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MONETARY POLICIES OF CENTRAL BANKS IN THE COMING PERIOD

Monetarne politike centralnih banaka
u narednom periodu

Abstract

Contemporary economic landscape is characterised, among other things, by significant structural changes, increasing rigidity in production and logistics systems, and developments that go beyond traditional cycles of economic fluctuations. Nowadays, the sources of shocks are far more complex – ranging from geopolitics and supply chain disruptions, through energy crises, to technological, climate and environmental risks. Both the sources and the perception of risk are rapidly changing because of disrupted global supply chains and the inflationary pressures they generate, as well as rising geopolitical tensions that are reshaping the patterns of world trade and redefining the global strategic landscape. The altered combination of systemic and idiosyncratic shocks makes it more difficult to distinguish between temporary and permanent changes, as well as to determine appropriate responses to them. With regard to inflation, in recent times inflationary pressures increasingly arise suddenly and originate from the supply side. In addition to traditional factors such as excessive aggregate demand and a tight labour market, the matrix of inflation drivers is further intensified by supply chain bottlenecks and volatile energy prices. Monetary policy is no longer confronted solely with cyclical shocks, but also with deep, often unexpected structural disruptions. Today, when the global economy is entering a period of intensive transformation, preserving price and financial stability also entails enhancing analytical frameworks through the development of multiple scenarios and the integration of economic, climate and technological risks. A well-timed and appropriate response to economic, technological and geopolitical shocks, as well as to ongoing structural changes, requires central banks to carefully combine interest rate policy with other monetary policy instruments and to complement them with prudential and unconventional measures. The practice of the National Bank of Serbia can serve as an example of how appropriate monetary policy by applying a flexible and comprehensive approach helps a small and open economy achieve strong results in a challenging global environment.

Keywords: *monetary policy, inflation, global uncertainty, supplementary and unconventional monetary policy instruments*

Sažetak

Savremeno ekonomsko okruženje, između ostalog, karakterišu značajne strukturne promene, rastuća rigidnost u proizvodnim i logističkim sistemima i kretanja koja prevazilaze tradicionalne cikluse ekonomskih fluktuacija. Danas su izvori šokova daleko kompleksniji – od geopolitike i poremećaja u lancima snabdevanja, preko energetske krize, do tehnoloških, klimatskih i ekoloških rizika. Narušeni globalni lanci snabdevanja i inflatorni pritisci njima generisani, kao i rastuće geopolitičke tenzije koje preoblikuju obrasce svetske trgovine i dovode do redefinisavanja strateške slike sveta, ubrzano menjaju i izvore i percepciju rizika. Izmenjena kombinacija sistemskih i specifičnih šokova otežava razlikovanje privremenih i trajnih promena, i načine odgovora na njih. U pogledu inflacije, savremeni inflatorni pritisci sve češće nastaju iznenada i dolaze sa strane ponude. Sa tradicionalnih faktora poput prekomerne agregatne tražnje i zategnutog tržišta rada, matricu faktora inflacije pojačavaju i zastoji u lancima snabdevanja i volatilne cene energenata. Monetarna politika se više ne suočava samo sa cikličnim šokovima, već i sa dubokim, često neočekivanim strukturnim poremećajima. Danas kada globalna ekonomija ulazi u period intenzivne transformacije, očuvanje cenovne i finansijske stabilnosti podrazumeva i unapređenje analitičkih okvira razradom različitih scenarija i integracijom ekonomskih, klimatskih i tehnoloških rizika. Pravovremen i adekvatan odgovor na ekonomske, tehnološke i geopolitičke šokove i strukturne promene koje se dešavaju, od centralnih banaka zahteva oprezno kombinovanje kamatnih stopa sa ostalim instrumentima monetarne politike, i njihovu dopunu prudencijalnim i nekonvencionalnim merama. Praksa Narodne banke Srbije može da posluži kao primer kako adekvatna monetarna politika doprinosi maloj i otvorenoj ekonomiji u postizanju dobrih rezultata primenom fleksibilnog i sveobuhvatnog pristupa u izazovnom globalnom okruženju.

Ključne reči: *monetarna politika, inflacija, globalna neizvesnost, dopunski i nekonvencionalni instrumenti monetarne politike*

Introduction

The question of what central banks' monetary policies will look like is a recurring theme in contemporary macroeconomics. Given that the interest rate is one of the key factors shaping consumption and investment decisions – thereby affecting inflation and overall economic activity – interest in the future character of monetary policy is to be expected. This is particularly true in circumstances where information spreads simultaneously across all markets, and when even announcements of changes, or expectations of changes, in interest rates can have an effect almost equal to that of the decision itself. In modern terms, markets “price in” such decisions in advance.

Nevertheless, providing an answer to the question “what lies ahead” has never been more complex than it is today. Prior to the pandemic, a clear tendency had been established among central banks to increase the transparency of their activities through a well-defined communication strategy, which included the use of so-called forward guidance and the publication of projected paths of key macroeconomic parameters as part of the standard toolkit for directing market expectations [29, pp. 53-55].

However, in recent years the structure of uncertainty has changed significantly. The world is facing a range of profound risks – from geopolitical tensions and the fragmentation of international markets, through climate and environmental challenges, to the uncertain effects of the accelerated development of artificial intelligence. Under such conditions, monetary policy is no longer confronted solely with cyclical shocks, but also with deep, often unexpected structural disruptions. The pandemic marked a turning point – after a protracted period of low inflation and low interest rates (in some cases even negative), a series of interconnected shocks triggered a sharp rise in global inflation and a rapid shift toward monetary tightening. Given the nature of the shocks and disruptions, no model could have predicted such a development of global events and their consequences.

The aim of this paper is to analyse contemporary monetary policy mechanisms in the context of rapidly unfolding global changes, as well as shocks that are increasingly interconnected and whose effects reinforce

one another. In such an environment, the function of maintaining price stability also entails the development of additional tools that provide rapid assessment of the effects of shocks from the international environment – from geopolitical and energy crises to the consequences of climate change and technological innovations in various segments of the financial and commodity markets. A part of these tools includes scenario-based projections, as well as innovative risk assessment instruments, which complement the toolkit for managing inflation expectations and preserving the credibility of monetary policy.

The future of monetary policy requires an integrated approach that combines flexibility in response with a long-term strategic vision. In this way, central banks remain one of the pillars of stability in the modern global economy, while becoming adaptive actors capable of addressing the increasingly complex challenges in today's world.

Monetary Policy amid Pronounced Global Uncertainty

If we summarise the developments in the economic sphere over the past half-decade, one general conclusion is that we are witnessing fundamental changes in the nature and frequency of economic shocks, which are so pronounced that they make the international economic system significantly more unpredictable than before. If we ever had the illusion that the world behaved like our economic models, now is the time to say goodbye to that illusion [25, p. 1].

The processes of fragmentation, regionalisation, and, more generally, the reduced dependence on individual markets further complicate the international economic framework and create uncertainty regarding the future architecture of the global economy. In addition, climate and environmental crises bring structural challenges that go beyond conventional economic categories, while digitalisation and fast technological advancement bring innovations and productivity growth but also introduce new risks. It is precisely the structural changes in the global economy and the increasing rigidity in production and logistics systems that generate developments that go beyond the traditional cycles of economic fluctuations.

At the same time, disrupted global supply chains and the inflationary pressures they generate, along with rising geopolitical tensions that are reshaping the patterns of world trade and redefining the global strategic landscape, are rapidly changing both the sources and the perception of risk.

In previous decades, central banks primarily viewed inflation through the lens of demand, with rare exceptions such as stagflation of the 1970s [8, p. 6]. The prevailing belief was that supply shocks would be short-lived and therefore less relevant for conducting monetary policy, which implied a more limited response by central banks to inflation caused by such shocks. This approach was based on assumptions about the nature of the inflationary shock, where more aggressive interest rate hikes would do more harm to real economic activity than they would contribute to price stabilisation. However, contemporary inflationary pressures increasingly arise suddenly and originate from the supply side, rather than solely from excessive aggregate demand [4, p. 4], and can have a significant impact on inflation expectations. Today, the sources of shocks are far more complex – from geopolitics and supply chain disruptions, through energy crises, to technological, climate and environmental risks – where an intensified combination of systemic and idiosyncratic shocks makes it difficult to determine the nature of developments in terms of distinguishing between temporary and permanent changes [37]. The post-pandemic environment has particularly highlighted the complexity of these developments: in addition to traditional factors such as excessive aggregate demand and a tight labour market, the matrix of inflationary factors is further intensified by supply chain bottlenecks and spikes in energy prices. Today, central banks are increasingly using granular models that “drill down” to the lowest level of data – at the firm and household level – in order to better capture the sources of inflation and monetary policy transmission mechanisms. Special attention is focused on “amplification” effects, that is, situations in which moderate disruptions escalate into more persistent inflationary processes.

