SERBIA: Problems extending far beyond winter

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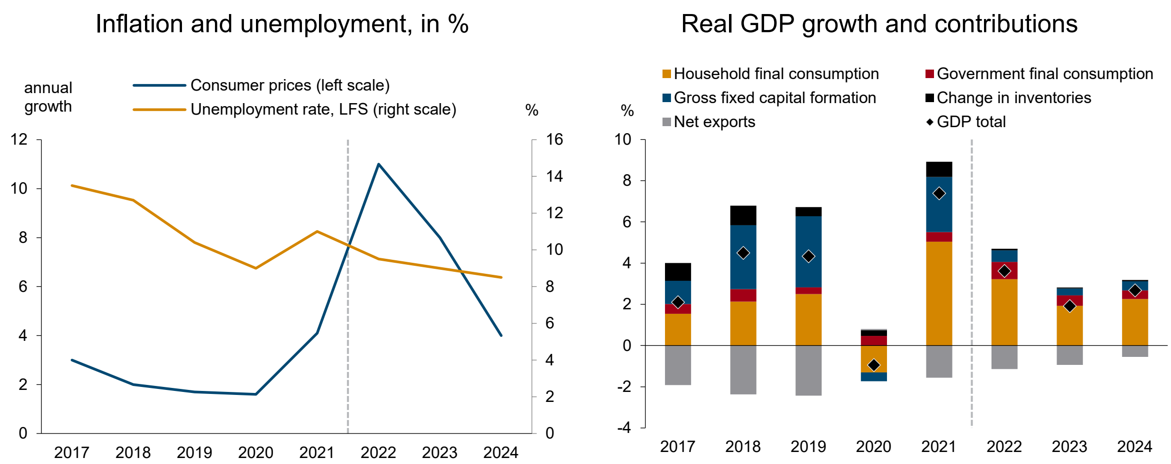
Despite the hard times brought about by the Russian invasion of Ukraine, Serbia is doing relatively well in an economic sense, mainly because of supportive government measures. The country should be able to see the winter through without major problems, but its medium-term economic prospects remain uncertain, depending as they do essentially on how the country positions itself vis-à-vis Russia.

Figure 6.19 / Serbia: Main macroeconomic indicators



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

Inflation in Serbia is proving more persistent than was previously thought, but is still among the lowest in the region. In August it reached 13.2%, which is the highest since 2011, but is still the second lowest in the Western Balkans, with only Albania performing better. The government is maintaining the price freeze on basic foodstuffs (10 months now), and this does seem to be working, at least partially. The cost of electricity is capped, and the price of fuels is heavily regulated, which also helps.

Real wages are continuing to grow, despite inflation. In June, real growth in the average net wage was 2.1% year on year, among the highest in the whole CESEE region. The government raised the minimum wage and public-sector wages from the start of the year, and this has certainly helped the situation; but the wage increase was evident in all sectors, and indeed was higher in the private sector than in the public. Further increases in the minimum wage and public-sector wages have been announced for the coming period, which should prevent inflation from eating into real incomes.

Thanks to these measures, GDP growth in the first half of the year remained solid, reaching 4.1% year on year. This indeed represents a slowdown compared to last year, when GDP grew by 7.4%, but it is still in line with our previous forecasts. Growth in the first half of 2022 was driven by household consumption, which expanded by 5.5%, due to the post-pandemic release of pent-up demand, and also supported by the positive trend in real wages. By contrast, investment was rather weak in the first six months of 2022, growing by only 1.4%. Exports and imports both expanded by around 20% (all in real terms).

The slowdown in investment was partly due to weaker foreign direct investment (FDI). FDI inflows in the first six months of 2022 declined by 9% nominally, and by 20% in real terms, which runs counter to developments in previous years, when Serbia was something of an FDI champion in the wider region. This is even more surprising, given that most of the CESEE countries experienced an increase in FDI inflows in the first half of 2022. It is hard to say what the reasons were for the decline, as there are as yet no data on FDI inflows by country of origin for 2022; but the most obvious explanation would be that Serbia has lost its Russian FDI, which provided around 7% of FDI in the country before the war. The second explanation is that EU companies have turned their backs on Serbia, due to its close ties with Russia. It may also be that FDI inflows are simply too volatile from year to year. Only with time can a firmer conclusion be reached, but it should come as no surprise if Serbia continues to receive less FDI in the coming period than over the past few years.

Elevated global energy prices pushed the current account deficit to 9.3% of GDP in the first half of the year. High current account deficits are not uncommon for Serbia – the country ran a deficit of 20% of GDP in 2008 – but the deficit in the first six months of 2022 was still the highest for 10 years. On the plus side, remittances (approximated by ‘secondary income’ in the balance of payments accounts) expanded by 25% over the same period (in nominal terms), signalling that workers abroad are sending more money back home to help their families deal with the crisis. The higher current account deficit, in combination with the lower FDI inflows, may put Serbia’s external balance under pressure in the coming period.

