SERBIA: Investment is the key

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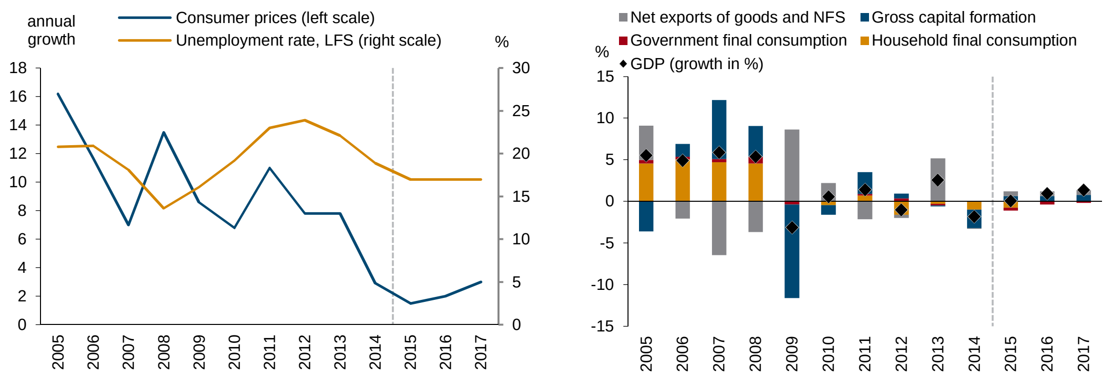
Growth will stabilise in the course of the current year, the upside risks to the forecast being the country's weak performance in the latter half of the previous year. Growth prospects should improve at a moderate pace in the medium term. Assuming that political stability is assured and reforms are sustained over that period, adjustment of the main GDP components, in tandem with a relatively strong investment performance and continued export growth, should allow on average for real GDP growth in the order of 3% for the next five years or so.

Figure 58 / 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.

This year's growth may turn out better than forecasted due to the stronger rebound from last year's slump. If that happens, it will be due to investments on the demand side and due to industrial production on the supply side. In addition, exports are doing relatively well, though imports are recovering too, so the contribution of net exports to GDP growth may be more muted. In any case, on balance, stagnation is more likely than growth by 0.5%, which is the official forecast. In the medium term, growth should accelerate to about 2%, again, mostly on investment and export growth.

Serbia was traditionally a country with a relatively high inflation rate because of the monetary policy that relied on periodic devaluations. In essence, the exchange rate would be pegged, informally more often than explicitly, in order to sap the price increases while wages would be allowed to continue growing, so relatively fast inflation (usually at around 10%) would be slowed down due to the stable exchange rate until an accumulation of excessive external imbalances would force a devaluation and the speed-up of inflation in order to correct the real wages. This has changed in the last couple of years as the loss of employment has put pressure on the growth of wages and there have been periods of freezes of wage growth in the public sector. This year wages were cut by 10% and pensions similarly on average, which led to falling consumption and stagnant imports and thus a stable exchange rate. On the back of that, the central bank was able to start to cut the policy rate sharply while deflationary pressures remained. So, while some revival of inflationary pressures can be expected, those should not push the inflation rate towards the official central target of 4% with a corridor of 1.5 percentage points up or down.

The government has been concentrated on bringing the fiscal deficit down because the development of the public debt has been assessed to be on an unsustainable path. Indeed, according to the current forecasts, it will peek at 80% of GDP by next year or the year after, before it levels off and possibly starts to decline due to accelerating growth and cuts in government spending on compensations. Additional cuts in nominal wages are not planned and in fact some rises have been promised, so savings should be achieved through cuts in public employment. Also, additional cuts in subsidies should prove possible if the current programmes for privatisation and restructuring (which include bankruptcies and liquidations) of public enterprises are carried out.

These additional measures may have to wait for early elections which seem increasingly probable at least according to public pronouncements of the ruling party. Though the support of the government and especially of the prime minister is very strong, the assessment seems to be that the renewed support from the public and the new composition of the governing coalition, with perhaps even a single-party government, could prove supportive of additional changes and not only in economic policy.

Early elections, if they were to occur in late winter or early spring of next year, would also allow for a reshaping of the opposition. The left has been weakened by the developments in Greece while the nationalists are more popular in the media than in the polls. The latter also rely on Russian support whose strength is hard to tell. It is possible that both of these strands of opposition will prove to be weaker than currently perceived, which would prove stabilising not just for the government but also more broadly. It would also signal that the current president, who is strongly pro-Russian, may not be able to win a second mandate, which would weaken his influence even when he is still in office.

The election results would be more than certain if the negotiations with the European Union start in earnest by the end of this year. Assuming relatively positive economic numbers at the end of the year and heightened support from the EU, the prime minister and his party would be assured a new four-year mandate. In that period, the constitution could be changed and the process of normalisation with Kosovo should become irreversible. These, in any case, are current forecastable ends and means.

In the medium term, the adjustment to sustainable growth should proceed with little help from increased government spending, but capital investment should increase (mainly in infrastructure). Similarly, household consumption should not post too much of a growth, which should allow for net exports to continue to contribute positively to growth of GDP. Unlike in the past, the policy rate should remain low and monetary policy more supportive if inflation remains subdued. That could lead to the inflation targeting regime to start operating in earnest, which would allow for monetary policy to be more active and more predictable.

Overall, this year will prove stabilising for growth with growth prospects improving at a moderate pace in the medium term. Assuming political stability is preserved and the reforms are sustained, in the medium run the adjustment of main GDP components with a relatively strong investment performance and continued growth of exports, should allow for real GDP growth of 3% on average for the next five years or so.

