual information, marketing and risks pertaining to the sale via bancassurance), commensurate with risks arising from market behaviour, and in line with the future insurance market development, and creating a foundation for more adequate regulations in this area and preparation of theme guidelines under individual segments of operation.

Plans for improvement of the supervisory framework/function in the area of prevention of money laundering and terrorism financing also entail intensified on-site supervision of life insurance operations.

Off-site examinations will also be carried out in certain specific aspects of operations of insurance undertakings, primarily in sales and relations with customers. The plan also envisages measures to remove the established illegalities and irregularities, to monitor whether measures imposed on supervised entities are implemented, and to monitor risk through supervisory risk matrices of insurance undertakings.

The NBS continues to develop the concept of constant supervision based on risk assessment on the grounds of good and internationally accepted practice. A special emphasis will be placed on adequate allocation and investment of technical reserves, capital adequacy, timeliness in settling claims, observing the rights of

policyholders and insurance beneficiaries, and insisting on transparency in operations of insurance undertakings. In addition, setting good business practice standards will continue in the insurance market, as will improvement of market behaviour and anti-money laundering mechanisms.

Concerning Solvency II implementation in 2018, the plan is to conduct the first quantitative impact study with the aim of partial testing of the impact of Solvency II first pillar quantitative requirements on the capital adequacy of individual undertakings, as well as an assessment of their readiness and capacity for implementation of Solvency II quantitative requirements and identification of key areas for further improvement of the existing regulatory framework in the Republic of Serbia.

The third revision of the National Programme for the Adoption of the *Acquis* envisages the following for the coming period:

- Publication of “Guidelines on minimum standards of behaviour and good business practice of insurance market participants”, for the purpose of preparing insurance market participants for the implementation of the Directive on insurance distribution, the observance of which is expected to set new quality standards in customer relations;

- In the period up to Q4 2018, a gap analysis will be performed to determine the gap between national regulations and the Directive on insurance distribution, as well as EIOPA’s Guidelines (European Insurance and Occupational Pensions Authority) in this area based on which the Plan for the implementation of the Directive on insurance distribution in the Republic of Serbia will be prepared;

- By Q4 2018 all the segments of the Directive on financial statements and consolidated financial statements of insurance undertakings which are not completely transposed into national legislation will be analysed in detail. Also, EU regulations governing this area will be additionally analysed and relevant International Financial Reporting Standards (IFRS 9 and IFRS 17) studied.

An NBS representative will take part in the working group for the preparation of the draft law governing the supplementary supervision of financial conglomerates, for the purpose of alignment with the Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, as well as the Directive on supplementary supervision of insurance undertakings in a group of insurance undertakings and the Directive on establishment and operation of credit institutions. The plan is to propose and adopt this regulation in 2021.

Ensuring conditions for further development of the insurance sector will also entail continued efforts to enhance communication with undertakings and professional associations, as well as consistent supervision of undertakings with the aim of maintaining sector stability and safety. Exams for obtaining the title of a certified actuary, as well as a certified insurance broker/agent, etc. will also be organised.

The supervisory function will be further developed through: continued improvement of work methods and improvement of early warning indicators;

participation in supervisory colleges; improvement of standards, decisions and guidelines regarding the protection of policyholders, risk management, market behaviour, reliability of reporting, data disclosure; upgrade of the database, data management methods and the electronic reporting system; constant education and professional development of NBS employees, etc.

### II.2.3 Voluntary pension funds

At end-2017, the market consisted of four companies managing seven voluntary pension funds (VPFs). Assets of all funds were held with one custody bank. Mediation services in the conclusion of VPF membership contracts were provided by five intermediary banks, while information services on membership in VPFs were provided by 433 sales agents (of 733 persons licensed by the NBS to perform these activities) who were engaged by management companies and intermediary banks. For the purpose of securities purchase and sale, management companies cooperated with ten brokerage firms.

The market remained highly concentrated, as indicated by HHI at 2,818 points at end-2017. The share of the largest fund in net assets of the entire sector was around 41%, while four largest funds held over 95% of the market.

The VPF balance sheet total was on a constant rise in 2017. Net assets of the funds reached RSD 36.2 bn at end-2017 and were up by around 10.3% relative to the end of the previous year. Payments to individual accounts of members in 2017 amounted to RSD 3.2 bn, while withdrawals totalled RSD 1.3 bn. Return on investment came at RSD 1.6 bn.

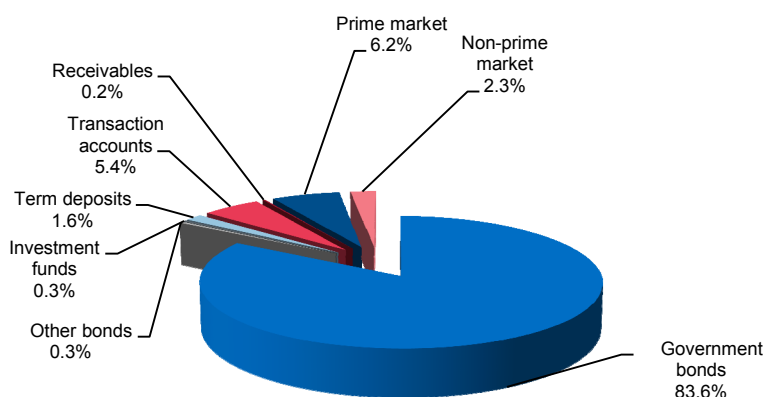
The number of VPF beneficiaries at end-2017 stood at 185,445, which is around 2.6% of total population, or around 9.3% of the total number of employed persons.

The main investment principles of each fund are defined by its investment policy. Investment policy is a document which presents the fund to its members and, among other, defines the goals of the fund's asset investment, as well as limitations in terms of investment risk. In relation to this, each fund's investment structure is defined; hence, some VPFs invest in euro instruments only, and others mainly in dinar instruments. All VPFs invest primarily in government debt securities.

As the investment structure varies, the returns of VPFs also differ. In 2017 they ranged from -1.09% to 9.85%. Funds with assets expressed in euros recorded a negative return, as a result of the dinar appreciation, but the return of those funds expressed in euros was positive. The average return in the sector in 2017, measured by FONDex, which shows movements in investment unit values of all VPFs, stood at 4.7%.

VPF investment was, as in the past period, driven by the circumstances in the financial market. Thus, at end-2017 the bulk of funds' assets (83.6%) were invested in government securities. Demand deposits accounted for 5.4%, shares for 8.5% and term deposits for 1.6% of funds' assets, while 0.3% of funds' assets were invested in EBRD bonds.

Chart II.2.3.1 **Composition of VPF assets**  
(as at 31 Dec 2017)



Source: NBS.

At end-2017, the maturity of the largest share of government debt instruments in which VPF assets were invested was one to five years. More specifically, 4.6% were with the maturity of up to one year, 26.1% of one–two years, 50.5% with the maturity of two–five years, 15.2% with the maturity of five–ten years, and 3.5% with the maturity over ten years. The average maturity of assets invested in government securities, weighted by their share in total investments in those securities, was 3.4 years.

Broken down by currency structure, at end-2017 dinar assets accounted for 86.4% of total assets, while FX-denominated assets (EUR and USD) made up the remaining (13.6%) total VPF assets.

The emergence of new financial instruments, notably long-term dinar ones, is rather important for VPFs as they enable them to manage their assets and risks more efficiently and/or to diversify their investment to a greater extent, in accordance with their investment policies.

## Continuous supervision

During 2017, the NBS performed continuous supervision of VPFs through off- and on-site examinations and the licensing processes.

In 2017, based on the results of a comprehensive on-site examination, the NBS issued one decision to pronounce supervisory measures against one company, as well as a decision on fine. Based on the results of the on-site examination of the extent to which measures from an earlier NBS decision from 2016 were

implemented, one management company received a new order for eliminating detected irregularities.

In H2 2017, upon establishing that two management companies implemented all orders issued by the NBS, two decisions on termination of the on-site examination procedure were issued. Late in 2017, one targeted on-site supervision procedure was initiated.

Also, four decisions were issued granting consent to the appointment of management members of management companies and one decision rejecting the request for consent to the appointment of a management member of one management company. Moreover, seven decisions were issued approving VPF fund prospectuses and summary prospectuses, as well as one decision approving the text and placement of advertisement for two VPFs.

The NBS organised two licensing examinations in two exam terms for natural persons to be engaged in the dissemination of information on VPF membership and, based on the submitted applications, 37 licenses were issued to persons who passed the examination.

## Potential for VPF development

Though a part of the pension system reform concerning the introduction of VPFs began relatively late, significant results have been achieved so far. Considering that VPF assets are continuously increasing, further development of this segment of financial services might help develop the local capital market. Equally so, strengthening the domestic (dinar and long-term) sources of financing is very important and it can be aided by the development of domestic institutional investors, such as VPFs.

One of the incentives to VPF development in Serbia are tax breaks. Contributions by employees and employers up to a specified amount are exempt from paying household income tax and contributions for mandatory social insurance. This is an additional incentive to employees and employers to allocate a certain amount of funds to saving in VPFs. In 2017, the non-taxable contribution amounted to RSD 5,589. There are tax breaks for payouts of accumulated funds from VPFs since withdrawal is not considered the grounds for capital gain.

Comprehensive development of the VPF sector was also stimulated by the fact that since early 2018 the fund management fee is calculated at a lower rate of 1.25% (previously 2.0%), whereby the assets of VPFs are increased, which additionally contributes to the protection of material interests of all VPF members. Management companies are additionally allowed to freely set the rate for the calculation of contribution fees, thus further stimulating market competition.

## Plans for 2018

In 2018, in addition to regular off-site supervision of management companies and VPFs, and licensing operations, the NBS will also conduct comprehensive on-

site supervision activities in accordance with the plan. Furthermore, the implementation of supervisory measures ordered during previous examinations will be monitored.

Intensified activities will also be carried out to improve the supervision process and the existing regulations in terms of their full alignment with the EU acquis. In this regard, activities under the PLAC II project (Legal support for EU negotiations) will be implemented with a view to drafting the Law on Voluntary Pension Funds and Pension Plans which would be completely aligned with the provisions of the Directive on the activities and supervision of institutions for occupational retirement provision (IORP II) and other relevant EU acquis communautaire. With reference to this, a working group has been established to deal with amendments to, and improvement of the above regulation. Relevant internal acts and by-laws will also be amended to address the requirements and recommendations in the area of AML and CTF, amendments to other national regulations and circumstances surrounding the business practice.

## II.2.4 Financial leasing

### Market participants

There were 16 licensed financial lessors in Serbia at end-2017. Financial leasing sector employed 363 people in total.

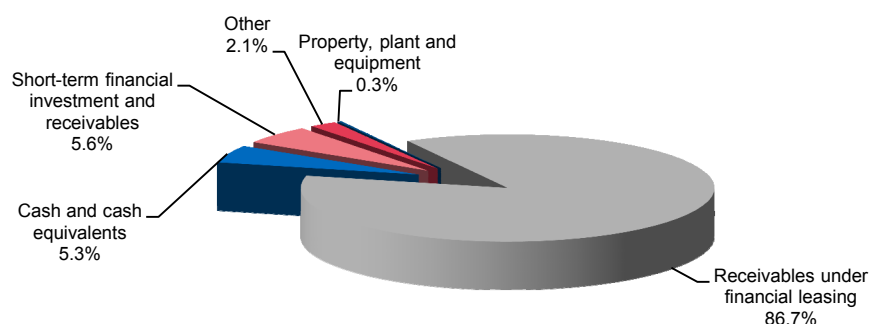
Of the total number of financial lessors, seven were in majority ownership of foreign legal persons, while nine were in majority ownership of domestic entities. Two leasing companies were founded by non-financial sector entities, and the remaining companies were founded by banks, banking group members or other financial institutions.

### Balance sheet

As at 31 December 2017, balance sheet assets of all financial leasing companies totalled RSD 75.3 bn, up by 13.7% relative to 31 December 2016, when they stood at RSD 66.3 bn. The largest share of financial lessors' total balance sheets was made up of financial lease receivables (86.7%). The share of cash and cash equivalent in total balance sheet assets amounted to 5.3%, while the share of short-term financial assets and other receivables stood at 5.6%.

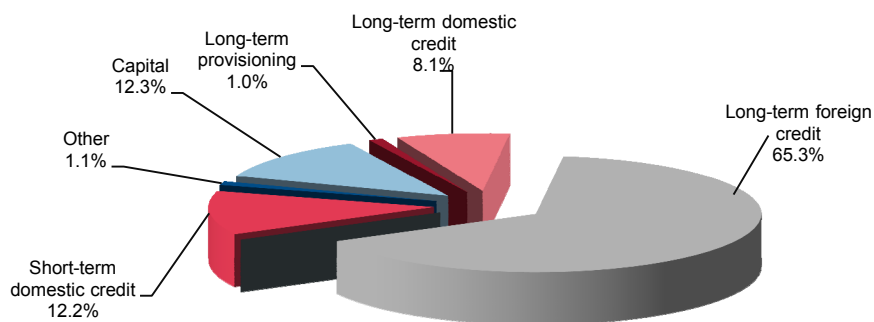
Financial lessors finance most of their activities by long-term foreign borrowing, so long-term foreign loans made up the largest portion (65.3%) of total balance sheet liabilities as at 31 December 2017. The share of capital in total balance sheet liabilities stood at 12.3%.

Chart II.2.4.1 **Composition of lessors' assets**  
(as at 31 Dec 2017)



Source: NBS.

Chart II.2.4.2 **Composition of lessors' liabilities**  
(as at 31 Dec 2017)



Source: NBS.

## Market share

The financial leasing market belongs to a moderate competition group, as indicated by HHI, which rose from 1,159.9 points in 2016 to 1,317.4 points in 2017. The share of the largest financial lessor in total balance sheet assets stood at 19.0%, negligibly lower than in 2016 (19.3%).

### *Structure of lease investments*

The bulk of financial leasing went to non-financial corporates (84.3%), while entrepreneurs received 4.5% of the funding, public enterprises 4.4%, natural persons 3.3% and farmers 2.7%.

At end-2017, the structure of investment by the lease asset shows that the financing of freight vehicles, minibuses and buses accounted for the highest share – 43.1% (40.7% in 2016). The share of financing of passenger vehicles rose from 31.0% in 2016 to 33.2% in 2017.

The breakdown by sector shows that the majority of financial lease investments went to transport, storage, information and communications (35.2%), followed by other activities (20.5%), trade (15.3%) and manufacturing with mining and water, electricity and gas supply sectors (13.9%).

## Income statement

Profit before tax of all financial lessors equalled RSD 671.4 mn in 2017. Relative to 2016, total income and profit fell by 16.8% and total expenses and losses by 6.7%.

The most significant category of lessor income was interest income with a share of 59.2% in total income, followed by impairment of property income, with a share of 18.5% in total income. Income from leasing accounted for 13.7% of the total.

The largest share in total lessor expenses pertained to salaries and wages and other related employee benefits (26.7%), followed by other operating expenses (24.6%), and interest payments (18.2%).

## Off-site supervision of financial lessors

The Q4 2016 report and the first three quarterly reports for 2017 were the basis for a formal supervision of legality and regularity of all financial lessors' operations within the meaning of the Law on Financial Leasing and pertinent by-laws. None of the three off-site supervision cycles detected actions featuring irregularities and illegalities on the basis of which financial lessors may be sanctioned under the above Law.

Based on the information received in responses to questionnaires in the AML and CTF area received from financial lessors, certain analyses of responses were made in order to consider the quality and scope of risk management in the financial leasing sector.

## On-site supervision of financial lessors

In 2017 two on-site examinations were conducted addressing financial lessors' management of money laundering and terrorism financing risk.

Based on the findings of on-site examinations:

– one lessor was imposed a measure whereby orders were sent by a letter. Off-site supervision of implementation of measures pronounced in the decision on measure was conducted – by looking into the documents submitted to the NBS by the lessor in line with the deadlines prescribed in that decision. Also, as illegalities were identified, an economic offence was reported to the competent prosecutor's office;

– no illegalities or irregularities were identified in the case of the other lessor, which is why the conclusion on termination of on-site supervision procedure was issued.

## Granting licences

In 2017 the NBS issued 19 decisions granting consent to the appointment of members of managing and executive boards in seven financial lessors.

One decision was also issued which granted consent to a bank to acquire ownership of stakes of the lessor, which give the owner 10% (100%) and more of management rights in that lessor.

One decision was issued granting consent to performing voluntary liquidation of a financial lessor.

## Plans for 2018

Activities planned for 2018 include:

– regulatory activities aimed at adopting regulations and internal acts improving licencing, methodology for establishing risk profile of lessors and pronouncing measures and fines on account of irregularities and illegalities established in the supervision;

– ongoing monitoring and analysis of financial lessor operations and taking appropriate measures to improve their operations in such a manner so as to maintain and enhance this segment of the financial market – aimed at adequate regulatory activities;

– ongoing off-site supervision of lessors' operations;

– on-site supervision under the adopted plan.

## II.2.5 Payment institutions and electronic money institutions

At end-2017, 12 payment institutions and one electronic money institution operated in Serbia, which also provided payment services through the network of 1,359 agents (vs. 441 in 2016). Other payment service providers are commercial banks and one public postal operator.

Most payment institutions (83%) are owned by one or more natural persons. Ten payment institutions are owned by domestic legal and natural persons while a foreign legal person and foreign natural persons have the majority ownership of two payment institutions. The electronic money institution is owned by domestic persons (a natural person and two legal persons).

In 2017 the development of the payment services market continued. This development is reflected in the increase in the number of providers of international remittance services in the territory of the Republic of Serbia, but also in the

distribution of the network of agents providing payment services as agents of different payment institutions.

## On-site and off-site supervision of payment services provision

In 2017 the NBS initiated (based on the Law on Payment Services and the Decision on Detailed Conditions and Manner of Supervision of Payment Institutions, Electronic Money Institutions and Public Postal Operator) on-site supervision of two payment institutions and the public postal operator and conducted a targeted off-site supervision of one payment institution addressing risk management in the area of operating through agents. Off-site supervision of payment service providers and the electronic money issuer proceeds in line with the provisions of the Decision on Capital and Capital Adequacy of Payment and Electronic Money Institutions and other relevant NBS by-laws.

Supervision under the Law on Payment Services continued with a view to detecting unauthorised payment service delivery. A total of 44 reports on unauthorised payment service delivery were drafted and sent to natural persons. They reported that natural persons had provided payment services without an NBS licence. The number of concluded supervision procedures under the Law on Payment Services was 17. They resulted in the prohibition of further service provision along with a fine, while other procedures are at different supervision stages.

## Granting licences

In 2017 the NBS issued five decisions on granting the license to provide payment services and two decisions on prior consent to the acquisition of a qualified stake in the electronic money institution. The licence of one payment institution ceased to be valid since a bankruptcy procedure was initiated.

Dynamic development of the network of agents of payment institutions continued, as testified by a large number of applications for their registration received by the NBS in 2017. The network of payment service provision through agents continued to be developed by nine payment institutions and the electronic money institution. In addition to providing payment services, the electronic money institution carries out electronic money distribution activities through a widespread distributors' network.

## Plans for 2018

Activities planned for 2018 will focus on:

- continuous monitoring and analysing the operations of payment institutions and the electronic money institution (and their agents), and proposing appropriate activities to enhance the system of payment service providers;

- continuation of activities regarding the procedure of deciding on applications for the licence to provide payment services and issue electronic money;
- support to interested business entities in testing innovative payment models as one of the promotional activities in the area of payment service provision and issuance of electronic money;
- supervision of the implementation of the Law on the Prevention of Money Laundering and Terrorism Financing in persons dealing with services of purchase, sale and transfer of virtual currencies or exchange of those currencies for money or other property via online platforms, physical devices or otherwise and/or persons who broker these services.

## II.2.6 Information systems supervision

For the purpose of timely interventions, the NBS continuously monitors how financial institutions manage information system risk arising from information and communications technologies. It also assesses that risk in financial institutions aiming to achieve higher levels of security and stability in their operations.

In order to assess the implementation of standards and regulations governing the application of information and communications technologies in financial institutions, the NBS circulates a Questionnaire on financial institution information systems annually. The NBS also constantly keeps track of external audit reports, which cover the information system assessment and the recommendations for the system improvement. Based on the information collected through the Questionnaire on financial institution information systems, external audit reports, and information received from on-site and off-site examinations of financial institution information systems, the NBS timely identifies and assesses risks of financial institution information systems to be able to take pre-emptive actions and eliminate irregularities.

Information system risk assessment for all financial institutions was carried out in the following areas: (a) information system management, risks and audit, (b) information system development and maintenance, (c) information system security, (d) business continuity management and (e) outsourcing activities. Risks were assessed in relation to the size, i.e. relevance of a financial institution. Since the Questionnaire on information systems has been disseminated for the fourth year in a row, the results have been compared to the results of the analyses from the past years and the risk trend has been established relative to the previous reporting period.

In accordance with the regulatory requirements, when acting upon requests to grant operating licences to financial institutions, the NBS assessed the adequacy of information systems according to the nature, scope and complexity of the operations of such institutions. Also, considering the new trends in the development of information and communications technologies, the analysis of financial institutions' activities continued through examination of the documents

they submitted, particularly the notifications of information system outsourcing activities and notifications of new technologies, migration of data to new business applications and risk assessment in electronic service provision. Financial institutions pay utmost attention to new technological solutions in information system security, and to innovative solutions in electronic services that include new channels of communication with users of those services. In addition, the NBS monitors the implementation of measures issued based on the findings of on-site supervision of information systems in the previous period for the purpose of more stable and safe operations.

The NBS adopted the Decision Amending the Decision on Minimum Information System Management Standards for Financial Institutions (RS Official Gazette, No 2/2017), which expanded the coverage of supervision of information systems to payment institutions, electronic money institutions, and the public postal operator (addressing the segment of its operations which refers to payment service provision and/or electronic money issuance). Requirements for the security of financial institutions' information systems have also been better formulated and are now in line with generally accepted standards in this area and standards governing electronic services and secure use of those services. In 2017 based on these amendments, supervision of information systems targeted payment institutions and electronic money institutions, in addition to standard financial institutions.

Bearing in mind that the supervision of information systems is a complex and continuous process that needs to integrate and adjust the best practices of central banks and supervisory bodies, cooperation with information system supervisors from neighbouring countries and sector associations in Serbia was intensified in 2017.

## Plans for 2018

The plan in 2018 was for the NBS to continuously keep track of how financial institutions assess information system risks and manage them through off-site and on-site supervision, as needed and in line with the supervision plan.

For the purpose of implementation of the Law on Information Security, in the coming period the NBS will participate in activities aimed at improving information security in the country and exchange of information about security incidents.

## **II.3 Bank resolution function**

### Legal framework

During the global financial crisis and its aftermath, the existing mechanisms proved insufficient and inappropriate to address the problems of banks facing serious difficulties in their operation. These mechanisms did not allow for

sufficiently prompt and efficient intervention of competent authorities, nor did they ensure the conditions for preserving banks' critical functions to a sufficient degree or for safeguarding the stability of the financial system as a whole. This raised the national and international awareness of the need to define clear rules and mechanisms for crisis response. In the EU this resulted in the adoption of the Directive on establishing a framework for recovery and resolution of credit institutions and investment firms<sup>33</sup> (hereinafter: the Directive) in May 2014. The application of the Directive in all member countries commenced on 1 January 2015.

In line with the strategic commitment of the Republic of Serbia to join the EU, the NBS prepared the draft Law Amending the Law on Banks, which was adopted in February 2015, as a part of the corpus of financial laws (Law on the National Bank of Serbia, Law on Banks, Law on Deposit Insurance, Law on Deposit Insurance Agency, and Law on Bankruptcy and Liquidation of Banks and Insurance Companies) which started to be applied on 1 April 2015. The amended set of financial laws ensured alignment of the legal framework in the area of bank resolution with the above Directive and best international practice and regulatory trends.

According to the Law on Banks, bank resolution is conducted in order to:

- ensure the continuity of critical functions of a bank;
- avoid a significant adverse effect on the stability of the financial system;
- protect budgetary funds and other public funds;
- protect depositors and investors; and
- protect client funds and other assets.

The main objective of bank resolution is to minimise the use of budgetary and other public funds with a view to preserving financial stability. This is achieved by ensuring that losses incurred by a failing bank are to be borne first by bank shareholders and creditors, observing the prescribed limitations and protective mechanisms (the losses may not exceed those entailed by a bankruptcy procedure).

The NBS was assigned a new role – the role of a body competent for bank resolution.

In the resolution procedure, the NBS may opt for a resolution tool or a combination of tools that most effectively meet the bank resolution objectives. Resolution tools envisaged by the Law on Banks are as follows:

- the sale of shares and/or of all or any assets and liabilities of the bank;
- the transfer of shares of one or more banks under resolution or transfer of all or any assets and/or liabilities of one or more banks under resolution to a bridge bank;
- the asset separation tool, i.e. transfer of assets and liabilities of the bank under resolution or the bridge bank to the Deposit Insurance Agency or another

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<sup>33</sup> Directive 2014/59/EU on establishing a framework for recovery and resolution of credit institutions and investment firms.

legal person (the so-called asset management company founded by the Republic of Serbia);

- the bail-in tool.

In order to further the resolution objectives, the Law on Banks provides for implementation of resolution tools without shareholder and creditor consent. On the other hand, the Law also provides for measures and mechanisms for the protection of shareholders, creditors and third parties to which the NBS must adhere in the resolution procedure. The NBS will use all the above tools on as needed basis, taking into account specific circumstances of a given case and the best solutions from the comparative practice, committed to its objective of preserving financial stability at the least possible cost.

## Activities

### *Resolution plans*

In late 2015 and early 2016 the NBS prepared and adopted resolution plans for all licenced banks in line with the deadlines set in the Law on Banks. In line with the provisions of the said Law the first regular update of banks' resolution plans was done in late 2016 and early 2017. At the same time the first resolution plans were prepared for banking groups supervised on a consolidated basis by the NBS.

On completion of the first cycle of banks' resolution plans update, and the preparation of the first resolution plans for banking groups, 2017 saw certain efforts made to collect additional reports from banks and the Deposit Insurance Agency judged as necessary for adequate assessment of the possibility for bank and banking group resolution. Besides, internal acts were also prepared to govern the planning of bank and banking group resolution, with special emphasis on assessment of the possibility for resolution and identification of potential obstacles to resolution, as well as the method for assessing the critical business functions of banks and banking groups.

The second cycle of regular annual updates of banks' and banking groups' resolution plans commenced late in 2017 and finished in early 2018.

### *Minimum requirement for capital and eligible liabilities*

In line with the provisions of the Law on Banks, the minimum requirement for capital and eligible liabilities is integral to the resolution plan, setting the deadline for the bank to reach the prescribed level of the requirement. The first resolution plans were accompanied by decisions setting the special minimum requirements for capital and eligible liabilities for each individual bank.

Starting from the assessment of the possibility of resolution, in updating bank resolution plans, the NBS reviewed minimum requirements for capital and eligible liabilities set by the decisions adopted along with the first plans and prescribed the new ones. In accordance with the Decision on the Minimum Requirement for

Capital and Eligible Liabilities of a Bank<sup>34</sup> and NBS decisions, all banks are obliged to comply with (at least) 50% of the prescribed minimum requirement for capital and eligible liabilities, as at 31 December 2017.

In order to monitor whether the set minimum requirement for capital and eligible liabilities is met, and to prepare and update resolution plans, banks and ultimate parent companies of banking groups supervised by the NBS on a consolidated basis submit reports prescribed by the Decision on the Information and Data Submitted to the National Bank of Serbia for the Purpose of Drafting and Updating Resolution Plans of Banks and Banking Groups, on a semi-annual basis.<sup>35</sup> After examining the submitted reports, their analysis indicated that in both reporting periods reviewed in 2017 (ending on 31 December 2016 and 30 June 2017), all banks had capital and eligible liabilities that exceeded 50% of the prescribed special minimum requirement. In addition, as at 31 December 2017, all banks were in line with this requirement.

### *Regulatory activities*

In order to align domestic legislation with the regulations introducing the Basel III standards and to improve the quality of data and information submitted for the purpose of the preparation and update of resolution plans, the Decision on the Minimum Requirement for Capital and Eligible Liabilities of a Bank and Decision on the Information and Data Submitted to the National Bank of Serbia for the Purpose of Drafting and Updating Resolution Plans of Banks and Banking Groups were amended in 2017.

In addition, internal acts governing the bank resolution planning process were prepared in 2017. The focus was on the method for assessment of the possibility for resolution and identification of potential obstacles to resolution, as well as on acts governing the assessment of critical business functions of banks so as to identify those that may be deemed critical. Both acts were taken into consideration in the update of resolution plans.

### *Cooperation with other regulatory bodies*

The NBS established cooperation with the Hungarian central bank in the area of bank resolution for the purpose of participation in the College for the resolution of a banking group whose member operates in the territory of the Republic of Serbia. The plan is also to sign an agreement which would formally govern the relations of two institutions and significant issues pertaining to cooperation and exchange of data and information in this area.

In 2017, the NBS also conducted negotiations aimed at signing the Cooperation Agreement with the Single Resolution Board in charge of resolution

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<sup>34</sup> RS Official Gazette, Nos 30/2015 and 78/2017.

<sup>35</sup> RS Official Gazette, Nos 78/2015 and 78/2017.

of institutions covered by the Single Supervisory Mechanism in the EU and their subsidiary companies. These negotiations were successfully completed and this agreement is expected to be signed in 2018.

In 2017, several meetings were held with the Deposit Insurance Agency for the purpose of establishing appropriate forms of cooperation with this institution in the area of bank resolution.

## Plans for 2018

Within the regular annual resolution plan update cycle (the process commenced in late 2017) the expectation for 2018 is to prepare and adopt updated resolution plans for the remaining banks and banking groups, and to set new minimum requirements for capital and eligible liabilities for all remaining banks. With reference to that, there is a plan to communicate with banks on the identification and assessment of identified critical functions in order to reach an agreement. There is also a plan to check the fulfilment of conditions for including a portion of eligible liabilities of banks in the calculation of the minimum requirement for capital and eligible liabilities.

There are plans to amend the current by-laws which govern forms and content of items in financial statement forms to be completed by banks, and the collection, processing and submission of data on the balance and structure of accounts in the Chart of Accounts for banks. In addition, the method for report submission by banks will be further improved, primarily for the purpose of increasing the level of security and reliability of communication and exchange of data and information.

The NBS will also continue to upgrade the bank resolution framework by preparing and enhancing internal acts, and establishing and expanding cooperation with other national and foreign regulatory authorities.

## II.4 Stability of the financial system

### II.4.1 Financial stability function

In addition to its primary objective which is to preserve price stability, under amendments to the Law on the National Bank of Serbia of 1 July 2010, the NBS is mandated to safeguard and strengthen the stability of the financial system.

