

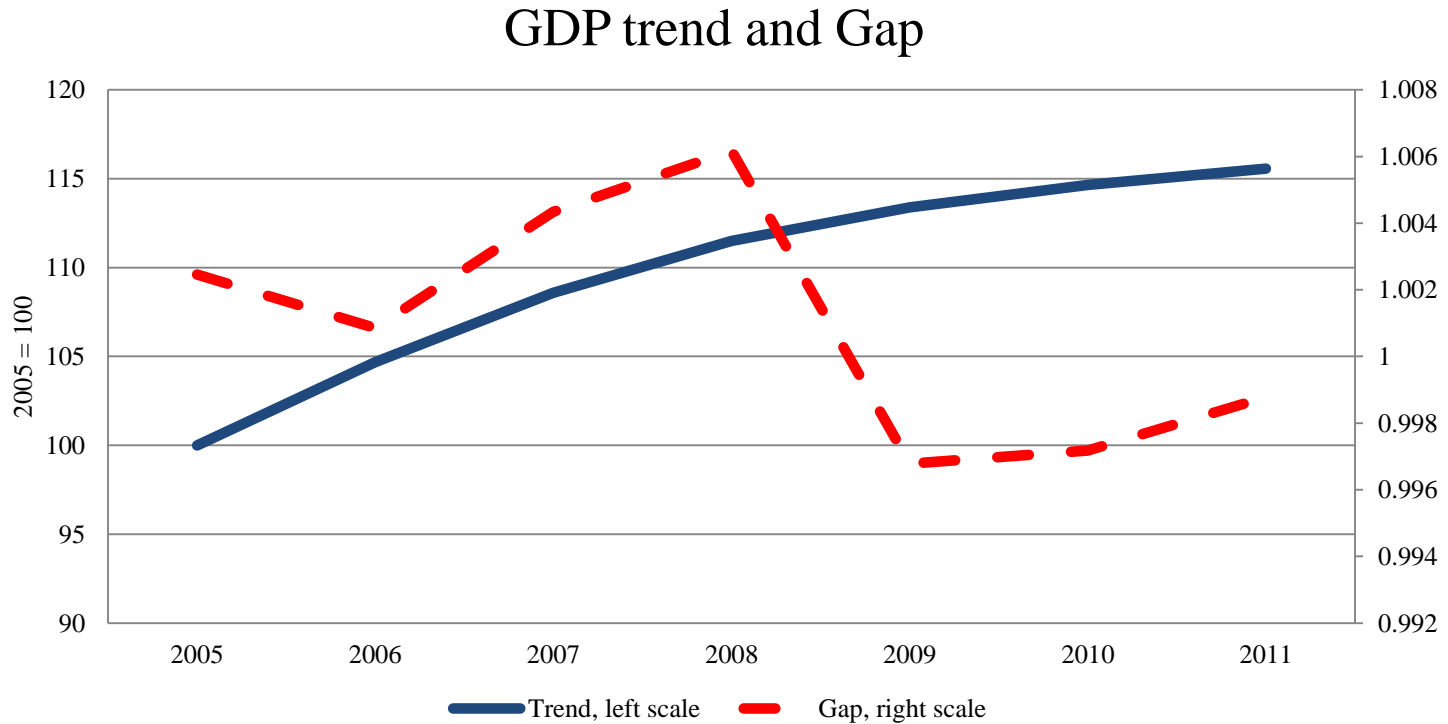
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**Double-Dip Recession
and
Policy Options**

