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Analytical and Notation Conventions

Values

The data is shown in the currency we believe best reflects relevant economic processes, regardless of the currency in which it is published or is in official use in the cited transactions. For example, the balance of payments is shown in euros as most flows in Serbia's international trade are valued in euros and because this comes closest to the measurement of real flows. Banks' credit activity is also shown in euros as it is thus indexed in the majority of cases, but is shown in dinars in analyses of monetary flows as the aim is to describe the generation of dinar aggregates.

Definitions of Aggregates and Indices

When local use and international conventions differ, we attempt to use international definitions wherever applicable to facilitate comparison.

Flows – In monetary accounts, the original data is stocks. Flows are taken as balance changes between two periods.

New Economy – Enterprises formed through private initiative

Traditional Economy - Enterprises that are/were state-owned or public companies

Y-O-Y Indices – We are more inclined to use this index (growth rate) than is the case in local practice. Comparison with the same period in the previous year informs about the process absorbing the effect of all seasonal variations which occurred over the previous year, especially in the observed seasons, and raises the change measure to the annual level.

Notations

CPI – Consumer Price Index

Cumulative – Refers to incremental changes of an aggregate in several periods within one year, from the beginning of that year.

H – Primary money (high-powered money)

IPPI – Industrial Producers Price Index

M1 – Cash in circulation and dinar sight deposits

M2 in dinars – In accordance with IMF definition: cash in circulation, sight and time deposits in both dinars and foreign currency. The same as M2 in the accepted methodology in Serbia

M2 – Cash in circulation, sight and time deposits

in both dinars and foreign currency (in accordance with the IMF definition; the same as M3 in accepted methodology in Serbia)

NDA – Net Domestic Assets

NFA – Net Foreign Assets

RPI – Retail Price Index

y-o-y - Index or growth relative to the same period of the previous year

Abbreviations

CEFTA – Central European Free Trade Agreement

EU – European Union

FDI – Foreign Direct Investment

FFCD – Frozen Foreign Currency Deposit

FREN – Foundation for the Advancement of Economics

GDP – Gross Domestic Product

GVA – Gross Value Added

IMF – International Monetary Fund

LRS – Loan for the Rebirth of Serbia

MAT – Macroeconomic Analyses and Trends, publication of the Belgrade Institute of Economics

NES - National Employment Service

NIP – National Investment Plan

NBS – National Bank of Serbia

OECD – **Organization for Economic Cooperation and Development**

PRO – Public Revenue Office

Q1, Q2, Q3, Q4 – 1st, 2nd, 3rd, and 4th quarters of the year

QM – Quarterly Monitor

SBS – Serbian Bureau of Statistics

SDF – Serbian Development Fund

SEE – South East Europe

SEPC – Serbian Electric Power Company

SITC – Standard International Trade Classification

SME – Small and Medium Enterprise

VAT – Value Added Tax

From the Editor



As predicted in the previous issue of *QM*, the internal imbalance – inflation – has shifted to external imbalance – a large foreign trade deficit. Inflation was very low in Q1, with production, wages and credit growing vigorously; the market is well supplied with widely available imported goods. The big fiscal feast in late 2006 triggered the surge in spending and production which, however, resulted in a huge foreign trade deficit.

The first quarter of 2007 was marked by the expansion of aggregate demand, which led to a high growth of production as well as a record foreign trade deficit and imports, while inflation was kept under control.

Production grew at a very high rate in Q1: GDP growth was around 9%, or 10% when the agriculture is excluded. This was considerably above the Serbian economy's potential medium-term growth trend and indicates that it was driven by high demand. Aggregate demand pushed up domestic production and spilled over into imports. Proof of the growth of aggregate demand is the hefty rise in the foreign trade deficit, which is higher than the GDP growth: we are currently spending 22% more than we produce. This figure in the previous quarter was 20% of GDP.

The consequence of the excessive growth of demand with respect to production is the deficit in the current account, which reached a record 17.6% of GDP in Q1, far above the critical level of 10%. The chronically high deficit has so far been offset by the major capital inflow from abroad – foreign direct investments and borrowing, so that the total foreign balance of payments was largely positive. For the first time since 2004, Q1 2007 saw a negative balance of payments, meaning that capital inflows were not sufficient to offset the huge current deficit. Although the probability is that capital inflows will increase during the year, the negative balance of payments in Q1 should be seen as a indication of a possible balance of payments crisis. An additional indicator of the high foreign trade imbalance is that the enormous imports in Q1 came close to the NBS's four-month net own reserves (see Table T6-1).

The growth of demand was generated by the growth of wages, the effects of the fiscal expansion in late 2006, and the growth of credit.

The average gross wage rose by 19% in real terms compared to Q1 last year. Net wages increased much more, by 24% in real terms. The difference arises from the reduction of the income tax, most of which apparently found its way into net wages. The growth of net wages naturally has a direct impact on pushing up demand. On the other hand, a growth of gross wages that is much higher than the already high growth of non-agricultural production – which means productivity as well – weakens the competitiveness of the economy.

Salaries in the government sector (administration, education, health...) carried over their high level from the end of last year and contributed to the growth of consumption in Q1. They recorded a real growth of some 16% compared to Q1 2006, while real net wages, because of the cut in the tax rate, grew far more – around 24%.

Growth of credit to the non-government sector accelerated from 16% in Q4 2006 to 20% in Q1 2007, triggering a rapid expansion of real M2 supply (from 30.6% to 35.4%). Bank credit to companies rose by €313 mn. The real y-o-y growth rate went from 4% in the preceding quarter to 8% in this quarter. The total growth of credit is, however, still due to credits to household, which continued to rise at a very high y-o-y rate of 50% in real terms. In addition to credits from domestic banks, companies continued borrowing abroad to the tune of a new €450 mn, which also pushed up aggregate demand.

While fiscal policy was unintentionally tightened, the easing of monetary policy was deliberate.

Following the major deficit in the preceding quarter and the expansive draft 2007 budget, Q1 surprisingly ended with a minimal fiscal deficit. The reason was the unforeseen high growth of public revenue on the one hand, and lower spending because of the temporary financing regimen on the other. Revenue grew exceptionally because of the high growth of consumption and, consequently, of imports and production.

After three years, the National Bank unexpectedly found itself in a favorable position. It no longer has to struggle with a large inflow of foreign capital and the pressures for appreciation of the dinar it generates, which force it to resort to expensive repo operations to withdraw the large amounts of money caused by the inflow. But this is only the reverse of the mentioned imbalance, i.e. the balance of payments deficit caused by the huge current account deficit and insufficient capital inflow to offset it.

In these circumstances, the NBS was able to opt for phased monetary relaxation by reducing the reference interest rate from 14% in December to 10.5% in March and then to 9.5% in late May. In parallel, it allowed the nominal and real depreciation of the dinar – 3% nominally in Q1, or about 4% in the first five months of the year. This steered the ship of monetary policy into calmer waters where it can combine the low inflation with the moderate reference rate and mild dinar depreciation. Altogether, this provides a good framework for economic growth.

There are two possible explanations for the NBS's favorable position. First, either it was the result of the "collateral boon" of the extremely high current account deficit or, second, of the policy of lowering the NBS reference rate and the consequential reduction of the inflow of "hot" capital. If the latter is true, in other words that the problem of capital inflow was caused by the high NBS interest rates, then all the credit for calming the situation goes to the National Bank. But, at the same time, it implies that the NBS caused the problem in the first place, by fixing over-high interest rates last year.

In my opinion, the truth lies somewhere in between these two extreme explanations, but is probably closer to the one that invokes the high current account deficit. Of course, a lower reference interest rate combined with the mild depreciation of the dinar made NBS repo instruments less attractive in terms of the euro and discouraged at least a part of the potential inflow from abroad.

Outlook

At present, the Serbian economy is characterized by low inflation as well as a huge deficit of the current balance, and the growth of imports. Thus the assessment made in the previous issue of *QM* that the internal imbalance – inflation – would shift to external imbalance has proved true. The external imbalance is primarily the result of the high demand as well as the dinar's exchange rate.

As the inflow of capital has calmed down, there are no major pressures from that side on the growth of demand and for appreciation of the dinar. This gives the NBS room to allow further depreciation of the national currency and thereby slow down the growth of imports and improve Serbia's foreign trade position.

It has been announced that the new budget, which is to be adopted by late June, will be balanced, i.e. with a small deficit. This means that the analytically consolidated budget viewed from the aspect of aggregate demand (FREN's definition) will achieve a deficit of up to 2% of GDP. It ensues that the government will not help to cut back the aggregate demand and huge foreign trade deficit.

A fiscal deficit of 2% of GDP is low even in orderly economies that successfully maintain macroeconomic stability; 3% is the cutoff for European Monetary Union members. Serbia's problem is the high spending of the private sector, i.e. its low savings, and this is by definition reflected in a high foreign trade deficit. In this situation, the government should step in with its savings, the fiscal surplus, to alleviate the external deficit without jeopardizing the foreign economic balance. Hence, viewed strategically, Serbia should aim for a fiscal surplus over the medium term.



TRENDS

1. Review

Q1 2007 was characterized by high economic growth, low inflation as well as a major foreign trade deficit. These trends were for the most part the consequence of a significant rise in domestic demand, which started in Q4 2006 and was prompted by increased government spending and a high growth of wages. The fiscal expansion of the second semester of last year ahead of the elections triggered a high growth of production but, in conjunction with the appreciation of the dinar, the growth of imports as well. Despite the solid performance of exports, the high increase of imports and drop in current transfers led to a very high current account deficit, in excess of 17% of GDP, which resulted in the first decline in foreign exchange reserves since 2004. The major capital transfers were insufficient to cover such a high deficit. Owing to the successful curbing of inflation, the NBS continued lowering the reference interest rate on 2 week repos, bringing it down to 9.5% at end-May (as much as 850 basis points lower than in September 2006). The drop in real yields on repos generated liquidity. Probably in direct connection with this, bank credits to companies picked up in Q1, after an almost complete standstill in Q4 2006. The balance of payments deficit and continued reduction of the NBS repo rate led to a fresh nominal depreciation of the dinar (by about 3% relative to end-2006). In this country, depreciation of the exchange rate usually pushes up prices. This, however, has not happened thus far and core inflation remains at a very low level. The first quarter was marked also by fiscal movements whose results were unexpectedly positive – the consolidated balance had a mild deficit, practically neutral. This was the result primarily of the high growth of revenue (VAT on imports, excises and customs duties) which, in its turn, resulted from the rise in domestic demand.

Economic growth accelerated in Q1. *QM* estimates the real y-o-y GDP growth at 8.8%, due both to the continuation of the trends initiated in 2006 (rising consumption and investment) and extraordinary circumstances, above all the warm winter owing to which the expected seasonal drop in some segments of the economy did not occur. Services continued to record a higher growth rate than material production, and *QM* estimates it at about 30%. Industrial production achieved a solid y-o-y growth of 4.8%. Because of the rise in domestic demand in Q1 2007, sections that look primarily to the domestic market made the biggest contribution to the growth of industrial production, in contrast to the major part of 2006 when this role was played by export-oriented sectors. Thanks to the good weather, construction recorded an exceptionally high growth rate, estimated by *QM* to be no lower than 35%. The economic growth, however, did not lead to higher employment. Employment in legal entities continued to decline between September 2006 and March 2007 (data on employment by entrepreneurs is not yet available). At the same time, however, the number of unemployed fell, indicating that the size of the economically active population is decreasing.

The 18.6% y-o-y real growth of gross wages was far above the y-o-y growth of GDP. Instead of the expected seasonal fall, wages in Q1 remained at the high level of the previous quarter, and for the first time since 2003 were higher in the first quarter of the year than in the last. Because of modifications in the taxing of personal incomes, the growth of net wages relative to previous years was faster than that of gross wages, with the real y-o-y growth of the average net wage standing at a high 24.2%.

Though inflation in Q1 2007 was somewhat higher than in Q4 2006, it remained low, in particular core inflation. The annualized average monthly rate in Q1 2007 was 5.1%, compared to only 2.1% in the preceding quarter (Table T3-1). Low inflation rate was achieved despite growing domestic demand and dinar depreciating in Q1. This can be attributed to the aggressive policy of the NBS in sterilizing excess liquidity and the appreciation of the dinar in the preceding quarter,

equilibrium of the fiscal balance owing to the unexpected growth of revenue, and shifting of excess demand to the growth of the foreign trade deficit. Virtually the entire increase in prices in the first five months of this year can be ascribed to the rise in non-core prices (primarily of oil products and electricity). The average core inflation in the first five months of 2007 was below 0.1% a month, i.e. only an annualized 1%, which is considerably below the 4%-8% the NBS is targeting. After almost continual nominal appreciation in the second semester of 2006, the dinar nominally depreciated against the euro by about 3% in Q1.

The balance of payments deficit worsened further and reached a very high 17.6% of GDP in Q1 2007. The deterioration, which started in Q4 2006, is primarily the result of accelerating imports, which could not be offset by the good performance of exports. In Q1, imports grew at a y-o-y rate of as much as 31.5%, while exports rose 34.9%. As a result, the merchandise trade deficit rose by 28.2% from a year ago. The poor performance of current transfers further aggravated the current account deficit. On the other hand, the capital-financial balance fell relative to the same quarter last year, mainly due to the banking sector repaying a major proportion of foreign debts, but also due to the early repayment of debt to IMF. The rise of the current account deficit and mild fall of the balance of payments capital account led to the foreign exchange reserves shrinking by some €200 mn. The NBS own net foreign exchange reserves (gross NBS foreign exchange reserves less banks' reserve requirements and the government foreign exchange deposit) amounted to €4,021 mn and are sufficient for only four months' worth of imports.

Fiscal trends in Q1 2007 were better than expected. Following the favorable movements in March, the fiscal deficit, defined from the aspect of influence on aggregate demand, was reduced to the minimum. The favorable movements were the consequence of the faster-than-expected growth of revenue on the one hand, and the slower growth of expenditure due to the temporary financing on the other. The fast rise in public revenue can most probably be attributed to the surge in domestic demand (which was far higher than the GDP growth). The high demand in Q1 was the result of the delayed effect of the growth of fiscal spending in late 2006, and the rise of the average wage at the end of last and beginning of this year. In view of the dominance of indirect taxes (VAT, excises, duties), the growth of domestic demand generated the growth of total public revenue in spite of the income tax cut. The relatively slow growth of public spending in Q1 can be directly linked to the temporary financing regimen, and the reduced activities of the outgoing government. Net government deposits with the banking sector rose by some 37 bn dinars in Q1 2007. The largest increase was in the deposits of the Republic of Serbia, which rose by 28 bn dinars. The major proportion of the increase can be ascribed to the inflow from the sale of the third mobile telephony license and other privatization revenues rather than the accumulation of collected taxes and other levies. In view of the expected deceleration of the growth of public revenue and the planned growth of public investment, current public spending will have to slow down if a relatively low deficit is to be achieved over the rest of the year.

The restrictive monetary policy was eased in Q1. Monetary supply continued accelerating its y-o-y growth to 42.9% from 39.2% in Q4 2006, mainly under the influence of the faster growth of credit to the non-government sector. The NBS lowered the reference interest rate several times – from 14% in December 2006 to 10.5% at end-Q1 and then to 9.5% in late May 2007. Real yields on repos also fell and, measured with respect to inflation, ranged from 5% to 8%. As a result, banks' interest in NBS papers waned. NBS activities included the net sale of foreign exchange to the non-government sector (withdrawal of dinars through net purchases of foreign exchange from exchange offices and net sales to banks on the inter-bank foreign exchange market), and the withdrawal of dinars through auctions of NBS papers (repos and outright sales). In Q1, the NBS withdrew considerably less dinars through auctions than in the preceding two quarters – about 17 bn dinars (68 bn in Q4, and 25 bn in Q3 2006). Since government increased its dinar deposits with the NBS by some 30 bn dinars, primary money fell in Q1. Bank credits to companies picked up in Q1. This was most likely directly connected with the reduced investment in NBS papers, which amounted to only €200 mn (compared to €900 mn in Q4 2006). Banks put about half of the new funding (€300 mn) into these credits, which had all but ceased in Q4 2006.

Like in the latter half of 2006, the credits were financed from domestic deposits, primarily new foreign exchange savings, reduction of banks' reserve requirement deposits with the NBS, and the reduction of net credit to government. Banks' foreign borrowing ceased completely compared to the previous quarter, but companies continued acquiring credits from banks abroad (about €450 mn in Q1 2007).

The number of transactions on the equity market doubled in Q1 compared to the preceding quarter, and the dinar turnover increased by 13.4%. This increase is apparently ascribable to domestic investors, with individual investors giving a significant contribution. Both the official indices of the Belgrade Stock Exchange, BELEXfm and BELEX15, recorded growth in Q1 and hit their all time highs. BELEXfm rose by 19.7% and BELEX15, the index of best performing shares, by 49.6% compared to the previous quarter. The fall in returns on FFCD bonds continued in Q1, with their losing up to 23 basis points. The exception, as usual, were bonds with the earliest maturity, A2007, which grew on the average by 121 bp relative to Q4 2006. After the Q4 2006 surge, turnover on the FFCD bond market fell in Q1. As the participation of foreign investors increased significantly (from 3.4% in February to 23.0% in March), it would appear that domestic investors were this time responsible for the drop in turnover.

1. Review

Serbia: Selected Macroeconomic Indicators, 2004-2007¹⁾

	Annual Data			Quarterly Data						
	2004	2005	2006	2005		2006		2007		
				Q3	Q4	Q1	Q2	Q3	Q4	Q1
Prices and the Exchange Rate					y-o-y²⁾					
Retail Price Index - total	10.1	16.5	12.7	17.1	17.9	14.8	15.6	12.5	8.2	5.8
Retail Price Index - core inflation ³⁾	7.9	14.8	10.3	14.9	15.1	12.0	11.6	10.8	6.9	4.7
Real fx dinar/euro (Dec.02=100)	106.3	105.8	97.4	105.8	104.5	102.7	100.3	95.5	91.4	91.1
Nominal fx dinar/euro (period average) ⁴⁾	72.62	82.92	84.19	83.83	85.71	87.09	86.87	83.25	79.55	79.98
Economic Growth					y-o-y, real growth²⁾					
GDP (in billions of dinars)	1,431	1,750	2,085	...	...	...	...	...	...	...
GDP	8.4	6.2	5.7	7.4	5.0	7.0	5.9	5.3	5.0	8.8
Industrial production	7.1	0.8	4.7	3.2	3.2	5.3	6.1	3.9	2.9	4.8
Manufacturing	9.7	-0.7	5.3	3.6	1.8	7.5	6.2	4.4	2.9	8.5
Average net wage (per month, in dinars)	14,108	17,478	21,745	17,969	19,680	19,284	21,126	21,986	24,585	25,103
Fiscal data		in % of GDP			y-o-y, real growth					
Public Revenues	41.2	40.1	38.9	-0.6	1.3	4.8	3.8	4.4	5.9	15.9
Public Expenditures	-40.0	-38.2	-38.3	-2.5	0.7	8.1	-2.4	5.2	21.0	9.7
					in billions of dinars					
Consolidated balance	17.5	33.8	12.0	9.9	15.2	0.4	16.3	9.9	-14.8	12.2
Analytical balance (FREN's definiton) ⁵⁾	-7.7	-2.9	-37.2	0.8	7.3	-3.9	-0.8	-0.2	-32.3	-2.5
Balance of Payments					in millions of euros, flows					
Imports of goods	-8,302	-8,286	-10,096	-2,234	-2,455	-2,139	-2,494	-2,541	-2,910	-2,813
Exports of goods	2,991	4,006	5,146	1,019	1,163	1,039	1,244	1,368	1,484	1,401
Current account balance	-2,197	-1,805	-2,892	-519	-671	-679	-469	-633	-1,111	-1,141
Foreign direct investments	773	1,248	4,077	495	250	164	545	1,671	1,668	617
NBS gross reserves (increase +)	229	1,857	4,240	454	738	390	1,079	1,539	1,232	-202
Monetary data⁶⁾					in billions of dinars, e.o.p. stock²⁾					
NBS net own reserves ⁷⁾	103,158	175,288	303,849	159,055	175,288	182,772	224,808	244,631	302,783	327,997
NBS net own reserves ⁷⁾ , in mn of euros	1,291	2,050	3,846	1,878	2,050	2,103	2,614	2,983	3,833	4,021
Credit to the non-government sector	342,666	518,298	610,305	456,541	518,298	547,564	591,270	614,698	609,171	666,007
FX deposits of households	110,713	190,136	260,689	162,667	190,136	207,609	222,105	243,328	260,661	293,195
M2 (y-o-y, real growth, in %)	10.4	20.8	29.8	22.4	20.8	24.7	19.8	20.5	30.6	35.4
Credit to the non-government sector (y-o-y, real growth, in %)	27.4	26.4	9.8	27.6	28.6	26.9	25.4	20.7	10.3	15.2

Source: FREN.

1) For more details (monthly series) see web page www.fren.org.yu.

2) Unless otherwise indicated.

3) Core inflation measures the price movements of goods and services that are not under administrative control, but formed freely on the market.

4) Calculation based on twelve-month averages for annual data and three-month averages for quarterly data.

5) Under FREN's definition, the analytical balance includes on the expenditure side the payment of old (domestic) debts, specifically payments for FFCs, the Serbia Reconstruction Loan, debt to pensioners, etc. Defined in this way, the result measures the liquidity effect government transactions have on the economy.

6) Monetary data that are used in this section of QM differ from those used in previous issues of QM due to the change in methodology in the Statistical bulletin of NBS. QM methodology remains the same but only based on a slightly modified database.

7) NBS net own reserves = NBS fx reserves, net - (foreign deposits of commercial banks + government foreign deposits). For details see Trends' section Monetary Flows and Policy.

2. International Environment

The international environment continues to be encouraging. The euro zone's GDP grew at a robust y-o-y rate of 3.1% in Q1. Although EU growth was stable, the European Central Bank will in all likelihood raise its reference interest rate in June so as to preempt the effects of any increase in the prices of oil and other raw materials. US growth was lower, standing at a y-o-y rate of 1.3%. Although US inflation accelerated, the Federal Reserve will probably retain its present interest rate. The East European economies grew at a high rate of almost 7%, while inflation remained at the levels recorded in the previous quarter.

Table T2-1. World: GDP Growth and Inflation, 2005–2007

in %	Real GDP						Inflation	
	real GDP growth		real GDP growth (seasonally adjusted annual rate)				annualised rates	
	2005	2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q4 2006	Q1 2007
World total	3.2	3.6	3.5	2.8	4.0	3.2	2.1	2.3
out of which:								
USA	3.5	3.3	2.6	2.0	2.5	1.3	0.2	3.6
Canada	2.9	2.8	2.0	1.7	1.0	3.9	1.5	1.8
Japan	2.7	2.8	1.5	0.8	3.8	2.4	0.5	0.2
China	10.2	10.6	13.1	10.4	7.9	11.1	2.0	2.7
India	8.4	8.0	7.7	9.6	7.8	9.4	6.2	6.2
Euro area	1.5	2.7	2.7	2.7	3.3	3.1	1.8	1.8
Germany	1.1	2.8	4.4	2.6	4.0	3.6	1.6	1.9
France	1.2	2.1	4.9	0.0	2.2	2.0	1.3	1.3
UK	1.9	2.6	2.8	2.8	2.7	2.8	2.7	2.9
Italy	0.1	1.9	2.6	1.1	2.8	2.3	2.0	2.0
Russia	6.4	6.7	9.9	1.8	7.7	7.9	9.2	7.9
Bulgaria	5.5	6.0	6.4	6.7	5.7	...	6.0	5.3
Romania	4.1	6.9	7.7	8.2	7.6	...	6.1	3.9
Hungary	4.1	3.8	4.1	3.9	3.4	...	6.4	8.8
Croatia	3.8	5.0	3.5	4.7	4.9	4.9	2.2	1.8
Macedonia	3.8	4.0	5.7	3.6	...	...	0.4	...
BIH	5.0	...	...	...	...	...	...	...

Sources: JP Morgan, National Bank of Bulgaria, National Bank of Romania, National Bank of the Republic of Macedonia, National Bank of Croatia.

European Union. In the first quarter of 2007, GDP in the euro zone grew at an annualized rate of 3.1%, and was up 0.6% on the previous quarter. It was the fourth consecutive quarter in which its GDP grew more quickly than the US. In the previous quarter, the euro zone's annualized GDP growth rate stood at 3.3%. Germany's GDP rose by 0.5% in relation to the previous quarter – less than half of the increase in that period. However, as an even sharper drop was expected due to the hike in the VAT rate, this is seen as optimistic. Data released by Germany's national statistics office showed a significant drop in personal spending, and ascribed the GDP growth to an investment boom. France recorded a quarterly growth of 0.5%, identical to the previous quarter's, or 2% at an annualized rate (the figure for Q4 2006 was 2.2%). Italy's GDP growth in Q1 2007 was only 0.2% (1.1% in Q4 2006), or 2.3% at an annualized rate (2.8% in Q4 2006). Annualized inflation throughout the euro zone was 1.8% and remained stable relative to the previous quarter. The European Central Bank has indicated it may raise the reference interest rate to 4% from the present 3.75%, probably in June. Although positive factors, such as the relatively favorable interest rate and growing foreign demand, point to stable future economic growth for the euro zone (i.e. no inflationary pressures are expected), by raising the interest rate the ECB is hedging against the domino effect of a possible hike in the prices of oil and other raw materials. In Q1 this year the euro zone recorded a net trade deficit of €1 bn. Exports grew at an annual rate of 9% (reaching €357.6 bn), while imports rose by 5% (to €358.6 bn). Good weather

and the consequent reduction of the energy deficit contributed to these results. In addition, the pharmaceutical industry and equipment manufacturing increased their foreign trade surplus. Foreign trade with leading trade partners grew as follows: *exports* to Russia increased by 26% in relation to the same period the year before; to South Korea by 18%; to India by 14%; and to China by 13%; *imports* from China grew by 24%; from Turkey by 21%; and from India by 18%.¹

United States. Real GDP growth in the USA amounted to an annualized 1.3% in Q1 2007 – half of the previous quarter's rate (2.5%). The factors that caused the slowdown included a reduction in exports, an increase in imports, a **slump in consumer spending, and a cut in budget spending.** They were followed by sluggish demand in the real estate market, which remained in the doldrums, primarily because of the high mortgage interest rates, as well as a fall in new employment. Annualized inflation stood at 3.6% in this quarter, while the core inflation rate was 2.8%, a noticeable rise in relation to the previous quarter, when total inflation was a mere 0.2%, and core inflation 2.4%. Inflation growth was a consequence of, among other factors, wage increases in the public sector (public administration and the armed forces). To this can be added the rise in the prices of energy and other raw materials. In spite of the major rise in inflation, the Fed has decided not to change the reference interest rate because of ever poorer GDP growth results – and it will remain at 5.25%. Q1 exports amounted to \$267.4 bn, and imports stood at \$452.4 bn, making a deficit of \$185 bn, a reduction of about 5% in relation to Q1 2006.

East, Central-east, and South-east Europe. According to JP Morgan estimates, average GDP growth in this region stood at an annualized 6.6% in Q1 2007. GDP growth and inflation in individual countries remain generally unchanged from the previous quarter. In spite of joining the EU, Romania and Bulgaria are being rocked by political upheavals; these have not, however, at least in Q1 2007, caused a slowdown in GDP growth. That said, Romania recorded a foreign trade deficit of €4,046 mn in Q1 2007, up 140% relative to the same quarter of 2006. This figure was due in great part to a change in customs duties imposed on foreign goods after EU accession, as well as the halving of oil and textile exports. Total exports in the period observed amounted to €7,102 mn, while imports stood at €11,148 mn.² For the first time since it embarked on transition, Hungary recorded a trade surplus – a mere €17 mn – in March. This was mainly the consequence of reduced import growth, which was less than half of the growth rate for exports. A drop in investment-oriented imports also became apparent. Hungary's trade deficit for the whole of Q1 2007 amounted to €280 mn (1.8% of GDP); the figure for the same period the year before was €1,104 mn. The average annualized import growth rate was 15.2% in Q1 2007, while the annualized export growth rate stood at 18.5%.³ Russia's GDP grew at an annualized 7.9% over the same period, compared to the previous quarter's 7.7%. Domestic demand and the rising prices of energy (particularly gas) had a favorable impact on GDP growth. Foreign investment intensified, causing the fiscal authorities' concern over possible inflationary pressures, which is why the Russian Central Bank raised its reserve requirement from 3.5% to 4.5%.⁴ Annualized inflation stood at 7.9%. Imports increased by 36% in the same period over the previous quarter; owing to the rise in living standards, personal spending is mainly directed at imported goods. The foreign trade surplus has consequently dropped by 29% – to \$22 bn – in relation to the previous quarter.⁵ Russia is the EU's third largest trading partner, with a share of 10% of its imports. The mutual balance of trade in 2006 amounted to nearly €70 bn in Russia's favor, since this country is the EU's chief energy supplier.

Asia. China recorded an annualized GDP growth of 11.1% in Q1 2007 (7.9% in Q4 2006). Inflation jumped to 2.7%, 1.5 percentage points more than in Q1 2006 – the highest level in three years. Officials have set the upper tolerance limit for inflation at an annual 3%.⁶ The country's foreign trade amounted to \$457.7 bn, creating a surplus of \$46.4 bn. China's Prime

¹ Source: Eurostat homepage.

² Romanian National Institute of Statistics, www.insse.ro.

³ JP Morgan Chase Bank, Global Data Watch, 11 May 2007, p. 67.

⁴ JP Morgan Chase Bank, Global Data Watch, 18 May 2007, p. 59.

⁵ Ria Novosti, "Risks facing Russian economy", 18 May 2007, <http://en.rian.ru/analysis/20070518/65722981.html>.

⁶ Fox News, "China's Economy Sizzles, Grows By 11.1 Percent in First Quarter; Some Worried About Inflation", 19 April 2007, <http://www.foxnews.com/story/0,2933,266992,00.html>.

Minister said his government would work towards curbing the trade surplus, controlling real estate price growth, and maintaining price stability. In the field of foreign trade, China plans to reduce tax breaks for certain raw materials and textiles, remove customs duties on coal, and reduce those on other raw materials.⁷ Japan's GDP growth amounted to 0.6% over the previous quarter in Q1 (an annualized rate of 2.4%, as opposed to 3.8% in Q4 2006). Personal spending (recording a quarterly growth of 0.9%) and exports (with a quarterly growth of 3.3%) remained at a high level, but the corporate sector under-performed due to the poor results in the automotive and telecommunications industries. Corporate investment fell by 0.9% in relation to the previous quarter (in contrast, Q4 2006 saw a quarterly growth of 2.3%). Prices increased by 0.2% relative to the previous quarter (while Q4 2006 growth amounted to 0.5%). It is noteworthy that 2006 saw China become Japan's largest trading partner.⁸

7 China Daily News, "China Trade to Reach 2 trillion in 2007", 18 May 2007, http://www.chinadaily.com.cn/china/2007-05/18/content_875677.htm.

8 Japan Times Online, "Economy grew just 0.6% in quarter", 18 May 2007, <http://search.japantimes.co.jp/cgi-bin/nb20070518a1.html>

3. Prices and the Exchange Rate

The average monthly inflation rate in Q1 2007 was 5.1% at an annual level,¹ while in the previous quarter (Q4 2006) it amounted to a mere 2.1% (compared to 11.7% in the first half of 2006). Although inflation in Q1 2007 was somewhat higher than in Q4 2006, it remained low, especially core inflation. Almost the entire price growth in the first five months of this year was the result of increases in non-core prices. Low inflation is a consequence of: the NBS's aggressive policy aimed at sterilizing excess liquidity and of the dinar appreciation in the previous quarter, as well as of an equilibrated fiscal balance due to the unexpected over-performance of revenue and the shifting of excess demand to the rising trade deficit. After six months of almost uninterrupted nominal appreciation in the second half of 2006, the dinar nominally depreciated against the euro in Q1 2007, by around 3%. Real depreciation in Q1 was 2%.

Table T3-1. Serbia: Retail Price Index and Core Inflation, 2005–2007

	Retail Price Index				Core inflation			
	base index (avg. 2005 = 100)	y-o-y growth	monthly growth	3m moving average, annualized*	base index (avg. 2005 = 100)	y-o-y growth	monthly growth	3m moving average, annualized*
2005								
dec	107.6	17.6	2.2	22.5	106.3	14.6	0.9	18.6
2006								
mar	110.0	14.4	0.3	9.1	108.1	11.7	0.8	7.0
jun	113.7	15.1	0.0	14.4	110.4	11.3	0.6	8.7
sep	114.1	11.6	-0.2	1.4	112.1	10.1	0.6	6.6
oct	113.7	9.3	-0.4	0.3	112.3	8.0	0.1	4.5
nov	114.6	8.8	0.8	0.6	112.5	6.8	0.2	3.7
dec	114.7	6.6	0.1	2.1	112.5	5.8	0.0	1.2
2007								
jan	115.1	6.5	0.4	5.2	112.5	5.3	0.0	0.8
feb	115.3	5.2	0.1	2.5	112.2	4.7	-0.2	-0.8
mar	116.1	5.6	0.8	5.1	112.4	4.0	0.1	-0.4
apr	117.1	4.6	0.9	7.2	112.6	3.3	0.2	0.4
may	118.8	4.4	1.4	12.7	112.8	2.8	0.2	2.0

Source: SBS

* Moving averages of monthly price increases for three months, annualized.

(e.g., the value for March was obtained through annualization of the average of monthly price increases in January, February and March; similarly, the value for October, for instance, was arrived at by annualizing the average monthly price increases in August, September and October)

Inflation in Q1 2007 remained low, and was driven by increases in non-core prices:

Inflation in Q1 2007, although somewhat higher than in Q4 2006, remained relatively low. The y-o-y rate of price increases was 5.6% in March, while the average y-o-y rate for Q1 amounted to 5.8% (in Q4 2006, it was 8.2%). Average monthly inflation in the first three months of this year amounted to 0.4%, that is, 5.1% annualized (Table T3-1). This was a rise relative to the previous quarter, when the rate was only 2.1%. It is important to point out that almost the entire price growth in Q1 was due to the rise in non-core prices,² while core prices³ practically stagnated in the period.

of tobacco products in January...

In January, inflation was low (0.4% monthly and 6.5% y-o-y), which was in line with expectations that no major price increases would occur at the beginning of the year (Table T3-1). The fact that

1 This rate has been obtained through annualization of average monthly inflation for a given period (e.g. for Q1, the calculation was made of the average of monthly inflation in January, February and March). Unlike in the previous issues of QM, when we paid more attention to the y-o-y price growth, we believe that average monthly price growth is a better trend indicator against the backdrop of the strong deceleration of inflation (which occurred in the second half of 2006 and this year).

2 Non-core prices are prices which are under direct administrative control (electricity, utility services, etc.) or are directly influenced by seasonal factors (agricultural produce) or under the influence of exogenous factors (prices of petroleum products).

3 Core inflation measures the price movements of goods and services that are not under administrative control, but formed freely on the market.

the monthly price growth in January was higher than in December (going up from 0.1% to 0.4%) was perhaps an indication of a slight acceleration; however, the registered increase in prices was for the most part due to the rise in cigarette prices in late December 2006. Inflation in February decelerated again, and thus a very low monthly growth rate of 0.1% and a y-o-y rate of only 5.2% were recorded.

**...of petroleum products
in March...**

Inflation in March was somewhat higher than in January and February – with a monthly growth of 0.8%. The largest contribution to this rise was made by increases in fuel prices (contributed 50% to the total monthly price growth), prices of heating fuels (contributed 6%), and education services (contributed 13%), as well as the prices of utilities (contributed 7%). The y-o-y price growth in March was 5.6% (slightly higher than the 5.2% in February). The average y-o-y price growth in Q1 thus reached 5.8%, while in Q4 2006 it was 8.2%.

...and in April...

Inflation in April 2007 was 0.9% at the monthly level, that is, 4.6% at the y-o-y level. It accelerated slightly relative to March. Average monthly inflation in the first four months of this year thus reached 0.5%, or 6.6% annualized. As in the previous months, the price growth was a consequence primarily of the rise in non-core inflation. The contribution of petroleum products to the total price growth in April was the largest: about two-thirds of the monthly price growth was due to increases in their prices. Apart from them, a strong contribution to the price growth was also made by agricultural products, whose prices went up by around 6% relative to March, but due to a lower weight their contribution to the total price growth in April was around one-fifth.

**...and of electricity in
May...**

May's inflation was the highest since the beginning of the year (1.4% relative to the previous month), as electricity prices went up in that month. Almost the entire price growth in May resulted from the electricity price adjustment. Despite that, the y-o-y inflation rate in May (4.4%) was lower than in April (4.6%), owing to the high base to which it is compared (monthly inflation in April and May last year was 1.8% and 1.6% respectively).

**...while core inflation
was stagnant
throughout Q1**

Core inflation was at a very low level throughout Q1, that is, it practically stopped (Table T3-1). Relative to December 2006, core prices in January remained unchanged, while at the y-o-y level, core inflation in January was 5.3% (in December 5.7%). Core prices were even lower in February than in January, while y-o-y core inflation fell below 5% in February. In March, core prices grew by 0.1% at the monthly level, thereby remaining at the December level (or even slightly lower). Core inflation in April stayed very low: 0.2% at the monthly level and 3.4% at the y-o-y level. A similar thing happened in May, when core inflation also amounted to 0.2% at the monthly level and 2.8% at the y-o-y level. Average core inflation in the first five months of this year was less than 0.1% a month, that is, a mere 1% annualized, which is substantially lower than the floor of the band targeted by the NBS (4%–8%).

**Low inflation in Q1 was
a consequence of:
sterilization of liquidity,
and the dinar's
appreciation in the
previous quarter...**

The very low inflation in Q1 2007 was a result of the operation of several factors.

First, in the previous quarter the NBS very aggressively and successfully sterilized excess liquidity, and caused the dinar to appreciate through its interest rate and exchange rate policies. In this manner, inflation was successfully arrested in the second semester of 2006, and this continued in Q1 this year. The price of those measures, however, was the high interest which the NBS paid on its repo operations, as well as the dinar appreciation, which, inter alia, caused a deterioration of the trade balance;

**...the equilibrated fiscal
balance...**

Second, the Q1 fiscal result was neutral, primarily as a result of higher-than-expected revenue over-performance.⁴ Likewise, temporary financing caused a rise in public sector wages, which was high, but still lower than projected by the Draft Budget, and a much lower degree of the NIP implementation relative to the plan. Owing to the low fiscal deficit, the pressure on total consumption, and thereby also on prices, was lower.

**...a "shift" of excess
demand to imports...**

Third, excess demand was shifted to imports rather than to domestic prices. As a consequence, Q1 2007 saw a rapid widening of the trade deficit. In the first three months of 2007, it was 25.1% higher than in Q1 2006.

