4. Balance of Payments and Foreign Trade

In Q1 2018, the current account deficit amounted to 650 million euros, i.e. 7.0% of GDP, and was lower than the realised deficit in the same period of the previous year. On the one hand, there was a more pronounced increase in the foreign trade deficit, while on the other hand there was a significant reduction in the deficit in the Primary Income account, as well as a small increase in the surplus on the Secondary Income account. The growth of the foreign trade deficit was the result of a slightly faster growth in Q1 of imports of goods and services than exports, although both growth rates were in the double-digits. The increase in the foreign trade deficit was due to the effects of real appreciation of the dinar from 2017, higher global energy prices, growth of domestic demand, while the growth of the Eurozone countries and the favourable world price of domestic export products (metals, grains) contributed to its decrease. Further movement of foreign trade components will be conditioned by the future level of prices of primary products on the world market, the pace of Eurozone growth, further growth in investment and production in Serbia, as well as domestic economic policy (fiscal policy, exchange rate policy). The inflow of direct investments and portfolio investment during Q1 was higher than the current account deficit, so the level of foreign exchange reserves increased since the beginning of the year.

In Q1 2018, current account deficit was 650 million euros, i.e. 7.0% of GDP...

In Q1 2018, current account deficit was 650 million euros, i.e. 7.0% of GDP. Therefore, the current deficit is at a lower level by 44 million euros, i.e. 1.3 pp of GDP compared to the level of Q1 2017 (Table T4-1). On the one hand, there has been a more pronounced increased in the foreign trade deficit, while on the other, a significant decrease in the Primary Income account deficit was recorded (mostly due to lower spending on dividends)[1], as well as a small increase of surplus in the Secondary Income account.

...on the one hand, foreign trade deficit is increasing...

Still, we should keep in mind that the level of the current account deficit was particularly high in Q1 2017. At that time, the current deficit was 694 million euros, i.e. 8.3% of GDP. This was a sudden jump since, in 2016, the current deficit amounted to 3.1% of GDP. Such an increase at the beginning of the previous year was the result of an increase in the foreign trade deficit (due to the growth of imports, which occurred due to the deterioration of the exchange ratio, as a result of the increase in the price of energy products), as well as the increase in the primary income (due to the outflow of funds for dividends).

...on the other hand, deficit in the Primary Income account has been reduced, while the surplus in the Secondary Income account has slightly increased

In Q1 2018, trade deficit was 1.133 million euros (12.2% of GDP), which was by 206 million euros, i.e. by 1.1 pp of GDP, higher than the deficit in the same period of 2017. During Q1, a surplus of 226 million euros was realised on the Services account, and the foreign trade deficit amounted to 906.5 million euros (9.8% of GDP), which was 1.3 pp of GDP above the deficit recorded in Q1 a year earlier (Graph T4-2). It should be noted that during 2017, the foreign trade deficit was also relatively high. Namely, this deficit had relatively high values in Q1 and Q4 2017: 8.5% of GDP and 10.6% of GDP, respectively, while it was at a relatively lower level in Q2 (7.7% of GDP) in Q3 (6.1% of GDP).

In Q1, foreign trade deficit was 906.5 million euros, i.e. 9.8% of GDP...

In fact, foreign trade deficit has been increasing since 2016 (see Graph T4-2), so it is not the result of any temporary factors, but of a systemic problem (exchange rate, etc.), which affects the foreign trade deficit. Also, we note that this level of foreign trade deficit is quite high, especially considering that in the previous period a restrictive fiscal policy has been conducted. Therefore, with each growth of the fiscal deficit, it is realistic to expect an increase in the foreign trade deficit.

The increase in foreign trade deficit was the result of a slightly faster growth in Q1 of imports of goods and services than exports, although both growth rates were in the double-digits. The accelerated growth of exports in Q1 was significantly affected by the growth of the Eurozone countries, while the growth of exports decelerated due to the delayed effects of the appreciation of the dinar against the euro in 2017. At the same time, the growth of imports was largely de-

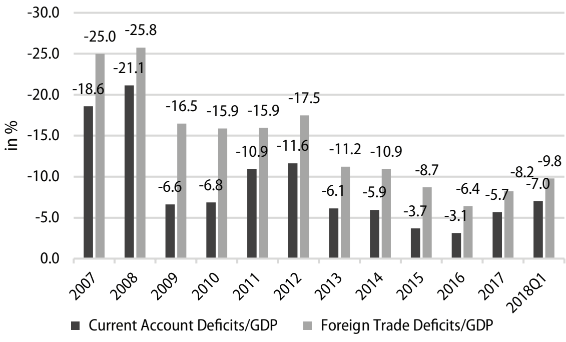
1 Primary income includes income from factors of production such as income based on dividends, interest and other income from capital and labour.

