Jorgovanka Tabakovi: A new global context - challenges of an uncertain future

Speech by Dr Jorgovanka Tabakovi, Governor of the National Bank of Serbia, at the 31st Kopaonik Business Forum, Kopaonik, 4 March 2024.

* * *

Slides accompanying the speech

Esteemed members of the Government, representatives of the diplomatic corps, members of the business community, fellow economists, ladies and gentlemen, dear friends,

How much is the ideal from the famous sentence worth today: **"government of the people, by the people, for the people"?**

It is a sentence of Abraham Lincoln on the new birth of freedom in his Gettysburg address, delivered in 1864 in honour of the soldiers who fell at Gettysburg in one of the decisive battles of the American Civil War. Today we speak about the challenges of an uncertain future, though future is always uncertain.

However, we live in a time when the past is uncertain too and is often intentionally falsified in order to use that fake money to buy believers for new theories to which real money and real values need to be redistributed.

In December last year, we celebrated 150 years of the Serbian dinar as the national currency. Marking that important anniversary, I said that few nations in the world can boast of having a currency of their own for a century and a half.

In addition to the conventional national symbols - coat of arms, flag and anthem, the spirit and strength of a country are made up of its tradition, culture and national currency. The duration of these state symbols is an indicator of how long-lasting, how stable and how enduring a nation is.

They are a reflection of the history and achievements of a nation, and they are of essential importance for its sovereignty and reputation in the world.

No matter what we discuss during these three days, it will all be pointless if a part of our people does not have the right to their own currency and basic means of livelihood.

No one has the right to deny our people the right to their own currency, nor the right to live in peace, and this calls for the response of each and every person and institution in order to have a future at all!

It is easy to remain untouchable and lofty, to not get involved in the problem, to stand aside, to dispense advice, to stand up and preach, to confidently talk about theory. It is easy to flaunt your moral convictions, to use helplessness as an excuse...

Words, platitude....Words as a beginning because it is only actions and results that speak of us all.

On the global front, changes seem to have never been faster. The world economy went from almost deflation to high inflation in a very short time. From negative interest rates and cheap money, to never faster tightening of monetary policies by leading central banks.

There is almost fanatical buzz about the green economy, the positive and negative sides of the rapidly growing generative artificial intelligence. Various forms of fragmentation and polarization are testing consumer and investment confidence and have the power to change the global economic landscape. All of this reminds us that any serious discussion about recent and future developments must take into account the complexity of macroeconomic conditions and geopolitical relations in which economic policy decisions are made and implemented.

Economic policy, always and everywhere, must be guided by medium-term objectives, which are not a wish list. That is why I will repeat the conclusion from last year - what separates theory from practice is our responsibility for people, for growth and development, and for social stability. We depend on the conditions of the time we live in, but also on the decisions we make and the consequences of which we are held accountable for.

Ladies and gentlemen,

(Slide 2) In such a global environment, the resilience of the Serbian economy has again been tested and confirmed! Let me give you a few examples.

- The record exports of goods and services worth EUR 41 bn in 2023 are by 75% higher than in the pre-pandemic 2019.
- We have ensured record high FX reserves in the amount of EUR 25 bn, which are by 87% higher than in the pre-pandemic 2019.
- We have built an environment for record high FDIs of EUR 4.5 bn last year, or around 20% higher than in the pre-pandemic 2019.
- The unemployment rate is at its lowest level.
- Formal employment in the private sector is around 10% higher than before the pandemic.
- Average wage in December was 64% higher than pre-crisis.
- Because of all this, analysts and investors agree that "the Serbian bonds are shining", which is confirmed by the huge demand for eight-year dinar bonds, while the difference in yields on foreign currency bonds compared to German bonds is significantly reduced.

All these results attest to the appropriateness of the economic policy we have implemented. That's why we are relentlessly working towards the goal of Serbia getting an investment grade, and are more focused than ever. We tackle all the factors that can affect the outlook/ratings upgrade. Our commitment to that goal should result in even more investments and expand the investor base, and position Serbia even better on the investment map in terms of both FDI and portfolio investment.

This is the ideal moment to ask a question: What is the difference between investments by domestic and foreign investors? Someone please show me an analysis of the effects where the state has made it difficult for domestic investors to invest, and give me one piece of evidence to support that claim. And please tell me what foreign or domestic investors are guided by, except by the same two goals: to make money, to have a profit, to pay as little tax as possible and to use that profit as they wish. There is no difference. In this sense, getting an investment grade, which has been practically recognised through investments, is something we will work on to obtain improved outlook formally as well.

