National Bank of Serbia

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

Dr Jorgovanka Tabaković, Governor

Belgrade, 14 May 2024

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

Welcome to the presentation of the May *Inflation Report*. As usual, in today's conference we will present key information from the *Report*, notably current economic developments, new macroeconomic projections and monetary policy decisions taken in the period since the previous *Report*. We will also be glad to take your questions and provide additional clarifications, if needed.

At the very start of the conference, I would like to underline that in the past year inflation in Serbia has been on a solid downward trajectory, and over the previous months it has slowed even faster than we anticipated. In view of such movements, our current projection expects inflation to enter the bounds of the target tolerance band already in May, while the previous projection expected this to transpire in mid-year. At the same time, economic activity in the first quarter of 2024 picked up the pace beyond our expectations, to 4.6% y-o-y, giving us reasons to believe that we will achieve the 3.5% GDP growth rate this year, whereas in the previous projection we forecast growth in the 3–4% range. All of this indicates that our monetary policy was adequate and that it also ensured price stability in the medium-term, a continuation of positive economic growth rates and preservation of NPL ratios close to the historical lowest level of 3%.

We will now give a more detailed presentation of achieved macroeconomic movements and our latest projections.

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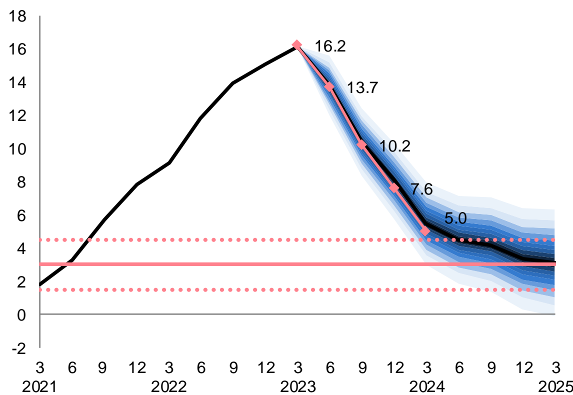
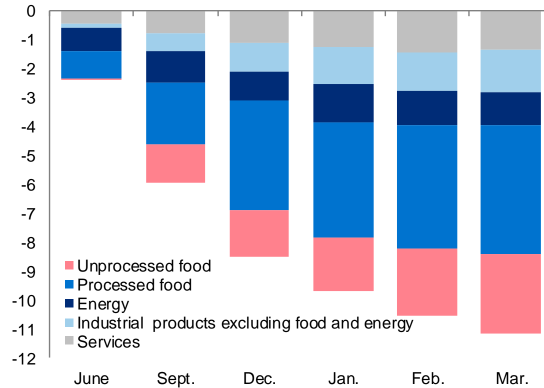
As noted in the beginning, inflation in Serbia continued to lose breath, even faster than we projected in February, as well as a year ago. Relative to its peak from March last year, headline inflation this April was more than three times lower, measuring 5.0%. It slowed further owing to the smaller increase in food prices amid the easing of global cost-push pressures, which stood below headline inflation as of February and measured 2.9% y-o-y in April. Core inflation also acted as an important drag on headline inflation and, thanks to the past monetary policy tightening and the lower imported inflation in the same period, it edged down by 6.5 pp to 4.8% in April.

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



Source: NBS.

