

5. Prices and the Exchange Rate

Inflation trend in Q4 and January was around the lower limit of the National Bank of Serbia target band and at the end of January it to 0.1%. Underlying inflation (measured by the consumer price index excluding the prices of food, energy, alcohol and tobacco) is extremely low as well (in January, it amounted to 1.6%), and since of August, it is below the lower limit of the NBS target band. A moderate deflation was recorded during three out of four previous months (October, December and January), while November was without any change in the prices. A low domestic demand and recessionary tendencies, a decline of world oil prices, low prices of unprocessed food and the lack of growth in regulated prices gave the largest contribution to maintaining the inflation at a extremely low level, with occasional deflation. In conditions of low domestic demand, the impact of dinar depreciation to inflation is lower than in “normal” times. The return of inflation within the limits of the target band can be expected only with the active measures of the NBS, given that major changes in the prices will not occur, except for the announced increase in electricity prices, especially when one takes into account a low domestic demand, stabilization of the dinar exchange rate and the absence of overflow of so far realized depreciation to the prices. During Q4, the dinar nominally depreciated by around 1.8% against the euro (2.5 % for the period average), i.e. 6.2% against the dollar (8.7% on the average level). The depreciation continued in January, when dinar weakened by additional 2.1% (0.9% for the month average) against the euro, i.e. 9.5% (7.2% on average level) against the dollar. Exchange rate changes are mostly driven by the global factors (uncertainty in international financial markets, the reactions of the FED and ECB), while domestic factors usually affected the amplification of depreciation or mitigation of appreciation when compared to the countries in the region with a similar exchange rate regime (unfavorable news in Q4 in relation to the sustainability of public finances, the pace and intensity of fiscal consolidation and structural reforms). The approval of the arrangement with the IMF has influenced the reduction of the country risk and the consequent stabilization of the dinar exchange rate. Real depreciation of about 2.7% in Q4, softened by the appreciation of about 0.5% in January (in January, dinar nominally depreciated, but the appreciation is a result of a significantly higher deflation in Eurozone than in Serbia) contributes to improving the competitiveness of the economy, which could be sustained with the NBS measures aimed at preventing a further exchange rate appreciation and returning within the target band.

Prices

Inflation in Q4 continued its trend below the lower limit of the NBS target band, and in January was close to zero

In December, year-on-year inflation amounted to 1.8%, being below the lower limit of the tolerated deviation from the target, where it has been since of May 2014 (Table T5-1). In January 2015, the prices are almost at the same level as in January last year- year-on-year inflation was a mere 0.1%. Since August, underlying inflation (measured by the consumer price index excluding the price of food, alcohol, tobacco and energy) has been also below the lower limit of the NBS target band, and in December, it amounted to 2.2% and in January 1.6%, which suggests that low inflationary pressures are largely the result of a low aggregate demand (among other things because there was no significant overflow of the exchange rate depreciation to the prices), whose recovery is not expected in the near future. Extremely low inflation is the result of a few domestic and global (external) factors. Entering into a recession in 2014 and the expected fall of GDP in 2015, low aggregate demand, additionally reduced with the measures of fiscal consolidation (reduction in pensions and salaries in public sector), the lack of a growth in regulated prices and a weak effect of the overflow of exchange rate depreciation to the prices (rather than the expenses are partly borne by the consumers, it has completely overflowed to the manufacturers and traders through the reduction of margins) are the most important domestic factors that contribute to sustaining the inflation at a low level. A strong drop in the prices of primary agricultural products

