



Key developments

The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, concluded on 25 May, invited Serbia to further strengthen fiscal consolidation, continue the restructuring of large utility companies, improve revenue collection, advance the reform of the public administration, and pursue reforms to enhance competitiveness.

In June, an IMF mission reached a staff-level agreement with the authorities on the policies needed to complete the fourth and fifth review of the Stand-By Arrangement. Once elected, the new Serbian government is expected to endorse the agreement, which is also scheduled for consideration by the IMF Management and Executive Board for late August.

In June, the rating agency Fitch upgraded Serbia's long-term foreign and local currency ratings from B+ to BB- with stable outlooks. The better macroeconomic performance, strong fiscal consolidation, narrowing external imbalances, formal opening of EU accession chapters, political stability, and government commitment to reforms in the context of the IMF agreement have been key factors driving the rating upgrade.

The immediate impact of the UK referendum on leaving the EU was limited. The central bank reacted strongly and pressure on the dinar exchange rate dissipated quickly.

Real sector

GDP growth accelerated strongly from 1.2 % in the last quarter of 2015 to 3.5 % y-o-y in the first quarter of 2016. The growth continued to be driven mainly by robust investment and export performance, increasing by 7.9 % and 11.5 % y-o-y, respectively. Household final consumption turned to growth as well – still marginal at 0.7 %, supported by steadily increasing real wages, increased confidence and minor gains in employment. Public consumption rose markedly, growing by 3.2 % y-o-y. Although expenditure on wages and salaries remained restrained, public consumption was underpinned by base effects and double-digit increases of government spending on goods and

services. On the supply side, economic growth was broad-based as all sectors, but real estate, which declined marginally, contributed to it. The industry has continued to perform strongly and there was a marked acceleration of wholesale and retail trade growth. In line with the very upbeat investment activity, construction registered the highest growth rate of 15 % y-o-y.

High frequency indicators indicate a continuation of economic growth in the second quarter, albeit at a reduced pace. Following a period of strong growth in the first four months of the year, industrial production growth decelerated to 0.9 % y-o-y in May. With a few exceptions, this deceleration was across the board but was particularly strong in sectors that have recovered from the devastating floods in 2014. Nevertheless, manufacturing activity stayed on a positive trajectory and the cumulative performance of most industries in the period from the beginning of the year until May remained robust. Retail trade turnover continued to increase strongly in April and May, growing by 8.6 % y-o-y in the first five months.

Labour market

According to LFS data, in the first quarter of 2016 total employment increased by 2.7 % y-o-y, reversing the trend from the previous two quarters. Although most of the gains were in formal employment, informal employment increased as well, keeping the rate of informal employment high at 20.3 %. The activity rate rose strongly as some 80,000 people joined the labour force. However, as the labour market was not yet dynamic enough to provide sufficient employment opportunities, unemployment increased as well by close to 15,000 people and the unemployment rate remained at 19.0 % – the same as in the first quarter last year. However, the National Employment Service data on registered unemployment diverge from the LFS, showing a continuous decline in the number of unemployed – by 1.8 % y-o-y in the first and 4.4 % in the second quarter.

The Statistical office also published a revised series of data on registered employment. According to it, registered employment increased only marginally by 0.1 % y-o-y in the first quarter of 2016. Supported by base effects

and the ongoing economic recovery, gross real wages have increased on average by 3.2 % y-o-y in the first five months of the year.

External sector

The trade gap expanded in May, curtailing the overall decline of the cumulative January-May merchandise trade deficit to 10.9 % y-o-y. Following a very strong performance in the first four months, the growth in exports of goods decelerated (in euro terms) to 4.8 % y-o-y in May on the back of weaker energy and capital goods export. Imports, on the other hand, picked up across most of the sectors and grew by 10.6 % y-o-y. However, in the period January-May exports still outpaced imports, growing by 10.5 % versus 4.9 % y-o-y.

The cumulative current account deficit fell by almost half in euro terms by the end of April and in the four quarters until end-March it was down below 4 % of GDP. The strong reduction in the merchandise trade deficit was the main factor behind this development. The balance of trade in services has improved strongly as well, expanding by 36.5 % y-o-y, while the primary and secondary income balances have worsened by close to 10 % y-o-y each. Net FDI remained broadly unchanged over the previous year and stood at EUR 459 million in the first four months, covering more than 150 % of the current account deficit.

Monetary developments

Annual inflation remained below the central bank tolerance band of $4\pm 1.5\%$. It fell to 0.3 % y-o-y in June – its lowest level in more than a year, as food prices continued declining.

Due to persistently low inflationary pressure and further reductions of domestic and external imbalances, in July the central bank has cut its key policy rate by 25 basis points to 4 %. It also narrowed the interest rate corridor from $\pm 1.75\%$ to $\pm 1.50\%$ in order to further stabilise interest rates in the interbank money market. The dinar exchange rate remained broadly stable against the euro in the second quarter, depreciating by around 2 % y-o-y. The central bank interventions on the market continued on a lower scale and it sold net EUR 205 million in April and May. The NBS foreign exchange reserves fell further to EUR 9.3 billion in May, still covering about six months' worth of imports of goods and services.

