Current macroeconomic developments – January 2012

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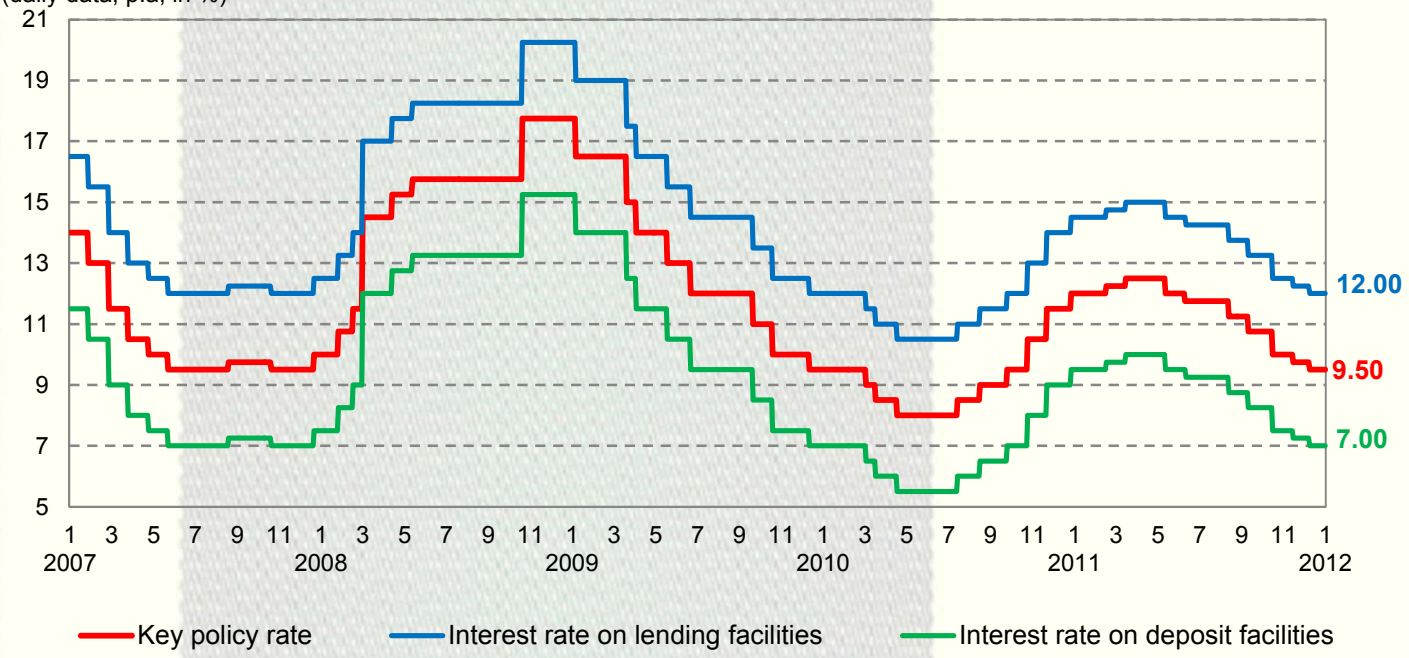
Belgrade, 23 January 2012

Down by 25 bp, key policy rate stands at 9.50%

Chart 1 **NBS Interest rates corridor**
(daily data, p.a, in %)



- In response to diminishing inflationary pressures, the National Bank of Serbia continued to lower **the key policy rate.** The January cut of 25 bp brought the rate down to **9.50%, and the overall lowering since June 2011 to 3 pp.**
- Future path of the **key policy rate** continues to depend strongly on the materialisation of risks stemming from the international environment and fiscal policy at home, and their impact on inflation.