at a world market, which caused the fall of these prices in the domestic market and contributed to a low cost pressures in food production, as well as a fall in a world oil prices, which mostly influenced the fall in the prices of petroleum products and the reduction in the cost pressures in the branches of the industry that uses these fuels are the most important external factors of the trend in domestic prices. Reduction in disinflationary pressures was not even helped by the passive attitude of the NBS towards the deflation in the past several months (slow and insufficient mitigation of the monetary policy restrictiveness), which focused its measures exclusively towards the dinar exchange rate stabilization. Price trend in Q4 was at the expected level, taking into account the absence of adjustments in regulated prices and the reduction of the key policy rate (KPR) by the NBS, and the deflation realized was 0.6%. January was marked by the further deflation of about 0.2%, so now both total and underlying inflation are at a record low level, the lowest since the inflation has been measured by the consumer price index (Graph T5-2). Next to the factors with a long-term impact, deflation was also contributed by one-off factors- low year-on-year growth in the regulated prices (a drop in these prices was recorded in Q4) and a low growth in the prices of primary products in the country and world market. As previously estimated, aggregate demand in the following period will have additional increased disinflationary effect due to the effect of the implementation of the fiscal consolidation measures- reduction in pensions and salaries in public sector, as well as possible implementation of structural reform measures.

Reduced and stable inflation favorably affect the business conditions, but the inflation level is too low

Table T5-1. Serbia: Consumer Price Index, 2009-2015

	Consumer price index				
	Base index (avg. 2006 =100)	Y-o-y growth	Cumulative index	Monthly growth	3m moving average, annualized
2009					
dec	130.8	6.6	6.6	-0.3	1.6
2010					
dec	144.2	10.2	10.2	0.3	11.7
2011					
dec	154.3	7.0	7.0	-0.7	2.5
2012					
mar	157.4	3.4	2.0	1.1	8.4
jun	162.4	5.4	5.3	1.2	13.2
sep	169.1	10.3	9.6	2.3	17.7
dec	173.1	12.2	12.2	-0.4	9.9
2013					
mar	175.1	11.2	1.2	0.0	4.7
jun	178.2	9.7	2.9	1.0	7.3
sep	177.3	4.8	2.4	0.0	-2.0
dec	176.9	2.2	2.2	0.2	-0.9
2014					
jan	179.5	3.1	1.5	1.5	4.4
feb	179.7	2.6	1.6	0.1	7.5
mar	179.1	2.3	1.2	-0.3	5.1
apr	180.1	2.0	1.8	0.6	1.4
may	180.2	2.1	1.9	0.1	1.1
jun	180.4	1.2	2.0	0.1	2.9
jul	180.2	2.0	1.9	-0.1	0.2
aug	179.9	1.5	1.7	-0.2	-0.7
sep	181.2	2.1	2.4	0.7	1.6
oct	180.8	1.8	2.2	-0.2	1.3
nov	180.8	2.4	2.2	0.0	2.0
dec	180.0	1.8	1.8	-0.4	-2.4
2015					
jan	179.6	0.1	-0.2	-0.2	-2.6

* Three-month moving average of a price growth rose to an annual level. (For example, the March value is obtained by raising the average monthly price growth in January, February and March to an annual level). Source: SORS.

Low and stable inflation is one of the important elements of a good business environment because it is a good way to increase the predictability of business conditions and reduce business risks. Since the late 2013 Serbia has been realizing low inflation, while its variability has been moderate. However, zero inflation and occasional deflation, which Serbia has often been faced with since the end of the first quarter of 2014, has a negative effect on economic activity. The realization of inflation of about 4% per year is important also from the standpoint of fiscal consolidation, as additional savings based on real devaluation of salaries and pensions are accounted within it. It is therefore necessary that NBS more decisively reduces the monetary policy restrictiveness so that the inflation could return to the target band and stabilize within it.

