4. Balance of payments and foreign trade

During Q2 2013, tendency in reduction of current account deficit continued. The low deficit of 276 million euros (3.3% of GDP) partly reflects a long-term tendency, while it is partly the result of temporary factors. Trade deficit in Q2 was 990 million euros (11.7% of GDP), which is significantly below the previous quarterly values. Reduction of foreign trade and by the same token current account deficit is the result of fast growth of exports, accompanied by modest growth of imports (18.8% compared to 3.5%). This continues the growth of coverage of imports by exports and reaches the record value; almost ¾ of imports are covered by exports. In addition to good foreign trade results, what also contributed to the reduction of current deficit was a higher amount of current transfers, whose growth is probably temporary. It is our estimate that the current deficit in 2013 will be 6-7% of GDP, which means it will be significantly lower than in previous years, but still above the sustainable level in the long term. Trends in capital balance during 2013, including Q2, have negative macroeconomic implications. Companies and banks are lowering their debts, while the inflow of foreign direct investments is extremely low. Payment of business debts is jeopardising their liquidity and deepening the recession, while low foreign direct investments reduce the chances of accelerated growth of economy in the following year. During Q2, due to the financing of current account deficit and net outflows of capital, foreign currency reserves have been reduced by 886 million euros. Decline of foreign debt, which was realised in Q2, is primarily a consequence of settling part of the public sector debt, and to a smaller extent of settling debts of the private sector. In the following period, we expect a growth of foreign debt, which will primarily be determined by additional foreign borrowing of the public sector.

Balance of payments current account deficit dropped significantly in Q2 2013 ...partly due to temporary factors

Reduction of balance of payments current account deficit that started at the end of 2012, accelerated in the first half of 2013. Current account deficit in Q2 2013 recorded an extremely low value for Serbia, i.e. 276 million euros, which is 3.3% of GDP (Table T4-1 and Graph T4-2). Favourable decline trend, as well as currently unusually low level of current deficit are primarily the result of improved results in foreign trade (fast growth of exports, followed by modest growth of imports). Also, this reduction is the consequence of currently relatively high inflow of current transfers, which is at least partially the result of temporary factors.

At the beginning of the crisis, the deficit was reduced due to a decline in domestic demand and depreciation of dinar

Seasonally adjusted current account deficit presented in Graph T4-2 indicates that it is reaching one of the minimal values in the past several years. In the first wave, at the beginning of the global crisis, the current deficit was reduced due to the drop in domestic demand and depreciation of dinar. As of the second half of previous year, the reduction in deficit is not only the result of the reduction in domestic demand[1], but also of the factors on the supply side, which generate growth of exports.

...this year, factors on the supply side have had significant contribution

In the first half of 2013, the current deficit was 903 million euros (5.6% of GDP). If the achieved favourable results in foreign trade hold, together with other unchanged conditions, the value of the current deficit will be 6% of GDP in 2013[2]. If this value is realised in 2013, it will be significantly lower compared to previous years, but still quite high.

Current deficit in 2013, although lower compared to previous years, is still high

During the first six months of 2013, the value of the current account deficit was 52.9% below the realised value in the same period last year. This decline, although mostly the result of a reduction in deficit in real terms, is partly due to a high base. That is, considering that previous year was an election year, high public spending was recorded that caused a high growth of domestic demand and, by the same token, an unusually high current deficit. A much smaller decline of

1 New recession wave was recorded at the beginning of 2012. Even though since the beginning of 2013 there has been a year-on-year growth of GDP, the growth is initiated by agriculture and only a few successful companies (FIAT, NIS), while the biggest part of Serbian economy is still in recession, see section 2: „Economic Activity" of this issue of *QM*.

2 For calculation, we used in the denominator the estimated GDP of the Ministry of Finance and Economy, and in the numerator the usual annual values on the accounts of Services, Income and Current Transfers (whose annual values don't vary significantly) and double value of the trade deficit realised in the first half of 2013. That means that if there are no further reductions in trade deficit in the second half of 2013, ceteris paribus, the current deficit could be even below 6% of GDP.

current deficit is reached if it is compared to the first half of 2010 or 2011 (34% and 31% respectively) – comparison to 2010 and 2011 probably reflects better the real improvement of the current balance.

