7. Monetary Trends and Policy

Despite the fact that inflation rose at a faster rate in Q1 its value at the end of March was still below the target level of 3% which, along with the expected slowing down in May when the effects of the seasonal rise in vegetable prices was exhausted, caused the National Bank of Serbia (NBS) to keep its key policy rate unchanged. The depreciation pressure at the end of 2018 soon turned into strong pressure to strengthen the Dinar which is ongoing. NBS interventions on the FX market were intended to defend the Dinar exchange rate both in terms of offer and demand for hard currency with the net effect standing at just 30 million Euro of hard currency bought. The NBS continued its interventions and was a net buyer of hard currency to the tune of more than 550 million Euro by the first week in June. The NBS net own reserves recorded a rise in Q1 by 68 million Euro which, along with the withdrawal of banks from REPO placements, had an effect on the creating of primary money but those effects were neutralized with the rise in the deposits in state accounts. Compared to the value in the same period a year earlier, the money mass continued to grow at a nominal rate of 14.6% which was mainly stimulated by a rise in credit activity among both households and the economy. The net new placements by banks since the start of the year were negative primarily because of negative net placements to the state but the positive trend of placements to households and the economy following a correction to write off NPLs continues. Along with the rise in net new placements to the economy from abroad, the overall net placements to households and the economy in Q1 stood at some 400 million Euro. Although the net deposits by the population increased, the overall sources for new placements by banks dropped in Q1 because of the seasonal withdrawal of deposits by the economy and the repayment of loans taken by banks from their home offices abroad. The share of NPLs has dropped slightly since the start of the year mainly because of the rise of the level of loans overall while the level of NPLs recorded a slight drop. Interest rates in real terms on Dinar loans caused by slightly higher inflation in Q1 recorded a drop while indexed housing loans and current asset loans recorded a growth compared to the end of 2018.

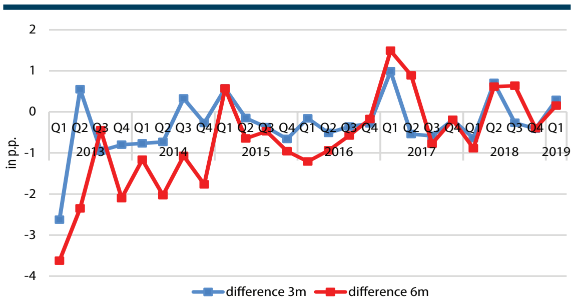
Central Bank: Balances and Monetary Policy

No changes to key policy rate in Q1 …

…because inflation remains in target framework

Despite the fact that inflation speeded up from the start of the year, the NBS did not change the level of its key policy rate to the latest session of its executive board early in June. The key policy rate has remained unchanged for more than a year which was certainly justified in the case of inflation which stood near the lower limit of the target framework in 2018. Inflationary pressure increased from the start of the year because of the seasonal rise in the prices of fresh fruit and vegetables to the end of April when inflation reached 3.1 percent and returned to the level of 2.2 percent y.o.y. in May after those effects of the inflation were exhausted. The elements which will act for the rest of the year such as the growth of domestic demand on the basis of increased salaries in the public sector and potential rise in fuel prices due to geopolitical instability can cause inflation to move around the middle of the target corridor of 3±1,5% to the end of the year. Depending on the implementation of those elements, the NBS will probably keep the key policy rate at its current level in the coming period with the possibility of a correction in the case of greater pressure on prices. Inflation in Q1 went past the expectation that the NBS had three and six months earlier (Graph T7-1) which shows that the short-term fluctuation in this period was significantly stronger than expected while the base inflation of the y.o.y. rate showed somewhat smaller changes which remained at a level of around 1.5%. Bearing in mind that representatives of the European Central Bank and the FED are

Graph T7-1. Deviation from the planned inflation 3 and 6 months in advance of the actual 2013-2018



