
# SERBIA: On the crest of a wave

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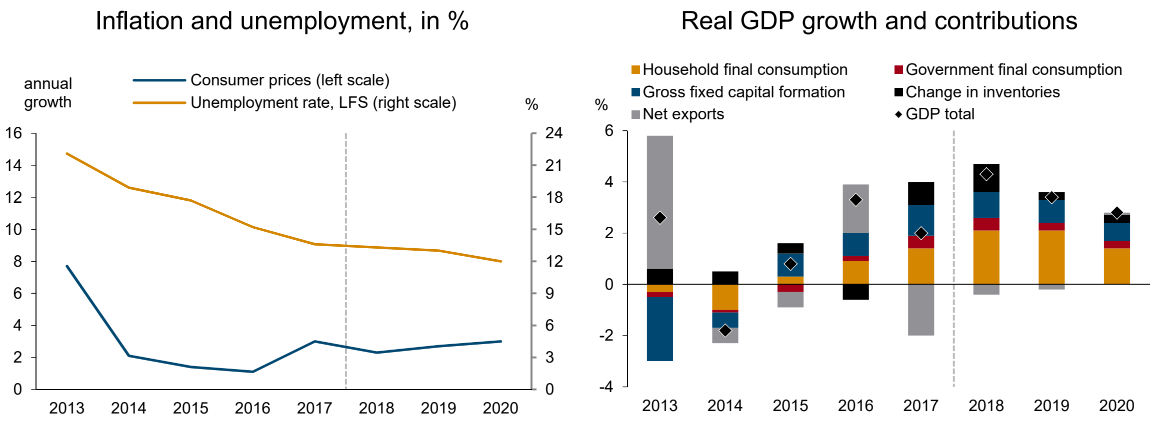
**Current economic growth and the near-term outlook are as good as has been the case at any time since the global financial crisis a decade ago. A combination of FDI inflows and private consumption are likely to remain the key growth drivers. The economy continues to face challenges, although efforts to bring down public debt and clean up the banking sector have been partly successful. Over the medium term, growth will trend down towards 3%, implying very slow convergence with Western Europe.**

**Figure 53 / Serbia: Main macroeconomic indicators**




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

**Growth has picked up strongly this year, after a very weak 2017, and the near-term outlook remains positive.** The economy had expanded by just 2% last year, in part owing to a drought, but posted real GDP growth of almost 5% year on year in both Q1 and Q2, the fastest rates recorded in Serbia since before the global financial crisis. Household consumption rose by around 3% in both quarters, while government spending increased by over 5% in Q2. The most significant uptick however came from investment, which increased by 15% year on year in Q1 and 12% in Q2. Net exports made a negative contribution to growth in the first half of the year, despite robust export growth. Imports grew even more quickly on the back of rising domestic demand, and are much bigger in absolute terms. There are also signs that external demand may have slowed somewhat relative to 2017 levels, reflecting weaker momentum in the EU.

**The near-term outlook is positive, with high-frequency indicators at the start of the third quarter mostly suggesting that momentum may even have increased.** Retail sales growth in Q3 looks on course to surpass the rates of 3-3.5% year on year posted in H1, while euro-denominated merchandise export growth picked up in July-August compared with the first half of the year. Monthly employment growth remained steady at just over 3% year on year in July-August, similar to the level in the first half of the year. However, latest industrial output data suggest some reason for concern. Production excluding construction fell by almost 5% year on year in August, its first decline for over a year.

**Private consumption still accounts for over 70% of GDP, one of the highest levels in the region, and as such will remain the key determinant of growth trends in Serbia.** We expect real private consumption growth to maintain its growth rate of around 3% in real terms in the rest of 2018 and into 2019, driven by rising wages and pensions. Domestic investment should also contribute significantly to growth during the forecast period, helped by improvements in banking sector asset quality and consequently rising credit growth. The government has been focused strongly on attracting foreign direct investment (FDI) inflows to stimulate growth, and data for the first half of 2018 indicate that FDI inflows remained strong.

