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Serbia:
risking instability

The impact of the crisis on Serbia is nothing out of the ordinary. The main features have been a decrease in foreign investment and a sharp decline in foreign trade. Even before that, industrial production had started to decline, ending the year close to stagnation. This was partly attributable to tighter monetary policy that the central bank introduced as it struggled to check inflation. In the last quarter, however, the decline was more pronounced owing to falling exports and declining consumption.

Perhaps the major story has been the budget. In September 2008, it was revised in order to increase pensions on average by 10%, thus fulfilling a pre-election promise. Three months later in December, however, the government drew up the budget for the coming year assuming a GDP growth rate of 3.5% in 2009. That budget served as the basis for the stand-by agreement with the IMF that entered into effect in mid-January 2009. At that very moment, however, it was clear that the initial assumptions had been too optimistic. Equally miscalculated and hence more than inadequate was the financial support of just over 400 million euro, which the Serb government had negotiated with the IMF, the declared intention being only to draw down the funds, if absolutely necessary.

As a consequence, it transpired that the assumptions on which the monetary and fiscal polices had been predicated were completely out of touch with reality. Awareness of that fact was reflected in the sharp depreciation of the dinar – of about 25% in the final months of 2008 and the first month of 2009. The budget, on the other hand, has been facing a series of shortfalls; it will have to be revised in the very near future. Initially, the idea was to put a cap on the current expenditures, yet continue with public investments and even increase them. In the next budget revision, it is quite likely that current expenditures will have to be cut and some investments either postponed or discontinued.

An additional problem is the relatively high inflation rate. With imports falling in tandem with import prices, such as those of oil, gas and raw materials, one could expect inflation to decelerate. This should be matched by a decrease in consumption owing to credit not being readily available. Disinflation will thus eventually come; at present, however, depreciation and the long overdue adjustment of regulated prices are keeping the inflation rate at a relatively high level. The central bank expects inflation to run to 8% (plus or minus 2%) year-on-year. Given the speed with which the economy is deteriorating, an even lower inflation rate seems realistic. At the moment, however, prices are going in the opposite direction.

The government's revised projection for GDP growth in 2009 is 1.9% with a rebound in 2010. The basis for this assessment is not known. Most observers expect a zero GDP growth rate at best. This can only be achieved if macro-economic stability is ensured. For want of a significant inflow of foreign funds, however, it will not be possible to stabilize the currency; that in turn may lead to problems with refinancing private debt. The country runs the risk of a surge of bankruptcies that will place the banks in a very awkward position. Thus, there is every risk of a full-blown crisis.

Current government strategy seems to be to one of seeking financial support from the international financial institutions and sovereign lenders. The first step will have to be the revised stand-by agreement with the IMF; it will include major savings in the public sector in exchange for significant financial support for the central bank reserves designed to stabilize the currency. When it comes, that programme will lead to further contraction as it will require a trade-off between growth and stability.

In addition to that, there are hopes of receiving some financial support from the EU funds for macro-economic stability; those funds, however, are rather limited (around 1 billion euro) and all candidate and potential candidate countries in need of support are eligible. Projects financed by the World Bank will be continued; however, the source of funds that the government will draw on to co-finance those projects is not clear. No other financial sources have been identified to date.

Given the negative outlook, GDP cannot be expected to grow this year. Employment will also decline in both the public and private sectors. It is not clear whether the government will have the money to finance ever-increasing social and welfare needs. Enterprises are also demanding ever more financial support from the budget as they face problems of securing credits and servicing the higher costs of borrowing. The budget can hardly satisfy all these demands.

Beyond the current crisis, it is uncertain whether the economy can return to its previous growth strategy. It seems more realistic to base the medium-term strategy on increased savings and export-led growth. If that turns out to be the case, one can hardly expect the economy to return to high rate of growth in the next two years. It will take at least that long to build up the necessary export base.

