

НАРОДНА БАНКА

СРБИЈЕ



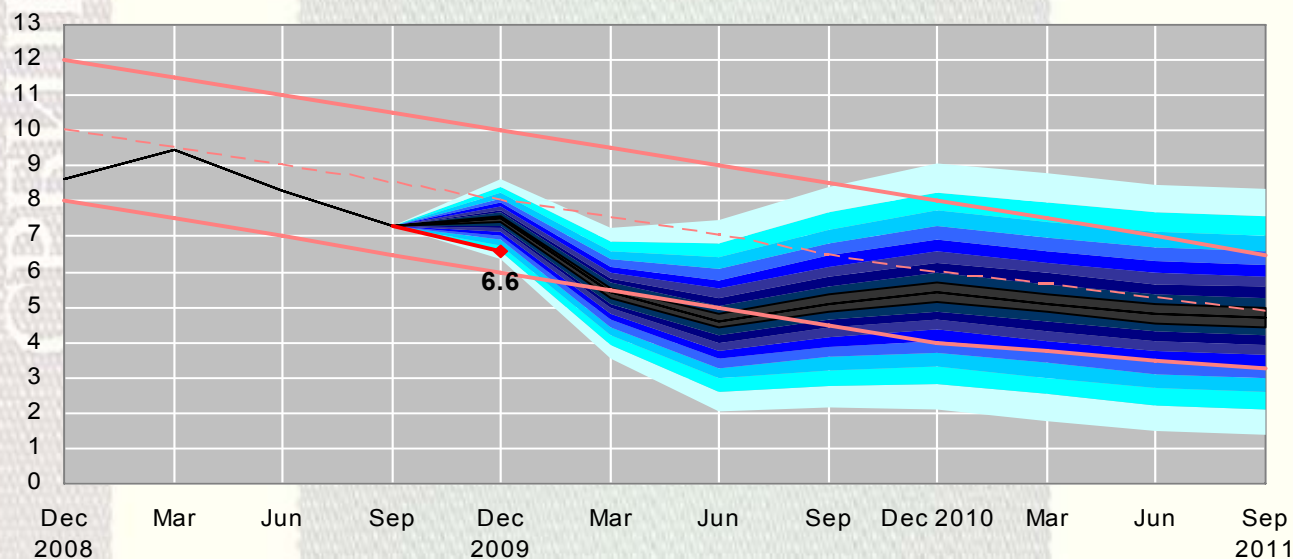
Current macroeconomic challenges

Radovan Jelašić – Governor of the National Bank of Serbia

Novi Sad, 27 January 2010

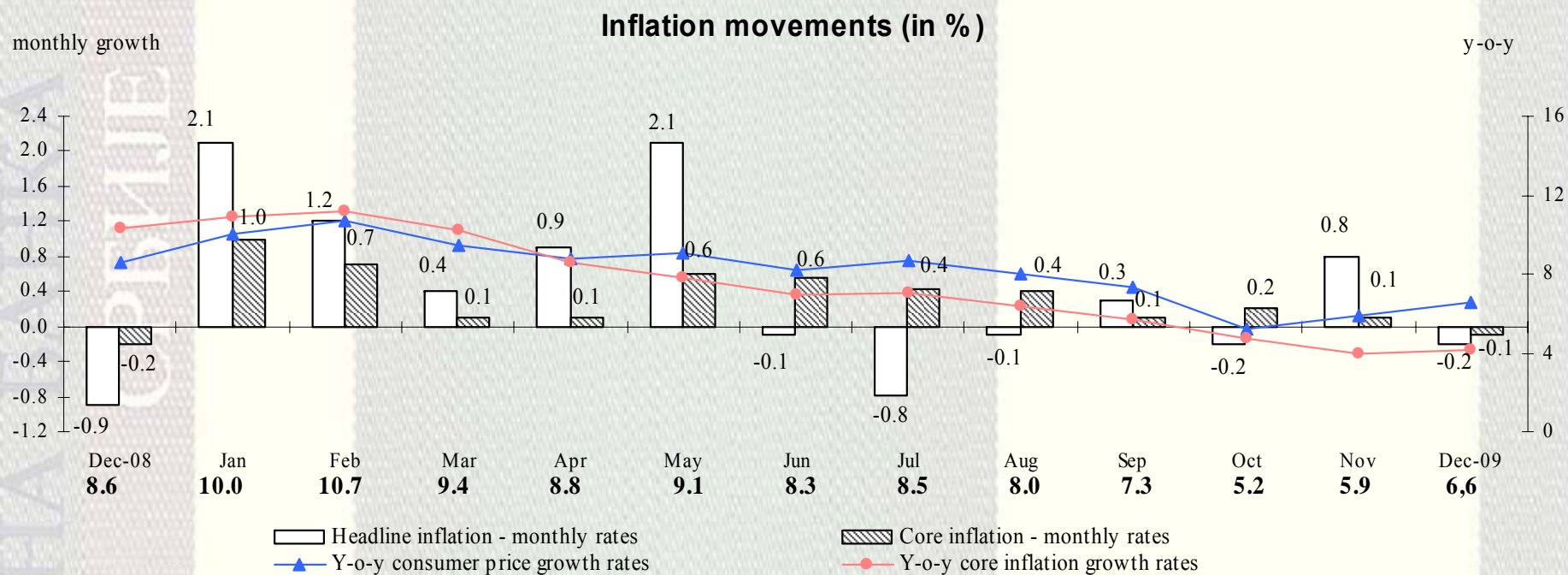
NBS is successful in the pursuit of its primary objective: inflation is moving within the projected band

