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Serbia: fiscal blues

The first half of this year has been mostly about elections, with presidential election held in late January and early February while early parliamentary election and regular local elections were held in mid-May. The elections were mostly about the reaction to the independence of Kosovo, with the hardliners losing both the presidential and the parliamentary elections. However, during the pre-election and post-election period (the latter is still not yet over), the government could hardly operate. That added to the uncertainty which was anyway increased because it was not easy to predict the election results and the government coalition that would emerge after the election. This led to a marked slowdown of foreign investments and a number of business deals had to be put on hold or given up on due to mounting political risks.

The major short-term consequence has been a growing threat to macroeconomic stability. Inflation has speeded up and is now running at close to 15% year-on-year. It is expected to slow down in the second half of 2008, but the rate of inflation will still be in double digits, most probably around 12%. This has temporarily helped the budget, which has relied on inflation tax to compensate for much lower than planned privatization receipts. However, the budget will run into increasing deficits in the near future if foreign investors continue to avoid Serbia.

Even if politics stabilizes, these worsened macroeconomic imbalances will keep the risks of investing in Serbia high. The Serbian central bank has had to hike the interest rate quite significantly, but that may not be enough both to slow down inflation and to reassure foreign creditors and investors. The perception of Serbian sovereign and corporate risks has worsened lately and some rating agencies have downgraded the country. Thus, even if money keeps coming in, the costs for the budget and for the economy will be higher.

In the medium run, Serbia's main problem is high external imbalance. The current account deficit was above 15% of GDP in the first quarter of 2008 and though it may decline over the course of the year, it will still remain quite high at above 13%. This is unsustainable in the medium term. That means that the exchange rate will have to be adjusted, hopefully through slow depreciation. The central bank, however, prefers real appreciation of the exchange rate as the easiest way to keep the inflation under control or at least to prevent it from getting completely out of control. That, of course, only deepens the external imbalance.

In these circumstances, the medium-term outcomes depend on short-term stabilization policy. The expectations that GDP will continue to grow at around 5% annually for the next couple of years

depend on the new government taking control of the budget and thus supporting disinflation together with gradual depreciation of the dinar. In that, it will have to renege on the election promises of the likely coalition partners who have all promised more social justice in the form of higher pensions, higher wages and massive new public investments. The political cost of broken promises may be too high, in which case medium-term prospects would have to be revised as the serious risk of forced adjustment will emerge.