Pursuant to Article 4, paragraph 1, item 3 and Article 14, paragraph 1, item 11 of the Law on the National Bank of Serbia, the NBS sets and pursues measures and activities, within its scope of authority, aimed at preserving and strengthening the stability of the financial system. These provisions are the legal basis for conducting macroprudential policy, whose main objective is the stability of the financial system. Besides adopting its own measures, the NBS may propose that other institutions take specific measures aimed at maintaining and strengthening financial stability. The NBS regulatory and other recommendations and measures

in this field, as well as a detailed analysis of financial stability and potential risks, are published in the Annual Financial Stability Report.

In 2015 the NBS published a consultation document *Macroprudential Framework*. This document sets out in detail the objectives, instruments and decision-making process of macroprudential policy, without prejudice to the achievement of the primary objective of the NBS – maintaining price stability.

At its December 2016 meeting, the NBS Executive Board adopted a set of regulations that incorporate Basel III standards into national regulations for the purpose of implementing the Strategy for Implementation of Basel III Standards in Serbia. An integral part of this package is the Decision on Capital Adequacy of Banks, which governs capital buffers – additional CET 1 capital that banks are obliged to keep above the prescribed regulatory minimum to limit systemic risks in the financial system. The capital buffers consist of the capital conservation buffer, countercyclical buffer, capital buffer for global systemically important banks, capital buffer for systemically important banks and systemic risk buffer. Capital buffers have been applied since 30 June 2017.

The capital conservation buffer is the requirement for a bank to maintain an additional CET 1 capital equal to 2.5% of its total risk-weighted assets. This buffer was first introduced into the Serbian regulatory framework as early as in 2011. However, the new regulations set out that this buffer may be maintained exclusively in the form of CET 1 capital, which is the highest quality capital.

The countercyclical capital buffer is an additional buffer of CET 1 capital, introduced during periods of excessive credit growth to improve the resilience of the banking sector and reduce the possibility of a financial crisis outbreak. The rate of this buffer may range between 0% and 2.5% of risk-weighted assets of a bank, though it can be higher in exceptional circumstances. The Decision on Countercyclical Capital Buffer Rate for the Republic of Serbia of 8 June 2017, prescribed this buffer rate at 0%, applied as of 30 June 2017. The said rate was kept at the same level throughout 2017. The NBS sets the countercyclical capital buffer rate quarterly, taking into account the value of the buffer guide, current guidance and recommendations of the European Systemic Risk Board and other variables deemed relevant for monitoring the cyclical dimension of systemic risk. The deviation of the credit-to-GDP gap) from its long term trend is used as the guide for the calculation of the buffer guide. For the purpose of setting the countercyclical buffer rate, in addition to the credit-to-GDP gap, the NBS also takes into account additional optional indicators of lending activity which reflect characteristics of the domestic financial system. These additional indicators pertain to the real estate market, external imbalance and banking sector developments.

The capital buffer for global systemically important banks is an additional buffer of CET 1 capital, which an institution, identified under the established criteria and prescribed methodology as a global systemically important institution, must maintain on a consolidated basis. The rate of this buffer may range between 1% and 3.5% of risk-weighted assets. Application of this buffer in Serbia will be postponed until the date of its accession to the EU.

The capital buffer for systemically important banks is an instrument under which banks recognised as systemically important for Serbia may be required to maintain additional CET 1 capital in the amount of 0–2% of risk-weighted assets. A bank's systemic importance is assessed based on at least one of the following criteria: its size, importance for the Serbian economy, significance of cross-border activities, connection with the financial system, replaceability in the financial system and complexity of its operations. The capital buffer for systemically important banks was established in June 2017, and the list of systemically important banks is published on the NBS website. The Decision on compiling the list of systemically important banks and the accompanying buffer rate is re-examined at least once a year.

The systemic risk buffer is an additional CET 1 capital buffer maintained by a bank to prevent and mitigate long-term non-cyclical systemic risks. The rate of this buffer may be at least 1% based on exposures in Serbia or another country to which this buffer applies, and may be introduced for one, more or all banks, with uniform or different rates. The systemic risk buffer was set in June 2017 to curb systemic euroisation risk. Since euroisation is a major systemic risk, it was decided that all the banks with headquarters in Serbia in which euroisation exceeds 10% were obliged to maintain the systemic risk buffer at the rate of 3% of FX and FX-indexed loans to corporates and households in Serbia. Using FX and FX-indexed loans as the basis for the calculation of capital requirements, it is expected that banks will be additionally encouraged to reduce the degree of euroisation and consequently the amount of capital requirements.

Aware of the importance of preventive measures in precluding the development of systemic risks, in 2017 the NBS published some of the possible measures<sup>36</sup> that could be taken in relation to:

- NPL resolution:
  - development of plans by banks to reduce the share of NPLs. These plans need to include the following elements: the established objective in terms of the percentage share of NPLs in total loans, timeframe for reaching this objective, methods of reducing the share of NPLs and sources of funding in the implementation of the plan;
  - improving and promoting the legal framework set up by the Law on Consensual Financial Restructuring;
  - simulating annuity plans to interest risk and foreign exchange risk when informing bank clients on loan terms in order to enable better understanding of the underlying risks;
- limiting euroisation risk:
  - considering the introduction of different insured amounts and insurance premiums for foreign currency and dinar deposits;
  - setting the systemic risk buffer;

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<sup>36</sup> A detailed overview of measures can be found in the Annual Financial Stability Report for 2016.

- differentiation between housing loans granted in foreign currency or in dinars with foreign currency clause and dinar housing loans in a way to limit the loan amount relative to the value of mortgaged real estate to 80% and to 90% in the case when this loan is approved as a government-support measure to certain groups of natural persons;
- limiting the potential risk of cross-border deleveraging of domestic banks:
  - boosting the domestic dinar sources of funding.

## II.4.2 Financial stability assessment

### International environment risks

Global economic movements in 2017 indicated that a recovery of the global economy has continued. Global growth sped up to 3.8% in 2017, and the acceleration was recorded both in developed economies (from 1.7% in 2016 to 2.3% in 2017) and emerging economies (from 4.4% in 2016 to 4.8% in 2017).<sup>37</sup> Acceleration of global growth to 3.9% is expected for 2018 and 2019. The euro area, with which Serbia has the most important financial and trade links, has seen its growth rate accelerate to 2.4% in 2017, the highest figure since 2007. The euro area growth acceleration spilled over to improved outlook for growth of CESEE countries, resulting in a downward trend of these countries' risk premiums which reached record lows in 2017. Economic recovery in Europe is expected in 2018, with growth rates forecast by the IMF higher for European emerging and developing economies (4.3%)<sup>38</sup> than for the euro area (2.4%).

Despite the relatively robust pace of economic growth, inflation in the euro area was below the target of “below but close to 2%”. However, it was higher in 2017 (1.5% y-o-y) than in 2016 (0.3% y-o-y) primarily on account of the energy price hike.

The primary commodities market saw price growth continue in 2017, which contributed to better growth prospects of the countries exporting primary commodities. After a temporary drop in Brent oil prices to below 50 dollars per barrel at the end of H1 2017, the second half of the year saw the prices increase. The trend of rising oil prices was mostly driven by the extended agreement between OPEC countries and other large producers on production cut as well as geopolitical tensions in the Middle East.

Monetary policies of the leading central banks, the ECB and the Fed, continued to diverge during 2017, as the euro area and the USA are going through different stages of the economic cycle. The ECB kept key interest rates unaltered. The ECB's monetary policy accommodation in this period was reflected in the continued implementation of non-standard monetary policy measures, but the pace

<sup>37</sup> According to IMF WEO from April 2018.

<sup>38</sup> Turkey, Poland, Romania, Hungary, Bulgaria, Serbia, Croatia, Albania, Bosnia and Herzegovina, Macedonia and Montenegro.

of relaxation on those grounds was milder than in the year before. Namely, by March 2017 the ECB conducted its asset purchase programme, with monthly purchases of EUR 80 bn, while from April until the end of the year monthly purchases were reduced to EUR 60 bn. At the October meeting, the ECB announced further reduction in the monthly pace of asset purchases to EUR 30 bn starting from January 2018 until September 2018, or beyond if necessary, i.e. until inflation is brought to the level consistent with the ECB's target.

On the other hand, the Fed continued monetary policy tightening in 2017 and raised the Fed funds rate target range by 0.25 pp three times (in March, June and December). Thus the rate was in the range 1.25–1.50% at the end of the year. This pace of interest rate increases was in line with market expectations. Also, as of October 2017 the Fed has been unwinding its balance sheet, which had increased from USD 800 bn to USD 4.5 trillion during the global economic crisis. Under the plan, the monthly reduction of reinvestment needs to increase by USD 10 bn on a quarterly level until it reaches USD 50 bn at the end of 2018. From then on, the Fed will apply a monthly reduction of USD 50 bn for as long as it deems necessary.

According to BIS data, in Q4 2017 relative to the onset of the crisis (Q3 2008), euro area banks reduced their cross-border exposure to countries of the region, except to the Czech Republic and Turkey. In terms of percentage change, exposure was reduced the most for Hungary and Croatia and the least for Poland and Serbia. Compared to end-2016, Q4 2017 saw higher cross-border exposure to all countries in the region, except Croatia.

The November 2017 CESEE Bank Lending Survey published by the EIB shows that, during 2017, the risk of reduction in financial exposure in the banking sector of CESEE countries was lower than in 2015 and 2016. In H2 2017, around 20% of the banking groups expressed expectations of a reduction in the LtD ratio at the banking group level in the coming period.

Owing to the strong domestic deposit base which grew during the post-crisis period, and well-calibrated measures of the NBS, the risk of deleveraging of foreign banks has been reduced to a minimum.

## Domestic macroeconomic environment

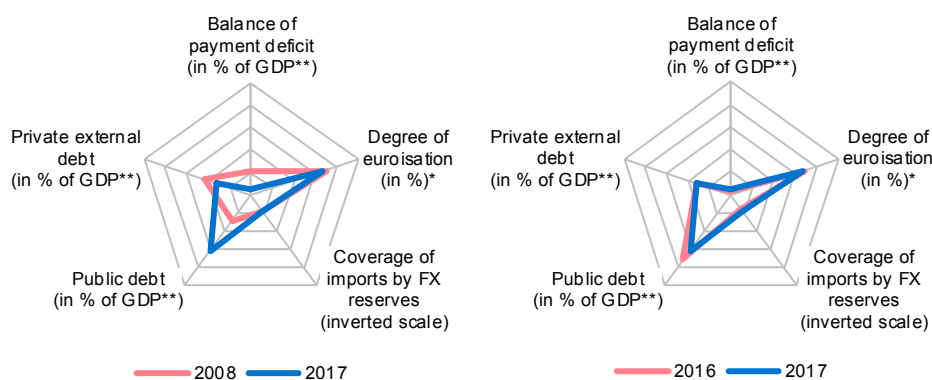
Comparing the indicators<sup>39</sup> in 2017 and 2016, the reduced vulnerability of the financial system is indicated by a significant cut in the share of public debt in GDP. The growing trend of the share of public debt in GDP that began in 2009 shifted in 2016 as a consequence of vigorous fiscal adjustment. The reduction in the share of public debt in GDP continued into 2017 by additional 10.4 pp. In addition,

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<sup>39</sup> The following were used as basic indicators of vulnerability of the Serbian financial system: change in the current account deficit, private external debt, public debt, degree of euroisation and FX reserves adequacy (measured by the inverse scale of coverage of imports by gross FX reserves). The farther position from centre indicates a higher risk for each of the indicators.

compared to the year before, the degree of lending euroisation edged down by additional 1.8 pp. Temporary widening of the current account deficit and the reduced coverage of imports by FX reserves, as well as an increased share of private external debt in GDP worked in the opposite direction.

Chart II.4.2.1 Key macroeconomic risks



\* Share of FX and FX-indexed loans in total corporate and household loans.

\*\* GDP is harmonised with ESA 2010 methodology.

Source: NBS.

It is expected that in the coming period, as the current account deficit is brought back to 4-5%, this factor will further reduce the vulnerability of the financial system. In addition, bearing in mind that the Fiscal Strategy for the period 2018–2020 envisages the general government deficit in the medium term at the level of 0.5% of GDP, public debt is expected to continue down. Such public debt movement will contribute to a further reduction of financial vulnerability in the coming period.

## Financial stability assessment

Several methods were used to assess financial stability of the country, as follows: (a) comparison of selected financial soundness indicators, (b) financial stress index, and systemic stress indicator and (c) exposure of the financial system to large-scale shocks in stress tests and assessing systemic risk components by network modelling.

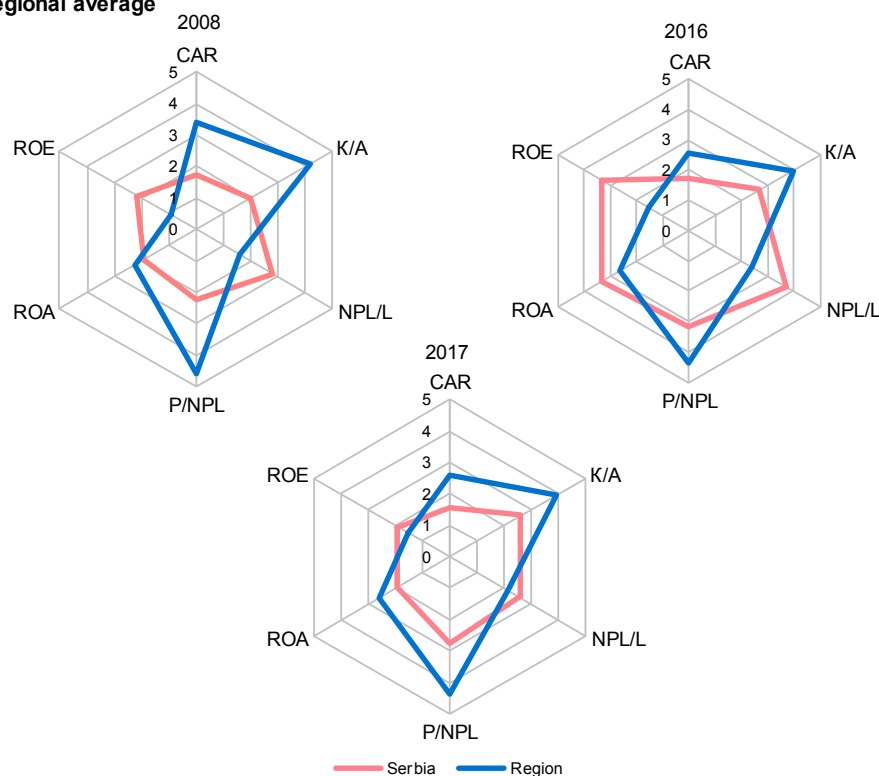
The comparison of selected financial soundness indicators is used to assess the financial soundness of the Serbian banking sector relative to other countries in the region. In addition, macroprudential stress-tests of the NBS conducted quarterly indicate high resilience of the banking sector even to the strongest shocks. Under the most unfavourable macroeconomic scenario (which implies high depreciation of the dinar and a decrease in real wages), on the whole, the Serbian banking sector remains adequately capitalised. Even in the event of an extremely high deposit outflow (twice that in October 2008), the domestic banking sector would stay liquid. In addition, the results of network modelling indicate that there is no

significant systemic risk component in the Serbian banking sector arising from the interconnectedness of banks.

Based on financial soundness indicators and owing to NBS prudential regulations, the Serbian banking sector appears to be in better shape than the average for the region in terms of capitalisation and coverage of NPLs by regulatory provisions. Profitability indicators and the reduction of the NPL ratio are showing signs of noticeable progress made since last year. In 2017, the Serbian banking sector posted positive results, with return on assets above the region's average. In 2017 the NPL ratio recorded its lowest value since 2008, though negligibly above the region's average.

The financial stress index (FSIX) is a composite indicator of financial soundness. It aims to identify episodes of elevated financial stress, their culmination and duration. Positive values of the financial stress index point to the above-average level of financial stress and the negative values to that below the average. In 2017 negative values of this index again indicate lower level of financial stress as a result of low stock exchange volatility and relatively stable exchange rate, and so financial soundness may be assessed as positive.

Chart II.4.2.2 Financial soundness of the Serbian banking sector compared to regional average

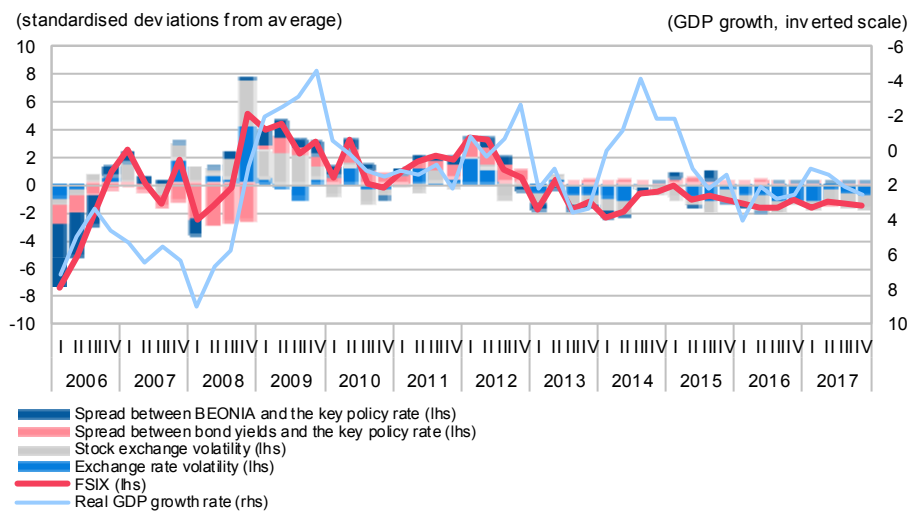


Notes:

- 1) The Chart shows standardised values of the most common Financial Soundness Indicators: CAR - Capital Adequacy Ratio (Regulatory Capital to Risk-Weighted Assets); C/A - Capital to Assets; NPL/L - Gross NPLs to Total Gross Loans; P/NPLs - Provisions to Gross NPLs; ROA - Return on Assets; ROE - Return on Equity.
- 2) Greater distance from the network centre indicates greater risk.
- 3) The region refers to CEE countries: Bosnia and Herzegovina, Bulgaria, Hungary, Macedonia, Poland, Romania, Turkey and Croatia. Region FSIs are non-weighted averages of the individual countries' FSIs.

Sources: NBS and IMF: GFSR.

Chart II.4.2.3 Financial stress index (FSIX) and GDP growth

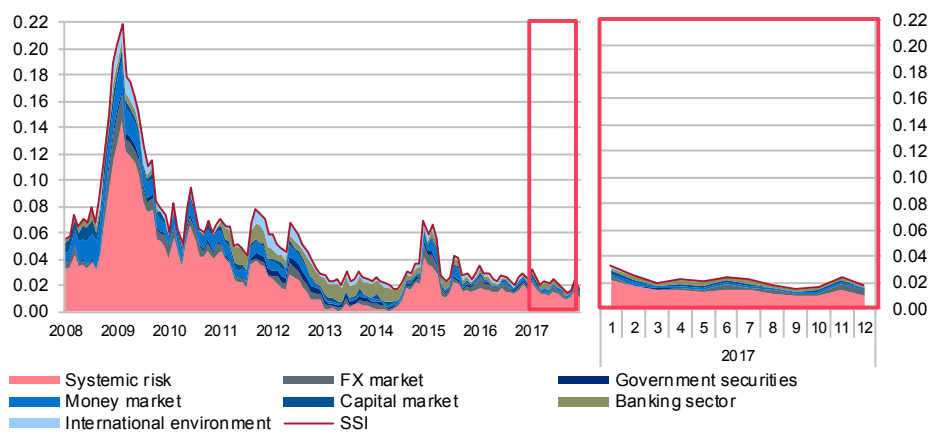


Source: NBS.

A methodology for identifying crisis periods and estimating the level of systemic stress of the Serbian financial system was developed. The methodology was used to construct the composite indicator of systemic stress.<sup>40</sup> This indicator is used by the European Systemic Risk Board<sup>41</sup> and ECB<sup>42</sup> for analysing risk accumulation in different segments of the financial system and assessing the level of total systemic stress.

This indicator gives decision-makers significant and timely information about trends in the financial markets, i.e. instabilities in the financial system and possible implications for financial and macroeconomic stability. Additionally, this indicator enables identification of early warning signals, which provides timely information on the potential occurrences of a systemic crisis.

Chart II 4.2.4 Systemic stress indicator



Source: NBS.

<sup>40</sup> For a more detailed analysis of the systemic stress indicator see the Annual Financial Stability Report for 2015.

<sup>41</sup> <https://www.esrb.europa.eu/pub/rd/html/index.en.html>.

<sup>42</sup> <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1426.pdf?6d36165d0aa9ae601070927f3ab799fc>.

The composite indicator of systemic stress covers 25 indicators which reflect the magnitude of financial stress (low, moderate and high) in six major segments of the Serbian financial system: the FX market, government securities market, money market, capital market, banking sector and the international environment.

In 2017 the indicator of systemic stress pointed to a low risk period with the exception of a negligibly elevated stress level in early 2017. The systemic risk component was low and stable throughout the reference period.

Low inflationary pressures, favourable fiscal developments, higher inflow of capital to Serbia, monetary policy easing, coupled with a stable banking system, boost the resilience of the domestic financial system and thus macroeconomic stability of the country.

### II.4.3 Promoting the financial system

During 2017, together with other competent institutions, the NBS carried out activities to improve the Serbian financial system.

#### Database on real estate valuations in the Republic of Serbia

Inadequate real estate valuation is a risk in a number of countries as banks are directly exposed to the risk of fluctuation in real estate prices. Poorly collateralised loans were one of the main causes of the global financial crisis. In order to improve real estate valuation in the Republic of Serbia, the NPL Resolution Strategy and the NBS Action Plan envisage that the NBS should set up a functional database of valuations of mortgaged real estate and loans secured by mortgage.

In 2015, the NBS adopted the Decision on Submission of Data on Valuation of Mortgaged Real Estate and Loans Secured by Mortgage in order to implement the said activities. According to this Decision, banks are required to submit relevant data on a monthly basis, which are then fed into the NBS database.

All banks have access to this database, i.e. to data on real estate valuations. In June 2017 the NBS adopted the new Decision on the Content, Deadlines and Manner of Submission of Data on the Valuation of Mortgaged Real Estate and Loans Secured by Mortgage, which, in line with the Law on Real Estate Valuers (adopted in December 2016) enabled licensed real estate valuers access to the database. In addition, General Terms for Accessing Real Estate Valuation Data in the Database on Real Estate Valuations by Certified Valuers were adopted. They set out in detail the terms and manner of gaining access to the said database by licenced real estate valuers. Also, one application of the database on real estate valuations has been improved. This application regards the reception, processing and analysis of data and this largely facilitates the processing and analysis of data from that database.

## Plans for 2018

The following activities are planned for 2018 with a view to further strengthening the financial stability function:

- in line with the adopted set of regulations introducing Basel III standards into domestic legislation, the following rates will be set:
  - countercyclical capital buffer rate (quarterly) and
  - capital buffer rates for domestic systemically important banks;
  - continued improvement of macroprudential stress tests in line with the Basel III set of regulations;
  - improvement of Serbian financial soundness indicators in line with the adopted Basel III regulatory standard and alignment with the IMF methodology for the composition of these indicators;
  - analysis of creditworthiness of groups of related companies and impact on the banking sector using network modelling;
  - establishment of analytical reporting from the database on real estate valuations.



# III OTHER FUNCTIONS AND ACTIVITIES OF THE NATIONAL BANK OF SERBIA

## III.1 Foreign exchange reserve management

The NBS manages FX reserves pursuant to the Law on the National Bank of Serbia and in accordance with the NBS Foreign Exchange Reserve Management Strategy. The Strategy, as the principal document, sets out the long-term FX reserves investment framework, investment principles and general goals, investment instruments, methods of risk and yield estimation and reporting on FX reserves investment. The adoption of the Strategy improved the FX reserves management process and enhanced its transparency, observing the practice of the leading central banks in the world.

During 2017, NBS FX reserves were managed in accordance with the Strategic and Tactical Guidelines for the Management of FX Reserves of the National Bank of Serbia, adopted by the NBS Executive Board. The Guidelines specify the eligible currencies, types of assets, currency structure, reference value for measuring the success of FX reserves management, as well as the necessary limits to ensure market and credit risk hedging. In line with the fundamental principles of safety and liquidity, FX reserves are invested with top tier institutions (central banks, international financial institutions and organisations, and top tier foreign banks), as well as in highly liquid securities issued by the most developed countries and international financial institutions.

Pursuant to the Guidelines, in the course of 2017, FX reserves were invested in short- and long-term government securities of the most developed countries (bills, notes and bonds) with maturities of up to ten years, and a minimum combined credit rating of A according to Standard & Poor's, Moody's and Fitch.

Also, FX reserves were invested in securities with minimum combined credit rating of A+, and AA (according to Standard & Poor's, Moody's and Fitch): of the following issuers:

- sovereign bonds and bonds issued on behalf of the government not denominated in local currency, with maturities of up to five years;
- supranational bonds with maturities of up to five years;
- subnational-municipal bonds with maturities of up to five years;
- agency bonds with maturities of up to five years;
- EUR covered bonds with maturities of up to five years.

Aiming to find an additional source of income amid low and negative interest rates without jeopardising basic principles of FX reserve management (safety and liquidity) as well as risk profile, at the end of February 2017 the NBS initiated securities lending transactions acting solely as the lender. In this way, as soon as these transactions commenced, the NBS managed to compensate regular expenses arising from trading in bonds with income from the said transactions.

Observing the safety principle, FX reserves were also invested in short-term deposits with central banks, international financial institutions and organisations and foreign commercial banks with minimum composite credit rating of AA-, according to world's leading rating agencies (Standard & Poor's, Moody's and Fitch).

## Stock and changes in FX reserves in 2017

On 31 December 2017, NBS FX reserves stood at EUR 9,961.7 mn, down by EUR 243.0 mn from end-2016. That level of FX reserves ensured 176% coverage of M1 or more than five months of goods and services imports.

In the course of 2017, the major inflow into FX reserves came from the sale of Serbian government securities in the domestic financial market in the amount of EUR 1,117.2 mn.

In 2017 NBS interventions in the IFEM recorded an FX inflow in the net amount of EUR 830.0 mn.<sup>43</sup>

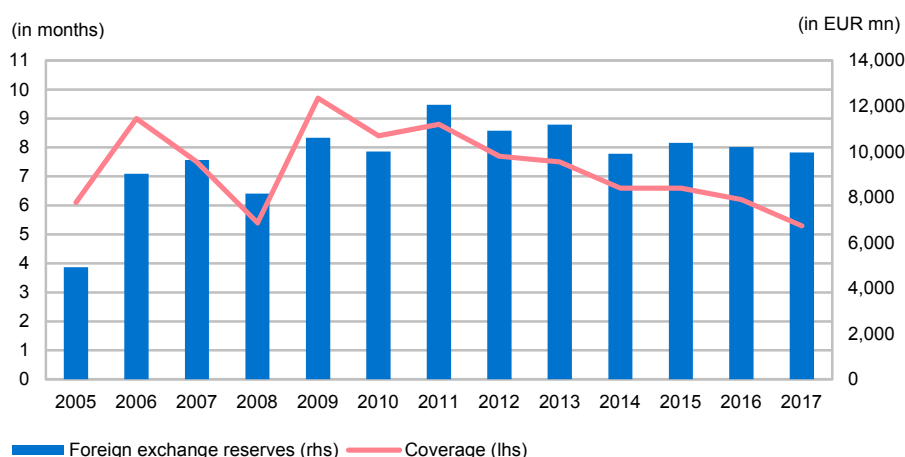
The total inflow from loans disbursed by the Republic of Serbia through NBS FX reserves amounted to EUR 733.5 mn. The loans were granted by: the World Bank (EUR 311.2 mn) for development policies in the areas of public expenditures and public enterprises, development and restructuring of enterprises, a competitiveness and jobs project, the need to modernise the public administration, Deposit Insurance Agency, the floods emergency recovery and land administration enhancement; the EIB (EUR 202.8 mn) for Corridor 10, road reconstruction, Belgrade ring road, upgrading the facilities of the judiciary authorities, medical centres reconstruction, City of Belgrade – bridge on the Sava river, SME development, municipal and regional infrastructure and public sector R&D; Abu Dhabi Development Fund loan for the government budget support (EUR 167.8 mn); Council of Europe Development Bank (EUR 37.0 mn) for an education and

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<sup>43</sup> In accordance with accounting rules, transactions in respect of NBS interventions in the IFEM are disclosed on the execution day and not on the trading day.

social inclusion project, building and equipping prison facilities, and investment in science infrastructure; and the EBRD (EUR 14.7 mn) for improvement of Belgrade public transportation and transport infrastructure and for the needs of the town of Kragujevac.

Chart III.1.1 Coverage of imports by FX reserves



Source: NBS.

A substantial inflow of EUR 486.6 mn originated from temporary payment transactions with Kosovo and Metohija, pursuant to the Law on Temporary Performance of Specific Payment Transactions in the Territory of the FRY (requiring that banks sell to the NBS all FX inflows arising from resident transactions with Kosovo and Metohija).<sup>44</sup>

There was an FX inflow of EUR 232.8 mn arising from donations.

In 2017 liabilities to foreign creditors amounting to EUR 1,450.7 mn were regularly settled. Higher FX outflows were recorded on account of payment of matured government securities, specifically euro-denominated securities issued in the domestic market in the amount of EUR 1,002.9 mn and eurobonds in the amount of EUR 655.9 mn (issued in November 2012 in the international market). In the period observed, banks withdrew required reserves in the net amount of EUR 284.8 mn, while EUR 23.1 mn was paid out to service old frozen FX savings bonds.

## Net FX reserves

On 31 December 2017, NBS net FX reserves stood at EUR 8,274.0 mn, down by EUR 90.0 mn from end-2016.

In 2017 the NBS met the net international reserves floor criterion agreed and defined under the Technical Memorandum of Understanding with the IMF. Net FX reserves, calculated at the IMF's programme exchange rate<sup>45</sup> applied in monitoring

<sup>44</sup> FRY Official Gazette, No 9/01.

<sup>45</sup> NBS exchange rate list No 187 dated 30 September 2014.

the programme implementation, stood at EUR 7,475.0 mn on 31 December 2017, exceeding the performance criterion by EUR 1,801.0 mn (the floor for end-December 2017 was EUR 5,674.0 mn).