Inflation projection - November Inflation Report
(y-o-y rate, in %)



- In December 2009, headline inflation measured 6.6% y-o-y.
- Headline inflation moved within the target band throughout the year save in October and November when it fell slightly below the target band amid falling food prices.
- In the first half of the year, inflation is expected to revolve around the lower bound of the target range, trending closer to its mid-point later on.

There was no inflation in the last seven months of 2009

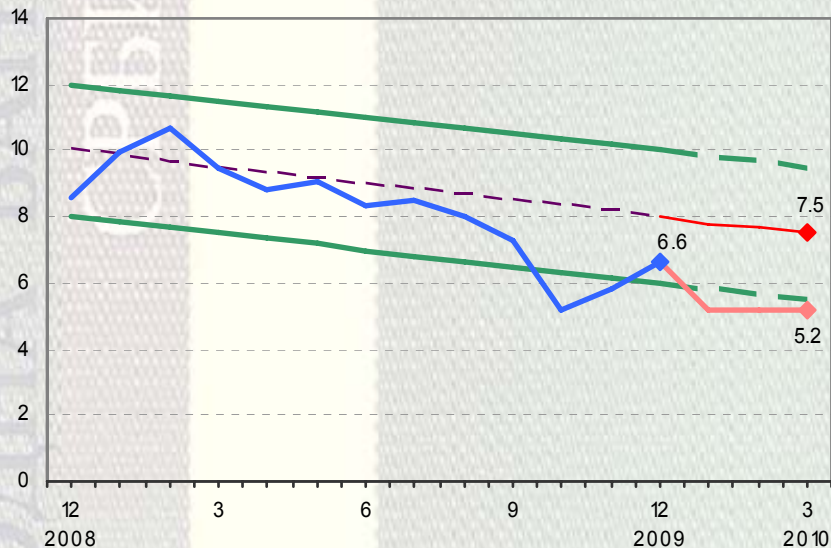


- From end-May to December, headline inflation measured -0.3%;
- Regulated prices rose 15.5% in 2009 (the strongest growth was recorded for petroleum products – around 46%, which contributed 6.2 percentage points to the overall growth in regulated prices);
- The achieved price stability is primarily a result of dampened aggregate demand and declining food prices, but also of restrictive monetary policy implemented in H2 2009.

