8. International environment

The global recovery slows down, but there are still significant changes in the growth rates among the groups of countries. The group of the developed countries (USA, Germany and some smaller countris) has realized a solid growth, but with signals of a slowdown, while the bigger part of the eurozone is either in stagnation, or in reccession. The developing countries go through a similar situation- Eastern Asia has achieved high growth rates, though with the signals of a slowdown, while the countries of Central and Easter Europe are either stagnating or moving to recession. Inflation in the developed countries is decreasing, while in some developing countries is still relatively high. Since the bigining of the year, major developed economies haven't seen any significant changes in the monetary and fiscal policy. However, the major economies are currently debating whether the countries achieving a relatively fast growth (USA, Germany, some smaller countries) should continue with the strong fiscal consolidation or slow down, so that their demands attract the economies of the rest of the world. The unravelling of the economic and political crisis is still uncertain, and possibility of poor outcome is heightened due to political problems in Greece, as well as the problems in the banking sector in Spain.

Global Trends

The IMF, according to the latest published estimate, slightly corrected the growth rate upwords in 2012 at a global level, by 0.2 percentage points. The global economy should have a growth rate of 3.5%, developed countries 1.4% and developing countries 5.7%. The Eurozone should record a negative growth of 0.3%, primarely due to a downturn in activity in Spain and Italy. Based on the subsequently published data and forecasts for the individual countries and global regions, it can be expected that the IMF will correct downwards the growth estimates for this year.

The global economy stands is in a turbulent state, thus any additional shocks could trigger a new global crisis. Two risks could cause such a scenario: re-detoriation of the condition in the eurozone due to an uncertain solvency of the Member States and the growth of the geopolitical risks on the Near and Middle East, and with regard to this, a possible leap in the oil price. The agreement on the Fiscal Compact in the EU and the ECB intervention to increase the liquidity, had a positive influence on the recovery of European countries, which were in a solid position even before that, while their positive impact on the Mediterranean members of the EU was mostly absent. The IMF's Chief Economist (Oliver Blanchard), using IT jargon, called these measures *a firewall* and pointed out that these are not a final solution, but a current aid, as they cannot eliminate the problems of a high debt, low growth and a lack of competitiveness.

According to the IMF, there is some room for maneuver within the monetary policy of the ECB. However, there is a problem in this case as well- is there a monetary policy that is optimal for the entire eurozone? On the one side, there are Germany, Austria and some other countries that realize relatively high economic growth and have low unemployment rate and to which the expansionary monetary policy is not only unnecessary, but also undesirable. On the other side, there are countries such as Italy, Spain, Portugal, Greece and others, that would welcome the monetary expansion.

Accordingly, it can be concluded that, at least in a short-term, there is no monetary policy optimal for all the EU Members. However, when considering long-term goals of the Member States, it might be possible to reach the optimal monetary policy that would include moderate expansion in the EU-wide and the internal devaluation in the noncompetitive states.

Economists and polititians are currently debating whether there is room for a further fiscal stimulans and in which countries. Fiscal stimulans is usually recommended for developed countries realizing high growth (USA, Germany and some smaller countries). The developing countries, especially China, have room for fiscal stimulation. However, the problem is that these stimulanses, short-term observed, are more needed by their partners (France, Spain, Italy, countries of Central and Eastern Europe, etc.) than the above mentioned countries (USA, Germany, China, etc.). However, looking on a long-term basis, a crisis deepening in Italy, Spain, Greece, Portugal and others could irreversibly jeopardize the growth of Germany, USA and the global recovery.

Financial markets exhibit some kind of inconsistent behaviour. First, there is a significant pressure to reduce the public debts of heavily indebted countries, and then, when the requirements for savings are met, and as a consequence the economy growth slows down, those same investors are being surprised by the low growth and react negatively again. It should not discourage countries with a problem of a high public debt that the only way out of the crisis is a credible medium-term reform plan, which includes spending cuts by implementing the measures, which will lead to the increased competitiveness in the medium and long term.

According to the recent estimates, GDP growth, in the U.S. during Q1, amounted to 2% annually, slightly lower than expected. The greatest support to the growth was provided by the personal consumption, warmer weather and increased employment. The investing of companies and the public spending reduced, while the net exports contribution to GDP growth was neutral. There were no changes in the monetary policy, inflation was under control, and the recovery pace in the first quarter was relatively in line with the FED expectations, while the future fiscal policy framework is to be determined after the upcoming presidential elections.

