

31. SERBIA

Investment and exports to remain the engines of growth

GDP growth is forecast to accelerate, supported by robust investment and export performance. Private consumption, after being a drag on growth for a number of years, is also expected to rebound marginally on the back of rising private sector wages and employment. Continuously strong revenue outturn, including one-offs, is seen contributing to the lower than planned budget deficit in 2016. However, fiscal risks remain elevated and government debt is still set on an upward trajectory.

In a recovery mode

Despite a significant fiscal consolidation in 2015, increased confidence as a result of implemented reforms and low oil prices helped the economy recover faster than initially expected. Investments, in particular, benefitted from significant monetary easing and from recent measures to reduce the budget deficit and improve the business environment. Helped by rebounding economic activity in major trading partners and gains in competitiveness, exports increased as well. FDI inflows grew markedly and covered the current account deficit. They were channelled mainly in tradable sectors, likely to sustain further export growth. Household consumption declined for a fourth year in a row, suppressed by lower public transfers and the still weak labour market. Public consumption also had a negative contribution to growth, although it increased in the second half of the year.

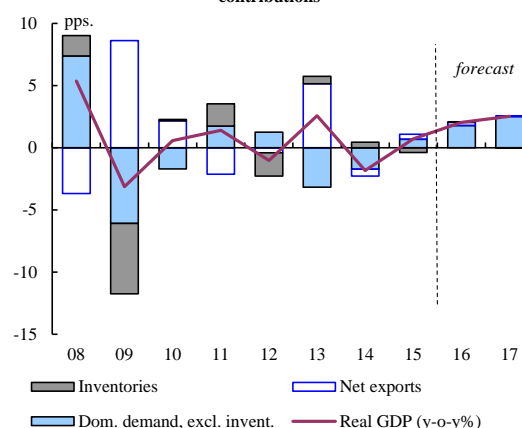
High-frequency indicators suggest that economic recovery has accelerated in early 2016. Industrial production, still largely driven by energy and mining, picked up in the first two months of the year. Manufacturing performed well, growing across most of the sectors. Retail trade and wage data also signal a revival in private consumption.

Investment and exports to remain the engines of growth

Export growth is expected to remain robust over the forecast horizon, supported by an ongoing recovery in Serbia's major trading partners, recent and new investments, and productivity gains due to domestic reforms. However, net exports are forecast to contribute only marginally to growth as rising domestic demand triggers higher imports. The new investment cycle, launched in 2015 from a very low base, implies a relatively strong investment growth in the next few years. Capital formation is seen boosted by confidence effects from recent and ongoing reform efforts, past monetary easing, rising foreign direct investments,

and higher public capital expenditure. Contrary to the previous investment peak in 2012, which was largely driven by a single project in the automotive industry, the ongoing investment profile is much more diversified. As the economy recovers, private consumption is forecast to pick up as well, largely driven by continuous increases in private sector wages and employment. The trajectory of public consumption is uncertain, depending on the magnitude and timing of announced employment cuts. As at present these measures are not sufficiently well defined, the forecast assumes their effect on public consumption to be marginal. The economy continues to be exposed to multiple external risks and remains highly sensitive to international capital flow reversals and fluctuations in oil prices. Although reduced as a result of recent policy measures, major risks to the forecast scenario also come from potential relaxation in fiscal consolidation and structural reform efforts.

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

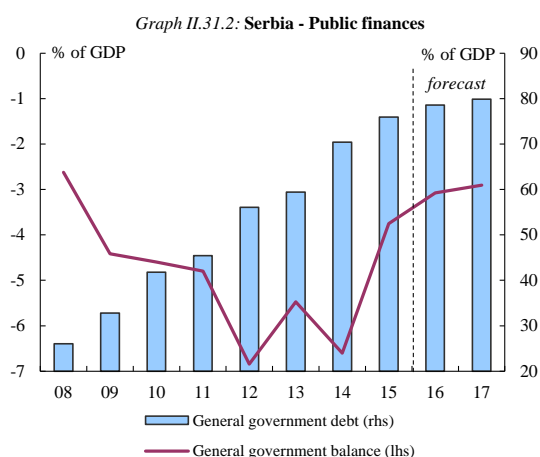


Low inflation and small employment gains

Buoyant investments are expected to lead to limited employment gains, as growth in private sector employment is set to be partly offset by lay-offs related to ongoing and planned restructurings of state-owned enterprises. Price pressures are likely to remain low and exchange rate stability and stable inflation expectations are

envisaged to continue anchoring price dynamics. However, inflation is forecast to gradually increase and enter the central bank tolerance band, pushed up by rising domestic demand, adjustments in administered prices and as disinflationary effects from the international environment start to wane.