Source: NBS

thinking about postponing the announced policy of gradually increasing monetary strictness or even re-introducing some monetary easing, we can expect those elements to raise prices on the capital inflow side towards the end of the current or in next year. Even though credit activity in the economy was significantly lower once we take out the effects of the writing off of NPLs compared to the previous quarter, in Q2 and in the rest of the year we can expect a faster pace if there is no deterioration in the loan conditions which, based on current indicators, is very unlikely. We will probably see stronger NBS interventions on the FX market by the end of summer, directed at maintaining the target level of the Dinar exchange rate which has drawn closer to the level of 2014 with the latest reinforcement. Despite NBS statements that the trust of serious foreign investors is strengthening the national currency, the Dinar's trends run counter to Serbia's base macro-economic positions. Although this can have positive effects on the export-oriented part of the economy, in the long term it causes more damage because of the deterioration in the position of domestic producers who are increasingly exposed to lower prices of imports. That additionally burdens the economy which has shown the first signs of its recovery slowing down.

Table T7-2. NBS interventions and foreign currency reserves 2015-2018

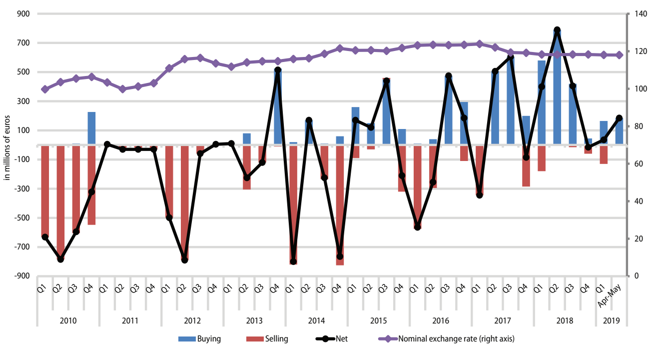
	2016				2017				2018				2019
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Repo stock (in milions of euros)	246.50	239.12	325.82	279.23	480.53	572.42	634.74	384.53	348.00	562.51	339.53	142.95	139.16
NBS interest rate	4.25	4.25	4.00	4.00	4.00	4.00	3.75	3.50	3.25	3.00	3.00	3.00	3.00
NBS interest rate	2.60	1.78	3.17	1.94	-5.11	1.94	4.17	2.68	0.40	-2.60	4.24	2.59	-2.98
NBS interest rate	-0.34	3.35	4.57	3.37	4.48	15.71	7.77	3.50	4.75	3.50	1.65	3.10	3.00
NBS interventions on FX market (in milions of euros)	-555.00	-820.00	-345.00	-160.00	-345.00	160.00	765.00	680.00	400.00	1190.00	1595.00	1580.00	35.00
INCREASE	**in millions of euros, cumulative from the beginning of the year**												
NBS own resreves[1]	-469.43	-785.86	-346.46	-163.03	-269.73	-265.22	364.16	-4.87	-154.90	653.92	547.26	616.64	67.93
NDA	45.62	395.60	-99.67	94.92	-171.42	-248.75	-704.00	137.47	-264.65	-845.34	-649.45	-142.59	-199.62
Government, dinar deposits[2]	41.52	275.36	35.00	195.73	-41.59	-358.48	-755.64	-247.10	-376.19	-567.19	-612.17	-153.41	-158.73
Repo transactions[3]	5.09	19.53	-279.20	-25.66	-207.38	-285.41	-346.27	-95.49	43.47	-168.83	42.95	241.88	12.74
Other items , net[4]	-0.99	100.71	144.53	-75.15	77.56	395.14	397.91	480.06	68.07	-109.33	-80.23	-231.06	-53.63
H	-423.81	-390.27	-446.13	-68.11	-441.15	-513.96	-339.84	132.60	-419.56	-191.42	-102.19	474.05	-131.69
o/w: currency in circulation	-68.06	-20.21	40.74	157.26	-104.02	-114.39	-103.93	39.59	-102.01	-41.46	60.29	157.82	-37.81
o/w: excess liquidity	-284.91	-319.01	-465.39	-241.74	-351.17	-422.08	-269.15	22.35	-335.18	-200.87	-265.64	185.56	-143.78
	in millions of euros, cumulative from the beginning of the year												
NBS, net	-865.84	-1061.63	-784.51	-137.62	-464.59	-618.87	452.21	-280.73	64.63	915.44	997.16	1069.34	187.71
Gross foreign reserves	-880.04	-1080.32	-807.49	-153.76	-469.25	-632.21	431.51	-302.83	36.47	894.42	977.20	1048.44	181.07
Foreign liabilities	14.21	18.69	22.97	16.14	4.66	13.34	20.70	22.10	28.16	21.03	19.96	20.90	6.64
IMF	8.10	15.09	16.00	14.12	-0.04	5.81	7.68	8.67	9.42	1.44	1.75	0.84	-0.95
Other liabilities	6.10	3.59	6.98	2.02	4.69	7.53	13.02	13.43	18.75	19.59	18.21	20.07	7.59
NBS, NET RESERVES-STRUCTURE													
1. NBS, net	-865.84	-1061.63	-784.51	-137.62	-464.59	-618.87	452.21	-280.73	64.63	915.44	997.16	1069.34	187.71
1.1 Commercial banks deposits	331.11	302.75	339.40	90.80	144.67	156.34	123.17	159.61	47.26	38.80	-33.79	-572.93	-69.13
1.2 Government deposits	65.30	-26.98	98.65	-116.22	50.18	197.32	-211.22	116.25	-271.67	-305.19	-420.98	115.36	-50.65
1.3 **NBS own reserves** (1.3 = 1 - 1.1 - 1.2)	-469.43	-785.86	-346.46	-163.03	-269.73	-265.22	364.16	-4.87	-159.78	649.05	542.39	611.77	67.93

