From the Editor

With the beginning of the war in Ukraine, the countries that directly and indirectly participate in the conflict have put their economic interests second to their geostrategic interests. The dominance of geostrategic goals in relation to economic is clearly visible in the fact that Russia entered into a conflict with Ukraine, although it was predictable that it would suffer great economic losses as a result. On the other hand, Western countries have imposed sanctions on Russia, although they themselves will have significant economic losses due to their introduction and possible countermeasures by Russia. The war in Ukraine and Western sanctions against Russia will result in lower GDP growth and rising inflation and unemployment worldwide. The negative economic consequences will hit the countries directly participating in the war, Ukraine and Russia, the hardest, followed by the countries of Europe and Central Asia, while the impact on other countries will be smaller. The negative economic consequences of the war will be exacerbated by the fact that the war occurred before the end of the recovery from the economic crisis caused by the pandemic. A large number of countries in Europe and the world have not yet reached the pre-crisis level of GDP, and some activities such as the automotive industry, tourism, etc., have not yet recovered. In addition, after strong fiscal and monetary stimulus was applied over the past two years, resulting in rising inflation and public debt, the scope for new stimulus in most countries is very limited.

Although it is certain that the war in Ukraine will have a negative impact on Serbian economy, the magnitude and longevity of that impact cannot be estimated for now because the duration, course and outcome of the war and sanctions are unpredictable. However, it is possible to identify the mechanisms through which the war in Ukraine will affect Serbian economy, such as rising commodity prices, changes in relative product prices, declining exports to Russia and Ukraine, breaking production chains, lower GDP growth in European countries, relocation from Russia, etc. The most important macroeconomic consequences of the crisis for Serbia are slower GDP growth, accelerating inflation, growing fiscal deficit and public debt, growing foreign trade deficit, falling foreign direct investment and a significant reduction in foreign exchange reserves. Apart from the negative consequences of the war, certain economic benefits for Serbia are also possible, as is the case with the increase of quotas for iron exports to the EU. There are also indications that some Western companies will be relocated from Russia to other Central and Eastern European countries, including Serbia. For now, it is not certain how massive this phenomenon will be, or whether it will be conditioned by the introduction of sanctions against Russia in the case of Serbia.

Reduced supply and increased demand for products in which Russia and Ukraine significantly participate have resulted in high growth in their prices, and it is possible that there will be a shortage in some products. The growth in prices of energy, metals and agricultural products will have a strong direct impact on Serbian economy, and the growth of their prices will be transferred to other products, as a result of which inflation will increase. The consequences of the growth of product prices for Serbia differ depending on whether Serbia is a net importer or producer of these products. Serbia imports most of the required quantities of oil and gas, so the growth of their prices will negatively affect the economy and citizens of Serbia. The effect of rising gas prices on Serbia is particularly strong due to the fact that a significant part of consumption in the winter months is covered by gas imports at stock exchange prices, due to delays in expanding domestic gas storage, but also consumption of gas reserves for electricity production due to problems in EPS before the Ukrainian crisis.

The price of electricity in Europe rose before the start of the war in Ukraine, as a result of falling production in thermal power plants and renewable energy sources, on the one hand, and rising gas prices, on the other. The increase in electricity prices in Serbia is a consequence of the import of expensive electricity from Europe, which in the previous months covered 10-15% of domestic consumption. The need for large imports of electricity is a consequence of the decline in electricity production in thermal power plants, which occurred due to many years of poor management of EPS, which results in periodic shortages of coal and occasional accidents. The growth of prices and imported quantities of gas and electricity will directly affect the increase of the foreign trade deficit, the reduction of foreign exchange reserves, the lower growth of GDP and increase of inflation in Serbia.

