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THE IMPACT OF THE NEW ECONOMIC REALITY ON WAGES AND INFLATION WITH REFERENCE TO SERBIA

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***Abstract**: Current events in the world, the most dangerous of which are the SMO in Ukraine and the war in the Middle East, are leading the world to a new economic reality and major changes. The conflict in Ukraine is essentially a conflict between Russia and the West, and a new international order is emerging in light of a growing Russian-Chinese axis facing a declining West. The recovery from the COVID-19 pandemic lost momentum in 2022, regardless of employment stabilization. The quality of jobs offered has improved in some dimensions, but real wages are falling significantly in almost all OECD countries despite an increase in nominal wage growth. But that's why in most of those countries, there was an increase in profits, often more than nominal wages. Nominal minimum wages try to keep pace with inflation, with the high risk that any real growth could quickly disappear if inflation remains high. The goal of the research is to present the situation in the global market, with special reference to the trend of wages and inflation in the EU, as well as the presentation of the situation in Serbia, according to the same parameters. The paper will use the deduction method. Materials from scientific journals and primary sources were used in the presented research, using the method of content analysis. An appropriate statistical regression method was applied. The hypothesis put forward in the paper is that the nominal increase in wages is a consequence of the inflation increase. It is expected that the research will confirm the hypothesis.*

***Key words**: global economy, GDP, debt, inflation, wages*

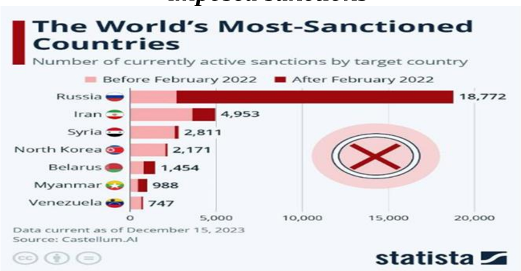
***JEL classification:** E2, E3*

1. INTRODUCTION

According to the Iranian Institute of International Studies (Therme, 2022), before the war in Ukraine (2022) and the US withdrawal from Afghanistan (August 2021), the dominant idea in Western strategic circles was based on the concept of a "rules-based international order", where the international order was based on the idea of one hegemon - the United States of America. The current situation in Ukraine is leading the world to a new reality and major changes, given that this conflict goes far beyond Ukraine, and essentially represents a conflict between Russia and the West. The New International Order of 2022 is taking on new contours in light of a growing Russian-Chinese axis facing a declining West. This decline will not be short-lived as the European continent will remain at war and subject to increasing fragmentation as long as the military confrontation in Ukraine continues. The members of the European Union (EU) do not agree on the idea of total separation of Russia from the West and the globalized international financial system based on the US dollar, considering that the exclusion of Russia from the global economy is not the same as the exclusion of Iran, Syria or North Korea. The EU's fear that sanctions against

Russia could have unintended consequences in the form of self-sanctioning of its economies proved to be justified. The biggest challenge facing the current sanctions regime is that it is supported by only a minority of countries around the world.

Table 1. Countries with the largest number of imposed sanctions



Source: Statista, 2023

The European refusal to use the ruble as a currency for trade (except for Hungary and Slovakia) carries with it a great political risk for accepting such a decision. If European countries accept the ruble to buy gas, it will mean opening a Pandora's box for other commodities such as fertilizers and oil, which is a significant step towards the de-dollarization of international trade. Sanctions against Russia threaten to undermine the US dollar's dominance, the IMF says (Financial Times, 2022).

Monetary policy struggles with curbing inflation, on the one hand, and the need to limit production losses, on the other. Unfortunately, much of the pressure on prices comes from forces outside the control of central banks, such as energy and food market shocks, as well as supply chain disruptions. Nonetheless, monetary policymakers must continue with a conservative policy of credit conditions to work to curb inflationary expectations and bring under control domestic drivers of inflation, such as wages and rents (Irtyshcheva, Kramarenko, and Sirenko, 2022).
Fiscal pressures will be far more present in countries that have opened their borders to refugees, such as Poland, which has received almost 3 million people, or Moldova, where the ratio of the number of refugees to the number of inhabitants is very high. This highlights the need to share humanitarian aid costs fairly among EU members (Insights & analysis on economics & finance, 2022).

The confrontation between the West and Russia, which has escalated to a great extent, forces company leaders, entrepreneurs, and policymakers to implement the long-term consequences of current hostilities in their business. It is already clear that this will have a long-term negative impact on most European companies and economies, which will result in a permanent restructuring of world trade (Prohorovs, 2022).

