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Serbia and Montenegro: growth despite instability

In the first half of 2004, Serbia and Montenegro (S&M) will post positive growth, though political turbulences have not ceased. In Serbia, it is expected that industrial production will grow 5-6% in the first half of the year and will continue to grow in the second half as well. Agricultural production should rebound from last year's drop which was due to the severe drought. The tertiary sector is also growing, though precise figures are lacking. All in all, GDP should grow by about 3% in 2004 or perhaps more if agriculture does even better than expected.

Growth is mainly supported by consumption. Public consumption is to increase this year. This was a stumbling block in the negotiations with the International Monetary Fund (IMF) because of the initially projected general budget deficit of around 4% of GDP. Eventually, an agreement was reached that the deficit would not exceed 2.5%, the gap to be closed mainly with higher public revenues. In the first half of 2004, wages in the public sector have continued to grow quite fast signalling that a lax fiscal policy has indeed been implemented. This is in part due to the presidential elections held in June 2004. It is to be expected that public expenditures will continue to be generous because there are local and provincial election in the autumn and early parliamentary elections are quite likely before the end of the year as well.

According to anecdotal evidence investments are picking up. However, disinvestments will have to accelerate as well later this year and next year because the restructuring of public firms will have to be speeded up. The combined effect may very well be dampening for growth. What is certain is the continued growth of the trade deficit. Though the data are coming with a significant lag, the imports' coverage by exports has probably reached a historical low in the first quarter of 2004: it is only about 30% – this despite the fact that exports are rising, but imports are rising even faster. The current account deficit, though not as large as the trade deficit, is also expected to grow, on the basis of observed trends and in view of the other developments in consumption and investment. The government and the central bank together with the IMF expect that the trade and current account deficits will start to narrow down in the medium term and continue on that path subsequently. Otherwise, the sustainability of the exchange rate and of the overall macroeconomic stability will be endangered.

The current economic developments are mostly the consequence of the policies pursued by the previous government. The new government, coming in at the end of March 2004, has had little chance to make its mark on the economy. It has been faced with a very large agenda and not much political stability. Its two main tasks were to adopt this year's budget and to restart the reform process. While it has succeeded in patching up a budget, which is being corrected along the way, it has largely taken a pause when it comes to the reform process.

The stalled privatization process is probably the main victim of the change of government. The new one wanted to review previous privatizations and to introduce innovations in the law on privatization. With that, it succeeded in initiating a lot of public debate about a number of privatizations, but it has been unable to do much about those. It, however, did succeed in slowing down the process considerably. It intended to restart the selling of banks and perhaps of the fixed and mobile telephone companies, but then the presidential elections interfered. The government's candidate did quite poorly in the first round and that led to more political instability. It seems likely at this point that early parliamentary elections will have to be held in the autumn of this year.

In addition to taking a pause in the process of transition, the new government put its relations with the international community on hold. The main stumbling block has been the cooperation with the Hague Tribunal. The new government would rather prefer not to cooperate with it at all. That, however, has costs. The EU feasibility study that should open the door to the negotiations of the Stabilization and Association Agreement has been postponed. Also, the entrance into NATO's Partnership for Peace has been delayed. Indeed, unlike the previous government, the new one has shown little initiative in international relations. This is partly due to its inability to make progress in the two fundamental problems that Serbia faces: its relations with Montenegro and Kosovo.

Montenegro is a small state that is in a state union with Serbia. In economic and political matters, the two states are basically independent. They share the foreign and defence ministries, though they largely follow their own independent foreign and security policies. They also have different monetary, fiscal and trade regimes. As a consequence, it does not make much sense to report their economic developments jointly.

Montenegro uses the euro and relatively high inflation has been a problem for its competitiveness in the past few years. Inflation was fuelled by the high level of public expenditures with the attendant high fiscal deficit. Beginning with the last year, fiscal policy has been more responsible with higher revenues and stable expenditures. This has slowed down inflation while industrial production and tourism have started to recover. Growth of the former is still quite sluggish as is the overall GDP growth. This year's GDP is expected to grow by 2-3% while some acceleration is expected next year.

Political stability in Montenegro is a problem though unlike that in Serbia. The current Serbian government does not have a problem with legitimacy but with low parliamentary and public support. The government of Montenegro, however, enjoys sufficient parliamentary and even public support, but is troubled by issues of legitimacy. The recent assassination of the editor-in-chief of the main opposition daily has raised additional issues of the government's legitimacy. Specific to Montenegro is the fact that the parliamentary opposition lacks legitimacy too, because the main opposition parties were staunch supporters of Milošević. Thus, the main alternative is the non-parliamentary opposition of an NGO called the Group for Change. The Group is yet to prove powerful enough to initiate early elections, so the existing type of stability will persist at least until well into 2005.

In 2005, the deliberations on the final status of Kosovo will start. This international protectorate is expected to demand full independence from Serbia. It is hard to see how that demand will be denied and it is also hard to predict the political consequences that it will initiate. In any case, a reconsideration of the relationship between Serbia, Montenegro and Kosovo seems unavoidable in the next two years.