Annual inflation rates are expected to continue declining in 2010

Short-term inflation projection

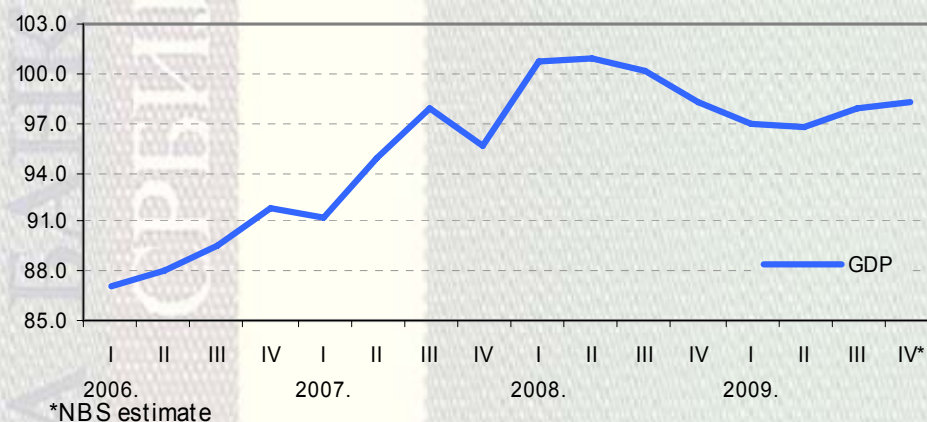
(y-o-y growth, in %)



- Consumer prices will go up by around 2.4% in Q1 2010 mainly as a result of growth in regulated prices (electricity, cigarettes and petroleum products);
- According to our estimates, Q1 inflation will revolve around the lower bound of the target range, reaching at end-March around 5.2% (March target – 7.5%±2 p.p.);
- Following through on the agreed regulated price growth (9%±2 p.p.) will contribute to the achievement of inflation projected for end-2010 (6%±2 p.p.)

The year 2010 brings economic recovery...

GDP movements
(seasonally-adjusted data, 2008=100)



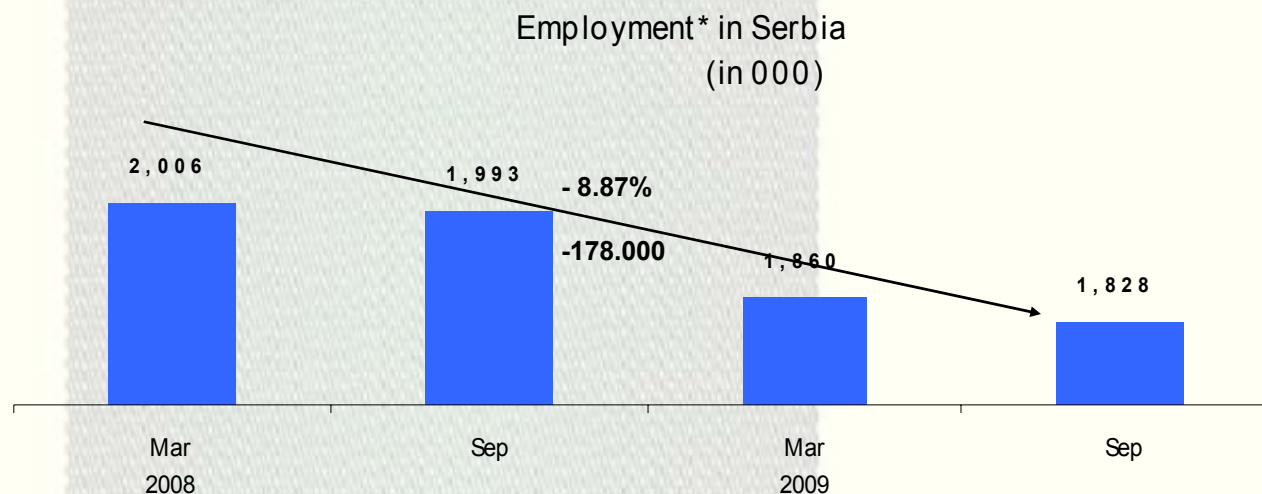
Contribution to y-o-y GDP growth

	2007	2008	2009*	2010**
GDP	6.9	5.5	-2.8	1.5
Domestic demand	18.5	6.3	-12.1	1.8
Total final consumption	9.9	5.8	-5.4	-1.4
Investment consumption	8.6	0.4	-6.8	3.2
Net export (export - import)	-11.6	-0.8	9.3	-0.3

* NBS estimate
** NBS estimate

- In 2009, economic activity declined by 2.8% due to a decrease in foreign and domestic (investment) demand. Set against the background of the global economic crisis, such a result is relatively favourable;
- The year 2010 is expected to see economic recovery and a 1.5% GDP growth driven by investment consumption and growing export demand;
- Negative contribution of net export in 2010 points to a slight increase in foreign trade deficit, which is in line with the expected economic recovery.

