NATIONAL BANK OF SERBIA

Opening remarks at the presentation of the Inflation Report – May 2019

Dr Jorgovanka Tabaković, Governor

Belgrade, 15 May 2019

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

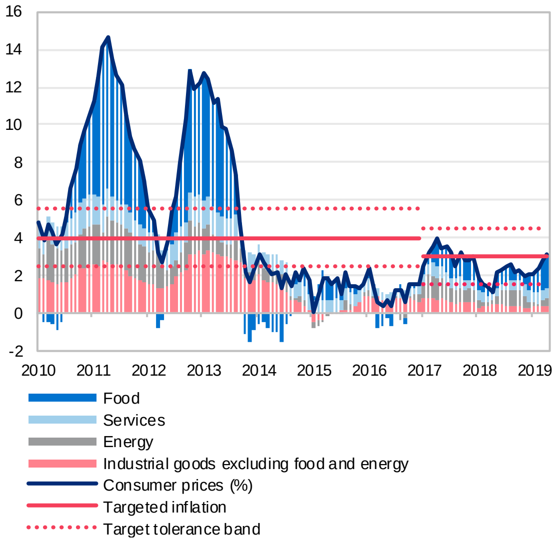
Welcome to the presentation of the May *Inflation Report.* We will give you an overview of the current macroeconomic developments, our new inflation and economic activity projections, as well as monetary policy decisions in the period since the previous *Report*.

To begin with, I would like to underline that positive economic trends have continued in 2019 – macroeconomic and financial stability have been preserved, economic, investment and external trade activities have increased, while the share of our country's public debt in GDP has contracted even further. All of this has been achieved despite the adverse effects of some factors from the international environment, notably the slowdown in euro area growth.

For six years in a row, inflation has been low and stable, and we expect it to remain so in the coming period as well.

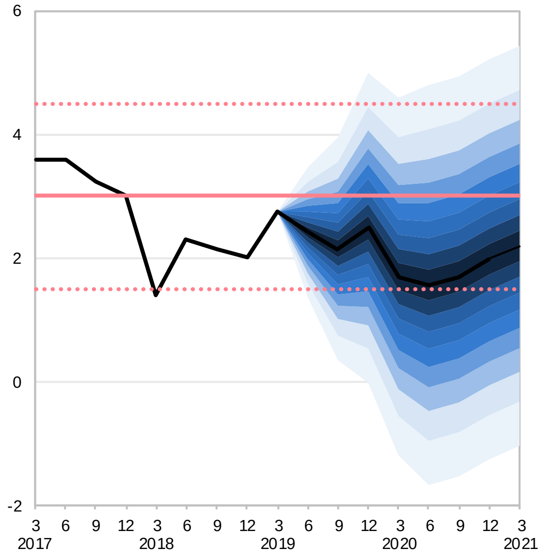
In accordance with our expectations, inflation has continued to move within the bounds of the target tolerance band (3.0±1.5%) in 2019. **In April this year, consumer price growth equalled 3.1% y-o-y**, with more than half of the increase attributable to the rise in the prices of vegetables on account of the low base and last year's dampened yield in other parts of Europe as well. **Other than that, inflationary pressures remained low on both the cost and supply sides, as attested by the core inflation of 1.4% in April.** As announced in February, we expect inflation to slow down during the next 12 months due to the base effect from vegetable prices. We expect it to come close to the target midpoint over the medium term, which will be facilitated by growth in aggregate demand. **To put it briefly, inflation will remain low and stable within the bounds of the target tolerance band until the end of the projection horizon, i.e. over the next two years.** These are also the expectations of the financial and corporate sectors. Anchored inflation expectations are indicative of monetary policy credibility, which contributes to greater resilience to potential negative effects of developments in the international environment.

Chart 1 **Contribution to y-o-y consumer price growth**
(in pp)



Sources: SORS and NBS calculation.

