IMPACT OF THE ECONOMIC CRISIS ON THE SERBIAN ECONOMY WITH THE SPECIAL REFERENCE TO BANKING SECTOR PERFORMANCES AND EXTERNAL STABILITY[1]

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Abstract

This paper studies the impact of the world economic crisis on the Serbian economy with a special reference to banking sector and external economic (in)stability. Primary goal of the paper was to test to how much extent was Serbian external economic stability jeopardized by the global economic meltdown and what might be consequences of the apparent external imbalance. Additionally, we tried to examine what are the effects of the crisis on banking sector in the context of potential future instability. Our analysis brought us to conclude that the external imbalances have just become more visible in the crisis period. The real reason for these imbalances was actually inadequate growth model led by the policy makers, based on consumption and unstable inflows of foreign capital. On the other hand, during the crisis period, banking sector have shown quite solid performances while its stagnation was just a consequence of the real sector slowdown. Our conclusion is that banking sector was professionally led, highly capitalized and shall not be a trigger for some future crisis. According to the performed analysis, Serbia needs dramatically different economic growth model in the future, mainly export oriented and with a more strict external borrowing policy.

Key words*: Crisis, external position, FDI, Banking sector, Serbia*

INTRODUCTION

The economic crisis that affected developed and undeveloped economies has imposed numerous issues for policy makers and macro-economists. In period 2008 -2012, almost all SEE countries were punished (by market) due to high debt and licentious expenditure, while they had stagnation and decline of the real sector. This common feature is particularly the case for Serbian economy too.

In Serbia, a country in transition, macroeconomic trends were primarily affected by delayed and accumulated transition problems. We summarized the main negative effects of the global economic crisis on the Serbian economy: the decline in foreign demand and a fall in exports, decline in total and especially industrial production, decrease of the growth rate of GDP, and its movement towards negative values, unemployment increasing, capital withdrawal from commercial banks in foreign ownership, and reduced credit placements in productive activities; decline of FDI inflows and low short-term perspective for their growth, the growth of trade deficit and balance of payments, and total debt to foreign countries, further decline in aggregate demand and increase of the entire economy illiquidity.

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In addition to the global recession negative impacts, Serbia has accumulated economic problems which represent particular challenge for policy makers. Aiming to detect main weaknesses of the Serbian economy and trying to find an adequate response to the current economic crisis in Serbia, we have analysed mechanisms by which crisis transmitted to the real sector of the economy. Our special focus was on external position and banking sector. As it will be shown in the rest of the paper we are of the opinion that structure of the economy affected Balance of Payments deficit in the period of growth while dynamic rise of external borrowing seems unsustainable source of capital in a long term. On the other hand, banking sector have shown quite solid performances proving to be relatively stable in turbulent period.

EXTERNAL POSITION

In this chapter we will analyse the effects of global financial crisis on the Serbian external position, more precisely balance of payments, external debt, foreign direct investments as well as structure of export and import. Republic of Serbia achieved economic growth in the period 2002-2008 which is quite respectable amounting to 4.9% in average. However, despite of the recorded results, we argue that the growth model of the Serbian economy is at least questionable in the sense of sustainability since it is primarily consumption based and dependent on the limited capital inflows. Privatization revenues, foreign financial support and extensive foreign direct investments influenced strengthening of domestic demand in the first years of transition. Unfortunately, strengthening of domestic demand, in the situation of vulnerable and undeveloped domestic industry in line with the processes of liberalization, resulted in serious balance of payment deterioration. External position indicators are probably the best illustration to prove the Serbian growth model unsustainability and argument for the necessity of economic policy redesign in the future period. In that context, crisis could be analysed just as an external shock which have only shown main weaknesses of the Serbian economy. The growth model that had been implemented over the past few years in Southeast Europe, combined with the institutional weaknesses, had left the region vulnerable to external shocks in several respects[5].

Balance of Payments

First of all, it could be noticed that growth rates in the pre-crisis period has moderate negative correlation[6] with the balance of payment (BoP) measured by share of BoP deficit in GDP. Theoretical arguments for running such a high deficit as a tool for „catching up“ processes are not theoretically confirmed. Moreover, some economists even proved the opposite. Scheide (1990.) argued that prediction by which poor countries catch up in the course of time and that this process is made possible by capital from abroad is at variance with the data: *Low-income countries tend to borrow more but they do not grow faster*[7].

We are aware of the fact that more strict policy would result in lower living standard in the short term but there is also lack of consistent and systematic approach to reduce this misbalance in almost 12 years of transition. Such an imbalance is becoming potential threat for the macroeconomic stability in the long term since potential capital inflows are quite limited. Privatization process is almost over, while external debt exceeded 80% of GDP so far, which is relatively high having in mind level of development and the country’s reputation. Foreign direct investments were also modest in the previous years, partly as a consequence of global crisis and their future inflow will mainly depend on economic recovery in the EU and the region but also on the Government ability to create better business

