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OF ECONOMIC TRENDS AND POLICIES IN SERBIA

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HIGHLIGHTS

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Analytical and Notation Conventions

Values

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

Definitions of Aggregates and Indices

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

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

New Economy – Enterprises formed through private initiative

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

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

Notations

CPI – Consumer Price Index

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

H – Primary money (high-powered money)

IPPI – Industrial Producers Price Index

M1 – Cash in circulation and dinar sight deposits

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

M2 – Cash in circulation, sight and time deposits in both dinars and foreign currency (in accordance with the IMF definition; the same as M3 in accepted methodology in Serbia)

NDA – Net Domestic Assets

NFA – Net Foreign Assets

RPI – Retail Price Index

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

Abbreviations

CEFTA – Central European Free Trade Agreement

EU – European Union

FDI – Foreign Direct Investment

FFCD – Frozen Foreign Currency Deposit

FREN – Foundation for the Advancement of Economics

GDP – Gross Domestic Product

GVA – Gross Value Added

IMF – International Monetary Fund

LRS – Loan for the Rebirth of Serbia

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

NES - National Employment Service

NIP – National Investment Plan

NBS – National Bank of Serbia

OECD – Organization for Economic Cooperation and Development

PRO – Public Revenue Office

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

QM – Quarterly Monitor

SORS – Statistical Office of the Republic of Serbia

SDF – Serbian Development Fund

SEE – South East Europe

SEPC – Serbian Electric Power Company

SITC – Standard International Trade Classification

SME – Small and Medium Enterprise

VAT – Value Added Tax

From the Editor

Since the Enlightenment, there has been a belief that mass education of the population is a necessary condition for economic and social progress. Education affects productivity in the current period but also drives technical progress that increases future productivity, thus enabling sustainable growth in citizens' standards of living. Numerous empirical studies conducted on large samples of countries over several decades provide evidence that a country's long-term economic growth depends on the quantity and quality of its education. Empirical research suggests that achieving a middle level of development requires general primary and secondary education with solid quality higher education that enhances employee productivity. To reach a high level of development, broad access and high-quality education that allows for the improvement of existing technologies and the creation of new ones are essential.

Given that the quality of education in Serbia's primary schools has stagnated at a low level for over a decade while higher education shows modest progress, it is important to consider the causes of this situation. The quality of education in any country depends on many factors, some common to all education levels and others specific to certain levels. Important general factors influencing the quality of education at all levels include the amount of public investment in education, the quality of the institutional framework, and the quality of teaching staff.

One factor affecting the quality of education is the amount of public investment in education. It is expected that if the state invests more in building a network of educational institutions, equipping them, paying teaching and non-teaching staff, providing quality textbooks, creating adequate regulations and supervision, and other related aspects, the result will be higher quality education. According to various data sources, total public investment in education in Serbia ranges between 3.3 and 3.6% of GDP. Investment in education in Serbia, expressed as a percentage of GDP, is significantly lower than in European Union countries, which on average allocate around 5% of GDP for education. According to Eurostat data, of the 11 CEE countries for which data is available, only Romania allocates a smaller percentage of GDP for education than Serbia. According to United Nations sustainable development data, public investment in education in Serbia amounted to 3.3% of GDP in 2021, while the average for all European countries was 4.9% of GDP. Of the 34 European countries for which data is available for that year, only three countries invested a smaller percentage of GDP in education than Serbia. The five European countries that achieve the best results on PISA tests on average invest 5% of GDP from public sources, and excluding Ireland this average investment is 5.5% of GDP.

Based on the above, it is quite clear that higher public investment in education is needed to improve its quality in Serbia.

Increasing the allocation for education relative to GDP would reduce the wage gap in education compared to wages of employees in other sectors with the same level of qualification, improve teaching staff performance, enhance school equipment, advance teaching procedures, improve school supervision, and more. A fiscally sustainable increase in the share of public expenditures for education in GDP implies that expenditures for several other state functions would grow more slowly than GDP in the coming years. Creating fiscal space would allow the growth of education expenditures as a percentage of GDP without increasing the fiscal deficit or necessitating higher taxes. It is estimated that achieving the goal of increasing education expenditures to about 4.5% of GDP over a medium-term period of 5-7 years would not jeopardize macroeconomic stability or crowd out other state functions.

Increasing public expenditures is necessary but not sufficient to improve the quality of education in Serbia. To enhance education quality, it is necessary to improve the institutional framework of the education system, enhance employee selection, improve pedagogical skills of teaching staff, introduce regular external evaluations of student, teacher, and school performance, and more.

The quality of education in a country depends on formal institutional rules regulating education and general institutional solutions in that country. The formal institutional rules in Serbia's education system result from historical development from the early 19th century to the present, including the period of self-managing socialism. Since 2000, education reforms have largely been aligned with the rules in developed countries, particularly EU countries. Formal rules are contained in numerous regulations adopted by state bodies and educational institutions governing the functioning of education. In addition to the Law on the fundamentals of the education system, there are specific laws for primary, secondary, and higher education, adult education, dual education, textbooks and other teaching materials, science and research. General laws regulating labour relations, public procurement, and others are also relevant for the functioning of educational institutions. Besides laws, education is regulated by a large number of decrees, rulebooks, standards, manuals, and more adopted by various state bodies, while the goals and directions of education development are defined by strategies adopted by the state. In addition to regulations adopted by state bodies, education is regulated by regulations adopted by educational institutions with varying degrees of autonomy (statutes, rulebooks, strategies, decisions, instructions, and more).

Formal rules regulating education are generally aligned with good practices in developed countries with a long tradition of education where the quality of education is high, based on va-

rious studies. However, there are still certain deviations from good practice that negatively impact education quality. In Serbia, unlike most European countries, secondary education is not yet mandatory. Rules for the promotion and reward of teachers in primary and secondary schools are not firmly linked to their students' success. In the case of master's and doctoral studies in Serbia, studying while working predominates, negatively affecting the duration and quality of studies. The main reason for most students choosing to study for a master's and doctoral degrees while working is the lack of adequate state funding for these studies.

In addition to deviations from formal rules, there are important instances of non-compliance or circumvention of regulations. For example, in the case of closing primary schools in rural areas, the state often does not provide transportation for students to neighbouring primary schools. The state occasionally fails to meet the legally prescribed financial obligations to state faculties necessary to cover material costs, particularly negatively impacting the quality of education at faculties with high exercise and experiment costs. Some private faculties simulate meeting accreditation conditions, which regulatory bodies tolerate. An extreme example of violating legal rules was the organization of doctoral studies by private universities not accredited for them. The state tolerated this practice to the point of recognizing about 1,000 doctorates defended at unaccredited universities through a special law!? One incentive for such university behaviour is the legal provision conditioning the establishment of universities on the existence of doctoral studies, which is not common practice worldwide.

The quality of education is also influenced by informal institutions, i.e., customs, inherited practices, and the belief system of students, their parents, and teachers. The quality of education in a country depends on the prevailing attitudes toward education among its citizens. If education is treated as a virtue, it positively impacts education quality. Conversely, if education is not considered a particular value, it will negatively impact education quality. The low quality of education in primary and secondary schools is negatively affected by the pedagogical tradition that requires students to reproduce extensive teaching content instead of insisting on understanding and connecting different knowledge. This pedagogical tradition could be changed with additional training for teachers and professors, accompanied by external supervision and linking teacher advancement to their students' results. In recent decades, poor class attendance by students has become more common in Serbia, complemented by the practice of paying for private lessons by students and parents. Poor class attendance negatively affects education quality and leads to unproductive resource waste due to paying for private lessons and prolonged studying. The solution is to introduce regulations requiring class attendance, with special treatment for working students.

A significant incentive for education quality is the existence of positive selection in hiring and promotion in the public sector, which represents the largest employer in all countries. Positive selection means that those who achieved better results in school and at university and graduated from higher-quality schools and universities have an advantage in public sector employment, and that expertise is the key criterion for rewarding and promoting employees. A negative incentive for education quality is the practice of mass employment of party activists of ruling parties who graduated from low-quality universities, with advancement in the public sector increasingly depending on party affiliation. Party employment and advancement based on party affiliation in Serbia have a long tradition that has escalated over the past decade to levels that existed in the early period of socialism. This practice sends a signal to young people that party affiliation and loyalty to the ruling party are more important for getting a job and career advancement than diligent and dedicated studying.

The quality of education is expected to be better if teachers and professors have higher social prestige. The social prestige of teaching staff depends on how society values their work and their performance. Significantly lower salaries for teachers and professors compared to employees in other sectors with the same education level indicate that society does not highly value education. An important signal that education work is not highly valued by the state and society is the exclusion of education employees from state housing subsidy programs over the past decade. This treatment of education results in negative selection of employees in the education sector, reducing the prestige of teaching staff and education quality.

