



NATIONAL BANK OF SERBIA

Introductory speech at the presentation of the
Inflation Report – February 2024

Dr Jorgovanka Tabaković, Governor

Belgrade, 14 February 2024

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

Welcome to the presentation of the February *Inflation Report*.

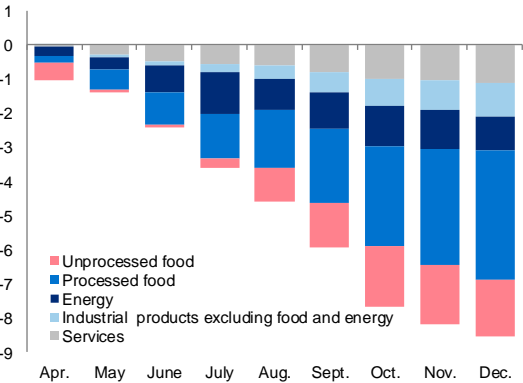
As usual, in today's conference we will present our new projections and expectations for the coming period. Before that, however, I would like to look back at the year behind us, a year fraught with challenges and new geopolitical uncertainties that seem to have become characteristic of modern times. Even in such circumstances we were successful in achieving our objectives and projections from a year ago. Before I elaborate in detail on current macroeconomic developments and our new projections, allow me to present several facts and figures relating to our projections presented here one year ago. Specifically:

- Already in February last year, when inflation was just shy of its peak, I pointed out that it would be halved in late 2023. This has materialised, with end-2023 y-o-y inflation at 7.6%. Back then, as now, we expected inflation to retreat within the target band by mid-2024.
- Consistent with our expectations, GDP growth picked up speed in H2 2023 and real growth measured 2.5% in the year as a whole. Let me remind you that, a year ago, we projected economic growth in the range of 2–3%, with central projection at 2.5%. At the time, we projected that, due to the planned implementation of investment projects, growth would accelerate to the range of 3–4% this year, with central projection at 3.5%, the same as in our current forecast. We expected economic activity to gather further momentum in the coming years and have now revised up our GDP growth projection for 2025 and 2026 to the range of 4–5%.
- Thanks to a powerful improvement in the external position in 2023, the current account deficit was much lower than projected a year ago. It measured only 2.6% of GDP, reflecting an improved energy balance and robust growth in manufacturing and services exports. FDI inflow climbed to a new all-time high of EUR 4.5 bn. As a result, FX reserves rose to a new record high of close to EUR 25 bn at end-2023, topping all reserve adequacy metrics. It is equally important that FDI inflow fully covered the current account deficit for the ninth consecutive year, and even exceeded it multiple times in 2023.

Later in the conference, we will present recent macroeconomic developments and our new projections in more detail.

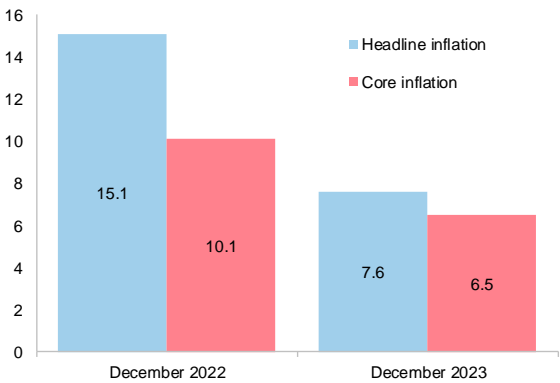
As I highlighted at the start, inflation continued to slow in the final quarter of 2023 to 7.6% at year end. This is half its level a year ago and somewhat less than we anticipated in our November projection. Inflation’s continued slowdown was propped up by the dissipation of cost-push pressures and the base effect from food prices, as well as by the effects of past monetary tightening which also supported core inflation’s decline to 6.5% y-o-y in December.

Chart 1 Change in contribution of main CPI components to y-o-y inflation - relative to March 2023*
(in pp)



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

Chart 2 Inflation at the end of 2022 and 2023
(in %)



Sources: SORS and NBS calculation.

