

Jorgovanka Tabaković: Strategic analysis of Serbia's position and perspectives of recovery

Speech by Dr Jorgovanka Tabaković, Governor of the National Bank of Serbia, at the Kopaonik Business Forum 2016 "Catching up and convergence with leading trends: how to fix up the main fractures of the system", organized by the Serbian Economists Association and the Association of Corporate Directors of Serbia, Kopaonik, 8 March 2016.

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Esteemed members of the diplomatic corps, members of the Government, fellow economists, businessmen, ladies and gentlemen,

Allow me to extend special greetings, and I shall presently explain why, to Prime Minister Mr Vučić and the representative of the Serbian Academy of Sciences and Arts, Mr Vladimir Kostić. Two years ago at this gathering I spoke of temporariness and of divisions, the two long-standing drawbacks of the Serbian people identified long ago by Isidora Sekulić. And look at us today – Mr Šoškić is moderating this panel, I am at the speaker's stand, many of my fellow economists, at one time in government, yet at other in opposition, we are all gathered here. It is so because we are on the right path to overcome the divisions between us and to ensure continuity for the Serbian people, as Mr Vladimir Kostić phrased it in his first TV appearance that I had the opportunity to watch. "When young people are leaving", I apologise for imprecise quoting, "I feel sorry not because they are leaving, but because they burn bridges behind them". Since everything we do, we do it for the sake of the people, for the people and with the people, our first task is to help the person who is prepared to make unpopular political moves and to gather us all, to give credit to everyone who deserves it, without a touch of conceit, a credit for even the slightest contribution to the wellbeing of us all and the Serbian people whom we represent, in whatever office we may hold.

I am very honoured to be participating in our work today, now, and at this particular place. Traditionally, these annual gatherings give us an opportunity to analyse what was achieved thus far and to listen to new ideas on how we can attain our common objective, that magic word – sustainable economic growth. This time last year we all hoped that measures which at that moment had been in place for a few months only, would be successful and would trigger an irreversible economic recovery. Today we can say, with great satisfaction, that numerous results have been achieved over the last year, outperforming even the most optimistic expectations in some areas. It is precisely these successes that cause the public to put the manner of policy implementation into the focus of attention and to call for re-examination of solutions and identification of potential weaknesses.

Placing in the foreground the importance of the Kopaonik Business Forum and its mission, as a gathering of all of us who have the leverage and wish to contribute to the adoption of best solutions, I believe this is the right occasion to compare where we were a few years ago to where we stand today.

First, I would like to highlight what is very important for sustainable growth, as also pointed out by Mr Vlahović – the fact that we switched to a different growth model. And maybe I could finish my speech by an illustration of that change. As of 2013 exports have grown much faster than imports, thus driving down the goods and services deficit from 17.4% to 10% of GDP. Not less importantly, the current account deficit is by around 2.5 times lower, i.e. reduced from 11.6% to 4.8% of GDP. In the same period gross FX reserves declined from RSD 10.9 bln at end-2012 to RSD 10.4 bln at end-2015. At the same time, FX reserves – usually referred to as NBS FX reserves, and in fact FX reserves of the Republic of Serbia, increased from EUR 6.6 bln in late 2012 to EUR 8.4 bln in late 2015. And if anyone asks: "What is the price paid for the stability?", I will reply as follows: it was paid by gross FX reserves, reduced by EUR 500 mln only. These were actually the foreign currency reserves

of banks, as well as funds under the unsuccessfully initiated and uncompleted arrangement with the IMF from 2011. So in fact, the stability was achieved through an increase in net FX reserves of the NBS, i.e. of the Republic of Serbia.

When we speak of spending the FX reserves, it often brings to mind the topic which is favourite among many – these being interventions in the FX market. In this regard, allow me to say that the 2010–2012 period was marked by pronounced volatility of the dinar, although the NBS intervened by selling EUR 3.7 bln net cumulatively over three years. Since 2013 to date, EUR 1.4 bln net have been sold in interventions, at significantly weaker daily volatility of the dinar exchange rate against the euro, with special attention paid to movements in the FX market and the spillover of effects from international markets. By responding in a timely fashion, the NBS aims to mitigate short-term and temporary shocks affecting exchange rate volatility, while being mindful of the need to rationally spend FX reserves. I believe this is also underpinned by the data that we put forward – EUR 3.7 bln (for the same period) versus EUR 1.4 bln in interventions, net. It is noteworthy that – unlike in the earlier times, the achieved and maintained relative stability of the exchange rate is an important pillar for the improvement of the business and investment climate. Thus, last year as well, the NBS was carefully monitoring and assessing the magnitude of external shocks, responding when necessary in order to cushion these shocks at home. Depending on the direction and intensity of pressures, we intervened in the FX market on both sides – as both the buyer and the seller of foreign currency. Having bought EUR 970 mln and sold EUR 450 mln in 2015, we ended the year with FX reserves of the NBS and of the Republic of Serbia bolstered by more than half a billion euros.