Accelerated decline of year-on-year inflation

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

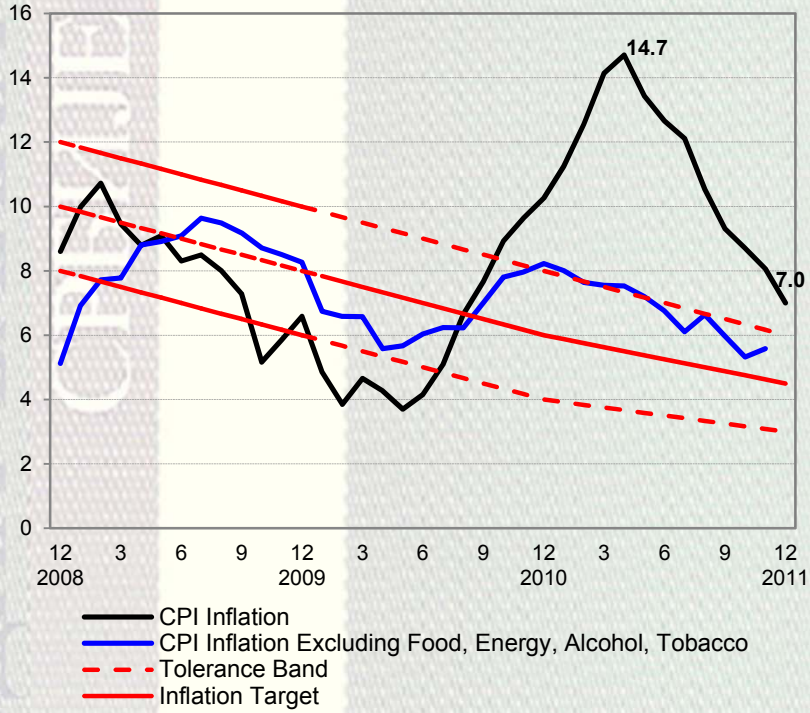
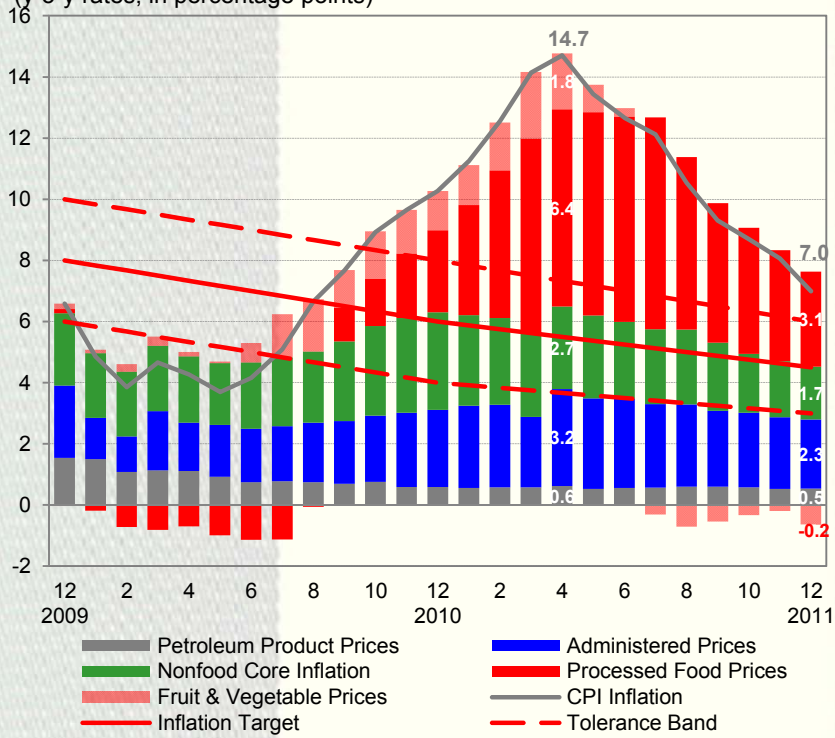


Chart 3. **Contribution of CPI components to y-o-y inflation growth**
(y-o-y rates, in percentage points)



- At end-2011, inflation came close to the upper bound of the target (6%), settling at 7% **year-on-year.**
- Key contribution to disinflation came from the reduced cost-push pressures on processed food, falling inflation expectations and low aggregate demand.
- **CPI excluding food, energy, alcohol and tobacco** (internationally accepted measure of core inflation) stayed within the target tolerance band practically since the introduction of inflation targeting regime (December 2008).
- **Inflation expectations have been declining in January**, according to available surveys of all sectors, with the exception of the household survey, where stagnation was detected.

Inflation to return within the target tolerance band in Q1 2012

Chart 4 **Short term inflation projection (IR, November 2011)**
(y-o-y rates, in %)

