7. Monetary Trends and Policy

Monetary policy in Q3 remained unchanged which is a compromise between the extremely low monthly inflation rate and occasional deflation on the one hand and strong depreciation pressure on the other. The NBS lowered its key policy rate from 8.5% to 8% in mid-November when it was obvious that the drop in aggregate demand based on the rebalancing of the budget and trends in the prices of fuels and food meant that inflation in the coming period would remain at a similar level. In the same period, depreciation pressure caused an increased level of interventions on the inter-banking market and the NBS used 225 million Euro and an additional 140 million Euro in October. The weakening of the exchange rate caused a withdrawal of business banks from REPO bonds which continued to the end of October reaching a value of 600 million Euro. We suggest that in conditions of recession and occasional deflation, the NBS should have allowed a moderate depreciation of the Dinar until inflation draws closer to middle of the target corridor. Credit activities continued to drop with the real change at y.o.y. level stood at –5.8% while the money mass recorded a drop in real growth of 4.3% y.o.y. thanks to a monetization of foreign currency deposits which the state implemented in this period. The economy in Q3 raised its debts minimally with domestic business banks but there was a somewhat higher level of cross-border credits of 82 million Euro. On the side of sources for new placements, there was a significant increase of domestic deposits in the accounts of the economy and the population but those funds were used in the majority of cases for banks to repay foreign debts. The slight improvement was noted in terms of the participation of bad loans in the overall credit placements. In Q3 the segment of bad loans placed with companies recorded a drop of participation of 1.5 percentage points while a similar trend was noted in the nominal amount of those credits since the end of last year.

Central Bank: balance and monetary policy

Despite inflation trends over the target framework...

... the NBS did not change its monetary policy in Q3 because of strong depreciation pressure

Despite the fact that y.o.y. inflation continued to move below the lower limit of the target corridor because of strong depreciation pressure, the NBS in Q3 was not prepared to relax its monetary policy. The lowering of the key policy rate came in mid-November when it became obvious that inflation would by the end of the year stand below the level of 2% except in the case of some greater external shocks. Deflation which was present in several months in the second half of the year reflects strong recession trends which justifies the easing of the restrictive nature of the monetary policy. Strong interventions on the foreign currency market which are aimed at preventing a depreciation of the Dinar give the impression that the NBS is occasionally giving preference to the stability of the exchange rate over target inflation and anti-recession policy. In November the NBS lowered its key policy rate from 8.5% to 8% which gave justification, although probably late, to its decision to ease its restrictive monetary policy. Along with the lowering of the key policy rate, the NBS also decided to change the mandatory reserves in order to lower depreciation pressure. The NBS lowered the mandatory foreign currency reserves in order to increase the offer of hard currency but raised part of the foreign currency reserves which are in Dinars to lower the quantity of Dinars and consequently the demand for foreign currency. Because of a drop in domestic demand and strong recession, we can expect that inflation will remain at its current level of 1.8–2% to the end of the year which leaves room for the NBS to further relax monetary policy. More room for relaxation of monetary policy is created with the launching of the program of fiscal consolidation which will significantly lower domestic demand.

NBS strongly intervening on foreign currency market since mid-year but Dinar depreciates by about 5%

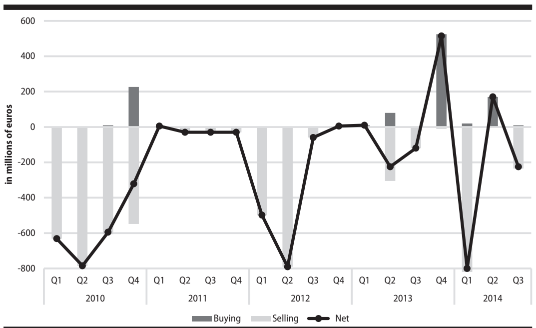
Trends on the inter-banking foreign currency market in Q3 were directed towards a weakening of the Dinar exchange rate which influenced the direction of the interventions by the NBS. Unlike Q2 when the NBS was a net buyer of foreign currency on the inter-banking foreign currency market, Q3 was dominated by depreciation pressure due to which the NBS intervened with 225 million Euro (Graph T7-2). Those interventions continued in October when the NBS sold an additional 140 million Euro to ease excessive daily exchange rate oscillations.

