Radovan Jelašić: Macroeconomic policy in 2009

Speech by Mr Radovan Jelašić, Governor of the National Bank of Serbia, at the Second Business Roundtable with Government Representatives, organized by the Ekonomist Media Group, Belgrade, 27 October 2008.

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In terms of political turbulences and uncertainties, this year can only be compared with the year 2000. The country was faced with the issue of territorial sovereignty, early parliamentary and local elections, and signing and deferral of ratification of the Stabilization and Association Agreement with the European Union. As regards the economy, however, no sooner had inflationary pressures subsided in the wake of a fall in prices of food and petroleum products, when a new, still greater challenge appeared on the scene. An unprecedented crisis broke out in the global financial markets and, whereas its negative consequences were soon felt in Serbia as well, its end effects and duration are still impossible to forecast.

But let me ask you a question: is anyone in this country aware that, despite all the above external and internal turbulences, inflation in Serbia is within single-digit bounds, GDP growth is still robust, the exchange rate had, until recently, been "firmly" stable, real wages have been rising at double-digit rates for several years now, credits are available, etc.? Or, let me ask another question which is more important both for myself, and, I am firmly convinced, for the future of this country – why do people take these results "for granted," as something which will be sustained of itself, regardless of how we behave? Why do they believe that we can keep on disregarding external and internal influences without bearing any consequences? And, especially when we all know that our doings were due to frequent elections. Why must "bad times" return before people understand that present times were good, only we failed to make the best of them?!

Macroeconomic stability in Serbia will continue to hinge on the following key factors:

1. Movements in global money and capital markets leave no room for doubt: the situation is bad, and, for the time being, there is no light at the end of the tunnel. Capital markets worldwide are swayed by unprecedented turbulences and money remains expensive despite a) government interventions worth thousands of billions of euros and b) policy rate cuts and cash injections by central banks.

   At the same time, the banking system faces a number of serious challenges, such as: a) capital adequacy, which governments are now acting to improve and hence acquire a significant ownership in the banking system, b) the dilemma of whether to continue lending to clients now that banks are no longer able to borrow in the financial market, and c) the question of market valuation of assets when there is simply no market for specific services and products. In light of the above, it is much less likely that banks will continue to generously "pump" money into our region or approve cross-border loans.

   In current circumstances, it would certainly be very useful to have a political buffer against economic challenges – if not in the form of the euro as Slovenia and Slovakia, then at least in the form of EU membership as Hungary or the Baltic countries. As things now stand, we will obviously have to take on this external challenge by ourselves. And to be successful, everybody in Serbia, or at least the decision-makers, need to understand that the situation is very serious indeed. My warnings can no longer be discarded with: "The Governor is scaring people because he does not want wages or pensions to go up!" What I suggest is that all Doubting Thomases watch the news at least once or read at least one daily newspaper from any country they choose – Brazil or China, Venezuela or Russia. The time of slogans and empty phrases is long past. If Serbia does not make major changes to its economic policy in the near future, it may easily end up high on the black list next to some other countries of the region. And I am sure that no one wants this to happen!

2. Monetary policy: This instrument has traditionally been restrictive, at times even too restrictive, which frankly only left more room for the fiscal policy! At the moment, however, there is no alternative for the NBS but to implement restrictive policy stance as inflation, the key challenge for the central bank and the main threat to both macroeconomic stability and standard of living, is not yet overcome. Professionally, however, we can be satisfied that all international financial institutions and rating agencies are commending the work of the National Bank of Serbia.

   Turbulences in the international financial market will not only affect the value of the dinar, but will also very much strengthen its role in the banking sector, even without any further restrictive measures by the NBS. Still, I hope that the government understands that these cheaper dinar loans will be in larger supply only if inflation and inflation expectations are reined in, which will, in turn, lead to cuts in the NBS key policy rate.

   Of late, many have asked why the NBS does not cut its key policy rate like other central banks have. And the answer is simple – whereas normally any decline in economic growth automatically dampens inflationary pressures, Serbia is unique in this respect again and, capable of doing two bad things at the same time: having both lower economic growth and higher inflation. This has been proved several times over the past few decades. And this is why it is necessary that the NBS continues pursuing a highly restrictive monetary policy.

3. Fiscal policy: Everyone is perfectly clear as to what needs to be done. All projections currently under preparation as part of the 2009 budget must be as pessimistic as possible, on both the revenue and expenditure sides. Let me make a note of some of the key categories:

   - Privatization revenue from the prior period has been spent and the likelihood of substantial future inflow of revenue on this account is diminishing;
   - Terms of borrowing in both domestic and international financial markets have already worsened – the price is not even asked;
   - VAT revenue will certainly dwindle, as uncertainties rise and the purchasing power diminishes,
   - The volume of contributions will also shrink!

   On the expenditure side, calls for looser fiscal policy will grow even stronger, especially as the private sector is retreating. The time of easy and cheap bank lending is now over. What is more, limited access to new lending may lead to limited investment in the private sector which Serbia stands in great need of.

   The two enduring macroeconomic challenges for Serbia – inflation and current account deficit – will become even more difficult to take on. And we are repeatedly sent the same message: by Standard&Poor's two months ago, by EU representatives at end-September, and by the World Bank and the IMF early this month. These messages are loud and clear for all to understand. And, since we ourselves are fully aware of what needs to be done, the question remains: What keeps us from doing it?

4. Structural changes: Restructuring of large public enterprises, privatization of the remaining state-owned enterprises and institution of bankruptcy proceedings against enterprises that cannot be privatized lies at the core of the transition process in Serbia. In this regard, however, we must be realistic: what we can do today is based on a couple of years' work and the first positive results of our present activities will be visible in two to three years. Structural changes are very significant and must be implemented without delay, but their results are slow in coming!

   Structural reforms have been postponed time and again in an effort to preserve social peace and now, the conditions for implementing them will only have deteriorated further. Many are aware that financial and organizational restructuring on a larger scale, including declaring redundancies, was postponed in anticipation of better days, when it will be easier for people to find new jobs or take out loans to start their own businesses. This is, however, highly unlikely in the months ahead.

But this is not the first time that Serbia is facing major challenges. In fact, we often perform best under worst circumstances and I have every reason to believe that we will succeed this time again. It is important that all decision makers understand one thing: in the course of the next year or two, it will be impossible to be a popular and a responsible politician at the same time unless you are in opposition. And no coalition agreements, reference to "specific" circumstances or excuses that we are simply late in the transition process will help us fight the two major macroeconomic challenges, current account deficit and inflation. Inflation and external deficit respond to the above listed four categories only. The first – movements in global money and capital markets – is beyond our control and will probably only produce further negative effects. Monetary reins are already tight enough and structural changes are not the quick medicine we now need! What else are we left with other than fiscal policy!