Table T4-1. Serbia: Balance of Payments

	2016	2017	2016				2017				2018
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
						mil. euros					
CURRENT ACCOUNT	-1,075	-2,090	-305	-284	-239	-247	-694	-333	-384	-678	-650
Goods	-3,119	-3,986	-662	-849	-718	-890	-927	-883	-824	-1,352	-1,133
Credit	12,814	14,090	2,976	3,310	3,160	3,369	3,277	3,693	3,559	3,560	3,571
Debit	15,933	18,076	3,638	4,159	3,878	4,258	4,204	4,576	4,383	4,912	4,704
Services	907	951	186	196	268	258	220	167	236	327	226
Credit	4,571	5,240	993	1,068	1,258	1,252	1,106	1,241	1,424	1,470	1,274
Debit	3,664	4,289	807	872	990	994	886	1,074	1,187	1,143	1,048
Primary income	-2,022	-2,570	-499	-524	-581	-418	-700	-564	-638	-668	-544
Credit	630	568	142	185	140	164	105	153	132	179	116
Debit	2,653	3,138	641	709	721	583	805	717	769	847	660
Secondary income	3,159	3,516	670	894	792	803	713	946	842	1,015	800
Credit	3,635	4,098	771	1,009	921	933	848	1,086	986	1,178	941
Debit	476	583	102	115	130	129	135	139	145	164	141
Personal transfers, net [1]	2,510	2,758	521	735	624	630	565	790	630	773	633
Of which: Workers' remittances	1,874	2,049	379	577	458	460	414	595	475	565	480
CAPITAL ACCOUNT - NET	-10	5	5	-4	-1	-9	1	-3	11	-4	6
FINANCIAL ACCOUNT	-535	-1,690	-99	-180	-95	-162	-486	-328	-266	-610	-460
Direct investment - net	-1,899	-2,415	-470	-454	-533	-443	-558	-626	-660	-571	-569
Portfolio investment	917	827	363	332	-10	232	219	-29	-92	728	-328
Financial derivatives	9	-21	0	1	5	3	-5	-2	-9	-5	17
Other investment	740	-310	845	257	110	-473	313	106	-566	-162	21
Other equity	-1	-1	0	-1	-1	0	0	-1	0	0	0
Currency and deposits	220	-623	318	20	-19	-99	-79	-23	-550	29	21
Loans	303	-203	317	260	-1	-272	316	23	-317	-226	5
Central banks	23	9	12	7	4	0	4	0	4	0	4
Deposit-taking corporations,	279	-272	100	199	80	-99	271	-316	11	-239	94
General government	-308	30	30	11	5	-355	34	290	-314	20	-93
Other sectors	309	31	176	42	-91	182	6	49	-18	-7	0
Insurance, pension, and standardized	8	0	3	7	-6	4	0	0	0	0	0
Trade credit and advances	209	518	207	-29	137	-105	75	106	301	36	-4
Other accounts receivable/payable	0	0	0	0	0	0	0	0	0	0	0
SDR (Net incurrence of liabilities)	0	0	0	0	0	0	0	0	0	0	0
Reserve assets	-302	228	-836	-317	332	519	-455	222	1,061	-600	398
ERRORS AND OMISSIONS, net	549	395	201	109	145	94	208	8	107	72	183
PRO MEMORIA						in % of GDP					
Current account	-3.1	-5.7	-3.8	-3.2	-2.7	-2.8	-8.3	-3.6	-4.0	-7.0	-7.0
Balance of goods	-9.0	-10.8	-8.2	-9.7	-8.0	-10.0	-11.1	-9.6	-8.5	-14.0	-12.2
Exports of goods	37.0	38.2	36.9	37.7	35.4	38.0	39.3	39.9	36.8	36.8	38.5
Imports of goods	46.0	49.0	45.1	47.4	43.5	48.0	50.5	49.5	45.3	50.8	50.8
Balance of goods and services	-6.4	-8.2	-5.9	-7.5	-5.0	-7.1	-8.5	-7.7	-6.1	-10.6	-9.8
Personal transfers, net	7.2	7.5	6.5	8.4	7.0	7.1	6.8	8.5	6.5	8.0	6.8
GDP in euros [2]	34,619	36,926	8,061	8,768	8,921	8,869	8,333	9,245	9,677	9,671	9,263

Note: Balance of Payments of the Republic of Serbia is aligned with the international guidelines stated in the IMF's Balance of Payments Manual no. 6 (BPM6).
Source: NBS
1) Personal transfers present current transfers between the resident and non-resident households.
2) Quarterly values. Conversion of annual GDP to euro was done according to the average annual exchange rate (average of official daily exchange rates of NBS).