⁴ See section *Fiscal Flows and Policy*.

3. Prices and the Exchange Rate

...and the delay of the electricity price adjustment

The growth of industrial producers' prices and consumer prices was also low

Fourth, in Q1 the announced and expected price adjustments did not occur, first and foremost, of electricity and also utilities. In May, however, an increase of 15% in electricity prices was approved (although a 20% price increase had been initially announced). This hike will directly result in the rise in the monthly inflation rate for May of around 1.2 percentage points, while the indirect contribution could be around 0.4 percentage points.

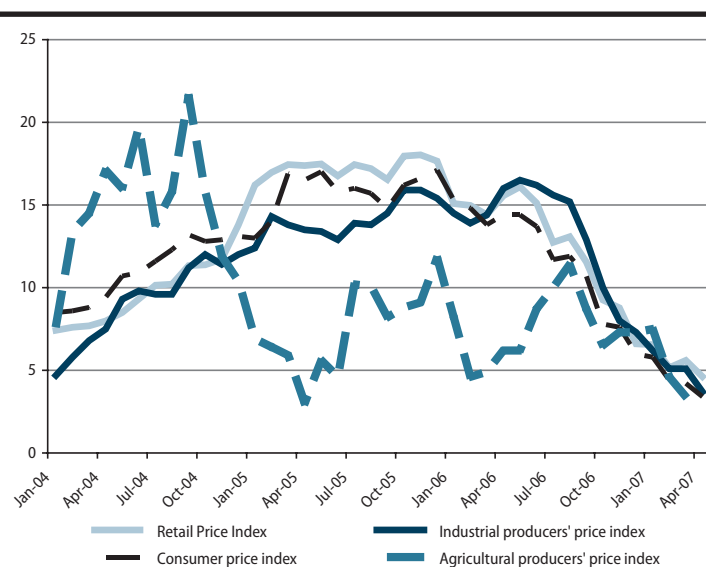
As in the previous quarters, the industrial producers' price index and the consumer price index moved in tune with the retail price index and thus, these, too, had very low values (Table T3-2). The average y-o-y increase in industrial producers' prices in Q1 was 5.5%, while the average y-o-y increase in the consumer price index was only 4.8%.

Table T3-2. Serbia: Movements in Selected Price Indices, 2005–2007

	Retail Price Index			Consumer price index		Industrial producers' price index		Agricultural producers' price index	
	base index (avg. 2005 = 100)	y-o-y growth	monthly growth	y-o-y growth	monthly growth	y-o-y growth	monthly growth	y-o-y growth	monthly growth
2005									
dec	107.6	17.6	2.2	17.1	1.6	15.4	0.4	11.8	1.0
2006									
mar	110.0	14.4	0.3	13.8	0.6	14.4	0.6	4.9	1.1
jun	113.7	15.1	0.0	13.7	0.0	16.2	0.2	8.7	1.2
sep	114.1	11.6	-0.2	10.7	-0.1	12.9	0.0	8.7	0.8
oct	113.7	9.3	-0.4	7.8	-0.4	10.0	-0.3	6.5	-2.4
nov	114.6	8.8	0.8	7.6	1.0	8.0	-0.3	7.3	1.2
dec	114.7	6.6	0.1	6.0	0.1	7.3	-0.2	7.3	1.1
2007									
jan	115.1	6.6	0.4	5.8	0.5	6.2	0.5	7.5	-1.5
feb	115.3	5.2	0.1	4.4	-0.2	5.1	0.0	4.6	-1.0
mar	116.1	5.6	0.7	4.2	0.4	5.1	0.6	3.4	-0.5
apr	117.1	4.6	0.9	3.4	0.8	3.7	0.8	...	...

Source: Serbian Bureau of Statistics

Graph T3-3. Serbia: Selected Price Indices, 12-m growth in %, 2004–2007



Source: Serbian Bureau of Statistics

Unlike in the second half of 2006, in Q1 2007 the dinar depreciated in nominal terms

The exchange rate of the dinar against the euro nominally depreciated from end-December 2006 to end-March 2007 by 3.3%. After nominally appreciating practically throughout the June - December 2006 period (with occasional short episodes of slight depreciation), the trend changed in early 2007 (Table T3-3). Since inflation was low in Q1 2007, though somewhat higher than in the euro area, real depreciation amounted to 1.9%. It is important to note that

depreciation in this period did not result in an immediate acceleration of price growth. There is, however, a lag in the pass-through of exchange rate movements into prices; hence it remains to be seen whether a possible pick-up in inflation will occur in Q2 as a consequence of the nominal depreciation of 3%.

Table T3-4. Serbia: Movements in the Euro Exchange Rate, 2003–2007

	Nominal				Real			USD/EUR rate
	exchange rate (FX) ¹⁾	base index ²⁾ (Dec.02=100)	y-o-y index ³⁾	cumulative index ⁴⁾	real FX ⁵⁾ (Dec.02=100)	y-o-y index ³⁾	cumulative index ⁴⁾	
	annual exchange rate⁶⁾							
2003	64.9743	105.6	107.1	110.5	102.4	97.8	104.4	1.1241
2004	72.6215	118.0	111.8	115.6	106.3	103.8	103.9	1.2392
2005	82.9188	134.7	114.2	109.3	105.8	99.5	94.9	1.2433
2006	84.1879	136.8	101.5	91.7	97.4	92.1	87.9	1.2537
	monthly exchange rate							
2005								
March	80.7498	131.2	116.1	102.7	106.5	101.0	98.1	1.3074
June	82.5172	134.1	115.3	105.0	106.7	100.7	98.3	1.2180
September	84.4958	137.3	113.6	107.5	106.2	100.0	97.8	1.2265
December	85.9073	139.6	109.3	109.3	102.9	94.9	94.9	1.1861
2006								
March	87.1033	141.5	107.9	101.4	102.5	96.2	99.6	1.2013
June	86.7609	140.9	105.1	101.0	99.8	93.6	97.0	1.2677
September	83.0621	134.9	98.3	96.7	95.3	89.8	92.6	1.2748
October	80.9242	131.5	95.0	94.2	93.3	88.5	90.7	1.2615
November	78.9404	128.2	91.7	91.9	90.4	86.0	87.8	1.2876
December	78.7812	128.0	91.7	91.7	90.4	87.9	87.9	1.3210
2007								
January	79.6587	129.4	91.7	101.1	90.7	87.8	100.3	1.2993
February	79.3993	129.0	91.0	100.8	90.6	88.3	100.1	1.3075
March	80.8968	131.4	92.9	102.7	92.1	89.9	101.9	1.3246
April	80.5768	130.9	93.1	102.3	91.5	90.8	101.1	1.3516
May	81.4770	132.4	93.3	103.4	91.7	91.4	101.4	1.3512

1) Monthly average, the official daily NBS mid-rate. 2) Ratio between the exchange rate in column 1 and the average in Dec 2002.

3) Ratio between the exchange rate column 1 and the same period in the previous year.

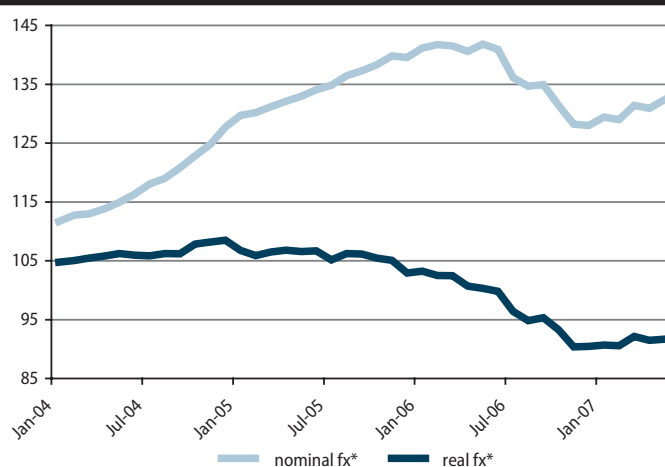
4) Cumulative is the ratio between the observed period and December of the previous year.

5) Calculation of the real exchange rate includes euro area inflation. The formula for index calculation: $RE = (NE/p) \times p^*$, where

RE = real exchange rate index NE = nominal exchange rate index p = Serbia's RPI p* = Euro area CPI 6) Average for the period.

The change in the exchange rate fixing method in early March went smoothly

In early March, the method used to fix the exchange rate underwent a change. Specifically, as of 5 March, the official mid-rate of the dinar against the euro is fixed at the start of each business day at the level of the weighted average exchange rate of the dinar against the euro, calculated on the basis of total interbank trade in foreign exchange – in euros, carried out on the previous business day, namely before the interbank fx market session, in the interbank fx market session and after the interbank fx market session. Similarly, in the same period, the NBS's interventions were reduced to the minimum.⁵ It should be pointed out that these changes have not affected the level

Graph T3-5. Serbia: Nominal and Real Dinar/Euro Exchange Rate, 2004–2007 (December 2002 = 100)


Source: Table P-3, Analytical Appendix.

*See the definition of the real exchange rate in Table T3-4.

of the exchange rate in any major way, which testifies that the current exchange rate, at least in the short run, is a realistic reflection of the ratio between dinar supply/demand.

In April, the dinar grew slightly stronger against the euro, only to drop sharply in mid-May. This was linked primarily to the uncertainty surrounding the installing of a new Serbian government. As soon as the formation of the government had been confirmed, the exchange rate stabilized again.

5 For more details see section: *Monetary Flows and Policy*.

4. Employment and Wages

Employment in legal entities continued to fall between September 2006 and March 2007, while the data on the number of entrepreneurs and their employees is still not available. The number of unemployed also dropped in this period, though more slowly than the number of employed, indicating a decrease in labor force participation. Wages in Q1 remained at the high level seen in the previous quarter, instead of undergoing the usual seasonal reduction. The y-o-y real increase in gross wages of 18.6% by far outstripped the y-o-y GDP growth of around 9%. Due to the January 2007 change in personal income tax, the average net wage growth of 24.2% in Q1 was faster than the average gross wage growth in the same period.

Employment

Table T4-1. Serbia: Registered Employment, 2003–2007

	Total No. of employed (employees and entrepreneurs)	Employees in legal entities	Entrepreneurs		Total No. of employees	
			Total	No. of employees with entrepreneurs		
	1 (=2+3)	2	3 (=4+5)	4	5	6 (=2+5)
in thousands						
2003						
March	2,046	1,628	418	198	220	1,848
September	2,036	1,595	441	202	239	1,834
2004						
March	2,065	1,601	464	208	255	1,856
September	2,037	1,560	477	210	267	1,827
2005						
March	2,070	1,557	513	228	285	1,842
September	2,067	1,536	531	230	300	1,836
2006						
March	2,032	1,496	536	228	308	1,804
September	2,019	1,447	572	242	330	1,777
2007						
March	1,992	1420 ¹⁾	572 ²⁾	242	330	1,750

Source: SBS Semi-annual Report on the Employed and Wages RAD-1/P; Additional Survey to the Semi-annual RAD-1 Report; Semi-annual Report on Small Businesses and Their Employees RAD-15.

Notes by column:

1) The total number of employed (employees and entrepreneurs) includes those employed by legal entities (enterprises, organizations, institutions) - Column 2, and small businesses i.e. entrepreneurs - Column 3 (including store owners, self-employed professionals, etc., and those working for them). Employees of the Ministry of Defense of Serbia, and the Serbian Ministry of Internal Affairs are not included.

2) Employees in legal entities (companies, organizations, institutions).

3) Owners of small businesses and self-employed persons (entrepreneurs) and their employees (Column 4 + Column 5)

4) Owners of small businesses and self-employed persons (entrepreneurs).

5) Employees of small businesses (entrepreneurs).

Footnotes:

1) SBS estimate.

2) The latest available data on entrepreneurs date September 2006.

Total employment continues to fall...

Total employment continued to fall in Q1 (Table T4-1), according to SBS estimates, even though the final data from the RAD-1 and RAD-15 surveys for March 2007 are not available yet. Due to this data unavailability, we infer the fall in total employment from only observing job cuts in natural entities. These job cuts mainly occurred in the manufacturing industry, as well as in the real estate and renting activities sector (Table P-5 in the Appendix). Since the most recent data on the number of entrepreneurs and their employees dates September 2006, we are unsure of the employment trends in this sector of the economy over the last six months. There is, however, no reason to assume that employment by entrepreneurs in this period grew faster than the fall in employment in natural entities. This is borne out by the fact that the Serbian Business Registries Agency data show the number of newly-registered companies over the last six months to be minimal.

Table T4-2. Serbia: Registered Unemployment, 2003–2007

	Individuals searching employment (NES) ¹⁾	Total number of unemployed (NES 15-64) ²⁾	Unemployment rate (NES) ³⁾	Unemployment rate (LFS 15-64) ⁴⁾
2003				
March	945,960	...	25.8	..
September	954,794	...	26.1	16.0
2004				
March	948,837	...	26.0	..
September	946,512	842,775	23.9	19.5
2005				
March	992,147	884,111	25.0	..
September	1,000,652	897,724	25.3	21.8
2006				
March	1,012,245	920,031	26.6	..
September	1,007,657	914,564	26.6	21.6
2007				
March	997,306	913,299	28.2	..

Source: National Employment Service (NES); Labor Force Survey (LFS).

Note: Population aged 15-64 is considered working-age population.

1) Unemployed individuals searching work or employed individuals requesting job change via NES.

2) As of July 2004, "Total number of unemployed" are a separate category from "Individuals searching employment".

3) As of September 2004, "Unemployment rate" is based on the "Total number of unemployed", rather than "Individuals searching employment".

4) Labor Force Survey is conducted in October each year (once per year), thus the September data are in fact October data for that same year.

The unemployment rate stood at 28.2% in March...

...which is an increase of 1.6 percentage points in relation to September 2006

The real picture, however, will emerge only when the data on entrepreneurs is available

Total unemployment decreased between September 2006 and March 2007, with the downward trend beginning in early 2006, according to the National Employment Service (NES) data (Table T4-2). As total employment also declined over the same period, we conclude that Serbia's labor force participation is decreasing. This could be because of population aging, additionally accelerated by early retirement, with severance being paid out to elderly workers in state-owned companies in order for them to retire a few years before their mandatory retirement age. It is also possible that this putative

decrease in labor force participation is the reason why the unemployment rate has grown between September 2006 and March 2007 – from 26.6% to 28.2%¹. However, the employment data for March 2007 have not been updated with the latest employment surveys and it is therefore quite likely that the number of employed in Table T4-1 is an underestimate. This in turn would have had a direct impact on the rise in the unemployment rate from September to March 2007 shown in Table T4-2. Therefore, the March 2007 unemployment rate data need to be taken with a grain of salt.

Box 1. Tracking unemployment in Serbia

As of this issue, *QM* will be monitoring statistical data on unemployment in Serbia. Table T4-2 shows the unemployment rates provided by the National Employment Service (NES), as well as the unemployment rates derived from the Labor Force Survey (LFS) conducted by the SBS. Although both sources define the unemployment rate as the ratio between the number of unemployed and the active labor force ("active labor force = number of unemployed + number of employed"), their data, and thus the unemployment rates from these two sources differ significantly. While the NES uses the number of unemployed registered with them, LFS is based on interviews conducted with a random sample of households, i.e. on information provided by the respondents themselves on their status in the labor market, regardless of whether or not they are registered as formally employed. Based on the significantly higher unemployment rates reported by the NES, and personal communication with their officials, *QM* concludes that a number of people not registered by their employers register at the unemployment bureau in order to become eligible for health and pension insurance. This indicates that the NES data *overestimate* actual unemployment.

On the other hand, LFS lists people as *unemployed* if, in the observed week, they neither held a paying job nor were temporarily absent from a job they would resume, and under the condition that the following criteria were met: (a) that they had taken active steps over the four weeks prior to the survey to find employment and would be able to start within two weeks if offered a job; and (b) that they did not actively seek employment over the past four weeks since they had already found

¹ Unemployment rate is defined as: "total number of unemployed/total active labor force".

4. Employment and Wages

a job they would start after the survey week was over or, at the latest, within three months of the survey. Based on this classification, LFS certainly lists a number of people in short-term or seasonal jobs as employed, thereby *underestimating* actual unemployment. We therefore conclude that the *actual unemployment* is probably somewhere in between these two rates, while the mentioned issues point to the fact that the fundamental problem in adequately tracking unemployment in Serbia is the presence of the informal labor market.

It should also be noted that the pre-2004 data from the LFS are not very reliable, and it is the methodological changes implemented in 2004 that explain the significant increase in the unemployment rate between 2003 and 2004 (Table T4-2). This is especially clear since the NES unemployment rate remained relatively stable or even declined in September 2004 (though this can also be partially ascribed to NES' methodological changes as they switched from 'individuals seeking employment' to the 'total number of unemployed' when calculating the unemployment rate). Therefore, due to the interruption in both series in 2004, only the data from September 2004 onwards are mutually comparable.

Table T4-2 shows data from both NES and LFS for persons aged 15 to 64, as these are the internationally comparable unemployment rates.

Wages

Table T4-3. Serbia: Wage Bill and Average Monthly Wage, 2003–2007

	Wage Bill (SBS) ¹⁾			Average Monthly Wage (SBS)		
	in 000 dinars	% of GDP	% of non-agricultural GVA	Gross, in dinars	Net, in dinars	Gross, in euros
2003	367,111,910	31.4	43.1	16,612	11,500	256
2004	454,125,726	32.7	45.5	20,555	14,108	283
2005	560,368,368	32.4	44.6	25,514	17,478	308
2006	684,758,123	33.3	45.2	31,801	21,745	379
2005						
Q1	122,356,320	34.3	45.5	22,166	15,140	276
Q2	137,692,500	33.5	45.3	25,035	17,122	306
Q3	144,569,591	31.5	44.2	26,280	17,969	313
Q4	157,575,975	30.9	43.9	28,781	19,680	336
2006						
Q1	152,864,571	35.1	45.5	28,209	19,284	324
Q2	167,304,764	33.3	44.6	30,914	21,126	356
Q3	171,961,544	31.9	43.9	32,130	21,986	386
Q4	192,627,244	32.2	46.7	35,951	24,585	452
2007						
Q1	183,991,500	36.2	46.3	35,046	25,103	438

Source: Serbian Bureau of Statistics (SBS).

1) The wage bill is an inferred value representing the multiple of the total number of employed with the average wage, using SBS data.

In Q1, wages retained the high level from the previous quarter and thereby contributed to the growth of aggregate demand

The real y-o-y gross wage growth amounted to 18.6%; the increase was 24.2% for net wages

In Q1, wages stayed at the high level of the previous quarter. Thus, real y-o-y gross wage growth amounted to 18.6% (Table T4-4), real y-o-y net wage growth stood at 24.2% (Table P-6 in the Appendix), while GDP grew by around 9% in the same period. This high wage growth definitely affected the rise in aggregate demand, and thereby the high y-o-y GDP growth in Q1.

For the first time since 2003, the average net wage in Q1 was higher than in

the previous quarter (Table T4-2), while the average gross wage nominally fell by 2.5% (while remaining the same in real terms). Furthermore, if December were to be excluded from Q4 because of the high seasonal effects (year-end bonuses), the average monthly gross wage in Q1 in relation to October and November 2006 nominally grew by 5.3%, while the average monthly net wage nominally grew by 10.4% over the same period (see Table P-6 in the Appendix for nominal monthly wages). These data lead to the conclusion that the high wage growth in Q4 2006 was not a short-term effect of the election campaign, but rather that the high level was carried over into 2007 as well.

Gross wage growth slowed in Q1 as the tax rate was cut from 14% to 12%

Gross wage growth in Q1 slowed somewhat as the income tax system changed on January 1, 2007. The tax was reduced from 14% to 12%, the first 5,000 dinars became non-taxable, while contributions paid by the employee and the employer remained at the same level (they also apply to the first 5,000 dinars). These changes resulted in net wages growing more quickly than gross wages.

Changes in taxation had a significant impact on the net wage growth...

...thereby creating additional inflationary pressures on the expenditure side in Q1

There are two ways the change in taxation could have influenced the average wage: (1) the employer could have retained the same gross wage for employees, thereby increasing their net wages; or (2) the employer could have reduced the gross wage for employees and continued paying the same net wage. Although both have been observed in practice, it cannot be said with certainty which one was prevalent. Having noted that the average net wage grew in Q1, while the average gross wage minimally decreased in relation to the previous quarter (Table T4-3), the impression is that tax changes have, on average, led to net wage growth rather than gross wage reduction. This effect of the change in taxation on the average wage was only to be expected, as the average wage monitored by the SBS is somewhat biased towards the government sector with strong workers' unions, making it more difficult to prevent wage growth. Unfortunately, it is not clear which of these two effects has prevailed in the private sector, as wages with entrepreneurs and small businesses are not included into SBS' average wage. If the hypothesis that net wages grew as a consequence of the change in taxation is true, as we suggest it is, then this change in the tax system exerted additional short-term inflationary pressure through boosting aggregate demand in Q1.

Additionally, due to the lower tax burden, gross wages in Q1 grew more slowly than net wages in relation to the previous year. This caused unit labor costs to slow their growth too, albeit keeping their high level from Q4. Furthermore, the share of the wage bill in non-agricultural gross value added (GVA) – it being a good indicator of unit labor costs, slid from 46.7% in Q4 to 46.3% in Q1; however, both values are significantly higher in comparison to the earlier trend (Table T4-3).

The wage bill continues to grow faster than GDP; unit labor costs rise too

Q1 saw the wage bill rise by 14.9% in real terms when compared with Q1 2006. Its share in GDP and non-agricultural GVA is higher than in the first quarter of any previous year, indicating that the wage bill continues to grow more quickly than GDP, i.e. that unit labor costs are rising (although their growth rate is slowing down). This is of special significance when it is taken into account that y-o-y GDP growth in Q1 amounted to as much as 9% (Table T4-3).

Table T4-4. Serbia: Wage Indices, Y-o-y data, 2003–2007

	Wage Bill Index (SBS) ¹⁾		Average Gross Monthly Wage Index (SBS)	
	nominal	real	nominal	real
2003	123.0	111.9	125.3	114.0
2004	123.7	111.0	123.7	111.1
2005	123.4	106.2	124.1	106.8
2006	122.2	108.4	124.4	111.3
2005				
Q1	121.6	104.9	121.8	105.0
Q2	124.1	106.6	125.3	107.6
Q3	124.1	107.5	124.3	107.6
Q4	124.8	107.1	125.3	107.5
2006				
Q1	124.9	109.0	127.3	111.0
Q2	121.5	106.4	123.5	108.1
Q3	119.7	107.4	122.3	109.7
Q4	122.2	114.1	124.7	116.4
December	..	..	128.1	120.8
2007				
Q1	120.4	114.9	124.3	118.6

Source: Serbian Bureau of Statistics (SBS).

1) The wage bill is an inferred value representing the multiple of the total number of employed with the average wage, using SBS data.

Table T4-5. Serbia: Average Gross Wages by Activities, Y-o-y Real Indices, 2005–2007

	2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	2006	Q1 2007
Total	106.8	110.9	108.0	109.7	116.4	111.3	118.6
Agriculture, forestry and water works supply	112.2	118.3	115.7	112.4	112.4	114.7	110.2
Fishing	116.2	105.5	70.8	93.6	100.5	92.6	78.8
Mining and quarrying	100.4	108.9	114.5	115.5	115.1	113.5	135.4
Manufacturing	109.1	114.4	110.9	113.8	115.8	113.7	114.9
Electricity, gas and water supply	104.1	104.0	99.4	107.1	114.9	106.3	143.0
Construction	104.5	108.7	111.0	112.7	119.4	112.9	123.9
Wholesale and retail trade, repair	111.6	114.2	113.9	112.0	117.9	114.5	118.7
Hotels and restaurants	108.3	112.0	111.0	106.4	108.6	109.5	112.0
Transport, storage and communications	104.2	110.0	111.0	104.0	109.1	108.5	108.5
Financial intermediation	110.5	112.9	111.5	113.9	111.3	112.4	112.9
Real estate, renting activities	111.6	101.5	99.1	105.8	107.3	103.4	122.0
Public administration and social insurance	105.0	112.6	104.3	107.6	112.5	109.2	111.5
Education	108.2	114.9	103.5	105.0	112.0	108.9	111.9
Health and social work	100.0	101.4	102.3	104.9	125.5	108.5	125.5
Other community, social and personal service	102.6	105.2	100.7	103.1	111.0	105.0	106.2

Source: Serbian Bureau of Statistics (SBS), RAD-1 Survey.

The public sector leads y-o-y wage growth

The public sector leads the way in y-o-y wage growth – in state-owned public enterprises y-o-y wage growth reached as much as 35.8%;² whereas wages in healthcare were significantly increased in Q4 2006 following the Government budget rebalance, and recorded y-o-y real gross growth of 25.5% (31.8% net). It is noteworthy that the draft 2007 budget provided for additional wage growth in the government sector in Q1. The raises, however, failed to materialize due to interim financing being put into place until the new Serbian government was formed.

Electricity, gas and water supply as well as mining and quarrying sectors record the highest wage growth

In more detail, the highest y-o-y real gross wage growth (43%) was recorded in the electricity, water and gas supply sector (the tax change made real net wage growth even higher – 49.9%), followed by a real gross wage growth of 35.4% (or 40.98% for net wages) in the mining and quarrying sector, driven mainly by rising wages in the metallic ore extraction sub-sector (85.5% - Table 64-5). The rise in wages in electricity production was mostly due to very high bonuses (over 50% of December wages) Electric Power Industry of Serbia (EPS) paid out for the first time in 2007 (no year-end bonuses were ever paid out in this sector in previous years).

Gross wages in construction record real y-o-y growth of 24.1% in Q1, with net wages rising by 29.6%

Due to an extraordinarily warm winter and therefore unusually high activity levels, construction recorded a real y-o-y growth of 24.1% in Q1 (with net average wages growing by 29.6%). The average gross wages in services, for sectors such as financial intermediation and real estate and renting activities, saw real y-o-y growth of 22% and 12.9% respectively. Furthermore, when December and January are excluded because of the high seasonal fluctuations, and only February and March 2007 are compared with October and November 2006, we observe that the average gross wages in the services sector (financial intermediation, real estate and renting activities and transport, storage and communications) grew by between 13% and 15% in real terms. Wage growth in these areas can be explained to a large extent by the expansion of these sectors in Serbia's economy. The highest wage growth in financial intermediation was recorded in insurance, probably as it is a relatively new and dynamic sector in Serbia.

In April 2007, the average wage remained at the high level seen in the previous months

In April 2007, the average wage remained at the high level seen in the previous months; the y-o-y real gross wage growth rate of 17.4% was very high, although somewhat lower than in the preceding period (see Table P-6 in the Appendix). When viewed by sectors, the highest y-o-y real gross wage growth was observed in healthcare, followed by hotels and catering. The real gross wage growth in the hotels and catering sector – 24.5% – was also the highest in this sector since 2005.

² MAT, April 2007, Belgrade Institute of Economics, p. 25

Box 2. Minimum Wage

Table T4-6. Serbia: Minimum Wage, 2003–2007

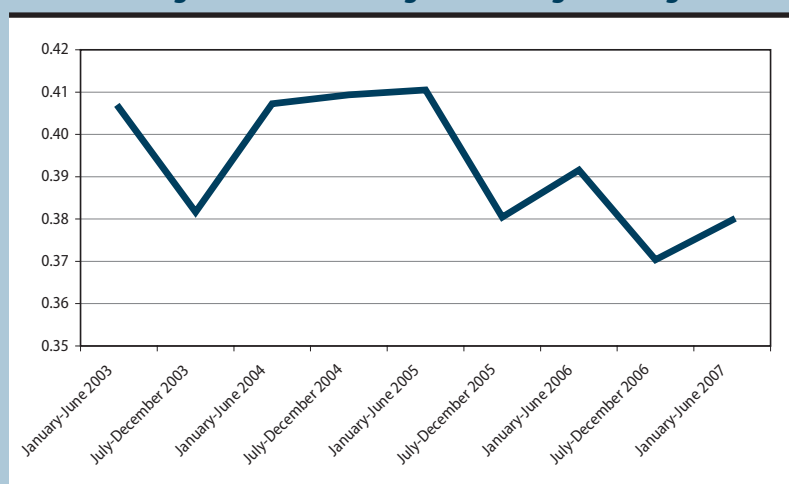
	Net Minimum Hourly Wage, in dinars	Net Minimum Monthly Wage, in dinars	Net Minimum Monthly Wage Y-o-y Indices	
			nominal	real
2003				
January-June	25.0	4,300	135.1	120.6
July-December	27.0	4,752	120.0	111.3
2004				
January-June	31.0	5,373	125.0	114.2
July-December	35.0	6,160	129.6	115.2
2005				
January-June	38.5	6,622	123.2	106.1
July-December	41.0	7,161	116.3	100.2
2006				
January-June	46.0	7,912	119.5	104.4
July-December	49.0	8,624	120.4	110.3
2007				
January-June	55.0	9,533	120.5	..

Source: Official Gazette.

In the period January – June 2007 (the minimum wage is negotiated by semester), net minimum wage nominally increased by 20.5% relative to the first half of 2006, and it now amounts to 9,570 dinars. Thus, y-o-y net minimum wage in Q1 nominally grew by 9.7 percentage points (Table T4-6). However, it is still too early to draw conclusions on the relation between average and minimum wage in the first semester of 2007, as information on the growth of the average wage in Q2 2007 is not available. Nevertheless, in the second semester of 2006, the nominal minimum wage growth of 20.4% was lower than the average wage growth, which amounted to 23.7%. A similar trend – the minimum wage growing more slowly than the average wage – was also observed in the previous periods.

Graph T4-7 illustrates the relationship between the minimum and the average wage in Serbia since 2003. As the graph shows, the minimum net wage in Serbia has been in a slow decline in relation to the average net wage.

Graph T4-7. Ratio of Average Net Minimum Wage and Average Net Wage in Serbia, 2003–2007



Source: Official Gazette.

5. Economic Activity

Economic growth accelerated in Q1, with GDP estimated up about 8.8% relative to the same period a year ago. The high growth was a consequence both of trends that continued from 2006 (increased spending and investment) and extraordinary circumstances – above all the warm winter, thanks to which there were no usual seasonal drops in some segments of the economy. The growth of services led the field, ahead of material production. Commerce saw the highest acceleration, with QM estimating its growth at some 30% in Q1. Industrial production recorded a robust y-o-y growth of 4.8%, while construction surged due to the favorable weather. It is not easy to precisely ascertain the rate of growth of this segment, but QM believes it was no lower than 35%.

Gross Domestic Product

We estimate GDP growth in Q1 at 8.8%

According to QM estimates, based on the methodology and data of the SBS, real GDP growth was 8.8%¹ in relation to the same period a year ago (Table T5-1). This high rate can be attributed to several factors. On the one hand, the Q4 2006 trends contributing to quicker GDP growth (rising wages and growing credit to companies) carried over into this year, heightening the pressure on spending and investment. On the other hand, there were extraordinary circumstances – the warm winter thanks to which there were no usual seasonal drops in certain sections, and the low 2006 base used for comparison with Q1 2007. Another factor was the stabilized growth of the GDP tax component that came two years after the VAT was introduced two years ago.² The GDP tax component was significantly lower than the growth of GVA throughout 2006.

Table T5-1. Serbia: Gross Domestic Product, 2004–2007¹⁾

			y-o-y indices				2007 Q1 ²⁾	base index	GDP share
	2005	2006	2006					(jan-mar) ₀₇ / (jan-mar) ₀₆	2006
			Q1	Q2	Q3	Q4			
Total	106.2	105.3	106.2	105.6	104.6	105.0	108.8	132.5	100.0
Taxes minus subsidies	110.2	99.6	98.4	101.5	95.3	103.0	108.5	143.5	15.3
Value Added at basic prices	105.5	106.4	107.7	106.4	106.4	105.4	108.9	130.1	84.7
Non agricultural Value Added	106.3	106.8	108.2	106.6	106.4	106.1	109.7	135.1	87.1
Agriculture	95.1	102.0	98.1	102.1	105.8	100.7	101.0	99.5	12.9
Manufacturing	99.9	105.2	107.7	106.4	104.5	103.0	108.5	110.7	16.1
Construction	102.0	112.4	125.5	106.5	102.7	120.2	135.0	163.3	3.5
Transport	123.4	126.5	128.1	126.8	127.0	124.6	115.0	200.1	11.5
Wholesale and retail trade	122.0	109.1	116.6	107.4	108.4	106.5	130.0	229.0	12.9
Financial intermediation	117.4	114.6	117.6	116.6	114.6	110.5	119.6	221.8	7.4
Other	99.9	100.3	99.4	100.0	99.9	100.1	99.0	104.4	35.7

Source: SBS.

1) At constant 2002 prices.

2) QM estimate.

The strong acceleration of the economy was driven by: high demand...

The high growth of real wages (18.6% in Q1 relative to Q1 2006)³ led to increased household spending, which in turn prompted GDP growth. Another consequence of the greater household spending was the 32.2% y-o-y growth of retail trade at constant prices, as well as an acceleration of production (Table T5-5) and import of consumer goods.⁴

1 Due to extraordinary changes to indicators we use in estimating growth of individual areas in Q1 (e.g. cement production: y-o-y growth of 93.8% in Q1, or retail trade at constant prices: y-o-y growth of 32.2% in Q1), the GDP growth estimate for Q1 is less reliable than usual. It needs to be underlined that the growth estimate of 9.2% is conservative – we assume that actual growth was even higher.

2 See "VAT in Serbia – Two Years On", QM7, or "Economic Growth", QM7.

3 For more details see "Employment and Wages" in Trends, this issue of QM.

4 For more details see "Balance of Payments and Foreign Trade" in Trends, this issue of QM.

Credit to companies picked up in Q1, both through the domestic financial system and through companies directly borrowing abroad,⁵ owing to which investment also accelerated. Capital goods imports surged by over 50% in Q1, and domestic production of these goods also recovered (Table T5-5).

...but also by the favorable effect of the warm winter

Construction best illustrates the favorable effect of the unseasonably warm winter. The sector saw record y-o-y growth in Q1, estimated at a minimum of 35%. Related activities have recorded growth. Production of non-metallic mineral products rose by 23.4% in Q1 relative to the same period in 2006 (Table T5-4). There was a drop, however, in electricity production (Table T5-5). Notwithstanding this reduction, the cumulative effect of the warm winter on GDP growth, was positive.

Finally, it is evident that the Q1 2006 base used for comparison with Q1 2007 is relatively low. Although Q1 2006 economic growth appeared to be high (7%), this was mainly because of comparison with an even lower Q1 2005 base, the quarter when the VAT was introduced. In fact, the economy was stagnant in Q1 2006, which is why the Q1 2007 base remained low. The indisputable acceleration of economic growth in Q1 becomes even more apparent.⁶

Non-agricultural GVA grew by a high 9.7% Services lead GDP growth...

We estimate the y-o-y growth of non-agricultural GVA in Q1 at 9.7%. Non-agricultural GVA is a relevant indicator of economic activity, as the agriculture and the GDP tax component are affected by non-market factors. Services led GDP growth, with commerce growing at an estimated rate of some 30% (Table T5-1) - the retail index at constant prices is used here as an indicator of growth.⁷ The growth of transport is estimated at 15%, lower than in the previous quarter. This, however, is only an illusion of a slowdown, caused by modifications in the SBS methodology,⁸ with the transport growth actually remaining unchanged. Growth in telecommunications services - which recorded a 2.5-fold increase between only 2004 and 2006 - had the greatest impact on the high transport growth. Mobile telephony and data transfer led the field, ahead of landline telephony services. Financial intermediation grew at a quicker pace in Q1, i.e. an estimated 19.6%. Credits to companies and households, as well as deposits, also accelerated their growth; conversely, repo operations slowed down.

...but material production also recorded high growth

Material production also recorded high growth in Q1: construction grew mainly because of the good weather, but there should be no doubt that its underlying trend remains high. Firmer data about the actual movements in construction will be available in Q2. The manufacturing industry also recorded high growth, of about 8.5%. Only energy production recorded a y-o-y drop - but this was a temporary glitch ascribable to weather conditions. The agriculture will in all likelihood see another below-average season in 2007.

Industrial Production

Industrial production in Q1 grew by 4.8%

In Q1, industrial production did not continue the strong acceleration that started in December 2006. It has, however, retained the high growth rates achieved. Year-on-year industrial production quarterly growth stood at 4.8%, which was above the level recorded in Q4 2006.

5 For more details see "Monetary Flows and Policy" in Trends, this issue of QM.

6 If quarterly GDP growth from Q1 2004 to Q1 2007 is observed and compared with quarterly growth in the similar three-year period from Q4 2003 to Q4 2006 (thereby avoiding the influence of the VAT on y-o-y quarterly growth indices), higher growth is apparent in the latter case. Seasonal adjustments of series does, however, lead to the conclusion that Q1 saw an acceleration of economic growth relative to Q4 2006 - but this needs to be interpreted with caution.

7 Data on the volume of wholesale trade at constant prices in Q1 was not available at the time of writing. As growth in the volume of wholesale trade was greater than that in retail in 2006, we consider the estimated 30% growth rate for commerce conservative.

8 Complete data on transport in Q1 was not available before this issue went into print; however, due to changes in SBS methodology for measuring telecommunications growth, we expect total transport growth in Q1 to be slightly lower than in Q4. The actual transport growth trend has not really changed. The SBS may revise its figures, but this is something we will not go into at present.

Table T5-2. Serbia: Industrial Production Indices, 2005–2007

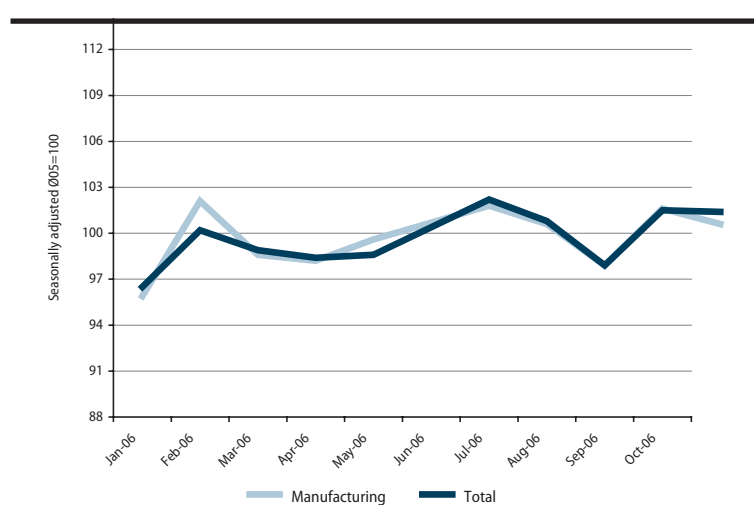
	y-o-y indices							base index (jan-mar) ₀₇ / (jan-mar) ₀₂	share 2006
	2005	2006	2006				2007		
			Q1	Q2	Q3	Q4		Q1	
Total	100.8	104.7	105.3	106.1	103.9	102.9	104.8	110.0	100.0
Mining and quarrying	102.1	104.1	104.0	102.6	102.8	104.6	102.1	104.0	6.3
Manufacturing	99.3	105.3	107.5	106.2	104.4	102.9	108.5	112.5	75.4
Electricity, gas, and water supply	106.6	102.2	99.3	107.6	101.6	102.1	94.2	104.0	18.3

Source: SBS.

