From the Editor

The most important results of Serbia's economy this year are relatively high GDP growth, a slowed decline in inflation, and an increase in external deficits. In the EU, Serbia's most important economic partner, the economy stagnated, and inflation was brought down near the target level. Central and Eastern European countries achieved slightly faster economic growth but also slightly higher inflation. In the coming year, we expect Serbia to achieve somewhat higher GDP growth, slightly lower inflation, and a further increase in external deficits.

Serbia's economy, as a small, open economy, is strongly influenced by developments in the global economy, especially in the EU. According to prevailing forecasts, a slight acceleration of EU economic growth is expected in the next year, although there are risks that this will not occur. According to the latest estimates, Germany, the largest economy in the EU and Serbia's most important economic partner, will achieve growth of only 0.2% next year, which is significantly less than forecasts from a month or two ago. An additional problem is the growing evidence that Germany's economic issues are structural in nature and will take several years to resolve. Germany's economy, which was a driver of Europe's progress in past decades, is now facing technological lag in relation to China and the US in several important areas, burdened by high labour costs and, since the start of the war in Ukraine, high energy prices. The potential introduction of tariffs on EU products by the US would negatively affect the EU economy and, consequently, Serbia. A possible tariff war between the US and the EU on one side and China on the other would complicate the exports of Chinese companies operating in Serbia and reduce Serbia's attractiveness to Chinese investments. It is uncertain whether a truce between Russia and Ukraine will be established and geopolitical tensions eased or whether the conflict will escalate further, worsening relations between the West and Russia. Besides international risks, the potential deepening of political crises in Serbia could also negatively impact its economy.

We estimate that Serbia's economy will achieve GDP growth of between 3.6% and 3.7% in 2024, which represents a relatively good result in a year when European economies stagnated. The revision of the expected GDP growth rate for this year from 3.5% to 3.6–3.7% is a consequence of the GDP revision that changed the GDP structure by activity in 2023. Serbia's GDP growth in 2024 is significantly higher than the average of Central and Eastern European countries, which stands at around 1.5%, with only Croatia and Albania expected to achieve similar growth to Serbia.

This year's GDP revision for Serbia, covering the period 1995–2023, resulted in an average increase of about 5%, which, along with the previous two revisions, has led to GDP being revised upward by 15–20% in most years during this period. This implies that economic policy decisions over the past three decades were made based on significantly underestimated GDP figures, leading to some suboptimal or incorrect decisions. Therefore, in the coming period, one of the priorities should be improving the work of the Statistical Office of the Republic of Serbia to provide reliable real-time information on Serbia's economic condition.

The main driver of Serbia's economic growth in 2024 is domestic demand, i.e., investments, private, and public consumption, while net exports negatively impacted growth. In the context of EU stagnation, which represents Serbia's most important economic partner, relying on domestic demand growth is justified. However, in small, open economies, domestic demand can be a growth driver for a relatively short period, as increased domestic demand results in rising external deficits and inflation, as well as growth in Serbia's external and public debt. Economic growth in Serbia in 2024 was relatively broad-based across sectors. All sectors except agriculture achieved growth, with IT services and telecommunications maintaining consistently high growth throughout the year, while other sectors experienced significant fluctuations during the year. Growth in construction and traditional services (trade, transportation, hospitality) slowed during the year, while industrial production growth accelerated.

For 2025, we estimate that Serbia's economy will achieve GDP growth of about 4%. The main driver of GDP growth in the coming year will be domestic demand, i.e., investments, private, and public consumption, while the impact of net exports will be negative. The negative impact of export demand on economic growth is a consequence of the stagnation of European economies and the weakening of Serbia's price competitiveness due to the strengthening of the dinar and rising unit labour costs.

Year-on-year inflation in 2024 decreased from 6.3% in January to 3.8% in June, after which it fluctuated between 4.3% and 4.5%. Cumulative inflation in the second half of the year will be at a similar level to the first half, indicating no significant downward trend in inflation within the year. The largest contribution to inflation this year came from services and a heterogeneous group of other products, while food prices influenced inflation in the second half of the year. The rise in service prices is largely a result of wage growth, which has a significant share in service cost structures, while the increase in food prices is due to drought conditions. Serbia will be among the four or five countries with the highest inflation in Europe this year, influenced by strong domestic demand growth, but also cost pressures stemming from wage increases and higher administratively controlled prices (utility services), while the strengthening of the dinar and falling energy prices contributed to slowing inflation.