Source: NBS.
1) Definition of net own reserves NBS is given in section 8 Monetary Trends and Policy, Frame 4, *QM* No. 5.
2) State includes all levels of government: republic to local.
3) This category includes NBS Treasury Bonds and repo operations.
4) Other domestic assets include: domestic loans (net bank debts, not including Treasury Bonds and repo transactions; net debts of the economy) along with other assets (capital and reserves; and items on the balance: other assets) and corrected by changes to the exchange rate.

Hard currency purchase on FX has positive effect on growth of own reserves

Depreciation pressure spilled over from the end of the previous year to Q1 which led the NBS to intervene on the FX market to sell hard currency. In February, the direction of the pressure changed leading the NBS to intervene and buy hard currency on the FX market. At quarterly level, those two episodes neutralized each other and the net position of the NBS stood at 35 million Euro bought in Q1 (Graph T7-3). The pressure to strengthen the Dinar continued in April and the NBS bought an additional 75 million Euro on the FX market and partly slowed down the effects on the strengthening of the exchange rate. In May, the NBS bought another 110 million Euro and that tempo continued in the first seven days of June when it bought another 370 million Euro. Despite these interventions the Dinar continued to appreciate nominally and bearing in mind the higher inflation in Serbia

Graph T7-3. NBS interventions on FX market 2010-2018



Source: NBS

compared to the EU zone, the price competitiveness deteriorated further for both the export-oriented part of the economy and the part facing cheaper competitive imports. The NBS net own reserves in Q1 recorded a rise of 68 million Euro with net domestic assets (NDA) dropping by 200 million Euro. The drop in the NDA was caused by a rise in the state deposits of 159 million Euro combined with rise in other domestic assets by 54 million Euro which was just slightly reduced by the withdrawal of banks from REPO operations by 13 million Euro. Because of the strong drop in NDA compared to the rise in net own reserves, primary money recorded a drop of 132 million Euro in Q1 compared to the value at the start of the year.

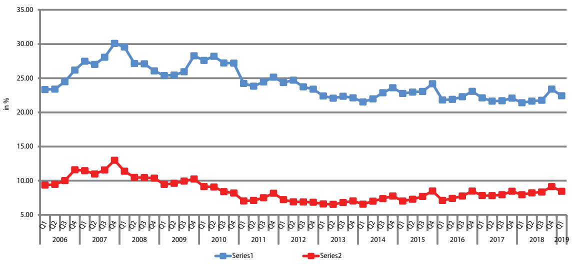
Monetary System: Money Mass Structure and Trends

The growth of the money mass continued in Q1 ...