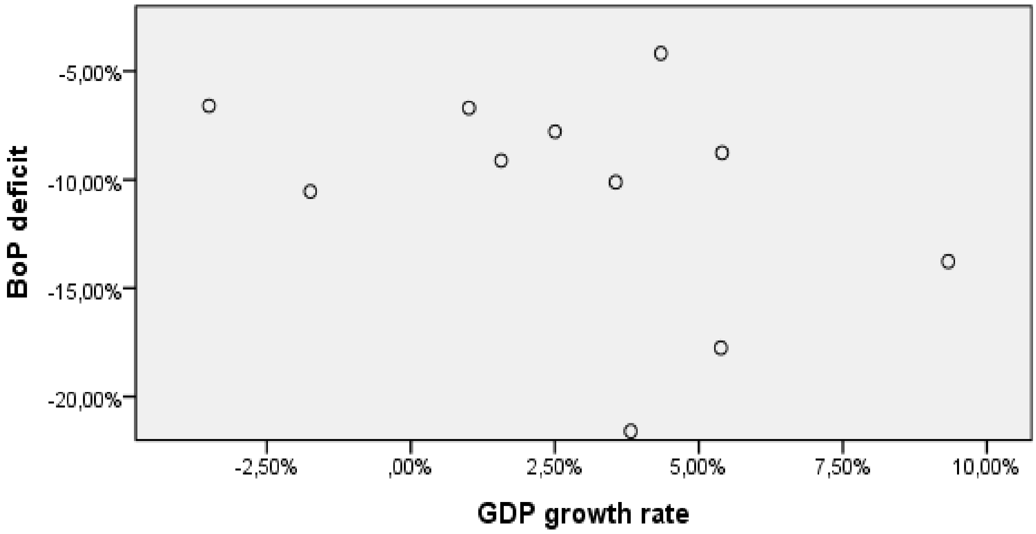
[5] Panagiotu, R., (2012.), EUI Working papers, RSCAS 2012/64, The Impact of the Economic Crisis on the Western Balkans and their EU Accession Prospects,

[6] Pearson coefficient of correlation is -0,384

[7] Scheide, J. (1990), The net external asset position and economic growth : some simple correlations for 116 countries, Kiel Working Papers, No. 427

environment. We may say that the global crisis impact helped Serbian economy weaknesses just to become more visible.

Figure 1. Correlation BoP deficit and between GDP growth



Source: Author's calculation according to the National Bank of Serbia data

Table 1. Balance of Payment structure of the Republic of Serbia in the period 2008-2012 (in mln EUR)

Position/Year	**2008**	**2009**	**2010**	**2011**	**2012**
I. Current Account	-7.054	-1.910	-1.887	-2.870	-3.155
Balance of goods and services	-8.686	-4.926	-4.573	-5.155	-5.297
Income	-922	-502	-670	-758	-798
Current transfers	2.554	3.518	3.356	3.043	2.941
II. Capital Account	13	2	1	-3	-11
III. Financial Account	7.133	2.033	1.819	2.694	2.883
a. Direct Investments	1.824,4	1.372,5	860,1	1.826,9	231,9
b. Portfolio Investments	-90,9	-51,0	38,8	1.619,1	1.665,9
c. Other Investments	3.713,2	3.074,6	-9,1	1.049,2	-151,7
d. Reserves	1.686,6	-2.363,5	928,7	-1.801,5	1.137,2
IV. Net errors and omissions	-92	-124	68	179	283

Source: National Bank of Serbia

When it comes to the structure of the external imbalance, the largest portion of deficit is consequence of current account deficit showing a huge gap between ability to sell in the foreign markets and imported goods and services. Due to slowdown of economic activity and international demand decrease, this gap was reduced in the first years of crisis. Current account deficit in 2008 amounted to 21,6%, significantly higher comparing to 2009 and 2010 when it was about 6,6% and 6,7% respectively.

Export and import trends

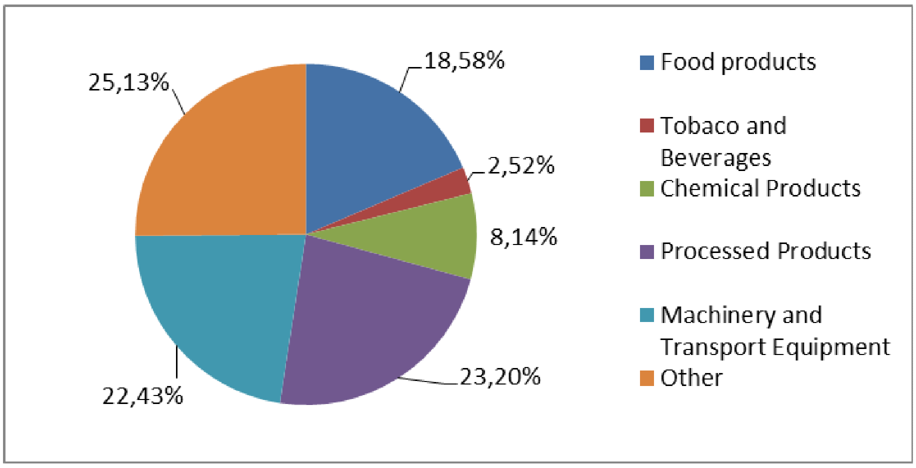
According to the relevant data, it could be seen that Serbian export experienced strong decline only in 2009, when total export lowered for about 20% in nominal terms comparing to 2008. It is a direct consequence of global economic slowdown, especially in the EU area. After that period, export had rising trend, amounting to almost 9 bln EUR in 2012. Export share of particular markets did not change a lot. It could be seen that lower export in 2009 is related to the lower share of EU 28 in total export. Serbia is dominantly dependant to the EU 28 countries when it comes to the export orientation. Every economic slowdown in the EU area is potential threat to the Serbian export potentials. However, CIS market export share has upward trend both in nominal and real terms. Total value of exports to the CIS almost doubled in the period 2007-2012 amounting to 880 mln EUR in 2012 which is almost 10% of total export. Apart from necessity to regain the export in the EU, it would be of special importance for Serbian economy to strengthen regional cooperation. In that context, very indicative are analyses which stress that the crisis negatively affected the region's trade with the EU more than intraregional trade in the Western Balkans (Bjelić et al)[8].