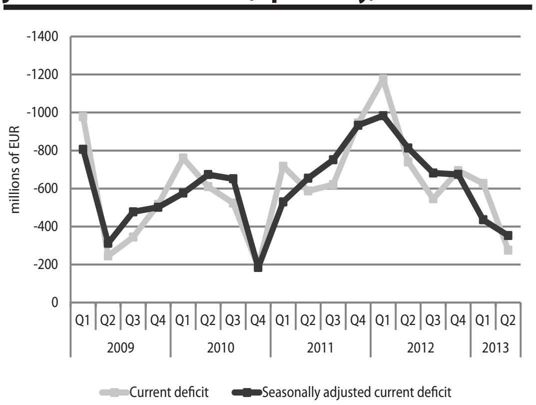
Table T4-1 Serbia: Balance of Payments

	2010	2011	2012	2012				2013
				Q1	Q2	Q3	Q4	Q1
				mil. euros				
CURRENT ACCOUNT	-2,082	-2,870	-3,155	-1,176	-740	-546	-694	-627
Goods	-4,774	-5,318	-5,450	-1,549	-1,294	-1,186	-1,420	-1,152
Export f.o.b[1)]	7,402	8,440	8,822	1,854	2,282	2,244	2,442	2,260
Import f.o.b[1)]	-12,176	-13,758	-14,272	-3,403	-3,577	-3,430	-3,862	-3,413
Services	5	163	152	29	1	33	90	34
Export	2,667	3,032	3,091	667	747	839	838	698
Import	-2,662	-2,869	-2,939	-638	-747	-805	-749	-664
Income, net	-670	-758	-798	-229	-211	-156	-203	-190
Receipts	438	428	547	109	134	138	167	102
Payments	-1,108	-1,186	-1,346	-338	-345	-293	-369	-291
Current transfers, net	3,356	3,043	2,941	574	765	762	839	681
o/w grants	193	206	144	26	38	43	38	30
o/w private remittances, net	2,383	2,065	1,934	359	523	483	570	457
CAPITAL ACCOUNT	1	-3	-11	-3	-4	-1	-2	-2
FINANCIAL ACCOUNT	1,986	2,694	2,988	1,120	685	490	692	612
Direct investment, net	860	1,827	242	-362	234	117	253	155
Portfolio investment, net	39	1,619	1,720	130	58	-37	1,569	1,402
Other investments	158	1,049	-112	436	-707	71	88	-85
Trade credits	83	493	498	164	199	27	108	78
Loans	830	-413	-437	-29	-135	-160	-113	-366
NBS	341	45	-219	-4	0	-111	-105	-150
Government	735	687	261	18	91	86	65	162
Commercial banks	626	-729	-521	-146	-348	-63	35	-308
Long-term	619	419	-368	-80	-107	-80	-100	-179
Short-term	6	-1,148	-154	-66	-241	18	135	-129
Other (enterprises)	-872	-416	42	102	122	-73	-109	-70
Currency and deposits	-754	970	-172	300	-770	204	93	203
Other assets and liabilities	0	0	0	0	0	0	0	0
Allocation of SDR	0	0	0	0	0	0	0	0
Reserves Assets (- increase)	929	-1,801	1,137	916	1,100	340	-1,218	-859
ERRORS AND OMISSIONS, net	96	179	178	59	60	57	3	17
OVERALL BALANCE	-929	1,801	-1,137 0	-916	-1,100	-340	1,218	859
PRO MEMORIA				in % of GDP				
Current account	-7.4	-9.1	-10.6	-17.0	-9.8	-7.3	-8.7	-8.2
Balance of goods	-17.1	-16.9	-18.2	-22.5	-17.2	-15.9	-17.7	-15.0
Exports of goods	26.5	26.8	29.5	26.9	30.4	30.1	30.5	29.5
Imports of goods	-43.6	-43.6	-47.8	-49.3	-47.6	-46.0	-48.2	-44.5
Balance of goods and services	-17.1	-16.3	-17.7	-22.0	-17.2	-15.5	-16.6	-14.6
Current transfers, net	12.0	9.7	9.8	8.3	10.2	10.2	10.5	8.9
GDP in euros[2)]	27,956	31,534	29,870	6,900	7,516	7,449	8,004	7,664

Source: NBS.
1) Exports and imports FOB, according to NBS methodology adjusted to IMF BOPM-5.
2) Quarterly values. Conversion of the annual GDP to euros was done based on average annual exchange rate (average of official daily middle exchange rates of NBS).

Trade deficit visibly below previous quarterly values

Graph T4-2 Current Deficit and Seasonally Adjusted Current Deficit, quarterly, 2009-2013



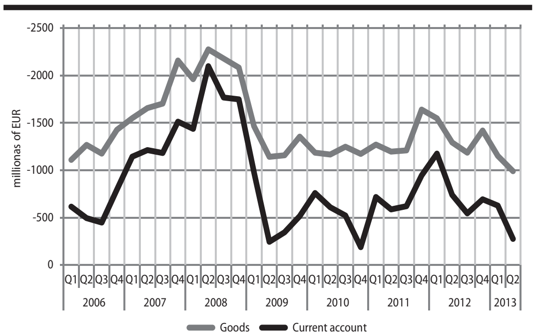
Source: NBS, *QM*.

