7. Monetary Trends and Policy

The continuing drop of the y.o.y. inflation rate in Q4 freed space for a further relaxation of monetary policy. Still, the Serbian National Bank (NBS) very cautiously lowered its key policy rate while directing most of its activities towards stabilizing the Dinars exchange rate. In the last quarter of the previous year interventions were aimed at preventing a sudden depreciation of the Dinar while interventions in the first two months of this year were aimed at preventing sudden changes in the exchange rate in both directions. The state of the Serbian economy (the recession, low inflation, a drop in credit activity), the adopted measures of fiscal consolidation and trends in the international environment create room for a more significant and faster easing of the restrictive monetary policy. The credit activities of domestic banks rose slightly in the enterprises segment while other placements dropped. Foreign owned banks are continuing to withdraw their placements from Serbia which indicates serious problems in companies and in the banking sector. Bearing in mind these negative trends and the end of the program of subsidized loans, a new mechanism needs to be found to move credit activity in Serbia. In 2014 there was an evident stabilization and slight reduction of bad loans with improvements recorded in the enterprises and household segments.

Centrala Bank: Balance and Monetary Policy

NBS moderately and cautiously eases restrictive monetary policy

The Serbian National Bank (NBS) monetary policy was directed to stabilizing the foreign currency market in Q4 despite the drop in the y.o.y. inflation rate below the planned framework. That view is confirmed by the fact that despite deflation at monthly level, the NBS corrected its key policy rate only once by 0.5 percentage points to leave it at the level of 8% up to mid-March when it was reduced to 7.5%. On the side of interventions primarily directed at stabilizing the foreign currency market, the NBS changed its decision on mandatory foreign currency reserves twice in Q4 and once more in January in order to withdraw Dinar liquidity and reduce the pressure on the inter-banking foreign currency market. The weaker pace in lowering the key policy rate is the consequence partly of the great withdrawal of banks from REPO placements which started in Q3. In the second half of the year, REPO stock was reduced by about 755 million Euro, partly as the consequence of a reduction in Dinar liquidity which happened because of the obligation of banks to cover most of their foreign currency required reserve with Dinars. The freed foreign currency reserves were mainly returned to the bank head offices outside the country. The y.o.y. inflation rate stood at 0.1% in January because of a high base from the previous year and because of that we can expect inflation to remain below the target framework in the first half of 2015 despite the announced rise in the price of electricity due to the low aggregate demand. In February amendments to the law on banks were adopted showing that the NBS is paying increasing attention to the problems in the banking sector with an accent on the high level of bad loans (see in more detail in Spotlight On 1). We still believe that despite these efforts, the center of future activities should lie in the creating of positive stimulation for new credit placements and not just a stabilization of the foreign currency market.

Table T7-1. Serbia: NBS interventions and foreign currency reserves 2012-2014

	2012				2013				2014			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
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	824.19	387.39	69.48
NBS interest rate	9.50	10.00	10.50	11.25	11.75	11.00	11.00	9.50	9.50	8.50	8.50	8.00
NBS interest rate	1.11	-2.77	-5.74	1.11	6.95	3.31	13.24	10.38	4.38	5.09	6.78	10.63
NBS interest rate	-18.43	-7.27	-6.50	-3.99	19.25	12.85	12.83	9.25	5.28	7.08	0.03	-1.94
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	-630.00	-855.00	-1620.00
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	-31.2	-4.9	2.0	-6.6
NDA	2.4	61.3	65.8	41.3	-15.3	-3.9	-16.2	-31.3	12.2	-11.4	-7.6	15.6
Government, dinar deposits[3)]	-5.1	6.1	4.3	-4.3	1.0	-1.2	-4.7	-19.9	3.3	-14.6	-24.3	-9.5
Repo transactions[4)]	2.2	53.7	59.3	40.2	-16.0	-14.7	-23.8	-30.7	9.2	6.5	28.9	46.0
Other items , net[5)]	5.3	1.5	2.3	5.4	-0.3	12.0	12.4	19.3	-0.3	-3.4	-12.2	-20.9
H	-15.2	15.9	30.2	35.3	-2.8	3.3	1.7	12.0	-19.0	-16.3	-5.6	9.0
o/w: currency in circulation	-3.3	-4.0	-1.4	-1.6	-3.9	-0.7	1.0	5.4	-5.2	-3.5	0.5	3.7
o/w: excess liquidity	-13.6	-1.6	-1.1	5.4	0.6	2.1	-1.4	4.4	-12.1	-11.6	-7.3	-0.6
					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	-608.63	-725.22	169.79	-778.03
Gross foreign reserves	-1138.11	-2090.09	-2536.57	-1324.15	-385.77	-1576.91	-1822.60	240.33	-793.11	-1090.74	-276.23	-1309.69
Foreign liabilities	67.51	2.64	152.60	273.20	415.78	584.90	781.10	703.63	184.49	365.52	446.02	531.66
IMF	58.24	-6.44	138.99	258.95	401.14	568.40	759.83	695.60	182.35	364.90	446.72	539.97
Other liabilities	9.27	9.07	13.61	14.25	14.65	16.50	21.27	8.03	2.14	0.61	-0.70	-8.31
NBS, NET RESERVES-STRUCTURE												
1. NBS, net	-1070.60	-2087.45	-2389.97	-1050.95	30.01	-992.01	-1041.50	943.97	-608.63	-725.22	169.79	-778.03
1.1 Commercial banks deposits	459.45	740.45	1030.19	907.59	911.80	967.01	1058.25	240.42	-125.77	91.72	28.90	610.69
1.2 Government deposits	263.40	488.43	683.75	28.63	-811.79	47.05	209.55	-359.83	144.17	541.44	-162.64	48.59
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	-590.22	-92.05	36.05	-118.75