Table 2. Export Value and Export Share of Particular markets

Year	Total Export Value in ths EUR	EU 28 share	CEFTA	CIS	Other
2007	6.433	60%	28%	7%	5%
2008	7.429	58%	29%	7%	5%
2009	5.961	57%	28%	7%	8%
2010	7.393	60%	26%	8%	6%
2011	8.441	62%	23%	9%	6%
2012	8.837	62%	22%	10%	7%

Source: National Bank of Serbia

Figure 2. Structure of the Serbian Export in 2012 (in % of total export)



Source: Author's calculation based on NBS data

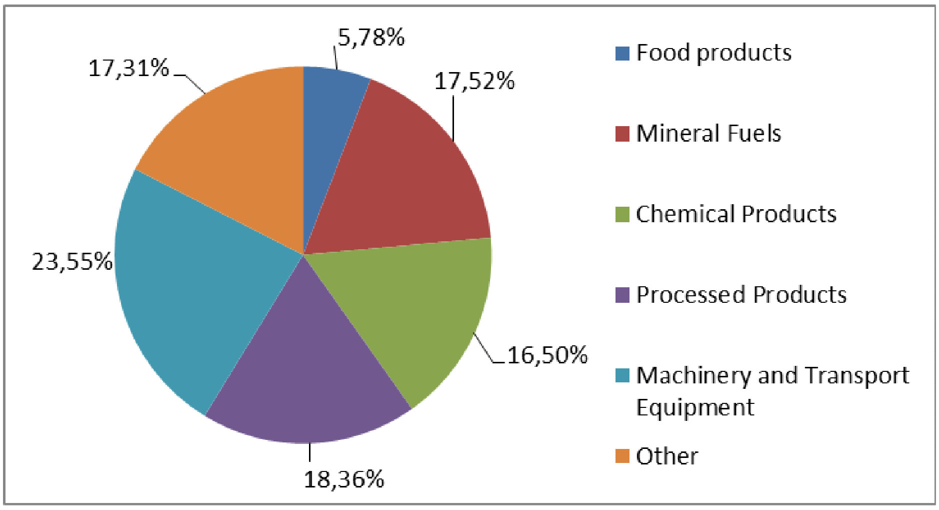
Export structure is showing particular strengths of the Serbian economy and the recent years have shown that some sectors are less vulnerable to the global economic shocks than others. For example, food industry, tobacco and drinks as well as machines and transport equipment are sectors which

[8] Bjelić, P. et. al., (2013.), Effects of The World Economic Crisis on Exports in the CEEC: Focus On The Western Balkans, ECONOMIC ANNALS, Volume LVIII, No. 196

recorded continuous rise in the recent years despite relatively unfavourable conditions at the international market. Aforementioned three sectors recorded export share in 2012 of almost 44% of the total export.

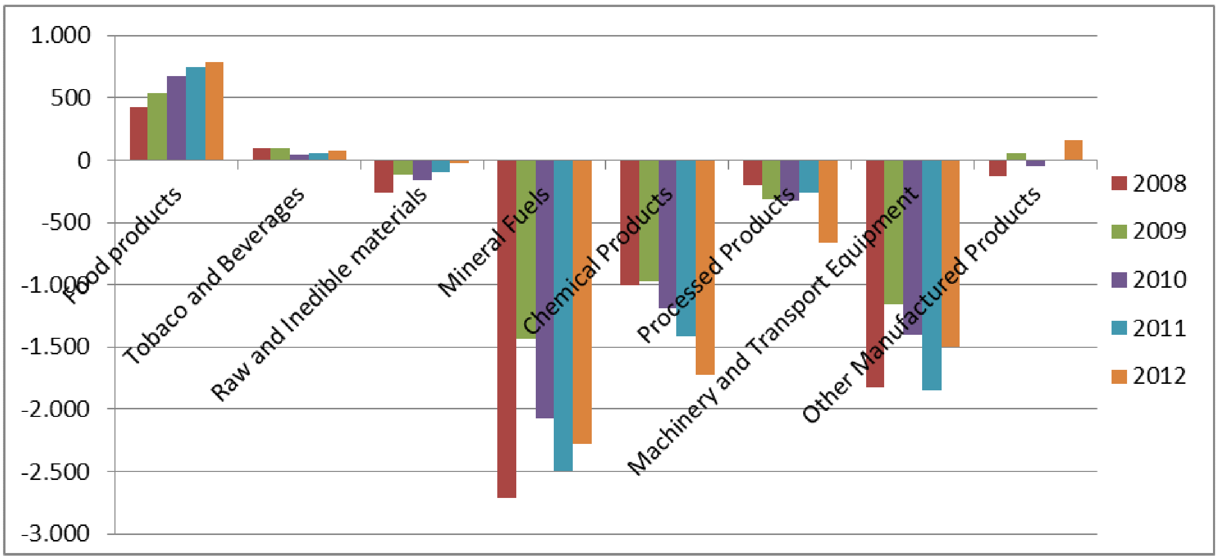
Import is still high in the industry of mineral fuels, chemical industry as well as machinery and transport equipment. Mineral fuels import is quite understandable since Serbia is, as most of the countries, energy dependant, as well as the import of machinery and infrastructure which should be considered as an investment. On the other hand, increasing import of processed products is showing that Serbian economy needs to invest more in order to strengthen its own industry.

