Weekly *Economic* Bulletin

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ANALYSIS

Economic Trends in Serbia

(Part III)

- **Serbia's total foreign debt at the end of January 2012 was 24.3 billion euros and it was 0.9% higher at the monthly level. Compared to 2008 when this government's tenure started, the foreign debt grew by a full 15.4%, i.e. from 21.1 billion euros to 24.3 billion euros. If, in this regard, one bears in mind the fact that it was the public sector that generated the space and volume of borrowing from foreign creditors, the picture of Serbia's total foreign debt is even worse. Namely, the public sector's foreign debt grew from 6.5 billion euros in 2008 and nearly 10.8 billion euros in 2011 to 10.7 billion euros in the first month of 2012. Therefore, from December 2008 to January 2012 the public sector's foreign debt grew by a full 64%. True, at the monthly level it was reduced by a negligible 0.7% as the result of the return of certain due obligations and a short lull prior to the mass borrowing in February and March. Therefore, the regularity of the trend of the state's galloping borrowing for the purpose of filling the holes in the budget, true with also the conclusion of credit arrangements for the purpose of building infrastructure facilities, will remain a characteristic of this business year as well, which, in conditions of the declining economic dynamics, will bring Serbia to the door of the Greek scenario, placing it among highly indebted countries, which will not be able to service its obligations on its own, upon the sale of the remaining state "silver". For this reason, one should expect with certainty a new arrangement with the IMF which, through the badly needed reforms in the public sector, should bring the country economic stability on a long term basis. Contrary to the dynamics of the public foreign debt, the foreign debt of the private sector, which reached 13.6 billion euros at the end of January 2012, was 2.6% higher than a month earlier, but it was smaller by a full 6.3% than in 2008. This indicates that it is primarily the public sector that initiated the galloping pace of Serbia's borrowing. Thus, the share of the public sector in Serbia's total foreign debt grew from 30.9% in 2008 to 43.9% in January 2012, with a tendency of the further increase in its share, because Serbia additionally borrowed from foreign creditors at the end of February, only on the basis of the ratification of the agreement on crediting and the issuing of guarantees at the republican parliament for around 1.3 billion euros, pushing the total foreign debt to around 25.6 billion euros. On the other hand, the share of the public sector in Serbia's total foreign debt was reduced from 69.1% in 2008 to 56.1% in the first months of 2012.**

Foreign debt according to the type of debtor

\- in millions of euro –

	Period		
	31. 12. 2008	31. 12. 2011	1. 1. 2012
Public sector	6,520.7	10,773.3	10,693.8
Private sector	14,567.7	13,352.1	13,644.2
Total	**21,088.4**	**24,125.4**	**24,338.0**

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

It is quite certain that the new government of the Republic of Serbia will have to conclude a stand by arrangement with the IMF so as to receive support for the serious implementation of reform processes, without which it would quite certainly downgrade its credit rating and reach the verge of bankruptcy;

- **At the end of February 2012, the Republic of Serbia's total foreign currency reserves were around 11.9 billion euros and they were smaller by 3.5% compared to January this year, and by as much as 7.3% relative to**

December last year. In this regard, the foreign currency reserves in the central bank's portfolio were around 11.175 billion euros, which was 3.7% less at the monthly level, i.e. 7.3% less than at the end of 2011. The foreign currency reserves of commercial banks dropped from 809 million euros in December 2011 and 762 million euros in January, to 752 million euros in February 2012. However, as commercial banks have a small share in the creation of the total foreign currency reserves, the predominantly negative dynamics in the trends of the NBS foreign currency reserves also determined the overall negative dynamics of Serbia's foreign currency reserves.

Foreign currency reserves

- in mill. 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**
February	11,174.6	752.0	**11,926.6**

Source: NBS data

The drop in the NBS foreign currency reserves and, therefore, also of the total foreign currency reserves, was the result of a wrong economic policy based on excessive public spending and the further expansion of the public sector, which burdened business operations and the little of the healthy tissue in the real sector that was left, so in conditions of reduced income, and increased expenditures from the state budget, what was resorted to was the sale of state securities, which partly fell due in February in the amount of 204.2 million euros. Furthermore, based on interventions by the NBS on the inter-bank market for the purpose of calming down the depreciation of the domestic currency, an outpour of foreign currency in the amount of 188.5 million euros was registered.

Until a new arrangement with the IMF is concluded, the investors' mistrust of the Serbian market will continue to grow, producing instabilities on the financial market and raising the temperature in the form of the domestic currency's depreciation and inflationary trends in the country. It will be possible to keep this fever under control for a short period of time with direct interventions on the market or the possible tightening of the restrictive course in conducting the credit and monetary policy. However, it is only with the treatment of the causes of the economic crisis which Serbia is in, that it will be possible fully to stabilize both the exchange rate and the prices, i.e. to lower the temperature to the normal point. And these causes are causes lie in the non-transformed public sector, insufficient investments in the real sector and excessive fiscal burdens of the economy;

- **After the appreciation of the dinar against the euro in 2011 (at the end of 2010 the euro was worth 105.5 dinars, at the end of 2011 it was 104.64 dinars), without this being a deserved improvement of the export performances of the domestic economy, but primarily through the sale of lucrative securities, in 2012 such a monetary policy, along with an irresponsible fiscal policy came to collect its toll, which is illustrated by the depreciation of the domestic currency. Thus, at the end of February 2012, the euro was worth 110.19 dinars and it appreciated by 3.9% in nominal terms, i.e. by 3.1% in real terms against the euro. Compared to December 2011, the domestic currency depreciated by 5.3% in nominal terms or by 4.4% in real terms.**

In March, the further sliding of the domestic currency continued, indicating that the government’s avoiding to face the key economic challenges during its term-in-office and the lost time obtained on the basis of the stand by arrangement with the IMF at the very start of this government’s tenure, brought to the surface all the bitter fruits of the work of the present economic policy creators, which is embodied, in the form of a fever, by the dinar’s exchange rate. Furthermore, one should also bear in mind the fact that, in the first two months of this year, there was a considerable drop in export activities, which is, again, the result not only of the drop in the foreign demand, but also of the non-transformed public sector and the lack of investments in Serbia’s real sector.

Exchange rate trends

	EUR value against the dinar
Year 2010	
December	105.50
Year 2011	
December	104.64
Year 2012	
January	106.06
February	110.19

Source: NBS data

Therefore, the exchange rate represents only a signal of the developments in the economy and the depreciation of the dinar will be a problem as long as we have poor production and export performances, i.e. while we have excessive public spending. A sustainable stabilization of the dinar on a long-term basis would also mean the improvement of the economic situation in the country and would, therefore, lower the temperature which is currently shaking the domestic currency in the form of a fever. Therefore, the dinar's exchange rate is only reflecting the metastasis in the domestic economy and only serious cuts on these metastases can pull the domestic currency out of the crisis it is in.

(to be continued)