7. Monetary Trends and Policy

Inflation has been stable for the past two quarters at about the lower level of the target corridor but the National Bank of Serbia (NBS) is still implementing its restrictive monetary policy. The main elements keeping inflation at a low level are control of the exchange rate and a drop in domestic demand. The strong interventions on the foreign currency market create the impression that the NBS has quietly moved from the model of target inflation and a managed floating exchange rate to a visibly firmer foreign currency exchange regime. There is justification to ask whether it is appropriate to control inflation by keeping the exchange rate almost at a set level in condition of a still high current deficit and outflow of capital? Loans to the economy have continued their two year trend of dropping strongly – at the end of the first quarter the y.o.y. loan drop in real terms stood at –8.3%. The banking sector placement to the enterprises and households saw their greatest quarterly drop of 577 million Euro which was partly caused by the revoking of the license of the Univerzal Bank late in January. Along with the drop in placements to the enterprises and households, domestic banks also recorded a drop in foreign sources for new placements because of the drop in domestic deposits and the repayment of bank debts to their head offices abroad. The negative trends are continuing in the number of bad loans which rose to 22.3% of the overall credit stock in Q1 with all segments of debtors seeing the situation deteriorate.

Centrala Bank: Balance and Monetary Policy

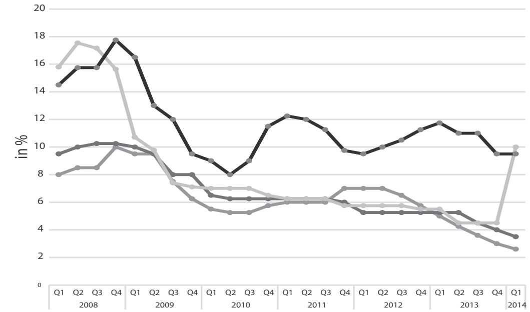
Inflation at low level but monetary policy remains restrictive

Inflationary pressure in the first four months of 2014 was very low, the economy was in stagnation and the credit activities of banks dropped. Despite that the NBS continues to be cautious in relaxing monetary policy. The key policy rate was lowered early in May from 9.5% to 9% and it exceeded the y.o.y. inflation several times over – that inflation rate mainly stood at between 2% and 2.5% in the past six months. Arguments in favor of keeping the restrictive monetary policy in place can be found in the strong depreciation pressure over the first quarter, the high liquidity of banks and worrying tendencies in public finances which the government still has not defined response to. Also, investor confidence in the macroeconomic stability of Serbia is low which is confirmed by the withdrawal of banks from REPO placements in the pre-election period during the first quarter. Business banks lowered their placements in REPO bonds by 183 million Euro in Q1 despite the fact that inflation stood at 2%, the key policy rate at 9.5% and the bank liquidity was high. The funds withdrawn from REPO bonds were used by banks to buy hard currency with the aim of protecting themselves from a possible depreciation of the Dinar. The behavior of the banks showed that their decisions depend of expected trends in the Dinar exchange rate more than on expected inflation and Dinar interest rates.

Despite indisputable risks, a speedier and stronger relaxation of monetary policy is justified

The monetary policy in conditions of high euroization must balance on the sharp edge between inflation control, Dinar exchange rate control and attempts to stimulate credit activities among banks which means economic activity as well. We believe that as long as Serbia has an independent central bank and monetary policy, the NBS besides conducting inflation control, should try to influence credit activity through monetary policy including GDP trends. Considering the fact that inflation has been close to the lower limit of the target corridor with the economy in stagnation and credit activity dropping, we believe that it is justified for the NBS to lower the key policy rate further. It is not certain that a lowering of the key policy rate would

Graph T7-1. Movement of key policy rate in select countries 2008-2014



Source: Central banks of select countries affect the interest rates of business banks but it is fairly certain that it would affect a depreciation of the exchange rate. A moderate depreciation of the exchange rate would cause an increase in inflation within the frameworks of the target interval, deteriorate the balance position of foreign currency debtors but would also caused a delayed improvement of price competitiveness for Serbia and a rise in exports. Given the situation when domestic demand is still significantly greater than the GDP, a rise in exports would be the main stimulator of economic growth on a healthy footing along with a rise in investments. The possibility and need to lower the NBS key policy rate is indicated by comparisons with key policy rates in Euro countries which conduct a policy of target inflation and have a flexible exchange rate (Graph T7-1). Also, the rate used for REPO auctions is 1-2 percentage points lower than the key policy rate which shows that it is possible to lower the key policy rate. Eliminating the difference between the key policy rate and interest rate for auctions would remove the divergent signals the NBS is sending to the market.

