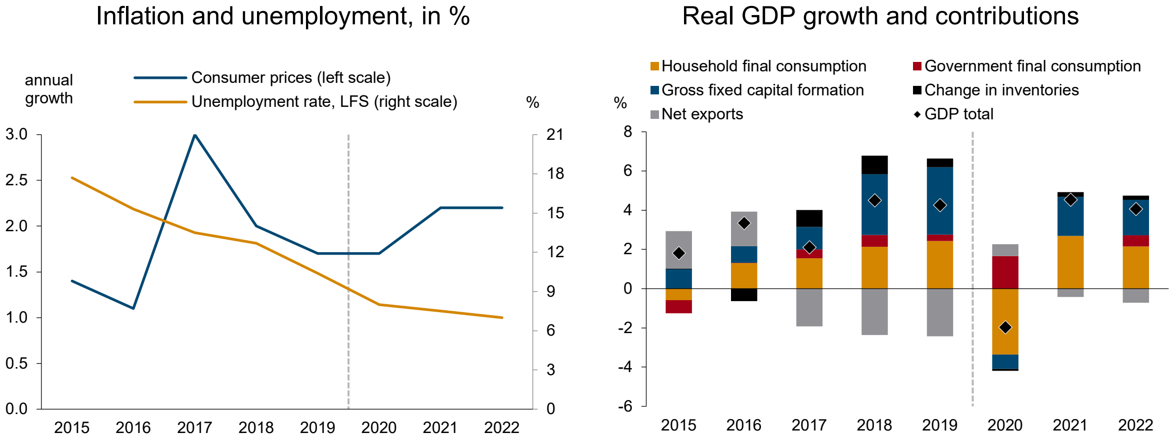
SERBIA: Expansionary fiscal policy helping the economy weather the crisis

BRANIMIR JOVANOVIC

Serbia has been among the best-performing European countries during the COVID-19 pandemic. GDP fell by just 0.8% in the first half of the year, and data for Q3 suggest a solid recovery. We are thus upgrading our forecast for 2020, from -4% to -2%. The good results are mainly due to the massive fiscal support by the government, which has borrowed abroad and used the money to support the economy during the crisis. This cannot continue indefinitely, and prospects for the future depend on the viability of its current economic model, based on attracting FDI, in the post-coronavirus world.

Figure 4.19 / Serbia: Main macroeconomic indicators



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

Serbia was expected to do relatively well during this crisis. In our previous forecast, we projected that its GDP would shrink by 4% this year, which was among the smallest contractions of all the countries for which we forecast. The main reason behind that relatively benign expectation was that the country is not too dependent on tourism and it depends a lot on domestic factors, such as agriculture, which was expected to do well this year.

But the performance of the Serbian economy in the first half of the year exceeded all expectations. In Q1, GDP grew by 5.1% year on year (y-o-y), driven by solid investment (+10.8% y-o-y) and government consumption (+11.8% y-o-y). Then, in Q2, it did decline, due to the lockdown – but by only 6.4% y-o-y, which was one of the smallest contractions in Europe. The lockdown caused most GDP components to decline in Q2 – household consumption by 8%, investment by 11.9%, exports by 20.7% and imports by

19.3%. The exception was government consumption, which grew by 8.9% and provided a much-needed stimulus to the economy.

The fiscal stimulus provided by the Serbian government in Q2 was really exceptional. General government total spending amounted to 58% of GDP in Q2, which was 16-17 percentage points above the average level of government spending over the past three years. Serbia enacted the biggest stimulus package of all the Western Balkan countries, announced at EUR 5.1 billion (11% of GDP). Its largest part was the credit guarantee scheme of EUR 2 billion, which resulted in cheaper credits for firms and was used extensively. Another important component was the favourable credit line of EUR 200 million for SMEs. The government also provided wage subsidies to firms, for three months, in an amount equivalent to the monthly minimum wage per worker. The most controversial component of the package was the infamous cash giveaway programme of EUR 100 for every adult citizen, which amounted to EUR 600 million in total. This was untargeted, giving money even to better-off citizens, and was introduced just a few weeks ahead of the parliamentary elections in June, raising concerns of vote buying. But it has probably supported consumption and cushioned the economic decline.

The budget deficit for 2020 is anticipated to be around 8% of GDP, pushing public debt above 60% of GDP. The government is expected to enact fully the planned budget for 2020, which implies general government expenditure for 2020 of 48% of GDP, the highest in recent years. At the same time, general government revenues are expected to decline to 40% of GDP, due to the crisis. The difference of 8% of GDP will be covered by borrowing, and back in May the government issued a Eurobond of EUR 2 billion. This raised public debt to 58% of GDP in Q2, and further domestic borrowing up to the end of the year is likely to push it above 60%. The interest rate on the new debt is also rising: the yield of this year’s Eurobond was 3.375%, which is much higher than that of the Eurobond from 2019 (1.619%), raising questions about future debt developments.

