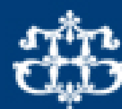

National Bank of Serbia

May 2024

INFLATION REPORT

May 2024

INFLATION REPORT

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Introductory note

The Agreement on Inflation Targeting between the Government of the Republic of Serbia and the National Bank of Serbia, effective as of 1 January 2009, marks a formal switch of the National Bank of Serbia to inflation targeting as a monetary policy regime. The main principles and operation of the new regime are defined by the Memorandum on Inflation Targeting as a Monetary Strategy.

Since one of the underlying principles of inflation targeting is strengthening the transparency of monetary policy and improving the efficiency of communication with the public, the National Bank of Serbia prepares and publishes quarterly Inflation Reports as its main communication tool. The *Inflation Report* provides key economic facts and figures that shape the Executive Board's decisions and underpin activities of the National Bank of Serbia.

The *Inflation Report* aims to cover information on the current and expected inflation movements and to provide an analysis of underlying macroeconomic developments. It also seeks to explain the reasoning behind the Executive Board's decisions and to provide an assessment of monetary policy effectiveness during the previous quarter. Also integral to this *Report* are the inflation projection for eight quarters ahead, assumptions on which the projection is based and an analysis of key risks to achieving the target.

The information contained in this *Report* will help raise public understanding of monetary policy implemented by the central bank and awareness of its commitment to achieving the inflation target. It will also play a role in containing inflation expectations, as well as in achieving and maintaining price stability, which is the main statutory task of the National Bank of Serbia.

The May *Inflation Report* was considered and adopted by the NBS Executive Board at its meeting of 10 May 2024.

Earlier issues of the *Inflation Report* are available on the National Bank of Serbia's website (http://www.nbs.rs).

Executive Board of the National Bank of Serbia:

Jorgovanka Tabaković, Governor

Željko Jović, Vice Governor

Ana Ivković, Vice Governor

Dragana Stanić, Vice Governor

Nikola Dragašević, Vice Governor

ABBREVIATIONS

bp – basis point
CPI – Consumer Price Index
EBRD – European Bank for Reconstruction and Development
ECB – European Central Bank
EIB – European Investment Bank
EMBI – Emerging Markets Bond Index
EU – European Union
FAO – UN Food and Agriculture Organization
FDI – foreign direct investment
Fed – Federal Reserve System
FOMC – Federal Open Market Committee
GDP – gross domestic product
GVA – gross value added
H – half-year
IFEM – Interbank Foreign Exchange Market
IMF – International Monetary Fund
LHS – left hand scale
mn – million
NAVA – non-agricultural value added
NPL – non-performing loan
OFO – other financial organisation
OPEC – Organization of the Petroleum Exporting Countries
pp – percentage point
Q – quarter
q-o-q – quarter-on-quarter
RHS – right hand scale
RMCP – real marginal cost of processed food production
s-a – seasonally-adjusted
SDR – Special Drawing Right
SORS – Statistical Office of the Republic of Serbia
y-o-y – year-on-year

Other generally accepted abbreviations are not cited.

Macroeconomic projections presented in the *Report* were concluded on 30 April.

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I Overview

Aided by declining inflation, global economic growth has proved more resilient than anticipated during the period of monetary restriction, which signals that a soft landing has been achieved.

Despite tight monetary conditions and the risks of recession and stagflation in the past two years, the global economy posted stable growth, proving more resilient than anticipated. In the April round of projections, the IMF estimates **global growth to be identical this and the next year, measuring 3.2%**. The projection for this year is slightly more favourable than in January. The risks to the global outlook are relatively balanced, the same as in January. The key downside risks include possible spikes in global prices of primary commodities stemming from geopolitical tensions in the Middle East and Ukraine, persistent core inflation where labour markets are tight, weaker growth outlook of China, and greater economic and political fragmentation. Conversely, a looser fiscal policy, a faster than expected decline in inflation and interest rates amid further gains in labour force participation, and a stronger positive impact of artificial intelligence and structural reforms on productivity could lead to faster-paced global growth. Economic activity in the euro area, our key trade partner, was practically stagnant in Q4 2023. Growth projections for this year are again slightly lower than three months ago, but higher than in 2023.

According to the IMF, the pace of global inflation's slowdown is the same as the pace of its increase in prior years.

Lower global inflation is aided primarily by food and energy prices whose growth is now below multiyear averages, but also by the resolution of global supply chain bottlenecks and the drop in China's export prices. The effects of monetary policy tightening by central banks have helped anchor inflation expectations, but growth in the prices of services remains relatively high, mostly reflecting higher wages and tight labour markets, which will probably continue to slow inflation's decline for some time yet and may defer inflation's return to target in some countries.

Leading central banks are expected to start easing their monetary policies from mid-year, while monetary relaxation by inflation-targeting central banks in the Central and Southeast European region is set to continue.

It is no longer a question whether **leading central banks will continue tightening their monetary policies, but when the cycle of policy rate reductions will begin**. The ECB has not ruled out starting monetary easing in June, but its pace will depend on further movements in inflation, economic activity and developments in the labour market. As core inflation remains elevated and

labour markets are tight, the Fed will probably start easing its monetary policy later than expected. Some inflation-targeting central banks of the Central and Southeast European region continued to ease their monetary policies.

In the period since the previous Inflation Report*, the NBS Executive Board kept the key policy rate unchanged at 6.5%, its level since July 2023.*

The decision of the NBS Executive Board to **keep the key policy rate unchanged** in the past months was motivated by the medium-term inflation projection, the declining, though still elevated global inflationary pressures, and the persisting uncertainty regarding global prices of energy and other primary commodities. In making this decision, the Board also took into account the fact that the effects of past monetary tightening have to a large degree spilled over to the price and volume of private sector borrowing.

Interest rates in the interbank market of money and dinar loans stabilised, while the interest rates on issued dinar government securities continued down as investors were readier to accept lower yields.

As the key policy rate was kept unchanged over the past months, **interest rates in the interbank money market levelled off, resulting in a broadly unchanged price of dinar loans**. The yield rates on dinar government securities continued down, reflecting the country's lower risk premium due primarily to Serbia's positive macroeconomic outlook. Risk premium also declined on account of global factors and investors' readiness to accept lower yield rates. In Q1, the planned volume of issue of dinar government securities of RSD 150 bn with the original maturity of eight years was sold out. The yield rate decreased relative to the first auctions of these securities held in late 2023, and the share of non-residents participating in the purchase was notable.

The effects of past monetary tightening dampened inflationary pressures through the credit channel, without prejudice to financial stability.

Lending activity to the non-monetary sector remained low in Q1 2024, reflecting the effects of past monetary tightening and the maturing of corporate loans approved under guarantee schemes. Still, **y-o-y growth in total loans picked up some speed relative to end-2023, measuring 1.3% in March**. This was supported by households' rising loan demand and the easing of banks' credit standards prompted by a positive assessment of the overall economic situation. Thanks to a robust bank regulatory framework and the adopted macroprudential policy measures, synchronised with monetary policy measures, the **share of NPLs in total loans stayed close to the minimum level of around 3% in Q1 2024**.

As the responsible conduct of economic policy contributed to an improvement of macroeconomic indicators, and especially to reduced internal and external imbalances, Serbia's outlook for investment-grade rating has been raised.

Standard & Poor's raised Serbia's outlook for investment-grade rating reflecting strong macroeconomic outcomes, resilience demonstrated by our country in the previous years marked by global uncertainty and crises, and reduced external and fiscal imbalances. This is also one of the key strategic objectives of the NBS, the achievement of which would make Serbia even more recognisable on the international

investment map and improve financing conditions for the government, corporates and households.

Though higher than in the same period of 2023, the current account deficit remained covered by net FDI inflow multiple times in Q1 2024; as a result, appreciation pressures prevailed.

In Q1 2024 the current account deficit increased from its record-low level last year to EUR 395 mn (2.3% of GDP), reflecting a lower services trade surplus, reduced secondary income surplus and higher primary income deficit. A lower goods deficit continued to work in the opposite direction, having declined by around 12% compared to the same period last year as goods imports declined more (-3.9%) than exports (-1.9%). Within goods exports, manufacturing exports continued up (at a rate of 3.9% y-o-y) reflecting past investments. Export growth was supported primarily by higher exports of base metals, means of transport, motor vehicles and trailers, metal products and electrical equipment. Thanks to high yields of autumn crops, agricultural exports also rallied, but this was offset by lower exports of electricity and mining. The decline in goods imports continues to be fuelled by lower energy imports. **FDI inflow to Serbia reached EUR 1.3 bn in Q1**, up by 53.4% from the same period in 2023. This ensures more than full coverage of the current account deficit. For this reason, appreciation pressures prevailed and the NBS bought EUR 530 million net in the foreign exchange market in the first four months of 2024.

Fiscal trends in Q1 2024 were again more favourable than expected.

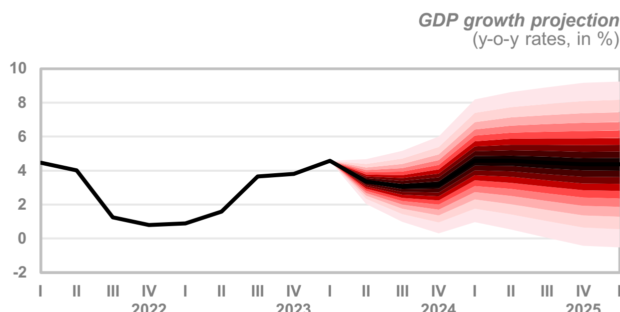
In Q1 2024, the consolidated government deficit amounted to 0.9% of GDP and the surplus on the primary income account to 2.2% of GDP, exceeding the last year's outturn and continuing the trend of better than projected fiscal trends. This reflects primarily two-digit tax revenue growth, led largely by rising VAT and social insurance contribution items, amid a further rise in wages and a rebound of private consumption. Fiscal developments turned out to be more favourable even though government current and capital expenditure increased in accordance with plan. **The share of general government public debt in estimated GDP came at 48.0% in March**, down by 4.3 pp from end-2023 owing to higher projected GDP for this year.

GDP grew 4.6% y-o-y in Q1, exceeding our expectations from the previous Report.

The SORS flash estimate of **GDP growth of 4.6% y-o-y (1.1% s-a, according to our estimate) suggests that economic activity in Q1 sped up more than anticipated in the previous projection**. On the production side, GDP growth is estimated to have been led by upturns in trade, industry and construction, with other service sectors also lending an impetus. In terms of GDP use, growth was led by domestic demand, with household consumption and investment giving the strongest boost, and net exports providing a moderate positive contribution as real growth in goods and services exports was somewhat higher than in imports.

It is increasingly certain that the GDP growth rate will measure 3.5% this year. Starting from 2025, growth will speed up to a 4–5% range, also owing to investment planned under the "Leap into the Future – Serbia Expo 2027" programme.

GDP growth projection
(y-o-y rates, in %)



Faster than expected GDP growth in Q1 increases the probability that this year's growth rate will be closer to the central value of the forecast range of 3–4%, as stated in the previous Report, and equal 3.5%. The expectations of other relevant international institutions (the IMF and the World Bank) are similar. In the remainder of the year, growth will be led by domestic demand, with all its components providing a positive contribution. Higher private consumption will be propped by a continued rise in employment and wages, notably in the private sector, but no significant inflationary pressures will be generated as wage growth will largely reflect elevated productivity. Investment is expected to increase owing to robust FDI inflows and preserved investment confidence, supported by subdued global inflationary pressures and more favourable financing conditions. Another contributor will be the projects in transport, energy and utility infrastructure. Despite the anticipated continued export growth, driven by past investment in export-oriented sectors and a gradual rebound of external demand, we again forecast imports to rise faster than exports, in light of the expected acceleration of investment and personal consumption, which will result in a negative contribution of net exports. Economic activity is likely to accelerate to 4–5% over the next two years, owing to investment planned under the "Leap into the Future – Serbia Expo 2027" programme. As the investment cycle is set to speed up, spurring the imports of equipment and intermediate goods, the share of **the current account deficit in GDP is projected at around 4% this year and around 5% in the years to come**. As in the past nine years, the current account deficit is estimated to remain fully covered by net FDI inflows, ensuring the sustainability of the country's external position and further growth in FX reserves, which remain at an adequate level according to all metrics.

Since early 2024, y-o-y inflation in Serbia has been lower than projected in February, primarily thanks to smaller than anticipated growth in unprocessed food prices in an environment of favourable weather and good supply.

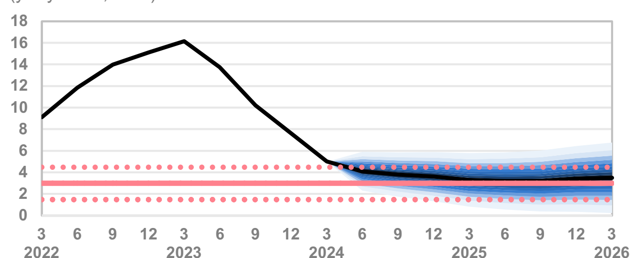
Inflation has continued to decelerate even faster than we projected in February. Since March 2023, when a peak was reached, inflation fell by over 11 pp, to 5.0% in March 2024. The decline was aided by smaller growth in food and energy prices as global cost-push pressures were alleviated, as well as by core inflation, which fell by over 6 pp to 5.0% y-o-y, owing to the effects of past monetary tightening and lower imported inflation. Inflation's slowdown was also supported by reduced short-term inflation expectations of financial and corporate sectors, with financial sector expectations returning within the NBS target band, and by anchored medium-term expectations.

Under our new projection, inflation is expected to retreat within the target band in May and continue to approach the target midpoint of 3%.

Under our new projection, **y-o-y inflation will retreat within the target band most probably in May, somewhat earlier than expected in February. It is**

anticipated to continue to slow in the remainder of the year and move around the target midpoint of 3% from 2025. Such trend will be aided by the effects of past monetary policy tightening, subsiding inflation expectations, the weakening of global cost-push pressures, further slowing of imported inflation and the still subdued external demand. The new inflation projection for Q2 and Q3 is slightly lower than in February reflecting weaker growth recorded in the year so far, while the projection as of Q4 is slightly above the February projection. A disinflationary effect is produced by lower projected inflation in the euro area and a smaller than expected rise in administered prices owing to lower utility price growth. In contrast, we project higher global prices of oil and primary agricultural commodities, while the disinflationary impact of demand this year is somewhat smaller than projected in February owing to higher projected growth in investment and consumption.

Inflation projection
(y-o-y rates, in %)



The uncertainty surrounding the inflation and GDP projections is still mainly associated with factors from the international environment – geopolitical relations, outlook for global growth and their impact on world prices of energy and other primary commodities. To some degree, the risks also stem from the persistence of core inflation globally and the duration of monetary policy tightening by leading central banks. The risks are also associated with the pace of growth in domestic demand, primarily on account of the level of FDI inflows, and investment in infrastructure and the energy sector. Another source of risk is the outcome of the agricultural season at home – it concerns primarily fruit and vegetable prices in the case of inflation, and cereal yields in the case of GDP. Overall, we judge the risks to the inflation and GDP projections to be symmetric this year and beyond. The NBS will continue to monitor and analyse trends in the domestic and international markets, and make monetary policy decisions depending on the pace of inflation's slowdown. Going forward, delivering price and financial stability in the medium term will remain the monetary policy priority, along with supporting further growth and development of our economy, a further rise in employment and preservation of a favourable investment environment.

The key risks to the inflation and GDP projections are still mainly associated with factors from the international environment. Overall, we judge the risks to be symmetric this year and beyond.

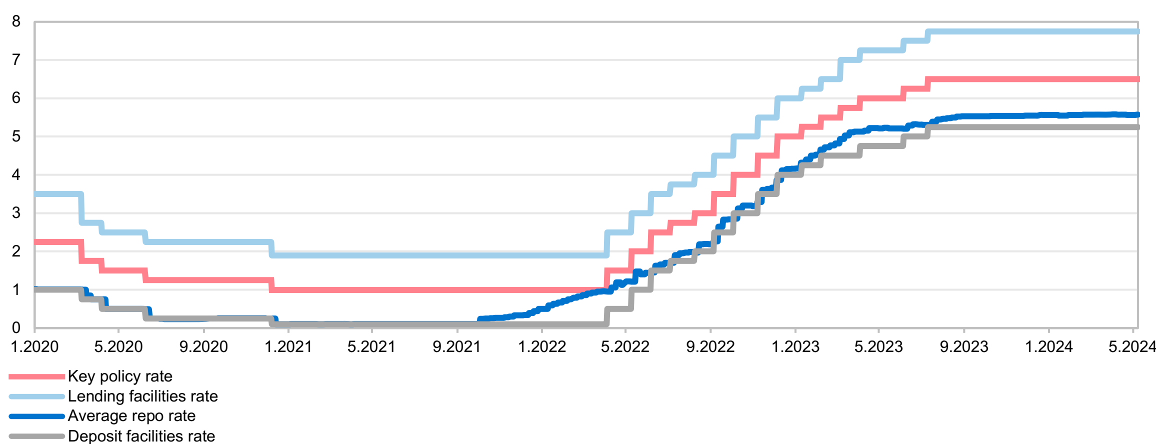
II Monetary policy since the February *Report*

The NBS has kept the key policy rate unchanged from its July 2023 level of 6.5%. The Executive Board made the decision to keep the key policy rate on hold taking into account the medium-term inflation projection, elevated, albeit declining, global inflationary pressures, and persisting considerable uncertainty regarding the movement of global prices of energy and other primary commodities.

In the period since the February *Report*, **the NBS Executive Board has kept the key policy rate unchanged at 6.5%**. The deposit and lending facility rates have been kept at 5.25% and 7.75%, respectively. All three rates are unchanged from July 2023, when the last hike took place. In fact, that was the 15th consecutive hike in the current cycle of monetary policy tightening (since April 2022), resulting in a 550 bp higher key policy rate overall. Since October 2021, the weighted average repo rate was also raised almost to the same extent, to 5.56% at end-April 2024. Moreover, in an environment of pronounced excess dinar liquidity in the banking sector, in September last year the NBS Executive Board raised banks' required reserve ratios and the percentages of dinar allocations of FX required reserves, thus further tightening monetary conditions. Past monetary tightening has passed through to interest rates in the markets of money, loans and savings, leading to lower inflation expectations of all economic agents, signalling the efficiency of the monetary policy transmission mechanism. Amid a slowdown in imported inflation and still subdued external demand, this contributed to establishing a downward trajectory of inflation at home.

Since the February *Report*, the conditions in the domestic and international environment in which monetary policy was conducted in Serbia, as well as in most other countries, increasingly encouraged talks about when monetary policy easing should begin and to what extent and at what pace it should be carried out. Such decisions require careful consideration of all available information and data, analysis of inflation trends and monetary transmission, so that monetary easing does not come too early and thus threaten the sustainability of the inflation's downward path and convergence to the target.

Chart II.0.1 **Key policy rate and average repo rate**
(y-o-y rates, in %)



Source: NBS.

The Executive Board's decisions in March and April 2024 were based on the **February medium-term inflation projection**, according to which inflation would continue to decline and retreat within the target tolerance band in mid-2024, then approach the 3% target midpoint at end-2024 and stay around that level in the medium run. In accordance with the Executive Board's announcements, **y-o-y inflation in Serbia** continued its sharp decline since the start of the year, which proved to be even faster than projected in February. Inflation decline resulted primarily from the slowdown in the y-o-y growth in food prices, and the prices of products and services within core inflation (CPI excluding food, energy, alcohol and cigarettes).

In its monetary policy making, the Executive Board was particularly mindful of the **declining, but still elevated imported inflation, as well as of the weak, but better than expected external demand**. It also had in mind that the risks regarding the further movement of global inflation were increasingly balanced. Despite persisting geopolitical risks, it was estimated that the global economy is approaching price stability. The majority of central banks predicted with increasing certainty that inflation in their countries would return within the target tolerance band in H2 this year or H1 next year, in view of the easing of inflationary pressures and the effects of restrictive monetary conditions. However, caution in the euro area and the USA is still mandated by core inflation, which continued to move above headline inflation, mostly amid tight labour market conditions and wage growth. This is the reason why the ECB and the Fed postponed the start of monetary policy easing.

Headline and core inflation in the **euro area**, our key trade partner, continued to decline more than expected, but rising wages remained a cause for concern. Headline inflation declined in March to 2.4% y-o-y, its lowest level since November 2021. A fall was recorded in energy prices, while a slowdown was recorded in the prices of food and industrial products, which dragged core inflation down to 2.9% in March. Services prices continued to exhibit resilience, with growth still well above the historical average. Inflation in the euro area is expected to slow down further in the period ahead, though at a slower pace than so far, and approach the 2% target in mid-2025. Meanwhile, core inflation will continue to move above headline inflation. It is estimated that corporate profits are now more moderate and that supply-side developments have created room for growth in real wages, which will prop up private consumption and economic recovery in the euro area, without risking inflation. However, persistently tight labour market conditions raise concerns that labour cost growth could be excessive and entirely passed onto consumers, which could keep inflation above the target for a longer period of time.

The **ECB** has not changed its main interest rates in March and April – interest rates on deposit facilities, main refinancing operations and lending facilities remained at 4.00%, 4.50% and 4.75%, respectively. The ECB's rates are at the highest level since the introduction of the euro in 1999. Their robust pass-through to financial conditions weakened the dynamic of inflation, as well as credit and economic activity. The ECB President, Christine Lagarde, pointed out that the ECB was still not confident about inflation further converging to the 2% target, and that the disinflation progress was still not sufficient. The ECB will have more information on inflation and economic activity movements **in June, which is when most market participants expect that the ECB will begin its rate-cutting cycle**. The NBS Executive Board took into account that the expected monetary policy easing by the ECB would put a downward pressure on interest rates on euro-indexed loans at home.

Economic indicators in leading economies suggested that the fight against inflation would require an unexpectedly small trade-off in terms of lower GDP growth and higher unemployment. A recession in the leading economies has, in all likelihood, been avoided. According to the Eurostat estimate, the euro area's economic activity stagnated in Q4 2023, after falling in Q3. Albeit slower, the economic growth in the USA continued up in Q4 2023, outperforming expectations. Even though the euro area's economic outlook was revised down, its growth should gather pace in H2, and so should the external demand for our exports.

In its monetary policy making, the Executive Board took into account that **financial conditions, which are currently tightened, are expected to ease** in the coming period, supported by the anticipated **further fall in the global risk premium of emerging economies**. As for Serbia, **FDI inflow surpassed expectations** – in the first two months of this year, it was more than doubled compared to the same period the year before, when it was also high. It, hence, **outstripped the current account deficit by multiple times**, contributing to the record increase in the NBS's FX reserves. In addition, the Executive Board emphasized that Standard & Poor's **upgraded Serbia's outlook from stable to positive** in April. The rating agency stressed that Serbia is poised for accelerated and sustainable economic growth in the coming period, which will further improve fiscal indicators. Moreover, it pointed out that, together with

broadly diverse FDIs, the buffers built in the previous period will serve to cushion potential shocks from the international environment.

Among the challenges from the international environment which mandate caution, the Executive Board highlighted **geopolitical conflicts** and the consequent risk of rising global prices of oil and other primary commodities. The prices of most primary commodities in the global market declined in 2023, but are still considerably above the pre-pandemic level. The **global oil prices proved particularly volatile** – after declining last year, they were on the rise in the first three months this year. In addition to the Ukraine and the Middle East conflicts, this was chiefly influenced by the decision of the OPEC+ countries to extend the cap on oil supply also in Q2 this year, as well as by the decreased oil inventories in the USA. The Executive Board had in mind that uncertainty surrounding the movement of energy prices remains pronounced, particularly prices of oil and gas, with potential escalation of the Middle East conflict, longer transport routes and higher logistics costs posing the main risk.

As for **global food prices**, the key factors which led to their decline from record highs in 2022 are supply chains, which almost entirely stabilised, followed by gas prices, which fell to much more acceptable levels, as well as the fact that the Ukrainian grain exports continued via the Black Sea corridor. Although global disinflation in this area is expected to continue, caution is mandated by the world food price index (FAO), which, after declining for seven consecutive months, posted a rise in March.

China's economic performance could also affect global prices of energy and most other primary commodities, which is why China's growth outlook is one of the important factors of inflation movements in the period ahead. China took a number of steps to strengthen its economy, with better than expected results in manufacturing and retail trade in the first two months of the year, fuelling optimism that the ambitious goal of 5.0% GDP growth could be reached this year. In April, the IMF kept its January projection of China's GDP growth in 2024 at 4.6%, while forecasting 4.1% growth for 2025.

On the domestic front, the Executive Board had in mind that **inflation expectations** of the financial and corporate sectors continued on the downward path. One-year ahead inflation expectations of the financial sector have been within the target band since the start of the year, while medium-term expectations have been anchored for quite some time, which points to the credibility of the NBS's monetary policy. The decrease in short-term inflation expectations of corporates continued, with a downward trend in the dispersion of responses, which indicates less uncertainty among corporates regarding inflation movements in the period ahead. Short-term inflation expectations of households began to decrease in March, which is good news considering that they are typically higher and decline much more slowly. Lower inflation expectations support lower inflation and a higher real interest rate, i.e. restrictive monetary conditions even without changes in the key policy rate. Despite the continuing rise in real wages since the beginning of the year, in conditions of high rates of formal employment and lower registered unemployment, **household consumption** did not exert any major inflationary pressures. Additionally, despite higher outlays for public sector wages and pensions, the **central government budget** recorded a lower deficit in Q1 2024 than in the same period last year, while the primary balance recorded a surplus.

The Executive Board carefully considered available data on the **real sector**, which indicated better than expected trends in the first two months of this year, i.e. that growth in Q1 this year could be higher than projected in February. In y-o-y terms, industrial production growth stepped up to around 8% in January and February, driven by growth in manufacturing of almost 9%. At the same time, real retail trade turnover went up by 6.4% y-o-y, and a higher number of tourists and their overnight stays suggested further positive trends in tourism.

Despite weaker external demand, further progress was noted also in foreign trade in goods. According to SORS data, in the first two months goods exports rose by 3.2% y-o-y, driven by manufacturing and agriculture, while goods imports contracted by 1.3% y-o-y, as a consequence of the still lower energy imports.

As for overall economic activity this year, according to the February medium-term projection, the Executive Board forecasts **GDP growth in the range of 3–4%,** with the central projection at 3.5%. Growth will be supported by the waning of global inflationary pressures and a gradual recovery of the euro area, as well as by the anticipated further acceleration in the implementation of planned investment projects in transport, energy and utility infrastructure. According to their estimate, personal consumption will remain an important growth factor, though not to the extent that would cause any major inflationary pressures, and so will fixed investments, which also boost potential output.

The Board's decision **at its May meeting to keep the key policy rate unchanged** was motivated primarily by the new medium-term inflation projection and the expected movement of key inflation factors, and by the still elevated, though subsiding, global inflationary pressures, and heightened uncertainty over the global prices of energy and other primary commodities. Moreover, the effects of past monetary tightening have largely spilled over to the cost and volume of private sector borrowing, while financing conditions have stabilised since the key policy rate was raised last time, in July 2023.

As the main risks to inflation and other economic developments still emanate from the international environment, the NBS will continue to monitor and analyse trends in the international commodity and financial markets and make monetary policy decisions based on that and the analysis of trends at home and the pace of domestic inflation's slowdown. Going forward, delivering price and financial stability in the medium term will remain the monetary policy priority, along with supporting continued growth and development of our economy, a further rise in employment and a favourable investment environment.

III Inflation movements

Consistent with our expectations, y-o-y inflation continued to slow down in Q1, dropping to 5.0% in March, primarily thanks to a much slower food price growth. The effects of past monetary tightening reflected on a further slowdown in core inflation as well, which in March came to the same level as headline inflation. Relative to its peak in March 2023, headline inflation was three times lower in March this year, and core inflation was more than halved.

Inflation slowdown is also supported by a further decline in one-year ahead inflation expectations of the financial and corporate sectors, with short-term inflation expectations of the financial sector too anchored within the NBS target band since the start of the year.

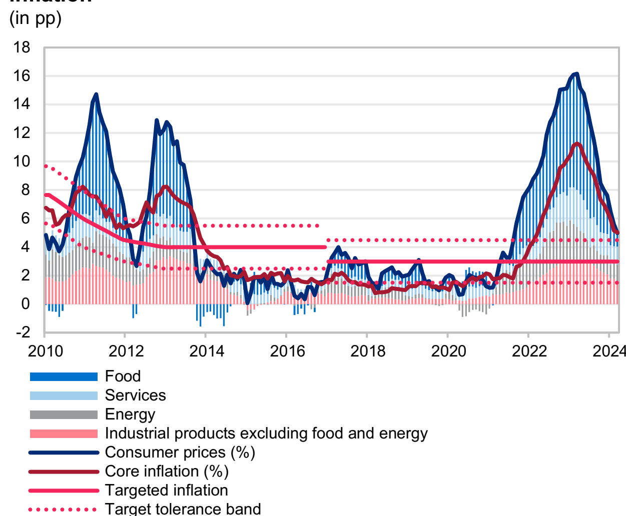
Inflation movements in Q1

Y-o-y inflation decelerated further in Q1, and measured 5.0% in March, down by 2.6 pp from end- 2023. This was chiefly driven by a significant slowdown in the y-o-y growth in food prices (primarily unprocessed food), with a 1.8 pp lower contribution to y-o-y inflation in Q1, due to lower costs in food production and the effect of high last year's base. A slower y-o-y rise was also recorded in the prices of industrial products and services within **core inflation** (CPI[1] excluding food, energy, alcohol and cigarettes), which dropped by 1.5 pp relative to end-2023 and measured 5.0% y-o-y in March, the same as headline inflation. The downward path of core inflation reflects the effects of past monetary tightening, the waning of global cost-push pressures and lower imported inflation. After excluding from the consumer basket 15% of products and services whose prices recorded the largest changes in both directions, the **trimmed mean** decreased in the past year and measured 4.4% y-o-y in March.

In quarterly terms, **consumer prices posted a 1.1% rise in Q1** (similar to Q4 2023). The **prices of food and non-alcoholic beverages** edged up by 0.8% in Q1 (with a 0.3 pp contribution to inflation), entirely driven by the rise in **processed food prices** (1.3%), dictated by higher prices of processed meat, milk and dairy products, and non-alcoholic beverages. However, inflation growth in Q1 was lower than expected in the February *Report*, chiefly owing to a further fall in **unprocessed food prices**, due to lower prices of fresh fruit (1.4%) and fresh meat (2.3%).

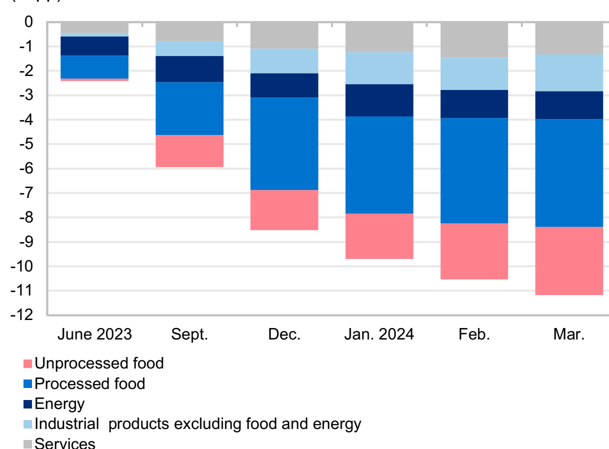
[1] In the structure of 2024 CPI weights, compared to 2023, the share of prices of products and services within core inflation decreased slightly, the same as the share of prices of processed food, while that of energy and unprocessed food prices increased.

Chart III.0.1 **Contribution of main CPI components to y-o-y inflation**
(in pp)



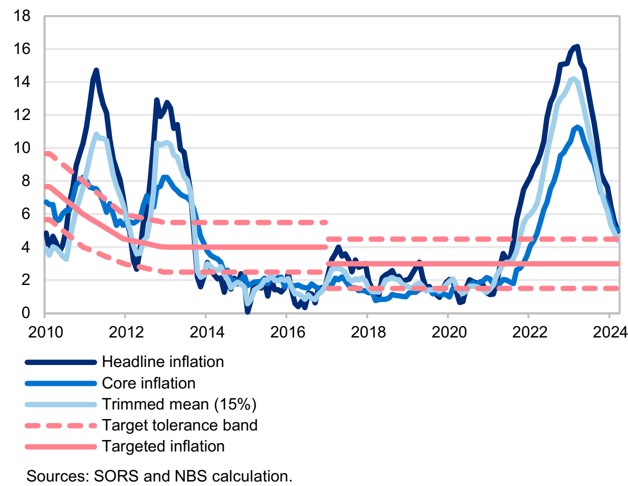
Sources: SORS and NBS calculation.

Chart III.0.2 **Change in contribution of main CPI components to y-o-y inflation - relative to March 2023***
(in pp)



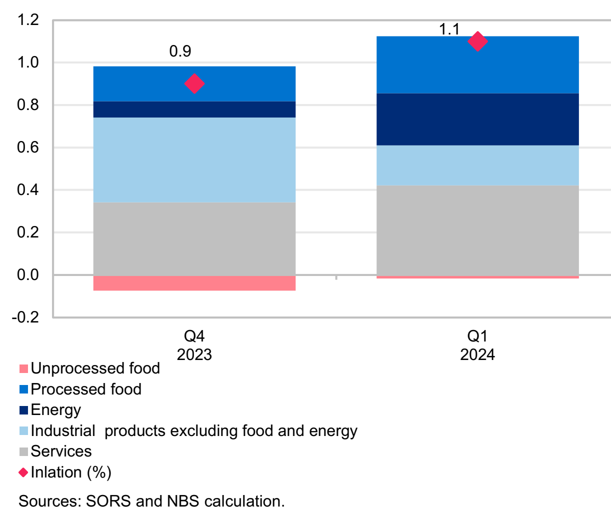
Sources: SORS and NBS calculation.
* Y-o-y inflation peaked in March.

Chart III.0.3 **Headline, core and trimmed mean inflation**
(y-o-y rates, in %)



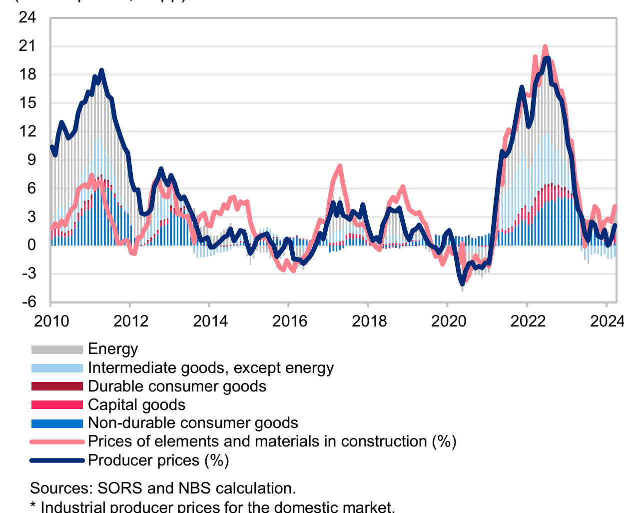
Sources: SORS and NBS calculation.

Chart III.0.4 **Contribution of main CPI components to quarterly inflation**
(in pp)



Sources: SORS and NBS calculation.

Chart III.0.5 **Contribution by destination groups of consumption to the y-o-y producer price dynamics***
(end-of-period, in pp)



Sources: SORS and NBS calculation.
* Industrial producer prices for the domestic market.

Moreover, in Q1 fresh vegetable prices posted much lower growth rates (3.0%) than typical for the season, owing to a good supply amid favourable weather conditions.

Energy prices grew by 1.6% in Q1 (with a 0.2 pp contribution to inflation), dominantly due to higher prices of petroleum products (4.1%), which mirrored the hike in the global crude oil price since February this year. Conversely, the prices of solid fuels fell in Q1 (by 1.6%), reflecting the decline in the prices of firewood as the winter months turned out to be warmer than usual. The prices of electricity and gas for households did not change in Q1.

The contribution of **industrial product prices (excluding food and energy)** to inflation in Q1 (0.2 pp) was halved relative to the previous quarter, as they posted an increase of 0.7%. These prices grew, primarily owing to the February adjustment of the prices of cigarettes (by 2.7%) and alcoholic beverages (2.1%), while the seasonal cheapening of clothes and footwear (2.3%) worked in the opposite direction.

The **prices of services** increased by 1.7% in Q1 (with a 0.4 pp contribution to inflation), led by the higher prices of mobile telephony services (5.2%), as well as utility services, catering and medical services, and rents. On the other hand, the prices of travel packages dipped by 10%, chiefly because of their seasonal decline in March.