Source: NBS.
1) "Initial M2" designates the state of primary money at the start of the current, ie the end of the previous year.
2) Definition of net own reserves NBS is given in section 8 „Monetary trends and policy", Frame 4, QM 5.
3) State includes all levels of government: republic and local.
4) This category includes NBS treasury bonds (BZ) and repo operations.
5) Other domestic net assets includes: domestic loans (net debts from banks, not including BZ and repo transactions; net debts of economy) together with other assets (capital and reserves; and balance items: other assets) and corrected by exchange rate changes.

There is room for a stronger easing of restrictive monetary policy

The state of the Serbian economy, adopted measures of fiscal consolidation and trends in the international environment are creating room for a more significant and faster easing of restrictive monetary policy. The economy continues to be in recession, inflation is below the target level (with frequent periods of deflation) and the credit activity of banks has seen a downwards trend for several years. In the second half of the year the government introduced a series of measures aimed at achieving a significant reduction of the fiscal deficit which have already started producing effects which are approximately in harmony with expectations. The European Central Bank started a program of strong monetary expansion which will cause a weakening of the Euro against other currencies in the world. In those circumstances, we believe there is room for an additional easing of restrictive monetary policy both through a lowering of the key policy rate and through a gradual reduction of the required reserves rate. The NBS should ease its restrictive monetary policy until inflation stabilizes at around the middle of the target corridor (4% a year). The NBS would continue preventing sudden depreciations of the Dinar because it would have a negative effect on foreign currency debts in the highly Euro oriented economy such as the Serbian economy.

An expansive monetary policy would be anti-recession and would contribute to improving the competitiveness of the Serbian economy

An expansive monetary policy would have a moderate anti-recession effect because lower interest rates would cause a rise in private investments and private spending. If private investments, private spending and exports rise quickly the recession effects of fiscal consolidation would be lesser and shorter lasting. A rise in private investments and private spending depends on a large number of elements, with monetary policy not being the most important but that relatively modest influence should be used. An expansive NBS monetary policy should secure a moderate weakening of the Dinar against the Euro in the next few years despite the strong monetary expansion in the Eurozone. The weakening of the Dinar would stimulate exports and discourage imports which, combined with the planned structural reforms, would have a positive effect on economic activity and employment.

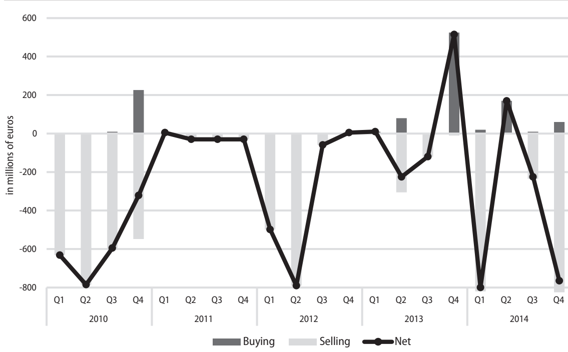
Primary money growth in Q4...

