National Bank of Serbia

Introductory speech at the presentation of the *Inflation Report* – May 2025

Dr Jorgovanka Tabaković, Governor

Belgrade, 14 May 2025

Ladies and gentlemen, esteemed members of the press, dear colleagues,

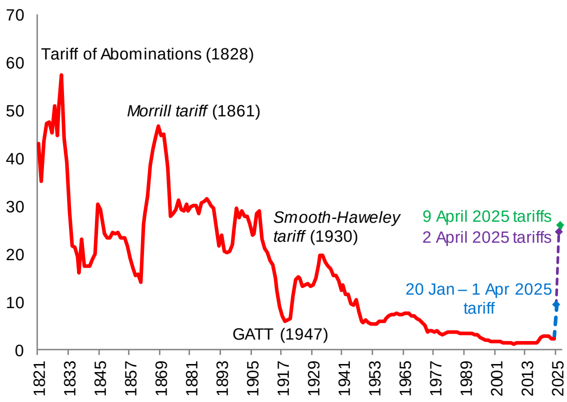
Welcome to the presentation of the May *Inflation Report*!

The period since our previous meeting in February has been marked by rising trade tensions, with the announced introduction of additional tariffs driving uncertainty in the international commodity and financial markets up to unprecedented levels that have not been recorded since the coronavirus pandemic. Such movements also reflected on rising volatility of stock exchange indices and in turn on the investment sentiment and deterioration of global financial conditions. I shall therefore begin my address by referring to international developments, since our macroeconomic developments and projections for the upcoming period are significantly shaped by them.

The global economy has shown significant resilience to a series of negative shocks to which it has been exposed over the past years, with growth preserved at around 3% on average in the period between 2020 and 2024. Until only a few months ago it was believed that growth would pick up to 3.3% this and the following year. However, as of late January, the increasingly frequent announcements of the introduction of additional tariffs by the new US administration and the reciprocal measures by their trade partners resulted in a rise in effective tariffs to levels not recorded over the past one hundred years, creating a strong negative shock to economic growth.

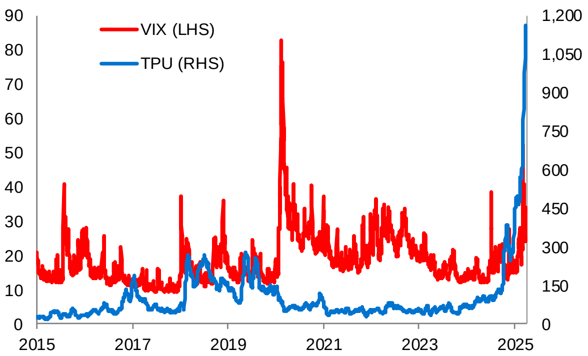
Chart 1 **US tariff rates on entire imports**

(in %)



Source: IMF WEO, April 2025.

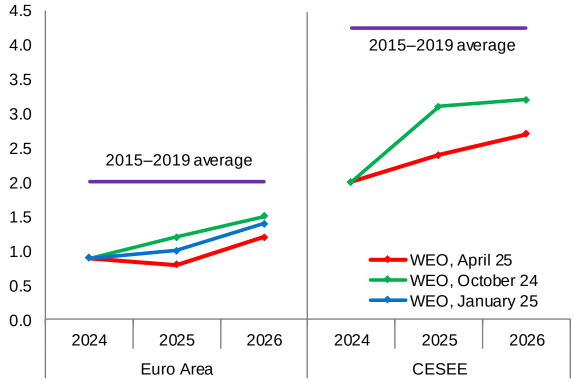
Chart 2 **Measures of volatility and uncertainty in the international financial market***



Sources: Bloomberg, Caldara et. al. (2022).
* VIX (Chicago Board Options Exchange Market Volatility Index) is a measure of implicit volatility of a S&P 500 stock option; TPU – Trade Policy Uncertainty Index) is the index of trade policy uncertainty.