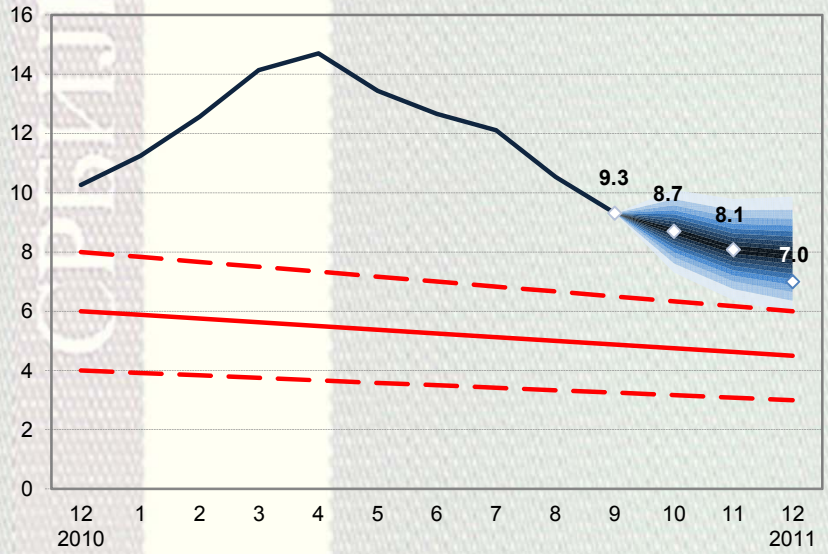
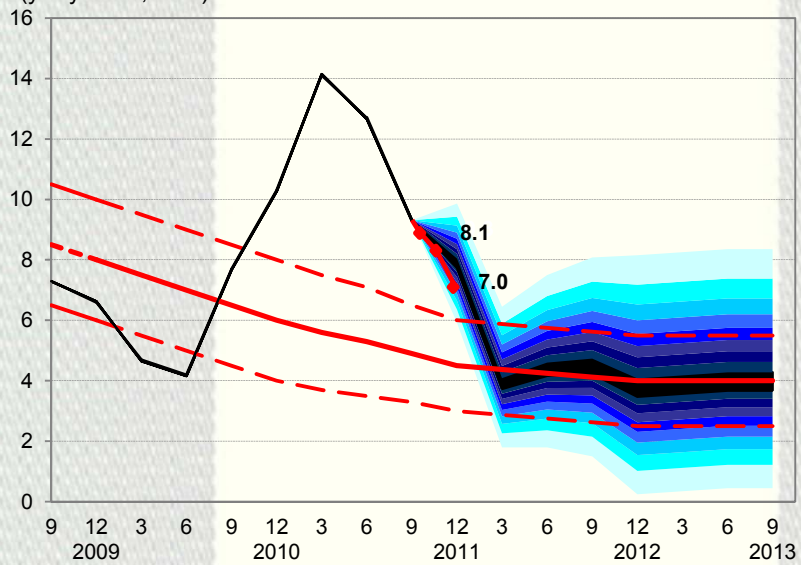


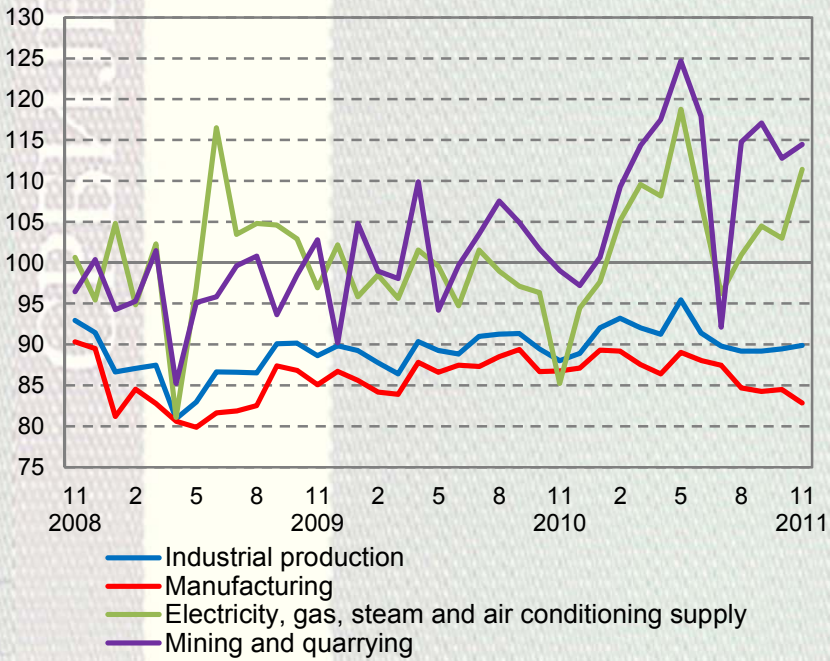
Chart 5 **Medium-term inflation projection (IR, November 2011)**
(y-o-y rates, in %)



- Inflation ended 2011 somewhat lower than expected by the National Bank of Serbia, mainly due to the **one-off effect of methodological changes** in the calculation of fruit and vegetables prices.
- Q1 2012 promises an even stronger fall in y-o-y inflation and its return within the target tolerance band (primarily due to the **base effect** of high monthly inflation rates from early 2011 and **administrative cap** on trade margins), with possible temporary undershooting of the target tolerance band during some months of H1.
- As they are currently at a low level, fruit and vegetable prices are expected to increase in the new agricultural season, which will result in modest growth of y-o-y inflation in Q2 and its gradual stabilisation around the target.