... because of the rise in credit activity in the household and economy segments

The faster nominal growth of the M2[1] at the end of last year continued in Q1 and the rise in primary money stood at 14.8% y.o.y. at the start of the year (in Q4 2018, the nominal growth of M2 stood at 14.5% y.o.y., Table T7-5). At quarterly level, primary money recorded a drop of –0.7% of the value recorded at the end of December 2018 mainly because of the drop in NSA while at quarterly level the NDA recorded growth. Compared to the level at the end of the previous year, the NSA dropped by 1.6% and the primary money recorded a drop in Q1 which was slightly eased by the increase in NDA of 1% compared to the end of 2018. Following a correction for inflation which in Q1 was somewhat higher, the real growth of the M2 stood at 11.8% y.o.y. which is a slight slowdown compared to the previous quarter but the real growth of loans to the economy and households was somewhat higher and stood at 8% y.o.y. (the real growth of M2 in Q4 2018 stood at 12.4% while the rise in loans stood at 7.8% y.o.y.). The real rate of growth to households by 10% y.o.y. is slightly below the level of the previous quarter while the real rate of growth for loans to the economy continued to speed up to stand at 6.3% y.o.y. (in Q4 2018, the real growth rate of loans to the economy stood at 5.7% y.o.y.).

Graph T7-4. Money mass trends as percentage of GDP, 2005-2018



Source: *QM* calculation

Table T7-5. Growth of money and contributing aggregates, 2015–2018

	2016				2017				2018				2019
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	y-o-y, in %												
M2[1)]	7.9	7.8	10.2	9.9	10.3	7.4	5.6	3.6	3.3	7.9	8.2	14.5	14.8
Credit to the non-government sector[2)]	2.2	4.7	5.9	2.6	4.1	2.0	0.7	1.8	1.9	4.0	5.9	9.4	9.7
Credit to the non-government sector[2)],	0.6	3.1	3.9	1.5	3.5	3.5	2.9	4.7	5.1	5.6	6.5	9.6	10.0
Households	3.8	5.8	8.4	9.4	11.0	11.8	10.8	10.9	10.2	10.6	12.3	12.7	12.4
Enterprises	-1.4	1.4	1.0	-3.3	-1.3	-2.1	-2.4	0.4	1.3	1.8	2.0	7.2	8.0
	real y-o-y, in %												
M2[1)]	7.2	7.3	9.4	8.0	6.4	3.8	2.3	0.6	2.0	5.6	7.2	12.3	11.8
Credit to the non-government sector[2)],	0.2	2.3	2.8	0.9	2.1	2.7	2.4	4.0	4.6	4.7	5.5	7.8	8.0
Households	2.9	4.6	6.6	7.5	8.6	9.7	9.0	9.2	8.9	8.8	10.0	10.4	10.0
Enterprises	-1.5	0.9	0.4	-3.2	-1.7	-2.0	-2.1	0.4	1.5	1.5	1.9	5.8	6.3
	in bilions of dinars, end of period												
M2[1)]	1,979.6	2,023.2	2,087.0	2,196.8	2,182.7	2,173.3	2,204.5	2275.5	2255.1	2345.7	2424.3	2605.3	2588.9
M2[1)] dinars	645.5	685.0	727.1	808.0	772.7	785.2	808.3	872.1	838.6	893.1	924.3	1017.3	974.8
Fx deposits (enterprise and housholds)	1,334.1	1,338.2	1,359.9	1,388.7	1,410.0	1,388.1	1,396.2	1403.4	1416.5	1452.6	1500.0	1588.0	1614.0
	quarterly growth M2[4)] and shares												
M2[1)]	-1.0	2.2	3.2	5.3	-0.6	-0.4	1.4	3.2	-0.9	4.0	3.3	9.2	-0.7
NFA, dinar increase	-2.9	2.0	2.1	3.9	-1.6	0.6	1.1	2.9	-1.5	6.5	1.2	4.2	-1.6
NDA	1.9	0.2	1.1	1.4	1.0	-1.0	0.4	0.3	0.6	2.5	1.8	5.0	1.0

Source: NBS
1) Money mass components – see Analytical and Notation Conventions *QM*.
2) Loans to private sector– loans to the economy (including local government) and households.
3) Trends are corrected by changes to the exchange rate. Corrections are implemented under the assumption that 70% of loans to the private sector (households and companies) are indexed in Euro.
4) Trends are corrected by changes to the exchange rate and inflation. Corrections are implemented under the assumption that 70% of loans to the private sector (households and companies) are indexed in Euro.

