Global financial crisis and Serbia

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- Global financial market developments
- Effects so far
- State of the Serbian financial sector
- Measures taken by the NBS so far (foreign exchange reserves)
- Effects expected

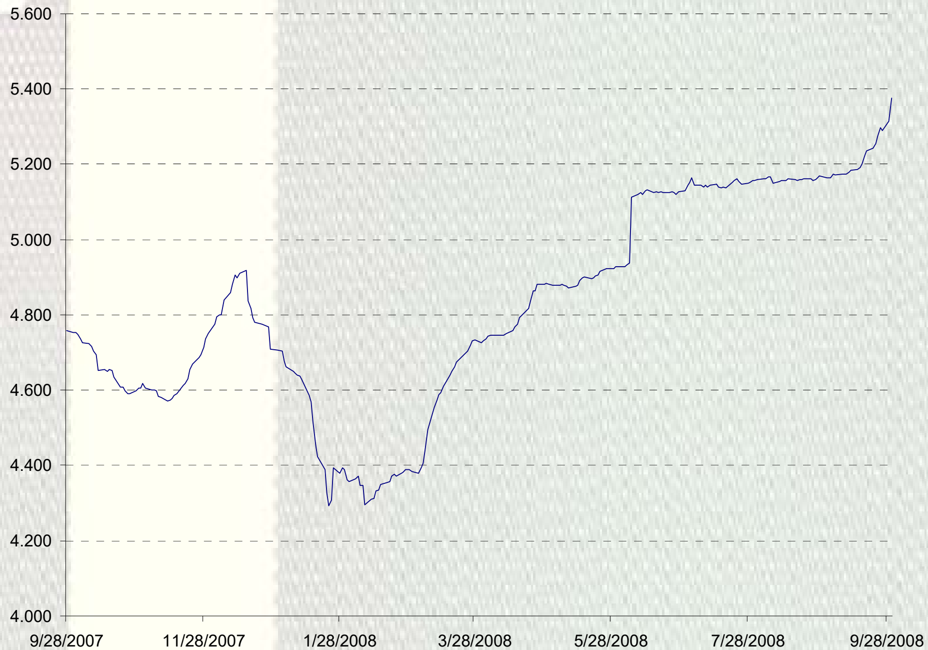
Central banks' efforts over the past decade to achieve a "soft landing" of the economy have not produced the desired result

- The challenge of "orderly resolution of global imbalances" – the focal point of each semi-annual IMF/WB meeting – has not been successfully tackled, as the countries were reluctant to:
  - allow insight into the state of their financial sector;
  - discuss the issue of currency overvaluation;
  - take concrete steps to address deteriorating balance of payments and fiscal deficits.
- The property bubble kept inflating, in spite of warnings by central bankers;
- The system of "originating and holding" loans to maturity has been replaced by a system of "originating and distributing", which boosted banks' profitability (leverage effect).

International financial markets have been hit by unprecedented turbulences (1/2)

- Lack of trust among commercial banks: as at 30 September, commercial banks' deposits in the ECB came to EUR 44,353 billion, which is +60% compared to a day earlier; at the same time, the ECB lent EUR 15,481 billion to commercial banks;

6M EURIBOR September 2007/2008

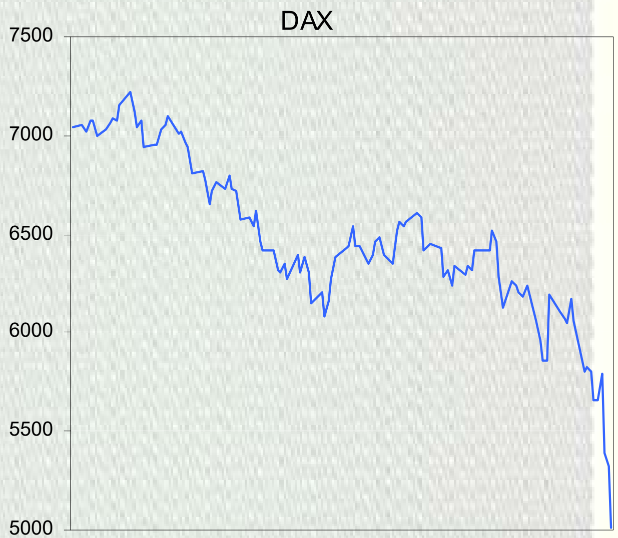


- Withdrawal of central banks' funds from commercial banks and depositing them with other central banks;

- Despite notable liquidity "injections" by the ECB, FED, etc., the EURIBOR reference rate has been on a constant rise.