Table T7-2. Serbia: NBS interventions and foreign currency reserves 2012-2014

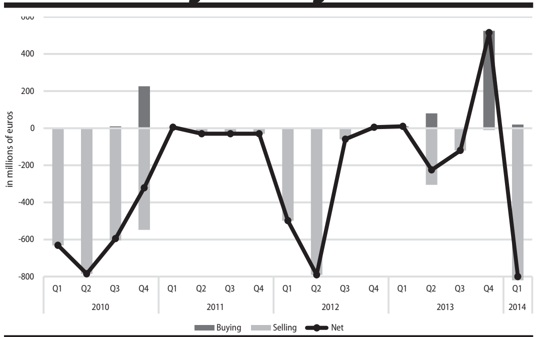
	2012				2013				2014
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Repo stock (in milions of euros)	1,055.98	111.98	2.29	354.16	678.86	663.82	832.03	966.40	783.96
NBS interest rate	9.50	10.00	10.50	11.25	11.75	11.00	11.00	9.50	9.50
NBS interest rate	1.11	-2.77	-5.74	1.11	6.95	3.31	13.24	10.38	4.38
NBS interest rate	-18.43	-7.27	-6.50	-3.99	19.25	12.85	12.83	9.25	5.28
NBS interventions on FX market (in milions of euros)	-498.50	-1288.80	-1348.30	-1343.30	10.00	-215.00	-140.00	375.00	-800.00
INCREASE					**cumulative, in % of initial M2[1)]**				
NBS own resreves[2)]	-17.6	-45.4	-35.6	-6.0	12.5	7.1	17.9	43.2	-21.4
NDA	2.4	61.3	65.8	41.3	-15.3	-3.9	-16.2	-31.3	1.9
Government, dinar deposits[3)]	-5.1	6.1	4.3	-4.3	1.0	-1.2	-4.7	-19.9	-0.3
Repo transactions[4)]	2.2	53.7	59.3	40.2	-16.0	-14.7	-23.8	-30.7	4.2
Other items , net[5)]	5.3	1.5	2.3	5.4	-0.3	12.0	12.4	19.3	-2.1
H	-15.2	15.9	30.2	35.3	-2.8	3.3	1.7	12.0	-19.5
o/w: currency in circulation	-3.3	-4.0	-1.4	-1.6	-3.9	-0.7	1.0	5.4	-3.6
o/w: excess liquidity	-13.6	-1.6	-1.1	5.4	0.6	2.1	-1.4	4.4	-14.3
				in millions of euros, cumulative from the beginning of the year					
NBS, net	-1070.60	-2087.45	-2383.97	-1050.95	30.01	-992.01	-1041.50	943.97	-230.19
Gross foreign reserves	-1138.11	-2090.09	-2536.57	-1324.15	-385.77	-1576.91	-1822.60	240.33	-344.35
Foreign liabilities	67.51	2.64	152.60	273.20	415.78	584.90	781.10	703.63	114.16
IMF	58.24	-6.44	138.99	258.95	401.14	568.40	759.83	695.60	112.50
Other liabilities	9.27	9.07	13.61	14.25	14.65	16.50	21.27	8.03	1.66
NBS, NET RESERVES-STRUCTURE									
1. NBS, net	-1070.60	-2087.45	-2389.97	-1050.95	30.01	-992.01	-1041.50	943.97	-230.19
1.1 Commercial banks deposits	459.45	740.45	1030.19	907.59	911.80	967.01	1058.25	240.42	-132.58
1.2 Government deposits	263.40	488.43	683.75	28.63	-811.79	47.05	209.55	-359.83	-41.34
1.3 **NBS own reserves** (1.3 = 1 - 1.1 - 1.2)	-347.74	-858.58	-670.03	-114.73	130.02	22.06	226.30	824.56	-404.10

