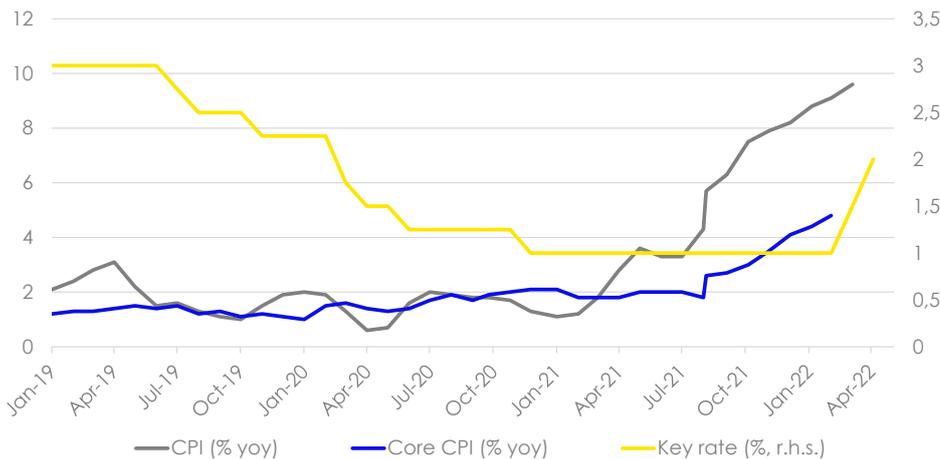


# Watch Serbia: Key rate hiked by 50bp to 2.0% to cope with the growing inflation

Although the market was not expecting the hike, the Executive Board of the NBS decided to hike the benchmark rate (+50 bp), for the second time in a row to 2.0%, while interest rates on standing facilities were also raised by 50bp (1%-3%).

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NBS, Refinitiv, RBI/Raiffeisen Research

Following April's long-awaited key rate hike (+50bp) to 1.5%, NBS decided for another 50bp increase to 2%. The decision was supported by the inflationary pressure on the global and local markets which are, according to the NBS, stronger than were initially expected, demanding more monetary policy strengthening in order to avoid second-round effects on the inflation and inflationary expectations growth. Obviously, geopolitical tensions are taking adding to the energy price challenges, as well as pulling food and raw materials prices upwards. According to the Bloomberg consensus, only six analysts (including us) expected the rate hike (out of 20 analysts).

NBS expects inflation will slow down in H2 while returning to the inflation target in H2/2023 (3% +/- 1.5pp). Obviously, primary agricultural products, energy and imported inflation will be weighing on the higher inflation for some time. On the other side, the new agricultural season will result in lower fruits and vegetable prices, that together with the insofar monetary policy restrictiveness and govt's measures (freeze in food prices until the end of June and oil price adjustments) will positively impact retail prices losing momentum in H2.

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The institution is satisfied with the fundamentals in Q1 (GDP: +4.3%) expecting the economy will underperform compared to last year (2021: 7.5%), but not materially. Still, interest rate hikes by the Fed, and ECB to follow this year, might negatively impact capital flows in the country and reflect on the GDP slowdown and exchange rate weakening.

After a slight depreciation of the dinar against the euro in March (-0.08% mom), the dinar strengthened by 0.07% mom in April as demand for foreign exchange decreased, both from energy importers (end of heating season) and households (i.e. reduced concerns about the possible consequences of the Russia-Ukraine conflict on Serbia). As a result, the need for interventions in the foreign exchange market decreased in April (EUR 155 mn), after record interventions in March (EUR 1.2 bn). We assume a calm market during the summer months and a weakening cycle to start with the beginning of the heating season and increased energy imports.

**We expect one more rate hike in June (+50bp) to 2.5% and no decision during summer on the base of the expected good agricultural season. We keep our key rate forecast at 2.5% (eop) for this year, nonetheless, will reconsider a new scenario i.e. more rate hikes from autumn due to a) more dinar weakening as the heating season starts (i.e. more energy imports causing high foreign trade deficit) and b) possibly still high inflation driven by the energy prices (i.e. uncertainty regarding the Ukraine/Russia war/negotiations) in H2.**

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