

НАРОДНА БАНКА

СРБИЈЕ



Crisis Resilience and Access to Finance - the Macro Perspective from Serbia

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Generally, countries like Serbia, do need a stronger buffer for the time of a potential crisis

Why a larger buffer?

1. Long history of macroeconomic instability, such as: a) high inflation, b) fixed exchange rates for a limited time period, c) rigid fiscal policy ...
2. Complete failure of financial system in the 90s including pyramid banks;
3. No EU membership, not even a candidate status;
4. Low level of understanding of why government should help “foreign” banks in Serbia;
5. Flexible exchange rate;
6. Exponential credit growth, especially to private individuals ...

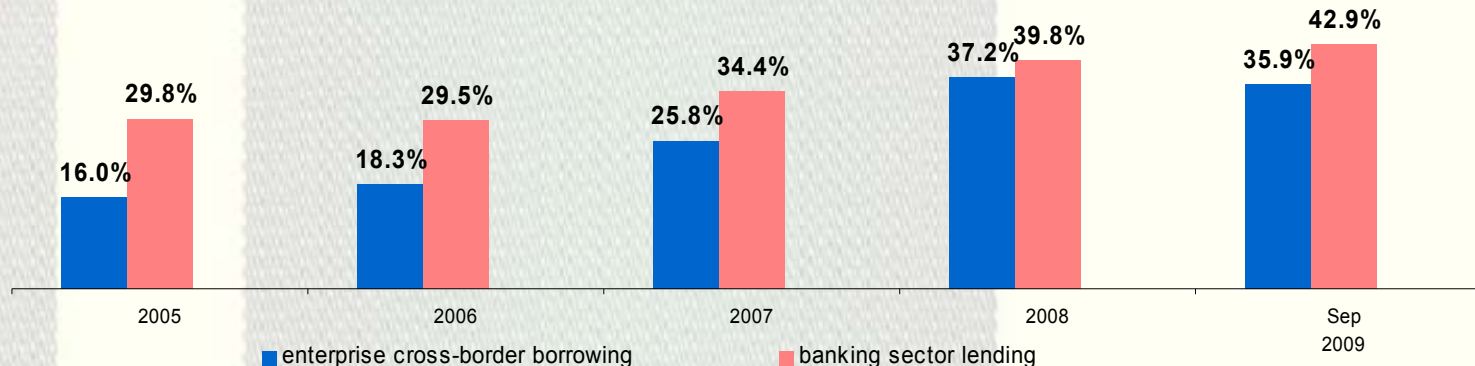
What type of buffer?

1. Higher capital adequacy ratio (23.2% as of 09/2008);
2. Higher reference rate in order to make high level of liquidity more attractive (14% of the balance sheet as of 09/2008 in NBS repo);
3. More restrictive banking supervision - higher provisioning for a) banks that are growing above the average, b) unhedged borrowers, ...
4. Program with the IMF;
5. Improved ownership structure of the banking sector...

Taking away the punch bowl before the party starts was not an easy and popular exercise ...

- Politicians, businesses, population, foreign investors, even some IFIs were all against the restrictive policy of the central bank;
- Usual comments regarding the National Bank of Serbia were: “unnecessarily restrictive”, “hindering free movement of capital”, “makes borrowing overly expensive”, ...;
- High capital adequacy ratio was the result of the way banks acted in Serbia;
- The more restrictive we were, the faster alternative financing vehicles (cross-border financing) got developed, including leasing and factoring activities;

Banking sector lending and enterprise cross-border borrowing (share in GDP)



... but it did pay off!

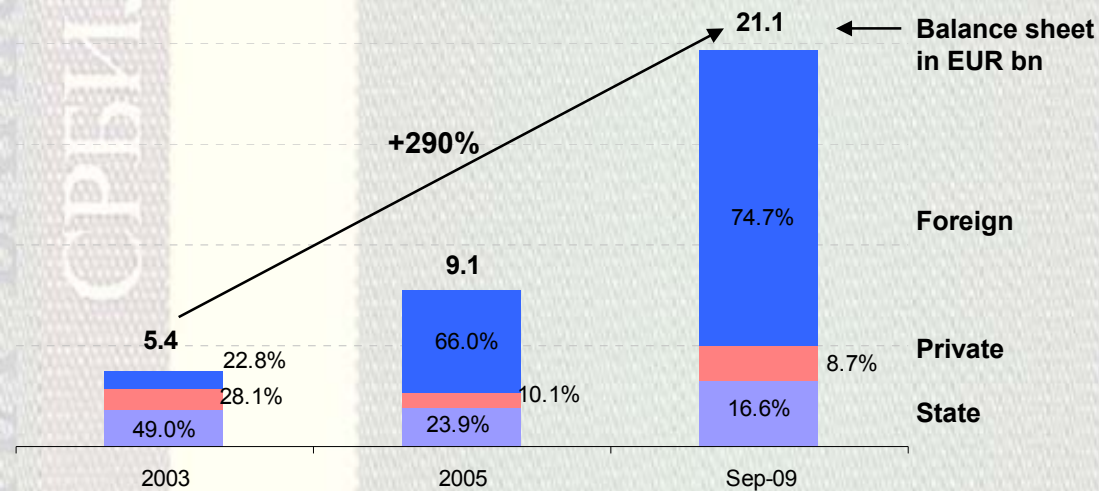
- “You only find out who is swimming naked when the tide goes out” – W. Buffett
- Thanks to restrictive policy during the good times in Serbia
 - a) no money of taxpayers was used to bail out any of the banks,
 - b) banks continued to provide loans despite the withdrawal of some 16% of deposits (~ EUR 1bn) within 6 weeks and
 - c) major provider of FX was NBS based on
 - o high reserve requirement ratio and
 - o high liquidity of the banking sector in RSD thanks to attractive reference rate of the NBS
- Banks were able to meet the cash withdrawal shock – 16% (EUR 1 bn) of all private individual deposits got withdrawn within 6 weeks!

