10 Minutes

Tax and macroeconomic point of view on the 2014 Budget of the Republic of Serbia

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Tax perspective | Macroeconomic perspective

December 2013

The Budget of the Republic of Serbia for 2014 has been prepared taking into account the 2013 macroeconomic trends, the 2014 macroeconomic projections and the economic and fiscal policies for 2014.

Tax perspective

Fiscal policy measures to reduce the budget deficit include, inter alia:

- Increasing the lower Value Added Tax (VAT) rate from 8% to 10%
- Reducing public sector pay
- Reducing subsidies
- Reducing the size of the shadow economy (increasing tax collection)

VAT is the major source of revenue for the budget. It is estimated that an increase in the lower VAT rate (from 8 to 10%) and a transfer of certain product category rates from lower to general will reflect in a budget revenue increase of RSD 21,4 billion.

Excises are the second major source of revenue for the budget. Estimated effects of a decrease in the size of the shadow economy of RSD 6,2 billion were taken into account in the projections of revenues coming from levies on tobacco products.

The share of Corporate Income Tax (CIT) in the budget revenue will grow mainly because of the tax rate increase from 10% to 15% in 2013, the full effect of which is expected in 2014. It is expected that the share of CIT will further grow in consequence of the abolition of the right to tax credit for investments in property, plant and equipment.

The share of Personal Income Tax (PIT) in the budget revenue will fall because of the drop in the salary tax rate from 12% to 10% and the rise in the tax-free threshold to RSD 11,000.

The share of customs duties revenue will continue to fall in 2014. It is expected that the customs duties revenue will stabilise upon harmonising customs rates with those applied in trade with the European Union, the EFTA and Turkey under trade arrangements.

Budget revenue	% of Budget revenue	
	2013	2014
Tax revenue	**87.2**	**86.3**
VAT	46.3	46.2
Excises	24.9	24.5
CIT	5.5	6.2
PIT	5.6	5.2
Custom duties	4.0	3.2
Other tax revenue	1.0	1.0
Other	**12.7**	**13.7**
Total	100	100

Macroeconomic perspective

Inflation
The year on year (y-o-y) inflation rate declined to 1.6% in November 2013 from 11.9% a year ago and is likely to remain low for the next three months. This is considered a remarkable achievement of the monetary policy in 2013. Inflation trend is expected to resume afterwards, and inflation will cross from below the target inflation rate in summer next year. The budget assumes average annual inflation rate of 5.5%. If this rate is correctly envisaged, the year end inflation in 2014 should be above 8%.

GDP
The nominal Gross Domestic Product (GDP) in 2013 will be RSD 3,761.3 billion if the anticipated annual real growth rate of 2% is achieved. In any case, the economy is drifting out of the recession due to export boom and good harvest, which is also an achievement. The nominal GDP for 2014 is set by the budget at RSD 4,007.8 billion. It implies 1% real growth rate and 5.5% average inflation rate. The economy will keep departing from recession, but at a very modest pace.

Exchange rate
The budget applied the nominal exchange rate as of the end of September 2013 as the benchmark for the whole year (114,6044 RSD/EUR). The implicit nominal exchange rate in the budget for the next year is 118.8 RSD/EUR, which indicates a 3.7% loss of its level value over the year. If the average inflation rate in 2014 is 5.5%, this means that the real exchange rate will continue to appreciate. This is good news for importers, but bad news for exporters.

Fiscal deficit
The budget revenue in 2013 is RSD 930 b. or 23.2% of GDP. Expenditures are set at RSD 1,113 b. or 27.8% of GDP. Hence, fiscal deficit is projected to RSD 182.5 b. or 4.6% of GDP. If below-the-line items are added up, the general government fiscal deficit will be propelled to 7.1% of GDP. This is the historic high regarding the past decade.

Public debt
Consequently, the overall public borrowing in 2014 will be €5.7 billion (including public guarantees of €787 million). This equals 16.5% of GDP, of which 12% will be used to repay due loans and guarantees. It is envisaged that Euro bond market borrowing will be rather modest (less than one billion), since €2.2 billion will be borrowed from foreign governments. It is claimed that these loans will be much cheaper than those at the Euro bond market. Still, a considerable amount of loans (€2.8 billion) will be taken in the domestic credit market (in RSD or hard currencies), which will keep interest rates high.

Interest rates
There is a good liquidity in the banking sector, and a weak one in the real economy. Therefore, interest rates on short-term working capital loans are our concern. They have recently declined in local currency, but still above 16%, while they are 7.5% for indexed loans, with almost a flat trend. This broadly implies 8% of the expected inflation rate. The repo interest rate is set at 10% and the NBS does not intend to reduce it in the near future as it expects a rise in inflation next year.

Current account
Current account has significantly improved in 2013, due to an expansion in export (especially cars) and somehow constrained import caused by low domestic demand. It is envisaged that the current account deficit will be less than 5% of GDP by the end of this year, which is also good news.

Employment
The Government has adopted a decree on the upper limit of staff in the public administration. However, the budget indicates that only 21 thousand jobs are frozen, whereas the remaining 249 thousand jobs in the police, military and education sectors are not. Public sector salaries, as well as pensions, will be indexed by 0.5% in April and 1% in October 2014, which is below the expected inflation rate. Public administration is also subject to a "solidarity tax" in 2014, but this will not be enough to cover losses in State Owned Enterprises (SOEs). On this account, there is a Government commitment to start restructuring SOEs in 2014.