
# SERBIA: Improved outlook, but structural issues remain

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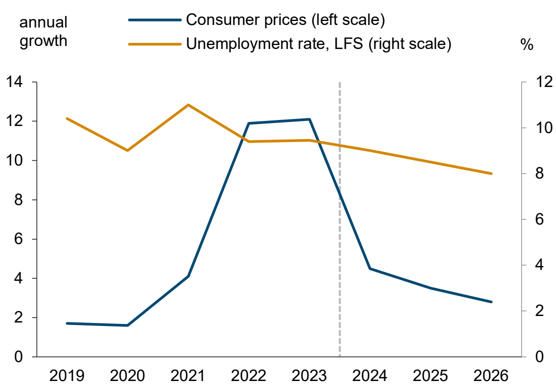
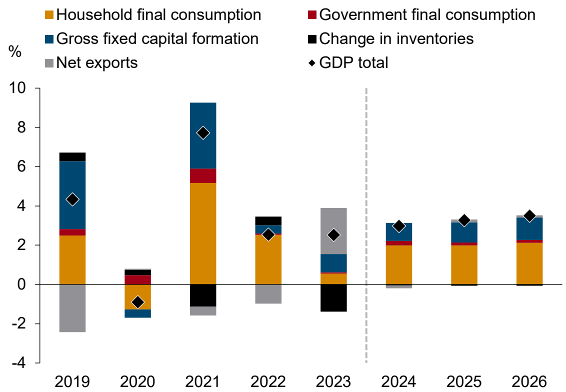
**The decline in inflation is boosting real incomes and consumption, while the industrial sector appears to be coming back to life, after two challenging years. Foreign direct investment remains strong, as always, with a notable return of EU investors and the continued strong presence of the Chinese. Public investment is strong, too, lately focused on the upcoming EXPO 2027 in Belgrade. Although the economic conditions in the country have undoubtedly improved, we maintain that numerous structural issues will continue, limiting the potential for higher growth.**

**Figure 6.19 / Serbia: Main macroeconomic indicators**

Inflation and unemployment, in %




Real GDP growth and contributions




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

**Serbia's economy saw an upturn in the final quarter of 2023, with GDP expanding by 3.8% year on year.** This owed primarily to the resurgence in private consumption, which rose by 2.5% as inflation began to slow down and real incomes started to recover. Government consumption also contributed, growing by 5.8%, largely influenced by the December elections. Investment remained robust, as throughout the year, increasing by 5.2%. Exports edged up by a mere 0.3%, a reflection of the global economic slowdown and the recession in Germany. In contrast, imports gained momentum, rising by 4.2%, propelled by strengthened domestic demand.

**The start of 2024 looks promising, as the industrial sector, Serbia's traditional powerhouse, shows signs of reviving.** Following two years of modest performance, with growth rates hovering at around 2-3%, industrial production in January and February surged by 7.9% year on year. The improvement is broad based, with three quarters of industrial sectors registering expansion, signalling a general improvement in economic conditions. Notably, the metal and automotive sectors, critical to Serbia's industrial backbone, have witnessed robust double-digit growth, suggesting a rebound in external demand for these Serbian products. Beyond industry, the retail sector is also on a solid trajectory, posting a 6.4% increase in real terms during the first two months, driven by uniform growth across various consumption segments, including food, motor fuels and other goods.

**On a less positive note, the country continues to grapple with persistent inflation, which remains among the highest in Europe.** Although there has been a steady decline from a peak of 16.2% in March 2023 to 5.6% in February 2024, the rate is still significantly above the central bank's target of 3%±1.5%, and is almost double that seen in the neighbouring countries. Although the persistence of inflation can partly be attributed to robust domestic demand, the primary factor is the frequent adjustment in regulated prices by the government. It has incrementally increased the price of electricity, central heating, tobacco and motor fuels on several occasions, and these adjustments have directly spurred price hikes and led companies to raise their prices further to maintain their profit margins. Measures like the price controls introduced in October 2023, which target a limited range of products, were implemented too late and have proved ineffective in curbing the inflationary trend this time.