Table RS

Serbia: Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 [1]	2009	2010 Forecast	2011
Population, th pers., average [2]	7481	7463	7441	7412	7382	7350	.	.	.
Gross domestic product, RSD mn, nom.	1137607	1388099	1691941	1987765	2329400	2760700	2867800	2953800	3103300
annual change in % (real)	2.8	8.2	6.0	5.6	7.1	6.1	-2	0	2
GDP/capita (EUR at exchange rate)	2300	2600	2700	3200	4000	4600	.	.	.
GDP/capita (EUR at PPP - wiiw)	5900	6600	7200	7800	8500	9300	.	.	.
Consumption of households, RSD mn, nom.	881317	1052684	1281014	1492693	1831500	.	.	.	.
annual change in % (real) [3]	.	.	5.0	5.4	6	6	-2	0	2
Gross fixed capital form., RSD mn, nom.	188875	265714	319859	412752	498000	.	.	.	.
annual change in % (real) [3]	.	.	5.0	15.2	12	8	-2	0	3
Gross industrial production									
annual change in % (real)	-3.0	7.1	0.8	4.7	3.7	1.1	0	0	3
Gross agricultural production									
annual change in % (real)	-11.4	26.0	-3.4	-2.6	.	.	.	.	.
Construction output total									
annual change in % (real) [4]	10.8	3.5	2.0	7.7	8.3	.	.	.	.
Employed persons - LFS, th, Oct [5]	2918.6	2930.8	2733.4	2630.7	2655.7	2805.3	.	.	.
annual change in %	-2.7	0.4	.	-3.8	1.0	5.6	.	.	.
Unemployed persons - LFS, th, Oct [5]	500.3	665.4	719.9	693.0	585.5	457.2	.	.	.
Unemployment rate - LFS, in %, Oct [5]	14.6	18.5	20.8	20.9	18.1	14.0	18	20	20
Reg. unemployment rate, in %, end of period [6]	31.9	26.4	27.1	27.9	25.1	24		.	.
Average gross monthly wages, RSD	16612	20555	25514	31745	38744	45674	.	.	.
annual change in % (real, net)	13.6	10.1	6.4	11.4	19.5	3.9	.	.	.
Consumer prices, % p.a. [7]	9.9	11.4	16.2	11.7	7.0	11.7	6	3	3
Producer prices in industry, % p.a. [8]	4.6	9.1	14.2	13.3	5.9	12.4	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	41.6	42.5	42.7	43.6	43.3	42.5	.	.	.
Expenditures	42.7	41.5	41.8	45.2	45.2	45.0	.	.	.
Deficit (-) / surplus (+), % GDP	-1.1	0.9	0.9	-1.7	-1.9	-2.5	-2	-2	-1
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate of NB, % p.a., end of period	9.0	8.5	8.5	8.5	8.5	8.5	.	.	.
Current account, EUR mn [9]	-1356.1	-2639.5	-1766.1	-2382.1	-3863.8	-6000	-2900	-2700	-3100
Current account in % of GDP	-7.8	-13.8	-8.7	-10.1	-13.3	-17.8	-10	-10	-12
Exports of goods, BOP, EUR mn [9)10)]	2937.9	3283.8	3998.9	5137.4	6473.5	7900	7100	7100	7800
annual growth rate in %	25.1	11.8	21.8	28.5	26.0	22	-10	0	10
Imports of goods, BOP, EUR mn [9)10)]	6497.1	8487.9	8255.3	10138.4	12927.3	16700	15000	15000	16500
annual growth rate in %	12.5	30.6	-2.7	22.8	27.5	29	-10	0	10
Exports of services, BOP, EUR mn [9)10)]	919.7	1186.6	1315.5	1851.0	2148.6	2600	2500	2500	2800
annual growth rate in %	15.7	29.0	10.9	40.7	16.1	20	-5	0	10
Imports of services, BOP, EUR mn [9)10))]	740.9	1055.5	1321.2	1892.4	2161.7	2500	2300	2300	2500
annual growth rate in %	12.8	42.5	25.2	43.2	14.2	15	-10	0	10
FDI inflow, EUR mn [9)11)]	1208.3	777.1	1265.3	3515.7	2272.5	1900	.	.	.
FDI outflow, EUR mn [9]	.	.	18	17	668	160	.	.	.
Gross reserves of NB, excl. gold, EUR mn	2728.2	3008.0	4753.7	8841.3	9422.2	7875.1	.	.	.
Gross external debt, EUR mn	10858.3	10354.5	13064.0	14884.6	17790.5	22000	.	.	.
Gross external debt in % of GDP	65.2	58.8	66.0	59.2	60.5	70.6	.	.	.
Average exchange rate RSD/EUR	65.05	72.57	82.91	84.19	79.98	81.90	100	110	120
Purchasing power parity RSD/EUR [12]	25.62	28.22	31.72	34.34	37.30	40.49	.	.	.

Note: From 2004 the term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 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) Until 2003 jobseekers in per cent of labour force excluding farmers. - 7) From 2008 according to COICOP-classification. - 8) Based on domestic output prices. - 9) Converted from USD with the average exchange rate. - 10) From 2006 including transactions with Montenegro. - 11) Until 2004 FDI net. - 12) Benchmark results 2005 from Eurostat and wiiw estimates.

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