Table RS

Serbia: Selected Economic Indicators

	2004	2005	2006	2007 ¹⁾	2007 1st quarter	2008	2008 Forecast	2009 Forecast	2010 Forecast
Population, th pers., mid-year ²⁾	7463	7441	7412	7400	.	.	.	.	.
Gross domestic product, RSD bn, nom.	1431.3	1747.5	2042.0	2376.7	506.3	603.5	2790	3220	3650
annual change in % (real)	8.4	6.2	5.7	7.5	8.2	7.1	5	5	5
GDP/capita (EUR at exchange rate)	2643	2833	3278	4010	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6700	7300	7830	8660	.	.	.	.	.
Gross industrial production									
annual change in % (real)	7.1	0.8	4.7	3.7	4.8	6.0	5	5	5
Gross agricultural production									
annual change in % (real)	26.0	-3.4	-2.6	.	.	.	.	.	.
Construction output total									
annual change in % (real) ³⁾	3.5	2.0	7.7	.	.	.	.	.	.
Consumption of households, RSD bn, nom.	998.5	1214.2	1432.0	.	.	.	.	.	.
annual change in % (real) ⁴⁾	.	5	5.4	6	.	.	5	5	5
Gross fixed capital form., RSD bn, nom.	253.3	302.0	374.4	.	.	.	.	.	.
annual change in % (real) ⁴⁾	.	5	15.2	12	.	.	10	8	8
LFS - employed persons, th. Oct	2930.8	2733.4	2630.7	2655.7	.	.	.	.	.
annual change in %	0.4	-6.7	-3.8	1.0	.	.	.	.	.
Reg. employees in industry, th pers., avg.	562.2	536.1	493.3	460.4	470.0	441 ^{I-II}	.	.	.
annual change in %	-7.1	-4.7	-8.0	-6.7	-8.4	-5.6 ^{I-II}	.	.	.
LFS - unemployed, th pers., Oct	665.4	719.9	693.0	585.5	.	.	.	.	.
LFS - unemployment rate in %, Oct	18.5	20.8	20.9	18.8	.	.	21	23	23
Reg. unemployment rate in %, end of period ⁵⁾	26.4	27.1	27.9	25.1	27.9	25.4	.	.	.
Average gross monthly wages, RSD	20555	25514	31745	38744	35048	41807	.	.	.
annual change in % (real, net)	10.1	6.4	11.4	19.5	18.6	5.4	.	.	.
Consumer prices, % p.a.	11.4	16.2	11.7	7.0	4.8	13.3	12	10	8
Producer prices in industry, % p.a.	9.1	14.2	13.3	5.9	5.5	11.7	6	.	.
General governm. budget, nat.def., % GDP									
Revenues	41.2	.	.	.	.	.	.	.	.
Expenditures	42.6	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-1.4	1.4	-0.6	-0.5	.	.	-2	-1	-1
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	8.5	8.5	8.5	8.5	8.5	8.5	.	.	.
Current account, EUR mn ⁶⁾	-2308.0	-1790.2	-2906.1	-5001.7	-906.9	-1148.0	-4500	-4500	-4500
Current account in % of GDP	-11.7	-8.5	-12.0	-16.9	-14.4	-15.8	-13.5	-12.3	-11.1
Gross reserves of NB, excl. gold, EUR mn	3008.0	4753.7	8841.3	9409.3	8598.4	9321.1	.	.	.
Gross external debt, EUR mn	10354.5	13064.0	14884.6	17769.3	14857.6	17957.3	.	.	.
Gross external debt in % of GDP	57.1	63.9	57.6	59.3	.	.	.	.	.
FDI inflow, EUR mn ^{6/7)}	777.1	1265.3	3504.3	2257.7	649.7	717.3	1500	.	.
FDI outflow, EUR mn ⁶⁾	.	17.9	16.8	663.8	-11.4	3.9	20	.	.
Exports of goods, BOP, EUR mn ⁶⁾	3283.8	3998.9	5155.7	6431.3	1384.3	1641.5	8000	9600	11500
annual growth rate in %	11.8	21.8	28.9	24.7	33.7	18.6	20	20	20
Imports of goods, BOP, EUR mn ⁶⁾	8487.9	8255.3	10107.8	12843.1	2965.9	3554.0	16300	20400	25500
annual growth rate in %	30.6	-2.7	22.4	27.1	33.8	19.8	25	25	25
Exports of services, BOP, EUR mn ⁶⁾	1188.2	1316.3	1674.8	2134.6	514.0	673.0	2700	3400	4100
annual growth rate in %	29.2	10.8	27.2	27.4	.	30.9	25	20	20
Imports of services, BOP, EUR mn ⁶⁾	1047.4	1321.2	1724.1	2147.7	548.0	620.5	2700	3200	3800
annual growth rate in %	41.4	26.1	30.5	24.6	.	13.2	20	20	20
Average exchange rate RSD/USD	58.38	66.71	66.82	58.15	60.86	54.23	.	.	.
Average exchange rate RSD/EUR (ECU)	72.57	82.91	84.06	80.09	80.19	82.85	84	88	90
Purchasing power parity RSD/USD ⁸⁾	24.08	27.21	29.59	31.26	.	.	.	.	.
Purchasing power parity RSD/EUR ⁸⁾	28.63	32.17	35.19	37.10	.	.	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) wiiw estimate in 2007. - 3) Gross value added. - 4) wiiw estimate. - 5) Rate in per cent of labour force excluding farmers. - 6) Converted from USD at average cross exchange rate. From 2003 including transactions with Montenegro. - 7) In 2004 FDI net. - 8) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.