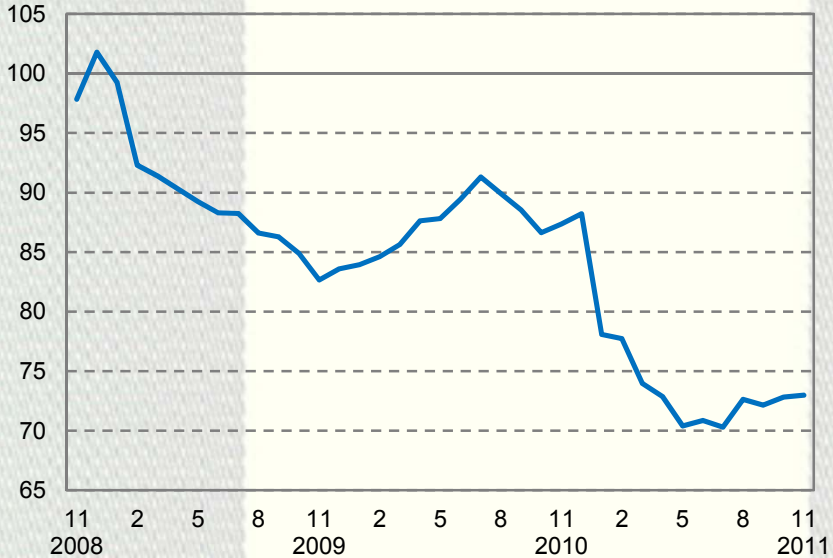
Growth of industrial production and mild recovery of trade turnover in November

Chart 6 **Industrial output**
(seasonally-adjusted data, 2008= 100)



Source: Serbian Statistical Office

Chart 7 **Real retail trade turnover**
(seasonally-adjusted data, 2008= 100)

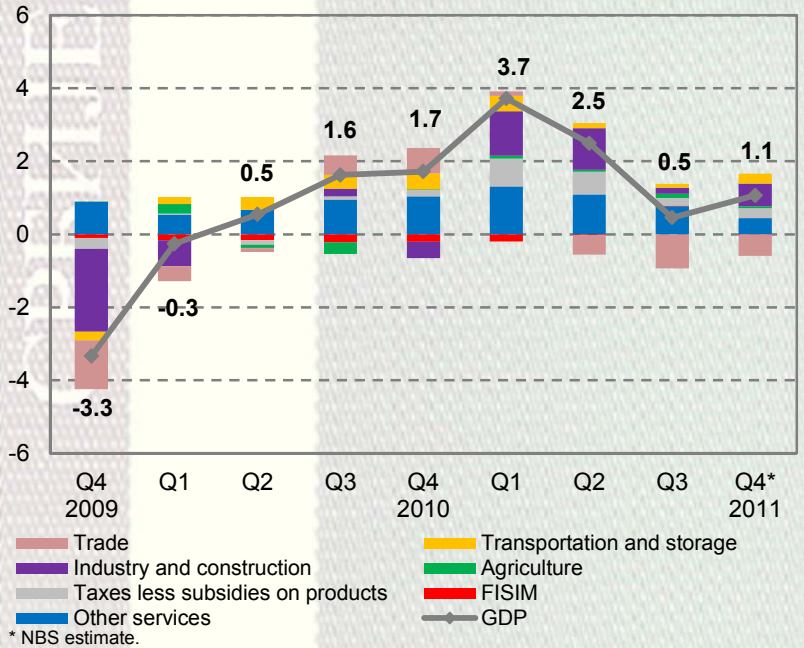


Source: Serbian Statistical Office

- Driven by mining and electricity supply (which expanded by 1.5% and 8.1% s-a, respectively), total **industrial production** in November recorded a **0.5%** s-a growth
- **Manufacturing** plunged (**2.0%** s-a), primarily as a consequence of declining pharmaceutical, chemical and rubber and plastics production.
- Despite a November rebound, **retail turnover** remains low (y-o-y fall of 16.4%), signalling continued weak domestic consumer demand.

