National Bank of Serbia

Introductory speech at the presentation of the *Inflation Report* – February 2025

Dr Željko Jović, Vice Governor

Belgrade, 19 February 2025

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

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

Allow me, first, to briefly summarise the year behind us. Just as the previous post-pandemic years, last year was marked by global uncertainty, heightened geopolitical tensions and rising protectionism. And yet it was the year in which global inflation, which remains elevated, was reined in. On top of this, inflation was contained without triggering global recession, though growth remains below-average in a number of countries, including in the euro area – a region particularly important for us. Even in such highly complex conditions, our country continued to demonstrate a high degree of resilience, and we successfully achieved all our objectives.

- Most importantly, when it comes to monetary policy, in May 2024, we brought inflation back to the target tolerance band of 3±1.5%, consistent with expectations, while ensuring that it stays there in the remainder of the year.
- This helped us support economic growth more directly by cautious monetary easing, more favourable borrowing conditions and accelerated lending.
- A favourable growth outlook for our economy was an important feature of macroeconomic trends in 2024 – the growth measured 3.9% and was one of the highest in Europe. As we diversified growth sources and responded to challenges in an adequate and timely manner, GDP exceeded the pre-pandemic level by over 18%.
- I particularly wish to emphasise the new record-high FDI inflows worth EUR 5.2 bn in 2024, as well as record-high government capital expenditure worth around EUR 6 bn, which are important pillars of investment financing.
- Though government capital expenditure was fully executed in accordance with plan, the fiscal deficit of 2% of GDP was lower than projected, allowing for a further decline in public debt. FX reserves are at a record high, exceeding all adequacy criteria and guaranteeing the sustainability of our external position.
- An increase in the degree of dinarisation of loans and deposits, record-high dinar household savings above RSD 190 bn, and a reduction in the NPL ratio to a new low of 2.5% at end-2024 attest to the preserved and further reinforced financial stability.

- Owing to all the above results, the NBS and the Government achieved one of our key strategic objectives – in October 2024, Standard & Poor's awarded us an investment-grade rating, and in late January Fitch affirmed Serbia's positive outlook, leaving room for an investment-grade rating at the time of its next review.

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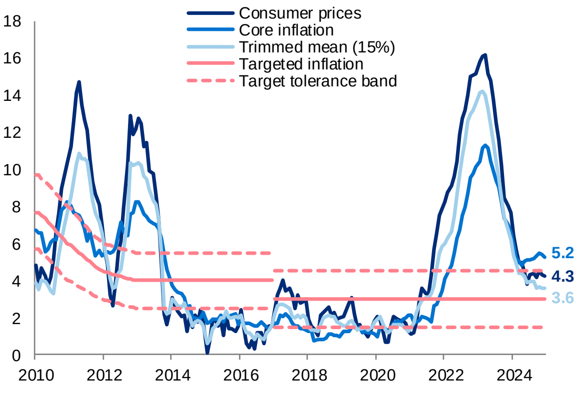
Further on, we shall present current economic trends, our new macroeconomic projections and monetary policy decisions made in the period since the previous *Report*.

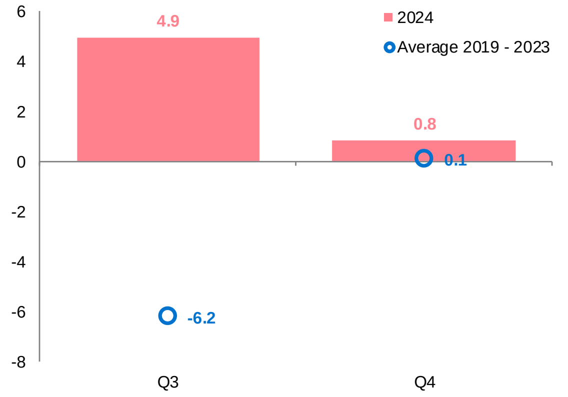
As I highlighted at the beginning, after retreating within the target tolerance band in May 2024, y-o-y inflation remained within its bounds, measuring 4.3% in December, i.e. it stabilised around that level in the second half of the year. In the course of Q4, the contribution of energy prices increased somewhat, mainly due to the low base for petroleum product prices. The drop-out from calculation of electricity price hikes from November 2023 worked in the opposite direction. Food prices, mainly on account of reduced vegetable supply following the summer drought, also provided a stronger impulse than in September, whilst the contribution of services prices declined. Similarly to other countries in the region, including the euro area, core inflation remained above the headline figure due to services prices and measured 5.3% y-o-y in December.

