EXECUTIVE BOARD MEETING

EBS/20/136
Correction 1

August 21, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Serbia—Fourth Review Under the Policy Coordination Instrument**

Board Action: The attached corrections to EBS/20/136 (8/10/20) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Pages 13 and 23

Questions:

Mr. Martijn, EUR (ext. 38734)
Ms. Marinkov, EUR (ext. 38914)
Mr. Dallari, EUR (ext. 37560)

liquidity returned to elevated levels with BEONIA at the lower bound of the interest rate corridor.

- The NBS also underscored that they had sufficient policy space to respond to further pressures if needed, including through the prolongued and stepped-up use of the measures implemented so far. In July, the ECB and NBS set up a repo line arrangement to address potential euro liquidity needs in light of the COVID-19 shock.

- Staff agreed with a continued accommodative monetary stance to support the economy, as well as additional liquidity support for banks and financial markets as needed.

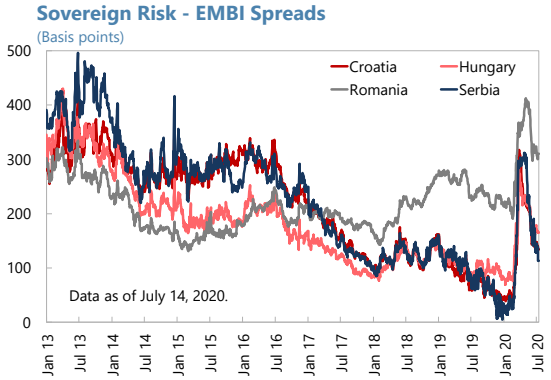
18. Pressures on the exchange rate have been contained. While interventions to support the currency amounted to EUR 98~~6~~0 million from March through June, reserves rose to EUR 14.3 billion at end-June, boosted by the Eurobond issuance (Annex IV). Staff pointed out that in a conjectural scenario with mounting external pressures, policy choices would likely become more difficult and the authorities would need to consider a broad range of options to preserve macroeconomic and financial stability, including a possible tightening of the policy stance.

19. While the uptake of emergency measures has been strong and financial stabiliy has been maintained, staff foresees an increase in NPLs. The authorities confirmed that most companies and individuals have opted to make use of the initial bank loan repayment moratorium through early July, and argued that it had been critical to maintain credit, avoid liquidity pressures for the corporates and households, and limit credit risk. The state guarantee scheme for bank loans to SMEs had been designed in collaboration with banks, and utilization of this scheme has been strong. Staff considered that the partial guarantee scheme was broadly aligned with good practices, balancing effective support to firms and mitigating credit risk faced by banks while ensuring risk sharing, capping the potential costs for the state, and limiting the administrative burden. Boosted by these policies, credit growth reached 12.5 percent yoy at end-May. Staff expects that NPLs will gradually increase in the second half of 2020 after the loan repayment moratorium and the fiscal measures to support firms and employment have expired (see Box 3), whereas the authorities foresaw that the measures that were implemented would likely prevent an increase in NPLs in the near term.

20. To help support credit growth, the authorities have rightly adjusted the macroprudential stance. They have delayed the implementation of announced macroprudential measures aimed at limiting corporate FX borrowing and reduced the regulatory minimum down-payment for first-time home buyers from 20 to 10 percent. The authorities noted that the results of their macroprudential stress tests confirmed that the domestic banking sector will remain adequately capitalized, highly liquid and with low levels of systemic risk even in the face of the COVID-19 shock. Deposit dinarization continued to rise gradually through mid-2020 along with dinarization of credit to households, but the dinarization of credit to corporates has not.