Financial sector

The growth in domestic claims accelerated to 14.6 % y-o-y in May. It remained largely driven by claims on government which continued rising rapidly by 27.0 %, while claims on households expanded by 6.2 % y-o-y. The long decline in credit to private companies has been reversed and the growth in bank claims on them accelerated to 6.8 % y-o-y in May. Commercial banks' deposit base continued expanding steadily and non-monetary sector deposits grew by 8.4 %, underpinned by a strong rise in the long-term deposits, and in particular of households foreign currency deposits. Government deposits with commercial banks increased by almost a quarter since the beginning of the year. Following an 8.6 % monthly increase in last December, banks provisioning against losses on enterprise claims have declined by 3.8 % since the beginning of the year. In comparison to the last quarter of 2015, the level of non-performing loans declined by 0.7 percentage points to 20.9 % in March. This decrease was mainly driven by reductions of NPLs in the corporate sector as a result of collection, restructuring, write-off and sale of some of them. Despite the high level of NPLs, capital adequacy remained significantly above the regulatory minimum, at close to 21 %.

Fiscal developments

Following a strong reduction of the deficit to 3.8 % of GDP in 2015, the budget continued to over-perform. By the end of May the cumulative deficit stood at RSD 23.9 billion (-12.5 % y-o-y). Revenue grew steadily (8.6 % y-o-y), underpinned by robust increases in VAT (10.3 % y-o-y) and excise (25.3 % y-o-y) receipts. Expenditure execution remained cautious (7.7 % y-o-y), curtailing the overall deficit. Key categories, like expenditure for employees and pensions stood at or even below their levels in the corresponding period of the previous year. The structure of expenditure improved significantly as capital spending increased by 62.2 % y-o-y by the end of May. The government used part of its deposits with the NBS to finance the deficit and by the end of May, government debt fell to RSD 2,990 billion (72.3 % of the estimated GDP). Nevertheless, the legacy of high government debt and exchange rate dynamics, have continued pushing interest expenditure up and they still grew by a double-digit rate (11.2 % y-o-y).

