EY Macroeconomic Pulse

Trends and outlook in the Serbian economy

October 2024

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1 Executive summary

Growth intensifies driven by rising consumption and public capex, inflation returns to relatively low levels and credit activity revives

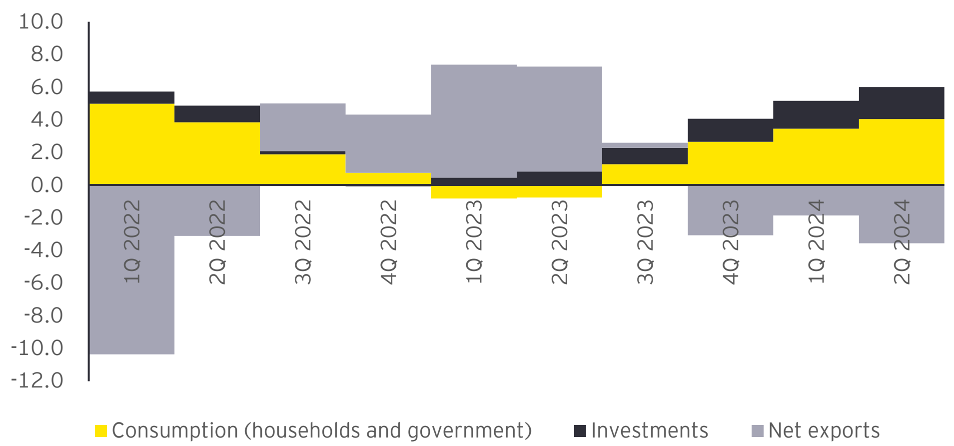
Serbia's economic growth speeding up since mid 2023 on heating household consumption and public CAPEX. Real growth plausibly reached cca 4% YoY in the first three quarters of 2024, following a milder 2.5% growth in 2023 and 2022. Behind this speedup is a fiscal expansion, reflected in real increase of public sector wages (+6% YoY in H1 24 in real terms) and pensions (+15% YoY), but also in an increase in private sector wages (+8%) on tight labor market (deficit and inflow of foreign workers) – all these factors building into an improved household demand. As for investment activity, its contribution to growth is positive, on strong public CAPEX, and solid FDI, while private domestic investment remain subdued, especially by manufacturing exporters.

Unemployment continuously recedes. The unemployment rate dropped to 8.2% in Q2 24, or cca 1pp lower than at the end of 2023. In absolute terms, the number of the unemployed decreased to 256 thousand, or nearly 40 thousand less than at the end of 2023 – suggesting that most of the remaining unemployment might be structural.

Annual inflation slows down, prompting the start of monetary easing. Prices rose by 4.3% YoY in Aug-24, receding from 7.6% at end 2023, and 15.1% at end 2022. A slower pace of inflation, and its retreat to NBS' targeted corridor band of 3% ± 1.5%, left room for the central bank to start the easing cycle, in which it has decreased key rate by a total of 75bp to 5.75% since its start in June-24. However, some remainders of monetary restrictiveness remain in play, as real interest rate remains relatively high (approx. 1.5% by end Aug-24), while RSD has appreciated in real terms by 2-3% YoY.

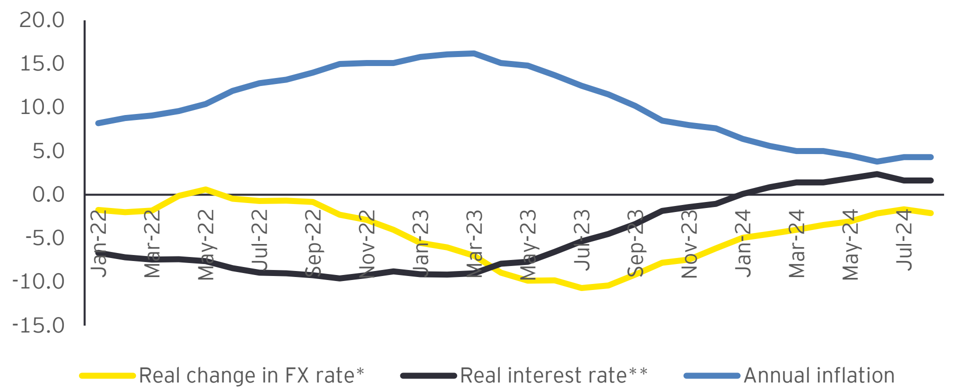
Credit activity speeding up since late 2023 but liquidity in banking sector remains elevated. Lending stock rose by cca 6% YoY by end Aug-24, up from 1% increase in 2023 – much of this increase owing to cash, consumer loans in retail and to liquidity in corporate segment. Despite a speedup in lending, banks' liquidity at disposal remains very high – Serbia's banks held nearly EUR 4 b in REPO in average throughout entire 2024 so far, against merely EUR 1-1.5 b in early 2023 – suggesting the still very high reserves of liquidity throughout the system.

Growth model: contributions by key aggregates (in pp)



Source: SORS, EY calculation

FX rate and NBS key rate (in %)



*Calculated as annual rate of change in the index of Real exchange rate, which is provided by Breugel (2024). Negative values point to appreciation (strengthening) of RSD relative to a basket of relevant currencies
** Real interest rate obtained as nominal rate adjusted for inflation rate

Source: Breugel, SORS, NBS, EY calculation

Growth is stronger, but of a different structure – as it is now prevailingly driven by retail trade, public-CAPEX related construction and activity in some emerging sectors such as mining. Economy will plausibly keep expanding by a similar rate in the near term, but risks to this scenario remain elevated

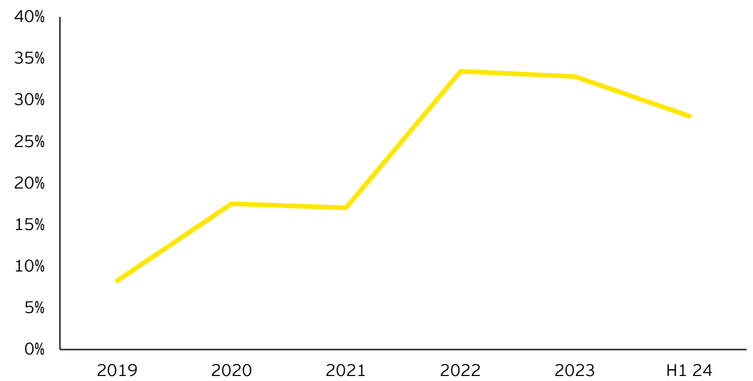
Serbian economy undergoes structural changes. Economic growth in 2024 speeds up to relatively strong levels, even amidst softening demand in key trading partners in EU. This effect is seemingly buffered by a rising presence of some non-EU players, such as China. Its share in inward FDIs and in exports rapidly is increasing in the past several years, and which is contributing, on the supply side, to mining and construction sectors, and to export demand for raw materials. On the other side, the recent massive inflows of mainly Russian citizens positively impacts the ICT on the supply side, while also pushing up local demand for real estate and consumption. Weather also exerted very negative impact on economy in 2024, especially on agriculture and energy sectors, while its increasingly adverse impacts might structurally impact economy in the future.

In remainder of 2024 and in 2025, economy is likely to keep hovering around 4% on expansionary fiscal policy and ambitious public CAPEX and recent export-impacting investment cycle, on the positive side. Fiscal room is for now very ample, while public investment projects ahead of the 2027 EXPO are very ambitious, which could help sustain the ongoing pace of investment activities – solid fiscal position is also mirrored in the recent increase of Serbia's credit rating to investment grade (BBB-) with S&P. In parallel to this, we anticipate the consumption to keep exerting positive contribution, as imply the announcements of further hikes of public sector wages and pensions. Net exports might also improve on the back of the recent investment activity in mining and some industrial sectors, such as automotive.

Yet, there are important risk factors to be considered and watched due to their impact on export and investment prospects, especially given already weakened domestic private investments. Such risk factors might include, among other, ongoing geopolitical tensions, relatively tepid growth of traditional trading partners in EU (e.g. recession in Germany), all coupled by increasingly frequent and devastating weather conditions. Also, the ongoing real appreciation of RSD, coupled by a strong real increase in wages, volatility in energy prices, all with the still high financing costs, do not bode well for export competitiveness, especially in mid-tech manufacturing sectors – of which many are domestic SMEs.

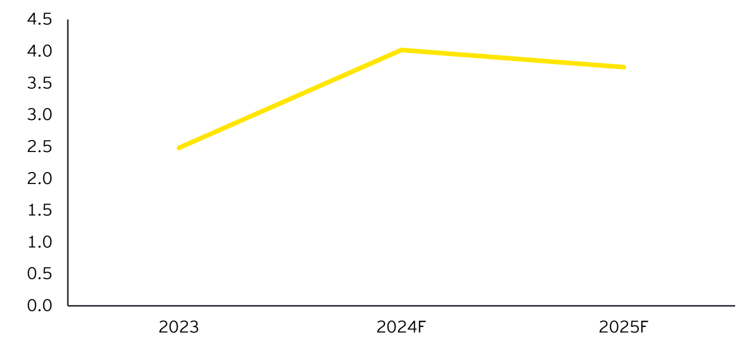
For a thorough, sector and firm-level perspective of these trends, please refer to our complementary publication EY Business Pulse.

Chinese FDI in % of total inward FDI



Source: NBS, EY

Forecasted GDP growth in the near term



Source: EY

2

Economic activity

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Strong consumption and public CAPEX are key growth drivers, while export demand and weather conditions weigh down – strong performance in retail and construction, but very poor output in drought-struck sectors, such as energy or agriculture

Serbian growth speeds up since mid 2023, as economy expanded by 2.5% YoY in 2023 and 4.3% in H1 2024, as reported by SORS, while in Q3 24 it seems to have hovered around 3.5-4%, for a total of approx 4% in the first three quarters.

When observing growth from the perspective of consumption aggregates, the ongoing speedup is largely driven by:

- **Recovering local consumption**, on the back of the:
  - Increasing real wages in both public and private sector and pensions
  - Rising employment and tight labor market
- **Strong investment activity** – which is now driven more by public capital expenditures than by private – sector related construction of real estate and commercial real estate, as was the case until recently
- **But against negative contribution of net exports**, with export demand in key trading partners in EU being subdued. Meanwhile, imports rising much faster on stronger local consumption and investment cycle in some industrial sectors, such as automotive.

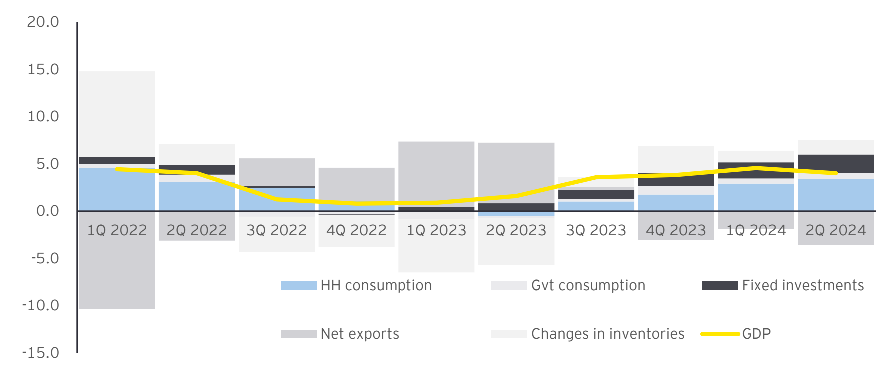
When growth is observed from a sectoral perspective several areas of activity have been providing especially strong contribution to overall growth in recent quarters:

- **Retail trade** – on improving household demand. The latter is also fueling growth in other services, which are also buoying.
- **Construction** – large infrastructure and building projects
- **ICT** – strong export-driven growth coupled by inflows of large international companies on local market

Against a particularly negative contribution exerted by:

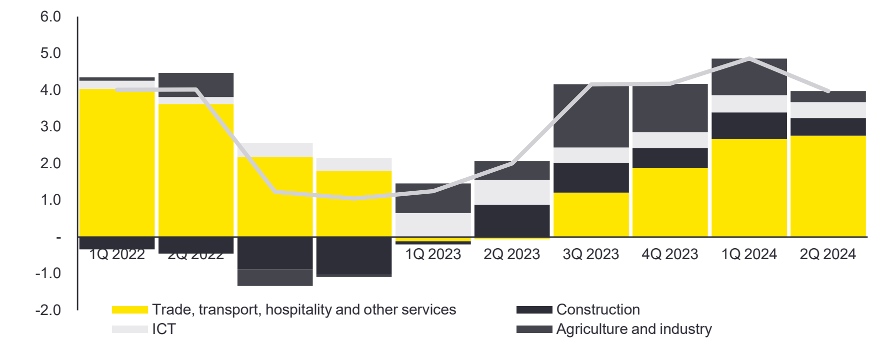
- **Agriculture** – on extremely adverse weather conditions
- **Energy** – also related to weather – related decline in hydro output

Structure of GDP growth: consumption approach (contribution to overall GDP growth in pp)



Source: SORS, EY calculation

Structure of GVA growth: production approach (contribution to overall growth of GVA in pp)



Source: SORS, EY calculation

International environment in 2024 is characterized by sluggish growth in Serbia's key trading partners, but also with an increasing presence of new non-EU players at local markets. Meanwhile, global inflation recedes and interest rates start to lower

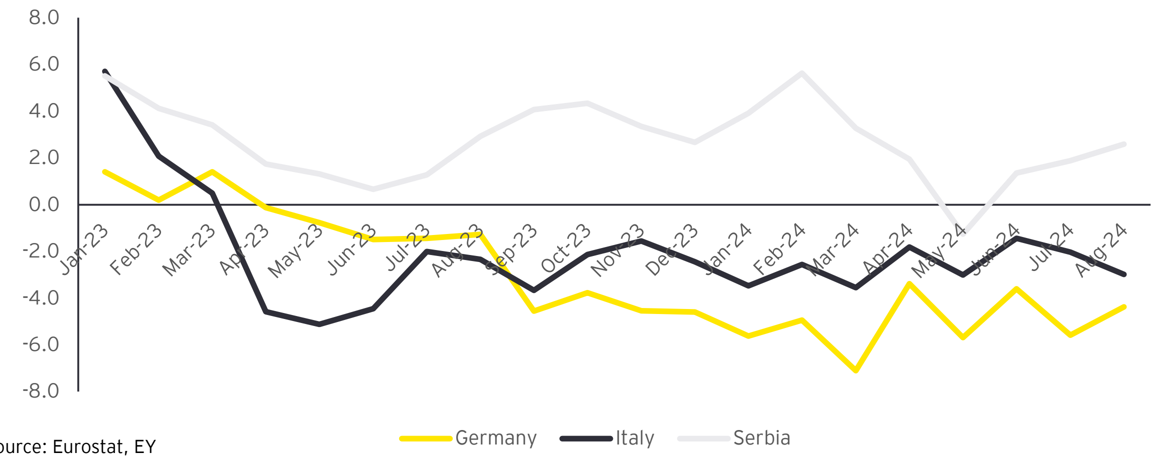
Traditional trading partners' growth stalls. In some of the key EU economies, like Germany or Italy, growth slows down to stagnation or recession, largely on the back of contracting investment activity – which has a negative effect on the demand for Serbian goods.