The end of the year was characterized by continued depreciation pressure on the inter-banking foreign currency market. That led to NBS interventions in Q4 which were dominated by the sale of foreign currency totaling 825 million Euro as opposed to purchases totaling just 60 million Euro (Graph T7-2). In 2014, the NBS sold 1.62 billion Euro to slow down the weakening of

... due to significant withdrawal of banks from REPO placements

the Dinar (in 2013, the NBS was a net buyer of foreign currency totaling 375 million Euro, Table T7-1). In Q4, the NBS continued freeing up foreign currency liquidity in the banking sector with new changes to the Decision on banks FX reserve requirements. For the first time in mid-October and then again in December and January, the NBS lowered the rate of the FX reserve requirement to the current 26% for obligations with a due date of up to two years and to 19% for obligations with a due date of more than two years. The overall effect was strengthened further with the change of structure of the FX reserve requirement since the portion set aside in Dinars was increased to 38% and to 30% for obligations with due dates of up to and more than two years. The relatively high increase of the Dinar portion of the FX reserve requirement compared to the decrease of the overall rate meant that business banks had a part of their Dinar liquidity pulled out while their foreign currency liquidity was freed up. In January 2015, the ECB adopted a program of quantitative easing under which, as of March, state bonds would be bough at a monthly level of 60 billion Euro. The planned duration of the program is at least to September 2016 with a possible extension which leads to expectations of more than 1,200 billion Euro being pumped into the Eurozone market.

Graph T7-2. Serbia: NBS interventions on inter-banking foreign currency market 2010-2014



Source: NBS

More interventions on inter-banking foreign currency market cause drop in net own reserves

There was an evidently lower number of interventions on the inter-banking foreign currency market in the first two months of 2015 with the NBS making net purchases of 50 million Euro by the end of February (it sold 90 million in January and bought 140 million Euro in February). We feel that it is very positive that the NBS prevented a strengthening of the Dinar with interventions on the foreign currency market since the start of the year. The strengthening of the Dinar in conditions of a high foreign deficit and high unemployment would bring short-term benefits to the population (lower cost of repaying loans, cheaper imported products) but in the long-term it would be harmful because if would cause the closing down of jobs. The greater extent of interventions on the inter-banking foreign currency market caused a drop in the NBS own reserves[1] in Q4 by 155 million Euro while at the level of all of 2014 the net own reserves dropped by 118 million Euro (in Q3 the NBS net own reserves increased by 128 million Euro, Table T7-1). Nonetheless, primary money recorded a growth of 14.67% of the value at the start of the year in Q4 (in Q3 primary money rose by 10.69% of the value at the start of the year). The negative effect of the drop in net own reserves in creating primary money was neutralized with the new rise in net domestic assets which in Q4 stood at 23.21% of the value at the start of the year. As in the previous quarter, the net domestic assets' growth was the consequence of a reduction of REPO placements by 317.5 million Euro, or 17.1% of the value at the start of the year. The increase in net assets in Q4 by 8.69% also had a positive effect on the growth of primary money while the higher rise was compensated by the increase of state Dinar deposits by 14.8% of the value at the start of the year.

Monetary System: Structure and Money Mass Trends

The money mass recorded a y.o.y. growth in Q4 ...

Compared to the value at the start of the year, the money mass M2[2] recorded a nominal increase of 8.6% in Q4. This is also the first quarter after more than 18 months in which the loans to the non-state sector were increased by 3% (in Q3 loans to the non-state sector saw a drop of –1.2% y.o.y. and in Q2 –4.5% y.o.y., Table T7-4). Following the correction for inflation during the year

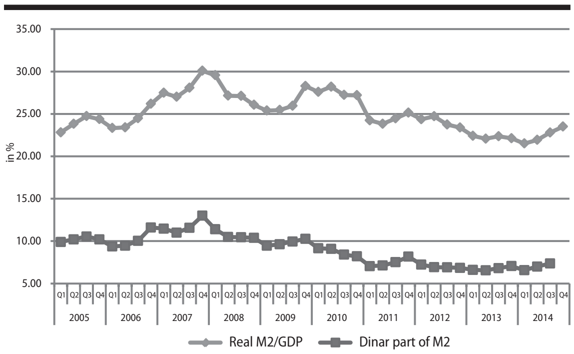
1 Repaying NBS loans to the IMF also caused a drop in foreign currency reserves (see section on Balance of Payments)

2 Monetary aggregate M2 in the section Monetary Trends and Policy includes the lesser aggregate M1, savings and timed deposits as well as foreign currency deposits in business banks. The the aggregate M2 which we observe is equal to the monetary aggregate M3 in NBS reports.

