From the Editor

Serbia's economy, much like the world economy, faces major risks and uncertainties at the beginning of 2020 due to the pandemic of the corona virus. Therefore, questions such as how the pandemic will affect the economy, how significant this impact will be, and how long it will last, are now coming to the fore? The answers to these questions are very uncertain because it is unknown what the magnitude of the pandemic will be at a world level, how it will be distributed across countries, how long it will last and how the governments will reduce the negative economic consequences of the pandemic. The additional question is whether the pandemic in some countries will be the trigger that will activate the pre-existing problems in the economy and lead to a lasting recession?

Observed by activity, the first wave of the pandemic in Serbia has hit the hotel companies, tourist agencies, as well as companies dealing with international transport of goods and passengers, as well as institutions dealing with the organization of public cultural, sports and other events. If the pandemic persists for several months, the crisis will also hit businesses engaged in the production of consumer durables (cars, household appliances, furniture, kitchenware, etc.), as well as businesses using inputs from countries where quarantine has been introduced, due to the interruption of supply lines. Should the pandemic persist throughout the year and be accompanied by the introduction of quarantines in some parts of the country or throughout Serbia, the negative effects will affect the entire economy of the country. The pandemic will hit SMEs more strongly, with low level of resources and less access to the financial market. The outbreak or even suspension of economic activity due to the pandemic will call into question the capability of highly indebted companies to service loans, which will increase the rate of non-performing loans, impair the performance of the banking sector and the number of corporate bankruptcies. The general increase of risk, as well as the introduction of physical barriers to the movement of people and capital will negatively affect investments and particularly strongly reduce foreign direct investment. In countries with more developed financial markets, deteriorating economic outlook has led to a sharp fall in stock market indices, while in Serbia it did not happened by mid-March, and if it does it will not have a major impact on the real economy.

Although the negative impact of the pandemic on the Serbian economy is quite certain, the magnitude of the negative impact cannot be estimated reliably. The reason for this is that the key features of the pandemic are uncertain - the length of its duration, the total number of people to be infected in Serbia and its key economic partners, or the number of people quarantined, etc., are unknown. Also, measures that will be taken in Serbia and the countries which are our major economic partners to mitigate the effects of the pandemic on the economy are only partially known. Therefore, for the time being, in mid-March, it is possible to create several scenarios that will be mutually differentiated by assumptions on the legth of the pandemic, amount of people that will get sick, but also on the measures that countries will implement to curb the pandemic and mitigate its negative impact on citizens and economy.

Should the pandemic end in the first half of the year, we expect GDP in Serbia to grow by about 2% over the full year instead of the planned 4%. A y-o-y growth of 2% would be the result of a slowdown in the first quarter, a sharp decline in the second quarter and relatively strong recovery in the second half of this year. Slower GDP growth but also a decrease in domestic demand and deterioration in taxpayer liquidity will result in an automatic fall in tax revenues and fiscal deficit growth of about 1.5% of GDP. The fiscal deficit will further increase due to costs directly targeted at combating against the pandemic (rising health care costs, security services, etc.) as well as implementing measures to mitigate the negative effects of the pandemic on the economy. The pandemic could have the effect of a slowdown in the realization of public investments, due to illness of workers, introduction of quarantines, inability to procure certain inputs, and the state's expenditures on this basis could be lower than planned. Considering all the factors affecting taxes and spending, we estimate that the fiscal deficit in 2020 could amount to 2-2.5% of GDP.

If the pandemic persisted throughout 2020, the negative effects on the economy would be even stronger and the Serbian economy would enter a recession (GDP would decline), while the fiscal deficit would be over 3% of GDP. A longer-term pandemic would result in a significant reduction in foreign direct investment in Serbia, whose fall would almost certainly be greater than a reduction in the current account deficit, which would significantly reduce foreign exchange reserves while intensifying pressure on the dinar's weakening.

