SERBIA: Cloudy with a chance of sun

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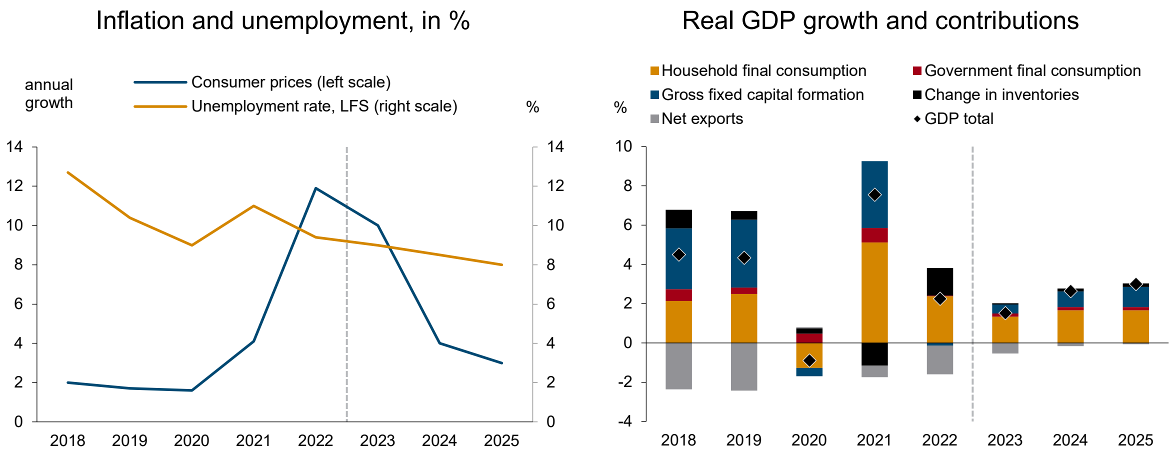
Weak investment meant that the economy grew by less than expected in 2022, but there are signs of a recovery in early 2023. Inflation has been on the rise since the government started to lift the price controls it had introduced, and this poses some additional challenges. A major deal has been struck on the normalisation of relations with Kosovo; this could mark a turning point for the country, but questions remain about the implementation of the deal.

Figure 5.19 / Serbia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Serbia's GDP in 2022 grew by 2.3%, which fell short of expectations. The poorer outturn was due to weak investment, as gross fixed capital formation declined by 0.6%, following the vibrant growth of 16% the previous year. Household consumption was solid (up 3.7%), backed by policies that raised the minimum wage and public-sector salaries. Government consumption was supportive, albeit weakly, with growth of 0.2%. Both exports and imports were strong, rising by around 18% in real terms.

The decline in investment was due to a decrease in public investment, which fell by approximately 3% in real terms. Still, public investment in Serbia remains robust, accounting for 7.2% of GDP. This is among the highest in the entire CESEE region and comes on the back of the government's ambitious public infrastructure investment programme. Foreign direct investment (FDI) inflows were also strong overall, averaging 7.3% of GDP for the year as a whole. Despite strong public investment and FDI, total investment in the country remained at below 23% of GDP, which is around the regional average. This highlights a significant structural problem in the country: namely the persistently low level of domestic private investment.

FDI had a volatile year in 2022 and will continue to be a puzzle in the coming period. In the first half of the year, it was relatively weak by Serbian standards, at just 5.7% of GDP. However, in the second half of the year investment poured in, reaching 8.6% of GDP. FDI inflows from the EU contracted significantly in 2022, falling to just 33% of total FDI (roughly half of the share in previous years). This may be attributable to Serbia's ambivalent position regarding the war in Ukraine and its still close ties with Russia, which create political uncertainty that deters European companies. On the other hand, Chinese FDI more than trebled in 2022 to reach 32% of total FDI (almost matching investment from the EU), most of it in manufacturing. While this investment clearly has positive economic effects, it is unclear whether it could also have political implications. Meanwhile, Russian FDI also grew considerably in 2022 – eight-fold, to reach 8% of total FDI inflows. The bulk of this came in the final quarter of the year and is attributable to the big influx into the country of Russian refugees, following September's military mobilisation in Russia.

