2. Economic Activity

The beginning of 2018 was marked by primarily positive economic flows. GDP growth in Q1 was 4.6%, which made it a quarter with the highest y-o-y growth in past ten years. The achieved result in Q1 also shows that our forecast for the economic growth to be about 4% in 2018 was not optimistic, but objective. Namely, although we expect GDP growth rates to be somewhat lower in the next quarters than in Q1, it is unlikely that total GDP growth in 2018 will be below 4%. What we have particularly emphasized in this edition of the QM is that economic growth of around 4% in 2018 is still not a satisfactory result for Serbia and there are some worrying economic trends that should be taken into account. Other Central and Eastern European Countries (CEECs) recorded average growth of 4.6% in 2017, and a growth of at least 4% is expected in 2018. Therefore, the projected economic growth in Serbia is only at the average level of comparable countries. In addition, the economic growth of 4% forecasted for Serbia in 2018 is not entirely sustainable, as it is partly based on the recovery of agriculture from drought and the recovery of the electricity production sector, which in 2017 also had a temporary decline. The growth of the largest part of the Serbian economy is actually around 3%. A more detailed analysis of economic growth in Q1 confirms these findings. The relatively high economic growth in Q1 of 4.6% is primarily a result of a high growth in three sectors that were compared to their low base in Q1 2017: construction, electricity production and agriculture. Without this, GDP growth would amount to about 3%. In addition, negative trends of decrease in net exports continue in Q1, i.e. imports continue to grow faster than exports. Finally, the trends of manufacturing industry, whose seasonally adjusted production indices show a sharp fall from January to April, are also troublesome. Therefore, the Government should not "relax" because of temporary and seemingly good results of the economy, but to invest more efforts in stimulating economic growth by implementing structural reforms of the public sector and improving the economic environment (rule of law, reduction of corruption, increasing the efficiency of the state administration, etc.). Also, it is very important that the NBS more decisively stops excessive strengthening of the dinar, which negatively affects the international price competitiveness of the economy and the deterioration of net exports. We believe that in order to achieve these goals, it would be very good to sign a new arrangement with the IMF, which would primarily be aimed at structural reforms that failed in the previous arrangement.

Gross Domestic Product

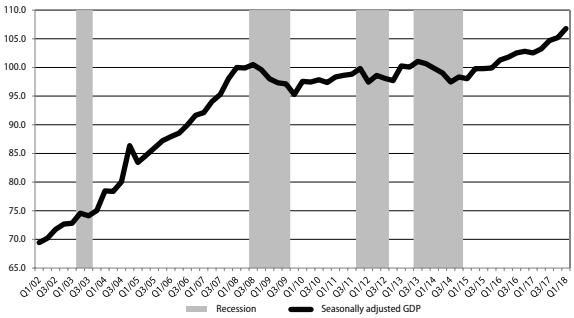
Q1 saw a relatively high growth of 4.6%

According to the latest SORS data, the y-o-y GDP growth in Q1 was 4.6%, which is basically a good result. Namely, the y-o-y growth accelerated noticeably by more than 2.5 pp, compared to 2017, when it was 1.9% on average. Also, the economic growth achieved in Q1 was the highest since the outbreak of the crisis in 2008, which means that in the previous ten years not even one quarter had the approximate growth rates of Serbian economy as the ones in Q1 2018 (in the last ten years, the y-o-y economic growth was more than 3% only in three quarters and it has never reached the 4% line). However, it is very dangerous to be over-optimistic when interpreting these, at first glance, good indicators, since they hide some unfavorable and unsatisfactory trends that are temporarily masked by relatively high y-o-y GDP growth.

Seasonally adjusted GDP growth in Q1 was 1.5% compared to the previous quarter

Graph T2-1 shows a series of seasonally adjusted GDP growth which indicate short-term trends of economic activity somewhat more reliably than the y-o-y indices (the shaded periods represent a recession according to the Bry-Boschan procedure). The seasonally adjusted GDP growth in Q1, compared to the previous quarter, was solid 1.5%, but unlike the y-o-y indices, it already suggests that there was no turn in the long-term economic trends, that is, there were not so many unusual changes that were indicated by a strong increase in the y-o-y growth of GDP. Namely, although the seasonally adjusted GDP growth in Q1 also shows the acceleration of the GDP growth trend, compared to Q4 2017 (when it was 0.6%), such acceleration of seasonally

Graph T2-1. Serbia: Seasonally adjusted GDP growth, 2002-2018 (2008 = 100)



Source: *QM* estimates based on SORS

adjusted GDP is not so unusual, i.e. it occasionally occured in the previous quarters (Graph T2-1), especially at the beginning of the year when new data on agricultural production are entered[1]. Because the acceleration of seasonally adjusted GDP growth in Q1 was partly the result of temporary factors, it is likely that it will be exhausted already in the next quarter, so the growth of the seasonally adjusted GDP will rapidly return to its medium-term growth path and confirm that Serbia's economic growth trend is lower than 4.6%.

