

# Serbia, Montenegro and Kosovo Business Forecast Report Q1 2015

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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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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.

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Long-Term Political Outlook

Unresolved Tensions Remain Despite Agreement With Kosovo

Unresolved regional tensions and a fractious domestic political environment are expected to continue to hang over Serbia's political risk profile over the long term. In turn, the country's EU accession prospects and economic growth profile could suffer as a result. However, owing to the large diplomatic presence in the region, which we expect to persist over the long term, we believe it is very unlikely that lingering disputes will devolve into open conflict.

### **CHAPTER 2: ECONOMIC OUTLOOK**

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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.

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### 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.

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#### 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.

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