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Serbia: stability at risk

Recovery continues in Serbia, but economic and political stability is at risk. Growth has been strong, at 5.8% in 2006, but has been slowing down in the past few years. It has been driven by private consumption and by exports. Investments, however, have been lagging, though there is some uncertainty about the accuracy of the data. In terms of sectors, services are growing faster than industry and agriculture. In fact, both industry and agriculture have been basically stagnant over the past few years. That is probably the consequence of slow privatization and of slow restructuring of the large state enterprises.

While the economy is growing, employment has been declining, rather sharply in the last couple of years. Employment in the private sector is increasing while that in the state sector and in agriculture is falling. The net effect is negative, because the private sector is still small in terms of employment. Unemployment is also increasing and reached an estimated 22% in 2006 (registered unemployment is higher). The labour force survey is conducted only once a year, in October, and the results for 2006 have not yet been published. It is to be expected that employment will see a further decline in the medium run, and the unemployment rate may go above 25% in the same period.

Throughout the past year, inflation was the main policy concern. Initially it accelerated and decisive anti-inflationary measures were taken only in May and June. The central bank reversed its exchange rate policy of measured depreciation and let the dinar appreciate rather sharply. At the same time, the government practically froze the prices it controls, which is about 45% of all prices, by the central bank's account. Finally, the central bank hiked both the interest rates and the reserve requirement on foreign deposits to an astonishing 60%. All these measures had a political side to them, as they were intended to boost the chances of the governing coalition in the upcoming elections and also to secure the positions of the governing bodies of the central bank in view of growing criticism and open calls by some parties to sack the governor. Their efforts at putting inflation under control were helped by the declining oil prices that made it possible for the government to lower prices of gasoline several times and especially sharply just before the parliamentary elections.

Ahead of the elections, the government came out with a National Investment Plan (NIP) that targets infrastructure, education, health, agriculture, small and medium-size enterprises and just about everything else. Its stated intention was to use the large inflows of foreign investments, which may have topped EUR 4 billion on a net basis in 2006, to pay for these vast public investments. Concerns were voiced by the IMF and the central bank that these significant increases in public investments could speed up inflation and threaten macroeconomic stability. It was also argued that it would be better to use the growing privatization receipts to pay back the foreign debt. The latter policy was adopted and much of the debt to the IMF and to some other creditors has been paid back ahead of time. As for the NIP, not too much of the money was spent immediately and it did not have an all that important, let alone decisive, influence on the elections.

The elections were held on 21 January 2007 and the opposition Radical Party came out as the winner with 28% of the votes. The Democratic Party, which is in opposition in the parliament while its leader is the president of the republic, came in second with just over 23%. The ruling Democratic Party of Serbia of the prime minister (together with two coalition partners) was third with close to 17% of the votes cast. Three more parties or coalitions made it into the parliament, as did several parties that are representing minorities. These electoral results open up a number of possibilities to put together a ruling coalition. The problem, however, is the incongruence of the political and the ideological distribution of the votes.

Politically, a coalition of the two democratic parties, of the president and of the prime minister, with the support of one of the smaller parties, e.g. that of the finance minister, would be the natural one. Ideologically, however, the Democratic Party of Serbia is closer to the Radical Party than to the other Democratic Party. Thus, the natural ruling coalition, from the ideological point of view, would be the one of the Democratic Party of Serbia and the Radical Party. That coalition is even more likely because of the fact that the main post-election issue is neither the economy nor transition and EU integration, but how to handle the impending independence of the province of Kosovo. On that issue, the strongly nationalist Democratic Party of Serbia and the Radical Party see eye to eye. They may call for a government of national unity, which will be an impossible one for the Democratic Party to join. In that context, the two ideologically close parties could form a patriotic coalition to 'save the nation' and reject the independence of Kosovo. Their problem will be to come up with a foreign policy in the face of the rather cold reception they would get in the EU and the USA.

With this sharp conflict between the politically realistic and the desirable, instability is rather likely whichever way the governing coalition is formed. The political crisis, in the sense of inability to put together a government, or to guarantee its stability once it is formed, may be a prolonged one and new early elections may be called for. In the meantime, economic instability may increase too. It is hard to predict the form that these two instabilities may take, but investments could suffer as well as consumption. Similarly to the year 2003, after the assassination of Prime Minister Djindjić, growth may slow down sharply and that may have consequences for the outcome of the parliamentary elections if those were to be held again later in the year.

The political crisis, if it were to last, could present problems to the regional integration too. The regional free trade area, CEFTA, that has been agreed upon in December 2006 should be ratified by all member states, which are essentially those from the Western Balkans, in order to come into being in May 2007. Serbia has a problem with CEFTA because it is required under that agreement to reduce the protection of its tobacco industry. This issue needs to be resolved before the parliament could ratify the treaty. The Serbian business community, except for the influential producers of cigarettes, has signalled that it is very much in favour of this regional agreement. If there are delays in its adoption and implementation, that will also deepen the economic instability.

This is not the end of the story. As the independence of Kosovo is all but certain now, as it should be formalized during this year, the outcome of the political crisis in Serbia can be at the expense of the pro-European and pro-reform forces. If such an outcome is to be avoided, the pro-democratic and pro-European parties need to be much more determined than they are at the moment, and that may be the risk they are not ready to take. Thus there are turbulent times ahead. At the moment, the business community shows little fear that the political crisis may get out of hand. The main challenges, however, are yet to be faced.

