National Bank of Serbia

Introductory speech at the presentation of the *Inflation Report* – August 2024

Dr Jorgovanka Tabaković, Governor

Belgrade, 14 August 2024

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

Welcome to the presentation of the August *Inflation Report*. As usual, at today's conference we will present current economic developments, our new macroeconomic projections and monetary policy decisions adopted since the last *Report*.

At the very beginning, I wish to emphasise that since the previous *Report*, first and foremost, inflation returned within the target bounds and inflation expectations fell further, enabling us to embark on monetary policy easing. This means that we have won our battle against inflation and that, going ahead, it will move at levels consistent with our target. In addition, as GDP growth in the first half of the year turned out to be faster than expected, we increased the economic growth projection for this year to 3.8%, anticipating further growth acceleration to 4–5% in the next two years. The recorded economic growth and preserved financial stability, coupled with the decline in the share of NPLs in total loans to below 3%, confirm that we managed to provide both medium-term price stability and a soft landing with our appropriate monetary policy which was tightened in the previous period continuously, but at a gradual and moderate pace.

I will give more details on all these points further on.

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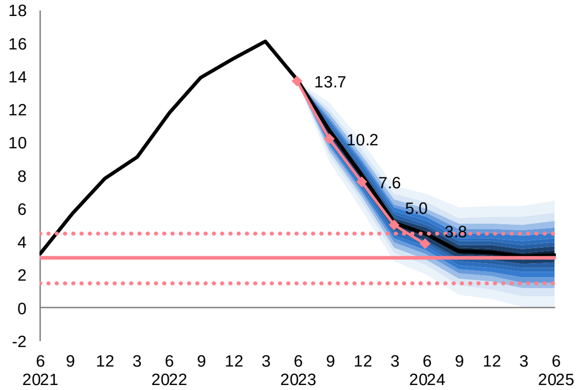
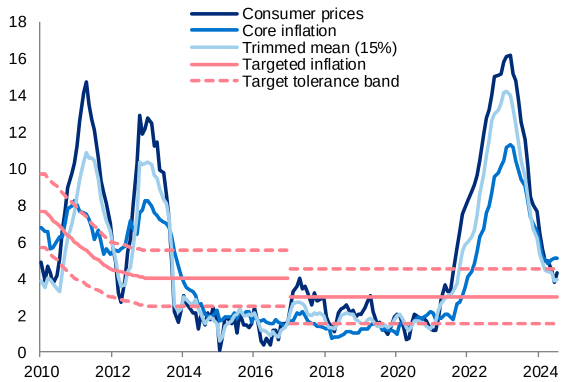
Let me start with inflation, which is our main goal and a measure of success. As announced at the last conference, but also almost a year and a half back, inflation returned within the target tolerance band of 3±1.5% this May and continued to move within the band for another two months. Following its decline to 3.8% y-o-y in June, inflation rose to 4.3% in July owing to a series of one-off price hikes (bread, package delivery, tolls) and the increase in the global prices of some primary agricultural commodities which pushed up the prices of some of the products in Serbia too (here I have to point out coffee and cocoa). As the said hikes remain in the calculation of the y-o-y inflation rate for a year and as the growth in domestic demand since the beginning of the year turned out to be stronger than expected, we now project that inflation will decline at a somewhat slower pace in the coming period. Under the new central projection, inflation will continue to move within the target band in the next two years, which is our projection horizon. It will first slow down to around 4% at the end of this year and gradually approach the 3% midpoint in the course of 2025. As in most other countries, core inflation has been higher than headline inflation since May and has stabilised at around 5% y-o-y in recent months. Nevertheless, according to our projection, core inflation too will slow down until the end of the year and approach headline inflation next year.

Chart 1 **August 2023 inflation projection and its outcome**
(y-o-y rates, in %)



Source: NBS.