Chart 1 **Headline, core and trimmed mean inflation**
(y-o-y rates, in %)



Sources: SORS and NBS calculation.

Chart 2 **Quarterly growth rates of fruit and vegetable prices**
(in %)

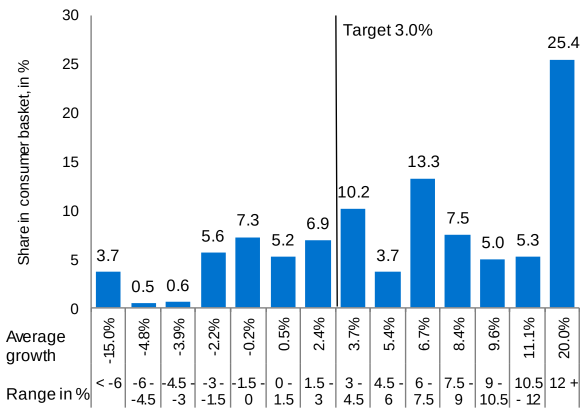


Sources: SORS and NBS.

We would like to draw your attention to two text boxes in the February *Inflation Report*, where we provided a more detailed analysis of prices.

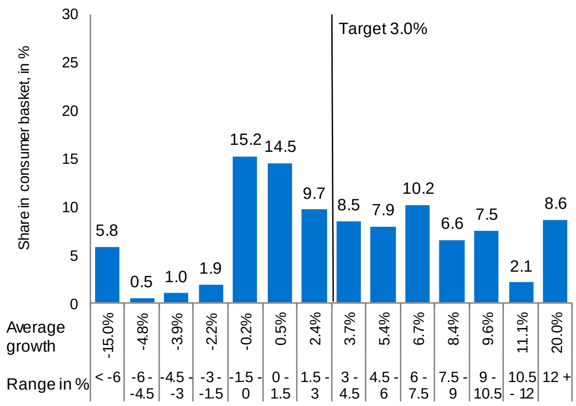
In one of the text boxes, we analysed how the distribution of y-o-y consumer price growth in 2024 changed compared to the previous year. The results of the analysis show that the distribution improved noticeably over the course of the year, with a considerable reduction in the share of products and services within the consumer basket that recorded double-digit y-o-y growth. Additionally, the percentage of products and services that did not experience any price increase in 2024 rose to about 25%, with as many as 100 products and services having lower prices than in the year before.

Chart 3 **Distribution of the y-o-y CPI growth rate in December 2023**



Sources: SORS and NBS.

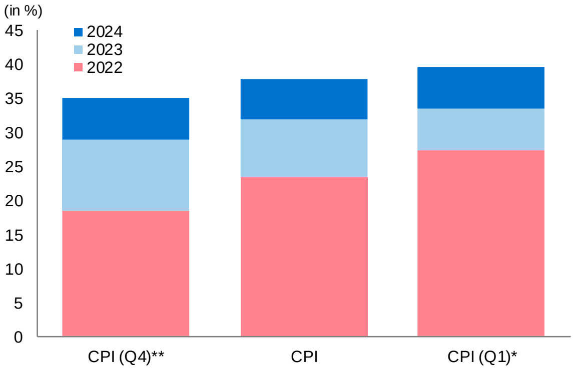
Chart 4 **Distribution of the y-o-y CPI growth rate in December 2024**



Sources: SORS and NBS.

