From the Editor

In the first half of the year, the economy of Serbia has achieved relatively modest results, with little chance of improving significantly until the end of the year. The growth of the economy in the first half of the year is only 1.2% of GDP, far below the average of Central and Eastern European Countries, and even below the growth of developed European countries. The modest growth of the economy is partially the result of unfavourable weather conditions, while the other part is a result of the weakness of the economic environment and economic policy. Another unfavourable tendency is the re-growth of the foreign trade deficit and the current account deficit. The good result is that inflation is downsized and stabilized, but the strengthening of the dinar is not in accordance with the movement of the economic power of the economy of Serbia, and if this continues it will have negative effect on exports, employment and growth of the economy. Fiscal policy was overly restrictive this year, which had a certain impact on the slowdown in the economy, but also on the strengthening of the dinar. Economic reforms are still slow, most probably affected by the presidential elections, and then the government's reconstruction.

The growth of the economy of Serbia in the first half of the year amounts to only 1.2%, which is far below the projected growth for this year. In addition, the growth structure is bad, investments which were the main drivers of growth in recent years have now slowed down to only 2%, so the investment rate continues to be 18-19% of GDP, which is well below the required level for long-term sustainable high growth. After years of net exports contributing to the growth of the economy, this year its contribution is negative, primarily due to the strong growth of imports. Current consumption of citizens and the state is growing at a similar rate as GDP, so their additional acceleration would not be desirable given that external deficits are growing, and these components already have a high share in GDP. In the second half of the year, the growth of the economy will likely be somewhat faster, so the GDP growth in this year will be 1.5-2%. The growth of Serbia's economy this year is the result of non-agricultural activity growth of about 2.5% and fall in agricultural production by 10-15%. Production trends in non-agricultural activities can be interpreted as approximations of the growth trend of the economy, which shows that the economy growth would be less than 3%, even without a fall in agricultural production.

The growth of the economy in Serbia over this year is significantly lagging behind the growth of Central and Eastern European Countries. Central and Eastern European Countries recorded an average growth of 4.2% in the first half of this year, and a growth of around 4% is expected at the level of the whole year, which is the fastest growth since the beginning of the world economic crisis. The acceleration of the growth of European economies has resulted in improvements of the fiscal position in most countries, improvement of structural policies and also strong monetary expansion of the ECB. ECB monetary policy has a beneficial effect not only on the growth of the Eurozone countries, but also on the growth of other European economies, including Serbian economy. Expansionary policy of the ECB affects the decline in banking interest rates throughout Europe, as well as the growth in demand in the Eurozone, which then allows for high growth of exports from other countries, while abundant supply of cheap money results in high amounts of foreign direct and portfolio investment and loans.

The unfavourable weather conditions, which have affected the decline in agricultural production, can explain about half of the difference in the growth of Serbian economy when compared to the countries of the region. The remaining difference between the growth of the Serbian economy and the growth of the CEI countries, by about 1.5 percentage points, is the result of a worse economic environment and the absence of timely reaction of fiscal policy to changes in the economy and public finances. Although Serbia made some progress in some segments, which is reflected by the progress of 16 places on the list of World Bank Doing Business report, the economic environment in Serbia remains among the most unfavourable in Europe. Serbia is on the lists of World economic forum, World Bank and EBRD, which rank countries by the level of competitiveness, quality of governance by the state and progress in implementing structural reforms, together with Albania and Bosnia and Herzegovina, in the group of the least-placed European countries. Several weaknesses of the economic environment in Serbia are recognized for a long time, the inefficiency of the judiciary, incompetent and inefficient state administration, high level of corruption, poor management of public enterprises, inequality of market participants, etc. The unfavourable economic environment directly affects low investments, which, despite generous subsidies do not exceed 20% of

GDP. With such low investment rate in Serbia we cannot count on long-term high economic growth, and consequently on catching up with the Central and Eastern Europe Countries. In order for Serbia, as one of the least developed European countries, to gradually catch up with the developed European countries, it is necessary for its economy to grow for a longer period at a rate of 4-5%, which requires investments of at least 25% of GDP.

