Living with or without the Euro in times of crisis

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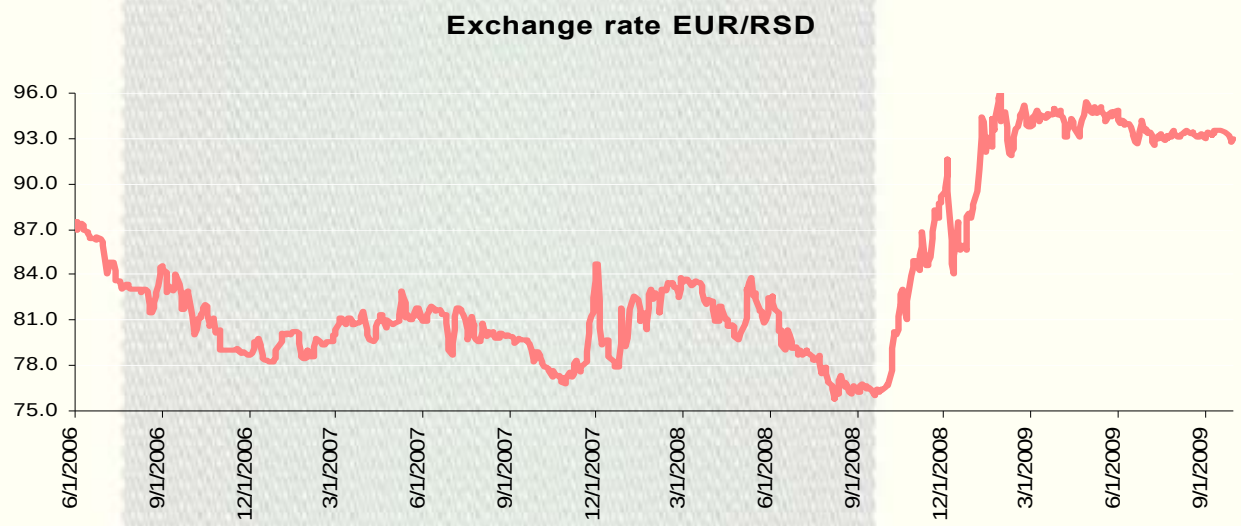
Serbia is practically living with Euro, although officially without Euro

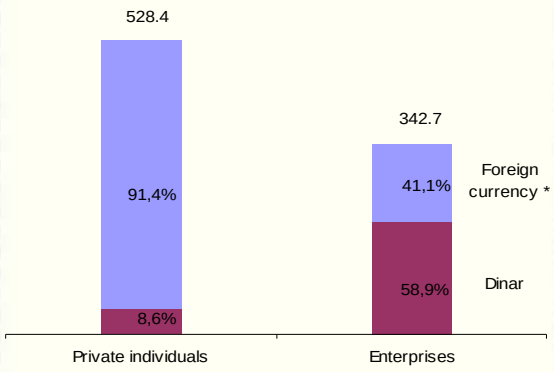
- What does a Serb do if she/he has no more dinars? - She/He changes 100 Euros !
- Citizens of Serbia are
  - *saving in FX* due to traditionally higher level of inflation and several depreciations in the past but also,
  - *taking loans in FX* as they perceive such loans “cheaper”.
- Despite high RSD rates (up to 25% p.a.) and appreciation in the period of mid 2006 - september 2008, neither changed the structure of deposits nor the structure of loans;
- It is easier to convince investors in London, Frankfurt or Vienna to trust the RSD than the average citizen of Serbia who learns fast but forgets very slowly;
- Main source of RSD funding are companies i.e. short term funds mainly;
- Governments treat FX loans the same way as private individuals – lower interest rate = cheaper loan!