The central bank is continuing to tighten its monetary policy, and this could slow the economy. The policy rate has been hiked six times since April, to stand at 3.5% in September, up from 1% prior to April. While it is unclear whether this will have any effect on inflation, it is already retarding credit activity: the rate of growth of total credit to the private sector fell to 11.5% in August, from 13.4% in May. This refers both to corporate and household loans, and may indeed be one of the headwinds to growth in months to come, especially as the effects of the tighter monetary policy will take some time to filter through. On the other hand, the higher interest rates have strengthened the dinar, which in September was trading at 117.3 to the euro, whereas in April the rate had stood at 117.7. Foreign exchange reserves have also increased by 8% since May.

Fiscal policy remains supportive. Government expenditure in the first seven months rose by 12.7% year on year in nominal and by 2.3% in real terms, owing to higher public-sector wages, social assistance and pensions. Government capital spending likewise grew substantially, by 44% nominally (to reach 6% of GDP), due to the ambitious infrastructure investment agenda. Despite the government’s spending spree, the budget was still in surplus during those seven months, as revenue grew even more than expenditure (14.4% nominally), bolstered by inflation. Due to the high market borrowing costs, the government took out a loan of EUR 1bn from the United Arab Emirates, at an interest rate of 3%. Despite the favourable interest rate, many of the loan’s conditions remain unknown, including its repayment schedule, which may prove problematic. The country is also negotiating a stand-by arrangement with the International Monetary Fund, which should calm investors and improve the stability of public finances ahead of the winter.

The economy seems to have slowed down in the third quarter, but growth should still remain in positive territory. Industrial production in July and August declined by 0.7% year on year, but retail trade grew by 4.3% in real terms. Real wages in July were still growing on an annual basis – though only marginally, by 0.2%.

The winter will be tough, but the country should be able to endure it without any great difficulty. The government signed a favourable gas deal with Russia in May, which covers around 75% of the industrial needs of the country. Nor should electricity be a problem, as the country meets almost all of its requirement through domestic generation. Industry is one channel through which Serbia could suffer during the winter, given the country's high level of integration into European value chains. However, it is not as exposed as certain regional peers, such as North Macedonia. Exports to Germany constitute around 13% of total exports and 5% of the country's GDP; that represents moderate dependence, and is much lower than in some other CESEE countries.

In light of all this, we are keeping our growth forecast for 2022 the same as three months ago, but have revised our forecast for 2023 substantially downwards. Specifically, we still project GDP to grow by 3.6% for 2022 as a whole, which implies a moderate slowdown over the remainder of the year vis-à-vis the first half of the year. For 2023, we now forecast that GDP will grow by 1.9%, which is almost half of the previous forecast. That implies that economic activity next year will decelerate further.

Regarding inflation, as it is proving more persistent than was previously anticipated, we have revised it upwards for both 2022 and 2023. Specifically, for 2022, we now project that it will average 11% for the whole year. That is an upward revision of 1 percentage point (pp) compared to the summer forecast, and means that inflation will stay close to the current level until the end of the year. It will then begin to moderate gradually, declining to 8% for 2023 as a whole – an upward revision of 2 pp over the previous forecast.

Despite the relatively benign short-term economic outlook, Serbia's medium-term prospects are much harder to assess. It has retained close ties to Russia, mainly because of its gas dependence, but until now this has not come with a particularly high price tag. The only cost in the economic sense seems to be the slightly lower FDI inflows, but those are not yet of a magnitude that should raise concern. In the political sense, the price is rather higher, as the country has obviously lost some of its Western support, though not excessively so. But the real price may become evident only after some time, especially if Russia loses the war, which no longer seems that unlikely. The key question thus appears to be: how will Serbia position itself in the future, especially in the event of a Russian defeat in Ukraine? If it distances itself from Russia, its medium-term economic prospects may remain solid. The first indication that this could already be happening is that several Serbian officials have stated that the country will not recognise the referendums on the annexation of parts of Ukraine by Russia. Still, this could simply be on account of the status of Kosovo, which previously held a referendum on independence that Serbia does not recognise. Whatever the reason, the uncertainties facing Serbia extend far beyond the current winter.

