SERBIA: Fiscal consolidation starts

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The economy slid into recession in 2014. It is expected at best to stagnate over the current year. This is mostly due to the fiscal consolidation measures being planned, as well as to stagnating exports. In the medium term, the government expects recovery that will be driven for the most part by public and foreign investments. It also anticipates support from a three-year IMF programme that was approved at the end of February. Recovery should pick up speed, increasing to about 2% by 2017.

Growth will be at best flat this year if investments, including public ones, start to increase. Over the medium term, growth should accelerate to around or somewhat above 1%. Policies aim at stabilising the public debt to GDP ratio and at reforming the public sector.

Last year saw a decline of GDP by about 2%, a decline of industrial production by over 5%, and almost stagnant exports. Practically all elements of demand receded, with investments down by more than 4%. Labour force surveys, however, show growth of employment, both formal and informal. This is in all probability a statistical effect, though it is not clear due to what precisely.

Fiscal consolidation and the reform of the public sector dominate the policy agenda. This year's budget marks the beginning of a protracted process of fiscal consolidation. At the end of last year, public debt stood just above 70% of GDP. The government target is to stabilise it at a level of 80% in three years; then it should start a long-term decline. Given that the assumptions about GDP growth for the next three years are not ambitious, possible overshooting could stop at 85% of GDP. It will take about a decade to bring it down to 45%, which is the ceiling imposed by the law on fiscal responsibility. That means that not only in the medium term, but even in the long term the contribution to growth from public spending will be small or nonexistent.

Private consumption cannot be relied on to provide much of a boost to the economy, however. In the past five or so years, real wages have been stagnant at best. They have now been cut by 10%, nominally, in the public sector, and pensions were cut too, though not that much. Having in mind that significant lay-offs are planned in the public sector, consumption will be subdued.

That requires investments, which have been declining year after year. They are now below 18% of GDP and a rather fast increase would be needed for them to make a difference to the growth of GDP in the medium run. Public investments could be increased by as much as 2% or even 3% of GDP, but the efficiency of their implementation has been very low in the past. One indication is that the economy experienced hardly any boost from the post-flood recovery in the second half of last year. There are clearly institutional obstacles to an effective planning and implementation of public investment projects.

Private investments are still not recovering and foreign investments are also not pouring in. The most recent estimate for 2014 is FDI of about EUR 1.2 billion. Given that domestic private investments as well as public ones are rather sluggish and cannot be expected to increase a lot this year or over the medium term, foreign investments are certainly crucial. The government is looking to sell a steel-mill and also the state-owned telecommunication company with the expectation that the new private owners will invest in these and related businesses. All that does not suggest that an investment boom is around the corner, and as a consequence a strong recovery of GDP growth.

The country is enjoying a period of political stability due to the strong support for the majority party in the current coalition government. Also, no regional or wider international discords are expected in the near future or in the next few years. The government and most of the public understand the connection between regional stability and economic development. Also, the government is committed to EU integration, though the process is slow. Finally and most importantly, normalisation with Kosovo is proceeding, which helps both politically and in economic terms.

The discontinuation of the South Stream project was a disappointment, but not a big surprise. On the other hand, the drop in oil prices will benefit the trade balance if not necessarily the domestic consumption. The former effect may be huge if oil prices stay as low as they are now. The latter is countervailed by the depreciation of the Serbian dinar especially in relation to the US dollar. The forecast for the exchange rate calls for further depreciation because the central bank has hardly an alternative instrument to spur price growth. The end of last year saw prices actually falling, which is rather a new phenomenon for this country that has been used to inflation rates close to double digits.

On a minor point, loans in Swiss francs are not as massive as in some other countries, so financially it is the strengthening of the euro vis-à-vis the dinar that may have negative consequences for the non-performing loans in the banking sector. In any case, credits are scarce and demand is low anyway. Most publicly owned or strongly influenced banks have failed and there is some consideration to selling off the remaining big one, Komercijalna banka. Also, the state-owned insurance company, Dunav osiguranje, is probably going to be privatised. Still, a backlog of bad loans will weigh on the banking sector for some time.

Thus, this year’s growth is going to be flat at best (with a point estimate of -0.5% GDP growth), while the medium-term prospect is for some recovery (1% and 1.4% growth for 2016 and 2017, respectively), though not much of an acceleration can be expected as of now. The current forecast does not differ substantially from the previous one. The fall of 2014 GDP has been larger than anticipated by 1 percentage point due mostly to the disappointing performance of exports.