TABLE



European Commission, ECFIN-D-1

SERBIA

| | | | | | | | ECFIN 2016 Spring forecast | | | | | | | |
|--|----------|----------|----------|----------|---------|----------|-------------------------------|-------|----------|---------|--------|---------|---------|--------|
| | | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Q4 15 | Q1 16 | Q2 16 | Apr 16 | May 16 | Jun 16 |
| 1 Real sector | | | | | | | | | | | | | | |
| Industrial confidence ^{1.1} | Balance | N.A. | N.A. | N.A. | N.A. | N.A. | : | : | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| Industrial production ^{1.2} | Ann. %ch | 2.0 | -3.4 | 5.6 | -6.1 | 8.4 | : | : | 10.2 | 10.4 | : | 8.4 | 0.9 | : |
| Gross domestic product ^{1.3} | Ann. %ch | 1.4 | -1.0 | 2.6 | -1.8 | 0.7 | 2.0 | 2.5 | 1.2 | 3.5 | : | N.A. | N.A. | N.A. |
| Private consumption ^{1.4} | Ann. %ch | 0.9 | -2.1 | -0.4 | -1.3 | -0.6 | 0.5 | 1.5 | -0.3 | 0.7 | : | N.A. | N.A. | N.A. |
| Gross fixed capital formation ^{1.5} | Ann. %ch | 4.6 | 13.2 | -12.0 | -3.6 | 8.3 | 7.5 | 7.5 | 7.8 | 7.9 | : | N.A. | N.A. | N.A. |
| Construction index ^{1.6} | Ann. %ch | 28.6 | -14.6 | -23.8 | 26.6 | 17.2 | : | : | 5.1 | 24.2 | : | N.A. | N.A. | N.A. |
| Retail sales ^{1.7} | Ann. %ch | -14.6 | -3.9 | -5.3 | 2.0 | 1.4 | : | : | 3.4 | 10.2 | : | 9.6 | 4.0 | : |
| 2 Labour market | | | | | | | | | | | | | | |
| Unemployment ^{2.1} | % | 23.0 | 23.9 | 22.1 | 19.2 | 17.7 | 17.0 | 16.2 | 17.7 | 19.0 | : | N.A. | N.A. | N.A. |
| Employment ^{2.2} | Ann. %ch | -6.0 | -1.1 | 3.7 | 10.1 | 0.6 | 0.2 | 0.3 | -1.1 | 2.7 | : | N.A. | N.A. | N.A. |
| Wages ^{2.3} | Ann. %ch | 11.1 | 9.0 | 5.7 | 1.1 | -0.4 | : | : | 0.4 | 4.5 | : | 7.9 | 0.1 | : |
| 3 External sector | | | | | | | | | | | | | | |
| Exports of goods ^{3.1} | Ann. %ch | 14.1 | 4.5 | 24.7 | 1.5 | 7.8 | : | : | 6.0 | 11.0 | : | 13.8 | 4.8 | : |
| Imports of goods ^{3.2} | Ann. %ch | 13.4 | 3.2 | 4.7 | 0.2 | 5.7 | : | : | 6.7 | 2.7 | : | 5.5 | 10.6 | : |
| Trade balance* ^{3.3} | %of GDP | -17.6 | -18.8 | -13.0 | -13.0 | -13.2 | -10.8 | -10.8 | -13.2 | -12.5 | : | N.A. | N.A. | N.A. |
| Exports goods and services ^{3.4} | %of GDP | 34.4 | 36.3 | 40.7 | 43.4 | 47.6 | : | : | 47.6 | 48.4 | : | N.A. | N.A. | N.A. |
| Imports goods and services ^{3.5} | %of GDP | -49.8 | -53.6 | -51.9 | -54.4 | -57.5 | : | : | -57.5 | -57.3 | : | N.A. | N.A. | N.A. |
| Current account balance* ^{3.6} | %of GDP | -10.9 | -11.6 | -6.1 | -6.0 | -4.8 | -4.3 | -4.3 | -4.8 | -4.0 | : | N.A. | N.A. | N.A. |
| Direct investment (FDI, net)* ^{3.7} | %of GDP | -5.5 | 2.2 | 3.9 | 3.7 | 5.5 | : | : | 5.5 | 5.4 | : | N.A. | N.A. | N.A. |
| International reserves ^{3.8} | mio EUR | 12,058.2 | 10,914.7 | 11,188.8 | 9,907.2 | 10,378.0 | : | : | 10,378.0 | 9,500.9 | : | 9,338.0 | 9,264.0 | : |
| Int. reserves / months Imp ^{3.9} | Ratio | 10.5 | 9.3 | 9.2 | 8.0 | 8.1 | : | : | 8.1 | 7.4 | : | 7.2 | : | : |
| 4 Monetary developments | | | | | | | | | | | | | | |
| CPI ^{4.1} | Ann. %ch | 11.2 | 7.3 | 7.9 | 2.1 | 1.4 | 1.6 | 2.8 | 1.4 | 1.5 | 0.5 | 0.4 | 0.7 | 0.3 |
| Producer prices ^{4.2} | Ann. %ch | 9.7 | 6.4 | 0.8 | 0.2 | 0.7 | : | : | 0.7 | -1.5 | : | -1.5 | -1.9 | : |
| Food prices ^{4.3} | Ann. %ch | 6.4 | 15.4 | -2.5 | 2.2 | -0.1 | : | : | -0.1 | -1.8 | -1.7 | -2.0 | -0.8 | -2.3 |
| M3 ^{4.4} | Ann. %ch | 10.3 | 9.4 | 4.6 | 8.7 | 7.2 | : | : | 7.2 | 7.9 | : | 7.8 | 9.7 | : |
| Exchange rate RSD/EUR ^{4.5} | Value | 101.96 | 113.01 | 113.09 | 117.25 | 120.76 | : | : | 120.83 | 122.85 | 123.01 | 122.81 | 122.82 | 123.40 |
| Nominal eff. exchange rate ^{4.6} | Index | 81.8 | 74.1 | 74.0 | 68.4 | 66.6 | : | : | 66.6 | 66.1 | 66.1 | 66.5 | 66.5 | 66.1 |
| 5 Financial indicators | | | | | | | | | | | | | | |
| Interest rate (3 months) ^{5.1} | %p.a. | 12.56 | 12.50 | 9.49 | 7.24 | 5.18 | : | : | 2.95 | 2.77 | : | : | : | : |
| Bond yield (12 months) ^{5.2} | %p.a. | 12.90 | 13.04 | 10.67 | 9.18 | 7.27 | : | : | 4.95 | 4.95 | : | : | : | : |
| Stock markets ^{5.3} | Index | 1,270 | 932 | 1,035 | 1,215 | 1,359 | : | : | 1,323 | 1,303 | 1,341 | 1,337 | 1,338 | 1,347 |
| Credit growth ^{5.4} | Ann. %ch | 5.5 | 12.9 | -6.5 | 6.7 | 7.6 | : | : | 7.6 | 11.4 | : | 12.6 | 14.6 | : |
| Deposit growth ^{5.5} | Ann. %ch | 9.2 | 10.4 | 3.3 | 8.1 | 6.5 | : | : | 6.5 | 6.8 | : | 6.6 | 8.4 | : |
| Non-performing loans ^{5.6} | %total | 19.0 | 18.6 | 21.4 | 21.5 | 21.6 | : | : | 21.6 | 20.9 | : | N.A. | N.A. | N.A. |
| 6 Fiscal developments | | | | | | | | | | | | | | |
| General government balance* ^{6.1} | %of GDP | -4.7 | -6.8 | -5.5 | -6.6 | -3.8 | -3.1 | -2.9 | -9.2 | -1.7 | : | N.A. | N.A. | N.A. |
| General government debt ^{6.2} | %of GDP | 44.2 | 55.9 | 58.8 | 71.0 | 75.4 | 78.6 | 79.9 | 75.4 | 73.7 | : | N.A. | N.A. | N.A. |

f: ECFIN forecast Spring 2016

* Q figures refer to a 4 quarters moving average.