Source: NBS.
1) "Initial M2" designates the state of the primary money at the start of the year, ie the end of the previous year.
2) Definition of net own reserves NBS is given in section „Monetary trends and policy", Frame 4, *QM* no. 5.
3) Government designates all levels of government: republic level and local government level.
4) This category includes Treasury Bonds NBS (BZ), and repo operations.
5) Other domestic assets net includes: domestic loans (net debts to banks, not including BZ and repo transactions; net debts of enterprises) together with other assets (capital and reserves; and items in balance: other assets) and corrected by exchange rate.

Has NBS informally changed to policy of firmer control of exchange rate?

By observing the inter-bank foreign currency market from the start of this year, we see two periods in which the NBS behaved differently in terms of interventions. In the first period which lasted up to the elections, the NBS intervened strongly by selling hard currency (800 million Euro net) which prevented a weakening of the Dinar. The quick forming of the new government had a positive effect on stopping depreciation pressure and in April the NBS bought 150 million Euro on the inter-bank foreign currency market to decrease the excessive strengthening of the Dinar. Strong interventions on the inter-bank market and a high key policy rate practically blocked the depreciation of the Dinar which indicates that the NBS informally changed from a policy of a managed floating exchange rate to a policy of a stronger control of the exchange rate. In conditions of high euroization, maintaining the exchange rate a an almost fixed level is an efficient way to control inflation but that could prove to be an inadequate policy when that fixed exchange rate is maintained at a level which suits the high deficit in the current account. Persevering with that policy over a longer term means that the NBS is acting in a way similar as the

Graph T7-3. Serbia: NBS interventions on interbank foreign exchange market



Source: NBS

currency board and that monetary policy could have similar advantages and flaws as the ones typical for currency board. The difference lies in the fact that there is no explicit promise to keep the exchange rate at a fixed level which means that the NBS is keeping open the possibility of depreciation, and the price for that possibility is the risk premium for the change in the exchange rate. Bear in mind that in highly euroized economy (as is Serbia's) this risk premium is high even when the possibility of depreciation is not significant.

Due to the extensive interventions aimed at preventing a greater depreciation of the Dinar and the repayment of loans to the International Monetary Fund (IMF), the NBS net own reserves in Q1 recorded a drop of 404 million Euro (in Q4 2013, the net own reserves were increased by 598.26 million Euro). That sale of hard currency on the market caused a drop in primary money levels which in Q1 dropped by 19.55% from the level of the start of the year. That drop was eased minimally by a growth of domestic net assets (NDA) by 1.86% compared to the value of primary money at the start of the year. The growth of the net domestic assets is owed solely to the fact that in Q1 business banks reduced their placements in REPO by 183 million Euro or 4.25% of the primary money at the start of the year.

Monetary System: Structure and Trends of the Money Mass

The money mass M2 has decreased since the start of the year...

... because of a reduction in the Dinar part of the M2

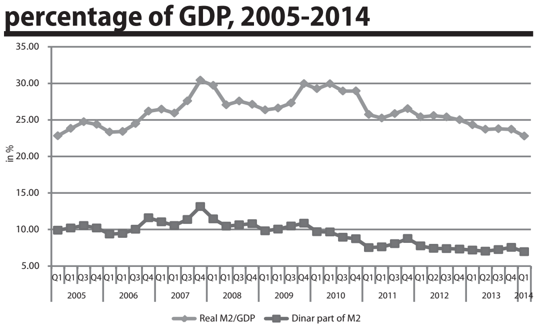
Compared to the level at the start of the year, the money mass M2 recorded a drop of 1.5% in Q1 (a growth of 0.6% was recorded in Q4 2013, Table T7-5), which is due completely to the drop in net domestic assets by 1.6% of the value of M2 at the start of the year. Unlike the previous quarter, the net domestic assets in Q1 recorded a minimal rise of 0.2% which was not enough to compensate fo the drop in the NDS and consequently the M2 money mass. Compared to the same period of the previous year the M2[1] money mass recorded a nominal growth of 4.23% and after a correction by the inflation rate the money mass growth rate stood at a y.o.y. 1.9%. The thing that causes the most concern is the downwards trend in credit to the non-goverment sector which has been evident since mid-2012. That drop has continued without any slowdown and in Q1 it stood at a nominal –6.1% y.o.y. while the real downwards rate is even higher and stands at –8.3% y.o.y. (Table T7-5).