Trade deficit is 990 million euros, i.e. 11.7% of GDP. This level of trade deficit is both in absolute and relative terms (as share of GDP) significantly below the previous quarterly values recorded in the observed period (since 2006, Graph T4-3 and T4-4). During Q2, exports were 2,711 million euros and have reached 32.0% of GDP. This share of exports in GDP is above previous values of this indicator (2008: 22.7% of GDP, 2009: 20.6% of GDP, 2010: 26.5% of GDP, 2011: 26.8% of GDP, and 2012: 29.5%, see Table T4-1). Exports will probably reach in 2013 the historic maximum, both in euros and in relative terms (in % of GDP). Such value of exports is still relatively low compared to other countries. In 2012, with exports of goods and services of 39.9% of GDP, Serbia was behind the countries in the region: Hungary 94.8% of GDP, Slovenia 76.1% of GDP, Bulgaria 66.6% of GDP, Macedonia 53.1% of GDP, Croatia 43.4% of GDP, Montenegro 40.3% of GDP, and Romania 40.0% of GDP[3]. In 2013, exports of goods and services will be increased as % of GDP, but it will still be among the lowest in the region. Due to real appreciation of dinar, GDP in euros has significantly increased in 2013, so the share of exports of goods and services in GDP will modestly grow – by around 1 percentage point (pp). If it were not for real appreciation of dinar, the share of exports of goods and services in GDP would have grown by 4-5 pp.

On the other hand, imports are recording modest results. During Q2, 3,701 million euros worth of goods were imported, which is 43.7% of realised quarterly value of GDP. Thus, the share of imports compared to Q1 has been decreased by almost 1 pp, while significantly below the quarterly levels of previous year (especially compared to Q1 and Q2 of 2012, when the growth of domestic demand due to election period reflected on the growth of imports).

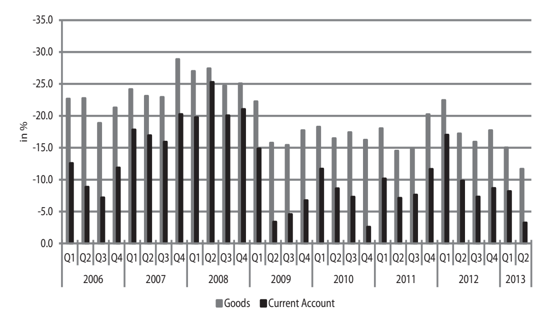
A mild surplus on the account of services was realised, i.e. 79 million euros. So the foreign trade deficit in Q2 was 911 million euros, which was only 10.8% of GDP.

Graph T4-3 Current and Trade Deficit, 2006-2013



Source: NBS, *QM.*

Graph T4-4 Current and Trade Deficit in % of GDP, 2006-2013

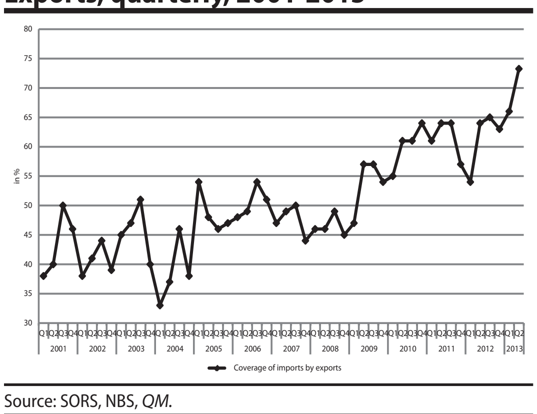


Source: NBS, *QM.*

Reduction of foreign trade and consequentially current account deficit is the result of very fast growth of exports, accompanied by modest growth of imports

Reduction of external imbalances: foreign trade and consequentially balance of payments current account deficit, is the result of very fast growth of exports, accompanied by a modest growth of imports. Exports are by 18.8% above the value recorded in Q2 2012, while imports have a year-on-year growth of 3.5%. Thus the growth of exports-covered imports is continued. This indicator has reached record high value, where almost ¾ of imports are covered by exports (Graph T4-5). This kind of dynamic of imports and exports evidently contributes to the desirable change of structure in foreign trade in favour of exports, which we emphasised as a necessary road to achieving a balanced level of current deficit. Still, a negative fact is that the acceleration of exports is for the largest part due to starting production in one factory (FIAT), considering that increase of exports excluding road vehicles has recorded an annual growth of 3.4%[4]. When export results of one country depend on the business operations of a single company, it is not a strategically good solution and bears a lot of risk (which was already the case in Serbia in the years up to 2012, when most of exports depended on the business of US Steel, and when exports were significantly reduced after its withdrawal from the market). On the other hand, the example of FIAT should indicate the importance of creating business environment for attracting foreign

Graph T4-5 Serbia: Coverage of Imports by Exports, quarterly, 2001-2013



Source: SORS, NBS, *QM.*

3 Source: Eurostat.

4 See section *Exports* further down in the text.

investments in Serbia, especially in the environment of low employment and poor inflow of foreign capital.

Aside from motor vehicles (FIAT Automobiles Serbia - FAS), high contribution to growth of total exports was also realised by the exports of oil derivatives (NIS) and the pharmaceutical industry. Additionally, what also contributed to growth of exports were companies that produce auto-parts, as well as other industries: production of rubber and plastic products, and production of electrical equipment[5].

