SERBIA: The good results continue, but a trinity of headwinds is looming

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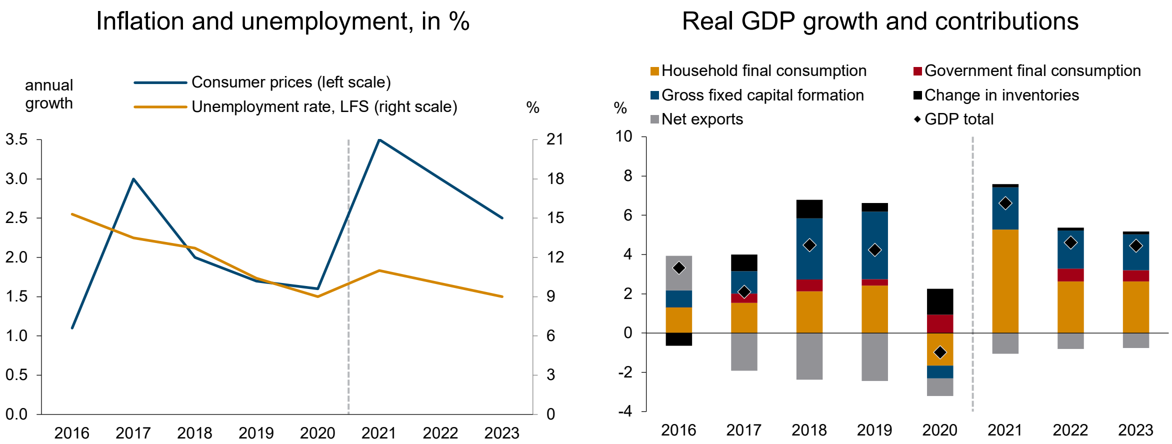
Firm government support and effective vaccine roll-out in the first half of the year have helped the Serbian economy offset the losses brought about by the pandemic. We are upgrading our GDP forecast for 2021 to 6.6%, from 6%. There are three issues that could potentially slow growth down in the coming period: the global problems in the automotive industry, the fiscal consolidation announced by the government and the recent political tensions in the region.

Figure 4.19 / Serbia: Main macroeconomic indicators



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

Serbia continued with its impressive economic results in Q2 2021. GDP grew by 13.7% year on year – a much stronger improvement than the 6.3% decline the previous year, meaning that the economy is already well ahead of its pre-pandemic level. The buoyant growth this time was brought about by robust investment and household consumption. Gross fixed capital formation grew by 22.5% year on year, while household consumption increased by 17.6% – both growth rates much higher (approximately 10 percentage points) than the declines witnessed in the same period last year. The good results were helped by the solid vaccine roll-out in this period, which allowed social and economic life to get back to something like normal.

Industry, the dominant sector of the economy, has kept on growing, though the speed has moderated in recent months. In the first eight months, its growth averaged 6.9% – quite a performance, given that last year it declined by only 0.7%. Still, after peaking in February 2021, production has moderated somewhat; this may be linked to issues surrounding global supply chains. The automotive industry (which has been particularly badly affected by these issues) expanded its production in Serbia in the first eight months of 2021 by 25.9%, year on year; while that figure is high, it does not make up for the decline in the same period of 2020 (34.8%). This could imply that growth in the second half of the year will not be as strong as in the first half.

Government support for the economy has weakened a little, but remains strong. Government consumption in Q2 declined by 3.8%, year on year, but that was due to the big increase the previous year (8.9%). The budget deficit in the first half of 2021 was just 1.3% of GDP – far lower than either the deficit in 2020 (8.1%) or the planned deficit for 2021 (3%). However, this was a consequence of the exceptionally high revenues from the first half of the year: those reached 44.6% of GDP (some 3 percentage points (pp) more than in the pre-pandemic period), due to the buoyant economic activity and the collection of certain taxes that had been deferred in 2020. Government spending remained strong in the first half of the year – 45.9% of GDP, some 4-5 pp above the pre-pandemic level. Especially solid was government investment, which reached 4.6% of GDP, as the government continued its ambitious infrastructure investment plan.

After increasing last year, public debt stabilised in 2021. At the end of July, it stood at 55.2% of GDP, slightly below the level at the end of 2020 (57.4%). In September, the government issued two euro-denominated bonds on quite favourable conditions. The first is a seven-year ‘green’ bond, with a value of EUR 1bn and a coupon rate of 1% (yield of 1.26%); the money raised will be used for green projects. The second is a 15-year bond, with a value of EUR 750m and a coupon rate of 2.05% (yield of 2.3%), which will be used to help repay old debt. We thus expect public debt to increase a little by the end of the year, but not by much.

Developments in the external sector have also been good. The current account deficit in the first half of 2021 narrowed to 1.8% of GDP, which is the lowest for years. The reason was that the growth in exports was much higher than the growth in imports. We expect some widening of the deficit in the second half of the year, as exports in small economies like Serbia’s cannot grow much more than imports over a prolonged period of time.