An important factor affecting education quality is the quality of teaching staff. Generally, if teaching staff have better professional and pedagogical knowledge, educational outcomes will be better. In East Asian countries and European countries leading in education quality, teaching staff are selected from the top 5-10% of university graduates. In OECD countries, salaries of employees with university degrees in education are 5-15% lower than those of employees with the same level of qualifications in other sectors. In Serbia, according to data for October 2023, the average salaries of employees with university, master's, or doctoral degrees in education were 27% lower than the average salaries of employees with comparable education levels in Serbia. Salaries in education in Serbia lag behind comparable salaries in other sectors much more than in OECD countries. Due to the large salary gap in education compared to other sectors, it is very difficult to attract the best university-educated personnel to education in Serbia. Moreover, primary and secondary schools face a drain of good personnel, while universities struggle to hire the best students. Reducing the salary gap in education compared to salaries of employees with comparable education levels in other sectors is possible only by increasing total education expenditures as a percentage of GDP, as salaries account for about 80% of education costs.

The fact that education employees are willing to accept lower salaries compared to what they would earn in other sectors indicates that other motives for working in education exist, such as social prestige, job security, free time, affinity for education, and more. These other factors are relevant for most people if salaries in education are moderately lower than those they could earn in other sectors. If salaries in education are significantly lower than those earned by employees with the same level of qualifications in other sectors, it is unlikely that the best personnel will work in education.

TRENDS

1. Review

The beginning of 2024 in Serbia was marked by generally favourable macroeconomic trends, especially considering that most other European countries are still dealing with serious economic challenges, primarily slow economic growth. The year-on-year GDP growth in Q1 was 4.7%, making it the quarter with the highest economic growth in Serbia since 2021. Inflation significantly slowed down in the early months of 2024 and fell to 4.5% year-on-year in May. Thus, inflation finally returned to the NBS's target corridor (3 ± 1.5%) for the first time since August 2021. In the labour market in Q1, there was moderate employment growth (2.2% according to the LFS) and a substantial real wage increase (8.7%), which is a consequence of slowing inflation. The current account deficit amounted to 2.3% of GDP, which is an increase compared to the same period last year but still relatively low for Serbia. Additionally, fiscal trends can be considered favourable since the budget deficit was relatively low (0.9% of GDP) and the public debt-to-GDP ratio decreased by 0.8 percentage points during Q1 2024 compared to the end of 2023 (now amounting to 51.5% of GDP).

Regarding economic policies, perhaps the most important news is that the NBS (almost simultaneously with the ECB) started to lower the key policy rate, i.e., to relax monetary policy. In mid-June, the NBS lowered the key policy rate slightly from 6.5% to 6.25%. Although this June reduction of the key policy rate was minimal, it is an important signal that inflation is coming under control and that a shift in monetary policy is beginning. In previous years, monetary policy significantly increased its restrictiveness by raising the key policy rate 15 times in a row from mid-April 2022 to mid-July 2023 (from 1% to 6.5%). As for fiscal policy, it was not in the spotlight at the beginning of 2024, which can currently be interpreted as good news. For comparison, in the same period of the previous, election, year 2023, top state officials competed in announcing (and later implementing) numerous fiscal policy measures of questionable justification (extraordinary pension increases, one-time child support for children under the age of 16, etc.) – which was not the case this time. A curiosity is that the formation of the new government at the beginning of May was not followed by a budget revision, which was a usual practice during previous changes of government.

Economic activity in Q1 achieved year-on-year growth of 4.7%, which was noticeably faster than in most other European countries (see section 2. "Economic Activity"). Specifically, Central and Eastern European (CEE) countries on average achieved GDP growth of 1.4% in Q1, while the growth at the EU level was only 0.1%. Serbia's economic growth in Q1 was based on relatively high domestic demand (investments, private and public consumption), while external demand remained low due to weak economic growth in the EU. In the coming quarters, we expect the year-on-year GDP growth rate to gradually slow down, indicated by the trend of seasonally adjusted GDP growth, which was 0.8% in Q1 (annualized 3.2%). Therefore, we currently forecast Serbia's GDP growth in 2024 to be around 3.5%, which is fully in line with other forecasts by relevant domestic (Government, NBS) and international institutions (IMF, European Commission, World Bank, EBRD). A potentially important change in economic trends in Q1 did not occur in Serbia but in the EU, where the first strong signs of economic recovery appeared after more than a year of stagnation. The seasonally adjusted GDP growth in the EU in Q1 compared to the previous quarter was 0.3% (and it averaged zero from Q3 2022 to Q4 2023). In the CEE region, economic recovery started slightly earlier than in the entire EU and was further strengthened in Q1 (seasonally adjusted GDP growth in CEE averaged 0.5%).

Inflation in Serbia peaked in March 2023 when it reached a high of 16.2%. Since then, it has been gradually slowing down, continuing through the first five months of 2024 (see section 5.

"Prices and the Exchange Rate"). In December 2023, year-on-year price growth was 7.6%, and in May, it fell to 4.5%. The gradual slowdown of inflation is mainly due to the stabilization of food and energy prices. Food and energy prices were the main drivers of the rapid inflation increase from mid-2021 to the first half of 2023. However, after these products reached their maximum prices, they remained relatively stable over the past year, leading to a gradual slowdown in overall inflation. Despite favourable inflation trends since the beginning of the year, Serbia is still among the countries with the highest inflation in Europe (right after Romania and Montenegro), i.e., with noticeably higher consumer price growth than in the Eurozone (2.6%) and in the CEE and Western Balkan regions (averaging 2.8%). In the rest of 2024 we expect further reduction in year-on-year inflation due to easing global cost pressures and still relatively restrictive monetary conditions. This slowdown will proceed at a somewhat slower pace than in previous months. Namely, from July, the disinflationary effect of the high base from last year will be exhausted, and the high real growth of private consumption will continue to generate demand-side pressures that slow down the reduction of core inflation (inflation excluding energy, food, alcohol, and cigarettes). According to our central projection, inflation should decrease to around 3.5% by the end of the year, meaning that the average price increase in 2024 will likely be in the range of 4-4.5%.

Labour market trends in Q1 are quite interesting (see section 3. "Labour Market"). First, the real growth of average wages accelerated to a high 8.7% year-on-year, mainly due to slowing inflation. Namely, the nominal growth of wages throughout 2023 and the first three months of 2024 was approximately unchanged at about 15%. However, due to different inflation rates in these two years, real wage growth varies significantly. In 2023, it was relatively low, around 2% (and in some months, it was even negative). With the slowdown in inflation, the picture changed, and real wages in Q1 (despite the identical nominal growth as in 2023) now achieve high year-on-year growth (8.7%). Employment continued its moderate growth in Q1, amounting to 2.2% year-on-year (according to the LFS total employment) and 0.8% based on administrative data (registered employment). At the same time, the activity rate slightly increased, reaching 56.2% in Q1 (a record for Serbia), while the unemployment rate was 9.4%, reduced by 0.6 percentage points compared to the same period last year.

Labour market indicators in recent years are beginning to indicate a labour shortage, likely a consequence of long-term unfavourable demographic trends and emigration of the working-age population. The labour shortage is primarily indicated by wage trends in the private sector, which have systematically grown significantly faster than productivity growth since 2018. The phenomenon of faster wage growth than productivity is linked to the increasing value of skilled employees, who receive better working conditions (relatively fast wage growth, full wage registration). In addition, the labour shortage is indicated by the long-term reduction in the share of informal employment in total employment, the gradual decrease in the unemployment rate, and the increase in the percentage of the working-age population. Similar labour market trends occurred in other CEE countries before Serbia, which faced similar challenges of poor demographics and increased emigration. Although faster wage growth than economic growth initially has positive implications for GDP growth and fiscal trends (contributions and labour taxes are the most important fiscal revenues, and they are now growing rapidly), this trend is not sustainable in the long term. It will eventually start to negatively affect the price competitiveness of the domestic economy and will have to be halted. Potential wage growth slowdown is particularly important to consider when planning future fiscal policy, which in previous years was significantly facilitated by extraordinary large inflows from contributions and labour taxes.

Balance of payments trends slightly (and expectedly) worsened at the beginning of 2024 but remain generally favourable (see section 4. "Balance of Payments and Foreign Trade"). The current account deficit in Q1 amounted to 390 million euros, or 2.3% of the corresponding GDP. The achieved current account deficit in Q1 was slightly higher than in the same period last year (in Q1 2023, it was 1.1% of GDP) but significantly lower than the long-term average for Serbia. The year-on-year growth of exports of goods and services in Q1 (in euros) was 2.3%,

while import growth was 1.7%. As a result of these trends, the coverage of imports of goods and services by exports was (for Serbia) high 92% in Q1. What is specific about the movement of imports and exports since mid-2021 is that it has been significantly influenced by the large change in prices of Serbia's imported and exported products (primarily food and energy). This effect was significant in Q1, given that the year-on-year drop in export product prices was 6.6%, and import prices 4.5%. The high inflow of foreign direct investments (FDI) in Serbia continued and slightly accelerated at the beginning of 2024. The net inflow of FDI in Q1 amounted to 1.1 billion euros, which makes up 6.4% of comparable GDP (in the same period last year, it was 5.1% of GDP). FDIs were thus almost three times larger than the current account deficit, generating significantly greater supply than demand for foreign currency – i.e., pressure on the dinar to appreciate. The NBS bought about 650 million euros on the interbank foreign exchange market from the beginning of the year to the end of May to prevent a stronger appreciation of the dinar (but despite this, the dinar appreciated slightly nominally and somewhat more strongly in real terms against the euro in the first half of 2024).