The stability of the national currency is also conducive to a higher degree of dinarisation of the financial system, which is a common objective of us all. Economic policy makers have long been advocating a greater use of the dinar, but the growth in dinar deposits and dinar lending to households has been particularly noticeable only lately. It may sound little to some, but if we say that dinar savings are 2.6 times higher today compared to end-2012, this result is no longer so negligible. The share of dinar in total savings is still not high, but it climbed from 1.9% to 4.3%. More than two thirds of new household loans (67.5%) in 2015 were extended in dinars. We are happy to see that the achieved price stability and the relative stability of the exchange rate have encouraged dinarisation, but we know it is a long ride yet. We have embarked on it, and that is what counts. The example of the dinarisation makes it clear that models, causality and predictions are not tied up in a methodological knot that cannot be untangled, and that the results are sure to follow from a firm commitment to that objective. The results are guaranteed by committed work in line with that and similar goals, which gradually restores confidence in the system and the domestic currency. That what the language amounts to a nation is what domestic currency amounts to its economy.

Those of you who closely monitor the work and results achieved by the NBS will only be reminded, while for others this will be news – inflation in Serbia has been low and stable at around 2% for three years now. It averaged 1.9% in 2015. This period is sufficiently long to give us grounds to conclude that, in terms of price stability, Serbia has become comparable to other European countries, and that we have at the same time managed to avoid deflation. We expect inflation in the coming period to remain low and stable, which will continue to be the result of a balanced monetary policy and its coordination with fiscal policy measures. And this is why the general public has been so interested in the coordination of the monetary policy with the executive branch of government, with clearly demarcated responsibilities. The professional public also can and must make a contribution by choosing not to identify the superiors and subordinates, the victors and the vanquished, but rather by proposing the best solutions for our coordinated activities. The credibility of our monetary policy is also confirmed by low inflationary expectations, both in the financial sector and the real economy. Such expectations confirm that these sectors, which most reliably identify the outlook for investments in Serbia, are the sectors which contribute the most to the accelerated recovery of economic activity and higher employment.

In addition to contributing to Serbia's recovery based on the achieved and preserved monetary and financial stability, the NBS paved the way for a strong decline in interest rates on dinar loans. Owing to the results in terms of inflation, we began the cycle of policy rate cuts in May 2013. Since then, the key policy rate was reduced 16 times by a total of 7.5 percentage points, to 4.25%, its lowest level in the inflation targeting regime. In 2015, monetary policy was substantially eased, including the cuts in the required reserve ratio, all of which was first and above all permitted by the excellent fiscal policy results.

How did this reflect on dinar interest rates and lending activity? In the period from September 2013 to January 2016, banks cut interest rates on dinar corporate loans by 11.7 percentage points, to 5.9%. Interest rates on dinar household loans were lowered by 7.9 percentage points on average, to 12.1%. Overall, interest rates on dinar loans were more than halved relative to September 2013. You will agree this is neither a small nor a negligible amount. Interest rates on euro loans were also reduced in the same period – by 2.9 percentage points, to 4.2% in January, which is linked in part to the ECB's accommodative monetary policy, but also to the reduction in Serbia's risk premium. This cleared the way for the recovery in lending activity and the expected growth in economic activity.

We are aware that we cannot change external circumstances. Geopolitical tensions, volatile movements in the global commodity and financial markets, unpredictable capital flows, weaker prospects of global recovery illustrate the existence of uncertainties. Our joint strategic response must and can come through our will and determination to steadfastly complete the not so easy reforms that we have undertaken. This will undoubtedly accelerate economic growth and further reduce Serbia's exposure to external challenges.

Serbia's improved growth prospects have been confirmed by world-known rating agencies, international financial institutions, but what is more important, by the behaviour of domestic and foreign investors. In the last year, investments gave a strong positive contribution to the achieved economic recovery. In financial terms, it was the inflow of FDIs that gave an additional contribution, besides higher disposable income made available by lower costs of borrowing and lower price of energy products. What I would like to underscore is the rise in newly approved investment loans. In 2015, net FDI inflow in Serbia rose by 45.6% from 2014 and came at EUR 1.8 bln, their highest level in the last four years. Consequently, in 2015 Serbia managed to use the net FDI inflow to more than fully cover its current account deficit which equalled EUR 1.6 billion. All this speaks of improvement in the quality of sources of funding, of improvement in the manner of final consumption of disposable assets, now used for investment rather than for consumption.

Finally, I believe that the results we have achieved so far allow us to reaffirm yet again the NBS's commitment to actively contributing to economic recovery, higher employment and the standard of living in the period ahead, while at the same time safeguarding price and financial stability. The results speak for themselves. We expect them to be acknowledged, just as we expect that all of you, people of influence, resolve and knowledge will help our nation to overcome that feature of temporariness, of not being persistent in either financial reforms or in its presence on the world political scene.

Thank you.