The labour market performed relatively well during the pandemic. Perhaps surprisingly, the rate of unemployment (according to the Labour Force Survey) dropped to 7.3% in Q2, from 9.7% in Q1. Still, this decline was mostly due to a rise in inactivity, which increased by 113,100 people in Q2. Basically, many people stopped looking for jobs during the pandemic, either because of the lockdown or on account of the government subsidies. Employment, however, did not improve; indeed, it actually declined by 33,200 people, or 1.2%. The growth of net wages in the first half of the year averaged 7.9% in real terms, driven by an increase in the minimum wage from the beginning of the year and the public-sector wage increase from the previous year.

Monetary policy has also been supportive during the crisis. The National Bank of Serbia, following the example of other central banks around the world, relaxed its monetary policy in an effort to boost the economy, lowering its base interest rate on three occasions in 2020, to 1.25% in June. In addition, the central bank initiated two waves of debt payment moratoria, which were taken up by approximately 80% of households and 60% of businesses.

Inflation and the exchange rate have been stable throughout 2020 and are expected to remain so in the coming period. Inflation reached 1.9% in August in year-on-year terms, and we expect it to remain close to 2% for some time to come, continuing the trend from 2018, since when it has consistently been around that level. This stands in stark contrast to the period before 2014, when inflation never fell below 6%, driven by the depreciating dinar. The dinar has since stabilised, and has actually gone through a trend of appreciation, moving from around 124 RSD/EUR in 2017 to its current level of 117.6 RSD/EUR, due to strong capital inflows into the country (FDI and exports). That has made the central bank start intervening more on the forex market, buying foreign currency to prevent further appreciation; this has stabilised the dinar at around 117.6 RSD/EUR for the past year. We foresee no major changes in these trends in the coming period, and expect the dinar and inflation to remain stable at their current levels.

Foreign trade declined markedly in Q2, but the external balance improved. Exports and imports of goods both declined by around 20% in Q2; but as imports are bigger, this actually closed the trade deficit somewhat. Therefore, the current account deficit is expected to narrow slightly in 2020, to 5.7% of GDP (from 6.9% in 2019), and will be fully covered by the solid FDI inflows. These reached EUR 1.5 billion in the first half of the year, driven by the solid investments in manufacturing (EUR 477 million) and transport (EUR 353 million), the former being due to the free zones and the latter to the TurkStream natural gas pipeline. It is notable that foreign direct investment remained fairly stable even in Q2, when it reached EUR 674 million; for that reason, we expect it to reach EUR 3.5 billion for the whole year (7.6% of GDP) – slightly lower than in 2019, but still solid. For the last two years, FDI in Serbia has exceeded 8% of GDP and is the main driver of growth. We currently do not foresee any slowdown in FDI inflows in coming years, but acknowledge that this will essentially depend on what happens elsewhere in the world. If the global economy recovers sluggishly, that could slow FDI, and thus GDP growth.

Data for July and August indicate a solid recovery of economic activity already in Q3. Industrial production in July and August was already growing by 2% y-o-y, while retail trade was expanding even more, at around 4%. This, accompanied by the relatively good results from the first half year, has led us to revise upwards our GDP growth forecast for 2020, from -4% in spring to -2% now.

The prospects until the end of the year also depend on coronavirus developments. The number of new cases has started growing again in the second half of October, but the number of fatal cases remains still low. There are also doubts about the official number of cases that the authorities are admitting to. Investigative journalists have published documents showing that the numbers are much higher than the official figures, and certain doctors, members of the national crisis council, have made similar statements. Even the president of the country has announced that a full review of the death toll will be undertaken. At present, we do not envisage dramatic changes in the country before the end of the year, but if there is a big new wave, it might take a toll on the economy.

Overall, the short-term economic prospects for Serbia seem rather good, though the medium term is less clear. The current good economic results are primarily due to an expansionary fiscal policy, which has been accompanied by a sizeable increase in the public debt. This is fine for the time being, but the country cannot borrow and spend indefinitely. Public debt will likely exceed 60% of GDP soon, and the interest rate on new debt is already growing. Medium-term prospects will depend crucially on the viability of the country’s recent economic model in the post-pandemic economic order. Whether Serbia can continue to attract FDI in years to come remains to be seen.