Inflation is expected to slow further in 2024. Under our new projection, it will most probably retreat within the target band of 3±1.5% by mid-2024, approach the target midpoint late in the year and hover around that level over the medium term. Such inflation movements will mostly reflect the effects of past monetary tightening, softer global cost-push pressures, slowing imported inflation, still subdued external demand and the expected continued slide in inflation expectations. The new inflation projection is slightly lower than the November projection due to lower global prices of primary commodities and a faster decline in inflation expectations than we projected in November. It is important to note that not only medium-term but also short-term inflation expectations of the financial sector are now within the target band, and that corporate sector expectations are on a decline as well, confirming the credibility of our monetary policy.

Chart 3 Inflation projection
(y-o-y rates, in %)

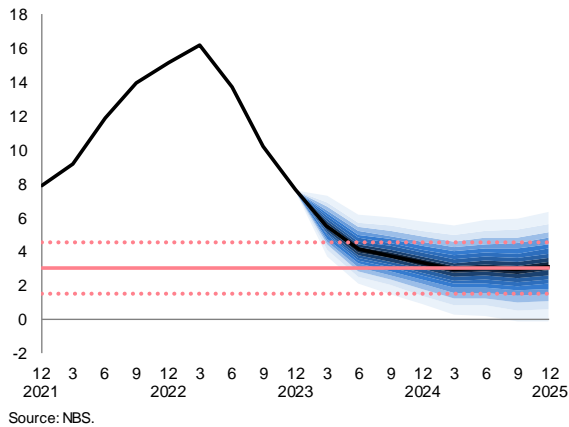
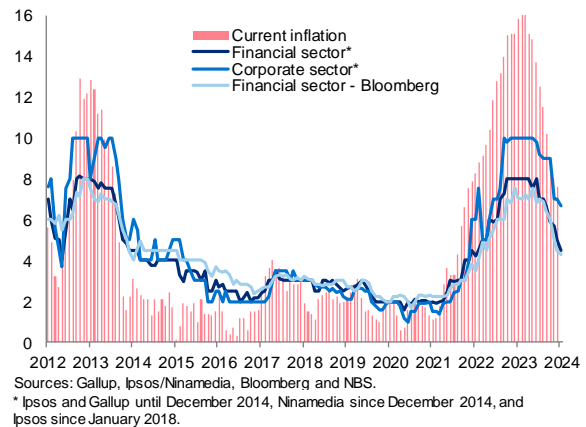
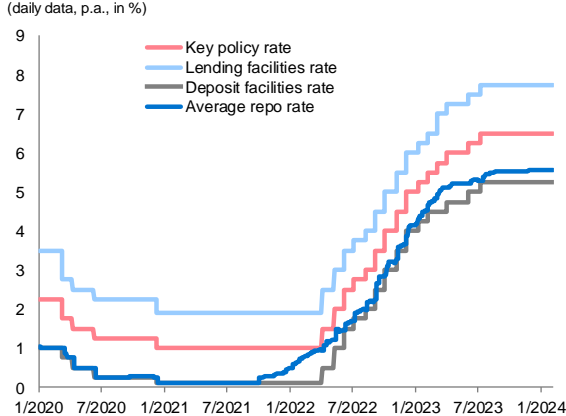


Chart 4 Current inflation and one-year ahead inflation expectations
(y-o-y rates, in %)