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In the past three months, the NBS has kept its key policy rate unchanged

Although through Q3 and Q4 inflation moved below the lower limit of tolerated deviation from the target band, the key policy rate of NBS was in this period reduced only in November by 50 base points- from 8.5% to 8.0%, where it currently stands (Graph T5-3). The attitude of the NBS's Executive Board is that the reasons for a slow and cautious reduction of KPR are- achieving permanent stabilization of the inflation at a low level, as well as the existence of the risk in under circumstances of uncertain movement in international environment: dynamics of the economic recovery of the world economy, the effects of divergent monetary policies of the Fed and ECB, the trend of oil prices at the world market and the presence of geopolitical tensions. However, the instability in the foreign exchange market largely influenced the decisions of NBS on the reduction of KPR, and this was the main reason for very slow relaxation of monetary policy. We estimate that the space for depreciation exists until it doesn't threaten the inflation movement, for which there are no signs now, nor there were signs in the previous two quarters. Although domestic risks (relatively high fiscal and foreign-trade deficit, high level of public debt and high percent of bad loans which would increase in the case of stronger depreciation) limit the scope for more significant growth of monetary policy expansiveness, it is estimated that NBS should gradually increase the monetary policy expansiveness at the cost of the acceptance of moderate risks. It is possible that even greater easing of monetary policy would not have significant effect on inflation movement in conditions of low aggregate demand, but it would be an adequate answer upon economy's entering the recession, given that the GDP growth is expected only from 2016. Slightly higher inflation would in particular contribute to easing the growth of unemployment rate, which inevitably occurs when the economy enters the recession, and would as well boost the effects of fiscal adjustment measures. The NBS policy rate is high even in comparison to other countries in the region that also apply the flexible exchange rate regime, and whose inflation rates and exchange rate changes were comparable in the previous period (with the exception of Turkey, see Graph T5-7). The equivalents of the NBS key policy rate in these countries at the end of February (and their y-o-y inflation rates in January) are: the Czech Republic 0.05% (inflation -0.1%), Croatia 5% (inflation -0.6%), Poland 2% (inflation -1.0%), Romania 2.25% (inflation 0.5%), Hungary 2.1% (inflation -1.4%) and Turkey 7.5% (inflation 7.2%). Approximate value of the KPR in Serbia is only in Turkey, whose central bank nevertheless applies a lower rate of NBS although, unlike Serbia, Turkey's inflation is relatively high.

Reducing the rate of required reserves and changes in its structure stabilize the exchange rate and strengthen the disinflationary pressures

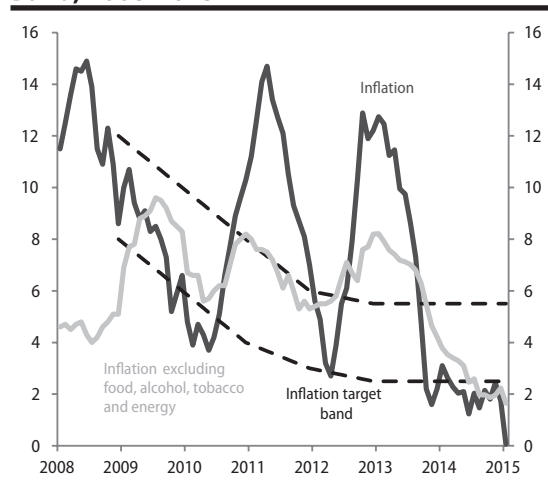
By using the unconventional monetary policy measures-reducing the required reserves rate and increasing the rate of allocation of its dinar portion by twice the percentage, the NBS indirectly increases the supply of foreign currency and reduces the supply of dinars. Ending a subsidized loan programs, thanks to which the credit activity continued to grow in Q4 (but slower than in Q3), will cause the slowdown in credit activity in 2015, forcing the NBS to reduce the required reserves rates repeatedly, but at the same time to increase the rate of allocation of required reserves in dinars. This measure of NBS is also directed toward alleviating depreciation and consequent easing of inflationary pressures. During Q4 the rate of foreign currency required reserves was reduced by 2 p.p. (a reduction from 29% to 27% to the portion of the foreign currency base with maturity up to two years and a reduction from 22% to 20% to the portion of base with maturity over two years). At the same time, the structure of foreign currency required reserves is changed- the foreign currency required reserves rate that is allocated in dinars by 4 p.p. (from 32% and 24% to 36% and 28% depending of maturity). In January, these rates were further reduced by 1 p. p. (foreign currency required reserves rate), i.e. increased by 2 p.p. (required reserves rate in dinars).