Chart 2 **Inflation projection**
(y-o-y, in %)

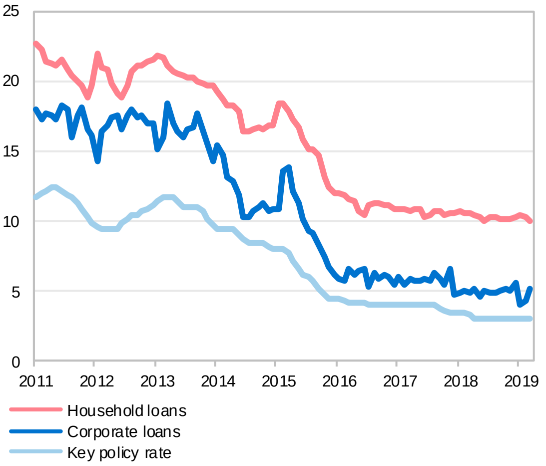


Source: NBS.

Financial conditions in the domestic market have remained favourable.

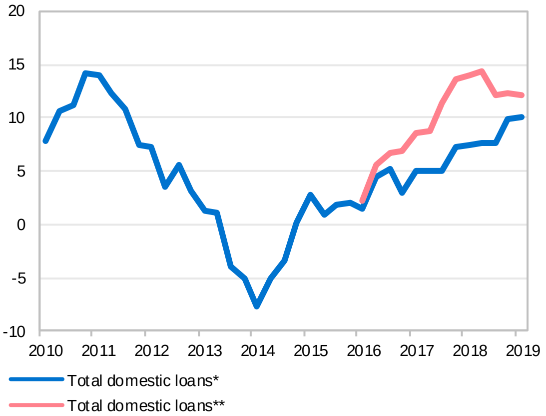
The favourable financial conditions in the domestic market are also evidenced by movements in loan rates, which dropped to their lowest levels in the dinar segment of the market at the start of the year. The declining interest rates, coupled with the rising economic activity and positive labour market developments, contribute to the increase in lending activity. Although the y-o-y growth in lending is measured in two digits, the share of loans in GDP is stable and poses no risk to either price or financial stability. Through our activities, we have bolstered banking sector stability additionally in the prior period – **the share of NPLs in total loans declined to 5.5% at end-March 2019**, its lowest level on record.

Chart 3. **Interest rates on new dinar loans**
(weighted average values, p.a., in %)



Source: NBS.

Chart 4 **Lending activity***
(y-o-y rates, in %)

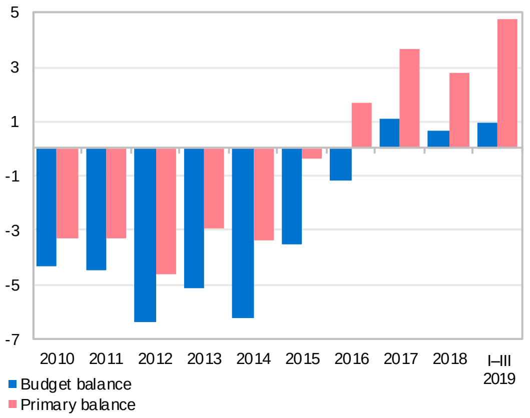


Source: НБС.
* Excluding the exchange rate effect.
** Excluding the effect of NPL write-off and sale since early 2016.

Favourable fiscal trends have been maintained.

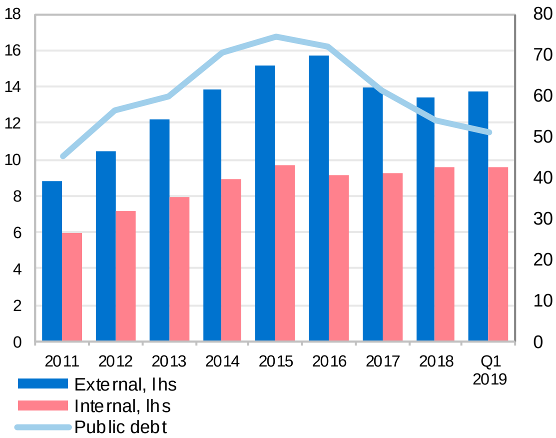
As in the past two years, 2019 has also seen a fiscal surplus, which measured 0.9% of GDP at the consolidated level in Q1, while the central government public debt declined further and equalled 50.9% of GDP at end-March. The fiscal policy, in full coordination with the monetary policy, stimulates economic growth, without giving rise to inflationary pressures – growth in the government's capital expenditures contributes to the increase in investments, while rising public sector wages and pensions provide support to sustainable consumption growth.