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
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
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
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
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
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
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
NDA	2.4	61.3	65.8	41.3	-15.3	-3.9	-16.2	-31.3	12.2	-11.4	-7.6
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
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
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
H	-15.2	15.9	30.2	35.3	-2.8	3.3	1.7	12.0	-19.0	-16.3	-5.6
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
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
					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
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
Foreign liabilities	67.51	2.64	152.60	273.20	415.78	584.90	781.10	703.63	184.49	365.52	446.02
IMF	58.24	-6.44	138.99	258.95	401.14	568.40	759.83	695.60	182.35	364.90	446.72
Other liabilities	9.27	9.07	13.61	14.25	14.65	16.50	21.27	8.03	2.14	0.61	-0.70
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
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
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
1.3 **NBS own reserves**	-347.74	-858.58	-670.03	-114.73	130.02	22.06	226.30	824.56	-590.22	-92.05	36.05
(1.3 = 1 - 1.1 - 1.2)											

Source: NBS.
1) "Initial M2" designates the state of primary money at the start of the current year, ie the end of the previous.
2) The definition of net own reserves NBS is given in section 8 „Monetary Trends and Policy", frame 4, QM no. 5.
3) State includes all levels of government: republic and local.
4) This category includes Treasury Bonds NBS (BZ), and repo operations.
5) Other domestic net assets include: domestic loans (net debts of banks, not including BZ and repo transactions; net debts of economy) together with other assets (capital and reserves; and items in the balance, all other assets) and corrected by changes in the exchange rate.

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



Source: NBS

In mid-October, the NBS Executive Board adopted changes to the rate of mandatory foreign currency reserves and the mandatory part of the foreign currency reserves that are earmarked in Dinars. The lowering of the foreign currency reserves by one percentage point each in both categories of due date on one side should increase the credit potentials of the banking sector but it seems that the primary reason behind this measure is lowering depreciation pressure because of the increase in the amount of free foreign currency with business banks. That view gets added confirmation from the increase in the mandatory part of the foreign currency reserves which are set aside in Dinars from 32% to 34% and from 24% to 26% depending on the due date. Although the overall amount of mandatory foreign currency reserves was lowered, the increase in the mandatory Dinar part of the mandatory foreign currency reserve is relatively higher and now less Euro but more Dinars are earmarked for the same deposit by business banks. In that way, the NBS is trying by increasing the foreign currency and lowering Dinar liquidity to influence the Dinar and Euro exchange rates. Despite the sale of foreign currency on the inter-banking foreign currency market, Q3 saw the NBS own reserves grow by 128 million Euro (in Q2 the new own reserves were increased by 498 million Euro). Although the sale of foreign currency on the inter-banking foreign currency market meant that primary money was withdrawn, it was increased in Q3 by 10.69% compared to the value at the start of the year (in Q2 there was a rise in primary money of 2.72%, Table T7-1). The growth of primary money was achieved on the basis of the growth of domestic net assets of 3.58% of the value at the start of the year (in Q2 there was a drop in net domestic assets of 23.64% of the value at the start of the year). The increase in net domestic assets in Q4 is the consequence primarily of a lowering of REPO placements by 437 million Euro or 22.34% of the value at the start of the year while the rise in net domestic assets was caused by the positive effect of increased state spending in the period.

In conditions of recession and frequent deflation ...

