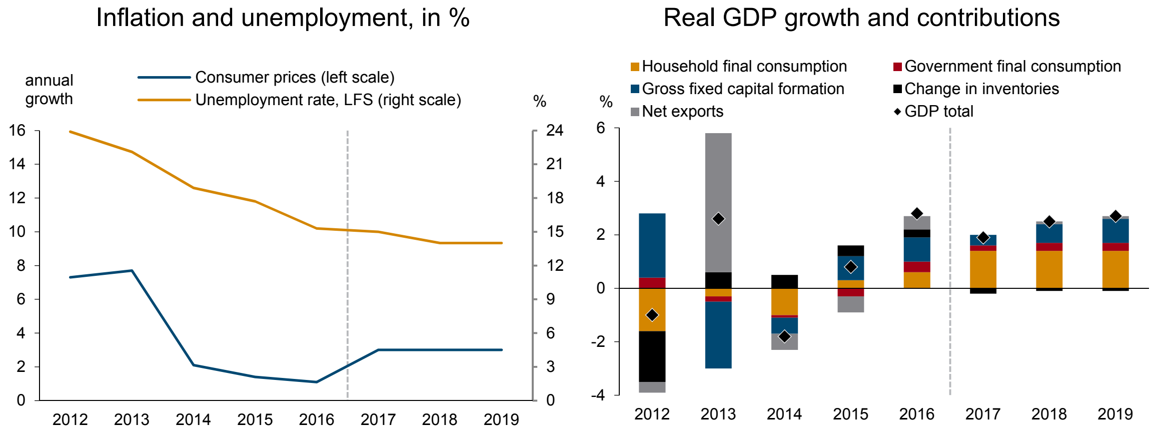
SERBIA: Slowdown and confusion

VLADIMIR GLIGOROV

If there is no sustained recovery of investments, which stand at just around 18% of GDP now, growth cannot speed up too much in the medium term. It should rise to around 2.5% in 2018, and probably some more in 2019. But growth rates above 3%, which are certainly within the economy's potential, can be contemplated only beyond that period.

Figure 47 / Serbia: Main macroeconomic indicators



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

This year's growth will disappoint. The first half came in with just over 1% growth of GDP over the previous year. It is expected to speed up in the second half, but probably not as much as to push the growth rate higher than 2%. With continuing growth of manufacturing and exports and with the recovery of consumption, both private and public, it is the slowdown of investment together with falling energy and agricultural production which are slowing the growth. The unemployment rate continues to decline, heading to 12% or even 10% in the medium run, which is the consequence of the rise of informal employment, outward migration, and expansion of jobs with low productivity. The three-year agreement with the IMF is expiring, so the government is contemplating some increases in wages of public sector employees and in pensions.

Fiscal consolidation has proved costly in terms of growth. There is not much new to be said about current and even medium-term developments. Perhaps the key issue, given the economic history of the country, is the strength or lack of policy commitment. In the last few years, the challenge has been fiscal consolidation, pursued rather single-mindedly since early 2014. Within three years, the high fiscal deficit has been slashed to close to balance with public debt declining from more than 70% of GDP to somewhere above 60%. Some of it is due to the exchange rate changes, as more than 50% of the debt is in foreign currency (euro and dollar). However, the average real growth rate in the last three years is going to be below 2%. Given the potential growth rate being somewhere around 4%, this policy adjustment has proved costly.

Some macroeconomic rebalancing has been achieved. Like most Balkan economies, Serbia features a rather high share of consumption in GDP. Before the current fiscal policy adjustment, final consumption tended to be 90% to 95% of GDP. In the last three years, it has declined by as much as 10 percentage points (depending on the base year or period). Exports have increased to compensate for that in part, and investments increased, after declining quite strongly since 2008. Still, the overall growth performance disappointed. In 2017, the central government is running a primary surplus of between 2% and 3% of GDP (it is hard to say before the end of the year), which it seems had no idea what to do with. As a consequence, it is contemplating a stimulus package to boost consumption and perhaps some easy-to-implement investments. So, the macroeconomic balances seem to be tending towards a long-term structure with high consumption and reliance on foreign investments.