Administered prices grew 1.4% in Q1 (with a 0.3 pp contribution to inflation), on account of the hike in the prices of cigarettes and utility services. In y-o-y terms, these prices decelerated further, to 8.0% in March, which is also expected in the period ahead, in parallel with the drop-out of the last year's increases in the prices of electricity and gas for households from y-o-y inflation calculation.

Core inflation decelerated to 1.0% in Q1 (from 1.4% in Q4 2023), with a 0.4 pp contribution to inflation, mostly owing to the higher prices of services compared to industrial products.

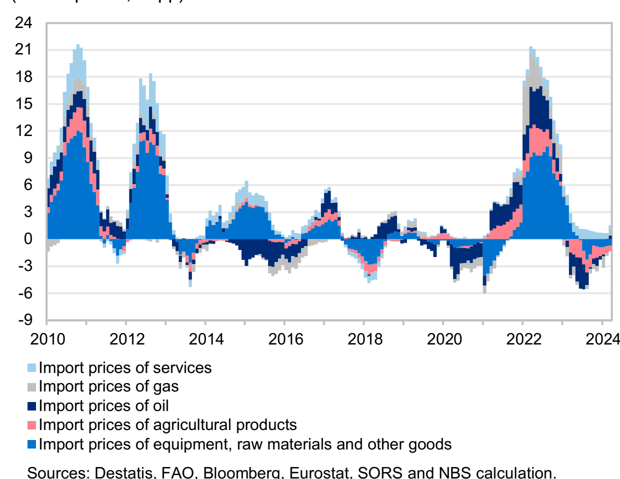
Producer and import prices in Q1

Industrial producer prices in the domestic market stepped up y-o-y in Q1, to 2.1% in March (from 1.6% in December). This was mostly driven by the renewed y-o-y price rise in the **exploitation of crude oil and production of petroleum products**, as well as in the production of **capital goods**, mainly motor vehicles and trailers, machinery and equipment, but also construction

material. The **prices of elements and materials in construction** also picked up to 4.1% y-o-y in March (from 2.5% in December). The producer **prices of consumer goods** (durable and non-durable) posted growth between 0% and 1% y-o-y since the start of the year. On the other hand, the prices in food production dropped further, by 4.6% y-o-y in March. In addition, **prices in the production of intermediate goods**, notably rubber, plastic and paper products, continued the y-o-y decline in Q1, which was after three years also recorded in the production of metal products. At quarterly level, industrial producer prices in the domestic market increased by 2.0% in Q1, and the prices of elements and materials in construction by 1.9%

Import prices expressed in dinars[2] declined further y-o-y also in Q1, to 1.5% in March, primarily due to significantly lower import prices of natural gas, and to a lesser extent, lower global prices of primary agricultural commodities and equipment, intermediate goods and other imported goods, approximated by the export prices of Germany. A positive contribution to the y-o-y dynamics of import prices expressed in dinars stemmed from the prices of imported services, approximated by the euro area core inflation, as well as higher global oil prices. At quarterly level, import prices of goods and services edged down by 0.4% in Q1, primarily due to lower import gas prices.

Chart III.0.6 **Contribution of selected components to y-o-y growth rate of imported prices in RSD**
(end-of-period, in pp)



Sources: Destatis, FAO, Bloomberg, Eurostat, SORS and NBS calculation.

[2] Preliminary data. The base year is 2010. The weighted average of several components is used as an indicator of import prices: the global Brent oil prices, import gas price, food price index (FAO index), consumer prices within euro area core inflation, and export prices of Germany, one of Serbia's key trade partners. The fixed weights of the components are calculated according to the value of imported goods and services in 2023.

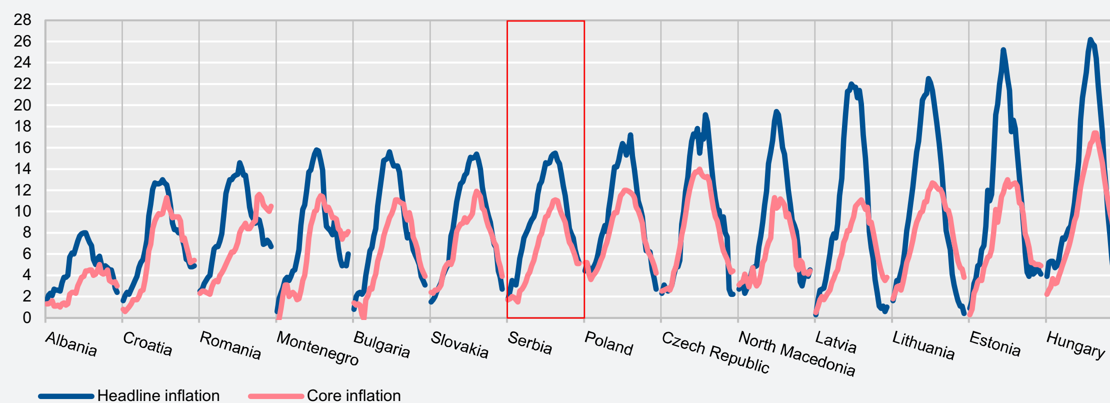
Text box 1: Core inflation trends at home and in the region

Global inflationary pressures, prevailing over the past several years, have put inflation at the centre of interest of economic policy makers and all other economic agents. The effectiveness of monetary policy instruments is not identical for all inflation components, as the prices of some categories, particularly food and energy, are under a strong impact of numerous external, supply- and demand-side factors, which are beyond the reach of domestic monetary policy. That is why monetary policy makers pay particular attention to core inflation, which excludes these more volatile components.

Charts O.1.1 and O.1.2 show y-o-y rates of headline and core inflation (changes in CPI excluding the prices of food, energy, alcohol and tobacco) from early 2021 to March 2024 in selected CESEE countries. In most of the observed countries, in the last three years, core inflation ranged from 6% to 8% on average, with the exception of Albania, where it was much lower (around 3%), and Hungary, where it was somewhat higher (around 9%).

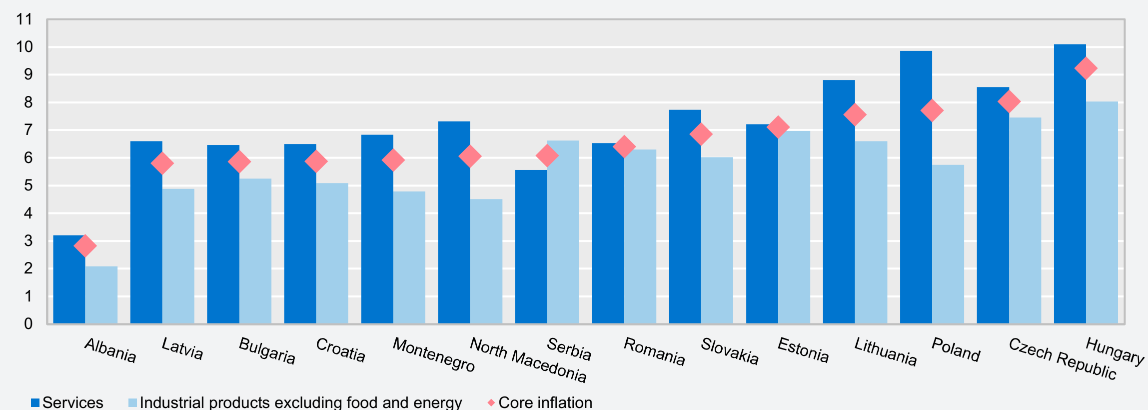
Average core inflation was not only relatively similar across countries in the period concerned, but it also had similar dynamics. In all the observed countries, core inflation began to rise in Q2 or Q3 2021, which can be partly explained by the easing of restrictive health measures and the consequent sharp increase in demand for products and

Chart O.1.1 **Headline and core inflation movements from 2021 to 2024**
(y-o-y rates, in %)



Source: Eurostat.

Chart O.1.2 **Average consumer price growth rates from 2021 to 2024**
(y-o-y rates, in %)



Source: Eurostat.

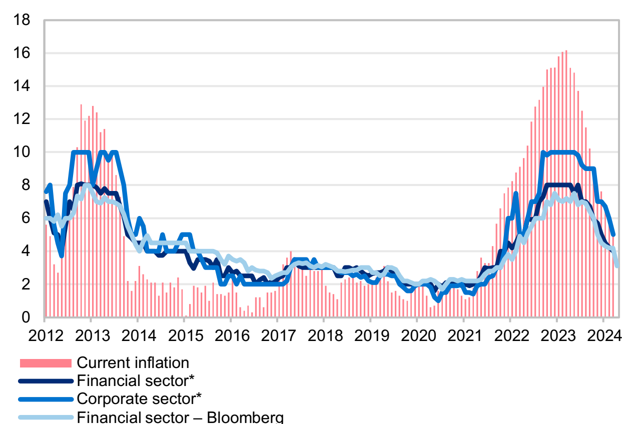
services that could not be met during the covid pandemic. Headline inflation in most countries also began to increase, initially at a similar pace, and later somewhat faster. Throughout 2022 and in H1 2023, headline inflation generally trended above core inflation. This can be largely explained by the energy crisis, which broke out in H2 2021 and intensified with the outbreak of the Ukraine conflict in early 2022, and the drought that affected most of Europe in 2021, pushing up food prices.

In most countries, both headline and core inflation peaked in Q4 2022 or Q1 2023. In all the observed countries, the peak of core inflation was below that of headline, ranging between 11% and 13% y-o-y. Inflation's slowdown was largely determined by the deceleration of food and energy prices, but thanks to central banks' monetary tightening, core inflation slowed as well, and it slowed everywhere.

In most countries (except for Romania and Montenegro), current core inflation is two to three times lower than the peak, moving between 3.8% (Latvia and Lithuania) and 6.5% y-o-y (Hungary). Since the start of 2024, core inflation in all countries has stood above headline inflation (except in Serbia). Such movement of core inflation is determined by its structure as it consists of the prices of goods and services, which are, as a rule, less volatile than those of food and energy.

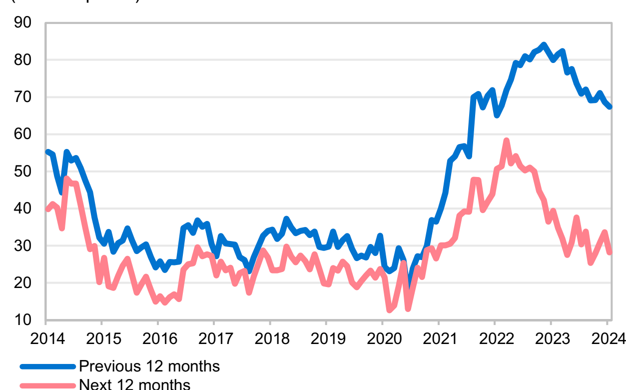
Within core inflation, services prices grew faster than industrial product prices in most countries (except for Serbia) on average. The reason is their greater rigidity compared to industrial product prices as they are strongly dependent on labour market trends. Core inflation is likely to continue to move above headline inflation in a number of countries for some time yet. Thus, monetary policy priority will remain to ensure a slowdown in core inflation (particularly the services component) and thus further anchor inflation expectations.

Chart III.0.7 **Current inflation and one-year ahead inflation expectations**
(y-o-y rates, in %)



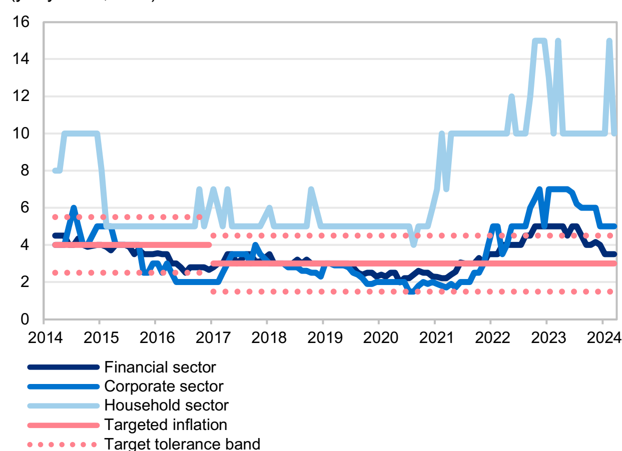
Sources: Gallup, Ipsos/Ninamedia, Bloomberg and NBS.
* Ipsos and Gallup until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

Chart III.0.8 **Household perceived and expected inflation***
(in index points)



Sources: Ipsos/Ninamedia and NBS calculation.
* Ipsos until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

Chart III.0.9 **Two-year ahead inflation expectations***
(y-o-y rates, in %)



Sources: Ipsos/Ninamedia and NBS.
* Ipsos until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

Inflation expectations

Inflation expectations of the financial and corporate sectors continued on the downward path in Q1, with one-year ahead inflation expectations of the financial sector within the target band since the start of the year, while medium-term expectations have been anchored for quite some time, which speaks in favour of higher credibility of the NBS and portrays the confidence of market agents in the NBS's monetary measures. Inflation expectations of households edged down as well in Q1.

According to the April Bloomberg survey, **one-year ahead inflation expectations of the financial sector** measured 3.1% and were almost at the target midpoint. According to the March Ipsos survey, these inflation expectations measured 4.0%, moving within the NBS target tolerance band for the third month in a row.

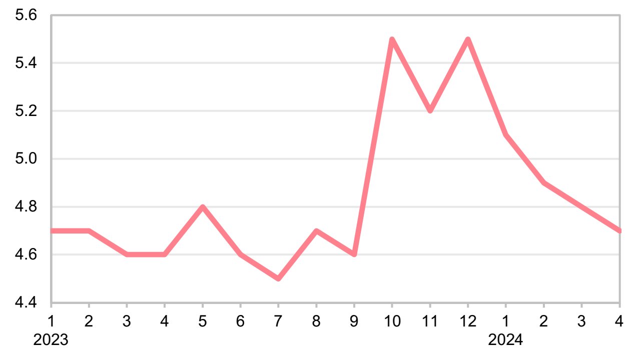
One-year ahead inflation expectations of the corporate sector declined to 5.0% in March. The dispersion of corporate sector responses regarding expected inflation declined in recent months, while the share of corporates expecting inflation within the target band increased. More than a half of respondents do not expect a rise in the prices of their products and services over the next twelve months.

Short-term inflation expectations of households fell to 11.0% in March, their lowest level since January 2022. According to the results of the qualitative survey, the index of expected inflation (28.2%) recorded lower values than the index of perceived inflation (67.4%), indicating that households expect that inflation will be lower in the coming 12 months than in the previous year. While nearly 60% of respondents estimate that price growth in the previous 12 months was considerable, around a quarter of respondents expect this trend to continue in the next year as well. Compared to previous surveys, there was a rise in the share of respondents anticipating no change in prices.

Medium-term inflation expectations of the financial sector are anchored within the target tolerance band, with two-year ahead expectations equalling 3.5% and three-year ahead expectations 3.2% in Q1. **Medium-term inflation expectations of corporates** for two years ahead equalled 5.0% in Q1, while their expectations for three years ahead fell to 3.5%. **Medium-term inflation expectations of households** declined as well, with two- and three-year ahead expectations equalling 10% in March.

According to the April forecast of *Consensus Economics*, professional forecasters also anticipate lower inflation in Serbia for this and the next year compared to their expectations three months ago. Average inflation is expected at 4.7% this year and 3.4% next year.

Chart III.0.10 **Inflation expected in 2024 according to leading economic forecasters**
(in %)



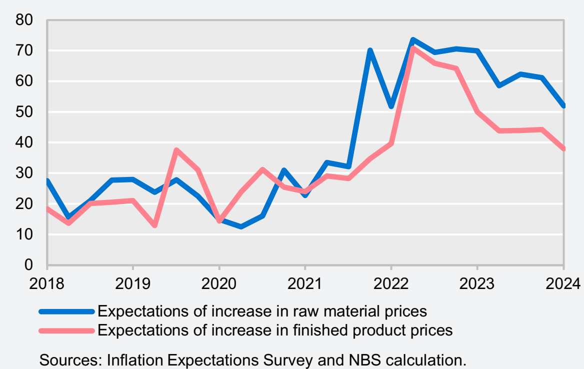
Source: Consensus Economics.

Text box 2: Corporates' expectations of business conditions in Serbia

This text box looks into corporates' expectations regarding selected indicators of price and non-price factors of the macroeconomic, investment and business environment in Serbia. **The analysis draws on the results of the survey of economic agents' expectations**[1] conducted for the NBS by market and public opinion research agencies, as well as on the results of the survey of economic activity indicators conducted by the SORS for the European Commission.

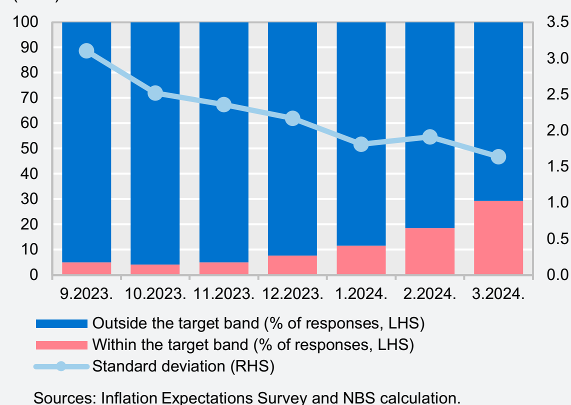
When it comes to the *price factors of the business environment*, it is important to note that corporates perceive inflation largely on the basis of their own production costs. Their inflation expectations are, for this reason, greatly influenced by their expectations of raw material prices, especially in the next three months. **The share of corporates expecting raw material prices to go up in the next three months** contracted notably for the first time, from 70% in Q1 to around 58.5% in Q2 2023 (Chart O.2.1). **In Q2 2023**, **corporates** began to anticipate an easing of cost-push pressures in the short term; **consequently, their inflation expectations started to subside in H2 2023** from around 10% at the time to 7.0% in late 2023. In Q1 2024, the share of corporates expecting raw material prices to go up in the next three months slid further down to 52.0%. Inflation expectations continued down as well, dropping to 5.0% in March and approaching the NBS target band. That inflation expectations are subsiding and cost-push pressures are easing is also confirmed by a decline in the share of respondents **expecting the prices of their products/services to go up in the next three months (37.9% in Q1 2024)**. **This is the lowest level in the past two and a half years** which were marked by the multidimensional global crisis and record-high growth in the global prices of energy and other raw materials. **Over the past months, there has also been less dispersion in corporates' responses regarding one-year ahead expected inflation, while the share of corporates whose expectations are within the NBS target band went up** (Chart O.2.2).

Chart O.2.1 **Share of Serbian corporates expecting an increase in prices of raw materials and finished products/services in the next three months**
(quarterly average, in %)



Sources: Inflation Expectations Survey and NBS calculation.

Chart O.2.2 **Share of corporates with inflation expectations within and outside the target band and the dispersion in their responses**
(in %)



Sources: Inflation Expectations Survey and NBS calculation.

Corporates not only expect more favourable price movements in the coming period, but they also report on a gradual improvement in the *non-price factors of the business environment in Serbia*. **Since early 2024, a rising number of respondents expect an increase in the volume of production/turnover in the next three months** (41.4% in Q1) **and in the next 12 months** (55.3% in Q1), **which is more than in H2 2023 and above the long-term average for both indicators** (Chart O.2.3). As there is more optimism with regard to future production/turnover, corporates also gave a **positive assessment** of important components of future business – **number of employees and investment volume**.

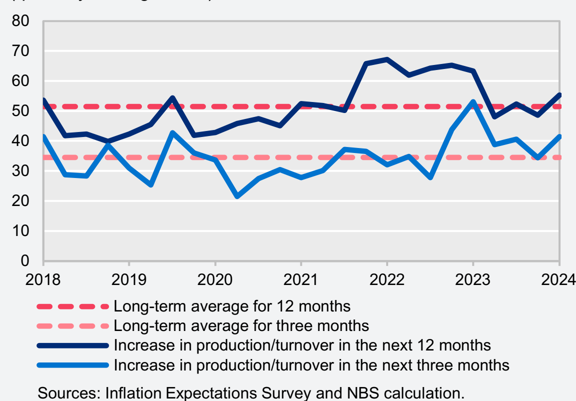
[1] Research is conducted on a monthly basis, on a sample of 100 companies according to the criterion of operating income from the annual statement of accounts. The methodology in line with which the survey is conducted is available at the NBS website: https://www.nbs.rs/export/sites/NBS_site/documents-eng/publikacije/io/I-IF_e.pdf.

Reflecting the rise in the physical volume of production activity in key manufacturing sectors and in the quantity of turnover in retail and wholesale trade, **the share of companies expecting employment to go up increased to 34% in March, topping the annual averages in the 2018–2023 period** (Chart O.2.4). At the same time, the share of companies expecting the number of employees to go down was stable at around 5% in the past year, which is much lower even when compared with the pre-crisis years (2018 and 2019).

A useful tool in analysing investment plans is the net percentage of respondents calculated as the difference between the number of corporates expecting fixed investment to go up and those expecting it to go down. In case of exogenous shocks and heightened uncertainty, corporates generally become more risk averse. This is exactly what happened in Q2 2020, when corporates faced lockdowns due to the coronavirus pandemic, or in Q2 2022 when the energy crisis escalated and geopolitical tensions mounted in the wake of the Ukraine conflict outbreak. In both cases, the share of corporates planning a higher volume of investment decreased and the share of corporates planning to reduce their investment increased. **Companies' expectations in this respect** rallied as of H2 2023, however, **and since Q1 2024 approached their pre-crisis (before 2020) values** (Chart O.2.5).

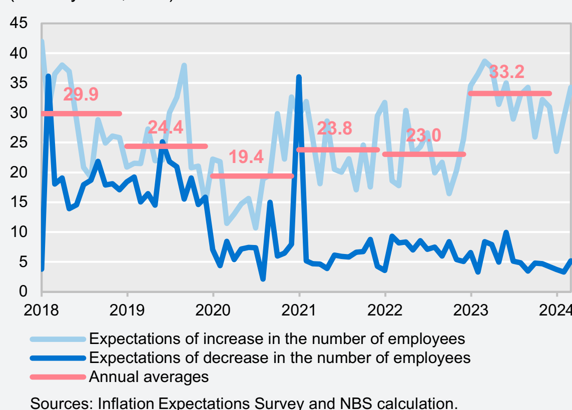
The period before 2020 was marked by a notable easing of loan conditions, supported by monetary accommodation by the NBS. Due to accommodative monetary conditions, the share of corporates expecting easy loan access was continuously higher than the share of those anticipating difficult access to external sources of funding. After the pandemic was declared, in 2020 and 2021, an increasing share of corporates expected loan conditions to deteriorate. This share would have probably even been higher had the **NBS not taken a timely and appropriate response by trimming its key policy rate, introducing the guarantee scheme, moratorium on loan repayment and other measures**. Global inflationary pressures which intensified since 2021 induced an almost synchronous tightening of monetary policies of central banks worldwide. As a result, since Q4 2022 the percentage of companies assessing loan conditions as negative was higher than the percentage of those assessing them as positive. Though the share of corporates assessing loan conditions as less favourable is still higher, since Q4 2023 there has been an increase in

Chart O.2.3 **Share of Serbian corporates expecting an increase in production/turnover**
(quarterly average, in %)



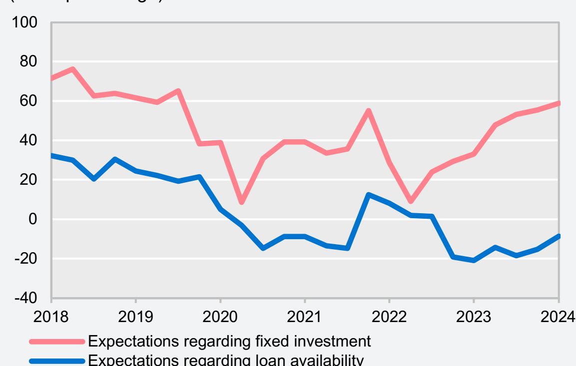
Sources: Inflation Expectations Survey and NBS calculation.

Chart O.2.4 **Expectations of Serbian corporates regarding the number of employees in the next 12 months**
(monthly data, in %)



Sources: Inflation Expectations Survey and NBS calculation.

Chart O.2.5 **Expectations of Serbian corporates regarding investment and loan availability in the next 12 months**
(in net percentage)*



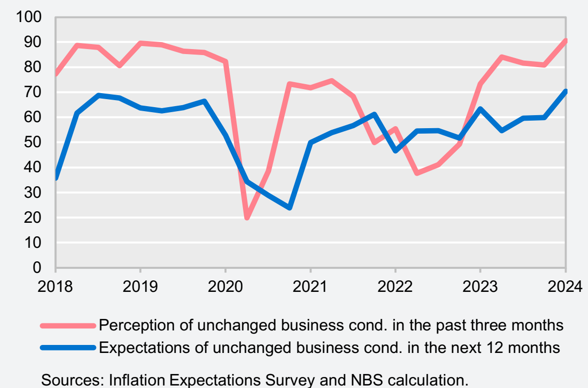
* The net percentage is the difference between the number of respondents expecting these indicators to improve and the number of respondents expecting them to deteriorate.
Sources: Inflation Expectations Survey and NBS calculation.

the share of respondents who consider that loan availability has improved (Chart O.2.5). This can be associated with the completion of the cycle of policy rate hikes and leading central banks' announcements of monetary policy easing in the coming period.

Both price and non-price factors of the business environment improved from H2 2023, signalling that the corporate sector perceives the general economic situation in Serbia to have stabilised as the negative effects of the multifaceted crisis in the 2020–2023 period wore out. This is also signalled by corporates' responses regarding their perception of business conditions over the short term and their expectations of long-term business conditions, which returned to pre-crisis levels in Q1 2024 (Chart O.2.6).

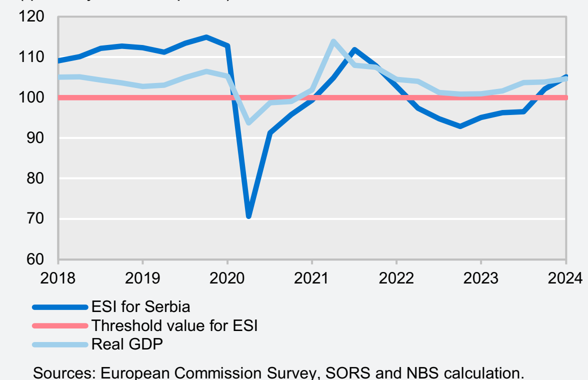
Movements in the aggregate indicator of economic expectations – the Economic Sentiment Indicator[2] (hereinafter: ESI) also attest to stabilisation and gradual improvement of business conditions in Serbia over the past months. This indicator is constructed based on quantified expectations of consumers and employers in key economic sectors – industry, services, retail trade and construction. **In Serbia, ESI has moved above its long-term average** (which has the value of 100 points) **since November 2023**, indicating economic expansion. In March 2024, it measured 106.2 points, its highest level since end-2021. On a quarterly basis, ESI reached 105.1 points on average in Q1 2024 (Chart O.2.7), under the impact of, primarily, **continued rise in the confidence indicator of employers in the services and retail trade sectors, further rebound of the confidence indicator in the industry sector**, while the confidence indicator in construction approached the neutral level (Chart O.2.8). In Q1 2024 the consumer confidence indicator returned to positive territory after close to two years, which means that consumers' perception of the expected economic situation in the country and the financial position of households has improved. **Since ESI can be considered both as the leading and the coincident indicator of economic activity and has a significant positive correlation with economic growth dynamics, its upward path since early 2024 is consistent with our projection of accelerated economic growth in Serbia in Q1, which has in the meantime been confirmed by the SORS estimate of GDP growth of 4.6% y-o-y.**

Chart O.2.6 **Expectations of Serbian corporates regarding business conditions in the next 12 months**
(in %)



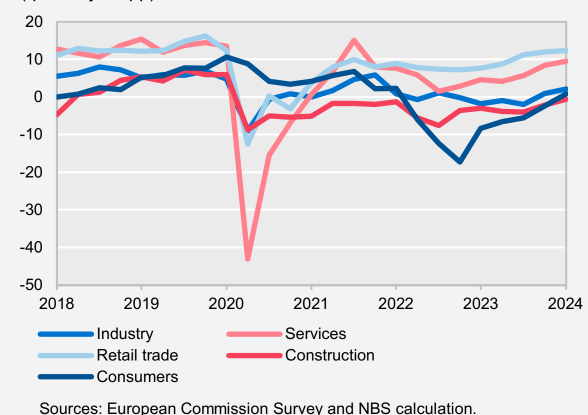
Sources: Inflation Expectations Survey and NBS calculation.

Chart O.2.7 **Dynamics of the ESI composite index and Serbia's real GDP**
(quarterly, in index points)



Sources: European Commission Survey, SORS and NBS calculation.

Chart O.2.8 **Dynamics of confidence indicators among consumers and employers in key economic sectors in Serbia**
(quarterly, in pp)



Sources: European Commission Survey and NBS calculation.

[2] The methodology used to examine economic agents' expectations and construct the composite ESI is available at the European Commission's website: https://economy-finance.ec.europa.eu/document/download/4f162b92-e654-4cef-beed-38960dae1b09_en?filename= bcs_user_guide.pdf.

IV Inflation determinants

1 Financial market trends

As the NBS has kept the key policy rate on hold since August 2023, the interest rates in the interbank money market have almost flatlined. The interest rates on dinar corporate loans also broadly stagnated in Q1 2024, while those on dinar household loans edged down relative to Q4 2023.

The yield rates on dinar government securities continued down, prompted by the lower country risk premium, while auctions for the sale of dinar securities with original 8Y maturity attracted record investor demand, with a significant non-resident share. The secondary market of dinar securities saw a considerable increase in turnover as well.

Interest rates

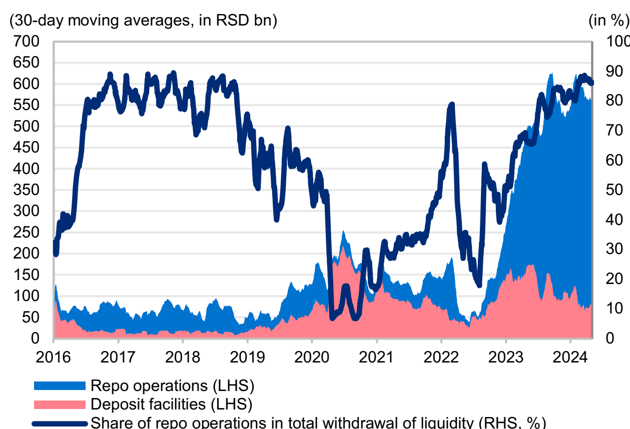
Since August 2023, the NBS has kept the **key policy rate** at 6.50%, and the rates on lending and deposit facilities at 7.75% and 5.25%, respectively. This reflected on the interest rates in the **interbank money market** which almost flatlined in Q1 2024.

Speaking of excess dinar liquidity of banks, the average stock of investments into NBS repo operations increased by RSD 45.1 bn from December 2023 to RSD 489.8 bn in March, while the average daily balance of overnight bank deposits with the NBS went down by RSD 28.2 bn to RSD 73.8 bn.

At end-March, BEONIA measured 5.25%, with the average daily turnover in the overnight interbank market rising from RSD 4.0 bn in Q4 2023 to RSD 5.6 bn in Q1 2024. At end-March 2024, BELIBOR rates remained at end-2023 levels, moving from 5.25% for the shortest to 5.80% for the six-month maturity.

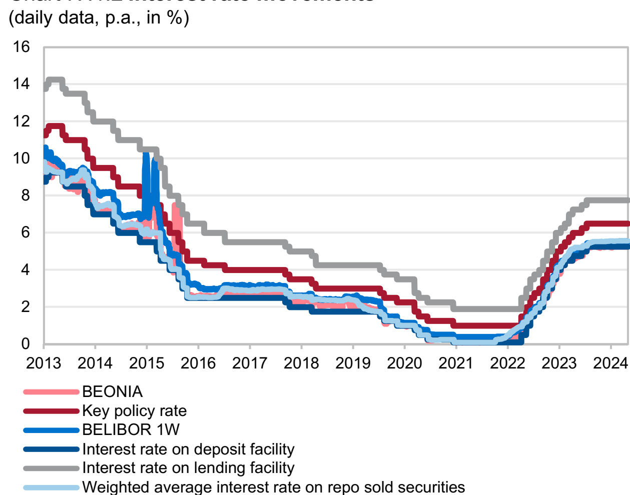
In the **primary market of dinar government securities**, 8Y government bonds were offered in three auctions in Q1 2024. The January and February auctions attracted high investor demand, resulting in total sale nominally worth RSD 104.7 bn, with a significant share of non-

Chart IV.1.1 **NBS operations – liquidity withdrawal**



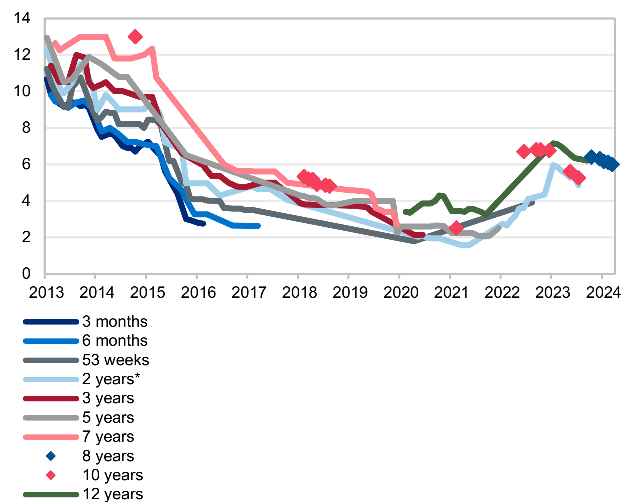
Source: NBS.

Chart IV.1.2 **Interest rate movements**



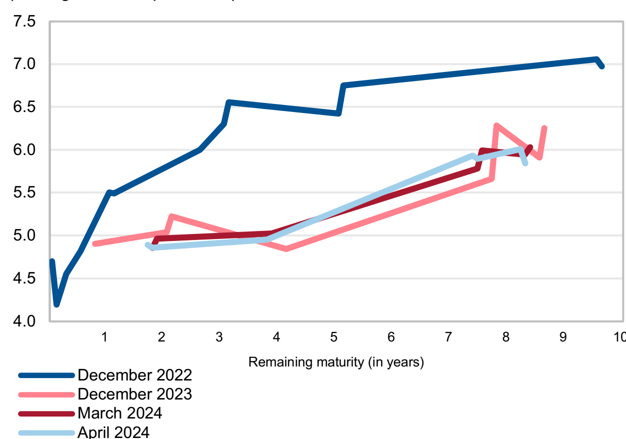
Sources: Thomson Reuters and NBS.

Chart IV.1.3 **Interest rates in the primary market of dinar government securities**
(p.a., in %)



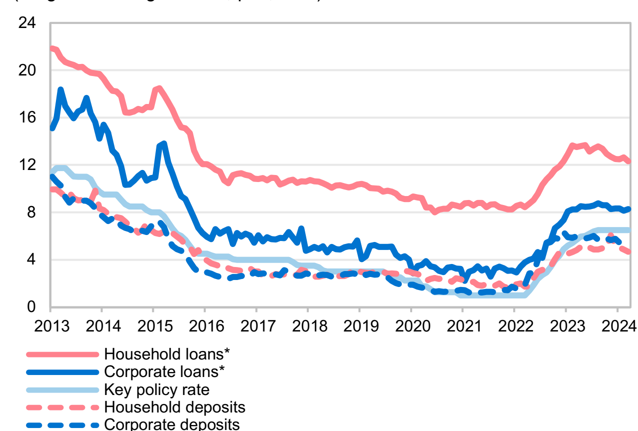
Source: Ministry of Finance.
* Excluding coupon securities with the rate linked to the NBS key policy rate.

Chart IV.1.4 **Yield curve in the secondary government securities market**
(average values, p.a., in %)



Source: Central Securities Depository and Clearing House.

Chart IV.1.5 **Interest rates on new dinar loans and deposits**
(weighted average values, p.a., in %)



Source: NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

residents (around 43%). The remaining RSD 2.9 bn worth of these securities were sold in the March auction, with the sales adding up to the total issue size of RSD 150 bn. Compared to the auction from end-Q4 2023, the effective yield rate in the last auction in March decreased by 30 bp to 6.00%, significantly below the coupon rate of 7.00%. Given that the principal of earlier sold securities worth RSD 72.4 bn fell due in Q1, the stock of dinar securities went up by RSD 35.3 bn to RSD 874.9 bn at end-March.

