



NATIONAL BANK OF SERBIA

Governor's introductory speech at the presentation  
of the *Inflation Report – August 2016*

---

Dr Jorgovanka Tabaković, Governor

Belgrade, 17 August 2016

*Ladies and gentlemen, dear colleagues,*

Welcome to the presentation of the August *Inflation Report*. As always, we will give you an overview of monetary and macroeconomic trends for the period since the previous *Report* and set out our expectations for 2016 and 2017.

However, before we move on to this, I would like to share with you a few thoughts about a much longer period, because recently it was four years since my appointment as the Governor of the National Bank of Serbia. Together with us you were witnesses to the numerous challenges we faced, particularly from the international environment. Despite the challenges, the National Bank of Serbia has achieved admirable results – inflation is low and stable today as it has been for three years straight, which was not the case earlier. Our good results are not only due to global circumstances and low inflation abroad, because inflation in the international environment was around 2% rather long, while at the same time it was much higher and more volatile in Serbia. It was the reduction in Serbia’s internal and external imbalances and the maintaining of relative stability of the exchange rate that were instrumental to bringing inflation in Serbia to a level comparable to that of other countries. At the same time, deflation was averted. Expectations of market participants that inflation will remain low for the next two years represent another indicator of confidence in the National Bank of Serbia and the measures it implements.

Chart 1 **Consumer prices and target tolerance band**  
(y-o-y rates, in %)

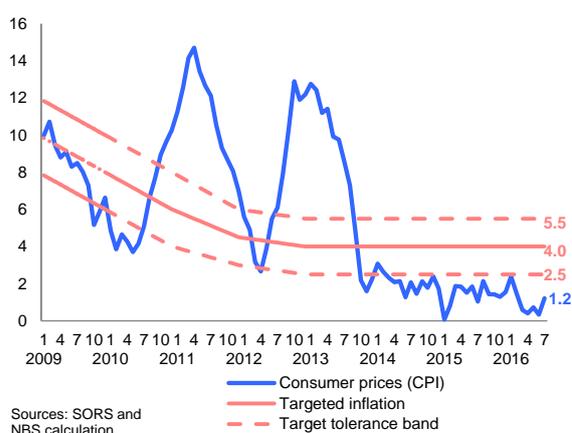
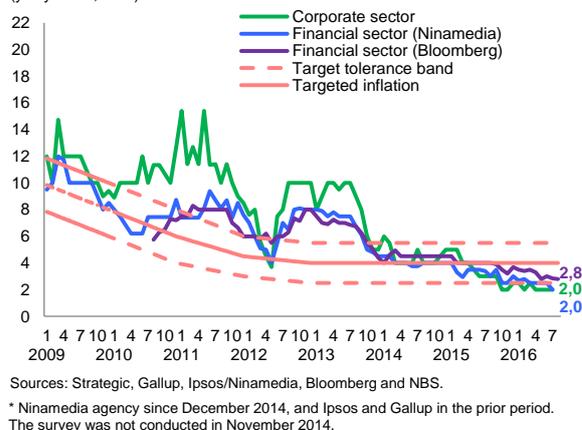


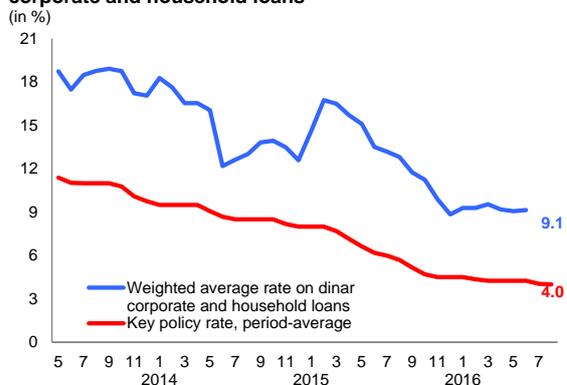
Chart 2 **One-year ahead inflation expectations\* and target tolerance band**  
(y-o-y rates, in %)