Regarding monetary policy, it was certainly marked by the aforementioned easing of the ECB's restrictiveness and a few days later by the NBS (see section 7. "Monetary Trends and Policy"). This happened in mid-June after almost three years of tightening and then maintaining increased monetary policy restrictiveness. Both of these decisions will affect the reduction of borrowing costs in Serbia (the NBS decision on dinar borrowing and the ECB decision on euro borrowing). However, the reduction in interest rates is expected to have a greater impact on Serbia's economy than on the population since interest rates in an important segment of household borrowing (housing loans) have already been temporarily limited by the NBS decision from September 2023. Net borrowing by the economy and households had solid growth in Q1, increasing by about 630 million euros. The economy was deleveraging with domestic banks in Q1 and increased borrowing abroad, which is a consequence of lower interest rates abroad than indexed loans in Serbia. The share of non-performing loans in total placements slightly increased during Q1 but remained low. This share was at its lowest recorded level in Serbia of 3.85% at the end of 2023, and at the end of Q1 2024, it slightly increased to 4%.

Fiscal trends at the beginning of 2024 were relatively stable and somewhat better than expected (see section 6. "Fiscal Trends and Policy"). The achieved fiscal deficit in the first four months of 2024 amounted to approximately 24 billion dinars (about 200 million euros), which is almost identical to the result from the same period last year. If similar fiscal trends continue in the rest of the year, it is possible that the consolidated state's deficit in 2024 will be lower than the planned 2.2% of GDP (about 1.7 billion euros), i.e., noticeably below 2% of GDP. Better fiscal results at the beginning of 2024 were primarily influenced by a very high growth of public revenues, which amounted to about 12% in real terms in the first four months compared to the same period last year. This growth in public revenues fully compensated for the substantial increase in pensions and public sector wages as well as the growth in interest expenses. Public debt slightly increased in absolute terms at the beginning of 2024 but continues to decrease relative to GDP. At the end of April, Serbia's total public debt amounted to just over 36.5 billion euros, according to the Public Debt Administration, which is an increase of about 150 million euros compared to the end of 2023. Since nominal GDP is growing significantly faster than this (and the euro-dinar exchange rate is stable), this leads to a decrease in the public debt-to-GDP ratio. At the end of Q1, the public debt-to-GDP ratio was 51.5%, which is 0.8 percentage points less than at the end of 2023. Although the new government avoided a budget revision immediately after its formation, it will likely happen in the second half of the year. It would be good if this budget revision uses the almost certainly increased execution of public revenues to reduce the fiscal deficit compared to the initial budget – instead of being directed towards further increasing public expenditures.

Trends

Serbia: Selected Macroeconomic Indicators, 2019–2023

	2019	2020	2021	2022	2023	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1
Economic Growth														
GDP (in billions of dinars)	5,421.9	5,504.4	6,272.0	7,097.6	8,150.5	1,523.5	1,760.8	1,836.5	1,976.9	1,788.1	2,024.3	2,095.7	2,242.4	1,972.9
GDP	4.3	-0.9	7.7	2.5	2.5	4.4	4.0	1.3	0.8	0.9	1.6	3.6	3.8	4.7
Non-agricultural GVA	4.9	-0.8	8.7	3.3	2.6	4.8	4.8	2.1	1.7	0.9	1.7	3.8	3.9	5.4
Industrial production	0.0	-0.1	6.6	1.9	2.5	1.8	4.9	-0.3	1.3	3.3	0.6	4.0	2.7	2.9
Manufacturing	-0.2	-0.7	6.2	1.4	0.7	3.8	4.7	-0.8	-1.7	-0.4	-1.0	2.5	2.8	3.1
Average net wage (per month, in dinars)[2]	54,908	60,057	65,864	74,914	86,007	72,067	73,828	74,459	79,302	83,208	85,190	84,985	90,597	95,625
Registered Employment (in millions)	2,173	2,216	2,274	2,310	2,361	2,284	2,305	2,309	2,342	2,350	2,364	2,361	2,368	2,365
Fiscal data														
Public Revenues	6.2	-2.6	15.5	1.4	-0.2	5.0	4.9	1.0	-3.8	-2.7	-2.4	-3.4	6.7	7.7
Public Expenditures	8.4	16.0	5.8	-0.8	-2.0	13.1	-5.5	-11.2	1.1	-10.0	-3.0	7.8	-2.0	6.5
Overall fiscal balance (GFS definition)[3]	-11.1	-442.8	-259.4	221.2	-181.1	-68.1	52.5	63.8	265.2	-24.9	69.9	-29.3	-196.9	-18.0
Balance of Payments														
Imports of goods[4]	-22,038	-21,280	-19,038	-36,266	-34,534	-8,733	-9,564	-8,707	-9,289	-8,847	-8,622	-8,003	-9,062	-8,502
Exports of goods[4]	16,415	16,079	14,992	26,913	27,930	6,147	6,820	6,819	7,142	7,088	7,102	6,759	6,980	6,956
Current account[5]	-3,161	-1,929	-1,354	-4,139	-1,810	-1,531	-1,360	-407	-865	-162	-404	-208	-1,037	-395
in % GDP[5]	-6.9	-4.1	-4.4	-6.9	-2.6	-11.8	-9.1	-2.6	-5.1	-1.1	-2.3	-1.2	-5.4	-2.3
Capital account[5]	3,104	2,079	1,058	3,783	1,331	1,856	1,627	74	769	123	320	37	852	300
Foreign direct investments	3,551	2,938	2,836	4,306	4,220	586	928	1,264	1,550	781	1,245	965	1,228	1,107
NBS gross reserves (increase +)	1,873	270	3,185	2,919	5,104	-2,256	316	1,659	3,200	1,863	1,267	1,414	560	-320
Monetary data														
NBS net own reserves[6]	1,218,085	1,127,942	1,331,164	1,519,385		1,173,699	1,222,943	1,395,432	1,519,385	1,647,986	1,798,929	2,014,802	2,112,077	2,150,031
NBS net own reserves[6], in mn of euros	10,363	9,593	11,321	12,952		9,974	10,414	11,894	12,952	14,048	15,340	17,191	18,025	18,346
Credit to the non-government sector	2,467,546	2,760,481	3,027,481	3,242,781		3,108,894	3,210,333	3,257,091	3,242,781	3,223,115	3,237,867	3,261,136	3,277,448	3,264,755
FX deposits of households	1,231,028	1,301,580	1,448,165	1,505,254		1,458,479	1,490,922	1,498,556	1,505,254	1,512,241	1,516,148	1,537,632	1,570,372	1,611,126
M2 (y-o-y, real growth, in %)	6.5	16.6	5.1	-7.1		-0.7	-5.1	-6.1	-7.1	-3.7	-1.5	1.2	4.6	5.8
Credit to the non-government sector (y-o-y, real growth, in %)	7.7	9.7	7.0	-6.9		2.3	0.9	-2.2	-6.9	-10.8	-11.5	-9.4	-6.2	-3.6
Credit to the non-government sector, in % GDP	44.9	48.8	49.9			47.4	50.2	46.6	45.7	42.8	41.6	40.5	39.4	38.3
Prices and the Exchange Rate														
Consumer Prices Index[7]	1.8	1.5	3.6	12.5		9.1	11.9	14.0	15.1	16.0	14.6	11.4	8.0	5.7
Real exchange rate dinar/euro (average 2005=100)[8]	85.7	84.4	83.5	80.5		82.1	81.7	79.8	78.4	76.2	75.5	75.0	74.5	73.9
Nominal exchange rate dinar/euro[8]	117.9	117.6	117.6	117.5		117.6	117.6	117.4	117.3	117.3	117.3	117.2	117.2	117.2

Source: FREN.

1) Unless indicated otherwise.

2) Data for 2008 represent adjusted figures based on a wider sample for calculating the average wage. Thus, the nominal wages for 2008 are comparable with nominal wages for 2009 and 2010, but are not comparable with previous years.

3) We monitor the overall fiscal result (overall fiscal balance according to GFS 2001) – Consolidated surplus/deficit adjusted for "budgetary lending" (lending minus repayment according to the old GFS).

4) The Statistical Office of the Republic of Serbia has changed its methodology for calculating foreign trade. As from 01/01/2010, in line with recommendations from the UN Statistics Department, Serbia started applying the general system of trade, which is a broader concept that the previous one, in order to better adjust to criteria given in the Balance of Payments and the System of National Accounts. A more detailed explanation is given in QM no. 20, Section 4, "Balance of Payments and Foreign Trade".

5) The National Bank of Serbia changed its methodology for compiling the balance of payments in Q1 2008. This change in methodology has led to a lower current account deficit, and to a smaller capital account balance. A more detailed explanation is given in QM no. 12, Section 6, "Balance of Payments and Foreign Trade".

6) The NBS net own reserves represent the difference between the NBS net foreign currency reserves and the sum of foreign currency deposits of commercial banks and of the foreign currency deposits of the government. More detailed explanations are given in the Section Monetary Flows and Policy.