Graph T4-2 Serbia: Current Account and Foreign Trade Deficits, 2007-2018Q



Source: NBS, *QM*

….while exports of goods and services was above 50% of GDP at the beginning of 2018

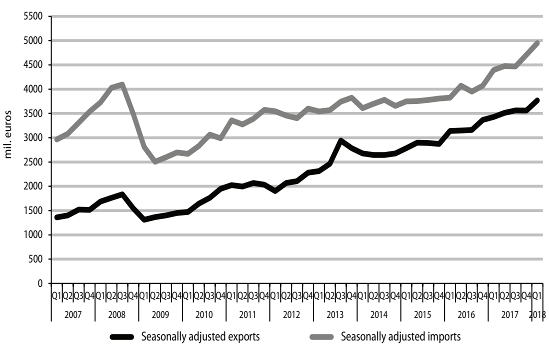
termined by higher global energy prices, the growth of domestic demand, and the effects of real appreciation of the dinar.

Export of goods and services in Q1 2018 was 4.85 billion euros, making it, starting from Q4 2016, more than half of the value of the realised quarterly GDP (more precisely 52.3%). Import of goods and services in the first three months of 2018 was at the level of 5.75 billion euros, i.e. 62.1% of GDP. Exports of goods continued to grow and in Q1 2018 reached 3.57 billion euros, i.e. 38.5% of GDP, while imports of goods amounted to 4.70 billion euros (50.8% of GDP, see Table T4-1). At the beginning of 2018, the coverage of imports by exports in the case of goods was 75.9%, and 84.2% in the case of goods and services.

Therefore, Q1 2018 recorded a 28.2% growth of foreign trade deficit - where the growth of trade deficit amounted to 22.2%, while the growth of surplus of services was 2.7%. Imports and exports of goods and services also recorded a two-digit growth of 13.9% and 10.5%, respectively.

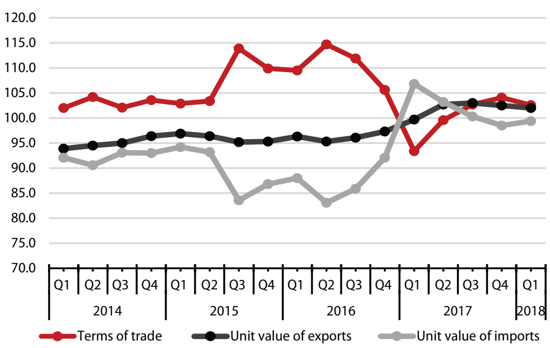
In this period, the growth of exports of goods amounted to 9.0%, while the import of goods increased by 11.9%. Compared to the previous quarter, seasonally adjusted data also indicate a similar growth of exports and imports of goods, although imports recorded slower growth than exports (Graph T4-3). Exports in Q1 2018 were 5.9% above the level from the previous quarter, while at the same time imports increased by 5.1%.

Graph T4-3. Serbia: Seasonally Adjusted Exports and Imports, Quarterly, 2007-2018 Q1



Source: NBS, SORS, *QM*

Graph T4-4. Year-on-Year Index of Trade Ratios, 2014-2018Q1



Source: SORS, *QM*

Changes in the ratio of export and import prices affected the movements and levels in the value of foreign trade. The change in this ratio is represented by the y-o-y exchange rate index. Graph T4-4 shows that this index reached very high values (indicating an improvement in the exchange ratio) from mid-2015 until the beginning of 2017 (when exchange-related ratios are suddenly aggravated), only to improve again from the second half of 2017. In the first three months of 2018, the exchange ratio index was 102.6. Although it is lower compared to the previous quarter (104.1), it remained above 100, indicating still relatively favourable circumstances and a more favourable ratio of export and import prices than a year earlier. In fact, most of the described changes in the exchange rate indices were determined by the level of unit value of imports, which is largely influenced by the movement of the global energy prices. As it is expected that the price of energy in 2018 will be higher than in the previous year, this will also affect the ratio of export and import prices, and thus to the value of foreign trade exchange in our country. It is therefore important that economic policies encourage further export growth in order to neutralise possible unfavourable changes in global prices to the level of foreign trade balance in the current year.

A more pronounced decrease in the net outflow on the Primary Income account

A significant decrease of deficit on the Primary Income account was recorded in Q1

The net outflow on this account was 544 million euros (5.9% of GDP), which was by 156 million euros (by 2.5 pp of GDP) less compared to the same quarter of 2017[2] (Table T4-1). On the Secondary Income account (mostly determined by the movement of personal transfers / remittances), a lower amount of net inflow was recorded in Q1 2018 compared to Q1 of the previous year - although the share of net inflows into GDP remained almost unchanged. The net inflow on Secondary Income account amounted to 800 million euros in Q1 2018, accounting for 8.6% of GDP, recording a mild growth compared to Q1 2017 (by 87 million euros, i.e. by 0.1 pp of GDP). The largest part of this inflow is the inflow from personal transfers of 633 million euros, i.e. 6.8% of GDP, of which the remittance income of workers amounted to 480 million euros (5.2% of GDP).