Foreign direct investment (FDI) has continued to be solid. It reached EUR 1.7bn in the first half of the year, or 7% of GDP, which is 20% up on the same period a year before. This was not just delayed investment, as 2020 was also good in terms of FDI: it suggests, rather, that Serbia has managed to establish itself as a regional hub for investment in manufacturing. The solid FDI inflows might also reflect indirect near-shoring trends, i.e. the decision by European companies to invest in the Eastern European region, instead of in Asia.

The solid economic performance has led to an increase in employment. The rate of employment in Q2 2022 reached 48.3%, which is the highest ever recorded. The number of people employed in Q2 was 71,000 (2.5%) higher than in the pre-pandemic period (Q1 2020). An improvement can be observed in both formal and informal employment. Perhaps surprisingly, the rate of unemployment has also increased, to stand at 11.1% in Q2 – markedly higher than in the same quarter of the previous year (7.9%). The reason is that unemployment in Q2 2020 was artificially low, due to the lockdown and the government-supported furlough schemes – because of them, people were not looking for jobs. A year on, with the weakening of the pandemic, the opening-up of the economy and the withdrawal of the furlough schemes, people have again started looking for jobs. Since not all of them manage to find employment, unemployment also increases.

The improvement in the labour market was also seen in average wages. For the first seven months, average wages increased nominally by 8.2%, year on year. Although the improvement may have been triggered by the increase in the minimum wage and in public-sector wages, it has been broad based, covering all industries and regions; both the public and the private sector; both people employed full time and those in occasional employment.

Higher wages, combined with higher global energy and food prices, have pushed inflation up. In August, it reached 4.3% (the highest rate since the end of 2013). The average rate for the first eight months was 2.7%. Producer prices are also rising – in August, they were 10.4% above the level of a year before. Because of this, we are upgrading our consumer price inflation projection for 2021 to 3.5% (from 3%). Due to the carry-over effects, we are also raising our forecast for 2022 to 3% (from 2.6%).

The higher inflation and the buoyant economic activity may induce the central bank to raise its policy interest rate by the end of the year. Monetary policy throughout the pandemic has been supportive: the central bank reduced its policy rate four times during 2020, from 2.25% in February to 1% in December. But conditions since then have changed substantially – economic activity has improved considerably and inflation has been rising. Several Eastern European central banks have already hiked their rates, and the US Fed is for ever talking about tapering. It is just a question of time when the Serbian central bank will increase its rate, but we believe that this will happen by the end of the year. The increase will not be large, though, but will rather be a symbolic 0.25 pp.

The indicators available for Q3 suggest that the economy is generally doing well, though there have been some changes since the previous quarter. The growth in industrial production slowed in July and August to 0.9%, year on year. This is partly a consequence of the high growth in the previous year, but is also due to the weaker output of the automotive sector (which is clearly affected by the global microchip shortage). Retail trade, on the other hand, grew strongly in July and August, by 9.4% year on year (in real terms), indicating that the driver of growth in Q3 will be private consumption.

The country has been enduring a new and severe wave of the pandemic in September-October, but we do not foresee this causing major economic damage. After the excellent vaccine roll-out in the first half of the year, inoculation in Q3 almost ground to a halt because of pronounced COVID denial and vaccine hesitancy. Since almost all restrictions had been removed and social life had been getting back to normal, this led to an upsurge in COVID infections. Still, experience from Q2 teaches us that the economy can perform well even under such conditions, as people and businesses continue their activities.

We are upgrading our GDP forecast for 2021 to 6.6% (from 6%), on the grounds of the strong outturn in the first half of the year and the decent preliminary results in Q3. We are still aware of certain headwinds over the coming period that could retard growth. The first is the global problem that the automotive industry is facing with a shortage of semiconductors: this could limit production and investment by Serbian automotive factories, at least for some time. The second is the fiscal consolidation announced by the government, which may retard growth if undertaken too quickly or too vigorously.

The third – and perhaps the most serious – headwind refers to the new wave of political tensions in the Western Balkan region. From Montenegro, through Bosnia and Herzegovina, to Kosovo, various political tensions have been in evidence in recent months – and all could have implications for Serbia, one way or another. While the tensions seem to have eased for now, they serve to recall the unresolved political issues in the region, which, if ignored, could easily flare up, increasing political instability and indirectly also affecting economic growth.