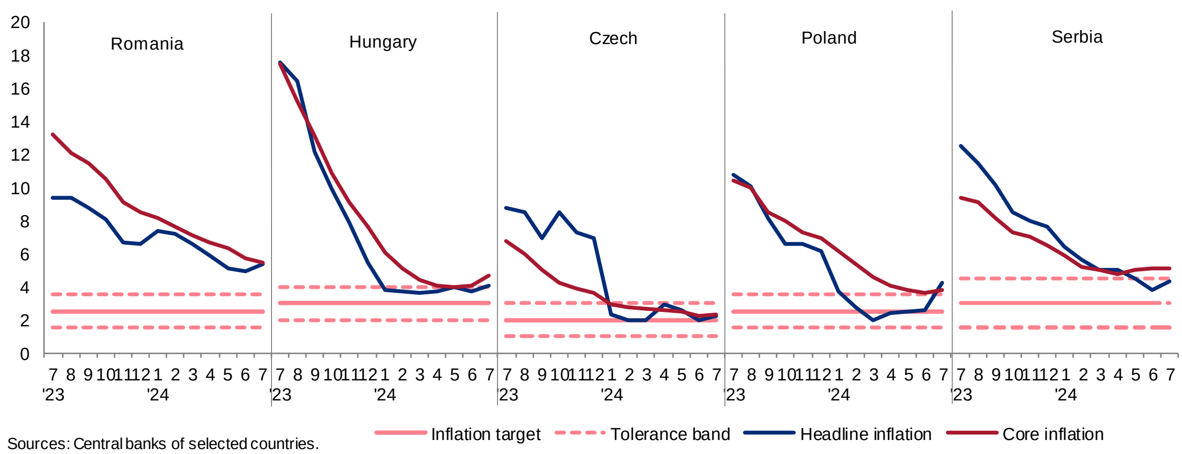
Chart 2 **Headline, core and trimmed mean inflation**
(y-o-y rates, in %)



Sources: SORS and NBS calculation.

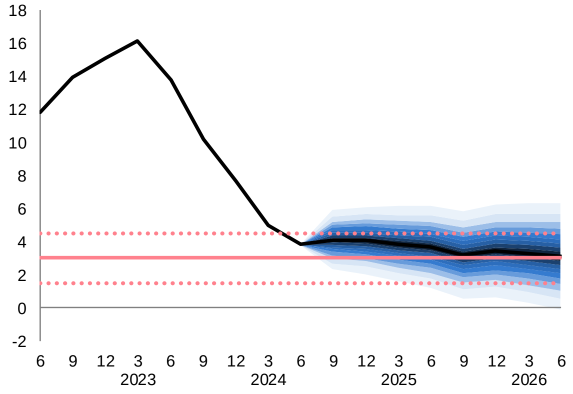
Considering inflation's downward trajectory and its expected profile over the monetary policy horizon, in June we began and in July continued trimming the key policy rate by 25 bp each, to 6%. At the August meeting, we kept the key policy rate on hold, having in mind that the effects of past measures are yet to play out fully. Here I wish to stress that in the previous months we made monetary policy decisions with great caution, acknowledging the risks, and that despite the relaxation, the monetary policy stance is still restrictive which will contribute to keeping inflationary pressures low in the coming period as well.

Chart 3 **CPI movements in selected CESEE countries in the previous year (until July 2024)**
(y-o-y rates, in %)



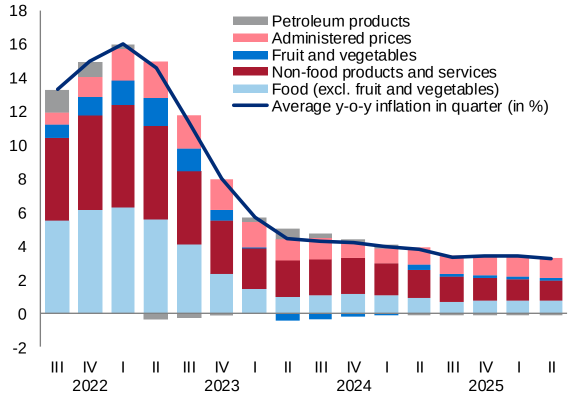
Sources: Central banks of selected countries.

Chart 4 **Inflation projection**
(y-o-y rates, in %)



Source: NBS.