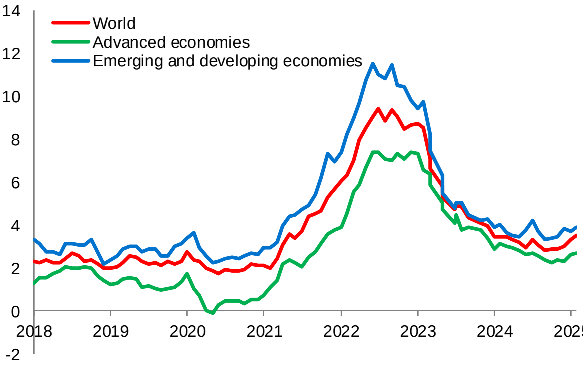
The uncertainty accompanying the announcement of these measures is also reflected on investor and consumer confidence, as well as on economic prospects in general, and at the same time it significantly compounds the decision-making process for economic policy makers as it hampers the making of assumptions underlying macroeconomic projections, and also makes projections more uncertain. In such conditions, our task as a monetary policy maker is anything but easy.

Chart 3 **IMF's GDP projections for 2025 and 2026**
(y-o-y rates, in %)



Source: IMF WEO (April 2025).
Note: CESEE countries exclude Belarus, Russia, Turkey and Ukraine.

Chart 4 **Headline inflation dynamics**
(in %)



Source: IMF WEO (April 2025).
Note: Data are aggregated on a sample of 57 economies that account for 78% of the world GDP.

In its April projections, the IMF lowered the global economic growth prospects by 0.5 pp to 2.8% in 2025, and by 0.3 pp to 3.0% in 2026. For the euro area, our largest trade partner, projected growth has been trimmed by 0.2 pp for each year, to 0.8% and 1.2%, given that the negative effects of tariffs are expected to be partly neutralised by the positive effects of new infrastructure and security investment programmes, as well as a more favourable outlook for countries with a dominant service sector, which is not impacted by the tariffs. In view of the slower euro area growth, prospects for the majority of emerging European economies, including Serbia, have also been revised down, with growth of 3.5% and 4.2% projected for Serbia this and the following year. This will still be one of the highest growth rates in Europe.

According to the same assessment, global inflation will recede slightly more slowly than expected in the previous projection, and it is expected to edge down from last year's 5.7% to 4.3% this year, and then to 3.6% in 2026, with the return within the target tolerance band unfolding at a faster pace in advanced countries than in emerging and developing ones. The effects of the tariffs are reflected on inflation, as it has been projected higher than expected back in January, but they will depend on whether the tariffs are temporary or permanent, how much companies will adjust their profits to increased import costs, whether goods import is charged in US dollars or a local currency, etc. Countries implementing the tariffs are expected to face shocks mainly on the supply side due to growth in unit labour cost and lower productivity, while countries against which tariffs are introduced will face a negative shock on the demand side amid dampened external demand. As for Serbia, in its April projection the IMF expects inflation to average 4.0% in 2025, and then edge down moderately to 3.3% in 2026, where it will remain in 2027.

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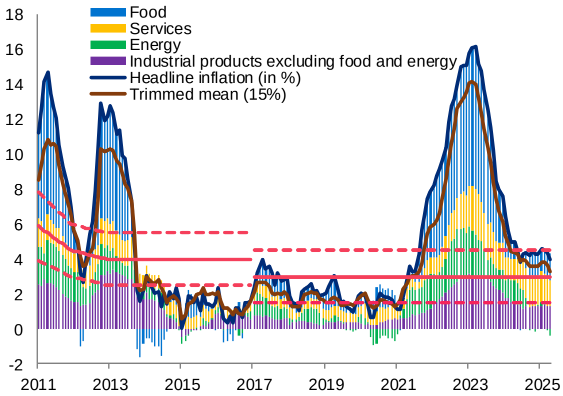
We will now briefly lay out our view of macroeconomic movements, new macroeconomic projections and monetary policy decisions taken in the period since the previous *Report*.