2. THE EUROPEAN CENTRAL BANK

A war in Ukraine will trigger a massive negative supply shock in the global economy (Roubini, 2022).

According to the European Central Bank, half of the recent rise in inflation has been driven by higher energy prices (ECB, 2022).

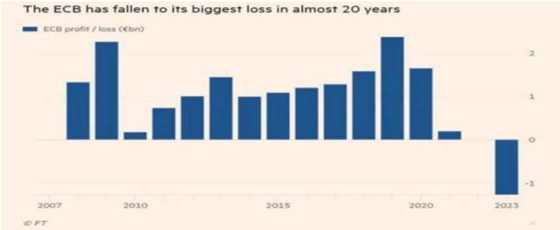
The war in Ukraine brought to the fore the dilemma faced by central banks on both sides of the Atlantic, namely, how quickly, comprehensively, and strongly to tighten financial conditions in an environment of inflation that can no longer be seen as only temporary and reversible. The challenge is all the greater because it is necessary not to reduce the pace of economic activity at the same time, without causing financial turmoil (Canuto, 2022).

Among the Eurozone countries, Estonia, Lithuania, the Czech Republic, and Latvia have significantly higher inflation rates than other EU countries. The ECB believes that the increased level of corporate debt dating back to the COVID-19 pandemic makes companies more sensitive to increased risks, higher interest rates, or falling profits. Therefore, worse balance sheets of companies represent a risk for banks (ECB, 2022). Both America and the Eurozone will face recession in 2022 and 2023 (McKinsey, 2022).

For the first time in its history, the European Central Bank is facing such a crisis and potential stagflation. If we look at what caused this crisis, it is clear that tightening policies will not reduce inflation. Likewise, additional stimulus will not be able to prevent an economic downturn, as it is caused by a lack of supply (RaboResearch 2022).

The European banking sector remains segmented along national lines. The crisis management framework for small and medium-sized banks is less robust than for larger banks, accompanied by prudential regulatory barriers to the single European banking market. Cross-border integration is progressing at a slow pace. In 2021, the amount of domestic assets was more than four times the amount of non-domestic assets in the Eurozone.

Graph 1. The biggest loss in the business of the ECB

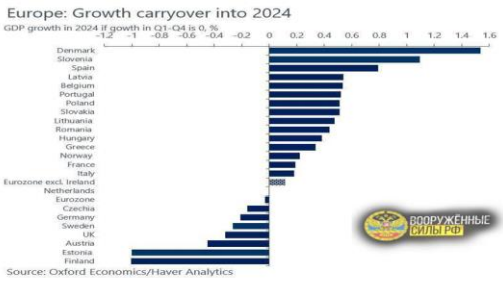


Source: Financial Times, 2024.

From a European perspective, the Russian SMO in Ukraine is the main cause of the potentially severe consequences of geopolitical disturbances. This was the reason, among other things, for the introduction of unprecedented economic and financial sanctions, such as the exclusion of Russian banks from SWIFT, the freezing of the country's financial assets (including central bank reserves), and the blocking of trade in key raw materials and agricultural products. The consequence of all this is that the EU was forced to try to drastically reduce its dependence on Russia, which was the main supplier of energy in the EU, with increased costs (ECB, 2023).

According to the assessment of the International Monetary Fund, the risks of the projection of global economic growth, for the first time in a long time, were assessed as symmetrical, whereby economic growth is estimated to be 3.1% this year, which is more favorable than the expectations from October. When it comes to economic activity in the eurozone, it practically stagnated in the second half of last year, which is why growth is forecast for this year to be slightly lower than three months ago, but still higher than in 2023 (NBS, 2023).

Graph 2. GDP in the EU in the first quarter of 2024.



Source:OxfordEconomics/Haver Analytic, 2024.

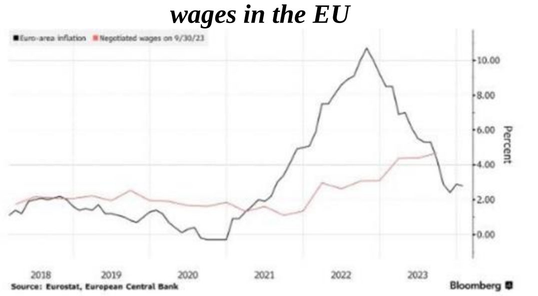
Interestingly, the countries that recorded a drop in GDP in the first quarter of 2024 are at the same time the loudest in their aggressive rhetoric concerning Russia.