Both stress tests in 2009 proved that the banking sector is stable

- Stress tests carried out as a part of Vienna Initiative proved that banks in Serbia do not need fresh capital !
 - Starting point was 31.3.2009 performed on 2-year horizon;
 - Materialization of a downside scenario would lead to a) a 13.9% increase in NPLs (from 8.1% to 22%), i.e. 175% nominal increase relative to the March 2009 level and b) a drop in capital adequacy from 19.0% to 16.4% at end-2010 (well above the regulatory minimum of 12%);
 - Current economic development is substantially better than downside scenario in all aspects: GDP reduction smaller, reference rate lower, level of depreciation smaller etc...
- FSAP (Financial Sector Assessment Program) carried out by IMF and WB using figures a quarter later (June 2009) confirmed the previous findings.
 - Starting point was 30.06.2009 performed on 1-year horizon and included liquidity stress tests with significant withdrawals;
 - Stress test used even harsher macroeconomic assumptions.

Majority strategic foreign ownership from the EU paid off in the case of the banking sector

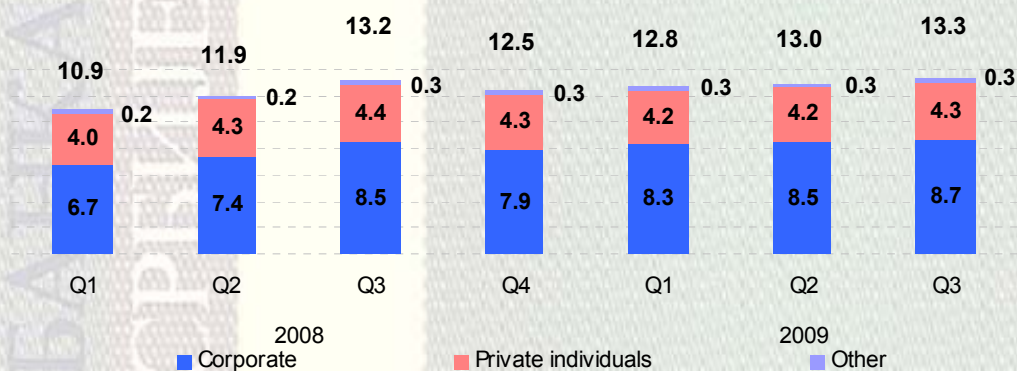
Ownership structure of the Serbian banking sector



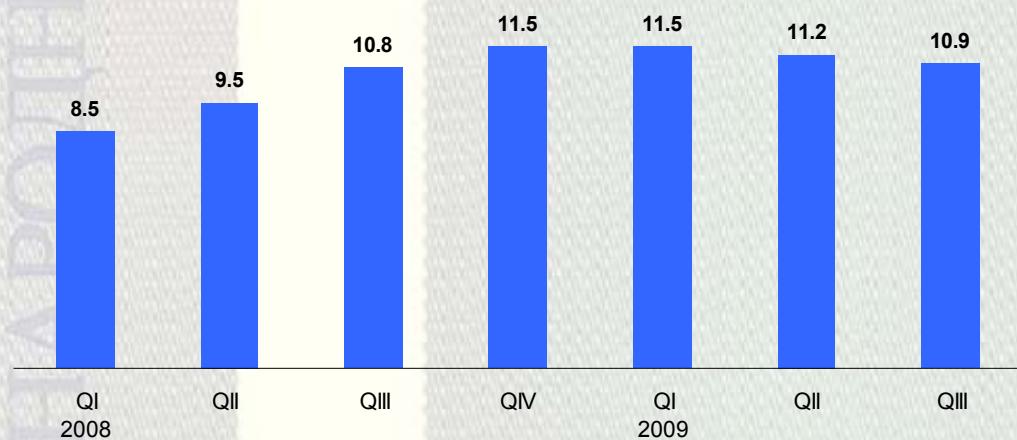
- 99.6% of foreign ownership in the banking sector comes from the EU;
- Almost all the profits in the second half of 2008 were retained and used to strengthen capital;
- In the case of cash withdrawal, banks were standing fully behind their subsidiaries providing funding and even capital if needed;
- Problematic were only banks with local ownership without strategic owners where shareholders did not understand that ownership does not mean only a right to dividend and higher share price, but also an obligation to provide more capital in the case banks need additional capital!

