

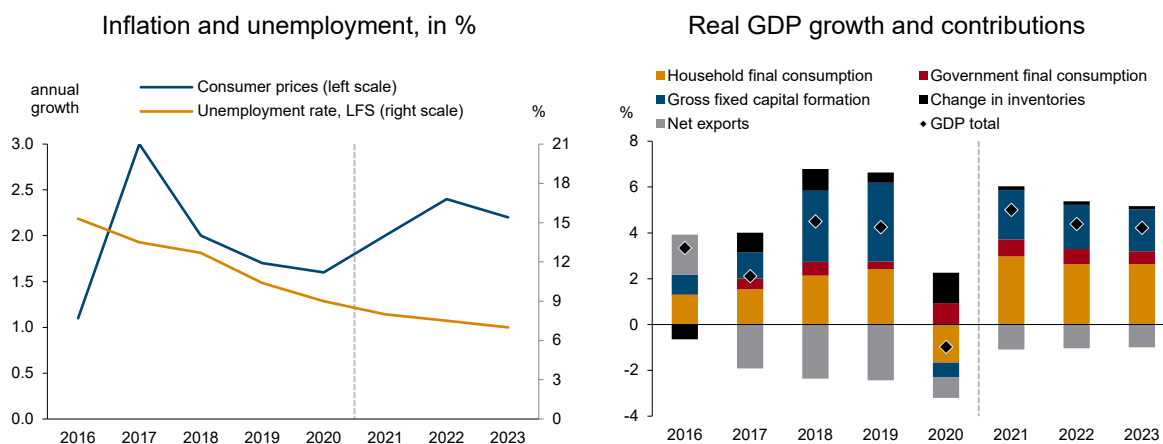


SERBIA: Setting an example for the region

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Serbia finished 2020 as one of the best-performing European economies, and started 2021 in a similar manner. Real GDP fell by just 1% in 2020, fuelled by strong public spending. Thanks to an excellent vaccine roll-out and growth in high-frequency indicators, we project 5% growth for 2021. The main risks lie with the ongoing pandemic wave, which might stall the economy for a while, and the announced fiscal consolidation, which could hamper growth if undertaken too soon.

Figure 4.19 / Serbia: Main macroeconomic indicators



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

No economy did well in 2020, but Serbia's performance was almost as good as it gets. Its GDP declined by just 1%, cushioned by growth of public consumption (5.6%) and gross investment (2.7%). Household consumption was the main cause of the decline, falling 2.5% due to the reduced propensity to consume amidst the pandemic. Exports also fell by 5.9%, though this was largely offset by a reduction in imports of 3.5%.

The main driver behind these relatively good results was expansionary fiscal policy. General government expenditures increased by 18% in 2020 in nominal terms. In the second quarter, in the trough of the recession, the increase was 35%. As a share of GDP, expenditures for the whole year amounted to 49.4% of GDP, which is 8 pp up from the average of the previous three years. The deficit for the whole year reached 8.1% of GDP, the highest in 15 years. The increase was not only due to higher pandemic-related transfers. Capital spending was also 10% higher than the year before at 5.5% of GDP, owing to the ambitious public infrastructure investment plan the government has been pursuing in recent years.

Supportive public spending contributed to an overall benign economic picture for the year. Wage subsidies prevented massive lay-offs and employment declined by just 6,000 people. As inactivity increased due to the pandemic, unemployment actually declined to 9%, from 10.4% the year before. Increases in the minimum wage and public sector wages pushed average wages up by 7.7% in real terms, improving general purchasing power. Despite the wage increases, inflation remained low (1.6%), owing to low commodity prices. The banking sector remained stable – a debt moratoria pushed down non-performing loans to 3.4% (from 4.1% in 2019), while credit guarantee schemes accelerated private sector credit growth to 11.1% (from 8.9% in 2019). This was also supported by the national bank, which reduced its interest rate to an historical low of 1%. The exchange rate was kept stable at an average parity of 117.6 RSD/EUR, minimizing currency risks. The picture is completed by FDI which declined by 21%, but still reached EUR 3bn, or 6.5% of GDP.

The supportive fiscal policy came at the expense of increased indebtedness. Public debt rose to 57% of GDP at the end of 2020 from 52.9% in 2019 due to two Eurobonds issued during the year. The first one was in May, for EUR 2 billion with a maturity of 7 years and a yield of 3.375%, and the second in December, for USD 1.2 billion, with a maturity of 10 years and a yield of 2.350%. These were partly used to repay old debts with higher interest.

The country also seems to have prioritised the economy over public health. No lockdowns were introduced after the spring wave, with milder restrictions instated towards the end of the year. This made the number of daily COVID-19 infections jump to 8,000 in early December, 16 times higher than the summer peak. Despite that, the death toll remained rather low, among the lowest in Europe, which gave rise to widespread suspicion about the way the numbers are calculated. Excess mortality in December was 84% according to The Economist, supporting suspicions. Serbia's President Vucic announced that a full review of the death toll would be undertaken, but these results have never been published.