The manufacturing industry was the leader in growth, with a rate of 8.5% (Table T5-2). Electricity, gas and water supply saw lower-than-average results, dropping by 5.8%, and bringing down total industrial production. Ore and stone extraction stood at 2.1% above the level recorded in Q1 2006. A part of this production is directly linked to energy, so the somewhat lower growth in that sector was to be expected.

The underlying trends in industrial production are favorable

Seasonally adjusted indices indicate that total industrial production slowed down slightly in Q1 (Table T5-3). However, even these show the separation of levels of industrial production in the manufacturing industry and the rest of the industry (caused by a drop in electricity and gas supply). The seasonally adjusted growth trend in the manufacturing industry (Table T5-3), which has not been under much seasonal influence in Q1, should be viewed as relevant. This trend indicates that *no slowdown actually happened*, and that the high industrial production growth of some 5% was retained. Similar growth levels throughout the industry as a whole can be expected over the rest of the year, barring any major turnabouts in economic policy. The April growth indices for total industrial production and the manufacturing industry started to converge again, confirming *QM's* assumption that *actual* industrial production growth is evident in the manufacturing industry results.

Graph T5-3. Serbia: Industrial Production, Seasonally Adjusted Indices, 2006–2007

Source: SBS.

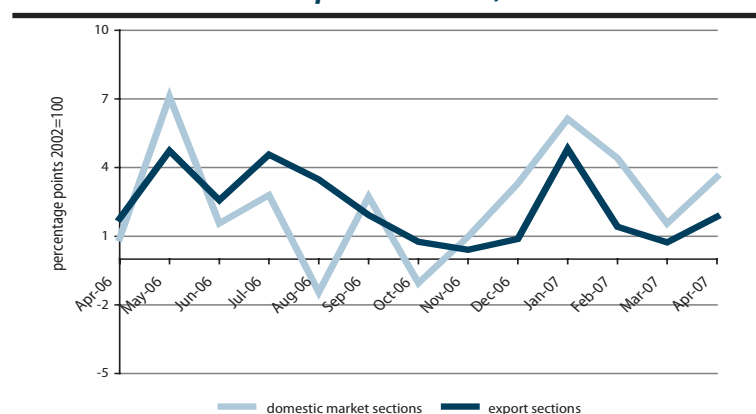
domestic market, they lacked the access to foreign credit the large and medium-sized companies had. In Q1 it appeared that access to credit no longer played any role in industrial production growth.

After a six-month period in which industrial production growth was higher for large and medium-sized companies than for small ones, a change has set in since February 2007.⁹ Small companies again showed higher growth rates, which was usual before last year's monetary policy measures were introduced. In *QM's* opinion, small companies were hardest hit by these measures, as, in conditions of high interest rates on the

⁹ The SBS conducts small companies' industrial production surveys by polling a sample of 300 companies. This survey is not included in the total industrial production index.

Increased domestic demand drives industrial production in late 2006 and Q1 2007

Graph T5-4. Serbia: Contribution to Y-o-y Manufacturing Industry Growth, domestic market sections¹⁾ and export sections²⁾, 2006–2007



Source: SBS.

- 1) Manufacturing industry sections selling most of their production on the domestic market.
2) Manufacturing industry sections exporting a significant part of their production.

The manufacturing industry recorded a high growth rate of 8.5% in Q1 (Table T5-4); *QM* considers that the rising domestic demand was the key factor in this growth. Indices of the movement of stocks for Q1 also point to the rising demand as a crucial factor for Q1 industrial production growth: in addition to a higher physical volume of production, stocks declined by some 2.5% relative to Q4

2006. Further analysis was conducted into whether the demand was domestic or export-oriented. Contrary to most of 2006, when high growth was recorded mainly by sections which export the bulk of their production, sections that are mostly oriented to the domestic market are now recording accelerated growth. We looked at two groups of six industrial sections in each: those exporting the major part of their production – *export sections*, and those selling almost all their production in the domestic market – *domestic market sections* (Graph T5-4). For most of 2006, the *export sections* contributed more to manufacturing industry growth than the *domestic market sections*, even though their share in manufacturing was smaller. Indeed, in August and October 2006 the *domestic market sections* even recorded negative contributions to total manufacturing growth. The trend was reversed in November 2006, and domestic market sections have since been the drivers of manufacturing industry growth. All this is a strong indication that increased domestic demand spurred industrial production in late Q4 2006 and Q1 2007.

Industrial production grew across the board

Further analysis of the structure of industrial production growth brings out that both the leaders¹⁰ and other sections are recording an acceleration of growth. Trends that have been apparent since late 2006 are continuing – the gap between the leaders and other industrial production sections is narrower than it was for most of 2006. Table T5-5 shows sections contributing the most to industrial production growth in 2006 (*leader sections*): basic metals, food and beverages, furniture and related products, chemicals and chemical products, tobacco products, and non-metallic mineral products.

Table T5-5. Serbia: Sub-Sectors with Highest Growth Rates in 2006, 2005–2007

	y-o-y indices							base index	share	
	2004	2005	2006	2006						2007
				Q1	Q2	Q3	Q4	Q1	(jan-mar) ₀₇ / (jan-mar) ₀₂	2006
Manufacturing	109.7	99.3	105.3	107.5	106.2	104.4	102.9	108.5	112.5	100.0
Total-selected sectors	115.5	108.3	111.9	110.6	114.4	117.4	106.9	114.1	145.6	65.1
Basic metals	140.9	121.8	122.7	116.6	131.7	135.4	109.8	115.1	253.0	10.9
Food and beverages	103.4	104.6	105.3	104.2	105.1	109.5	102.5	112.2	120.5	30.0
Furniture and related products	92.1	92.2	165.5	134.3	163.0	197.8	160.2	169.5	169.1	3.1
Chemicals and chemical products	118.2	103.8	108.3	105.1	107.7	112.8	107.5	105.5	142.4	12.9
Tobacco industry	97.6	114.6	111.3	158.6	128.2	80.1	106.1	90.1	102.0	2.8
Non-metallic mineral products	102.8	97.7	106.6	119.3	107.8	103.3	103.1	123.4	85.0	5.4
Other	97.6	80.6	91.7	101.1	89.3	77.5	94.7	98.1	66.8	34.9

Source: SBS.

¹⁰ Leaders are sections exerting the greatest influence on industrial production growth in 2006.

Production of basic metals slowed down its exceptionally high long-term growth trend...

Production of basic metals grew by 15.1% in Q1 (Table T5-5). This sub-sector is mainly export-oriented, and its high growth can be ascribed mostly to the January level of industrial production of basic metals, up 41.6% on to the same period the year before. Year-on-year growth indices were significantly lower in February and March (about 6%). Taking into account that production of basic metals was halted in January 2006 due to the natural gas supply crisis, the high y-o-y growth recorded in January 2007 comes as no surprise. Production of basic metals was 2.5 times higher in Q1 2007 than in Q1 2002 (Table T5-5), while average quarterly y-o-y growth in this period was about 20%. The growth slowdown in February and March could mean the privatized companies are operating at almost full capacity, and that the several-year-long extraordinary growth trend in the production of basic metals could be drawing to an end (hopefully only temporarily), all the more so since the future of the Bor copper mining and smelting complex is still uncertain.

...but the food industry picked up...

The food industry recorded a growth that was 12.2% up on the same period a year ago – its highest y-o-y growth in the past several years. Because of its heterogeneity and large share in manufacturing, this section is considered with special attention. Production of food and beverages, despite its significant share in Serbia's total exports, remains oriented mainly towards the domestic market. All things considered, increased domestic spending was the main cause of the high Q1 growth, but the major export growth – 21.4% in Q1 in relation to Q1 2006 – is good news for the food industry.

...and the production of furniture maintained very high growth rate

Production of furniture and related products continued its extraordinary y-o-y growth – 69.5% in Q1. The growth of this section was dealt with in more detail in previous issues of *QM*. It should be noted, however, that it is the result of the recovery of production facilities taken over by private entrepreneurs in the 1990s. This production is no longer recorded by the SBS.¹¹

Production of chemicals and chemical products was in Q1 up 5.5% in relation to the same period a year ago, continuing the slowdown that started as early as Q4 2006 (Table T5-5). It remains to be seen, in Q2, whether the slowdown is of a more permanent nature.

Production of tobacco products went down 9.9% in Q1 relative to the same period a year ago. It is still too early to speak of any long-term decline, all the more so since the tobacco industry's growth index is greatly influenced by two major producers. These companies' policies (such as stockpiling products or nearly halting production during modernization projects) have in the past resulted in wide oscillations of the total production index for tobacco products.

In line with construction, production of non-metallic minerals grew strongly

Products made of non-metallic minerals saw a record y-o-y growth of 23.4% in Q1. Cement production had the greatest impact on this sector's growth, rising by 93.4% in relation to the same period a year ago. Intensified construction activity was the motor of the Q1 growth in this area of manufacturing. Cement production is mainly oriented towards the domestic market.

The production of industrial products by use is shown in Table T5-6.

Viewed by use, consumer goods recorded highest growth

When viewed by use, consumer goods recorded the highest growth rate in Q1 – 22.4%. This was mainly due to the production of furniture and related products, as well as the food industry. The high growth in the production of consumer goods was mainly in response to the rising demand on the domestic market, where most products are sold (notwithstanding the robust export growth of 24.9%).

Intermediary goods also recorded a high y-o-y growth of 13.1%. A good piece of news was that, contrary to the usual situation, the rise in the production of intermediary goods was not a direct consequence only of the growth of the production of basic metals (Table T5-6). The accelerating growth of the rest of intermediary goods production is especially significant when a possible slowdown of basic metals production is taken into account. Production of investment goods remained stable at Q1 2006 levels, which is a positive result bearing in mind the long-term trends in the production of this group of products (Graph T5-7). It is to be hoped that the steady decline of production of this group of products over the last several years, is at an end, all the more so since an acceleration in the growth of exports of capital goods was noticeable in Q1.

¹¹ See "Economic Growth" in QM6.

Table T5-6. Serbia: Components of Industrial Production, 2005–2007

			y-o-y indices				base index		share ⁵⁾
	2005	2006	2006				2007	(jan-mar) ₀₇ / (jan-mar) ₀₂	
			Q1	Q2	Q3	Q4			
Total	100.6	104.7	105.3	106.1	103.9	102.9	104.8	110.0	100.0
Energy ¹⁾	103.9	102.5	100.7	104.8	99.9	102.7	93.0	101.8	23.6
Investment goods ²⁾	74.2	90.0	107.2	87.9	78.4	90.3	97.1	71.3	7.5
Intermediate goods ³⁾	104.9	106.7	109.4	109.1	106.5	102.3	113.6	130.7	32.2
Intermediate goods without basic metals	101.5	101.3	107.9	104.5	96.7	99.8	113.1	100.1	24.0
Consumer goods ⁴⁾	101.6	112.0	107.5	110.0	116.2	110.2	122.4	123.0	36.7
Consumer goods without food industry	96.3	128.3	113.4	118.6	132.5	128.9	138.7	127.0	14.1

Source: SBS.

1) Extraction of coal, crude oil, natural gas, electricity and water supply.

2) Manufacture of metal products excluding machines (sections 281, 282 and 283, *Classification of Activities*); manufacture of machines and equipment (excluding electrical); manufacture of office machinery and computers, radio, TV and communications equipment, precision and optical instruments; manufacture of motor vehicles and trailers, manufacture of other transport equipment.

3) Mining of metal and non-metallic ores, stone quarrying; manufacture of textile yarns and fabrics, wood and cork products (except furniture), cellulose, paper and paper products, rubber and plastic products, chemical products (except pharmaceuticals and home chemicals products), petrochemicals, construction materials, basic metals, sub-sector of metal goods production except machines (sectors 284, 285, 286 and 287), electric machines and appliances, and recycling sub-sector.

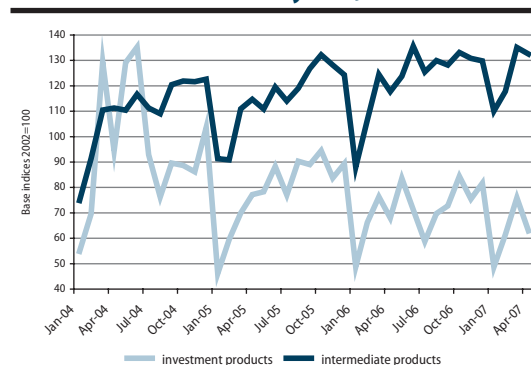
4) Food industry products, tobacco products, clothing, leather products and footwear, publishing products, pharmaceutical products and home chemicals, furniture and various other products.

5) Share in total industrial production.

Energy production dropped, mainly due to warm winter

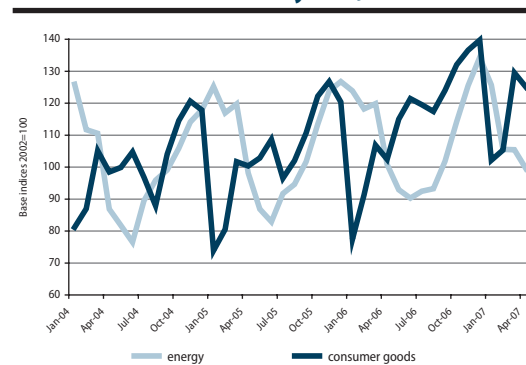
Because of the warm winter, less energy was consumed in Q1, which had a direct impact on the production of this group of products. Graphs T5-7 and T5-8 show movements in industrial production by use for investment and intermediary goods (Graph T5-7), and energy and consumer goods (Graph T5-8).

Graph T5-7. Serbia: Industrial Production by Use, 2004–2007



Source: SBS.

Graph T5-8. Serbia: Industrial Production by Use, 2004–2007



Source: SBS.

Construction

Construction recorded a very high growth rate in Q1...

Construction recorded a high y-o-y growth in Q1, an estimated 35%.¹² The main reason for this unusually high figure was the favorable weather, which made possible an extraordinary increase in the number of working days; that said, the underlying trend is, judging by all factors, also high. Due to construction's pronounced seasonal character, Q1 showed much lower levels of

12 Because of high changes in cement production, we have for this issue of QM adopted a more conservative estimate of construction growth. The estimate is based on data on the value of construction work in Q1 published by the SBS, to which additional deflator conversion was applied. Although we consider cement production data more reliable, these indices have undergone sudden and large-scale changes, which makes us unsure of how cement production will impact the growth of construction activity – all the more so since there is a time shift between cement production and consumption.

5. Economic Activity

construction activity than Q2 or Q3 2006. Sharp y-o-y changes to quarterly growth in Q1 are not unusual, but have a much slighter effect on total annual construction growth (Table T5-9). An estimate of the underlying trend will be made after Q2, when changeable seasonal factors have a smaller impact on construction.

...mostly due to favorable weather...

Among the several indicators describing movements in construction, QM believes cement production to be the most reliable (Table T5-9).¹³ Cement production in Q1 2007 was up 93.8% on the same period a year ago.

...but the underlying trend is very strong as well

Other construction indicators published by the SBS include: the value of construction works in Q1 was nominally up by 61.6% (or 50.2% at constant prices) in relation to the same period last year; before; the number of workers on construction sites rose by 7.5%; while the y-o-y rise in work hours amounted to 14.8%.¹⁴

Table T5-9. Serbia: Cement Production, 2001–2007

	y-o-y indices				
	I quarter	II quarter	III quarter	IV quarter	total
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	-	-	-	-

Source: SBS.

¹³ Cement consumption would be a more appropriate indicator, but this is not available at the quarterly level. Research has shown that cement production approximates consumption relatively reliably.

¹⁴ The imbalance between the published indicators points to a high increase in productivity but also, in our view, reflects the low reliability of available data.

6. Balance of Payments and Foreign Trade

In Q1 2007, the current account deficit in the balance of payments recorded further deterioration –reaching a very high level of 17.6% of GDP. That deterioration of the external position, which started in Q4 2006, was predominantly a consequence of the acceleration of imports that caused a widening of the trade deficit despite the good export performance. The poor performance of current transfers further aggravated the current account deficit. On the other hand, the capital and financial balance fell relative to the same quarter of the previous year, mainly due to a significant reduction of the banking sector's foreign liabilities. A rise in the current account deficit and a mild decline in the capital account of the balance of payments resulted in the lowering of NBS foreign reserves (by €202 mn). The NBS own net international reserves – NBS gross international reserves less banks' foreign currency reserve requirement and foreign currency government deposits – amounted to €4,021 mn euros, enough for only four months' worth of imports.

A record-high current account deficit (17.6% of GDP)

The current account balance deteriorated already in Q4 2006, with the trend accelerating in Q1. The current account of the balance of payments in Q1 ran a record-high deficit (€1,141 mn euros, or 17.6% of estimated quarterly GDP). The reasons for the further widening of the deficit lie in the high trade deficit (–€1,412 mn), as well as in the low level of current transfers (€318 mn). Despite a strong y-o-y export growth, (34.9%), due to the acceleration of import growth of 31.5% – the trade deficit deteriorated (28.2%). The balance of current transfers declined due to a low inflow into non-residents' foreign currency accounts (a fall of –39.0%), as well as to a decline in inflows of foreign exchange from exchange operations (–39.0%).

Exports and imports in Q1 grew at y-o-y rates of 34.9% and 31.5% respectively causing the trade deficit to rise by 28.2%

According to NBS methodology, the trade balance in Q1 2007 deteriorated by 28.2% relative to the previous year, despite a y-o-y export growth of 34.9% and import growth of 31.5% in the quarter. Over the period, goods worth €1,401 mn were exported, while imports were worth €2,813 mn. Import acceleration, (y-o-y growth went from 14.1% in Q3 2006 to 18.5% in Q4 2006, and to 35.5% in Q1 2007) was the consequence of strong imports of intermediary goods (raw materials and manufacturing components) and capital goods (equipment), as well as of stronger private demand. If the trade deficit is to narrow, exports should grow approximately twice as fast as imports, and that – due to the low coverage of imports by exports of 49.8% in Q1 – was hardly the case

Imports accelerated in Q1, primarily due to the growth in imports of intermediary and capital goods

What are the causes underlying these developments in the trade balance? Privatization, the strengthening of the private sector, substantial investment and penetration of external markets, as well as foreign demand – resulted in export growth, despite the negative impact of the appreciation of the dinar against the euro. On the other hand, import growth was driven primarily by increasing imports of intermediary and capital goods (with shares in Q1 growth of 38.2% and 34.1%, respectively, in total 72.3%). These imports are necessary for the further development of domestic production. Moreover, the strengthening of domestic demand, mostly due to the development of the financial sector and a further increase in consumption financing, coupled with the dinar appreciation, resulted in strong import growth of durable and non-durable consumer goods.

Service revenue and expenditure both continued to grow steadily in Q1 2007 (43.3% and 31.3% respectively), resulting in almost identical amounts of imported and exported services (a balance of €–4 mn), as was the case in the previous quarters.

Net factor transfers (interest) in Q1 amounted to €–84 mn, which was by 43.9% higher relative to the same quarter of the previous year. A rise in NBS foreign reserves, which the National Bank invests, in line with the IMF recommendations,¹ in foreign first class low-risk securities – led to an increase in interest earnings (22.4%). On the other hand, the y-o-y growth of the stock of foreign private debt caused an increase in interest payments (36.2%). Foreign interest payments² in Q4 amounted to €124 mn.

¹ *Guidelines for Foreign Exchange Reserve Management*, IMF 2001, <http://www.imf.org/external/np/mae/ferm/eng/index.htm>.

² Excluding early interest payment on World Bank loans.

Table T6-1. Serbia: Balance of Payments, 2004–2007¹⁾

	2004	2005	2006	2005				2006				2007
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
flows, cumulative from the beginning of the year, in millions of euros												
CURRENT ACCOUNT	-2197	-1805	-2892	-324	-291	-519	-671	-680	-475	-625	-1111	-1141
Balance of goods	-5311	-4279	-4950	-683	-1089	-1215	-1292	-1101	-1256	-1167	-1426	-1412
Exports of goods	2991	4006	5146	813	1011	1019	1163	1039	1243	1380	1484	1401
Growth rate (12-m, in %)	14.7	33.9	28.5	54.4	52.6	23.4	19.0	27.8	22.9	35.5	27.6	34.9
Imports of goods	-8302	-8285	-10096	-1496	-2100	-2234	-2455	-2140	-2498	-2548	-2910	-2813
Growth rate (12-m, in %)	29.4	-0.2	21.9	-13.4	6.6	15.2	-7.9	43.0	19.0	14.1	18.5	31.5
Balance of services	155	-5	-49	-25	42	0	-22	-31	4	16	-37	-4
Income, net	-172	-260	-314	-59	-83	-56	-62	-58	-97	-81	-79	-84
Current transfers	2728	2471	2240	410	790	686	586	474	828	566	373	318
F/X purchases, net	1592	1631	1447	320	563	445	303	289	593	284	281	196
Non-resident's accounts	568	460	561	37	70	151	202	183	94	218	67	111
Grants	403	268	181	33	49	66	120	36	45	42	58	41
ERRORS AND OMISSIONS	168	-384	-35	-184	109	-130	-179	-31	-32	-83	-75	-87
CAPITAL AND FINANCIAL ACCOUNT	2377	3863	7166	710	463	1103	1587	1100	1587	2247	2232	1026
Foreign direct investment (FDI)	773	1248	4077	262	240	495	250	164	574	1671	1668	617
Foreign borrowing and other inflows	1604	2615	3089	448	223	608	1337	936	1013	577	564	409
Medium and long-term loans, net	1221	1820	3140	157	444	387	819	443	1242	771	684	494
Extraordinary debt and interest repayment ²⁾	-1060	0	0	0	0	0	-189	-188	-683	-177
Other ^{3,4)}	383	795	1009	291	-221	220	518	493	-40	-6	563	93
NBS Reserves, net⁵⁾, (increase +)	-349	-1675	-4240	-202	-281	-454	-738	-390	-1079	-1539	-1232	202
MEMORANDUM ITEMS												
NBS reserves excl. com. banks deposits	-299	-679	-1666	-51	-219	-185	-225	-92	-340	-181	-1052	288
in % of GDP												
External debt	53.2	61.8	59.8	...	...	...	...	...	...	...	...	...
Public debt	36.5	36.5	25.8	...	...	...	...	...	...	...	...	...
Private debt	16.7	25.3	34.0	...	...	...	...	...	...	...	...	...
Net external debt ⁵⁾	15.8	23.5	36.4	...	...	...	...	...	...	...	...	...
Exports of goods	15.2	19.0	20.7	17.8	19.7	18.5	19.8	20.1	21.0	21.0	20.6	21.6
Imports of goods	-42.1	-39.3	-40.6	-32.7	-41.0	-40.5	-41.7	-41.3	-42.2	-38.7	-40.4	-43.3
Balance of goods	-26.9	-20.3	-19.9	-14.9	-21.2	-22.0	-21.9	-21.3	-21.2	-17.7	-19.8	-21.8
Balance of services	-11.1	-8.6	-11.6	-7.1	-5.7	-9.4	-11.4	-13.1	-8.0	-9.5	-15.4	-17.6
GDP in euros ⁶⁾	19,723	21,108	24,886	4,578	5,125	5,517	5,888	5,181	5,914	6,580	7,211	6,492

Source: Table P-7 in Analytical Appendix.

1) Original US dollars monthly data are converted to euros using monthly averages of official daily NBS mid rates.

2) Includes extraordinary repayment of principal and interests on WB and IMF loans

3) Includes short term trade credits, unpaid imports of oil and gas, short-term loans, other assets and liabilities and gross reserves of commercial banks.

4) Excluding IMF tranches.

5) External debt minus NBS Fx deposits

6) For the stated period. GDP 2006 and Q1 2007: FREN's estimate.

A y-o-y decline in current transfers of 32.9%...

... contributed to the widening of the current account deficit

A drop in inflows from exchange offices (-32.3%)

The capital account was slightly lower than in Q1 2006

Medium-term and long-term borrowing went up at y-o-y level...

... primarily due to the strong growth of direct borrowing by enterprises

The balance of current transfers was by 32.9% lower than in Q1 2006, considerably contributing to the deterioration of the current account deficit, as in the last quarter of the previous year. Remittances from abroad remained at an almost identical level as in Q1 2006. Inflows from remittances (Table P-6, Analytical Appendix) were higher by 3.2%, and outflows by 2.3% relative to the previous year. Inflows into non-residents' foreign currency accounts dropped by 39.0% at a y-o-y level, also contributing to the fall in the current transfer balance. After a decline in foreign exchange purchases in Q3³⁾ (-36.4%) and Q4 (-7.1%), in Q1 too the purchases of foreign exchange remained below last year's value (-32.3), which probably indicates a permanent change in the movement of these inflows, since they had been constantly growing before the strong appreciation of the dinar in the summer of 2006.

In Q1, the capital and financial account recorded a y-o-y decline (-6.8%), due to lower medium-term and long-term bank borrowing, as well a significant reduction in short-term loans and deposits (€-223 mn). Foreign direct investment was substantially higher (274%) and amounted to €617 mn, of which portfolio investments accounted for €270 mn. Medium-term and long-term foreign borrowing in Q1 (€494 mn, Table P-6, Analytical Appendix) slightly accelerated at a y-o-y level (a rise of 11.4%). The structure of this borrowing, however, was essentially different from that in Q1 2006. Namely, as in the previous two quarters, direct foreign borrowing by enterprises accounted for the largest share of net medium-term and short-term borrowing (€438 mn), while the banking sector's borrowing became almost marginal (€37 mn). It seems that foreign-owned domestic banks have found a way to circumvent the high reserve requirement on foreign borrowing, and now extend loans to their corporate clients directly from abroad, with local logistics. The decline in borrowing was also caused by the September decision of the NBS,

³ For more details on underlying causes of the decline in inflows from exchange operations see FREN (2006) "Balance of Payments and Foreign Trade" Quarterly Monitor 6.

which set a cap on loans and advances to households in the amount of 200% of the bank's capital, thus forcing banks to use recapitalization instead of borrowing as a primary source of loans and advances to households. In view of these two phenomena, it is easy to understand the drop in the banking sector's borrowing. This is also corroborated by the strong reduction in short-term foreign liabilities, although in December the reserve requirement ratio on short-term foreign borrowing by banks was brought to the level of the reserve requirement ratio on long-term borrowing (45%). Net short-term borrowing amounted to €-223 mn (reduction in liabilities) and almost completely referred to a reduction in banks' indebtedness. Other capital inflows had y-o-y growth of 51.1%, with the greatest contribution to the increase being made by newly deposited foreign currency savings (up by €345 mn in Q1, y-o-y growth of 77.4%). In March 2007, the NBS settled its liabilities to the IMF, with the early repayment of €177 mn.

Capital account was insufficient to cover the rising current account deficit

Due to the serious deterioration of the current account, in Q1, for the first time since Q2 2004, NBS gross foreign reserves declined (by €202 mn). The level of gross foreign reserves (€8819 mn) covers nine months of imports. However, since banks' statutory reserve on foreign exchange liabilities accounts for a larger portion of gross reserves, the NBS own net foreign reserves (€4021 mn) cover just four months of imports. This should alert foreign trade policymakers to the importance of planning strategies aimed at preventing any further deterioration of the current account balance.

Exports⁴

Exports in Q1 accelerated strongly (y-o-y growth of 34.5%)

After a slight deceleration in Q4 2006, exports in Q1 2007 returned to the high growth levels of Q3. This strong export performance was a consequence of growth in a broad range of product groups. Apart from the already customary strong export growth of ferrous metals, driven by higher demand on the global market and the opening of new capacities last year, various groups of export goods recorded strong growth (e.g., vegetables and fruit, cereals and cereal products, clothing, electrical machinery etc.). But the behavior of different export sections is not uniform, so some sections, which had grown strongly in 2006, underperformed in Q1 2007, such as non-ferrous metals, plastics in primary forms and sugar and sugar preparations.

The y-o-y growth of exports in Q1 was 34.5%. However, part of this strong growth was related to the shift of December exports to January. Namely, as noted in the previous issue of *Quarterly Monitor*, and as the January export data confirmed, December saw a temporary slowdown in export growth (a rise of 15.7%), which was compensated by a steep y-o-y growth in January (a rise of 46.9%). Growth rates of exports in February and March were 32.6% and 27.7% respectively. Therefore, the actual export performance in Q1, in view of the shift of the December exports, was lower than the observed growth. We can use the y-o-y export growth for the four-month period December–March (29.0%), or the y-o-y growth for the period February–March (29.8%) as a proxy for underlying export growth. These two estimates are lower than the estimated quarterly export growth, and they provide a more reliable assessment of the actual export trends, as well as a basis for a more credible forecast of further developments in domestic exports.

For the sake of greater clarity of the export trend analysis, exports are classified into three major groups, as is usually done in the *Quarterly Monitor: Bulky Exports, Core Group* and *Other Exports*. In this issue, however, we reclassified the SITC export sections (at the two-digit level) that we include in each group. Thus, we included in the group *Bulky Exports* (Graph T6-2) those goods whose exports depend on aleatory factors (such as prices on global exchanges (metals) or the weather (cereals and fruit and vegetables), which in 2006 accounted for more than 4% of total imports, and whose growth was strong. Total exports reduced by *Bulky Exports* are defined as *Underlying Exports*, which consists of two categories, the *Core Group* and *Other Exports*. The *Core Group* includes groups of products whose respective shares in 2006 total exports were higher than 2%, with annual growth rates exceeding 15%. Other groups of export goods according to the

⁴ As of September, the SBS publishes data which includes trade with Montenegro. *Quarterly Monitor* used in this analysis the data for the period Q3 2005 – Q1 2007, which includes trade with Montenegro.

6. Balance of Payments and Foreign Trade

SITC classification are included in the group *Other*. These goods, which in 2006 accounted for 35.4% of total exports, grew strongly in Q1 2007 (36.8%). But, owing to their small individual shares, they remain in the residual group.

Bulky Exports, (32.8% of total exports in 2006) – though growing strongly in Q1 2007 (by 36.1%) these exports recorded a deceleration of their y-o-y growth relative to Q4 2006 (y-o-y growth of 45.9%), due to the poor export performance of non-ferrous metals, which in Q1 grew by only 11.8% (Table T6-2). Iron and steel, as in the previous period, remained the leader of domestic exports, with these products having a y-o-y export growth of as much as 61.5% in Q1, a share in total imports of 15.3% and contributing to the total import growth with 22.7%. Exports of cereals and cereal products, and of vegetables and fruit, together accounting for 9.6% of total exports, in Q1 grew at rates of 30.3% and 26.6% respectively. Four sections of SITC goods included in *Bulky Exports* contributed one-third of the growth of domestic exports in Q1.

Table T6-2. Serbia: Merchandise Exports Growth, 2005–2007

	Exports share in 2006 (%)	mil.euros		y-o-y growth (%)					
		2007	2005		2006				
		Q1	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Total	100.0	1389.9	28.5	25.6	38.0	36.7	35.3	28.7	34.5
Bulky exports	32.8	454.8	21.9	27.6	32.7	13.1	55.0	45.9	36.1
Iron and steel	13.6	212.7	-13.6	5.4	2.2	24.7	92.5	43.4	61.5
Non ferrous metals	9.6	119.9	76.1	67.7	79.9	53.5	58.8	73.3	11.8
Fruits and vegetables	5.1	57.3	19.2	8.5	88.0	31.9	20.5	26.9	30.3
Cereal and cereal products	4.5	65.0	130.5	77.1	88.0	31.9	21.2	29.6	26.6
Underlying exports	67.2	935.1	31.6	24.8	23.2	26.2	26.8	21.4	33.8
Core	31.9	443.4	38.2	40.4	29.6	24.0	26.8	26.0	30.6
Clothes	5.0	76.1	69.9	55.8	8.6	1.4	19.1	28.0	29.8
Miscellaneous manufactured articles, n.e.s.	4.4	50.9	40.5	32.9	34.8	21.8	7.2	4.5	6.0
Manufactures of metals, n.e.s.	4.2	59.9	37.1	36.6	24.1	14.7	68.8	50.8	76.7
Rubber products	3.8	54.7	36.2	17.8	24.1	14.7	10.0	17.7	16.2
Electrical machinery, apparatus and appliances	2.8	41.7	49.6	81.9	19.7	9.5	70.5	56.1	77.6
Organic chemicals	2.6	43.4	20.0	29.8	61.4	69.6	16.9	36.0	42.8
Plastics in primary forms	2.6	29.5	-4.8	14.6	30.2	11.7	35.7	3.8	-7.4
Footwear	2.5	35.1	55.0	60.0	45.2	19.4	21.6	22.2	34.9
Paper, paperboard and articles of paper pulp	2.1	26.8	36.2	61.9	20.2	72.1	18.0	22.1	12.3
Non-metal mineral produce	2.0	25.3	40.2	70.0	32.5	33.8	34.2	26.0	55.3
Other	35.4	491.7	25.8	14.0	13.4	29.4	26.8	17.5	36.8

Source: SBS.

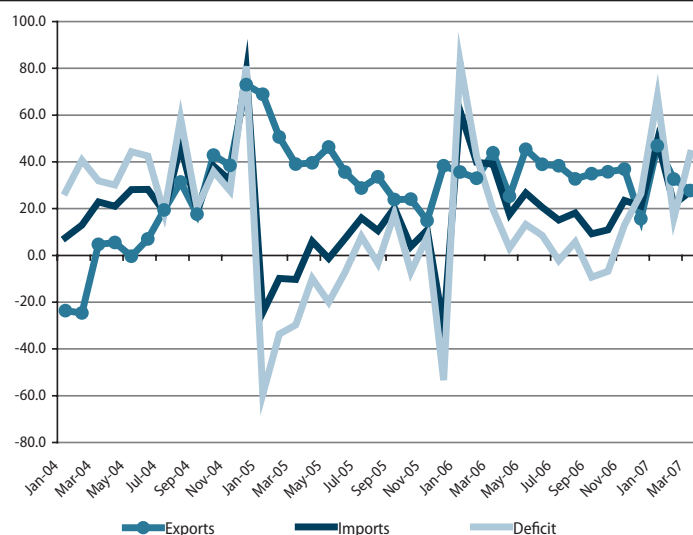
Underlying Exports, after decelerating in Q4 2006, grew rapidly in Q1 (33.8%)

Underlying Exports – exports excluding *Bulky Exports* – grew at a rate of 33.8%, which was an acceleration in comparison with Q4 2006, and was probably associated with the shift of December exports to January. Specifically, at the monthly level, *Underlying Exports* decelerated considerably in December (y-o-y growth of a mere 11.2%), only to strongly accelerate in January (a rise of 52.3%). It is still unclear what caused this delay in exports. The exceptional export results in Q1 should therefore be taken with some reservation, i.e. account should be taken of the fact that the presented export growth in Q4 2006 was actually underestimated, while in Q1 2007 it was overestimated. This is also confirmed by the monthly movements of exports; after an extraordinary leap in the growth rate in January, the growth rates of *Underlying Exports* in February declined (29.1%) – and in March they returned to the level of their medium-term growth trend (26.3%).

For the sake of more precise analysis, *Underlying Exports* are divided into the *Core Group* and *Other Exports*. The *Core Group*, which includes those groups of export goods which substantially contributed to the import growth in the previous year, in Q1 grew at a rate of 30.6%, somewhat slower than other groups, mainly due to the poor performance of exports of plastics in primary forms (a y-o-y decline of -7.4%), miscellaneous manufactured articles n.e.s. (6.0%), and paper, cardboard and cellulose products (12.3%). Exports of electrical machinery, apparatus and appliances (77.6%), metal manufactures, n.e.s. (76.7%) and non-metallic mineral products (55.3%)

strongly increased in this period, thus substantially contributing to the good performance of the *Core Group*. Exports of clothing and footwear grew steadily, at rates of 34.9% and 29.8% respectively.

Graph T6-3. Serbia: Merchandise Exports, Imports and Trade Deficit, Y-o-y Growth Rates 2004–2007



Source: SBS.

category was recorded by the following groups: mineral ores and scrap iron and steel, (the share in total exports in Q1 of 2.9%, y-o-y growth of 223.1%), power-generation machinery and equipment (a share of 2.5%, up 118%), as well as general industrial machinery and equipment (a share of 2.2%, up 73.2%)

Overall, the exports in Q1 2007 can be qualified as satisfactory. Exports have been growing for four years now at annual rates of over 25%, albeit from a low base. Underlying the continuous and strong growth of domestic exports are: privatization, growth of the private sector, development of financial intermediation, investment and opening of new markets. The dinar appreciation, which, in theory, could have caused a stagnation of exports – has so far not been a major impediment.

Imports

Imports accelerated... mainly due to the rise in imports of intermediary and capital goods... as a consequence of the dinar appreciation and rising domestic demand

In Q1 2007 imports of goods accelerated strongly, at a y-o-y rate of 31.0%, compared to 18.5% in Q4 2006. Imports excluding energy grew as much as 36.2%. If the disaggregated imports classified according to the economic destination of EU are observed – it is clear the growth was driven primarily by the rise in imports of intermediary (34.1%) and capital goods (51.1%). Since these categories of goods have high shares in total imports (35.2% and 23.9% respectively), their growth had a strong impact on the total import growth (contribution to the growth in Q1 of 38.2% and 34.1% respectively). Likewise, groups of products whose imports are driven by private demand (durable and non-durable consumer goods) strongly grew in Q1 (29.1% and 23.3% respectively), spurred by the dinar's appreciation and stronger domestic demand for imported goods.

Energy imports in Q1 2007 were 14.2% higher than in the same period last year. The slight increase can probably be ascribed to favorable weather conditions in Q1, as well as with high energy imports in Q4 2006. Imports of oil and petroleum products (€304 mn), as well as natural gas imports (€194 mn) are the first and the third category respectively in terms of value of total imports classified according to the SITC categories. It should be noted that coke and coal worth €53 mn, as well as €40 mn worth of electricity, were imported in Q1.

Imports of intermediary goods (growth of 34.1%) are directly linked to the demand of the domestic economy for semi-manufactures and raw materials. The correlation with the rise in

The group *Other*, which comprises groups of export goods with low shares in total exports in 2006, had a strong growth (36.8%), even stronger than the growth of *Bulky Exports* and the *Core Group*. This is good news, indicating the revival of export sectors whose performance so far has been poorer, as well as diversification, which reduces the risk of external sectoral shocks for domestic exports, such as a fall in the prices of raw materials on global markets. An especially strong performance in this

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domestic GVA is obvious: imports of intermediary goods accelerated precisely in the quarter in which GDP, according to FREN's estimate, reached a y-o-y growth of more than 8.8%. It is noteworthy that the most important intermediary goods Serbia imports are in the same categories in which it exports the most: iron and steel (€131 mn) and non-ferrous metals (€111 mn).

