National Bank of Serbia

2020

May

# INFLATION REPORT

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**NATIONAL BANK OF SERBIA**
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# Introductory note

The *Agreement on Inflation Targeting* between the Government of the Republic of Serbia and the National Bank of Serbia, effective as of 1 January 2009, marks a formal switch of the National Bank of Serbia to inflation targeting as a monetary policy regime. The main principles and operation of the new regime are defined by the Memorandum on Inflation Targeting as a Monetary Strategy.

Since one of the underlying principles of inflation targeting is strengthening the transparency of monetary policy and improving the efficiency of communication with the public, the National Bank of Serbia prepares and publishes quarterly *Inflation Reports* as its main communication tool. The *Inflation Report* provides key economic facts and figures that shape the Executive Board's decisions and underpin activities of the National Bank of Serbia.

The *Inflation Report* aims to cover information on the current and expected inflation movements and to provide an analysis of underlying macroeconomic developments. It also seeks to explain the reasoning behind the Executive Board's decisions and to provide an assessment of monetary policy effectiveness during the previous quarter. Also integral to this *Report* are the inflation projection for eight quarters ahead, assumptions on which the projection is based and an analysis of key risks to achieving the target.

The information contained in this *Report* will help raise public understanding of monetary policy implemented by the central bank and awareness of its commitment to achieving the inflation target. It will also play a role in containing inflation expectations, as well as in achieving and maintaining price stability, which is the main statutory task of the National Bank of Serbia.

The *May Inflation Report* was considered and adopted by the NBS Executive Board at its meeting of 7 May 2020.

Earlier issues of the *Inflation Report* are available on the National Bank of Serbia's website (http://www.nbs.rs).

Executive Board of the National Bank of Serbia:

Jorgovanka Tabaković, Governor

Željko Jović, Vice Governor

Ana Ivković, Vice Governor

Dragana Stanić, Vice Governor

**ABBREVIATIONS**

**bp** – basis point
**CPI** – Consumer Price Index
**EBRD** – European Bank for Reconstruction and Development
**ECB** – European Central Bank
**EIB** – European Investment Bank
**EMBI** – Emerging Markets Bond Index
**EU** – European Union
**FAO** – UN Food and Agriculture Organization
**FDI** – foreign direct investment
**Fed** – Federal Reserve System
**FOMC** – Federal Open Market Committee
**GDP** – gross domestic product
**GVA** – gross value added
**H** – half-year
**IFEM** – Interbank Foreign Exchange Market
**IMF** – International Monetary Fund
**LHS** – left hand scale
**mn** – million
**NAVA** – non-agricultural value added
**NPL** – non-performing loan
**OFO** – other financial organisation
**OPEC** – Organization of the Petroleum Exporting Countries
**pp** – percentage point
**Q** – quarter
**q-o-q** – quarter-on-quarter
**RHS** – right hand scale
**RMCP** – real marginal cost of processed food production
**s-a** – seasonally-adjusted
**SDR** – Special Drawing Right
**SORS** – Statistical Office of the Republic of Serbia
**y-o-y** – year-on-year

Other generally accepted abbreviations are not cited.

Macroeconomic projections presented in the *Report* were concluded on 15 April.

# Contents

# I Overview

Though in late 2019 there were signals of incipient recovery of leading world economies, which was expected to gradually speed up, according to estimates of international institutions, the sudden and unexpected escalation of the coronavirus pandemic at the global level will result in **global recession** this year, and GDP is not likely to return to pre-crisis levels earlier than 2022. According to the IMF, within three months only, the global growth outlook for 2020 deteriorated from the expected 3.3% to -3.0%, which is a much sharper fall than in the global economic crisis of 2009 when the global economy contracted by 0.1%. The euro area, our most important trade partner, is particularly affected, not only due to reduced external demand and disrupted supply chains, but also due to the social distancing measures aimed at saving people's lives. The global downturn would have been even greater had it not been for the response of central banks of the majority of countries, which **eased their monetary policies** by conventional and unconventional measures, and the response of governments, which launched **robust fiscal package**s aimed at supporting the economy during the crisis and ensuring it recovers as quickly as possible after the pandemic. Though this will result in rising fiscal imbalance and debts of public and private sectors in many countries, leading international institutions agree that the priority should currently be given to economic recovery.

*It appears that the coronavirus pandemic will plunge the global economy this year into recession, probably the worst since the Great Depression of the 1930s. Gradual recovery is expected in the second half of the year.*

Despite robust monetary accommodation by leading central banks, **uncertainty in the international financial market** increased. As investment in safe assets (gold, government securities of advanced economies) went up, capital flows to emerging markets declined. The economic slowdown and worsened global growth outlook reflected on **falling global prices of oil and other primary commodities**. Oil prices declined in March also because Russia and Saudi Arabia failed to reach a deal to cap production. In mid-April, as demand plummeted further, oil futures entered the negative zone for the first time on record. The falling oil prices also reflected on the **slowdown in inflation** globally in the past several months. The prevailing view is that inflation will remain low against the backdrop of lower oil prices and dented demand.

*The worsened global growth outlook has heightened uncertainty in the international commodity and financial markets, impacting on plummeting prices of primary commodities in the world market, most notably oil.*

*The period before the outbreak of the pandemic was marked by favourable macroeconomic trends in the domestic market, as signalled by leading monthly economic indicators, labour market indicators and fiscal and monetary trends.*

Serbia faced the crisis **in a much better position**, with the average GDP growth rate of 4.3% in the past two years, low and stable inflation for the seventh year in a row, eliminated fiscal and significantly reduced external imbalance and record high FX reserves. In the first two months of 2020, leading monthly indicators of economic activity and its funding sources in the domestic market were positive, many even exceeding NBS expectations. The economy contracted in the second half of March, reflecting dented external demand and aggravated terms of business in many sectors.

*When the crisis erupted, even before the state of emergency was declared (15 March) Serbia adopted the first measures to support the economy, reflected primarily in monetary policy easing.*

The NBS was the first institution in the country and one of the first central banks in the region which responded to the COVID-19 pandemic by adopting concrete measures. At its extraordinary meeting of 11 March, the NBS Executive Board **lowered the key policy rate** by 50 bp to 1.75% and narrowed the corridor of main interest rates from ±1.25% to ±1.0% relative to the key policy rate, in order to preserve the favourable financing conditions for businesses and citizens. At its April meeting, assessing that the negative effects of the virus on global economic growth were stronger than initially estimated, and that low inflationary pressures were conducive to such move, the Board cut the key policy rate by additional 25 bp to 1.5%. By organising the repo purchase of dinar government securities and regular and additional FX swap auctions, the NBS provided to banks further dinar and FX liquidity so that they could continue to provide credit support to businesses and citizens. This resulted in rising excess dinar liquidity of banks and falling interest rates in the money market.

*The planned one-off increase in the deficit and public debt this year, aimed at providing adequate support to businesses and citizens in the fight against the pandemic, does not jeopardise the solvency of the country or the sustainability of public finance.*

**A responsible fiscal policy** in the past several years and its full coordination with monetary policy, resulting in the eliminated fiscal imbalance and a reduction in the public debt share in GDP to sustainable levels, enabled the Government to adopt, in late March, the Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy. As estimated by the Ministry of Finance, the Programme worth RSD 608 bn will result in a general government deficit of around 7% of GDP this year, while public debt is not likely to exceed 60%. According to our estimate, the one-off increase in the deficit and public debt this year does not jeopardise the solvency of the country or the sustainability of public finance.

*Robust credit growth continues, with a favourable structure and favourable terms of borrowing.*

An important part of the Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy consists of liquidity loans for micro, small and medium-sized enterprises and entrepreneurs, which will be

disbursed through the Development Fund and banks with a government guarantee. A direct support to businesses and households was ensured by introducing a minimum 90-day moratorium on the repayment of loans and financial leasing debt. This measure also contributes to the preservation and further strengthening of financial stability, achieved primarily owing to the systemic resolution of the **NPL** issue, with the NPL share in total loans reduced to 4.0%. Trends in the lending market were very favourable. Y-o-y **lending** growth accelerated from one month to another, and reached 11.9% in March, as a result of accelerated growth in corporate loans (contributing around 7.5 pp to overall lending growth in March). Not less importantly, lending conditions in the domestic market remained favourable. The average rate on dinar corporate loans was reduced to a new minimum at the start of the year, getting closer to the euro interest rate.

***The crisis triggered by the coronavirus and the resulting decline in domestic demand will bring about a sharp fall in imports and a reduction in the current account deficit in 2020.***

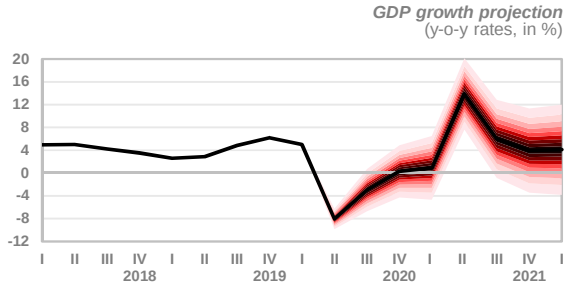
**Serbia's foreign trade** recorded growth in the first two months of the year, with goods and services exports (12.2% y-o-y) rising faster than imports (11.8% y-o-y) despite the slowdown in external demand. In March, due to the shock in the world market, exports contracted and imports slowed down. Given the greater share of imports than exports in the structure of foreign trade, the deficit in goods trade increased at the quarterly level, as did the current account deficit, which remained almost fully covered by the net FDI inflow (around EUR 822 mn according to preliminary data). A net outflow worth EUR 134 mn was recorded in respect of portfolio investment, but it was primarily due to the repayment of the maturing remaining eurobonds issued in 2013. Under our estimate, falling external demand and supply-side restrictions will trigger a fall in exports in the remainder of the year, but due to reduced domestic demand, imports will be even more strongly affected. Along with lower oil prices, this will contribute to a reduction in the current account deficit to around 5% of GDP this year. In the medium run, as export capacities increase and global economic recovery takes place, in line with expectations, the share of the current account deficit in GDP is likely to decline somewhat, with the pace of the reduction depending on the dynamics of the investment cycle going forward.

***Led by rising investment and supported by other components of domestic demand, the economy posted relatively strong growth in Q1 as well (around 5% in our estimate), despite the contraction since mid-March.***

In the first two months, the **economy** grew at a relatively high y-o-y rate, as indicated primarily by industrial production, retail trade, construction indicators and continued positive trends in the labour market. Halts and, in some service sectors, full suspension of activity, happened in the second half of March. However, this did not have a strong negative effect on the pace of GDP growth at the quarterly level. GDP is estimated to have grown by around 5% y-o-y in Q1. On the expenditure side, it was led by rising investment and household

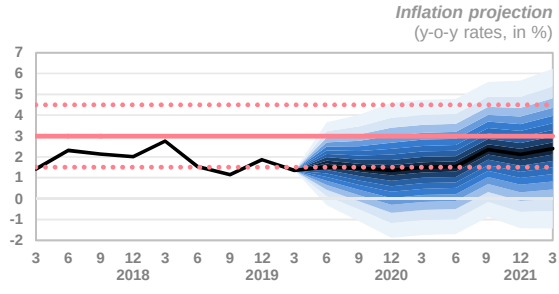
consumption, and on the production side, by elevated activity in the service sector, construction and industry. Industrial production has been rising since mid-2019, its physical volume speeding up to 4.4% y-o-y in Q1. As external demand slowed in the same period, the growth in industrial production from the second half of 2019 is fully due to the investment cycle in the country, which created new production capacities.

*Taking into account the latest trends in the international environment, the effects of public health measures on economic activity and the adopted corporate and household support measures, we have revised down the growth rate of the Serbian economy for 2020 from 4% to -1.5%. Bearing in mind the maintained favourable medium-term prospects of our country and the adopted economic measures, we expect the economy to more than fully recover next year from the crisis, at the growth rate of around 6%.*




Declining external demand and the undertaken measures to protect citizens' health will inevitably dampen activity in all economic sectors in Q2. Recovery is likely in the remainder of the year, helped by the measures adopted by the Government and the NBS. On the production side, the strongest negative effect this year will be provided by the service sector. Construction will be affected the least as construction works on the most important infrastructure projects continued even after the state of emergency was introduced. They merely slowed and are likely to be in full swing already as of May. On the expenditure side, domestic demand will decline, with a positive contribution coming from net exports due to the expected larger fall in imports than exports. The adopted economic measures will preclude a greater fall this year and help the economy to speedily recover next year, on account of domestic demand and exports, which will enable a return to a stable medium-term growth trajectory of around 4% p.a. The IMF also agrees with the estimate that Serbia will be one of the rare countries which will more than fully recover from the crisis already next year. The risks to the **GDP** projection are mostly related to the uncertainty of the duration of the pandemic globally, the speed of relaxation of social distancing measures and the magnitude of the shock. Risks stemming from the international environment are particularly associated with the speed of recovery of the euro area and are judged to be tilted to the downside, while those from the domestic environment to the upside as investment could rebound faster than expected.

*Since the start of the year, inflation has been moving in line with NBS expectations.*




Consistent with expectations from the February *Inflation Report*, in Q1 **y-o-y inflation** slowed down, to 1.3% in March, reflecting mainly a sharper y-o-y decline in vegetable prices due to the high base effect, and a hefty fall in petroleum product prices. That inflationary pressures remained low is also confirmed by core inflation – which in Q1 remained stable, equalling 1.6% in March – and financial and corporate sector inflation expectations which stand in the lower bound of the target band for both one and two years ahead.

Under the central May projection, **y-o-y inflation** will return within the target tolerance band around the middle of the year, helped by the wearing off of the base effect

for vegetable prices, and continue to move around the lower bound of the target tolerance band until the end of the year due to low import prices, notably subdued global oil prices, and lower aggregate demand. As demand recovers, y-o-y inflation is expected to gradually approach the target midpoint of 3.0% in 2021, but remain below it until the end of the projection horizon, i.e. in the next two years. Uncertainties surrounding the inflation projection are still mostly associated with movements in the international environment, including primarily the pace of global economic growth and trade, capital flows to emerging economies and global prices of oil and other primary commodities. The risks to the projection also relate to the speed of recovery in domestic demand, movement in administered prices at home and the character of the new agricultural season. Risks to the projection, taken together, are assessed to be symmetric. In line with this, monetary policy decisions in the coming period will depend on the assessment of the effects of past monetary policy easing, anticipated movements in key factors from the domestic and international environment and their impact on inflation, financial stability and the speed of economic recovery.

***Compared to the previous projection, the new inflation projection is at a lower level in this and next year due to lower oil prices and the expected reduction in demand.***

# II Monetary policy since the February *Report*

*In March and April, the NBS Executive Board cut the key policy rate by 75 bp in total, to 1.5%, in order to mitigate the negative effects of the coronavirus on the economy and ensure that inflation remains within the target band in the medium run. In March, the corridor of NBS main interest rates was narrowed from ±1.25 pp to ±1 pp relative to the key policy rate. Liquidity was provided to banks through the repo operations of the purchase of dinar government securities and an additional FX swap purchase auction. Owing to the coordinated response of the Serbian Government and the NBS, direct support was ensured for all debtors with the introduction of a minimum 90-day moratorium on loan repayment and the adoption of a package of fiscal aid measures for corporates and households.*

*The NBS Executive Board emphasised that the adoption of the monetary and fiscal policy measures aimed at supporting economic growth was made possible in an environment of ensured macroeconomic stability, notably low and stable inflation, eliminated fiscal and reduced external imbalance, whereby the economy's resilience to external risks was also bolstered.*

**The NBS stepped up monetary policy easing since the February *Report* in order to mitigate the negative effects of the coronavirus** on the economy, while at the same time keeping inflation within the target band in the medium run. As the virus spread fast globally, containment measures were introduced, triggering heightened uncertainty in the international commodity and financial markets. On 11 March 2020, the WHO declared the coronavirus outbreak a global pandemic. On the same day, at its extraordinary meeting the NBS Executive Board **responded by cutting the key policy rate by 50 bp. At its April meeting, the Board cut the rate by additional 25 bp, to 1.5%**, as the indicators from the international environment suggested that the negative effects of the coronavirus on global growth were stronger than initially assessed. Such adverse developments also affected the international commodity and financial markets and decisions of central banks and governments across the world.

At its March meeting, the Executive Board **narrowed the corridor of its main interest rates, from ±1.25 pp to ±1 pp** relative to the key policy rate. The deposit facility rate was lowered by 25 bp to 0.75% and the credit facilities rate by 75 bp to 2.75%. The NBS also undertook **additional measures to provide liquidity** to banks through repo operations of the purchase of dinar government securities and an additional EUR/RSD swap purchase auction. The Government and the NBS acted in concert, introducing a moratorium on debt payments for all who wish to apply it, which cannot be shorter than 90 days, i.e. shorter than the state of emergency declared.

The room for the NBS to respond with the above measures and to contribute, in full coordination with the Government, to the mitigation of negative effects of the pandemic, was created in the prior period. **Serbia faced the crisis boasting a favourable macroeconomic environment**, with the average GDP growth rate of over 4.3% in the past two years, low and stable inflation for the seventh year in a row, eliminated fiscal and significantly reduced external imbalance and record high FX reserves.

Owing to the position it ensured, Serbia was able to **respond vigorously, both through monetary and fiscal measures, in line with best world practice, without jeopardising macroeconomic stability**. The Government adopted the Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy, worth RSD 608.3 bn (EUR 5.1 bn). This set of measures is designed to support primarily the private sector and mitigate the negative effects of the COVID-19 pandemic on economic activity and employment. The aim is to preserve jobs and businesses, and accelerate recovery after the pandemic is over. Owing to the fiscal

consolidation implemented in the prior period, Serbia's public finances have the capacity to tackle the current crisis without jeopardising the achieved low and stable inflation and other indicators of macroeconomic stability.

According to the Executive Board's estimate, **inflationary pressures will remain low, with somewhat more pronounced risks that inflation may be even lower than in the February medium-term projection**. The Board had in mind that due to the pandemic global oil prices plummeted as demand declined against the backdrop of excessive supply. Aggregate demand is expected to be lower than expected although its reduction is likely to be softened by the undertaken monetary and fiscal policy measures.

The spread of the coronavirus negatively affected the global growth outlook, which is why growth projections for this year are being reduced for all leading world economies and emerging markets. The economy contracted on the back of dampened activity in many service sectors, halts and, in some cases, disruptions in global supply chains, and undermined consumer and business confidence. This fuels uncertainty in the international financial market, and as investors shift their focus on safe assets, the indices on global stock exchanges slump and the prices of gold and government securities of advanced economies go up.

To diminish the negative effects of the crisis, many central banks across the world responded by further easing their monetary policies and introducing robust unconventional measures. The Fed lowered the target range for the federal funds rate to almost zero and launched a quantitative easing programme, unlimited in terms of duration and scope, and unprecedented in its over a 100-year history. With its key rate at a zero level since 2016, the ECB expanded the scope of its asset purchase programme. Also, governments of a number of countries responded with sizeable fiscal aid packages. In deciding on monetary policy easing, the Executive Board bore in mind the fact that a coordinated response of monetary and fiscal policies in the largest world economies should mitigate the negative effects of the pandemic on global growth and maintain favourable financing conditions in the international market.

The Executive Board stated that **in the first two months of 2020, the indicators of Serbia's economic activity and its funding sources in the domestic market were positive, many even exceeding NBS expectations**. The economy contracted in the second half of March, reflecting dented external demand and aggravated terms of business in many sectors. **After a downturn in Q2, recovery should ensue in the remainder of the year, its pace depending on the duration of the pandemic**. According to the Executive Board's estimate, the economy's medium-term prospects remain favourable and the adopted monetary and fiscal policy measures should contribute to the mitigation of the negative effects of the crisis on economic activity.

**At its May meeting, the Executive Board kept the key policy rate on hold**. It had in mind that the effects of undertaken monetary policy measures will be largely manifested with further resumption of economic activity. The Board also underscored that the direct support to the private sector, hit most by the crisis, was ensured through timely and coordinated actions of the Serbian Government and the NBS, i.e. measures to support liquidity of the banking sector, introduction of a moratorium on loan repayment and launching a package of fiscal aid to the corporate sector and households.

The Executive Board emphasised that full coordination of monetary and fiscal policy measures would continue, which will diminish potential further negative shocks from the international environment and the economic fallout from the coronavirus. In coordination with the Government, the NBS has implemented and will implement all necessary measures to preserve the achieved price and financial stability and ease the position of households and corporates in the current extreme circumstances.

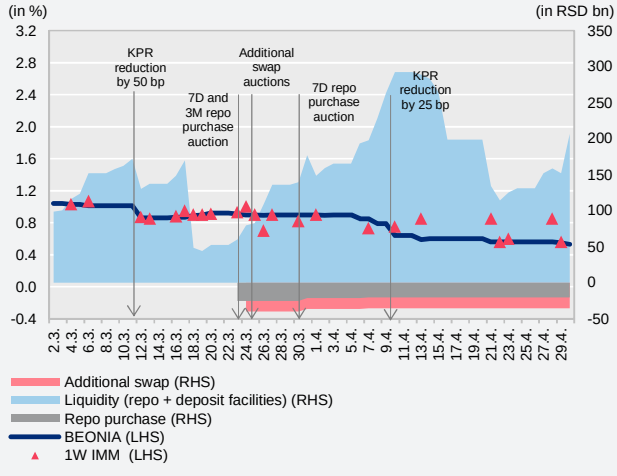
## *Text box 1: Serbia's economic measures in the fight against the coronavirus pandemic*

The first signals that the coronavirus could affect the global economy emerged early in the year. At the time of the February *Inflation Report* this was already reflected in the lower global oil price and heightened uncertainty in the international financial market. Back then we said that the coronavirus might affect global economic growth and that the weaker external demand might slow down our exports too. In the meantime, the coronavirus was declared a pandemic and it became quite clear that its impact would be much stronger than initially anticipated and that appropriate measures needed to be taken to mitigate the consequences of the spread of COVID-19 for the domestic economy.

Faced with the new crisis, **Serbia adopted the first measures to support the domestic economy even before the state of emergency was declared (15 March). The NBS was the first institution in the country and one of the first central banks in the region to have responded to the pandemic by taking concrete actions.** At the extraordinary meeting convened on 11 March, the NBS Executive Board decided to cut the key policy rate by 50 bp, to 1.75%, in order to maintain favourable financing conditions for our people and businesses. This was also supported by the decision to narrow the interest rate corridor from ±1.25% to ±1.0% relative to the key policy rate. Assessing that the negative effects of the coronavirus on global economic growth are stronger than anticipated earlier and that low inflationary pressures are conducive to such move, at its April meeting the NBS Executive Board trimmed the key policy rate by further 25 bp, to 1.5%, lowering thereby the deposit facility rate to 0.5% and the lending facilities rate to 2.5%.

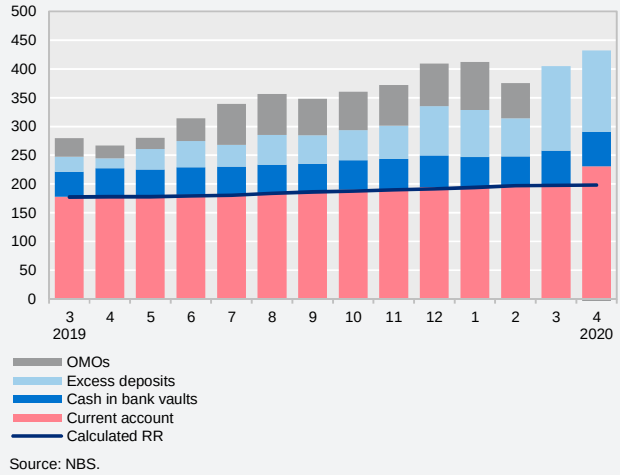
**With its timely and appropriate measures, the NBS provided additional dinar and FX liquidity to banks to sustain their lending to households and businesses.** These measures include repo purchase of dinar government securities and regular and additional FX swap auctions. The first additional FX swap auction in 2020 was held on 23 March, at fixed swap points, and it supplied banks with dinar liquidity worth RSD 14.9 bn (in exchange for EUR 127 mn) for a period of three months, at a favourable dinar interest rate of 0.85%. On the following day there were two auctions of repo purchase of government securities at a fixed interest rate of 0.75%. One of them was a fine-tuning seven-day operation, which provided liquidity worth RSD 4.7 bn, and the other was a three-month operation, providing liquidity in the amount of RSD 20.5 bn. On the maturity date of the seven-day repo, in late March, the NBS held another repo auction supplying RSD 1.0 bn, which pushed the total amount of liquidity provided to banks to RSD 41.1 bn. As a result, total excess liquidity of banks (funds deposited overnight and held in the NBS repo portfolio) increased from RSD 186 bn at end-February to RSD 238 bn at end-April.

Chart O.1.1 **Impact of FX swap and repo purchase auctions on liquidity and interest rates in the IMM**




Source: NBS.

Chart O.1.2 **Banks' dinar liquidity by RR maintenance period – average**
(in RSD bn)




Source: NBS.

In addition, starting from 31 March the method of holding regular FX swap auctions was changed – we switched from the variable multiple to the fixed swap points method. The realisation principle was also changed so that the volumes of swap purchase and sale no longer have to be the same. In the regular swap auctions held on 31 March, at fixed swap points, the NBS swap sold EUR 56 mn (in exchange for RSD 6.6 bn) and swap bought EUR 25 mn (in exchange for RSD 2.9 bn), enabling banks to access the necessary dinar and FX liquidity at favourable interest rates – 0.85% for dinars and 0% for euros.

Consistent with the cut to the NBS main interest rates in April, the rate on dinar funds in swap auctions was lowered by 25 bp, which ensured even more favourable conditions of liquidity supply for the banking sector (the interest rate on dinars is the NBS deposit facility rate plus 10 bp).

In its regular FX swap auctions held in April, the NBS swap sold EUR 218.5 mn (in exchange for RSD 25.7 bn) and swap bought EUR 131 mn (in exchange for RSD 15.4 bn).

To preserve and further strengthen financial system stability and to ease the position of citizens and businesses in the new crisis, at its extraordinary meeting convened on 17 March, the NBS Executive Board introduced the option of a minimum 90-day moratorium on the repayment of loan and financial leasing debt for all debtors (natural persons, farmers, entrepreneurs and companies) who wish to apply it. Based on the data submitted to the NBS by banks in late March, 94% of citizens and 93% of businesses accepted the moratorium on loan payments.

In line with the best world practice, in late March the Government adopted the **Economic Measures Programme to mitigate the negative effects of the COVID-19 pandemic and support the Serbian economy, which has two priority goals: 1) help the economic entities in distress and 2) preserve jobs and employee wages.** These measures apply to enterprises which reduced their employee numbers by less than 10% during the state of emergency (excluding people whose definite-term contracts expired), and to enterprises which had not frozen their operations before the state of emergency was declared. That the announced measures did prevent major layoffs is shown by the official data of the National Employment Service – **of close to 11 thousand workers fired until end-March, almost 9 thousand returned to work in the meantime**. Among them are over 8 thousand persons in standard employment (of which 6.7 thousand with legal entities and 1.3 thousand with entrepreneurs) and around a thousand in non-standard employment. Also, according to the Business Registers Agency, as early as the support programme was announced a decrease in the number of temporary shutdowns was registered (by mid-March around 7.4 thousand and around 6.3 thousand by mid-April), while a certain number of entrepreneurs reported resumption of activity.

The economic support package consists of **nine measures, classified into four sets, their total value estimated at RSD 608.3 bn or EUR 5.1 bn (around 11.0% of GDP)**, which makes around a half of Serbia's annual budget. **These are tax policy measures, direct assistance to the private sector, liquidity preservation and other measures** (moratorium on dividend payments until the end of the year and one-off assistance to all Serbian citizens of age), whose application began on 13 April once the legal framework had been defined and the relevant Government decrees passed. An important part of the programme is the **corporate loans guarantee scheme (worth around RSD 240 bn), with a government guarantee of around EUR 480 mn**, which does not constitute a budget expense unless activated. A part of the economic support programme should be financed from the funds raised in the local and international capital market and a part from budget reserves (by relocating specific appropriations). The corporate bond market could also serve as an additional source of funding. The competent institutions are working intensively on its development and the relevant legal framework. This would be most beneficial for large companies, which could raise the funding shortfall in the local capital market at relatively favourable conditions.

**The first set consists of tax policy measures for private sector enterprises**: deferred payment of payroll taxes and contributions (for a minimum of three months) with subsequent repayment of liabilities in instalments (maximum 24 months), deferred payment of income tax advances in Q2 and exemption of donors from the obligation to pay VAT. By releasing employers from the obligation to pay taxes and contributions, the government is implicitly encouraging them to keep jobs. **The second set of measures implies direct assistance to all businesses** during the state of emergency, notably to entrepreneurs, micro, small and medium-sized enterprises, which will be paid out 100% of the minimum net wage for each employee on paid temporary leave on employer's decision, while large enterprises will be paid out 50% of that wage.

**Both sets of measures aim to maintain an adequate level of business activity and employment**, as well as to unlock additional funds above all for the segment of micro, small and medium-sized enterprises. **The third set of measures – measures to preserve liquidity** will be implemented as: 1) loans granted to enterprises by the Development Fund of the Republic of Serbia and 2) loans granted to enterprises by banks, with a government guarantee.

For both types of financial support (worth RSD 264 bn or around EUR 2.2 bn in total) there are certain conditions prescribed, such as the eligibility requirements, loan approval criteria and collateral requirements. The following economic entities are entitled to use the said financial support: entrepreneurs, cooperatives, micro enterprises, small and medium-sized enterprises that are in majority private or cooperative ownership and perform production, service, trade or agricultural activity.

**Loans through the Development Fund are approved in dinars** at the interest rate of 1% p.a., with a repayment term of up to 36 months, which includes a grace period of up to 12 months, and the maximum loan amount depending on the size of the enterprise.[1] Also, **banks can approve loans to enterprises (against a government guarantee)** for liquidity purposes and procurement of current assets, in the maximum amount of EUR 2 bn, provided the disbursement of these loans begins no later than by end-January 2021. The maximum amount of the guarantee at the level of a bank's insured portfolio is EUR 480 mn, while the highest amount of individual guarantee is calculated as the product of the value of the bank's insured portfolio, the coverage rate (80%) and the maximum guarantee rate (30%). At the same time, at least half of the amount of loans under the guarantee scheme should be new loans, meaning that no more than a half can be refinancing loans. A half of the total amount of loans under the guarantee scheme (up to EUR 1 bn) will be given to banks proportionately to their market shares (in the segment of entrepreneurs, micro, small and medium-sized enterprises). Once it has used funds equivalent to 90% of the maximum insured portfolio, a bank may apply for an increase, but each individual application cannot be lower than EUR 5 mn or higher than EUR 25 mn. Loans can be extended in dinars and euros, at the maximum rate equal to 1M BELIBOR plus 2.5 pp or 3M EURIBOR plus 3 pp.[2] Furthermore, through the Administration for Agrarian Payments (working under the auspices of the Ministry of Agriculture) the government earmarked additional RSD 2.6 bn to help agricultural estates. Favourable financing for all segments of the economy aims to minimize the negative impact of the necessary social distancing measures and the adverse effects from the international environment (weaker demand and disrupted supply chains), and their consequences (increased illiquidity and worker layoffs).

Table O.1.1 **Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy**

| |
|---|
| **I Group – Tax policy measures** |
| 1. Deferred payment of payroll taxes and contributions in the private sector (during the state of emergency) with subsequent repayment of liabilities in instalments (starting from 2021 at the earliest) |
| 2. Deferred payment of income tax advances in Q2 2020 |
| 3. Exemption of donors from the obligation to pay VAT |
| **II Group – Direct assistance to the private sector** |
| 4. Payment of three minimum wages to entrepreneurs that are subject to the flat rate tax and pay tax on actual income, and to micro-, small- and medium-sized enterprises in the private sector |
| 5. Payment of assistance to large private sector enterprises in the amount of 50% of net minimum wage for employees on paid temporary leave on employer's decision |
| **III Group – Measures to preserve liquidity** |
| 6. Financial support to the corporate sector through the Development Fund |
| 7. Corporate support guarantee scheme |
| **IV Group – Other measures** |
| 8. Moratorium on dividend payments until the end of 2020, except for public enterprises |
| 9. Direct assistance to all adult Serbian citizens in the dinar equivalent of EUR 100 |

Source: Ministry of Finance.

[1] https://www.mfin.gov.rs/propisi/uredba-o-utvrdjivanju-programa-finansijske-podrske-privrednim-subjektima-za-odrzavanje-likvidnosti-i-obrtna-sredstva-u-otezanim-ekonomskim-uslovima-usled-pandemije-covid-19-izazvane-virusom-sars-cov-2/.

[2] https://www.mfin.gov.rs/propisi/uredba-o-utvrdjivanju-garantne-seme-kao-mera-podrske-privredi-za-ublazavanje-posledica-pandemije-bolesti-covid-19-izazvane-virusom-sars-cov-2-sluzbeni-glasnik-rs-br-57-2020.

**Other measures** include a moratorium on dividend payments to shareholders in the private sector until the end of the year, and direct assistance to all adult Serbian citizens in the dinar equivalent of EUR 100 to bolster personal consumption and strengthen consumer confidence. Even before the adoption of the Economic Measures Programme, the Government adopted decisions, as the first measures in fighting the crisis, to invest additional funds in capital infrastructure projects (around RSD 24 bn), to raise salaries to all health workers by 10% (starting from 1 April), and to pay out one-off assistance to pensioners in the amount of RSD 4,000 (10 April). In addition, ceilings were put on the retail and wholesale prices of basic foodstuffs and protective equipment so as to prevent any market disruptions and ensure unhindered supply to citizens. For the same reasons, a 30-day ban was imposed on the export of essential products (seeds, cooking oil, yeast, soap, detergents, disinfectants, sanitizers, alcohol, protective equipment), as well as on the export of medicines produced in Serbia. Additional economic measures to help the private sector remain a possibility, depending on the duration of the pandemic.

