# TRENDS

## 1. Review

Serbia enters 2023 with mixed macroeconomic trends, within which there are somewhat more unfavorable than favorable indicators. The biggest macroeconomic challenge is high and still growing inflation. At the end of 2022 price growth was 15.1%, and by the end of February 2023 it was further increased to 16.1%. Economic activity is currently in stagnation, since the year-on-year growth of GDP in Q4 2022 was only 0.4% and there are uncertainties in which direction economic trends will continue in 2023. Balance of payments trends have noticeably worsened throughout 2022 (the current account deficit increased from 4.2% of GDP in 2021 to 6.9% of GDP), but there was still a significant improvement in the second half of the year. The main trends in the labor market at the end of 2022 were stagnation of employment and unemployment, with a slight real drop in average wage (due to the acceleration of inflation). Fiscal developments can in principle be assessed as stable despite the fact that in 2022 a relatively high budget deficit of 3.1% of GDP was realized. However, within this deficit, a very high level of public investments of 7.2% of GDP was realized, and there were also some extraordinary budget expenditures (energy, one-time allocations for young people) that should be significantly reduced or abolished during 2023. When this is taken into account, the basic fiscal trends can still be assessed as stable. An additional guarantee that Serbia's public finances will be under control in 2023 is provided by the standby arrangement with the IMF, which was signed at the end of 2022.

Although two and a half months of 2023 have already passed, macroeconomic forecasts for this year are still uncertain, especially considering the extremely unstable and unpredictable international circumstances. The current expectations of QM remain moderately optimistic, which basically means that we forecast that during 2023 there will be a significant slowdown in inflation and a certain revival of economic growth in Serbia. However, it is very possible that the results of these two important macroeconomic indicators in 2023 will still be slightly worse than the currently valid forecasts of the Government and the National Bank of Serbia. As far as inflation is concerned, in January and February 2023 it was already above the forecasts of the NBS (from the latest Inflation Report). Because of this, it is possible that its average level in 2023 could be slightly over 12% instead of the expected 11% (which was also used for the preparation of the Budget). When it comes to economic growth, there are currently not many indicators from 2023 on the basis of which a somewhat more reliable forecast for the current year could be given. However, the relatively weak results from the second half of 2022 indicate that economic growth in 2023 could easily be slightly lower than the officially forecasted 2.5% (perhaps it could be around 2%). So, taking all of the above into account, it still seems that the main macroeconomic indicators during 2023 will go in the direction of the expected improvements - but there are also certain warning signs that require increased caution and additional preparedness of the economic policy to react in time if the need arises.

In addition to geopolitical risks, which are unpredictable, and which significantly affect the economy, a crisis in banks in the USA and Switzerland appeared during March. The strong reactions of central banks and governments in the USA and Switzerland have, for now, prevented the spread of panic but the emergence of a more serious crisis in the banking sector is still not excluded. A possible more serious banking crisis would almost certainly further reduce the GDP, which would encourage central banks to ease monetary policy, through the abundant issuance of loans for liquidity, and in such circumstances a halt and perhaps a reduction of interest rates is likely.

Economic activity in Q4 continued to slow down (see section 2. "Economic Activity"). Year-on-year GDP growth was only 0.4%, which is the lowest quarterly rate of economic growth in Serbia since 2020. The slowdown of economic activity is influenced by the acceleration of inflation, which reduces the real income of the population and consequently private consumption, but also the continuation of the slowdown of economic activity in the EU, with which the domestic economy is closely connected. Also, investments and industrial production at the end of 2022 recorded declining or barely positive trends. On an annual level Serbia achieved a relatively modest economic growth of 2.3% in 2023, which was 2 p.p. lower than the average economic growth of comparable CEE countries. We wrote about the reasons why Serbia had worse results than comparable countries in 2022 in previous editions of QM. We see them primarily in the bad agricultural season due to the drought and in the somewhat different dynamics of the economic recovery from the health crisis in Serbia compared to other CEE countries. Namely, in the CEE countries the effect of recovery from the health crisis was still delayed during 2022 (e.g. the strong growth of tourism in Croatia), and Serbia exhausted the effect of recovery from the crisis somewhat earlier, with faster economic growth during 2021. As we mentioned, we are currently forecasting that Serbia's GDP growth in 2023 could be around 2% (partly due to the expected recovery of agriculture from the drought). This forecast, however, should be interpreted as conditional and indicative. Ever since the outbreak of the health crisis in March 2020, it has become common for economic growth forecasts for the current year to change significantly during the year - which we do not exclude will happen again in 2023.