In Q1 2024, **non-residents participated in the auctions of dinar securities** with original 8Y maturity, in the total nominal value of RSD 45.7 bn. However, since non-residents participated as net sellers in the secondary market and earlier issued securities with original 2Y and 5Y maturities concurrently fell due, the stock of dinar government securities owned by non-residents increased by RSD 37.0 bn from end-2023, to RSD 171.6 bn at end-March, which is close to 20% of the total portfolio of dinar government securities.

In Q1 2024, the turnover in the **secondary market of dinar government securities** considerably expanded relative to Q4 2023, by 63% to RSD 97.0 bn. Among other things, the turnover was boosted by inclusion of new benchmark 8Y dinar bonds in J.P. Morgan Government Bond-Emerging Market Index (GBI-EM) starting from 1 March 2024. The weighted average yields on dinar government securities fell from the previous *Report*, mainly owing to the lower country risk premium. In March, the weighted average bond yields for the remaining 2Y, 8Y and 9Y maturities dropped by 24–28 bp relative to December 2023, to 4.89%, 5.98% and 5.99%, respectively, while the weighted average yield on securities with the remaining 4Y maturity increased by 18 bp to 5.02%.

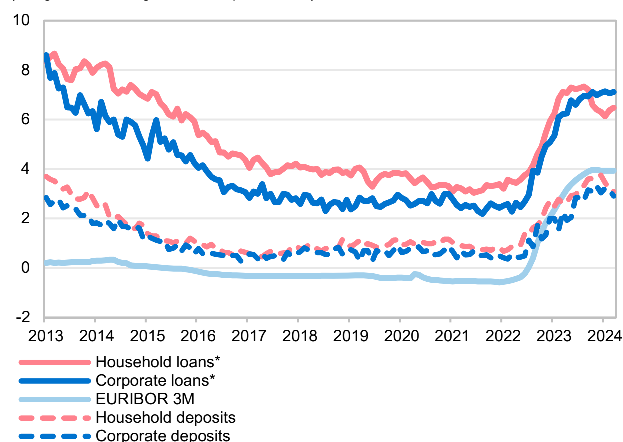
Q1 saw one auction of 3Y **euro government securities**, with the sale nominally worth EUR 99.8 mn and the yield rate of 4.0%. Another auction ensued in April, with the unchanged yield rate and the sale nominally worth RSD 66.2 mn. However, as the previously issued EUR 476.4 mn-worth of securities fell due in January and April, the stock of sold euro securities decreased by EUR 310.3 mn relative to end-2023, coming to EUR 1,609.2 mn at end-April.

Minimal oscillations of interest rates in the domestic interbank money market in Q1 2024 resulted in the interest rate on **new dinar corporate loans** remaining almost unchanged, at 8.3%, while promotional cash loan offers of some banks pushed down the rate on **new dinar household loans** by 0.2 pp to 12.3% in March.

Looking at the structure of dinar corporate lending, a decline in interest rates on working capital and investment loans, by 0.2–0.3 pp to 8.1% and 9.1%, respectively, appears to have been almost fully offset by the rise in interest rate on other non-categorised loans, by 0.1 pp to 8.4%. The fall in the interest rate on dinar household loans was fully led by the decline in the interest rate on cash loans, by 0.5 pp to 12.7%.

After the September hike, the ECB kept the main interest rates on hold, so EURIBOR volatility was minimal, and consequently the **interest rates on euro corporate loans** in the domestic market remained unchanged, measuring 7.1% in March. In the composition of euro lending to corporates by category, a 0.3 pp decline in the interest rate on working capital loans was offset by the rise in the interest rate on other non-categorised and import loans. **The interest rate on euro household loans** edged up by 0.2 pp to 6.5% in March, due to the rise in the interest rate on other non-categorised loans, by 0.2 pp to 10.1%, and the lower share of housing loans, whose interest rate is significantly below the average rate (5.1%), as a result of the application of the NBS decision to cap the interest rates on this loan category.

Chart IV.1.6 **Interest rates on new euro and euro-indexed loans and deposits**
(weighted average values, p.a., in %)



Sources: European Banking Federation and NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

Table IV.1.1 **Interest rates on new loans – by type and currency**
(in %)

	Dinar			Euro and euro-indexed		
	2022	2023	2024	2022	2023	2024
	Q4	Q4	Q1	Q4	Q4	Q1
Total household loans*	12.3	12.5	12.3	5.9	6.3	6.5
Cash loans	13.0	13.2	12.7	3.5	3.3	3.9
Housing loans	11.5	12.9	16.6	5.1	5.0	5.1
Consumer loans	2.7	3.0	3.7	5.5	6.5	6.2
Other loans	10.8	10.5	10.6	8.2	9.8	10.0
Total corporate loans*	7.3	8.3	8.3	5.1	7.1	7.1
Working capital loans	7.6	8.3	8.1	5.2	7.0	6.7
Investment loans	7.6	9.4	9.1	5.2	7.3	7.3
Other loans	7.0	8.3	8.4	4.2	7.3	7.4
Import loans	-	-	-	5.5	6.5	8.0

Source: NBS.
Note: Data relate to average values on the last day of the month in the quarter observed.
* Excluding revolving loans, current account overdrafts and credit card debt.

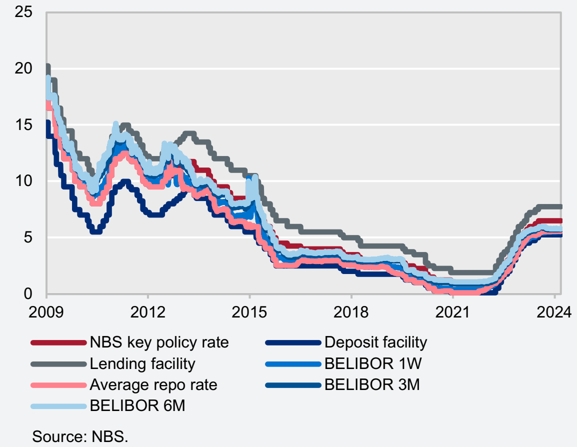
Text box 3: Workings of the transmission mechanism and cycles of monetary policy tightening by the National Bank of Serbia

This text box looks into the efficiency of the NBS's monetary policy transmission mechanism at times of monetary policy contraction, with special emphasis on the latest monetary tightening wave which was undertaken in response to the multidimensional global crisis and which is now most probably over given the anticipated movements in inflation and its key factors.

In small and open economies such as ours, the exchange rate has an important role in the transmission of monetary policy to inflation. For years, the NBS has managed to ensure relative stability of the dinar exchange rate against the euro by making well-timed and measured interventions in the IFEM in both directions, having in mind its significance for price and financial stability and for the certainty of doing business in Serbia. During the latest multidimensional crisis when heightened global pressures prevailed and the entire world was importing high inflation, it is precisely exchange rate stability that helped the domestic economy avoid even higher inflation due to the depreciation of the dinar. We are now not facing the effect which was present before 2012 when, in addition to imported inflation, it was the sharp exchange rate oscillations that made domestic inflation much higher than in euro area countries and countries of the region.

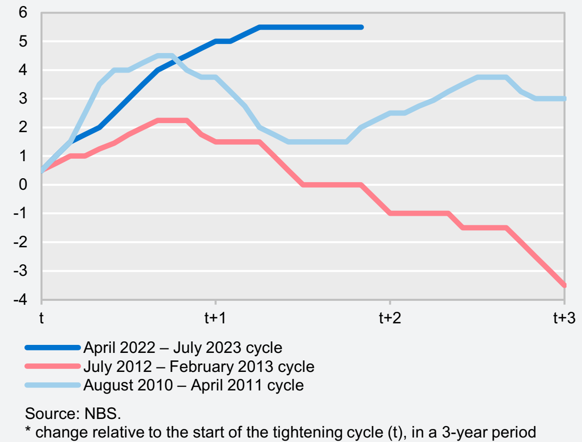
The transmission of monetary policy measures to inflation and economic activity occurs at a different pace and with different intensity through different channels. In Serbia, the most important monetary transmission channels are the exchange rate channel and the interest rate channel, but the expectations channel is also becoming increasingly important, reflecting the rising credibility of the NBS. In inflation-targeting central banks such as the NBS, the key policy rate is the main monetary policy instrument. Its effects are transmitted **through the interest rate channel** via its impact on money market interest rates and, further, on dinar lending and deposit rates of commercial banks. The efficiency of the interest rate channel depends on the speed and degree of transmission and on the elasticity of loan demand to changes in interest rate levels. Thanks to the flexibility of its monetary policy framework, the NBS began its latest cycle of monetary policy tightening already in October 2021 by raising the average repo rate in reverse repo auctions of securities. Monetary policy was tightened in the conditions of global inflation growth which was mostly guided by rising food and energy prices in international markets. An additional push to global

Chart O.3.1 **Interest rate movements**
(daily data, in %)



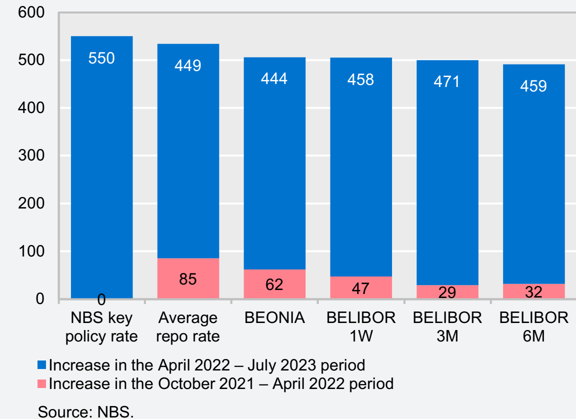
Source: NBS.

Chart O.3.2 **Cumulative change in the key policy rate relative to the start of the tightening cycle***
(in pp)



Source: NBS.
* change relative to the start of the tightening cycle (t), in a 3-year period

Chart O.3.3 **Change in money market interest rates in the October 2021 – July 2023 period**
(in bp)



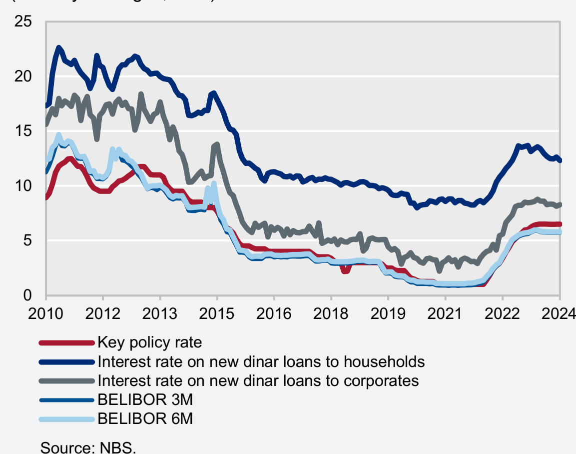
Source: NBS.

inflation came from prices of other products which spiked due to problems in global supply chains amid sudden rallying of aggregate demand that had previously been subdued in the first stage of the coronavirus pandemic. With the outbreak of the Ukraine conflict in early 2022, inflation growth became more entrenched, soaring to record-high levels globally, and it became necessary to intensify the latest cycle of monetary policy tightening by leading central banks as well as by the NBS. Between April 2022 and July 2023, the NBS responded by lifting its key policy rate by a total of 550 bp to 6.5%. Though this cycle of monetary policy tightening was longer than the earlier ones and this is the largest cumulative key policy rate increase so far, the achieved key policy rate level of 6.5% is lower than in previous cycles of key policy rate increases – the key policy rate was raised by 450 bp to 12.5% between August 2010 and April 2011, and by 225 bp to 11.75% between July 2012 and February 2013. It is also important to note that the domestic macroeconomic fundamentals were much different during the previous two cycles of monetary policy tightening, when pronounced external and fiscal imbalances were present. The monetary contraction cycle which began in 2010 was triggered mostly by the public debt crisis faced by some euro area economies after the global financial crisis. Because of strong economic and financial ties, the risk premium of South and East European countries, including Serbia, increased, leading to local currency depreciation. This was compounded by pressures from rising food prices, both at home and abroad. The cycle of key policy rate hikes initiated in 2012 was shorter and less intensive. It was, to a degree, spurred by an increase in global oil prices, but also by depreciation pressures in the domestic market caused by excessive government spending in the pre-election period.

As we can see in Chart O.3.2 which shows cumulative changes in the key policy rate in given periods of time, the latest cycle of monetary policy tightening took place at a more measured pace, spanning a longer time interval, particularly compared to the 2010 monetary policy contraction. After its increase, the key policy rate remained unchanged, while the previous cycles were quickly followed by monetary policy easing because inflation was more volatile as well.

Looking at the extent of transmission of monetary policy tightening to interest rates in the money market during the last cycle, we can conclude that it was almost full. In the latest cycle, the BEONIA rate increased by 506 bp from end-September 2021 to 5.20% at end-July 2023, while BELIBOR interest rates of all maturities rose by 501 bp on average and ranged from 5.24% for the shortest to 5.98% for the six-month maturity. In the previous cycles, the degree of transmission was somewhat lower – in the 2010 cycle, the BEONIA interest rate gained 390 bp and BELIBOR interest rates of all maturities around 398 bp on average. Changes in the level of money market interest rates during the 2012 monetary policy contraction cycle are not comparable because the auction model was changed during the cycle of policy rate hikes (there was a switch from repo purchase to repo sale of securities in December 2012, and from the fixed interest rate method to the variable interest rate method, leading to a decline in the average repo rate and its deviation from the key policy rate). The efficiency of the interest rate transmission channel is also reflected in the movement of interest rates on new dinar loans, whereas the intensity of transmission to banks' deposit rates is somewhat weaker due to banking sector's high liquidity. In the latest cycle of monetary policy tightening, the interest rate on total dinar corporate loans (mostly working capital loans) increased by 5.3 pp while the interest rate on dinar loans to households (mostly dinar cash loans) gained 5.0 pp, which means that the transmission was almost full. The interest rate on dinar corporate deposits rose by 4.6 pp in the observed period, while the rate on dinar household savings edged up by 3.2 pp. As in 2010 the key policy rate hike cycle was less intensive and money market interest rates increased less, the interest rate on dinar corporate loans also increased to a smaller degree, by 1.9 pp, and that on household loans by 3.9 pp. During the 2012 cycle, the interest rate on corporate loans fell by 1.7 pp due to a lower average repo rate, while that on

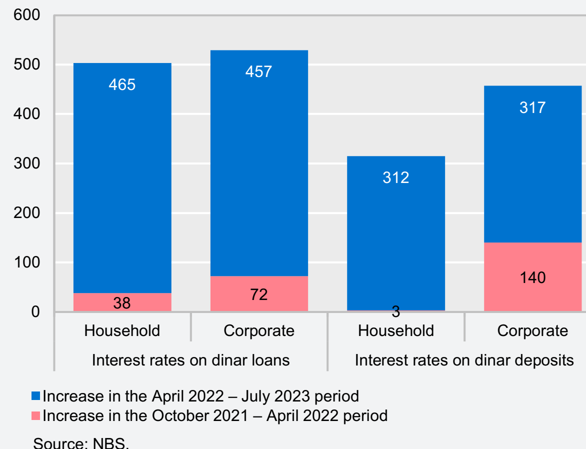
Chart O.3.4 **Interest rate movements**
(monthly averages, in %)



Source: NBS.

household loans rose by 2.0 pp. However, even as interest rates on dinar loans increased more than in the previous cycles, dinar loans are still much cheaper than before thanks to the reduced risk premium of the country and a more favourable credit rating for long-term borrowing which is now a notch away from investment-grade (Chart O.3.4). The efficiency of the transmission mechanism increased in the observed period also due to higher dinarisation of loans and deposits which, relative to April 2012 when the first Memorandum on the Dinarisation Strategy was signed, grew by 6.9 pp to 35.2% in March 2024 for receivables and by 24.1 pp to 43.4% for deposits.

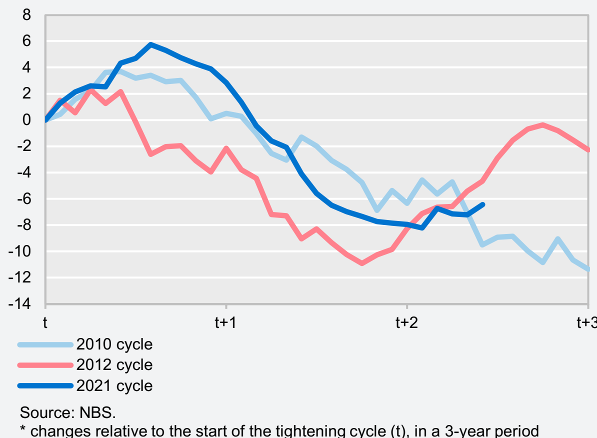
Chart O.3.5 **Changes in interest rates in the dinar market of loans and deposits in the October 2021 – July 2023 period**
(in bp)



Source: NBS.

The same as in the previous cycles, in the latest tightening cycle y-o-y lending activity growth slowed, mostly for corporate loans, which speaks in favour of the efficiency of the credit channel. The slowing of loan growth in the latest cycle was influenced by several factors. Not only was the NBS's monetary policy tightening the most intense to date, but it also largely coincided with the ECB's monetary restriction. The 450 bp hike in the ECB's policy rate between June 2022 and September 2023 pushed up rates on euro loans which make up around two-thirds of total loans to the non-monetary sector. Lending activity growth was also slowed by the maturing of guarantee scheme loans approved to mitigate the negative effects of the coronavirus pandemic, with the highest amounts of those loans maturing in 2022 and 2023. In addition to monetary policy tightening, according to the results of the bank lending survey, banks have tightened their corporate credit standards from H2 2021 and household credit standards from Q2 2022, resulting in fewer loans being approved. In 2022, total loans gained RSD 211.9 bn (of which corporate loans RSD 106.5 bn and household loans RSD 85.4 bn), compared to 2021 when they increased by RSD 260.8 bn. In 2023, total loans went up by RSD 32.1 bn (of which corporate loans by RSD 13.8 bn and household loans by RSD 16.8 bn). The increase recorded in 2023 is the lowest annual increase in loans since 2015; it should be noted that the annual increase in loans exceeded RSD 200 bn in the period 2019–2022.

Chart O.3.6 **Changes in y-o-y growth rates of total loans relative to the start of the NBS monetary tightening cycle***
(in pp)



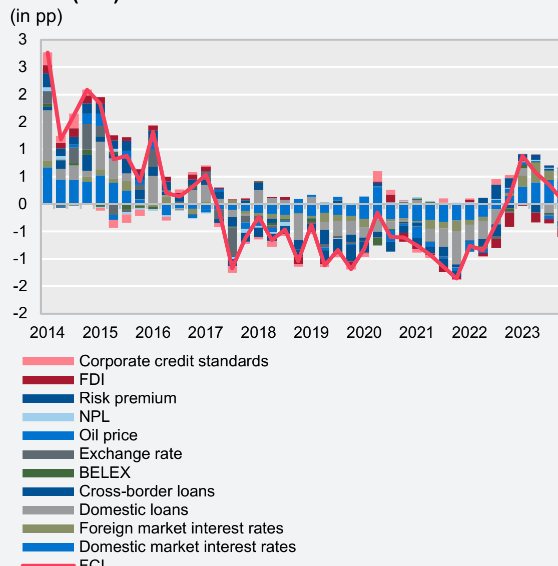
Source: NBS.
* changes relative to the start of the tightening cycle (t), in a 3-year period

The efficiency of our transmission mechanism is also confirmed by movements in the estimated financial conditions index (FCI),[1] which is a composite indicator summarizing financial conditions for financing an economy. The value of the index is calibrated so that its decline points to improved financial conditions and positive values are interpreted as a tightening of financial conditions. Chart O.3.7 shows that the FCI was mostly on a downward path until Q4 2021, which was consistent with the monetary policy stance and inflation movements. After the start of monetary policy tightening by the NBS and the ECB, the FCI's value began to rise from Q4 2021, i.e. financial conditions became less propitious for economic growth which was inevitable in the conditions of rising inflation. Observed by index component, we can see that monetary policy tightening by the NBS and the ECB induced a rise in the interest rates on dinar, and euro and euro-

[1] See: Inflation Report – May 2021, Text box 3 (https://www.nbs.rs/export/sites/NBS_site/documents-eng/publikacije/ioi/izvestaji/inflation_report_05_2021.pdf

indexed loans (at home and abroad) and contributed to more stringent financial conditions in Serbia. Also, if we look at the increase in interest rates and the maturing of guarantee scheme loans, we can see that lending activity growth at home began to slow and work towards tighter financial conditions. The situation was similar with credit standards which banks tightened gradually due to reduced risk propensity and higher financing costs. Mounting uncertainty in the international financial market heightened investors' risk aversion, pushing up the risk premium; from 2022, financial conditions tightened on this account as well. The 2022 and 2023 increase in oil prices also affected the corporate sector's financial position. On the other hand, owing to the preserved financial stability in Serbia, corporate NPLs continued down even during the crisis and moved around their all-time minimum. A positive impulse to financial conditions, even in times of crisis, came from the steady increase in FDI inflows and from corporate borrowing abroad which greatly slowed the entry of financial conditions into restrictive zone and represents evidence that investment and business confidence has been preserved during the crises, thanks also to a great extent to the relative stability of the exchange rate.

Chart O.3.7 **Decomposition of the financial conditions index (FCI)**
(in pp)

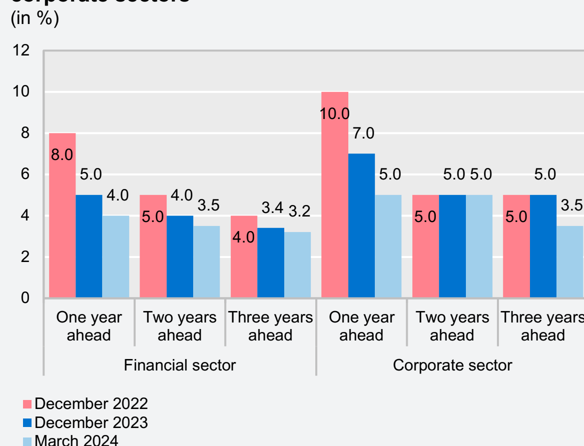


Source: NBS.

The efficiency of the expectations channel has also been confirmed. In particular, one-year ahead inflation expectations of the financial sector returned within the target band in early 2024, after hovering above its upper bound in 2023. Medium-term expectations of the financial sector have been anchored for quite some time, reflecting improved credibility of the NBS and market players' confidence in the NBS's measures. Corporate sector's expectations also continued down, approaching the upper bound of the target band.

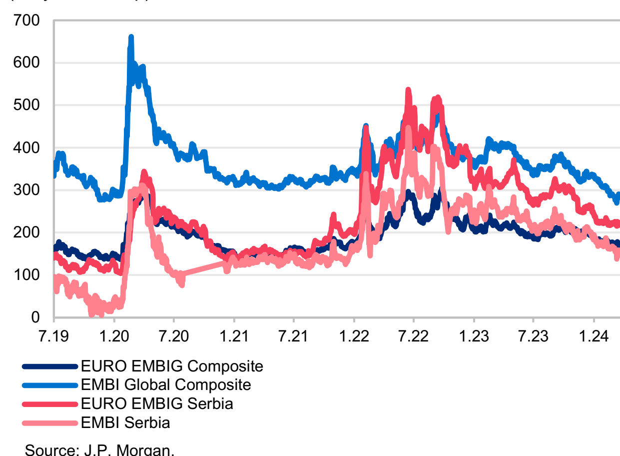
Given that inflation has been on a steady downward path since April 2023, that the pace of its deceleration is the same as that of its acceleration, and that it has approached the upper bound of the target band, we can conclude that the monetary policy transmission mechanism has been efficient. In addition, by taking measured and well-timed decisions, we have preserved financial stability and a favourable growth outlook for our economy, ensuring a soft landing. Based on the rhetoric of leading central banks' officials and market participants' expectations, monetary conditions can be expected to ease in the near future, reflecting positively on credit growth at home. This is also confirmed by the results of the bank lending survey according to which banks relaxed their corporate credit standards in Q1 2024, for the first time in almost three years. Further relaxation of standards is expected going forward. In addition, the results of an ad hoc survey of expectations for 2024 and 2025 show that almost all banks expect lending activity to expand this and the next year, with growth anticipated to gather further momentum in 2025. At the same time, banks expect the degree of financial system dinarisation to go up, further reinforcing the NBS's transmission mechanism.

Chart O.3.8 **Inflation expectations of the financial and corporate sectors**
(in %)



Sources: Ipsos and NBS.

Chart IV.1.7 **Risk premium indicators**
(daily data, in bp)



Source: J.P. Morgan.

Table IV.1.2 **Credit rating**
(change of rating and outlook)

	2019	2020	2021	2022	2024
S&P	BB+ /positive[6]	BB+ /stable[3]	BB+ /positive[6]	BB+ /stable[4]	BB+ /positive[2]
Fitch	BB+ /stable[5]				
Moody's	Ba3 /positive[5]		Ba2 /stable[1]		

Source: NBS.
[1] March, [2] April, [3] May, [4] June, [5] September, [6] December.
Note: There was no change in rating/outlook in 2023.

Risk premium

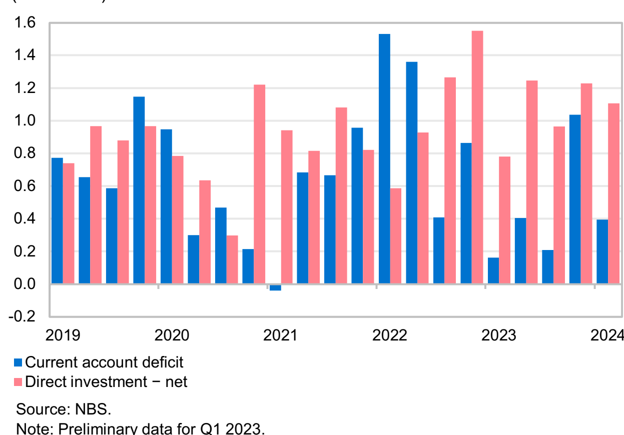
Having increased moderately early in the year, the global risk premium of emerging economies declined in the remainder of Q1, mainly reflecting market participants' expectations that leading economies will manage to dodge recession and that soft landing is almost certain, with their central banks about to embark on a rate-cutting cycle this summer.

EURO EMBIG Composite declined by 23 bp in Q1 and by 7 bp in April, to 170 bp at the end of the month. Serbia's EURO EMBIG edged down to the same degree in Q1 and by 8 bp to 216 bp in April. Serbia's dollar risk premium EMBI dropped by 20 bp in Q1, and by further 12 bp in April to 156 bp. It thus continued to move below EMBI Composite which in Q1 fell by 32 bp, to 287 bp at end-March, and then regained 14 bp in April.

In February, Fitch affirmed Serbia's credit rating at BB+ with a stable outlook, one notch below investment grade. The key factors cited were the credible overall economic policy framework, a higher level of economic development, better governance and stronger human development compared with BB medians, as well as sound public finances and falling public debt.

In April, Standard & Poor's increased Serbia's outlook from stable to positive. The decision reflects Serbia's strong macroeconomic outcomes in 2023, the resilience of our economy amid global turbulences over the past years, and most of all the consistent macroeconomic policy framework underpinning economic growth sustainability, buffers that can be tapped in case of external shocks, a high and diversified FDI inflow and improvement of the fiscal and external position.

Chart IV.1.8 **Current account deficit and net FDI inflow**
(in EUR bn)



Source: NBS.
Note: Preliminary data for Q1 2023.

Foreign capital inflow

FDIs continued to account for the bulk of capital inflow to the financial account in Q1 2024, recording high values and providing multiple coverage for the current account deficit. Along with inflows from financial loans, FDI inflow sufficed to compensate for the outflows stemming from increased balances in domestic banks' foreign accounts, trade loans and portfolio investments.

FDI inflow to Serbia amounted to EUR 1.3 bn in Q1, up by 53.4% y-o-y. The major part of FDI inflow took the form of equity and reinvested earnings (79%), attesting to foreign investors' continuing commitment to Serbia. Sector-wise, the bulk of investments were channelled to construction, information and communications and

manufacturing. At the same time, net FDI inflow in Q1 equalled EUR 1.1 bn, up by nearly 42% from the same period in 2023.

During January and February, non-residents increased their investment in dinar government securities in the primary market. Nevertheless, this inflow was outweighed by the outflow on account of resident investments in the international market and payments under amortisation bonds, which were sold in the international market through private placement in 2022. Such trends led to a net capital outflow of EUR 424.3 mn under **portfolio investments** in Q1.

Financial loans generated a net inflow of EUR 305.5 mn in Q1, on the back of higher corporate and government borrowing, while banks reduced their foreign credit liabilities. Domestic banks increased balances in their foreign accounts, which exceeded the rise in non-resident accounts with domestic banks, leading to the outflow of EUR 768.5 mn in currency and deposits in Q1. An outflow was also registered under trade loans and advances (EUR 239.6 mn).

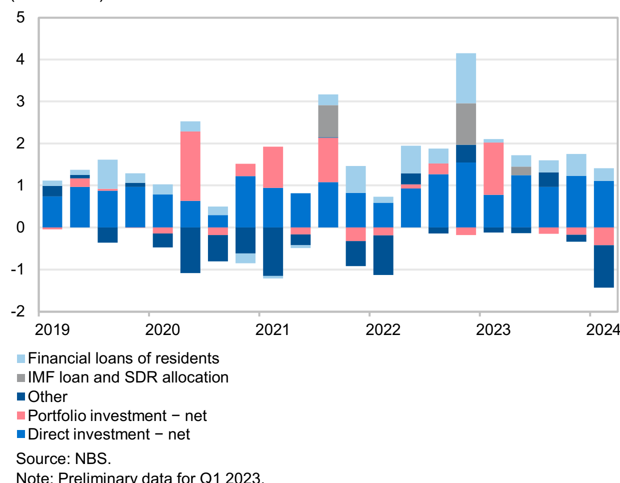
Trends in the FX market and exchange rate

The dinar stayed relatively stable against the euro in Q1, its end-March value being broadly unchanged from end-2023. At the same time, affected by the euro's depreciation against the dollar in the international market, the dinar nominally weakened against the dollar by 2.6%.

Early 2024 witnessed depreciation pressures, while appreciation pressures reemerged in the second half of January, reaching their strongest in February. On a quarterly basis, FX supply outstripped the demand, with the residents being the key contributors to the supply growth. Quite unseasonally, they were net sellers of FX in Q1, thanks to the continuing rise in exports and FDI inflows, despite the FX purchases for energy import purposes. Working in the same direction were the net purchase of foreign cash and FX inflow from payment card transactions. FX supply was also boosted by non-residents, who bought dinar government securities in the second half of January and early February. They created FX demand in March which was fully covered by FX inflows from other sources. On the other hand, mainly during January and to a lesser extent in February, FX demand was also driven by a decline in FX-indexed banks' assets.[3]

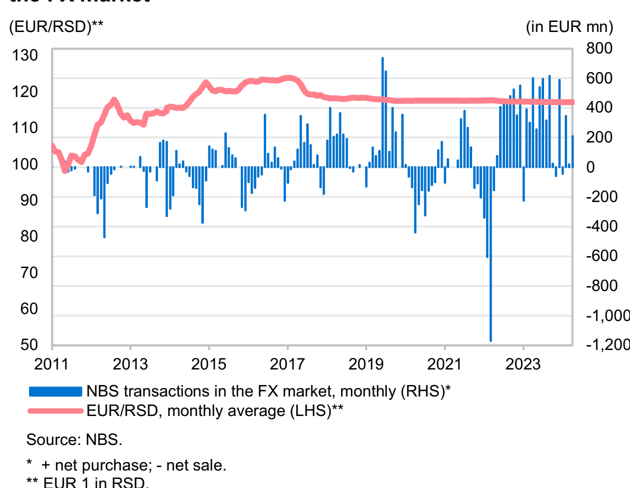
[3] Aiming to balance their short open FX positions and reduce exposure to FX risk, banks buy foreign currency, which works toward the weakening of the dinar.

Chart IV.1.9 **Structure of the financial account**
(in EUR bn)



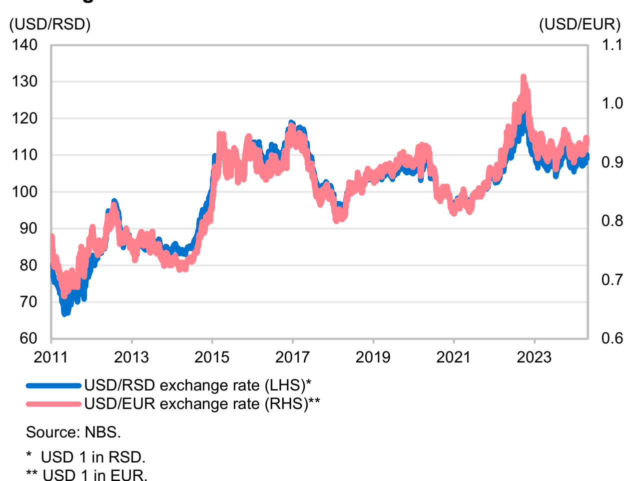
Source: NBS.
Note: Preliminary data for Q1 2023.

Chart IV.1.10 **Dinar exchange rate and NBS transactions in the FX market**



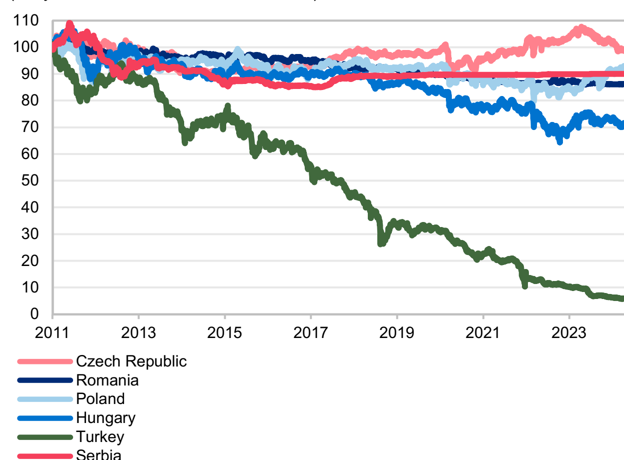
Source: NBS.
* + net purchase; - net sale.
** EUR 1 in RSD.

Chart IV.1.11 **Movements in USD/RSD and USD/EUR exchange rates**



Source: NBS.
* USD 1 in RSD.
** USD 1 in EUR.

Chart IV.1.12 **Exchange rates of selected national currencies against the euro***
(daily data, 31 December 2010 = 100)



Sources: NBS and websites of central banks.
* Growth indicates appreciation.

To maintain the relative stability of the dinar exchange rate against the euro, the NBS intervened in the IFEM mainly on the purchase side in January and mainly on the sale side in February, March and April, which resulted in a net purchase of EUR 530.0 mn since the beginning of the year.

The currencies of inflation-targeting regional peers recorded divergent trends relative to the euro in Q1. Thus, due to lower policy rates, the Hungarian forint weakened by 3.3% and the Czech koruna by 2.3%, while the Turkish lira lost the most (6.1%) in the face of additional monetary policy tightening. Conversely, the Polish zloty and Romanian leu gained ground (1.1% and 0.1%, respectively).

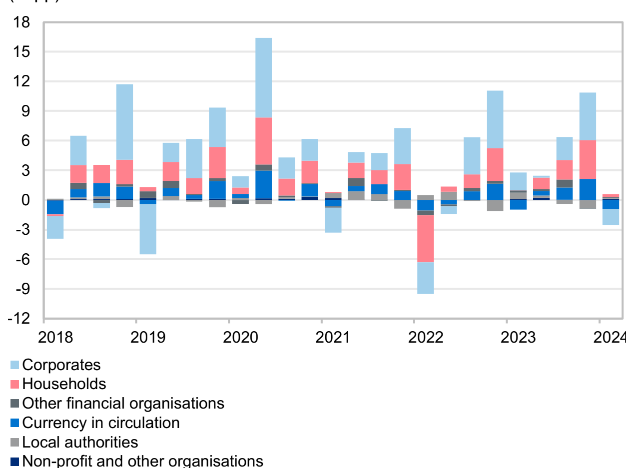
2 Money and loans

Overall money supply M3 decelerated further y-o-y. Namely, its growth in Q1 was weaker than in the same period last year due to a contraction in dinar demand deposits.

Lending remained subdued in Q1. A mild acceleration of its y-o-y growth to 1.3% in March came as a result of the easing of credit standards amid a more favourable overall economic situation, primarily for corporate loans, and elevated household loan demand.

Money

Chart IV.2.1 **Contributions to quarterly growth in M2, by sector**
(in pp)



Source: NBS.

