Serbia

Highlights

- **Growth has moderated in the past year.** Lower external demand, which has affected manufacturing output, and persistent inflationary pressures, which have restrained household consumption, have weighed on economic performance.
- **A two-year disbursing programme with the International Monetary Fund (IMF) centred on energy reform is under way.** Measures already taken include increasing electricity and natural gas tariffs, changing the legal status of the largest state-owned electricity company to a joint-stock company, adopting a new law on the management of state-owned enterprises (SOEs) and introducing a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy.
- **Serbia has successfully concluded its first renewable energy auctions.** With the regulatory framework for renewable energy complete, the auctions were launched with support from the European Bank for Reconstruction and Development (EBRD) in June 2023 for 400 MW of wind power and 50 MW of solar photovoltaics. The auctions were successfully concluded in August, with the capacities awarded doubling current wind generation and prices realised for most capacities a little more than half current market prices.

Key priorities for 2024

- **Prudent policies need to support medium-term fiscal sustainability.** In view of unfavourable global financing conditions, the authorities should save inflation-driven fiscal over-performance or direct it towards investments that promote growth. They should also budget measures to support the economy in line with the fiscal rule and with a view to medium-term sustainability.
- **SOE governance needs further improvement.** The new law on SOEs provides a good starting point for completing the legal framework on SOE governance, and for advancing broader SOE reforms on improving their performance and oversight beyond the energy sector.
- **Further improvements to the investment climate would enhance medium-term growth prospects.** Reforms to support human capital development and better access to finance, strengthen the rule of law and reduce administrative complexities would help to sustain the strong inflow of foreign direct investment (FDI) and encourage much-needed domestic private investment.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.3	-0.9	7.7	2.5	1.8
Inflation (average)	1.7	1.6	4.1	12.0	12.4
Government balance/GDP	0.0	-7.2	-3.3	-0.1	-1.8
Current account balance/GDP	-6.9	-4.1	-4.2	-6.9	-2.3
Net FDI/GDP [neg. sign = inflows]	-7.7	-6.3	-6.9	-7.2	-6.1
External debt/GDP	61.4	65.8	68.4	69.3	n.a.
Gross reserves/GDP	29.1	28.8	30.8	32.1	n.a.
Credit to private sector/GDP	49.0	60.0	52.3	48.4	n.a.

Macroeconomic developments and policy response

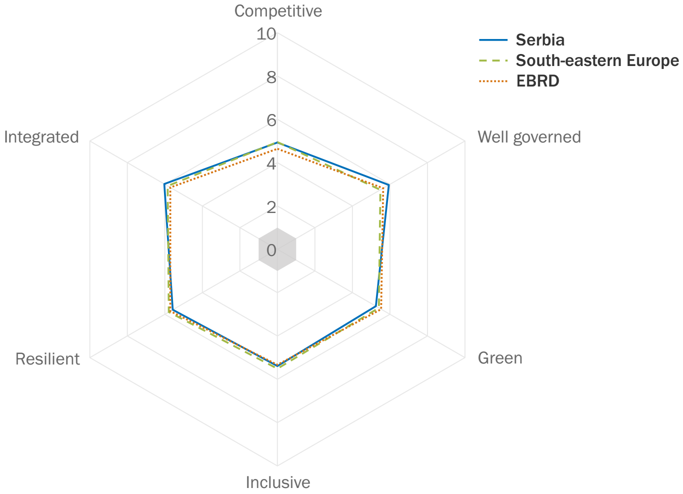
Economic activity is moderating. In line with the adverse global macroeconomic environment, gross domestic product (GDP) growth slowed to 2.5 per cent in 2022 and continued at a muted pace of 0.9 per cent year on year in the first quarter of 2023, before rising to 1.7 per cent year on year in the second quarter of the year. Household consumption growth slowed, ultimately contracting by the first quarter of 2023 as inflation remained firmly at double-digit levels. Construction activity declined in line with muted investment growth, but rebounded in the second quarter of 2023 as the authorities began implementing several sizeable public infrastructure projects. Despite heavy rainfall and occasional flooding, agricultural output grew compared with the previous year, which had been marked by drought. Industry maintained a mildly positive contribution to growth as the recovery of electricity production offset the impact of contracting mining and manufacturing activity. The current account deficit shrank to a fifth of its size year on year in the first half of 2023, driven by cheaper energy imports and strong electricity exports. Despite the shock brought about by the energy crisis, the current account deficit was entirely covered by record FDI inflows in 2022. FDI momentum was maintained in the first half of 2023, up 33 per cent year on year.