However, this is somewhat compensated by a changing structure of Serbia's trade and investments. Some non-EU players, such as most notably China, are increasingly present in Serbian markets – for instance, China's inward investments to Serbia almost quadrupled between 2019 and 2023, while its share in Serbia's exports rose three-fold.

Monetary easing globally starts from mid 2024. As annual inflation decreased from the 2022 highs, many key central banks, including FED, ECB, China central bank or NBS started to ease monetary restrictiveness from mid 2024 onwards – to provide additional stimulus to economic growth via reduced financing costs.

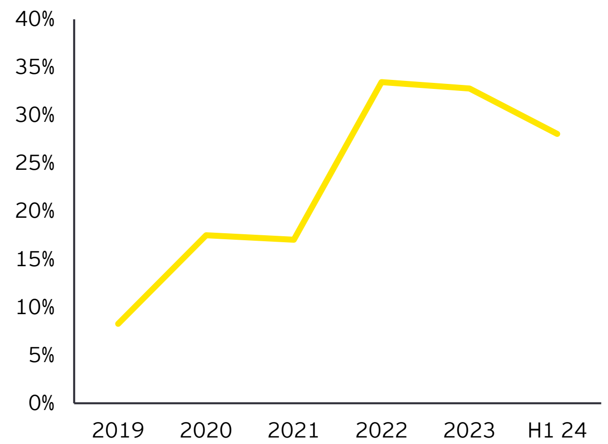
However, inflationary resurge still cannot be ruled out. Geopolitical tensions and conflicts in strategic regions across the world might occasionally lead to resurge in some of the key price categories, such as fuel or cereals. This said, a more tangible monetary easing, and retreat of interest rates towards the pre-2022 levels might require more stable geopolitical environment.

Industrial production (in % YoY, 3MMA)

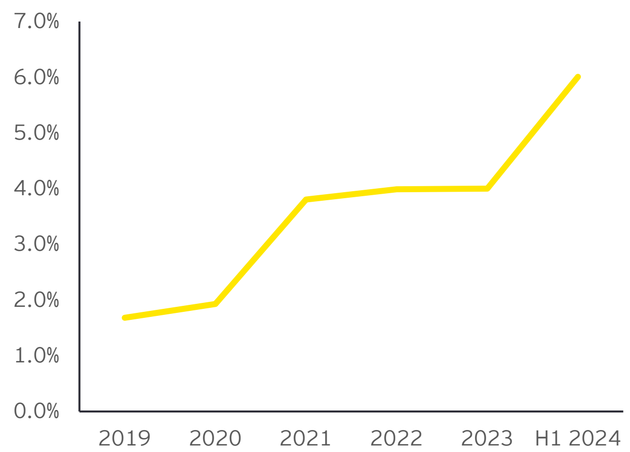


Source: Eurostat, EY

Chinese FDI in % of total inward FDI



Serbian exports to China in % of total



Source: SORS, NBS

Weather conditions are exerting an increasingly negative effect on economy. Heat is increasing, precipitation is decreasing, which exerts direct negative effect on energy and agriculture, as well as indirectly on many other sectors.

Weather conditions significantly diverge from historical averages. The key weather – related indicators in the recent period are characterized by the following:

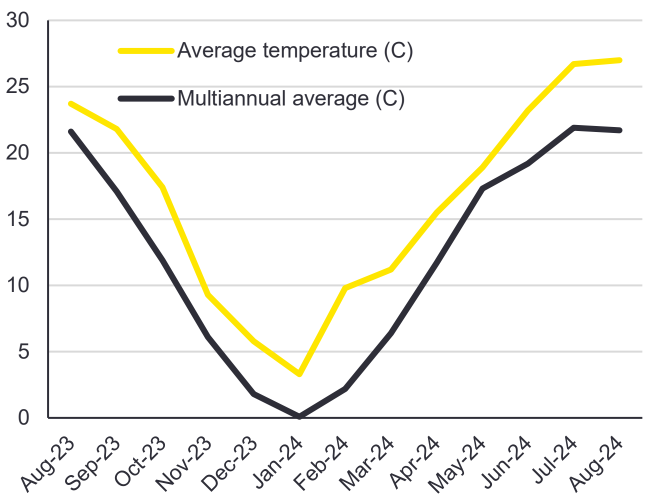
- **Significantly warmer**: Average temperature in each month of 2024 was app 3-5 C above the multiannual average
- **Significantly dryer**: total precipitation in almost each month below multiannual average, while in Aug-24 only reached merely 5% of the average!

Adverse weather results in heavy drought. The heat and lack of precipitation is causing relatively strong drought. Out of 12 months between Aug-23 and Aug-24, there were are many as 8 months characterized by drought, of which 4 were around or beyond extreme drought levels.

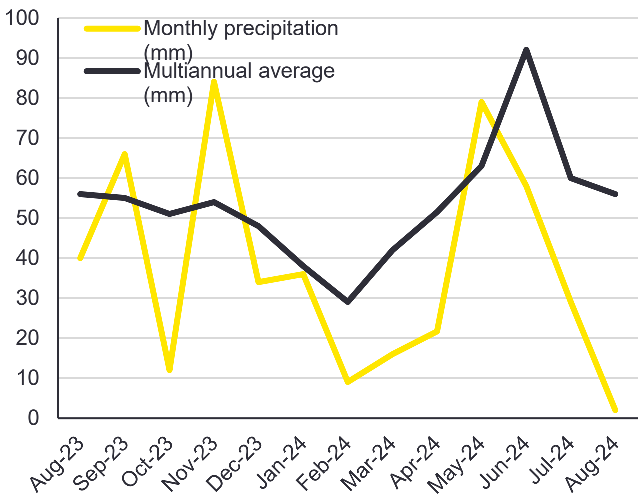
Heavy drought affects most sectors. Directly affected are the agriculture and energy sectors – as for the former, it directly lowers the yields across key crops; and for the latter, it decreases production of electricity in the hydro power plants, which generate approximately a third of Serbia's electro output. However, it also indirectly affects more sectors – especially those across manufacturing industry.

While weather conditions change across the world, the changes seem to be more severe in Serbia than elsewhere. Weather conditions on a global scale are characterized by rising temperatures and increasingly frequent extreme climatic events – such as heatwaves or extreme rainfall. However, these changes seem to be stronger in Serbia than in other regions, as reports the recent UNDP study.

Temperatures vs long term average

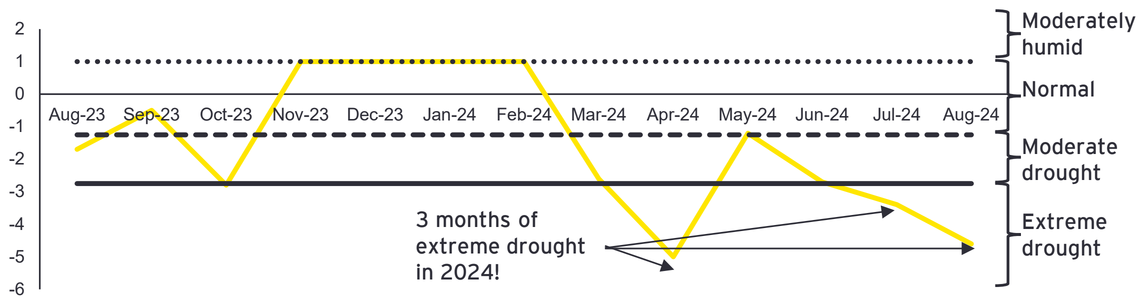


Precipitation vs long term average



Source: Republic Hydrometeorologic Service of Serbia. The data relate to statistics on climate conditions reported in and around Novi Sad. Multiannual data refer to an average for the period 1981-2010

Palmer drought index*

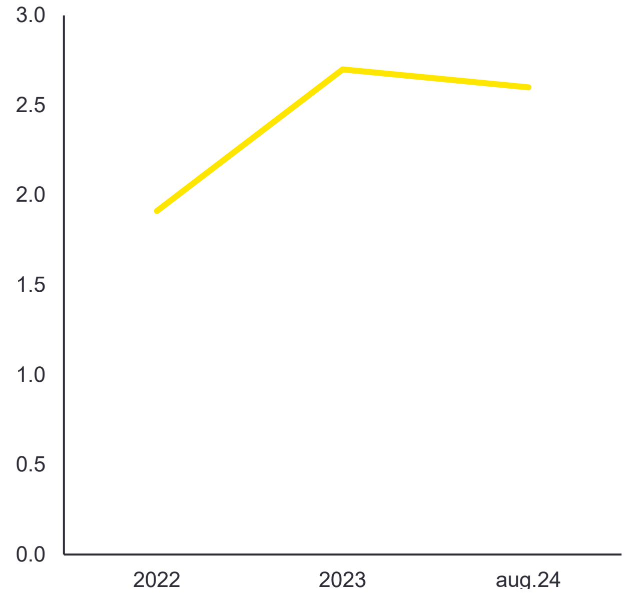


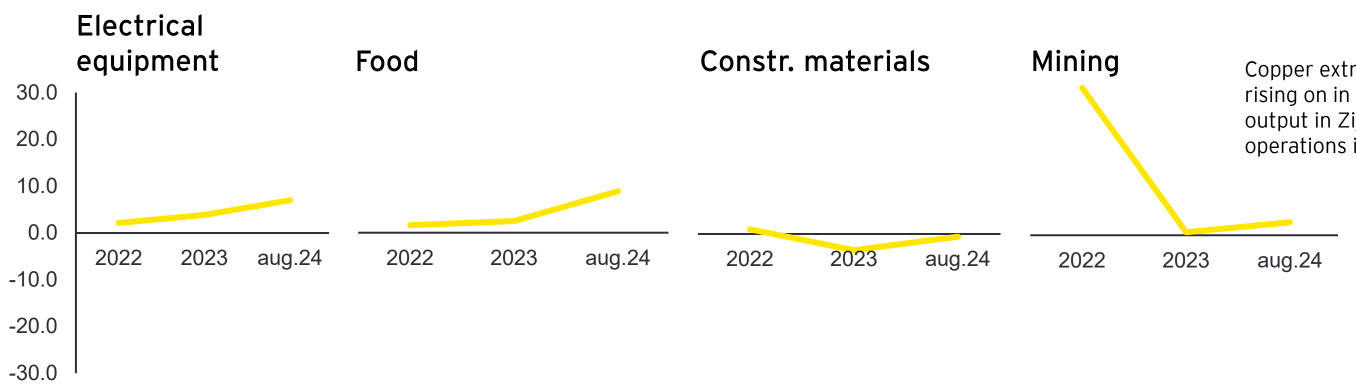
Source: Republic Hydrometeorologic Service of Serbia.
* Palmer drought index measures drought by using temperature and precipitation data to estimate dryness, based on temperature and precipitation data. It ranges from -2.5 and below (extreme drought) and 2.5 and above (extreme humiditiy)

Sluggish growth of industrial output in 2024, but with an increasing mine and basic metals production. Several sectors affected by decreased EU demand and by adverse weather, somewhat compensated by production in mining, basic metals and automotive