**The policy stance is likely to remain focused on attracting FDI inflows, which will mean that the government will continue reforms to improve the business environment.** This impression has been strengthened by the signing of a 30-month Policy Coordination Instrument (PCI) with the IMF. The PCI involves no disbursements, but is rather a signal for foreign investors that Serbia is committed to further investor-friendly reforms, with a particular focus on institutional upgrading and improvement of economic competitiveness. Meanwhile, in the background the anchor of potential EU accession is likely to remain a strong incentive to reform. We have already expressed our scepticism about the targeted 2025 EU accession date for Serbia, but our caution is chiefly owing to political factors: otherwise, momentum towards accession is solid, and new chapters continue to be opened.

**Macroeconomic stability is gradually improving, but the post-crisis clean-up in Serbia has been one of the slowest in the region, reflecting a particularly weak growth performance over the past decade.** Two things stand out: the high public debt load, and vulnerabilities in the banking sector. However, in line with stronger economic growth, both are now improving. The public debt/GDP ratio fell to 58% in 2017, down from 70% in 2014-15, which has significantly eased fiscal pressures and the negative fiscal impact on growth. Meanwhile the non-performing loan (NPL) ratio – which has been one of the region's highest for much of the post-crisis period – dropped to 7.8% at end-June 2018, significantly below many regional peers. Serbia's long-term sovereign credit rating was upgraded by S&P and Fitch in December 2017, and Moody's in March 2018, reflecting positive momentum towards greater macroeconomic stability. A key risk that the agencies continue to identify are contingent liabilities from struggling state-owned Enterprises (SOEs). In August the Chinese firm Zijin bought 63% of one of these SOEs, the copper producer RTB Bor, although several others remain in state hands (and consequently a source of fiscal risk).

**Inflation is likely to rise gradually over the forecast period, although much of the current upward pressure on prices is coming from higher global energy costs.** After bottoming at 1.1% in April 2018, headline consumer price inflation increased by 2.6% in August. This is still below the midpoint of the central bank's 1.5%-4.5% target range. We expect full-year average inflation of 2.3% this year, rising to 2.7% in 2019 and 3% in 2020. Monetary policy is likely to remain fairly loose until greater signs of demand-pull inflationary pressures emerge, although the central bank will continue to intervene in the currency market to stabilise the dinar. Serbia has been relatively unaffected by the volatility in global markets caused by Fed tightening, and we expect this to remain the case. Stronger or quicker-than-expected monetary tightening by the ECB would have more material consequences for Serbia, but we view this is a very unlikely scenario. Our forecast is that the dinar will weaken slightly against the euro during the forecast period.

**The labour market is performing well, although employment growth is significantly lower than GDP growth, indicating improving productivity (in contrast to last year).** Relatively meagre employment growth in the first half of 2018 contributed to a rise in the unemployment rate, to 13.4% on the LFS measure (from 13.2% in the same period of 2017). However, the wage response to higher growth has been more significant, with real gross wages rising by 3.7% year on year in H1 2018, up from 1.1% in the same period of 2017. The fact that wages are increasing much more strongly than employment could indicate the emergence of labour shortages, or at least skills shortages in particular areas. Many Serbs have emigrated to other parts of EU-CEE (especially Slovakia) in response to labour shortages (and higher wages) there, which could now be having an impact on the Serbian labour market. Particularly in the construction sector, anecdotal evidence suggests that Serbia is now itself importing workers from Macedonia to fill the gap.

**There were indications over the summer that Serbia and Kosovo were moving towards a land swap deal, which would lead to a normalisation of relations and give Serbia in particular a major boost on its path towards EU accession.** We think that Serbia is capable of fulfilling the economic criteria for EU accession in the coming years, meaning that a deal with Kosovo is the main stumbling block. However, despite widespread optimism, talks appear to have broken down, in line with our expectations. We think that the chances of a workable deal involving a land swap are quite low, reflecting major domestic political impediments to making the necessary concessions on both sides. Many outside actors are also highly wary, although probably would not stand in the way if a genuine deal is arrived at between Belgrade and Pristina.