... caused by a slight rise in credit activity in the non-state sector

which was extremely low, the real growth of the M2 at annual level stood at 6.7% with loans to the non-state sector at annual level recording an increase of 1.2%. Taking into consideration the depreciation of the Dinar in all of 2014, loans to the non-state sector recorded a drop of –2.5% with a clear trend from the start of the year of slowing down following that drop (after the correction for the exchange rate changes in Q1 a drop of –10.3%, in Q2 –6.75% while in Q3 the drop stood at –5.85%).

Graph T7-3. Serbia: money mass trends as percentage of GDP, 2005-2014



Source: *QM* calculation

At quarterly level, the money mass saw a rise of 2.7% of the value at the start of the year (in Q3 a quarterly rise of 4.5%, Table T7-4), in which the biggest contribution was due to changes in the state of the net domestic assets. Unlike the previous quarter, the net domestic assets now contributed positively to the growth of the money mass because of an increase of 3.4% of the M2 since the start of the year. The other key element the net foreign assets recorded a minimal reduction of 0.6% of the value of the M2 at the start of the year in Q4 following a big increase in Q3 (in Q3 the net foreign assets rose by 11.8%).

Table T7-4. Serbia: growth of money and contributing aggregates, 2012–2014

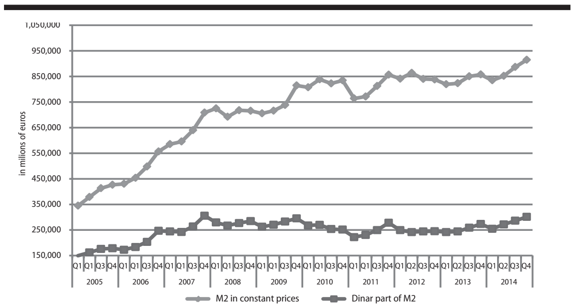
	2012				2013				2014			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
					y-o-y, in %							
M2[1)]	14.0	18.1	13.8	9.6	8.2	4.5	6.1	4.6	4.2	4.8	6.6	8.6
Credit to the non-government sector[2)]	14.4	14.0	16.6	9.8	1.9	-0.5	-4.4	-4.5	-6.1	-4.5	-1.2	3.0
Credit to the non-government sector[2)], adjusted[3)]	8.6	4.6	7	3.8	1.6	0.6	-4.1	-5.0	-8.2	-5.4	-3.7	-0.7
Households	5.7	3.3	3	2.5	3.0	2.9	2.9	2.6	2.0	2.5	3.0	3.6
Enterprises	10.1	5.3	9.1	4.4	0.9	-0.6	-7.6	-8.8	-13.4	-9.7	-7.3	-3.2
					real y-o-y, in %							
M2[1)]	10.1	12.0	3.4	-2.2	-2.6	-5	1.2	2.3	1.9	3.5	4.3	6.7
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	-5.7	-3.3	1.2
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	-6.7	-5.8	-2.5
Households	2.0	-2.4	-7.2	-9.2	-7.5	-6.1	-1.9	0.4	-0.3	1.2	0.7	1.8
Enterprises	6.3	-0.5	-1.7	-7.5	-9.3	-9.3	-11.8	-10.7	-15.4	-10.8	-9.3	-4.9
					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	1740.2	1818.4	1864.7
M2[1)] dinars	445.0	444.6	467.4	480.6	478.8	492.5	519.5	547.6	516.4	555.3	587.1	614.5
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	1185.0	1231.3	1250.2
					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	1.4	5.9	8.6
NFA, dinar increase	-5.6	-4.5	-7.9	0.2	7.2	2.7	5.2	10.6	0.2	-0.1	11.7	11.1
NDA	5.7	10.5	15.2	9.4	-8.4	-1.6	-1.3	-6.0	-1.6	1.4	-5.8	-2.4