In conditions of relatively high euroisation of the financial system which has grown strong roots in Serbia and is inherited from the hyperinflation period, we all feel very strongly about the relative stability of the exchange rate. It is important to us because relative stability of the exchange rate means lower pressure on the prices of imported products and in turn on inflation at home. Moreover, it has shown to be the cornerstone of the overall financial stability and business predictability. I believe that over the past four years we have demonstrated not only the desire but also the capacity to achieve and maintain relative stability of the exchange rate, even in difficult times, when many other countries failed to do so. I use the word “capacity” because the value of the dinar was preserved owing to greater effectiveness of the National Bank of Serbia’s interventions in the foreign exchange market,

whereas overall stability was attained through full coordination of monetary and fiscal policy measures. You can judge for yourselves whether it truly is so based on the fact that over the past four years the dinar depreciated by less than 3.5%.

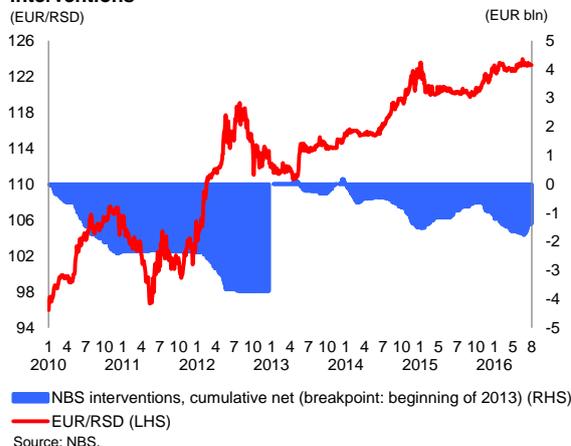
Chart 3 Key policy rate and the average rate on dinar corporate and household loans\*



Source: NBS.

\* Excluding revolving loans, current account overdrafts and credit card debt.

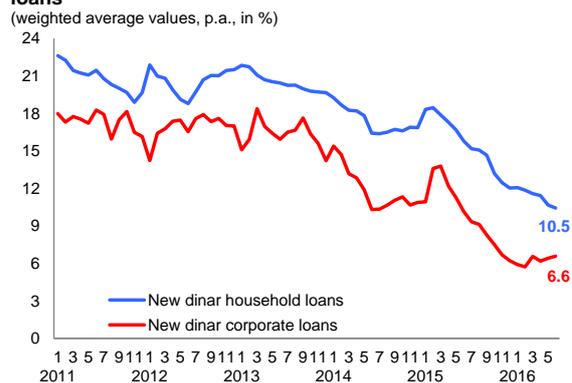
Chart 4 Movements in EUR/RSD exchange rate and NBS FX interventions



Source: NBS.

Having reduced the key policy rate from 11.75%, where it was in May 2013, to the current 4.0%, which is its lowest since the introduction of the inflation targeting regime, the National Bank of Serbia, beyond any doubt, has provided critical support to the country's economic recovery. As a result, interest rates on dinar loans to corporates and households dropped by more than 10 percentage points. We find it encouraging that the number of your questions about dinarisation is increasing because this means that you too recognise that dinarisation is gradually and unquestionably growing in the household sector. Dinar savings have risen almost threefold since end-2012, which we interpret as growth of confidence in the domestic currency, as well as in the activities of the NBS. When compared to savings in foreign currencies, savings in dinars do not measure up, but they are constantly increasing. In the first half of the year, 75% of new loans to households were denominated in dinars. We are pleased to see that the results achieved by the National Bank of Serbia – such as low inflation, relative stability of the exchange rate and halved interest rates in the dinar market – are encouraging both household saving and borrowing in dinars. Aware of how deep the roots of euroisation are, it was clear to us that the process of dinarisation would be a long one, and yet we decided to go ahead with it. It is equally important that the household sector is not the only one to record an upturn in lending – overall lending activity has been on the mend since the second half of 2015, and in June domestic lending to corporates and households recorded growth of 3.5% year-on-year.