The achieved GDP growth in Q1 is mainly supported by construction industry, electricity production and agriculture

As we anticipated, the key to understanding the strong acceleration of the year-on-year economic growth in Q1 is in the movement of individual sectors of the economy and their local trends. For that reason, we will start a more detailed analysis of economic trends in Q1 untypically, with the analysis of GDP by activity. Table T2-2 shows the data on the growth of production by individual sectors of the economy. The table shows that the biggest growth in all sectors of the economy was recorded by the construction industry with a y-o-y real growth of gross value added (GVA) of as much as 26.4%. It is specific for construction that every year in Q1 there are large oscillations in production under the influence of changing weather conditions (different number of work days during the winter when construction works can be performed). It is a bit warmer winter of 2018, compared to the previous year, that is an important reason why construction activity had a very high growth. In addition, we believe that one of the reasons for the extremely high growth of construction activity in Q1 is the unreliability of the statistical measurement of this sector, which will be further elaborated in the special chapter of this text. Another sector that had a relatively high growth in Q1 of over 6% is agriculture, which is compared to the dry 2017[2]. Finally, although Table T2-2 does not show the electricity production sector directly because it is merged with manufacturing industry and mining in the aggregate industry sector - electricity production was a third individual sector which significantly contributed to somewhat better result of economic activity in Q1 with its high annual growth of over 10%. The year-on-year growth of electricity production in Q1 was high because it was compared to low production from the same quarter of the last year, when due to problems in EPS operations there was a temporary deep decline in electricity production.

Table T2-2. Serbia: Gross Domestic Product by Activity, 2008-2018[1]

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	Share 2016
Total	96.9	100.6	101.4	99.0	102.6	98.2	100.8	102.8	101.9	101.1	101.6	102.3	102.4	104.6	100.0
Taxes minus subsidies	98.6	99.5	101.1	97.8	98.9	99.2	100.9	101.0	102.1	102.1	101.8	102.4	102.1	103.2	15.7
Value Added at basic prices	96.6	100.8	101.5	99.2	103.3	98.0	100.7	103.2	101.8	100.9	101.6	102.3	102.4	105.0	84.3
Non agricultural Value Added	96.7	100.2	101.5	101.1	101.6	97.5	101.7	102.7	103.1	101.5	102.6	104.2	103.8	104.9	90,1[2)]
Agriculture	95.2	106.4	100.9	82.7	120.9	102.0	92.3	108.1	90.5	93.7	90.9	88.1	90.5	106.1	9,9[2)]
Industry	96.8	100.8	103.2	105.6	106.0	92.4	103.2	102.6	103.5	101.3	103.5	106.4	102.8	105.3	24,3[2)]
Construction	87.1	97.6	105.9	90.2	96.1	98.5	102.7	103.2	105.5	96.3	97.9	106.0	117.9	126.4	5,2[2)]
Trade, transport and tourism	92.9	100.0	99.5	99.3	102.3	101.1	102.2	103.7	104.6	103.0	104.1	105.9	104.9	104.6	18,5[2)]
Informations and communications	97.0	103.2	102.6	102.8	99.9	96.1	101.7	105.8	101.2	99.9	101.3	100.9	102.7	105.1	5,2[2)]
Financial sector and insurance	102.6	101.9	98.4	92.0	90.5	97.2	102.3	104.0	102.4	104.8	101.7	101.8	101.1	101.1	3,2[2)]
Other	99.7	99.8	100.9	101.8	100.2	99.9	99.8	101.5	101.1	100.6	101.1	101.2	101.3	102.6	33.8[2)]

Source: SORS
1) In prices from the previous year
2) Share in GVA

1 The SORS methodology is such that the expected y-o-y growth of agriculture in 2018 in relation to 2017 is roughly distributed equally across all four quarters during the year. Bearing in mind that in 2018 the recovery of agriculture from drought in 2017 is expected, i.e. its relatively high growth, this on the seasonally adjusted indices reflects in the one-time growth of agriculture and, consequently, the acceleration of the GDP only in Q1. In the coming quarters, agricultural production will have significantly slower growth and therefore will not significantly affect the growth of seasonally adjusted GDP form quarter to quarter.