Because of the high Euro-isation the Dinar exchange rate is one of the key determining factors of inflation in Serbia. Besides the exchange rate, determining factors of inflation include earnings and domestic demand[1]. Of all the determining factors on inflation, the NBS has the greatest influence on exchange rate trends. The influence of the NBS on the credit activities of banks, and on domestic demand, is very modest because of the high level of Euro-isation. In conditions of a drop in domestic demand and lower earnings within the fiscal consolidation, the depreciation of the exchange rate is the key lever to bring inflation back into the target framework. Besides, the depreciation of the Dinar has a favorable effect on exports and foreign direct investments (once--off working expenses in Euro are dropping), which represent basic potential movers of economic growth in the next years (see section on economic activity). All that leads us to believe that the NBS should conduct a policy of moderate intervention on the foreign currency market until the depreciation of the Dinar raises inflation to the middle of the target interval. When creating exchange rate policy it is necessary to bear in mind that in conditions of relatively deep recession and a drop in domestic demand the effect of the deprecation of the Dinar on inflation is reduced. It is necessary to bear in mind the time frame between depreciation and inflation when creating policy so that the effect of depreciation on inflation is not underestimated.

... a moderate depreciation of the Dinar is desirable

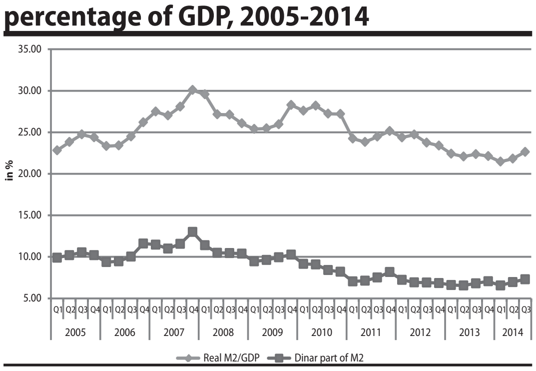
Monetary System: structure and money mass trends

Growth of money mass M2 compared to start of year ...

The money mass M2[2] at y.o.y. level rose in Q3 viewed nominally. That growth of 6.6%, including credits to the non-state sector, continue to drop by –1.2% y.o.y. and now stand at –3.7% following exchange rate corrections (in Q2 credits to the non-state sector recorded a drop of –5.4% y.o.y. following a correction of the exchange rate, Table T7-4). After including inflation over the past period, the real growth of the M2 is 4.3% y.o.y. with the drop in credit to the economy and population raised additionally to –5.8% y.o.y. following exchange rate changes. If we view the trends in the money mass compared to the value at the start of the year, an increase of 4.5% was achieved in Q3 (in Q2 a growth of 2.9% was recorded of the value of the M2 at the start of the year, Table T7-4). The registered growth of M2 at quarterly level is due solely to the extremely high growth of net foreign assets (NSA) which registered a growth of 11.6% compared to the situation at the start of the year. At the same time, the net domestic assets (NDA) were reduced by 7.2% of the initial value of M2 which prevented a higher growth of primary money in Q3.

... was achieved thanks to growth of net foreign assets (NSA) of 11,6%

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



Source: Calculation *QM*

1 There is a large number of econometric research which showed that the exchange rate and earnings were the main determining factors of inflation in Serbia.

2 Monetary aggregate M2 in the section Monetary Trends and Policy cover the more narrow aggregate M1, savings and timed 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.

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
					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
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
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
Households	5.7	3.3	3	2.5	3.0	2.9	2.9	2.6	2.0	2.5	3.0
Enterprises	10.1	5.3	9.1	4.4	0.9	-0.6	-7.6	-8.8	-13.4	-9.7	-7.3
					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
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
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
Households	2.0	-2.4	-7.2	-9.2	-7.5	-6.1	-1.9	0.4	-0.3	1.2	0.7
Enterprises	6.3	-0.5	-1.7	-7.5	-9.3	-9.3	-11.8	-10.7	-15.4	-10.8	-9.3
					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
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
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
					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
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
NDA	5.7	10.5	15.2	9.4	-8.4	-1.6	-1.3	-6.0	-1.6	1.4	-5.8

Source: NBS

1) Money mass components – see Analytical and Notation Conventions QM.

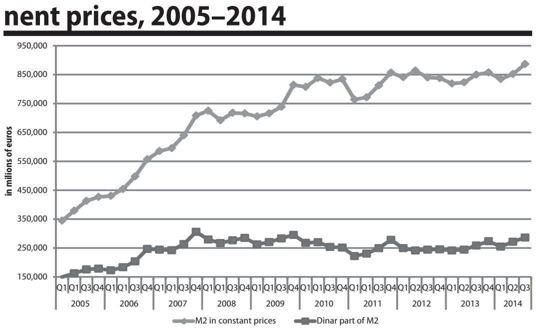
2) Credits to non-state sector – credits to economy (not including local government) and households.