**A shift towards easing the monetary cycle is expected, but it is unclear when this will start.** The central bank has kept its key interest rate at 6.5% since July 2023, and we expect it to stay at that level for at least another two months. Once inflation falls below the upper range of the target (4.5%), and once the European Central Bank lowers its rate, we expect that National Bank of Serbia to start its easing cycle, which should bring the base interest rate to 5.5% by the end of the year.

**The fall in inflation has led to a rise in real wages, which is expected to stimulate consumption and economic activity.** Throughout 2023, nominal wage growth hovered at around 14-15%; but with inflation reaching similar (or even higher) levels for much of the year, real wages either fell or remained flat. The recent dip in inflation has reversed this trend, resulting in a positive real wage growth of 8.8% in January. This growth is consistent across both public and private sectors. Notably, the rise in lower wages has outpaced that in higher wages, with the median wage experiencing real growth of 10%.

**Foreign direct investment (FDI) has remained robust, with a significant resurgence of European investors.** FDI inflows hit EUR 4.5bn in 2023, equating to 6.5% of GDP. This represents a slight drop from the previous year's 7.3% of GDP, but still ranks among the highest in Eastern Europe. Investments from EU countries surged by 55% over the previous year, accounting for about half of the country's total FDI inflows. This increase is a strong indicator of Western investors' renewed confidence in Serbia and its geopolitical trajectory. Chinese investment has remained steady, contributing around a third of Serbia's total FDI. Data from January 2024 suggest that these trends are continuing, with inflows in a single month amounting to EUR 560m.

**Public investment remains robust, the new focus being EXPO 2027.** In 2023, it reached 7% of GDP, slightly down on the 7.4% of 2022, yet still the highest in Europe. This trend is expected to persist, especially with the upcoming specialised EXPO 2027. This is set to take place in Belgrade between May and August 2027, and is expected to attract more than a hundred countries wishing to showcase their cultural heritage and achievements in sport and music. The government has estimated the cost at around EUR 18bn, which includes also investments in infrastructure related to the EXPO, such as highways and public transportation systems. Over a four-year span, this equates to an annual investment of 5-6% of GDP, aligning with public investment levels from recent years. Although the project is expected to boost economic activity during its execution and potentially to yield positive medium-term economic benefits through infrastructure development, it has faced criticism for its lack of transparency and the risk of corruption.

**Despite the robust public investment and the elections toward the end of 2023, the fiscal landscape shows a trend towards consolidation.** The deficit shrank to 2.2% of GDP in 2023, outperforming the initial target of 3.3% and falling from 3.2% the year before. This marks a steady reduction from 8% in 2020. The 2024 budget projects a deficit of 2.2%, which appears achievable. Early data for 2024 indicate a budget surplus in January, although this is likely to shift to a deficit in the subsequent months. On the debt front, public debt declined to 52% of GDP at the end of 2023, down from 57% at the end of 2020, helped by the high inflation. As inflation eases, so this trend is likely to be reversed, and public debt is expected either to hover at the current level or to increase gradually, though not to exceed 60% any time soon.

**Given the overall positive outlook for the economy, we are adjusting our GDP growth projections upwards.** For 2024, we now anticipate a growth rate of 3%, gradually increasing to 3.5% by 2026. Despite the recent improvements, we still think that the numerous structural issues related to the neglect of domestic private investment, the lack of rule of law, problems with corruption and democratic backsliding will be a burden that will prevent the country from achieving sustainable growth in the longer run. Our inflation predictions remain unchanged – 4.5% for 2024, with a gradual decline to 2.8% by 2026.

**The improved economic situation has prompted Serbian officials to assert their optimism about receiving an investment-grade rating from credit-rating agencies this year.** Notably, S&P recently upgraded Serbia’s outlook to positive, affirming its rating at BB+, while Fitch confirmed the country’s rating at BB+, with a stable outlook. Our view is that if the economic results this year exceed our current expectations, and if the political situation remains stable, then there could be an upgrade to the rating towards the end of the year. But if growth hovers at around 3% and inflation is above 4%, this is unlikely to happen.