The broadest monetary aggregate M3, which in addition to dinars includes FX deposits of non-monetary sectors, edged up negligibly by 0.3% in Q1 2024, driven by the expansion of FX deposits, while the contracted dinar component worked in the opposite direction due to a seasonal fall in the most liquid dinar component M1.

In terms of individual categories, dinar **demand deposits** dipped in Q1 by RSD 24.8 bn, chiefly on account of reduced transaction deposits of corporates, and to a lesser extent, of households too. The RSD 19.9 bn fall in dinar time deposits of corporates was in part compensated by the rise in **household dinar savings** (RSD 12.6 bn), but also deposits of other sectors. Hence, the stock of time deposits stayed unchanged in Q1. Thanks to the preserved financial stability in the periods of heightened global uncertainty, household dinar savings recorded the most dynamic growth thus far (by RSD 40.8 bn) and continued to post new record levels, measuring RSD 149.1 bn at

end-March.[4] Relative stability of the dinar exchange rate against the euro, higher interest rates on dinar compared to euro savings, as well as the more favourable tax treatment, made dinar savings more profitable than FX savings, contributing to their more dynamic growth. The degree of corporate and household deposits dinarisation measured 43.4% in March, close to its historical record.

FX deposits of non-monetary sectors went up by EUR 474.3 mn in Q1 2024, mostly led by the rising FX deposits of households (by RSD 351.5 mn), which reached their highest level thus far (EUR 13.8 bn), and by higher corporate FX deposits (by RSD 129.7 mn).

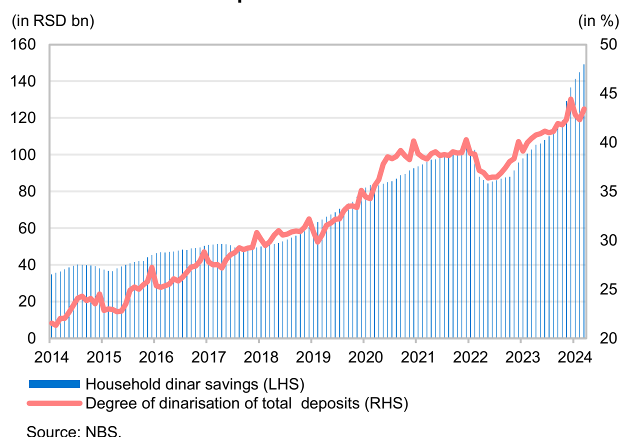
Y-**o-y**, the rise in M3 slackened in Q1 2024 compared to Q4 2023, to 11.2% in March. In addition, the excess money ratio, measuring the deviation of the actual money supply M3 from the estimated one,[5] was negative, indicating that M3 was below the inflationary level.

Loans

Excluding the exchange rate effect,[6] **total domestic loans to the non-monetary sector** picked up their y-o-y growth by 1.3% in March (from 1.0% at end-2023), primarily owing to **household loans**, which accelerated by 2.7% y-o-y, whereas **corporate loans** stagnated. Lending activity is still under the impact of higher lending rates on dinar and euro-indexed loans amid past monetary tightening by the NBS and the ECB. In addition, in the corporate loan segment, albeit weaker than in earlier years, a negative impact on the loan stock came from the maturing of guarantee scheme loans. Still, for the first time after a longer period of tightening, banks eased their credit standards in Q1, notably for the corporate sector. The easing is expected to continue in Q2 as well, which should contribute to higher lending to the private sector in the forthcoming period.

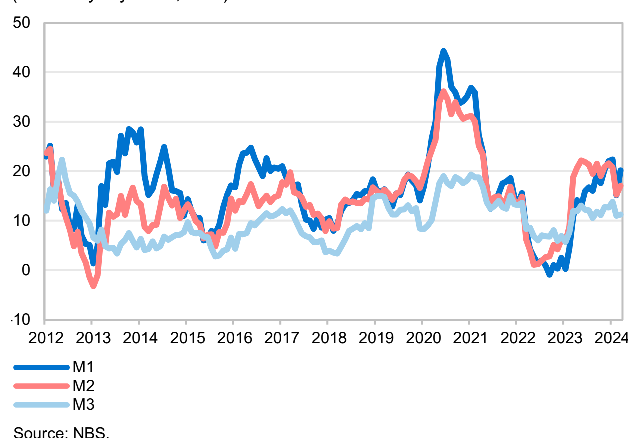
Corporate loans declined by RSD 26.6 bn in Q1, partly owing to the seasonal drop in these loans at the start of the year, with the decline more pronounced in loans to public enterprises. By type of loans, receivables under investment, liquidity and working capital loans decreased, in part due to the maturing of guarantee scheme loans, and so did receivables under other non-

Chart IV.2.2 **Dinar household savings and degree of dinarisation of total deposits**



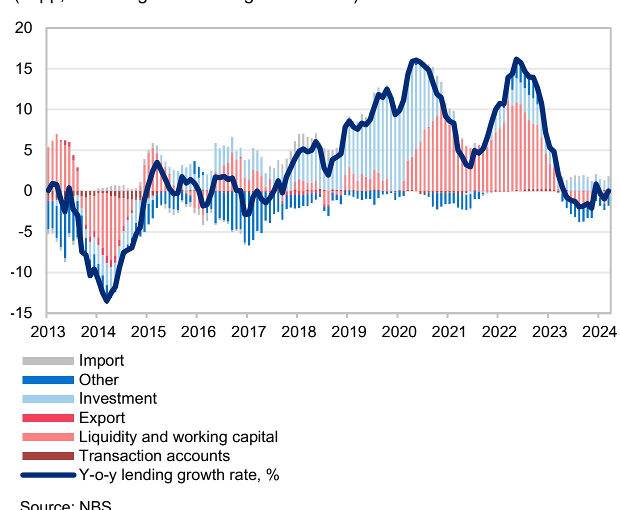
Source: NBS.

Chart IV.2.3 **Monetary aggregate movements**
(nominal y-o-y rates, in %)



Source: NBS.

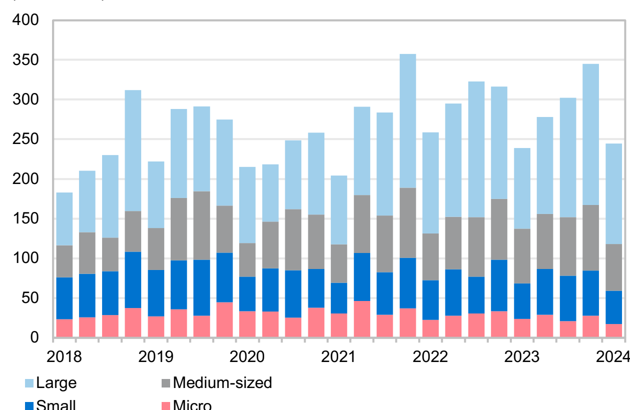
Chart IV.2.4 **Contributions to y-o-y corporate lending growth**
(in pp, excluding the exchange rate effect)



Source: NBS.

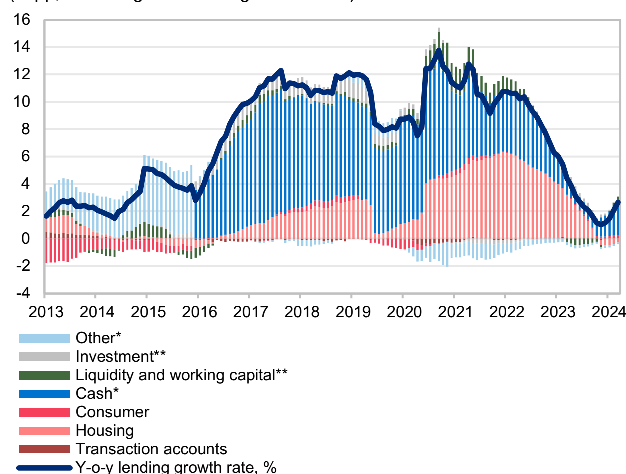
[4] If the assets of non-residents are included, end-March dinar savings equalled RSD 151.6 bn and FX savings EUR 14.8 bn.
[5] The money demand equation was estimated using the regression model, with the real GDP and 3M BELIBOR featuring as explanatory variables.
[6] Calculated at the new programme exchange rate, as at 31 October 2022.

Chart IV.2.5 **Structure of new corporate loans, by enterprise size**
(in RSD bn)



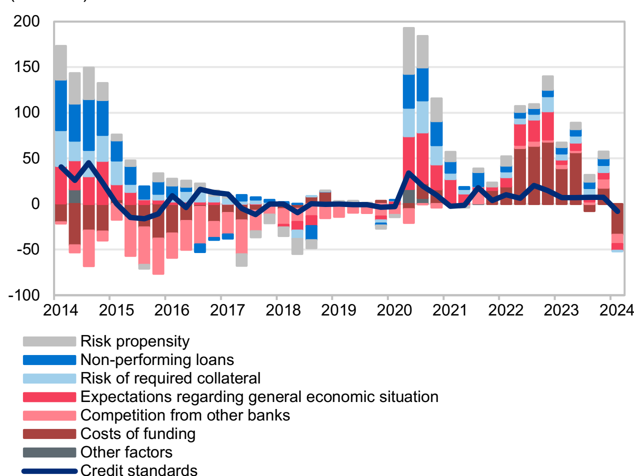
Source: NBS.

Chart IV.2.6 **Contributions to y-o-y household lending growth**
(in pp, excluding the exchange rate effect)



Source: NBS.
* Until December 2015, the contribution of cash loans is shown within the contribution of other loans.
** Loans extended to entrepreneurs.

Chart IV.2.7 **Change in corporate credit standards and contributing factors**
(in net %)



Source: NBS.
Note: Growth indicates the tightening and decline indicates the easing of credit standards.

categorised loans. On the other hand, borrowing under import and current account loans increased. The share of liquidity and working capital loans in total corporate loans increased in Q1 by 0.1 pp to 46.9% in March, while the share of investment loans, the next in line, decreased to 41.2% (from 41.9% at end-2023). Companies across almost all sectors borrowed less, mostly those in transport, agriculture and construction, while only companies in energy and trade recorded higher borrowing. By company size, micro, small and medium-sized enterprises reduced their liabilities to banks more than large enterprises, resulting in a 0.4 pp lower share of loans approved to this segment of enterprises in March (58.7%) compared to end-2023. The decrease in FX-indexed corporate receivables and a mild rise in dinar corporate receivables led to a higher degree of dinarisation of corporate receivables in March this year (17.8% vs. 17.3% at end-2023).

The volume of new corporate loans in Q1 amounted to RSD 244.4 bn, up by 2.3% compared to the same period of 2023. Liquidity and working capital loans remained dominant (62%). More than a half of these loans was approved to micro, small and medium-sized enterprises. Investment loans accounted for one-fifth of new loans, and two-thirds of them were absorbed by micro, small and medium-sized enterprises.

Household loans, excluding the exchange rate effect, grew by RSD 20.9 bn in Q1, driven by the rise in cash loans, followed by housing loans and borrowing under transaction accounts. As a result, the share of cash loans in total household loans went up by 0.3 pp in Q1, to 45.0%, while the share of housing loans decreased to the same extent, to 39.0% in March. Borrowing in dinars accounted for over four-fifths of the rise in household loans in Q1, pushing the degree of dinarisation of household receivables further up by 0.4 pp, to 54.5% in March.

The volume of new household loans amounted to RSD 157.8 bn in Q1, up by 31.5% y-o-y. This was driven mainly by cash loans, which accounted for almost 70% of new household loans. The next in line were housing loans, which made up 13% of new household loans (a decrease from 2022, when they accounted for over one-fifth of new household loans on average), reflecting elevated real estate prices and costs of borrowing.

The results of the NBS's April bank lending survey[7] show that for the first time after a longer period of

[7] The NBS has conducted the survey since the beginning of 2014.

tightening, banks eased their credit standards in Q1, mainly for dinar loans. The standards were eased primarily for corporates, reflecting lower costs of financing, competition and positive expectations regarding the overall economic situation. Household credit standards were loosened mildly as well, under the impact of positive expectations regarding economic activity. Banks expect that credit standards for both sectors will be loosened further in Q2. In banks' view, dinar corporate loan demand expanded, while FX loan demand contracted. Loan demand of enterprises of all sizes subsided, reflecting lower need to finance investment and working capital, while debt restructuring worked in the opposite direction. At the same time, household loan demand expanded for dinar cash and refinancing loans. For the first time in a year a half, banks assessed that FX-indexed housing loan demand went up. Demand growth in the household segment reflected the needs to refinance existing loans and purchase durable consumer goods, with a positive influence stemming from rising wages, while the situation in the real estate market, i.e. high apartment prices, worked in the opposite direction. Banks expect loan demand to expand in Q2 in both sectors.

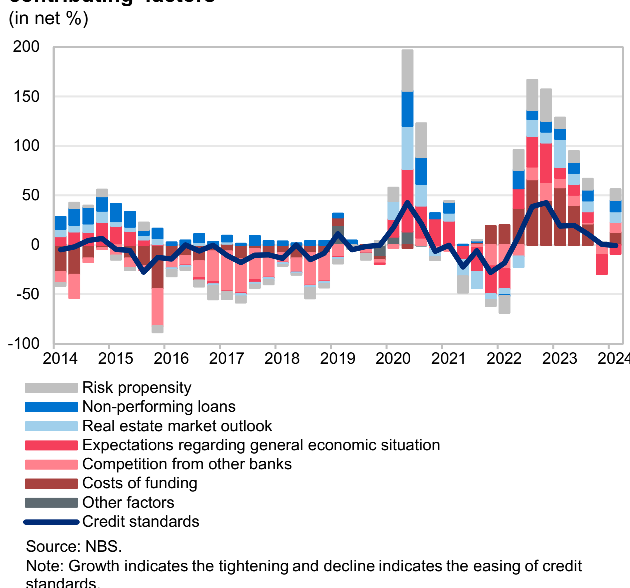
Gross NPL ratio continued to move close to its historical low in Q1, suggesting that the tightening of financial conditions had no major impact on bank asset quality. In March, this ratio measured 3.2%, unchanged from end-2023. Gross NPL ratio of the corporate sector[8] equalled 2.3% in March and of the household sector 4.3%.[9] NPL coverage remained high as allowances for impairment of total loans measured 98.7% of NPLs and allowances for impairment of NPLs – 59.1% of NPLs.

Capital adequacy ratio equalled 21.2% at end-Q1, down by 0.2 pp from end-2023, indicating high capitalisation (regulatory minimum – 8.0%) and resilience of the banking sector to external and local risks.

3 Aggregate demand

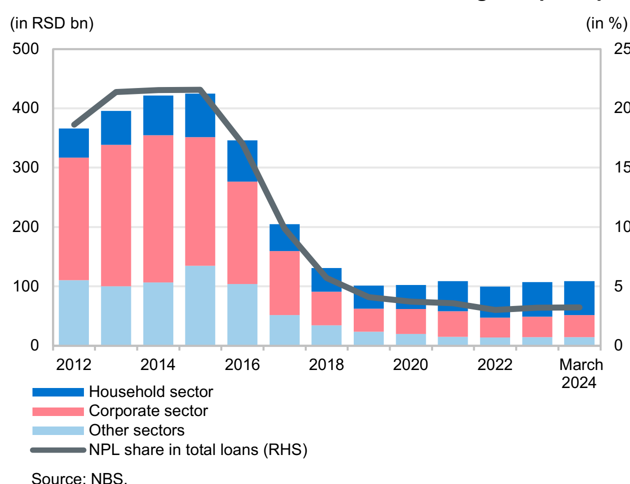
According to SORS, economic growth in Q1 exceeded our expectations from the previous Report and amounted to 4.6% y-o-y. We estimate that the growth was driven by domestic demand, with the highest contribution coming from household consumption and

Chart IV.2.8 **Change in household credit standards and contributing factors**
(in net %)



Source: NBS.
Note: Growth indicates the tightening and decline indicates the easing of credit standards.

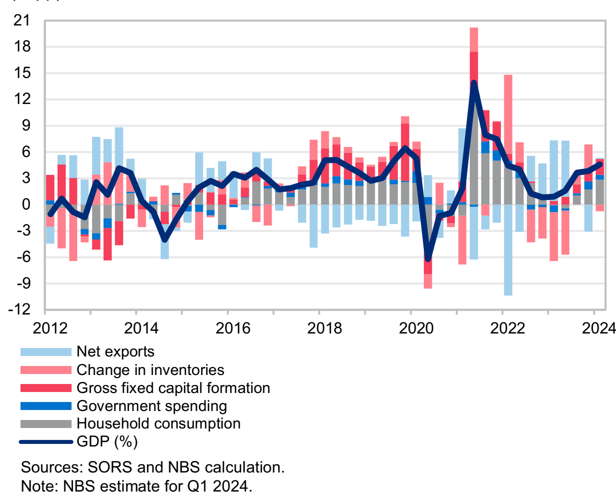
Chart IV.2.9 **NPL level and share in total loans, gross principle**



Source: NBS.

[8] Including companies and public enterprises. Looking at companies only, the share of NPLs in total loans increased by 0.2 pp to 2.6% in March.
[9] With entrepreneurs and private households included, the share of NPLs declined by 0.1 pp, to 4.2% in March.

Chart IV.3.1 **Contributions to y-o-y GDP growth rate, expenditure side**
(in pp)



Sources: SORS and NBS calculation.
Note: NBS estimate for Q1 2024.

Table IV.3.1 **Movement in key indicators and sources of household consumption**
(real y-o-y growth rates, in %)

	2023			2024
	Q2	Q3	Q4	Q1
Household consumption	**-0.6**	**1.5**	**2.6**	**4.3 ***
Indicators				
Retail trade	-5.7	-1.4	2.6	6.5
Catering turnover	7.3	6.0	8.8	14.6 ***
Number of domestic tourists	1.0	-4.7	-5.4	7.5
Number of overnight stays of domestic tourists	0.8	-10.4	-14.0	6.2
Consumer goods import (BEC classification), nominal	5.7	4.2	-0.3	6.2
Sources				
Total wage bill, nominal	18	16.4	15.9	17.0 **
Net remittances inflow, nominal	0.1	-6.0	-15.8	-0.7
Stock of loans intended for consumption, nominal	1.0	0.9	2.0	4.0

Sources: SORS and NBS calculation.
* NBS estimate.
** January–February.
*** January.

Table IV.3.2 **Investment indicators**

	2023			2024
	Q2	Q3	Q4	Q1
Real y-o-y growth rates (in %)				
Fixed investment (national accounts)	3.9	4.1	5.2	8.0 *
Construction (national accounts)	14.8	13.0	7.4	8.0 *
Government investment	7.2	10.0	12.0	5.0 *
Number of issued construction permits	2.9	11.2	15.6	1.7 **
Production of construction material	-10.8	3.5	-2.4	3.5
Value of works performed	17.6	15.9	11.1	18.3
Equipment imports, nominal	-20.5	-15.6	7.6	7.6
Production of domestic machinery and equipment	11.1	-2.4	-10.6	-18.0

Sources: SORS and NBS calculation.
* NBS estimate.
** January–February.

fixed investments. Net exports also generated a mildly positive contribution as the real growth in the exports of goods and services was somewhat faster than that of imports, reflecting the euro area recovery.

Domestic demand

According to our estimate, **private consumption** has been recovering gradually since H2 2023, and its y-o-y rise accelerated in Q1 to 4.3%, adding 2.9 pp to GDP growth. Household consumption growth is indicated by the retail trade turnover which increased by 6.5% y-o-y in Q1, as well as catering turnover which expanded by 14.6% y-o-y in January. At the same time, the number of domestic tourists' arrivals and overnight stays increased by 7.5% and 6.2% y-o-y, respectively. The import of consumer goods also went up, by 6.2% y-o-y in Q1.

Observing the sources, the rise in household consumption in Q1 was driven by its main source, i.e. the wage bill which continues to record a double-digit nominal y-o-y increase (17.0% in January–February), while its real growth reached 10.2% y-o-y owing to inflation's further slowdown. Household consumption in Q1 was also supported by loans intended for consumption, whose y-o-y rise gradually accelerated as of Q3 2023, to 4.0% in Q1. On the other hand, remittances recorded a decrease for the third consecutive quarter, which amounted to 0.7% y-o-y in Q1.

We estimate that **government consumption** continued to provide a positive contribution to GDP growth (0.5 pp in Q1), rising by 3.5% y-o-y, driven by higher expenses for public sector wages and procurement of goods and services. As a result of these movements, **total consumption** increased by 4.2% y-o-y in Q1.

Private investments maintained the positive dynamics in Q1 despite the still pronounced geopolitical tensions which have an adverse impact on global investment confidence. We estimate that the growth in private investment accelerated to 9.5% y-o-y in Q1 partly as a result of the last year's low base. As for the sources of investment financing, a significant rise in FDI inflow is striking. In Q1, it was higher by almost 50% in y-o-y terms. Q1 also saw an increase in investment loans by 1.8% y-o-y and we estimate that the bulk of private investments was financed from corporate profit generated in previous years. That private investments rose is also indicated by the continued growth in the production of construction materials (3.5% y-o-y) in Q1, as well as by the number of issued construction permits which went up by 1.7% y-o-y in January–February. The

value of construction works performed, which increased by 18.3% y-o-y in Q1, points to the same conclusion.

Supported by the continued implementation of government-financed infrastructure projects, **government investments** went up by 5.0% y-o-y in Q1, in our estimate. Accordingly, **total fixed investment** increase is estimated at 8.0% y-o-y, with a 1.8 pp contribution to GDP growth in Q1.

At the same time, **a decrease in inventories**, primarily of agricultural products, on account of increased exports, provided a negative contribution to GDP growth (0.7 pp) in Q1. Besides, inventories of final industrial products also slumped, mainly under the impact of smaller supplies of petroleum products due to the overhaul-induced halt in domestic production.

In quarterly terms, we estimate that GDP growth in Q1 mildly stepped up from Q4 2023 and measured 1.1% s-a. Quarterly growth was led by net exports, thanks to a faster rise in exports than in imports of goods and services. A positive contribution also came from household consumption and private investments, while headwinds came from inventories and government consumption and investments.

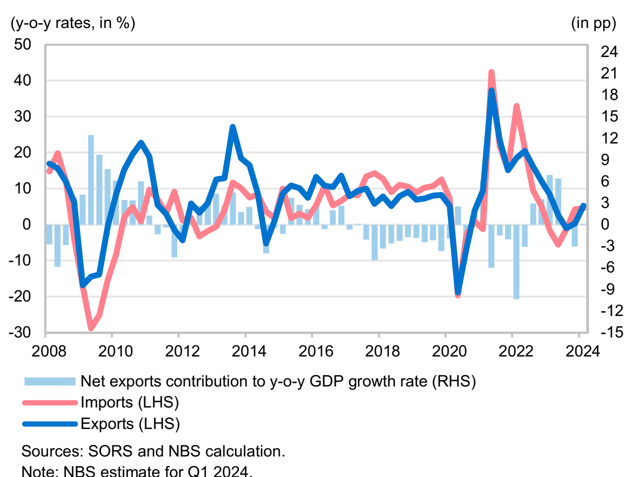
Net external demand

We estimate that Serbia's **real export** and **import** growth accelerated to 5.2% and 4.5% y-o-y, respectively, which resulted in a marginal positive contribution of **net exports** to GDP growth in Q1 (0.1 pp).

Commodity exports in euros decreased for the third consecutive quarter, by 1.9% y-o-y in Q1. The decrease mostly reflects lower electricity exports (-4.1 pp), primarily due to the last year's high base, as well as lower mining exports (-1.9 pp). On the other hand, manufacturing exports continued up, primarily on account of investments from the previous period. In Q1, they were 3.9% higher (3.3 pp contribution). Agriculture exports also provided a positive contribution (1.2 pp), recording double-digit y-o-y growth for the second consecutive quarter owing to the solid last year's agricultural season.

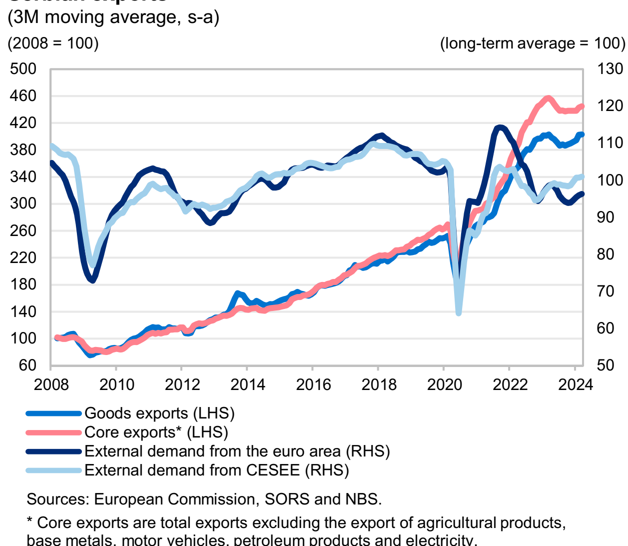
Relative to the same period in 2023, the rise in manufacturing exports in Q1 was recorded in 10 out of 23 branches, with the greatest positive contribution stemming from base metals, other transport equipment, computers, metal products and motor vehicles. Lower exports of chemical industry, other machinery and

Chart IV.3.2 **Exports and imports of goods and services**
(in previous-year constant prices, ref. 2015)



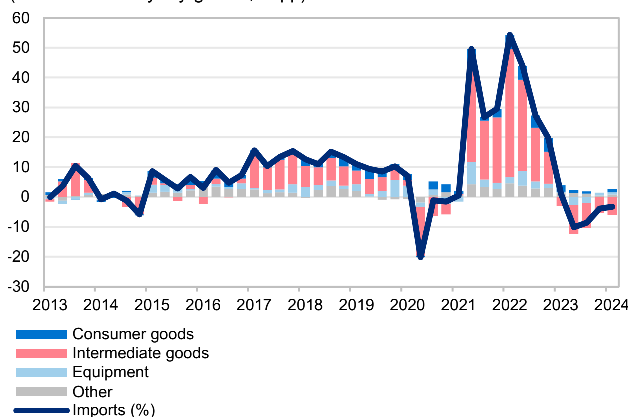
Sources: SORS and NBS calculation.
Note: NBS estimate for Q1 2024.

Chart IV.3.3 **Movement in external demand indicators for Serbian exports**
(3M moving average, s-a)



Sources: European Commission, SORS and NBS.
* Core exports are total exports excluding the export of agricultural products, base metals, motor vehicles, petroleum products and electricity.

Chart IV.3.4 **Movement of key import components**
(contributions to y-o-y growth, in pp)



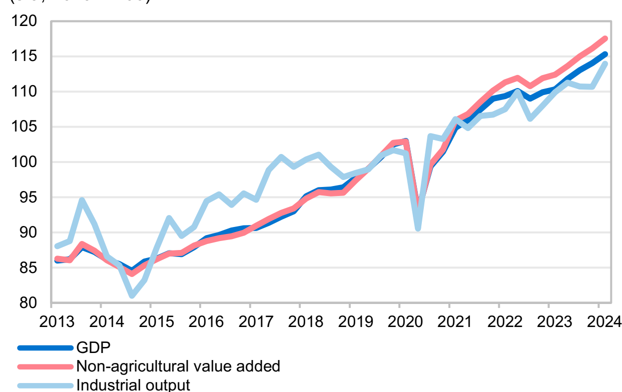
Sources: SORS and NBS calculation.

Table IV.4.1 **Contributions to y-o-y GDP growth**
(in pp)

	2023				2024
	Q1	Q2	Q3	Q4	Q1*
GDP (in %, y-o-y)	**0.9**	**1.6**	**3.6**	**3.8**	**4.6**
Agriculture	0.4	0.3	0.5	0.4	0.0
Industry	0.5	0.1	0.7	0.5	0.6
Construction	-0.1	0.7	0.7	0.4	0.4
Services	0.3	0.4	1.6	2.1	3.0
Net taxes	-0.2	0.0	0.1	0.3	0.6

Sources: SORS and NBS calculation.
* NBS estimate.

Chart IV.4.1 **Economic activity indicators**
(s-a, 2019 = 100)



Sources: SORS and NBS calculation.

Chart IV.4.2 **Service sector indicators**
(s-a, 2019 = 100)

Sources: SORS and NBS calculation.

equipment, as well as rubber and plastic products, exerted the strongest effect in the opposite direction.

Commodity imports in euros declined by 3.9% y-o-y in Q1 as a result of lower import prices. Imports classification by BEC (Broad Economic Categories) reveals that the decline is mostly owed to intermediate goods (-10.2%), a category inclusive of energy. In y-o-y terms, energy imports dropped by EUR 409 mn, with imports of all energy products going down. On the other hand, the import of equipment and consumer goods went up by 7.6% and 6.2%, respectively.

Positive trends in foreign **trade in services** extended in Q1, as a surplus was recorded in the amount of EUR 633 mn. Export growth received the largest impetus from ICT and business services and import growth from tourist and business services.

Faster deceleration of commodity imports than that of exports reflected on a higher coverage of commodity imports with exports in Q1, measuring 81.5% in March[10] and 92.3% including services, up by 0.5 pp and 0.2 pp, respectively from end-2023.

4 Economic activity

The acceleration of y-o-y economic growth continued for the fifth quarter in a row. In Q1, growth amounted to 4.6% (3.8% in Q4 2023), driven by trade, manufacturing and construction, but receiving positive contributions from other sectors as well.

At the quarterly level, economic activity in Q1 is estimated to have accelerated from a quarter earlier, by 1.1% s-a.

Having increased collectively by 5.6% y-o-y in Q1, in our estimate, **services** added 3.0 pp to economic growth in Q1. This is indicated primarily by trade data, as the real retail trade turnover went up by 6.5% y-o-y in Q1. Catering also continued up, its real turnover rising by 14.6% y-o-y in January. At the same time, the total number of tourist arrivals and overnight stays increased in Q1 by 9.9% and 5.3% y-o-y, respectively.

Industrial production growth is estimated to have accelerated to 2.9% y-o-y in Q1, with a positive contribution from all sectors. Manufacturing provided the highest contribution and its volume continued up despite

[10] Measured by 12-month moving average.

subdued external demand. At the same time, owing to the intensified exploitation of metal ore and production in the "other mining" category (mainly consisting of construction materials, such as gravel, sand, etc.), the volume of mining output in Q1 increased by 6.4% y-o-y, providing a positive contribution to economic growth. The volume of electricity production went up negligibly (0.3% y-o-y) in Q1.

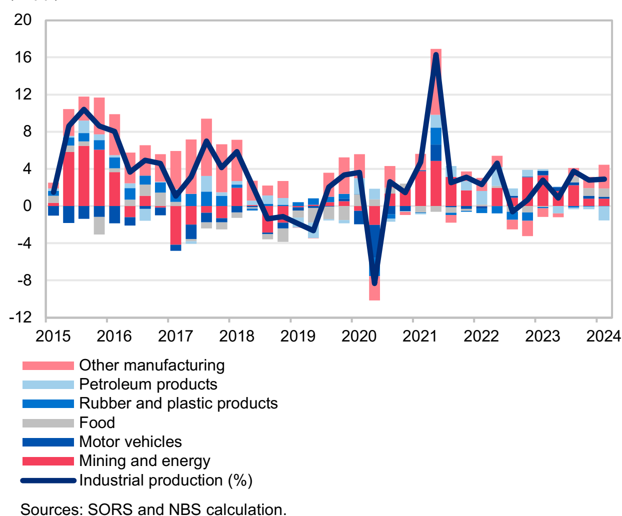
Positive developments in manufacturing extended to Q1 2024 when production growth accelerated to 3.1% y-o-y, from 2.5% in H2 2023. Growth in the volume of production was registered in 14 out of 24 branches. The greatest positive contribution came from the production of computers, food, metal products and base metals. The production of electrical equipment, other transport equipment and chemical products also increased in Q1. On the other hand, the production of petroleum products decreased the most, owing to the initiated overhaul of the oil refinery in Pančevo.

In our estimate, **construction** growth measured 8.0% y-o-y in Q1. This estimate is supported by the higher production in the "other mining" category, covering largely the exploitation of construction materials. The number of issued construction permits rose by 1.7% y-o-y in the January–February period, while the value of construction works performed climbed by 18.3% y-o-y in Q1. The import of construction materials went up in Q1 by 5.4% and the import of equipment by 7.6%. y-o-y.

Net taxes are estimated to have edged up by 3.8% y-o-y in Q1 and contributed 0.6 pp to GDP growth, owing to higher consumption and better collection of tax revenues.

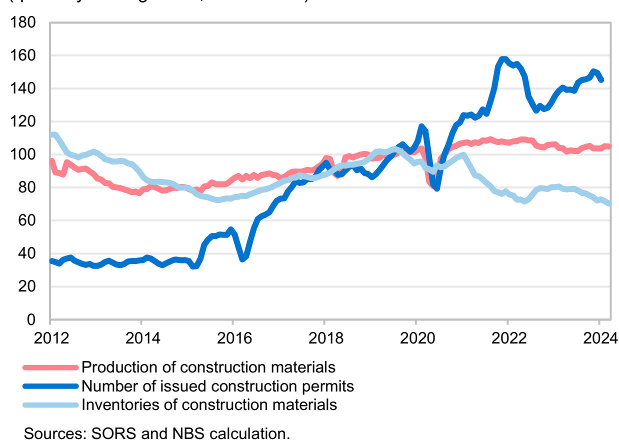
At the quarterly level, GDP is estimated to have accelerated from Q4 2023 to 1.1% s-a in Q1 2024. The growth was mostly driven by trade and construction, though nearly all other activities also recorded an increase relative to the quarter before.

Chart IV.4.3 **Contributions to y-o-y industry growth rate**
(in pp)



Sources: SORS and NBS calculation.

Chart IV.4.4 **Construction activity indicators**
(quarterly averages s-a, 2019 = 100)



Sources: SORS and NBS calculation.

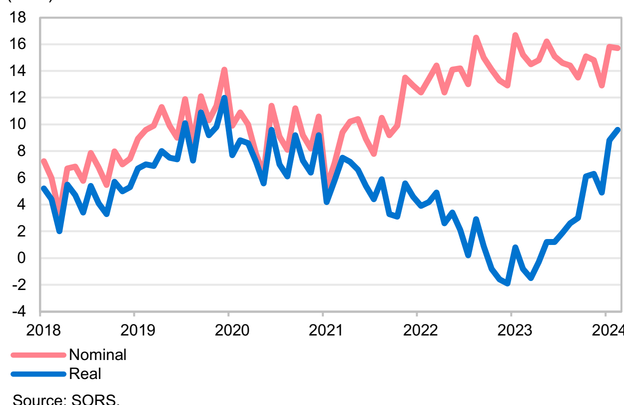
5 Labour market developments

Q1 saw a further rise in formal employment and wages and a y-o-y reduction in registered unemployment.

Wages

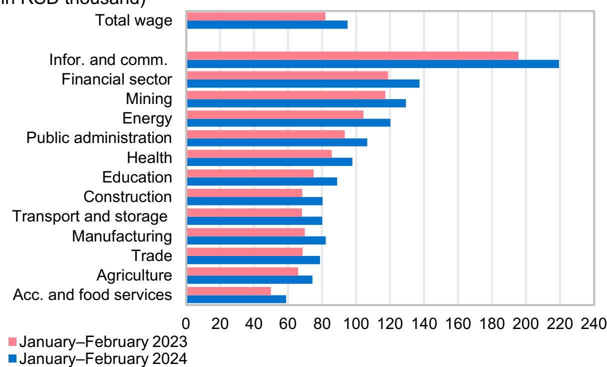
The average nominal net wage measured RSD 94,979 in January and February (EUR 810), its y-o-y rise accelerating to 15.7% (from 14.2% in Q4 2023), with an

Chart IV.5.1 **Y-o-y growth rates of average net wage**
(in %)



Source: SORS.

Chart IV.5.2 **Nominal net wage by economic sector**
(in RSD thousand)



Source: SORS.

almost equal increase in both **public and private sector** wages. The real y-o-y growth in average net wages stepped up as well – to 9.2%, from 5.6% in Q4. Driven by the higher minimum wage, the median net wage rose by 17.2% y-o-y in the January–February period, overshooting the RSD 70,000 limit in January for the first time since comparable data are available. Another sign of improved living standards is the increase in the coverage of the average consumer basket by the average wage and of the minimum basket by the minimum wage, to around 94%, the highest level so far.

