

Radovan Jelasic: Monetary policy, current economic movements and challenges facing Serbian economic policy

Speech by Mr Radovan Jelasic, Governor of the National Bank of Serbia, at the press conference on the International Savings Day, Belgrade, 29 October 2004.

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1. Deposit base

- The banking sector deposit base as of August 31 amounted to 274.2 billion dinars, registering an increase of 51.2 billion dinars, i.e. 22.8%, compared to the end of the last year balance.
- Total savings (dinar and foreign exchange) as of August 31, 2004 reached the amount of 106.3 billion dinars, which is about 21.3 million dinars (+25.1%) higher than at the end of 2003.
- So far this year, as of October 19, new foreign exchange savings deposits increased by 25.1%, or EUR 261 million, exceeding the amount of EUR 1.3 billion, i.e. USD 1.6 billion.
- The increase in savings and domestic accumulation increase represent a vital condition for a vigorous lending activity of the banks, which means not only new investments - new employment opportunities, but also lower interest rates.

The NBS announces a campaign: SAVE MORE TODAY SO AS TO HAVE MORE TOMORROW

- As part of activities designed to celebrate October 31, Savings Day, and with a view to stimulating an increase in savings, the National Bank has supplemented its regulations relieving the banks from the compulsory allocation of a part of newly deposited foreign currency savings with the NBS in the period from November 1 to November 7 this year. The NBS hopes that banks shall also confirm in practice their professed readiness to ensure that the total effect of this measure be felt by the end-users, that is, savings depositors.
- For savings deposited in the course of the "SAVINGS WEEK", banks will apply higher than usual interest rates, up to 2 percent annually, or a fixed bonus (one-off reward) as well as special privileges for certain population groups (newborns, newly married couples...) etc.

The NBS hopes that this facility shall contribute to a more widespread response of savings depositors and to a further strengthening of the banks' deposit base, increasing, in return, their lending potential.

2. Lending activity

In the course of the first eight months this year, total lending of the banking sector increased by 30.4%, or 73.7 billion dinars. Within this figure, loans to economy increased by 37.8 billion dinars (+27.8%), whereas loans to households increased by 18.8 billion dinars (+66.6%). The remaining part of the lending activity of 17.1 billion dinars is comprised of loans to public sector and investments in the public sector, banks and nonresidents.

Maturity structure is also improving: total long-term loans have increased by 42.8 billion dinars, which represents an increase of 56.1%. Short-term loans and investments have increased by 30.9 billion dinars, or by 18.6%. According to data for the first eight months of this year, dinar loans amounted to 45.4 billion dinars, and foreign exchange ones by 28.3 billion dinars. Five largest banks have accounted for 65.9% of the total lending increase in the course of this year.

Given its low basis, the growth of household loans is apparently more quick-paced, amounting to an average of 6,300 dinars per capita. However, a large share of funds obtained from loan resources is used by the citizens for purchasing imported goods. Such consumption results in increased imports (January - August + 44.8%; however, export expressed in euros accounts for 31.6%), and results in an increase of foreign trade deficit (USD 4.5 billion) at a slight increase of export level (January - September +21.7%; however, export expressed in euros is 10.5%).

Restricting demand - acting in accordance with our resources

The NBS is currently considering the measures which would provide for directing loan potential towards investments, i.e. economy, since the NBS bears the responsibility to ensure a sustainable economic growth rate in the long term, without which there will be no new employment opportunities nor any higher incomes in the long term. By contrast, if consumption is given priority over investments, everything can be consumed very quickly - not only incomes and foreign exchange, but the achieved macroeconomic stability as well. In case foreign debts are used for consumption rather than investments, the NBS shall have to react, which means that we have to act in accordance with our resources, - our real resources!

3. Incomes - inflation - exchange rate

Compared to the matching period last year, in the course of the first nine months of 2004, net incomes registered an increase of 23.7% in nominal, and 12% in real terms.

Bearing in mind the already achieved level of incomes in public companies and constant pressures that these be increased, it is necessary to point out that by increasing the cost of services rendered by public companies, without improving their efficiency, the price shock is transferred to a) the entire economy, b) the living standard of the population, which again places additional pressure on income increase, independently of productivity.

What significance does a real income increase have without an increase in productivity? It is like buying goods on credit! And since, ultimately, someone always has to pick up the bill, the role of the "volunteer" will be assumed by the NBS through adapting the exchange rate, which means that all citizens of Serbia will be paying someone else's bill. This is a scenario well-known to us from the 80s and the 90s, and we all know to what extremes this has brought our country in the economic sense!

Exporters are those who know best how difficult it is to really earn some money, since it is them who balance the world market forces on a day-to-day basis, and who should represent the driving force of economic growth and employment.

If we want to realize a real increase of incomes, this should be done through an increase in productivity - the distribution of the unearned does not bode well for the country!