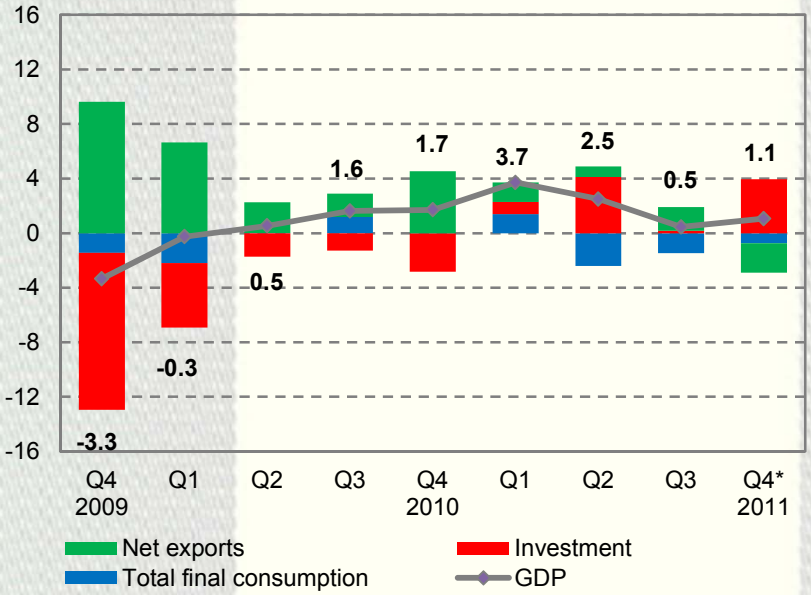
Mild recovery in economic activity in Q4

Chart 8 **Contribution to y-o-y GDP growth**
(production side)



* NBS estimate.
Source: Statistical Office Republic of Serbia.

Chart 9 **Contribution to y-o-y GDP growth**
(expenditure side)

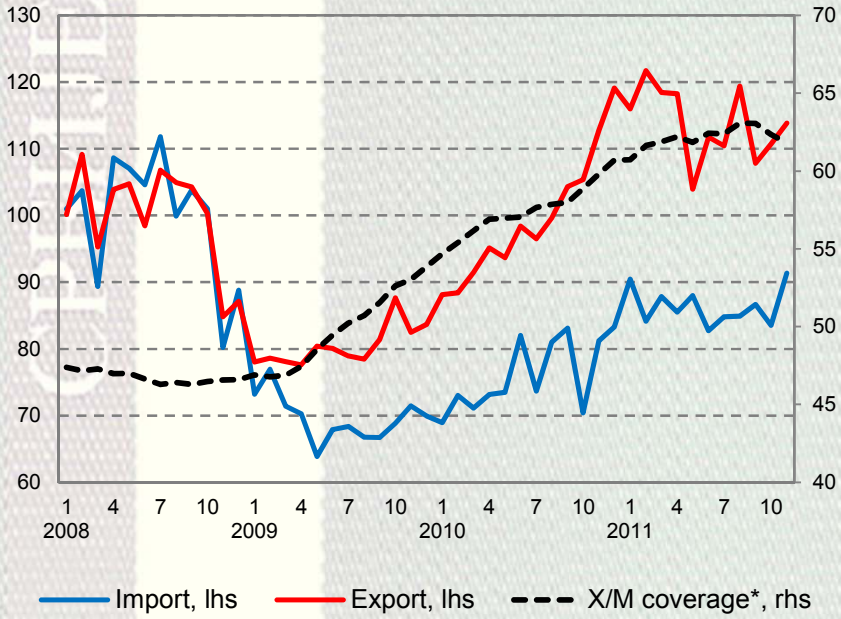


* NBS estimate.

- Based on available economic activity indicators, we estimate **GDP** to have **recovered mildly** in Q4 on the back of growing industrial production, transport and other services. The largest negative contribution to economic activity came from retail and wholesale trading.
- On the expenditure side, we estimate GDP growth in Q4 to have been led by investment, while receiving headwinds from total final consumption and net exports.
- GDP growth in 2011 is estimated at around **2%**.

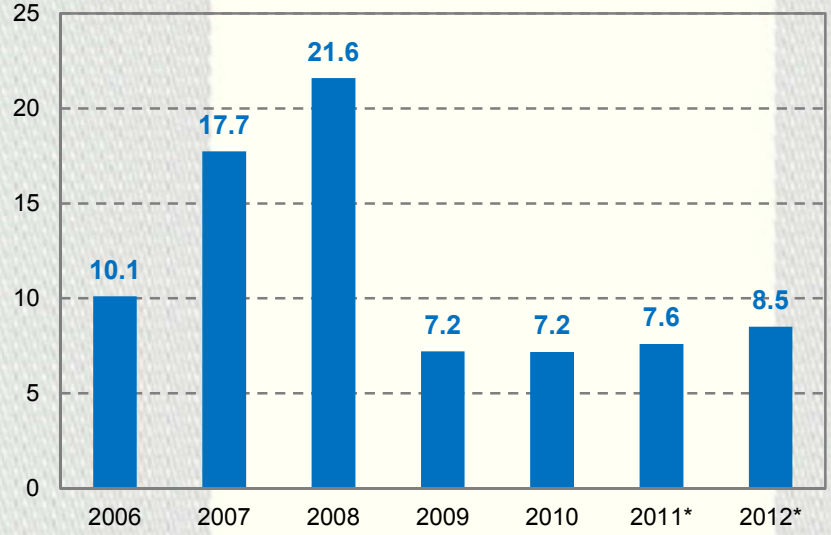
Exports remain above and imports below their pre-crisis levels