## Structure and profitability of FX reserves

On 31 December 2017, the composition of NBS FX reserves was made up of: 61.6% of foreign securities, 20.0% of FX funds in accounts abroad, 10.9% of foreign cash, 6.8% of gold – in the NBS vault and in the account abroad and 0.7% of SDR holdings with the IMF.

A major portion of FX reserves, EUR 6,140.4 mn was invested in securities denominated in the euro, US dollar, pound sterling and Canadian dollar. Of this, 62.9% was invested in long-term and 37.1% in short-term securities.

Speaking of long-term securities, funds were invested in the following types of assets: government securities with maturity of one to ten years (the USA, including floating rate notes, Canada, the United Kingdom, Germany, France, the Netherlands, Austria, Finland, Belgium and Ireland), public sector securities (supranational, agencies, sovereign, including floating rate notes) and covered bonds.

As for short-term securities, funds were invested in the following types of assets: government discount securities (T-bills) with up to one year maturity (the USA), coupon securities with up to one year maturity – government securities (the USA, Canada, the United Kingdom, France, Germany, the Netherlands, Belgium, Austria, Finland and Ireland), government-guaranteed public sector securities (supranational, agencies, sovereign) and covered bonds.

A portion of FX reserves (EUR 1,996.1 mn) was invested in accounts abroad and placed in term deposits and current accounts. Of this amount, 40.2% are investments with central banks (the Fed, Bundesbank, Bank of Canada, Bank of Austria and Central Bank of Luxembourg) and international financial institutions (BIS), while 59.8% are investments with top tier foreign commercial banks with minimum composite credit rating of AA- (maturity of up to three months), that is, current accounts with commercial banks abroad.

At end-2017, the currency composition of NBS FX reserves (excluding gold) was as follows: 60.7% in EUR, 34.4% in USD, 1.8% in GBP, 1.8% in CAD, 0.7% in SDR and 0.6% in other currencies.

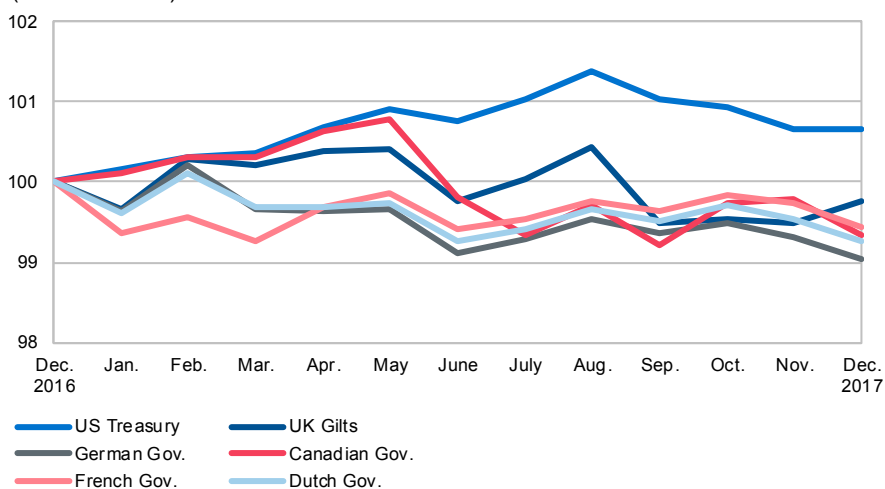
In 2017, NBS income from investment in foreign securities and interest on foreign assets totalled EUR 27.1 mn.

## Risk management

In 2017, the NBS remained committed to maintaining its portfolio risk at a very low level, sustaining high levels of security and liquidity, even under extremely difficult financial market conditions. Despite signs of improved economic growth the ECB did not raise rates in the European market. On the other

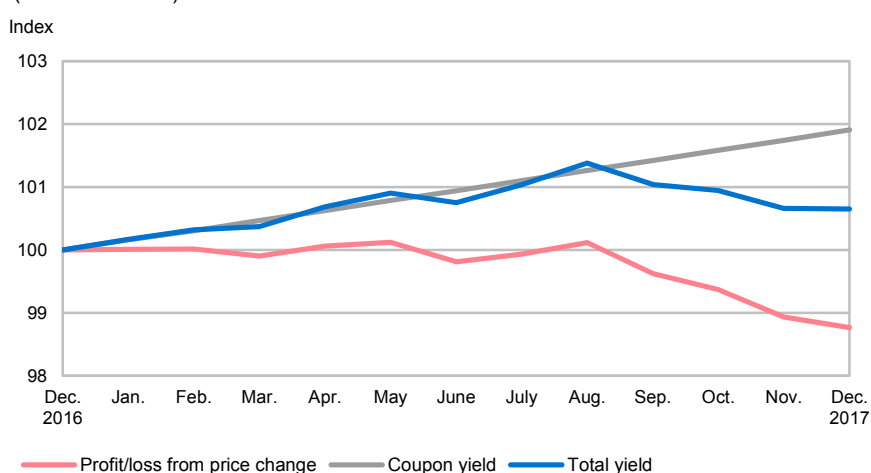
hand, there was further economic recovery in the American market, along with a new increase in the Fed funds rate target range.

**Chart III.1.2 Sovereign bond indices in original currency**  
(Dec 2016 = 100)



Sources: BofA Merrill Lynch and NBS.

**Chart III.1.3 Composition of total yield on US treasuries**  
(Dec 2016 = 100)



Sources: BofA Merrill Lynch and NBS.

Yield rates on all government bonds in the NBS portfolio (European, American, UK and Canadian) rose in 2017. US Treasuries in the NBS portfolio recorded a change in the yield curve slope, since the increase in the yield rates in case of shorter maturities is higher than in case of longer maturities. The highest yield in original currencies was recorded for US Treasuries.

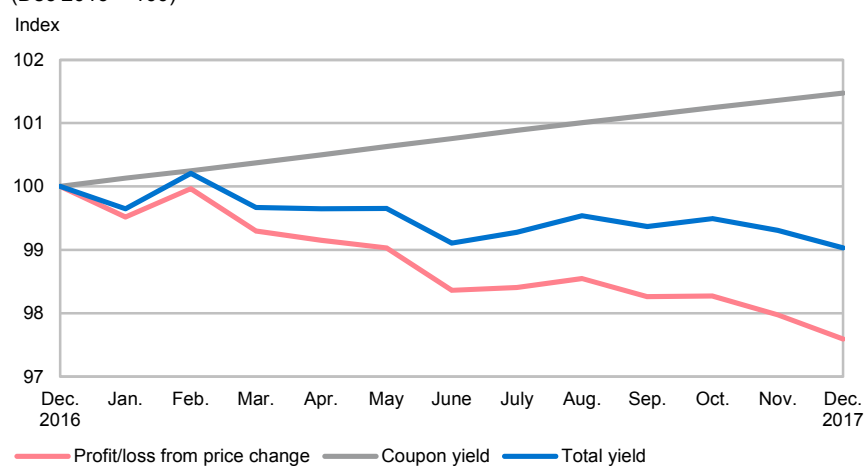
The yield structure shows that positive yields on US Treasuries originated mostly from interest collected, i.e. from coupon redemption, whereas this effect in the case of German government bonds was lower than the negative effect on account of the drop in prices.

In such circumstances and owing to the cautious investment approach of the NBS and its low portfolio duration which equalled around 1.2 in 2017, a positive

yield was achieved in USD, GBP and CAD portfolios, while a negative yield was recorded in EUR portfolio. The highest yield of 0.85% was recorded in the USD portfolio, followed by the CAD portfolio – 0.17% and the GBP portfolio – 0.14%, while yield of -0.34% was recorded in the EUR portfolio, which is above the rate on deposit facilities of the ECB (-0.40%).

Chart III.1.4 **Composition of total yield on German gov. bonds**

(Dec 2016 = 100)



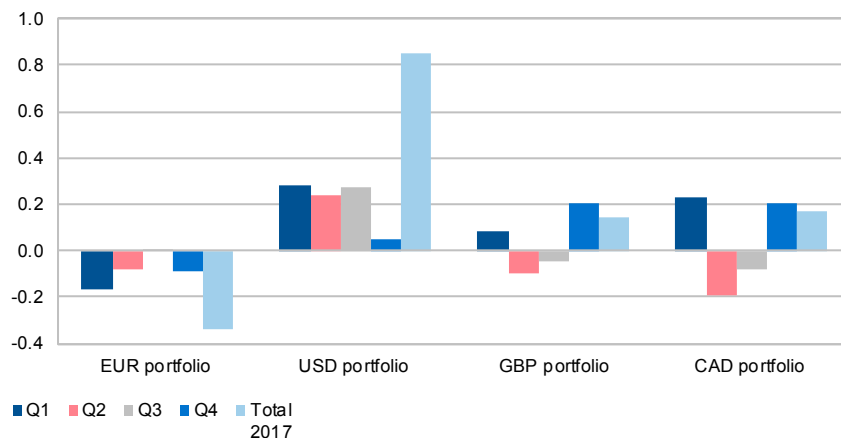
Sources: BofA Merrill Lynch and NBS.

At the same time, all NBS portfolios (EUR, USD, GBP and CAD) recorded higher yields relative to benchmarks.

Yields in the euro portfolio were slightly positive only in Q3. As for the US dollar portfolio, the results were positive and almost identical in the first three quarters, and weaker in Q4, while the pound sterling and Canadian dollar portfolios recorded positive results in Q1 and Q4. The underlying reason are market developments.

Chart III.1.5 **Portfolio return in original currency**

(by quarter, in %)

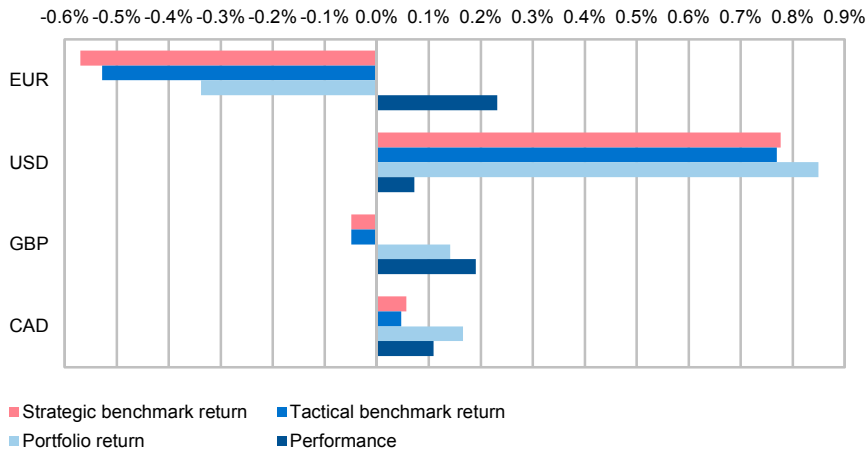


Source: NBS.

The American market was affected by new increases in the Fed funds rate which occurred three times in the year, so that the Fed raised the funds rate target range by 75 bp in total, to 1.25–1.50%. Despite the rise in short-term interest rates,

long-term yield rates did not follow this trend due to solid investor demand and massive stimulating asset purchase programmes in Europe and Japan.

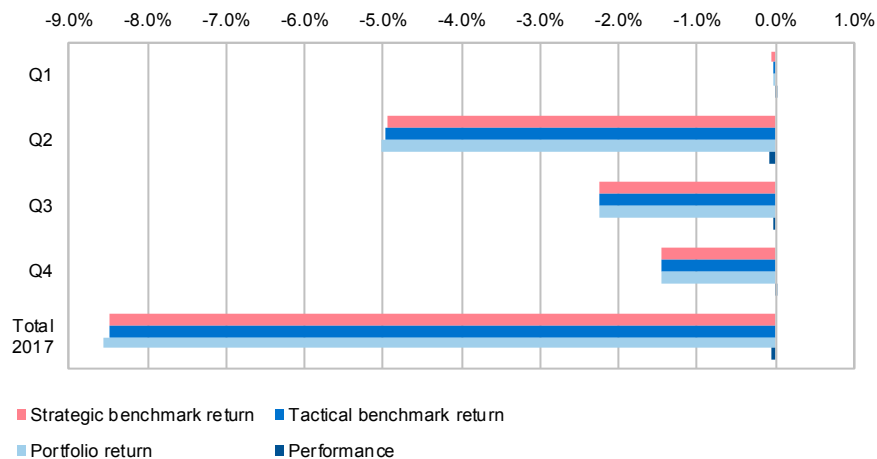
**Chart III.1.6 Portfolio and benchmark return in original currency in 2017**



Source: NBS.

Bank of England raised its key policy rate from 0.25% to 0.5% in November for the first time in ten years, at the same time indicating Brexit-related risks.

**Chart III.1.7 Total portfolio and benchmark return recalculated in RSD, by quarter**



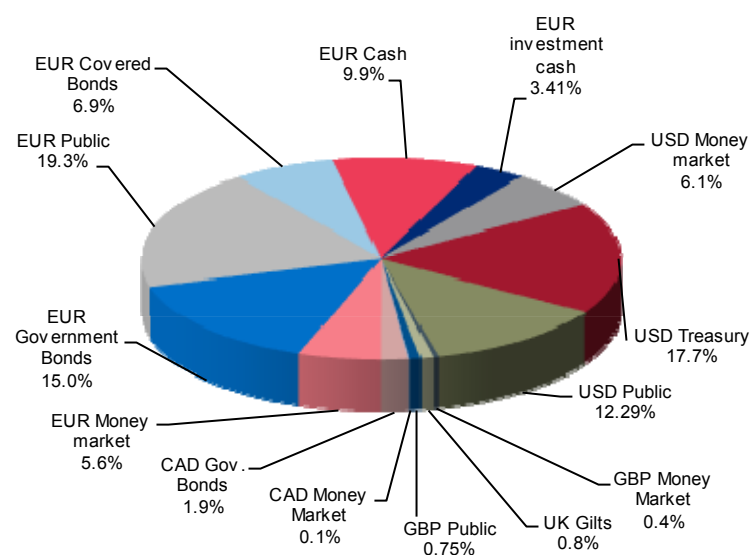
Source: NBS.

In parallel, the ECB did not raise interest rates despite signs of improved economic growth. Incentives aimed at reviving the European economy gave new impetus to the European economy and financial markets. These incentives include the extension of the asset purchase programme until September 2018 with the reduction in the 2018 monthly purchase volume and maintenance of negative interest rates. All of the above had a positive impact on the euro, which appreciated against the US dollar by 13.22%, against the pound sterling by 4.51% and against the Canadian dollar by 6.53%. Yields in original currencies and the dinar's appreciation against the euro and, consequently, against other currencies in the

portfolio, resulted in negative yield of the total portfolio calculated in dinars, amounting to -8.55%.

The structure of the investment portfolio by type of assets and the currency structure were aligned with the Guidelines for the Management of FX Reserves of the National Bank of Serbia.

Chart III.1.8 **Composition of investment portfolio**  
as at 29 Dec 2017



Source: NBS.

In 2017, the NBS invested in highly liquid bonds with low market and credit risk. Currency risk was largely offset by matching the currency structure of FX reserves and external debt of the country, while interest rate risk was offset by maintaining low portfolio duration. This is also confirmed by low value-at-risk (VaR) which estimates the value of market risk for the given level of confidence, calculated by individual portfolios and various calculation methods.

Table III.1.1 **Value-at-Risk (VaR) as at 31 December 2017**  
(degree of probability 95%, reference period one day)

	EUR portfolio	USD portfolio	GBP portfolio	CAD portfolio
Parametric VaR	0.02%	0.03%	0.04%	0.04%
Historical VaR	0.02%	0.03%	0.05%	0.04%
Monte Carlo VaR	0.02%	0.03%	0.04%	0.04%

Source: NBS.

Stress testing indicates the percentage by which the market value of the NBS portfolio would decrease in case of a sudden and unexpected 1.00% rise in market yield rates.

Table III.1.2 Stress test as at 31 December 2017

(observed period one day)

Scenario	Change in market value			
	EUR portfolio	USD portfolio	GBP portfolio	CAD portfolio
Rise in market interest rates by 100 bp	-1.08%	-0.95%	-1.08%	-1.05%

Source: NBS.

In order to manage credit risk, the NBS set high criteria for investing in banks with the minimum composite rating of AA-. The minimum eligible combined credit rating for government bonds and issuers is A according to Standard & Poor's, Moody's and Fitch. For securities in the portfolio which are not fully guaranteed by the government (public sector bonds) the minimum combined credit rating is A+ according to Standard & Poor's, Moody's, and Fitch, while for bonds covered with collaterals the minimum combined credit rating is AA according to Standard & Poor's, Moody's and Fitch. In 2017, Moody's lowered the Chinese credit rating from Aa3 to A1 and raised the credit rating of Ireland from A2 to A3. Standard & Poor's lowered the credit rating of China and a certain number of Chinese financial institutions from AA- to A+. The credit rating of other issuers and bonds in the NBS portfolio remained the same as in 2016, according to all rating agencies.

In addition to financial indicators from bank balance sheets, other credit risk indicators were also monitored, such as five-year CDS<sup>46</sup> spread for the bank.

All other indicators: tracking error, VaR backtesting and credit limits set for foreign banks stayed within the prescribed values during 2017, as defined by the Strategic Guidelines for the Management of FX Reserves of the National Bank of Serbia.

## Plans for 2018

In order to expand securities lending transactions to the portion of bonds from the portfolio with the Deutsche Bundesbank, Frankfurt, the NBS will sign the Transaction Bank Relationship Management Agreement (TBA) with this bank in 2018. The income made from the above operations is expected to compensate for the costs of custody services charged by the Deutsche Bundesbank, Frankfurt to the NBS.

In order to further improve the process of monitoring the results of FX operations in 2018, the NBS plans to introduce new reports on monitoring the process of FX reserve management and an accounting report on business results.

Regular foreign payment transactions will continue in 2018, aimed at timely settlement of all NBS and government liabilities with constant improvement of

<sup>46</sup> CDS (Credit Default Swap) spread is a market risk indicator. It includes the implicit probability of the issuer's bankruptcy according to market assessment. CDS spread is frequently a better indicator of credit migration than rating by credit agencies, given its immediate reaction and reliance on the assessment of a large number of market participants.

international banking standards and practice. Cooperation with the Ministry of Finance – Treasury Administration will also be accordingly enhanced in order to perform foreign payment transactions through the consolidated treasury account system for foreign currency reserves with the NBS. In addition, it will also continue to cooperate with other clients holding accounts with the NBS in accordance with law.

## III.2 Issue of banknotes and coins and cash management

### III.2.1 Issue of banknotes and coins

#### Currency in circulation

During 2017, currency in circulation included banknote series issued by the NBS from 2003 onwards – banknotes in denominations of 10, 20, 50, 100, 200, 500, 1,000, 2,000 and 5,000 dinars and coins in denominations of 1, 2, 5, 10 and 20 dinars.

As at 31 December 2017, currency in circulation (excluding currency kept in the NBS vaults, cash vaults of banks and the Ministry of Finance) totalled RSD 163.9 bn (banknotes and coins), up by 2.9% on end-2016. Of this amount, banknotes accounted for 98.7% (RSD 161.7 bn) and coins for 1.3% (RSD 2.2 bn). These percentage shares remained unchanged from end-2016.

Table III.2.1.1 Denomination structure of currency in circulation

Denomination	31 December 2016		31 December 2017	
	RSD mn	In %	RSD mn	In %
RSD 5,000	13,741	8.8	13,964	8.6
RSD 2,000	69,025	43.9	82,274	50.9
RSD 1,000	57,305	36.4	47,578	29.4
RSD 500	9,171	5.8	9,544	5.9
RSD 200	3,459	2.2	3,620	2.2
RSD 100	2,171	1.4	2,217	1.4
RSD 50	1,114	0.7	1,192	0.7
RSD 20	714	0.5	765	0.5
RSD 10	531	0.3	576	0.4
<b>Total:</b>	<b>157,231</b>	<b>100.0</b>	<b>161,730</b>	<b>100.0</b>

Source: NBS.

#### *Denomination structure of currency in circulation*

At end-2017 there were 270.5 mn pieces of banknotes in circulation, by 7.5 mn or 2.9% more than at end-2016.

The share of 2,000-dinar banknotes increased, while that of 1,000 and 5,000 dinars declined. The share of banknotes of other denominations remained at the similar level as in 2016.

In 2017, 500-, 1,000-, 2,000- and 5,000-dinar banknotes accounted for 94.8% of the cash payment transactions, thus slightly decreasing their share from end-2016 (by 0.1 pp).

There were 735.7 mn circulating coins at end-2017, up by 54.8 mn or 8.1% compared to end-2016.

The denomination structure of circulating coins shows the prevalence of 1-dinar coins (45.4%), followed by 5-dinar coins (24.6%) and 2-dinar coins (24.3%), while 10- and 20-dinar coins held smaller shares (3.3% and 2.5%, respectively).

## Production of banknotes and coins

To meet the needs of cash payment operations and replace banknotes unfit for circulation, the NBS produced additional banknotes in denominations of 200 and 10 dinars in 2017 (in total 24.7 mn). The production of the rest of denominations of 200, 50 and 20 dinars, planned for 2017, will be carried out in 2018. In 2017, it also continued producing coins under the production programme for 2016 (13.2 mn of 1-dinar coins).

## Expert analysis of banknotes and coins

In the process of aligning domestic with the EU regulations, in 2017 the Decision on Handling Suspected Counterfeit Money was adopted (RS Official Gazette, No 111/2017), which concluded the aligning process in the area of the protection of the euro against counterfeiting.

In the process of expert analysis of suspect counterfeits, 5,834 counterfeit banknotes were detected in 2017, down by 5.5% than in 2016. In nominal terms, this is a 22.0% decrease (RSD 7,126,600.00 in 2017 relative to RSD 9,133,400.00 in 2016).

In value terms, most counterfeits were in the denomination of 2,000 dinars, followed by 1,000, 500 and 5,000-dinar notes. In percentage terms, these four denominations taken together accounted for 99.9% of the total number of detected banknote counterfeits.

**Table III.2.1.2 Overview of detected banknote counterfeits**  
(in pieces)

Denomination	5,000	2,000	1,000	500	200	100	50	20	10	Total in 2017
Pieces	129	1,510	2,770	1,372	7	38	8	0	0	5,834
Share in %	2.2	25.9	47.5	23.5	0.1	0.7	0.1	0	0	100

Source: NBS.

A comparison of the number of detected dinar counterfeits with that of genuine dinar banknotes in circulation reveals that 17.6 in every 1 million circulating

banknotes were found to be counterfeit, i.e. in nominal terms, there was RSD 36,006 worth of counterfeits in every RSD 1 billion.

**Table III.2.1.3 Overview of detected banknote counterfeits**

(in RSD thousand)

Denomination	5,000	2,000	1,000	500	200	100	50	20	10	Total in 2017
Amount	645	3,020	2,770	686	1.4	3.8	0.4	0	0	7,126.6
Share in %	9.1	42.4	38.9	9.6	0.0	0.1	0.0	0	0	100

Source: NBS.

The largest share of detected counterfeits was produced on commercial paper using inkjet or laser printers, or colour photocopying machines of the newer generation. They were therefore considered bad and medium-quality counterfeits. The only exception was one type of 1,000-dinar banknote counterfeit, produced on security paper with threads that fluoresce under a UV lamp, which was considered a good quality counterfeit. There were no very good quality or dangerous types of detected counterfeits.

## Commemorative coins

In 2017 no gold and silver commemorative coins were issued to mark events of national or global importance.

## III.2.2 Cash management

### Cash cycle

In 2017, a total of 507.7 mn pieces of banknotes and coins worth RSD 400,744.3 mn nominally were paid out to banks. Relative to 2016, the quantity decreased by 6.1% (33.1 mn pieces), while the nominal value of banknotes and coins fell by 6.5% (RSD 27,986.5 mn).

A total of 429.6 mn pieces of banknotes and coins in the nominal value of RSD 394,511.1 mn were paid in by banks. Relative to 2016, the quantity decreased by 3.5% (15.7 mn pieces), while the nominal value of banknotes and coins fell by 3.0% (RSD 12,370.2 mn). The decrease in dinar cash inpayments and outpayments in 2017 was mostly prompted by further substitution of 1,000-dinar banknotes by 2,000-dinar ones, which was the initial intention in order to cover the same nominal value of inpayments and outpayments using a smaller number of banknotes. The share of other denominations in inpayments and outpayments, in nominal value, remained relatively unchanged from 2016.

Regarding coins, as observed in earlier years, there was a significant imbalance between inpayments and outpayments, both in terms of quantity and the nominal value (only 3.3 mn pieces were paid in, in the nominal amount of RSD 29.9 mn, while 72.7 mn pieces of coins were paid out, amounting to RSD 240.6 mn in

nominal terms). Like in previous years, such imbalance was offset by additional production of coins needed to execute cash payment transactions.

## Processing and destruction of banknotes and coins

In the NBS count rooms, 434.5 mn pieces of banknotes were processed, in the nominal amount of RSD 396,944.2 mn, of which 82.2% (or 357.0 mn pieces) were found fit for circulation. The share of fit banknotes in nominal terms was 90.7% (or RSD 360,204.0 mn). The velocity of circulation, calculated as the number of processed banknotes relative to the number of banknotes in circulation, was 1.6 in 2017.

During 2017, a total of 71.1 mn pieces of banknotes unfit for circulation, worth RSD 34,505.1 mn nominally, were destroyed. The renewal index (number of destroyed banknotes to the number of banknotes in circulation) was 26.3. In addition, 300,000 mn pieces of maculated banknotes of 10-dinar denominations were destroyed. The cash and coin processing procedure, introduced in late 2008, was running smoothly. It was carried out in three BPS 1040 automated systems for banknote sorting, packing and destruction, two BPS 216 automated banknote sorting machines, four automated banknote sorting machines BPS C4-4S and two banknote processing machines Numeron F. It is expected that the high standard of the circulating banknote quality will be maintained in the coming period, that processing will be updated and the quantity of processed banknotes lowered.

## Plans for 2018

To achieve strategic and operational objectives aimed at ensuring the adequate volume, quality and denomination structure of currency in circulation and to replenish the stocks in its vaults, in 2018 the NBS plans to produce an additional quantity of 90.0 mn pieces of banknotes (2,000-, 200-, 50-, 20- and 10-dinar denominations) and 85.0 mn coins (1-, 2- and 5-dinar denominations).

### III.2.3 Activities of NBS branches

In 2017, the NBS branches performed vault and teller operations as part of cash management and organised education of financial service consumers about financial products and services of institutions supervised by the NBS.

#### Belgrade Branch

In the process of managing the flow of cash and other valuables in 2017, the Belgrade Branch received from and delivered to banks dinar and foreign cash, and provided them with uniform blank bills of exchange, received foreign cash from government bodies, sold commemorative coins and performed safe custody operations.

**Table III.2.3.1 Cash management and foreign cash operations  
– Belgrade Branch**

(RSD, unless specified otherwise)

Type of operation	Turnover		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash inpayments by banks	228,633,728,000	240,631,680,000	240,631,680,000	105.2
Cash outpayments to banks	250,560,897,850	231,795,415,520	231,795,415,520	92.5
Foreign cash inpayments by banks	29,814,418*	23,685,016*	2,806,027,769**	79.4
Foreign cash inpayments by government bodies	1,667,084*	1,396,553*	165,453,448**	83.8
Inpayments through consolidated FX treasury account	/	162,920*	19,301,550**	/
Foreign cash outpayments to banks	263,437,102*	83,661,100*	9,911,556,395**	31.7
Outpayments through consolidated FX treasury account	/	930,651*	110,256,766**	/
<b>TOTAL</b>			<b>485,439,691,448</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

Source: NBS.

In 2017, total inpayments from banks increased by 5.2%, while outpayments to banks dropped by 7.5% from 2016. Inpayments of foreign cash, in nominal amount, recorded a significant fall relative to 2016 (20.6%), while outpayments edged down by as much as 68.3%. The NBS received EUR 1.4 mn from government bodies, by 16.2% less than in the previous year.

The Belgrade Branch processed 349.8 mn pieces of banknotes, i.e. RSD 319.2 bn, as well as all foreign cash received from banks operating in the territory of the Republic of Serbia, i.e. 4.5 mn pieces of banknotes in the equivalent of EUR 391.2 mn.

**Table III.2.3.2 Cash and foreign cash processing  
– Belgrade Branch**

(RSD, unless specified otherwise)

Type of operation	Processed		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash processed				
– nominal value	359,328,238,849	319,254,161,188	319,254,161,188	88.8
– pieces	373,205,367	349,839,450	349,839,450	93.7
Foreign cash processed				
– nominal value	762,252,768*	391,170,848*	46,343,066,524**	51.3
– pieces	8,257,356	4,540,193	4,540,193	55.0
<b>TOTAL</b>				
– nominal value			<b>365,597,227,712</b>	
– pieces			<b>354,379,643</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

Source: NBS.

A total of 89.5 mn banknotes, worth RSD 48.9 bn (25.6% of the total volume of banknotes processed), were found to be unfit for circulation and were consequently destroyed.

Total 6,469 dinar banknotes and 197 foreign currency banknotes were sent for expert analysis as being suspect counterfeits. In addition, the Branch handed over 2.2 mn blank bills of exchange worth RSD 111.6 mn to commission banks and organised 17 sales of commemorative coins in the total amount of RSD 415,548.45. It also received 15 and issued 14 safe custody items (as at 31 December 2017, the number of items in safe custody was 245). Given that it holds an electronic database of account statements and payment orders from accounts of government bodies, legal entities and entrepreneurs, the Belgrade Branch processed 78 applications requesting copies of account statements, payment orders and statements on balance and changes in accounts (until 31 December 2002, these records were kept by the National Bank of Yugoslavia – Accounts and Payment Bureau, ZOP), and also issued 55 fee payment notifications for services provided.

## Novi Sad Branch

In 2017, the Novi Sad Branch processed 2,784 cash inpayment and outpayment transactions with banks and the Treasury Administration and 196 foreign cash inpayment and outpayment transactions with banks and customs, judiciary and other government bodies, in the total amount of RSD 106.2 bn. The Novi Sad Branch processed all foreign cash inpayments from customs, judiciary and other government bodies at its tellers upon receipt. In the reporting period, as part of vault operations, the Branch received 17 and issued five safe custody items.

Table III.2.3.3 **Cash management and foreign cash operations – Novi Sad Branch**  
(RSD)

Type of operation	Turnover		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash inpayments	54,964,587,500	51,977,517,500	51,977,517,500	94.6
Cash outpayments	53,693,422,500	54,241,394,000	54,241,394,000	101.0
Foreign cash inpayments by banks	12,566,622*	8,994,416*	1,065,592,748**	71.6
Foreign cash inpayments by government bodies	2,029,516*	1,205,247*	142,788,866**	59.4
Foreign cash outpayments to banks	38,543,943*	11,390,754*	1,349,493,381**	29.6
Outpayments through consolidated FX treasury account	0*	118,365*	14,023,021**	-
Inpayments through consolidated FX treasury account	0*	11,355*	1,345,258**	-
<b>TOTAL</b>			<b>108,792,154,774</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

Source: NBS.