The inflation amounted to 0.5% in October, whereas in the first nine months this year it reached 9.7% (if October 2004 is viewed relative to October 2003, the inflation amounts to 11.1%).

This year's increase of prices was caused to a considerable degree by the increase of world oil prices of approximately 42.3% and a 36.1% hike in metal prices. However, inflation was also influenced by increased domestic demand, and especially by a high growth of real incomes. Therefore, the reduction of public consumption, adopted by means of the budget rebalance, is a necessary and sound move, from which public companies must in no way be exempted.

Increased production is also well illustrated by the fact that real turnover of goods in retail trade increased by 14.2% in comparison to the same period (January - September) last year, as well as that consumption tax, calculated as revenues from turnover tax and excises, registered a real increase of 10.6%.

Inflation determines the exchange rate, the exchange rate does not determine inflation!!! Therefore, the main issue is NOT what the dinar exchange rate will be, but whether we ourselves are spurring inflation on by excessive domestic consumption.

4. Monetary policy

At present, there is barely any room for tightening the monetary policy, primarily due to the fact that it is already extremely restrictive, which has been arrived at through measures implemented in August this year:

- Increase of banks' required reserves rate from 18% to 21%
- Increase of interest rates, and
- Changed method of calculating required reserves.

As regards a possible relaxation of the policy, it will depend primarily on the budget deficit realized until the end of the year, as well as by the wages policy of the Government.

In such a situation, with room for further tightening of the monetary policy is restricted, a still more responsible policy of the RS Government is required for the implementation of the economic programme as agreed with the International Monetary Fund. This can be achieved through:

- Restrictive fiscal policy, directed at limiting public consumption and incomes
- Increase of the efficiency of public companies, primarily through
 - a. accelerated separation of core from ancillary activities
 - b. privatization
 - c. reduction of the number of employees.
- Privatization of the real sector and the banks
- Privatization of large public companies in the process of restructuring.

5. Foreign exchange reserves

Foreign exchange reserves remain stable at USD 3.76 billion. In the course of 2004, there occurred an increase of as much as USD 218 million, although this was partly due to euro/dollar exchange differentials. When it comes to dealers, ending with this week, the NBS will have purchased a total of approximately USD 1.42 billion, which is equal to the amount purchased from dealers in the course of the entire 2003. When it comes to the sale of foreign exchange, the NBS sold a daily average of USD 7.9 billion on the interbank foreign exchange market. Foreign exchange trade among banks increased considerably. In October, ending with October 28, the trade between the NBS and the banks, amounted to USD 5.1 million, while among banks alone it amounted to USD 10.9 million.

Although for a central bank:

- Inflation can never be sufficiently low and
- Foreign exchange reserves can never be sufficiently high

The present level of reserves does represent a solid basis for a continuation of the exchange rate policy as it has been to date.

6. Serbian state budget for 2005

The NBS has given its support to the Serbian State Budget for 2005, pointing out the following issues:

- **Incomes:**

Since incomes still account for a high portion of the GDP, incomes of budget beneficiaries (both direct and indirect ones) should not outstrip the growth of nominal domestic product (a slower-paced income growth would have a favorable effect on the increase of competitiveness of our economy and on overall macroeconomic stability). Incomes in public companies (even if not financed from the budget) should be urgently placed under direct supervision of the Government/Ministry of Finance with the aim of establishing ex-ante the incomes levels.

- **Restructuring:**

The restructuring of large public companies should be accelerated, and the payment of subsidies should depend on the outcome of implemented reforms.

- **Privatization:**

In the course of 2005, the process of privatization should be accelerated, both through tenders and auctions, as well as privatization of the companies undergoing restructuring. This process, rather than an increased sale of government bonds, should provide funds for the real financing of the budget deficit.

- **State administration reform:**

Reform in this field should be accelerated, both from the aspect of improving efficiency, productivity and quality, as well as with the aim of a further reduction of budgetary expenditures.

Aside from the abovementioned, the NBS pointed out that "in case the abovementioned measures are not implemented, the notoriously well-known past model of functioning of our economy shall shortly begin threatening the macroeconomic balance (foreign and domestic), which may lead to a further increase in incomes unaccompanied by increase in productivity (i.e. without real grounds), as well as to a further increase of export (outstripping the increase in demand) and further deterioration of the balance of payments position of our economy on the one hand, and a further acceleration of inflation, on the other hand."

7. Privatization of banks

Six banks have submitted their statements of interest in the privatization of the Novosadska Banka - Banca Intesa and Unicredito from Italy, General Electric (Great Britain), Erste Bank (Austria) and two Greek banks, EFG Eurobank and Piraeus Bank.

Four banks have submitted their statements of interest in the privatization of Kontinental Banka- Nova Ljubljanska Banka (Slovenia), General Electric (Great Britain), EFG Eurobank and Piraeus Bank (Greece).