It is important to note that it was possible to put in place this economic support programme thanks to the achieved macroeconomic stability, the created fiscal space and well-coordinated monetary and fiscal policies. The programme is adjusted to the character of the crisis faced by Serbia and aligned with the recommendations of leading international institutions specializing in measures that need to be taken to ensure a proactive and timely support to businesses and households.

This is best illustrated by the Tax Administration data, according to which, from the adoption of the national economic measures programme until end-April, close to 240 thousand employers opted for the payment of direct assistance via a dedicated account with a selected bank, with over 1.1 mn employees receiving the minimum wage. Besides, as at 21 April, tax return for deferred payment of payroll taxes and contributions (PPP-PD Form) was filed by more than 38 thousand enterprises for close to 280 thousand employees, postponing the payment of employers' current liabilities in the amount of around RSD 6.9 bn.

The above measures of the NBS and Serbian Government should contribute to a faster economic recovery once the pandemic is over. Owing to these measures the private sector will continue to settle its tax liabilities, which will lead to a gradual increase in budget revenues and put budget deficit and public debt again on a downward path. Having this in mind, **we expect that the economic situation in our country will normalise in H2 2020 and recover at an accelerated pace in 2021**.

# III Inflation movements

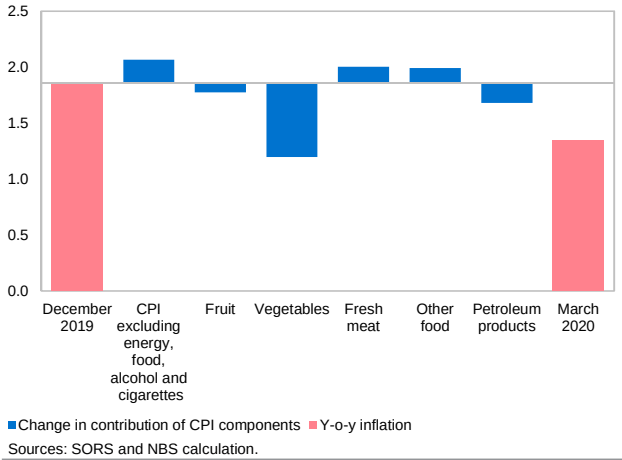
*Consistent with our expectations, y-o-y inflation slowed down since the start of 2020 and measured 1.3% in March. Such dynamics of y-o-y inflation in Q1 was predominantly determined by the base effect of vegetable prices and the lower prices of petroleum products, resulting from a fall in global oil prices. That inflationary pressures stayed low is also confirmed by core inflation, which remained stable in Q1, reaching 1.6% in March, and by inflation expectations of the financial and corporate sectors, which stand in the lower part of the target band both for one and two years ahead.*

*At quarterly level, consumer prices picked up by 1.0% in Q1, driven by higher prices of food and some services, while the decline in the prices of petroleum products worked in the opposite direction.*

## Inflation movements in Q1

Consistent with expectations in the February *Inflation Report*, **inflation slowed down in Q1, measuring 1.3% y-o-y in March**. The slowdown is mainly attributable to the further reduction in the contribution of vegetable prices to y-o-y inflation (from -0.3 pp in December to -1.0 pp in March), resulting from the high base effect from the same period in 2019. In addition, y-o-y inflation decelerated in March as a result of a considerable fall in the prices of petroleum products, whose contribution to headline inflation went to the negative zone (-0.14 pp in March), and to a lesser extent, a lower increase in the prices of fruit. In contrast, the contribution of fresh meat and processed food prices picked up (0.9 pp cumulatively). **Core inflation** (CPI excluding the prices of energy, food, alcohol and cigarettes) remained stable in Q1, **measuring 1.6% y-o-y in March**, with a somewhat higher contribution to y-o-y inflation in March (0.7 pp) than in December (0.5 pp).

Chart III.0.1 **Change in contribution of the most important CPI categories to y-o-y inflation**
(in pp)




Sources: SORS and NBS calculation.

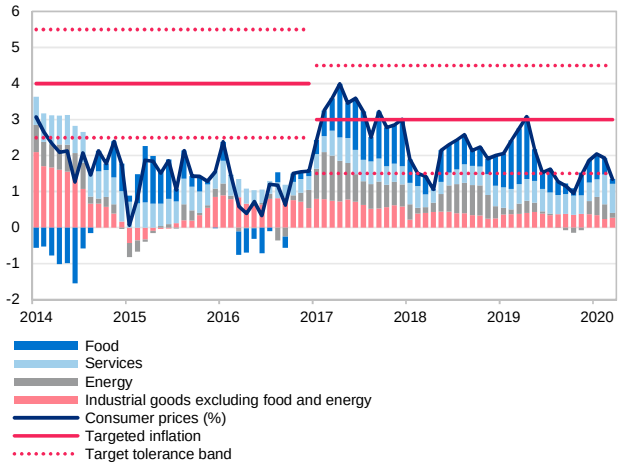
**At quarterly level, consumer prices picked up by 1.0%**, predominantly driven by the hike in **prices of food and non-alcoholic beverages** (2.9%, contribution: 0.9 pp). Higher prices in Q1 were also recorded in **unprocessed food** (6.0%, contribution to inflation: 0.6 pp), led by the increase in the prices of fresh vegetables and fruit, and in **processed food** (1.4%, contribution to inflation: 0.3 pp), led by the higher prices of meat products, vegetable oil, milk and dairy products. Due to the spread of the coronavirus, **the Government decided to limit the price increase of certain products** to a period of 60 days (relevant is the price level registered on

Table III.0.1 **Growth and contribution of components to consumer price growth in Q1 2020**
(quarterly rates)

| | Growth rates (%) | Contribution (pp) |
|---|---|---|
| **Consumer prices (CPI)** | **1.0** | **1.0** |
| Unprocessed food | 6.0 | 0.6 |
| Processed food | 1.4 | 0.3 |
| Industrial products excluding food and energy | 0.1 | 0.0 |
| Energy | -1.3 | -0.2 |
| Services | 1.2 | 0.3 |
| **CPI excluding energy, food, alcohol and cigarettes** | 0.3 | 0.2 |
| **Administered prices** | 2.3 | 0.4 |

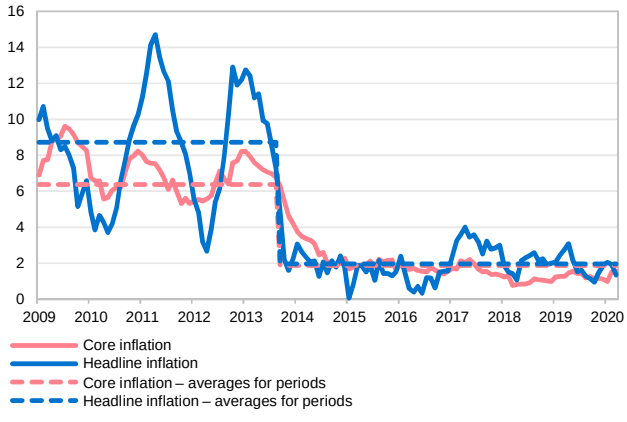
Sources: SORS and NBS calculation.

Chart III.0.2 **Contribution to y-o-y consumer price growth**
(in pp)



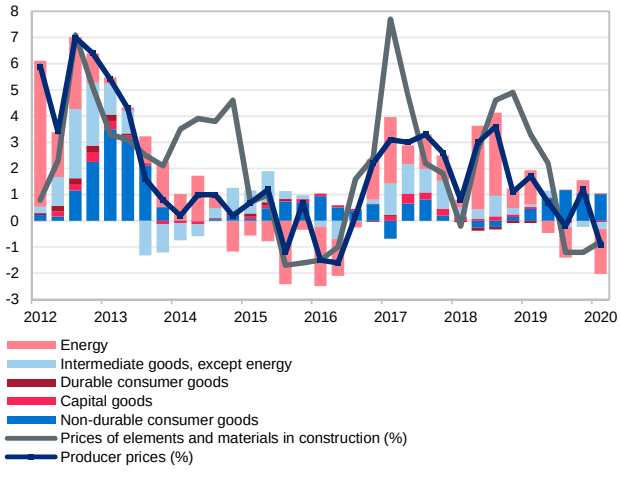

Sources: SORS and NBS calculation.

Chart III.0.3 **Headline and core inflation**
(y-o-y rates, in %)




Source: SORS and NBS calculation.

Chart III.0.4 **Contribution to y-o-y producer price growth***
(in pp)




Sources: SORS and NBS calculation.

* Industrial producer prices for the domestic market.

5 March) to prevent disruptions in the supply of essential food (water, bread, fruit and vegetables, flour, sugar, salt, milk and dairy products, meat and meat products and other products).

**Energy prices** decreased in Q1 by 1.3%, giving a 0.2 pp negative contribution to quarterly inflation. This is entirely attributable to a significant decrease in petroleum product prices in the domestic market (-3.3% in Q1), resulting from a drastic fall in global oil prices due to the coronavirus pandemic.

**The prices of services** rose by 1.2% in Q1 (0.3 pp contribution), largely determined by the increase in the prices of landline telephony services in February (13.9%). Also, Q1 saw an increase in the prices of services related to recreation and culture, mainly travel packages (3.1%) and TV subscription in January (15.9%).

Consumer prices picked up in Q1 on account of the cigarette price hike in February (3.5%) and higher prices of alcohol beverages (1.3%), but this was almost fully neutralised by the seasonal decline in the prices of clothes and footwear (-4.0%). Thus, the prices of **industrial products (excluding food and energy)** edged up by only 0.1%, providing a negligible contribution to quarterly inflation.

**Administered prices** grew by 2.3% in Q1 (0.4 pp contribution) on account of the February increase in the prices of landline telephony services and the regular annual cigarette excise adjustment.

**The prices within core inflation** (measured by CPI excluding food, energy, alcohol and cigarettes) increased by 0.3% in Q1 (0.15 pp contribution), chiefly due to higher prices of landline telephony services, while the seasonal decline in the prices of clothes and footwear worked in the opposite direction.

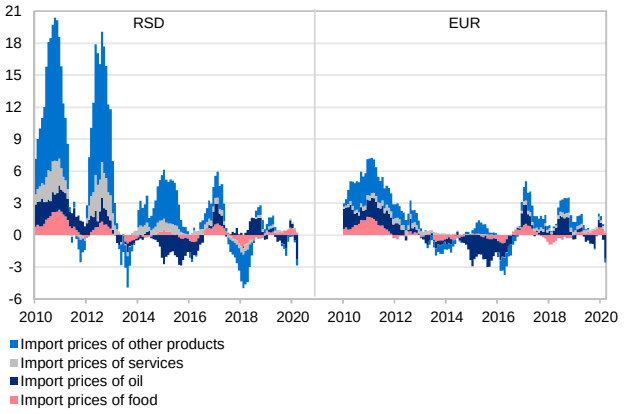
## Producer and import prices

After climbing by 1.2% y-o-y in December, **industrial producer prices in the domestic market** decreased by 0.9% y-o-y in March, indicating that cost-push pressures in the industry declined since the start of 2020. Amid the coronavirus pandemic, the y-o-y decline in producer prices in Q1 was driven by the decrease **in the energy production prices** (due to a considerable decline in the prices of domestic crude oil), while the **prices of non-durable consumer goods rose** (due to higher costs of

food production and beverages). After falling by 1.2% y-o-y in December, the **prices of elements and materials incorporated in construction** fell further by 0.8% y-o-y in March, confirming low cost-push pressures in construction as well.

After an increase in December, the indicator used to track movements in the prices of goods and services imported into Serbia shows that **dinar-denominated import prices**[1] decreased by 2.6% y-o-y in March. This was predominantly driven by a strong decline in global oil prices expressed in USD (with a contribution to total import prices of -2.2 pp), which were halved on average in March relative to the same period in 2019. Working in the same direction was a y-o-y reduction in export prices of Germany (-0.6 pp contribution), which are used to approximate prices of imported equipment and intermediate goods. On the other hand, a positive contribution to total import prices came from higher global food prices expressed in USD (0.2 pp) and consumer prices in the euro area (0.1 pp), which are used to approximate prices of imported services.

Chart III.0.5 **Contribution of individual components to y-o-y rate of import price growth**
(in pp)




Sources: Destatis, FAO, Bloomberg, Eurostat, SORS and NBS calculation.

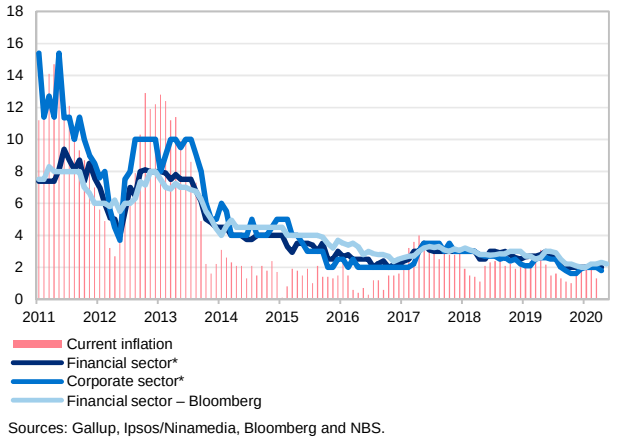
## Inflation expectations

**Inflation expectations of the financial and corporate sectors continued to move within the target tolerance band (3±1.5%)**, contributing to higher credibility of the NBS and reflecting the confidence of market participants in its measures.

According to the results of the Ipsos survey, in Q1, **one-year ahead inflation expectations of the financial sector** stood at 2.0%, the same as in April.[2] At the same time, the Bloomberg survey results indicate that the financial sector expects inflation to range from 2.0% to 2.3% in the period January–May 2021. Looking at a longer horizon, the financial sector has expected inflation within the NBS target tolerance band for more than six years now (since October 2013). Anchored inflation expectations are also reflected in the lower dispersion of responses of individual financial sector representatives.

**One-year ahead inflation expectations of corporates** were stable at 2.0% in Q1, falling to 1.8% in April. At the same time, more than 70% of corporates expect that the prices of production inputs will not change over the next

Chart III.0.6 **Current inflation and one-year ahead inflation expectations**
(y-o-y rates, in %)



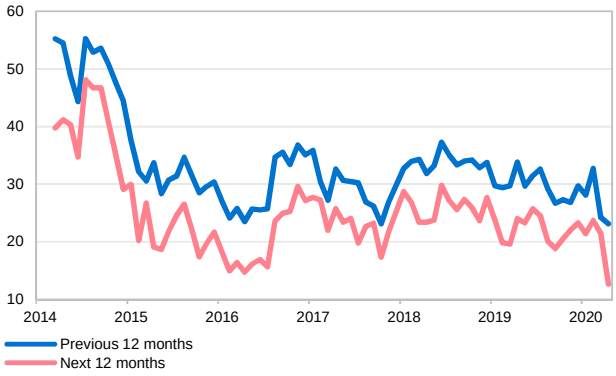

Sources: Gallup, Ipsos/Ninamedia, Bloomberg and NBS.

* Ipsos and Gallup until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

[1] The weighted average of the global Brent oil price and food price index (FAO index), euro area consumer prices, and export prices of Germany, one of Serbia's most significant foreign trade partners, is used as an indicator of import prices.

[2] For eight consecutive months.

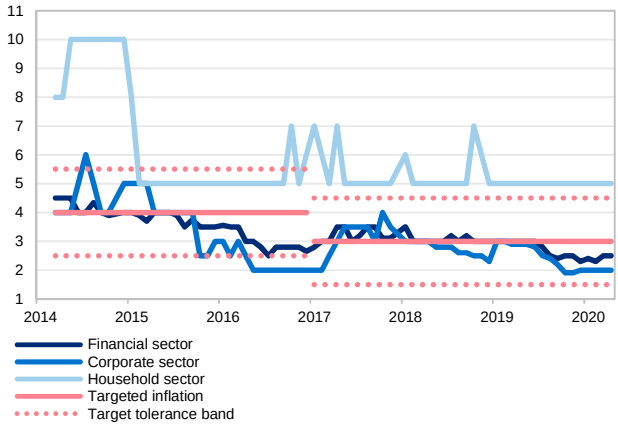
Chart III.0.7 **Household perceived and expected inflation***
(in index points)




Sources: Ipsos/Ninamedia and NBS calculation.

* Ipsos until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

Chart III.0.8 **Two-year ahead inflation expectations***
(y-o-y rates, in %)




Sources: Ipsos/Ninamedia and NBS.

* Ipsos until December 2014, Ninamedia since December 2014, and Ipsos since January 2018.

twelve months, while 50% of them anticipate that the prices of final products and services will not change either.

Typically higher than those of other sectors, **one-year ahead inflation expectations of the household sector** were stable at 5.0% since July 2019 and stayed unchanged in the first two months of this year. The temporary increase to 8.0% in March can be attributed to the spread of the coronavirus and its psychological effect on citizens, as expectations were lowered to 5.0% already in April. The results of the qualitative survey[3] of household inflation expectations show that this increase is short-term, as suggested by the index of perceived inflation which continued to record higher values than the index of expected inflation, indicating that households expected inflation to be lower over the next twelve months than in the past year.

**Two-year ahead inflation expectations of the financial sector** are anchored within the NBS target tolerance band since their monitoring began (March 2014), moving in the range 2.3–2.5% in the first four months of 2020, while **those of the corporate sector** were stable at 2.0%. **Two-year ahead inflation expectations of households** have been stable at 5.0% over the past seventeen months.

[3] For more details on qualitative expectations of households see the February 2016 Inflation Report – Text box 2, p. 15.

# IV Inflation determinants

## 1 Financial market trends

***Monetary policy measures taken in response to heightened uncertainty in the international environment caused by the spread of the coronavirus fully reflected on the movement of interest rates in the money market, which recorded a fall. Despite the heightened uncertainties in the international financial market and rising risk aversion, the dinar remained relatively stable against the euro.***

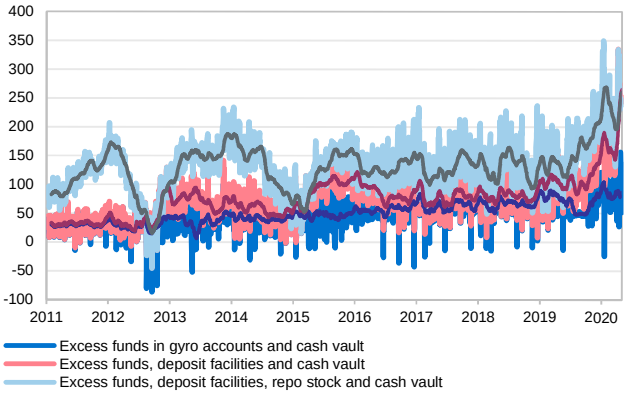
### Interest rates

In Q1, the NBS key policy rate cut by 0.5 pp and the deposit facility rate cut by 0.25 pp fully reflected on the average repo rate, which remained at the level of the deposit facility rate at end-March (0.75%).

In addition to key policy rate cuts, the movement of **interest rates in the interbank money market** was influenced by the NBS decision to hold two auctions of repo purchase of dinar government securities with a seven-day maturity and one with a three-month maturity, at a deposit facility rate (0.75%), as well as one extraordinary FX swap purchase auction with a three-month maturity, at the rate of 0.85% in order to further increase dinar liquidity. In an environment of a further rise in bank liquidity, at the quarterly level, BEONIA fell by 16 bp to 0.9% at end-March. It should be noted that trading volumes in the overnight money market increased from RSD 2.7 bn in Q4 2019 to RSD 3.2 bn in Q1, primarily due to an increase in turnover in March, when daily trading volumes averaged RSD 4.6 bn in extraordinary circumstances. BELIBOR rates of all maturities also declined in Q1, more sharply for longer maturities (from 0.2 pp to 0.3 pp for six-month maturity), ranging between 0.9% and 1.5% at end-March.

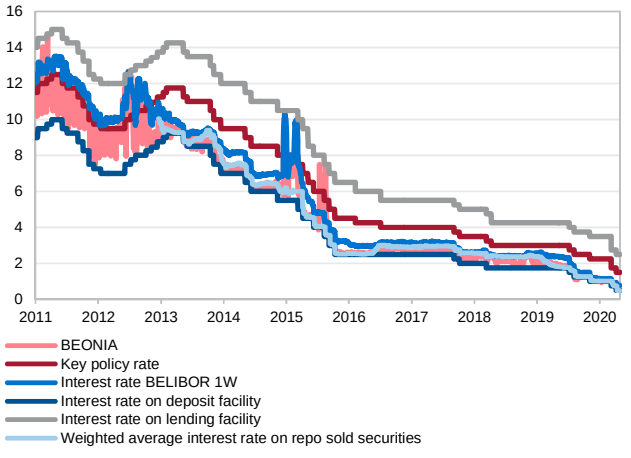
The additional key policy rate cut of 0.25 pp in April drove down the average repo rate to 0.5%, mostly reflecting on the BEONIA interest rate, which was cut by

Chart IV.1.1 **Dinar liquidity**
(daily stock and 30-day moving averages, in RSD bn)



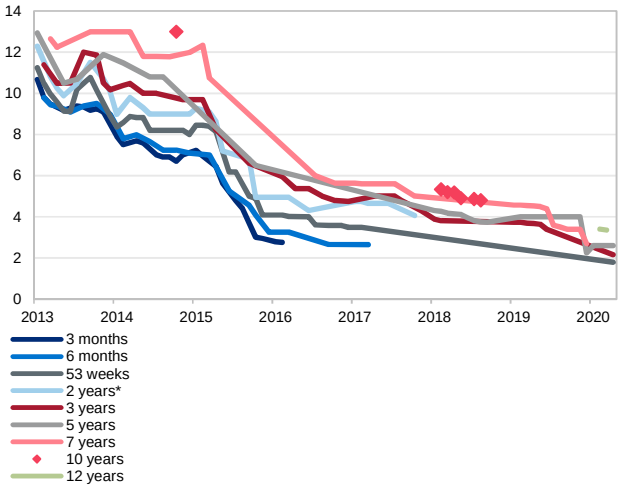

Source: NBS.

Chart IV.1.2 **Interest rate movements**
(daily data, p.a., in %)



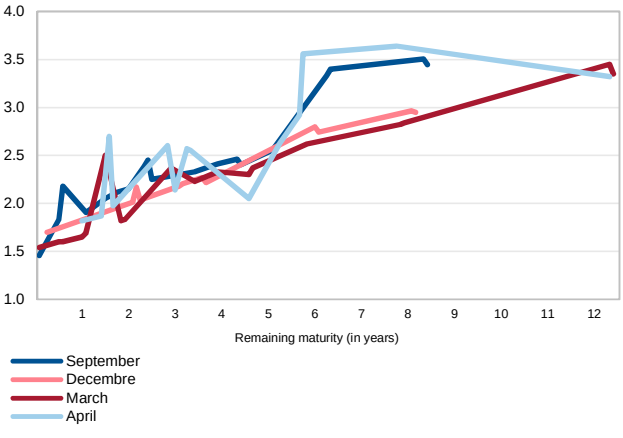

Sources: Thomson Reuters and NBS.

Chart IV.1.3 **Interest rates in the primary market of dinar government securities**
(p.a., in %)




Source: Ministry of Finance.
* Excluding coupon securities with the rate linked to the NBS key policy rate.

Chart IV.1.4 **Yield curve in the secondary government securities market**
(average values, p.a., in %)




Source: Central Securities Depository and Clearing House.

0.37 pp to 0.53% in April, while BELIBOR rates of all maturities declined by around 0.2 pp, ranging between 0.7% and 1.4% at end-month.

In the **primary market of dinar government securities**, twelve-year dinar securities were issued for the first time in February, with the coupon rate of 4.5%. The demand outstripped the planned sales volume of RSD 7 bn by more than ten times, so securities worth nominal RSD 19.3 bn were sold at a rate of 3.4%. Another auction for the sale of these securities was organised in early March, in which demand was also high and recorded performance higher than the planned sales volume (RSD 14.3 bn vs. RSD 10 bn), with the rate falling by 5 bp, to 3.35%. In addition, the government issued five-year dinar securities early in the year. In both auctions in January and February, the total sales amounted to RSD 19.7 bn, with the effective rates at 2.6%.

Non-residents showed great interest in investing in twelve-year dinar securities, which they bought in the primary market in the nominal amount of RSD 11.5 bn. However, they were more active on the sale side in the secondary market of government securities. As a result, the stock of sold dinar securities owned by non-residents decreased to RSD 224 bn, or 27.5% of the entire stock of sold dinar securities.

In Q1, two early buyback auctions for three- and seven-year securities were organised, with the buyback volume of RSD 10.2 bn nominally. Also, Q1 saw the maturing of previously sold dinar securities in the nominal amount of RSD 3 bn, so the stock of dinar securities sold in Q1 increased by RSD 40.1 bn, to RSD 814.2 bn at end-March.

In the **primary market of euro-denominated government securities**, January saw the first issue of 20-year euro-denominated securities. The entire issue worth nominal EUR 150 mn was sold out, with a significant share of non-residents, at the rate of 3% (coupon rate 3.5%). In addition, Q1 saw the issue of two-, five- and twelve-year euro-denominated securities at effective rates of 0.49%, 1.1% and 1.89%, respectively.

Higher investor activity was registered in the **secondary market**, mostly pronounced early in the year, resulting in an over 20% rise in the total turnover at the quarterly level. At end-Q1, yield rates went down, ranging from 1.5% for the remaining one-month maturity to 3.35% for the remaining twelve-year maturity.

In order to amortise the maturing of three-year dinar securities in the nominal amount of RSD 88 bn (6 April), the government issued a new issue of three-year bonds in

early April, in which securities were sold in the nominal amount of RSD 51.7 bn, at the rate of 2.15%. For the first time since 2017, April saw the issue of short-term dinar securities – 53-week T-bills. In the two held auctions, T-bills were sold in the nominal amount of RSD 35.0 bn, at the effective rate of 1.8%. Also, the issue of five-year dinar securities was reopened, in which the achieved rate stayed unchanged relative to the last auction in February (2.6%).

Interest rates on **new dinar loans for corporates and households** stood at their lowest levels at the start of the year. Current assets loans for corporates were approved at the rate of 3.3% in March. This represents a 1.1 pp fall from December 2019, leading to a decline in the weighted average rate on dinar corporate loans by 0.5 pp, to 3.6%. The interest rate on new dinar household loans stayed almost unchanged, measuring 9.2% in March. The average interest rate on cash loans, which are the dominant category of dinar household loans, declined to 9.3% in March (from 9.4% in December), its lowest level on record.

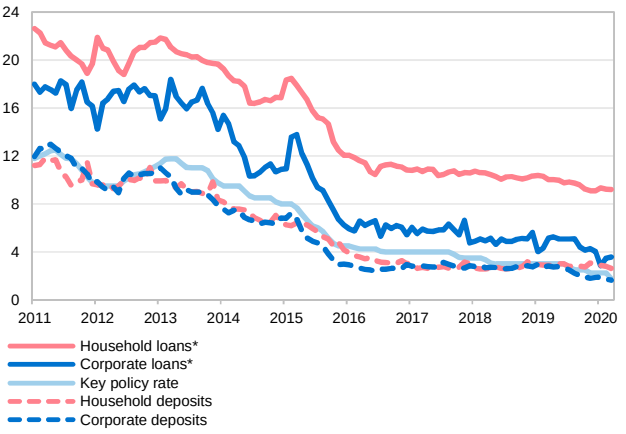
**Interest rates on euro-indexed corporate loans** stood at 2.5% in March, which is 0.4 pp lower than in December 2019. The fall in interest rates was most pronounced for investment loans (-0.7 pp), which were approved in March at the rate of 2.7%, and for current assets loans (-0.2 pp, to 2.5% in March). The weighted average rate on euro-indexed household loans dropped by 0.2 pp, to 3.6% in Q1, as a result of lowered interest rates on housing loans (0.1 pp), which were approved in March at the rate of 2.7%.

**Interest rates on household savings** in euros stayed almost unchanged in Q1, averaging 1.1% in March, as in December 2019, while those on dinar savings declined by 0.4 pp, to 2.6%. Interest rates on time dinar deposits of corporates edged down by 0.2 pp to 1.7%, while the decline in interest rates on time euro deposits was somewhat less pronounced in Q1 (-0.1 pp), measuring 0.8% in March.

## Risk premium

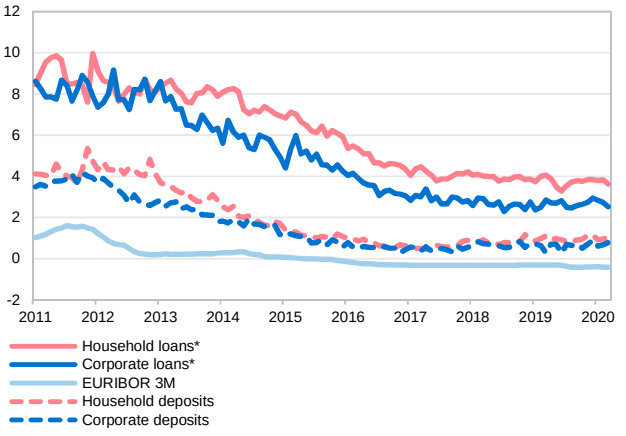
Emerging markets' risk premia were relatively stable until mid-February, when heightened global uncertainty caused by the coronavirus pandemic stoked up investors' risk aversion and shifted their focus on safe assets. In Q1, the composite measure of emerging markets' risk premia for dollar-denominated debt – EMBI Global Composite soared by 300 bp to 577 bp and EMBI Europe by 262 bp to 511 bp at quarter end. The risk premia of our regional

Chart IV.1.5 **Interest rates on new dinar loans and deposits**
(weighted average values, p.a., in %)



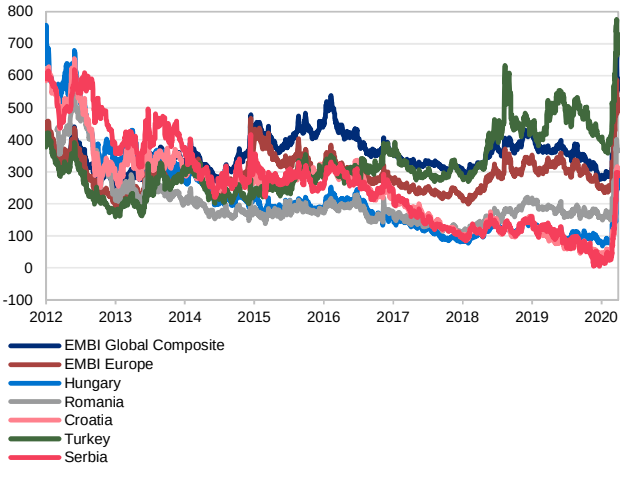

Source: NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

Chart IV.1.6 **Interest rates on new euro and euro-indexed loans and deposits**
(weighted average values, p.a., in %)



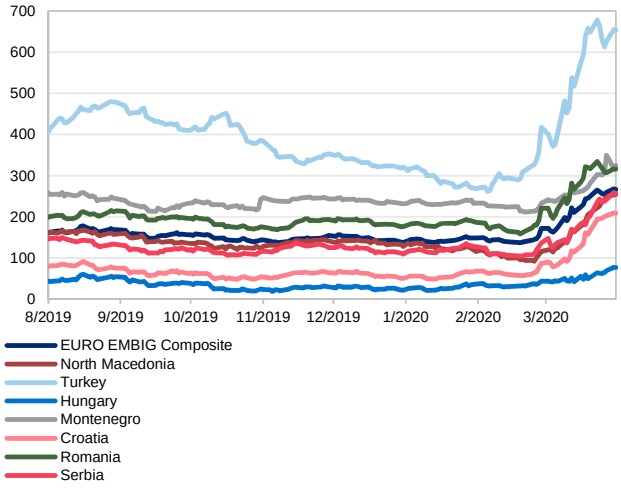

Sources: European Banking Federation and NBS.
* Excluding revolving loans, current account overdrafts and credit card debt.

Chart IV.1.7 **Risk premium indicator – EMBI by country**
(daily data, in bp)




Source: J.P. Morgan.

Chart IV.1.8 **Risk premium indicator for countries in the region (euro debt)**
(daily data, in bp)



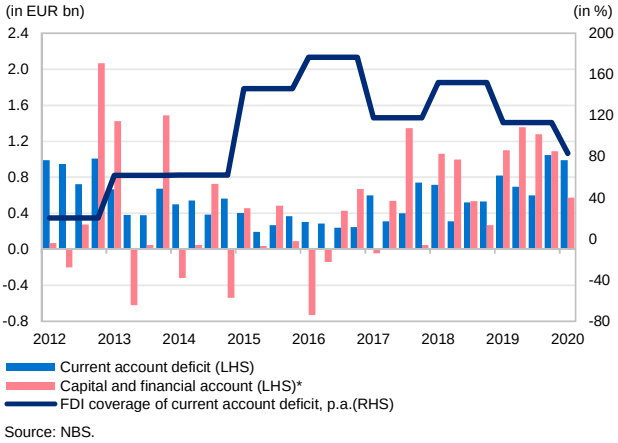

Source: J.P. Morgan.

Table IV.1.1 **Credit rating**
(change of rating and outlook)

| | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| S&P | BB- /stable[1] /positive[5] | BB /stable[5] | BB /positive[5] | BB+ /positive[5] |
| Fitch | BB- /stable[3] | BB /stable[5] | | BB+ /stable[4] |
| Moody's | B1 /positive[2] | Ba3 /stable[2] | | Ba3 /positive[4] |

Source: NBS.
[1] January, [2] March, [3] June, [4] September, [5] December.

