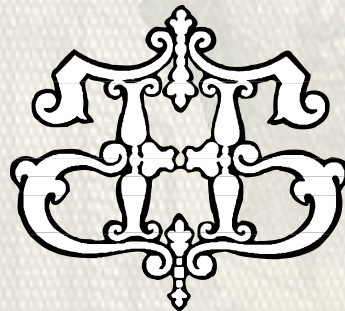


НАРОДНА БАНКА

СРБИЈЕ



Monetary Policy and Financial Sector in Serbia

Radovan Jelašić – Governor
Zrenjanin, 3 May 2007

Central bank's objectives are clearly defined in the Law on the NBS and there are no restrictions on the means to achieve these objectives

Article 3

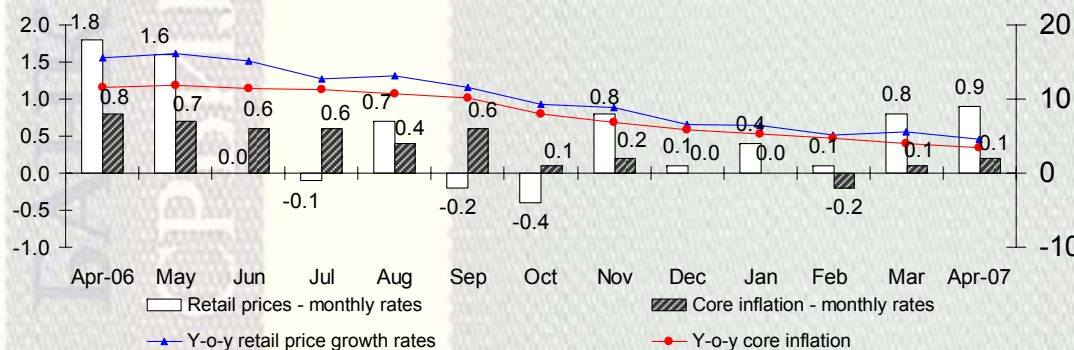
The primary objective of the National Bank of Serbia shall be to **achieve and maintain price stability**.

In addition to its primary objective, the National Bank of Serbia shall also **pursue the objective of financial stability**.

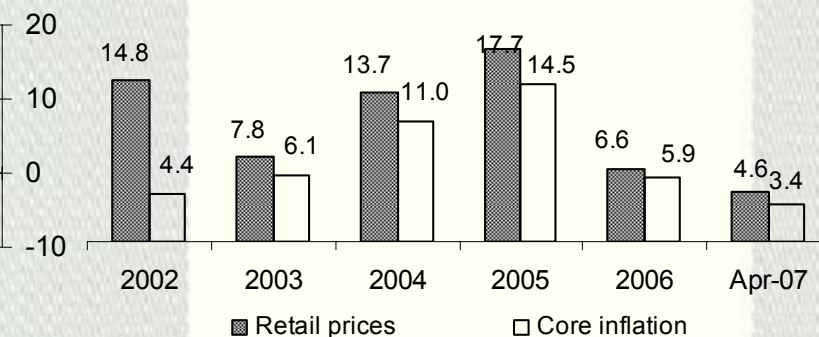
Without prejudice to its primary objective, the National Bank of Serbia **shall support the economic policy of the Government of the Republic of Serbia**, acting in accordance with the principles of a market economy.

April core inflation rate was at a satisfactory level!

Inflation movements (in %)