1 Monetary aggregate M2 in the section Monetary Trends and Policy includes the lesser aggregate M1, savings and timed deposits in business banks. Because of that the M2 aggregate which we observe is equal to the monetary aggregate M3 in NBS reports

Nominal growth of money mass in Q1 guided by growth of hard currency deposits

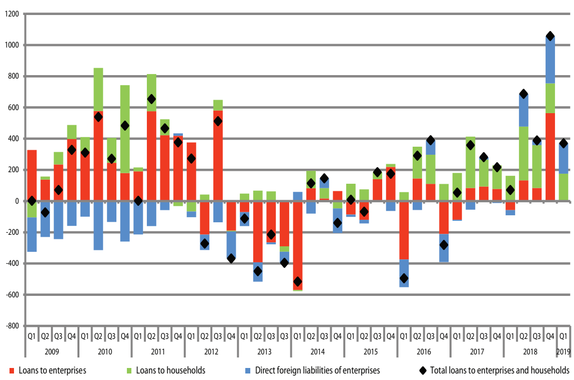
Viewed by individual element, the overall nominal growth of the M2 money mass of 14.8% y.o.y. was achieved mainly thanks to an increase in hard currency deposits. In Q1 the hard currency deposits contributed to the growth of M2 with 8.76 percentage points which accounts for almost 60% of the growth of the money mass. The second largest contribution came from the lesser aggregate M1 whose growth contributed with 4.6 percentage points to the overall growth of M2 in Q1. Savings and timed deposits slightly increased in significance compared to the previous quarter and contributed with 1.44 percentage points to the overall growth of primary money since the start of the year.

Banking Sector: Placements and Sources of Financing

The positive trends in the recovery of credit activity continued in Q1

The overall net placements by business banks since the start of the year were negative, primarily because of the increase in state deposits as the result of a budget surplus in Q1 and because of funds collected by the state for the early redemption of some issued bonds. The rise in state deposits in business bank accounts stood at 259 million Euro and that, combined with the seasonally lower credit activity since the start of the year among both companies and households led to a drop in overall net placements by the banking sector of 89 million Euro (Table T7-7). The withdrawal of banks from REPO placements to the tune of four million Euro in Q1 had a negative effect to a small extent at the level of overall net placements. On the positive side, a growth in placements to companies and households was recorded but it was lower than in other quarters. Net loans to companies suffered a minimal drop of two million Euro compared to the end of 2018 but if we take into consideration the write-off of NPLs to companies in this period, the net placements to the economy actually rose by 22 million Euro. Net loans to households in Q1 saw a rise of 174 million Euro which is higher than in the same quarter of 2018 and, based on data from April, we can expected a faster growth in Q2. Most of the newly-approved loans to companies were for current assets and liquidity accounting for some 51% while investment loans accounted for about 32%. The newly-approved loans to households were mainly cash and re-financing loans which accounted for some 57% while the number of housing loans was higher than in the same period a year earlier.

Graph T7-6. Yield of new loans to the economy and households, 2009-2018



Source: *QM* calculation
See footnote 1 in Table T7-5

Although the net credit activities by banks to the economy was fairly weak in Q1 after the effects of the write-off of NPLs, we get a somewhat better impression if we include the effects of cross-border loans taken out by local companies. This form of financing for the economy was practically non-existent in the first half of last year when the first positive trends were noticed. Although the rise in net cross-border loans of 196 million Euro in Q1 was lower than in the previous quarter, it still indicates a recovery of this form of financing which was dominant in the Serbian economy prior to the global financial crisis (in Q4 2018, net cross-border loans increased by 303 million Euro, Graph T7-6). Take into consideration the increase in net placements to companies and households from domestic and foreign sources and the overall value stands at the level of 370 million Euro in Q1 which is closer to the value of 400 million Euro once the effects of the write-off of NPLs are included. In the rest of the year, the possibility that monetary conditions could be relaxed on the European Union and American markets could be eased will partly neutralize the negative effects through a reduction of the const of financing. Loans to companies and households from domestic and foreign sources currently stand at the level of some 68% of the GDP which is lower compared to similar economies by some 15 percentage points on the average which indicates that there is more room for credit activity to grow.

