SERBIA: Recovery, finally

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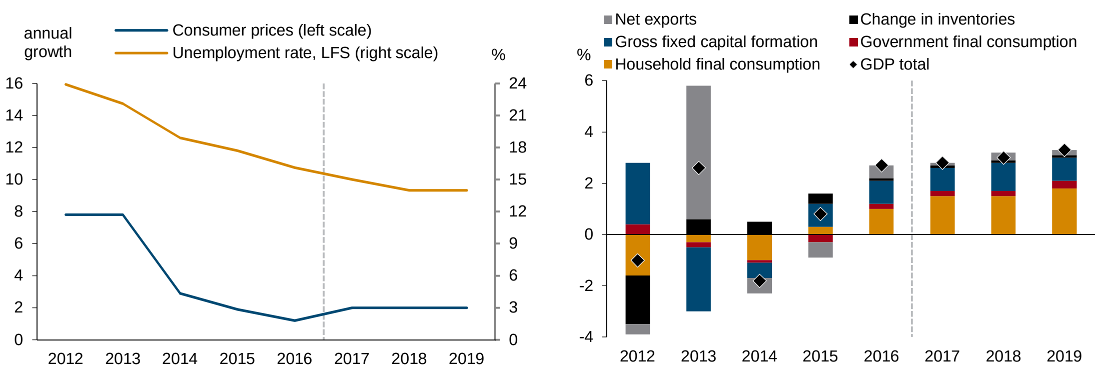
Growth proved better than expected in 2016, at 2.7%. Looking ahead, it should approach 3% in the medium term. This is mainly because consumption – both private and public – will increase, now that fiscal consolidation is largely at an end; meanwhile investment and exports should continue to grow.

Figure 50 / Serbia: Main macroeconomic indicators

Inflation and unemployment, in % | Real GDP growth and contributions



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

Investments are continuing to drive growth. Investments slumped in the aftermath of the 2008-2009 crisis and started to recover only in the last couple of years. Last year they grew by about 6%. The level of investments is still low – their share of GDP remains below 20% – and so additional recovery is expected in the coming years. Furthermore, the efficiency of public investments is improving, i.e. efficiency of spending is improving.

Exports are continuing to grow. Up until 2008, the economy was rather closed, at least when it came to exports. Since then, exports of both goods and services have grown strongly: by 2016, exports of goods had risen by over 80% in euro terms compared to 2008, and services by over 60%. Exports to the EU have grown particularly strongly; but the Central European Free Trade Agreement (CEFTA), which came into effect in 2006, has also helped, especially with agricultural goods. Thanks to a recovery in the past year or so from the post-2008 stagnation, and also to steady export growth since 2009, the Serbian economy is now much more open, with exports of goods and services above 50% of GDP. Export-led growth is expected to continue.

Industrial production has continued to grow, too. Manufacturing has been doing better: at about 15% of total value added, its share in the economy is somewhat higher than in the region as a whole, and so the improved performance matters. Growth has been more pronounced over the past few years, but overall industry is still recovering from the 2009 slump (and the decline in 2013). It is expected to continue to improve in the medium term, though that will depend a lot on the availability of investment.

Agricultural production has also improved. It is still the case, however, that weather is the main factor in the performance of agriculture. Demand in the region and on other markets is not a constraint, but investments and productivity are. This is one country that has a trade surplus in food products.

Fiscal adjustment is almost over – at least in terms of cutting fiscal deficit. Though the numbers are not entirely transparent, fiscal deficit was down to around 2% of GDP in 2016. With implicit liabilities, the figure is probably a shade higher, but the planned deficit of less than 2% in coming years seems attainable and sustainable. Indeed, public spending recorded real growth in 2016 for the first time since the programme of fiscal consolidation was adopted in 2014. The cost in lost GDP has been borne, and a modest positive contribution is planned for the next few years. It is likely to be more on the side of public investments, while wage and pension growth will probably be rather subdued. Last year there were parliamentary elections, and there are presidential elections this year (in April), and so additional fiscal measures can only be expected later in the year or even next year. Those may prove necessary if public debt does not start to decline due to improved growth: it stands at over 70% of GDP at the moment. The aim is to bring it down to 45%, in accordance with the law on fiscal responsibility.

