# SERBIA

## Highlights

- **Growth is slowing down in 2017.** Investments and exports had supported a growth rate of 2.8 per cent in 2016 but both have decelerated significantly in the first half of 2017. On the production side, unfavourable developments in agriculture, mining and electricity are also contributing to the weak growth performance this year.
- **Fiscal adjustment has over-performed.** This reflects consistent application of spending cuts introduced earlier as well as rising revenues in 2016. However, significant contingent fiscal risks still stem from large, unreformed state-owned enterprises (SOEs) while the "rightsizing" of the public administration is progressing slowly.
- **Non-performing loans (NPLs) have started to decline but corporate over-indebtedness may still limit lending.** NPLs have dropped significantly in the past two years but remain high by regional standards while long-term debt of over-indebted companies is around 25 per cent of GDP.

## Key priorities for 2018

- **Deepening of public sector reforms is needed.** Key measures that need to be advanced include privatisation and SOE restructuring, and improved efficiency of public administration. A new IMF programme, after the end of the present one in February 2018, could underpin the reform momentum.
- **The still-low level of investment calls for a more business-friendly environment.** Higher predictability of the business environment, lower para-fiscal charges, and an easier access to finance would support entrepreneurs and small and medium-sized enterprises (SMEs) the most.
- **Strengthening resilience needs non-performing loan (NPL) sales and further de-euroisation.** With the NPL resolution strategy serving as a good basis for bringing NPLs down, the focus now should be on more efficient judicial processes, improved out-of-court restructuring, and an easier access to NPLs for a broader range of potential investors. Despite the recent increase in dinar deposits and household dinar loans, Serbia is still among the most euroised countries globally.

Main macroeconomic indicators %

| | 2013 | 2014 | 2015 | 2016 | 2017 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.6 | -1.8 | 0.8 | 2.8 | 1.8 |
| Inflation (average) | 7.7 | 2.1 | 1.4 | 1.1 | 3.3 |
| Government balance/GDP | -5.5 | -6.6 | -3.7 | -1.3 | 0.0 |
| Current account balance/GDP | -6.1 | -6.0 | -4.7 | -4.0 | -4.5 |
| Net FDI/GDP [neg. sign = inflows] | -3.8 | -3.7 | -5.4 | -5.5 | -4.8 |
| External debt/GDP | 74.8 | 77.1 | 78.3 | 77.8 | n.a. |
| Gross reserves/GDP | 32.7 | 29.7 | 31.0 | 29.9 | n.a. |
| Credit to private sector/GDP | 43.6 | 43.4 | 43.4 | 44.1 | n.a. |

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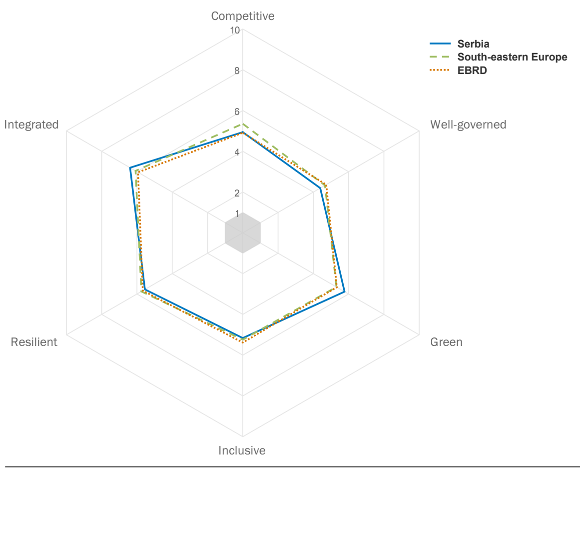
## Macroeconomic performance

**Growth in 2016 accelerated, but a slow-down is occurring in 2017.** GDP grew by 2.8 per cent in 2016, up from 0.8 per cent in 2015. Growth was driven by investment and exports amid stronger external demand and an improved investment environment, but was also helped by supply-side factors, including relatively low oil prices and interest rates, and a very good agricultural season. However, growth slowed to 1.2 per cent year-on-year in the first half of 2017 and may reach only around 1.8 per cent for the year as a whole, due to faster imports growth and weaker investments. On the production side, the main contributors to the growth slow-down have been agriculture as well as mining and electricity generation. Despite relatively high foreign direct investment (FDI) inflow (above 5 per cent of GDP in 2015 and 2016), the total investment remains below 20 per cent of GDP which is significantly lower than needed to support faster convergence.

**Fiscal performance has continued to be better than envisaged.** The budget deficit narrowed from 6.6 per cent of GDP in 2014 to 1.3 per cent in 2016, while public debt (72.9 per cent of GDP at the end of 2016) started falling one year earlier than expected. The decline in public debt continued in 2017, due to lower financing needs given the fiscal surplus in the first eight months of the year but also thanks to the dinar strengthening against the euro and the US dollar. The good fiscal performance reflects measures taken earlier, including public wage and pension cuts and continuation of attrition rules, but also stronger revenues and some one-offs (for example, payment of the central bank's profit). In view of the achievements so far, the government has decided on a gradual relaxation of austerity measures. This includes a one-off assistance of RSD 5,000 (around €40) to pensioners in November 2016, a general 1.5 per cent rise in pensions, and a targeted increase of public sector wages from 3 to 6 per cent for the police, army, judiciary, scientific, cultural, social and health care institutions from January 2017. On the other hand, a ban on new hiring, introduced in 2013, has been extended until the end of 2017. In October 2017, the government announced another RSD 5,000 one-off bonus to be paid to pensioners the next month, as well as a rise in pensions (5 per cent) and public sector wages (5 to 10 per cent) as of 1 January 2018.