...but not a better standard of living



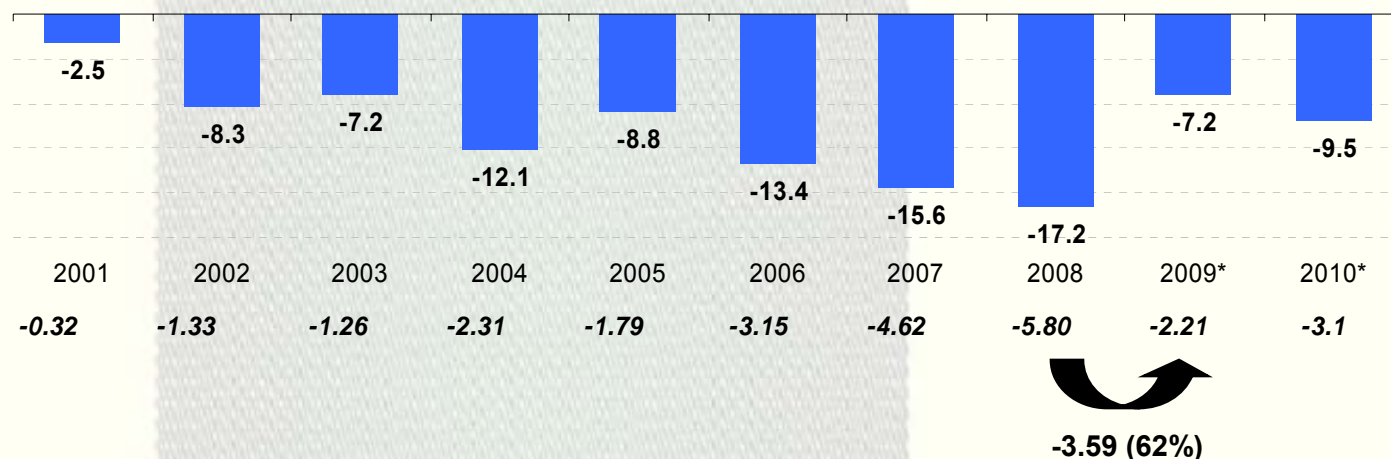
Source: Statistical Office

*Number of employees in enterprises, institutions and organisations, as well as the number of entrepreneurs, excluding farmers.

- In an economic downturn there is less need for new employment. Although economic activity is showing signs of recovery, it would be unreasonable to expect a rise in employment for quite some time yet. The announced downsizing of public administration will also play a role;
- The government has decided to keep the freeze on public sector wages and pensions throughout 2010.
- Bank lending is unlikely to reach its level of two years ago for some time yet...

