

НАРОДНА БАНКА
СРБИЈЕ



Financial sector of Serbia in the light of global financial market developments

Radovan Jelašić – Governor of the National Bank of Serbia

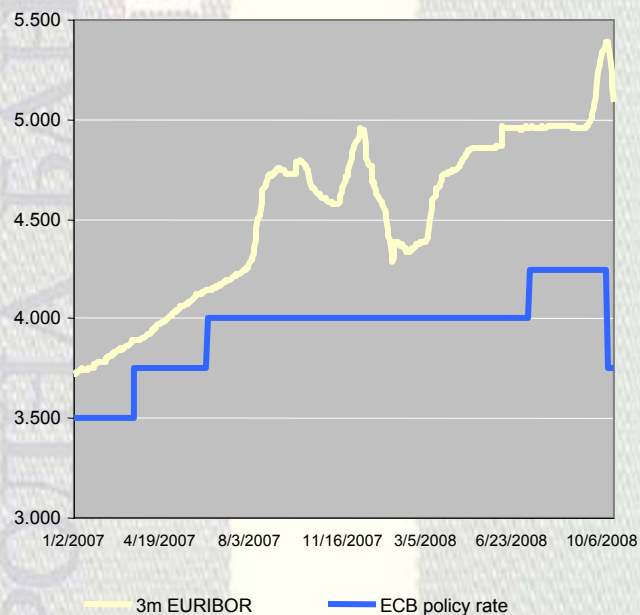
Belgrade, 17 October 2008

And while governments and central banks across the world are competing who will now promise and later do more...

- Refinancing of almost all banks' receivables by central banks;
- Acquisition of equity stakes in banks;
- Raising the level of explicitly insured deposits (EUR 50,000 – 100,000) and promising complete safety of unlimited deposits (Ireland, Germany, Austria, Hungary, etc.);
- Assuming guarantees for interbank credit lines in order to resuscitate the money market;
- Coordinated policy rate cuts;
- Promises to provide ~USD 700 billion in the USA, ~EUR 1,700 billion in the EU...

... these measures have so far produced no significant effects

Interest rates in the three-month money market in Europe
(in %)

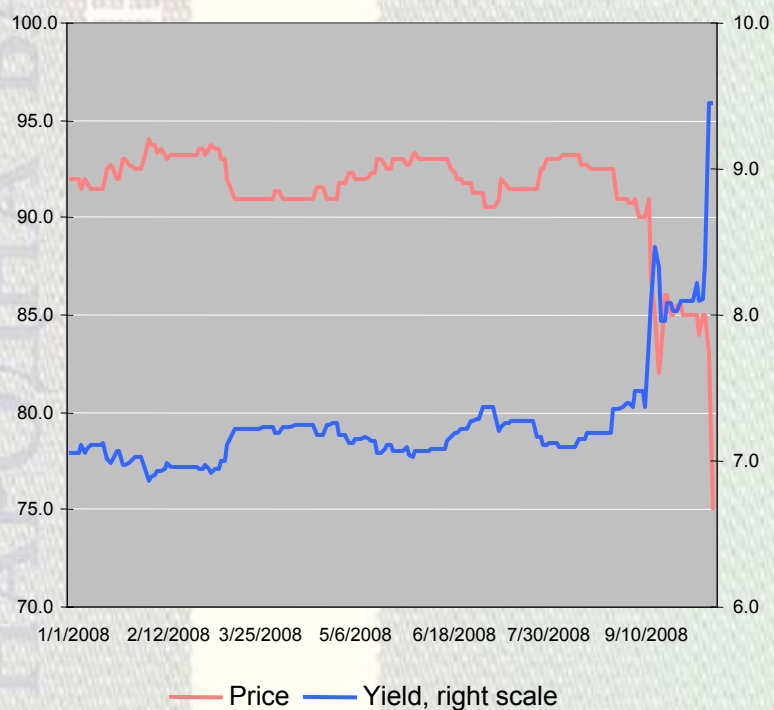


- The chart illustrates periods of turbulence in the European three-month money markets;
- Despite policy rate cuts (by 0.5%) by 6 central banks on 9 October, the cost of money remains high, reflecting a lack of trust among banks;
- Increase in the EURIBOR reference rate has been felt by our citizens, too;
- As in a chain reaction, a large number of measures spread across Europe;
- Given the ownership structure of our financial sector, measures taken by EU governments automatically reflect on Serbia.