Chart 10 **Commodity exchange**
(in EUR, seasonally-adjusted data, 2008=100)



* 12M moving average

Chart 11 **Current account deficit**
(in % of GDP)

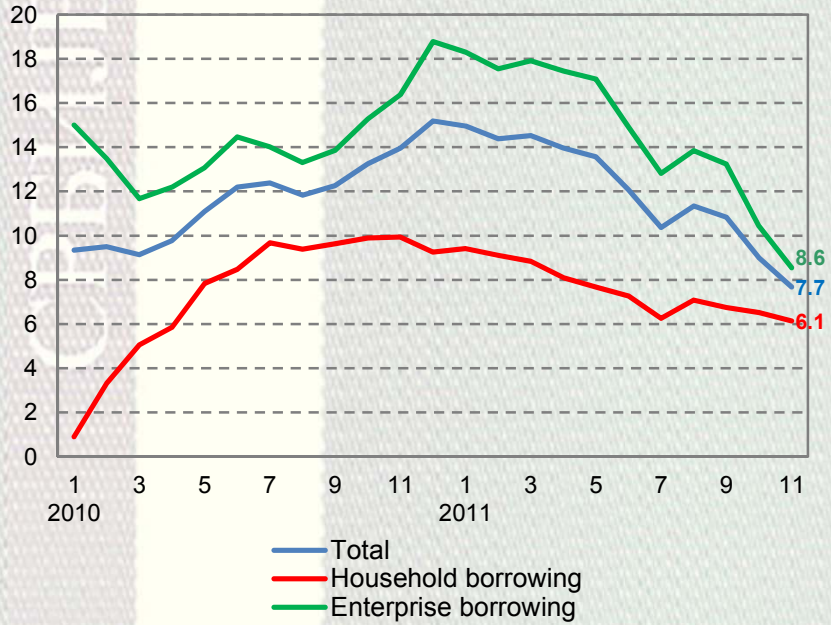


* NBS estimate

- In November 2011, **exports** rose **2.8%** and **imports** **9.3%** s-a. The export/import cover ratio was **62%** of imports.
- November **exports** were 10% above and imports 12% below their pre-crisis levels.
- As the investment cycle in export-oriented sectors ends and imports go up, 2012 is likely to see a somewhat higher **current account deficit** (8.5% of GDP).

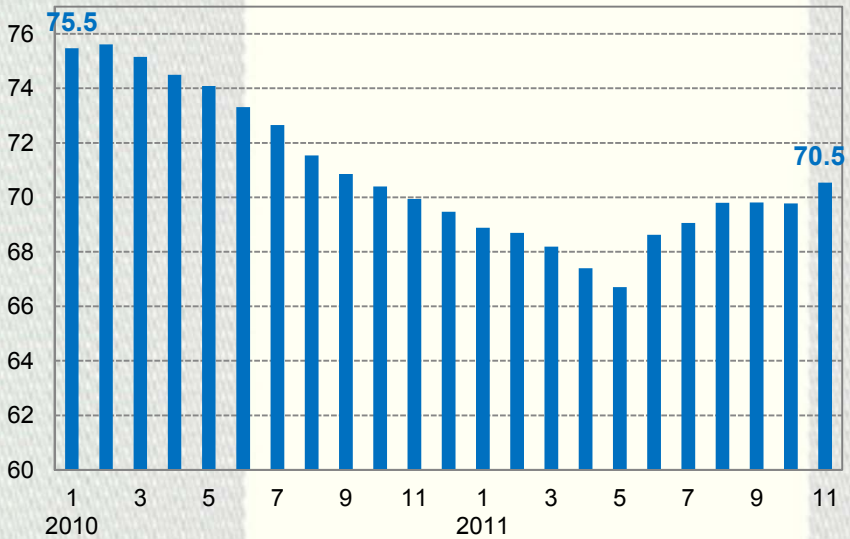
Lending growth continues to slow down

Chart 12 **Real bank loan receivables***
(y-o-y growth rate in %)