Under such conditions, after nearly a decade of exceptionally low inflation, a disruption of the fundamental supply and demand mechanisms has triggered a sudden

and sharp rise in overall prices, making the formulation and implementation of monetary policy much more complex than before. On the one hand, central banks must maintain a high level of transparency and predictability in order to preserve market confidence and keep inflation expectations anchored. On the other hand, it is precisely because of the intensity of current shocks that the flexibility in responding to events that cannot be predicted by standard macroeconomic models becomes imperative. At the end of the day, central banks have the traditional role of guardians of stability, but also the modern role of adaptive actors in a rapidly changing world.

Central Bank Toolkit in a Changed Global Order

The practice of central banks during the first quarter of the 21st century has shown that their response mechanism under conditions of pronounced uncertainty involves a combination of traditional instruments and unconventional monetary and prudential policy measures. The primary tools in their arsenal are interest rates, followed by open market operations, foreign exchange market interventions, standing facilities, and reserve requirements. In conditions of stronger shocks, maintaining monetary and economic stability is also supplemented by unconventional measures such as quantitative easing and state-contingent forward guidance [17, p. 6], and often by specially designed prudential policy measures.

For many small and open economies that are exposed to relatively high capital flows, as well as a relatively high degree of dollarisation (or euroisation) of their financial system, a fully flexible exchange rate has not proven to be the best option. Today, around two-thirds of countries peg their currencies to one of the major global currencies or otherwise influence their exchange rate [5]. Pronounced exchange rate fluctuations, in conditions of global shocks, which are both more frequent and more severe, would quickly transmit to the prices of goods and services (energy, food, imported products and services), as well as to the balance sheets of businesses and households, and consequently to the financial sector. This is especially the case when the domestic currency depreciates and there is pressure from the labour market for wages to rise in line

with exchange rate changes. Moreover, due to shallower financial markets, even smaller shocks can generate larger exchange rate movements in these countries through channels of psychology and panic. Under such conditions, central bank interventions that are small in scale can stabilise the foreign exchange market more efficiently than a significant adjustment of the policy rate, and thereby better cushion the impact on prices and financial market parameters. To enhance their effectiveness, central banks have learned to tailor the tactics of foreign exchange interventions in response to their objectives, the market environment and the market structure [3, p. 9].

Especially since the global financial crisis, which evolved into a global economic crisis, international institutions such as the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) have pointed out that foreign exchange market interventions can be an effective instrument for stabilising emerging economies [32], especially in small and open economies with a high degree of dollarisation [14, pp. 21-22]. Providing a systemic framework for selecting an appropriate policy mix to ensure the maintenance of price and financial stability, the IMF has also developed the Integrated Policy Framework [20], which groups instruments into four complementary areas: (1) monetary policy, which encompasses interest rate policy and the provision of liquidity; (2) macroprudential policy, including the management of credit expansion through constraint instruments; (3) capital flow management measures, such as various types of restrictions or increased costs on foreign exchange transactions, or limits on positions in foreign exchange derivatives; and (4) foreign exchange interventions as a direct instrument for stabilising the exchange rate. An important feature of the framework is its flexibility – that is, the recognition that policy recommendations need to differ depending on the specific characteristics of each country, the shocks to which it is exposed, and its initial conditions, such as: (a) destabilising arbitrage premiums in shallower foreign exchange markets; (b) mitigating risks to financial stability arising from unhedged foreign exchange positions; and (c) supporting the maintenance of price stability when exchange rate fluctuations could destabilise inflation expectations. There is no universal solution, and each

country must find its own balance depending on the structure of its economy, exposure to external risks and the development of its financial market. During 2019 and 2020, the IMF developed both conceptual [18] and quantitative [19] models which, when determining a combination of policy instruments and measures, take greater account of financial market frictions and vulnerabilities. The model results are also complemented by a detailed empirical analysis and country-specific case studies.

One example of a central bank that uses foreign exchange interventions is the Swiss National Bank, particularly to mitigate upward pressure on the Swiss franc during times of crisis, when investors flock to the franc as a safe-haven asset. Similarly, during the period 2022-2023, the Swiss National Bank sold foreign currency to strengthen the Swiss franc and curb inflationary pressures.

According to the *Reserve Management Trends* report [33], published in April 2025, around 50% of the 91 central banks surveyed intervened in the foreign exchange market over the previous 12 months. The percentage rises to 61% if euro area countries are excluded. Among the central banks that intervened, half held foreign exchange reserves exceeding USD 100 bn, with the size of interventions rarely disclosed publicly. Moreover, more than half of central banks (54%) indicated that they plan to increase their foreign exchange reserves in 2025, and nearly 40% planned to raise their gold holdings. In the context of pronounced global instability, foreign exchange reserves represent an important instrument for maintaining macroeconomic and financial stability, as they signal a central bank's ability to intervene in the foreign exchange market during crises, thereby ensuring stability and protecting the domestic economy from external shocks. There is empirical evidence that the currencies of emerging economies with larger reserves depreciated less during crisis episodes, including the global financial crisis, the “taper tantrum” and the COVID-19 pandemic [2, p. 60].

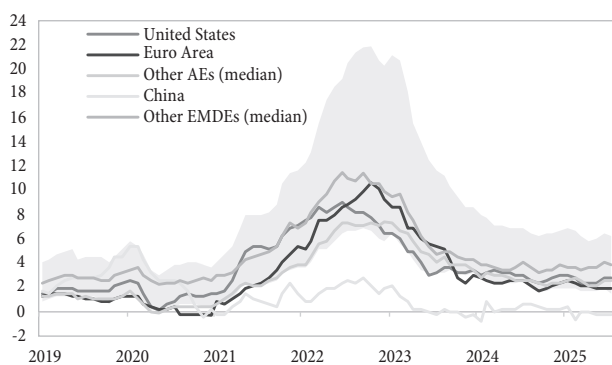
At the same time, the conditions of the “new global dis(order)” highlight the need for further improvement in communication and more concrete explanations of the uncertainties accompanying monetary policy decisions, for which scenario analyses are increasingly recommended and utilized [6, p. 10]. Central banks no longer rely solely

on the baseline scenario of their projections but also incorporate alternative scenarios into their analytical framework. The goal is not only to gain a more comprehensive understanding of potential macroeconomic outcomes, but also to assess appropriate measures for each scenario [11, p. 115], as well as to improve communication with the public regarding how monetary policy might respond if certain risks actually materialise. Such a practice is also present in the work of the National Bank of Serbia (NBS), which projects alternative inflation paths to account for various possible shocks, such as sudden increases or decreases in international energy prices, escalating geopolitical and trade tensions, or the effect of drought on the outcome of the agricultural season. At a time when developments in the international environment are becoming increasingly unpredictable, alternative scenarios provide support for more effective navigation through a complex economic reality. As with everything, it is important to strike the right balance when communicating alternative scenarios, because over-emphasizing of adverse outcomes can draw public attention to negative risks and, under certain circumstances, contribute to those outcomes through the expectations channel.

Monetary Policies of Central Banks in the Coming Period

After a period of aggressive monetary tightening in response to a global inflationary shock – which also helped curb inflationary pressures (Figure 1) – a large number of central banks have embarked on a cycle of monetary easing in 2024.

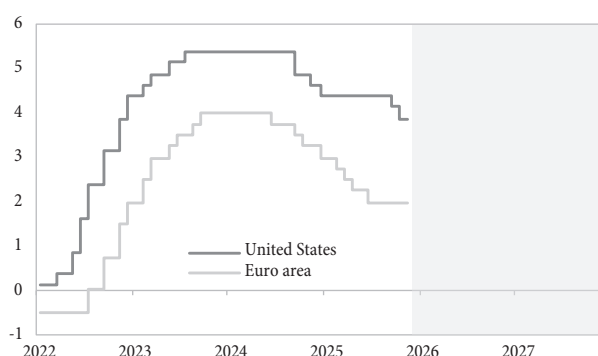
Figure 1: Headline Inflation (in %)



Source: WEO, IMF, October

- *The European Central Bank (ECB)* began easing monetary policy in June 2024 and, through eight reductions of 25 bp each, lowered its key interest rate to 2% by June 2025 (Figure 2). Previously, from July 2022 to September 2023, it had raised the key interest rate through ten iterations totalling 450 bp (from -0.5% to 4.0%). At a level of 2%, the ECB's key interest rate remains 250 bp higher than before the start of the tightening cycle.
- *The Federal Reserve System (Fed)* began easing in September 2024, with a total reduction of 100 bp by the end of that year. This was followed by a one-year pause, after which three additional reductions of 25 bp each were implemented, bringing the federal funds rate range down to 3.5-3.75%. Previously, from March 2022 to July 2023, the Fed had raised its benchmark rate range through eleven iterations totalling 500 bp (to 5.25-5.5%). This means that the current federal funds rate range remains 325 bp higher than before the start of the tightening cycle. As with the ECB, it is assessed that the initial interest rate levels were exceptionally low.
- *The central bank with a zero interest rate is Switzerland*, which made this decision in June 2025. This central bank had begun a cycle of monetary tightening in mid-2022, implementing five iterations totalling 250 bp. Specifically, the interest rate was raised from -0.75% in June 2022 to 1.75% in June 2023. From March 2024 to June 2025, the interest rate was reduced through six cuts totalling 175 bp, to 0%.
- *In emerging economies*, the rate cuts were somewhat larger, but the initial interest rate levels were also higher.