Table 1 / Serbia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1)]	2015	2016 Forecast	2017
Population, th. pers., mid-year [2)]	7,291	7,234	7,199	7,164	7,070	7,040	7,010	7,000
Gross domestic product, RSD bn, nom. [3)]	3,067	3,408	3,584	3,876	3,900	4,000	4,200	4,400
annual change in % (real) [3)]	0.6	1.4	-1.0	2.6	-2.0	-0.5	1.0	1.4
GDP/capita (EUR at exchange rate)	4,100	4,600	4,400	4,800	4,700	.	.	.
GDP/capita (EUR at PPP)	9,000	9,500	9,700	9,900	9,900	.	.	.
Consumption of households, RSD bn, nom. [3)]	2,366	2,596	2,728	2,886	2,900	.	.	.
annual change in % (real) [3)]	-0.6	0.9	-2.1	-0.4	-2.0	-2.0	0.0	0.0
Gross fixed capital form., RSD bn, nom. [3)]	570	627	759	668	650	.	.	.
annual change in % (real) [3)]	-6.5	4.6	13.2	-12.0	-5.0	4.0	4.0	5.0
Gross industrial production [4)]								
annual change in % (real)	1.2	2.5	-2.2	5.3	-6.8	5.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	-0.6	0.9	-17.3	21.7	2.0	8.0	5.0	5.0
Construction output [5)]								
annual change in % (real)	-2.4	5.9	-9.8	11.1	-4.0	5.0	5.0	5.0
Employed persons, LFS, th, average [6)]	2,396	2,253	2,228	2,311	2,442	2,500	2,500	2,500
annual change in %	-8.4	-6.0	-1.1	3.7	5.7	1.0	1.0	1.0
Unemployed persons, LFS, th, average [6)]	569	671	701	656	535	.	.	.
Unemployment rate, LFS, in %, average [6)]	19.2	23.0	23.9	22.1	17.6	17	17	17
Reg. unemployment rate, in %, end of period	26.7	27.6	28.2	28.2	28.0	28	28	28
Average monthly gross wages, RSD	47,450	52,733	57,430	60,708	61,426	.	.	.
annual change in % (real, gross)	0.6	0.1	1.0	-1.9	-0.9	0.0	1.0	1.0
Average monthly net wages, RSD	34,142	37,976	41,377	43,932	44,530	.	.	.
annual change in % (real, net)	0.7	0.2	1.1	-1.5	-1.5	0.0	1.0	1.0
Consumer prices, % p.a.	6.8	11.0	7.8	7.8	2.9	3.0	3.0	3.0
Producer prices in industry, % p.a.	13.7	12.7	6.8	2.7	1.3	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	39.9	38.2	39.2	37.9	40.0	40.0	40.0	40.0
Expenditures	44.4	42.9	45.3	42.5	47.0	45.0	44.0	43.0
Deficit (-) / surplus (+)	-4.5	-4.7	-6.1	-4.7	-7.0	-5.0	-4.0	-3.0
Public debt, nat.def., % of GDP	41.8	45.4	56.2	59.6	70.0	75.0	80.0	85.0
Central bank policy rate, % p.a., end of period [7)]	11.50	9.75	11.25	9.50	8.00	7.0	6.0	6.0
Current account, EUR mn [8)]	.	.	-3,640	-2,092	-1,950	-1,950	-2,100	-1,900
Current account, % of GDP	.	.	-11.5	-6.1	-5.9	-6.0	-6.0	-6.0
Exports of goods, BOP, EUR mn [8)]	.	.	8,394	10,540	10,700	11,000	11,600	12,200
annual change in %	.	.	.	25.6	1.5	3.0	5.0	5.0
Imports of goods, BOP, EUR mn [8)]	.	.	14,028	14,693	14,800	15,100	15,600	16,200
annual change in %	.	.	.	4.7	0.7	2.0	3.0	4.0
Exports of services, BOP, EUR mn [8)]	.	.	3,104	3,423	3,800	4,000	4,200	4,400
annual change in %	.	.	.	10.3	11.0	5.0	5.0	5.0
Imports of services, BOP, EUR mn [8)]	.	.	2,965	3,103	3,300	3,500	3,700	3,900
annual change in %	.	.	.	4.7	6.3	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn [8)]	.	.	926	1,485	1,550	700	1,000	1,000
FDI outflow (assets), EUR mn [8)]	.	.	257	257	300	100	100	100
Gross reserves of NB, excl. gold, EUR mn	9,555	11,497	10,295	10,734	9,800	9,500	9,500	9,500
Gross external debt, EUR mn	23,786	24,125	25,721	25,842	27,000	28,000	29,000	30,000
Gross external debt, % of GDP	79.9	72.2	81.2	75.4	81.2	87	87	87
Average exchange rate RSD/EUR	103.04	101.95	113.13	113.14	117.25	124	126	128
Purchasing power parity RSD/EUR	46.73	49.57	51.46	54.39	55.50	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) According to ESA 2010. - 4) Excluding arms industry. - 5) According to gross value added. - 6) Survey in April and October. - 7) Two-week repo rate. - 8) BOP 6th edition.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.