

Radovan Jelašić: Developments in the Serbian banking sector

Speech by Mr Radovan Jelašić, Governor of the National Bank of Serbia, at the Annual Assembly of the Association of Serbian Banks, Belgrade, 29 May 2007.

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Ladies and gentlemen, esteemed fellow bankers,

A very successful year is behind us, and even more successful ahead of us.

Macroeconomic data to corroborate such conviction are presented in the material prepared for the ASB Assembly. On this occasion, however, I wish to discuss a subject rarely discussed, the subject that represents a real revolution behind the scene and is called monetary policy. Except for bankers and those well-informed, hardly anyone is aware that the NBS has been managing a) monetary aggregates, as well as b) the exchange rate primarily, or almost solely, through monetary policy. The best proof lies in the fact that in almost three months the NBS engaged in trading in the foreign exchange market on two occasions only and for well known reasons. I truly find it a joke when even today some people talk about “unrealistic exchange rate” and volunteer estimates of what the exchange rate should be. Nobody even noticed that monetary policy has finally entered the 21st century, not to mention that nobody even bothered to praise us for such achievement. Never before has there been any talk about documents, such as Inflation Report, within the NBS walls. Moreover, many of our colleagues find it difficult to volunteer any opinion, while others are wondering how the exchange rate manages to remain stable without the NBS intervening in the process. All of the above goes to prove that the NBS is finally on the right track to becoming a real adjudicator rather than a player – which is, after all, its actual role.

It comes as no surprise to me that the politicians, hungry for self promotion, talk of substantial price that has been paid by the NBS for achievement of price stability, as this only speaks of their ignorance of the role of a central bank, which is one of the first lessons in textbooks on banking. One of the reasons for attending annual meetings of the IMF and World Bank is, inter alia, to talk to Mr. Greenspan, the legendary Chairman of the Federal Reserve, who told me a month ago at a dinner party in Washington: “By definition, politicians do not understand monetary policy – otherwise, they would not be politicians!” Still, I find it very surprising that a country, such as Serbia, should have so many “professors” and “experts” on monetary policy who are a disgrace to their own profession and the very subject matter that they have been teaching their students for decades. As with the banking sector reform, I never expected to get much support, but neither did I expect to get so little of it. Fortunately, we enjoy tremendous support from our citizens and that is most important to us.

Let me now turn to the banking sector and speak of how I see its further development. Though the largest and the most spectacular part of the banking sector restructuring has already been completed, its fine tuning is a challenge that should on no account be underestimated, and there are quite a few details to tackle not only in 2007, but until the end of the decade.

1. Ownership structure

As an indispensable, albeit insufficient, prerequisite for banking sector reform, transformation of the ownership structure paved the way for a modern and stable banking sector. Nearly 80% of the Serbian banking sector has, so to say, already joined the European Union, as it is in majority ownership of strategic investors from the EU member countries.

Some challenges still remain, such as:

- The Republic of Serbia has to define its further strategy clearly in terms of both majority and minority interest in banks;
- The National Bank of Serbia has set a deadline until 30 June this year to all qualified holders of more than 5% interest, as specified by the recently adopted Banking Law (15% before), for submission of necessary documents for the purpose of assessing their financial standing, reputation and investment strategy.
- The frequency and method of capital increases, as well as the capital adequacy ratio of some banks confirm that some bank owners are interested only in fast price gains from their

stock of shares and hope to re-sell them and make a quick buck. It remains yet to be seen whether such banks will be able to find strategic partners or fight increasingly stronger competition.

At this stage of the banking sector development, strategic investors show interest in both purchasing existing banks and setting up new institutions based on greenfield licenses. Surely, this will not only boost the level of competitiveness of the Serbian banking sector, which is one of the key NBS goals, but also ensure a wider range and better quality of banking services and products for Serbian citizens.

The National Bank does not expect a significant drop in the number of banks in the forthcoming period as there are equal chances of local banks being acquired by competitors as of the prime-rate strategic investors applying for a greenfield license.