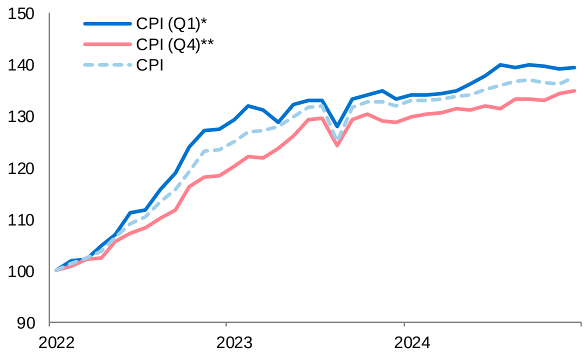
In the second text box, we analysed a phenomenon that is increasingly being discussed worldwide and has come to be known as cheapflation. Cheapflation occurs when during inflationary pressures there is a faster price increase for cheaper brands compared to more expensive brands of the same products. Our analysis confirmed that within the food and beverage category, between 2022 and 2024, the cumulative price increase of cheaper brands was 5 pp higher compared to more expensive brands. The second characteristic of cheapflation was also confirmed: the largest price difference between cheaper and more expensive brands occurs during the most pronounced inflationary pressures. Several factors could be the cause of this phenomenon. First, the demand elasticity for food is generally low, and it is lowest for the cheapest brands. Additionally, price growth can lead to the substitution of more expensive products with cheaper alternatives of the same item, thereby increasing the demand for the cheapest brands and creating additional price pressures. Furthermore, the imperfect market structure makes it easier for producers and retailers to pass increased costs on to retail prices, often more than fully. This is an issue the National Bank of Serbia has repeatedly warned about and one to which we have consistently dedicated significant attention, urging retailers to be mindful of the important role they play in the supply chain.

Chart 5 **Cumulative average price growth for 58 types of products in January 2022 – December 2024 (all, the cheapest and most expensive)**



Source: NBS.
* CPI consisting of the cheapest brands.
** CPI consisting of the most expensive brands.

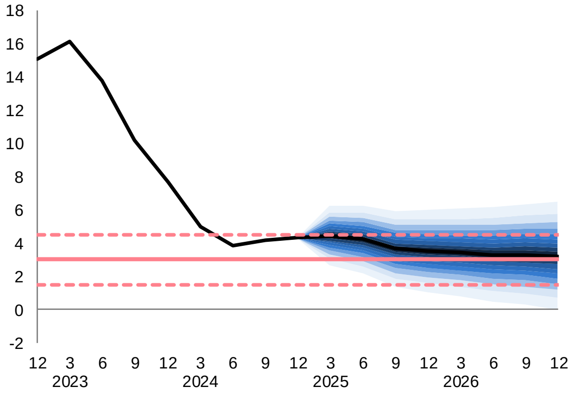
Chart 6 **Monthly CPI dynamics for all, the most expensive and cheapest brands**
(indices, January 2022 = 100)



Source: NBS.
* CPI consisting of the cheapest brands.
** CPI consisting of the most expensive brands.

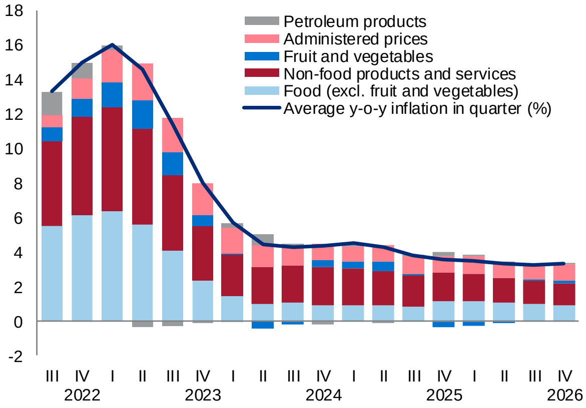
Under our new central projection, inflation will continue to move within the target band over the next two years – the time horizon of our projection. More specifically, y-o-y inflation should move around the upper bound of the target band in early 2025, though we do not exclude the possibility that in some months it could temporarily overshoot the band by a thin margin. Inflation should slow gradually thereafter, approach the target midpoint late in the year and stay around this level until the end of the projection horizon. Such inflation movements will be underpinned by the still tight monetary conditions, subdued imported inflation and the anticipated lower global energy prices according to relevant international institutions' projections and market futures. If the new agricultural season which begins in May is average, fruit and vegetable prices should go down and food production costs decline. The projected movement of real wages in line with productivity growth should help core inflation slow and approach headline inflation.