Also, based on the Decision on the Manner of Performing Transactions Between the NBS and the Treasury Administration, applied since 27 February 2017, the Branch carried out 187 transactions worth EUR 118.4 thousand in outpayments and 61 transactions worth EUR 11.4 thousand in inpayments, through the consolidated treasury account system for foreign exchange funds.

In addition, as part of its teller operations, the Branch handed over 439,000 blank bills of exchange worth nominal RSD 22 mn to commission banks. In 22 transactions with natural persons and legal entities, it sold 103 commemorative coin packs and vacuum sets of coins issued by the National Bank of Yugoslavia and the NBS, in the total amount of RSD 95.8 thousand. The Branch received 8,306 pieces of dinar and foreign currency banknotes which were suspect counterfeits, stained with colour or unfit for replacement, and they were sent for expert analysis.

In the reporting period, the Novi Sad Branch processed cash inpayments received at its tellers from banks and the Treasury Administration, as well as cash paid in to cash tellers of other branches in the NBS system. In total, RSD 84,287.4 mn, i.e. 93.5 mn pieces of banknotes were processed. In the processing procedure, the Branch cancelled 11.2 mn pieces of banknotes, worth RSD 4,001.8 mn and destroyed 3.7 mn banknotes, worth RSD 1,912 mn. In the course of processing, 61 suspect counterfeits were sent for further expert analysis. In the processing procedure, the Branch also set aside 2,639 non-circulating coins and 25 non-circulating banknotes whose replacement term expired.

In 2017, the Novi Sad Branch processed 218 applications requesting copies of statements of changes in accounts (until end-2002, these records were kept by the National Bank of Yugoslavia – Accounts and Payment Bureau, ZOP).

## Niš Branch

In 2017, through dinar and foreign cash receipt from and delivery to clients (banks and government bodies), as part of cash management, the Niš Branch generated a turnover of RSD 99.1 bn.

A total of 1,316 cash inpayment transactions from banks and the Treasury Administration were worth RSD 43.2 bn, down by 13.3% from the year before, while 2,002 outpayment transactions amounted to RSD 53.1 bn, falling by 8.2% relative to the year before.

Inpayments of foreign cash from banks in 85 transactions, worth EUR 15.2 mn, declined by 19.4% relative to the previous year, while outpayments in 72 transactions, worth EUR 5.2 mn, edged down by 69.9% relative to 2016.

The NBS received EUR 3.4 mn from government bodies, through 132 transactions, by 11.6 % more than in the previous year.

The Niš Branch processed 9.5 mn pieces of banknotes in nominal amount of RSD 13.4 bn.

Branch tellers received 470 pieces of dinar banknotes and 117 pieces of foreign currency suspect counterfeit banknotes and sent them for expert analysis.

Table III.2.3.4 **Cash management and foreign cash operations – Niš Branch**  
(RSD, unless specified otherwise)

Type of operation	Turnover		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash inpayments	49,808,924,000	43,171,079,000	43,171,079,000	86.7
Cash outpayments	57,796,739,000	53,074,856,000	53,074,856,000	91.8
Foreign cash inpayments by banks	18,884,801*	15,228,300*	1,804,137,817**	80.6
Foreign cash inpayments by government bodies	3,026,107*	3,376,338*	400,003,879**	111.6
Foreign cash outpayments to banks	17,258,156*	5,200,877*	616,161,940**	30.1
<b>TOTAL</b>			<b>99,066,238,636</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

Source: NBS.

During 2017, through three transactions, the Niš Branch sold commemorative coins issued by the NBS to natural persons in the total amount of RSD 29,852.0.

In addition, the Branch handed over 317,000 blank bills of exchange to commission banks, worth RSD 15.8 mn nominally.

Since the Niš Branch keeps a part of the electronic database of copies of payment orders and changes in accounts (until end-2002, these records were kept by the National Bank of Yugoslavia – Accounts and Payment Bureau, ZOP), in 2017 it processed 26 applications and issued eight such copies.

## Kragujevac Branch

In 2017, the Kragujevac Branch performed vault and teller operations as part of cash management and organised education of financial service consumers about financial products and services of institutions supervised by the NBS.

Through 3,101 dinar inpayment and outpayment transactions with banks and the Treasury Administration, 197 foreign cash inpayment and outpayment transactions with banks, customs, judiciary and other government bodies, 36 inpayments and outpayments through the consolidated treasury account system and 2,254 transactions of buying and selling foreign cash from/to natural persons, the Kragujevac Branch generated a turnover of RSD 79.9 bn in 2017.

Table III.2.3.5 **Cash management and foreign cash operations – Kragujevac Branch**

(RSD, unless specified otherwise)

Type of operation	Turnover		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash inpayments	43,258,690,720	36,434,295,000	36,434,295,000	84.2
Cash outpayments	33,720,120,720	40,252,547,500	40,252,547,500	119.4
Foreign cash inpayments by banks	36,253,845*	22,258,475*	2.637.021.631**	61.4
Foreign cash outpayments to banks	47,719,897*	4,746,964*	562,385,642**	9.9
Foreign cash inpayments by government bodies	25,064*	7,924*	938,778**	31.6
Inpayment through the consolidated FX treasury account	-	1,640*	194,295**	-
Outpayment through the consolidated FX treasury account	-	54,440*	6,449,654**	-
Purchase of foreign cash from natural persons	132,275*	115,982*	14,079,194**	87.7
Sale of foreign cash to natural persons	84,383*	67,036*	8,172,157**	79.4
<b>TOTAL</b>			<b>79,916,083,851</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

\*\*\* In the dinar equivalent at the daily middle exchange rate.

Source: NBS.

In addition, the Kragujevac Branch handed over 315,000 blank bills of exchange to commission banks, worth RSD 15.7 mn nominally. The Branch sold commemorative coins and performed nine transactions worth RSD 142,976.2. It received 326 pieces of dinar and foreign currency banknotes, worth RSD 393,481.0, suspect of being counterfeits, stained with colour or unfit for replacement, and sent them to further expert analysis. In 2017, the Kragujevac Branch processed 9.3 mn pieces of banknotes in nominal amount of RSD 12.6 bn.

In 2017, the Branch also processed 3 applications for the issuance of copies of payment orders and statements on changes in accounts (until 31 December 2002, these records were kept by the National Bank of Yugoslavia – Accounts and Payment Bureau, ZOP).

## Užice Branch

In 2017, the Branch received dinar cash inpayments worth RSD 22,049.1 mn and handed over dinar cash outpayments worth RSD 21,194.9 mn from banks. Dinar and foreign currency inpayments and outpayments declined in 2017 relative to 2016.

In 2017, it supplied commission banks with 207,000 blank bills of exchange, worth RSD 10,350 mn, up by 6.7 % relative to 2016. Also, it received 345 suspect/stained with colour counterfeit dinar and foreign currency banknotes and sent them to further expert analysis. During 2017, the volume of sold commemorative coins significantly decreased relative to 2016.

Table III.2.3.6 Cash management and foreign cash operations – Užice Branch

(RSD, unless specified otherwise)

Type of operation	Turnover		Total in 2017	Index 2017/2016
	In 2016	In 2017		
Cash inpayments by banks	29,942,978,500	22,049,087,500	22,049,087,500	73.6
Cash outpayments to banks	32,771,485,500	21,194,851,000	21,194,851,000	64.7
Foreign cash inpayments by banks	793,688*	157,351*	18,641,798*	19.8
Foreign cash inpayments by government bodies	10,600*	5,190*	614,873*	49.0
Foreign cash outpayments to banks	16,363,219*	2,024,860*	239,890,631*	12.4
<b>TOTAL</b>			<b>43,503,085,802</b>	

\* EUR.

\*\* In the dinar equivalent at the middle exchange rate for foreign cash as at 29 December 2017.

Source: NBS.

In the reporting period, the Užice Branch processed cash inpayments received at its tellers from banks and the Treasury Administration, as well as cash paid in to cash tellers of other branches in the NBS system.

A total of 31.4 mn banknotes, in nominal amount of RSD 23,941.3 mn were processed.

In the processing procedure, the Branch cancelled 6.3 mn pieces of banknotes, worth RSD 1,333.8 mn and destroyed 30,422 banknotes, worth RSD 19.6 mn. In the course of processing, 43 suspect counterfeits were set aside and sent for further expert analysis. In the processing procedure, the Branch also set aside 22 non-circulating banknotes whose replacement term expired.

In 2017, the Užice Branch processed 9 applications requesting copies of payment orders and statements of changes in accounts (until 31 December 2002, these records were kept by the National Bank of Yugoslavia – Accounts and Payment Bureau, ZOP).

## Plans for 2018

As regards vault and teller operations, further technical and technological improvements are planned in the processing of dinar and foreign cash.

### **III.3 Payment system**

#### **III.3.1 Payment system and payment card activities**

##### **NBS as the payment system operator**

The NBS operates four payment systems: for processing dinar payments in the country – the RTGS (Real Time Gross Settlement) and clearing system, DinaCard clearing system and the system of interbank and international clearing of foreign exchange payments.

At the beginning of the year, the RTGS and clearing system included 35 participants – 31 banks, the Ministry of Finance – Treasury Administration, Central Securities Depository and Clearing House, Association of Serbian Banks and the NBS. During the year, some domestic banks merged to form a system of 33 participants, of which 29 banks, at end-2017.

At end-2017, the DinaCard clearing system comprised 25 banks and seven processing houses, while 19 banks participated in the settlement of transactions under payment cards in Visa and MasterCard systems. The number of participants in the system of interbank and international clearing of foreign exchange payments was 20, involving: 14 banks from the Republic of Serbia, the NBS and five banks from Bosnia and Herzegovina.

A total of 205.9 mn payments were made through the RTGS and clearing system of the NBS in 2017, of which 75.0% were RTGS and 25.0% clearing payments. The total number of payments increased by 2.8% relative to 2016. A total worth of payments effected in the RTGS and clearing system was RSD 46,858.3 bn.

The share of RTGS payments in the turnover was 99.1%. In 2017, RTGS and clearing system availability was 100%. Out of the total number of transactions in the DinaCard system, 30 mn transactions were effected through the clearing system of the NBS, which is an increase of 5.0% from a year earlier.

The turnover totalled RSD 46.4 bn, up by 4.0% relative to the previous year. Thereby, 95% of transactions and 82% of the turnover effected through switch were payment transactions for goods and services. The availability of the central switch in the DinaCard payment system was 100% in 2017.

*RTGS system*

Table III.3.1.1 Value of turnover and number of payments in RTGS

(turnover in RSD bn, number of payments in mn)

2017	Number of business days	Number of payments	Value of turnover	Daily average turnover
January	20	10.5	3,712.8	185.6
February	18	11.6	3,201.8	177.9
March	23	13.1	3,396.4	147.7
April	18	12.0	3,065.0	170.3
May	21	13.6	4,151.3	197.7
June	22	13.2	3,616.8	164.4
July	21	12.6	3,586.3	170.8
August	23	12.8	4,199.6	182.6
September	21	12.5	4,216.3	200.8
October	22	13.6	4,385.0	199.3
November	22	13.6	4,574.6	207.9
December	21	14.9	4,326.3	206.0
<b>Total</b>	<b>252</b>	<b>154.0</b>	<b>46,432.3</b>	
			<b>Monthly average: 3,869.4</b>	<b>Daily average: 184.2</b>

Source: NBS.

The RTGS is a system for real-time gross settlement of interbank and urgent payments. A total of 154.0 mn payments, worth RSD 46,432.3 bn, were processed through the RTGS in 2017, up by 9.5 mn (6.6%) from 2016. The monthly average number of payments was 12.8 mn, while the monthly average value of the turnover was RSD 3,869.4 bn. The highest turnover was recorded in November (RSD 4,574.6 bn).

*Clearing system*

The clearing system is a system for the exchange and processing of individual or aggregate payment orders of payment system participants, on a multilateral net basis.

A total of 52.0 mn payments, worth RSD 426.0 bn, were effected in the clearing system in 2017 (RSD 5.0 bn, or 1.2% more than in 2016). The monthly average number of payments was 4.3 mn in 2017, while the monthly average value of the turnover was RSD 35.5 bn.

The highest turnover was recorded in May (RSD 38.6 bn).

Table III.3.1.2 Value of turnover and number of payments in clearing system

(turnover in RSD bn, number of payments in mn)

2017	Number of business days	Number of payments	Value of turnover	Daily average turnover
January	20	3.9	30.0	1.5
February	18	4.4	31.7	1.8
March	23	4.7	38.4	1.7
April	18	4.0	33.4	1.9
May	21	5.2	38.6	1.8
June	22	4.7	38.2	1.7
July	21	4.2	36.2	1.7
August	23	4.4	36.8	1.6
September	21	4.0	34.4	1.6
October	22	4.3	37.1	1.7
November	22	4.3	35.4	1.6
December	21	4.0	35.9	1.7
<b>Total</b>	<b>252</b>	<b>52.0</b>	<b>426.0</b>	
			<b>Monthly average: 35.5</b>	<b>Daily average: 1.7</b>

Source: NBS.

*DinaCard clearing system*

The DinaCard clearing system is a payment system of the NBS used for processing and netting of transfer orders submitted by participants in the system through payment transactions executed using DinaCard payment cards. In 2017, over 42.5 mn transactions were carried out (up by 4% relative to 2016), with the turnover of RSD 125.5 bn (up by 3% relative to 2016). Of this, 71% of transactions and 32% of trading were recorded at PoS (payments for goods and services), while the rest were cash withdrawal transactions. Debit cards dominated, accounting for over 98% of turnover and transactions. As at end-2017, there were 1.9 mn issued DinaCard payment cards in the market.

The main activities of the NBS regarding the management of the national payment card system were as follows:

- cooperation with participants within the system and support in launching new products;
- cooperation with the Chinese national payment card system China UnionPay;
- continuation of cooperation with Discover Financial Services in accepting DinaCard payment cards abroad;
- activities aimed at promoting the national payment card;
- participation in drafting proposals of domestic regulations in the field of payment card operations.

The most significant activity during 2017 was setting up business and technical cooperation with the Chinese national payment card system China UnionPay, which was established in 2002 and is the most dominant payment card system in the world, with over 6.5 bn issued cards, i.e. almost 50% of the global market. Also, China UnionPay is the fastest growing system in the world in the previous years, with pronounced development of new technologies, such as payments based on the defined QR code. It has a 75% share in the global market and holds a leading position regarding the number of contactless payment cards issued, which are accepted in over 160 states and territories across the world. The international branch of this company – UnionPay International was established in 2012, with the aim of widening the global acceptance network, encouraging the issuance of UnionPay cards through introducing innovative products and services in other countries, and using new payment technologies.

Owing to the signing of the Memorandum of Understanding between the NBS and UnionPay International, a path was opened for defining the model of cooperation that would enable technological improvement of DinaCard payment cards, acceptance of the domestic card abroad in the UnionPay International network, as well as acceptance of UnionPay cards in Serbia in the DinaCard acceptance network. Establishing this business cooperation is a logical continuation of excellent cooperation between the Republic of Serbia and the People's Republic of China, and a concrete result of traditional and firm friendship of the two countries. In this respect, after significant improvement in trade relations, cultural exchange and an increasing number of Chinese tourists visiting or intending to visit our country, it was quite natural to launch a project that should result in a common, secure and efficient infrastructure of card systems, to the satisfaction of both Chinese and our citizens and companies.

During 2017, special co-brand programmes were established with individual national companies in the DinaCard system. The certification of Procredit Bank a.d. was completed for accepting DinaCard payment cards at PoS, and of Halkbank a.d. for independent processing. The certification of Banka Poštanska štedionica a.d. was also initiated for independent processing. In addition, in cooperation with the E-Government Directorate within the Ministry of Public Administration and Local Self-Government, citizens are now able to pay with DinaCard cards on the E-Government Portal. The system introduced two new features – “Withdraw dinars”, allowing for dinar cash outpayments at PoS within the DinaCard system. It also introduced the mPOS system allowing for electronic payments at PoS by using card readers and mobile devices with an appropriate application. In order to promote the national payment card, a new, improved DinaCard system website was created, and a public competition for the selection of the new DinaCard payment card logo was held. The payment gateway of the NBS was designed and internally developed, which will be used for payment by DinaCard payment cards of services provided by the NBS.

### *System of interbank and international clearing of foreign exchange payments*

The interbank and international payments clearing enables the processing of euro payments between banks in the Republic of Serbia and payments with banks from Bosnia and Herzegovina. Payment transactions between banks in Serbia and those in Bosnia and Herzegovina are settled on a multilateral net basis.

During 2017, 54,845 payments worth EUR 428.0 mn were processed in the system (or 3.9% more than in 2016). The monthly average number of payments was 4,570, while the monthly average value of the turnover was EUR 35.7 mn. The highest turnover was recorded in December (EUR 50.4 mn). System availability in 2017 was 100%.

### *Project for developing an instant payment system*

In Q1 2017, the NBS initiated activities on implementing a new payment system for instant payments (IPS NBS payment system) as the most modern payment model so far. In that way, the NBS, as a payment system operator, stands next to operators from the most developed European countries that work on enabling the service of instant payments. Instant payments allow for cashless transfer of funds, which can be effected in any moment, with an instant payment confirmation and instant availability of funds to the payee, implying that all participants in the system will be obliged to provide constant availability of the instant payment service. This type of service will be available at PoS, through mobile and electronic banking, or by using other service that the bank provides for instant payments, and will be particularly suitable for e-commerce payments.

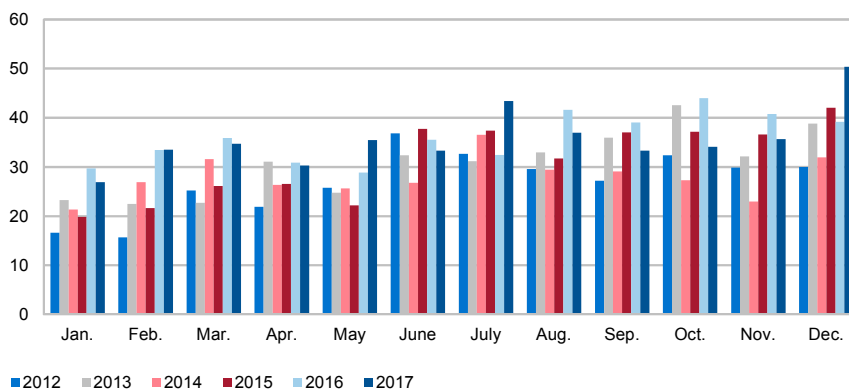
During the second half of 2017, activities related to the drafting of the Rules which further regulate the operations of the IPS NBS payment system were launched. These activities were preceded by a thorough research of comparative practices and similar solutions in the world, primarily in the EU, where the instant payment system is currently being implemented. Since the very beginning of the implementation of this project, the NBS had close, direct and constructive cooperation with payment service providers, which fully supported this project. The instant payment project will be carried out through the improvement of the existing software platform of the RTGS payment system, given the far greater financial and technical advantages of such a solution compared to the development and implementation of a completely new payment system and infrastructure. The settlement of monetary obligations between participants in the instant payment system will be effected through accounts with the RTGS payment system.

## **Regulatory activity**

During 2017, the NBS continued to give opinions and answers regarding the implementation of the Law on Payment Services and its by-laws, and drafting of two new laws was finalised – the Draft Law on the Comparability of Fees for

Payment Services Linked to Payment Account, Payment Account Switching and the Right to a Payment Account with Basic Features, and the Draft Law on Multilateral Interchange Fees and Special Operating Rules for Card-Based Payment Transactions.

Chart III.3.1.1 **Turnover in international clearing**  
(in EUR mn)



Source: NBS.

The Draft Law on the Comparability of Fees for Payment Services Linked to Payment Account, Payment Account Switching and the Right to a Payment Account with Basic Features should enable greater transparency and comparability of fees for payment services relating to payment accounts, create assumptions for fast and simple procedure of payment account switching from one to another financial institution, as well as determine in which cases and under what conditions it is possible to open a payment account with basic features. The first version of this Draft Law was prepared at the end of December 2017.

The Draft Law on Multilateral Interchange Fees and Special Operating Rules for Card-Based Payment Transactions aims to eliminate certain operating rules in the area of card payments, which are limiting factors for the development of cashless payments by this payment instrument. The proposed reduction in interchange fees will give a great impetus to the greater acceptance of card payments by merchants, especially medium- and small-sized, that is, a contribution to an increase in the share of cashless in total payments, thereby reducing the grey economy, bearing in mind that this relates to fees that are the main generator of high costs of card payments. This Draft Law was at the public debate in the period from May to September 2017, when interested persons had the opportunity to contribute to the improvement of the Draft Law with their proposals and comments.

In 2017 the NBS adopted amendments to the by-laws in the field of payment transactions, which stipulate the provisions regarding the non-obligatory use of seals of companies, supporting the Government to create a more favourable business ambience and improve the position of our country on the Doing Business list of the World Bank. In addition, in cooperation with the Policy and Legal Advice Centre – PLAC II, a project of assistance was initiated, regarding harmonisation of national legislation with Directive (EU) 2015/2366 on payment

services in the internal market, through recommendations for necessary changes in domestic legislation.

In June 2017, the NBS organised a very successful conference “E-Commerce in Serbia – a Safe Path for Online Purchases”, in cooperation with payment service providers that enable card payments on the internet in Serbia. The conference was held to further promote and develop e-commerce in the Republic of Serbia, to inform the general public about obstacles that merchants face, factors that influence the success of merchants in e-commerce, and promote safe and secure card payments on the internet.

## Payment system oversight

Activities of the NBS in performing its oversight function in 2017 were aimed at overseeing the current operations of payment systems and operators of those systems and analysing data and information provided by operators, in accordance with regulations, on a quarterly basis and in extraordinary reports, for the purpose of adequately detecting potential risks in payment systems and coordination of activities with operators for successful management of changes in these systems, which is important for their safe and stable operation.

According to the submitted reports, the payment systems in the Republic of Serbia operated without interruptions in 2017 (the availability of all payment systems was 100%), which indicates high reliability of these systems and smooth operation of transactions between their participants. Also, in netting payment systems, in 2017 there were no cases of non-settlement of monetary obligations in respect of net positions of participants at the moment when this is expected from them. Due to status changes in two banks (merger), the monitoring of the procedures for exclusion of these banks was enhanced, with no delays in the operation of payment systems. Additionally, monitoring focused on preparation of the draft operating rules and technical documentation regarding the IPS payment system of the NBS, as well as other relevant acts necessary for the future operation of this system.

## Plans for 2018

As part of the oversight function, the activities in 2018 will be directed towards further monitoring of the implementation of the IPS NBS payment system project, as well as the analysis of payment system operations and the operators of these systems, and taking appropriate measures to improve those operations so as to contribute to maintaining security and a high degree of availability of all payment systems.

Regarding regulatory activities, the NBS plans to continue implementing procedures regarding the adoption of prepared draft laws and further harmonisation with the EU *acquis*. It will also continue to promote state-of-the-art cashless payment methods, bearing in mind their significance in the contemporary world,

both for the individual and for society as a whole, while continuing to fully support the efforts of the Government in the field of digitisation, simplification and acceleration of administrative procedures, and the fight against the grey economy.

As for the operation of the national card system, in 2018, the NBS plans to define the model of cooperation with the Chinese national card system, to sign the necessary contracts, and then begin to issue the first joint payment cards DinaCard and UnionPay. In this regard, it also plans to improve the hardware and software used for switching in the DinaCard payment system, and to improve the internally developed solution for the clearing of payment cards to support the UnionPay system. Also planned is the increase in the number of internet acceptance points for the national card and promotional activities in schools and faculties to raise awareness among young people about the importance and advantages of a national payment card system. After registration of the new logo of the DinaCard system, the NBS will start with its commercial use. The plan is to complete the work on enabling payments via the internet with DinaCard cards for services provided by the NBS.

### III.3.2 Enforced collection

Since 2003, the NBS performs enforced collection pursuant to Article 57 of the Law on Payment Transactions.

In 2017, the NBS Enforced Collection received, checked and recorded 463,616 execution titles issued by Tax Administration units, customs, courts, public enforcement officers and other competent bodies, up by 8.6% relative to the last year. This was mainly due to an increase in the number of conclusions allowing debt recovery by public enforcement officers, which is a result of the start of implementation of the new Law on Enforcement and Security, as of 1 July 2016, which narrowed the competencies of the judiciary and broadened those of public enforcement officers. In all, 34,026 decisions were returned to the issuing bodies on account of irregularities. Of the total number, 373 decisions related to debtors whose debt is not collected electronically (trade unions, tenant assemblies and other debtors registered under the same identification number).

Somewhat less than a half of execution titles (49.5%) were decisions received from commercial, basic and misdemeanour courts, and public enforcement officers. Observed by type of court decisions received, a significant proportion related to the postponement and suspension of enforcement (17,201). A considerable number of decisions (104,244) received from central government tax authorities and local government tax units related to temporary measures aimed at securing the collection of tax liabilities by prohibiting late taxpayers to settle their financial liabilities to third parties by assignation, cession, compensation or otherwise.

In addition to the said decisions, the NBS also enforces court decisions on the institution, suspension and closing of bankruptcy proceedings against debtors. In 2017, the NBS received 404 decisions on instituting bankruptcy proceedings, 266 decisions on closing, 18 decisions on suspension and 44 decisions on suspension of

the proceedings in order to sell the debtor's assets. In addition, the NBS received 156 decisions on instituting a preliminary bankruptcy procedure with security measures, and 33 decisions on the adoption of the pre-pack reorganisation plan. Given that enforced collection against bank debtors is carried out through the exchange of electronic messages with banks and the Treasury Administration, more than 8.6 mn electronic messages were exchanged in the course of 2017.

During 2017, the NBS issued 22,148 certificates on the number of blockade days, total amount blocked and priority of collection of a particular order within pending titles and orders against a blocked debtor, as well as other data from the database. The fee for this service was charged in accordance with the NBS Tariff List. A large number of certificates and data were issued at the request of competent government authorities and organisations, free of charge. Also, a significant number of clients' requests and queries were answered in writing or through the call centre. On the NBS website, clients can access the Register of Blocked Debtors, Register of Received Claim Enforcement Decisions and Register of Bills of Exchange and Mandates. Clients can also use web services to obtain the data they need.

In accordance with regulations, the NBS informed on a daily basis commercial and basic courts and public enforcement officers of the fully enforced decisions, as well as of decisions not executed within 15 days from the date of their receipt.

Pursuant to the Law on Companies, in 2017 the NBS submitted 5,791 requests to the Business Registers Agency to strike off from the register the entrepreneurs blocked for longer than two years.

As of October 2015, in line with the Law on Payment Services, the NBS has kept the Single Register of Accounts of Natural Persons – Consumers. Based on 32,420 requests received from authorised persons and bodies in 2017, the NBS submitted account data for 33,604 natural persons.

In 2017, a number of meetings were initiated and held with government bodies to resolve problems relating to NBS handling of their orders, and to analyse the possibilities and methods of electronic data exchange. In addition, in cooperation with the Legal Department, the Enforced Collection began to negotiate an agreement on data exchange with the Ministry of Justice. The NBS also established contacts with other competent registration bodies for the purpose of obtaining, linking and updating data on economic entities falling under their remit.

## Plans for 2018

Activities relating to the establishment of contacts with competent registration bodies (line ministries, courts, chambers etc.) will continue in 2018. The NBS will also continue to implement activities concerning normative regulation of enforced collection and further comprehensive electronic linking and exchange of data with entities issuing enforced collection decisions, notably courts and tax administration authorities.

### III.4 Other activities

#### III.4.1 Economic analysis and statistics

##### *Economic analysis*

The main objective of economic analysis at the NBS is the provision of **analytical support** to the NBS Executive Board and the Council of the Governor in decision-making within their remit, and the enhancement of external communication with markets and the professional and wider public. In 2017 the NBS economic analysis and research focused primarily on areas that are of key importance for the performance of statutory activities of the NBS, i.e. preservation of price and financial stability. In addition, the NBS analyses gave insight into many significant issues and challenges for monetary and economic policy.

When making monetary policy decisions in 2017, the NBS relied on the analyses of macroeconomic developments at home, inflation projections and economic activity for the coming period, as well as factors from the international environment.

In the area of monitoring and analysing inflation, the focus was also placed on headline inflation and various indicators of core inflation which are especially relevant for monetary policy. The intensity of inflationary pressures was regularly assessed on both the demand and supply side. A special emphasis was placed on movements in food prices, given their volatility and susceptibility to supply-side shocks, including adverse weather. Given the significance of global oil prices and their volatile movements, the factors behind such movements were regularly analysed and their impact on prices at home was assessed. Monetary conditions were also regularly assessed. Medium-term projections of inflation and economic activity were prepared on a quarterly basis, along with the analysis of the key risks to their achievement and their impact on monetary policy. Short-term projections were prepared on a monthly basis. In addition to expert assessments, econometric models developed in the previous years were used for inflation projections, including the analysis of factors behind the deviation from those projections.

Within the real sector, a focus was placed on annual and quarterly analyses and projections of GDP growth on the production and expenditure side. In addition to real growth, a significant element of the real sector were the analyses and projections of deflators and nominal GDP. Expert assessments and econometric models were used for the purposes of projections of GDP and its components. In the labour market area, available indicators were monitored (wages, employment, productivity, unit labour costs etc.), and their effect on macroeconomic developments was analysed.

In terms of balance of payments, the analyses and projections of current and financial account components were made. Within the current account, special attention was given to foreign trade developments, i.e. dynamics, structure and factors of growth in exports and imports of goods and services and terms of trade.

Within the financial account, emphasis was placed on foreign direct and portfolio investments and factors determining their pace. To ascertain the factors impacting the current account deficit, analyses and projections of savings and private sector and government investments were made. Also, the international investment position of the country was analysed and external sustainability of the country assessed, showing that the share of external debt will decline in the medium run under the assumption of various scenarios and potential macroeconomic shocks. It also showed that the current account deficit was below the level necessary for further lowering the share of external debt in GDP.

In terms of fiscal developments, the NBS continuously monitored the execution of the central government and consolidated budget, public debt and the monetary effect of fiscal policy, and the assessment of the impact of fiscal trends on other macroeconomic indicators was carried out.

In addition, trends in the money, loan and capital markets were monitored, liquidity of the banking sector analysed and annual loan and deposit projections prepared.

