NATIONAL BANK OF SERBIA

Speech at the presentation of the *Inflation Report* – November 2021

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

We shall now present to you in more detail our new macroeconomic projections of GDP and inflation, and the expected movement of the underlying key factors from the domestic and international environment.

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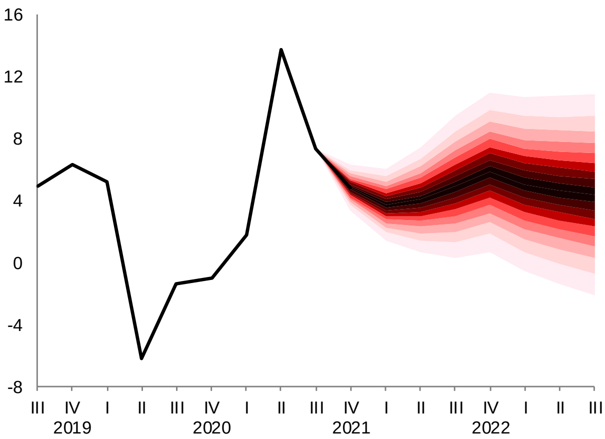
As Governor Jorgovanka Tabaković stated in her introductory address, economic activity in Serbia was more favourable than we expected in all three quarters of this year, which is why we **revised up our GDP growth projection for 2021** – from 6.5% to the range of 6.5% to 7%. Within this revised projection, we were conservative about the growth in the fourth quarter of this year, bearing in mind the current risks. In view of this, there is a possibility that GDP growth this year turns out to be higher than currently projected. In the next year and in the medium run, we expect GDP growth rates to range between 4% and 5%, i.e. we expect a model of growth driven by investment and exports, and supported by private consumption rising on real and sound foundations.

On the production side, a positive impetus to GDP growth this year is expected from all sectors, apart from agriculture, which will most probably decline by around 5% due to the drought.

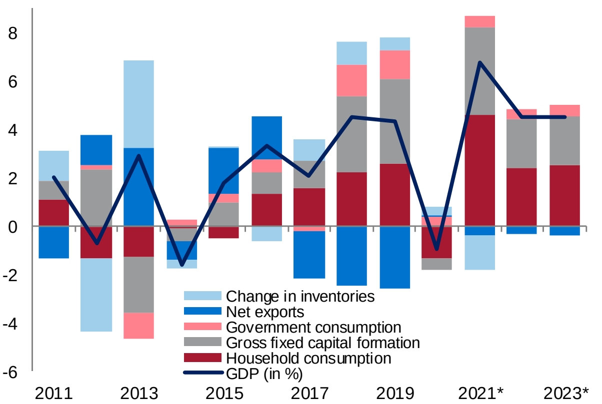
On the expenditure side, we should stress the recovery of **private consumption**, which was hit most severely by the pandemic last year. Private consumption is expected to contribute most to GDP growth this year, owing to a further increase in wages and employment, favourable lending conditions and fiscal incentives. We expect the contribution of private consumption to remain significant in the years to come, as a result of a continued increase in employment and wages in both the private and public sector. An important source of consumption will also be higher pensions and lending activity.

Chart 1 **GDP growth projection**
(y-o-y rates, in %)



Source: NBS.

Chart 2 **Contributions to real GDP growth, expenditure side**
(in pp)



Sources: SORS and NBS.
* NBS estimate.

Although **fixed investment** declined only marginally last year, we expect it to rise by around 16% in real terms this year and to give a significant contribution, of around 3.6 pp, to GDP growth this year. The rise in fixed investment is supported primarily by the preserved macroeconomic stability, favourable financing conditions and further, relatively high FDI inflows, projected at around EUR 3.4

bn this year. Under the budget revision, government investment went up further this year, to 7.8% of GDP, whereby its contribution to economic growth also increased. In the next year and in the medium run, we expect the contribution of fixed investment to economic growth to remain relatively high, in light of the announced infrastructure projects, the expected continuation of robust FDI inflows, and government capital expenditure. The share of fixed investment in GDP will thus exceed 25% in 2023 and continue to grow.

Exports are also expected to maintain positive dynamics. Investment in earlier years increased our export supply, which, along with the normalisation of global economic flows and the rebound of external demand, contributes to two-digit export growth rates.