Inflation in Serbia has been accelerating month by month since August 2021, and according to the latest available data, the year-on-year price increase in February 2023 was a high 16.1% (see section 5. "Prices and the Exchange rate"). This is a record level of inflation since it is measured in Serbia by the Consumer Price Index (since the beginning of 2007) and as much as 11.6 p.p. above the upper limit of the NBS target corridor (3 ± 1.5%). QM's assessment is that inflation in Serbia is currently most likely at its peak (or very close to it), which means that we expect its gradual slowdown in the coming period. This is indicated by the weakening of international inflationary pressures - since global inflation has been gradually slowing down for several months. Inflation in the USA peaked in June 2022 at 9.1% and by February 2023 it was reduced to 6%. In the Eurozone, the maximum inflation of 10.6% was reached in October 2022, and by February 2023 price growth was reduced to 8.5%, and in the CEE countries the peak of inflation of around 18% was reached in September 2022 and now it is reduced to about 16%. In addition to international factors, domestic factors should also affect the expected slowdown of year-on-year inflation in Serbia in the coming months - stagnation of economic growth with a slowdown in real growth of private consumption, the effect of a higher base from the previous year and an increase in the restrictiveness of monetary policy.

However, we draw attention to one specific feature of inflation in Serbia due to which its slowdown during 2023 will, by all accounts, be noticeably slower than in other CEE countries. Namely, Serbia was significantly late with the increase in controlled energy prices (electricity and gas). Unlike other CEE countries, which increased these prices strongly (sometimes multiple times) during 2022, the policy of the Government of Serbia was to first freeze the prices of these energy sources at the pre-crisis level, and then to allow their modest increase until the end of 2022. This kind of policy, however, cannot continue indefinitely, among other things, because the losses of public companies from the energy sector (Srbijagas and EPS) have so far cost the budget as much as 2.4 billion euros. For this reason, in January 2023, Serbia implemented relatively strong corrections in the prices of electricity and gas, and similar increases are foreseen in May of the current year (after that May increase two additional increases in the price of gas alone are planned at the end of 2023 and in the first half of 2024.). This (delayed) increase in energy prices in January 2023 was the main reason why inflation in Serbia continued to rise in the first two months of 2023, while it declined in most other European countries. Because of all this, we assess that the Government's policy of maintaining non-market gas and electricity prices for too long was economically wrong. It not only led to a huge budget cost, but because of late corrections of energy prices high inflation in Serbia will most likely last a bit longer compared to comparable countries.

In 2022, the current account deficit of the balance of payments was relatively high (6.9% of GDP), which is the result of high deficit values in the first half of the year (10.5% of GDP) and significantly lower values in the second half of the year (3,8% of GDP). An important factor that influenced such unusual foreign economic trends was the import of energy products. Namely, in the first half of 2022, and especially in Q1, Serbia had an unusually large deficit in the trade exchange of energy products. The reason for this was a strong increase in world prices (Serbia is a net energy importer), but also an extraordinary increase in the amount of imported electricity due to the collapse of production in EPS. In the second half of the year, however, there was a reversal of this trend since world energy prices began to fall EPS recovered a part of the lost production and Serbia benefited from a slightly milder autumn and winter, so energy consumption at the end was extraordinarily reduced. A positive and rather unexpected balance of payments trend in 2022 was the strong growth of foreign direct investments (FDI). Net FDI inflows to Serbia in 2022 amounted to 4.3 billion euros, i.e. 7.1% of GDP. Of this, as much as 2.8 billion FDI came in the second half of the year, which is an unexpected result taking into account the great international instability (war in Ukraine), the global increase in interest rates, but also the fact that in the second half of 2022 total investments in Serbia were on a downward trend.