Chart IV.1.9 **Current account deficit and net capital inflow**




Source: NBS.
Note: Revised data for 2018 and 2019. Preliminary data for Q1 2020.
* Excluding changes in NBS FX reserves.

peers also increased, but all of them, with the exception of Turkey, stayed much lower than EMBI Global Composite and EMBI Europe. EMBI for Serbia rose by 269 bp to 288 bp at end-Q1.

As for euro-denominated debt (EURO EMBIG)[4], the risk premia of countries in the region, Serbia included, also went up in Q1, but this rise was smaller than in case of debt in dollars. EMBIG for Serbia climbed by 146 bp to 255 bp, which is still below EURO EMBIG Composite that increased to 266 bp at the close of Q1.

In March 2020, Fitch affirmed Serbia's credit rating at BB+, with a stable outlook, confirming once again Serbia's favourable medium-term economic prospects despite the ongoing coronavirus crisis. In its press release, Fitch states that the affirmed ratings and outlook reflect Serbia's resilience to the pandemic-caused crisis, underpinned by increased NBS FX reserves, low external government debt, maintained fiscal discipline and sound public finances.

## Foreign capital inflow

In Q1 as well, the financial account of the balance of payments recorded a net capital inflow. Like before, most of that inflow was FDI. Financial loans also provided an inflow, as corporates and banks stepped up their borrowing abroad, while portfolio investment witnessed an outflow, driven mainly by the payment of due eurobonds.

Despite increased uncertainty in the international financial market, the net **FDI** inflow to Serbia in Q1 was relatively high (EUR 821.6 mn according to preliminary data). Investment was channelled mainly into tradable sectors, most notably into manufacturing and transport. As before, the bulk of investment came from European countries, though investment from Asian countries also recorded a rise.

**Portfolio investment** saw a net outflow of EUR 133.9 mn in Q1, driven chiefly by the payment of the remaining due eurobonds issued in 2013. Most of these bonds were bought back early in the course of the previous year. At the same time, non-residents stepped up their investment in the primary market of government securities, while residents scaled down their investment in foreign

[4] For more information about EURO EMBIG see the February 2020 *Inflation Report*.

securities. That allowed for the outflow on account of the net sale in the secondary market and due securities in the domestic market to be covered to a large degree.

Resident liabilities under **financial loans** went up in Q1 by EUR 148.9 mn net, led mainly by corporates and banks, whose net liabilities to foreign creditors increased by EUR 80.7 mn and EUR 120.8 mn, respectively. On the other hand, the government reduced its external debt by EUR 48.4 mn and the NBS by EUR 4.2 mn.

## Trends in the FX market and exchange rate

Despite significantly heightened uncertainty in the international financial market, the dinar remained stable against the euro in Q1. End-of-period, its value vis-à-vis the euro was almost unchanged (0.1% appreciation). At the same time, as the dollar strengthened against the euro, the dinar weakened against the dollar by 1.6%. In April as well, the value of the dinar against the euro stayed broadly unchanged.

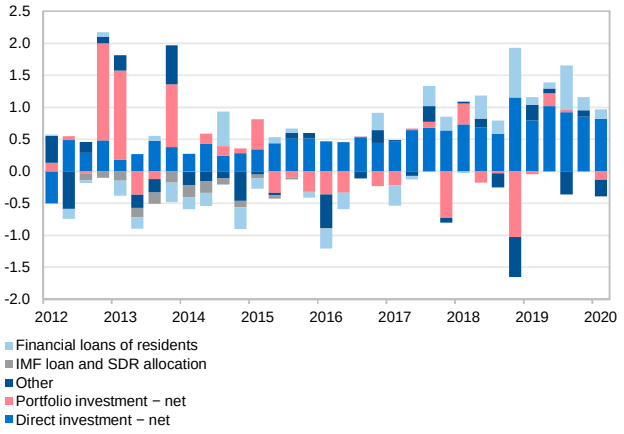
The demand for foreign exchange in Q1 originated from domestic enterprises amid seasonally higher energy imports early in the year, but also from non-residents, especially in March, when uncertainty in the international financial market increased over the pandemic. What worked on the supply side was the FX-indexed lending to corporates and households, i.e. FX-indexed bank assets,[5] and partly the purchase of foreign cash and the lengthening of banks' positions on account of payment card use.

In its IFEM activities in Q1, the NBS net sold EUR 185.0 mn.

At the same time, daily trading volumes in the IFEM[6] averaged EUR 30.8 mn and were somewhat lower (by EUR 1.7 mn) than in Q4 2019. The highest volumes were recorded in March (EUR 35.2 mn a day on average).

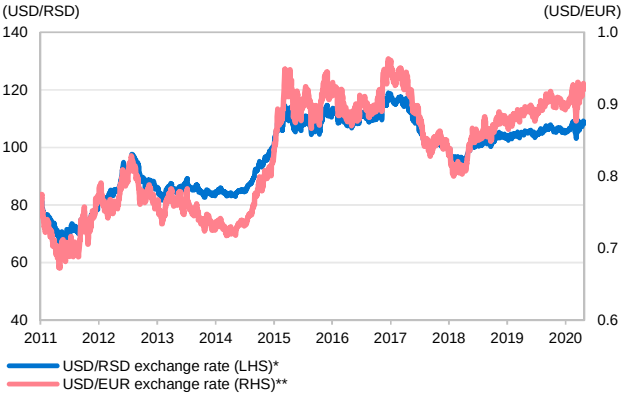
Turnover in the NBS swap auctions increased significantly in Q1, reflecting active use of this instrument as of mid-March for the provision of additional dinar and FX liquidity to banks amid the spread of the coronavirus. Thus, on top of regular swap auctions in March, the NBS organised an additional

Chart IV.1.10 **Structure of the financial account**
(in EUR bn)



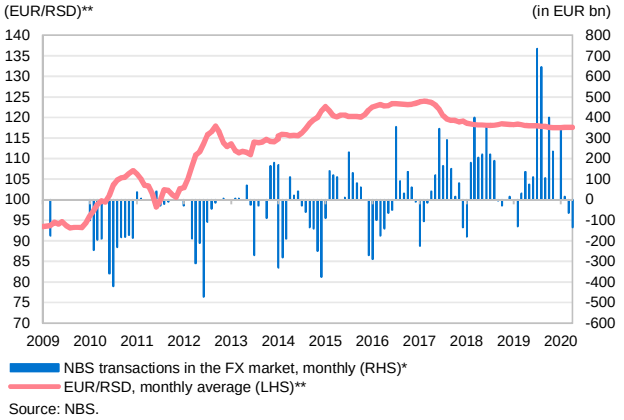

Source: NBS.
Note: Revised data for 2018 and 2019. Preliminary data for Q1 2020.

Chart IV.1.11 **Movements in USD/RSD and USD/EUR exchange rates**




Source: NBS.
* USD 1 in RSD.
** USD 1 in EUR.

Chart IV.1.12 **Dinar exchange rate and NBS transactions in the FX market**

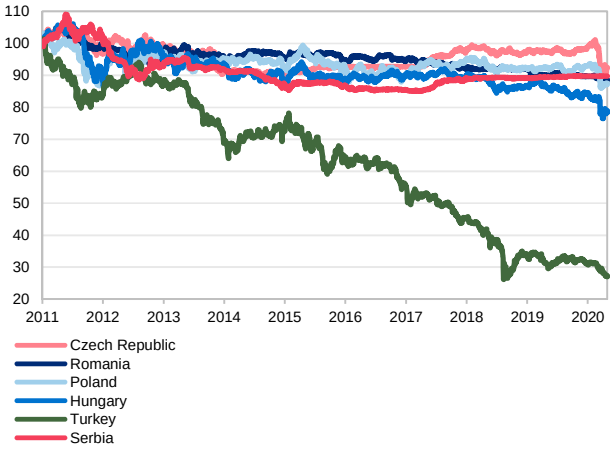



Source: NBS.
* + net purchase; - net sale.
** EUR 1 in RSD.

[5] Aiming to balance their open long FX position and thus reduce the exposure to FX risk, banks sell foreign currency, which leads to the strengthening of the dinar.

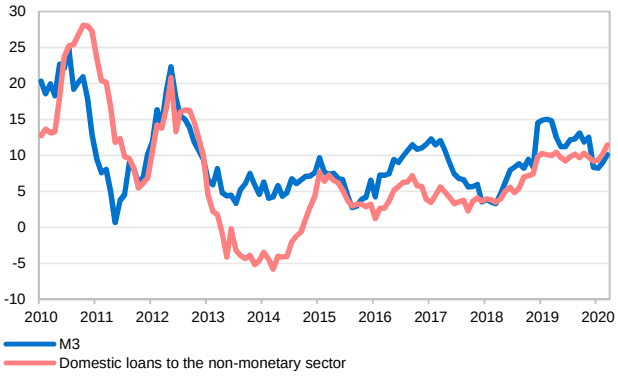
[6] Excluding the NBS.

Chart IV.1.13 **Exchange rates of selected national currencies against the euro***
(daily data, 31 December 2010 = 100)



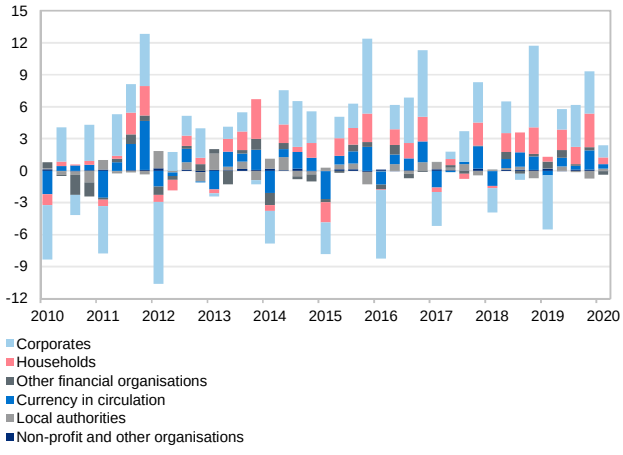

Sources: NBS and websites of central banks.
* Growth indicates appreciation.

Chart IV.2.1 **Domestic loans to the non-monetary sector and M3**
(nominal y-o-y rates, in %)




Source: NBS.

Chart IV.2.2 **Contributions to quarterly growth in M2, by sector**
(in pp)




Source: NBS.

auction of three-month swap purchase of foreign exchange (EUR 127.0 mn) at fixed swap points. Furthermore, starting from end-March regular auctions were also implemented at fixed swap points, and not at the variable multiple swap points as before. The realisation principle was also changed so that the volumes of swap purchase and swap sale no longer have to be the same. In the two-week swap auctions held in Q1 the NBS bought/sold from/to banks EUR 91.0 mn each, while in the three-month auctions it bought EUR 90.0 mn and sold EUR 121.0 mn, which is more than in Q4 2019, especially when it comes to the three-month swaps.

In contrast to the dinar, the currencies of other countries in the region running similar exchange rate regimes weakened during Q1. End-of-period, a more significant weakening against the euro was recorded by the Hungarian forint (8.0%), Turkish lira (7.8%), Czech koruna (7.0%) and Polish zloty (6.5%), while the Romanian leu lost 1.0%.

# 2 Money and loans

***The upturn in credit and economic activity, as well as the spending of government deposits in March, boosted money supply in Q1, leading to accelerated y-o-y growth in monetary aggregates M1, M2 and M3 in March relative to the end of last year. Lending growth continued at a faster pace, propped by higher lending to corporates.***

## Monetary aggregates

Primarily owing to the rise in the most liquid components, Q1 saw no decline in money supply usual for the season. The broadest monetary aggregate M3 increased by 1.0%, and almost all of this increase originated from the dinar component.

In terms of individual categories, atypically for the season, **sight deposits** rose the most, by RSD 23.7 bn. The biggest growth was recorded in corporate accounts, followed by transaction deposits of households. This movement resulted from positive trends in economic activity (primarily in January and February), as well as in the labour market, which recorded an increase in wages and employment. Amid the pandemic, current government revenue shrank, and expenditure rose, which also worked towards the growing money supply of non-monetary sectors.

**Dinar time deposits** of non-monetary sectors decreased by RSD 5.1 bn in Q1, the entire decrease being recorded

in March, which can be associated with the coronavirus pandemic in our country and the need to hold more liquid assets. Save for households and the local government, the contraction was recorded in account balances of all sectors. In Q1, dinar household savings expanded by RSD 4.1 bn, reaching RSD 83.1 bn at end-March. Continued growth in dinar savings indicates household confidence in the stability of the domestic currency, as a result of the achieved price and macroeconomic stability. In addition, dinar savings are more attractive than FX savings thanks to higher interest rates and a more favourable tax treatment.

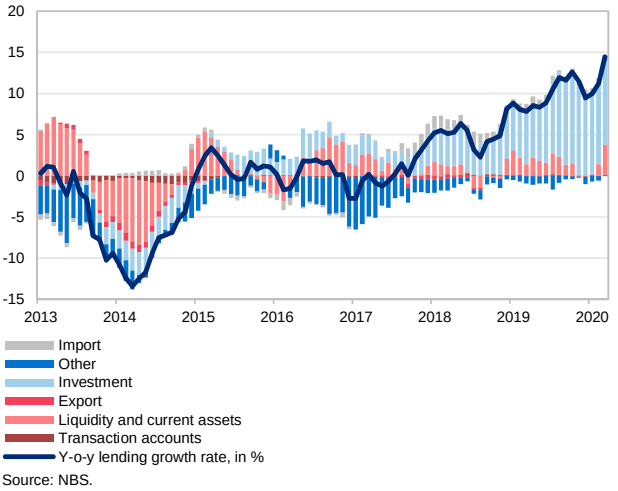
**FX deposits** increased by EUR 40.7 mn in Q1, primarily thanks to rising corporate FX deposits, driven by the FX inflows on account of exports, FDI and corporate borrowing abroad. Household FX savings edged up negligibly, reaching EUR 10.5 bn[7] at end-March. Preserved confidence in the banking system during the crisis is evidenced by the preliminary data for April, indicating further growth in household savings.

## Loans

**Total domestic loans** posted two-digit y-o-y growth rates in Q1, thanks to unusually high disbursement rates since the start of the year. This is a continuation of a trend of stable and sustainable lending growth, which, excluding the exchange rate effect, accelerated further to 11.9% y-o-y in March. The credit structure remained favourable, as the lending growth was primarily driven by corporate investment loans.[8]

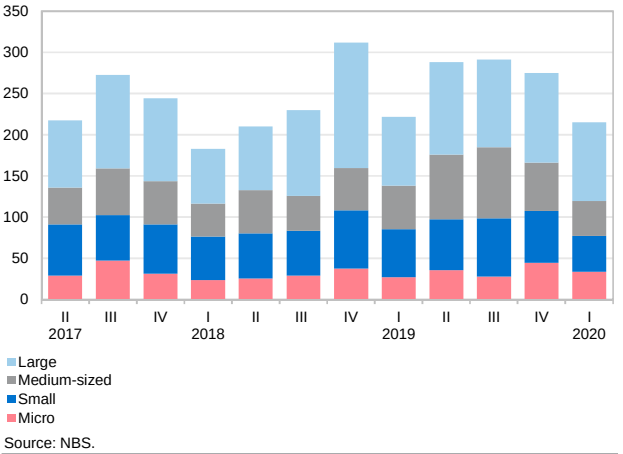
At the quarterly level, **corporate loans**, excluding the exchange rate effect, increased by RSD 58.2 bn, which is the highest growth recorded in Q1 (contraction or modest growth is typically recorded in account balances in this quarter). In terms of purpose,[9] investment loans took the lead in the segment of corporate loans (44.9% in March), representing an important source of investment cycle financing in place since 2015. They are followed by current assets loans, accounting for a 39.7% share. Sector-wise, corporate accounts posted growth across all sectors (save for agriculture), most notably in trade, transport, real estate and manufacturing.

Chart IV.2.3 **Contributions to y-o-y corporate lending growth**
(in pp, excluding the exchange rate effect)



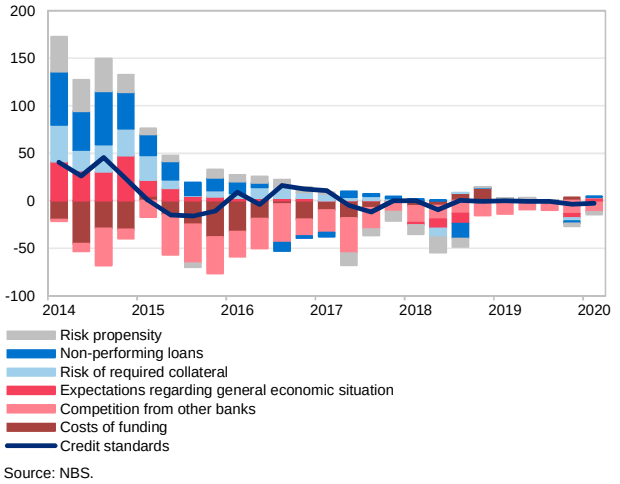

Source: NBS.

Chart IV.2.4 **Structure of new corporate loans, by enterprise size**
(in RSD bn)




Source: NBS.

Chart IV.2.5 **Change in corporate credit standards and contributing factors**
(in net %)




Source: NBS.

Note: Growth indicates the tightening and decline indicates the easing of credit standards.

[7] Money supply M3 includes only resident funds. With non-resident funds included, at end-March dinar savings equalled RSD 83.7 bn and FX savings EUR 10.8 bn.

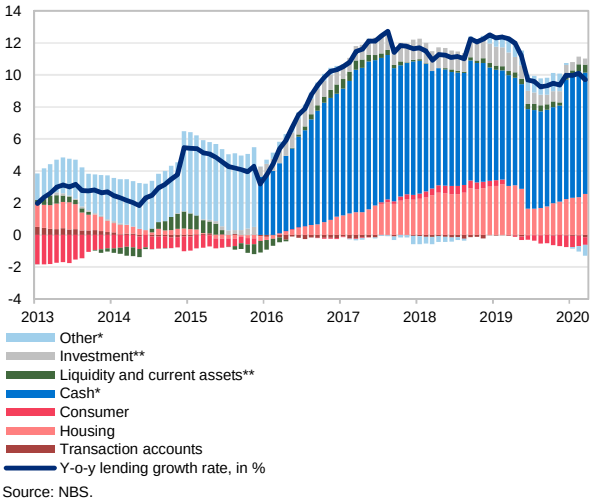
[8] In March, y-o-y growth of corporate loans reached 14.5%, and of household loans 9.7%, excluding the exchange rate effect.

[9] In Q1, investment loans growth came at RSD 21.9 bn, and that of current assets loans RSD 30.1 bn.

**The stock of new corporate loans** in Q1 stood at RSD 215.0 bn, excluding the loans refinanced with the same bank, up by 11.4% from the same period last year. Over 55% of these loans were approved to micro, small and medium-sized enterprises. This market segment took up almost 65% of new investment loans and almost 60% of current assets loans in Q1.

**The results of the NBS Bank Lending Survey in April**[10] indicate that competition in the banking sector and stronger risk appetite contributed to the easing of corporate credit standards in Q1. At the same time, banks assess that corporate loan demand was on the rise in Q1, mostly investment loans. Banks expect further growth in corporate loan demand in Q2, with credit standards being tightened in an environment of higher perceived risk due to the coronavirus pandemic.

Chart IV.2.6 **Contributions to y-o-y household lending growth**
(in pp, excluding the exchange rate effect)

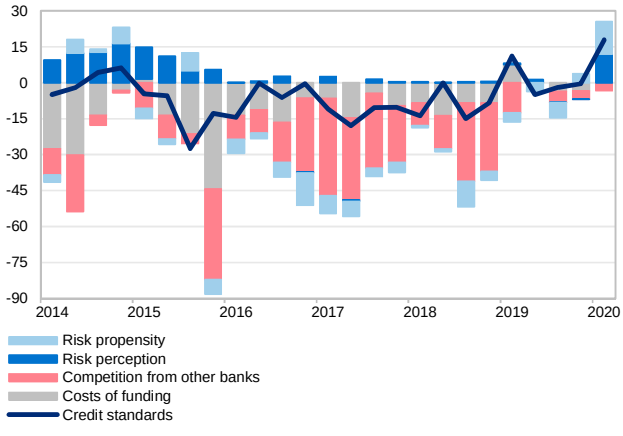



Source: NBS.
* Until December 2015, the contribution of cash loans is shown within the contribution of other loans.
** Loans extended to entrepreneurs.

In Q1, excluding the exchange rate effect, **household loans** increased by RSD 18.9 bn, of which over 50% relates to housing loans, supported by extended real estate supply, a rise in employment and wages, as well as lower costs of borrowing. By purpose, cash and housing loans held the dominant share in household loans at end-Q1 – 44.1% and 36.7%, respectively. Owing to a relatively quick and simple procedure of loan approval, cash loans recorded growth of RSD 13.0 bn in Q1, while their average maturity continued to shorten in 2020 as well.

**The stock of new household loans** in Q1 stood at RSD 103.4 bn which, excluding the loans refinanced with the same bank, is up by 0.8% from the same period last year.

Chart IV.2.7 **Change in household credit standards and contributing factors**
(in net %)




Source: NBS.

Note: Growth indicates the tightening and decline indicates the easing of credit standards.

The results of the **April Lending Survey** indicate that, in banks' view, household demand rose for housing loans in Q1, whereas the demand for cash loans dropped from the previous quarter. Household credit standards were tightened, mostly reflecting on their maximum maturity. Banks expect that household demand for loans will dampen in Q2 in conditions of heightened uncertainty amid the coronavirus pandemic.

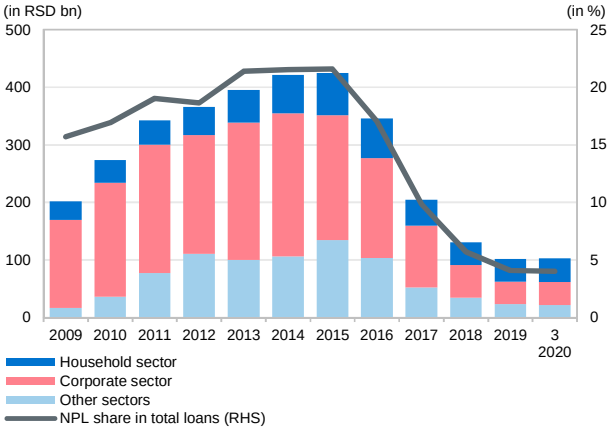
**At end-Q1, the share of dinar receivables in total corporate and household receivables** stood at 33.2%, an increase of 0.1 pp from end-2019. Dinarisation of corporate receivables increased to 14.7% at end-Q1 (from 14.0% at end-2019), mostly as a result of increased dinar lending in March. On the other hand, dinarisation of household receivables contracted by 0.2 pp, to 55.1%, due to a greater rise in FX-indexed receivables compared to dinar household receivables.

[10] The NBS implements the survey since the start of 2014.

In 2020, the **gross NPL ratio**[11] continued to decline and measured 4.0% at end-March, the lowest level since this indicator of asset quality is monitored. In Q1, the NPL share in total loans decreased by 0.1 pp, with the corporate NPL ratio going down to 3.1%,[12] and the household one going up to 4.1%.[13] NPL coverage remained high – allowances for impairment of total loans measured 84.7% of NPLs in March, while allowances for impairment of NPLs stood at 61.4% of NPLs.

According to the latest available data, the **capital adequacy ratio**[14] measured 22.7% at end-Q1 2020, indicating high capitalisation and resilience of the banking sector (regulatory minimum 8.0%).

Chart IV.2.8 **NPL share in total loans, gross principle**

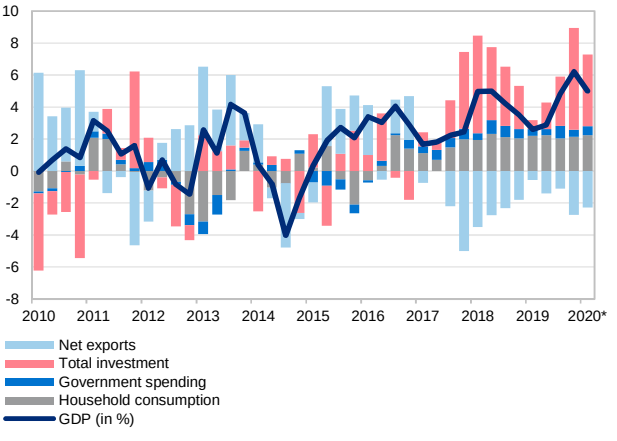



Source: NBS.

## 3 Aggregate demand

*Driven by domestic demand, GDP growth is estimated to have reached 5.0% y-o-y in Q1. Available monthly indicators of fixed investment and final consumption show that positive trends continued in the early part of the year, with the adverse impact of the coronavirus pandemic starting to be felt in March, so their contribution to GDP growth in Q1 remained relatively high (4.6 pp and 2.8 pp, respectively). On the other hand, global pandemic declaration and the economic shutdown of Serbia's key export markets made our exports slow down, while our imports remained dynamic amid continued investment cycle. As a result, net exports were a negative contributor to GDP growth (2.3 pp).*

Chart IV.3.1 **Contributions to y-o-y GDP growth rate – expenditure side**
(in pp)

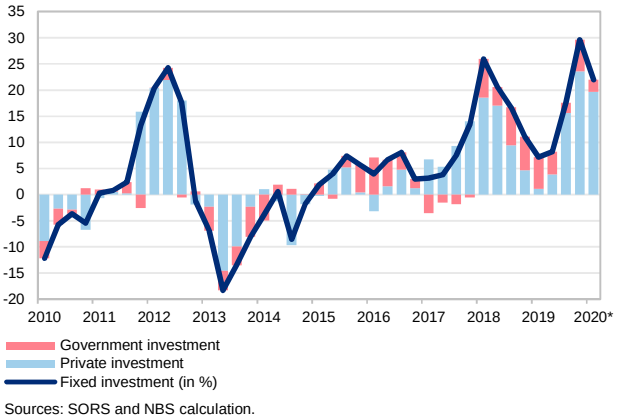



Sources: SORS and NBS calculation.
* NBS estimate for Q1 2020.

### Domestic demand

**Private consumption** growth in Q1 is estimated to have been at last year's level (3.4% y-o-y, with a 2.2 pp contribution to GDP). This is also confirmed by consumption indicators, which went up significantly in the first two months. Thus, the import of consumer goods rose by over 15% y-o-y, and retail trade turnover by 12% y-o-y. In addition, the number of domestic guests and their overnight stays recorded growth of over 20%, but this was offset after the hotels shuttered (from 15 March) due to the emergency state. On the other hand, retail trade turnover in March was also higher than the year before (3.9%) as the demand for groceries went up partly on

Chart IV.3.2 **Fixed investment**
(y-o-y growth, in pp)




Sources: SORS and NBS calculation.
* NBS estimate for Q1 2020.

[11] Relative to July 2015, i.e. the period just before the Strategy adoption, this indicator declined by 18.4 pp, while the NPL stock contracted by RSD 326.5 bn (76.0%).

[12] Includes companies and public enterprises. Looking only at companies, the share of NPLs in total loans came at 3.3% in March, unchanged from end-2019.

[13] Including entrepreneurs and private households, the share increased by 0.1 pp to 4.1%.

[14] The regulatory Basel III framework is applied as of 30 June 2017.

Table IV.3.1 **Movement in main indicators and sources of household consumption**
(real y-o-y growth rates, in %)

| | 2019 | | | 2020 |
|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Q1 |
| **Household consumption** | **3.2** | **3.0** | **3.1** | **3.4 *** |
| **Indicators** | | | | |
| Retail trade | 8.8 | 8.6 | 11.4 | 9.1 |
| Catering turnover | 8.1 | 10.7 | 8.5 | 8.1 ** |
| Number of domestic tourists | 7.1 | 7.1 | 10.5 | -3.5 |
| Number of overnight stays of domestic tourists | 7.6 | 5.5 | 13.6 | 1.5 |
| Consumer goods imports (BEC classification), nominal | 17.5 | 15.9 | 8.0 | 8.9 |
| **Sources** | | | | |
| Total wage bill, nominal | 14.0 | 14.6 | 15.4 | 13.8 *** |
| Net remittances inflow, nominal | -7.5 | 2.5 | -3.4 | -11.2 |
| Stock of loans intended for consumption, nominal | 15.7 | 13.9 | 13.2 | 12.8 |

Sources: SORS and NBS calculation.
* NBS estimate.
** January (SORS estimate).
*** January–February.

Table IV.3.2 **Investment indicators**

| | 2019 | | | 2020 |
|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Q1 |
| **Real y-o-y growth rates** (in %) | | | | |
| Fixed investment (national accounts)* | 8.2 | 17.5 | 29.6 | 22.0 |
| Construction (national accounts)* | 17.4 | 36.0 | 48.3 | 28.7 |
| Government investment | 33.3 | 10.6 | 30.8 | 10.0 |
| Number of construction permits issued | 6.9 | 18.4 | 18.5 | 29.1** |
| Production of construction material | -0.6 | 3.4 | 0.3 | -3.0 |
| Value of works performed | 23.0 | 40.8 | 54.1 | - |
| Imports of equipment, nominal | 6.8 | 16.0 | 42.5 | 17.3 |
| Production of domestic machinery and equipment | -4.3 | -9.2 | 13.0 | 0.7 |
| Finished product inventories in industry | 0.7 | -3.2 | -3.8 | -5.1 |

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

account of intensified psychological factors at the beginning of the pandemic. In Q1, the sources of consumption, overall, were larger than in the same period of the year before, owing primarily to the 13.8% wage bill growth in the first two months and higher pension expenditures, and to a smaller extent, to consumer loans, while remittances went down.

After the outbreak of the pandemic, the government was forced to considerably step up the purchase of medical supplies, which increased the outlays for goods and services. With this in mind, we estimate that **government consumption** rose by 3.3% y-o-y in Q1 (with 0.6 pp contribution to GDP growth).

Higher **fixed investment** in Q1 was largely driven by private investment which, in our estimate, rose by over 25% y-o-y, adding 4.1 pp to GDP growth. This increase was recorded primarily in the first two months and is a continuation of intensive investment in the previous year. Investment was largely financed from domestic sources, first and foremost from companies' own sources on account of profit made in the previous year. Furthermore, at quarter level, investment loans recorded RSD 21.9 bn growth (14.7% y-o-y). The FDI inflow of around EUR 822 mn in Q1, as a result of macroeconomic stability and continued improvement of the business and investment environment, was also a significant source of finance for investment projects.

Intensive implementation of government-financed infrastructure projects continued into Q1 and the estimate is that **government investment** went up by 10% y-o-y, contributing 0.5 pp to GDP growth. It needs to be emphasised that construction works on infrastructure projects in transport and energy were not halted even after the state of emergency was declared. They only decelerated and are likely to be in full swing as early as of May.

Due to the halt in production amid disrupted global supply chains, **inventories** were expended, leading to their fall of around 2% y-o-y in Q1, with a 0.1 pp negative contribution to GDP growth.

At quarter level, domestic demand is estimated to have risen by 3.8% s-a, adding 5.0 pp to GDP growth and offsetting the negative contribution of net exports.

## Net external demand

Dampened external demand, disrupted global supply chains and worldwide containment measures, which particularly lowered the demand for services, resulted in the deceleration of the real y-o-y growth in services exports and imports in Q1, to 3.0% and 6.0% respectively. Thus, the negative contribution of net exports to GDP weakened, touching 2.3 pp in Q1.

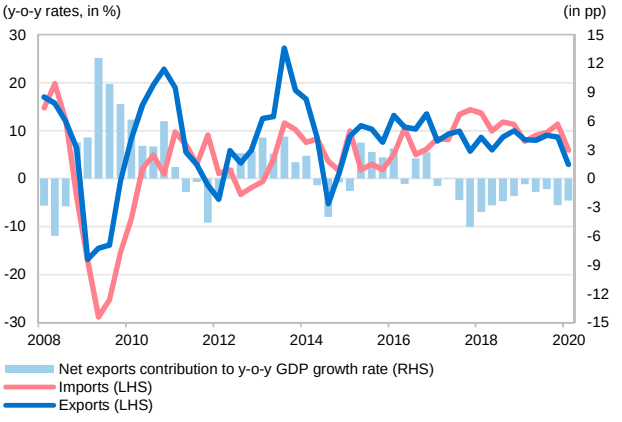
Despite the global economic slowdown and plummeting external demand amid escalating coronavirus pandemic, according to the balance of payments data, the export of goods in euro terms went up by 2.5% y-o-y in Q1. Another limiting factor was a temporary ban on the export of products essential for the population aimed at preventing their shortage during the pandemic – certain food products, disinfectants, drugs, medical and protection equipment. As usual, the rise in exports was driven by manufacturing, while the contribution of agriculture was minimally positive. According to foreign trade data, manufacturing exports rose by 3.3% y-o-y in Q1, and growth was recorded in 16 out of 23 areas. The greatest contribution came from the export of tobacco and food products, and to a somewhat lesser extent from electrical equipment, petroleum products and furniture. On the other hand, the new crisis had the most adverse impact on the export of base metals, which dropped by 16.6% y-o-y in Q1.

Goods imports in euro terms slowed down to 9.2% y-o-y in Q1, as a consequence of reduced demand and halts and disruptions to supply chains. The import of equipment rose 17.3% y-o-y, while the import of intermediate and consumer goods went up by 6.3% and 8.9% y-o-y, respectively. Looking at imports structure according to the EU classification into end-use categories, one can see that the largest contributions came from capital and consumer goods, while smaller stemmed from intermediate goods and energy, partly also on account of lower oil prices.

According to the balance of payments data, Q1 also posted a foreign trade surplus in services. The rise in the export of services was almost two-digit (9.9% y-o-y), driven by business and ICT services, while the import of services went up by 2.5% y-o-y.