Tendencies in the EU

The eurozone economy stagnated during the first quarter of 2012- both annually and quarterly. However, movements by the groups of countries are highly different. German economy, in Q1, established a solid economic growth, which, in comparison with a previous quarter, amounted to 0.5%. Unemployment in Germany in April was 6.8%, which is the lowest level in 20 years. Similar positive tendencies were recorded in the group of countries that are tightly associated with Germany (Austria and others). Nevertheless, some data from April and May, such as, e.g., a substantial decline in car sales, suggest a slowdown in the German economy growth. The situation is, of course, completely different in the eurozone periphery- the decline in Spain and Italy was recorded (as much as 0.8% q/q). The uncertainity in Greece has a negative impact on the investors in the period when their activity is needed for the consolidation of the economic growth in the eurozone. Given that the short-term indicators are quite low in the last two months, the eurozone growth might be negative in the next quarter.

Within the eurozone in its impact on the economic growth of Serbia, of particular importance are its main export markets - Italy and Germany. The reduction of exports from Serbia had a strong impact on a slowdown in the GDP growth rate, thus, it is advisable to comment on the prospects of change in the export demands of its major trading partners. In Germany, a solid personal consumption will affect the level of imports to continue growing, while Italy's import level is expected to mildly decrease over 2012. Export from Serbia to Italy, over Q1 is by 64,8mn € lower than in the first quarter of 2011, and now amounts to about ¾ of the last year. Annually, this is a drop by as much as 25 percentage points. It is evident that the export from Serbia to Italy survived a substantial drop when compared with the total drop of goods import from the countries outside the EU to Italy. The main reason for the fall is the cessation of the U.S. Steel operations, which exported to Italy significant amounts of tinplate, hot rolled and cold rolled products. Nevertheless, it is certain that besides the closing of the U.S.Steel, the reduction of exports from Serbia to Italy, in the next period will be affected by the tendency to reduce its import demand. Contrary to the cooperation with Italy, exports from Serbia to Germany recorded a growth over a first quarter, annually by about 8%.

The economy of Italy suffers a negative impact of the crisis in the eurozone. The costs of Italy and Spain's borrowing are highly correlated with the outcome of the political situation in Greece. When the government borrowing costs increase, simultaneously there is an increase in the borrowing costs of the Italian banks, which are therefore forced to tighten the credit conditions to the economy. Fiscal consolidation reduces the employment rate and with that the domestic demand, thus companies are having a hard time deciding whether to increase the investments, especially when banks tightened loan conditions. Citizens, in the time when the situation on the labour market is not likely to improve, rearly decide on making a major purchase, thus it is expected to drop by 2.3% over 2012. Italy, above all, has a problem with a low growth, and not with a budget deficit. This can be seen from the fact that Italy, in the past, frequently recorded the primary budget surplus, meaning that the entire fiscal deficit was the consequence of interest payments. Italian economy productivity per working hour since 2005 has increased by 0.8%, and the average growth on the eurozone level amounts to about 5%. Therefore, the structural reforms are a necessity. Measures directed to this, cannot contribute to a short-term growth, but the long-term one.

However, the budget deficit could soon become the core of the problem due to the effects of a low growth. The growth rate is lower than the borrowing costs, so the public debt is in a constant growth in relation to GDP. The amount of the public debt is very high, thus, as a significant portion of bonds is to be collected (in 2012, Italy will need to rollover the bonds in the amount of 20% of GDP), there is a risk that the investors would not be interested in buying the bonds in this extent. Besides the problem of a high public debt and the low growth, Italy has a problem with banking sector, which is dependent on the financing through money market, and not through deposit. In these risky times, it is possible that the institutions on the money market are to reduce the willingness to lend to Italian banks. Therefore, in addition to labour market reforms and productivity increase, it is necessary to reform the banks in terms of their borrowing structure. Fortunately, real estate market in Italy didn't collapse, so the banks are not further burdened by the losses in that sector, but they have a significant share of Italian bonds in their portfolio.