3) Trends are corrected by exchange rate changes. Corrections are conducted under assumption that 70% of credit to non-state sector (and households and the economy) indexed against the Euro.

4) Initial M2 designates the state of the M2 at the start of current, ie end of previous year.

Credit to non-state sector in Q3 continue to drop –5.3% y.o.y.

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



Source: *QM* calculation

While observing the structure of the nominal growth of M2 we noted that the negative effect of savings and timed deposits in Q3 was stopped. In the overall growth of M2 of 6.6% y.o.y., savings and timed deposits accounted for 0.6 percentage points which is a positive change following more than six quarters in which those deposits had a negative effect on the growth of M2. The narrowest observed aggregate M1 once again recorded the highest individual contribution to growth of 3.4 percentage points while the rise in foreign currency deposits explains the remaining 2.6 percentage points of M2 growth. The recorded contribution of foreign currency deposits is somewhat higher compared to the previous quarters (in Q2 the foreign currency deposits participated with 1.06 percentage points in the growth of M2 while in Q1 it contributed with 1.92 percentage points).

Banking Sector: placement and sources of financing

Credit activity by domestic banks is stagnating …

… while a slight rise is expected in cross-border credits

Following a growth in placement in the previous quarter, business banks recorded lower placements by 85 million Euro in Q3. The drop in placements is the consequence of the withdrawal of banks from REPO bonds which dropped by 423 million Euro in Q3, a drop continuing into October with another 175 million Euro. The overall drop in placements was eased through an increase in crediting of the state in this period and a slight recovery of credit activity within the non-state sector. In Q3, the placement of credit to the economy and population grew by 82 million Euro with 66 million of that placed to the population while the economy increased its debts by 16 million Euro (Table T7-6). The growth of placements to the economy was launched during Q2 thanks to the new program of subsidized loans intended to maintain liquidity and finance permanent turnover funds. In Q3 the growth of placements in this segment slowed down compared to the previous quarter because of somewhat stricter standards which business banks started implementing when approving loans to the economy. The economy managed to draw part of the necessary funds from foreign sources which is shown by the inflow of cross-border loans totaling 68 million Euro in Q3 (in Q2 the economy repaid 82 million Euro of its foreign debt while in Q1 a rise in cross-border loans of 58 million Euro was recorded Graph T7-7).

Low credit activity will represent a serious limitation to the economy in the next year

In the next year, economic activity is expected to drop by about 0.5% despite the significant recovery of activities affected by the floods (see section on economic activities). The increase in credit activities by banks could ease the recession but the chances of that happening in the next year are slim. One thing making the situation more difficult is the fact that the government and NBS do not have any significant instruments within monetary and fiscal policy to stimulate credit activity. It is necessary for state activities to be directed to ordering the economic environment which would reduce credit risks. Some of the more important activities in that direction include a more efficient elimination of insolvent companies from the market, increased transparency of business operations, sanctioning the founders of fraudulent companies, introducing added stimulation to resolve problems of bad credit and other things. Because of the lack of banking credits to micro and small companies and entrepreneurs, we believe that it is necessary to once again create legal possibilities to form non-banking credit institutions.