2021 is off to a good start with positive developments on the vaccination front. Vaccination roll-out has been excellent, and at the end of March the country has administered around 35 vaccine doses per 100 people, only lagging behind the UK in the whole of Europe. The process has proved to be very safe so far, with just around 600 cases of adverse reactions on more than 2 million shots. Most of the vaccines come from China and Russia, another sign of the country's foreign policy of maintaining good relations with these two countries. The vaccine success is strengthening the position of President Vucic and has allowed him to engage in regional vaccine diplomacy. Serbia first donated vaccines to North Macedonia, Montenegro, Bosnia and Herzegovina (both Republika Srpska and Federation BiH) and Kosovo (the Serb-populated part), and then, during the last weekend of March, vaccinated around 25,000 foreign citizens on its territory, most of them from neighbouring countries. Both actions were seen positively by the public and are likely to improve relations in the region. Serbia has also announced that it will start producing both the Russian and Chinese vaccines soon. The production of the Russian Sputnik V vaccine is expected to begin this year at the Torlak Institute in Belgrade, while for the Chinese Sinopharm vaccine a new factory is expected next year.

The first economic data for 2021 are also positive. Industrial production in January was up 2.5% compared to the previous year, retail trade was up 3.2%, while general government revenues were 2.9% higher than the year before (all in real terms). Exports in January were on the same level as in 2020, but imports were 11% down (nominally), implying a positive contribution of net exports to GDP growth. FDI inflows in January were EUR 232 million, the same as the year before.

Positive expectations for the coming year are widely-shared. Moody's upgraded the country's credit rating in March 2021 by one notch to Ba2 with a stable outlook. As key drivers for the upgrade they note the country's relative economic resilience to the coronavirus shock, solid medium term growth prospects and the expectation that Serbia's fiscal situation will continue to outperform its peers over the next few years. Serbia also issued another Eurobond in March 2021 for EUR 1 billion with a maturity of 12 years, which is the longest maturity the country has had so far, with a relatively low yield of 1.920%.

We are thus projecting growth of 5% for 2021, among the highest in the region and in Europe, and the country should exceed the pre-crisis level of activity by mid-year. Growth is expected to be broad-based. Household consumption will grow by 4.5% as the health situation improves and people start spending again. Investment will grow by 10%, driven by the announced investment in public infrastructure, improved FDI, and revived domestic private investment, due to improved business confidence. Exports will grow by 9%, led by improved foreign demand and restored exports from the zones, though this will be offset by an increase in imports of 9.5%. Government consumption will grow 4%, driven by the increase in public sector wages.

Positive trends are expected in all sectors of the economy. Employment will increase by 2.5% (75,000 new jobs), unemployment will decline to 8% (260,000 people), while average wages will rise by 5% in real terms. The banking sector will remain stable, with credit growth continuing and non-performing loans remaining low. FDI will reach EUR 3.8 billion (7.6% of GDP), close to the pre-crisis level, with positive prospects for the future. Inflation will increase slightly, averaging 2% for the whole year, driven by the rise in global commodity prices. The exchange rate will remain stable at 117.6 RSD/EUR as the central bank will continue to intervene on the forex market to prevent currency appreciation. However, we expect slight monetary tightening by the end of the year with the central bank interest rate rising to 1.5%, due to the improved economic situation.

We see two main risks to the above-described positive outlook, related to the pandemic unfolding and fiscal support. The country is currently going through a fourth wave of the pandemic, with the number of daily COVID-19 infections around 4,000 at the beginning of April. So far the government has been very reluctant to introduce restrictions, enacting only mild and short-time closures. But if the health situation does not improve, harsher measures may be required. Some recent studies have argued that vaccination alone may not always be sufficient to contain the pandemic, and that it needs to be accompanied by certain restrictions. In addition, even though the country has been a champion in terms of inoculation so far, there is also widespread scepticism about vaccines. According to a Gallup poll conducted at the end of 2020 just 49% of the Serbian population would take the vaccine, significantly lower than the global average of 67%. Even with the best vaccine roll-out it is possible that collective immunity will not be reached soon, as a large part of the population will simply reject getting the shot. These things may well drag economic growth down.

The second risk factor is related to the planned fiscal consolidation. The government has announced that it will start consolidation already in 2021, with the budget deficit for the year projected at 3% of GDP, down from 8.1% in 2020. We expect it to be slightly higher at around 4%, considering the likelihood that the government will have to provide slightly stronger support to keep the economy afloat and maintain popular support. But if the government presses too strongly with consolidation and sticks to its plan to keep the deficit at 3% of GDP, it will certainly retard growth.