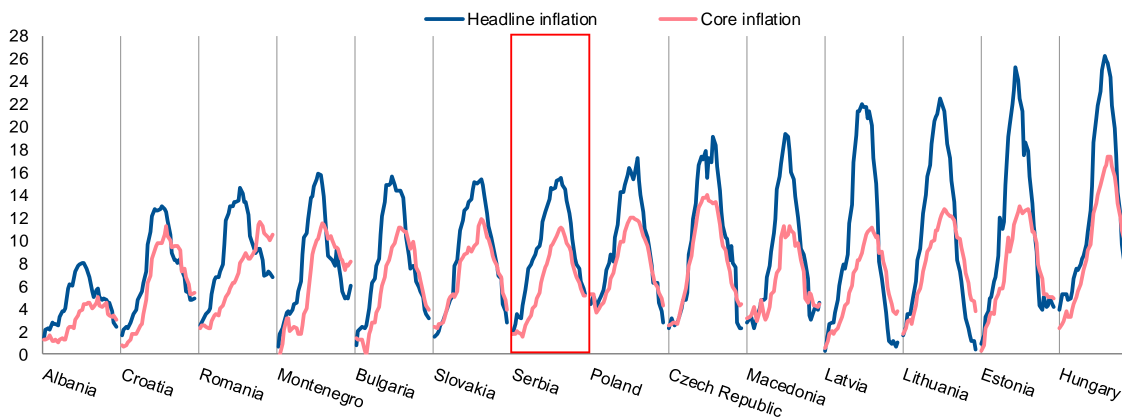
Chart 2 **Change in contribution of main CPI components to y-o-y inflation - relative to March 2023***
(in pp)



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

Also, in the majority of neighbouring countries, just as in the euro area and the USA, since the start of the year core inflation has trended at a higher level than headline, therefore a priority of central banks' monetary policies will be to ensure that core inflation continues on the downward path. A more detailed overview of core inflation trends in Serbia and the neighbouring countries is available in one of the text boxes in our May *Report*.

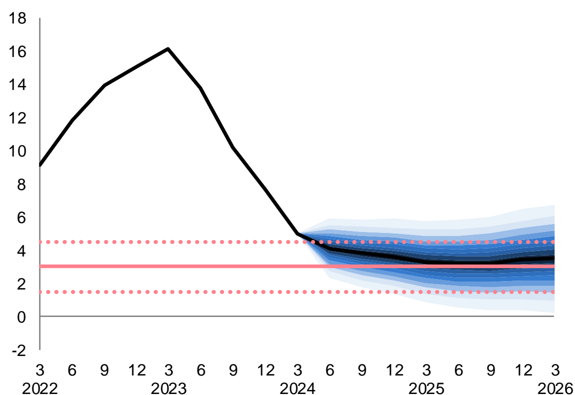
Chart 3 **Headline and core inflation movements from 2021 to 2024**
(y-o-y rates, in %)



Source: Eurostat.

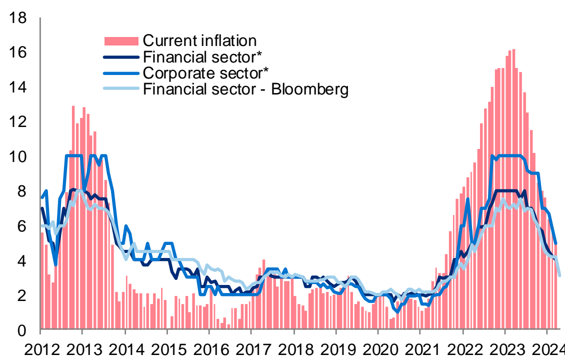
According to our latest projection, inflation will return within the bounds of the target tolerance band of 3±1.5% most likely in May, which is somewhat earlier than what we expected in the February projection. This is also indicated by our nowcasting model through which we obtain and process around 30,000 prices of products and services from around 130 internet sites in real time, and within which we develop techniques that rely on artificial intelligence. So far, this model has been rather reliable in assessing current inflation, and we will continue to develop it in the coming period.

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



Source: NBS.