Figure 2: Policy Rates (in %)



Source: OECD

What is common to all central banks is that geopolitical and trade tensions lie at the centre of global macroeconomic challenges. Adjustments in tariff rates marked 2025 at the global level and were accompanied by heightened tensions and volatility (Figures 3 and 4), as well as a reallocation of global supply and production chains.

However, the global economy proved more resilient than expected, while inflation in most countries has declined significantly from the high levels reached after the pandemic. According to the OECD assessment [31, pp. 44-45], growth prospects could gradually improve over the next two years. Positive supply shocks are also expected, primarily due to the use of artificial intelligence, which could materialise earlier and on a larger scale than previously anticipated. According to the IMF’s updated projections from January 2026, which cover a smaller number of countries, global growth is forecast to remain resilient in the coming period, at 3.3% (2026) and 3.2% (2027). The forecast indicates a slight upward revision for 2026 and no change for 2027 compared to the October 2025 projections, as the negative effects of changing trade policies are offset by rising investment in technology, including artificial intelligence, favourable financial conditions, and greater adaptability of the private sector [24].

In its updated projections from January 2026, the IMF forecasts a further slowdown in global inflation, from an estimated 4.1% in 2025 to 3.8% in 2026, and further to 3.4% in 2027. Although the differing nature of inflationary pressures across countries drives divergence in monetary policies, most central banks in advanced economies expect inflation to be on target in 2026. In such conditions – and given that producers, consumers, and financial markets must continually adjust in an environment where assessing

the nature and effects of geo-economic developments is extremely challenging – one question will almost certainly dominate economic discussions in 2026: Is there still room for further rate cuts by central banks, or have the cycles of monetary easing gradually come to an end?

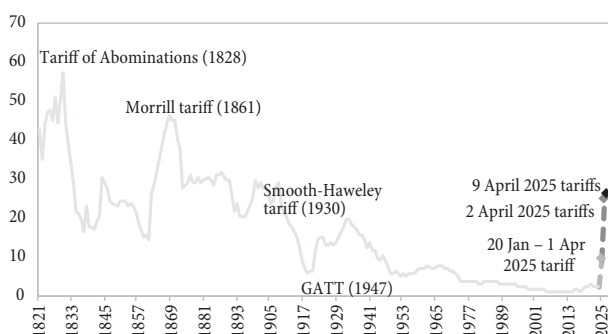
European Central Bank

After the eighth reduction of key interest rates by 25 bp in June 2025, the ECB did not change their level for the remainder of the year, assessing that they were consistent with the 2% medium-term inflation target and that the previous cuts continued to pass through to more favourable financing conditions for companies. At the same time, the ECB continued to scale down its balance sheet according to plan, at a moderate pace, with euro area inflation projected to stabilise at around 2% and economic growth slightly above 1% per year.

In justifying its monetary policy decisions during 2025, the ECB emphasized that the disinflation process was on a good path and that, as expected, both headline and core inflation had declined since the beginning of the year. By mid-2025, headline inflation had fallen to the medium-term target level, and projections indicated that inflation in 2025 and 2026 would be lower than previously anticipated, primarily owing to lower energy prices and a stronger euro against the dollar. Wage growth remained elevated but continued to ease, with its impact on inflation partially absorbed through lower profit margins.

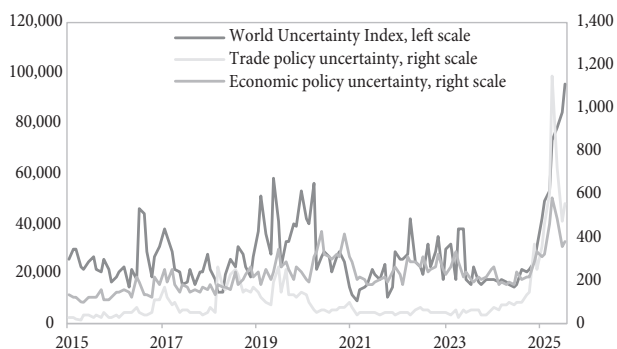
Regarding the real sector, uncertainties stemming from global trade policies worsened prospects for investment and exports, and consequently economic growth in the

Figure 3: US Tariff Rates on All Imports (in %)



Source: WEO, IMF, April 2025

Figure 4: Indicators of Global Uncertainty (Index)



Source: WEO, IMF, October 2025

euro area, particularly in the short term. On the other hand, rising government investments in defence and infrastructure were expected to spur economic growth in the medium term. A deal reached by the European Union (EU) with the US administration at the end of July 2025, which set tariffs at half the level initially announced, helped avoid greater trade tensions that would have affected nearly one-third of global trade. Although economic growth in the euro area was weak, a recession was averted despite a series of negative shocks [26].

However, due to the still unstable global trade and geopolitical environment, uncertainty remained higher than usual, which also contributed to some divergence among ECB Governing Council members in assessing the nature of inflationary risks (both upside and downside). On the other hand, there is a growing consensus that small deviations in inflation or inflation expectations should not trigger excessive response. It has been emphasized that the ECB will continue to make monetary policy decisions based on its assessment of inflation prospects, taking into account incoming economic and financial data, the dynamics of inflation, and the strength of monetary policy transmission, without committing to a predetermined path for the key interest rate.

The ECB also maintained the assessment that it is in a “good position,” with no urgent need to adjust interest rates. Given estimates that the euro area’s neutral interest rate is around zero, the cycle of key rate cuts is considered complete or nearly so. However, with many structural changes underway in the global economy and uncertainty about the potential level of the neutral rate, no scenario can be entirely ruled out. Estimates suggest that in the event of a significant decline in inflation below target, one or two additional cuts in key interest rates in the first half of 2026 could not be ruled out. Factors that could influence such a decision include potential delayed effects of trade policies, further strengthening of the euro against the dollar, and delays in fiscal stimulus in the leading euro area economies. In addition, the ECB’s December 2025 inflation projection [12] for 2027 incorporates a 0.2 pp increase due to the introduction of ETS2 (the second carbon emissions trading system), so any delay in its implementation could lead to lower inflation, thereby increasing the likelihood of

interest rate cuts. On the other hand, there are occasional assessments that key interest rates could rise in 2026, based on the argument that keeping rates unchanged for too long poses a risk of higher inflation, as monetary policy gradually becomes increasingly accommodative [34]. It is also estimated that developments in artificial intelligence and public investment are gradually pushing the neutral interest rate upward.

In summary, based on projections for 2026, it is more likely that the ECB will maintain the current level of key interest rates through the end of 2026, with the possibility of minor adjustments in response to external or domestic shocks.

Federal Reserve System

Throughout 2025, the Fed did not change its policy rate range until September 2025, waiting for additional data on inflation factors and economic activity. Initial expectations were that higher import tariffs would push inflation up and employment down, but there was considerable uncertainty regarding the magnitude and persistence of these effects.

In September 2025, and then again in October and December, the Fed lowered its policy rate range to the lowest level in the past three years (3.5-3.75%), taking into account its dual mandate of price stability and full employment. Given upside risks to inflation and downside risks to employment, greater weight was placed on labour market developments. The decision-making was also influenced by the interruption in data releases during the federal government shutdown, which ended in November 2025. The federal government shutdown also affected certain segments of economic activity, but this impact was assessed as short-lived and offset in the subsequent quarter. Following the December 2025 meeting [13], the Fed stated that it was well-positioned to wait for the effects of the previous three rate cuts implemented between September and December 2025 to fully play out and for the trajectory of economic developments to become clearer.

The new projections released after the December 2025 meeting indicate that the majority of FOMC members (Federal Open Market Committee) expect another, 25 bp rate cut in 2026, as also anticipated in September projections.

Inflation was expected to slow to 2.4% by the end of 2026, economic growth to accelerate to an above-average 2.3%, while the unemployment rate was projected to remain at a moderate 4.4%. The key factors underpinning these developments are expected to be the diminishing impact of higher tariffs, tax relief measures, and more favourable financial conditions. Analysts assess that the trajectory of monetary policy and the pace of reductions in the Fed's policy rate range should be viewed with significant uncertainty, depending on the path of inflation and the resilience of the labour market. Some estimates point to only one additional rate cut, while other forecasts suggest two to three cuts by the end of 2026 [15]. The main factors behind these differing projections are the speed of inflation easing, GDP growth rate and labour market developments.

In addition, in order to ensure an adequate level of reserves, the December meeting also resulted in a decision to purchase shorter-term Treasury securities and, if necessary, Treasury securities with up-to-three-years remaining maturity, as well as the decision to remove the cap on the total stock of repo operations. These operations are intended to support the smooth functioning of the financial market and are to be used when economically justified.

Furthermore, during the December discussion, FOMC members assessed that structural factors such as technological progress and stronger productivity growth – likely reflecting the increasing use of artificial intelligence – can contribute to economic growth without generating cost-push pressures, while at the same time potentially exerting a negative impact on employment. Nevertheless, the prevailing view remains that it is still difficult to determine the extent to which current economic conditions reflect such structural factors rather than cyclical ones.