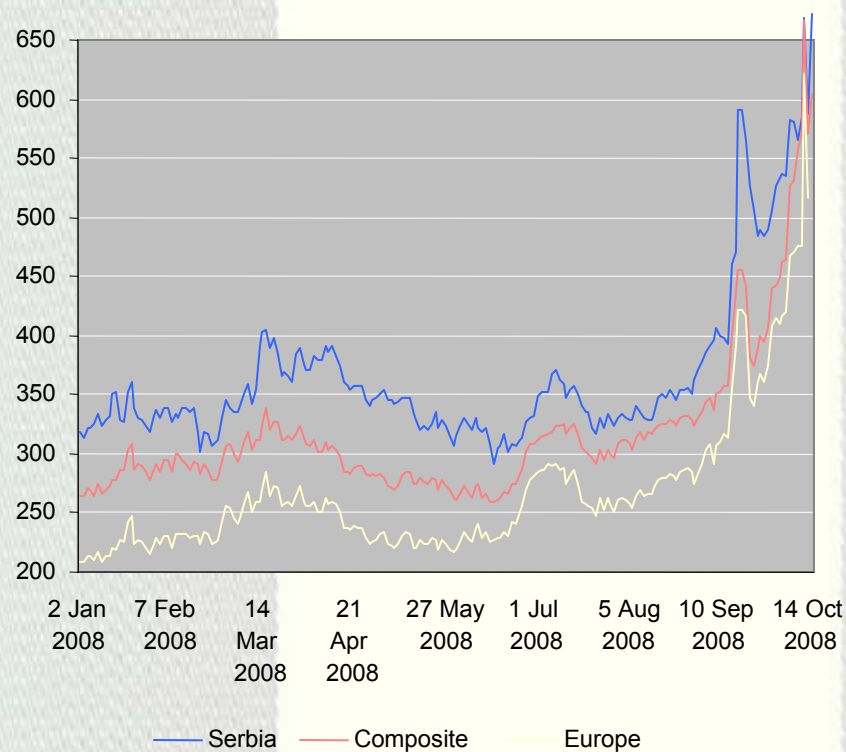
Emerging markets have been under particular pressure over the past several days!

- Risk premium rose notably for all countries in this category:

Movements in dollar prices of RS bond in the Luxembourg Stock Exchange
(in %, 1 Jan 2008 – 13 Oct 2008)



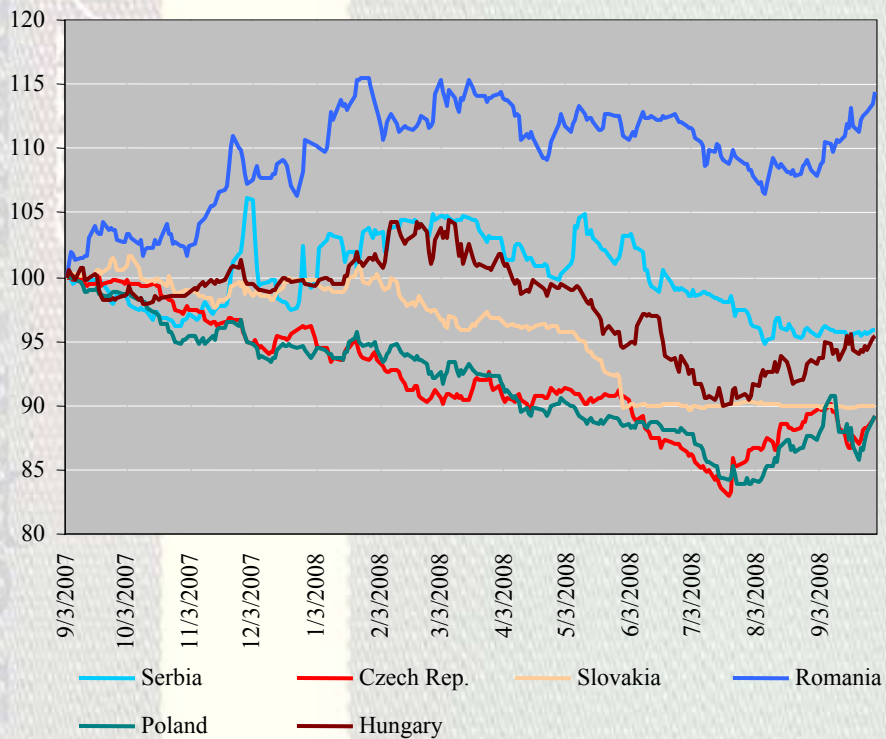
EMBI Global
(in bp)