2 Although in Q1 the results of the agricultural season in 2018 are not yet known, the SORS methodology is such that in Q1 agricultural production is estimated at the level of its average in the last several years. Since 2017 was a dry year and agricultural production was well below the average in the years that preceded it, Q1 saw a relatively high y-o-y growth in agriculture.

The largest part of the economy in Q1 grew by about 3%

The relatively high y-o-y GDP growth in Q1 was a result of the strong increase in production in a smaller part of the economy (high production growth in three sectors, which together account for only slightly over 15% of Serbia's economy). The remaining part, i.e. the dominant part, of the economy recorded the y-o-y growth of production of about 3% in Q1. This data suggests that there was no essential acceleration of the trend of economic activity in Q1 when compared to the previous year (indicated also by seasonally adjusted indices). Namely the largest part of the Serbian economy achieved a growth of about 3% (Table T2-4), and the lower rate of total economic growth of 1.9%, achieved in that year, was primarily the result of a temporary decline of agriculture due to a drought and decline in production of electricity (which we described in detail in the previous issues of QM). Now, these temporary factors have turned direction and are temporarily affecting somewhat higher y-o-y growth rates during 2018, but the basic trends of Serbia's economic activity in 2018 are for now very similar to the ones in 2017, and there are no clear indications of their acceleration.

We expect the gradual slowdown of the y-o-y GDP growth n the coming quarters

The GDP trend in the coming quarters, just like in Q1, will largely depend on changes in a limited part of the economy, namely in the three mentioned sectors (agriculture, construction industry and electricity production). Of the three mentioned sectors of the economy, only agriculture will keep recording high growth rates by the end of the year, as it will be compared throughout the year with the dry 2017 (y-o-y growth rates are likely to accelerate in the coming quarters). Electricity production and construction activity will significantly slow down their growth in Q2 compared to Q1, but they will still probably have a solid year-on-year growth, given that this quarter as well will be compared with the low base from the previous year (in Q2 2017 these sectors also had a sharp decline in production, only this decline was slightly lower than in Q1 2017). Since there was no decline in production in these two sectors in second half of 2017, we do not expect that they will be able to contribute significantly to the overall GDP growth of Serbia in Q3 and Q4. Taking all this into account, we expect that y-o-y GDP growth in Q2 should be around 4%, and that the y-o-y growth rate of GDP is likely to fall below 4% in the second half of the year (if there are no significant changes in the meantime).

The QM forecast that GDP growth in 2018 should be around 4% is being realized for now

As we have pointed out, we expect that in the first half of 2018 the growth of economic activity will be somewhat above 4%, because it will be compared with a low base from the previous year - and that in the second half of the year (unless there are some major changes, such as, for example, an exceptionally good agricultural season), the y-o-y GDP growth will fall below 4%. The result of such quarterly GDP trends would be the economic growth in 2018 of about 4%, which we forecasted in the previous three issues of QM. One of the most important messages of this QM issue is that the GDP growth of about 4% expected in 2018 is neither a surprise (we announced it even in the middle of the previous year) nor is it impressive (it is largely a result of the high growth of a smaller number of sectors of the economy which are compared to the low base from 2017 and not the result of a significant increase of the basic trend of economic activity). This is important to point out because for some time now, at the beginning of every year, the public is presented with optimistic estimates of economic trends which are then basis for some economically unsustainable promises of the Government - such as a large increase in pensions and salaries in the public sector. What is even worse, in addition to overestimating the economic results achieved in the beginning of 2018, some important and rather worrisome trends are neglected, which will be explained in more details in the following part of this text.