At its first FOMC monetary policy meeting held in January 2026, the Fed kept the target range for the federal funds rate unchanged, assessing that available indicators point to a solid pace of economic growth, that the unemployment rate has shown some signs of stabilisation, while inflation has remained somewhat elevated. Taking into account the dual mandate – price stability and maximum employment – it was assessed that the two objectives are still to some extent in conflict, though less so than in the

previous period. It was also assessed that upside risks to inflation and downside risks to employment are lower. As a positive factor, and one supporting a potential reduction of the rate range in the coming period, the Fed highlighted that inflation was driven by increases in goods prices influenced by higher tariffs (without their effect, inflation would be around the target level), which is considered a one-off effect that will gradually drop out of the base (assuming there are no new changes in trade policy that would have an inflationary impact). Service prices across all categories, the absence of demand-side pressures, and the slowing growth of both supply and demand in the labour market also support lower inflationary pressures. The Fed reiterated that its decisions in the period ahead will remain data-dependent and that its assessments will take into account a broad range of information and the estimated impact on economic outlook.

Central Banks of Emerging Economies

Over an extended period, the implementation of countercyclical monetary policy in emerging economies was constrained by shallow financial markets, pro-cyclical fiscal policy, significant currency mismatches on the balance sheets of the corporate sector, households, and the government, as well as a strong exchange rate pass-through to inflation. Additional complexity stemmed from external shocks and volatile capital flows, which were also influenced by leading central banks through their extensive use of unconventional instruments, alongside the presence of macroeconomic imbalances and external financing needs.

Owing to the reduction of internal and external imbalances, reforms in the financial sector, rising credibility and increased transparency of monetary policy, emerging economies have enhanced their ability to act countercyclically. Stronger economic fundamentals and resilience proved to be a key response enabling swift action during the COVID-19 pandemic, as well as during the period of global inflation growth, when interest rates were raised sharply to curb inflation and keep inflation expectations anchored [16].

As a result, emerging economies have demonstrated significantly greater resilience to global financial shocks

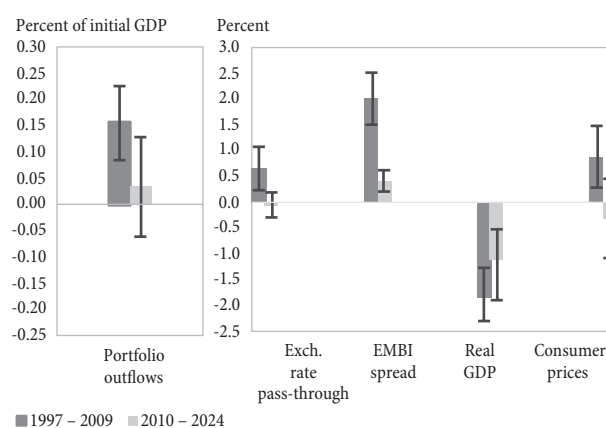
compared with previous crises, as the lessons learned and sound policies strengthened their economies' resilience to global risks and financial market volatility. While favourable external conditions have at times provided support, the IMF concludes that good economic policies played a critical role [21]. At the same time, the BIS notes that monetary and financial frameworks in emerging economies often include the use of foreign exchange interventions and macroprudential instruments, which helped reduce the frequency of financial crises [9, p. 3].

At the macroeconomic level, this required policymakers in small and open economies to pursue responsible fiscal policies, ensure full coordination between monetary and fiscal policy, and implement structural reforms to address macroeconomic imbalances and build buffers capable of cushioning potential future capital outflows. As a result, emerging economies were able to manage shocks from the international environment far more effectively than in the past, when such shocks had led to rapid and severe capital outflows, depreciation pressures and rising inflation. At the microeconomic level, balance sheets across economic agents were adjusted: banks shifted towards less risky assets and longer-term, more stable sources of funding; corporates improved the currency and maturity matching of their assets and liabilities; and governments took into account the need to ensure the sustainability of public debt.

Strengthened institutional frameworks, independent central banks, more credible monetary policy and greater fiscal transparency increased investor confidence, anchored inflation expectations, and reduced the vulnerability of these economies. An IMF analysis [21], based on a sample of 26 emerging markets (including Serbia), shows that since 2010 there have been significant improvements in both monetary policy conduct and the credibility of central banks in emerging economies. A comparison of the effects of shocks in the 2010-2024 period with those observed in 1997-2009 reveals that emerging economies demonstrated greater resilience to sudden spikes in risk aversion. Portfolio investment outflows were significantly smaller, exchange rate pass-through to prices weakened, and the increase in government bond yield spreads amounted to around one-fifth of the levels previously recorded (Figure 5). Greater resilience in emerging economies enables more effective

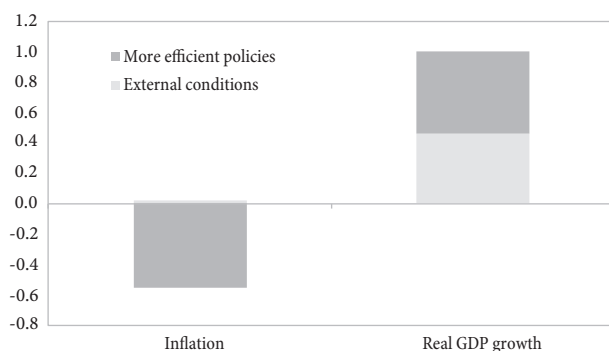
implementation of monetary and overall economic policy. As a result, six months after the onset of a shock, output losses in the 2010-2024 period were considerably smaller (1% compared with 1.8% of GDP), while there was no increase in prices, in contrast to the earlier period (0.9%). These IMF findings point to a substantial improvement in macroeconomic stability and policy effectiveness in emerging economies in the face of external financial shocks. The quality of the business environment is also confirmed by the steady growth in overall business activity and its underlying drivers, accompanied by a rise in real operating revenues. Since 2012, corporate business activity has increased most strongly in sectors dependent on investment demand, as well as among enterprises that place the majority of their output on the global market. This growth model has been established gradually and systematically. Predictable and sound policies, along with the favourable and stable macroeconomic conditions they have ensured, have made Serbia an attractive investment destination and an environment in which both resident and non-resident investors increasingly implement long-term business plans. Structural adjustment has also been clearly supported by greater availability of financial resources, stemming from the directly measurable effects of a significant reduction in interest expenses (by more than 50%) and exchange rate losses. All of this points to the conclusion that price stability and relative stability of the exchange rate constitute a public good that supports the performance of the domestic economy, thereby fostering economic growth and employment [35, pp. 48-49].

Figure 5: Greater Resilience of Emerging Markets (in %)



Source: WEO, IMF, October 2025

Figure 6: Factors Contributing to Greater Resilience of Emerging Economies (in pp)



Source: WEO, IMF, October 2025

A comparative IMF analysis also reveals the extent to which good policies contributed to the strengthening of the resilience of emerging economies, as opposed to favourable conditions in the international environment (Figure 6). In terms of inflation, it is 0.6 pp lower thanks to more efficient policies, while economic activity is 0.5 pp higher compared to the level that would have prevailed without improved policies. The 0.5 pp contribution is a result of favourable external conditions.

The IMF concludes that sound policies and strengthened monetary, fiscal and macroprudential frameworks in emerging economies played a critical role in enhancing their resilience to shocks. As an illustration, the analysis shows that with robust policy frameworks, a central bank does not need to tighten monetary policy as aggressively to curb inflation. In the event of a 10% nominal depreciation of the domestic currency, output losses in emerging economies with strong frameworks were 85% lower than in countries with weak policy frameworks. Conversely, countries with weak policy frameworks must implement a more restrictive monetary policy – meaning they need to raise interest rates nominally much more in order to control inflation than central banks in countries with strong frameworks.

NBS Monetary and Prudential Policies: Stability despite Uncertainty

In an uncertain environment, the NBS monetary policy combines independence, credibility and flexibility within the inflation targeting regime. One of the main reasons for the success of this monetary policy regime, applied by

numerous central banks, is its capacity to adapt to current macroeconomic and financial conditions [7, p. 43].

In the case of the NBS, a clearly defined inflation target of $3\pm 1.5\%$ in the medium term, the use of available monetary instruments, and prudent risk management contribute to the preservation of price and financial stability, while simultaneously supporting the Government's economic policy. The inflation target of $3\pm 1.5\%$ has been in effect since 2017, when it was lowered from $4\pm 1.5\%$, after inflation was reduced from double-digit levels in the period from August 2012 to October 2013 to levels comparable to inflation targeters from the region and subsequently maintained at comparable levels.

The main monetary policy instrument is the key policy rate, applied in main open market operations – one-week reverse repo operations. This is the highest interest rate at which the NBS can withdraw excess dinar liquidity from the banking sector. Its adjustments depend on economic developments and inflation projections, taking into account the transmission lag, as its full impact on inflation materialises after approximately one year. In light of this, temporary short-term deviations of inflation from the defined target are permitted in order to avoid sudden monetary policy adjustments that could cause macroeconomic disruptions. Such deviations may arise from sudden and unexpected price shocks, for instance in primary commodity prices [27, p. 3]. In the medium run, price stability is aligned with goals for financial stability and economic activity at its potential level. In line with its statutory objectives, the NBS regularly and thoroughly assesses the impact of monetary policy measures on all three goals across different time horizons.