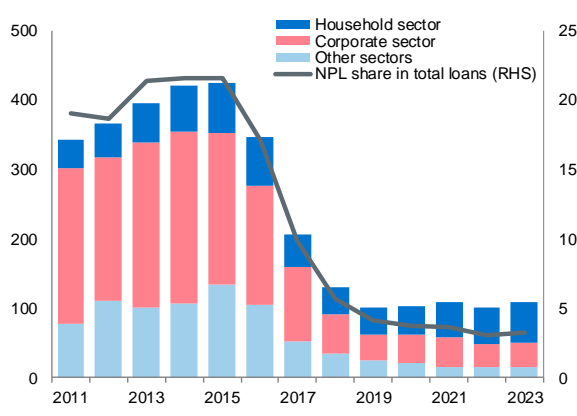
Our decision to keep the key policy rate unchanged at 6.5% in the period since the previous *Report* was underpinned by the projected inflation movements and the transmission of the effects of past monetary tightening to interest rates in the money, lending and savings markets, as well as to inflation expectations. From this time distance, taking into account movements in key macroeconomic indicators, we may freely say that it is thanks to our monetary policy, which we tightened at a continuous, but moderate and measured pace, that a concurrent reduction of inflationary pressures and inflation's return within the target band over the monetary policy horizon were achieved. The negative effects on economic growth were minimised and the financial stability fully preserved. This is confirmed by the fact that the share of NPLs in total loans has remained at its historical low of around 3%, underpinned by a robust regulatory framework and a carefully designed mix of monetary and macroprudential policy measures. A good example of such policy is our September decision to cap the interest rate on variable-rate housing loans at 4.08% for first-time home buyers. This decision has had no major impact on the banks' financial result and does not fuel inflationary pressures, but it has helped alleviate the credit risk and preserve financial stability, and, to an extent, supported the recovery of personal consumption.

Chart 5 Movement in the key policy rate and average repo rate
(daily data, p.a., in %)



Source: NBS.

Chart 6 NPL level and share in total loans, gross principle
(in RSD bn) (in %)



Source: NBS.

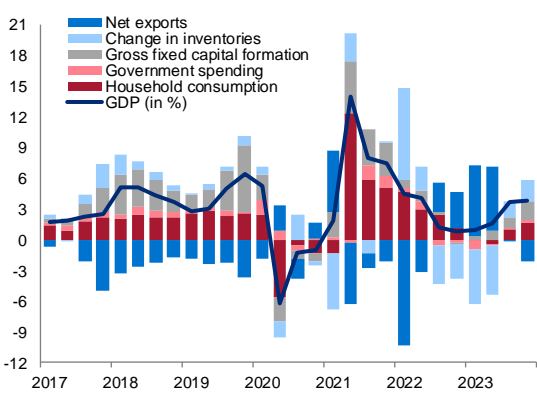
That we have managed to achieve the so-called “soft landing” by pursuing an appropriate monetary policy is also confirmed by GDP growth which measured 3.8% y-o-y in Q4 2023 or around 1% s-a relative to the previous quarter, according to our estimates.

Such GDP movements are consistent with the SORS preliminary estimate which places 2023 GDP growth at 2.5%, and with our November projection. Economic growth was led by elevated activity in all production and most service sectors. An almost equal impetus came from industry, construction and agriculture. On the expenditure side, the key impulse is estimated to have come from net exports due to the real growth in goods and services exports and a fall in imports in H1 2023, as well as from fixed investment. To a lesser extent, growth was also supported by personal consumption which rallied in H2 2023, mostly reflecting real wage growth due to inflation’s slowdown and fiscal incentives.

The acceleration of economic activity in H2 2023 will make it easier to achieve the economic growth rate projected for this year, and the carry-over effect from 2023 is estimated at 1.5 pp. Taking into account this and the accelerated investment cycle implementation, we expect GDP growth to pick up to the range of 3–4% this year, with central projection at 3.5%. We revised up our growth projection for the next two years to the range of 4–5%, having in mind investments planned in the lead-up to hosting Expo 2027. In our estimate, personal consumption will remain an important growth factor this year, reflecting the preserved labour market and the continued rise in households’ employment and income, but not to an extent that could fuel any major inflationary pressures. Another important growth factor are investments, private

