Double-Dip Recession and Policy Options

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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

- 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.

- Standard version plus
- Money demand equation, and
- Fiscal equation
  - Current and capital expenditures
  - Current revenue, and
  - Interest payments

GDP growth rate

-10 -8 -6 -4 -2 0 2 4 6 8 10
2005Q4 2007Q4 2009Q4 2011Q4
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

- **Output level and trend**
  - 2005Q4: 100
  - 2007Q4: 105
  - 2009Q4: 110
  - 2011Q4: 115

- **Real exchange rate level and trend**
  - 2005Q4: 100
  - 2007Q4: 105
  - 2009Q4: 110
  - 2011Q4: 115

- **Policy rate**
  - 2005Q4: 0
  - 2007Q4: 5
  - 2009Q4: 10
  - 2011Q4: 15

- **GDP growth rate**
  - 2005Q4: -10
  - 2007Q4: -5
  - 2009Q4: 0
  - 2011Q4: 5

- **Currency depreciation**
  - 2005Q4: -20
  - 2007Q4: -10
  - 2009Q4: 0
  - 2011Q4: 10

- **Real money balances**
  - 2005Q4: 100
  - 2007Q4: 150
  - 2009Q4: 200
  - 2011Q4: 250

- **Real interest rate**
  - 2005Q4: -20
  - 2007Q4: -10
  - 2009Q4: 0
  - 2011Q4: 10

- **Headline and target inflation rates**
  - 2005Q4: 0
  - 2007Q4: 5
  - 2009Q4: 10
  - 2011Q4: 15
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.
Revenue increase measures
  • Taxes on property, income and profit
VAT increase
Expenditure cuts
Goal: Increase primary fiscal surplus

Pro-Cyclical Fiscal Policy
Pro-Cyclical Fiscal Policy: Forecast for 2012

- 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

- 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

Relative size of structural and cyclical primary fiscal surplus

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

- 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.