Imports have also been picking up gradually since the second quarter – notably the imports of equipment and intermediate goods owing to the continued investment cycle, and, to a lesser degree, the imports of consumer goods thanks to the recovery of domestic demand. With this in mind, we expect the contribution of **net exports** to GDP growth to be mildly negative this year.

The risks to the GDP projection remain associated with the path of the pandemic and its impact on economic activity and inflation globally, including movements in commodity and financial markets. Overall, the risks are judged to be symmetric, with those from the international environment mildly tilted to the downside and those from the domestic environment slightly skewed to the upside.

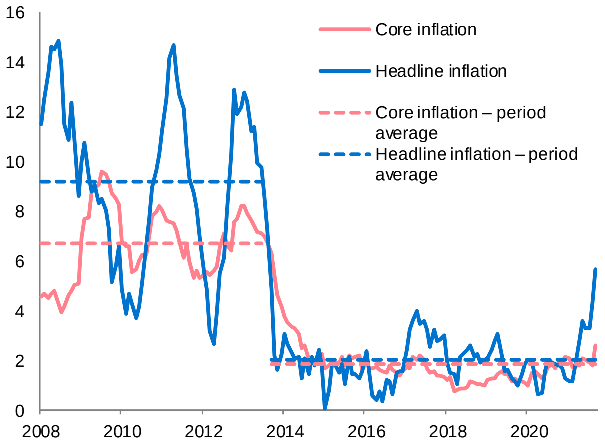
In terms of factors from the international environment, downside risks to our manufacturing and exports include, primarily, longer than expected halts in global supply chains and the continuation of the energy crisis that the world is currently facing. Consistent with the estimates of relevant international financial institutions, we assumed that bottlenecks in most production sectors will be eliminated next year, and that the natural gas price will begin to decline as of spring, though problems could last longer than expected. However, we wish to emphasise that owing to the underground storage in Banatski Dvor and the launch of the TurkStream, Serbia has improved and significantly increased the safety of natural gas supply. In addition, owing to the oil-linked contracts concluded earlier with Russia, Serbia is currently paying a much lower price of gas than the market price in the rest of Europe. Although it is estimated that starting from next year the gas price will be higher for Serbia as well, it will probably stay lower than in other countries.

Among domestic factors, we single out a potential sharper rise in fixed investment on account of FDI inflows and government capital expenditure, with fixed investment being the healthiest source of GDP growth, as it simultaneously boosts potential output.

Now let me briefly present our new **inflation projection**. At this stage of the pandemic, inflation is one of the burning topics both at home and worldwide, with the majority of central banks revising up their inflation projections.

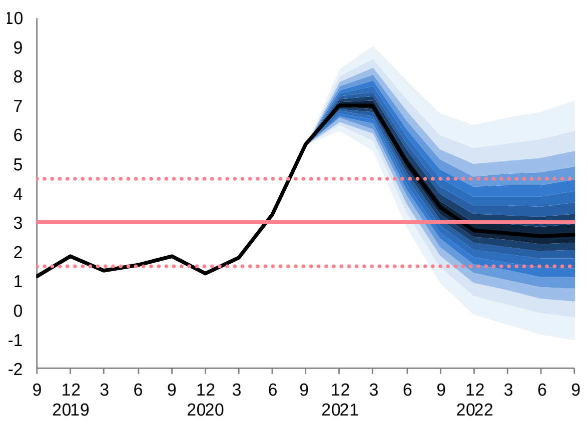
Our new inflation projection is also higher than three months ago. This is largely a consequence of food and petroleum product prices rising more than expected under the impact of developments in global commodity markets, and, in part, also the drought in Serbia, as far as food prices are concerned. This can be corroborated by the fact that the contribution of food and energy prices to y-o-y inflation in October amounted to 4.8 pp (of the total 6.6%, which was the inflation figure). To a lesser extent, the upward revision of the inflation projection also reflects a higher than expected rise in prices of non-food products and services, under the influence of higher import and producer prices.

Chart 3 **Headline and core inflation**
(y-o-y rates, in %)



Sources: SORS and NBS calculation.