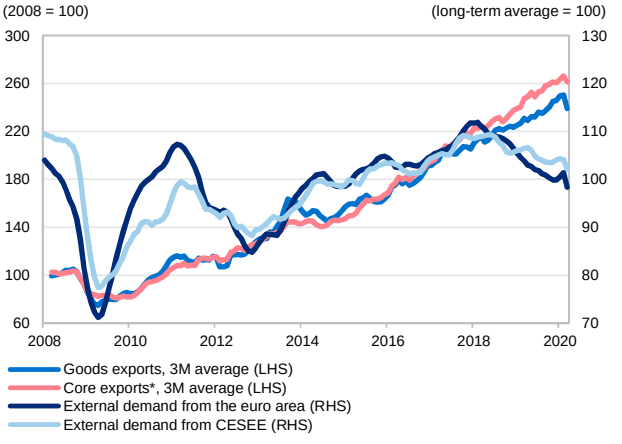
The export/import cover ratio[15] equalled 73.7% in March, or 83.3% if services are included, which is close to the 2019 level.

Chart IV.3.3 **Exports and imports of goods and services**
(in previous-year constant prices, ref. 2010)



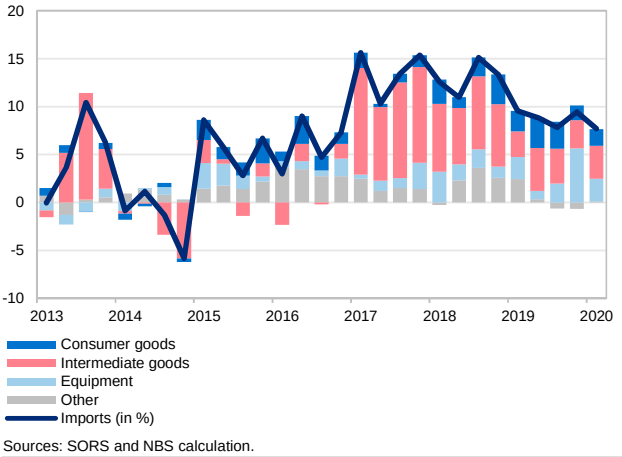

Sources: SORS and NBS calculation.
Note: NBS estimate for Q1 2020.

Chart IV.3.4 **Movement of indicators of external demand for Serbian exports**
(3M moving average, s-a)




Sources: European Commission, SORS and NBS.
* Core exports are total exports excluding exports of agricultural products, base metals, motor vehicles, petroleum products and electricity.

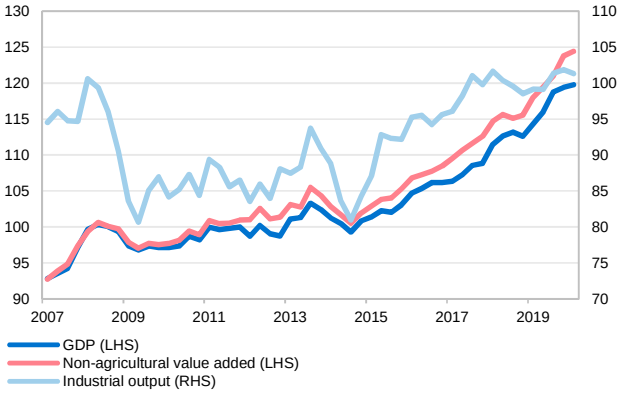
Chart IV.3.5 **Movement of key import components**
(contributions to y-o-y growth, in pp)




Sources: SORS and NBS calculation.

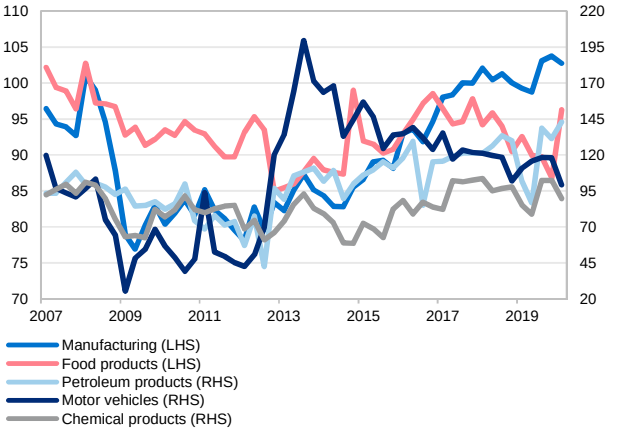
[15] Measured by a 12-month moving average.

Chart IV.4.1 **Economic activity indicators**
(s-a, H1 2008 = 100)




Sources: SORS and NBS calculation.

Chart IV.4.2 **Physical volume of production by branch of manufacturing**
(s-a, H1 2008 = 100)




Sources: SORS and NBS calculation.

# 4 Economic activity

***In the first two months economic activity was rising at a relatively high y-o-y rate, indicated primarily by industrial production, retail trade turnover, construction indicators, and continued positive labour market trends, only to be suspended and even halted in some service sectors in the second half of March. Even though the spread of the pandemic and the declaration of the emergency state in the second half of March led to a lower utilisation of production capacities, GDP growth measured around 5% y-o-y.***

For the third consecutive quarter **industrial production** posted growth, which, in our estimate, accelerated from 3.1% y-o-y in Q4 2019 to 4.3% in Q1 2020. As the same period also saw a deceleration of external demand, the industrial production growth since H2 2019 is completely due to the investment cycle in the country, which has created new production capacities.

That industry accelerated in Q1 is indicated by the increase in the physical volume of industrial production by 7% y-o-y in the first two months of 2020, while the physical volume of manufacturing posted somewhat higher growth (8% y-o-y). Since the second half of March saw significantly dampened production due to the emergency state, and some factories even completely stopped their operation, growth in the physical volume of production in manufacturing at the quarterly level slowed down to 6.1% y-o-y. The largest positive contribution to growth in Q1 stemmed from the oil (2.6 pp)[16] and food industry (1.0 pp). As the mining sector was less affected by restrictive measures, Q1 saw a somewhat higher increase (9% y-o-y). On the other hand, activity in the electricity supply sector decreased by 3% y-o-y.

In quarterly terms, the physical volume of production in manufacturing mildly dropped (-1.0 s-a), primarily on account of halted production in predominantly export-oriented industries. Thus, the volume of production of motor vehicles went down by 16.0% s-a, while a somewhat less pronounced decrease was recorded in the chemical industry and base metals production (-12.5% s-a and -9.9% s-a, respectively). On the other hand, food and tobacco products industries recorded robust quarterly growth (10.9% s-a and 13.1% s-a, respectively).

[16] A high y-o-y increase in the oil industry production is almost entirely a result of the low base from the previous year due to the overhaul in oil plants in Q1 2019.

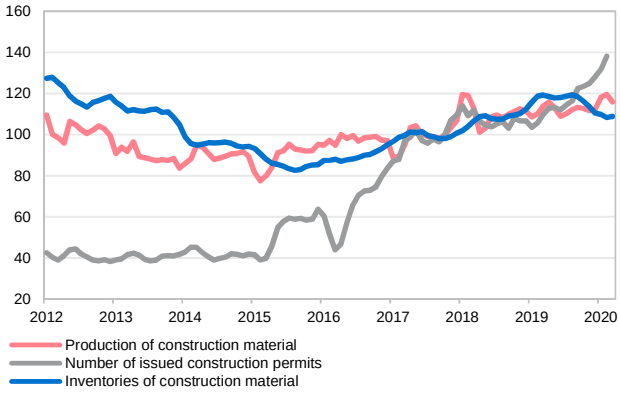
Rising private sector investment and continued implementation of government-financed capital projects spurred **construction** sector growth, estimated at 28.7% y-o-y in Q1, with a 1.0 pp contribution to GDP growth. This is also confirmed by construction indicators in January and February. Namely, the number of issued construction permits went up by 29.1% y-o-y, while the envisaged value of works based on those permits was higher by 26% y-o-y.

The greatest positive contribution to GDP growth in Q1 came from **service sectors** (2.5 pp), which is indicated by the continued positive trends of available indicators – primarily in trade. Namely, quarterly real retail trade turnover increased by 9% y-o-y. On the other hand, tourist and transport activities were almost entirely suspended in the second half of March due to the introduction of containment measures, which entailed, *inter alia*, the closing of restaurants, hotels and air traffic. Nevertheless, one needs to bear in mind that almost all service sectors intensified their activity in January and February, which explains why the positive pace of services growth at quarterly level was retained, as indicated by the stable growth in household consumption.

Bearing in mind that agricultural season was above-average in the past two years, and that in the absence of complete information about this year's season, we expect it to be at the level of a long-term average, the annual drop in agricultural production should equal around 4% (with a slightly negative contribution to GDP of around 0.3 pp).

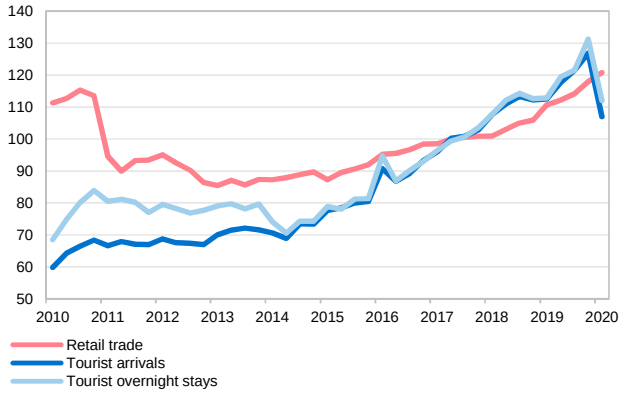
Looking at the quarter, the achieved mild economic growth is estimated at 0.3% s-a, primarily on account of service sectors increase. It needs to be emphasised that, in our estimate, activity levels in industry and construction remained almost unchanged despite the emergency circumstances in the second half of March.

Chart IV.4.3 **Construction activity indicators**
(quarterly averages s-a, 2017 = 100)




Sources: SORS and NBS calculation.

Chart IV.4.4 **Service sector indicators**
(s-a, 2017 = 100)




Sources: SORS and NBS calculation.

Table IV.4.1 **Contributions to y-o-y GDP growth**
(in pp)

| | 2019 | | | | 2020 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1* |
| **GDP (in %, y-o-y)** | **2.6** | **2.9** | **4.8** | **6.2** | **5.0** |
| Agriculture | 0.0 | 0.0 | 0.0 | 0.0 | -0.2 |
| Industry | -0.4 | -0.5 | 0.4 | 0.7 | 1.0 |
| Construction | 0.3 | 0.7 | 1.7 | 2.3 | 1.0 |
| Services | 2.0 | 2.0 | 2.1 | 2.5 | 2.5 |
| Net taxes | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |

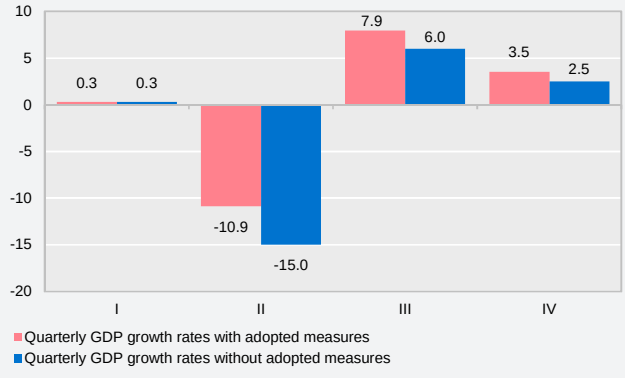
Sources: SORS and NBS calculation.
* NBS estimate.

## *Text box 2: First assessments of the macroeconomic impact of the COVID-19 pandemic in Serbia*

When it faced the crisis triggered by the COVID-19 pandemic, Serbia boasted a favourable macroeconomic environment, with the average GDP growth rate of 4.3% in the past two years, low and stable inflation for the seventh year in a row, eliminated fiscal and significantly reduced external imbalance and FX reserves – which are an important security safeguard in crisis times – at their record high. In the first two months of 2020, the indicators of economic activity and its funding sources were positive, many even exceeding NBS expectations. They suggested that the external demand slowdown and disruptions in global supply chains caused by the spread of the coronavirus did not significantly affect Serbia at first. The physical volume of industrial production was rising at a 7% rate, with four fifths of the contributions to that rise coming from manufacturing. Positive trends from 2019 continued, as also signalled by construction indicators. The number of construction permits issued increased by almost 30%, with the envisaged value of works recording similar dynamics. Retail trade was up 12%. Tourism indicators also posted high growth rates. Funding sources remained favourable, as suggested by the FDI inflow, two-digit lending growth, which stepped up further, and 50% higher growth in government capital expenditure y-o-y.

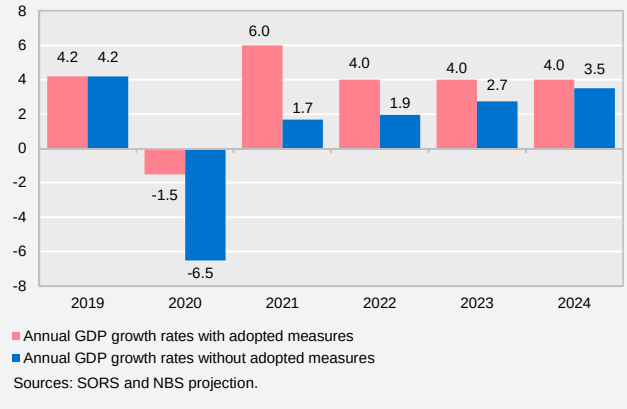
The **economic contraction** was registered as of mid-March as many countries introduced containment measures within a short period of time, which led to unprecedented shutdowns, supply-chain disruptions and the economic downturn. The Serbian Government also adopted a number of measures to preserve citizens' health – it closed borders, service sector facilities, schools and kindergartens, introduced movement restrictions etc. Nonetheless, owing to good indicators in January and February, despite the contraction in March, the economy was not strongly hit by the pandemic at the quarter-level. According to our estimate, the economy grew by 0.3% s-a in q-o-q terms and by around 5% in y-o-y terms. Still, it is almost certain that Q2 will witness downturn. The crisis hit almost all production and service sectors, most notably transport, tourism and catering (where the activity sank probably by more than a half; these sectors, taken together, account for around 6% of GVA). Industrial production will also decline as numerous factories halted or scaled down production in the course of several weeks. However, many companies rolled out mandatory remote work, partly mitigating the limiting effect of containment measures and opening new possibilities of more flexible work practices in future. Construction is estimated to have been hit less by the pandemic. Construction works on infrastructure projects in the transport and energy sectors were not stopped even after the state of emergency was declared. They merely slowed down and are likely to be in full swing as of May. The drop in retail trade in consumer goods was partly offset by strong growth in food and other staples turnover.

Chart O.2.1 **GDP growth in 2020 with and without measures**
(in %)




Sources: SORS and NBS projection.

Chart O.2.2 **GDP growth in 2019–2024 with and without measures**
(in %)




Sources: SORS and NBS projection.

To mitigate the economic fallout from the coronavirus and ensure smooth functioning of the domestic market, robust economic measures were put in place. The NBS measures aim to provide for stronger credit support to businesses and citizens, and ensure a higher disposable

income, and Government measures target employee retention and maintenance of private sector liquidity. With these measures, the economic downturn should be temporary and limited to Q2 2020 only, with the chance for the economy to start on a path of accelerated recovery already in H2. Judging by our preliminary projections, GDP is likely to contract by around 1.5% in 2020 and step up to around 6% in 2021. If the measures had not been adopted, the contraction could exceed 6% in 2020 and growth in 2021 would be modest and far below the pre-pandemic levels in the medium run. Thankfully, in the past eight years the Serbian economy has stabilised, which opened room for the adoption of the above economic measures which support businesses and citizens.

The smaller than expected economic growth will most probably affect the **labour market**, but the negative effects will be significantly allayed by the adopted economic policy measures. We therefore anticipate that the labour market will stabilise until the year-end and return to a positive, pre-pandemic trajectory. According to registered unemployment data of the National Employment Service, there were 513,058 unemployed persons in March 2020, which is a figure slightly lower than in January and February.

**Inflation** has remained low and, as we expected, slowed further in March – to 1.3% y-o-y, due to the high base effect for vegetable and petroleum product prices. Dented domestic and external demand, reflecting on a further drop in global oil prices, is likely to translate into lower inflation this year than we expected in February. The expectations regarding global inflation are similar.

Since early 2020, trends in the **credit market** have been more favourable than anticipated. Lending grew at a two-digit y-o-y rate, and interest rates on corporate and household loans touched new lows, where they stayed in March as well. High capital adequacy and liquidity of the banking sector, and a drastic reduction in NPLs, suggest that financial stability has been preserved and reinforced, ensuring the resilience to shocks, such as the one triggered by the pandemic.

**Serbia's foreign trade** was on an upturn in the first two months, with goods and services exports (12.2% y-o-y) rising faster than imports (11.8% y-o-y), despite the slowdown in external demand, notably in the euro area. With the exception of exports of base metals (copper and steel), probably affected by lower demand from China, the exports of other manufacturing sectors were relatively high. Through dampened external demand, halts or disruptions to global supply chains and border closures, the new crisis prompted a decline in exports and a sharp slowdown in imports in March (-8.4% and 1.3% y-o-y, respectively). Manufacturing was the main contributor to the export reduction, its exports falling by 11.3% y-o-y in March. Besides, exports declined in the majority of sectors. A y-o-y rise was recorded only for tobacco products, food, beverages, petroleum, pharmaceutical and agricultural products. The y-o-y import slowdown resulted from smaller imports of consumer (by 2.1% y-o-y) and intermediate goods (by 0.9% y-o-y), with higher equipment imports working in the opposite direction. As imports went up in the first two months of the year with the continuation of the investment cycle, and their share in the foreign trade structure is higher than the share of exports, the trade in goods deficit widened at the quarter level (by 29.6% y-o-y). Consequently, the current account deficit increased, but remained largely covered by the net FDI inflow (around EUR 822 mn). In the remainder of the year, we expect foreign trade, notably trade in goods, to contract, and imports to decline at a faster pace than exports. As a result, the current account deficit is estimated to narrow by at least a third compared to 2019, and stand at around 5% of GDP. Imports will fall on account of investment which is lower than last year and reduced household consumption, despite an increase in medical equipment imports. The current account deficit is also likely to decline owing to positive terms of trade, particularly with lower energy prices, and a further rise in the trade surplus in services, given that smaller exports of transport and tourism services would be fully offset by rising ICT and business services exports, while the imports of tourism and transport services would also be lower. The current account deficit should be fully covered by the net FDI inflow. A significant capital inflow is also expected from portfolio investment, notably the expected new issue of eurobonds. In the medium run, the share of the current account deficit in GDP is expected to be relatively stable as the rising imports, with the continuation of the investment cycle, will be compensated for by elevated export supply based on past investment in tradable sectors.

Owing to the responsible **fiscal policy** pursued over the past several years in full coordination with monetary policy, which eliminated fiscal imbalance and made the public debt share in GDP sustainable, in late March the Government adopted the Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy. According to Ministry of Finance estimates, the Programme will result in a general

government deficit of around 7% of GDP this year, while public debt should not exceed 60%. In our estimate, the one-off deficit and public debt increase this year will not jeopardise the solvency of the country or the sustainability of public finances, while the public debt share in GDP is expected resume its downward trajectory as of next year.

Being a small and open economy integrated in global supply chains, Serbia is hit by the COVID-19 pandemic both directly and indirectly. It is currently hard to give precise estimates of the key macroeconomic indicators for Serbia for this year, just as it is hard to assess the pandemic effects. Namely, the crisis has still not ended and many containment measures are still in force. Moreover, it is still impossible to fully assess the magnitude of the shock globally and at home. Still, in light of the undertaken economic measures, the preserved favourable medium-term prospects of the country, and given that the January and February performance suggests that the planned 4% growth rate would have been achieved had it not been for the pandemic, we believe that the economic recovery following the pandemic will be fast and that the pre-crisis GDP figure will be exceeded already next year.

# 5 Labour market developments

*Positive labour market trends recorded in the previous period continued into early 2020, as reflected in further employment and wage growth and a reduction in unemployment. To minimise the expected adverse impact of the coronavirus pandemic on the labour market, the government undertook a series of economic measures to safeguard jobs and help the affected sectors.*

## Wages and labour productivity

**In early 2020 the nominal net wage reached its highest level** since statistically monitored. The average for January and February was RSD 59,037 (EUR 502), up by 10.4% y-o-y. The rise in the nominal net wage was recorded both in the private (10.7% y-o-y) and public sector (10.5% y-o-y), partly on account of the revocation of the regulation on the temporary reduction of wages in a part of the public sector[17] owing to excellent fiscal results and the stabilisation of public finance in the past years.

In y-o-y terms, **the average nominal net wage in January and February rose in all sectors**, primarily in industry (cumulatively 11.8%) and services (cumulatively 10.5%). In parallel with the wage increase in industries dominated by the private sector, higher wages were also recorded in health, education, and public administration, where the public sector dominates. As part of the state support measures, the Government adopted the Decree on the 10% wage increase for health workers for their efforts to protect the public health and prevent the spread of the pandemic.

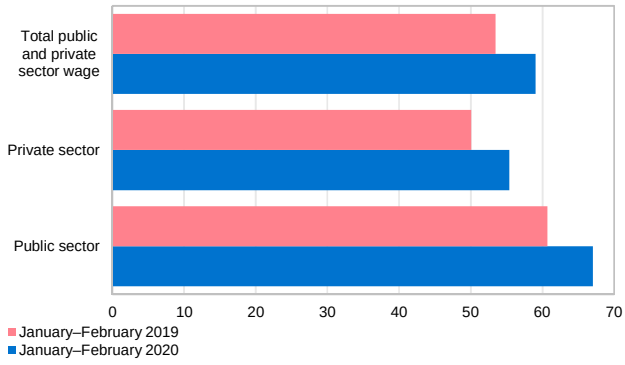
**The overall nominal net wage bill**, as the main source of consumer demand, was by 13.8% higher **in January and February** than in the same period last year, primarily owing to the private sector wage and employment rise.

With the GDP growing faster than employment, **the overall economic productivity** continued to rise in 2020. According to preliminary data for Q1, it went up by 3.1% y-o-y.

## Employment

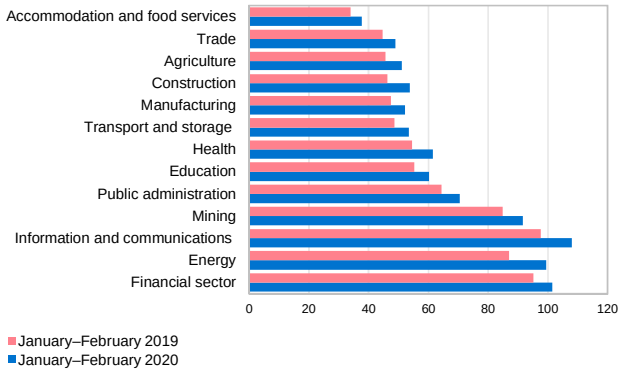
Though slackening compared to the previous quarter, **total formal employment rose by 1.8% y-o-y in Q1**, driven by further recruitment by legal entities and

Chart IV.5.1 **Average nominal net wage**
(in RSD thousand)



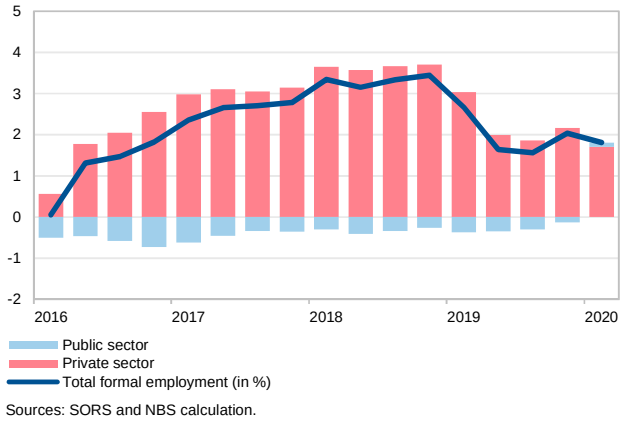

Source: SORS.

Chart IV.5.2 **Nominal net wage by economic sector**
(in RSD thousand)




Source: SORS.

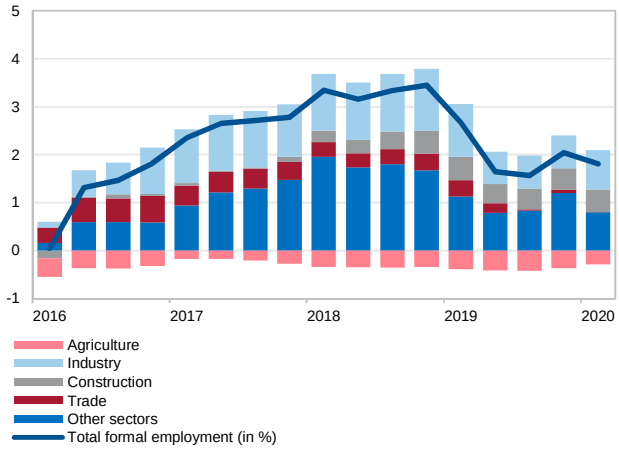
Chart IV.5.3 **Structure of y-o-y growth in total formal employment**
(in pp, period average)




Sources: SORS and NBS calculation.

[17] The Law Repealing the Law on Temporary Regulation of Salaries i.e. Wages and Other Steady Income Calculation and Payment Bases of Public Fund Users (RS Official Gazette", No 86/2019).

Chart IV.5.4 **Contribution to y-o-y growth in total formal employment by economic sector**
(in pp, period average)




Sources: SORS and NBS calculation.

Table IV.5.1 **Formal employment and unemployment**
(y-o-y growth rates, period average)

| | 2019 | | | 2020 |
|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Q1 |
| Total number of formally employed | 1.6 | 1.6 | 2.0 | 1.8 |
| Employed with legal persons | 1.9 | 1.7 | 2.2 | 2.4 |
| Entrepreneurs and their employees | 2.8 | 3.0 | 3.4 | 1.0 |
| Individual farmers | -8.7 | -8.6 | -8.4 | -7.4 |
| Unemployed | -9.3 | -9.5 | -8.9 | -9.1 |
| First-time job seekers | 21.1 | 26.1 | 32.9 | 26.3 |
| Used to be employed | -24.3 | -27.2 | -29.4 | -28.5 |

Sources: SORS and NES.

entrepreneurs, against the background of a less pronounced fall in the number of individual farmers than in the previous period. In March, the Serbian labour market faced the coronavirus pandemic, which, according to SORS data obtained from the Central Registry of Mandatory Social Insurance, reflected in the recorded y-o-y drop in the number of workers employed in non-standard arrangements[18] in Q1, by close to 2 thousand persons in the private sector. However, soon after the announcement of economic support measures[19], the National Employment Service records showed that the bulk of laid off workers were returned to their jobs, while the Business Registers Agency registered a reduced number of temporary shutdowns.

**New recruits in the private sector account on average for almost 37 thousand** of the total y-o-y increase in formal employment in Q1.The same period also saw a rise in the public sector employment (by around 2.2 thousand persons on average), for the first time since the right-sizing process began by end-2015. However, **social distancing measures introduced in March have affected the service sectors the most**, primarily catering, tourism and transport where employment cuts can therefore be expected in the coming period.

According to the National Employment Service, **registered unemployment continued to drop, reaching 513,058 in March**. Hence, the number of the unemployed was cut by more than 55 thousand persons in a year. At the same time, unemployment declined y-o-y in Q1 in all occupation groups, and most of all in those within manufacturing (by close to 16 thousand on average) and trade, catering, and tourism (by around 5 thousand on average). In Q1, unemployment also dropped in agriculture, construction, and transport on account of better investment and business environment in Serbia, as well as continued implementation of active labour market policies.[20]

[18] Workers employed in non-standard arrangements work under temporary and casual employment contracts, service contracts, authors' contracts, and similar.

[19] See Text box 1 on page 9.

[20] Active labour market policies encompass, inter alia: job matching services, career guidance and counselling, support to self-employment, further education and training, special programmes for youth in transition from education to the labour market.

# 6 International environment

***Though signs of incipient recovery emerged at end-2019, it seems that the global coronavirus pandemic has pushed the world economy into recession, most likely the biggest one since the Great Depression of the 1930s. However, dampened economic activity would have been even more pronounced if countries across the world had not taken a number of monetary and fiscal measures to support the economy in the newly-emerged crisis, as well as to help it recover rapidly once the crisis ends.***

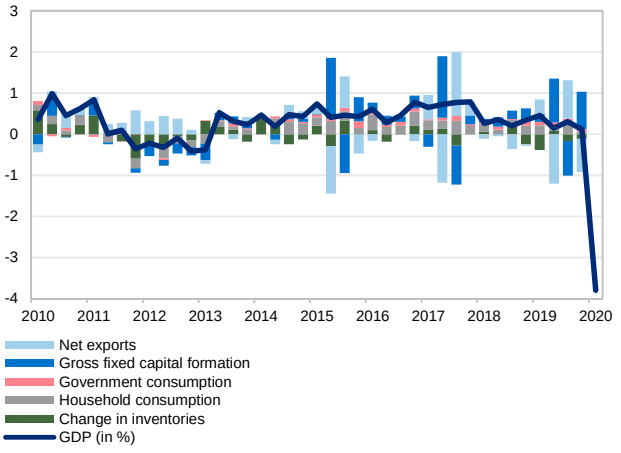
***So far, the impact of the pandemic on inflation is reflected in lower prices of petroleum products, due to which inflation slowed down at the global level, and going forward it is likely to slow down further under the dominant impact of lower oil prices and decreased aggregate demand. Despite significant accommodation of leading central banks' monetary policies, uncertainty in the international financial market has increased. Also, against the backdrop of stepped-up investments in safe assets, indices at global stock exchanges struck a downward path, and capital flows to emerging countries decreased.***

## Economic activity

In the period since the previous report, the **world faced a health and economic crisis caused by the global coronavirus pandemic**, which the leading international institutions estimate will lead to a sharp fall in economic activity and push the majority of countries into recession. Given the newly-emerged crisis, **in its April World Economic Outlook (WEO), the IMF projected a 3% fall in the global economy in 2020**, due to a series of factors, notably the virus pandemic and enforcement of social distancing measures, halts in supply chains, drastic deterioration of conditions in financial markets, changes in consumer habits and a fall in confidence, as well as the volatility of the prices of primary commodities. The services sector fared the worst – the Global Services Business Activity Index in March dropped to its lowest level on record (37.0). On the assumption of the pandemic abating in H2 2020, mitigation of adopted containment measures and gradual normalisation of economic activity, the **IMF expects global economic growth of 5.8% in 2021**, in conditions of adequate economic support. It stressed that risks to these projections are very much pronounced and skewed to the downside.

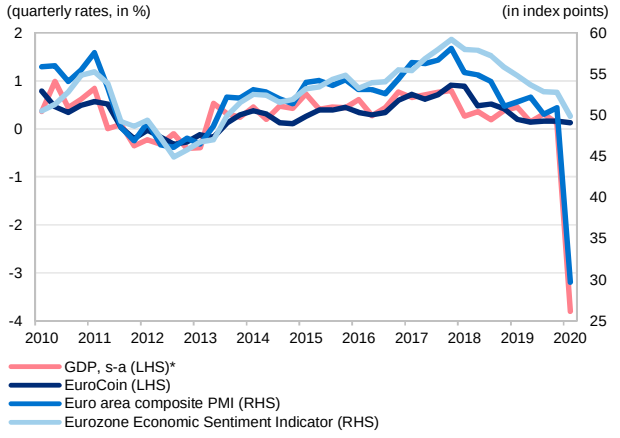
With the weakening of industrial activity and external demand, euro area economy posted modest growth of 0.1% s-a in Q4, mainly driven by final consumption. In

Chart IV.6.1 **Contributions to s-a GDP growth rate of the euro area**
(in pp)



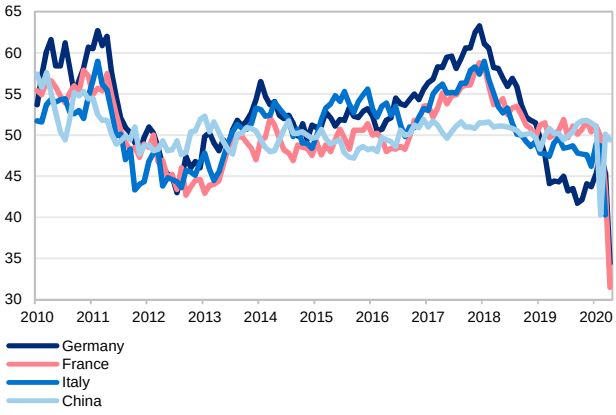

Source: Eurostat.

Chart IV.6.2 **Movements in GDP and economic activity indicators of the euro area**
(quarterly rates, in %) (in index points)




Sources: Eurostat, Markit Group, Banca d'Italia and European Commission.
* Eurostat's preliminary flash estimate for Q4 2019.
** ESI is standardised relative to PMI.

Chart IV.6.3 **PMI Manufacturing for selected countries**
(in index points)




Source: Markit Group.

the same period, a rise in fixed investment was offset by a fall in net exports. The spread of COVID-19 at end-February greatly deteriorated the euro area's outlook. **Leading economic activity indicators also suggest a contraction in the euro area economy**, given that after recovering in February, they fell sharply in March – the Eurozone PMI Composite[21] to 29.7, and the Economic Sentiment Indicator[22] to 94.5. As business activity came to a halt across the euro area, these indicators dropped to their record-lows in April – 13.5 and 67.0 respectively. The negative effects of the pandemic further aggravated the incipient economic weakening in leading euro area countries in Q4 (stagnation in **Germany**[23] and a 0.3% s-a fall in **Italy's** GDP), thus signalling that these countries entered recession at end-Q1. Adverse economic indicators were evident in other euro area countries, notably Spain, France and the Netherlands, i.e. infection hotspots in Europe.