Table T7-7. Business banks – sources and structure of placements, corrected[1)] trends, 2015-2018

	2016				2017				2018				2019
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	in millions of euros, cumulative from the beginning of the year												
Funding(-, increase in liabilities)	377	168	-363	-1,130	354	-252	-1,138	-2,185	286	-727	-1,388	-3,641	573
Domestic deposits	223	-235	-708	-1,425	107	-104	-426	-1,032	65	-664	-854	-2,694	80
Households deposits	-16	-235	-362	-625	-69	-164	-258	-517	-166	-411	-646	-1,016	-292
dinar deposits	3	-75	-154	-290	27	-7	25	-121	15	-110	-250	-442	-35
fx deposits	-19	-161	-208	-334	-96	-157	-283	-395	-181	-301	-396	-574	-256
Enterprise deposits	239	0	-346	-800	175	60	-167	-515	231	-253	-208	-1,677	372
dinar deposits	385	222	5	-352	207	142	-30	-307	170	-95	-44	-657	358
fx deposits	-146	-222	-351	-448	-31	-82	-137	-208	61	-158	-164	-1,021	14
Foreign liabilities	181	397	427	335	218	49	-317	-546	-169	-217	-531	-821	136
Capital and reserves	-27	6	-82	-40	29	-198	-395	-607	390	154	-3	-126	357
Gross foreign reserves(-,decline in assets)	214	337	284	244	-35	-153	-286	-261	215	-75	138	625	-54
Credits and Investment[1)]	128	426	1,129	997	255	856	1,162	1,237	219	978	1,227	1,548	-89
Credit to the non-government sector, total	-316	32	329	186	61	474	740	972	105	582	941	1,695	174
Enterprises	-374	-228	-118	-372	-119	-36	58	138	-58	75	159	723	-2
Households	57	260	447	559	180	510	682	833	162	507	781	972	176
Placements with NBS (Repo transactions and treasury bills)	-7	-14	276	27	202	289	341	90	-39	175	-48	-244	-4
Government, net[2)]	452	408	525	784	-8	93	82	176	154	221	334	96	-259
MEMORANDUM ITEMS													
Required reserves and deposits	-598	-864	-859	-565	-161	-94	-83	-30	120	213	287	1,130	1
Other net claims on NBS[3)]	-107	160	6	201	-324	-401	-220	62	-338	-249	-262	-80	-31
o/w: Excess reserves	-102	160	3	187	-326	-415	-223	42	-339	-254	-280	-197	40
Other items[4)]	0	-204	-175	253	-79	18	545	1,176	-514	-152	-8	428	-400
Effective required reserves (in %)[5)]	17	16	15	16	16	15	15	15	15	15	15	17	17

Source: NBS
1) Yield is calculated under the assumption that 70% of loans to the private sector (households and companies) are indexed in Euro. Yield for originally Dinar value deposits are calculated based on the average exchange rate for the period. For hard currency deposits – as the difference of the state calculated based on the exchange rate at the ends of the period. Capital and reserves are calculated on the basis of the Euro exchange rate at the ends of the period and do not include the effects of changes to the exchange rate in calculating the remainder of the balance.
2) NBS bonds includes state and NBS treasury bonds which are sold at repo rate and at rate set by the market for lasting auction sales with a due date longer than 14 days.
3) Net loans to the state: loans approved to the state are lowered by state deposits in business banks; the negative prefix denotes a higher growth of deposits than of loans. State includes all levels of government: republic and local level.
4) Other NBS debts (net): the difference in NBS debts to banks on the basis of cash and free reserves and debts to the NBS.
5) Items on bank balances: other assets, deposits by companies in bankruptcy, inter-bank relations (net) and other assets including capital and reserves.
6) Mandatory cash reserve means the share of the mandatory reserve and deposits in the overall deposits (households and companies) and bank debts abroad. The basis to calculate the mandatory reserve does not include subordinate debts because that data is not available