Table 4.19 / Serbia: Selected economic indicators

	2018	2019	2020 1)	2020 January-June	2021 January-June	2021 Forecast	2022 Forecast	2023 Forecast
Population, th. pers., mid-year	6,983	6,945	6,899	.	.	6,885	6,855	6,830
Gross domestic product, RSD bn, nom. 2)	5,073	5,418	5,464	2,576	2,885	6,000	6,500	7,000
annual change in % (real)	4.5	4.2	-1.0	-0.7	7.6	6.6	4.6	4.5
GDP/capita (EUR at PPP)	12,030	12,710	12,810	.	.	.	.	.
Consumption of households, RSD bn, nom. 2)	3,463	3,634	3,603	1,708	1,890	.	.	.
annual change in % (real)	3.1	3.5	-2.5	-3.1	7.9	8.0	4.0	4.0
Gross fixed capital form., RSD bn, nom. 2)	1,017	1,218	1,174	517	612	.	.	.
annual change in % (real)	17.5	17.2	-2.8	-0.9	15.6	10.0	9.0	8.5
Gross industrial production 3)								
annual change in % (real)	1.3	0.3	0.4	-1.9	9.0	8.0	6.0	5.0
Gross agricultural production								
annual change in % (real)	14.3	-1.2	4.3	.	.	.	.	.
Construction output								
annual change in % (real)	14.1	35.5	-2.5	11.7	18.2	.	.	.
Employed persons, LFS, th, average 4)	2,833	2,901	2,895	2,861	2,777	2,895	2,960	3,030
annual change in %	1.4	2.4	-0.2	-0.1	.	2.5	2.4	2.3
Unemployed persons, LFS, th, average 4)	412	336	287	267	376	360	330	300
Unemployment rate, LFS, in %, average 4)	12.7	10.4	9.0	8.5	11.6	11.0	10.0	9.0
Reg. unemployment rate, in %, eop	20.3	18.7	17.9	19.2	19.2	.	.	.
Average monthly gross wages, RSD	68,629	75,814	82,984	81,828	88,652	91,000	98,400	104,900
annual change in % (real, gross)	3.9	8.4	7.8	8.0	5.9	6.0	5.0	4.0
Average monthly net wages, RSD	49,650	54,919	60,073	59,220	64,287	65,900	71,300	76,000
annual change in % (real, net)	4.4	8.5	7.7	7.9	6.1	6.0	5.0	4.0
Consumer prices, % p.a.	2.0	1.7	1.6	1.4	2.3	3.5	3.0	2.5
Producer prices in industry, % p.a.	0.9	0.6	-1.3	-1.2	5.0	7.5	5.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	41.5	42.1	41.3	39.3	44.6	43.0	42.0	42.0
Expenditures	40.9	42.3	49.4	51.4	45.9	46.0	44.5	44.0
Deficit (-) / surplus (+)	0.6	-0.2	-8.1	-12.0	-1.3	-3.0	-2.5	-2.0
General gov.gross debt, nat.def., % of GDP	54.4	52.9	58.2	56.6	55.7	56.0	55.0	54.0
Stock of loans of non-fin.private sector, % p.a.	9.9	8.9	11.1	13.9	7.3	.	.	.
Non-performing loans (NPL), in %, eop	5.7	4.1	3.7	3.7	3.6	.	.	.
Central bank policy rate, % p.a., eop 5)	3.0	2.3	1.0	1.3	1.0	1.3	2.0	2.5
Current account, EUR m	-2,076	-3,161	-1,929	-1,246	-518	-1,500	-1,650	-1,830
Current account, % of GDP	-4.8	-6.9	-4.2	-5.7	-2.1	-2.9	-3.0	-3.0
Exports of goods, BOP, EUR m	15,106	16,415	16,079	7,343	9,620	19,600	22,500	25,300
annual change in %	7.4	8.7	-2.0	-8.7	31.0	22.0	15.0	12.5
Imports of goods, BOP, EUR m	20,191	22,038	21,280	9,923	12,222	24,700	28,200	31,700
annual change in %	11.8	9.1	-3.4	-6.1	23.2	16.0	14.0	12.5
Exports of services, BOP, EUR m	6,061	6,934	6,191	2,926	3,456	7,200	8,100	9,200
annual change in %	15.5	14.4	-10.7	-5.4	18.1	16.0	13.0	13.0
Imports of services, BOP, EUR m	5,066	5,922	5,090	2,428	2,647	5,500	6,100	6,800
annual change in %	18.4	16.9	-14.1	-10.8	9.0	8.0	10.0	11.0
FDI liabilities, EUR m	3,464	3,815	3,039	1,450	1,755	3,800	.	.
FDI assets, EUR m	308	264	100	30	166	300	.	.
Gross reserves of CB, excl. gold, EUR m	10,526	12,042	11,732	12,360	12,358	.	.	.
Gross external debt, EUR m	26,662	28,254	30,787	30,959	32,291	35,700	40,000	42,700
Gross external debt, % of GDP	62.2	61.5	66.3	66.6	63.3	70.0	72.0	71.0
Average exchange rate RSD/EUR	118.27	117.86	117.58	117.57	117.58	117.6	117.0	116.5

1) Preliminary. - 2) Half-year data unrevised. - 3) Excluding arms industry. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS. - 5) Two-week repo rate.

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