Though total effects of the pandemic are hard to estimate, based on the data available in March the **ECB** forecast a much weaker short-term growth dynamics in the euro area, dominantly under the impact of the enforced containment measures, contracted external demand and disrupted supply chains. When tighter financial conditions are added to this, as well as the expected fall in consumer and business confidence, **euro area economic activity will suffer a heavy blow in H1 2020**, most of all in tourism, transport and catering activities. This is substantiated by the Eurostat's flash estimate, which in Q1 recorded the sharpest fall in euro area GDP since the introduction of time series (-3.8% s-a), primarily due to the enforcement of social distancing measures in March. After reaching the lowest level in 12 years (7.3% in February), euro area unemployment edged up to 7.4% in March, as the rising uncertainty drove many companies into laying off their employees. This is also confirmed by the Employment Expectations Indicator,[24] which fell to 93.8 in March and then dropped further in April, to 63.7. However, **the ECB expects economic situation in the euro area to normalise during H2**, continuing on that path in 2021, propped by the monetary and fiscal stimulus. Still, the IMF estimates that this year's fall will be only partially compensated next year.

For the major part of 2019, **the US economy** posted a moderate growth rate, which in Q4 measured 2.1%

[21] Index value above 50 points indicates expansion, and below 50 a decline in economic activity.

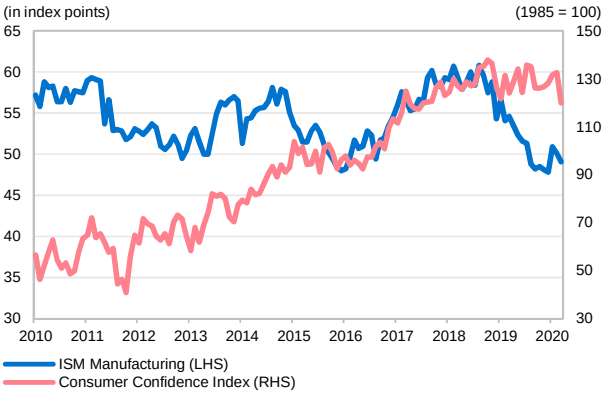
[22] Index value above 100 points indicates improvement, and below 100 worsening of economic expectations.

[23] Germany and Italy are Serbia's key foreign trade partners in the euro area.

[24] The index has been designed to indicate long-term average with 100 points

annualised (0.5% s-a), owing to personal and government consumption, and a rebound in exports, while the fall in total investments acted in the opposite direction. Positive indications from end-2019 began to wane as the virus appeared on US territory, as indicated by the ISM Manufacturing Index entering the economic contraction zone (49.1 in March) and the evident deterioration in consumer confidence. According to preliminary data of the Bureau of Economic Analysis, GDP decreased at an annual rate of 4.8% in Q1, driven by a noticeable decline in personal consumption (notably in the services sector). Due to this, **in March the Fed forecast a fall in economic activity and a rise in unemployment in H1 2020**, the intensity of which will depend on the consequences of the pandemic and the enforced containment measures. Thus, in its *optimistic scenario*, the Fed expects a gradual recovery of economic activity during H2, with the support of a robust fiscal programme, while the *pessimistic scenario* envisages the US economy plunging into recession in 2020, and recovering slowly in 2021.

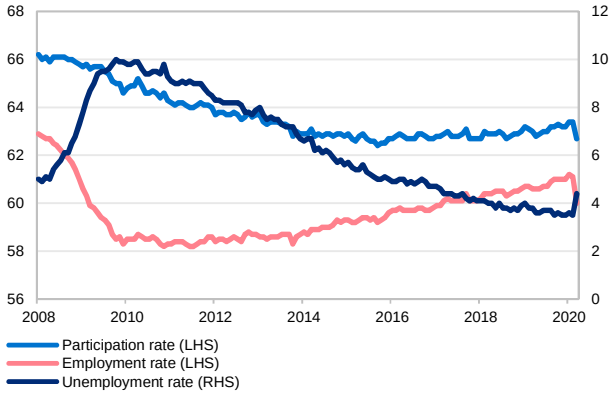
Chart IV.6.4 **Leading economic indicators in the USA**




Sources: Institute for Supply Management, Conference Board.

**The labour market suffered the heaviest consequences of the pandemic**, as the unemployment rate in the USA rose to 4.4% in March (from 3.5% in February), which is its biggest monthly increase since January 1975, and it drove the number of the unemployed up by 1.4 mn in one month. This was accompanied by a dramatic spike in the number of submitted claims for compensation in the event of job loss (more than 30 mn since the pandemic outbreak), whereby the entire job creation in the wake of the global economic crisis was practically annulled. Also, participation and employment indicators are on the decline, as attested by the cut in the number of non-farm payrolls by around 700,000 in March, dominantly in catering, recreation and entertainment.

Chart IV.6.5 **US labour market**
(monthly rates, in %)




Source: Bureau of Labor Statistics.

On the whole, **economic growth in the Central and Eastern European region** slowed down to 3.2% y-o-y in Q4 (from 3.5% in Q3), which was facilitated by a further decline in net exports and weaker growth in fixed investments, while the rise in household and government consumption acted in the opposite direction. At the same time, the highest y-o-y growth in Q4 was posted by Serbia (6.2%), followed by Hungary (4.5%) and Romania (4.3%). However, the consequences of COVID-19 will have an adverse effect on production and export in these regions, and in turn on domestic demand, which was the main driver of growth during 2019. In regard to this, the IMF expects a fall in economic activity of **Europe's emerging and developing countries** (-5.2% in 2020), where the heaviest blow will fall on

countries that rely greatly on tourism and catering services (Croatia, Slovenia, the Czech Republic, Turkey, etc.). **As for Serbia, the smallest GDP fall of 3.0% was projected in 2020**, however already in 2021 it will be compensated by strong economic recovery.

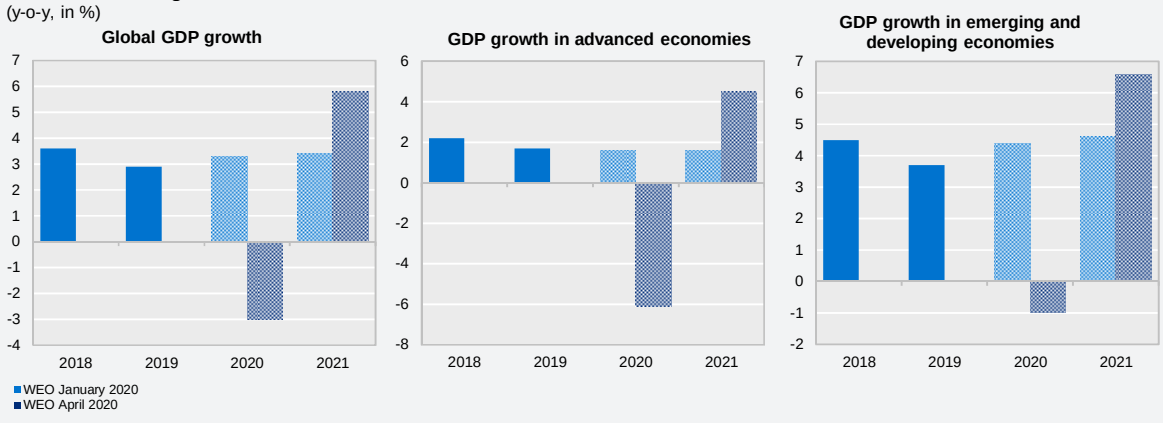
Owing to better-than-expected performance of industry and agriculture, **the Russian economy** rose 1.3% at the level of 2019, mostly on the back of household and government consumption. Fixed investment also lent a hand in that, contrary to a further decline in external demand amid restrictions in oil production and slower global growth. When the global coronavirus pandemic broke out, international prices of primary commodities, notably oil, fell sharply, which is why Russia, being a net exporter, will suffer a significant loss on this account. The enforced social distancing measures will act in the same direction, as will tighter financial conditions, therefore the IMF forecast a 5.5% contraction in Russia's economy in 2020.

At end-2019, **China** declared the coronavirus epidemic, to which the authorities responded by enforcing a comprehensive package of fiscal measures. According to the National Bureau of Statistics, China's GDP in Q1 decreased 6.8% y-o-y due to the fall in catering, trade, construction and transport. A somewhat lower fall in activity was recorded in agriculture and manufacturing, where the PMI Manufacturing Index went up in March (50.1). In contrast to the majority of countries where full effects of the crisis are expected in Q2, China is showing signals of gradual recovery which, according to the IMF projection, could imply economic growth of 1.2% in 2020.

## *Text box 3: Impact of the coronavirus pandemic on the global economy*

The coronavirus-induced pandemic is a worldwide health and economic shock. Social distancing measures introduced to protect people's lives triggered turbulences in the international financial market, an extreme surge of uncertainty and flight to safe assets, disturbances in the majority of commodity markets, primarily the oil market, halts/disruptions in global value chains etc., which led to a sharp contraction in economic activity and the rise in unemployment. The pandemic would definitely have adverse effects, but the introduction of necessary containment measures aimed at controlling its spread and protecting citizens' lives additionally aggravated the fall in demand and economic activity. The key question in evaluating the economic toll is what part of the economy has been affected and how long it will take to restore normal operations. That is why economic consequences must be analysed in parallel with the future course of the pandemic, which is highly uncertain at the moment, though the projections of all institutions had to rely on some concrete assumptions about the unfolding of the pandemic. The service sector is by all means the most severely hit in all countries (catering, tourism, transport, trade in durable consumer goods etc.), while the impact on manufacturing varies across countries, depending on the extent of disruption of supply chains and the degree of contraction in external demand for those products.

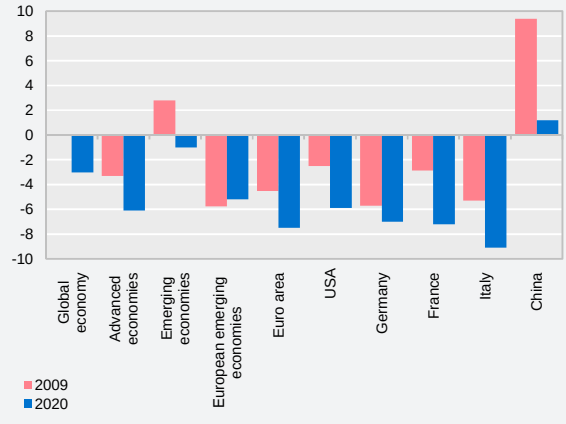
Chart O.3.1. **GDP growth**
(y-o-y, in %)




Source: IMF, WEO.
* Projection.

It is estimated that this is the worst global economic downturn since the Great Depression of the 1930s. In only three months, the global growth outlook for 2020 deteriorated from the expected 3.3% to -3.0%,[1] a fall much steeper than the one induced by the economic crisis in 2009 (-0.1%). What is more, this year the recession is expected not only in advanced economies (-6.1%) but also in emerging economies (-1.0%), which, observed aggregately, managed to avoid it back in 2009. China is supposed to post growth, but much lower than in 2009.

Chart O.3.2 **Comparison of projected economic growth for 2020 and growth during the global economic crisis**
(y-o-y, in %)




Source: IMF, WEO April 2020.

Assuming a waning of the pandemic until summer, and the ensuing gradual lifting of social distancing measures and normalisation of production in H2, the IMF expects global growth of 5.8% in 2021, but emphasises that the projection is highly uncertain, conditioned on factors that are hard to predict, with downside risks. As opposed to common crises triggered by muted demand, we are now facing a simultaneous contraction in both supply and demand, with the tightening of conditions in the international financial market.

[1] IMF, World Economic Outlook, April 2020.

Namely, the key factors which caused a sizeable contraction in global economic activity may be classified in three groups:

1) contraction of supply against the background of disrupted production and supply chains, reduced engagement of the labour force and weakened position of corporates;

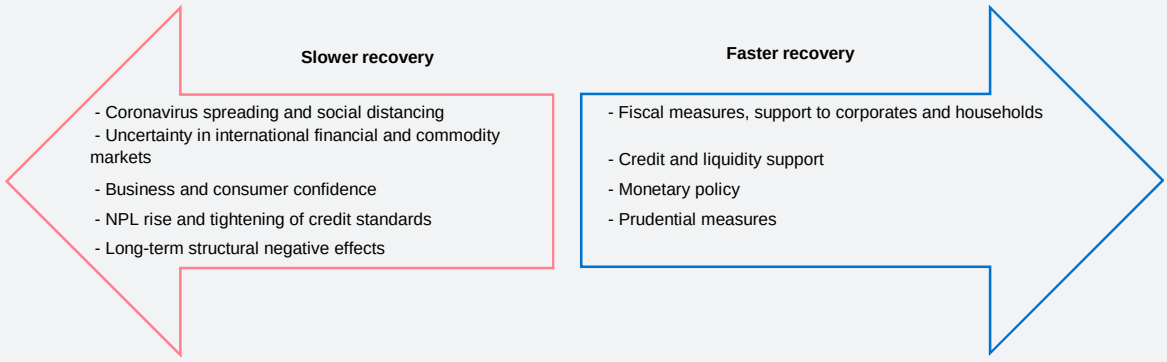
2) dampened demand due to social distancing measures, a drop in employment and wages, consumer and business confidence, as well as income contraction in countries exporters of primary commodities, which have been strongly affected by the fall in demand;

3) tightening of conditions in the international financial market and capital outflows from emerging economies, in the conditions of rising global uncertainty and risk aversion.

The global economic slump would have definitely been even sharper had it not been countered by strong economic measures of the majority of countries, in many cases unprecedented in recent history, aimed at softening the economic contraction and speeding up the post-pandemic recovery. Central banks of the majority of countries responded by monetary policy accommodation, conventional and non-conventional measures, while governments stepped in with lofty fiscal packages which, along with fiscal stabilisers (a drop in fiscal income and a rise in transfers), are aimed at propping up the economy during the crisis and ensuring its faster recovery.

Although there is a high level of consensus among forecasters that a global recession is inevitable in the short run, there is no such consensus about medium- and long-term developments, because forecasts depend on the course of the pandemic, which cannot be predicted with certainty. According to some, the pandemic will last longer and have a potential second wave, which will weaken the position of corporates and households, with the spillover of negative effects on the financial sector, primarily through the rise in uncollectible receivables of corporates and households hit hard by the crisis. Others deem that the crisis will have substantial, but short-term negative effects, because its main triggers (business shutdown, employees' sick leave and loss of confidence) will not persist in the long run, while monetary and fiscal measures in the majority of countries have been relatively prompt and strong.

Chart O.3.3 **Key factors determining the speed of global recovery**



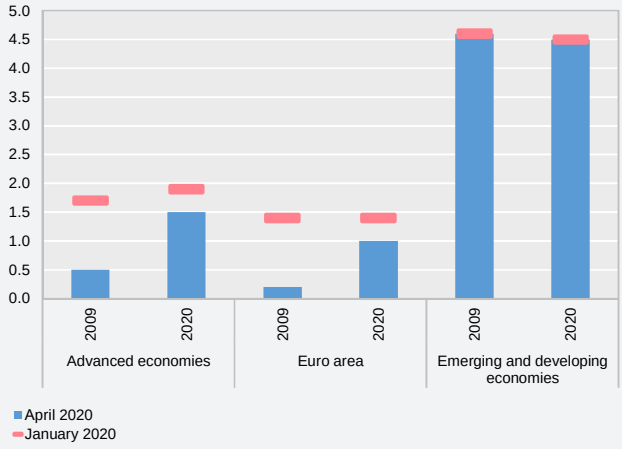

The economic downturn is coupled with a sharp surge in unemployment. The picture is particularly bleak for the US, where in the first six weeks of the pandemic at least 30 mn people applied for unemployment benefits. It is estimated that the unemployment rate went up in April to 10–15%, compared to only 3.5% in February, its lowest level in the last 50 years. The unemployment figures in the euro area have also increased significantly, though at a slower pace than in the US.

Considering the complex direct and indirect effects of the pandemic on the global economy, a question may also be raised about the future path of inflation. Given the concurrent shock on the demand side (exerting downward pressure on prices) and on the supply side (upward pressure on prices), inflation movements will depend on the net effect of these two shocks. There is high consensus among forecasters that the net effect will result in lower than expected global inflation. Forecasters do not even exclude the possibility of a short-term deflation in advanced economies in the short run, especially

bearing in mind the sizeable fall in the global oil price (with futures even entering the negative territory) due to the extreme imbalance between excessive supply and drastically reduced demand. Inflation could possibly rise only in emerging economies facing currency depreciation.

While social distancing measures are in place, we may expect changes in relative prices, i.e. changes in price relations, because variations in supply and demand differ significantly across sectors. The most pronounced is the fall in demand for non-food products and catering, tourist and transport services, while demand for basic food products has increased.

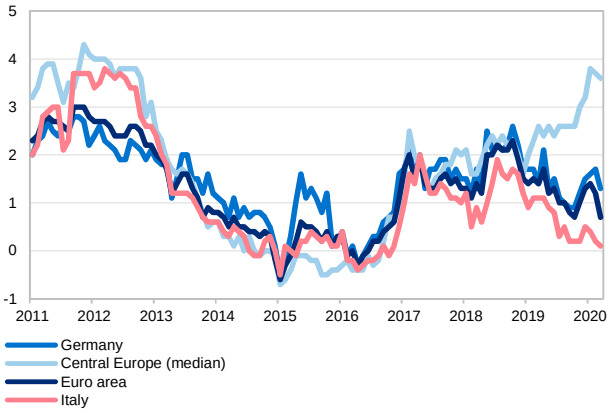
Chart O.3.4 **Inflation projections**
(y-o-y, in %)




Source: IMF WEO, January and April 2020.

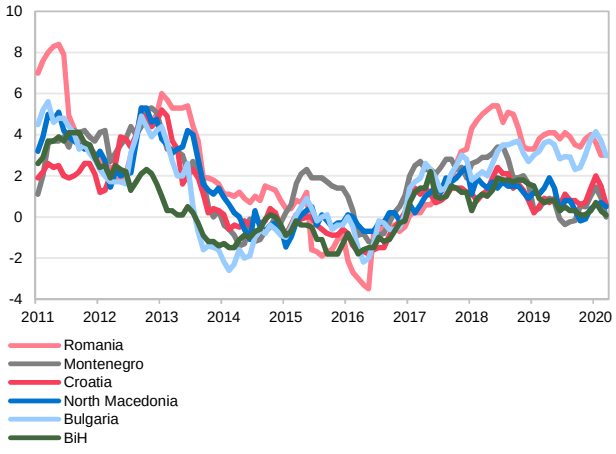
It may be said that the first results in virus containment are encouraging and that economic activity is gradually recovering in China and other Asian countries that were first hit by the pandemic. Europe, USA and other regions which were affected later are gradually loosening social distancing measures and corporates and households are adjusting to the new situation. Countries are generally pursuing a cautious approach, because if measures were to be lifted too quickly, the virus could spread again, which would lead to re-imposing of social distancing measures and even harsher economic consequences.

Chart IV.6.6 **HICP across selected countries**
(y-o-y rates, in %)




Source: Eurostat.

Chart IV.6.7 **Movement in CPI for selected countries**
(p.a., in %)




Sources: Statistical offices of selected countries.

## Inflation movements

The recovery of energy prices and their last year's low base, coupled with a faster rise in unprocessed food prices, led to a slight acceleration in **euro area** inflation, by 0.1 pp to 1.4% y-o-y in January. However, soon afterwards, energy prices declined and their contribution in February again turned negative, hence y-o-y inflation slowed down to 1.2%. A further decline in the global price of oil led to a fall in euro area inflation – to 0.7% y-o-y in March, whereby it deviated further from the inflation target of below, but close to 2%. On the other hand, food prices gave a positive contribution to inflation, as they gained speed in Q1, which is associated with the rising demand for basic foodstuffs and the panic caused by the coronavirus. Inflation expectations in the euro area decreased, and core inflation remained low, slowing down additionally from 1.3% y-o-y at end-2019 to 1.0% y-o-y in March. As for Serbia's key foreign trade partners, y-o-y inflation, measured by the Harmonised Index of Consumer Prices, decelerated to 1.3% in **Germany** and 0.1% in **Italy** in March.

As in the euro area, inflation in the majority of observed **Central and Southeast European countries** increased in January, driven by the rising energy prices and the low base from last year, as well as the higher prices of food. In Hungary, Poland and the Czech Republic, it overshot the upper bound of the target tolerance band, reaching maximum levels in the past eight years. Inflation continued up in February in Poland and the Czech Republic amid rising domestic demand, but slowed down in Hungary and Romania. With the exception of Romania, where y-o-y inflation remained unchanged in March (3.1%), in other observed countries it slowed down (to 3.9% in Hungary, 3.4% in the Czech Republic and 4.6% in Poland) amid plummeting oil prices in the global market, while food prices in all of the observed countries acted towards y-o-y inflation growth.

Similarly to Serbia, other **Western Balkan** countries also saw y-o-y inflation in Q1 remain relatively low. After edging up mildly in January, inflation in Montenegro and Bosnia and Herzegovina declined for the remainder of the quarter, to 0.0% and 0.1% y-o-y in March, respectively, i.e. below end-2019 levels. In North Macedonia, inflation rose in February as well, only to decline to 0.5% y-o-y in March, which is still somewhat higher than at end-2019 (by 0.1 pp). Albania was the only one to see inflation rise in March to the highest level since September 2018 (2.1%), mainly owing to faster growth in the prices of food and non-alcoholic beverages.

The two-digit inflation in **Turkey** stayed relatively stable during Q1. After rising mildly in the first two months, it fell to 11.9% in March – slightly higher than at end-2019 – due to the fall in global oil prices. Inflation in **Russia** continued down in January and February, when it reached its lowest level in more than a year and a half, only to edge up slightly in March (to 2.5%), for the first time in 12 months. Global oil prices had a disinflationary effect, while the depreciating rouble acted towards inflation growth.

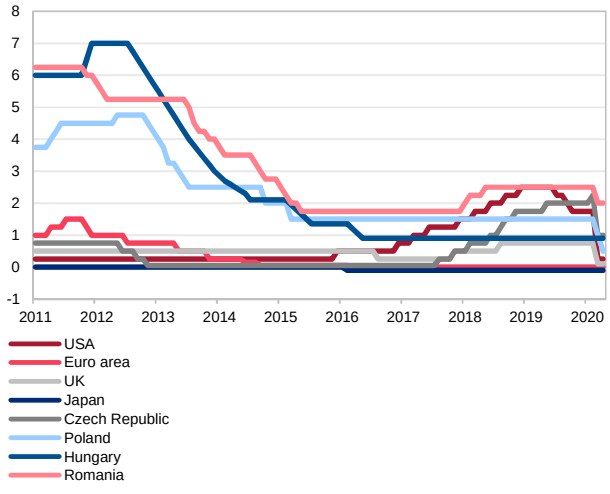
Measured by the personal consumption expenditures index, headline y-o-y inflation in the **USA** remained below 2% in Q1, and even dipped to 1.3% in March. Inflation excluding energy and food prices – as the Fed's preferred measure – also remained below target, measuring 1.7% y-o-y at end-Q1. The Fed anticipates low inflationary pressures going forward, owing to lower utilisation of capacities and a sharp fall in energy prices.

## Monetary policy

Though it kept its main refinancing rate unchanged, during Q1 and in April the **ECB** adopted a robust package of other stimulating measures to mitigate the negative effects of the pandemic on euro area economy. It launched the purchase of an additional EUR 120 bn by end-2020 within the asset purchase programme in order to limit the tightening of financial conditions in the euro area. In addition, it introduced a temporary Pandemic Emergency Purchase Programme (PEPP) in the amount of EUR 750 bn, which will be implemented until the ECB estimates that the phase of the crisis caused by the virus has ended, and at least until end-2020. It eased the conditions relating to the volume and interest rate for longer-term refinancing operations (TLTROs III), and during the period June 2020 – June 2021, the interest rate applied will be 50 bp lower than the rate on the main refinancing operations, rather than equal to it. It expanded the eligible collateral base within the corporate sector purchase programme (CSPP), and further mitigated the collateral criteria for refinancing operations (main refinancing operations, LTROs, TLTROs). At the April meeting, the ECB decided to introduce new pandemic emergency longer-term refinancing operations (PELTROs), starting in May and maturing between July and September 2021. The rate applied will be 25 bp lower than the rate on the main refinancing operations.

In March, the **Fed** lowered its federal funds target range twice, by a total of 150 bp, to 0–0.25%. It relaunched the quantitative easing programme based on the purchase of Treasury bonds and mortgage-backed securities, which

Chart IV.6.8 **Policy rates across selected countries**
(p.a., in %)




Sources: Central banks of selected countries.

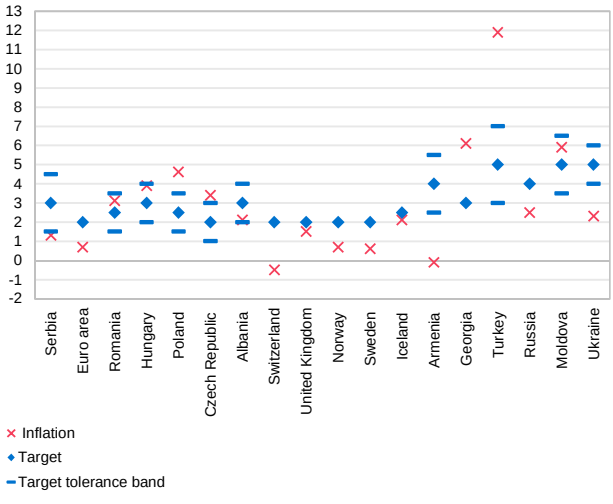
Table IV.6.1 **Inflation, policy rates and inflation target by country**
(in %)

| Central banks | Inflation* | Inflation target | Policy rate** |
|---|---|---|---|
| Serbia | 1.3 | 3.0 ± 1.5 | 1.50 |
| Poland | 4.6 | 2.5 ± 1.0 | 0.50 |
| Czech Republic | 3.4 | 2.0 ± 1.0 | 1.00 |
| Hungary | 3.9 | 3.0 ± 1.0 | 0.90 |
| Romania | 3.1 | 2.5 ± 1.0 | 2.00 |
| Turkey | 11.9 | 5.0 ± 2.0 | 8.75 |

Sources: Websites of central banks.
* CPI, y-o-y rates in March.
** End-April 2020.

will be carried out in the amounts needed to ensure the normal functioning of the market. It also started conducting temporary large repo transactions to inject additional liquidity into the banking system, as well as international repo transactions which ensure dollar liquidity to foreign central banks and other monetary institutions. Also, dollar swap lines with central banks of other developed countries (including the ECB) and several emerging market central banks have been activated. The reserve requirement ratio has been slashed to zero, while banks have been explicitly instructed to use their capital and liquidity buffers in order to encourage higher lending. The Fed also launched support programmes, such as the Commercial Paper Funding Facility (CPFF), the more favourable Primary Dealer Credit Facility (PDCF), facilities to support the corporate bond market in the USA (PMCCF and SMCCF), the Money Market Mutual Fund Liquidity Facility (MMLF), support lending to small and medium-sized businesses (MSLP), and many others.

Chart IV.6.9 **Inflation and target by country in March 2020**
(p.a., in %)




Sources: Eurostat and websites of central banks.

Central banks in countries of the Central and Southeast European region also reacted to the newly-emerged situation caused by the pandemic by easing their monetary policies. After lifting its key policy rate by 25 bp in February, the central bank of the **Czech Republic** trimmed it twice in March, by a total of 125 bp, to 1.0%. In an emergency meeting in March, the central bank of **Poland** first cut its policy rate by 50 bp – its first change since March 2015 – and then by another 50 bp in April, to 0.5%. The central bank of **Hungary** did not change its policy rate during Q1 (0.9%), but it secured unlimited liquidity to banks by introducing a new instrument of collateralised loan with a fixed interest rate, and it drove liquidity up by abolishing the required reserve for domestic banks and increasing the volume of FX swap transactions. The **Romanian** central bank held an emergency meeting in March and introduced a set of new measures to support the economy, including a 50 bp cut in the key policy rate to 2.0%, narrowing the main interest rates corridor, securing liquidity via repo operations, and launching a programme of purchasing government securities in the domestic currency.

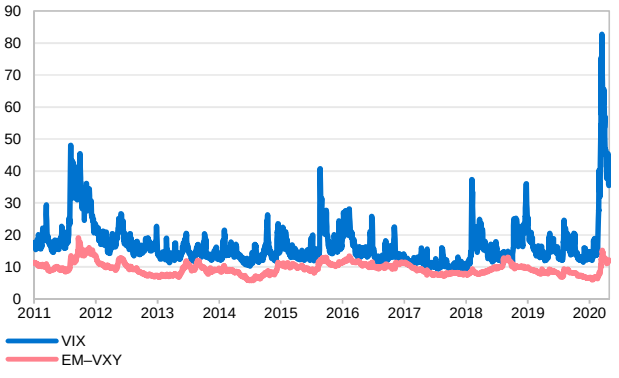
During Q1, the central bank of **Turkey** continued trimming its policy rate by a total of 225 bp, in four meetings, and by an additional 100 bp in April, to 8.75%, in conditions of dampened demand and cost-push pressures, despite the lira depreciating in the prior period. The central bank of **Russia** cut its policy rate by 25 bp in February, and then by another 50 bp in April, to the lowest level since February 2014 (5.5%), though the possibility of trimming it further is not off the table. According to the central bank's statement, such decision was made amid a

significant increase in disinflationary pressures on account of reduced domestic and external demand, which compensate for the effect of temporary factors, such as the depreciation of the rouble and stepped-up demand for certain groups of products which are conducive to inflation growth.

## Financial and commodity markets

In Q1, financial markets were under the dominant sway of news and developments related to coronavirus spreading. Investors fled from shares and corporate bonds into safer and more liquid assets, pushing the leading stock exchanges into the sharpest slumps since the global financial crisis. As countries worldwide took decisive measures and pledged to react further if needed, financial markets calmed down somewhat, which prevented an even sharper fall in asset prices and investor confidence. Particularly significant was the rising volume of dollar liquidity, provided in response to the huge demand, via Fed's swap lines with other central banks. The implicit measure of **financial market volatility** (VIX) reached its historic maximum in mid-March, increasing by 39.8 pp to 53.5% in Q1, while the volatility of currencies of emerging economies, measured by EM–VXY, rose by 5.7 pp to 12.3%. Both measures indicated reduced volatility in financial markets in April, though still considerably higher than at the start of the year.

Chart IV.6.10 **Implied volatility of the global financial market***
(in %)

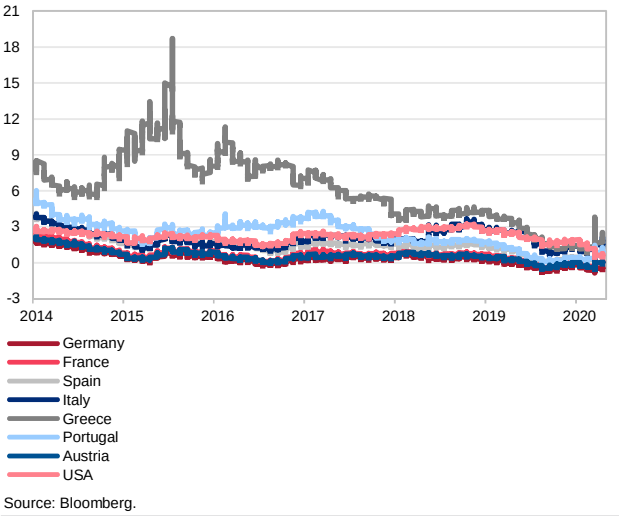



Source: Bloomberg.

* VIX (Chicago Board Options Exchange Market Volatility Index) measures implied volatility of the S&P 500 index; EM–VXY (JPMorgan emerging markets implied volatility index) measures aggregate volatility of emerging market currencies based on three-month forward options.

**Yields on ten-year government bonds** of developed economies in Q1 were highly volatile, with US Treasury yields posting a record low value. Due to the rising risk aversion, investors increasingly sought security in government bonds of developed countries, putting a downward pressure on yields until early March. However, March saw an unexpected rise, though end-of-period yields on US and German sovereign bonds were still much lower than at end-2019, remaining at those relatively low levels in April as well. So the yields on ten-year US Treasuries declined by 1.2 pp to 0.7% in Q1, and the whole yield curve for the first time went below 1%. The yield curve on German government bonds remained in the negative territory, with yields on ten-year bonds dropping by 0.3 pp to -0.5%. The drop was largely prompted by the launch of the new asset purchase programme (PEPP), with the lifting of some restrictions previously applied in asset purchases. On the other hand, though much lower than in mid-March, the yields on benchmark bonds of peripheral euro area countries at end-April were somewhat higher than at end-2019.

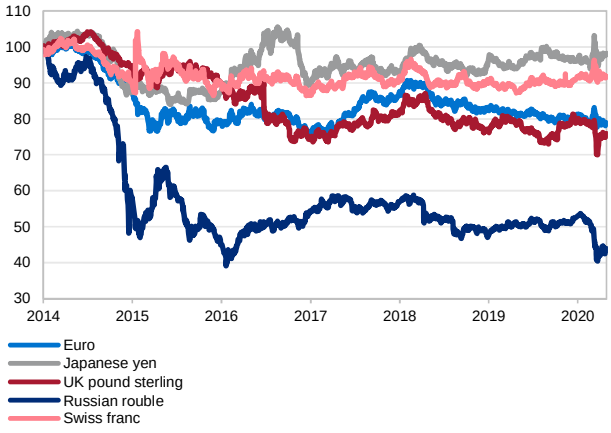
Chart IV.6.11 **Yields on ten-year bonds of selected countries**
(daily data, in %)




Source: Bloomberg.