(Slide 3) That is why today, when we are taking a look at the results and challenges, I will talk about five topics:

- The first are inflation factors, as the key global issue in economic discussions in the past three years;
- The second is the monetary and macroprudential policy response;
- he third topic, important from the aspect of navigating our economy through numerous challenges, are the indicators of our resilience to external risks;
- The fourth topic, also important within the framework set for discussion here at the Forum, is the contribution of macroeconomic stability to corporate performance;
- And the fifth are the National Bank of Serbia's projections, with the assessment of key risks.

Let's go from the first one.

(Slide 4) The good news is that in most countries inflation struck a downward path last year. In Serbia too, inflation has been on a firm downward trajectory since last April. At end-2023, it was half the level recorded at end-2022, in line with our projection stated here a year ago.

- Along with a good agricultural season, the strongest disinflationary factor was the easing of cost-push pressures in food production at the global level, which had been the largest contributor to domestic inflation in the first place.
- Inflationary pressures weakened also in response to lower energy prices, and the resolution of a major part of supply chain bottlenecks.
- Inflationary pressures subsided in the past year also on account of other import and producer prices.
- This was coupled with the disinflationary effect of external and domestic aggregate demand, with tighter monetary conditions.

In January, y-o-y inflation dropped further, to 6.4%, fully consistent with our nowcast model, supported by artificial intelligence. According to our estimates, inflation decelerated further in February, to 5.5% y-o-y.

(Slide 5) In relation to occasional discussions about inflation factors and peaks in Serbia and other Central European countries, let me just introduce a few facts:

- Inflation rise in Serbia over the past three years was mostly driven by food and energy prices – which account for 53–75% of y-o-y inflation and are crucially affected by global factors.

- In comparable Central European countries, inflation spiralled up to highs unseen in decades, though peaking at different points in time. In Serbia, inflation peak was reached somewhat later and was generally lower than in those countries, so the high base effect from the same period in 2022 was also comparatively lower.
- Serbia's inflation peaking later compared to other countries may be explained by the fact that in the first wave of the energy crisis our state assumed the major part of the cost burden. It thus reduced uncertainty in the domestic market and mitigated the first wave of the crisis, while in the majority of other countries, the bulk of these price adjustments were made abruptly already in 2022.
- Also, core inflation, excluding the prices of food and energy and measuring the impact of monetary policy, edged up less in Serbia than in the majority of comparable Central European countries over the past three years.

(Slide 6) The second topic builds on the first one. Last year was marked by the further tightening of monetary conditions by the majority of central banks, which is certainly one of the factors behind the declining inflation path.

- The NBS was one of the first to tighten monetary conditions as of October 2021, nd our timely and well-calibrated decisions allowed for a more moderate response in 2023.
- In 2023, we lifted the key policy rate by a total of 1.5 percentage points and as of July it equals 6.5%.
- Further, in September, using the required reserve tool, we permanently mopped up a portion of excess dinar liquidity from the market.
- The goal of our measures is to anchor inflation expectations and limit second-round effects of the higher food and energy prices on the rise in other prices.
- That the interest rate channel works well is confirmed by the fact that past key policy rate increases have passed through to all dinar interest rates.
- At the same time, the efficiency of the expectations channel is confirmed by the return of financial sector inflation expectations within the target band and the anchoring of their medium-term expectations, as well as by the decline in short-term inflation expectations of the corporate sector.
- As a responsible regulator and looking into all aspects of the impact of the interest rate rise in the euro money market on the domestic financial market, we adopted a temporary measure of capping interest rates on housing loans. The effect of this measure on the financial result of the banking sector does not jeopardise banking sector operations in any way, while it does contribute to the preservation of financial stability by preventing a rise in non-performing loans. This measure also boosts disposable household income, but to the extent that does not undermine the inflation's firm downward trajectory, as it accounts for around 0.3% of total household consumption in Serbia over one year. In this way, we struck the right balance in the hierarchy of objectives – price stability, financial stability and economic growth.

(Slide 7) he third topic is the resilience of the Serbian economy, which was tested and affirmed in 2023 as well.

