2. Economic activity

Worrying trends in the movement of economic activity continued in the second quarter and it is unlikely that there will be a turning point by the end of the year. Year-on-year decline of economic activity in Q2 was over 1%. This fall is only partly a consequence of May floods because even if we exclude negative effects of floods – GDP would be in decline. This is already third successive quarter in which seasonally adjusted GDP has decreased, which is why we estimate that the Serbian economy is without a doubt once again in a recession, for the third time since 2008. Because of additional deterioration trends, we corrected downward the estimation of GDP decline from the previous QM. At that time we expected that GDP will achieve a drop of between 0 and 0.5% in 2014, and now we estimate that GDP in 2014 will have a real decline of about 1%, and possibly somewhat higher than that. Exports, which is the only factor that had positive and strong contribution to the growth in the previous two years and which represented counterbalances to the decline in domestic demand, halted its growth in Q2 – primarily because full capacity in exports of motor vehicles (Fiat) has been reached, and nothing new happened that could extend this growth. Domestic demand is a multi-year decline, in which unfortunately drop in investment is the most significant, which also reduces the potential for future recovery and growth. Economic policy should be much more determined in response to worsening economic trends. This means an adjustment of excessive government expenditure to the actual strength of the economy, improving the business environment, solving the fate of companies in restructuring, and then to see which antirecession measures are available to mitigate the increasing decline in economic activity. Based on the current information, we expect that the GDP in the coming year will fall probably by about 1%.

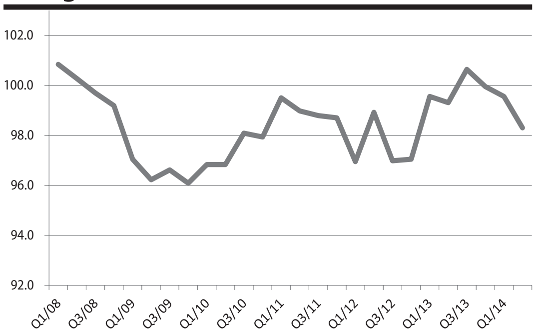
Gross domestic product

Year-on-year fall in Q2 of 1.1%

According to the preliminary, flash, SORS estimate, the real y-o-y GDP fall in Q2 was 1.1%, and this is the first y-o-y GDP fall since 2012. However, this fall was expected considering bad trends of the economic activity, which started at the end of the last year and which we described in the previous issue of QM. The May floods only further contribute to the fall of economic activity in Q2. Also, in the period between two issues of QM SORS published final assessments of GDP trend in Q1, which are somewhat lower than previous flash estimates. According to a new data GDP in Q1 recorded a y-o-y growth of only 0.1%, not 0.4% as previously published. Data on economic activity trend in the first half of the year indicate that in 2014 economic activity will almost certainly record a fall compared to 2013, and for now we estimate that this fall will be around 1%, which will be further discussed in the following paragraphs.

Seasonally adjusted GDP indicates a strong fall in economic activity in Q2

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

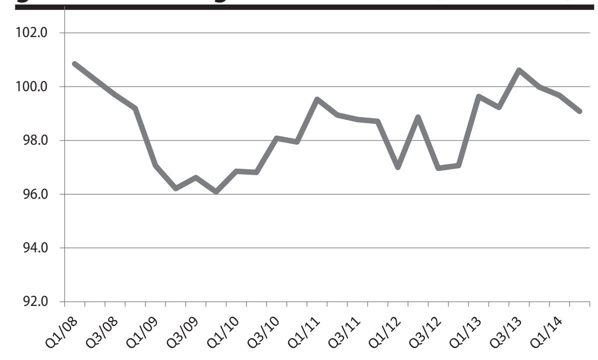


Source: *QM* estimates based on SORS data

Seasonally adjusted GDP growth index (Graph T2-1) confirms negative trends in the movement of economic activity and its relatively strong fall in Q2. Graph also shows that Q2 is a third successive quarter in which seasonally adjusted GDP decreases, which is a definite confirmation that the Serbian economy is in a recession. GDP level, after a last, strong fall (Graph T2-1), is once again significantly lower than the one before the crisis (2008) which means that the economy has not reached that level of production even six years after the outbreak of the crisis. Even the most pessimistic estimates from that period did not indicated that its negative impact on the economy and its duration will be so significant.

