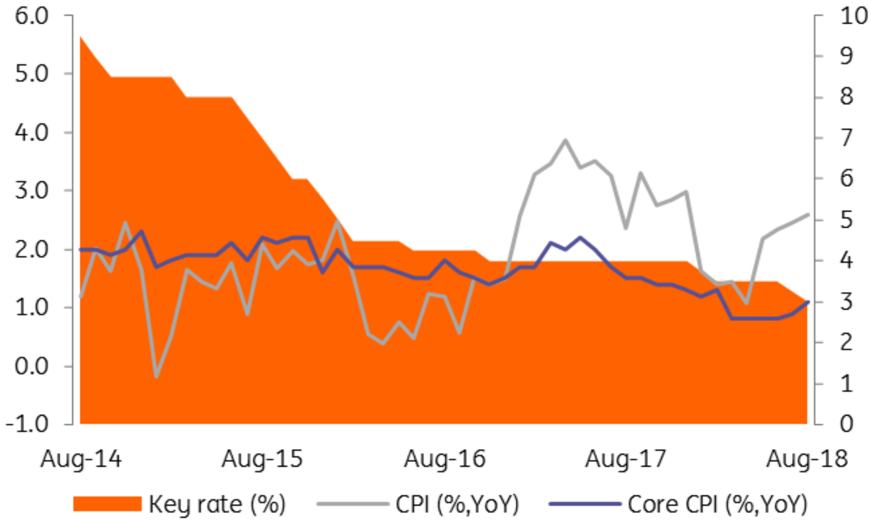
Serbia: Central bank to keep the key rate on hold at 3.00%

We expect the National Bank of Serbia (NBS) to maintain its key policy rate at 3.00% on 8 October on low inflationary pressures, but raise an eyebrow to external developments

Well behaved inflation

At 2.6% year-on-year, August 2018 inflation marked a high for the year so far and reconfirmed the NBS forecast on inflation moving towards the 3.0% target. We forecast the inflation to remain close to but below the mid-point of the 3±1.5% target interval for the remainder of the year. Core inflation is ticking slightly higher as well, at 1.1% YoY in August, but remains subdued and doesn't seem to have the potential to give any headaches to the NBS in the near future.

CORE CPI pointing to low upside pressures

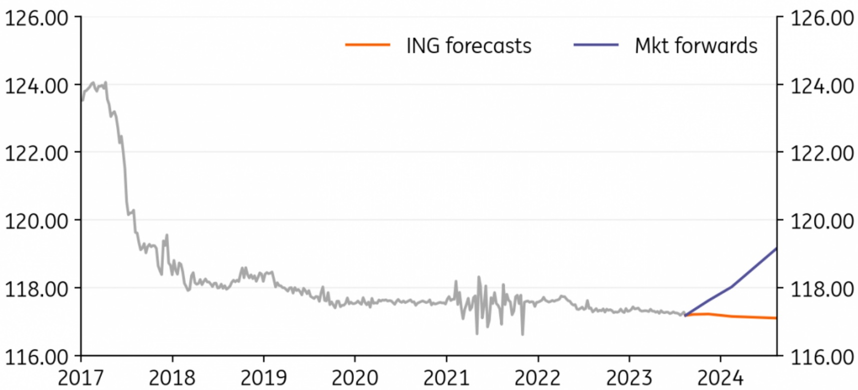


Source: NBS, ING

Speaking of headaches...

This year's dinar (RSD) fairy tale seems to be done for now as the NBS started to intervene in September to curb RSD depreciation, a first this year. We tend to see this move more in the larger context of a negative EM backdrop and less related to particular country specifics, though corporate demand for euros has been increasing along with the termination of dinar-denominated bond issuance for this year. Also, a widening trade gap and geopolitical issues still on the table are not helping; hence we could see more upside tests for EUR/RSD with the NBS ready to smooth volatility.

EUR/RSD back to life



Source: NBS, ING

The economy marches ahead

We have already raised our GDP growth forecast for 2018 to 4.5% as the Serbian economy seems to be on a robust and pretty well-balanced growth path based on investments and private consumption. The current 30-month non-financial arrangement with the IMF signed in July 2018 is progressing well, with the Fund upgrading its growth forecast for this year to 4.2% from 3.5%. As the current economic growth is not necessarily credit-driven, the NBS is likely to try to avoid premature tightening and delay hikes as much as possible.

> The external sector is expected to capture more attention from the NBS amid the increasingly negative EM backdrop, higher oil prices and the hawkish US Fed. We still expect the NBS to maintain its current policy stance for the rest of the year. A "soft tightening" however by narrowing the standing facilities corridor could be on the table towards the end of the year, followed by firmer liquidity management and eventually hike rates in-sync with the ECB.

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