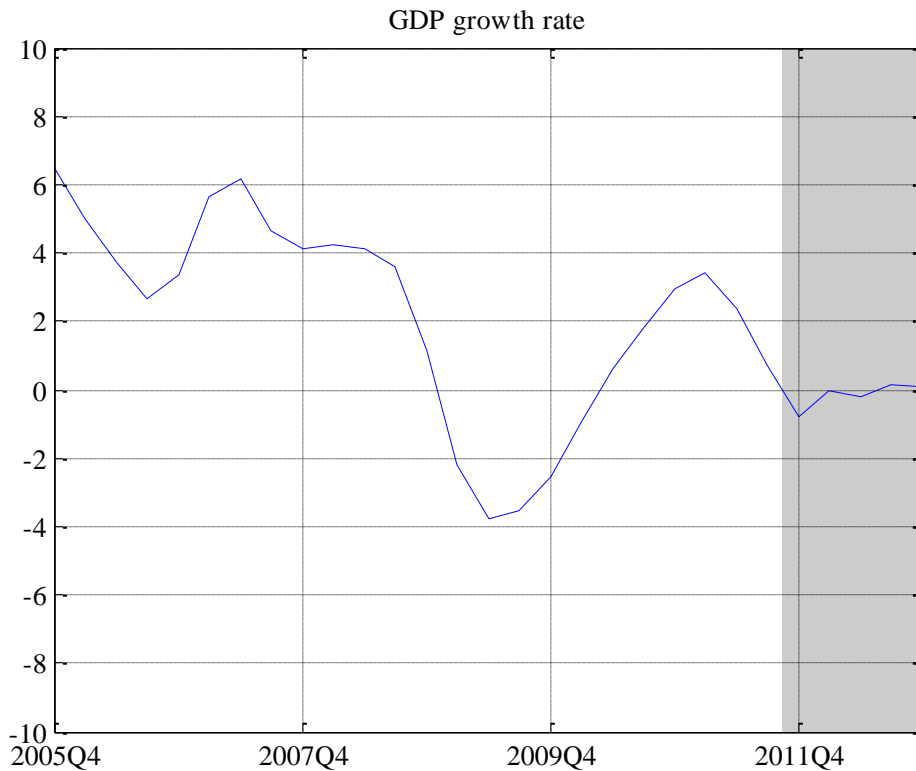
Kopaonik Business Forum 2012
March 7, 2012

Long-term crisis



- **We went out of recession in 2010, but still...**
- **The Serbia's economy is in a bust stage of the crisis**

Double-Dip recession



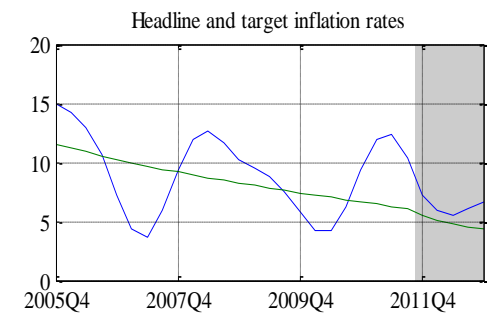
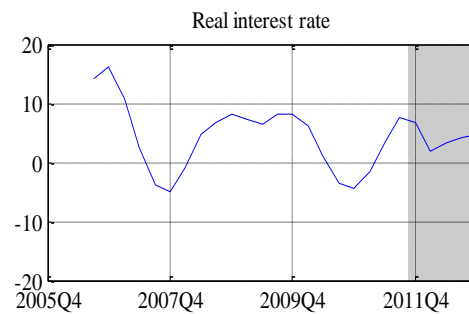
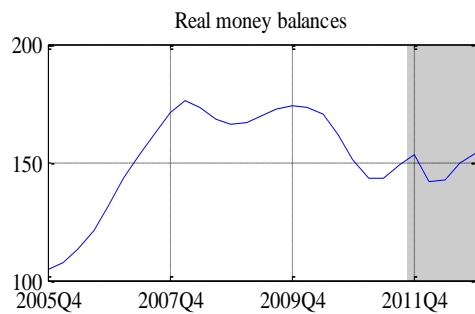
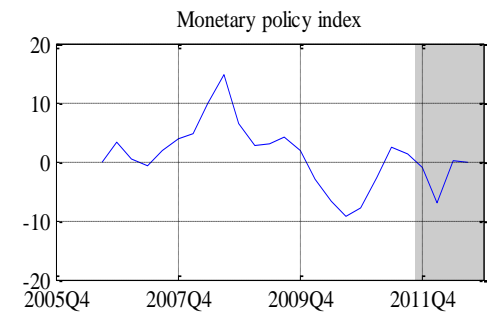
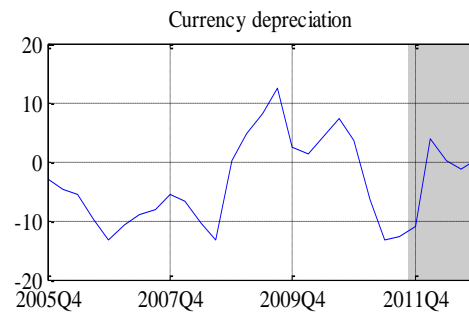
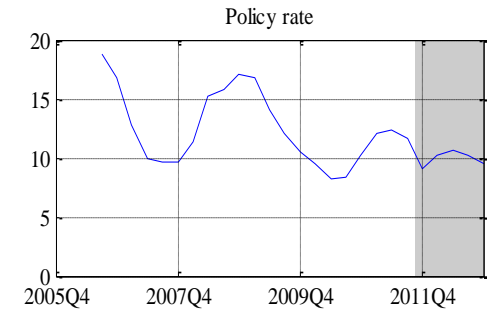
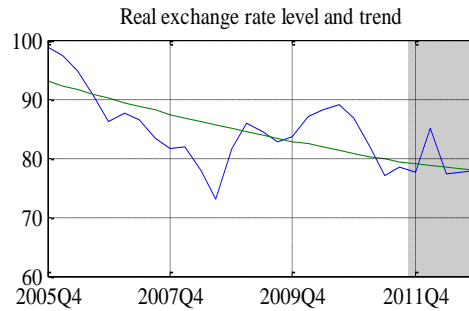
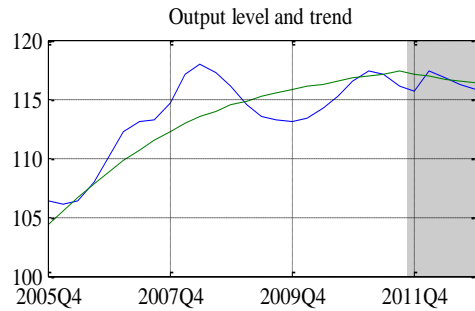
- DSGE model 2001:Q1 – 2011:Q3
- Standard version plus
- Money demand equation, and
- Fiscal equation
 - Current and capital expenditures
 - Current revenue, and
 - Interest payments