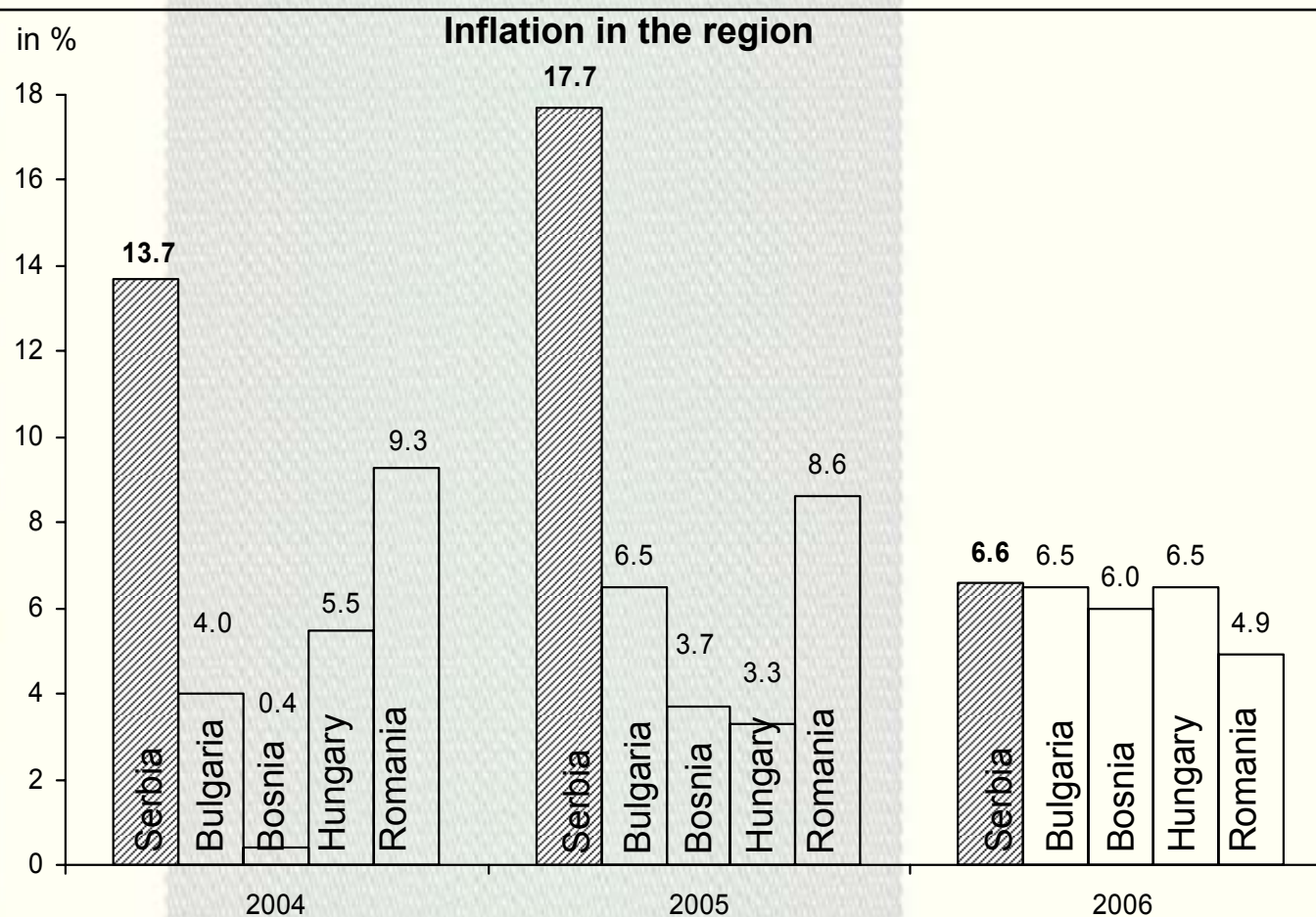


Annual inflation rates (in %)



- Core inflation in 2006 (5.9%) undershot the target (7-9%) as a result of a) appreciation of the dinar, b) drop in prices of petroleum products and c) deferred adjustment in prices of utility and housing services in Q4 2006. Thus 2006 retail price growth reached 6.6% instead of the projected 9.3%;
- Core inflation in the first four months of 2007 reached +0.1%, while retail prices equaled +2.1% (mainly as a result of change in prices under administrative control – petroleum products and utility and public services).

Inflation rate in Serbia corresponds to the regional average!



In terms of inflation, Serbia is exactly where it should be, but, in difference to some of its neighbours, it achieved this using its own currency!

“Monetary economy” in Serbia still seems to be stuck in the 1970s!

“Before the 1980s, governments were convinced that there was a trade off between “a little more inflation” and less unemployment. This policy eventually led to **double digit inflation in advanced economies and galloping inflation in a number of developing countries. High inflation was finally recognized as inimical to growth and socially disruptive.** In 1979-1980, the game of systematically seeking employment at the expense of price stability came to an end. **The whole process had entailed high economic and social costs.**”

