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Abstracts

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Core Views

We see growing risk to social and political stability in Serbia and the region due to the slowing economic growth, impending austerity measures and the emergence of radical Islamist cells in neighbouring Kosovo.

Serbia's current account deficit will be wider than we previously anticipated due to softer external demand on the back of escalating trade war between Russia and the EU. However, we see limited risks of a balance of payments crisis, as the government's market-friendly reforms will help anchor investor confidence and boost financial account inflows.

The suspension of operations by automaker Fiat's Serbian subsidiary on September 8, an overall soft external demand on the back of escalating trade war between the EU and Russia, and Serbia's forthcoming deal with IMF, which will entail harsher austerity measures than we previously anticipated, has prompted us to readjust our economic growth. Fiat's subsidiary is Serbia's biggest exporter, with the company's exports accounting for 7% of GDP in H114, and the halting of production will have a tangible negative impact on overall export growth in 2014.

Despite Serbia's grim 2014 fiscal outlook, the government's credible fiscal consolidation measures and pending IMF deal will anchor investor confidence from 2015 onwards, underpinning the improvement in the country's fiscal and debt metrics.

Major Forecast Changes

We have revised down our forecasts for both the domestic demand and export expenditure components of GDP, which has taken our headline real GDP growth forecast to a contraction of 0.4% against our previous forecast for modest growth of 0.5% for 2014. We now believe that the worsening outlook for the dinar will prompt the NBS to slow the pace of easing, and we now expect to see only 25 basis points (bps) of a rate cut to 8.25% by year-end, instead of 75bps previously.

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Contents

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Wider Deficits No Cause For Alarm
Serbia's current account deficit will be wider than we previously anticipated due to softer external demand on the back of escalating
trade war between Russia and the EU. However, we see limited risks of a balance of payments crisis, as the government's marketfriendly
reforms will help anchor investor confidence and boost financial account inflows.
Table: Balance Of Payments
Fiscal Policy
Despite Grim 2014 Fiscal Outlook, Long-Term Prospects Brighter
Despite Serbia's grim 2014 fiscal outlook, the government's credible fiscal consolidation measures and pending IMF deal will anchor
investor confidence from 2015 onwards, underpinning the improvement in the country's fiscal and debt metrics.
Table: Fiscal Policy
Monetary Policy
Dinar Sell-Off To Slow Monetary Easing
Even though the outlook for inflation and economic growth in Serbia remains weak, the National Bank of Serbia (NBS) is likely to slow
the pace of easing in the coming months. The NBS has low tolerance for a weaker dinar - due to concerns over accumulated FX loans
in Serbia - and the recent fall in reserves will prompt greater use of interest rates to stem currency weakness.
Table: Monetary Policy

CHAPTER 3: 10-YEAR FORECAST

The Serbian Economy To 2023
EU Convergence Key
Serbia's convergence process with the more developed states of Western Europe is expected to continue apace over the long term,
with the harmonisation of the underlying domestic legal and regulatory framework with that of the EU being a fundamental factor driving
growth. This will lead to marked improvements in Serbia's business environment, enabling greater access to the export markets of EU
member states and enhancing the country's appeal to foreign investors in the process. That said, we caution that political instability,
particularly around Kosovo, poses the greatest risk to our forecasts, although the April 2013 agreement should go some way to cooling
tensions at a governmental level.

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Table: Long-Term Macroeconomic Forecasts

CHAPTER 4: OPERATIONAL RISK

Operational Risk Index
Operational Risk
Table: Operationa l Risk
Transport Network
Table: Emerging Europe - Transport Network Risks
Economic Openness
Table: Emerging Europe - Economic Openes
Table: Top Five Products Exported (USDmn)
Table: Top Five Trade Partners Product Imports (USDmn)

CHAPTER 5: KEY SECTORS

Consumer Electronics
Table: Consumer Electronics Overview
Retail
Table: Retai l Sector Spending (%)
Other Key Sectors
Table: Pharma Sector Key Indicators
Table: Telecoms Sector Key Indicators
Table: Defence and Securit y Sector Key Indicators
Table: Food and Drink Sector Key Indicators
Table: Autos Sector Key Indicators
Table: Freight Key Indicators

CHAPTER 6: BMI GLOBAL ASSUMPTIONS

Global Outlook
Big Emerging Market Revisions
Table: Global Assumptions
Table: Developed States , Rea l GDP Growt H, %
Table: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH FORECASTS, %
Table: Emerging Markets , Rea l GDP Growth , %

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