Divergent monetary policy: the contraction of the monetary policy of the FED and ECB expansion

The announced implementation of a more restrictive monetary policy of the Fed (Federal Reserve System of the United States) and the implementation of monetary expansion measures of the European Central Bank (ECB), as well as the decision of the Swiss Central Bank to abolish the minimum franc rate against the euro, contribute to increasing uncertainty in international financial market. Positive developments in the real sector of the United States (the strong growth of economic activity and the recovery of the labor market) indicated the completion of the program of Fed's quantitative easing and the increase of the reference rate is announced in 2015, although it is not known to what extent and when it will start. On the other hand, ECB has

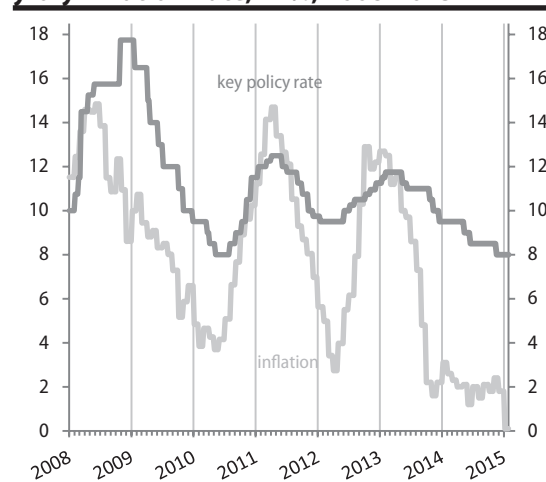
decided, due to the intensified deflationary pressures in the EU and slow economic activity (a recovery of the euro zone is more moderate and does not overflow into the job market, while in Central and Eastern Europe economic activity is slowing down), to implement the unconventional measures of the expansionary monetary policy. Following the purchase of private securities, ECB decided to purchase government securities of the Eurozone countries (measures similar to quantitative easing of the Fed). Starting from March this year up to September 2016, over 1,100 billion euros will be injected, to which financial markets reacted by reducing the yield on government securities in all member states of the eurozone except Greece. A different character of ECB and Fed's and monetary policy will most possibly contribute to a further weakening of the euro, which has made Swiss central bank, after more than three years, to abolish the minimum franc exchange rate against the euro of 1.2 francs per euro. This particularly had a negative impact on the credit market of certain countries of Central and Eastern Europe in which the part of credit portfolio is denominated in Swiss francs. This reflected to Serbia as well, where loans in CHF represent about 3% of GDP, which is however significantly lower than in some other countries (eg. in Poland and Croatia, where it amounts to about 8% and 7% of GDP).

Chart T5-2. Serbia: Y-o-y Inflation Rate and Underlying Inflation and the NBS Target Band, 2008-2015



Source: NBS and QM

Chart T5-3. Serbia: NBS Key Policy Rate and y-o-y Inflation Rate, in %, 2008-2015



Source: NBS

Deflation in Q4 and in January 2015

Deflation is achieved in Q4 and it amounted to 0.6% (Table T5-4), i.e. by months: in October, 0.2%, 0.0% in November and in December 0.4%, while in January deflation was 0.2%. A highest negative contribution to inflation came from the lower prices of unprocessed food, petroleum products and cigarettes, while the largest positive contribution came from the growth in the prices of pharmaceutical products and car prices, as well as a modest rise in the price of processed food. Prices of food and non-alcoholic beverages recorded a fall of 1.4% in Q4, where the prices of unprocessed food had a largest contribution (a drop of 4% is largely of seasonal character- the prices of fruit and fresh meat dropped, while the prices of vegetables and eggs increased). Prices of processed food increased slightly (2% growth- rise in the prices of milk and dairy products is neutralized by the fall in the prices of edible oil and sugar). A rise in the prices of pharmaceutical products (1.1% growth) contributed to the inflation by 0.05%, while the rise in the price of cars of 2.8% (which is a direct consequence of dinar exchange rate depreciation, given that these prices are, as a rule, stated in euros) contributed by 0.06%. The prices of cigarettes dropped by about 8% (contribution of 0.36%) due to fall in turnover on the market and higher competition among manufacturers, who are trying to maintain the position in the declining market, as well as the possible dumping by some manufacturers. The prices of petroleum products decreased by 8.2% (contribution by -0.4pp) due to a significant fall in the world oil prices (the effect of a drop in the prices of petroleum in the world market is partly neutralized by dinar depreciation against the dollar). The prices of Ural type petroleum, which Petroleum industry of Serbia processes at its refineries, dropped during Q4 from 93 dollars per barrel to about 56 \$/barrel, while in this