Even when we exclude the negative impacts of May floods economic activity is in a decline

Graph T2-2. Serbia: Seasonally adjusted GDP growth excluding effects of floods (2008=100)



Source: *QM* estimate based on SORS data

To separate long-term economic trends and a temporary effects of floods from the results of the economic activity in Q2 we excluded those sectors which were the most affected by floods – such as mining and production of electricity. When we exclude these sectors we see that the y-o-y fall in economic activity would still exist, but it would be significantly lower and would be 0.2-0.3% instead of 1.1%. Somewhat more relevant for the analysis of economic activity trend without the effects of floods is seasonally adjusted GDP which we presented in Graph T2-2.

Graph shows that the economic activity, even when we exclude effects of floods, is on a downward path and its declining trend started and practically remained unchanged since Q3 2013. One of the important reasons for the declining trend of economic activity since Q3 2013 is the fact that at that time the FAS Company reached its full production capacity and stopped its positive contribution to the growth of total economic activity. Without that contribution, prevailing unfavourable GDP trends were revealed, and they were undoubtedly present before Q3 2013, but were concealed with strong short-term growth of FAS Company production as well as by good agriculture season.

Net exports is slowing down while other GDP components have been in decline for a long time

We have analysed the GDP growth structure by use. Table T2-3 shows the GDP structure by expenditure method with last available data for Q1. The table clearly shows that in the last year, including also Q1 2014 only net export had high and significant growth, while all other GDP components – private consumption, state consumption and investments – were in decline or in the best case stagnant. Such structure of economic growth explains above stated assessment that a positive rate of growth of economic activity won't be possible in 2014. We state this because the growth of exports in the last several months is slowing down, and there are no signs that other components of GDP will compensate that with its own growth in short term. The slowdown in exports will clearly be seen as soon as the detailed data for Q2 become available. Namely, exports of goods in 2013 had a growth rate of about 26% in Q1 2014 y-o-y growth rate of exports was reduced to 17.4% in Q2 to 6.4%, and the last data show that exports in July recorded a y-o-y decrease of 11%.

Even deeper explanation for the slowdown in exports and thus the total production is found in the movement of investments. Namely, investments for some time have the largest real decline of all GDP components (7.7% in 2013), and without new investments it is not possible to continue further increase in exports and total production. Large investments from FAS and NIS in 2011 and 2012 led to a high growth of exports in the last two years but now they are exhausted, and there are no new similar investments. Therefore, exports in 2014 can no longer give a great contribution to the growth of the economy as it was the case in 2013, and the big question is whether it will have a positive effect on economic growth in 2015. We believe that for the future growth of the economy sharp increase in investments in the next period will be crucial and that this will have to be one of the main objectives of economic policy in Serbia.

Table T2-3. Serbia: GDP by expenditure method, 2009-2013

	Y-o-y indices										Share
	2009	2010	2011	2012	2013	2013				2014	
						Q1	Q2	Q3	Q4	Q1	2013
GDP	96.5	101.0	101.6	98.5	102.5	102.8	100.4	103.8	103.0	100.1	100.0
Private consumption	97.2	99.1	98.9	98.2	98.5	98.0	98.1	97.4	100.6	98.0	74.8
State consumption	98.1	100.4	101.0	101.7	98.3	96.7	93.5	101.9	101.3	97.9	19.4
Investment	77.9	94.5	108.4	114.4	92.3	102.4	83.3	90.4	96.0	93.7	19.9
Export	92.0	115.3	103.4	101.8	116.6	110.6	111.8	126.3	116.7	114.2	43.1
Import	80.9	103.1	107.0	101.9	102.0	97.1	99.5	106.5	104.5	103.2	57.6

Source: SORS

As we already mentioned, other GDP components won't be able to compensate already noted slowdown of net exports in 2014 for eventual growth. State consumption will have to be reduced due to a high deficit and fast growth of public debt. Private consumption is under the influence of bad trends on the labor market (real decrease of wage mass due to a further decrease in the number of employed and low growth of average wage), but also a real fall of pensions, so it will also continue to decrease in real terms. For now there are no indications that the significant recovery in investments will happen – financial results of companies are poor, credit activity is low and there are no reliable announcements of large FDI. Investments could temporarily rise in the second part of the year due to repairs of floods consequences. Taking all said into consideration GDP analysis by use confirms and suggests continuation of worsening economic trends by the end of the year.