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

All elements see positive contribution within growth of M2 …

… with foreign currency deposits leading

Graph T7-5. State of the money mass in permanent prices, 2005–2014



Source: *QM* calculation

At the end of Q4 the growth structure of the money mass M2 of 8.6% y.o.y. shows a positive contribution of all the individual elements of this monetary aggregate. Although the growth in previous quarters was carried by the increase of the lesser aggregate M1, in Q4 its contribution remained at 2.3 percentage points of the overall growth of the M2. Foreign currency deposits in Q4 once again took the role of the leading elements of growth and they accounted for 4.7 percentage points of the total increase of the

M2 at y.o.y. level (in Q3 the foreign currency deposit contribution was 2.6 percentage points and the M1 explained 3.3 percentage points of the y.o.y. growth of the M2). Although they had the lowest individual contribution, savings and timed deposits contributed to the y.o.y. growth of the M2 with 1.4 percentage points which we feel is a positive trend bearing in mind that this element prior to Q3 2014 recorded negative values from more than two years.

Banking Sector: Placements and Sources of Financing

Loans to the enterprises in Q4 rise …

… but the population frees itself of debt again

The drop in the placements of business banks which was noted in the previous quarter grew stronger in Q4 which saw a reduction of 432 million Euro (in Q3 the drop in the overall placements of banks stood at 85 million, Table T7-6). The drop in placements was once more the result of the withdrawal of banks from REPO bills which in Q4 stood at 313 million Euro (in Q3 the withdrawal from REPO placements stood at 423 million Euro). Another cause of the drop in overall placements in Q4 was the drop in net loans to the state of 124 million Euro because of an increase in state deposits in this period. The situation was partly better in the case of credit activities in the non-state sector. In Q4, there was an increase in credit placements to the enterprises sector by 61 million Euro which is mainly the consequence of the use of funds from the program of subsidized loans to maintain liquidity and finance permanent turnover funds. The positive effect of the growth of this placement was almost completely neutralized since the households was freed of debts totaling 57 million Euro in Q4. Because of that, the overall rise in placements to the non-state sector stood at just 4 million Euro. Take into account foreign sources of credit and the situation grows worse because of the fact that companies repaid 91 million Euro in debts in Q4 on the basis of cross-border loans. Viewed in total, the enterprises and the households repaid 87 million Euro in debts to both domestic and foreign sources in Q4 (Graph T7-7).

Table T7-6. Serbia: Bank operations – sources and structure of placements, corrected[1)] trends, 2012-2014

	2012				2013				2014			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	in millions of euros, cumulative from the beginning of the year											
Funding(-, increase in liabilities)	672	692	472	-384	109	341	213	420	578	540	504	678
Domestic deposits	589	146	15	-459	4	-56	-325	-394	240	-32	-382	-460
Households deposits	-49	-189	-296	-578	-87	-132	-252	-423	45	-105	-149	-250
dinar deposits	30	69	36	11	16	-34	-110	-279	27	-51	-75	-143
fx deposits	-79	-258	-332	-589	-102	-98	-141	-144	17	-54	-74	-107
Enterprise deposits	638	336	311	120	91	76	-73	29	195	72	-233	-210
dinar deposits	362	304	230	99	-11	-11	-109	-162	210	45	-159	-273
fx deposits	275	31	81	21	102	87	36	191	-15	27	-75	63
Foreign liabilities	3	345	335	127	357	406	588	806	358	396	610	907
Capital and reserves	80	200	123	-52	-252	-9	-50	8	-20	176	276	232
Gross foreign reserves(-,decline in assets)	-199	371	164	284	-278	-104	84	-304	193	215	673	1,019
Credits and Investment[1)]	409	-424	201	521	123	-169	-67	42	-343	66	-19	-451
Credit to the non-government sector, total	309	136	784	589	-23	-348	-551	-875	-577	-382	-300	-296
Enterprises	375	161	741	552	-71	-463	-728	-1,018	-570	-488	-471	-410
Households	-36	-25	42	37	48	115	177	143	-7	105	171	114
Placements with NBS (Repo transactions and treasury bills)	-28	-944	-1,052	-701	321	319	492	628	-176	-133	-556	-869
Government, net[2)]	128	385	470	632	-175	-140	-8	290	411	581	837	713
MEMORANDUM ITEMS												
Required reserves and deposits	-552	-418	-451	-265	-17	-87	-443	-134	-2	-215	-223	-730
Other net claims on NBS[3)]	-199	-20	-42	58	-154	-85	118	44	-136	-135	-4	110
o/w: Excess reserves	-187	45	54	10	-151	-96	60	38	-156	-162	-9	112
Other items[4)]	150	222	56	146	100	50	54	-22	-289	-454	-822	-592
Effective required reserves (in %)[5)]	22	23	23	23	25	24	22	23	23	22	22	19