7) Data for 2004, 2005 and 2006 are based on the Retail Prices Index. SORS has transferred to the calculation of the Consumer Price Index from 2007.

8) The calculation is based on 12-m averages for annual data, and the quarterly averages for quarterly data.

2. Economic Activity

Economic activity in Q1 achieved a year-on-year growth of 4.7%, which can be considered a good result. The seasonally adjusted GDP growth in Q1 compared to Q4 2023 was a solid 0.8%, corresponding to an annualized growth rate of 3.2%. The results achieved in Q1 are primarily based on relatively high domestic demand, while external demand remains low due to weak economic growth in the EU. In Q1, within domestic demand, investments led the way, with year-on-year growth estimated by the SORS to be over 7%. This investment growth is accompanied by a high double-digit growth in construction on the production side of GDP. In addition to investments, private consumption also saw very solid growth in Q1, likely due to high real wage and pension growth as a result of strong deceleration of inflation. Comparative analysis shows that Serbia had significantly higher economic growth in Q1 than most CEE countries, where the average year-on-year GDP growth rate was 1.4%, while it was only 0.1% at the EU level. Although economic growth in both the EU and CEE is still low in Q1, clear positive signs of economic recovery are emerging in this quarter. This is a good signal for Serbia, which is closely linked to these economies. Due to good economic trends in Serbia in Q1, we are slightly increasing the GDP forecast for the entire year 2024. In previous editions of QM, this forecast was 3-3.5%, and now we are raising it to around 3.5%. The new forecast is fully aligned with the expectations of all relevant domestic and international institutions.

Year-on-year GDP growth in Q1 was 4.7%

According to the latest estimates by the SORS, Serbia's year-on-year GDP growth in Q1 was 4.7%. Thus, Q1 was the quarter in which the highest year-on-year economic growth rate since 2021 was achieved. It is indisputable that the result in Q1 is primarily a consequence of the solid trend that Serbia's economic activity currently has. However, it should also be noted that part of the achieved growth came as a result of comparison with a low base from the previous year when GDP had the poorest result in 2023 (Table T2-2). Therefore, we expect the year-on-year GDP growth rate to gradually slow down in the coming quarters as it will then be compared to a significantly higher base.

Seasonally adjusted GDP growth in Q1 compared to the previous quarter was a solid 0.8%

Short-term trends in economic activity are best seen in seasonally adjusted GDP indices, which we presented in Graph T2-1. The seasonally adjusted GDP growth in Q1 compared to Q4 2023 was a solid 0.8%, corresponding to an annualized GDP growth of just over 3.2%. The analysis of seasonally adjusted GDP shows that its growth compared to the previous quarter is slightly slowing down - in Q3 2023, it was 1.4%, in Q4 2023, it was 1%, and now in Q1 2024, it has decreased to 0.8%. This slowdown is not yet concerning and was expected, as it is difficult for quarterly GDP growth to sustain at 1.4% for an extended period (this would correspond to an annual growth of almost 6%). Although not concerning, the slowdown in seasonally adjusted GDP, which has been ongoing for several quarters, should certainly be noted and monitored to see if it continues in the future. It is also important to note that it is unlikely that seasonally adjusted GDP growth will again achieve growth of over 1% in the coming quarters, as it did on average from Q2 to Q4 2023. Therefore, year-on-year GDP growth rates are most likely to start gradually slowing down from Q2 2024.

Graph T2-1. Serbia: Seasonally Adjusted GDP Growth 2001-2024 (2008=100)
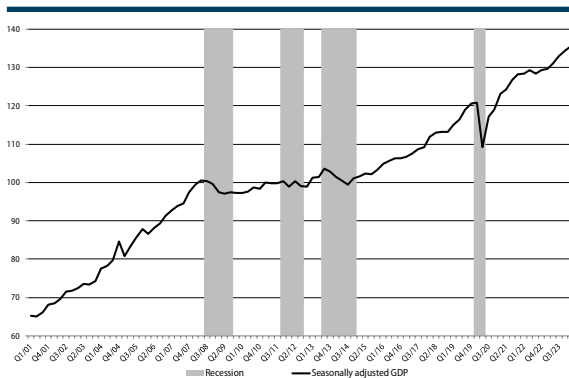
Source: *QM* based on SORS data
Note: Shaded areas represent recessions assessed using the Bry-Boschan procedure

Trends

Sectors that drove GDP growth the most in Q1 were Construction, Traditional Services, and IT

In Table T2-2, we presented data on Serbia's year-on-year GDP growth by production principle, i.e., by individual sectors of the economy. Three sectors stand out with high GDP growth in Q1: 1) Construction 14.2%, 2) Traditional services group (Trade, Transport, and Tourism)[1] with a year-on-year growth of 7.3%, and 3) Information and Communication (which mainly refers to telecommunications and the IT industry) with a growth of 6.1%. In the case of construction, it currently has an undeniable trend of solid growth in Serbia, confirmed by indirect indicators related to this sector (wages and employment in this sector, cement production index). However, the very high year-on-year growth achieved in Q1 is partly due to the comparison with a low base from the previous year (Table T2-2), when construction had a decline. Since there was a strong turnaround in this sector from Q2 2023, we expect year-on-year growth in construction to slow down significantly in the coming quarters. The high real growth of the heterogeneous service sector (Trade, Transport, and Tourism) of 7.3% is primarily a result of the increase in private consumption generated by high real wage and pension growth, which in turn is a result of the relatively strong slowdown in inflation. Finally, IT services are on a long-term trend of relatively high growth. The result achieved in Q1 is actually somewhat worse than what this sector of the economy had in 2023 (8%), but it is in line with its multi-year average.

Table T2-2. Serbia: Gross Domestic Product by Activity 2019–2024[1]

						Y-o-y indices					
							2023			2024	Share
	2019	2020	2021	2022	2023	Q1	Q2	Q3	Q4	Q1	2022
Total	104.3	99.1	107.7	102.5	102.5	100.9	101.6	103.6	103.8	104.7	100.0
Taxes minus subsidies	104.2	97.7	108.3	102.8	100.3	98.8	100.0	100.7	101.7	103.2	16.0
Value Added at basic prices	104.4	99.4	107.6	102.5	102.9	101.2	102.0	104.2	104.2	105.1	84.0
Non agricultural Value Added	104.9	99.2	108.7	103.3	102.6	100.9	101.7	103.8	103.9	105.4	92,3[2]
Agriculture	98.3	102.3	94.5	91.7	108.1	108.6	107.3	108.9	107.7	100.2	7,7[2]
Industry	100.3	100.5	106.4	103.0	102.2	102.2	100.6	103.4	102.7	102.9	22,5[2]
Construction	133.6	96.7	118.2	90.2	108.7	98.3	114.7	113.0	107.5	114.2	6,5[2]
Trade, transport and tourism	106.0	94.7	114.6	105.5	100.4	98.8	97.2	101.7	103.3	107.3	20,5[2]
Informations and communications	108.2	108.7	105.1	104.4	108.0	109.2	110.0	106.3	106.5	106.1	6,1[2]
Financial sector and insurance	102.4	104.6	109.4	100.4	102.6	102.2	102.3	102.2	103.9	102.6	3,8[2]
Other	102.5	98.8	105.6	105.6	101.9	100.2	101.5	102.4	103.4	103.4	32,9[2]

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

All economic sectors had positive y-o-y growth rates in Q1

When analysing the remaining economic sectors (Table T2-2), it can be seen that they had relatively uniform growth rates. Agriculture had a somewhat lower y-o-y growth compared to other sectors (only 0.2%), but this actually has no significant analytical importance in Q1. Namely, the result of the Agriculture sector in Q1 is estimated based on the assumption that the agricultural season will be at the average level, not on the basis of actually achieved results.[2] However, although the actual results of agriculture in 2024 are still unknown, it is unlikely that its high growth from 2023 will be repeated. The high growth from 2023 was due to the comparison with the drought year of 2022, and this effect has now been exhausted. Industry, Financial Activities, and other economic sectors (which we grouped under 'Other' in Table T2-2) had relatively stable growth rates of around 3% in Q1 - very similar to the results from Q4 2023. This indicates that these sectors currently have quite stable moderate growth trends.

The highest growth in Q1 was in investments and private consumption

The structure of achieved GDP growth by *expenditure principle* is presented in Table T2-3. Of all the expenditure components of GDP, investments had the highest growth of 7.3%, driven primarily by construction activity. Construction works constitute just over 40% of total investments, and the Construction sector had a y-o-y growth of 14.2% in Q1. Based on this, we implicitly conclude that investment in equipment and machinery had a slight y-o-y growth of

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1 In the quarterly national accounts, the three NACE sectors (G - Trade, H - Transport and I - Tourism and Hospitality) are considered together. Disaggregated data for individual sectors is published only on an annual basis.
2 Since the actual results of agricultural production in 2024 will be known only in the middle of the calendar year, the assumption that the agricultural season will be average is preliminarily used to estimate the movement of this sector in Q1 and then the y-o-y growth rate at the beginning of the year is estimated on that basis. As soon as the first reliable data on the agricultural season arrive, this preliminary estimate will be revised. We have written about this methodological practice for assessing agricultural activity in Q1 several times in previous editions of QM and it is not disputed.

about 2% in Q1. Besides investments, private consumption also had a relatively high growth of 4.4%. The increase in the y-o-y real growth of private consumption was expected and is a result of the slowdown in inflation, which influenced the increase in the real income of the population. Government consumption, which measures the value of government services (educational, healthcare, security, administrative, social, etc.), also achieved a relatively high y-o-y growth of 3.6% in Q1, driven mainly by the growth of wages in the public sector.