Inflation is still low. Prolonged economic stagnation or slow recovery has changed the traditional exchange-rate and monetary-policy stance. In the past, a fixed exchange rate with relatively high inflation tended to be disrupted by periodic devaluations. In the last few years, deflationary pressures have been strong, and so the exchange rate has been anchored; the Serbian dinar (RSD) has depreciated only slightly, and prices have been growing ever more slowly. This has induced the central bank to cut its interest rate to levels rarely seen in Serbia. Currently, consumer prices are growing at just above 1%, whereas the inflation target is 3%, plus or minus 1.5 percentage points (reduced from 4%). The central bank expects inflation to return to within the tolerance band this year, but it is not clear when it will be fully on target.

The unemployment rate has declined significantly – to below 14% in the third quarter of 2016. For the year as a whole, it will be around 15%. The employment rate among those aged over 15 has also improved, and now stands at a little below 47% (probably around 45% for the year as a whole). Some of that progress is due to an increase in informal employment; some to outward migration; and some to a decline in productivity (probably supported by a decline in real wages in recent years).

Consumption has started to pick up. Households bore the brunt of fiscal consolidation, and also of the trend for expenditure to switch towards exports. Last year, household consumption started to improve and this is expected to continue in the medium term. Growth in consumption is, however, likely to lag behind growth in investments and exports. An improved current account – needed in part due to relatively high foreign debt and foreign investment position (close to 80% and 100% of GDP, respectively) – will require a further increase in national savings, and thus subdued improvement in consumption. With that, overall recovery cannot be too rapid in the medium term, but should reach around 3%.

Politics continues to generate downside risks. The upcoming presidential elections provide another challenge, in addition to the regional challenges and those that stem from the altered international environment. Serbia still needs to get used to democratic changes in government and to cohabitation, and it also needs to continue the normalisation of its relations within the region. Improved economic prospects and reliance on the regional market should help, but downside risks continue because of dissatisfaction with the government's authoritarian tendencies.

Overall, we can expect an adjustment to export and investment-led growth of 3% by the end of the medium term, with a slow improvement in the labour market and a growing share of manufacturing. Fiscal consolidation is over, in the sense that public consumption is increasing. In addition, household consumption will continue to rise, in part because of growing wages in the public sector and an associated increase in pensions. Investments, public and private, should continue to increase, as should exports, because of the real exchange rate adjustment. Economic risks are on the up side, while political risks are on the down side.