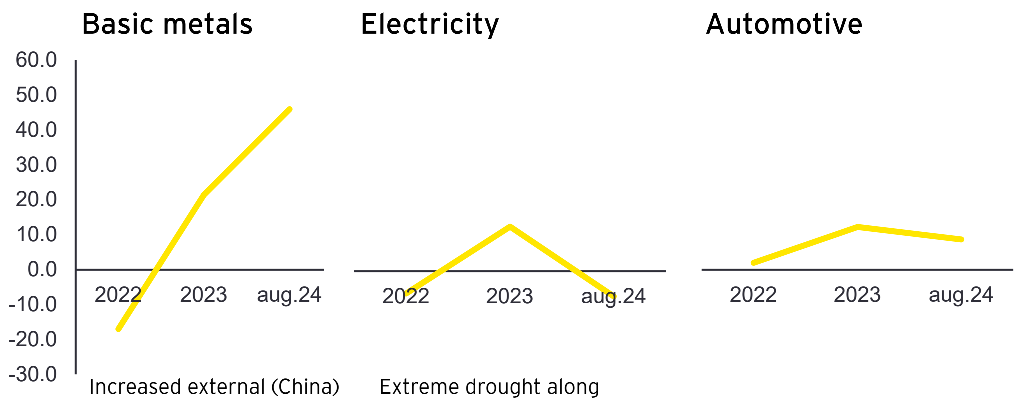
Growth of industrial output in key sectors (YoY)

Total industry





Copper extraction rising on in increasing output in Zijing operations in Bor



Increasing car part production. Stellantis' plant in Kragujevac was announced to start production of new EV Panda from Sep-24, but there may be some delays

Increased external (China) demand for basic metals (steel, copper...) pushing up the production, but also supported by statistical effect – as one of the two blast furnaces closed in 2022

Extreme drought along most of 2024 curbing hydro production

Source: SORS, EY

A speedup in retail trade seems to be one of the key drivers behind the recent economic rebound. Recovering trade largely owes to soaring wages and pensions in real terms

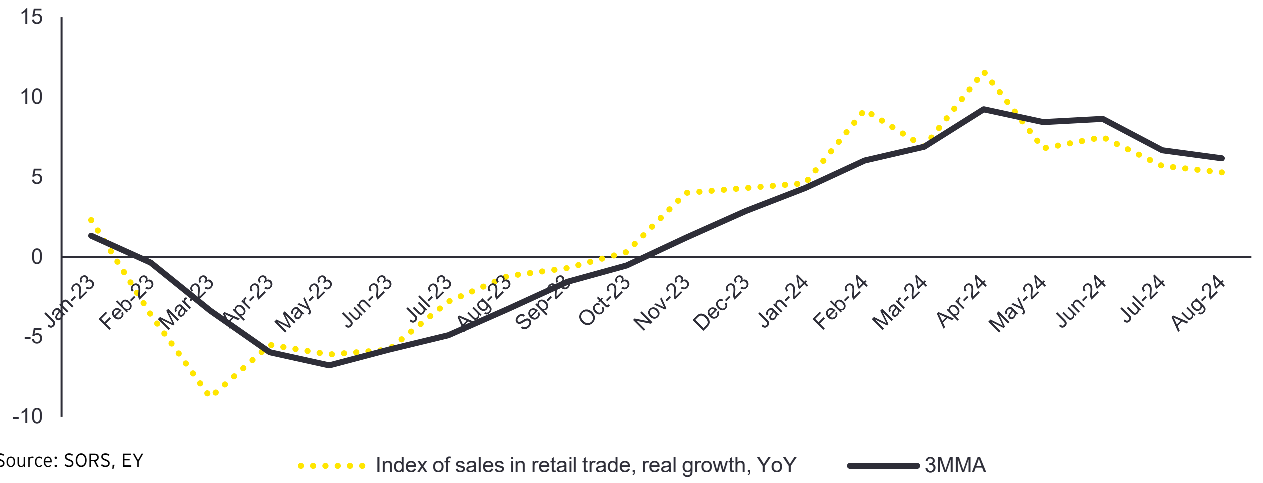
Retail trade has been speeding up since mid 2023, on the back of the improving household consumption – increasing wages and decreasing unemployment. In such circumstances, retail trade rose by 7.1% YoY in real terms in 8M 2024.

Massive inflows of foreign citizens from 2022 provides another support for ongoing increase in retail trade.

Tourism also resurges, as an increased number of tourist arrivals – there were 15% more tourists YoY in 8M 24.

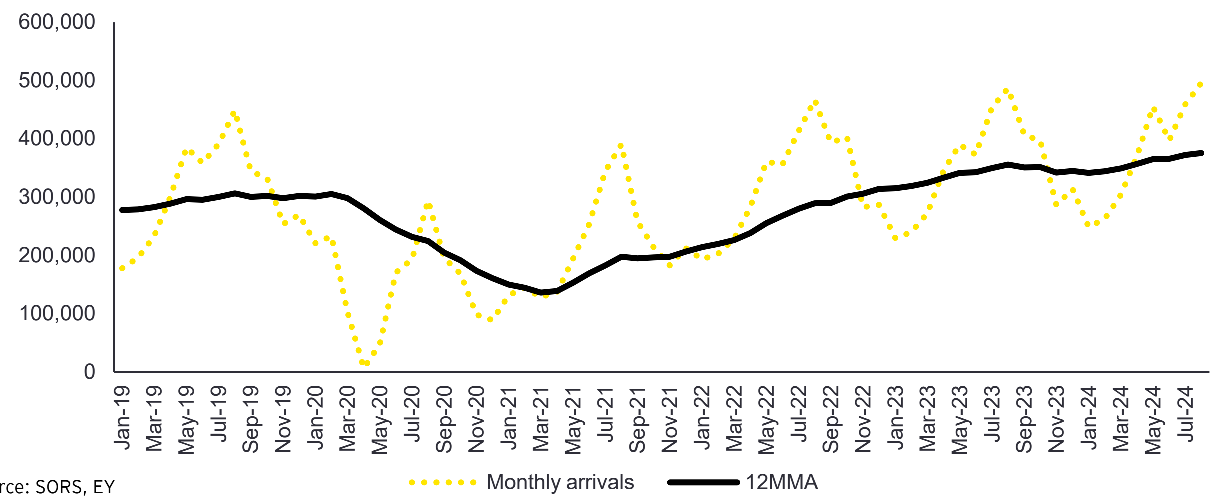
The trend will likely prolong into 2025, as newly announced increases of wages and pensions for later in 2024 and 2025 might help keep the high pulse in the retail sector.

Real growth of retail trade (in % YoY)



Source: SORS, EY

Monhtly arrivals of tourists



Source: SORS, EY

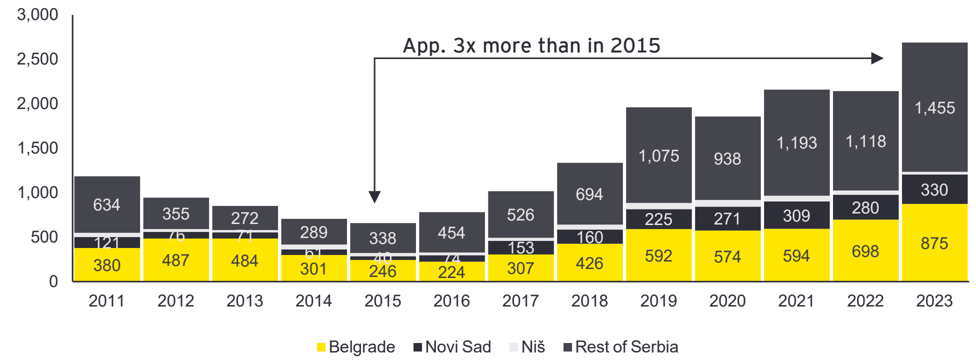
Construction keeps expanding at high pace, but its structure appears to be changing. The activity in the sector now seems to be driven by infrastructure projects, while construction of real estate and housing appears to be gradually cooling down

Construction sector is one of the key drivers of growth recently. It has been a major contributor to economic growth at least since 2016, predominantly amidst a boom in private (residential, office, retail) projects. For instance, the area of annually constructed residential buildings has more than tripled between 2015 and 2023.

Public CAPEX now intensifies and takes the primary role in construction activity. While construction activity continues to grow by a very strong pace, it seems that it is now predominantly contributed to by public investments, such as construction of transport or energy infrastructure. This will likely prolong into the near future, as suggest the Gvt' plans set out by the reshuffled 2024 Budget and by the 2025-27 Fiscal strategy, all ahead of the major EXPO 2027 exposition.

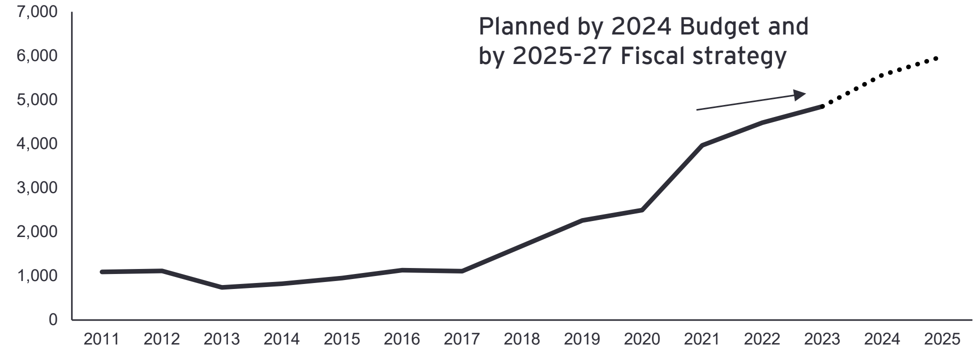
In the same time private activity seems to be wearing off: growth rate of construction permit issuance quasi stagnates, as rate of construction permits for residential and commercial buildings drops by 0.7% YoY in 7M 2024, following a 5.5% increase in 2023.

Private construction: area of constructed residential buildings (000 m2)



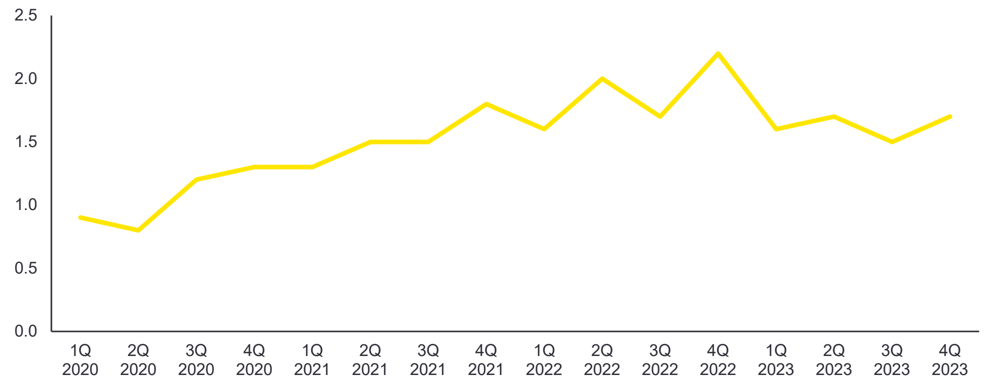
Source: SORS

Public construction: consolidated state CAPEX (EUR m)



Source: Mfin

Vaue of real estate market (in EUR b)



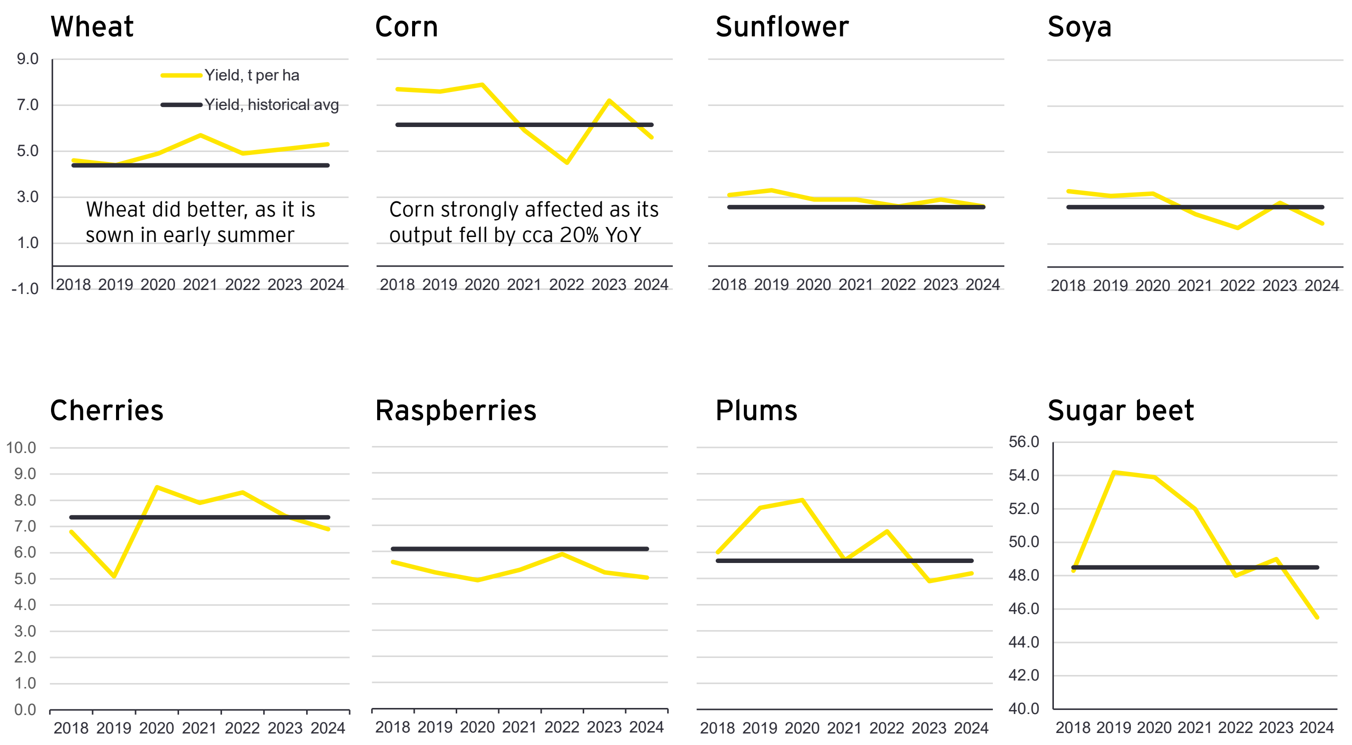
Source: Republic geodetic authority

Agricultural production in 2024 slumped after a mediocre season in 2023. Very adverse weather conditions in 2024, including extreme drought affected agricultural output; output of corn, sunflower and most fruit crops is especially hard hit

The agricultural season of 2023 was mediocre – the production of field crops was around the average, and the production of fruit crops was very poor. Weather conditions during 2023 were relatively favorable for the cultivation of most field crops, especially corn, whose yield was almost 60% higher than in 2022. However, the weather was unfavorable for fruits: a warm winter followed by a severe spring frost led to a sharp decline in the production volume of most key crops, such as apples or raspberries, by 20-30% relative to 2022.