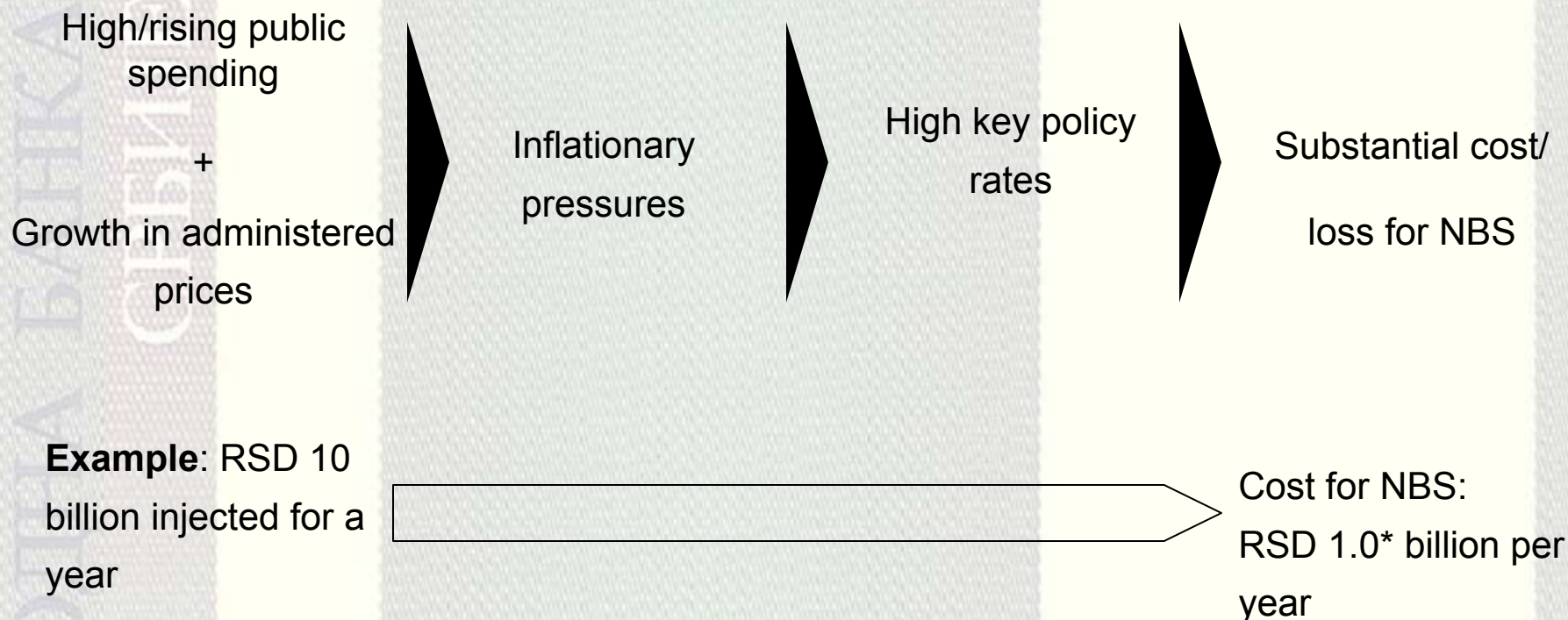
Jacques de Larosière

former Managing Director of the IMF, EBRD President

and former Governor of the Banque de France

Budapest, 19 January 2007

Maintaining price stability by means of monetary policy is costly – BUT there are no alternatives!

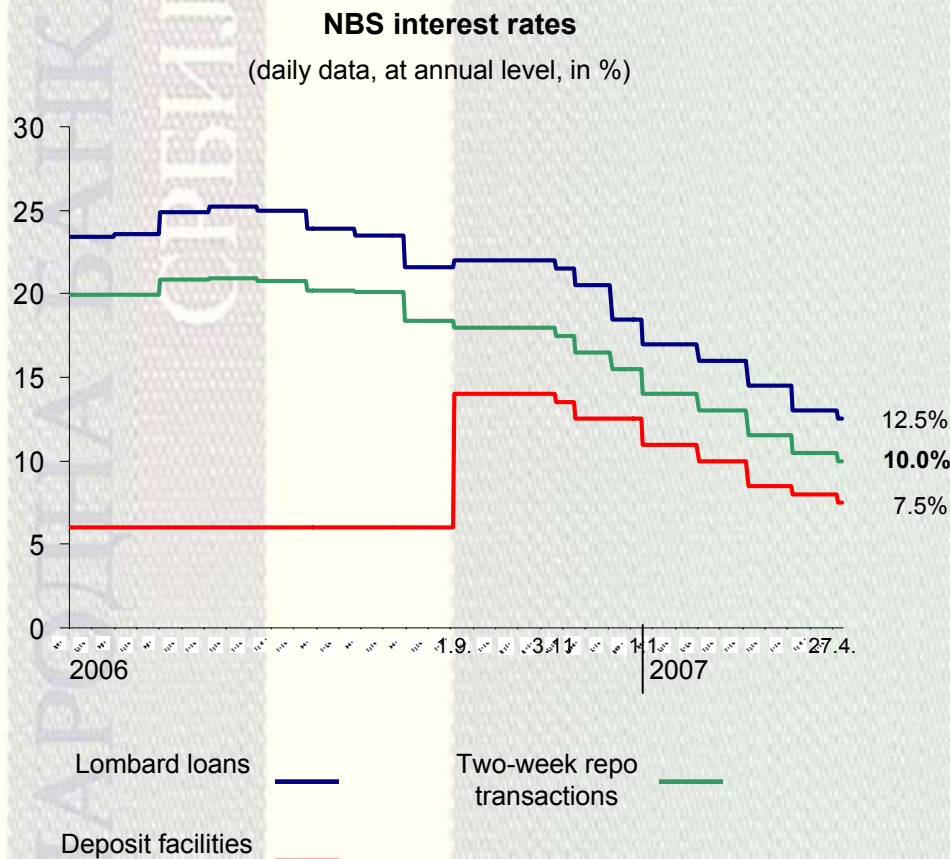


An alternative is to raise the reserve requirement still further, i.e. rise in the cost of borrowing!