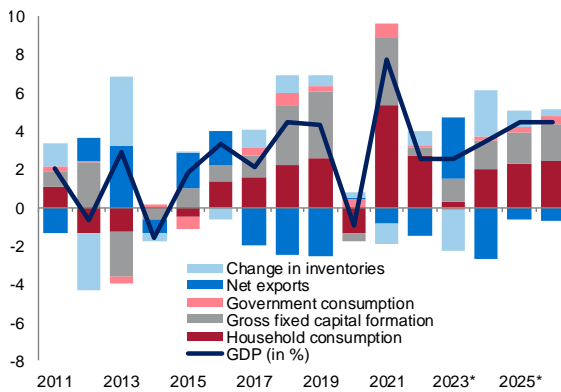
and government, which raise the potential output. Private investment growth will be supported by reduced inflationary pressures, preserved investment confidence, increased corporate profitability and the expected high FDI inflows. Substantial government investment in transport, energy and utility infrastructure has been planned, as have other projects recently presented by President Vučić as part of the “Leap into the future – Serbia Expo 2027” programme.

Chart 7 Contributions to y-o-y GDP growth rate, expenditure side
(in pp)



Sources: SORS and NBS calculation.
Note: NBS estimate for Q4 2023.

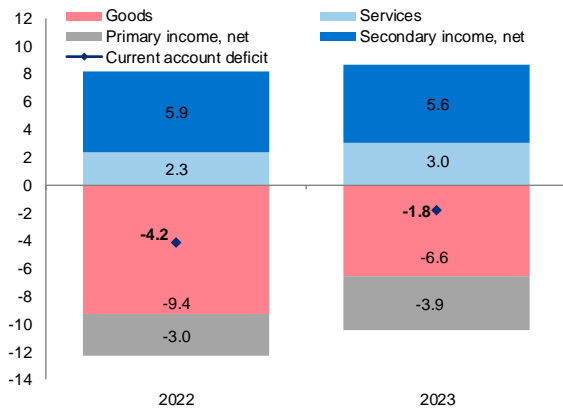
Chart 8 Contributions to real GDP growth, expenditure side
(in pp)



Sources: SORS and NBS.
* NBS estimate.

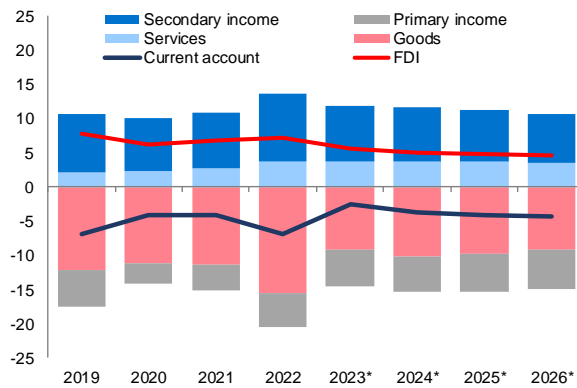
As a result of increased export capacities, ensured energy security and lower global energy prices, the current account deficit declined to a mere EUR 1.8 bn in 2023, measuring 2.6% of GDP at the annual level, this being the lowest deficit on record. According to our projection, the anticipated pick-up in the investment cycle and the associated import of equipment and intermediate goods, which will greatly be offset by the rise in export capacities and recovery of the euro area’s external demand, will result in the current account deficit trending at around 4–5% of GDP this year and in the medium term, which is sufficient to ensure the country’s external sustainability. We are still projecting its full coverage by net inflows from FDI, and we expect that in nominal terms, inflows to Serbia over the following years will maintain last year’s record level that exceeded EUR 4.5 bn.

Chart 9 Structure of the current account
(in EUR bn)



Source: NBS.

Chart 10 Current account and FDI projection
(in % of GDP)



Sources: SORS and NBS.

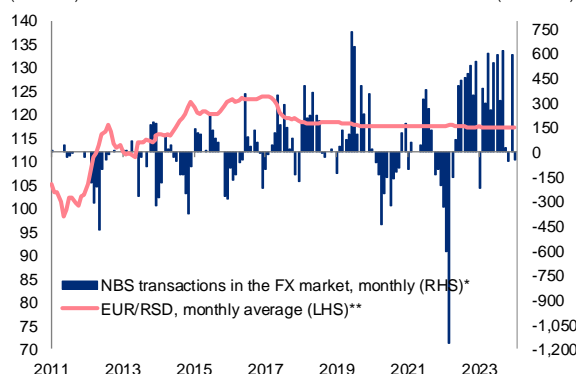
* NBS projection.