Figure 3. Structure of the Serbian import in 2012 (in % of total import)



Source: Author's calculation based on NBS data

Figure 4. Serbian trade balance by sectors (in mln EUR)



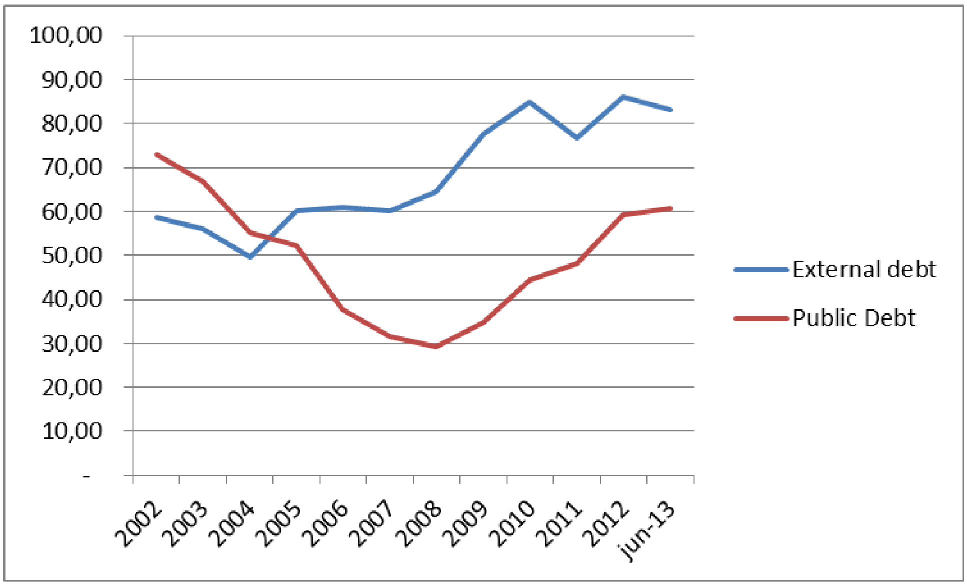
Source: Author's calculation based on NBS data

Only in two sectors Serbia has recorded trade suficit. Food industry had 787 mln EUR surplus while drink and tobaco sector recorded surplus in the amount of 79 mln EUR. Trade suficit of the food industry doubled in the period 2008-2012, while the industry of tobaco and beverages has recovered after serious decline in 2009. However, sectors which are considered to have high value added such as machines, chemicals and processed products recorded serious trade deficits. Chemical products trade gap was growing in the period 2008-2012 amounting to 1,7 bln EUR in 2012. Also, Serbia is net importer of mineral fuels and machinery and transport equipment in the amount of 2,3 and 1,5 bln EUR respectively.

External debt

Global financial crisis has had dramatic effects on stability of public finances. In the period 2002-2008, when country was achieving quite solid growth rates, public and external debt rose in absolute figures but recorded decrease relative to GDP. Therefore, in 2008, Serbia had public debt on the level of 29,2% and the gross external debt on the level of 64,6% of GDP. In the following years both figures recorded dynamic rise imposing question of their sustainability in the future period. Public debt reached the level of 60% of GDP, which is value significantly higher than 45% required by the Law on Fiscal Responsibility and also 60% which is one of the condition defined by Maastrciht Criteria. Government and IMF projections were significantly lower, while some author's calculations were much closer but also failed to predict relatively inert behaviour of the Serbian Government in the context of necessity of public savings[9]. When considering external solvency we could say that current results should be recognized as a final warning for policy makers. External debt level reached 80% of GDP in 2012. Also, external debt repayment dynamics is having continously growing trend. In 2013, Serbia should repay more than 4 bln EUR of external debt which is more than 15% of total GDP[10].

Figure 5. External and public debt trends in the period 2002-2013. (in % GDP)



Source: National Bank of Serbia

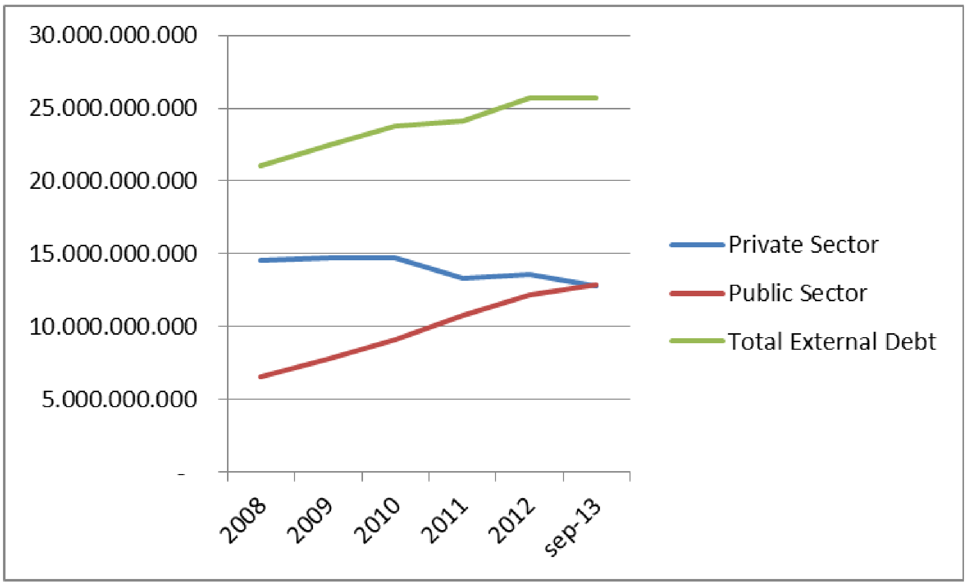
Presented figure made us to draw two very important conclusions. First, we could see that in the first years of transition public and external debt had the opposite directions. Public debt had decreasing trend since country's growth rates were higher than Central Government needs to finance fiscal deficits. On the other hand, due to private sector borrowing, external debt was stagnating or even had a slight rise. Second, when the first wave of the crisis hit Serbian economy public debt started to rise enormously, pushing external debt to rise too. It is evident that the external debt rise in the period before and after the crisis has completely different nature. First rise was modest, coming as a result of