**In summary, current trends and the near-term outlook for the economy are probably as positive as they have been for a decade, justifying our optimism expressed in previous reports.** We expect real GDP growth of 4.3% this year, which would be Serbia’s best performance since 2008, and make it one of the fastest growing economies in CESEE. However, we view the upswing as cyclical rather than structural at this stage, and see growth trending down to around 3% by the end of the forecast period, which will mean only very slow convergence with Western Europe (and no convergence with the wealthier parts of CESEE).

## Table 28 / Serbia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th. pers., mid-year | 7,132 | 7,095 | 7,058 | 7,021 | . | . | 6,986 | 6,951 | 6,916 |
| Gross domestic product, RSD bn, nom. 2) | 3,908 | 4,312 | 4,521 | 4,754 | 2,082 | 2,214 | 5,100 | 5,400 | 5,700 |
| annual change in % (real) | -1.8 | 0.8 | 3.3 | 2.0 | 1.4 | 4.9 | 4.3 | 3.4 | 2.8 |
| GDP/capita (EUR at PPP) | 10,100 | 11,200 | 11,300 | 11,700 | . | . | . | . | . |
| Consumption of households, RSD bn, nom. 2) | 2,922 | 3,052 | 3,152 | 3,311 | 1,539 | 1,604 | . | . | . |
| annual change in % (real) | -1.3 | 0.4 | 1.3 | 2.0 | 1.8 | 3.1 | 3.0 | 3.0 | 2.0 |
| Gross fixed capital form., RSD bn, nom. 2) | 652 | 723 | 766 | 844 | 371 | 426 | . | . | . |
| annual change in % (real) | -3.6 | 5.6 | 5.4 | 7.3 | 2.5 | 13.5 | 5.5 | 5.0 | 4.0 |
| Gross industrial production 3) | | | | | | | | | |
| annual change in % (real) | -7.3 | 7.3 | 5.2 | 3.9 | 2.3 | 4.4 | 4.2 | 3.5 | 2.8 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.4 | -8.4 | 8.3 | -11.8 | . | . | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) | 2.5 | 20.7 | 7.2 | 8.5 | 1.1 | 26.8 | . | . | . |
| Employed persons, LFS, th, average 4) | 2,421 | 2,574 | 2,719 | 2,795 | 2,767 | 2,793 | 2,880 | 2,940 | 2,970 |
| annual change in % | 4.8 | 0.6 | 5.6 | 2.8 | 3.8 | 0.9 | 3.0 | 2.0 | 1.0 |
| Unemployed persons, LFS, th, average 4) | 563 | 552 | 489 | 435 | 418 | 430 | 440 | 440 | 410 |
| Unemployment rate, LFS, in %, average 4) | 18.9 | 17.7 | 15.2 | 13.6 | 13.2 | 13.4 | 13.3 | 13.0 | 12.0 |
| Reg. unemployment rate, in %, eop 5) | 28.4 | 26.8 | 25.7 | 22.9 | 23.8 | 21.3 | . | . | . |
| Average monthly gross wages, RSD | 61,426 | 61,145 | 63,474 | 65,976 | 64,789 | 68,198 | 70,200 | 74,300 | 78,100 |
| annual change in % (real, gross) | -1.7 | -2.4 | 2.6 | 0.9 | 1.1 | 3.7 | 4.0 | 3.0 | 2.0 |
| Average monthly net wages, RSD | 44,530 | 44,432 | 46,097 | 47,893 | 47,054 | 49,331 | 51,300 | 54,300 | 57,000 |
| annual change in % (real, net) | -1.5 | -2.1 | 2.5 | 0.9 | 1.0 | 4.2 | 3.7 | 3.0 | 2.0 |
| Consumer prices, % p.a. | 2.1 | 1.4 | 1.1 | 3.0 | 3.4 | 1.7 | 2.3 | 2.7 | 3.0 |