On the last meeting of the executive board of the ECB, the reference rate has not been changed, and is still at the level of 1%. A general view on the inflation and growth has not much changed from the previous meetings. The overall inflation should be exceeding 2%, and there are equalized risks for deviation in any direction. Increase in the indirect tax or a shock at a goods market, would lead to the increase in the inflation rate, while a slowdown in the growth would lead to its decrease. There is no big chance for indirect effects, even despite the oil price growth the increase in the price of final products did not accelerate. This suggests that the firms are forced to offer discounts to stimulate the demand. Labour prices are not likely to increase due to a current unemployment.

The uncertainity was decreased in the months before the Greek elections by the long-term repo operations, but it will be continued with the accommodative monetary policy, as the growth in the eurozone is not certain. The President of ECB Mario Draghi stated that the positive effects of the long-term repo operations are felt, thus the credit conditions are more favourable, though it is not certain whether there would be a continuation with unconventional instruments. The essence of the EU Growth Compact is made of structural reforms in the field of productivity and in the labour market. According to some studies, the most responsible for high unemployement in some EU Member States is the over-protection of the employees through the union and the law. Reference rate might be corrected in a downward trend, though the ECB represents a somewhat tougher stance in this respect than the IMF. The ECB viewpoint is that in the conditions of a harsh fiscal consolidation, the expansionary monetary policy can hardly be of significant influence on the growth rate, while the negative effects can be dominant, so caution should exist in terms of further reduction of the reference rate. If future Greek government countinues with the anti-crisis program, it will be a good time to access some type of a common bond issuing. For starters, it is possible to launch the common treasury bills, with up to one-year maturity, which could help tracing the way towards the issuance of the eurozone common long-term bond.

Tendencies in Central and Eastern Europe

The recent forecast for Central and Eastern Europe are somewhat pessimistic. For most countries in Central and Eastern Europe, the European Comission (EC) and EBRD have reduced the growth estimates for this year and the forecasts for the next one. The reasons for a slowdown of both growth and fall are negative tendencies in the developed European countries from where the bulk of investmens comes to Central and Eastern Europe. Moreover, some lending institutions are withdrawing funds from Central and Easter Europe, both for the problems and the new regulations in their home countries, and for the increased risk crisis in the region. It is expected that the European banks will withdraw the capital in the region by 4% of a total amount of domestic loans, unless some significant changes occure on the financial market. A particular risk referes to the countries where there is a considerable activity of Greek banks and that may have much higher reduction in leverage. Furthermore, both stagnation and recession in the developed countries negatively affect the export of the Central and Eastern European countries.

Fiscal stimulation, as an option, is usually not available to the countries of Central and Eastern Europe, because the risk of a public debt crisis is higher than a potential gain of fiscal stimulus. Therefore, these countries massively enforce fiscal consolidation with various combinations of reducing public spending and increasing taxes. The character of fiscal consolidation in these countries is highly affected by socialistically oriented parties that rise to power. Slovakia, Romania and Croatia have obtained new governments of leftist views, which announce the continuation of a fiscal consolidation, but with less reliance on savings, and more on the tax increase. However, some right-wing governments, such as Hungary, realize most of the fiscal consolidation by increasing taxes without any significant reduction in spending. Unlike aforementioned countries, the new Slovenian government, at least for now, enforces fiscal consolidation by reducing public expanditures, with a nominal wage reduction in the public sector etc.

The new government in Slovakia is planning to reduce the budget deficit in the next few years - it should amount to 1.7% of GDP in 2015. The current proposals in Slovakia are those for the reintroduction of the increase in synthetic personal income tax in the corporate income tax from 19% to 23%, increase in the excise duties on alcohol and cigarettes, the introduction of a new tax on luxury goods. The government of Slovakia is committed to the fiscal consolidation, but mostly through an increase in revenue, which could worsen a long-term perspective of Slovakia. However, there is a little chance for that, because the tax rates in Slovakia were initially low, so it will remain at a competitive level even after the increase in rates. It remains uncertain whether these measures will be introduced and whether they will be sufficient to meet the set objectives of the budget deficit.

Last year, Croatia had a zero growth after two years of contraction, and this year, the growth rate of GDP will drop again. The new government has, at least for now, transferred the focus of fiscal consolidation to the increase of tax revenue. The public revenues were increased in the period from January to April by 5.6% annually, primarily due to the increase in VAT and income taxes, while the expanditures were by 0.8% lower. It is still uncertain whether the Croatian government will successfully implement the savings announced, which, in all likelihood are not enough. The structural reforms in the labour market will increase the labour market flexibility and equalize the rights of the employed in the public and private sector, and the employment contract for an indefinite period in the public service will not be extended. This will increase the unemployment in a short-term, but will create conditions for improving the long-term growth. After preservation of the Croatia's rating, a foreign demand for government bonds increased, thus the decline in the rate of the kuna was stopped and reversed.