- Last year our GDP increased by 2.5%, whereby cumulative growth in the past four challenging years climbed to 12%. The composition of last year's growth was also sound – it was driven by net exports and fixed investments despite the

decelerated growth in the euro area and our other major trade partners. Investment growth benefited from higher corporate profitability, high FDI inflows and government capital investments.
- Resilience is also confirmed by the goods and services exports which reached EUR 41 bn in 2023 – 3.5 times more than in 2012 and over 75% more than in the pre-pandemic 2019. The importance of higher export capacities is evidenced also by the fact that commodity exports to Germany, our most important trade partner, went up by 14% last year, despite the decline in their economic activity.
- FDI inflow also continues to break records with over EUR 4.5 bn in 2023, more than 60% of which remains channelled into tradable sectors.
- We also ensured record high FX reserves of EUR 25 bn, while increasing gold reserves to over 40 tonnes or around 10% of total reserves. Relative to 2012, the value of gold reserves increased by four times.

(Slide 8) We also preserved the relative stability of the dinar exchange rate against the euro, as one of the key pillars of financial stability, the certainty of doing business, and investment and consumer confidence.

- Amid prevailing appreciation pressures, in six out of seven years the NBS turned out a net buyer of foreign exchange. In 2023 alone, we net bought close to EUR 4 bn and as of 2017 over EUR 9 bn.
- That is why I am confounded over and over again by concerns raised by some individuals about the overvaluation of the dinar and their advice to allow its depreciation for the sake of greater support to exports. Why are such recommendations flawed, in addition to neglecting the fact that we have witnessed pronounced appreciation pressures for a number of years? They are flawed because they disregard the fact that it is the real rather than nominal exchange rate that is determining exports, while potential dinar weakening would reflect on inflation growth. For the sake of reminder, the dinar's depreciation against the euro in 2010 and 2012 significantly amplified the effect of imported on domestic inflation, without any major positive effects on external competitiveness of our economy. Let me repeat that competitiveness is bolstered by structural policies, and not by the exchange rate policy!

All these results point to at least three obvious conclusions. First, that Serbian policymakers worked strategically to build up buffers against shocks. Second, that Serbian policymakers knew how to respond to numerous shocks by taking appropriate and well-timed measures. And third, these results are the most reliable indicator of policymakers' future responses.

(Slide 9) Esteemed colleagues,

The contribution of macroeconomic stability in Serbia to our corporate sector's operations is an issue repeatedly discussed in forums of this kind. The data indicate the following:

1. The real operating income of the corporate sector rose by 5% p.a. on average in the 2013-2022 period, reflecting significant expansion of the corporate sector's business activity.

2. The rise in real operating income was a significant factor behind lower unit labour costs, profitability growth and stronger financial position of the domestic economy, which is also confirmed by the fact that growth is broadly dispersed across sectors.
3. The rise in real operating income, especially in the foreign market, also signals that Serbia's economic expansion is linked with increased competitiveness and export propensity, underpinned by higher investment in capacity expansion and modernisation, technology transfer and the introduction of new business models.
4. Additionally, thanks to the Government's well-timed and comprehensive responses to the negative effects of the pandemic and mounting geopolitical and geoeconomic tensions, real operating income growth was not only preserved but even picked up to 8.2% in the period since 2019.
5. Finally, if the observed ten-year period is divided into two five-year subperiods, we see that the net profit of the corporate sector increased cumulatively by EUR 18.6 bn in the second five-year period. The key source of such increase is the improved operating sub-balance which contributed EUR 10.3 bn, or 55.6% of the recorded increase in net profit. Total calculated lower financial costs in respect of interest rates and exchange rate differences measured EUR 6.9 bn or 37% of the total increase in net profit, observed through the relation of two five-year periods.
6. Even such quantified effect unambiguously confirms the importance of price stability and relative exchange rate stability for the successful performance of our corporate sector, and, by extension, for growth and employment. In addition to having a positive impact on corporate cash flows, creating additional own resources for investment, they are also important for ensuring additional external financial support. Moreover, in a predictable business environment, the financial potential is more efficiently mobilised for extending and modernising the existing and for building new capacities.

(Slide 10) The last topic refers to our expectations for the coming period and the challenges ahead of economic policymakers.

Let me start by concluding that the macroeconomic projections of the National Bank of Serbia which I presented in the last year's Forum were consistent with the ensuing developments. Going forward, we expect an even better medium-term growth outturn, taking into account the new investment plan, which is why we revised up our growth projection for the coming two years. In order of priority:

- End-2023 inflation was half its level a year ago, consistent with our expectation which I presented last March.
- We expect inflation to retreat within the target band in mid-2024, approach the target midpoint of 3% late in the year and remain around this level in the medium run. This too is consistent with the projection I presented last March.
- When it comes to the impact of international factors, the prices of most primary commodities in the global market subsided in 2023. Though the prices of overseas transport went up amid problems in the Red Sea and issues surrounding the transport of oil and other commodities, there have been no major effects on the oil price and inflation so far.
- Global economic growth is expected to stay below its long-term average this year due to tight financial conditions in most countries and weak global trade and investment, which should also help soothe inflationary pressures.