Table 4.19 / Serbia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th. pers., mid-year	7,021	6,983	6,945	.	.	.	6,915	6,885	6,855
Gross domestic product, RSD bn, nom.	4,761	5,073	5,418	1,296	1,264	2,560	5,400	5,800	6,200
annual change in % (real)	2.1	4.5	4.2	5.1	-6.4	-0.8	-2.0	4.5	4.1
GDP/capita (EUR at PPP)	11,360	11,990	12,730	.	.	.	.	.	.
Consumption of households, RSD bn, nom.	3,317	3,463	3,634	855	853	1,708	.	.	.
annual change in % (real)	2.2	3.1	3.5	3.2	-8.0	-2.7	-5.0	4.0	3.2
Gross fixed capital form., RSD bn, nom.	844	1,017	1,218	267	248	515	.	.	.
annual change in % (real)	6.6	17.5	17.2	10.8	-11.9	-1.5	-3.3	8.9	8.0
Gross industrial production 2)									
annual change in % (real)	3.9	1.3	0.3	4.4	-4.2	0.0	-2.0	5.0	4.5
Gross agricultural production									
annual change in % (real)	-11.9	14.3	0.0	.	.	.	.	.	.
Construction output									
annual change in % (real)	8.5	14.1	35.5	26.2	-0.8	9.7	.	.	.
Employed persons, LFS, th, average	2,795	2,833	2,901	2,877	2,844	2,861	2,860	2,920	2,980
annual change in %	2.8	1.4	2.4	2.4	-2.5	-0.1	-1.5	2.0	2.0
Unemployed persons, LFS, th, average	435	412	336	310	223	267	250	240	220
Unemployment rate, LFS, in %, average	13.5	12.7	10.4	9.7	7.3	8.5	8.0	7.5	7.0
Reg. unemployment rate, in %, eop	23.0	20.3	18.7	19.1	19.2	19.2	.	.	.
Average monthly gross wages, RSD 3)	65,976	68,629	75,814	81,815	81,841	81,828	82,900	89,000	93,700
annual change in % (real, gross)	0.9	3.9	8.4	8.4	7.6	8.0	7.5	5.0	3.0
Average monthly net wages, RSD 3)	47,893	49,650	54,919	59,251	59,188	59,220	60,000	64,400	67,800
annual change in % (real, net)	0.9	4.4	8.5	8.3	8.3	7.9	7.5	5.0	3.0
Consumer prices, % p.a.	3.0	2.0	1.7	1.8	1.4	1.4	1.7	2.2	2.2
Producer prices in industry, % p.a.	2.3	0.9	0.6	0.3	-2.7	-1.2	0.0	2.5	2.5
General governm.budget, nat.def., % of GDP									
Revenues	41.5	41.5	42.1	41.4	37.6	39.5	40.0	41.0	41.5
Expenditures	40.4	40.9	42.3	45.5	58.0	51.7	48.0	46.0	44.5
Deficit (-) / surplus (+)	1.1	0.6	-0.2	-4.1	-20.5	-12.2	-8.0	-5.0	-3.0
General gov.gross debt, nat.def., % of GDP	58.6	54.4	52.9	52.8	58.1	58.1	61.0	64.0	66.0
Stock of loans of non-fin.private sector, % p.a.	2.1	9.9	8.9	11.5	13.9	13.9	.	.	.
Non-performing loans (NPL), in %, eop	9.8	5.7	4.1	4.0	3.7	3.7	.	.	.
Central bank policy rate, % p.a., eop 4)	3.5	3.0	2.3	1.8	1.3	1.3	1.3	1.3	2.5
Current account, EUR mn	-2,051	-2,076	-3,160	-973	-367	-1,340	-2,600	-2,700	-3,000
Current account, % of GDP	-5.2	-4.8	-6.9	-8.8	-3.4	-6.2	-5.7	-5.5	-5.7
Exports of goods, BOP, EUR mn	14,066	15,106	16,428	3,934	3,372	7,306	14,500	16,700	18,300
annual change in %	9.8	7.4	8.8	2.7	-20.2	-9.3	-12.0	15.0	9.8
Imports of goods, BOP, EUR mn	18,064	20,191	22,044	5,560	4,400	9,960	19,600	22,300	24,400
annual change in %	13.4	11.8	9.2	9.0	-19.6	-5.8	-11.0	14.0	9.2
Exports of services, BOP, EUR mn	5,246	6,061	6,971	1,634	1,307	2,941	6,100	7,000	7,700
annual change in %	14.8	15.5	15.0	10.1	-19.6	-5.4	-12.0	14.0	9.8
Imports of services, BOP, EUR mn	4,280	5,066	5,922	1,319	1,080	2,399	5,300	6,000	6,600
annual change in %	16.8	18.4	16.9	3.0	-25.1	-11.9	-11.0	14.0	9.2
FDI liabilities, EUR mn	2,548	3,464	3,825	806	674	1,480	3,500	.	.
FDI assets, EUR mn	130	308	242	11.0	19.5	30.5	250	.	.
Gross reserves of NB, excl. gold, EUR mn	9,287	10,526	12,042	11,659	12,359	12,359	.	.	.
Gross external debt, EUR mn	25,526	26,662	28,254	28,738	31,024	28,738	31,700	35,000	37,700
Gross external debt, % of GDP	65.1	62.2	61.5	62.6	67.6	62.6	69.0	71.0	72.0
Average exchange rate RSD/EUR	121.34	118.27	117.86	117.57	117.57	117.57	118	118	119

1) Preliminary. - 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.