Low imports are the result of low domestic demand, due to the first series of applied measures of fiscal consolidation and their effect on the reduction of private and state spending, but also due to a fall in investments. Even though the drop of imports of investment goods reduces the foreign trade balance, the associated drop of investments jeopardises the growth of economy in the future. Improvement of trade balance in the future will be negatively affected by real appreciation of the domestic currency in the previous year and the slow recovery of eurozone. Observed year-on-year, trade deficit in Q2 2013 is lower by almost ¼ of the value realised in the same quarter of the previous year.

By end of 2013, we expect the main factors of the reduction in value of current account deficit to still be continued favourable trends in foreign trade. Primarily, high positive effect of export growth of motor vehicle, oil derivatives and chemical industry. Also, the additional factor on the side of reduction of current deficit will be the reduction of imports due to halted domestic demand – as the result of current and planned modest increase of salaries and pensions, as well as the still existing recession in the large part of domestic economy. Also, better agricultural season will lead to increased exports of agricultural and food products in the second half of 2013. Additionally, expected although modest recovery of EU, which is our biggest export area, will again affect export value and export structure.

In 2014, we expect the same effect of these factors, with anticipated slowdown in the growth of total exports led by the growth of exports of oil derivatives and cars. Also, as the recession played in favour of reducing the imbalance on foreign trade and current accounts, the exit out of recession in the future will bring the danger of these deficits increasing. Preventing the possible growth of foreign trade/current deficit, after the recession is over, could be realised through gradual real depreciation of dinar and reduction of domestic demand, which would be realised by continued reduction of the fiscal deficit.

In addition to good foreign trade results, higher value of current transfers also contributed to the reduction of current deficit, which is probably just a temporary improvement

Net inflow of current transfers is 879 million euros (10.4% of GDP). Of that amount, 630 million (7.4% of GDP) is inflow of remittances. These kinds of values of current transfers and remittances are above Q2 2012 and average of 2012, and by 1.5 percentage points of GDP above the values recorded in Q1 2013. So, in addition to good foreign trade results, what also contributed to the reduction of current deficit was a somewhat higher value of current transfers. Inflow of current transfers during Q2 2013 was higher by 15% compared to Q2 2012, due to growth of remittances by 20% in the same period. Still, this growth of inflows of remittances (and current transfers) is probably only one-time occurrence, so it is hard to count on it staying on such a high level in the coming period.

On the income account, a net outflow of 244 million euros was recorded, and it is on the rise compared to previous quarters. Income on expenditure side includes payments of interests on short-term and long-term loans and borrowings, dividends, etc. of the private and public sector. Having in mind that public sector obligations will increase on this basis in the coming period, we expect that such a result on the income account will be relatively permanent unfavourable tendency.

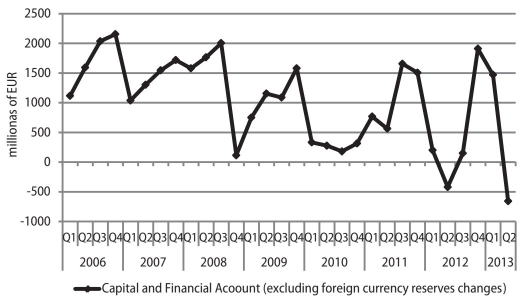
Net outflow of capital realised in Q2...

Realised favourable trends in the current part of balance of payments are accompanied by unfavourable trends in its financial part. That is, Q2 recorded a net outflow of capital of 666[6] million euros (Table T4-1 and Graph T4-6). Stated outflow of capital is primarily the consequence

5 See Text box 3 in *NBS Inflation Report*, August 2013, p. 31

6 619 million euros with a correction of the account *Errors and Ommissions*.

Graph T4-6 Capital and Financial Account, 2006-2013



Source: NBS, *QM.*

...primarily due to settling part of the state's debt...

of state's debt payment to the London Club executed at the end of April, and other debts that have matured for payment, repayment of financial loans of the banks and businesses, and modest inflows of FDIs. Therefore, net foreign assets haven't significantly changed.

During Q2, there has been a net outflow of portfolio investments of 347 million euros. This result is primarily the consequence of an early repayment of part of the debt, but to a certain extent of increased risk premium of the country. Still, this reduction of debt is temporary, because it is expected that by the end of the year, the public sector debt will grow in order to finance the fiscal deficit. At the end of April, the state settled almost half of the remaining debt towards the London Club – 400 million dollars out of the remaining 860 million dollars. Settling part of the debt was enabled thanks to the increased budget liquidity due to previously accumulated funds collected by the emission of eurobonds and other borrowings in the previous months, as well as through positive starting effects of the implementation of fiscal consolidation. As a reaction to Fed's announcements, there has been an increase in the risk premium of surrounding countries as of end of May and a general withdrawal from and avoiding of further investments in risky markets by investors. Increased risk premium in Serbia was additionally caused by poorer than expected results of fiscal adjustment.