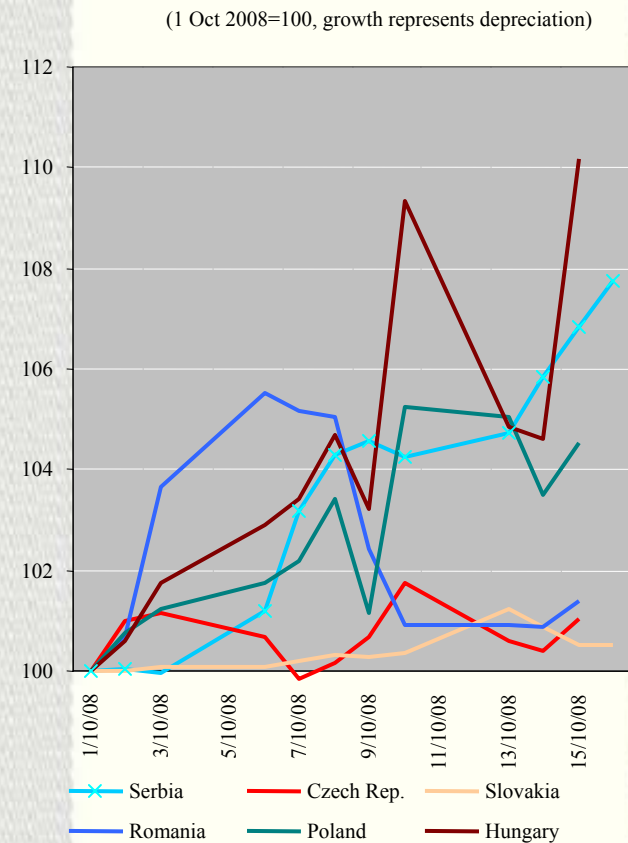
Source: JP Morgan

Movements in selected national exchange rates

Movements in exchange rates of national currencies against the euro in selected transition economies until September 2008
(3 Sep 2007=100, growth represents depreciation)