Substantial exchange rate floatation neither changed the currency structure of deposits, …



Deposits (in %)	Private individuals		Enterprises	
	FX	Dinar	FX	Dinar
2006	90.7	9.3	40.9	59.1
2007	91.0	9.0	43.3	56.7
2008	90.6	9.4	52.4	47.6
Sep 2009	91.4	8.6	50.4	49.6

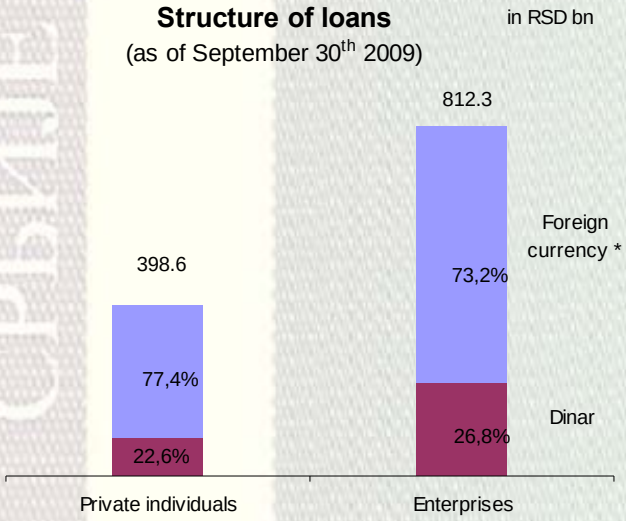
Structure of deposits
(as of September 30th 2009)



* thereof in EUR 95% (for private individuals) and 93% (for enterprises)

… nor the currency structure of loans during the last 3 years!

Structure of loans
(as of September 30th 2009)

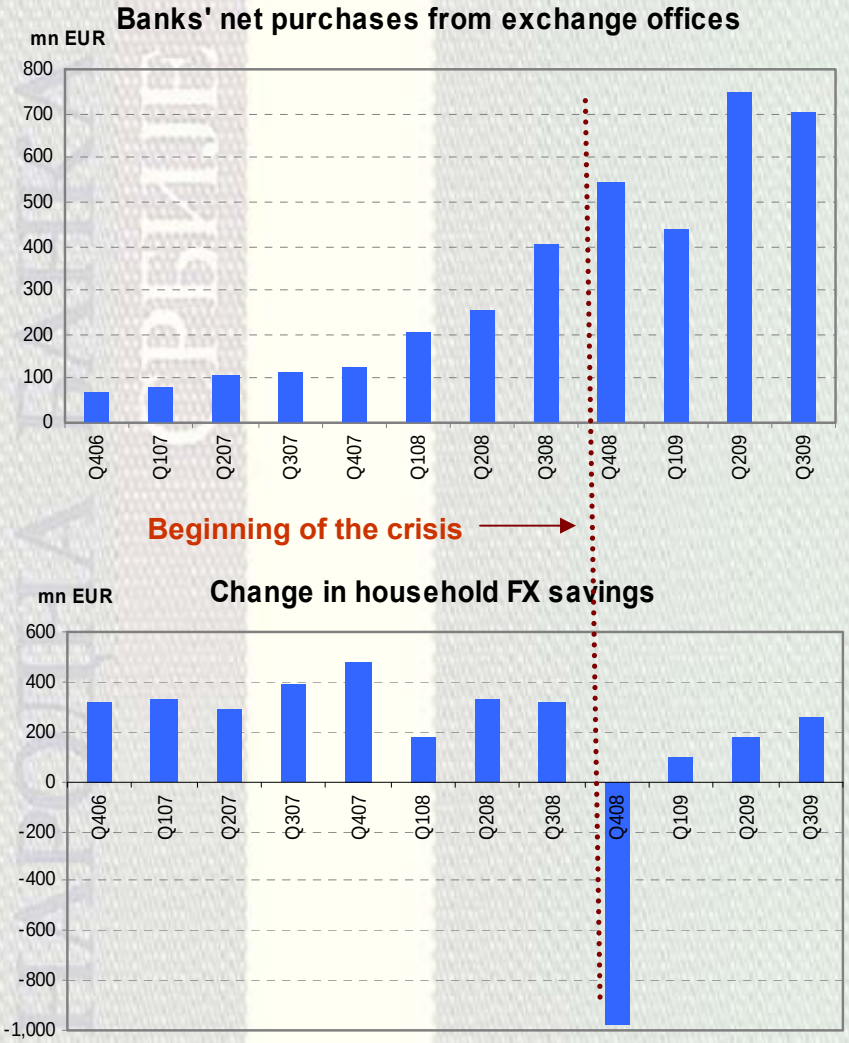


* thereof in EUR 52% (for private entities) and 58% (for enterprises)

