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Serbia:
continuous deterioration

The crisis has hit Serbia harder than has been expected. Given that the economy is quite closed, in terms of exports, the decline in foreign trade was not believed to have a large influence on domestic consumption and investment and thus on production. However, reliance on foreign financing is heavy and that dried out in the first quarter of 2009 and has not recovered since. This has led to high illiquidity in the economy and thus to a sharp decline in consumption and investment. In sum, GDP is contracting by 5% to 6% year-on-year. Investment is falling even more, though the data are not very reliable. Consumption is also declining, which can be seen from the sharp fall in imports.

Public consumption is under significant pressure because expenditure obligations were increased at the end of last year, while revenues have been falling throughout this year. In mid-year, the fiscal deficit is headed towards 5% of GDP. There will be some more clarity once the new budget revision is done, probably in early autumn. Though the deficit is increasing, public expenditures are not, in real terms. Thus, public spending has a pro-cyclical influence and the chances are that it will continue to contribute to the recession because further budget cuts will in most probability be necessary.

Serbia has concluded its second IMF stand-by agreement only few months after the first one was approved. The current one may prove to be adequate not because of its policy content, but because external balances are improving faster than expected. This is the consequence of the recession being deeper than anticipated. Thus, imports are declining faster and the exchange rate has stabilized without too much support from the reserves of the central bank. This, however, is not good news because it is a symptom of widespread lack of financial resources, both in the private and in the public sectors. Indeed, the government is trying to borrow money left and right not only on its own behalf but on the behalf of the corporate and the household sectors too. This is because only sovereign and multilateral sources of credit are really available, though it cannot be expected to be very generous. Thus, Serbia is expecting budget support from the EU of about EUR 100 million, has increased its borrowing from the World Bank and the EBRD and has asked Russia for a loan of about EUR 1 billion. These loans, even if they are realized as intended, will not be enough and certainly provide only temporary respite from the financial problems.

At the turn between the first and the second quarter there was some indication that the worst might be over and that the decline had slowed down. Later data, especially on monthly growth of industrial production, have however not proved supportive of this conclusion. The decline seems to have accelerated in April and the same may turn out to be true for May. Similarly, figures on foreign trade and on the development in the labor market point to a continuing deterioration. Particularly suggestive is the sharp decline in manufacturing, but there are signs that the services sector is also continuing to shrink. The hope is that agriculture will do well and will support exports of food and food products which have proved stable so far.

The inflation rate is still rather high and there has even been some acceleration of price increases. The fastest growth appears to be in controlled prices. In a number of cases, public and communal services are pricing their services higher because the transfers from the budgets are less generous. Also, prices of oil, gas and gasoline are not declining as fast as the world market prices would suggest because these monopolies have been incurring losses that they are trying to cover by keeping the prices high. How successful they are is hard to tell because of growing illiquidity and debt arrears. So, Serbia seems to be suffering from both deflation and inflation at the same time. Prices of goods and services and wages are under pressure to decline, while taxes, prices of public services and utilities and of the monopolies are going up. The latter will deepen the former if recovery disappoints – as it seems all but certain at the moment.

Policy response has been slow and confused so far. Monetary policy has been tight and will continue to be so because of the central bank's belief that it can pursue inflation targeting. Thus, it is trying to slow down inflation by keeping the interest rates high. Also, it aims to stabilize the exchange rate in that way, which in turn should help stabilize the prices too. So far, success has been limited. Lately, the central bank has started to cut the rate of its key policy instrument, the two-week repo-rate; it has indicated that it will continue to do so as long as the prospect for inflation improves. Arguably, it could have been more aggressive in monetary easing as inflation is not really the key worry at the moment. Indeed, it is providing additional revenues, as explained, is reducing real wages and pensions and is contributing to an increase in competitiveness in that way.

The prospects for a short-term recovery are not overwhelming because of the persistent volatility in most short-term real and financial indicators. Prospects for a short-term stabilization of the decline are better, but it is hard to say whether the bottom is going to be touched this summer or maybe a bit later. GDP may decline by 4% in an optimistic scenario and by as much as 6% in a more pessimistic one. Investments will fall even more and consumption may decline as much as GDP. Net exports will play a more positive role with a sharp reduction in the foreign trade deficit.

In the next couple of years, stagnation seems more likely than recovery. Serbia will have to rely more on domestic savings and on exports, and it will take a while for that turnaround to take place.