In conducting its main open market operations, the NBS applies a variable multiple interest rate model, which, by determining the amount of liquidity withdrawn and indirectly influencing the level of the weighted average repo rate, enables monetary conditions to be adjusted even between Executive Board meetings. The fact that this is achieved without changing the main rates provides the necessary flexibility in the implementation of monetary policy. This system, introduced in December 2012, has contributed to greater efficiency of the NBS monetary framework, which has been particularly important in

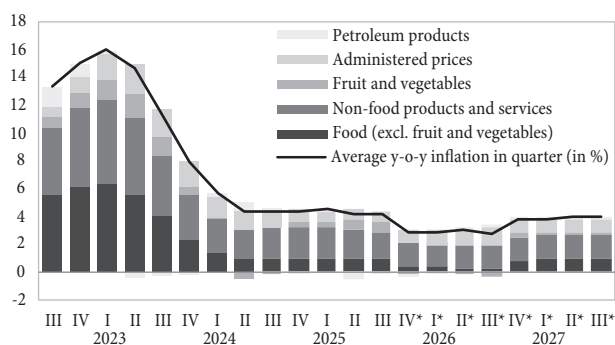
the context of numerous global crises – the pandemic, the energy crisis, the outbreak of the conflict in Ukraine, and the subsequent sharp rise in global inflation. The NBS addressed these challenges by deploying a wide range of measures from its monetary and macroprudential toolkit, thereby supporting the gradual adjustment of households and businesses to changing financial conditions. In addition, the NBS uses standing facilities to maintain stable conditions in the money market, as well as required reserves to regulate liquidity in the banking sector as a monetary policy instrument and, at the same time, as a macroprudential tool that encourages the use of the dinar and longer-term sources of funding within the financial system.

Interventions in the FX market help alleviate short-term pressures on the exchange rate, particularly in periods of heightened external risk, sudden capital inflows or outflows, and situations in which exchange rate volatility could threaten price or financial stability. In countries operating under a managed floating exchange rate regime, such as Serbia, FX market interventions are not intended to maintain a fixed exchange rate level, but rather to prevent excessive and destabilising fluctuations that are not aligned with fundamental economic indicators. This approach helps reduce risks for businesses and citizens exposed to currency risk, as well as for the banking sector, while at the same time preserving monetary policy credibility. FX market interventions also provide the NBS with operational flexibility, enabling a more effective response to short-term risks while maintaining a focus on its primary objective – preserving price and financial stability.

Regarding inflation trends, global cost-push pressures that intensified from mid-2021 were transmitted to higher prices in the domestic market through the channel of imported inflation. Owing to timely and well-calibrated monetary policy measures that took into account the specific nature of inflationary pressures, together with the easing of global cost-push pressures and the maintained relative stability of the dinar against the euro, inflation has been on a downward trajectory since April 2023, returning within the target band in May 2024 (Figure 7). By the end of 2025, y-o-y inflation slowed to 2.7%, slightly below the 3% midpoint, also supported by the application of the Decree on Special Conditions for Trade in Certain Types of Goods (hereinafter: Decree), which capped wholesale and retail trade margins. The fact that core inflation also began to decelerate in early 2024, returned within the NBS target band, and ended 2025 at 4% further confirms the adequacy of the monetary policy measures implemented.

In terms of individual interest rate decisions, the NBS was among the first central banks to respond to heightened global inflationary pressures, initially through increases in the weighted average repo rate from October 2021 to April 2022, as allowed by its flexible monetary framework. From April 2022, the monetary policy response also included adjustments to the key policy rate, which was raised by a total of 550 bp to 6.5% (Figure 9). With inflation on a declining trajectory and expected to remain within the target band, the NBS lowered the key policy rate in three 25 bp steps between June and September 2024, bringing it to 5.75%. The decisions to maintain the key policy rate at this level since September 2024 have reflected ongoing

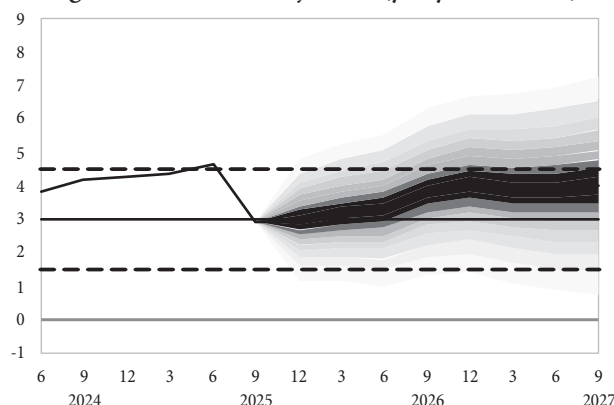
Figure 7: Contributions to y-o-y Inflation by Component (in pp)



* NBS projections.

Source: SORS and NBS calculation

Figure 8: Inflation Projection (y-o-y rates, in %)



Source: NBS, Inflation Report, November 2025

geopolitical tensions, rising protectionism, and the fact that food price growth during most of 2025 exceeded expectations both internationally and domestically.

The IMF has frequently highlighted in its communications that the NBS conducts appropriate and responsible monetary policy, even under conditions that are arguably more complex and challenging than ever. One example is the IMF analysis presented in the *Regional Economic Outlook for Europe* (October 2025) [22], which indicates that the degree of monetary policy tightness maintained by the NBS is appropriate. This assessment is based on a comparison of the key policy rate with an estimated range of rates consistent with a Taylor-type rule.

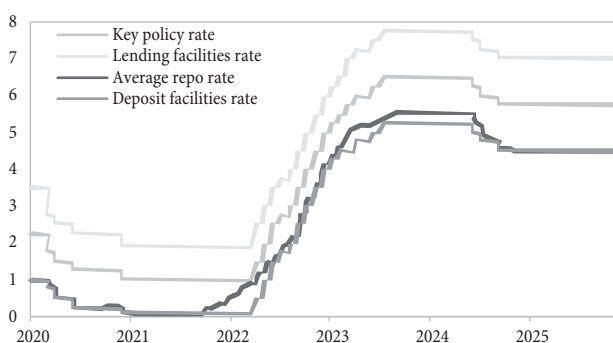
The latest central projection of the NBS, published in the November 2025 *Inflation Report* [30, p. 39], outlines a trajectory for both headline and core inflation that remains within the target band (Figure 8). Regarding the main inflation drivers, in addition to the base effect of the Decree, it is expected that the inflation path over the projection horizon will be influenced by the continued gradual easing of cost-push pressures from the international environment, as well as the weakening of the US dollar against the euro. It is also anticipated that a new agricultural season could exert a disinflationary effect, provided it outperforms the previous two seasons, leading to lower fruit and vegetable prices. Growth in disposable income is expected to exert upward pressure on inflation, but without significant impact, since wage growth is expected to be accompanied by productivity gains. Risks to the inflation projection include uncertain trade policies and ongoing pronounced geopolitical tensions, whose macroeconomic

effects on emerging economies can operate through multiple channels. Global prices of primary agricultural commodities and other food production inputs warrant attention, as they depend on the outcomes of the global agricultural season. Domestic factors, including the pace of growth in domestic demand and the performance of the upcoming agricultural season, also play a significant role.

Against the backdrop of heightened global uncertainty, the development and communication of alternative scenarios for the medium-term inflation projection is one of the tools the NBS uses to better understand potential risks and possible inflation paths. The assumptions underlying these scenarios are selected based on the key risks that could significantly influence price developments in the medium run. In terms of global risks, these assumptions are broadly aligned with ECB scenarios, as supply-side shocks affect all European countries in a similar way. Presenting multiple possible inflation paths and explaining the assumptions behind each scenario forms part of the NBS's overall strategy of transparent communication with market participants. This approach has also helped anchor medium-term inflation expectations of the financial sector, even under conditions of extreme global uncertainty. Clearly communicated scenarios improve the understanding of potential risks and support more rational financial decision-making, thereby enhancing the central bank's effectiveness in maintaining price stability.

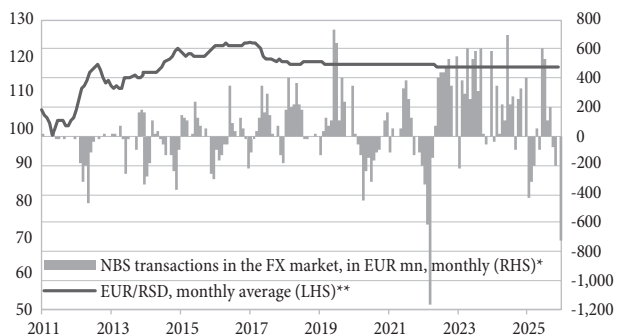
The maintained relative stability of the dinar exchange rate against the euro for over thirteen years – achieved through the NBS's proactive measures, careful monitoring of the FX market and unbiased responses in

Figure 9: Key Policy Rate and Average Repo Rate (in %)



Source: NBS

Figure 10: Dinar Exchange Rate and NBS Transactions in the FX Market



* + net purchase; - net sale. ** EUR 1 in RSD.

