From the Editor

Although the situation in most economies improved during the summer months, a deep economic crisis and strong fiscal and monetary expansions implemented in the previous part of the year will have a longer-lasting impact on economies around the world.

One of the most evident consequences of the current crisis is the relatively large growth of public debt in many countries, which was used to finance fiscal deficits. According to the forecasts of the IMF and the World Bank, from June this year, the public debt at the world level will increase by almost one fifth this year, and at the end of the year it will be higher than the world GDP. Serbia's public debt will increase by about 9 percentage points of GDP this year, and will reach about 60% of GDP by the end of the year. This is a relatively high public debt for the country at our level of development, so its further growth should be stopped by fiscal policy measures. Due to record low interest rates, the costs of servicing high public debt are low at the moment, but interest rates are expected to grow in the future, and thus increase the risk of a public debt crisis.

Highly indebted countries basically have several options for solving the public debt problem. The first possibility is to implement a fiscal consolidation program after the end of the pandemic, which would reduce the fiscal deficit or achieve a surplus, after which the public debt would begin to decline. Such a fiscal policy, especially if implemented in a higher number of large countries, would adversely affect the growth of the world economy in the future.

Another possibility, used by many countries in the past, is to solve the problem of high public debts, which increased during wars or major economic crises, to a greater or lesser extent, by devaluing them through inflation. This option is only available to those countries that are indebted in their own currency, which means that it is not available to most developing countries. It is estimated that there is little chance that indebted large highly developed countries will rely mainly on this possibility, because doing so they would lose the trust of investors in a longer period of time. Also, the existence of independent central banks, which have the task to keep inflation low and stable, makes it difficult for inflation to devalue public debt. However, it is possible that real interest rates on public debt will be negative in some years, which would to some extent contribute to the inflationary devaluation of public debt.

The third possibility is for highly indebted countries to declare some kind of bankruptcy and request a rescheduling and partial write-off of debts. A request for rescheduling and writing off debts by a country would lead to a drop in private investment, and then to a general economic crisis in that country, which would then spill over to other countries. The effect on the world economy would be more unfavorable if the debt crisis occurred in one of the large highly developed countries. Summarizing previously, it can be estimated that the high growth of public debts in most countries during the pandemic period will negatively affect the growth of the world economy in the future.

In response to the economic crisis, central banks around the world have implemented expansionary monetary policies. The result of the ECB's policy is an increase in the money supply in the narrower sense (M1) in July this year compared to the same period of the last year by 13.5%, while the money supply in the broad sense (M3) increased by 10.2%. Monetary expansion in the United States was even stronger, so the money supply M2 in August this year was higher by 23.3% than in the same month of the last year. Expansive monetary policy was also pursued by small countries, such as Serbia, so the money supply M1 in Serbia in July this year increased by 42.5% compared to the same period of the last year, while the broadest monetary aggregate M3 increased by 17.6%. The professional and general public is asking whether monetary expansion will affect the acceleration of inflation in the future, how it will affect the movement of exchange rates and whether interest rates will increase. Similar questions regarding the consequences of monetary expansion were raised during and after the great economic crisis of 2008-2009.

Some acceleration in inflation in the EU and the US can be expected in the next two to three years, but it is unlikely to be significant, meaning that inflation will rise from the current level of around 0.5% to around 2-3% per year. There are several reasons for the relatively small acceleration of inflation despite strong monetary expansion, the most important of which is the strong confidence of citizens and economies in the commitment of central banks to keep inflation low. Therefore, citizens and the economy do not use excess liquidity to buy goods and services, because they believe that their prices will be stable. Instead, citizens use excess liquidity to save as a precaution, and the wealthier to invest in assets such as real estate and securities. As a result of this behavior, citizens' savings and stock prices rise during the crisis, while real estate prices stagnate or rise. Thus, in a situation where there is a trust in monetary policy, the effects of monetary expansion are largely manifested through the growth of savings and rise in property prices, while their impact on the growth in prices of goods and services is small and occurs with delayed effect. Macroeconomically, monetary and fiscal expansion mitigates the decline in demand of citizens and economy for goods and services and prevents deflation. Without fiscal and monetary expansion, the fall in GDP would be much larger and longer lasting, while the prices of goods and services would fall, as they did during the great recessions in the past.