| Producer prices in industry, % p.a. | 1.3 | 1.0 | 0.0 | 2.3 | 3.0 | -0.2 | 2.5 | 2.9 | 3.3 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 41.5 | 39.3 | 40.8 | 41.5 | 45.8 | 45.1 | 44.0 | 44.0 | 43.0 |
| Expenditures | 48.1 | 42.8 | 41.9 | 40.4 | 43.7 | 44.8 | 44.5 | 45.0 | 45.0 |
| Deficit (-) / surplus (+) | -6.6 | -3.5 | -1.2 | 1.1 | 2.1 | 0.4 | -0.5 | -1.0 | -2.0 |
| General gov.gross debt, nat.def., % of GDP | 70.4 | 70.0 | 67.8 | 57.9 | . | . | 68.0 | 68.0 | 67.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.5 | 3.0 | 2.3 | 2.1 | 2.2 | 4.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 21.5 | 21.5 | 17.0 | 9.9 | 15.6 | 9.2 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 8.00 | 4.50 | 4.00 | 3.50 | 4.0 | 3.0 | 3.00 | 3.25 | 4.00 |
| Current account, EUR mn | -1,985 | -1,234 | -1,075 | -2,090 | -1,027 | -1,014 | -2,200 | -2,200 | -2,200 |
| Current account, % of GDP | -6.0 | -3.5 | -2.9 | -5.3 | -6.1 | -5.4 | -5.1 | -4.8 | -4.6 |
| Exports of goods, BOP, EUR mn | 10,641 | 11,454 | 12,814 | 14,090 | 6,970 | 7,504 | 16,600 | 17,800 | 19,200 |
| annual change in % | 1.2 | 7.6 | 11.9 | 10.0 | 10.9 | 7.7 | 18.0 | 7.0 | 8.0 |
| Imports of goods, BOP, EUR mn | 14,752 | 15,099 | 15,933 | 18,076 | 8,781 | 9,796 | 21,800 | 23,200 | 24,800 |
| annual change in % | 0.5 | 2.4 | 5.5 | 13.4 | 12.6 | 11.6 | 20.5 | 6.5 | 7.0 |
| Exports of services, BOP, EUR mn | 3,810 | 4,273 | 4,571 | 5,240 | 2,346 | 2,683 | 5,800 | 6,200 | 6,700 |
| annual change in % | 11.3 | 12.2 | 7.0 | 14.6 | 13.9 | 14.4 | 10.0 | 7.0 | 8.0 |
| Imports of services, BOP, EUR mn | 3,344 | 3,544 | 3,664 | 4,289 | 1,958 | 2,211 | 4,800 | 5,100 | 5,500 |
| annual change in % | 7.6 | 6.0 | 3.4 | 17.1 | 16.6 | 12.9 | 11.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 1,500 | 2,114 | 2,127 | 2,545 | 1,216 | 1,406 | 2,800 | . | . |
| FDI assets, EUR mn | 264 | 310 | 228 | 130 | 31.0 | 78.0 | 190 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 9,351 | 9,812 | 9,543 | 9,287 | 9,006 | 10,421 | . | . | . |
| Gross external debt, EUR mn 7) | 25,679 | 26,234 | 26,494 | 25,630 | 25,416 | 26,108 | 25,553 | 25,681 | 25,809 |
| Gross external debt, % of GDP 7) | 77.1 | 73.5 | 72.1 | 65.4 | 65.0 | 60.0 | 59.0 | 57.0 | 54.0 |
| Average exchange rate RSD/EUR | 117.31 | 120.76 | 123.12 | 121.34 | 123.39 | 118.30 | 118 | 119 | 120 |

1) Preliminary . - 2) From 2015 major GDP revisions by incorporating new data sources. Half-year data unrevised. - 3) Excluding arms industry. - 4) From 2015 adjustments according to ILO and Eurostat. - 5) From 2015 new source for labour force potential. - 6) Two-week repo rate. – 7) BOP 5th Edition.

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