[9] See Zdravkovic, A., Bradic, A., (2012.), Public Debt Sustainability in Western Balkan Countries, European Integration Process in Western Balkan Countries, 2012, vol. 1, pp 472-492. Institute of Economic Sciences

[10] http://www.nbs.rs/internet/cirilica/90/dug/index.html

private sector borrowing in the period of economic prosperity, while second one was rather sharp and may seriously undermine confidence in our economy in the international financial markets. The following figure could be a good illustration of the aforementioned. In the period 2008-2013, public share of external debt almost doubled amounting to 12,9 bln EUR as of September 2013. External debt increase in that period was only the consequence of the public sector rise since private sector reacted on crisis in a quite rational way, by decreasing costs and repayment of debts. Rise of private external debt would be the only reliable signal of potential economic recovery.

Figure 6. Public and private external debt movements in the period 2008-2013



Source: Author's calculation according to the NBS data

Foreign direct investment

The global economic crisis drastically jeopardized the capacity of the economy concerning new investments, both investments in developed countries and countries in transition. In these circumstances, investors are becoming more conservative, avoiding to invest in developing markets. A decrease in the inflow of foreign direct investment (FDI) is one of the negative economic effects of the global financial crisis that struck the Serbian economy. Given that Serbia has chosen the concept of transitional development based on attracting FDI and their potentially developmental impact, reducing the inflow of FDI is set to be a serious threat to the unimpeded growth and development within the process of transitional change.

Table 3. Net foreign direct investments 2008-2012

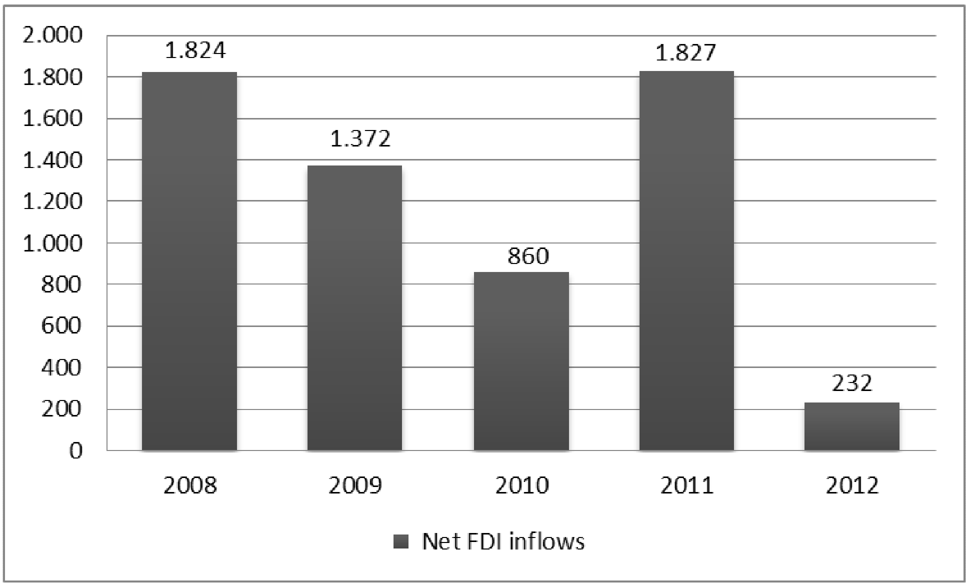
Years	In mil EUR	% of GDP	FDI per capita in EUR
2008	1824,4	5,6	248
2009	1372,5	4,7	187
2010	860,1	3,1	118
2011	1826,9	5,8	252
2012	231,9	0,8	32

Source: Calculated on the basis of the statistics of the NBS

The level and dynamics of foreign direct investment from 2008 to 2012 were quite uneven. These trends were influenced by internal and external factors. When it comes to internal factors, the first place goes to the economic and political instability and inefficiency of state institutions. A key external factor is certainly the impact of the global financial crisis that has hit the entire world, especially the European countries that have been the key investors in Serbia in recent years.