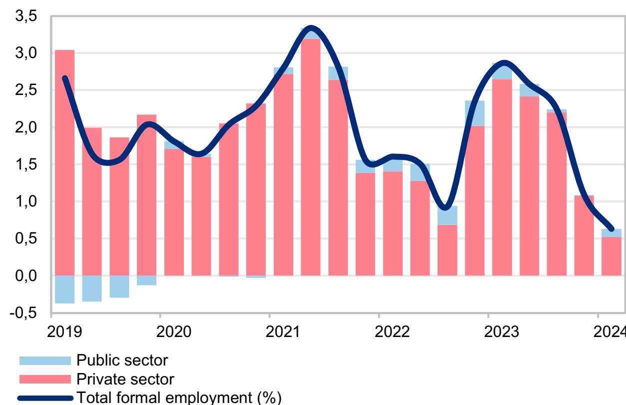
The sharpest y-o-y increase in average wages in January and February was recorded in education, catering, transport and storage, construction and manufacturing. The increase ranged between 18.5% and 17.6%. At the same time, average wages grew at double-digit y-o-y rates in almost every **economic activity**, except for professional, scientific, innovation and technical services (9.2%).

In the January–February period, the **nominal net wage** bill as the main source of consumer demand increased by 17.0% y-o-y on account of a continued rise in wages and formal employment.

According to a preliminary estimate, **overall economic productivity** growth accelerated further in Q1, to 3.9% y-o-y (from 2.7% in Q4), as the economy grew faster than employment.

Employment

Chart IV.5.3 **Structure of y-o-y growth in total formal employment**
(in pp, quarterly average)



Sources: SORS and NBS calculation.

According to SORS data, **total formal employment** slowed down its y-o-y growth from 1.1% in Q4 to 0.6% in Q1, reaching a new record high level of 2.37 mn people in March. The y-o-y growth in formal employment in March was driven by employment with legal entities and entrepreneurs, whereas the number of registered individual farmers kept decreasing.

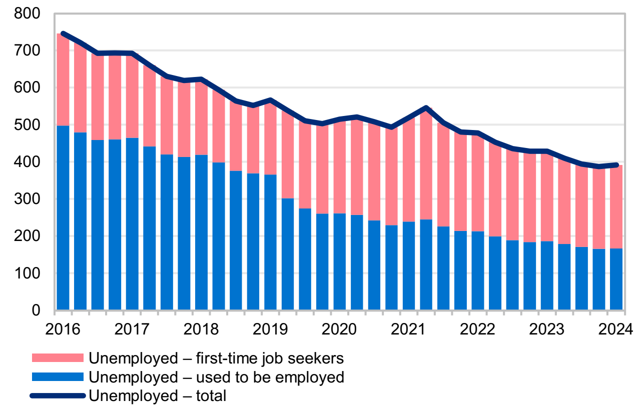
Private sector formal employment reached a new record high level of 1.76 mn in March, with employment outstripping last year's level by around 15 thousand people. Observing dominantly private sector activities, registered employment rose the most in professional, scientific, innovation and technical services, ICT services and construction, while decreasing the most in administrative and auxiliary services, as well as trade.

Public sector employment rose by around four thousand y-o-y in March.

According to the National Employment Service, **registered unemployment** is typically higher at the beginning of the year, but it declined to 387,920 by March, down by around 37 thousand unemployed from the same period a year earlier.

According to the available **LFS** data, covering both formal and informal labour market segments, the participation rate of the working age population (15–64) stood at 71.5% in Q4 2023, while the activity rate (15+) measured 55.3%. The employment rate went up by 1.2 pp y-o-y, to 50.3% in Q4 2023, while the unemployment rate decreased by 0.3 pp, to 9.1%.

Chart IV.5.4 **Movement of registered unemployment**
(in thousand persons, quarterly average)



Source: National Employment Service.
Note: Data concluding with November 2023.

Text box 4: Impact of wages on inflation

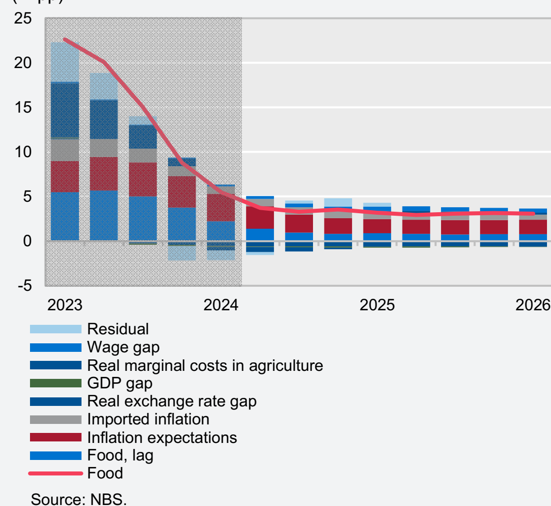
In a number of countries, a tight labour market, i.e. record low unemployment and high wage growth, currently represents one of the risks keeping inflation elevated over a longer period. Moreover, the period during which global inflation trended high lasted longer than initially expected and, by extension, increased the likelihood of additional wage growth, in order to fall in step with inflation and maintain the real wage value, which might drive inflationary pressures further up, that is, create the wage-price spiral.

For the time being, the prevailing estimates say that in the current cycle of rising inflationary pressures the inflation spiral has not been created, but that cautious monetary policies of central banks are certainly needed. Also, based on the historical experience, we can draw conclusions in regard to the possible scenarios relating to movements in wages and inflation going forward.

Thus, in the World Economic Outlook from October 2022,[1] observing advanced countries over the previous 40 years (in some cases 60 years), the IMF identified 22 episodes in which inflation and nominal wages rose for several consecutive quarters. The results of the analysis showed that during these episodes, the wage-price spiral was usually not created. Nominal wages tended to increase after episodes of elevated inflation, though inflation retreated over time, driving up real wages and helping to stabilise unemployment. The analysis also showed that the majority of observed episodes were followed by a restrictive monetary policy, which helped rein in inflation. Similarly, Alvarez et al. (2022)[2] identified 79 episodes of rising wages and inflation from the 1960s onward, and in only a handful of them growth lasted more than eight quarters. Looking at episodes similar to the current one, in which real wages are declining in many countries and labour markets are tightening, for the most part inflation started to slow and nominal wages continued to rise, thus pushing up real wages, based on which authors concluded that nominal wage growth does not necessarily mean that the wage-price spiral will be created.

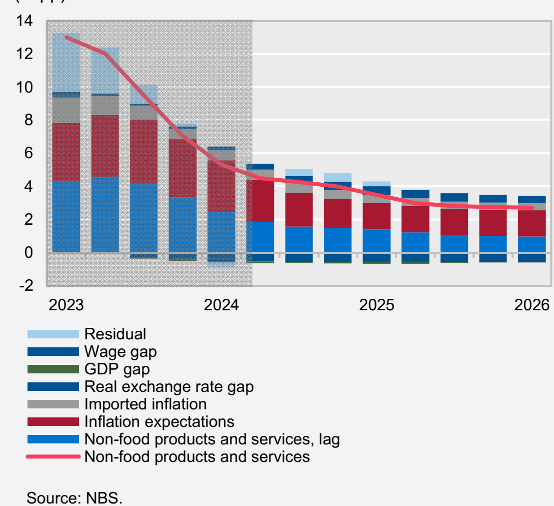
In economic theory, the key factors determining the degree of interaction between wages and inflation are macroeconomic conditions – inflation expectations, inflation level, the production cycle phase, conditions in the labour market, etc. Thus, if workers have high inflation expectations, even in conditions of declining inflation, the demands toward a further wage increase will grow. Likewise, if inflation is at a higher level, companies will tend to change their product and service prices more often, thus increasing the interaction between prices and wages. Also, if economic growth is faster and aggregate demand higher, it will be easier for companies to raise their profit margins and shift high production

Chart O.4.1 **Decomposition of the y-o-y food price growth**
(in pp)



Source: NBS.

Chart O.4.2 **Decomposition of the y-o-y non-food price growth**
(in pp)



Source: NBS.

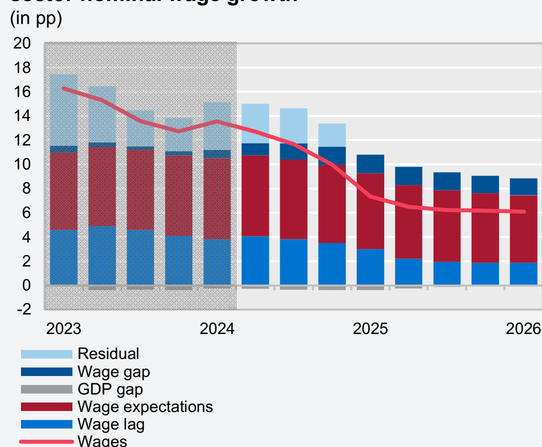
[1] https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022.

[2] Alvarez, J., J. Bluedorn, N-J. H. Hansen, Y. Huang, E. Pugacheva, A. Sollaci, 2022. "Wage-Price Spirals: What is the Historical Evidence?", IMF Working Papers, issue 221.

costs onto consumers, while workers will have higher wages. Moreover, if the economy operates in conditions of full employment or close to that level, companies will experience difficulties finding labour force and filling up job positions, which will strengthen workers' negotiating power. Important factors determining the intensity of the wage-price spiral are the strength of the negotiating power of trade unions, as well as the level of market competition. In case of a lower degree of market competition, companies have greater options to raise profit margins.

In view of the above, we believe there is a small probability that the wage-price spiral will be created in Serbia during the projection horizon. Short-term inflation expectations are on a downward trajectory, medium-term ones are anchored within the target bounds, y-o-y inflation is on a stable downward path, and we judge that the output gap will remain negative this year. Moreover, we should bear in mind that our economy is not operating in conditions of full employment and that there is still room for a further increase in the participation rate in the labour market and a decrease in unemployment. Granger causality test indicates that inflation does not drive wages significantly up, as it has confirmed that after two quarters changes in wages result in statistically significant changes in the level of consumer prices, while the opposite is not true.

Chart O.4.3 **Decomposition of the y-o-y non-public sector nominal wage growth**
(in pp)



Source: NBS.

In the remainder of the text box we will try to provide a closer look at the dynamics and the relation between inflation and wages, as well as the impact of wages on inflation movements this and the following year, based on the models we use in our medium-term inflation projection.

In the medium-term inflation projection model the impact of wages on inflation is included on the supply side too, i.e. via the impact of labour costs on producer prices, and on the demand side via the impact of wages on the output gap (for more details, see the NBS Working Papers Bulletin, September 2022).

Specifically, the non-food inflation equation (non-food industrial products and services) in our model is as follows:

$$\pi_t^{nonfood} = b_1 \cdot \pi_{t-1}^{nonfood} + b_2\pi_t^M + (1 - b_1 - b_2)E_t\pi 4_{t+4} + b_3 \cdot zgap_{t-1} + b_4 \cdot ygap_{t-1} + b_5 \cdot wagegap_t + \varepsilon_t^{nonfood},$$

where: $\pi_{t-1}^{nonfood}$ is non-food inflation with a lag, π_t^M – imported inflation, $E_t\pi 4_{t+4}$ – one-year ahead inflation expectations, $zgap_t$ – real exchange rate gap, $ygap_t$ – output gap and $wagegap_t$ – real wage gap.

The real wage gap is a measure of real marginal labour costs and is calculated as a deviation of real wages from the marginal product of labour, i.e. from the trend determined by the potential GDP, corrected by the increase in working age population over the medium term.

The food inflation equation is as follows:

$$\pi_t^{food} = a_1 \cdot \pi_{t-1}^{food} + a_2\pi_t^M + (1 - a_1 - a_2)E_t\pi 4_{t+4} + a_3 \cdot RMCPgap_t + a_4 \cdot zgap_{t-1} + a_5 \cdot ygap_{t-1} + a_6, wagegap_t + \varepsilon_t^{food}$$

where π_t^{food} is food inflation, π_t^M – imported inflation, $E_t\pi 4_{t+4}$ – one-year ahead inflation expectations, $RMCPgap_t$ – real marginal costs gap in agriculture, $zgap_t$ – real exchange rate gap, $ygap_t$ – output gap, and $wagegap_t$ – real wage gap.

The output gap, as a measure of aggregate demand, is estimated based on the following equation:

$$ygap_t = a_{31} \cdot ygap_{t-1} - a_{32} \cdot rmci_t + a_{33} \cdot ygap_t^{ez} + a_{34} \cdot fi_t + a_{35} \cdot wagegap_{t-1} + \varepsilon_t^{ygap},$$

where $ygap_t$ is output gap, $rmci_t$ – real monetary conditions index, $ygap_t^{ez}$ – euro area output gap, fi_t – fiscal impulse (fiscal policy character) and $wagegap_t$ – real wage gap. All gaps and trends in the model are estimated using the Kalman filter, while nominal wages were estimated using the Phillips wage curve:

$$\pi_t^{wage} = a_{11} \cdot \pi_{t-1}^{wage} + (1 - a_{11}) \cdot \pi_{t+1}^{wage} + a_{12}(a_{13} \cdot ygap_t - (1 - a_{13}) \cdot wagegap_t) + \varepsilon_t^{\pi wage},$$

where π_t^{wage} is nominal wage growth, $ygap_t$ – output gap and $wagegap_t$ – real wage gap.

Based on medium-term inflation projection models, during 2024 wages will record y-o-y growth of around 7.7% on average, in real terms, compared to the 2.7% growth in 2023, while the following year they are expected to slow to around 3.5%. Through higher marginal product of labour, wages will have a higher positive contribution to the non-food and food inflation component, and by extension to headline inflation this year by around 0.3 pp more than in 2023, and the contribution will be around 0.5 pp at end-2024. For next year, the real wage gap is projected to narrow gradually due to the lower expected real wage growth, which should result in an 0.1 pp lower contribution to inflation on this account. In contrast, based on demand-side factors, i.e. the impact on household consumption, we do not expect any major inflationary pressures as we estimate that the output gap will remain negative this year, and around the neutral level in 2025.

All of the above indicates that wages are not likely to jeopardise inflation's downward trajectory and its return to the target midpoint.

V Projection

Faster than expected GDP growth in Q1 increases the probability that this year's GDP growth rate will be closer to the central value of the forecast range of 3–4%, as stated in the previous Report. According to our May projection, the projected GDP growth rate for this year equals 3.5%. In 2025 and 2026, GDP is expected to step up further, to a 4.0–5.0% range, reflecting investments planned under the "Leap into the Future – Serbia Expo 2027" programme. Growth will be guided by domestic demand, with higher private consumption propped up by a continued rise in employment and wages, mostly in the private sector, and investment growth supported by the implementation of projects in transport, energy and utility infrastructure. As investments and personal consumption are anticipated to gather speed, we expect imports to rise faster than exports and the contribution of net exports to be negative.

Under our new projection, y-o-y inflation will most probably retreat within the target band in May, somewhat sooner than we anticipated in our February projection. It is expected to slow further in the remainder of the year and move around the target midpoint of 3% from 2025 until the end of the projection horizon. Such inflation movements will reflect primarily the effects of past monetary tightening, subsiding inflation expectations, weaker global cost-push pressures, further slowing of imported inflation and the still subdued external demand.

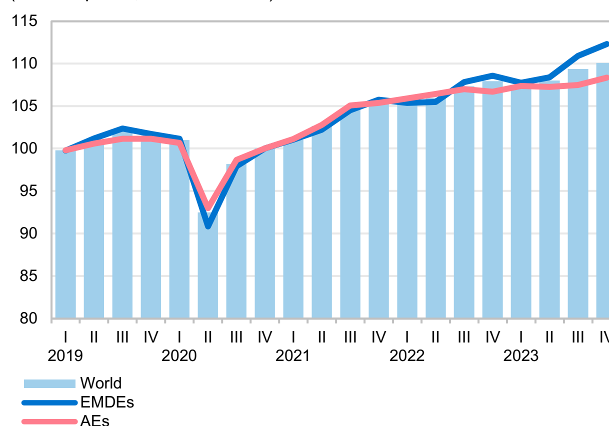
Uncertainty surrounding the inflation and GDP projections remains largely associated with international factors – geopolitical relations, outlook for global growth, particularly euro area growth, and their impact on world prices of energy and primary commodities. To a degree, risks also stem from the persistence of core inflation globally and the duration of monetary policy tightening by leading central banks. At home, the risks to the projection are associated with the pace of rebound in domestic demand, primarily on account of the level of FDI inflows, and investment in infrastructure and the energy sector. Another source of risk is the outcome of the agricultural season at home which mostly concerns fruit and vegetable prices in the case of inflation and cereal yields in the case of GDP.

External assumptions

Economic activity

Despite tightened monetary conditions and risks of recession and stagflation over the past two years, the **global economy showed resilience and trended steadily up while global inflation declined**. This was facilitated by stepped-up government consumption and the recovery of household consumption supported by the accumulated savings, rising employment and income, and increased labour force participation. In April, the **IMF's** baseline scenario projected that the same **pace of global economic growth from 2023 (3.2%) will continue in 2024 and 2025**, with the higher likelihood of a soft landing. Even so, this is still below the long-term annual average (3.8% in the period 2000–2019), mainly because of the still high borrowing costs and the expiry of fiscal incentives (in the short-term). The global economy is still adversely impacted by the more far-reaching consequences of the pandemic and the Ukraine crisis, weaker productivity growth and heightened geopolitical divides. Relative to

Chart V.0.1 **Real GDP dynamics**
(in index points, Q4 2020 = 100)



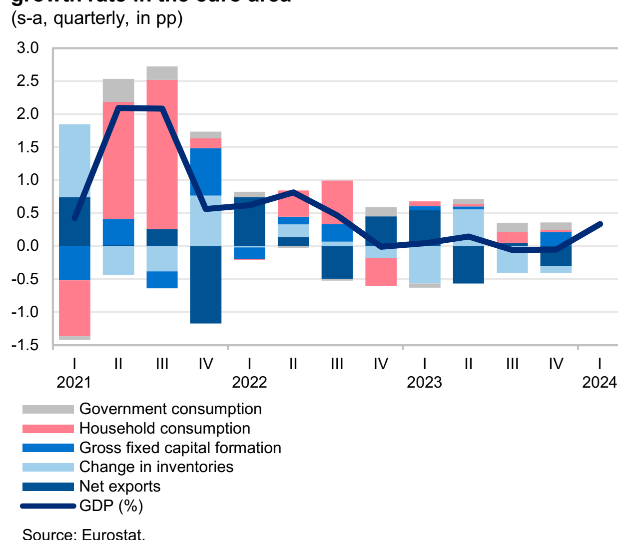
Source: IMF WEO (April 2024).

Table V.0.1 **Real GDP growth projections for 2024 and 2025**
(in %)

	2023	2024		2025	
	Out-come	Prev. proj.	New proj.	Prev. proj.	New proj.
World	3.2	3.1	3.2	3.2	3.2
Advanced economies	1.6	1.5	1.7	1.8	1.8
Euro area	0.4	0.9	0.8	1.7	1.5
USA	2.5	2.1	2.7	1.7	1.9
Emerging and developing economies	4.3	4.1	4.2	4.2	4.2
Russia	3.6	2.6	3.2	1.1	1.8
China	5.2	4.6	4.6	4.1	4.1

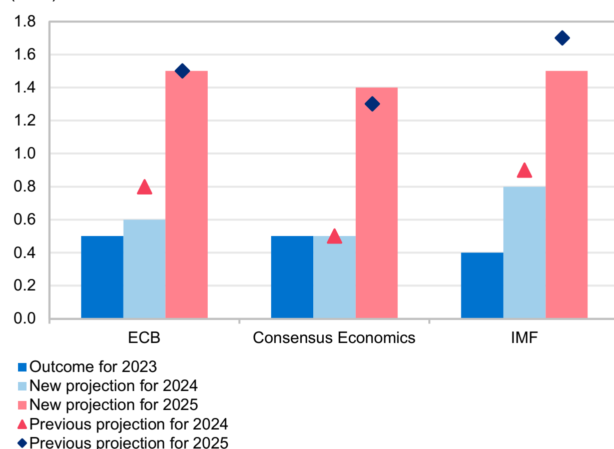
Source: IMF WEO (April and January 2024).

Chart V.0.2 **Contributions of components to the real GDP growth rate in the euro area**
(s-a, quarterly, in pp)



Source: Eurostat.

Chart V.0.3 **Adjustments to the euro area's GDP growth projection for 2024 and 2025**
(in %)



Sources: ECB (December and March), Consensus Economics (January and April) and IMF (January and April).

January, in April the IMF revised its global economic growth forecast for 2024 slightly up (by 0.1 pp), assuming that growth in the **group of advanced countries** will pick up slightly – from 1.6% in 2023 to 1.7% in 2024 (and to 1.8% in 2025), while in the **group of emerging and developing countries** it will slightly slow – from 4.3% in 2023 to 4.2% in 2024 (the same as the projection for 2025).

In Q4 2023 the **euro area economy** edged down 0.1% as the rebound in total consumption and fixed investments was offset by the fall in goods inventories and external demand, while the pass-through effect of previous monetary tightening on economic activity has not ended yet. The euro area industry recorded a contraction in activity in Q4 as well (0.4% s-a), while the services sector saw a slight increase in activity (0.1% s-a). Looking at our key foreign trade partners in the euro area, in Q4 **the German economy** recorded a contraction of 0.5% s-a, notably due to the contracted industrial activity, while **Italy's economy** edged up mildly, 0.1% s-a in Q4, thanks to the sound activity in services and construction.

Based on the negative tendencies from the prior period and expectations that economic activity would remain subdued going forward, in March the **ECB** revised down its December GDP growth projection for the euro area in 2024 – by 0.2 pp, to 0.6%. GDP growth projection was unchanged for 2025 (1.5%). These ECB projections were used as underlying assumptions of euro area economic growth in our latest projections. The dynamics of short-term economic indicators, PMI and ESI, indicates a gradual economic recovery in the majority of European countries during Q1 and early Q2 dominantly owing to stepped up activity in the services sector. The ECB expects household consumption, which is still supressed, to recover hand in hand with real income growth, as well as that business investment prospects will brighten up by the end of the year despite depleted inventories and stricter financing conditions. The Eurostat's preliminary data indicate that the euro area's GDP in Q1 rose by 0.3% s-a, going up in all leading European economies. Though labour force demand is reducing speed, employment in the euro area continued up in Q4 as well (by 0.5%) while labour force activity also rose (by 0.4%). During Q1, the unemployment rate remained at its lowest level since the euro area establishment, which the ECB projected in March at 6.7% for 2024.

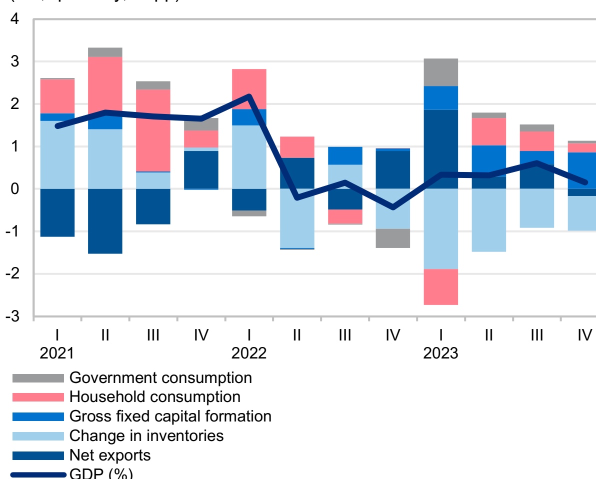
In April, leading Consensus Economics analysts kept their January GDP growth projection for the euro area of 0.5% in 2024, under the impact of the previously tightened monetary and financial conditions and poor

performance in the production sector, while the resilient labour market, lower inflation and the expected recovery of external demand should prop up economic activity in the euro area. They also underlined that the leading indices in March and April herald a nascent recovery in the euro area, mainly driven by the rising activity in the services sector. This should be further facilitated in H2 by the lower borrowing costs and the resilience of the Spanish and Italian economies.

In Q4, GDP in the **CESEE** region rose slightly, by 0.2% s-a (1.3% y-o-y), on account of increased fixed investments and household consumption, while the reduction of inventories and net exports worked in the opposite direction. As in the prior period, the economic dynamics varied across countries of the region in Q4 – the highest s-a GDP growth rates were recorded by Croatia and Slovenia, the economies of Hungary and Poland stagnated, while Romania saw a fall in GDP. In view of the weak economic activity in the euro area, notably Germany, a key trade partner of countries in the region, leading Consensus Economics analysts said that domestic demand will remain the main driver of economic growth at the level of the region. Household consumption will be supported by growth in real income parallel with the decline in inflation, while fixed investments are under a major impact of inflows from EU funds. In April, the Consensus Economics forecast 2.9% GDP growth in 2024 in Southeast European countries and 2.4% in Central European ones, projecting growth of 3.4% and 3.3%, respectively, for 2025.

In Q4, **the US economy** grew 0.8% s-a (3.4% annualised) as a result of the rise in almost all components of GDP, except inventories, which declined. Activity growth in Q4 was recorded in 18 of the 22 economic branches, with manufacturing and retail trade yielding the largest contribution to GDP growth. In March, the **Fed** estimated that during Q1 the US economic growth continued at a sound pace driven by the continued rise in household consumption, supported by stepped-up employment and wages. According to the preliminary assessment of the US Bureau of Economic Analysis, in Q1 GDP rose 0.4% s-a. Amid positive tendencies carried over from the prior period, in March the Fed made major upward revisions to its December GDP growth projection for 2024 – by 0.7 pp, to 2.1%, with a slightly lower projection for 2025 (2.0%). The unemployment rate was negligibly higher in March (3.8%) than at end-2023, with the Fed noting that the labour force supply and demand gap continues to narrow on the back of a stronger inflow of labour force and the decline in the number of new jobs. In March the Fed forecast unemployment rate at 4.0% in 2024.

Chart V.0.4 **Contributions of components to the real GDP growth rate in the CESEE region***
(s-a, quarterly, in pp)



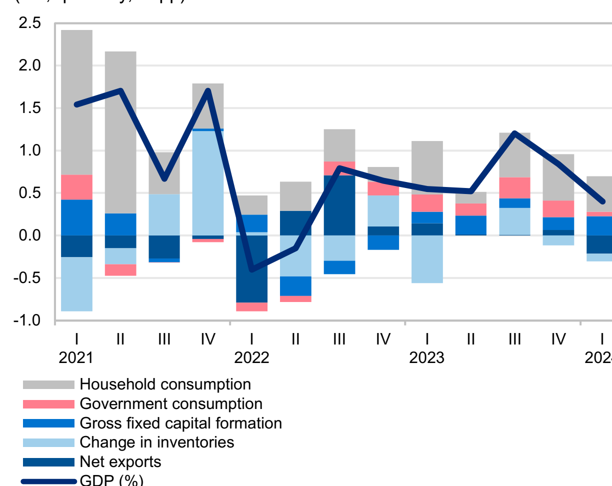
Source: Eurostat.
* Including Bulgaria, Czech Republic, Croatia, Hungary, Poland, Romania, Slovenia and Slovakia.

Table V.0.2 **Real GDP growth projections by country of the region for 2024 and 2025**
(in %)

	2023	2024		2025	
	Out-come	Prev. proj.	New proj.	Prev. proj.	New proj.
Poland	0.5	2.9	3.5	2.7	3.6
Czech Republic	-0.4	1.4	2.8	2.2	2.9
Hungary	-0.5	2.7	3.3	2.7	3.5
Romania	2.0	3.3	3.7	3.4	4.1
Slovakia	1.2	1.9	2.6	2.0	2.8
Slovenia	1.4	2.2	2.4	2.3	2.5
Croatia	2.5	2.4	2.7	2.4	2.7
Bulgaria	1.8	2.1	2.8	2.3	2.8
Albania	3.0	3.1	3.7	3.6	-
Bosnia and Herzegovina	2.4	2.5	2.9	2.6	-
North Macedonia	1.8	2.8	3.5	2.8	-
Montenegro	4.7	3.8	3.4	3.4	-

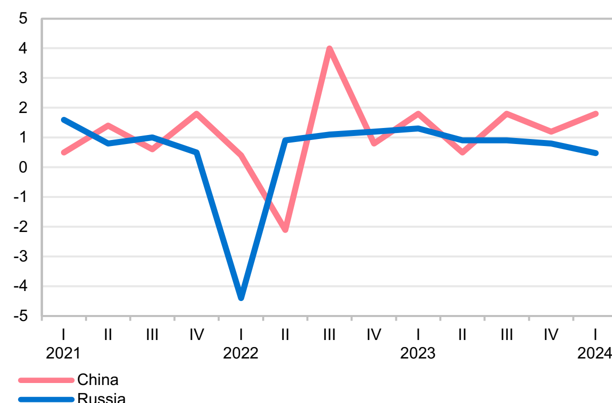
Source: IMF WEO (April 2024 and October 2023).

Chart V.0.5 **Contribution of components to the real GDP growth rate in the USA**
(s-a, quarterly, in pp)



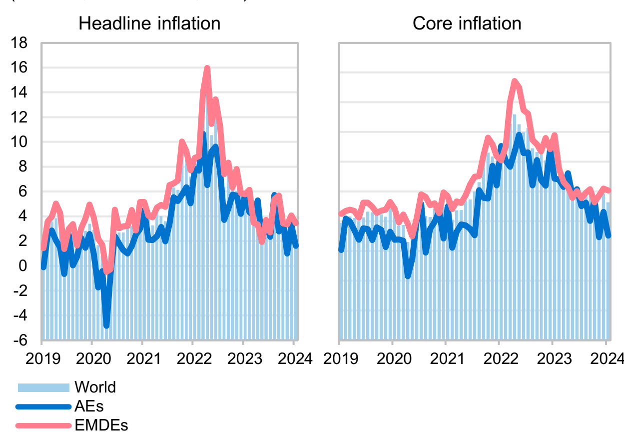
Sources: U.S. BEA and NBS calculation.

Chart V.0.6 **Movement of real GDP in Russia and China**
(s-a, quarterly, in %)



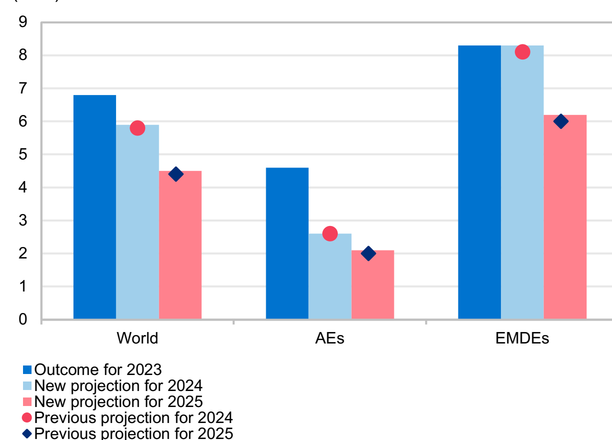
Sources: Rosstat and National Bureau of Statistics of China.

Chart V.0.7 **Inflation movements by economic region**
(s-a data, annual rates, in %)



Source: IMF WEO Update (April 2024).

Chart V.0.8 **Revisions of inflation projections by economic region for 2024 and 2025**
(in %)



Sources: IMF WEO (January and April 2024).

The **Russian economy** rose 0.8% s-a in Q4, or 4.9% y-o-y, which is lower than in the previous quarter (5.7%), since growth in government and household consumption slowed in Q4, while fixed investments picked up. Despite the slower y-o-y GDP growth in Q4, sound economic activity was preserved, especially in sectors that profit from government investments in the defence system and military industry, and partly due to the low base from the corresponding period in 2022, under the impact of Western sanctions. In April, the IMF's January projection of Russian GDP growth for 2024 underwent a major upward revision – by 0.6 pp, to 3.2%, while growth of 1.8% was forecast for 2025.

In Q1, the **Chinese economy** rose 1.6% s-a, or 5.3% y-o-y, recording the highest growth rate since Q2 2023, supported by the continued fiscal incentives and government consumption. Fixed investments in Q1 posted the highest y-o-y growth in a year, which is an important factor in achieving the target 5.0% GDP growth rate this year – slightly below the last year's figure of 5.2%, notably because of the extended crisis in the real estate sector. In April, the IMF stuck to its January GDP growth projection for China of 4.6% in 2024, while 4.1% growth was forecast for 2025.

Inflation

At end-2023, after almost three years, **global inflation came close to the pre-pandemic level**. At the annual level, looking at the advanced countries group, inflation on average slowed to 2.3% in Q4 2023 (after peaking at 9.5% in Q2 2022), while in the emerging and developing countries group it slowed to 9.9% (after peaking at 13.7% in Q1 2022), or to 3.9% if high inflation countries, such as Turkey, are left out. **In April, the IMF projected continued and stable downward path of global inflation** – from 6.8% in 2023 to 5.9% in 2024, and further down to 4.5% in 2025, estimating that core inflation would retreat more slowly than headline. The April projection of global inflation for 2024 was slightly revised up from January – by 0.1 pp to 5.9%, given that inflation projection in the group of emerging and developing countries was raised by 0.2 pp to 8.3%, mostly on account of inflation going up in several low-income countries. For the advanced countries group, inflation projection has been kept at 2.6%. In the majority of countries around the world, inflation is still outside of the target tolerance band and should return within its bounds by Q2 2025, according to IMF forecasts.

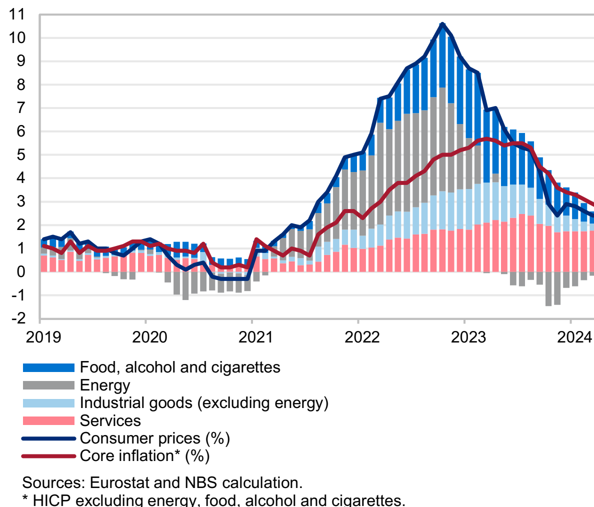
During Q1, **y-o-y inflation in the euro area** trended down, measuring 2.4% in March, mostly on account of the significantly slower growth in food prices (2.6%),

while the y-o-y fall in energy prices was held back during Q1, partly due to the low base effect from the corresponding period last year. Core inflation in the euro area decelerated to 2.9% y-o-y in March as a result of slower y-o-y growth of industrial product prices (excluding food and energy), while services prices rose around 4% y-o-y since last November. Measured by the change in HICP, **y-o-y inflation in Germany** was tempered to 2.3%, thanks to a slowdown in food inflation, while **y-o-y inflation in Italy** rose to 1.2% in March, as the prices of electricity, where the base effect is dissipating, slowed their y-o-y fall during Q1. According to Eurostat's preliminary flash estimate, in April y-o-y inflation remained unchanged in the euro area – 2.4%, the same as in Germany, while Italy's dipped to 1.0%.

In March, the **ECB** assessed that euro area inflation continued to slacken under the impact of exhausted negative effects of supply-side shocks in the past years, as well as suppressed demand amid the previously tightened monetary conditions. Though the still pronounced nominal wage growth and the declining productivity are exerting pressure on domestic prices, there are signals that wage growth is slowing, while companies are absorbing a part of increased labour costs by lower profits and margins, thus mitigating cost-push pressures. In the coming months, the **ECB expects euro area inflation to remain on the downward path** and return within the bounds of the target tolerance band during 2025, parallel with a more moderate rise in labour costs and a full dissipation of the effects of previous energy shocks and supply bottlenecks. Indicators of long-term inflation expectations are mostly stable, at around 2%. Assuming lower energy prices and weakened pressures from the labour market, in March the ECB revised down its December inflation projection for the euro area – by 0.4 pp to 2.3% in 2024, and by 0.1 pp to 2.0% in 2025. Euro area core inflation, which will retreat more slowly than headline, was also projected at a lower level in March than in December – 2.6% in 2024 and 2.1% in 2025. These forecasts for the euro area were used as assumptions in our latest projection.