Table 23 / Serbia: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th. pers., mid-year 2)	7,237	7,201	7,167	7,132	.	.	7,040	7,010	7,000
Gross domestic product, RSD bn, nom. 3)	3,408	3,584	3,876	3,878	1,840	1,854	3,900	4,000	4,200
annual change in % (real)	1.4	-1.0	2.6	-1.8	-0.7	-0.5	0.1	0.9	1.4
GDP/capita (EUR at exchange rate) 3)	4,600	4,400	4,800	4,600	.	.	4,500	4,500	4,700
GDP/capita (EUR at PPP) 3)	9,500	9,700	9,800	9,600	.	.	.	.	.
Consumption of households, RSD bn, nom. 3)	2,596	2,728	2,886	2,921	720	725	.	.	.
annual change in % (real)	0.9	-2.1	-0.4	-1.3	-1.4	-1.0	-1.0	0.0	0.0
Gross fixed capital form., RSD bn, nom. 3)	627	759	668	666	160	177	.	.	.
annual change in % (real)	4.6	13.2	-12.0	-2.7	-2.2	6.5	4.0	4.0	5.0
Gross industrial production 4)									
annual change in % (real)	2.5	-2.2	5.3	-6.5	-1.1	2.4	5.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	0.9	-17.3	21.7	2.0	.	.	.	.	.
Construction output 5)									
annual change in % (real)	5.9	-9.8	11.1	-4.0	.	.	.	.	.
Employed persons, LFS, th, average 6)	2,253	2,228	2,311	2,421	2,408	2,566	2,500	2,530	2,560
annual change in %	-6.0	-1.1	.	4.8	8.1	6.6	3.0	1.0	1.0
Unemployed persons, LFS, th, average 6)	671	701	656	563	612	558	510	520	520
Unemployment rate, LFS, in %, average 6)	23.0	23.9	22.1	18.9	20	18	17	17	17
Reg. unemployment rate, in %, end of period	27.6	28.6	29.1	28.4	29	28	.	.	.
Average monthly gross wages, RSD	52,733	57,430	60,708	61,426	59,865	59,444	61,100	62,900	65,400
annual change in % (real, gross)	0.1	1.0	-1.9	-0.9	-1.3	-2.1	-2.0	1.0	1.0
Average monthly net wages, RSD	37,976	41,377	43,932	44,530	43,398	43,218	44,300	45,600	47,400
annual change in % (real, net)	0.2	1.1	-1.5	-1.5	-1.0	-1.7	-2.0	1.0	1.0
Consumer prices, % p.a.	11.0	7.8	7.8	2.9	2.3	1.3	1.5	2.0	3.0
Producer prices in industry, % p.a.	12.7	6.8	2.7	1.3	0.6	1.7	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	40.0	41.1	39.7	41.8	41.1	43.4	40.0	40.0	40.0
Expenditures	44.8	47.9	45.1	48.4	47.3	45.3	45.0	44.0	43.0
Deficit (-) / surplus (+)	-4.8	-6.8	-5.5	-6.7	-6.2	-1.9	-5.0	-4.0	-3.0
Public debt, nat.def., % of GDP	45.4	56.2	59.6	71.0	.	.	75.0	80.0	85.0
Central bank policy rate, % p.a., end of period 7)	9.75	11.25	9.50	8.00	8.5	6.0	5.0	5.0	5.0
Current account, EUR mn 8)	-3,656	-3,671	-2,098	-1,985	-1,037	-668	-1,950	-2,100	-1,900
Current account, % of GDP 8)	-10.9	-11.6	-6.1	-6.0	-6.5	-4.4	-6.0	-7.0	-6.0
Exports of goods, BOP, EUR mn 8)	8,118	8,376	10,515	10,641	5,279	5,588	11,200	11,800	12,400
annual change in %	18.4	3.2	25.5	1.2	11.9	5.8	5.0	5.0	5.0
Imports of goods, BOP, EUR mn 8)	13,614	14,011	14,674	14,752	7,177	7,504	15,200	15,700	16,300
annual change in %	17.6	2.9	4.7	0.5	3.1	4.5	3.0	3.0	4.0
Exports of services, BOP, EUR mn 8)	3,027	3,093	3,422	3,810	1,680	1,931	4,200	4,400	4,600
annual change in %	13.8	2.2	10.6	11.3	10.3	15.0	10.0	5.0	5.0
Imports of services, BOP, EUR mn 8)	2,873	2,981	3,109	3,344	1,538	1,681	3,600	3,800	4,000
annual change in %	7.6	3.8	4.3	7.6	8.3	9.2	8.0	5.0	5.0
FDI liabilities (inflow), EUR mn 8)	3,544	1,009	1,548	1,500	821	742	700	.	.
FDI assets (outflow), EUR mn 8)	225	256	250	264	115	67	100	.	.
Gross reserves of NB, excl. gold, EUR mn	11,497	10,295	10,734	9,351	9,597	9,694	.	.	.
Gross external debt, EUR mn	24,125	25,645	25,746	25,792	25,261	26,512	28,000	29,000	30,000
Gross external debt, % of GDP	72.2	80.9	75.1	78.0	76.4	84.3	89	91	91
Average exchange rate RSD/EUR	101.95	113.13	113.14	117.31	115.70	121.00	124	126	128
Purchasing power parity RSD/EUR	49.66	51.14	55.03	56.89	.	.	.	.	.

1) Preliminary . - 2) From 2011 according to census October 2011. - 3) According to ESA 2010. - 4) Excluding arms industry. -
5) According to gross value added. - 6) Until 2013 survey of April and October, quarterly thereafter. From 2013 based on census 2011. -
7) Two-week repo rate. - 8) BOP 6th edition.

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