Given that trends in the international economic environment significantly determine economic developments in small and open economies such as Serbia, international indicators in the area of prices, economic activity, balance of payments, fiscal trends and decisions of the leading central banks were monitored on a regular basis. A focus was placed on the analysis of the euro area, the largest euro area economies and countries of the region.

The NBS continued its efforts to upgrade the NBS medium-term projections model – the model structure was revised regularly, some model coefficients were recalibrated on the basis of the Bayesian inference method, and new variables were considered to be included to obtain a more accurate inflation projection, i.e. ensure greater reliability of the model.

Projections and analyses of macroeconomic developments were presented to the public on a quarterly basis in the Inflation Report. Besides, the Inflation Report contained text boxes on various current topics, such as estimates of the impact of the seasonal factors on Serbia's inflation and also of the cold weather in early 2017, economic and foreign trade activity, followed by the analysis of credit growth and results of the NPL resolution efforts, contribution of household consumption to Serbia's economic growth, enhancing competitiveness of Serbia's position, etc.

To strengthen the transparency of its monetary policy and the effectiveness of communication with the public, the NBS continued to publish the monthly Report on the Results of the Inflation Expectation Survey. Also, the NBS continued to carry out the survey on bank lending activity, which is the main source of data concerning terms, standards and demand in the lending market. As previously, results of the survey were published on a quarterly basis in the Report on the Results of the Bank Lending Survey. The Trends in Lending publication was also published on a quarterly basis, giving a detailed overview of lending market trends,

conditions of corporate and household borrowing and an assessment of loan supply and demand.

The NBS continued to organise research seminars which gathered leading world experts from European and US universities and other central banks. Seminars of this kind are highly important for raising the standard of economic research and development of economics in Serbia, while at the same time their quality makes the NBS recognisable at the European level.

## NBS statistical operations

The NBS carries out official statistical activities in accordance with the Law on Official Statistics (RS Official Gazette, No 104/2009), Article 68 of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015), and the five-year statistical programme and annual plans. Data are collected, verified, processed and published for different statistical fields (monetary, financial, balance of payments and international investment position statistics) as support to economic policy. These statistics are used by the NBS to prepare reports and analyses, as well as by government institutions, participants in the domestic and international financial markets, domestic and international financial institutions, scientific institutes, the media and the general public.

The NBS cooperated with other government institutions in coordinating statistical activities, preparing the Official Statistics Plan for 2018 and aligning its statistics with EU statistical standards and requirements.

Within monetary and financial statistics, new regulations in the area of accounting and financial reporting were adopted at the end of the year in order to allow the implementation of the International Financial Reporting Standard – IFRS 9 – Financial Instruments in banks and the NBS, thus providing the necessary data structure. Recording data on the stock of loans and deposits indexed to the NBS key policy rate, BELIBOR rates, as well as recording of FX indexations to EURIBOR rates of various maturities was enabled. For this purpose, legal persons were sorted according to their size, in line with the provisions of the law governing accounting.

Since November 2016, the NBS regularly submits to the ECB data in the field of statistics of bank interest rates. The data are submitted on a monthly basis, in accordance with the set timeframe and ECB's regulations in that field.

In the area of government finance statistics, development activities continued in 2017. The quality of excessive deficit procedure (EDP) reporting was enhanced. In cooperation with the Statistical Office of the Republic of Serbia, this Report is submitted to the Eurostat twice a year (April and October). The NBS takes part in the project of improving government finance statistics.

In the area of balance of payments statistics, the NBS submitted reports within the prescribed deadline (monthly, quarterly and annual) – balance of payments and the international investment position, international trade in services and foreign

direct investments. According to the EU Economic and Financial Committee Progress Report on the Action Plan on Economic, Monetary and Financial Statistics for Candidate Countries 2018, the data submitted for 2017, their coverage and method of submission were assessed as very good and largely aligned with EU statistical regulations.

In 2017, together with the Statistical Office of the Republic of Serbia, in the project “Sources of Data Necessary for Calculating Indicators in the Macroeconomic Imbalance Procedure” within the multiuser pre-accession assistance programme IPA 2014, the NBS published data within its scope of authority for calculating indicators of macroeconomic imbalances.

The indicator of sustainable development “Real Effective Exchange Rate – 37 Trading Partners” was calculated for the needs of the project “Strengthening Statistical System of Serbia by Upgrading Methodologies and Standards, and Application of Good Practice”. The indicator was then submitted to the Statistical Office of the Republic of Serbia, together with the accompanying report on quality and metadata.

In October 2017, the NBS was a host to the European Committee of Central Balance-Sheet Data Offices (ECCBSO).

In November 2017, the NBS participated in meetings between the producers and beneficiaries of official statistics from the Republic of Serbia and international experts and Eurostat representatives, with the purpose of evaluating the alignment of the official Serbian statistics with the principles of the Peer Review of the European Statistics Code of Practice.

Within the framework of cooperation with Eurostat, NBS representatives participated in regular meetings of statistics working groups in the area of the excessive deficit procedure, balance of payments, FDIs and international trade in services, and the Committee on Monetary, Financial and Balance of Payments Statistics. They also took part in the workshop dedicated to writing reports on the quality and metadata for sustainable development indicators, organised by the Statistical Office of the Republic of Serbia and Eurostat.

## Plans for 2018

In order to continue supporting decision-making on monetary policy, the NBS will continue to improve its analytical and research activities. As so far, full transparency in work and efficient communication with the public will be a priority, while maintaining the key role of the NBS’s main public communication tool – the Inflation Report. Presentations to the professional and wider public will continue to be held, and active participation in domestic and international panels on monetary and economic policy will be ensured.

Within current macroeconomic analyses and short-term projections, the NBS plans to develop new models for inflation and GDP projections, in cooperation with the leading central banks from the euro area and the region.

In the field of research, the working paper “General Economic Equilibrium Model for Serbia” is in its final stage of preparation and will be published in cooperation with the Czech central bank.

In 2018, the NBS and the Belgrade Faculty of Economics will embark on joint organisation of scientific-research seminars called “Belgrade Economics and Finance Research Seminars”, following on the earlier NBS research seminars. Their aim is to raise the level of scientific and research work and encourage a higher quality and creative academic discussion in Serbia, through lectures held by authors with international repute, and direct exchange of opinions with participants.

Further alignment of methodologies with EU regulations governing the fields of monetary, financial and balance of payments statistics will be continued in line with the National Programme for Adoption of the Acquis and the negotiating position of the Republic of Serbia for Chapter 18 – Statistics.

Together with the Statistical Office of the Republic of Serbia, the NBS will participate in the pilot project “The International Trade in Services Statistics” and “Sources of Data Necessary for Calculating Indicators in the Macroeconomic Imbalance Procedure” within the multiuser pre-accession assistance programme IPA 2015.

In cooperation with the Statistical Office of the Republic of Serbia and the IMF, a national web page will be developed, containing relevant macroeconomic and demographic data for the Republic of Serbia, within the statistical standard e-GDDS. In addition, regular excessive deficit procedure (EDP) reporting to the Eurostat will continue, as well as reporting to the ECB in the field of interest rate statistics. In 2018 banks are expected to change the method of monetary statistics reporting.

### III.4.2 International cooperation

#### Relations with international institutions and the European Union

Intensive cooperation with the IMF continued in implementation and monitoring of the stand-by arrangement. There were two successful reviews of the agreed economic programme – the seventh and eighth (the last one). The objectives of the economic programme were achieved in terms of establishing macroeconomic equilibrium, by ensuring the sustainability of public finance, increasing the resilience of the financial sector and strengthening competitiveness and economic growth. In addition, the IMF concluded consultations under Article IV of the IMF’s Articles of Agreement with our country for 2017.

Further progress was made in the process of Serbia’s accession to the EU during 2017. The most significant activities of the NBS were aimed at preparation of draft negotiating positions, intensive consultations with the European Commission, preparations for the opening of negotiations under individual chapters, and also fulfilment of criteria for closing the opened chapters.

Of negotiation chapters in which the NBS is a chair institution (Financial services and Economic and monetary policy), the greatest progress was achieved in the field of financial services, for which a negotiating position was submitted to the General Secretariat of the Council on 16 October.

The current trends in Serbia's EU accession process called for the third revision of the National Programme for the Adoption of the Acquis (NPAA), as well as the preparation of the fourth Economic Reform Programme (ERP).

Within the framework of the accession process, the NBS continued to fulfil the remaining obligations in the areas under its jurisdiction, as defined by the Stabilisation and Association Agreement.

### *International Monetary Fund*

The economic programme supported by the IMF precautionary stand-by arrangement was successfully implemented for the third year. To monitor progress in implementation of the programme, the IMF mission visited Belgrade four times in 2017. Discussions under the seventh review of the results were held from 27 February to 6 March, and from 22 June to 5 July. At the same time, the IMF concluded consultations under Article IV of the IMF's Articles of Agreement with our country. Preliminary talks concerning the eighth review of the current arrangement were conducted from 13 to 19 September, and detailed talks from 26 October to 7 November. The last, eighth review of the arrangement was successfully concluded with a positive assessment at the meeting of the IMF Executive Board on 20 December.

It was concluded that the Republic of Serbia made significant progress in implementing the agreed economic programme. Continuing GDP growth, above the pre-crisis level in 2017, was led by a rise in investments and exports. Owing to well-calibrated monetary policy, inflation was kept at bay, supporting economic recovery of the country. Fiscal results were much better than envisaged by the programme, with a primary and overall fiscal surplus, while the downward trend in the share of public debt in GDP was maintained. Financial sector reforms contributed to the strengthening of the banking sector, which is now in a much better position to support economic activity. At the same time, measures to reduce NPLs yielded excellent results. Also, significant progress was noted in the implementation of structural reforms, which strengthened the potential for economic growth.

By implementing the economic programme supported by the IMF stand-by arrangement, macroeconomic adjustment was achieved and economic capacity of the country significantly strengthened. The arrangement approved on 23 February 2015 expired in February 2018. During this arrangement, eight reviews of the agreed economic programme were successfully completed, with results exceeding expectations in many areas. There was no need to use funds that were made available to the Republic of Serbia.

NBS representatives were part of the delegation of the Republic of Serbia at the regular Spring Meetings of the IMF and the World Bank Group, as well as the Annual Meetings of the Boards of Governors of these institutions, held in Washington. The delegation was headed by NBS Governor Jorgovanka Tabaković, who represents the Republic of Serbia in the IMF.

### *World Bank*

The Republic of Serbia and the World Bank cooperated within the “Country Partnership Framework for Serbia for the Period FY2016–2020”<sup>47</sup>, which aims to support our country in achieving a competitive and inclusive economy and in the EU accession process. Under this programme, in 2017 the World Bank approved the following project loans to the Republic of Serbia: in January – First Public Expenditure and Public Utilities Development Policy Loan (DPL) in the amount of EUR 182.6 mn; in February – Inclusive Early Childhood Education and Care in the amount of around EUR 47 mn; in May – Disaster Risk Management DPL-CAT DDO in the amount of around EUR 66.1 mn; in November – Enhancing Infrastructure Efficiency and Sustainability in the amount of EUR 100 mn.

In the period from March 2002 until the end of 2017, the World Bank approved to the Republic of Serbia funds for programme and project loans in the amount of around EUR 2.55 bn, of which around EUR 2 bn was used.

In accordance with the regular replenishment of capital of the International Development Association and a call for participation in the 18<sup>th</sup> replenishment, the Republic of Serbia paid in July capital worth RSD 5.52 mn to the account of this institution with the NBS as a depositary. This payment provided an increase in the number of votes by 3,300, so the total number of votes of our country now stands at 86,096, accounting for 0.31% of the total voting power of the members of the International Development Association.

A World Bank technical mission as part of the Remittances and Payments Programme was implemented at the NBS, under the auspices of the Swiss State Secretariat for Economic Affairs, to improve the remittances market in Serbia. As a result of joint cooperation, the report “Review of the Market for Remittances in Serbia” was prepared, providing a detailed overview of the remittances market in our country and identifying key activities that can increase the security and efficiency of remittance transfers. Incentive measures were also proposed that should contribute to creating a more competitive remittances market and reducing the cost of sending money. In H2, the preparation of the National Low-Value Payments Strategy was initiated, aiming to further develop the remittances market and cashless payments in general.

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<sup>47</sup> The World Bank’s fiscal year (FY) covers the period from 1 July of the current year to 30 June of the following year.

### *European Union*

During 2017, the NBS continued to actively participate in the process of accession of the Republic of Serbia to the EU, and the main activities within the negotiating areas it chairs (Financial services and Economic and monetary policy) or acts as an institution of the second order of competence (Free movement of capital) related to the preparation of negotiating positions proposals, with intensive consultations with the European Commission on plans for the transposition of EU regulations.

The greatest progress was made in the area of financial services. After receiving opinions of competent institutions on the documents necessary for the adoption of the Negotiating Position and discussions by relevant committees in the Assembly, on 12 October, the Government adopted the Negotiating Position and submitted it to the General Secretariat of the Council on 16 October. In anticipation of the opening of the Financial services chapter at the next, eighth meeting of the Accession Conference with Serbia at ministerial level, the NBS undertook activities on drafting the introductory statement at end- November.

At end-2017, after the consultations with the European Commission, the proposal of the negotiating position for the Economic and monetary policy chapter was finalised, while the drafting of the negotiating position for the chapter Free movement of capital was in the final stage. In regard to the chapter Free movement of capital, in the part relating to foreign credit transactions, unofficial consultations were held with the European Commission on comments related to the conditions under which non-financial sector legal persons can grant financial loans to non-residents. Also, in order to fulfil the obligations that the Republic of Serbia assumed by signing the Stabilisation and Association Agreement, a proposal for amendments and supplements to the Law on Foreign Exchange Operations in the part relating to foreign credit transactions was drafted. The NBS submitted it to the Ministry of Finance.

Within negotiating groups in which the NBS participates as a member, the most important activities related to the preparation of the Company law chapter, which was opened at the seventh meeting of the Accession Conference with Serbia at ministerial level on 11 December in Brussels.

Activities of fulfilling the criteria for closing the Financial control chapter continued, of which the NBS regularly reported to the European Commission. By adopting the Decision on Handling Suspected Counterfeit Money (RS Official Gazette, No 111 of 11 December 2017), which harmonised domestic legislation with EU regulations on the verification of authenticity of euro coins and banknotes and handling of euro coins and banknotes that are not fit for circulation, the NBS fulfilled a part of the requirements under the chapter closing criteria. The remaining condition under the NBS competence concerns the enhancement of administrative capacities in the technical expertise centre, which is why NBS representatives participated in several important workshops and training sessions in the country and abroad during 2017.

NBS representatives were also actively engaged in the preparation of negotiating positions for the chapters Freedom of movement for workers, Statistics, Consumer and health protection, and Financial and budgetary provisions.

On 6 October, the Government adopted the Plan for the Preparation of the Third Revised Version of the National Programme for the Adoption of the Acquis (NPAA). The period from 1 January 2018 to 31 December 2021 was determined as a new timeframe for defining plans for the harmonisation of Serbian legislation with the EU *acquis*. During October and November, the NBS prepared information for this document within 11 negotiating areas, presenting the most important regulatory activities since the last, second revision of the NPAA (17 November 2016), measures undertaken to establish the institutional framework and administrative capacities relevant for the transposition, implementation and application of the EU *acquis*, as well as detailed plans for the harmonisation of Serbian legislation under the NBS competence with the EU *acquis*. Also, the NBS participated in the development of a part of the document relating to Chapter II – Economic criteria, sections 2.1.2 Macroeconomic stability and 2.1.6 Financial sector development.

In addition to the negotiation process, the NBS continued to participate in the bodies established to monitor the implementation of the Stabilisation and Association Agreement in 2017. During the fourth meeting of the Subcommittee for Economic and Financial Issues and Statistics, on 18 January in Belgrade, issues in the area of monetary policy and exchange rate policy (inflation, development of monetary and foreign exchange policy, monetary policy framework, coordination of fiscal and monetary policy), balance of payments statistics and external debt were discussed. At the fourth meeting of the Committee for Monitoring the Implementation of the Stabilisation and Association Agreement, on 27 April in Belgrade, NBS representatives participated in the part relating to Economic criteria, in the Statistics field, together with representatives of the Statistical Office of the Republic of Serbia.

Within preparations for regular reporting on the reform process in the Republic of Serbia, and for the purpose of preparing the European Commission Annual Progress Report for 2017, the NBS prepared and submitted materials falling within its competence by end-October 2017. Compared to previous reporting cycles, the European Commission altered the reporting methodology as now answers to concrete questions were provided to assess the criterion “Ability to assume the obligations of membership”, while the publication of the Enlargement package was moved from October 2017 to April 2018. The methodology for the preparation of the Economic criteria remained the same and, accordingly, the NBS prepared information for the preparation of reports in the areas of Macroeconomic stability and Financial sector development, under the chapter Existence of a functional market economy. At end-2017, the preparation of the second part of information was initiated – in accordance with the European Commission requirement, it was prepared by updating the material submitted during the first round of reporting, with information on measures and activities carried out after October.

The NBS also gave a significant contribution to the fourth cycle of preparation of the Economic Reform Programme (ERP) for the period 2018–2020, in the chapters Macroeconomic Framework and Fiscal Framework, sections Monetary and Exchange Rate Policy and Inflation, External Sector and Its Medium-Term Sustainability and the Financial Sector.

The NBS Governor participated in the Annual ministerial dialogue on economic policy between the EU, i.e. ministers of finance and governors of central banks of member states and the Western Balkans and Turkey, held in Brussels on 23 May within the framework of the EU Economic and Financial Affairs Council (ECOFIN). At the meeting, Joint Conclusions were adopted, with individual recommendations for the Western Balkans and Turkey. The Annual ministerial dialogue was preceded by meetings organised by the Economic and Financial Committee (EFC), with active participation of NBS representatives.

During 2017, the NBS continued to actively participate in the project of the German Agency for International Cooperation (GIZ), as well as in the PLAC II project “Legal Support to Negotiations” funded by the EU, within which support was provided to the negotiating areas Free movement of capital and Financial services.

In December 2017, the new project “Strengthening of the Institutional Capacities of the National Bank of Serbia in the European Integration Process” was approved, financed from the EU Instrument for Pre-Accession Assistance (IPA). The project, worth EUR 800,000, will be carried out in 2018 and foresees the implementation of activities within ten areas of operations of the NBS.

In the process of programming international development and pre-accession assistance of the EU (IPA II) for the period 2014–2020, the NBS participated in sectoral working groups tasked with public administration reform and competitiveness.

In late 2017, in cooperation with the Ministry of European Integration, the NBS launched an initiative for the nomination of project activities for the Technical Assistance and Information Exchange Instrument (TAIEX), whose main role is to provide support for the harmonisation of national legislation with EU legislation. Ten areas were proposed in which expert missions, study visits, seminars and workshops would be carried out in cooperation with EU partner institutions, with the aim of strengthening the administrative capacities of the NBS in the process of European integration.

Funds of the Serbian Revolving Credit Fund (initially EU donation) were used during 2017 to finance small- and medium-sized enterprises and entrepreneurs. To date, 1,111 loans have been disbursed through nine intermediary banks, in the total amount of EUR 113.1 mn.

During the year, the NBS, as an agent of the Republic of Serbia, carried out supervision of spending of funds under ten loans from the Revolving Credit Fund in four intermediary banks, including two loans with final beneficiaries. It was noted that the funds were used for authorised purposes.

### *European Bank for Reconstruction and Development*

The EBRD has supported the Republic of Serbia financially since 2001. As at end-2017, this institution approved to Serbia loans worth EUR 4.35 bn, of which EUR 3.43 bn were disbursed. The funds were intended for infrastructural projects, projects in the transport, energy and environment protection sectors, as well as to encourage economic activity and SMEs development, and to support financial institutions and local self-governments.

In 2017, the EBRD provided over EUR 380 mn, through more than 20 projects within various economic sectors. Support to economic development was provided through loans for the construction of two big wind turbines, railroad maintenance, modernisation of air traffic control, support to SMEs and for the construction of a shopping centre in Belgrade.

The implementation of the EBRD's programme of support to SMEs in the local currency in the Republic of Serbia was made possible by the signing of the Memorandum of Understanding between the Ministry of Finance, NBS and this international institution in February 2017. Also, activities defined by this Memorandum support the issuance of EBRD dinar securities and development of dinar securities market.

According to the regular EBRD Transition Report, in which the EBRD analyses macroeconomic trends and structural reforms in emerging economies, Serbia's economic growth during the year was temporarily slowed down, fiscal results continued to be better than expected and inflation was within the target tolerance band. The improved business ambiance and further harmonisation of the banking sector regulations with the EU standards were assessed positively.

### *Bank for International Settlements*

The NBS is a BIS member and holds 2,920 of BIS shares. Also, NBS representatives participate in regular annual meetings of this institution's Assembly, and of its various committees, whose principal aim is to ensure global monetary and financial stability, and to support international cooperation of central banks in these areas.

The NBS has been an active member of the Central Bank Governance Network within the BIS, which aims to enhance the exchange of relevant information between 60 central banks – member institutions.

### *European Investment Bank*

In the period 2001–2017, the EIB provided to the public and private sectors of the Republic of Serbia financial support worth EUR 4.37 bn, of which around EUR 3.79 bn were disbursed. The approved loans were intended for all major infrastructural areas, as well as for the support of SMEs, finance and energy sectors, industry, services and local self-governments.

In order to implement the second tranche of the fifth Apex loan for SMEs and other priorities, worth EUR 150 mn, the EIB, Republic of Serbia and NBS signed the Side Letter on 14 March, specifying the EIB's criteria for the allocation of funds. After that, in cooperation with the Ministry of Economy, the criteria for allocation of funds were defined more precisely, a meeting was held with representatives of intermediary banks in order to clarify the conditions and technical issues related to the realisation of the loan, a Steering Committee was established to monitor the realisation of the loan, provide support in its implementation and to evaluate the results of the projects financed. By the end of 2017, as an agent of the Republic of Serbia, the NBS concluded intermediary financial agreements with 14 banks, selected by the EIB, as the borrower, and obtained the EIB's consent to the draft contracts with final beneficiaries presented by 13 intermediary banks. The implementation of the second tranche of the fifth Apex loan started in September and lasted until the end of 2017. The EIB approved 23 projects in the amount of EUR 11.6 mn, while one tranche worth EUR 5 mn was drawn.

In 2017, the NBS carried out supervision of the spending of funds from 17 EIB Apex loans in nine intermediary banks, including the use of funds under one loan with final beneficiary. It was noted that the Apex loan funds were used for authorised purposes.

#### *Cooperation with other central banks*

On the initiative of the National Bank of Austria (OeNB) to establish a new type of cooperation and deeper relations with the NBS, the first annual informal dialogue between the representatives of the two central banks was held in Vienna on 7 and 8 July. The topics discussed were areas of cooperation with international financial organisations and the EU, the manner of operation and organisation of the OeNB and NBS, monetary policy and its effects, macroeconomic forecasts and communication with the public.

In order to enhance bilateral cooperation between the Central Bank of the Republic of Turkey and the NBS, a Memorandum of Understanding and Cooperation was concluded on 26 September, envisaging exchange of knowledge and experience in the field of central banking, by organising working-level visits.

#### **Relations with the Paris Club creditors**

Within the Paris Club creditors, further activities were taken relating to the conclusion of the new bilateral agreement with the Russian Federation.

As the Government's debt servicing agent, the NBS settled its obligations towards the Paris Club creditors.

## Bilateral financial cooperation

During March, the NBS signed an amendment to the May 2013 arrangement with the Vnesheconombank from Moscow on the technical procedure for bookkeeping and debt repayment under the Russian state loan approved in January 2013, in the amount of up to USD 800 mn, for financing infrastructure projects and the purchase of rolling stock. This was done on the basis of the Protocol signed in December 2016 between the governments of the Russian Federation and the Republic of Serbia on amendments to the intergovernmental Agreement on the approval of the said loan.

In July, the NBS and Československe obchodni banka from Prague concluded a banking arrangement on the technical procedure for the accounting separation of the clearing debt of the former SFRY to the Czech Republic and the Slovak Republic, as well as the recording of the corresponding part of the debt of the Republic of Serbia towards each of these states. This arrangement represents the basis for bilateral negotiations with those two countries.

The NBS conducted activities on the implementation of the Preferential Buyer Credit Loan Agreement for the Project of modernisation and reconstruction of the Hungarian-Serbian railway line in the territory of the Republic of Serbia for section Belgrade Centre–Stara Pazova, concluded in May between the Government of the Republic of Serbia and Export-Import Bank of China, worth up to USD 297.64 mn.

Representatives of the NBS actively participated in the technical consultations and formal negotiations of the Republic of Serbia with the Republic of Turkey on expanding the scope of the Free Trade Agreement between the two countries to services, including financial. Considering the participation of Turkey in Serbia's foreign trade, as well as the possibilities for strengthening and enhancing economic cooperation of the two countries, the Turkish lira was introduced into the list of currencies traded in the foreign exchange market.

For the purposes of holding mixed committees for economic cooperation, the NBS compiled information within its scope of competence regarding cooperation with the Czech Republic, Belarus and the Swiss Confederation, while its representatives participated in the mixed committee with the Czech Republic.

As regards the Agreement on Succession Issues, the NBS continued its activities pertaining to the joint proof of claim in the liquidation process against Jugobanka and Beogradska banka agencies in New York which the NBS filed on behalf and for the account of the successor states of the former SFRY in January 2012. The October payments marked completion of a very complex procedure for the distribution of funds in the liquidation process of these agencies in New York.

The first loan of the Republic of Italy worth EUR 33.25 mn, including the revolving fund assets (formed by the repayment of principal and interest) was used by 164 SMEs in the total amount of EUR 55.2 mn by end-September. Given the low interest of the final beneficiaries and the Republic of Serbia's interest expenses, the NBS launched an initiative for the early repayment of this loan,

which was accepted by the Italian side. With the payment of EUR 13.9 mn, the loan was repaid in full on 21 December.

Regarding the second Italian loan of EUR 30 mn, the NBS also launched an initiative for the early repayment of the unused funds under the first tranche and the cancellation of the second tranche of the loan due to the lack of interest of final beneficiaries and the fact that the Republic of Serbia had to bear a part of interest expenses. After the implementation of all the necessary activities in order to meet the conditions for the early repayment of unused funds (obtaining an audit report on the used funds and the approval of the said report by the Italian side), the Republic of Serbia returned to the Republic of Italy the amount of EUR 15 mn on 15 December, thus fully repaying the loan.

The funds of the KfW loan worth EUR 100 mn, intended for agriculture, energy efficiency, renewable energy sources and municipal infrastructure, were also used during 2017 through three intermediary banks.

During 2017, a donation from the Kingdom of Denmark (the Programme for Local Economic Development in the Balkans - LEDIB) was used for financing SMEs and entrepreneurs, farmers and cooperatives in Serbia's five southern districts – Nišava, Jablanica, Pčinja, Toplica and Pirot. The donation was worth DKK 15 mn (c. EUR 2 mn). From January 2010 to December 2017 as many as 387 dinar loans and dinar loans with an FX clause (depending on the choice of final beneficiaries), worth RSD 277.8 mn, were disbursed.

## Reporting on foreign credit transactions

In 2017, total foreign borrowing amounted to EUR 3.47 bn and total lending abroad to EUR 272.72 mn, as a result of 838 new borrowing transactions and 181 new lending transactions. As at 31 December 2017, total liabilities stemming from foreign trade transactions that have not been settled within a year came at EUR 351.5 mn, while receivables on this account equalled EUR 335 mn.

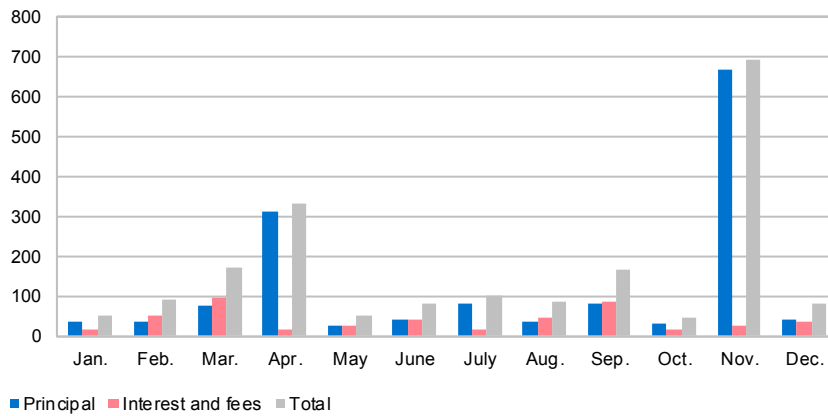
Within its activities aimed at ensuring timely reporting on foreign credit transactions, in 2017 the NBS filed to the Misdemeanour Court in Belgrade a motion for the initiation of misdemeanour proceedings against one bank that was late in submitting Annex to the Agreement on a loan this bank approved to a non-resident and was late in reporting to the NBS on the transactions under that loan. In 2017 this court issued one conviction based on the NBS's motion filed in 2016.

At the beginning of February, the NBS issued a decision granting authorisations for carrying out payment transactions and foreign credit operations to the Bank of China Srbija, Beograd, at the request of that bank.

## Servicing foreign credit obligations

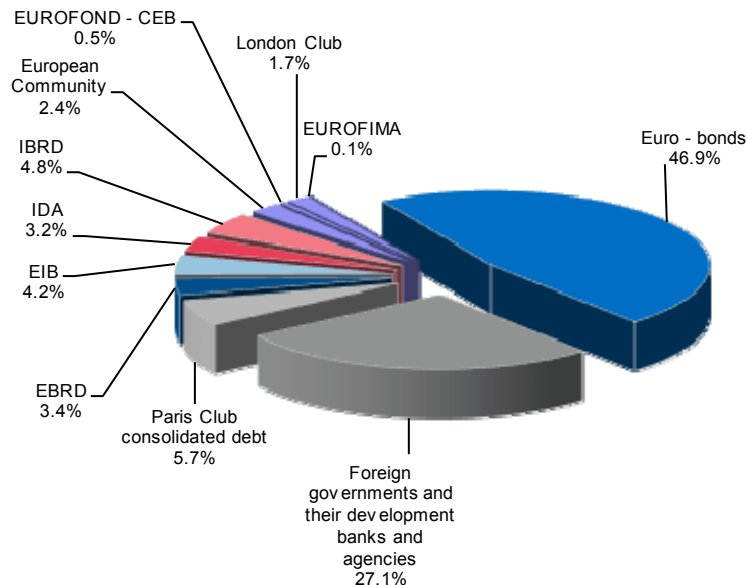
During 2017, all obligations under foreign credits and loans in respect of which the Republic of Serbia is the debtor or guarantor were serviced in time, as well as all obligations under credits in respect of which the NBS is the debtor. In 2017, in the capacity of the Government's agent, the NBS repaid EUR 1,959.36 mn (EUR 1,471.63 mn of which was the repayment of principal and EUR 487.73 mn interest and other expenses). Out of the total liabilities paid under the loan principal, in April a loan to Societe Generale Paris worth EUR 292.6 mn was fully repaid, while in November the entire amount of debt under the second issue of eurobonds on the foreign financial market was repaid in the amount of EUR 639.17 mn (USD 750 mn).