Optimism of the government and the IMF proved unfounded. As has been the case in a number of other instances of fiscal adjustments, there were unrealistic expectations. There is no doubt that rebalancing was needed, however, one that was sustainable. The IMF was optimistic that growth would speed up after the initial slowdown. Indeed, as late as the end of June 2017, it projected growth of 3% for this year. It also expects recovery next year and in the medium term. Eventually, that will happen, though probably due to a change of policy rather than because of enduring policy commitment.

Political pressure is mounting. The current government dates from 2012. However, in order to get ahead of a possible increase in instability, it called for three early elections in five years. It also changed the nature of the system of governance with the last presidential elections in 2017. It is now de facto a presidential rather than parliamentary system of government, the latter being the constitutional one. With that, political responsibility is weaker and authoritarianism is easier to practise. There are rumours in the public of possible early elections together with the upcoming election for the city government in the capital of Belgrade. Because there is growing dissatisfaction, chances are the opposition may have a strong showing and perhaps even win. In that context, plans for increases in wages and pensions ahead of the elections together with an early general poll may seem attractive to the government. However, such manoeuvres are increasingly risky given the declining prospects for economic recovery.

Medium-term prospects are rather less than optimistic. After five years, the government does not have much to show for itself. Also, its international and regional policies are not without problems. There is still strong support in the EU and in Berlin in particular, but doubts about the ability of President Vučić to deliver are increasing. Also, fiscal consolidation is increasingly seen as a failure, not in terms of the fiscal deficit or the current level of public debt, but because of lack of improvement in the real economy and slow growth. Thus, if it proves unsustainable, and consumption-driven growth is the alternative strategy with the aim of shoring up political support, instability both domestic and international is possible. In addition, the system has advanced enough on the path to authoritarianism to be able to accept a division of power if the opposition were to make inroads in the capital city especially and preserve stability.

Investments are the key. Investments stand at around 18% of GDP. They recovered from as low as 16% in the period after 2008. Their growth has slowed down however. If there is no sustained recovery, growth cannot speed up too much in the medium term. It should amount to around 2.5% in 2018 and probably some more in 2019. But growth rates above 3%, which are certainly within the economy's potential, can be contemplated only beyond that period.