unbudgeted one-off revenue from a concession for the use of several telecommunication frequencies. Over-performing revenue are expected to lead to a better than planned budget deficit this year. However, the budget deficit is forecast to decline only slightly in 2017.



Strong revenue growth to support further budget deficit reduction

The strong revenue performance continued in the first months of 2016, also due to significant and

Mandatory expenditure are set to continue falling, although rising interest payments, higher capital expenditure, and pension and wage indexations adopted at the end of 2015 are likely to offset them. With the exception of increases in excise duties on oil products and the full impact of the excise duty on electricity, introduced in August 2015, major tax rates are planned to remain unchanged.

The fiscal scenario faces a number of uncertainties. As the public administration reform and the restructuring of state-owned enterprises remain the two pillars for a sustainable reduction of fiscal imbalances, further delays in their implementation are a key risk. Reversing the trend of growing government debt would, therefore, require a steadfast implementation of reform intentions and a careful evaluation before underwriting new expenditure commitments.

Table II.31.1:

Main features of country forecast - SERBIA

	2014			96-11	Annual percentage change					
	bn RSD	Curr. prices	% GDP		2012	2013	2014	2015	2016	2017
GDP	3908.5		100.0	-	-1.0	2.6	-1.8	0.7	2.0	2.5
Private Consumption	2955.8		75.6	-	-2.0	-0.6	-1.3	-0.6	0.5	1.5
Public Consumption	692.9		17.7	-	1.9	-1.1	-0.6	-1.2	0.5	0.0
Gross fixed capital formation	652.0		16.7	-	13.2	-12.0	-3.6	8.3	7.5	7.5
of which: equipment	-		-	-	-	-	-	-	-	-
Exports (goods and services)	1695.3		43.4	-	0.8	21.3	5.7	7.8	6.9	6.3
Imports (goods and services)	2119.3		54.2	-	1.4	5.0	5.6	5.5	5.3	5.2
GNI (GDP deflator)	3751.1		96.0	-	-0.4	1.8	-1.7	-0.5	1.8	2.4
Contribution to GDP growth:										
Domestic demand				-	1.2	-3.2	-1.7	0.7	1.8	2.5
Inventories				-	-1.9	0.6	0.5	-0.4	0.0	0.0
Net exports				-	-0.4	5.2	-0.6	0.4	0.2	0.0
Employment				-	-1.1	3.7	10.1	0.6	0.2	0.3
Unemployment rate (a)				-	23.9	22.1	19.4	17.9	17.0	16.2
Compensation of employees / head				-	-	-	-	-	-	-
Unit labour costs whole economy				-	-	-	-	-	-	-
Real unit labour cost				-	-	-	-	-	-	-
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				-	6.3	5.4	2.7	0.9	2.0	2.7
Consumer-price index				-	7.3	7.8	2.1	1.4	1.6	2.8
Terms of trade goods				-	2.3	-2.3	0.4	2.2	1.0	0.0
Trade balance (goods) (c)				-	-17.1	-11.6	-12.3	-11.4	-10.8	-10.8
Current-account balance (c)				-	-11.6	-6.1	-6.0	-4.8	-4.3	-4.3
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	-	-	-
General government balance (c)				-	-6.8	-5.3	-6.6	-3.8	-3.1	-2.9
Cyclically-adjusted budget balance (d)				-	-	-	-	-	-	-
Structural budget balance (d)				-	-	-	-	-	-	-
General government gross debt (c)				-	56.1	59.4	70.4	75.9	78.6	79.9

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