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Yugoslavia becomes Serbia and Montenegro

After one year of negotiations a new Constitutional Charter has been adopted by the parliaments of Serbia and Montenegro and by the federal parliament of Yugoslavia. The Charter dismantles the Federation and establishes the Union of Serbia and Montenegro. The Union will have a parliament and a president, who will also preside over the cabinet with five ministers, for foreign policy, defence, foreign economic relations, internal economic relations and for human and minority rights. There is no finance ministry because the Union will not have its own budget nor will it have any assets. The National Bank of Yugoslavia will become the National Bank of Serbia. Montenegro has its own central bank and uses the euro as its legal tender.

Serbia and Montenegro will practically become independent states. Only in external representation and relations will they have joint sovereignty. This incoherence between the internal and external sovereignty has already caused the emergence of problems. Thus, in order to negotiate an association agreement with the European Union and to accede to the World Trade Organization, Serbia and Montenegro need to harmonize their trade regimes and policies. This may prove to be difficult and time consuming. In general, the efficiency of the functioning of the Union will depend on the ability of the governments of Serbia and Montenegro to work together.

The new Union devolves the responsibility for economic and every other policy to the member states. They will now have to concentrate on the necessary reforms of institutions and policies. This will be even more urgent because the economic developments have not been all that favourable. For most of the year 2002, the economies of both Serbia and Montenegro have been in recession with industrial production falling in the first half and recovering somewhat in the second half. In the end, a growth of less than 2% has been registered for the year as a whole. Preliminary data indicate GDP growth of around 4% in Serbia and somewhat less for Montenegro. As agriculture has posted a decline of about 3% and construction is also declining, the growth of GDP has to be attributed to the services sector. That growth has been driven mainly by consumption, in which the rise of wages has played the major role in Serbia. A significant part of it comes from the budget, which is being supported by foreign grants and soft loans. In addition, banks are increasingly lending to households, who also hold most of the foreign currency deposits in the banks.

The sluggish supply response to the sharply rising consumption is balanced by the fast growth of imports – and thus of the trade deficit. There are some doubts about the quality of the foreign trade data, but the notably widening trade deficit is unmistakable. Exports have been growing too, at least in Serbia. In Montenegro, income from tourism has increased by about one third (ten months 2002 on ten months 2001). The current account deficit has been much smaller, because both countries cannot borrow very much, so the trade deficit has to be financed from remittances and other transfers and from foreign investments. Assuming that remittances will not grow very much in the next years and assuming that grants and other transfers will also stabilize and possibly decline, further growth of imports will depend mostly on foreign investments. However, they will be increasingly competing with the debt service, which will rise slowly in the next two to three years and then quite sharply once the grace period for the repayment of the principal is over. Thus, the growth of imports will have to be much more moderate.

Both states hope to increase the amount of foreign direct investments significantly in the next couple of years. Montenegro has been able to sell the gasoline distributor in 2002 and that sale has probably saved the budget, which is chronically running large deficits. Serbia hopes to sell companies in the oil and gasoline industries and in the tobacco industry, and it plans to sell the mobile telephone provider. With numerous sales of medium- and small-size companies, Serbia expects to cash in about one billion dollars of foreign direct investments in 2003. Similar or larger inflows are expected for the following few years. These financial inflows should help preserve macroeconomic stability.

Inflation has been falling in Serbia and Montenegro throughout 2002 – for different reasons, however. In Serbia, this was the consequence of the increase in imports and of weak demand for domestic goods. Still, because of adjustments in administered prices and of the prices of services, inflation was around 20%, year on year. In Montenegro inflation was slightly lower, somewhat above 15%, year on year. Further deceleration of inflation is expected this year and the next. This is presumed on growth accelerating and on wage increases moderating.

In Serbia, inflationary expectations depend on the stability of the exchange rate. In the last two years, the dinar has been pegged to the euro. Some nominal depreciation has occurred, mainly as a by-product of the euro conversion (basically, the German mark was exchanged for 30 dinars before the conversion while the euro was exchanged for 60 dinars after the conversion, i.e., two German marks for one euro, which is a few percentages more than the true conversion rate). By contrast, strong real appreciation has occurred; certainly in excess of 50%. This has supported imports, but has increasingly raised questions about the competitiveness of Serbian exports. With the exchange rate all but fixed and with wages rising, competitiveness has been eroding fast. This has led to the growing expectation that the exchange rate will start to depreciate.

Growth projections for 2003 and 2004 are not very ambitious. The accent is rather going to be on privatization and restructuring, at least officially. That of course implies further growth of unemployment, which is already much too high. However, there will be elections in both years in Serbia, where the government is not very popular. In Montenegro there is no pressure from elections, but the government does have to be sensitive to its popularity if it wants to push reforms and to also gain support for the vote for independence as it still plans to hold a referendum on that issue in the next couple of years.

In conclusion, the new union of Serbia and Montenegro leaves the impression of a temporary constitutional arrangement that will be tested and adjusted continuously. Reforms may suffer as a consequence, but they will also have to face squarely the growing dissatisfaction with their speed and performance.

