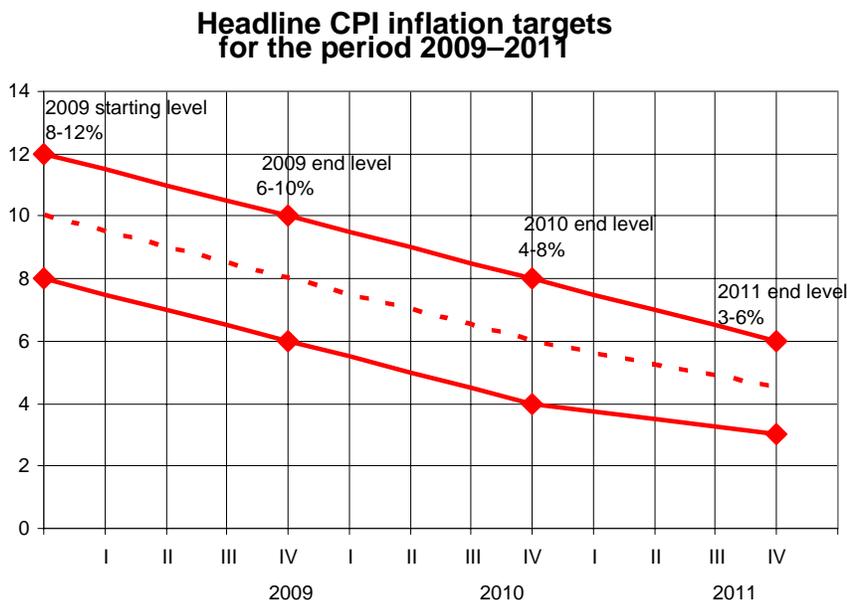


Memorandum of the National Bank of Serbia on Setting Inflation Targets for the Period 2009–2011¹

In line with the Law on the National Bank of Serbia, which defines the achievement and maintenance of price stability as the principal objective of the central bank, the Agreement between the National Bank of Serbia and the Government of the Republic of Serbia on Inflation Targeting² as a framework for achieving medium-term price stability and the Memorandum of the National Bank of Serbia on Monetary Strategy³, pursuant to which the National Bank of Serbia has committed to set inflation targets in cooperation with the Government, the Monetary Policy Committee hereby sets the **headline inflation target (band with a midpoint), measured as an annual percentage change in the consumer price index**, for the period 2009–2011 with the following parameters:

- 2009 starting level: 8-12% with a midpoint of 10%,
- 2009 end level: 6-10% with a midpoint of 8%,
- 2010 end level: 4-8% with a midpoint of 6% and
- 2011 end level: 3-6% with a midpoint of 4.5%.



Inflation target is set as a linearly declining band of headline CPI inflation rates (see the chart). The band, with a midpoint, is defined for each month of the year. The trajectory of inflation targets until 2011 is consistent with the need to achieve medium-term price stability which, in view of Serbia's medium-term ambition to converge to EU price and income levels, is defined as annual inflation of 2–4%.

¹ The Memorandum was adopted in the NBS Monetary Policy Committee meeting of 22 December 2008.

² The Agreement was adopted in the meeting of the Government of the Republic of Serbia of 19 December 2008.

³ The Memorandum was adopted in the NBS Monetary Policy Committee meeting of 22 December 2008.

CPI inflation targets for 2009 and 2010 are consistent with the already defined targets for core inflation as measured by retail prices. Although still formulated as continuous bands with a midpoint, the targets are now defined in terms of headline CPI inflation rather than core RPI inflation.

CPI inflation targets reflect movements in prices more fully and ensure a clear demarcation of responsibilities of the National Bank of Serbia and the Government for achieving and maintaining their stability. Thus formulated inflation targets also enable a more efficient communication with the general public and stronger impact on inflation expectations, which are essential for the stabilization of economic activity.

Inflation targets for the period 2009–2011 have been set by the National Bank of Serbia in cooperation with the Government based on the analysis of current and expected macroeconomic developments and numerical guidelines for the increase in prices of products and services under the Government's direct or indirect regulation⁴.

Important features of inflation targets:

- **Target inflation rates are gradually declining.** The set inflation targets reflect intention to achieve price stability through gradual disinflation, without causing any disruptions to the macroeconomic processes in the economy. Gradual lowering of inflation targets is based on the assessment of long-term macroeconomic movements and the need to ease the pressures on the nominal exchange rate, and reduce the resulting risks from potentially negative impact on the competitiveness of the country's economy.

- **The target is set as a band with a midpoint.** The width of the target band (± 2 until 2011, ± 1.5 pp for end-2011) reflects interest in the stabilization of economic activity, as it provides scope for the flexibility of monetary policy in the period ahead without any detriment to its credibility. The band indicates a comfort zone providing for the fact that there may be many small transitory shocks causing short-term volatility of inflation, but not requiring a monetary policy response.

- **The target is continuous.** The midpoint and the band are defined for each month of the year. This means that the achievement of inflation target is watched continuously, not only at a particular point in time. The continuity also helps anchor inflation expectations in situations when a large shock pushes inflation temporarily away from the targeted level.

- **The target is defined for several years ahead.** This represents the MPC's focus on achieving medium-term price stability and helps anchor inflation expectations.

In cooperation with the Government, the National Bank of Serbia may change the set inflation targets. Such changes will be undertaken in exceptional circumstances only and subject to the provision of an adequate explanation by the National Bank of Serbia.

⁴ Following consultation with the National Bank of Serbia, the Government may revise the numerical guidelines subject to the provision of an adequate explanation for such revision (according to *the Agreement between the National Bank of Serbia and the Government of the Republic of Serbia on Inflation Targeting*).