**Political uncertainties, particularly regarding the status of Kosovo, remain a key downside risk.** The dialogue between Belgrade and Prishtina has been stalled for some time, and tensions have flared up from time to time, most recently over the decision by the Kosovo authorities to ban the Serbian dinar. While such sporadic disputes are conceivable and likely, we believe that any major incident is highly unlikely – not only because of the presence of NATO troops in Kosovo, but also because Serbia does not have any real interest in escalating the situation. Serbia’s focus in recent years has been on the economy. The strategy of the current Serbian government has been to ‘Make Serbia Great Again’ – but in the economic sense: any escalation in northern Kosovo would only undermine this. That does not mean that things may not get out of control, though; and because of that, the only sustainable way forward is through the full implementation of the Brussels and Ohrid agreements on the normalisation of relations between Serbia and Kosovo – and most immediately through the establishment of an Association of Serb-Majority Municipalities in Kosovo.

**The upcoming local elections in June could turn out to be very important for Serbia’s political dynamics.** Despite the convincing victory of the ruling conservative SNS party in the December 2023 parliamentary elections, a rerun of the Belgrade local elections is scheduled, following fraud allegations by the opposition and a critical report from the Office for Democratic Institutions and Human Rights. An opposition victory in these elections would be a serious blow to the ruling party, potentially indicating a shift in political momentum. Conversely, a win for the ruling party would cement its grip on power and knock down the opposition. Both outcomes seem equally likely. The ruling party has gained strength since December, buoyed by its parliamentary success and an improved economic climate. But Belgrade traditionally resists nationalistic and authoritarian tendencies; if the elections proceed without significant irregularities, and if the opposition manages to get its act together, it could well emerge as the winner. Despite the political importance of these elections, they are unlikely to bring any changes in terms of economic or social policies, as the ruling party will maintain power at the national level and will continue to implement its programmes.