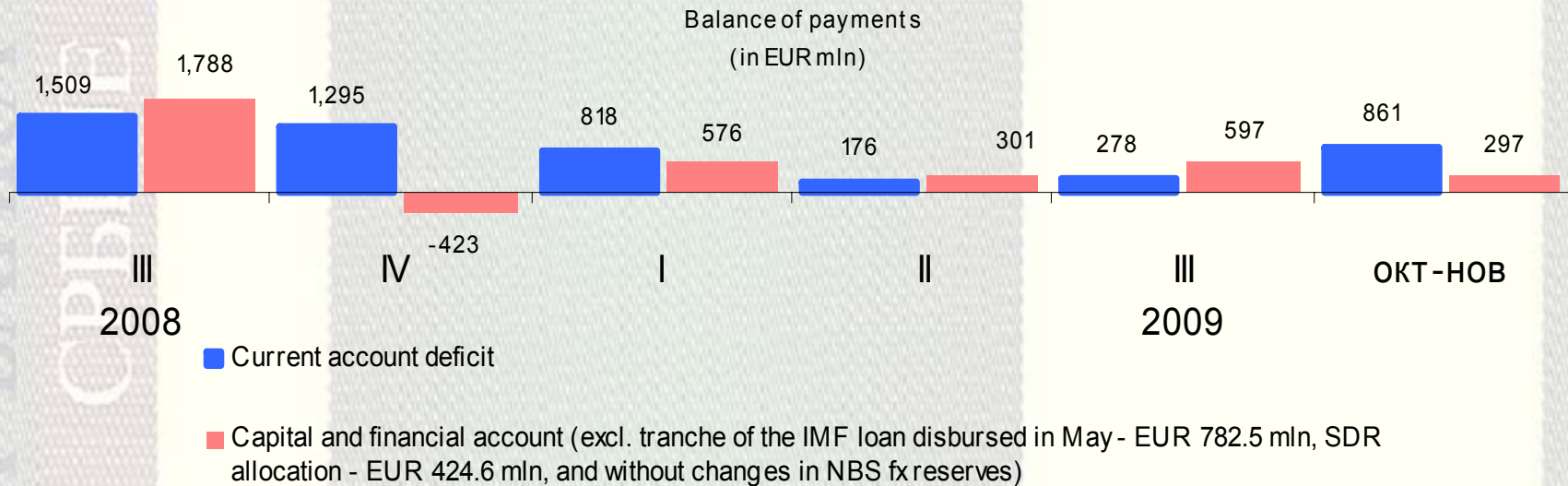
The decline in economic activity and foreign trade reflected on the narrowing of the current account deficit

Current account deficit
(as % of GDP)



- The current account deficit narrowed down to 7.2% of GDP amid declining foreign trade deficit and higher inflow from remittances.
- The economic recovery in 2010 (1.5% GDP growth) is expected to push the current account deficit to 9.5% of GDP .

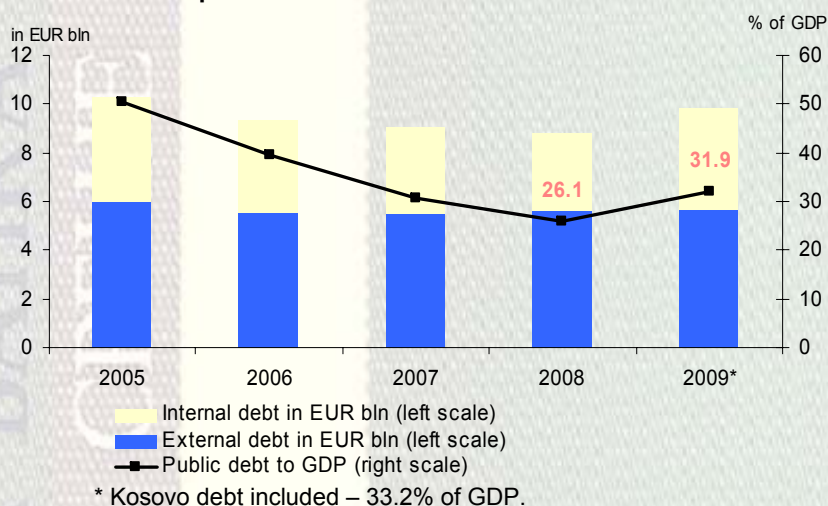
Though small, net capital inflow in 2009 was sufficient to cover the reduced current account deficit