Table T2-3. Serbia: Gross Domestic Product by Expenditure 2019-2024

| | Y-o-y indices | | | | | | | | | | |
| | | | | | | 2023 | | | | 2024 | Share |
	2019	2020	2021	2022	2023	Q1	Q2	Q3	Q4	Q1	2022
GDP	104.3	99.1	107.7	102.5	102.5	100.9	101.6	103.6	103.8	104.7	100.0
Private consumption	103.7	98.1	107.8	104.0	100.8	100.0	99.3	101.5	102.6	104.4	68.3
Government consumption	102.0	102.9	104.3	100.4	100.1	94.9	98.4	101.8	105.9	103.6	16.2
Investment	117.2	98.1	115.7	101.9	103.9	102.1	103.7	104.1	105.2	107.3	24.2
Export	107.7	95.8	120.5	116.6	102.4	108.4	102.7	99.0	100.3	101.1	63.8
Import	110.7	96.4	118.3	116.1	98.9	98.4	94.4	98.7	104.2	103.2	74.8

Source: SORS

Net exports negatively contributed to gdp growth in Q1, and this aggregate provides some additional interesting indications

Analytically, it is important to pay attention to the movement of net exports in Q1. Net exports negatively contributed to GDP growth in Q1, as import growth was slightly higher than export growth (Table T2-3). However, it is important to note that the decrease in net exports was primarily due to the slow growth of exports, while imports did not actually achieve significant growth. The real growth of imports of 3.2% was noticeably lower than the overall GDP growth in Serbia in Q1 (4.7%), which is quite an interesting fact. The modest growth of exports and imports in Q1 is largely a result of falling prices on the global market, but also the stagnation of production and demand in European countries, Serbia's main trading partners. Namely, Serbia's economic growth in Q1 was predominantly driven by relatively high growth in domestic demand, but this did not translate into high import growth. This confirms our previous analysis that investments are currently primarily directed towards construction works, not so much towards investment in equipment (which is mostly of foreign origin). Moreover, it seems that the growth of private consumption was largely directed towards basic domestically produced products, as this did not result in a significant increase in imports. The absence of the spillover effect of domestic demand growth on import value growth in Q1 is largely due to the fall in world prices of imported products by 4.5% compared to the same period last year. This will be discussed in more detail during the later analysis of industrial production. The slow real growth of exports in Q1 of 1.1% is associated with weak economic growth in the EU, which is Serbia's largest trading partner, but also with a drop in export prices by 6.6% compared to the same period last year.

The EU and CEE countries had slow economic growth in Q1, but some positive signs of economic recovery are emerging

In Table T2-4, along with Serbia, the year-on-year GDP growth rates in the EU and CEE[3] countries are shown. It can be seen that Serbia, with a growth of 4.7%, had noticeably higher economic growth in Q1 compared to the EU, but also compared to all CEE countries (except Montenegro). GDP growth in the EU in 2023 was 0.1%, and in the CEE region on average 1.4%. Although year-on-year growth rates in the EU and CEE are still not high, what provides some optimism are the seasonally adjusted growth indices in Q1 compared to the previous quarter. At the EU level, seasonally adjusted quarterly GDP growth in Q1 was 0.3% (annualized 1.2%), which may indicate that the EU is finally emerging from the stagnation that lasted from the end of 2022[4]. As for CEE, economic recovery started a bit earlier, and seasonally adjusted GDP growth in Q1 has now reached 0.5% (it was 0.1% in Q3 2023 and 0.3% in Q4 2023).

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3 Along with the CEE11 EU member countries, our data also includes the countries of the Western Balkans.
4 Seasonally adjusted EU GDP growth was zero from Q3 2022 to Q4 2023, so Q1 2024 is the first quarter in which somewhat clearer signs of EU economic recovery appear after more than a year.

Table T2-4. Serbia and CEE Countries: GDP Growth 2019-2024

						2023				2024
	2019	2020	2021	2022	2023	Q1	Q2	Q3	Q4	Q1
Serbia	4.3	-0.9	7.7	2.5	2.5	0.9	1.6	3.6	3.8	4.7
EU27	1.8	-5.6	6.0	3.4	0.5	1.5	0.2	0.0	0.2	0.1
CEE (weighted average)	3.9	-3.5	6.5	4.1	0.6	0.1	0.2	1.1	1.2	1.4
Albania	2.1	-3.5	8.9	4.9	3.4	2.8	3.3	3.8	3.8	:
Bosnia and Herzegovina	2.9	-3.0	7.4	4.2	1.7	1.8	1.2	1.9	1.7	:
Bulgaria	4.0	-4.0	7.7	3.9	1.8	2.2	1.9	1.5	1.8	1.9
Montenegro	4.1	-15.3	13.0	6.4	5.8	4.7	5.4	7.1	6.1	6.2
Czech Republic	3.0	-5.5	3.6	2.4	-0.5	0.1	-0.6	-0.9	0.2	-0.3
Estonia	4.0	-1.0	7.2	-0.5	-3.0	-3.9	-2.7	-2.7	-2.6	-2.4
Croatia	3.4	-8.6	13.8	6.3	2.8	2.9	3.8	1.4	4.4	3.9
Latvia	0.6	-3.5	6.7	3.0	-0.3	0.7	-0.6	-0.6	-0.5	0.1
Lithuania	4.7	0.0	6.3	2.4	-0.3	-2.4	0.8	0.3	-0.2	2.9
Hungary	4.9	-4.5	7.1	4.6	-0.9	-0.9	-2.4	-0.4	0.0	1.1
North Macedonia	3.9	-4.7	4.5	2.2	1.0	1.4	0.9	1.0	0.9	1.2
Poland	4.4	-2.0	6.9	5.3	0.2	-0.6	-1.2	0.8	1.4	1.4
Romania	3.9	-3.7	5.7	4.1	2.1	1.0	2.8	3.6	1.1	1.6
Slovakia	2.5	-3.3	4.8	1.8	1.1	0.2	1.8	2.0	2.2	2.7
Slovenia	3.5	-4.2	8.2	2.5	1.6	1.1	1.7	1.3	2.2	2.1

Note: Data for Q1 for Albania and BiH are not yet published.
Source: QM based on Eurostat data

We forecast Serbia's GDP growth to be around 3.5% in 2024

Forecasts of economic trends in the upcoming period are still heavily influenced by numerous global instabilities and uncertainties. Therefore, they should still be treated as indicative and conditional. As already mentioned, Serbia's year-on-year GDP growth of 4.7% in Q1 was partly due to the comparison with a low base, so we expect it to gradually decrease in the coming quarters. However, the GDP growth trend in the first quarter, measured by the annualized growth rate of seasonally adjusted GDP in Q1 compared to the previous quarter, is 3.2%. Therefore, for the entire year, we currently forecast that economic growth in Serbia could be around 3.5%. This new forecast represents a slight upward correction compared to previous QM issues, when we expected Serbia's GDP growth to be 3-3.5% in 2024.

The new QM forecast is fully aligned with the expectations of all relevant institutions

A particular curiosity that (to the authors' recollection) is happening for the first time in nearly twenty years since QM has been published is that all relevant international and domestic institutions are forecasting the same economic growth rate for Serbia this year – 3.5%. On the domestic side, these are: the Government (current budget and Fiscal Strategy) and NBS (May Inflation Report); and on the international side: the IMF (*April World Economic Outlook*), the World Bank (*June Global Economic Prospects*), the European Commission (*May Spring Economic Forecast*), and the EBRD (*May Regional Economic Prospects*). It is particularly interesting that such an extremely unusual unification of all relevant short-term GDP growth forecasts for Serbia is happening now in a period of pronounced geopolitical uncertainties when all forecasts are quite uncertain.

Industrial Production

Industrial production had a moderate growth of 2.9% in Q1

Industrial production achieved a y-o-y growth of 2.9% in Q1 (Table T2-5), very similar to the growth in Q4 2023 (2.7%). This data indicates that there were no significant changes in the industry's trend in Q1 compared to the previous period (although there were certainly some oscillations in its individual segments). Mining, after variable results in 2023, achieved a relatively high growth of 6.1% in Q1 (supported by a 5.3% growth in April for which preliminary data are available). Electricity production, on the other hand, significantly slowed its growth in Q1 to only 0.3% (after having a high growth of 12.7% in 2023). Additionally, in April, electricity production had a strong decline of 15% compared to the same period last year (Table T2-5). The decline in electricity production in 2024 was actually expected, as an important reason for the high growth of this industrial sector in 2023 was unusually good hydrology (which resulted in a strong growth of hydroelectric power production by as much as 41%). This factor is, however, temporary in nature, so we announced in previous QM issues that electricity production in 2024 would return to its usual level, which implies a decline in production compared to 2023.