and modest inflow of FDIs

Net FDIs are still low and they were 139 million euros in Q2, which is cumulatively since the beginning of the year a modest inflow of 294 million euros. Even though the inflow is above the one realised in the same period of 2012, it cannot be considered a good result, considering the record low last year's inflow due to specific circumstances (increased instability of the country because of the election year and a long period of forming the Government, which had a counter-stimulating effect on investors, as well as the once-off withdrawal of capital in telecommunications at the beginning of the year)[7]. What sends a positive signal to foreign investors in 2013 is the beginning of fiscal reform, stabilisation of the foreign exchange rate, and lowering inflation towards its goal, as well as indications of recovery of the eurozone. Still, it is our estimate that foreign investments in 2013 will be relatively modest and that they will at best reach a billion euros (around 3% of GDP). Such low foreign direct investment in this year, with low local investments, indicate that no considerable acceleration of the economic growth can be expected in the following year (for more details see section 2: "Economic Activity" in this issue of QM).

Foreign direct investments in Serbia in 2012 and first half of 2013 are among the lowest in the countries of Central and Eastern Europe

With the start of the crisis, there has been a decline in foreign direct investments in all countries of Central and Eastern Europe (the Region). In the period 2009-2011, the decline of foreign investments in Serbia was lower than in other countries of the Region, primarily due to high investments of FIAT and NIS. However, during 2012 and in the first half of 2013, foreign direct investments in Serbia were extremely low – among the lowest compared to the countries of the Region.

Net borrowing of NBS, the banks and companies for financial loans

During Q2, there was a net outflow on the account of other investments of 458 million euros. That was primarily the result of net borrowings of the banks and companies for financial loans (291 million euros), net outflow on the account *Cash and Deposits* of 165 million euros, while the account of trade loans was almost balanced (a slight net outflow in the net amount of 2 million euros was recorded, Table T4-1).

Deleveraging of financial loans is the result of NBS settling their obligations towards IMF (148 million euros were paid for these purposes), deleveraging of companies towards foreign creditors (in the net amount of 142 million euros – which is almost entirely long-term borrowing), and reduction of the banking sector's debt (43 million euros, out of which the biggest part – 41

7 For details see *QM28* & *QM29*, section "Balance of Payment and Foreign Trade"

million euros was towards repayment of short-term loans). On the other hand, the public sector increased its obligations towards foreign creditors by 42 million euros for financial loans.

Considerable reduction of forex reserves realised during Q2

In Q2, NBS forex reserves decreased by 886 million euros. Out of that amount, the biggest reduction was recorded in April – 543 million euros, primarily due to early repayment of part of the state debt (305 million euros) and withdrawal of the surplus of mandatory reserves deposited in the past by the banking sector (274 million euros)[8]. During April and May, NBS intervened with a smaller amount in order to mitigate excessive daily fluctuations of the foreign exchange rate, while in June it sold 270 million euros for the same purposes.

Exports

Trend of fast growth of exports continued in Q2

In Q2, exports continued fast growth started at the end of the previous and especially at the beginning of the current year. Goods in the value of 2,738 million euros were exported, which represents 19.5% year-on-year growth[9]. Achieved growth of exports is primarily due to exports of the automobile industry (FAS), as well as exports of oil derivatives (NIS) and the chemical industry. Also, companies producing car components, as well as other branches (production of rubber and plastic products and production of the electrical equipment) have made a significant contribution to the increase of exports in Q2.

Exports excluding road vehicles have recorded a much more modest growth

After excluding exports of road vehicles, the value of exports record a significantly lower growth of 3.4% year-on-year (thus observed exports recorded a year-on-year growth of 8.2% in Q1 2013, see Table T4-7). We feel that the acceleration of exports excluding road vehicles realised in Q1 2013 is partly due to the delayed effect of real foreign exchange rate – depreciation of dinar recorded in the first three quarters of last year, while the recorded slowdown in Q2 2013 is the result of appreciation of the domestic currency, which started at the end of 2012 and continued at the beginning of 2013.

In 2013, the exports will probably reach a historic maximum, both nominally and in real terms (in % of GDP). Still, compared to other countries, not just the developed ones, but transitional European countries as well, such export values are still relatively low.

Energy exports continue to accelerate growth thanks to the exports of oil derivatives

Energy exports are accelerating growth. In Q2 2013, the year-on-year growth of exports in Energy was 53.6% (after 48.2% in Q4 2012 and 49.4% in Q1 2013). High export growth rates of energy products were realised thanks to the investments undertaken during 2012 and the improvement of NIS production capacities, which led to the expansion of oil derivatives exports since the beginning of 2013.

Year-on-year growth of exports of *Intermediary Products* is 11.7%. It is a continuation of the growth trend of exports of these products, which started in 2013, after the negative year-on-year growth rates realised during all four quarters of 2012. *Capital Products* recorded an increase of 108.3% year-on-year, which is predominantly owed to the exports of the automobile industry. After the category of road vehicles is excluded, the growth of exports of capital products is 8.7% and is significantly slower compared to the previous quarter (when the export of capital products excluding road vehicles grew by 21.5% year-on-year).

