



National Bank of Serbia

2024  
August

# INFLATION REPORT



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**NATIONAL BANK OF SERBIA**

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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 August *Inflation Report* was considered and adopted by the NBS Executive Board at its meeting of 8 August 2024.

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

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## **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 2 August.

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# I Overview

In line with our expectations from the previous *Report*, **y-o-y inflation returned within the bounds of the target tolerance band in May, thereafter slowing further to 3.8% in June**, its lowest level since July 2021. The slowdown of inflation over the past months was facilitated by all inflation components, with **food prices posting more languid growth as of February compared to headline inflation**, while in June their contribution to headline inflation became neutral. As in other countries of the region, including the euro area, core inflation in Serbia has trended at a higher level than headline since May, and stabilised at around 5% y-o-y in Q2. Having returned within the target bounds early in the year, one-year ahead inflation expectations of the financial sector continued down, while medium-term expectations in June touched the target midpoint (3.0%). This will help slow inflation down, attesting to the high credibility of the NBS's monetary policy.

The Statistical Office's estimates of y-o-y **GDP growth in Q1 and Q2 of 4.7% and 4.2%** (i.e. 1.2% and 0.7% s-a, according to our estimate) indicate that since the start of the year, economic activity accelerated more than we anticipated in the previous *Report*. In our estimate, on the production side GDP growth was mostly supported by the services sectors, notably trade, as well as construction and manufacturing. On the consumption side, growth was propped by domestic demand, mostly household consumption and fixed investments.

After peaking at end-2022, **imported inflation declined**, yielding a contribution to the downward trajectory of Serbia's inflation. According to projections of relevant international institutions, euro area inflation will continue to retreat, **but at a more gradual pace than expected**, mostly due to core inflation posting somewhat higher figures than anticipated. Imported inflation will still decrease on the back of both supply- and demand-side factors. As for the supply side, it is important that energy and food prices were previously reduced, as well as that better functioning of global supply chains was ensured. On the demand side, the disinflationary effect still comes

*Sustainable return of inflation within the  $3\pm 1.5\%$  range as of May is the result of the NBS's success in bringing inflation down and alleviation of global cost-push pressures.*

*Inflation was lowered thanks to dynamic economic growth which unfolded faster than anticipated since the start of the year.*

*Serbia's downward inflation trajectory is aligned with the further alleviation of global inflationary pressures and imported inflation.*

*Global recession has been avoided and the world economy is recovering even faster than anticipated, despite the still tight monetary conditions. This is also true for the euro area, our key trade partner.*

*The majority of central banks began accommodating their monetary policies, with the pace of relaxation being somewhat slower than anticipated at the onset of the year due to estimates that inflationary pressures still mandate caution.*

*In the period since the previous Inflation Report, the NBS Executive Board initiated a cycle of key policy rate cuts.*

from the interest rates of leading central banks which will stay elevated in real terms for quite some time.

Despite the still restrictive monetary conditions, **the global economy has been recovering since the start of the year even faster than anticipated.** As for the euro area, the Consensus Economics expects this year's growth to measure 0.7% and to pick up to 1.4% the following year, while the ECB and the IMF's projections for this year's growth are somewhat higher (0.9%). Risks to global growth are still present, the key downside ones being the possible hike in the global prices of primary commodities under the impact of geopolitical tensions in the Middle East and Ukraine, more persistent core inflation amid a tight labour market, poorer prospects of China's economic growth and increased economic fragmentation and protectionism. On the other hand, more expansive fiscal policy, inflation and interest rates decreasing faster than expected, and the positive impact of artificial intelligence and structural reforms on productivity could trigger a faster pace of global economic growth.

After synchronised and intensive monetary tightening in the prior period, the beginning and **pace of monetary policy easing differ among central banks to a certain degree.** A more cautious approach is mandated by the persistence of core inflation and the slower pace of its retreat relative to headline inflation, reflecting factors in the labour market. In June, the **ECB** decided to begin with monetary policy easing, underlining that this does not mean that consecutive cuts in key interest rates could be expected. Thereafter, in the July meeting, the key interest rates were kept unchanged. Unlike the euro area, the **Fed** kept its federal funds rate unchanged in June and July. Central banks of inflation targeting countries in the CESEE region are in the monetary accommodation cycle, though the beginning and the pace of relaxation differ by country, just as with leading central banks. Thus, the central banks of Hungary and the Czech Republic continued with monetary easing in the previous months, the Romanian central bank merely began with the accommodation, while the central bank of Poland took a break from easing, most likely until the end of the year.

**In June, the NBS Executive Board began, and in July continued with monetary policy accommodation** by trimming the key policy rate by 25 bp each, to 6.0%. When making the decisions on monetary policy easing, the Executive Board took into account the downward trajectory of inflation and its anticipated movement within the monetary policy horizon, alleviation of global inflationary pressures and the fact that, despite the easing, monetary policy still has a restrictive character due to

dampened inflation expectations. In August the Executive Board decided to keep the key policy rate unchanged in view of, among other, the need to consider the effects of past measures, i.e. the previous two consecutive key policy rate cuts.

**Interest rates on dinar loans, as well as on euro-indexed ones, continued to post a moderate fall in Q2**, which began in late-2023 amid market expectations that the NBS and the ECB would soon embark on monetary policy accommodation. The NBS's monetary policy relaxation – through the lower average repo rate and the key policy rate in June and July – translated onto interest rates in the interbank money market, which also retreated. In early June, Serbia successfully **issued ten-year dollar sustainability bonds** in the international financial market, in the amount of USD 1.5 bn, whose proceeds will be used for sustainable Green Agenda projects and socially responsible activities. After the hedging operation, the final **costs of borrowing in euros were 4.75%**, which can be deemed favourable financial conditions, especially compared to the financing conditions of some neighbouring countries that are already investment grade.

Lending to the non-monetary sector, excluding the exchange rate effect, **picked up to 4.7% y-o-y in June**, thanks to increased corporate and household loan demand against the backdrop of **eased dinar credit standards and a more favourable cost of borrowing**. Increased dinar lending reflected on a further increase in the degree of dinarisation. As a result of a strong regulatory framework for banks and the adopted macroprudential policy measures which were synchronised with monetary policy measures, **the share of NPLs in total loans dropped below 3% in June this year**.

**In H1, the current account deficit increased relative to the record low figure from last year, measuring EUR 1.2 bn (3.4% of GDP)**. As expected, goods and services export continued to post growth (4% y-o-y), driven primarily by the rising agricultural exports amid good last year's season, the mining and manufacturing industries, as a result of investments in the prior period, and the rise in ICT services export. Still, imports recorded faster growth (5% y-o-y), notably due to the increased import of equipment to meet the needs of the current investment cycle. The current account deficit was more than fully covered by the most desirable category of capital inflows, i.e. inflows from FDI. **In H1 2024**, FDI inflow to Serbia equalled **EUR 2.3 bn**, up by 6.7% from the same period in 2023. Capital inflow was also recorded from the issuance of ten-year eurobonds in the international market, which drove FX reserves up to the record high

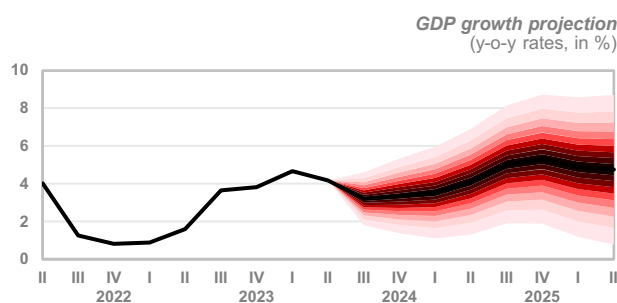
*The expected monetary accommodation of the NBS and its outturn translated onto interest rates in the interbank money market, which also decreased, and onto the lower cost of dinar loans.*

*Reflecting the easing of lending conditions and dinar credit standards, corporate and household loan demand increased, resulting in accelerated growth in overall lending activity at the y-o-y level of close to 5%.*

*Movements in the current account in the year to date were aligned with our expectations, while inflows to the financial account, mostly on account of FDI, still contributed to appreciation pressures on the dinar.*

*In the year so far, fiscal policy has produced a restrictive effect on aggregate demand and, by extension, on inflation.*

*In view of stronger than anticipated growth since the start of the year, we revised up the GDP growth projection to 3.8% for this year. We expect GDP to step up further, to a 4–5% range in the next two years, owing to the investment cycle supported by the “Leap into the Future – Serbia Expo 2027” programme.*



level of EUR 28.1 bn at end-July. Amid the prevalent appreciation pressures, and in order to maintain the relative stability of the EUR/RSD exchange rate, the NBS helped boost FX reserves by net purchasing foreign currency in the seven months of the year in the amount of EUR 1.56 bn.

**In the first six months of 2024, the consolidated government surplus equalled 0.8% of GDP, while the surplus on the primary income account measured 3.1%.** As so far, according to the Fiscal Strategy for 2025 with Projections for 2026 and 2027, the government deficit is expected at 2.2% of GDP in 2024, with slight upward revisions of both revenue and expenditure (0.1 pp each). The adjustment of public revenue was led by better than anticipated revenue performance in the year so far, while the revision of expenditure was guided by higher capital investment in public infrastructure and higher current expenditure for social aid and transfers to households, which was made possible with the re-channelling of unused funds intended for the energy sector.

**As GDP growth in H1 turned out to be higher than expected, we revised up the economic growth projection for this year to 3.8%, from 3.5% which we projected in May.** The IMF expects the same level of growth, revising up in July its April projection by 0.3 pp. Growth will be led by domestic demand, with all its components providing a positive contribution. Private consumption will be propped by a continued rise in employment and wages, notably in the private sector. As wage growth is likely to be accompanied with productivity growth, no major inflationary effect will be generated. Investment is anticipated to increase owing to robust FDI inflows, preserved investment confidence and the implementation of projects in transport, energy and utility infrastructure. Despite the anticipated further export growth, primarily owing to investment in export-oriented sectors in earlier years, we project faster growth in imports than exports in the context of the expected acceleration of investment and personal consumption, which will result in a negative contribution of net exports. **The economy is expected to step up further over the next two years, to a 4–5% range,** reflecting the implementation of the “Leap into the Future – Serbia Expo 2027” programme, estimated at close to EUR 18 bn. Under the Fiscal Strategy for 2025 with Projections for 2026 and 2027, the **general government deficit** is projected at 2.5% of GDP for 2025. In the next two years, GDP is expected to decline moderately, to 2.3% of GDP. Still, the widening of the deficit will not jeopardise the downward trajectory of public debt, which is likely to decline to around 50% of GDP in the coming period,

from 52.3% at end-2023. Under our estimate, **the fiscal impulse** will be almost neutral in this period, which means fiscal policy measures are not likely to produce any inflationary effect. At the same time, investment in the modernisation of public infrastructure will give a boost to the potential output.

With balance of payments developments in the year so far being in line with our expectations, we have not significantly changed our projection of the external position relative to May. As the investment cycle is expected to accelerate, the imports of equipment and intermediate goods are likely to go up. We therefore project the current account deficit share in GDP at around 4% this year and around 5% in the years to come. As in the past nine years, **the current account is estimated to remain fully covered by net FDI inflows**. This will ensure the sustainability of our external position and continued growth in FX reserves, which remain at an adequate level under all criteria and act as a safeguard against all potential external shocks.

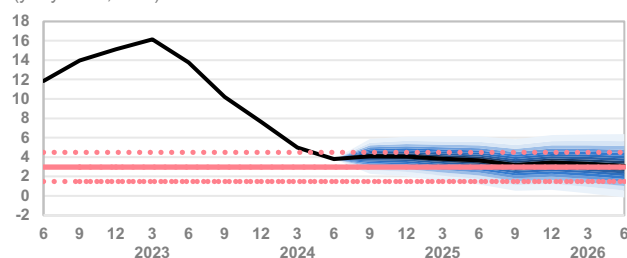
Under our new projection, **y-o-y inflation will continue to move within the bounds of the target tolerance band ( $3\pm 1.5\%$ )**. After a temporary increase in July, when it came close to the upper bound of the tolerance band amid a series of one-off hikes, **inflation is expected to slow to around 4% at end-2024, only to gradually converge to the 3% central midpoint during 2025**. Such inflation movements will largely be under the impact of still tight monetary conditions, lower imported inflation and inflation expectations, the anticipated gradual slowdown in real wage growth and the expected fall in global oil prices, in line with futures. The one-off July hikes of the prices of some industrial food products and services (bread, coffee, confectionery due to soaring cocoa prices, as well as tolls) are the main reason why our new inflation projection is somewhat higher than the May forecast for the next year.

**Uncertainty surrounding the inflation and GDP projections is still mainly associated with factors from the international environment**, notably geopolitical relations, outlook for global growth and its impact on world prices of energy and other primary commodities. To a degree, the risks also stem from the persistence of core inflation globally. Another source of risks to the projection is the **pace of domestic demand growth**, notably on account of the level of FDI inflow and investments in infrastructure and the energy sector. Closer to home, the impact of weather on the supply and prices of fruits and vegetables is important for inflation, and on autumn crops for GDP. Overall, we judge the risks to the inflation and GDP projections to be

*As the investment cycle is accelerating, the current account deficit share in GDP is expected at 4% this year and around 5% in the next two years, which is within the bounds of external sustainability.*

*Under our new projection, inflation will continue to move within the bounds of the target tolerance band until the end of the projection horizon.*

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



*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 the projection for this year and beyond to be symmetric.*

**symmetric** for 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. Delivering price stability and financial stability in the medium term will remain the monetary policy priority, including support to further economic growth and development, a further rise in employment, and preservation of a favourable investment environment.

## II Monetary policy since the May Report

The NBS Executive Board embarked on monetary policy easing in June and continued in July, by lowering the key policy rate. In making such decisions, the Executive Board primarily took into account the downward trajectory of inflation and its expected movement within the monetary policy horizon, declining global inflationary pressures, and the fact that, despite the easing, monetary policy is still restrictive, reflecting also lower inflation expectations. In August the Board kept the key policy rate on hold, mainly in view of the need to analyse the effects of past measures, i.e. the previous two consecutive key rate cuts.

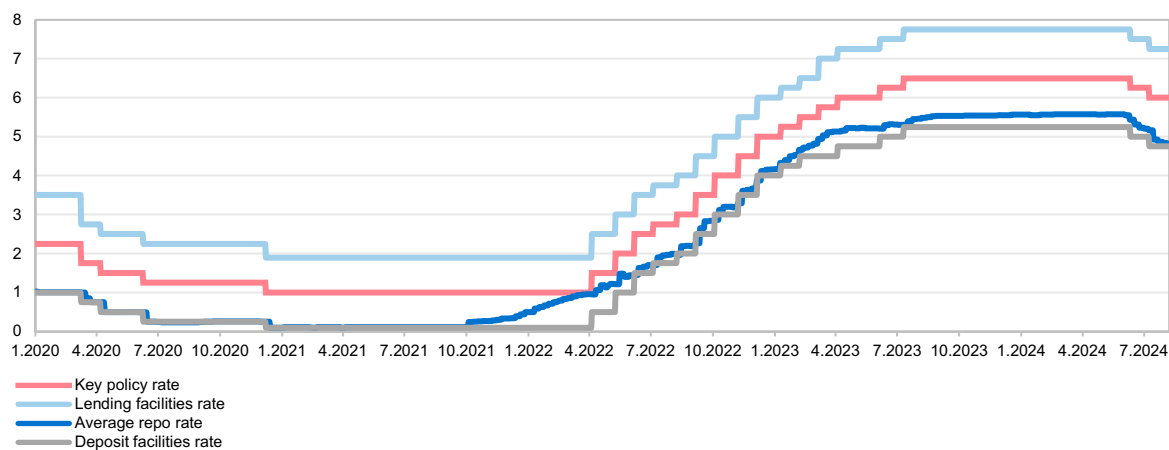
In the period since the May Report, the NBS Executive Board cut the key policy rate by 25 bp in June and July each, to 6.0%. The deposit and lending facility rates were also trimmed to 4.75% and 7.25%, respectively. Together with the lowering of key policy rate, the weighted average repo rate was also cut from 5.43% to 4.83% at end-July. The expected and past NBS monetary policy easing passed through to interbank money market rates, which also decreased, and to cheaper dinar loans, signalling the efficiency of the monetary policy transmission mechanism.

Since the May Report, the conditions in the domestic and international environment in which monetary policy was conducted in Serbia, as well as in most other countries, encouraged a gradual monetary policy easing in June and further easing in July. The Executive Board made such a

decision with careful consideration of all available information and data, analysis of inflation trends and monetary transmission, so that monetary easing would not threaten the sustainability of inflation’s downward path and convergence to the target.

The Executive Board’s decisions in June and July 2024 were based on the **May medium-term inflation projection**, according to which inflation would retreat within the target tolerance band earlier than expected in the previous projection – probably in May, which materialised. In the remainder of the year, inflation would continue to slow down, and stay around the 3% target midpoint from the next year until the end of the projection horizon. According to that projection, such inflation profile would be underpinned by the effects of past monetary tightening and a slide in inflation expectations,

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



Source: NBS.

as well as weaker global cost push pressures, further slackening of imported inflation and persistently weak external demand.

In accordance with the Executive Board's announcements, **y-o-y inflation in Serbia** retreated within the target tolerance band ( $3\pm 1.5\%$ ) in May and measured 4.5%, only to slow down further to 3.8% in June. Inflation decline resulted primarily from the prices of food and petroleum products. Core inflation (CPI excluding food, energy, alcohol and cigarettes) measured 5.1% y-o-y in June, hovering around that level for the last few months as a result of the faster growth in the prices of services, on the one hand, and slower prices of products, on the other, typical also for other countries.

In its monetary policy making, the Executive Board was particularly mindful of the **factors from the international environment, particularly imported inflation, which is expected to decline also in the period ahead**, albeit more gradually, **as well as of the external demand**, which is slowly trending upward. A steady decline in inflation, judging by all indicators, will lead central banks in both developed and emerging economies to adopt a **more cautious approach in respect of monetary policy easing** compared to what was expected earlier this year.

In mid-2024, global inflation was at its lowest level in the last three years. According to the World Bank's latest projection from June, it is expected to slow down in this and the next year to 3.5% and 2.9%, respectively. In the July WEO, the IMF projected a slightly higher global inflation, at 5.9% in 2024 and 4.4% in 2025. Considering the easing of inflationary pressures and the effects of restrictive monetary conditions, most central banks predict that inflation in their countries will retreat within the target tolerance band in H2 2024 or H1 2025. In line with this, the Executive Board expects a further slowdown in the price growth of imported goods and services.

In the **euro area**, our key trade partner, inflation declined from 2.6% in May to 2.5% in June, but core inflation (2.9% y-o-y) and rising prices of services (4.1% y-o-y), which are carefully monitored, are still stable and significantly above the historic average due to labour cost growth. Our key foreign trade partners, Germany and Italy, recorded disinflation. In Germany, inflation measured by the CPI dipped to 2.2% in June, and core inflation to 2.9%, its record low since February 2022. Inflation in Italy underperformed expectations and measured 0.8% in June, the same as in the previous two

months. In the remainder of the year, some volatility in inflation is expected in the euro area due to base effects from energy prices. The ECB's projection from June anticipates inflation decline from 5.4% in 2023 to 2.5% in 2024, and 2.2% in 2025. This is 0.2 pp higher than projected three months earlier, in both years, largely due to higher energy prices and somewhat higher than expected core inflation. Despite expecting slightly higher inflation than three months ago, in June the **ECB** lowered its key interest rates by 25 bp for the first time since 2019, assessing that it was time to ease the restrictiveness of its monetary policy. Interest rates on deposit facilities, main refinancing operations and lending facilities were lowered at 3.75%, 4.25% and 4.50%, respectively. The ECB President, Christine Lagarde, pointed out in June that the reduction in key interest rates does not imply consecutive cuts in the future. Market participants expect new cuts to possibly follow in September and December, or only at year end, as inflation in the services sector has not yet decreased. The NBS Executive Board considered that the expected gradual decrease in the price of euro-indexed loans at home, based on lower euro area money market rates due to the ECB's monetary policy easing, along with the reduction of the NBS key policy rate, should provide impetus to a gradual lending and domestic demand growth, which will not jeopardize the declining inflation trajectory.

Inflation in the US this and the next year is expected to be somewhat higher than in the previous projection. Hence, there was no decision by the Fed in June to decrease the target range of the federal funds rate, as market participants had expected. According to Consensus Economics, US growth prospects were revised down in June. However, even with this revision, solid growth is expected for the American economy, which is among the fastest-growing advanced countries, despite restrictive monetary policy. Given that economic activity indicators point to the slackening in economic growth and less pressure from the labour market, there is an increased probability that the Fed would trim federal funds rate twice by the end of this year, in September and December. A similar signal was sent by the Fed's projections of the federal funds rate in June.

Considering external demand, the NBS Executive Board was aware of the fact that both developing and emerging economies were expected to grow at a slower pace in the period 2024–2026 compared to the pre-pandemic decade. Nevertheless, growth has remained stable despite global challenges, in line with the gradual recovery from global high inflation, tightened financial conditions, and weak industrial activity. GDP growth in the euro area, our main



trade partner, was better than expected early in the year, driven by trade and rising household consumption, prompting the ECB to revise up its growth forecast for this year by 0.3 pp to 0.9%, and downgrade the next year's forecast by 0.1 pp to 1.4%. Gradual global economic growth, particularly in the euro area, will prop up external demand for our exports.

In its monetary policy making, the Executive Board took into account that this year as well FDI inflow **outstripped the current account deficit by multiple times, sustaining further appreciation pressures and the record increase in FX reserves**. In June, for the first time, the Republic of Serbia issued sustainability eurobonds worth USD 1.5 bn in the international financial market. To maintain the relative stability of the dinar exchange rate against the euro, as at July the NBS intervened in the FX market by buying EUR 1,555.0 mn net, thus driving FX reserves up to a new highest level and further strengthening economy's resilience to external risks.

Speaking of potential shocks coming from the international environment, **geopolitical risks** have mandated caution for some time already, and the consequent risk of rising global prices of oil and other primary commodities. The **prices of most primary commodities in the global market** were on the rise in 2024, triggered by supply side factors and recovered global industrial activity. The prices of primary commodities are expected to decline negligibly in the period ahead as a result of better supply conditions, but will still trend considerably above the pre-pandemic level. **The global oil prices proved particularly volatile**, chiefly influenced by geopolitical tensions in the Middle East, but also decisions of the OPEC+ countries, volatile global growth prospects, oil inventories, etc. 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.

Despite changes in some categories, **global food prices** did not change significantly in aggregate terms since the start of the year. The key reasons are the normalisation in supply chains, followed by gas prices, which trended at acceptable levels, as well as the fact that the Ukrainian grain exports continued via the Black Sea corridor (early data from the start of the season show that exports increased significantly relative to last year). In its latest projections from June, the World Bank forecast a mild decrease in food prices in 2024 and 2025, by 6% and 4%, respectively, owing primarily to good supply. The World

Bank also calls for caution, as volatile weather conditions and new protectionist measures and trade restrictions could drive food prices up.

Global economic growth, which is still below trend, is expected to gradually accelerate in the coming period, reflecting on **global prices of primary commodities**. Furthermore, growth remains stronger in the US compared to most other advanced economies. At the same time, China's growth outlook is forecast at somewhat lower levels compared to the previous period, despite a number of measures to strengthen its economy.

On the domestic front, the Executive Board had in mind that **inflation expectations** continued on the downward path, which points to the credibility of the NBS monetary policy. One-year ahead inflation expectations of the financial sector declined further in Q2, within the target band, while their expectations for two years ahead declined to 3.0% in Q2 (from 3.5% in March). Thus, medium-term inflation expectations of the financial sector for two and three years ahead stand at the NBS target midpoint. Lower inflation expectations support lower inflation and a higher real interest rate, i.e. more restrictive monetary conditions even without changes in the key policy rate.

The Executive Board carefully considered available data on the **real sector**, with most indicators continuing to record positive trends. GDP growth in Q2 could be higher than projected by the NBS, as suggested by service sector and construction indicators, as well as a faster than anticipated recovery in production following the overhaul in Pančevo refinery. This increases the likelihood of annual **GDP growth exceeding the 3.5% May projection**. Positive trends in the real sector are expected to continue in the remainder of the year, driven by growth in domestic demand. Increased private consumption should be aided by the rise in real income stemming from higher wages and pensions, as well as a decrease in inflation. Additionally, fixed investment growth should be bolstered by increased profitability of the economy in recent years, high FDI inflows, and government capital expenditures, primarily for investment in transport infrastructure. According to the Executive Board's estimate, although growth will continue to be driven by domestic demand in the coming period, this should not exert any major impact on inflation growth.

The Executive Board's decision at its **August meeting to keep the key policy rate on hold** was mainly motivated by the need to analyse the effects of past measures, i.e. the previous two consecutive key rate cuts.

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 future monetary policy decisions based on that and the analysis of trends at home and the pace of domestic inflation's slowdown, on a

meeting-by-meeting basis. 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 from the previous Report, y-o-y inflation returned within the target band in May, only to slow down further in June, to 3.8%, its lowest record since July 2021. The slowdown was chiefly driven by food prices, whose contribution to headline inflation in June turned neutral. Like in other countries in the region, including the euro area, core inflation in Serbia has trended higher than headline inflation since May and stabilised in Q2 at around 5% y-o-y.

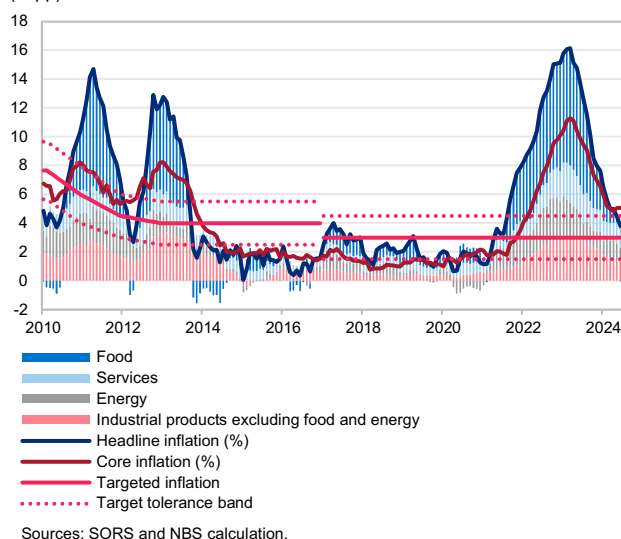
After returning within the target tolerance band early in the year, one-year ahead inflation expectations of the financial sector declined further, with medium-term inflation expectations standing at the 3.0% target midpoint in June. Besides supporting inflation slowdown, this also signals the credibility of the NBS's monetary policy.

#### Inflation movements in Q2

**Y-o-y inflation decelerated further in Q2**, standing at the upper bound of the target tolerance band in May (4.5%), only to drop further to 3.8% in June. The downward path of inflation in Q2 was chiefly driven by the food prices, with even a slightly negative y-o-y contribution to headline inflation in June, while it previously measured 0.9 pp in March. This was mostly driven by the prices of unprocessed food, their y-o-y growth entering the negative territory in Q2, due to the drop in the prices of fresh vegetables, whereas the processed food prices slowed down their y-o-y growth further. The downward trend of inflation reflects also the drop-out of the last year's electricity price hike from the calculation in May (-0.4 pp), albeit to a lesser extent. The **trimmed mean** measure of inflation, which excludes 15% of products and services whose prices recorded the largest changes in both directions from the consumer basket, stood at a similar level as headline inflation, and measured 3.9% y-o-y in June.

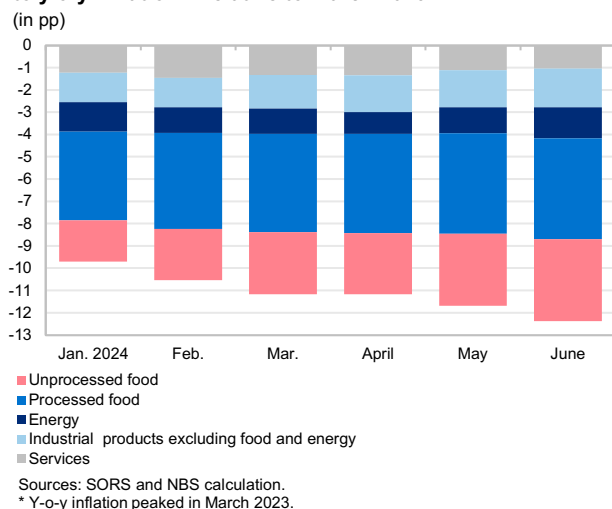
**Core inflation** (CPI<sup>1</sup> excluding food, energy, alcohol and cigarettes) stayed almost unchanged during Q2, at around 5% y-o-y. Core inflation dynamics was, on the one hand, driven by accelerated growth of the prices of services, and, on the other, by a further downward path of the y-o-y growth in the prices of products within core inflation.

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



<sup>1</sup> The comparison of CPI weights for 2024 relative to 2023 shows a mild decrease in the share of the prices of products and services within core inflation and processed food prices, while the share of the energy and unprocessed food prices edged up.

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



In quarterly terms, **consumer prices posted a 1.1% rise in Q2, the same as in Q1**, with a somewhat different structure – a higher contribution of the prices of services and a smaller contribution of the prices of food and energy. Relative to the projection from the May *Inflation Report*, lower inflation in June was a result of a sharper decline in unprocessed food prices and a smaller than expected rise in petroleum product prices.

The **prices of food and non-alcoholic beverages** edged up by 0.5% in Q2 (with a 0.2 pp contribution to inflation), with basic food subcategories displaying different movements – **processed food prices** rose by 1.2%, at an almost identical rate as in Q1, dictated by the higher prices of processed meat, non-alcoholic beverages and confectionery products (which can be associated with the hike in the global price of cocoa). Conversely, **unprocessed food prices** fell by 0.7% in Q2, owing to good supply and lower prices of fresh vegetables (-7.6%).

The **contribution of energy prices** to quarterly inflation was almost neutral (a mere 0.1% rise), as the rise in the prices of petroleum products (1.2%) was compensated by the fall in the prices of solid fuels (2.2%). The prices of electricity and gas for households did not change in Q2.

**Industrial product prices (excluding food and energy)** increased by 1.5% in Q2, owing to the May adjustment of the prices of cigarettes (by 2.6%) due to the excise hike, as well as a seasonal rise in the prices of clothes and footwear (3.8%).

The **2.1% rise in the prices of services** in Q2 (with a 0.5 pp contribution to inflation) was broadly dispersed – the prices went up in Q2 for apartment rent (8.4%), travel packages (23.3%), restaurants and hotels (3.0%) and transport services (2.1%). **Core inflation** grew by 1.7% in Q2 on account of the mentioned hike in the prices of services, with a 0.8 pp contribution to inflation.

**Administered prices** grew 0.7% in Q2 (with a 0.1 pp contribution to inflation), on account of the mentioned cigarettes price adjustment. In y-o-y terms, these prices decelerated further, to 6.9% in June, due to the drop-out of the last year's increases in the prices of electricity and gas for households from the y-o-y inflation calculation.

