SERBIA: Early elections, then reforms

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Last year delivered a recovery in GDP growth, early estimate 2.4%, which can be attributed to the full rebound of agricultural production and the start of Fiat's production and export of cars. This and the next couple of years will see a slowdown of growth, with probably slight recession in 2014 and a speed-up to not more than 2% in the medium term, due to the disappearance of these one-time effects. Inflation is decelerating and positive employment effects cannot be expected.

The start of the car production is reflected also in the increase in industrial production. Construction, however, continued to decline and indeed GDP minus the two items mentioned above probably posted negative growth. On the domestic demand side, private consumption declined as well as the public one, while investments did much worse than expected. In view of that, it would not be a surprise if the preliminary GDP number were to be revised downwards.

The unemployment rate declined by 4 percentage points (to 20%) in October's labour force survey (LFS; the year average is higher), due to an increase in LFS-reported informal employment. The survey data have become quite volatile, while those of registered unemployment have been quite stagnant, so it is hard to say what is going on in the labour market. As for the financial markets, non-performing loans (NPLs) of the corporate sector continue to pile up and small state-owned banks continue to fail. NPLs are mostly concentrated in the corporate sector and are headed to the level of 30% of banks' assets. Otherwise, the central bank reports that the bulk of the banking system is stable and well capitalised, though it proceeds to deleverage towards foreign creditors. In addition, there are still some banks with significant state ownership, and if those were to get into trouble, the stability of the financial system cannot be guaranteed. Banks owned by the state or with a significant share owned by the state have suffered from oligarchic connections between the entrepreneurs and the political parties that they finance.

The main policy developments were connected with the rebooting of the government. In the middle of the last year, there was a major reshuffle of the government with new ministers – technocrats, not party people – taking the posts of finance and economy ministers. Both announced major reforms in fiscal policy and in the regulatory environment (i.e. structural reforms). However, the budget that was adopted seems destined for revision, primarily due to falling revenues, while the whole package of structural reforms, which would have targeted the corporate losses and debts as well as the labour law, was scraped partly due to the opposition from the firms and the trade unions. Indeed, the leading party in the government, the Progressive Party, decided to call for early elections expecting to take an even larger share in the government.

The promise with which the electorate is courted is that the elections will make the reforms possible. No specifics of what these reforms will look like have been disclosed so far. The elections are scheduled for 16th March, so details may surface during the campaign. The problem is that the new, old government – it is forecasted that the Progressive Party will form the bulk of the government – will have to convince the awakened interest groups and will thus fight an uphill battle. The appeal of the reforms is low because of the many failed attempts and in particular the most recent one last year.

Even with the reforms, the current government strategy calls for slow recovery in the next ten or so years due to the perceived need to engineer fiscal consolidation. In part, this is also due to the need to cut government employment and increase the private one. In the process, however, private consumption is expected to decline or stagnate at the same time when public consumption is being cut. Everything is staked on investments increasing with a view to exporting the bulk of the increased production. There are various investment projects announced, which should be financed by various investors from the countries in the Persian Gulf. Those are reportedly targeting agriculture, housing, and the IT sector. If those, public or private, investments fail to revive, not only public but also private finances will prove to be unsustainable. The risk of this disappointing outcome materialising seems to be rising.

Tax hikes tend not to increase public revenues significantly while investments, domestic and foreign, are not yet forthcoming. Not much will happen until after the early elections, scheduled for 16th March, which means that some of the possible effects of the perhaps new strategy of the new government cannot be in place much before early autumn. Prospects for this year are not very encouraging, though mild weather may boost agricultural production. In the next two years, however, some type of debt restructuring seems unavoidable with IMF conditions most probably attached to it. Those will leave little room for the recovery of growth. So, mid-term prospects are for slow recovery at best.

In view of the political and social developments in the region, it is questionable whether the upcoming early elections will provide for political and social stability. The government, which is almost certainly going to be re-elected, has already wasted almost two years. If it proves incapable of turning things around in the next year or so, the worsening social situation may prove to be challenging. The official strategy, which will almost certainly be confirmed in the expected programme with the IMF, calls for slow recovery with up to 2% growth of GDP in the medium run, due to declining or stagnating private and public consumption and stagnating employment. Possible upside risks may materialise if investment performs better than expected, though so far it has tended to disappoint. Also, net exports should contribute positively, which is hard to sustain due to the high import dependence of the exporting industries. Finally, high unemployment rates or rather low employment rates will persist.

These relatively sober expectations increase the risk of further macroeconomic destabilisation. Monetary policy is between the rock and the hard place because the central bank feels that it cannot afford fast depreciation of the currency, for fear of the stability of the banking sector, so it keeps the reference interest rate high and is running the risk of deflation. However, the prospect of low inflation and slow recovery is putting the willingness to service the public debt to a serious test. If the expected investments and reforms do not materialise and do not spur growth respectively, the prospect of debt restructuring may increase in probability.