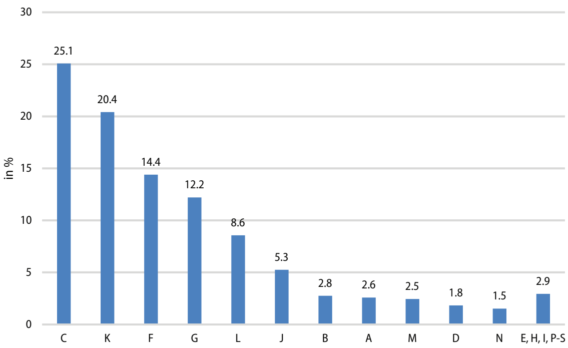
Significant net capital inflow during Q1...

... As a result of inflow of Portfolio and Direct Investments

Q1 recorded a significant net inflow of capital of 865 million euros[3] (Table T4-1). The realised net inflow of capital was due to the inflow of portfolio investments (EUR 328 million) and foreign investment inflows (EUR 569 million), followed by a minor outflow of financial derivatives (EUR 17 million) and other investments (EUR 21 million). FDI inflows are significant, but somewhat lower than the amount of current deficits. The net outflow on the Other Investments account was 21 million euros, recording a net inflow of trade loans in the amount of 4 million euros and a net outflow of financial loans of 5 million euros. Banks deleveraged 94 million euros net, which was offset by state borrowing of 93 million euros. At the same time, a smaller net out-

2 It is possible that the high outflow in the first quarter of 2017 was partly due to the uncertainty surrounding the presidential elections.
3 1.05 billion euros including *Errors and Omittances* account.

Graph T4-5. Net Increase of Financial Liabilities from FDI in 2017: Share of increase by individual economic branches in the overall increase



Source: NBS, QM
Note:
1. C – Manufacturing, K – Financial and Insurance activities, F – Construction, G – Wholesale and Retail trade, Repair of motor vehicles and motorcycles, L – Real estate activities, J – Information and communication, B – Mining and quarrying, A – Agriculture, Forestry and Fishing, M – Professional, scientific and technical activities, D – Electricity, gas, steam and air conditioning supply, N – Administrative and Support Services activities, E, H, I, P-S: Water supply, Sewerage, Waste Management, and remediation activities (E), Transportation and Storage (H), Accommodation and Food service activities (I), Education (P), Human Health and Social Work activities (Q), Arts, Entertainment and Recreation (R), Other Service activities (S), and Not allocated.
2. Foreign Direct Investment methodology is in line with IMF BPM6 and international investment position.
3. Industry branches classified according to statistical classification of economic activities of EC, revision 2 from 2008 (NACE Rev. 2, 2008).
4. Foreign Direct Investment include investments in money, goods, rights, conversion of debt to capital, loans between companies and reinvested profit.
5. Graph was made using NBS data that was available until March 30, 2018 and are subject to changes in line with the changes of the official data sources.

flow of financial loans (EUR 4 million) was recorded on the National Bank account. In Q1 on the Cash and Deposits account, a net outflow of 21 million euros was recorded.

Graph T4-5 shows that in 2017, a quarter of FDI inflows went into the manufacturing industry, where the largest inflow was in the following groups: Production of Motor Vehicles, Trailers and Semi-trailers, Production of Rubber and Plastic, Production of Basic Metals and Metal Products, excluding machinery and equipment, and Other. In addition, a significant portion of the inflow (one fifth) was invested in Financial and Insurance activities, followed by Construction (14.4%), Trade (12.2%), Real Estate (8.6%), Information and Communication (5.3%), etc. (Graph T4-5). The structure of the net increase in financial liabilities of Foreign Direct Investment in 2017 suggests that there is still significant room for directing FDI into the processing sector. Significant FDI inflows continue to go into insurance, trade and finance. From the aspect of further export growth and export-oriented economic development, Serbia is interested in the future FDI inflow to be more focused on manufacturing activities in which interchangeable goods are produced. The structure of Foreign Direct Investments significantly depends on the level of the real exchange rate of the dinar. The overestimation of the real dinar exchange rate makes investments in activities that produce non-transferable goods more profitable than investments in sectors that produce interchangeable goods. In addition, for investments in the sector of commodities, it is important to improve the regulatory framework, reduce administrative and customs procedures, provide educated workforce, etc.

It should also be noted that net income from foreign investments is recorded in the current portion of the balance of payments within the Primary Income account, while the net inflow of FDI is recorded within the financial part of the balance of payments. When paying and analysing foreign investments, we should keep in mind that the positive effect of FDI inflows on the balance of payments is: a) considerably smaller than the one visible only in the financial account, b) decreased over time. Thus, in 2016, the net inflow of capital under the FDI amounted to EUR 1.899 million, and expenditures from FDI recorded on the Primary Income account were EUR 1.416 million, with a difference of EUR 483 million. In 2017, the net inflow of FDI was 2.415, while the net outflow from income from FDI under the Primary Income account was 2.075 million euros, and their balance was 340 million euros. Since the net inflow of FDI during Q1 2018 amounted to 569 million euros, and the outflow from income of FDI 400 million euros, the difference was positive and amounted to 169 million euros. Therefore, we need to bear in mind that there is a significant negative amount on the income account of FDI within the Primary Income, which indicates obligations on this basis. Since the difference between FDI inflows and net outflows of FDI income is still positive, FDI continues to affect favourably the balance of payments of Serbia, but this influence decreases over time.