I will start with inflation, our main objective and a benchmark of success. In line with our expectations, during Q1 y-o-y inflation moved around the upper bound of the target tolerance band, slowing to 4.0% in April. Relative to end-2024, when inflation equalled 4.3%, the contribution of energy prices to April inflation decreased by 0.4 pp and turned negative, and of service prices by 0.1 pp. Conversely, there was an increase in the contribution of food prices, mostly unprocessed food, by 0.3 pp, which still reflects the effects of last year's draught on the domestic market. The last year's increase in the prices of mobile telephony dropped out of the y-o-y calculation, whereby core inflation slowed to 5.0% in April, its lowest level since May 2024. There is a loosening in cost-push pressures and the trimmed mean (core inflation measure obtained by excluding 15% of products and services from the consumer basket whose prices record the largest changes in both directions), which equalled 3.3% y-o-y in April, as well as the measure of the so-called inflation momentum (annualised seasonally-adjusted monthly inflation rates) which receded to below 2% in April.

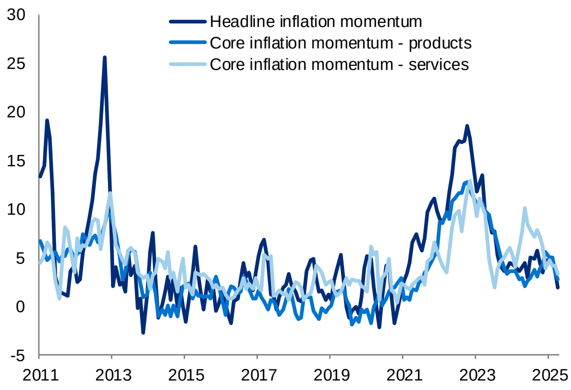
According to our latest central projection, over the entire projection horizon, i.e. the following two years, inflation should remain within the target tolerance band (3±1.5%) and will have a declining trajectory this year. More specifically, inflation should continue to slow down from the level of 4%, where it is expected to hover by mid-year, and approach the target midpoint around the end of the year, where it will remain until the end of the projection horizon. Such inflation movements will be largely facilitated by the still tight monetary conditions, lower imported inflation and the anticipated lower global prices of energy, as indicated by the projections of relevant international institutions, as well as by market futures. The arrival of the new agricultural season in May, assumed to be average, should also result in lower prices of fruit and vegetables, and decreased costs of food production. In addition, the projected movements in real wages in accordance with productivity growth should contribute to a slowdown in core inflation and its approach to headline inflation. The new inflation projection for this year is slightly lower than the February projection, notably due to the lower prices of petroleum products given that they reflect not only the fall in global oil prices, but also the euro's appreciation against the dollar. Another factor is smaller than expected growth in external and domestic demand.

Chart 5 **Contribution of main CPI components to y-o-y inflation**
(in pp)



Sources: SORS and NBS calculation.

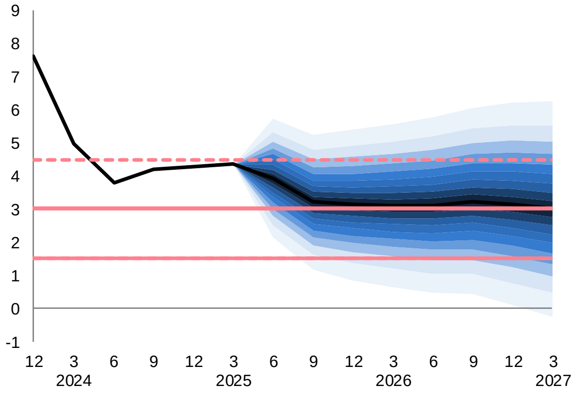
Chart 6 **Inflation momentum in Serbia**
(annualised quarterly moving averages, in %)



Sources: SORS and NBS calculation.