In Romania, after the measures for reducing the public spending and the tax increase, public protest ensued and eventually led to a collapse of the government in April, because it was voted of no confidence in the parliament. Shortly after, a vacuum in the negotiations with the IMF was created, and the Romanian leu devalued against the euro to a historical minimum value. The newly formed government with the socialist Prime Minister continued the negotiations, and it requires, as of June, the rise in the wages on two occasions in the public service, to pacify a discontent among the people. Wages of the public servants will be increased by 16% until the end of the year, and "the health tax", charged earlier, will be restored to the retirees with the low pensions (this will increase the deficit by 0.1% of GDP). Therefore, the planned budget deficit was increased from 1.9% to 2.2%. It remains to be seen how this deficit will be achieved with the aforementioned increased expanditures.

Romanian Central Bank has, since November, reduced the reference rate four times, each time by 0.25 percentage points, thus it amounts to 5.25%. Inflation is decreasing - overall annual dropped from 3.2% in December 2011 to 2.4% in April of this year. By way of a reminder, in March last year stood at as much as 8% at an annual rate, thus, current inflation is closer to the planned. The Central Bank wants to maintain the liquidity of the banking system, in the situation when some banks withdraw the money from Romania, and at the same time encourage the economic activity. Therefore, it is expected that, in this year, the reference interest rate will remain unchanged, but will probably increase the minimum reserve ratio for the deposits in a domestic currency. A moderate withdraw of the capital occurred in the last year, which didn't have much impact on the rate and the level of foreign reserves. The GDP growth was forecast by the EC to stand at 1.4% over the year 2012. It is evident that the planned wage increases by 16% are a preparation for the success in the upcoming parliamentary elections in November. The example of Romania suggest that there is a risk of such a scenario in other countries of the region and that the ensuring the political stability is a complementary process to the fiscal consolidation.

The economy of Hungary recorded a drop by 0.7% at an annual level during Q1. The EC preassures the Hungarian government for making "non-European" laws, and the EU finance ministers decided to suspend the funding to help the underdeveloped areas of nearly 500 mn € for the next year, if the country does not show a clear progress in the fiscal consolidation. It is necessary that in 2011 it meets its budget deficit target of 2.5%, and provides a deficit lower then 3% from the next year. It is evident that this is a form of a pressure on the Hungarian government, whose undemocratic changes in the Law on the Judiciary and Central Bank and the introduction of controversial taxes are highly unexceptable for the EC. The formal reason, i.e. exceeding the budget deficit amount, is not met in 19 out of 27 countries of the EU.

It is expected that the Hungarian government will crack under pressure in order to reach the agreement with the IMF, because it is necessary to provide the financial aid to prevent the interest growth on the government bonds. Currently, the interest rate amounts to 8%, highest in the Central Europe, and if it remains at that level, Hungarian public debt will become unsustainable. Therefore, it is almost certain that the concessions are to be made in order to continue the negotiations with the IMF, and the stalling of the Hungarian government is a part of a political marketing and strategy. According to the government sources, the precautionary arrangement in the amount of 15bn € is planned and last 3 years. The IMF stated that the negotiations will begin only when the government takes adequate steps to ensure the independence of the Central Bank.

Hungary has proposed a plan of a new "crisis" taxes that are consistent with the already negative image of the Prime Minister Orban. From the January next year taxes on the financial transaction of 0.1% will be introduced. They will mainly affect the companies and physical entities, but there is a plan of a restriction that would help a big capital coming into the country to be partially spared. The tax on telecommunications, by the number of minutes during conversation and the number of text messages, will be applied as of June. Such a plan fits in with the intention of the Hungarian government to increase the amount of revenue through indirect taxes. Another contradiction in this government- the new economic program declaratively protects citizens who are not "wealthy" in order to obtain their political support, but indirect taxes, in fact, affect equally all layers of the population- both rich and poor. This is an example of how political populism, which manipulates with the voters discontent over the crisis, represents a threat to the successful implementation of the economic reforms, because it annuls the urgency of structural reforms.