Table RS

Serbia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007 forecast	2008 forecast
Population, th pers., mid-year [2)]	7516.3	7503.4	7500.0	7480.6	7463.2	7450	7440	.	
Gross domestic product, RSD mn, nom.	397656	783897	1020117	1171564	1431313	1750000	2139800	2471000	2854000
annual change in % (real)	4.5	4.8	4.2	2.5	8.4	6.2	5.8	5	5
GDP/capita (EUR at exchange rate)	1007	1757	2242	2408	2643	2833	3424	.	.
GDP/capita (EUR at PPP - wiiw)	4680	5020	5380	5530	6170	6690	7230	.	.
Gross industrial production [3)]									
annual change in % (real)	11.4	0.1	1.8	-3.0	7.1	0.8	4.7	5	5
Gross agricultural production									
annual change in % (real)	-18.6	27.9	-2.1	-11.4	26.0	-3.4	.	.	.
Construction output total									
annual change in % (real) [4)]	16.8	-14.3	-7.4	10.8	3.5	2.0	.	.	.
Consumption of households, RSD mn, nom.	305988	644394	819739	885658	998540	1221531	1475003	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Gross fixed capital form., RSD mn, nom.	48842	81293	120502	188875	253333	301962	383907	.	.
annual change in % (real)	.	.	.	.	.	.	.		
LFS - employed persons, th. Oct [5)]	3093.7	3105.6	3000.2	2918.6	2930.8	2733.4	2700	.	.
annual change in %	-0.3	0.4	-3.4	-2.7	0.4	-6.7	-1.2	.	.
Reg. employees in industry, th pers., avg.	.	704.5	648.1	605.3	562.2	536.1	493.3	.	.
annual change in %	.	.	-8.0	-6.6	-7.1	-4.7	-8.0	.	.
LFS - unemployed, th pers., Oct [5)]	425.6	432.7	459.6	500.3	665.4	719.9	760	.	.
LFS - unemployment rate in %, Oct [5)]	12.1	12.2	13.3	14.6	18.5	20.8	22	23	24
Reg. unemployment rate in %,end of period [6)]	.	.	30.5	31.9	26.4	27.1	28	29	30
Average gross monthly wages, RSD [7)]	3799	8691	13260	16612	20555	25514	31745	.	.
annual change in % (real, net)	5.5	16.5	29.9	13.6	10.1	6.4	11.4	.	.
Consumer prices, % p.a.	79.6	93.3	16.6	9.9	11.4	16.2	11.6	10	10
Producer prices in industry, % p.a.	102.6	87.7	8.8	4.6	9.1	14.2	13.3	10	10
General governm. budget, nat.def., % GDP									
Revenues	.	35.3	39.9	40.3	41.2	.	.	.	.
Expenditures	.	36.8	43.2	44.2	42.6	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-1.5	-3.3	-4.0	-1.4	1.4	-0.6	-2	-2
Public debt in % of GDP	.	.	.	.	.			.	.
Discount rate, % p.a., end of period	26.3	16.4	9.5	9.0	8.5	8.5	8.5	.	.
Current account, EUR mn [8)]	-167	-318	-1323	-1301	-2279	-1812	-2500	-2800	-3000
Current account in % of GDP	-0.6	-2.4	-7.9	-7.2	-11.6	-8.6	-9.8	-9.9	-9.5
Gross reserves of NB, excl. gold, EUR mn	429.9	1138.6	2076.8	2728.2	3008.0	4753.7	9000	.	.
Gross external debt, EUR mn	11658.6	12608.9	10767.6	10858.3	10354.5	13064.0	15000	.	.
Gross external debt in % of GDP	44.1	95.6	64.0	60.3	52.5	61.9	59	.	.
FDI net, EUR mn [8)]	55	184	504	1204	777	1247	2100	.	.
Exports of goods, BOP, EUR mn [8)9)]	1794	2032	2348	2599	2997	3664	5000	5750	6300
annual growth rate in %	.	13.3	15.5	10.7	15.3	22.2	36	15	10
Imports of goods, BOP, EUR mn [8)9)]	3519	4608	5774	6413	8341	8130	10150	12200	14600
annual growth rate in %	.	31.0	25.3	11.1	30.1	-2.5	25	20	20
Exports of services, BOP, EUR mn [8)9)]	459	685	795	906	1171	1289	1650	.	.
annual growth rate in %	.	49.3	16.0	13.9	29.3	10.1	28	.	.
Imports of services, BOP, EUR mn [8)9)]	305	413	657	720	1020	1287	1680	.	.
annual growth rate in %	.	35.2	59.1	9.5	41.7	26.2	30	.	.
Average exchange rate RSD/USD	16.40	66.36	64.40	57.58	58.38	66.71	66.82	.	.
Average exchange rate RSD/EUR (ECU)	15.04	59.46	60.68	65.05	72.57	82.91	84.06	87	90
Purchasing power parity RSD/USD, wiiw	9.90	18.20	21.80	24.00	26.20	29.40	32.30	.	.
Purchasing power parity RSD/EUR, wiiw	11.30	20.80	25.30	28.30	31.10	35.10	39.80	.	.

Note: The new ISO code for the Serbian dinar is RSD. - From 2004 the term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census 2002. wiiw estimate in 2005 and 2006 . - 3) From 2004 according to NACE and new weighting system. - 4) Gross value-added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) Until 2003 jobseekers, rate in per cent of labour force excluding farmers. - 7) From 2002 including various allowances. - 8) Converted from USD. - 9) From 2006 including trade with Montenegro.

Source: wiiw Database incorporating national statistics; wiiw forecasts.