National Bank of Serbia

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

Dr Jorgovanka Tabaković, Governor

Belgrade, 13 November 2024

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

Welcome to the presentation of the November *Inflation Report* where we will present our views of the recent and future macroeconomic developments which dictate our monetary and macroprudential policy decisions.

I would like to begin by underlining what I believe to be the key takeaways from this conference.

Based on data and analyses which we will present to you today, as well as the estimates of all relevant international institutions keeping an eye on Serbia's economic policy, we may conclude unambiguously that the Serbian economy has shown significant resilience to the adverse events in the international environment. This is confirmed by the following:

- Dynamic economic growth, which, in cumulative terms and inclusive of this year, will exceed the pre-pandemic level by more than 18%;
- Established downward trajectory of inflation and its anticipated movement within the bounds of the target tolerance band throughout the projection horizon, i.e. over the next two years;
- Sustainable public finance and fortified external position of the country;
- Record high FX reserves, exceeding all the criteria used for assessing their adequacy.

The obtainment of an investment grade rating from Standard & Poor's, one of the three leading global rating agencies, further supports the above achievements, as does the successful completion of the fourth review of the precautionary arrangement with the IMF and the agreement on a new, advisory, non-financial Policy Coordination Instrument. Serbia has received its first-ever investment grade rating, with its most significant expected positive effects including more favourable financing conditions for both the government and the private sector, as well as Serbia's increased recognisability on the global investment map. This has fulfilled one of the key strategic objectives of the National Bank of Serbia and the Government for this year.

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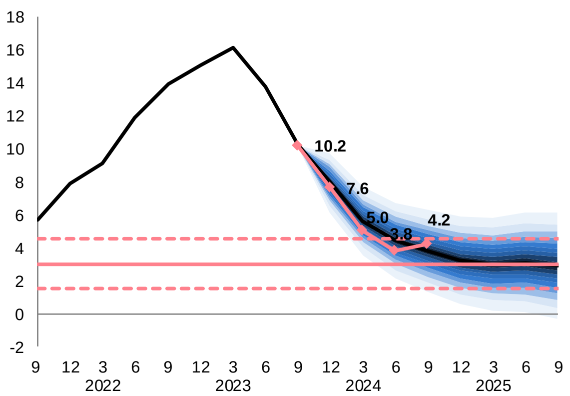
We will now briefly lay out the current economic developments, our new macroeconomic projections and monetary policy decisions taken in the period since the previous *Report*.

As is our practice, and given that price stability is our main objective and a benchmark of success, I shall start with inflation.

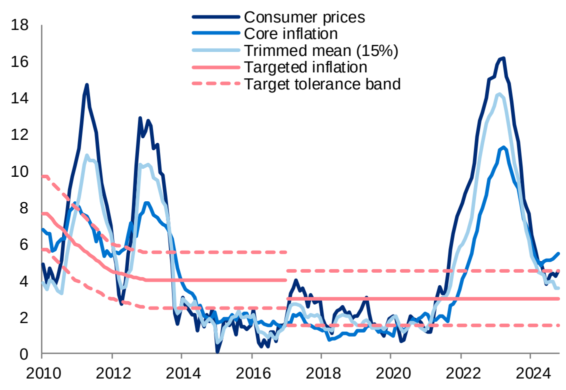
After returning within the target tolerance band of 3±1.5% in May, y-o-y inflation continued to move within its bounds over the following months, measuring 4.5% in October. Relative to the peak from March last year, inflation was set on a downward path by all of its key components, most of all food prices, whose y-o-y growth since February this year has been constantly lower than headline inflation. Core inflation also recorded a sharp fall in the same period, coming down from more than 11% in March last year to less than half that number, and trending at around 5% y-o-y over the past months. The level of inflation in the previous months was in line with the projection from the August *Report*, as well as with our projection from a year ago, which you can read about in more detail in one of the text boxes in the November *Report*. Due to the negative effects of the drought, the October inflation outturn was slightly higher than anticipated.

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



Source: NBS.