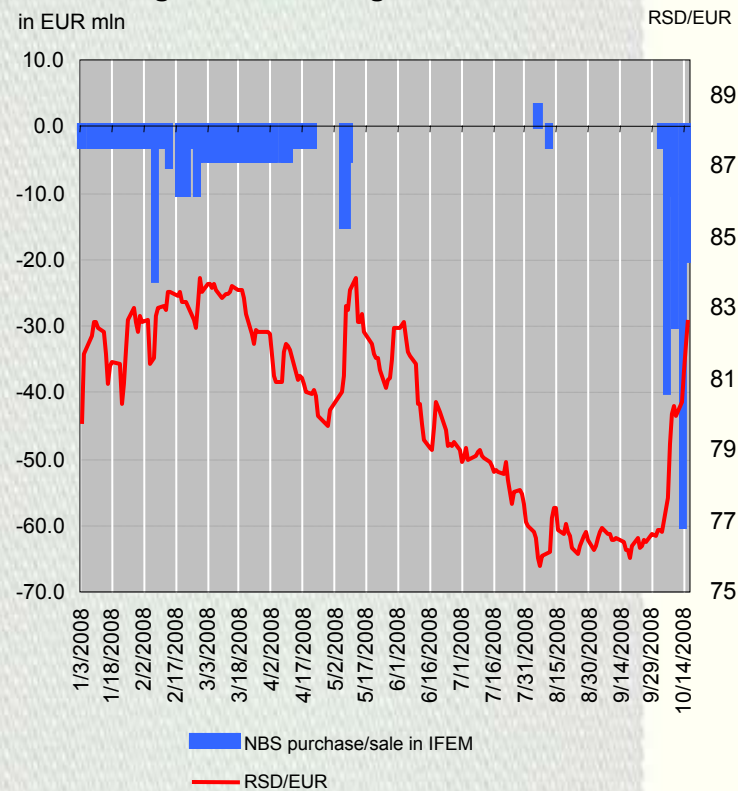


Movements in exchange rates of national currencies against the euro in selected transition economies in October 2008
(1 Oct 2008=100, growth represents depreciation)



The dinar will continue floating – but in rougher seas

**NBS participation in the foreign exchange market
and average euro exchange rate¹⁾**



¹⁾ Positive values indicate purchase and negative values sale of foreign exchange.

- Fluctuations of the dinar against the euro are smaller than those of some other foreign currencies (e.g. USD).

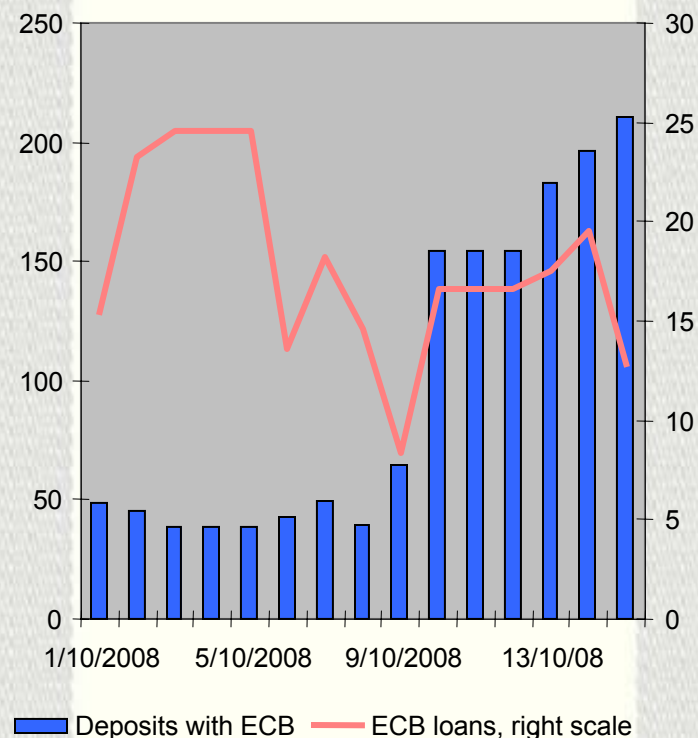
... and the NBS is already used to navigating in such circumstances!

- The exchange rate will continue to be formed according to the following principles:
 - No significant daily fluctuations that could disrupt the functioning of the foreign exchange market;
 - No opposition to the trend;
 - Taking into account the impact of the exchange rate on achieving the targeted inflation range and on the adequacy of foreign exchange reserves.

By contrast to banks in Europe and the USA...

- Capital adequacy of just over 8%;
- High exposure to mortgage loans;
- Level of liquid assets much lower than in Serbian banks → governments and central banks purchase banks' receivables to boost their liquidity;
- Greater exposure to the international capital market;
- High illiquidity and maturity mismatch of deposits and lending, governments are notably raising deposit insurance levels – some to EUR 50,000, and some even insure all deposits to prevent their withdrawal.


Bank deposits with ECB in October 2008
(in EUR bln)



...Serbia's banking sector is well prepared for any external challenges!