A strong drop in net exports continues in Q1

The structure of the achieved GDP growth in Q1 by use is presented in Table T2-3. The table shows that in Q1 the year-on-year growth of investments accelerated and reached 14.9% in that quarter. This, in principle very positive trend of investment growth for now is observed very cautiously for now, as it is the result of a very strong growth of construction activity due to the mild winter, which will not continue in the remaining part of the year. In addition, as we have already mentioned, very high real growth of construction activity in Q1 of over 25% is probably to some extent the consequences of unrealistic measurement of this sector of the economy by the SORS (see the chapter on construction). We also have a certain reservation about the sustainability and reliability of the presented high growth of investments because of the fact that domestic production and imports of capital equipment do not have even closely a strong growth

trend as construction activity[3]. Unlike investments, net exports declined in Q1, as the growth of imports is significantly higher than exports growth (Table T2-3). Such net exports trends at the beginning of 2018 cannot be explained only by the low agricultural season in 2017 and shortage of agricultural products for exports, as trends of net exports decrease are widespread. The Government and the NBS should therefore pay special attention to them. We particularly emphasize that strengthening of the Dinar in the previous year is very dangerous as it negatively affects the movement of net exports. This channel could undermine the Serbian economy growth, i.e. influence the re-expansion of the foreign imbalances, which since the outbreak of the crisis in 2008 until 2016 were significantly reduced. Therefore, in the forthcoming period, the NBS would have to take far stronger measures to prevent the strengthening of the Dinar.

Table T2-3. Serbia: GDP by expenditure method, 2009-2018

	Y-o-y indices														
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017				2018	Share
										Q1	Q2	Q3	Q4	Q1	2016
GDP	96.9	100.6	101.4	99.0	102.6	98.2	100.8	102.8	101.9	101.1	101.6	102.3	102.4	104.6	100.0
Private consumption	99.4	99.4	100.9	98.2	99.4	98.7	100.5	101.0	101.8	102.1	101.6	101.8	101.8	103.0	72.4
State consumption	100.6	100.8	101.1	102.4	98.9	99.4	98.5	102.2	101.0	100.4	101.6	101.0	101.1	102.3	16.0
Investment	77.5	93.5	104.6	113.2	88.0	96.4	105.6	105.1	106.2	102.4	102.6	106.2	112.4	114.9	17.7
Export	93.1	115.0	105.0	100.8	121.3	105.7	110.2	112.0	109.8	109.1	111.2	111.6	107.5	109.3	50.0
Import	80.4	104.4	107.9	101.4	105.0	105.6	109.3	109.0	110.7	111.3	108.9	110.7	112.1	112.5	57.5

Source: SORS

Private consumption in Q1 had a somewhat faster growth than the usual and desirable

The real growth of private consumption in Q1 was 3%, which is the fastest quarterly growth of this component of GDP since the outbreak of the crisis in the second half of 2008. Such a trend of accelerating growth of private consumption is not really so favorable, as the Serbian economy continues to have a pronounced structural imbalance resulting from a much higher consumption than production (a relatively high current account deficit) and a high share of private consumption in GDP (private consumption participates in Serbia's GDP with over 70%, while the average share in the GDP of other CEECs is below 60%). For Serbia, therefore, it would be optimal for private consumption to grow at least one percentage point slower than long-term GDP growth over a longer period of time. Although at first glance, consumption growth in Q1 seems to have met this condition, i.e. that it is by about 1.5 p.p. lower than GDP growth (consumption grew by 3% and GDP by 4.6%), we remind once again that the basic trend of Serbian economy growth is actually 3% and not 4.6% (additional acceleration of economic growth in Q1 is the consequence of temporary factors). The acceleration of consumption in Q1 was most likely contributed by the Government of Serbia with its decision to increase wages in the general government by an average of around 9% in 2018, although this is not only significantly faster than the nominal GDP growth, but also than the growth of wages in private sector, which in the first four months of 2018 is only 4.5% y-o-y.

We expect that Serbia's economic growth in 2018 will be at the regional average level.

Table T2-4 shows GDP growth of Serbia and other countries in the region since 2014, ending with the forecasts for 2018. The data from the Table clearly show that Serbia systematically lags behind the growth rates of comparable countries, because in the past four years it almost always had the lowest economic growth in the entire CEE. Although in 2018 we expect that Serbia's GDP growth will accelerate to around 4%, it will not be as impressive in the regional context - according to the European Commission's forecast, this would only be the average economic growth of comparable countries.[4]

3 It is not disputed that the construction sector as well as total investments grew in Q1 2018, but the rates of their extreme y-o-y growth do not reflect their market trends well and are not sustainable. High growth in construction activity is a temporary consequence of a mild winter with more working days, and is also probably not well mesured by the SORS. Since the growth of construction activity of over 25% is not sustainable, consequently the growth of investments of about 15% is not sustainable. In fact, even these data itself - that construction activity has increased by more than 25%, and the total investments almost half less, about 15% - point out to unnatural mismatch between investing in construction works and investing in equipment. Namely, construction activity represents nearly half of total investments in Serbia, so almost half the slower growth of total investments implies that all other investments have had a very modest growth. If a strong increase in overall investment activity is a general and sustainable economic trend then the differences in investing in construction works and investment in equipment would not be so significant.