In 2014 there are no strong drivers of economic growth as agriculture and industry were in 2013

GDP trend analysis in the first half of 2014 can be complemented by the last available data on the level of economic activity by sectors in Q2 which are still not published, but based on partial data it is evident that trends in this quarter worsened. Therefore Table T2-4 shows growth of individual sectors of the economy ending with last complete official data which refer to Q1. It can be noticed that in 2014 growth rates of individual sectors are much more equable than they were in 2013. Preliminary and incomplete indicators for Q2 indicate that most sectors will continue with similar trends as in Q1– with the exception of the industrial production (especially mining and production of electric energy) that will record a strong fall, and this is mostly explained by flood consequences, and the trade which will record a growth. For that growth, until recently, we thought that it was a consequence of floods (buying of stocks, help for endangered, buying of necessary objects and electronics which were ruined in floods), but July data show even higher growth than in May and June indicating some other explanation. These data are not in line with the movement of domestic demand so we will analyze trade movements in more detail in the next issue of QM, when more data for the analysis will be available.

Table T2-4. Serbia: Gross Domestic Product by Activity, 2009-2013[1]

	Y-o-y indices										
	2009	2010	2011	2012	2013	2013				2014	Share
						Q1	Q2	Q3	Q4	Q1	2013
Total	96.5	101.0	101.6	98.5	102.5	102.8	100.4	103.8	103.0	100.1	100.0
Taxes minus subsidies	98.3	100.9	101.6	98.6	102.4	102.7	99.4	104.1	103.2	99.9	17.4
Value Added at basic prices	96.1	101.0	101.6	98.5	102.5	102.8	100.5	103.6	102.7	100.0	82.6
Non agricultural Value Added	95.8	101.6	101.5	100.6	100.4	101.1	98.2	101.4	100.8	100.1	90,4[2)]
Agriculture	100.8	99.6	100.9	82.7	120.2	123.2	124.1	117.8	117.8	97.0	9,6[2)]
Manufacturing	84.2	100.9	100.6	101.1	104.8	104.5	103.1	108.7	103.2	101.6	16,4[2)]
Construction	80.3	92.9	107.7	99.2	74.3	78.6	62.8	75.1	82.7	92.2	3,7[2)]
Wholesale and retail trade	92.5	101.7	94.5	100.2	98.6	96.8	96.0	98.5	102.8	98.0	9,8[2)]
Transport and storage	90.0	108.2	103.1	100.0	103.2	105.4	100.0	103.6	104.1	102.7	5,6[2)]
Informations and communications	110.0	105.4	108.4	104.8	110.8	110.0	109.8	113.3	110.3	105.1	6,3[2)]
Financial sector and insurance	105.5	107.2	101.0	104.0	98.7	101.8	99.4	96.9	96.8	96.3	3,8[2)]
Other	101.6	100.8	102.0	99.9	100.5	101.2	99.5	101.4	100.1	99.9	44,7[2)]

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

We expect GDP fall in 2014 of about 1%

With gradual arrival of new data economic activity trend is getting clearer, but also the impact floods had on GDP which give us more reliable estimates for this year. In the previous issue of QM we estimated that the economy is in stagnation and that the negative impact of floods with positive effects of the reconstruction) could be up to 0.5% of GDP. Because of that we estimated that the fall of GDP in 2014 could be around 0 and 0.5%. Last available data[1] and information however indicate that the impact of floods on the mining and production of electricity will be somewhat higher than we expected (partially because of the delay in the drying of coalmine Tamnava). According to the first indications the reconstruction from floods is for now very inefficient – the announced recovery of the railway infrastructure still did not happen (railroad

1 Data on industrial production trend, which includes mining and production of electric energy, are available ending with June so we ae are able to predict more accurately impacts of floods on GDP.

Belgrade – Bar) although already four months have passed. Instead of the expected 0.5 p.p negative impact could therefore be higher, around 0.7%. Besides that, even the economic trend without floods is not stagnation but recession, therefore we expect that the total fall of GDP in 2014 will be around 1% instead of expected 0.5%. For now we will hold on to the estimate that the fall of GDP in 2014 will be around 1%, although it could be easily somewhat higher.