Chart 5 **General government fiscal and primary budget balance**
(in % of GDP)



Source: Ministry of Finance

Chart 6 **Public debt**
(in EUR bn) (in % of GDP)

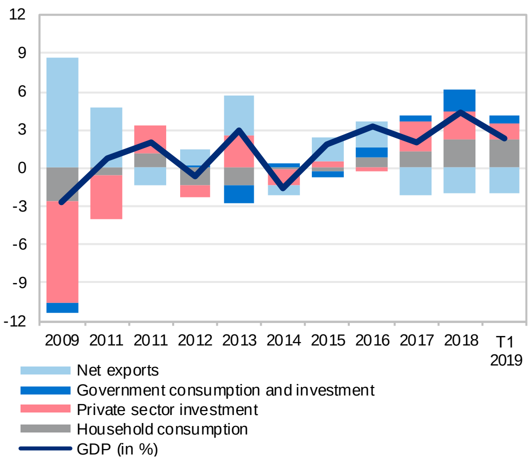


Source: Public debt administration.

Stable economic growth is driven by investments, propped by the improved macroeconomic and financial climate.

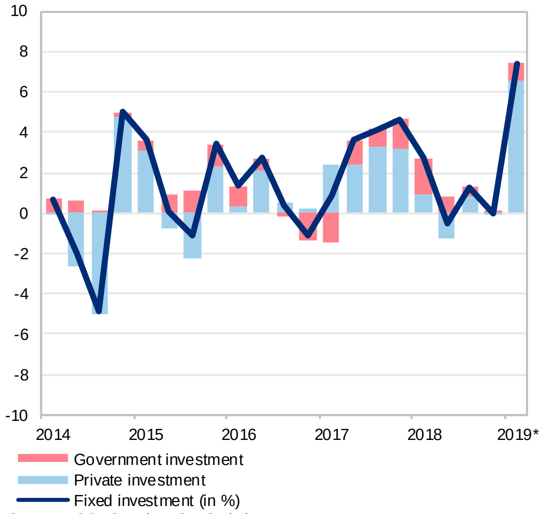
According to preliminary data of the Serbian Statistical Office, **GDP growth in the first quarter this year equalled 2.3% y-o-y.** Excluding the seasonal effect, quarterly GDP growth equalled 0.9%, meaning that **economic activity has upheld the upward trajectory for 18 consecutive months. Though growth in external demand slowed down as of mid-2018,** according to our estimate, **the achieved GDP growth is attributable to domestic factors**. A key contribution to growth came from fixed investments, which posted an s-a growth of 7.4% in the first quarter – namely, private investment by 8.0%, and government by 4.7%. Serbia's economy has become more attractive to investors mainly owing to the improved business climate and favourable financial conditions, while the implementation of infrastructure projects has also accelerated. In regard to this, we should note the increased profitability of the economy, which ended the previous year with a net profit of RSD 500 bn. This is an important source of investment and indicates that investment in our economy pays off. Our growth forecast for this year has been retained at 3.5%, and we expect it to pick up to around 4% in the coming years, with growth resting on firm grounds, primarily owing to the preserved macroeconomic stability.

Chart 7 **Contributions to y-o-y GDP growth rate – expenditure side**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate for Q1 2019.

Chart 8 **Fixed investment**
(s-a, in pp.)

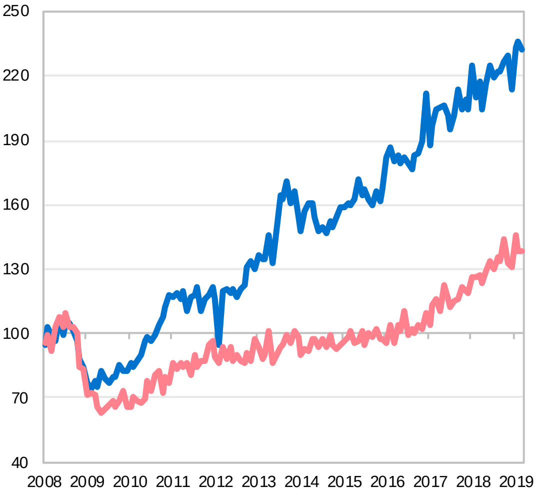


Sources: SORS and NBS calculation
* NBS estimate for Q1 2019.