In 2025, a continued slow reduction in inflation is expected, remaining within the upper limit of the target corridor. Cost pressures from wages are expected to weaken, while the impact of domestic demand on inflation will remain relatively strong. Based on this, we estimate that average inflation next year will be around 4%.

The current account deficit in 2024 will likely be between 5.5% and 6% of GDP, representing a significant deterioration compared to the previous year. Within 2024, the current account deficit experienced substantial growth—from less than 3% of GDP in the first half of the year to 10.5% of GDP in the third quarter. Deterioration occurred across all components of the current account balance: the trade balance deficit increased, outflows of capital income rose, and remittance inflows declined. The deterioration in the trade balance is due to Serbia's reduced price competitiveness caused by the appreciation of the dinar and faster wage growth compared to productivity growth, as well as increased domestic demand. The rise in outflows of funds through dividends and interest payments is a result of the growth in the value of foreign capital in Serbia and the increase in external debt. The outflow of capital income in the first ten months of this year was approximately equal to the value of foreign direct investments during the same period. In the coming years, capital income outflows are expected to grow as the value of foreign loans and capital invested in Serbia increases. The decline in secondary income is considered temporary and is likely a result of stagnation and recession in countries where the majority of Serbia's emigrants work.

In the next year, a moderate increase in the current account deficit is expected, as the trade balance deficit and capital income outflows will rise, while the trajectory of labour income (remittances) will depend on the recovery of European economies. A prolonged increase in the current account deficit can be expected if the policy of stimulating the economy through domestic demand growth continues, along with the strengthening of the dinar and faster wage growth compared to productivity growth.

In the labour market in 2024, short-term trends are predominantly positive as real wages achieve high growth, employment rises, and unemployment decreases. It is positive that labour productivity is growing relatively quickly, but real wage growth is significantly faster, resulting in rising unit labour costs. Unit labour costs in Serbia have been increasing for several years, undermining its international competitiveness and creating inflationary pressures.

In 2025, with the expected GDP growth of around 4%, moderate growth in employment and productivity is anticipated, along with a slowdown in real wage growth and unit labour costs. The slowdown in real wage and unit labour cost growth will be influenced by moderate wage increases in the public sector and inflation stabilization within the target corridor.

The planned fiscal deficit of 3% of GDP in 2025 is high but corresponds to Serbia's economic situation and the stagnation of European economies. A relatively high fiscal deficit will stimulate economic activity and employment but also increase external deficits while slowing the decline in inflation. A significant exceedance of the 3% deficit, which is possible through ad hoc measures such as subsidizing housing loans for young people or increasing subsidies for public transport companies, could destabilize Serbia's fiscal position. A 3% GDP deficit is not sustainable in the long term, so a gradual reduction of the deficit to the level defined by fiscal rules will be necessary in the coming years. Fiscal policy for 2025 does not contain significant structural changes to address the developmental and social challenges facing Serbia. Investments in key sectors for catching up with developed countries, such as education, scientific research, and environmental protection, have not significantly increased. Similarly, tax and expenditure policies lack measures to alleviate poverty, reduce economic inequality, and increase social mobility.

Although the National Bank of Serbia formally continues to implement an inflation-targeting regime, maintaining the dinar's exchange rate against the euro at an approximately fixed level represents one of the key levers of monetary policy. A fixed exchange rate policy is one of the relevant alternatives for a small, open, highly euroized economy like Serbia's. However, for such a policy to yield good long-term results, other policies, especially fiscal and income policies, must support the fixed exchange rate. This means that fiscal policy must align domestic demand with economic activity and ensure that real wage growth corresponds to productivity growth. If a fixed exchange rate policy is applied over a long period while expansionary fiscal policy is pursued and real wages grow faster than productivity, the result will be increased external deficits and inflation, as well as a relatively rapid alignment of prices in Serbia with those in developed European countries. Such economic policies increase the risk of macroeconomic instability and negatively affect economic growth.