*Deflated by inflation, after exchange rate adjustment

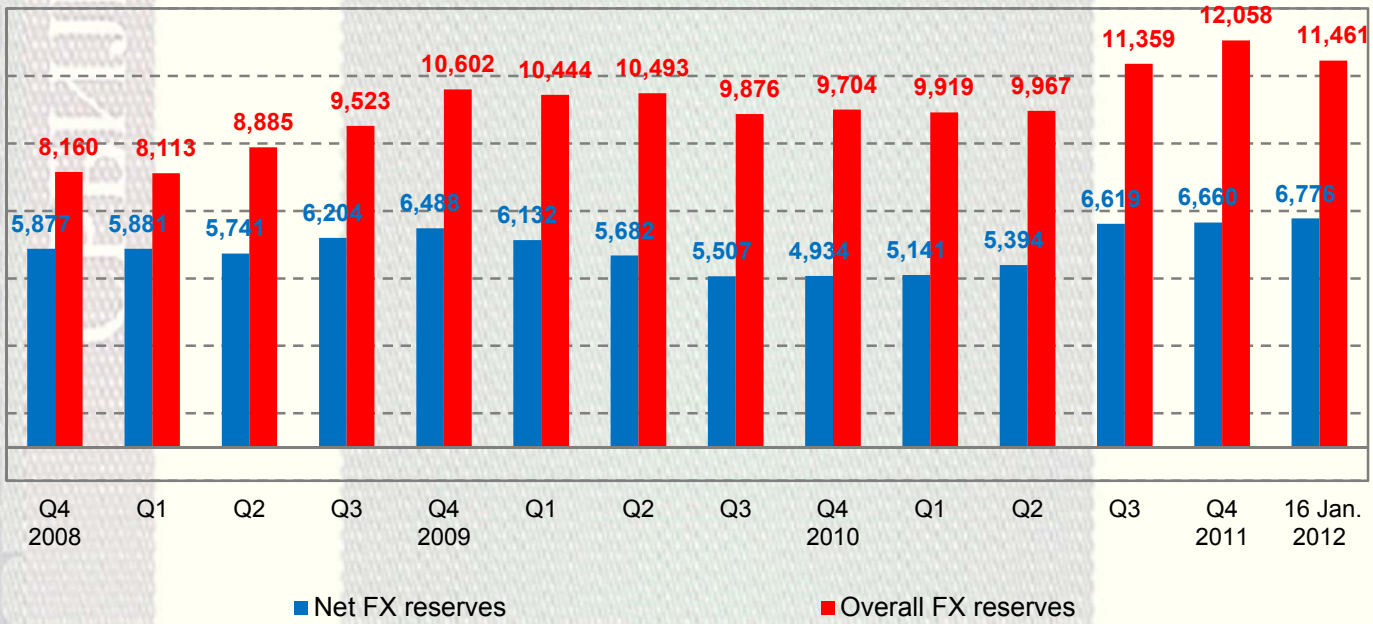
Chart 13 **Share of FX indexed and FX receivables in total bank receivables from households and enterprises**
(in %)



- **Lending growth** slowed further - real y-o-y growth rate of corporate and household lending equalled **7.7%** in November.
- The share of FX-indexed and -denominated loans in total lending came at 70.5%. It rose relative to October on account of a reduced share of dinar loans in newly granted loans during that month (35.9%).
- By the gross principle, the share of **NPLs in total loans** was **19.3%** (**8.4%** for households and **23.2%** for corporates).

The level of NBS FX reserves is satisfactory

Chart 14 **NBS FX Reserves**
(in EUR mln)



Net FX reserves:

FX assets
(monetary gold, foreign cash, NBS claims on accounts abroad and securities)

