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Focus Notes: Serbia

Serbia: Economy exits recession, yet recovery will be modest and fragile

- ✓ A recent stream of macroeconomic data suggests that Serbia has already exited recession. After four consecutive quarters of negative growth, real GDP grew by 0.6% yoy (revised down from 1% yoy reported initially) in Q1-2010. Moreover, growth accelerated in Q2 to 1.6% yoy (flash estimate of the Statistical Service vs. 1.8% yoy estimate of the Central Bank).

- ✓ Although there is no detailed breakdown of Q2 GDP yet, manufacturing has likely been one of the main contributors to the rebound. Manufacturing already posted growth of 2% yoy in Q1, which compared with a contraction of 6.9% in Q4 2009. The improvement appears to have continued in Q2 as well. Indeed, industrial production, increased by 4.6% yoy in 1H-2010 (here you need to provide both Q1 & Q2 data) compared to a decline of -17.4% at the same period last year.

- ✓ Manufacturing has been benefiting the most from the rebound in exports. Exports showed signs of revival expanding by 13% yoy in 1H against imports growing by only 3% over the same period. The economic recovery in EU-27, where ca two thirds of Serbian exports are heading, is one reason behind this. The depreciation trend of the Dinar provides an additional boost to exports, helping to boost export competitiveness and thus, economic growth. As a result, if any of those two factors fade, then output recovery could be in danger.

- ✓ There is one more distinct, compared to the rest of the region, feature of the economic rebound in Serbia. The rebound is assisted by the positive private sector credit growth. Private sector credit growth registered a 23.1% yoy increase in nominal terms in the 1H-2010. This trend is underpinned by the government subsidized Dinar loans program.

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- ✓ What is more important, the government is on track with its IMF program. Implementation has been smooth so far, being current at the stage of the fifth review. All the quantitative targets for end March were met, with the exception that of the fiscal deficit which was not met by a small margin. In fact, Serbia withdrew only €56 mn of the latest loan tranche (€383 mn in late June), bringing the overall disbursements so far to €1.5bn, out of a total financial package of €2.9bn.

- ✓ Furthermore, the government is implementing successfully the required structural reforms. The government has already implemented most of the politically-sensitive structural reforms including, among others, the pension system reform and the downsizing (by 10%) of the central government personnel. In that respect, the Serbian government has so far complied with the IMF program requirements more effectively than other governments in New Europe running similar programs.

- ✓ In conclusion, our view on the GDP outlook for 2010 has remained unchanged from the beginning of the current year. We forecast a mild output recovery 1.5% yoy for 2010 as a whole, compared to -3% yoy in 2009. Our forecast is broadly in agreement with the current market consensus. Note that the IMF recently downgraded its Serbia growth forecast for 2010 to 1.5% against a 2% expected earlier.

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