However, the season of 2024 was extremely poor – field and fruit crops were the hardest hit. Extremely unfavorable weather conditions, including extreme drought, led to a decline in production volume in the majority of key crops across the country. Particularly hard hit was production of crops harvested in late summer or early autumn – for example, corn, sunflower, or sugar beet, as well as most fruit crops. Thus, the production volume of corn decreased by about 20% compared to 2023, soybeans by about 30%, and key fruit crops, such as apples or raspberries, achieved similar production as in the very poor 2023.

Yield in key agricultural cultures



Source: SORS

Looking ahead – we expect Serbian economy to keep its pace in 2024 before mildly slowing down in 2025. Consumption, public CAPEX and government spending, will remain key drivers of Serbia's economic growth in the mid term, against a set of mostly exogeneous risks

Serbian economy could keep pace of growth in near term and slightly slow down in 2025: our base case sees growth at level of 2024 at 4%, before slightly slowing down to 3.8% in 2025.

Growth model would remain unchanged – it would keep being driven by household consumption, investments and government spending, against a negative contribution of net exports.

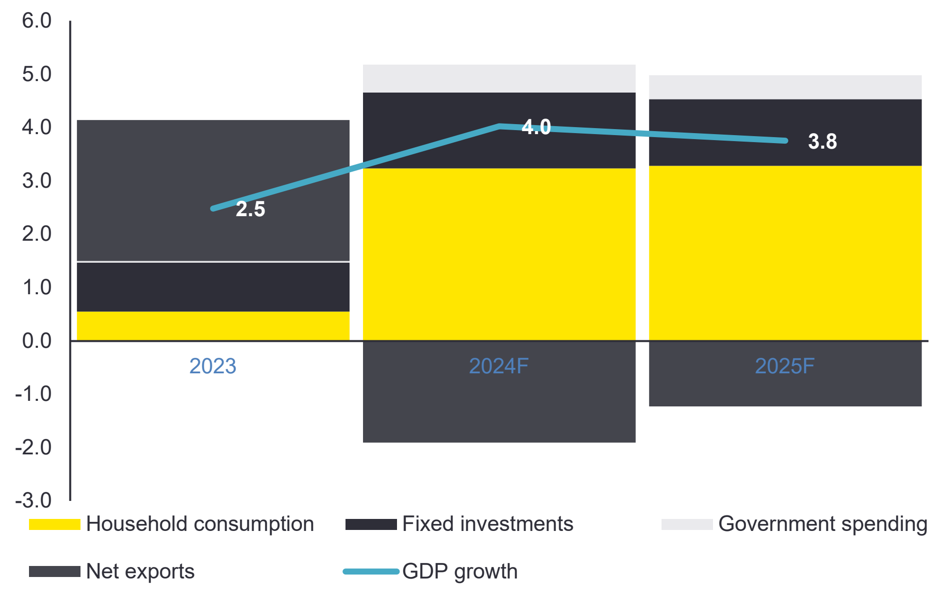
- Fiscal picture looks positive, with a relatively large fiscal surplus in 8M 2024, and S&P improving Serbia's rating to investment level – leaving ample room for increases in public CAPEX, public wages and pensions, boding well for consumption, investments and government spending. Additionally in context of public infrastructure – while their construction contributes directly to growth, better quality and more available public infrastructure may contribute to higher efficiency of all businesses in mid to long term.
- **Exports would gradually improve, as Serbia diversified its investment and trading portfolio,** with an increasingly visible presence of non-EU actors, such as China. Also, the economic growth is expected to improve in EU itself. Adding to this is an expected increase in exports in some sectors like mining and automotive which have been intensively investing.

We expect interest rates to continue sliding towards pre-2023 levels, as inflationary pressures gradually subside. We expect annual inflation to end 2024 at around 4.5% and to move towards app 3.5% at end of 2025, as global and local markets normalize after the recent inflationary episode, while statistical effect is waning out.

However, risks to the base case remain elevated:

- **Geopolitical tensions keep mounting,** potentially provoking a resurge in inflation
- **Recovery in the EU** – Growth in Serbia's key trading and investment partner – is still relatively tepid – limiting the demand for local goods and services and investment inflows.
- **Devastating weather conditions** in Serbia and the wider Western Balkans region are increasingly frequent and could provoke sporadic shocks in output in some sectors, such as energy or agriculture

Contributions to growth per aggregates of consumption (in pp)



Source: SORS, EY

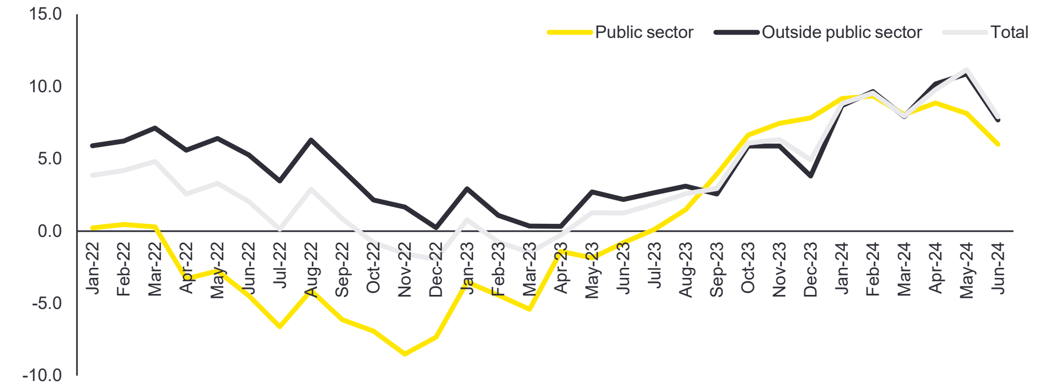
Labor market is increasingly tight, with lowering unemployment and soaring wages. Strong wage growth reported in both public and private sectors, while job openings are increasingly difficult to fill across most sectors

Wages have been soaring along 2023 and 2024, both in the public and private sectors.

The trend is likely to pursue in the forthcoming period, as the Gvt announces a series of wage and pension hikes for later in 2024 or 2025, including a minimum wage hike.

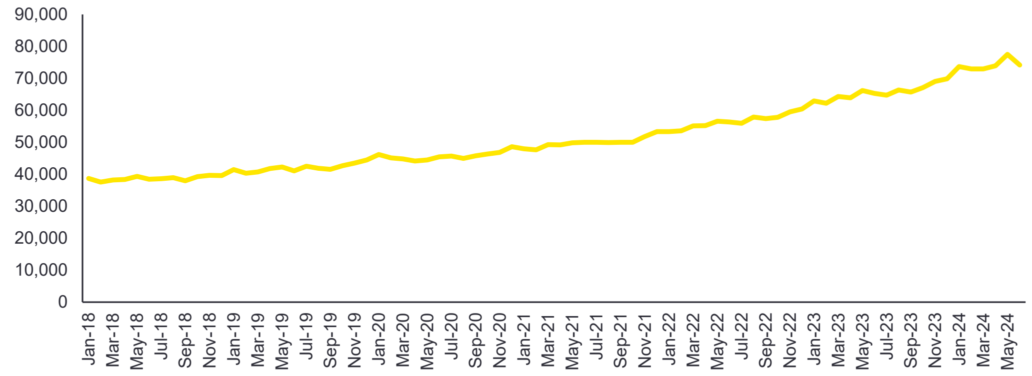
Job openings are increasingly difficult to fill, as widely reported across many sectors. The number of the unemployed fell to merely cca 250k, or almost a 100k lower than 5 years ago. Moreover, it seems that across several sectors – ranging from ICT to hospitality to logistics – migrant workers fill an increasing part of job openings.

Real YoY growth of average wages (in %)



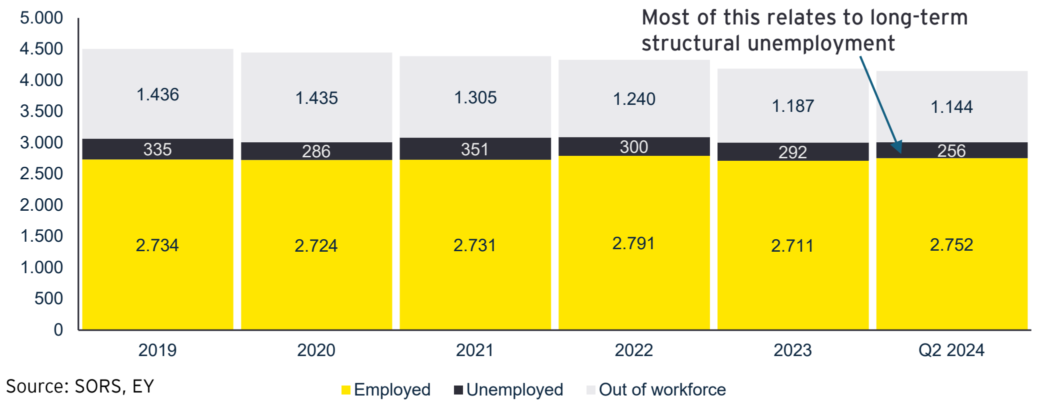
Source: SORS, EY

Median wage (net, RSD)



Source: SORS (Labor force survey)

Structure of working age population between ages 15 and 64 (in 000)



Source: SORS, EY

4

Trade and balance of payments

EY

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Trade gap widens along 2024 as import growth outpaces exports.

Exports seem to be subdued on external demand, local weather conditions and export competitiveness, while imports increase likely owes to resurging local demand and to upgrades of some industrial objects

Export rise by a sluggish pace. They increase by less than 1% YoY in 8M 2024, against the backdrop of:

- Softened EU demand
- Poor hydro conditions affecting electricity and agri output
- Somewhat weakened export competitiveness: RSD strengthening against EUR coupled by soaring wages in private and public sectors

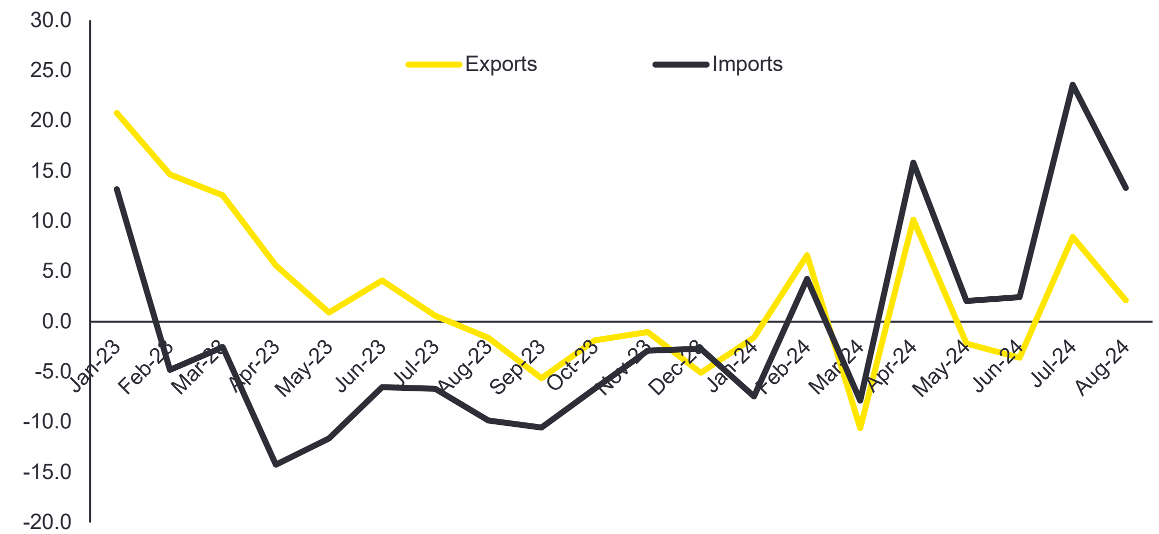
Imports rise more dynamically, by app 5% YoY, in a context of:

- Increase of imports of capital goods and machinery of nearly 20% YoY – against the backdrop of investments in automotive, petrol and some other industries
- Increase of imports of consumer goods of nearly 8% YoY, related to recovery in household demand

On balance, export gap widens:

- Exports rose to EUR 19.2 b in 8M 24, imports rose to EUR 25.4 b
- ....so the deficit tops EUR 6.2 bn, or as much as EUR 1.1 b more (+22% YoY)