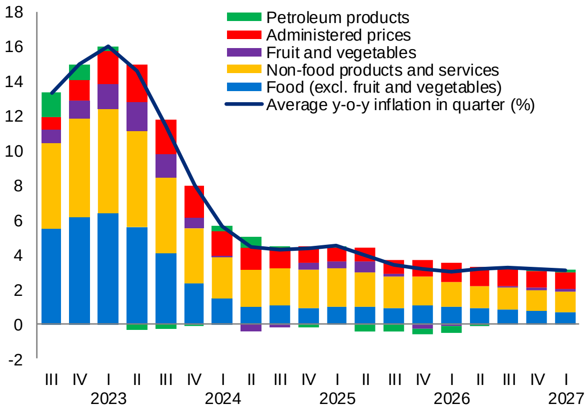
I would like to underline that thanks to the cautious approach and responsible monetary policy conduct, we have ensured the return of inflation within the target tolerance band, while maintaining favourable economic growth prospects. Even so, relative to our expectations from the February projection, growth in Q1 was lower in both the manufacturing and service sectors and, according to the flash estimate of the Serbian Statistical Office, it measured 2.0% y-o-y. Lower economic growth than anticipated reflected the persistently low external demand and issues in the European automobile industry, as well as risk aversion elevated on a global scale amid rising uncertainty in terms of trade policies of leading world economies and the effects on global economic growth, which impacted activity in the domestic manufacturing industry and exports. Moreover, protests and blockades in Serbia resulted in investments and personal consumption recording smaller growth than expected, that is, on the production side, activity slowed down in the service sectors. We estimate that the construction sector recorded a contraction, partly due to the above factors and partly due to the high base from the corresponding period last year.

Chart 7 **Inflation projection**
(y-o-y rates, in %)



Source: NBS.

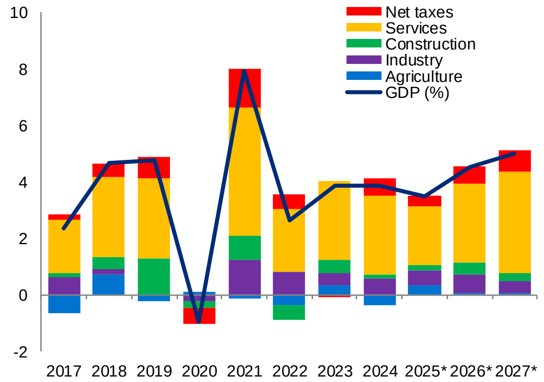
Chart 8 **Contributions to y-o-y inflation by component**
(average y-o-y rates, in pp)



Source: NBS.

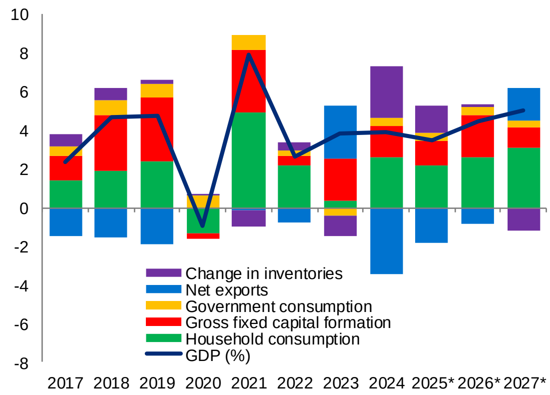
Our new GDP growth projection for this year is revised down from February and equals 3.5%. The revision is largely due to the lower-than-expected outturn of economic growth in Q1, but in the remainder of the year we expect to see acceleration. A pick-up in growth in the coming quarters should be underpinned by the positive effects of supply-side factors, i.e. growth of production in automobile and energy industry owing to increased capacities and the planned implementation of infrastructure projects under the "Expo 2027" programme. At the annual level, a positive contribution to GDP growth will come from service and production sectors, assuming an average agricultural season this year after the last year's drought. GDP growth projection for the next two years is within the range of 4–5%, and in 2027, owing to the hosting of the specialised international exhibition "Expo 2027", the growth rate should come close to the upper bound of the projected range. From the standpoint of use, GDP growth will be led by domestic demand, but less so than expected in February. Demand growth will continue to receive tailwinds from positive trends in the labour market, as well as the expected investment growth by the end of the year. As a result of the start of serial production in the automobile industry and new capacities in the energy sector, and as of next year – also the expected acceleration of economic growth of our key trade partners, a positive contribution should come from exports too. Nevertheless, due to the planned investment and domestic consumption growth, in 2025 and 2026 imports will rise faster than exports, resulting in a negative contribution of net exports which will however diminish thereafter. The acceleration of Serbia's economic growth over the medium term, based on the maintained solid fundamentals, and the planned growth of investment and productivity, should also contribute to potential output growth