Imports of capital goods (y-o-y growth of 51.1%) are related to the vigorous revival of the investment cycle in the Serbian economy. In addition to the growth in imports of vehicles (31.1%), general industrial machinery and equipment and electrical machinery, apparatus and appliances (growth of 56.1% and 34.1% respectively), imports of telecommunications apparatus and equipment (a rise of 159.2%), mainly due to the modernization of the recently privatized Telenor mobile telephony network made a specially strong contribution to the growth of capital goods imports. In Q1, vehicles worth €199 mn and telecommunications apparatus and equipment worth €107 mn were imported. Imports of passenger cars, which accounted for 15.3% of capital goods imports, grew in Q1 at a rate of 18.5% and amounted to €105.9 mn. Imports of capital goods excluding passenger cars grew at a very high rate of 59.0%.

Imports of durable and non-durable consumer goods grew at rates of 29.1% and 23.3% respectively. This was a result of stronger domestic demand due to the real wage growth, another retail lending boom, and the benefits of the dinar's appreciation.

Table T6-4. Serbia: Imports, Y-o-y Growth, 2004–2007

	Imports share (%)	in mil.euros		y-o-y growth (in %)				2007 Q1
		2007		2006				
		Q1		Q1	Q2	Q3	Q4	
Total	100.0	2,901		44.4	21.7	13.9	18.5	31.0
Energy	20.5	594		42.3	43.1	3.6	24.1	14.2
Intermediate products	35.2	1,021		42.5	14.0	22.5	21.1	34.6
Capital products	23.9	693		54.1	21.4	15.4	13.7	51.1
Durable consumer goods	3.5	101		45.2	16.2	1.7	6.0	29.1
Non-durable consumer goods	13.9	403		45.9	22.1	11.2	19.3	23.3
Other	3.1	90		20.0	6.8	-2.9	7.0	24.3
Imports excluding energy	79.5	2,307		45.0	17.3	16.6	17.3	36.2

Source: SBS.

Policymakers should be concerned over the fast pace of growth of imports. How can their further acceleration be slowed down? A point that must be borne in mind is that, although exports are growing strongly, due to the low coverage of imports with exports, the trade deficit cannot be reduced as long as import growth remains this high. Therefore, it is reasonable to ask whether import growth is just a consequence of investment and production demand that will result in a rise in production and exports in the medium term. Furthermore, how will possible future movements in the exchange rate of the dinar affect the pace of both exports and imports? It is necessary to immediately start working, with a clear idea and plan, on a design of solutions and policies aimed at preventing a further deterioration of Serbia's endemically bad situation with respect to foreign trade.

7. Fiscal Flows and Policy

Fiscal developments in Q1 2007 were better than expected. After favorable developments in March, the fiscal deficit, defined from the standpoint of its effect on aggregate demand, was reduced to a minimum. These developments were the result of faster-than-expected revenue growth on the one hand, and slower expenditure growth due to temporary financing, on the other. Additional research is required to reliably establish why public revenue grew so rapidly, but, on the basis of the data available so far, the most probable cause was the sharp rise in domestic demand, considerably higher than GDP growth. The surge in demand in Q1 was a consequence of the lagged effect of higher fiscal spending toward the end of 2006, as well as of the growth of wages late last and early this year. The rise in domestic demand, in view of the domination of indirect taxes – the VAT, excises, customs duties – generated the increase in total public revenue, despite a cut in the payroll tax.

General Trends

Rapid revenue growth, moderate expenditure growth, a low deficit

In Q1 2007, consolidated public revenue was higher in real terms by 15.9% relative to the same quarter of the previous year (Table T7-2). Consolidated public expenditure grew slower than revenue, at a rate which more or less tallies with the estimated real GDP growth. The fiscal deficit that corresponds to FREN's analytical definition amounted to 2.5 bn dinars, which was lower than in the same period last year in both nominal and real terms (Table T7-1). An annualized level of the fiscal deficit in Q1 amounted to less than 0.5% of Serbia's estimated GDP for 2007.

Revenue was driven by rising domestic demand and wage growth

The relatively slow growth of *public expenditure* in Q1 can be directly linked to the regimen of temporary financing, as well as the reduced activity of the outgoing government. The reasons for the rapid growth of *public revenue* are not that straightforward. Real public revenue growth in Q1 was considerably higher than estimated GDP growth, although some tax rates were cut in the meantime. Similarly, it is not very likely that the collection of public revenue was much improved under the caretaker government, that is, the coordinator of the Ministry of Finance. Therefore, the probable cause for the high real public revenue growth, as mentioned before, is in rising aggregate demand, whose growth was faster than GDP growth. The reasons for the faster growth of aggregate demand were the fiscal expansion and wage growth in Q4 2006, as well as domestic and foreign credit growth in Q1 of this year.

Government built up deposits in Q1 by as much as 37 bn dinars ...

Monetary accounts show that net government deposits with the banking sector rose in Q1 2007 by about 37 bn dinars (Table T7-3). The bulk of the increase refers to the deposits of the Republic of Serbia, whose net increase amounted to as much as 28 bn dinars. The net increase in local government deposits amounted to almost 8 bn dinars, and was mainly due to the seasonality of local expenditure.

... primarily due to the inflow of proceeds from the third mobile telephony license

In normal circumstances, a strong increase in net government deposits with the banking sector would mean that the government collected much more from taxes and other dues than it spent on executed public expenditure, which would be an indicator of a restrictive fiscal policy. In the specific circumstances, however, the increase in government deposits with banks was not an indicator of restrictive fiscal policy, or was so only to a minor degree.¹ Namely, the increase in net government deposits with banks was, for the most part, a consequence of the inflow of proceeds from the license for the third mobile telephony operator and other privatization proceeds, rather than of the accumulation of collected taxes and other dues.

¹ An exact assessment of the restrictiveness of fiscal policy would require analytical data providing a breakdown between regular public revenue and expenditure and revenue and receipts and expenses related to privatization, credit relations, etc. Since analytical data is not publicly available, it has been deemed that the fiscal policy restrictiveness or expansiveness can be more adequately assessed on the basis of FREN's *analytical deficit* than on the basis of the change in *general government net position*.

Table T7-1. Serbia: Consolidated General Government Fiscal Operations¹⁾, 2005–2007

	2005		2006				2007	
	Q4	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4	Q1
	in billions of dinars							
I TOTAL REVENUE	210.2	701.6	175.4	201.6	207.5	240.6	825.0	215.2
II TOTAL EXPENDITURE	-195.1	-667.8	-174.9	-185.3	-197.6	-255.4	-813.2	-203.1
III "OLD" DEBT REPAYMENT AND NET LENDING	-7.8	-36.63	-4.4	-17.1	-10.1	-17.5	-49.1	-14.6
<i>o/w III.3 Net lending²⁾</i>	-1.5	-4.9	-1.8	-0.8	-1.3	-3.2	-7.1	-0.6
IVa CASH BALANCE (I+II), MoF definition ³⁾	15.2	33.8	0.4	16.3	9.9	-14.8	11.8	12.2
IVc ANALYTICAL BALANCE (I+II+III), FREN's definition ³⁾	7.3	-2.9	-3.9	-0.8	-0.2	-32.3	-37.3	-2.5
V FINANCING (FREN's definition)	6.9	27.7	8.5	1.4	103.2	8.7	121.7	24.7
VI ACCOUNT BALANCE CHANGE (IVc+V)	14.2	24.8	4.5	0.5	103.0	-23.7	84.4	22.2
MEMORANDUM ITEMS								
Government net position in banking system, change (NBS)	10.3	36.0	10.6	6.7	90.1	-31.9	75.5	36.7
Enterprises' claims on VAT (FREN's estimate) ⁴⁾	7.5	17.1	-1.6	2.1	0.0	0.0	0.5	..
License fee ⁵⁾	27.0	..	27.0	25.5

Source: Table P-8 in the Analytical Appendix.

1) Includes all levels of government (central, provincial and municipal) and their budget beneficiaries and social security organizations (Serbian Pension and Disability Insurance Funds, Health Insurance Fund, National Employment Service), but not public enterprises and the NBS.

2) The item corresponds to the item "Net acquisition of financial assets for policy purposes" in the PFB, i.e. to the item "net lending" in the IMF presentation. It comprises loans to students, financing of the National Corporation for Housing Loan Insurance and the like.

3) IVa Consolidated balance (a cash surplus/deficit under GFS 2001) is the difference between current revenue and receipts from the sale of non-financial assets (that is, capital revenue) and current expenditure and expenses for acquisition of non-financial assets (that is, capital expenditure). IVc Analytical balance according to FREN's definition also includes on the expenditure side amortization of old (domestic) debts, specifically the FFCD repayment, the Loan for Recovery of Serbia, the debt to pensioners, etc. The thus defined result measures the liquidity effect of government operations on the economy. See the methodological discussion in Box 1, QM 3, for details.

4) Since the proceeds from the mobile telephony license are one-off by nature, they are treated here as financing, whereas the MoF treats them as non-tax revenue.

5) FREN's estimate based on unofficial information regarding VAT credits and on the analysis of VAT redemption PFB data.

Note: For details see Table P-8, Analytical Appendix.

Macroeconomic Implications of Fiscal Policy

The low deficit will help mitigate macroeconomic imbalances

Macroeconomic developments in Q1 2007 indicate that the combination of expansive fiscal policy and restrictive monetary policy implemented in late 2006 has almost entirely spilt over into the higher external imbalance, while the internal equilibrium has been successfully maintained. Such a policy produces favorable short-term effects on the stability of the economy, and a rise in the standard of living, but, because of the consequential increase in the trade deficit, it is not sustainable in the long run.

The extension of temporary financing to the whole first semester of 2007 will have substantial macroeconomic implications. The temporary financing regimen has reduced public spending relative to late 2006, even after the seasonality of public spending is factored in. The restrictive fiscal policy conducted in Q1 and which will be continued in Q2 as well, has partially neutralized the macroeconomic consequences of fiscal expansion at the end of last year. The slowdown in public spending growth in the first half of 2007 will contribute to the reduction of domestic demand over the coming period. This, in turn, will have a favorable impact on narrowing of the trade deficit and will reduce pressure on monetary policy in the coming quarters.

Accordingly, while the expansive fiscal policy in late 2006 contributed to the growth in domestic demand and exacerbated imbalances in the first semester this year, the neutral fiscal policy in Q1 and Q2 2007 is expected to contribute to the stabilization of aggregate demand and to the balancing of macroeconomic flows in the second half of the year.

The estimate is that reducing the external imbalance requires the running of a relatively low deficit of Serbia's general government consolidated balance in 2007 (around 1% of GDP). More specifically, it is important for the consolidated general government balance to be stated in accordance with international accounting standards, that is, to include expenditure under the NIP in public spending (public investment). Likewise, from the standpoint of the impact on

domestic demand – it is reasonable for the proceeds of mobile operator licenses not to be treated as regular revenue, but as a financing item for covering the fiscal deficit.

Public revenue growth is expected to decelerate in the second semester

In projecting the consolidated general government balance, it is important to bear in mind the impact of the expected deceleration of aggregate demand growth on public revenue trends. A slower growth of domestic demand will result in a slower growth of public revenue, which should be taken into account in planning public finances for the second half of 2007.

Expenditure control is necessary in order to keep the deficit low

In order to keep the deficit at a relatively low level, against the backdrop of the expected deceleration in public revenue growth and with the planned rise in public investment (projects under the NIP), it is necessary to slow down the growth of current public spending. At the same time, the projects under the NIP must be thoroughly reviewed, with a view to rejecting, reducing or postponing projects that have no nation-wide significance, as well as to move current maintenance from the NIP to the regular current expenditure of budget beneficiaries.

Analysis of Individual Tax Instruments and Expenditure Items

The revenue of consolidated general government in Q1 2007 recorded an exceptionally high real growth relative to the same period of 2006, being higher by 15.9% in real terms (Table T7-2). High real growth is characteristic of both tax revenue (15.6%), and non-tax and capital revenue (15.5% and 48.3%, respectively).

All taxes, except for the payroll tax, grew rapidly

Within *tax revenue*, all categories, except for the personal income tax, recorded real growth relative to the same period last year.

Table T7-2. Serbia: Consolidated General Government Fiscal Operations¹⁾, 2005–2007

	in billions of dinars						Real growth (in %)					
	2005		2006		2007		y-o-y				Comparing to previous period	
	Q4	Q1-Q4	Q1-Q3	Q4	Q1-Q4	Q1	2006		2007		Q1 2006 / Q4 2005	Q1 2007 / Q4 2006
							Q1-Q3	Q4	Q1-Q4	Q1		
I PUBLIC REVENUES	210.2	701.6	584.5	240.6	825.0	215.2	4.3	5.9	4.7	15.9	-19.3	-11.6
<i>o/w: Public revenues excluding VAT liabilities to enterprises and offsets with SDF²⁾</i>	200.9	191.1	579.9	235.1	815.0	215.1	6.3	8.2	6.8	15.0	-14.8	-9.5
1. Current revenues	207.8	693.7	577.5	237.3	814.8	212.0	4.2	5.6	4.6	15.6	-19.3	-11.6
Personal income taxes	27.2	94.3	84.3	34.3	118.6	24.9	10.2	16.5	11.9	-8.9	-8.0	-28.1
Corporate income taxes	2.8	10.3	14.3	4.0	18.3	11.7	66.1	34.0	58.0	39.2	178.7	189.5
VAT and retail sales tax	62.2	215.9	161.1	64.0	225.1	60.5	-8.2	-4.9	-7.3	23.4	-27.9	-6.5
<i>o/w: Net VAT and retail sales tax²⁾</i>	54.7	198.8	160.6	64.0	224.6	60.5	-2.4	8.2	0.4	19.3	-15.2	-6.5
Excises	20.0	71.3	57.4	24.2	81.6	19.1	-1.8	11.8	1.8	23.1	-29.2	-22.1
Custom duties	20.0	71.3	57.4	24.2	81.6	12.0	6.0	-1.5	3.7	18.1	-24.0	-8.9
Social contributions	12.3	39.0	32.2	13.1	45.3	58.9	9.7	18.9	12.3	14.7	-14.0	-17.0
<i>o/w: contributions excluding offsets with SDF³⁾</i>	54.6	184.0	162.0	70.2	232.2	58.8	10.1	13.5	11.0	14.8	-11.2	-10.2
Other taxes	6.8	24.1	21.7	8.5	30.1	7.9	9.2	15.8	11.0	14.4	-6.4	-7.6
Non-tax revenue	22.0	54.8	44.4	19.1	63.5	17.0	19.2	-20.0	4.1	15.5	-38.9	-11.9
2. Capital revenues	2.4	7.9	7.0	3.3	10.3	3.2	11.6	25.6	15.7	48.3	-17.3	-2.3
II TOTAL EXPENDITURE	-195.1	-667.8	-557.8	-255.4	-813.2	-203.1	3.4	21.0	8.3	9.7	-13.2	-21.3
1. Current expenditures	-184.3	-634.8	-526.5	-222.8	-749.3	-187.5	2.5	11.7	5.0	5.7	-12.0	-16.8
Wages and salaries	-47.7	-166.3	-138.9	-59.6	-198.6	-51.9	2.7	15.7	6.2	6.5	-6.5	-13.9
<i>Wages and salaries excluding severance payments⁴⁾</i>	-45.5	-164.1	-136.6	-59.6	-196.3	-51.9	0.9	21.1	6.2	8.6	-4.0	-13.9
Expenditure on goods and services	-29.7	-92.2	-76.7	-37.5	-114.1	-25.5	7.4	16.7	10.3	7.9	-27.0	-32.5
Interest payment	-7.8	-24.5	-19.5	-9.4	-28.9	-5.7	2.5	10.8	5.0	-5.7	-29.3	-39.8
Subsidies	-15.8	-54.5	-36.4	-18.0	-54.4	-9.3	-17.4	5.2	-11.2	-13.1	-38.3	-49.1
Social transfers	-78.7	-281.5	-242.8	-93.1	-335.8	-91.1	5.0	9.3	6.1	7.8	-1.8	-3.2
<i>o/w: pensions⁵⁾</i>	-51.5	-186.1	-166.9	-60.8	-227.7	-62.0	8.7	9.2	8.8	11.1	-0.8	1.0
Other current expenditures	-4.6	-15.8	-12.2	-5.2	-17.4	-3.9	-4.5	4.5	-2.0	5.1	-25.6	-25.2
2. Capital expenditures ⁶⁾	-10.8	-33.0	-31.3	-32.6	-63.9	-15.6	23.0	180.1	71.8	101.3	-34.2	-52.7
III "OLD" DEBT REPAYMENT AND GOVERNMENT NET LENDING	-7.8	-36.6	-31.6	-17.5	-49.1	-14.6	-3.8	106.5	18.6	216.8	-46.1	-17.4
1. Debt repayment+FFCDs and LRS	-0.8	-21.9	-20.4	-1.4	-21.8	-5.1	-15.7	56.7	-13.2	391.9	18.2	271.2
2. Pensions	-5.6	-9.8	-7.3	-13.0	-20.3	-8.9	49.1	115.4	85.5	431.7	-72.4	-31.9
3. Net lending ⁷⁾	-1.5	-1.3	-4.0	-3.2	-7.1	-0.6	3.1	100.0	30.8	-70.1	18.9	-82.2

Source: Table P-8 in the Analytical Appendix.

1) See footnote 1) in Table T7-1.

2) Retail sales tax/VAT minus new tax credits to enterprises.

3) Social contributions reduced by offsets between the Pension Fund, the Serbian Development Fund and enterprises in arrears to the Pension Fund.

4) FREN's estimate, for details see Table P-8 in the Analytical Appendix.

5) Refers only to the current pension expenditure.

6) Capital expenditure excludes foreign financed projects (except for 2004, see footnote 16 in Table P-7)

7) The item corresponds to the item "Net acquisition of financial assets for policy purposes" in the PFB, i.e. to the item "net lending" in the IMF presentation. It comprises loans to students, financing of the National Corporation for Housing Loan Insurance and the like.

Note: Real growth is arrived at by applying the average base RPI (the base is the average for 2003) to quarterly data.

The cause of the lower personal income tax revenue (8.9%) was a decline in the payroll tax revenue, with the beginning of the application of a lower tax rate and the introduction of the tax allowance. A lower-than-expected decline in this revenue category was caused by two phenomena. First, the decline in revenue from the payroll tax was mitigated by the high wage growth in this period (wage growth of 24.2% in January – March 2007 over January– March 2006). Second, other income taxes, with the exception of the payroll tax, recorded a real growth relative to the same period of the previous year, in the amount of 25%, which mitigated the decline in the personal income tax revenue.

The corporate income tax revenue once again recorded an exceptionally high real growth of 39.2% relative to Q1 2006. If the increase in 2006 relative to 2005 could be partially explained by the fact that international accounting standards were for the first time applied in the compilation of companies' financial statements, which also contributed to a more realistic presentation of results – this time the increase in the corporate income tax revenue is attributable to the good performance of the economy (companies, banks, etc.).

Faster-than-average growth of consumption taxes

VAT tax revenue increased by 23.4% in real terms relative to Q1 2006, which was the highest y-o-y quarterly growth rate since the VAT introduction. Considering the fact that arrears to enterprises for refunds were reduced last January, the increase was a bit lower, 19.3%. The rise in the VAT revenue was driven by high spending in Q4 2006, especially in December.

Real growth of the excise revenue in Q1 2007 amounted to 23.1%. Underlying the increase in this revenue was higher consumption of excisable goods, primarily petroleum products.

The customs revenue increased by 18.1% relative to Q1 2006. The higher revenue from customs duties and the import VAT was in line with the increase in imports.

The revenue from mandatory social security contributions increased at a rate of 14.7%, against the same period of the previous year, and rose in line with the wage growth in the period.

Other tax revenues (taxes on the use and possession of goods and on licenses for the use of goods and the property tax of local self-governments) recorded a rise of 14.4% relative to the same period of the previous year. Other tax revenues also include other proceeds from goods and services at the central level, the property tax of local self-governments and other taxes on goods and services that accrue to the local level of government. The highest increase relative to the same period of the previous year was recorded precisely by these other taxes (local utility fees and the like) in local self-governments (nominal growth of 45%).

The rise in the capital revenue was driven by the increase in this revenue in local budgets – from the category proceeds from assets, mainly rental fee revenue.

In Q1 2007, almost all levels of consolidated general government were under a regimen of temporary financing. Namely, in addition to the Republic and the social security and health insurance funds, the autonomous province of Vojvodina and some major municipalities and cities were in temporary financing.

Public expenditure grew moderately, with the exception of public investment

Temporary financing should result in restrictive spending of general government. To a degree, general government current expenditure in Q1 reflected the restrictiveness caused by the temporary financing regimen. Real growth of current expenditure relative to the same period of the previous year amounted to 5.7% (Table T7-2). Within current expenditure, only two categories recorded a fall relative to the same period of 2006: expenditure for subsidies and interest expense. The expenditure for subsidies has been on a downward trend for quite some time now, though it often happens that a decline in subsidies is compensated through a rise in budget loans. This did not happen this time – budget loans fell even more than subsidies relative to the same period last year.

Real levels of general government expenditure for employees and for purchases of goods and services went up relative to Q1 2006: expenditure for employees by 6.5%, and purchases of goods and services by 7.9%. A relatively moderate growth in expenditure for employees, despite the

strong wage growth late last year, was the consequence of the reduction of the fiscal burden on wages, which entered into force on 1 January 2007. Namely, as of 1 January 2007, the labor costs of the state, just as of any other employer, for the payment of the same net wages and salaries, have been somewhat lower, by about 10% due to the cut in the payroll tax².

The largest contribution to the rise in total public expenditure (9.7%) was made by capital expenditure with 101.3% over the same period of the previous year, due to the implementation of the NIP, which amounted to 8.4 bn dinars for the period January–March.

Expenditure for social assistance and transfers had a real growth of 7.8% relative to the same period last year. Pensions grew faster than the category as a whole, and were higher by 11.1% than in Q1 2006. This increase in the pension expenditure was caused by two pension indexations – in April and October 2006.

Table T7-3. Serbia: Government Position in the Banking Sector, 2004–2007

	2004		2005				2006				2007
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	
	in billions of dinars, stocks										
Total	-7.1	-25.8	-22.0	-32.8	-43.1	-53.7	-60.4	-150.5	-118.6	-155.3	
Republics and State Union	6.0	-6.9	-1.6	-10.2	-27.8	-31.1	-34.0	-124.2	-100.1	-128.9	
Municipalities	-13.1	-19.0	-20.4	-22.6	-15.3	-22.6	-26.4	-26.3	-18.5	-26.4	
	cumulative, from the beginning of the year										
Total	8.8	-18.7	-14.9	-25.7	-36.0	-10.6	-17.3	-107.4	-75.5	-36.7	
Republics and State Union	15.1	-12.8	-7.6	-16.2	-33.8	-3.3	-6.1	-96.3	-72.7	-28.8	
Dinar position	1.0	-7.3	-10.1	-16.8	-27.9	-3.1	-16.3	-13.1	13.6	-27.0	
Fx position	14.1	-5.5	2.6	0.6	-5.9	-0.2	10.2	-83.2	-85.8	-1.8	
Municipalities	-6.3	-5.9	-7.3	-9.5	-2.2	-7.3	-11.1	-11.0	-3.3	-7.8	
NBS	-3.8	-5.3	-3.2	-5.0	-0.8	-6.1	-5.1	-5.5	-3.5	-6.8	
Commercial banks	-2.5	-0.6	-4.1	-4.5	-1.4	-1.2	-5.8	-5.5	0.2	-1.1	

Source: NBS.

² According to the SBS, average wages of employees, which include employee taxes and contributions, in Q1 2007 were higher by 15–16% relative to the same quarter of 2006, thus considerably exceeding the rise in government expenses for employees, 6% in real terms. Although there may be some other reasons for this (downsizing in the government sector by around 1%, incomplete statistical coverage of employees, etc.), the estimate is that the main reason for this discrepancy is in the fact that the consolidated balance includes only the expenditure of the budget and social security funds for employees, while the statistics, when calculating average wages, covers all the earnings of employees in the public sector, not only earnings from the budget and social security funds. Other earnings of employees in the public sector are financed from the so-called own sources of beneficiaries of the budget and funds, such as revenue of healthcare providers from the services they rendered, revenue of courts from fees and the like, revenue of the Ministry of the Interior from fines, etc., revenues of schools from the lease of gyms, etc., revenue of universities from part-time students, etc.

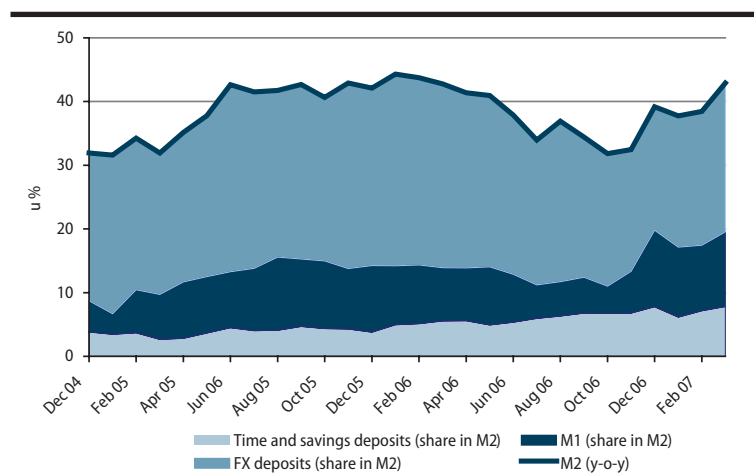
8. Monetary Flows and Policy

The y-o-y growth of money supply continued to accelerate, reaching 42.9% (39.2% in Q4 of 2006), mainly due to the expansion of credit to the non-government sector. Monetary policy became less restrictive in Q1. Repeated lowering of the NBS reference interest rate – from 14% in December 2006 to 10.5% at the end of Q1 and further to 9.5% at end-May 2007 – reduced banks' interest in NBS papers. NBS activities consisted mainly of net withdrawal of dinars through net sales of foreign exchange to the public and through auctions of NBS papers (repo and outright sales). The amount of dinars withdrawn by the NBS through the auctions was much lower than in the preceding two quarters – about 17 bn (68 bn in Q4 and 25 bn in Q3 2006). Since the government dinar deposit with the NBS rose by some 30 bn dinars, primary money recorded a drop in Q1. Bank credit to companies rose in Q1, most probably due to the lower investments in NBS papers (only €200 mn compared to €900 mn in Q4 2006). About half of the new credit went to companies (€300 mn), while these credits were at a complete standstill in Q4 2006. As in the last two quarters of 2006, bank credit continued to be financed from domestic deposits, primarily new foreign exchange savings, reduction of deposits with the NBS related to reserve requirements, and reduction of net credit to government. Compared to the preceding quarter, banks stopped borrowing abroad, but domestic companies continued to borrow directly from foreign banks (some €450 mn in Q1 2007).

Monetary System: Structure and Flows of Monetary Supply

Graph. T8-1. Serbia: Money and Component Aggregates¹⁾, 2004–2007

The growth of nominal and real M2 continued accelerating



Source: Table P-9. in Analytical Appendix.

1) The share of money components was obtained as their ratio against the value of M2 in the same period of the preceding year, whereby the sum of obtained ratios is equal to the y-o-y growth of total money (M2).

Total monetary supply continued the 12-m trend of accelerated growth from Q4 2006. Nominal M2 recorded a 12-m growth rate of 42.9% (39.2% in the last quarter of 2006), and a real growth of 35.4% (30.6% in Q4 2006, Table T8-2). With respect to the different forms of use of monetary supply, (Graph T8-1), there was no change in structure of M2 in Q1 2007 compared to Q4 2006, with the contribution of foreign exchange deposits remaining the largest.

Monetary growth in Q1 was the consequence of the growth of net foreign exchange reserves...

... and the expansion of credit to the non-government sector

The total increase of monetary supply in Q1 2007 (5.9% of M2 at the beginning of the year) was the result of the growth of net foreign assets (NFA, 5.3% of opening M2) and the rise in net domestic assets (NDA, 0.6% of opening M2), Table T8-2. The 0.6% NDA growth was due mainly to the expansion of credit to the non-government sector, which amounted to 6.6% of opening M2 (more than the 5.1% recorded in the same period of 2006) and reduction of net credit to government, i.e. the rise in government deposits with the monetary sector (-4.1% of opening M2). The remainder of the NDA increase pertained to other items, which are not all specified in the Table T8-2. The conclusion, therefore, is that, in contrast to Q4 2006 when the main source of monetary supply growth was the increased spending of government deposits, in Q1 2007, this was again credit to companies and households.

Table T8-2. Serbia: Monetary Survey, Selected Indicators, 2004–2007

	2004		2005				2006				2007
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	
	y-o-y, in %										
M2 ¹⁾	31.9	37.0	42.6	42.7	42.1	42.8	37.9	34.4	39.2	42.9	
Credit to the non-government sector ²⁾	44.3	50.9	46.0	48.7	51.3	45.3	44.4	34.6	17.5	21.6	
Credit to the non-government sector ²⁾ , adjusted ³⁾	30.6	39.2	34.6	38.6	45.6	39.6	41.6	38.0	24.1	26.3	
Households	107.0	100.2	94.7	91.3	92.5	100.6	96.6	80.8	62.2	58.4	
Enterprises	19.8	29.7	24.2	27.6	34.3	25.0	26.9	24.7	11.1	14.2	
	real y-o-y, in %										
M2 ¹⁾	10.4	16.3	22.1	22.4	20.8	24.7	19.8	20.5	30.6	35.4	
Credit to the non-government sector ²⁾	27.4	28.0	25.0	27.6	28.6	26.9	25.4	20.7	10.3	15.2	
Credit to the non-government sector ²⁾ , adjusted ³⁾	28.2	28.2	28.2	28.2	28.2	21.5	22.7	23.6	16.4	19.8	
Households	59.1	59.1	59.1	59.1	59.1	74.8	70.4	61.9	52.2	50.2	
Enterprises	18.2	18.2	18.2	18.2	18.2	8.8	9.9	11.7	4.2	8.3	
	cumulative, in % of opening M2⁴⁾										
M2 ¹⁾	31.9	2.6	15.9	30.8	42.1	3.1	12.4	23.8	39.2	5.9	
M2 dinar ¹⁾	8.7	-0.8	4.4	10.5	14.2	-0.5	3.6	8.8	19.8	-0.1	
Foreign deposits (households and enterprises)	12.8	2.5	9.2	16.1	22.5	2.6	8.4	18.1	25.7	4.0	
Valuation adjustments ⁵⁾	10.5	0.8	2.3	4.3	5.4	1.0	0.4	-3.1	-6.4	1.9	
NFA, dinar increase	-3.8	0.5	7.0	17.1	18.0	-4.0	2.4	30.9	41.1	5.2	
NFA, fx increase	-13.3	-0.2	5.0	13.3	13.5	-4.7	2.1	34.3	48.4	3.1	
Valuation adjustments ⁶⁾	9.5	0.7	2.0	3.8	4.4	0.7	0.3	-3.4	-7.3	2.2	
NDA	35.8	2.1	8.9	13.7	24.2	7.1	10.0	-7.1	-1.9	0.6	
o/w: credit to the non-government sector ²⁾ , adjusted ³⁾	15.9	6.7	12.5	21.2	34.1	5.1	15.6	25.0	27.3	6.6	
o/w: net credit to government ⁷⁾	6.1	-3.9	-2.4	-5.0	-10.4	-0.7	-1.3	-21.8	-17.4	-4.1	
o/w: NBS and com. banks capital and reserves	-10.2	-5.6	-8.2	-10.7	-12.1	-1.2	-7.5	-8.5	-13.2	-2.2	
	cumulative, in % of GDP⁸⁾										
Net credit to government ⁷⁾	1.1	-0.8	-0.5	-1.0	-1.9	-0.2	-0.3	-4.8	-3.4	-1.3	
o/w: dinar credits	0.1	-0.5	-0.6	-1.0	-1.6	-0.2	-0.9	-0.7	0.6	-1.2	
Credit to the non-government sector ²⁾ , adjusted ³⁾	7.3	2.3	4.2	6.8	10.0	1.6	3.8	4.8	4.3	2.6	

Source: Tabela P-9, in Analytical Appendix.

1) Definitions of M2, M2 dinar, NFA and NDA - see Analytical and Notation Conventions.

2) Credits to the non-government sector: credits to households and enterprises (including cities and municipalities, non-profit and other non-government entities).

3) Flows are adjusted for exchange rate changes. Adjustments are applied under the assumption that 70% of credit to the non-government sector (both households and enterprises) are euro-indexed.

4) "Opening M2" refers to the stock of M2 from the beginning of stated year (i.e. end of previous year).

5) The contribution of fx deposits to the growth of M2 measures only the contribution of the increase in fx-denominated fx deposits so that their revalorization produces the exchange differentials.

6) Valuation adjustments refer to the difference in NFA contribution to M2 growth calculated in dinars and NFA contribution to M2 growth calculated in euros.

7) Net credit to government: difference between government credits (dinar and fx) and deposits (dinar and fx). Government does not include cities and municipalities which are considered within the non-government sector.

8) The GDP used in the calculations is annually centered.

Table T8-3. Serbia: Monetary Survey, 2005–2007

	2005				2006				2007
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	in millions of dinars, end of period								
STOCK									
NFA	162,488	183,484	216,183	218,886	200,462	229,984	360,685	407,565	441,048
o/w: NBS gross reserves	274,136	304,386	362,216	424,844	465,497	549,529	648,946	715,114	719,381
o/w: commercial bank foreign liabilities	-98,169	-114,781	-131,090	-191,124	-229,081	-302,170	-300,781	-307,742	-318,598
NDA	168,841	190,622	206,257	239,985	272,642	285,856	207,195	231,055	234,991
Net credit to government ¹⁾	-6,864	-1,602	-10,242	-27,831	-31,129	-33,954	-124,159	-100,061	-128,909
Net dinar credit	-1,823	-4,583	-11,268	-22,332	-25,479	-38,649	-35,438	-8,776	-35,782
Net fx credit	-5,041	2,981	1,026	-5,499	-5,650	4,695	-88,721	-91,285	-93,127
Credit to the non-government sector ²⁾	376,883	409,397	456,541	518,298	547,564	591,270	614,698	609,171	666,007
Other items, net	-201,178	-217,173	-240,042	-250,482	-243,793	-271,460	-283,344	-278,055	-302,107
M2 ³⁾	331,331	374,106	422,441	458,870	473,103	515,840	567,881	638,620	676,039
M2 dinar ³⁾	143,768	160,351	180,043	192,180	189,911	208,606	232,506	283,116	282,299
Fx deposits (households and economy)	187,563	213,755	242,398	266,690	283,192	307,234	335,375	355,504	393,740
STRUCTURAL INDICATORS									
Currency outside banks/Dinar deposits (households and economy), in %	37.7	35.9	35.6	38.7	31.8	30.6	28.9	31.9	26.2
Fx deposits (households and economy) / M2 (%)	56.6	57.1	57.4	58.1	59.9	59.6	59.1	55.7	58.2
Velocity (GDP ⁴⁾ / M2)	4.6	4.3	4.0	3.8	3.9	3.7	3.5	3.3	3.2
M2 / GDP ⁴⁾	0.22	0.24	0.25	0.26	0.26	0.27	0.29	0.30	0.31
Credits to the non-government sector / GDP ⁴⁾	0.25	0.26	0.27	0.30	0.30	0.31	0.31	0.29	0.30
Non-performing loans ⁵⁾ (in % of total loans)	..	..	..	..	..	..	..	4.7	4.9
Money multiplier (dinar M2/H)	1.8	2.0	2.0	1.9	2.1	2.1	2.1	2.0	2.4

Source: Table P-9 in Analytical Appendix.

1) See footnote 7) in Table T8-2.

2) See footnote 2) in Table T8-2.

3) Definitions of M2, M2 dinar, NFA and NDA - see Analytical and Notation Conventions.

4) See footnote 8) in Table T8-2.

5) The figure for December 2006 relates to January, 31 2007 and represents the ratio of loans with overdue payments of 90 days and more to total outstanding loans. The source for data in this row is The Credit bureau, Association of Serbian banks. For details, see QM6, Spotlight on No.1.

Growth of credit to non-government sector speeds up

After two quarters in which credit to the non-government sector slowed down, Q1 2007 saw it accelerate again, reaching a 12-m nominal rate of 21.6% (17.5% in Q4 2006), and a real rate of 15.2% (10.3% in Q4 2006), Table T8-2. When observed on the basis of flows adjusted for the effect of exchange rate differences (for details of the correction methodology see footnote 3, Table T8-2 or Box 2, part 8, QM 6) the acceleration is also apparent: the 12-m growth at the end of Q1 2007 was 26.3%, compared to 24.1% at the end of Q4 2006).

Credit to companies through the domestic banking system picks up in Q1...

Banking Sector: Credits and Sources of Financing

Following two consecutive quarters in 2006 when banks mostly invested in repo instruments, and new credit to companies accounted for only a tiny fraction of the growth of credit, Q1 2007 saw a structural shift in favor of new bank credits to companies. In that quarter, credit to companies accounted for as much as half of total credit, or a new €313 mn, of which €195 mn were short-term and €118 mn long-term loans (Table T8-4). Companies borrowed a new €450 mn abroad, continuing a trend that became noticeable in the second semester of 2006 and which endured into 2007 in spite of the recovery of credit through the domestic banking system.

