

## 2. Economic Activity

The economic activity growth in Q2 was very weak. With year on year (y-o-y) GDP growth of only 1.3% of GDP, Serbia had the lowest economic growth compared to all other Central and Eastern European countries (CEECs) except Macedonia. The poor performance of economic activity in Q2 was partly affected by temporary factors - a drop of 10% in agriculture due to the drought and the continuing problem of electricity production in April and May resulting in a sharp fall of this sector of 5%. Without these factors GDP growth in Q2 would be considerably higher and would amount to 2.4% instead of 1.3%. However, even then, we would have maintained a relatively unfavourable assessment of the trend of economic activity in Serbia, as the economic growth of all other CEE countries (except for Macedonia) in Q2 was higher than 2.4% and amounted to over 4% in average. Thus, relatively bad economic indicators in Serbia and lagging behind the comparable countries cannot be completely explained by drought and poor EPS management, but there are other structural problems in the functioning of the domestic economy behind them. As a reaction to low economic growth, the government has announced short-term measures to boost economic activity related to the launch of new public investments, and in this context a reduction in taxes and an increase in current consumption of the state has been mentioned (announcements of relatively high growth of public pensions and wages in 2018).

However, these measures will not be implemented in 2017, when we expect GDP growth to range from 1.5 to 2%, and we also rate them as insufficiently well-thought out. The announced increase in wages and pensions is many times tried out, inefficient measure for stimulating economic growth in Serbia, while one-off tax reductions have limited range and should be very cautiously accessed, as the tax system in Serbia does not differ significantly from other comparable countries and is not a significant barrier for a high economic growth of the country. Finally, the start of new investment projects is not disputable (if economically justified), but before this it should be examined why the realization of public investments already planned in the existing budget is late. The key to long-term high and sustainable economic growth of over 4%, instead in announced short term measures, should be sought in significantly more severe systematic structural reforms of the public sector and state owned enterprises, increase of efficiency in the implementation of public investments and in the improvement of the economic environment (rule of law, reduction of corruption, increased efficiency of the state administration and others).

### Gross Domestic Product

*A relatively low GDP growth of 1.3% was achieved in Q2*

According to the most recent SORS data, the y-o-y GDP growth in Q2 was 1.3%, which is estimated as a bad result. Although in previous QM issue we estimated that a significant acceleration in economic activity will happen in Q2 in comparison to Q1, i.e., that despite the poor results in Q1, GDP growth rate of 3% in 2017 was still attainable - results from Q2 now exclude this option. Compared to the spring, when we made the previous forecasts, it turned out: 1) that the agricultural season in 2017 will be very bad because of the drought; 2) that EPS did not, as we assumed, set up normal electricity production in April, instead its problems lasted longer, until May; and 3) that the rest of the economy did not speed up its activity in accordance with our expectations. Because of all this, it is already certain that instead of the estimated GDP growth rate of 3% in 2017, a significantly lower economic growth of between 1.5% and 2% of GDP will be achieved.

*Permanent growth rate of economic activity is about 2.5% ...*

As we already mentioned, bad results of the economic activity in Q2, as well as in the whole of 2017, are significantly influenced by the drought which (by recent SORS estimates) reduced total agricultural production by about 10%, but also poor EPS management which lead to large fall of coal production (Kolubara) at the end of 2016 and in Q1 2017, and then the electricity production (thermal power plants) which lasted from the end of 2016 until May 2017. Since these factors were one-off by their nature and were unpredictable at the beginning of the year - for

*... but it is still lower than the planned 3% of economic growth*

*Seasonally adjusted GDP growth in Q2 of 0.5% confirms the estimated trends*

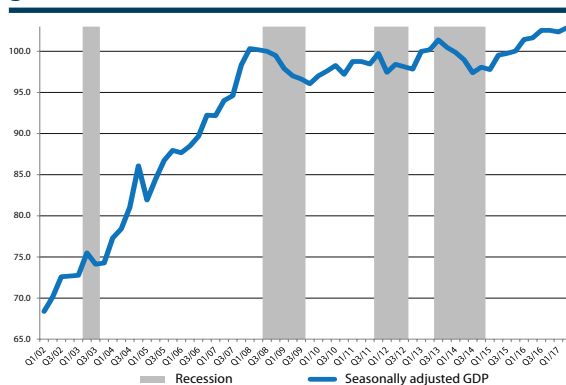
*GDP growth in Q2 is well below the regional average*

comparison with the forecasted growth rate of 3% in 2017 and assessment of a more sustainable trend in economic activity, these factors should be excluded. With the exclusion of agriculture and EPS, the y-o-y growth of the “underlying” GDP in Q2 was 2.4%, and in Q1 2.3%. This would, therefore, significantly improve the estimate of economic trend in 2017, i.e., it would appear that in 2017 the “underlying” trend of economic growth is not slowing down compared to 2016<sup>1</sup>.