Level of forex reserves increased since the beginning of the year

Increase of forex reserves in Q1 2018 was 398 million euros and it continue to grow in April. There was a decrease in forex reserves of 173 million euros in January, followed by its increase in February and March by 99 and 472 million euros. Therefore, at the end of April, forex reserves were 10.43 billion euros, which covers more than five months of imports of goods and services, as well as the money mass M1 of 189%[4].

Exports

Exports in Q1 2018 were 3.8 billion euros, realising a year-on-year growth of 8.5%...

Exports in Q1 2018 amounted to 3.8 billion euros, recording a year-on-year growth of 8.5%. Thus, export growth slightly accelerated in Q1 and decelerated again in April (year-on-year export growth in April was 4.2%, Table T4-6). The value of exports after excluding road vehicles also accelerated growth in Q1 (y-o-y growth at a rate of 11.0%) and decelerated in April (6.6%).

... decelerating their growth in April

Table T4-6. Serbia: Exports, Year-on-Year Growth Rates, 2016–2018

	Exports share in 2017	2016	2017	2017		2018		2017		2018	
				Q3	Q4	Q1	April	Q3	Q4	Q1	April
	in %	in mil. euros						in %			
Total	100.0	13,432	15,047	3,778	3,786	3,815	1,303	12.7	7.8	8.5	4.2
Total excluding road vehicles	91.7	12,057	13,797	3,536	3,511	3,502	1,195	14.6	8.6	11.0	6.6
Energy	2.5	329	379	107	117	77	35	24.0	55.7	11.8	41.9
Intermediate products	38.2	4,669	5,743	1,496	1,445	1,555	508	24.7	18.8	19.4	4.8
Capital products	24.1	3,352	3,633	821	979	956	336	7.8	17.4	9.6	9.3
Capital products excluding road vehicles	15.8	1,977	2,383	579	703	642	228	17.5	26.8	25.6	28.2
Durable consumer goods	5.4	739	811	204	207	196	73	6.5	1.2	5.4	10.2
Non-durable consumer goods	22.3	3,198	3,358	888	860	813	270	6.2	2.0	5.0	5.1
Other	7.5	1,145	1,124	262	179	219	82	-5.8	-47.2	-30.1	-26.1

Source: SORS

The increase in total exports since the beginning of the year is the result of an increase in exports of all production groups with the exception of unclassified exports (see the item Other in Table T4-6). In fact, investments from the previous period, as well as the recovery of the Eurozone countries and the region, as our most important foreign trade partners, are key determinants of the observed y-o-y growth of exports since the beginning of the year, as well as significant seasonally adjusted growth of 5.6% in Q1 2018 compared to Q4 2017. The contribution of previous investments to exports and its sustainability can be seen in the fact that in almost all areas of the processing industry, exports are growing. Also, the increase in the value of exports since the beginning of the year has largely contributed to higher prices of primary products on the world market, such as prices of metals and cereals. In fact, the biggest contribution to the growth of exports in Q1 was due to the high increase in the export of metals, partly due to the increased production of Smederevo Steelworks and partly due to the increase in global prices. There has been a significant increase in cereal exports since the beginning of the year due to the increase in corn and wheat prices[5].

On the other hand, deceleration of the growth of exports since the beginning of 2018 was influenced by the real appreciation of dinar from the previous year. In Q1, the year-on-year decline in the value of exports of road vehicles had adverse effects on export growth. In other words, the export of road vehicles, with the exception of Q1 2015, as well as Q2 and Q3 2016, recorded negative rates starting from the second half of 2014. In Q1, exports of road vehicles were by 13% and in April by 17% below the respective period of the previous year.

At the beginning of 2018, a year-on-year growth of the value of energy exports was recorded, from 11.8% in Q1 to 41.9% in April, both due to the increase in export volumes and the rise in energy prices. The 9.6% y-o-y growth of exports of *Capital Goods* in Q1 2018 slowed down compared to the previous quarter, and this slowdown continued in April as well (yoy rate of 9.2%). On the other hand, the export of *Capital Goods after Excluding Road Vehicles*, decelerated its growth in the first three months, only to slightly accelerate again in the fourth month of 2018 (the year-on-year increase in exports of these products in Q1 was 25.6%, followed by 28.2% in April, see Table T4-5). Exports of *Intermediate Goods* slightly accelerated in Q1 2018 compared to Q4 2017, and recorded a y-o-y growth of 19.4%, only to decelerate significantly in April, recording

4 https://www.nbs.rs/internet/cirilica/scripts/showContent.html?id=12777&konverzija=no

5 *Inflation Report*, NBS, May 2018, p.34

a 4.8% growth rate. Export of *Consumer Goods* recorded a certain acceleration in growth in Q1 2018 compared to the same period of 2017, which continued in April as well. The y-o-y growth in export value of *Durable* and *Non-Durable Consumer Goods* in Q1 2018 amounted to 5.4% and 5.0%, and in April 10.2% and 5.1%, respectively. Only the value of *Other* exports recorded a year-on-year decrease since the beginning of the year, i.e. the value of exports of products classified in this group was by 30.1% in Q1 and 26.1% in April lower than those realised in the same period of 2017.