Table T8-4. Serbia: Funding, Credit and Investment Activity, Adjusted¹⁾ Flows, 2005–2007

	2005				2006				2007
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	in millions of euros, cumulative from the beginning of the year								
Funding(-, increase in liabilities)	-377	-1,051	-1,712	-2,783	-539	-2,208	-3,468	-5,237	-325
Domestic deposits	-73	-488	-913	-1,314	-116	-550	-1,322	-2,245	-339
Households deposits	-144	-350	-575	-884	-178	-413	-795	-1,200	-329
dinar deposits	1	-27	-40	-46	-13	-54	-51	-124	-35
fx deposits	-145	-323	-535	-838	-165	-359	-744	-1,076	-295
Enterprise deposits	71	-138	-338	-430	63	-137	-527	-1,045	-10
dinar deposits	29	-92	-223	-363	36	-52	-295	-739	23
fx deposits	43	-46	-115	-68	27	-85	-232	-307	-33
Foreign liabilities	-169	-345	-506	-1,194	-401	-1,278	-1,433	-1,660	-10
Capital and reserves ¹⁾	-134	-218	-293	-275	-22	-380	-713	-1,331	25
Gross foreign reserves(-, decline in assets)	-89	-3	-27	-29	-190	-191	-36	-77	-14
Credits and Investment¹⁾	402	802	1,369	2,058	417	1,193	1,906	3,100	687
Credit to the non-government sector, total	337	651	1,147	1,893	272	847	1,320	1,541	575
Enterprises	274	437	697	1,172	85	390	557	536	313
short term	217	385	597	835	85	254	258	194	195
long term	57	52	101	337	1	136	299	341	118
Households	63	214	450	721	187	457	763	1,006	263
short term	8	18	38	81	50	106	169	194	36
long term	54	196	412	640	137	351	594	811	226
Placements with NBS (Repo transactions and treasury bills)	20	196	235	185	162	448	740	1,637	200
Government, net ²⁾	25	-64	-21	-43	-20	-107	-157	-79	-89
MEMORANDUM ITEMS									
Direct foreign liabilities of enterprises and banks' credits to enterprises	353	799	1,281	2,035	325	897	1,599	2,102	762
o/w: direct foreign liabilities of enterprises	79	363	583	863	239	507	1,043	1,567	450
Mid and long term	75	349	589	846	224	479	979	1,523	438
Short term	5	14	-6	17	15	29	64	43	12
Required reserves and deposits	24	241	438	945	216	1,182	1,535	1,813	-146
Other net claims on NBS ³⁾	-38	-5	-3	54	-56	-75	-46	0	13
o/w: Excess reserves	-32	-21	-19	12	-55	-59	-73	-50	20
Other items ⁴⁾	61	1	-61	-158	168	130	166	499	-110
Effective required reserves (in %) ⁵⁾	26	27	28	31	32	38	38	36	34

Source: Table P-10 in Analytical Appendix.

1) The increases in credits were obtained on the assumption that 70% of total credits are euro-indexed and that all long-term credits to companies and households are thus indexed. The increases in the original dinar values of deposits were calculated at the average exchange rate in the period, and in fx deposits as the difference in balances calculated at the exchange rates at ends of periods. Capital and reserves were calculated at the exchange rates at the ends of periods and do not include the effects of exchange rate differentials from revaluation of all previous items.

2) Credits to government, net: difference between credits to the government and government deposits held in commercial banks; negative sign means that deposits increase is larger than the growth of credits. Government include: Republic level and cities and municipalities.

3) Other net claims on NBS: difference between claims on NBS (cash and excess reserves) and liabilities to NBS.

4) Includes: Other assets; Deposits of enterprises undergoing liquidation; Interbank, net; and Other liabilities, excluding Capital and reserves.

5) Effective required reserve: refers to share of required reserves and deposits in total deposits (households and enterprises) and banks' foreign liabilities. The base for calculating required reserves does not include subordinated debt owing to unavailability of data.

... but companies continued borrowing abroad

Banks invested relatively less in NBS papers in Q1

Banks invested the dinar equivalent of €200 mn in NBS papers in Q1 (14-day repo instruments and six-month T-bills, see Box 3 for more details). The relative reduction of investment in NBS papers in Q1 compared to the second semester of 2006 was probably due to the falling returns on these papers (lowering of the reference interest rate, more details in Box 3 and Graph T9-3 and T9-4 in section 9, Financial Markets), Table T8-4. In Q4 2006, new repo operations accounted for about 75% of the total increase in that quarter, with no increase in total credit to companies being recorded in the period. Credit to companies picked up in Q1 2007, with banks putting about half of their new funding (approximately €300 mn) into new credits and only about one-third (€200 mn) into NBS papers. This indicates that they now prefer to invest the liquidity freed up by the maturation of repos in credits to companies rather than new repo transactions. In other words, it would appear that the record repo operations of late 2006 contributed, among other things, to cutting back credit to companies in that period.

Banks find sources of new credit in household deposits and freeing of reserve requirements

As in the whole of the second semester of 2006, banks mainly financed new credit from new domestic deposits. Additional sources were the €146 mn reduction of funds deposited with the NBS (reserve requirement) relative to end-2006, and the €89 mn reduction in net credit to government. Banks almost ceased borrowing abroad (increase of only €10 mn in Q1 2007 compared to €220 mn in Q4 2006 and €400 mn in Q1 2006, Table T8-4). Total company deposits grew by only €10 mn in Q1 (€510 mn in Q4 2006), which can only partly be ascribed to seasonal factors. It also seems that the trend of accelerated growth of company deposits recorded in the second semester of 2006 is winding down.

The increase in household deposits by €329 mn in Q1 was due to the rise in new foreign exchange savings by €295 mn (€330 mn in Q4 2006, €178 mn in Q1 2006) and the rise in dinar deposits by €35 mn. The €89 mn reduction in net credit to government was the result of both repayment of bank loans and the increase of deposits with the banking sector, and constitutes quite a significant source of new bank credit.

Box 1. Payment Cards – Number and Type

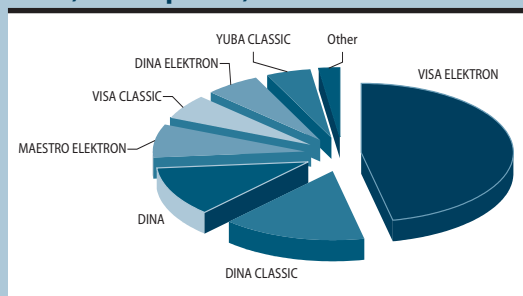
At the end of April 2007, the number of issued debit cards was 1,764,360 and 807,607 credit cards. The predominant card is Visa Electron (46%), Graph T8-6. The payment card market is shared by MasterCard, Dina and Visa, with each accounting for about one-third, Graph T8-7.

Table T8-5. Payment Cards, as of April 30, 2007

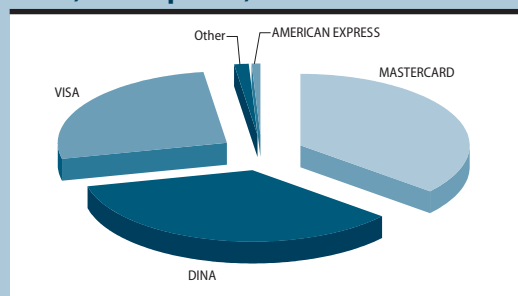
Type of card	Number of cards issued	Number of users	Total approved overdraft	Amount of overdraft used
			in millions of dinars	
Debit Cards	1,764,360	1,179,997		
VISA ELEKTRON	821,588	697,262		
DINA CLASSIC	269,937	260,354		
DINA	205,201	187,789		
MAESTRO (ELEKTRON)	140,558	124,770		
VISA CLASSIC	102,406	94,147		
DINA ELEKTRON	102,348	100,307		
YUBA CLASSIC	83,274	83,253		
Other ¹⁾	39,047	16,742		
Credit Cards	807,607	681,946	42,419	19,186
MASTERCARD	291,575	268,532	12,252	5,119
DINA	285,462	277,151	16,061	7,650
VISA	212,642	205,227	12,566	6,027
OSTALE KARTICE	11,795	11,779	260	104
AMERICAN EXPRESS	6,133	6,123	1,280	286

Source: Association of Serbian banks, Credit bureau

1) Other cards are: MASTERCARD (STANDARD), VISA, VISA ALTERNA, VISA GOLD, YUBA, YUBA ELECTRON, YUBA GOLD.

Graph T8-6. Structure of issued debit cards, as of April 30, 2007

Source: Association of Serbian banks, Credit Bureau

Graph T8-7. Structure of issued credit cards, as of April 30, 2007

Source: Association of Serbian banks, Credit Bureau

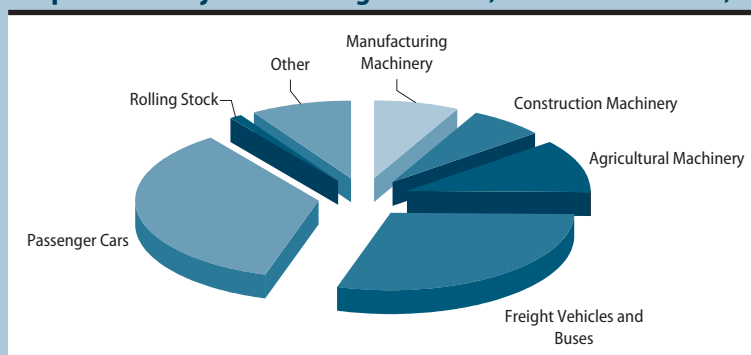
Box 2. Activities of Leasing Companies

Fifteen leasing companies are currently operating in Serbia, of which five are domestic and 10 foreign-owned. The market is highly concentrated, with the two biggest companies covering 50%. Measured by total balance sum, their business expanded by 30% in 2006 relative to end-2005. Leasing companies operated very profitably in 2006, achieving a 23% return on their capital. Claims based on leasing make up some 90% of the total assets of these companies. According to data released by the Credit Bureau of the Association of Serbian Banks and shown in Table T8-8, companies and households owed a total of €879 mn on the basis of financial leasing contracts on 30 April 2007 (about 3.5% of GDP). Companies accounted for the bulk (€718 mn), followed by households (€105 mn) and entrepreneurs (€57 mn). Of the total number of customers, 17,774 were private citizens, 9,669 companies, and 3,608 entrepreneurs. Companies have an average of three leasing contracts and private citizens one (Table T8-8). Of the total number of contracts, 35% were for passenger cars, 29% for freight vehicles and buses, and 11% for agricultural machinery, Graph T9.

Table T8-8. Leasing companies activities, as at April 30, 2007

	Total debt	Number of users of leasing contracts	Number of contracts	Average debt by contract	Average debt by user
	in millions of euros			in euros	
Enterprises	717.92	9,669	29,295	24,506.68	3.03
Entrepreneurs	56.93	3,608	4,471	12,732.85	1.24
Households	104.56	17,774	18,507	5,649.52	1.04
TOTAL	879.41	31,051	52,273	16,823.36	1.68

Source: Association of Serbian Banks, Credit Bureau.

Graph T8-9. Subject of leasing contracts, as at December 31, 2006

Source: NBS, Financial Leasing Supervision Office, Q4 2006 Report.

Central Bank: Balance and Monetary Policy

Table T8-10. Serbia: NBS - Foreign Exchange Purchases and Dinar Sterilization, 2005–2007¹⁾

	2005				2006				2007
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
FLOW	in millions of dinars, cumulative from the beginning of the year								
NBS own reserves ²⁾	9,949	29,646	48,293	63,136	4,628	49,014	78,899	145,315	15,055
NBS own reserves (in euros)	723	364	587	759	53	564	933	1,783	188
NDA	-18,426	-35,268	-44,208	-46,040	-20,755	-54,348	-74,989	-105,744	-46,267
Government, dinar credits	-284	-4,883	-5,506	-6,077	-1,595	-1,856	-1,858	120	-710
Government, dinar deposits	-12,538	-8,482	-14,796	-18,576	-4,789	-14,422	-10,572	17,540	-30,939
o/w: municipalities	-5,259	-3,213	-4,965	-824	-6,068	-5,339	-5,505	-3,500	-6,768
Repo transactions ³⁾	-3,206	-17,607	-19,804	-16,829	-14,258	-39,152	-63,335	-132,903	-16,675
Other items, net ⁴⁾	-2,398	-4,296	-4,102	-4,558	-113	1,082	776	9,499	2,057
H	-8,477	-5,622	4,085	17,096	-16,127	-5,334	3,910	39,571	-31,212
o/w: currency in circulation	-5,797	-2,849	2,118	8,485	-7,825	-4,724	-1,540	14,811	-9,792
o/w: excess liquidity	-2,403	-3,675	-1,753	3,518	-8,643	-7,916	-2,106	16,516	-13,061
INCREASE	cumulative, in % of opening H⁵⁾								
NBS own reserves ²⁾	14.9	43.9	72.4	93.4	7.9	52.5	73.5	135.1	18.8
NDA	-25.9	-51.1	-67.1	-71.2	-25.0	-58.1	-69.4	-93.2	-42.1
Government, dinar deposits	-16.2	-11.0	-19.2	-24.0	-5.1	-15.3	-11.2	19	-23.1
Repo transactions ³⁾	-4.1	-22.8	-25.6	-21.8	-15.1	-41.5	-67.1	-141	-12.5
Other items, net ⁴⁾	-5.5	-17.4	-22.3	-25.4	-4.8	-1.4	9.0	29	-6.6
H	-11.0	-7.3	5.3	22.1	-17.1	-5.7	4.1	41.9	-23.3
o/w: currency in circulation	-7.5	-3.7	2.7	11.0	-8.3	-5.0	-1.6	16	-7.3
o/w: excess liquidity	-3.1	-4.8	-2.3	4.6	-9.2	-8.4	-2.2	18	-9.8
MEMORANDUM ITEMS									
Gross fx reserves (flow, cumulative from the beginning of the year, in euros)	273.3	568.3	1,167.5	1,860.0	387.7	1,420.9	2,945.0	4,083.1	-233.3
Gross fx reserves (in % of opening H in euros)	33.3	72.5	147.4	228.4	43.1	132.1	237.5	307.6	3.2
H (growth rate, y-o-y, in %)	18.0	15.0	26.6	22.1	13.7	24.3	20.8	41.9	31.3
Currency in circulation (growth rate, y-o-y, in %)	3.6	4.9	11.4	18.8	16.4	15.6	10.2	27.6	28.0

Source: Table P-11. in Analytical Appendix.

1) Government include: Republic level and cities and municipalities.

2) Net own reserves definition - see Box 4 in QM5.

3) Up to December 2004, this category included NBS bills, in the January-February 2005 period NBS bills and repo transactions, and as of March 2005 only repo transactions.

4) Other domestic assets, net, include domestic credits (net claims on banks excluding NBS bills and repo transactions; net claims on enterprises together with other assets (capital, reserves and balance items; other assets and liabilities corrected by exchange rate differentials).

5) "Opening H" refers to stock of primary money (H) at the beginning of stated year (i.e. end of previous year).

Primary money considerably reduced in Q1

owing to the withdrawal of dinars through the foreign exchange market...

...and the NBS papers market

... and the growth of the government dinar deposit with the NBS

Primary money was reduced in Q1 by -23.3% of opening H, which represented a deceleration of the nominal 12-m growth rate to 31.3% at end Q1 (41.9% at end-Q4 2006), Table T8-10.

Money base was reduced as the result of the following net changes in the stocks of some of its components: the 18.8% of opening H increase in NBS net own reserves and the higher negative increase in NDA by -42.1% of opening H. The drop in NDA led to a rise in government dinar deposits by 23.1% of opening H, a rise in NBS liabilities toward banks on the basis of sales of NBS papers by -12.5% of opening H and a drop in other net assets by -6.6% of opening H. In Q1, the NBS withdrew about 17 bn dinars through repo operations and outright sale of six-month T-bills, which was far less than in Q4 2006 (62 bn dinars) since there was no intense creation of dinars through the foreign exchange market like in the second semester of 2006 and, hence, no comparable need for sterilization by way of repo operations. In the first quarter, the NBS sold a net €238 mn (Table T8-12) to the non-government sector (through interventions on the interbank foreign exchange market and purchases from exchange offices), and thereby withdrew dinars to the same amount. At the same time, its net own reserves in Q1 2007 rose by €188 mn (Tables T8-10 and T8-13). The conclusion, therefore, is that direct purchase of foreign exchange from government was involved. As there was only €63 mn less in the government foreign exchange deposit at end Q1 2007 relative to the end of 2006, the conclusion is that the government in Q1 converted with the NBS the funds paid into its foreign exchange account in the period so that these do not figure in its foreign exchange deposit either in late 2006 or the end of Q1 2007. The amount is about €363 mn (238+188-63), and most likely involved an inflow of foreign exchange from the sale of the mobile telephony licence to Mobilkom, which the

NBS recorded in the government deposit in January 2007 while the payment was actually made in December 2006). It seems that the government kept the entire converted sum in its dinar account with the NBS since it rose by some 30 bn dinars in Q1. The government's non-expansive attitude in Q1 contributed to a net reduction of the monetary base.

Box 3. In Q1, the NBS eased the restrictiveness of monetary policy

The NBS did not change the reserve requirement rate in 2007 but, in the same period, lowered the reference interest rate on a number of occasions: standing at 14% in December 2006, the rate was reduced to 13% in January 2007, then to 10.5% in March, to 10% in late April and, finally, to 9.5% at the end of May. The exchange rate depreciated by about 2% in real terms in Q1 (more details in part 3). When all these factors (reserve requirement, NBS interest rate and exchange rate) are taken into consideration, it may be concluded that monetary policy became less restrictive in Q1 than it was in the preceding period.

The most active on the securities market, in which the NBS intervenes regularly by withdrawing dinars, were 14-day repos and outright sales of six-month NBS T-bills. The NBS first started to sell these bills in December 2006, until which time the longest maturity at auctions on the open market was two months. A characteristic of repo auctions was that the NBS sold the instruments to banks on condition of their repurchase in 14 days at a discount, namely the NBS reference rate (repo rate). The amount that banks can invest in these instruments is not limited at the auction. When six-month T-bills are auctioned, the sale is permanent, with the NBS offering a limited amount and banks bidding for the interest rate. The rate thus obtained is usually close to the repo rate, and could provide the NBS with useful information for setting the repo rate as, besides liquidity premiums, it also reflects market expectations (Table T8-11).

Table T8-11. Outright sale of NBS treasury bills, interest rates (p.a.)

Date of auction	Average weighted interest rate by auction	Actual reference (repo) rate
	in %, p.a.	
13/11/2006	16.46	16.50
18/12/2006	13.77	15.50
15/01/2007	13.56	14.00
29/01/2007	13.77	14.00
12/02/2007	12.93	13.00
26/02/2007	12.59	13.00
12/03/2007	11.73	11.50
26/03/2007	11.76	11.50
16/04/2007	11.02	10.50
30/04/2007	10.52	10.50
14/05/2007	10.44	10.00
28/05/2007	10.28	10.00

Source: NBS.

Banks invested considerably less in repos in Q1 relative to the second semester of 2006. By the end of the quarter, total investment in 14-day repos had fallen by €126 mn (equivalent in dinars), meaning that more had matured than was reinvested in the instruments. Banks apparently preferred six-month NBS T-bills (at six outright sale auctions) and their stock grew by some €320 mn in Q1. Thus the dinars withdrawn by the NBS in Q1 through operations on the open market (repos and outright sale of T-bills) totalled about 16.5 bn (Table T8-10), or some €200 mn (Table T8-4), which was the amount additionally invested by banks in NBS papers.

Having no need for large-scale sterilization, the NBS lowers the repo rate

Table T8-12. Banks' Reserve Requirements with NBS¹⁾, 12/ 2004 -5/ 2007

	12/2004	05/2005	07/2005	10/2005	11/2005	03/2006	04/2006	05/2006	11/2006	12/2006
Rate on:										
					in %					
DINAR DENOMINATED BASE	21	20	20	18	18	18	18	18	15	10
non-resident accounts with maturity up to 2 years:								60	60	
non-resident accounts with maturity over 2 years:								40	40	
FX DENOMINATED BASE	21	26	29	35	38	40	40	40	40	45
foreign borrowing with maturity up to 2 years ²⁾							60	60	60	45
NEW FX SAVINGS DEPOSITS ³⁾	47	47	45	41	38	40	40	40	40	40
SUBORDINATED CAPITAL						20	20	20	20	20
Key regulation changes:		Introduction of required reserves on foreign borrowing	Separation of the dinar denominated from the fx denominated base		The 38% ratio applies to new fx savings deposits		Introduction of required reserves on subordinated debt			

Source: NBS.

1) Applied to average daily book value of the base from the previous calendar month. na prosečno dnevno knjigovodstveno stanje osnovice u posljednjem kalendarskom mesecu. Effective from the 10th of the next month. Bank is obliged to hold average daily reserve balance at the level of the accounted reserve during the entire accounting period.

2) Up to April 2006 and since December 2006, banks' foreign borrowing was treated equally, irrespective of the repayment period. This sub-category therefore is invalid until March 2006, i.e. the uniform fx base was applied to all foreign inflows on the basis of commercial banks' borrowing.

3) Up to December 2005, reserve requirements on new fx savings of households (fx deposits collected after 30 June 2001) were regulated by a special NBS decision. In December 2005, the regulation became uniform since the NBS introduced a unique reserve requirement rate for all commercial banks' fx accounts.

Note:

Under current regulations, banks' reserve requirements with the NBS include:

- dinar base: dinar deposits (including the government), dinar credits (including the government), securities and other dinar liabilities;
- fx base: fx deposits (including the government), fx-indexed dinar deposits, fx credits (including the government), subordinated capital, securities, other fx liabilities and other fx funds received from abroad for bank services on behalf and for the account of third persons.

Excluded from the dinar/fx-denominated base are: liabilities to the NBS; up to December 2005 – liabilities arising from household fx savings deposited after 30 June 2001; the amounts generated with the settlement of debts for FFCDS, and those arising in the rescheduling of debt to creditors from the Paris and London Clubs. Amount of long-term housing mortgage credits insured with the National Corporation for Housing Loan Insurance is deducted from the required reserves base.

Table T8-13. Net monthly transactions on foreign currency market, NBS-banks and exchange offices

	Interbank fx market (NBS-commercial banks)	Exchange offices	Total	
(-, net sale of foreign currency by NBS)				
	in millions of euros			
Monthly average January-October 2006	-64	151	87	
November 2006	260	131	391	
December 2006	154	86	240	
January 2007	-412	42	-370	} -238 in Q1 2007
February 2007	-14.8	86	72	
March 2007	-54.1	114	60	
April 2007	0	137	137	

Source: NBS

Table T8-12 indicates also that the NBS, following a major intervention in January 2006 (discussed in detail in the previous issue of QM in the same section) to a major extent reduced its interventions on the interbank fx market, as announced and envisaged by the new framework for monetary policy from August 2006. Also in keeping with the new policy framework, as of 5 March 2007, the exchange rate is set officially on the basis of total interbank trading of the euro at and outside of meetings of the market (up until then it was set only on the basis of trading with the market) on the previous day, at the level of the average weighted rate of the dinar against the euro.

NBS is less active on interbank foreign exchange market in Q1

Table T8-14. Serbia: Foreign Exchange Reserves, Stock and Flow, 2005–2007

	2005				2006				2007
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
	stock, in millions of euros								
NFA of Serbia	2,028	2,241	2,548	2,544	2,303	2,674	4,403	5,164	5,413
Commercial banks, net	-487	-577	-761	-1,451	-2,042	-2,921	-2,920	-3,188	-3,213
Gross foreign reserves	724	810	787	784	594	593	748	707	693
Foreign liabilities	-1,211	-1,387	-1,548	-2,235	-2,636	-3,514	-3,668	-3,895	-3,906
NBS, net	2,515	2,818	3,309	3,995	4,345	5,595	7,323	8,352	8,626
Gross foreign reserves	3,382	3,677	4,276	4,969	5,357	6,390	7,914	9,052	8,819
Foreign liabilities	-868	-859	-967	-974	-1,011	-795	-591	-700	-193
IMF	-654	-630	-765	-748	-787	-575	-373	-181	6
Other liabilities	-213	-229	-202	-226	-225	-220	-218	-519	-200
NBS, NET RESERVES-STRUCTURE									
1. NBS, net	2,515	2,818	3,309	3,995	4,345	5,595	7,323	8,352	8,626
1.1 Commercial banks deposits	-877	-1,083	-1,262	-1,725	-1,995	-2,858	-3,126	-3,210	-3,358
1.2 Government deposits	-223	-79	-170	-220	-247	-123	-1,213	-1,309	-1,247
1.3 NBS own reserves (1.3 = 1 - 1.1 - 1.2)	1,415	1,656	1,878	2,050	2,103	2,614	2,983	3,833	4,021
NFA of Serbia	19	233	540	535	-240	131	1,859	2,620	249
Commercial banks, net	-258	-348	-533	-1,223	-591	-1,469	-1,468	-1,737	-24
Gross foreign reserves	-89	-3	-27	-29	-190	-191	-36	-77	-14
Foreign liabilities	-169	-345	-506	-1,194	-401	-1,278	-1,433	-1,660	-10
NBS, net	278	581	1,072	1,758	350	1,600	3,328	4,357	274
Gross foreign reserves	273	568	1,167	1,860	388	1,421	2,945	4,083	-233
Foreign liabilities	4	13	-95	-102	-37	179	383	274	507
IMF	50	75	-61	-44	-38	173	375	567	187
Other liabilities	-46	-62	-34	-58	1	6	8	-294	320
NBS, NET RESERVES-STRUCTURE									
1. NBS, net	278	581	1,072	1,758	350	1,600	3,328	4,357	274
1.1 Commercial banks deposits	-56	-263	-441	-904	-270	-1,133	-1,401	-1,485	-148
1.2 Government deposits	-98	46	-45	-95	-27	97	-993	-1,089	63
1.3 NBS own reserves (1.3 = 1 - 1.1 - 1.2)	123	364	587	759	53	564	933	1,783	188

Source: NBS.

Note: NBS fx liabilities are treated differently in the monetary survey and in NBS balance sheet. In the monetary survey, this category includes IMF credits and other foreign liabilities. In the NBS balance sheet, however, it also includes commercial bank's fx deposits (reserve requirements funds and other fx deposits).

9. Financial Markets

The number of performed transactions on the stock market in Q1 2007 doubled relative to the previous quarter, while the dinar-denominated turnover grew by 13.44%. The growth is attributable mainly to the continuously traded stock. The number of performed transactions went up by 115.61%, and the dinar-denominated turnover increased by 20.55% against Q4 2006. The higher turnover was, in all probability, driven by domestic investors, this time with a significant contribution by individual investors. In March 2007, Wiener Börse (the Vienna Stock Exchange) launched a new index, SRX, based on the shares of the Belgrade Stock Exchange. SRX, as well as both official indices, BELEXfm and BELEX15, recorded a rise in Q1 2007 and reached new all-time highs. Relative to the previous quarter, BELEXfm grew by 19.67%, and the index of the most liquid shares, BELEX15, by 49.62%. The NBS continued to pursue the policy of cuts in nominal yields on 2w repos, which dropped to 10.5% at the end of Q1, while at end-May they stood at 9.5%. Real yields on repos also fell and, measured against inflation, they ranged from 8% to 5%. The drop in yields on FFCD bonds continued in this quarter as well, with these bonds losing up to 23 basis points. The exception was, as usual, the bond with the shortest maturity, A2007, which, against Q4 2006, grew on average by 121 basis points. The turnover on the FFCD bond market fell in this quarter, after a strong surge in Q4 2006. Since foreign investors' participation on this market increased significantly in March – from 3.42% in February to 23.05% in March – it seems that this time domestic investors were responsible for the decline in the turnover.

The trading volume growth trend continued in Q1 2007

The stock market in Serbia in Q1 2007 continued the uninterrupted growth trend that started in early 2006 (Graph T9-1). Relative to the previous quarter, the number of performed transactions went up by as much as 104.72%, while the total dinar-denominated turnover recorded a rise of 13.44%. On a 12-m basis, relative to Q1 2006, the number of performed transactions rose by 125.34%, and the dinar-denominated turnover grew by 178.74%.

The activity of individual investors grows..

The high increase in the number of transactions and a much lower increase in the volume – indicate that trading by small, individual investors has increased. The average value of a transaction in Q1 2007 amounted to around 590,000 dinars, which was some 45% less than in the previous quarter, when it amounted to about 1,650,000 dinars. Data on foreign investors' participation on the stock market shows that domestic investors were driving the increased turnover (see part on foreign investors' participation at the end of the text).

...and they are increasingly present on the demand side

An important novelty is that domestic individual investors, unlike in the previous periods when they were mostly on the supply side, started increasingly to appear on the demand side. Among other things, this had a stabilizing effect on the market. Specifically, due to the larger number of investors, the density of sell and buy orders increased. This is why share prices can be more precisely formed, which increases the operating efficiency of the market. Likewise, it has also been noticed that, in all likelihood, individual investors are much more sensitive to new developments, which could also be observed during the period of political instability in May (of which more in the next issue of Quarterly Monitor).

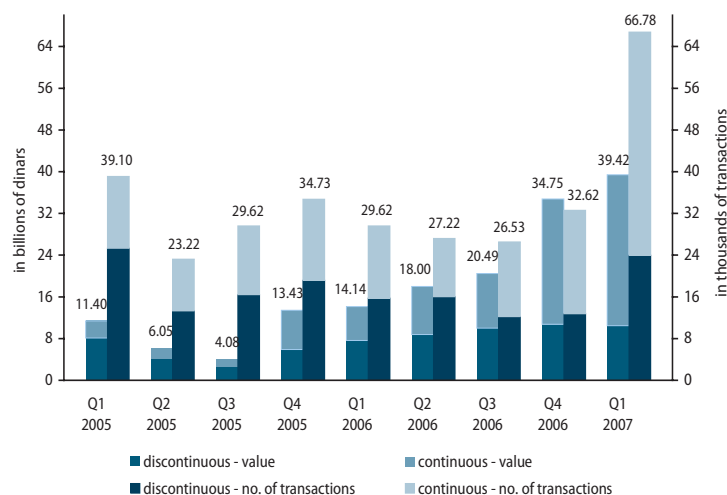
Continuous trading underlies the upward trend in trading on BELEX.

The structure of trading shows that most of the credit for the higher volume on the stock market in Q1 2007 goes to the continuous trading segment. Some 43,000 transactions were performed on this market segment in Q1, with a total value of around 29 bn dinars. Relative to Q4 2006, this was by 115.61% more transactions and by 20.55% higher turnover in dinars – as many as three times more performed transactions and a four times higher dinar-denominated turnover than in Q1 2006. On the other hand, in discontinuous trading, 50% more transactions were performed, whose total value was higher by around 40% than in Q1 2006. Relative to the previous quarter, the discontinuous market segment did record a rise of 87.81% in terms of the number of performed transactions, but their value in dinars fell by 2.46%.

If the most active shares are observed throughout the quarter, it is noticeable that they still account for more than one-half of the total turnover on the continuous market segment. The basket of five

shares, which were always at the top of the market in Q1 2007 by trading volume,¹ achieved a turnover of around 17 bn dinars, which was nearly 59% of the total dinar-denominated turnover on the continuous market segment. Of them, one share alone, AIK Banka a.d. Niš (AIKBN), accounted for as much as 20% of the turnover on the continuous market. Interestingly, the shares of Belgrade's Komercijalna Banka a.d. (KMBN), which had been among the top five in terms of volume from the beginning of trading (on average, even occupying the high second position), fell to the ninth place during January and February 2007, only to drop out completely from the top ten group in March.

Graph T9-1. Stock Trading Volume, Value and Structure, 2005–2007



Source: www.belex.co.yu.

Both official indices of the Belgrade Stock Exchange continued their rise in Q1 2007 (Graph T9-2). Relative to the previous quarter, the BELEXfm index went up by 19.67% and reached its new all-time high of 2532.40 index points on the last day of the quarter. On that same day, the BELEX15 index also reached its new all-time high of 2956.67 points, thus recording an increase of 49.62%. The stock market grew very strongly over the past year. The BELEXfm index had a

growth of 48.76% against Q1 of the previous year; an investor who invested in the most liquid shares of the Belgrade Stock Exchange increased his investment by 2.5 times since the relevant index, BELEX15, went up by 158.30% against Q1 2006. During April and May, all indices continued a trend of somewhat more moderate growth and reached new all-time highs. In mid-

Box 1. New Indices of the Belgrade Stock Exchange

As of 7 March, the Vienna Stock Exchange offers its investors a new index, SRX, based on the shares of companies traded on the Belgrade Stock Exchange. The SRX index is a price index weighted by the market capitalization, calculated on the basis of a basket of the top eight shares, which are also the most liquid on the Belgrade Stock Exchange, and in three currencies: RSD, EUR and USD. The basket comprises the shares of: Komercijalna Banka, AIK Banka, Agrobanka, Metals Banka, Univerzal Banka, Energoprojekt Holding, Privredna Banka and Soja Protein. SRX was created as an index to be traded and used as a basis for structured products and standard financial derivatives. The index is expected to contribute to increasing the liquidity of the Belgrade Stock Exchange, as well draw the attention of international investors to the Serbian capital market.

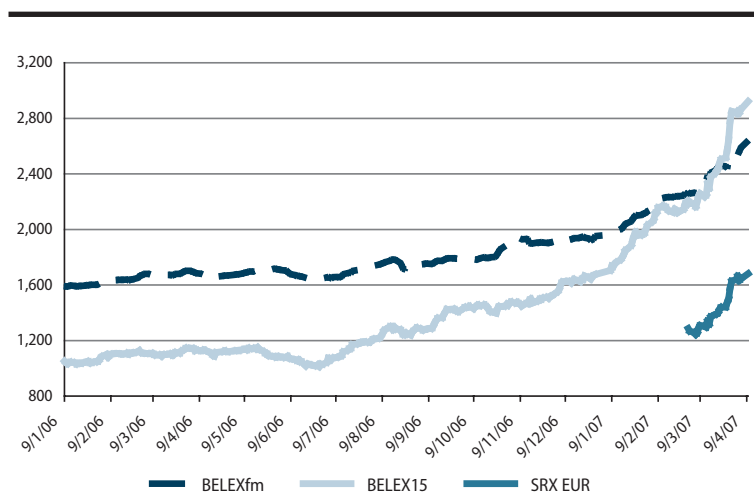
As of this issue, *Quarterly Monitor* will be tracking the movements in the SRX EUR index. After its introduction in early March, this index rose by around 30% in one month. As in the case of the Belgrade Stock Exchange indices, it reached its maximum value in Q1, 1628.53 points, on the last day of the quarter, only to arrive at 1680.64 index points before 10 April. The movements in the SRX index are generally very positively correlated with the BELEX15 index, which is logical as all the shares from the SRX basket are also in the BELEX15 basket.

The Belgrade Stock Exchange has also started to calculate a new index since 2nd April, BELEXline, which has completely replaced BELEXfm. The last calculation of BELEXfm was made on 30th April. There will be more details on this new index in the next issue of *QM*.

An upward trend on the stock market and new all-time highs of all indices

May, a temporary slump occurred in their value due to the political instability in the country. This showed the increased efficiency of the domestic market, which responded quickly to new political circumstances.

Graph T9-2. BELEXfm, BELEX15 and SRX EUR Indices, 2006–2007



Source: www.belex.co.yu.

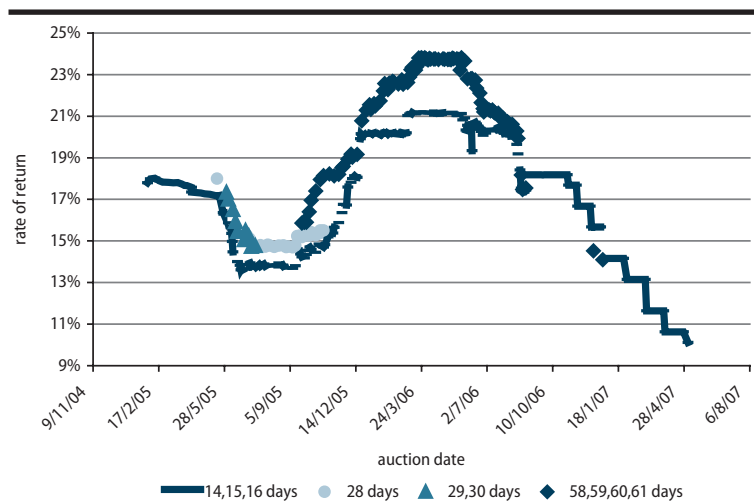
Financial intermediation, particularly banking, still ranked first in terms of market capitalization and continued growing. At the end of Q1 2007, this sector realized a capitalization of around 437 bn dinars, almost two times more than at the end of Q4 2006.

In 2007, the first domestic investment funds appeared on the domestic capital market. Two are at present: Delta Plus, managed by the Delta Investments a.d. company of Beograd, and FIMA ProActive, under the management of FIMA Invest a.d. Belgrade. Delta Plus is an *open-end balanced fund*, while FIMA ProActive is an *open-end growth fund*. The former started to trade on 26 February, and latter on 7 May 2007, and at end-May they reached the values of the investment unit of 1,366.23 and 1,072.71 dinars, respectively.² As of the next issue, *QM* will be monitoring and analyzing developments related to these two funds.

The NBS continued cutting the reference interest rate on 2w repo transactions, which started in late August 2006³. The year began with a rate of 14%, which was adjusted by the NBS three times in Q1, to 13%, then to 11.5% and to 10.5%, only to fall to 9.5% in mid-Q2 (Graph

The NBS continued to cut the reference rate on 2w repos

Graph T9-3. Repo Yields, 2004–2007 (by maturity)



Source: NBS.

T9-3). As for two-month repo instruments, they have not been offered in NBS auctions since December 2006, when two auctions were held and brought yields of 14.53% and 14.10%.

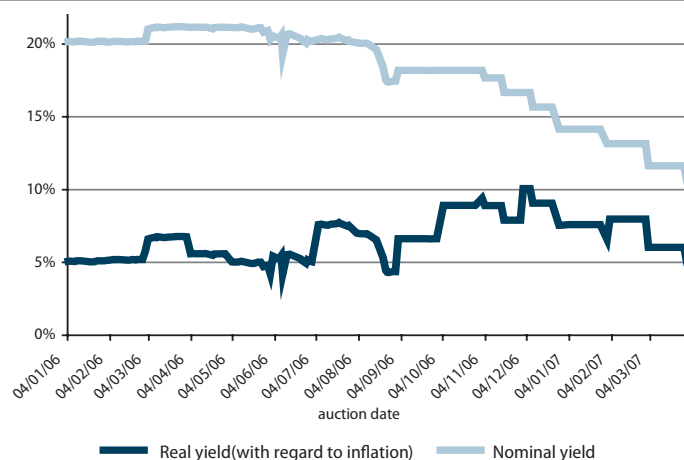
In Q1 2007, the stock of repo instruments was reduced by around €126 mn. On the other hand, investments in NBS securities, with a maturity of 182 days, sold by the method of outright sales, went up by around €320 mn (see Box 3 in Section 8, *Monetary Flows and Policy*). The stock of NBS securities in total increased relative to the previous quarter by around €200 mn, while in Q4 2006 the increase in the stock of these securities against the end of Q3 2006 was around €900 mn. The reason for the slackening of interest on the part of investors lies in the fact that the drop in nominal yields on repo instruments was coupled with a drop in real yields due to the

² The initial value of the investment unit in both funds amounted to 1,000 dinars.

³ The NBS Memorandum of 30 August 2006 made the 14-day (2w) repo instruments the key monetary instrument whose return rate is set by the NBS as a fixed rate.