2. Competitiveness and profitability

Both the decline in inflation (and the key policy rate that led to a fall in the weighted average interest rate from 18.15% to 12.95% in the past seven months), and the rise in income from increased number of employees and new business units, will have a major influence on the commercial bank profit and loss account as early as in this year. Taking into account interest of some banks to position themselves well in our market irrespective of current losses but with a view to the expected growth of Serbian economy on the longer run, the real battle for clients is yet to begin. Coupled with increasingly aggressive lending, relatively high fixed costs in the banking sector will be a great challenge for banks not only from the aspect of their profit and loss account, but also from the standpoint of their market positioning. Profit margins earned in 2005 are ancient history now, and so will soon be those earned in 2006 – profits will be based primarily on the volume of operations, and not on the of margin levels. Competition will slice profitability of some banks, and I sincerely hope that taboos such as costs of a) running current accounts, b) administrative injunction for payment, v) money transfers, g) loan processing, etc. will soon be on the table again!

3. Transparency and education

The best way to boost competition in the banking sector is by improving transparency and educating consumers of financial services. Transparent market of services and educated consumers are essential for building an efficient banking and financial sector. In a maze of commissions, nominal and effective interest rates, one-off costs, etc. it is difficult for citizens, even those holding a degree, to decide on which service is best to choose. Bearing in mind that many of them are turning to those services for the first time after more than a decade, and that some banking products such as mortgage loans are in most cases used once in a lifetime, the responsibility of banks and the National Bank of Serbia in respect of enhanced transparency and education becomes even greater. This means that banks should provide full and clear information on their services in a simple and understandable way to enable their clients to compare offer terms for different products as well as for the same product by different banks and be able to make informed decisions. At the same time, the customer is educated and his sense of responsibility for his own decision and the risk that it involves is developed.

All developed countries are challenged with increased transparency and improved consumer education, and their central banks, from ECB, Bank of England and the FED, keep reiterating their significance.

I truly believe, and my belief is based on discussions with hundreds of financial services consumers, that banks need to be more proactive in their public relations in order to change the image of the banking profession. Banks have to respond to all criticism, comments and complaints, they have to defend their line of business and, above all, they have to provide full information to their clients. In this respect, I welcome the ASB's Code of Professional Banking Conduct which sets a good example of self-regulation, and at the same time, reduces pressures on the National Bank as the regulatory authority. Nevertheless, the NBS will continue to insist on disclosure of the effective interest rate, education of bank clients, as well as on fast and efficient processing of customer complaints!

4. NBS regulations

Six years of transition and the current level of development of the banking sector call for another systematic review of all NBS regulations. Another reason for such general review is the introduction of Basel II in Serbia. It is expected that this strategy will be implemented primarily through banks with adequate risk management system and using it as a platform for more efficient risk management in their home countries, i.e. EU member countries. The review of the regulatory framework should go in three directions:

- Commercial banks ought to be given greater flexibility in assessing their risks exposure;
- The number of reports submitted to the NBS and the frequency of their submission have to be rationalized,
- Regulations in the area of supervision should aim primarily at liquidity and solvency of the banking sector, and not at macroeconomic issues.

Needless to say that communication and mutual understanding are essential to the success and that the above revision has to be done in full cooperation with commercial banks.

Unfortunately, stability is valued in Serbia only once it is lost! Events of the second week of May and an unexpected flashback into the nineties which, thank Lord, lasted for several days only, proved that there are no guarantees and that politics has a significant impact on movements in the exchange rate of the dinar and on the stock exchange. I sincerely hope that not only the citizens and all institutions, but politicians as well, will all learn a good lesson from events of that notorious week. All of us in the NBS most certainly have!

The last, but not least, I wish you a successful and profitable business year – and as I can see, its onset is promising – and we, on our part, shall do everything in our power to uphold our legal obligation and sustain stability!

Thank you!