Banks saved themselves but what about their debtors?

Local loans of banks (in EUR bn)



Outstanding cross-border loans (in EUR bn)

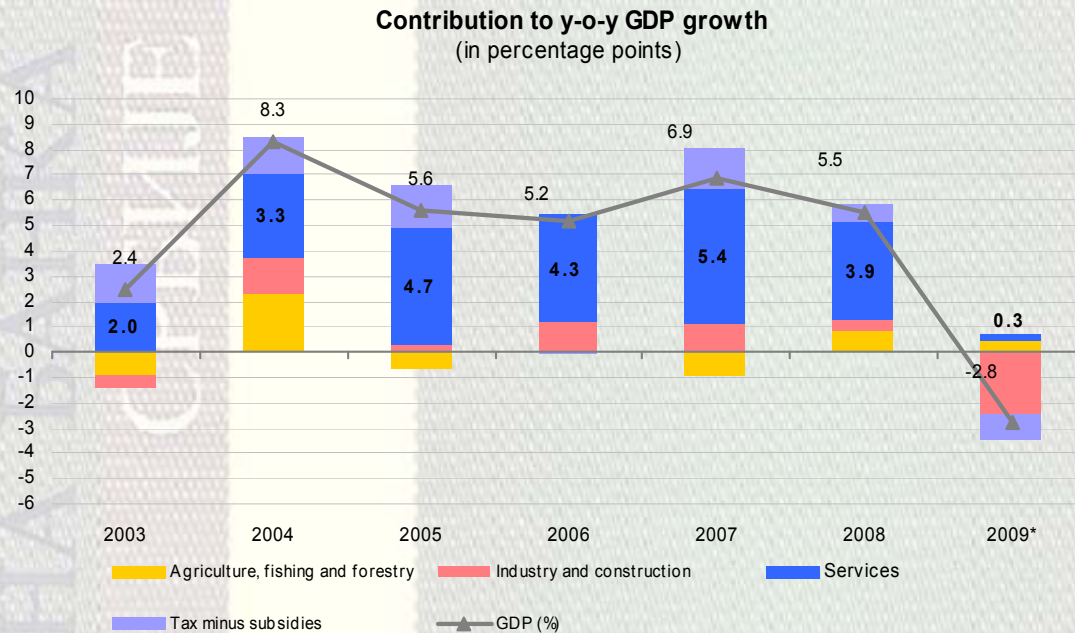


- Loan portfolio of the banking sector is back to where it was before the beginning of the crisis;
- Loans to companies dropped substantially in Q4 2008 but recuperated relatively fast;
- Loans to private individuals are even decreasing as citizens are getting more cautious regarding borrowing and are prepaying part of their debt;
- Cross border loans got reduced substantially despite the “Vienna agreement”.

In crisis times things that can be done in London, Berlin or Vienna cannot be done in Belgrade, Sarajevo or Skopje

- Developed countries are hardly, if at all, adjusting to the new macroeconomic reality - pumping in public money is not adjustment, it is simply financing!
- Developed countries are not only squeezing out emerging economies in competing for limited financing, but are also setting a bad precedent regarding policies that should be implemented;
- Majority of additional borrowing went to finance public consumption while the investments from the budget are at a historical low level in Serbia;
- High GDP growth based on sizeable increase of non-tradables driven by domestic demand (high wages, credit boom and foreign borrowing) is no longer viable as a) salaries and wages are frozen till the end of 2010, b) credit growth will be modest and c) FDIs and foreign borrowing will be at a substantially lower level than before the crisis. The only way out is more investments + export-driven economic growth that cannot be achieved over-night!
- Even among the countries of the Western Balkans there is a substantial difference as countries such as Bosnia and Herzegovina, Romania and Serbia decided to have a program with the IMF while the others decided to go alone, e.g. Albania, Croatia and Macedonia. By the time one can say who was right, it is going to be too late!

Main driver of the economic growth in the transition period were services, i.e. none-tradables



- Key contribution to economic growth came from the sector of services, mainly from communications, trade, financial services and real estate, mainly due to a very low starting base;
- Traditionally significant industry (from the aspect of GDP formation) recorded low growth rates due to the urgent need of restructuring that was taking place rather slowly;
- Effects of the crisis hit us fast and deep, as we were rather vulnerable even without the international crisis!

* NBS estimate

Will after the crisis be as before the crisis?

- Definitely not, and countries must prepare for the new reality fast.
- One thing is certain: CEE will enjoy the positive impact of reemerging growth with a substantial delay, economically weakest countries of CEE could face substantial social challenges as well;
- We must revisit every single category of social policy related expenditures in the budget – a “premature welfare state” is not financeable anymore, particularly the pension scheme as well as the healthcare and education systems;
- Competitiveness must be urgently and substantially improved as there is major fixing needed regarding the level of a) wages and/or b) public expenditure and/or c) exchange rate regimes;
- Markets will continuously watch all the participants and punish them instantaneously. Since maturity and price of loans seen in the first half of 2008 will not be back for a longer time period, central banks should not worry about exponential credit growth;
- **The sooner we understand the lessons the easier the adjustment will be !**