

SERBIA

Key conditions and challenges

Table 1 **2020**

Population, million	6.9
GDP, current US\$ billion	53.0
GDP per capita, current US\$	7673.3
Upper middle-income poverty rate (\$5.5) ^a	19.8
Gini index ^a	37.2
School enrollment, primary (% gross) ^b	99.6
Life expectancy at birth, years ^b	75.9

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

Notes:

(a) Most recent value (2017), 2011 PPPs.

(b) WDI for school enrollment (2019); life expectancy (2018).

The Serbian economy entered only a mild recession of -1 percent in 2020 thanks to the significant fiscal stimulus program of around 13 percent of GDP. As a result, there was not a substantial increase in poverty, which is estimated to be close to its 2019 level. Downside risks remain, primarily because of uncertainties related to the external environment. To promote economic growth this year the government announced a new fiscal stimulus program worth around 5 percent of GDP.

The focus of the Government of Serbia in recent years has been on macroeconomic stability, in light of deficits of over 6 percent of GDP (2012-14) and high and increasing public debt. A substantial fiscal consolidation effort started in 2014 to lower total expenditures from 45.2 percent of GDP in 2014 to 42.3 percent in 2019, and to increase revenues from around 38 percent of GDP to 42.1 in 2019. As a result, the large deficits were turned into a surplus in 2017 and a balanced budget thereafter. Tighter fiscal policy together with natural disasters, including a drought in 2012 and major floods in 2014, resulted in lower growth, which averaged 1.9 percent over 2010-19 period. The rate of economic growth started to improve just before the COVID-19 pandemic, averaging 4.4 percent in 2018 and 2019. Growth was primarily led by consumption, and investment remained low as a share of GDP at around 19 percent over 2010-19 period. The Serbian economy went through the first year of the pandemic with a minimal recession since the government used most of the available fiscal space and buffers at the start of the pandemic. The impact of the program on the economy and living standards was favorable but came at a considerable fiscal cost. With limited space for future stimulus packages, further reforms are needed to bring the economy back to sustained growth and to

secure jobs and incomes while strengthening resilience to shocks.

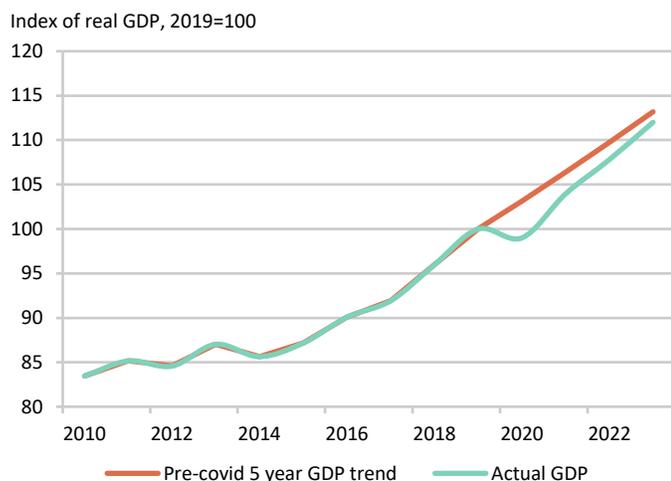
Over the medium term the Serbian economy is expected to return to the pre-COVID-19 growth pattern. However, some challenges that limit growth both over the short and over the medium to long term will remain. Most importantly, Serbia needs to continue efforts to remove bottlenecks for private sector growth stemming from the deteriorating governance environment, insufficiently developed infrastructure and unreformed education sector which creates increasing concern about skills mismatch.

Recent developments

After a robust growth of 4.2 percent in 2019, the COVID-19 pandemic caused a recession of -1 percent in 2020. This is a significantly better result than what was previously projected (a drop of 3 percent). Services sectors were hit most by the pandemic-related events (down 1.5 percent, y/y) while value added in industry remained flat in real terms, and the agriculture sector grew by 4.9 percent. On the expenditure side, both investment and consumption had a negative contribution to growth in 2020 (-1.1 and -0.7pp, respectively) while net exports had a positive contribution to growth (0.8pp).

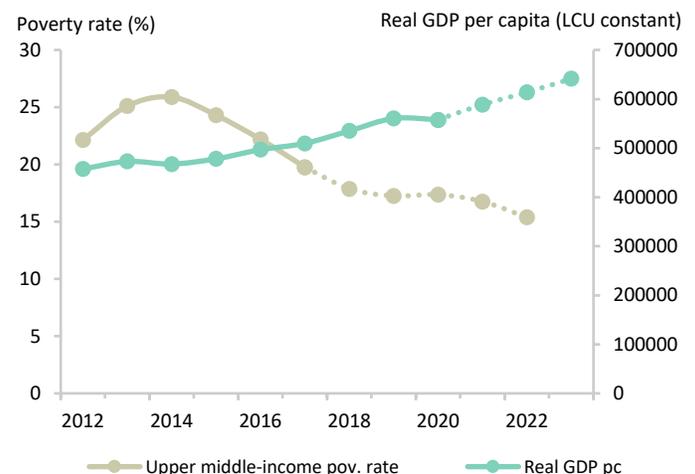
The large fiscal stimulus program, of close to 13 percent of GDP, helped to keep the recession mild. It comprised tax deferrals and increased expenditures of around 8 percent of GDP and guarantees

FIGURE 1 Serbia / Actual and forecast GDP vs 5-year pre-covid trend



Source: World Bank.