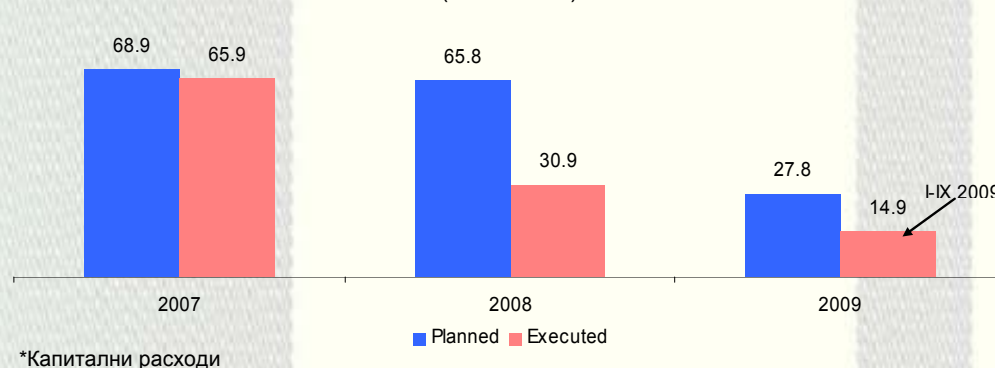
- FDI reached around EUR 1.1 bln, net, in the period January-November 2009.
- In the same period, the banking sector borrowed around EUR 650 mln, net (of which EUR 281.9 mln in short-term loans);
- Enterprises reduced their foreign debt by around EUR 710 mln;
- In 2010, FDI is expected to reach around EUR 1.3 bln which will, together with EUR 1.9 bln long-term borrowing by all sectors, result in a EUR 3.3 bln surplus on the financial account.

Sustainable economic growth requires fiscal stimulus, but a fiscal stimulus that will not threaten public debt sustainability

Serbia's public debt

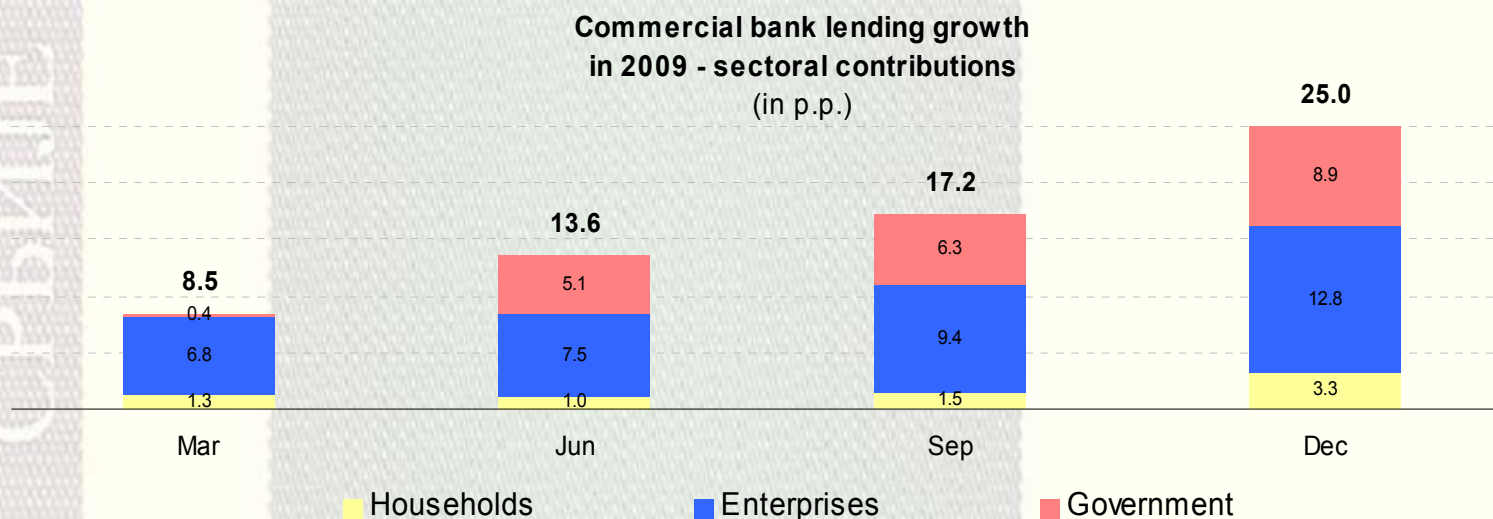


Budget investment expenditure*
(in RSD bln)



- In 2009 public debt increased by EUR 1.4 bln (excl. the write-off of EUR 381.3 mln of Kosovo's debt) primarily as a result of government borrowing in the domestic money market. Currency composition of public debt remains unfavourable – mere 12% of debt is denominated in dinars.
- Public debt sustainability is not an issue for the time being – what raises concern is not the level of public debt, but its pace of growth, purpose and unfavourable currency composition.
- As government borrowing is expected to continue in the coming period, it is critical that these funds be invested, and not used to finance current consumption. This would ensure sustainable economic growth and provide conditions for regular debt servicing.