Chart 5 **Current inflation and one-year ahead inflation expectations**
(y-o-y rates, in %)



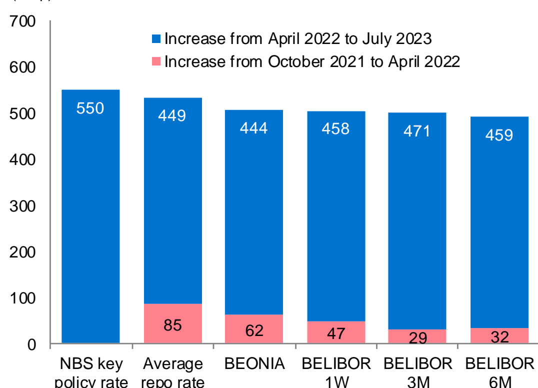
Sources: Gallup, Ipsos/Ninamedia, Bloomberg and NBS.
* Ipsos and Gallup until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

In the remainder of the year, we expect inflation to slow further and move around the 3% target midpoint as of next year and over the projection horizon. Such inflation movements will be under the biggest impact of the effects of past monetary tightening and receding inflation expectations, as well as the loosening global cost-push pressures, the continued slowdown in imported inflation and the still subdued external demand.

Short-term inflation expectations of the financial and corporate sectors decreased significantly in the past year, and financial sector's expectations returned within the target bounds at the start of the year. According to the results of Bloomberg's April survey, they are almost on the target midpoint and measure 3.1%. Such movements are helping push inflationary pressures further down, and at the same time speak in favour of enhanced credibility of our monetary policy.

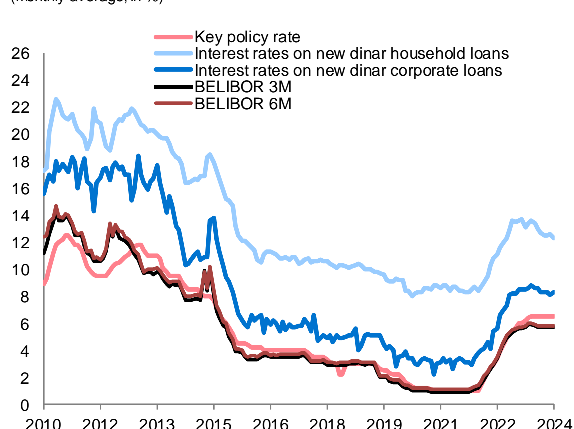
The downward inflation trajectory and the expected movements of its key factors in the domestic and international environment are pressing the question of when we should start with monetary accommodation, to what extent and at what pace. Our stance was to adhere to the principle of cautiousness so as not to rush into premature monetary policy relaxation. Our decision to keep our key policy rate unchanged at 6.5% was dictated by the still elevated – though receding – global inflationary pressures and the persistent and significant uncertainty in terms of movements in global energy and other primary commodities prices.

Chart 6 **Changes in money market interest rates from October 2021 to July 2023**
(in bp)



Source: NBS.

Chart 7 **Interest rate movements**
(monthly average, in %)



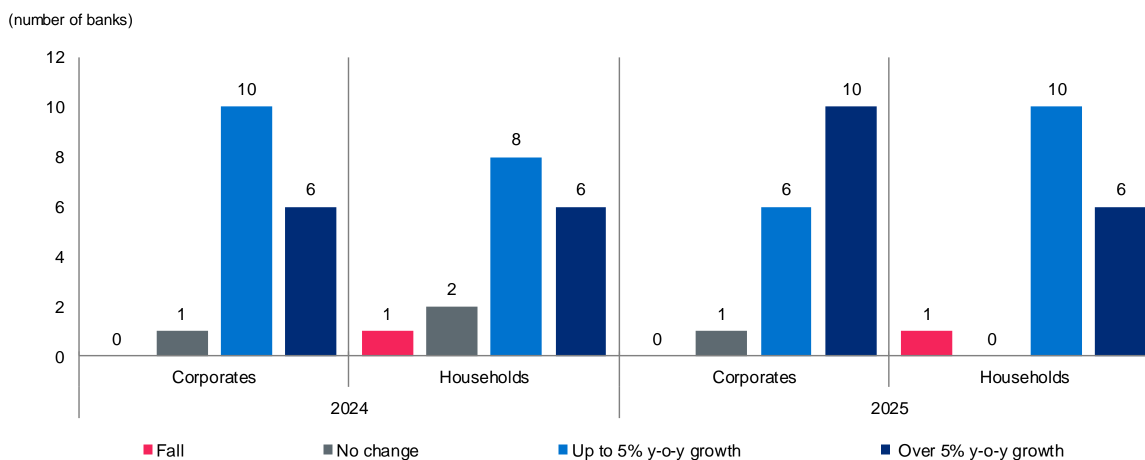
Source: NBS.