At y.o.y. level the M2 growth rate slowed down to 1.9%...

... while loans to the non-government sector dropped even more to -8.3%

The recorded drop in credit to the non-government sector was caused by the constant drop in credit to the enterprises which in Q1 stood at –15.4% at y.o.y. level. Measures to stimulate credit activity proposed after the new government was formed could partly improve the situation in this segment. We don't know how much these measures can cover all the endangered sectors of the Serbian economy. Namely, to avoid the dominance of political interests over economic logic, decisions to approve subsidized loans will be taken only by business banks on the basis of their own analysis of the credit abilities of potential clients. In terms of efficiency, this is definitely the better option compared to the solution in which the government takes the decision on approving subsidized loans. The government

Graph T7-4. Serbia: money mass trends as percentage of GDP, 2005-2014



Source: *QM* calculation

1 Monetary aggregate M2 in section Monetary Trends and Policy includes the more narrow aggregate M1, savings and times deposits as well as foreign currency deposits in business banks. Because of that the aggregate M2 which we observe is equal to the monetary aggregate M3 in NBS reports.

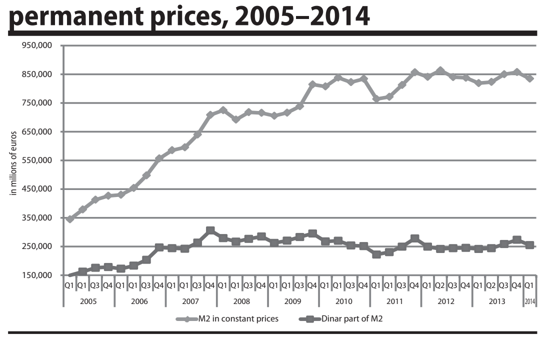
should be included in defining areas where credits should be placed, that is setting the minimum level of funds which have to be placed to small and medium-sized enterprises, investment loans and similar. If that framework is not introduced, business banks could be tempted to approve subsidized loans to big debtors in order to move them to a better category so that their reserves for assessed losses would get lowered. That would mean that favorable subsidized loans would once more go to problematic companies and those loans would not be available to small and medium sized enterprises which are doing health business.

Table T7-5. Serbia: growth of money and contributing aggregates, 2012–2014

	2012				2013				2014
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
					y-o-y, in %				
M2[1)]	14.0	18.1	13.8	9.6	8.2	4.5	6.1	4.6	4.2
Credit to the non-government sector[2)]	14.4	14.0	16.6	9.8	1.9	-0.5	-4.4	-4.5	-6.1
Credit to the non-government sector[2)], adjusted[3)]	8.6	4.6	7	3.8	1.6	0.6	-4.1	-5.0	-8.2
Households	5.7	3.3	3	2.5	3.0	2.9	2.9	2.6	2.0
Enterprises	10.1	5.3	9.1	4.4	0.9	-0.6	-7.6	-8.8	-13.4
					real y-o-y, in %				
M2[1)]	10.1	12.0	3.4	-2.2	-2.6	-5	1.2	2.3	1.9
Credit to the non-government sector[2)]	10.5	8.1	5.9	-2.0	-8.2	-9.2	-8.9	-6.5	-8.3
Credit to the non-government sector[2)], adjusted[3)]	4.9	-1.2	-3.6	-8.1	-8.7	-8.2	-8.5	-7.0	-10.3
Households	2.0	-2.4	-7.2	-9.2	-7.5	-6.1	-1.9	0.4	-0.3
Enterprises	6.3	-0.5	-1.7	-7.5	-9.3	-9.3	-11.8	-10.7	-15.4
					in bilions of dinars, end of period				
M2[1)]	1,499.7	1,588.6	1,607.6	1,641.7	1622.7	1659.8	1705.8	1719.3	1691.4
M2[1)] dinars	445.0	444.6	467.4	480.6	478.8	492.5	519.5	547.6	516.4
Fx deposits (enterprise and housholds)	1,054.7	1,144.0	1,140.2	1,161.1	1143.8	1167.3	1186.3	1169.3	1175.0
					cumulative, in % of opening M2[4)]				
M2[1)]	0.1	6.1	7.3	9.6	-1.2	1.1	3.9	4.6	-1.5
NFA, dinar increase	-5.6	-4.5	-7.9	0.2	7.2	2.7	5.2	10.6	0.2
NDA	5.7	10.5	15.2	9.4	-8.4	-1.6	-1.3	-6.0	-1.6

