31. SERBIA

The Serbian economy is projected to rebound strongly in 2021 to above its pre-crisis level, mainly driven by private consumption and investment. Inflation is set to record a sharp temporary increase in 2021 but expected to slow down as of spring 2022. Supported by the recovery in revenue and the phasing-out of fiscal support measures, the general government deficit is expected to decrease to below 5% of GDP in 2021 and to record further gradual reductions in 2022 and 2023. The debt-to-GDP ratio is set to stabilise in 2021 and to gradually decrease thereafter.

Strong recovery after 2020 contraction

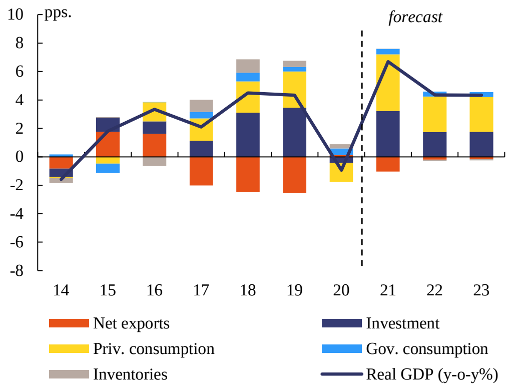
Following a relatively mild contraction by 0.9% in 2020, the Serbian economy returned to positive year-on-year growth of 1.7% in the first quarter of 2021, before base effects helped it accelerate to 13.7% in the second quarter. The rebound in the first half of the year was the result of strong increases in private consumption and investment that were only partially offset by lower government consumption and a negative contribution of net exports. Short-term indicators suggest that the expansion of economic activity, while slightly decelerating, has continued over the summer. Thus, industrial production grew by 1.7% year-on-year in July and 0.1% year-on-year in August while real retail turnover increased by 11.1% and 7.7% year-on-year, respectively.

Strong 2021 rebound before return to pre-crisis growth path

The full-year expansion of the economy is expected to reach 6.7% in 2021, mostly driven by increases in private consumption, gross fixed capital formation and public consumption that are expected to be only slightly offset by a negative contribution of net exports to growth. On the production side, a strong rebound in the services sector and buoyant construction supported by large infrastructure projects are set to particularly contribute to strong annual growth.

After largely exceeding its pre-crisis output level in 2021, the economy is set to return to its pre-crisis rate of expansion of somewhat above 4% in 2022 and 2023. Growth is projected to be mostly driven by private consumption and investment and a more positive contribution of net exports due to the recovery in the EU and increased export capacity supported by foreign direct investment in the tradable sector. The current account deficit, after increasing temporarily in 2021, particularly due to strong investment, is expected to slightly narrow in 2022 and 2023.

Graph II.31.1: **Serbia - Real GDP growth and contributions**



Short-term inflationary pressures

Inflation is set to accelerate strongly in 2021, mostly reflecting the sharp rebound of oil prices from their 2020 level and a hike in food prices. Inflation is projected to decelerate as of spring 2022 as base effects from lower price levels in early 2021 are set to subside, leading average annual inflation to stabilise in 2022 and to decline in 2023. Following a decrease in 2020, driven by falling labour market participation, the unemployment rate is expected to temporarily record a slight increase in 2021 as the pace of return of discouraged workers to the labour market is projected to initially exceed the growth of employment.

Outlook still subject to high uncertainty

The growth outlook is subject to a relatively high level of uncertainty while risks appear to be balanced. On one hand, relatively low vaccination rates could lead to a protracted impact of the pandemic thereby dampening consumer confidence and private consumption in the short term. A stronger or more durable hike of inflation, maintaining or exceeding the September 2021 level for a prolonged period particularly due to continued pressure from unprocessed food and energy prices, could weaken purchasing power and thereby become a drag on real growth. A protracted impact of supply-side bottlenecks, particularly in the EU, could dampen net exports as compared to the baseline. On the other hand, increased nearshoring of production could have beneficial effects on foreign direct investment and exports. Faster-than-expected implementation of public infrastructure projects and of reforms of state-owned enterprises could also drive up medium-term growth prospects.

Deficit and debt levels to resume downward path

After reaching 8.0% of GDP in 2020, mostly as a result of a large package of crisis-mitigating discretionary fiscal support measures, the general government deficit is projected to decrease to below 5% of GDP in 2021. The decrease is set to mostly reflect strong revenue performance thanks to the vigorous economic recovery and deferred tax payments. It is also driven by a reduction of the overall expenditure on crisis support measures, notwithstanding a substantial new package of support adopted in April (including wage subsidies open to all enterprises, one-off payments to citizens and specific support to the most affected sectors) and despite substantial further increases in capital spending.