When making the decision, we took into account the fact that the effects of past monetary tightening have been greatly reflected on the cost and scope of private sector borrowing. I would like to recall that the analysis we presented in one of our text boxes confirms the efficiency of the monetary policy transmission mechanism through the interest, credit and expectation channels.

As the key policy rate was kept unchanged for the past months, interest rates in the interbank money market have stabilised, resulting in almost unchanged prices of dinar loans in the period since the prior *Report*. Corporate and household lending remained low in Q1 this year as well, reflecting the effects of past monetary policy tightening and the maturing of corporate loans disbursed within guarantee schemes. Even so, y-o-y growth in total loans picked up slightly relative to end-2023, measuring 1.3% in March. Credit growth was facilitated by growth in household loan demand and alleviation of banks' credit standards, notably for corporates. The results of our April lending survey show that almost all banks expect credit activity to post growth this year, which should pick up additionally in 2025, and a large number of banks expect growth in corporate and household lending to exceed 5% this and the next year. These expectations are also founded on the positive assessment of the overall economic situation in the country.

Preserved financial stability and real sector indicators that suggest a significant pick-up in economic activity since H2 2023 confirm that with adequate monetary policy, which was tightened continually, but gradually and in a balanced manner, we succeeded in ensuring a soft landing.

Chart 8 **Lending outlook for 2024 and 2025**

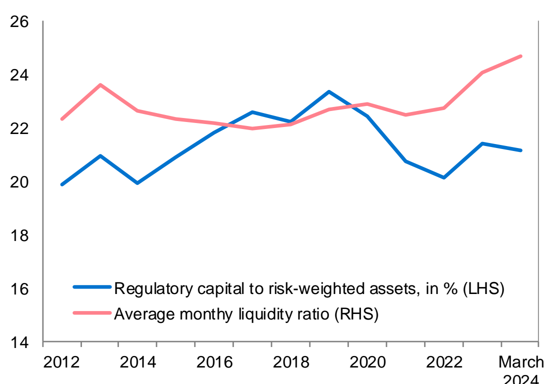


Source: NBS.

The preserved financial stability is illustrated by the high capital adequacy of banks of close to 22%, with liquidity indicators almost two times higher than the minimum, as well as the share of NPLs in total loans being kept at the historical low of around 3%. This was certainly facilitated by the strong regulatory framework for banks that was implemented even before this multidimensional crisis, as well as the carefully combined and synchronised measures of monetary and macroprudential policies.

Chart 9 **Banking sector capital adequacy and liquidity indicators**

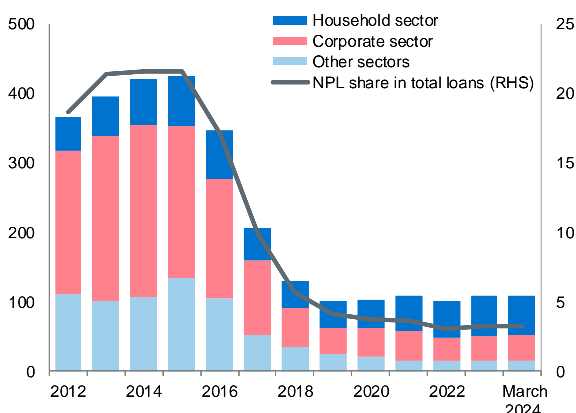
(in %)



Source: NBS.