2.1. INFLATION AND WAGES IN THE EU

The recovery from the COVID-19 pandemic lost momentum in 2022, related to employment and stabilization of unemployment. The energy shock caused by the Russian SMO in Ukraine has led to a halt in the growth of the global world and has affected the rise of price inflation in many countries to levels not seen in decades. Labor markets are still under severe pressure, despite signs of easing. From the aspect of the quality of the jobs offered, it can be said that the labor market has improved in some dimensions. However, real wages still record a significant decline in almost all OECD countries despite the increase in nominal wage growth. In parallel, there is a strong growth in profits, often more than nominal wages. In many countries, profit growth far exceeds labor costs, which puts additional pressure on domestic prices and causes them to rise, all of which results in a decline in the labor force's share. And while public transfers and fiscal support have provided some relief, the loss of purchasing power has proven particularly hard on low-income workers. Such households therefore face higher effective inflation rates because a greater part of their consumption goes to energy and food.

Nominal minimum wages try to keep pace with inflation, with the high risk that any real gains could quickly fade if inflation remains high. At the same time, wages resulting from negotiations, collective agreements between employers or employers' organizations and trade unions react with a certain delay even in countries where the majority of workers are covered by a collective agreement The role of collective bargaining, related to minimum wages, is to achieve a fair distribution of the costs of inflation between workers and employers, as well as among workers of different wage levels, to prevent further increases in inequality (OECD, 2023).

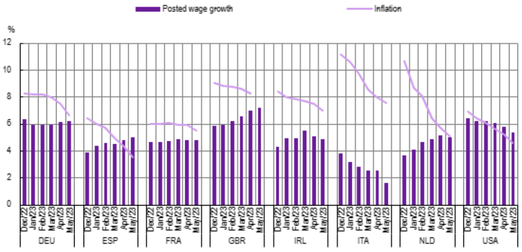
Graph 3. Trends in inflation and negotiated wages in the EU



Sourse: Eurostat, EC,2023.

What is visible at first glance in **Graph 4**. is that inflation in all the countries shown exceeds nominal wage growth. Observed by the months shown, inflation records a downward trend, while stable or declining nominal wage growth during the first five months of 2023 was recorded in Germany, France, Ireland, Italy, and the United States of America. It is also worth noting that in Spain, the Netherlands, and the United Kingdom, nominal wage growth increased slightly. In general, the gap between inflation and nominal wage growth has narrowed. However, real wage growth only turned positive in Spain and the United States last months. In Italy, the gap between inflation and wage growth widened again in May 2023, after falling in the first four months of the year.

Graph 4. The gap between inflation and nominal wages



Source: Economic Indicators (database), 2023.

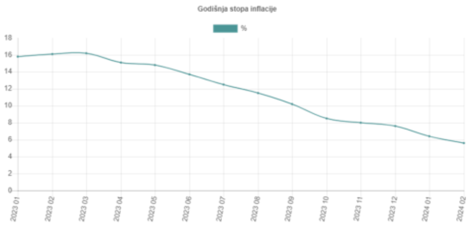
During the last quarter of 2023, global inflation continued to slow, as a result of tight monetary policy and lower food prices. The further speed of its slowdown will depend on the impact of geopolitical changes in the price of primary products. Although inflation in the eurozone increased in December, for the first time since April 2023 (to 2.9% year-on-year), this was expected in the conditions of a low base for energy prices, and the realized inflation growth was lower than expected. In January 2024, inflation in the eurozone, according to Eurostat's estimate, slightly decreased to 2.8%, and its continued slowdown is predicted both this year and in the next year, according to the assessment of the European Central Bank, 2025 it should be at the level of 2%. Nevertheless, inflationary pressures in the euro area are still elevated, primarily due to the strong growth of unit labor costs due to tight conditions in the labor market, but they will gradually decrease because, with the slowdown of inflation, the pressures on wage growth will also decrease. The cycle of increasing reference interest rates was mostly completed during 2023 (NBS, 2023).

3. INFLATION AND SALARIES IN SERBIA

The National Bank of Serbia has kept the reference interest rate at an unchanged high level of 6.5% in 2024 as well. With this, it confirmed its commitment to the further reduction of global inflationary pressures, as well as the continuity related to the downward trajectory of domestic inflation, with very optimistic goals that inflation will return to the targeted limits (3%) in the middle of the current year. Considering that in the previous period, the reference interest rate, and the mandatory reserves, it is to be expected that the effects of those measures will continue to be transmitted to inflation this year as well.