The decline in electricity production was also influenced by a relatively mild winter and low electricity prices, making it more profitable to import than to produce electricity. The trend of the manufacturing industry, which is the largest and most heterogeneous part of industrial production, had a similar growth in Q1 as in the second half of 2023 (a y-o-y growth of 3.1% in Q1 and 2.7% in the second half of 2023). In April, this growth slightly accelerated (to 6.6%), but we interpret this as a temporary oscillation around the trend rather than a sign of a long-term acceleration of this sector.

Table T2-5. Serbia: Industrial Production Indices 2019–2024

|	Y-o-y indices											Share
						2023				2024		2022
	2019	2020	2021	2022	2023	Q1	Q2	Q3	Q4	Q1	April	
Total	100.3	100.5	106.4	101.7	102.5	103.3	100.6	104.0	102.7	102.9	102.9	100.0
Mining and quarrying	101.2	102.7	127.6	122.6	99.9	106.8	93.6	106.0	94.7	106.4	105.3	14.3
Manufacturing	100.2	100.1	105.6	101.4	100.7	99.6	99.0	102.5	102.8	103.1	106.6	71.4
Electricity, gas, and water supply	100.5	101.0	100.7	92.9	112.7	118.5	114.9	111.1	106.5	100.3	85.0	14.3

Source: SORS

Within the manufacturing industry, the food industry shows good and stable results, while some areas are in temporary deep decline and others in temporary expansion

Looking at individual areas of the manufacturing industry, two sectors stand out significantly. The first is the production of basic metals, which had a y-o-y growth of as much as 70% in the first four months of 2024. This growth is due to the comparison with a low base from the previous year when some important facilities in this area were being overhauled, as we wrote in previous QM issues. On the other hand, the sector that recorded a deep decline of over 40% in the first four months of 2024 is the production of petroleum products, for a similar reason as last year in the production of basic metals. Namely, NIS has been conducting a major overhaul of the oil refinery in Pančevo since the end of February. Since this overhaul is planned to be completed in the second half of April, we expect this area to have usual growth rates compared to the previous year from May onwards. Analytically, the most significant growth at the beginning of 2024 is likely in the food industry. This is the largest individual area of the manufacturing industry, which is also very heterogeneous (a large number of independent companies in this area). The food industry had relatively high and stable growth of 8% in the first four months of 2024. The growth of the food industry this year is driven by a good yield of important agricultural products last year, which provided large quantities of relatively cheap raw materials.

Seasonally adjusted indices confirm a stable slightly upward trend in Industrial Production

Graph T2-6. Serbia: Seasonally Adjusted Industrial Production Indices 2008–2024
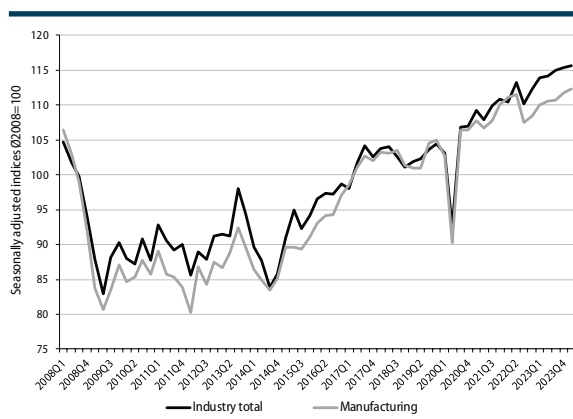
Source: SORS and Eurostat

Seasonally adjusted industrial production indices (and separately for the manufacturing industry) are shown in Graph T2-6. This graph probably better summarizes and confirms the trends we previously assessed when analyzing the y-o-y industrial production indices (and the manufacturing industry). Namely, after a relatively sharp decline in Q3 2022, industrial production and the manufacturing industry established an upward production trend. This positive trend is still not overly strong, but it has been maintained for more than a year, which is rare in the current conditions of the general decline in industrial production in Europe.

In the EU and CEE countries, poor industrial production results continued in Q1

As mentioned earlier, Serbia was a rare exception in the European context in terms of industrial production growth in both Q1 2024 and the previous year 2023. This is clearly shown by the comparative data presented in Table T2-7. At the EU level, the decline in industrial production in Q1 was 4%, and in the CEE region, it was 1.4%, continuing the negative trends that have been ongoing for a year. Besides Serbia, only Lithuania had positive year-on-year industrial production growth in Q1, and it was only 0.4% (Lithuania is not a country whose economy

relies heavily on industry)[5]. The current deviation of Serbia from industrial trends in the EU is quite unusual, given that Serbia's and the EU's industrial production trends have been highly correlated in previous years. A possible explanation for this phenomenon is the difference in the structure of industrial production in Serbia compared to the EU and CEE. Namely, so-called traditional industries, which have relatively stable demand even in periods of stagnation, still dominate in Serbia. In the current circumstances of increased global uncertainty and higher interest rates, it is possible that the demand for more expensive industrial products (higher added value) has significantly decreased, while the demand for basic industrial products, which Serbia predominantly produces, has not. Supporting this assumption is the relatively strong growth of the food industry in Serbia. Another reason could be that multinational companies continue to produce at full capacity in Serbia during periods of stagnation because production costs in Serbia are lower than in other European countries.

Table T2-7. Serbia and CEE Countries: Year-on-year Industrial Production Growth 2019-2024

	Y-o-y indices									
	2019	2020	2021	2022	2023	2023				2024
						Q1	Q2	Q3	Q4	Q1
Serbia	0.3	0.5	6.4	1.7	2.5	3.3	0.6	4.0	2.7	2.9
EU27	-0.2	-7.3	9.1	3.1	-1.9	0.9	-0.9	-4.3	-3.2	-4.0
CEE (weighted average)	1.8	-5.2	10.9	5.3	-2.2	-2.2	-2.8	-2.8	-1.2	-1.4
Bulgaria	-5.4	-6.6	9.7	1.0	-3.8	-2.5	-6.3	-0.1	-6.1	:
Montenegro	0.6	-6.2	10.1	12.8	-8.2	-4.4	-10.3	-10.5	-7.6	-8.3
Czech Republic	-0.4	-7.2	6.6	2.5	-0.8	0.6	0.3	-3.5	-0.7	-1.0
Estonia	7.1	-2.8	12.8	-2.3	-12.0	-11.5	-15.9	-12.7	-8.0	-7.0
Croatia	0.6	-3.4	6.3	1.6	-0.1	-1.7	0.1	-0.4	1.7	-3.9
Latvia	0.8	-1.7	6.4	0.8	-3.9	-4.3	-8.9	0.3	-2.7	-0.2
Lithuania	2.9	-1.8	20.1	9.3	-6.3	-13.3	-1.6	-6.2	-4.0	0.4
Hungary	5.6	-7.1	9.9	6.1	-4.9	-4.5	-5.2	-5.0	-4.9	-1.7
North Macedonia	3.7	-9.5	1.5	-0.3	0.7	0.1	2.7	-0.6	0.4	-3.0
Poland	4.3	-2.1	14.9	11.0	-1.1	-0.9	-2.4	-1.1	0.1	-0.4
Romania	-3.2	-9.3	6.7	-1.7	-2.4	-3.2	-3.0	-2.3	-1.2	-0.5
Slovakia	0.9	-8.5	10.3	-4.0	1.8	-0.2	1.5	1.0	5.0	-1.4
Slovenia	3.1	-5.3	10.3	1.2	-5.7	-3.4	-4.1	-10.1	-5.0	-3.2

Source: *QM* based on Eurostat data

Construction

According to the SORS estimate, Construction had a high y-o-y growth of 14.2% in Q1

According to RZS data, construction achieved a y-o-y growth of 14.2% in Q1 (Table T2-2). This estimate by the SORS is primarily based on the movement of the Index construction works performed in the country, which had a very high year-on-year growth of 18.3% (at constant prices) in Q1. Thus, construction was the sector with the highest year-on-year growth in Q1. Analyzing this result in more detail, we see that it is partly due to a favourable basic trend in construction but also due to the comparison with a low base from the previous year when construction had a decline.

Indirect indicators support official data on high growth in Construction in Q1

As we have often pointed out in previous QM issues, construction is an activity that official statistics struggle to monitor accurately. It is a very dynamic sector with a large number of companies being quickly established and closed, and a significant portion of activities is carried out in the informal economy. Therefore, it sometimes happens that official data on the movement of construction activity, especially in the short term, do not best reflect real market trends in this sector. Consequently, in QM, we regularly conduct additional analysis of economic indicators closely related to construction. These are: 1) movement of wages and employment in this sector, and 2) cement production. These additional indicators often show significantly different results of construction activity than those shown by official construction statistics. Unlike official statistics, related indicators typically have much smaller (and likely) quarterly and annual fluctuations but do not differ much from the official estimates of this sector's movement in the long run.