Table T7-6. Sebia: 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
	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
Domestic deposits	589	146	15	-459	4	-56	-325	-394	240	-32	-382
Households deposits	-49	-189	-296	-578	-87	-132	-252	-423	45	-105	-149
dinar deposits	30	69	36	11	16	-34	-110	-279	27	-51	-75
fx deposits	-79	-258	-332	-589	-102	-98	-141	-144	17	-54	-74
Enterprise deposits	638	336	311	120	91	76	-73	29	195	72	-233
dinar deposits	362	304	230	99	-11	-11	-109	-162	210	45	-159
fx deposits	275	31	81	21	102	87	36	191	-15	27	-75
Foreign liabilities	3	345	335	127	357	406	588	806	358	396	610
Capital and reserves	80	200	123	-52	-252	-9	-50	8	-20	176	276
Gross foreign reserves(-,decline in assets)	-199	371	164	284	-278	-104	84	-304	193	215	673
Credits and Investment[1)]	409	-424	201	521	123	-169	-67	42	-343	66	-19
Credit to the non-government sector, total	309	136	784	589	-23	-348	-551	-875	-577	-382	-300
Enterprises	375	161	741	552	-71	-463	-728	-1,018	-570	-488	-471
Households	-36	-25	42	37	48	115	177	143	-7	105	171
Placements with NBS (Repo transactions and treasury bills)	-28	-944	-1,052	-701	321	319	492	628	-176	-133	-556
Government, net[2)]	128	385	470	632	-175	-140	-8	290	411	581	837
MEMORANDUM ITEMS											
Required reserves and deposits	-552	-418	-451	-265	-17	-87	-443	-134	-2	-215	-223
Other net claims on NBS[3)]	-199	-20	-42	58	-154	-85	118	44	-136	-135	-4
o/w: Excess reserves	-187	45	54	10	-151	-96	60	38	-156	-162	-9
Other items[4)]	150	222	56	146	100	50	54	-22	-289	-454	-822
Effective required reserves (in %)[5)]	22	23	23	23	25	24	22	23	23	22	22

Source: NBS

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

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

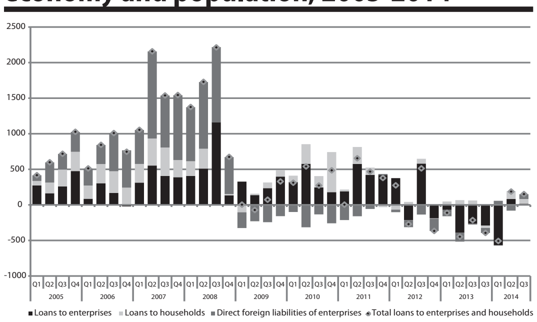
3) Net crediting of the state: loans are approved to the state lowered by the state deposit in business banks: a negative designation marks the higher growth of deposits over loans. The state includes all levels of government: republic to local government.

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

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

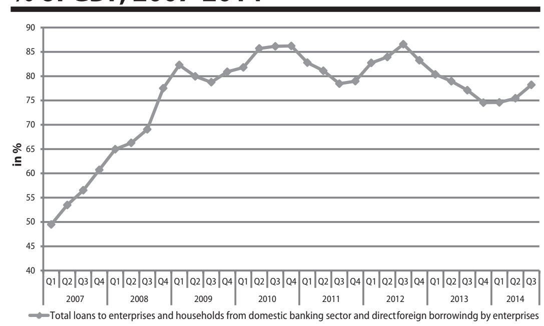
6) Effective mandatory reserve represents the participation of mandatory reserves and deposits in the sum total of overall deposits (population and economy) and bank debts abroad. The basis to calculate mandatory reserves does not include subordinate debts because that was not available.

Graph T7-7. Serbia: growth of new loans to economy and population, 2005-2014



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

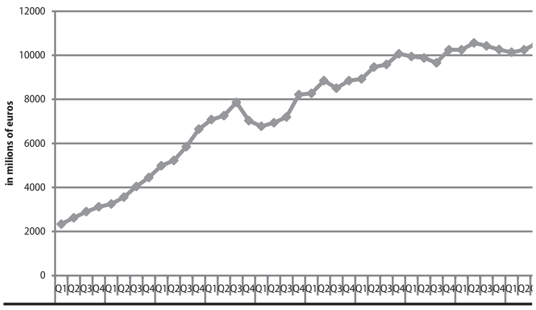
Graph T7-8. Serbia: overall credit debts in % of GDP, 2007-2014