An important question is how long lasting the effects of the pandemic on the economy of Serbia and other countries will be. Assuming that the pandemic would end this year, the negative impact of the pandemic on the economy would be short-lived, meaning it would end soon after the pandemic ends. Serbia's economy would largely recover from the negative effects of the pandemic during the following year, with a relatively high growth rate. The impact of the pandemic on the economy is similar to the impact of other natural disasters such as major floods or droughts, which cause a major economic downturn in the year in which they occur, but already in the coming year there is a strong recovery. The nature of a slowdown or decline in economic activity due to the pandemic is fundamentally different from the recession resulting from the internal problems of the economic system, as was the case with the great recession of 2008-2009. Internal economic problems such as high uncollectible private and public debt, inadequate regulation of the financial sector, inflated securities and real estate prices, high level of corruption and inefficient state lead to a prolonged recession and slow economic recovery, while natural disasters and pandemics lead to an abrupt economic downturn followed by a rapid recovery.

The rapid recovery of the economy after the end of the pandemic would be absent only in the case of countries which, before the outbreak of the pandemic, had serious problems and where the pandemic was some kind of trigger for a lasting recession. Macroeconomic imbalances in Serbia, such as the high current account deficit, are not of such magnitude that the pandemic would trigger a balance of payments crisis, which would then lead to a prolonged recession or slow economic recovery. The pandemic will lead to a sharp decline in foreign direct investment, which will then not be sufficient to finance the reduced current account deficit. Missing funds will be provided through the use of foreign exchange reserves, and it is possible that there will be some depreciation of the dinar, but not the balance of payments crisis and prolonged recession. Spending foreign exchange reserves will be the price for inadequate exchange rate policy over the last three years.

The negative impact of the pandemic on the economy can be mitigated to some extent by economic policy measures, which would reduce the liquidity crisis of the economy and prevent mass bankruptcy of enterprises. Such measures should be fiscally sustainable in the long run, which means that measures permanently increasing government spending or reducing tax revenues should be avoided. In that line, the announced 10% increase in health care sector wages is an example of an impulsive, reckless economic policy measure. Instead of a permanent increase in wages, a more adequate solution would be to allow health care workers to receive additional benefits during the pandemic, while wages would be determined in the regular budgetary procedure. Similarly, the proposal by the hotel business industry to permanently reduce VAT from 20% to 10% is economically unacceptable and unsustainable.

Measures aimed at mitigating the economic impact of the pandemic should be focused on the part of the economy and the citizens most affected by the pandemic, and their duration should be limited in time. The granting of temporary tax breaks and exemptions for businesses in particularly pandemic-affected industries, such as hotels and passenger transport businesses, would help these businesses overcome the liquidity problem until recovery begins. Such benefits could include exemption from property tax for the hospitality industry during the pandemic, deferral of payroll taxes and social security contributions for employees who did not work during the pandemic, and other. Exemptions and deferrals of tax liabilities could be conditioned on keeping companies at a pre-pandemic level for a certain period of time. The state could form a fund from which it would grant emergency social assistance to workers who stopped coming to work due to the pandemic.

A similar goal would be to reach an agreement between businesses in particularly affected industries and banks that would suspend or reduce repayment of loans during the pandemic. The state could offer subsidies or guarantees for liquidity bank loans to small and medium-sized enterprises in order to overcome the pandemic period. Similarly, it would be appropriate to temporarily delay loan repayments to citizens who did not earn income during the pandemic.

Increasing public investment is one of the standard measures that Governments take in times of recession when it is caused by falling demand or other internal economic problems. However, in the event of a pandemic, this measure is almost certainly not feasible because of the sickness of workers, but also because of the restriction on the movement of workers and international transport of products. Therefore, in a pandemic, preventing a decline in public investment would be a success, while increasing public investment is an unrealistic goal. Another reason for the inefficiency of this measure is that the economic slowdown or decline due to the pandemic is much shorter than in the case of the classical recession. In this relatively short time, it is not possible to do quality projects, evaluate the justification of their realization, select contractors in a competitive procedure, etc.