4 It should be noted that the European Commission's forecasts are generally conservative, so it is very likely that the economic growth of the CEE countries will in 2018 be, as in the previous three years, slightly higher than the Commission's forecasts currently at 4% (Table T2-4). For example, in the same report for Serbia, the Commission forecast GDP growth in 2018 of only 3.3%, which is even lower than the conservative forecast of the Government and the IMF of 3.5%. Now it is almost certain that the EU's forecast for Serbia will not be realized, that is, the GDP growth in Serbia will be higher, and similarly it could happen for the majority of other CEE countries.

After the exclusion of one-off factors, Serbia's economic growth is still slower than the region's average

Table T2-4, besides the growth of the GDP of Serbia, presents its "trend" economic growth - which excludes temporary factors that affect the growth of GDP (agricultural seasons, changes in electricity production and coal mining under the great impact of the floods from 2014, and the problems in the operations of EPS in the first half of 2017). The table shows that the trend of Serbia's economic growth in 2018 is actually lower than 4% and amounts to around 3% (Table T2-4). This in fact means that economic growth in Serbia in 2018 also continues to structurally lag behind other comparable countries, just as in the previous four years for which we presented the data as well.

Table T2-4. Serbia and countries in the region: GDP growth, 2014-2018

	2014	2015	2016	2017	2018[1)]
Serbia	-1.8	0.8	2.8	1.9	4.0
Serbia – underlying growth [2)]	-0.8	1.2	2.3	2.9	3.1
CEE (weighted average)	2.9	3.8	3.1	4.6	4.0
Neighbouring countries (weighted average)	2.7	3.5	3.7	4.9	4.0
Albania	1.8	2.2	3.4	3.9	3.6
Bosnia and Herzegovina	1.1	3.1	3.1	3.1	-
Bulgaria	1.3	3.6	3.9	3.6	3.8
Croatia	-0.1	2.3	3.2	2.8	2.8
Hungary	4.2	3.4	2.2	4.0	4.0
Macedonia	3.6	3.9	2.9	0.0	3.1
Montenegro	1.8	3.4	2.9	4.4	3.0
Romania	3.1	4.0	4.8	6.9	4.5

1) The European Commission's Progress Report for CEECs, For Serbia QM For BiH there is no forecast of GDP growth, as this country has not yet been granted candidate status for the EU
2) Excessive effect of drought, floods and poor EPS control excluded
Source: Eurostat, European Commission (*European Economic Forecast. Spring 2018)*

The key structural problems of Serbian economy are the lack of investments and relatively low exports

We have recognized the reasons for systematically significantly lower economic growth of Serbia in relation to comparable countries in a much worse structure of Serbia's GDP than in the other countries. Namely, in in relation to comparable countries, Serbia is characterized by a low share of investments in GDP and a low share of exports, while on the other hand the share of private consumption in GDP is extremely high, as much as 15 pp. above the CEE average. This comparative analysis clearly indicates that Serbia cannot seek a permanent boost for economic growth in the further increase of private consumption, which is already oversized compared to the production. Instead, the main drivers of Serbia's growth in the medium term should be investments and (net) exports, and consumption should grow slightly slower than GDP growth. Therefore, the Government and the NBS, for the necessary sustained acceleration of economic growth, would have to pursue policies that would encourage the development of investments in exchangeable goods and net exports, and not consumption.

