

## Serbia

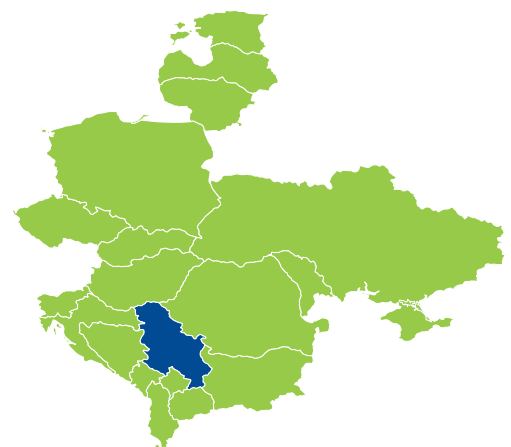


The Serbian government is led by a coalition of four parties, called European Serbia (ZES). The alliance is dominated by the pro-EU Democratic Party (DS) of President Boris Tadic. The question of Kosovo still remains one of the key points in Serbian foreign policy. The government has declared that it will never recognise Kosovo's independence, even if recognition were to become a condition for EU membership. Irrespective of this, Serbia's EU membership is and will be one of the top priorities for the government. Serbia also has an important bilateral relationship with Russia, which strongly supported Serbian opposition to Kosovo's independence and is Serbia's dominant energy supplier.

The Serbian population (excluding Kosovo) is gradually falling: the estimate of 7.3 million by mid-2008 contrasts with the 7.8 million recorded in the 1991 census. The 2002 census indicated that 16.5% of the population was aged 65 or above, roughly in line with the EU average. However, because of declining fertility rates, the average age of Serbia's population increased from 35 years in 1991 to 40 in 2005. This is contributing to a rise in the old-age dependency ratio (the ratio of people aged above 60 to the working-age population). Implications for the state pension system are particularly important because one of the parties in the ruling coalition is calling on the government to raise pensions to 70% of the average salary (from about 55% in mid-2008).

The 2002 census found that almost 83% of the country's permanent population (excluding Kosovo) declared themselves as Serbs. The next-largest group was ethnic Hungarians, with less than 4% of the population, concentrated in the province of Vojvodina in the north of Serbia.

After the economic crisis of the 1990s, following Milosevic's ousting in 2000, Serbia started to recover from its long crisis. Trade and prices were liberalised, fiscal reforms were implemented, privatisation commenced and the entire banking and financial system was reformed. Serbia's budget also became a lot more transparent, including expenditure on social security and pensions. A number of reforms were also introduced in an effort to attract foreign investors; these included a reduction in the number of taxes, corporate tax was cut to 14% and VAT was introduced at the beginning of 2005. The end of 2005 also was significant, when corporate tax was lowered again to 10%, making it the lowest corporate tax in the region. Although the government claimed in the early years of this century that the budget was in surplus, the Ministry of Finance has changed the way in which the budget is calculated, in line with IMF methodology by including net lending in total expenditure. (This was previously a financing item).



Using the old methodology, the budget was in surplus in 2005-2007; using the new methodology, however, the budget recorded deficits in 2006 and 2007. Since 2006, fiscal policy has been loosened with large increases in public sector wages and high government spending, and large public enterprises continue to be a drain on the budget.

The National Bank of Serbia (NBS) has successfully maintained the stability of the Dinar in recent times. The current governor, Radovan Jelasic, has further tightened monetary policy in order to combat increased bank lending. However, the central bank had few tools at its disposal to achieve stability, and used the two-week repo rate as its main policy instrument. The bank raised repo rate sharply in late 2007, citing its concerns regarding heightened inflationary expectations. Core inflation rose to 10.3% year-on-year in July 2008, well above the 6% which was the upper limit of the bank's target for the end of the year. The NBS raised its policy rate in late May by 50 basis points, to 15.75%, and it will consider further increases to ensure that its target for core inflation in 2008 is met (or at least not seriously overshot). In 2001, Serbia adopted a managed float system for the Dinar's exchange rate, giving it limited flexibility. While the central bank does not have an exchange rate target, it has expressed its determination to intervene in currency markets whenever necessary, particularly if currency stability is jeopardised.