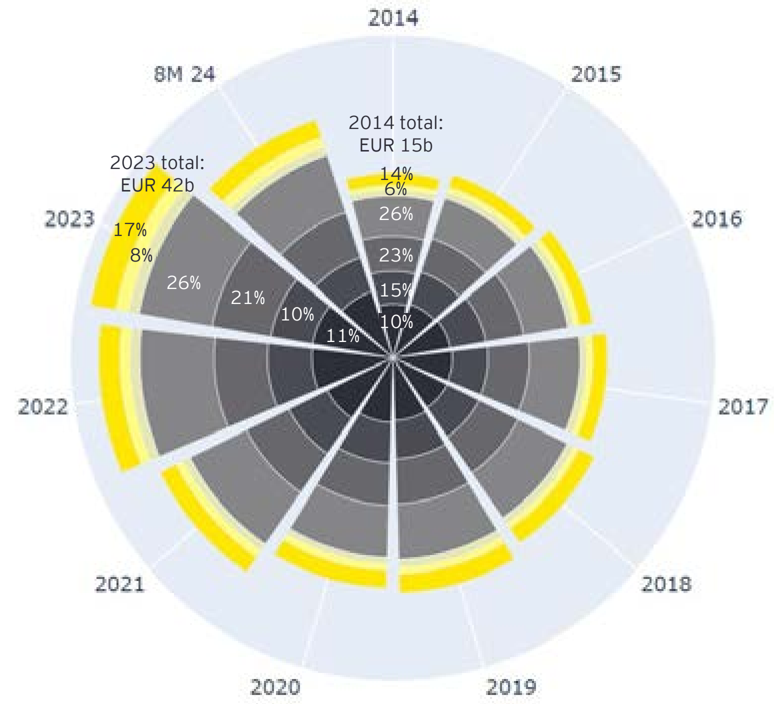
Overall dynamics of exports and imports (in % YoY)



Source: SORS

The structure of foreign trade is increasingly complex, with services, higher – tech manufacturing, but also some extractive industries like mining taking up more and more significance in both export and import

Export

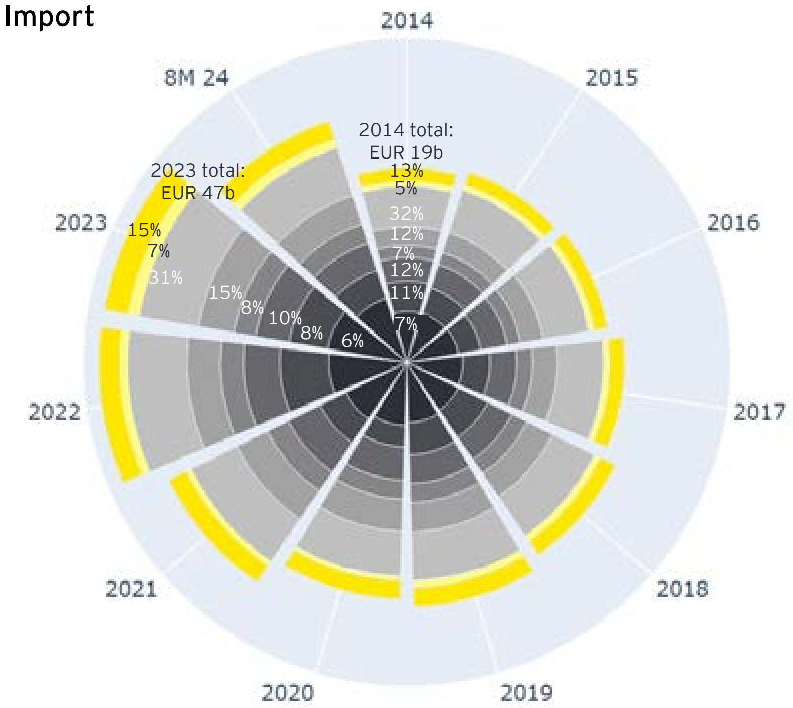


Category
- Mining, basic and fabricated metals
- Agriculture, food and beverages
- Automotive and related*
- Other goods
- Tourism
- ICT
- Other services

* Consists of automotive, rubber and plastic and electronic cables

Increasing and structurally changing: exports rose to EUR 42 b in 2023, which is nearly three times more than in 2014. Its structure changed too: services now make up 32% of exports, or 6pp more, largely on strongly increasing IT and tourism. Mining is also generating an increasingly large share in exports, especially in the previous 5 years.

Import



Category
- Agriculture, food and beverages
- Crude and fabricated petroleum and gas
- Chemicals and pharma
- Basic and fabricated metals
- Electronic equipment and machinery
- Other goods
- Tourism
- Other services

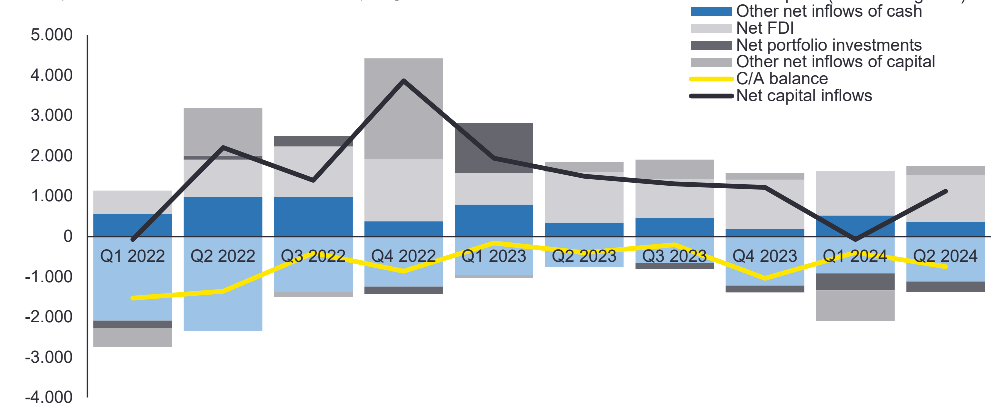
Imports rise less dynamically but remain systemically higher than exports. Imports rose to EUR 47 b, or 2.5x more than in 2014. In recent years, imports were very dependent on global commodity prices – for example, value of crude and fabricated oil imports rose tripled between 2020 and 2023. Tourism is also quickly expanding as local consumption recovers – only in 8M 24, it rose by nearly 30% YoY

Source: SORS, NBS, EY

Note: Each colored area of the pie-like segment represents the share of the category (indicated by the color) in the import or export of Serbia for the year shown on the edge of the diagram.

Current account gap widens, but capital inflows are strong enough to cover the deficit. CAD reached 3.5 % of GDP, or more than 2x the size in 2023 – but was adequately covered by FDIs and other capital inflows, so the FX reserves kept increasing

Composition of balance of payments (in EUR m)



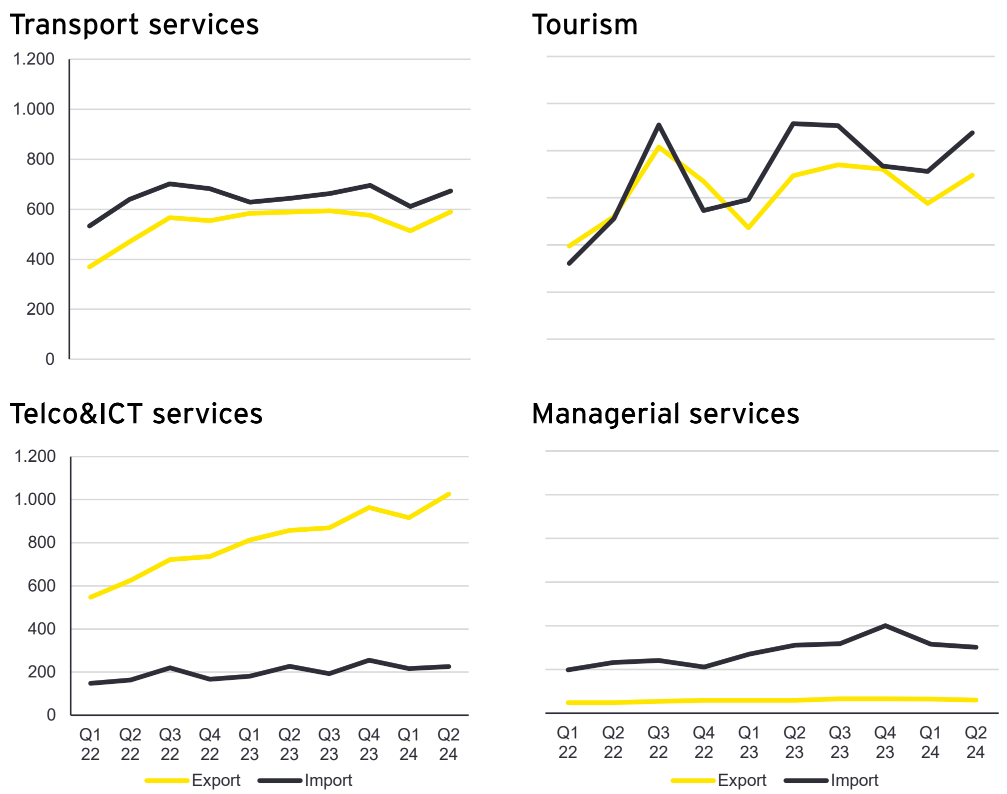
Source: NBS

Current account gap widens. CA gap in H1 24 rose to EUR 1.2 b (cca 3.5% of GDP), which is more than the EUR 0.6 b (cca 1.5% of GDP) attained in the same period in 2023. The increase largely owes to:

- Larger merchandise trade gap
- Increased outflows related to repatriation of profits in foreign ownership

However, the widened current account gap is fully countered, as FDIs and other capital inflows intensify – leading to a further increase in FX reserves along 2024.

Dynamics of net exports of key services (EUR m)



Source: NBS, EY

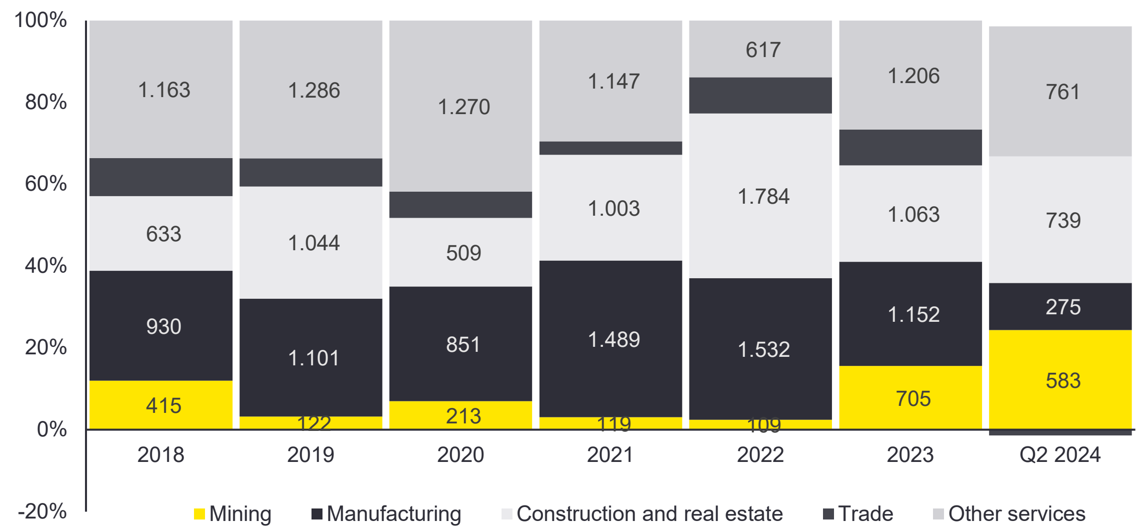
FDIs keep increasing, while its structure is changing. There is an increasing share of mining and automotive investments; while country-wise, there is a rising Chinese presence

Trend of increase of FDIs continues into 2024. Inflows attained approx EUR 2.9 b along 7M 24, or nearly 15% more YoY, following a 2% increase in 2023, and 14% in 2022.

