

Weekly *Economic* Bulletin

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ANALYSIS

Economic Trends in Serbia

(Part III)

- In view of the state's considerable borrowing, Serbia's total foreign debt, at the end of September 2011 reached the amount of 23.860 billion euros, which was 4.5% more than in the preceding month. Compared to the end of December 2010, Serbia's foreign debt grew by 0.3%. The reasons why the total foreign debt did not considerably grow compared to the end of last year lies in the fact that the private sector's foreign debt, although enlarged at the monthly level by 0.7%, was, nevertheless, reduced compared to December 2010 by as much as 8.7%. In other words, noticeable is a declining tendency in the trends of the level of the foreign debt generated by the private sector, so that, in the last month of 2010, it dropped from 14.710 billion euros in the last month of 2010 to 13.427 billion euros in September 2011.

The downward path in the dynamics of the private sector's borrowing is the result of the over-indebtedness of the domestic economy, which, not so rarely, is unable even to meet the present financial obligations, to say nothing of entering new credit arrangements. Domestic businessmen over-invested in the previous period through credit lines which, due to poorer business performances, they are unlikely to repay, while they cannot conclude new credit agreements, as they do not ensure for them emergence from the business crisis, but they will rather only additionally tighten the debtor noose around their neck and accelerate their ruin on the market. For this reason, we are witnesses to a change of the ownership structure, mostly of larger companies, but also of the closing down of small or medium-sized enterprises, which cannot meet their financial obligations in conditions of the insufficient employment of business capacities. This process will become especially pronounced in 2012, when the state, due to reduced possibilities for further borrowing (the ratio between the total public debt and the GDP is already at the point of 46.7%, which is above the set 45%), will not be able largely to subsidize credits, i.e. to moderate the price of crediting.

Foreign debt by type of debtor

- in millions of euros -

	Period		
	31. 12. 2010	31. 8 . 2011	30. 9. 2011
Public sector	9,076.4	9,499.4	10,433.4
Private sector	14,710.0	13,328.3	13,426.9
Total	23,786.4	22,827.7	23,860.3

Source: Data of the National Bank of Serbia (NBS)

Since the outbreak of the world economic crisis, noticeable has been the intensive borrowing of the public sector, which can also be seen by its share in generating the total public debt from 2009 to the present day. Thus, the share of this sector in creating Serbia's foreign debt in 2009 was 34.5%, only for it to grow to 38.2% in 2010, and at the end of June, i.e. the first six months of 2011 to 40.4%, after which, in August, it reached a share of 41.6%, and at the end of September a share of as much as 43.7%. Therefore, this structure additionally deteriorated in the reporting month, since, through euro bonds, the Republic of Serbia collected on the international financial market around 724 million new euros.

Without a turnaround strategy one cannot expect a change in the country's present economic political position. Moreover, this position can further deteriorate. It is quite certain that, with the current economic policy, based more on technical changes and a short-term orientation rather than on essential reforms, Serbia, after the sale of the remaining state "silver",

and for the purpose of preventing an economic and financial collapse, must conclude a new financial arrangement with the IMF.

- In October, Serbia's total foreign currency reserves reached the amount of 12.431 billion euros, which is only 0.1% less than in the preceding month. The fact that the country's foreign currency reserves did not drop to a greater extent at the monthly level is the "doing" of commercial banks whose foreign currency reserves increased from 1.089 billion euros in September to 1.158 billion euros in October 2011, or by 6.4%. Contrary to this, the foreign currency reserves of the National Bank of Serbia (NBS) were reduced from 11.358 billion euros to 11.272 billion euros, i.e. by 0.8%.

The drop of the foreign currency reserves in the Serbian central bank's portfolio was the result of the settling of obligations towards foreign creditors (around 64 million euros) and the drawing of the commercial banks' funds for the foreign currency reserve requirement in the amount of around 50 million euros.

However, compared to December 2010, Serbia's total foreign currency reserves grew by 6.4%. In this regard, the NBS foreign currency reserves increased from around 10 billion euros to 11.272 billion euros in the reporting month or by 12.7%, while the foreign currency reserves of foreign banks were reduced from 1.684 billion euros to 1.158 billion euros, i.e. by as much as 31.2%. The positive dynamics in the NBS foreign currency reserves was primarily the result of new borrowings from international financial institutions, and not owing to an improvement in the country's export performances. This means that the stability of these foreign currency reserves is fragile, and that, with the foreign investors' avoidance of our market, i.e. their increasingly small interest in investing capital in our market, there will be a considerable melting away of these foreign currency reserves and the calling of the IMF to the assistance. Therefore, an analysis of the foreign currency reserves, i.e. the sources of their formation, leads to the conclusion that Serbia's macroeconomic stability is also on fragile legs and is threatening to end with the well known Greek dance.

