32. SERBIA

Growth remains firm

Despite the global economic slowdown, Serbia's economy is on track to continue its robust growth. Its strength is broad-based, coming from strong investment and a steady private consumption, sustained by rising employment and income levels. In addition, Serbia remains an attractive destination for foreign direct investment, which is expected to continue driving export growth. Risks appear balanced, as possible spill-overs from the external environment are countered by significant policy space to further support growth.

The slowdown is left behind

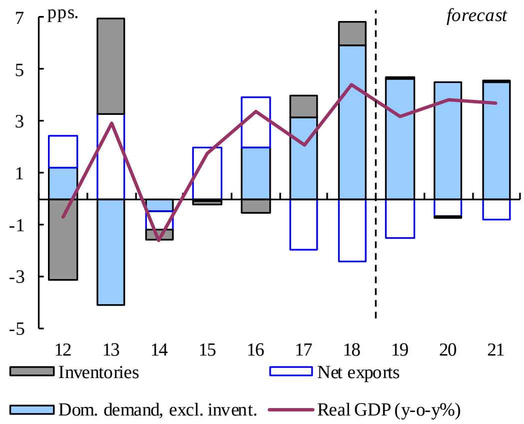
The soft patch in the first quarter extended into the second one, although growth accelerated slightly from 2.7% to 2.9% y-o-y. Robust domestic demand continued to set the pace in the economy, with strong imports resulting in negative contribution to growth from net external trade, despite decelerating but still high exports growth. Household consumption increased steadily. On the supply side, a powerful investment drive was visible in the double-digit increase of construction activity in the first two quarters. Benefiting from strong domestic demand, the trade and service-oriented sectors of the economy maintained robust growth. On the other hand, following a very good 2018, the agricultural sector stagnated in the first half of 2019. Industry underperformed as well, as one-off interruptions in production, such as overhauls of major production facilities affected some important sectors like oil and petrochemicals.

Short-term indicators suggest that growth may have accelerated in the third quarter. Industrial production increased in July and August. However, manufacturing performance remained uneven. The production of motor vehicles in particular declined, affected by the global slump in the sector. Boosted by higher earnings and increased consumer confidence and employment, retail trade turnover picked up further in the summer months.

Record-high FDI to sustain export growth

The strong FDI inflow in tradable sectors over recent years has sustained a faster than previously expected export expansion in the current year. Net exports will subtract less from 2019 growth than projected in the spring forecast. As the Serbian economy continued to attract record-high and well-diversified FDI in 2019, it is well positioned to maintain its strong export momentum, despite pressures from the external environment.

Graph II.32.1: **Serbia - Real GDP growth and contributions**



Domestic demand growth to remain broad-based

Robust domestic demand has been a key feature of the economy in the last few years and is forecast to remain a major growth driver in the next two years. It is also expected to remain broad-based, with important contributions to growth from both consumption and investment. The labour market is expected to become increasingly tight as new jobs continue to be added, while population and labour force are set to decline further. The strong real wage growth is, therefore, likely to persist and will, together with increased government transfers, provide a boost to household consumption, especially in 2020. Government spending is also expected to continue supporting economic activity directly through higher public consumption and capital expenditure. Gross fixed capital formation has expanded significantly recently, but its share in GDP is still low at around 20% of GDP. Investment growth is projected to moderate but is likely to remain robust, in view of the good macroeconomic prospects, lower risk premiums, improved financing conditions, and the high FDI inflow. Price stability remains well anchored and demand-driven pressures are expected to be largely contained over the forecast period.

Risks appear balanced

As in the previous forecast, there are persistent downside risks from the external environment due to a possible further deterioration in geopolitical and trade tensions. However, they appear balanced out by upside risks from investment in case FDI inflow continues apace, and on the export side if past FDI boosts export potential more than currently projected. In addition, there is still significant policy space to support growth if needed.

