SERBIA

Table 1	2019
Population, million	7.0
GDP, current US$ billion	51.4
GDP per capita, current US$	7378.7
School enrollment, primary (% gross)[a]	100.3
Life expectancy at birth, years[a]	75.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2018).

After a couple of years of solid growth, the Serbian economy entered recession in 2020 caused by the COVID-19 pandemic. The immediate negative impact on the population and the economy was buffered by the large fiscal package of around 13 percent of GDP. As a result, there was not a substantial increase in unemployment and the GDP contraction in Q2 at 6.4 percent (y/y) was less pronounced than in neighboring countries. Poverty is estimated to be slightly higher than in 2019 but may worsen if the crisis is prolonged.

Key conditions and challenges

Serbia used most of the available fiscal space early on, when the COVID-19 pandemic started. The impact was favorable but came at a considerable fiscal cost. With the economy in recession, and public debt on a sharp rise, the space for future stimulus packages is limited. Therefore, further reforms are needed to bring the economy back to sustained growth and to secure jobs and incomes while strengthening resilience to shocks. Focus on improved business environment and governance in order to increase private investment, as well as efforts to improve the quality of infrastructure should be priorities.

Over the medium term the Serbian economy is expected to return to the pre-COVID-19 growth pattern. However, some challenges will become more urgent. First, an aging and shrinking population will leave Serbia with a smaller available labor force. Labor shortages combined with skills mismatches could significantly hurt competitiveness of the Serbian economy. Second, the impact of climate change – more frequent and severe droughts and floods - will hit agriculture and food production hard and will make the cost of infrastructure maintenance much higher. Progress on these challenges crucially depends on the pace of the EU accession process. A faster process could enable the timely adoption of structural reforms and faster and inclusive economic growth.

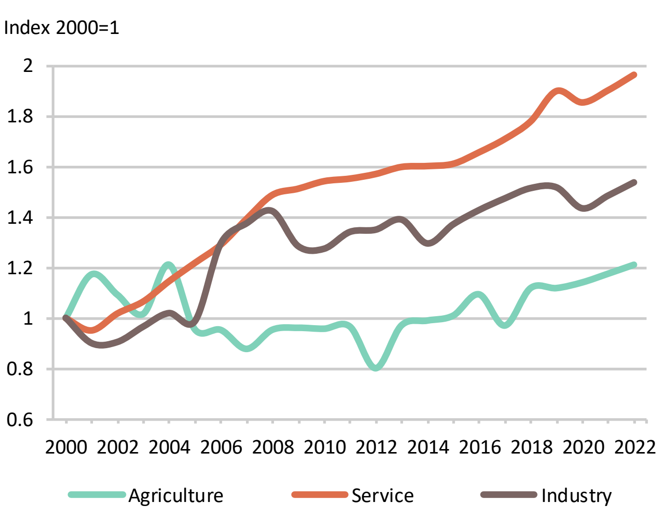
Recent developments

After robust growth of 4.2 percent in 2019, the COVID-19 pandemic caused a sudden stop in economic activity. It is estimated that GDP decreased 6.4 percent (y/y) in Q2. Sectors that were hit most are services (down 6.6 percent, y/y) and industry (down 6.2 percent, y/y).

On the expenditure side of GDP, both consumption and investment will have a large negative contribution to growth in 2020 (-2.1 and -1.4pp, respectively) while net exports will have a small positive contribution to growth (0.1pp). Both in the case of consumption and investment, the main reason for the decline is the private sector since the government sector's contribution to growth will remain broadly unchanged.

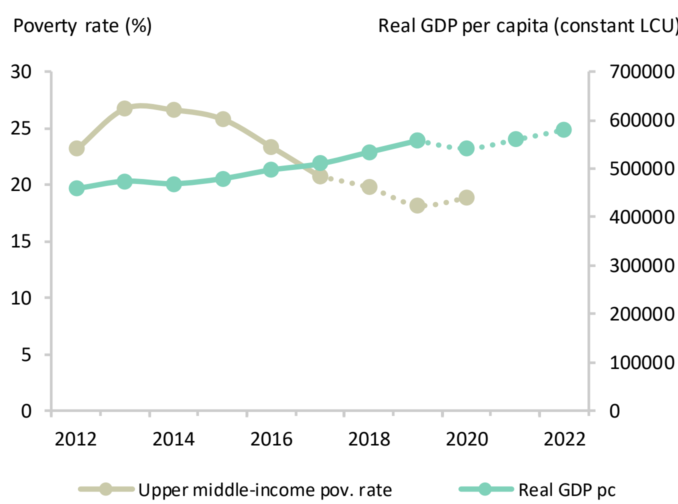
The large fiscal stimulus program, particularly the wage subsidy for all sectors, helped to temporarily protect formal jobs. However, informal employment was hurt. The Q2 employment rate among the population aged 15+ in 2020 was 48.2 percent, down from 49.2 percent in 2019 and back to 2017 levels. Given strict lockdown and containment measures in Q2 2020, inactivity increased compared to the same quarter last year, mainly because of the limited opportunities for informal workers to find jobs. The wage subsidy and cash support (including Euro 100 to all adults) helped to avert a spike in poverty for now. But better targeting of these measures could achieve similar results in terms of poverty alleviation at lower costs and allow for a longer duration of support.