In the coming period, the appreciation of the domestic currency will have adverse effects on exports. On the other hand, realisation of good growth forecasts of economic activity in the world would reflect favourably on exports (EU, countries of the region, Russia, etc.). Further dynamics of exports will largely depend on the movement of prices of important export products (agricultural products, basic metals, etc.), while in the long term, it will be significantly determined by the continued growth in investments and production in sectors that produce interchangeable goods.

Imports

In Q1, imports recorded a 12.5% year-on-year growth, which accelerated in April

The value of imported goods in the first three months of 2018 was 5.07 billion euros. From the beginning of the year, the growth of imports slightly decelerated in Q1 (y-o-y growth of 12.5% in Q1 2018 after 15.5% in Q4 2017), only to accelerate in April (year-on-year rate of 16.6%, see Table T4 -7). The growth of imports at the end of 2017 and the beginning of 2018 was largely determined by higher global energy prices, the effects of real appreciation of the dinar, and the growth of domestic demand. In this period, the structure of the growth of imports was solid, because in addition to the growth of consumer goods due to the recovery of domestic consumption, the growth of intermediate and capital goods was also recorded, which indicates the growth of the current economic activity, as well as possible investments for the purpose of future growth.

All import groups of products recorded growth in the first four months. The value of energy imports in Q1 was almost equal to last year's level in the first three months. In April, the value was as much as 39.3% higher than the value of imports of energy products from April 2017. Imports of *Intermediate Goods* recorded a certain acceleration of growth - y-o-y growth of 16.4% in Q1, only to record a slight slowdown in April. The growth of imports of *Capital Goods* also accelerated in Q1 (y-o-y rate of 9.7%) with a certain slowdown in April. Similar dynamics of imports - acceleration in Q1 with deceleration in April - were recorded by *Durable Consumer Goods*, while imports of *Non-Durable Consumer Goods* have been accelerating since the beginning of the year. The growth in imports of *Intermediate* and *Capital Goods* points to a potential increase in production in the coming period, while consumption growth is related to the recovery of household consumption. Imports excluding energy have been growing for three consecutive quarters at an unchanged y-o-y rate of 14-15% (Table T4-7).

Table T4-7. Serbia: Imports, Year-on-Year Growth Rates, 2016-2018

	Imports share in 2017	2016	2017	2017		2018		2017		2018	
				Q3	Q4	Q1	April	Q3	Q4	Q1	April
	in %			in mil. euros				in %			
Total	100.0	17,068	19,419	4,730	5,265	5,070	1,756	13.3	15.5	12	17
Energy	10.4	1,544	2,025	485	549	525	200	32.2	21.2	0	39
Intermediate products	35.3	5,880	6,862	1,737	1,779	1,803	617	16.2	14.0	16	14
Capital products	21.2	4,128	4,120	909	1,087	1,012	361	-6.9	4.5	10	7
Durable consumer goods	2.1	380	411	100	115	103	34	10.7	4.1	13	10
Non-durable consumer goods	15.0	2,595	2,906	709	796	755	254	7.3	10.3	13	16
Other	15.9	2,541	3,095	790	940	873	289	34.7	39.2	16	24
Imports excluding energy	89.6	15,524	17,393	4,245	4,716	4,546	1,556	11.5	14.8	14	14

Source: SORS

Imports are expected to continue growing in 2018

We expect an increase in imports in the coming quarters of 2018, due to the high probability that energy prices will be higher than last year's, as well as due to a certain increase in domestic demand. The real appreciation of the dinar will also affect the increase of imports in the coming period.

Foreign Debt

At the end of 2017, the foreign debt was 25.74 billion euros, i.e. 69.7% of GDP

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In 2017, external debt was reduced by 759 million euros, based on a reduction in the external debt of the public sector, which is partly compensated by the growth of external debt of the private sector (Table T4-8). Much of the changes in the overall external debt and its relation to GDP is due to the currency changes - the appreciation of the euro against the dollar and the strengthening of the dinar against the euro.

In 2017, during the entire year, as well as the last quarter, the level of the foreign debt was reduced…

… which is a net result of the reduction of the public sector's foreign debt and increase of the private sector's debt

Public sector's foreign debt decreased in 2017 by 1.786 million euros, while that of the private sector increased by 1.027 million euros. In this 12 month period, the long-term external debt of the private sector has increased by 815 million euros, of which 690 million euros are an increase of the amount of long-term debt of the business sector. At the same time, banks increased their external borrowing for long-term debt by 122 million euros. The banks' short-term debt at the end of 2017 increased by 212 million euros and the business sector's by one million euros compared to the situation a year earlier (Table T4-8).

