

SERBIA

Recent developments

Table 1 **2018**

| | |
|---|-------|
| Population, million | 7.0 |
| GDP, current US\$ billion | 49.9 |
| GDP per capita, current US\$ | 7134 |
| International poverty rate (\$ 19) ^a | 5.6 |
| Lower middle-income poverty rate (\$3.2) ^a | 11.1 |
| Upper middle-income poverty rate (\$5.5) ^a | 23.6 |
| Gini index ^a | 39.7 |
| School enrollment, primary (% gross) ^b | 100.6 |
| Life expectancy at birth, years ^b | 75.2 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2015), 2011 PPPs.

(b) Most recent WDI value (2016)

Growth in 2018 is estimated at 4.2 percent. Growth is broad-based and driven by both investment and consumption. Growth has translated into steady improvement in the labor market outcomes, bringing unemployment to 12.9 percent in Q4 2018. Poverty is estimated to have declined from 23.8 percent in 2014 to 21.2 percent in 2018. Over the medium-term, growth is expected to reach 3-4 percent, although risks remain, including from policy reversals as well as from delays in structural reforms.

The strong 4.8 percent y/y growth in the first half of 2018 was mainly related to a rebound from the low base in the same period of 2017. In the second half of the year growth moderated to 3.7 percent (y/y) thus leading to a new estimate for the annual growth of 4.2 percent. Growth in 2018 was primarily driven by investment which increased by 16.4 percent in real terms. As public sector wages and pensions were increased, consumption was up 3.3 percent, y/y. Higher consumption to some extent influenced an increase in imports (up 12.6 percent, in euro terms) which led to a negative contribution of net exports to growth of 2 percentage points. Looking at sectoral composition, growth in 2018 was broad-based, with all sectors increasing value added compared to the same period last year.

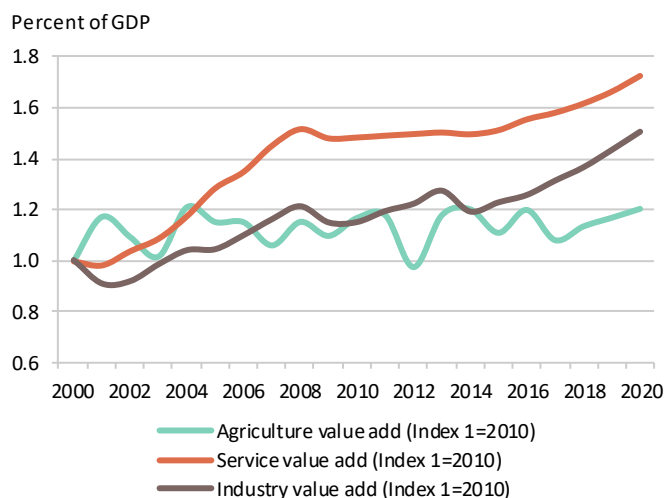
Recent economic growth contributed to steady labor market performance in 2018. The activity rate (within the working age cohort) increased to 67.8 percent in 2018, while the employment rate stood at 58.8 percent. Unemployment also declined from 14.1 percent in 2017 to 13.2 percent in 2018 (annual average). Female employment rate still remains significantly lower, at 41.7 percent in Q3 2018 compared to 57.3 percent for males. Average salaries increased by 6 percent in nominal terms (or 3.9 percent in real terms) in 2018. Thanks to improvements in the labor market outcomes and to higher salaries and pensions, poverty (living on income under

\$5.5/day in 2011PPP terms, the standardized middle-income-country poverty line) is estimated to have declined from 23.8 percent in 2014, to estimated 21.3 percent in 2018.

The budget remained in surplus (of an estimated 0.6 percent of GDP) in 2018, thus helping to continue lowering the public debt burden. Strong revenue collection helped to offset an increase in expenditures in 2018. Revenues increased by 6.7 percent while expenditures increased by 7.9 percent compared to 2017. Revenues were up primarily because of higher proceeds from social insurance contributions (up by 9.4 percent) and the VAT (up 11.8 percent), but practically all other sources of revenues increased as well. The fiscal surplus, as well as a favorable dollar/euro and dinar/euro exchange rate dynamic (in particular appreciation of dinar against euro) have helped to reduce public debt as a share of GDP from 62.5 percent at the end of 2017, to an estimated 54.3 percent at the end of 2018.

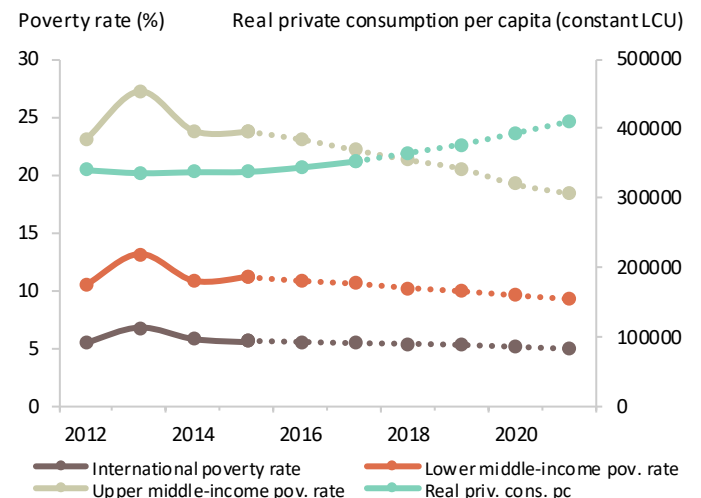
Inflation averaged 2 percent in 2018, after reaching a peak level of 2.6 percent (y/y) in August. As food price inflation reached a peak in August at 2.7 percent y/y, it drove the CPI. The NBS lowered the key policy rate to 3.25 percent in March 2018, it lowered it again to 3.0 percent in April 2018, and kept it unchanged since. After a significant appreciation of the dinar in the last quarter of 2017 the exchange rate against the euro remained stable in 2018. The NBS intervened regularly on the foreign exchange market to prevent more significant volatility of the exchange rate. In 2018, the

FIGURE 1 Serbia / Value added index: 2000=1



Source: Statistics Office.