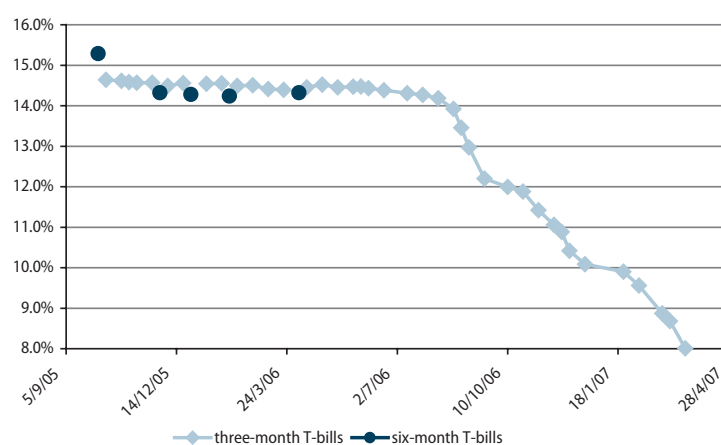
dinar ceasing to appreciate and the relatively stable inflation rate (Graph T9-4). In Q4 2006, real yields on repo instruments, measured against inflation, had ranged between 7.5% and 10%, whereas in Q1 2007 they dropped to the band ranging from 5% to 8%.

Graph T9-4. Real (relative to inflation) and Nominal Repo Yields, 2006–2007



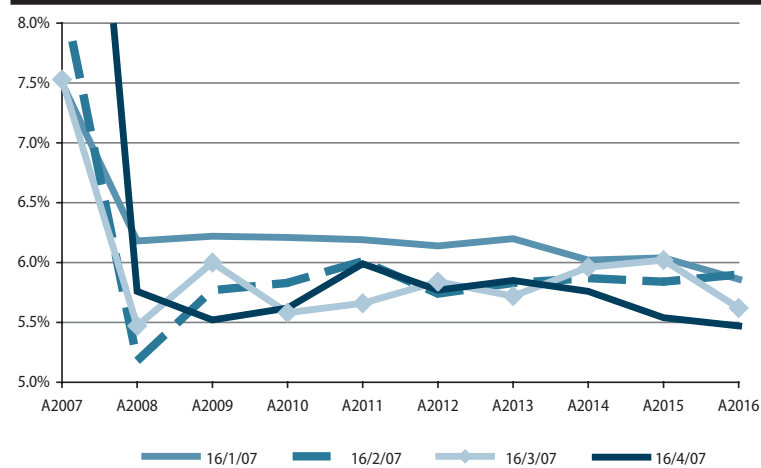
Source: NBS.

Graph T9-5. Yields in T-Bill Market, 2005–2007



Source: Ministry of Finance.

Graph T9-6. FFCD Bonds Yield Curves



Source: www.belex.co.yu.

Yields on the Republic of Serbia's treasury bills continued to fall in Q1 2007 (Graph T9-5). The highest yield of 9.90% was achieved in the auction of 23 January, and the lowest, 8%, in the auction held on 20 March. The values of three-month T-bill issues were either 500 mn or 1 bn dinars, while six-month T-bills were not offered in Q1 2007 either. The total nominal value of all T-bills issued in Q1 amounted to 4 bn, or 1 bn less than in Q4 and Q3 2006.

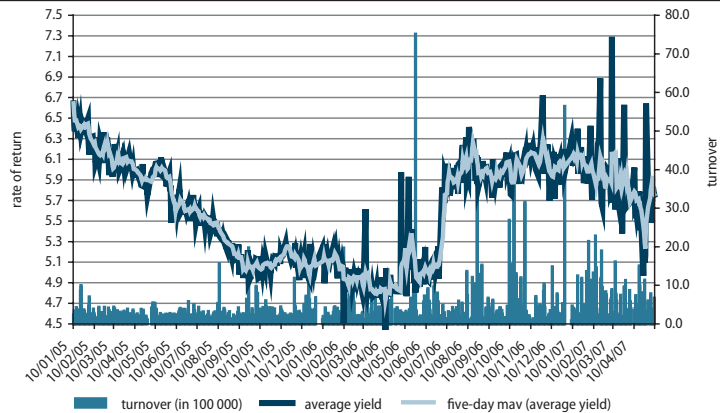
The drop in FFCD bond yields that started in late Q4 2006 continued in Q1 2007 (T9-7). A rise was recorded only in the case of the bond with the shortest maturity, A2007, while yields on bonds with longer maturities dropped. The average yield on A2007 in Q1 went up by 121 basis points, while A2008 to A2016 bonds recorded a decline in yields ranging from 3 basis points to 23 basis points, depending on the maturity. There is no obvious correlation between the maturity dates of FFCD bonds and the size of the drop in their yields. Thus, the A2008 and A2010 bonds lost about 16 basis points and 17 basis points respectively, while A2009 recorded a drop of only 3 basis points. April saw a further rise in the average yield of 390 basis points on A2007. The high yields on A2007 are primarily a

consequence of the close maturity date of this bond, as investors want a higher yield in order to cover transaction costs⁴.

In Q1 2007, the turnover on the FFCD bond market declined by 10.74% relative to the previous quarter, while against the same period last year it increased by 77.24%, so that the turnover in this quarter amounted to around €35.6 mn. As for the volume, it also fell relative to Q3 2006, by 8.22%, while against Q1 2006, it went up by 86.79% and amounted to around €51.6 mn⁵.

Graph T9-7. Average Yields on FFCD Bonds¹⁾, 2005–2007

The average yield on FFCD bonds dropped in Q1



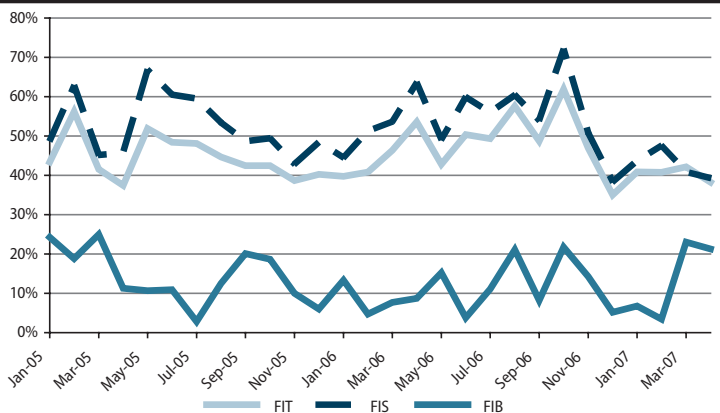
Source: www.belex.co.yu.

1) The graph depicts average values, excluding the extraordinary yield of 42% on the A2006 bond of 10 March 2006.

Note: The graph was constructed as a weighted average of yields on A2006 to A2016 bonds. The weights were the values of turnover for each of the bonds.

Graph T9-8. Foreign Investors' Participation Rates, 2005–2007

Foreign investors' participation on the FFCD bond market has increased since February



Source: www.belex.co.yu.

FIT - Participation of foreign investors in the total turnover, FIS - foreign investors on the stock market, FIB - foreign investors on the bond market.

investors' participation on the FFCD bond market, it seems that domestic investors were the ones who were leaving this market.

It is interesting to note that in the first four months of 2007 there was an almost perfect negative correlation between the series that reflect the movements in foreign investors' participation on the stock market and on the bond market. When that participation was rising on one market, it was falling on the other, and vice versa. This phenomenon had been noticed before, or to be more precise, from the beginning of the measuring up to Q3 2006. Q3 and Q4 2006 saw a turnaround, and foreign investors' participation on both markets had very similar trajectories.

The participation of foreign investors in the total turnover on the stock market was on the rise at the beginning of 2007 relative to December 2006 (the FIS curve, Graph T9-8), but in terms of averages, their participation in Q1 2007 against Q4 2006 declined by almost 10%. Since the share turnover went up by 13.44% relative to the previous quarter, it can be said that foreign investors' participation dropped in absolute terms and that the increased turnover was driven by domestic investors. On the FFCD bond market (the FIB curve, Graph T9-8), the participation of foreign investors reached the lowest value since July 2005, 3.42%, in February, only to rise to 23.05% in March, which was the highest since April 2005. As the volume on the FFCD market declined by 36% in March relative to February, and, in terms of absolute values, a significant increase occurred in foreign

4 See "Serbia's Financial Market: 2000–2005" Spotlight on: 4, QM1, 2005.

5 The actual volume on the FFCD bond market, despite the fact that it is denominated in euros, essentially constitutes the number of bonds that were traded, since the nominal value of one bond is one euro.

SPOTLIGHT ON:

Is Energy Efficiency Attainable without Disproportionate Costs for Serbia? Potential Gains from the Kyoto Protocol

Sonja Avlijaš

Serbia's economic decision-makers seem to be unaware of the economic benefits the Kyoto Protocol can bring to the country, and while most European governments are making global warming their top priority, Serbia has not even signed the Protocol. Being classified as a developing country under the Protocol, Serbia is missing out on the opportunity to participate in the international market for carbon trade, and through being a net seller of carbon credits, finance improvements in the country's energy efficiency, that way boosting its international competitiveness. The paper uncovers the mechanisms through which Serbia can benefit from the ratification of the Kyoto Protocol and estimates these benefits in a quantitative fashion.

Introduction

The Kyoto Protocol should be an economic priority for the Serbian government, rather than solely an environmental one. The key argument is that through the ratification of the Protocol, the international market in CO₂ trade would open up for Serbia, and together with it, a potential for low cost improvements in the country's energy efficiency, it being an essential prerequisite for technological progress and continuous economic growth. As over the last decade the developed countries have intensified their efforts to reduce greenhouse gas emissions, responsible for the man-induced aspect of global warming, market-oriented mechanisms for curbing emissions have been established. Having a legal burden to reduce air pollution, the developed countries have become net buyers of carbon credits in the growing international carbon market, whereas the countries whose governments are not obliged to reduce emissions, i.e. the developing countries, have become net sellers of carbon credits. Because of this market mechanism, reduction of greenhouse gas emissions and improved energy efficiency in a developing country can be self-financed once the country ratifies the Kyoto Protocol. Therefore, a sound environmental policy leading to the ratification can lead to favorable economic outcomes in a transition economy like Serbia, plagued by a high level of energy inefficiency as well as high carbon intensity of its energy, since the country is still treated as a developing nation by the international community. This paper therefore starts with the overview of international market-oriented mechanisms established for the prevention of global warming, as well as the analysis of the trends in the international carbon market. It thereupon discusses the potential role of Serbia in the international endeavors to reduce greenhouse gas emissions and presents the economic benefits the country stands to gain from international cooperation on this major global concern.

Global Warming and International Prevention Mechanisms

Global warming represents the increase in average temperature of the Earth's atmosphere and oceans, and its projected continuation is expected to produce dire consequences for humans through rising sea levels, water scarcity, destroyed habitats, adverse health effects from warmer temperatures, and the spread of disease, to name but a few. Among the factors that promote

warming of the Earth's atmosphere are greenhouse gases, released primarily through the combustion of fossil fuels, industrial processes and land use changes. Greenhouse gases include carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF₆). Since reducing GHG emissions is not an easy endeavor, serious international efforts have been mobilized in order to tackle global warming. The main outcome of these efforts is the Kyoto Protocol, an international agreement, which builds on the United Nations Framework Convention on Climate Change (UNFCCC), and sets legally binding targets and timetables for cutting greenhouse gas (GHG) emissions of the industrialized countries. Kyoto represents the first international venture to reduce GHG emissions, and it is the largest international regulatory framework for GHG trade, since each country that ratified it incorporated its obligations into their national law. The Kyoto Protocol came into force on February 16, 2005, and it now covers more than 163 countries and over 55% of global greenhouse gas emissions. The first commitment period of the Kyoto Protocol is 2008–2012, but it is almost certain that it will be extended, since all of the signatories continue to be extremely concerned with climate change and committed to tackling it. The signatory countries are separated into two general categories:

i) Annex I countries (mostly developed countries) which have taken on the international obligation to reduce their GHG emissions. They are therefore committed to reducing their annual emissions in the 2008–2012 period by around 8%¹ in relation to their emissions' level in 1990, because 1990 was chosen to be the baseline year for measuring and faring countries' annual GHG emissions²;

ii) Non-Annex I countries (mostly developing countries) which are not obliged to reduce their GHG emissions, because they are “allowed” to grow and develop. Serbia would be classified under this category of countries when it ratifies the agreement. Even though Non-Annex I countries are not legally bound to reduce their emissions, they can participate in the Clean Development Mechanism of the Kyoto Protocol, which entails hosting projects to reduce current or future carbon emissions so that these reductions both help the sustainable development in the developing countries as well as contribute to the developed countries efforts to fulfill their emission quotas. The mechanism is described in further detail below, but the main idea behind the mechanism stems from the fact that it is more cost-effective to reduce carbon emissions in developing countries whose technologies and production processes are obsolete and inefficient than in the developed countries, that way contributing to the global combat against the warming of the Earth's surface.

All of the countries that have ratified Kyoto need to maintain national greenhouse gas (GHG) inventories, and the Annex I (developed countries) national governments thereupon allocate GHG emission allowances to their industry. These emissions targets, which for most companies are difficult to reach due to the negative effects of such constraints on production, in turn generated a vibrant market for GHG emissions trade, more popularly called the carbon market^{a)}. The mechanism of carbon trading is the following: the industrialized countries committed to reducing their GHG emissions can, instead of reducing their emissions, offset them by purchasing carbon credits from countries/companies whose emissions were below the obligatory requirements. Moreover, they can invest into projects that reduce GHG emissions in the developing countries (e.g. projects that improve energy efficiency), through the Clean Development Mechanism of the Kyoto Protocol and thereupon acquire credits for the amount of GHG emissions the project will have reduced for the period of around 10 years from the date of project implementation^{b)}. Of course, these projects and their effect on emissions are seriously evaluated by the UN before they are certified. In addition, international carbon funds have been set up by multilateral institutions, such as the World Bank, which invest into greenhouse gas

a) The remaining five greenhouse gases are converted to CO₂ units, and then also traded.

b) See De Klerk 2007.

¹ Reduction requirements are negotiated by each country individually, thus, for example, Russia and Ukraine are expected to maintain their emissions at the 1990 level, whereas EU15 have around 8% reduction commitment with respect to 1990.

² The more recent Eastern European EU members had the discretion to choose an earlier baseline year, since with the fall of the Iron Curtain in 1989, their industrial production levels in 1990 were significantly below their actual capacities, making 1990 an unfair baseline year for them.

reduction projects in the developing countries and then accordingly trade the generated carbon credits in the carbon market for their own profits. Finally, the government of a Non-Annex I country (developing country) can invest into a local GHG reduction project on its own, and then sell the acquired carbon credits in the international market. However, in order to be able to do this, the developing country needs to have ratified the Kyoto Protocol, and have the adequate implementation and enforcement mechanisms in place.

Even though the Kyoto Protocol will become legally binding for all parties only in 2008, there is an abundance of mechanisms and trading already in place, since industrialized countries developed their own regional trading mechanisms in order for their industries to maintain a competitive edge once the Kyoto targets become binding by international law.

For example, the European Union's Emissions Trading Scheme (EU ETS) commenced on January 1, 2005, creating the world's first multi-country emissions trading system and the largest scheme ever implemented. It is a mandatory, market-based system and helps ensure that the EU meets its Kyoto target. The EU ETS runs in two phases: 2005-2007 (Phase I) and 2008-2012 (Phase II, coinciding with the first commitment period of the Kyoto Protocol). European Climate Exchange (ECX) was set up consequentially in order to provide its European clients with a pan-European platform for carbon trading. More than 70 leading businesses, including global companies such as Barclays, BP, Calyon, E.ON UK, Endesa, Fortis, Goldman Sachs, Morgan Stanley and Shell have signed up for membership to trade carbon at the ECX. In addition, several hundred clients can access the market daily via banks and brokers^{c)}. The European commission and the United Nations provision to link the ETS to the international carbon market before December 2007, in order to allow EU based trade in carbon credits from emission reduction projects^{d)}.

Industrialized countries that have not ratified the Kyoto Protocol, such as the United States, also participate in carbon trade because they established voluntary trading schemes, such as the Chicago Climate Exchange, which is a self-regulatory, rules-based exchange designed and governed by its members. Members make a voluntary but legally binding commitment to reduce GHG emissions, in order to maintain their competitiveness in the growing global market for low-carbon solutions, as well to improve their social corporate responsibility image with their customers. Furthermore, *leading US financial investors joined hands with some of the country's largest companies and urged the federal government to follow Europe by setting mandatory targets to reduce US greenhouse gas emissions*, since in the absence of strong federal leadership there is a risk that US businesses may get left behind in terms of their competitive edge when it comes to energy efficiency^{e)}.

Besides Europe and the United States, other industrialized countries such as Australia, Japan and New Zealand, either already have established trading schemes or are in the process of setting them up.

The Carbon Market

Trading greenhouse gas emissions is one of the prime examples of using a market-based mechanism for environmental protection. Carbon trading gives companies the flexibility to meet emission targets set by their national governments according to their own strategy - thus offering the most cost-effective way for energy and carbon intensive industries to meet their obligation to reduce emissions. The CO₂ emissions market is rapidly growing, and most of the world's major banks such as Goldman Sachs Group Inc. and Morgan Stanley are already well established in it. Citigroup Inc., the largest US bank, entered the market last year, and they have since expressed great regret for not entering earlier^{f)}.

The carbon market is different from other commodity markets to the extent that carbon emissions or credits cannot be stocked and rolled over to the consecutive years, but they have to be used during the current year. This is because the emissions reduction mechanism works towards reducing *annual emissions* by the agreed percentage in relation to 1990^{g)}. Therefore, each year, annual emissions are fared to 1990 independently, making it impossible to speculate in the market on the account of, for example, a warmer winter in a country in one year.

c) See *European Climate Exchange*.

d) See *"EU and UN on path to link carbon market by 1 December" 2007*.

e) See *"US investors join business to call for emission cut" 2007*.

f) See *"Citigroup to Trade European Gas, Power to Compete With Goldman" 2007*.

g) See footnote 1.

h) See "Carbon market to grow 50% in 2007" 2007.

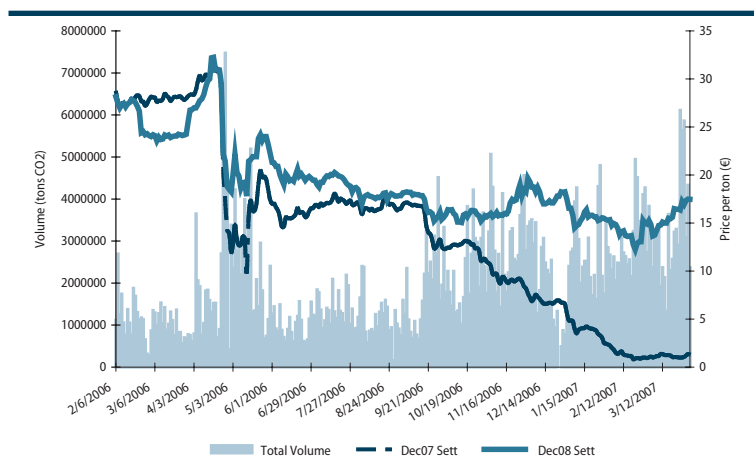
i) See "Carbon market to grow 50% in 2007" 2007.

j) See "Money flow to carbon funds sector swells to \$11.8 billion" 2007.

Trade volumes in the global carbon market are set to grow by 50% in 2007. Some 2.4bn tons of carbon dioxide equivalent (CO₂e) are expected to be traded in 2007, up from 1.6bn tons in 2006, according to Point Carbon's *Carbon 2007* report^h). The value of transactions in the carbon markets is forecast to grow much less dramatically between 2006 and 2007, despite higher volumes, given lower average carbon prices in 2007 compared to 2006.ⁱ) The European Climate Exchange, Europe's main trading platform for carbon futures and options traded almost 50% of its entire 2006 volume in Q1 of 2007. Money flowing into the carbon fund sector grew by €3.5 billion over the past six months to total €9 billion, thanks in part to 12 new funds entering the carbon market. The private sector accounted for nearly 90% of the new money flowing into the market over the past six months, including a €2.3bn commitment to the carbon markets from investment bank Morgan Stanley. Less than half (42%) of the total money committed to the carbon markets is now for direct compliance purchasing, with the remaining amount (58%) being invested in developing the projects required to generate carbon credits.^j)

In the European carbon market, which is currently the most dynamic one, during 2006 the average December 2006 futures contracts' price was €17.90 per ton, whereas the average December 2008 futures contracts' price was €20.43 per ton. In Q1 of 2007, the average December 2007 futures contracts' price was €2.11 per ton, whereas the average December 2008 futures contracts' price was €15.16 per ton (see Graph 1). Powernext Carbon, which is currently Europe's leading spot exchange with more than 60% of market share in Europe, has been recording very low spot prices for carbon ever since mid 2006 (see Graph 2). Therefore, the current trend in the carbon market is that while the futures price for the end of 2008 is not dropping very much, the spot price of carbon has plummeted over the last year.

Graph.1. ECX CFI Futures Contracts: Price and Volume



Source: European Climate Exchange, accessed on: March 20, 2007.

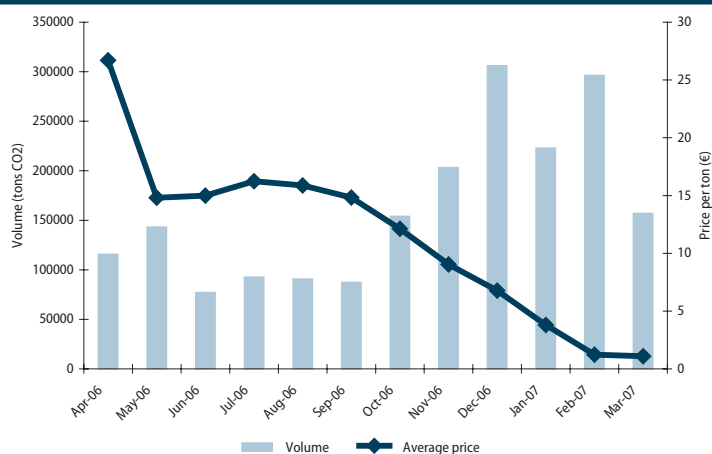
It is argued that the hasty set-up of the EU's trading scheme resulted in the over-allocation of carbon credits in the current phase, which thereupon caused the price of a ton of CO₂ to drop to around €1. This divergence between the present (around €1) and the December 2008 forward price of carbon – standing at over €15 per ton in Q1 of 2007 indicates that the price of CO₂ is expected to rise in 2008.

This price increase is not surprising since the Kyoto Protocol is becoming legally binding for all Annex-I countries as of 2008, and it is also the reason why most of the world's leading banks and businesses are entering the market.

k) See World Bank 2006.

World Bank's 2006 report on the carbon market^k) documents that price signals in the carbon markets have stimulated innovation, especially in developing countries, since *a new urgency enveloped business managers in developing countries* last year who got an economic incentive to reduce emissions. Along those lines, the Deputy Executive Secretary of the UN Climate Change Secretariat warned that countries that have not ratified the Kyoto Protocol may miss out on a potential market opportunity. Chancellor of the Exchequer of the United Kingdom, Gordon Brown, declared that the innovation of carbon trading offered a way to reinforce economic and environmental objectives simultaneously, and that carbon saving could be a way of making money and increasing returns on investment. He also argued that it made economic opportunities of a climate-friendly energy policy real and tangible^l).

l) See Aziakou 2006.

Graph 2: Spot Market: Monthly Prices and Volumes, 2006–2007

Source: Powernext, accessed on: March 20, 2007.

Advantages of the Kyoto Protocol for Serbia

In light of the presented evidence, it would make economic sense for Serbia to sign and ratify the Kyoto Protocol. Serbia and Bosnia and Herzegovina are the only two countries in the region that have still not signed or ratified the Kyoto Protocol^{m)}. FYR Macedonia ratified it in 2004 and Albania in 2005, and the most recent parties to ratify it were Montenegro in March and Croatia³ in April 2007. Moreover, all the new members of the EU⁴ had to ratify it as one of the accession prerequisites. Even though those parties that have not signed the Kyoto Protocol may accede to it at any time, not much public or political attention has been given to the Kyoto Protocol in Serbia, apart from referring to it as one of the numerous prerequisites for EU accession, and at times even as one of those “regrettable necessities” of development. During 2005 there has been some talk over “intensive preparations” for the signing and ratification, and even a Ratification Law has been drafted, but due to the lack of clear state priorities as well as burdensome procedures when it comes to law passing, the government has not shown serious commitment to adopting it yet. In the meantime Serbia is missing out on a rapidly growing market opportunity for CO₂ emissions trade. Since Serbia will be listed as a Non-Annex I country once it ratifies the Protocolⁿ⁾, it will be eligible to participate in the Clean Development Mechanism, which implies that it will be able to cash in the carbon credits acquired from reducing GHG emissions in the international carbon market through the Clean Development Mechanism presented in this paper.

In case Serbia’s status is shifted to Annex I, there would still not be any economically adverse consequences, since the country would not need to reduce its emissions. CEVES estimates its current emissions to be well below the Republic’s 1990 levels (over 30% less)^{o)}. It would instead be in a position to trade “hot air” (the difference between 1990 and the current level of emissions), until it reaches its 1990 emissions level⁵. Besides emissions trading, Serbia would also be able to continue hosting greenhouse gas reduction projects through the Joint Implementation mechanism of the Kyoto Protocol, which functions under the same principal as the Clean Development Mechanism, but is exclusively accessible to Annex I countries, which have reduction commitments.

Although an official greenhouse gas emissions inventory does not exist in Serbia, the most recent data from the International Energy Agency indicate that Serbia and Montenegro^{p)} emitted around 53 million tons of CO₂ in 2004 (plus other greenhouse gases). CEVES estimates that around 30%

m) A party can sign the Protocol, without at the same time consenting to bringing it into force, i.e. ratifying it.

n) Until the beginning of its official EU accession negotiations, or until the end of the first phase of the Protocol in 2012.

o) CEVES’ estimate is based on United States’ Energy Information Administration data.

p) Montenegro’s share of the emissions is very small, estimated at around 3 tons.

3 Croatia belongs to the Annex I category, because it is in official EU negotiations.

4 Including Bulgaria and Romania

5 Or alternatively until it reaches the negotiated level of emissions, since as we explain earlier, Russia and Ukraine, who are Annex I countries, are committed to maintaining their emissions at their 1990 levels, rather than reducing them, whereas old EU members are committed to reducing their emissions by 8%.

q) According to International Energy Agency 2004 data.

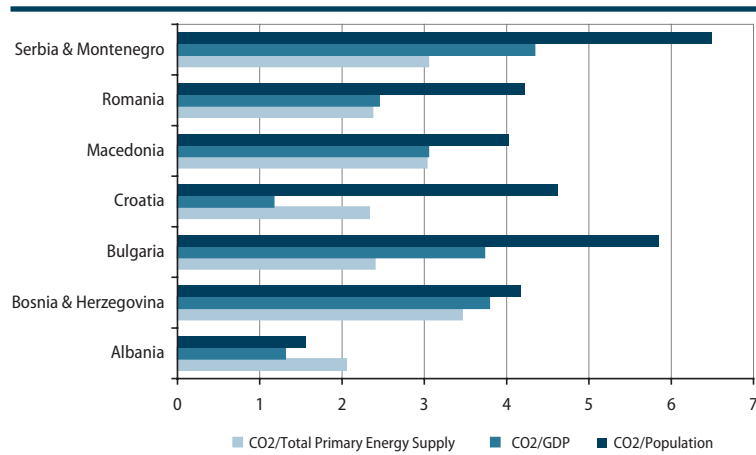
of annual emissions are generated by the Electric Power Industry of Serbia (EPS) alone⁶, from fossil fuel combustion (75% coal; 8% crude oil and gas; the rest is hydro and renewables^{q)}) used in electric energy production. With CO₂ being a tradable commodity in international markets, it is important for Serbia to understand that nowadays air pollution is an economic asset, rather than simply a negative externality of production processes. Therefore, with the average December 2008 futures contracts price of around €20 per ton of CO₂ in the European market, the total monetary value of Serbia's annual CO₂ emissions stands at around €1bn. This is to say that in case Serbia would have zero annual emissions, it could earn €1bn per year in the international carbon market. Even though zero emissions would obviously be unattainable, through this stylized example, we want to emphasize that every reduction of annual greenhouse gas emissions that stems out of the improved energy efficiency or cleaner production processes could be sold in the international carbon market. In that manner, greater energy efficiency, which is crucial for competitiveness of any economy, can be self-financed through cashing in the greenhouse gas reductions that stem out of it.

r) Low carbon intensity can either come from clean energy sources (nuclear or renewables) or more efficient energy use.

When compared to the region, in terms of CO₂/Total Primary Energy Supply, CO₂/GDP as well as CO₂/Population, Serbia and Montenegro is worse in terms of carbon intensity^{r)} of its energy than other countries in the region (see Graph 3). Even though the last available internationally comparable data is from 2004, one of the highest growth rates in Southeast Europe (on average 6% over the last 3 years) and minimal improvements in energy efficiency indicate that GHG emissions in Serbia could have only grown since 2004 in relation to other countries in the region. When we compare Serbia to the EU countries^{s)}, all of the countries are less carbon intense, with Sweden leading the way, followed by Norway, Lithuania and France. Such positioning of Serbia in international carbon intensity rankings indicates that there is significant room for reduction of GHG emissions, through investment in modern technology and energy efficiency projects (e.g. renewable energy, technological advances).

s) See "EPS ulaže 3,2 milijarde evra u razvoj", 2007.

Graph 3: Carbon Intensity – Southeast Europe, 2004



Source: International Energy Agency, accessed on: April 23, 2007.
Note: GDP data were corrected with figures from the countries' official statistics.

Once greenhouse gas reduction projects such as energy efficient start-ups or technologies that make better use of the energy going into the system are implemented, CO₂ savings in the form of carbon credits can be sold in the international market by the investor (whether the investment is from a multilateral fund, a foreign/domestic company, or national government). Moreover, since Clean

t) See De Klerk 2007.

Development Mechanism projects generate carbon credits for around 10 years after their implementation^{t)}, they represent a medium term source of revenue from the carbon market, rather than a one-off market transaction. Through this system, even domestic banks or the Serbian government can enter CO₂ exchange platforms and trade on them in order to diversify their portfolios. By reducing air pollution through the money acquired from the international carbon market, Serbian government's scarce resources can be freed up from air pollution and energy efficiency projects (which are a major focus at the moment), and directed at other types of pollution, such as waste management and recycling that urgently need to be tackled.

6 Calculations based on Serbian Chamber of Commerce data for energy production inputs, applying methodology from: UK Department for Environment, Food and Rural Affairs 2003.

u) See "EPS ulaže 3,2 milijarde evra u razvoj", 2007.

The main single source of CO₂ emissions in Serbia - the state-owned Electric Power Industry of Serbia (EPS) plans to invest €3.2bn into the development of new and revitalization of the existing capacities by 2010^{u)}. In addition, they announced an investment of €60 million into air pollution reduction in 2007⁷. This is a significant fraction of resources that will go into improving energy efficiency of EPS over the next three years (around 4% of annual GDP each year), and the ratification of the Kyoto Protocol and obtaining access to the international carbon market can help to lower this cost. Through the following stylized scenario, we will attempt to explain the potential benefits of EPS joining the CDM. Let us assume that through the provisioned investment into new capacities, EPS will manage to reduce CO₂ emissions by 5mn tons per year in its production process. By entering the international carbon market through the Kyoto Protocol, it can sell these emissions as futures in the European carbon market, and that way EPS can earn around €1bn at current prices ('5mn tons per year' x '€20 per ton' x '10 years of emissions'), getting a higher return on its overall investment (in addition to improving the company's profitability from improved capacities). We need to take into account that this amount of carbon credits can be generated from only curbing CO₂ emissions, whereas five more gases (listed in the introduction) are internationally traded. An alternative is that an international fund or company is allowed to invest into improving EPS' efficiency instead, and let them leave with the generated carbon credits from emissions' reduction. This can prove to be an excellent mechanism of getting private investment into a state-owned power company like EPS and improving its efficiency, while leaving the actual company in the hands of the government. EPS has in fact provisioned to develop a strategy where they would identify potential CDM projects within the EPS system, as it is aware of the lost market opportunity as well as the exigent and costly need to improve EPS' efficiency, but its efforts are futile until the government ratifies the Kyoto Protocol^{v)}.

v) D Vukotic 2007, pers. comm., 7 May.

Besides the high level of carbon intensity of Serbia's electricity production processes, Serbia's electric energy prices are very low, i.e. subsidized by the government. In fact, they are among the lowest in Europe and Central Asia^{w)}. This is a legacy of socialism, where electricity prices were and still are too low to motivate Serbian energy consumers to undertake significant efficiency investments and the system itself makes it difficult for individuals to control their spending (e.g. with the centralized heating system, heat cannot be regulated to suit individual consumers' needs). Moreover, the electric power prices have been prevented from growing in the last couple of years because of the national policy of maintaining low inflation. Because of the low electricity price, companies have often been more focused on revenue expansion through increased production and sales, rather than boosting profits by reducing costs for inputs such as energy. Once electricity prices start rising due to market forces, which is bound to happen, Serbian companies' competitiveness in international markets will be threatened by a high level of energy inefficiency.

w) According to Energy Information Administration data.

According to the European Bank for Reconstruction and Development's **Energy Policy Report** for 2006, "transition countries' energy needs are projected to rise by 60-80% over the next 20 years. In most, energy efficiency is their biggest potential source of new energy supply, since only four of the 27 countries are rich in oil and gas."^{x)} With the volatility of world oil and gas prices, and Serbia's domestic oil extraction amounting to only 1/5 of the country's yearly consumption, as well as only 1/4 of its gas consumption coming from domestic sources, it is of the country's vital interest to boost its overall energy efficiency.

x) See European Bank for Reconstruction and Development, 2006.

Moreover, when we examine the fiscal burden of EU accession to the 10 newly accessed members, in most cases, the largest part of the costs are expected to fall on the private sector and should not trigger substantial public expenditure, the exception being environmental policy^{y)}. Therefore, if most of the fiscal burden will come from the implementation of environmental policy, Serbian government should not miss on the existing chance of improving its current environmental circumstances (predominantly air pollution) while it is still classified as a Non-Annex I country under the Kyoto Protocol and has no reduction obligations. Moreover, as a significant share of

y) See Hallet 2004.

7 See "EPS: Za ekologiju 60 miliona evra", 2007

the overall cost of EU accession will fall on the private sector, carbon trading should be identified as a unique opportunity to improve competitiveness of Serbian companies, rather than let them become overwhelmed with costs once the accession takes place.

Conclusion

The key point of this paper is that Serbia can turn its energy inefficiency into a competitive advantage in the global carbon market. Naturally, each market has its idiosyncratic risks, but the carbon market appears to be quite risk-free for the developing countries, since the only risk in case of a unilateral investment is the loss of additional profits from carbon credits, rather than loss of the capital which would have to be invested anyway. In the case of bilateral or multilateral investments, the investor bears the entire risk. The only burden would be the necessary administration to approve such projects, which is cumbersome as the standards for project approval are strict, but it is certainly a worthwhile effort.

Improvements in energy efficiency through the international carbon market can therefore result in: i) attracting new technology, ii) encouraging industry towards innovation, iii) improving the competitiveness of industry, and iv) stimulating long-term growth. The global market on greenhouse gas emissions therefore represents a tangible chance for Serbia to improve its energy efficiency, which is vital for long term sustainability of its economy. By attracting investment into energy efficient projects, Serbia can benefit from an excellent and innovative mechanism for much needed investment. Moreover such investments can have very positive effects to the economy, in case they bring about technological progress, and that way boost long term economic growth. Businesses adopting clean energy projects will become more profitable, since they will reduce their energy bills, and their products will become more competitive in the Western markets, due to reductions in production costs as well as the popularity of environmentally friendly production processes among the consumers in the Western markets. Therefore, the Kyoto Protocol could represent an important vehicle for economic growth whose benefits should be seriously considered by the Ministry of Mining and Energy and the Ministry of Economy, as well as the Serbian Agency for Energy Efficiency, rather than solely by the Ministry of Environment.

Finally, the ratification of the Kyoto Protocol would also signal to the international community Serbia's willingness to be up-to-date with world socio-economic trends and be able to use them to its advantage, that way improving the country's investment climate. It is therefore economically irrational and intolerable that slow decision making and bureaucracy of the Serbian government have been halting the process of ratification for over two years now, and this is why the new government must ratify the Kyoto Protocol as soon as possible, in order for the country's energy and industry sectors to start exploiting the economic benefits of the Kyoto Protocol.

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The Competition Commission: One Year On

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The Competition Commission was set up just over year ago under the Competition Protection Act, which was enacted almost two years ago. This paper is a commentary on the Act and the effects of its application. Adoption of this law is, in principle, a precondition for effectively and directly tackling monopolies, and also meets the EU's requirement for the harmonization of legislation as part of the accession process. However, the Commission's work over the past year and an analysis of the Act itself, reveal major shortcomings. On the one hand, the Commission lacks sufficient authority and, on the other, is burdened with numerous petty or less important cases, which prevents it from devoting itself full time to cartels and abuses of dominant position. We therefore propose that the Commission be granted wider powers in pronouncing sanctions for violations of the Act. Also, requirements for reporting concentrations should be changed, and the amounts increased. This would create conditions for the Commission to focus on cases of real importance for ensuring free competition.

1. Introduction

According to Professor Posner, almost everyone with a professional involvement in the protection of free competition agrees that the only aim of antitrust legislation^{a)} is the promotion of economic welfare, perceived as an economic concept of efficiency.¹ Regardless of whether or not all professionals in Serbia share this view, it is to be hoped that it will in time become dominant in this country too. Free competition is the cornerstone of a market economy. Without effective competition among participants in the market, there can be no efficient allocation of resources or greater prosperity for society. Legislation regulating competition is an important tool countries have today to help build up and protect free competition. Of course, the efficacy of antitrust legislation should not be overestimated and expected to establish free competition on the market of and by itself. It should be seen as an integral part of all the legislation regulating the economy. Thus, for example, laws regulating foreign trade and various barriers to market entry are of major importance for creating and maintaining competition on the market, as are regulations governing infrastructure (e.g. telecommunications or energy). It is in this context that the Competition Protection Act, passed by the Serbian Parliament in mid-September 2005, should be judged.^{b)}

a) "Competition law" and "antitrust law" are used interchangeably in this paper.

b) Competition Protection Act, Official Gazette of the Republic of Serbia, No. 79/2005.

Although Serbia's legal system had previously contained antitrust legislation, it was only the adoption of this Act that fulfilled one of the conditions for effectively and directly tackling monopolies and other forms of anti-competitive behavior. The Act is to a great extent in harmony with the European standards and obligations Serbia will have to meet in the stabilization and association process. Nevertheless, it does have shortcomings that significantly undermine its efficacy.