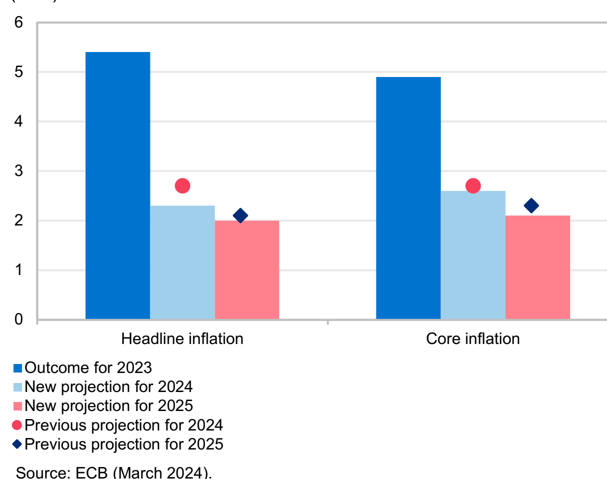
After slowing in January, **inflation in the USA** (measured by the change in the CPI), picked up y-o-y in Q1, measuring 3.5% in March. This was dominantly under the impact of the y-o-y dynamic of energy prices which went up in March for the first time in more than a year on the back of the higher prices of liquefied petroleum gas. During Q1, y-o-y growth in food prices decelerated, while the prices of industrial products (excluding food and energy) posted a y-o-y fall. This was conducive to slightly milder **core inflation** in Q1 (3.8%)

Chart V.0.9 **Contributions of HICP components to y-o-y inflation in the euro area**
(in pp)



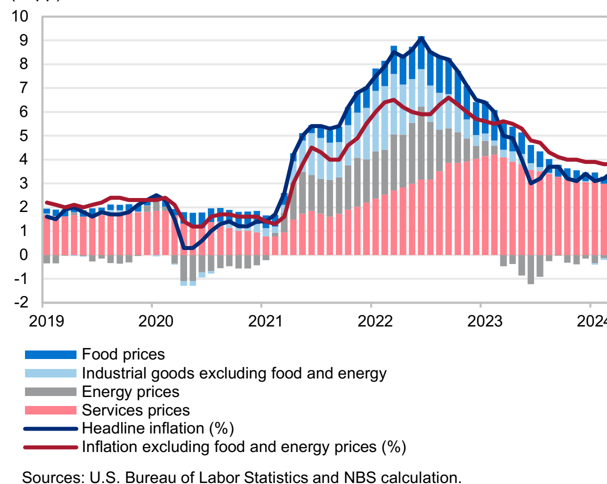
Sources: Eurostat and NBS calculation.
* HICP excluding energy, food, alcohol and cigarettes.

Chart V.0.10 **Revision of the euro area inflation projection for 2024 and 2025**
(in %)



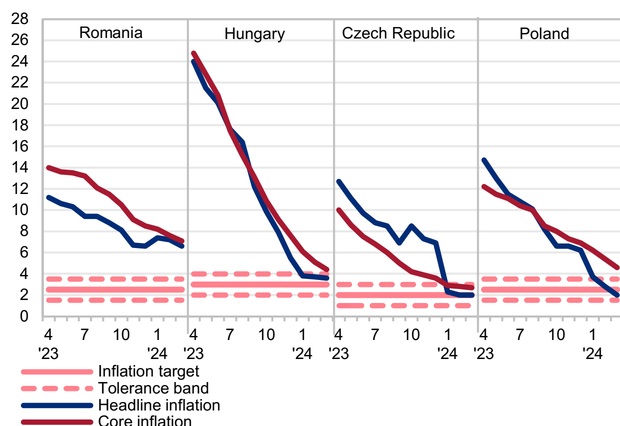
Source: ECB (March 2024).

Chart V.0.11 **Contributions of CPI components to y-o-y inflation in the USA**
(in pp)



Sources: U.S. Bureau of Labor Statistics and NBS calculation.

Chart V.0.12 **CPI movements in selected CESEE countries in the previous year (until March 2024)**
(y-o-y rates, in %)



Sources: Central banks of selected countries.

Table V.0.3 **Inflation projections by country of the region**
(in %)

	April 2024			January 2024	
	2023	2024	2025	2024	2025
Poland	11.5	3.9	3.9	4.7	4.0
Czech Republic	10.7	2.2	2.1	2.7	2.2
Hungary	17.6	4.0	3.6	4.5	3.7
Romania	10.5	5.8	3.9	5.7	4.0
Slovakia	10.5	3.1	3.0	4.0	3.0
Slovenia	7.5	2.8	2.5	3.2	2.4
Croatia	7.9	3.2	2.6	3.5	2.6
Bulgaria	9.5	3.4	3.0	4.1	3.3
Albania	4.6	3.3	2.9	3.3	3.0
Bosnia and Herzegovina	6.8	2.4	2.2	3.0	2.3
North Macedonia	9.6	3.9	2.8	4.8	2.9
Montenegro	8.8	5.9	4.0	5.4	3.6

Source: Consensus Economics.

than in Q4, though services prices were somewhat higher in March. A similar y-o-y dynamic as the CPI was recorded during Q1 by personal consumption indices (total and excluding food and energy), recording y-o-y growth of 2.7% and 2.8%, respectively, in March. Assuming a further balancing of the supply and demand in the commodity and labour force markets, in March the Fed projected these inflation measures at around 2.5% for 2024, slightly higher than in December, though still below the outturn from last year. For 2025, the Fed's March forecast sees inflation continuing down (to 2.2%), though its return to the target level is not on radar before 2026.

In the **CESEE region**, y-o-y inflation was on a decline during Q1, dominantly under the impact of slower y-o-y food price growth. In **Hungary**, inflation declined to 3.6% in March, in the **Czech Republic** it was at the target midpoint of 2.0%, the same as in **Poland**, where the y-o-y fall in inflation was facilitated by a y-o-y fall in all energy prices. Y-o-y inflation in these three countries was within the target tolerance band in Q1. After going up in January, y-o-y inflation in **Romania** returned to the level from end last year (6.6%) by end-Q1. With the dissipation of high base effects from the same period last year, in some countries of the region inflation will climb in H2 from the current levels (Hungary, Poland), however, the projected inflation rates for this and the following year are mostly lower than previously expected. Poland faces a risk of an even higher inflation in H2 now that the zero VAT rate on food prices has been returned to its previous level as of April, and it remains uncertain how long the cap on household energy prices will be in place. Leading Consensus Economics analysts lowered their January inflation projections for 2024 in April for almost all countries, except Romania. Nevertheless, they estimate that though inflation is declining, there is still reason for concern due to the escalating conflict in the Middle East which could trigger inflationary pressures again in case of an additional increase in energy prices and transport costs.

In the **Western Balkan region**, y-o-y inflation trended down in **Bosnia and Herzegovina** and **Albania**, dropping to 2.0% and 2.3%, respectively, in March. In contrast, y-o-y inflation in Q1 was on the rise in **North Macedonia** and **Montenegro**, mostly under the impact of elevated food prices, equalling 4.0% and 5.5%, respectively, in March, which is higher than the levels from end-2023. In April, leading Consensus Economics analysts revised down their January inflation projections for 2024 for Bosnia and Herzegovina and North Macedonia, while the forecast for Albania remained unchanged and Montenegro's was revised up.

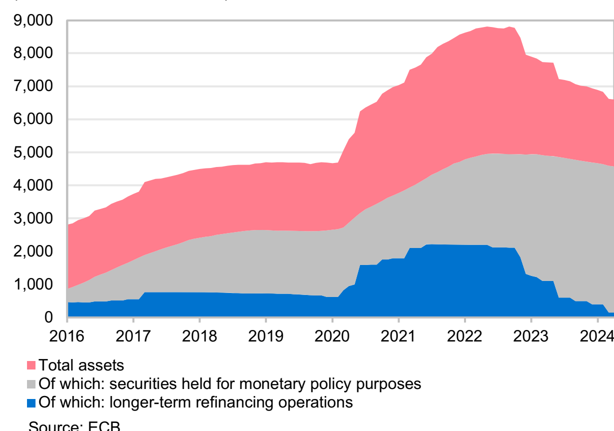
Monetary policy

Having assessed that inflationary pressures still mandate caution, the majority of central banks kept their policy rates untouched for months, judging them to have most likely already reached their peaks. **A slight relaxation of long-term global financing conditions began last October**, under the impact of market participants' expectations that central banks would soon start trimming their policy rates. Still, **global financing conditions remain much stricter than before the pandemic**. A more **visible easing is expected in H2 this year**, when the majority of central banks are predicted to embark on a cycle of policy rate cuts, in line with the projected further decrease of inflation towards the target.

In March and April 2024 meetings, the **ECB** decided to keep its deposit and credit facilities and main refinancing operations rates unchanged (4.00%, 4.50% and 4.75%, respectively), noting that inflation is slowing, but that inflationary pressures at home are still worrying, notably in the services sector. At the same time, the ECB continued to downsize its balance sheet as planned, at a moderate pace. It continued unwinding the portfolio of securities purchased under the **Asset Purchase Programme (APP)**, as the ECB is no longer reinvesting the principal payments from maturing securities. As for the **Pandemic Emergency Purchase Programme (PEPP)**, the ECB will fully reinvest the principal payments from maturing securities during H1 this year, and then gradually downsize the portfolio in H2 in order to discontinue reinvesting by the end of the year. Additionally, the ECB is regularly monitoring the impact of the return of funds to banks, borrowed under the **long-term refinancing operations (TLTROs)**, on monetary conditions.

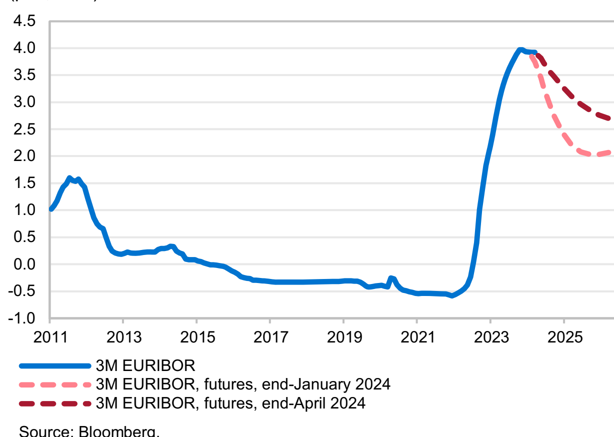
Keeping its interest rates unchanged, the ECB stated that financial conditions in the euro area are still restrictive and that previous rate hikes are keeping demand in check, thus helping to bring inflation down. However, domestic cost-push pressures from the labour market are still estimated as elevated and are keeping inflation in the services sector relatively high, mandating caution in the pursuit of monetary policy. ECB President Christine Lagarde noted that the ECB would ensure that the rates remain restrictive for as long as necessary, and that they will be trimmed if the estimates of inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission continue to fuel the belief that inflation is converging to the target in a sustainable manner. The ECB will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of

Chart V.0.13 **Consolidated Eurosystem balance sheet**
(end-of-month, in EUR bn)



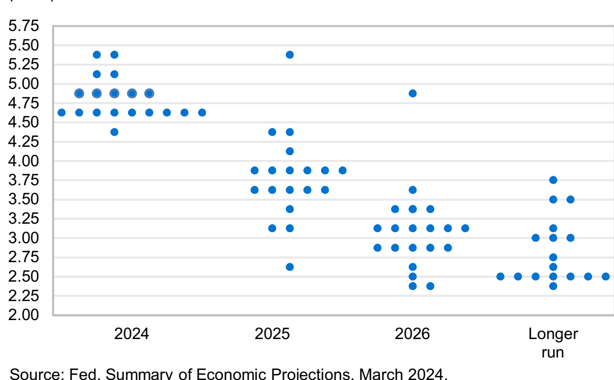
Source: ECB.

Chart V.0.14 **Expected 3M EURIBOR**
(p.a., in %)



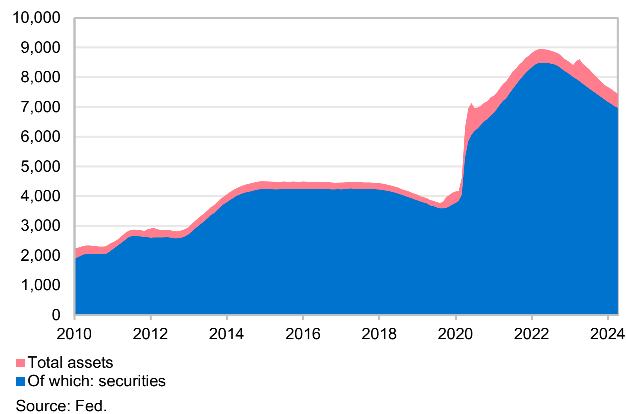
Source: Bloomberg.

Chart V.0.15 **FOMC participants' expectations of adequate monetary policy: midpoint of target range or target level for the federal funds rate**
(in %)



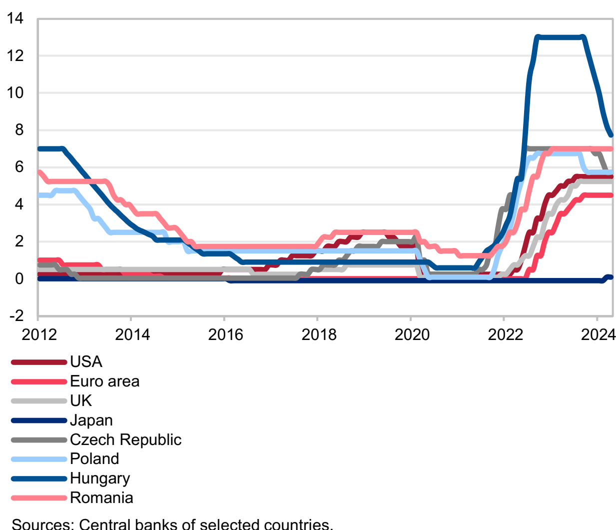
Source: Fed, Summary of Economic Projections, March 2024.

Chart V.0.16 **Fed's total assets**
(monthly average, in USD bn)



Source: Fed.

Chart V.0.17 **Policy rates across selected countries**
(p.a., in %)



Sources: Central banks of selected countries.

restriction, and it is not pre-committing to any particular rate path. In June, once more information and data are available, including new projections, the ECB will assess whether inflation is converging to the target in a sustainable manner, not excluding the possibility of the first cut in main rates occurring in June.

The euro area economic growth started off from very low levels this year and, unlike in the USA, the recorded growth rates are not that high, therefore the **ECB is expected to embark on monetary policy accommodation sooner than the Fed**. According to the IMF, by the end of the year the ECB might lower the main refinancing rate f**rom 4.0% to 3.3%**.[11]

Unlike the euro area, the IMF underlined that the much stronger economic activity in the USA is attributable to growth in productivity and labour supply, as well as strong pressures on the demand side, which might stir up inflation again, therefore, the **Fed's** approach to monetary accommodation should be cautious and gradual. In the March meeting, the Fed unanimously decided to maintain the federal funds rate range unchanged (5.25–5.50%). It also proceeded with the downsizing of its balance sheet assets at a monthly pace of USD 95 bn, of which USD 60 bn are government bonds (and Treasuries) and USD 35 bn are mortgage bonds. In the subsequent meeting, concluded on 1 May, the Fed left the federal funds rate range untouched, but decided to reduce the volume of downsizing government bonds and Treasuries as of June to USD 25 bn a month, instead of the previous USD 60 bn. The pace of downsizing mortgage bonds was kept at USD 35 bn a month. The press release issued after the meeting says that economic growth in the USA is sound and inflation moderated, though still elevated, adding that the past several months have not seen further progress toward the achievement of the 2% target. Also, growth in employment is still strong and unemployment rate at a low level. It underlined that the Fed is carefully monitoring economic data and stands ready to adjust its monetary policy stance accordingly in the event of risks that might interfere with the achievement of central bank's objectives.

March projections of macroeconomic indicators were updated, and the Fed's monetary policy stance by end-2024 remains unchanged from December – the federal funds rate should **retreat to 4.6%**, which is what the IMF also expects. The Fed's anticipated federal funds rate for end-2025 and 2026 was somewhat higher in March (3.9% and 3.1%) relative to December (3.6% and 2.9%).

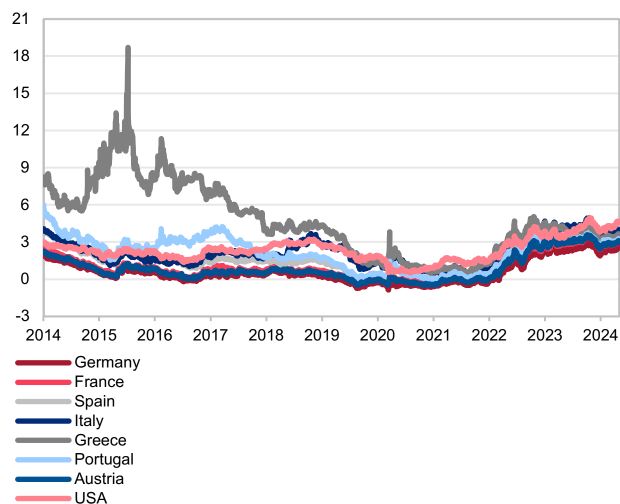
[11] IMF, World Economic Outlook, April 2024.

The Swiss National Bank was the first among leading central banks to trim its policy rate in March, by 25 bp to 1.5%. The decision was motivated by the fact that in February, for the ninth consecutive month, inflation trended below 2% y-o-y, in line with the central bank's objective, and was also supported by the real appreciation of the Swiss franc over the past year. In contrast, the **Bank of Japan** was the last central bank whose policy rate left the negative territory in March, by climbing to the 0%–0.1% range, after measuring -0.1% for eight years. The **Bank of England** did not change its 5.25% policy rate, which is the highest level since 2008. Inflation is retreating, but requires greater certainty in terms of controlling cost-push pressures, said the BoE Governor.

Of the inflation targeting central banks in the **CESEE region**, the **central bank of Turkey** raised its policy rate further in March, by 5 pp to 50%. Given that the rate was unchanged in February, market participants did not anticipate this increase. However, data about February inflation of almost 70% – the highest in the past 15 months – and the high growth in the prices of services and the depreciation of the lira are the main reasons behind the central bank's decision. Since the start of the year, the **Russian central bank** has not lifted its rate further (16%), as was anticipated, assessing the risks of inflation growth as lower than in Q4 2023. Monetary conditions in Russia are expected to remain restrictive for some time in order to lower inflation.

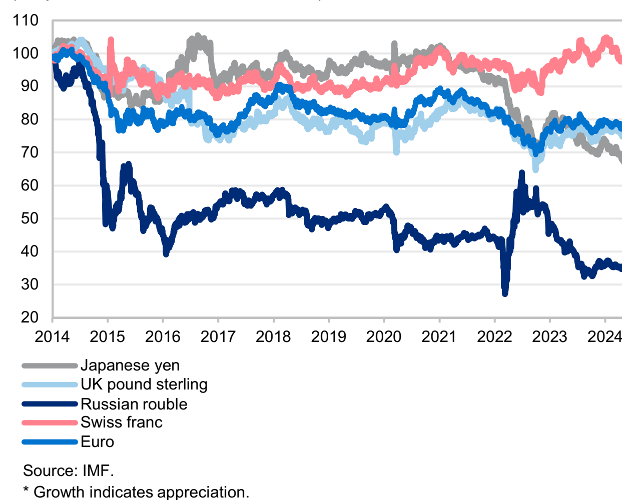
In contrast, the **Czech central bank** continued trimming its policy rate in February and March, each time by 0.5 pp, to 5.75%, as expected by most market participants. Analysts say that the Czech central bank had been waiting for the right moment to join Hungary and Poland in monetary policy accommodation, but that the beginning of the cycle was postponed amid concerns that the inflation rate would remain elevated. This did not transpire, rather, the inflation rate dropped below the expectations and reached the 2% y-o-y target in February, where it remained in March as well. As expected, the **central bank of Hungary** continued trimming its policy rate, by a total of 2.25 pp in the period February–April, to 7.75%. After last October's cut to 5.75%, the **central bank of Poland** kept its policy rate on hold, in line with expectations. Namely, though inflation slowed abruptly to 1.9% y-o-y in March and for the second month in a row remained within the bounds of the target tolerance band, price growth risks increased, notably because the 5% VAT rate on basic food staples was reinstated as of April, after it was abolished in February 2022. The **Romanian central bank** also did not change its policy rate, keeping it at 7% for more than a year.

Chart V.0.18 **Yields on ten-year bonds of euro area countries**
(daily data, in %)



Source: Bloomberg.

Chart V.0.19 **Exchange rates of selected national currencies against the dollar***
(daily data, 31 December 2013 = 100)



Source: IMF.
* Growth indicates appreciation.

Financial and commodity markets

Yields on ten-year government bonds of advanced European countries rose mildly in Q1 2024, on average by 23 bp, the same as ten-year US Treasuries, which rose by 32 bp. However, since the start of the year, the yield rates on these countries' government bonds were volatile amid market participants' insecurities as to the anticipated beginning of monetary policy accommodation by leading central banks. Cautiousness in the conduct of the ECB and the Fed's monetary policies was indicated by the core inflation declining more slowly than headline and the tight conditions in the labour market, as well as the risk of a renewed surge in energy prices amid exacerbated geopolitical tensions.

During Q1, **the dollar gained vis-à-vis the euro and other leading currencies** in the international financial market, which can be associated with the relatively better performances of the US economy, notably when compared to the euro area, as well as the pronounced resilience of inflation in their economy, which will drive the Fed to embark on monetary policy accommodation later than expected.

Chart V.0.20 **Assumption for Brent oil prices**
(USD/barrel)

Source: Bloomberg.

The global Brent oil price was on the upward path in Q1 amid elevated geopolitical risk over tensions in the Middle East, forecasts of OPEC and the International Energy Agency about rising oil demand in 2024 and 2025, as well as OPEC's decision to reduce oil production at the start of the year, which was later extended until end-Q2. Even so, the price of oil in Q1 averaged around USD 83 per barrel, or 1.6% below Q4 2023, while in y-o-y terms it was 2.3% higher. Amid heightened geopolitical tensions in the Middle East, depleting inventories and rising global demand, the price of oil continued up in April, averaging around USD 90 per barrel. The IMF estimates that the oil price will trend down by the end of the year, averaging around USD 79 per barrel. Under their assumptions, the subdued demand in China and the rising output in non-OPEC+ members will push the global oil price down, with the exacerbation of the Middle East conflict posing an upward risk. According to our projection, the oil price will trend down in the coming period, though it will be somewhat higher than in the previous projection, ending the year at around USD 84 per barrel. The Consensus Economics' expectation is similar to ours (USD 83 per barrel). On the other hand, the US Energy Information Administration anticipates a continuation of oil price growth until August, when the price will retreat to around USD 89 per barrel.

The benchmark price of natural gas for Europe (Dutch TTF hub) trended down in January and February, only to turn moderately up in March to around EUR 27 per MWh (equivalent to around USD 300 per 1,000 cubic metres)[12] on average. The factors that drove the price down included unseasonal warm weather and high filling levels in gas storage facilities, while the price turning back up in March was a reflection of the seasonal maintenance of the terminal in Norway and repairs at liquid gas terminals in Texas. The natural gas price in Q1 averaged around USD 27 per MWh, which is half the figure from a year earlier as well as 33.0% lower than in Q4 2023. In April, the natural gas price climbed 9.2% from March, averaging around EUR 29 per MWh, dominantly due to heightened geopolitical tensions. Based on market futures, we expect the natural gas price to continue moderately up until end-Q1 2025, when it will measure around EUR 35 per MWh, and with certain seasonal oscillations it will hold a similar course in the remainder of the year as well. These expectations are shared by the Consensus Economics, hence the natural gas price forecast for end-2024 and 2025 is around EUR 33 and EUR 34 per MWh, respectively.

The benchmark price of electricity for Europe (German stock exchange) moved steadily down during Q1, averaging around EUR 70 per MWh, or 19.4% lower than in Q4 2023, while in y-o-y terms it was 40.4% lower. Factors driving the electricity price down include dampened demand, lower price of natural gas and stepped-up production from renewable energy sources. The power price in the Hungarian exchange displayed similar dynamics, averaging around EUR 77 per MWh in Q1. The electricity price continued moderately down in April, averaging around EUR 64 and EUR 66 per MWh in the German and Hungarian Stock Exchange, respectively. According to market futures, the price of electricity will mirror the natural gas price and rise to around EUR 95 per MWh until end-Q1 2025, similarly to the level at which it will trend at the end of the year.

Under the impact of stepped-up production and subdued imports to China, **thermal coal price** decreased in January and February, but turned moderately up in March, averaging around USD 130 per tonne. Even so, the coal price was still 7.3% below the December level, while in y-o-y terms it was 29.8% lower. Amid stronger demand in China, thermal coal price continued up in April, while the Consensus Economics expects it to remain almost

Chart V.0.21 **European price of natural gas**
(EUR/MWh)

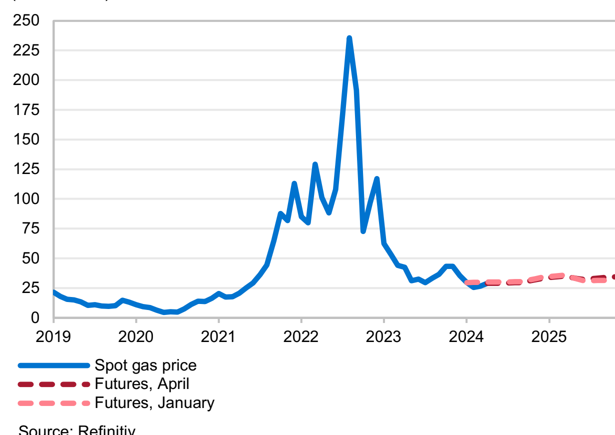


Chart V.0.22 **EU gas storage levels**
(mn m³)

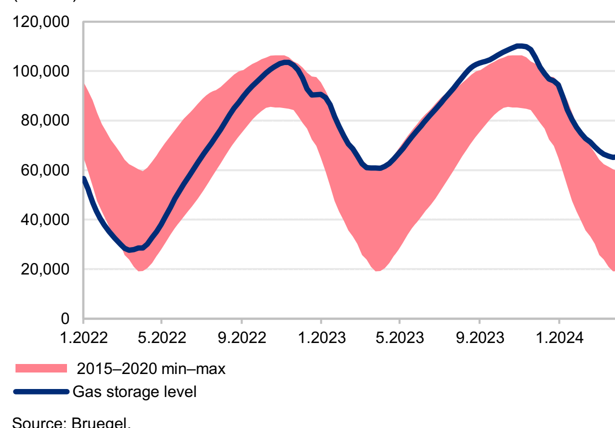
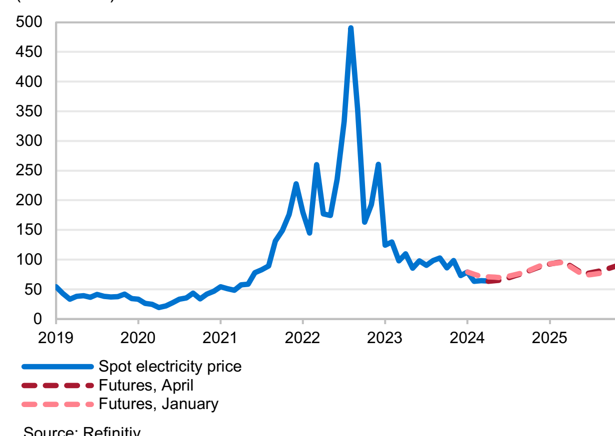
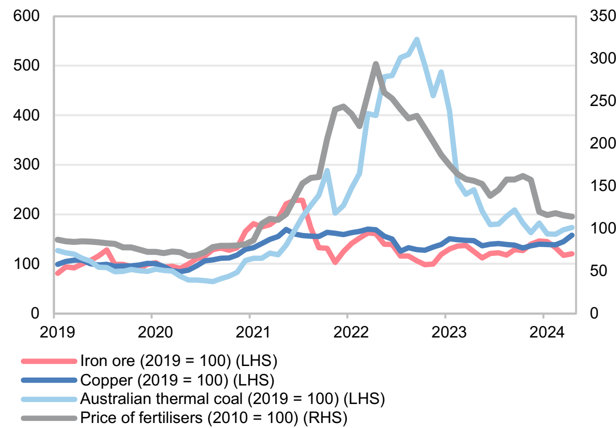


Chart V.0.23 **European price of electricity**
(EUR/MWh)



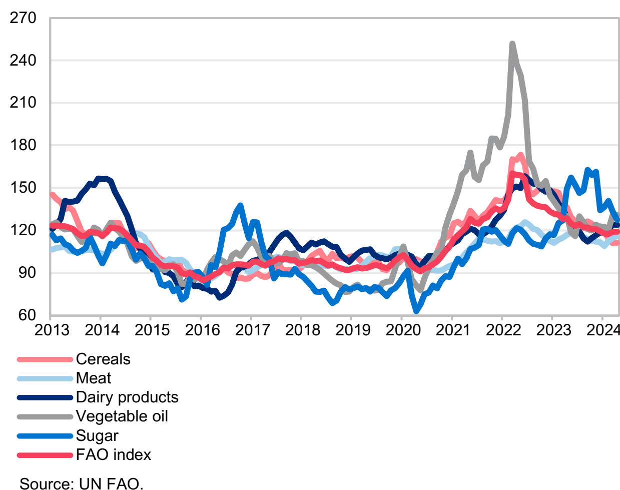
[12] The price expressed in dollars per 1,000 cubic metres of gas was calculated based on the production price of gas expressed in MWh, the EUR/USD exchange rate and an appropriate coefficient (10.55 MWh ≡ 1,000 m³).

Chart V.0.24 **Selected commodity prices in the global market**
(index)



Source: Commodity Prices, World Bank.

Chart V.0.25 **World Food Price Index**
(in nominal terms, 2014−2016 = 100)



Source: UN FAO.

unchanged until end-2024, striking a downward path in 2025.

Dominantly under the impact of the lower natural gas price, the **global prices of mineral fertilizers** retreated in Q1, and in March stood 3.4% below the December level, while relative to the same period the previous year they were 27% lower. The global prices of mineral fertilizers contracted further in April, reaching their lowest level in three years.

The prices of metals and minerals took a dip in January and February due to weak industrial activity in China, while a more favourable outlook of global industrial activity helped them edge up moderately in March. They continued up in April, mirroring industrial recovery and the fall in inventories in the London Stock Exchange. The Consensus Economics expects metals prices to recover going forward, with the index of global prices of basic metals[13] 7.1% higher at end-2024 than at end-2023.

The global food prices, measured by the FAO index, mirrored the dynamics of the prices of other primary commodities – falling in the first two months and recovering in March. They were 0.8% lower in March relative to December, or 7.3% relative to the same period a year earlier. The decline was mostly facilitated by the lower prices of cereals (9.7%), and the slightly lower sugar prices (0.7%). In contrast, the prices of plant oils (6.8%), dairy (4.5%) and meat (2.6%) increased. In April, global food prices remained broadly unchanged m-o-m, with the prices of meat, vegetable oil and cereals going up, and sugar and dairy prices down.

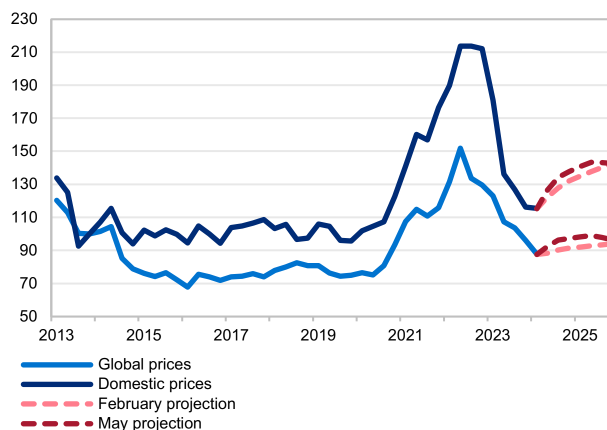
The prices of primary agricultural commodities in global markets trended dominantly down in Q1 2024 and were 8.8% lower than in Q4 2023, reflecting subdued activity around New Year's holidays and strong competition in the Black Sea and South American region. In contrast, the prices of primary agricultural commodities rose moderately in April amid adverse weather and uncertainties regarding the coming harvest. Going forward, we expect primary agricultural commodities prices to rise moderately, hence at end-2024 they will be around 1.1% higher than a year ago, while at end-2025 they will be around 1.0% lower y-o-y.

[13] This index has been calculated by The Economist, and the shares of individual metals reflect their respective shares in world metal trade: aluminium (47%), copper (32%), nickel (8%), zinc (7%), lead and tin (3% each).

Internal assumptions

Consistent with the anticipated moderate rise in global primary agricultural commodity prices, we expect the **domestic prices of primary agricultural commodities** to grow moderately in the remainder of the year. As for the character of the agricultural season at home, one should bear in mind the expected effects of equipment modernisation and enhanced application of agrotechnical measures, supported by higher government subsidies to the agricultural sector. However, as it is still too early to make conclusions, our projection, for the time being, assumes this year's agricultural season to be somewhat above the last year's and agricultural production to grow by around 1%. The same assumptions of further moderate growth have been used for next year as well.

Chart V.0.26 **Assumption for prices of primary agricultural commodities***
(Q4 2013 = 100)



Sources: Novi Sad Commodity Exchange, CBOT, Euronext and NBS calculation.
* Measured by the composite index of wheat, corn and soybean prices.

The assumptions of **administered price** growth are underpinned by the fact that a major part of the adjustment of electricity and natural gas prices in the domestic market was carried out last year. No adjustments are planned for this year, consistent with the second review of the IMF arrangement and the expectations stated in the previous Report. Thus, we expect administered price growth to amount to 4.3% this year, reflecting the adjustment of excises on cigarettes, coffee, alcoholic beverages and petroleum products. As the prices of utility and housing services increased less than we projected in February, the expected administered price growth is lower than in the previous projection (5.2%). We project administered prices to grow 6.5% in 2025, unchanged relative to the previous projection.

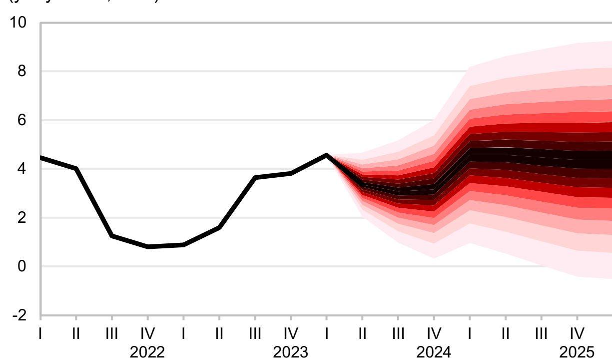
As regards the factors impacting **domestic consumption**, we expect real wages to continue to rise, by around 8% this year. The growth will be smaller in the next two years, reflecting inflation's slowdown. Having risen by around 17% last year, the wage bill is projected to increase by around 12%, as a result of a higher minimum cost of labour (17.8%) and the projected continued rise in employment and wages in the public and private sectors, remaining the key source of consumer demand. Consumer demand will also be propped up by remittances, projected at a similar level as last year (EUR 5 bn). The gradual easing of lending standards, the capping of interest rates on new euro-indexed housing loans, and lower costs of repayment of current loans of first-time homebuyers, approved at a variable rate and worth up to EUR 200,000, are likely to push up disposable household income this year. Consumption will also be driven by the hitherto increase in wages and

pensions by the government. Owing to the defined fiscal rules, the share of these expenditures will not exceed 10% and 10.5% of GDP respectively, ensuring a downward trajectory of public debt.

Favourable macroeconomic trends, along with the maintained downward trajectory of public debt going forward, will also positively affect the country's **credit rating** and **risk premium**. Moreover, acknowledging the results achieved so far and the economy's resilience, the Standard & Poor's rating agency upgraded Serbia's outlook from stable to positive, a notch away from investment grade.

GDP projection

Chart V.0.27 **GDP growth projection**
(y-o-y rates, in %)

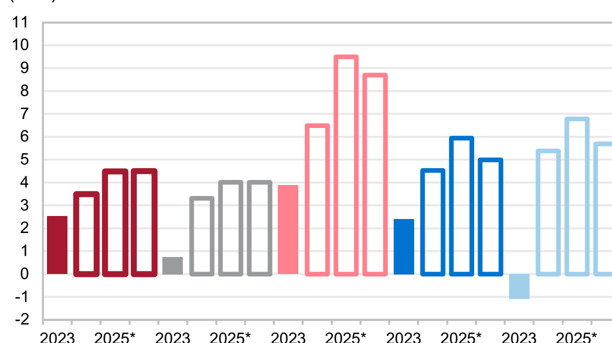


Source: NBS.

Faster than expected GDP growth in Q1 increases the probability that this year's GDP growth rate will be closer to the central value of the forecast range of 3–4%, as stated in the previous Report. According to our May projection, the projected GDP growth rate for this year equals 3.5%. The 2024 growth will also be spurred by the estimated carry-over effect from 2023, worth 1.5 pp.