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5 According to Eurostat's estimate, the share of industry in Lithuania's GVA in 2023 was 19.1%, and the CEE average is around 23%.

Indirect Indicators Confirm High Growth in Construction in Q1

Table T2-8. Serbia: Cement Production 2001–2023

	Q1	Q2	Q3	Q4	Total
			Y-o-y indices		
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	110.2	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	110.6	112.8	106.3	109.7
2019	112.2	96.7	103.3	104.1	102.8
2020	154.9	97.9	112.7	118.2	116.8
2021	80.2	130.8	101.9	101.2	103.9
2022	108.1	97.8	94.3	105.9	100.6
2023	100.3	96.6	108.6	100.9	101.6
2024	113.2	-	-	-	-

Source: *QM* based on SORS data

Construction growth is likely to slow down in the coming quarters due to comparison with a higher base

Registered employment in construction had a y-o-y growth of 3.5% in Q1, and total employment according to the Labour Force Survey (which includes informal employment) of 5.2%. Real wages of employees in this sector grew by 9.5% in Q1. The wage bill in construction thus had a y-o-y real growth of 13-15%. Additionally, the growth of employment and wages in construction was noticeably faster than in other economic sectors, which generally confirms that this sector indeed had higher y-o-y growth in Q1 than other activities. A similar conclusion is suggested by the cement production index. The cement production index had a high growth of 13.2% in Q1 (Table T2-8), consistent with the movement of other indicators in this sector.

Future movements in construction are difficult to predict reliably[6]. Analysing the official results of this activity from the previous year, it is observed that Q1 2023 was the last quarter when construction had a decline (Table T2-2), and from Q2 2023, there was an extremely strong change, i.e., since then, official construction estimates show high double-digit growth. Considering this, it is expected that from Q2, there will be a relatively strong slowdown in the y-o-y growth of this sector. On an annual basis, we currently expect construction to grow by 5-10% in 2024.

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6 Once again, we emphasize that we do not doubt that official statistics estimate construction trends well over the long term, but there are strong arguments that annual and quarterly estimates by official statistics can often significantly deviate from actual trends.

3. Labour Market

According to the Labour Force Survey (LFS) data, in Q1 2024, there was a moderate increase in the activity and employment rates, and a slight decrease in the unemployment and informal employment rates compared to the same period last year. According to the Central Register of Compulsory Social Insurance (CROCSI), registered employment (excluding registered individual farmers) increased slightly by 0.8% year-on-year. The growth in employment is lower than the growth in economic activity, leading to a year-on-year increase in labour productivity. Although employment in the service sector increased slightly, there are significant differences between activities. The highest year-on-year growth in the number of employees was achieved in professional, scientific, and technical activities, as well as in health and social care, with an increase of 8–10%. Employment growth in the private sector is slowing down. Wages achieved a significant year-on-year real growth of 8.7%, which is a consequence of the slowdown in inflation in Q1 2024. Real wage growth was the same in both the private and public sectors compared to the same period last year. Wages achieved higher real growth compared to Gross Value Added (GVA) and labour productivity. Year-on-year real growth in labour productivity and unit labour costs was around 4%.

The employment rate was 50.9%

The unemployment rate was 9.4%

There are noticeable continuous slight improvements in basic labour market indicators

Graph T3-1. Employment and Unemployment Rate Trends 15+ %
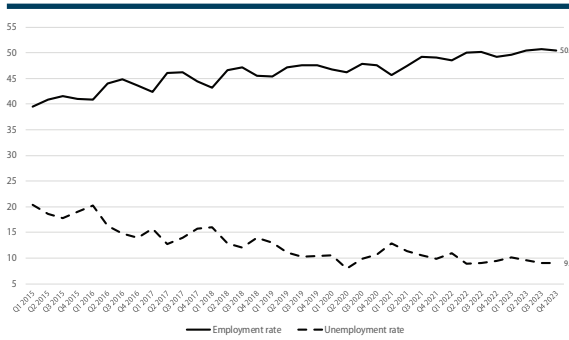
Note: Interruption in the 2021 series. Data revised for the period Q1 2015–Q1 2023.
Source: SORS, LFS

Graph T3-2. Formal and Informal Employment in % of total employment 15+
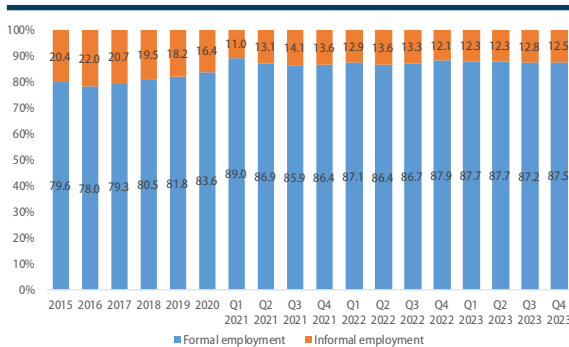
Note: Interruption in the 2021 series. Data revised for the period Q1 2021–Q1 2023.
Source: SORS, LFS

Employment and Unemployment

Basic labour market indicators show moderate improvements compared to the previous quarter and the same quarter last year. The employment rate was 50.9%, up by 1.4 pp compared to the same quarter last year, and the unemployment rate of 9.4% was down by 0.6 pp respectively. The employment rate increased as a result of a decrease in the total population by 29.6 thousand (0.5%) and an increase in the total number of employed by 61.6 thousand (2.1%) compared to the same quarter last year. The number of unemployed decreased compared to the same quarter last year but increased seasonally compared to the previous quarter.

The informal employment rate was 12.1% in Q1 2024, down compared to the previous quarter and the same quarter last year. The trend of decreasing informal employment continues.

Registered employment (excluding registered individual farmers) increased by 0.8% (about 19 thousand employees) year-on-year, while real GVA growth was 5.1% in the same period. Real year-on-year GVA growth is higher than employment growth in the observed activities (Table 3.1). The number of employees in construction increased by 3.5% year-on-year, while GVA grew by 14.2% in real terms. Higher GVA growth than employment growth leads to an increase in labour productivity, which we consider a positive trend.

Table T3-1. Trends in the number of employees (15+) and real Gross Value Added (GVA) by sector of activity y-o-y change %

|	2017	2018	2019	2020	2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023
Employment CRCSI	3.0	3.8	2.4	2.3	3.0	1.9	1.8	1.2	2.6	3.1	2.8	2.4	1.3
Total GVA	2.1	4.3	4.4	-0.6	7.6	4.0	4.0	1.2	1.0	1.2	2.0	4.2	4.2
Employment- agriculture	-0.7	-1.2	-5.5	-1.7	-1.8	-4.6	-5.2	-6.6	-6.1	-3.4	-2.5	-1.1	-1.1
GVA-agriculture	-11.4	15.1	-1.7	2.3	-5.5	-8.3	-8.6	-8.5	-7.8	8.6	7.3	8.9	7.7
Employment-industry (B-E)	4.7	5.0	3.1	3.3	2.9	1.2	1.0	-0.2	0.7	1.0	1.7	1.7	0.8
GVA-industry (B-E)	2.6	0.9	0.3	0.5	6.4	3.1	5.6	1.0	2.3	2.2	0.6	3.4	2.7
Employment-construction	1.2	7.9	9.7	9.1	4.8	3.4	2.1	0.3	1.2	1.7	1.2	2.0	2.9
GVA-construction	5.4	12.4	33.6	-3.3	18.2	-5.6	-6.8	-12.1	-12.5	-1.6	14.8	13.0	7.4
Employment-services	2.5	3.2	1.8	1.5	2.9	2.1	2.2	1.9	3.6	4.1	3.4	2.8	1.4
GVA-services	3.4	3.8	4.4	-1.1	8.6	6.5	5.8	4.2	3.4	0.5	0.9	3.0	4.0

Source: SORS, CROCSI and SNA

Notes: Registered employment excluding registered individual farmers was used for employment (CROCSI). Employment in Q1 2024 is the previous data. The quarterly data for GVA in the period Q1 2023–Q1 2024 are previous data, while the annual data for 2021 has been revised. Given that quarterly GVA data is published for sectors B–E, for data comparability, we also include B–E activities in industrial employment.

When we look at all service activities, employment in them increased by 0.8% year-on-year, but there are significant differences between individual activities. Professional, scientific, and technical activities achieved a year-on-year growth of almost 10%. The number of employees in health and social care increased by 8.3%, with this growth significantly driven by the large increase in the number of employees in social care without accommodation. The increase in the number of employees in social care by almost 10 thousand (i.e., 50%) observed in Q4 2023 and Q1 2024 is due to a change in statistical classification rather than actual employment growth in this activity. Information and communications have been increasing the number of employees for a long period, which continued in Q1 this year with a growth of 4.7%. Accommodation and food services increased the number of employees by 3.6% year-on-year.

In terms of ownership, the public sector achieved a slight increase in the number of employees compared to the previous quarter and the same quarter last year. Wages for a large number of occupations and jobs in the public sector are not competitive with wages in the private sector, leading to occasional employee outflows from this sector, which are compensated by hiring less qualified workers, reducing the quality of services in the public sector. Employment growth in the private sector is slowing down compared to the previous period, with employment in Q1 2024 being 1% higher year-on-year.