Chart 10 **NPL level and share in total loans, gross principle**

(in RSD bn) (in %)



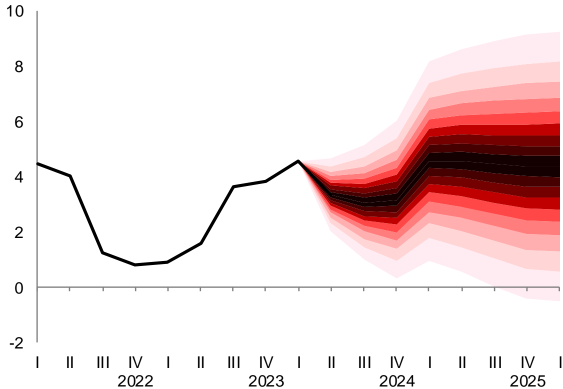
Source: NBS.

According to the flash estimate of the Serbian Statistical Office, y-o-y GDP growth in Q1 this year accelerated to 4.6%, and according to our estimate, seasonally-adjusted growth measured 1.1% relative to the previous quarter. On the production side, we estimate that y-o-y growth in GDP was driven by the rising activity in trade, industry and construction, with other services sectors also yielding a positive contribution. In terms of use, growth was driven by domestic demand, where private consumption and fixed investments gave the largest contributions.

Faster than expected GDP growth in Q1 boosted the likelihood that this year's economic growth rate will be closer to the central value of the 3–4% forecast range from the previous *Report*, therefore we now estimate GDP growth at the rate of 3.5%. Other relevant international institutions share similar expectations of economic growth for this year, including the International Monetary Fund, World Bank and Consensus Economics, and they estimate growth to be among the highest in the Central and Southeast European region. We expect an additional pick-up in economic activity, to the range of 4–5% over the next two years, which will be facilitated by the realisation of investments planned as part of the "Leap into the Future – Serbia Expo 2027" programme, alleviated global inflationary pressures and more favourable financing conditions.

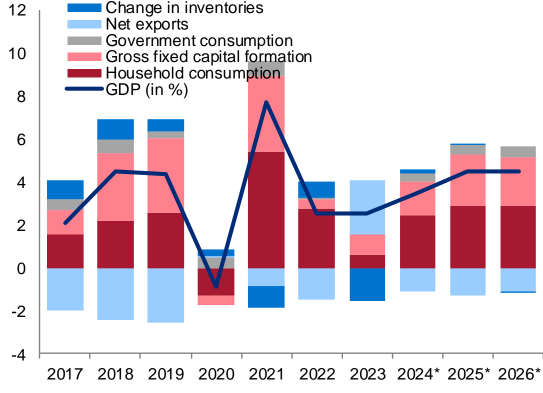
Growth will be driven by domestic demand, with a positive contribution of all components. Private consumption will increase owing to the continued growth in employment and wages, notably in the private sector, but without major inflationary effects given that wage growth will be largely a result of increased productivity.

Chart 11 **GDP growth projection**
(y-o-y rates, in %)



Source: NBS.

Chart 12 **Contributions to real GDP growth**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

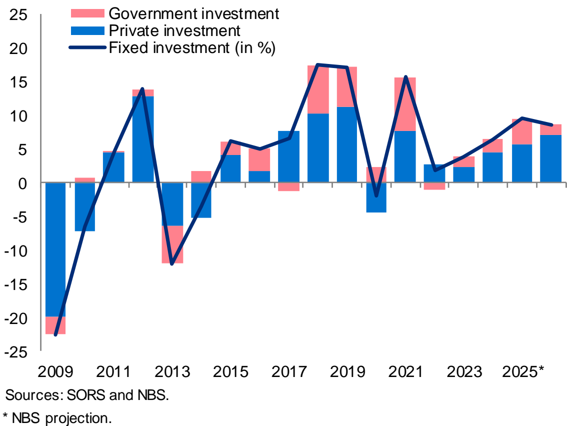
Considering that in the past months we heard comments that inflation has eaten up citizens' living standard, I would like to stress that wage and pension growth and decelerating inflation have pushed y-o-y real wage growth in January and February to 9.2%, and pension growth to 14.2%. That the living standard is improving is attested to by the increase in the coverage of the average consumer basket by the average wage and increase in the coverage of the minimum basket with the minimum wage to around 94%, the highest level on record. Wage growth and its relationship with

inflation was elaborated in more detail in a text box in the current issue of the *Inflation Report*.

