

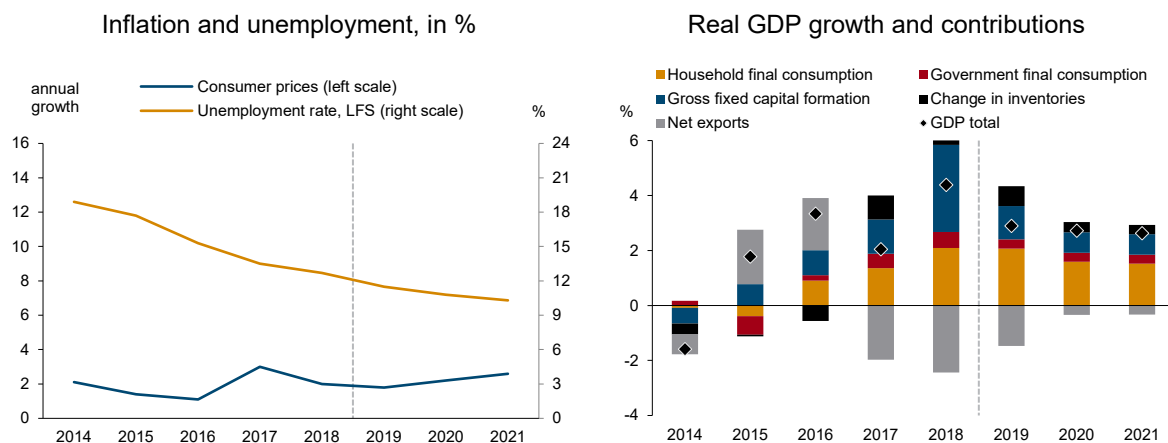


## SERBIA: Back to reality

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After posting comfortably its strongest real GDP increase for a decade in 2018, the Serbian economy has adjusted back to a more muted growth path, and should expand by just under 3% this year. Growth of 2.5-3% is likely during the rest of the forecast period, with the government set to remain focused on FDI-driven investment. Political tensions in the region are rising, but would have to get much worse to constitute a significant downside risk to the economy.

Figure 5.19 / Serbia: Main macroeconomic indicators



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

**Economic momentum has tailed off so far in 2019, in line with our expectations, and we continue to expect full-year expansion of a bit below 3%.** This is down from 4.3% in 2018, and reflects a combination of domestic and external headwinds. 100% tariffs on exports imposed by Kosovo, production shutdowns at the key Fiat-Chrysler plant and the broader downturn in the global manufacturing sector all present challenges for near-term economic growth. The growth contribution from agriculture in 2019 has also been held down by the high statistical base.

**Investment continues to hold up very well, and this looks set to remain the case during the forecast period.** Big infrastructure projects are ongoing and FDI inflows remain robust. Strong investment activity has contributed to rapid import growth (up 11% year on year in Q2), leading to a clear negative contribution from net exports to headline growth so far this year.

**Nevertheless, in the context of the Kosovo tariffs, production shutdowns and external weakness, exports have held up quite well so far.** However, it is unlikely that this will remain the case indefinitely. The recent election result in Kosovo suggests that tariffs will not be removed anytime soon (this would

require unimaginable political concessions from Serbia), while the downturn in the global manufacturing sector appears unlikely to abate. At the global level, the situation could get worse before it gets better. In a prolonged period of low growth or recession in countries like Germany and Italy, it is hard to see how Serbia will not suffer.

**Private consumption trends look solid, continuing at a similar level to 2018.** Real wages surged by 7.5% year on year in Q2, while employment and credit growth have also been strong. The trends in employment and real wages largely mirror those seen in much of the rest of CESEE, and especially the EU Member States of the region, with labour shortages starting to bite and increasing employees' bargaining power. Declining inflation is also helping to push up real income growth; inflation fell from 3.1% (on an annual basis) in April to 1.3% in August.

**Monetary policy looks set to remain at historically loose levels throughout the forecast period.**

With inflationary pressures cooling rapidly, and the big central banks (the ECB and the US Federal Reserve) back in easing mode, the National Bank of Serbia (NBS) has felt comfortable cutting rates twice recently. The real policy rate is now at around 1%, compared with almost 8% as recently as 2015. We expect the NBS to retain this loose monetary stance, and to get away with it, owing to high levels of global liquidity. This should provide some moderate support for growth. Inflation should bottom out and gradually pick up towards the end of the year, although a lot of that will depend on the direction of oil prices. The dinar is likely to remain roughly stable against the euro during the forecast period.