International financial markets have been hit by unprecedented turbulences (2/2)

- Plummeting prices of shares (by 40%) of HBOS (Halifax Bank of Scotland) and RBS (Royal Bank of Scotland) on 7 October, followed by an increase of around 50% on the next day, 8 October!
- Decline in all leading stock exchange indices since early May 2008.



- Transmission of effects of the crisis on the real sector (shares of car manufacturers, luxury goods...)

In fact, measures taken by governments and central banks aimed to achieve a dual objective…

Financial sector stability

- Pre-emptive measures against mass withdrawal of bank deposits (capital increase – nationalization; raising the deposit insurance limit);
- Granting additional loans, discount of receivables, capital stake.

Avoiding economic recession

- Opel shut down 2 plants in Germany, in Bochum (5,000 employees) and in Eisenach (1,800 employees), for 2 and 3 weeks, respectively – 40,000 cars less this year

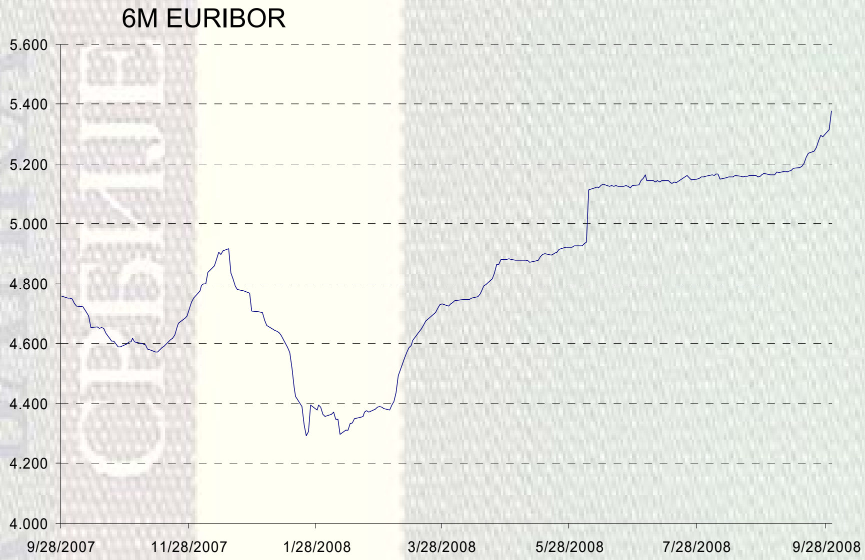
.. but these measures...

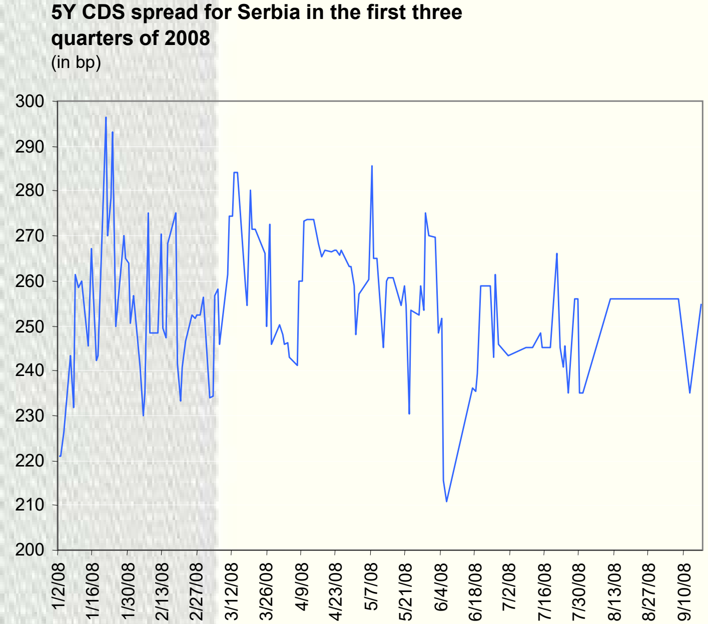
- USA: so far, interventions of around USD 1,000 billion or approximately 7% of GDP for 2008;
- England: intervention of GBP 500 billion;
- Drastic lowering of central banks’ criteria regarding commercial banks’ receivables that can be refinanced with central banks (the key objective is to ensure banking sector liquidity);
- Increase in the volume of insured deposits;
- Coordinated policy rate cuts – by 0.50% by the ECB, FED, Canada, Sweden, Switzerland and China (0.27%);
- Nationalization, acquisition of part of bank assets as collateral for loans approved...