The impact of rising energy prices on inflation has been partially mitigated and delayed by keeping their prices for households unchanged, while gas prices for the economy are frozen and electricity prices are limited to 75 euros per mwh. Although energy prices for companies have risen significantly less than on the world market, their costs will still rise, which will in part spill over onto inflation, while in part it will reduce profits or make losses. It is now certain that the price of gas in the new agreement with Russia, which will enter into force in the middle of the year, will be significantly higher, which will initiate an increase in costs for the economy and citizens, as well as the increase of inflation in the second half of the year.

Given that Serbia is a net exporter of agricultural products, the growth of their prices will have a different effect on producers and consumers. Producers of agricultural products will generate higher revenues and profits due to rising prices of agricultural products, and this effect can be reduced or neutralized by high rising prices of their inputs (fertilizers, fuels, etc.). Conversely, rising agricultural prices will increase costs and lower the standard of living of citizens, with the effect being particularly strong for poorer households, which spend most of their income on food. At the macroeconomic level, Serbia will benefit from the growth of prices of agricultural products in proportion to the export of those products, while in the case of domestic consumption, the growth of prices will result in the redistribution of income from consumers to producers. The macroeconomic consequences of the growth of prices of agricultural products for Serbia will be the reduction of the deficit in foreign trade balance, the growth of GDP, but also the growth of inflation and decline of citizens' standards. The growth of metal prices will not significantly directly affect the foreign trade balance and GDP, given that Serbia has an approximately balanced value of foreign trade in metals.

The growth of prices of energy, food, metals, etc. has resulted in large changes in relative prices of products, which can significantly affect the business results of companies. Changes in relative prices will have significant effects because these are products that are widely used as inputs in various economic activities. If companies that consume these products as inputs cannot increase the prices of their own products, the result will be a reduction in their profits or even a loss, and in some cases bankruptcy. Therefore, high growth in input prices can make unprofitable production, which until recently was profitable. If a company that uses these products as inputs increases the prices of its products, the result will be a drop in demand for its products, which also has a reduction in profits or even a loss. The macroeconomic consequences of large changes in relative prices are a decline in the volume of economic activity, but also a reduction in investment due to great uncertainty.

The war in Ukraine and the worsening economic situation in Russia will reduce Serbia's exports to these countries, which will negatively affect Serbia's GDP this year. The value of Serbia's exports to Russia and Ukraine in 2021 amounted to about one billion euros, which is about 2% of Serbia's GDP. Exports to Russia will fall due to increased transport costs, a drastic drop in the value of the ruble and recession in Russia, while exports to Ukraine will be almost suspended due to the war. The possibilities of redirecting exports to other countries are limited in the short term, especially in conditions when their growth is slowing down.

It is quite certain that the Ukrainian war will result in a significant reduction in Serbia's foreign exchange reserves, but the dinar's exchange rate against the euro will probably remain stable. Despite significant reductions over the past few months, Serbia's foreign exchange reserves remain high, allowing the current exchange rate to be defended. Defending the exchange rate with foreign exchange reserves is possible under the condition that the NBS abandons other mechanisms for creating dinars, such as the purchase of bonds of public companies. Of course, although the policy of a fixed nominal exchange rate is possible, it does not imply that it is the best policy for the economic development of Serbia.

According to official documents, the fiscal deficit this year is planned to be 3% of GDP, and the public debt at the end of the year 56.5% of GDP. Due to additional unplanned expenditures, such as pre-election assistance to young people, rising energy prices in the world, problems in the Serbian energy sector, giving up excise taxes in January even before the war in Ukraine, it was certain that the deficit would be 3.5-4% of GDP , which means that the public debt will be higher than planned. The war in Ukraine will further increase the fiscal deficit and public debt on several grounds. The real value of revenues will be lower due to slower GDP growth and reduced excise duties on fuel, while the real value of expenditures will be higher due to covering of the losses of EPS and Srbijagas, which are the result of freezing or limiting energy prices. Freezing and limiting of energy prices will result in transfer of obligations from citizens and companies that consume these products to taxpayers, who will repay the public debt. This means that the burden of rising energy prices will ultimately be borne by the citizens, not the state, because the state, which is not a physical being, cannot bear any burden.