Excessive reliance on domestic demand, with the tolerance of dinar strengthening, and a strong increase in foreign trade imbalances were precisely the main mistakes in the management of Serbia's economy in the period 2005-2008. These fundamentally unsustainable trends were severely interrupted by the outbreak of the global economic crisis in the second half of 2008, when there was a sharp drop in the value of dinar, with a sharp decrease in GDP, consumption, imports and employment. However, it is also important to point out that the economy of Serbia would very soon face the limitations of economic growth based on domestic consumption even without world crisis, that is, it would have to be adjusted and restructured with the slowdown or decrease of the GDP. We particularly emphasize this episode (2005-2008), because there are first indications that the Serbian economy is going the same direction again. The dinar exchange rate appreciates, the foreign trade imbalance opens, and data on the FDI structure for 2017 indicate that foreign investors' interest for investments in manufacturing industry is decreasing, while investments in trade, banking and construction are growing. There are now some differences in relation to that period, primarily because GDP growth is significantly lower, and fiscal policies are more restrictive. However, once again, we note that a sustainable way to accelerate economic growth leads through an increase in investments in exchangeable production and exports growth, and that the "shortcuts" that lead through the increase in domestic demand and investments

in the non-exchangeable part of the economy proved to be wrong in not so distant past, so this mistake should not be repeated.

Industrial production

Solid industrial production growth in Q1 of about 6% is largely a result of electricity production

Industrial production in Q1 recorded a growth of 5.9% (Table T2-5), which is slightly higher than the average of 2017 (3.5%). However, this acceleration of economic activity at the beginning of 2018, compared to 2017, is the result of the recovery of electricity production after a deep fall in Q1 2017, which is why only this part of industrial production achieved a growth of over 10%. On the other hand, the manufacturing industry, which represents the most important part of industrial production and produces the largest part of Serbian goods, slowed down its growth in Q1 2018 compared to the average of 2017 (the y-o-y growth of manufacturing industry in Q1 was 5%, while the average growth in 2017 was 6.4%).

Table T2-5. Serbia: Industrial Production Indices, 2009-2018

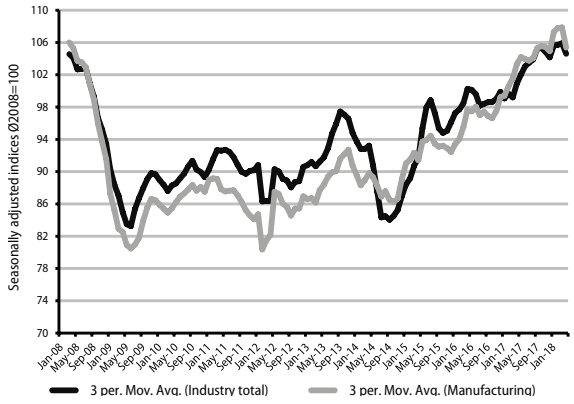
	Y-o-y indices														Share
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017				2018	2016
										Q1	Q2	Q3	Q4	Q1	
Total	87.4	102.5	102.2	97.1	105.5	93.5	108.2	104.7	103.5	100.7	103.1	106.3	103.5	105.9	100.0
Mining and quarrying	96.2	105.8	110.4	97.8	105.3	83.3	110.5	104.0	102.7	93.7	107.3	105.3	105.4	103.0	6.5
Manufacturing	83.9	103.9	99.6	98.2	104.8	98.6	105.3	105.3	106.4	107.3	105.1	107.7	104.9	105.0	80.0
Electricity, gas, and water supply	100.8	95.6	109.7	92.9	108.1	79.9	118.8	102.7	93.8	85.5	94.1	100.7	97.4	110.9	13.5

Source: SORS

Seasonally adjusted data show a slowdown in the manufacturing industry

More detailed estimate of industrial production trends in Q1 can be given on the basis of the seasonally adjusted indices we have shown in Graph T2-6. We draw attention in particular to the movement of manufacturing industry (darker line on the chart). After a relatively high growth during the most of 2017, the manufacturing industry slowed down at the end of the year and halted its growth in early 2018. However, the individual monthly indices of seasonally adjusted industrial production cannot be seen clearly on Graph T2-6 (as the Graph shows three-month moving average in order to reduce monthly volatility of indicators). Individual monthly seasonally adjusted production indices of manufacturing industry in 2018 are therefore shown separately in Table T2-7, with the latest available data for April. In January 2018, seasonally adjusted production of the manufacturing industry reached its maximum, when it was 6.4% higher than the average of 2017. In each following month of 2018 seasonally adjusted production of the manufacturing industry recorded a sharp drop, so that in April (the latest available data) it fell below the average of 2017. Similar trends are also shown by the year-on-year manufacturing production indices by month. Year-on-year growth was the highest in January when it was over 11%, only to drop to mere 1% in April (Table T2-7).