Growth of exports of *Durable Consumer Goods* continued to accelerate during Q2. So the exports of this group of products were by 25.9% above the one realised in Q2 of last year. On the other hand, exports of *Non-durable Consumer Goods* continued to slow down and in Q2 they grew by 3.1% year-on-year. Exported value of products in the group *Other Exports* was by 48.8% lower compared to the one realised in Q2 2012 (Table T4-7).

8 http://www.nbs.rs/internet/cirilica/scripts/showContent.html?id=6442&konverzija=no

9 Part of the text dealing wih the analysis of balance of payments uses the adjusted data for imports and exports (FOB) published by NBS and calculated according to the IMF methodology ("Balance of Payments Manual", fifth edition, IMF; http://www.imf.org/external/np/sta/bop/BOPman.pdf.). Part of the text dealing wih the analysis of imports and exports uses RZS data, which are methodologically different than NBS data. That is why there is a difference in the presented imports and exports, as well as in growth rates.

Table T4-7 Serbia: Exports, year-on-year growth rates, 2011–2013

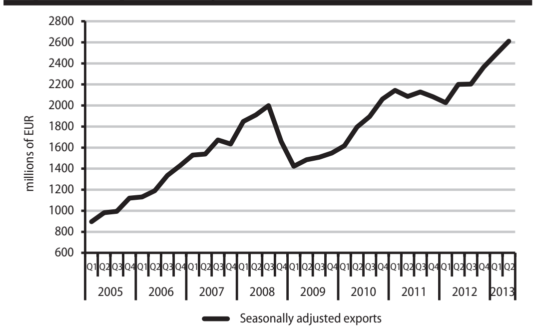
	Exports share in 2012	2011[1)]	2012[1)]	2012		2013		2012		2013	
				Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
	in %			mil. euros				in %			
Total	100.0	8,441	8,836	1,862	2,283	2,265	2,728	-5.2	5.8	21.7	19.5
Total excluding road vehicles	94.7	8,253	8,366	1,822	2,228	1,972	2,304	-5.2	5.9	8.2	3.4
Energy	3.4	310	304	64	86	95	131	1.1	-26.7	49.4	53.6
Intermediate products	38.3	3,980	3,387	739	878	838	981	-25.0	-7.1	13.5	11.7
Capital products	17.7	1,001	1,566	268	365	570	761	35.6	25.5	112.8	108.3
Capital products excluding road vehi	12.4	813	1,096	228	310	278	337	48.0	32.2	21.6	8.7
Durable consumer goods	4.5	347	397	78	100	104	136	5.0	12.3	32.9	35.9
Non-durable consumer goods	25.7	2,118	2,272	478	543	503	560	2.5	13.2	5.3	3.1
Other	10.3	686	910	235	312	154	160	32.6	69.3	-34.3	-48.8

Source: SORS.

1) data in millions of euros, as well as year-on-year growth rates, were calculated based on the data from the Statistical Office of the Republic of Serbia (RZS) according to a new methodology. For details, see QM no.20, Box1 "Change of Foreign Trade Methodology of the Statistical Office of the Republic of Serbia".

Seasonally adjusted data also shows sudden growth of exported value

Graph T4-8 Serbia: Seasonally Adjusted Exports, quarterly, 2005-2013



Source: NBS, SORS, *QM*.

Seasonally adjusted data also shows fast growth of total exports (Graph T4-8). Thus observed exports were by 4.9% higher in Q2 than they were in the previous quarter (which is a growth of 21.2% at the year-on-year level). Also, seasonally adjusted data indicate that exports in Q2 2013 were by 31% above the maximum value that domestic exports recorded before the start of the global economic crisis.

Imports

In Q2, imports recorded a modest growth, although they slightly accelerated compared to previous quarters

Imports in Q2 were 3,822 million euros, which was 3.2% above the values from Q2 2012. Even though such a growth of imports is pretty modest, it is still higher compared to previous year-on-year growth rates recorded as of the middle of the previous year: 1.2% in Q3 2012, 1.6% in Q4 2012 and 0.1% in Q1 2013 (Table T4-9).

It should be noted that the growth of imports in Q1 and Q2 2013 was calculated against a high base (Q2 2012). That is, at the beginning of 2012, imports were at an irregularly higher level due to the fiscal expansion in the pre-election period. Therefore, if we took 2011 as comparison basis, the imports would have been higher in Q1 2013 by 4.2% and in Q2 2013 by 11.3%.

Aside from the high base, the reason for the slow growth of imports is low domestic demand, which is primarily the result of the effects of certain measures of fiscal consolidation applied so far. So during Q2, there was a significant drop in all components of the domestic demand: private and public spending, but also lack of larger investments. On the other hand, real appreciation of dinar from the previous period (started at the end of 2012)[10] had a stimulating effect on the import demand.