* Based on the present key policy rate of 10.0%

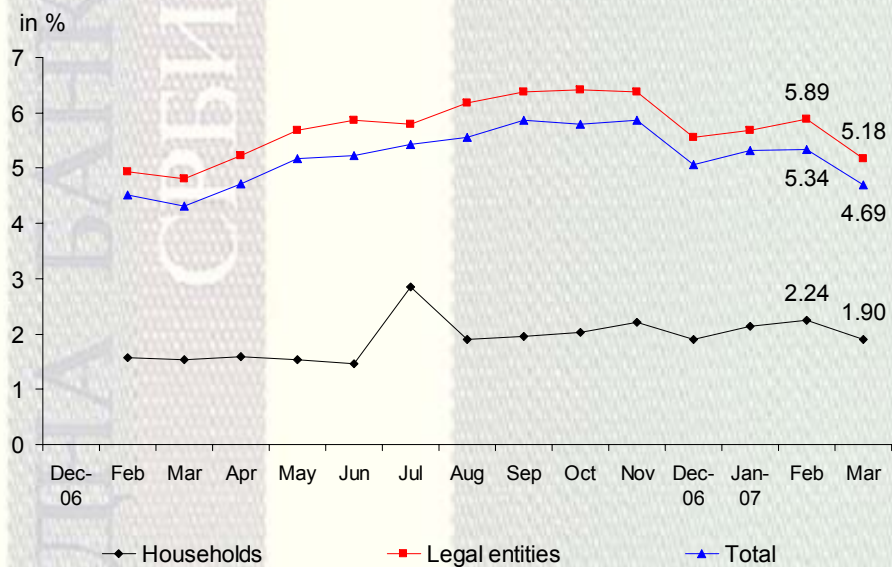
As the NBS key policy rate declines...

- Factors behind NBS decision to cut the key policy rate:
 - Low headline and especially core inflation;
 - Stability in the foreign exchange market;
 - Stable growth in economic activity.
- NBS remains cautious, due to the following risks:
 - Uncertainty regarding the character and expansiveness of fiscal policy;
 - Uncertainty regarding movements in administered prices and their indirect impact on core inflation;
 - Strong rise in household income (wages, payment of pension arrears...).

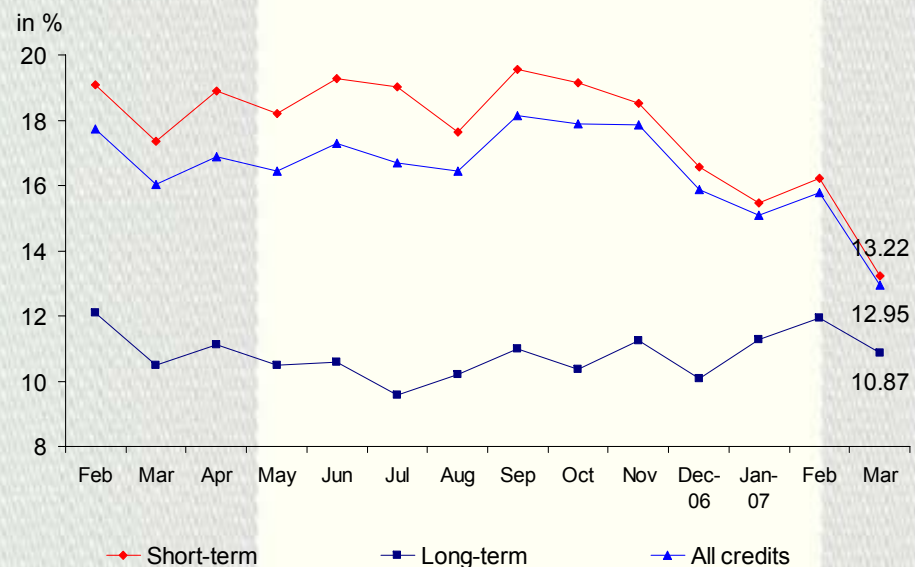


... .. so do interest rates of commercial banks!

Deposit rates



Lending rates



Everyone profits from a stable dinar!