Source: NBS

1) Calculating yield is done under the assumption that 70% of the overall placement is indexed in Euro. Yields for original Dinar values of deposits are calculated based on the average exchange rate for the period. For foreign currency deposits – as the difference in the state caculated under the exchange rate at the ends of the period. Capital and reserves are calculated based on the Euro exchange rate at the ends of the period and do not include the effects of the exchange rate of the calculation of the remainder of the balance.

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

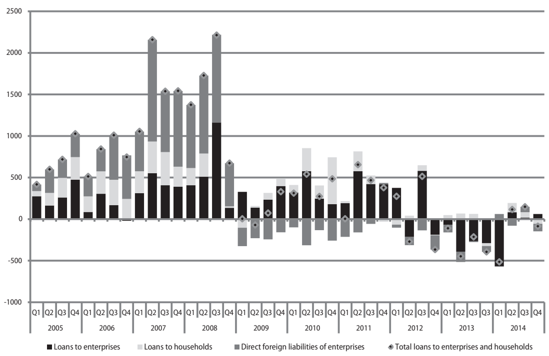
3) Net crediting of the state: loans approved to the state are reduced by the state deposits with business banks; the negative prefix denotes a higher growth of deposits than of loans. The state includes all levels of government: republic and local level.

4) Other debts of the NBS (net): the difference between what the banks are owed by the NBS based on cash and free reserves and dues to the NBS.

5) Items in bank balances: other assets, deposits of companies in liquidation, inter-banking relationships (net) and other assets not including capital and reserves.

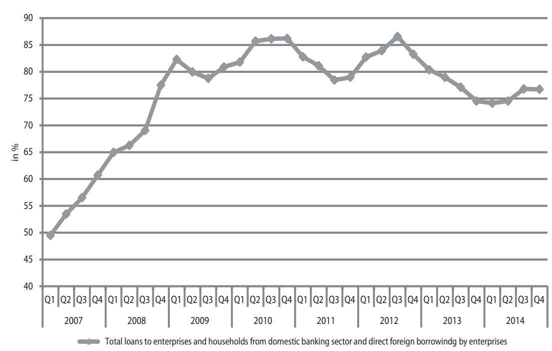
6) Effective mandatory reserves means the mandatory reserve and deposits in the total of overall deposits (population and economy) and bank debts abroad. The basis to calculate mandatory reserves does not include subordinate debts because they are not available

Graph T7-7. Serbia: yield of new loans to enterprises and households, 2005-2014



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

Graph T7-8. Serbia: overall credit debts in % of GDP, 2007-2014



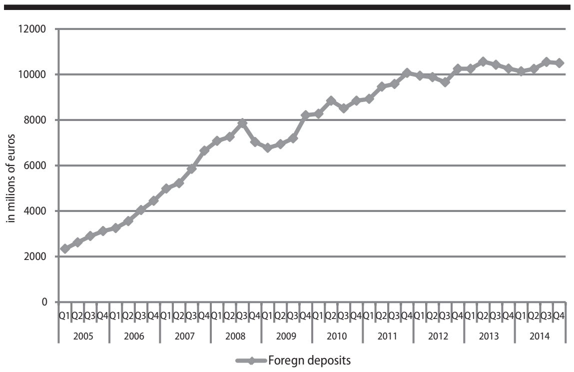
Source: *QM* calculation

Sources for new placements are dropping …

… because of repayment of bank debts abroad

On the side of the sources for new placements, there are also negative trends in the domestic banking sector. Following a slight rise in the previous quarter, Q4 registered a drop in the sources by 174 million Euro (in Q3 sources rose by 36 million Euro, Table T7-6). Within the total sources for placements, domestic deposits had a positive effect due to the increase of 78 million Euro. Within that, the households sector increased its deposits with business banks in Q4 by 101 million Euro of which 2/3 in Dinars and the rest in foreign currency. The deposits of the enterprises registered a drop which is typical for the end of the year and in Q4 they stood at 23 million Euro. The increase of the capital and reserves of business banks of 44 million Euro had a positive effect on the rise in the sources for new placements in Q4 which increased the credit potential in this quarter. Despite the positive contributions of these two sources, the repayment of foreign debts by business banks totaling 297 million Euro cased a drop in overall sources for new placements at quarterly level (in Q3 the banks repaid 214 million Euro of foreign debts). Domestic banks repaid a total of 907 million Euro in earlier loans from their central offices abroad which is more than was repaid on the same basis in 2013 when 806 million Euro were repaid.