The strong increase in inflation and the slowdown in economic activity during 2022 also affected the labor market (see section 3. “Labor Market”). Although the year-on-year nominal growth of average wage throughout 2022 was relatively high and amounted to almost 14%, the acceleration of inflation led to the fact that at the end of the year the year-on-year real growth of wages was slightly negative. More specifically, in Q4 the year-on-year drop in wages amounted to 1.5%. The slowdown in economic activity gradually began to be reflected in the trend of employment, so that according to the LFS in Q4 there was a slight year-on-year decrease in the number of employees of 1% (although according to administrative data registered employment maintained a growth of 2.4% in Q4). Despite a certain worsening of trends at the end of the year, trends on the labor market in 2022 can still be assessed as moderately favorable in principle. The total number of employees in Serbia according to the LFS (both in the formal and informal sector) was over 2.9 million in 2023, which is the largest number of employees in Serbia since this survey was introduced, and the unemployment rate was also at a record low level for Serbia - 9.4%.

High and growing inflation led to an increase in the restrictiveness of monetary policy during 2022 and in the first three months of 2023 (see section 7. “Monetary Flows and Policy”). The NBS started gradually increasing the reference interest rate in April 2022 (from its historically lowest level of 1%). Thus, after 12 consecutive increases the reference interest rate reached the level of 5.75% in mid-March 2023. Current inflation trends suggest that the cycle of monetary adjustment will most likely end after one or two more hikes in this interest rate. Market interest rates offered by banks on both indexed and dinar loans are also on the rise. Average weighted interest rates on indexed loans increased from the beginning to the end of 2022 by 2.55 p.p., which means that they almost doubled compared to their level at the end of 2021. The growth of the credit activity of the economy during 2022 slowed down, so that in Q4 companies already had a net deleveraging towards domestic banks (for about 270 million euros). An important positive result of the domestic financial sector is that the share of bad loans in the total did not increase despite the relatively strong growth in interest rates. At the end of February 2023 the share of bad loans in total loans amounted to only about 4%.

Fiscal trends in 2022 were quite specific (see section 6. “Fiscal Flows and Policy”). On an annual level, a relatively high budget deficit of 3.1% of GDP was realized, which was noticeably higher than the fiscal deficit of comparable CEE countries, as well as the entire EU. However, within the realized deficit in Serbia of 3.1% of GDP, as much as 2.7% of GDP was actually budget costs to cover the losses of Srbijagas and EPS - which means that the budget of Serbia in 2022 would already be approximately in balance without these costs. At the same time, it should also be borne in mind that in 2022 Serbia realized an unusually high level of public investments of as much as 7.2% of GDP, and had some extraordinary expenditures (such as unselective aid for young people) which should not be repeated. So, taking all of the above into account, it can be assessed that the basic fiscal flows in Serbia are actually quite stable, that is, that the structural (systemic) deficit is low.