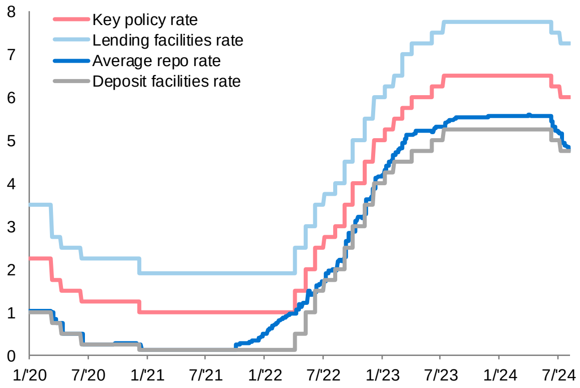
Chart 5 **Contributions to y-o-y inflation by component**
(average y-o-y rates, in pp)



Source: NBS.

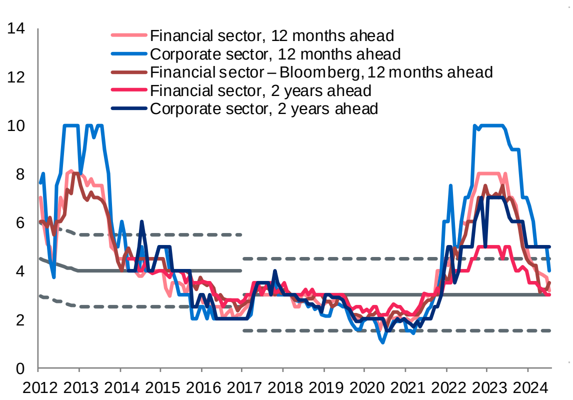
Inflation expectations are an important factor of the restrictiveness of our monetary policy and, at the same time, a proof of its high credibility. Short-term expectations of the financial and corporate sectors have gone considerably down in the last year, and one-year ahead expectations of the financial sector were lowered to 3.15%, according to the July survey, almost equalling medium-term expectations which have been at the target midpoint for quite some time now. The decrease in short-term and anchored medium-term expectations directly contribute to lower inflation.

Chart 6 **Key policy rate and average repo rate**
(y-o-y rates, in %)



Source: NBS.

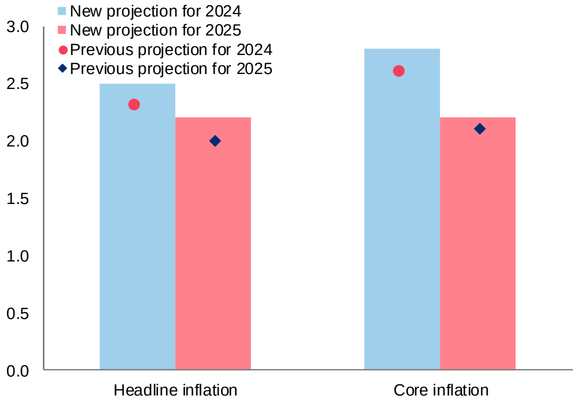
Chart 7 **Inflation expectations**
(y-o-y rates, in %)



Sources: Gallup/Ipsos/Ninamedia, Bloomberg and NBS.

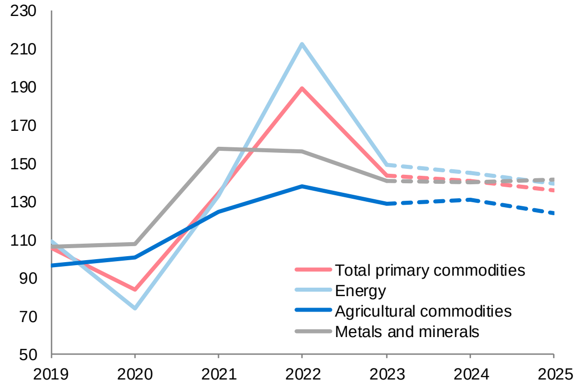
The downward path of domestic inflation was also underpinned by the fall in imported inflation from its end-2022 peak. According to the projections of the relevant international institutions, euro area inflation will continue to decline, but its pace will be more gradual than expected, mostly due to a somewhat higher core inflation than anticipated.

Chart 8 **Revision of the euro area inflation projections for 2024 and 2025**
(in %)



Source: ECB (June and March 2024).