Movements in FX markets also reflected higher risk aversion, with the leading world currencies turning highly volatile against the dollar in Q1. In the second half of

Chart IV.6.12 **Exchange rates of selected national currencies against the dollar***
(daily data, 31 December 2013 = 100)

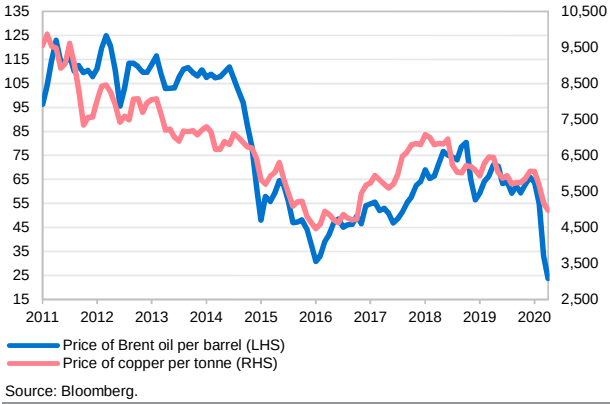



Source: IMF.
* Growth indicates appreciation.

February, **the dollar** reached its highest value **against the euro** since April 2017 (1.08 EUR/USD), only to touch the lowest value in more than 12 months in early March (1.15 EUR/USD), reflecting the concerns about the coronavirus impact on the US economy. Due to the ensuing pandemic, the dollar, as the most liquid and the world's primary reserve currency, gained strength again, reaching its new peak since April 2017 (1.07 EUR/USD). Additional measures of leading central banks aimed at boosting dollar liquidity to some degree satisfied a huge demand for this currency, therefore the dollar lost steam until end-Q1, though still remaining stronger against the euro compared to end-2019, by 2.1%. Investors also sought safety in currencies such as the Japanese yen and the Swiss franc which, with significant volatility in the period observed, gained 0.4% and 0.6% on the dollar in Q1, respectively. On the other hand, the British pound weakened against the dollar by 5.8%, and the Russian rouble by 20.4%. In April, the euro and the Swiss franc mildly weakened against the dollar (by 0.7% and 0.5%, respectively), while the British pound, Japanese yen and Russian rouble gained ground (1.2%, 2.0% and 6.9% respectively).

**The price of gold** was also highly volatile in Q1. The upward pressure on the price was generated by the increased investment in this form of safe assets, the downward revisions of the global growth outlook, cuts in Fed's federal funds rate, etc. In early March, the price of gold climbed to its highest level in more than seven years. After a short-term decline due to the expectation that the monetary and fiscal stimulus will alleviate the negative effect of the pandemic on the economy and help to boost liquidity in the money market, the price of gold turned upward again, rising by 6.2% at end-Q1 compared to end-2019, to USD 1,609 per ounce. During April, the price of gold continued up, reaching USD 1,703 per ounce at end-April.

Chart IV.6.13 **Oil and copper price movements**
(average monthly prices, in USD)




Source: Bloomberg.

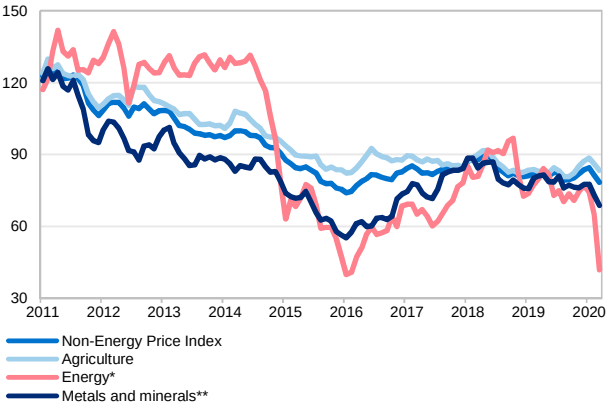
**Global oil price** plummeted in Q1 2020, by 67.7% to USD 21.5 per barrel, and was at approximately the same level at end-April. The drop in the oil price was prompted by the lower demand due to the newly introduced counter-pandemic measures which directly affected the transport sector, the overloaded oil storage facilities, as well as the concerns about the oil demand going forward, which overpowered the optimism sparked by the economic stimulus. In addition, the fall in the oil price was also under the impact of the agreement between OPEC+ countries to cut down production, along with the price war between the Saudi Arabia and Russia. In April, OPEC+ countries nevertheless reached an agreement on drastic capping of production, but this did not suffice to

prevent the fall in the oil price. For the first time in history, US oil futures entered the negative territory, demonstrating the extent of contraction in oil demand induced by the coronavirus pandemic.

After a short-lived optimism in early January, sparked by the signing of the Phase 1 trade deal between the US and China, the emergency virus containment measures slowed down China's industry and construction, causing a sharp fall in the **prices of metals and minerals** as well. The shutdown of factories around the world soon thereafter led to a further fall in demand, so according to the World Bank primary commodity price index, the prices of metals and minerals fell by 11.3% in Q1, with decreases recorded in all sub-categories observed. The price of zinc decreased the most, by 16.2%, copper price lost 14.7%, nickel 14.3%, while the price of the iron ore declined by 4.0%.

World food prices, measured by the **FAO index**, declined by 5.1% in Q1. Vegetable oil prices declined the most (15.6%), mainly due to the fall in palm oil price. Sugar price went down by 10.9% due to measures of some countries which dampened import demand. In addition, a strong fall in energy prices led to redirecting sugar cane from biofuel to sugar production, especially in Brazil, the main sugar exporter. This expanded the supply and additionally lowered the sugar price. Meat prices were 7.7% lower than at end-2019, mainly due to the contraction in the Chinese import of ovine and bovine meat caused by transport delays and the consequent accumulation of inventories in exporting countries. However, pork prices rose in March due to a significant spike in demand and halts in meat processing due to logistics problems and limitations on workers' commute. Q1 also saw a rise in dairy product prices (2.3%), while the prices of cereals, though volatile, rose only slightly at end-Q1 relative to end-2019 (0.1%). The prices of wheat and corn, the most important primary agricultural commodities for Serbia, went up in January owing to the rise in demand, only to decline for the rest of the quarter due to large world inventories, in combination with the promising wheat harvest and lower demand for corn in the biofuel sector, induced by the falling energy prices.

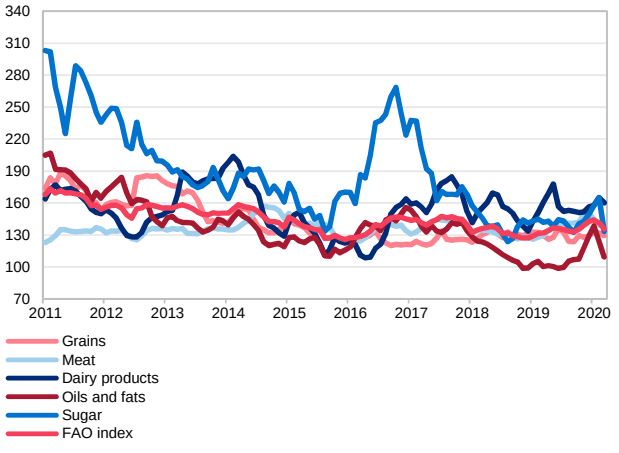
Chart IV.6.14 **Primary Commodity Prices Index**
(2010 = 100)




Source: World Bank.

* Crude oil, natural gas and coal.
** Copper, aluminium, iron ore, lead, nickel, zinc and tin.

Chart IV.6.15 **World Food Price Index**
(in real terms, 2002−2004 = 100)




Source: UN FAO.

## *Text box 4: Central bank and government measures aimed at alleviating negative economic consequences of the coronavirus*

Apart from the health crisis, the quick spread of coronavirus also represents a strong economic shock, the full effects of which will be known only after the global pandemic is over. There will hardly be a country in the world that will not suffer at least some form of negative consequences, either direct or indirect. While the full-scale economic toll is yet unknown, it is sure to be huge, given the negative shock on both the supply and the demand side, calling for concerted action of all authorities, monetary and fiscal alike, as well as intensive international cooperation in the fight for the recovery of the global economy.

Speaking of **monetary measures**, central banks reacted promptly in response to the economic lockdown and tightening of financial conditions, issuing comprehensive measures to support the credit and economic activity. It was the **Fed that adopted the largest and at the same time most comprehensive package of measures in history. Unprecedented measures were taken by the ECB** as well, in order to additionally support financial conditions in the euro area. Even before the pandemic outbreak, key policy rates of many central banks were relatively low, so there was less room for rate cuts compared to the global financial crisis of 2008. The **central banks of advanced economies** such as the US, Canada, UK, Australia and Norway **reduced their interest rates**, which, coupled with other monetary policy measures, opened room for central banks of emerging economies such as the Czech Republic, Poland, Romania, Brazil, Mexico, India, Russia, Turkey, as well as countries in our immediate environment (North Macedonia, Albania) to respond by rate cuts. Though the ECB kept its key interest rates on hold, it adopted a package of measures providing additional liquidity to the financial sector and enabling a significant loosening of conditions within the targeted longer-term refinancing operations (TLTRO III), mainly by increasing the amount of loans available to banks and reducing the interest rate applied in those operations by 50 bp. It also announced new Pandemic Emergency Longer-Term Refinancing Operations (PELTRO), applying an interest rate 25 bp lower than the key interest rate, in order to ensure sufficient liquidity and additionally relax financial conditions in the euro area during the pandemic.

**In parallel with conventional instruments, the leading central banks also applied comprehensive unconventional measures**, including broadening of the asset purchase programmes and launching new, emergency programmes with the primary goal to ensure the necessary liquidity. The Fed announced the relaunch of the asset purchase programme based on repurchase of government bonds worth USD 500 bn and mortgage bonds of USD 200 bn, only to communicate later that asset purchases will be increased by as much as necessary and for as long as needed. Along with the Fed, the ECB also significantly broadened its asset purchase programme, in order to limit the tightening of financial conditions in the euro area. The initial programme, launched in November 2019, assuming net purchase of EUR 20 bn a month, was increased by additional EUR 120 bn by year-end, with stronger focus on private sector securities. After that, a temporary asset purchase programme (Pandemic Emergency Purchase Program – PEPP) with an envelope of EUR 750 bn was introduced, covering for the first time, apart from public and private sector bonds, also non-financial sector commercial paper meeting certain credit rating eligibility criteria. This type of security was also included in the ongoing asset purchase programme. The ECB states it is prepared to increase the size of its asset purchase programme and adjust its composition, by as much as necessary and for as long as needed. Unlike before, purchases are not conditioned by asset classes and the pre-set proportions by states (maximum 33% of each country's debt), so Greek bonds will be included for the first time, which is a deviation from previously defined rules. The ECB will be able to buy bonds with maturities from 70 days until 31 years, while previously it was able to buy only under-one-year bonds. Other leading central banks also increased (Bank of Japan) or relaunched their asset purchase programmes (Bank of England), while the Bank of Canada introduced a quantitative easing programme for the first time.

**In order to encourage lending, along with the abovementioned measures, the Fed also defined a number of additional programmes**, some of which were adopted in cooperation with the US Treasury. Among other, they adopted the programme of purchase of commercial paper to support the liquidity of municipalities and companies, and additional liquidity was also ensured for primary dealers in order to enable smooth market functioning. Also adopted were the programme of support for approval of new loans and issuance of corporate bonds in the primary market, as well as the programme for boosting liquidity of outstanding corporate bonds. The Fed also introduced a liquidity support programme for investment funds in the money market facing sizeable deposit outflows, by lending money to financial institutions to

purchase the funds' assets. To support small businesses, it launched a programme enabling the issuance of asset-backed securities, where the collateral for these securities is made up of small enterprise loans, car loans, student loans etc.

In coordination with other central banks, the Fed provided additional dollar liquidity via the existing currency swap lines, while also agreeing new swap lines with other central banks of advanced economies and certain emerging markets (Australia, Sweden, Norway, Denmark, Mexico, Brazil, Singapore, New Zealand and South Korea). It also introduced international repo transactions in order to enable foreign central banks to swap overnight US Treasuries for US dollars. **Many central banks are implementing additional repo transactions of different maturities in order to provide sufficient liquidity and are cutting the reserve requirement ratios, to incentivise commercial banks to use their capital and liquidity buffers in provision of credit support to corporates and households**. A very frequent central bank measure is the moratorium on loan repayment, which was also applied by countries in our immediate environment, such as Hungary, Romania, Montenegro, Bosnia and Herzegovina, Albania and Croatia. Countries in the Western Balkan region allowed banks to reschedule client debt by extending loan maturity, allowing grace period, lower interest rates etc. These measures also apply to other financial institutions – lessors, savings institutions, microfinance organisations etc. which postponed the payout of dividends and bonuses to shareholders for an indefinite period.

Table O.4.1 **Measures of selected central banks in response to the consequences of COVID-19**

**FED**

Federal funds rate target range lowered by a total of 150 bp, to 0–0.25%;

Launched asset purchases unlimited as to the volume and duration;

CPFF (Commercial Paper Funding Facility) – liquidity support to municipalities and companies;

PDCF (Primary Dealer Credit Facility) – overnight loans to primary dealers with a term up to 90 days;

PMCCF and SMCCF (Primary and Secondary Market Corporate Credit Facility) – support to approval of new loans and issuance of corporate bonds in the primary market, as well as liquidity support to outstanding bonds;

MMLF (Money Market Mutual Fund Liquidity Facility ) – secured loans to financial institutions that purchase certain assets from investment funds in the money market (such as municipal bonds and commercial paper) which are facing large deposit outflows;

TALF (Term Asset-Backed Securities Loan Facility) – support to small businesses through issuance of asset-backed securities, involving student loans, small enterprise loans, car loans, credit card loans etc.;

Main Street Business Lending Program – purchase of debt of small and medium-sized enterprises;

Municipal Liquidity Facility – loans to federal states and municipalities;

PPPLF – refinancing for banks which approve government-guaranteed loans.

**Central Bank of Japan**

Decision to expand purchases of bonds of the Japanese Government, exchange-traded funds (ETFs), Japan-Real Estate Investment Trusts (J-REITs) and temporary increase in purchases of commercial paper and corporate bonds.

**Central Bank of Canada**

Policy rate cut by a total of 150 bp, to 0.25%;

Launched programmes of purchase of securities in the secondary market, including government bonds along the whole yield curve for an indefinite period, commercial paper and bank acceptances used by small and medium-sized enterprises in their operations.

**ECB**

Additional Long Term Refinancing Operations (LTRO) and loosened requirements for TLTRO III, as well as new Pandemic Emergency Longer-Term Refinancing Operations (PELTRO);

Purchase of additional EUR 120 bn under the asset purchase programme (APP), and the temporary asset purchase programme (Pandemic Emergency Purchase Program - PEPP) with an envelope of EUR 750 bn;

Expansion of eligible collateral under the corporate sector purchase programme (CSPP), to also include non-financial sector;

Loosening collateral requirements in bank refinancing operations within the eurosystem.

**Bank of England**

Policy rate cut by a total of 65 bp, to 0.10%;

Launched the asset purachase programme involving primarily government, but also corporate bonds, in the amount of GBP 200 bn;

Launched a new funding scheme with additional incentives for SMEs (TFSME);

Two coordinated corporate support programmes in total value of GBP 330 bn: the BoE embarked on purchases of corporate commercial paper under the Covid Corporate Financing Facility (CCFF), and the Ministry of Finance provided guarantees for loans to small and medium-sized enterprises under the Coronavirus Business Interruption Loan Scheme (CBILS).

**Reserve Bank of Australia**

Policy rate lowered by a total of 50 bp to 0.25% and the interest rate corridor narrowed from 50 bp to 40 bp;

Targeting of yields on three-year government bonds at the level of around 0.25% through purchase of government bonds in the secondary market;

Planned purchase of government bonds of all maturities in the secondary market;

A long-term funding programme (Term Funding Facility – TFF), making available to banks, until September, AUD 90 bn for a three-year term, at the rate of 0.25%. Banks which step up corporate lending this year will gain access to additional funds.

**Central Bank of Sweden**

The rate on credit facilities cut by 55 bp to 0.2%;

Increasing asset purchases up to SEK 300 bn (around EUR 27 bn) covering also government and municipal bonds, mortgage bonds and securities of the non-financial sector.

**Central Bank of Norway**

Policy rate cut by a total of 125 bp to 0.25%.

**Central Bank of the Czech Republic**

Policy rate cut by a total of 125 bp to 1.0%.

**Central Bank of Poland**

Policy rate cut by a total of 100 bp to 0.5% and the corridor of key interest rates narrowed (to ±0.5 pp);

Launched the programme of purchase of Poland government bonds in domestic currency;

Introduced the programme enabling commercial banks to refinance new household and corporate loans at favourable interest rates.

**Central Bank of Romania**

Policy rate cut by 50 bp to 2.0% and interest rate corridor narrowed from ±1.0 pp to ± 0,5 pp;

Launched programme of purchase of Romanian government securities in the secondary market.

**Central Bank of Turkey**

Policy rate cut by 200 bp to 8.75%.

Decision on the purchase of government bonds and broadened collateral base in operations implemented by the bank.

**National Bank of Northern Macedonia**

Policy rate cut by 25 bp to 1.75%.

**Central Bank of Albania**

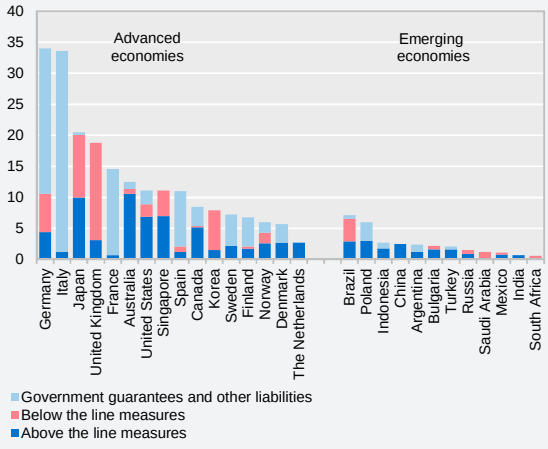
Policy rate cut by 50 bp to 0.5%.

Source: IMF Policy Responses To Covid-19, Institute of International Finance, Covid-19.

**Monetary policy measures targeted primarily economic disturbances on the demand side**. The coronavirus-induced crisis is particularly challenging for economic policymakers, as it also brings a supply side shock – which is why monetary policy measures must be complemented by those of fiscal policy. While the pandemic created a need for unprecedented fiscal support, distinguished economists and international institutions are almost unanimous in their view that fiscal measures, while considerably burdening many a country's budget at the moment, are by all means necessary to ensure economic recovery in the medium and long term. Though aware that this will increase fiscal imbalance and public and private sector debt, the majority agree that priority at this moment should be given to creating conditions conducive to a prompt economic recovery. With this in mind, governments around the world adopted measures tailored to the specificities of their economies, with the unequivocal purpose – to provide direct or indirect support to corporates and households in the conditions of partial or full business shutdown and to preserve jobs. For this reason, they decided to temporarily postpone the payment of taxes and contributions with a view to ensuring additional liquidity to companies and reducing the cost pressure on business in the emergency situation. The majority of these measures are temporary in nature and the eligibility conditions for companies vary, while the period of application and coverage should be aligned with the budgetary constraints of each country.

**The US fiscal package of close to USD 2,000 bn (almost 10% of GDP) is unprecedented in recent history**, since it is almost twice larger than the fiscal package adopted in response to the global economic crisis of 2008. The package envisages direct financial support to households, raising unemployment benefits, support to large enterprises in the form of traditional loans, support to SMEs, allocations for health institutions, deferral of student loans and employer tax liabilities for employees etc. **A frequent form of fiscal support in EU countries are loans and government loan guarantees**, accounting for around 17% of GDP of 27 EU member states. In some countries (France, Germany, Italy, Japan and the UK) fiscal packages in the form of support to liquidity, loans and guarantees go even beyond 10% of GDP.

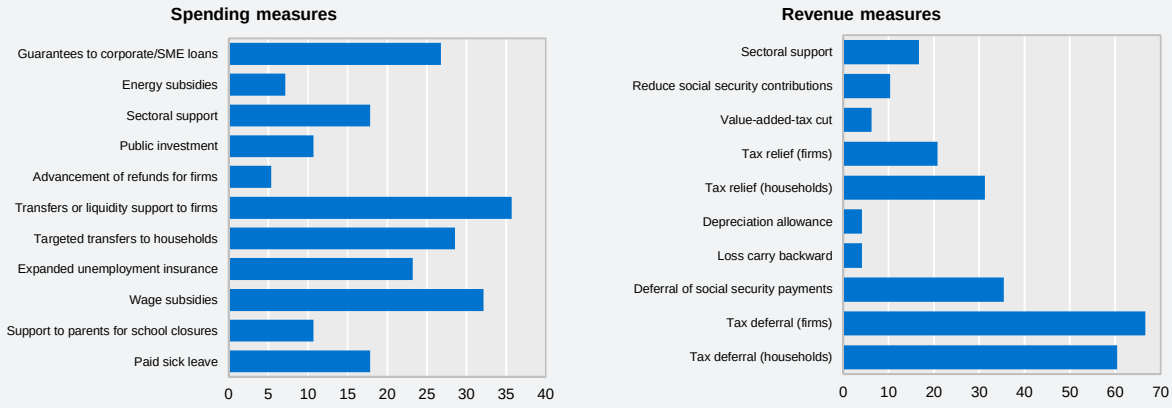
Chart O.4.1. **Fiscal packages in advanced and emerging economies in response to COVID-19 pandemic, by share in GDP**
(in %)




Source: IMF Fiscal Monitor (concluding with 8 April 2020).
Note: Fiscal packages are not directly comparable among countries, due to their specificities.

**Similar packages of measures were also adopted by many European emerging economies**, primarily by offering assistance to companies directly hit by the crisis in covering a part of salaries of employees who due to the current circumstances are unable to perform their jobs or companies operating in particularly vulnerable sectors. The main idea behind these measures is to preserve production capacities in the economy, as well as jobs, in order to speed up the economic recovery. The Czech Republic and Slovakia decided that under certain conditions, this assistance may reach as much as 80% of employees' gross wage. **In Western Balkan countries** it ranges from the payout of the minimum net wage (the Republic of Srpska, Albania, North Macedonia) to 50–70% of the average wage (Montenegro). Given the increased corporate liquidity needs and the fact that in the conditions of heightened uncertainty and risks many banks will decide to tighten their credit standards and financing conditions, **the majority of countries adopted packages to support corporate funding, primarily the market segment of micro, small and medium-sized enterprises, as the most vulnerable part of the economy**. The Czech Republic provided a separate credit line for enterprise financing, while allocating around EUR 33.3 bn in the form of government guarantees (16% of GDP). Poland envisaged assistance in the form of liquidity and current assets loans, 60% of which can be written off if the companies meet certain criteria. Countries in the region followed in the footsteps of advanced economies – Montenegro issued a credit line for entrepreneurs worth around EUR 120 mn, Albania allocated around USD 110 mn to cover current liabilities in the private sector, while North Macedonia earmarked around EUR 50 mn to maintain corporate liquidity. Financial assistance for workers laid off during the crisis, vulnerable households and economic sectors most severely hit by the crisis was also envisaged, as well as social transfers for the unemployed.

Chart O.4.2 **Common fiscal support measures for non-health sectors in response to COVID-19**
(% of economies with fiscal support measures)




Source: IMF, Fiscal Monitor, April 2020.

**The coronavirus pandemic is bound to entail negative consequences for the global economy – it remains to be seen how long they will persist**. International institutions, national governments and leading economists agree that the implemented monetary and fiscal policy measures were justified, as the most important step in laying the groundwork for the global economic recovery. Had it not been for these measures, many countries would have experienced a much harsher economic downturn and a much slower recovery. The variety of these measures, their wide coverage and a relatively quick implementation instil optimism that negative effects of this sudden economic and health crisis can be overcome by joint effort.

# V Projection

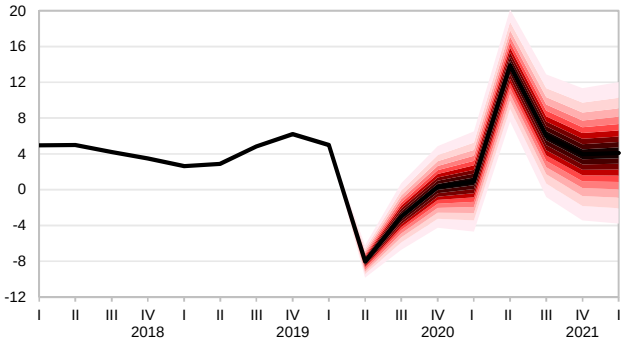
***Considering latest developments in the domestic and international environment and the effects of necessary containment measures on economic activity, we revised down the Serbian economy's growth projection for 2020 from 4% to -1.5%. This projection also takes into account the measures taken to support corporates and households that enable a minimization of the decline in economic activity in the short run and allow for a powerful recovery of the economy thereafter. In our estimate, together with the maintained favourable medium-term outlook, these measures will lead to a more than complete recovery from the crisis in 2021, when a growth rate of around 6% is expected, and a return to a stable and sustainable growth path of around 4% thereafter. The risks to the GDP projection are mostly related to uncertainties regarding the length of the pandemic worldwide and, by extension, the pace of relaxation of social distancing measures, as well as the exact size of the shock. Risks stemming from the international environment are particularly related to the speed of recovery of the euro area and are judged to be titlted to the downside, and those from the domestic environment to the upside due to the potentially faster than expected recovery of investment.***

***Under the central May projection, y-o-y inflation will return within the bounds of the target tolerance band around mid-year as the base effect for vegetable prices wears off. Thereafter, we expect inflation to move around the lower bound of the target tolerance band until year end, in the conditions of low import prices, including oil prices, and subdued aggregate demand. Inflation is expected to approach the target midpoint gradually in 2021 on the back of an expected recovery in demand. Still, we expect inflation to stay below the target midpoint of 3.0% over the projection horizon, i.e. in the next two years. Uncertainties surrounding the inflation projection continue to be associated primarily with developments in the international environment, and relate mostly to the speed of recovery of global economic growth and trade, capital flows to emerging economies and prices of oil and other primary commodities. The risks to the projection are also associated with the pace of relaxation of social distancing measures and the resultant recovery in domestic demand, movement in administered prices at home and the character of the new agricultural season. On the whole, the risks to the inflation projection are judged to be symmetric.***

## GDP projection

The first signals that the coronavirus could affect global economic growth emerged early in the year. At the time of the February *Inflation Report*, this was already reflected in the global oil price downturn and heightened uncertainty in the international financial market. At the time, we pointed out that risks to Serbia's GDP projection of 4% in 2020 are associated with the spread of the coronavirus leading to slower global growth and lower external demand, which would also dampen our exports.

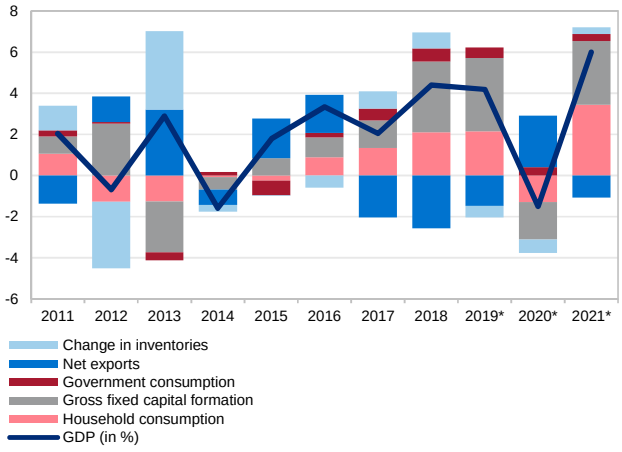
Chart V.0.1 **GDP growth projection**
(y-o-y rates, in %)




Source: NBS.

Initially, Serbia was not significantly affected by the slowdown in external demand and disruptions in global supply chains due to the spread of the virus. In the first two months of the year, domestic macroeconomic movements were favourable, with some indicators of economic activity and the sources of its financing going up even more than we expected. Most notably, this was signalled by data on industrial production, exports, retail

Chart V.0.2 **Contributions to real GDP growth**
(in pp)




Sources: SORS and NBS.
* NBS estimate.

Table V.0.1 **Revision of IMF forecast of real GDP growth for 2020 and 2021**
(in %)

| | 2020 | | 2021 | |
|---|---|---|---|---|
| | Previous projection | New projection | Previous projection | New projection |
| Euro area | 1.3 | –7.5 | 1.4 | 4.7 |
| Germany | 1.1 | –7.0 | 1.4 | 5.2 |
| Italy | 0.5 | –9.1 | 0.7 | 4.8 |
| USA | 2.0 | –5.9 | 1.7 | 4.7 |
| Russia | 1.9 | –5.5 | 2.0 | 3.5 |
| China | 6.0 | 1.2 | 5.8 | 9.2 |

Source: IMF WEO January and April 2020.

trade turnover, construction-related indicators and continued positive trends in the labour market. In addition, the volume of foreign trade exceeded that in the same period a year earlier, while the consolidated budget recorded a minor deficit. However, the accelerated spread of the coronavirus in Europe and the lockdown measures put in place led to a halt and, and in some service sectors, complete suspension of activities in the latter half of March. Still, according to our estimate, quarterly GDP growth remained high at around 5% y-o-y, thanks to performances in the first two months of 2020 and the initial two weeks of March.

Like most other countries in the world, except China which was particularly affected by the pandemic in Q1 and is now gradually recovering, Serbia will feel the effects of the pandemic in Q2 the most. The escalation of the crisis was quick and sudden, with the service sector hit particularly hard, notably tourism, catering, trade and transport, as in the latter half of March shopping malls, catering and hotel facilities were closed, and air, city and intercity passenger transport suspended. According to our estimate, construction was less affected by the pandemic, as construction works on infrastructure projects in the area of transport and energy carried on even after the state of emergency was declared, but at a slower pace, and are expected to continue in full capacity from May onwards. The dip in external demand and breaks and disruptions in supply chains will, in our estimate, also result in lower activity in industry in Q2. In view of the above, and the fact that containment measures will be phased out gradually, we expect that the strongest effect on GDP will be felt in Q2 (a fall of as much as 8% y-o-y).

Based on recent and anticipated developments in the domestic and international environment, and the estimated effects of lockdown measures on economic activity during Q2, we revised down Serbia's economic growth projection for 2020 from 4% to -1.5%. This projection also takes into account the measures taken to support corporates and households without which, in our estimate, the drop in the 2020 GDP would be much sharper and the recovery next year much slower. Together with a maintained favourable medium-term outlook, these measures will allow for a more than full recovery from the crisis next year, with an economic growth rate of around 6%, and a return to a stable and sustainable growth path of around 4% thereafter. On the expenditure side, such GDP dynamics will mostly be led by domestic demand which, after this year's drop, will see an accelerated recovery next year, propped up mainly by the continuation of the investment cycle and the rise in disposable income of corporates and households. In

addition, this year's growth structure is also expected to be marked by an improved foreign trade position, as imports are expected to contract more than exports.

At this point, the **international environment** is characterised by breaks and disruptions in global supply chains, and a continued decline in demand and volume of trade amid application of social distancing measures. The euro area, as our most important foreign trade partner, has been particularly affected due to its openness and deep integration into global supply chains. Key indicators of euro area economic activity in March and April slid to record lows, as did indicators of business and consumer confidence. They signal that the euro area is in the midst of a deep recession, and the countries that have been hit particularly hard are our most important foreign trade partners – Italy and Germany. As at this point it is still very difficult to assess the size of the shock, length of the pandemic and the pace of lifting of containment measures, estimates for 2020 provided by relevant international financial institutions vary greatly and have been revised down from month to month. With regard to the euro area in particular, the prevailing estimate is that GDP will drop by around 5%, which is the assumption we used in making this projection. A partial rebound is expected next year when euro area growth will be around 4%, supported by unconventional measures of the ECB and large-scale fiscal programmes adopted by some countries.

As the pandemic is a shock on both the demand and the supply side, it has resulted in a significant opening of the **negative output gap of the euro area** and the opening of Serbia's output gap which, according to our estimates, will be -2.4% on average this year and will close partly to around -0.8% in 2021, on the back of a gradual rise in external demand and accelerated recovery in domestic demand.

