

Speech by Veselin Pješčić, Vice-Governor of the National Bank of Serbia at the 11th International Belgrade Stock Exchange Conference, 21 November 2012

Desirable tendencies in the debt securities market

Ladies and gentlemen,

On the occasion of the anniversary of the Belgrade Stock Exchange, founded on 21 November 1894, I wish to thank the organisers for their long-lasting and steadfast commitment to the development of the domestic capital market and organisation of a number of industry-related and educational activities. Though generally we cannot boast any major results, what makes a difference is the perseverance and dedication of key market players to design and take all available measures to further upgrade the financial market in these turbulent times. The National Bank of Serbia is aware of its role of one of the key stakeholders, along with the Government, banks and other financial institutions.

When speaking of desirable tendencies in further development of debt instruments, we should reflect on the achievements so far, which are not insignificant considering the current, unfaltering crisis. The market of government securities had not even been set up until a few years ago, and today it is practically the dominant source of government funding. The maturity of these securities in the primary market was extended up to five (for dinar securities) and 15 years (for foreign exchange securities) and domestic and foreign investor participation has significantly increased. Further, we have seen the first issues of municipal and bank dinar bonds, with some international institutions also showing interest in using such form of funding. These first steps of development of a proper capital market within the meaning used in developed countries are all the more significant because they represent the very driving force of further market growth.

However, the development of the debt market must be properly guided to be sustainable and stable, as well as beneficial to all participants and the market itself. This can be achieved by pursuing the following three lines of development: 1) further development of the primary and improvement of the secondary market of government securities, 2) broadening the circle of issuers and the investor base of debt securities, and 3) stronger development of dinar debt instruments.

As for the primary market, the maturity of government securities has been extended to a greater degree over the past two years: in March 2011, dinar-denominated securities with three-year maturity were

issued for the first time, and in January this year those with five-year maturity. This has led to an extension of the dinar yield curve, creation of investment instruments of financial institutions with a long-term investment horizon, such as pension funds and insurance companies, and the creation of room for the valuation of other long-term riskier securities. Investment in government securities has also been aided by legislation which ensures a more favourable tax treatment of investments in these securities. The National Bank of Serbia, on its part, directly contributes to the development of the government securities market by designing its basic monetary policy instruments. Thus, for instance, the main open market operations, as well as all lending operations – use dinar-denominated government securities as collateral.

This will further enhance the secondary market of government securities as banks can utilise these instruments to more actively manage their liquidity, which will, ultimately, make government securities more attractive in the primary market as well.

The National Bank of Serbia contributes to the development of the secondary market by taking active part in a number of market initiatives and projects. We are in the process of drafting standardised interbank repo agreements which should provide a legal framework for repo transactions in compliance with the international practice. The development of this market segment is directly dependant on the legal security and effectiveness of the financial collateral and calls for the improvement of regulations in this field, including the netting and better protection of creditors prior to initiating the bankruptcy proceedings. Legislation in this area is of a systemic importance, as it enhances market liquidity, reduces risks associated with transactions and contributes to financial stability. The National Bank of Serbia also took part in initiatives such as the introduction of the platform for secondary trading in government securities (in early November this year), which is expected to increase the liquidity and transparency of this market segment.

The second desirable line of development is the broadening of the circle of issuers and the investor base of debt securities. Apart from the government, there are no other significant issuers, while the investor base is concentrated in the banking sector and lacks broader participation. Speaking of corporate securities, they are mainly issued in order to ensure short-term funding from buyers known in advance.

However, issues of long-term dinar debt securities by some domestic banks are an encouraging sign. In May this year, Societe Generale Banka, Serbia, issued a three-year dinar bonds for a broader circle of investors, while Erste Banka, Novi Sad sold in early November, in primary trading, the first series of two-year dinar bonds in the Belgrade Stock Exchange. The successful sale of these securities proved that

market participants are interested in investing not only in government securities, but also in long-term debt securities of the banking sector.

We expect that other banks will follow suit and rely increasingly on this type of financing in the future. The same goes for other categories of issuers, domestic companies with good solvency and viable development plans, as well as local governments which could encourage investors by granting tax and other incentives commonly used in international practice.

The third desirable line of development is the stronger development of dinar debt instruments, which would contribute to greater use of the dinar and improved stability of the domestic financial system. A larger share of the dinar sources of funding of banks means a larger potential for dinar lending, whereas in the case of other institutions, including the government, it may also mean lower exposure to foreign exchange risks. For the National Bank of Serbia, the expansion of this type of financing means lower exposure to foreign exchange risks and, by extension, greater financial stability. A larger share of the dinar sources of funding would reinforce the effectiveness of the key policy rate and other monetary policy instruments and the overall efficiency of monetary policy. This is why the National Bank of Serbia's monetary instruments are designed to encourage borrowing in dinars (through reserve requirements) and dinar government securities (through repo operations and lending facilities).

The National Bank of Serbia also fully supports the announced issuing of dinar debt securities by international financial institutions. Namely, in cooperation with the National Bank of Serbia, some of them have been considering issuing long-term local currency bonds for quite some time already. These issues would not only provide longer-term sources for dinar lending by these institutions, but would also have multiple positive effects on the capital market – their first class rating would attract investors and they would increase the transparency and credibility of local money market indices.

Finally, it is no secret that the growth prospects for the market of debt instruments depend on international and local developments. We may and must affect local developments by creating a favourable investment climate, by upgrading market infrastructure and by ensuring stable and sustainable macroeconomic conditions. The success in following the desirable lines of development of debt instruments will also depend on the initiatives and coordinated actions of all players in the market. As so far, the National Bank of Serbia will not only actively participate in these initiatives and actions, but also take the leading role.

Thank you for your attention. I wish you a successful and enjoyable Conference.