Real reasons for recession are bad economic fundaments and not floods – stronger reaction of economic policy is needed

For almost two years we have indicated in QM that long-term trend of economic activity is negative. This was not so obvious in 2013 because the negative trend of the largest part of the economy was overshadowed by a high growth of agriculture (due to the comparison with the droughty 2012) and a high growth in production of FAS. Thoughtful and decisive economic policy response to poor economic trends, however, is still pending, although in 2014 unfavorable economic trends became stripped and apparently and even worse[2]. Real reasons for reduction of economic activity are essential and not temporary – unsustainable fiscal position (high and growing public debt and high deficit), reduction of investments, low credit activity, slowdown of exports and other. Economic policy should therefore have to react more decisively and begin to implement stronger antirecession measures, but also begin to eliminate core problems the Serbian economy is facing.

Growth in conditions of fiscal consolidation and restructuring of enterprises.

Growth of Serbian economy in the long term will crucially depend on the economic environment, thus its improvement represents a key driver of investment and economic growth. At the middle of this year labour market reforms were implemented in Serbia, the bankruptcy procedure was improved, and significant simplification of construction procedures was announced by the end of the year. Progress in other elements of economic environment remains very slow. Construction of infrastructure is still very inefficient and in the work of state bodies there were no systematic improvements for years. Even in the best case scenario, if in the coming years systematic improvement in the economic environment is achieved, it will take few years for it to affect the growth of the economy.

Macroeconomic stability represents one of the important elements of economic environment, and it rapidly deteriorated in Serbia in the last few years. High fiscal deficit and strong public debt growth which it generates represent the main sources of macroeconomic instability, and therefore the mid-term growth of the economy will largely depend on the planned fiscal consolidation. If in 2015 the most difficult part of the fiscal consolidation is implemented, the public debt crisis is avoided, and steps are taken towards the recovery of public finances – this could have negative effects on economic activity in the short term, but in the mid-term, faster and sustainable growth could be expected. With incomplete consolidation of public finances (which now seems possible, because it indicates less severe reduction in pensions and public sector wages than required) – crisis in 2015 will most likely be avoided, but the Serbian economy will be doomed to recession or stagnation, not only in 2015 but most likely in the medium term. Simply put, it is not realistic to expect high economic growth and investments in the environment which is threatened by the outbreak of the public debt crisis and macroeconomic instability, and this risk with incomplete fiscal consolidation will not be avoided. Finally, if necessary measures are not taken and savings in 2015 are significantly lower compared to the magnitude of the problem in public finances, than a drop in GDP of 1% will prove to be optimistic, because crisis of public debt with GDP fall of over 5% will be very probable.

The growth of Serbian economy in the coming year will be under the dominant influence of a number of specific factors. Although there is a number of unknowns due to which it is still impossible to give a reliable assessment of trends in the economic activity in 2015, it is almost certain that it will be another year of recession. We highlight some of the many reasons for this: 1) a multi-year decline in investment has reduced the potential for future growth in production, 2) solving the fate of the companies in restructuring is expected and a shutdown in the largest number of companies from this group in 2015, which is good for Serbian economy, but in the

2 Occasionally some ad hoc antirecession measures appear, such as the extension of subsidized loans, but comprehensive and thoughtful policy responses to the recession is still lacking.

short term will affect the temporary reduction of GDP 3) fiscal consolidation, which will also have a temporary negative impact on the economy, but which is essential for avoiding public debt crisis and 4) an unfavorable international environment - stagnation in the EU and possible further escalation of its relations with Russia with negative economic consequences. Factors which could enhance economic growth in 2015 are mostly limited. It could be heard in public that after Russia imposed sanctions for goods from the EU, Serbia's export to Russia is a great chance for economic growth. However, Serbia's export is almost marginally tied to Russia, only about 6% of total exports. Even if it would increase within a year by 50%, it could contribute to the overall growth in exports of around 3%, which is insufficient, especially considering that a possible recession or stagnation in the EU at the same time would reduce the demand on the market where we export more than two-thirds of all products. Somewhat more realistic opportunity for mitigation of expected negative trends in economic activity could be a growth in investments, but it requires appropriate, good and decisive economic policy. We believe that during the implementation of fiscal consolidation, public investments must not only be efficiently executed but also that the room for their increase must be left. Attracting large FDI and eventual privatization of a number of companies in restructuring, accompanied by investments of new owners, are also areas in which the economic policy could play a crucial role. Besides all this subsidies for loans should be retained or possibly increased, and the introduction of some other limited antirecession measures should be considered. Taking all this into account, we believe that the negative trends will prevail in 2015, which will be another year of recession with a possible drop in GDP of around 1%.