Source: NBS

both directions – has been an important pillar of price and financial stability in Serbia. To prevent excessive appreciation of the dinar against the euro, the NBS was a net buyer of EUR 11.3 bn in the FX market between 2017 and end-2025, despite pronounced international tensions and multiple crises (Figure 10). In addition to supporting the stability of the dinar exchange rate against the euro, these net FX purchases boosted the country's FX reserves, further enhancing the resilience of the domestic economy. By end-2025, FX reserves reached EUR 29.0 bn, 2.7 times higher than at end-2012, covering 6.8 months' worth of the country's imports of goods and services – more than double the level prescribed by the relevant adequacy standard. Gold has also assumed a strategic role in strengthening resilience and safeguarding the domestic economy. By end-2025, gold holdings amounted to 52.5 tonnes, valued at EUR 6.2 bn – more than three and a half times the volume held in July 2012, with their value increasing more than tenfold. The enhanced composition of FX reserves, tailored to conditions of heightened global risk, underscores that economic policy in Serbia is grounded in a long-term security-oriented strategy.

A stable macroeconomic environment, together with predictable monetary policy and a sound financial system, has also contributed to a significant increase in the dinarisation of household and corporate deposits since 2012, by more than 26 pp. Over the same period, dinar household savings grew more than elevenfold, reaching over RSD 206 bn by end-2025, reflecting citizens' increasing confidence in the national currency – a notable achievement given the country's long history of high inflation. A favourable business environment, strong policy coordination, and inter-institutional cooperation in addressing non-performing loans through the 2015 NPL Resolution Strategy also contributed to reducing the share of non-performing loans in total banking sector loans to a record low of 2.1% in December 2025. At the time the Strategy was adopted, this share exceeded 20%. Throughout the post-pandemic period, the share of non-performing loans continued to decline, contrary to forecasts that suggested an increase in line with economic theory. This sustained reduction was supported by a range of economic policy measures aimed at supporting employment, boosting

disposable income for households and businesses, and easing credit conditions. In general, the stabilisation of macroeconomic conditions in the country since 2013, particularly tackling of inflation and the relatively stable exchange rate of the dinar against the euro, along with the rise in employment and wages, have fully reflected in the growth of the volume and quality of credit activity. The improvements in risk management processes have also had a positive impact on the results. Thanks to the stabilisation of macroeconomic conditions, banks were able to significantly reduce credit losses. Although net interest income increased in 2023 amid the fastest and most aggressive tightening of monetary policies ever, the net interest margin in 2023 was still lower compared to the period before 2012 [36, p. 49].

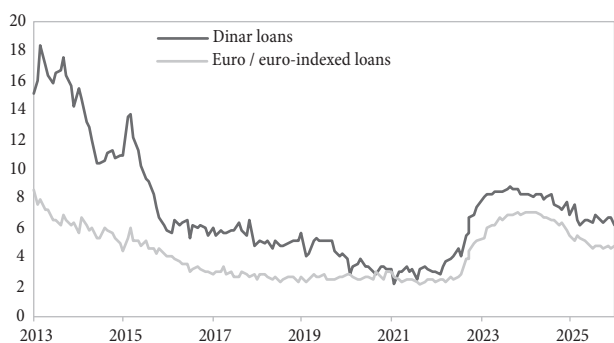
Overall, the results achieved in 2025 indicate that the NBS successfully fulfilled its statutory mandate to maintain price and financial stability, while also supporting economic growth, despite numerous external challenges. By contributing to higher disposable income and ensuring more favourable financing conditions, the NBS supported credit capacity and activity, resulting in a y-o-y increase in corporate and household loans of 15.4% in December 2025. This robust lending growth reflects not only the three reductions in the key policy rate in June, July and September 2024, but also a range of NBS measures, including the 2024 cap on interest rates for housing loans, the setting of maximum rates for certain types of consumer lending through a relevant decision, and their subsequent permanent regulation under the new Law on the Protection of Financial Service Consumers. Lending activity was further supported by NBS supervisory expectations, which encouraged more favourable lending conditions for low-income earners and pensioners, as well as by the approval of subsidised loans under the Government's Youth Housing Loan Programme, reinforced by NBS regulatory measures. In addition, the reduction in euro area interest rates also contributed to the expansion of lending activity.

In December, interest rates on corporate dinar loans stood at 6.2%, down 1.9 pp from June 2024, when the monetary policy easing cycle began. Interest rates on euro-denominated corporate loans were 4.8%, 1.9

pp lower than in June 2024 (Figure 11). Corporate loans recorded y-o-y growth of 11.3% in December. The largest contributions to this growth came from working capital loans, which increased by 11.8% y-o-y (contributing 5.6 pp), and investment loans, which rose by 12.8% y-o-y (contributing 5.5 pp) (Figure 12). The share of loans to micro, small and medium-sized enterprises reached 60.6% in December, up 11.2 pp y-o-y.

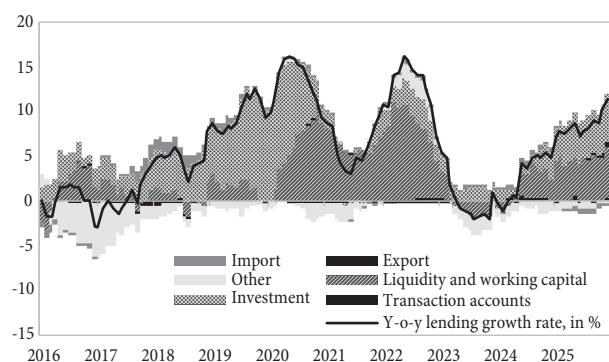
Household loans recorded y-o-y growth of 19.5% in December, with increases in both cash loans (22.3% y-o-y) and housing loans (19.0% y-o-y) (Figure 14). The expansion of cash loans was supported by lower interest rates resulting from monetary policy easing, as well as by NBS prudential and supervisory measures. Growth in housing loans was driven by the NBS’s earlier decision to temporarily cap interest rates, the introduction of the new Law on the Protection of Financial Service Consumers, the approval of government-backed housing loans for young people under more favourable conditions than the market, and the easing of ECB monetary policy.

Figure 11: Interest Rates on Newly Approved Loans to the Corporate Sector (in %)



Source: NBS

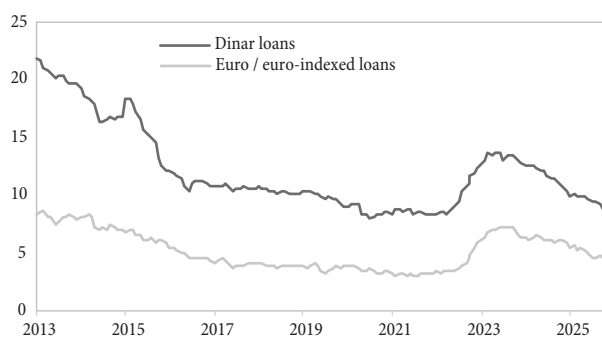
Figure 12: Contributions to y-o-y Corporate Lending Growth (in pp)



Source: NBS

From September 2025, additional support for lending activity came from measures enabling more favourable borrowing conditions for low-income citizens. Under supervisory expectations, interest rates were to be reduced to at least 7.5% for employees with incomes up to RSD 100,000 and to 10.5% for pensioners. The average interest rate on cash loans between September and December was lowered cumulatively by 1.0 pp, to 8.2%. The total weighted average interest rate on new dinar loans to households stood at 8.1% (Figure 13), down by 3.6 pp compared to June 2024, when the monetary policy easing began. Application of the caps under the Law on the Protection of Financial Service Consumers also significantly reduced interest rates on the riskiest and most expensive forms of household borrowing – credit card debt (from 22.3% at end-2024 to 14.7%) and current account overdrafts (from nearly 28% at end-2024 to 17.1%). The average interest rate on housing loans stood at 4.5% in December, 0.6 pp lower than in June 2024.

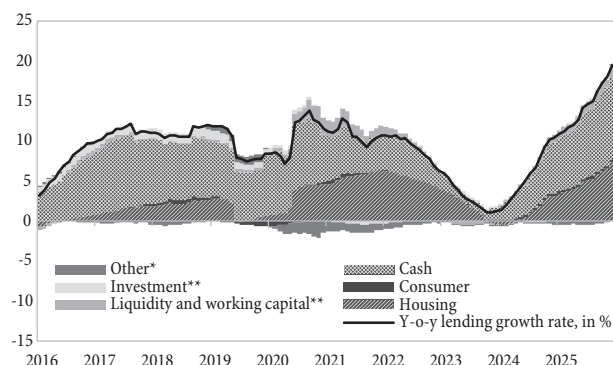
Figure 13: Interest Rates on Newly Approved Loans to Households* (in %)



* Revolving loans, current account overdrafts, and credit card debt are excluded

Source: NBS

Figure 14: Contributions to y-o-y Household Lending Growth (in pp)



* Includes the contributions of receivables under transaction accounts, credit cards and other non-categorised loans.