During Q4 2017, foreign debt increased by 354 million euros. Expressed as a percentage of GDP, the external debt at the end of 2017 was lower by 2.5 pp compared to the situation three months earlier. Public sector recorded a debt reduction of 759 million euros in Q4, due to a reduction in the amount of the long-term debt, which was predominantly a result of the repayment of debt on the basis of Eurobonds issued in 2012. On the other hand, the private sector in the last three months of 2017 borrowed 405 million euros. The level of long-term debt increased by 245 million euros, where the banks additionally borrowed 115 million euros, and the business sector 129 million euros (Table T4-8). The level of short-term debt increased by EUR 160 million compared to Q3 2017, exclusively as a result of the higher short-term debt of banks.

Table T4-8. Serbia: Foreign Debt Trend Dynamics, 2014–2017

	2014	2015	2016				2017			
			Mar.	Jun	Sep.	Dec.	Mar.	Jun	Sep.	Dec.
	stocks, in EUR millions, end of the period									
Total foreign debt	25,679	26,234	25,682	25,621	25,603	26,494	26,143	25,462	26,089	25,735
(in % of GDP) [4]	*76.8*	*78.2*	*75.5*	*75.0*	*74.5*	*76.5*	*74.9*	*72.0*	*72.2*	*69.7*
Public debt[1]	14,145	15,295	14,934	15,031	14,923	15,680	15,508	14,590	14,652	13,894
(in % of GDP)[4]	*42.3*	*45.6*	*43.9*	*44.0*	*43.4*	*45.3*	*44.4*	*41.3*	*40.6*	*37.6*
Long term	14,140	15,295	14,934	15,031	14,923	15,680	15,508	14,590	14,652	13,894
o/w: to IMF	152	15	7	0	0	0	0	0	0	0
o/w: Government obligation under IMF SDR allocation	463	493	483	488	484	494	495	472	465	462
Short term	5	0	0	0	0	0	0	0	0	0
Private debt[2]	11,534	10,939	10,748	10,589	10,680	10,815	10,636	10,872	11,437	11,842
(in % of GDP) [4]	*34.5*	*32.6*	*31.6*	*31.0*	*31.1*	*31.2*	*30.5*	*30.7*	*31.7*	*32.1*
Long term	11,441	10,636	10,436	10,314	10,231	10,138	10,114	10,184	10,708	10,953
o/w: Banks debt	2,503	2,057	1,912	1,730	1,514	1,408	1,347	1,392	1,415	1,530
o/w: Enterprises debt	8,935	8,576	8,520	8,580	8,711	8,725	8,760	8,785	9,285	9,414
o/w: Others	3	4	4	4	6	6	7	7	9	9
Short term	94	303	312	275	450	676	522	688	729	889
o/w: Banks debt	57	186	237	220	404	590	382	602	641	802
o/w: Enterprises debt	37	116	75	55	46	86	139	86	87	87
Foreign debt, net 3), (in% of GDP)[4]	47.2	47.2	47.6	47.8	46.7	47.1	47.0	44.7	42.8	42.7

Note: Foreign debt of the Republic of Serbia is calculated according to the "matured debt" principle, which includes amounts of debt from capital and amounts of calculated interest not paid in the moment of agreed maturity.
Source: NBS, QM
1) Foreign debt of the Republic of Serbia's public sector includes the debt of the state (not including the debt of Kosovo and Metohija, for loans concluded before the arrival of KFOR, unregulated debt toward Libya and the clearing debt toward former Czechoslovakia), National Bank of Serbia, local self-governments, funds and agencies formed by the state, and the debt for which state guarantee was issued.
2) Foreign debt of Republic of Serbia's private sector includes the debt of banks, companies and other sectors for which no state guarantee has been issued. Foreign debt of the private sector does not include loans concluded before December 20, 2000 for which no payments are done (934.8 million euro, out of which 402.0 million euro is from domestic banks, and 532.8 million euro is from domestic companies).
3) Total foreign debt reduced by NBS forex reserves.
4) Sum value of GDP of the observed quarter and previous three quarterly values of GDP.

6 Source of data for the foreign debt and international investment position is NBS, and the last available data refers to the end of 2017.

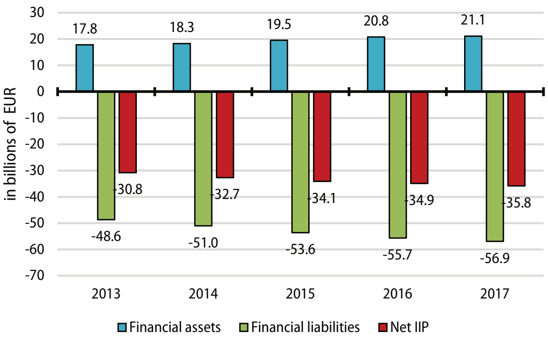
International Investment Position

A country's International Investment Position (IIP) includes external financial assets and liabilities[7]. It represents the difference between foreign financial assets in our possession (foreign exchange reserves, our direct and portfolio investments abroad, approved loans abroad, etc.) and foreign financial liabilities in Serbia (foreign direct and portfolio investments, debts abroad, etc.). The country is a net creditor if its claims and assets abroad are higher than its assets in the country and debts abroad.

