SERBIA: Slow recovery continues

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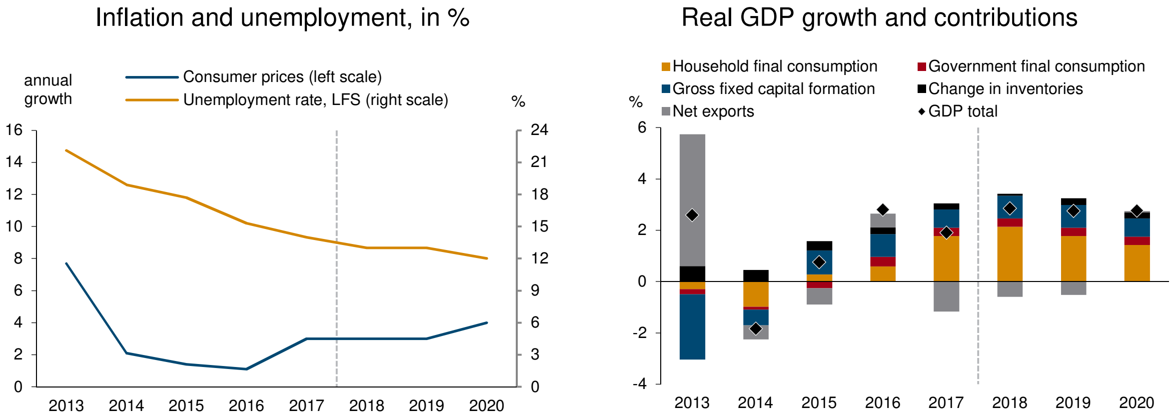
Slow recovery and tenuous political stability is the medium-term prospect. This means growth of around 3% on average in the medium run. A recovery of agriculture may push growth up this year, political support for the government may weaken and depress investment and growth in the medium run.

Figure 57 / Serbia: Main macroeconomic indicators



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

Last year's performance was disappointing, with GDP growth of 1.9%. Manufacturing advanced, but electricity production underperformed, and agriculture suffered from bad weather. On the demand side, investments grew less than expected, in part because of slow implementation of public projects, while consumption increased after few years of stagnation and slow growth. Exports continued to grow, but imports speeded up, with net exports contributing negatively to growth of GDP in 2017. Employment continued to grow, with the unemployment rate also declining. However, the continued improvement of the labour market with disappointing growth of production indicated a decline in productivity. Also, real wage growth is very slow, while the average wage is low, e.g. by regional standards.

Official forecasts, by the government and by the Fiscal Council, are optimistic at least for this year. The economy is seen expanding by 3.5% to 4%. The forecasts for the medium term diverge, with the government expecting growth to accelerate to 4% by 2020, while the Fiscal Council worries that the underlying potential growth rate is closer to 3%. All see the potential for a growth speed-up in more public investments and in increasing private consumption, e.g. through higher public-sector wages and pensions.

A change in fiscal policy, primarily, is seen as manageable due to an improved fiscal position, credited to the programme of fiscal consolidation from 2015. This year's fiscal deficit is below 1% of GDP and should remain close to 1% in the medium term. In addition, a stronger dinar and lower interest rates have contributed to the decline of the public debt to GDP ratio, which is officially expected to be close to 60% at the end of this year. In addition, nominal GDP is growing faster due to some speed-up of inflation, which is now around 3%.

Interestingly, public revenues have also been supported by growing imports. VAT is the most important source of the general government budget, besides social contributions. Together with excises, growing imports are quite supportive of fiscal balances. Of course, they also lead to higher foreign financial obligations, with the net foreign investment position being above 100% of GDP now.

Overall, the new economic policy stance is in a way a reversal to the one preceding the 2008 crisis: domestic consumption plus foreign investments. Aggregate domestic consumption is around 90% of GDP while investments are around 18% of GDP. If both continue to grow as intended and if domestic consumption advances faster than GDP, investments will have to be increasingly financed from foreign sources. That is a possible development if indeed, as has been the case historically, and certainly before 2008, imports grow faster than exports. With current elasticities, that is to be expected.

In addition, the central bank has let the dinar appreciate in 2017 and seems intent on continuing to implement a fixed exchange rate policy to support foreign financial inflows and consumption and also as a way to control inflation, which is the policy followed in the past, e.g. between 2004 and 2008. This time it may be somewhat different because the economy is more open, in terms of exports to GDP, now than it was then, but it remains to be seen how resilient the exporting sector has become.

Assuming a recovery of agriculture and industry, electricity production in particular, GDP could grow by around 3% in the medium term. There is some substitutability between agriculture and industry because better weather conditions support growth of the former but not of the latter. Also, investments in both are not growing, which is why they are so dependent on the climate. So, while an average year in agricultural production will support economic recovery this year, it will do nothing in the medium term with risk exposure to changing weather staying as it is. So, having in mind that growth was just 2.6% in the fourth quarter of 2017 when the effects of bad weather had already been gone, it is probably realistic to expect slow recovery of up to 2.8% growth in 2018 and up to 3% in 2019 and 2020.

Given the economic strategy of reliance on foreign investments, and increasingly on public investments too, political risks are seen as important, which is why there is an effort to improve international relations as much as possible. In that, regional normalisation is of key importance. That, however, is a very slow process, as is the negotiation with the EU. Also, internally and internationally normalisation efforts is are under constant pressure from nationalists and their international supporters, not only in Russia, but from populists everywhere. Finally, the current government has been in charge for six years now with not much to show in terms of welfare and political and institutional development and so public support is declining and politics may become more uncertain in the medium term.