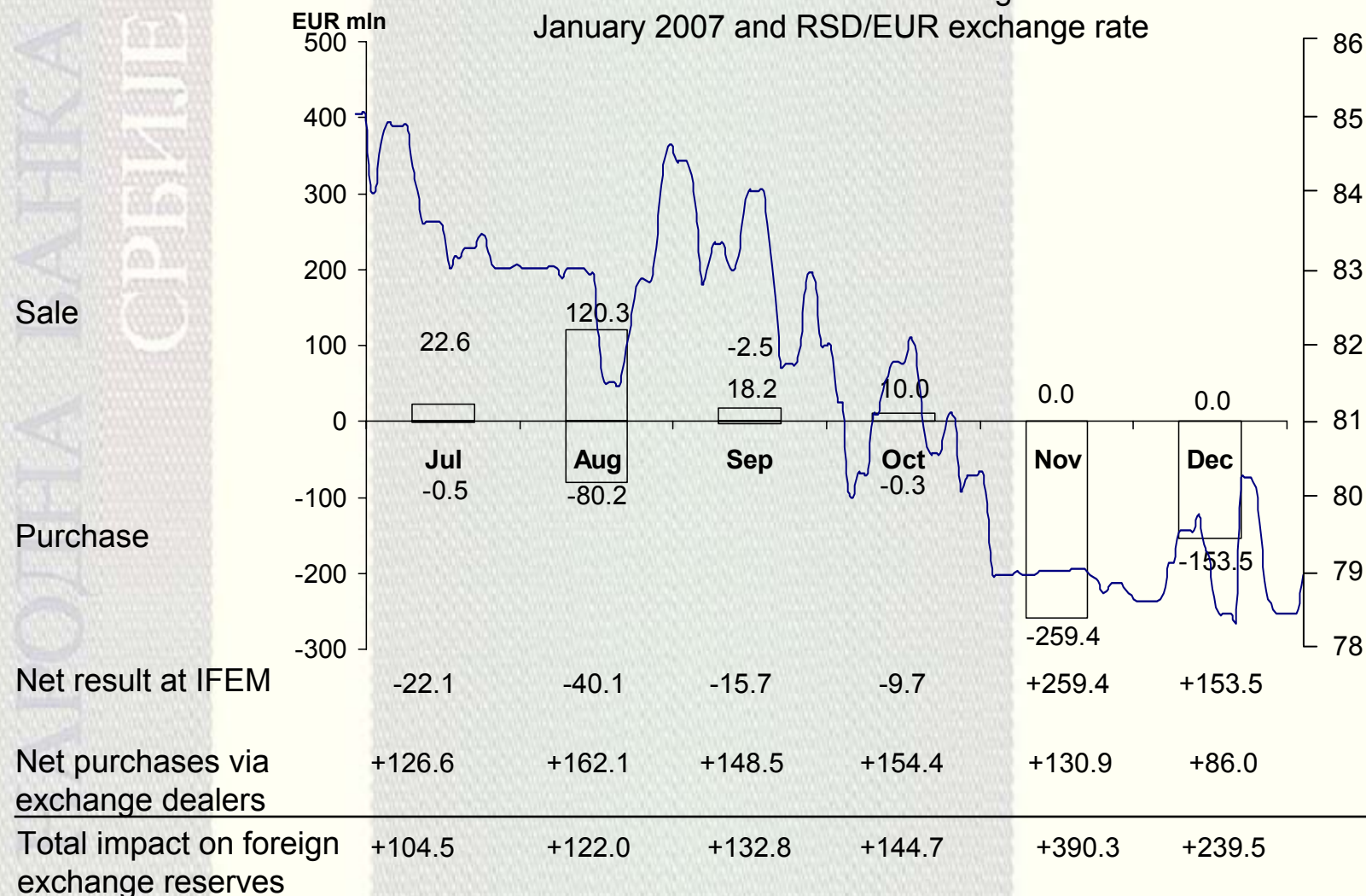
- Pensioners – semiannual indexation to price growth;
- Our investors abroad – for each euro invested abroad, they need to allocate (approximately) the same amount of dinars;
- All who save in Serbia – dinar and foreign currency savings, voluntary pension funds, shares and other investments (which erode in the context of dinar devaluation);
- Enterprise sector – price stability is the best way for the enterprise sector to finally focus on productivity and market competition, rather than price and exchange rate movements!
- Earlier claims that “prices keep growing while the dinar is unrealistically strong” are now obviously out of place!

There are very few economists in Serbia who think through the entire chain of events related to changes in the exchange rate

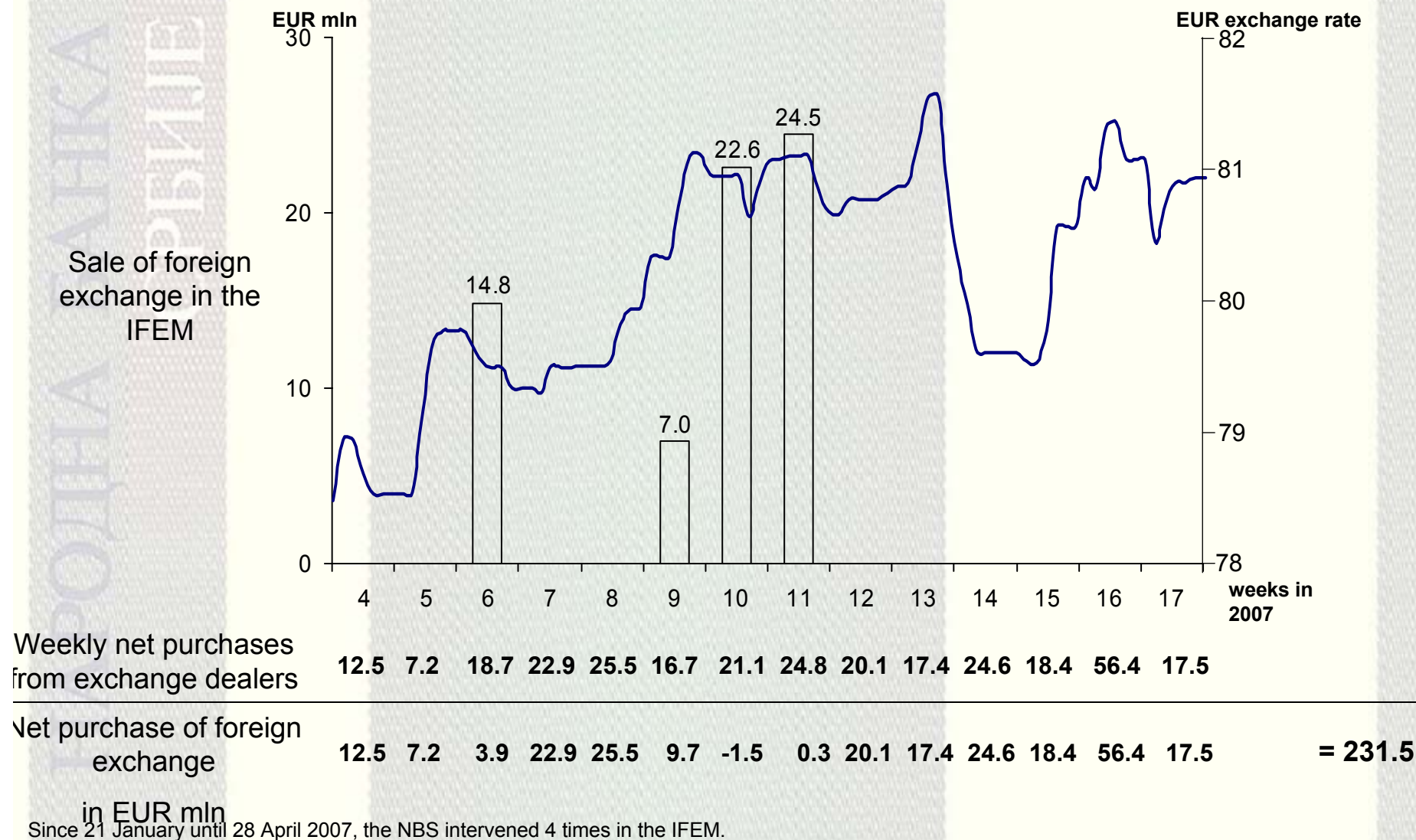
- **What is advocated by those who believe that today's exchange rate should be, e.g., RSD 90 for EUR 1.0?**
 - higher foreign exchange reserves, due to additional purchase of foreign exchange by the NBS in order to “defend the exchange rate”;
 - more dinars in the system leading to:
 - higher inflation rate and/or
 - higher interest rates on account of increased sterilization (repo rate or reserve requirement!)
- **What is advocated by those who believe that exchange rate should be, e.g., RSD 70 for EUR 1.0**
 - lower level of foreign exchange reserves, as the NBS would not intervene at all by buying foreign exchange (e.g. purchase of close to EUR 1 billion in the latter half of 2006)
 - less dinars in the system leading to:
 - lower inflation rate and/or
 - lower interest rates due to shortfall of money