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same period the dinar exchange rate against the dollar increased from 93.6 to 99.5 dinars per dollar. Petroleum prices continued to decrease in January as well, when (at the end of the month) it amounted to about 45 dollars per barrel, while in the same month dinar weakened against the dollar to about 109 dinars per dollar. In late February the price of petroleum increased to 59 \$/barrel, while dinar strengthened slightly against the dollar (to 107.3 dinars per dollar). Given that the petroleum prices in late February and early March stabilized, while the dinar exchange rate against the dollar slightly depreciated, the effect of the growth in the petroleum prices on the prices of petroleum products can be expected in February and March this year. Prices of services increased by 1.6%, mostly as the result of an increase in the travel arrangements and mobile telephony services. Import prices denominated in dinars declined by 4.2%, which is almost entirely the result of lower petroleum prices. World food prices which continued to fall in Q4 had a disinflationary effect, while import prices of production material stagnated. Deflation was recorded in January, when the drop in the prices amounted to 0.2% (in the last 12 months, deflation was realized during six months). A positive contribution to January inflation was given by the growth in the prices of food (growth of 0.64%, contribution of 0.2%) and the growth in the central heating price (growth of 2.4%, contribution of 0.03%), while a drop in the petroleum product prices (drop of 4.9%, contribution -0.24%) and a drop in pharmaceutical product prices (a decrease of 2.6%, contribution of -0.1%) had a negative contribution.

Table T5-4. Serbia: Consumer Price Index: Contribution to Growth by selected Components

	Share in CPI (in %)	price increase in Q4 2014	Contribution to overall CPI increase (in p.p.)	Share in CPI (in %)	Price increase in January 2015	Contribution to overall CPI increase (in p.p.)
Total	100.0	-0.6	-0.6	100.0	-0.22	-0.22
Food and non-alcoholic beverages	35.0	-1.4	-0.5	32.8	0.54	0.19
Food	31.3	-1.5	-0.5	29.2	0.64	0.20
Alcoholic beverages and tobacco	7.7	-5.0	-0.4	7.4	0.13	0.01
Tobacco	4.5	-8.0	-0.4	4.7	0.00	0.00
Clothing and footwear	4.6	0.7	0.0	4.5	-0.75	-0.03
Housing, water, electricity and other fuels	12.9	1.5	0.2	13.6	0.36	0.05
Electricity	5.0	0.0	0.0	4.8	0.00	0.00
Furniture, household equipment, routine maintenance	3.9	0.0	0.0	4.6	0.52	0.02
Health	6.2	0.9	0.1	5.0	-1.59	-0.10
Transport	12.4	-2.4	-0.3	12.9	-1.99	-0.25
Oil products	4.9	-8.2	-0.4	5.8	-4.89	-0.24
Communications	5.1	2.1	0.1	5.0	-0.23	-0.01
Other items	12.2		0.2	14.3		-0.1