However, although in 2017 there hasn't been a slowdown in GDP growth trend compared to 2016, it was estimated that GDP growth in 2017 will accelerate faster than in 2016 and reach 3%, while some state officials and economists went a step further by calling the economic growth forecast of 3% conservative and announced a growth of GDP in 2017 from 3.5 to 4%. Our analysis shows that GDP growth of 3% would be achieved in the first half of the year even without the drought and with EPS working “normally”, so independently of temporary factors influence, we can say that the economic trends in the first half of 2017 were about 0.5 pp lower than forecasted. Other announcements of economic growth above 3% that were widely publicized before the beginning of 2017 were more politically motivated than economically based, and the results of the economy in the first half of 2017 show that unambiguously.

Graph T2-1 shows a series of seasonally adjusted GDP growth that shows short-term trends in economic activity from the y-o-y indices somewhat more reliably (shaded periods represent a recession according to the Bry-Boschan procedure). Unlike the year-on-year GDP indices, which will be reduced throughout 2017 due to a fall of agricultural production, for seasonally adjusted indices the effect of one-off factors was mainly exhausted in Q<sup>2</sup><sub>1</sub>, so seasonally adjusted GDP growth in Q<sup>2</sup> compared to Q<sup>1</sup> may be an additional indication of “underlying” economic trends (without temporary factors). Seasonally adjusted GDP growth in Q<sup>2</sup> compared to Q<sup>1</sup> amounted to about 0.5, which would indicate an economic growth rate of about 2% annually. Although this quarterly indicator is not so reliable for a more accurate assessment of annual economic activity trends (if the seasonally adjusted quarterly Q<sup>2</sup> growth was only slightly higher, for example 0.7% instead of 0.5%, then we could easily conclude that GDP growth rate was about 3% annually) - in Q<sup>2</sup> it is approximately in line with our previous estimate that the growth of “underlying” GDP, without the effects of the drought and problems in EPS, was in the first half of 2017 around 2.5%.

**Graph T2-1. Serbia: Seasonally adjusted GDP growth, 2002-2017 (2008 = 100)**



Source: QM estimates based on SORS

and in countries in the immediate neighbourhood of Serbia 4.3%. The only country in Central and Eastern Europe that had a lower growth than Serbia is Macedonia, but the reason for such bad result of the Macedonian economy is the political instability that marked the first half of the year in this country.

<sup>1</sup> In fact, when we consider that the agricultural season in 2016 was above average, or that “carrying” GDP growth in 2016 was slightly lower than the 2.8% achieved, we come to the conclusion that the permanent trends of economic activity in 2017 even mildly accelerate (Table T2-2).

<sup>2</sup> SORS methodology is such that the y-o-y impact of bad agricultural season is roughly distributed over all four quarters throughout the year. This, on the other hand, reflects a higher one-off seasonally adjusted decline in GDP only in the first quarter, while the impact of agriculture on seasonally adjusted quarterly growth in the following quarters is relatively small. Similarly, the effect of falling EPS production on seasonally adjusted indices was depleted in Q4 2016 and Q1 2017.

In this section of the text we will hold on a little more on the assessment of the results of economic activity in the first half (H1) of 2017, observing them also in an international context. To this end, in Table T2-2 we have shown the GDP growth of Serbia and Central and Eastern European countries (CEE). Although we have shown only the last three years in the Table, Serbia has, since the beginning of the crisis (since 2010), achieved a steady economic growth compared to the CEE countries. In H1, this lag was further deepened as GDP growth in Serbia was 1.2%, average y-o-y growth of Central and Eastern Europe countries 4.2%,

In Table T2-2, we also added the growth rate of Serbia's GDP, which we called "underlying" economic growth, where we excluded the changes in GDP growth caused by agricultural seasons and the production of electricity and coal mining which were under large influence of the 2014 floods, and the problems in EPS in the first half of 2017. It can be seen from the Table that the GDP growth in Serbia, even after the exclusion of these factors, systematically lags behind the growth of the countries in the region and that the reasons for the low economic growth in Serbia should not be sought solely in the temporary effects of droughts and problems in the electric power sector.