Table 21 / Serbia: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2018
Population, th. pers., mid-year	7,201	7,167	7,132	7,095	7,000	7,000	7,000	7,000
Gross domestic product, RSD bn, nom.	3,584	3,876	3,908	4,043	4,200	4,400	4,600	4,800
annual change in % (real)	-1.0	2.6	-1.8	0.8	2.7	2.8	3.0	3.3
GDP/capita (EUR at PPP)	9,900	10,100	10,100	10,500	11,000	.	.	.
Consumption of households, RSD bn, nom.	2,728	2,886	2,922	2,982	3,024	.	.	.
annual change in % (real)	-2.1	-0.4	-1.3	0.4	1.4	2.0	2.0	2.5
Gross fixed capital form., RSD bn, nom.	759	668	652	715	751	.	.	
annual change in % (real)	13.2	-12.0	-3.6	5.6	5.0	5.0	6.0	5.0
Gross industrial production 2)								
annual change in % (real)	-2.2	5.5	-6.5	8.3	4.7	5.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	-19.5	21.7	2.1	-8.0	8.1	.	.	.
Construction output								
annual change in % (real)	-0.3	-20.0	2.4	20.9	4.4	.	.	.
Employed persons, LFS, th, average 3)	2,228	2,311	2,421	2,574	2,600	2,650	2,700	2,750
annual change in %	-1.1	3.7	4.8	0.6	1.0	2.0	2.0	2.0
Unemployed persons, LFS, th, average 3)	701	656	563	552	500	470	440	450
Unemployment rate, LFS, in %, average 3)	23.9	22.1	18.9	17.7	16.1	15.0	14.0	14.0
Reg. unemployment rate, in %, end of period 4)	28.6	29.1	28.4	26.8	.	.	.	.
Average monthly gross wages, RSD	57,430	60,708	61,426	61,145	63,474	66,000	68,700	71,500
annual change in % (real, gross)	1.0	-1.9	-1.7	-2.4	2.6	2.0	2.0	2.0
Average monthly net wages, RSD	41,377	43,932	44,530	44,432	46,097	48,000	49,900	51,900
annual change in % (real, net)	1.1	-1.5	-1.5	-2.1	2.5	2.0	2.0	2.0
Consumer prices, % p.a.	7.8	7.8	2.9	1.9	1.2	2.0	2.0	2.0
Producer prices in industry, % p.a.	6.8	2.7	1.3	1.0	0.0	1.0	1.2	2.0
General governm.budget, nat.def., % of GDP								
Revenues	41.1	39.7	41.5	41.9	44.0	44.0	44.0	44.0
Expenditures	47.9	45.1	48.1	45.6	47.0	46.0	45.0	46.0
Deficit (-) / surplus (+)	-6.8	-5.5	-6.6	-3.7	-3.0	-2.0	-1.0	-2.0
Public debt, nat.def., % of GDP	56.2	59.6	70.4	74.6	74.0	73.0	72.0	72.0
Stock of loans of non-fin.private sector, % p.a	9.4	-4.9	4.5	3.0	2.4	.	.	.
Non-performing loans (NPL), in %, Dec	18.6	21.4	21.5	21.5	19.4	.	.	.
Central bank policy rate, % p.a., end of period 5)	11.25	9.50	8.00	4.50	4.00	4.00	4.00	4.00
Current account, EUR mn	-3,671	-2,098	-1,985	-1,577	-1,700	-1,500	-1,500	-1,600
Current account, % of GDP	-11.6	-6.1	-6.0	-4.7	-5.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	8,376	10,515	10,641	11,357	12,500	13,100	13,800	14,500
annual change in %	3.2	25.5	1.2	6.7	10.1	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	14,011	14,674	14,752	15,350	16,270	16,900	17,700	18,600
annual change in %	2.9	4.7	0.5	4.1	6.0	4.0	5.0	5.0
Exports of services, BOP, EUR mn	3,093	3,422	3,810	4,273	4,530	4,800	5,000	5,300
annual change in %	2.2	10.6	11.3	12.2	6.0	5.0	5.0	5.0
Imports of services, BOP, EUR mn	2,981	3,109	3,344	3,548	3,620	3,800	4,000	4,200
annual change in %	3.8	4.3	7.6	6.1	2.0	5.0	5.0	5.0
FDI liabilities, EUR mn	1,009	1,548	1,500	2,114	1,800	.	.	.
FDI assets, EUR mn	256	250	264	310	150	.	.	.
Gross reserves of NB, excl. gold, EUR mn	10,295	10,734	9,351	9,812	9,543	.	.	.
Gross external debt, EUR mn 6)	25,645	25,644	25,679	26,374	27,000	28,000	29,000	30,000
Gross external debt, % of GDP 6)	80.9	74.8	77.1	78.8	79.1	79.0	79.0	79.0
Average exchange rate RSD/EUR	113.13	113.14	117.31	120.76	123.10	124	125	126

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) Until 2013 survey of April and October, quarterly thereafter. From 2013 census 2011, from 2015 further adjustments according to ILO, Eurostat and EU-LFS. - 4) From 2015 new source for labour force potential. - 5) Two week repo rate. - 6) BOP 5th Edition.

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