... have so far failed to produce satisfactory results

- Reference rate in the interbank market is the same as 13 years ago – 3M EURIBOR;
  - current borrowing keeps getting costlier, future prospects are equally gloomy!
- Property prices keep falling, primarily in the USA; owners are walking away or ***going in default***, as their debts are now far in excess of the current value of their property!
- Lack of trust among commercial banks continues.

The effects of the global financial market crisis have been felt in Serbia for some time now (1/2)





- Frozen foreign currency savings bonds yields gained 2%!

The effects of the global financial market crisis have been felt in Serbia for some time now (2/2)

- In Serbia, both lending activity of commercial banks and foreign borrowing have slowed down;
- Banks adjust variable interest rates in accordance with contracts (3/6M EURIBOR);
- Fresh borrowing is arranged at higher interest rates;
- Access to international financial market is limited to international financial institutions.

The state of Serbia's financial sector differs a lot from that of other countries of the region...

- Capital adequacy ratio, as indicator of banking sector solvency, equals 28.1% (own capital 24%) instead of the prescribed minimum of 12% – 3.5 higher than in the EU countries;
- Liquidity ratio is two times higher than prescribed, over 2; 35% of total bank assets in cash + required reserves with the NBS + NBS securities!
- All banks in Serbia are daughter banks, i.e. separate legal entities with own capital, under NBS supervision;
- 75% of banking sector balance sheet total is owned by banks from EU countries.
- Banks have no difficulty in meeting their obligations to clients!

... restrictive and circumspect stance of the NBS has paid off

- Reserve requirement ratio of 40% on foreign currency household savings deposits and 45% on other foreign currency deposits (household savings of EUR 5.7 billion)
- Volume of lending to households (excl. mortgage loans) – maximum 150% of the bank’s capital;
- Strong investment by commercial banks in NBS repo securities (aim is to sterilize excess liquidity by applying market interest rate and taking on exchange rate risk!)
- The NBS invests in prime securities only and has during the summer transferred most of its foreign reserves to central banks.

The NBS took strong pre-emptive measures even before the crisis broke out

- The key policy rate was raised from 10.00 to 15.75% since the start of the year;
- The public was informed of the risks involved in long-term borrowing at a variable interest rate;
- The NBS made dinar borrowing more attractive than foreign currency clause indexed loans;
- The NBS made arrangements for setting up the Consumer Protection Centre, which distributes brochures and leaflets, operates “hotlines”, arranges visits, public appearances, etc.
- The NBS warned of the risks involved in investment in corporate shares;
- The NBS introduced a requirement for voluntary pension funds to buy listed rather than quoted shares...

In the past several days the NBS implemented activities at three different levels

Public

- Issuing statements and press releases, and holding presentations on developments in the Serbian financial sector and explaining possible effects of the global financial crisis;
- Reminding the media of their responsibility in the coverage of news related to the domestic banking sector and movements in the international financial markets;