What is particularly interesting is the perspective of Serbia's fiscal policy in 2023 and the following years. It is obvious that the costs for support for public companies (Srbijagas and EPS) will decrease significantly in 2023, partly due to the increase in electricity and gas prices on the domestic market, and partly due to the drop in energy prices on the international market. Since these costs were the main source of fiscal imbalances in 2022 Serbia has an excellent opportunity to significantly reduce the fiscal deficit in 2023, i.e. instead of the initially planned budget deficit in 2023 of 3.3% of GDP, bring the deficit below 2% of GDP. This is not only relatively easy to do now but it is also economically desirable for several reasons. First of all, a lower budget deficit would lead to a faster decrease in the share of public debt in GDP, which may prove to be very important in the near future. Namely, although the share of public debt in Serbia has not gotten out of control (currently public debt is at the level of about 55% of GDP), the costs of servicing this debt could very quickly become a significant burden on public finances because global interest rates are on a strong rise. Another reason why in 2023 there should be a greater reduction of the fiscal deficit than originally planned is that such a fiscal policy would significantly contribute to slowing down high inflation, which is currently Serbia's biggest macroeconomic problem. The third reason for a more restrictive fiscal policy is the fact that there are numerous instabilities and uncertainties (primarily in the international environment) which in the worst possible outcome could require some new and unplanned state interventions. Because of all this, QM's firm recommendation is for the state to take advantage of the opportunity that has now been presented to it and to lead its public finances during 2023 in the direction of faster balancing than is foreseen by the Fiscal Strategy and the arrangement with the IMF.