Source: NBS
1) Money mass: components – see Analytical and Notation Conventions *QM*
2) Loans to non-government sector – loans to enterprises (including local government) and households.
3) Trends corrected by exchange rate changes. Corrections made under assumption that 70% of loans to non-government sector (both households and enterprises) are indexed against the Euro.
4) Initial M2 designates state of M2 at start of this, ie end of previous year.

Graph T7-6. State of money mass in permanent prices, 2005–2014



Source: *QM* calculation

The nominal growth of the M2 of 4.23% at y.o.y. level is due to the growth of M1 by 2.91 percentage points, which explains more than 2/3 growth of the M2. A positive contribution to the growth of M2 came from hard currency deposits with 1.92 percentage points while savings and timed deposits continued their negative influence on the growth of M2 with -.6 percentage points in Q1.

Banking sector: placement and sources of financing

As in the previous year, placements to the enterprises and the households recorded drops which in Q1 stood at 577 million Euro. The overall drop in placements by the banking sector in Q1 is somewhat less and stands at 343 million Euro (in Q1 2013, banks placed 123 million Euro and in the same period of 2012 409 million Table T7-8), and was caused by increased loans to the

The enterprises and households continued repaying off debts in Q1 ...

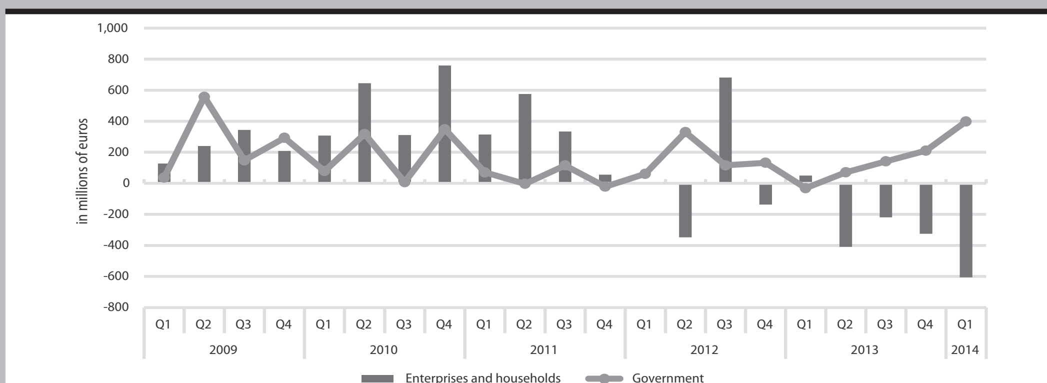
... while the only growth of placement was recorded on the basis of net loans to the government