Source: NBS and QM

**Total and underlying
inflation are low**

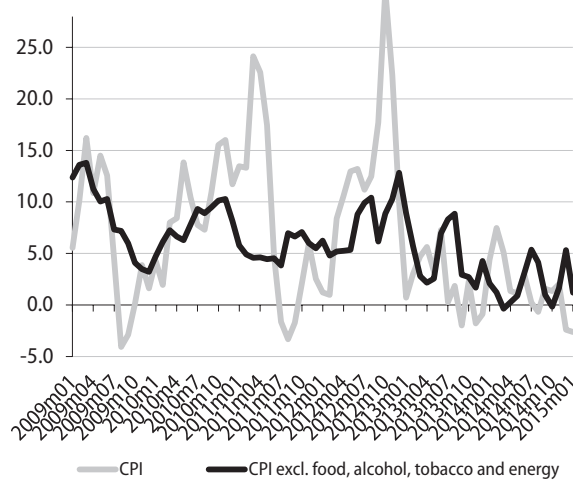
Underlying inflation (inflation excluding food, alcohol, tobacco and energy) during Q4 and in January 2015 is on a stable low level, as well as during the whole of 2014. A slight increase recorded in July and December (Graph T5-5) was caused by the changes in the prices of one-off character, i.e. by dinar weakening. In June, there was a rise in the prices of insurance and prices of the group "recreation and culture", whose effect disappeared and underlying inflation swiftly returned within the stable low frames. However, in December, the main reason for the underlying inflation leap (next to the release of September negative underlying inflation from the annualized 3m average account shown in the graph) was the rise in the prices of cars and telephone equipment, which largely depend on the dinar exchange rate, as these are imported goods. The growth of these prices continued in January, when dinar continued to weaken further, thus the future pace of underlying inflation dynamics will depend largely on the dinar exchange rate. But since the exchange rate stabilized in February, a higher and more lasting changes in underlying inflation are not expected in the coming months, especially if one bears in mind the trend of further weakening in aggregate demand. Total inflation was at a moderate low level

during first two months of Q4, due to an account of a high September inflation in annualized 3m period. However, when the September inflation came out from the account, December and January recorded relatively high deflation (2.4% and 2.6% when annualized). Regulated prices in Q4 continued to decrease (1.4% drop) primarily on the basis of the lower cigarette prices, which was partially compensated by the ncrease in the prices of natural gas and utilities. Year-on-year growth of the regulated prices in December amounted to 1.1%, which is unusually low, given that in the previous years it amounted to about 10%. In the forthcoming period, we expect the rise in the prices of electricity of 15% since of April 2015, which will directly affect the inflation growth by about 0.7pp.

The return of inflation within the target band will depend on the increase of electricity prices, but also on the NBS assessment

As NBS has directed its decisions on the conduct of monetary policy towards the exchange rate stabilization since the second half of the year 2014, the inflation will return within the target band only if NBS takes an active role in its movement in the coming period. NBS’s central projection of inflation trends is such that in the mid-year inflation should return within the tolerance band and by the end of the year move within that range. However, only the announced electricity price growth of 15% (contribution to inflation of about 0.7%) will significantly contribute to its growth, while the effect of electricity price overflow to other prices will be absent to a large extent and will not give any important contribution to inflation. Relatively modest growth of world oil price during February and stabilization during March wwill not affect inflation greatly, but it is uncertain how the oil price will move in the future. In the first half of the year only seasonal growth of primary agricultural products will act inflationary, but also not to a large extent. Dinar weakening was stooped in early February, since when dinar has started to slightly strengthen, thus the effect of overflow of exchange rate depreciation to the prices cannot be expected (which didn’t even occure in January when dinar, observed at the end of the month, weakened by 2.1% against the euro), given that the exchange rate by the end of March returned to the December level. Low aggregate demand (increased by the measures of fiscal adjustment) and low inflation in international environment, despite the expansionary monetary policies of central banks, will remain the main disinflationary factors in the long term. The inflation trend in the future will be affected by the NBS decisions on the further easing of monetary policy, which is, as noted above, more restrictive than it should be under the current circumstances in Serbia, as well as in comparison to the countries in the region. As after the approval of the arrangement of Serbia with the IMF country risks reduced, making the stabilization of the dinar exchange rate more probable in the future, there is a good chance that the additional space for the easing of NBS monetary policy and consistent implementation of the inflation targeting policy will open. Also, not even a long period of the inflation movement below the target represents something that NBS could passively watch, given that the main task of most central banks, including the NBS, is achieving and maintaining the price stability; central bank itself determines the limits of inflation movement, but it also must implement measures to ensure the inflation is moving within these limits.