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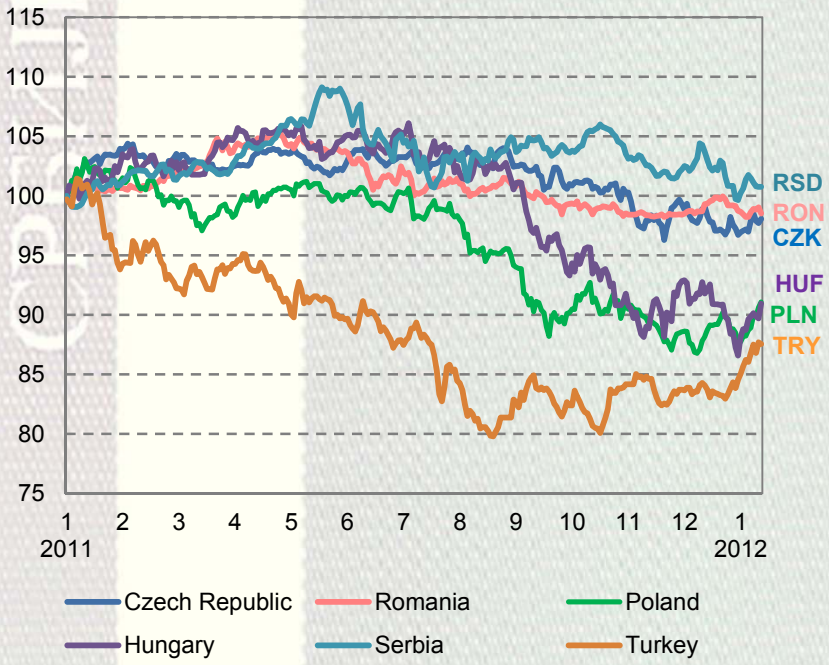
FX liabilities
(IMF loans, reserve requirement funds, other external funds)

- At end-2011, FX reserves stood at ≈ EUR 12.1 bln (a one-off increase in required reserve allocations due to the application of Basel 2).
- Mid-January 2012, **FX reserves** amounted to ≈ **EUR 11.5 bln** (covering around eight months of imports or 449% of M1), which is satisfactory by all criteria of external liquidity and financial risk exposure.
- Mid-January 2012, **net FX reserves** equalled **EUR 6.8 bln**.

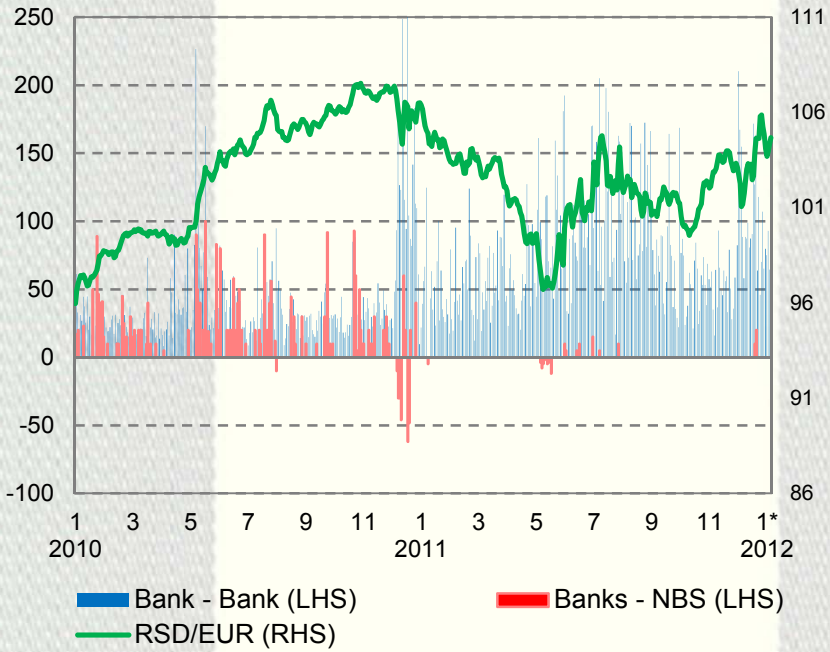
The dinar is relatively stable compared to its regional peers

Chart 15 **Movements in exchange rates of national currencies against the euro**
(31.12. 2010 = 100, increase represents appreciation)



*Until 18th January.

Chart 16 **IFEM turnover and exchange rate**
(in EUR mln)



*Until 18th January.

- The weakening of the **dinar** in the second half of December was chiefly due to a seasonally-induced increase in corporate demand for foreign exchange.
- In late December, the NBS intervened twice in the foreign exchange market (by selling a total of **EUR 30 mln**) in order to ease excessive daily volatility of the exchange rate.
- Despite exhibiting high short-term volatility, overall in 2011, the exchange rate of the dinar was relatively stable with minimum intervention by the NBS (net sale of **EUR 45 mln**).

Why is arrangement with the IMF important?

- It acts as an additional guarantee of the country's short- and medium-term macroeconomic stability in conditions of international financial instability;
- It has a direct impact on the lowering of the country risk premium (lower interest rates, growth in FDI and portfolio investments);
- It has a direct impact on getting more favourable terms for financing Serbia's public debt;
- It facilitates access to favourable financing facilities offered by other IFIs;
- It acts as an additional assurance of the observance of fiscal responsibility rules and of the credibility of fiscal policy;
- The NBS urges extra effort to come to an agreement and continue the arrangement with the IMF.