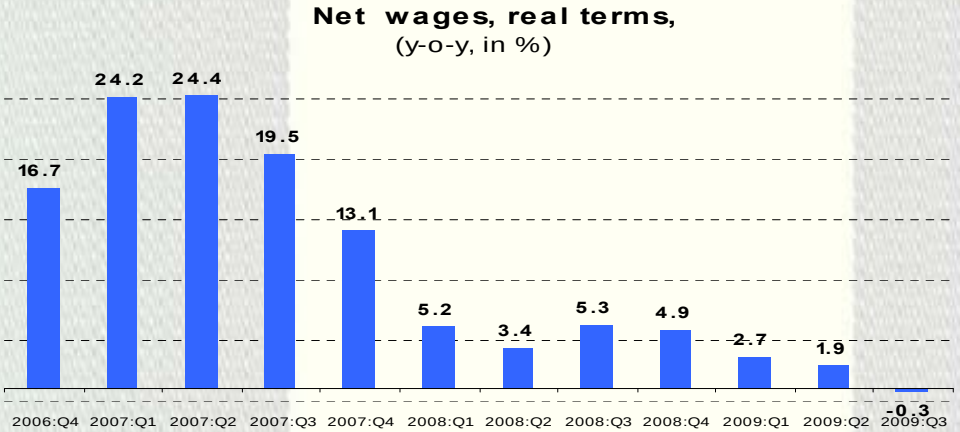
Loans (in %)	Private individuals		Enterprises	
	FX	Dinar	FX	Dinar
2006	78.0	22.0	67.1	32.9
2007	81.1	18.9	61.5	38.5
2008	78.2	21.8	62.1	37.9
Sep 2009	77.4	22.6	73.2	26.8

- Despite the almost 20% depreciation during the last 12 months, the companies are taking even more FX than RSD denominated loans! Main reason: the government provides interest rate subsidies for liquidity loans up to 12 months in FX!!!

Withdrawn deposits from the banks were at the end sold to the commercial banks by the exchange offices!



- Since the beginning of the crisis, banks have reported record purchases from exchange offices - people exchanged a part of their withdrawn savings.
- Lower net real wages are also contributing to lower increase of household savings, although banks are purchasing a record amount of FX from the exchange offices (mattress money!)

