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Serbia:
Stagnation at Best

In Serbia, growth is grinding to a halt this year. Medium-term prospects depend in part on the outcome of the general elections in May and the presidential elections sometime this year. There is scope for significant economic policy changes and gradual recovery in the following couple of years. Improved relations with the EU – Serbia is now a candidate country hoping to start negotiating with the EU early next year – should prove helpful if sustained. The key issue is the huge drop in employment and possible social backlash.

The growth forecast has been revised down in recent discussions with the IMF mission to 0.5% for 2012. The mission could not agree on the fiscal policy for this year and postponed the approval of the precautionary stand-by agreement for after the upcoming general elections. They should take place in early May. Still, the IMF staff left an aid-memoire in which it outlined its recommendations to the new government's economic policy programme.

The model the IMF suggests is based on fiscal consolidation to ensure macroeconomic stability and structural reforms to spur growth. Though the forecast for the next couple of years of the implementation of that programme features an admittedly slow recovery, it is loaded with downside risks even without taking into account the political and even more the social sustainability of such a policy stance. Employment has been declining quite strongly since late 2008 and will continue to decline with a stagnating economy. In fact, the proposed structural reforms will certainly lead to rather significant shedding of labour in the public sector in particular and the unemployment rate, currently standing at above 24%, may shoot up to 30% in the next couple of years. Serbia has no experience with such a high unemployment rate and it is hard to predict the social response. In the past, outward migration tended to be a way to handle adverse labour market developments, but this may prove more difficult this time around.

The hope is that with macroeconomic stability, private and perhaps public investments will rise and thus spur growth and increase employment. The major problem is whether the external constraint will allow that. Foreign debt stands at just above EUR 24 billion and has increased only slightly over the last year, most of the current account deficit being covered by foreign direct investments of about EUR 1.5 billion in 2011. It is not expected that foreign credits will increase in the next few years and in fact the trade and current account deficits need to shrink further in order for foreign debts to be serviced. That will also limit the amount of foreign investment that is in accordance with external sustainability.

The increase of domestic investment cannot be too fast due to the pressure on the corporate sector to deleverage. Massive layoffs in the past three years have probably led to an improvement of the corporate balance sheets, but have significantly constrained private consumption. Public consumption has also declined because public revenues have declined rather sharply – about 5 percentage points since 2008 (from 44% of GDP to 39%) – and the ability to borrow has been constrained by high interest rates. As a consequence, public expenditures have declined from close to 46% in 2008 to about 43.5% in 2011. Much of this contraction of public revenues and especially public expenditures has happened in 2011. The IMF is recommending further fiscal consolidation because public debt is projected to go well above 50% of GDP in this and the next year and that is deemed to be unsustainable and is anyway in violation of the law of fiscal responsibility that put the limit of public debt to GDP at 45%. How sensible that ceiling is may be a good question, but if the fiscal deficit is to go back to that level, it will have to experience a rather significant decline.

The suggestion is to hike the VAT rate and to cut expenditures on wages, pensions, and subsidies. The entrepreneurs are unhappy with the tax hike and a further decline of public expenditures will be recessionary. With such an economic programme in place, it will take few years of restructuring of the product and labour markets for fast growth to return. There are few if any alternative policy proposals ahead of the upcoming elections. It is not expected that the new government will accept the IMF proposal, at least not in the pure version, as it is more likely that it will continue to muddle through relying on improved external circumstances. Therefore, chances are the Serbian economy is in for a few years of stagnation, i.e. of growth between 0 this year and perhaps 2% in 2014.