In the latter half of 2006, the National Bank of Serbia made efforts to prevent further dinar appreciation

NBS interventions in the IFEM August 2006 – January 2007 and RSD/EUR exchange rate



In 2007, the National Bank of Serbia significantly downsized its role in exchange rate formation...



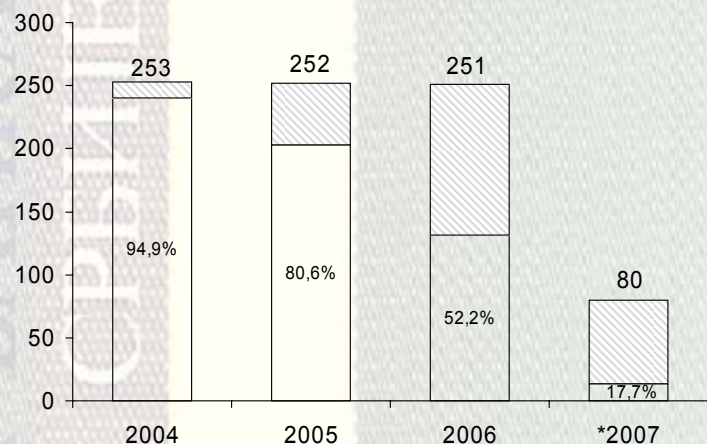
... while as of 5 March the exchange rate is calculated in a new way...

- The exchange rate is formed by balancing foreign exchange supply and demand in the entire interbank foreign exchange market;
- Fixing session is only one of the many transactions in the foreign exchange market;
- On 20 April, daily interbank trading hit record high levels, with a total of 100 transactions worth EUR 135.2 million;
- Fixing session is planned to be abolished in June;
- As of 5 March, the NBS buys and sells only three currencies – EUR, RSD and CHF – which already made up 96% of total currency trade in 2006, while banks and exchange dealers will continue to buy and sell all other 17 currencies.

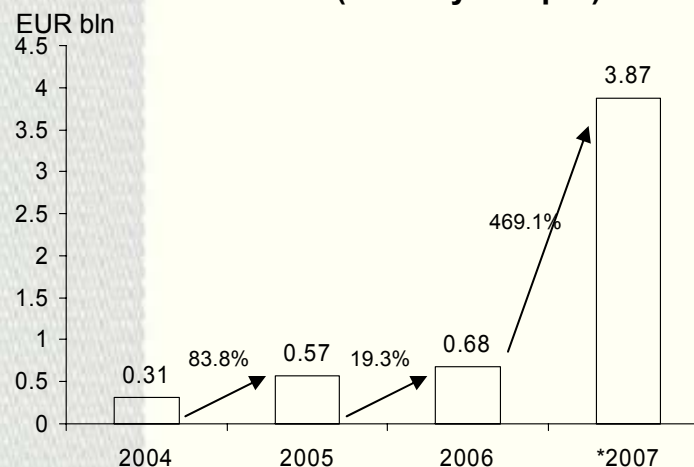
New methodology for setting the exchange rate does not affect
either its stability or the functioning of the foreign exchange
market!