Chart 9 **Projection of primary commodity prices**
(index, 100 = 2015-19 average)



Source: World Bank, *Global Economic Prospects*, June 2024.

Assuming unfavourable geopolitical developments do not reflect significantly on global energy and primary commodity prices in the coming period either, the said factors should ensure medium-term inflation levels which are consistent with our target.

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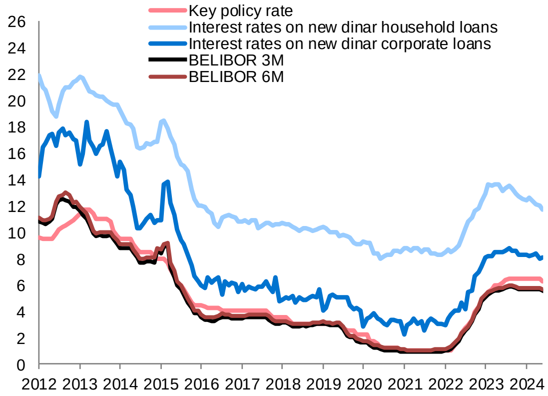
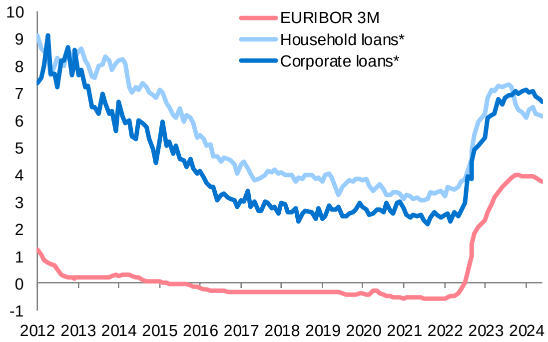
Due to market expectations of the start of monetary policy accommodation by the National Bank of Serbia and the European Central Bank, the interest rates on dinar and euro loans to corporates and households have been on a moderate decline ever since the end of last year, and the same can be expected going forward in view of the implemented easing of monetary conditions in both Serbia and the euro area. Consistent with the easing of credit conditions and standards for dinar loans, the loan demand of both corporates and households increased, resulting in the acceleration of total lending activity growth, to 4.7% y-o-y in June, with corporate loans rising by 4.2% and household by 4.9%. Increased dinar lending pushed up the dinarisation of corporate and household receivables to 36.1% in June. Stepped-up lending also contributed to the lowering of the NPL share in total loans to the new low of 2.9%, which was maintained at close to 3% owing to the solid regulatory framework for banks and carefully combined and synchronised measures of monetary and macroprudential policy for the entire duration of the multiple crisis.

Chart 10 **Interest rate on new dinar loans**
(monthly average, in %)



Source: NBS.

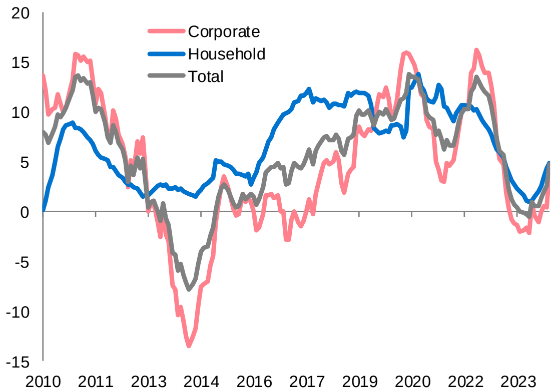
Chart 11 **Interest rates on new euro and euro-indexed loans**
(weighted average values, p.a., in %)



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

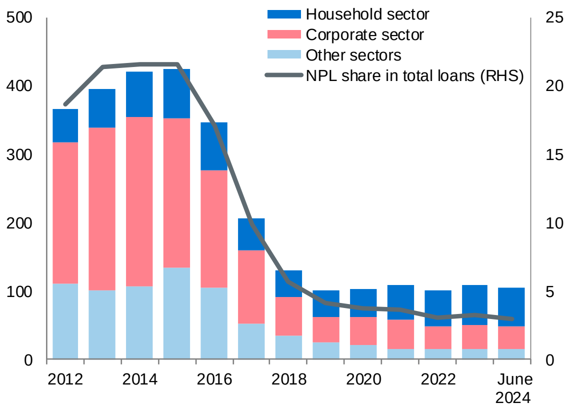
Owing to inflation slowdown, a rise in the real disposable income of households and corporates and the intensification of the investment cycle, the acceleration of Serbia's real GDP growth from the second half of last year continued into the first half of this

Chart 12 **Corporate and household lending**
(y-o-y growth rates, in %, at constant exchange rate, 31 October 2022)



Source: NBS.