**Monetary easing has slowed from previous years.** On the back of weak domestic demand and the decline in global commodity prices, inflation continued to move below the central bank's previous target (4 ± 1.5 per cent until the end of 2016) and at the end of 2016 reached 1.6 per cent year-on-year. Reflecting the decrease in inflation expectations and lower expected growth of regulated prices, the National Bank of Serbia (NBS) lowered the inflation target to 3±1.5 per cent as of 1 January 2017. Inflation has picked up in 2017, mainly on the back of food and beverage prices as well as a gradual increase in domestic demand and foreign inflation (notably in the euro area), but it is for now staying within the tolerance band. In 2016, the NBS cut the key policy rate by 50 basis points to 4.0 per cent, 7.75 percentage points down from the peak in 2013. Monetary easing was put on hold throughout most of 2017, to be reinstated in September and October by a total 50 basis points cut. More favourable terms of financing contributed to lending activity picking up over the past year.

Assessment of transition qualities (1-10)

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**After a disappointing rate in 2017, economic growth may accelerate again to 2.9 per cent in 2018.** Faster growth may be supported by the low base effect, and strengthening consumption and investment activities, with offsetting effects from higher imports. On the other hand, slowing down or discontinuing fiscal and structural reforms represent the main downside risks to the projection. Long-term convergence requires further business environment reforms and less state involvement in the economy.

## Major structural reform developments

**The business environment continued to improve, but more needs to be done.** Serbia ranked 43rd (up four places from the previous year) out of 190 countries in the World Bank's *Doing Business 2018* report. The improvement was mainly the result of making it easier to start a business (by reducing the signature certification fee and cutting the time for business registration), to register property (by improving the reliability of the land administration system) and to enforce contracts (by adopting a new enforcement law that broadens and clarifies the responsibilities of enforcement agents and powers of the courts during the enforcement process). Room for further improvement still remains in several areas, most notably in protecting minority investors, resolving insolvency, getting credit and electricity, as well as in enforcing contracts. Serbia has also improved its standing in the World Economic Forum's *Global Competitiveness Report 2017-2018* (up 12 places from the previous one), primarily on account of improvements in the macroeconomic environment, but its score still remains quite low (78th out of 137 countries) due to weak market efficiency, business sophistication, institutions and innovation capacity. As the "top five" most problematic factors for doing business in Serbia, respondents continue to identify tax rates, access to financing, inefficient government bureaucracy, corruption and policy instability.

**Privatisation and resolution of SOEs have progressed slowly.** Over the past year, out of around 180 enterprises in the portfolio of the Privatisation Agency, around 30 have been resolved, mostly by going into bankruptcy. Eleven strategic enterprises (out of 17 initially) were still not resolved by December 2016. These include drug-maker Galenika for which a new privatisation tender is under way and opening of the financial offer of a sole bidder is expected at the end of October 2017; copper mine RTB Bor for which the government is trying to find a strategic investor or privatise it; Komercijalna Banka for which the completion of privatisation was expected by the end of 2017 but due to the continuing corporate governance concerns the sale is more likely to be completed in 2018; chemical producer MSK; and fertiliser plant HIP Azotara. In March 2017 the Ministry of Economy invited interested investors to submit letters of intent for the sale of the petrochemicals producer Petrohemija. The privatisation method for Petrohemija is still to be decided on. In February 2017 the government also launched the procedure for a 25-year concession of the Belgrade Nikola Tesla airport, with five consortia allowed to proceed to the second stage. On the request of qualified bidders, the government twice extended the deadline for submission of binding bids in the second phase of the concession tender – first in August 2017, until 23 October, and then again in early October, until 23 November 2017.

**Public administration reforms have progressed slowly.** Tax collection has improved but reforms underlying the operation of tax administration (such as risk analysis of tax evasion, keeping and recruiting qualified staff, upgrading training and IT, as well as services to taxpayers) have been delayed. The rightsizing process of public administration continued, resulting in 22,000 people leaving from the end of 2014 to the end of 2016, close to the envisaged level of 25,000 to 30,000 in 2015-17. However, the current civil service framework still does not guarantee the neutrality of the public administration, merit-based recruitment, promotion and dismissal procedures. According to the European Commission, political influence plays a key role in choosing senior managers, and turnover of senior civil servants remains particularly worrisome. Capacities in capital investment management are still weak due to inefficiencies in budgeting, planning and contract oversight. A recently adopted Bylaw on Selection, Preparation, Evaluation, Monitoring and Reporting on Capital Projects may help public investment management to be more effective.

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**Harmonisation of banking sector regulation with EU standards has continued.** The NBS has implemented an agenda aimed at further strengthening the banking sector, reducing the NPLs and adjusting the regulatory framework in line with EU standards. The minimum capital requirement ratio has been cut from 12 to 8 per cent and additional capital buffers were introduced. However, reforms of state-owned financial institutions are lagging behind. Some consolidation has occurred in the sector; the National Bank of Greece sold Vojvodjanska Banka to the largest Hungarian bank, OTP.

**Regulatory improvements are helping NPL resolution.** The Real Estate Appraiser Law was adopted in December 2016, allowing more transparent and professional assessment of collateral values. Official interpretations by the NBS on the application of banking secrecy rules from March 2017, and by the Ministry of Finance on impairment provisions for corporate income tax purposes from September 2016 and March 2017, provide more guidance for sellers and buyers of NPL assets in these matters. The NPL ratio has dropped to 15.6 per cent in June 2017 from 22.8 per cent two years earlier.