During 2005-2007, the annual rate of GDP averaged around 5.9%. The main drivers for such growth were increasing domestic demand, where expansion of fixed investment was recorded, private consumption fuelled by strong wage growth. This was followed by credit growth, which contributed to a steady increase in household consumption, which grew on average by 3.4% during 2005-2007. Even more notable was growth in fixed investments, which grew of average by 14.3% during 2005-2007. Even at this rate, the pressing need for increased fixed investments in Serbia has not diminished at all.

Serbia's current account deficit remains large, and there is a prospect that it will expand further. During 2005-2007, Serbia's current account deficit amounted to around 12% of GDP, a potential threat to macroeconomic stability. The current account deficit increased further to almost 20% of GDP in 2008.

Since 2000, the majority of investments have been the result of privatisation. Several large multinationals established their businesses in Serbia during that period, including Phillip Morris which bought a tobacco factory in Nis, the Russian oil company Lukoil which bought Beopetrol, Lafarge which acquired BFC from Beocin, and many others. Although privatisation is considered to have been a moderate success, the number of greenfield investments is still lagging behind. The most notable greenfield investment was the opening of the Ball packaging facility for production of aluminium cans (USD 95 million).

Serbia received large FDI inflows in 2005-2007, peaking during 2006 when it totaled USD 5.6 billion. A major contribution to this growth, however, was made by the sale of mobile telecommunications operator Mobi 63 to Norwegian Telenor. This trend did not continue into 2007, when FDI totaled USD 2.2 billion. It should be noted, however, that there was a major outflow due to the purchase of Telekom Srpske by Serbia's largest telecommunication operator, Telekom Serbia.

In the first quarter of 2009, Industrial production contracted by 16.9% year-on-year. Manufacturing was hit the hardest in this period, posting a 22.5% year-on-year decline. Tumbling foreign and domestic demand cut the production of semi-finished goods, which comprise roughly one-third of total industrial output. Capital goods and consumer durables posted declines of 26% to 28%. Mining and quarrying fared slightly better, contracting by 7.3%, owing to a 34.5% expansion in the mining of metal ores. The utility sector also recorded relatively good results, with a 0.8% year-on-year decline in the first quarter and 6.1% year-on-year growth in March 2009.

Exports were affected by the strength of the Dinar, making Serbian goods expensive for the European market and contributed to the relatively slow growth of Serbia's main export markets. However, Serbia should eventually start to reap the benefits of previous inflows of FDI.

Serbia	2005/2007 Average Values	2007-2008	2008
	<b>Change (%)</b>	<b>Change (%)</b>	
Population (mil.)	-0.4	-1.1	7.3
Average monthly gross wage (EUR)	28.0	-1.5	602.1
EUR Exchange rate vis-à-vis	0.1	13.6	89.5
USD Exchange rate vis-à-vis	-0.2	16.4	63.9
	<b>Real change (%)</b>	<b>Real change (%)</b>	<b>EUR mil.</b>
GDP	5.9	5.4	31,191
Private consumption	3.4	11.8	n/a
Public consumption	7.0	13.8	n/a
Gross fixed capital investments	14.3	-7.7	n/a
Exports (goods and services)	12.2	9.8	n/a
Imports (goods and services)	6.7	9.2	n/a
	<b>Nominal change (EUR mil.)</b>	<b>Nominal change (EUR mil.)</b>	<b>EUR mil.</b>
Trade balance	-535	-1,805	-8,588
Current account balance	-757	-1,820	-6,235
General government balance	-76	-701	-540
General government gross debt	-518	-134	9,856
External debt	3,105	-408	5,802
Foreign currency reserves	755	-2,563	1,114
	<b>Percentage point change</b>	<b>Percentage point change</b>	<b>%</b>
Economic activity rate	0.4	0.5	66.5
Unemployment rate	-0.1	-4.5	13.6
CPI rate (previous year = 100%)	-0.4	-4.0	7.9
Central bank interest rate	-1.8	7.8	17.8
1-year yield on Treasury Bill	n/a	n/a	n/a
10-year yield on Treasury Bond	n/a	n/a	n/a

Sources used: Reuters EcoWin Pro

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