**Table T2-2. Serbia and countries in the region: GDP growth and share of investments in GDP, 2014-2017**

	2014	2015	2016	H1 2017	Share of investments in	Share of private consumption in
Serbia	-1.8	0.8	2.8	1.0	17.7	74.7
Serbia- underlying growth <sup>2)</sup>	-0.8	1.2	2.3	2.4	-	-
Neighbouring countries (weighted average)	2.7	3.4	3.5	4.3	22.7	60.1
Albania	1.8	2.2	3.4	3.9	27.2	80.9
Bosnia and Herzegovina	1.2	3.0	3.1	2.7	17.3	79.5
Bulgaria	1.4	3.6	3.4	4.0	21.0	62.5
Croatia	-0.5	2.3	3.0	2.7	19.5	58.8
Hungary	4.1	3.1	2.0	3.7	21.7	49.3
Macedonia	3.6	3.8	2.4	-0.9	23.0	68.5
Montenegro	1.8	3.4	2.5	3.2	20.3	79.2
Romania	3.0	4.0	4.8	5.8	24.7	61.9
CEE (weighted average)	2.9	3.7	3.0	4.2	22.0	57.4

1) In 2015

2) Effects of drought, flood and poor EPS management

Source: Eurostat, Statistical offices of individual countries and EU Commission (European Economic Forecast – Winter 2017)

***The permanent defect resulting in the low growth rate of Serbia's economy is the lack of investment***

Therefore, even if Serbia recorded a growth in the first half of 2017 of about 2.5% it would have been the lowest economic growth in comparison to all Central and Eastern European countries (except for Macedonia) – and we remind that Serbia has been lagging behind the region since 2010. Therefore, we conclude that not only temporary factors were the reason for relatively low growth of GDP in 2017, but that such result is only a continuation of the long-term unfavourable economic trends. We also showed indication of structural problems that hinder high GDP growth in Table T2-2. Specifically, in the second to last column of the Table we have show that the share of investment in GDP in Serbia is considerably lower than in the neighbouring countries – amounts to only about 18%<sup>3</sup> of GDP compared to around 23% of GDP in the neighbouring countries and 22% in all CEE countries. With such low level of investment, far lower than in comparable countries, Serbia cannot expect to begin catching up in the near future. We have written in detail in several previous issues of QM about the reasons for low investments so we will not describe them here again. It is important to note that these reasons are mostly of a structural nature (rule of law, inefficiency of the state administration, high level of corruption, poor state of the infrastructure and others) and only can be solved via medium-term reforms in these areas that are permanently avoided in Serbia.

Instead of implementing economic policies aimed at steady increase in investment, recent ideas revive the idea that accelerating economic growth in Serbia could be achieved by increasing consumption, i.e. by increasing public sector pensions and wages above nominal GDP growth. This is politically popular, but this measure has repeatedly proved ineffective in terms of boosting economic growth in Serbia. Perhaps the best example for this is 2015 (Table T2-2), when, in spite of a significant reduction in pensions and wages in the public sector, economic activity accelerated rather than slowed down compared to the previous year. An additional strong indication that the increase in private consumption is an ineffective measure for stimulation of economic growth can also be found in Table T2-2 where it can be seen that Serbia already has a higher share of consumption in GDP compared to other comparable countries, and this did not result in larger economic growth in Serbia – on the contrary, economic growth in Serbia was systematically lower in comparison to comparable countries. Encouraging private consumption to stimulate

<sup>3</sup> Accurate data on investment participation in GDP in 2016 for Serbia and the countries of the environment are not yet available, but on the basis of slightly faster growth of investments than other components of GDP in 2016, we conclude that this share in Serbia will increase from 17,7% of GDP to around 18% of GDP.

economic growth can only be effective in large economies with unused and competitive production capacities - which does not apply to Serbia. In Serbia, the growth of pensions and wages in the public sector above GDP growth would primarily reflect in the growth of foreign trade and internal imbalances (current deficit and inflation).