Graph T2-6. Serbia: Seasonally Adjusted Industrial Production Indices, 2008-2018



Source: SORS

Table T2-7. Serbia: Seasonally Adjusted and Y-o-y Manufacturing Industry Indices in 2018

	January	February	March	April
Manufacturing (seasonally adjusted indicies)	106.4	103.0	101.4	99.2
Manufacturing (y-o-y indicies)	111.3	104.7	100.0	101.0

Source: SORS

The slowdown in the manufacturing industry is relatively widespread

The next question we were trying to answer is what lies behind the sharp downturn of the manufacturing industry during the first four months of 2018. Namely, if the slowdown occured due to the unfavorable movement of smaller number of individual areas (e.g. a decline in the food production due to a bad agricultural season), and the major part of the manufacturing industry continues to grow rapidly in 2018, then there should not be many reasons for concern. More detailed analysis by sectors, however, shows the opposite - that the slowdown in manufacturing industry was relatively widespread and therefore significantly more dangerous. Individual areas that in the past had a habit of leading to a temporary decline of the entire manufacturing industry with its incidental drops, were in fact very stable in the first four months of 2018. Thus, in the first four months, the food processing industry had a relatively stable year-on-year decline of 1% and its trend did not change significantly in comparison with the previous year despite the bad agricultural season in the last year (in 2017, the food processing industry had a slight decline of 0.1%). Also, the production of motor vehicles, which in the past led to a temporary slowdown in the entire manufacturing industry (when FAS production was stopped) had relatively stable results in the first four months of 2018, a minimal but stable y-o-y increase of 0.2%. This result of motor vehicle production in 2018 is even slightly better than in the previous year when this sector of the manufacturing industry recorded a drop of 3.3%. Analysis by individual areas suggests that the gradual slowdown in industrial production during 2018 is a common trend of the largest part of the manufacturing industry and is not the consequence of incident falls limited to just a few activities. Although it is early to make a far-reaching conclusions based on data for only four months of 2018 (January and February were actually relatively good), the trends in the manufacturing industry will be monitored with some extra caution in the coming quarters.

Investment product production declined

Observed by the purpose of industrial products (Table T2-8), there were some changes in Q1 compared to the previous quarters. First of all, there was a relatively strong acceleration in energy production, but this trend can be easily explained by the high y-o-y growth of EPS production, which was compared with the low base from the previous year. That is why we expect that this acceleration of the y-o-y growth of energy production will be short-term and exhausted by the middle of the year. On the other hand, the biggest negative change in Q1 was recorded by the production of investment goods, which in Q1 had y-o-y fall of 1.3%, after a growth of almost 10% in 2017 (Table T2-8). As we have mentioned, the analysis of production in the area of motor vehicle production (which belongs to this special purpose group) suggests that the decline in the production of investment goods in Q1 2018 cannot be explained by possible halts in FAS, since this area has actually somewhat better results in 2018 than in the previous year. The widespread decline in investment goods production further doubts the data from national accounts which suggest that investments had a remarkably high growth of 15% in Q1. Other special purpose groups, intermediate and consumer goods production, had in principle similar movements in Q1 to those in the previous quarters.

Table T2-8. Serbia: Industrial Production by Purpose, 2009-2018

	Y-o-y indices													
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017				2018
										Q1	Q2	Q3	Q4	Q1
Total	87.4	102.5	102.1	97.1	105.5	93.5	108.2	104.7	103.5	100.7	103.1	106.3	103.5	105.9
Energy	98.8	97.7	106.2	93.6	113.2	82.6	116.9	101.9	97.2	88.0	95.2	108.7	100.1	107.9
Investment goods	79.3	93.6	103.2	103.8	127.6	95.9	103.0	101.6	109.2	113.0	107.0	114.6	103.6	98.7
Intermediate goods	78.4	109.2	102.2	91.2	99.0	96.8	105.3	109.5	110.0	110.3	109.5	110.3	109.3	110.7
Consumer goods	86.8	102.1	95.4	103.2	100.7	100.7	104.0	105.6	102.4	105.8	105.3	98.7	100.9	103.3