Table 1 / Serbia: Selected Economic Indicators

	2009	2010	2011	2012	2013 [1]	2014	2015 Forecast	2016
Population, th. pers., mid-year [2]	7320.8	7291.4	7234.1	7199.1	7100.0	7070	7040	7010
Gross domestic product, RSD bn, nom. [3]	2720.1	2881.9	3208.6	3348.7	3700.0	3800	4000	4200
annual change in % (real)	-3.5	1.0	1.6	-1.5	2.4	-0.5	1.0	1.9
GDP/capita (EUR at exchange rate)	4000	3800	4400	4100	4600	.	.	.
GDP/capita (EUR at PPP)	8400	8500	8900	9000	9500	.	.	.
Consumption of households, RSD bn, nom. [3]	2143.2	2282.8	2438.2	2543.5	2700.0	.	.	.
annual change in % (real) [3]	-2.7	-1.0	-1.2	-1.9	-1.0	-2.0	0.0	0.0
Gross fixed capital form., RSD bn, nom. [3]	510.2	512.3	592.8	717.2	750.0	.	.	.
annual change in % (real) [3]	-22.1	-5.5	8.4	14.4	-3.0	2.0	4.0	4.0
Gross industrial production [4]								
annual change in % (real)	-12.6	1.2	2.5	-2.2	6.3	4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	1.3	1.0	0.8	-17.3	22.1	5.0	10.0	8.0
Construction output [5]								
annual change in % (real)	-19.7	-7.1	10.4	-7.5	-5.0	3.0	5.0	5.0
Employed persons, LFS, th, average [6]	2616.4	2396.2	2253.2	2228.3	2310.7	2300	2300	2300
annual change in % [6]	-7.3	-8.4	-6.0	-1.1	3.7	0.0	1.0	1.0
Unemployed persons, LFS, th, average [6]	503.0	568.7	671.1	701.1	701.1	.	.	.
Unemployment rate, LFS, in %, average [6]	16.1	19.2	23.0	23.9	23.6	24.0	23.0	23.0
Reg. unemployment rate, in %, end of period	25.9	26.7	27.6	28.2	28.2	28.0	28.0	28.0
Average monthly gross wages, RSD [7]	44147	47450	52733	57430	60708	.	.	.
annual change in % (real, gross)	0.2	0.6	0.1	1.0	-1.9	0.0	0.0	1.0
Average monthly net wages, RSD [7]	31733	34142	37976	41377	43932	.	.	.
annual change in % (real, net)	0.2	0.7	0.2	1.1	-1.5	0.0	0.0	1.0
Consumer prices, % p.a.	8.6	6.8	11.0	7.8	7.8	4.0	4.0	3.0
Producer prices in industry, % p.a. [8]	5.6	12.7	14.2	5.6	3.6	.	.	.
General governm.budget, nat.def., % of GDP								
Revenues	42.1	42.5	40.6	42.0	39.7	.	.	.
Expenditures	46.6	47.2	45.5	48.5	44.5	.	.	.
Deficit (-) / surplus (+)	-4.5	-4.7	-4.9	-6.5	-4.8	-6.0	-5.0	-4.0
Public debt, nat.def., % of GDP	34.7	44.5	48.5	59.8	62.2	70.0	72.0	72.0
Central bank policy rate, % p.a., end of period [9]	9.50	11.50	9.75	11.25	9.50	7.0	7.0	6.0
Current account, EUR mn	-1909.9	-1887.5	-2870.0	-3155.1	-2280.0	-1950	-1950	-2100
Current account, % of GDP	-6.6	-6.7	-9.1	-10.7	-7.0	-6.0	-6.0	-6.0
Exports of goods, BOP, EUR mn	5977.8	7402.5	8439.6	8822.3	9530.0	10100	10700	11400
annual change in %	-19.4	23.8	14.0	4.5	8.0	6.0	6.0	7.0
Imports of goods, BOP, EUR mn	10924.2	11983.6	13758.0	14272.1	14560.0	15300	16100	16900
annual change in %	-31.4	9.7	14.8	3.7	2.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn	2500.1	2667.1	3032.2	3091.1	3309.0	3500	3700	3900
annual change in %	-8.8	6.7	13.7	1.9	7.0	7.0	5.0	5.0
Imports of services, BOP, EUR mn	2479.4	2659.4	2869.0	2938.8	3085.0	3200	3400	3600
annual change in %	-15.3	7.3	7.9	2.4	5.0	5.0	5.0	5.0
FDI inflow, EUR mn	1410.1	1003.1	1948.9	274.1	700.0	1000	1000	1000
FDI outflow, EUR mn	37.6	143.0	122.0	42.3	100.0	100	100	100
Gross reserves of NB, excl. gold, EUR mn	10278	9555	11497	10295	10734	.	.	.
Gross external debt, EUR mn	22487	23786	24125	25721	26000	.	.	.
Gross external debt, % of GDP	77.7	84.9	76.7	86.9	79.5	.	.	.
Average exchange rate RSD/EUR	93.94	102.90	101.96	113.13	113.09	116	118	120
Purchasing power parity RSD/EUR	44.34	46.73	49.57	51.46	54.66	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011, census March 2002 before. - 3) According to ESA'95 (FISIM not yet reallocated to industries). - 4) Excluding arms industry. - 5) According to gross value added. - 6) Extended survey as of April and October. - 7) Including wages of employees working for sole proprietors. - 8) Domestic output prices. - 9) Two-week repo rate.

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