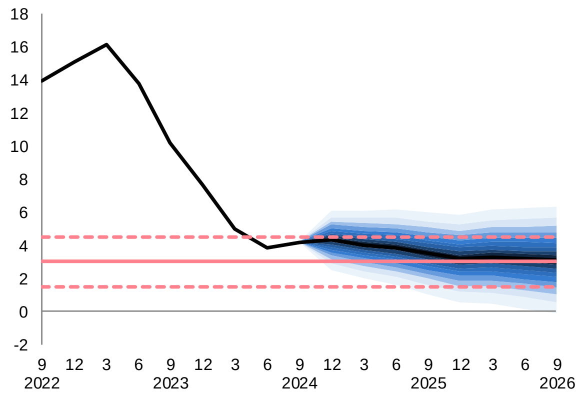
Chart 2 **Headline, core and trimmed mean inflation**
(y-o-y rates, in %)



Sources: SORS and NBS calculation.

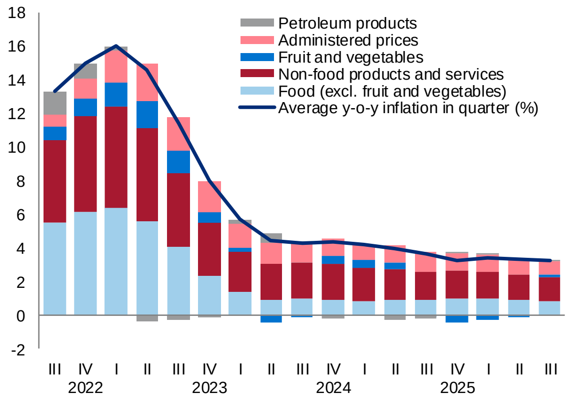
According to our new central projection, inflation will continue to move within the target tolerance band over the next two years, i.e. over our projection horizon. In the coming period, y-o-y inflation should gradually slow down and approach the target midpoint at the end of next year. The largest contribution to such inflation movements will come from the still restrictive monetary conditions, anchoring of not only medium-term but also of short-term inflation expectations within the target bounds, as well as lower imported inflation and the fall of global oil prices, which is expected based on the futures. In addition, we expect real wages to grow in line with productivity, helping core inflation decline and approach the headline rate. Relative to the previous projection, the negative effects of the drought on the supply and prices of fruit and vegetables are stronger, and domestic demand has been rising slightly faster. We estimate that this will mostly be offset by a lower global oil price, if it moves in line with the futures, and partly also by subdued imported inflation in the conditions of slower than anticipated recovery in the euro area. Taking all this into account, our headline inflation projection for next year is almost unchanged from August.

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



Source: NBS.

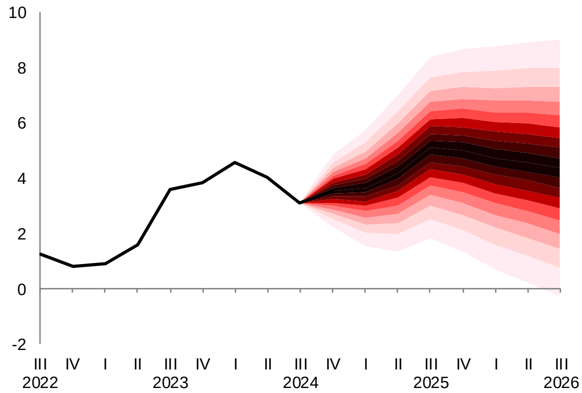
Chart 4 **Contributions to y-o-y inflation by component**
(average y-o-y rates, in pp)



Source: NBS.

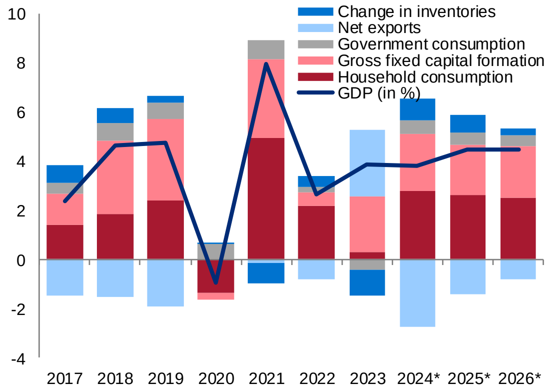
In the real sector, as positive dynamics in most production and service sectors extended into Q3, we kept our 2024 GDP growth projection at 3.8%. This year's GDP growth would probably be even higher were it not for the negative effects of the drought on agricultural output and electricity production in hydropower plants. Let me remind you that, as a result of the regular major five-year revision, 2023 GDP growth was revised up, also to 3.8%. One of the text boxes looks into the details of the revision, as well as its effects on economic growth and the GDP shares of key macroeconomic indicators.

