From the Editor

The most important trends in Serbian economy this year are the continuation of the recovery of economic activity and acceleration of inflation. Employment and real wages have risen moderately, but external deficits and external debt are rising. In order to stimulate economic recovery, the Government and the NBS continued to implement expansionary fiscal and monetary policies. The results of the Serbian economy basically follow European trends, with both positive and negative results being more intense than in most countries.

During 2021, the recovery of the Serbian economy, which began in the middle of 2020, continues, after a short but deep decline in economic activity in the second quarter of last year. It is estimated that GDP will grow by 7% this year, making Serbia one of the 5 or 6 most successful countries in Europe. The high growth of economic activity in Serbia is partly the result of the comparison with the low level from the last year, and this effect was particularly strong in the second quarter of this year. Serbia's good results in terms of GDP during the pandemic are a result of the structure of its economy, relatively high pre-crisis growth rates, strong fiscal and monetary stimulus, and relatively mild epidemiological constrains since the middle of last year.

The main drivers of the growth of Serbian economy in 2021 are services and construction activity, the contribution of industry is modest, while agriculture has declined. Observed within the year, the growth of Serbia's GDP is slowing down, with the slowdown being particularly strong in the industry, which stagnated during the second half of the year.

The Government of Serbia, the EU and international financial organizations predict the growth of the Serbian economy in 2022 of about 4.5%. It is expected that the main drivers of growth in next year will be public and foreign direct investments and exports, and that domestic private and state current demand will modestly contribute to growth, because their real value will be significantly reduced by high inflation. In the current circumstances, a possible attempt by the Government to stimulate the economy through an additional increase in salaries, pensions and other components of state spending, would additionally stimulate inflation. Observed by activities in the next year, high growth of service activities and construction and modest growth of industry and agriculture can be expected.

The growth of the Serbian economy in the next year is facing numerous risks. A possible increase in the restrictiveness of monetary policy in Europe and Serbia, in response to high and rising inflation, would result in rising interest rates on bank loans, which would negatively affect the inflow of foreign direct investment, but also domestic investment, including household investments in building houses or buying real estate. An increase in interest rates on the world market would slow down the recovery of the world economy, which would slow down the growth of demand for exports from Serbia, and thus the growth of its economy. Observed by activities, the growth of interest rates would particularly affect construction activity, an activity that has been expanding strongly in the last few years and which is one of the carriers of Serbia's economic growth. Rising interest rates would secondarily lead to problems with loan servicing, which would result in an increase in the number of bankruptcies.

Prolonging problems on the supply side for most of next year would result in keeping the prices of important products at a high level. High prices of some products, such as food products, iron, copper, etc., bring profit to Serbia, as a net exporter of these products. On the other hand, keeping energy prices at a high level for most of next year would significantly increase the costs of the Serbian economy and reduce its competitiveness. One of the consequences of high inflation is large change in relative product prices, as a result of which the production of some products may become unprofitable, resulting in a decline in production or bankruptcy of the company.

A possible crisis of public and private debts in a large country like Italy would spill over to its economic partners, as a result of which their economic recovery would further slow down. Although it is unlikely that there will be a significant and long-lasting tightening of epidemiological restrictions in the next year, if that happenes, it would slow down the economic recovery.

In the medium term, Serbian economy has significant chances, but also risks. In order for Serbia to use the potentials of its own citizens and natural environment, it is necessary to make a substantial turn towards establishing the rule of law and combating corruption. In addition, the progress of the economy requires permanent macroeconomic stability, modern infrastructure, improving the quality of education, etc. These conditions, with a favorable geographical position, would attract large foreign investments without direct subsidies from the state. Financial problems in large public companies, which can occur as a result of many years of poor management and could not be solved without additional growth of public debt pose a significant risk for the growth of the Serbian economy. The policy of a strong dinar, which contributed to the fall and stabilization of inflation, could reduce the competitiveness of Serbian economy and lead to unsustainable growth of external deficits. The sustainability of public and external debt depends on the stability of the dinar exchange rate, and the stability of the exchange rate is maintained by a large inflow of foreign capital. If, for any reason, a sharp decline in foreign capital inflows happens, macroeconomic stability and economic growth would be severely shaken. The sustainability of public finances could be called into question if relatively large and economically unprofitable public investments are financed by government borrowing.

During the second quarter of 2021 inflation began to rise, and growth continued during the second half of the year. In November, inflation reached a multi-decade high level in most European countries, while in Serbia it reached its highest level since mid-2013. Current inflation started much earlier and is much higher than the leading central banks predicted - at the beginning of this year, inflation growth was expected in 2023 or 2024. By the beginning of December, the management of the leading central banks agreed that inflation was temporary and that it would fall spontaneously during the second quarter of next year. Such expectations were due to the assessment that inflation is the result of short-term supply-side problems, which have led to rising prices in many markets (energy, food, base metals, building materials, chips, etc.), and that these problems will be resolved early next year. According to estimates that inflation is exclusively or at least predominantly a consequence of supply-side problems, leading central banks did not take restrictive monetary policy measures until December. It is estimated that at the end of 2021, it became quite certain that current inflation was partly due to monetary and fiscal expansion, which resulted in high demand growth, that significantly exceeded production capacity, so the balance between supply and demand was established through inflation.

Consensus on the temporary nature of inflation seems to have begun to weaken during November and December 2021. First, some central banks in Central Europe increased the restrictiveness of monetary policy, then the Fed chairman said that it was not certain that inflation was temporary, after which the Fed decided to reduce quantitative easing and raise interest rates in the spring of 2022, while the Bank of England raised interest rates in mid-December. Finally, in mid-December, the ECB decided to reduce the issue of money through the purchase of securities in 2022.

Serbia has inflation that is higher than the average of Europe and the region, and during the previous two years it applied a more expansive fiscal and monetary policy than most countries, so it is estimated that the NBS should increase the restrictiveness of monetary policy in the first quarter of next year. The fact that a significant part of inflation was imported does not exclude the possibility that inflation is partly a consequence of domestic factors, i.e. excessively expansive fiscal and monetary policy.

The important question is what results can be expected in the next year in terms of employment and wages? If the growth of the economy in the next year is approximately at the level of current estimates, employment in Serbia could increase by 2-3%. In the next year, nominal wage growth of 7-8% can be expected, while real wage growth could be about 2%, which roughly corresponds to productivity growth. The largest part of the nominal increase in wages in the next year will be devalued by inflation, through which incomes are balanced with production. A possible attempt to further increase wages would only contribute to further acceleration of inflation, which would reduce real wages to sustainable levels.

While real wages will have modest growth, their growth in euros will probably be significantly higher, because for now there are no indications of abandoning the policy of a de facto fixed dinar exchange rate against the euro. As a result of high inflation on the one hand and a fixed exchange rate on the other hand, the value of wages, GDP, etc. has been growing at a slower pace than their value in euros for several years now. From 2017 to 2021, GDP grew by about 15% in real terms, and grew by about 32% in euros, while wages in the same period grew by about 26% in real terms, with their growth in euros being as much as 40%. The progress of the economy or the growth of citizens' standards is adequately measured by the movement of GDP and wages at constant prices, and not by the movement of the stated values in euros.