Table CS

Serbia and Montenegro: Selected Economic Indicators *)

	1999	2000	2001	2002	2003 [1]	2003	2004	2004	2005
						1st quarter		forecast	
Population, th pers., mid-year	8372.7	8342.5	8326.4	8304.7	8300.0	.	.	.	.
Gross domestic product, CSD mn, nom.	191099	381661	771800	1006900	1124000	.	.	1273500	1456900
annual change in % (real) [2]	-18.0	5.0	5.5	3.8	2.0	.	.	3	4
GDP/capita (EUR at exchange rate)	1945	2990	1558	1996	2075	.	.	.	.
Gross industrial production [3]									
annual change in % (real)	-23.1	11.1	0.0	1.7	-2.7	-3.1	10.8	4	5
Construction output, value of work done									
annual change in % (real)	-9.9	14.4	-29.8	.	.	.	.	.	.
Actual final consump.of househ., CSD mn, nom.	147781	302081	.	.	.	.	.	.	.
Gross fixed investment, CSD mn, nom.	24868	59316	80003	.	.	.	.	.	.
annual change in % (real)	-26.3	13.3	-4.1	.	.	.	.	.	.
LFS - employed persons, th, Oct.	3325.0	3324.0	3320.0	3220.8	.	.	.	.	.
annual change in %	-14.6	0.0	-0.1	-3.0	.	.	.	.	.
Reg. employees in industry, th pers., avg.	804.5	764.7	744.0	685.8	640.0	620 [4]	567	.	.
annual change in %	-9.3	-5.0	-2.7	-7.8	-6.7	.	-8.6	.	.
LFS - unemployed persons, average	528.0	480.5	490.2	517.3	.	.	.		
LFS - unemployment rate in %, average	13.7	12.6	12.9	13.8	14.0	.	.	15	15
Reg. unemployment rate in %,end of period [4)5]	25.5	26.7	27.9	31.2	34.8	34.4	34.9	32	32
Average net monthly wages, CSD [6]	1309	2588	5545	9208	11500	9917	12566	.	.
annual change in % (real, net)	-15.0	6.5	13.3	29.9	13.6	.	16.7	.	.
Consumer prices, % p.a.	44.9	86.0	88.9	16.5	9.4	11.5	8.3	10	10
Producer prices in industry, % p.a.	43.4	106.5	85.1	8.7	4.6	4.8	5.7	5	5
General governm. budget, nat.def., % GDP									
Revenues	41.5	36.4	41.5	50.4	49.4	.	.	.	.
Expenditures	.	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	.	.	.	.	.	.	.	.
Public debt in % of GDP									
Discount rate, % p.a., end of period	26.3	26.3	16.4	9.5	9.0	9	8.5		
Current account, EUR mn [4)7]	-672	-382	-729	-1828	-1710	-495	-608	-2400	-2500
Current account in % of GDP [4]	-7.1	-4.0	-5.6	-11.0	-10.7	.	.	-14.3	-13.7
Gross reserves of NB, excl. gold, EUR mn [7]	157.9	429.9	1138.6	2076.8	2728.2	.	.	.	.
Gross external debt, EUR mn [7)8]	12422	12292	13306	11352	9641	.	.	.	.
FDI net, EUR mn [4)7]	105	55	186	502	1109	7.4	120.9	.	.
Exports of goods, BOP, EUR mn [4)7]	1572	2097	2252	2547	2180	577.2	595.6	2500	2750
annual growth rate in %	-41.9	33.4	7.4	13.1	.	.	3.2	15	10
Imports of goods, BOP, EUR mn [4)7]	3092	4048	5439	6674	6446	1537.7	1893.0	7200	8000
annual growth rate in %	-28.6	30.9	34.4	22.7	.	.	23.1	12	11
Exports of services, BOP, EUR mn [4)7]	442	681	832	854	886	212.5	272.6	.	.
annual growth rate in %	-45.8	54.1	22.2	2.6	.	.	28.3	.	.
Imports of services, BOP, EUR mn [4)7]	228	320	363	567	632	131.8	170.4	.	.
annual growth rate in %	-39.4	40.4	13.4	56.2	.	.	29.3	.	.
Average exchange rate CSD/USD	11.01	16.69	66.84	64.19	57.44	58.88	56.31	.	.
Average exchange rate CSD/EUR (ECU)	11.74	15.30	59.44	60.79	65.26	63.36	69.40	76	80

Notes: *) CSD: New international currency-code for Dinar. Excluding Kosovo and Metohia.
1) Preliminary. - 2) Based on GMP. - 3) Excluding private enterprises. - 4) From 2003 Serbia only. - 5) In % of unemployed plus employment. - 6) From 2002 Serbia only and including various allowances. - 7) Converted from USD. - 8) In 2003 including a part of Montenegrin foreign debt.

Source: wiiw Database incorporating national statistics; wiiw forecasts.