Chart 5 **GDP growth projection**
(y-o-y rates, in %)



Source: NBS.

Chart 6 **Contributions to real GDP growth**
(in pp)

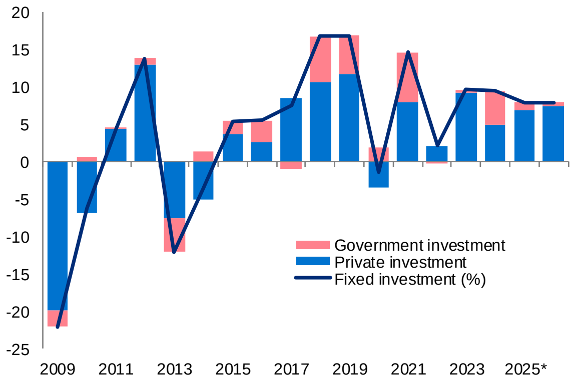


Sources: SORS and NBS calculation.
* NBS estimate.

As before, we expect economic activity to accelerate further in the next two years to the range of 4–5%, with a central value of 4.5%. The composition of growth for this year changed slightly from August in favour of higher domestic demand growth. Private consumption is expected to provide the largest positive impulse in the current and the coming years thanks to a rise in employment and wages, preserved consumer confidence and living standard of our citizens. Serbia has been awarded investment grade rating as an additional confirmation that investment confidence has been preserved, so fixed investment will continue to provide robust support to GDP growth. This will also be propped up by the implementation of investments planned under the “Leap into the Future – Serbia Expo 2027” programme. We believe that further growth in investment, expected to exceed 25% of GDP over the next two years, will be supported by the generally receding global inflationary pressures and improved financing conditions. The potential for investment will also benefit from high corporate profitability in previous years and FDI inflows.

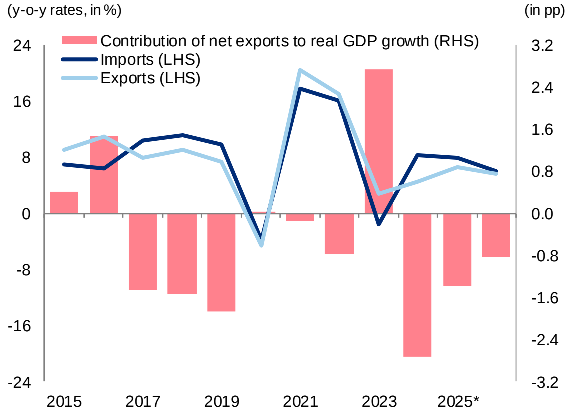
As investment and personal consumption are expected to gather momentum, we project that imports will rise faster than exports in 2024 and the coming years, resulting in a negative contribution of net exports, which will decline year after year. Other relevant international institutions – the International Monetary Fund, Consensus Economics, World Bank etc. – have similar expectations of economic growth and its structure for 2024 and beyond, placing it among the highest in Europe.

Chart 7 **Fixed investment**
(y-o-y growth, in pp)



Sources: SORS and NBS.
* NBS projection.

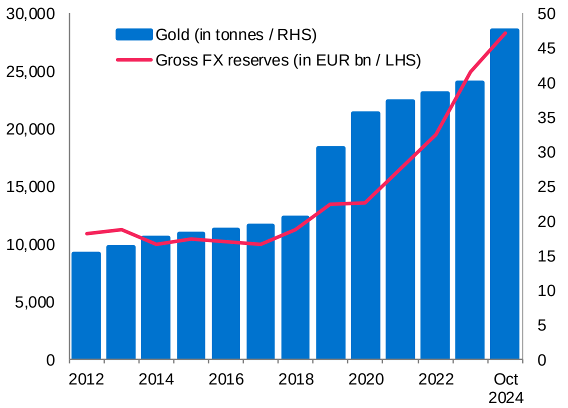
Chart 8 **Real export and import growth**



Sources: SORS and NBS.
* NBS estimate.