Investments, both private and government, are still an important factor of economic growth this year, as they boost our economy's output potential. Investment growth is expected amid a high inflow of FDI, increased profitability in the previous years and maintained investment confidence, and it will be further facilitated by the loosening global inflationary pressures and more favourable financing conditions. Also, investment growth will be under the impact of the realisation of projects in transport, energy and utility infrastructure.

Chart 13 **Fixed investment**

(y-o-y growth, in pp)

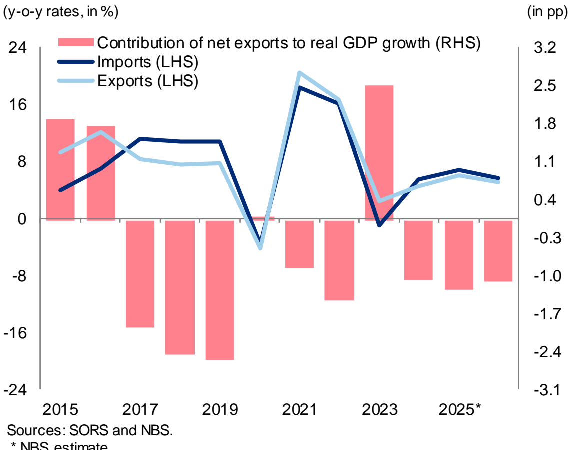


Sources: SORS and NBS.

* NBS projection.

Chart 14 **Real export and import growth**

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



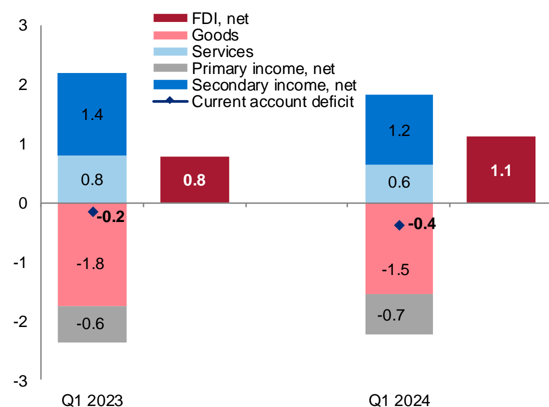
Sources: SORS and NBS.

* NBS estimate.

Despite the anticipated continued growth in exports which will pave the way for investments in export sectors from prior years and a gradual recovery of external demand, we still project imports rising faster than exports due to the accelerated investment cycle and needs for the import of equipment and raw materials, which will result in a negative contribution of net exports.

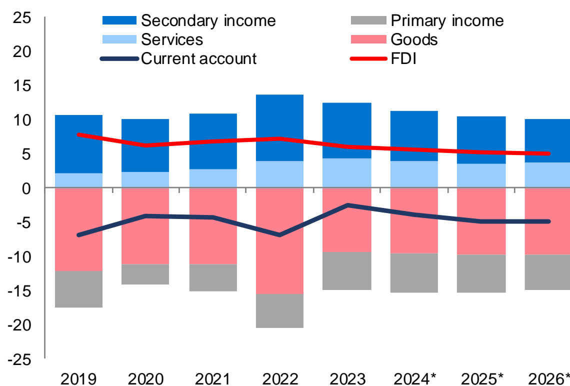
A pick-up in investments and the consequent import growth is also one of important factors why we projected gradual growth in the current account deficit in this and the following years. This year, we projected it at around 4% of GDP, and in the coming years at around 5%. In our judgement, the current account deficit will remain fully covered by net FDI inflows, which was the case in the past nine years as well. This will ensure the sustainability of our external position and a continued increase in FX reserves, which are currently at a record-high level of around EUR 25 bn and significantly above the criteria used for assessing their adequacy.