**The structure of GDP growth in Q2 was not economically favourable**

The structure of GDP growth in Q2 by expenditure method is presented in Table T2-3. Unlike in 2016, when economic growth was driven by investments (growth of about 5%) and net exports (growth of exports by 12% almost twice higher than the growth of imports), with significantly slower growth in personal consumption –the structure of growth in Q2 and in the whole first half of 2017 is considerably different. Personal consumption accelerated the year-on-year growth compared to the previous year and in the first half of 2017 it recorded a real y-o-y growth of 1.8%. On the other hand, investments slowed down to only about 2%, which is not enough for (needed) increase of their GDP share. Finally, net exports in 2017 negatively contribute to GDP growth (the foreign trade deficit is increasing). Such structure of GDP growth, which is not based on investments and growth in net exports, cannot, in the medium term, result in a high overall growth rate of GDP, but it leads to an increase of macroeconomic imbalances. Economic policies should recognize these unfavourable trends and react to their change, rather than announcing an even greater increase in private consumption and further deepening the imbalances.

**Table T2-3. Serbia: GDP by expenditure method, 2009-2017**

	Y-o-y indices														Share 2015
	2009	2010	2011	2012	2013	2014	2015	2016	2016				2017		
									Q1	Q2	Q3	Q4	Q1	Q2	
GDP	96.9	100.6	101.4	99.0	102.6	98.2	100.8	102.8	103.8	102.1	102.8	102.5	101.0	101.3	100.0
Private consumption	99.4	99.4	100.9	98.2	99.4	98.7	100.5	100.8	100.8	101.0	100.5	101.0	102.0	101.6	74.7
State consumption	100.6	100.8	101.1	102.4	98.9	99.4	98.5	102.3	102.3	103.7	100.8	102.3	100.5	101.7	16.2
Investment	77.5	93.5	104.6	113.2	88.0	96.4	105.6	104.9	106.8	104.4	106.2	102.6	101.9	102.0	17.7
Export	93.1	115.0	105.0	100.8	121.3	105.7	110.2	111.9	112.4	110.7	110.7	113.8	109.7	111.5	46.7
Import	80.4	104.4	107.9	101.4	105.0	105.6	109.3	106.8	104.3	111.1	105.7	105.9	111.7	110.3	56.4

Source: SORS

**Large decline in agriculture, relatively high growth in trade, traffic and tourism**

Table T2-4 shows GDP growth by activity. In Q2, a sharp drop in agriculture of 10% is evident, which is the consequence of the impact of the drought on the farming. On the other hand, growth of services accelerates, i.e. the trade, transport and tourism sector, with a real annual growth of 4.4% which is practically the largest since the outbreak of the crisis in the second half of 2008<sup>4</sup>. The growth of GDP by activity in Q2 was therefore consistent with the growth of GDP by expenditure method—it can be seen that the GDP growth is increasingly attributed to the growth of personal consumption, resulting in acceleration of the growth of services, while investments have slowed down compared to the previous years, which is indirectly indicated by a slight decline in construction activity. Other production sectors have relatively uniform annual growth rates ranging from 1.3% to 2.8% (Table T2-4).

**Table T2-4. Serbia: Gross Domestic Product by Activity, 2009-2017**

	2009	2010	2011	2012	2013	2014	2015	2016	2016				2017		Share 2015
									Q1	Q2	Q3	Q4	Q1	Q2	
	Total	96.9	100.6	101.4	99.0	102.6	98.2	100.8	102.8	103.8	102.1	102.8	102.5	101.0	
Taxes minus subsidies	98.6	99.5	101.1	97.8	98.9	99.2	100.9	101.1	101.0	101.7	100.2	101.4	102.2	101.9	16.0
Value Added at basic prices	96.6	100.8	101.5	99.2	103.3	98.0	100.7	103.1	104.4	102.2	103.3	102.7	100.7	101.2	84.0
Non agricultural Value Added	96.7	100.2	101.5	101.1	101.6	97.5	101.7	102.6	104.1	102.0	102.3	102.1	101.6	102.3	90,5 <sup>2)</sup>
Agriculture	95.2	106.4	100.9	82.7	120.9	102.0	92.3	108.3	107.7	104.6	111.8	108.1	92.0	90.0	9,5 <sup>2)</sup>
Industry	96.8	100.8	103.2	105.6	106.0	92.4	103.2	103.0	106.9	100.3	102.7	102.3	101.4	102.8	24,4 <sup>2)</sup>
Construction	87.1	97.6	105.9	90.2	96.1	98.5	102.7	106.4	112.9	107.8	108.6	99.4	96.9	97.2	5,2 <sup>2)</sup>
Trade, transport and tourism	92.9	100.0	99.5	99.3	102.3	101.1	102.2	103.9	105.1	103.1	103.4	104.2	103.2	104.4	18,4 <sup>2)</sup>
Informations and communications	97.0	103.2	102.6	102.8	99.9	96.1	101.7	102.3	102.3	102.3	102.0	102.6	101.1	101.7	5,1 <sup>2)</sup>
Financial sector and insurance	102.6	101.9	98.4	92.0	90.5	97.2	102.3	103.4	102.7	103.5	104.2	103.2	104.6	101.8	3,2 <sup>2)</sup>
Other	99.7	99.8	100.9	101.8	100.2	99.9	99.8	101.1	101.4	101.4	100.6	101.2	100.6	101.3	34,3 <sup>2)</sup>