Table 22 / Serbia: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th. pers., mid-year	7,167	7,132	7,095	7,058	.	.	7,000	7,000	7,000
Gross domestic product, RSD bn, nom. 2)	3,876	3,908	4,043	4,262	1,969	2,048	4,500	4,800	5,100
annual change in % (real)	2.6	-1.8	0.8	2.8	2.9	1.2	1.9	2.5	2.7
GDP/capita (EUR at PPP)	10,100	10,100	10,500	10,700	.	.	.	.	.
Consumption of households, RSD bn, nom. 2)	2,886	2,922	2,982	3,041	1,472	1,533	.	.	.
annual change in % (real)	-0.4	-1.3	0.4	0.8	0.9	1.8	2.0	2.0	2.0
Gross fixed capital form., RSD bn, nom. 2)	668	652	715	756	347	365	.	.	.
annual change in % (real)	-12.0	-3.6	5.6	5.1	5.5	2.0	2.0	4.0	5.0
Gross industrial production 3)									
annual change in % (real)	5.4	-6.4	8.3	4.7	6.7	0.4	2.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	21.8	2.4	-8.4	8.1	.	.	.	.	.
Construction output									
annual change in % (real)	-20.0	2.4	20.9	7.1	12.9	-2.5	.	.	.
Employed persons, LFS, th, average 4)	2,311	2,421	2,574	2,719	2,666	2,767	2,790	2,850	2,910
annual change in %	3.7	4.8	0.6	5.6	4.7	3.8	2.5	2.0	2.0
Unemployed persons, LFS, th, average 4)	656	563	552	489	549	418	490	460	470
Unemployment rate, LFS, in %, average 4)	22.1	18.9	17.7	15.3	17.1	13.2	15.0	14.0	14.0
Reg. unemployment rate, in %, eop 5)	29.1	28.4	26.8	25.9	26.0	23.8	.	.	.
Average monthly gross wages, RSD	60,708	61,426	61,145	63,474	62,012	64,694	66,700	70,100	73,600
annual change in % (real, gross)	-1.9	-1.7	-2.4	2.6	3.3	0.9	2.0	2.0	2.0
Average monthly net wages, RSD	43,932	44,530	44,432	46,097	45,069	47,029	48,400	50,800	53,400
annual change in % (real, net)	-1.5	-1.5	-2.1	2.5	3.3	1.0	2.0	2.0	2.0
Consumer prices, % p.a.	7.7	2.1	1.4	1.1	1.0	3.4	3.0	3.0	3.0
Producer prices in industry, % p.a.	2.7	1.3	1.0	0.0	-0.8	3.0	1.0	1.2	2.0
General governm.budget, nat.def., % of GDP									
Revenues	39.7	41.5	41.9	43.2	44.5	46.6	44.0	44.0	44.0
Expenditures	45.1	48.1	45.6	44.5	45.4	44.4	45.0	45.0	46.0
Deficit (-) / surplus (+)	-5.5	-6.6	-3.7	-1.3	-0.9	2.2	-1.0	-1.0	-2.0
Public debt, nat.def., % of GDP	59.6	70.4	74.7	71.9	.	.	68.0	68.0	68.0
Stock of loans of non-fin.private sector, % p.a	-4.9	4.5	3.0	2.3	4.7	2.2	.	.	.
Non-performing loans (NPL), in %, eop	21.4	21.5	21.5	17.0	.	.	.	.	.
Central bank policy rate, % p.a., eop 6)	9.50	8.00	4.50	4.00	4.3	4.0	3.75	3.75	4.00
Current account, EUR mn	-2,098	-1,985	-1,577	-1,370	-689	-1,113	-1,540	-1,770	-2,050
Current account, % of GDP	-6.1	-6.0	-4.7	-4.0	-4.3	-6.7	-4.2	-4.5	-5.0
Exports of goods, BOP, EUR mn	10,515	10,641	11,357	12,732	6,250	6,968	14,300	15,300	16,400
annual change in %	25.5	1.2	6.7	12.1	11.6	11.5	12.0	7.0	7.0
Imports of goods, BOP, EUR mn	14,674	14,752	15,350	16,209	7,931	8,949	18,000	19,300	20,700
annual change in %	4.7	0.5	4.1	5.6	5.5	12.8	11.0	7.0	7.0
Exports of services, BOP, EUR mn	3,422	3,810	4,273	4,581	2,061	2,346	4,800	5,100	5,500
annual change in %	10.6	11.3	12.2	7.2	6.7	13.8	5.0	6.0	7.0
Imports of services, BOP, EUR mn	3,109	3,344	3,548	3,686	1,691	1,962	4,000	4,400	4,800
annual change in %	4.3	7.6	6.1	3.9	0.6	16.0	9.0	9.0	8.0
FDI liabilities, EUR mn	1,548	1,500	2,114	2,080	1,010	1,129	2,000	.	.
FDI assets, EUR mn	250	264	310	219	128.0	38.0	100	.	.
Gross reserves of NB, excl. gold, EUR mn	10,734	9,351	9,812	9,543	8,585	9,006	.	.	.
Gross external debt, EUR mn 7)	25,644	25,679	26,234	26,549	25,667	25,425	28,000	29,000	30,000
Gross external debt, % of GDP 7)	74.8	77.1	78.3	76.7	74.0	69.0	76.0	74.0	73.0
Average exchange rate RSD/EUR	113.14	117.31	120.76	123.10	122.93	123.39	122	123	124

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Excluding arms industry. - 4) In 2013 survey of April and October, quarterly thereafter. From 2015 adjustments according to ILO, Eurostat and EU-LFS. - 5) From 2015 new source for labour force potential. - 6) Two week repo rate. - 7) BOP 5th Edition.

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