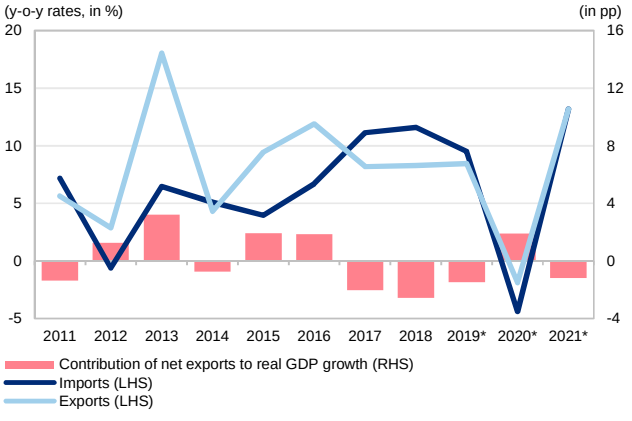
The slowdown in external demand will lead to lower **exports**, which at this point are estimated to decline by around 2% in real terms at year level. However, broken supply chains, dampened domestic demand and somewhat lower FDI inflow against the background of subdued economic activity worldwide and global risk aversion will also lead to a fall in imports, which, according to our current estimates, will be sharper (-4.4%). This should result in a positive contribution of net exports to GDP of around 2 pp this year. After that, as imports of equipment and intermediate goods for industrial purposes go up with the continuation of the investment cycle, the contribution of net exports is expected to be negative in 2021 (-1.2 pp). Subsequently,

Table V.0.2 **Economic growth estimate by country**
(real growth, in %)

| | October 2019 | | April 2020 | |
|---|---|---|---|---|
| | 2020 | 2021 | 2020 | 2021 |
| Poland | 3.1 | 2.7 | -4.6 | 4.2 |
| Czech Republic | 2.6 | 2.6 | -6.5 | 7.5 |
| Hungary | 3.3 | 2.9 | -3.1 | 4.2 |
| Romania | 3.5 | 3.0 | -5.0 | 3.9 |
| Slovakia | 2.7 | 2.7 | -6.2 | 5.0 |
| Slovenia | 2.9 | 2.7 | -8.0 | 5.4 |
| Croatia | 2.7 | 2.5 | -9.0 | 4.9 |
| Bulgaria | 3.2 | 3.0 | -4.0 | 6.0 |
| Albania | 4.0 | 4.0 | -5.0 | 8.0 |
| Bosnia and Herzegovina | 2.6 | 2.6 | -5.0 | 3.5 |
| Macedonia | 3.4 | 3.2 | -4.0 | 7.0 |
| Montenegro | 2.5 | 2.9 | -9.0 | 6.5 |
| **Serbia** | **4.0** | **4.0** | **-3.0** | **7.5** |

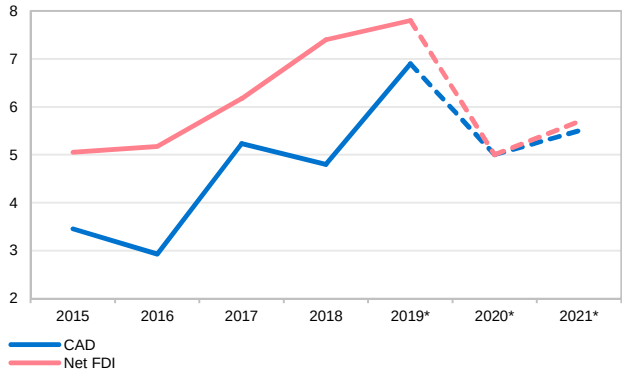
Source: IMF.

Chart V.0.3 **Real export and import growth**



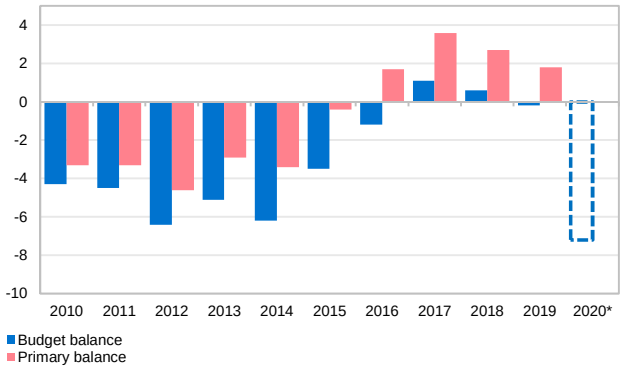

Sources: SORS and NBS.
* NBS estimate.

Chart V.0.4 **Current account deficit and net FDI inflow**
(in % of GDP)




Source: NBS.
* NBS projection.

Chart V.0.5 **General government fiscal and primary budget balance**
(in % of GDP)




Source: Ministry of Finance.
* NBS projection.

with the increase in export capacities in the coming years, net exports are expected to provide a mild positive contribution.

Given the favourable terms of trade, and primarily the effects of a lower global oil price estimated at around USD 40 per barrel on average this year, the higher real decline in imports than in exports will lead to a **contraction of the share of the current account deficit in GDP** to around 5% this year. Another positive contribution to the narrowing of the current account deficit will come from the lifting of the 100% tax on products delivered to Kosovo and Metohija. The current account deficit will continue to be fully covered by **net FDI inflow**, which we assumed to be around EUR 2.3 bn this year, a conservative estimate given its performances in Q1. Over the medium run, we expect the share of the current account deficit in GDP to be relatively stable, as import growth on account of investment will be offset by increased export supply.

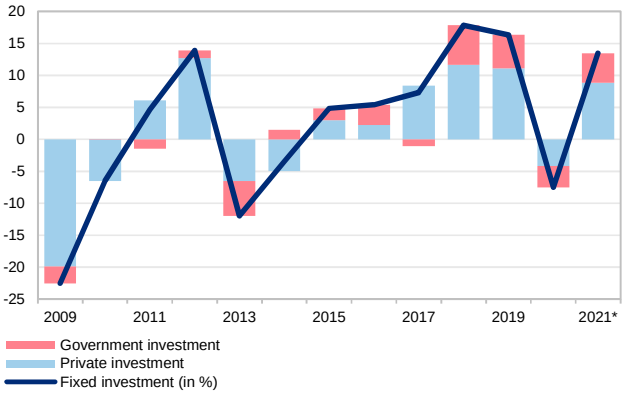
As the pandemic gradually wanes, **domestic demand** is expected to **recover** in H2. This will be supported by the maintained favourable terms of financing thanks to the effects of past monetary policy easing by the NBS and further unconventional measures of the ECB. The NBS's support to consumption and investment was also provided through the loan repayment moratorium in the duration of at least 90 days. Domestic demand was further propped up by the Government which adopted a Programme of Economic Measures worth EUR 5.1 bn, including the deferral of payment of payroll taxes and contributions, direct assistance to corporates to preserve employment, liquidity preservation measures for companies through credit support as well as measures for direct stimulation of private consumption through the rise in disposable income. According to estimates of the Ministry of Finance, this will result in a **general government fiscal deficit** of around 7% of GDP this year, but such one-off deficit is, in our view, fully justified as otherwise the fall in economic activity this year would be much sharper, followed by a steeper decline in employment and wages, and much slower recovery in 2021.

Having in mind a certain fall in consumption in Q2 and the expectation that households will, for some time to come, refrain from buying durable consumer goods and using services (such as travel and transport services), **private consumption** is expected to lose around 2% this year, providing a negative contribution of 1.3 pp to GDP. Next year, it is expected to recover fully (contributing around 3.5 pp to GDP growth). Of all components of domestic demand this year, the only one expected to provide a positive contribution is government

consumption, due to higher outlays for goods and services, including procurement of medical supplies.

Despite continued implementation of key infrastructure projects, in the conditions of global risk aversion, declining corporate sector profitability and the expected lower inflows from FDI, **fixed investment** is estimated to provide a negative contribution of 1.8 pp to GDP this year. A favourable macroeconomic outlook of the country, improved business environment, maintaining of favourable financial conditions and the planned investment projects of the government will, in our estimate, lead to investment growth in 2021 and a contribution of around 3 pp to GDP growth. The IMF's projection for Serbia also foresees a complete recovery of economic activity in 2021.

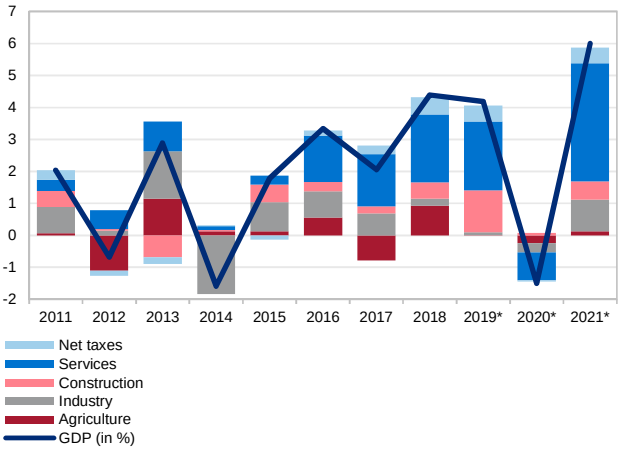
Chart V.0.6 **Fixed investment**
(y-o-y growth, in pp)




Sources: SORS and NBS calculation.
* NBS estimate.

**On the production side**, activity is expected to contract this year in all production sectors, excluding construction, whereas the previous projection envisaged an annual drop only in agriculture based on the assumption of an average agricultural season. As some areas almost completely stopped working in April, the service sector will see the sharpest fall in activity. Next year, we expect growth and a more than complete recovery of activity in both service and production sectors. Manufacturing industry growth will be propped up by the activation of new and expansion of existing capacities on the supply side, and by the expected gradual acceleration of economic growth of our main foreign trade partners on the demand side. Stepped-up growth in activity is expected in service sectors as well, on account of continued positive trends in the labour market and growth in domestic demand. Positive contribution to GDP growth should also come from construction, given the ongoing and planned projects in the area of transport infrastructure (according to "Serbia 2025" project, over EUR 5 bn is planned to be invested in road infrastructure in the next five years), and favourable trends in the real estate market.

Chart V.0.7 **Contributions to real GDP growth, production side**
(in pp)




Sources: SORS and NBS.
* NBS estimate.

**The risks to the GDP projection** are mostly related to uncertainties regarding the length of the pandemic globally, speed of lifting of social distancing measures and the exact size of the shock. Risks are judged to be symmetric, with those stemming from the international environment titlted to the downside, and those from the domestic environment to the upside.

Though Serbia lowered its exposure to disruptions in individual segments of external demand thanks to increased geographical and product diversification of its exports, the key risk from the international environment is still related to the **pace of growth in the euro area**, which has been hit hard by the current crisis. In addition to being

our most important trade partner, the euro area also has an impact on the pace of **economic growth in countries of Central and Southeast Europe**, with which Serbia is increasingly fostering strong economic ties. According to a number of relevant international financial institutions, euro area economic activity is expected to shrink by around 5% and rally partly next year. However, we judge risks to this projection to be tilted to the downside, as we still do not know the exact length of the pandemic, the strength of its effects or the intensity of the shock. Any sharper fall in economic activity in the euro area and the countries with which we have important trade ties would reflect on lower Serbian exports growth and, by extension, weaker output in manufacturing.

As a small and open economy, Serbia is also under the sway of **capital flows and the relations of leading currencies in the international financial market**. Slower than expected global growth would add to the uncertainty in the international financial market and reflect negatively on business confidence and investment decisions, which would probably dent the inflow of capital into emerging economies, including Serbia. The monetary policies of leading central banks have been eased in the face of the pandemic, with central banks expressing readiness to take further measures if needed to moderate any tightening of financial conditions. It is also important to note that, thanks to its preserved macroeconomic stability, and narrowed internal and external imbalances, Serbia has become a more attractive destination for longer-term investment, which is particularly important at a time when many countries face larger financing needs amid implementation of programmes of economic assistance to the private sector.

To a degree, the risks to the GDP projection are also associated with **movements in global prices of primary commodities, notably oil, base metals and grains, which have decreased significantly in the conditions of the pandemic**. Given that Serbia is a net importer of oil, a further decline in the oil price would spill over to higher disposable income and lower operating expenses, while its growth would have the opposite effect. When it comes to prices of base metals (iron and copper in particular) and grains, Serbia, as a net exporter, would not benefit from their further fall.

As regards **domestic factors** of GDP growth, their effect is judged to be skewed to the upside. A smaller dip in investments is possible this year, as is their faster growth next year, since low inflationary pressures, achieved macroeconomic stability and open fiscal space allow the NBS and the Government to take additional measures and activities to ease the position of **corporates**, without undermining price stability and the sustainability of public finances. Moreover, the continuation of structural reforms and the planned further systemic improvements of the business environment ought to contribute to faster growth in total factor productivity and, by extension, in the production potential. At the same time, overperformance of capital government expenditure relative to the plan in the past two years indicates that **government investment** could also grow faster than anticipated in the period ahead, spurring quicker than expected growth in construction. As investments are mostly directed into tradable sectors, their stronger activation should also lead to faster export growth on the expenditure side, and a rise in manufacturing on the production side. Another risk to the GDP projection relates to movements in **agricultural production**, which we assumed to be average in 2020 and beyond. As this projection may shift in either direction, depending primarily on agrometerological conditions, the risks on this account are judged to be symmetric.

## Inflation projection

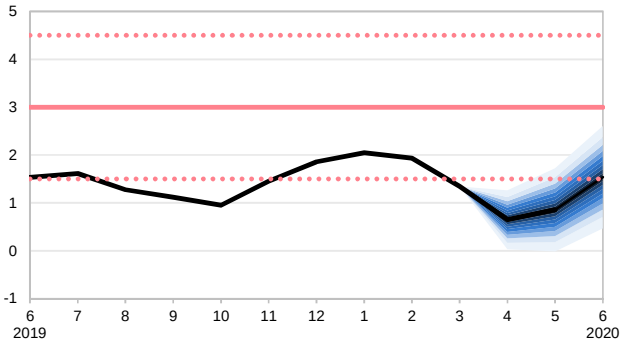
In making our inflation projection, we took into account that inflation movements in the period ahead will predominantly reflect the powerful impact of the pandemic on a reduction in both supply and demand, which played out almost simultaneously across all countries of the world. The effect of the pandemic has been disinflationary through the lowering of demand, and inflationary through its impact on reduced supply. Additionally, we considered the anticipated effects of large-scale fiscal and monetary policy measures taken to alleviate, to the largest possible extent, the negative effect of the pandemic on supply and demand. At the same time, we had in mind that the single strongest disinflationary factor this year will, in all likelihood, be the global oil price which toppled sharply as a result of a pronounced imbalance between excessive supply and drastically reduced demand. We estimate that, going forward, the net effect of the pandemic in Serbia, as in most other countries, will result in lower than expected inflation. Also, certain changes in price relations are possible, as variations in supply and demand due to the pandemic differ greatly across sectors. The most pronounced is the slump in demand for catering, travel and transport services and, to an extent, also for non-food products, where somewhat more pronounced disinflationary pressures could be expected.

### Short-term inflation projection

Under the central short-term projection, inflation will move around the lower bound of the target tolerance band in Q2 – it will first slow to below the lower bound, only to return within the target tolerance band in June. Inflation will slow down under the impact of lower petroleum product prices due to the global oil price downturn, as well as the high base effect for vegetable prices that will wear off by quarter end, helping inflation return within the target tolerance band.

According to our estimate, the key risks to the short-term inflation projection stem from movements in the global price of oil and petroleum product prices at home, as well as prices of vegetables, fruit and meat. A further risk is associated with lower than expected demand on account of the pandemic and the consequent opening of the negative output gap.

Chart V.0.8 **Short-term inflation projection**
(y-o-y rates, in %)

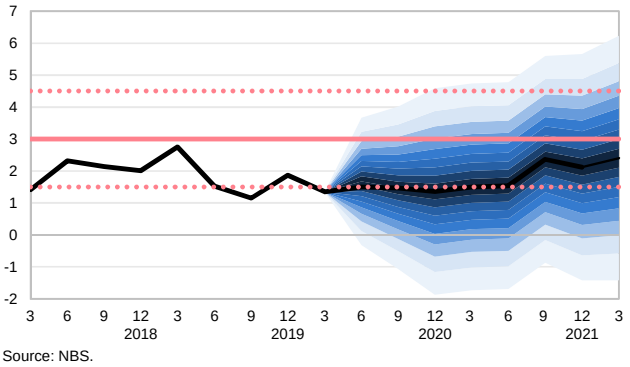



Source: NBS.

### Medium-term inflation projection

Under the central May projection, y-o-y inflation will return within the target tolerance band around the middle of the year, helped by the exhaustion of the base effect for vegetable prices, and continue to move around the lower bound of the target tolerance band until the end of the year due to low import prices, notably the subdued global oil price, and lower aggregate demand. As economic activity strengthens and demand picks up, y-o-y inflation in 2021 is expected to approach the target midpoint of 3.0% gradually, but remain below it until the end of the projection horizon.

Chart V.0.9 **Inflation projection**
(y-o-y rates, in %)



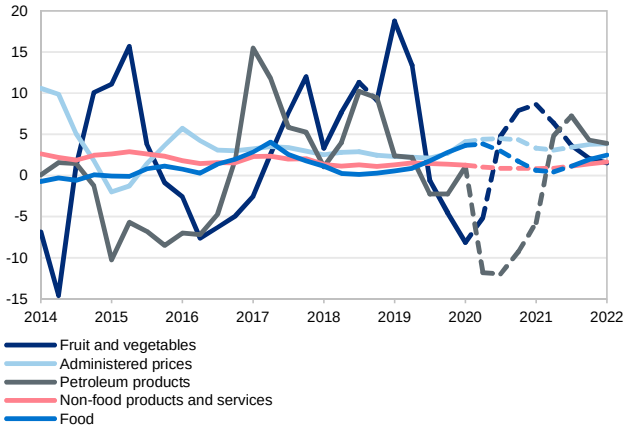

Source: NBS.

The fan chart depicts the probability of various inflation outcomes in the next eight quarters. The central projection is within the darkest central band and the probability that inflation would lie in it is 10%. Each following shade includes 10% probability, which means that outturns of inflation somewhere within the entire fan chart are expected with probability of 90%. In other words, the probability that inflation in the next eight quarters would lie somewhere outside the band in the chart is 10%.

In terms of individual inflation components, the inflation profile will mainly be determined by **prices of fresh vegetables**, not so much because of their current movements, but because of the base effect (as last year they departed from their usual trend), and **prices of petroleum products**, on account of a fall in the global oil price. The base effect for vegetable prices will provide a negative contribution to y-o-y inflation until April this year, and become positive thereafter, particularly during the autumn months, as in these months last year vegetable prices fell more than was typical for that part of the year. On the other hand, the global oil price dropped sharply with the outbreak of the pandemic and we expect it to stay relatively low going forward as well, potentially leading to a further reduction in petroleum product prices in the months ahead.

When it comes to **food prices (excluding fruit and vegetables)**, we expect no major upward pressures, as in

Chart V.0.10 **Projection of inflation components**
(average y-o-y rate, in %)



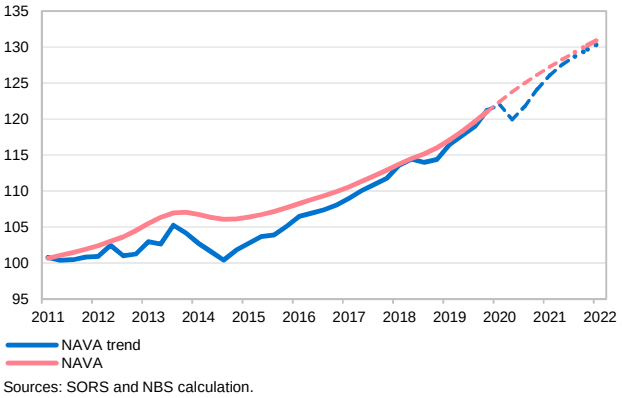

Source: NBS.

Table V.0.3 **Key projection assumptions**

| | 2020 | | 2021 | | 2022 |
|---|---|---|---|---|---|
| **External assumptions** | Feb. | May | Feb. | May | May |
| Euro area GDP growth | 1.1% | -5.0% | 1.4% | 4.2% | 2.5% |
| Euro area inflation (average) | 1.1% | 0.7% | 1.4% | 1.0% | 1.5% |
| EURIBOR 3M (December) | -0.5% | -0.4% | -0.4% | -0.4% | -0.4% |
| International prices of primary agricult. commodities (Q4 to Q4)* | 6.2% | 2.6% | 4.0% | 7.9% | 2.8% |
| Brent oil price per barrel (December, USD) | 57 | 40 | 56 | 43 | 46 |
| **Internal assumptions** | | | | | |
| Administered prices (Dec. to Dec.) | 3.8% | 4.0% | 3.8% | 4.0% | 4.0% |

* Composite index of soybean, wheat and corn prices.
Sources: NBS, ECB, Euronext, CBOT and Bloomberg.

Chart V.0.11 **Output gap projection**
(Q3 2008 = 100)




Sources: SORS and NBS calculation.

the coming two years we anticipate quite moderate growth in prices of primary agricultural commodities which are important raw materials in food production (wheat, corn, soybean). In H2 2019 and early 2020, food prices were on a rise, primarily due to disruptions in the global market caused by higher prices of pork. As this price increase drops out of the y-o-y inflation calculation, we expect this inflation component to slow down in H2 2020. In the medium run, we expect to see modest growth in food prices, guided primarily by a gradual rise in aggregate demand.

Due to low import costs and weak aggregate demand, we expect a slowing of the already modest rise in **prices of non-food products** and services. As demand gradually rallies, these prices are expected to see a moderate, though still relatively low, growth in 2021. We assumed a rise of around 4% in **administered prices** in 2020 and the next two years.

The May inflation projection was predominantly determined by the fact that **global supply and demand** were powerfully affected by the current pandemic. The **global economic downturn** is estimated to **lead to lower than previously expected inflation in the period ahead**, as the negative effect of the pandemic on demand will outstrip its negative effect on supply. The pandemic caused a halt in the functioning of a significant part of the global economy, weakening the position of corporates, undermining business confidence and heightening risk aversion, which in many countries already caused a drastic fall in employment, wages and investment, and, by extension, demand. Weaker demand also reflects households' precautionary reluctance to spend. Moreover, though the response of leading central banks greatly eased monetary conditions, financial conditions have tightened amid extremely heightened uncertainty and fear of a rise in bad receivables from corporates and households hit hard by the crisis.

**Economic growth of the euro area**, our most important trade partner, has been adjusted to -5.0% in our current projection, compared to 1.1% we assumed in our previous projection. In 2021, we expect a recovery in euro area growth to 4.2%, largely on account of expansionary measures taken by the ECB and strong fiscal stimulus packages in most member states.

At the time of making this projection (April 2020), the dominant expectation is that the **negative effect of the pandemic in our country, as in other European countries, will mostly play out during Q2, and that the recovery in economic activity and demand will**

**ensue in H2 this year**. We estimate that the open negative output gap will be around -2.4% on average in 2020 and contract to around -0.8% in 2021 as the recovery in domestic demand accelerates and external demand goes gradually up.

**The recovery of domestic demand will be supported by the timely taken monetary and fiscal policy measures,** which will contain the negative effects of the pandemic and support the recovery in economic activity from H2 onwards. Serbia faced this crisis in a much better macroeconomic position, which allowed the Serbian Government to **take powerful action in the form of a fiscal stimulus package** to support households and corporates in tackling the crisis caused by the pandemic and preserving the production potential. We expect that the taken monetary and fiscal measures will contain the decrease in economic activity, employment and wages in the private sector, as well as incite accelerated recovery once the pandemic is over.

In addition to the positive effect of the NBS's monetary policy easing on domestic demand, another positive impulse will come from low interest rates on euro-indexed loans which should remain low for longer than expected. In the euro area, Serbia's most important financial partner, the **ECB** has taken unconventional monetary policy measures, including large-scale asset purchases, to increase monetary policy accommodation. The aim is to provide additional liquidity to the financial sector in new circumstances and restrain the tightening of financial conditions in the euro area. The EURIBOR futures indicate that, thanks to the ECB's highly accommodative monetary policy stance, the three-month EURIBOR will be negative not only until the end of our projection but as far as in 2026. Together with large-scale fiscal stimulus packages adopted by most countries of the euro area, the ECB's monetary accommodation ought to spur gradual recovery in the region's economic activity and, by extension, our external demand.

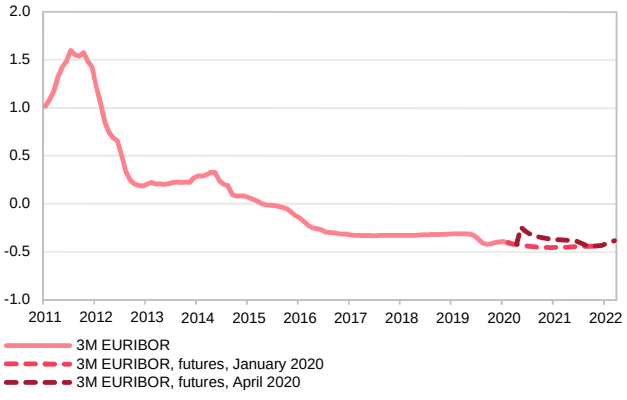
Despite extremely accommodative monetary and fiscal policy measures in many countries of the world, **global inflation is expected to undershoot expectations**. Advanced economies' inflation was already low at the outbreak of the crisis, and some of them may even experience deflation. In any case, most advanced economies are not expected to meet their inflation targets in the next two years. **In the euro area**, our most important trade partner, we expect inflation to slow to 0.7% in 2020, and pick up moderately to 1.0% in 2021 and 1.5% in 2022. In **most countries of the region**, which are also our important trade partners, inflation

Table V.0.4 **Inflation estimate by country**
(annual average, in %)

| | October 2019 | | April 2020 | |
|---|---|---|---|---|
| | 2020 | 2021 | 2020 | 2021 |
| Poland | 3.5 | 3.4 | 3.2 | 2.6 |
| Czech Republic | 2.3 | 2.0 | 2.1 | 2.0 |
| Hungary | 3.4 | 3.3 | 3.3 | 3.2 |
| Romania | 3.3 | 2.9 | 2.2 | 1.5 |
| Slovakia | 2.1 | 2.1 | 1.1 | 1.4 |
| Slovenia | 1.9 | 1.9 | 0.4 | 1.4 |
| Croatia | 1.2 | 1.3 | 1.3 | 1.2 |
| Bulgaria | 2.3 | 2.2 | 1.0 | 1.9 |
| Albania | 2.0 | 2.4 | 2.4 | 2.7 |
| Bosnia and Herzegovina | 1.4 | 1.5 | -0.6 | 1.4 |
| Macedonia | 1.7 | 2.0 | -0.9 | 0.8 |
| Montenegro | 1.9 | 1.6 | 0.7 | 0.9 |
| **Serbia** | **1.9** | **2.5** | **1.4** | **1.9** |

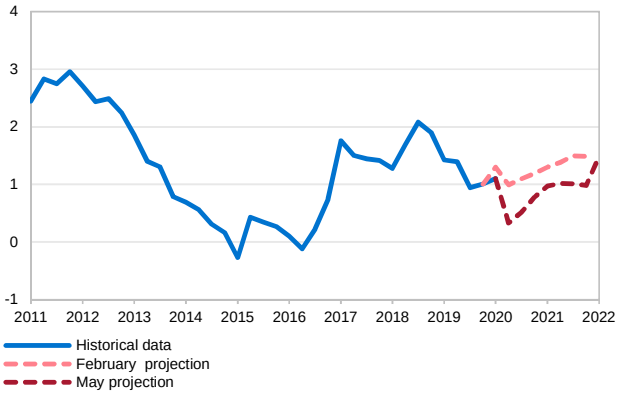
Source: IMF.

Chart V.0.12 **Expected 3M EURIBOR**
(p.a., in %)




Source: Bloomberg.
* Futures-based market expectations.

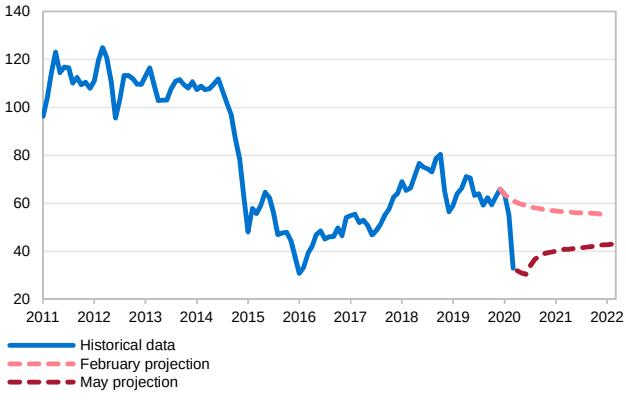
Chart V.0.13 **Assumption for euro area inflation**
(y-o-y growth, in %)




Source: NBS calculation based on projections of relevant institutions.

should be lower than expected. Assuming lower inflation in the international environment, primarily in the euro area, relative to our prior projection, we expect **inflationary pressures from dinar-denominated import prices to be extremely weak** until the end of the projection horizon.

Chart V.0.14 **Assumption for Brent oil prices**
(USD/barrel)

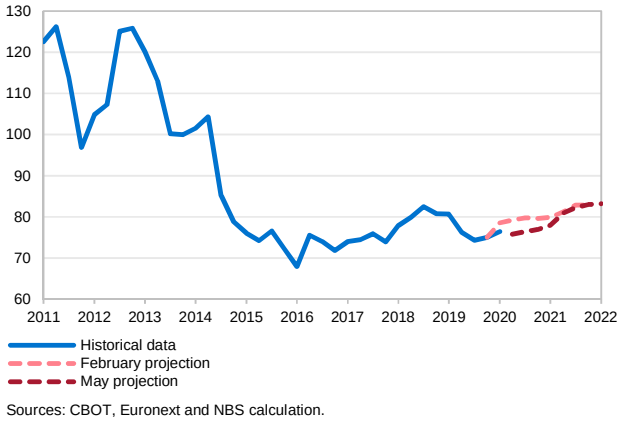



Source: Bloomberg.

When it comes to import prices, the **global oil price** is expected to be the strongest disinflationary factor in the period ahead. It fell sharply with the outbreak of the pandemic, on account of a pronounced imbalance between excessive supply and drastically subdued demand. Not even the agreement of OPEC+ countries on major production cuts in April was able to push global oil prices up again. Consistent with mid-April oil futures, our new projection assumes that the global oil price will be around USD 40 per barrel in December 2020 and around USD 43 per barrel in December 2021, compared with USD 57 per barrel and USD 56 per barrel, respectively, which we assumed in our previous projection on the basis of futures.

With regard to **global prices of primary agricultural commodities** relevant for us, our projection relies on futures data from Euronext Paris and the Chicago Board of Trade. Consistent with these data, we assumed that primary agricultural commodity prices will rise slightly less in 2020 and slightly more in 2021 (2.6% and 7.9%, respectively) than assumed in our previous projection. For this reason, **we also expect that prices of primary agricultural commodities in the domestic market,**[25] **which mirror movements in their global counterparts**, will display similar dynamics.

Chart V.0.15 **Assumption for international prices of primary agricultural commodities**
(Q4 2013 = 100)




Sources: CBOT, Euronext and NBS calculation.

In the conditions of low and stable inflation for seven years in a row, anticipated low inflationary pressures and enhanced credibility of the NBS, we expect **inflation expectations to remain stable until the end of the projection horizon**.

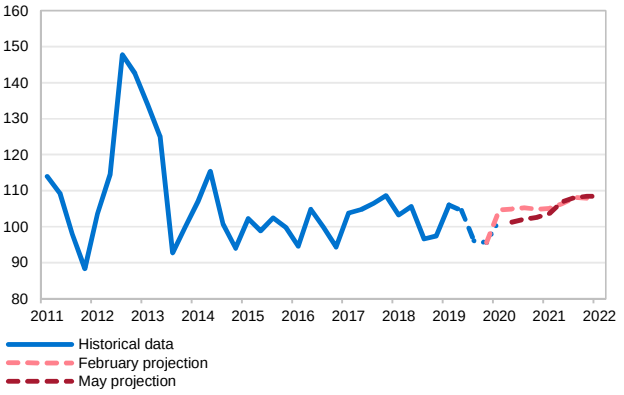
**Uncertainties surrounding the inflation projection** are still mostly associated with movements in the international environment, including primarily global trade and economic growth, capital flows to emerging economies and global prices of oil and other primary commodities. The risks to the projection also relate to the speed of relaxation of social distancing measures, and the resultant recovery in domestic demand, movement in administered prices at home and the character of the new agricultural season.

[25] Measured by the composite index of the prices of wheat, corn and soybean.

When it comes to **global trade and economic growth and, consequently, external demand and inflation in the international environment**, any assessment of their future movements is marked by a high degree of uncertainty. The spread of the coronavirus represents both a health and an economic shock, which cannot be viewed in isolation. In view of the estimated risks, the key question is which part of the economy will not function and for how long, having in mind the social distancing measures which, one the one hand, contain the spread of the virus and protect the healthcare system and people's lives, while on the other hand dampening economic activity. At present, it is not known how long the pandemic will last or if there is going to be a second wave. On the one side, it is possible that the key drivers of the current crisis will cease in the coming period (such as business shutdown, employees' sick leaves and loss of business confidence) if the pandemic ends during the summer and the virus does not return in the autumn or at least does not spread as fast. In that case, we might even see some post-recession leap in consumption, due to deferred purchases of consumer durables and reluctance to consume different services during social distancing measures. In addition, most countries took relatively prompt and extremely robust monetary and fiscal policy measures, which should spur a speedy recovery. On the other hand, the coronavirus could be present in the coming period as well, as there is a possibility of a second wave of contagion in autumn, which could aggravate the already sharp decline in global economic activity. According to the IMF, the global economic downturn due to the current pandemic will in all likelihood be greater than any of the crises experienced since the Great Depression of the 1930s and much worse than the 2008 crisis, with pronounced risks to the downside. Even after the calming of the first wave of contagion, the return to normal will be difficult – many social distancing measures will stay in place to contain the spread of the virus, while the position of corporates will be weaker. It is highly likely that risk aversion will go up and investments down, while unemployment will rise and households refrain from consumption out of precaution. Most countries are also expected to record a much higher fiscal deficit and public debt, etc.

High uncertainty is also associated with **conditions in the international financial market and, by extension, capital flows to emerging economies**. Investors' initial response to the pandemic was to reconsider their portfolios and favour investment in safe assets, which led to shifts in global capital flows, fall in stock exchange

Chart V.0.16 **Assumption for domestic prices of primary agricultural commodities***
(base index, 2013 = 100)




Sources: Commodity Exchange Novi Sad, CBOT, Euronext and NBS calculation.
* Measured by the composite index of the prices of wheat, corn and soybean.

indices, and rising prices of gold and sovereign securities of advanced economies. Uncertainty was, to a degree, moderated by extremely accommodative monetary policies of leading central banks and large-scale fiscal stimulus packages of a large number of countries, which ought to spill over to global financial conditions. Uncertainty in the international financial market in the coming period and, by extension, global capital flows, will largely be determined by the future course of the pandemic.