government in that period. The drop in overall placements is primarily the consequence of the critical state of the enterprises in regard to financial sustainability of operations. Funds to subsidize loans to the enterprises were completely exhausted early in 2013 and the government failed to implement the sorely needed reform of the public sector and regulatory framework to secure conditions for the economy to recover. In virtually unchanged conditions and with no financial injection in the form of subsidized loans for liquidity and turnover funds, the enterprises repaid more than a billion Euro in 2013. That negative trend continued in 2014 when in Q1 alone the enterprises lowered its debts by twice the amount of the average repayments per quarter in the previous year, that is 570 million Euro (in Q4 2013 the enterprises lowered its debts by 312 million Euro which at that moment was a record at quarterly level). The drop in credit activities was due in part to the fact that the Univerzal Bank Belgrade lost its license late in January which meant that its placements were excluded from the balance of the banking sector but even then the rest of the sector recorded a drop in credit activities. Credit placement to the households which increased slightly in 2013 also saw a drop in Q1 by 7 million Euro. At the same time, banks wit-

Frame. Crediting the government and non-government sector

Following the first drop in credit activities due to the effects of the financial crisis in 2008, the Serbian government subsidized loans program quickly showed positive effects in terms of the growth of new placements to the enterprises and the households. However, without reforms in the public sector and a new labor law instead of a return to the old path of economic growth, we only saw a short delay of the inevitable crisis of liquidity. In periods between the end of one and start of a new series of subsidized loans, there was an evident drop in credit activities which shows that the enterprises are unable to take out loans under market conditions and that business banks are not interested in taking some risks and offering better credit conditions (Picture T7-7). The first problems were noticed in 2012 when in Q3 alone the amount of newly approved loans exceeded the debt repayments of the enterprises and households to domestic banks. In 2013, when funds for subsidized loans were completely exhausted, there was a constant negative growth of credit placement. In the past five quarters, the enterprises repaid 1.6 billion Euro more than it took out new loans from business banks.

Picture T7-7. Growth of government loans to the enterprises and households in Serbia 2009-2014.



Source: *QM* calculation

In the same period the net placements to the government were mainly positive. In 2013, placements to the government* increased to reach almost 400 million Euro along with a lowering of the debts of the enterprises in the balance of the domestic banking sector. The increased exposure of the banking sector to the government with a constant growth of bad loans in the economic segment additionally complicated the position of both the state and business banks. Unless the government implements all necessary measures of fiscal consolidation in the coming period there is a latent danger of a public debt crisis which would spill over into the banking sector if the government is unable to service its dues on time.

* Government includes all levels of government: republic level and local government level.

hdrew some 176 million Euro from REPO placements which decreased the overall placement of the banking sector in Q1 even further. Due to the increase of loans to the government by 411 million Euro, the overall drop in credit placements in this period eased significantly but the question is how long the banking sector in Serbia will resist this negative trend in credit withdrawal.

Table T7-8. Serbia: bank operations – sources and structure of placement, corrected[1] trends, 2012-2014

	2012				2013				2014
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	in millions of euros, cumulative from the beginning of the year								
Funding(-, increase in liabilities)	672	692	472	-384	109	341	213	420	578
Domestic deposits	589	146	15	-459	4	-56	-325	-394	240
Households deposits	-49	-189	-296	-578	-87	-132	-252	-423	45
dinar deposits	30	69	36	11	16	-34	-110	-279	27
fx deposits	-79	-258	-332	-589	-102	-98	-141	-144	17
Enterprise deposits	638	336	311	120	91	76	-73	29	195
dinar deposits	362	304	230	99	-11	-11	-109	-162	210
fx deposits	275	31	81	21	102	87	36	191	-15
Foreign liabilities	3	345	335	127	357	406	588	806	358
Capital and reserves	80	200	123	-52	-252	-9	-50	8	-20
Gross foreign reserves(-,decline in assets)	-199	371	164	284	-278	-104	84	-304	193
Credits and Investment[1]	409	-424	201	521	123	-169	-67	42	-343
Credit to the non-government sector, total	309	136	784	589	-23	-348	-551	-875	-577
Enterprises	375	161	741	552	-71	-463	-728	-1,018	-570
Households	-36	-25	42	37	48	115	177	143	-7
Placements with NBS (Repo transactions and treasury bills)	-28	-944	-1,052	-701	321	319	492	628	-176
Government, net[2]	128	385	470	632	-175	-140	-8	290	411
MEMORANDUM ITEMS									
Required reserves and deposits	-552	-418	-451	-265	-17	-87	-443	-134	-2
Other net claims on NBS[3]	-199	-20	-42	58	-154	-85	118	44	-136
o/w: Excess reserves	-187	45	54	10	-151	-96	60	38	-156
Other items[4]	150	222	56	146	100	50	54	-22	-289
Effective required reserves (in %)[5]	22	23	23	23	25	24	22	23	23