Chart T5-5. Serbia: CPI and Underlying Inflation Trend, Annualized Rates, in %, 2009-2015



Source: NBS and QM

The exchange rate

Depreciation in Q4 and in January

During Q4, dinar weakened against the euro by 1.8%, i.e. 2.5% for the average period. At the late Q4, dinar weakened against the dollar by 6.2%, i.e. 8.7% at the quarter average (a large part of the depreciation is a result of the weakening of the euro against the dollar). Significantly stronger depreciation continued in January (Graph T5-6), when dinar weakened by an additional 2.1% against the euro, i.e. or 9.5% against the dollar (data for the end of January compared to the end of December), i.e. by 0.9% against the euro and 7.2% against the dollar (observed at the month average). The end of depreciation pressures that started at the beginning of Q3 (when the dinar exchange rate was 115.7 dinars per euro) occurred in the early February (when the dinar exchange rate reached over 123 dinars per euro), and nominal exchange rate appreciation has started since then, and is currently standing at the value of about 121 dinars per euro. The National Bank of Serbia intervened with net sales of 765 million euros during Q4, sales of 90 million euros in January, while in February it intervened with net purchase of 140 million euros. We consider that it is good that NBS didn't succumb to the temptation to allow the dinar strengthening, influenced by the factors in foreign exchange market. Dinar strengthening is not in accordance with the competitiveness of the Serbian economy, thus it would be only temporary, which means that dinar strengthening would be followed by its sudden fall. In highly euroized Serbian economy preventing sudden dinar fluctuations is one of the most important conditions for the stabilization of inflation. It is therefore estimated that a moderate inflation is the acceptable compromise between the needs to improve the price competitiveness with the exchange rate and the needs to prevent high exchange rate fluctuations.

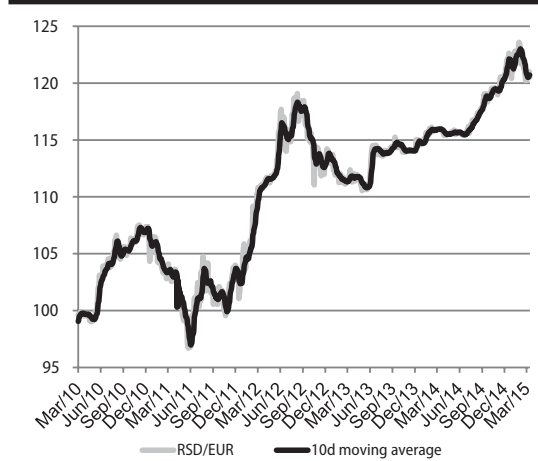
Box 1. Problem solution for the citizens indebted in Swiss francs

After Swiss Central Bank decided to abolish the minimum franc exchange rate against the euro, a strong depreciation of the dinar exchange rate against the Swiss franc occurred in January (about 12% for the month average), which jeopardized the repayment of mortgage loans denominated in this currency. On that occasion, the NBS did not react hastily, despite the pressures of the debtors, by shifting the burden to taxpayers, but at the end of February, they made the decision on the possibilities to convert the loans in Swiss francs to euro, the reduction of interest rate and the possibilities to extend the period of loan repayment.

Although we generally assess the NBS solution as good, we still believe that it could be more flexible in terms of the interest rate level. The flexibility is particularly justified as the mortgage loans are related to the period of 20 years and more, during which time the interest rates in international market can significantly fluctuate in an unpredictable manner. Therefore, we estimate that it would be better that instead the requirement to limit the interest rate on Swiss francs to 3% a year, which are currently high interest rates, but in the future they may be low, a more adequate solution would be to determine interest rates as the sum of LIBOR (by which a future changes in the interest rate market would be taken into account) and fixed margin of 2% for example.