In view of the uncertainties regarding movements in global trade and economic growth, and developments in the international financial market, we estimate that the risks to the inflation projection in this respect are skewed to the downside.

The outlook for recovery of global trade and economic growth will largely determine movements in the international commodity market, notably **prices of oil and other primary commodities**. On the demand side, there are risks that global economic growth could be weaker than estimated, hindering the rebound in demand for primary commodities and limiting recovery in their prices. Supply-side factors are specific for each primary commodity. Although market participants, according to futures, expect low **global oil prices**, shifts in either direction are possible. In addition to the effects of the pandemic, there are also trade and geopolitical tensions which, on balance, undermine business confidence and heighten uncertainty regarding oil production caps of OPEC+ countries and the extent to which members will adhere to the agreement. Global oil prices will also impact prices of **primary agricultural commodities**, primarily through the costs of fuel in agricultural production and fertiliser prices. Given the uncertainties surrounding global prices of oil and primary agricultural commodities, we estimate the risks to the projection in respect of global primary commodity prices to be symmetric.

The risks to the projection are also associated with the speed of relaxation of social distancing measures and the resulting pace of recovery of **domestic demand**. The economic activity in Serbia saw a downturn in the latter half of March and in April reflecting not only lower external demand, but also more difficult business conditions in many sectors. **Economic activity is expected to rally in the remainder of the year, but the speed of recovery will greatly depend on the course of the pandemic, i.e. the need for containment measures**. The recovery will be supported by timely taken monetary and fiscal policy measures. The coordination of monetary and fiscal policy measures will continue in the period ahead, helping alleviate further negative effects from the international environment and the consequences of the coronavirus spread on domestic economy. As, in our view, it is more likely that domestic demand growth will outstrip our expectations in the period ahead, we estimate that the risks on this account are mildly tilted to the upside.

Since, over the past few years, **administered price growth** at home was mostly slower than expected, we estimate that growth in these prices could be more sluggish than anticipated in the coming period as well, so risks on this account are skewed to the downside.

Another risk to the projection is the character of this year's **agricultural season**, which we assumed to be average after last year's better than average season. Shifts on this account are possible primarily for prices of vegetables, fruit and meat. At this point, we judge the risks to the projection on this account to be symmetric.

Overall, **the risks to the inflation projection are judged to be symmetric until the end of the projection horizon**.

Monetary policy decisions in the coming period will depend on the assessment of the impact of past monetary policy easing on future inflation, but also on anticipated movements in key factors from the domestic and international environment and their influence on the speed of economic recovery, inflation and financial stability.

## Comparison and outcome of inflation projections

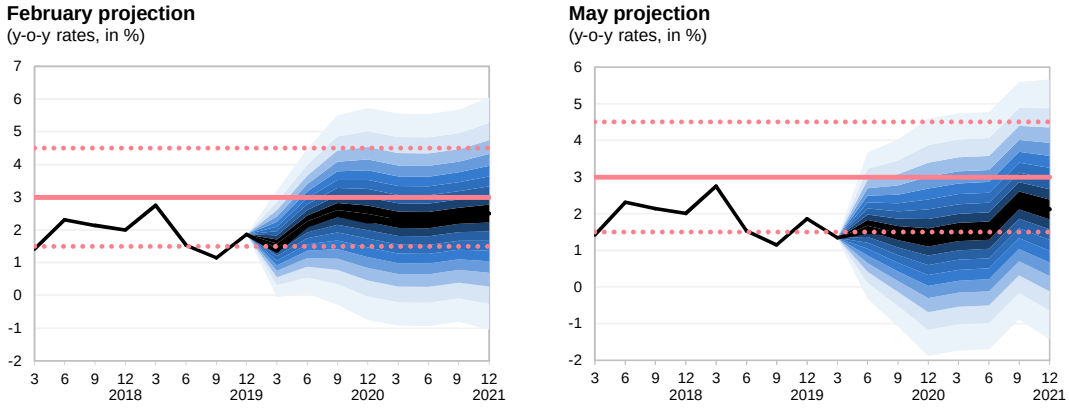
The period since our previous projection was marked by strong direct and indirect effects of the pandemic on economic flows in almost all countries. Compared to that projection, **the new medium-term inflation projection is lower**, primarily due to a sharp fall in the global price of oil and decreased aggregate demand. Cost-push pressures also weakened on account of lower import inflation and subdued prices of primary agricultural commodities.

In the period since our previous projection, **the global oil price** saw a sharp downturn, and expectations of its future movements were significantly adjusted. As we did not expect such movements in the global oil market at the time of the previous projection, our **projection of petroleum product prices is lower than three months ago**.

In addition, the pandemic led to the **opening of the negative output gap both in Serbia and in the euro area**, our main trade partner; as a result, we projected a lower inflation value than in the previous projection.

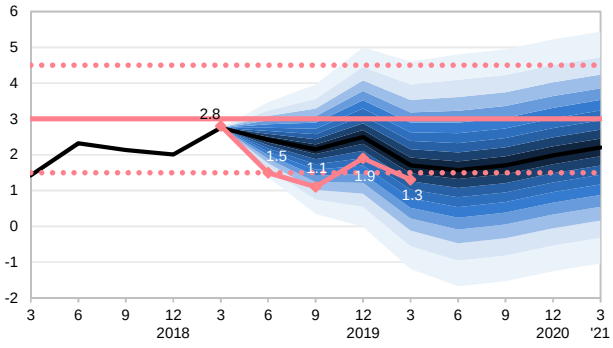
The current inflation projection is lower than the previous one also due to the anticipated **reduced cost-push pressures from import inflation**. Since our assumption of inflation in the international environment, most notably in the euro area, is lower than in February, we expect inflationary pressures from dinar-denominated import prices to be muted. Cost-push pressures should also be weaker on account of **lower prices of primary agricultural commodities**, which is another factor behind lower projected inflation than three months ago.

Chart V.0.17 **Current vs. previous inflation projection**




Source: NBS.

Chart V.0.18 **Achievement of May 2019 inflation projection**
(y-o-y rates, in %)




Source: NBS.

## Outcome of the May 2019 inflation projection

**In the past year, inflation was largely aligned with the projection made and published in the May 2019 Inflation Report**. It first moved along the lower bound of the projection band and approached the midpoint late last year.

Inflation slowdown in the first half of the observed period (Q2 and Q3 2019) was somewhat more pronounced than envisaged in the central projection from May 2019, primarily because of two inflation components characterised by the highest degree of uncertainty – prices of fresh vegetables and petroleum product prices. The **drop in vegetable prices** in the observed period was higher than typical for that time of the year, which we anticipated in our May 2019 projection. Also, the unexpected fall in the global oil price due to the escalation of trade tensions in mid-2019 began to spill over to **petroleum product prices** in the domestic market which rose less than we expected.

In the second half of the observed period (Q4 2019 and Q1 2020), inflation movements were **for the most part aligned with our projection from a year ago**, which helps strengthen confidence in the NBS and anchor inflation expectations.

## Table A
## Indicators of Serbia's external position

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Q1 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EXTERNAL LIQUIDITY INDICATORS (in %) | | | | | | | | | | | | | | | | |
| FX reserves/imports of goods and services (in months) | 6.1 | 9.0 | 7.5 | 5.4 | 9.7 | 8.4 | 8.8 | 7.7 | 7.6 | 6.6 | 6.7 | 6.2 | 5.4 | 5.4 | 5.7 | 5.5 |
| FX reserves/short-term debt | 177.0 | 265.1 | 250.6 | 162.6 | 220.6 | 191.2 | 299.9 | 237.3 | 268.6 | 294.0 | 256.4 | 234.0 | 202.1 | 210.9 | 260.1 | |
| FX reserves /GDP | 22.1 | 34.8 | 30.5 | 22.9 | 32.6 | 31.7 | 34.0 | 32.4 | 30.7 | 27.9 | 29.1 | 27.8 | 25.4 | 26.3 | 29.1 | 28.0 |
| Debt repayment/GDP | 4.7 | 9.7 | 9.6 | 10.1 | 12.1 | 11.3 | 11.7 | 12.3 | 12.6 | 13.3 | 11.1 | 12.3 | 10.9 | 11.3 | 10.0 | |
| Debt repayment/exports of goods and services | 19.8 | 36.2 | 37.5 | 37.5 | 48.8 | 37.5 | 37.3 | 36.0 | 33.0 | 32.7 | 25.2 | 25.9 | 22.2 | 22.9 | 19.5 | |
| EXTERNAL SOLVENCY INDICATORS (in %) | | | | | | | | | | | | | | | | |
| External debt/GDP | 56.2 | 55.2 | 55.1 | 58.8 | 68.6 | 74.5 | 68.1 | 76.1 | 70.4 | 72.4 | 73.5 | 72.1 | 65.1 | 62.2 | 61.9 | |
| Short-term debt/GDP | 12.5 | 13.1 | 12.2 | 14.1 | 14.8 | 16.6 | 11.3 | 13.7 | 11.4 | 9.5 | 11.3 | 11.9 | 12.6 | 12.5 | 11.2 | |
| External debt/exports of goods and services | 234.9 | 205.7 | 214.3 | 218.9 | 276.9 | 247.1 | 216.5 | 223.6 | 184.0 | 177.7 | 166.8 | 152.4 | 132.2 | 126.0 | 121.5 | |
| FINANCIAL RISK EXPOSURE INDICATORS (in %) | | | | | | | | | | | | | | | | |
| FX reserves/M1 | 290.3 | 356.1 | 306.7 | 300.4 | 393.4 | 416.6 | 429.6 | 402.1 | 330.4 | 278.1 | 250.2 | 207.3 | 176.2 | 168.0 | 174.1 | 165.3 |
| FX reserves/reserve money | 169.8 | 179.5 | 173.8 | 140.7 | 190.5 | 196.4 | 207.6 | 197.9 | 199.9 | 196.6 | 193.7 | 196.6 | 185.0 | 171.4 | 194.1 | 175.7 |
| OPENNESS OF ECONOMY (EXPORTS +IMPORTS)/GDP | 67.1 | 73.0 | 74.7 | 78.0 | 65.1 | 75.3 | 78.0 | 84.5 | 87.1 | 91.8 | 96.2 | 100.7 | 106.3 | 108.3 | 111.9 | 111.8 |
| MEMORANDUM: (in EUR million) | | | | | | | | | | | | | | | | |
| GDP[1] | 22,276 | 25,906 | 31,551 | 35,701 | 32,486 | 31,546 | 35,432 | 33,679 | 36,427 | 35,467 | 35,716 | 36,723 | 39,183 | 42,855 | 45.908 [3] | 11,131[4] |
| External debt | 12,520 | 14,291 | 17,382 | 20,982 | 22,272 | 23,509 | 24,123 | 25,645 | 25,644 | 25,679 | 26,234 | 26,494 | 25,526 | 26,662 | 28,418 | |
| External debt servicing | 1,054 | 2,513 | 3,039 | 3,594 | 3,922 | 3,564 | 4,154 | 4,130 | 4,595 | 4,728 | 3,960 | 4,508 | 4,285 | 4,849 | 4,573 | |
| Central bank foreign exchange reserves | 4,922 | 9,020 | 9,634 | 8,162 | 10,602 | 10,002 | 12,058 | 10,915 | 11,189 | 9,907 | 10,378 | 10,205 | 9,962 | 11,262 | 13,378 | 13,115 |
| Short-term debt[2] | 951 | 968 | 1,044 | 1,832 | 1,852 | 1,758 | 612 | 455 | 196 | 99 | 303 | 672 | 844 | 1,401 | 1,929 | |
| Current account balance | -1,778 | -2,356 | -5,474 | -7,126 | -2,032 | -2,037 | -3,656 | -3,671 | -2,098 | -1,985 | -1,234 | -1,075 | -2,051 | -2,076 | -3,160 | -989 |
| CREDIT RATING (change of rating and outlook) | 2005 July/May | 2006 Feb | 2007 July | 2008 March/ Dec | 2009 Dec | 2010 Nov | 2011 March | 2012 Aug | 2013 July | 2014 Jan | 2015 Dec | 2016 Jan/March/ June/Dec | 2017 Dec | 2018 Dec | 2019 Sept/Dec | |
| *S&P* | BB- /stable | BB- /positive | BB- /stable | BB- /negative | BB- /stable | | BB /stable | BB-/negative | | | | BB- /positive | BB /stable | BB /positive | BB+ /positive | |
| *Fitch* | BB- /stable | | | BB- /negative | | BB- /stable | | BB-/negative | | B+ /stable | B+ /positive | BB-/stable | BB /stable | | BB+ /stable | |
| *Moody's* | | | | | | | | | B1 /stable | | | B1 /positive | | | Ba3 /positive | |

Methodological notes:

Foreign exchange reserves/imports of goods and services (in months) - ratio of end-of-period foreign exchange reserves to average monthly imports of goods and services during period under review.
Foreign exchange reserves/short-term debt (in %) - ratio of foreign exchange reserves to stock of short-term debt at remaining maturity at end-of-period.
Foreign exchange reserves/GDP (in %) - ratio of end-of-period foreign exchange reserves to GDP.
Debt repayment/GDP (in %) - ratio of debt repayment (excl. early repayment of a part of debt to London Club creditors) to GDP during period under review.
Debt repayment/exports (in %) - ratio of debt repayment (excl. early repayment of a part of debt to London Club creditors) to exports of goods and services during period under review.
External debt/GDP – ratio of end-of-period outstanding debt to GDP.
Short-term debt/GDP – ratio of end-of-period short-term debt at remaining maturity to GDP.
External debt/exports (in %) – ratio of end-of-period outstanding debt to annual value of exports of goods and services.
Foreign exchange reserves/M1(in %) - ratio of foreign exchange reserves to money supply at end-of-period.
(Exports +imports)/GDP (in %) - ratio of value of exports and imports of goods and services to GDP during period under review.

[1] According to ESA 2010.

[2] At original maturity.

[3] SORS estimate as the sum of four quarters.

[4] NBS estimate.

Notes:

1. The Statistical Office revised GDP data for the period 2005-2017, which led to a change in the share of macroeconomic indicators in GDP.

2. Data are subject to corrections in line with the official data sources.

3. Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM5.

4. As of 1 January 2010 the Serbian Statistical Office applies the general trade system of registration of exports and imports which is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. Statistical Office has published comparable data for 2007, 2008 and 2009. Previous years are disseminated using the special trade system. Trade with Montenegro is registered within relevant transactions as of 2003.

5. In September 2010, the methodology of external debt statistics was changed – public sector external debt now includes liabilities under SDR allocation (EUR 479.2 mn) used in December 2009. Private sector external debt excludes loans concluded before 20 December 2000 in respect of which no payments are made (EUR 947.4 million, of which EUR 427.5 million relating to domestic banks and EUR 519.9 million to domestic enterprises).

6. Foreign debt repayment for 2019 does not include advance debt repayment on eurobonds.

Table B
## Key macroeconomic indicators

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Q1 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP growth (in %)[1] | 5.5 | 4.9 | 6.4 | 5.7 | -2.7 | 0.7 | 2.0 | -0.7 | 2.9 | -1.6 | 1.8 | 3.3 | 2.0 | 4.4 | 4.2 [9] | 5.0 [10] |
| Consumer prices (in %, relative to the same month a year earlier)[2] | 17.7 | 6.6 | 11.0 | 8.6 | 6.6 | 10.3 | 7.0 | 12.2 | 2.2 | 1.7 | 1.5 | 1.6 | 3.0 | 2.0 | 1.9 | 1.3 |
| NBS foreign exchange reserves (in EUR million) | 4,922 | 9,020 | 9,634 | 8,162 | 10,602 | 10,002 | 12,058 | 10,915 | 11,189 | 9,907 | 10,378 | 10,205 | 9,962 | 11,262 | 13,378 | 13,115 |
| Exports (in EUR million)[3] | 5,329 | 6,948 | 8,110 | 9,583 | 8,043 | 9,515 | 11,145 | 11,469 | 13,937 | 14,451 | 15,728 | 17,385 | 19,312 | 21,166 | 23,398 | 5,558 |
| - growth rate in % compared to a year earlier | 19.1 | 30.4 | - | 18.2 | -16.1 | 18.3 | 17.1 | 2.9 | 21.5 | 3.7 | 8.8 | 10.5 | 11.1 | 9.6 | 10.5 | 4.6 |
| Imports (in EUR million)[3] | 9,612 | 11,970 | 15,468 | 18,267 | 13,099 | 14,244 | 16,487 | 16,992 | 17,782 | 18,096 | 18,643 | 19,597 | 22,343 | 25,257 | 27,966 | 6,884 |
| - growth rate in % compared to a year earlier | 0.7 | 24.5 | - | 18.1 | -28.3 | 8.7 | 15.7 | 3.1 | 4.7 | 1.8 | 3.0 | 5.1 | 14.0 | 13.0 | 10.7 | 7.9 |
| Current account balance[3] | | | | | | | | | | | | | | | | |
| (in EUR million) | -1,778 | -2,356 | -5,474 | -7,125 | -2,032 | -2,037 | -3,656 | -3,671 | -2,098 | -1,985 | -1,234 | -1,075 | -2,051 | -2,076 | -3,160 | -989 |
| as % of GDP | -8.0 | -9.1 | -17.3 | -20.0 | -6.3 | -6.5 | -10.3 | -10.9 | -5.8 | -5.6 | -3.5 | -2.9 | -5.2 | -4.8 | -6.9 | -8.9 |
| Unemployment according to the Survey (in %)[6] | 20.8 | 20.9 | 18.1 | 13.6 | 16.1 | 19.2 | 23.0 | 23.9 | 22.1 | 19.2 | 17.7 | 15.3 | 13.5 | 12.7 | 10.4 | |
| Wages (average for the period, in EUR)[7] | 210.4 | 257.8 | 347.1 | 402.0 | 337.8 | 331.8 | 372.5 | 366.1 | 388.5 | 379.8 | 367.9 | 374.5 | 383.9 | 419.7 | 465.9 | 502.1 |
| RS budget deficit / surplus (in % of GDP)[4] | | | | -1.6 | -3.0 | -3.2 | -3.8 | -5.6 | -4.9 | -5.9 | -2.7 | -0.2 | 0.7 | 0.6 | 0.2 | -3.6 |
| Consolidated fiscal result (in % of GDP)[4] | 1.1 | -1.4 | -1.8 | -2.5 | -4.2 | -4.3 | -4.5 | -6.4 | -5.1 | -6.2 | -3.5 | -1.2 | 1.1 | 0.6 | -0.2 | -3.8 |
| RS public debt, (central government, in % of GDP)[8] | 47.6 | 33.9 | 27.9 | 26.8 | 30.9 | 39.5 | 42.8 | 52.9 | 56.0 | 66.2 | 70.0 | 67.8 | 57.9 | 53.7 | 52.0 | 51.9 |
| RSD/USD exchange rate (period average) | 66.87 | 67.03 | 58.39 | 55.76 | 67.47 | 77.91 | 73.34 | 88.12 | 85.17 | 88.54 | 108.85 | 111.29 | 107.50 | 100.28 | 105.28 | 106.57 |
| RSD/USD exchange rate (end of period) | 72.22 | 59.98 | 53.73 | 62.90 | 66.73 | 79.28 | 80.87 | 86.18 | 83.13 | 99.46 | 111.25 | 117.14 | 99.12 | 103.39 | 104.92 | 106.68 |
| RSD/EUR exchange rate (period average) | 82.99 | 84.11 | 79.96 | 81.44 | 93.95 | 103.04 | 101.95 | 113.13 | 113.14 | 117.31 | 120.73 | 123.12 | 121.34 | 118.27 | 117.85 | 117.57 |
| RSD/EUR exchange rate (end of period) | 85.50 | 79.00 | 79.24 | 88.60 | 95.89 | 105.50 | 104.64 | 113.72 | 114.64 | 120.96 | 121.63 | 123.47 | 118.47 | 118.19 | 117.59 | 117.50 |
| MEMORANDUM: | | | | | | | | | | | | | | | | |
| GDP (in EUR million)[5] | 22,276 | 25,906 | 31,551 | 35,701 | 32,486 | 31,546 | 35,432 | 33,679 | 36,427 | 35,467 | 35,716 | 36,723 | 39,183 | 42,855 | 45,908 [9] | 11,131 [10] |

[1] At constant prices of previous year.

[2] Retail prices until 2006.

[3] Starting from 2007 data on balance of payments (current account, exports and imports of goods and services) are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM5. Due to the break in the series for 2007, exports and imports growth rates are not shown. As of 1 January 2010, the Serbian Statistical Office applies the general trade system of registration of exports and imports which is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. The Statistical Office has published comparable data for 2007, 2008 and 2009. Previous years are disseminated using the special trade system. Trade with Montenegro is registered within relevant transactions as of 2003.

[4] Includes below-the-line items (payment of called guarantees, bank recapitalisations and debt takeover) in line with IMF methodology, as of 2008 on RS budget level and as of 2005 on consolidated level.

[5] According to ESA 2010.

[6] New methodology of Labour Force Survey since 2014. Data for 2019 - NBS calculation, average for four quarters.

[7] Until 2017, wages are shown according to the old methodology. Since 2017, wages are shown according to the new methodology and data are based on Tax Administration evidence. For conversion of wages from RSD to EUR, we used the average of the period RSD/EUR exchange rate. Data for Q1 2020 represent the average for two months.

[8] Data on the share of public debt in GDP were downloaded from the website of the Ministry of Finance.

[9] SORS estimate based on the sum of four quarters

[10] NBS estimate

Notes:

1. The Statistical Office revised GDP data for the period 2015-2017, which led to a change in the share of macroeconomic indicators in GDP.
2. Data are subject to corrections in line with official data sources.
3. Source for the data on unemployment: Labour Force Survey, Statistical Office.
4. Source for public debt: MoF.

# Index of charts and tables

## Charts

**Tables**

**Charts in text boxes**



**Tables in text boxes**

# Executive Board meetings and changes in the key policy rate

## 2019

| Date | Key policy rate (p.a, in %) | Change (in basis points) |
|---|---|---|
| 10 January | 3.00 | 0 |
| 7 February | 3.00 | 0 |
| 7 March | 3.00 | 0 |
| 9 April | 3.00 | 0 |
| 9 May | 3.00 | 0 |
| 6 June | 3.00 | 0 |
| 11 July | 2.75 | -25 |
| 8 August | 2.50 | -25 |
| 12 September | 2.50 | 0 |
| 10 October | 2.50 | 0 |
| 7 November | 2.25 | -25 |
| 12 December | 2.25 | 0 |

## 2020

| Date | Key policy rate (p.a, in %) | Change (in basis points) |
|---|---|---|
| 9 January | 2.25 | 0 |
| 13 February | 2.25 | 0 |
| 11 March | 1.75 | -50 |
| 9 April | 1.50 | -25 |
| 7 May | 1.50 | 0 |
| 11 June | | |
| 9 July | | |
| 13 August | | |
| 10 September | | |
| 8 October | | |
| 12 November | | |
| 10 December | | |

# Press releases from NBS Executive Board meetings

### Press release from Executive Board meeting held on 11 March 2019

At its extraordinary meeting today, the NBS Executive Board voted to cut the key policy rate by 50 bp to 1.75%. In making this decision, the NBS is taking a timely and adequate response to heightened uncertainty in the international environment triggered by the spread of the coronavirus (Covid-19), which is in line with the activities taken by other central banks worldwide.

This decision is also in line with favourable movements in the domestic environment. By trimming the key policy rate in the conditions of low inflationary pressures, the NBS is providing additional support to credit and economic growth.

At the same time, the NBS decided to narrow the corridor of its main interest rates from ±1.25 pp to ±1 pp relative to the key policy rate. As a result, the deposit facility rate was cut by 25 basis points to 0.75%, while the lending facility rate was cut by 75 basis points to 2.75%.

Over the past several days, the global financial market has been under the strong impact of coronavirus contagion – global stock markets are falling, while prices of safe forms of investment, such as gold or sovereign securities of advanced economies, are rising. Heightened uncertainty poses a risk to global economic growth, prompting relevant international institutions to revise down their forecasts for global economic growth for the current year.

In such circumstances, leading central banks worldwide (US Federal Reserve, Bank of England, Bank of Canada and Bank of Australia) have decided to cut their policy rates in the past several days, announcing their readiness to take all available measures to prevent negative consequences of the coronavirus spread for global economic growth. Similar steps towards monetary policy relaxation are expected from other central banks as well (primarily the European Central Bank). This should contribute to the lessening of uncertainties in the international financial market and the maintaining of favourable financing conditions in the coming period.

The Executive Board took the decision to continue monetary policy easing taking into account the domestic factors, stronger downside risks to global growth from the international environment, and the assessment that inflationary pressures in this respect have been further moderated relative to the February medium-term projection.

The NBS points out that the domestic economic and financial system is stable and strong enough to face potential negative consequences of the spreading of the coronavirus. Also, domestic factors which have contributed to domestic economic growth in the prior years will continue to have a strong stimulating effect on economic activity in Serbia, which will largely offset any negative effects coming from the international environment. Today's decision of the NBS is a step in this direction.

Inflation has been firmly under NBS control for the seventh year in a row. In January, in line with the NBS's expectations, it equalled 2.0% y-o-y. Core inflation remains low and stable at 1.0% y-o-y. That inflationary pressures are low is also indicated by inflation expectations, which are below the NBS's target midpoint both for one and two years ahead. The Executive Board expects y-o-y inflation to move around the lower bound of the target tolerance band until mid-2020 and gradually approach the target midpoint thereafter, led by a gradual rise in aggregate demand thanks also to the effects of past monetary easing by the NBS. Additional contribution to the lowering of inflationary pressures is expected to come from a drop in the prices of primary commodities, especially oil, which has been pronounced over the past days.

The Executive Board assesses that the outlook for Serbia's economic growth remains favourable, having in mind investment, primarily into tradable sectors, and favourable financing conditions which will continue to have a stimulating effect on economic growth. Growth was 6.2% y-o-y in Q4 2019, the unemployment rate was single-digit, while available indicators from the start of this year point to a continuation of positive trends in the real sector. Support to economic growth, primarily investment growth, also comes from fiscal policy, without threatening price stability, while maintaining the fiscal balance. Still, the slowdown in global economic growth, primarily in our important trade partners, could lead to a slackening of growth in Serbia. Let us reiterate, in the conditions of low inflationary pressures and pronounced global uncertainties, by trimming the key policy rate by 50 basis points the NBS is providing additional support to credit and economic growth.

The NBS keeps a close eye on developments in the international market and assesses their potential impact on the domestic economy on a daily basis. In accordance with that, we are prepared to respond timely in the coming period with all available instruments in order to minimise a potential adverse effect of the said global developments on the domestic economy.

The Executive Board emphasises that monetary and fiscal policy measures will continue to be fully coordinated, which will facilitate the preservation of the achieved macroeconomic stability and reduction of the negative effects of developments in the international environment. The NBS will continue to closely monitor global developments and assess their implications for the domestic economy and inflation and will respond timely in order to preserve the achieved price and financial stability and contribute to sustainable economic growth of the country.

The next rate-setting meeting will be held on 9 April.

### Press release from Executive Board meeting held on 9 April 2020

At its meeting today, the NBS Executive Board voted to cut the key policy rate further to 1.5%, in order to alleviate the negative effects of the coronavirus (Covid-19) on economic activity, while at the same time ensuring that inflation remains within the bounds of the target in the medium term. The Executive Board's decision on further monetary policy accommodation is based primarily on the fact that indicators from the international environment signal that the negative effects of the virus on global economic growth are stronger than expected, which has also reflected on developments in the international commodity and financial markets and the decisions of central banks and governments of countries worldwide.

The Executive Board highlights that Serbia faced this crisis in a much more favourable position, with a growth rate of over 4%, low and stable inflation for seven years in a row, eliminated fiscal imbalance and a much reduced external imbalance, and foreign exchange reserves at their highest level on record, which created space for further monetary and fiscal policy easing during the crisis period, without threatening macroeconomic stability.

In making this decision, the Executive Board also took into account the previous monetary policy measures taken to alleviate the negative effects of the spread of the coronavirus – trimming of the key policy rate by 50 basis points in March, narrowing of the corridor of its main interest rates, from ±1.25 pp to ±1 pp relative to the key policy rate, and the provision of additional liquidity to banks through repo purchase of dinar government securities and FX swap purchase operations. In addition, direct support to the private sector also came from a coordinated reaction of the Government of the Republic of Serbia and the NBS through the decision on the moratorium on loan repayment during the state of emergency for at least 90 days and the fiscal assistance package for businesses and citizens.

The Executive Board underlines that monetary and fiscal policy measures aimed at supporting economic growth are feasible in conditions of low and stable inflation, which according to the latest available data measured 1.9% y-o-y in February. Inflationary pressures are expected to remain low in the period ahead, with somewhat more prominent risks of inflation trending even below the medium-term projection from February, mainly on account of a significant drop in oil prices and lower aggregate demand as a consequence of the pandemic, which will be alleviated in part by the implemented monetary and fiscal policy measures.

The coronavirus spread has significantly deteriorated the global economic growth outlook, causing major downward revisions to growth projections for this year for leading economies and emerging markets alike. Economic contraction was caused by the aggravated and discontinued work in many service sectors, and in some cases also disruption of global value chains, and the fall in consumer and business confidence. In such conditions, uncertainty in the international financial market has increased and investors favour safe assets, causing a downspin in global stock exchange indices and a rise in the price of gold and government securities of developed countries. Dented global growth prospects reflected also on the falling global prices of primary commodities, notably oil.

To moderate the negative effects of the crisis, many central banks reacted by easing their monetary policies further. The Fed lowered the target range for the federal funds rate to near zero and announced a quantitative easing programme that has neither time nor amount limits, while the ECB, pursuing a zero interest rate policy for some time already, increased the volume of its asset purchases. At the same time, governments worldwide unleashed massive fiscal stimuli. Coordinated moves of monetary and fiscal policy should contribute to alleviating the negative impact on economic growth and to maintaining favourable terms of financing in the new situation.

The Executive Board underlines that the data on the movement of economic activity indicators and the sources of its financing in the domestic market in the first two months of the year were favourable, many even outperforming the NBS's expectations. It was in the second half of March that economic activity contracted under the impact of lower external demand, but also aggravated business conditions in many sectors. After contracting in Q2, economic activity is expected to recover in the remainder of the year, the pace of the recovery depending on the length of the pandemic. In the best collective judgement of the Executive Board, our medium-term economic growth prospects remain favourable, as the negative effects of the crisis on economic activity in the short term should be mitigated by the adopted monetary and fiscal policy measures.

The Executive Board emphasises that monetary and fiscal policy measures will continue to be fully coordinated, which will help ease potential further negative effects from the international environment and the consequences of the spread of the coronavirus. As so far, the NBS will closely monitor global developments and assess their implications for the domestic economy and inflation and will respond timely in order to preserve the achieved price and financial stability and contribute to the country's sustainable economic growth.

The next rate-setting meeting will be held on 7 May.

### Executive Board meeting held on 7 May 2020

At its meeting today, the NBS Executive Board voted to keep the key policy rate at 1.5%.

In making such decision, the Executive Board had in mind the undertaken monetary policy measures aimed at mitigating the economic fallout from the coronavirus (COVID-19), whose effects will be largely manifested with further resumption of economic activity. The Board was also guided by the fact that the direct support to the private sector, hit most by the crisis, has been ensured through timely and coordinated actions of the Serbian Government and the NBS, i.e. measures to support liquidity of the banking sector, introduction of a moratorium on loan repayment and launching a package of fiscal aid to businesses and households.

The Board emphasises that the adoption of the monetary and fiscal policy support measures was made possible in an environment of low and stable inflation which, consistent with NBS expectations, slowed to 1.3% y-o-y in March. According to the Board's estimate, inflation is likely to move around the lower bound of the target tolerance band in the remainder of the year against the backdrop of dampened aggregate demand and lower import prices, including oil prices. Inflation is likely to gradually get closer to the midpoint in the medium run, on account of the recovery of demand.

According to assessments of relevant international institutions, the spread of the coronavirus drove the global economy into recession and greatly deteriorated its growth prospects. In such conditions, uncertainty in the international financial market has increased, and investors favour safe assets, causing lower capital flows to emerging economies. Dented global growth prospects also reflected on the fall in the global prices of primary commodities, notably oil. To moderate the negative effects of the crisis, many central banks reacted by easing their monetary policies further, via conventional and unconventional measures, and governments in their countries offered robust fiscal stimulus packages. Coordinated moves of monetary and fiscal policy should contribute to alleviating the negative impact of the pandemic on economic growth, facilitating more favourable financing conditions and encouraging economic recovery in the coming period.

The economic contraction in the second half of March did not reflect significantly on Serbia's GDP growth dynamics in Q1, which, according to the Executive Board, remained high, measuring around 5% y-o-y. Against the backdrop of weaker external demand and halts or disruptions to business in some areas, the negative effects of the crisis will be most visible in the present, second quarter, but economic activity will recover in the remainder of the year, aided by the timely taken monetary and fiscal policy measures. The Executive Board underscores that, owing to a responsible economic policy, Serbia faced this crisis in a much better macroeconomic position than before, which opened the space for increasing monetary and fiscal policy expansiveness, without jeopardizing macroeconomic and financial stability.

The Executive Board stressed that full coordination of monetary and fiscal policy will be maintained, which will help mitigate potential further negative effects from the international environment. The NBS will continue to keep a close eye on global developments and their impact on the domestic economy and inflation and will respond timely in order to preserve price and financial stability and contribute to Serbia's sustainable economic growth.

At its meeting today, the Executive Board adopted the May Inflation Report. The Report and a detailed account of monetary policy decisions and underlying macroeconomic trends will be presented to the public on 13 May.

The next rate-setting meeting is scheduled for 11 June.

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