- **Official forecast for 2012 envisages mild growth of GDP by 0.5%,**
- **However, it is reasonable to expect the Serbian economy to decline up to**
- **-1% in 2012,**
- **A double-dip recession seems inevitable, but less severe than in 2009.**

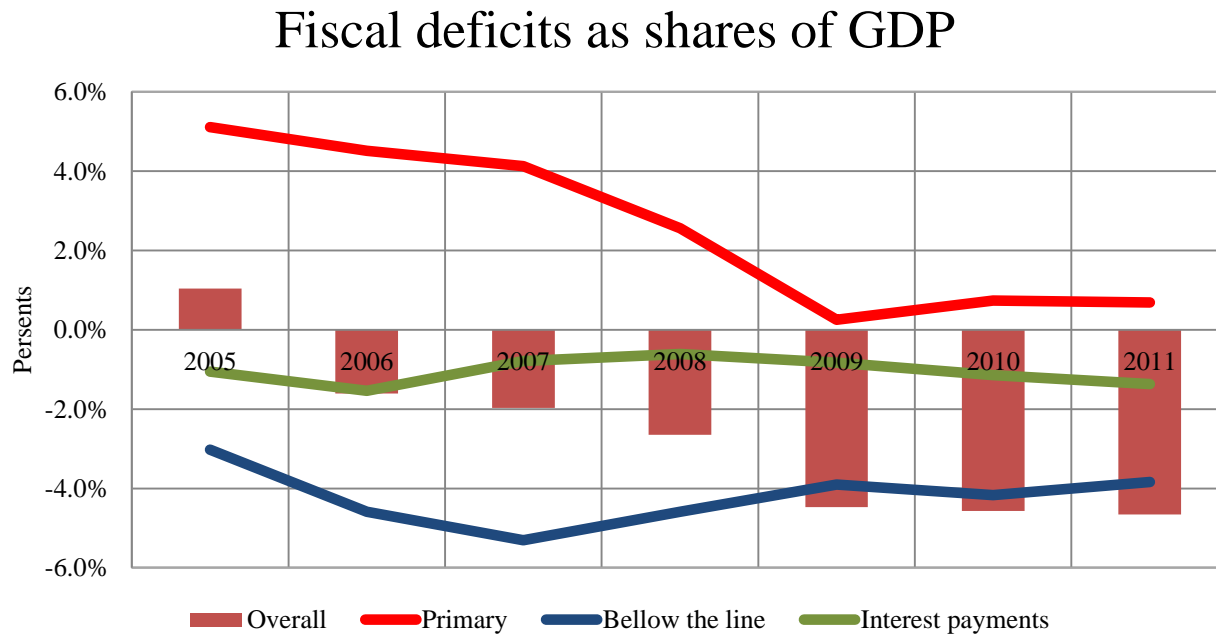
Policy options

- Do nothing
- Pro-Cyclical Fiscal and Monetary Policy
- Anti-Cyclical Fiscal and Pro-Cyclical Monetary Policy
- Anti-Cyclical Fiscal and Monetary Policy