The Competition Protection Act is in line with both similar legislation in neighboring countries and European practice. It defines, among other things, prohibited agreements between participants on the market (cartels) that prevent, restrict or distort free competition; abuses of dominant position, and exemptions from its application. It also regulates procedures for controlling

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1 Richard A. Posner, *Antitrust Law*, Second Edition, The University of Chicago Press, Chicago 2001, p. ix.

concentrations (takeovers) to prevent the creation of entities that could impede competition; establishes the Competition Commission, and, finally, prescribes penalties for non-compliance. The definitions of prohibited agreements, abuses of dominant position, and requirements for prohibiting concentrations are on the whole in line with European legislation;² the Competition Commission was established as an independent body, elected by the Parliament, and is charged with ensuring application of the Act. Legal standards for “significant restriction of competition” have yet to be established through the practice of the Commission and the courts, which will use economic principles to lay down more precise guidelines. Since this field of law is underdeveloped in Serbia, experiences from other jurisdictions – especially the EU – could be used.

The regulatory framework foreseen by the Act is still incomplete as the necessary bylaws has not been adopted. Only the Relevant Market Regulation and the Regulation on the Manner of Filing for Permits for Concentration have been passed so far. Yet to be adopted are regulations defining significant prevention, restriction or distortion of competition, the content of the application for exemption from the law’s effect, as well as requirements for exemption from the prohibition of cartel agreements by type. The Competition Commission was constituted with the election of its Council, in April 2006.³

The first section of this paper will present the Act’s key shortcomings, and then analyze the Commission’s activities over the past year. Finally, it will propose appropriate modifications to the Act to remedy the shortcomings identified.

2. An Analysis of the Shortcomings of the Competition Protection Act⁴

Based on an analysis of the Act, and the Commission’s one-year-long practice, the following can be identified as the biggest problems with the Act: (1) penal provisions preventing, or, at the very least, significantly hampering effective action against non-compliers (as the Commission has very limited powers to impose penalties, and can in practice only file misdemeanor charges to magistrate courts); and (2) an unreasonably low threshold for annual income triggering the requirement to notify a concentration (which will lead to the Commission being inundated and unable to focus on cartels and abuses of dominant position). In addition to these two main problems, we would also like to stress shortcomings related to (3) the Commission’s position and guarantees of its independence, and (4) exemptions from the Act’s application against entities engaging in activities of general interest.

1) The Commission’s powers and penal provisions

The Act confers on the Commission powers that are too limited, and grants authority for handing down penalties to magistrates’ courts. Relating to the control of concentrations, an additional key shortcoming is that the Act does not provided for a concentration being declared void if it has violated the Act’s provisions; in addition, the Commission cannot order a de-concentration (in case, for example, someone finds paying a fine acceptable, and then goes ahead with the intended transaction, only to recover the amount of the fine paid through monopolistic behavior). In the EU, the European Commission is authorized to hand down very high fines, while courts operate as a appellate bodies.

² The definition of prohibited agreements – cartels (Art. 7 of the Act) is very similar to the definition in Art. 81 of the EC Treaty; abuse of dominant position (Art. 18) is similar to Art. 82 EC Treaty, while requirements for prohibiting concentration (Art. 28) are almost identical to those set out in Art. 2(3) of EU Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings (Merger Control Regulation) (2004 O.J. L24/1).

³ The Commission’s constituting was delayed as the Parliament could not muster the quorum to elect the Commission’s Council before the statutory deadline. The Commission was finally set up in July, when its Statute was adopted. The Council also adopted the Commission’s Tariff List in July. Of the five members of the Council, four have a background in law, while one is an economist. Two members were elected to serve three-year terms, two will serve four-year terms, and the fifth’s term is five years.

⁴ Only the shortcomings considered to be the most important are presented here.

The Act envisages two types of sanctions for non-compliance. Firstly, there are measures the Commission can introduce when participants on the market fail to adhere to its decision establishing a violation of free competition (for cartels and abuses of dominant position). In that case, the Commission can first impose a temporary prohibition of trade in certain goods and/or rendering of certain services for a period not exceeding three months. If this approach should fail, a temporary prohibition not exceeding four months can also be applied. Another form of sanctions are misdemeanor fines, handed down by magistrates' courts, at the Commission's proposal, for violations of the Act. These fines can amount to between 1% and 10% of a company's income for the previous year, depending on the severity of the violation.

Under the Act, the Commission's powers are too narrow to enable it to effectively apply the law. Temporary prohibitions on trading products, rendering services, or performing activities should be supplemented by empowering the Commission to impose fines. In competition violation cases, a speedy reaction is often of the essence, as it is not always possible to make amends for the damage caused to competition. An additional problem is that the Commission has at its disposal no sanctions against those who fail to cooperate with an investigation, except for filing misdemeanor charges. In this context, the Commission should be given powers to directly sanction those who fail to comply in the evidence-gathering process. Two problems in this regard will be highlighted.

First, the question arises of whether a magistrates' court has the expert knowledge required to consider competition protection cases. Although these courts do have judges specializing in commercial misdemeanors, the importance of the cases is such that they cannot be entrusted to magistrates' courts, which are not even part of the judiciary – as magistrates are appointed and dismissed by the government. The fines prescribed and the economic importance of these cases, are too high for them to be considered by the same body that adjudicates traffic violations. As magistrates does not have the guaranteed tenure and independence that judges enjoy, they are more susceptible to pressure by both the state and the defendants in any particular case.

Secondly, two proceedings on the same issue can take place simultaneously before different bodies. Rulings the Commission issues to establish an infringement of the law can be voided in administrative proceedings before the Supreme Court; on the other hand, the Commission can at the same time bring charges with a magistrates' court. In consequence, the Supreme Court may void a Commission ruling, but the magistrates' court may fine the defendant (or vice versa) – since different procedural laws that apply in these proceedings make different decisions quite possible (especially for procedural infringements). In any event, the public's trust in the proceeding as a whole would be jeopardized if this happens; there would certainly be speculation about, which could compromise the Act itself.

c) Government of the Republic of Serbia: Serbian National Strategy for the Accession of SCG to the EU.

The penal provisions differ from the solutions foreseen in the National EU Accession Strategy.^{c)} This document stipulates that the entire sanctions procedure should be conducted by the Commission, which would also hand down penalties for violations of the Act, with judicial protection ensured through administrative proceedings that the entities sanctioned could bring against the Commission. This solution would ensure a simpler procedure and make it possible for the Commission to react and impose sanctions swiftly – in line with EU regulations, where the European Commission hands down penalties.

In order to achieve the desired aims, it is necessary to build up the Commission by making it possible for it to set sanctions (both for substantive violations of the law and for obstruction of evidence collection). If the existing solution is retained, sanctioning powers should at least be transferred from magistrates' to general courts.

2) Is the threshold too low for the concentration approval requirement (Art. 23)?

Article 23 requires parties to a possible concentration to seek approval from the Commission before the concentration can go ahead, if:

- “1) The combined total annual income of all undertakings involved in the concentration, on the market of the Republic of Serbia, exceeds the RSD equivalent of EUR 10 (ten) million (...), or
2) The combined total annual income of undertakings involved in concentration realized on the international market in the previous financial year exceeds the RSD equivalent of EUR 50 (fifty) million (...)”

Parties to the concentration are required to put in on hold until the Commission hands down its decision, or until the expiry of a four-month deadline, starting from the date of filing for approval.

Provisions of this article can cause significant problems in controlling concentration. Why? The income set as the threshold for mandatory concentration reporting is too low, which is especially true of the €50 mn income on the global market. The purpose of setting thresholds in concentration control is to relieve the body authorized to approve the transaction of handling concentrations between small entities (which can, with a fair degree of certainty, be assumed to pose no threat to competition). If the thresholds are set too low, the approving body will be swamped with cases, and will run out of resources to deal with cartels and abuses of dominant position.

We therefore feel that domestic and international income should be considered together in the requirement to report a concentration, while thresholds for both types of income should be raised to a level more appropriate on this market, thereby reducing the number of cases and unburdening the Commission. It could then devote more of its time and resources to more complicated cartel and abuse of dominant position cases.

According to 2004 data, all of Serbia's 300 largest companies had incomes exceeding €10 mn.^{d)} In addition, a global income of €50 mn is not a particularly high figure, meaning any reasonably serious foreign company acquiring even the smallest company in Serbia will have to request approval. The purpose of this provision remains unclear: from the competition protection standpoint, concentration between a party that is not even in the market (e.g. a foreign company with income exceeding €50 million) and a party that does not have a significant share of the market (e.g. a very small Serbian company) is totally irrelevant – and there is no need for any further investigation into possible threats to competition and undue burdening of the Commission.

Examples from numerous European countries and the EU itself, indicate that national and foreign incomes are most often combined when setting the threshold,⁵ unlike the Serbian solution of considering them separately. For example, in neighboring Croatia, the threshold is set at €135 mn on the international market and €13.5 mn on the domestic market for each of the (at least two) entities involved in the concentration.⁶

If only concentrations (takeovers) of joint stock companies listed with the Central Securities Registry were considered and the threshold applied to them, some two-thirds of the concentrations carried out in 2005 would have required the Commission's approval. If takeovers from bankruptcy and takeovers of LLCs are added, the total number of filings for approval would probably approach 100. If we assume 250 workdays for each year, it would mean that the Commission would have to process one application every 2.5 days. For instance, the European Commission's Competition Directorate General, much better equipped than Serbia's Commission, and with 15 years experience, had only 313 cases in 2005; in 1990, the year the EU began monitoring concentrations, it handled just 12 cases.

5 For example, in Germany, Slovakia, Ireland and Croatia. See antitrust bodies' web pages:

Germany, http://www.bundeskartellamt.de/wDeutsch/download/pdf/02_GWB_e.PDF; Slovakia, <http://www.antimon.gov.sk/files/7/2004/Zakon%20c.%20136-2001-%20rekon.%20znenie%20-%20po%20anglicky.rtf>; Ireland, <http://tca.ie/>; and Croatia, <http://www.crocompet.hr/eng/pdf/zakon/zztn.pdf>.

6 Zakon o zaštiti tržišnog natjecanja Hrvatske (Croatian Competition Law), Narodne novine, No. 122/03. Article 22(4): “The parties to the concentration are obliged to notify the concentration to the Agency if the following conditions are simultaneously met: 1. the total turnover of all the undertakings – parties to the concentration, realized by the sale of goods and/or services on the global market, amounts to at least 1 bn kuna in the financial year preceding the concentration, and 2. the total turnover of each of at least two parties to the concentration realized by the sale of goods and/or services in the domestic market, amounts to at least 100,000,000.00 kuna in the financial year preceding the concentration.”

d) *Ekonomist magazine, 300 najvećih special edition, Belgrade, November 2005 (in Serbian).*

3) The Competition Commission's position (Arts. 31-70)

The greatest shortcoming in the Commission's position is the fact that the Serbian government approves the Commission's financial plan. This solution is contrary to the idea of an independent body, as the Commission is elected by the Parliament – which should be the only body responsible for approving the financial plan (a role it already plays with respect to certain regulatory bodies, such as the Energy Agency or the Telecommunications Agency).

Article 50 of the Serbian Act stipulates that the Commission will be funded from the national budget only in its first year of operation – and will thereafter be funded from its own fees, with any excess income going into the national budget. Although the Commission is expected to realize significant revenue, especially with the low concentration reporting threshold, it would be a better solution to fund the Commission from the budget. The present arrangement simply forces the Commission to set excessively high fees to finance itself – a comparison that comes to mind is a police officer whose salary comes out of the fines he collects. Bearing in mind the importance of this institution, this issue should be resolved the way it was with regulatory bodies – by compensating any shortfall in revenue from the budget.

In its work the Competition Commission is obliged to adhere to the Act on General Administrative Procedure. The question is whether this statute's provisions are appropriate for antitrust issues, especially its articles dealing with public discussion and the rights of parties in proceedings, which can do more harm than good and give parties room to drag out the proceedings and circumvent the law's purpose. The same solution had been adopted in Croatia and Slovenia, but it transpired that it was better to have separate procedural provisions than to apply the Administrative Procedure Act.

The Commission's managing body is the Council. It is elected by the Parliament for a five-year term. Council members can be nominated by the Serbian Chamber of Commerce and Industry, the Society of Economists, the Jurists Association of Serbia, the Serbian Bar Association and the Serbian government. The Commission is accountable to the Parliament.

It is a question whether the bodies entitled to nominate Council members are the most felicitous choice. This applies especially to the Chamber of Commerce and Industry and the Bar Association: the Chamber of Commerce is an association of companies that can themselves be affected by competition law – it is not inconceivable that a member nominated by the Chamber of Commerce could be subjected to outside pressures. A similar objection could be raised for the Bar Association's involvement, as lawyers will appear as counsel to parties in a proceeding.

4) Activities of general interest (Art. 4)

The Competition Protection Act applies to all entities “engaged, directly or indirectly, in the trade of goods or services, and who by their acts and practices violate or may violate free competition.” The definition in itself is not a problem; the exception to this rule, however, is: it exempts entities “engaged in economic activities of general economic interest, as well as to such institutions entrusted with fiscal monopoly, if the application of this Act would obstruct the performance of activities of general economic interest, i.e. entrusted activities.” The problem here is the fact that the exemption is too general and insufficiently precise; it can, for instance, be invoked in a situation where a public enterprise, in addition to its core activities, also engages in activities otherwise open to competition (e.g. when a public enterprise, in addition to processing oil, also has a mineral water bottling plant). In such a situation the public enterprise could violate the Act, for instance by abusing its dominant position, and still remain protected under this article. This exemption also provides protection to state monopolies that remain so only because of the lack of action by regulatory bodies. For example, Telekom, the state-owned telecommunications company, could cite this article in its defense in a dispute over a possible abuse of dominant position. In view of all of the above, activities of general interest would need to be much more precisely defined to ensure greater transparency.

3. The Act's effects in the first year of operation of the Commission

The Act's main identified shortcomings, such as the inadequate powers of the Commission and the low threshold for mandatory concentration reporting, manifested themselves in the Competition Commission's first year of operation.

A case in point was the takeover of retailer C Market by Delta. In late 2005,⁷ Primer C acquired the C Market retail chain. Several months later, Delta announced it had taken control of C Market (probably by taking over Primer C), and that C Market had been merged with Delta's retail network, hitherto made up of the Pekabeta and Maxi supermarket chains. According to media reports, Delta had filed for concentration approval, but the Commission withheld permission; the takeover nevertheless went ahead. Delta objected, in administrative proceedings, to the Commission's ruling. Without going into the merits of the case, the fact that the dispute remains unresolved for over a year after C Market was taken over goes to show that the penal provisions are ineffective. If Delta did not violate the Competition Protection Act, the fact that there is still uncertainty surrounding the case could have a negative impact on the company – as the fine could run to 10% of its total annual income. On the other hand, if Delta did breach the Act, the state cannot order de-concentration, but can only impose a fine, leaving any monopoly intact. Even if it were possible to order de-concentration, it is still questionable whether this could happen in practice, bearing in mind that C Market has undergone great changes in the meantime (many buildings have changed their purpose, while some have been extensively refurbished). An additional issue here is that the founder of Primer C is an offshore company, making it significantly more difficult to determine its original owners – which will undoubtedly prove a problem in implementing the Act.

As was to be expected, the Ministry of Trade, and after it the Commission, mainly handled approving concentrations – the number of filings was very high due to the low threshold – and it was impossible to deal with cartels and abuses of dominant position.⁸ During its first year of operation, the Commission processed 80 requests, with the average time spent on each case slightly over three days. Of these, 56 were concentration control cases, 19 were cases of abuse of dominant position, and four involved cartels. The prediction that the low threshold for mandatory concentration notification would lead to the Commission mainly dealing with concentrations came true. Of all concentration control cases, the Commission passed a negative ruling in one instance only (C Market). In the case of the Merkator-Rodić supermarket chains merger, the Commission approved the concentration on condition that the company refrain from expanding in a specific area for a period of one year.

These examples show that the threshold has indeed been set too low, and should be raised, as this would still cover larger concentrations with greater influences on competition, and leave the Commission free to devote itself to cartels and abuses of dominant position. The need to unburden the Commission becomes even more apparent considering that it has a statutory obligation to initiate proceedings *ex officio* "on becoming aware" that the Act has been violated. In this sense, if the Commission is to be proactive, rather than a body simply reacting to filings, it needs to be relieved of unnecessary business.

4. Conclusion

For Serbia's antitrust policy to be effective and efficient, three conditions need to be met. First, there needs to be a clear regulatory framework, meaning good statutes and bylaws. Second, institutional capacity needs to be present – those entrusted with upholding the law must have the powers and resources necessary to act against those who jeopardize competition. Third, the political will to actually implement these quality laws must be present.

⁷ The Commission had not yet been formed at the time; the Act, however, was already in force. The Commission's duties were being carried out by the Antitrust Division of the Ministry of Trade, Tourism and Services.

⁸ We have here used data available in the media, such as interviews given by Commission members. We were unable to obtain more precise data, as the Commission's Annual Report has not been published yet. See <http://bif-monthly.mediaonweb.org/sh/30/skener/1245/> (in Serbian).

The adoption of the Competition Protection Act was the first step in constructing a modern antitrust policy. However, the Act has many shortcomings that will hinder its implementation if not amended. In this sense, the following is of the utmost importance:

- Increasing the Commission's powers to impose sanctions for violation of the Act: making it possible for the Commission to order the payment of fines, or fully assume the role currently played by magistrates' courts, and
- Changing the requirements for mandatory concentration reporting (€10/50 million annual turnover) by raising the threshold and linking foreign income with that realized in Serbia, and thereby ensuring that the Commission handles only cases that can be of relevance for protecting competition.

In addition to the shortcomings of the Act itself, a major challenge is also posed by the state's institutional capacity to implement laws consistently, in particular as competition protection is a new field in Serbia's jurisprudence.

Institutional capacities have only begun to be created with the setting up of the Commission; what lies ahead now is the difficult task of making it capable of doing its job efficiently. It is of paramount importance for the Commission's expert staff to become capable of processing cases and developing economic analysis capacities that will enable them to detect violations of competition on time. Human resources remain a problem for the Commission. In April 2007 the number of its employees was still in the single digit whereas, for instance, in 2004, the Hungarian Commission employed 119 people,⁹ and its Polish counterpart had as many as 278 employees.¹⁰ Croatia can also provide a good example: its Competition Agency employed 35 people in 2004 to handle a total of 58 concentration cases.¹¹ In addition, it will be necessary to establish contacts with the similar bodies of other countries, since it is not possible, in a modern economy, to consider complex antitrust cases without international cooperation.

Within the current regulatory and institutional framework, it is also necessary to build up the capacity of magistrates' courts to enable them to handle these complex cases. We are, however, of the opinion that powers to impose penalties should be transferred to the Commission, or, at the least, to general courts (where, on the other hand, additional training of judges will doubtless prove necessary, since the Serbian judiciary generally has a problems with "economic cases" – as the few convictions for white collar crime amply testify. More than a year since the coming into force of the Competition Protection Act, there has not been a single court ruling in this field. Because of the absence of empirical data, it is not possible to comment on the courts' handling of these cases.

Finally, implementation will also depend on the political will to promote competition, rather than protect favored companies. Politicians have so far sent out contradictory signals. Certain statements could be interpreted to mean that the Competition Protection Act was intended to make "greedy" businessmen share their profits, acquired through state protectionism, with the public. In this context, major importance must be attached to raising the awareness of the public as a whole, and also of the political elite, of the significance of protection of free competition for economic growth.

9 Annual Report on Competition Policy Developments in Hungary – 2004, OECD
<http://www.oecd.org/dataoecd/6/19/35111041.pdf>.

10 Annual Report on Competition Policy Developments in Poland – 2004, OECD
<http://www.oecd.org/dataoecd/51/45/35111190.pdf>.

11 Croatian Competition Agency 2004 Annual Report,
<http://www.aztn.hr/pdf/izvjesca/Godisnje%20izvjesce%20o%20radu%20Agencije%202004%20.pdf> (in Croatian).

ANALYTICAL APPENDIX

Analytical Appendix

Table P-1. Serbia: Retail Price Index (RPI), 2003–2007

	RPI			RPI components				
	base index (avg. 2005 = 100)	y-o-y growth	cumulative index ¹⁾	GOODS	Agricultural products	Industrial foodproducts	Industrial non- foodproducts	SERVICES
				y-o-y growth				
				annual indices²⁾				
2003	77.7	111.7	107.7	107.4	107.2	99.8	111.1	125.0
2004	85.3	110.1	113.8	110.0	103.4	112.4	109.6	110.2
2005	100.0	116.5	117.7	114.9	125.3	117.4	113.8	120.7
2006	112.7	112.7	106.6	112.4	117.6	111.2	112.3	113.3
				quarterly indices⁴⁾				
2005								
Q1	95.1	116.9	105.1	114.9	112.7	116.6	114.7	122.6
Q2	97.9	117.2	108.0	115.5	127.8	117.0	115.0	121.9
Q3	101.4	117.1	111.8	114.9	130.9	114.4	115.1	123.2
Q4	105.6	117.9	117.7	115.4	130.5	115.4	115.1	124.6
2006								
Q1	109.2	114.8	102.2	114.6	134.4	113.2	114.4	115.4
Q2	113.1	115.6	105.7	115.7	123.6	112.2	117.1	115.4
Q3	114.0	112.5	106.1	112.3	108.8	112.4	111.9	112.8
Q4	114.3	108.2	106.6	107.6	105.8	107.4	106.5	109.8
2007								
Q1	115.5	105.8	101.2	105.1	101.1	104.8	103.2	107.5
				monthly indices				
2005								
March	96.1	117.4	105.1	115.9	118.3	117.6	115.4	121.7
June	98.8	116.8	108.0	114.9	127.2	116.7	114.0	122.1
September	102.3	116.6	111.8	114.1	122.1	113.3	115.1	123.3
December	107.6	117.7	117.7	115.3	136.1	115.8	114.0	124.1
2006								
January	108.1	15.1	100.4	114.9	136.6	114.4	114.0	115.6
February	109.6	15.0	101.9	114.9	135.6	113.2	115.0	115.2
March	110.0	14.4	102.2	114.1	131.4	112.1	114.3	115.3
April	111.9	15.5	104.0	115.8	126.0	112.1	117.1	115.1
May	113.7	16.1	105.7	116.2	125.5	112.2	117.7	116.0
June	113.7	15.1	105.7	115.1	119.6	112.2	116.5	115.2
July	113.6	12.8	105.6	112.5	108.9	112.8	112.1	113.4
August	114.4	13.1	106.3	113.2	107.9	112.9	113.4	112.7
September	114.1	11.6	106.1	111.3	109.6	111.5	110.4	112.3
October	113.7	9.3	105.7	108.4	102.5	108.7	107.2	111.6
November	114.6	8.8	106.5	107.8	108.5	107.6	106.3	111.6
December	114.7	6.6	106.6	106.7	106.2	106.0	105.9	106.3
2007								
January	115.1	6.5	100.4	106.8	104.6	105.2	105.6	106.0
February	115.3	5.2	100.5	104.1	100.5	105.0	101.4	108.1
March	116.1	5.6	101.2	104.5	98.4	104.2	102.7	108.4
April	117.1	4.7	102.1	103.2	99.6	103.6	101.2	108.2

Source: SBS.

1) Cumulative is the ratio of given period and December of previous year.

2) Twelve-month averages for annual data, three-month averages for quarterly data.

Table P-2. Serbia: Selected Price Indices, 2003–2007

	Retail Price Index		Consumer price index		Industrial producers' price index		Agricultural producers' price index	
	base index (avg. 2005 =100)	y-o-y growth	base index (avg. 2005 =100)	y-o-y growth	base index (avg. of previous year =100)	y-o-y growth	base index (avg. of previous year =100)	y-o-y growth
annual indices¹⁾								
2003	77.7	111.7	77.6	109.9	104.6	104.6	100.5	100.5
2004	85.3	110.1	86.1	111.4	109.1	109.1	110.0	110.0
2005	100.0	116.5	100.0	116.2	114.2	114.2	115.6	115.6
2006	112.7	112.7	111.7	111.7	113.3	113.3	109.2	109.2
quarterly indices¹⁾								
2005								
Q1	95.1	116.9	94.8	115.9	108.2	113.5	113.2	106.4
Q2	97.9	117.2	98.7	116.4	111.0	113.3	114.7	104.4
Q3	101.4	117.1	101.0	115.5	116.0	114.1	116.9	109.5
Q4	105.6	117.9	105.5	116.6	121.6	115.7	120.4	109.9
2006								
Q1	109.2	114.8	108.7	114.6	108.9	114.3	105.0	105.9
Q2	113.1	115.6	112.7	114.2	113.3	116.2	107.0	107.0
Q3	114.0	112.5	112.6	111.4	115.7	114.6	110.9	110.0
Q4	114.3	108.2	113.0	107.1	115.2	108.4	111.0	107.0
2007								
Q1	115.5	105.8	113.9	104.8	101.8	105.5	101.9	105.2
monthly indices								
2005								
March	96.1	117.4	96.2	116.9	109.1	113.8	115.0	105.9
June	98.8	116.8	99.8	115.8	111.7	112.9	114.8	104.6
September	102.3	116.6	101.7	114.8	118.2	114.5	120.0	108.2
December	107.6	117.7	107.0	117.1	122.3	115.4	121.7	111.8
2006								
January	108.1	15.1	107.8	15.3	108.0	114.5	104.7	108.2
February	109.6	15.0	108.9	14.8	109.0	113.9	104.6	104.6
March	110.0	14.4	109.5	13.8	109.6	114.4	105.8	104.9
April	111.9	15.5	111.2	14.5	112.2	116.0	105.4	106.2
May	113.7	16.1	113.4	14.5	113.8	116.5	107.1	106.2
June	113.7	15.1	113.4	13.7	114.0	116.2	108.4	108.7
July	113.6	12.8	112.4	11.7	115.5	115.6	108.7	110.0
August	114.4	13.1	112.7	11.9	115.8	115.2	111.5	111.4
September	114.1	11.6	112.6	10.7	115.8	112.9	112.4	108.7
October	113.7	9.3	112.2	7.9	115.5	110.0	109.7	106.5
November	114.6	8.8	113.3	7.5	115.1	108.0	111.0	107.3
December	114.7	6.6	113.4	6.0	114.9	107.3	112.3	107.3
2007								
January	115.1	6.5	114.0	5.8	101.6	106.2	102.7	107.5
February	115.3	5.2	113.7	4.5	101.6	105.1	101.7	104.6
March	116.1	5.6	114.1	4.2	102.2	105.1	101.2	103.4
April	117.1	4.7	115.0	3.4	103.0	103.7	...	...

Source: SBS.

1) Twelve-month averages for annual data, three month averages for quarterly data.

Analytical Appendix

Table P-3. Serbia: Euro / Dinar Exchange rate, 2003–2007

	Nominal				Real				CPI in Euro area ⁴⁾ (Dec. 02=100)
	Exchange rate (FX) ¹⁾	Base index (Dec. 02=100)	y-o-y index	cumulative index ²⁾	USD/EUR	real FX ³⁾ (Dec. 02=100)	y-o-y index	cumulative index ²⁾	
annual exchange rate⁵⁾									
2003	64.9743	105.6	107.1	110.5	1.1241	102.4	97.8	104.4	101.0
2004	72.6215	118.0	111.8	115.6	1.2392	106.3	103.8	103.9	103.0
2005	82.9188	134.7	114.2	109.3	1.2433	105.8	99.5	94.9	105.3
2006	84.1879	136.8	101.5	91.7	1.2537	97.4	92.1	87.9	107.6
quarterly exchange rate⁵⁾									
2005									
Q1	80.2421	130.4	115.9	102.7	1.3145	106.4	101.2	98.1	104.0
Q2	81.8942	133.0	115.7	105.0	1.2606	106.7	100.7	98.3	105.2
Q3	83.8302	136.2	114.2	107.5	1.2199	105.8	99.8	97.8	105.6
Q4	85.7085	139.2	111.3	109.3	1.1898	104.5	96.6	94.9	106.2
2006									
Q1	87.0875	141.5	108.5	101.4	1.2031	102.7	96.6	99.6	106.3
Q2	86.8674	141.1	106.1	101.0	1.2552	100.3	94.0	97.9	107.7
Q3	83.2482	135.2	99.3	96.7	1.2745	95.5	90.3	92.6	108.0
Q4	79.5486	129.2	92.8	91.7	1.2893	91.4	87.5	87.9	108.3
monthly exchange rate									
2005									
March	80.7498	131.2	116.1	102.7	1.3074	106.5	101.0	98.1	104.5
June	82.5172	134.1	115.3	105.0	1.2180	106.7	100.7	98.3	105.3
September	84.4958	137.3	113.6	107.5	1.2265	106.2	100.0	97.8	106.0
December	85.9073	139.6	109.3	109.3	1.1861	102.9	94.9	94.9	106.3
2006									
January	86.9033	141.2	108.8	101.2	1.2122	103.2	96.7	100.3	105.9
February	87.2558	141.8	108.9	101.6	1.1960	102.5	96.8	99.6	106.2
March	87.1033	141.5	107.9	101.4	1.2013	102.5	96.2	99.6	106.7
April	86.5391	140.6	106.4	100.7	1.2239	100.7	94.3	97.9	107.4
May	87.3023	141.8	106.7	101.6	1.2750	100.3	94.2	97.5	107.8
June	86.7609	140.9	105.1	101.0	1.2677	99.8	93.6	97.0	107.9
July	83.7931	136.1	101.0	97.5	1.2684	96.4	91.7	93.7	107.8
August	82.8893	134.7	98.7	96.5	1.2803	94.8	89.3	92.2	108.0
September	83.0621	134.9	98.3	96.7	1.2748	95.3	89.8	92.6	108.1
October	80.9242	131.5	95.0	94.2	1.2615	93.3	88.5	90.7	108.1
November	78.9404	128.2	91.7	91.9	1.2876	90.4	86.0	87.8	108.2
December	78.7812	128.0	91.7	91.7	1.3210	90.4	87.9	87.9	108.6
2007									
January	79.6587	129.4	91.7	101.1	1.2993	90.7	87.8	100.3	108.2
February	79.3993	129.0	91.0	100.8	1.3075	90.6	88.3	100.1	108.5
March	80.8968	131.4	92.9	102.7	1.3246	92.1	89.9	101.9	109.2
April	80.5768	130.9	93.1	102.3	1.3516	91.5	90.8	101.1	109.8
May	81.4770	132.4	93.3	103.4	1.3512	91.7	91.4	101.4	110.3

Source: NBS, SBS, Eurostat (www.epp.eurostat.ec.eu.int)

1) Monthly average, official daily NBS mid rate.

2) Cumulative index: ratio of given period and December of previous year.

3) Real fx calculation includes Euro area inflation. See footnote 5) in Table T3-4.

4) Harmonized indices of consumer prices. Due to official revisions, this index differs slightly from values published in previous QM issues.

5) Twelve-month averages for annual data, three-month averages for quarterly data.

Table P4. Serbia: Registered Employment, 2004–2007

	Total No. of employed (employees and entrepreneurs)	Employees in legal entities	Entrepreneurs			Total No. of employees
			Total	No. of entrepreneurs	No. of employees with entrepreneurs	
	1 (=2+3)	2	3 (=4+5)	4	5	6(=2+5)
quarterly data - in thousands						
2004	2,050	1,577	473	210	263	1,840
Q1	2,050	1,589	461	207	253	1,842
Q2	2,059	1,592	468	208	259	1,851
Q3	2,045	1,570	475	209	266	1,836
Q4	2,048	1,559	489	216	273	1,832
2005	2,061	1,540	521	228	293	1,833
Q1	2,065	1,557	507	225	283	1,840
Q2	2,062	1,544	518	228	289	1,833
Q3	2,063	1,536	527	229	298	1,834
Q4	2,055	1,521	533	230	304	1,825
2006	2,022	1,472	562	239	323	1,795
Q1	2,035	1,500	535	228	307	1,806
Q2	2,017	1,481	550	234	316	1,797
Q3	2,012	1,462	571	243	328	1,790
Q4	2,023	1,445	590	249	341	1,786
monthly data - in thousands						
2005						
January	2,059	1,558	501	221	280	1,838
February	2,065	1,557	508	225	283	1,840
March	2,070	1,557	513	228	285	1,842
April	2,066	1,551	515	228	287	1,838
May	2,060	1,543	517	228	289	1,832
June	2,059	1,538	521	229	292	1,830
July	2,062	1,538	524	229	295	1,833
August	2,062	1,535	527	229	298	1,833
September	2,067	1,536	531	230	300	1,836
October	2,062	1,530	532	230	302	1,832
November	2,054	1,520	534	230	304	1,824
December	2,048	1,514	534	229	305	1,819
2006						
January	2,037	1,506	531	229	305	1,810
February	2,029	1,497	533	228	307	1,805
March	2,032	1,496	536	228	308	1,804
April	2,023	1,487	543	231	312	1,799
May	2,016	1,481	550	234	316	1,797
June	2,011	1,475	557	237	320	1,795
July	2,008	1,472	564	240	324	1,796
August	2,002	1,467	571	243	328	1,795
September	2,019	1,447	572	242	330	1,777
October	2,020	1,448	572	242	330	1,778
November	2,015	1,443	572	242	330	1,773
December	2,012	1,440	572	242	330	1,770
2007						
January	2,005	1,432	572	242	330	1,762
February	1,997	1,425	572	242	330	1,755
March	1,992	1,420 ⁶⁾	572	242	330	1,750

Source: Semi-annual Report on the Employed and Wages RAD-1/P; Additional Survey to the Semi-annual RAD-1 Report; Semi-annual Report on Small Businesses and Their Employees RAD-15. Note: Number of entrepreneurs and their employees are September 2006 data.

1) The total number of employed (employees and entrepreneurs) includes those employed by legal entities (enterprises, organizations, institutions) - Column 2, and small businesses i.e. entrepreneurs - Column 3 (including store owners, self-employed professionals, etc., and those working for them). Employees of the Ministry of Defense of Serbia-Montenegro, and the Serbian Ministry of Internal Affairs are not included.

2) Employees in legal entities (companies, organizations, institutions).

3) Owners of small businesses and self-employed persons (entrepreneurs) and their employees (Column 4 + Column 5).

4) Entrepreneurs, i.e. owners of small businesses.

5) Employees with entrepreneurs, i.e. in small businesses.

6) SBS estimate.

Analytical Appendix

Table P-5. Serbia: Employees by Activities, 2003–2007

	2003	2004	2005	2006	2006												2007
					Jan	Feb	Mar	Apr	May ¹⁾	Jun ¹⁾	Jul	Aug	Sep ²⁾	Oct	Nov	Dec	Jan
Employees in enterprises, institutions and organizations, by sections of activities	in thousands																
Agriculture, hunting and forestry	73	69	64	58	61	60	60	59	59	59	58	58	57	57	56	56	56
Fishing	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Mining and quarrying	33	32	31	27	29	29	28	28	28	28	28	28	29	25	24	24	24
Manufacturing	525	484	460	419	439	434	432	429	425	421	419	415	409	407	403	400	400
Electricity, gas and water supply	47	46	46	45	45	45	45	44	44	44	44	44	43	47	46	46	46
Construction	89	88	88	86	87	86	86	86	86	86	86	86	85	85	86	86	84
Wholesale and retail trade, repair	201	208	205	198	201	202	203	202	202	200	200	201	192	192	193	193	192
Hotels and restaurants	30	28	27	25	26	26	25	25	24	24	24	24	24	24	24	24	23
Transport, storage and communications	119	119	116	110	113	111	112	111	111	110	110	110	109	108	108	108	107
Financial mediation	30	29	29	30	29	30	30	29	30	30	30	30	30	30	30	30	30
Real estate, renting activities	55	59	63	67	66	66	67	67	67	67	67	68	68	67	67	67	63
Public administration and social insurance	68	71	71	69	69	69	69	69	69	69	69	69	69	69	69	69	69
Education	128	131	129	127	128	127	126	126	126	126	126	125	125	128	129	129	130
Health and social work	163	165	166	158	160	160	159	157	158	158	158	158	157	156	155	156	155
Other communal, social and personal services	48	49	51	52	52	52	52	52	52	52	52	52	51	51	51	51	51

Source: Semi-annual Report on the Employed and Wages RAD-1/P; Additional Survey to the Semi-annual RAD-1 Report; Semi-annual Report on Small Businesses and Their Employees RAD-15.

Notes:

1) Adjusted data.

2) For September the data are based on the final data for September 2006.

Table P-6. Serbia: Average Monthly Wage and Wage Index (SBS), 2005–2007

	Average monthly wage (SBS)			
	Gross, in dinars	Net, in dinars	Gross, y-o-y real growth index	Net, y-o-y real growth index
2005				
January	20,898	14,263	103.8	102.6
February	22,402	15,295	104.9	103.8
March	23,198	15,863	106.2	105.1
April	25,153	17,193	103.8	102.6
May	24,449	16,731	107.4	106.3
June	25,503	17,441	111.8	110.6
July	25,769	17,634	103.4	103.9
August	26,252	17,928	108.9	109.2
September	26,818	18,345	110.6	110.7
October	26,720	18,265	107.1	107.4
November	27,379	18,696	106.5	106.6
December	32,243	22,078	108.5	108.7
2006				
January	26,603	18,191	110.4	110.6
February	28,657	19,567	111.4	111.5
March	29,367	20,094	111.2	111.3
April	30,572	20,887	106.1	106.1
May	30,305	20,713	108.3	108.2
June	31,864	21,777	109.9	109.9
July	31,738	21,774	110.3	110.6
August	32,098	21,925	109.3	109.3
September	32,555	22,259	109.6	109.6
October	32,668	22,340	113.3	113.4
November	33,892	23,148	115.1	115.2
December	41,294	28,267	120.9	120.8
2007				
January	33,770	24,122	120.1	125.4
February	35,219	25,228	117.7	123.5
March	36,148	25,960	118.1	124.0
April	37,117	26,632	117.4	123.3

Source: Serbian Bureau of Statistics (SBS).

