Radovan Jelašić: Challenges for Serbia during the global economic turmoil

Speech by Mr Radovan Jelašić, Governor of the National Bank of Serbia, at the 4th Annual Forum – "Financial Services in South East Europe", Belgrade, 4 December 2008.

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Ladies and Gentlemen,

It is only four weeks until the end of the year and we may safely say that 2008 to date has been more eventful than the past 2 or 3 years taken together! Namely, no sooner had inflationary pressures subsided on the back of falling food and fuel prices than we were faced with another, even greater challenge. Global financial markets went into unprecedented turmoil, which has already affected Serbia and is likely to produce further effects in 2009. At times like these, however, it is of vital importance to be fully aware of the real state of things, and to adopt a pragmatic rather than a populist approach.

As we were well aware that Serbia had no political buffers, we made use of the relatively good times in the banking sector to prepare for the more difficult times we are now facing. Or as Warren Buffet famously said: "It is only when the tide goes out that you know who was swimming naked!" The unfortunate circumstances of late have given us a chance to prove that we were well prepared for the challenges, i.e. that we were not swimming "naked" on the tide of liquidity. And as usual we received no commendations for the strength of the country's banking system which, though faced with high deposit withdrawals, successfully withstood the challenge, greater maybe than that faced by other banking systems of the region. The success of our banking sector, however, is obvious: a) Serbian taxpayers did not have to spend a single dinar on rescuing banks; b) NBS' measures did not destabilize our banking sector – reserve requirement on domestic savings has remained at 40%; c) and the bank ownership structure has proved adequate in times of crisis.

For Serbia, a key question remains – what further steps to take in view of the global economic turmoil:

1. We should finally understand that the current macroeconomic policy cannot be continued: it is completely unrealistic to expect that the time of a) cheap foreign funds and b) plentiful foreign investment will suddenly return to help us finance our current account deficit of 15 – 20%. Now is the time of reckoning, and the sooner we accept this fact, the better it will be for all concerned: enterprises, banks, households, state, etc.
2. We must admit that current challenges are fast spilling over to Serbia, first as psychological effects and, as of late, as economic effects as well;
3. We must take emergency measures, both on a macro and on a micro level, to alleviate the effects of the financial turbulences. The budget of the Republic of Serbia will play a key role in that respect. And I am no longer talking about plans and intentions in general, but about building up concrete mechanisms and targeting figures to ensure not only sufficient liquidity levels but also an adequate volume of lending to enterprises.

Until about two months ago, I was often labeled a great pessimist who uses turbulences in international markets as a pretext for opposing an increase in pensions, which is, by the way, not based on real earnings. In the meantime, however, my pessimism has been surpassed by many, including those who had earlier argued that an increase in pensions would actually do us good. The reason for this is simple – the turmoil in international markets is now a good pretext for a U-turn in their economic policies! So, by a weird twist of events, I have suddenly been turned into an optimist again!

The grounds for my cautious optimism are as follows:

- On 19 December this year, the IMF Executive Board is to approve an arrangement with Serbia, which will buttress macroeconomic stability in the country;
- The drafting of the Memorandum between the Government of the Republic of Serbia, National Bank of Serbia and Deposit Insurance Agency relating to stability and liquidity of the financial sector is expected to complete this week. The Memorandum will contain not only concrete mechanisms, but also exact figures.
- Full support of international financial institutions to Serbia will continue in 2009:
    - European Investment Bank: loans to SMEs;
    - European Bank for Reconstruction and Development: capital increases by banks, loans to SMEs and large enterprises;
    - German Reconstruction Bank (KfW): financing energy efficiency projects and SMEs through commercial banks;
    - Loans of the Government of the Republic of Italy.

  All of the above, of course, is an add-on to domestic bank loans and foreign loans.
- Measures taken so far by the NBS have not worked to the detriment of the stability of the banking sector, or better still, our reserve requirements have not been lowered, which means that we are ready to get to grips with any additional challenges ahead!

However, there are things that keep me awake at night:

- First, the media – their unprofessional, sensational and incomplete reporting on the crisis has played a significant role in the withdrawal of household deposits. Thus, in percentage terms, more money was withdrawn from banks in Serbia than in countries that have three times lower capital adequacy ratios and which saw government rescue packages worth a dozen billion euros! It is as if the media were competing in the dissemination of bad economic news, trying to convince the public that everything "is the same as it was two decades ago" even though everybody knows it is not!
- Second area of concern is action taken outside Serbia: Measures taken by some governments within the EU, and by the Brussels itself, have been only half-measures. They were not targeted enough and it will take quite a while before they kick in. Hence, it is very difficult for us in Serbia to take any measures that would complement those taken abroad! Although everyone seems to be falling over themselves in making promises, substantive details are scarce and the money even scarcer: save in England! Let me illustrate this by asking: Will the interbank market in Serbia revive or just liven up briefly if banks in Frankfurt, Vienna or Athens continue to mistrust one another? Somehow, I doubt it.
- The third reason for concern are the financial systems of the neighbouring countries: A stable banking system in Serbia is not sufficient in itself because if anything goes wrong in the region, it is bound to produce consequences for Serbia as well. To foreign institutional investors looking for emerging market opportunities it is all one and the same thing, although we, of course, know it is not.
- And finally, how much longer will this last and how much further will it go? I truly hope that the pessimists will be proved wrong and that the sums invested by central banks and governments of major world countries will manage to prevent the worst-case scenario.

Let us be clear – there are no magic bullets, just as there are no absolutely good or bad solutions. We should, however, keep our mind on the objectives of the National Bank of

Serbia – the primary being price stability and the secondary, financial stability. For this very reason, the National Bank of Serbia's Monetary Policy Committee will, next Monday at the latest, consider the enactment of the following measures:

- To increase the share of foreign currency required reserves kept in dinars from 20 to 40 percent with a view to providing banks with extra foreign currency liquidity and withdrawing any excess dinars from circulation;
- To encourage banks to keep the released excess foreign currency liquidity in the domestic banking sector, rather than to use it to repay foreign debts or to reduce foreign deposits;
- To resume organizing fixing sessions as early as today since the current level of margins and trading volumes are not satisfactory;
- To lower the net open position of banks from 20 to only 10 percent, in order to reduce their exposure to the exchange rate risk.

In parallel, we have been drafting a decision to be adopted by mid-December to relax in 2009 requirements from some of the NBS regulations (e.g. 30%, 50% and 150% limits).

Everybody says that Serbia performs best when backed into a corner. Well, we have been in that position for quite a while and some seem to have realized it only now. Understanding your position is necessary, but not in itself sufficient. In most difficult times during the process of transition, one should step up and not rest on one's oars. Everybody is willing to help us, but no one will nor should do our job for us.

Thank you for your attention.