Banks

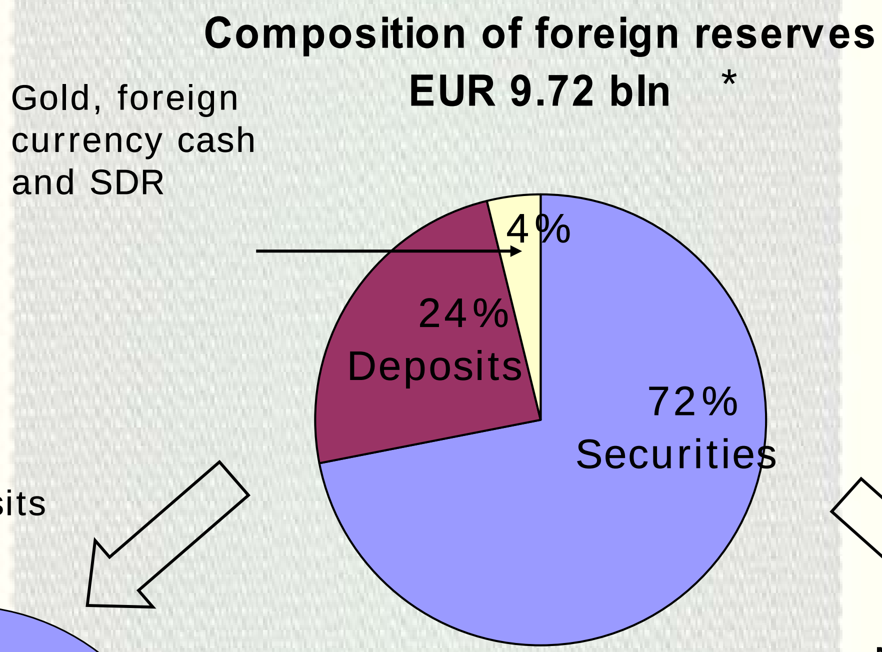
- Maintaining daily communication with banks, relating primarily to liquidity supply;
- Coordination of activities with the Association of Serbian Banks;
- Checking bank compliance with the terms and conditions of loans approved for the purposes of improving transparency;