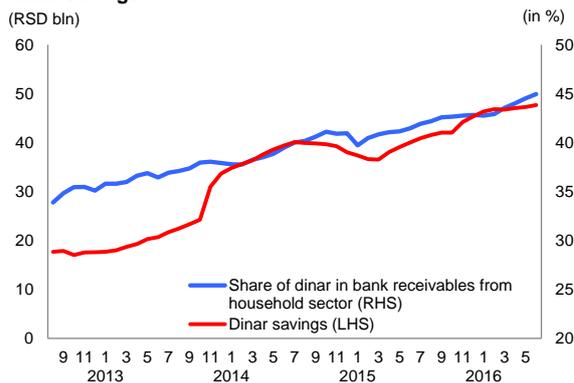
Chart 5 Interest rates on dinar corporate and household loans\*



Source: NBS.

\* Excluding revolving loans, current account overdrafts and credit card debt.

Chart 6 Dinarisation of household loans and a rise in dinar savings



Source: NBS.

I have been serving as Governor during a period marked by anything but certainties. More than that, it has been a period of unpredictable and turbulent developments. And yet, in such circumstances, we have managed to achieve and safeguard stability – both price and financial. We have recently had another opportunity to see for ourselves how important the role of a central bank is, namely when the United Kingdom voted to leave the European Union and Brexit caused havoc among investors in the global financial market. However, owing to our well-timed response, the Serbian foreign exchange market calmed down promptly and the dinar weakened by 0.1% that day. The following week, appreciation pressures on the dinar built up and our foreign currency purchases in July outstripped the sales in the entire second quarter. The result of such an approach by the National Bank of Serbia was relative stability of the exchange rate and the EUR 85 million inflow to foreign exchange reserves on account of interventions in the foreign exchange market since the start of 2015.

*Ladies and gentlemen, dear guests,*

I am hopeful that the results we have achieved undeniably attest to the National Bank of Serbia's commitment to preserving low and stable inflation and a sound financial system in the coming period, as this is the best way for a central bank to support economic recovery and further strengthening of domestic macroeconomic fundamentals.

In a few moments, my colleagues from the Directorate for Economic Research and Statistics will inform you about the details of our latest projections, but I too would like to underline that Serbia's macroeconomic outlook is even more favourable than it was when we last met in May. We expect economic growth to accelerate to 2.5% this and 3% next year. Strong improvement of fiscal prospects continued into the second quarter, driven mainly by sustainable increase in tax revenues. We estimate that budget deficit will be even lower this year, and that it will equal 2.5% of GDP. Year-on-year inflation was 1.2% in July, and according to our forecast, it will return within the target tolerance band in the first half of 2017 and remain within the band thereafter. We expect a further reduction in the current account deficit – from 4.8% in 2015 to 4.2% this year, as well as that it will be fully covered by the inflow of foreign direct investment.

Internal and external imbalances continue to narrow. Owing to full coordination of monetary and fiscal policy measures, Serbia is now much more resilient to external shocks – it boasts much stronger macroeconomic fundamentals and a high level of foreign exchange reserves. We rarely have an opportunity to repeatedly revise our economic projections upward, therefore we are particularly pleased that the past 18 months were chiefly marked by such successive upward revisions.

In the period ahead, the National Bank of Serbia will continue to closely monitor and analyse developments in the international financial and commodity markets, and make its future decisions on those grounds with the aim of preserving the stability that it has achieved.

Last but not least, having recognised the importance of communication with the public for the success of the bank's policy, we are aspiring to improve it further. As the number of central banks using social networks as a communication channel is increasing, last week the National Bank of Serbia created profiles on Twitter and Facebook. I am inviting you to join our Twitter and Facebook pages to keep abreast of our activities by following us on these networks.

Thank you for your attention.