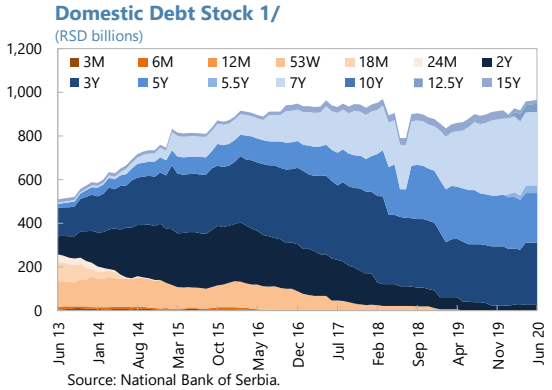
Figure 3. Serbia: Financial and Exchange Rate Developments

After rising sharply in March, EMBI spreads have stabilized....



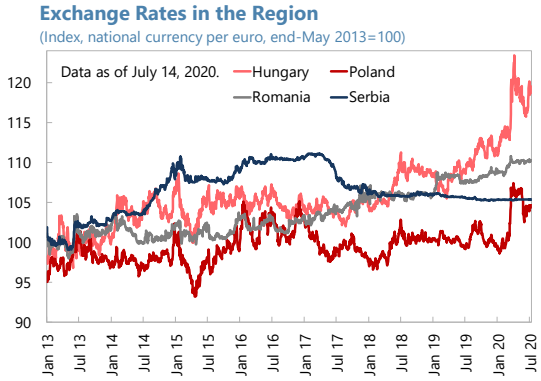
Source: Bloomberg.

....and efforts to lengthen the maturity of domestic securities continued until the COVID-19 shock hit.



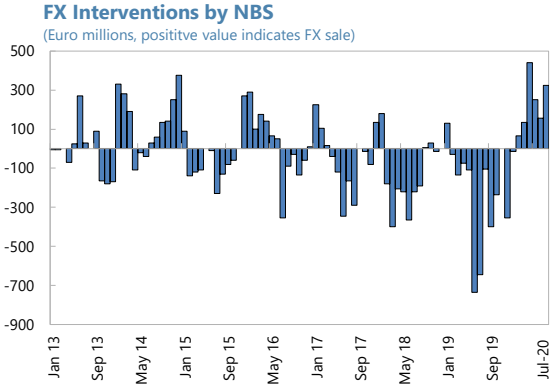
Source: National Bank of Serbia.
1/ Sum of dinar and FX-denominated securities at current exchange rate.

The exchange rate against the euro remains stable....



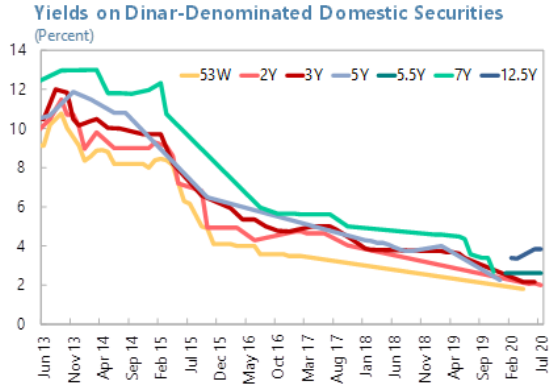
Sources: Bloomberg.

....while the NBS foreign exchange interventions have switched to FX sales in 2020.



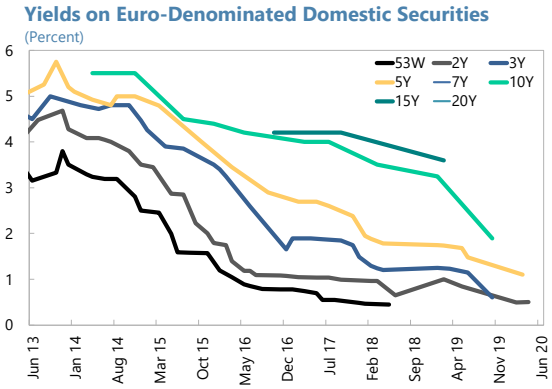
Sources: National Bank of Serbia.

Yields for dinar-denominated securities remain low....



Source: National Bank of Serbia.

....similar to the yields for euro-denominated securities



Sources: National Bank of Serbia.