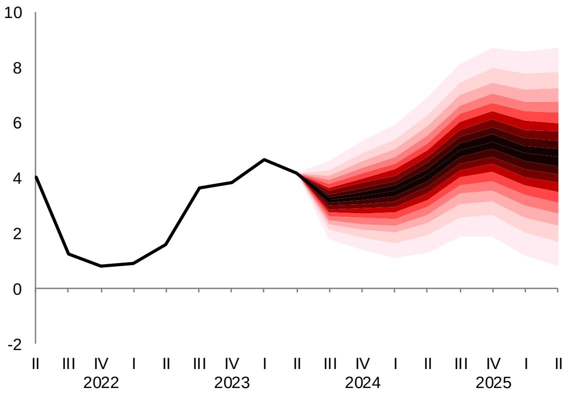
Chart 13 **NPL level and share in total loans, gross principle**
(in RSD bn) (in %)



Source: NBS.

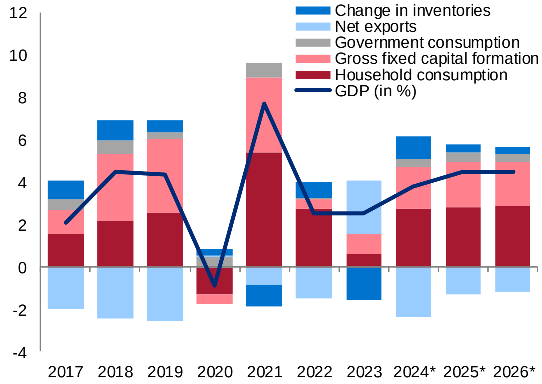
year, with the real GDP growth amounting to around 4.5% y-o-y. More specifically, according to the flash estimate of the Statistical Office, GDP growth measured 4.2% in Q2, driven by services, construction and manufacturing on the production side, and by higher private consumption and fixed investments on the consumption side. In quarterly terms and excluding the seasonal effect, GDP is estimated to have grown 0.7% in Q2, the growth being recorded for the seventh quarter in a row. Though external demand from the euro area is still subdued, it is recovering, as indicated by the 0.3% GDP growth in each of the first two quarters of the year, which should exert a positive effect on our exports and manufacturing output.

Chart 16 **GDP growth projection**
(y-o-y rates, in %)



Source: NBS.

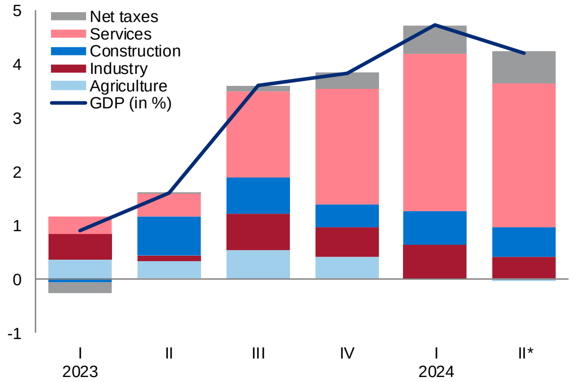
Chart 17 **Contributions to real GDP growth**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