Source: SORS

Construction activity

According to SORS construction activity strongly accelerated in Q1 by over 25%

According to the SORS estimates, the construction activity in Q1 achieved an exceptionally high real y-o-y growth of 26.4% (Table T2-5). This data was crucial to the acceleration of investment growth and contributed significantly to the growth of total economic activity in Q1. However, the real trend of construction activity is actually very difficult to evaluate correc-

Table T2-9. Serbia: Cement Production, 2001-2018

	Y-o-y indices				
	Q1	Q2	Q3	Q4	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	108.9	93.1	85.0	104.4
2008	100.1	103.7	108.1	110.1	105.9
2009	34.1	81.4	86.0	75.3	74.4
2010	160.7	96.9	96.0	97.4	101.1
2011	97.7	101.3	96.2	97.7	98.3
2012	107.9	88.3	58.2	84.9	79.6
2013	83.5	78.7	127.6	93.5	94.9
2014	136.2	90.3	96.2	104.7	101.5
2015	77.9	112.4	104.5	108.7	103.1
2016	120.2	109.8	109.9	100.4	108.9
2017	110.4	104.1	96.4	118.7	105.9
2018	107.5	-	-	-	-

Source: SORS

tly. The problem with the monitoring of this sector of the economy is that a large number of small private companies that are quickly established and closed, operate within it, which official statistics has a difficulty to monitor, and a good part of the activity is carried out in the gray zone, out of the sight of the statistics. In addition, construction activity in Q1 seasonally depends to a great extent on meteorological conditions, i.e. the number of working days in which construction work can be performed unobstructed by weather conditions. More detailed QM analysis shows that construction activity undoubtedly recorded a strong growth in Q1, but it is still unlikely that the growth was more than 25% as SORS shows.

For a somewhat more reliable monitoring of the construction activity trend in QM we analyze, besides the value of construction works performed (which is used as the main indicator of the growth of this economy sector), a whole series of additional indicators related to this activity (movement of registered employment, wages in construction sector, cement production and more). Thus, the value of construction works performed in Serbia in Q1 had high y-o-y growth of as much as 28% at constant prices, and this was the main indicator on the basis of which the statistics showed the exceptionally high growth in this activity. However, other construction activity indicators suggest that the growth in Q1, though undeniably high, was probably not so extreme. So, the registered employment in construction sector in Q1 recorded a 5.7% y-o-y increase, while wages in construction activity grew by about 2.7%. Cement production in Q1 recorded an y-o-y growth of 7.5% (Table T2-9).

We expect growth of construction activity in 2018 of over 10%

As we have pointed out, long-term trends in construction activity are difficult to accurately estimate based only on Q1 data. Namely, the winter of 2018 has been somewhat warmer than in the previous year, so that was an important one-time factor contributing to the y-o-y increase in working hours in this sector and, consequently to temporary acceleration of the growth of construction activity in Q1. Another important factor we consider to have temporarily increased construction activity in Q1 is the partiality in the statistical analysis of this sector towards large and state-owned construction companies. Since official statistics has difficulties to track the construction activity of private and informal sector, it is biased towards large and state-owned companies which perform larger and easier-to-see works (usually public investments). This is how the official assessment of the movement of construction activity, more than it should, reflects the dynamics of the execution of public investments, which in our opinion was exactly the case in Q1. Namely, in Q1, capital expenditures of the state had a tremendous increase of as much as 2.3 times higher than the same period of the previous year, which was transferred also to the unusually large growth of the entire construction sector.[5] However, even if we consider that the high growth of construction activity in Q1 was temporary and partly the result of unreliable measurements by the SORS, there is plenty of other and reliable indicators that suggest the acceleration of construction activity in 2018 compared to 2017 (cement production, acceleration of the growth of registered employment in construction activity and others). Good external conditions for the rapid growth of this sector should be added to all this, (a favorable economic cycle throughout Europe, still low interest rates on borrowing and the like). Taking all this into account, we estimate that construction activity in 2018 will most likely have a high double-digit growth of over 10%.

5 Public investments were record low in Q1 2017, so they had their exceptionally large y-o-y growth in Q1 2018. In the coming quarters, there will for sure be some reduction in the y-o-y growth of public investments, which will in all probability also strongly affect the reduction of the y-o-y growth of construction activity in official statistics. We note that during the sharp decline in public investments in Q1 2017 construction activity recorded an unexpected fall that we attributed to unreliable construction measurements in the analyses at the time (QM48) and evaluated as temporary - which proved to be accurate.