Chart 9 **Contributions to real GDP growth, production side**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

Chart 10 **Contributions to real GDP growth, expenditure side**
(in pp)



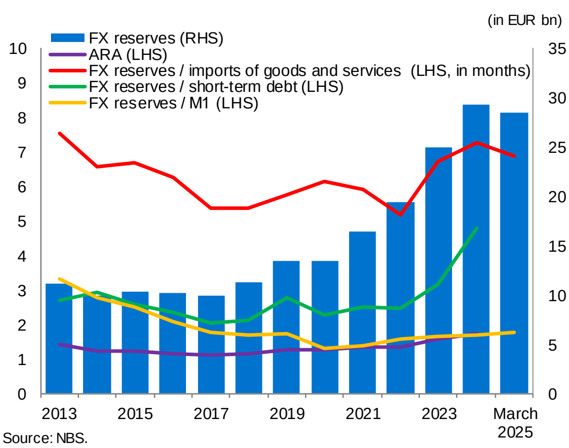
Sources: SORS and NBS calculation.
* NBS estimate.

and speed up Serbia's real convergence toward advanced economies, as well as pave the way for long-term sustainability of economic growth.

Our projection assumes that the US administration tariffs, imposed in early April and then delayed by 90 days, will be applied thereafter. If the tariffs are not enforced even after the 90-day delay, economic growth of the euro area and, in our assessment, Serbia as well, could turn out 0.2 pp higher than projected.

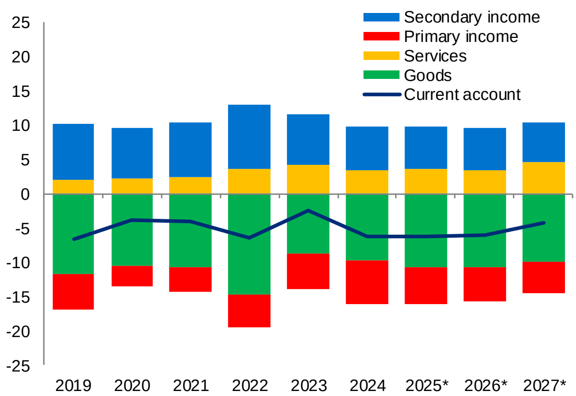
Goods imports rising faster than exports (14.5% compared to 2.9%) led to a further y-o-y rise in the current account deficit in Q1 this year, with the services trade surplus working in the opposite direction. Within goods exports, low external demand and problems in the automobile industry in Europe led to a stagnation in manufacturing exports relative to Q1 2024. However, they rebounded as quickly as March, manifesting the resilience of the manufacturing exports built up through investments in export capacities in the past period. Goods imports were primarily driven up by the rising imports of intermediate goods and, to a lesser extent, of consumer goods. In Q1,

Chart 11 **FX reserves and relevant adequacy indicators**



Source: NBS.