Chart 4 **Inflation projection**
(y-o-y rates, in %)



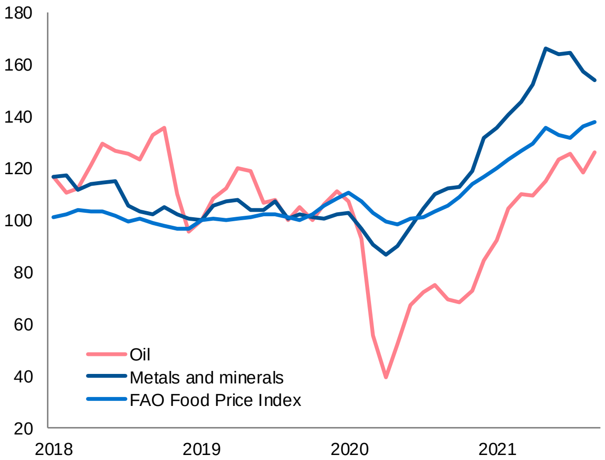
Source: NBS.

Nevertheless, the major part of the inflation increase is still judged to be temporary in nature. According to our new projection, y-o-y inflation should reach its peak by the end of 2021, or in the first quarter of 2022. As oil, fruit and vegetable price hikes drop out from the calculation, y-o-y inflation will start to decline as of the second quarter next year. In mid-2022 it is expected to return within the target tolerance band, and by the end of the year into the lower part of the band, where it will remain in 2023 as well. The inflation decline should be mainly supported by the softening of the inflationary effect of the majority of supply-side factors related to the agricultural season and the disruptions which occurred as the global economy was exiting the pandemic, as well as the assumed resolution of the energy crisis in the global market without any major consequences for the Serbian economy.

Aggregate demand is still not expected to generate any stronger inflationary pressures. The current projection of inflation and GDP is consistent with the gradual narrowing of Serbia's negative output gap, which we estimate will remain mildly negative until the end of the projection horizon. Keeping in mind this and the expected relative stability of the dinar exchange rate in the period ahead, core inflation should remain within the bounds of the target throughout the projection horizon.

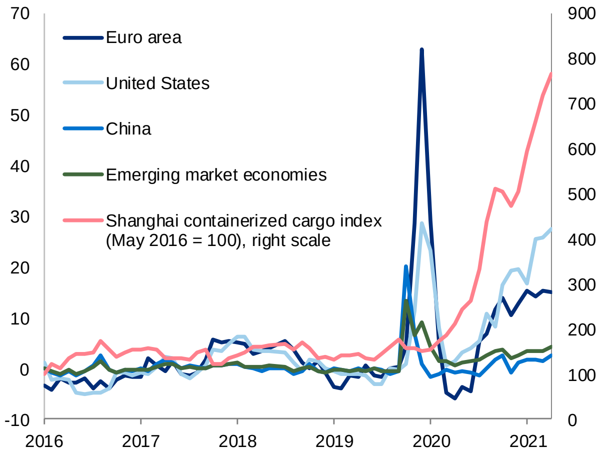
Uncertainty surrounding the inflation projection still generally stems from the international environment, and mainly concerns the speed of the global economic recovery and the length of delays in the global supply chains, movement of global prices of energy and primary agricultural commodities, as well as the normalisation of monetary policies of leading central banks. Risks to the projection are in smaller part also related to the domestic environment, primarily the next

Chart 5 **Global prices of primary commodities**
(јан 2019. = 100)



Sources: Bloomberg, World bank, UN FAO.

Chart 6 **Supply chain disruptions**
(in index points)



Source: WEO, IMF, October 2021.

agricultural season, the dynamics of domestic demand and movement of administered prices.

While there is a probability that the expected stabilisation and the gradual decline in global prices of oil and primary agricultural commodities might not take place, as we assumed in this projection based on futures and as is assumed and projected by the relevant international institutions, the increase of these prices of around 70% and 40%, respectively, which is an average to be recorded this year, could hardly repeat next year. In any case, it is almost certain that the profile of inflation will be as we just described, i.e. that it will decline as of the second quarter.

Ladies and gentlemen, dear colleagues,

To conclude today's speech, I would like to point out that the November *Inflation Report* includes five text boxes covering current topics:

1. In the first text box we explained the causes behind the current inflation rise;
2. The second text box offers the analysis as to how the normalisation of monetary policies of leading central banks could reflect on Serbia's private sector debt;
3. The third text box analyses the growth prospects of the Central and South East Europe region which gains in importance as our foreign trade partner;
4. The fourth text box is devoted to the main challenges facing monetary policies of emerging economies, including Serbia, in the period ahead;
5. In the fifth text box we assessed the role of the banking sector in the financing of economic growth and potential consequences of lawsuits concerning bank fees for financial and macroeconomic stability.