Source: NBS

1) Calculating growth is done under the assumption that 70% of overall placements are indexed against the Euro. Growth for original Dinar deposit values is calculated based on the average exchange rate for the period. For foreign currency deposits – as the difference calculated on the basis of the exchange rate at the ends of periods. Capital and reserves calculated based on Euro exchange rate at ends of periods and do not include effects of exchange rate changes in calculating balance remainder.

2) NBS bonds include government and treasury bonds NBS which are sold at repo rates and at rates set on the market for permanent auction sales with a due date longer than 14 days..

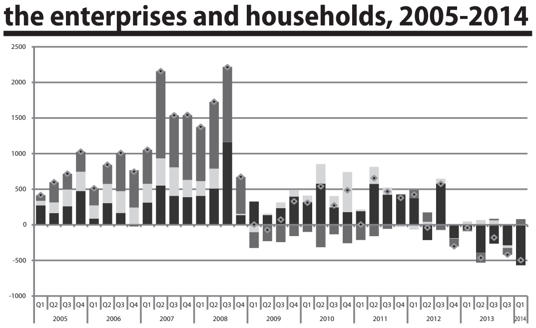
3) Net crediting of the government: credits approved to the government are lowered by the government deposits in business banks; the negative prefix designates a higher growth of deposits over credits. Government includes all levels of government: republic level and local government level.

4) Other NBS debts (net): difference between what NBS owes banks on basis of cash and free reserves and debts to NBS.

5) Items in bank balance: other assets, deposits by companies in receivership, inter-bank relation (net) and other assets not including capital and reserves.

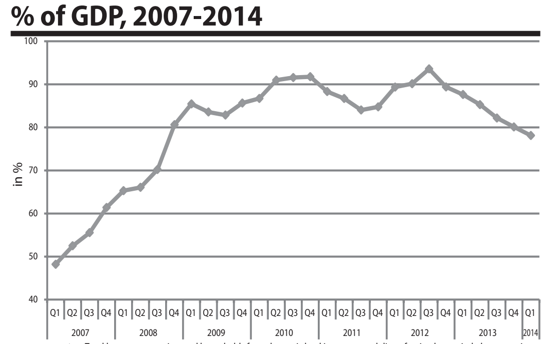
6) Effective mandatory reserve designates participation of mandatory reserve and deposits in sum of overall deposits (households and the enterprises) and bank debts abroad. Basis to calculate mandatory reserves does not include subordinate debt because it is unavailable

Graph T7-9. Serbia: growth of new credit to the enterprises and households, 2005-2014



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

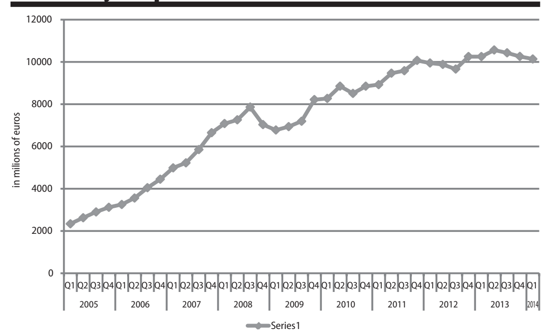
Graph T7-10. Serbia: overall credit debt in % of GDP, 2007-2014