As for FDI, I would like to underline that year after year, their inflow remained diversified both in terms of project and geography and was mostly channelled to tradable sectors. For nine consecutive years, it covered the current account deficit, thus contributing to stronger appreciation pressures and driving FX reserves further up, to around EUR 25 bn at end-2023, whereby they ensured the coverage of more than 6.7 months' worth of goods and services import.

In addition to capital inflows on account of the most desirable investments – FDI, and lower country risk premium, another confirmation of foreign investors' confidence in Serbia's macroeconomic prospects is the high demand of foreign investors for the eight-year dinar government bond, issued this January and sold in the record amount of more than RSD 63 bn. Investor demand was also high in early February, when additional eight-year dinar securities were sold in the amount of RSD 41.5 bn.

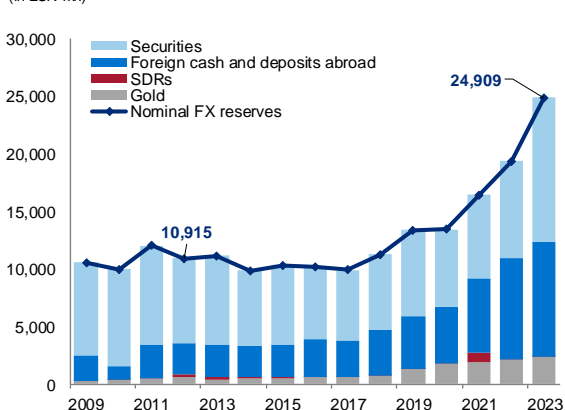
Against the backdrop of prevailing appreciation pressures and in order to maintain the dinar's relative stability to the euro as a key pillar of financial stability, business certainty, and investment and consumer confidence, this was the sixth of the seven past years that we ended up as a net FX buyer in the IFEM. In 2023 alone we bought nearly EUR 4 bn net, and more than EUR 9 bn since 2017.

Chart 11 Dinar exchange rate and NBS transactions in the FX market
(EUR/RSD)**



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

Chart 12 Value and structure of NBS FX reserves
(in EUR mn)



Source: NBS.

I believe that these results achieved in a turbulent time, where adverse political and economic developments are intertwined on the global scene, are a clear proof that measures and activities undertaken in the past period by the NBS and the Government are producing results and confirming that we are steering our economy in the right direction. We have not only preserved our macroeconomic stability and shown resilience to the negative effects of external shocks, but also secured favourable growth prospects in the long-term, as well as Serbia's status as an attractive investment destination.

Our economy's resilience is also underscored by the relevant international institutions that monitor and assess economic policies in other countries, as well as by rating agencies that have kept our credit rating at a step away from investment grade.

Ladies and gentlemen, dear colleagues,

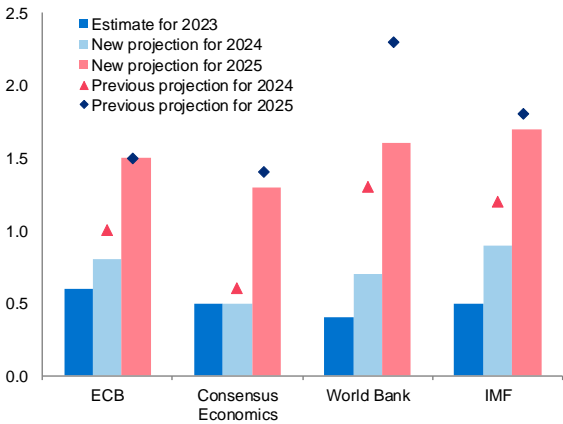
In the remainder, I shall give a more detailed overview of the factors from the international environment which will dictate inflation and economic movements going forward, and by extension affect our future decision-making.