## Table 6.19 / Serbia: Selected economic indicators

| | 2020 | 2021 | 2022 | 2023 1) | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|---|---|
| | | | | | | Forecast | |
| Population, th. pers., mid-year 2) | 6,899 | 6,834 | 6,664 | 6,614 | 6,564 | 6,514 | 6,464 |
| Gross domestic product, RSD bn, nom. | 5,504 | 6,272 | 7,098 | 8,150 | 8,800 | 9,400 | 10,000 |
| annual change in % (real) | -0.9 | 7.7 | 2.5 | 2.5 | 3.0 | 3.3 | 3.5 |
| GDP/capita (EUR at PPP) | 12,820 | 14,240 | 15,560 | 16,330 | . | . | . |
| Consumption of households, RSD bn, nom. | 3,606 | 4,071 | 4,761 | 5,385 | . | . | . |
| annual change in % (real) | -1.9 | 7.9 | 3.9 | 0.8 | 3.0 | 3.0 | 3.2 |
| Gross fixed capital form., RSD bn, nom. | 1,180 | 1,459 | 1,714 | 1,850 | . | . | . |
| annual change in % (real) | -1.9 | 15.7 | 1.9 | 3.9 | 4.0 | 4.5 | 5.0 |
| Gross industrial production | | | | | | | |
| annual change in % (real) | -0.1 | 6.6 | 1.9 | 2.6 | 3.0 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | |
| annual change in % (real) | 2.2 | -6.8 | -8.9 | 8.0 | . | . | . |
| Construction output | | | | | | | |
| annual change in % (real) | -2.5 | 17.0 | -10.4 | 11.6 | . | . | . |
| Employed persons, LFS, th, average 3) | 2,895 | 2,849 | 2,913 | 2,868 | 2,900 | 2,930 | 2,960 |
| annual change in % | -0.2 | 3.0 | 2.3 | 0.7 | 1.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average 3) | 287 | 352 | 302 | 299 | 290 | 270 | 260 |
| Unemployment rate, LFS, in %, average 3) | 9.0 | 11.0 | 9.4 | 9.5 | 9.0 | 8.5 | 8.0 |
| Reg. unemployment rate, in %, eop | 17.9 | 17.4 | 15.4 | 14.1 | . | . | . |
| Average monthly gross wages, RSD | 82,984 | 90,784 | 103,316 | 118,599 | 126,400 | 134,700 | 142,600 |
| annual change in % (real, gross) | 7.8 | 5.2 | 1.7 | 2.4 | 2.0 | 3.0 | 3.0 |
| Average monthly net wages, RSD | 60,073 | 65,864 | 74,933 | 86,007 | 91,700 | 97,800 | 103,600 |
| annual change in % (real, net) | 7.7 | 5.4 | 1.7 | 2.4 | 2.0 | 3.0 | 3.0 |
| Consumer prices, % p.a. | 1.6 | 4.1 | 11.9 | 12.1 | 4.5 | 3.5 | 2.8 |
| Producer prices in industry, % p.a. | -1.3 | 8.7 | 14.9 | 3.3 | 1.0 | 1.5 | 2.0 |
| General governm. budget, nat. def., % of GDP | | | | | | | |
| Revenues | 41.0 | 43.2 | 43.7 | 42.6 | 44.0 | 44.0 | 44.0 |
| Expenditures | 49.0 | 47.4 | 46.9 | 44.8 | 46.0 | 45.5 | 45.0 |
| Deficit (-) / surplus (+) | -8.0 | -4.1 | -3.2 | -2.2 | -2.0 | -1.5 | -1.0 |
| General gov. gross debt, nat. def., % of GDP | 57.8 | 57.1 | 55.6 | 52.3 | 52.0 | 52.0 | 52.0 |
| Stock of loans of non-fin. private sector, % p.a. | 11.1 | 10.2 | 6.5 | 1.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 3.7 | 3.5 | 3.0 | 3.0 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 1.0 | 1.0 | 5.0 | 6.5 | 5.50 | 5.0 | 4.5 |
| Current account, EUR m | -1,929 | -2,266 | -4,162 | -1,810 | -2,000 | -2,300 | -2,500 |
| Current account, % of GDP | -4.1 | -4.2 | -6.9 | -2.6 | -2.7 | -2.9 | -2.9 |
| Exports of goods, BOP, EUR m | 16,079 | 21,018 | 26,928 | 27,930 | 29,600 | 31,200 | 32,800 |
| annual change in % | -2.0 | 30.7 | 28.1 | 3.7 | 6.0 | 5.5 | 5.0 |
| Imports of goods, BOP, EUR m | 21,280 | 27,038 | 36,292 | 34,534 | 36,400 | 38,400 | 40,500 |
| annual change in % | -3.4 | 27.1 | 34.2 | -4.8 | 5.5 | 5.5 | 5.5 |
| Exports of services, BOP, EUR m | 6,191 | 7,800 | 11,076 | 13,079 | 14,400 | 15,800 | 17,400 |
| annual change in % | -10.7 | 26.0 | 42.0 | 18.1 | 10.0 | 10.0 | 10.0 |
| Imports of services, BOP, EUR m | 5,090 | 6,402 | 8,761 | 10,062 | 11,400 | 12,800 | 14,200 |
| annual change in % | -14.1 | 25.8 | 36.9 | 14.8 | 13.0 | 12.0 | 11.0 |
| FDI liabilities, EUR m | 3,039 | 3,886 | 4,432 | 4,522 | . | . | . |
| FDI assets, EUR m | 100 | 229 | 104 | 302 | . | . | . |
| Gross reserves of CB, excl. gold, EUR m | 11,732 | 14,523 | 17,311 | 22,516 | . | . | . |
| Gross external debt, EUR m | 30,787 | 36,488 | 41,895 | 45,378 | 50,400 | 54,900 | 59,500 |
| Gross external debt, % of GDP | 65.8 | 68.4 | 69.3 | 65.3 | 67.0 | 68.0 | 69.0 |
| Average exchange rate RSD/EUR | 117.58 | 117.57 | 117.46 | 117.25 | 117.0 | 116.5 | 116.0 |

Note: Introduction of new index 2021=100 (new weights) for gross industrial production.

1) Preliminary and wiiw estimates. - 2) From 2022 according to census 2022. - 3) From 2023 according to census 2022. From 2021 new LFS methodology in line with the Integrated European Social Statistics Regulation (IESS). - 4) Key policy rate.

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