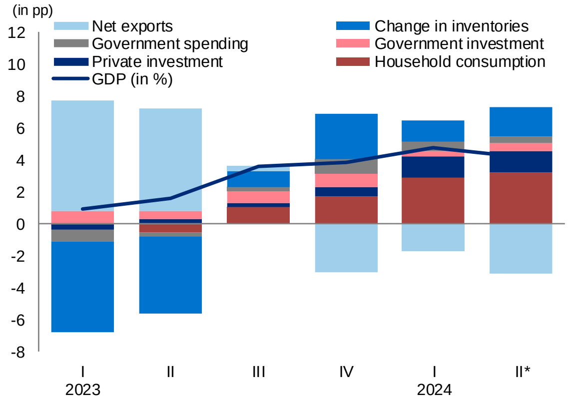
Since GDP growth in the first half of the year exceeded our expectations, **we raised our projection of economic growth for this year to 3.8%, from the 3.5% projected in May**. Similar expectations for economic growth for this year are shared by other relevant institutions, the International Monetary Fund and Consensus Economics, which place Serbia's growth among the highest in the CESEE region. In the next two years we expect to see further economic growth acceleration, to the range of 4–5%. This will be underpinned by the rollout of investments under the "Leap into the Future – Serbia EXPO 2027" programme, reduced global inflationary pressures and more favourable financing conditions reflecting the National Bank of Serbia's and the European Central Bank's start of monetary policy accommodation. Growth will be led by domestic demand, with positive contributions coming from all its components. Private consumption will expand on the back of a continued rise in employment and wages, primarily in the private sector, but without any major inflationary effects, because wage growth will also reflect increased productivity. An important factor of economic growth are fixed investments, which boost the potential output of our economy and should come close to 25% of GDP in the medium term. Private investment growth should be propelled by high FDI inflow, higher corporate profitability from the past years and preserved investment confidence, as well as reduced global inflationary pressures and more favourable financing conditions. Investment growth will also be impacted by the implementation of public investments in transport, energy and utility infrastructure.

Chart 14 **Contributions to y-o-y GDP growth rate, production side**
(in pp)



Sources: SORS and NBS.
* NBS estimate.

Chart 15 **Contributions to y-o-y GDP growth rate, expenditure side**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

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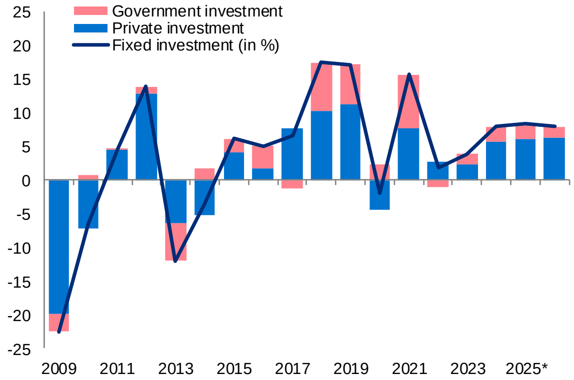
Trends in the current account of the balance of payments in the year to date were consistent with our expectations. We thus kept the projection of the current account deficit share in GDP for this year at around 4%. Having in mind the accelerated implementation of the investment cycle, this share is anticipated at around 5% of GDP over the next two years, which in our estimate, as well as that of the International Monetary Fund, is within the boundaries of external sustainability. As we expected, in the first six months of the year, goods and services exports were some 4% higher than in the same period of 2023, driven primarily by the growing exports of manufacturing and mining, as a result of past investment, and of agricultural products following a good agricultural season last year. Goods and services imports grew faster in the same period, at around 5% y-o-y, mostly due to higher imports of equipment and intermediate goods for the investment cycle. Given the outturns in H1 – a current account deficit of EUR 1.2 bn or 3.4% of GDP and an FDI inflow of over EUR 2.3 bn (or EUR 2.8 bn if preliminary July data are included) – we can say that for a whole decade now, the current account deficit has been fully covered by the most desirable category of foreign capital inflows, and this trend is projected to continue going forward.

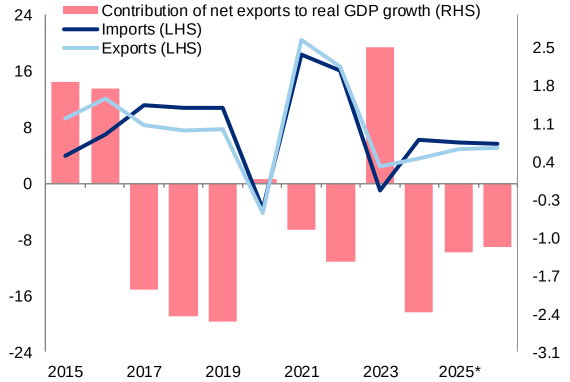
Chart 18 **Fixed investment**
(y-o-y growth, in pp)



Sources: SORS and NBS.
* NBS projection.