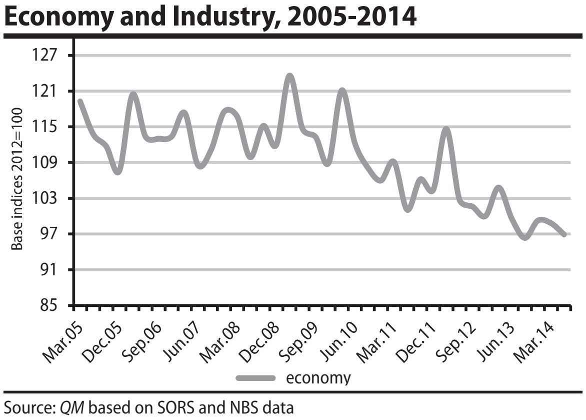
In 2015 fall of economic activity is probable, maybe about 1%

Although there are many uncertainties due to which it is still impossible to give reliable estimate of the economic activity trend in 2015, it is almost evident that it will be another recession year. We estimate that the factors which will have an impact on the fall of economic activity in the next year, will be dominant compared to the ones which could start its growth (see Highlight 2). When creating fiscal policies and reforms first step is to recognize the trends in the local economy, instead of emphasizing unreliable and probably poorly measured data on employment growth.

Unit Labour Costs continue to fall

Unit labour costs[3] (ULC), measured in dinars, continue to fall in Q2 (Graph T2-5). This tempo of decrease is somewhat slower in Q2 than in Q1, because y-o-y ULC decrease in Q2 was about 3% while in Q1 it was about 5%. ULC decrease is a consequence of unfavourable trends on the labour market and unfavourable trends of economic activity – because of which wage mass is falling not only in real terms but also in nominal terms. Because the real labour costs are declining slightly faster than the economic activity - ULC decrease. It is interesting to note that based on the data on formal employment by sectors of the economy, based on which we calculate the movement of the ULC, employment in the economy decreased in Q2 by about 2% (in the manufacturing industry for over 4%), while the data from the Labour Force Survey which include informal employment show growth of employment.

Graph T2-5. Serbia: Real Unit Labor Costs in the Economy and Industry, 2005-2014



Source: *QM* based on SORS and NBS data

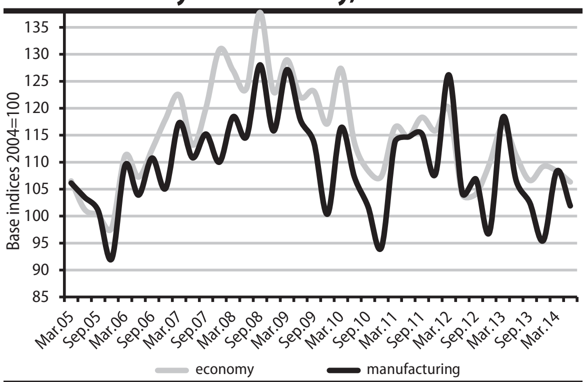
Unit labour costs measured in euros (euro-ULC) are an indicator of the price competitiveness of the Serbian economy, as they define the greatest national cost component (labour costs) in relation to the added value. We calculate euro-ULC for the manufacturing sector (which produces by far the greatest share of tradable goods), and for the economy as a whole4, as shown in Graph T2-6.

3 Unit Labor Costs in dinars are calculated for the economy (excluding the Agriculture and Public Administration sectors) and industry.
4 Excluding the Public Administration and Agriculture sectors.

The price competitiveness of the economy is improving with real dinar depreciation

Graph T2-5 shows, despite strong seasonality, a trend of gradual reduction of the euro-ULC. Euro ULC in Q2 decreased y-o-y slightly more than the dinar ULC, because there was a mild y--o-y dinar depreciation. Last, slightly higher, dinar depreciation from August and the beginning of September still has not been included in the data, and in the future will (if lasting) additionally influence euro ULC to decrease further and come roughly to the level of 2005. We use this year as benchmark year because it is a year before the beginning of strong capital inflows, the enormous increase in wages and pensions (period 2006-2008), a sharp real appreciation of the dinar and the deterioration in the competitiveness of the domestic economy. Strong growth of euro – ULC after 2005 due to the real dinar appreciation was one of the main reasons why in the pre-crisis period Serbian economy was on unsustainable path which was based on the growth of domestic demand, instead of production of tradable goods and exports. After the outbreak of crisis and relatively strong dinar depreciation at the end of 2008, there was a rebalancing of the domestic economy– imports decreased and exports increased compared to their pre-crisis level. It is interesting to notice that in 2014 relatively favourable and competitive labour costs seem to have no influence on increase of FDI, exports and production. This short analysis points out that the price competitiveness is required, but not sufficient, for the growth of investments and exports, and that the sustainable growth of the economy depends on some other factors such as stabile macroeconomic environment (now there is a risk of public debt crisis), favourable business environment and other.