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

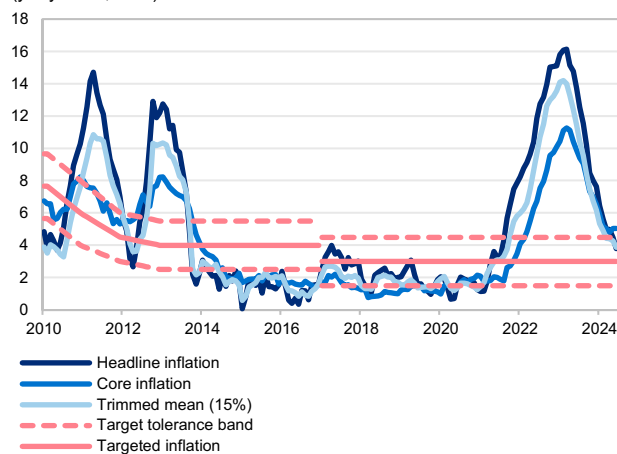
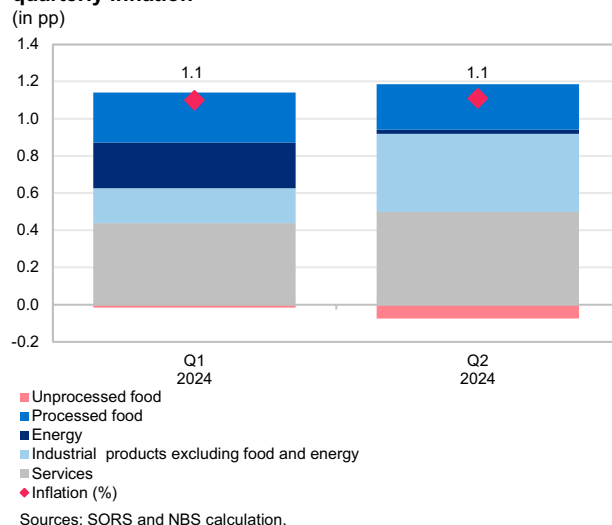


Chart III.0.4 Contribution of main CPI components to quarterly inflation (in pp)



### Text box 1: Recent food price trends in Serbia

One of the key triggers of global food price growth, which has been driving up global inflation since 2021, was the easing of tight health measures after the covid pandemic, followed by rising prices of energy, transport and mineral fertilisers. Moreover, the escalation of geopolitical tensions put additional pressure on food price growth on several grounds, particularly because Russia and Ukraine have a significant share in the world production of primary agricultural commodities. The situation in the world market affected Serbia, with an additional impetus to price growth at home coming from two consecutive weak agricultural seasons (agriculture posted a real decline of 5.5% in 2021 and 8.3% in 2022).

After reaching the highest level on record in March 2022, world food prices, measured by the FAO index, have been decreasing, contributing to a slowdown in global inflation. Nonetheless, food prices are still above the pre-pandemic levels. Due to various factors (climate-related, geopolitical, etc.), their return to pre-pandemic levels can hardly be expected. Since February 2024, world food prices have again turned mildly up (increasing 3.4% y-o-y in May), reflecting primarily the rise in cereal prices under the impact of unfavourable weather conditions before the upcoming harvest in Europe and North America. There are also concerns about the movement of dairy prices due to elevated demand in the holiday season, as well as market expectations that milk production could fall to a historic low in Western Europe. Besides, in the countries that are the world’s largest coffee producers, such as Brazil, the coffee yield was lower due to unfavourable weather, which pushed up the stock prices of coffee. Also, the price of cocoa has increased by more than 150% since the beginning of the year, reflecting bad weather in West Africa (Ghana and Ivory Coast), which supply about 70% of the world’s cocoa.

Food prices in Serbia mirrored their global counterparts. Y-o-y, their growth accelerated from 1.8% to 27.0% from July 2021 to March 2023, when inflation peaked. The share of the prices of food and non-alcoholic beverages in the consumer price index in Serbia is around 32%, i.e. this category of products explains inflation in Serbia to a greater extent than, for example, in the euro area, where the share of food prices is around 20%. In some months of 2022, when inflationary pressures were the strongest, food prices in Serbia accounted for more than 50% of headline y-o-y inflation. For instance, when inflation in Serbia touched its peak in March 2023 and amounted to 16.2%, as much as 8.2 p.p. pertained to the rise in food prices. Similar y-o-y food price growth rates were also recorded in other countries of the region (Romania, the Czech Republic, Poland, North Macedonia, while in Hungary they exceeded 40%). Under the impact of weakening global cost-push pressures in food production, and above all the prices of primary agricultural commodities and the high base for vegetable prices due to last year’s bad agricultural season and reduced market supply, since April 2023 food prices have been on a strong y-o-y downward trajectory. Since February 2024, y-o-y food price growth has been lower than headline y-o-y inflation (4.7% vs. 5.6% y-o-y), while in June food prices were even slightly lower than a year earlier. Within food prices, in June fruit and vegetable prices taken together recorded a y-o-y drop of 10.5%, with vegetable prices alone going down by around 17% y-o-y.

Chart O.1.1 World Food Price Index (2014-16=100)



Source: UN FAO.

Table O.1.1 Cumulative rates of food price growth (in %)

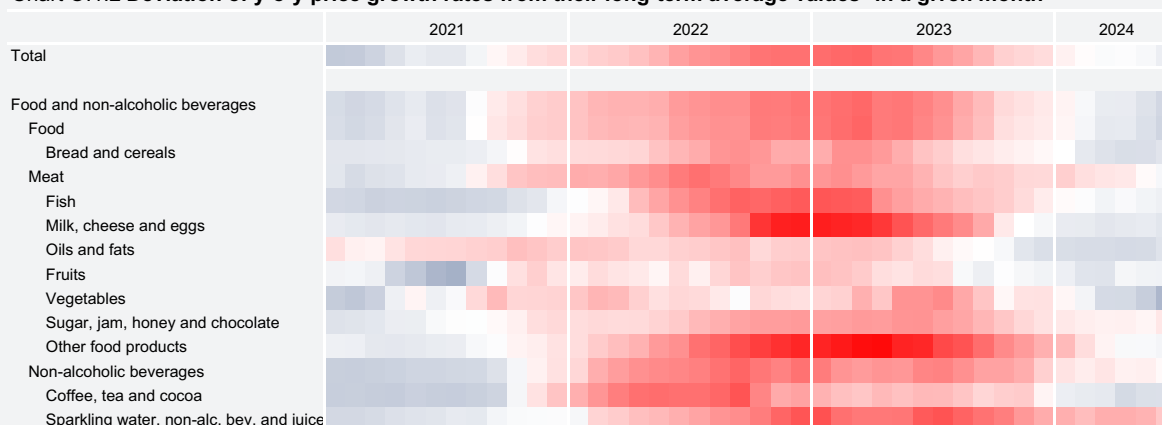
	H1 2023	H1 2024
Czech Republic	4.1	0.1
France	6.8	0.2
Greece	8.1	0.5
Hungary	4.3	0.6
Slovenia	5.0	0.6
Bulgaria	4.9	0.7
Italy	5.2	0.8
Euro area	5.3	1.0
Germany	4.7	1.2
Montenegro	3.2	1.3
Spain	4.4	1.4
Slovakia	7.5	1.5
<b>Serbia</b>	<b>10.7</b>	<b>1.8</b>
Romania	7.3	2.1
Croatia	7.0	2.2
Poland	8.1	3.3
North Macedonia	5.1	3.6

Sources: SORS, Eurostat, NBS calculation.

In the year to June, food prices in Serbia increased by 1.8%, which is much lower than in the same period in 2023, when they rose by 10.7%. Much slower growth in H1 2024 compared to H1 2023 was also recorded for most countries of the region. In H1 food price growth in Serbia was lower than in Romania, Croatia, Poland and North Macedonia.

If we look at the heatmap of deviations of y-o-y growth in prices of different food and non-alcoholic beverage subcategories from their long-term average values in a given month, it is clear that cost-push pressures are easing and growth is below the long-term average for most categories. Pressures are easing the least for the prices of mineral water and non-alcoholic beverages, followed by meat, partly due to African swine fever and reduced livestock.

Chart O.1.2 Deviation of y-o-y price growth rates from their long-term average values\* in a given month



Sources: SORS and NBS calculation.

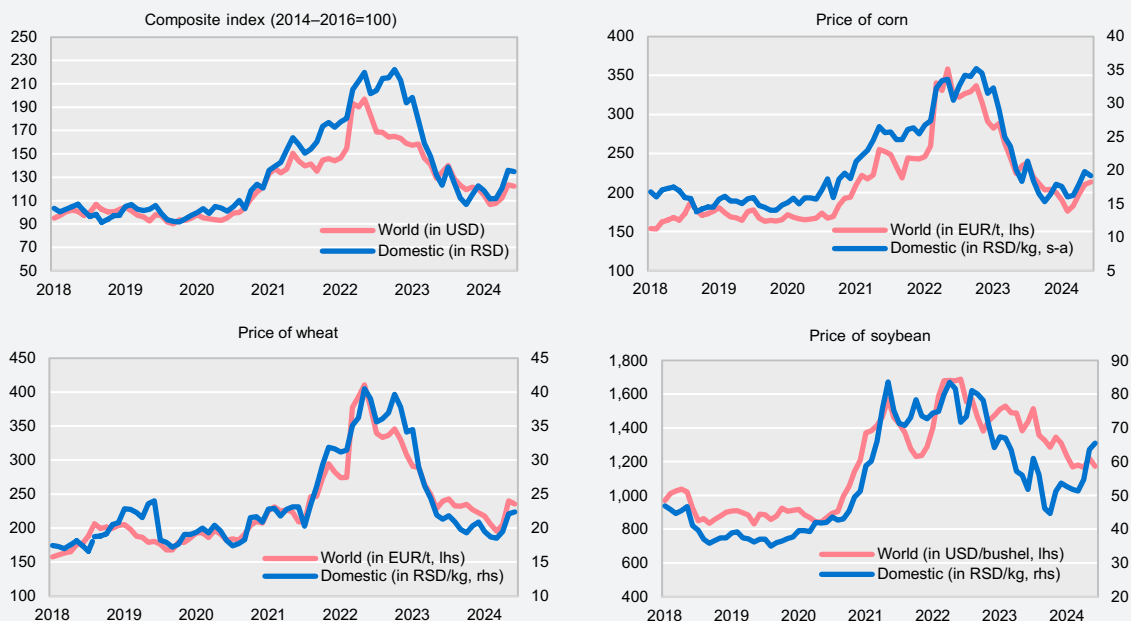
\* Long-term averages are calculated for the 2007–2020 period.

World cereal prices have been rising in recent months mostly under the influence of unfavourable weather conditions and uncertainty regarding yields in the most important production regions. There are great concerns over wheat production in Russia, due to a heatwave in the south and frosts in the central areas of the country. This is why the new crop forecast for Russia was revised down by as much as 10% compared to the projections of a few months ago. The price of corn rose mostly due to problems related to production in Brazil (where drought and floods threaten the agricultural season) and Argentina (where plant diseases put the new crop in question), while imports from Ukraine have contracted. Moreover, the increase in the price of stock goods in European markets was conditioned by the depreciation of the euro against the dollar. On the other hand, the price of soybeans on the Chicago stock exchange generally recorded a decline during the previous months under the impact of Brazilian competition, the strengthening of the dollar, a high soybean seeding rate in the USA, and the estimate that global stocks of this oilseed are at a high level. The situation regarding cereal price movements generally improved in June – after three consecutive months of growth in the world markets, prices dropped moderately, mainly reflecting a fall in the global oil price at the beginning of the month, as well as relatively more favourable weather conditions in June and a better crop outlook globally.

The latest Eurostat analysis, published in June, shows that as at 2023 the prices of food and non-alcoholic beverages in Serbia were at around 96% of the EU 27 average, with 18 of the 37 countries included in the analysis recording a higher level of food prices than Serbia. The degree of convergence of food prices in Serbia with those in the EU was faster than the overall price level, with Serbia reaching 68% of the EU average, but it is realistic to expect that the degree of convergence will be faster for tradeable (e.g. food) compared to non-tradeable goods (e.g. services).

The high volatility of food prices and their dependence on numerous factors that the central bank cannot influence makes their projection significantly more complex than the projection of prices of other products that are included in the calculation of the consumer price index, and in the short run it can affect oscillations of headline inflation. In July, food prices were affected by the announced increases in the prices of bread, coffee and chocolate and other confectionery, under the influence of a significant increase in the global price of cocoa, which will also lead to an increase in y-o-y headline inflation in July compared to June and a temporary interruption of its downward trajectory. The price of bread has already been raised based on the decree valid since July, while the prices of coffee and chocolate

Chart O.1.3 Prices of selected products in the world and domestic markets

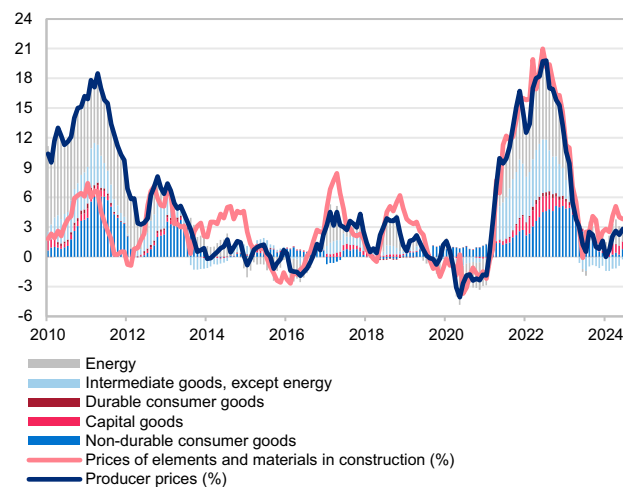


Sources: Commodity Exchange Novi Sad, Paris and Chicago stock exchanges, NBS calculation.

in the domestic market will be affected by the expected increase in the price of raw coffee and cocoa in the international market due to this year’s poorer season. World cereal prices have recorded moderate growth in recent months, mostly due to unfavourable weather conditions and uncertainty regarding harvest output in the most important production regions. Still, the situation regarding cereal price movements generally improved in June, thanks to expectations of a better crop globally and more favourable weather conditions. Thus, the pressures in terms of further food price growth are still low, as also indicated by primary agricultural commodity futures, which are declining. The latest World Bank report points to a similar conclusion – food prices are forecast to fall by 6% in 2024 and 4% in 2025, mainly as a result of abundant global supplies of cereals and oilseeds. However, potential negative climate factors are stated as a risk for the further movement of food prices, as well as increasing trade restrictions and barriers, which could potentially drive up food prices.

According to our projection, food prices (excluding fruits and vegetables) should give a relatively stable contribution to inflation in the rest of this year of around 1 p.p. The contribution should gradually decrease over the next year, as no significant cost-push pressures based on global primary commodity prices are expected, if they move in line with futures. Our projection assumes that fruit and vegetable prices in the coming period will move around their long-term trend, in which case the y-o-y contribution of fruit and vegetable prices would remain negative until the end of 2024, and enter a moderately positive territory in 2025.

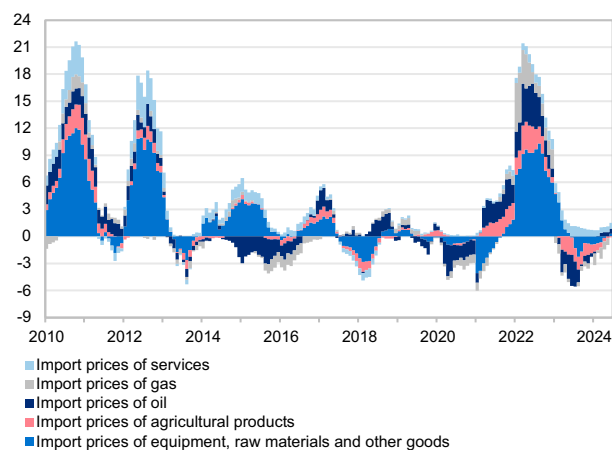
Chart III.0.5 Contribution by destination groups of consumption to the y-o-y producer price dynamics\* (end-of-period, in pp)



Sources: SORS and NBS calculation.

\* Industrial producer prices for the domestic market.

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.

## Producer and import prices in Q2

**Industrial producer prices in the domestic market** averaged around 2.5% y-o-y during Q2, posting a slightly higher rate in June (2.8%). This was mostly driven by stronger contribution from the prices of **production of petroleum products**, which entered a positive territory at end-Q2 amid last year's low base. In addition, due to the low base, the producer **prices of base metals and food products** pushed up total producer prices.

The producer **prices of consumer goods** (durable and non-durable) posted growth between 1.5% and 2.5% y-o-y in June, respectively, somewhat higher than in March. The **prices in the production of intermediate goods** continued their y-o-y decline, though to a smaller degree than at end-Q1.

At quarterly level, industrial producer prices in the domestic market decreased by 0.4% in Q2 due to lower prices in the production of petroleum products, as well as motor vehicles and trailers, and chemical products.

The **prices of elements and materials in construction** slowed down their growth to 3.8% y-o-y in June (from 4.1% in March).

After declining in March (1.5% y-o-y), **import prices expressed in dinars<sup>2</sup>** increased by 1.4% y-o-y in June, for the first time since February last year. A positive contribution to the y-o-y rise in import prices in Q2 stemmed mainly from higher global oil price and the prices of imported services (approximated by the euro area core inflation), and to a lesser extent, the prices of equipment, intermediate goods and other imported goods (approximated by the export prices of Germany). The contribution of imported gas prices in Q2 was neutral, while global prices of primary agricultural commodities gave a mildly negative contribution to the y-o-y dynamics of import prices in Q2. At quarterly level, these prices edged up by 0.6% in Q2, primarily reflecting higher prices of imported goods.

<sup>2</sup> Preliminary data. The base year is 2010. The weighted average of several elements 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 2: Analysis of promotional sales across retail chains based on the NBS’s survey

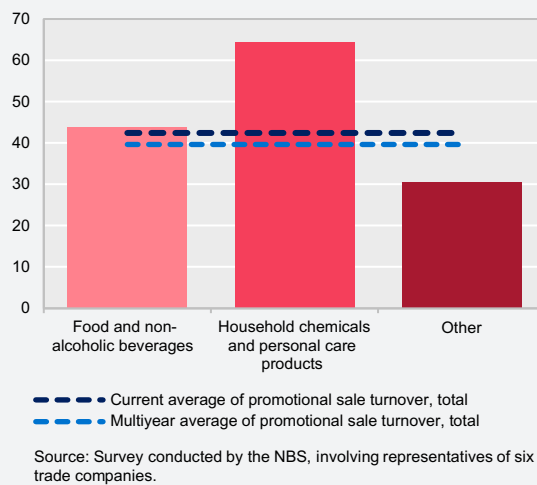
The emergence of strong inflationary pressures persisting longer than expected, hand in hand with the negative effects of the coronavirus pandemic, have transfigured consumer habits and the structure of the consumer basket worldwide. Trying to adapt to the new circumstances, consumers changed both the manner of purchase and the types of products purchased. Accordingly, promotional sales by retail chains have become increasingly important in the past years.

In Serbia, promotional sale is regulated by the Trade Law. Article 37 of the Law defines promotional sale as “the sale of goods/services at a price lower than the previous price of those goods/services over a period of up to 31 days”. Time duration of promotional sale is important in the context of measuring headline inflation, given that the SORS takes into account only promotional sales lasting longer than ten days. The EU regulations do not apply the principle of a uniform time limitation of promotional sale prices, but place emphasis on the truthfulness of the advertised promotional price, making sure that it is supported by an adequate volume of supply at given terms. Limiting the promotional sale in Serbia to a maximum of 31 days is motivated by the need to preclude misleading of the consumers, as prolonged promotional sales could create a false impression of the terms of purchase being more favourable than they actually are. This issue has provoked conflicting opinions among retail chain representatives. Some deem that the promotional period should be extended, to the benefit of both sellers and consumers, because discounted products would be available for a longer time period. Also, according to the 2023 White Book of the Foreign Investors Council, one of the recommendations for improving the business environment in trade is to extend the allowed duration of promotional sales to up to two months, to the benefit of both consumers and merchants. On the other hand, some merchants believe that excessive duration of promotional sales brings the regular product price into question, possibly misleading consumers as to their perception of the real effect of the reduced price.

Regular talks with the representatives of trade companies have confirmed the importance and topicality of this issue, so this year a survey about promotional sales was conducted. It included the representatives of six retail chains with which the NBS regularly meets to discuss movements in producer and retail prices and the intensity of cost-push pressures. The questionnaire included questions about the share of promotional sale turnover in total turnover, excluding wholesale and online sale. The companies also answered the questions about the types of promotional sales and product categories most suitable for them, as well as the effects of their increasing frequency on consumer habits.

The survey results confirm that promotional sales have become more frequent, as cost-push pressures have gone down and suppliers request upward price adjustments less frequently and on a smaller scale. Promotional sale turnover accounts for 30% to 60% of the total turnover of the six retail chains participating in the survey, with the average at around 45%. It can be observed that in the majority of companies (five out of six) this share has risen relative to the multi-year average, consistent with the expectations based on changed consumer habits and the information retailers presented at meetings. These trends can also be explained by increased market competition and the concept of the business strategy to attract consumers. This may partly be concluded from responses about the effects of more frequent promotional offers on consumer habits, where half of the companies recognised the higher number of individual transactions as the most important effect and the other half responded that there were no significant changes in turnover.

Chart O.2.1 Share of promotional sale turnover by selected category and comparison with the average level of promotional sale turnover (in %)



Speaking of the types of promotional sales and their contribution to total turnover, the dominant share in all companies is that of weekly and monthly promotional sales, with weekend sales being a less prevalent format. The concept of the permanently low price is also worth mentioning. Namely, it recently gained prominence in the majority of surveyed trade companies, but the share of this type of promotional sale remains low for the time being. This could be attributed to the fact that this form has only recently emerged, with the easing of global supply chain bottlenecks. However, keeping in mind the downward rigidity of prices, it takes time for survey participants to assure themselves that global cost-push pressures have declined on a durable basis. The significance of promotional sales is not exhausted in the area of trade only, sending ripple effects across the supply chain, because both producers and suppliers bear a part of promotional sale costs. The majority of trade companies bear a greater share of promotional sale costs (around 60%), compared to their suppliers.

In trade companies boasting greater business opportunities and a more developed system of relations with producers in terms of having their own brand, the participation of these products in the total promotional offer is significant, ranging from 20% to as much as 80%. The fact that private label brands are present in all respondents suggests the convergence toward modern trade practices, where companies opt for vertical integration for the sake of more efficient cost management. As for the structure of promotional sale, the three offered response categories (food items, household chemicals and personal care products, other) were formulated based on prior talks with trade companies and the fact that they make up the largest share of the sales assortment.

The share of promotional sale turnover for food products is close to that of total promotional sale, averaging around 45%. For household chemicals and personal care products, around 70% of total turnover is generated through promotional sales. A higher share of promotional sales can be explained by greater elasticity of consumer demand, longer shelf life of these products and the consequent optimisation of supplies.

Thus, we may conclude that an increased share of promotional sales has become one of the features of change in consumer buying habits. Today's buyers are well informed about the market offer and product prices. Thus, retail chains make efforts to attract as many consumers as possible and generate a higher turnover by making their offer more attractive, bearing in mind that the generated turnover is of great importance for the company's success. The benefits of promotional sales for the buyers primarily include financial savings and the psychological effect concerning the affordability of such purchase, as well as the possibility of buying higher quality products at a lower price. Merchants, on their part, generate higher turnover. Also, attractive prices may motivate buyers to buy even products that they do not need at the moment or will not use immediately.

## Inflation expectations

One-year ahead inflation expectations of the financial and household sectors continued on the downward path, with one-year ahead inflation expectations of the financial sector within the target band since the start of the year. This speaks in favour of higher credibility of the NBS and reflects the confidence of market participants in the NBS’s monetary measures and projections.

According to the results of the Bloomberg survey, **one-year ahead inflation expectations of the financial sector** measured 3.5% in July. According to the results of the Ipsos survey, these inflation expectations moved on a downward path since the start of the year and measured 3.15% in July.

**One-year ahead inflation expectations of the corporate sector** moved at 5.0% from March until June, only to drop to 4.0% in July. Although the share of corporates expecting an increase in input prices over the next twelve months almost doubled compared to Q1, the share of respondents who expect this increase to impact the prices of finished products and services stood only mildly above the expectations from the March survey.

**Short-term inflation expectations of households** fell to 10.0% in May, staying at that level also in June, their lowest level since January 2022. These inflation expectations increased by 11% in July, most likely influenced by the announcements of one-off increases in the prices of some food and services. According to the results of the qualitative survey, the index of expected inflation (30.4%) recorded lower values than the index of perceived inflation (53.3%), indicating that households expect that inflation will be lower in the coming 12 months than in the previous year. While around 39% of respondents estimate that price growth in the previous period was considerable, the majority (51.1%) believe that the prices rose moderately or somewhat. At the same time, the **share of respondents expecting a considerable increase in the prices over the next twelve months declined** from 24% in March to 20% in July, while those expecting prices to increase **moderately or somewhat climbed** from 52% in March to 60% in July.

**Medium-term expectations of the financial sector measured 3.0% for both two and three years ahead, standing at the NBS target midpoint**, after **two-year ahead expectations declined in Q2**, from 3.5% in March. **Medium-term inflation expectations of corporates** for two and three years ahead equalled 5.0% in July.

Chart III.0.7 Current inflation and one-year ahead inflation expectations

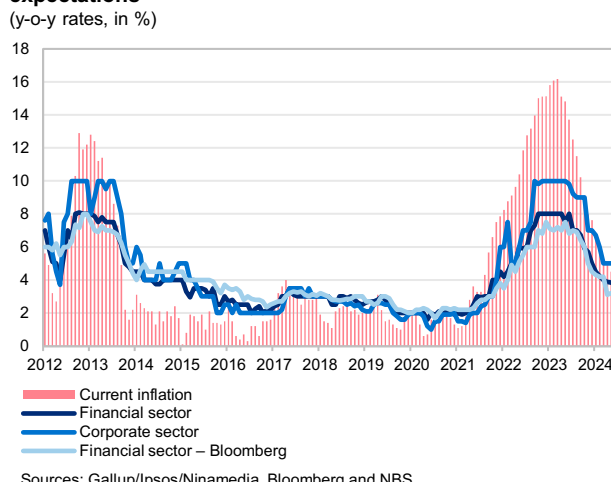


Chart III.0.8 Household perceived and expected inflation\* (in index points)

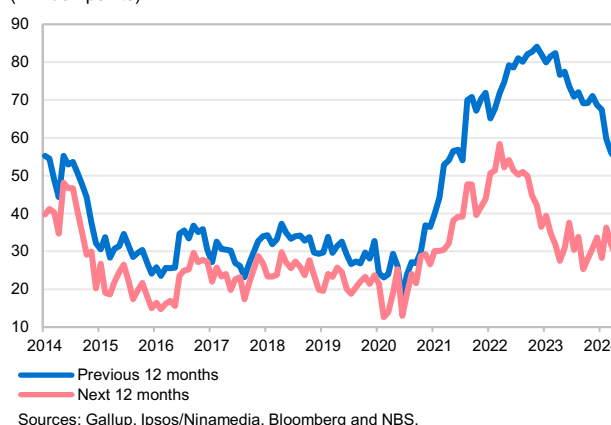
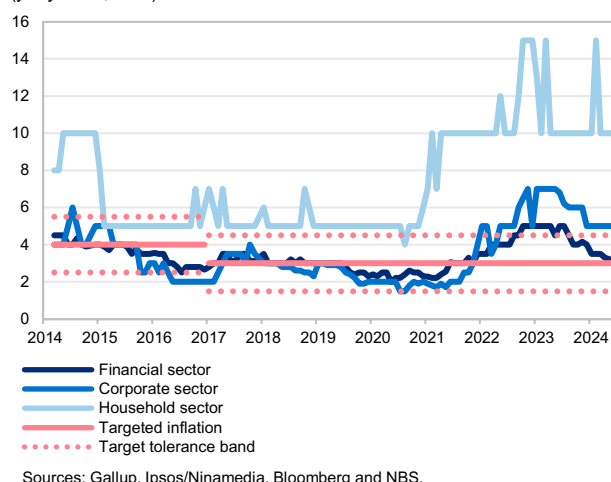


Chart III.0.9 Two-year ahead inflation expectations\* (y-o-y rates, in %)





## IV Inflation determinants

### 1 Financial market trends

*In Q2, interest rates on dinar and euro loans continued their mild decline which began late last year, due to markets' expectations that the NBS and ECB were soon about to embark on monetary policy accommodation.*

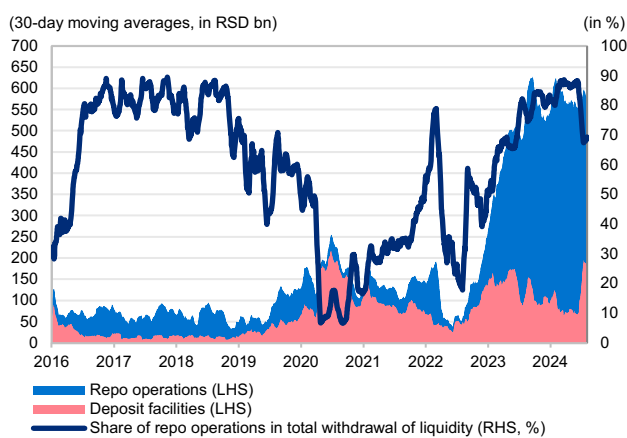
*Making use of the full flexibility of its monetary framework, the NBS started to gradually ease monetary conditions in early June, by scaling down the excess liquidity withdrawn through repo operations, whereby it impacted a decline in the weighted average repo rate. After that, in Executive Board meetings in June and July, it lowered the key policy rate. These decisions successfully passed through to interest rates in the interbank money market.*

*In early June, the Republic of Serbia successfully issued 10Y ESG dollar bonds worth USD 1.5 bn in the international financial market. After a hedging operation, the final cost of borrowing in euros amounted to 4.75%, which can be considered favourable, especially when compared to the terms of financing of some of the countries in the region which already have investment-grade rating.*

#### Interest rates

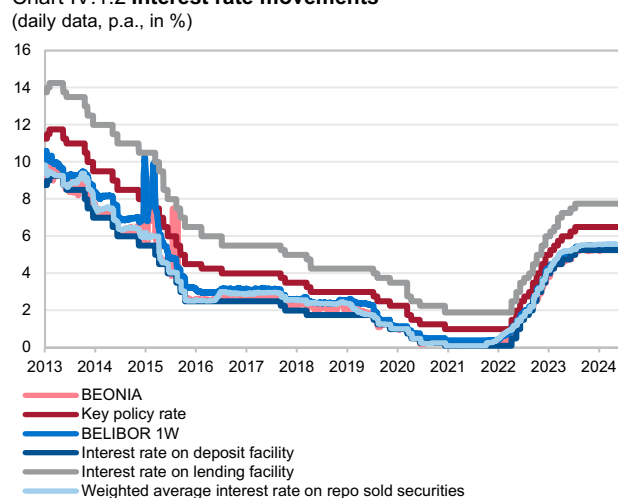
In the June and July meetings, the NBS lowered the **key policy rate and interest rates on lending and deposit facilities** by 25 bp each, to 6.00%, 7.25% and 4.75%, respectively, after keeping them on hold for almost a year (since July 2023). Previously, starting from the first repo auction in June, the NBS adjusted the strategy in the conduct of its main operations, reducing the supply volume relative to the estimated banks' demand for one-week auctions of repo sale of securities. Such approach resulted in the reduction of a relative amount of excess dinar liquidity which the NBS withdraws via main operations and in the lower weighted average repo rate. Accordingly, interest rates in the **interbank money market** declined almost to the same degree.

Chart IV.1.1 NBS operations – liquidity withdrawal



Source: NBS.

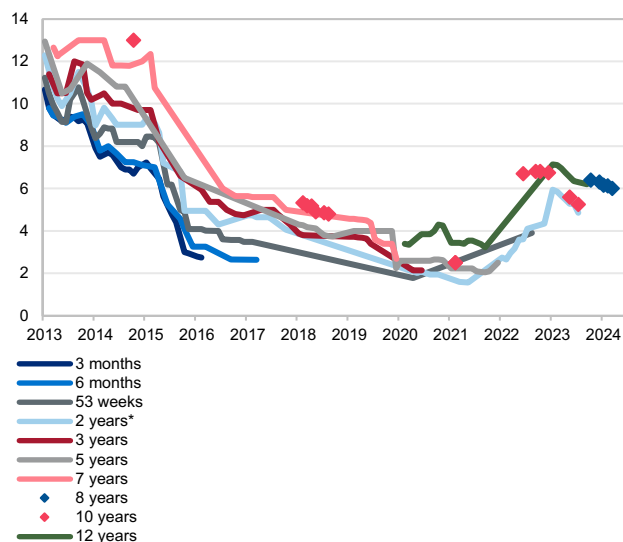
Chart IV.1.2 Interest rate movements



Sources: Thomson Reuters and NBS.