Inflation in 2022 was among the lowest in the region, thanks to the government's price caps on basic foodstuffs; but that is changing in 2023. Inflation averaged 11.9% in 2022 (among the Western Balkan economies, only in Albania and Kosovo was it lower). The price caps on food staples that the government introduced towards the end of 2021 proved effective in taming inflation, but from April 2022 the government started to raise the levels at which the caps were set, which fuelled inflation in the second half of the year. Inflation continued to accelerate on an annual basis in the first three months of 2023, reaching 16.2% in March, up from 15.1% in December – the reason being that the government removed some of the price caps it had previously introduced, and also raised some other administered prices (e.g. for electricity, gas and cigarettes) from the beginning of the year.

The response to inflation by the central bank has been aggressive and is expected to continue that way. Since April 2022, the central bank has raised its policy rate every single month – on 13 consecutive occasions. As of April 2023, its policy rate stands at 6%, up from 1% in March 2022. This has been much more aggressive than the tightening of the European Central Bank, which hiked its rate only six times over the same period, and by only 350 basis points in total. While we see no indication that the tightening has had (or will have) any significant impact on inflation (given its supply-side nature), we expect the central bank to continue tightening, until such time as inflation begins to fall. On the other hand, the tightening has already had an impact on the economy: in February 2023, credit growth slowed to 4.8%, year on year – the lowest level since mid-2018.

Otherwise, the economic policies pursued by the authorities have generally been appropriate. The increase in the minimum wage and in public-sector salaries prevented real incomes from declining, and Serbia ended 2022 as one of those rare European countries to experience a rise in real wages, of 1.7%. Fiscal policy was also supportive overall: general government expenditure reached 46.5% of GDP in 2022 – slightly below the exceptional levels of the previous two years, but much higher than before the pandemic, when it was around 42% of GDP.

Despite the sound fiscal policies, economic performance in 2022 remained modest, indicating profound structural issues in the economy. The first issue concerns the persistently weak domestic private investment and the need for appropriate industrial and innovation policies to boost it. The second pertains to the persistently high poverty and inequality in the country: with a poverty rate of 22% (according to the national poverty threshold) and a Gini coefficient of disposable income of around 35% – both among the highest in Europe – Serbia clearly lacks equal opportunities for all and is in need of comprehensive social reform. The third issue relates to the imperative to speed up the green transition in the country, particularly in terms of renewable energy – something that requires much greater public investment in this area. Unless these challenges are addressed, Serbia will struggle to achieve sustainable and inclusive growth and development in the long term.

The beginning of 2023 appears to herald an improvement in the economy, although some risks persist. Industrial production has increased by 3.1% year on year in the first two months, which is better than at the end of 2022. However, retail trade has fallen by 1.1% in the same period. We thus keep our forecast for GDP growth in 2023 unchanged, at 1.5%, which is the lowest in the Western Balkans. Because of the acceleration in inflation at the beginning of the year, we are revising our average inflation forecast for 2023 upwards, to 10% (from 9% in January).

A major positive development is the new agreement on the normalisation of relations with Kosovo; however, uncertainty remains about the deal's implementation. The agreement was reached in March in Ohrid, only verbally and without official signatures, though with mediation from the EU and support from the US. The essence of the deal is that Serbia is no longer required to officially recognise Kosovo, but should not block its integration into international organisations. Meanwhile, Kosovo is required to establish an Association of Serb majority municipalities, in order to ensure self-management for the Serbian community in Kosovo. While these provisions are promising, it remains to be seen how they will be implemented. It is worth recalling that the 2013 Brussels Agreement on the normalisation of relations looked good on paper, but was never fully implemented.

There are several important differences between the new Ohrid Agreement and the previous Brussels Agreement. One key difference is that implementation of the new deal is now a condition for EU accession: that should serve as a stick, encouraging both parties to comply. In addition, the agreement also includes a carrot, in the form of a donor conference that will put together an investment and financial aid package for the two sides. Still, there is no guarantee that the parties will adhere to the agreement, especially if their domestic support weakens and they see an opportunity to gain political advantage by promoting a nationalist agenda. But if the deal does get implemented, it will mark a turning point for Serbia, both politically and economically.