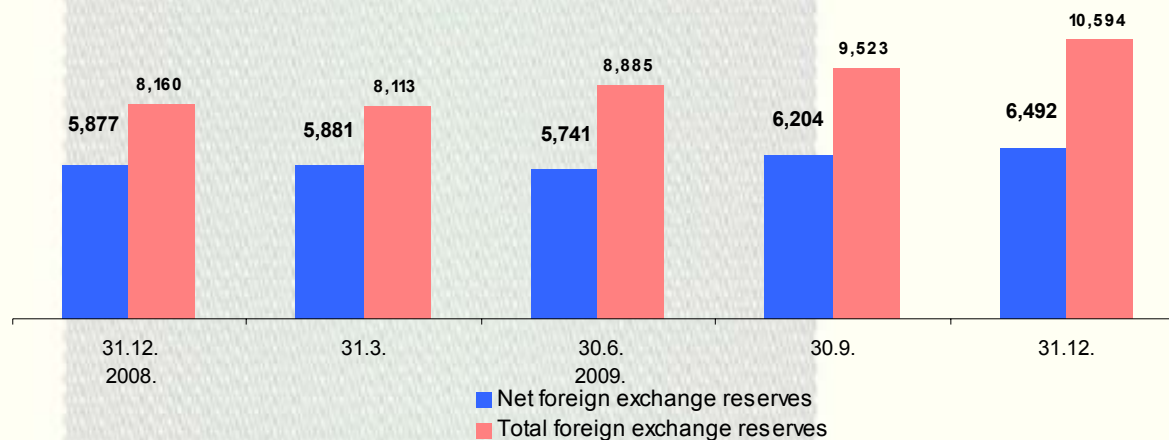
Recovery of lending activity begun in 2009 will continue in 2010



- After stagnating in H1 2009, lending has started to improve.
- The 2009 growth in lending to government was driven primarily by the government's decision to finance the budget deficit by issuing treasury bills.
- Last year, enterprises repaid around EUR 775 mln of their foreign debt.
- A decrease in credit exposures of banks-signatories to the Vienna Initiative towards Serbia will not affect their lending activity.
- Dinar loans are expected to get cheaper in the coming period.

The level of foreign exchange reserves is comfortable

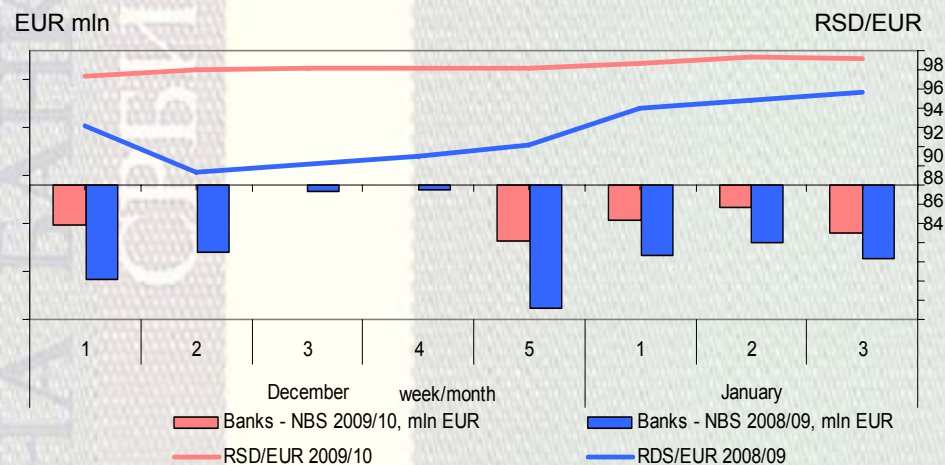
NBS foreign exchange reserves in 2009 (in EUR bln)



- In 2009, NBS foreign exchange reserves rose by EUR 2.4 billion, reaching EUR 10.6 bln by end-December;
- In 2009, under a Stand-By Arrangement with the IMF (worth EUR 2.87 bln), Serbia drew two loan tranches (in the amount of EUR 1.13 bln) in support of its FX reserves;
- Serbia's SDR allocation (EUR 424.6 mln), intended for fiscal deficit coverage, was converted by the government into dinars by end-2009;
- At end-2009, of the total NBS foreign exchange reserves, EUR 6.5 bln were not collected in respect of required reserves or foreign borrowing.