Therefore, Serbia is still in the position of a serious addict who, without someone else's sources of financing is unable to service its current obligations. This dependence only deepens and deteriorates as time passes, and once this disease starts being seriously treated, a more long-lasting and comprehensive therapy will be sought.

Foreign currency reserves			
- in millions of euros -			
Foreign currency reserves			
	NBS	Commercial banks	Total
<i>Year 2010</i>			
December	10,001.6	1,684.3	11,685.9
<i>Year 2011</i>			
January	9,859.8	1,021.7	10,881.5
February	10,061.0	990.5	11,051.5
March	9,918.9	1,066.1	10,985.0
April	9,951.9	1,073.3	11,025.2
May	10,064.2	1,230.0	11,294.2
June	9,966.8	1,176.9	11,143.7
July	10,383.8	983.0	11,366.8
August	10,420.0	1,036.7	11,456.7
September	11,358.2	1,088.9	12,447.1
October	11,272.3	1,158.4	12,430.7

Source: NBS data

Already next year, due to the need for resolving the debtor crisis in the euro zone and for the recapitalization of commercial banks, foreign sources of financing will be limited, so it is high time to make sharp cuts of the transformation of the public sector and the reduction of public expenditures and to present to the public, without clouding the ugly picture of the economic reality, the only possible directions for emerging from the economic crisis which Serbia is in, and which would not be based on constant credits and verbal, superficial reforms. This primarily presumes the confrontation of the people employed in the public sector, especially in the administration with the need for their more efficient work, which also means the sacking of redundant labor. Therefore, the public sector must adapt to the needs and possibilities of Serbia's economy and show solidarity in resolving the economic crisis in the country for the purpose of preventing Serbia from passing from the entrance hall into the main hall of a Greek tragedy. Furthermore, the transformation of public companies has created conditions not only for savings in the budget in the future, but also for new investments in these companies, especially in the energy sector and, therefore, also space for the additional filling of the budget;

- In October, the dinar's exchange rate appreciated against the euro compared to the end of December of the preceding year by 6.1% nominally, i.e. by as much as 10.6% in real terms, having reached the point of 100.48

dinars to one euro. At the monthly level as well, the appreciation of the domestic currency was also registered, by 0.7% in nominal terms, i.e. by 1.1% in real terms.

Exchange rate trends

	EUR value against the dinar
<i>Year 2010</i>	
December	105.50
<i>Year 2011</i>	
January	104.60
February	103.22
March	103.60
April	99.63
May	96.98
June	102.46
July	102.13
August	101.58
September	101.17
October	100.48

Source: NBS data

Therefore, in conditions of stronger inflationary tensions than planned for this year, we are witnessing the building of the domestic currency's muscles with steroids. And every artificial pumping of the muscles in the organism which has no foundations for such a super-structure, in conditions when these foundations are not reanimated, and especially when the external circumstances in the form of the strengthening of the debtor crisis in the euro zone are not favorable, Serbia, with narrowed down possibilities for borrowing, can quite realistically find itself in the position of the precipitate sliding of the domestic currency's value. Becoming increasingly realistic is the option of the dinar's depreciation i.e. the reduction of its value to within real frameworks in accordance with the domestic economy's competitive strength. This can be postponed with the sale of the remaining state "silver", but, in a milder or sharper form, this process will be inevitable. In accordance with this process, proceeding alongside will also be the process of the melting down of the NBS foreign currency reserves. It is precisely for these reasons that the NBS does not agree to free the foreign currency reserve requirements of commercial banks, in order to prevent the outpour of foreign currency outside the national borders, because this would now already shake both the dinar's exchange rate and the total NBS foreign currency reserves. True, the NBS foreign currency reserves would be filled, which is precisely what will be done in the following year with those 1 billion euros from the IMF which are standing at Serbia's disposal, so they are currently not in a crisis, but with an un-changed economic policy, the crisis of the foreign currency reserves and of the exchange rate becomes a reality, especially in 2013, because the negative external circumstances will continue to be consistent, while the new government will not have large possibilities for borrowing.

In the upcoming period one should expect a trend of the domestic currency's depreciation, because this is also pointed to by the dropping of the NBS reference interest rate, which now stands at 9.75%. Also, the settling of the private sector's obligations towards foreign creditors at the end of November and in December will lead to the additional sliding of the dinar. Therefore, the depreciation of the domestic currency will become a regular trend, with certain seasonal oscillations, since there simply do not exist realistic economic foundations on which a higher value of the domestic currency would be built.

(to be continued)