The growth of interest rates on the world market, in response to the increase in inflation, could be expected in two to three years. In addition, the weakening in currencies of countries that had stronger monetary expansion when compared to other countries can be expected, as has been the case this year with the weakening of the dollar against the euro. The above-average monetary and fiscal expansion in Serbia in relation to other countries will create pressure towards the weakening of the dinar, but the sale of foreign currency by the NBS will probably neutralize these effects.

The delay in performing economic activities, which lasted for a month or two in most activities, and in some activities, such as hotel accommodation, tourism, entertainment industry, etc., for much longer, had an impact on deterioration of financial performance of companies, and thus their ability to repay loans. The possibility of postponing loan repayment during the pandemic period has delayed this problem, but it will escalate after the loan deferral period expires. According to various forecasts, the share of bad loans in total bank placements in the EU could, in the next two years, reach between 8% and 10%, and that percentage could be significantly higher in some large countries such as Italy. In Serbia, the share of bad loans is expected to increase by few percentage points, but the risk of a banking crisis is low for now, although problems in some banks are not ruled out. A rise in the percentage of bad loans and a possible banking crisis would slow down country's recovery, while public debt would rise, due to government intervention either in the form of aid to vulnerable banks or in the form of the cost of insuring citizens' deposits. If the banking crisis happened in a large country or in several small countries it would slow down the recovery of the world, and thus the Serbian economy.

Despite the deep fall in GDP during the first half of this year, the unemployment rate in most countries has not increased significantly. For example, the unemployment rate in the EU in the period April-July increased by only 0.3 percentage points compared to the same period of the last year. The United States is the only large developed country in which, due to the extremely flexible labor market, the unemployment rate increased by 8.7 percentage points in that period. In Serbia, the unemployment rate, despite a 6.4% drop in GDP in the second quarter of this year, fell by 3 percentage points compared to the same period of the last year. As a result, the unemployment rate reached a historic low of 7.3%, although the economy experienced a deep decline?!? The fall in the unemployment rate during the crisis is a consequence of the statistical methodology applied in European countries, according to which only those people who are actively looking for a job are counted as unemployed. Under the conditions of strict epidemiological measures, persons who lost their jobs were not able to look for a job, so they were classified as inactive persons. A more realistic situation on the labor market in Serbia and Europe is shown by the data on the number of working hours or on the number of persons who remained formally employed, although they did not work (see. the Labor Market Review). Hypothetically speaking, if the number of inactive persons remained the same as in the last year, the unemployment rate in the second quarter in Serbia would be 11.7% and would be higher by 1.4 percentage points than in the same quarter last year.

Despite the divergent trends on the labor market in the first part of the year, it is quite certain that the situation on the labor market will worsen in the coming period, i.e. that the unemployment rate will increase. According to the May forecasts of the European Commission, the unemployment rate in European countries is expected to increase from 6.7% last year to around 9% this year. Similarly, the unemployment rate in Serbia can be expected to increase from 7.3% in the second quarter of this year to about 9-10% in the first half of next year. Provided that GDP increases solidly next year, a gradual decline in the unemployment rate is expected in the second half of next year. The negative impact of the current crisis on the labor market is likely to be shorter than in the case of the 2008 crisis because this crisis was triggered by natural factors, while the previous one was a consequence of internal weaknesses in the economy. A long-term reduction of unemployment rate in European countries will be contributed by negative demographic trends as a result of which the labor force contingent is decreasing from year to year. In the case of Serbia and other countries in Central and Eastern Europe, the mass emigration of labor force to developed European countries also contributes to the reduction of unemployment.