Chart III.4.2.1 **Liabilities to foreign creditors paid in 2017, by month**  
(in EUR mn)



Source: NBS

Chart III.4.2.2 **Structure of liabilities paid in 2017, by creditor**



Source: NBS.

At the same time, EUR 728.15 mn worth of loans were disbursed. These loans were granted by international financial organisations (the World Bank, EIB, Council of Europe Development Bank) and the Abu Dhabi Fund for Development.

## Plans for 2018

The IMF stand-by arrangement was successfully concluded on 22 February 2018, and it is expected that good cooperation with this international financial institution will be continued.

In accordance with the general increase in capital with the International Bank for Reconstruction and Development, in early 2018 with the payment of USD 5.5 mn, our country will register additional 760 shares with this institution.

The EBRD is expected to approve a new Strategy for the Republic of Serbia for the period 2018–2023 at the beginning of the year. The strategy will define the activities of the EBRD in accordance with the Government's priorities in terms of the EU accession process, macroeconomic stability, public debt reduction, financial sector strengthening, including the process of dinarisation, improvement of the business environment, acceleration of the privatisation process and restructuring of state-owned enterprises, as well as the strengthening of innovation and digitalisation.

The most important activities of the NBS in the process of EU accession will be focused on preparations for intergovernmental accession conferences, during which chapters where the NBS acts as an institution of the first or the second order of competence will be opened. The NBS will continue to provide an active contribution to the work of all negotiating groups in which it participates as a member, especially in the finalisation of negotiating positions that have not yet been delivered to the EU. Also, activities in the second phase of the Project of the Policy and Legal Advice Centre (Plac II) will continue by organising expert visits and other forms of cooperation.

The NBS will continue to actively participate in the bodies set up to monitor the implementation of the Stabilisation and Association Agreement (the Subcommittee for Internal Market and Protection of Competition and Subcommittee for Economic and Financial Matters and Statistics and the Stabilisation and Association Committee). In addition, meetings with the representatives of the European Commission will also review the progress in the following negotiation chapters: Right of establishment and freedom to provide services, Company law, Competition policy, Financial services, Economic and monetary policy, Statistics, Consumer and health protection and Financial control.

Considering that the ERP is a rolling programme, developed every year, while retaining continuity in the area of priority structural reforms, the NBS will continue to participate in the preparation of this strategic document in 2018.

Within regular reporting to the European Commission on the reform process in the Republic of Serbia, the NBS will prepare information for the European Commission Progress Report for 2018, and its representatives will continue to

participate in the annual economic policy dialogue between the ministers of finance and central bank governors of EU member states and the Western Balkans and Turkey.

The implementation of the project “Strengthening of the Institutional Capacities of the National Bank of Serbia in the European Integration Process” is planned for 2018. The project should be financed from the EU Instrument for Pre-Accession Assistance (IPA). The implementation of activities supported by the TAIEX is also planned.

NBS representatives in sectoral working groups for public administration and competitiveness reform will take part in the activities regarding the planning and use of international development and EU pre-accession assistance (IPA II) for the 2014–2020 period.

As regards the Agreement on Succession Issues, the NBS representatives will continue to participate in the meetings of the Committee for the Distribution of Financial Assets and Liabilities of the former SFRY, Annex C, and the Standing Joint Committee of senior representatives of each successor state.

The process of concluding bilateral agreements and agreements with the Paris Club creditors will intensify, and the continuation of negotiations on the settlement of debt from the previous period with the governments of non-Paris Club members is also planned.

A representative of the NBS will participate in the Working Group for monitoring the implementation of the National Action Plan for implementation of the UN Security Council Resolution 1540 (2004) concerning the prevention of proliferation of weapons of mass destruction and their delivery systems for the 2017-2021 period.

Also, meetings are planned for end-March 2018 with the representatives of the UN Security Council Counter-Terrorism Committee in connection with the implementation of UN Security Council Resolution 1373 (2001), in the part relating to the fight against terrorism financing.

In cooperation with the Ministry of Economy, intermediary banks and the EIB, the NBS will consider modalities for more efficient use of the funds of the second tranche of the fifth Apex loan for SMEs and other priorities. The third tranche of this loan is also planned.

Since the Financial Agreement between the Republic of Serbia, the Kingdom of Denmark and the NBS on the donation of the Kingdom of Denmark - the Local Economic Development Programme in the Balkans (LEDIB) - expires on 31 December 2018, the intermediary banks will return all the approved funds to the special account of the Republic of Serbia with the NBS. In this regard, the NBS will, in agreement with the Ministry of Economy, determine the conditions and criteria for granting donation funds for the period after the expiry of the Financial Agreement.

In 2018, the NBS plans to carry out supervision of the spending of funds from the Revolving Credit Fund of the Republic of Serbia and EIB Apex loans.

### III.4.3 Legislative activities

#### Current legislative activity

In the course of 2017, the NBS took part in preparing and giving opinion on the following drafts and proposals of laws: Proposal of Law Amending the Law on the National Bank of Serbia, Draft Law on Multilateral Interchange fees and Special Operating Rules for Card-based Payment Transactions, Draft Law Amending the Law on Foreign Exchange Operations, Draft Law on the Settlement of the Public Debt of the Republic of Serbia Arising from Unpaid Foreign Exchange Savings of Citizens Deposited with Banks Having their Head Office in the Territory of the Republic of Serbia and their Branches in the Territories of Former SFRY Republics, Draft Law on the Prevention of Money Laundering and Terrorism Financing, Draft Law on the Comparability of Fees for Payment Services Relating to Payment Accounts, Payment Account Switching and Right to Payment Accounts with Basic Services, Draft Law Amending the Law on Deposit Insurance Agency, Draft Law Amending the Law on Deposit Insurance, Draft Law on the Budget of the Republic of Serbia for 2018, Draft Law Amending the Law on the Budget System, Draft Law on Electronic Government, Draft Law Amending the Law on Bankruptcy, Draft Law Amending the Law on Corporate Income Tax, Draft Law Amending the Law on Value Added Tax, Draft Law Amending the Law on Personal Income Tax, Draft Law Amending the Law on Republic Administrative Fees, Draft Law Amending the Law on Contributions for Compulsory Social Insurance, Draft Law Supplementing the Law on Citizenship, Draft Law on Commodity Markets, Draft Law Amending the Law on Compulsory Traffic Insurance, Draft Law on Archival Material and Archival Activities and Draft Law on Alternative Investment Funds.

In 2017, the NBS enacted 44 by-laws published in the RS Official Gazette – of which 39 decisions and five guidelines. These regulations cover the following functions and activities of the NBS:

- monetary policy operations (determining the 2018 Monetary Policy Programme, determining NBS interest rates applied in the implementation of monetary policy, the terms and manner of operation of the FX market, types of foreign currency and foreign cash bought and sold in the FX market, submission of banks' data on household dinar savings deposits, implementation of the Decision on Banks' Required Reserves, submission of banks' data for the purpose of monitoring certain monetary trends);
- financial stability operations (setting the countercyclical capital buffer rate for the Republic of Serbia, determining and maintaining the systemic risk buffer, content, deadlines and manner of submission of data on the valuation of mortgaged real estate and loans secured by mortgage, and measures for safeguarding and strengthening stability of the financial system);
- foreign exchange operations and international relations (terms and manner of performing foreign payment transactions, terms of opening and manner of

keeping FX accounts for residents and dinar and FX accounts for non-residents, terms of payment, collection, pay-in and pay-out of foreign cash);

- payment system operations (detailed conditions and manner of opening, keeping and closing current accounts, and content and manner of using payment order forms for the execution of payment transactions in dinars);

- bank supervision (classification of on- and off-balance sheet items of banks, forms and content of items in financial statement forms to be completed by banks, risk management by banks, Chart of Accounts and contents of accounts in the Chart of Accounts for banks, collection, processing and submission of data on the balance and structure of accounts in the Chart of Accounts of banks, accounting write-off of bank balance sheet assets, supervision of banking groups on a consolidated basis, reporting requirements for banks, identification of default, implementation of specific provisions of the Decision on Capital Adequacy of Banks relating to bank capital);

- operations in the area of bank resolution (setting up minimum requirement for capital and eligible liabilities of a bank, information and data submitted to the NBS for the purpose of preparing and updating resolution plans for banks and banking groups);

- supervision of the insurance sector (implementation of the provisions of the Insurance Law relating to the issuance of license to carry on insurance/reinsurance activities and specific approvals of the National Bank of Serbia, calculation and setting up of technical provisions, investment of insurance funds, obtaining the title of a certified actuary and the professional education of actuaries, acquiring the title and education of a certified broker and/or certified agent in insurance, content and manner of keeping data registers of insurance/reinsurance undertakings and other subjects of supervision in insurance);

- supervision of voluntary pension fund management companies (determining the share of the net asset value of all voluntary pension funds in estimated GDP for 2016, the method of calculation of fees charged by a voluntary pension fund management companies, intermediaries of VPF management companies and issuing licenses for disseminating information on VPFs);

- supervision of information systems of the financial institutions (establishing minimum information system management standards for financial institutions);

- cash operations (handling suspected counterfeit money);

- enforced collection (detailed conditions, content and manner of keeping the register of bills of exchange and mandates);

- single tariff used by the NBS to charge fees for the services provided.

## **Court representation**

In the course of 2017, 15 administrative proceedings were conducted before the Administrative Court, of which seven were legally terminated. Proceedings

conducted before commercial courts included 36 litigations, of which 11 were finally disposed of, then 49 bankruptcy proceedings, three liquidation proceedings, and three proceedings in respect of corporate offences. A total of 49 litigations, nine non-litigious proceedings, 21 enforcement and four criminal proceedings, of which 20 were finally disposed of, were conducted before general jurisdiction courts. Eighteen proceedings were conducted before misdemeanour courts. Seven litigations and one bankruptcy proceeding were conducted before foreign courts.

## Compliance

In 2017, 30 general internal acts were adopted by the NBS in relation to labour relations, internal organisation and job classification, office administration, defence, use of automobiles and mobile phones, protection of confidential data and security of information, accounting and finance, procurements etc.

The NBS initiated or conducted the procedure of examining the compliance of operations in certain segments of its operations in order to identify compliance risks and formulate measures to reduce those risks.

Necessary activities were undertaken to ensure regular annual reporting of organisational units on identified and assessed compliance risks.

The NBS performed activities to improve ethical conduct and standards of professional behaviour of its staff, as well as activities aimed at ensuring that the NBS fulfils obligations under the Law on the Anti-Corruption Agency.

## Activities regarding the implementation of the Law on Free Access to Information of Public Importance

In 2017, the NBS received 76 requests for the supply of information of public importance, of which 59 were granted or partially granted, 16 rejected and one dismissed. The majority of requests were submitted by citizens (50), the media (16), NGOs and other civic organisations (4), and others (6). A total of 20 complaints were filed in relation to the above requests, 12 for being rejected, one for being dismissed and seven for other reasons.

Pursuant to Article 43 of the Law on Free Access to Information of Public Importance (RS Official Gazette, Nos 120/04, 54/07, 104/09 and 36/10), the NBS submitted the annual report to the Commissioner for Information of Public Importance and Personal Data Protection, outlining activities and measures undertaken in 2017 for the purpose of implementing the said Law.

## Plans for 2018

During 2018 the NBS will prepare amendments to the by-laws in order to harmonise the regulations governing foreign exchange operations with the Stabilisation and Association Agreement concluded by the Republic of Serbia with the EU. This agreement envisages free movement of capital that relates to portfolio

investments and financial loans and loans with a maturity of up to one year, which will further liberalise capital flows. Considering that the most recent amendments to the law governing foreign exchange operations stipulate that from 1 January 2019 the NBS will take over the responsibilities of the Ministry of Finance - the Tax Administration relating to issuing and revoking of authorisations to perform exchange operations, issuing certificates to perform exchange operations, as well as supervision of exchange operations and foreign exchange operations of residents and non-residents, in the course of 2018, by-laws will be prepared to regulate the manner in which the NBS will supervise these operations. In addition, foreign exchange regulations will be continuously modified in order to create a favourable ambience for companies and enable citizens to perform cross-border payments in a simpler way, with lower costs and less administration.

In the course of 2018, the NBS will prepare legal proposals to regulate financial security, multilateral interchange fees on payment card-based transactions, protection of financial service consumers in distance contracts and additional protection of consumer rights regarding payment accounts.

The NBS also plans to undertake appropriate measures to improve the process of drafting primary and secondary legislation under its competence and keep track of EU regulations, as well as to improve the quality of NBS legal representation before courts and NBS compliance activities.

#### III.4.4 Communication with the public

In 2017, the NBS continued to inform the public about its operations in intensive cooperation with the media by publishing information on social networks, as well as on the official website and its subdomains. By issuing press releases, answering journalist queries, engaging in interviews, television and radio appearances, organising press conferences and posting on social networks, the central bank continued to inform the general public about its activities in a responsible, consistent and timely manner.

During 2017, a total of 363 press releases were published and 361 answers provided to journalist queries. As many as 59 statements and 15 interviews were given for both the print and electronic media. Also, six television and radio appearances were made by the Governor and other employees of the NBS.

The NBS presented to the professional community and the media four Inflation Reports and the Annual Financial Stability Report for 2017. It also ensured media support for:

- meetings with the IMF during two visits of the IMF mission to Serbia,
- conference “E-Commerce in Serbia – a Safe Path for Online Purchases”,
- signing of the Memorandum of Understanding between the NBS and China UnionPay,
- signing of the Memorandum on Business Cooperation between the NBS and the Faculty of Mathematics in Belgrade,

- events “Open Day Door”, “Museum Night”, “European Heritage Days”, “Global Money Week” and “Global Savings Week” and the student prize tournament “Moneture”;
- humanitarian and other socially responsible activities that are implemented by the NBS and the opening of numerous exhibitions hosted at the NBS exhibition space.

The NBS was active in 2017 in its Twitter and Facebook accounts. It published 619 tweets on its official Twitter account and 372 posts on its Facebook account.

In 2017, the Annual Report on Activities and Results, Annual Financial Stability Report, Annual Monetary Policy Report for the previous year and Semi-Annual Monetary Policy Report for the current year were published on the NBS website. Other publications include monthly issues of the Statistical Bulletin, quarterly reports on the banking sector, financial leasing supervision, supervision of the insurance sector and voluntary pension funds sector, and activities in the field of financial consumer protection. Also published quarterly were the Report on Dinarisation of the Financial System and the Inflation Report. Available to the public are also the following quarterly reports: Trends in Lending, Report on Detected Counterfeits and Report on the Results of the Bank Lending Survey, as well as the monthly Report on the Results of the Inflation Expectations Survey.

In 2017, the NBS used its website to transparently inform the general public about the instruments and measures applied to preserve and strengthen financial stability, as well as instruments and measures applied to implement monetary and foreign exchange policies. With its regular publications, statistical analyses and press releases, the NBS presented to the public its activities in the field of supervision of financial institutions, payment service providers and electronic money institutions. Press-conferences presenting the Inflation Report, the Annual Financial Stability Report, and conclusions on the banking sector stress-tests and challenges and situation in the financial system were broadcast live on the NBS website.

In an effort to constantly improve its operations and public relations, the NBS introduced new contents, in accordance with its innovative spirit and desire to provide all interested parties with faster access to information.

A new DinaCard system website was created. All relevant data and useful information for DinaCard users, as well as for those who want to get acquainted with all DinaCard benefits, are published on the system’s new website.

Through its subdomains (Tvoj novac and Visitor Centre), the NBS informed the public about its activities in the field of financial education, exhibitions and workshops for younger and older students.

All printed and electronic materials made for the public are available in both Serbian and English.

## Plans for 2018

In 2018, the NBS will continue to inform the public about its operations and activities in a responsible and timely manner through active cooperation with the media. It also plans to further enhance its communication with the public on social networks, as well as to upgrade its internet domain and subdomains, and to intensify the promotion of its exhibition and educational activities.

### III.4.5 Financial consumer protection and education

In 2017, the NBS continued to actively assist financial service consumers in exercising their rights, by dealing with complaints against financial institutions, mediating in disputes and informing and educating financial service consumers.

#### Handling of complaints

In 2017, the NBS received 1,767 complaints in relation to the operation of financial institutions. Of this number, 57.4% pertained to insurance undertakings, 42% to banks, 0.2% to lessors and payments service providers each and 0.1% to VPF management companies.

**Table III.4.5.1 Number of complaints by type of financial service provider in 2017**

Financial services provider	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Total	In %
Banks	62	59	75	51	60	78	70	46	55	54	59	74	743	42.0
Insurance undertakings	72	76	100	75	92	101	85	83	75	68	83	105	1,015	57.4
Lessors	0	0	0	1	0	1	0	0	1	0	1	0	4	0.2
VPF mng companies	0	0	0	1	0	1	0	0	0	0	0	0	2	0.1
Payment institutions	0	0	0	1	0	1	0	0	0	0	1	0	3	0.2
<b>TOTAL</b>	<b>134</b>	<b>135</b>	<b>175</b>	<b>129</b>	<b>152</b>	<b>182</b>	<b>155</b>	<b>129</b>	<b>131</b>	<b>122</b>	<b>144</b>	<b>179</b>	<b>1,767</b>	<b>100</b>

Source:NBS.

In 2017, a total of 1,015 complaints against insurance undertakings were received, up by 2.5% relative to the year before. An increasing number of complaints against insurance undertakings was a result of the new Insurance Law and adoption of the Decision on the Manner of Protecting the Rights and Interests of Insurance Service Consumers in 2015. This Decision stipulates that the insurance undertakings are obligated to inform the insurance beneficiaries of their right to file a complaint with the NBS if they are not satisfied with the reply received from the insurance undertaking. The highest number of complaints against insurance undertakings received in 2017 related to motor third party liability insurance (34.2%), accident insurance (26.3%), property insurance (9.9%) and life insurance (9%).

A total of 743 complaints against banks were received, down by 15% compared to the previous year. The reduction in the number of complaints against banks is a result of the 2015 amendments to the Law on the Protection of Financial Service Consumers, which changed the structure of the grounds for consumer complaints. The bulk of complaints against banks concerned loans (45.6%), current accounts (22.7%), payment cards (15.3%) and FX savings (6.9%).

In addition, the NBS received 667 complaints, which were not first addressed to relevant financial institutions. The NBS accordingly forwarded such complaints to relevant financial institutions for further handling. The total number of such complaints is up by 16.61% relative to 2016, the majority concerning banks (78.7%).

Also, in the observed period, 1,179 consumers approached the NBS and received answers to one or more queries about financial services or consumer rights. Most of the queries concerned bank operations (86%), primarily loans (51.2%) and current accounts (20.1%).

## Measures to remove irregularities in the complaint procedures

Acting upon complaints of financial service consumers in 2017, the NBS issued measures to remove the detected irregularities in individual cases (five banks), and to provide documentation in the procedure (two banks).

## Mediation

In 2017, 367 mediation proposals were submitted and 92 mediation procedures were conducted, which is by 19.5% more than in the previous year. Seventy-five mediations were concluded, of which 36 ended in the settlement between the financial institution and the consumer. The majority of mediations in 2017 related to loans (33%) and motor third party liability insurance (21%).

Table III.4.5.2 Number of mediation procedures in 2017

Financial services provider	In progress	Settlement	Cancellation	Abandonment	Total	In %
Banks	10	18	21	4	53	57.6
Insurance undertakings	7	18	11	2	38	41.3
Lessors	0	0	1	0	1	1.1
VPF mng companies	0	0	0	0	0	0
<b>TOTAL</b>	<b>17</b>	<b>36</b>	<b>33</b>	<b>6</b>	<b>92</b>	<b>100</b>

Source: NBS.

## Informing financial service consumers

In 2017, 52 journalist queries were answered, by giving 38 telephone statements and 14 replies to queries by the print and electronic media.

The NBS Information Centre received 15,757 telephone calls and queries by citizens in 2017. The majority addressed the Centre with regard to banking services.

## Financial education of citizens

In 2017, 105 educational panels and 186 presentations were held across Serbia, with the participation of 4,300 financial service consumers. The number of panels in 2017 was the highest since 2011, when the NBS first launched activities to educate consumers of financial services.

In the observed period, 1,645 citizens addressed the regional offices for financial education in the NBS branches, and 93,000 educational leaflets were distributed.

The official NBS website and the website [www.tvojnovac.nbs.rs](http://www.tvojnovac.nbs.rs), intended primarily for financial service consumers, were updated with financial services information on a regular basis.

## Plans for 2018

The NBS will continue its activities to protect and inform financial service consumers in 2018.

Also, the NBS will continue aligning its regulations with the EU acquis in the area of consumer protection and carrying out activities to improve the protection of rights and interests of consumers.

Planned activities for 2018 include organising panels and workshops on financial products and services for citizens, entrepreneurs, SMEs and associations, as well as developing a communication channel for the citizens. Also, further cooperation with institutions and associations engaging in financial education is planned.

## III.4.6 Social responsibility

In order to support the entire community with its responsible attitude through various forms of humanitarian actions, the NBS organised numerous activities in the headquarters and branch offices during 2017. The employees engaged actively in campaigns aimed at collecting funds, food and clothes for socially vulnerable groups, children with developmental disabilities, children deprived of parental care and the elderly. The charity events of the NBS employees are more and more successful each year, their total cash value in 2017 being RSD 560,840.

In one such event “Humaneness against Hunger”, almost two tonnes of food were collected and distributed to the most vulnerable categories of the population.

Ahead of the New Year’s and Easter holidays, the Belgrade head office and the Novi Sad Branch organised sales exhibitions of artwork made by children, young people and the elderly with developmental disabilities, in order to collect funds for

programmes supporting their development. On the occasion of New Year and Christmas holidays, as part of the traditional humanitarian campaign “A Present for an Unknown Friend”, NBS employees donated 220 Christmas presents to children beneficiaries of the National Cuisine of the Serbian Orthodox Church from Belgrade and children with developmental disabilities from the Day Care Centre “Neven” in Pančevo, as well as to children and youth of the Residential Centre “Sremčica” in Belgrade.

In the charity event called “To Children, with Love”, carried out in the Niš Branch, funds were collected in the amount of RSD 37,000 to procure a hospital inhaler for the Paediatric Internal Diseases Clinic of the Clinical Centre Niš. The Užice Branch was host to the charity event in which the funds collected (RSD 15,500) were spent on buying beds for the Drašković family living in extremely difficult conditions.

NBS volunteers participated in numerous activities during 2017. In cooperation with the Secretariat for Environment Protection and public enterprise “Srbijašume”, in the campaign called “Let's Save Nature”, over 30 employees participated in the cleaning of the Miljakovac Forest in Belgrade, which meant clearing out the forest, painting benches and exercise equipment, repairing wooden shade structures and so on. With the desire to help and provide assistance to those most in need, the employees of the Novi Sad Branch and the NBS headquarters participated in the campaign “With All Our Heart”, decorating the Senior Day Care and Nursing Home in Futog.

In 2017, NBS employees joined the ecological and humanitarian action “Bottle Cap for Handicap”, gathering 930 kg of plastic bottle caps, and thus helping the purchase of orthopaedic aids for people with disabilities across Serbia. In cooperation with the Association “Bottle Cap for Handicap”, the NBS organised a sports event “Games without Frontiers”, which was held in the Primary School “Anton Skala” in Belgrade. Belgrade primary schools “Ivo Andrić”, “Laza Kostić”, “Mihajlo Pupin” and “Anton Skala” participated in “Games without Frontiers”, as well as representatives of the Home for Children and Youth with Hearing Impairments, who were most successful in collecting caps.

In the campaign for the beneficiaries of the Gerontological Centres “Novi Sad” and “Beograd”, employees at the headquarters and Novi Sad Branch collected clothes, linen and other hygiene products.

The Institute for Manufacturing Banknotes and Coins – Topčider helped the students from the Graphic School in Belgrade to participate in the national competition in Subotica after a years-long break. This enabled further training and education of students in the only school in Serbia that offers all educational profiles of the graphic profession and is the largest source of potential employees for the Institute for Manufacturing Banknotes and Coins – Topčider.

Recognising the importance of cultural development and preservation of cultural heritage, the Institute for Manufacturing Banknotes and Coins – Topčider donated plaquettes to the “Dositej Obradović” Foundation in 2017.

An important segment of socially responsible behaviour is the concern for environment protection. It is an integral part of everyday activities of the NBS, especially the Institute for Manufacturing Banknotes and Coins – Topčider, since it produces various types of non-hazardous and hazardous waste in its business activities. The waste management has been recognised for many years as very important in terms of environment protection and continuous improvement of responsible behaviour.

The concept of responsible and efficient waste management, applied by the NBS, implies the sorting of waste according to the place of origin, proper marking, temporary storage of waste in controlled and safe conditions, as well as its handing over to long-standing partners for final disposal.

All activities of the NBS regarding environment protection have been harmonised with the legal regulations and requirements of the ISO 14001 standard, with the aim of minimising the impact on the environment. In 2017, the NBS handed over around 100 tonnes of hazardous waste and around 200 tonnes of non-hazardous waste to authorised operators for further disposal, and submitted regular reports on the quantity of that to the Ministry of Environment Protection.

The Institute for Manufacturing Banknotes and Coins – Topčider constantly monitors, controls and measures the quality of environmental media that it has an impact on. Wastewater treatment within the plants of the Institute for Manufacturing Banknotes and Coins – Topčider is at a high level, and the quality of the effluent that is released into the sewer meets all regulatory requirements. For the purpose of quality control and establishing the monitoring of the quality of soil and groundwater, three piezometers were installed, which are used for taking samples of water for analysis. Atmospheric emissions that result from combustion of fuel for the production of heat energy are regularly measured, monitored and controlled. All the analyses of water and emissions of pollutants are done by certified laboratories, and all the findings are within the prescribed values.

In 2017, the Institute for Manufacturing Banknotes and Coins – Topčider procured a machine for developing printing plates that uses water instead of hazardous chemicals, as was the case before. This reduced the use of hazardous chemicals to the minimum, contributing to better employee health and environment protection.

In accordance with the principles of responsible behaviour, the NBS raises the awareness of its employees about the importance of environment protection through continuous education, by organising courses and training, as well as by providing timely and quality information.

## Plans for 2018

The NBS will continue to promote social responsibility, carry out humanitarian and volunteer campaigns, and expand the network of its associates and the range of activities.

In order to ensure continued application of the Environmental Management System defined in the ISO 14001 standard, the NBS plans to adapt to the requirements of the new version of this standard, which was revised by the International Organisation for Standardisation.

## III.5 Management

### III.5.1 Human resource management

#### Organisational changes and number of employees in 2017

The Rulebook on Internal Organisation of the NBS was amended in 2017 as follows:

- Administration for Supervision of Financial Institutions – the basic organisational unit Centre for Financial Consumer Protection and Education changed its name to Department for Financial Consumer Protection and Education;

- Administration for Supervision of Financial Institutions – in the basic organisational unit Bank Supervision Department, the Division for Off-Site Supervision, the Unit for Reporting, Banking Sector Analysis and Support to Bank Supervision was abolished, while the Group for Accounting and Audit operating within that unit was set up at the level of the Division for Off-Site Supervision. In addition, within the said Division, a new organisational unit was established – Group for Off-Site Supervision of Financial Transactions in Banks; in the Division for Legal Matters, the Unit for Banking Sector Regulations was abolished; in the Division for Development, two new units were formed – Unit for the Development of Supervision and Unit for the Development of Banking Sector Regulations; Division for Special Supervision changed its name to Division for Supervision of Payment Services, Electronic Money Issuance and Financial Leasing, within which two units were established – Unit for Supervision of Payment Services and Electronic Money Issuance and Unit for Supervision of Financial Leasing; the Bank Supervision Department set up three smaller organisational units – Division for Banking Sector Analysis and Reporting, Group for Quantity Models Development and Bank Supervision Support, as well as the Group for Development of Bank Supervision Applications;

- basic organisational unit National Payment Card Centre was abolished and its operations were integrated into the Payment System Department, within which the Unit for Methodology and Payment System Development changed its name to Unit for Payment System Regulations and Development. Also, a new unit was set up – Division for Products and Support to DinaCard System, with one unit – Unit for DinaCard System Technology and Development;
- basic organisational unit Sector for Information-Communication Technologies changed its name to Department for Information-Communication Technologies;
- in accordance with the importance, complexity and nature of the work carried out by the organisational unit Human Resources, it changed its scope and name to Department for Human Resources and Organisational Matters, in which the Division for Labour Relations and Employment changed its name to Division for Labour Relations. Within this Division, the Group for Labour Records replaced the Unit for Labour Records; within the Department for Human Resources and Organisational Matters, the Unit for Occupational Safety and Health replaced the Group for Occupational Safety and Health.

Table III.5.1.1 **Comparative overview of the number of staff**

Organisational unit	31 December 2016			31 December 2017			Change (%)
	Indefinite term	Definite term	Total	Indefinite term	Definite term	Total	
1	2	3	4 (2+3)	5	6	7 (5+6)	8
Main organisational units	1,177	74	1,251	1,163	95	1,258	0.56
Administration for Supervision of Financial Institutions	192	19	211	196	27	223	5.69
Belgrade Branch	96	2	98	94	2	96	-2.04
Novi Sad Branch	104	4	108	106	1	107	-0.93
Niš Branch	35	4	39	36	3	39	0.00
Kragujevac Branch	41	3	44	40	5	45	2.27
Užice Branch	28	15	43	30	15	45	4.65
Institute for Manufacturing Banknotes and Coins	546	19	565	533	9	542	-4.07
<b>Total in NBS:</b>	<b>2,219</b>	<b>140</b>	<b>2,359</b>	<b>2,198</b>	<b>157</b>	<b>2,355</b>	<b>-0.17</b>

Source: NBS

## Staff qualification and age structure

In terms of staff qualification levels as regulated by the Law on Higher Education, on 31 December 2017 the qualification structure of NBS staff was as follows: 18 employees had a PhD degree, 851 employees an MSc/MA degree and 254 employees a university degree. There were 983 employees with secondary and 92 employees with primary education.