Table 6.19 / Serbia: Selected economic indicators

	2019	2020	2021 1)	2021 January-June	2022 January-June	2022 Forecast	2023 Forecast	2024 Forecast
Population, th. pers., mid-year	6,945	6,899	6,834	.	.	6,800	6,750	6,700
Gross domestic product, RSD bn, nom.	5,422	5,502	6,269	2,897	3,280	7,200	7,900	8,400
annual change in % (real)	4.3	-0.9	7.4	7.5	4.1	3.6	1.9	2.7
GDP/capita (EUR at PPP)	12,800	12,760	14,290	.	.	.	.	.
Consumption of households, RSD bn, nom.	3,637	3,604	4,035	1,887	2,177	.	.	.
annual change in % (real)	3.7	-1.9	7.7	7.7	5.3	5.0	3.0	3.5
Gross fixed capital form., RSD bn, nom.	1,218	1,180	1,409	608	699	.	.	.
annual change in % (real)	17.2	-1.9	12.5	14.5	1.4	2.5	1.5	2.0
Gross industrial production 2)								
annual change in % (real)	0.3	0.4	6.4	10.0	3.2	2.5	1.5	2.5
Gross agricultural production								
annual change in % (real)	-1.2	2.0	-6.0	.	.	.	.	.
Construction output								
annual change in % (real)	35.5	-2.5	17.0	18.6	-8.6	.	.	.
Employed persons, LFS, th, average 3)	2,901	2,895	2,849	2,777	2,912	2,910	2,940	2,970
annual change in %	2.4	-0.2	2.6	1.2	4.9	2.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	336	287	352	376	314	310	290	280
Unemployment rate, LFS, in %, average 3)	10.4	9.0	11.0	12.0	9.8	9.5	9.0	8.5
Reg. unemployment rate, in %, eop	18.7	17.9	17.4	.	.	.	.	.
Average monthly gross wages, RSD	75,814	82,984	90,784	88,652	100,622	103,300	114,900	123,700
annual change in % (real, gross)	8.4	7.8	5.2	5.9	3.5	2.5	3.0	3.5
Average monthly net wages, RSD	54,919	60,073	65,864	64,287	72,945	74,900	83,300	89,700
annual change in % (real, net)	8.5	7.7	5.4	6.1	3.4	2.5	3.0	3.5
Consumer prices, % p.a.	1.7	1.6	4.1	2.3	9.7	11.0	8.0	4.0
Producer prices in industry, % p.a.	0.6	-1.3	8.7	5.0	14.8	15.0	5.0	3.5
General governm. budget, nat. def., % of GDP								
Revenues	42.0	41.0	43.3	44.4	45.2	45.0	44.0	44.0
Expenditures	42.2	49.0	47.4	45.7	45.6	46.0	46.0	46.0
Deficit (-) / surplus (+)	-0.2	-8.0	-4.1	-1.3	-0.5	-1.0	-2.0	-2.0
General gov. gross debt, nat. def., % of GDP	52.8	57.8	57.1	53.7	53.8	57.0	58.0	59.0
Stock of loans of non-fin. private sector, % p.a.	8.9	11.1	10.2	7.3	12.8	.	.	.
Non-performing loans (NPL), in %, eop	4.1	3.7	3.5	3.6	3.3	.	.	.
Central bank policy rate, % p.a., eop 4)	2.3	1.0	1.0	1.0	2.5	4.0	3.5	3.0
Current account, EUR m	-3,161	-1,929	-2,296	-681	-2,616	-5,100	-5,400	-5,600
Current account, % of GDP	-6.9	-4.1	-4.3	-2.8	-9.4	-8.3	-8.0	-7.8
Exports of goods, BOP, EUR m	16,415	16,079	20,783	9,633	12,787	27,400	30,000	33,200
annual change in %	8.7	-2.0	29.3	31.2	32.7	32.0	9.5	10.5
Imports of goods, BOP, EUR m	22,038	21,280	26,707	12,217	17,586	36,900	40,400	44,400
annual change in %	9.1	-3.4	25.5	23.1	43.9	38.0	9.5	10.0
Exports of services, BOP, EUR m	6,934	6,191	7,800	3,444	4,692	10,300	11,300	12,500
annual change in %	14.4	-10.7	26.0	17.7	36.3	32.0	10.0	11.0
Imports of services, BOP, EUR m	5,922	5,090	6,402	2,693	3,840	8,800	9,600	10,600
annual change in %	16.9	-14.1	25.8	10.9	42.6	38.0	9.5	10.0
FDI liabilities, EUR m	3,815	3,039	3,886	1,909	1,608	3,600	.	.
FDI assets, EUR m	264	100	229	153	101	300	.	.
Gross reserves of CB, excl. gold, EUR m	12,042	11,732	14,523	12,358	12,642	.	.	.
Gross external debt, EUR m	28,254	30,787	36,488	32,272	38,287	43,000	49,300	54,800
Gross external debt, % of GDP	61.4	65.8	68.4	60.5	62.4	70.0	73.0	76.0
Average exchange rate RSD/EUR	117.85	117.58	117.57	117.58	117.59	117.3	117.0	116.5

1) Preliminary. - 2) Excluding arms industry. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Key policy rate.

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