Weekly *Economic* Bulletin

V.I.P. News Services, Cika Ljubina 6/II, 11000 Belgrade, Serbia
Phone: (381 11) 328 23 60, 328 61 40, Fax: (381 11) 328 61 41
Internet: vipnews@sbb.rs; bracavip@eunet.rs
Editor-in-chief: Bratislav Grubacic **Editors: Vesna P.Marjanovic, Tanja Jakobi**

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ANALYSIS

Economic Trends in Serbia

(Part III)

It is becoming quite certain that the new Serbian government will have to conclude a stand by arrangement with the IMF in order to receive support for the serious realization of reform processes, without which it would quite certainly aggravate its credit rating and find itself on the verge of bankruptcy. This will require considerable sacrifices of the population, because to be expected in an increase in the VAT, the sacking of redundant labor in the public sector, both at the level of the state administration and in public companies and those that have become state-owned. Unfortunately, if these reforms had been carried out much earlier, and primarily if the neo-liberal doctrine of the economic policy, where the casino principle reigns, had not been applied, such a high price would not be paid, and as time passes, these rigorous saving measures in the public sector will be increasingly necessary. Of course, these reform processes should be accompanied by the state's investing in all types of the infrastructure, especially in the energy and transport infrastructure, as well as the offering of more generous support to agriculture. Therefore, the cutting down of non-productive, barren spending and the stimulating of investment spending in conditions of the building of a respectable legal infrastructure are the main points on which to pave Serbia's way out of the economic and general social crisis;

- **In January, Serbia's total foreign currency reserves were 12,365 billion euros.** This was 3.9% less than in the preceding month, but, nevertheless, 5.8% more than in 2010. The reduction of the foreign currency reserves at the monthly level was the result of the drop of foreign currency reserves, both in the NBS portfolio, and in the portfolio of commercial banks. However, this is more the consequence of the season, because, in December, commercial banks allocated more than the prescribed foreign currency reserve requirement due to which, in the last month of 2011, there was a moderate, mostly artificially induced, growth of the NBS foreign currency reserves, only for this foreign currency reserve requirement of commercial banks to be withdrawn to the prescribed level. This led to a drop of the foreign currency reserves in the central bank's possession. Therefore, it could be said that, with the achieved 11.6 billion euros, the NBS foreign currency reserves were stable in January 2012. In the reporting month, commercial banks disposed of 762 million euros, i.e. 5.8% less than a month earlier, which is the result of the repayment of their debt to their mother banks and partly the placement of liquid assets in domestic securities. Since 2010, present has been the trend of the reduction of commercial bank's foreign currency reserves as the result of the restrictive credit and monetary policy of the NBS, i.e. the attractive securities which the government and the NBS are presenting on the financial market.

The positive dynamics of the NBS foreign currency reserves in 2011 was primarily the result of the restrictive credit and monetary policy and the new borrowings from international financial institutions, and not the result of the improvement of the country's export performances. This means that the stability of these foreign currency reserves is fragile, and that with foreign investors bypassing our market, i.e. their increasingly small interest in investing capital in our market, these foreign currency reserves will considerably melt away and the IMF will be called to the rescue again.

Foreign currency reserves

- in mill. of euros -

	Foreign currency reserves		
	NBS	Commercial banks	**Total**
Year 2010			
December	10,001.6	1,684.3	**11,685.9**
Year 2011			
December	12,057.7	809.1	**12,866.8**

Year 2012			
January	11,603.7	761.8	**12,365.5**

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

- **Since the beginning of 2012, the dinar's exchange rate started considerably eroding against the euro. This is the result of the loosening up of the restrictive course in the conducting of the credit and monetary policy of the NBS, as well as the gradual shying away of investors from our market because of the intimated instability, which the IMF had signaled, making it clear that it could not stand behind the current economic policy. For this reason, in the upcoming period, apart from the spending of the foreign currency reserves on the defense of a sustainably stable exchange rate, we will witness the additional tightening of the restrictive credit and monetary policy so that investors would catch the bate of lucrative securities, i.e. securities with higher yield rates.**

Exchange rate trends

	EUR value against the dinar
Year 2010	
December	105.50
Year 2011	
December	104.64
Year 2012	
January	106.06

Source: NBS data

At the end of January 2012, the euro was worth 106.06 dinars and it was higher 15% nominally and 0.3% in real terms against the dinar compared to the end of 2011. Relative to January 2011, the dinar depreciated by 0.4% in nominal terms, i.e. by around 4% in real terms. The further larger sliding of the dinar's value continued in February, and at the beginning of March as well, which only confirms our conclusions from the earlier reports that the domestic currency's exchange rate is unrealistic, i.e. considerably overestimated compared to the domestic economy's competitive strength and that the semblance of its stability kept being preserved through short-term financial operations initiated by the NBS, and later on also with the sale of the Serbian government's treasury bonds. The acquiring of the candidate status for membership in the EU will, for psychological reasons, only shortly halt the depreciation of the dinar, but its erosion will be a regular trend, without sudden precipitate turbulences, which will only be accompanied by certain positive seasonal fluctuations. The dinar's true stability can be achieved only through a reform process of the public sector and the arrival of new investments, as well as the IMF's guaranteeing that Serbia is on the road to economic recovery with the implementation of the badly needed reforms.

(to be continued)