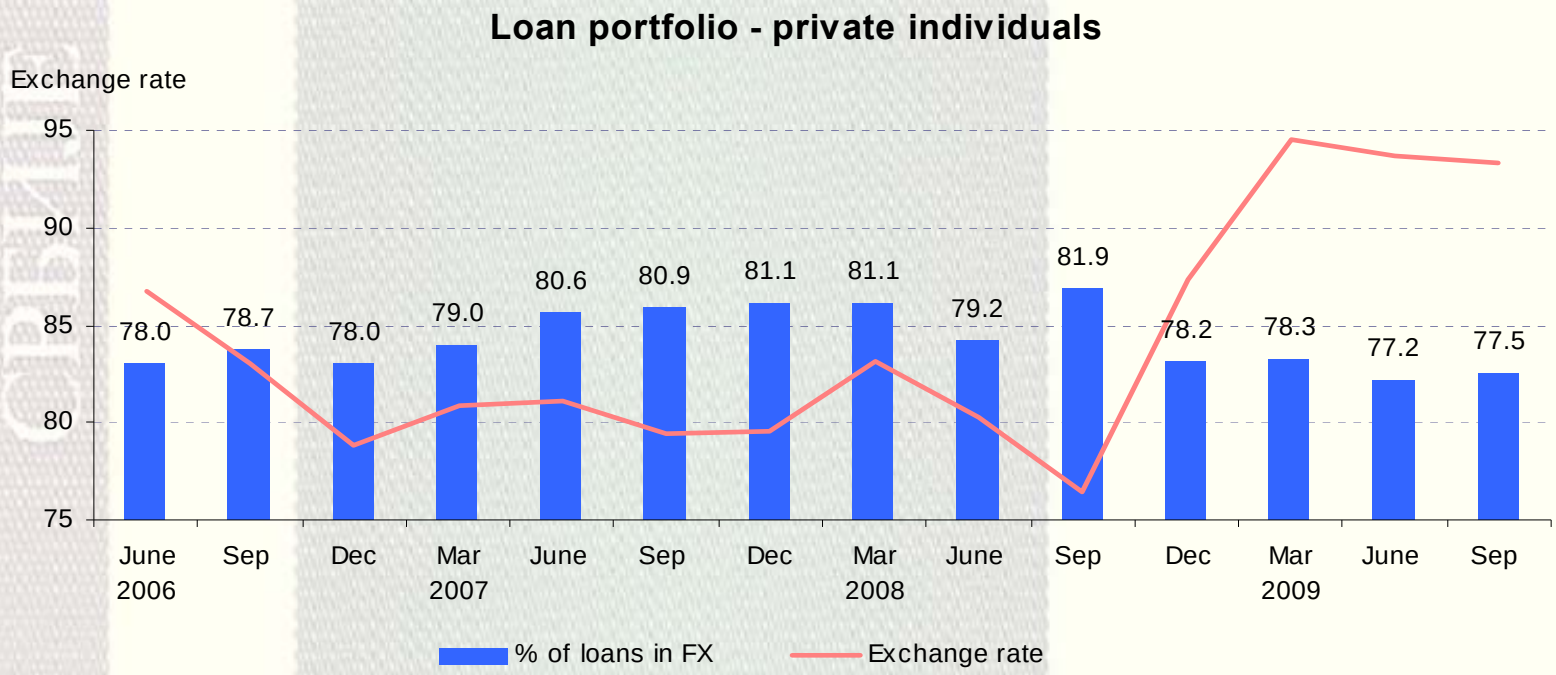


High level of euroisation & floating exchange rate (?!) determined our monetary and financial sector supervisory policy

Despite high level of euroisation, depreciation during the crisis did not affect our banking system because of pre-crisis restrictive monetary and supervisory policy (as of 30.9.2008):

- High capital adequacy ratio of 23.3% mainly due to the supervisory limit regarding consumer loans – main solvency buffer;
- High and differentiated FX reserve requirements (FX 40-45% while for RSD 5-10%);
- High NBS repo - EUR 3.2bn that provided a key liquidity buffer against the crisis;
- Additional capital requirements for unhedged borrowers (125%), limits on private borrowing to 50% of monthly disposable income, higher CAR for banks with strong loan portfolio growth etc.
- 75% of banks owned by strategic owners from the EU, 20% owned by the state and only 5% owned by local private shareholders!
- Consumer protection (consumer hot line, educational materials, code of conduct, public warnings etc.)

Under the conditions of low percentage of domestic currency savings banks have no alternatives but to lend in FX



- There is some decrease in the loan portfolio of private individuals as an impact of the depreciation, but how long will it last?
- How can banks provide dinar loans based on FX deposits?

Lessons of the crisis as of today …

1. Central banks in the highly euroized countries as a LOLR need to provide support not only in local currency but FX as well – IMF is playing key role for non-EU members while EU members can count with the support of Brussels as well;
2. Fiscal policy adjustment in the case of crises as we were facing recently is a) politically very unpopular and with a b) financially limited domain! Is the helping hand of the exchange rate policy necessary?
3. Natural boarder of floating is where the stability of the banking sector starts to be endangered;
4. Governments are slow in undertaking the necessary correction. In the case that governments are against the IMF program central banks can do nothing against it.
5. Higher CAR can be achieved by lowering the size of the balance sheet too! …

… and unanswered questions

1. Could the time after the crises be used to lower the level of euroization?
2. Will central banks get more support in implementing contercyclical and deeuroization measaures in the area of monetary and supervisory policy as before? Will it be supported by some legislation as well?
3. Did governments learn how expensive could be FX loans in the case of currency turbulances and what will they do in ordert to minimize them?
4. Will ECB be ready to provide a stronger helping to the (non) EU members when the next currency crises strikes?
5. Will some governments but also central banks use the crises to get their house in order or just demand even a faster implementation of Euro as a legal tender?