Table 4.19 / Serbia: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th. pers., mid-year	7,021	6,983	6,945	6,915	6,885	6,855	6,830
Gross domestic product, RSD bn, nom.	4,761	5,073	5,418	5,464	5,900	6,300	6,700
annual change in % (real)	2.1	4.5	4.2	-1.0	5.0	4.4	4.2
GDP/capita (EUR at PPP)	11,410	12,020	12,710	12,810	.	.	.
Consumption of households, RSD bn, nom.	3,317	3,463	3,634	3,603	.	.	.
annual change in % (real)	2.2	3.1	3.5	-2.5	4.5	4.0	4.0
Gross fixed capital form., RSD bn, nom.	844	1,017	1,218	1,174	.	.	.
annual change in % (real)	6.6	17.5	17.2	-2.8	10.0	9.0	8.5
Gross industrial production ²⁾							
annual change in % (real)	3.9	1.3	0.3	0.4	5.0	4.5	4.0
Gross agricultural production							
annual change in % (real)	-11.9	14.3	-1.2	4.3	.	.	.
Construction output							
annual change in % (real)	8.5	14.1	35.5	-4.2	.	.	.
Employed persons, LFS, th, average	2,795	2,833	2,901	2,895	2,970	3,040	3,110
annual change in %	2.8	1.4	2.4	-0.2	2.5	2.4	2.3
Unemployed persons, LFS, th, average	435	412	336	287	260	250	230
Unemployment rate, LFS, in %, average	13.5	12.7	10.4	9.0	8.0	7.5	7.0
Reg. unemployment rate, in %, eop	23.0	20.3	18.7	17.9	.	.	.
Average monthly gross wages, RSD ³⁾	65,976	68,629	75,814	82,984	88,900	95,100	101,100
annual change in % (real, gross)	0.9	3.9	8.4	7.8	5.0	4.5	4.0
Average monthly net wages, RSD ³⁾	47,893	49,650	54,919	60,073	64,300	68,800	73,100
annual change in % (real, net)	0.9	4.4	8.5	7.7	5.0	4.5	4.0
Consumer prices, % p.a.	3.0	2.0	1.7	1.6	2.0	2.4	2.2
Producer prices in industry, % p.a.	2.3	0.9	0.6	-1.3	3.0	1.5	2.0
General governm.budget, nat.def., % of GDP							
Revenues	41.5	41.5	42.1	41.3	41.0	41.5	42.0
Expenditures	40.4	40.9	42.3	49.4	45.0	44.5	44.0
Deficit (-) / surplus (+)	1.1	0.6	-0.2	-8.1	-4.0	-3.0	-2.0
General gov.gross debt, nat.def., % of GDP	58.6	54.4	52.9	57.0	56.0	55.0	54.0
Stock of loans of non-fin.private sector, % p.a.	2.1	9.9	8.9	11.1	.	.	.
Non-performing loans (NPL), in %, eop	9.8	5.7	4.1	3.4	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	3.5	3.0	2.3	1.0	1.5	2.0	2.5
Current account, EUR m	-2,051	-2,076	-3,161	-1,981	-2,800	-3,500	-4,200
Current account, % of GDP	-5.2	-4.8	-6.9	-4.3	-5.6	-6.5	-7.3
Exports of goods, BOP, EUR m	14,066	15,106	16,415	16,032	17,800	19,500	21,300
annual change in %	9.8	7.4	8.7	-2.3	11.0	9.5	9.0
Imports of goods, BOP, EUR m	18,064	20,191	22,038	21,257	23,700	26,200	28,800
annual change in %	13.4	11.8	9.1	-3.5	11.5	10.5	10.0
Exports of services, BOP, EUR m	5,246	6,061	6,934	6,163	7,100	8,000	9,000
annual change in %	14.8	15.5	14.4	-11.1	15.0	13.0	13.0
Imports of services, BOP, EUR m	4,280	5,066	5,922	5,089	5,900	6,800	7,800
annual change in %	16.8	18.4	16.9	-14.1	16.0	15.0	14.0
FDI liabilities, EUR m	2,548	3,464	3,815	3,014	.	.	.
FDI assets, EUR m	130	308	264	112	.	.	.
Gross reserves of CB excl. gold, EUR m	9,287	10,526	12,042	11,732	.	.	.
Gross external debt, EUR m	25,526	26,662	28,254	31,000	35,100	38,600	40,700
Gross external debt, % of GDP	65.1	62.2	61.5	66.7	70.0	72.0	71.0
Average exchange rate RSD/EUR	121.34	118.27	117.86	117.58	117.6	117.5	117.0

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2018 based on tax administration data, before on wage survey data supplemented by tax administration data. - 4) Two-week repo rate.

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