Chart 7 **Inflation projection**
(y-o-y rates, in %)



Source: NBS.

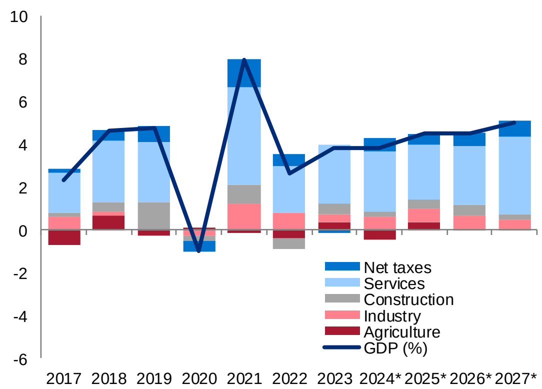
Chart 8 **Contributions to y-o-y inflation by component**
(average y-o-y rates, in pp)



Source: NBS.

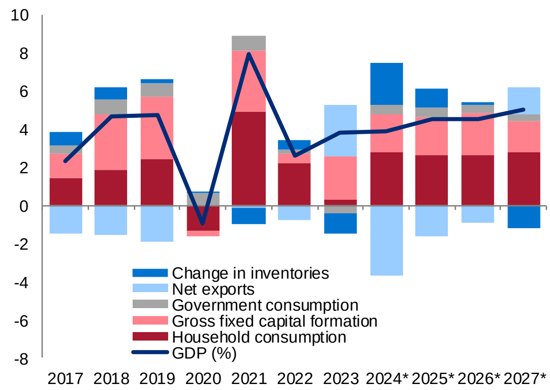
I wish to emphasise that, by adopting a cautious approach and pursuing a responsible monetary policy, we have ensured inflation's return within the target band, while maintaining favourable economic growth prospects. Positive economic dynamics extended into Q4 2024 when, according to the SORS estimate, GDP rose by 3.3% y-o-y, while in 2024 overall it rose 3.9%, slightly exceeding the November projection. Though the negative effects of the drought on agricultural production were stronger in 2024 than we estimated in November, they were more than offset by better outturns in manufacturing and service sectors. Construction also gave a positive impulse thanks primarily to the implementation of infrastructure projects planned under the "Leap into the Future – Serbia Expo 2027" programme. According to our estimate, quarterly s-a GDP growth was around 1% in Q4 2024 and the carry-over effect for this year was roughly the same.

Chart 9 **Contributions to real GDP growth, production side**
(in pp)



Sources: SORS and NBS calculation.
* NBS estimate.

Chart 10 **Contributions to real GDP growth**
(in pp)

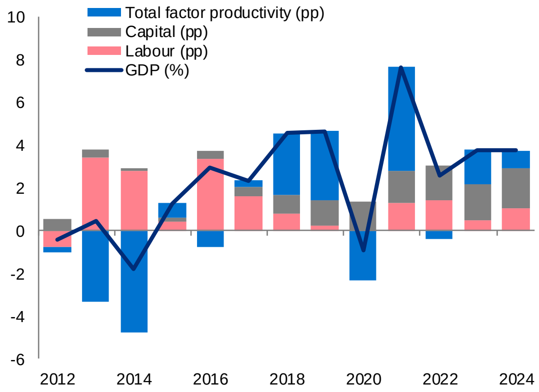


Sources: SORS and NBS calculation.
* NBS estimate.

Under our new projection, we expect GDP growth to pick up to 4.5% this year and range between 4% and 5% in 2026 and 2027, but probably closer to the upper bound of the range in 2027 due to the hosting of “Expo 2027”. From the aspect of use, GDP growth will be guided by domestic demand, with private consumption growth propped up by higher disposable income and positive trends in the labour market. Fixed investment growth will be supported by increased corporate profitability in recent years, high FDI inflows, planned government capital expenditure for projects in transport, energy and utility infrastructure, and improved financing conditions amid the initiated monetary easing and receding global inflationary pressures. Exports are also expected to provide a positive contribution reflecting the start of serial production in the automobile industry and new capacities in the energy sector, despite the still weak external demand, particularly from the euro area. Imports of goods and services will rise faster than exports in 2025 and 2026, however, as the investment cycle accelerates and private consumption goes up, resulting in a negative contribution of net exports. The contribution of net exports is expected to turn positive in the year of hosting “Expo 2027”.