Monetary and fiscal measures were employed to support the economy. Increasingly broad-based inflation reached a decade-high level of 16.2 per cent in March 2023, before moderating to 12.5 per cent by July 2023. Inflation peaked later in Serbia than in other Western Balkans countries and the eurozone and is declining at a slower pace, partly owing to ongoing increases in regulated energy prices. The National Bank of Serbia gradually tightened monetary conditions in response, increasing the policy rate several times from 1 per cent in March 2021 to 6.5 per cent in July 2023. The authorities employed fiscal measures to support disposable income, including a pension hike and an increase in public healthcare and education wages, valid from September 2023; a price cap on 20 essential food and household products; one-off assistance for children; tourist vouchers; and state aid for repairing damages caused by storms. An increase in excise duties on fuel, tobacco, alcohol and coffee from October 2023 should contribute to a lower-than-originally-planned government deficit, as outlined in the budget rebalance adopted in September 2023.

The authorities repeatedly accessed external funding. In January 2023 Serbia returned to the external market via two issuances: a five-year Eurobond of US$ 750 million (€690 million) at a 6.3 per cent yield and a 10-year Eurobond of US$ 1 billion (€920 million) at a 6.8 per cent yield, and hedged the issuances against the euro. International reserves reached a record high of €23.6 billion (around six months of import coverage) at the end of August 2023 on account of enhanced access to external funding, including disbursement of the second tranche of the ongoing Stand-By Arrangement (SBA) with the IMF, strong remittances and exports, and central bank interventions in the foreign-exchange market aimed at quelling appreciation pressures.

Growth is set to remain subdued in the near term. Economic growth is expected to slow further to 1.8 per cent in 2023 before returning to nearer its medium-term potential at 3.5 per cent in 2024, in line with expected global recovery. The slowdown in eurozone export markets will weigh on external demand, persistently high inflation will continue to erode disposable incomes, and tight financial conditions on local and external markets, reflected in a slowdown of credit growth, will further damp domestic demand. Early elections could slow the implementation of public investments and economic reforms further, posing a downside risk to the medium-term outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The new IMF programme focuses on energy and public-sector reform. The IMF Board approved a €2.4 billion SBA in December 2022, and the Serbian authorities successfully completed the first review in July 2023. The measures taken so far include increasing electricity and natural gas tariffs, transforming the largest energy SOE into a joint-stock company, and adopting a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy. The new law on SOE management, a key structural benchmark, was adopted in September 2023, following a second round of public consultations. According to the new law, which is aligned with the EBRD-supported State Ownership Policy, more than 20 public enterprises are now obliged to change their legal status from public enterprise to either limited liability or joint-stock company no later than one year from the law's entry into force, alongside other corporate governance improvements. The phased implementation of a centralised public wage and employment registry (ISKRA) is on track, with the registry set to cover most of the 450,000 public-sector employees by the end of 2023.

Serbia completed its regulatory framework for renewable energy and launched renewable energy auctions. Amendments to the Law on the Use of Renewable Energy Sources adopted in March 2023 and accompanying secondary legislation, such as the balancing decree and the feed-in premium decree, enable faster integration of new renewable capacities in the power system and market, while preserving the reliability and stability of the system's operations. Renewable energy producers will now take on a proportion of the balancing costs that the guaranteed supplier (the state-owned electricity company, EPS) used to bear entirely through the feed-in tariff, therefore mitigating the public costs resulting from volatile renewable energy generation. The amendments also grant the Ministry of Mining and Energy the authority to determine maximum offered prices at auctions, unlocking the auctions process. In June 2023 Serbia, with EBRD support, launched renewable energy auctions for 400 MW of wind power and 50 MW of solar photovoltaics, marking the first auction in a three-year plan for market-premium support for 1,300 MW of renewable energy. The auction was successfully concluded in August, with the wind segment quota oversubscribed and the solar segment quota undersubscribed. The capacities awarded will double the current wind generation and prices realised for most of the capacities will be just over half current market prices.

A set of judicial laws related to constitutional changes has been adopted. Parliament needed to approve a set of laws in February 2023 to implement the preceding year's changes to the constitution. As part of these changes, parliament will no longer elect judges and prosecutors; the High Judicial Council and the High Prosecutorial Council will elect them instead.

The Serbian electricity exchange SEEPEX has launched an intra-day market. The new market segment, launched in July 2023, operates on a continuous trading mechanism, enabling market participants to adjust their position almost instantaneously. This is crucial for reducing risks associated with volatile renewable energy sources.

The government approved the 2023-25 Programme for Suppressing the Grey Economy. The Programme, which was adopted in March 2023, sets out 23 measures aimed at strengthening the capacity of inspections and misdemeanour courts, and improving tax supervision and reporting procedures, as well as easing the fiscal and administrative burden on businesses.

Businesses are now solely registered online. A recent amendment to the Law on Registration Procedure requires companies to register electronically with the Serbian Business Registers Agency from May 2023, streamlining the process and aligning it with international best practices.