Chart IV.1.3 Interest rates in the primary market of dinar government securities

(p.a., in %)

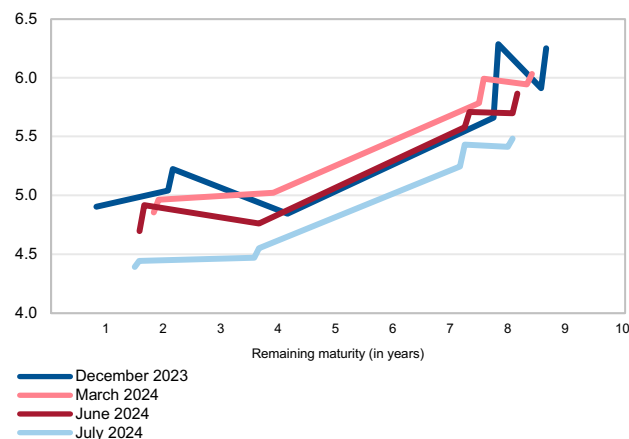


Source: Ministry of Finance.

\* 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.

As for **surplus dinar liquidity** of banks, the average stock of the NBS's portfolio of reverse repo operations contracted significantly relative to March, by RSD 80.3 bn, coming at RSD 409.5 bn in June, which was followed by a drop in the average repo rate, by 34 bp to 5.23% in the last auction in June. Conversely, the average daily amount of overnight bank deposits at the NBS increased to a similar degree – by RSD 75.9 bn, to RSD 149.7 bn. Such dynamic of fluctuation in surplus dinar liquidity extended into July and the average repo rate declined to 4.83% at the month end.

Interest rates in the **interbank money market** decreased in June, almost equally as the key policy rate (by 24 bp on average). The interest rate in the overnight interbank money market, BEONIA, edged down to 5.01%, while BELIBOR rates moved from 5.01% for the shortest to 5.55% for the six-month maturity at the end of the month. The interest rate decline in the interbank money market continued into July.

**On 5 June 2024, the Republic of Serbia successfully issued for the first time 10Y ESG dollar bonds in the international financial market.** It sold securities in the total amount of USD 1.5 bn, at the coupon rate of 6.0%. In order to efficiently manage public debt, a hedging transaction was concurrently concluded, whereby the government converted these liabilities into euros, reducing the cost of borrowing to 4.750% after the transaction.

No auctions were held in the **primary market of dinar government securities** in Q2, and since no securities matured in that period, the stock of dinar securities in the portfolio was maintained at RSD 874.9 bn at end-June. In the same period, two auctions of 3Y **government euro securities** were organised, resulting in the sale nominally worth EUR 121 mn. The yield rate in both auctions remained unchanged from the January auction, at 4.00%. However, as earlier issued securities worth EUR 125.0 mn fell due in April, the stock of sold euro securities edged down mildly to EUR 1,664.0 mn at end-June.

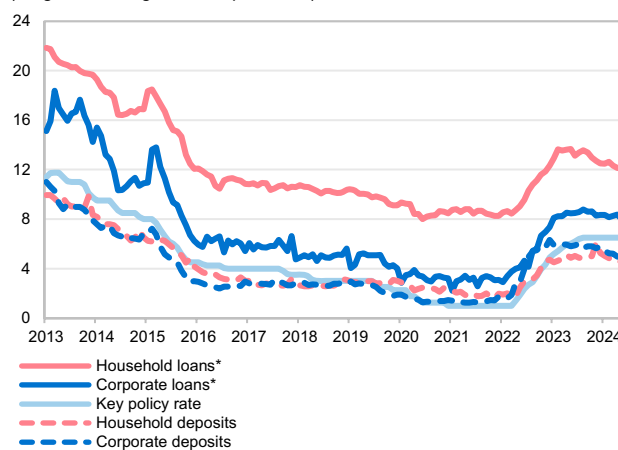
In Q2, the turnover in the **secondary market of dinar government securities** declined relative to Q1 by 32%, coming at around RSD 66.0 bn. The weighted average yields recorded a decline, mirroring a decline in the key policy rate and interest rates in the interbank money market. Average yields on bonds with the remaining maturity 2Y–9Y declined from 17 bp to 30 bp in June compared to March, moving in the range from 4.71% for bonds with the remaining 2Y maturity to 5.82% for those with the remaining 9Y maturity.

The expected and past monetary policy easing resulted in further cheapening of **new dinar loans**, so the interest rate on **dinar household loans** in Q2 declined by 0.6 pp to 11.7% in June, while the average interest rate on **dinar corporate loans** dropped by 0.2 pp to 8.1%.

A decrease in the **weighted average interest rate on dinar corporate loans** largely reflects a decline in the interest rate on investment loans, by 1.9 pp, to below the average rate (7.2%). The interest rate on working capital loans was slightly adjusted up, by 0.1 pp to 8.2%. The fall in the interest rate on dinar household loans was mostly determined by a decline in the interest rate on cash loans, by 0.6 pp to 12.1%, as this loan category prevails in dinar household lending (87%), while a decrease in the interest rate on other non-categorised loans, which make up the remaining part of the household segment, contributed to a somewhat smaller degree (down by 1.2 pp to 9.4%).

In Q2, the **interest rate on euro corporate loans** declined by 0.4 pp to 6.7%, as interest rates edged down across all loan categories. In terms of purpose, the greatest contribution to the decline in the average interest rate came from the cheapening of investment and working capital loans, by 0.4 pp and 0.1 pp, to 6.9% and 6.6%, respectively, as these loans account for around 90% of corporate lending in euros. A somewhat smaller impact was that of the interest rate on other non-categorised loans (down by 0.5 pp to 6.9%), since they make up the remaining share of euro lending to corporates. **The interest rate on euro household loans** fell by 0.4 pp to 6.1% in June, reflecting a drop in the interest rate on other non-categorised loans, by 0.7 pp to 9.3%, and also the increased higher share of housing loans (from 65% to 69%), whose interest rate was kept significantly below the average (5.1%), thanks to the application of the NBS's decision which temporarily capped interest rates on this category of loans.

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.

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

	Dinar			Euro and euro-indexed		
	2023		2024	2023		2024
	Q4	Q1	Q2	Q4	Q1	Q2
Total household loans*	12.5	12.3	11.7	6.3	6.5	6.1
Cash loans	13.2	12.7	12.1	3.3	3.9	3.5
Housing loans	12.9	16.6	17.6	5.0	5.1	5.1
Consumer loans	3.0	3.7	3.7	6.5	6.2	6.1
Other loans	10.5	10.6	9.4	9.8	10.0	9.3
Total corporate loans*	8.3	8.3	8.1	7.1	7.1	6.7
Working capital loans	8.3	8.1	8.2	7.0	6.7	6.6
Investment loans	9.4	9.1	7.2	7.3	7.3	6.9
Other loans	8.3	8.4	8.5	7.3	7.4	6.9
Import loans	-	-	-	6.5	8.0	6.7

Source: NBS.

Note: Data relate to average values on the last day of the month in the quarter

\* Excluding revolving loans, current account overdrafts and credit card debt.

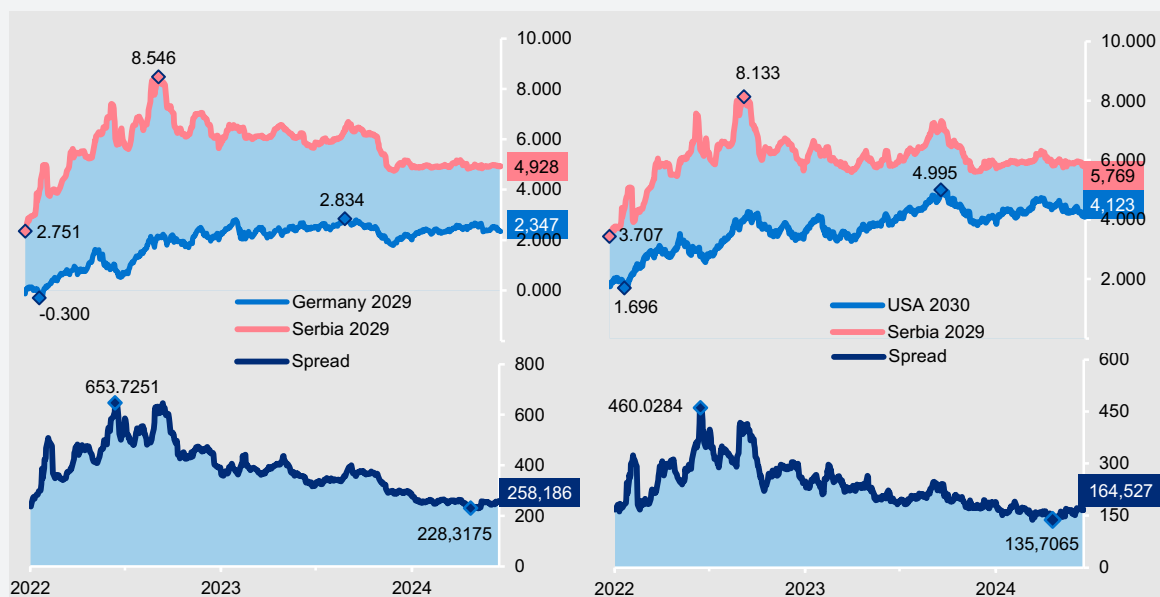
### Text box 3: Terms of foreign borrowing by the Republic of Serbia

In the five months of 2024, the activity of CESEE countries in the international financial market was vibrant, particularly in the segment of issuance of dollar eurobonds. Poland (triple-tranche), Romania (dual-tranche) and Hungary (single-tranche) issued **six dollar-denominated eurobonds worth a total of USD 14.5 bn**, or USD 2.4 bn on average per tranche.

On 5 June, Serbia successfully issued **ten-year dollar-denominated sustainability bonds** in the international market. The proceeds from these bonds will be used to finance green and socially responsible projects. Bonds in the nominal value of **USD 1.5 bn** were sold, at the **yield-to-maturity rate of 6.291%** and the **coupon rate of 6.000%**.

As was the case in earlier issues of dollar eurobonds, the Republic of Serbia concluded hedging transactions at the same time in order to reduce both the currency and the interest rate risk. Liabilities under the eurobonds were thus immediately converted from dollars into euros, containing the impact of USD/EUR volatility on Republic of Serbia's public debt. In addition to reducing the exposure to the currency risk, hedging also led to a **lowering of the cost of borrowing by the Republic of Serbia to 4.750%**. It is important to note that **due care was taken of the market conditions prevailing at the time of issuance of the eurobonds**, and the option to issue eurobonds in dollars and then convert liabilities into euros through hedging was **close to one percentage point more favourable** than the option of issuing the bonds in euros.

Chart O.3.1 Yields and spreads – Serbian eurobonds compared to German Bunds (left) and US Treasuries (right)



Source: Bloomberg.

In view of uncertainty in international markets fuelled mostly by geopolitical tensions but also by persisting risks surrounding the global inflation outlook (which is why interest rates worldwide remain high), the issue of ten-year Serbian eurobonds can be assessed as successful taking into account the **key auction indicators**:

- **Robust investor demand (in excess of USD 6.5 bn)** – due to vigorous demand (over fourfold the amount of bonds sold), Serbia was able to achieve financing conditions more favourable than indicated in the initial price thoughts (IPT) which were set at 240 bp over US Treasuries (T+240).

- **Financing costs declined during the auction** – strong and sustained investor demand made it possible for the Serbian delegation to **reduce financing costs** two times during the auction, **by a total of 40 bp (to T+200)**. Though it is



customary for terms to improve during the auction, the reduction achieved by Serbia was **larger than the average reduction achieved by regional peers** since the start of the year (the average based on the above six dollar-denominated eurobonds issued by the countries of the region was 30 bp). It is important to note that the timing of the issue also led to lower financing costs. Namely, the yield rate on comparable US Treasuries decreased notably in the days preceding the issue (from 4.62% in late May to 4.29% at the time of the issue), resulting in considerable savings and a yield rate 33 bp more favourable than would have been the case had the issue taken place before this reduction.

- **No new issuer premium** – international investors usually request additional yield or new issuer premium (NIP) relative to the yield rate on already issued comparable bonds of an issuer (with similar maturity), in order to make sure that demand for new securities is sufficiently strong. This was not the case with the issue of Serbian bonds (unlike the issues by other countries of the region). In the days around the issue, comparable dollar-denominated Serbian eurobonds (maturing in 2033) were mostly traded at yield rates above or around the achieved rate of 6.291%.

In addition to using the above, auction indicators, another way to gauge the success of an issue from the viewpoint of achieved financial conditions is to monitor Serbia's risk premium (and its changes relative to comparable countries), which has a bearing on the final yield rate. This approach is particularly suitable amid high volatility of inflation outlooks and financial conditions shaping the global economic environment in the 2020-2024 period, which is why mere comparison of the absolute yield on new eurobonds and the yield achieved in earlier years is not relevant. One of the ways to track the evolution of the risk premium is to analyse the spread between the yield on Serbian eurobonds traded in the liquid international market and the yield on benchmark (so-called risk-free) bonds issued by the most advanced economies. In the months preceding the transaction, as well as over a longer time period, **Serbia's risk premium on both dollar and euro debt was on a decline.**

**Serbia's risk premium on euro debt** can be analysed by looking at the spread between the yield on Serbian eurobonds in euros maturing in 2029 and the yield on benchmark German government bonds with comparable remaining maturity. **This spread shrank from 400 bp** (on 9 October 2023) **to 258 bp** (according to the latest available data), and is **close to its lowest level since February 2022** (Chart O.3.1). On the day when Serbia issued new eurobonds, the above spread was around 230 bp.

If we observe the period since February 2022 (outbreak of the war in Ukraine) until the latest available data, the **spread between benchmark German and Serbian bonds averaged 383 bp** (it is now **125 bp below this average**), peaking on 15 July 2022 at as much as 654 bp. In order to adopt a more conservative approach and exclude the effects of the war in Ukraine, we looked at the period since the start of 2023 **when the spread averaged 331 bp** (it is currently **73 bp lower**).

Therefore, thanks to our country's lower risk premium, the terms of borrowing in euros (after hedging) achieved by Serbia (4.750%) were **more favourable even when compared to some countries of the region which have investment-grade rating and are members of the EU**, such as Romania, which issued 8-year euro-denominated eurobonds only few days earlier at a coupon rate of 5.250%, which is half a percentage point higher than the rate on Serbian eurobonds achieved after the hedging transaction.

There are two reasons for considering that the Republic of Serbia chose a very favourable moment to issue the eurobonds, taking into account the yield rate achieved in the auction and formed as the sum of the rate on benchmark bonds (in this case on US Treasuries) and our country's risk premium:

- **The yields on benchmark US Treasuries decreased by around 30 bp only several days before Serbia tapped the international market** (from 29 May until 5 June).

- **Serbia's risk premium on dollar debt also decreased significantly in the period preceding the issue.** The reduction was also evident from the spreads between yields on Serbian dollar-denominated eurobonds and the yields on benchmark US Treasury bonds. Namely, if we compare the spread between comparable securities maturing in 2030, **Serbia's risk premium measured in this way fell to its minimum in the past two and a half years** in late May (it **equalled mere 136 bp**), which is a substantial decline compared to the peak recorded after the outbreak of the Ukraine war (460 bp in July 2022).

Chart IV.1.6 Risk premium indicator  
(daily data, in bp)

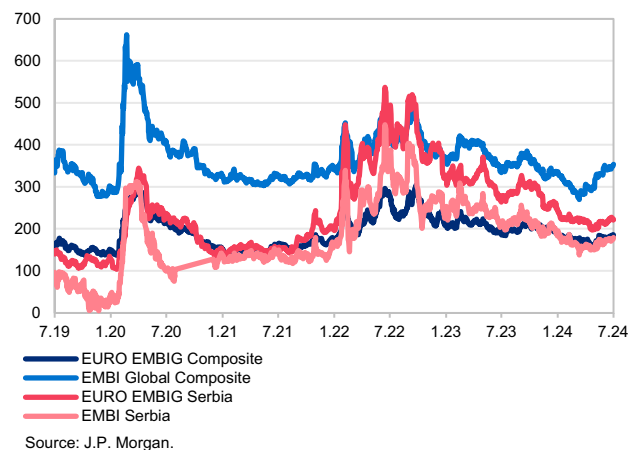


Table IV.1.2 Credit rating  
(change of rating and outlook)

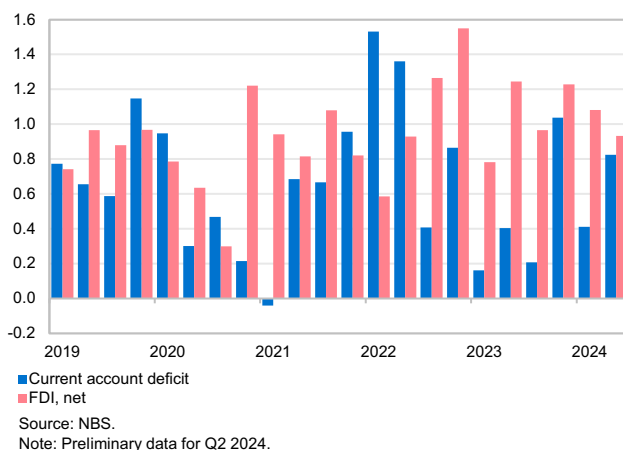
	2019	2020	2021	2022	2024
S&P	BB+/positive <sup>6)</sup>	BB+/stable <sup>3)</sup>	BB+/positive <sup>6)</sup>	BB+/stable <sup>4)</sup>	BB+/positive <sup>2)</sup>
Fitch	BB+/stable <sup>5)</sup>				
Moody's	Ba3/positive <sup>5)</sup>		Ba2/stable <sup>1)</sup>		

Source: NBS.

<sup>1)</sup> March, <sup>2)</sup> April, <sup>3)</sup> May, <sup>4)</sup> June, <sup>5)</sup> September, <sup>6)</sup> December.

Note: There was no change in rating/outlook in 2023.

Chart IV.1.7 Current account deficit and net FDI inflow  
(in EUR bn)



## Risk premium

The dollar risk premium of emerging economies was on the rise in Q2, which may be associated with the expectations of market participants about a milder decline in the Fed's interest rates in the coming period, in line with the announcements of Fed officials and with the good performance of the US economy. Serbia's dollar risk premium remained unchanged in Q2, at 168 bp at end-June, slightly edging up in July – to 179 bp. This is twice lower than the EMBI Composite, which gained 57 bp in Q2, climbing to 344 bp, and gaining additional 9 bp in July.

EURO EMBIG Composite was slightly adjusted upward in Q2, by 3 bp to 180 bp at end-June, and by some 6 bp in July. Conversely, Serbia's EURO EMBIG lost 10 bp in Q2, coming at 214 bp at end-June. In July, it was revised up by 8 bp, almost returning to its March level.

## Foreign capital inflow

The bulk of capital inflow to the financial account in Q2 originated from the successful sale of eurobonds in the international market, and FDI, which continued to record high values and cover the current account deficit. The inflows were generated also on account of higher credit debt of corporates and government, as well as trade loans, which more than sufficed to compensate for the outflows stemming from reduced assets in non-residents' accounts with domestic banks.

Q2 also saw a relatively high **FDI inflow to Serbia**, of EUR 1,047.8 mn (EUR 932.0 mn net inflow). In H1, total FDI inflow to Serbia surpassed EUR 2.3 bn, up by 6.7% y-o-y. More than four-fifths of FDI inflow were in the form of equity capital and reinvested earnings, testifying to foreign investors' commitment to Serbia. Sector-wise, the bulk of investments were channelled to construction, mining, information and communications and manufacturing.

In early June, the Republic of Serbia successfully issued sustainable 10Y bonds, aimed at funding sustainable projects within the Green Agenda and socially responsible activities. It issued securities worth USD 1.5 bn. On the other hand, in Q2, residents stepped up their investment into securities in foreign markets and outflows were also generated from trading in the domestic secondary market and the maturing of government securities, bringing a net capital inflow from **portfolio investments** to EUR 877.3 mn in Q2.

Net inflow on account of **financial loans** in Q2 came at EUR 831.4 mn. Rising corporate and government borrowing provided almost equal contributions, while bank borrowing also went up. At the same time, non-residents lowered balances in accounts with domestic banks, while domestic banks slightly increased their assets in accounts abroad, so that an outflow of EUR 235.0 mn was recorded under **cash and deposits** in Q2. Following the Q1 outflow, Q2 saw an inflow of EUR 556.8 mn under **trade loans and advances**.

### Trends in the FX market and exchange rate

The **dinar continued its relatively stable movement against the euro in Q2**, rising by 0.1% at end-June compared to end-March and strengthening to the same degree relative to end-2023. At the same time, since the euro continued to lose ground against the dollar in the international market, reflecting the rising divergence between the ECB’s and Fed’s monetary policies, in Q2 the dinar nominally depreciated against the dollar by 0.8%, which added to its weakening against the US currency, by 3.3% in H1.

The appreciation pressures which prevailed in Q2 were at their strongest in June. FX supply outstripped the demand by multiple times, mainly driven by residents, which turned out as net FX sellers in the IFEM for the fifth consecutive quarter, thanks to the increased inflow from exports and FDI. Working in the same direction were the net purchase of foreign cash and FX inflow from payment card transactions. In addition, FX supply, especially in June, was boosted by an increase in FX-indexed banks’ assets.<sup>3</sup>

To maintain relative stability of the dinar exchange rate against the euro, the NBS net bought EUR 1,235.0 mn net in the IFEM in April–July and EUR 1,555.0 mn since the start of the year, also contributing to a rise in FX reserves. At end-July, FX reserves stood at EUR 28.1 bn, their historical maximum. Such level of FX reserves covers more than seven months’ worth of goods and services imports and 186% of M1 money supply, which is far above the adequacy standards.

The currencies of regional inflation-targeting peers displayed divergent movements against the euro in Q2. The Czech koruna and Hungarian forint gained ground (by 1.1% and 0.2%, respectively), even though the Czech and Hungarian central banks reduced their policy rates. Conversely, currencies losing ground were the Romanian

Chart IV.1.8 Structure of the financial account (in EUR bn)

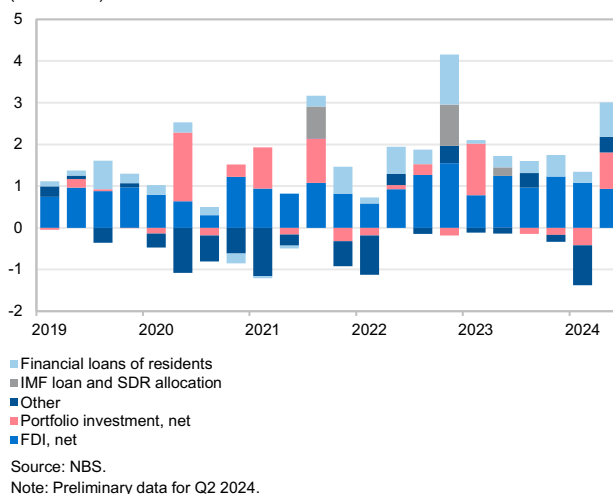


Chart IV.1.9 Dinar exchange rate and NBS transactions in the FX market

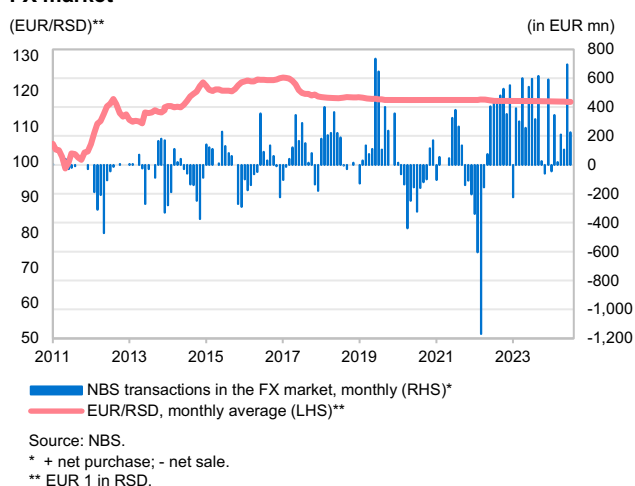
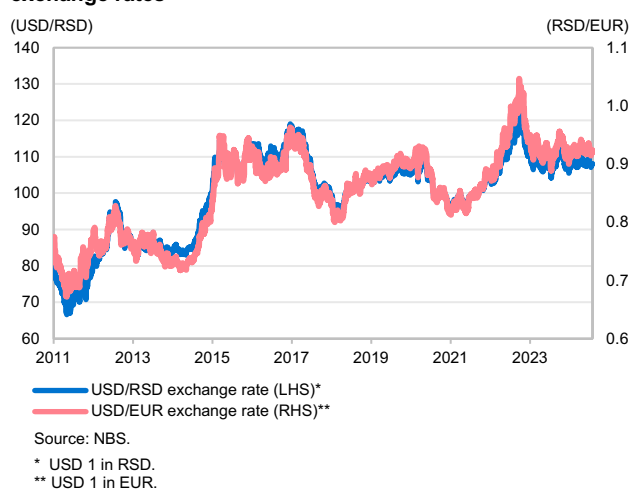


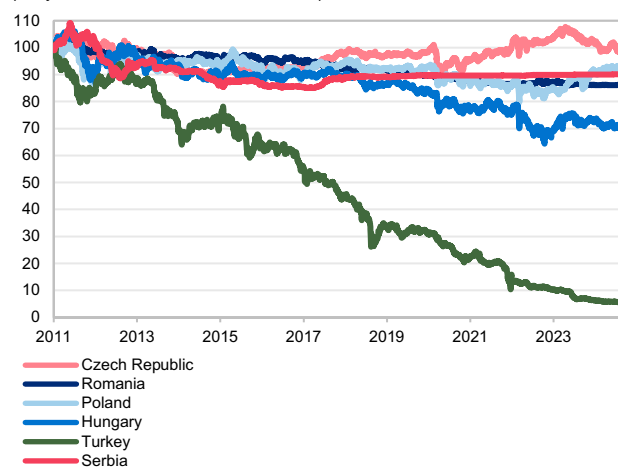
Chart IV.1.10 Movements in USD/RSD and USD/EUR exchange rates



<sup>3</sup> Aiming to balance their long open FX positions and reduce exposure to FX risk, banks sell foreign currency, which works toward the strengthening of the dinar.

Chart IV.1.11 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.

leu (0.2%), Polish zloty (0.3%) and Turkish lira (0.9%). In the year to June, only the Polish zloty appreciated (0.8%), while other currencies weakened – the Romanian leu by 0.1%, the Czech koruna by 1.2%, the Hungarian forint by 3.1% and the Turkish lira by 6.9%.

## 2 Money and loans

*Overall money supply M3 accelerated its y-o-y growth in Q2, led primarily by rising demand deposits, followed by FX deposits. Household dinar savings continued reaching new record levels.*

*Lending accelerated its y-o-y growth to 4.7% in June, owing to the rise in corporate and household loan demand amid eased dinar lending standards. Growth in dinar lending boosted dinarisation further.*

### Money

The broadest monetary aggregate M3, which in addition to dinar money includes FX deposits of non-monetary sectors, rose by 3.7% in Q2 2024, driven mainly by the expansion of the most liquid dinar component – demand deposits, followed by FX deposits.

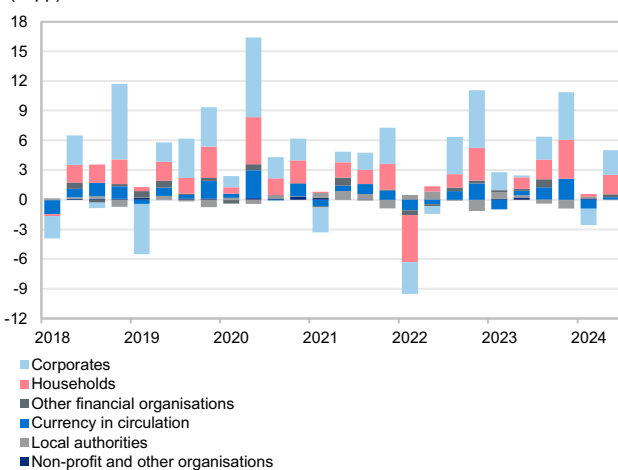
In terms of individual categories, dinar **demand deposits** gained RSD 87.2 bn in Q2 2024, thanks to the rise in transaction deposits of corporates and households (RSD 46.5 bn and RSD 34.1 bn, respectively). **Dinar time deposits** also rose, driven by the surge in household savings (RSD 10.1 bn) and corporate deposits (RSD 9.2 bn). Household dinar savings continued to post new record levels, measuring RSD 159.2 bn at end-June.<sup>4</sup> Relative stability of the dinar exchange rate against the euro, higher interest rates on dinar compared to FX savings, as well as their 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 44.2% in June, slightly below its record high (44.4%).

**FX deposits** of non-monetary sectors went up by EUR 534.5 mn in Q2 2024, mostly on the back of the rising FX deposits of households (by EUR 240.8 mn), which reached their highest level thus far (EUR 14.0 bn), and higher corporate FX deposits (by EUR 215.1 mn), which can be associated with the relatively high FDI inflow.

**Y-o-y**, the rise in money supply M3 accelerated in Q2 2024 compared to Q1, to 14.0% in June. In addition, the

Chart IV.2.1 Contributions to quarterly growth in M2, by sector

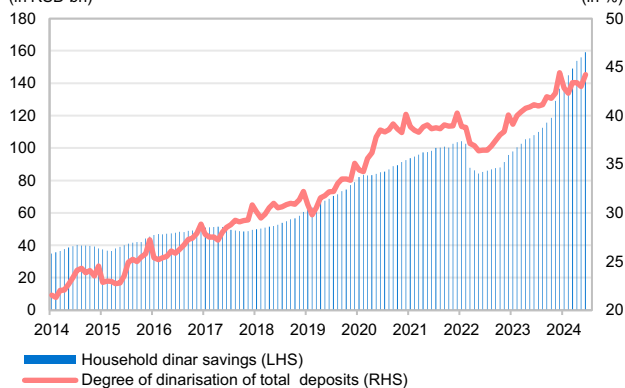
(in pp)



Source: NBS.

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

(in RSD bn)



Source: NBS.

<sup>4</sup> If the assets of non-residents are included, end-June dinar savings equalled RSD 161.0 bn and FX savings EUR 15.0 bn.

excess money ratio, measuring the deviation of the real money supply M3 from the estimated one,<sup>5</sup> remained negative, indicating that M3 was below the level that would work towards a higher inflation.

## Loans

Excluding the exchange rate effect,<sup>6</sup> **total domestic loans to the non-monetary sector** picked up their y-o-y growth to 4.7% in June (from 1.3% in March), almost equally driven by corporate and household loans. **Corporate loans** accelerated to 4.2% y-o-y, and **household loans** to 4.9%.

Due to high loan approval in June, **corporate loans** increased in Q2 by RSD 65.9 bn, which is the biggest quarterly increase since Q3 2008. The growth is entirely attributable to companies' borrowing (RSD 67.7 bn), while loans to public enterprises decreased. Almost a half of this growth referred to dinar loans, which led to a higher degree of dinarisation of corporate receivables (17.8% in March vs. 19.3% in June). The substantial growth in dinar loans can partly be attributed to the NBS's Decision on Capital Adequacy of Banks which sets out that starting from 2025, when calculating capital adequacy ratios banks are required to reduce capital if the share of approved FX-indexed and FX loans in total loans to non-financial and non-government sector exceeds 71%. Corporates increased their use of loans of all categories, with liquidity and working capital loans accounting for more than three-fifths of the growth in Q2, followed by investment loans and current account overdrafts. As a result, the share of liquidity and working capital in total corporate loans went up by 0.6 pp in Q2, to 47.4% in June, while the share of investment loans, the next in line, decreased by 0.9 pp, to 40.3%. Companies across almost all sectors borrowed more, mostly those in energy, trade, construction and manufacturing. As bank lending was channelled to micro, small and medium-sized enterprises more than to large enterprises, the share of loans approved to this segment in total corporate loans increased by 0.6 pp from March, to 59.3% in June, and their stock was higher 2.6% y-o-y.

