

PUBLIC PANEL DISCUSSION

**THE FINANCIAL CRISIS IN CENTRAL, EASTERN AND
SOUTHEASTERN EUROPE:
WHAT IS TO BE DONE?**

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THE CASE OF SERBIA

Vienna, March 26th, 2008

Impact of the crisis in Serbia

- ❑ Recession ... GDP will decrease in 2009, ... -2%?
...from 6 to 7% growth

- ❑ Trade deficit sharply contracts ... by 50% in January;
2008: 23% BDP-a to 17% BDP 2009?

- ❑ Current account from 2008: 6 billion euros (17.5% GDP) to 3.5 –
4 billion euros (13% GDP) in 2009?
- ❑ Additional: foreign debt servicing 4 billion euros ... inflow needed
8 billion euros

Impact ...

☐ **Fortunately flexible exchange rate:**

- ☐ 23% nominal depreciation October – February/March
- ☐ Real depreciation app. 17%
- ☐ Pass-through from exchange rate depreciation to inflation small: 18%

☐ **Inflation although present will be under control:**

- ☐ CPI large in January (2,4%) and February (1,3%) ... change in administrative prices
- ☐ Core below 1% monthly
- ☐ Targeted CPI 8 to 10%, expected 10 to 12%

Impact ...

- ❑ Crisis hit Serbia through sharp drop in aggregate demand

Aggregate demand in Serbia

y-o-y growth rates

	2008 Q3	2008 Q4	Contribution
Total	7.6%	0.3%	100%
Domestic	6.2%	0.1%	67%
Export	13.2%	1.2%	33%

- ❑ Drop in domestic demand is dominant

Impact ...

- ❑ Credit has halted causing drop in domestic demand

New loans, quarterly: million euros

	2008 Q1	Q2	Q3	Q4
Total	1 333	1 624	2 210	287
Domestic sources	614	789	1193	-29
Cross-border	719	835	1017	316

- ❑ Domestic sources ... Fx deposit withdrawal from banks upon crisis eruption
Recapitalization of banks has halted
- ❑ Cross-border ... Global financial crisis

Policy responses: Fiscal policy

- ❑ Unintended expansion in Q4: deficit 6.5% GDP
- ❑ Looking backward ... election promises: pensions up, additional 1.2% GDP in 2009
- ❑ Drop in revenues due to crisis

Fiscal policy

- ❑ Serbia entered crisis with 2% GDP structural fiscal deficit: 2006 – 2008 pro-cyclical fiscal policy ... tax rates down, expenditure up
- ❑ Hit by the crisis ... deficit 5 to 6% GDP in 2009, hence adjustments needed: 2 to 3% of GDP
- ❑ Target 3% GDP deficit, ... plus 0.5% (repaying debt to households) total fiscal stimulus 3.5% GDP

Fiscal Adjustment – IMF

- ❑ Expenditure ‘predetermined’: large items pensions and wages in public sector cannot be decreased ... other items already low
- ❑ Therefore increase taxes
 - ❑ On wages ... easy to collect
 - ❑ Also on pensions
- ❑ Nominal wage freeze in public sector: government, education, health
But also in public enterprises
- ❑ Still not enough

Financing fiscal deficit

- ❑ 3% GDP just below 1 billion euros
... servicing public debt 0.5 billion euros ... 1.5 billion euros needed

- ❑ Should come from foreign sources to:
 - ❑ Avoid crowding out private sector
 - ❑ To cover part of current account deficit

Debt

- ❑ Debt by the end of 2008 looks sustainable:
 - ❑ Foreign debt 65% GDP ...
 - ❑ Private debt 46%

- ❑ Public debt, foreign and domestic app. 25% GDP

- ❑ But in 2009 might become large: debt up, GDP in euro terms down ...
 - ❑ Foreign debt 82% of GDP?
 - ❑ Public debt 31% GDP?

Monetary policy: issues

- ❑ Deeper depreciation should be allowed for... to switch from over CAD of 15% GDP to below 10% in medium term ...
 - ❑ opportunity to hit the 'right' lower value of dinar in medium term ... improve tradable sector
 - ❑ also expansionary ...
 - ❑ vs. FX indexed credits

- ❑ Central bank interest rate turned to be ineffective defense of currency in turbulent times: 17.75% interest in dinars forgone for 2% in euros (December 2008)

- ❑ Current CB interest rate 16.5%, expected inflation 10-12%, recession: should monetary policy be relaxed?