** Loans extended to entrepreneurs.

Source: NBS

Prudential measures and supervisory expectations were carefully calibrated to protect living standards and increase disposable income without triggering excessive lending growth that could threaten price or financial stability. The effectiveness of this calibration is further evidenced by the share of non-performing household loans, which stood at a 2.7% low at end-December 2025 (1.05% for housing loans). Through this channel as well, the NBS fully supported the Government's policies aimed at stimulating economic growth and improving the business environment, particularly for low-income citizens and first-time homebuyers, without undermining price and financial stability. This is yet another example of effective coordination between monetary and fiscal policy in Serbia – a practice that is always important, especially in turbulent times like today. Close cooperation between the central bank and fiscal authorities reduces the risk of market destabilisation and sudden price fluctuations, ensuring a predictable economic environment and creating space to support sustainable economic growth.

Modern Challenges of Monetary Policy

Rapid development of artificial intelligence, growing popularity of cryptocurrencies, and challenges posed by climate change are creating a need to reassess traditional approaches to monetary policy. The contemporary environment of accelerated technological progress and increasing climate-related risks presents central banks with a new set of challenges, as well as opportunities. The monetary system of the future must be sufficiently flexible to respond to these dynamic and interconnected factors, while at the same time preserving central banks' credibility and ensuring macroeconomic and financial stability.

Today, central banks are exploring the potential of new technologies so they could see how they may change economic dynamics, with implications for monetary policy. The key research questions include [1, pp. 109-114]:

- the potential impact of new technologies on productivity and long-term economic growth,
- implications for price setting,
- effects on the labour market structure,

- macroeconomic consequences of large-scale investment in relevant infrastructure, such as data centres and energy systems.

Artificial intelligence is often viewed as the next “general-purpose technology,” akin to electricity, which drives waves of other innovations, transforming the entire economy, and ultimately enhancing productivity. As productivity increases, aggregate supply expands, while rising consumption and investment boost aggregate demand, leaving the net effect on inflation uncertain. Whether inflation declines or temporarily increases in the short term will largely depend on inflation expectations. Experience with previous general-purpose technologies suggests that artificial intelligence is more likely to have a disinflationary effect in the short run. In the long run, increased demand for labour and capital may generate inflationary pressures, while changes in price-setting processes – through greater uniformity and flexibility – accelerate the transmission of shocks to inflation. At the same time, the long-term effects of artificial intelligence on productivity and innovation may contribute to higher potential output, making careful monitoring and assessment of these effects, as well as strategic policy adjustment, essential to ensuring the maximisation of positive outcomes.

Moreover, the use of artificial intelligence is leading to structural changes in the labour market that affect the work of central banks through several channels, including its impact on wages and employment. The use of artificial intelligence results in the creation of new jobs as well as the disappearance of existing ones, leading to a structural reallocation of labour. However, the gains are not evenly distributed, either within or across countries. This is confirmed by the findings of an IMF analysis published in January 2026, which examines demand and supply for new skills driven by developments in information technologies and artificial intelligence. Around 10% of job vacancies in advanced economies require at least one new skill, while in emerging economies this share is typically about half as large [23]. These skills increase average wages and employment but also deepen polarisation – primarily benefiting high-skilled workers, as well as low-skilled workers through increased consumption of services – while potentially

contributing to the shrinking of the middle class. The IMF also developed a Skill Imbalance Index which, as expected, points to substantial cross-country differences and, consequently, to the need for differentiated policy responses. Economies facing strong demand pressures should prioritise education and reskilling, while countries experiencing high labour supply should stimulate companies to absorb it through innovation and access to loans. The fact that it remains difficult to determine the extent to which the observed labour market changes are driven by structural rather than cyclical factors implies that coordinated global responses are needed to address one of the key medium-term challenges: how the deployment of artificial intelligence will reshape labour markets. Careful governance, continuous policy adjustment, and a focus on skills development are essential to minimise risks and harness artificial intelligence to build a more resilient and inclusive economy.

Artificial intelligence is also increasingly applied in central banking to enhance macroeconomic analyses and macroeconomic modelling processes. The use of large language models (LLMs) and other techniques can improve data collection, statistical processing, and analysis. Data sharing and the availability of databases in an advanced digital environment are becoming ever more valuable – ranging from satellite imagery to social media content [38]. Artificial intelligence is particularly important for nowcasting, as it enables real-time estimation of key economic indicators such as GDP and inflation. By analysing consumption patterns and identifying bottlenecks in supply chains, artificial intelligence helps build a clearer picture of current economic dynamics.

Addressing the consequences of climate change, energy transition and environmental degradation is also an important issue for future economic policies, including monetary policy. Climate change is no longer solely an environmental concern, but one of the major global challenges of the 21st century, with significant implications for economic and financial stability. Central banks recognise that climate change gives rise to both physical and transition risks [10, p. 6]. Physical risks include damage caused by extreme weather events such as floods, droughts and storms, which can impair

productive capacity and infrastructure, while transition risks stem from the adjustment of the economy to green policies, regulatory changes and the energy transition. Consequently, assessing and understanding the effects of climate change requires global, regional and local action as these changes affect market structures, asset valuations, and prices, particularly in the agricultural and food sectors. On banks' balance sheets, these effects are reflected in changes in asset values, credit risk, and the liquidity of the financial system.

In these highly uncertain times, one thing is certain: today, central banks operate in an exceptionally dynamic and uncertain global environment, which is likely to remain such in the future. As so far, central banks will be expected to play a pivotal role in preserving macroeconomic stability, through proactive action to prevent the emergence of new risks and/or by appropriately responding to them, as these risks become increasingly complex. One of the key challenges facing every central bank is identifying the level of the neutral real interest rate (r^*), defined as the equilibrium interest rate that ensures the targeted level of inflation and a closed output gap over the medium term, thereby exerting neither inflationary nor disinflationary pressures [28, p. 51]. When the real interest rate is above the estimated level of r^* , monetary policy is restrictive, but when it falls below that level, the monetary policy stance is expansionary.

What level central banks' real interest rates will settle at in the future – will they return to pre-pandemic levels or remain higher due to an increase in r^* ? Expectations in this regard vary considerably, not rarely because of differing estimates of r^* . The value of r^* is determined by a range of real factors affecting savings and investment, some of which exert upward pressure, while others push r^* downward. Given that r^* cannot be directly measured but must be estimated using various econometric approaches, the choice of the methodology has significant implications for monetary policy decisions. Inaccurate estimates of r^* may lead to an inappropriate level of the policy rate: underestimating r^* entails the risk of heightened inflationary pressures; while overestimating it may result in excessively restrictive monetary conditions and pose risks to economic activity.

Risks and Limitations of Monetary Easing in 2026

Despite mounting market expectations regarding monetary easing in 2026, central banks are facing an array of risks and structural limitations that might constrain such outcomes. These are not only limitations reflecting cyclical uncertainties, but also deeper structural challenges shaping the post-pandemic macroeconomic environment.

One of the risks to monetary easing in 2026 is the possibility that inflation might turn out to be more persistent than currently predicted. Though headline inflation has retreated in a number of economies, geopolitical tensions that still generate volatility in energy and raw material markets, as well as disruptions in supply chains, continue to pose pronounced risks to inflation. In such an environment, easing the monetary policy too rapidly or too substantially might undermine the central bank's credibility and de-anchor inflation expectations. Therefore, maintaining a cautious stance, aided by macroprudential instruments, remains a justified choice.

A *strong labour market* is also a limitation to faster monetary easing. Against the backdrop of historically the lowest unemployment rates, with wage growth still elevated, inflation in the services sector may turn out to be more persistent, even when growth in the prices of goods is slowing down. Drawing a final conclusion in this context would require an in-depth analysis of labour market factors and the character of changes, which could postpone the monetary policy response.

Also, prolonged monetary policy accommodation can generate *risks to financial stability*. Low interest rates can encourage excessive risk-taking, spark excessive growth in asset prices, and increase indebtedness both in the financial and the real sector. In such conditions, monetary easing must also take into account the potential impact on asset markets and systemic risks. These are factors that can limit the room for stronger or lengthier monetary easing, even in a lower inflation environment.

The *high public debt level and an expansionary fiscal policy* can also impact decisions on monetary accommodation. The higher share of public debt in GDP increases the sensitivity to interest rate changes and can give rise to implicit pressure on central banks to mitigate

financial conditions. Likewise, an expansionary fiscal policy in conditions of already excessive aggregate demand, can postpone the need for monetary policy response. That is why it is always important to have strategic coordination of monetary and fiscal policy, and it seems even more relevant in conditions of contemporary structural changes.

Though all risks are constantly present, in 2026 they will particularly narrow central banks' manoeuvring room, i.e. cautiousness could be defined as a pillar of response. Too early or excessive easing could re-kindle inflationary pressures and destabilise inflation expectations, whereas putting off the easing for too long carries the risk of postponing economic recovery. Navigating this environment will require carefully timed moves, constant monitoring of inflation expectations and the labour market, as well as transparent communication in order to preserve confidence. Every decision on monetary policy accommodation in 2026 will be gradual, data-dependent and carefully communicated.