In line with the expiry of one-off government support measures and lower capital spending, the deficit is forecast to drop to around 3% of GDP in 2022 and to further decline in 2023. Following an increase by 5 pps in 2020 to 57.8%, the debt-to-GDP ratio is projected to stabilise at around 58% in 2021 before resuming a gradual decline in 2022 and 2023 in line with lower public deficits and high nominal GDP growth.

Graph II.31.2: **Serbia- General government budget balance and gross debt**

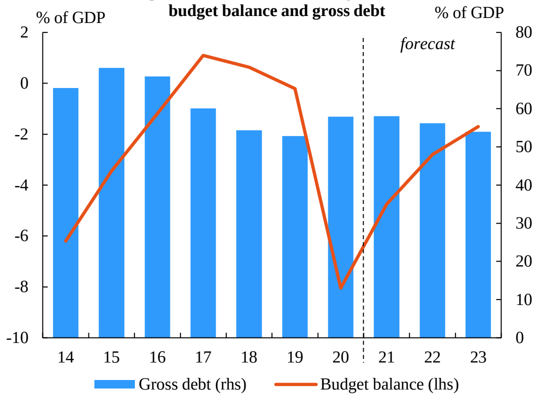


Table II.31.1:

Main features of country forecast - SERBIA

	2020		02-17	Annual percentage change					
bn RSD	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP	5502.2	100.0	3.1	4.5	4.3	-0.9	**6.7**	**4.3**	**4.3**
Private Consumption	3664.5	66.6	2.8	3.1	3.7	-1.9	**6.0**	**3.8**	**3.7**
Public Consumption	962.2	17.5	1.7	3.7	1.9	2.8	**2.2**	**2.0**	**2.1**
Gross fixed capital formation	1180.1	21.4	6.4	17.5	17.2	-1.9	**15.1**	**7.5**	**7.3**
of which: equipment	:	:	:	:	:	:	**:**	**:**	**:**
Exports (goods and services)	2654.2	48.2	9.8	7.5	7.6	-4.1	**14.5**	**9.8**	**8.5**
Imports (goods and services)	3110.0	56.5	8.0	10.8	10.7	-3.6	**14.1**	**8.9**	**7.6**
GNI (GDP deflator)	5334.7	97.0	2.7	6.0	4.2	1.5	**6.0**	**4.3**	**4.3**
Contribution to GDP growth: Domestic demand			3.7	5.9	6.3	-1.3	**7.6**	**4.6**	**4.5**
Inventories			0.1	0.9	0.4	0.3	**0.0**	**-0.1**	**-0.1**
Net exports			1.4	-2.4	-2.5	0.1	**-1.0**	**-0.2**	**-0.1**
Employment			-0.7	1.4	2.5	-0.2	**2.0**	**1.1**	**1.0**
Unemployment rate (a)			18.1	12.7	10.4	9.0	**10.7**	**10.0**	**9.2**
Compensation of employees / head			:	:	:	:	**:**	**:**	**:**
Unit labour costs whole economy			:	:	:	:	**:**	**:**	**:**
Real unit labour cost			:	:	:	:	**:**	**:**	**:**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			7.9	2.0	2.4	2.4	**4.8**	**4.1**	**3.0**
Consumer price index			8.3	2.0	1.7	1.6	**3.6**	**3.6**	**2.6**
Terms of trade goods			:	-1.3	3.1	1.0	**1.0**	**0.0**	**0.0**
Trade balance (goods) (c)			-14.6	-11.9	-12.2	-11.1	**-11.0**	**-11.0**	**-11.1**
Current-account balance (c)			-8.1	-4.8	-6.9	-4.1	**-4.4**	**-4.3**	**-4.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-8.5	-4.9	-7.1	:	**:**	**:**	**:**
General government balance (c)			-3.0	0.6	-0.2	-8.0	**-4.9**	**-2.7**	**-1.6**
Cyclically-adjusted budget balance (d)			:	:	:	:	**:**	**:**	**:**
Structural budget balance (d)			:	:	:	:	**:**	**:**	**:**
General government gross debt (c)			52.0	54.4	52.8	57.8	**58.1**	**56.3**	**54.1**

(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.