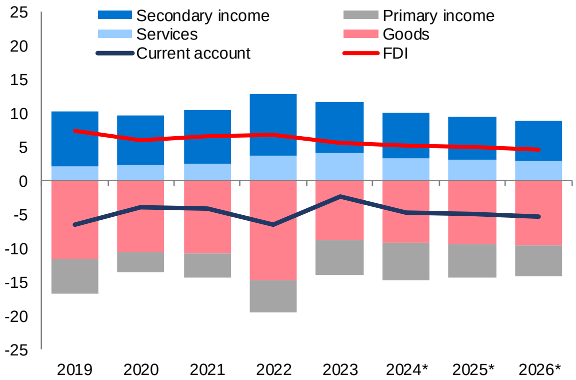
In the nine months of the year, Serbia's external position is marked by growth in both exports and imports of goods and services, though with a faster y-o-y growth in imports (8.5%) than in exports (4.3%). Within goods exports, despite persistently weak external demand, manufacturing exports continued up at a rate of around 3% y-o-y, owing to past investment. Agricultural exports also rebounded thanks to high autumn crop yields from 2023. The growth in imports was driven by the imports of equipment for capacity modernisation and the ongoing investment cycle, and partly by the imports of consumer goods and tourist services due to higher disposable income of households. Despite widening, the current account deficit was more than fully covered by FDI inflow. FDI inflow to Serbia in the first nine months amounted to EUR 3.6 bn, or EUR 3.9 bn inclusive of preliminary October data. Consequently, appreciation pressures prevailed this year as well, with the NBS turning out as the net FX buyer in the IFEM in the first ten months, having purchased EUR 1,990 mn. As a result, the country's FX reserves, at EUR 28.3 bn at end-October, exceeded all adequacy metrics, representing an important pillar of defence against external risks.

Chart 9 **NBS FX reserves**



Sources: NBS.

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



Sources: SORS and NBS.
* NBS projection.

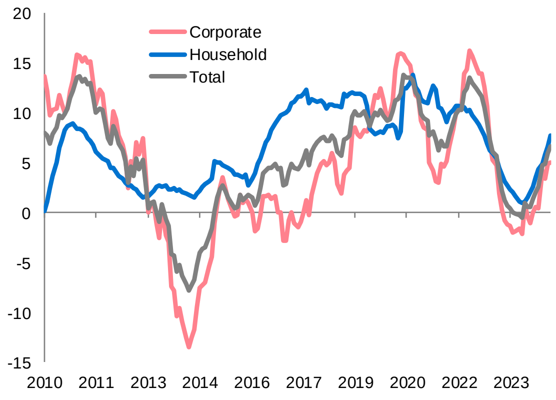
As the investment cycle is expected to gather momentum, the current account deficit is projected at around 4.7% of GDP this year and around 5% in the next two years, which is within the bounds of external sustainability. The favourable external position will also be sustained by the high inflow of FDI, which is broad-based in terms of both geography and project and is expected to stay around the last year's level.

The acceleration of Serbia's economic growth on account of investment and productivity growth, supported also by FDI inflow, ought to push up potential output and speed up the process of Serbia's real convergence to the EU. We draw your attention to a text box in this *Report*, empirically confirming that the credit rating upgrade, reflecting the Government's and NBS's results on the macroeconomic stability plane, contributes to the growing FDI inflow.

This year witnessed the continuation of favourable fiscal trends, with the surplus in the year to September reaching RSD 29.1 bn. The better than expected result can be attributed to revenue overperformance reflecting favourable labour market trends and higher than initially assessed profitability of domestic corporates in the last year. The created fiscal space was used to boost public investment, particularly in transport, energy and utility infrastructure, which is expected to remain at around 7.3% of GDP in the coming years. Although the medium-term fiscal framework envisages a more expansionary fiscal policy to support investment planned under the "Leap into the Future – Serbia Expo 2027" programme, we deem that this will not undermine the declining public-debt-to-GDP ratio, which measured 46.8% at end-September, significantly below the Maastricht criterion of 60%.

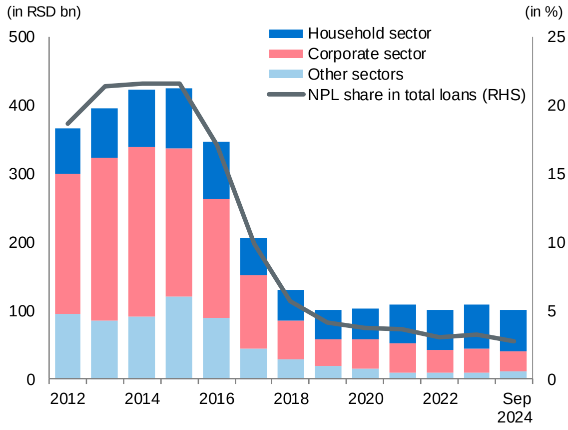
Based on all previously said, I believe that we have clearly ensured the so-called soft landing of our economy after strong shocks coming from the international environment and that now, amid reduced inflationary pressures and inflation moving within the bounds of the target, we are able to support more favourable conditions and sources of credit growth and thus also additionally support economic growth.