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



Source: World Bank. Notes: see Table 2.

in the amount of 4.8 percent of GDP. As the largest part of the package (7.4 percent of GDP) went to businesses, it helped to avoid a major reduction in employment. In fact, registered employment increased by 1.9 percent compared to 2019. The Q3 unemployment rate, as measured by the Labor Force Survey, stood at 9 percent in 2020, slightly lower than 2019. The wage subsidy and cash support to citizens also helped to avert a spike in poverty, although at a significant fiscal cost. Due to the support package, limited labor market impacts, and growth in agriculture, poverty (income under \$5.5/day in revised 2011 PPP) is estimated to have remained stagnant from 17.3 percent in 2019 to 17.4 percent in 2020.

The fiscal deficit increased significantly in 2020 and reached an estimated 8.1 percent of GDP. This increase is primarily the result of the large fiscal stimulus program. Public debt is estimated at 58.2 percent of GDP by end-2020.

Inflation by year-end reached 1.3 percent y/y, however food prices increased by 2.1 percent. The dinar has remained broadly stable against the euro, supported by significant interventions by the NBS on the foreign exchange market (NBS sold reserves worth 1.5 billion euros in 2020). The banking sector's performance remains robust despite two rounds of debt moratoria

introduced in 2020 as part of the COVID-19 response measures. NPLs stood at 3.5 percent as of November. On the external side, CAD decreased significantly – from 6.9 percent of GDP in 2019 to 4.3 percent in 2020.

Outlook

Recovery from the COVID-19 related recession is expected to start in 2021. Growth will be supported by a recently announced new package of measures to support citizens and the economy worth 5.1 percent of GDP. As a result, the economy is expected to rebound by 5 percent in 2021. Over the medium term, growth is expected to be around 4 percent. Growth will be driven by consumption and investment will recover only slowly, which may slow down the impact of growth on labor markets (both employment and wages). This medium-term outlook crucially depends on international developments (including the control of COVID-19), the pace of structural reforms and political developments.

Immediate focus is needed on measures to improve the business environment and governance in order to lower the cost of doing business and ensure security and

safety, as well as efforts to improve the quality of infrastructure. Regarding the medium- to long-term challenges the focus should be on demography and climate change. First, an aging and shrinking population will leave Serbia with a smaller available labor force. Labor shortages combined with skills mismatches could significantly hurt the competitiveness of the Serbian economy. Second, the impact of climate change – including more frequent and severe droughts and floods – will hit agriculture and food production hard and will make the cost of infrastructure maintenance much higher.

The pace of labor market recovery will be critical for resumed poverty reduction. The new package is expected to support citizens and economic recovery, though poor and vulnerable households, who tend to depend more on self-employment and less secure jobs, may take longer to regain their income level. Poverty is projected to slowly decline to 16.8 percent in 2021.

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)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	4.4	4.2	-1.0	5.0	3.7	3.9
Private Consumption	3.1	3.1	-2.5	5.7	4.2	4.0
Government Consumption	3.7	8.7	11.8	-6.4	1.9	4.0
Gross Fixed Capital Investment	17.8	11.2	-8.2	15.1	5.6	5.2
Exports, Goods and Services	8.3	8.5	-5.9	7.8	8.6	9.5
Imports, Goods and Services	11.6	9.5	-3.5	7.3	8.0	8.7
Real GDP growth, at constant factor prices	4.5	4.2	-1.0	5.0	3.7	3.9
Agriculture	15.2	0.0	4.2	-4.0	1.0	0.0
Industry	2.8	0.2	0.0	4.0	4.5	5.0
Services	4.1	6.8	-2.1	6.6	3.6	3.8
Inflation (Consumer Price Index)	2.0	2.2	1.6	2.5	2.8	2.6
Current Account Balance (% of GDP)	-5.2	-6.9	-4.4	-5.2	-5.9	-6.2
Net Foreign Direct Investment (% of GDP)	3.8	6.3	4.8	5.0	5.6	5.3
Fiscal Balance (% of GDP)	0.6	-0.2	-8.1	-5.0	-2.5	-1.4
Debt (% of GDP)	55.6	52.9	58.2	58.0	56.2	54.9
Primary Balance (% of GDP)	2.7	1.4	-7.1	-3.8	-0.5	0.5
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	17.9	17.3	17.4	16.8	15.4	

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

Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2013-EU-SILC and 2017-EU-SILC. Actual data: 2017. Nowcast: 2018-2020. Forecast are from 2021 to 2023.

(b) Projection using point-to-point elasticity (2013-2017) with pass-through = 0.7 based on GDP per capita in constant LCU and simulations of Covid-19 impacts.