FIGURE 1 Serbia / Index of real value-added by sector



Sources: WB staff calculations based on Statistics Office data.

FIGURE 2 Serbia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

After the consolidated general government budget showed a small deficit of 0.2 percent of GDP in 2019, the deficit is expected to deteriorate in 2020 as a result of the large fiscal stimulus program of close to 13 percent of GDP. In addition, revenues will decline as the economy slows down and numerous tax breaks are offered to businesses. Public debt is projected to increase to close to 60 percent of GDP by end-2020.

Inflation is low and stable as consumption is decreasing and despite the central bank significantly increasing the money supply. In addition, the NBS lowered its policy rate to 1.25 percent, a record low level. In 2020, the dinar was broadly stable against the euro, thanks to significant interventions by the NBS on the foreign exchange market. The banking sector's performance remains robust and NPLs have not increased. On the external side, the trade deficit increased further in the first half of the year as exports fell more than imports, although the CAD remained broadly the same compared to the same period in 2019.

Outlook

The COVID-19 pandemic and the related containment measures are taking a heavy toll on the Serbian economy. It is expected to enter recession in 2020 with a projected decrease in real GDP of 3 percent. Recovery will start in 2021, but at a modest pace. Investment will only slowly return to previous levels, and consumption will be subdued as the real impact on labor markets (both employment and wages) will be felt only later in the year or in early 2021. Over the medium term (2022-2023), growth will return to its previous trajectory. This medium-term outlook crucially depends on international developments (including the impact of COVID-19), the pace of structural reforms and political developments. Most importantly, Serbia needs to work further on removing bottlenecks to private sector growth stemming from the poor governance environment and red tape.

The adverse impacts of the pandemic are expected to lead to a small uptick in poverty in 2020, with significant downside risks. After several years of continuous decline, poverty (at the US$5.5/day middle-income-country poverty line) is estimated to increase slightly from 18.2 percent in 2019 to 18.9 percent in 2020.

Risks are associated primarily with the length and depth of the crisis caused by the COVID-19 pandemic and implementation of containment measures. If the crisis continues as the temporary effect of the policy package wanes, workers and families may suffer later in 2020 and early 2021. Poor and vulnerable households, who tend to depend more on self-employment and less secure jobs, may take longer to regain their income during the subsequent economic recovery.

In the medium term, regional disputes and slow progress with the EU accession process could affect investment sentiment and therefore delay investment projects in infrastructure and other sectors. Labor market challenges limit the scope for robust welfare improvements and could be exacerbated by a significant brain-drain.

TABLE 2 **Serbia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	2.0	4.4	4.2	-3.0	2.9	3.3
Private Consumption	1.9	3.1	3.1	-3.1	3.1	3.7
Government Consumption	3.3	3.7	8.7	11.3	-4.5	3.5
Gross Fixed Capital Investment	7.3	17.8	11.2	-12.3	10.4	4.1
Exports, Goods and Services	8.2	8.3	8.5	-10.2	7.8	8.5
Imports, Goods and Services	11.1	11.6	9.5	-8.7	6.9	8.0
Real GDP growth, at constant factor prices	2.0	4.5	4.2	-3.0	2.9	3.3
Agriculture	-11.2	15.2	0.0	2.0	3.0	3.0
Industry	3.3	2.8	0.2	-5.5	3.5	3.5
Services	3.2	4.1	6.8	-2.4	2.6	3.2
Inflation (Consumer Price Index)	3.1	2.0	2.2	1.9	2.5	2.8
Current Account Balance (% of GDP)	-5.3	-5.2	-6.9	-6.4	-6.5	-6.7
Net Foreign Direct Investment (% of GDP)	4.4	3.8	6.3	4.7	5.1	5.8
Fiscal Balance (% of GDP)	1.4	0.6	-0.2	-7.6	-2.1	-0.5
Debt (% of GDP)	58.7	55.6	52.9	59.6	58.5	56.0
Primary Balance (% of GDP)	3.9	2.7	1.4	-6.6	-0.8	1.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]		19.8	18.2	18.9		

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization and original 2011 PPP, using 2013-EU-SILC, 2016-EU-SILC, and 2017-EU-SILC. Actual data: 2017. Nowcast: 2018-2019. Forecast are from 2020 to 2022.

(b) Projection for 2018 using point-to-point elasticity (2013-2016) with pass-through = 0.4 based on GDP per capita in constant LCU, for 2019-2020 based on nowcasting and simulation of poverty impacts and policy responses.