Effective risk management requires independent central banks, which are of crucial importance for macroeconomic stability and economic growth. Preserving central bank independence – both operational and legal, *de facto* and *de jure* – is essential to avoiding the risk of fiscal dominance and firmly anchoring inflation expectations [24, p. 8]. Those expected to fulfil important societal objectives must have independence in choosing instruments and measures, but this does not imply independence from other policies. On the contrary, this implies full coordination with other policy areas.

Conclusion

In the 21st century we have witnessed fundamental changes in the nature and frequency of economic shocks – shocks so pronounced as to render the economic system significantly less predictable than before. The processes of fragmentation, regionalisation, rapid technological progress and climate change are resulting in extremely fast structural changes, the effects of which go beyond the traditional cycles of economic fluctuations. Growing geopolitical tensions are reshaping the patterns of global trade and redefining the strategic global landscape, rapidly

changing the risk perception and making it difficult to determine the character of developments in the sense of differentiating between temporary and permanent changes.

In previous decades, central banks primarily viewed inflation through the lens of demand, while contemporary inflationary pressures increasingly arise suddenly and from the supply side, thus amplifying the impact on inflation expectations. Due to the disruption of fundamental supply mechanisms, the creation and implementation of monetary policy have become significantly more complex than before. In addition to traditional factors such as excessive aggregate demand and a tight labour market, in the post-pandemic environment the matrix of inflationary factors is further intensified by supply chain bottlenecks and pronounced volatility of energy prices. Nowadays, central banks are increasingly using granular models to better capture the sources of inflation and monetary policy transmission mechanisms. Also, special attention is focused on situations in which moderate disruptions escalate into more persistent inflationary processes. This is why central banks have to maintain a high level of transparency and predictability but also increase flexibility when responding to events that cannot be predicted by standard macroeconomic models.

Amid pronounced uncertainties, central bank response consists of a mix of traditional instruments and unconventional monetary and prudential policy measures. Interest rates, open market operations, FX market interventions, standing facilities and reserve requirements have also been supplemented by unconventional measures such as quantitative easing and state-contingent forward guidance, and often by specially formulated prudential policy measures as well. Additionally, there has been an increased need for further enhancements in communication and more concrete explanations of the uncertainties accompanying monetary policy decisions. For this purpose, alternative scenario analyses are also used, which supplement the baseline projection scenarios. Alternative scenarios are used as auxiliary tools for understanding and clarifying a complex economic reality, however, they too must be carefully communicated because over-emphasizing unfavourable outcomes can focus public attention on negative risks and, under certain

circumstances, contribute to such outcomes through the expectations channel.

Practice has shown that a fully flexible exchange rate would be unsuitable for a large number of small and open economies that are exposed to relatively high capital flows, as well as a relatively high degree of dollarisation (euroisation) of their financial systems. Exchange rate volatility can have adverse consequences on overall economic activity as it introduces uncertainty in the business environment and obstructs financial decision-making. When the exchange rate fluctuates frequently and abruptly, enterprises are faced with a high risk in terms of planning the costs for repaying foreign currency-denominated loans and investment projects, as well as in terms of the volume of foreign trade. Such uncertainty can result in delayed investments and decreased competitiveness of the local economy. A relatively stable exchange rate offers not only short-term but also long-term predictability, which is why it is an important factor of safety in business and strategic planning, in contrast to having to constantly adjust to short-term shocks. Citizens are also affected by the consequences, as volatility impacts the value of savings, borrowing and everyday costs. Under such conditions, even small-scale central bank interventions can stabilise the foreign exchange market more efficiently than a significant increase or decrease in the key policy rate, and thereby better cushion the impact on prices and financial market parameters. To enhance their effectiveness, central banks have learned to tailor the tactics of foreign exchange interventions to their objectives, the market environment and the market structure. According to the *Reserve Management Trends* report, published in April 2025, around 50% of the 91 central banks surveyed intervened in the foreign exchange market over the past 12 months, half of which were with foreign exchange reserves exceeding USD 100 bn.

Providing a systemic framework for selecting an appropriate policy mix to ensure the maintenance of price and financial stability in altered conditions, the IMF has also developed the Integrated Policy Framework, dividing instruments into four complementary areas:

- 1) monetary policy – which encompasses the interest rate policy and the provision of liquidity;

- 2) macroprudential policy – including the management of credit activity through constraint instruments;
- 3) capital flow management measures, such as restrictions on positions in foreign exchange derivatives, or various types of increased costs and/or limits to foreign exchange transactions;
- 4) foreign exchange interventions as a direct instrument for stabilising the exchange rate.

An important feature of the framework is its flexibility, i.e. the recognition of the specific characteristics of each country in terms of its initial conditions and shocks the country is exposed to, including: (a) destabilising arbitrage premiums in shallower foreign exchange markets; (b) mitigating risks to financial stability arising from unhedged foreign exchange positions; and (c) supporting the maintenance of price stability when exchange rate fluctuations could destabilise inflation expectations.

Naturally, there are no alternatives to good policies. The IMF's analysis based on a sample of 26 emerging markets (including Serbia) showed that good policies, and fortified monetary, fiscal and macroprudential frameworks in emerging countries played a key role during the period of global shocks, contributing to higher growth and lower inflation. Progress in these areas was conducive to inflation being lower by 0.6 pp and economic growth higher by 0.5 pp, on average, during the latest global shocks, compared to the period before the global financial crisis.

Projections indicate that in 2026 monetary policy will remain data-driven and forward-looking, with any monetary easing being gradual, conditional, and uneven across countries. Although the trajectory of inflation has created room for policy easing, risks from the labour and commodity markets still remain, along with pronounced risks to financial stability. Premature or excessive easing also carries risks, by encouraging excessive risk-taking, driving immoderate asset price growth, and threatening financial stability, particularly in highly indebted countries. Well-calibrated, clear and credible communication can reduce term premiums, stabilise yield curves, and limit excessive volatility in financial markets, and should be used as such. Therefore, central banks will carefully weigh the benefits and costs of a) excessive or premature easing, which could reignite inflation, and b) excessive

delay, which could slow the economic recovery. Under current conditions, the effectiveness of monetary policy will depend not only on the adjustment of interest rates, but also on the nature of other policies, particularly fiscal. Consequently, 2026 will also be marked by the application of monetary policy measures in combination with macroprudential policy measures, which will ensure the objectives of price stability, as well as financial stability and support to economic growth. An example of this is the policy of the NBS which actively combines monetary and macroprudential policy instruments, using the flexibility of the monetary framework, clear communication with market participants, including the scenario analyses, targeted credit support for two segments of households – the young and lower-income earners and pensioners, as well as carefully measured interventions in the foreign exchange market that have multiple benefits for the overall ecosystem.

The example of the NBS actually demonstrates that, through appropriate monetary and macroprudential policy, with full coordination with fiscal policy measures, it is possible to maintain monetary and financial stability even during a period of high uncertainty and rapid changes in the global economic environment. Despite the multifaceted crisis, economic stability and the confidence of consumers and investors have been preserved, as confirmed by a healthy financial system across all metrics and cumulative real GDP growth, which by the end of 2025 was approximately 20% higher than pre-pandemic. These results are reinforced by data on strong export growth, robust increases in private sector employment and wages, as well as foreign exchange reserves that provide coverage for 6.8 months of imports of goods and services. Furthermore, gold reserves of 52.5 tonnes at the end of 2025, valued at EUR 6.2 bn and constituting 21.4% of total foreign exchange reserves, were and remain a guarantee of security in conditions of pronounced global risks. At the end of 2025, the volume of gold reserves was more than three and a half times greater than in July 2012, while their value increased approximately tenfold, which also speaks in favour of the fact that economic policy in Serbia is based on long-term security, not on temporary impulses. This is only part of the results that enabled

Serbia to receive an investment-grade credit rating from Standard&Poor's in October 2024, marking the first time a non-EU Southeastern European country has entered the investment-grade category. Furthermore, Standard&Poor's has long emphasized that, thanks to the continuity of good results, the NBS has gained credibility and affirmed its operational independence. Their assessment is also that the NBS's interventions in the foreign exchange market contribute to the preservation of price and financial stability, growth of foreign exchange reserves to record levels, and significant extension of the maturity of dinar-denominated government securities.

A confirmation that the NBS is pursuing an appropriate and responsible monetary policy, even under conditions that have likely never been more complex and challenging, is also provided by the IMF assessment presented in the *Regional Economic Outlook for Europe* in October 2025. According to the IMF, the degree of monetary policy tightness by the NBS is appropriate. This assessment is based on a comparison of the key policy rate with an estimated range of rates consistent with a Taylor-type rule. Through consistent monitoring of inflation and its drivers, appropriate use of the key policy rate and supplementary instruments, as well as transparent communication with the public, the NBS has demonstrated that a small, open economy can successfully ensure price and financial stability while simultaneously supporting economic growth. In the period ahead, we shall remain committed to the policies that have delivered good results.

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