The greatest uncertainty related to the perception of the realization of inflation and gross domestic product in Serbia comes from the international environment, dominantly related to the further development of geopolitical relations, as well as global economic growth. Movements in world prices of energy, food, and other primary products remain key factors for inflationary dynamics. As for factors from the domestic environment, the most significant sources of risk are certainly the speed of recovery of domestic demand, which again depends on the level of foreign investment inflows, investments in infrastructure, and the energy sector. We can also consider the outcome of the agricultural season as a risk factor, which will primarily affect the price of fruits and vegetables.

Graph 5. Annual inflation rate in Serbia



Source: Republički zavod za statistiku, 2023.

The annual inflation rate is expressed through price changes in the current month compared to the same month of the previous year, in %. Consumer price indices have been used as an official measure of inflation since January 2009. Consumer price indices are defined as a measure of the average price change of a fixed basket of goods and services that households buy to satisfy their needs (Republički zavod za statistiku, 2023).

Table No. 2 presents the movement of the average consumer basket expressed in RSD dinars and average monthly net earnings (expressed in RSD dinars) per employee in Serbia, in the shown period, from 2019 to 2022. It is already visible at first glance that the height of the average consumer basket every year in the observed period is higher than the average monthly salary, which already speaks volumes about the damaged standard and quality of life of the employed. The average monthly earnings trend shows no signs of recovery.

Table 2. Movement of the average consumer basket and average monthly net earnings per employee in Serbia (in RSD dinars)

Year	2019	2020	2021	2022
Av. Cons. basket	71.398	73.322	77.040	91.635
Av. wages	54.908	60.057	65.844	75.353

Source: Ministarstvo unutrašnje i spoljne trgovine, Republika Srbija, 2023

The hypothesis that is put forward in the paper is that the nominal increase in wages is a consequence of the increase in inflation.

Intending to test the hypothesis, based on the data listed in Table 2 in the observed time period Table 3 shows the results.

Table 3. Relationship between consumer basket and wages

Indicator	Wages			
	R^2	F	*t*	*p*
Consumer basket	0.954	41.282	15.823	<0.001

Source: Author's calculation

The authors have employed the SPSS statistical package for regression analysis to investigate the relationships between these two variables and predict the outcome based on observed data in Table 2. Through the analysis in SPSS, the hypothesis has been tested, generating insights concerning the outcome.

Regression was used to test whether consumer prices affect wages. Consumer prices as an independent variable were regressed on the dependent variable wages. Consumer prices predict wages F (3, 1) = 41.282, p = <0.001, indicating that consumer prices play a significant role in shaping wages. R^2= 0.954 shows that the model explains 95,4% of wages.

CONCLUSION

From everything previously stated in the paper, we can conclude the following:

a) The SMO in Ukraine has turned into a confrontation between the West and Russia, and it is already possible to conclude that it will have comprehensive long-term consequences for the global economy and the business of countries

b) Changes in geopolitics will have a great impact on the banking and financial sphere, as well as on international trade. This further implies that there could be a permanent realignment of world trade: the global economy is becoming more regionalized – shorter supply chains with reliable partners.

c) As a result of the SMO in Ukraine, the confrontation between Russia and the EU will have long-term negative consequences for most European companies and economies.

First of all, there will be a decrease in the volume of sales, which in itself leads to a decrease in income. A significant drop in revenue, along with a significant increase in costs, will lead to a large reduction in profits and/or an increase in losses for many companies. A decrease in the profitability of the company will affect the increase in the interest rates of the central bank and, therefore, the increase in the price of credit resources.

Although during 2023, global inflation had a downward trajectory, which is a direct consequence of the reduction in global energy and food prices, but also due to weaker demand. Inflation in the service sector proved to be persistent, especially in developed countries, which is primarily a consequence of increased nominal wages due to the still tight labor market.

As for the demand in Serbia, the growth of nominal wages and pensions is expected to continue this year, but at a more moderate pace than last year, as inflation also has a slowing trend. Great support for the growth of consumer demand is also remittances from abroad, whose inflow is expected at a similar level as last year (5 billion euros). The gap between the average consumer prices and average wages per employee remains very pronounced, to the detriment of nominal wages.

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