Chart 15 **Current account and FDI**
(in EUR bn)



Source: NBS.

Chart 16 **Current account and FDI projection**
(in % of GDP)



Sources: SORS and NBS.
* NBS projection.

The current account deficit remained relatively low and in Q1 this year equalled 2.3% of GDP, with a reduced deficit in goods and services trade as a result of the continued growth of manufacturing exports, a two-digit hike in services exports and the rebound in agricultural commodities exports on the one hand, and lower energy imports on the other. The current account deficit was covered by FDI inflows to Serbia many times over, given that in the first three months of the year they equalled around EUR 1.3 bn, while including the preliminary data for April, they reached EUR 1.7 bn, thus supporting the continuation of appreciation pressures. Under these circumstances and in order to maintain relative stability of the dinar vis-à-vis the euro, in the four months of the year the NBS intervened by net purchasing FX in the amount of EUR 530 mn.

All of the results I presented, including the reduction in fiscal imbalance and the downward public debt trajectory, but primarily the resilience our country has shown in the past years, have driven Standard & Poor's last month to raise Serbia's outlook for obtaining investment grade. This is yet another confirmation of our responsible economic policy conduct in the years riddled with global insecurities and overlapping global crises. Increasing Serbia's credit rating to investment grade is one of the strategic goals of the NBS and the Government. Once it is reached, it will ensure that Serbia is even better recognised on the international investment map and that it has more favourable conditions for financing the government, corporates and households.

Ladies and gentlemen, dear colleagues,

We will now take a closer look at risks which, if materialised, could affect the deviation of achieved inflation and economic activity in the coming period from our projections, thus by extension impacting our future decision-making.

Uncertainty regarding the materialisation of inflation and GDP projections still largely stems from geopolitical relations and prospects for global economic growth, as well as their impact on the global prices of energy and other primary commodities. The effects of different levels of global prices of oil and primary agricultural commodities are presented in a text box about alternative projection scenarios. We must underline that the materialisation of these risks should not have a major impact on our inflation projection or lead to inflation exiting the target bounds. To a certain extent, the risks also pertain to the persistence of core inflation globally and the length of monetary policy tightness by leading central banks. Risks to the projection also arise from the pace of growth of domestic demand, notably on account of the level of FDI inflow and investments in infrastructure and the energy sector. As for domestic risks, the outcome of the agricultural season at home is relevant and, in case of inflation, it mostly pertains to movements in fruit and vegetable prices, while in case of GDP the yield of cereals is particularly important. Overall, risks to the inflation projection and risks to the GDP growth projection for this and the following years are judged to be symmetrical.

The key message with which I would like to conclude my introductory speech is that our past monetary policy measures have been efficient and yielded the desired effects. Our priority is to keep inflation sustainably within the bounds of the target tolerance band going forward, and to preserve financial system stability, because along with the maintained relative stability of the exchange rate, this is the best way in which a central bank can contribute to the certainty of business, strengthening of macroeconomic fundamentals and ensuring a favourable outlook for our economic growth. This way we safeguard investment confidence, and support employment growth and the living standard of our citizens. In line with the achievement of these objectives and assuming that in the coming period we will "sail through more peaceful international waters, without major winds and storms", we will estimate when and at what pace we should begin with monetary policy accommodation. And if it happens that we are again exposed to storms from the international surroundings, we have

shown in the past years that we are able to navigate even the most severe ones. Nevertheless, we hope that the years ahead will bring fewer challenges than the ones behind us, and that this will help us achieve faster economic growth and overall progress of our country and all of our citizens.

Our colleagues from the Economic Research and Statistics Department will give a more thorough presentation of our projections, after which we will take your questions.