**The volume of new corporate loans** in Q2 amounted to RSD 370.4 bn, up by 33.3% compared to the same period in 2023. Liquidity and working capital loans remained dominant (62%), and 70% of these loans was approved to micro, small and medium-sized enterprises. Investment loans accounted for one-fourth of new loans, and they

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

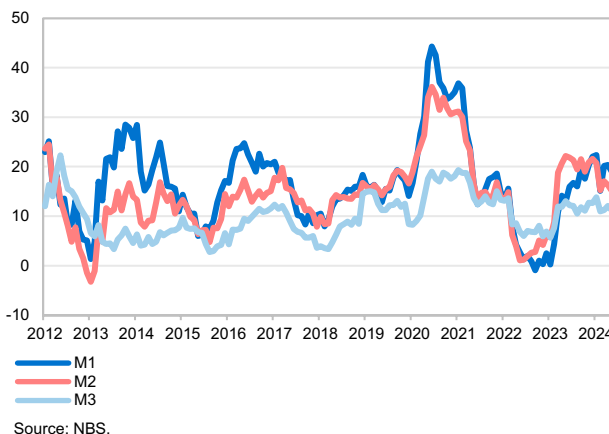


Chart IV.2.4 Contributions to y-o-y corporate lending growth (in pp, excluding the exchange rate effect)

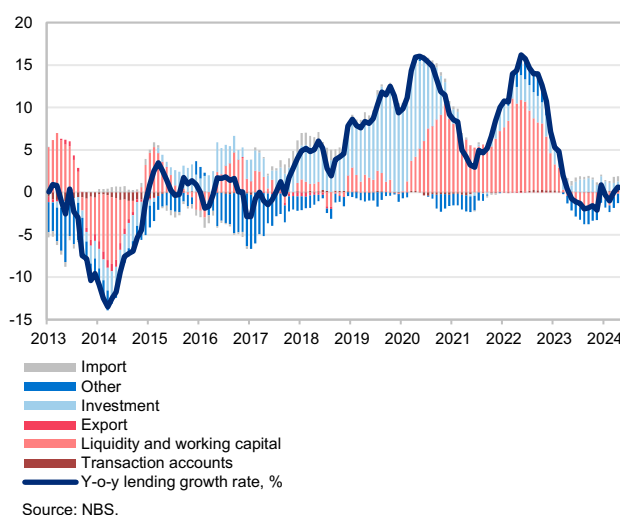
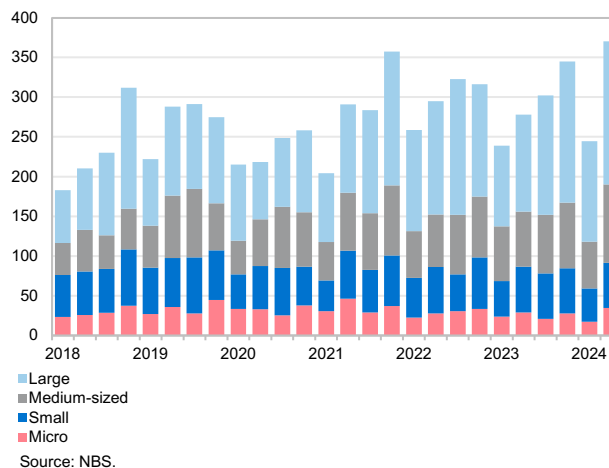


Chart IV.2.5 Structure of new corporate loans, by enterprise size (in RSD bn)

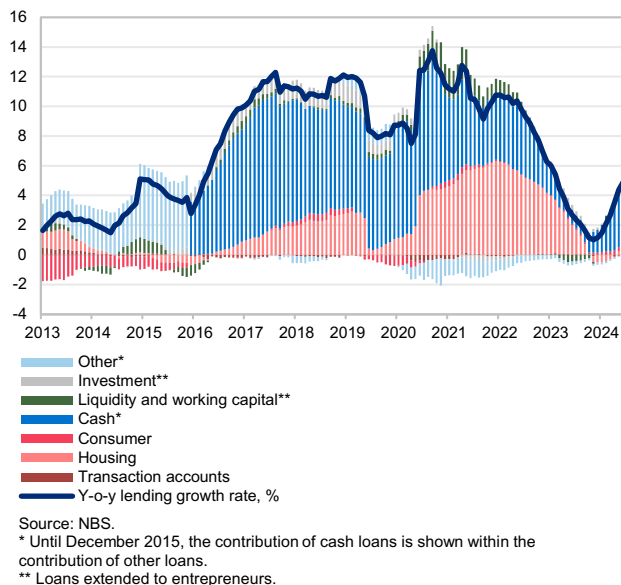


<sup>5</sup> The money demand equation was estimated using the regression equation, with real GDP and 3M BELIBOR as explanatory variables.

<sup>6</sup> Calculated at the new programme exchange rate, as at 31 October 2022.

**Chart IV.2.6 Contributions to y-o-y household lending growth**

(in pp, excluding the exchange rate effect)



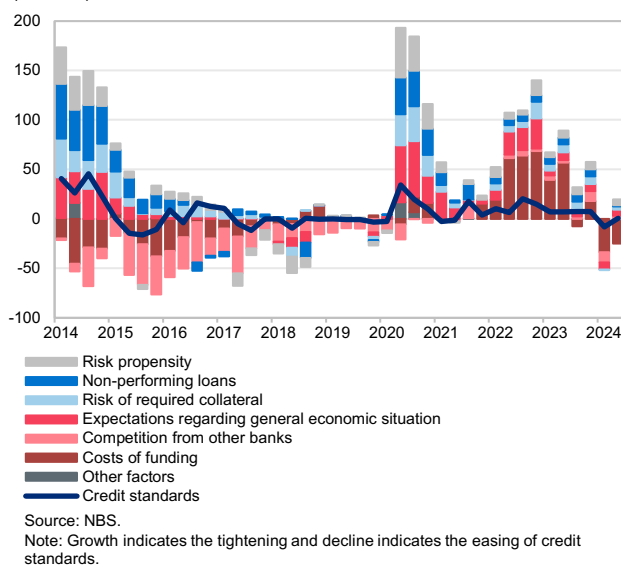
were mostly (almost 90%) absorbed by micro, small and medium-sized enterprises.

**Household loans**, excluding the exchange rate effect, grew by RSD 48.3 bn in Q2. More than one half of the increase pertained to cash loans, followed by housing loans. As a result, the share of cash loans in total household loans went up by 0.3 pp in Q2, to 45.3%, while the share of housing loans decreased to the same extent, to 38.7% in June. Borrowing in dinars accounted for over two-thirds of the rise in household loans in Q2, pushing the degree of dinarisation of household receivables further up by 0.4 pp, to 54.9% in June.

The **volume of new household loans** amounted to RSD 190.6 bn in Q2, up by 38.1% y-o-y. This was driven mainly by cash loans, which accounted for somewhat more than two-thirds of new household loans. The next in line were housing loans, which made up 15% 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.

**Chart IV.2.7 Change in corporate credit standards and contributing factors**

(in net %)



The **results of the July NBS's bank lending survey**<sup>7</sup> show that banks continued to ease their credit standards for dinar corporate and household loans in Q2. Credit standards were tightened for FX-indexed loans to corporates, while staying unchanged for households. Overall, household credit standards were eased, while standards for corporates remained unchanged. The easing of standards was determined by the lower costs of financing, which could be associated with the expected reduction of the NBS's and ECB's main interest rates. In case of households, this was aided by the effects of competition. On the other hand, as assessed by banks, elevated risk perception due to the uncertainty regarding the overall economic situation and the riskiness of the required collateral worked in the opposite direction for corporates, which translated into a lower propensity to risk. At the same time, loan demand in both sectors increased, with a further rise expected in Q3 as well. An increase in corporate loan demand was recorded after three quarters, mainly in small and medium-sized enterprises, driven by the need for financing working capital, followed by investment and debt restructuring. Household loan demand expanded for dinar cash and refinancing loans, as well as for FX-indexed housing loans and consumer loans. In banks' view, the increase in loan demand was motivated by the need to refinance existing loans and purchase durable consumer goods,

<sup>7</sup> The NBS has conducted the survey since the beginning of 2014.

with a positive influence stemming from rising wages, and after quite some time, by real estate purchases.

Gross **NPL ratio** continued to move close to its historical low in Q2, suggesting that the tightening of financial conditions had no major impact on bank asset quality. In June, this ratio dropped to its new minimum, and measured 2.9%, down by 0.3 pp from March and end-2023. Gross NPL ratio of the corporate sector<sup>8</sup> equalled 2.0% in June and of the household sector<sup>9</sup> – 4.0%, each down by 0.3 pp from March. NPL coverage remained high as allowances for impairment of total loans measured 101.85% of NPLs in June and allowances for impairment of NPLs – 60.7% of NPLs.

**Capital adequacy ratio** equalled 21.8% at end-Q2, up by 0.4 pp from end-2023, indicating high capitalisation (regulatory minimum – 8.0%) and resilience of the banking sector to external and domestic risks.

### 3 Aggregate demand

*According to SORS estimate, economic activity growth in Q2 surpassed our expectations from the previous Report, reaching 4.2% y-o-y. As in the quarter before, this growth is estimated to have been led by domestic demand, with household consumption and fixed investment being the strongest contributors. On the other hand, net exports provided a negative contribution to economic activity in Q2, as imports rose faster than exports amid the ongoing investment cycle.*

#### Domestic demand

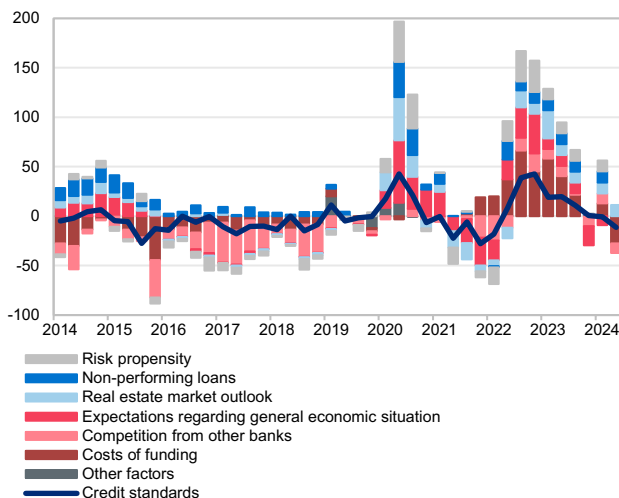
According to NBS estimate, y-o-y growth of **private consumption** gathered pace for the fourth quarter in a row, measuring 4.5% in Q2 and adding 3.2 pp to GDP growth. Household consumption growth is indicated by the retail turnover, which picked up further, to 8.3% y-o-y in Q2, and catering turnover, going up by 13.9% y-o-y in April. Concurrently, the number of arrivals and overnight stays of domestic tourists went up, by 4.6% and 6.3% y-o-y, respectively. Consumer goods imports were also on the rise, gaining 9.4% y-o-y in Q2.

Looking at the sources of private consumption, household consumption growth in Q2 was led by the

<sup>8</sup> Including companies and public enterprises. Looking at companies only, the share of NPLs in total loans decreased by 0.4 pp to 2.3% in June.

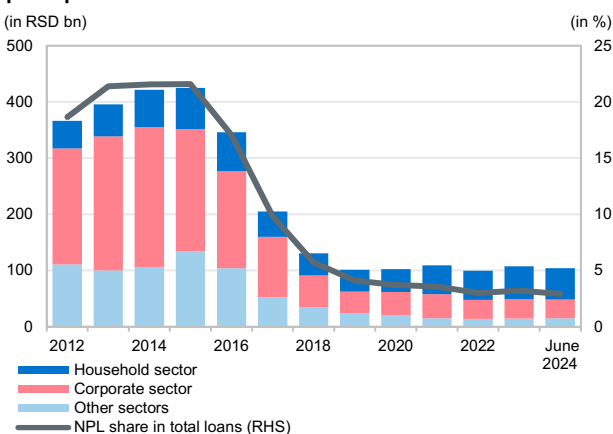
<sup>9</sup> With entrepreneurs and private households included, the share of NPLs also declined by 0.3 pp, to 4.0% in June.

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



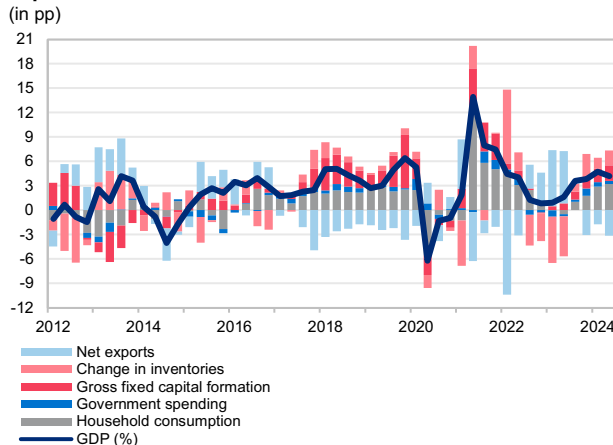
Source: NBS.  
Note: Growth indicates the tightening and decline indicates the easing of credit standards.

**Chart IV.2.9 NPL level and share in total loans, gross principle**  
(in RSD bn)



Source: NBS.

**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 Q2 2024.

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

	2023		2024	
	Q3	Q4	Q1	T2
<b>Household consumption</b>	<b>1.5</b>	<b>2.6</b>	<b>4.4</b>	<b>4.5 *</b>
<b>Indicators</b>				
Retail trade	-1.4	2.6	6.9	8.3
Catering turnover	6.0	8.8	11.7	13.9 ***
Number of domestic tourists	-4.7	-5.4	7.5	4.6
Number of overnight stays of domestic tourists	-10.4	-14.0	6.2	6.3
Consumer goods import (BEC classification), nominal	4.8	0.1	7.2	9.4
<b>Sources</b>				
Total wage bill, nominal	16.4	15.9	16.0	16.7 **
Net remittances inflow, nominal	-6.0	-15.8	-0.7	4.1
Stock of loans intended for consumption, nominal	0.9	2.0	4.0	7.7

Sources: SORS and NBS calculation.  
\* NBS estimate.  
\*\* April–May.  
\*\*\* April.

**Table IV.3.2 Investment indicators**

	2023		2024	
	Q3	Q4	Q1	Q2
<b>Real y-o-y growth rates (%)</b>				
Fixed investment (national accounts)	4.1	5.2	7.3	8.2 *
Construction (national accounts)	13.0	7.5	14.2	10.0 *
Government investment	10.0	12.0	5.0	8.0 *
Number of issued construction permits	11.2	15.6	-3.8	18.5 **
Production of construction material	3.5	-2.4	3.3	3.1
Value of works performed	17.3	10.5	17.8	10.3
Equipment imports, nominal	-14.4	9.5	6.8	25.4
Production of domestic machinery and equipment	-2.4	-10.6	-17.9	-5.9

Sources: SORS and NBS calculation.  
\* NBS estimate.  
\*\* April–May.

wage bill (the main source), which continued to record two-digit nominal y-o-y growth (16.7% in April–May), while thanks to a further deceleration in inflation, the real wage bill growth reached 11.4% y-o-y. At the same time, household consumption in Q2 was also supported by the loans intended for consumption, which have gradually gathered y-o-y pace since Q3 2023, coming to 7.7% in Q2, and pension growth, of around 21% y-o-y in April–May. Also, after one year, household remittances again posted a y-o-y increase, measuring 4.1% in Q2.

In our estimate, **government consumption** edged up by 2.7% y-o-y, continuing to positively contribute to GDP growth (0.4 pp in Q2), driven by the higher expenditure for public sector employees and the purchase of goods and services. Owing to these trends, **total consumption** expanded by 4.2% y-o-y in Q2.

**Private investment** kept the positive dynamic from the quarter before and, according to our estimate, rose by 8.3% y-o-y in Q2. Private investment growth is suggested mainly by data on construction, which, in our estimate, expanded by 10.0% y-o-y in Q2. Speaking in favour of this is the rise in issued construction permits in April–May by 18.5% y-o-y, and higher production of construction material, by 3.1% y-o-y in Q2. The value of executed works was higher by 10.3% y-o-y in Q2. At the same time, equipment imports posted strong growth, of 25.4% y-o-y. In terms of investment financing sources, FDI inflow in the year to date increased by 6.7% relative to the same period last year. Q2 also saw a 2.2% y-o-y increase in investment loans, and the major part of private investment is estimated to have been financed from corporate profitability in the past years (according to preliminary data of the Business Registers Agency, net corporate profit in 2023 equalled RSD 972 bn and was higher by 12.3% y-o-y).

In our estimate, continued implementation of government-financed infrastructure projects helped **government investment growth** to pick up to 8.0% y-o-y in Q2. Accordingly, **total fixed investment** is estimated to have increased by 8.2% y-o-y, adding 1.9 pp to GDP growth in Q2.

**The rise in inventories** in Q2 is estimated to have positively contributed to GDP growth in Q2 (1.8 pp), largely reflecting the low last year's base.

Observed on a quarterly basis, GDP growth in Q2 is estimated at 0.7% s-a, driven by total investment and private consumption. On the other hand, net exports gave a negative contribution owing to strong equipment imports supporting the ongoing investment cycle.



## Net external demand

Serbia’s **real exports** sped up to 4.2% y-o-y in Q2. As the **real import** growth accelerated as well (to 7.8% y-o-y), **net exports** remained a negative contributor to GDP growth in Q2 (-3.1 pp), consistent with our expectations having in mind the acceleration of domestic demand, primarily investment.

**Commodity exports** in euro terms bounced back in Q2, rising by 2.4% y-o-y. The increase mainly resulted from the higher exports in mining (2.3 pp), partly owing to the low last year’s base, and agriculture, which, thanks to the well-performing last year’s season, recorded double-digit y-o-y growth for the third consecutive quarter. The rising manufacturing exports also gave a positive contribution (1.1 pp), reflecting past investments. On the other hand, Q2 saw a contraction in electricity exports, primarily because of the high last year’s base, which gave a negative contribution to total commodity exports (-3.3 pp).

Compared to the same period of 2023, manufacturing exports grew in almost half of the branches in Q2, with the greatest positive contributions coming from base metals, computers, electronic and optical products, tobacco and food industry. Working in the opposite direction were the reduced exports of other machinery and equipment and motor vehicles and trailers.

**Commodity imports** in euro terms increased by 6.2% in Q2, partly as a result of the low base and partly due to the vigorously expanding imports of products for the current investment cycle. According to BEC classification, import growth mainly reflected higher imports of equipment (25.4% y-o-y) and of consumer goods (9.4%). On the other hand, a decrease was recorded for imports of intermediate goods (-0.6%), a category inclusive of energy. Compared to the same period last year, energy imports contracted by EUR 322 mn, going down for all energy products.

Foreign trade in services maintained the positive dynamic from a quarter earlier, recording in Q2 a surplus of EUR 816 mn. The rise in services exports was mostly driven by ICT, tourist and business services, and that in imports by tourist and business services.

As commodity imports rose faster than exports, commodity export/import coverage ratio slightly edged down in Q2, to 80.6% in June,<sup>10</sup> or 91.7% with services included – a drop of 0.8 pp and 0.6 pp, respectively, compared to end-Q1.

<sup>10</sup> Measured by 12-month moving average.

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

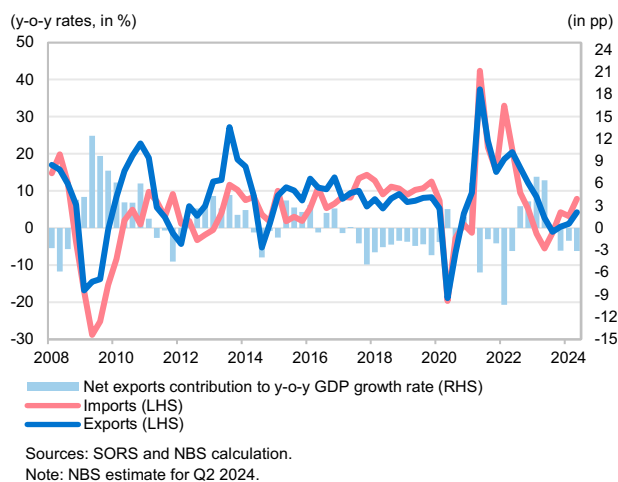
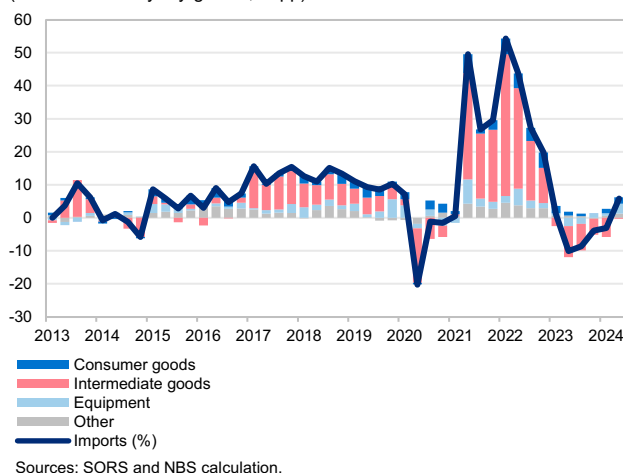


Chart IV.3.3 Movement in external demand indicators for Serbian exports (3M moving average, s-a)



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



### Text box 4: Recent trends in manufacturing

The accumulated effects of different crises gave rise to global supply chain bottlenecks and slowed down growth in leading economies, posing a major challenge for the manufacturing sectors of many countries, especially of small open economies which are directly integrated in these supply chains and depend on advanced economies' external demand. The manufacturing industry at home demonstrated resilience in the conditions of the multidimensional crisis, having reinforced its production and export capacities in the preceding period thanks to earlier FDI inflows and preserved corporate profitability.

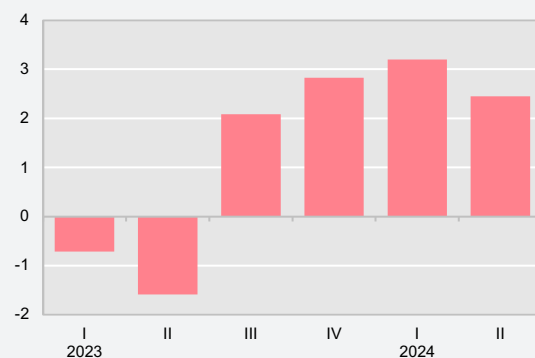
As external demand was weak, manufacturing production volume dipped by 1.2% y-o-y in H1 2023 (Chart O.4.1), mostly due to subdued production of base metals and metal products, but also of chemical industry products, construction materials and petroleum products. In H2, however, production volumes in manufacturing went up by 2.5%, reflecting primarily increased production of computers, electronic and optical products, other transport equipment and food industry products, and contributing to accelerated GDP growth in this period.

Positive trends in manufacturing extended into 2024 and the y-o-y rate of growth in the volume of production was 2.8% in the six months of the year. Production increased in 13 out of 24 branches of manufacturing. The largest contribution continued to come from the production of computers, electronic and optical products, as well as of metal and food products. Growth would have been even higher in H1 2024 if not for the overhaul and investment works in the Pančevo refinery in March and April, though earlier production volumes were resumed already in June. As the manufacturing industry rallied, so did its contribution to the y-o-y growth rate of the industry as a whole. From mid-2023, this contribution has, for the largest part, determined the growth rate of total industrial production (Chart O.4.2).

Manufacturing industry exports decreased in the pandemic year of 2020, posted high growth rates in 2021 and 2022, and measured EUR 24.7 bn in 2023, up by more than 50% relative to the pre-crisis year of 2019 (EUR 16.1 bn). Growth in 2023 was still slower than in 2021 and 2022 as external demand of many European countries which are our key trade partners slumped, partly also because of reduced consumer and investment confidence amid heightening geopolitical tensions and fears of a global recession. Though weaker, cost-push pressures remained high, posing an additional challenge for manufacturing exports.

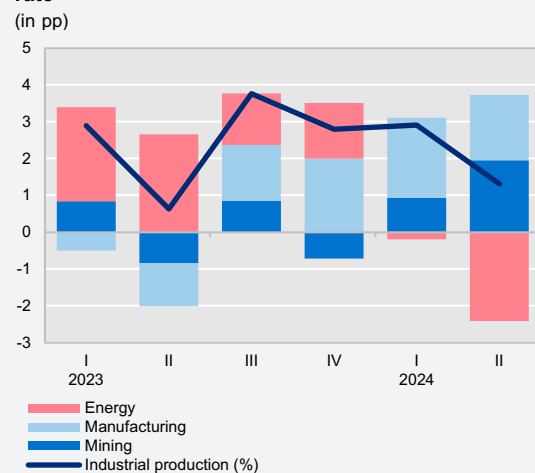
In order to assess movements in the real (quantity) export growth, we used SORS data on monthly indices of producer export prices by manufacturing sector. Our analysis showed that manufacturing posted annual export growth of 5.4% in nominal terms in 2023, with 16 out of 23 manufacturing branches providing a positive contribution. The largest positive impulse came from the export of electrical and other equipment, machines and motor vehicles. Exports also posted real, i.e. quantity, growth of around 1%. During 2023, real exports posted weaker results in H2, and even fell by 1.8% y-o-y in Q3, most probably reflecting the negative cumulative effects of weaker external demand. They rallied somewhat in Q4

Chart O.4.1 Physical volume of production in manufacturing (y-o-y rates, in %)



Sources: SORS and NBS calculation.

Chart O.4.2 Contributions to y-o-y industry growth rate (in pp)



Sources: SORS and NBS calculation.

and continued up in 2024, at a nominal growth rate of 2.4% y-o-y in the six months of the year, with real growth measuring 1.2% in Q2 (Chart O.4.3).

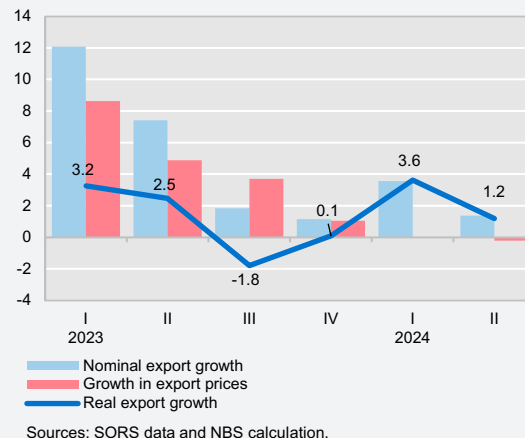
Not only did exports go up steadily but their quality improved as well, as the share of advanced technology products increased (Chart O.4.4). The share of medium-value-added products and higher technology products in total manufacturing exports rose from 41.8% in 2019 to 46.6% in 2023. When it comes to technologically most sophisticated products, their exports continued up in 2024 at a rate of 9.8% and their share in exports ought to reach a double-digit level for the first time ever this year.

Manufacturing export resilience was propped up by earlier FDIs in this sector which, in addition to boosting production capacities, also resulted in the transfer of new technologies and know-how, enhancing competitiveness in the international market. Almost a third of all FDIs in the 2019–2022 period were channelled to manufacturing (32.8%), and a similar trend continued in 2023, when the inflow was around EUR 1.2 bn (25.5% of total FDIs), which ought to encourage higher goods exports and ensure external sustainability of the domestic economy going forward.

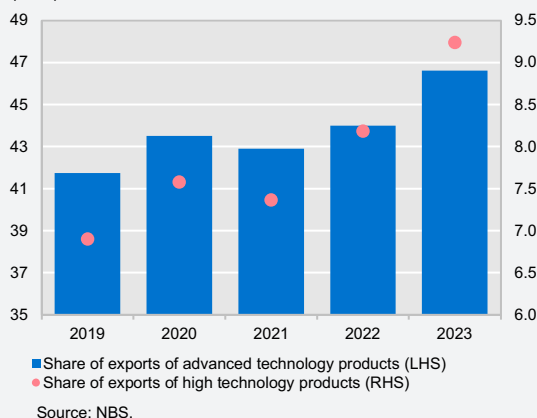
As trends in manufacturing were favourable, formal employment and productivity in this sector continued up (Chart O.4.5). In the past decade, employment in manufacturing increased by around 12 thousand persons on average per annum, reaching over 500 thousand persons in 2023, or close to 10% more than in the pre-crisis year of 2019. It stayed around the same level in H1 2024. Productivity in manufacturing was also on a mostly upward path in the past ten years, except in 2018–2020 when relatively high growth in employment was recorded, so that even this temporary dip in productivity was, conditionally speaking, on a sound basis. Since the start of 2023, after falling in H1, productivity returned to positive zone from August and struck an upward path in the coming period, increasing by 3.6% y-o-y in H1 2024.

The above indicators of the physical volume of production, exports and the labour market show that, despite exogenous shocks, the stability of doing business in the manufacturing sector was not undermined, as confirmed by the preliminary financial results for 2023. Total profitability of manufacturing in 2023 remains high (RSD 159.7 bn), with a net profit rate of 3.4% (4.0% in 2022). Manufacturing industry profitability is an important indicator of resilience also because it leaves room for companies to rely on their own sources to fund new investment projects, including those planned within the “Leap into the Future – Serbia Expo 2027” programme.

**Chart O.4.3 Real export growth in 2023 and Q1 2024**  
(quarterly data, y-o-y rates, in %)



**Chart O.4.4 Exports of advanced technology products and, within them, high technology products – share in total manufacturing exports**  
(in %)



**Chart O.4.5 Y-o-y growth rates of total formal employment and productivity**  
(in %)

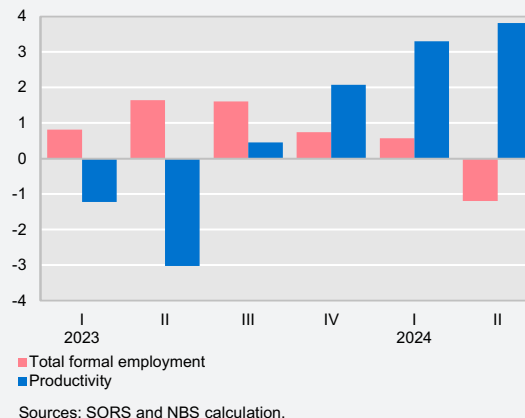


Table IV.4.1 Contributions to y-o-y GDP growth (in pp)

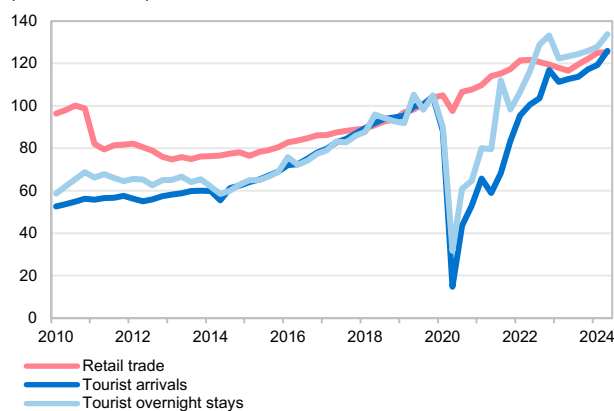
	2023			2024	
	Q2	Q3	Q4	Q1	Q2*
<b>GDP (% y-o-y)</b>	<b>1.6</b>	<b>3.6</b>	<b>3.8</b>	<b>4.7</b>	<b>4.2</b>
Agriculture	0.3	0.5	0.4	0.0	0.0
Industry	0.1	0.7	0.5	0.6	0.3
Construction	0.7	0.7	0.4	0.6	0.6
Services	0.4	1.6	2.2	2.9	2.8
Net taxes	0.0	0.1	0.3	0.5	0.6

Sources: SORS and NBS calculation.