Source: SORS

1) Prices in the previous year

2) Participation in GAV

<sup>4</sup> Only the third quarter of 2010 saw a slightly higher year-on-year growth in this sector, but it was the result of a comparison with a very low base from Q3 2009 and did not prove to be sustainable.

**We expect GDP growth in 2017 to be between 1.5 and 2%**

Since in the first half of the year a low GDP growth of 1.2% was recorded, by the end of the year, this result cannot change significantly. However, in the second half of the year we expect a certain acceleration of economic activity. Economic growth of the whole EU and Serbia's most important foreign trade partners in mid-2017 is speeding up<sup>5</sup>, which encourages the growth of Serbia's exports and the increase of FDI (and exports and FDIs have a relatively strong growth of more than 10% compared to the previous year). In addition, we expect to see a rise in construction activity in the coming quarters, among other things because the government has accelerated the implementation of infrastructure projects after their very slow execution in the first five months. Also, a relatively sharp decline in EPS production began in Q4 2016, which is why there will be a comparison between the electric power sector's results at the end of the year and a low base from the previous year (of course, assuming that EPS solves the problems that led to its production decline at the end of 2016 and in the first half of 2017). Taking all this into account, by the end of the year, we expect a certain acceleration of the growth of economic activity, which will result in total GDP growth rate in 2017 between 1.5% and 2%.

**In 2018 it is possible to temporarily accelerate GDP growth to around 4%**

At the end of this analysis we note once again that the growth of GDP in 2017 is lower than forecasted partly as a result of the effect of the factors which will, most likely, be exhausted by the end of the year (drought and EPS production drop). At the same time, these factors reduced the 2017 base, with which the results of the economy will be compared in 2018. Therefore, it is highly likely that the GDP growth rate in 2018 will be relatively fast, i.e. around 4%, without significant acceleration of the "underlying" trend of economic activity, which could amount to about 3% in 2018. We note, however, that this kind of "acceleration" of economic growth in 2018, if it happens, should not be interpreted positively without critics. A more detailed analysis undoubtedly shows that the Serbian economy has major structural weaknesses, because of which for a longer period of time Serbia significantly has been lagging behind the growth of other comparable CEE countries.

## Industrial production

**Total industrial production is gradually recovering in Q2 due to a smaller fall in the electrical power sector**

Industrial production in Q2 recorded a growth of 3.1% (Table T2-5), which represents a solid acceleration of 0.7% compared to Q1. This, more favourable result actually only hides better trends in the electric power sector than in the previous quarter, rather than the widespread acceleration of industrial production. These individual trends have led to an acceleration in the growth of total industrial production despite the fact that the manufacturing industry slowed down its y-o-y growth of around 7% from Q1 to around 5% in Q2 (Table T2-5).