Table RS

Serbia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average [2]	7441	7412	7382	7350	.	.	.	.	.
Gross domestic product, RSD bn, nom.	1688	1980	2363	2761	.	.	2900	3100	3300
annual change in % (real)	5.6	5.2	6.9	5.4	8.5		-4	0	2
GDP/capita (EUR at exchange rate)	2700	3200	4000	4600	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	7200	7800	8600	9100	.	.	.	.	.
Consumption of households, RSD mn, nom.	1281014	1492693	1714040	.	.	.	.	.	.
annual change in % (real) [3]	5.0	5.4	6	6	.	.	-2	0	2
Gross fixed capital form., RSD mn, nom.	319859	412752	552271	.	.	.	.	.	.
annual change in % (real) [3]	5.0	15.2	12	8	.	.	-5	0	3
Gross industrial production									
annual change in % (real)	0.8	4.7	3.7	1.1	6.1	-16.9	-5	0	3
Gross agricultural production									
annual change in % (real)	-3.4	-2.6	.	.	.	.	.	.	.
Construction output total									
annual change in % (real) [4]	2.0	7.7	10.8	1.7	4.8	.	.	.	.
Employed persons - LFS, th, Oct [5]	2733.4	2630.7	2655.7	2805.3	.	.	.	.	.
annual change in %	.	-3.8	1.0	5.6	.	.	.	.	.
Unemployed persons - LFS, th, Oct [5]	719.9	693.0	585.5	457.2	.	.	.	.	.
Unemployment rate - LFS, in %, Oct [5]	20.8	20.9	18.1	14.0	.	.	18	20	20
Reg. unemployment rate, in %, end of period	27.1	27.9	25.1	23.7	25.2	24.6	.	.	.
Average gross monthly wages, RSD	25514	31745	38744	45674	41807	41933	.	.	.
annual change in % (real, net)	6.4	11.4	19.5	3.9	5.4	2.4	.	.	.
Consumer prices, % p.a. [6]	16.2	11.7	7.0	11.7	13.6	9.4	8	6	3
Producer prices in industry, % p.a. [7]	14.2	13.3	5.9	12.4	11.7	4.9	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	42.9	43.8	42.4	42.5	.	.	.	.	.
Expenditures	41.9	45.4	44.3	45.0	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	0.9	-1.7	-1.9	-2.5	.	.	-5	-2	-1
Public debt in % of GDP	50.2	36.2	29.4	25.9	30.2	28.9	.	.	.
Discount rate of NB, % p.a., end of period	8.5	8.5	8.5	8.5	8.5	8.5	.	.	.
Current account, EUR mn [8]	-1766.1	-2382.1	-4628.9	-5949.4	-1290.4	-797.8	-2900	-2700	-3100
Current account in % of GDP	-8.7	-10.1	-15.7	-17.6	.	.	-10	-10	-11
Exports of goods, BOP, EUR mn [8)9)]	3998.9	5137.4	6399.0	7474.8	1672.6	1290.5	6700	6700	7400
annual growth rate in %	21.8	28.5	24.6	16.8	21.4	-22.8	-10	0	10
Imports of goods, BOP, EUR mn [8)9)]	8255.3	10138.4	13071.2	15153.6	3485.4	2576.4	13600	13600	15000
annual growth rate in %	-2.7	22.8	28.9	15.9	22.2	-26.1	-10	0	10
Exports of services, BOP, EUR mn [8)9)]	1315.5	1851.0	2314.5	2751.3	687.6	568	2600	2600	2900
annual growth rate in %	10.9	40.7	25.0	18.9	38.1	-17.4	-5	0	10
Imports of services, BOP, EUR mn [8)9))]	1321.2	1892.4	2568.8	2925.2	652.1	604.6	2600	2600	2900
annual growth rate in %	25.2	43.2	35.7	13.9	18.0	-7.3	-10	0	10
FDI inflow, EUR mn [8]	1265.3	3515.7	2530.1	2042.5	850.1	844.7	.	.	.
FDI outflow, EUR mn [8]	18	17	686	189	19.3	1.4	.	.	.
Gross reserves of NB, excl. gold, EUR mn	4753.7	8841.3	9422.2	7908.8	9321.1	7828.2	.	.	.
Gross external debt, EUR mn	13064.0	14884.6	17790.5	21800.5	17957.3	21445.0	.	.	.
Gross external debt in % of GDP	66.2	59.4	59.7	70.0	57.6	73.9	.	.	.
Average exchange rate RSD/EUR	82.91	84.19	79.98	81.90	82.8	94.5	100	110	120
Purchasing power parity RSD/EUR [10]	31.72	34.34	37.30	41.30	.	.	.	.	.

1) Preliminary. - 2) wiiw estimate in 2008. - 3) wiiw estimate. - 4) Gross value added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) From 2008 according to COICOP-classification. - 7) Based on domestic output prices. - 8) Converted from USD with the average exchange rate. - 9) From 2006 including transactions with Montenegro. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

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