\* NBS estimate.

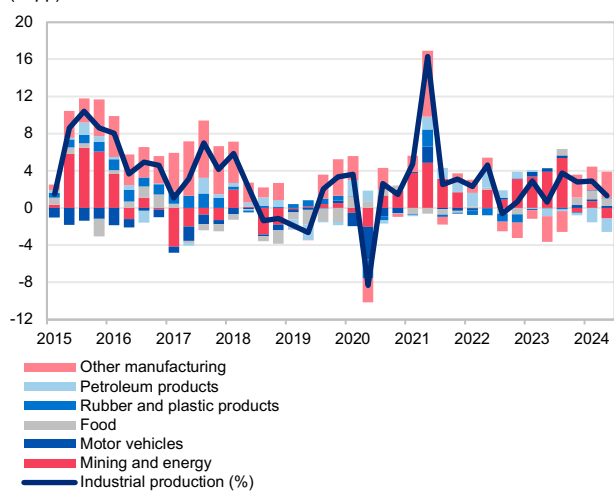
Chart IV.4.1 Service sector indicators

(s-a, 2019 = 100)



Sources: SORS and NBS calculation.

Chart IV.4.2 Contributions to y-o-y industry growth rate (in pp)



Sources: SORS and NBS calculation.

## 4 Economic activity

According to the SORS flash estimate, Serbia recorded economic growth of 4.2% y-o-y in Q2, higher than expected in the last Report. Growth was driven by services, particularly trade, as well as construction and industry. At the quarterly level, economic growth measured 0.7% s-a in Q2, in our estimate.

**Services**, collectively, continued up, to 5.6% in Q2, contributing 2.8 pp to economic growth. This is indicated primarily by trade data, as the real retail trade turnover went up by 8.3% y-o-y in Q2. Catering also picked up further, its real turnover rising by 13.9% y-o-y in April. At the same time, the total number of tourist arrivals increased in y-o-y terms by 10.4% and of overnight stays by 9.7% in Q2.

**Industrial production** grew 1.3% y-o-y in Q2, in our estimate, led by mining and manufacturing, while the production of electricity dropped y-o-y, partly as a consequence of the high last year's base. Positive trends in the mining sector continued into Q2, with the increase in the volume of production by 15.3% y-o-y, primarily owing to the intensified exploitation of metal ore and production in the "other mining" category (which mainly includes construction materials, such as gravel, sand, etc.)

Positive trends in manufacturing from H2 2023 extended into Q2 2024, with the production growing by 2.5% y-o-y despite the still relatively modest external demand. The growth in the volume of production was registered in 15 out of 24 branches of manufacturing. The greatest positive contribution came from the production of computers, metal products and food. On the other hand, the production of petroleum products decreased the most in y-o-y terms owing to the overhaul of the oil refinery in Pančevo. Still, the fact that as of May the production of petroleum products almost returned to the average level of production in 2023 is encouraging and suggesting that the overhaul is finished and that full normalisation can be expected in the remainder of the year.

The NBS estimates that the **construction** growth in Q2 measured 10.0% y-o-y. This estimate is based on the higher production in the "other mining" category, which largely covers the exploitation of construction materials, and the rise in the production of construction materials. The number of issued construction permits also rose – by 18.5% y-o-y in April–May, while the value of executed works in Q2 increased by 10.3% y-o-y. The import of equipment increased by 25.4% y-o-y in Q2 and of construction materials by 12.0% y-o-y.

We estimate that owing to the consumption growth and better collection of tax revenues, **net taxes rose** by 3.5% y-o-y, adding 0.6 pp to GDP growth.

At the quarterly level, GDP increased by 0.7% s-a in Q2 relative to Q1. Looking at individual contributors, GDP growth was driven the most by construction and trade, though almost all other activities recorded a q-o-q increase as well.

## 5 Labour market developments

*Favourable labour market trends continued into Q2 2024, as testified by the formal employment increase and unemployment decrease to a new low, along with the rise in wages which does not jeopardise inflation’s movement within the target band.*

### Wages

In the April–May period, the average nominal net wage came at RSD 98,392 (EUR 840), its y-o-y growth accelerating to 15.7% (from 14.9% in Q1). In May, it exceeded RSD 100,000 for the first time since we have comparable data. At the same time, the real y-o-y growth in the average net wages stepped up to 10.5%, from 8.7% in Q1. In the April–May period, the median net wage amounted to RSD 75,750, up by 16.4% from the same period last year. A considerable rise in wages resulted in the improvement of the living standard, as evidenced by the data saying that in April the coverage of the average consumer basket with the average wage stood at 93.7% and the coverage of the minimum basket with the minimum wage at 89.4%, up by 8.3 pp and 17.3 pp, respectively, from a year ago.

In April and May, **public and private sector** wages rose almost to the same degree, with average wages rising at double-digit y-o-y rates in all **economic branches**. The most pronounced y-o-y increase was recorded in education, water supply, manufacturing and administrative and auxiliary services, ranging between 17.5% and 18.8%.

As a result of further wage and formal employment increases, the total nominal **net wage bill**, as the main source of consumption, went up by 16.7% y-o-y in April–May.

According to preliminary data, **overall economic productivity** rose by 4.1% y-o-y in Q2 as the economy grew at a faster pace than employment.

Chart IV.4.3 Construction activity indicators (quarterly averages s-a, 2019 = 100)

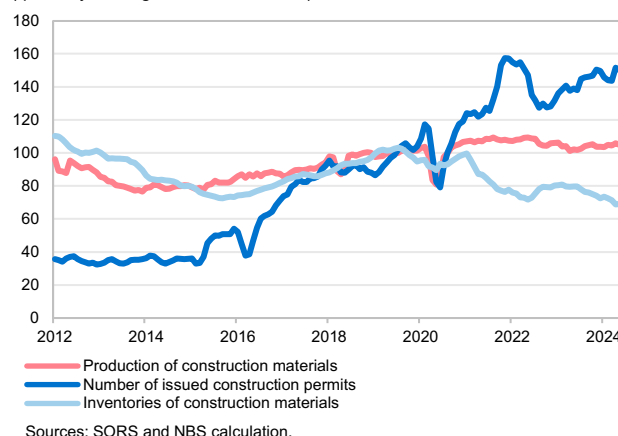


Chart IV.5.1 Y-o-y growth rates of average net wage (in %)

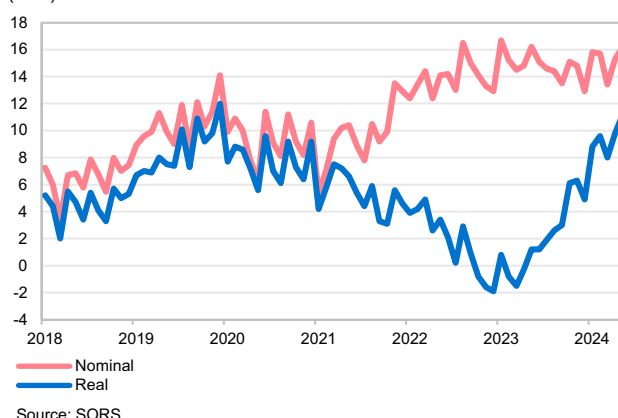


Chart IV.5.2 Nominal net wage by economic sector (in RSD thousand)

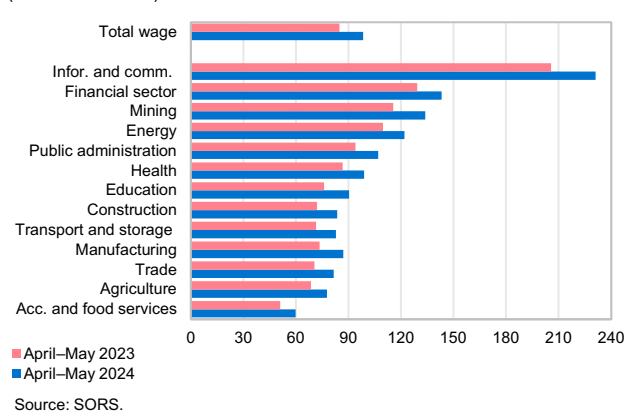
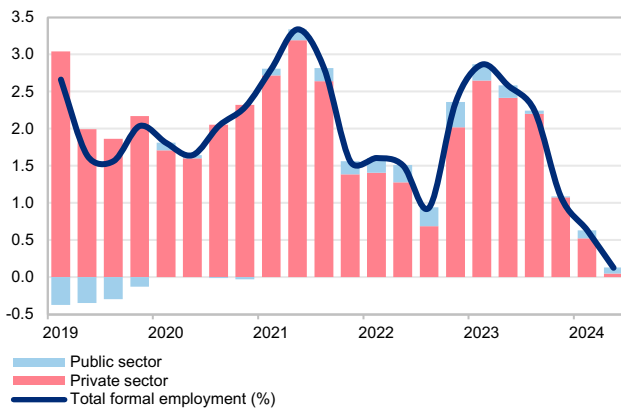


Chart IV.5.3 Structure of y-o-y growth in total formal employment

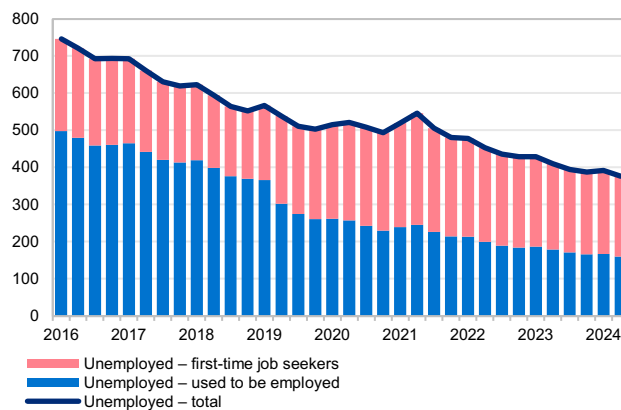
(in pp, quarterly average)



Sources: SORS and NBS calculation.

Chart IV.5.4 Movement of registered unemployment

(in thousand persons, quarterly average)



Source: National Employment Service.

## Employment

**Total formal employment** in Q2 measured around 2.37 mn on average. In June, it was higher by around 12 thousand than a year ago, its y-o-y growth decelerating to 0.1% in Q2 (from 0.6% in Q1). The y-o-y growth in formal employment in June reflects continued employment with legal entities and entrepreneurs, whereas the number of individual farmers declined.

As in the previous period, the bulk of new jobs were created in the private sector in Q2, which is why **private sector formal employment** came at around the record level of 1.76 mn in June, up by around eight thousand from a year ago. Observing dominantly private sector activities in June, 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. At the same time, **public sector employment** rose by around four thousand y-o-y in June.

According to the National Employment Service's records, **registered unemployment** declined to a new low (370,611) in June, with around 32 thousand unemployed people less than in the same period last year.

According to the **LFS**, inclusive of both formal and informal labour market segments, the working age (15–64) participation rate stood at 72.5% in Q1 2024, while the activity rate of the population older than 15 measured 56.2%, both rates marking a y-o-y increase of 1.3 pp and 1.2 pp, respectively. The employment rate went up by 1.4 pp y-o-y, to 50.9% in Q1 2024, while the unemployment rate decreased by 0.6 pp, to 9.4%.

## V Projection

With GDP growth in H1 exceeding our expectations, we raised the economic growth projection for this year from 3.5%, as projected in May, to 3.8%. An additional pick-up in economic activity, to the range of 4–5%, is expected to unfold over the next two years, facilitated by the realisation of investments planned as part of the “Leap into the Future – Serbia Expo 2027” programme. Growth will be driven by domestic demand, while continued growth in employment and wages, notably in the private sector, will drive private consumption up. Investment growth will be propped by the realisation of projects in road, energy and utility infrastructure. Amid the expected acceleration of investments and personal consumption, we project that imports will grow faster than exports, resulting in a negative contribution of net exports.

According to our latest projection, y-o-y inflation will continue to move within the bounds of the target tolerance band ( $3\pm 1.5\%$ ). After a temporary increase in July, when it came close to the upper bound of the tolerance band amid a series of one-off hikes, inflation is expected to slow to around 4% at end-2024, only to gradually converge to the 3% central midpoint during 2025. Such inflation movements will largely remain under the impact of the still tight monetary conditions, lower imported inflation and inflation expectations, the anticipated gradual slowdown in real wage growth and the expected fall in global oil prices, in line with futures.

Uncertainty in terms of the outcome of inflation and GDP projections still stem mostly from factors in the international environment, notably geopolitical tensions and global growth prospects, as well as their impact on the global prices of energy and primary commodities. To a certain extent, the risks also pertain to the steadiness of core inflation on a global scale. Another source of risks to the projection is the pace of domestic demand growth, notably on account of the level of FDI inflow and investments in infrastructure and the energy sector. Closer to home, the impact of weather on the supply and prices of fruits and vegetables is important for inflation, and on autumn crops for GDP.

### External assumptions

#### Economic activity

Despite elevated geopolitical tensions and the still high interest rates, in the June Global Economics Prospects the World Bank revised up its **global economic** growth projection for 2024, by 0.2 pp relative to January, to 2.6%. The World Bank expects the global GDP growth rate to pick up to 2.7% in 2025–2026, which is still below the long-term average (3.1% in the period 2010–2019). **Risks to the 2024 global growth projection have been estimated as skewed to the downside** considering the possible escalation of geopolitical tensions, which might push the global prices of primary commodities further up and lead to the fragmentation of global trade. Moreover, the World Bank underlined that the persistent inflation could act as a drag on the nascent monetary accommodation, which would reflect negatively on economic activity. In July, the **IMF** kept the April projection of 2024 global growth unchanged at 3.2%, while the projection for 2025 was revised up, by 0.1 pp to 3.3%. Global economic growth is estimated to be in line

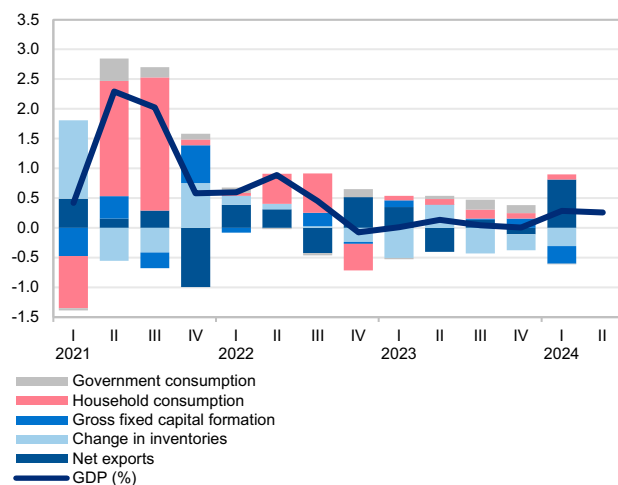
Table V.0.1 Real GDP growth projections for 2024 and 2025 (in %)

	2024		2025	
	Prev. proj.	New proj.	Prev. proj.	New proj.
World	3.2	3.2	3.2	3.3
Advanced economies	1.7	1.7	1.8	1.8
Euro area	0.8	0.9	1.5	1.5
USA	2.7	2.6	1.9	1.9
Emerging and developing economies	4.2	4.3	4.2	4.3
Russia	3.2	3.2	1.8	1.5
China	4.6	5.0	4.1	4.5

Source: IMF WEO (July and April 2024).

**Chart V.0.1 Contributions of components to the real GDP growth rate in the euro area**

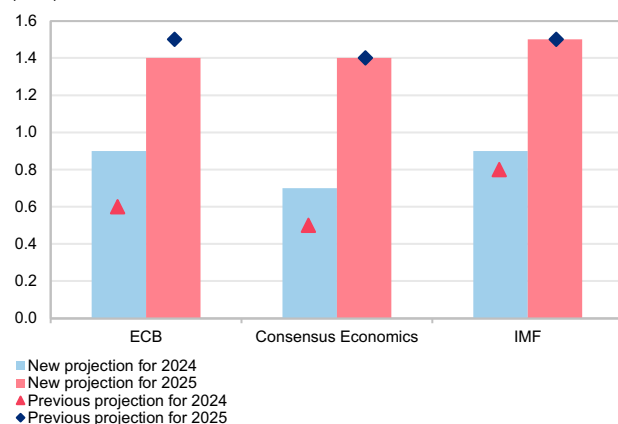
(s-a, quarterly, in pp)



Source: Eurostat.

**Chart V.0.2 Adjustments to the euro area's GDP growth projection for 2024 and 2025**

(in %)



Sources: ECB (March and June), Consensus Economics (April and July) and IMF (Apr and July).

with the April forecast, with high inflation in the services sector underlined as the key risk. As for additional risks, the IMF listed interest rates possibly remaining elevated for a longer period, geopolitical risks and increased protectionism in international trade.

After five consecutive quarters of stagnation, the **euro area economic activity** in Q1 rose by 0.3% s-a, almost entirely thanks to the rising net exports amid elevated global demand for products and services. In contrast, Q1 saw a decrease in fixed investments and inventories, while private and government consumption remained broadly unchanged. In **Germany and Italy**, our key foreign trade partners in the euro area, Q1 also saw s-a GDP growth of 0.2% and 0.3%, respectively.

The leading short-term economic indices for the euro area, PMI and ESI, indicate a gradual recovery of economic activity, with the PMI in the expansion zone as of March. The ECB expects euro area economic recovery to unfold concurrently with the increase in real disposable income on account of higher wages and more favourable trade conditions. According to Eurostat's preliminary data, the euro area GDP rose 0.3% s-a in Q2. After dipping in April and May, the euro area unemployment rate returned to the March figure (6.5%) in June, while the ECB's June projection had the rate at 6.6% in 2024.

Considering the better outcome than anticipated from the start of 2024 onwards, in June the **ECB** revised up its March euro area GDP forecast by 0.3 pp, to 0.9% in 2024. The 2025 economic growth projection was slightly revised down (by 0.1 pp to 1.4%), while the one for 2026 remained unchanged (1.6%).

In July, the Consensus Economics also revised up the April projection of euro area growth for 2024, by 0.2 pp to 0.7%, while the 2025 projection stayed the same (1.4%). Analysts underlined that they expect euro area economic activity to look brighter in the coming quarters under the impact of a resilient labour market and the rebound in global industrial production. Despite the cuts in the ECB's key interest rates in June, the Consensus Economics underlined that the cycle of monetary relaxation will most likely be slower than the cycle of monetary tightening. In our latest forecasts we relied on the above Consensus Economics projections for assumptions of euro area economic growth.

**At the CESEE level**, GDP picked up to 0.5% s-a in Q1 (from 0.1% in Q4), with growth dominantly driven by household consumption, followed by the rise in inventories and government consumption. A decrease in fixed investments and net exports worked in the opposite



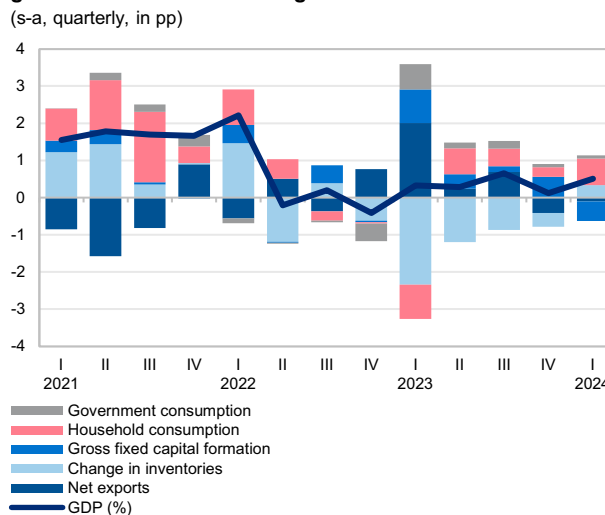
direction. Economic activity in Q1 rose in almost all countries of the region, except Slovenia, where it stagnated, while the highest s-a GDP growth rates were recorded by Croatia, Hungary, Romania and Slovakia. In view of the subdued investment activity attributable to the lingering global uncertainty, the Consensus Economics estimated that going forward, domestic consumption will remain the key driver of economic growth in the region. In July, the Consensus Economics projected 2024 GDP growth at 2.9% in Southeast European countries and 2.4% in Central European countries, while 2025 growth rates for these regions stand at 3.4% and 3.3%, respectively.

In Q1, the **US economy** slowed to 0.3% s-a (from 0.8% in Q4), under the impact of increased fixed investments and domestic consumption, while a decrease in net exports and inventories had the opposite effect. In June, the **Fed** estimated that GDP recorded a sound growth pace during Q2, driven by the continued consumption increase and a robust labour market. According to a preliminary assessment of the US Bureau of Economic Analysis, US GDP rose by 0.7% s-a in Q2 as a result of elevated domestic demand. In June, the Fed kept the March forecast of annual GDP growth in 2024 and 2025 at 2.1% and 2.0%, respectively. The US unemployment rate continued up in Q2, measuring 4.1% in June (3.8% in March), while the Fed stated that the labour force supply and demand gap continued to narrow. The Fed’s June projection of unemployment in 2024 (4.0%) was the same as in March.

**Russia’s** economic growth in Q1 picked up to 5.4% y-o-y, from 4.9% in Q4, exceeding the expectations of market participants (5.3%). On the production side, GDP growth was driven by increased industrial activity, while activity in the services sector decelerated. In July, the IMF kept its April projection of Russia’s economic growth in 2024 at 3.2%, while the forecast for 2025 was revised down by 0.3 pp, to 1.5%.

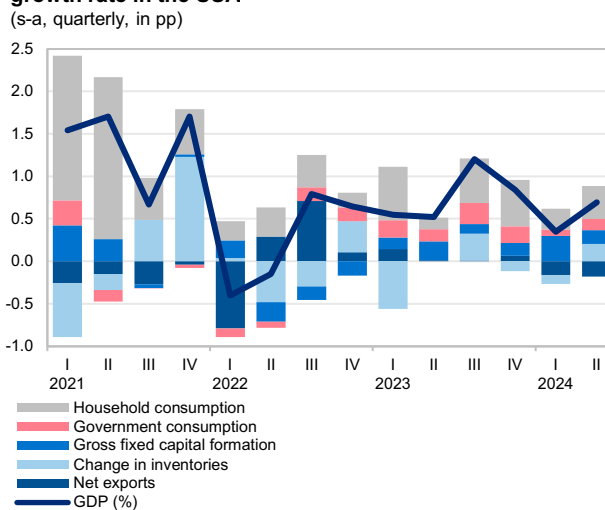
Under the impact of further fiscal incentives and increased government spending, in Q1 the **Chinese economy** grew 5.3% y-o-y. In July, the IMF made significant revisions to the April forecast of China’s growth, by 0.4 pp to 5.0%, in view of the accelerated growth in domestic consumption and exports in Q1, despite the fact that preliminary data showed that China’s GDP slowed in Q2 to 4.7% y-o-y amid somewhat subdued consumer demand.

**Chart V.0.3 Contributions of components to the real GDP growth rate in the CESEE region\***



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

**Chart V.0.4 Contribution of components to the real GDP growth rate in the USA**



Sources: U.S. BEA and NBS calculation.

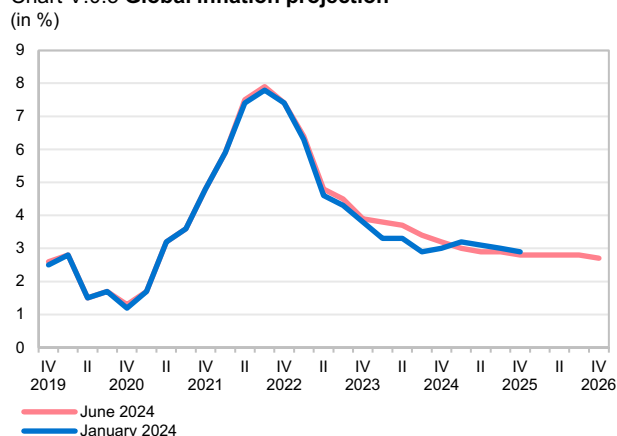
**Table V.0.2 Real GDP growth projections by country of the region for 2024 and 2025**

(in %)

	2024		2025	
	Prev. proj.	New proj.	Prev. proj.	New proj.
Poland	2.9	2.9	3.7	3.8
Czech Republic	1.2	1.2	2.8	2.7
Hungary	2.2	2.3	3.3	3.4
Romania	2.9	2.8	3.5	3.5
Slovakia	1.9	2.3	2.7	2.6
Slovenia	2.4	2.4	2.4	2.4
Croatia	2.9	3.3	2.7	2.8
Bulgaria	2.2	2.2	3.0	2.9
Albania	3.3	3.5	3.8	3.7
Bosnia and Herzegovina	2.7	2.5	3.0	3.0
North Macedonia	2.9	2.6	3.6	3.2
Montenegro	3.8	4.3	3.4	4.1

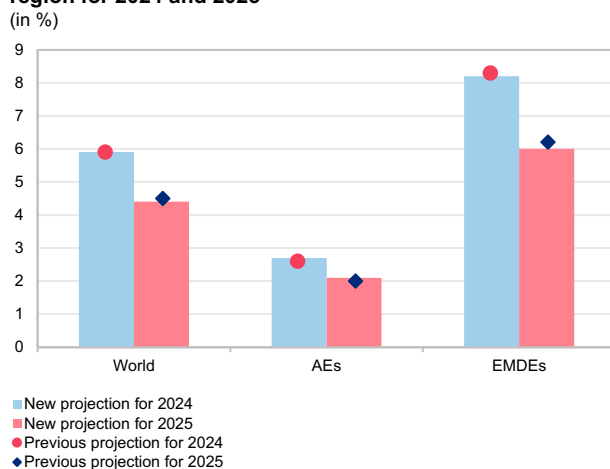
Source: Consensus Economics (April and July).

Chart V.0.5 Global inflation projection



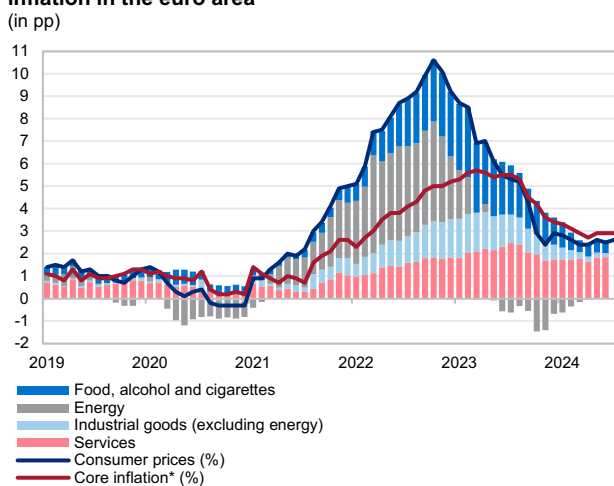
Source: World Bank (June 2024).

Chart V.0.6 Revisions of inflation projections by economic region for 2024 and 2025



Sources: IMF WEO (July and April 2024).

Chart V.0.7 Contributions of HICP components to y-o-y inflation in the euro area



Sources: Eurostat and NBS calculation.

\* HICP excluding energy, food, alcohol and cigarettes.

## Inflation

**Global inflation slowed further in Q2, though still trending above the target tolerance band in the majority of advanced countries.** In the June Global Economics Prospects, the **World Bank** underlined that it expects global inflation slowdown to continue, though at a weaker pace than in previous expectations, therefore inflation in 2024 is projected at 3.5% on average, 0.4 pp above the January forecast. In the July WEO Update, the **IMF** underlined that they still expect global inflation to decelerate further, though at a weaker pace than in the previous period due to the more persistent inflation in the services sector and higher global prices of primary commodities. Nonetheless, the IMF expects a gradual dissipation of pressures from the labour market and a decline in global energy prices, which should be conducive to a further fall in inflation. The global inflation projection for 2024 was kept unchanged relative to April (5.9%), while the projection for 2025 was revised down – by 0.1 pp to 4.4%.

During Q2, the downward trend of **y-o-y inflation in the euro area** was halted, with inflation measuring 2.5% in June, dominantly due to the moderate y-o-y growth in global energy prices and the effects of low last year's base. In June, euro area core inflation was unchanged from March (2.9% y-o-y), on account of a mild pick-up in the y-o-y prices of services and the concurrent slowdown in y-o-y growth in industrial product prices (excluding food and energy). Measured by the change in the HCPI, **y-o-y inflation in Germany** climbed to 2.5% in June (from 2.3% in March), while **y-o-y inflation in Italy** slowed to 0.9% in June (from 1.2% in March). According to Eurostat's preliminary data, y-o-y inflation in July measured 2.6% in the euro area, as well as in Germany, while in Italy it rose significantly, to 1.7%.

In June, the **ECB** underlined that pressures on inflation remained elevated, notably on account of spiralling wages, compensating for the previous inflation growth, as attested to by the increase in contracted wages in Q1 2024. Assuming a gradual wage adjustment process, the ECB expects labour costs in the near future to fluctuate. Inflation is expected to trend close to the current levels during the remainder of 2024, partly due to the base effect from energy prices, while in H2 2025 it will begin to converge to the 2% target as a result of the slowly rising labour costs, the effects of past monetary policy restrictiveness and the weakening impact of the energy crisis and the pandemic. **The ECB underlined that inflation is likely to remain above the target in 2025 as well, coming to 2% in 2026.** In view of the above, in June

the ECB revised up its March inflation forecast for 2024 from 2.3% to 2.5%, and for 2025 from 2.0% to 2.2%.

**Inflation in the US** (measured as the change in CPI) trended down during Q2, measuring 3.0% y-o-y in June. This was facilitated by the slowdown in y-o-y energy prices due to the lower prices of liquid oil gas, while the y-o-y food price growth remained the same as in March. During Q2, **core inflation** underwent an identical decrease, by 0.5 pp to 3.3%, owing to the y-o-y fall in the prices of industrial products (excluding food and energy) and slower y-o-y growth of services prices. Y-o-y dynamics similar to the CPI's was recorded by personal consumption indices in Q2 (total and excluding food and energy), which rose by 2.6% y-o-y each in June. Going forward, the **Fed** expects inflation to slow down, supported by a more efficient alignment of supply and demand in the goods and services and labour markets. Therefore in June the Fed forecast inflation at 2.7% in 2024 and 2.3% in 2025, i.e. at slightly higher levels than in March.

In the **CESEE region**, headline y-o-y inflation posted diverging movements in Q2, while core inflation was dominantly on the downward path. Even so, core inflation still trended above headline in all observed countries. After the anticipated increase in April, y-o-y inflation in the **Czech Republic** returned to the central midpoint in June (2.0%), mostly owing to the slowdown in the y-o-y growth in petroleum product prices, while y-o-y inflation in **Hungary** displayed similar dynamics. Namely, after moderate growth in April and May, it retreated to 3.7% by end-Q2, also driven by lower petroleum product prices. Y-o-y inflation in **Romania** trended down in Q2, measuring 4.9% in June on the back of the continued slowdown in food inflation and lower electricity and gas prices. In contrast, y-o-y inflation in **Poland** accelerated during Q2, equalling 2.6% in June, and is expected to continue on the upward path until end-Q1 2025 due to higher energy prices. In July, the Consensus Economics forecast average inflation in 2024 at 4.4% in Southeast European countries and at 3.3% in Central European countries, which is lower than in April, while in 2025 inflation in these regions is expected to measure 3.3% and 3.5%, respectively.

In the **Western Balkan region**, y-o-y inflation mostly trended down during Q2, thus in **Bosnia and Herzegovina** and **Albania** it dipped to 1.6% and 2.1%, respectively, in June. After going up in Q1 due to food price growth, in June y-o-y inflation edged down to 3.2% in **North Macedonia** and 4.1% in **Montenegro**.