Table YU

Serbia & Montenegro: Selected economic indicators *)

	1996	1997	1998	1999	2000	2001	2002 ¹⁾	2003 forecast	2004 forecast
Population, th pers., mid-year	10577.2	10600.1	10616.9	8372.7	8342.5	8325.7	8338.4	.	.
Gross domestic product, USD mn, nom. ²⁾	16477	18146	18212	10376	8100	10500	13200	16900	19300
annual change in % (real) ³⁾	5.9	7.4	2.5	-17.7	6.4	5.1	3	4	4
GDP/capita (USD at exchange rate) ²⁾	1558	1712	1715	976	970	1260	1580	.	.
Gross industrial production ⁴⁾									
annual change in % (real)	7.6	9.5	3.6	-23.1	11.2	0.0	1.7	3	5
Gross agricultural production									
annual change in % (real)	1.5	7.3	-3.2	-1.0	-12.9	17.2	-2.1	.	.
Goods transport, mn t-kms	28957	38164	45601	30026	32865	17456	5371	.	.
annual change in %	.	31.8	19.5	.	9.5	-46.9	-69.2	.	.
Gross fixed investment, YUM mn, nom.	9702.5	13525.3	17893.2	24867.8	59315.5	.	.	.	.
annual change in % (real)	-5.7	0.8	-2.2	-26.3	13.3	.	.	.	.
Construction output, value of work done									
annual change in % (real)	2.7	6.9	-0.8	.	.	.	.	.	.
Dwellings completed, units	15160	14768	13096	13123	12732	12156	12776	.	.
annual change in %	5.7	-2.6	-11.3	0.2	-3.0	-4.5	5.1	.	.
Employment total, th pers., average ⁵⁾	2367	2332	2504	2298	2238	2241	2201	.	.
annual change in %	-0.5	-1.5	-0.1	.	-2.6	0.1	-1.8	.	.
Employees in industry, th pers., average ⁶⁾	894.4	864.1	884.4	804.5	764.7	739.0	684.0	.	.
annual change in % ⁶⁾	-1.7	-3.4	2.4	.	-5.0	-3.4	-7.4	.	.
Reg. unemployed, th pers, end of period	826.8	793.8	849.4	774.3	812.4	860.5	988.7	.	.
Reg. unemployment rate in %, end of period ⁷⁾	26.1	25.5	25.4	25.5	26.7	27.9	31.2	30	30
LFS - unemployment rate in %, average	13.2	13.8	13.7	13.7	12.6	12.9	13.0	15	15
Average net monthly wages, YUM	658	803	1063	1309	2588	5545	9113	.	.
annual change in % (real, net)	1.0	21.2	2.0	-15.0	6.5	13.3	24.6	.	.
Retail trade turnover, YUM mn	27896	35433	48748	57697	119522	250312	322902	.	.
annual change in % (real, calc.)	7.4	11.8	3.9	-13.5	11.6	10.2	8.2	.	.
Consumer prices, % p.a.	91.5	21.6	29.9	44.9	85.6	89.0	16.5	15	10
Producer prices in industry, % p.a.	90.2	19.5	25.5	43.4	106.9	85.1	8.7	10	10
General government budget, YUM mn									
Revenues	35941	47455	61360	79321	138749	320475	507008	.	.
Expenditures	39044	55315	70739	.	.	.	.	.	.
Deficit (-) / surplus (+)	-3103	-7860	-9379	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-7.0	-6.1	.	.	.	.	.	.
Money supply, YUM mn, end of period	.								
M1, Money	5495.3	9148.0	10807.3	16332.0	26954.0	52686.0	94573.0	.	.
Broad money ⁸⁾	31434.7	38948.4	62352.0	75393.7	65522.0	107825.0	190284.0	.	.
Discount rate, % p.a., end of period	68.2	33.7	33.7	26.3	26.3	16.4	9.5	.	.
Current account, USD mn ⁹⁾	-1317	-1837	-1180	-1341	-339	-624	-2000	-2000	-2000
Current account in % of GDP	-8.0	-10.1	-6.5	-12.9	-4.2	-5.9	-15.2	-11.8	-10.4
Forex reserves of NBY, USD mn	300	300	300	297	524	1169	2280	.	.
Gross external debt, USD mn	9000	10500	11500	12500	11418	11740	11472 ^{Sep}	.	.
Exports total, fob, EUR mn ¹⁰⁾	1592.8	2360.0	2517.7	1391.1	1808.2	2095.1	2273.7	2480	2630
annual growth rate in %	.	48.2	6.7	-44.0	30.0	15.9	8.5	9	6
Imports total, cif, EUR mn ¹⁰⁾	3250.6	4245.2	4283.5	3080.8	3892.1	5385.7	6002.9	6120	6240
annual growth rate in %	.	30.6	0.9	-26.4	26.3	38.4	11.5	2	2
Average exchange rate YUM/USD	4.97	5.72	9.34	11.01	16.69	66.84	64.19	60	60
Average exchange rate YUM/EUR (ECU)	6.30	6.48	10.46	11.74	15.30	59.50	60.73	65	65

*) Note: From 1999 (GDP from 2000) excluding Kosovo and Metohia.

Notes: 1) Preliminary. - 2) Estimates based on World Bank method. From 1999 based on market exchange rate. - 3) Based on GMP in Dinar. - 4) Excluding private enterprises. - 5) Employees plus own account workers, excluding individual farmers; from 1998 including small enterprises. - 6) From 1998 including small enterprises. - 7) In % of unemployed plus employment. - 8) From 2000: at official exchange rate, excluding Montenegro, government deposits, household frozen foreign currency saving deposits. - 9) From 2000 including official grants. - 10) Converted from the national currency to EUR at the official exchange rate.

Source: **wiiw** Database incorporating national statistics; **wiiw** forecasts.