In 2015 and 2016 major progress was made in the area of fiscal policy - the fiscal deficit was reduced from 6.7% to 1.4% of GDP, while public debt began to decline. In plans for this year, the Government projected economy growth of 3%, as well as the fiscal deficit growth of 1.7% of GDP. However, already after the first quarter it was fairly certain that there are serious economic growth problems and that the fiscal outcome will be much better than planned. Adequate government response to weak economic growth and a growing fiscal surplus could have been giving up on taking public enterprises dividends by the state and the acceleration of existing and the launch of new public investments. The above-mentioned measures would impact the acceleration of the economic growth in this year, but the increase in economic capacity would have beneficial impact on the growth in the coming years. A somewhat more expansive fiscal policy, that would generate a low fiscal deficit of 0.5-1% of GDP, would be more suitable to economic trends in this year, and would also be sustainable in the long run. The delay in taking adequate measures was influenced by the holding of presidential elections, and then the government's reconstruction, as well as the attitudes of economists that are close to current government, who until the beginning of September claimed that a growth of 3% in this year will be achieved.

This year's slow economic growth brings up the question of what can be expected in the following year. Assuming that favourable trends in European economies will continue, as well as that agricultural production will be on an average level next year, and problems in EPS solved by the end of this year, a growth of around 4% in the next year can be expected. This growth could be the result of accelerating activities in non-agricultural activities from this year's 2.5% to around 3% in the following year and agriculture growth of around 10%. Although 4% growth looks as relatively high, behind it there is still a relatively slow growth trend of around 3% and a one-time growth due to the recovery of agriculture.

Given that cyclical fluctuations in the economy are under the influence of a large number of uncontrolled factors, such as weather conditions and developments in the international environment, the focus of economic policy and reforms should in the coming period be to create favourable conditions for accelerating the growth trend of the Serbian economy. Therefore, in the coming years, the improvement of the efficiency of judiciary and state administration, the restructuring and improvement of management in public companies, the suppression of corruption, the acceleration of infrastructure construction and so on, should be the Government's priority. It can be expected that the EU and international financial organizations will insist on mentioned reforms, but a decisive political commitment to their realization is crucial for the progress. The several-year delay of these reforms suggests that there are powerful interest groups in Serbia that are better off without these reforms, so their realization is uncertain in the future. The strongest resistance to the improvement of the economic environment comes from political party structures and bureaucrats as the existing environments enables them to achieve high rents, as well as from businessmen whose privileged jobs allow them extra profits. If, in the future, necessary reforms are not implemented, Serbia can only count on a temporary and limited growth of the economy. Past experience has shown that the lack of reforms cannot be compensated with high state subsidies to investors or strong growth of domestic demand. A synthetic indicator of substantial progress in the economic environment would be the increase of the investment rate to around 25%, whereby these investments would be dominantly financed from their own funds.

For the long-term growth of the economy it is important that the Government continues with a sustainable fiscal policy after the IMF arrangement expires. It is important not to repeat mistakes from the period of 2006-2008 when, after the expiration of the IMF arrangement, wages were significantly increased, followed by pensions, NIP (National Investment Plan) and numerous subsidy programs were launched, while taxes were reduced, leading to a large increase in the fiscal deficit. Adequate fiscal policy target in the next year, which would be in line with economic trends and sustainability of public finances, would be a fiscal deficit between 0.5 and 1% of GDP. In addition to keeping the fiscal deficit in the long-term sustainable framework, there is a need for changes in the structure of public expenditures in order to increase the share of productive expenditures that directly affect the acceleration of economic growth, such as public investments and investments in education and innovations. The state should give up on taking dividends from public companies, as dividends most directly reduce overall investments. Sustainable fiscal result implies that the growth of wages in the public sector essentially follow GDP growth, while the pensions rise at a somewhat lower real rate, in accordance with certain permanent rule such as the Swiss formula. If there is a certain fiscal space after that, a good idea would be to cut some of the taxes which would increase the available funds for investments in companies.