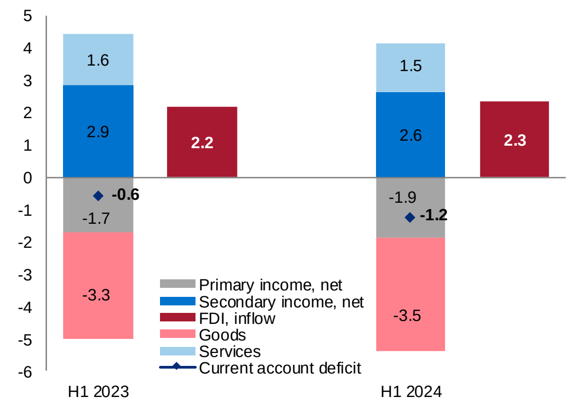
Chart 19 **Real export and import growth**

(y-o-y rates, in %) (in pp)



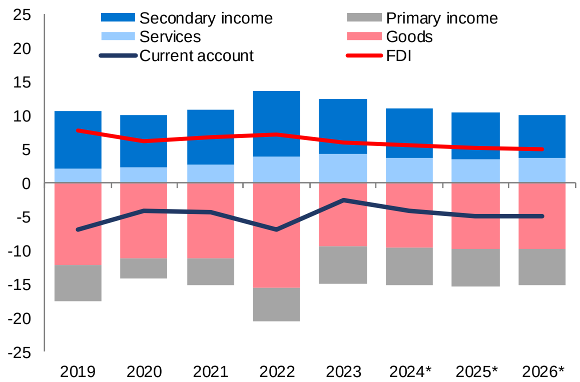
Sources: SORS and NBS.
* NBS estimate.

Chart 20 **Current account and FDI**
(in EUR bn)



Source: NBS.

Chart 21 **Current account and FDI projection**
(in % of GDP)



Sources: SORS and NBS.
* NBS projection.

A capital inflow was also generated by the issue of 10Y eurobonds in the international market, worth USD 1.5 bn, which boosted the country's FX reserves to EUR 28.1 bn at end-July. The rise in FX reserves also resulted from the National Bank of Serbia's interventions in the FX market – in order to maintain relative stability of the EUR/RSD exchange rate amid prevailing appreciation pressures, during seven months of 2024 the NBS acted as the net buyer of foreign currency, in the amount of EUR 1.56 bn. At the same time, I want to stress that the Republic of Serbia did not issue eurobonds because of any financing difficulties, but in order to raise funds for the implementation of the Green Agenda and socially responsible projects. In view of the persisting uncertainty in the international markets, the issue of Serbia's 10Y ESG bonds may be characterised as highly successful. This is confirmed by the high investor demand for these bonds and reduced costs of borrowing during the auction, as well as by the fact that after the hedging transaction, the terms of borrowing in euros, at 4.75%, turned out more favourable even when compared to some countries in the region with an investment-grade rating.

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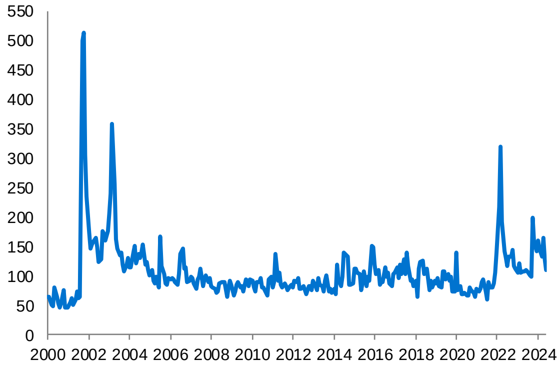
In the year to date, fiscal trends have outperformed the expectations. Contributing factors were higher than expected revenues, partly owing to greater corporate profitability in the previous year, which came at RSD 972 bn in 2023, recording a 12% increase on the year before. On a consolidated basis, the first half of 2024 saw a surplus of RSD 33 bn (0.8% of GDP), while a deficit of 2.2% of GDP is planned at the annual level. General government public debt as a share of GDP came at 50.3% in June, down by 2 pp compared to end-2023. In the National Bank of Serbia's estimate, the fiscal impulse in this period will be almost neutral, meaning that fiscal policy measures should not exert inflationary pressure, while investment in the modernisation of public infrastructure will also boost the country's potential output.