## Serbia: Selected Macroeconomic Indicators, 2015–2022

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2020 | | | | 2021 | | | | 2022 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Economic Growth** | | | | | | | | | | | | | | | | | | | |
| GDP (in billions of dinars) | 4,312.0 | 45,281.2 | 4,760.7 | 5,072.9 | 5,421.9 | 5,502.2 | 6,270.1 | 1,312.5 | 1,280.7 | 1,411.5 | 1,497.5 | 1,366.9 | 1,531.4 | 1,626.3 | 1,745.5 | 1,534.6 | 1,738.5 | 1,839.8 | 1,967.0 |
| GDP | 1.8 | 3.3 | 2.1 | 4.5 | 4.2 | -0.9 | 7.5 | 5.2 | -6.3 | -1.3 | -1.0 | 1.7 | 13.8 | 7.8 | 7.2 | 4.2 | 3.8 | 1.0 | 0.4 |
| Non-agricultural GVA | 2.3 | 2.5 | 3.3 | 3.4 | 4.9 | -1.0 | 8.5 | 5.7 | -6.7 | -1.7 | -1.0 | 2.7 | 14.6 | 8.9 | 8.2 | 4.1 | 4.3 | 1.4 | 0.9 |
| Industrial production | 7.3 | 4.9 | 4.2 | 1.4 | 0.3 | 0.5 | 6.4 | 4.2 | -7.7 | 3.4 | 1.7 | 3.8 | 15.9 | 1.1 | 3.8 | 1.9 | 4.8 | -0.5 | 0.7 |
| Manufacturing | 5.7 | 5.6 | 6.6 | 2.0 | 0.2 | 0.1 | 5.6 | 6.0 | -8.0 | 2.6 | 0.3 | 2.5 | 19.8 | 0.3 | 3.0 | 4.1 | 4.8 | -0.9 | -2.3 |
| Average net wage (per month, in dinars)[2] | 44,437 | 46,087 | 47,888 | 49,643 | 54,908 | 60,057 | 65,864 | 59,251 | 59,188 | 59,413 | 62,374 | 63,559 | 65,014 | 64,863 | 69,938 | 72,067 | 73,828 | 74,459 | 79,302 |
| Registered Employment (in millions) | 1,990 | 1989 | 2,177 | 2,131 | 2,173 | 2,216 | 2,274 | 2187 | 2197 | 2225 | 2253 | 2248 | 2270 | 2287 | 2288 | 2284 | 2305 | 2308.955 | 2342 |
| **Fiscal data** | | | | | | | | | | | | | | | | | | | |
| Public Revenues | 3.1 | 7.5 | 4.0 | 4.6 | 6.2 | -2.6 | 15.5 | -0.2 | -14.9 | 1.4 | 1.9 | 9.2 | 40.8 | 11.5 | 5.7 | 5.0 | 4.9 | 1.0 | -3.8 |
| Public Expenditures | -3.2 | 1.9 | -1.7 | 5.8 | 8.4 | 16.0 | 5.8 | 11.7 | 33.2 | 13.4 | 6.9 | 1.7 | -5.3 | 7.1 | 18.2 | 13.1 | -5.5 | -11.2 | 1.1 |
| Overall fiscal balance (GFS definition)[3] | -149.1 | -57.1 | 52.3 | 32.2 | -11.1 | -442.8 | -259.4 | -52.2 | -258.0 | -50.7 | -82.0 | -12.7 | -26.1 | -29.3 | -191.4 | -68.1 | 52.5 | 63.8 | 265.2 |
| **Balance of Payments** | | | | | | | | | | | | | | | | | | | |
| Imports of goods[4] | -15,099 | -15,933 | -18,064 | -20,191 | -22,038 | -21,280 | -26,699 | -5,532 | -4,391 | -5,383 | -5,974 | -5,582 | -6,635 | -6,821 | -7,660 | -8,298 | -9,241 | -8,246 | -9,278 |
| Exports of goods[4] | 11,454 | 12,814 | 14,066 | 15,106 | 16,415 | 16,079 | 20,772 | 3,957 | 3,386 | 4,161 | 4,576 | 4,620 | 5,013 | 5,360 | 5,779 | 6,055 | 6,720 | 6,629 | 7,126 |
| Current account5[)] | -1,234 | -1,075 | -2,051 | -2,076 | -3,161 | -1,929 | -2,359 | -947 | -300 | -468 | -215 | 25 | -706 | -673 | -1,005 | -1,351 | -1,266 | -207 | -837 |
| *in % GDP*[5] | -3.4 | -2.9 | *-5.2* | *-4.8* | *-6.9* | *-4.1* | *-4.4* | *-8.5* | *-2.8* | *-3.9* | *-1.7* | *0.2* | *-5.4* | *-4.9* | *-6.8* | *-10.4* | *-8.6* | *-1.3* | -5.0 |
| Capital account[5] | 920 | 535 | 1,648 | 1,743 | 3,104 | 2,079 | 2,158 | 993 | 638 | 487 | -38 | 5 | 486 | 567 | 1,100 | 1,520 | 1,225 | -202 | 606 |
| Foreign direct investments | 1,804 | 1,899 | 2,418 | 3,157 | 3,551 | 2,938 | 3,699 | 785 | 635 | 298 | 1,221 | 941 | 815 | 1,080 | 863 | 561 | 951 | 1,290 | 1525 |
| NBS gross reserves (increase +) | 166 | -302 | 228 | 1,123 | 1,873 | 270 | 2,619 | -443 | 806 | -797 | 705 | 724 | -142 | 2,604 | -566 | -2,256 | 316 | 1,659 | 3200 |
| **Monetary data** | | | | | | | | | | | | | | | | | | | |
| NBS net own reserves[6] | 931,320 | 923,966 | 891,349 | 963,944 | 1,218,085 | 1,127,942 | 1,331,164 | 1,194,599 | 1,180,603 | 1,085,928 | 1,127,942 | 1,117,820 | 1,122,632 | 1,282,740 | 1,331,164 | 1,173,699 | 1,222,943 | 1,395,432 | 1,519,385 |
| NBS net own reserves[6], in mn of euros | 7,649 | 7,486 | 7,482 | 8,166 | 10,363 | 9,593 | 11,321 | 10,161 | 10,040 | 9,235 | 9,593 | 9,507 | 9,549 | 10,911 | 11,321 | 9,974 | 10,414 | 11,894 | 12,952 |
| Credit to the non-government sector | 1,982,974 | 2,031,825 | 2,067,826 | 2,282,988 | 2,467,546 | 2,760,481 | 3,027,481 | 2,536,569 | 2,636,541 | 2,753,218 | 2,760,481 | 2,786,153 | 2,848,534 | 2,928,909 | 3,027,481 | 3,108,894 | 3,210,333 | 3,257,091 | 3,242,781 |
| FX deposits of households | 1,014,260 | 1,070,944 | 1,074,424 | 1,167,846 | 1,231,028 | 1,301,580 | 1,448,165 | 1,230,553 | 1,251,162 | 1,270,785 | 1,301,580 | 1,341,246 | 1,379,848 | 1,403,488 | 1,448,165 | 1,458,479 | 1,490,922 | 1,498,556 | 1,505,254 |
| M2 (y-o-y, real growth, in %) | 5.5 | 8.0 | 0.6 | 11.8 | 6.5 | 16.6 | 5.1 | 8.7 | 17.1 | 16.6 | 16.6 | 16.7 | 8.9 | 6.7 | 5.1 | -0.7 | -5.1 | -6.1 | -7.1 |
| Credit to the non-government sector (y-o-y, real growth, in %) | 1.4 | 0.9 | 4.0 | 8.0 | 7.7 | 9.7 | 7.0 | 9.4 | 11.1 | 12.2 | 9.7 | 7.9 | 6.2 | 4.6 | 7.0 | 2.3 | 0.9 | -2.2 | -6.9 |
| Credit to the non-government sector, in % GDP | 48.4 | 47.2 | 45.4 | 44.4 | 44.9 | 48.8 | 49.9 | 46.1 | 47.6 | 48.9 | 48.8 | 48.8 | 48.8 | 49.3 | 49.9 | 47.4 | 50.2 | 46.6 | 45.7 |
| **Prices and the Exchange Rate** | | | | | | | | | | | | | | | | | | | |
| Consumer Prices Index[7] | 1.6 | 1.5 | 3.0 | 2.0 | 1.8 | 1.5 | 4.7 | 1.4 | 1.6 | 1.9 | 1.3 | 1.8 | 3.3 | 5.7 | 7.9 | 9.1 | 11.9 | 14.0 | 15.1 |
| Real exchange rate dinar/euro (average 2005=100)[8] | 90.6 | 91.6 | 88.9 | 86.6 | 85.7 | 84.4 | 83.2 | 84.3 | 84.8 | 84.2 | 84.3 | 84.0 | 83.6 | 82.9 | 82.2 | 82.1 | 81.7 | 79.8 | 78.4 |
| Nominal exchange rate dinar/euro[8] | 120.8 | 123.3 | 121.4 | 118.3 | 117.9 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.6 | 117.4 | 117.3 |