Chart 11 **Corporate and household lending**
(y-o-y growth rates, in %, at constant exchange rate, 31 October 2022)



Source: NBS.

Chart 12 **NPL level and share in total loans, gross principle**



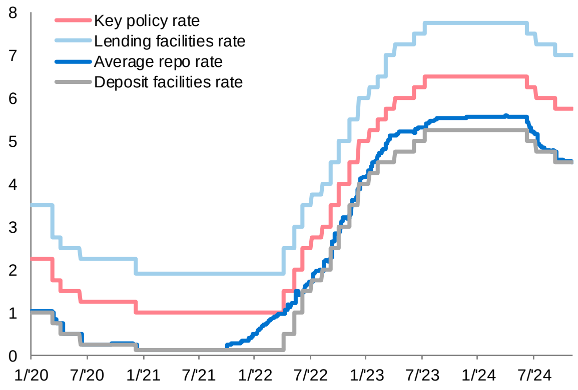
Source: NBS.

In Q3, lending to the non-monetary sector picked up further y-o-y, to 6.6% in September, driven by the rise in both corporate and household lending. Lending acceleration was also supported by the expected and initiated monetary policy easing by the NBS and ECB and softened bank credit standards. Lending growth, along with a lower amount of NPLs, resulted in a decline in the NPL ratio to its new record low of 2.7% in August, where it remained in September. Owing to a robust bank regulatory framework and well-calibrated and synchronised monetary and macroprudential policy measures, the NPL ratio was kept close to 3% throughout the current multidimensional crisis, with the degree of dinarisation of corporate and household receivables going up to 36.8% in September.

Being responsible monetary policy makers, we are aware that caution is still needed given numerous challenges, unpredictable macroeconomic developments in the international environment and mounting geopolitical tensions. With this in mind and recognising the need to assess the effects of past monetary policy easing, after reducing the key policy rate by 25 bp at three meetings each since mid-year to 5.75%, we kept it unchanged in October and November.

Here, I wish to emphasise that, according to our estimate, monetary policy remains restrictive despite the easing, helping keep inflationary pressures low in the period ahead. An important factor in maintaining the restrictiveness of our monetary policy and a confirmation of its high credibility are the lower inflation expectations, which, in the case of the financial sector, are within the inflation target band both one year ahead and in the medium term.

Chart 13 **Key policy rate and average repo rate**
(y-o-y rates, in %)



Source: NBS.

Chart 14 **Inflation expectations**
(y-o-y rates, in %)

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

We will make monetary policy decisions cautiously, on a meeting-to-meeting basis, depending on the pace of inflation's slowdown and movement of its key factors, mindful of the effects on financial stability and economic growth. The aim of our measures is to ensure the best possible support to economic growth by delivering price stability and relative exchange rate stability, thereby contributing to greater business certainty, a more favourable investment climate, as well as higher employment and living standards for our citizens. At the same time, by preserving financial stability, we enable a stronger feedback loop between the financial and real sectors.

Ladies and gentlemen, dear colleagues,

The results achieved did not come overnight, nor were they a gift from God. They had to be earned through a well-thought-out and responsible economic policy. The NBS had a clear mandate, was independent in choosing instruments of action, and exercised effective coordination with the Government and constructive cooperation with the financial sector. Only in this way could it successfully respond to numerous external challenges, while preserving macroeconomic stability and prospects for dynamic economic growth, which are key factors for employment, as well as the security and stability of our citizens' incomes. Moreover, the NBS strives to further ease the financial situation for citizens during these turbulent times and to protect them from potential sudden market disruptions. Closing my speech, I would like to remind you that, with this goal in mind, we capped the interest rate on euro-indexed housing loans for first-time homebuyers last year, taking a pre-emptive action to safeguard financial stability. We are now preparing legal solutions aimed at capping the maximum interest rates banks can offer on some categories of household loans. This will help increase citizens’ disposable income, while further strengthening the transmission of monetary policy measures through the interest rate channel.

In the remainder of the conference, our colleagues from the Economic Research and Statistics Department will present our projections in more detail, and after that, please feel free to ask questions.