Despite the rise in private deposits, the credit potential dropped in Q1 …

…because banks repaid loans abroad and capital and reserves were reduced

As in previous year, the credit potential of the domestic banking system was reduced in Q1 by 573 million Euro. That drop was to a lesser extent the result of an 80 million Euro drop in net domestic deposits while the remainder is the consequence of debt repayment by domestic banks to their head offices abroad and the drop in capital and reserves. Net domestic deposits were reduced since the start of the year because of the withdrawal of 372 million Euro in net deposits by companies in Q1. in the same period, households increased their net deposits with business banks by 292 million Euro but that was not enough to cover the withdrawals by companies (Table T7-7). The greatest cause of the reduction in sources for new placements was the reduction of capital and reserves which stood at 357 million Euro in Q1. Although business banks increased their foreign debts all through last year, net repayments of 136 million Euro were recorded in Q1 which additionally reduced the sources for new bank placements.

Table T7-8. Share of NPLs by debtor type, 2008-2018

	2009	2010	2011	2012	2013	2014	2015	2016				2017				2018				2019
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	balance at the end of period																			
Corporate	12.14	14.02	17.07	19.06	27.76	25.5	24.40	26.89	26.26	23.56	19.48	19.92	19.24	16.86	13.83	12.51	12.51	10.37	9.63	9.57
Entrepreneurs	11.21	15.8	17.07	15.92	20.82	43.29	29.92	33.03	30.12	28.44	27.42	26.49	25.02	23.90	16.96	12.60	12.16	9.98	9.07	8.82
Individuals	6.69	6.71	7.24	8.32	8.59	9.97	10.53	10.95	10.63	10.36	9.66	9.21	8.35	7.56	6.43	5.84	5.71	5.15	4.72	4.66
Ammount of dept by NPL (in bilions of euros)	1.58	1.94	2.63	3.19	4.09	3.70	3.52	3.76	3.75	3.45	2.83	2.83	2.77	2.63	2.16	9.93	9.80	1.59	1.52	1.51

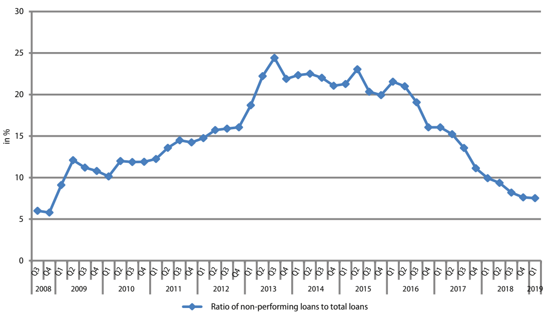
Source: *QM* calculation

Share of NPLs drops slightly

The share of NPLs in the overall placements dropped slightly from the start of the year which is in line with our assessments that future changes of this indicator will mainly be determined by changes in denominator in the overall mass of loans. Credit Bureau data and QM methodology2 showed a drop in the share of NPLs in overall placements at the end of March by 0.1 percentage points which is equal to a level of 7.52%. For a second quarter running, the drop in their share stands at less than 0.5 percentage points which will probably continue to the end of the year

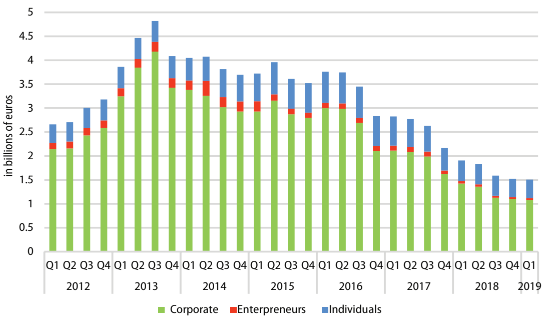
2 For details on manner of calculation share of loans see QM 6 – Spotlight on 1: NPLs in Serbia – What is the true measure?