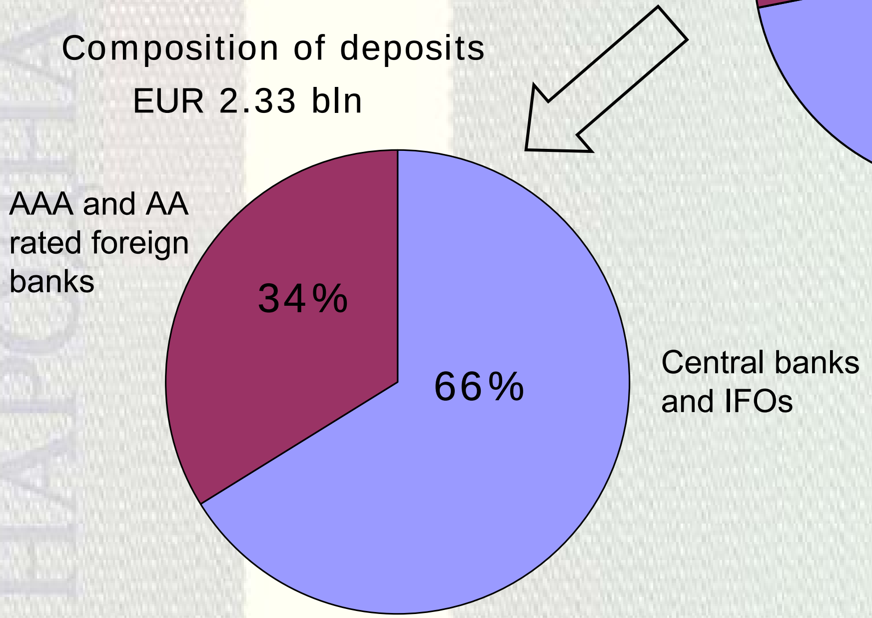
RS Government

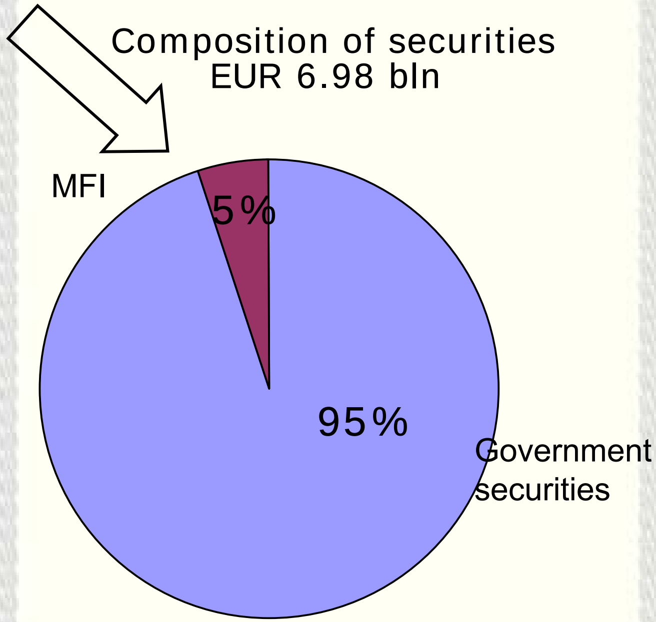
- Participation in the RS Government Working Group and providing information on
  - developments in the international financial markets;
  - measures taken by some countries;
  - ECOFIN's recommendations…

NBS foreign reserves are safe!

Currency composition of foreign reserves : EUR 70%, USD 20%, GBP 6%, other 4%







* on 30 September 2008

This week's developments are under the National Bank of Serbia's full control

Cash:

- Banks have sufficient liquidity on hands, which is the best defense mechanism against arbitrary and tendentious information;

Exchange rate:

- After interventions prompted by excessive daily fluctuations of the exchange rate - EUR 40 mln on Monday (exchange rate 79,1725) and EUR 197.6 mln total volume of trading; EUR 10 mln on Tuesday (exchange rate 80,0352) and EUR 275.4 mln total volume of trading – yesterday, the exchange rate levelled off at 80,2279 in the absence of any interventions by the NBS, and total volume of trading reached EUR 99.3 mln.
- Similar pressures on domestic currency were also recorded in Poland, Hungary and Romania.