Good times for the budget

Stable economic growth and rising employment and income levels helped sustain a good fiscal performance. The government revised the 2019 budget, keeping the deficit target of 0.5 % of GDP unchanged while providing additional funding for capital spending, social transfers, wages, and the interest costs of buying back short-dated bonds.

The fiscal outlook remains upbeat. The projected deficit hovers around the medium-term objective of a deficit of 0.5% of GDP, and government debt is projected to fall below 50% of GDP. However, the tendency to use the available fiscal space largely for increasing current spending continued with the 2020 budget. In particular, significant wage increases are likely to raise the public wage bill as a share of GDP, despite previous government commitments. Thus, the structure of the fiscal expansion in 2020 benefits more short-term consumption rather than investment growth and, in view of delayed reforms to the public administration and the wage system, may prove costly for the budget in the future.

Graph II.32.2: **Serbia - Public finances**

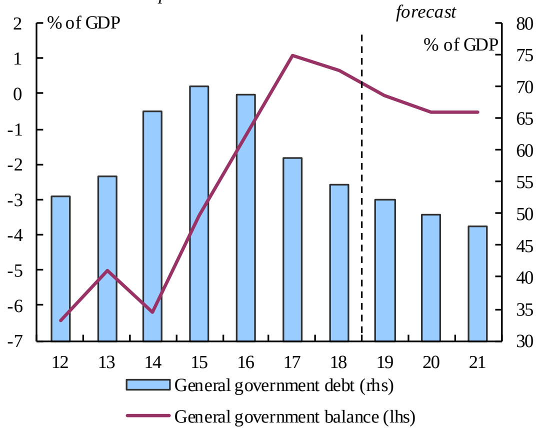


Table II.32.1:

Main features of country forecast - SERBIA

		2018			Annual percentage change					
	bn RSD	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		5068.6	100.0	-	3.3	2.0	4.4	**3.2**	**3.8**	**3.7**
Private Consumption		3511.9	69.3	-	1.3	1.9	3.1	**3.3**	**3.8**	**3.5**
Public Consumption		839.3	16.6	-	1.2	3.3	3.7	**2.9**	**2.4**	**2.5**
Gross fixed capital formation		1016.5	20.1	-	5.4	7.3	17.8	**9.3**	**6.9**	**7.6**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		2573.6	50.8	-	11.9	8.2	8.3	**8.1**	**7.9**	**7.4**
Imports (goods and services)		3005.3	59.3	-	6.7	11.1	11.6	**9.5**	**7.8**	**7.5**
GNI (GDP deflator)		4806.8	94.8	-	2.4	1.0	5.9	**3.2**	**4.2**	**3.9**
Contribution to GDP growth:	Domestic demand			-	2.0	3.1	5.9	**4.6**	**4.5**	**4.5**
	Inventories			-	-0.6	0.9	0.9	**0.0**	**0.0**	**0.0**
	Net exports			-	1.9	-2.0	-2.4	**-1.5**	**-0.7**	**-0.8**
Employment				-	5.6	2.8	1.4	**1.8**	**1.2**	**1.2**
Unemployment rate (a)				-	15.3	13.5	12.7	**10.5**	**8.9**	**7.2**
Compensation of employees / head				-	-	-	-	**-**	**-**	**-**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour cost				-	-	-	-	**-**	**-**	**-**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	1.5	3.0	2.1	**2.4**	**2.4**	**2.5**
Consumer-price index				-	1.1	3.2	2.0	**2.1**	**2.1**	**2.1**
Terms of trade goods				-	0.0	-1.0	-1.6	**-0.3**	**0.0**	**0.0**
Trade balance (goods) (c)				-	-7.3	-9.0	-11.1	**-12.2**	**-12.5**	**-12.9**
Current-account balance (c)				-	-2.9	-5.2	-5.2	**-6.0**	**-5.5**	**-5.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-1.2	1.1	0.6	**-0.1**	**-0.5**	**-0.5**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	68.8	58.7	54.5	**52.1**	**49.9**	**48.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.