Table RS

Serbia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013	2014
								Forecast	
Population, th. pers., mid-year	7411.6	7381.6	7350.2	7320.8	7291.4	7280	7250	7220	7200
Gross domestic product, RSD bn, nom. [2]	1962.1	2276.9	2661.4	2713.2	2986.6	3400	3600	3800	4100
annual change in % (real) [2]	3.6	5.4	3.8	-3.5	1.0	1.9	0	1	2
GDP/capita (EUR at exchange rate)	3100	3900	4400	3900	4000	4500	.	.	.
GDP/capita (EUR at PPP - wiiw)	7700	8200	9000	8400	8700	9100	.	.	.
Consumption of households, RSD bn, nom. [2]	1492.7	1714.0	2023.6	2143.2	2300.0	2600	.	.	.
annual change in % (real) [3]	5.4	6	6	-2	2	1	0	1	1
Gross fixed capital form., RSD bn, nom. [2]	412.8	552.3	632.4	510.2	600.0	700	.	.	.
annual change in % (real) [3]	15.2	12	8	-5	-4	0	3	3	3
Gross industrial production									
annual change in % (real) [4]	4.2	4.1	1.4	-12.6	2.5	2.1	2	3	4
Gross agricultural production									
annual change in % (real)	-2.6	-11.7	13.7	1.3	1.0	0.8	2	3	3
Construction output [5]									
annual change in % (real)	5.9	10.8	4.7	-19.7	-7.8	17.7	3	3	3
Employed persons - LFS, th, average [6]	2630.7	2655.7	2821.7	2616.4	2396.2	2253.2	2150	2100	2100
annual change in %	-3.8	1.0	.	-7.3	-8.4	-6.0	-5	-2	0
Unemployed persons - LFS, th, average [6]	693.0	585.5	445.4	503.0	568.7	671.1	.	.	.
Unemployment rate - LFS, in %, average [6]	20.9	18.1	13.6	16.1	19.2	23.0	25	25	25
Unemployment rate, reg., in %, end of period	28.0	25.4	24.0	25.9	26.7	27.2	28	28	28
Average gross monthly wages, RSD [7]	31745	38744	45674	44147	47450	52733	.	.	.
real growth rate, % (net wages) [7]	11.4	19.5	3.9	0.2	0.7	0.2	.	.	.
Consumer prices, % p.a.	11.7	7.0	13.5	8.6	6.8	11.0	7	5	5
Producer prices in industry, % p.a. [8]	.	.	12.4	5.6	12.7	14.3	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	44.2	44.0	43.0	42.3	41.0	39	.	.	.
Expenditures	45.8	46.0	45.6	46.7	45.5	44	.	.	.
Deficit (-) / surplus (+), % GDP	-1.6	-2.0	-2.6	-4.5	-4.6	-5	-5	-4	-4
Public debt, nat.def., in % of GDP	37.7	30.9	29.2	34.8	42.9	45	48	49	49
Central bank policy rate, % p.a., end of period [9]	14.00	10.00	17.75	9.50	11.50	9.75	8	6	5
Current account, EUR mn	-2356.0	-5052.6	-7054.1	-2084.4	-2082.0	-2490	-2900	-3280	-3240
Current account in % of GDP	-10.1	-17.7	-21.6	-7.2	-7.2	-7.5	-9.0	-10.0	-9.5
Exports of goods, BOP, EUR mn	5109.0	6382.5	7416.0	5977.8	7402.5	8500	9400	10300	11500
annual growth rate in %	27.4	24.9	16.2	-19.4	23.8	15	10	10	12
Imports of goods, BOP, EUR mn	10090.0	13451.3	15917.2	11096.3	12175.8	14000	15400	16900	18600
annual growth rate in %	21.8	33.3	18.3	-30.3	9.7	15	10	10	10
Exports of services, BOP, EUR mn	1839.0	2304.0	2741.4	2500.0	2667.1	2930	3200	3500	3900
annual growth rate in %	39.3	25.3	19.0	-8.8	6.7	10	10	10	10
Imports of services, BOP, EUR mn	1880.0	2565.1	2926.1	2481.7	2661.9	2930	3200	3500	3900
annual growth rate in %	41.9	36.4	14.1	-15.2	7.3	10	10	10	10
FDI inflow, EUR mn	3392.4	2512.6	2017.5	1410.1	1003.1	2000	2000	2000	2000
FDI outflow, EUR mn	69.8	691.8	193.1	37.6	143.0	50	300	100	100
Gross reserves of NB, excl. gold, EUR mn	8857.9	9440.7	7938.5	10277.7	9554.9	10500	.	.	.
Gross external debt, EUR mn	14182.0	17139.0	21088.0	22487.0	23786.4	24000	.	.	.
Gross external debt in % of GDP	60.9	60.2	64.6	77.9	82.0	72.7	.	.	.
Exchange rate RSD/EUR, average	84.19	79.98	81.47	93.94	102.90	102.93	112	116	120
Purchasing power parity RSD/EUR [10]	34.42	37.59	40.16	44.35	46.92	51.59	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (non-observed economy partially included, real growth rates based on previous year prices). - 3) wiiw estimate. - 4) Accorrding to gross value added. -5) From 2008 extended survey as of April and October (before October only). - 6) From 2009 including wages of employees working for sole proprietors. - 7) Domestic output prices. - 8) Two-week repo rate. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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