Source: *QM* calculation

The negative trends continued in Q1 in terms of business banks sources for new placements. Although a drop in sources for new placements is characteristic for the start of the year (in Q1 2013 a drop in those sources by 109 million Euro, in Q1 2012 a drop in those sources of 672 million Euro, Table T7-8), there is cause for concern over the fact that in the previous year that trend spread to the entire year. The lowering of sources to finance placement is party due to the drop on the account of domestic deposits by 240 million Euro. That drop was caused by the withdrawal of enterprises deposits totaling 195 million Euro while the remaining 45 million Euro were withdrawn from the accounts of private individuals. In terms of structure, withdrawals were almost completely from Dinar accounts while the foreign currency accounts of the enterprises and households dropped by just 2 million Euro. Sources for new placement in the remaining part were decreased because of the debt repayment of business banks abroad. In 2013, banks lowered their debts to their head offices abroad by 806 million Euro and another 358 million in the first three months of this year. That withdrawal of capital is also an indicator of the confidence of foreign investors who have a much more realistic image of the international position in terms of evaluating the business capacities of the Serbian economy. The decrease in the number of sources for new placements combined with the drop in credit placements means that the domestic banking sector is adapting to a lower level of economic activity and is an additional brake for the already debatable prospects of economic growth in 2014.

Graph T7-11. Serbia: level of foreign currency deposits, 2005-2014



Source: NBS

Table T7-12. Serbia: participation of bad loans by type of debtor, 2011-2014

	2009	2010	2011				2012				2013				2014
	Dec	Mar	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	balance at the end of period														
Corporate	12.14	14.02	14.39	16.23	17.44	17.07	17.72	19.26	19.04	19.06	22.62	27.77	31.13	27.76	28.67
Entrepreneurs	11.21	15.8	15.66	15.75	16.99	17.07	16.05	18.47	17.56	15.92	16.79	18.19	20.86	20.82	21.11
Individuals	6.69	6.71	6.79	7.1	7.4	7.24	7.57	7.69	8.05	8.32	8.44	8.37	8.14	8.59	8.7
Ammount of dept by NPL (in bilions of euros)	1.58	1.94	2.09	2.46	2.64	2.63	2.67	2.71	2.97	3.19	3.87	4.47	4.82	4.09	4.048

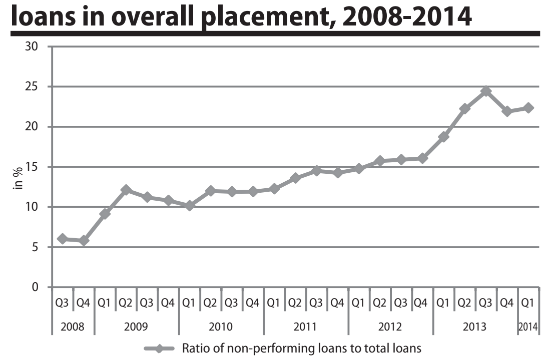
Source: *QM* calculation

Bad loans continue growing …

The revoking of the license of the Univerzal Bank a.d. Belgrade late in January because of the untenable under-capitalization is another indicator of how serious the situation is in the Serbian banking sector and of the problems stemming from bad loans which can no longer be ignored. In Q1 the overall participation of bad loans calculated using QM methodology increased to 22.33% which means that the growth trend which started in 2008 is continuing (Graph T7-13). In the overall structure of bad loans, the greatest contribution came from bad loans to companies which increased by 28.67% (in Q4 2013 that stood at 27,76%, Table T7-12). A somewhat lesser deterioration was noted in the entrepreneur and private individuals segment in which there is no sign that this trend is about to stop. An attempt to decrease the participation of bad loans by relinquishing debts fallen due to persons outside the financial sector obviously was not successful enough. Since there were no better solutions and the Serbian government and NBS were not ready to tackle the problem seriously, it seems that the revoking of the licenses of business banks will become common practice in the Serbian banking system. Solving the problem of bad loans in the banking sector will demand a more active role to be played by the government and NBS not just in creating the regulatory framework but in directly initiating the sale or restructuring of companies which to a large extent generated the rise in bad loans in Serbia.

… with deterioration registered in all three segments

Graph T7-13. Serbia: participation of bad loans in overall placement, 2008-2014



Source: *QM* calculation