FDIs are also structurally changing. It seems that the structure of incoming FDIs begins to change in at least three respects:

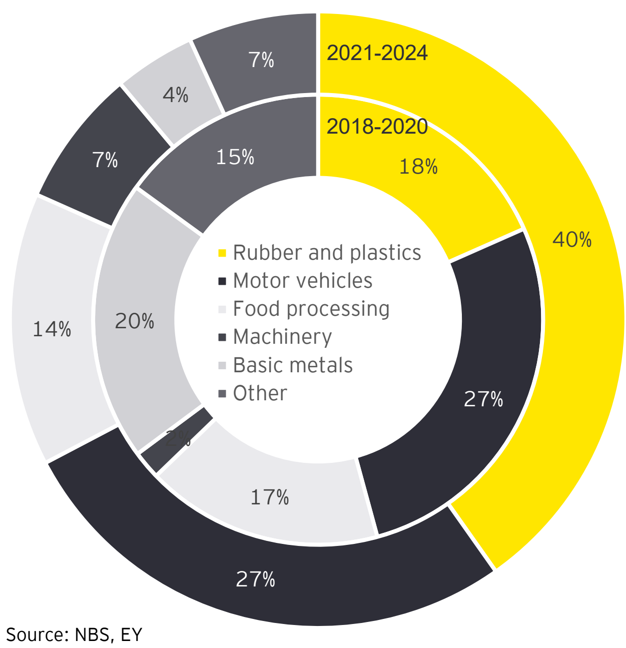
- **More mining investments** which now attain some 25% of total FDIs in 2024, and app 16% in 2023, after approx 7% in period between 2010 and 2022
- **More car-related investments:** FDIs into vehicles and car parts (tires, electrical equipment, cables...) keep increasing by a steady pace and now attract the lion's share of total investments in manufacturing
- **More Chinese investments** - increase since 2018, and intensify from 2022 onwards, and reach nearly 30% in H1 2024, against some 1-2% in period before 2018

Sectoral structure of FDI inflows (in % of total and in EUR m)



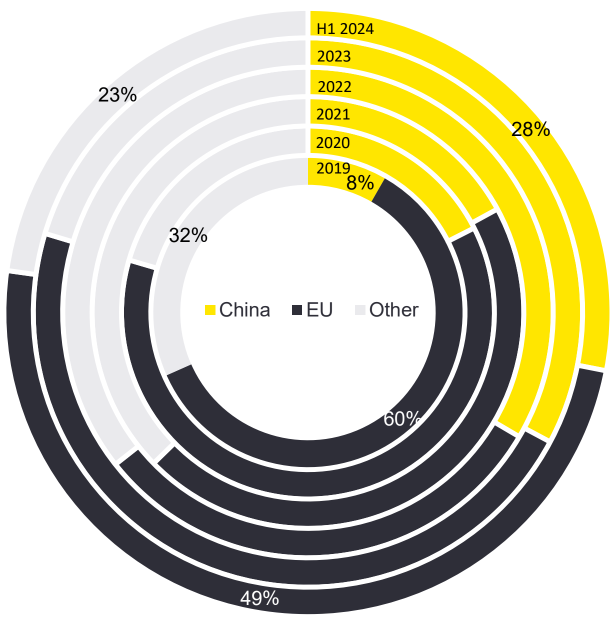
Source: NBS, EY

Structure of manufacturing FDIs



Source: NBS, EY

Countries of origin of FDIs



Source: NBS, EY

5

Fiscal policy and public debt

Shape the future
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Fiscal policy turns expansionary in 2024, as strong consumption-related increase in revenues is matched by strong increase in key expense items. Strong local demand seems to pushing up tax inflows related to consumption and employment, against intensifying spending on wages, pensions and capital investments – the latter stimulating overall growth

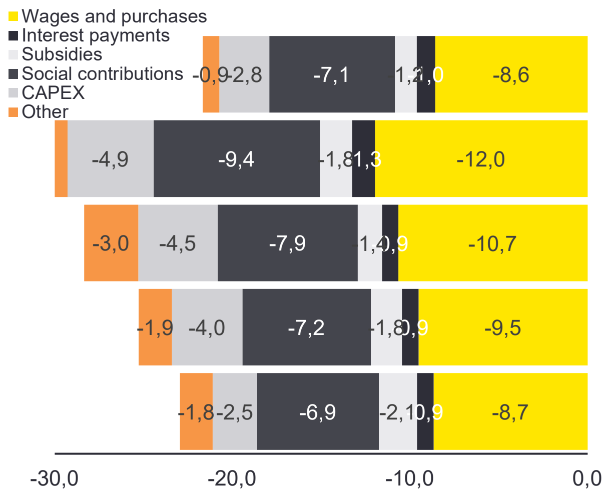
Serbia's fiscal position improves along 2024. Fiscal revenues surpass expenditures along the 8M 24, and Mfin reports as much as cca EUR 230 m in fiscal surplus.

- **Revenues rose by 9% in real terms YoY,** with VAT income rising by 12% and social contributions and personal income tax each by ~10%, mirroring increase of household demand and somewhat higher employment
- **Expendiures rise by 11% in real terms YoY**, largely driven by
  - A 15% and a 12% real YoY increase in pensions and public wages expedintures respectively
  - Interest expenses rising by 5%
  - CAPEX increased by as much as 16%

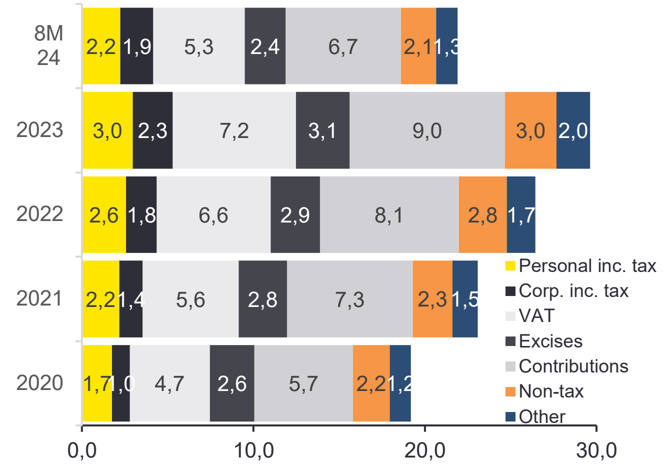
Parliament reshuffles budget in Sep-24. In line with relatively positive fiscal results, foreseeing:

- A 6.5% increase in revenues – much impacted by the higher economic growth than initially planned by Mfin
- A 12.5% increase in expenditures, of which very notable 22% increase in CAPEX budget
- All making a plan for deficit of approx. RSD 260 b, relatively significantly higher than the initially planned RSD 200 b.

Budget expenditures (EUR b)

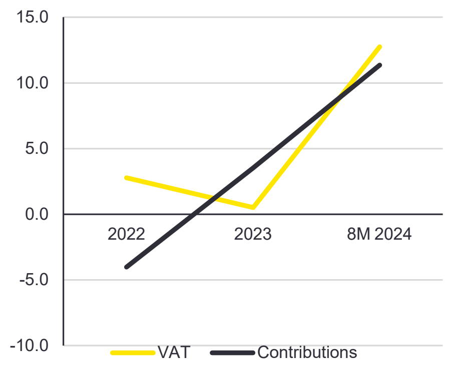


Budget revenues (EUR b)

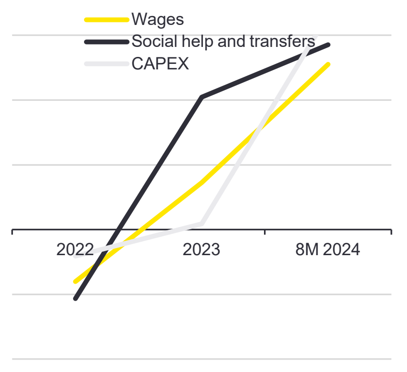


Source: Mfin, EY

Real growth rate of key income categories (in % YoY)



Real growth rate of key expenditure items (in % YoY)



Source: Mfin, EY

Fiscal picture is increasingly positive, as public debt remains at moderate levels, while Serbia's credit rating increases. Serbia's rating hiked to investment grade by S&P, while outlook for its increase with Moody's and Fitch is positive, mirroring stable public debt and relatively strong growth recently

Public debt at sustainable levels (app. 50% of GDP), with a slight downward trajectory in recent years.

Its structure is changing:

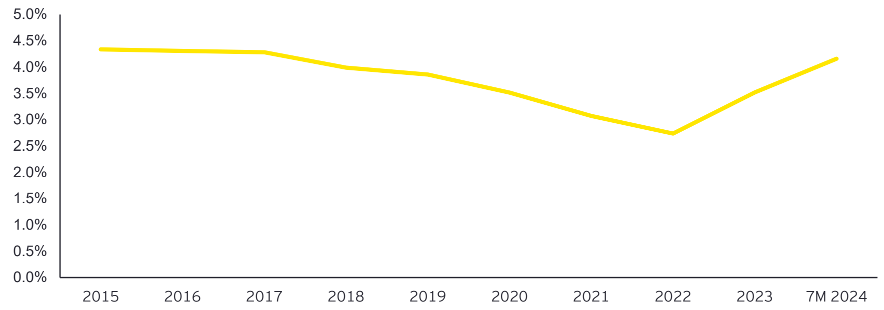
- **Less reliance on local funding** (Tbills) and increasing share of Eurobonds, fgn govts and IFIs
- **Smaller share of RSD indexed debt**, and increasing share of EUR indexed debt

Total financing needs between Sep-24 and Dec-24 at ~ EUR 6-6.5 b.

- Deficit ~2-2.5 b
- Debt maturities ~ 4 b

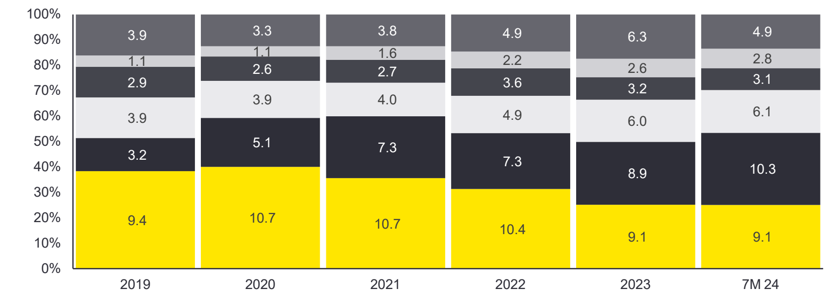
Positive and improving fiscal outlook. S&P increased Serbia's rating to investment grade (BBB-) in early Oct-24, after Moody's and Fitch both confirmed Serbia's credit rating at Ba2 and BB+ respectively with both quoting positive outlook for improvement.

Cost of borrowing - interest payments vs public debt (in %)



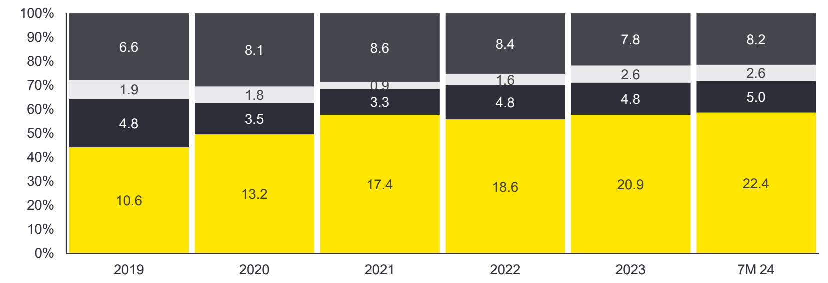
Source: Mfin, EY

Creditor structure (in % of total public debt, also with expressed value in EUR b)



Source: Mfin, EY Tbills Eurobonds IMF, IBRD, EIB Fgn gvts Eximbank Other

Currency structure (in % of total public debt, also with expressed value in EUR b)



Source: Mfin, EY EUR USD Other RSD

6

Banking sector

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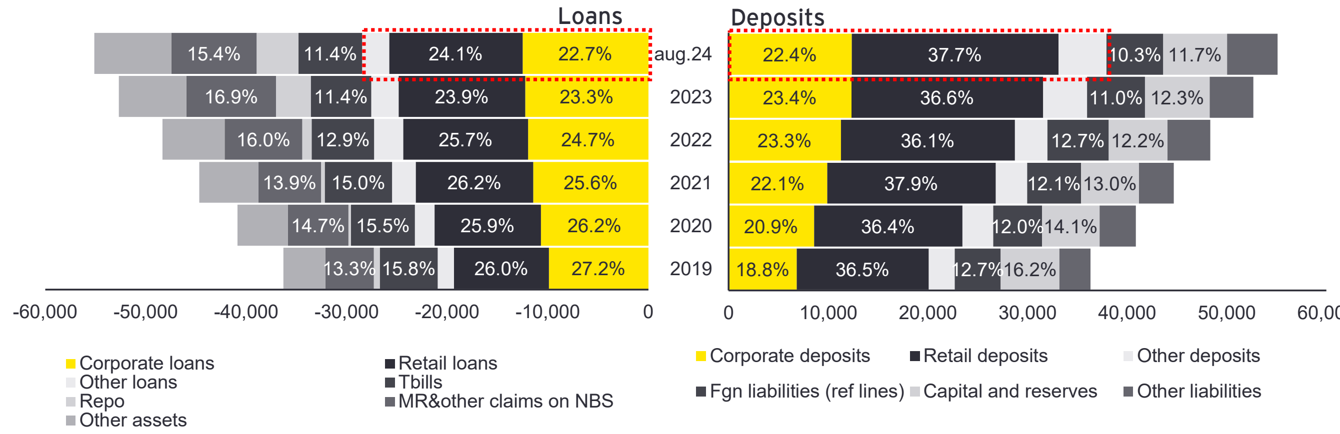
Banks' balance sheet keeps increasing but with a different structure. Share of lending in total asset declines, while banks are increasingly reliant on domestic savings and decreasingly reliant on foreign lines and deposits

Banks' balance sheet grows at an increasing pace, and by 8M 24 tops 11% YoY, after 9% in 2023.