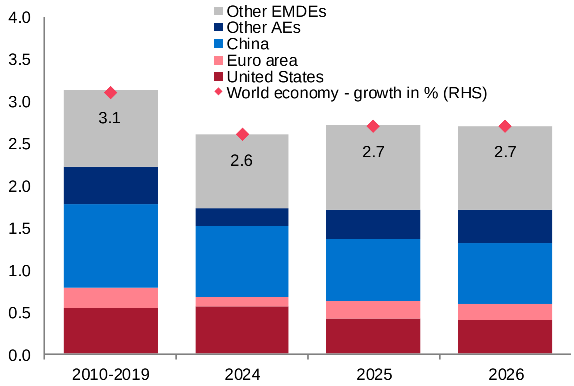
Recent macroeconomic movements at home and abating external inflationary pressures, along with a more favourable global growth outlook and Serbia's proven resilience to adverse geopolitical developments, indicate that the most turbulent period of economic challenges is behind us and that we managed to weather through it, while preserving macroeconomic stability and strengthening resilience to external shocks. However, though currently less pronounced, the risks to our macroeconomic projections still mandate caution in the conduct of monetary policy. Uncertainty surrounding the inflation and GDP projections still largely stems from geopolitical relations and the global growth outlook, as well as their impact on global prices of energy and other primary commodities. To a certain extent the risks also relate to the persistence of core inflation on a global level and the duration of tight monetary policies of leading central banks. The risks to the projection also stem from the pace of growth of domestic demand and the outcome of the domestic and global agricultural season. Overall, the risks to inflation and GDP growth projections for this and the next year are judged to be symmetric.

Chart 22 **Geopolitical Risk Index**
(in pp)



Source: *Caldara and Iacoviello (2022); data downloaded from https://www.matteoiacoviello.com/gpr.htm.*

Chart 23 **Contribution to global economic growth**
(in pp)



Source: World Bank (June 2024).
Note: Data for 2024, 2025 and 2026 are projections.

In this context, I would like to underscore that in making our future monetary policy decisions we will follow a meeting-by-meeting approach, taking into account the speed of inflation slowdown and the movement of its key factors, while also taking care about the effects on financial stability and economic growth. We tightened monetary conditions carefully and cautiously and we will apply the same principle of caution in easing them.

Dear ladies and gentlemen, dear colleagues,

Considering that the last week marked twelve years since I took the helm of the National Bank of Serbia, I will conclude my introductory speech with a brief overview of that period, probably the most turbulent and challenging one in recent history, for economic policymakers not only in Serbia, but worldwide. Let me remind you that in the past four years alone we faced the coronavirus pandemic, unprecedented economic lockdowns, energy crisis, war in Ukraine and the Middle East. The period before that was not bereft of challenges either. Brexit occurred, as well as the Greek bank crisis… It fills me with special pride that I served as governor in this period and that even in such circumstances medium-term price and financial stability and the relative exchange rate stability were preserved. As a result of the responsible conduct of economic policy, primarily synchronised actions of monetary and fiscal authorities, as two hands of the same body, fiscal and external imbalances were reduced, a favourable growth outlook of our economy and Serbia's status as a desirable investment destination were preserved, and the country's resilience to external challenges was strengthened. Owing to that, last week Fitch, and in April

Standard & Poor's, improved Serbia's outlook for credit rating, which is currently at BB+, from stable to positive, placing us a mere half a step away from investment grade.

I use this opportunity to thank President Aleksandar Vučić for entrusting me with the leadership of the National Bank of Serbia for the next six years. I hope that in the coming period as well the National Bank of Serbia will continue to be a synonym for stability, continuity and consistency in achieving goals to the benefit of the state, the economy and our citizens.

In the remainder of the conference, the colleagues from the Economic Research and Statistics Department will give a more detailed overview of our projections, after which we remain open for your questions.