From the Editor

The third quarter of the Serbian economy is dominated by negative trends, although it registered some positive trends. The decline in the economic activity in Q3 is relatively deep, but it is estimated that its nature is partially temporary and thus Q4 will achieve more favorable results. Based on preliminary data, the number of employees in Q3 is slightly reduced, which is in line with the assessment that the GDP decline in Q3 is in substantial part temporary. Rapid acceleration of inflation through third quarter and October was mainly the consequence of one-off factors, but to some extent, also, delayed effect of the dinar depreciation in the previous part of the year. During third quarter foreign trade balance was significantly improved, which is mostly the consequence of the real depreciation of the dinar in the first half of the year. Over Q3 and in October, the dinar significantly appreciated in nominal and real terms, which will, with a certain time lag, have a negative impact on foreign economic developments of Serbia.

The budget for the next year and fiscal consolidation program until the year 2015 were presented at the end of third quarter. According to the program of fiscal consolidation, a coming year is planned to have a deficit of 3.6% GDP, in order to reach the deficit of 1% in the year 2015. Notwithstanding the fiscal deficit in the coming year is likely to be around 4% of GDP, the real challenge for fiscal policy will be the reduction of fiscal deficit to around 2% of GDP in the year 2014. While the reduction of fiscal deficit from around 6% in the year 2012 to 4% in the year 2013 was achieved with a significant reliance on the tax increase and one-time revenues, the reduction of fiscal deficit in the following years will be almost exclusively realized with expenditure savings. In order to achieve these savings, fundamental reforms of the public sector are needed and should be prepared as soon as the first half of the year 2013.

First reactions investors had to the published program of fiscal consolidation in Serbia are favorable, as expressed trough relatively low interest rates at which the bonds of the Republic of Serbia were sold. However, the favorable reactions of investors should not influence the Government to significantly deviate from the fiscal consolidation program, nor to withdraw from the agreement with the IMF. The risk of a debt crisis in Serbia has been postponed for now, but not removed, so the reliance upon the trust of commercial investors, without any arrangement with the IMF, is very risky.

During a third quarter, NBS reference interest rate was increased repeatedly, but despite that, the bank credit activity has grown significantly. . The increase in bank credit activity was crucially influenced by restarting of the subsidized credit program._Although the reference interest rate in Q3 and in October was mainly negative in real terms, it is estimated that the response of monetary policy was appropriate, as the inflation acceleration was mostly influenced by the one-off supply-side factors (drought, tax increase, increase in administratively controlled prices, etc..). Additional increase in the reference interest rate could affect the appreciation of the dinar which would be undesirable in the given macroeconomic circumstances.

Unfavorable trends in the EU worsen the perspectives of Serbia's economy for the next year. The overall recovery of the economy of Serbia, which would be characterized by the activity growth in the majority of economic sectors, is likely to be absent. Private demand in the coming year will decline in real terms, due to the implementation of fiscal consolidation, which mitigates the probability of a debt crisis and reduces the imbalance between domestic demand and GDP. Recession or at best stagnation in the EU means that the demand for Serbian products will decline, as well as that investments in the industrial sector, which mainly come from the EU, will be relatively modest. Despite that, the Serbian economy in the next year could achieve the growth in the range of 1.5-2% provided that the agricultural season is at the level of a multi-year average and the production of FIAT is increased in accordance with the company plans. The high growth of agricultural production and the automobile production would be enough to compensate for a moderate decline of the activities in other economic sectors.

Given the unfavorable developments in the EU and the need for the implementation of a fiscal consolidation, a question is raised whether there is a room to encourage the economy growth through economic policy, but without jeopardizing macroeconomic stability at the same time._Domestic demand is already high in relation to GDP; hence, its further stimulation could have more impact on the inflation growth and external deficit than the initiation of economic activity. Room for incentives within the economic policy is very modest and limited to moderate real depreciation of the dinar, which would enhance the price competitiveness of the Serbian economy and thus partly neutralize the effect of GDP drop in the EU. Among the remaining stimulants, certain effectiveness in Serbia was shown by the subsidized credits, which, with a relatively small amount of resources, provide a relatively high growth in credit activity of the banks. Subsidized credits are a kind of compensation for the limited effects of monetary stimulants in the dual currency system. Finally, a certain incentive for the economy in the following year could be achieved by accelerating the implementation of infrastructure projects that have been started in Serbia. Effective liberalization of electricity production and defining the binding dynamics of achieving economic price of electricity could eventually lead to a significant foreign investment in the area.

Considering that the major constraints to the growth of the Serbian economy are on the supply side, it is necessary to accelerate the reforms of the economic system, which would improve business conditions in Serbia. Although the implementation of these reforms takes few years, and their effects are manifested in the medium and long term, some of major weaknesses in the economic system of Serbia, such as inefficient procedures for the issuance of building permits, the simplification of tax procedures, etc. can be implemented relatively quickly. Quick implementation of these reforms with the initiation of reforms whose implementation takes several years, as is the case with the establishment of the financial discipline, could lead to a significant improvement of Serbia's placement in international ranking lists of competitiveness and business conditions. Improvement of placement in these rankings, along with possible improvement of the country's credit rating, could draw the attention of investors to Serbia, which would contribute to the increase in foreign investments despite the stagnation in the region. From the beginning of the year 2014, a new phase in the reform of tax system could be implemented, within which the taxes on income would be reduced, and the lost revenues would be compensated by increase in VAT. Such a reform would positively affect the international price competitiveness of Serbian products, but would also encourage employment.

Considering the modest growth, which is expected in the following year, and the fact that the growth will be concentrated on a few activities, the next year, at best, is expected to have stagnation in employment, but it is more likely that the employment will reduce.

The spending of a government foreign currency account deficit to cover the fiscal deficit will affect the growth of the dinar liquidity, which will partly focus on a demand for foreign currency, and that will result in a depreciation of the dinar. In the coming year, with a modest real depreciation of the dinar, one can expect the continuation in the trend of reducing the foreign deficit and the deficit in the current account balance, despite the fact that a poor agricultural season will have a negative impact on the export of food products.

It is estimated that the inflation will be declining in the following months, with the occasional one-off leaps due to the increase in administratively controlled prices, such as the prices of gas, electricity and others. Inflation, in the course of the next year, will almost certainly be somewhat higher than a planned inflation of 5.5%, but the difference will not be significant if there are no new shocks on the supply side (growth in energy and food prices).

In this, 30th anniversary issue of QM, one Highlight and as many as four Spotlights will be published. The Highlight (Rakić-Žarković) analyzes the current reforms on the labor market. Spotlight 1 (Arsić) analyzes the fiscal consolidation program with a special focus on its impact on the growth of Serbia's economy. The Spotlight estimates that the sustainable economic growth, apart from fiscal consolidation, requires the reform of public sector and economic system, as well as the appropriate course policy that would encourage the growth based on exports. Spotlights 2-4 are dedicated to specific structural measures aimed at the improvement of business conditions in Serbia. Spotlight 2 (Nenezić and Radulović) analyzes possible measures to encourage public-private partnership, but also the limitations and risks that these programs would be experiencing. Spotlight 3 (Đulić and Zivkovic) analyzes the regulatory and economic constraints to the development of corporate bond market and estimates the range of that market. Fourth Spotlight analyzes the weaknesses of the existing legislation relating to the protection of the minority stockholders, as well as the inadequate implementation of the regulations in practice, and recommends the measures to improve the protection of the minority stockholders.