The international investment position of Serbia at the end of 2017 was the result of capital and financial transactions (loans issued and taken out, foreign investments in Serbia and ours abroad, etc.) that have been achieved over the past several decades. Therefore, the IIP is the basis for assessing the country's risk of exposure in economic relations with foreign countries.

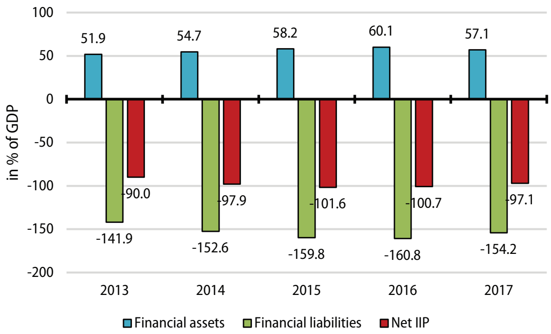
Graphs (Graph T4-9 and Graph T4-10) show that in 2017, Serbia was a net borrower abroad, with IIP of 35.84 billion euros. At the end of 2017, foreign claims amounted to 21.1 billion euros, and liabilities amounted to 56.9 billion euros. Within the net financial liabilities, FDI amounted to 31.4 billion euros, loans were 16.1 billion euros, and portfolio investments 5.5 billion euros. Within FDI, the largest part was equity, in which the smaller part was the reinvested profit. In addition, the IIP of Serbia is deteriorating, it was more than 5 billion euros worse at the end of 2017 than at the end of 2013.

Graph T4-9. Serbia: Net IIP in billions of EUR



Source: NBS
Note: Net financial liabilities are shown as a negative value.

Graph T4-10. Serbia: Net IIP in % of GDP



Source: NBS, *QM*
Note: Share of net financial liabilities in GDP are shown as a negative value.

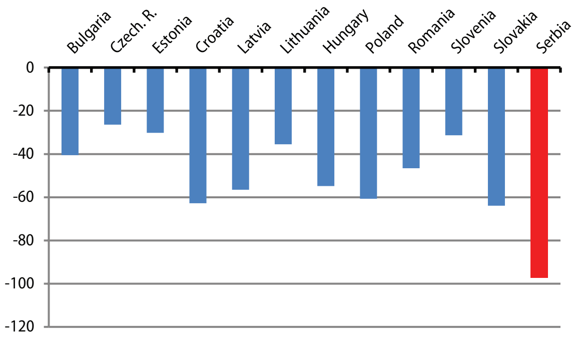
The data indicate that Serbia has a high IIP, almost equal to the annual GDP. Additionally, considerable part of the net liabilities are foreign loans and other forms of foreign debts (25.74 billion euros).

All countries in Central and Eastern Europe have been net importers of capital over the past several decades. Therefore, at the end of 2017 foreign assets and liabilities abroad were significantly higher than their assets and foreign claims (GraphT4-10). This is not a surprising result considering these are developing countries, that were trying to gradually catch up with the developed countries through high investments, but in the first years of transition, they had little funds of their own to invest. However, as the time passes by, these countries are increasingly relying on their own investment funds (own savings), so in the past decade, most of them financed their development mainly with domestic savings. These countries still have high foreign direct investments, but are more and more investing abroad.

Unlike them, Serbia still generates very few of its investment funds (savings), and therefore its development is still largely based on foreign assets. As a result, the net value of foreign capital in Serbia and our foreign liabilities continue to grow both in euro and in relation to GDP. The increase in the value of foreign assets in Serbia results in a large outflow of funds from Serbia based on dividends, interest and other forms of capital income, which already affects the deterioration of the country's current balance of payments. In addition, high indebtedness and a large amount of

7 https://www.nbs.rs/internet/latinica/80/ino_ekonomski_odnosi/mip/mip_definicije_i_pojmovi.pdf

Graph T4-11. International Investment Position, in % of GDP, end of 2017



Source: Eurostat and NBS.

foreign capital make the country vulnerable to disruptions in the global financial market (as was the case in 2009) or to disruptions in the country. In such circumstances, foreign investors (especially portfolio investors) can suddenly stop investing in Serbia, and to withdraw a significant part of the capital, which would lead to a recession.

Serbia has a significantly less favourable International Investment Position than other CEE countries (Graph T4-11), which makes it more vulnerable than other countries in terms of financial disturbances home and abroad. If a high deficit in the current balance of payments is to be realised in the future, the International Investment Position of Serbia will continue to deteriorate, and the risk of the balance of payments crisis will increase.