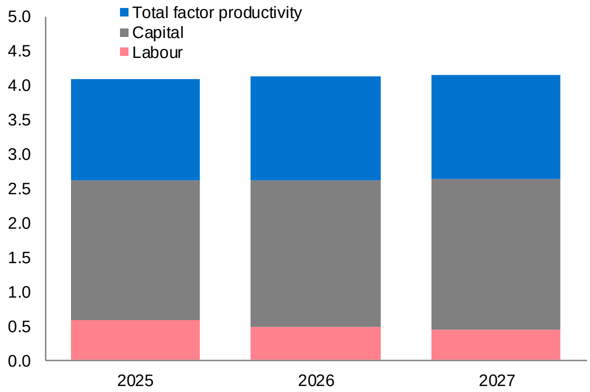
I would like to draw your attention to a text box in this *Report* where we estimated that Serbia’s potential output rate will measure around 4% in the medium term, propped up mainly by fixed investment which is set to exceed 25% of GDP in the next two years. We also expect an increase in the contribution of total factor productivity, driven by the application of new technologies in the production process, and by digitalisation and continuation of structural reforms, particularly in the energy sector. At the same time, the contribution of labour will remain positive, though lower than in recent years. All this should ensure the continuation of Serbia’s convergence towards advanced economies, making its growth sustainable over the long term.

Chart 11 **Contributions of labour, capital and total factor productivity to GDP**



Sources: SORS and NBS calculation.

Chart 12 **Contributions of labour, capital and total factor productivity to potential output**
(in pp)

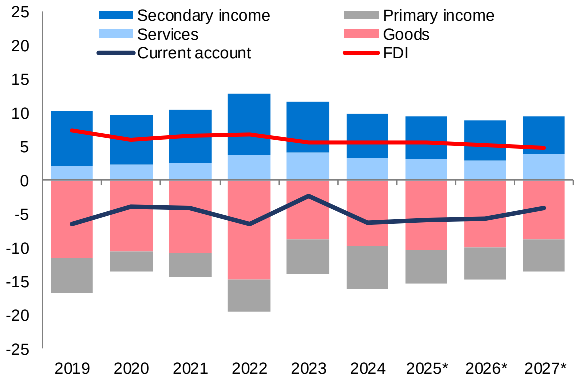


Sources: SORS and NBS.

The current account deficit measured 6.3% of GDP in 2024, close to the estimated average equilibrium rate, as imports of goods and services rose faster than exports and FDI income payments went up. Within goods exports, despite the still weak external demand and challenges in the European automobile industry, manufacturing exports continued up, at a rate of around 3%, as a result of past investment. Import growth was guided by the imports of intermediate goods and equipment for capacity modernisation and investment cycle purposes, as well as by the imports of consumer goods and tourism services, reflecting higher disposable income of households. Despite its increase, the current account deficit was fully covered by FDI inflows which measured EUR 5.2 bn in 2024. This was the fourth year in a row that appreciation pressures prevailed and the NBS was the net buyer in the FX market. Specifically, the NBS bought EUR 2,725 mn net in the FX market in 2024 to prevent excessive strengthening of the dinar. The country's FX reserves therefore climbed to EUR 29.3 bn at end-2024, further strengthening the economy's resilience to external risks.