Graph T2-6. Serbia: Real Euro - Unit Labor Costs in the Economy and Industry, 2005-2014



Source: QM based on SORS and NBS data
Note: the growth of euro-ULC on the graph represents the decline in price competitiveness

Industrial production

Industrial production recorded strong fall

Industrial production in Q2 recorded a y-o-y fall of 4.8% (Table T2-7). Within the industrial production large fall of even 13 or 14% was recorded by the mining industry and production of electricity, while the manufacturing industry also recorded a fall which was somewhat lower and amounted to around 2%. The reason for large fall of mining and production of electricity is May floods, which flooded the most important coal mines consequently influencing large fall in production of electricity. Besides this strong, but temporary fall, a drop in production industry is worrisome (although significantly lower) because it was not under the influence of temporary factors but probably under the influence of deeper negative trends.

Table T2-7. Serbia: Industrial Production Indices, 2009-2014

	Y-o-y indices											Share
						2013				2014		
	2009	2010	2011	2012	2013	Q1	Q2	Q3	Q4	Q1	Q2	2013
Total	87.4	102.5	102.2	97.1	105.5	105.2	103.0	110.8	103.3	102.1	95.2	100.0
Mining and quarrying	96.2	105.8	110.4	97.8	105.3	107.8	102.2	107.6	104.1	99.7	87.0	8.5
Manufacturing	83.9	103.9	99.6	98.2	104.8	105.4	103.2	108.8	102.2	103.6	98.0	73.9
Electricity, gas, and water supply	100.8	95.6	109.7	92.9	108.1	103.7	103.7	120.5	106.8	99.3	86.2	17.6

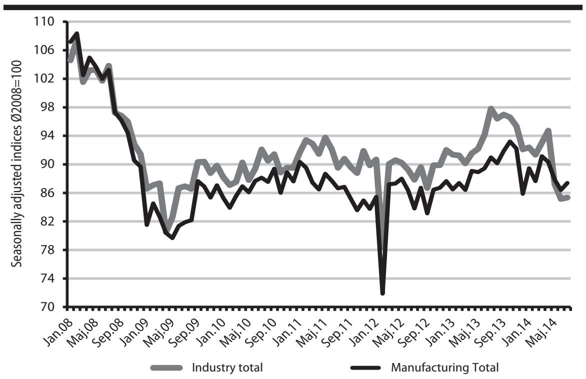
Source: SORS

In 2014 industrial production will undoubtedly record a fall. Mining and production of electricity will have even somewhat higher fall in Q3 compared to Q2, as Q2 includes relatively good April and the first half of May – period before floods – which won't be the case in Q3. These sectors of industrial production will gradually recover as flooded coal mines get drained, but on the annual level will undoubtedly be in deep fall. On the other hand manufacturing industry won't be able to compensate this fall with eventual growth in two sectors influenced by floods in order for total industrial production to be positive - all the more so because the manufacturing industry is currently in decline, and its noticeable growth by the end of the year we don't even expect.

Seasonally adjusted indices show big fall in May

Graph T2-8 shows seasonally adjusted production indices of total industry and manufacturing. We can immediately notice that the seasonally adjusted data confirm already mentioned large fall of production by about 10% since May under the influence of floods, but also a fall of manufacturing by about 4%, for which a more detailed analysis shows that it occurred regardless of floods. Namely, sectors of the manufacturing industry which recorded a fall in Q2 were motor vehicles production, oil derivatives, food processing, chemical products and other. These movements will be closely followed in the future issues of QM because by then we will have a final confirmation of whether the decline in the manufacturing industry from Q2 is temporary or permanent in nature. One of the assumptions which we will examine in more detail is whether the slowdown in manufacturing industry may be caused by falling export demand as exports in July recorded a very strong decline. For now, available industrial production data for July show that only decline in the production of oil derivatives in Q2 was temporary, because already in that month there was a sharp increase in production, while the drop in other areas is generally confirmed and probably more durable. We will also follow future trends in the production of motor vehicles (FAS) with special attention, which in July had a huge temporary decline due to the collective holidays. Occasional suspension of production in FAS in September could indicate that the plant is reaching its peak in production and that is now entering a phase of gradual decline, but also provide an additional argument that the drop in export demand is the main cause of the fall in manufacturing industry.