Source: *QM* calculation

Significant rise in domestic deposits …

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



Source: NBS

… used by banks to repay foreign debts instead of for loans

Business banks recorded a slight rise in sources for new placements which in Q3 stood at 36 million Euro, similar to the increase in the previous quarter (in Q1 sources for new placements were increased by 38 million Euro, Table T7-6). As one of the elements on the side of the rise in sources, we have domestic deposits which recorded a significant rise of 350 million Euro. The growth of domestic deposits is mainly the consequence of increases in the accounts for deposits by the economy of 305 million Euro while the population increased its deposits by 44 million Euro in Q3. Of the overall increase of deposits by the economy and population, 228 million Euro are Dinar deposits while 122 million Euro were deposited in other currencies. Since the rise in domestic deposits was not accompanied by a significant rise in credit placement to the economy and population, business banks used their surplus liquidity in this period to repay loans taken abroad to the value of 214 million Euro. Counting from 2012 onwards, business banks lowered their foreign debts by 1.42 billion Euro which shows that there is no quality demand for credit arrangements on the Serbian capital market. Besides paying the foreign debts, business banks also lowered the amount of funds on capital and reserve accounts by 100 million Euro in Q3 which had an added negative effect on the overall growth of sources for new placements.

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

	2009	2010	2011	2012				2013				2014		
	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep
	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
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
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
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

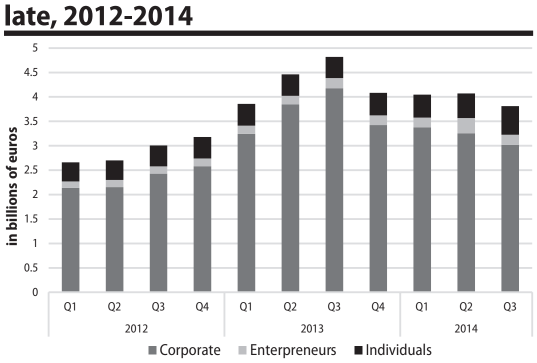
Source: *QM* calculation

The growth of bad loans was stopped in Q3…

… thanks to the lesser participation in the company sector

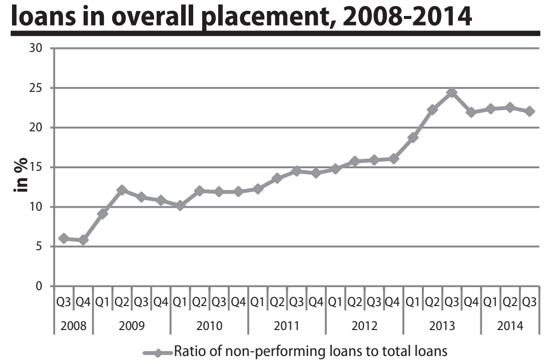
After almost constant growth over the past four years, the participation of bad loans in the overall placement dropped slightly in Q3 to 22.02% (in Q2 the participation of bad loans stood at 22.51% Table T7-10). The biggest positive change was achieved in the segment of bad loans placed with companies which dropped by 1.36 percentage points compared to the previous quarter which dragged down the percentage of overall bad loans because of the relatively highest participation. The negative trend of speedier growth of bad loans with entrepreneurs continued and in Q3 their participation was increased by 13.84 percentage points while a similar trend was noted with bad loans in the segment of private individuals which increased their participation by 2.19

Graph T7-11. Serbia: amount of loan falling late, 2012-2014



Source: *QM* calculation

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



Source: *QM* calculation

percentage points. By viewing the nominal amount of the remainder of the credit debts which were late by the end of 2013, we see a stabilization of the negative trend of increasing the overall amount of debts based on bad loans (Graph T7-11). The stabilization and consequent drop was caused by the fact that the NBS changed certain regulations and allowed the purchase of bad debts by companies and persons outside the financial sector. Along with the reduction of overall amount of bad loans to companies, the individuals sector is seeing a speedier rise in the participation of bad loans in both nominal value and the relative participation in the overall amount of loans placed. Bad loans to private individuals and entrepreneurs, account for about 20% of all bad loans which means that the growth is cause for concern in terms of the stability of the banking sector. The change shows a drop in income at household level and the small company sector which will reflect on the remainder of the economy through the drop in aggregate demand.