Do Nothing: Forecast for 2012



Formation of Fiscal Deficits



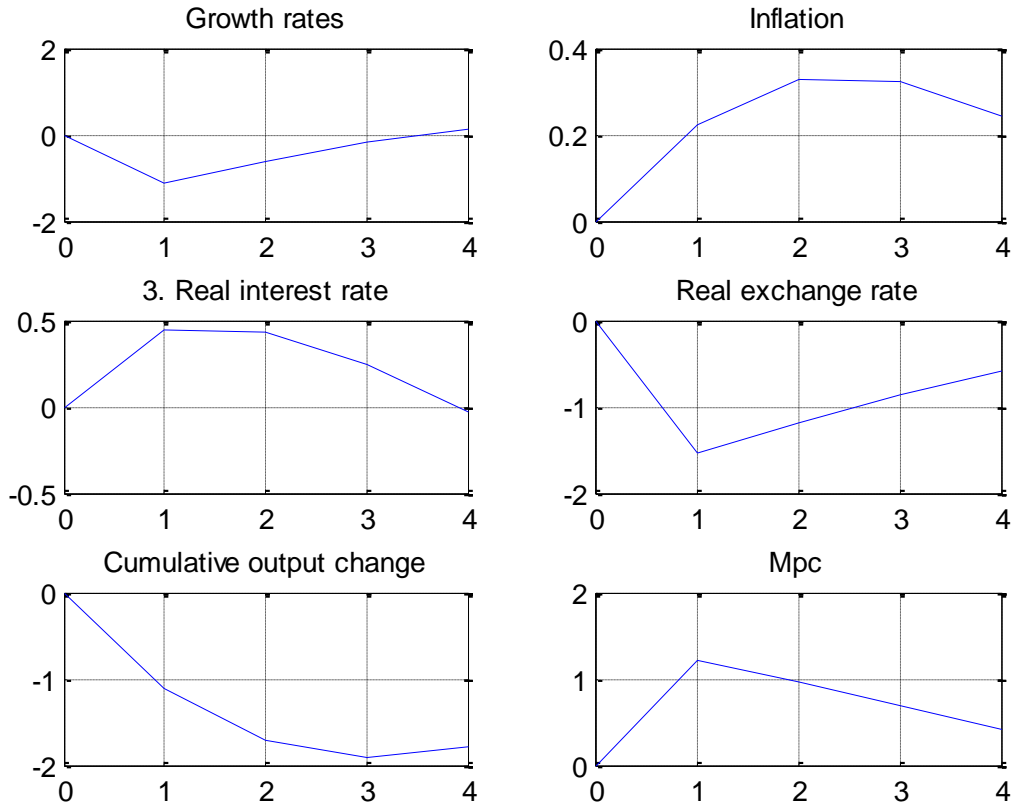
- **Costs of servicing public debt is close to its sustainability limits**
 - They represent one half of all transfers to the pension fund
- **Primary fiscal surplus must increase**
 - Government has to cut expenditures and increase its savings.

Pro-Cyclical Fiscal Policy

- Revenue increase measures
 - Taxes on property, income and profit
- VAT increase
- Expenditure cuts
- Goal: Increase primary fiscal surplus