On the expenditure side, according to the flash SORS estimate, the Q1 growth of 4.6% was led by domestic demand. The main impetus came from household consumption and fixed investment, with net exports also providing a mild positive contribution. On the production side, growth is estimated to have been led by trade, manufacturing and construction, with all other sectors also giving an impulse.

Chart V.0.28 **Real growth in GDP and its components, expenditure side**
(in %)



Sources: SORS and NBS.
* NBS estimate and projections.

In light of the developments since the start of the year, the growth structure changed somewhat compared to the February projection. As before, economic growth will be led by domestic demand, with all its components providing a positive contribution. Private consumption is expected to lend an impetus stronger than projected in February, reflecting a continued rise in employment and wages, notably in the private sector, as well as greater productivity, thus having no major inflationary effect. Owing to continued high FDI inflows and preserved investment confidence, the contribution of fixed investment also increased somewhat relative to the previous projection. Investment will also be supported by subdued global inflationary pressures, more favourable financing conditions, and the implementation of projects in transport, energy and utility infrastructure. On the other hand, despite the anticipated further export growth in 2024, primarily owing to past investment in export sectors, we projected faster import growth in the context of the expected acceleration of investment and personal

consumption. This will result in a negative contribution of net exports to GDP growth in 2024, though it will be smaller compared to the February projection.

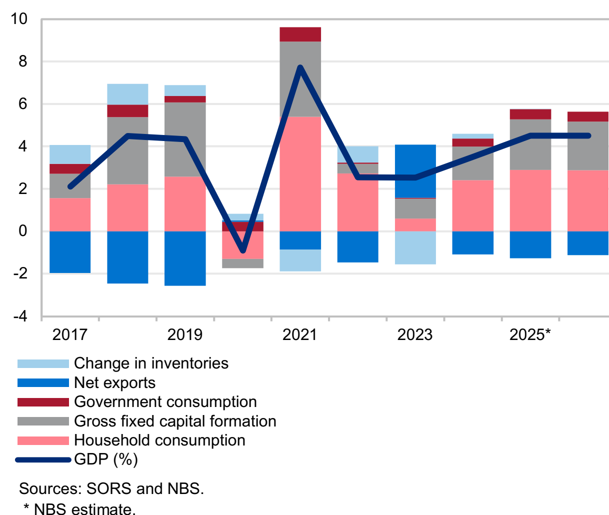
In 2025 and 2026, GDP is expected to step up further, to a 4.0–5.0% range, with the central value of 4.5%. This will reflect the investment planned under the "Leap into the Future – Serbia Expo 2027" programme, other infrastructure projects, and the expected recovery of the euro area, and thus of external demand.

In terms of GDP use, **private consumption**, with the highest share in GDP composition, is likely to provide the strongest positive contribution to growth, of 2.4 pp in 2024. Over the next two years, this contribution will rise to around 2.9 pp. Given the key consumption indicators in Q1, the projected rise in this component is somewhat higher than we expected in the February projection. Personal consumption will be led by the continued rise in employment and wages (notably in the private sector), as well as pensions, in accordance with the fiscal rules. As the expected wage growth will be largely the result of enhanced labour productivity, we expect no major inflationary pressures on these grounds. In addition, real disposable household income will be driven by inflation's further slowdown and lower housing loan repayment costs after the NBS temporarily capped the interest rates until end-2024. Bearing in mind the rhetoric of leading central banks' officials and market players' expectations, we can realistically expect leading central banks to embark on gradual monetary easing in 2024. The easing of financing conditions would incentivise lending and further support household consumption. However, the projected rise in private consumption in 2024 and the years to come is slower than the projected GDP growth, also contributing to medium-term price stability.

We expect **government spending** to continue to positively impact GDP growth, adding around 0.4 pp in 2024 and around 0.5 pp in 2025 and 2026, taking into account the planned wage and pension outlays and rising expenditure for goods and services under the announced "Leap into the Future – Serbia Expo 2027" programme.

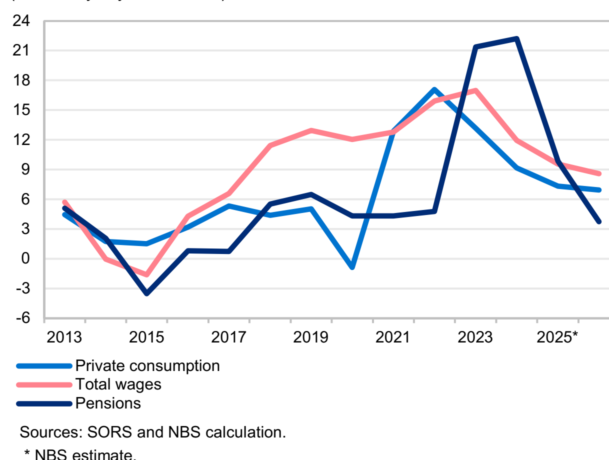
Under the May projection as well, we expect **private investment** to step up in 2024 and add 1.1 pp to GDP, which is almost unchanged compared to the previous projection. The contribution of investment is projected to increase, to around 1.4 pp in 2025 and 1.8 pp in 2026. In Q1, investment activity continued to grow at a positive pace, reflecting preserved investment confidence, a favourable growth outlook, and proven resilience to negative external shocks in the prior period. Moreover,

Chart V.0.29 **Contributions to real GDP growth**
(in pp)



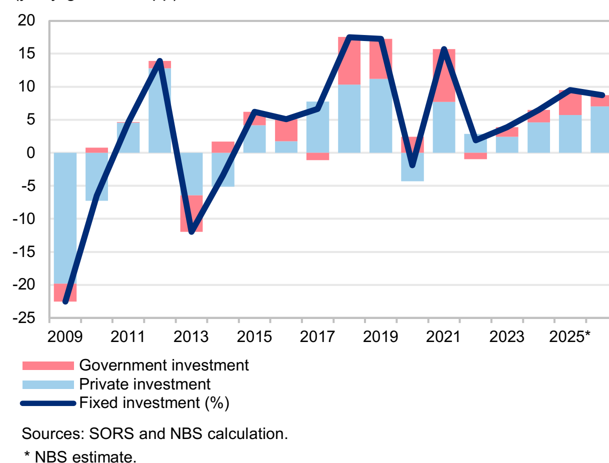
Sources: SORS and NBS.
* NBS estimate.

Chart V.0.30 **Rate of growth in private consumption and its sources**
(nominal y-o-y rates, in %)



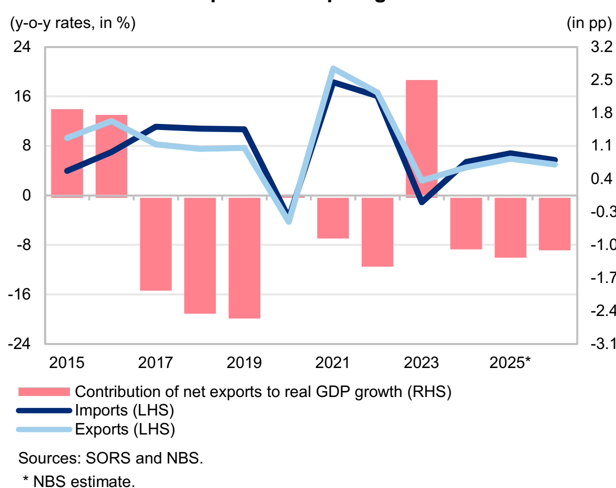
Sources: SORS and NBS calculation.
* NBS estimate.

Chart V.0.31 **Fixed investment**
(y-o-y growth, in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

Chart V.0.32 **Real export and import growth**



Sources: SORS and NBS.
* NBS estimate.

subdued global inflationary pressures and the expected easing of financing conditions will enhance the investment sentiment, positively affecting domestic and cross-border investment loans. FDI will remain a significant impetus for investment, while own capital will remain the main source of financing private investment, as a result of increased corporate profitability in the past years. In parallel with rising private investment, **government investment** is expected to step up, contributing 0.5 pp to overall GDP growth in 2024, according to the new projection. Significant, government-financed projects are planned in the fields of transport infrastructure and the energy sector. Owing to the "Leap into the Future – Serbia Expo 2027" programme, we can also expect sizeable further investment in other public infrastructure, i.e. the average contribution of government investment over the next two years is likely to be somewhat higher than in the previous projection.

Just as the previous one, the May projection assumes a gradual replenishment of **inventories** in 2024 as a bulk was used for domestic consumption and a part for exports last year. The inventories of agricultural commodities will expand owing to last year's good agricultural season, particularly of autumn crops. The contribution of inventories will be close to a neutral level in the years to come.

Given the expected effects of investment in export-oriented sectors in the past years and the gradual recovery of external demand, our exports are projected to increase further in 2024. Exports will rise faster this year, on account of last year's good agricultural season, particularly of autumn crops. The yields of primary agricultural commodities significantly exceeded the domestic needs, leaving room for higher exports this mercantile year, as confirmed by movements since early 2024. Commodities exports will also be spurred by higher manufacturing exports. We expect the surplus in services trade to stay at a similar level as in 2023, reflecting broad-based growth in the exports of services by type, notably ICT and business services, tourism and air transport services, despite the expected increase in imports, notably of tourism services, amid rising personal consumption. However, given the planned investment activities going forward, in 2024 we projected a somewhat faster rise in imports compared to exports, notably of equipment and intermediate goods. Growing private consumption on the back of higher disposable income will prop up consumer goods imports as well. This will result in a negative contribution of **net exports** in 2024 (-1.1 pp in the new projection), i.e. the negative contribution of net exports will be smaller than forecast in February. Given the expected acceleration of the investment cycle, net exports

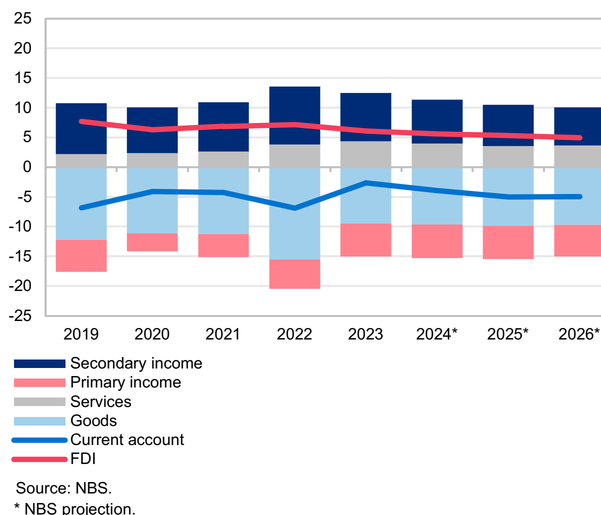
are likely to continue to provide a negative contribution of around 1.1–1.3 pp in the years to come as exports will rise somewhat more slowly than imports.

Faster real growth in imports than exports this year and in the years to come will lead to a higher foreign trade deficit than in 2023, while terms of trade, i.e. a faster projected rise in import compared to export prices, will work towards its increase in 2024 and 2025. As far as other components of the **current account** are concerned, the projection assumes that the surplus on the secondary income account will equal around 7% of GDP, which is an average pre-pandemic level. As net FDI inflows are expected at around 5% of GDP, the yield based on their ownership will remain a solid expenditure item on the primary income account, whose deficit will thus moderately widen. FDI inflows are expected to remain broad-based in terms of geography and project, with the bulk remaining channelled to export-oriented sectors.

Given all the above, we project the current account deficit to approach 4% this year, and hover at around 5% of GDP in the medium run. As in the past nine years, the current account deficit is estimated to be fully covered by net FDI inflows, ensuring external sustainability.

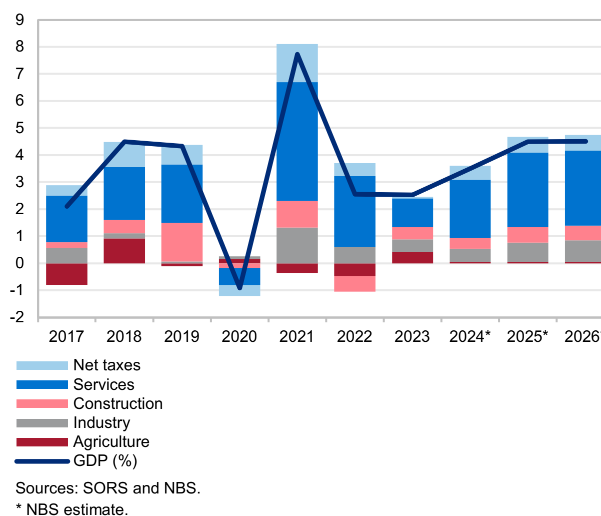
On the production side, GDP growth will continue to be led by service sectors (contribution of 2.2 pp in 2024 and 2.8 pp each in the following two years), supported by rising personal consumption, as a reflection of positive labour market trends, rising wages and disposable income, particularly in an environment of inflation's slowdown and the expected start of monetary easing. Consistent with growth in consumption and service sectors (resulting in improved tax revenue collection), a positive contribution to GDP is estimated to come from net taxes (around 0.5 pp annually). Production sectors are also projected to expand, providing a cumulative contribution to GDP growth of 0.9 pp in 2024, according to the May projection as well. The strongest positive impetus is expected from accelerated industrial growth (0.5 pp). A similar contribution (0.2 pp) is likely to come from its manufacturing segment, as new capacities are expected to be activated and the existing ones expanded. Energy will also be a contributor (0.2 pp) as, in accordance with the new arrangement with the IMF, structural reforms have been planned in the energy sector. The launch of a new facility in the Kostolac thermal power plant will also give a positive contribution to GDP. Owing to greater exploitation of coal and metal ores, particularly copper, mining is expected to give a mild, positive contribution (0.1 pp). Construction is also anticipated to be a positive contributor (0.4 pp in 2024) given the planned implementation of projects in the fields of transport, energy and utility infrastructure. We have assumed a

Chart V.0.33 **Current account and FDI projection**
(in % of GDP)



Source: NBS.
* NBS projection.

Chart V.0.34 **Contributions to real GDP growth, production side**
(in pp)



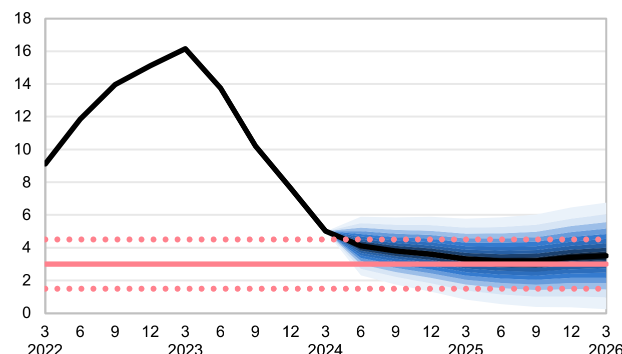
Sources: SORS and NBS.
* NBS estimate.

Table V.0.4 **Key projection assumptions**

	2024		2025		2026	
External assumptions	Feb.	May	Feb.	May	Feb.	May
Euro area GDP growth	0.8%	0.6%	1.5%	1.5%	1.5%	1.6%
Euro area inflation (average)	2.6%	2.3%	2.1%	2.0%	1.9%	1.9%
3M EURIBOR (December)	2.7%	3.2%	1.9%	2.3%	1.9%	2.3%
International prices of primary agricult. commodities (Q4 to Q4)*	-2.7%	1.1%	3.3%	-1.0%	3.1%	-7.8%
Brent oil price per barrel (December, USD)	83	84	80	82	80	80
Internal assumptions						
Administered prices (Dec. to Dec.)	5.2%	4.3%	6.6%	6.5%	5.0%	5.5%

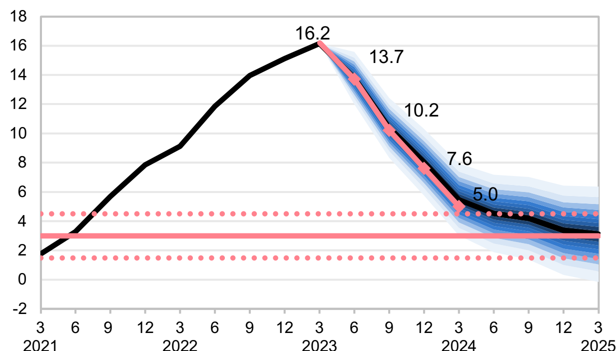
* Composite index of soybean, wheat and corn prices.
Sources: ECB, Consensus Economics, Euronext, CBOT, Bloomberg and NBS.

Chart V.0.35 **Inflation projection**
(y-o-y rates, in %)



Source: NBS.
The fan chart depicts the probability of various inflation outcomes in the next eight quarters. The central projection is within the darkest central band and the probability that inflation would lie in it is 10%. Each following shade includes 10% probability, which means that outturns of inflation somewhere within the entire fan chart are expected with probability of 90%. In other words, the probability that inflation in the next eight quarters would lie somewhere outside the band in the chart is 10%.

Chart V.0.36 **May 2023 inflation projection and outcome**
(y-o-y rates, in %)



Source: NBS.
The fan chart depicts the probability of various inflation outcomes in the next eight quarters. The central projection is within the darkest central band and the probability that inflation would lie in it is 10%. Each following shade includes 10% probability, which means that outturns of inflation somewhere within the entire fan chart are expected with probability of 90%. In other words, the probability that inflation in the next eight quarters would lie somewhere outside the band in the chart is 10%.

continued moderate increase in agricultural production, reflecting equipment modernisation and enhanced implementation of agrotechnical measures, supported by higher government subsidies to the agricultural sector. This should result in a mild positive contribution of agricultural production to GDP. The "Leap into the Future – Serbia Expo 2027" programme will drive up the contribution of construction, manufacturing and most service sectors in the years to come.

Inflation projection

Under the May central projection, y-o-y inflation is expected to retreat within the target band in May, continue to slow thereafter and move around the target midpoint of 3% from 2025 until the end of the projection horizon. The new inflation projection for Q2 and Q3 is slightly lower than in February reflecting faster than anticipated slowing of inflation so far in the year, while the projection for Q4 until the end of the projection horizon is slightly above the February projection mostly because of higher global prices of oil and primary agricultural commodities and the fact that the disinflationary impact of domestic demand is weaker than expected three months ago.

Despite high geopolitical tensions, protectionist measures, fragmentation and sanctions in international trade, y-o-y inflation will continue down until the end of the year, aided by several key factors: the effects of past monetary policy tightening, further slide in inflation expectations, slowing of imported inflation and the still negative output gap, mostly on account of low external demand.

Most central banks have now in all likelihood ended the cycle of monetary policy tightening, and some have embarked on monetary policy easing. As for leading central banks, the ECB is expected to start trimming its key rates in June, and the Fed later in the year. Since inflation has subsided, however, real interest rates will remain elevated and monetary policies will stay stringent for some time yet.

Similarly, the real interest rate of the NBS continued up in Q1 2024 as inflation expectations dwindled. Greater monetary policy restrictiveness in respect of the real interest rate confirms that the NBS's monetary policy is committed to reducing inflationary pressures. In the current cycle of monetary tightening, the NBS Executive Board sought primarily to impact market players' inflation expectations, speed up their retreat within the target band and ensure that inflation strikes a sustainable downward path. Inflation expectations of the financial sector declined in particular. This sector's short-term

expectations have been within the NBS target band since the start of the year, while its medium-term expectations have been anchored within the target band for a longer time period. Inflation expectations of all sectors are expected to go down as current inflation declines, prompting a further fall in inflation and, at the same time, supporting a rise in the real interest rate.

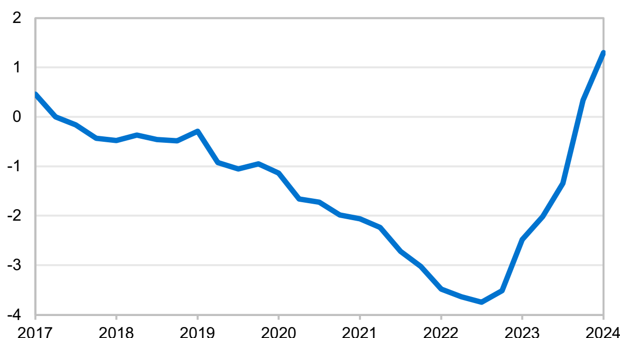
As in the prior projections, a key assumption underpinning the anticipated declining inflation trajectory in Serbia is the continued decrease in imported inflation. Euro area inflation will continue to slide, but the pace of its decrease will be more moderate than so far and the inflation target will be reached in 2025. Imported inflation will subside under the impact of both supply- and demand-side factors. On the supply side, it is important that the prices of energy and food have gone down, and global value chains have improved. On the demand side, higher interest rates of leading central banks had the strongest disinflationary effect and are likely to remain elevated for a while yet.

There is still concern over tight labour markets, though there has been some easing relative to three months ago. Labour costs are expected to rise further in the euro area, powering core inflation. The ECB, however, expects nominal wage growth to slow gradually during the projection horizon and inflation to subside, as this will weaken pressures for higher wages in order to offset inflation.

Having declined so far in the year, prices of primary agricultural commodities and food are expected to continue to contribute somewhat to the projected slowing of inflation, though the new projection places them at a slightly higher level at end-2024 relative to end-2023 and expects them to decline in the next two years consistent with the futures movements. Global food prices, according to the FAO index, have been on a slide for seven consecutive months until March 2024 when they inched up m-o-m (1.1%). They remain lower than a year ago (by 7.7%) which is consistent with lower costs of inputs in agricultural production, notably of mineral fertilisers whose prices are now much lower in the local market than a year ago.

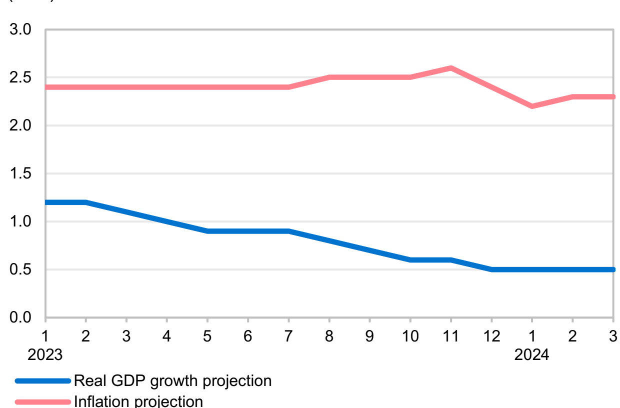
Within primary commodity prices, the global price of oil is particularly concerning. It started to rise from mid-March this year and topped USD 90 per barrel in early April, spurred by the escalation of geopolitical tensions amid rising global demand and OPEC+ production caps. As tensions in the Middle East eased, the global oil price dropped to below USD 90 per barrel in late April, but it remained above the level we expected three months ago.

Chart V.0.37 **Real interest rate**
(in %)



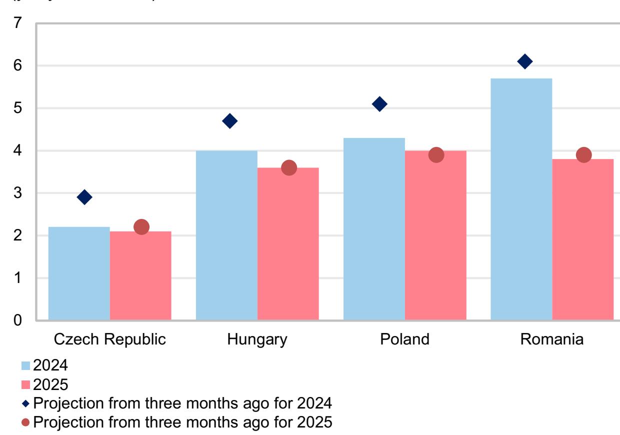
Sources: NBS.
Note: The real interest rate is obtained as a difference between 1W BELIBOR and one-year ahead inflation expectations of the financial sector, according to the Bloomberg survey.

Chart V.0.38 **GDP and inflation projections of the euro area for 2024**
(in %)



Source: Consensus Economics.

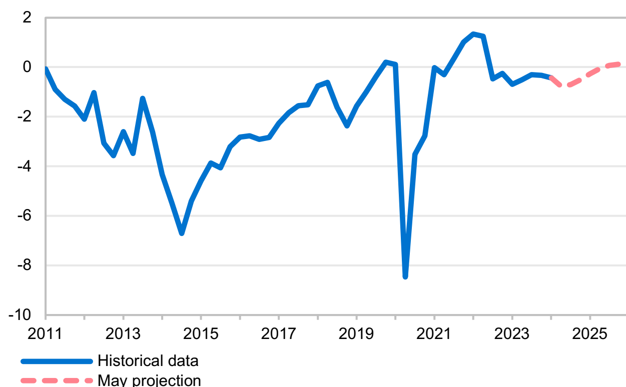
Chart V.0.39 **Projection of consumer price growth**
(y-o-y rates, in %)



Source: Consensus Economics, March 2024.

Oil futures also went up, as did oil price expectations of almost all relevant institutions. For this reason, the expected oil price trajectory in our projection, though declining, is now higher than three months ago. The key reason behind the increase in the anticipated oil price is the sharp slump in global inventories and the expectation that global oil demand will slowly climb to a new peak by August in the conditions of persisting geopolitical tensions which push up the risk premium included in the oil price. A sharper rise in the global oil price is contained by the fact that the interest rates of leading central banks are still relatively high. Next year, OPEC+ is expected to lift its production caps, prompting a decline in the global price of oil.

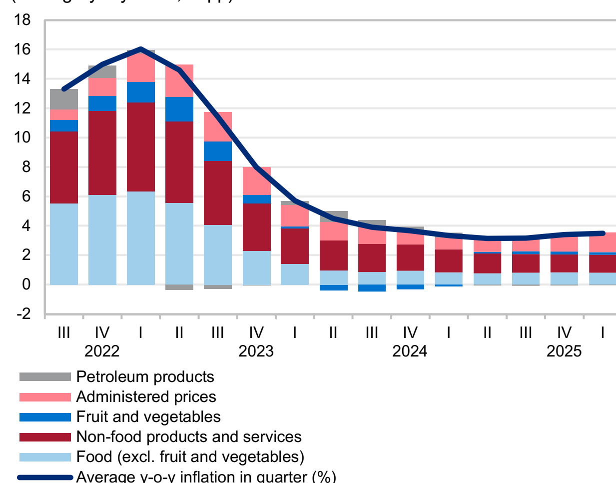
Chart V.0.40 **Output gap projection***
(in % of potential output)



Sources: SORS and NBS.
* Output gap is estimated on the basis of NAVA.

Consistent with weak growth globally, and particularly in the euro area, as well as tight financial conditions, we expect disinflationary pressures on account of external demand to persist during the first half of the projection horizon. Euro area growth is anticipated to measure 0.6% in 2024 and 1.5% in 2025. Such modest growth mostly reflects trends in Europe's strongest economy and our leading trade partner, Germany. Leading German institutes have revised down their projections of German economic growth, mostly placing it at mere 0.1% this year due to weak external and domestic demand. Growth is expected to accelerate next year to the range of 1.1% to 1.4%. In regard to domestic demand in Serbia, a somewhat lower income disposable for consumption on account of past monetary tightening by the ECB and the NBS will be offset by further growth in employment and wages. In the second half of the projection horizon, we expect to see the effects of gradual easing of financial conditions as monetary restriction starts to lessen. For this reason, the negative output gap is anticipated to start narrowing in H2 2024 and be neutral or slightly positive in 2025.

Chart V.0.41 **Contributions to y-o-y inflation by component**
(average y-o-y rates, in pp)



Source: NBS.

As in the previous projection, we expect the contribution of all components to y-o-y inflation to decrease, aiding its further slowdown. In particular, this refers to **food prices (excluding fruit and vegetables)**, which gave a major push to y-o-y inflation growth in the previous period. The decline in the contribution of food prices will reflect the high base for industrial food products and reduced cost-push pressures in food production due mostly to lower prices of primary agricultural commodities (corn, wheat and soy) which have returned to their pre-crisis levels. The stabilisation of food prices reflects raw material prices, but also lower imported inflation and inflation expectations. The dissipation of cost-push pressures in food production is indicated by the real marginal costs

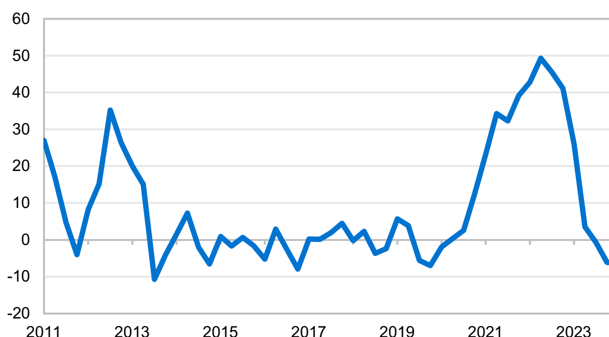
gap (measured by the deviation from trend of the ratio of input prices to prices of final food products) which has been in negative territory since Q3 2023. As primary agricultural commodity prices are expected to rally gradually in the coming period, the negative gap should gradually narrow and close. We therefore expect the contribution of food prices to y-o-y inflation to subside in the next year and level off at around 0.8 pp until the end of the projection horizon, which is almost half its present level.

The contribution of **non-food inflation** to y-o-y inflation is also expected to decline. The prices of this product category largely depend on the prices of numerous imported products, primarily from the euro area, our most important trade partner. The rise in non-food inflation coincides almost entirely with growth in imported inflation from the euro area and other non-euro area EU member countries, which are also our important partners (such as Hungary, Romania, the Czech Republic). As in the prior projection, imported inflation is a factor whose effect on non-food product prices will weaken considerably over the projection horizon. A continued decline in inflation expectations will also relieve pressures on domestic prices of non-food products. We expect no pressures on non-food inflation from global supply chains, as the index has been negative for over a year. We are more concerned about the end-2023 increase in the costs of international container transport, though they are still well below the peak reached in 2022 and have declined over the past months. With all this in mind, we expect the contribution of non-food products and services to halve – from around 2.4 pp early this year to around 1.2 pp towards the end of the projection horizon.

As most electricity and natural gas price adjustments were made in 2023, no further hikes are planned for this year. For this reason, in 2024 we expect **administered price** growth (4.3%) to be much lower than in 2023 and to contribute less to inflation (around 1.1 pp). In the next two years, administered prices are anticipated to grow by 6.5% and 5.5%, contributing slightly more to inflation than in 2024.

Given that the global oil price has increased since our previous projection and oil price expectations for the coming period have gone up, we expect **petroleum product prices** to contribute more to y-o-y inflation than we anticipated three months ago. Instead of having a negligible effect, we now expect petroleum product prices to have an inflationary effect during this and early next year, and an almost neutral contribution to y-o-y inflation until the end of the projection horizon.

Chart V.0.42 **Real marginal costs gap in food production**
(deviation in % from trend)

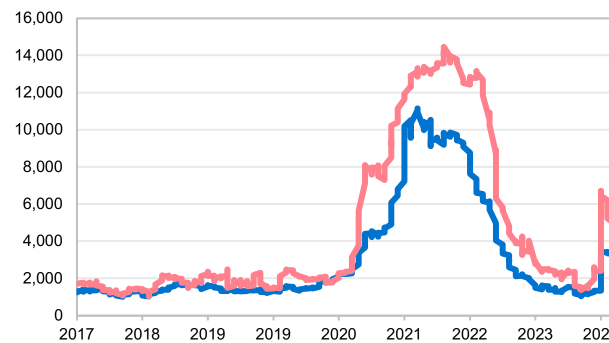


Source: NBS.

Chart V.0.43 **Global supply-chain pressures**
(index, in standard deviations)

Source: Federal Reserve Bank of New York.

Chart V.0.44 **Cost of container transport**
(in USD)



Source: Freightos.

Fruit and vegetable prices are now relatively low thanks mostly to robust supply due to favourable weather conditions, easing of cost-push pressures in production and the base effect. We expect this year's season to be average. The contribution of fruit and vegetable prices to headline y-o-y inflation should therefore be negative this year, i.e. work toward reducing y-o-y inflation. From Q2 next year until the end of the projection horizon, fruit and vegetable prices should provide a slightly positive contribution to inflation as we assume that they will gradually return to their long-term trend (which corresponds to the rise in the prices of non-food products and services).

Other institutions' projections for Serbia and comparison with the projections of the National Bank of Serbia

In April, the IMF revised up its October projection of Serbia's economic growth in 2024, by 0.5 pp to 3.5%, which is fully consistent with our projections. The **World Bank** revised up its projection by the same amount. **It estimates that real GDP growth will measure 3.5% in 2024**, guided primarily by rising private consumption, investment and export. Net export will provide a negative contribution, however, due to the anticipated acceleration of import. **Consensus Economics** analysts expect somewhat lower GDP growth of **3.3%**, but this is still 0.4 pp higher than in January. When it comes to 2025, the IMF projects growth of 4.5%, the same as in our projection, whereas Consensus Economics and the World Bank anticipate somewhat slower growth of 3.9% and 3.8%, respectively, which will also be guided by rising private consumption and fixed investment.

Table V.0.5 **Projections of macroeconomic indicators of Serbia**
(in %)

	NBS		IMF		Consensus Forecasts		World Bank	
	2024	2025	2024	2025	2024	2025	2024	2025
GDP projection	3.5	4.5	3.5	4.5	3.3	3.9	3.5	3.8
Current account projection	-4.0	-4.8	-3.9	-4.7			-3.6	-3.9
Inflation projection	4.4	3.3	4.8	3.1	4.7	3.4	5.0	3.5

Sources: The stated financial institutions.

Relative to October, the **IMF revised up its projection of the current account deficit for this year, by 0.7 pp to 3.9%**, which is still below our expectations (4.0%). The **World Bank's projection** was lifted less, **by 0.2 pp to 3.6%**. As the investment cycle is expected to accelerate, and import of equipment and intermediate goods to go up as a result, the current account deficit is anticipated to gather momentum in the coming period. The IMF places it at 4.7% in 2025, which is close to our projection, while the World Bank expects the deficit to measure 3.9% of GDP.

Due to the continued easing of global inflationary pressures and the effects of monetary policy tightening, international institutions expect inflation to slow further going forward. According to April projections, the IMF expects the average annual inflation to measure 4.8% in 2024, **down by 0.5 pp from**

October last year, whereas the World Bank revised its projection down by 0.3 pp to 5.0%. Consensus Economics anticipates a somewhat lower average inflation in 2024 – 4.7%, down by 0.4 pp from January. **Similarly to our projection for 2025 (3.3%), the IMF expects average annual inflation to measure 3.1% in 2025, while Consensus Economics and the World Bank project a somewhat higher inflation of 3.4% and 3.5%, respectively.**

Risks to the projection

The risks to our new inflation and GDP projections are still mainly associated with factors **from the international environment** – geopolitical relations, outlook for global growth and, in particular, euro area growth, and their impact on world prices of energy and other primary commodities. To some degree, the risks also stem from the persistence of core inflation globally and the duration of monetary policy tightening by leading central banks. **At home**, the risks are associated with the pace of growth in domestic demand, primarily on account of the level of FDI inflows, and investment in infrastructure and the energy sector. Another source of risk is the outcome of the agricultural season at home. **Overall, we judge the risks to the GDP and inflation projections to be symmetric over the projection horizon.**

Geopolitical tensions remain a source of instability in commodity and financial markets, primarily through their possible impact on global prices of energy and primary commodities. Disruptions in international trade and transport due to the escalation of conflicts in the Middle East and Ukraine could push global oil prices further up, as well as the prices of other primary commodities. This could inflate production costs, extend the duration of elevated inflation expectations globally and defer inflation's return to central banks' targets. A fresh round of inflationary pressures would extend and/or intensify future monetary policy tightening in order to rein in inflation. Even if this produced no direct effects on energy prices in Serbia, it would still lead to higher imported inflation and, by extension, inflation at home. Further global economic and political fragmentation could divide countries into trade blocs and cause major production losses worldwide, including negative effects on our key trade partners. Namely, further deterioration of relations between economies in the West and China could have negative spillovers on the world's economy and global supply chains. Our main trade partner, Germany, would be affected in particular, not only due to falling demand from China, but also due to the German economy's reliance on China's critical inputs. As the geopolitical situation is

unlikely to improve soon, we judge the **risks to the GDP projection on account of potential escalation of geopolitical tensions to be skewed to the downside, and to the inflation projection – to the upside.**

The global economy has avoided recession, but **global economic activity** will in all likelihood remain sluggish in H1 2024 as well and accelerate gradually thereafter. In particular, this refers to the euro area whose growth will pick up some speed this year, but from a very low level due to the ECB's tight monetary policy and the energy shock in the preceding period. The global economy and the euro area could, however, see weaker growth than we assumed in our baseline scenario given the geopolitical tensions and the resulting disruptions in global markets of primary commodities, which could place a further drag on global economic growth. If the global economy weakens more than anticipated, so will the **economic activity in the euro area**, our main trade partner. Euro area growth

Table V.0.6 **Key risks to the GDP and inflation projection**

Risk	Possible channels of influence	Estimate of the risk effect on GDP relative to the baseline scenario	Estimate of the risk effect on inflation relative to the baseline scenario
Intensification of geopolitical tensions and impact on the prices of oil, gas and electricity in the global market (Serbia is a net energy importer)	Intensification of geopolitical tensions and conflicts would lead to renewed growth in global energy prices. Production costs would go up, reducing funds for investment and possibly generating second-round effects on inflation, which could partly be offset by lower demand for these products.	↓	↑
Global growth prospects	Slower economic growth globally, and particularly in the euro area, would result in subdued external demand for our exports and reduced demand-side pressures on inflation.	↓	↓
Global inflation, notably in the euro area, and monetary policies of leading central banks	– Higher/lower than expected global inflation, notably in the euro area, leads to higher/lower imported inflation, which increases/decreases production costs. – Greater and/or faster than expected monetary policy tightening by leading central banks results in greater investor risk aversion and decreased capital flows to emerging economies, and vice versa.	↕	↕
International prices of primary agricultural commodities and metals (Serbia is a net exporter)	A rise/fall in the prices of primary agricultural commodities and metals has inflationary/disinflationary effects. This inflates/deflates production costs and decreases/increases income available for investment, but the effects on GDP would most probably be neutralised by higher/lower exports, as Serbia is a net exporter of primary agricultural commodities and metals.	↕	↕
Pace of domestic demand growth	Higher/lower disposable income on account of faster/slower than expected wage and employment growth due to higher/lower export demand and/or higher/lower FDI inflow would result in faster/slower growth in domestic demand and stronger/weaker inflationary pressures. Accelerated activity growth in construction amid faster implementation of infrastructure projects by the government, investments planned in the lead-up to hosting Expo 2027, as well as private investment in the conditions of receding inflationary pressures, would drive up domestic demand, GDP and inflation.	↑	↑
Recovery of the energy sector	Energy sector reform may have weaker or stronger than expected effects on the volume of production.	↑	↓
Agricultural season	A better than assumed agricultural season leads to higher supply of agricultural products and may produce disinflationary pressures, and vice versa: a poorer than assumed agricultural season results in reduced supply of agricultural products and inflationary pressures.	↕	↕

Note: ↑ means a more inflationary effect relative to the baseline scenario, ↓ lower economic growth, ↑ higher economic growth, ↓ a more disinflationary effect, and ↕ that the risks to the projection are symmetric relative to the baseline scenario.

could also surprise on the downside if the ECB's monetary restriction is extended and/or intensified. If the global economy and, in particular, the euro area slowed more than expected, this would affect Serbia through lower external demand and reduced energy and primary commodity prices. Subdued external demand would hold back growth in domestic manufacturing and exports, but it would also have a more disinflationary effect than in the baseline scenario.