**Fiscal policy is being slightly loosened ahead of the upcoming parliamentary election, but this is unlikely to make a significant difference to the headline budget balance.** The government has increased social transfers, and has promised to increase public sector wages and make a one-off payment to pensioners by the end of 2019. However, it also remains committed to quite a tight fiscal stance and to bringing down the public debt burden and the announced measures do not change this materially. We expect general government debt as a share of GDP to fall below 50% by 2021, compared with 70% as recently as 2015.

**Regional political tensions have increased in the last couple of years and could rise further following the Kosovo election result.** There, the left-wing Vetevendosje took the largest share of the vote. The party's leader, Albin Kurti, has said he will only remove the 100% tariffs on Serbia in return for Serbian recognition of Kosovan licence plates and IDs (very difficult to imagine). He has also in the past spoken in favour of the unification of Kosovo and Albania, and is strongly opposed to the territorial swap plan hatched by Kosovan president Hashim Thaçi and his Serbian equivalent Aleksandar Vučić. Taken together, it appears that progress on negotiations between Serbia and Kosovo has become less likely, and that the chances of higher tensions have increased. A territorial swap between Serbia and Kosovo was never very likely, mostly because of the practical difficulties of implementation rather than opposition from outside actors (although that also exists, not least from Germany).

**Parliamentary elections are due in Serbia in 2020, and tensions could rise further in the run up to polling as hardliners try to fire up their base.** The main opposition coalition, the Alliance for Serbia, continues to boycott parliament. In addition, popular protests against the government have been quite significant and widespread. These protests started in December 2018, after opposition leader Borko Stefanovic was attacked before a television debate, and have continued every week since. However, it would take quite a severe ratcheting up of tensions (either internally or between Serbia and Kosovo) to

put off foreign investors, and there is no evidence of that so far in the data. We expect the ruling Serbian Progressive Party (SNS) to win the election and stay in power, potentially again in coalition with the Socialist Party of Serbia.

**Separately, Serbia has agreed to sign a free trade agreement (FTA) with the Eurasian Economic Union (EAEU) on October 20<sup>th</sup>.** Economically, the agreement is of little significance; Serbia already has an FTA with Russia, Kazakhstan and Belarus, and the remaining EAEU countries are barely visible in external trade data. The political symbolism is potentially more significant as it brings Serbia closer to Russia and has angered the EU. On joining the EU, Serbia will be required to exit all other trade arrangements and adopt those of the EU. However, given the obstacles remaining on Serbia's EU accession path (not least the normalisation of relations with Kosovo), accession is likely to be some way off. As a result, Serbia will likely be able to continue to play a double game between Russia and the EU for some time yet.