In the period from 2008 to 2012, the total inflow of FDI in Serbia amounted to 6115.8 million. When we take a look at the each year separately, the lowest net inflow of FDI, only 231.9 million, was recorded in 2012, while the largest net inflow of FDI in Serbia was in 2011 and it amounted to 1827.0 million EUR. If the gross inflow of FDI in 2012 was close to 2 billion EUR, the main reason for this poor result is a large outflow of FDI, especially in the financial sector. Since the outbreak of the global financial crisis, with the exception of 2011, there is a downward trend in the net inflow of FDI. The total decline in net FDI inflows in 2012, when compared to 2008 when the crisis had began, was 1592.5 million EUR or 87.3%. The decline would have happened in 2011 if there weren't for a large investment by the Belgian supermarket chain Delhaize who bought the Serbian retail chain Delta Maxi.

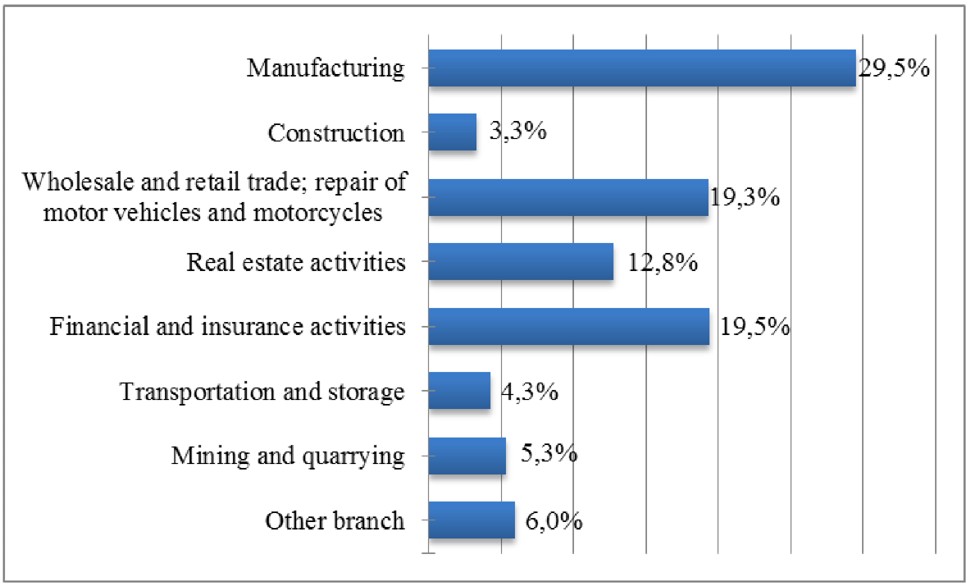
Figure 7. Net foreign direct investments 2008-2012, in mil EUR



Source: NBS

When we take a look at the specific sectors, in the period from 2008 to 2012 the largest FDI inflow was recorded in the manufacturing sector of 2,803.7 million EUR which makes 29.5% of all FDI inflows. The second and third place for FDI inflows during this period are taken by the Financial and insurance activities and Wholesale and retail trade, repair of motor vehicles and motorcycles with 1,849,8 million EUR, i.e. 1,837.7 million EUR inflow. They are followed by Real estate activities with 1,218.9 million EUR, Mining and quarrying with 504.8 million euros, Transportation and Storage 410.9 million and Construction 312.6 million. The 7 activities together accounted for 94.0% of the total inflow of FDI during this period.

Figure 8. FDI in Serbia by branch of activity, 2008-2012, share in %



Source: NBS

The fact that during the great economic crisis some of the largest names from various economic activities came to Serbia, surely gives hope and encouragement for all of us. Concerning FDI, Serbia went through the critical period much better than other countries in the region, having succeeded to attract the most FDI. That tells us that there is a space for further investments, but there are still important obstacles that investors pointed out. In the first place, it is necessary to continue to work on reduction of administrative barriers and thereby reduction of the investment and business costs. In times of crisis, it is necessary to ensure the economic stability of the country using a severe control of public spending and ending the economic reforms, and those more painful should be the priority of the government. Free trade agreements, such as the agreement with Russia, certainly present an important asset that Serbia has in attracting foreign investment in comparison to other countries.

Further inflow of FDI will depend on reducing domestic fiscal imbalances and getting the support of international partners. The current system of incentives has given good results in attracting investment, but in the future more emphasis should be placed on improving the business environment. Completion of the infrastructure, as a prerequisite for the development, in line with the more efficient public administration and simplification of the procedures for obtaining various permits, could be a good substitute for incentives. Also the status of a candidate for EU membership is very important, as it represents the best recommendation to investors that Serbia is a stable country and safe for the investment.

THE BANKING SECTOR

When a country's economy goes through a serious crisis, it is impossible for its banking system to remain intact. The banking sector, as the largest and the most developed sector within the Serbian economy, in autumn 2008 felt the first effects of the crisis when more than a billion euros of savings have been withdrawn from the banks. We should not forget that in a crisis, especially in the fragile economy such as Serbian, any withdrawal of savings and deposits on a large scale under the influence of psychological uncertainty and undesirable events, can lead to a dramatic impact and a collapse of the banking system. In order to prevent undesirable consequences, the government immediately undertook several measures to mitigate the effects of the crisis. First of all, a stand-by arrangement was concluded with the IMF and the first set of measures was adopted, which was aimed at the revival of credit activity of banks, by subsidizing loans that maintain liquidity, and financing permanent working capital and subsidizing the interest rates for consumer loans. In addition, a meeting of a *Vienna Initiative* was called, which resulted in an agreement that the banking groups in this region will not decrease their exposure to Serbia. Also, during this period, the banks had a conservative policy when they held the capital adequacy ratio to over 20 percent, even though the legal minimum is 12 percent. All this has enabled the banking sector to withstand the shock more easily, but it was not quite spared of the crisis.

