

# Serbia, Montenegro and Kosovo Business Forecast Report Q3 2014

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## Abstracts

### Core Views

The new government is likely to embark on a fiscal consolidation drive motivated by a growing foreign debt burden and longer-term goals of EU accession. Although the budget shortfall will remain elevated in 2014, as the government makes one-off payments to smooth the planned restructuring and privatisation of state-owned enterprises, in the medium-to-long term, Serbia's fiscal sustainability prospects have brightened. As such, we forecast the budget deficit to narrow from 7.2% of GDP in 2014 to 2.7% by 2018.

Having gained EU candidate status on March 1 2012, Serbia began formal talks on EU membership on January 21, meaning that the path towards EU integration is firmly set. While this will provide an important policy anchor for the country and encourage much needed investment, problems in the contentious northern district of Kosovo – Mitrovica – will continue to bedevil Serbia's progress on becoming a member of the EU – which we do not expect to take place before 2020.

### Major Forecast Changes

We have revised our forecast for the current account deficit – we now forecast it to arrive at -2.4% of GDP in 2014, from 3.4% previously, and to 1.0% in 2015, from 2.4% previously on the back of the impressive performance of the export sector. Although the upbeat outlook for Serbia's exports will see the country's current account shortfall narrow in 2014-2015, we continue to forecast persistent current account deficits for the foreseeable future.

We expect the National Bank of Serbia to continue its rate cutting cycle in 2014 – from 9.50% at the time of writing to 8.75% by end- 2014 – as disinflationary demand-side pressures and tepid economic growth tips the balance in favour of looser monetary conditions.

### **Core Views**

As accession talks get under way, Montenegro will need to adhere to the EU's *acquis communautaire* accumulated legislation, which will require the incorporation and implementation of all EU norms and regulations into the country's legal system. Given the still substantial gap that needs to be bridged between the Montenegrin and EU legal systems, we expect that accession talks will last at least until the latter half of the decade.

Deleveraging is going to continue dragging on economic growth into 2014. Real GDP in Montenegro will slow in 2014 to 0.9%, before accelerating to 1.6% in 2015. Tighter credit markets will weigh on domestic demand in 2014, while the bankruptcy of the country's largest industrial plant will weigh on exports.

### **Major Forecast Changes**

We have adjusted our forecast for real GDP, and now forecast it to grow by 0.9% in 2014, from 1.6% previously, and by 1.6% in 2015, from 1.9% previously, as a tighter credit markets and the fallout from aluminium producer Kombinat Aluminijuma Podgorica's bankruptcy will weigh on domestic demand and the export sector.

### **Core Views**

An EU-brokered accord between Kosovo and Serbia represents the first official acknowledgement of the legal authority of Pristina over northern Kosovo by Serbia. Although tensions are likely to remain elevated, with unrest in the north remaining a risk, a major hurdle in the way of eventual EU accession is now cleared. The Kosovar economy faces significant challenges, including a low level of development and a very high level of unemployment, and Kosovo remains one of the poorest European economies in GDP per capita terms. However, recent progress towards eventual EU accession could boost long-term growth potential and expedite improvements in the domestic economy.

### **Major Forecast Changes**

We have revised down our 2014 real GDP growth forecast to 4.4%, from 4.8% previously, as growing tensions in the northern provinces ahead of municipal elections are likely to further hamper private sector spending.

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