The effects of decline in the imports of Energy on total imports might possibly lessen soon

Reduction in the imports of *Energy,* started in the first half of 2012, continued in Q2 2013 as well. As we have already written in previous issues of QM, reduction of *Energy* imports is the result of increased exploitation of oil in Serbia due to the renewal of production capacities of the Serbian Oil Industry (NIS). So, the imports excluding energy recorded a year-on-year growth of 5.6% in Q2 (Table T4-9).

10 For details see section 5: "Prices and Foreign Exchange Rate" in this issue of *QM*.

Trends

At a first glance, the structure of imports is favourable, but the picture changes once we exclude the imports of components for FAS

Capital Products, *Other Imports* and *Non-durable Consumer Goods* recorded a year-on-year growth at a rate of 25.2%, 17.2% and 4.1%, respectively (Table T4-9). Still, the picture changes once we exclude components for motor vehicles that statistics record within imports of Capital Products and Other Imports. So, these two groups of products together had a year-on-year growth of 19.8% in Q2. When we exclude the imports of road vehicles, these groups realise imports as much as 8.1% below last year's. Therefore, we can conclude that by far, the biggest part of the year-on-year growth of imports in capital products is owed to FIAT. Just how important these components are in total imports is demonstrated by the fact that once their values are excluded, the total imports in Q2 are by 4.6% below last year's.

Year-on-year reduction of import value was recorded in *Intermediary Products* (-6.5%) and in *Durable Consumer Goods* (-7%). Such an import structure has to be tagged as unfavourable, because it reflects activities in one area, i.e. it is primarily the result of imports of components for the production of motor vehicles, low economic activity in other areas, as well as lack of considerable production investments.

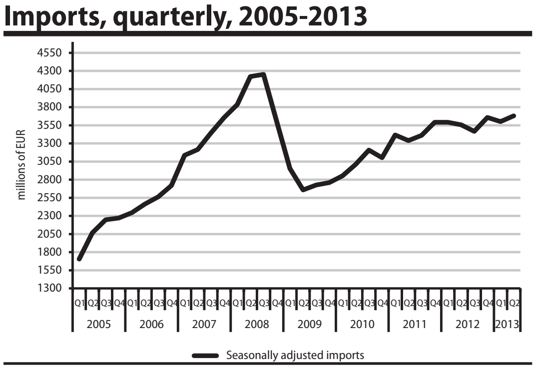
Table T4-9 Serbia: Imports, Year-on-Year Growth Rates, 2011-2013

	Imports share 2012	2011[1]	2012[1]	2012		2013		2012		2013	
				Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
	in %			mil. euros				in %			
	100.0	14,250	14,762	3,524	3,704	3,528	3,822	5.5	5.9	0.1	3.2
Total	17.5	2,846	2,582	817	553	548	485	6.4	-12.9	-32.9	-12.3
Energy	34.8	5,030	5,134	1,157	1,382	1,144	1,292	3.9	0.7	-1.2	-6.5
Intermediate products	19.4	2,812	2,865	637	744	774	931	-8.5	2.0	21.5	25.2
Capital products	2.2	320	323	77	83	75	77	15.2	15.0	-2.9	-7.0
Durable consumer goods	15.0	2,176	2,215	475	518	502	539	8.8	3.5	5.6	4.1
Non-durable consumer goods	11.1	1,066	1,644	361	425	486	498	39.8	101.2	34.8	17.2
Imports excluding energy	82.5	11,404	12,180	2,707	3,151	2,981	3,336	5.2	10.1	10.1	5.9

Source: SORS.
1) data in millions of euros, as well as year-on-year growth rates, were calculated based on the data from the Statistical Office of the Republic of Serbia (RZS) according to a new methodology. For details, see QM no.20 Box 1 "Change of Foreign Trade Methodology of the Statistical Office of the Republic of Serbia".

Seasonally adjusted imports in Q2 slightly above the values from the previous quarter

Graph T4-10 Serbia: Seasonally Adjusted Imports, quarterly, 2005-2013



Source: NBS, SORS, *QM*.

Seasonally adjusted data shows that imports in Q2 were slightly above the values from the previous quarter (2.2%, i.e. 9.0% annualised, Graph T4-10). The graph clearly indicates a very slow recovery of imports after the crisis, which is especially expressed as of mid-2012. So the imports are still by 13.5% below the values achieved in Q3 2008.

Foreign Debt

Foreign debt was reduced during Q2, but it is expected to grow again by the end of 2013

At the end of June, foreign debt was 26,072 million euros, i.e. 82.5% of GDP (Table T4-11). Compared to the situation three months ago, foreign indebtedness has been reduced by 651 million euros, i.e. by 4.7 percentage points of GDP. Realised reduction of the foreign debt is primarily the consequence of public sector deleveraging (due to settling part of the debt), and to a lesser extent of the private sector deleveraging. Considering that the state still has a high fiscal deficit, this drop is temporary, so there will be a rise in foreign debt by the end of 2013.