Source: FREN.

1) Unless indicated otherwise.

2) Data for 2008 represent adjusted figures based on a wider sample for calculating the average wage. Thus, the nominal wages for 2008 are comparable with nominal wages for 2009 and 2010, but are not comparable with previous years.

3) We monitor the overall fiscal result (overall fiscal balance according to GFS 2001) – Consolidated surplus/deficit adjusted for "budgetary lending" (lending minus repayment according to the old GFS).

4) The Statistical Office of the Republic of Serbia has changed its methodology for calculating foreign trade. As from 01/01/2010, in line with recommendations from the UN Statistics Department, Serbia started applying the general system of trade, which is a broader concept that the previous one, in order to better adjust to criteria given in the Balance of Payments and the System of National Accounts. A more detailed explanation is given in QM no. 20, Section 4, "Balance of Payments and Foreign Trade".

5) The National Bank of Serbia changed its methodology for compiling the balance of payments in Q1 2008. This change in methodology has led to a lower current account deficit, and to a smaller capital account balance. A more detailed explanation is given in QM no. 12, Section 6, "Balance of Payments and Foreign Trade".

6) The NBS net own reserves represent the difference between the NBS net foreign currency reserves and the sum of foreign currency deposits of commercial banks and of the foreign currency deposits of the government. More detailed explanations are given in the Section Monetary Flows and Policy.

7) Data for 2004, 2005 and 2006 are based on the Retail Prices Index. SORS has transferred to the calculation of the Consumer Price Index from 2007.

8) The calculation is based on 12-m averages for annual data, and the quarterly averages for quarterly data.