Table P-7. Serbia: Balance of Payments, 2003–2007¹⁾

	2003		2004			2005			2006			2007	
	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar		
flows, cumulative from the beginning of the year, in millions of euros													
CURRENT ACCOUNT	-1,355	-2,197	-324	-615	-1,134	-1,805	-680	-1,155	-1,780	-2,892	-1,141		
GOODS AND SERVICES	-3,621	-5,156	-708	-1,755	-2,970	-4,284	-1,132	-2,384	-3,536	-4,999	-1,416		
Goods	-3,808	-5,311	-683	-1,772	-2,987	-4,279	-1,101	-2,357	-3,524	-4,950	-1,412		
Exports, f.o.b. ²⁾	2,447	2,991	813	1,824	2,843	4,006	1,039	2,282	3,662	5,146	1,401		
Imports, f.o.b.	-6,415	-8,302	-1,496	-3,596	-5,830	-8,285	-2,140	-4,638	-7,186	-10,096	-2,813		
Exports/Imports (%)	38	36	54	51	49	48	49	49	51	51	50		
Services	187	155	-25	17	17	-5	-31	-27	-12	-49	-4		
Receipts	906	1,171	251	594	951	1,319	306	697	1,188	1,670	439		
Expenditures	-719	-1,016	-276	-577	-934	-1,324	-338	-724	-1,200	-1,719	-443		
Income, net	-180	-172	-59	-141	-198	-260	-58	-155	-236	-314	-84		
Earnings	61	64	12	32	53	80	32	66	105	154	40		
Payments	-241	-235	-71	-174	-250	-339	-91	-221	-341	-468	-124		
Current transfers	2,020	2,728	410	1,200	1,886	2,471	474	1,302	1,868	2,240	318		
Private remittances, net	332	340	35	167	225	281	-21	90	120	110	-19		
Inflow	690	796	184	424	683	955	95	95	200	512	271		
Outflow	-358	-456	-149	-256	-457	-674	-283	-450	-715	-1,037	-289		
F/X accounts of non-residents	308	568	37	108	259	460	183	276	494	561	111		
F/X purchases, net	1,106	1,592	320	884	1,329	1,631	289	882	1,166	1,447	196		
Other ³⁾	274	228	17	41	73	99	23	54	87	123	30		
Official grants	425	403	33	82	148	268	36	82	124	181	41		
ERRORS AND OMISSIONS	44	168	-184	-75	-205	-384	-31	-63	-147	21	-87		
CAPITAL AND FINANCIAL ACCOUNT	1,898	2,377	710	1,173	2,276	3,863	1,100	2,687	4,935	7,166	1,026		
Financial account	1,898	2,377	710	1,173	2,276	3,863	1,100	2,687	4,935	7,166	1,026		
Foreign direct investment (FDI)	1,198	773	262	502	998	1,248	164	738	2,409	4,077	617		
Other investment	701	1,604	448	671	1,278	2,615	936	1,949	2,526	3,089	409		
Medium/long term loans ⁴⁾	628	1,221	159	602	988	1,820	443	1,685	2,456	3,140	494		
Government	206	229	15	44	108	192	73	84	132	132	19		
Commercial banks	106	417	68	209	292	729	146	1,122	1,346	1,484	37		
Other	317	574	74	348	588	886	224	479	979	1,523	438		
Short-term loans	14	164	94	28	33	330	212	-189	25	170	-223		
Extraordinary debt and interest repayment ⁵⁾	0	0	0	0	0	0	0	-189	-377	-1,060	-177		
Other assets and liabilities	18	187	120	11	186	378	136	115	446	839	312		
Commercial banks F/X reserves (increase,-)	-3	33	77	30	71	100	144	146	-25	1	3		
NBS reserves, net ⁴⁾ , (increase,-)	-587	-349	-202	-483	-937	-1,675	-390	-1,469	-3,008	-4,296	202		
IMF disbursements	246	192	0	0	151	151	75	75	75	75	0		
IMF amortization ⁶⁾	0	-188	-47	-93	-133	-166	-22	-22	-22	-32	-10		
MEMORANDUM ITEMS	in % of GDP												
Exports of goods and services	19.5	21.1	20.2	22.9	24.0	25.2	26.0	26.8	27.4	27.4	28.3		
Imports of goods and services	-39.6	-47.2	-33.6	-39.5	-42.7	-45.5	-47.8	-48.3	-47.4	-47.5	-50.2		
Balance of goods and services	-21.1	-26.9	-12.9	-16.8	-18.9	-20.3	-21.3	-21.2	-19.9	-19.9	-21.8		
Current account	-7.5	-11.1	-6.1	-5.8	-7.2	-8.6	-13.1	-10.4	-10.1	-11.6	-17.6		
GDP in euros ⁷⁾	18,008	19,723	5,277	10,554	15,830	21,107	5,181	11,095	17,675	24,886	6,492		

Source: NBS, SBS.

1) Original US dollars monthly data are converted to euros using monthly averages of official daily NBS mid rates.

2) Exports f.o.b. corrected for unregistered exports.

3) Includes payments settlement with Kosovo.

4) Excluding IMF.

5) Includes extraordinary repayment of principal and interests on WB and IMF loans.

6) Principal repayments.

7) Cumulative from the beginning of the year. GDP 2006. and Q1 2007: FREN estimate.

Analytical Appendix

Table P-8. Serbia: Consolidated General Government Fiscal Operations¹⁾, 2004–2007

	in mlrd of dinars											% in GDP				
	2004		2005				2006				2007		2003	2004	2005	2006
	total	total	Q1	Q2	Q3	Q4	total	Q1	Q2	Q3	Q4	Q1				
I TOTAL REVENUE	589.4	701.6	146.0	168.4	177.0	210.2	825.0	175.3	201.6	207.5	240.6	215.2	40.3	41.2	40.1	38.9
<i>o/w: Public revenues excluding government VAT liabilities and offsets with SDF²⁾</i>	580.6	679.0	141.7	163.7	172.7	200.9	815.0	176.8	199.5	203.6	235.1	215.1	40.3	41.2	38.8	38.4
1. Current revenue	583.4	693.7	144.4	166.6	174.9	207.8	814.7	173.2	199.3	204.9	237.3	212.0	39.9	40.8	39.6	38.4
Tax revenue	540.8	638.9	135.5	155.0	162.6	185.8	751.3	159.4	185.1	188.5	218.2	195.0	37.3	37.8	36.5	35.4
Personal income tax	76.9	94.3	19.5	23.5	24.1	27.2	118.5	25.8	29.2	29.2	34.3	24.9	6.5	5.4	5.4	5.6
Corporate income tax	6.9	10.3	3.9	1.8	1.8	2.8	18.3	7.9	2.9	3.5	4.0	11.7	0.5	0.5	0.6	0.9
Value added tax and retail sales tax	159.1	215.9	47.4	52.0	54.3	62.2	225.2	46.3	57.9	57.0	64.0	60.5	10.8	11.1	12.3	10.6
<i>o/w: Net VAT and retail sales tax²⁾</i>	159.1	198.8	44.4	48.9	50.8	54.7	224.7	47.9	55.8	57.0	64.0	60.5	10.8	11.1	11.4	10.6
Excises	69.1	71.3	13.2	18.3	19.8	20.0	81.7	14.7	21.1	21.7	24.2	19.1	5.0	4.8	4.1	3.9
Custom duties	34.3	39.0	7.0	9.3	10.4	12.3	45.2	9.6	12.7	9.9	13.1	12.0	2.5	2.4	2.2	2.1
Social contributions	159.0	184.0	38.6	44.4	46.4	54.6	232.2	48.5	54.1	59.4	70.2	58.9	2.2	11.1	10.5	10.9
<i>o/w: contributions excluding offsets with SDF³⁾</i>	150.2	179.1	37.2	42.9	45.7	52.8	222.7	48.4	54.1	55.5	64.7	58.8	9.9	10.5	10.2	10.5
Other tax	35.5	24.1	5.9	5.7	5.7	6.8	30.1	6.5	7.2	7.9	8.5	7.9	9.9	2.5	1.4	1.4
Non-tax revenue	42.6	54.8	8.9	11.5	12.4	22.0	63.4	13.8	14.2	16.3	19.1	17.0	2.6	3.0	3.1	3.0
2. Capital revenue	6.1	7.9	1.6	1.8	2.1	2.4	10.3	2.1	2.3	2.6	3.3	3.2	0.4	0.4	0.5	0.5
II TOTAL EXPENDITURE	-572.0	-667.8	-141.1	-164.5	-167.1	-195.1	-813.0	-174.9	-185.1	-197.6	-255.4	-203.1	42.7	40.0	38.2	38.3
1. Current expenditure	-535.0	-634.8	-135.7	-155.4	-159.4	-184.3	-749.1	-167.6	-174.3	-184.4	-222.8	-187.5	40.9	37.4	36.3	35.3
Wages and salaries	-138.0	-166.3	-36.1	-41.0	-41.5	-47.7	-198.6	-46.0671	-45.7557	-47.0986	-59.6	-51.9	9.9	9.6	9.5	9.4
<i>o/w: wages and salaries excluding severance payments⁴⁾</i>	-0.26	-1.31	-0.1	-0.4	-0.5	-0.2	-3.19	-1.54	-0.28	-0.43	-0.94	0.0	..	..	0.1	0.2
<i>o/w: Health Insurance Bureau severance payments⁵⁾</i>	0.00	-2.17	0.00	0.00	0.00	-2.17	-2.28	-0.90	0.00	-1.38	0.00	0.00	..	..	0.1	0.1
Expenditure on goods and services	-78.3	-92.2	-17.2	-22.2	-23.1	-29.7	-114.1	-22.4	-25.3	-29.0	-37.5	-25.5	6.2	5.5	5.3	5.4
Interest payments	-24.6	-24.5	-5.9	-5.0	-5.8	-7.8	-28.9	-5.7	-4.9	-8.8	-9.4	-5.7	0.9	1.7	1.4	1.4
Subsidies	-63.8	-54.5	-11.1	-13.5	-14.1	-15.8	-54.4	-10.1	-12.7	-13.602	-18.0	-9.3	5.0	4.5	3.1	2.6
Social transfers	-217.0	-281.5	-62.2	-69.8	-70.8	-78.7	-335.8	-79.8	-81.1	-81.7	-93.1	-91.1	18.0	15.2	16.1	15.8
<i>o/w: pensions⁶⁾</i>	-151.1	-186.1	-41.9	-45.8	-46.9	-51.5	-227.7	-52.7	-55.7	-58.501	-60.8	-62.0	10.8	10.6	10.6	10.7
Other current expenditure	-13.3	-15.8	-3.1	-3.9	-4.2	-4.6	-17.4	-3.5	-4.6	-4.1	-5.2	-3.9	0.8	0.9	0.9	0.8
2. Capital expenditure ⁷⁾	-37.0	-33.0	-5.4	-9.0	-7.8	-10.8	-63.9	-7.3	-10.8	-13.2	-32.6	-15.6	1.9	2.6	1.9	3.0
III "OLD" DEBT REPAYMENT AND GOVERNMENT NET LENDING	-25.2	-36.7	-2.5	-17.4	-8.9	-7.9	-49.1	-4.4	-17.1	-10.1	-17.5	-14.6	2.7	1.8	2.1	2.3
1. Debt repayment - FFCDs and LRS	-18.9	-21.9	-0.9	-15.1	-5.1	-0.8	-21.7	-1.0	-14.6	-4.8	-1.4	-5.1	1.6	1.3	1.3	1.0
2. Pensions ⁸⁾	-4.5	-9.8	-1.3	-1.5	-1.4	-5.6	-20.3	-1.6	-1.7	-4.0	-13.0	-8.9	0.3	0.3	0.6	1.0
3. Budget credits, net ⁹⁾	-1.8	-4.9	-0.3	-0.8	-2.3	-1.5	-7.1	-1.8	-0.8	-1.3	-3.2	-0.6	0.8	0.1	0.3	0.3
IVa CASH BALANCE (I+II), MoF definition¹⁰⁾	17.5	33.8	4.9	3.9	9.8	15.2	12.0	0.4	16.5	9.9	-14.8	12.2	2.4	1.2	1.9	0.6
Republic budget	-0.78	26.8	-0.9	4.7	6.0	17.0	3.3	-9.1	7.5	4.9	0.0	..	..	0.1	1.5	0.2
Pension and Disability Insurance Employee Fund	-0.8	-0.5	-1.0	0.0	1.2	0.7	5.0	1.8	1.4	0.1	1.7	..	..	0.1	0.0	0.2
Pension and Disability Insurance Self-employed Fund	2.7	2.5	0.2	0.1	-0.1	2.3	5.2	0.6	1.2	1.3	2.1	..	..	0.2	0.1	0.2
Pension and Disability Insurance Farmers Fund	0.0	0.0	0.2	-0.1	0.0	-0.1	0.1	0.1	0.0	0.0	0.0	..	..	0.0	0.0	0.0
Health Insurance Fund	1.4	-0.5	1.3	-0.7	1.1	-2.2	3.1	1.0	2.4	1.8	-2.1	..	..	0.1	0.0	0.1
National Employment Service	0.8	0.8	-0.3	0.3	-0.4	0.0	0.2	0.3	0.8	0.2	-1.2	..	..	0.1	0.0	0.0
Vojvodina budget	-0.6	-1.8	0.3	-0.1	-0.1	-1.9	-2.7	0.7	0.0	-1.1	-2.3	..	..	0.0	0.1	0.1
Local government	..	3.8	5.4	0.0	1.3	-2.9	1.3	5.7	3.4	0.3	-8.2	..	..	0.2	0.1	0.1
IVb OVERALL BALANCE (IVa+III.3.), IMF definition, MoF data¹¹⁾	15.7	28.9	4.6	3.1	7.5	13.7	4.9	-1.4	15.7	8.6	-18.0	11.6	3.2	1.1	1.6	0.2
IVc ANALYTICAL BALANCE (I+II+III), FREN's definition¹²⁾	-7.7	-2.9	2.4	-13.4	0.8	7.3	-37.2	-4.0	-0.6	-0.2	-32.3	-2.5	5.1	0.5	0.2	1.8
V FINANCING (FREN's definition)	23.9	27.8	12.9	-3.9	11.8	7.0	121.8	8.5	1.4	103.2	8.7	24.7	3.8	1.7	1.6	5.7
Grants ¹³⁾	0.9	0.2	0.0	0.0	0.1	0.1	0.7	0.1	0.1	0.2	0.3	0.1	0.2	0.1	0.0	0.0
Privatization receipts ¹⁴⁾	14.2	21.7	12.1	-2.1	14.0	-2.3	106.1	9.1	1.3	103.0	-7.3	26.6	2.8	1.0	1.2	5.0
Domestic financing ¹⁵⁾	5.9	5.0	1.5	1.7	0.7	1.1	21.0	1.4	0.2	1.4	18.0	0.5	0.2	0.4	0.3	1.0
Foreign financing ¹⁶⁾	7.4	6.7	0.0	1.5	1.9	3.3	2.0	-0.4	1.4	1.0	0.1	-0.4	0.8	0.5	0.4	0.1
Expenditures for principal repayments to domestic and foreign creditors ¹⁷⁾	-4.5	-5.8	-0.7	-5.0	-4.9	4.8	-8.1	-1.7	-1.7	-2.4	-2.3	-2.0	0.1	0.3	0.3	0.4
VI ACCOUNT BALANCE CHANGE (IVc+V)	16.2	24.9	15.3	-17.3	12.6	14.3	84.6	4.5	0.7	103.0	-23.7	22.2	1.3	1.1	1.4	4.0
MEMORANDUM ITEMS																
Government net position in banking system, change:																
- based on recorded fiscal flows (IVc+V)	16.2	24.9	15.3	-17.3	12.6	14.3	84.6	4.5	0.7	103.0	-23.7	22.2	1.3	1.1	1.4	4.0
- based on commercial bank's financial reports (NBS data)	-7.0	38.1	20.2	16.0	-9.5	11.4	134.8	10.5	17.1	107.2	..	..	0.7	0.5	2.2	6.4
Enterprises' claims on VAT (FREN's estimate) ¹⁸⁾	..	17.1	3.0	3.1	3.5	7.5	0.5	-1.6	2.1	0.0	0.0	0.0	..	..	1.0	0.0
Offsets with SDF ¹⁹⁾	8.8	5.5	1.4	1.6	0.7	1.8	9.5	0.1	0.0	3.9	5.4	0.1	..	..	0.6	0.3
IVb Total fiscal result, IMF data ²⁰⁾	8.0	25.4	..	..	..	..	..	..	..	..	..	..	..	..	2.5	0.6
Investment projects (FLIPs), IMF data ²¹⁾	-8.3	-6.1	..	..	..	..	..	..	..	..	..	..	..	..	0.5	0.6

Source: Public Finance Bulletin (PFB), IMF Country Report No. 06/58, FREN's estimates, Memorandum on the Budget and Economic Policy for 2006 with Projections to 2009 and for 2007 with projections to 2009.

- 1) Includes all levels of government (central, provincial and municipal) and their budget beneficiaries and social security organizations (Serbian Pension and Disability Insurance Funds, Health Insurance Funds, National Employment Office, but not public enterprises and the NBS).
- 2) VAT revenue excluding government VAT liabilities given in Memorandum items (see footnote 16).
- 3) Contributions revenue reduced by the item "Offsets with SDF" in the Memorandum items (see footnote 19).
- 4) Account 414 - Social benefits for employees, including sick benefits, expenditure for training employed persons, and severance payments. This item refers only to the Republic budget.
- 5) FREN's estimate based on media reports and the MoF website, which tallies with item on receipts from borrowing (Account 91) Serbian Health Insurance Bureau from PFB.
- 6) Expenditures on current pensions, adjusted for the payment of the "old debt" and debt incurred through the delay in pension payments starting in December 2005. (See item III.2 and footnote 8).
- 7) Capital expenditure figures for 2003 and 2004 were taken from the Memorandum on the Budget and Economic Policy for 2006 with Projections to 2009. (see footnote 16).
- 8) In December 2002, payment started of the "old debt" to pensioners which was incurred in the April 1994-June 1995 period when only 83% of the

due pension amounts was paid. Payment was envisaged in 43 installments (mid-2006). In addition, the delay in pension payments inherited from the 1990s was eliminated at the end of last year, with payment of the 1.5 pension arrears starting in December 2005.

9) The item corresponds to the item "Outlays for acquisition of financial assets" in the PFB, i.e. to the item "net lending" in the IMF presentation. This refers exclusively to credits deemed to be for public policy purposes. It comprises loans to students, financing of the National Corporation for Housing Loan Insurance and the like. A large amount in 2003 can probably be explained by the shift in financing of government spending for the period of the temporary budget in the first months of 2004.

10) Cash surplus/deficit under (GFS 2001) represents the difference between current revenue and receipts from the sale of non-financial property (i.e. capital revenues) and current expenditures and spending on acquisition of non-financial property (i.e. capital expenditures). See discussion on methodology in Box 1, QM 3 for more details. The unconsolidated (total of results at all levels of government) and consolidated results should, by definition, agree but differences exist due to inconsistencies in the fiscal data.

11) Overall fiscal balance (GFS 2001) - Cash surplus/deficit adjusted for transactions in assets and liabilities that are deemed to be for public policy purposes (i.e. lending minus repayment - GFS 1986), or what we named "budget credits". See discussion on methodology in Box 1, QM 3 for more details.

12) Under FREN's definition, the analytical balance includes on the expenditure side the payment of old (domestic) debts, specifically payments for FFCDs, the Serbia Reconstruction Loan, debt to pensioners, etc. Defined in this way, the result measures the liquidity effect government transactions have on the economy.

13) Information from IMF CR 06/58. There is no data on grants in the PFB.

14) Estimate based on the reported republic's privatization proceeds, increased by 10% an account of the statutory allocations to the Pension Fund and the Restitution Fund. We have no explanation for the negative privatization proceeds in the PFB in Q4 2005.

15) Financing through the issuance of T-bills of the Republic of Serbia. There is a possibility that new loans to the government extended by domestic banks are included here, in which case they should be excluded from the item: "Change in Government Net Position in the Banking System on the basis of data from commercial bank's balance sheets (NBS data)" in Memorandum items.

16) Foreign financing in the budget of the Republic has been increased by 30% (an allowance for unknown local financing).

17) Expenses for debt amortization from the PFB, which are not included in Section III.

18) FREN's estimate, based on: unofficial information that tax credit of enterprises at end-2005 amounted to around 11 billion, and VAT refund flows presented in the PFB.

19) These are offsets of the Serbian Pension and Disability Insurance Funds debt to the Serbian Development Fund and contribution arrears of companies that are debtors of the Serbian Development Fund.

20) Line item "Overall balance, excluding project loans", Table 8. Serbia: General Government Fiscal Operations, 2003-06, INF Country Report No. 06/58, February 2006, page 37.

21) FLIPs - Foreign loan financed investment projects, data from IMF Country Report No. 06/58. According to the IMF's methodology, FLIPs are classified as part of capital expenditure, while, according to the methodology used by the Ministry of Finance they are not. A comparison with the IMF data, however, suggests that this item may have been included in official capital expenditure figures in 2004 after all.

Note: The figures do not always sum up due to rounding off.

Analytical Appendix

Table P-9. Serbia: Monetary Survey, 2004–2007

	2004		2005			2006			2007	
	Dec.	Mar.	Jun	Sep.	Dec.	Mar.	Jun	Sep.	Dec.	Mar.
	in millions dinars, end of period ¹⁾									
Net Foreign Assets (NFA)	160,868	162,488	183,484	216,183	218,886	200,462	229,984	360,685	407,565	441,048
Net Foreign Assets (NFA) (in euros)	2,014	2,005	2,217	2,552	2,560	2,307	2,674	4,399	5,159	5,407
Assets	313,353	332,844	371,427	428,842	491,883	517,118	600,522	710,311	770,999	775,921
Assets (in euros)	3,922	4,107	4,487	5,063	5,753	5,951	6,983	8,662	9,759	9,512
NBS	248,376	274,136	304,386	362,216	424,844	465,497	549,529	648,966	715,114	719,381
NBS (in euros)	3,109	3,382	3,677	4,276	4,969	5,357	6,390	7,914	9,052	8,819
Commercial banks	64,977	58,708	67,041	66,626	67,039	51,621	50,993	61,365	55,885	56,540
Commercial banks (in euros)	813	724	810	787	784	594	593	748	707	693
Liabilities (-)	-152,485	-170,356	-187,943	-212,659	-272,997	-316,656	-370,538	-349,626	-363,434	-334,873
Liabilities (-) (in euros)	-1,909	-2,102	-2,271	-2,511	-3,193	-3,644	-4,309	-4,264	-4,600	-4,105
NBS	-69,260	-72,187	-73,162	-81,569	-81,873	-87,575	-68,368	-48,845	-55,692	-16,275
NBS (in euros)	-867	-891	-884	-963	-958	-1,008	-795	-596	-705	-200
Commercial banks	-83,225	-98,169	-114,781	-131,090	-191,124	-229,081	-302,170	-300,781	-307,742	-318,598
Commercial banks (in euros)	-1,042	-1,211	-1,387	-1,548	-2,235	-2,636	-3,514	-3,668	-3,895	-3,906
Net Domestic Assets (NDA)	162,007	168,841	190,622	206,257	239,985	272,642	285,856	207,195	231,055	234,991
Domestic credits	348,617	370,019	407,795	446,299	490,467	516,435	557,316	490,539	509,110	537,098
Net credits to government ²⁾	5,951	-6,864	-1,602	-10,242	-27,831	-31,129	-33,954	-124,159	-100,061	-128,909
Credits	44,001	46,961	41,744	43,492	40,106	40,311	37,919	31,415	34,896	29,559
Dinar credits	30,008	30,237	25,285	23,313	21,272	18,381	16,408	15,322	18,271	16,193
NBS	22,407	22,123	17,524	16,901	16,330	14,735	14,474	14,472	16,450	15,740
Commercial banks	7,601	8,114	7,761	6,412	4,942	3,646	1,934	850	1,821	453
Fx credits	13,993	16,724	16,459	20,179	18,834	21,930	21,511	16,093	16,625	13,366
Fx credits (in euros)	175	206	199	238	220	252	250	196	210	164
NBS	0	0	0	0	181	184	182	0	0	0
NBS (in euros)	0	0	0	0	2	2	2	0	0	0
Commercial banks	13,993	16,724	16,459	20,179	18,653	21,746	21,329	16,093	16,625	13,366
Commercial banks (in euros)	175	206	199	238	218	250	248	196	210	164
Deposits (-)	-38,050	-53,825	-43,346	-53,734	-67,937	-71,440	-71,873	-155,574	-134,957	-158,468
Dinar deposits	-24,484	-32,060	-29,868	-34,581	-43,604	-43,860	-55,057	-50,760	-27,047	-51,975
NBS	-22,966	-30,245	-28,235	-32,797	-40,718	-39,439	-49,801	-45,785	-19,678	-43,849
Commercial banks	-1,518	-1,815	-1,633	-1,784	-2,886	-4,421	-5,256	-4,975	-7,369	-8,126
Fx deposits	-13,566	-21,765	-13,478	-19,153	-24,333	-27,580	-16,816	-104,814	-107,910	-106,493
Fx deposits (in euros)	-170	-269	-163	-226	-285	-317	-196	-1,278	-1,366	-1,305
NBS	-9,990	-18,088	-6,571	-14,392	-18,806	-21,464	-10,586	-99,498	-103,443	-101,705
NBS (in euros)	-125	-223	-79	-170	-220	-247	-123	-1,213	-1,309	-1,247
Commercial banks	-3,576	-3,677	-6,907	-4,761	-5,527	-6,116	-6,230	-5,316	-4,467	-4,788
Commercial banks (in euros)	-45	-45	-83	-56	-65	-70	-72	-65	-57	-59
Credit to the non-government sector	342,666	376,883	409,397	456,541	518,298	547,564	591,270	614,698	609,171	666,007
Households	66,514	72,489	86,340	108,053	132,146	150,290	172,185	190,378	203,631	230,775
Enterprises	276,152	304,394	323,057	348,488	386,152	397,274	419,085	424,320	405,540	435,232
Other item, net ³⁾	-186,610	-201,178	-217,173	-240,042	-250,482	-243,793	-271,460	-283,344	-278,055	-302,107
o/w: Capital and Reserves (-)	-142,753	-160,723	-169,226	-177,165	-181,772	-187,095	-216,178	-220,712	-242,254	-256,429
NBS	-33,580	-39,068	-38,085	-36,571	-41,450	-42,531	-42,364	-27,662	-7,454	-15,993
Commercial banks	-109,173	-121,655	-131,141	-140,594	-140,322	-144,564	-173,814	-193,050	-234,800	-240,436
Broad money: M2⁴⁾	322,876	331,331	374,106	422,441	458,870	473,103	515,840	567,881	638,620	676,039
Dinar denominated M2 ⁵⁾	146,209	143,768	160,351	180,043	192,180	189,911	208,606	232,506	283,116	282,299
M1	111,258	110,073	120,481	134,727	144,949	137,800	148,694	158,452	200,090	193,187
Currency outside banks	45,165	39,368	42,316	47,283	53,650	45,825	48,926	52,110	68,461	58,669
Demand deposits (households and economy)	66,093	70,705	78,165	87,444	91,299	91,975	99,768	106,342	131,629	134,518
Time and savings deposits (households and economy)	34,951	33,695	39,870	45,316	47,231	52,111	59,912	74,054	83,026	89,112
Fx deposits (households and economy)	176,667	187,563	213,755	242,398	266,690	283,192	307,234	335,375	355,504	393,740
Fx deposits (households and economy), in euros	2,211	2,314	2,582	2,862	3,119	3,259	3,572	4,090	4,500	4,827
o/w: households ⁶⁾	110,713	124,107	141,477	162,667	190,136	207,609	222,105	243,328	260,661	293,195
o/w: households ⁶⁾ (in euros)	1,386	1,531	1,709	1,921	2,224	2,389	2,583	2,967	3,300	3,594

Source: NBS: Statistical bulletin.

1) Unless otherwise indicated.

2) Government does not include cities and municipalities, these are treated as a non-government sector.

3) As mentioned in footnote 3 in Table T-22: Enterprises also include non-profit and other non-government economic entities.

4) M2 refers to M3 in accepted methodology in Serbia, and it includes: currency outside banks; demand deposits of households and enterprises; time and savings dinar deposits of households and enterprises; and time and savings fx deposits of households and

5) M2 dinar refers to M2 in accepted methodology in Serbia, and it includes: currency outside banks; demand deposits of households and economy; and time and savings dinar deposits of households and economy.

6) Household savings.

Table P-10. Serbia: Commercial Banks Balance Sheet, 2004–2007

	2004		2005				2006			2007	
	Dec.	Mar.	Jun	Sep.	Dec.	Mar.	Jun	Sep.	Dec.	Mar.	
	in millions dinars, end of period ¹⁾										
Net foreign reserves	-18,248	-39,461	-47,740	-64,464	-124,085	-177,460	-251,177	-239,416	-251,857	-262,058	
Net foreign reserves (in euros)	-228	-487	-577	-761	-1,451	-2,042	-2,921	-2,920	-3,188	-3,213	
Gross foreign reserves	64,977	58,708	67,041	66,626	67,039	51,621	50,993	61,365	55,885	56,540	
Gross foreign reserves (in euros)	813	724	810	787	784	594	593	748	707	693	
Gross reserve liabilities (-)	-83,225	-98,169	-114,781	-131,090	-191,124	-229,081	-302,170	-300,781	-307,742	-318,598	
Gross reserve liabilities (-) (n euros)	-1,042	-1,211	-1,387	-1,548	-2,235	-2,636	-3,514	-3,668	-3,895	-3,906	
Net Domestic Assets (NDA)	18,250	39,461	47,740	64,464	124,085	177,460	251,177	239,416	251,857	262,058	
Domestic credits	177,391	206,895	230,533	263,230	331,378	375,536	481,132	483,067	509,090	534,592	
Net claims on government ²⁾	8,515	10,731	3,600	7,558	5,838	4,295	-3,369	-8,219	-2,492	-9,261	
Claims	22,863	25,948	25,396	28,062	25,803	27,837	26,044	20,745	23,479	19,134	
Dinar credits	8,868	9,220	8,932	7,878	7,145	6,086	4,710	4,652	6,854	5,768	
Fx credits	13,995	16,728	16,464	20,184	18,658	21,751	21,334	16,093	16,625	13,366	
Fx credits (in euros)	175	206	199	238	218	250	248	196	210	164	
Liabilities (-)	-14,348	-15,217	-21,796	-20,504	-19,965	-23,542	-29,413	-28,964	-25,971	-28,395	
Dinar deposits	-10,750	-11,506	-14,859	-15,702	-14,399	-17,382	-23,171	-23,630	-21,496	-23,592	
Fx deposits	-3,598	-3,711	-6,937	-4,802	-5,566	-6,160	-6,242	-5,334	-4,475	-4,803	
Fx deposits (in euros)	-45	-46	-84	-57	-65	-71	-73	-65	-57	-59	
Net claims on NBS	97,706	99,551	136,668	159,585	204,896	235,986	340,148	382,531	467,869	483,231	
Claims	99,461	101,304	137,187	160,321	205,631	236,443	341,952	382,974	468,312	483,620	
Cash	4,281	3,812	4,430	4,822	7,053	6,793	6,799	8,654	10,206	9,889	
Required reserves	20,953	20,676	21,855	24,673	26,046	26,387	33,352	33,602	34,290	25,931	
Excess reserves	1,481	-1,076	-211	-76	2,621	-2,109	-2,473	-3,440	-1,524	49	
Deposits (-)	72,746	74,685	93,482	111,094	153,016	174,078	247,994	263,765	273,808	280,284	
o/w: dinar deposits	7,512	3,679	3,827	5,317	5,274	948	2,564	7,535	20,189	6,651	
NBS bills/repo ³⁾	0	3,207	17,631	19,808	16,895	31,294	56,280	80,393	151,532	167,467	
Liabilities (-)	-1,755	-1,753	-519	-736	-735	-457	-1,804	-443	-443	-389	
Net claims on the rest of the economy	71,170	96,613	90,265	96,087	120,644	135,255	144,353	108,755	43,713	60,622	
Claims	333,582	367,552	399,378	446,022	507,171	536,214	579,880	593,628	589,303	645,429	
Households	66,356	72,261	86,064	107,781	131,860	150,007	171,904	190,098	203,318	230,357	
Long-term claims	49,563	54,699	67,600	87,403	107,724	121,378	138,539	151,998	163,638	187,445	
Short-term claims	16,793	17,562	18,464	20,378	24,136	28,629	33,365	38,100	39,680	42,912	
Enterprises	267,226	295,291	313,314	338,241	375,311	386,207	407,976	403,530	385,985	415,072	
Long-term claims	127,659	134,122	136,572	143,875	165,442	168,212	178,091	183,205	179,842	195,326	
Short-term claims	139,567	161,169	176,742	194,366	209,869	217,995	229,885	220,325	206,143	219,746	
Liabilities (-)	-262,412	-270,939	-309,113	-349,935	-386,527	-400,959	-435,527	-484,873	-545,590	-584,807	
Dinar deposits	-86,669	-84,305	-96,457	-108,557	-121,022	-119,059	-130,309	-150,239	-191,040	-191,962	
Households	-12,733	-12,624	-14,931	-16,017	-16,542	-17,688	-21,273	-20,972	-26,729	-29,482	
Enterprises	-73,936	-71,681	-81,526	-92,540	-104,480	-101,371	-109,036	-129,267	-164,311	-162,480	
Fx deposits	-175,743	-186,634	-212,656	-241,378	-265,505	-281,900	-305,218	-334,634	-354,550	-392,845	
Households ⁴⁾	-110,713	-124,107	-141,477	-162,667	-190,136	-207,609	-222,105	-243,328	-260,661	-293,195	
Households (in euros)	-1,386	-1,531	-1,709	-1,921	-2,224	-2,389	-2,583	-2,967	-3,300	-3,594	
Enterprises	-65,030	-62,527	-71,179	-78,711	-75,369	-74,291	-83,113	-91,306	-93,889	-99,650	
Enterprises (in euros)	-814	-771	-860	-929	-882	-855	-966	-1,113	-1,188	-1,222	
Other item, net⁵⁾	-159,141	-167,434	-182,793	-198,766	-207,293	-198,076	-229,955	-243,651	-257,233	-272,534	
o/w: capital and reserves	-109,173	-121,655	-131,141	-140,594	-140,322	-144,564	-173,814	-193,050	-234,800	-240,436	

Source: NBS, Statistical Bulletin.

1) Unless otherwise indicated.

2) Government include: Republic level and cities and municipalities.

3) Repo transactions include treasury bills and NBS bills, which were initially substituted by T-bills in January 2005, only to be introduced anew nine months later.

4) Household savings.

5) Includes: Other assets: Deposits of enterprises undergoing liquidation; Capital and reserves; Other liabilities; and Interbank, net.

Analytical Appendix

Table P-11. Serbia: National Bank of Serbia Balance Sheet, 2004–2007

	2004		2005			2006			2007	
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
	in millions dinars, end of period ¹⁾									
Foreign assets , net	113,148	132,749	143,615	173,447	194,094	204,236	235,394	344,129	406,226	429,702
Foreign assets, net (in euros)	1,416	1,638	1,735	2,048	2,270	2,350	2,737	4,197	5,142	5,268
Gross foreign reserves	248,376	274,137	304,386	362,216	424,844	465,497	549,529	648,946	715,114	719,381
Gross foreign reserves (in euros)	3,109	3,382	3,677	4,276	4,969	5,357	6,390	7,914	9,052	8,819
Gross foreign liabilities (-)	-135,228	-141,388	-160,771	-188,769	-230,750	-261,261	-314,135	-304,817	-308,888	-289,679
Gross foreign liabilities (-) (in euros)	-1,693	-1,744	-1,942	-2,229	-2,699	-3,006	-3,653	-3,717	-3,910	-3,551
o/w: fx deposits of commercial banks	-65,565	-71,063	-89,662	-106,865	-147,467	-173,371	-245,784	-256,325	-253,563	-273,927
o/w: fx deposits of commercial banks (in euros)	-821	-877	-1,083	-1,262	-1,725	-1,995	-2,858	-3,126	-3,210	-3,358
Net Domestic Assets (NDA)	-35,895	-63,970	-71,980	-92,104	-99,741	-126,011	-146,374	-245,869	-272,302	-326,990
Domestic credits	-13,459	-37,295	-41,763	-58,665	-64,206	-87,578	-110,436	-220,997	-264,055	-310,446
Net claims on government ²⁾	-15,648	-36,568	-25,594	-40,352	-48,936	-57,975	-56,993	-142,239	-116,094	-146,005
Claims	22,407	22,123	17,524	16,901	16,511	14,919	14,656	14,472	16,450	15,740
o/w: other dinar credits	22,407	22,123	17,524	16,901	16,330	14,735	14,474	14,472	16,450	15,740
Deposits (-)	-38,055	-58,691	-43,118	-57,253	-65,447	-72,894	-71,649	-156,711	-132,544	-161,745
Dinar deposits	-28,065	-40,603	-36,547	-42,861	-46,641	-51,430	-61,063	-57,213	-29,101	-60,040
o/w: municipalities	-5,099	-10,358	-8,312	-10,064	-5,923	-11,991	-11,262	-11,428	-9,423	-16,191
Fx deposits	-9,990	-18,088	-6,571	-14,392	-18,806	-21,464	-10,586	-99,498	-103,443	-101,705
Fx deposits (in euros)	-125	-223	-79	-170	-220	-247	-123	-1,213	-1,309	-1,247
Net claims on banks	1,747	-1,214	-16,782	-18,830	-15,875	-30,218	-53,912	-79,337	-149,252	-165,948
Claims	1,747	1,992	825	974	954	869	2,069	827	488	467
o/w: other dinar credits	1,740	1,669	471	612	946	493	1,710	489	481	453
o/w: Fx credits	7	323	354	362	8	376	359	338	7	14
o/w: Fx credits (in euros)	0	4	4	4	0	4	4	4	0	0
Liabilities (NBS bills, repo transactions) (-)	0	-3,206	-17,607	-19,804	-16,829	-31,087	-55,981	-80,164	-149,740	-166,415
Net claim on the rest of the economy	442	487	613	517	605	615	469	579	1,291	1,507
Claims	469	514	640	732	670	674	653	639	1,353	1,509
Dinar and fx credits	469	514	640	732	670	674	653	639	1,353	1,509
Liabilities (-)	-27	-27	-27	-215	-65	-59	-184	-60	-62	-2
Dinar deposits	-27	-27	-27	-215	-65	-59	-184	-60	-62	-2
Other items, net ³⁾	-22,436	-26,675	-30,217	-33,439	-35,535	-38,433	-35,938	-24,872	-8,247	-16,544
Reserve money (H)	77,257	68,780	71,635	81,342	94,353	78,226	89,019	98,263	133,924	102,712
Currency in circulation	45,165	39,368	42,316	47,283	53,650	45,825	48,926	52,110	68,461	58,669
Commercial bank's reserves	32,092	29,412	29,319	34,059	40,703	32,401	40,093	46,153	65,463	44,043
Required reserves allocated	20,953	20,676	21,855	24,673	26,046	26,387	33,352	33,602	34,290	25,931
Excess reserves	11,139	8,736	7,464	9,386	14,657	6,014	6,741	12,551	31,173	18,112
Overnight deposits	6,858	4,924	3,034	4,564	7,604	-779	-58	3,897	20,967	8,223
Giro account and cash	4,281	3,812	4,430	4,822	7,053	6,793	6,799	8,654	10,206	9,889

Source: NBS, Statistical bulletin.

1) Unless otherwise indicated.

2) Government include: Republic level and cities and municipalities.

3) Includes: Other assets; Fx deposits of other financial institutions; Deposits of banks undergoing liquidation; Capital and reserves; and Other liabilities.

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