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**SERBIA ECONOMIC
GROWTH ACTIVITY**

Serbian Response to the Financial Crisis USAID Sarajevo Workshop

Serbia Economic Growth Activity
19 May 2010



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Serbia - Rapid Growth Masks Weak Fundamentals

Serbia Pre-Crisis

- Starting from low base – fast-paced GDP growth (2004 – 2008)**
- Growth accompanied by troubling symptoms**
 - Lagging tradable sector**
 - Low domestic savings**
 - Extensive FX lending**
 - High inflation**
- Symptoms rooted in unfavorable fundamentals**
 - Supply side of economy hampered by slow & inconsistent privatizations**
 - Large government sector invested little in country's future**
 - High unemployment & public-sector –led wage increases exceeded targeted inflation & labor productivity growth**
 - Monetary instabilities of 1990's caused inflation expectations to remain high relative to actual inflation**
- Until 2006, authorities undertook efforts to foster more balanced growth, but policy responses for rebalancing did not take hold**



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Serbia – Crisis Arrives (October 2008)

By 2008, substantial absorption gaps opened with domestic spending reflected by growing external imbalance

- Growth in excess domestic demand outpaced rate of internal & external balances resulting in surging imports and a large external imbalance
- Large sums of capital inflows, intermediated by foreign-owned banking system , financed the rapidly widening current account gap

As global contagion spread from Sep-2008 events, policymakers dismissed potential adverse impacts for Serbia

In late 2008, global crisis rapidly spilled into Serbia through both finance and trade channels

- Country risk indicators soared
- Capital inflows stopped suddenly
- Households withdrew a sizeable share of their deposits
- Both exports and imports plunged



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Serbia – Responding to the Crisis (1)

Response: Initial measures to contain the crisis

- **Address first wave from contagion:**
 - **Systemic liquidity concerns & liquid inter-bank market**
 - **Public confidence in the financial system**
 - **Sovereign liquidity & confidence of cross-border investors**
 - **Stabilize banking sector & ensure functioning payment systems**

Response: Measures (in-process) to mitigate intermediate & long-term impacts from the crisis

- **Structural & fiscal policies**
- **Solvency concerns**
- **Adopt (different) post-crisis strategy for economic growth**



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Serbia – Responding to the Crisis (2)

Response: led by MOF and Central Bank

Response: Initial measures to contain the crisis

– Address first wave of contagion:

- Systemic liquidity concerns & liquid inter-bank market
- Public confidence in the financial system
- Sovereign liquidity & confidence of cross-border investors
- Stabilize banking sector & ensure functioning payment systems

MOF & GoS:

- Initiate new IMF loan facility
- GoS stimulus to stimulate lending
- MOU: crisis management (MOF; NBS; DIA)
- Expand deposit insurance

National Bank of Serbia:

- Stimulate inter-bank FX market
- Loans to banks (bilateral & auctions)
- Administer GoS stimulus thru banks
- Enhanced supervision activities
- Pilot IFI's Bank Coordination Initiative
- Modifications to risk rating standards for bank receivables & renegotiated credits
- Reduce mandatory reserve requirements
- Modify NBS collateral requirements
- Incentivize dinar lending & savings
- Increased transparency & public disclosure
- Relax limits on loan growth



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Serbia – Responding to Crisis (3)

Response: Measures (in process) to mitigate intermediate & long-term impacts from the crisis

- **Structural & fiscal policies**
- **Solvency concerns**
- **Adopt (different) post-crisis strategy for economic growth**



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Serbia – Responding to the Crisis (4)

Structural & fiscal policies:

Structural:

- Increase the role of private sector
- Improve business climate
- Address public infrastructure bottlenecks
- Expand trading opportunities thru closer integration with EU & WTO
- Reduce dominance of Euro & the level of un-hedged FX risk

Fiscal:

- Frozen public sector wages & pensions
- Changes to the tax code
- Increased attention to tax administration – collection & enforcement
- New fiscal responsibility & debt restructuring law with codified limits
- Increase external borrowing to cover deficit – rebalance expenditures to stimulate domestic consumption and make infrastructure investments



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Serbia – Responding to Crisis (5)

Response: Measures (in process) to mitigate intermediate & long-term impacts from the crisis

- **Structural & fiscal policies**
- **Solvency concerns**
- **Adopt (different) post-crisis strategy for economic growth**



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Serbia – Responding to the Crisis (6)

Solvency concerns:

State:

- **IMF loan agreement provides credibility**
- **Adopt and implement structural and fiscal reforms to avoid European PIIGS scenario**

Banks:

- **Maintain adequate levels of liquidity – bank level & inter-bank**
- **Maintain prudential capital and loan loss provisioning requirements**
- **Ring-fence Serbian bank operations where parent bank concerns exist**
- **Manage “Bank Coordination Initiative”**

Private Sector:

- **Initiatives to reduce reliance on Euro and introduce FX hedging**
- **Mitigating non-performing loan increases through GoS stimulus and NBS measures for renegotiated credit**
- **More efficient & effective debt collection thru newly enacted Bankruptcy and Enforcement Law**



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Serbia – Responding to Crisis (7)

Response: Measures (in process) to mitigate intermediate & long-term impacts from the crisis

- **Structural & fiscal policies**
- **Solvency concerns**
- **Adopt (different) post-crisis strategy for economic growth**



Serbia – Responding to the Crisis (8)

Adopt and transition to (different) post-crisis strategy for economic growth

- **Pre-crisis strategy:**
 - **High-risk model for growth**
 - **Driven by public sector expenditures**
 - **Consumption-led growth**
 - **Reliance on external capital inflows to finance imbalances**
 - **Low exports**
 - **Low domestic savings**
 - **Addiction to Euro**
 - **Many of these factors reinforce each other, exacerbating the problem**
- **Transitioning environment: outlook for 2010-11**
 - **Expected GDP growth of 2% in 2010 and 3% in 2011**
 - **Main trading partners, particularly EU, are also in gradual recovery mode**
 - **Corporate sector needs to deleverage & reallocate resources**
 - **Fragile environment with potential for disruption (e.g. European debt crisis)**



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Serbia – Responding to the Crisis (9)

Adopt and transition to (different) post-crisis strategy for economic growth

- Post-crisis strategy for sustainable growth:**
 - **Export-led growth model**
 - Foster trade flows (Western Balkans Trade Pact, EU SAA, WTO)**
 - **Increased private sector involvement**
 - **Smaller, more efficient public sector with competitive income policies**
 - **Stable, long-term FDI**
 - **Increased domestic savings**
 - **Stable financial sector and deeper capital market**
 - **Reduced reliance on Euro and reduction in unhedged FX exposures**



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Thank You

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