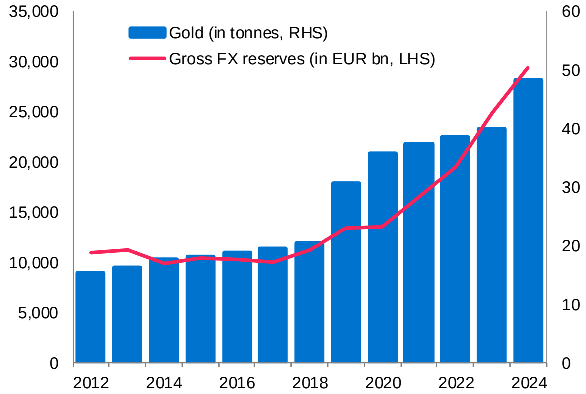
We project that the share of the current account deficit in GDP this year and the next will be similar as in 2024 and that it will subside to around 4% in 2027 as service exports go up in the year of hosting "Expo 2027" and foreign trade improves. A favourable external position will be maintained by the high FDI inflow diversified by project and geography and estimated to be around its last year's record-high level.

Chart 13 **Current account and FDI projection**
(in % of GDP)



Sources: SORS and NBS.
* NBS projection.

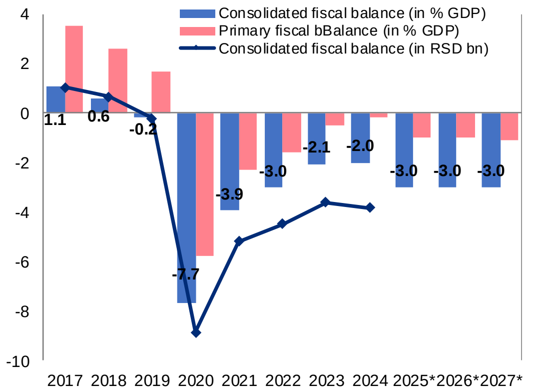
Chart 14 **NBS FX reserves**



Source: NBS.

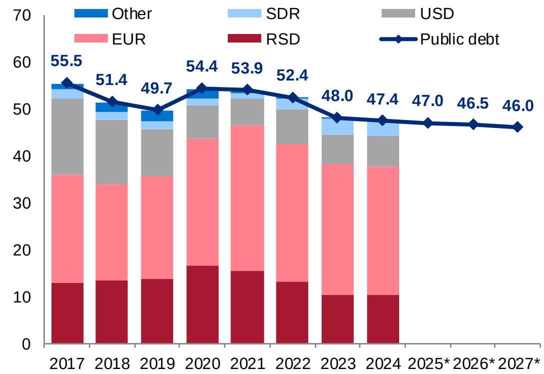
Fiscal trends in 2024 outperformed the expectations. This is primarily indicated by the consolidated fiscal deficit which measured 2.0% of GDP instead of 2.7% planned under the supplementary budget. Capital expenditure envisaged under the 2024 supplementary budget (7.3% of GDP) was fully executed, while outlays for the purchase of goods and services turned out lower than projected. At the same time, higher tax revenue mainly reflected improved collection of excise duties and profit tax. Although the medium-term fiscal framework envisaged a more generous fiscal policy for the purpose of funding investments under the "Leap into the Future – Serbia Expo 2027" programme, we do not expect this to undermine the declining trajectory of the public debt share in GDP, which at end-2024 stood at 47.6%, significantly below the Maastricht criterion of 60%.

Chart 15 **Fiscal and primary balance of the general government budget**
(in % of GDP)



Source: Ministry of Finance.
* Projection from the Fiscal Strategy for 2025 with Projections for 2026 and 2027.

Chart 16 **Central government public debt**
(in %)



Source: Ministry of Finance.
* Projection from the Fiscal Strategy for 2025 with Projections for 2026 and 2027.

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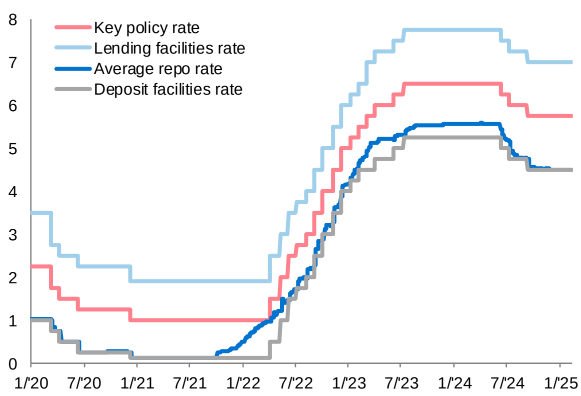
We have not changed the key policy rate of 5.75% since the last *Inflation Report*. In making such decision, we were fully aware that a cautious monetary policy is still warranted despite inflation's movement within the bounds of the target. Caution is primarily mandated by heightened geopolitical tensions and global market fragmentation, coupled with the risk of a further rise in protectionism, which could trigger an increase in the prices of energy, primary agricultural commodities and other raw materials in production, as well as halts in global supply chains. Skyrocketing prices of some food raw materials, such as cocoa and coffee, in global stock exchanges also cause concerns regarding global food prices, as does the dented supply of agricultural produce in the domestic market due to the summer months' drought.