**Table T2-5. Serbia: Industrial Production Indices, 2009-2017**

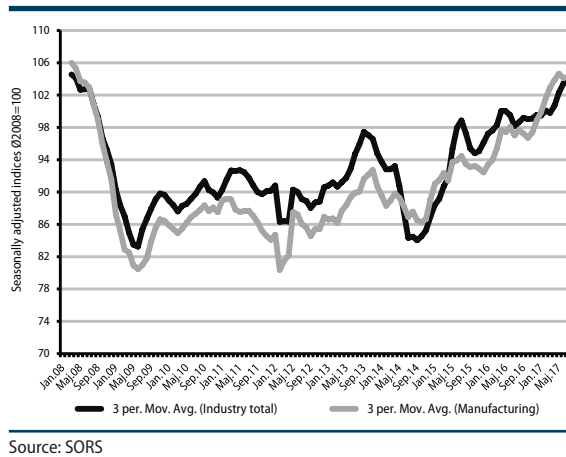
	Y-o-y indices												Share 2015		
	2009	2010	2011	2012	2013	2014	2015	2016	2016					2017	
									Q1	Q2	Q3	Q4		Q1	Q2
Total	87.4	102.5	102.2	97.1	105.5	93.5	108.2	104.7	110.5	102.4	103.7	102.8	100.7	103.1	100.0
Mining and quarrying	96.2	105.8	110.4	97.8	105.3	83.3	110.5	104.0	114.3	99.2	103.4	100.5	93.7	107.3	7.0
Manufacturing	83.9	103.9	99.6	98.2	104.8	98.6	105.3	105.3	106.5	105.9	104.4	105.3	107.3	105.1	80.1
Electricity, gas, and water supply	100.8	95.6	109.7	92.9	108.1	79.9	118.8	102.7	120.9	90.2	102.1	95.9	85.5	94.1	12.9

Source: SORS

Electricity production in Q2 decreased its y-o-y drop by as much as 10 pp, or from 15% to about 6%, and mining left the zone of the y-o-y decline (the decline in Q1 was a result of problems of coal mining) and recorded a growth in Q2 of about 7%. For now it is not yet fully known whether these indices indicate that EPS, in the first six months of the year, succeeded in resolving problems in its operations that led to a sharp decline in its Q1 production, or a slightly better y-o-y results of the electric power sector in Q2 are the consequence of the end of heating season which is always followed with the usual, seasonal, slowdown. The latter would mean that

<sup>5</sup> Y-o-y growth of GDP in EU28 is around 2.4%, and of the Eurozone 2.3%

**Graph T2-6. Serbia: Seasonally Adjusted Industrial Production Indices, 2008-2017**



**A significant fall in motor vehicle production and slowdown in the food industry in Q2**

The slowdown in the manufacturing industry is the consequence of the decline in the production of a smaller number of sectors, while the largest part of the manufacturing industry continues with relatively high rates of growth as in Q2. Within the manufacturing industry, the largest change in Q2 compared to Q1 had the production of motor vehicles, which passed from the area of positive y-o-y growth of more than 7% to the y-o-y decline of around 10% (which culminated in July with a fall of about 20%). The reason for this decline is the strike of employees in FAS. Given that the strike was ended by the end of July, we expect the results of this field of industrial production to be more favourable as of August. However, the slowdown in food industry may last longer, as the poor agricultural season certainly affects the results of this area. The food industry has reduced its annual growth from over 5% in Q1 to about 1% in Q2. These two sectors are most responsible for slowing the y-o-y growth of the manufacturing industry (and the stagnation of the seasonally adjusted index), while the remaining areas generally have similar growth rates in Q2 compared to Q1. On the positive side, there are sectors that stand out with the high double-digit growth and are mainly export-oriented: chemical industry, rubber products production, furniture production, basic metals (privatization of the Železara) as well as the tobacco industry. Among the most important sectors of the manufacturing industry which during the whole of 2017 have had a significant decline compared to the previous year, only the production of petroleum products stands out with the decline of about 10%.

**Table T2-7. Serbia: Components of Industrial Production by Use, 2009-2017**

	Y-o-y indices													
									2016				2017	
	2009	2010	2011	2012	2013	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2
Total	87.4	102.5	102.1	97.1	105.5	93.5	108.2	104.7	110.5	102.4	103.7	102.8	100.7	103.1
Energy	98.8	97.7	106.2	93.6	113.2	82.6	116.9	101.9	118.3	94.3	96.5	97.1	88.0	95.2
Investment goods	79.3	93.6	103.2	103.8	127.6	95.9	103.0	101.6	97.7	100.3	104.7	102.6	113.0	107.0
Intermediate goods	78.4	109.2	102.2	91.2	99.0	96.8	105.3	109.5	111.2	110.6	108.0	106.5	110.3	109.5
Consumer goods	86.8	102.1	95.4	103.2	100.7	100.7	104.0	105.6	107.4	103.9	107.0	105.6	105.8	105.3

Source: SORS

**The decline in energy production reduces**

Observing components of industrial production by use (Table T2-7), the only group that recorded the y-o-y decline in Q2 was energy production, while other groups had a solid growth of about 5% (consumer goods) to about 10% (intermediate goods). The changes that we observed by analysing industrial production by sectors are reflected in the movement of industrial products by use. In Q2 the huge decline in EPS production from Q1 was reduced, which led to a decrease in energy production decline from 12% to about 5%. On the other hand, the strike at FAS has affected the decrease in the production of investment products (including car production). Production of intermediate products prevails over other products as a result of high production in privatized iron works from Smederevo and the chemical industry. The production of consumer

EPS with ongoing production problems was able to meet the reduced need for production when the winter ended, but that the actual condition of this company will be seen when a new heating season begins. So, the definitive answer to this question will be given in the last months of 2017.