Global growth could also be higher than anticipated if inflation slows more quickly. Combined with a faster decline in inflation expectations, this could allow central banks to move forward with their policy easing and contribute to growth acceleration. Policy support measures in China could make a greater than anticipated contribution to the recovery of the domestic and global economy. In Q1, China saw stronger industrial production and higher GDP growth than expected, so many relevant institutions have recently revised their projections. Faster than anticipated GDP growth in China would probably result in higher prices of energy and other primary commodities, making it more difficult to rein in inflation and calling for more stringent monetary policy. With all this in mind, we judge the **risks to the GDP projection, and to a smaller extent to the inflation projection, to be somewhat tilted to the downside in respect of global growth and external demand, particularly from the euro area.**

Taking into account the risks to global growth on the one hand, and the risks from geopolitical tensions on the other, we judge **the risks of departure of global prices of primary commodities (agricultural commodities and metals) to be symmetric**.

Though **global inflation** has receded, sustainable price stability worldwide has still not been achieved and the path towards it remains fraught with challenges. First of all, tight labour markets, particularly in advanced economies, could lead to higher than anticipated wage growth. A key issue in the euro area is still to what extent companies will shift higher wage costs onto consumers by further lifting the prices of their products and services, or whether they will offset this by reducing their profit margins, as the achievement of the inflation target in 2025 greatly depends on this. Wages are anticipated to go up by around 4.5% this year in the euro area, but a more robust increase could extend pressures on growth in prices, particularly the prices of services, and compromise inflation's return to target. The ECB would then respond by tightening its monetary policy over a longer time period, which could produce negative effects on

economic growth and financial stability. Weaker demand amid tighter than expected credit conditions and a more efficient monetary policy transmission mechanism would work in the opposite direction.

Renewed inflation growth would lead to **tighter than expected monetary policies by leading central banks over a longer time period**. Global financing conditions would then be even stricter, with risk premium going up and capital inflow to emerging economies dwindling, generating depreciation pressures. This would drive up the cost of FX borrowing at home, which would then have a dampening effect on domestic demand through lower disposable income for consumption and investments, while the maintained relative stability of the dinar exchange rate would significantly alleviate inflationary pressures from a possibly reduced inflow of portfolio investments. If inflation in advanced economies returns to lower levels sooner than expected and/or economic growth slows down more significantly, leading central banks could start lowering their rates more than expected. As this would result in more favourable financial conditions globally, **we assess the risks on this account as symmetric**.

At home, the risks to the projection are associated with the **speed of domestic demand growth**. On the one hand, lower than anticipated income from export demand could reflect negatively on the labour market, i.e. result in slower than expected employment and wage growth, with negative implications for domestic demand. On the other hand, **Serbia's ability to attract FDI** could turn out to be greater than anticipated, especially as our FDI inflow projections are quite conservative and record-high outturns were recorded over the past years, exceeding our projections. This would lead to further growth in wages and employment. Faster than expected performance of government-financed **infrastructure projects** would work in the same direction, as would private investments, particularly those planned under the "Leap into the Future – Serbia Expo 2027" programme. With this in mind, we judge the **risks to the GDP projection on account of domestic demand to be skewed to the upside. Also, faster than anticipated domestic demand growth would add somewhat to inflationary pressures**.

Another risk to the projection are the **developments in the domestic energy sector**. Given the need to ensure energy security, but also a gradual transition to a green economy, significant investments in the energy sector have been planned under the IMF arrangement, which could produce stronger than anticipated effects on electricity exports. We therefore judge the risks to the **economic growth projection on this account to be**

tilted to the upside. At the same time, this reduces the need for major electricity price adjustments at home.

The agricultural season poses a symmetric risk to the inflation and GDP projections. We have assumed the agricultural season this year to be slightly better than last year, and we used the same assumption for next year's agricultural season, taking into account advances in equipment modernisation and wider application of agrotechnical measures, as well as higher government subsidies to agriculture. However, the outturn of the agricultural season will greatly depend on weather conditions and surprises in both directions are possible.

Future monetary policy decisions will depend on the movement in key factors at home and abroad, and on geopolitical relations and their impact on the pace of further slowdown of inflation at home. Delivering price stability and preserving financial stability in the medium term will remain the monetary policy priority, as this contributes to sustainable economic growth and, by extension, to a further rise in employment and a favourable investment environment.

Text box 5: Alternative projection scenarios

Geopolitical relations, primarily in the Middle East, tightened further since our last Report, so geopolitical tensions remain the greatest risk to the materialisation of projections. Since the materialisation of this risk would primarily affect the global prices of primary commodities – oil and primary agricultural commodities, our downside scenario rests on the assumption of their higher prices. Conversely, the upside scenario assumes that euro area inflation will continue down faster than expected and that primary commodity prices will be lower than in the baseline.

Failed negotiations and the prolongation of the Middle East conflict, attacks of Yemen's Houthi rebels on ships in the Red Sea, and mutual attacks on energy infrastructure in Ukraine and Russia stirred price volatility in the global markets of primary commodities in Q1. The rise in global primary commodity prices was particularly pronounced in late March and early April, after the Israeli strike on the Iranian embassy in Syria and Iran's response, with the oil price spiralling to around USD 93 per barrel in mid-April, up by 20.2% from end-2023. The upswing in global primary commodity prices was also under the sway of surging costs of overseas transport, as conventional ships stayed well away from Bab el-Mandeb Strait to avoid Houthi attacks. In relation to this, FBX Global Container Index in mid-April was 87.5% higher than at end-2023, despite its predominant downward trend in Q1. However, according to the global supply chain pressure index (GSCPI), constructed by the New York Fed, which in March still hovered in the negative territory and below the multiple-year average, elevated transport costs did not cause bottlenecks in global supply chains.

Given the significant levels of crude oil production and exports and the geostrategic position of Iran on the Strait of Hormuz connecting the Persian Gulf and Indian ocean, the continuation of direct conflict with Israel would trigger a rise in the prices of energy and, by extension, other primary commodities. Elevated global prices of primary commodities would endanger the declining inflation path globally, most likely postponing the anticipated easing of monetary conditions, which would entail slower economic growth further on. Additional inflationary pressures in the coming period could also stem from continued Houthi attacks on Red Sea ships, due to the rising costs of transport and potential setbacks in global supply chains, as well as new attacks on energy infrastructure in Russia and Ukraine. Apart from that, potential economic and political fragmentation and trade blocks formation may impose new restrictions in global trade and capital, technology and workforce movements. The effects would be stronger in emerging and developing economies, due to the negative effects on FDI, reflecting increased risk aversion among investors. What is more, the IMF's research suggests that geopolitical fragmentation has already taken toll on global trade. Namely, since the outbreak of the Ukraine conflict, the annual exchange between countries aligning with different blocks declined on average by 4.9%, vs. 2.4% between countries belonging to the same block.[1]

In the case of materialisation of the above risks, the global oil price is assumed to climb to over USD 102 per barrel by end-2024, only to drop moderately in 2025 and settle at around USD 95 per barrel at year end. Higher oil prices would put upward pressure on global prices of primary agricultural commodities, so at end-2024 they would gain 11% compared to end-2023, while losing around 8.0% in 2025, meaning they would be higher by 10% at end-2024 and by 3% at end-2025 relative to the baseline scenario. The consequences of this downside scenario would be as follows:

• The rise in the global oil price would reflect on inflation at home, directly, via higher prices of petroleum products in the domestic market, as well as indirectly, via higher food prices due to the rising production costs. The same effects would put an upward pressure on euro area inflation, passing through to domestic inflation via import prices. In that case, average inflation would exceed the baseline scenario figure by 0.2 pp in 2024 and by around 0.4 pp in 2025.

• The rise in global inflation would probably lead to the postponement of expected policy rate cuts by leading central banks this summer, which would negatively reflect on global economic growth and financing conditions. Lower external demand and tightened global financing conditions would weigh down on Serbia's exports, and, to some extent, investment and consumption, so domestic GDP would also underperform the baseline growth figure, by around 0.3 pp.

• The effects of the downside scenario on the current account deficit would not be significant, because the effects of lower external demand and the growing prices of primary agricultural commodities and metals on exports would probably

[1] IMF WEO April 2024.

offset each other. Also, counterbalancing effects on imports would come from higher energy prices and elevated expenses in the primary income account due to higher interest rates and, on the other hand, the impact of lower external and domestic demand on the imports of equipment and consumer goods.

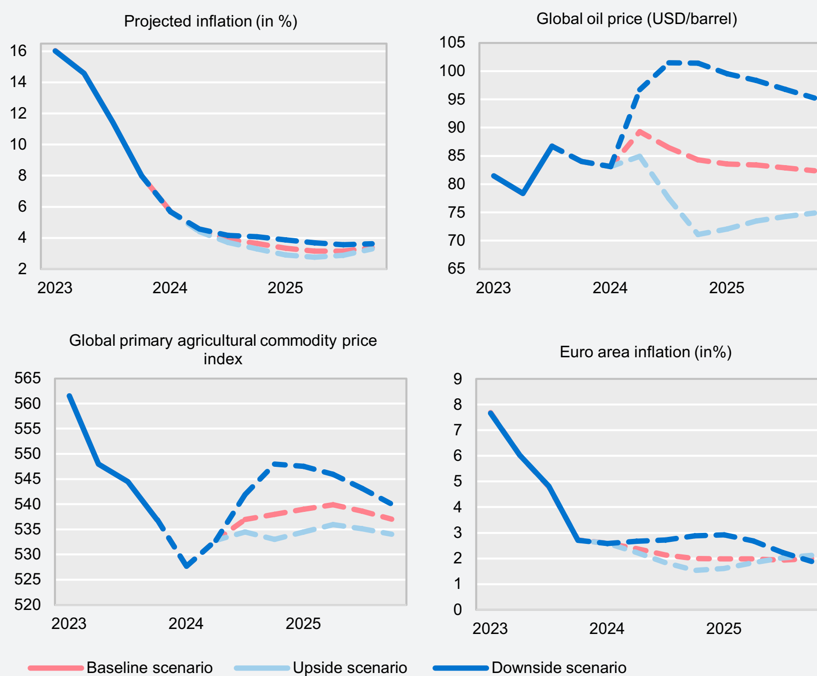
In the second alternative scenario, we start from the assumption that euro area inflation would decelerate faster than expected, averaging 2.0% in 2024 and 1.9% in 2025 (instead of 2.3% and 2.0%, respectively, in the baseline). Apart from that, this upside scenario assumes that geopolitical tensions will gradually abate in the coming period, which would translate into lower global prices of primary commodities, e.g. global oil price equalling some USD 71 per barrel at end-2024 and USD 75 per barrel at end-2025. At the same time, global prices of primary agricultural commodities would be by 5% lower in 2024 and by 3% in 2025 relative to the baseline. The effects of the upside scenario would be as follows:

• Average inflation would be lower by 0.1 pp in 2024 and by 0.3 pp in 2025 compared to the baseline, owing to softer euro area inflation and a drop in import prices, as well as in global prices of primary commodities.

• In such case, monetary accommodation would be more generous than in the baseline scenario, which would spur production and moderate global financing conditions. The effects on domestic GDP growth would be positive, measuring around 0.2 pp and materialising via higher external demand, weaker inflationary pressures and lower risk premium.

• Speaking of the current account deficit, same as in the previous alternative scenario, the effects will depend on which counterbalancing factors affecting exports and imports prevail. The rise in external demand would entail export growth, while declining primary commodity prices would work in the opposite direction. Similarly, speaking of imports, the fall in energy prices would entail lower energy imports, while the rise in domestic demand would have the opposite effect.

Chart O.5.1 **Effects of alternative scenarios on inflation**



Sources: SORS and NBS calculation.

Table A
Indicators of Serbia's external position

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Q1 2024
EXTERNAL LIQUIDITY INDICATORS (in %)																				
FX reserves/imports of goods and services (in months)	6.1	9.0	7.5	5.4	9.7	8.4	8.8	7.7	7.6	6.6	6.7	6.2	5.4	5.4	5.7	6.1	5.9	5.2	6.7	6.7
FX reserves/short-term debt	177.0	265.1	250.6	162.6	220.6	191.2	299.9	237.3	268.6	294.0	256.4	234.0	202.1	210.9	275.6	228.1	249.6	245.4	320.5	
FX reserves /GDP	22.1	34.8	30.5	22.9	32.6	31.7	34.0	32.4	30.7	27.9	29.1	27.8	25.4	26.3	29.1	28.8	30.8	32.1	35.8	35.0
Debt repayment/GDP	4.7	9.7	9.6	10.1	12.1	11.3	11.7	12.3	12.6	13.3	11.1	12.3	10.9	11.3	10.0	5.8	9.2	9.6	9.8	
Debt repayment/exports of goods and services	19.8	36.2	37.5	37.5	48.8	37.5	37.3	36.0	33.0	32.7	25.2	25.9	22.2	22.9	19.7	12.2	17.0	15.3	16.6	
EXTERNAL SOLVENCY INDICATORS (in %)																				
External debt/GDP	56.2	55.2	55.1	58.8	68.6	74.5	68.1	76.1	70.4	72.4	73.4	72.0	65.1	62.2	61.4	65.8	68.4	69.3	65.3	
Short-term debt/GDP	12.5	13.1	12.2	14.1	14.8	16.6	11.3	13.7	11.4	9.5	11.3	11.9	12.6	12.4	10.6	12.6	12.4	13.1	11.2	
External debt/exports of goods and services	234.9	205.7	214.3	218.9	276.9	247.1	216.5	223.6	184.0	177.7	166.8	152.4	132.2	126.0	121.0	138.2	126.6	110.2	110.7	
FINANCIAL RISK EXPOSURE INDICATORS (in %)																				
FX reserves/M1	290.3	356.1	306.7	300.4	393.4	416.6	429.6	402.1	330.4	278.1	250.2	207.3	176.2	168.0	174.1	130.0	138.1	158.7	166.6	171.3
FX reserves/reserve money	169.8	179.5	173.8	140.7	190.5	196.4	207.6	197.9	199.9	196.6	193.7	196.6	185.0	171.4	194.1	157.1	180.0	180.2	201.0	214.7
OPENNESS OF ECONOMY (EXPORTS + IMPORTS)/GDP	67.1	73.0	74.7	78.0	65.1	75.3	78.0	84.5	87.1	91.8	96.2	100.6	106.2	108.2	111.5	103.9	116.7	137.5	123.1	126.3
MEMORANDUM: (in EUR million)																				
GDP[1)]	22,276	25,906	31,551	35,701	32,486	31,546	35,432	33,679	36,427	35,467	35,740	36,779	39,235	42,892	46,005	46,815	53,345	60,426	69,521	16,918
External debt	12,520	14,291	17,382	20,982	22,272	23,509	24,123	25,645	25,644	25,679	26,234	26,494	25,526	26,662	28,254	30,787	36,488	41,895	45,378	
External debt servicing	1,054	2,513	3,039	3,594	3,922	3,564	4,154	4,130	4,595	4,728	3,960	4,508	4,285	4,849	4,592	2,710	4,886	5,801	6,810	
Central bank foreign exchange reserves	4,922	9,020	9,634	8,162	10,602	10,002	12,058	10,915	11,189	9,907	10,378	10,205	9,962	11,262	13,378	13,492	16,455	19,416	24,909	24,942
Short-term debt[2)]	951	968	1,044	1,832	1,852	1,758	612	455	196	99	303	672	844	1,401	1,925	1,585	1,612	2,405	876	
Current account balance	-1,778	-2,356	-5,474	-7,125	-2,032	-2,037	-3,656	-3,671	-2,098	-1,985	-1,234	-1,075	-2,051	-2,076	-3,161	-1,929	-2,266	-4,162	-1,810	-395

CREDIT RATING (change of rating and outlook)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2024	
	May/July	Feb	July	March/ Dec	Dec	Nov	March	Aug	July	Jan	Dec	Jan/March/ June/Dec	March/Dec	Dec	Sept/Dec	May	March/Dec	June	Apr	
S&P	BB- /stable	BB- /positive	BB- /stable	BB- /negative	BB- /stable		BB /stable	BB- /negative				BB- /positive	BB /stable	BB /positive	BB+ /positive	BB+ /stable	BB+ /positive	BB+ /stable	BB+ /positive	
Fitch	BB- /stable			BB- /negative		BB- /stable		BB- /negative		B+ /stable	B+ /positive	BB-/stable	BB /stable		BB+ /stable					
Moody's									B1 /stable			B1 /positive	Ba3 /stable		Ba3 /positive		Ba2 /stable			

Methodological notes:

Foreign exchange reserves/imports of goods and services (in months) − ratio of end-of-period foreign exchange reserves to average monthly imports of goods and services during last 12 months.
Foreign exchange reserves/short-term debt (in %) − ratio of foreign exchange reserves to stock of short-term debt at remaining maturity at end-of-period.
Foreign exchange reserves/GDP (in %) - ratio of end-of-period foreign exchange reserves to GDP.
Debt repayment/GDP (in %) − ratio of debt repayment (excl. early repayment of a part of debt to London Club creditors) to GDP during period under review.
Debt repayment/exports (in %) − ratio of debt repayment (excl. early repayment of a part of debt to London Club creditors) to exports of goods and services during period under review.
External debt/GDP* (in %) − ratio of end-of-period outstanding debt to GDP.
Short-term debt/GDP − ratio of end-of-period short-term debt at remaining maturity to GDP.
External debt/exports (in %) − ratio of end-of-period outstanding debt to annual value of exports of goods and services.
Foreign exchange reserves/M1 (in %) − ratio of foreign exchange reserves to money supply at end-of-period.
(Exports + imports)/GDP (in %) − ratio of value of exports and imports of goods and services to GDP during period under review.

1) According to ESA 2010. Data for 2023 and Q1 2024 are NBS estimate.

2) At original maturity.

Notes:

1. SORS revised GDP data for the period 2005-2017, which led to a change in the share of macroeconomic indicators in GDP.
2. Data are subject to corrections in line with the official data sources.
3. Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to previous methodology.
4. Starting from 2007 the general trade system of registration of exports and imports of goods is applied. This is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. Data for 2005 and 2006 are disseminated using the special trade system.
5. External debt servicing does not include advance debt repayments.

Table B
Key macroeconomic indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Q1 2024.
Real GDP growth (in %)[1)]	5.5	5.1	6.4	5.7	-2.7	0.7	2.0	-0.7	2.9	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.7	2.5	2.5	4.6
Consumer prices (in %, relative to the same month a year earlier)[2)]	17.7	6.6	11.0	8.6	6.6	10.3	7.0	12.2	2.2	1.7	1.5	1.6	3.0	2.0	1.9	1.3	7.9	15.1	7.6	5.0
NBS foreign exchange reserves (in EUR million)	4,922	9,020	9,634	8,162	10,602	10,002	12,058	10,915	11,189	9,907	10,378	10,205	9,962	11,262	13,378	13,492	16,455	19,416	24,909	24,942
Exports (in EUR million)[3)]	5,329	6,948	8,110	9,583	8,043	9,515	11,145	11,469	13,937	14,451	15,728	17,385	19,312	21,166	23,349	22,271	28,818	38,004	41,009	10,224
- growth rate in % compared to a year earlier	19.1	30.4	-	18.2	-16.1	18.3	17.1	2.9	21.5	3.7	8.8	10.5	11.1	9.6	10.3	-4.6	29.4	31.9	7.9	1.9
Imports (in EUR million)[3)]	9,612	11,970	15,468	18,267	13,099	14,244	16,487	16,992	17,782	18,096	18,643	19,597	22,343	25,257	27,960	26,370	33,439	45,054	44,596	11,138
- growth rate in % compared to a year earlier	0.7	24.5	-	18.1	-28.3	8.7	15.7	3.1	4.7	1.8	3.0	5.1	14.0	13.0	10.7	-5.7	26.8	34.7	-1.0	1.4
Current account balance[3)]																				
(in EUR million)	-1,778	-2,356	-5,474	-7,125	-2,032	-2,037	-3,656	-3,671	-2,098	-1,985	-1,234	-1,075	-2,051	-2,076	-3,161	-1,929	-2,266	-4,162	-1,810	-395
as % of GDP	-8.0	-9.1	-17.3	-20.0	-6.3	-6.5	-10.3	-10.9	-5.8	-5.6	-3.5	-2.9	-5.2	-4.8	-6.9	-4.1	-4.2	-6.9	-2.6	-2.3
Unemployment according to the Survey (in %)[6)]						20.9	24.9	25.9	24.0	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.1	9.5	9.4	
Wages (average for the period, in EUR)[7)]	210.4	257.8	347.1	402.0	337.8	331.8	372.5	366.1	388.5	379.8	367.9	374.5	394.5	419.8	466.0	510.9	560.2	637.9	733.5	810.4
RS budget deficit / surplus (in % of GDP)[4)]				-1.6	-3.0	-3.2	-3.8	-5.6	-4.9	-5.9	-2.7	-0.2	0.7	0.6	0.2	-8.3	-4.6	-3.3	-2.2	-1.0
Consolidated fiscal result (in % of GDP)[4)]	1.1	-1.4	-1.8	-2.5	-4.2	-4.3	-4.5	-6.4	-5.1	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.2	-2.2	-0.9
RS public debt, (central government, in % of GDP)[8)]	47.6	33.9	27.9	26.8	30.9	39.5	42.8	52.9	56.0	66.2	70.0	67.7	57.8	53.6	51.9	57.0	56.5	55.1	52.0	48.7
RSD/USD exchange rate (period average)	66.87	67.03	58.39	55.76	67.47	77.91	73.34	88.12	85.17	88.54	108.85	111.29	107.50	100.28	105.28	103.03	99.49	111.86	108.41	107.89
RSD/USD exchange rate (end of period)	72.22	59.98	53.73	62.90	66.73	79.28	80.87	86.18	83.13	99.46	111.25	117.14	99.12	103.39	104.92	95.66	103.93	110.15	105.87	108.69
RSD/EUR exchange rate (period average)	82.99	84.11	79.96	81.44	93.95	103.04	101.95	113.13	113.14	117.31	120.73	123.12	121.34	118.27	117.85	117.58	117.57	117.46	117.25	117.19
RSD/EUR exchange rate (end of period)	85.50	79.00	79.24	88.60	95.89	105.50	104.64	113.72	114.64	120.96	121.63	123.47	118.47	118.19	117.59	117.58	117.58	117.32	117.17	117.14
MEMORANDUM:																				
GDP (in EUR million)[5)]	22,276	25,906	31,551	35,701	32,486	31,546	35,432	33,679	36,427	35,467	35,740	36,779	39,235	42,892	46,005	46,815	53,345	60,426	69,521	16,918

[1)] At constant prices of previous year. Data for Q1 2024 is SORS flash estimate.

[2)] Retail prices until 2006.

[3)] Starting from 2007 data on the balance of payments (current account, exports and imports of goods and services) are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to the previous methodology. Due to the break in the series for 2007, exports and imports growth rates are not shown. Starting 2007 the general trade system of registration of exports and imports is applied. This is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. Data for 2005 and 2006 are disseminated using the special trade system.

[4)] Includes below-the-line items (payment of called guarantees, bank recapitalisations and debt takeover) in line with IMF methodology, as of 2008 on RS budget level and as of 2005 on consolidated level.

[5)] According to ESA 2010. Data for 2023 and Q1 2024 are NBS estimate.

[6)] In 2024, SORS conducted a post-census revision of data for the period 2021-2023. Data series is given according to the methodology of the 2021 Labour Force Survey.

[7)] Until 2018, wages are shown according to the old methodology. Since 2018, wages are shown according to the new methodology and data are based on Tax Administration evidence. For conversion of wages from RSD to EUR, we used the average of the period RSD/EUR exchange rate. Data for Q1 2024 is average of two months.

[8)] Data on the share of public debt in GDP were downloaded from the website of the Ministry of Finance.

Notes:

1. SORS revised GDP data for the period 2005-2017, which led to a change in the share of macroeconomic indicators in GDP.
2. Data are subject to corrections in line with official data sources.
3. Source for the data on unemployment: Labour Force Survey, Statistical Office.
4. Source for public debt: MoF.

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Executive Board meetings and changes in the key policy rate

2023

Date	Key policy rate (p.a, in %)	Change (in basis points)
12 January	5.25	+25
9 February	5.50	+25
9 March	5.75	+25
6 April	6.00	+25
11 May	6.00	0
8 June	6.25	+25
13 July	6.50	+25
10 August	6.50	0
7 September	6.50	0
10 October	6.50	0
9 November	6.50	0
7 December	6.50	0

2024

Date	Key policy rate (p.a, in %)	Change (in basis points)
11 January	6.50	0
8 February	6.50	0
7 March	6.50	0
11 April	6.50	0
10 May	6.50	0
13 June		
11 July		
8 August		
12 September		
10 October		
7 November		
12 December		

Press releases from NBS Executive Board meetings

Press release from Executive Board meeting held on 7 March 2024

At its meeting today, the NBS Executive Board voted to keep the key policy rate on hold, at 6.50%. It did not change the deposit (5.25%) and lending facility (7.75%) rates either.

The Board's decision to keep the key policy rate unchanged for the eighth month in a row was motivated by receding, though still elevated global inflationary pressures and the current medium-term inflation projection according to which inflation is expected to retreat within the NBS target band in mid-2024. The Board also took into account the past increases in the key policy and required reserve rates, whose effects will continue to spill over to inflation. The pass-through of past monetary tightening on interest rates in the markets of money, loans and savings, and the fall in one-year-ahead financial and corporate sector inflation expectations signal the efficiency of the monetary policy transmission mechanism.

Moreover, global inflation continues to slow and approach pre-pandemic levels, reflecting the subsiding of cost-push pressures, the easing of global supply bottlenecks, and the effects of past monetary tightening by central banks. Although transportation and other logistics costs went up due to geopolitical tensions and issues surrounding shipping through the Red Sea, this has so far had no major impact on global prices of oil, other energy and primary commodities, or on inflation of our main trade partners, partly also because of subdued global demand. The NBS Executive Board nonetheless maintains that pronounced geopolitical tensions mandate caution in monetary policy decision making. In addition, further global fragmentation may trigger significant losses in global production, including negative effects for our key trade partners. In such conditions, expectations have receded that leading central banks, the Fed and the ECB, might start easing their monetary policies even before mid-year.

Inflation in Serbia stayed on a downward path this year and measured 6.4% according to the estimates underlying the NBS's February medium-term projection. Further slowdown in inflation was aided by the subsiding of cost-push pressures and the high base effect from food prices, as well as the effects of past monetary tightening, which also helped push core inflation (CPI excluding food, energy, alcohol and cigarettes) down to 5.9% y-o-y in January. The Executive Board expects inflation to decrease further, return within the target band in mid-2024 and approach the target midpoint by the year end and hover around that level in the medium term. Such inflation profile will be underpinned by the past monetary policy tightening, the slowdown in imported inflation, persistently weak external demand and the expected further drop in inflation expectations.

SORS data confirm that GDP growth, led by fixed investment and private consumption, stepped up to 3.8% in Q4 2023, and by 2.5% in real terms in 2023 overall. Having in mind the weakening of global inflationary pressures and the gradual recovery of the euro area, as well as the expected further acceleration of the implementation of planned investment projects in transport, energy and utility infrastructure, the NBS Executive Board forecasts Serbia's GDP growth this year within the 3–4% range, with the 3.5% central value. Available monthly data seem to support such projection of economic growth this year. Industrial production increased 6.9% y-o-y in January, while continued employment growth and a reduction in unemployment, indicated by the results of the Labour Force Survey for Q4 2023, contributed to a rise in real retail turnover (4.1% y-o-y) and a higher number of arrivals and overnight stays of domestic tourists.

The Board stresses that future monetary policy decisions will depend on the movement of key inflation factors at home and abroad and on the pace of domestic inflation's further slowdown. Decisions will be made taking into account the effects on financial stability and GDP, as well as the maintenance of financial stability and favourable growth prospects.

The next rate-setting meeting will be held on 11 April.

Press release from Executive Board meeting held on 11 April 2024

At its meeting today, the NBS Executive Board voted to keep the key policy rate on hold, at 6.50%. The rates on deposit (5.25%) and lending (7.75%) facilities were also kept unchanged.

The Board's decision to keep the key policy rate on hold for the ninth consecutive month was motivated by the declining, though still elevated global inflationary pressures, the current medium-term inflation projection, and global uncertainty over energy and primary commodity prices. The Board also took into account the past hikes in the key policy rate and required reserve ratios, and the continued impact of their effects on inflation. The pass-through of hitherto monetary tightening on interest rates in the money, lending and savings market, and a fall in inflation expectations, signal the efficiency of the monetary policy transmission mechanism.

Furthermore, global inflation continues to slow, with the risks as to its further movement being increasingly balanced. In light of the subsiding inflationary pressures and the effects of restrictive monetary conditions, many central banks are projecting with increasing certainty that inflation in their countries will return within the target band in H2 2024 or H1 2025. Caution in the euro area and the USA is still mandated by core inflation, which continues to move above headline inflation, mainly due to higher wages. This is why the ECB and the Fed are cautious as to the start of the monetary easing cycle. The NBS Executive Board judges that caution in domestic monetary policy conduct is needed also due to rising global oil prices after the OPEC+ countries extended supply curbs to Q2, in an environment of elevated geopolitical tensions, longer transport routes and higher logistical costs.

Consistent with the Executive Board's earlier announcements, y-o-y inflation stayed on a firm downward path this year, having fallen to 5.6% in February. A critical role in this respect was played by the slowing of y-o-y food inflation to 4.7% in February, which is below the level of headline inflation, as well as of core inflation to 5.2% (CPI excluding food, energy, alcohol and cigarettes). The Executive Board expects inflation to decrease further and return within the target band probably in May this year, which is somewhat earlier than envisaged by the February inflation projection. Inflation should approach the target midpoint by the year end and hover around that level in the medium term. Such inflation profile will be underpinned by the past monetary policy tightening, the slowdown in imported inflation, persistently weak external demand and the expected further drop in inflation expectations, which in the case of the financial sector are now within the NBS target band also for one year ahead.

Available data on the real sector point to better than expected outturns in January and February. Y-o-y, industrial production growth stepped up to around 8% in this period, led by the around 9% increase in manufacturing. At the same time, real retail trade turnover picked up by 6.4% y-o-y, and the rising number of tourists and their overnight stays suggests the continuation of positive trends in tourism.

Despite weaker external demand, further progress was recorded in external trade too. According to SORS data for January–February, exports grew 3.2% y-o-y (led by manufacturing and agricultural exports), while imports contracted by 1.3%, amid still lower energy imports.

Having in mind the weakening of global inflationary pressures and the gradual recovery of the euro area, as well as the expected further acceleration of planned investment projects in transport, energy and utility infrastructure, the NBS Executive Board forecasts Serbia's GDP growth this year within the 3–4% range, with the 3.5% central value.

The Board stresses that future monetary policy decisions will depend on the movement of key inflation factors at home and abroad and on the pace of domestic inflation's further slowdown. Decisions will be made taking into account the maintenance of financial stability and favourable growth prospects.

The next rate-setting meeting will be held on 10 May.

Press release from Executive Board meeting held on 10 May 2024

At its meeting today, the NBS Executive Board voted to keep the key policy rate on hold, at 6.50%. The rates on deposit (5.25%) and lending (7.75%) facilities were also kept unchanged.

The Board's decision was motivated primarily by the medium-term inflation projection and the expected movement of key inflation factors, and by the still elevated, though subsiding, global inflationary pressures, and heightened uncertainty over the global prices of energy and other primary commodities. Moreover, the effects of past monetary tightening have largely spilled over to the cost and volume of private sector borrowing, while financing conditions have stabilised since the key policy rate was raised last time, in July 2023.

The Board also had in mind the continuing deceleration of global inflation, which is, however, still elevated, whilst the risks as to its further movement are increasingly balanced. Most central banks are forecasting with increasing certainty that inflation in their respective countries will retreat within the target band in H2 2024 or H1 2025, owing to past monetary tightening, which has, in all probability, ended. Despite higher core inflation amid tight labour markets, expectations prevail that the ECB will start trimming its key rates in June, which is likely to reflect on the gradual lowering of the price of euro-indexed borrowing in Serbia, whereas the Fed will probably defer this process for some time yet. Caution in monetary policy conduct by the NBS is necessary due to the volatile movement of global prices of primary commodities, notably of oil, in an environment of pronounced geopolitical tensions, continued OPEC+ supply cuts, and a number of other factors.

The Executive Board underlined that y-o-y inflation in Serbia continues to slow down, even faster than expected, and that it measured 5% in March. Core inflation also lost further pace, under the impact of past monetary tightening, and became equal to the headline rate in March. The inflation slowdown reflects the lower food price growth and a further decline in one-year ahead inflation expectations of the financial and corporate sectors. It should be noted that as of the beginning of this year short-term expectations of the financial sector are within the NBS target band as well. The Executive Board expects that inflation will recede further and return within the target band probably this May, which is somewhat earlier compared to the medium-term projection released in February.

Available data on the real sector suggest that the outcomes in Q1 this year were better than expected and that tight monetary conditions did not have any major negative effects on economic activity. According to the SORS flash estimate, real GDP growth stepped up to 4.6% y-o-y, led by the upswing in trade, industry and construction, and receiving a positive impulse from other service sectors too. Favourable developments in the real sector are supported by the further growth in employment and wages and a reduction in unemployment. It should be noted that the slowdown in inflation is also contributing to the real income growth.

The Board stresses that it will keep a close eye on domestic and international markets and that future monetary policy decisions will depend on the pace of further slowdown of inflation at home. Decisions will be made taking into account the maintenance of financial stability and favourable growth prospects.

In today's meeting, the Executive Board adopted the *May Inflation Report* with the latest macroeconomic projections that will be presented to the public in more detail at a press conference on 14 May, along with additional explanations of monetary policy decisions.

The next rate-setting meeting will be held on 13 June.

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