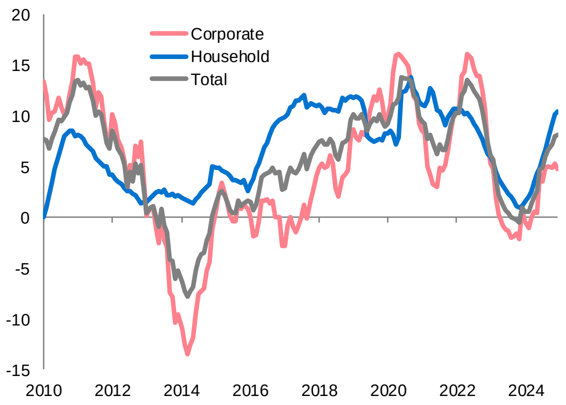
Given that past monetary policy easing has fully passed through to interest rates in money and credit markets, accelerating lending, we deem that a cautious approach is warranted and that the effects of past key policy rate cuts on inflation and economic activity in the coming period need to be fully considered.

Chart 17 **Key policy rate and average repo rate**
(in %)



Source: NBS.

Chart 18 **Corporate and household lending**
(y-o-y growth rates, in %, at constant exchange rate, 30 September 2024)



Source: NBS.

Reflecting a more favourable price of borrowing and credit standards easing, lending to the non-monetary sector sped up y-o-y, to 8.2% at year end, with corporate loans rising by 4.8% and household by 10.2%. In 2024, lending was driven more by dinar loans, pushing dinarisation of receivables up to 37.4%. Lending growth, along with a lower amount of non-performing receivables as a result of carefully combined and synchronised monetary and macroprudential policy measures, contributed to bringing the NPL share in total loans down to a new all-time low of 2.5% at end-2024.

Let me draw your attention to the Decision on Temporary Interest Rate Cap we adopted late last year with a view to protecting financial stability and living standards of citizens, primarily housing loan consumers, and making the monetary policy transmission mechanism even more efficient by linking the effective interest rates to the key policy rate for some categories of loans to natural persons.

Our future monetary policy decisions will also be made cautiously, on a meeting-to-meeting basis, depending on the pace of inflation's slowdown and its key underlying factors in the domestic and international environment, and taking care of the effects on financial stability and economic growth.

Ladies and gentlemen, dear colleagues,

The macroeconomic projections we have just presented are based on the assumptions that there will be no major tightening of geopolitical relations in the coming period and that global protectionism will not gain considerable traction. Nevertheless, there is a realistic risk of materialisation of such unfavourable scenarios – for economic growth globally and, by extension, for a small and open economy such as Serbia. We believe it is important, in such complex circumstances, that we should continue to strengthen the domestic fundamentals and our resilience to external risks, that we should keep running a responsible economic policy and preserve stability in every sense. Only in this way will we be able to remain on the path of sustainable growth and development, preserve investment and consumer confidence and direct our efforts toward further strengthening of productivity and competitiveness of our economy and a rise in the living standards of our citizens. We have come a long way toward a medium-income country and a country deserving of investment-grade rating. This is confirmed by the Fitch report saying that in the period from 2018 to 2024 our GDP per capita rose by over 80%, as well as by the great demand for dinar government securities at the first auction held this year after we obtained investment-grade rating. Now that we have the momentum, it is important to maintain it.

In the remaining part of the conference my colleagues from the Economic Research and Statistics Department will present our projections in more detail after which we remain open for all your questions.