The NBS should adhere to its legally defined mandate

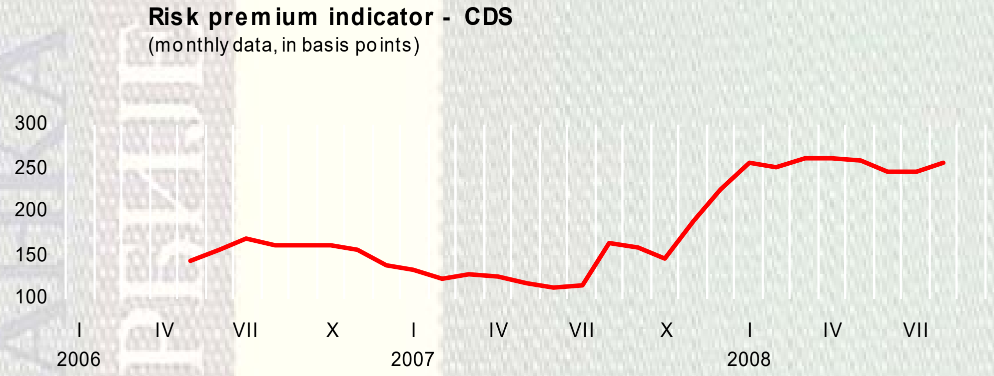
Article 3

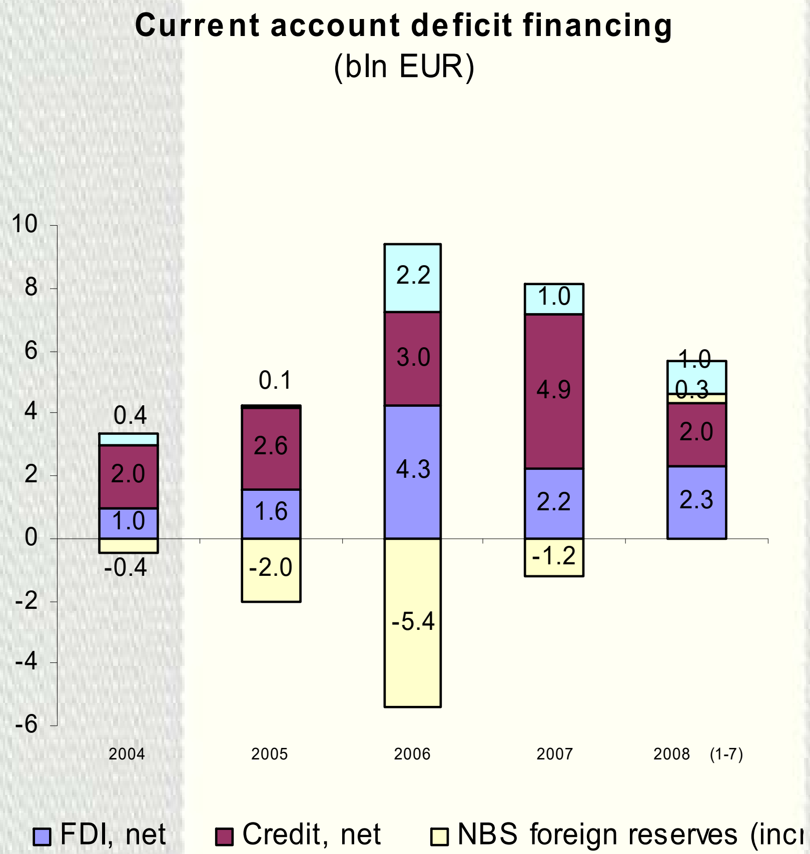
The primary objective of the NBS shall be **to achieve and maintain price stability**.

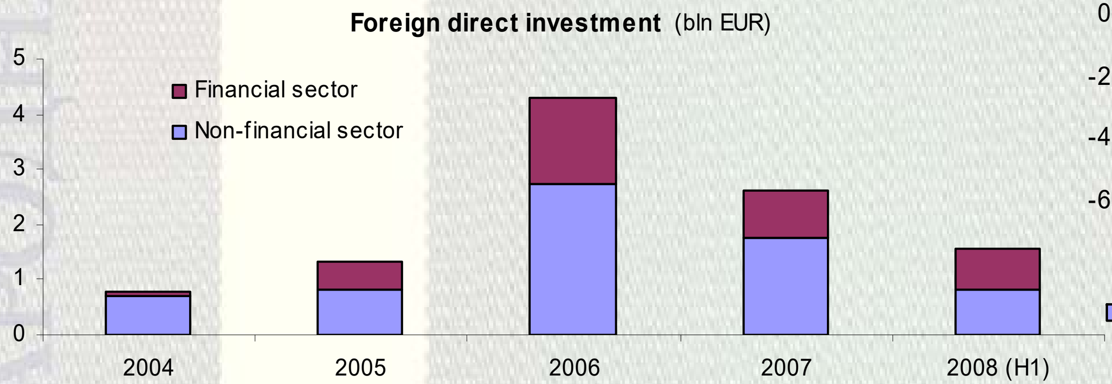
In addition to its primary objective, the NBS shall also strive **to preserve financial stability**.

Without prejudice to its primary objective, the NBS shall **support the pursuance of the economic policy of the Government of the Republic of Serbia**, operating in accordance with the principles of market economy.

Creators of the budget for 2009 should be more mindful of the international financial market developments







NBS will keep a close eye on future movements in both international and domestic market

- Nobody can predict the duration and scale of the crisis → currently, it is essential to maintain stability of the financial system (at the same time, the NBS is preparing a set of measures aimed at precluding any major decrease in the volume of domestic and foreign borrowing) – supervision measures;
- Any easing of restrictive monetary policy now would affect stability of the financial sector;
- Measures should be designed by taking the following market principles into account: money knows no colour; relaxation of monetary policy stance does not automatically result in better terms of borrowing for households/ enterprises;

Interest rates on current and future obligations of Serbian households and enterprises may be lowered in the following three cases:

1) On dinar loans – by a cut in the NBS key policy rate, depending on inflation expectations;

2) On euro-denominated loans – by a decline in six-month EURIBOR, subject to reduction of the ECB rate;

3) On dinar and foreign currency loans – by a decrease in lending margin in Serbia, subject to country rating and general assessment of investment climate in Central and East European countries;

And finally!

- Serbia’s financial system is under no threat – banks are highly solvent and liquid;
- Crisis in the international financial market has already affected, and will continue to affect, the volume and price of loans in Serbia;
- The principal objective of the NBS is to ensure stability of the financial system – any change in the budget will lead to higher public consumption!