However, the structure of balance sheet is changing on both sides:

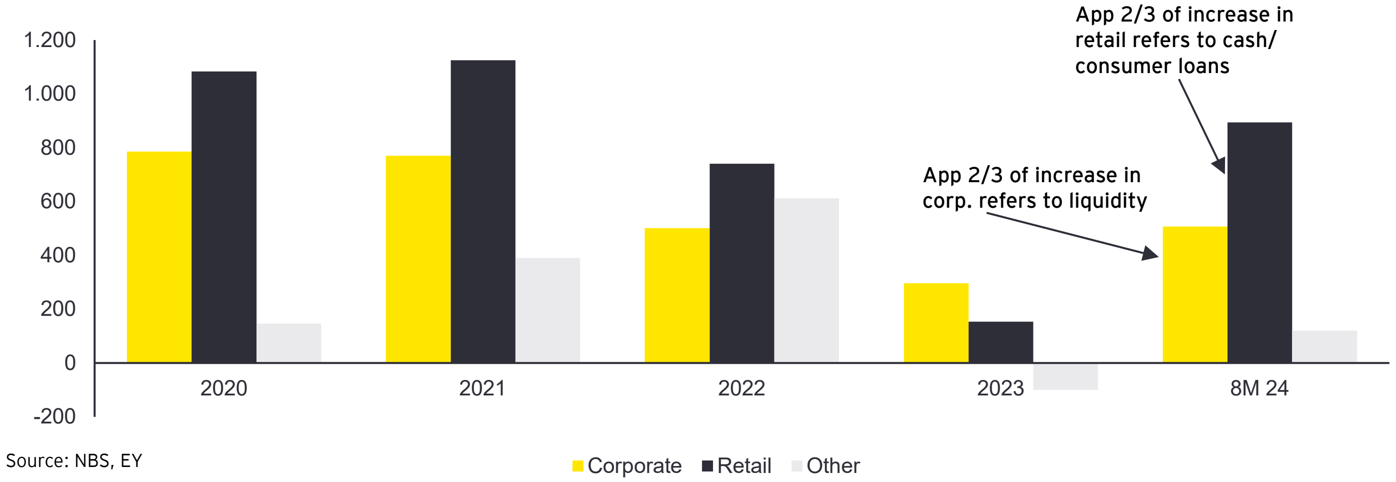
- Asset side:
  - **Share of loans and Tbills stagnates**, reached 63.9% in Aug-24,a tad above end 2023, and nearly 5 pp down since end 2022 – reflecting the lower demand for lending amidst monetary tightening and high interest rates
  - **Loan activity starts to heat up again in mid 2024**, as interest rates slide to lower levels, and which is mainly led by retail segment – in line with recent increase in household demand. Thus total loan stock rises by 6% YoY in Aug-24, up from 1% at the end of 2023
  - **Share of REPO placements soared**, having reached 6.1% of balance sheet in Aug-24, about the same level as at end 2023, but nearly 5 pp above 2022 – suggesting a very high level of liquidity in the system, and that the demand for lending is still relatively weak
- Liability side:
  - **Deposits strongly increase**, as their share in balance sheet rose to nearly 70%, nearly 1 pp higher YtD, and about 3 pp higher since end 2022. Hence their stock keeps expanding by nearly 15% YoY in 8M 24, up from 13% in 2023 – banks increasingly relying on local savings
  - **Avista and other short term deposits share increase**, as they reached around 90% by Aug-24, or 3pp more than at the end of 2023

Assets (EUR mln and in % of total balance sheet) Liabilities



Source: NBS, EY

YtD increase in loan stock (in EUR m)



Source: NBS, EY

Banks' profitability skyrockets in 2023 and 2024, as increase in interest rates on loans significantly outspeed deposit rates and other costs

Net interest income surge along 2023 and 2024, with the increase in active rates outpacing that of interest rates on deposits.

Net commission income follows suit, even despite heavy investments by banks in digitalization in previous period. Hence, they rose by some 20-30% since end 2021.

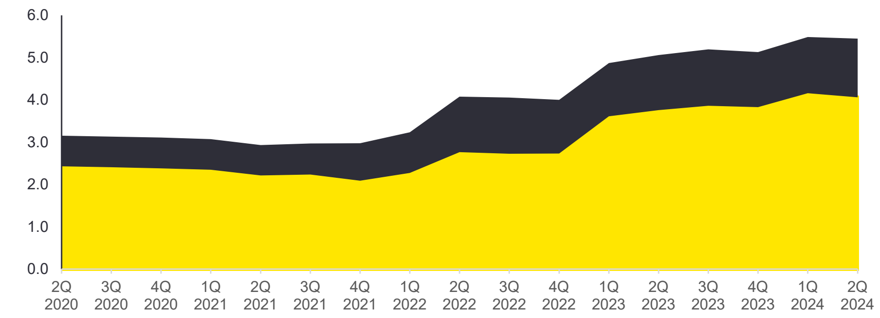
Costs also increased but at a significantly weaker pace than revenues: increase of costs partially minimized by continuing consolidation of sector, decrease of number of branches, digitalization…

Risks remain relatively subdued:

- NPLs remain relatively low in Q1 24: 2.3% in corporate and 4.3% in retail (both mildly up since Dec 22)
- Well capitalized with an increasing share of equity in assets
- Highly liquid, with ample room to absorb increases of lending demand

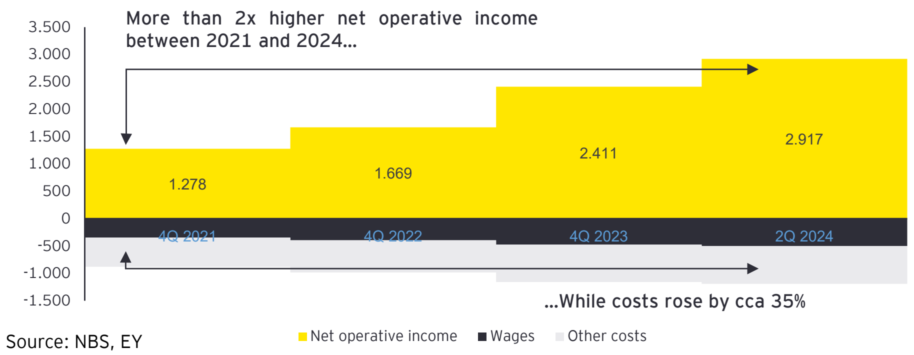
Other financing opportunities for businesses are expected to open up in near future, on Gvt's initiative to support development of the capital market through issuances of corporate bonds. Presently, local market is very bank-centric, with banks holding almost entire stake in companies' external funding.

Net interest income and net commission income (in % of assets)



Source: NBS, EY

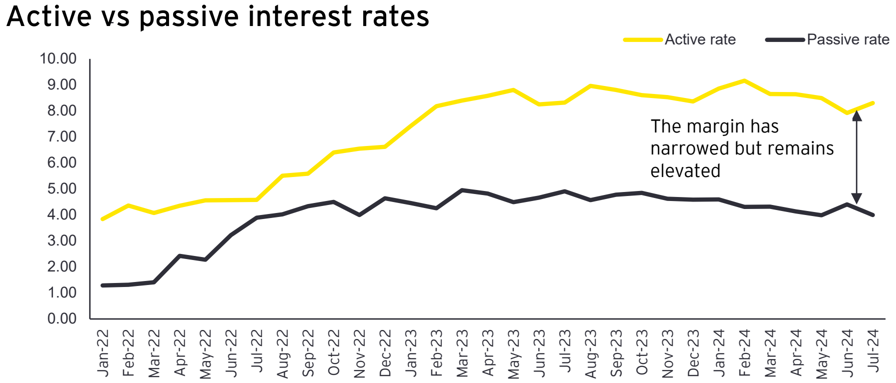
Revenues and costs (in EUR m, annualized*)



Source: NBS, EY

* Data for full year 2024 are obtained as an estimation, based on annualization, i.e. by multiplying H1 2024 data by factor of 2.

Active vs passive interest rates



Source: NBS, EY

7

Prices, monetary conditions and interest rates

EY

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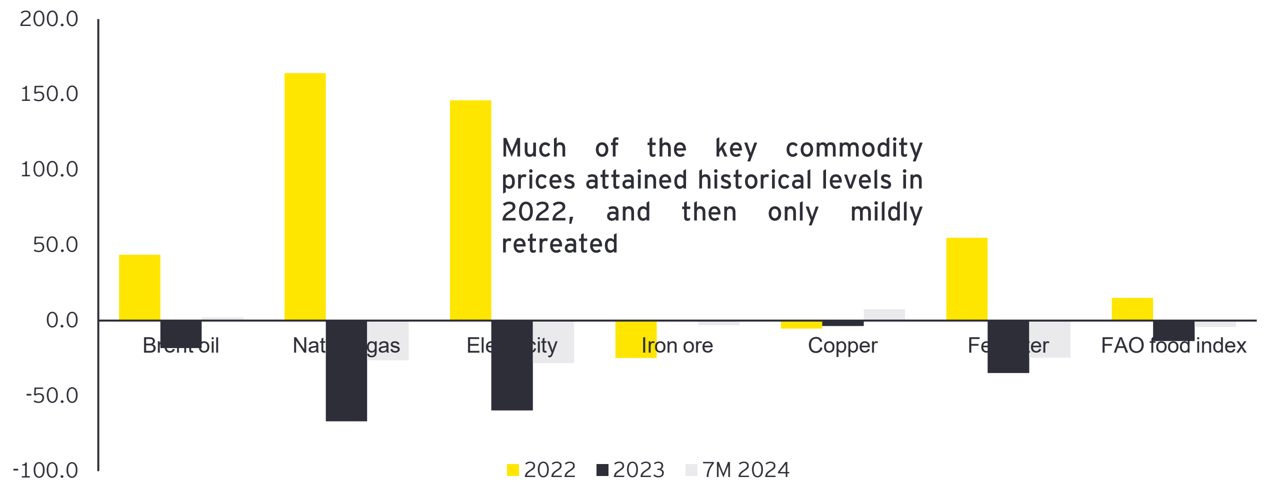
Annual inflation slows down along 2023 and early 2024, but it seems that inflationary pressures mildly resurface in mid 2024. After a year long period of disinflation in 2023, inflationary pressures in Serbia and elsewhere pick up seemingly driven by local food and global commodity prices

Average annual growth of intl' prices of key commodities (in % YtD)

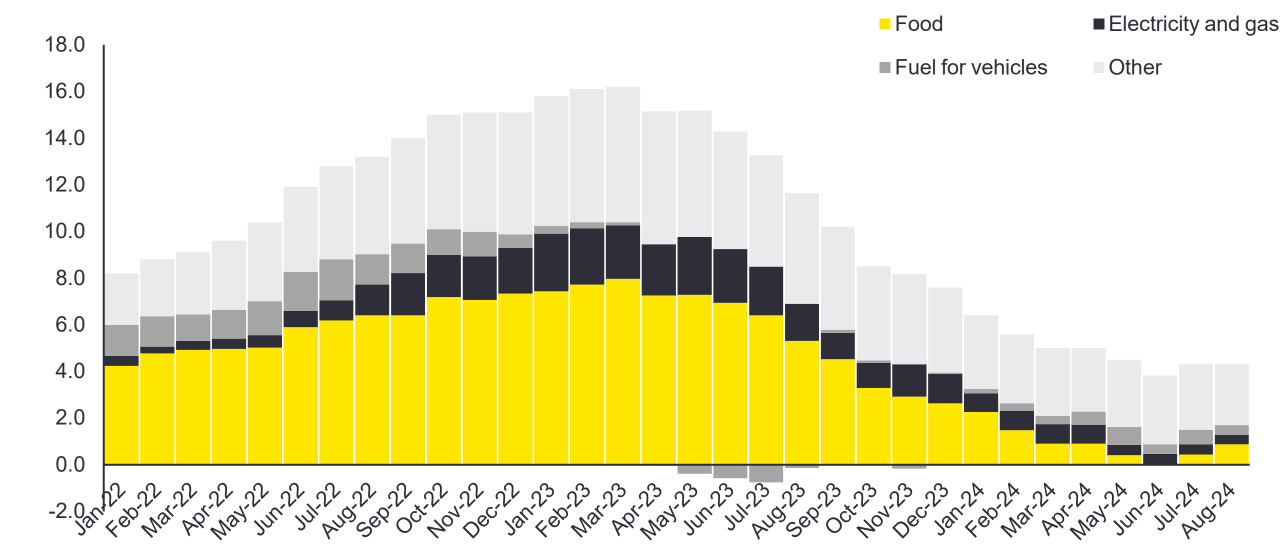


Source: NBS Inflation report Aug 24, EY

Inflationary pressures mildly resurge in mid 2024, after a disinflation period in 2023.

The renewed inflationary pressure in mid 2024 seems to largely owe to food and fuel/energy prices, which have started to grow again, possibly as an effect of poor local agricultural output and geopolitical turmoil affecting oil production. This said, Serbian annual inflation hovers around 4.5% in mid and late 2024, a tad below the upper border of the targeted band (3 +/- 1.5%).

Annual inflation and its key components (in pp)



Source: NBS Inflation report Aug 24, EY

Prices, monetary conditions and interest rates

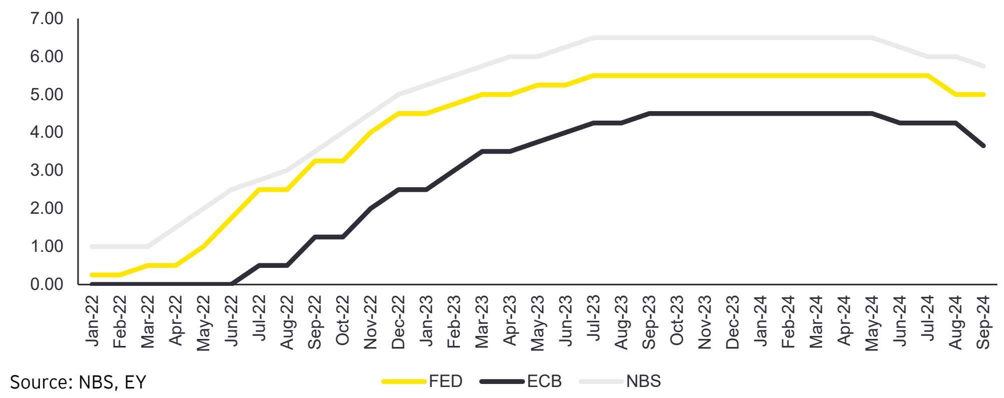
Interest rates at financial markets start decreasing in 2024 after the 2023 highs as central banks, including FED, ECB and NBS started easing monetary policy in mid 2024 as annual inflation had receded from 2022/23 highs

Many central banks embarked on rate cuts in mid 2024, in line with disinflation in Serbia and abroad.