The analysis of industrial production trend, which was made on the basis of the y-o-y indices, is fully corroborated by the seasonally adjusted indices we have shown in the Graph T2-6. The graph shows that the overall industrial production (darker line on the graph) accelerated its seasonal growth in Q2, but that the manufacturing industry (lighter line on the chart) stagnated.

goods has somewhat slowed down under the influence of the food industry, but this slowdown is partly compensated with a slight acceleration in the production of other activities from this group.

## Construction

**Official statistics shows fall in construction activity**

According to data from National Accounts statistics, construction activity had a mild y-o-y decline of about 2.5% in Q2. This estimate is mostly based on the index value of construction works published by SORS in the field of civil engineering statistics, which shows a y-o-y drop in the value of construction works in Q2 of about 5% at constant prices. We note, however, that construction activity is very difficult to estimate statistically in the short term and in a reliable manner. Construction is a highly dynamic sector where there is a large number of small businesses which are easily founded and closed, and a good part of construction activity is carried out in a gray zone and remains unregistered. Because of the easier monitoring of large and state-owned enterprises, the indexes of construction activity of official statistics are biased towards their results, which do not necessarily have to fully describe the movement of the whole sector. Our analysis suggests that this was probably the case in the first half of 2017. In other words, the slow execution of public investment in the first half of the year reduced the activity of the part of the construction sector which is better monitored by the statistics, resulting in presented results of the overall sector worse than the actual results.

**Table T2-8. Serbia: Cement Production, 2001-2017**

	Y-o-y indices				Total
	Q1	Q2	Q3	Q4	
2001	89.5	103.5	126.9	148.1	114.2
2002	83.6	107.9	115.6	81.6	99.1
2003	51.1	94.4	92.7	94.4	86.6
2004	118.8	107.4	98.5	120.1	108.0
2005	66.1	105.0	105.8	107.4	101.6
2006	136.0	102.7	112.2	120.2	112.7
2007	193.8	108.9	93.1	85.0	104.4
2008	100.1	103.7	108.1	110.1	105.9
2009	34.1	81.4	86.0	75.3	74.4
2010	160.7	96.9	96.0	97.4	101.1
2011	97.7	101.3	96.2	97.7	98.3
2012	107.9	88.3	58.2	84.9	79.6
2013	83.5	78.7	127.6	93.5	94.9
2014	136.2	90.3	96.2	104.7	101.5
2015	77.9	112.4	104.5	108.7	103.1
2016	120.2	109.8	109.9	100.4	108.9
2017	110.4	104.1	-	-	-

Source: SORS

**However, construction activity in Q2 is likely to have a slight growth compared to the previous year**

In order to assess the real trends of construction activity in Q2 more reliably, we use cement production index as an additional indicator (cement is used as construction material in almost all construction works, used by small and big companies including those in grey area), and other available indicators. Table T2-8 shows that the cement production in Q2 had y-o-y growth of about 4%, which indicates that the real trends of the construction activity are probably mildly positive, and not negative as shown by the construction statistics. Additional indicator we also analysed, and which confirms this conclusion, is the movement of a number of employees from the data of the Central registry of compulsory social insurance (CROCSI)<sup>6</sup>. According to this data, the number of employed persons in construction increased in Q2 compared to the same period of the previous year, by 0.75%. If the trend of construction activity was its reduction, this would affect the firing rather than increasing the number of employees in this activity.

**We expect a certain acceleration of construction activity by the end of the year**

Acceleration in the realization of public investments, which will happen in the mid-2017, is likely to have an impact on the increase in the construction activity by the end of the year. As statistics records developments in this part of the construction sector more easily, this acceleration will most probably affect the official estimates of the movement of construction activity as well, which we expect to enter a positive zone after a slight fall in the first half of the year.

<sup>6</sup> These data are far more reliable than the data from the Labour force survey (LFS)