Graph T2-8. Serbia: Seasonally Adjusted Industrial Production Indices, 2008-2014



Source: SORS

In Q2 massive drop in energy production due to the floods

Observed by use (Table T2-9) we see that in Q2 all specific groups of industrial products recorded a y-o-y decline. This decline was particularly pronounced in the production of energy and it is explained with negative impact of floods. Production of capital goods moved from the zone of high y-o-y increase from Q1 to the 3% decrease. This is primarily a result of a slowdown in production of the FAS Company - because motor vehicles are classified into this category - but negative y-o-y growth of capital goods implicitly points to the low investment activity in Serbia[5]. Production of consumer goods is currently stagnating, while the production of intermediate goods decreases, but we note that it is subject to slightly larger oscillations, which are mostly caused by occasional production of Železara Smederevo (Table T2-9).

Table T2-9. Serbia: Components of Industrial Production by use, 2009-2014

	Y-o-y indices														
	2009	2010	2011	2012	2013	2012				2013				2014	
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Total	87.4	102.5	102.1	97.1	105.5	94.5	97.2	96.4	99.4	105.2	103.0	110.8	103.3	102.1	95.2
Energy	98.8	97.7	106.2	93.6	113.2	95.8	88.3	91.4	98.7	108.6	109.7	131.6	107.7	101.1	89.1
Investment goods	79.3	93.6	103.2	103.8	127.6	92.0	105.4	113.7	104.2	132.3	130.2	140.5	104.2	107.7	97.0
Intermediate goods	78.4	109.2	102.2	91.2	99.0	89.4	96.3	89.1	90.0	94.7	93.1	101.9	104.8	103.9	94.3
Consumer goods	86.8	102.1	95.4	103.2	100.7	97.8	104.5	104.6	106.1	107.0	101.5	97.4	100.0	100.2	99.6

Source: SORS

5 Motor vehicles production in spite of a slowdown recorded an annual increase of about 5%, which means that the rest of the production of capital goods declined by about 5%.

Construction

The construction sector has been in a continuous decline for three years in a row (Table T2-4 and T2-10). Latest SORS construction data indicate a year-on-year real decline of this sector of economy in Q2 of 5.7%. This decline is quite similar to the one measured in Q1 (5.1%) and we believe that despite the insufficient reliability of the construction indicators from the official statistics – this time they describe real trends in the construction activity well.

Table T2-10. Serbia: Cement Production, 2001-2014

	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			

Source: SORS

Confirmation of similar movements in the construction sector is given by the cement production index which, because of the difficulties in monitoring the construction sector, we use as additional indicator of its movement (T2-10). Cement production in Q2 was for 9.7% lower than the one from the same period of the last year[6]. Taking into consideration the inaccuracy of this indicator, we believe that this is however a good confirmation of the previously exposed estimates from the official construction statistics that the construction sector in Q2 was in a moderate decline of somewhat over 5%.

The main reason for the fall of the construction sector was low level of investments of a private, but also public sector. We already discussed the fall of private investments and the main reason for that was a low level of FDI, bad financial results of domestic companies and low credit activity of companies and citizens (mortgage loans). On the other hand there are not many convincing explanations for large underperformance in the execution of public investments, which will in 2014 be for even 30% lower than planned at the beginning of the year. Those investments are not only planned by the budget but also the financial funds for them are secured and so the only remaining explanation why they are not executed is - inefficiency of the State.

It is possible that there will be a recovery due to the remediation from floods

By the end of the year we can expect a moderate recovery of the construction sector due to remediation of the consequences of floods, so the construction sector could enter the area of positive growth. That growth could hardly be strong, in part because we have already noted the government's inefficiency in sanitation of the consequences of floods (draining coal mines, restoration of railway infrastructure, etc.). Also, even if the growth of the construction sector happens by the end of the year, without reversal of the essential trends of economic activity, growth of private investments and increase in efficiency in the execution of public investments, this eventual recovery will likely prove to be temporary.