Chart V.0.8 Revision of the euro area inflation projection for 2024 and 2025

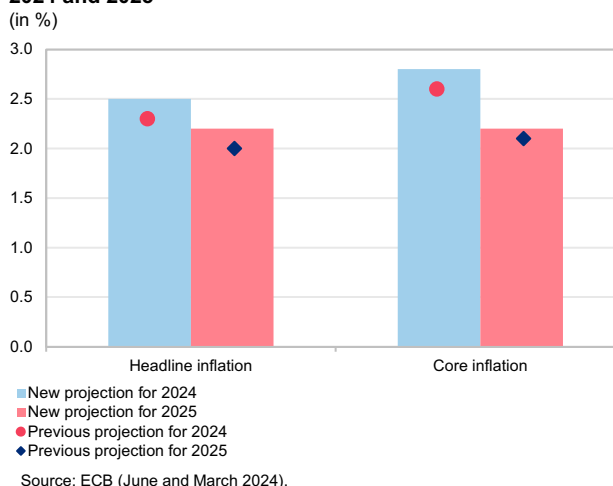


Chart V.0.9 Contributions of CPI components to y-o-y inflation in the USA

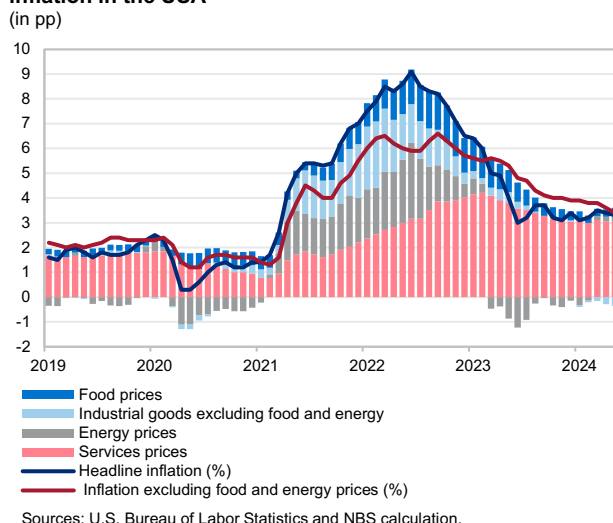
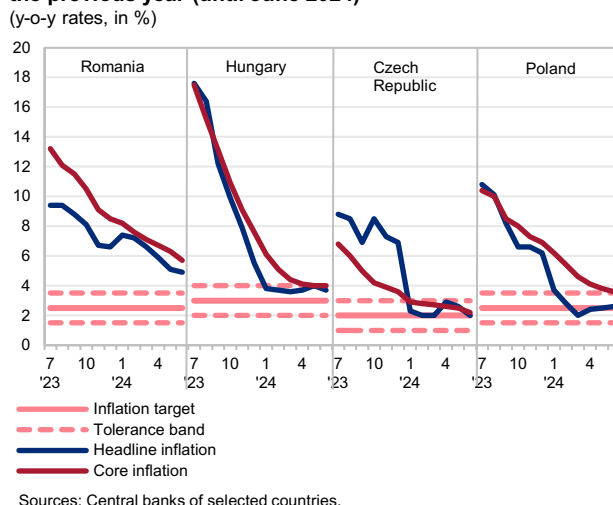


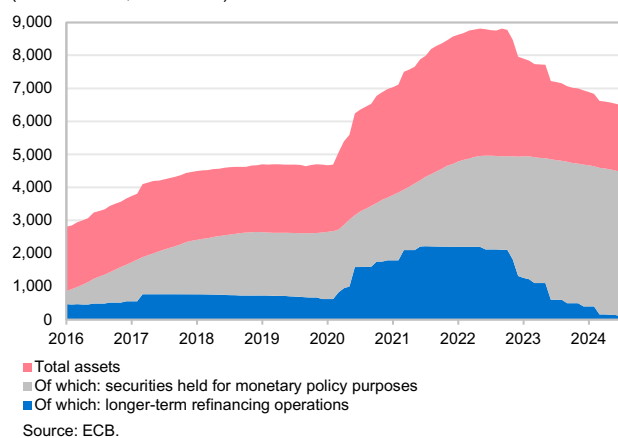
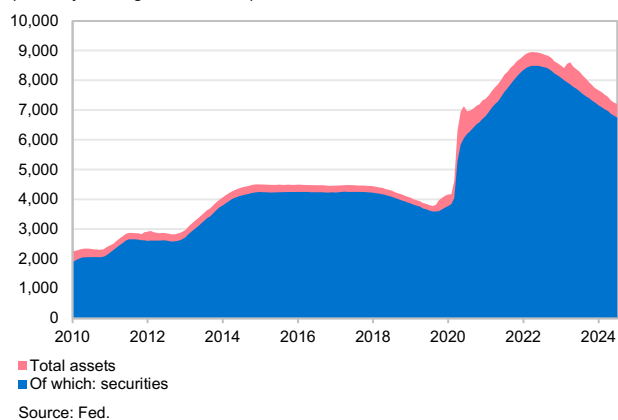
Chart V.0.10 CPI movements in selected CESEE countries in the previous year (until June 2024)



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

	July 2024		April 2024	
	2024	2025	2024	2025
Poland	3.7	4.2	3.9	3.9
Czech Republic	2.3	2.1	2.2	2.1
Hungary	4.0	3.5	4.0	3.6
Romania	5.4	3.9	5.8	3.9
Slovakia	2.8	3.2	3.1	3.0
Slovenia	2.8	2.5	2.8	2.5
Croatia	3.3	2.6	3.2	2.6
Bulgaria	2.9	2.8	3.4	3.0
Albania	2.6	2.8	3.3	2.9
Bosnia and Herzegovina	2.5	2.2	2.4	2.2
North Macedonia	3.7	2.8	3.9	2.8
Montenegro	4.7	3.1	5.9	4.0

Source: Consensus Economics.

**Chart V.0.11 Consolidated Eurosystem balance sheet**  
(end-of-month, in EUR bn)**Chart V.0.12 Fed's total assets**  
(monthly average, in USD bn)

## Monetary policy

In line with the anticipated further slowdown in inflation and convergence to the target, the majority of central banks either started or announced monetary policy accommodation in the period ahead. The **pace of monetary relaxation will be somewhat slower than anticipated at the start of the year**, considering central banks' assessments that inflationary pressures still mandate caution.

The **ECB's** decision to embark on monetary policy accommodation in June by trimming the rates by 25 bp each, to 3.75% on the deposit facility rate, 4.25% on main refinancing operations rate and 4.50% on lending facility rate, was made primarily in view of the weakening of cost-push pressures and inflation slowing down, which was greatly facilitated by the previously tightened monetary policy and the subsequently tightened financial conditions. At the conference following the June meeting, the ECB President Christine Lagarde stressed that the cuts in key interest rates do not mean that the rates will undergo further consecutive cuts and in the July meeting, the key interest rates were kept unchanged. The ECB said it would ensure that interest rates remain restrictive for as long as necessary for inflation to return to the target in a sustainable manner and in the medium term. Despite the progress achieved, it was noted that cost-push pressures in the local labour market remain strong, keeping inflation in the services sector relatively high, which mandates caution in monetary policy conduct. Accordingly, market participants expect new cuts in September and December, but possibly only at the end of the year, as inflation in the services sector has still not retreated.

The ECB continued to unwind its balance sheet as planned, at a moderate pace. The downsizing of the portfolio of securities purchased within the **Asset Purchase Programme (APP)** continued, as the ECB is no longer reinvesting the principal payments from maturing securities. As for the **Pandemic Emergency Purchase Programme (PEPP)**, the ECB is no longer reinvesting the principal payments from maturing securities in full, and during H2 it started to gradually downsize the portfolio at the monthly pace of EUR 7.5 bn on average 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 **targeted longer-term refinancing operations (TLTROs)**, on monetary conditions.

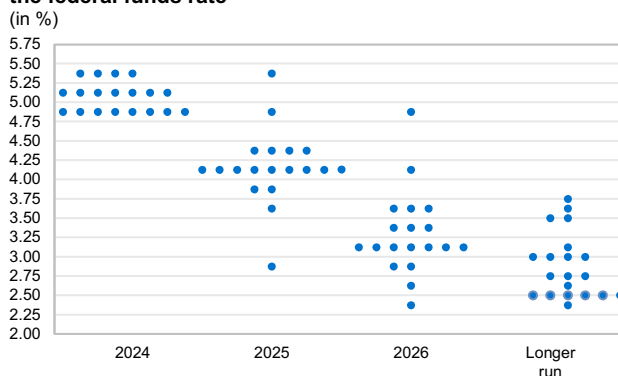
Unlike the ECB, the **Fed** kept the federal funds rate unchanged (5.25–5.50%) in June, for the seventh time in a row. It also proceeded with the downsizing of its

balance sheet assets. The report from the meeting said that the sound economic growth in the USA continued, employment numbers remained strong and the unemployment rate low, while inflation was moderated in the prior year, though it remains elevated. The report also noted a major change relative to the prior one, as it stressed that over the past several months moderate progress was achieved toward reaching the 2% inflation target (in place of the previous statement that no progress had been made). The federal funds rate was unchanged in the July meeting, but the report stated that progress was made in terms of reaching the inflation target, which market participants interpreted as an announcement of future federal funds rate cuts. The Fed will continue 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 their objectives.

As the first among leading central banks to trim its policy rate in March, the **Swiss National Bank** cut its rate again in June, by 25 bp to 1.25%. This move had been anticipated by market participants, given the appreciation of the Swiss franc and the relatively low inflation (according to central bank projection of 1.3% in 2024 and 1.1% in 2025, provided that the policy rate remains 1.25%). After the first raise since 2007, to 0–0.1% in March, whereby it left the negative territory, the **Bank of Japan’s** policy rate was lifted again in July, to around 0.25%. The **Bank of England** did not change its 5.25% policy rate, noting that it would monitor how long the policy rate should be kept at the present level.

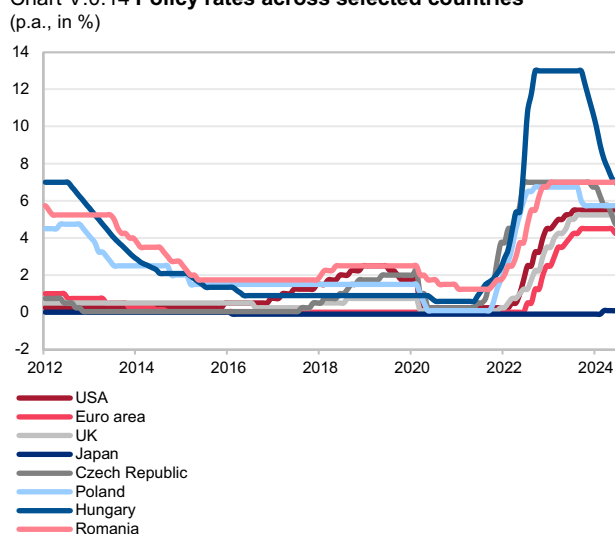
Of the inflation targeting central banks in the **CESEE region**, the **central bank of the Czech Republic** trimmed its policy rate the most in the past three months, by 50 bp in May and June each, to 4.75%, thus exceeding market participants’ expectations. The central bank underlined the continued slowdown of inflation and subdued economic activity as the main reasons behind such decisions. Considering the risks to inflation movements amid price growth in the services sector, the Czech central bank’s governor highlighted that the pace of monetary policy accommodation will probably be reined in at upcoming meetings, as well as that there is a possibility, depending on data, to make a pause in the cycle of policy rate cuts. The **central bank of Hungary** also continued trimming the rate, by 25 bp each in June and July, to 6.75%. These are the smallest cuts since the monetary relaxation began last October. The pace of monetary policy easing is expected to slow further, bearing in mind statements by central bank officials that there is very little room for policy rate cuts in the

Chart V.0.13 FOMC participants’ expectations of adequate monetary policy: midpoint of target range or target level for the federal funds rate



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

Chart V.0.14 Policy rates across selected countries

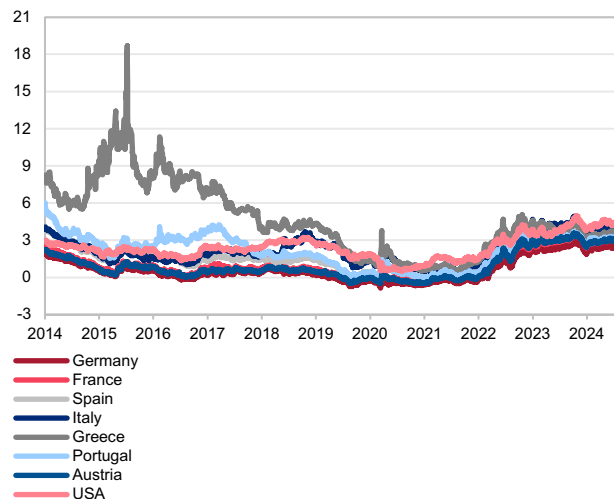


Sources: Central banks of selected countries.

remainder of the year. The **central bank of Romania** also trimmed its policy rate in July – the first cut since January 2021 – by 25 bp to 6.75%. The central bank’s inflation projection is lower than last year’s, hence in the period ahead further cuts can be expected. Still, uncertainty as to the character of the fiscal policy, dynamics of public sector wages and effects of the new pension law mandate caution.

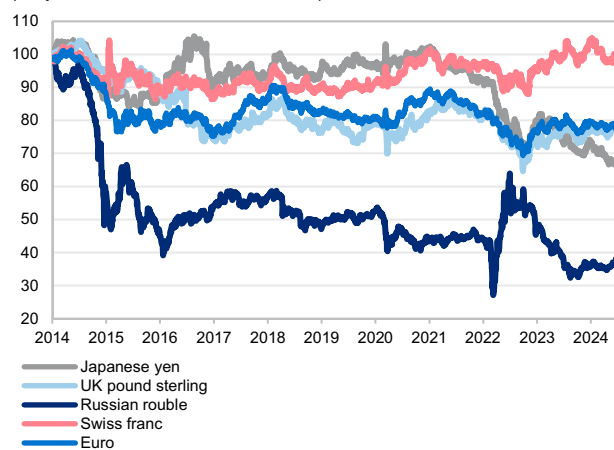
After last October’s cut to 5.75%, the **central bank of Poland** kept its policy rate on hold, in line with expectations. Though inflation is trending within the bounds of the target tolerance band, the central bank is anticipating a pick-up in price growth in H2, triggered by the strong labour market, and dismisses the possibility of further policy cuts this year. Over the past three months, **the central bank of Turkey kept its policy rate on hold**, at 50.0%. The extremely tight lending conditions and persistently high inflation in the services sector are acting as a drag on domestic demand, however, inflation expectations are elevated. Though in June, for the fourth straight month, the policy rate was kept at 16%, the **central bank of Russia** underlined that the rate might be raised in the following meeting, which indeed transpired in July – the rate was raised by 200 bp to 18%. Domestic demand still exceeds supply due to the conflict in Ukraine and Western sanctions, which resulted in disruptions in value chains and the local labour market.

Chart V.0.15 Yields on ten-year bonds of euro area countries (daily data, in %)



Source: Bloomberg.

Chart V.0.16 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 and the USA** rose mildly in Q2, on average by 31 bp and 20 bp, respectively, largely on the back of the more conservative expectations of market participants as to the future cuts of the ECB and Fed’s interest rates.

During Q2, the **dollar gained vis-à-vis the euro** in the international financial market, which can be associated with the relatively better performances of the US economy whose labour market still shows high resilience compared to the more moderate economic rebound in the euro area. Uncertainty as to developments surrounding the French elections also contributed to the weakening of the euro.

The global oil price displayed volatile movements in the past months. After reaching this year’s maximum of USD 93 per barrel in mid-April due to elevated geopolitical tensions in the Middle East, depleted inventories and expectations of growth in global demand, the **global Brent oil price** trended down and measured USD 76 per barrel in early June, on account of OPEC+ announcement

of the gradual reduction of the voluntary production cap as of October, defused geopolitical tensions and expectations that the Fed could keep interest rates high for a longer period than what was forecast earlier. The global oil price rose again afterwards, reflecting depleted inventories in the USA and the fall in oil and gas export from Norway to Europe due to the damaged pipeline. Thus, it reached around USD 89 per barrel in early July and then edged down to around USD 79 per barrel at end-month, dominantly under the impact of the Chinese economy’s weaker performance in Q2. Quarter-wise, the price of oil averaged around USD 85 per barrel in Q2, up by 2.2% from Q1. The US Energy Information Administration anticipates that Brent oil price will trend higher until February 2025, when it will equal around USD 89 per barrel, thereafter trending down until end-2025, averaging around USD 83 per barrel in December. In contrast, the Consensus Economics expects the global oil price to measure around USD 85 per barrel in Q3 and then descend to around USD 78 per barrel by end-2025. Similar expectations are included in our projection – Brent oil price of around USD 80 per barrel at end-2024 and around USD 78 per barrel at end-2025.

**The benchmark price of natural gas for Europe (Dutch TTF hub)** trended up during Q2, averaging around EUR 32 per MWh (equivalent to around USD 365 per 1,000 cubic metres)<sup>11</sup> or up by 16.2% from Q1, though still 9.2% lower in y-o-y terms. The factors underpinning the natural gas price growth included elevated geopolitical uncertainty, increased demand for liquid gas in Asia, and the seasonal maintenance of refineries and the unexpected disruptions of the Norway terminal. Conversely, the natural gas price went down in July, dominantly under the impact of high filling levels in gas storage facilities, and measured around EUR 32 per MWh on average. Based on market futures, we expect the natural gas price to continue moderately up until end-Q1 2025, when it will measure around EUR 39 per MWh, and with certain seasonal oscillations it will hold a similar course in the remainder of the year as well. The Consensus Economics expects the gas price to trend slightly lower, equalling around EUR 36 and EUR 34 per MWh at end-2024 and 2025, respectively.

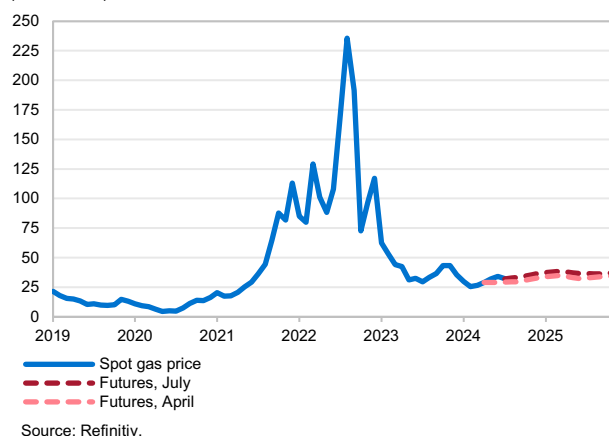
**The benchmark price of electricity for Europe (German stock exchange)** moved steadily up during Q2, averaging around EUR 71 per MWh, up by 2.6% from Q1, but 26.4% lower than in the corresponding period the previous year. Factors driving the price of electricity up

Chart V.0.17 Assumption for Brent oil prices (USD/barrel)



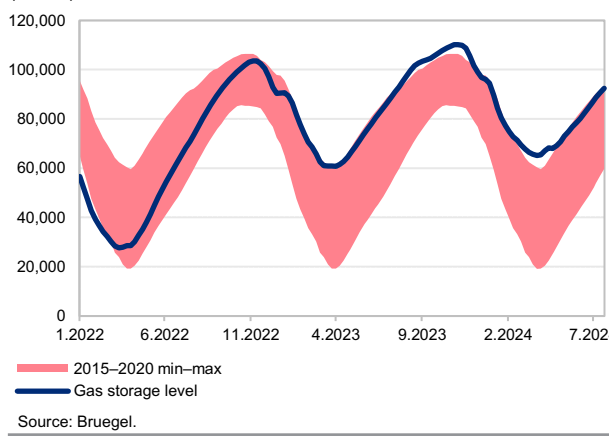
Source: Bloomberg.

Chart V.0.18 European price of natural gas (EUR/MWh)



Source: Refinitiv.

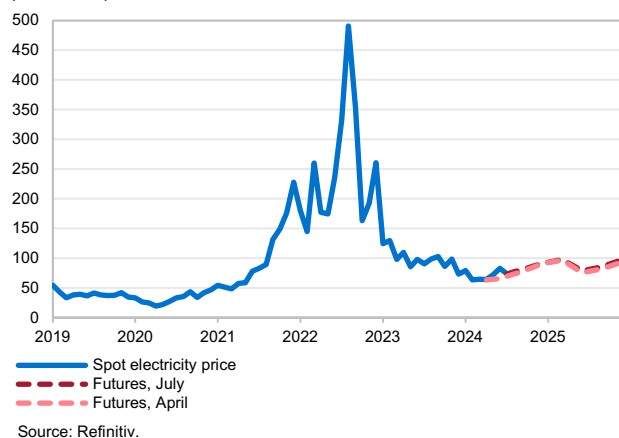
Chart V.0.19 EU gas storage levels (mn m³)



Source: Bruegel.

<sup>11</sup> 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 m<sup>3</sup>).

Chart V.0.20 European price of electricity (EUR/MWh)



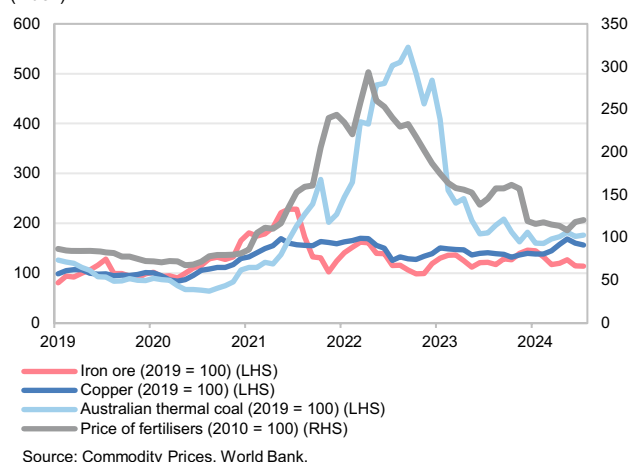
include the higher price of natural gas, rising demand due to high temperatures, and subdued electricity output in wind farms. The price of electricity in the Hungarian stock exchange displayed similar dynamics, measuring around EUR 81 per MWh on average in Q2. In contrast, the electricity price in the German stock exchange retreated in July, averaging around EUR 74 per MWh, while the price in the Hungarian stock exchange continued up amid high temperatures and decreased net transfer capacity with the neighbouring countries, reaching an average price of around EUR 145 per MWh. According to market futures, the price of electricity will mirror the natural gas price and rise to around EUR 98 per MWh until end-Q1 2025, similarly to the level at which it will trend at the end of the year.

Amid stepped-up demand in China and Europe, as well as tighter US sanctions on the import of Russian coal, **thermal coal price** trended up in April and May, edging down moderately in June when it averaged around USD 135 per tonne. Even so, the coal price was 2.7% above the end-of-March level, or 3.1% lower in y-o-y terms. In July, the thermal coal price rose moderately (by 1.8% from June), notably due to increased electricity demand. The Consensus Economics expects the coal price to remain largely unchanged until end-2024, thereafter edging down to around USD 118 per tonne by end-2025.

Having dipped in April and May due to lower input prices and brighter production prospects, the **global prices of mineral fertilizers** went up in June. Still, their Q2 average was 2.5% lower than in Q1. The prices trended moderately up in July, mostly on account of the higher prices of triple superphosphate and urea. Going forward, mineral fertilizer prices could be affected by the dynamics in the prices of key inputs, natural gas and sulphur, as well as China's renewed export.

**The global prices of metals and minerals** rose in April and May due to tighter EU and US sanctions on metal import from Russia and market participants' fear of copper shortages in the coming period, but took a dip in June amid alleviated concerns over the shortage and increased metal inventories in the London stock exchange. The economic slowdown in China had a dominant impact on the prices of most metals, driving them further down in July. The Consensus Economics expects a moderate decline in metal prices in Q3, as well as their recovery by the end of next year, while the index

Chart V.0.21 Selected commodity prices in the global market (index)





of global prices of basic metals<sup>12</sup> will be 1.8% higher at end-2025 than at end-2024.

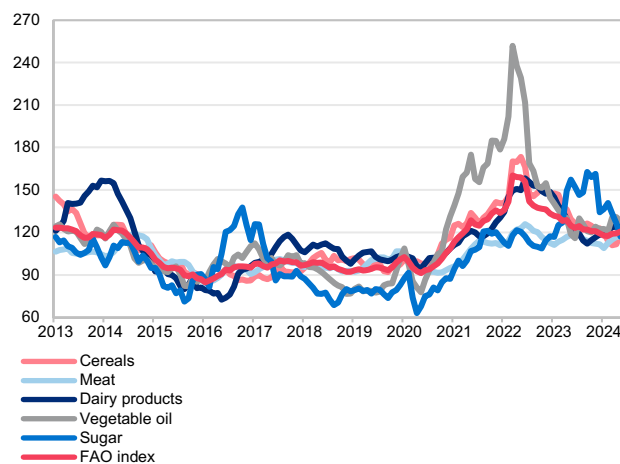
**The global food prices, measured by the FAO index,** rose slightly during Q2 and were 1.7% higher in June relative to March, while in y-o-y terms they were 1.8% lower. This is attributable to almost all food categories, notably the higher prices of cereals (3.9%), followed by the prices of dairy (3.1%), meat (2.7%) and vegetable oils (1.0%). In contrast, sugar prices were 10.5% lower in June compared to March. In July, global food prices dipped slightly, by 0.2% m-o-m, mostly due to the lower prices of cereals. Also, Q2 saw higher global prices of cocoa and coffee, which were 16.7% and 18.9% higher than in March, respectively.

Having been raised in April and May, dominantly under the impact of adverse weather conditions and uncertain yields in key production regions of the northern and southern hemispheres, the prices of **primary agricultural commodities** retreated in June, reflecting the fall in the price of oil at the start of the month, improved weather, and the wheat and barley harvests in the northern hemisphere. The global prices of cereals mirrored the weather conditions and forecasts of new yields in July as well, with the price of wheat going down and corn up. According to our projection, based on market futures, the prices of primary agricultural commodities will be 3.3% lower at end-2024 than at end-2023, while posting moderate growth in 2025 and ending the year 5.4% above the end-2024 level.

### Internal assumptions

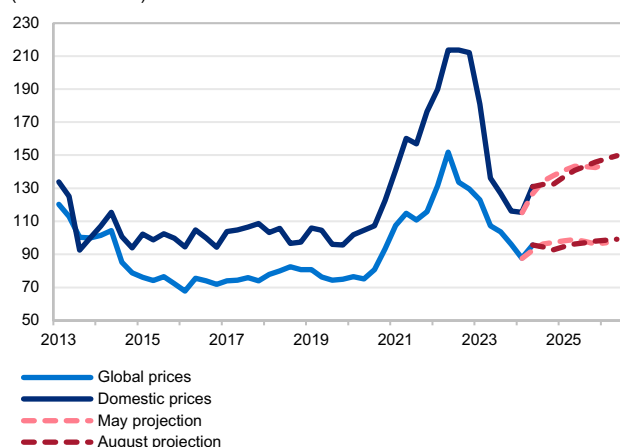
According to futures, the world prices of **primary agricultural commodities** are not likely to change significantly this year – we expect the same for the prices of primary agricultural commodities at home, which in general follow the movement of world prices. In view of the available SORS data about the expected reduction in wheat production by around 16%, a decline in the production of some types of fruit (raspberries and sour cherries by 5% each), and weather conditions during summer months, we slightly revised down the estimate of this year’s agricultural season, which is now assumed to fall by around 2%. According to SORS estimates, the decline in wheat production is largely due to lesser sown surfaces, while the surfaces sown with corn, sugar beet, sunflower and soy increased. A moderate decline in

Chart V.0.22 **World Food Price Index**  
(in nominal terms, 2014–2016 = 100)



Source: UN FAO.

Chart V.0.23 **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.

<sup>12</sup> 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).

agricultural production this year should not jeopardise the expected relative stability of the prices of primary agricultural commodities in Serbia. The next two years are likely to see a moderate rise in primary agricultural commodity prices, amid a mild rise in agricultural production, reflecting the effects of equipment modernisation and enhanced application of agrotechnical measures, owing, among other things, to higher government subsidies to the agricultural sector.

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, with no adjustments planned for this year, consistent with the expectations from our previous projection. Thus, we expect administered price growth to amount to 4.6% this year, reflecting the adjustment of excises on cigarettes, coffee, alcoholic beverages and petroleum products, and a rise in utility prices. We project administered prices to grow by 6.5% in 2025 and 5.5% in 2026, 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, with the growth likely to 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, also supported by the hitherto government's increases of wages and pensions. We expect private sector wages to rise consistently with rising GDP and employment, with the outlays for employees in the public sector remaining at around 10% of GDP. Consumer demand will also be propped up by remittances, projected at a similar level as last year (EUR 5 bn). Disposable household income should increase on the back of further easing of credit standards and falling interest rates – as was the case with new dinar cash loans, which saw record disbursements in H1 2024 – including 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).

In the first six months of 2024, the **consolidated** government surplus amounted to RSD 33.2 bn, or 0.8% of GDP<sup>13</sup>, while the surplus on the primary fiscal balance

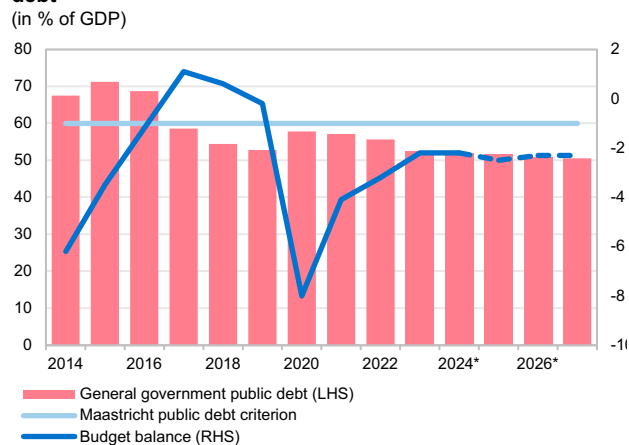
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<sup>13</sup> Nominal GDP in H1 2024 is based on the published SORS data for Q1 and the NBS estimate for Q2.

came at RSD 131.8 bn or 3.1% of GDP. The estimate of the consolidated **government deficit** for 2024 remained unchanged compared to the previous plan (2.2% of GDP), with slight upward revisions, of 0.1 pp each, of both revenue and expenditure. The adjustment of public revenue (to 42.7% of GDP) was led by better than expected revenue performance in the year so far, while the revision of expenditure (to 44.9% of GDP) was led by higher capital investment in public infrastructure (by 0.5 pp to 7.3% of GDP) and higher current expenditure for social aid and transfers to households, which was made possible with the re-channelling of unused funds intended for the energy sector. Despite the elevated planned government expenditure, the estimated fiscal impulse<sup>14</sup> for 2024 is negative (-0.4), which implies a mildly restrictive effect of fiscal policy on aggregate demand, and therefore on inflation. General government public debt is projected at 52.0% of GDP in 2024.

The Fiscal Strategy for 2025 with Projections for 2026 and 2027 defines a **medium-term fiscal framework**, envisaging the intensification of public investment in infrastructure (primarily road and rail) within the “Leap into the Future – Serbia Expo 2027” programme, whose total estimated value equals almost EUR 18 bn. The new fiscal programme will envisage an increase in the share of **government capital expenditure** to a range of 7.3–7.5% of GDP in 2025 and 2026 from the 6.6–6.8% planned by the Revised Fiscal Strategy for 2024 with Projections for 2025 and 2026. The projections of the **general government deficit** for 2025 were revised up – to 2.5% of GDP, while in the next two years, however, it is expected to decline moderately, to 2.3% of GDP. Still, the widening of the deficit will not jeopardise the downward trajectory of public debt, which is likely to decline to around 50% of GDP. Under our estimate, the **fiscal impulse** will be almost neutral this year, which means fiscal policy measures are not likely to produce any inflationary effect. Investment in the modernisation of public infrastructure will give a significant boost to economic growth, which, along with preserved macroeconomic and fiscal stability, should positively affect **Serbia’s credit rating and a further reduction in the country’s risk premium**.