Firstly, it is important to note that global inflation is retreating faster than anticipated and is approaching pre-pandemic levels, thanks to the effects of past monetary policy tightening by the majority of central banks. As a result of lower inflation, we can expect leading central banks to start trimming their interest rates, and some inflation-targeting banks in the region have already started this cycle.

Still, the IMF and other relevant international institutions have warned that central banks should take a cautious approach when deciding to start trimming their rates so as not to give rise to renewed inflationary pressures. We still see pronounced risks that may result in inflation in many countries trending higher than expected and slow down its return to the target.

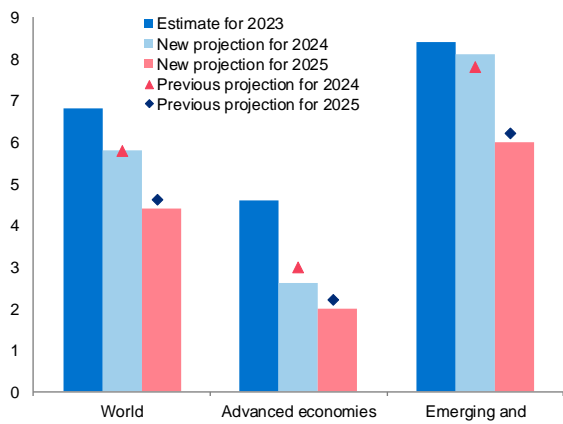
At present, the biggest source of uncertainty is geopolitical tension, which was exacerbated early this year, when the transport of oil and other commodities through the Red Sea and the Suez Canal was brought into question. So far, this has not had a major effect on the price of oil and other primary commodities which were lowered due to dampened demand from China, but it did reflect on the cost of overseas transport. Due to uncertainty, we did not base the movements in global oil prices solely on oil futures, which indicate a lower level this and the following year than the one currently held. When formulating the assumptions to our projection, we took into account the projections of relevant international institutions which expect the global oil price to move between USD 80 and USD 83 per barrel. We note that our new assumptions on the global price of oil are lower than the ones stated in the November projection.

Chart 13 Adjustments to the euro area's GDP growth projection for 2024 and 2025
(in %)



Sources: ECB (September and December), Consensus Economics (October and January), World Bank (June and January) and IMF (October and January).

Chart 14 Revision of the euro area inflation projection for 2024 and 2025
(in %)



Source: ECB (December 2023).

Other risks from the international environment seem to be lower than last year. Also encouraging is the fact that the IMF has revised up its global growth projection for this year, by 0.2 pp to 3.1%, and that it now estimates global risks to be balanced, instead of skewed to the downside. As for the economic activity in the euro area, our key trade partner, it practically stagnated in H2 last year, which is why the growth

forecast for this year is somewhat lower than three months ago, though still higher than in 2023. According to the ECB's projection, the euro area's economic growth will measure 0.8% this year, which is similar to the IMF's forecast.

In view of all of the above, the NBS will continue to monitor and analyse trends in the international commodity and financial markets, and make future monetary policy decisions in relation to the pace of inflation slowdown and movement of its key factors, as well as the assessment of risks which are for the time being assessed as symmetric for both inflation and GDP projection. We will maintain caution in our decision-making to ensure sustainable movement of inflation within the bounds of the target tolerance band. We will monitor and assess developments in the international environment, as well as central bank decisions, and monitor their effects on our economy, but we will not look up to anyone or copy someone else's solutions. We are aware that there are no shortcuts to success, and as so far, we will be prepared for different surprises that might arise from the international environment and we will make decisions in the general interest. This is the only way to ensure that our economy thrives in optimal conditions for efficient functioning, competitiveness and profitability, further rise of employment and wages and, by extension, continued and accelerated progress of Serbia and better lives of all our citizens.

We remain open to your questions in the remainder of the conference.