Pro-Cyclical Fiscal Policy: Forecast for 2012

Figure 2.1: Pro-Cyclical Fiscal and Monetary Policies



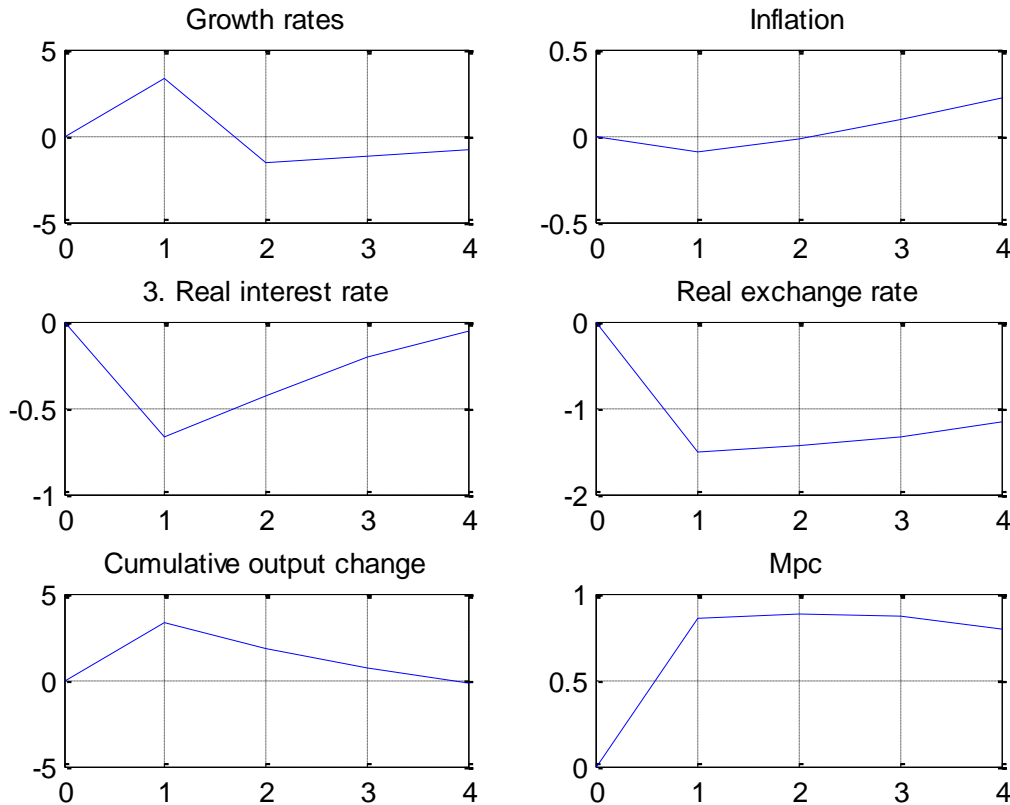
- Growth rates negative
- Modest inflation
- Positive interest rate
- Real exchange rate appreciates
- Cumulative output declines
- Restrictive monetary policy stance

Counter-Cyclical Fiscal Policy

- Revenue increase measures
- VAT increase
- Expenditure rise
- Goal: Sustainable budget deficit plus Demand boost

Counter-Cyclical Fiscal Policy: Forecast for 2012

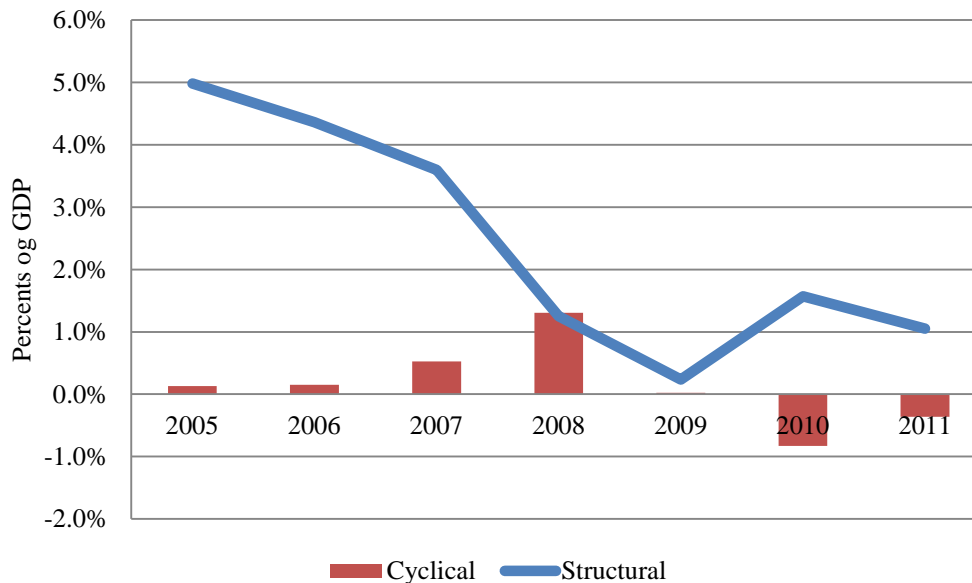
Figure 2.2: Anti-Cyclical Fiscal Policy and Pro-Cyclical Monetary Policy