- ECB cut its main interest rate from 4% by a total of 35bp since June-24
- FED cuts its rate by 50bp to 5% in Sep-24, and suggests two more cuts by year end
- NBS cut by total of 75bp to 5.75% since June-24
- China central bank cuts rates by 0.1pp to 3.35% while simultaneously decreasing mandatory reserve requirement in Sep-24

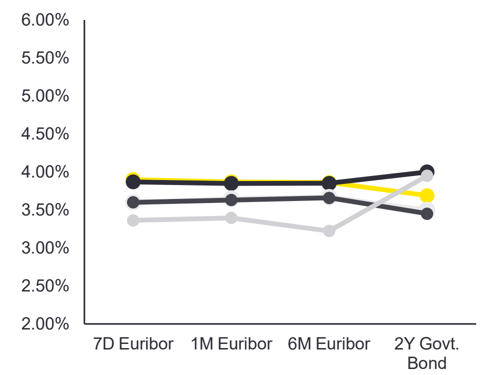
As result, market rates have mildly receded in mid 2024 from the historical highs in 2023.

Central banks' key rates (in %)



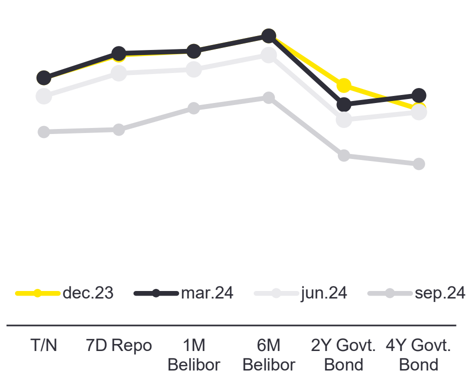
Source: NBS, EY

EUR yield curve



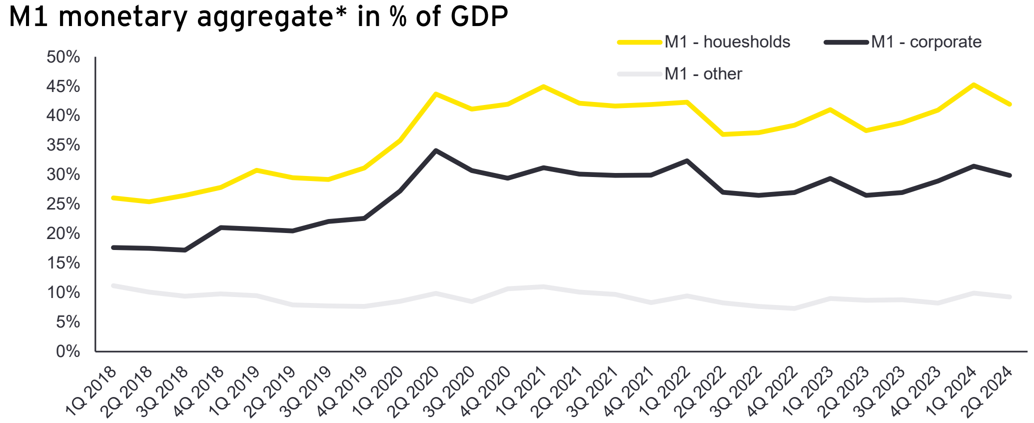
Source: NBS, EY

RSD yield curve



Source: NBS, EY

M1 monetary aggregate* in % of GDP



Source: NBS, SORS, EY

8

Glossary and appendix

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Summarized overview of key macroeconomic and financial indicators – trends and outlook

	2021	2022	2023	6M 2024	7M 2024	8M 2024	9M 2024	2024F	2025F	Source of forecast
Economic activity										
GDP growth rate, in % YoY	7.8	2.6	2.5	4.3				4.0	3.8	EY
GDP, EUR b	53.6	60.7	69.7	35.8				76.0	82.1	EY
Physical volume of industrial output, cumulative growth in % YoY	6.3	10.7	-1.0	2.1	2.5	2.6				
Retail trade, real cumulative growth in % YoY	10.3	5.9	-1.9	7.6	7.5	7.1				
Construction permits, value, cumulative growth in % YoY	42.7	10.1	9.5	-4.2	-4.1					
Labor market										
Employment rate, in %	49.1	49.2	50.5	51.4						
Unemployment rate, in %	9.9	9.4	9.1	8.2				9.0	9.3	IMF
Median net wage, RSD	53,349	60,413	69,842	74,185	76,000					
Average wage, growth in % YoY	4.6	-1.9	4.9	7.9	12.0					
Foreign trade and investments										
Export of goods and services, EUR b	28.8	38.0	41.0	21.1	24.8			41.9	43.1	EY
Export of goods and services, growth in % YoY	29.4	31.9	7.9	4.0	5.1			2.3	2.7	EY
Import of goods and services, EUR b	33.4	45.1	44.6	23.1	27.6			46.5	48.3	EY
Import of goods and services, growth in % YoY	26.8	34.7	-1.0	4.9	7.7			4.2	3.9	EY
Current account gap, EUR b	-2.3	-4.2	-1.8	-1.2	-2.0			-2.5	-3.9	IMF
Current account gap, in % of GDP	-4.2	-6.9	-2.6	-3.4				-3.3	-4.7	IMF
Net FDI, EUR b	3.7	4.3	4.2	2.0	2.5			4.2	4.3	IMF
Net FDI, in % of GDP	6.8	7.1	6.1	5.7				5.5	5.3	IMF
Prices and FX rate										
Inflation rate, EOP, in % YoY	7.9	15.1	7.6	3.8	4.3	4.3	4.2	4.7	3.7	EY
Inflation rate, avg, in % YoY	4.1	11.9	12.5	5.1	4.9	4.9	4.8	4.8	4.1	EY
EURRSD rate, end of period	117.6	117.3	117.2	117.0	117.1	117.0				
Fiscal policy										
Fiscal revenues, in EUR b	23.1	26.4	29.6	16.3	19.3	21.9		32.4	35.6	IMF
Fiscal revenues, growth in % YoY	20.3	14.5	12.1	14.2	15.0	14.4		9.2	10.1	IMF
Fiscal expenditures, in EUR b	25.3	28.3	31.2	16.1	18.7	21.7		34.0	37.7	IMF
Fiscal expenditures, growth in % YoY	10.1	12.1	10.0	15.4	14.5	16.4		9.2	10.7	IMF
Fiscal balance, in EUR b	-4.1	-3.2	-2.2	2.3	0.6	0.2		-1.7	-2.1	IMF
Fiscal balance, in % of GDP	-7.7	-5.3	-3.2	6.4				-2.2	-2.5	IMF
Public debt, in % of GDP	53.9	52.4	48.0	46.5	46.6	46.4		52.0	50.4	IMF
Monetary policy										
NBS rate, in %	1.00	5.00	6.50	6.25	6.00	6.00	5.75			
Lending growth rate, in % YoY	9.8	6.7	1.0	4.9	5.1	6.2		3.9	6.5	IMF
3M BELIBOR, in %	0.94	4.95	5.70	5.45	5.18	5.15	4.94			
International data										
Bosnia and Herzegovina, GDP growth rate in % YoY	7.4	4.3	1.7	2.7				2.5	3.0	IMF
Montenegro, GDP growth rate in % YoY	12.1	6.7	6.2	5.1				3.7	3.0	IMF
FED rate, in %	0.25	4.50	5.50	5.50	5.50	5.50	5.00	4.75	3.25	Concensus
ECB rate, in %	0.00	2.50	4.50	4.25	4.25	4.25	3.65	3.50	3.00	Concensus
3M EURIBOR, in %	-0.51	2.13	3.91	3.71	3.63	3.49	3.28	3.60	2.50	ECB
Brent crude oil prices (USD/barrel)	70.4	101.2	82.6	84.0	78.6	76.8	71.1	83.2	76.1	ECB
Natural gas prices (EUR/MWh)	46.6	123.1	40.7	29.6	36.6	39.3	41.0	34.2	41.1	ECB
Wholesale electricity prices (EUR/MWh)	100.4	247.1	99.6	71.0				77.4	93.3	ECB

Memo*	
Serbia population (in million)	6.6
Human development index**	0.805
GDP per capita*** (current prices, PPS**, in EUR 000 per person)	10,480
GDP per capita*** in % of EU27 average	28%
Territory (in 000 km2)	77.6
Credit rating (S&P)	BBB- (Stable outlook)

Source: SORS, Eurostat, UNDP, S&P
* Population and territory refer to Serbia outside of Kosovo, according to UN Security Council decision nr 1244. Population and GDP per capita refer to end 2023, HDI to end 2022, other data refers to Oct-24
** A composite measure that evaluates a country's average achievements in three key dimensions: health, education, and standard of living. It ranges from 0 (lowest) to 1 (highest).
*** GDP per capita in Purchasing Power Standard (PPS) is an adjusted measure of the economic output per person, which takes into account the relative cost of living and inflation rates between countries

Source for historical data: SORS, NBS, Mfin, IMF, Eurostat, EY. Sources for forecasted data is set out in the rightmost column
IMF forecasts for Serbia, Bosnia and Herzegovina and Montenegro provided in IMF' Article IV consultation for each of the country, published in period between May and July 2024

Glossary and appendix

Glossary of commonly used abbreviations, expressions and definitions

3MMA, 6MMA	3 or 6 month moving average
CAGR	compounded annual growth rate
CAPEX	Capital expenditures
CEE	Central and eastern Europe
ECB	European central bank
EU 28	European Union, also interchangeably referenced to as EU
EY	Ernst and Young
FED	US central bank
FDI	Foreign direct investment
Gvt	Government of the Republic of Serbia
ICT	Information, communication and telecommunication sectors
MoM	Month on month growth rate, i.e. percentage difference between a value in a certain month over the preceding month
Mfin	Ministry of finance of Serbia
Net profit	interchangeably referred to as net profit
NBS	National bank of Serbia
OECD	Organization of economic co-operation and development
P/L	Profit and loss (income) statement
pp	Percentage point
RSD	Serbian dinar
SBRA	Serbian business registers agency
SEE	Southeastern Europe
SORS	Serbian office of statistics
VAT	value added tax
YoY	YoY - Year on year growth rate, i.e. percentage difference between a value in a certain period over the same period in the previous year

How will we make the bold choices that create value for all?

The better the question. The better the answer. The better the world works.

EY

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EY Economic Advisory Services

EY Economic Advisory Services offer a comprehensive suite of tailored research and analysis designed to help clients to gain a clearer perspective on complex economic issues that can help navigate through business opportunities and risks for a diverse set of clients, ranging from companies, financial institutions, small and medium enterprises, public sector entities and international organizations.

Our internal team, experienced in applied economic research and skilled in advanced data analytics, together with our external network of specific domain experts is capable to develop tailor made solutions for your needs. Our approach consists of deep understanding of clients' needs and perspectives, defining the best suited methodologies for a specific question, and conducting robust research.

I: Economic Analysis and Forecasting:

Client Context: Private and public entities needing a clearer understanding of relevant economic trends and market development to get reliable inputs to medium to long-term strategic planning or annual business planning.

Services:

Analysis of macroeconomic trends and future economic outlook to inform planning and better define goals and milestones

In-depth industry analysis and assessment of market prospects to inform commercial due diligence with well elaborate inputs and assumptions related to broader economic developments or industry specific trends

Customized economic research tailored to the client's specific operational and strategic needs, such as estimating price elasticity, assessing market potential, and other

III: Public Policy and Regulation:

Client context: Public sector reforms, local economic development initiatives, or private sector associations seeking public intervention, including regulatory changes and can provide services to Government entities at all levels, international donors and IFIs, large corporations, private sector associations

Services:

Comprehensive **situation analysis and diagnostics** to identify and understand policy issues

Policy design and formulation of government strategy to address identified issues effectively

Preparation of **proposals for legislative changes,** supported by robust economic argumentation and regulatory impact assessments

Preparation of **public policy** planning **documents,** policy monitoring reports, and assistance with policy consultations

Policy and program evaluation

Capacity building services to enhance skills in public policy analysis and development.

II: Economic Valorization of Big Data in Decision Making (Data empowered strategy and everyday decisions):

Client Context: Private sector companies and public agencies looking to leverage their substantive internally generated/administrative data sets for performance improvement, internal tool development, or to create new or enhanced public services.

Services:

Design and development of business intelligence tools that incorporate advanced data analytics, machine learning (ML), and artificial intelligence (AI) to support decisions such as strategic decision-making, external reporting to stakeholder groups, and internal operations.

Building tools and internal capabilities (teams) for utilizing big data in public policy formulation, innovation in public sector, and modernization of public services.

Once developed and tested these solutions can be brought to **full-fledged integrated into an internal BI platform** by other EY teams with expertise in technology consulting and/or organization transformation.

IV: Market Structure and Competition Analysis:

Client Context: Companies engaged in mergers and acquisitions (M&A) needing to complement their legal strategies with economic studies and econometric models assessing effects on market structure and competition.

Services:

Horizontal mergers: assessment of market concentration and the implications for competition.

Vertical mergers: analysis of vertical integration within industries and its effects on market dynamics.

Evaluation of horizontal and vertical restrictive agreements and their compliance with competition laws.

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