FIGURE 2 Serbia / Actual and projected rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

NBS was a net-purchaser of foreign currency, in the amount of EUR 1.6 billion. Credit activity recovered in 2018 (up 7.6 percent, by December, y/y), but its structure remains somewhat unfavorable. Most of the increase in lending comes from the household sector (up 12.5 percent), while loans to private businesses were up by 6.9 percent, y/y. Loans to households increased primarily because of the high increase in short-term loans (so called cash-loans) to individuals. The stock of those loans is 18.7 percent higher than a year ago (in euro terms).

Outlook

The Serbian economy is expected to continue with the solid growth of around 3-4 percent over the medium-term, although growth in 2019 is expected to slow down to 3.5 percent, as effects from the increase in consumption and investment were to a large extent exhausted in 2018. Investment and exports will be the main drivers of growth. Exports are projected to grow by around 9.5 percent annually in real terms, while investment are projected to increase

by about 6.5 percent in real terms annually, over the next three years. On the other hand, consumption will increase as well, driven by wages and employment growth. Increase in consumption has already impacted imports (up by 12.6 percent in 2018, compared to 2017, in euro terms) and resulted in higher CAD in 2018 by 8.4 percent (in euro terms).

The medium-term growth projections crucially depend on the pace of structural reforms and progress with EU accession. Most importantly, Serbia needs to deal with its large and unsustainable state-owned enterprises (SOEs) sector. It was encouraging to see recent renewed attempt to deal with some of the main loss-makers (like for instance RTB Bor, PKB) and this should remain at the center of government's efforts. Similarly, it is expected that privatization of state-owned financial institutions speeds up. Slower growth in some parts of EU (most importantly Italy, which is one of the most important trading partners for Serbia) are a downside risk. Acceleration of the EU accession process is important not only from the point of view of strengthening of institutions but also as a signaling device to attract investment. In addition,

the work on regional projects (mainly on investment in infrastructure which connects – roads, railways etc.), would help Serbian exporters and growth of the economy overall.

With economic growth and improvements in the labor market, poverty is expected to continue its gradual decline. Poverty, measured as income below the standardized \$5.5/day 2011PPP line is estimated to fall to around 20.5 percent by 2019.

Risks and challenges

Risks are mainly associated with internal political developments. Regional disputes, slow progress with the EU accession process and constant threat of early elections cause a caution among both local and foreign investors. This in turn delays realization of some of important projects both related to infrastructure and to the real sector. Despite recent labor market improvements, employment rates remain low and limit the scope for robust welfare improvements.

TABLE 2 Serbia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

| | 2016 | 2017 | 2018 e | 2019 f | 2020 f | 2021 f |
|---|------|-------|--------|--------|--------|--------|
| Real GDP growth, at constant market prices | 3.3 | 2.0 | 4.2 | 3.5 | 4.0 | 4.0 |
| Private Consumption | 1.3 | 1.9 | 3.1 | 3.0 | 3.8 | 3.8 |
| Government Consumption | 1.3 | 3.3 | 4.6 | 2.1 | 1.5 | 2.3 |
| Gross Fixed Capital Investment | 5.4 | 7.3 | 12.4 | 7.5 | 6.2 | 5.8 |
| Exports, Goods and Services | 11.9 | 8.2 | 10.5 | 9.0 | 8.7 | 8.7 |
| Imports, Goods and Services | 6.7 | 11.1 | 10.8 | 8.4 | 8.1 | 8.0 |
| Real GDP growth, at constant factor prices | 3.8 | 2.1 | 3.4 | 3.5 | 4.0 | 4.0 |
| Agriculture | 8.3 | -11.2 | 10.0 | 3.8 | 3.0 | 3.0 |
| Industry | 4.3 | 3.4 | 1.5 | 4.6 | 3.5 | 3.5 |
| Services | 3.0 | 3.3 | 3.6 | 3.0 | 4.3 | 4.4 |
| Inflation (Consumer Price Index) | 1.1 | 3.1 | 2.0 | 2.6 | 3.0 | 3.0 |
| Current Account Balance (% of GDP) | -3.3 | -6.3 | -5.4 | -5.1 | -5.0 | -4.7 |
| Net Foreign Direct Investment (% of GDP) | 3.5 | 4.4 | 5.8 | 5.6 | 5.6 | 5.2 |
| Fiscal Balance (% of GDP) | -1.2 | 1.1 | 0.5 | -0.6 | -0.6 | -0.7 |
| Debt (% of GDP) | 68.9 | 58.7 | 56.2 | 55.4 | 53.7 | 51.9 |
| Primary Balance (% of GDP) | 1.7 | 3.6 | 2.6 | 1.4 | 1.6 | 1.6 |
| International poverty rate (\$1.9 in 2011 PPP)^{a,b} | 5.5 | 5.4 | 5.3 | 5.2 | 5.1 | 4.9 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b} | 10.8 | 10.6 | 10.2 | 9.9 | 9.5 | 9.2 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b} | 23.0 | 22.1 | 21.2 | 20.5 | 19.2 | 18.4 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.

(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.