Graph T7-9. Share of NPLs in overall placement, 2008-2018



Source: *QM* calculation

Graph T7-10. Remainder of debt on loans falling late, 2012-2018



Source: *QM* calculation

(Graph T7-9). Viewed by debtor type, the greatest reduction in relative amounts was recorded among entrepreneurs whose share of NPLs in Q1 dropped by 0.25 percentage points to 8.82%. In absolute terms, that drop had a much lesser effect because of the small overall amount of loans placed to entrepreneurs and the ensuing low absolute amount of NPLs in this group. The biggest absolute reduction was with NPLs to companies which dropped by 0.06 percentage points at the end of March to 9.57% or by some 20 million Euro compared to the situation at the end of December 2018 (Table T7-9). Although the share of NPLs to private individuals recorded a drop of 0.06 percentage points to 4.66%, the source of this drop lies in the rise in credit activity in the households segment while the absolute level of NPLs recorded a slight rise (Graph T7-10). That is also indicated by data from April and May when a rise in the share of NPLs is recorded in the entrepreneurs segment.

Interest Rates: State and Trends

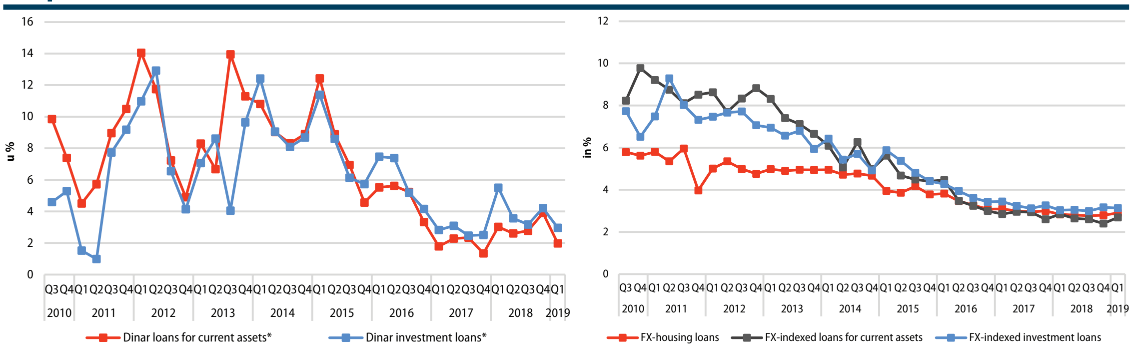
The rise of inflation at the start of the year reduced real Dinar interest rates …

…with indexed rates showing a partial growth

The European Central Bank (ECB) reacted to the danger of recession across the Eurozone by promising to keep interest rates at historic lows for at least the first half of next year. The announced came when the ECB sharply reduced the prediction of Eurozone growth for 2019 from 1.7% to 1.1%. The American Federal Reserve (FED) maintained the target rate at 2.25% at its meeting in May, concluding that economic activity was growing at a solid rate and that the labor market remained strong. FED President Jerome Powell told the latest meeting that the FED will respond in an appropriate manner to the risks presented by a global trade war and other recent events which indicates a possible change in monetary policy towards relaxation in the second half of the year.

The trends in interest rates in Serbia depended on whether their movements were being followed for indexed or loans in Dinars since the start of the year. This is the consequence of a somewhat higher inflation than expected since the start of the year which had a greater effect compared to the previous quarter. The average weighted rate for indexed housing loans increased by 0.11 percentage points compared to the end of 2018 (Graph T7-11b). A somewhat greater increase was

Graph T7-11. Interest rates on Dinar and indexed loans, 2010–2018



Source: *QM* calculation
* real interest rates

recorded with average weighted interest rates on indexed current asset loans of 0.29 percentage points while average weighted interest rates on indexed investment loans dropped slightly by 0.03 percentage points in Q1. Credit conditions measured in real average weighted interest rates on Dinar loans led to lower costs in Q1 because of a drop in nominal interest rates and a slightly faster rise in inflation since the start of the year. The average real weighted interest rate on Dinar loans for current assets showed a drop of almost 2 percentage points compared to the previous quarter and once again dropped below the level of 2% (Graph T7-12a). A similar situation was recorded with average real weighted interest rates on Dinar investment loans which dropped by 1.25 percentage points in Q1 to a level below 3%.