10 Minutes

Tax and macroeconomic point of view on the 2017 Budget of the Republic of Serbia

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Tax perspective | Macroeconomic perspective

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Due to the improvement in the 2016 fiscal result, budget projections for 2017 provide for some relaxation of existing fiscal measures and an increase in public sector salaries and pensions.

Tax perspective

The Budget of the Republic of Serbia for 2017 has been prepared taking into consideration the 2016 macroeconomic trends, as well as the macroeconomic projections and economic and fiscal policies for 2017.

Value added tax (VAT) remains the most significant source of budget revenue. It is estimated that VAT will increase its share in total budget revenues in 2017, mainly due to improvements in tax audit and tax collection.

Excise duties are the second most significant source of budget revenue. The projection of budget revenues from excise duty amounting to RSD 271,1 billion was calculated by taking into consideration the estimated effects of changes in excises policy, especially deriving from the harmonisation with the EU Directives relating to excises rates for tobacco products, expected consumption growth and regular adjustment of the nominal amount of the excise duty.

The expected share of corporate income tax (CIT) in total budget revenue is projected based on improved tax collection, economic growth recorded throughout 2016 and expected stable exchange rates.

It is estimated that personal income tax (PIT) will increase its share in total budget revenue as a result of the increase in public sector salaries and the decrease of the share of PIT revenues distributed to local authorities.

Estimated revenues from custom duties amounting to RSD 38,6 billion are projected based on current export trends and stable exchange rates. Following the completion of the harmonisation process relating to trade with EU, EFTA and Turkey, the share of revenues from custom duties in total budget revenue is expected to remain stable, and to record a slight increase.

Budget revenue	% of Budget revenue	
	2016	2017
Tax revenue	**82**	**83,9**
VAT	41,7	42,6
Excises	24,7	24,8
CIT	6,7	6,8
PIT	4,6	5,1
Custom duties	3,4	3,5
Other tax revenue	0,9	1,0
Other	**18**	**16,1**
Total	100	100

Macroeconomic perspective

Fiscal consolidation
The Parliament adopted Serbia's 2017 budget amid macroeconomic stability and improved prospects for growth. The budget further reduced fiscal deficit of the general government to 1.7% of GDP in 2017 compared to 2.1% in 2016 and 3.7% in 2015.

Fiscal consolidation slightly revised the trend of rising debt-to-GDP ratio, which is expected to reach 74% by the end of 2016.

Inflation
Inflation was subdued for the past three years, which indicates a sustainable market stability. Hence, the National bank of Serbia officially reduced the inflation target from 4% to 3% in 2017.

GDP growth
Real GDP growth is expected to be at least 2.7% in 2016 and 3% in 2017, after Serbia has undergone a period of triple-dip recession. Growth in 2016 was originated in manufacturing, construction and agriculture sectors, on the supply side, and export and investments, on the final use side of GDP.

After many years of tightening, labour market also shows signs of expansion.

Exchange rate
The real exchange rate was relatively stable. This stability is expected to prevail in 2017.

Interest rates
Interest rates were already falling down in 2016 (Beonia 2.57% and T-bills 2.65%, REPO 4%). Under present circumstances it hard to expect further reductions in the REPO policy rate. Current account deficit improved from -5% GDP in 2015 to -3.5% GDP in 2016.

Public debt
Consequently, the overall public borrowing in 2014 amounts to €5.7 b. (including public guarantees of €787 m.). This equals to 16.5% of GDP, out of which 12% of GDP will be used to repay due loans and guarantees. It is envisaged rather modest borrowing on the euro bond market (less than one billion), since €2.2 b. will be borrowed from foreign governments.

It is claimed that these loans will be much cheaper than ones at the euro bond market. Still, a considerable amount of loans (€2.8 b.) will be taken in the domestic credit market (in RSD or hard currencies). This will keep interest rate high.

Budget revenue and expenditure
Budget revenue will increase by 1.8% in 2017, reaching about RSD 1.09 trillion, while budget expenditure will rise by 3.9% or some RSD 1.16 trillion. It is envisaged larger tax base for VAT and tax excises and their better collection.

Public capital expenditure will also increase, while transfers for pension payments will decline. Other revenue and expenditure items in the Serbian budget will have minor changes in 2017.

Public borrowing
The level of public debt requires heavy borrowing in 2017 in order to smoothly financing it. Public borrowing will increase from 15.8% of GDP in 2016 to 19.5% in 2017. On the financing side, repayment of domestic principal amounts to 10% of GDP, while foreign principal adds additionally 8%. Government will mostly borrow on domestic market, which might trigger a crowding-out effect on the private sector with usual consequences of rising interest rates.

SBA with IMF
International Monetary Fund is expected to approve the sixth review under the ongoing stand-by arrangement with Serbia. After that, the IMF will reduce the frequency of reviews, and will perform these checks twice a year, instead of quarterly. This indicates that Serbia is advancing in the fiscal consolidation process.

Key budget indicators
Let us reiterate that key macroeconomic assumptions underlying the budget for 2017 are: expected GDP growth of 3%, inflation rate of 2.4% and fiscal deficit of 1.7% of GDP.