- Growth rates temporarily positive
- Temporarily disinflation
- Mostly positive interest rate
- Real exchange rate appreciates
- Cumulative output increases
- Restrictive monetary policy stance

Structural and cyclical primary fiscal surplus

Relative size of structural and cyclical primary fiscal surplus



- Cyclical part of primary fiscal surplus is rather small
- Structural surplus is insufficient
 - Counter-cyclical measures to boost economic activity
 - Structural adjustment to change long-term trend is more important

$$CAPD = R \cdot \left(\frac{GDP^{trend}}{GDP} \right)^{\varepsilon_R} - G \cdot \left(\frac{GDP^{trend}}{GDP} \right)^{\varepsilon_G}$$

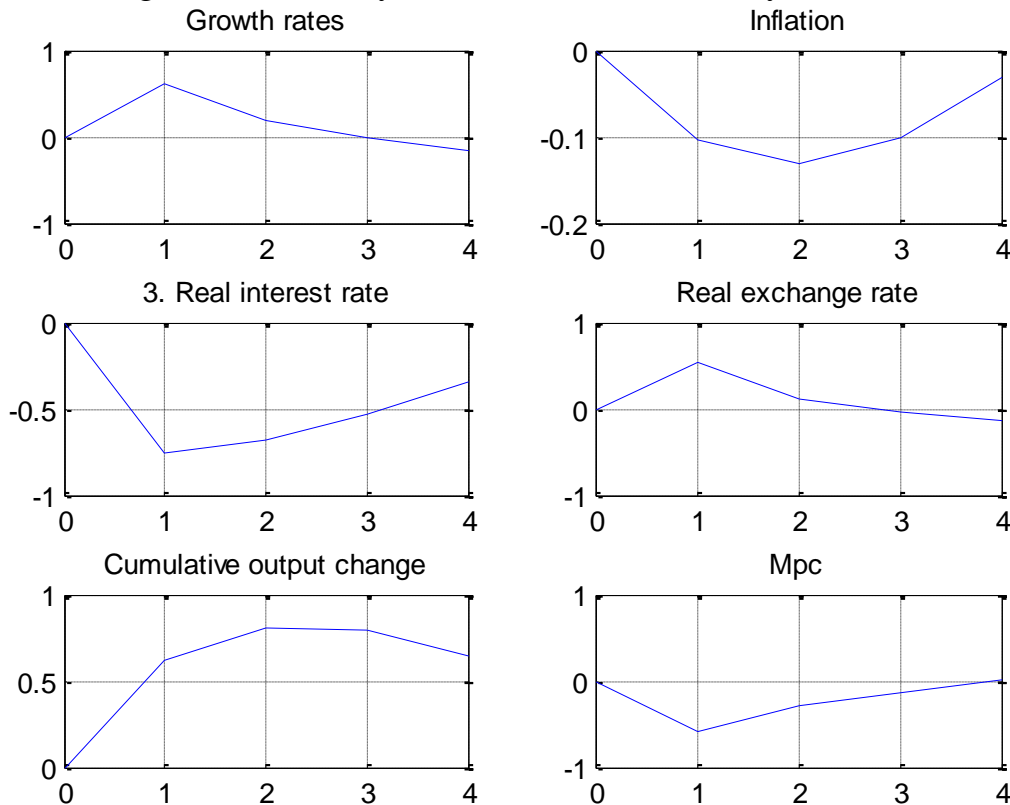
Policy Mix:

Counter-Cyclical Fiscal and Monetary Policies

- Revenue increase measures
- VAT increase
- Expenditure switch
- Non-Standard Monetary Measures
 - Credit subsidies (IMF Working Paper)
 - Mandatory reserves (quantitative easing)
 - [Bank recapitalization and real-sector restructuring]
- Goal: Fiscal consolidation plus Recovery from Double-Dip recession

Counter-Cyclical Fiscal and Monetary Policies: Forecast for 2012

Figure 2.3: Anti-Cyclical Fiscal and Monetary Policies



- Growth rates positive
- Disinflation followed by inflation
- Temporarily negative interest rate
- Real exchange rate depreciates
- Cumulative output increases
- Monetary policy easing

Conclusions

- Policy options are on the menu,
- Longer-term measures cannot be postponed any more,
- New government should align fiscal policy with monetary measures with the National bank,
- The NBS should pay due attention to the business cycle, not to inflation only.