Graph T7-9. Serbia: level of foreign currency deposits, 2005-2014



Source: NBS

Table T7-10. Serbia: participation of NPLs according to debtor type, 2011-2014

	2009	2010	2011	2012				2013				2014			
	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	balance at the end of period														
Corporate	12.14	14.02	17.07	17.72	19.26	19.04	19.06	22.62	27.77	31.13	27.76	28.67	28.12	26.76	25.5
Entrepreneurs	11.21	15.8	17.07	16.05	18.47	17.56	15.92	16.79	18.19	20.86	20.82	21.11	29.77	43.61	43.29
Individuals	6.69	6.71	7.24	7.57	7.69	8.05	8.32	8.44	8.37	8.14	8.59	8.7	9.22	11.41	9.97
Ammount of dept by NPL (in bilions of euros)	1.58	1.94	2.63	2.67	2.71	2.97	3.19	3.87	4.47	4.82	4.09	4.05	4.07	3.81	3.70

Source: *QM* calculation

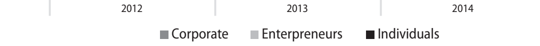
Stimulating bank credit activities should become an important goal for the NBS

The credit activities of banks has seen a downward tendency for several years with occasional breaks. One thing that is of special concern is the fact that loans to the economy are dropping since without a growth of credit activity its recovery is hard to achieve. Since the start of the crisis, the state has implemented a program of subsidized loans on several occasions managing to stimulate credit activity to a relatively significant degree but only temporarily. Considering the fact that no funds for new programs of subsidized loans were earmarked in the program of fiscal consolidation (and that probably was not even possible) the question arises of how it is possible to stimulate the growth of bank loans to the economy? In the medium term, the key measures are solving the problem of bad loans and improve the economic environment which would improve the performance of companies making them eligible for bank loans. However, considering the recession in the economy, it would be good if additional measures aimed at credit growth were implemented this year. Easing the restrictive monetary policy by lowering the key policy rate and rates of the mandatory reserves would increase the liquidity of banks and that would, at least partly, spill over into new loans for the economy. Besides that, the NBS should, in cooperation with banks operating in Serbia, consider the possibility that increased liquidity in the EU is partly used to finance companies in Serbia.

Stabilization in NPL segment

Due to the slightly increased credit activity and unchanged stock of bad loans, their participation in overall credit placements in Q4 registered a drop to 21.06% (in Q2 the participation of bad loans stood at 22.02%, Graph T7-11). A stabilization and slight drop in net amounts has been present since the end of 2013 but because of the drop in credit activities their relative participation continued to grow up to the previous quarter. The amount of debt in NPLs remains unchanged at 3.7 billion Euro compared to the previous quarter with the structure of bad loans seeing slight changes. The corporate segment which also represents the largest part slightly reduced the participation of bad loans to 25.5% which is an improvement of 1.26 percentage points. Following the worrying rise in the entrepreneur segment to more than 43%, Q4 saw an almost unchanged value but we should bear in mind that this segment had the lowest participation of some 6% in overall bad loans. What is a positive change is the improvement of 1.44 percentage points registered in the individuals segment despite the repayment of their debts in this quarter to business banks. In February, changes to the law on banks were adopted and they could lead to a narrowing of room for the growth of NPLs. The changes established a higher level of oversight, control and interventions by the NBS in cases when there is a danger to the stability of the financial system. A reduction of the current participation of NPLs requires the creating of conditions for a speedier recovery of economic activity since it is the main element of growth (see Spotlight On NPLs).

Graph T7-11. Serbia: remaining debt on loans by lateness, 2012-2014



Source: *QM* calculation

Graph T7-12. Serbia: participation of bad loans in overall placements, 2008-2014

Source: *QM* calculation