...and is floating more and more freely

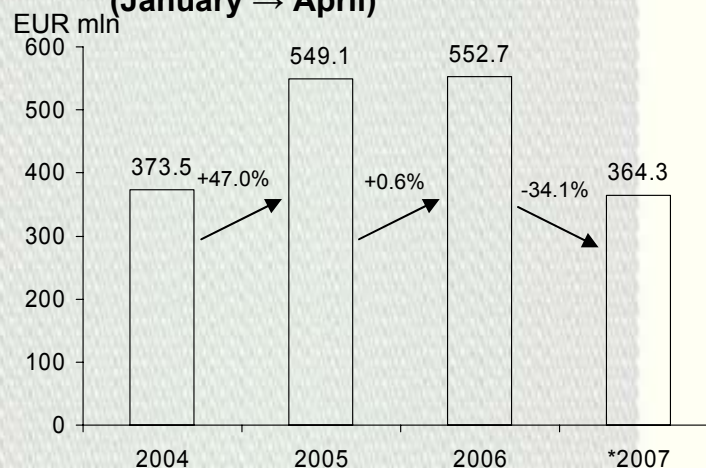
Number of days when NBS was active



Trade in IFEM (January → April)



Purchase from exchange dealers
(January → April)



* Until and including 28 April 2007.

Future exchange rate movements in 2007

- If necessary, the NBS will stand ready to “iron out” excessive daily and periodical oscillations, but without interfering with the exchange rate trend;
- Clients with significant foreign exchange inflows and outflows ought to safeguard against foreign exchange risk – especially those that have foreign exchange inflow only!
- The NBS aims to minimize the number of days when it participates in the market in the capacity of buyer or seller!

Forward transactions in foreign currency – exporter

- Exporter exports goods worth EUR 1,000,000 to the EU
- Foreign exchange inflow expected after 3 months
- Current selling foreign exchange rate **EUR/RSD=80.7000**
- The exporter concludes a forward agreement to sell EUR 1,000,000 three months later at the rate of **EUR/RSD=81.5000**
- 3 months later, if:
 - EUR/RSD= **80.0000**, the exporter earns “profit” of RSD **1,500,000** on account of exchange rate gains
 - EUR/RSD= **81.5000**, no “profit”, no “loss”
 - EUR/RSD= **82.0000**, the exporter sustains “loss” of RSD **500,000** on account of exchange rate losses.

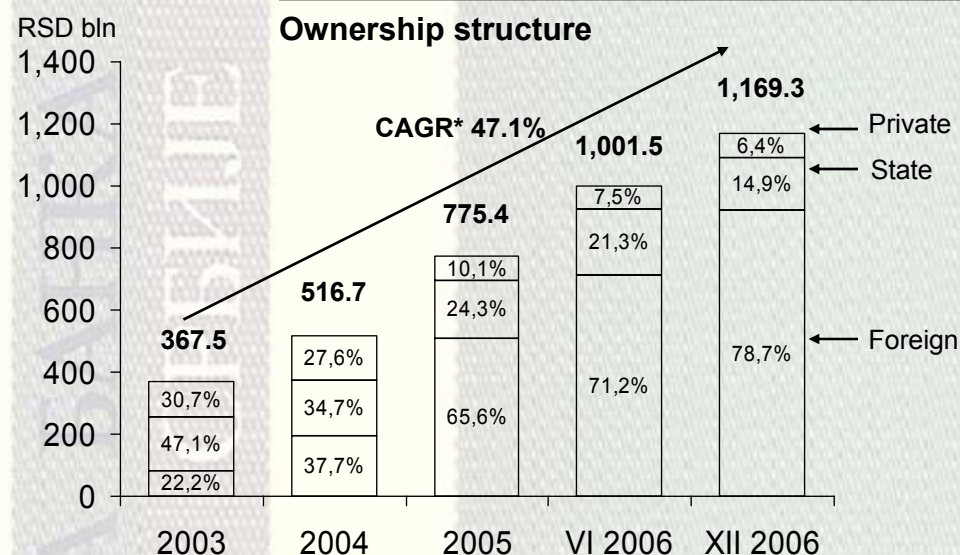
Forward transactions in foreign currency – importer

- Importer imports goods worth EUR 1,000,000 from the EU
- Payment due in 3 months
- Current buying exchange rate: **EUR/RSD=80.6000**
- The importer concludes a forward agreement to buy euros in 3 months at the rate of **EUR/RSD=81.50**
- 3 months later, if:
 - EUR/RSD= **80.4000**, the importer sustains “loss” of RSD **1,100,000** on account of exchange rate losses
 - EUR/RSD= 81.50, no “profit”, no “loss”
 - EUR/RSD= **82.0000**, the importer earns “profit” of RSD **500,000** on account of exchange rate gains

