Radovan Jelašić: Serbia's economy – on the right track

Speech by Mr Radovan Jelašić, Governor of the National Bank of Serbia, at the 7th Serbian Economic Summit, Belgrade, 15 October 2007.

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Ladies and Gentlemen,

I guess there is no "free dinner" for a central banker, let alone a free lunch. And though we as central bankers traditionally tend to be more cautious than anybody else, trust me, there is no reason for you not to enjoy the rest of your evening!

The National Bank of Serbia is run by a young management team that strongly believes in the "invisible hand of the market" and focuses on the medium and long term objectives only, despite a wide mixture of different monetary and exchange rate policies followed in our region.

Since the very beginning of the transition process, namely since October 2000, we have been hearing our politicians, scholars and economists speak of the advantages of the currency board or pegging our currency to the euro or even embarking on full euroization as opposed to the free-floating of the exchange rate and active use of monetary policy in order to achieve price stability. Recent developments, however, have taught us that all praised and hailed examples are very much short-lived, as inflation under the currency board regime is rising, e.g. 9.3% in Bulgaria year-on-year and 10.2% in Latvia, while even Montenegro is facing the challenges of a resurging inflation which reached 4.2% during the first 8 months with euro as legal tender! I hope that Mr. Jürgen Stark, Member of the Executive Board of the European Central Bank will allow me to quote from his speech given exactly two weeks ago in which he emphasized the very same argument that I would like to share with you tonight! Let me start with the first quote "To give you a striking example of macroeconomic performance depending on the underlying exchange rate regime, the countries with hard peg regimes have recently experienced a very rapid catching-up process, with cumulative real GDP growth standing on average at 18% in the past two years, which is almost twice as fast as the growth rates observed in the countries with flexible regimes. To some extent, this might also reflect the fact that the income level in the fixed exchange rate countries is on average still somewhat lower compared with the countries with flexible rates. Likewise, inflation in the countries with hard peg exchange regimes was almost one and a half times higher in the past two years compared with the countries with flexible regimes. The macroeconomic and financial developments in the CEE countries are puzzling in the sense that they are neither in line with economic theory, and nor do they reflect the empirical findings that are usually observed in other catching-up economies, including the cohesion countries in the 1990s."

As far as the recent use of policies is concerned, he pointed out four of them, namely fiscal policy, structural policy, supervisory and prudential policy and, last, but not least, monetary and the exchange rate policy. As far as monetary and exchange rate policies are concerned, he stated the following: "The ultimate question for a country is which monetary policy and exchange rate regime is best suited to ensuring a fast and stable convergence process. Let me stress at this point that the relevant question to discuss is not a general discourse about the pros and cons of fixed versus flexible exchange rates – we should not try to apply this more academic debate to the central and eastern European countries as a whole. In the same vein, I also do not buy the opposing argument that I hear from time to time, namely that rushing into the euro would solve all the problems experienced by the central and eastern European countries. Rather, the relevant question to ask is whether any exchange rate system is better suited for a country to cope with the country-specific challenges arising from real convergence. Obviously, this can only be assessed on a country-by-country basis."

Of course, I am pointing this out for a very good reason. Serbia operates with a) a floating exchange rate – for some people even too much "floating" and b) an active monetary policy – for some even "overly active" or better to say, too expensive, which is in my view a very relative term. Despite daily criticism of monetary policy costs and uncertainties regarding exchange rate developments, we will remain firm in our commitment because we know that our way is the right one in the medium and long run! Needless to say, it feels good to get confirmation from abroad, specifically from the ECB, that we are on the right track.

At no time in the history of Serbia and Yugoslavia was the exchange rate floating more freely than it is today. Direct involvement of the central bank is limited to a daily calculation of the medium exchange rate based exclusively on transactions among commercial banks. This is how we have been calculating the exchange rate day-by-day since March this year, and the last time the NBS was active on the foreign exchange market was 5 months ago! Yes, I admit that I also had the "fear of floating", which was widely present in Serbia, but we have done it just the same and done it successfully!

There is probably no country in the world where more professors of monetary policy are now denying their own profession and what they have been teaching for years than in Serbia. Almost every day we hear comments such as: "monetary policy can not solve all the problems without the support of fiscal policy", "central bank should give in and not pursue price stability by using only monetary policy", and " monetary policy cannot be successful in a euroized country" etc. But look at the results: despite elections that imply fiscal expansion, despite drought and the historically record high oil prices, we have made good on our promises and implemented a monetary policy that works in Serbia! Core inflation is down to 3.4% year-on-year and our inflation target set in August 2006 for this year at 4 – 8% will probably be at the level of 4 to 4.5% at the end of this year.

But the boundaries of monetary policy must be expanded even further if we want it to be more efficient: a) the government needs to think and act more in terms of dinars than in terms of euros, including, in particular, the issuing of denationalization bonds in dinars as almost all regular budgetary receipts are in dinars and there is no reason to increase currency risk exposure of the budget any further; b) our citizens should also save more in dinars and not only in euros – process of de-dollarization is just finishing in Russia, and I hope that the process of de-euroization will speed up in Serbia as well.

Ladies and Gentlemen,

Our mission as a central bank is very clear as our main goal is engraved in the central bank law, "to achieve and maintain price stability". In addition to the clear mandate we also have the tool independence, so we have nothing to complain about and we must succeed. Ultimately, only the results matter, and for us that is price stability!

Thank you!