From the Editor

The results of the Serbian economy in 2020 are relatively good, bearing in mind that they were achieved in conditions of a pandemic and global economic crisis. It is estimated that the fall in GDP this year will be around 1.5%, which will be one of the lowest fall rates in Europe. The solid results in terms of GDP trends were influenced by the fact that Serbia entered a pandemic with a relatively high growth rate, unlike most European countries whose economies slowed down significantly during the previous year, while some were in a slight recession. Better results are partly a result of the fact that in the structure of Serbian economy there is a high share of production of existential products, such as food, beverages, household chemicals, etc., while the share of activities particularly affected by the crisis, such as tourism, investment equipment and durable good, is low. Strong and indiscriminate fiscal stimulus, which resulted in a fiscal deficit of 9% of GDP, along with an expansive monetary policy, mitigated the decline in GDP this year.

Fiscal stimulus, which included the payment of minimum wage for most of the private sector over a five-month period, mitigated and delayed the deterioration in the labor market. The unemployment rate, after a temporary decline during Q2, due to increased inactivity of the population during the state of emergency, reached 9% in Q3, which is likely to be the average for the whole year. The first signs of a crisis in the labor market are the stagnation of real wages and employment during this year.

Macroeconomic stability has been preserved this year, but in the coming years it will be a challenge to maintain it while stimulating economic recovery. Inflation in Serbia, as in other European countries, was low and stable, which was influenced by the decline in private demand, which was only partially mitigated by strong monetary and fiscal stimulus. The nominal value of the dinar has remained practically fixed since the beginning of the crisis, despite the fact that the demand for foreign currency was significantly higher than supply. The lack of supply on foreign exchange market was filled by the sale of 1.6 billion euros by the NBS during the first 11 months of this year. For the fourth consecutive year, the real value of the dinar has been growing stronger than it corresponds to the economic performance of Serbia, which has resulted in the growth of external deficits. As expected during the crisis, there was a decline in foreign trade, but also a reduction in deficit in foreign trade and current account. The current account deficit will amount to about 5% of GDP this year, which is significantly lower than in the last year, but it still represents a high deficit. Unlike trade transactions, which had a relatively small decline throughout the year, the volume of foreign direct investment decreased by a third in the first three quarters, and a smaller decline of about 20% is expected for the whole year due to the inflow of funds from the sale of Komercijalna Banka. Deterioration of foreign economic flows, but also high dinar liquidity influenced the growth of demand for foreign exchange and reduction of foreign exchange reserves by about 500 million euros in the first 11 months of this year.

In the short run, the response of economic policy to the crisis was adequate, which is reflected in a small decline in GDP and the absence of significant growth in unemployment. However, the response was nonselective, which is why a lot of funds were spent in a short period, so the state does not have much room to continue supporting the economy next year, although that support will still be necessary. Non-selectivity is also disputable from the point of view of fairness, because the limited funds of the state were given equally to rich and poor citizens, as well as to companies that were strongly affected by the crisis, but also to those that were not affected at all. Another weakness of economic policy in this year is the unsustainability of the fixed exchange rate policy in the conditions of strong fiscal and monetary expansion, because it leads to a reduction of foreign exchange reserves. The decrease in foreign exchange reserves this year has been mitigated by government borrowing abroad, but the possibility of replenishing foreign exchange reserves in the future is limited. It seems that Serbia's economic policy this year was created on the basis of the belief that the pandemic and economic crisis will end by the end of the year, and that the economy will recover spontaneously in the next year - it is now obvious that this belief was wrong.

In the conditions of uncertainty regarding the end of the epidemic and the recovery of the world economy, the forecasts for the results of Serbian economy in the next year can only be indicative and conditional for now, and it is almost certain that they will be revised next year. The projection of GDP growth for the next year is based on the assumption that epidemiological measures will be applied in Serbia and Europe during the first half of the year, as well as fiscal and monetary stimulus. It is assumed that the recovery of European economies will begin in the second half of next year, but that it will be slower than expected a few months ago according to the latest ECB projections.