Nowhere in the region, and even wider, are deposits safer than in Serbia!

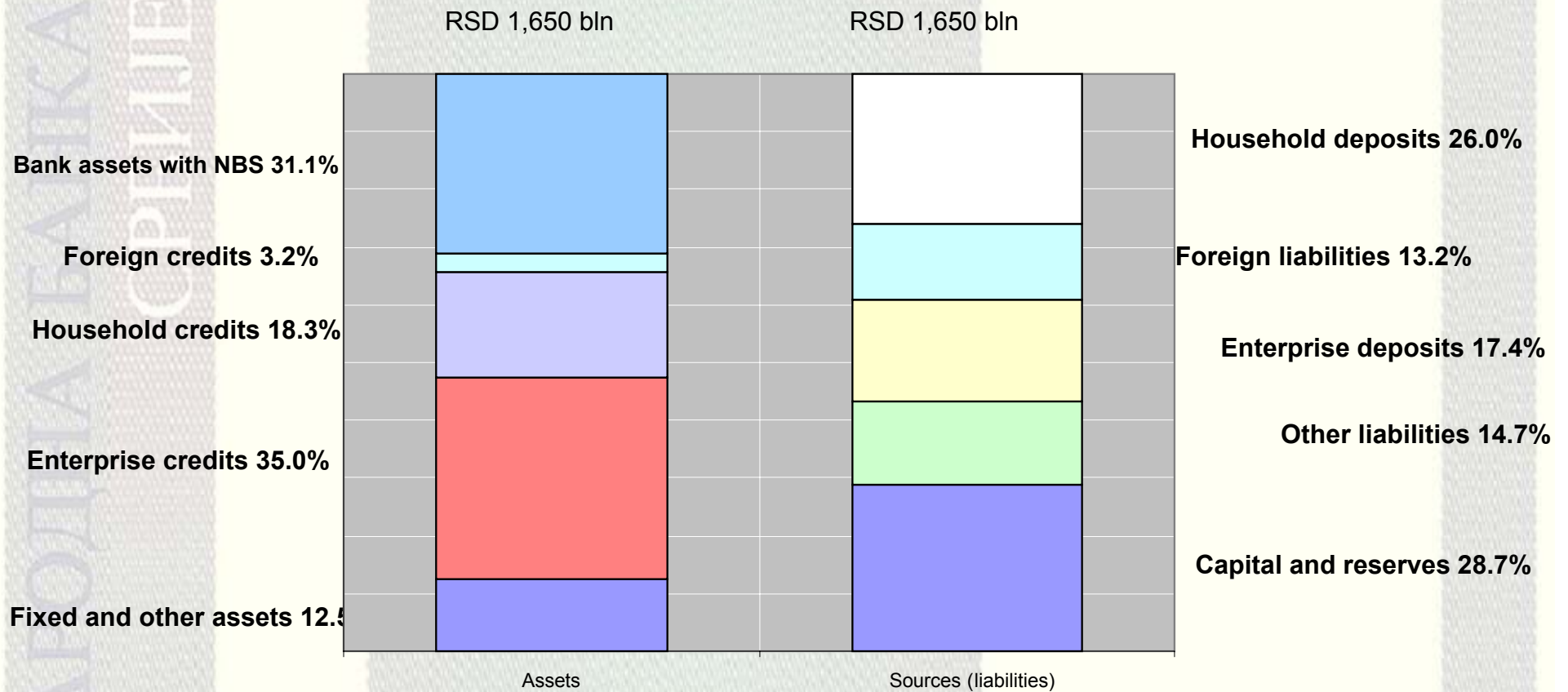
- Reserve requirement on new fcy savings deposits of 40% +
- Reserve requirement on fcy deposits of 45% +
- Reserve requirement on dinar deposits of 5% and 10%;
- Capital adequacy of 28.1%*;
- Cash, deposits with NBS and NBS securities make up a third of total balance sheet assets.
- Deposit insurance in the dinar equivalent of EUR 3,000 per depositor per bank – 80% of Serbia's depositors are insured!