Table III.5.1.2 Staff qualification structure

31 December 2017						
Organisational unit	Higher education			Secondary education	Primary education	Total
	PhD	MSc/MA	BSc/BA			
Main organisational units	13	518	161	414	57	1163
Administration for Supervision of Financial Institutions	3	163	19	11	-	196
Belgrade Branch	1	11	10	70	2	94
Novi Sad Branch	-	18	10	74	4	106
Niš Branch	-	11	5	19	1	36
Kragujevac Branch	-	11	3	25	1	40
Užice Branch	-	7	2	18	3	30
Institute for Manufacturing Banknotes and Coins	1	112	44	352	24	533
<b>Total in NBS:</b>	<b>18</b>	<b>851</b>	<b>254</b>	<b>983</b>	<b>92</b>	<b>2,198</b>

Source: NBS.

As regards the gender structure, like in the previous years, women (55.41%) outnumbered their male colleagues (44.59%).

Table III.5.1.3 Staff gender structure

31 December 2017				
Organisational unit	Men		Women	
Main organisational units	479	41.19	684	58.81
Administration for Supervision of Financial Institutions	60	30.61	136	69.39
Belgrade Branch	28	29.79	66	70.21
Novi Sad Branch	42	39.62	64	60.38
Niš Branch	17	47.22	19	52.78
Kragujevac Branch	19	47.50	21	52.50
Užice Branch	11	36.67	19	63.33
Institute for Manufacturing Banknotes and Coins	324	60.79	209	39.21
<b>Total in NBS:</b>	<b>980</b>	<b>44.59</b>	<b>1,218</b>	<b>55.41</b>

Source: NBS.

In terms of age structure, as in the several previous years, the two most prevalent age groups were 50 to 60 years (38.67%) and 40 to 50 (31.16%). The average age was 48.6.

Table III.5.1.4 Staff age structure

Organisational unit	31 December 2017							Average age
	Up to 20	20 to 30	30 to 40	40 to 50	50 to 60	Over 60	Total	
Main organisational units	-	65	192	383	408	115	1,163	48.2
Administration for Supervision of Financial Institutions	-	17	77	55	38	9	196	42.6
Belgrade Branch	-	-	6	20	52	16	94	53.6
Novi Sad Branch	-	8	11	26	52	9	106	50.0
Niš Branch	-	-	4	11	17	4	36	52.2
Kragujevac Branch	-	-	5	8	20	7	40	53.0
Užice Branch	-	2	3	5	15	5	30	52.1
Institute for Manufacturing Banknotes and Coins	-	13	64	177	248	31	533	49.9
<b>Total in NBS:</b>	-	<b>105</b>	<b>362</b>	<b>685</b>	<b>850</b>	<b>196</b>	<b>2,198</b>	<b>48.6</b>
<b>In %</b>	-	<b>4.78</b>	<b>16.47</b>	<b>31.16</b>	<b>38.67</b>	<b>8.92</b>	<b>100.00</b>	

Source: NBS.

## Education, professional development and training of NBS employees

In order to improve the capacities of its employees, as well as to increase the efficiency of business processes, the NBS has enabled its employees to attend professional trainings to acquire and maintain various professional licenses and certificates, which are a prerequisite for doing their job or specialising in different fields. The employees also attended seminars, workshops, conferences in the country and abroad on various topics in the field of central banking, participated in study visits to other central banks, and attended online trainings. For the purpose of acquiring higher education, the employees are funded to attend the first (BSc/BA), the second (MSc/MA) and the third (PhD) cycle of academic and vocational studies at the universities in the Republic of Serbia.

In accordance with the needs of the work, employees of the NBS attended English language courses, which included standard and business courses, as well as courses in the field of finances.

During 2017, three trainees started vocational training, while five trainees completed a twelve-month internship programme and successfully passed the trainee exam.

Table III.5.1.5 **Staff education, professional development and training**

2017	
Type of education, professional development and training	Number of employees
<b>Education</b>	
BSc/BA studies	2
MSc/MA studies	6
Doctoral studies	1
<b>Professional development</b>	
Professional training, licenses, certificates	26
Internship training	8
<b>Training</b>	
Seminars, workshops, counselling and conferences in the country	149
Seminars, workshops, counselling, study visits and conferences abroad	127
Online training	4
Foreign language courses	55
<b>Summer internship</b>	
Internship for domestic and foreign students July–August	42

Source: NBS.

From July to August, the NBS organised summer internship for 42 students attending final years of university studies in Serbia and abroad.

## Plans for 2018

To improve the efficiency of business operations and achieve organisational objectives, the NBS plans to continue investing in the training and development of its employees.

Given the rapid changes in the financial environment, legal regulations, IT advancement and business digitisation, the selection of seminars and other forms of training will be carried out so as to respond to the current needs of organisational units for strengthening the professional capacities of employees in new business areas, as well as to improve existing business processes and basic functions.

In order to introduce all NBS employees with obligations and responsibilities regarding information security, in 2018, online training on the Moodle platform will be conducted, and internal lectures will be organised on various topics, such as information security, social engineering, security of passwords, security of data on the workstation, work environment security, etc.

As in the previous years, the NBS plans to organise a summer internship for students attending final years of BSc/BA and MSc/MA university studies in Serbia, as well as for Serbian citizens studying abroad.

### III.5.2 Internal audit and risk management

The regulatory framework for internal audit at the NBS is established by the Law on the National Bank of Serbia, Statute of the National Bank of Serbia and internal general acts which regulate in more detail internal audit and the performance of internal audit work.

Internal audit is carried out in accordance with the Annual Plan adopted by the Council of the Governor. Reports on conducted audits are submitted to managers of the audited organisational units, to the Governor and NBS management in charge of the audited operations. The Council of the Governor is also informed, through the Audit Committee, on a quarterly basis about the performed internal audit activities.

In 2017, 14 audits were conducted. The audits covered business processes in the fields of procurement, training and staff development, calculation of wages, accounting, supervision of financial institutions, monetary operations, foreign exchange operations, economic research and statistics, information technology, physical and technical safety and protection of financial services consumers.

Internal audits in 2017 detected no high-risk findings in any of the audited process, while medium-risk findings accounted for 56% and low-risk findings for 44% of total risk findings. A total of 83 recommendations on implementing activities necessary for eliminating deficiencies and improving business processes were agreed upon with the management of the main organisational units in charge of implementation of recommendations. In 2017, the Internal Audit verified the status of implementation of 156 recommendations from previous years and determined that 113 of them were fully implemented.

In 2017, the monitoring of implementation of the project of designing the production information system at the Institute for Manufacturing Banknotes and Coins – Topčider continued, and the progress report was prepared. Compliance of data on the stock of net NBS FX reserves was analysed, as a part of the regular quarterly activity, for the purpose of monitoring the execution of the programme with the IMF.

Some activities in 2017 focused on improving the work methodology of Internal Audit. A new methodology for the preparation of the annual plan based on risk assessment was developed and the method of reporting on the results of monitoring the implementation of recommendations was changed.

#### Plans for 2018

In 2018, implementation of the NBS Internal Audit Annual Plan for 2018, adopted by the Council of the Governor, will be in focus. In addition, the completion of amendments to internal acts governing NBS internal audit activities initiated in 2017, is planned (Rulebook on Internal Audit of the NBS, Manual for Internal Audit of the NBS, procedures and instructions).

### III.5.3 Information and communications technology

With regard to application development, in 2017 the NBS implemented new and upgraded the existing application solutions to support its operation and apply the adopted regulations.

During 2017, improvement of the infrastructure systems security continued through the transition to a new system for controlling access to network devices, migration of software for centralised management of network devices and the launch of the project aimed at reorganisation and improvement of internet traffic security. Also, software for centralised monitoring of security information and events was further improved and certain systems were migrated to newer versions.

Through the single system for registering user requests made by phone or email, the NBS responded to 3,550 simpler requests, 6,734 more complex requests and 1,665 incidents reported by internal users, as well as external users through technical support regarding installation, use and maintenance of software for exchange transactions. Fees were also charged in 246 cases for installing desktop and network versions of software for exchange transactions and its maintenance with new certified exchange dealers, as well as 2,720 fees for the use and maintenance of the desktop and network version of the software for exchange transactions with the old exchange dealers.

#### Plans for 2018

The most important activities planned by the NBS in the field of ICT in 2018 are the following: further improvement of the information infrastructure and internet traffic security, restoration of the entire communication equipment, the introduction of new systems for archiving, storage and classification of data, migration of the SWIFT system and databases to new hardware and software, the introduction of the new Microsoft Windows 10 operating system and Microsoft Office 365 software package. Also, the development of internal software solutions, the improvement of existing and development of new applications for support of the NBS operations, as well as the implementation of the adopted regulations will continue.

## IV FINANCIAL STATEMENTS

### **IV.1 Financial position and result of operations of the National Bank of Serbia**

The NBS is a non-profit institution mandated to achieve legally defined objectives of ensuring price and financial stability in a sustainable manner, at the lowest possible cost to all economic agents. The success of the NBS, like the success of any other central bank in the world, is therefore not measured by the financial result achieved in a given year, but depends on whether we have delivered on our legally defined objectives and ensured stable conditions for doing business and investing.

The exercise of legally defined functions of the NBS, primarily formulation and implementation of the monetary and foreign exchange policies, foreign exchange reserves management, activities and measures to maintain and strengthen the stability of the financial system, determines the type and amount of income and expenses recorded by the NBS.

The reported income and expenses and the reported result also depend on the accounting principles and standards applied in the preparation and presentation of financial statements, which are, in accordance with the relevant regulations, aligned with international accounting standards and financial reporting standards. This applies in particular to accounting principles relating to the application of the fair value concept when valuing financial instruments and converting business changes and amounts denominated in foreign currency.

#### *Income and expenses from regular operations*

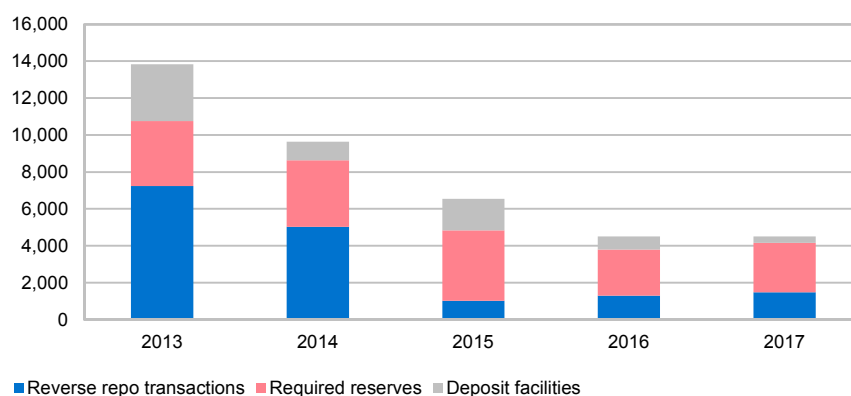
The most important income and expenses recorded by the NBS in its regular operations are interest income and expenses. Interest income in 2017 amounted to RSD 8.7 bn and resulted primarily from the investment of foreign exchange reserves. Interest expenses in the amount of RSD 4.8 bn primarily arose from the implementation of monetary operations aimed at achieving the main objective – price stability, where the NBS was successful.

Taking into account the basic principles of liquidity and security in foreign exchange reserve management, **the NBS has taken an active approach to achieving the highest possible yields on foreign currency assets, which in the conditions of low yields on safe securities in the global market was not an easy task at all.**

Foreign exchange reserve management was carried out under conditions of unfavourable developments in international financial markets, which are particularly reflected in the inability to invest funds in euros at positive interest rates, given that the ECB drove interest rates to the negative territory in June 2014.

The NBS, like many other central banks of developing countries, uses monetary policy instruments to absorb excess liquidity from the system so as not to encourage inflationary pressures. This necessarily incurs monetary operations costs. In view of this, interest expenses in the amount of RSD 4.8 bn were recorded, primarily on account of conducting monetary operations in the open market and implementing other monetary policy instruments.

Chart IV.1.1 **Expenditures under monetary operations**  
(in RSD mn)



Source: NBS.

**In the past five years, the NBS has shown that objectives can be achieved successfully, even with savings from the aspect of the financial result. The costs of conducting monetary operations have been greatly reduced in recent years, precisely owing to the activities of the NBS.** This was achieved primarily owing to a stable economic environment, which enabled a significant reduction of interest rates. From May 2013 to end-2017, the key policy rate was trimmed by a total of 8.25 pp – from 11.75% to 3.50%. At the same time, the deposit facility rates were lowered by 7.25 pp, and rates on lending facilities by 9.25 pp.

**Observed in the 5-year period, total NBS costs from conducting monetary operations recorded a threefold decrease, falling from RSD 13.8 bn in 2013 to RSD 4.5 bn in 2017 (decrease by RSD 9.3 bn).**

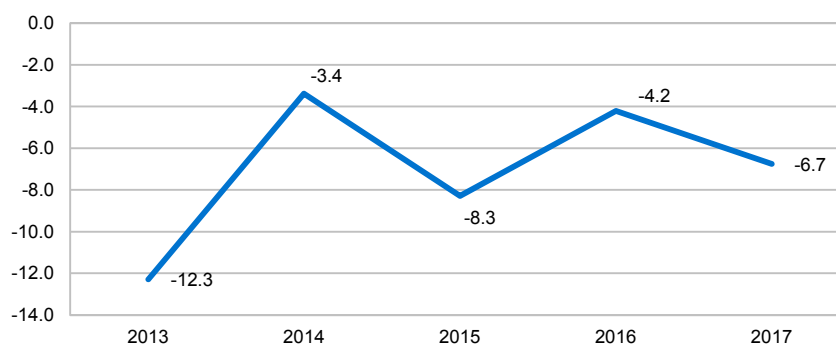
Besides the interest income arising from the investment of foreign exchange reserves, FX reserve management exposes the NBS's balance sheet to international financial market developments, primarily yield changes and, consequently, changes in the market value (prices) of securities. Balance sheet exposure is a consequence

of applying the fair value accounting principle when valuing financial instruments and recognising the relevant gains/losses in the income statement. With regard to this, in 2017 the NBS recorded the following:

- net loss from changes in the fair value of coupon and discount securities in the amount of RSD 5.4 bn due to a decline in prices in the EUR portfolio, which was also recorded in the USD, CAD and GBP portfolios (loss of RSD 2.8 bn in 2016); and
- net loss from the sale of those securities amounting to RSD 1.3 bn (loss of RSD 1.5 bn in 2016).

**In accordance with the changes of international financial reporting standards, applied as of 1 January 2018, gains/losses from changes in the fair value of securities incurred by their reporting at market value will not be recognised in the income statement until they are sold. This will enable more realistic reporting of the business result, since it contains only realised, but not calculated, unrealised gains/losses under this item.**

Chart IV.1.2 **Net losses from the change in fair value and sale of securities**  
(in RSD bn)



— Net losses from the change in fair value and sale of securities (in RSD bn)

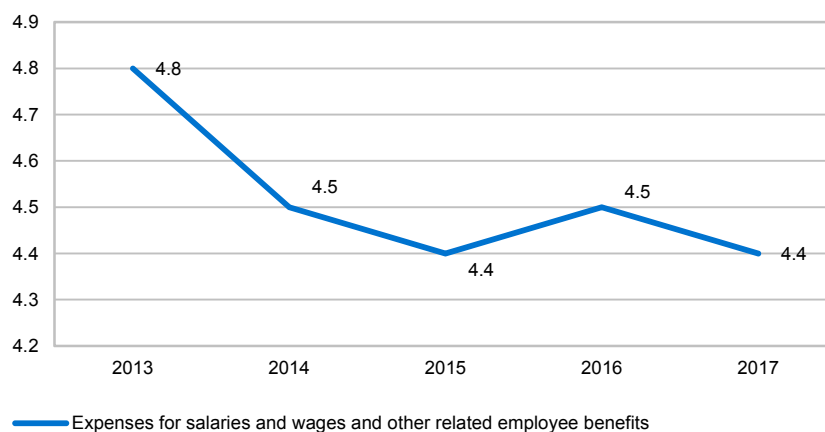
Source: NBS.

Of total other operating income of the NBS in the amount of RSD 12.6 bn (RSD 20.6 bn in 2016), income from business operations of the Institute for Manufacturing Banknotes and Coins – Topčider, i.e. income from the sale of their products in the domestic and foreign market, accounted for RSD 6.4 bn. Income of the Institute for Manufacturing Banknotes and Coins – Topčider in 2017 was higher by RSD 0.2 bn than in 2016 (RSD 6.2 bn).

Other operating expenses recorded by the NBS in its operations include: depreciation costs in the amount of RSD 1.7 bn (RSD 1.6 bn in 2016), other expenses (largely comprising production expenses of the Institute for Manufacturing Banknotes and Coins – Topčider) in the amount of RSD 5.1 bn (RSD 4.9 bn in 2016), and salaries, compensations and other expenses related to employees in the amount of RSD 4.4 bn (RSD 4.5 bn in 2016).

**Chart IV.1.3 Movements in salaries and wages and other related employee benefits**

(in RSD bn)



Source: NBS.

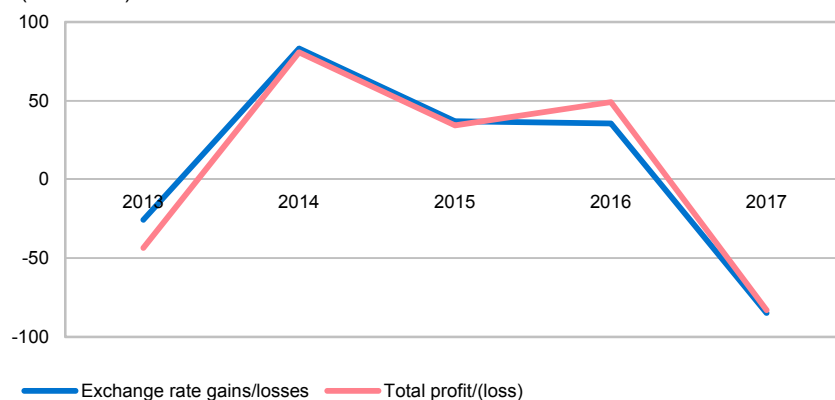
### *Exchange rate losses*

In the NBS balance sheet, 91% of assets and 31% of liabilities are denominated in foreign currency, which enables the NBS to respond, as needed, to requirements regarding the maintenance of external liquidity of the country and to moderate short-term volatility of the dinar exchange rate.

With regard to this, besides income and expenses recorded by the NBS in its regular operations, total financial result of the central bank is also significantly affected by the movement of exchange rates of currencies, primarily EUR and USD, and price movements of precious metals, chiefly gold. In 2017, the NBS recorded a net expense from exchange rate losses and currency clause effects in the amount of RSD 84.8 bn (vs. net exchange rate gains in the amount of RSD 35.5 bn in 2016).

**Chart IV.1.4 Impact of exchange rate gains/losses on the financial result of NBS operations**

(in RSD bn)



Source: NBS.

### Total operating result of the NBS

The NBS Income Statement for 2017 discloses loss in the amount of RSD 83.1 bn (vs. profit in the amount of RSD 49.2 bn in 2016). Exchange rate gains/losses excluded, the NBS **operated at a profit** in 2017, the same as in 2016.

**The total NBS financial result achieved in 2017 is not a burden for taxpayers in Serbia in any way. According to the Law on the National Bank of Serbia, a disclosed loss is covered from previously formed NBS special reserves.**

In 2016, when NBS profit amounted to RSD 49.2 bn, it transferred 70% of the result that did not originate from exchange rate gains/losses and revaluation reserves to the budget of the Republic of Serbia (total amount being RSD 9.6 bn), and the rest was allocated to core capital (RSD 13.2 bn) and NBS special reserves (RSD 26.4 bn).

Based on all of the above, it can be concluded that the NBS successfully achieved its legally defined objectives and provided stable business and investment conditions, which is the benchmark of success of each central bank, as a non-profit institution mandated to ensure price and financial stability in a sustainable manner at the lowest possible cost to all economic agents.

Table IV.1.2 **Income statement**  
(RSD thousand, 1 January – 31 December)

	2017	2016
Interest income	8,701,151	9,706,927
Interest expenses	(4,760,001)	(4,661,111)
<b>Net interest income</b>	<b>3,941,150</b>	<b>5,045,816</b>
Fee and commission income	4,508,232	4,302,793
Fee and commission expenses	(1,016,269)	(610,029)
<b>Net fee and commission income</b>	<b>3,491,963</b>	<b>3,692,764</b>
Net losses on financial assets held for trading	(6,738,050)	(4,202,245)
Net gains on hedges against risks	66	2,858
Net foreign exchange gains/(losses) and currency clause effects	(84,769,775)	35,465,803
Other operating income	12,586,387	20,643,672
Net expenses from impairment of financial assets and credit risk-weighted off-balance sheet items	(13,035)	(32,071)
Salaries, compensations and other expenses related to employees	(4,383,083)	(4,492,047)
Depreciation and amortisation charge	(1,672,490)	(1,632,334)
Other expenses	(5,134,290)	(4,898,997)
<b>PROFIT/(LOSS) BEFORE TAX</b>	<b>(82,691,157)</b>	<b>49,593,219</b>
Income tax	(454,479)	(408,113)
<b>PROFIT/(LOSS) AFTER TAX</b>	<b>(83,145,636)</b>	<b>49,185,106</b>

Source: NBS.

Table IV.1.1 Financial results of the NBS in 2016 and 2017

Year	Result – operating income		Exchange rate gains or losses		Financial result	Profit transferred to the RS budget
1	2		3		4=2+3	5=2*70%
2016	Profit	13.72	Gains	35.47	Profit 49.19	9.6
2017	Profit	1.62	Losses	(84.77)	Loss (83.15)	-

Source: NBS.

### *Financial position of the National Bank of Serbia*

The statement of the financial position of the NBS as at 31 December 2017 (balance sheet) discloses assets – property of the Republic of Serbia used by the NBS for the purpose of meeting its objectives and exercising its functions, and liabilities – total liabilities and capital of the NBS, in the amount of RSD 1,322.2 bn.

On the assets side, 89.3% of total assets are FX reserves managed by the NBS. Except for a small amount of dinar assets, FX reserves are disclosed within the following balance sheet items, depending on the form in which they are held: cash and current account balances held with banks (RSD 201.6 bn), deposits with banks (RSD 163.4 bn), gold and other precious metals (RSD 80.8 bn), financial assets at fair value through profit and loss held for trading (RSD 727.5 bn) and SDR holdings (RSD 7.9 bn).

In addition to FX reserves, balance sheet assets also include the IMF membership quota of the Republic of Serbia in the amount of RSD 92.4 bn. The value of property, plant, equipment, investment property and intangible investment used by the NBS in its operations came to RSD 20.8 bn.

In 2017, total assets of the NBS decreased by 6.9% or RSD 97.5 bn compared to 2016.

Within liabilities, disclosed liabilities of the NBS came at RSD 1,023.8 bn and its capital at RSD 298.3 bn.

As at 31 December 2017, NBS liabilities related primarily to:

- liabilities to banks and other financial organisations, arising mainly from the conduct of monetary policy (determining bank required reserves and implementing open market operations) in the amount of RSD 484.3 bn or 2.4% less than a year earlier;
- liabilities to the government and other depositors in respect of transaction and other deposits in dinars and foreign currency in the amount of RSD 268.5 bn or 4.5% more than a year earlier;
- liabilities to the IMF in the amount of RSD 100.4 bn or 10.4% less than in 2016;
- liabilities to transactors for currency in circulation in the amount of RSD 163.9 bn.

Table IV.1.3 **Balance sheet**

(RSD thousand)

	31 December 2017	31 December 2016
<b>ASSETS</b>		
Cash and current accounts held with banks	210,176,735	202,213,819
Gold and other precious metals	80,767,776	82,555,050
Deposits	163,435,360	206,672,592
Financial assets carried at fair value through profit and loss held for trading	727,503,422	775,159,641
Financial assets available for sale	9,931,739	10,735,222
Financial assets held to maturity	3,026,769	2,877,822
Loans	1,145,859	1,261,628
IMF membership quota and SDR holdings	100,405,431	112,236,035
Intangible investment	112,425	77,144
Property, plant and equipment	20,233,103	21,413,972
Investment property	467,609	467,609
Other assets	4,945,877	3,971,720
<b>TOTAL ASSETS</b>	<b>1,322,152,105</b>	<b>1,419,642,254</b>
<b>LIABILITIES</b>		
Liabilities		
Financial liabilities carried at fair value through profit and loss held for trading	35,365	5,433
Deposits and other liabilities to banks and other financial organisations	484,339,613	496,486,485
Deposits and other liabilities to the government and other depositors	268,460,430	256,890,975
Liabilities to the IMF	100,437,147	112,038,645
Provisions	1,412,699	1,260,355
Current tax liabilities	454,479	408,113
Currency in circulation	163,944,539	159,227,574
Other liabilities	4,755,384	2,666,493
<b>Total liabilities</b>	<b>1,023,839,656</b>	<b>1,028,984,073</b>
Capital		
State-owned capital	171,128,873	157,945,159
Reserves	210,329,212	183,522,896
Profit	-	49,190,126
Loss	(83,145,636)	-
<b>Total capital</b>	<b>298,312,449</b>	<b>390,658,181</b>
<b>TOTAL LIABILITIES</b>	<b>1,322,152,105</b>	<b>1,419,642,254</b>

Source: NBS.

## IV.2 Accounting principles and standards

The accounting principles and standards applied by the NBS in preparing, presenting and disclosing financial statements are defined by the accounting policies of the NBS, in line with the International Accounting Standards and International Financial Reporting Standards.

The goal of accounting policies of the NBS is to ensure that the property status, success of operations and change in the financial position of the NBS are disclosed fairly and objectively in its financial statements.

Accounting policies refer to the estimation of assets, liabilities and capital, calculation of operating results and disclosure of these items in financial statements.

Below is the summary of accounting policies applied at the time of recognising, valuing and disclosing the most important items of the balance sheet and income statement.

### *Interest income and expenses*

Interest income and expenses, including default interest and other operating income and expenses arising from interest-bearing assets and/or interest-bearing liabilities are calculated according to the principle of causality of income and expenses, by applying the effective interest rate.

### *Fee and commission income and expenses*

Fee and commission income and expenses from banking services are recognised when earned/due.

### *Conversion of FX-denominated assets and liabilities*

Transactions performed in foreign currencies whose exchange rates are officially published by the NBS are converted into dinars using the official middle exchange rates effective as at the transaction date, whereas for currencies whose exchange rates are not officially published by the NBS, conversion is performed using corresponding cross-exchange rates of the NBS effective as at the transaction date.

Monetary assets and liabilities denominated in foreign currency are converted into dinars using the official middle exchange rate valid on the balance sheet date (if the currency rate is published by the NBS in the official exchange rate list) or the corresponding exchange rate of the NBS (for currency rates not published in the official exchange rate list).

Foreign exchange gains or losses arising from the conversion of transactions in foreign currency and the conversion of monetary balance sheet items denominated

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in foreign currencies are credited or charged to the income statement as exchange rate gains/losses and currency clause effects.

### *Financial instruments*

The NBS classifies its financial assets and liabilities into the following categories: financial assets carried at fair value through profit and loss, loans and receivables, financial assets held to maturity and financial assets available for sale. Classification depends on the intended purpose for which the financial assets and liabilities were acquired. The NBS management classifies assets and liabilities upon initial recognition, whereas any subsequent reclassification is performed only if certain specific criteria are met for a particular financial instrument category.

#### *Financial assets carried at fair value through profit and loss*

This financial assets category includes debt securities in which the NBS invests the FX reserves it manages. It refers to securities designated as securities at fair value through profit and loss upon initial recognition and to securities held for trading.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortised cost net of any impairment. Loans are presented separately, while receivables are presented within other assets.

#### *Financial assets held to maturity*

Financial assets held to maturity represent investments in debt securities where the NBS has the positive intention and ability to hold these securities to maturity. These securities are measured at amortised cost net of any impairment.

#### *Financial assets available for sale*

Financial assets available for sale are non-derivative financial assets that are either initially designated as available for sale or are not classified into any other category. Equity investments in international financial institutions are stated at fair value disclosed in foreign currencies. The effects of foreign exchange rate changes are included in the income statement under foreign exchange gains/losses and currency clause effects. Shares in the capital of legal entities in the country are stated at fair value if determinable or at purchase cost net of allowance for impairment, if the fair value cannot be reasonably determined.

Financial assets available for sale for which there is an active market are reconciled with the market price (fair value) at the end of each month. Changes in

the market value of shares in capital and financial assets available for sale are presented within capital, as reserves on account of financial instruments available for sale. Gains and losses arising from the sale of these financial assets are credited/charged to the income statement.

#### *Financial liabilities carried at amortised cost*

Financial liabilities from repurchase transactions are carried at amortised cost. The difference between the cost and the repurchase value is recognised in the income statement over the term of the borrowing applying the effective interest method.

#### *Recognition date and determining financial instruments value*

Regular purchases and sales of investments are recognised as at the transaction date – the date when the NBS makes payments or collects funds based on the purchase or sale of assets. All investments, except for financial assets at fair value through profit and loss, are initially recognised at fair value increased by transaction costs.

Financial assets at fair value through profit and loss are initially recognised at fair value while costs of such transactions are included in the income statement. Assets are derecognised when the rights to the economic benefits arising from these investments have expired or have been ceded and when the NBS has substantially transferred all risks and rewards arising from ownership.

Financial assets available for sale and financial assets at fair value through profit and loss are subsequently carried at fair value.

Loans, receivables and securities held to maturity are measured at amortised cost applying the effective interest method. Gains and losses arising from changes in the fair value of financial assets at fair value through profit and loss, including interest income, are recorded in the income statement for the period when earned/incurred. Dividends from shares available for sale are recorded in the income statement when the NBS's right to such dividend has been established.

The fair value of financial assets quoted on the stock exchange is determined based on effective market value. If such instruments are not quoted on an active market (not quoted on a stock exchange), their fair value cannot be determined based on effective market value, the NBS determines their fair value through an assessment which implies the use of information on most recent market transactions involving such instruments, using the method of discounted cash flows or the option pricing model.

#### *Impairment of financial assets*

Financial assets, except for assets carried at fair value through profit and loss, are assessed for impairment at each balance sheet date. The assessment of

impairment is performed individually for each item of financial assets. The NBS does not perform group assessment of impairment of financial assets. Financial assets are impaired if there is objective evidence that, as a result of one or more events that occurred after initial recognition of the financial asset, the estimated future cash flows of the investment have been changed.

Objective evidence of impairment may include the following: significant financial difficulty of the issuer or counterparty; default or delinquency in interest or principal payments; or probability that the debtor will enter bankruptcy, liquidation or other financial reorganisation. For the purpose of assessing the impairment of financial assets, the NBS management assesses the financial position of borrowers but also the net realisable value of collateral.

For shares that are not quoted on the market and are classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is also objective evidence of impairment.

For financial assets carried at amortised cost, the amount of impairment loss is recognised as the difference between the carrying amount of the asset and the present value of the estimated future cash flows, obtained by discounting future cash flows of each financial asset by the original effective interest rate.