Chart V.0.24 **Budget balance and general government public debt**

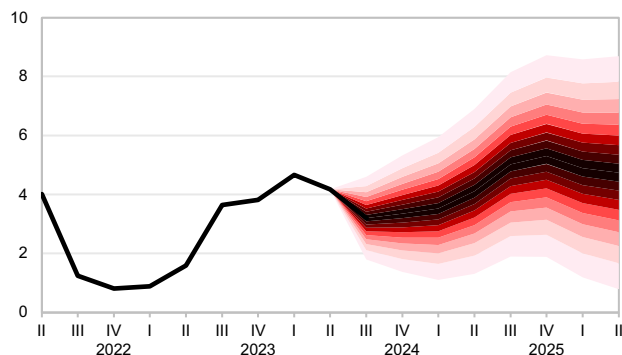


Source: Ministry of Finance.

\* Projection from the Fiscal Strategy for 2025 with Projections for 2026 and 2027.

<sup>14</sup> A derived variable, whose positive/negative values signal an expansionary/restrictive effect of fiscal policy on aggregate demand and thus on inflation. It is calculated as a difference between two consecutive structural fiscal results, obtained by excluding the fiscal balance components that are not the result of the current character of fiscal policy, but may be the consequence of cyclical movements in the economy or one-off effects that do not impact aggregate demand. For more details see the *Inflation Report – November 2023, Text box 3*.

Chart V.0.25 GDP growth projection  
(y-o-y rates, in %)

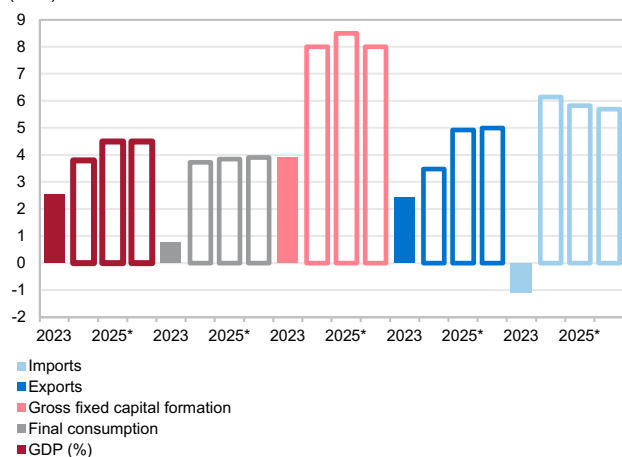


Source: NBS.

## GDP projection

According to the SORS flash estimate, in Q2 GDP growth amounted to 4.2%, exceeding our expectations from May. On the expenditure side, GDP was led primarily by elevated private consumption and investment, and on the production side – by service sectors, construction and manufacturing. As GDP growth in H1 turned out to be higher than we initially expected, in our new projection we raised the GDP growth rate for this year to 3.8%, from 3.5%, which we projected in May. The 2024 growth is also driven by the carry-over effect from 2023, estimated at around 1.5 pp.

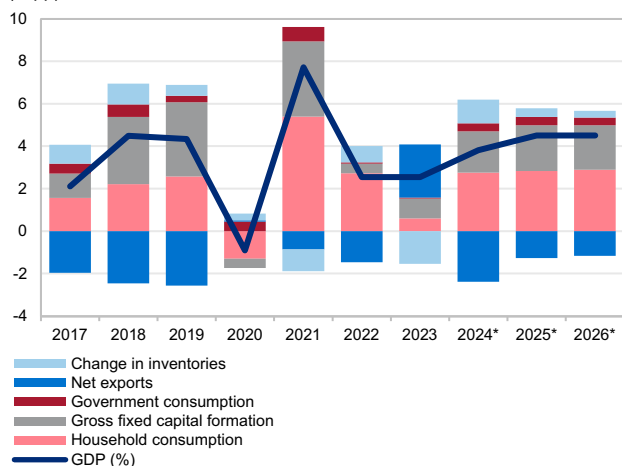
Chart V.0.26 Real growth in GDP and its components, expenditure side  
(in %)



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

Given the outturns since the start of the year, the growth structure did not change significantly compared to the May projection, but the contribution of individual categories was slightly revised. 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 May, reflecting a continued rise in employment and wages, notably in the private sector. However, since productivity is set to grow as well, no major inflationary effect will be generated. The contribution of fixed investment was also revised up, in accordance with the current investment cycle, underpinned, among other things, by continued high FDI inflows and preserved investment confidence. Further investment growth will also be supported by generally subdued global inflationary pressures, more favourable financing conditions, and the implementation of projects in transport, energy and utility infrastructure. Despite the anticipated further export growth in 2024, primarily owing to investment in export sectors in earlier years, we projected faster import growth in the context of the expected further acceleration of investment and personal consumption. This will result in a negative contribution of net exports to GDP growth in 2024.

Chart V.0.27 Contributions to real GDP growth  
(in pp)



Sources: SORS and NBS.  
\* NBS estimate.

The projections for 2025 and 2026 are unchanged from May – we expect GDP to step up further, to a 4.0–5.0% range, with the central value of 4.5%. The economic acceleration 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.

According to the August projection, **private consumption**, with the highest share in GDP composition, is likely to provide the strongest positive contribution to economic growth, of 2.8 pp in 2024 (and likewise in the next two years). As the key consumption

indicators further improved in Q2 compared to the quarter before, the projected rise in this component is somewhat higher than we expected in the May projection. In 2024 and the years to come, personal consumption will be led by the continued rise in wages (notably in the private sector) and employment, 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. This is why the projected growth in private consumption in 2024 and beyond is likely to move around or below the projected GDP growth, contributing to medium-term price stability. At the same time, real disposable household income will be driven by inflation's decline and lower housing loan repayment costs after the NBS temporarily capped the interest rates until end-2024. Moreover, the start of monetary policy easing by the NBS and the ECB will also reflect on generally more favourable financing conditions, underpinning further lending growth and, by extension, a rise in disposable income.

Under the August projection as well, we expect **government spending** to continue to positively impact GDP growth, adding around 0.4 pp in 2024 and the next two years, taking into account the planned wage expenditure and rising outlays for goods and services under the announced “Leap into the Future – Serbia Expo 2027” programme.

Compared to the May projection, we now expect **private investment** to grow somewhat faster in 2024 and give a higher, 1.4 pp contribution, to GDP. The contribution of investment is projected to increase in the years to come as well, to around 1.5 pp in 2025 and 1.7 pp in 2026. The outturns in Q2 improved further, confirming that investment activity continues to grow at a positive pace, reflecting preserved investment confidence, a favourable domestic growth outlook, and proven resilience to negative external shocks in the prior period. Moreover, subdued global inflationary pressures and the expected easing of financing conditions will enhance the overall investment sentiment, positively affecting domestic and cross-border investment loans. Own capital will remain the main source of financing private investment, as a result of increased corporate profitability in the past years. Namely, according to preliminary data of the Business Registers Agency, net corporate profit in 2023 was higher by as much as 12.3% compared to 2022. Rising at a steady pace in the year to date, FDI will remain a significant contributor to investment. In parallel with rising private investment, **government investment** is expected to step up, contributing somewhat more, i.e.

Chart V.0.28 Rate of growth in private consumption and its sources

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

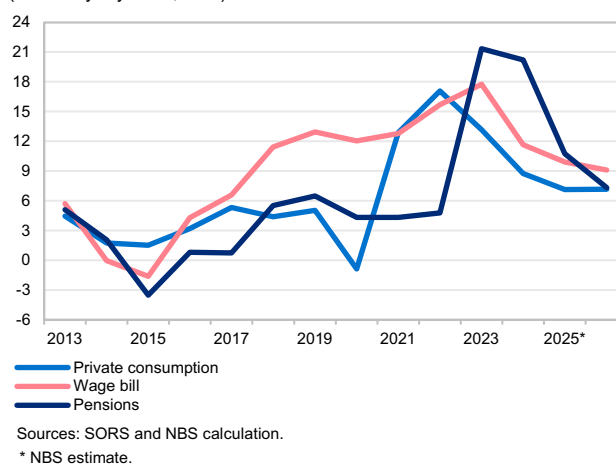
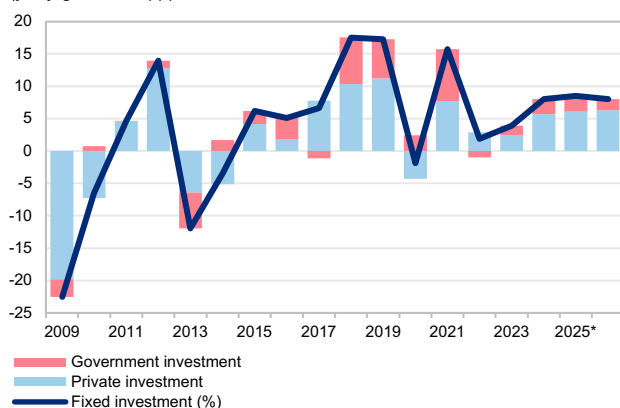


Chart V.0.29 Fixed investment

(y-o-y growth, in pp)



Sources: SORS and NBS calculation.

\* NBS estimate.

Table V.0.4 Projects within the “Leap into the Future – Serbia Expo 2027” programme

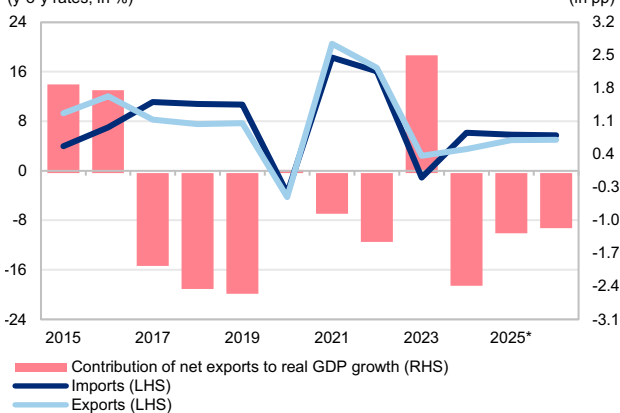
(in %)

Project	Project No	Value (in EUR bn)
1. EXPO, infrastructure for new city quarters, Aquatic Park, Zemun-Airport-Expo railway, housing complex with 1,500 units and new quay on the Sava	6	1.3
2. Infrastructure	121	11.4
2.1 Road infrastructure	13	5.3
2.2 Local roads		2.0
2.3 Railway infrastructure	11	2.0
2.4 Water and air transportation	97	2.2
3. Industrialisation	81	3.3
4. Urban modernisation	97	1.7
5. Integral development and tourism	18	0.1
<b>TOTAL</b>	<b>323</b>	<b>17.8</b>

Source: Fiscal Strategy for 2025 with Projections for 2026 and 2027.

Chart V.0.30 Real export and import growth

(y-o-y rates, in %)



Sources: SORS and NBS.

\* NBS estimate.

0.6 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 similar as in 2024.

Just as the previous one, the August projection assumes a gradual replenishment of **inventories** in 2024 and beyond as a bulk was used for domestic consumption and a part for exports last year. The inventories are rising also on the back of carried-over inventories of agricultural commodities owing to last year’s good agricultural season.

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. Last year’s good agricultural season, particularly of autumn crops, resulting in higher yields of primary agricultural commodities which significantly exceeded domestic needs, has been underpinning agricultural exports in the year to date. Overall export growth will also be spurred by manufacturing exports. We expect the positive trends in foreign trade to continue in 2024 and beyond, 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 goods and services imports compared to exports, notably of equipment, whose imports rose vigorously in H1. Expanding disposable income is driving a rise in personal consumption and consumables imports, as also confirmed by data on the outturns in the year so far. All this will result in a negative contribution of **net exports** in 2024: -2.4 pp in the new projection. On the other hand, we expect exports to accelerate in the coming years amid the expected recovery of the euro area and elevated external demand, while imports are likely to rise at a somewhat slower pace (given this year’s high base). These trends result in a smaller negative contribution of net exports of around 1.2–1.3 pp in 2025 and 2026.

We have not significantly changed the **projection of Serbia’s external position** compared to May, as balance of payments trends in the year to date are in line with the projection. Taking into account the expected acceleration

of the investment cycle, at the time we also projected the current account deficit to move around 4% this year, and around 5% of GDP in the medium run. Our current expectations are the same.

Faster real growth in goods and services imports compared to exports this year and beyond will lead to a higher foreign trade deficit than in 2023, but this will be partly neutralised by a faster rise in export compared to import prices. 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 close to an average pre-pandemic level. As net FDI inflows are expected at around 5–6% of GDP, the yield based on their ownership will remain a solid expenditure item on the primary income account, whose deficit will move around 6% of GDP. FDI inflows are expected to remain broad-based in terms of geography and project, with the bulk remaining channelled to export-oriented sectors.

It is worth noting that, just as in the past nine years, the current account deficit is estimated to be fully covered by net FDI inflows, ensuring external sustainability.

The same as in the May projection, the new projection assumes that, on the production side, GDP growth will continue to be led by service sectors, whose contribution in 2024 was revised slightly up – to 2.3 pp (the contributions in 2025 and 2026 equal 2.6 and 2.8 pp, respectively), 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 start of monetary easing. Consistent with faster growth in consumption and service sectors (resulting in improved tax revenue collection), according to the new projection, a somewhat higher positive contribution to GDP growth is estimated to come from **net taxes**, of around 0.6 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 August projection as well. The strongest positive impetus is expected from **construction** (0.5 pp in 2024), with economic activity indicators suggesting a better than initially assumed outcome. Further economic growth will be supported by the planned implementation of transport, energy and utility infrastructure projects. An impulse will also come from the **industry’s manufacturing segment** (0.3 pp) as new capacities are expected to be activated and the existing ones expanded.

A moderately positive contribution is also likely to come from **mining** owing to higher coal and metal ore (notably

Chart V.0.31 **Current account and FDI projection**  
(in % of GDP)

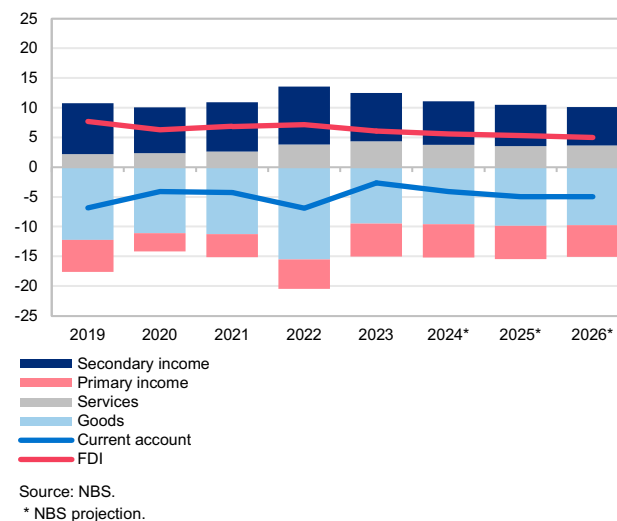


Chart V.0.32 **Contributions to real GDP growth, production side**  
(in pp)

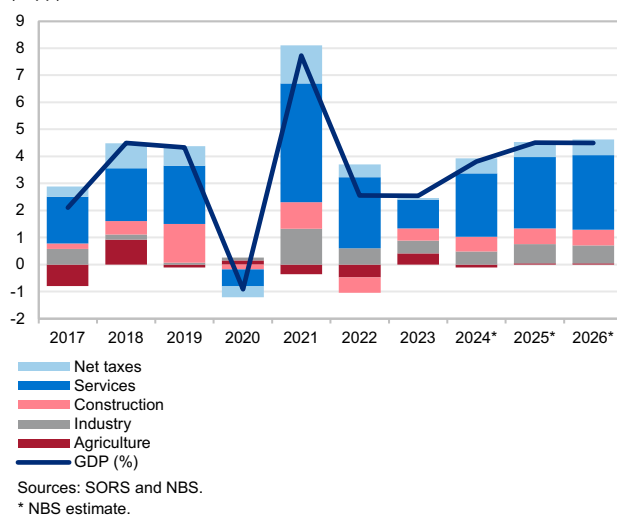


Table V.0.5 Key projection assumptions

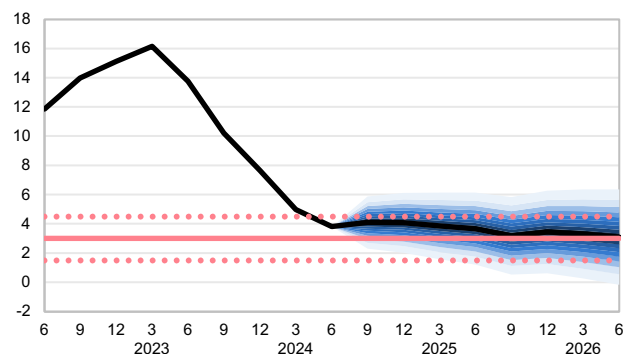
	2024		2025		2026	
	May	Aug.	May	Aug.	May	Aug.
<b>External assumptions</b>						
Euro area GDP growth	0.6%	0.7%	1.5%	1.4%	1.6%	1.5%
Euro area inflation (average)	2.3%	2.4%	2.0%	2.0%	1.9%	1.9%
3M EURIBOR (December)	3.2%	3.3%	2.3%	2.4%	2.3%	2.3%
International prices of primary agricult. commodities (Q4 to Q4)*	1.1%	-3.3%	-1.0%	5.4%	-7.8%	2.8%
Brent oil price per barrel (December, USD)	84	79	82	78	80	76
<b>Internal assumptions</b>						
Administered prices (Dec. to Dec.)	4.3%	4.6%	6.5%	6.5%	5.5%	5.5%

\* Composite index of soybean, wheat and corn prices.

Sources: ECB, Consensus Economics, Euronext, CBOT, Bloomberg and NBS.

Chart V.0.33 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 outcomes 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%.

copper) exploitation, while energy, due to reduced production in H1 (by 4.7% y-o-y), will probably have a mild negative contribution at the annual level. In following years, a positive contribution is also expected from the energy sector as a result of the structural reforms planned in accordance with the arrangement with the IMF, and the launch of a new facility in the Kostolac thermal power plant late this year. In light of the estimates of lower production of wheat and some fruit types, including bad weather conditions during the summer, the new projection assumes a mild negative contribution of **agricultural production** to GDP growth. In contrast, moderate growth in agricultural production in the years to come is likely to reflect equipment modernisation and enhanced implementation of agrotechnical measures, supported by higher government subsidies to the agricultural sector, assuming an average season. 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. Within manufacturing, GDP growth will probably be propped by the automobile industry as well, owing to the start of production of electrical vehicles in Kragujevac.

## Inflation projection

Under the August central projection, **y-o-y inflation is likely to continue to move within the bounds of the target tolerance band (3±1.5%) until the end of the projection horizon**. After a temporary increase in July, when it came close to the upper bound of the tolerance band amid a series of one-off hikes, inflation is expected to slow to around 4% at end-2024, only to gradually converge to the 3% central midpoint during 2025. The key factors behind inflation’s slowdown include: still tight monetary conditions, lower imported inflation and inflation expectations, the anticipated gradual slowdown in real wage growth and the expected fall in global oil prices, in line with futures. The one-off July hikes of the prices of industrial food products (bread, coffee, confectionery) and of some services (tolls, package delivery) are the main reason why our new inflation projection is somewhat higher than the May one. Other reasons include somewhat higher domestic demand (the disinflationary impact of domestic demand was weaker than expected three months ago) and imported inflation declining more gradually than anticipated three months ago.

As inflationary pressures were subsiding, most central banks, including the NBS, embarked on the monetary policy easing cycle. In June, the ECB began to trim its



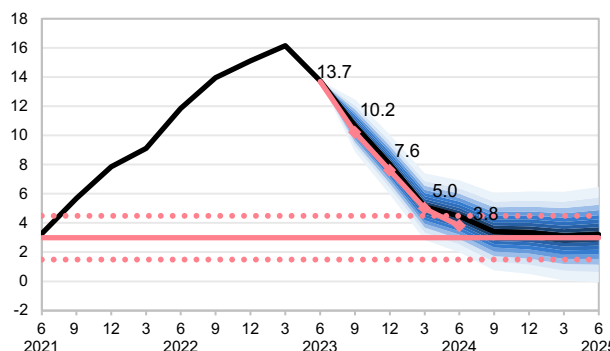
key rates, and the Fed is expected to do that somewhat later in the year. **Although the NBS began to ease monetary policy in June and continued in July – by cutting the key policy rate by 25 bp each month, monetary policy remains restrictive, on account of subdued inflation expectations (one-week BELIBOR was around 2% in Q2, in real terms).**

The NBS Executive Board carefully calibrated its measures, aiming, first of all, to impact **inflation expectations of market agents**, i.e. speed up their return within the target band and ensure that inflation strikes a sustainable downward path. Inflation expectations declined particularly sharply in the financial sector. Short-term expectations of this sector have been anchored within the NBS target tolerance band since the start of the year, and medium-term expectations for quite some time. As current inflation declines, inflation expectations of other sectors are likely to subside as well.

As in the prior projections, a key assumption underpinning the anticipated downward inflation trajectory in Serbia is the **continued decrease in imported inflation**. Euro area inflation will continue to slide, at a **more moderate pace than expected three months ago**, mainly due to somewhat higher than anticipated core inflation. Imported inflation will subside under the impact of both supply- and demand-side factors. On the supply side, 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 still have a disinflationary effect and are likely to remain elevated, in real terms, for a while yet.

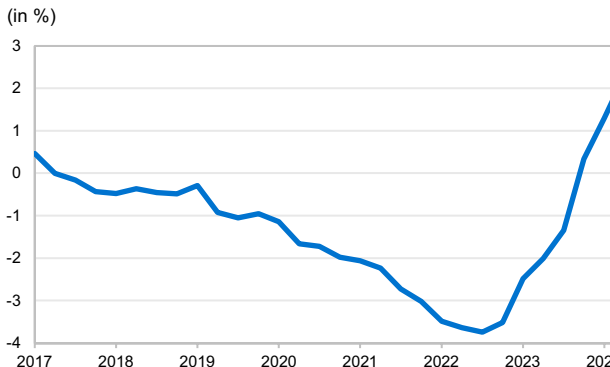
When it comes to **external demand**, though monetary conditions remain tight, since the start of this year, the global economy has been recovering, even somewhat better than expected. This concerns primarily the euro area, our key trade partner. Euro area growth is expected to reach 0.7% this year and accelerate to 1.4% next year. The euro area economic activity reflects primarily the trends in the strongest European economy and our leading economic partner – Germany, where industrial production continues to record poor results. An exception is the manufacture of cars and spare parts, which increased significantly in May, with similar trends expected in June as well. **Domestic demand** is propped primarily by higher corporate profitability, robust FDI inflows, rising government capital expenditure, and growing employment and wages. The effects of gradual easing of financial conditions are likely to materialise in the period to come, which should result in lending acceleration, while the **real wage growth should slow during the projection horizon**, as pressures on further wage growth

Chart V.0.34 August 2023 inflation projection and outcome (y-o-y rates, in %)



Source: NBS.

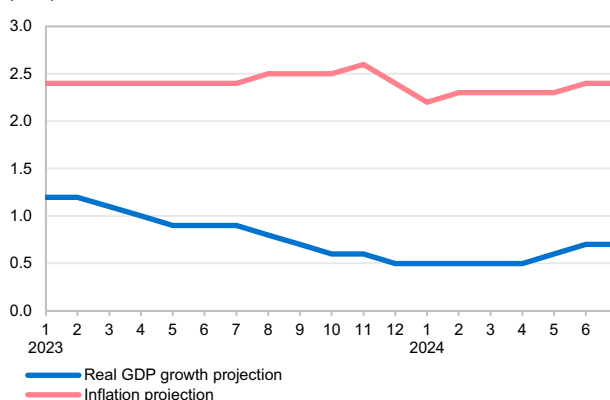
Chart V.0.35 Real interest rate



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.0.36 GDP and inflation projections of the euro area for 2024 (in %)



Source: Consensus Economics.

Chart V.0.37 **Projection of consumer price growth**  
(y-o-y rates, in %)

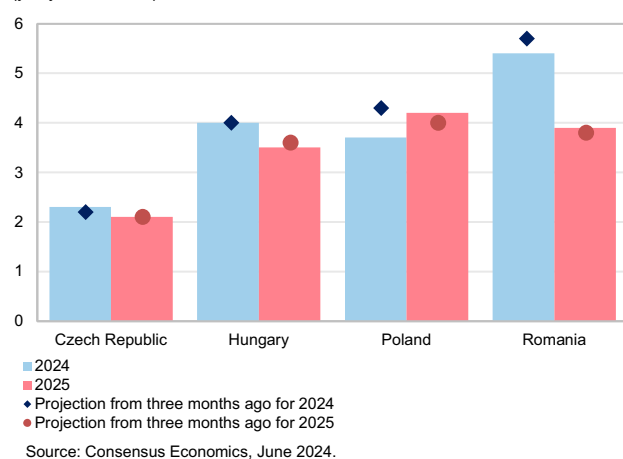


Chart V.0.38 **Output gap projection\***  
(in % of potential output)



will weaken alongside inflation's slowdown, compensating for inflation. Bearing this in mind and the fact that investment growth also boosts potential output, the **output gap**, which almost closed in H1, is estimated to continue to move around a neutral level until the end of the projection horizon.

The projected inflation's slowdown is anticipated to be supported, to an extent, by the **global oil price**, owing to its expected gradual fall, in accordance with futures, and by the drop-out of earlier price hikes from the y-o-y calculation.

The contribution of all **components** to y-o-y inflation, apart from fruit and vegetable prices, whose impulse is currently negative, is likely to decline.

The contribution of **non-food products and services** to y-o-y inflation is expected to decline starting mainly from next year, given that the higher than expected real wage growth in Q2 will slow the fall in non-food inflation until end-2024, notably in the services segment. The contribution of non-food inflation is expected to decline from the current level of 2.1 pp, where it will stand late this year as well, to around 1.3 pp until the end of the projection horizon. Several factors will add to non-food inflation's faster decline in the medium run. First, the prices of this category of products depend largely on the prices of a number of imported products, notably from the euro area, our key trade partner. As in the prior projection, the effect of imported inflation on non-food product prices will weaken over the projection horizon. A continued anticipated decline in inflation expectations and a slowdown in real wage growth will also relieve pressures on domestic prices of non-food products. We expect no significant pressures on non-food inflation from global supply chains, as the index, though elevated, is not entering positive territory. We are still more concerned about the rising costs of international container transport, which are still well below the peak reached in 2022, but call for caution.

Consistent with the assumption of the global oil price movement going forward, we expect **petroleum product prices** to contribute somewhat less to y-o-y inflation than we anticipated in our previous projection. We expect this contribution to be mildly positive until the end of this and early next year, and moderately negative until end-2025, only to turn neutral in terms of its impact on y-o-y inflation, until the end of the projection horizon.

The contribution of **food prices (excluding fruit and vegetables)** to y-o-y inflation is also expected to decline

– it will measure around 1 pp over the next year, and around 0.8 pp until the end of the projection horizon. Compared to the previous projection, the expected contribution of food prices will be somewhat higher over the next year due to the sharp rise in global prices of some raw materials (notably coffee and cacao), which will drive up food prices at home during Q3, notably in July. This increase is one-off, but will remain in the calculation of y-o-y food inflation in the course of next year. Food inflation is likely to slow thereafter, primarily under the influence of lower imported inflation and inflation expectations, given that we expect no significant cost-push pressures on food prices on account of prices of other primary commodities, provided they move in line with futures. Measured by the composite index (corn, wheat, soy), the domestic prices of primary agricultural commodities are likely to record a slight decline in line with futures, and a gradual rebound thereafter. The absence of pressures of raw material costs on food prices is also 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 neutral.

**Fruit and vegetable prices** are now relatively low thanks mostly to robust supply, the easing of cost-push pressures in production and the base effect. The contribution of fruit and vegetable prices to headline y-o-y inflation should therefore be negative this year, i.e. work towards 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, of around 0.1–0.2 pp, as we assume their gradual return to their long-term trend (which corresponds to the rise in the prices of non-food products and services).

There are no significant changes to administered prices compared to the previous projection. 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 (4.6%) to be much lower than in 2023 and to contribute less to inflation (around 0.9 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.

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

In July, the IMF revised up its April projection of Serbia’s economic growth in 2024, by 0.3 pp to 3.8%, which is fully consistent with our projections, and the

Chart V.0.39 Contributions to y-o-y inflation by component (average y-o-y rates, in pp)

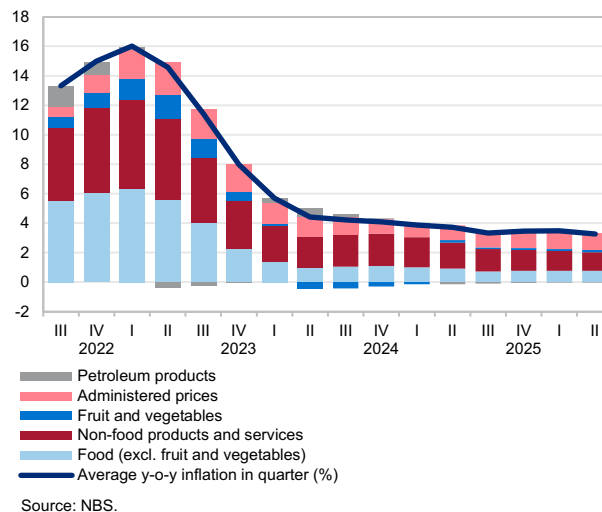


Chart V.0.40 Global supply-chain pressures (index, in standard deviations)

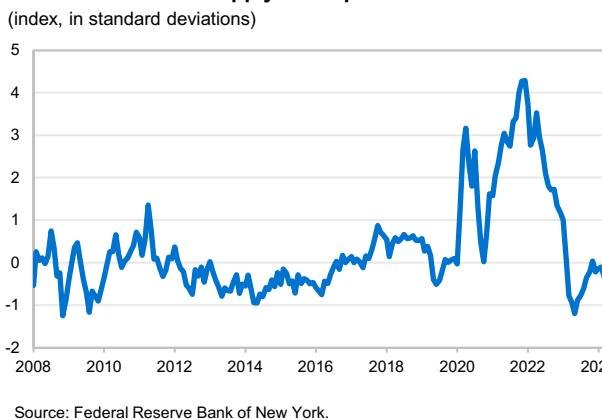


Chart V.0.41 Real marginal costs gap in food production (deviation in % from trend)

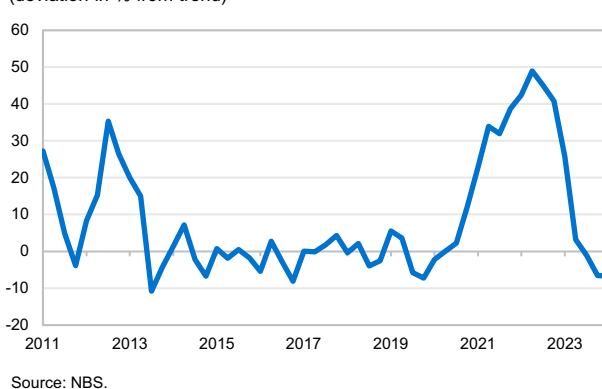


Table V.0.6 **Projections of macroeconomic indicators of Serbia**  
(in %)

		GDP	Current account	Inflation
NBS	2024	3.8	-4.0	4.6
	2025	4.5	-5.0	3.6
Ministry of Finance	2024	3.8	-4.1	4.9
	2025	4.2	-4.7	3.5
IMF	2024	3.8	-4.1	3.6*
	2025	4.2	-4.7	3.0*
Consensus Forecasts	2024	3.6		4.6
	2025	3.9		3.5
World Bank	2024	3.5	-3.6**	5.0**
	2025	3.8	-3.9**	3.5**

\* End-of-period.

\*\* Data from April 2024.