On the impoverished Serbian banking market at the end of 2012 there are 33 banks. Compared to other sectors, in the banking sector there is a satisfactory level of competition, and you could say the real battle for survival, because there is not enough space in the market for all participants. Serbian banking system still has the lowest concentration compared to other countries in the region, taking into consideration the large number of banks that participate even less in all major categories of business. The five largest banks took up about 48% market share in the end of 2012, neither one of them has an individual stake greater than 15%, and only two banks have a market share that exceeds 10%.

In order to understand the true state of the impact of the crisis on the banking sector, it is necessary to start a deeper analysis. Domestic banks were not directly exposed to losses related to the financial markets in the Eurozone, and domestic banks did not possess toxic types of assets. But they were indirectly affected by the recessionary trends in the real sector, which resulted in a rapid deterioration of loan portfolios. Another effect of the crisis is that the domestic banks can no longer count on generous funding from their parent banks abroad, and that in the recent period they have gone through the process of repayment.

A key problem that has manifested itself in the banking system is the growth and relatively high share of non-performing loans (NPL), which amounted to 19.9 at end of 2012. During the crisis, the level of NPL was 11.3. It is necessary to point out that within the current level of NPL there is also a part of the heritage from the past that is not written off due to unfavourable tax treatment and slow and complex legal process, so the real participation of NPL is probably lower and is at the level of the surrounding countries. Another problem is the decreased lending activity due to a greater general business risk. Several banks did not withstand the impact of the crisis so NBS quite justifiably revoked their license. Although the banking system is hit by the crisis that has affected Serbia, however, we can conclude that financial stability is not compromised.

The results of bank operations in 2012 showed that in the banking sector there has also been a deterioration of financial results, because the reported profit is lower and the losses are higher than in previous years. Growing bad debt and bad management of "domestic" banks can be seen through the incurred loss cumulatively achieved by 10 banks in the amount of 13.3 billion. We should be sure to add the sum that has been paid from the budget for Agrobanka and Razvojna banka Vojvodine. The two banks, which had relatively low total market share of about 4.5% of the banking market, and in which the state had a decisive influence on the management, have achieved record losses and made the balance sheet of the whole banking sector negative.

Banks' return on average assets and average equity of the banking sector in Serbia after 2008 have been declining. They are not adequate to assumed risks, especially if one takes into account inflation and all kinds of risk exposure. The biggest problem are extremely high and growing bad debt loans, which threaten to melt the capital. The real estate market does not work, which makes the risks even greater, because the collaterals cannot be converted into liquid assets without extremely high discounts. Bank revenue growth that comes from government deficit financing has decreased since the issuing of Eurobonds, and creditworthy corporate clients are almost gone.

"Loan-to-deposit" ratio in 2012 amounted to 125%, and there were no major changes were made when it comes to decreasing the same. This relatively high LTD ratio may indicate a limitation in terms of the future sector growth due to the fact that borrowing from abroad is no longer readily available or cheap, so banks usually finance the growth of deposits. In addition, high LTD can point to any liquidity problem in the future.

Almost all qualitative indicators of Serbian banking at the end of 2012 were much worse than five years before, as evidenced by the following data:

In next table we can see that the banking is stagnating. This especially applies to the bank lending activity. Regarding the banking sector, credit support is the key to the development of any industry. The banking sector needs to support only those projects that are considered to be profitable and that are expected to bring returns on investment. A composite measure of lending activity, which, apart from domestic loans, includes cross-border loans from economy, in the period from 2008 to 2012 grew in real terms at an average annual rate of 8.8%.[11]

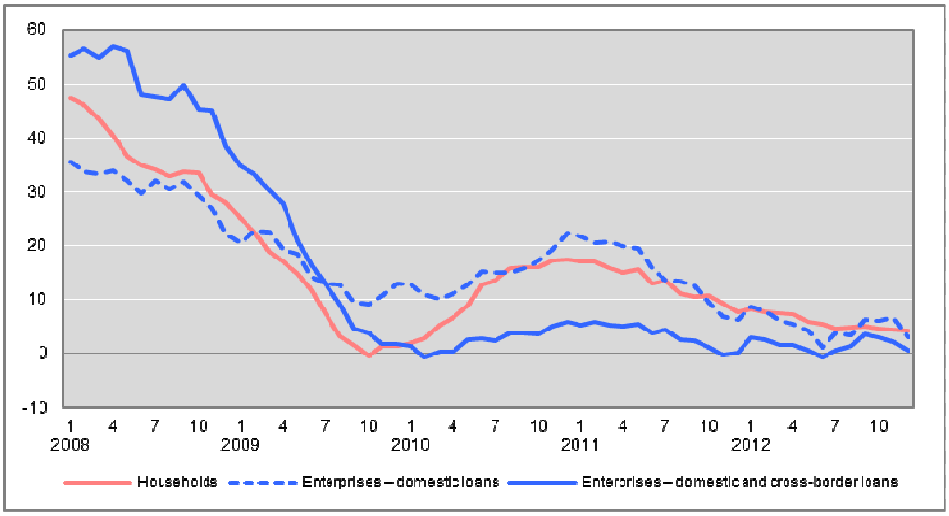
Table 4. Overview of banking sector in Serbia, 2008-2012.

Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	21.632	24.362	25.984	27.732	27.826
growth in % yoy	2,3	12,6	6,7	6,7	0,9
in % of GDP	64,7	84,4	91,6	87,9	94,0
Total loans (EUR mn)	12.262	13.138	15.166	16.452	16.630
growth in % yoy	21,4	7,1	15,4	8,5	1,1
in % of GDP	36,7	45,5	53,4	52,1	56,2
Total deposits (EUR mn)	10.019	11.408	11.894	41.287	13.311
growth in % yoy	-2,7	13,9	4,3	10,1	1,6
in % of GDP	30,0	39,5	41,9	41,5	45,0
Total loans (% of total deposits)	122,0	115,0	128,0	126,0	125,0
Structural information					
Number of banks	34	34	33	33	33
Market share of state-owned banks (% of total assets)	17,5	18,2	20,3	19,7	19,0
Market share of foreign-owned banks (% of total assets)	75,0	74,0	73,0	73,0	69,0
Profitability and efficiency					
Return on Assets (RoA)	2,4	1,0	1,1	1,3	1,0
Return on Equity (RoE)	10,5	4,5	5,3	6,3	4,7
Capital adequacy (% of risk weighted assets)	21,9	21,4	19,9	19,1	19,9
Gross non-performing loans to total gross loans	11,3	15,7	16,9	19,0	18,6

Source: NBS, Raiffeisen RESEARCH

[11] Real growth implies growth excluding the exchange rate effect (fixed exchange rate from August 2008), assuming a fixed currency structure prior to July 2008.

Figure 9. Real growth of loans to households and enterprises(y-o-y growth rates, %)*



** Calculated using the exchange rate of dinar to euro as of August 31, 2008 and assuming that all FX and FX-linked loans have the euro as the currency of indexation*

Source: NBS

In the banking sector, there is a space for reducing costs and strengthening the competition through its further consolidation, which will be possible given that the current negative trends are reversed and the overall investment climate is improved. Without the creation of conditions for the capital inflow and economic growth, the performance of the banking sector will continue to weaken, and it is possible that it will generate some problems. Also, it is high time that the state begins to take responsible policies and to reduce the minus in the cash register so that the banks can redirect more money to the economy. Every time the state sells bonds, that are bought by the banks, it effectively reduces the availability of funds to the economy, i.e. the real sector. Banks, attracted by high interest rates, are buying government bonds instead of having proactive approach supporting good projects in the real sector. Finally, we can conclude that during the crisis the Serbian banking sector was guided professionally and that it is highly capitalized. The downside is that the sector is overcrowded with banks and its room for real growth is limited, since very few good private companies control a large part of the economy.

CONCLUSION

During the first decade of economic and political transition, Serbian economy has undergone various structural reforms. One of the processes typical for the initial phase of transition was economic liberalization which was accompanied with rising imports and significant inflows of foreign capital. Sources of capital inflow were mainly privatization, foreign aid and foreign direct investments. Unfortunately, the capital inflow did not significantly change economic structure in the sense of strengthening export activities. In addition, it was quite predictable that those inflows had to be reduced in some point of time, since privatization and foreign aid were not infinite sources of financing. We could also see that the economic growth in the last decade was characterized by increasing balance of payments deficit and large external borrowing. Increasing balance of payments deficit was a consequence of rising import which was satisfying growing economic demand, fuelled by aforementioned capital inflows. That created some kind of *circulus vitiosus*, trap into which policy makers were easily caught.

Crisis influenced capital inflows to fall as well as the export. However, positive impact of the crisis was import decrease which also influenced lower government revenues leading to the second important point of our analysis – unsustainable external borrowing. While in the pre-crisis period, external borrowing of the private sector was growing comparing to the Government, during the crisis we could notice completely opposite trend. Lower revenues made Government to borrow more both in internal and external market. In order to avoid stronger recession, policy makers borrowed more which was short term oriented economic policy for Serbia. Nowdays, external position parameters are strongly unfavourable becoming serious limitation for the future economic growth. Also, Serbia face very slow and unstable growth in the recent years. Our new growth model should include measure for stimulating industrial production and export oriented sectors. Only by reducing current external imbalances Serbia could achieve stronger and sustainable economic growth. This new model should include more focused approach when attracting FDIs. Serbian economy needs greenfield investments in the sectors with the higher value. We could see that investment dominated so far were investments in services, rarely in a *greenfield* way.

We could see that in several developed economies, crisis strongly hit banking sector. Moreover, recovery of the banking sector was limiting factor of recovery of the whole economy. Serbia definitely did not have similar problems. Slight problems in the banking sector were just a reflection of problems in the real sector of the economy. Banks were overcapitalized conducting quite restrictive borrowing policy. Slightly higher NPLs, were sign of portfolio deterioration but did not jeopardize financial stability in general. We could even say that banking sector is healthier part of the Serbian economy contributing country’s financial stability in a long term.

Our conclusion is that economic crisis did not severely hit Serbian economy. Weaknesses which present in the previous period coming from turbulence period in 90s and inadequate growth model have just became more visible. Adverse effects of the short term oriented and populistic economic policy were about to jeopardize Serbian economy even without external turbulences. Aiming to achieve more sustainable and higher growth rates in the future period Serbia need to reconsider model of economic growth. Some of the recommendations would definitely be attraction of export oriented FDIs, Government support to export oriented sectors, lower external borrowing and creation of business friendly economic environment.

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