The carrying amount of financial assets is reduced by the impairment loss indirectly for all financial assets with the exception of financial assets measured at fair value and is disclosed within costs of impairment of financial assets. If the amount of the recognised impairment loss decreases during the following year as a consequence of an event that occurred after such recognised impairment, the previously recognised impairment loss is reduced by adjusting the allowance account, and the amount of such adjustment is recognised in the income statement.

In respect of equity instruments, within financial assets available for sale, impairment losses previously recognised in profit and loss are not reversed through profit and loss, but are recognised directly within capital.

### *Derecognition*

Financial assets are derecognised when the NBS loses control over contractual rights governing such instruments, which occurs when the right of use of such instruments has been realised, abandoned, expired or ceded. Financial liabilities are derecognised when they cease to exist.

### IV.3 Exposure and risk management

The key financial risks to which the NBS is exposed in its daily operations are the following:

- credit risk,
- liquidity risk,
- interest rate risk, and
- currency risk.

Given that the primary objective of the NBS is to preserve price and financial stability, its financial risk management framework differs from that of commercial financial institutions. The majority of financial risks in the NBS arise from FX reserve management and financial market operations.

FX reserve management is based on the Strategic Guidelines for Managing NBS FX reserves, determined by the Executive Board. The Guidelines define the criteria for investment of FX reserves, purposes for which the reserves are used, global investment framework and other. On the basis of these Guidelines, the NBS's Investment Committee prepares draft Tactical Guidelines for FX Reserve Management and submits them to the Executive Board for adoption.

#### Credit risk

The NBS's exposure to credit risk is primarily in the domain of FX reserve management. When investing FX reserves, the NBS is guided by the principles of liquidity and safety.

The analysis and measurement of credit risk inherent in the NBS portfolio is performed in accordance with generally accepted methods, including minimum credit rating requirements.

The securities in which investment is made must have a rating of at least Aa3 for state-issued bonds and Aa2 for public sector bonds and bonds securitised with collateral as rated by Moody's Investor Service, or AA- for state-issued bonds and AA for public sector bonds and bonds securitised with collateral as rated by Standard&Poor's.

Banks maintaining non-collateralised deposits of the NBS must have a minimum composite credit rating of AA-. A credit limit for each bank is determined based on the bank's credit rating, prior experience in operations with that bank and an analysis of its business performance data. A credit limit for each bank is set in the List of Authorised Issuers of Securities and Banks in which it is permissible to place FX reserve funds, which is approved by the Executive Board.

Banks maintaining collateralised deposits (repo deposits) of the NBS must have: a minimum long-term credit rating of A3 as rated by Moody's Investor Service, or A- as rated by Standard&Poor's, and collateral of adequate

quality, i.e. the collateral must comprise securities included in the NBS Global Investment Guidelines.

There are no limitations to investments with central banks and international financial institutions.

An exception to the above are funds held in regular current accounts of the NBS with banks not having the required credit rating and used for the performance of foreign payment transactions.

**Table IV.3.1 Concentration of assets' credit risk exposure by region**

(RSD thousand as at 31 December 2017)

	Serbia	European Union	USA and Canada	Other	Total
Cash and current accounts held with banks	8,613,453	72,953,043	99,577	176,179	81,842,252
Deposits	18,908	43,904,785	19,287,876	100,062,578	163,274,147
Financial assets carried at fair value through profit and loss	37,172	473,614,010	217,742,925	36,109,315	727,503,422
Financial assets held to maturity	3,026,769	-	-	-	3,026,769
Loans	1,145,859	-	-	-	1,145,859
IMF membership quota and SDR holdings	-	-	7,949,426	-	7,949,426
Other assets	372,862	782	6	108	373,758
<b>Total as at 31 December 2017</b>	<b>13,215,023</b>	<b>590,472,620</b>	<b>245,079,810</b>	<b>136,348,180</b>	<b>985,115,633</b>
<b>Total as at 31 December 2016</b>	<b>19,217,237</b>	<b>692,082,834</b>	<b>276,330,844</b>	<b>104,661,956</b>	<b>1,092,292,871</b>

Source: NBS.

## Liquidity risk

Liquidity risk refers to the ability to ensure regular payment of obligations and regular collection of receivables within agreed timelines.

As part of its strategy of liquidity risk management, the NBS holds a portfolio of liquid assets, including funds held in accounts with foreign banks and bonds of the most developed countries, international financial institutions, federal units of the most developed countries and financial institutions supported by these countries, as well as prime covered bonds, in line with the guidelines for managing FX reserves.

Table IV.3.2 Exposure to liquidity risk

(RSD thousand as at 31 December 2017)

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Without specified maturity	Total
Cash and current accounts held with banks	210,176,735	-	-	-	-	-	210,176,735
Deposits	75,557,374	42,797,011	43,776,528	-	18,908	1,124,326	163,274,147
Financial assets carried at fair value through profit and loss	8,008,331	43,579,267	218,318,981	457,559,671	-	37,172	727,503,422
Financial assets available for sale	-	-	-	-	-	9,931,739	9,931,739
Financial assets held to maturity	-	2,596,632	430,137	-	-	-	3,026,769
Loans	10,543	-	63	4,210	631,434	499,609	1,145,859
IMF membership quota and SDR holdings	7,949,426	-	-	-	-	92,427,246	100,376,672
Other assets	305,113	-	-	-	-	68,645	373,758
	<b>302,007,522</b>	<b>88,972,910</b>	<b>262,525,709</b>	<b>457,563,881</b>	<b>650,342</b>	<b>104,088,737</b>	<b>1,215,809,101</b>
Financial liabilities carried at fair value through profit and loss held for trading	-	-	-	-	-	35,365	35,365
Deposits and other liabilities to banks and other financial organisations	289,388,113	-	-	3,274,708	-	191,447,211	484,110,032
Deposits and other liabilities to the government and other depositors	191,910,905	-	25,240,170	-	-	51,305,462	268,456,537
Liabilities to the IMF	-	-	-	-	-	100,427,584	100,427,584
Currency in circulation	-	-	-	-	-	163,944,539	163,944,539
Other liabilities	3,762,474	-	-	-	-	345,075	4,107,549
	<b>485,061,492</b>	<b>-</b>	<b>25,240,170</b>	<b>3,274,708</b>	<b>-</b>	<b>507,505,236</b>	<b>1,021,081,606</b>
<b>Maturity gap as at 31 December 2017</b>	<b>-183,053,970</b>	<b>88,972,910</b>	<b>237,285,539</b>	<b>454,289,173</b>	<b>650,342</b>	<b>-403,416,499</b>	<b>194,727,495</b>
<b>Cumulative gap-as at 31 December 2017</b>	<b>-183,053,970</b>	<b>-94,081,060</b>	<b>143,204,479</b>	<b>597,493,652</b>	<b>598,143,994</b>	<b>194,727,495</b>	<b>-</b>
<b>Maturity gap as at 31 December 2016</b>	<b>-258,877,607</b>	<b>143,407,163</b>	<b>199,659,662</b>	<b>514,574,546</b>	<b>3,197,633</b>	<b>-316,399,146</b>	<b>285,562,251</b>
<b>Cumulative gap as at 31 December 2016</b>	<b>-258,877,607</b>	<b>-115,470,444</b>	<b>84,189,218</b>	<b>598,763,764</b>	<b>601,961,397</b>	<b>285,562,251</b>	<b>-</b>

Source: NBS.

## Interest rate risk

The NBS sets the level of interest rates on repo transactions and (dinar and foreign exchange) required reserves in order to meet its legally defined objectives – price and financial stability, and to support, without prejudice to its legally defined objectives, the economic policy of the Government of the Republic of Serbia. In addition, the Government and government institutions hold their dinar and foreign currency deposits with the NBS. On the other hand, interest-bearing assets, mostly kept abroad, are exposed to substantial risk of changes in market interest rates. As all this can induce a change in the financial position, the NBS's rules for investment, primarily of FX reserves, aim to limit potential losses arising from market risks.

Table IV.3.3 Exposure to interest rate risk

(RSD thousand as at 31 December 2017)

	Interest-bearing items	Non-interest-bearing items	Total
<b>Financial assets</b>			
Cash and current accounts held with banks	73,131,765	137,044,970	210,176,735
Deposits	163,274,135	12	163,274,147
Financial assets carried at fair value through profit and loss held for trading	727,466,250	37,172	727,503,422
Financial assets available for sale	-	9,931,739	9,931,739
Financial assets held to maturity	2,849,583	177,186	3,026,769
Loans	635,689	510,170	1,145,859
IMF membership quota and SDR holdings	7,949,426	92,427,246	100,376,672
Other assets	-	373,758	373,758
	975,306,848	240,502,253	1,215,809,101
<b>Financial liabilities</b>			
Financial liabilities carried at fair value through profit and loss held for trading	-	35,365	35,365
Deposits and other liabilities to banks and other financial organisations	248,797,082	235,312,950	484,110,032
Deposits and other liabilities to the Government and other depositors	190,241,465	78,215,072	268,456,537
Liabilities to the IMF	8,754,808	91,672,776	100,427,584
Currency in circulation	-	163,944,539	163,944,539
Other liabilities	-	4,107,549	4,107,549
	447,793,355	573,288,251	1,021,081,606
<b>Net exposure as at:</b>			
<b>31 December 2017</b>	<b>527,513,493</b>	<b>-332,785,998</b>	<b>194,727,495</b>
<b>31 December 2016</b>	<b>786,264,926</b>	<b>-500,801,193</b>	<b>285,463,733</b>

Source: NBS.

## Currency risk

The NBS is exposed to currency risk because of changes in exchange rates. Most of the assets and liabilities in the NBS balance sheet are denominated in a foreign currency, which enables the NBS to respond, as needed, to requirements regarding the maintenance of external liquidity of the country and to moderate short-term volatility of the dinar exchange rate.

To minimise currency risks over the medium run, the NBS makes efforts to match the currency structure of its assets with expected future foreign currency-denominated liabilities. Over the short run, this may result in exchange rate gains or losses, which are recorded in the income statement.

Table IV.3.4 **Currency risk exposure of financial assets and liabilities**

(in RSD thousand, as at 31 December 2017)

	EUR	USD	SDR	Other currencies	Total foreign currencies	RSD	Total
<b>Financial assets</b>							
Cash and current accounts held with banks	189,726,183	5,244,806	-	6,592,263	201,563,252	8,613,483	210,176,735
Deposits	77,836,564	80,035,766	-	5,382,908	163,255,238	18,909	163,274,147
Financial assets carried at fair value through profit and loss held for trading	400,197,782	293,301,810	-	33,966,658	727,466,250	37,172	727,503,422
Financial assets available for sale	553	-	9,931,186	-	9,931,739	-	9,931,739
Financial assets held to maturity	226,902	-	-	-	226,902	2,799,867	3,026,769
Loans	-	499,609	-	-	499,609	646,250	1,145,859
IMF membership quota and SDR holdings	-	-	100,376,672	-	100,376,672	-	100,376,672
Other assets	11,256	115	-	999	12,370	361,388	373,758
	667,999,240	379,082,106	110,307,858	45,942,828	1,203,332,032	12,477,069	1,215,809,101
<b>Financial liabilities</b>							
Financial liabilities carried at fair value through profit and loss held for trading	-	-	-	-	-	35,365	35,365
Deposits and other liabilities to banks and other financial organisations	194,453,846	4,182,719	-	109	198,636,674	285,473,358	484,110,032
Deposits and other liabilities to the government and other depositors	100,215,771	2,428,772	273	519,787	103,164,603	165,291,934	268,456,537
Liabilities to the IMF	-	-	100,427,584	-	100,427,584	-	100,427,584
Currency in circulation	-	-	-	-	-	163,944,539	163,944,539
Other liabilities	3,222,223	7,640	-	148,737	3,378,600	728,949	4,107,549
	297,891,840	6,619,131	100,427,857	668,633	405,607,461	615,474,145	1,021,081,606
<b>Net exposure as at:</b>							
<b>31 December 2017</b>	<b>370,107,400</b>	<b>372,462,975</b>	<b>9,880,001</b>	<b>45,274,195</b>	<b>797,724,571</b>	<b>-602,997,076</b>	<b>194,727,495</b>
<b>31 December 2016</b>	<b>404,713,815</b>	<b>370,035,070</b>	<b>10,912,084</b>	<b>45,593,619</b>	<b>831,254,588</b>	<b>-545,692,337</b>	<b>285,562,251</b>

Source: NBS.

## IV.4 Independent auditor's report



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### **TRANSLATION**

#### **Independent Auditors' Report**

TO THE COUNCIL OF THE GOVERNOR

NATIONAL BANK OF SERBIA

We have audited the accompanying financial statements of the National bank of Serbia, which comprise the balance sheet as at 31 December 2017, the income statement, statement of other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Law on Auditing of the Republic of Serbia and auditing standards applicable in the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation and fair presentation of financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

KPMG d.o.o. Beograd, a Serbian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Matični broj: 12148056  
PIB: 100059553  
Račun: 265-11031000190-61

**TRANSLATION***Opinion*

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the National bank of Serbia as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Belgrade, 30 March 2018

KPMG d.o.o. Beograd

(L.S.)

Dušan Tomić  
Certified Auditor

*This is a translation of the original Independent Auditors' Report issued in the Serbian language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Serbian version of the document shall prevail.*

Belgrade, 30 March 2018

KPMG d.o.o. Beograd

  
Dušan Tomić  
Certified Auditor

## 5 Annual financial statements<sup>48</sup>

### Balance sheet

TRANSLATION

NATIONAL BANK OF SERBIA

STATEMENT OF FINANCIAL POSITION  
As of December 31, 2017  
(Thousands of RSD)

	Note	December 31, 2017	December 31, 2016
<b>ASSETS</b>			
Cash and current accounts held with banks	12, 3.4	210,176,735	202,213,819
Gold and other precious metals	13, 3.5	80,767,776	82,555,050
Deposits	14, 3.3	163,435,360	206,672,592
Financial assets at fair value through profit and loss	15, 3.3	727,503,422	775,159,641
Financial assets available for sale	16, 3.3	9,931,739	10,735,222
Financial assets held to maturity	17, 3.3	3,026,769	2,877,822
Loans and placements	18, 3.3	1,145,859	1,261,628
IMF membership quota and SDR holdings	19	100,405,431	112,236,035
Intangible assets	20, 3.7	112,425	77,144
Property, plant and equipment	20, 3.7	20,233,103	21,413,972
Investment property	20, 3.7	467,609	467,609
Other assets	21	4,945,877	3,971,720
<b>TOTAL ASSETS</b>		<b>1,322,152,105</b>	<b>1,419,642,254</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Financial liabilities at fair value through profit and loss		35,365	5,433
Deposits and other liabilities to banks and other financial organizations	22	484,339,613	496,486,485
Deposits and other liabilities to Government and other depositors	23	268,460,430	256,890,975
Liabilities to the IMF	24	100,437,147	112,038,645
Provisions	25	1,412,699	1,260,355
Current tax liabilities	26, 3.9	454,479	408,113
Dinars in circulation	27	163,944,539	159,227,574
Other liabilities	28	4,755,384	2,666,493
<b>Total liabilities</b>		<b>1,023,839,656</b>	<b>1,028,984,073</b>
<b>Equity</b>			
State-owned capital		171,128,873	157,945,159
Reserves		210,329,212	183,522,896
(Loss)/Profit		(83,145,636)	49,190,126
<b>Total equity</b>	29	<b>298,312,449</b>	<b>390,658,181</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>1,322,152,105</b>	<b>1,419,642,254</b>

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form an integral part of these financial statements.

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Jorgovanka Tabaković, PhD  
Governor

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<sup>48</sup> Financial Statements for 2017 with notes, which form an integral part thereof, are submitted to the National Assembly by 30 June 2018 and are published on the website of the National Bank of Serbia.

## Income statement

TRANSLATION		NATIONAL BANK OF SERBIA	
INCOME STATEMENT			
Year Ended December 31, 2017			
(Thousands of RSD)			
	Note	2017	2016
Interest income		8,701,151	9,706,927
Interest expenses		(4,760,001)	(4,661,111)
<b>Net interest income</b>	4, 3.1	<u>3,941,150</u>	<u>5,045,816</u>
Fee and commission income		4,508,232	4,302,793
Fee and commission expenses		(1,016,269)	(610,029)
<b>Net fee and commission income</b>	5, 3.1	<u>3,491,963</u>	<u>3,692,764</u>
Net losses on the financial assets held for trading	6, 3.3	(6,738,050)	(4,202,245)
Net gains from hedging		66	2,858
Net exchange rate (losses)/gains and from agreed currency clause	3.2	(84,769,775)	35,465,803
Other operating income	7	12,586,387	20,643,672
Net expenses from impairment of financial assets and credit risk-weighted off-balance sheet items	8, 3.3	(13,035)	(32,071)
Salaries, salary compensations and other personal expenses	9, 3.10	(4,383,083)	(4,492,047)
Depreciation costs	10, 3.7	(1,672,490)	(1,632,334)
Other expenses	11	(5,134,290)	(4,898,997)
<b>PROFIT BEFORE TAX</b>		<u>(82,691,157)</u>	<u>49,593,219</u>
Income taxes	26, 3.9	(454,479)	(408,113)
<b>PROFIT AFTER TAX</b>	29	<u>(83,145,636)</u>	<u>49,185,106</u>

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## Statement of other comprehensive income

TRANSLATION	NATIONAL BANK OF SERBIA	
<b>STATEMENT OF OTHER COMPREHENSIVE INCOME</b>		
Year Ended December 31, 2017		
(Thousands of RSD)		
	<u>2017</u>	<u>2016</u>
<b>PROFIT FOR THE PERIOD</b>	(83,145,636)	49,185,106
<b>Components of other comprehensive income which cannot be reclassified to profit and loss:</b>		
Increase in revaluation reserves arising from intangible investments and fixed assets	134,127	-
Decrease in revaluation reserves arising from intangible investments and fixed assets	(1,882)	(5,020)
Actuarial losses	(66,224)	(43,334)
<b>Components of other comprehensive income which may be reclassified to profit and loss:</b>		
Positive effects of change in fair value of financial assets available for sale	<u>337,395</u>	<u>404,545</u>
<b>Other comprehensive income for the period</b>	<u>403,416</u>	<u>356,191</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE PERIOD</b>	<u><b>(82,742,220)</b></u>	<u><b>49,541,297</b></u>

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## Statement of changes in equity

NATIONAL BANK OF SERBIA

TRANSLATION

**STATEMENT OF CHANGES IN EQUITY**  
Year-Ended December 31, 2017  
(Thousands of RSD)

	State-owned capital	Special reserves	Revaluation reserves	Reserves from financial assets available for sale	Provisions for employee benefits	Actuarial gains –	Retained earnings	Total
<b>Balance as at January 1, 2016</b>								
Opening balance	146,512,991	138,555,643	15,538,509	5,995,641	178,246	-	34,330,834	341,111,864
Distribution of profit from previous year (Note 29)	11,432,168	22,898,666	-	-	-	-	(34,330,834)	-
Total positive other comprehensive income for the period	-	-	-	766,237	-	-	-	766,237
Total negative other comprehensive income for the period	-	-	-	(361,692)	(43,334)	-	-	(405,026)
Transfer from provisions due to provision reversal	-	-	(5,020)	-	-	-	5,020	-
Profit for the current year	-	-	-	-	-	-	49,185,106	49,185,106
<b>Balance as at December 31, 2016</b>	<b>157,945,159</b>	<b>161,454,309</b>	<b>15,533,489</b>	<b>6,400,186</b>	<b>134,912</b>	<b>-</b>	<b>49,190,126</b>	<b>390,658,181</b>
<b>Balance as at January 1, 2017</b>								
Opening balance	157,945,159	161,454,309	15,533,489	6,400,186	134,912	-	49,190,126	390,658,181
Distribution of profit from previous year (Note 29)	13,183,714	26,402,900	-	-	-	-	(49,190,126)	(9,603,512)
Total positive other comprehensive income for the period	-	-	134,127	531,675	-	-	-	665,802
Total negative other comprehensive income for the period	-	-	(1,882)	(194,280)	(66,224)	-	-	(262,386)
Transfer from provisions due to provision reversal	-	-	-	-	-	-	-	-
Profit for the current year	-	-	-	-	-	-	-	-
Loss for the current year	-	-	-	-	-	-	(83,145,636)	(83,145,636)
<b>Balance as at December 31, 2017</b>	<b>171,128,873</b>	<b>187,857,209</b>	<b>15,665,734</b>	<b>6,737,581</b>	<b>68,688</b>	<b>-</b>	<b>(83,145,636)</b>	<b>298,312,449</b>

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## Statement of cash flows

TRANSLATION

NATIONAL BANK OF SERBIA

### CASH FLOW STATEMENT

For the period January 1 - December 31, 2017  
(Thousands of RSD)

	Note	2017	2016
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Interest receipts		11,714,457	11,882,822
Fee and commission receipts		3,260,886	3,225,067
Inflows from sales of products and services (Institute for Manufacturing Banknotes and Coins)		6,787,891	8,447,413
Inflows from other operating activities		6,147,352	13,830,050
Receipts from dividends and profit sharing		128,715	97,301
Cash inflow from operating activities		<u>28,039,301</u>	<u>37,482,653</u>
Interest payments		(6,398,084)	(5,408,564)
Fee and commission payments		(1,024,349)	(603,943)
Payments for operating expenses		(15,868,643)	(18,937,289)
Cash outflow from operating activities		<u>(23,291,076)</u>	<u>(24,949,796)</u>
Net decrease in deposits received		(10,367,867)	(30,071,956)
Net increase/(decrease) in loans and placements		54,445,890	(1,613,128)
Net increase in securities held for trading and other securities not intended for investment		48,857,231	72,371,999
Net increase in loans and increase in deposits received		92,935,254	40,686,915
Income tax paid		(408,113)	(348,354)
Payment of the distributed result - transfer to the budget of the Republic of Serbia		(9,603,512)	-
<b>Net cash inflow from operating activities</b>		<b><u>87,671,854</u></b>	<b><u>52,871,418</u></b>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>			
Proceeds from the sale of intangible assets, property, plant and equipment		-	1,118
Purchases of intangible assets, property, plant and equipment		(794,735)	(575,150)
<b>Net cash outflow from investing activities</b>		<b><u>(794,735)</u></b>	<b><u>(574,032)</u></b>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>			
Net inflow from short-term borrowings		9,598,468	2,400,151
<b>Net cash inflow from financing activity</b>		<b><u>9,598,468</u></b>	<b><u>2,400,151</u></b>
<b>Net increase in cash and cash equivalents</b>		<b><u>96,475,587</u></b>	<b><u>54,697,537</u></b>
<b>Cash and cash equivalents at the beginning of the period</b>		<b><u>211,316,825</u></b>	<b><u>128,938,720</u></b>
Foreign exchange gains/(losses), net		(89,666,251)	27,680,568
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD</b>	2 (e)	<b><u>218,126,161</u></b>	<b><u>211,316,825</u></b>

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## IV.6 Institute for Manufacturing Banknotes and Coins – Topčider

### Income and expenses

Total income of the Institute for Manufacturing Banknotes and Coins – Topčider (ZIN) in 2017 amounted to RSD 7,261.3 mn or 1.6% less than in 2016, while total expenses came at RSD 5,040.2 mn or 0.4% less than in 2016.

Table IV.6.1 **Total income and expenses of ZIN**  
(RSD mn)

	2016	2017	Index 2017/2016
Total income	7,382.40	7,261.30	98.4
Operating income	7,219.10	6,572.40	91
Products for the NBS	1,003.10	145.4	14.5
Products for the domestic market	5,817.70	5,813.90	99.9
Export products	398.3	613	153.9
Other (financial) income	163.3	689	421.9
Total expenses	5,060.60	5,040.20	99.6
<b>Income-to-expense ratio</b>	145.9	144.1	-

Source: NBS.

In 2017, ZIN recorded a positive financial result of RSD 2,221.2 mn, including income from the production for internal purposes. Excluding that income, the financial result of ZIN amounted to RSD 2,075.7 mn.

The management and monitoring of costs and evaluation of their justifiability resulted in their optimisation. Thus, income-to-expense ratio was at a stable level, lower by 0.9 pp compared to the previous year.

Continuous monitoring of the stocks and standards of consumption of intermediate goods resulted in savings in procurements, as well as in their short-term conversion into more liquid forms of current assets. Consequently, efficiency ratios record growth every year.

After years-long efforts, a new application “PIS” (Production Information System) was developed and successfully implemented as a strategic project implementing mechanisms for the planning and management of complex production processes, in accordance with the standards applied in ZIN and International Accounting Standards.

## Structure of income

The largest share of ZIN's income (RSD 5,813.9 mn or 80.1% of total income) was generated in the domestic market. Income from the sale of products intended for the domestic market was at the same level as in the previous year.

Income earned from exports came to RSD 613 mn or 8.4% of total income, which is 53.9% higher than in 2016. As in the previous years, timely response to circumstances prevailing in external markets brought about a significant growth of exports. The breakdown of operational income in the domestic and foreign market again shows the predominance of income from the manufacturing and personalisation of payment cards and from products with security features.

Internal income, i.e. income from products for the NBS, amounted to RSD 145.4 mn or 2% of total income.

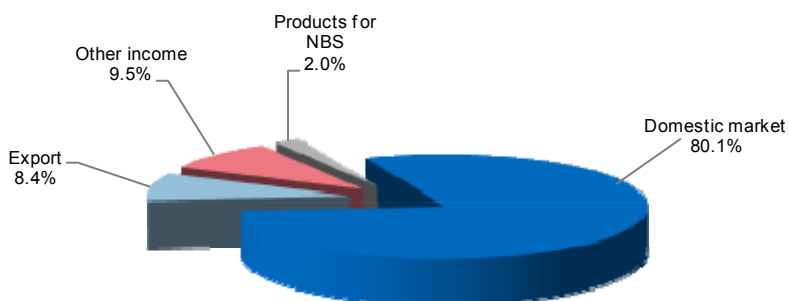
The percentage of the collection of receivables is very high. Receivables past due comprise less than 0.2% of the total invoiced value in 2017.

Table IV.6.2 **Structure of total income**  
(RSD mn)

	2016	2017	Index 2017/2016
<b>Total income</b>	7,382.40	7,261.30	98.4
Operating income	7,219.10	6,572.40	91
Products for the NBS	1,003.10	145.4	14.5
Banknotes	649.4	88.6	13.6
Circulating coins	343.5	39.4	11.5
Commemorative coins	-	-	-
Other products and services for the NBS	10.20	17.50	171.3
Domestic market and exports	6,216.00	6,426.90	103.4
Preparation services	11	9	81.8
Banknotes and other products	294.5	447.9	152.1
Circulating and commemorative coins	44.7	71	158.7
Other coined products and services	416.8	416.1	99.8
Valuables	849.20	829.90	97.7
Secured products	1,129.90	1,184.10	104.8
Books, publications and promotional material	7.3	10.6	145.4
Other products	857.20	827.00	96.5
<b>Personalisation</b>	2,605.40	2,631.20	101
<b>Other (financial) income</b>	<b>163.30</b>	<b>689.00</b>	<b>421.9</b>

Source: NBS.

**Chart IV.6.1 Structure of total income in 2017 –  
Institute for Manufacturing Banknotes and Coins**



Source: NBS.

## Structure of expenses

On the side of expenses, operating expenses were dominant, most notably basic material and energy (48.0%), gross wages and other personal expenses (20.5%) and depreciation (19.7%). The share of these expenses in total income decreased from a year earlier.

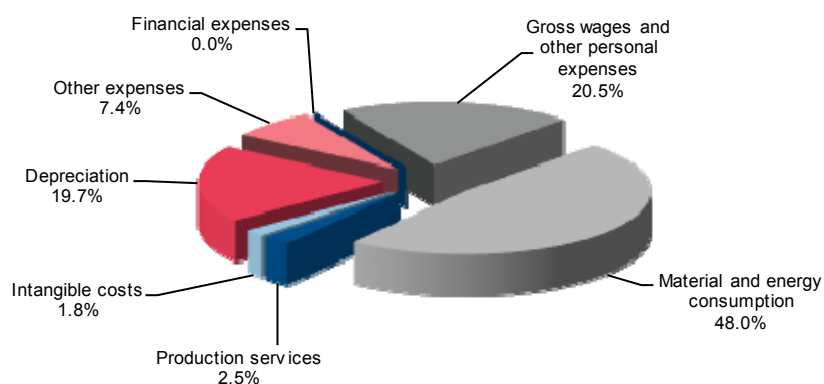
**Table IV.6.3 Structure of total expenses**

(RSD mn)

	2016	2017	Index 2017/2016
Total expenses	5,060.60	5,040.20	99.6
Financial expenses	0.70	0.60	87.2
Gross wages and other personal expenses	1,054.10	1,033.40	98
Material and energy costs	2,499.50	2,421.20	96.9
Production services	188.4	125.8	66.8
Intangible costs	106.5	90.9	85.3
Depreciation	956.7	994.3	103.9
<b>Other expenses</b>	<b>254.70</b>	<b>374.00</b>	<b>146.8</b>

Source: NBS.

Chart IV.6.2 Structure of total expenses in 2017 – Institute for Manufacturing Banknotes and Coins



Source: NBS.

## Plans for 2018

The planned operating income of ZIN for 2018 (including positive changes in inventories) equals RSD 6,357 mn.

Given that, as a manufacturing organisational unit of the NBS, ZIN achieves stable business results through its commitment, it is motivated and ready to continue to progress and achieve better results by finding new avenues to employ human and technological potential.

# ADDITIONAL INFORMATION

## **Publications of the National Bank of Serbia**

Annual Report on Activities and Results of the National Bank of Serbia  
Monetary Policy Report  
Annual Financial Stability Report  
Inflation Report  
Statistical Bulletin

### *Analyses and reports*

Report on Dinarisation of the Serbian Financial System  
Report on the Results of the Bank Lending Survey  
Analysis of Profitability of Dinar and FX Savings  
Trends in Lending  
Report on the Results of the Inflation Expectations Survey

### *Supervision reports*

Banking Sector in Serbia  
Financial Leasing Supervision in Serbia  
Insurance Sector in Serbia  
Voluntary Pension Funds Sector in Serbia  
Report on the Operations of the Centre for Financial Consumer Protection and Education  
Analysis of Banks' Responses to the Survey on Activities Regarding AML/CFT Risk Management – semi-annual  
Analysis of Financial Lessors' Responses to the Survey on Activities Regarding AML/CFT Risk Management  
Counterfeit Currency Report  
Payment System Oversight in 2014

### *Other publications*

Working papers  
Methodological materials  
Special publications – SEEMHN

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