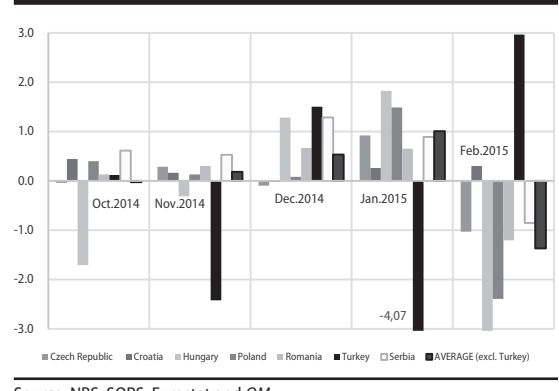
Global factors again had the greatest impact on the dinar exchange rate movement, while domestic factors reinforced depreciation pressures during Q4 (unfavorable news on the sustainability of public finances, the pace and intensity of fiscal consolidation and structural reforms), only to influence the reduction of country risk, exchange rate stabilization and dinar strengthening in early 2015, and especially upon the approval of the arrangement with the IMF. Global factors influencing the dinar exchange rate movement had a similar effect on the currencies of the countries in the region with a similar exchange rate regime (Graph-T5-7), although Serbia recorded somewhat higher depreciation (i.e. lower appreciation) than average.

Chart T5-6. Serbia: Daily RSD/EUR Exchange Rate, 2010-2015



Source: NBS

Chart T5-7. Nominal exchange rate depreciation (in %) in Period of October 2014-January 2015 in Chosen Central and Eastern European Countries

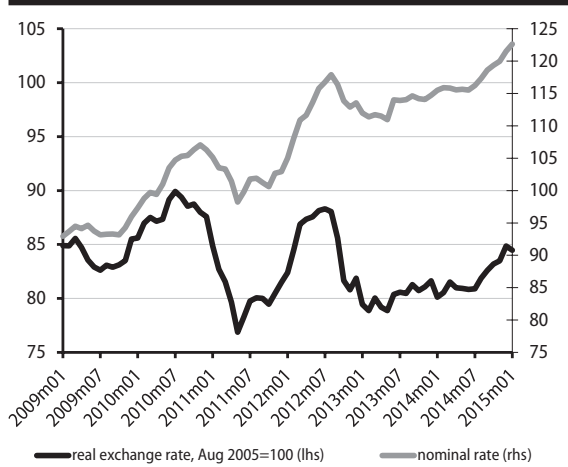


Source: NBS, SORS, Eurostat and QM

Real depreciation in Q4 and real appreciations in January

Q4 saw a real dinar depreciation of about 2.7% and January had appreciation of about 0.5%. Total real dinar depreciation during 2014 amounted to about 4.0% and was the result of nominal dinar exchange rate depreciation, partly compensated with the difference in inflation in Serbia and Eurozone (although inflation in Serbia during 2014 amounted to relatively modest 1.8%, eurozone realized deflation of about 0.2%). Although dinar depreciated in January by about 0.9% (at a month average) and deflation of 0.2% was realized, deflation in the Eurozone was high

Chart T5-8. Serbia: Nominal and Real RSD/EUR Exchange Rate, Monthly Averages, 2009-2015



Source: NBS, SORS, Eurostat and QM

enough (consumer price index fell by 1.5%) to turn the nominal dinar depreciation into a real appreciation. The real exchange rate was relatively stable from 2013 up until the second half of 2014 (Graph T5-6), but in early Q3, a moderate real depreciation period started, which reached its peak at the end of the year. It would be desirable that this moderate real depreciation doesn't annul itself, because with it, so far reached improved economy competitiveness would be lost (eg. Instead of buying Euros in interbank foreign exchange market, key policy rate should be decreased, which would influence the return of inflation within the target band and the prevention of the exchange rate appreciation).