We expect that Serbian economy could achieve the growth of 3-4% next year, which implies that it will fully compensate for the decline this year and that it will exceed the pre-crisis level of economic activity by about 2%. Achieving pre-crisis GDP is possible on the basis of existing capacities, which means that it does not require significant investments. The growth of the economy based on reaching the pre-crisis level of activity will be relatively modest, because the economy already approached the pre-crisis level in the second half of this year. Increasing economic activity above the pre-crisis level requires new investments that will increase economic capacity. The fall in investments this year by as much as 10%, with the expected modest growth in the next year, indicates that economic activity in 2021 will not significantly exceed the pre-crisis level.

The official GDP growth projection for next year which expects the growth of 6% we assess as overly optimistic. According to official projections, the main sources of growth in the next year are the expected increase in investments by as much as 13.3% and the growth of personal consumption of 5.4%. It is unlikely that the planned growth of investments will be achieved, so the contribution of investments to the growth of the economy will be lower than expected. The slower recovery of Serbian economy will be influenced by the slow recovery of European economies, as a result of which the growth of exports and inflow of foreign direct investments will be modest. Real private consumption is unlikely to increase by 5.4%, as the main sources of its financing will grow much more slowly - real wage growth is likely to be between 2% and 3%, pensions around 4%, while remittances will stagnate. Total private consumption could grow more slowly than average income growth, due to rising unemployment, increased loan repayment costs, and high uncertainty.

Unemployment is expected to increase during the next year, due to the dismissal of workers in activities that have been particularly hard hit by the crisis and stagnation of employment in other activities. For now, it is more likely that registered employment will decrease by several tens of thousands, rather than that several hundred thousand workers will lose their jobs. Real wages in the private sector are expected to stagnate or have relatively modest growth next year, while wages in the public sector will grow nominally by close to 5%, which will further increase the gap between wages in the public and private sectors. Average wages in the next year, with the expected stability of the dinar, will probably be in the range of 520-530 euros. We estimate that the pandemic will accelerate the current trends, such as automation and digitalization of business. In the absence of adjustment of labor supply to market demands, long-term unemployment is possible.

In the next year, inflation is expected to remain low and stable and below the 3% target throughout the year. Over the next year, we expect inflation to accelerate, which will be affected by the expected rise in oil prices after the beginning of the recovery of the world economy. The recovery of private demand in the next year will be slow, which will be affected by the modest growth of wages in private sector, growth of unemployment, but also a great uncertainty that will affect the postponement of purchases that are not necessary. Despite the fact that we expect that the supply of foreign currencies will be lower than the demand next year, we estimate that the NBS will keep the exchange rate at a stable level with interventions in the foreign exchange market, which will contribute to keeping inflation low, but will negatively affect the country's international price competitiveness.

In the next year, the growth of Serbia's foreign trade is expected, but also the growth of the foreign trade deficit. The growth of exports will be stimulated by the recovery of European countries and the growth of domestic supply, while the growth of imports will be stimulated by the recovery of domestic economy, but also by even faster growth of domestic demand. The increase in the foreign trade deficit will be influenced by the growth of domestic demand, strengthening of the dinar and growth of unit labor costs over the past few years, as well as the expected deterioration in trade relations due to rising oil prices. FDI will remain low because economic and non-economic risks will be high for most of the next year, and deterioration in financial performance of companies, potential investors, will affect the postponement or abandonment of investments abroad. It is possible that in the medium term, the pandemic will accelerate the reallocation of European investments from China to less developed parts of Europe, such as Serbia, due to rising business costs in China, but also the growing strategic rivalry between the West and China.

It is estimated that the fiscal deficit in the next year will be higher than the planned 3% of GDP, and will be in the range of 4%-5% of GDP. The key reasons for the larger fiscal deficit are the overestimated state revenues, which are a consequence of overly optimistic plan of GDP growth. In addition, rising corporate bankruptcies, rising unemployment, and deteriorating financial performance will worsen the collection of both current and deferred tax liabilities. It is possible that the expenditures will be slightly higher than planned due to the need to approve additional aid to the economy. Because of the fiscal deficit, which will be higher than planned, and lower GDP growth rate, the growth of public debt in relation to GDP is expected, even if the nominal exchange rate of the dinar remains approximately the same. In that case, the growth of the public debt-to-GDP ratio will be relatively modest, so that Serbia's fiscal position will remain stable.