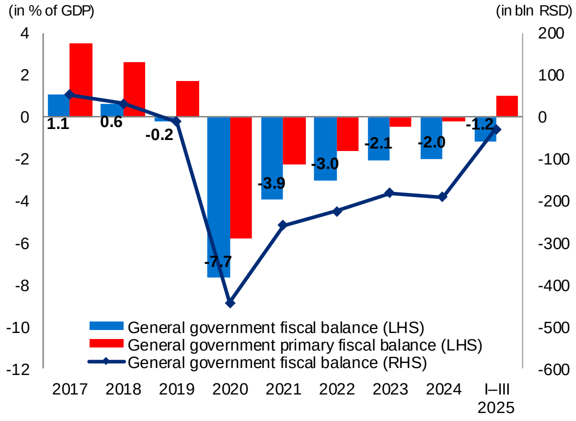
Chart 12 **Current account and FDI projection**
(in % of GDP)



Source: NBS.
* NBS projection.

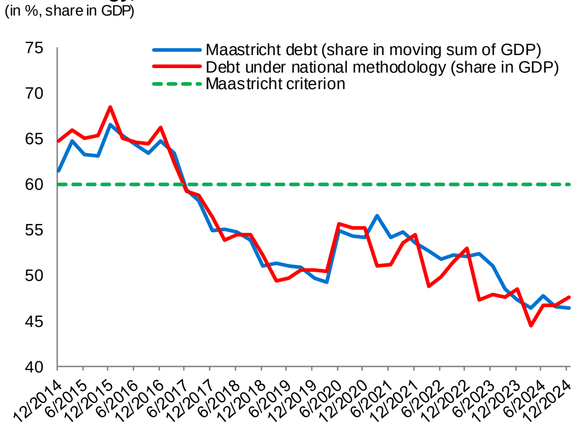
FDI inflow came at EUR 704 mn, half the amount in the same period of 2024, in part due to the above-average one-off inflows last year, dented investment confidence at the global level, and also postponement of some investments in the domestic market due to protests and blockades. Given the seasonally elevated energy imports at the start of the year, all these trends in combination fuelled depreciation pressures, so that the NBS, in an effort to preserve the relative stability of the dinar exchange rate against the euro, turned out as net FX seller in the local FX market in Q1, in the amount of EUR 955 mn. Nevertheless, FX reserves remain high, at EUR 28.5 bn at end-March, considerably above the adequacy metrics and providing an important backstop against external risks.

Chart 13 **Fiscal and primary balance of the general government budget**



Source: Ministry of Finance.

Chart 14 **Maastricht debt and debt under national methodology, 2014-2024**



Sources: Public Debt Administration and NBS.

The current account deficit share in GDP is projected to stand at a similar level as in 2024 this and the next year, and to decrease to around 4% in 2027, on the back of services exports in the year of hosting the specialised exhibition “Expo 2027” and the invigorated foreign trade in goods.

Q1 2025 saw a fiscal deficit of 1.2% of GDP and a similar level of the primary balance surplus. Although the medium-term fiscal framework envisages a more generous fiscal policy this year, aimed at implementing the investments planned under the “Leap into the Future – Expo 2027” programme, in our view, this should not produce any major inflationary effects because the largest share of expenditure increase refers to government capital expenditure which also boosts potential output. Also, the planned deficit will not undermine the downward trajectory of public debt-to-GDP ratio which at end-March stood at 43.4% (according to the national definition), significantly below the Maastricht criterion of 60%. In one of our text boxes in this *Inflation Report* you can also see that compared to the selected countries in Central and Southeast Europe, according to the Maastricht methodology, Serbia's debt share in GDP in the past years has been one of the lowest, displaying one of the most favourable dynamics.