Growth sustainability is also confirmed by the greater integration of our economy in the global economic flows – both trade and capital, since FDI inflows are on the rise.

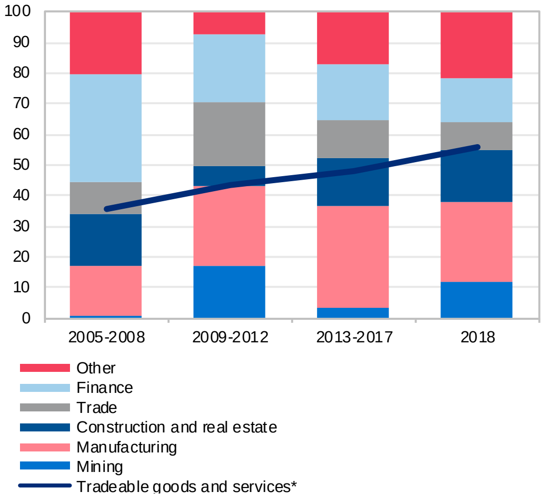
Although affected by the slack in external demand and steel quotas, the **export of goods recorded a 7.9% y-o-y increase in Q1 2019**, owing to the expansion of supply on account of earlier investments and accelerated sale of the surplus of agricultural commodities carried over from 2018. On the other hand, **the expansion of output and investment boosted the import of equipment and intermediate goods** and, in turn, the overall import of goods by 9.9% y-o-y. At the same time, the inflow of capital in the financial account, largely on account of FDI of over one billion euros since the beginning of the year, covered the current account deficit and brought the FX reserves up. Since most of the FDI inflow went to tradable sectors, in the medium term we expect a further rise in exports and a gradual narrowing of external imbalance. With external debt on a downward trajectory, this further strengthens the external position of the country.

Chart 9 **Trade in goods in euros**
(s-a, H1 2008 = 100)



Sources: SORS and NBS calculation.

Chart 10 **FDI structure by sector**
(in %)



Source: NBS.

Note: Preliminary data for 2018.
* Agriculture, industry, mining, transportation, catering, ICT.

Ladies and gentlemen, dear colleagues,

What has previously been said clearly indicates that Serbia's economic agenda continues to yield robust results, reflecting favourably on the credit rating and country risk premium. Let us remind you: at the end of the last year Standard & Poor's upgraded the outlook from stable to positive, while Fitch affirmed a stable outlook in early May, citing economic policy continuity aimed at further strengthening of macroeconomic indicators and public debt reduction. Lower risk premium, measured by EMBI, which almost reached its historical low in early May, also speaks in favour of the previously mentioned fact, and this is also backed up in practice by investments of foreign investors in securities, as witnessed by this month's successful implementation of seven-year dinar securities auctions. We believe that the good results of our economic programme will also be confirmed by the findings of the current IMF mission.

The achieved success was facilitated by the adoption of adequate, well-coordinated and timely economic policy measures. Integral to that is the monetary policy which, through provision and preservation of price and financial stability, significantly contributed to the sustainable acceleration of economic growth. The fact that the results were achieved amid uncertainties in the international environment only confirms the efficiency of the monetary policy and the measures the NBS takes in order to strengthen the resilience of our economy.

In the coming period too, monetary policy will continue to be predictable and consistent in delivering low and stable inflation in the medium term. As the key risks in the monetary policy pursuit still emanate from the international environment, the NBS will continue to closely monitor and analyse movements in the international financial and commodity markets and assess their impact on economic developments in Serbia.

Allow me to conclude by saying that our economic policy has made the economy more vital and capable of addressing the market challenges we had faced in the past and those that lie ahead. Serbia is now a country where doing business and finding a job is easier and the living standard is rising on sustainable grounds. Of course, further improvements are still possible, first and foremost by means of structural reforms which will sustain a further rise in investment, competitiveness, profitability and employment. This will enable us to preserve the achieved results and respond to future challenges.

I will end my introductory address here and give the floor to my colleagues from the Department for Economic Research and Statistics to present a detailed analysis of the current developments and our latest macroeconomic projections.