Table 5.19 / Serbia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th. pers., mid-year	6,945	6,899	6,834	6,790	6,745	6,700	6,655
Gross domestic product, RSD bn, nom.	5,422	5,504	6,270	7,091	7,900	8,400	8,900
annual change in % (real)	4.3	-0.9	7.5	2.3	1.5	2.6	3.0
GDP/capita (EUR at PPP)	12,800	12,810	14,350	15,130	.	.	.
Consumption of households, RSD bn, nom.	3,637	3,606	4,067	4,719	.	.	.
annual change in % (real)	3.7	-1.9	7.8	3.7	2.0	2.5	2.5
Gross fixed capital form., RSD bn, nom.	1,218	1,180	1,448	1,620	.	.	.
annual change in % (real)	17.2	-1.9	15.9	-0.6	2.0	3.5	4.5
Gross industrial production 2)							
annual change in % (real)	0.3	0.4	6.3	1.7	1.5	2.5	3.0
Gross agricultural production							
annual change in % (real)	-1.2	2.0	-5.6	-8.0	.	.	.
Construction output							
annual change in % (real)	35.5	-2.5	17.0	-11.5	.	.	.
Employed persons, LFS, th, average 3)	2,901	2,895	2,849	2,913	2,940	2,970	3,000
annual change in %	2.4	-0.2	2.6	2.3	1.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	336	287	352	302	290	280	260
Unemployment rate, LFS, in %, average 3)	10.4	9.0	11.0	9.4	9.0	8.5	8.0
Reg. unemployment rate, in %, eop	18.7	17.9	17.4	15.4	.	.	.
Average monthly gross wages, RSD	75,814	82,984	90,784	103,316	117,100	125,400	133,000
annual change in % (real, gross)	8.4	7.8	5.2	1.7	3.0	3.0	3.0
Average monthly net wages, RSD	54,919	60,073	65,864	74,933	84,900	90,900	96,400
annual change in % (real, net)	8.5	7.7	5.4	1.7	3.0	3.0	3.0
Consumer prices, % p.a.	1.7	1.6	4.1	11.9	10.0	4.0	3.0
Producer prices in industry, % p.a.	0.6	-1.3	8.7	14.9	6.0	3.5	2.5
General governm. budget, nat. def., % of GDP							
Revenues	42.0	41.0	43.3	43.4	44.0	44.0	44.0
Expenditures	42.2	49.0	47.4	46.5	46.5	46.0	45.5
Deficit (-) / surplus (+)	-0.2	-8.0	-4.1	-3.1	-2.5	-2.0	-1.5
General gov. gross debt, nat. def., % of GDP	52.8	57.8	57.1	55.6	57.0	58.0	59.0
Stock of loans of non-fin. private sector, % p.a.	8.9	11.1	10.2	6.5	.	.	.
Non-performing loans (NPL), in %, eop	4.1	3.7	3.5	3.0	.	.	.
Central bank policy rate, % p.a., eop 4)	2.3	1.0	1.0	5.0	6.0	5.5	5.0
Current account, EUR m	-3,161	-1,929	-2,266	-4,139	-3,900	-3,500	-3,200
Current account, % of GDP	-6.9	-4.1	-4.2	-6.9	-5.8	-4.9	-4.2
Exports of goods, BOP, EUR m	16,415	16,079	21,018	26,913	30,200	33,700	37,400
annual change in %	8.7	-2.0	30.7	28.0	12.2	11.5	11.0
Imports of goods, BOP, EUR m	22,038	21,280	27,038	36,266	40,100	43,900	48,100
annual change in %	9.1	-3.4	27.1	34.1	10.5	9.5	9.5
Exports of services, BOP, EUR m	6,934	6,191	7,800	11,087	12,400	13,800	15,300
annual change in %	14.4	-10.7	26.0	42.1	12.0	11.0	11.0
Imports of services, BOP, EUR m	5,922	5,090	6,402	8,771	9,600	10,500	11,400
annual change in %	16.9	-14.1	25.8	37.0	10.0	9.5	9.0
FDI liabilities, EUR m	3,815	3,039	3,886	4,416	.	.	.
FDI assets, EUR m	264	100	229	110	.	.	.
Gross reserves of CB, excl. gold, EUR m	12,042	11,732	14,523	17,311	.	.	.
Gross external debt, EUR m	28,254	30,787	36,488	41,885	47,800	51,600	55,500
Gross external debt, % of GDP	61.4	65.8	68.4	69.4	71.0	72.0	73.0
Average exchange rate RSD/EUR	117.85	117.58	117.57	117.46	117.3	117.2	117.1

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Key policy rate.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.