Radovan Jelašić: The impact of the crisis on Serbia's financial sector

Speech by Mr Radovan Jelašić, Governor of the National Bank of Serbia, at the "Conference on the Future of Financial Markets of Central and South East Europe", Sarajevo, 23 October 2008.

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"We are acting with unprecedented speed taking unprecedented measures that we never thought would be necessary", said the US Treasury Secretary, Mr. Paulson on 14 October this year – and the world is slowly beginning to understand the full meaning of his words. The Government has returned in style, replacing banks as lender but also as guarantor, and even owner of financial institutions. And, in a matter of days, circumstances have changed so much that such moves are not only approved, but even welcomed and applauded!

And while we know that, after these turbulences in the global financial market, nothing will be the same, all we know about the crisis itself is that it has reached one of its many peaks over the past few weeks and that its depth and duration cannot be foreseen. Today, I would like to talk about the impact of these unprecedented challenges on the financial sector of Serbia, focusing in particular on:

1. Effects so far
2. Likely future course of the crisis
3. Long-term effects

1. The effects on the Serbian banking system are already evident, as private individuals have lost no time in responding to external shocks. Fortunately, as our citizens have long ago learnt that it is not clever to wait for the unhurried and overly optimistic politicians to explain what the future has in store, the following trend has emerged since Q2: a) receding volume of borrowing by households, with the exception of mortgage loans, b) much pricier new loans, c) notable slowdown in external borrowing by banks. In several months, we will feel nostalgia for the "good old times" when we, the central bankers, strove to suppress the credit boom by all means available and with different success. But where central banks have failed, financial crisis has succeeded, by force. And to be honest, commercial banks did go a step too far: a) they advertised borrowing and borrowing alone, with hardly any mention of savings; b) products were offered by banks, but also by agents, merchants, etc.; c) telephone calls to potential clients became a usual practice, luring customers into yet another cash credit or credit card.

However, my main concern is not whether private individuals will manage to repay their loans or not. The real question here is what will happen to enterprises. With the Government itself paying a margin of 3-4%, which source of finance can enterprises rely on? And if the entire economy can only borrow at double-digit interest rates, and even such borrowing is in short supply, how will this reflect on the country's economic growth?

At this point, we may safely conclude that the measures taken by the US and EU governments and their respective central banks have so far produced no results, that money has not been costlier for over a decade, that the key policy rates of central banks and the market price of money (EURIBOR) are still moving in the opposite directions, that excess money pumped into the banking system by the ECB is returned in the form of deposits rather than lending, while trust among financial agents has troughed and the economy is already heading for recession!

2. It is practically impossible to foresee the future course of the crisis. Earlier taboos, such as the valuation of balance-sheet categories, are being broken overnight, the governments are nationalizing the banking sector in order to "strengthen the market mechanism", stock exchanges are even rewarding such moves and there is no end to government plans!

Learning from history, the governments have clearly decided that it is better to overreact than underreact, but, unfortunately, with little success so far!

The future course of events will largely hinge on:

- How far will the Government go in acquiring ownership of the banking sector and when and how will it pull out – if, indeed, it wants to?
- To what extent can central banks replace the financial sector as lenders and should they do so?
- What will happen if governments are really faced with the obligation to pay out a major portion of the promised funds, which could well lead to bankruptcy as in the case of Iceland?

The situation is already unravelling, and a number of countries – primarily Ukraine, Hungary and Kazakhstan – are mooted as potential "victims"! Why these countries? The answer is fairly simple: a) high level of debts maturing in the next year – question of possibility and cost of refinancing, b) high share of foreign currency clause indexed loans, with savings mostly in the domestic currency – at times of exchange rate turbulences, c) heavy dependence on inflow of foreign capital (foreign direct investment and foreign borrowing). The only reason why Serbia is not in the same category as these countries are its high foreign exchange reserves, restrictive monetary policy and banking supervision. I must say I am rather pleased that armchair critics are now praising my "farsightedness" and "conservativeness" which have turned out to be the key buttress of stability of the Serbian financial sector.

3. And finally, we need to face the long-term effects of this crisis which will certainly last much longer than was expected several months ago. When I speak of these effects, I will focus on our region and country:

- The Government is returning in style, and I am, personally, slightly apprehensive of this because of my experience with the Government and its mechanisms. The role of the Government will increase, both in the financial and in the real sector. The only hope left is that this role will remain indirect, rather than direct, and that it will be of limited duration!
- The role of financial sector supervision will gain strength, both locally and in the EU. There is always a positive side to any crisis, and now Europe has understood that a single monetary and economic union is incompatible with a nationally-based financial sector supervision. This is simply a negation of reality.
- The old adage: "What you pay is what you get" best illustrates the period ahead of us. Domestic deposits will come to play a key role in financing both enterprises and households. And because of this, we will need to invest even more efforts to maintain a stable financial sector and build up public trust in the banking sector. This will be a major challenge, especially given our recent history and the efficiency of the media in whipping up unnecessary panic.
- The banking industry is in need of a thorough overhaul! Not only will the job of supervisors finally receive the respect and appreciation it deserves, but commercial bankers will also have to tighten their belts a little and be more realistic.

And just one final comment: although, as central bankers, it is our job to be "concerned", this time there is really much cause for worry. That I, at my 40 years of age, am concerned is perhaps not as important as the fact that reputed central bankers of 60 and more are – and they have already been through thick and thin. But the challenges we are now facing are also an opportunity, and I am sure that once again we will come out as winners!