... as the result of settling part of the public sector's foreign debt...

Foreign debt of the public sector at the end of Q2 was 12,914 million euros[11] which was 40.9% of GDP. In Q2, public sector reduced the debt by 569 million euros. Out of this amount, the biggest part was early repayment of part of the principle towards the London Club, payment of matured state bonds, as well as settling of obligations towards local and foreign banks. Also, part of this amount is due to NBS debt settlement towards IMF (during Q2, 167 million euros were paid for these purposes).

...and to a lesser extent due to deleveraging of the private sector

Private sector – both banks and companies – settled 82 million euros of foreign debt (30 million for long-term and 52 million for short-term debts, see Table T4-11). Such a tendency of deleveraging foreign debt represents an additional mechanism of exhausting the economy, i.e. it deteriorates its liquidity and deepens the recession in the most parts of economy.

Decline of foreign debt is predominantly the result of a reduction of public debt, because in the first half of the year, the state settled part of the expensive loans based on relatively favourable loans it withdrew at the end of the previous and in the first quarter of the current year. Still, we expect further growth in public sector borrowing in net amount in the coming period, having in mind that previously collected funds from borrowing are almost depleted, and that fiscal deficit is still high. On the other hand, private sector hasn't changed its level of foreign debt in a while. So, if this trend continues, in 2013 – as was the case in 2011 and 2012 – the level and dynamic of the foreign debt will primarily be determined by the level and dynamic of public sector borrowing, which in turn will be determined by the level of the fiscal deficit and approved guarantees.

Table T4-11 Serbia: Foreign Debt Structure, 2010–2013

			2012				2013	
	2010	2011	Mar	Jun	Sep	Dec	Mar	Jun
			stocks, in EUR millions, end of the period					
Total foreign debt	23,786	24,125	24,068	24,086	24,832	25,721	26,722	26,072
(in % of GDP) 2)	*85.1*	*76.5*	*76.7*	*78.6*	*82.9*	*86.1*	*87.2*	*82.5*
Public debt	9,076	10,773	10,655	11,032	10,944	12,187	13,483	12,914
(in % of GDP) 2)	*32.5*	*34.2*	*34.0*	*36.0*	*36.5*	*40.8*	*44.0*	*40.9*
Long term	9,076	10,773	10,655	11,032	10,944	12,187	13,483	12,914
o/w: to IMF	1,529	1,618	1,581	1,644	1,524	1,389	1,245	1,079
o/w: Government obligation under IMF SDR allocation	449	459	449	467	462	452	454	447
Short term	0	0	0	0	0	0	0	0
Private debt	14,710	13,352	13,412	13,054	13,889	13,534	13,240	13,158
(in % of GDP) 2)	*52.6*	*42.3*	*42.7*	*42.6*	*46.3*	*45.3*	*43.2*	*41.6*
Long term	12,880	12,704	12,834	12,712	13,526	13,040	12,879	12,849
o/w: Banks debt	3,362	3,782	3,784	3,754	3,745	3,672	3,530	3,511
o/w: Enterprises debt	9,518	8,922	9,050	8,958	9,781	9,369	9,348	9,336
o/w: Others	0	0	0	0	0	0	1	1
Short term	1,830	648	578	342	363	493	361	309
o/w: Banks debt	1,731	582	515	275	292	428	303	261
o/w: Enterprises debt	100	66	63	67	71	65	58	47
Foreign debt, net 1), (in% of GDP) 2)	49.3	38.3	41.4	45.4	50.0	49.6	48.6	48.7

Note: As of September 2010, the methodology of the foreign debt statistics has been changed, so public sector foreign debt includes obligations as per SPV IMF allocations (447.1 million euros), used in December 2009, as well as capitalised interest towards the Paris Club (24.9 million euros), while the private sector foreign debt excludes loans concluded prior to December 20, 2000, for which no payments are made (872.1 million euros, out of which 403.1 million is related to local banks, and 469.0 million euros to local companies). Foreign debt data shown in the Table were calculated according to the new methodology.
Source: NBS, *QM*.
1) Total foreign debt decreased by NBS foreign reserves.
2) Sum of GDP values of the observed quarter and GDP values of the previous three quarters is used.

11 In part of the text dealing with the analysis of the Public debt in section 6: "Fiscal Trends and Policy", public foreign debt significantly differs from the one stated and is 9.5 billion euros. The difference of around 3.4 billion euros is the result of different scope of NBS and the Ministry of Finance, from which we take the data (in section 6, Ministry of Finance data is used, while in this text we use NBS data). The definition of public debt according to the Ministry of Finance doesn't include the debt of the National Bank of Serbia, unsettled obligations (debt for which payments are not made, and part of the debt of local governments and state agencies without state guarantees). On the other hand, the scope of National Bank of Serbia includes all the stated obligations, i.e. the entire foreign debt of the public sector is monitored (as part of the total foreign debt).