Over the last two months, the dinar was more stable than in the same period a year earlier!

December-January	2009/10	2008/9
Depreciation	2.0%	3.8%
Interventions, mln EUR	210.5	527.0



- Owing to the IMF Agreement and the Vienna Initiative, and not least to the lower deficit, the dinar gained 1.9% against the euro in the March-October 2009 period.
- The depreciation of 2.6% in November and December was due to:
 - Seasonally-induced higher foreign trade deficit by year-end;
 - Lower net capital inflow, most notably from remittances;
 - More expansive fiscal policy over the last few days of December.
- In January to date, the NBS has sold EUR 110 million to banks, whereas the dinar has lost 1.5% of its value. The volume of intervention and depreciation is much lower than in January 2009 (EUR 383.3 million and 7.3% respectively).

The NBS can not, should not and will not set the level of the exchange rate, but it can, should and must:

- Ensure smooth functioning of the foreign exchange market – exchange offices and banks freely engage in exchange transactions, while operations in the interbank foreign exchange market are smooth and unimpeded;
- Provide for the satisfactory level of foreign exchange reserves – foreign currency supply suffices to cover both the dinar money supply (2.5 times) and imports (9 months);

The current exchange rate for the dinar reflects the overall macroeconomic situation in Serbia today, which implies, inter alia: foreign currency inflows/outflows, level of current consumption, degree of monetary policy restrictiveness, etc.

The financial sector has withstood the negative impact of the global crisis

- The negative effects of the global financial crisis on the domestic financial sector have been mitigated owing to:
 - Several years of restrictive prudential supervision and monetary policy measures;
 - NBS measures aimed at boosting bank liquidity and lending activity;
 - Government measures aimed to encourage savings, lending activity and economic revival;
 - The IMF Arrangement and the Vienna Initiative (maintenance of the same level of exposure to Serbia by foreign banks signatories to the FSSP);
- The bailout of Serbian banks was not necessary.

What are the macroeconomic lessons important for the economy? (1/2)

1) Domestic demand will continue to constrain investment options, i.e. economic growth will be driven by the increase in a) exports (substitution of imports) and/or b) investment consumption. To be more specific, this means that:

- a) the citizens will have less money for current consumption this year (lower wages in real terms), b) expenditures will be lower (psychological effect of the crisis: expenditure goes down and saving go up) and c) there will hardly be any major borrowing;
- Luxury goods, which are not part of the current consumption, as well as durables, will be purchased less, and the price pressure on the consumer basket goods will build up;
- Attractiveness of exports will increase both on account of attractive prices and the security and volume of investments;
- Trade will come under additional pressure because of smaller turnover and high fixed costs (large retail chains will weather it more easily) – a part of the pressure will be transferred to suppliers;
- The correlation between “I bought this for 2 euros” and “I need to sell it for 200 dinars” will weaken – prices will be market-determined;

What are the macroeconomic lessons important for the economy?(2/2)

- 2) Loans will get cheaper, but still more expensive than two years ago;
 - Banks will insist on a higher share of own capital in any future lending;
 - Rescheduling of existing loans will not be automatic;
 - A decrease in margins will have no major bearing on the loan price as the reference rate is most likely to increase (EURIBOR);
 - Dinar loans will become cheaper, but their nominal interest rate will continue to be higher than the rate charged on euro loans;
 - Loans from international financial institutions (EIB, KfW, EBRD, loans extended by the Italian government, etc.) will be offered at more attractive terms than before...

- 3) All branches of industry related to the construction of Corridor 10 should capitalize on that project this year. It's not about the money, but about the efficiency in spending it!