**Table 5.19 / Serbia: Selected economic indicators**

	2015	2016	2017	2018 <sup>1)</sup>	2018 January-June	2019	2019 Forecast	2020 Forecast	2021
Population, th. pers., mid-year	7,095	7,058	7,021	6,983	.	.	6,950	6,920	6,880
Gross domestic product, RSD bn, nom. <sup>2)</sup>	4,312	4,521	4,754	5,069	2,410	2,537	5,300	5,600	5,900
annual change in % (real)	1.8	3.3	2.0	4.4	4.9	2.8	2.9	2.7	2.6
GDP/capita (EUR at PPP)	11,200	11,400	11,600	12,300	.	.	.	.	.
Consumption of households, RSD bn, nom. <sup>2)</sup>	3,052	3,152	3,311	3,453	1,659	1,750	.	.	.
annual change in % (real)	-0.5	1.3	2.0	3.0	3.3	3.3	3.0	2.3	2.2
Gross fixed capital form., RSD bn, nom. <sup>2)</sup>	723	766	844	1,017	432	482	.	.	.
annual change in % (real)	4.9	5.4	7.3	17.8	13.7	8.3	6.5	4.0	4.0
Gross industrial production <sup>3)</sup>									
annual change in % (real)	7.3	5.2	3.9	1.3	3.9	-2.3	0.7	2.5	3.3
Gross agricultural production									
annual change in % (real)	-8.4	9.0	-11.9	11.3	.	.	.	.	.
Construction output									
annual change in % (real)	20.7	7.2	8.5	14.1	24.6	15.3	.	.	.
Employed persons, LFS, th, average	2,574	2,719	2,795	2,833	2,793	2,864	2,950	2,980	3,010
annual change in %	0.6	5.6	2.8	1.4	0.9	2.5	4.0	1.0	1.0
Unemployed persons, LFS, th, average	552	489	435	412	430	361	380	360	350
Unemployment rate, LFS, in %, average	17.7	15.3	13.5	12.7	13.4	11.2	11.5	10.8	10.3
Reg. unemployment rate, in %, eop	26.8	25.7	23.0	20.3	21.3	19.5	.	.	.
Average monthly gross wages, RSD <sup>4)</sup>	61,145	63,474	65,976	68,629	68,198	74,727	74,400	78,500	83,000
annual change in % (real, gross)	-2.4	2.6	0.9	3.9	3.7	7.1	6.5	3.2	3.1
Average monthly net wages, RSD <sup>4)</sup>	44,432	46,097	47,893	49,650	49,331	54,146	53,900	56,200	58,800
annual change in % (real, net)	-2.1	2.5	0.9	4.4	4.2	7.3	6.7	2.0	2.0
Consumer prices, % p.a.	1.4	1.1	3.0	2.0	1.7	2.3	1.8	2.2	2.6
Producer prices in industry, % p.a.	1.0	0.0	2.3	0.9	-0.2	1.1	1.5	2.8	3.3
General governm. budget, nat. def., % of GDP									
Revenues	39.3	40.8	41.5	41.5	41.5	42.4	44.5	44.5	44.5
Expenditures	42.8	41.9	40.4	40.9	40.1	41.7	44.5	45.0	45.0
Deficit (-) / surplus (+)	-3.5	-1.2	1.1	0.6	1.4	0.7	0.0	-0.5	-0.5
General gov. gross debt, nat. def., % of GDP	70.0	67.8	57.9	53.7	56.0	51.4	52.0	51.5	48.5
Stock of loans of non-fin. private sector, % p.a.	3.0	2.3	2.1	9.9	4.4	8.9	.	.	.
Non-performing loans (NPL), in %, eop	21.6	17.0	9.8	5.7	7.8	5.2	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	4.5	4.0	3.5	3.0	3.0	3.0	2.5	2.5	3.0
Current account, EUR mn	-1,234	-1,075	-2,051	-2,223	-1,078	-1,636	-2,700	-2,600	-2,700
Current account, % of GDP	-3.5	-2.9	-5.2	-5.2	-5.3	-7.6	-6.0	-5.5	-5.4
Exports of goods, BOP, EUR mn	11,454	12,814	14,066	15,238	7,503	8,143	16,500	17,800	19,200
annual change in %	7.6	11.9	9.8	8.3	7.6	8.5	8.0	8.0	8.0
Imports of goods, BOP, EUR mn	15,099	15,933	18,064	20,483	9,798	10,803	22,400	24,000	25,700
annual change in %	2.4	5.5	13.4	13.4	11.6	10.3	9.5	7.0	7.0
Exports of services, BOP, EUR mn	4,273	4,571	5,246	6,000	2,683	3,132	7,000	7,600	8,200
annual change in %	12.2	7.0	14.8	14.4	14.1	16.7	16.0	8.0	8.0
Imports of services, BOP, EUR mn	3,544	3,664	4,280	4,909	2,210	2,672	5,800	6,200	6,600
annual change in %	6.0	3.4	16.8	14.7	13.3	20.9	18.0	7.0	7.0
FDI liabilities, EUR mn	2,114	2,127	2,548	3,496	1,476	1,905	5,000	.	.
FDI assets, EUR mn	310	228	130	308	70.2	131.9	500	.	.
Gross reserves of NB, excl. gold, EUR mn	9,812	9,543	9,287	10,526	10,421	11,307	.	.	.
Gross external debt, EUR mn <sup>6)</sup>	26,234	26,494	25,574	26,829	26,084	27,817	27,000	27,100	27,200
Gross external debt, % of GDP <sup>6)</sup>	73.5	72.1	65.3	62.6	60.9	61.9	60.0	57.0	54.0
Average exchange rate RSD/EUR	120.73	123.12	121.34	118.27	118.30	118.10	118	118	118

1) Preliminary. - 2) Half-year data unrevised. - 3) Excluding arms industry. - 4) From 2018 based on tax administration data, before on wage survey data supplemented by tax administration data. - 5) Two-week repo rate. - 6) BOP 5th Edition.

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