- GDP growth of 2.5% last year was also consistent with our projection. We still expect GDP growth to accelerate to 3–4% this year, but we revised up our growth projection for the next two years to 4–5% p.a. Faster growth will be underpinned by continued accelerated implementation of planned investment projects in transport, energy and utility infrastructure.
- When it comes to balance of payments movements, the current account deficit was at an all-time low of 2.6% of GDP last year. This outturn is 4.3 pp better than in 2022 and was supported by lower global prices of energy, the resilience of our exports and the rebound in electricity exports. The current account deficit is expected to range from 4% to 5% of GDP this year and in the medium run, ensuring external sustainability. This will be underpinned by investment cycle acceleration and the associated higher import of equipment and intermediate goods. We also expect the current account deficit to stay fully covered by net FDI inflow, as in the past nine years.

Naturally, like all macroeconomic projections, this one too is characterised by numerous risks.

- When it comes to economic risks, they still dominantly emanate from factors arising from the international environment, though to a lesser extent than six or 12 months ago. By contrast, we have stronger risks on account of geopolitical tensions, fragmentation, unfavourable demographic structure, climate factors, some aspects of artificial intelligence use which require new answers, as all of these factors combined have a potential to turn into pronounced economic risks.
- Aggravated geopolitical relations and the widening gap in the global political scene are acting as a drag on global trade and capital flows, which can be particularly harmful to small and open emerging countries.
- Changes in the demographic structure are also a challenge for a number of countries, notably in terms of the decrease in active working population and the widening skills gap in the labour market. This is why investing in people, their education and improvement of living conditions is a key global priority.
- Without global and regional cooperation there can be no adequate answer to climate change, which has economic as well as far deeper consequences. This is where no progress can be made unless we all join forces. The challenges arising from the drastic changes in climate conditions and the sustainability of natural resource exploitation can cause disruptions in the global food supply chain.
- Finally, accelerated development of artificial intelligence creates a multitude of possibilities, but also gives rise to many risks. The quantitative technological breakthrough is certainly conducive to productivity growth, but can also lead to major changes in the labour market, and this has already mandated a special policy. What will prevail depends on us. Indisputably, investment in development and implementation of new technologies is necessary if we want to remain competitive, but this must be done in a way that will enable all members of society to benefit from them.

Esteemed participants of the Business Forum, By embracing the fact that future is always uncertain, and even more so today when we are witnessing an interplay of numerous social, technological and biological factors shaping and changing our reality, our only answer can be the creation of a system that is not afraid of change.

A system in which all advantages of the inevitable changes will be fully utilised for the growth and development of society. Still, our attention should also focus on building a system that is more than resilient, and is most aligned with the term of antifragility, as defined by Nassim Nicholas Taleb, a well-known thinker in the remit of risks and unpredictable events. Taleb said that "antifragility is beyond resilience or robustness. The resilient resists shocks and stays the same; the antifragile gets better." To build a resilient system, and I have often spoken about this, we need the following, among other things:

- Stability – political, macroeconomic and financial;
- Cooperation and solidarity at home and abroad;
- Strengthening and sharing knowledge for a modern 21st century society;
- Overcoming differences and supporting everything that is good for the growth and development of Serbia.

Speaking of the challenges of an uncertain future, I would like to refer to Morgan Housel, who recently published his book Same as ever where he says that instead of wondering what the future will be like in one, two or ten years, we should focus on things that will not change. And what will always be true is that there are no and there can be no shortcuts on the path to growth and development. I believe that the only path to sustainable growth in all conditions is through dedicated work, accountability for the decisions made, and readiness to implement those decisions, no matter how painful they might be.

The realisation of the programme "Leap into the Future – Serbia Expo 2027", which President Vui presented, will help us strengthen domestic growth factors and the resilience of our economy, which is why I will say one more time that we have raised our growth projection for 2025 and 2026, with the central value of 4.5%.

And once again – no matter what we discuss during these three days, it will all be pointless if one part of our people does not have basic means of livelihood. No one has the right to deprive our people of their right to their own currency, or the right to live in peace. Each and every person and institution must react in this case! We should bear in mind "government of the people, by the people, for the people"!

Thank you for your attention. I wish you all a fruitful 31st Kopaonik Business Forum.