NATIONAL BANK OF SERBIA

Governor's opening remarks at the presentation of the Inflation Report – February 2017

Dr Jorgovanka Tabaković, Governor

Belgrade, 22 February 2017

Ladies and gentlemen,

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

I would like to begin just as I will conclude – by summing up last year. Namely, 2016 ended with year-on-year inflation of 1.6%, the fiscal deficit of 1.4%, the current account deficit of 4%, the NPL level of 17%, foreign direct investment of EUR 1.9 bln and the customary inflow of remittances of 2.6 bln. Why am I starting off like this? It is because the fiscal deficit of 1.4% was lowered by 2.3 percentage points relative to the year before, the current account deficit fell from 4.7% to 4%, and the level of NPLs fell by 4.6 percentage points to 17% compared to the end of the last year – these being preliminary results. All these are reasons which underpin our decision to start this year with the new target of 3.0±1.5%. The results from 2016 justify our decision to lower that target. I expect this will be the best confirmation that Serbia ranks among the countries running low and stable inflation.

Inflation is expected to move within the target tolerance band as of early this year, on account of the effects of past monetary policy easing, the recovery of domestic demand and global oil prices, and a gradual rise in inflation abroad. The key risks to the projected inflation path are related primarily to the international environment, notably the diverging policies of the leading central banks – the Federal Reserve and the European Central Bank, as well as uncertainties associated with movements in oil prices. The Federal Reserve raised its rate in December and it became probable that the pace of rate hikes would be faster than expected. On the other hand, the European Central Bank's decision to extend its quantitative easing programme until at least end-2017 signals the continuation of the Bank's monetary accommodation, expected to moderate adverse effects of the Fed's policy.

What I wish to highlight is that today Serbia is more resilient to all external shocks thanks to the improved macroeconomic fundamentals, such as the narrowing of internal and external imbalances set in place by fiscal and structural adjustments. In particular, the fiscal deficit was slashed from 6.6% in 2014 to 1.4% of GDP in 2016, bringing down the share of public debt in GDP. This helped achieve the three-year objectives of the fiscal consolidation programme, a year earlier than planned. At the same time, fully covered by foreign direct investment for the second year in a row, the current account deficit declined from 6.0% in 2014 to 4.0% of GDP in 2016.

The influence of external factors and the increased resilience of our economy are also evident in the FX market – through maintenance of relative stability of the dinar exchange rate, which is no longer news for anyone. Depreciation pressures, emerging late last and early this year, were in part generated by uncertainties in the international financial market and in part by the seasonally higher demand in foreign currency for the purchase of energy products. In an effort to ease excessive short-term volatility of the exchange rate, the National Bank of Serbia intervenes in the FX market and will continue to do so, regardless of the direction of pressures. This means intervening on both sides. In so doing, we do not target any particular level of the exchange rate nor do we intend to influence its trend.

Ladies and gentlemen, dear colleagues,

As is well known to you, the task of the National Bank of Serbia is to preserve not only price, but financial stability as well. The Bank has been striving to strengthen the capacity of banks to resolve the NPL issue and to encourage the development of the NPL market. **As a result of measures taken under the NPL Resolution Strategy, the share of NPLs in total loans declined significantly – according to preliminary data, from 21.6% at end-2015 to 17.0% at end-2016, their lowest since 2011.** This only serves to confirm once again that a systemic, interinstitutional and coordinated approach yields results in this area.

While my associates from the Directorate for Economic Research and Statistics will present in detail our assessments of macroeconomic developments and our latest projections, I would like to highlight several key messages.

The National Bank of Serbia will continue to keep a close eye on and to assess the developments and trends in the domestic market and the international environment. As so far, we shall use all available instruments to ensure that inflation stays low and stable in the medium run. This is the best way in which a central bank, while at the same time maintaining financial stability, can contribute to economic growth.

Growth is expected to accelerate to 3.0% this and 3.5% next year, driven, as so far, by investment and exports (which posted an exceptionally high growth rate in 2016). Household consumption is likely to provide an increasing contribution, mostly owing to the recovery in the labour market.

As exports significantly outpaced imports in 2016, the trade deficit narrowed by 21% compared to the year before. Reflecting further improvement of the investment ambience, the inflow of foreign direct investment was high and project-diversified – most notably in export-oriented sectors. It came close to EUR 1.9 billion in 2016 and was more than sufficient to cover the current account deficit.

Furthermore, thanks to all results of macroeconomic stabilisation, an international financial institution issued the first long-term dinar security. Namely, in December last year the EBRD issued a three-year dinar bond, which will be traded on the Belgrade Stock Exchange. The dinar proceeds will be on-lent to local enterprises, notably SMEs. This move underpins the dinarisation process, which remains among our strategic commitments.

Finally, please remember these figures, they are very simple. We ended last year with year-on-year inflation of 1.6%, the fiscal deficit of 1.4%, the current account deficit of 4%, and the NPL level of 17%. We intend to further improve these results which have exceeded the expectations of many.

Ladies and gentlemen, dear colleagues,

Thank you for your attention. I will now give the floor to my colleagues.