**Deposited
with the
National
Bank of
Serbia**

* As at 30 June 2008.

Structure of the Serbian banking sector balance sheet*



*As at 30 June 2008.

Serbia should stop trying to bring troubles upon itself!

- Inaccurate and incomplete reporting on global financial market developments;
- Denial and belittling of facts on the Serbian banking sector (capital adequacy, liquidity, NBS foreign reserves)

Creation of unfounded and artificial tensions!

Lower volume of deposits = costlier loans

Euro zone inflation of 3.6% p.a.!

EUR 100 mln decline in household savings

= RSD 2,000,000 (EUR 25,000) per day; RSD 60,000,000 (EUR 750,000) household income less per month

= EUR 100 mln loans to enterprises and households less

In compliance with its legally defined obligation, the NBS keeps a close eye on all movements in the financial sector!

Article 3, paragraph 2 of the Law on the National Bank of Serbia

“In addition to its primary objective, the NBS shall also strive **to preserve financial stability.**”

- The principal objective of the NBS is to:
 - maintain stability of the Serbian financial sector in the face of global financial market developments;
 - ensure unimpeded lending to enterprises and households – a costlier loan is better than no loan at all;
 - minimize the losses of voluntary pension funds and insurance companies!

New NBS measures are not designed to affect the stability of the banking sector, but to provide instant relief to banks (1/2)

- No required reserves are to be calculated against foreign assets (retroactive application from 1 October) including
 - foreign borrowing by banks (45% so far)
 - subordinated foreign capital (20% so far);
 - borrowing by financial leasing providers (20% so far).

Targeted effect: significantly lower costs of foreign re-financing, giving the current owners a chance to buttress the stability of their institutions with credits and capital and to ensure the same volume of loans!
- Currency structure of required reserves allocation is to be changed - instead of 90% in foreign currency and 10% in dinars so far, required reserves are now to be allocated in the following way: 80% in foreign currency and 20% in dinars.

Targeted effect: release of foreign currency liquidity of around EUR 350 million to the benefit of banks, higher demand for dinars and more dinar-denominated loans!

New NBS measures are not designed to affect stability of the banking sector, but to provide instant relief to banks (2/2)



- Reduction of the default interest rate charged on the amount of difference between the calculated and actual average daily balance of allocated dinar/foreign currency required reserves in the maintenance period
 - from 31.75% to 23.63% for dinar required reserves
 - from 31.75% to 3M EURIBOR + 10% for foreign currency required reserves

Targeted effect: reducing the financial penalty charged in the event of non-compliance with reserve requirements.
- The volume of required reserves to be allocated for the period 18 October-17 November will not be based on the average daily balance of deposits in September as it should, but on the balance of deposits as at 15 October due to extraordinary circumstances.

Targeted effect: taking into account the early October decline in foreign currency savings deposits one maintenance period in advance!

The 40% reserve requirement ratio on household foreign currency deposits is to remain unchanged!

Although new measures will help banks, it will be difficult to ensure the same volume of lending as so far

- EURIBOR remains high, margins for countries in the region (most notably those with lower rating) have seen a dramatic increase
- Even for parent companies, access to the world financial market has been significantly limited
- Although EU governments have provided significant support, it will take a long time before the capital market is alive and well again.
- **The volume of new lending will depend primarily on:**
 - availability/price of foreign sources  half of the sources of funds so far
 - domestic savings  most important source of funds in the near future!

And what has the future in store for us?

- The times of cheap loans and aggressive promotional campaigns for various types of financing are gone not to return for quite some time;
- Dinar loans will become more popular as they have escaped the direct effects of global financial crisis and their price depends solely on us
 - Lower inflation → lower key policy rate → cheaper loans with no foreign currency clause!
- Interest in loans of the European Bank for Reconstruction and Development, European Investment Bank, Government of the Republic of Italy and European Agency for Reconstruction will significantly increase as their prices are expected to decline on account of exemption from reserve requirements.
- The economy will need additional support!
- Much more attractive interest rates on invested funds.