



NATIONAL BANK OF SERBIA

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

Dr Jorgovanka Tabaković, Governor

Belgrade, 19 May 2017

Ladies and gentlemen, dear colleagues,

Welcome to the presentation of the *May Inflation Report*. As always, we will give an overview of the current monetary and macroeconomic developments and our expectations for this and the following year.

Inflation within the target tolerance band

First, I would like to underline that since the beginning of 2017, inflation has moved within the bounds of the new, lower target tolerance band. We anticipated that inflation would move within the target tolerance band this year and announced this trend at presentations of the *Inflation Report* last year as well as at the previous, February presentation. As in other countries, inflation in this period was affected by the recovery in global oil prices in the latter half of 2016 as was expected; however, adverse weather conditions early this year resulted in a higher than expected increase in the prices of fruit, vegetables and firewood. That this is an impact of one-off factors on inflation is suggested by low and relatively stable core inflation, which hovered at around 2% year-on-year. According to our latest projection, over the two-year horizon covered by the projection we expect inflation to move within the bounds of the target tolerance band of $3\pm 1.5\%$.

You will hear a more detailed elaboration on the projection of inflation and its factors later on in the conference. I would like to take a look at developments in the international environment which for quite a while have posed a challenge to Serbia, as well as to all small and open economies, which is why it is important that we preserve macroeconomic stability and improve our business ambience.

In the prior period, the international environment was marked by **uncertainty** – uncertainty regarding the pace of global recovery, uncertainty regarding the character of monetary policies of the leading central banks and uncertainty in terms of movements in the prices of primary commodities, notably oil.

The uncertainty in the international financial market originates primarily from the diverging monetary policies pursued by the Fed and the European Central Bank. Taking stock of the US economy, the Fed continued to raise its fed funds rate in 2017. By contrast, the European Central Bank's decision to extend the quantitative easing programme at least until the end of 2017 will mitigate the negative effects of the Fed's monetary policy normalisation. These decisions affect not only their economies, but also global markets and capital flows to emerging economies, which in turn inevitably affects the pace of Serbia's trade growth and financial cooperation with the rest of the world.

The recovery in the global market of primary commodities is largely attributable to the favourable outlook for global economic growth which is gaining speed and showing signs of sustainability, whereas volatile prices of these commodities are under the impact of specific factors – from weather conditions, through compliance with agreements of oil producers to geopolitical tensions.

It appears that the uncertainty on this account will persist in the period ahead. However, the results we achieve and anticipate when it comes to the narrowing in internal and external imbalances and implementation of structural reforms will determine the extent to which this uncertainty will reflect on us. Therefore I would like to particularly emphasise that owing to reduced macroeconomic imbalances Serbia is now much more resilient to potential adverse impacts from the international environment.

Lower fiscal deficit and stronger external position are our response to external shocks

Thanks to consolidation, the fiscal deficit was reduced to 1.3% of GDP in 2016, while positive movements continue into the current year. I wish to remind you that in the first quarter, the general government recorded a surplus of 1.2% of GDP, and the share of public debt in GDP was reduced further. At the same time, the current account deficit was reduced further in 2016 to 4.0% of GDP and was fully covered by foreign direct investment, which is likely to continue in the coming period. This is helpful for strengthening the country's external position, thereby increasing our resilience to external shocks.

The National Bank of Serbia's contribution to faster and sustainable economic growth and increase in employment will continue through price stability and relative stability of the exchange rate, with lower costs of private sector financing

A key fact regarding economic growth is that the current account deficit was reduced owing to outstanding export results of the Serbian economy, which was also facilitated by the activation of earlier investment and the recovery of external demand. Also, greater product and geographical diversification of exports reduces the dependence on developments in individual markets and in turn makes Serbia's exports and economic growth sustainable. The sustainability of growth is also confirmed by positive financial results of the economy over the past two years, which the National Bank of Serbia supported by ensuring price stability and relative stability of the exchange rate, with lower costs of private sector financing. Such results, coupled with further improvement in the business and investment ambience and continued structural reforms, create conditions conducive to faster economic growth. This year we expect GDP growth to step up to around 3% and then further up to 3.5% the following year, supported by continued favourable movements in the labour market.

Reduction in interest expenses and negative exchange rate differences – factor of the economy's success

Based on data of the Business Registers Agency, in 2016 the financial result of our economy improved by over RSD 360 bln compared to 2014.¹ In the same period, as a result of monetary policy easing by the National Bank of Serbia, a reduction in the country risk premium (resulting from more favourable macroeconomic performances of our economy) and monetary accommodation by the

¹ The difference between the net loss of RSD 131.8 bln in 2014 and net gain of RSD 229.3 bln in 2016. Net gain of RSD 67.2 bln was achieved in 2015.

European Central Bank, interest expenses declined from RSD 145 bln in 2014 to RSD 99.3 bln in 2016. This means that the corporate sector paid to creditors RSD 45.8 bln less in 2016 than in 2014. At the same time, owing to the stability of the dinar, which is the result of successful implementation of macroeconomic policies, and thus the National Bank of Serbia's policy as well, negative exchange rate differences fell by RSD 157.6 bln – from RSD 246.3 bln in 2014 to RSD 88.8 bln in 2016. In total, in respect of both these factors, the income statement of the corporate sector improved by RSD 203.4 bln in 2016 relative to 2014.

Given that the corporate sector has interest-bearing receivables, calculating positive exchange rate differences on FX receivables, the effect of savings in these two items on the profitability of the corporate sector equals RSD 148.4 bln in this period.

This makes us satisfied not only because of the volume of savings, but primarily because of the fact that this opens room for the corporate sector to engage in its regular business activities and to plan its development in more predictable circumstances. Of course, we are satisfied also because this confirms the soundness of the National Bank of Serbia's policy and gives us an incentive to continue with its implementation.

Ladies and gentlemen, dear colleagues,

Serbia's improved macroeconomic outlook and the results achieved in terms of the narrowing in internal imbalances and implementation of structural reforms have for quite some time been positively assessed by international financial institutions and rating agencies. Let me remind you that recently – in March to be precise – Moody's raised Serbia's credit rating. During the assessment, the agency took into account all of the results achieved in terms of reducing imbalances and achieving macroeconomic stabilisation, as well as the results of implementation of the dinarisation strategy and the resolution of non-performing loans. The risk premium, which since the start of the year has fallen in Serbia more than in the neighbouring countries, touching its ten-year low, also reflects the growing confidence in the Serbian economy.

In addition, the projections of key macroeconomic indicators for Serbia prepared by relevant institutions run close to our forecasts. They also assess that inflation will move within the target tolerance band both this and the next year, and expect further acceleration of GDP growth similar to our projections.

All the above factors indicate that our economy is now much more capable to respond to challenges – which is an additional incentive to us to preserve the stability we have ensured and to continue with structural reforms and improvements in the investment ambience.

You may rest assured that the National Bank of Serbia will continue to closely monitor and assess the developments and tendencies in the domestic market and the international environment. As so far, we will continue to apply all available instruments in order to maintain low and stable inflation in the

medium run, which, combined with the preservation of financial stability, will contribute to economic growth on sustainable grounds.

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