Sources: Ministry of Finance (July, Fiscal Strategy for 2025 with Projections for 2026 and 2027), IMF (July, third review of Serbia's economic programme), Consensus Economics (July), World Bank's GEP (June) and RER (April).

projections of the **Ministry of Finance**. **Consensus Economics** revised up its projection by the same amount, **estimating that real GDP growth will measure 3.6% in 2024**. The **World Bank** expects somewhat smaller growth, of **3.5%**, which is unchanged compared to the April projection. When it comes to 2025, the IMF projects growth of 4.2%, the same as the Ministry of Finance, whereas Consensus Economics and the World Bank anticipate somewhat slower growth, of 3.9% and 3.8%, respectively.

Relative to April, the **IMF revised up its projection of the current account deficit for this year, by 0.2 pp to 4.1% of GDP**, which is similar to our expectations (4.0%). As the investment cycle is expected to accelerate, and imports of equipment and intermediate goods to go up as a result, the IMF anticipates the current account deficit to widen to 4.7% of GDP in 2025.

**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 July projections, the **IMF** expects y-o-y inflation to measure 3.6% in late 2024, touching the 3.0% midpoint in late 2025. In July, **Consensus Economics analysts** projected the average inflation rate at 4.6% in 2024 and 3.5% in 2025.

## 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 their impact on world prices of energy and other primary commodities. To a degree, the risks also stem from the persistence of core inflation globally. **At home**, the risks are associated with the pace of domestic demand growth and the impact of weather conditions on the outcome of the agricultural season. **Overall, we judge the risks to the GDP and inflation projections to be symmetric over the projection horizon.**

Though somewhat reduced, **geopolitical risk** remains a source of instability in commodity and financial markets. The escalation of conflicts in the Middle East and Ukraine could push up the global prices of oil and other primary commodities. Moreover, the attacks on global shipping routes in the Red Sea, vitally important for trade between the East and the West, raised the transportation costs to their highest since mid-2022. If they last or deteriorate, these disruptions may constrain supply and drive up production costs, thus extending the duration of elevated

inflation expectations globally. Even in the absence of direct effects on energy prices in Serbia, imported inflation and, by extension, inflation at home, may go up. As trade tensions intensified and leading economies introduced new protectionist measures for a number of products and services traded in the world market, trade flows and supply chains may be disrupted. Given that 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 will in all likelihood remain weaker than we assumed in the baseline scenario. The impact of past monetary tightening by leading central banks may be stronger and more durable than expected. Also, high levels of debt and challenges to

Table V.0.7 **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 a higher supply of agricultural products and may produce disinflationary pressures, and vice versa: a poorer than assumed agricultural season results in a 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.

credit risk management in China may greatly influence lending activity and economic growth. Slower than expected global growth may lead to the re-assessment of risks in financial markets, falling asset prices and a wider credit spread, which may further amplify the weaknesses in the global economy. 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. On the other hand, global growth may exceed expectations provided inflation decelerates at a faster pace, which would enable central banks to ease their monetary policies earlier and faster, supporting economic growth. The growth of the euro area, our key economic partner, may surprise on the upside, particularly because the projections of many relevant institutions are somewhat higher than the Consensus Economics projection, used in our projection. 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.**

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, many challenges remain. 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, or whether they will offset this by reducing their profit margins. Renewed inflation growth would lead to tighter than expected monetary policies by leading central banks over a longer time period. This would drive up the cost of FX borrowing at home, which would 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. On the other hand, global inflation may slow down faster due to stronger effects of past restrictive monetary policies or faster deceleration of real wage growth, which is why central banks may start lowering their key rates faster than expected. As this would result in more favourable than expected financial conditions globally, **we assess the risks on account of global inflation 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 capacity to attract FDI** could turn out to be greater than anticipated, which would lead to further growth in wages and employment. It is currently difficult to estimate the magnitude of the effect of the production of electric vehicles in the Kragujevac plant, which is an upside risk to GDP, primarily in the years to come. 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.**

An upside risk to the GDP projection is also associated with investment in the **energy sector**, given the need to ensure energy security, but also a gradual transition to the green economy. Another risk is **mining**.

**The agricultural season** also poses a **risk to the inflation and GDP projections**. The impact of weather on the supply and prices of fruits and vegetables is important for inflation, and on autumn crops for GDP. Weather conditions may turn out to be both better and worse than expected, wherefore the **risks on this account are judged to be symmetric**.

Future monetary policy decisions will depend on the movement of 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: Geopolitical risk – channels of influence and quantification of risk

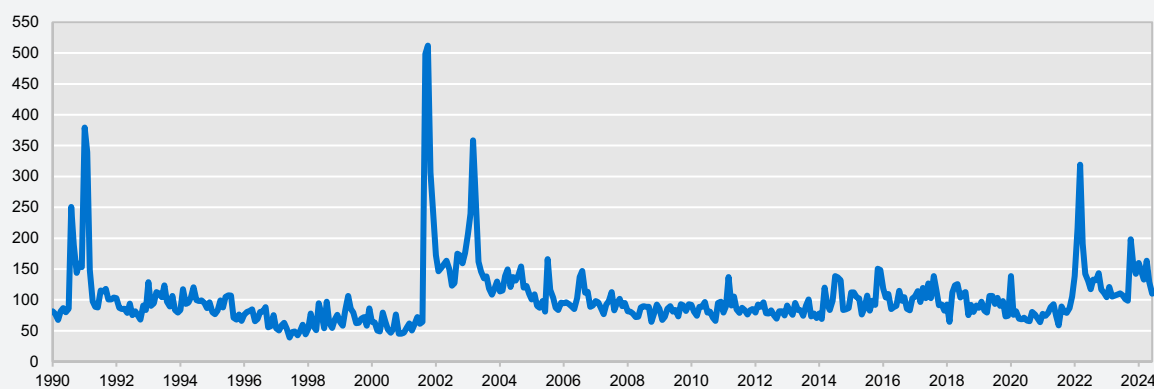
For quite some time, in the eyes of market participants, relevant international financial institutions and economic policy makers, geopolitical risk has featured as one of the key risks to global economic trends. The conflict in Ukraine, crisis in Middle East, trade wars, protectionism etc. have made geopolitical risk one of the key risks in the projections of the IMF, World Bank and the majority of central banks, including the NBS. This text box is therefore dedicated to the analysis of geopolitical risk, primarily the quantification of its strength and the channels for transmission of its influence on inflation and GDP.

Together with economic and policy uncertainty, geopolitical risk makes up the “uncertainty trinity”<sup>1</sup> and may be defined as the threat, realisation, and escalation of adverse events associated with wars, terrorism, and any tensions among states and political actors that affect the peaceful course of international relations.<sup>2</sup> Episodes of geopolitical conflicts fuel concerns regarding energy supply and are typically associated with tensions in the global energy market. Such movements, as a rule, result in higher inflation and lower economic activity, as well as a decline in investments and employment on a global scale. Geopolitical risk may augment the perception of catastrophic outcomes, make the investments in risky projects less attractive and undermine consumer confidence. To assess the effects of geopolitical tensions, we first need to quantify geopolitical risk.

The most frequently used measure on a global scale is **the Geopolitical Risk Index**, designed by Fed experts<sup>3</sup> in 2022. The goal was to measure consistently, over time, the strength of global geopolitical tensions as they are seen by journalists, the public, global investors and economic policy makers. The index was obtained by means of an algorithm that computes the share of articles considering growing geopolitical risks of global interest in the total number of articles published in leading newspapers in English speaking regions (six in the USA, three in the UK and one in Canada). The text search focuses on words associated with geopolitical risk, such as “crisis”, “terrorism”, “war”, “tensions between countries” etc. The index was constructed on a daily and monthly basis, since 1990. The authors also constructed **the Geopolitical Risk Index by individual country** (for 44 countries), based on common co-occurrence of the key words associated with geopolitical risk in specific countries.

An observation of the global Geopolitical Risk Index since 1990 to date shows that it has remained relatively unchanged over the greatest part of the period, but with prominent peaks during key episodes of geopolitical tensions, such as the outbreak of the Gulf War in 1990, the terrorist attack on the USA on 11 September 2001, the invasion of Iraq in 2003 and the recent outbreak of the conflict in Ukraine in 2022 and the Middle East crisis in 2023. After relatively

Chart O.5.1 Global Geopolitical Risk Index  
(in pp)



Source: Caldara and Iacoviello (2022); Data downloaded from <https://www.matteoiacoviello.com/gpr.htm>.

<sup>1</sup> Carney, Mark. 2016. “Uncertainty, the Economy and Policy”, *Speech, Bank of England*, London, June 30.

<sup>2</sup> Caldara, Dario and Matteo Iacoviello. 2022. “Measuring Geopolitical Risk”, *American Economic Review*, April, 112 (4), pp. 1194–1225.

<sup>3</sup> Ibid.



small variations over close to 20 years, when it averaged around 98 pp, the global Geopolitical Risk Index climbed to 319 pp in March 2022 due to the outbreak of the Ukraine conflict, and to 198 pp in October 2023 over the escalation of the crisis in the Middle East. Since then and until June this year, the global Geopolitical Risk Index ran relatively high (averaging 147 pp), only to drop to 110 pp in June, which is still an elevated level, but the lowest since September 2023, indicating some reduction in geopolitical risk.

Geopolitical risk indices specific for individual countries generally mirror the global index but may deviate in case of occurrence of a risk specific for the country observed. For example, the Ukraine conflict has resulted in a considerable spike of the global Geopolitical Risk Index, but Germany's Geopolitical Risk Index rose much more.

The growth of geopolitical risk entails a series of negative effects on GDP and inflation, transmitted **via different transmission channels**, one of the key being the **global market of primary commodities, particularly energy**. Bank of England experts<sup>4</sup> underscore energy supply as the key transmission channel of geopolitical risk which fuels inflation and may have significant negative effects on GDP.

They emphasize that geopolitical risk may be transmitted via two separate and intrinsically different channels: a) **a deflationary demand channel** and b) **an inflationary energy supply channel**. Namely, the rise in geopolitical risk works in the direction of a decline of the global energy price due to the contraction of economic activity and energy demand amid higher risk aversion of investors. Conversely, the rising geopolitical risk pushes the prices up via the energy supply channel, as the energy demand increases out of caution, fuelled by concerns that the supply could contract, even to the extent of interrupted deliveries. The geopolitical risk shock can put either a downward or an upward pressure on prices, depending on which of the two channels it spreads through. Economic policy makers should be aware of these two channels of influence because they warrant a different response.

Geopolitical risk also triggers considerable disruptions in global trade, which is a significant channel of influence in itself. The analyses show that both **the volume and prices in global trade** are extremely sensitive to global geopolitical risk – the volume of global trade three times more than GDP, and export prices (represented by a basket of tradeable goods and services) much more than consumer prices.<sup>5</sup>

**In NBS projections**, geopolitical risk has featured for quite a while as one of the key risks, primarily through the impact on energy prices in the global market. The risks to the GDP projection based on a potential escalation of geopolitical tensions are tilted to the downside, and to the inflation projection, to the upside. Given that Serbia is a net energy importer, the intensification of geopolitical tensions and conflicts would drive global energy prices up, consequently increasing production costs and reducing funds for investments. It could have second-round effects on inflation, which can partly be compensated by lower demand for these products. In the most recent, August projection, geopolitical risk remains one of the key risks to the projection, still pushing down on GDP and up on inflation. The escalation of geopolitical conflicts could heighten instability in the markets of primary commodities and drive their prices up, especially crude oil, which could result in slower disinflation globally. Also, trade tensions between the West and China have recently been reignited through the imposition of new tariffs on Chinese electric cars. New trade barriers and protectionist policies of some countries are disrupting global supply chains, making them inefficient and generating new costs due to relocation of production to other countries, in an effort to avoid newly imposed duties etc., which is a risk not only to inflation, but also to long-term global growth. Bearing that in mind, the NBS carefully monitors developments in the international environment and estimates the effects of geopolitical risk based on development of an alternative scenario with projections which assume the materialisation of this risk. Taking into account geopolitical risk, the NBS will remain cautious in the conduct of monetary policy, with a view to maintaining price stability in the medium-term.

<sup>4</sup> Smith, Samuel and Marco Pinchetti. April 2024. "The transmission channels of geopolitical risk", *Bank Underground, Blog for Bank of England staff*.

<sup>5</sup> Julian Reynolds. April 2024. "Quantifying the macroeconomic impact of geopolitical risk", *Bank Underground, Blog for Bank of England staff*.

### **Text box 6: Alternative projection scenarios**

Global primary commodity prices remained volatile in Q2, stirred by the still heightened geopolitical tensions amid a continued and escalating conflict between Israel and Hamas, as well as mutual attacks on energy infrastructure in Russia and Ukraine. Fuelled by the strengthening of tensions between Iran and Israel, global oil price touched the level of about USD 93 per barrel in mid-April, gaining 20.2% on end-2023. At the same time, the continued attacks of Yemen's Houthi rebels on ships in the Red Sea increased the costs of container transport, driving up the FBX Global Container Index in late July by as much as 272.4% from end-2023. However, increased costs of overseas transport did not exert any major impact on global supply bottlenecks, as the June Global Supply Chain Pressure Index (GSCPI), constructed by the New York Fed, was at the level of the multiple-year average.

The tightening of geopolitical tensions, therefore, remains the key risk to the achievement of macroeconomic projections in Serbia. Having in mind that the broadening of the conflict would affect chiefly global primary commodity prices, our downside scenario assumes higher prices of oil and primary agricultural commodities. According to the World Bank,<sup>1</sup> a potential spreading of the conflict in the Middle East would trigger oil supply disruptions and a rise in the global oil price, though this impact would depend on the intensity of the conflict and the pace and scope of the response of other oil producers. The World Bank estimates that if the conflict escalates and extends to major oil-producing countries of the region, the average oil price would top USD 100 per barrel this year, resulting in a 0.8 pp higher global inflation than in the baseline scenario. Renewed inflationary pressures in that case would keep interest rates high for a longer period than expected, weighing down on global economic growth. In addition to geopolitical developments, adverse weather conditions in key production regions in April and May have created uncertainty as to the outcome of the global agricultural season. If the season falls short of expectations, the prices of primary agricultural commodities are likely to trend higher in the period ahead. Apart from the global risks, the downside scenario discussed in this text box also includes a potentially worse agricultural season at home, having in mind that the temperatures in July were above average and that soil moisture is lower than last year.

The upside scenario, on the other hand, operates on the assumption of lower primary commodity prices. A potential end to the Middle East Conflict would lead to lower primary commodity prices, weaker pressures in global supply chains and lower prices of container transport, which would slow global inflation faster than expected. Energy and primary commodity prices could also drop if China's growth prospects turn bleaker than expected. At the same time, owing to the economic analysts' optimistic forecasts of euro area inflation, as well as the expectation of a slower wage growth in the coming period, the upside scenario assumes a lower inflation and a higher GDP growth in the euro area than the baseline, as also suggested by the projections of the ECB and the IMF.

If the risks assumed in the downside scenario materialise – geopolitical relations tighten and global and domestic agricultural season turns poor, the global oil price could soar to around USD 96 per barrel by the end of the year and then recede moderately until end-2025, to USD 90 per barrel. As for primary agricultural commodity prices, we assume that at end-2024 they would be 6.9% higher than at end-2023, only to retreat by 0.2% in 2025. The consequences of such a scenario on domestic macroeconomic indicators would be as follows:

- Average inflation would be higher than in the baseline by 0.3 pp in 2024 and by 0.5 pp in 2025. Higher inflation would reflect the price hike for petroleum products and food in the domestic market amid higher global primary commodity prices and higher prices of processed food, fruit and vegetables because of a weaker agricultural season at home, as well as the rise in imported inflation driven by the higher euro area inflation on the same grounds.
- GDP growth would be lower by around 0.3 pp due to the sluggish global growth and global financial conditions, amid a likely deferral of rate cuts by leading central banks. GDP growth would also fall victim to a weaker agricultural season at home as the contribution of agriculture to overall GDP growth would be lower.
- The downside scenario would not have any major impact on the current account deficit, given that the effects of lower external demand and higher prices of metals and primary agricultural commodities on exports would most probably offset each other. Counterbalancing effects on imports too would come from the higher energy prices and higher expenditure on

<sup>1</sup> World Bank, GEP (June 2024).

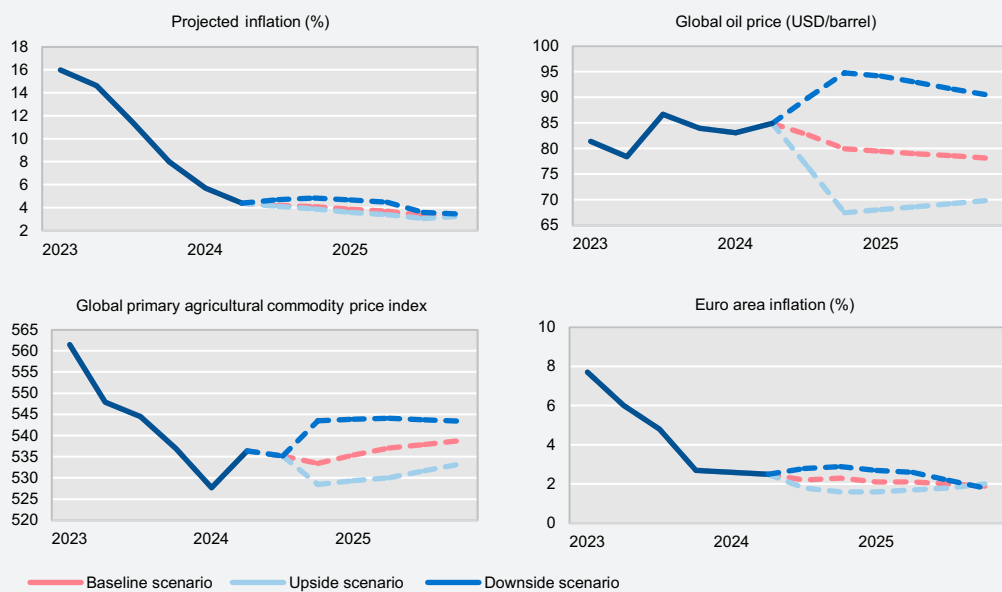
the primary income account on the back of still elevated interest rates, on the one hand, and the impact of lower external and domestic demand on the imports of equipment and consumer goods, on the other.

If, however, geopolitical tensions resolve earlier than projected in the baseline scenario, we assume that the global oil price will drop to the level of around USD 68 per barrel by the end of the year, and grow moderately in 2025, so that at the end of that year it amounts to USD 70 per barrel. If the global agricultural season turns out better than expected and the price of oil lower, the prices of primary agricultural commodities at the end of 2024 will be 8.0% lower than at the end of 2023, while they will recover in 2025 and be 4.8% higher at year end than at the close of 2024. At the same time, the upside scenario assumes that inflation in the euro area will average 2.1% this year and 1.8% the next, and that the area’s GDP growth this year will amount to 0.9% instead of 0.7%. 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 relative to the baseline, due to lower inflation in the euro area and a drop in import prices, as well as lower global prices of primary commodities.
- In that case, monetary easing would be stronger than in the baseline, resulting in the pick-up in production activity and relaxation of global financial conditions. Stronger external demand from the euro area, weaker inflationary pressures and a lower risk premium would push Serbia’s GDP growth rate up by around 0.2 pp compared to the baseline.
- Same as in the previous alternative scenario, the effects on the current account deficit 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, in case of imports, the fall in energy prices would entail lower energy imports, while the rise in domestic demand would have the opposite effect.

As the risks are now generally lower than they were at the height of the energy crisis and the outbreak of the conflict in Ukraine, we can say that the most turbulent period is behind us and that macroeconomic prospects are now more favourable. Because of this, alternative scenarios deviate less from the baseline than in some prior periods. Having in mind that our economy has demonstrated strong resilience in the most challenging of times, it is reasonable to expect that not even the materialisation of the downside scenario can jeopardise macroeconomic stability.

Chart O.6.1 Effects of alternative scenarios on inflation



Sources: NBS.

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	Q2 2024
<b>EXTERNAL LIQUIDITY INDICATORS (in %)</b>																					
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	7.2
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	338.2	
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	35.1	37.8
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	12.7	
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	20.9	
<b>EXTERNAL SOLVENCY INDICATORS (in %)</b>																					
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	64.2	
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	10.4	
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	110.7	
<b>FINANCIAL RISK EXPOSURE INDICATORS (in %)</b>																					
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	179.1
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	221.5
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	127.2	119.6
<b>MEMORANDUM: (in EUR million)</b>																					
GDP <sup>1)</sup>	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	16,835	19,002
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	45,668	
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	2,142	
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	27,507
Short-term debt <sup>2)</sup>	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	797	
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	-410	-824
<b>CREDIT RATING (change of rating and outlook)</b>																					
	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		
<b>S&amp;P</b>	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	BB+ /stable	BB+ /positive
<b>Fitch</b>	BB- /stable			BB- /negative		BB- /stable		BB- /negative		B+ /stable	B+ /positive	BB- /stable	BB /stable		BB+ /stable						
<b>Moody's</b>									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

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

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.

<sup>1)</sup> According to ESA 2010. Data for 2023 were obtained as the sum of four quarters. Data for Q2 2024 are NBS estimate.

<sup>2)</sup> 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	Q2 2024
Real GDP growth (in %) <sup>1)</sup>	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	4.7	4.2
Consumer prices (in %, relative to the same month a year earlier) <sup>2)</sup>	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	3.8
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	27,507
Exports (in EUR million) <sup>3)</sup>	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	10,242	10,826
- 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	2.1	5.8
Imports (in EUR million) <sup>3)</sup>	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	11,171	11,893
- 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	1.7	8.3
Current account balance <sup>3)</sup> (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	-410	-824
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	-2.4	-4.3
Unemployment according to the Survey (in %) <sup>4)</sup>						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	9.4	
Wages (average for the period, in EUR) <sup>7)</sup>	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	816.0	840.0
RS budget deficit / surplus (in % of GDP) <sup>5)</sup>				-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	2.1
Consolidated fiscal result (in % of GDP) <sup>5)</sup>	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	2.3
RS public debt, (central government, in % of GDP) <sup>6)</sup>	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	47.6	50.0
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	108.72
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	109.52
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	117.11
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	117.05
MEMORANDUM:																					
GDP (in EUR million) <sup>8)</sup>	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	16,835	19,002

<sup>1)</sup> At constant prices of previous year. Data for Q2 2024 is SORS flash estimate.

<sup>2)</sup> Retail prices until 2006.

<sup>3)</sup> Starting from 2007 data on 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.

<sup>4)</sup> 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.

<sup>5)</sup> According to ESA 2010. Data for 2023 were obtained as the sum of four quarters. Data for Q2 2024 are NBS estimate.

<sup>6)</sup> 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.

<sup>7)</sup> 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 Q2 2024 is average of two months.

<sup>8)</sup> Data on the share of public debt in GDP were downloaded from the website of the Ministry of Finance.

**Notes:**

- SORS revised GDP data for the period 2005-2017, which led to a change in the share of macroeconomic indicators in GDP.
- Data are subject to corrections in line with official data sources.
- Source for the data on unemployment: Labour Force Survey, Statistical Office.
- 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	6.25	-25
11 July	6.00	-25
8 August	6.00	0
12 September		
10 October		
7 November		
12 December		

## Press releases from NBS Executive Board meetings

### Press release from Executive Board meeting held on 13 June 2024

At its meeting today, the NBS Executive Board voted to trim the key policy rate by 25 bp to 6.25%. The rates on deposit and lending facilities were also lowered – to 5.00% and 7.50%, respectively.

The Board's decision was motivated primarily by several months of declining inflation at home and its return within the target band in May, consistent with the NBS's projections, as well as by the anticipated movements in inflation and other macroeconomic indicators at home and abroad in the coming period. In view of the further waning of global inflationary pressures and the disinflationary impact of tight monetary measures so far, the Executive Board assessed that conditions are in place to embark on monetary policy easing by lowering the key policy rate.

Global inflation has continued to subside and approach pre-pandemic levels, mostly reflecting the effects of past monetary policy tightening by central banks, weakening of cost-push pressures and the easing of global supply chain bottlenecks. The NBS Executive Board does not expect any major increase in the prices of products and services we import, but continues to keep a close eye on all supply- and demand-side factors which could impact future inflation movements, and this will form the basis of future monetary policy decisions.

Most central banks anticipate inflation to retreat within target bounds in H2 2024 or H1 2025, while market participants expect that the cycle of monetary policy tightening is over. At its meeting on 6 June, the ECB started easing its monetary policy by lowering its key rates by 25 bp each, pointing out that its future decisions will be based on a cautious assessment of inflation dynamics and outlook. The Fed kept monetary conditions unchanged in June, but is still expected to begin monetary policy easing before the end of the year. The expected gradual decrease in the price of euro-indexed borrowing in the local market, along with the initiated reduction of the NBS key policy rate, should contribute to a steady increase in lending activity and domestic demand, which will however not jeopardise the downward trajectory of inflation. The Board had in mind that the relevant institutions envisage a mild decline in global oil prices in the period ahead and their view that the oil price growth sparked over the past months by heightened geopolitical tensions and an array of other factors was temporary.

Consistent with the Executive Board's expectations, y-o-y inflation in Serbia returned within the 3±1.5% target band in May, measuring 4.5%. Inflation slowed down thanks to food prices, which recorded a 0.2% m-o-m decline in May, as well as energy prices where last year's electricity and gas price hikes dropped out of the y-o-y rates. At the same time, core inflation recorded a somewhat stronger increase than in April, amounting to 5% y-o-y. The Board expects inflation to recede further, staying within the target band in the medium term and hovering around the 3% target as of early 2025. Such inflation profile will be supported by the still restrictive monetary conditions, reduced global inflationary pressures, and lower inflation expectations of market agents.

According to the SORS data, real GDP growth stepped up in Q1 to 4.7% y-o-y, outperforming the flash estimate. Growth was led by the upswing in services, industry and construction. April data point to the continuation of favourable trends in early Q2. Domestic consumption growth is underpinned by the increase in real income originating from higher wages and pensions and lower inflation. At the same time, fixed investment is rising on the back of higher profitability of the corporate sector in recent years, robust FDI inflow and sizeable government capital expenditure, notably for investment in infrastructure. The Executive Board judges that though domestic demand will continue to drive growth going forward, it is not likely to exert any major impact on inflation.

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 inflation slowdown. Decisions will be made taking care of the maintenance of financial stability and favourable growth prospects.

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

### Press release from Executive Board meeting held on 11 July 2024

At its meeting today, the NBS Executive Board voted for further monetary easing, cutting the key policy rate by 25 bp to 6%, and deposit and lending facility rates to 4.75% and 7.25%, respectively.

In making the decision, the Board had in mind that inflation at home has been on a downward path for a number of months and that it returned within the target band in May, as projected by the NBS. It also took into account the expected movement of inflation and other macroeconomic indicators from the domestic and international environment going forward. Given a further reduction in global inflationary pressures and the hitherto disinflationary impact of restrictive monetary measures, the Board assessed that conditions are in place to continue to ease monetary policy by trimming the key policy rate.

Though somewhat more gradually than previously expected, global inflation continues to slow down. The majority of central banks forecast that inflation in their countries will return within the bounds of the target tolerance band in H2 2024 or H1 2025. Accordingly, the Executive Board expects a further slowdown in the prices of the goods and services that we import. The ECB trimmed its main rates in June, and market participants believe that a new cut could come about at the end of the year. As for the Fed, one or two cuts of the federal funds rate are expected by the year's end. The anticipated gradual decrease in the prices of euro-indexed borrowing in the local market, together with the NBS trimming the key policy rate, should gradually drive lending and domestic demand up, without threatening the downward inflation path. The Executive Board is aware that the relevant institutions project a mildly downward trend in global oil prices going forward and that growth in oil prices, which was occasionally present over the past months amid pronounced geopolitical tensions and a series of other factors, was temporary.

Consistent with the Board's expectations, y-o-y inflation in Serbia returned within the target band in May, settling at 4.5%. The Board judges that inflation will continue to move within the  $3\pm 1.5\%$  target band over the projection horizon, reflecting persistently tight monetary conditions, lower imported inflation and reduced inflation expectations.

According to the SORS data, most real sector indicators continued recording favourable trends in April and May. The indicators for services and construction, as well as a faster than expected recovery of production following the Pančevo refinery overhaul, suggest that growth in Q2 might turn out even higher than estimated by the NBS. This increases the likelihood of overperformance of the 2024 growth projected in May at 3.5%. Positive trends in the real sector are expected to extend in the remainder of the year, led by the rising domestic demand. Stronger private consumption should be supported by the rise in real income on account of higher wages and pensions and by the fall in inflation, while fixed investment growth should be underpinned by the increased corporate sector profitability in recent years, a robust FDI inflow and substantial government capital expenditure, notably for investment in transport infrastructure. Though domestic demand will continue to drive growth going forward, the Board expects it to generate no major impact on inflation.

The Executive Board stresses that it will keep a close eye on domestic and international markets and that future monetary policy decisions will depend on incoming data, the outlook for inflation and its key factors, as well as on the assessment of the effects of monetary policy measures. Decisions will be made taking care of the maintenance of financial stability and favourable growth prospects.

The next rate-setting meeting will be held on 8 August.

#### **Press release from Executive Board meeting held on 8 August 2024**

At its meeting today, the NBS Executive Board voted to keep the key policy rate at 6.0%. The rates on deposit (4.75%) and lending (7.25%) facilities also remained unchanged.

In making the decision, the Board highlighted that the key policy rate was cut by a total of 50 bp at the previous two meetings and that the effects of past measures are yet to play out. Moreover, although inflation has retreated within the target band, monetary policy caution is still needed.

As noted by the Board, caution is also mandated by the developments in the international environment, notably the still elevated geopolitical risks and their impact on the global prices of energy and other primary commodities. The estimates of global oil price trends differ among institutions due to international uncertainty, numerous supply- and demand-side factors, and mixed data on China's growth outlook. To an extent, caution is needed also because global inflation's slowdown is likely to be more gradual than anticipated, wherefore the pace of monetary policy easing by leading central banks is likely to be slower too. Moreover, the impact of weather conditions on the outcome of this year's world and domestic agricultural season remains uncertain.

In line with the Executive Board's expectations, y-o-y inflation returned within the bounds of the target tolerance band in May, thereafter slowing further to 3.8% in June. The slowdown of inflation over the past months was facilitated by

all inflation components. The Executive Board expects inflation to continue moving within the target band ( $3\pm 1.5\%$ ) over the entire projection horizon. According to the August central projection, after edging up briefly in July, inflation should slow and come close to the 3% target midpoint during the following year. The temporary rise in July inflation will mostly be attributable to a series of one-off hikes of some food items, reflecting the increase in the global prices of these products or the raw materials for their manufacture, as well as some services classified within administered prices. After July, inflation will decrease again owing to the continued restrictive monetary conditions, lower imported inflation and the anticipated fall in the global oil price, in line with futures. The fall in inflation expectations will also yield a contribution, indicating the high credibility of the NBS's monetary policy.

According to the SORS flash estimate, in Q2 as well economic activity recorded stronger y-o-y growth (4.2%) than envisaged by the May projection. Favourable developments in the real sector are expected to be maintained in the remainder of the year, led by elevated domestic demand. Stronger private consumption should be supported by the rise in real income on account of higher wages and pensions and by the inflation decline, while fixed investment growth should be underpinned by the increased profitability of the corporate sector in recent years, robust FDI inflow and government capital expenditure, primarily for investment in transport infrastructure. The Executive Board judges that though domestic demand will lead growth going forward as well, it will not have any major impact on inflation.

The NBS Executive Board will continue to follow closely developments in the domestic and international market and make monetary policy decisions based on the assessment of incoming data, the outlook for inflation and its key factors, and the effects of past monetary policy measures. In making decisions, the Board will remain mindful of the preservation of financial stability and favourable growth prospects.

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

The next rate-setting meeting will take place on 12 September.

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