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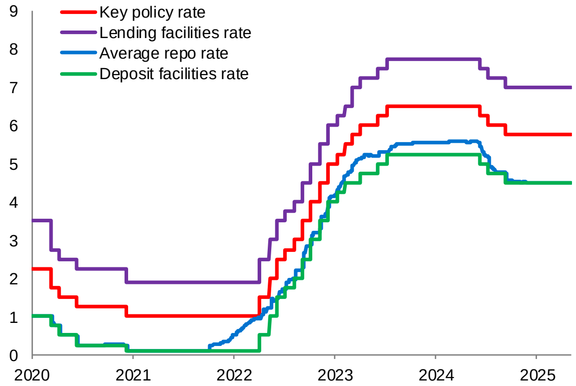
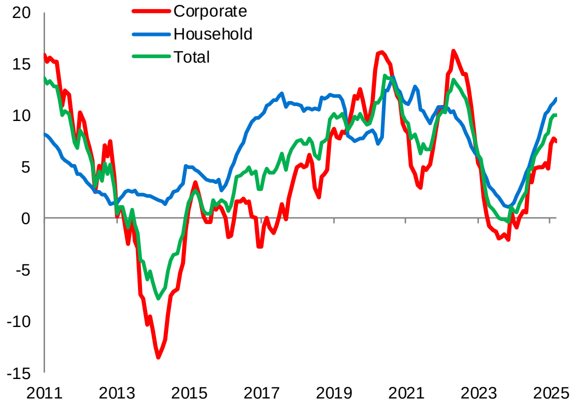
We have not changed the key policy rate of 5.75% since the last *Inflation Report*. Despite inflation's movements within the bounds of the target and its further slowdown, we estimated that cautious monetary policy is still warranted due to heightened uncertainty in the global commodity and financial markets and mounting trade tensions. The weighted average interest rate in one-week reverse repo auctions levelled off at around 4.50%, so the interest rates in the interbank money market also fluctuated minimally since the start of the year.

Chart 15 **Key policy rate and average repo rate**
(in %)



Source: NBS.

Chart 16 **Corporate and household lending**
(y-o-y growth rates, in %, at constant exchange rate, 30 September 2024)



Source: NBS.

Given that the past monetary policy easing fully passed through to interest rates in money and lending markets, also spurring a pick-up in lending, we deem that caution is still warranted and that the effects of the past key policy rate cuts on inflation and economic activity going forward need to be fully considered.

Owing to more favourable price of borrowing in dinars and euros and further easing of household credit standards, lending to the non-monetary sector recorded double-digit y-o-y growth in March, with corporate loans rising by 7.4% and household loans by 11.6%. Lending growth, coupled with a lower level of non-performing receivables owing to the carefully selected and synchronised mix of monetary and macroprudential policy measures, pushed the share of non-performing in total loans to the new low of 2.3% at end-March.

I particularly wish to underline that interest rates on housing loans have adhered to the 5% cap set for this year by the amendments to the Law on the Protection of Financial Service Consumers. On the same grounds, interest rates on credit card debt and current account overdrafts of natural persons were also reduced, boosting household disposable income and strengthening the monetary policy transmission mechanism at the same time, because the caps were set relative to the key policy rate. A more detailed account of this is given in one of the text boxes in our May *Inflation Report*.

We will make our future monetary policy decisions cautiously, on a meeting-by-meeting basis, depending on the pace of inflation slowdown and its key underlying factors in the domestic and international environment, taking into account also the effects on financial stability and economic growth.

Ladies and gentlemen, dear colleagues,

Let me conclude. The current global economic situation is fraught with such high uncertainty as has not been seen since the coronavirus pandemic. To the already present geopolitical tensions and the resulting energy price volatility, as well as the relatively high inflation compared to the pre-pandemic period, we can add heightened challenges and risks stemming from the rise in protectionism, and possible further fragmentation of the global market. No need to emphasise that such conditions add extreme complexity to forecasting, with projections undergoing more frequent and more substantial revisions, while monetary policy conduct becomes a complex endeavour mandating caution, especially in a small and open economy such as Serbia.

Overcoming of the current global challenges calls for a joint, proactive and strategic approach of economic policy makers. It is important to note that even in such complex circumstances, the NBS, in coordination with other economic policy makers in the country, will strive to strengthen the domestic fundamentals and our resilience to external risks and to safeguard stability in every sense of that word. Only in such way will we be able to persevere on the path of sustainable growth and development, safeguard investment and consumer confidence and direct our efforts toward further strengthening of productivity and competitiveness of our economy and growth of the living standard of our citizens.

In the remainder of the conference my colleagues from the Economic Research and Statistics Department will present our projections in more detail, after which we remain open for your questions.