Overall, a slow recovery and tenuous political stability is the medium-term prospect. This means growth of around 3% on average in the medium run, which is close to the past forecast. The upside risks are a good year for agriculture and better than anticipated foreign investments due to sustained recovery in the EU. Downside risks are mostly political as support for the government wanes in the medium run.

Table 27 / Serbia: Selected economic indicators

	2013	2014	2015	2016	2017 1)	2018 Forecast	2019 Forecast	2020 Forecast
Population, th. pers., mid-year	7,167	7,132	7,095	7,058	7,000	7,000	7,000	6,950
Gross domestic product, RSD bn, nom.	3,876	3,908	4,043	4,262	4,500	4,800	5,100	5,500
annual change in % (real)	2.6	-1.8	0.8	2.8	1.9	2.8	2.8	2.8
GDP/capita (EUR at PPP)	10,100	10,100	10,500	10,700	11,000	.	.	.
Consumption of households, RSD bn, nom.	2,886	2,922	2,982	3,041	3,211	.	.	.
annual change in % (real)	-0.4	-1.3	0.4	0.8	2.5	3.0	2.5	2.0
Gross fixed capital form., RSD bn, nom.	668	652	715	756	804	.	.	.
annual change in % (real)	-12.0	-3.6	5.6	5.1	4.0	5.0	5.0	4.0
Gross industrial production 2)								
annual change in % (real)	5.4	-6.4	8.3	4.7	2.0	4.0	5.0	4.0
Gross agricultural production								
annual change in % (real)	21.8	2.4	-8.4	8.3	-12.0	.	.	.
Construction output								
annual change in % (real)	-20.0	2.4	20.9	7.1	6.9	.	.	.
Employed persons, LFS, th, average 3)	2,311	2,421	2,574	2,719	2,790	2,850	2,910	2,940
annual change in %	3.7	4.8	0.6	5.6	2.6	2.0	2.0	1.0
Unemployed persons, LFS, th, average 3)	656	563	552	489	490	430	430	400
Unemployment rate, LFS, in %, average 3)	22.1	18.9	17.7	15.3	15.0	13.0	13.0	12.0
Reg. unemployment rate, in %, eop 4)	29.1	28.4	26.8	25.7	23.0	.	.	.
Average monthly gross wages, RSD	60,708	61,426	61,145	63,474	66,700	70,100	73,600	78,100
annual change in % (real, gross)	-1.9	-1.7	-2.4	2.6	2.0	2.0	2.0	2.0
Average monthly net wages, RSD	43,932	44,530	44,432	46,097	48,400	50,800	53,400	56,600
annual change in % (real, net)	-1.5	-1.5	-2.1	2.5	2.5	2.0	2.0	2.0
Consumer prices, % p.a.	7.7	2.1	1.4	1.1	3.0	3.0	3.0	4.0
Producer prices in industry, % p.a.	2.7	1.3	1.0	0.0	2.3	1.2	2.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	39.7	41.5	41.9	43.2	44.0	44.0	44.0	43.0
Expenditures	45.1	48.1	45.6	44.5	45.0	45.0	46.0	46.0
Deficit (-) / surplus (+)	-5.5	-6.6	-3.7	-1.3	-1.0	-1.0	-2.0	-3.0
General gov.gross debt, nat.def., % of GDP	59.6	70.4	74.7	71.9	68.0	68.0	68.0	67.0
Stock of loans of non-fin.private sector, % p.a.	-4.9	4.5	3.0	2.3	2.1	.	.	.
Non-performing loans (NPL), in %, eop	21.4	21.5	21.5	17.0	17.0	.	.	.
Central bank policy rate, % p.a., eop 5)	9.50	8.00	4.50	4.00	3.50	3.75	4.00	4.00
Current account, EUR mn	-2,098	-1,985	-1,577	-1,075	-1,800	-2,100	-2,500	-2,700
Current account, % of GDP	-6.1	-6.0	-4.7	-3.1	-4.9	-5.4	-6.1	-6.2
Exports of goods, BOP, EUR mn	10,515	10,641	11,357	12,814	14,400	15,400	16,500	17,800
annual change in %	25.5	1.2	6.7	12.8	12.4	7.0	7.0	8.0
Imports of goods, BOP, EUR mn	14,674	14,752	15,350	15,933	18,200	19,500	20,900	22,600
annual change in %	4.7	0.5	4.1	3.8	14.2	7.0	7.0	8.0
Exports of services, BOP, EUR mn	3,422	3,810	4,273	4,571	5,030	5,300	5,700	6,200
annual change in %	10.6	11.3	12.2	7.0	10.0	6.0	7.0	8.0
Imports of services, BOP, EUR mn	3,109	3,344	3,548	3,664	3,950	4,400	4,800	5,100
annual change in %	4.3	7.6	6.1	3.3	7.8	9.0	8.0	7.0
FDI liabilities, EUR mn	1,548	1,500	2,114	2,127	2,100	.	.	.
FDI assets, EUR mn	250	264	310	228	100	.	.	.
Gross reserves of NB, excl. gold, EUR mn	10,734	9,351	9,812	9,543	9,287	.	.	.
Gross external debt, EUR mn 6)	25,644	25,679	26,234	26,488	28,000	27,000	28,000	29,000
Gross external debt, % of GDP 6)	74.8	77.1	78.3	76.5	75.5	69.0	68.0	66.0
Average exchange rate RSD/EUR	113.14	117.31	120.76	123.12	121.34	123	124	126

1) Preliminary and wiiw estimates. -2) Excluding arms industry. - 3) In 2013 survey of April and October, quarterly thereafter. From 2015 adjustments according to ILO, Eurostat and EU-LFS. - 4) From 2015 new source for labour force potential. -
5) Two week repo rate. - 6) BOP 5th Edition.

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