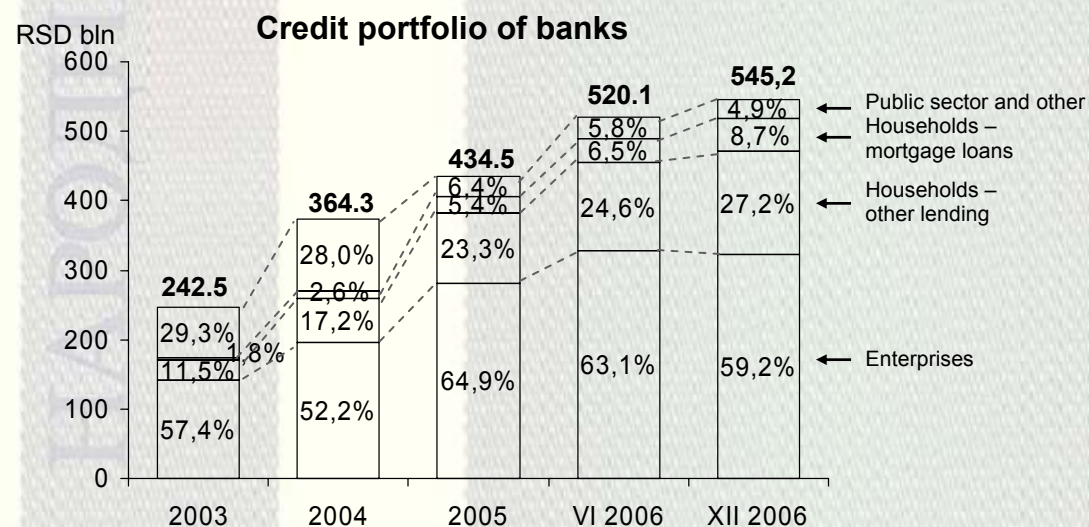
Production or foreign exchange risk?

- Entrepreneurs do not have to worry about exchange rate calculation if they close the financial deal at the agreed forward exchange rate level.
- Entrepreneurs have a clear choice – the only way they can count on profit is if they provide high-quality and competitive products, and not as a result of exchange rate calculations
- Forecasting of the EUR/RSD exchange rate is no less uncertain or complex than forecasting the EUR/USD, USD/CHF or another exchange rate;
- Those engaged in production should not experiment with exchange rate forecasting as this implies uncertainty even for the world's prime investment companies.

Banking sector in Serbia



- In 2006, balance sheet total of banks rose by 49.9% in dinar terms (RSD 386.7 billion) and by 62.2% in euro terms, an increase equal to balance sheet total at end-2003;
- Everyone profits from reforms: banks, employees, borrowers, depositors, government, NBS...;



- 2007 increase in credit portfolio of banks will be similar to that recorded in 2006*;
- Within household credit portfolio, mortgage loans increased most from around RSD 23 to RSD 47.2 billion during 2006.

* CAGR – compound annual growth rate

NBS borrowing advice

- Exchange rate movements cannot be predicted, and, in this particular case, history IS NOT “the best teacher”;
- People should not be ashamed to admit that they do not understand certain provisions of the contract, instead of signing something and only later admitting that it was not clear enough!
- Dial the NBS Call Centre toll-free: **0800-111-110**;
- EIR is the best indicator of the cost of borrowing;
- Before deciding where to borrow, visit at least 2 – 3 banks;
- Credits were, are and will continue to be in plenty supply!!!

What are the elements of high quality and professional client advice at the time of borrowing?

- The banker must prepare an overview of your overall income;
- The banker should calculate the monthly level of installment that you can finance;
- The banker must not impose upon you additional insurance at all costs and should count in existing types of insurance;
- At the end of the talk, the banker will give you an offer in writing which contains all key data (nominal + effective interest, repayment schedule, total amount of interest and credit to be repaid, etc.);
- The banking officer does not persuade you to sign the contract immediately but gives you additional time to consider your decision!



Народна банка
Србије

Insurance supervision introduced in 2004 contributed to faster development of the Serbian insurance market, and the trend continues...

	2004	2005	2006	trend
Total premium	22.6	34.7	38.3	↑ 10.4%
Life insurance premium in Σ premium	1.7 (7.5%)	3.3 (9.5%)	4 (11%)	↑ 23%
Non-life insurance premium in Σ premium	20.9	31.4	34.3	↑ 9.2%
Premium per capita	€ 38	€ 54	€ 65	↑
Life insurance premium per capita	€ 2.9	€ 5.1	€ 6.8	↑
Premium to GDP	1.7%	2%	2.1%	↑
Total assets	30.8	46,4	56	↑
Capital	15.6	18.6	20.7	↑
Technical reserves	11.5	22.9	28.9	↑ 26%
Number of insurance companies	40	19	17	↓
Number of employees	5,407	7,283	7,880	↑

* Data in RSD billion, except where otherwise specified.

Insurance, leasing and voluntary pension insurance

Leasing:

- Law on Financial Leasing entered into force on 1 January 2004;
- 15 leasing companies, owned mainly by banks;
- Total end-2006 balance sheet assets equaled RSD 67.7 billion, with investment at RSD 57.9 billion.

Voluntary pension insurance:

- Law on Voluntary Pension Funds and Pension Schemes entered into force on 1 April 2006;
- Six funds have been registered so far – Delta Generali, Raiffeisen Future, Garant penzijsko drustvo, DDOR Penzija plus, NLB Nova penzija and Pension Insurance Company “Dunav” a.d.;
- Balance sheet assets for 2006 equal RSD 820 million.

Thank you!

NBS Call Centre

Dial toll-free

0800-111-110