Graph T3-3. Employment trends in the public and private sector
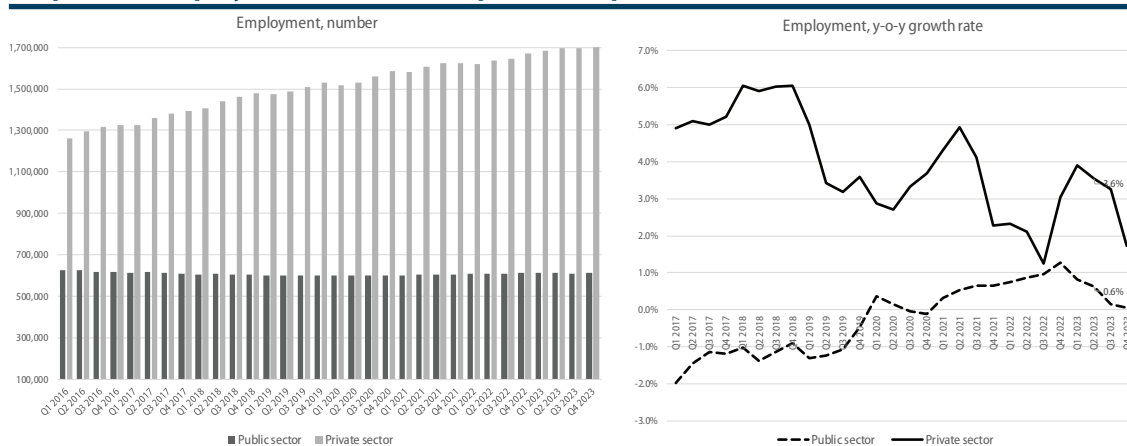
Note: Data for Q1 2024 is the previous data. Employment includes the number of employees in legal entities, entrepreneurs and their employees, and persons working independently.
Source: SORS, CROCSI

Wages

The average net wage was 95.6 thousand dinars, or 816 euros

There was a significant year-on-year real wage growth of 8.7%

Wages grew more in real terms than GVA

Higher real wage growth is a consequence of the slowdown in inflation at the end of 2023 and the beginning of 2024

In Q1 2024, wages grew significantly in real terms by 8.7% year-on-year. The growth was higher than the real GVA growth, which was 5.1% in the same period. The higher real year-on-year wage growth in Q1 2024 is also a result of the slowdown in inflation, which was 5.7% in Q1 2024. Average wages in the public sector and parts of the public sector are about six thousand dinars higher than in the private sector, or about 6%. While average wages in the public sector are around 99–100 thousand, in the private sector they are 94 thousand. When comparing wages in the public and private sectors, it is necessary to consider the existence of the grey economy in the private sector, which implies that actual wages in this sector are higher, thus making the wage ratio between the public and private sectors smaller than indicated by official wage data. Year-on-year real wage growth in both the public and private sectors is equal, around 8.7–8.8%. Compared to the previous quarter, wages grew more in the public sector than in the private sector, with real growth of 8.5% and 2.9%, respectively. Given that wages in the public sector are determined at the beginning of the calendar year, higher real wage growth at the beginning of the year in the public sector is usual, but it is also common for wages in the private sector to grow throughout the year, catching up with wages in the public sector.

The median wage was 73.7 thousand dinars, about 22 thousand dinars less than the average wage, or 23% in Q1 2024. The year-on-year real growth of the median wage was slightly higher than the growth of the average wage, 10.4%.

The average net wage in euros was 816 EUR, nominally higher by 15.1% year-on-year. The growth of wages in euros corresponds to the nominal growth of wages in dinars (14.9%) due to the unchanged exchange rate. Employer costs amounted to 1,296 EUR.

Graph T3-4. Real wage base index (2011=100)
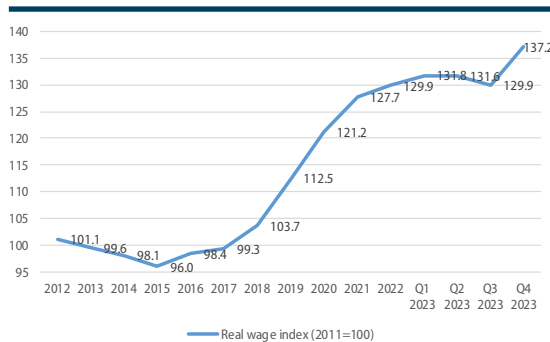
Source: Author's calculations using SORS data.

Graph T3-5. Average wage trends in the public sector, public enterprises, the state, and the private sector RSD
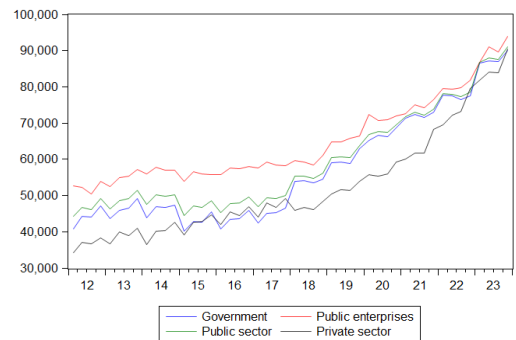
Note: Interruption in the 2018 series.
Source: SORS

Graph T3-6. Median and average wage trends
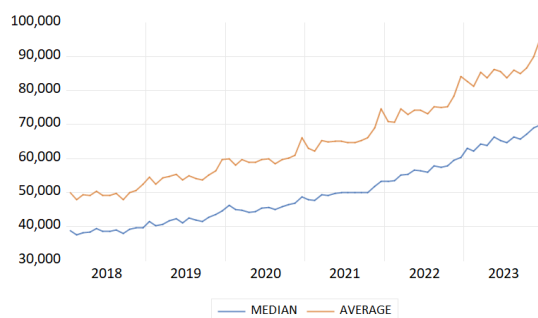
Source: SORS

Graph T3-7. Average net wages and employer's costs in EUR
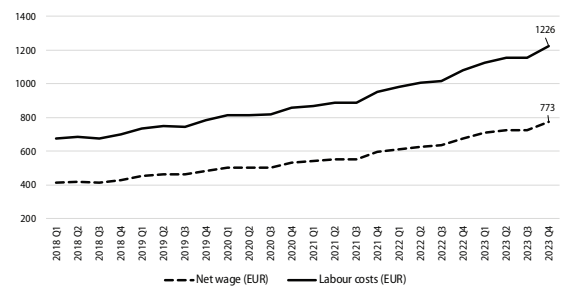
Source: SORS for wages, NBS for exchange rates.

Graph T3-8. Labour productivity and real unit labour costs trends

GVA growth is higher than employment growth

Real unit labour costs increased because wages grew more than labour productivity

Note: Registered employment excluding registered individual farmers was used for employment (CROCSI). Employment in Q1 2024 is the previous data. The quarterly data for GVA in the period Q1 2023–Q1 2024 are previous data, while the annual data for 2021 has been revised.
Source: Author's calculations using SORS data.

Labour Productivity

Higher real GVA growth of 5.1% compared to employment growth of 0.8% led to a year-on-year real labour productivity growth of 4.2%. In the same period, real unit labour costs increased by 4.3% due to higher real wage growth compared to productivity growth. The high growth of unit labour costs in Q1 continues their strong growth trend from the period 2018–2023, which cumulatively amounted to nearly 23% in that period. The high growth of unit labour costs, which has occurred in most European countries in recent years, is particularly strong in Southeast Europe, predominantly due to demographic trends affecting the decline in labour supply. The economic consequences of rising unit labour costs are reduced competitiveness of European economies and increased inflationary pressures.

Appendix

Table D3-1. Basic labour market indicators

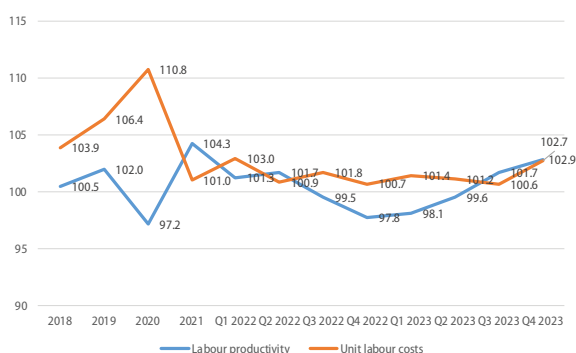|	2017	2018	2019	2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023
Activity rate (%)	54.0	54.5	54.6	54.0	52.5	53.4	55	54.5	54.4	54.8	55.1	54.2	55.2	55.8	55.8	55.6
Employment rate (%)	46.7	47.6	49.0	49.1	45.7	47.4	49.2	49.1	48.5	50	50.2	49.2	49.6	50.4	50.7	50.5
Unemployment rate (%)	13.5	12.7	10.4	9.0	12.9	11.3	10.6	9.9	10.9	8.9	9	9.4	10.1	9.6	9	9.1
Informal employment rate (%)	20.7	19.5	18.2	16.4	11	13.1	14.1	13.6	12.9	13.6	13.3	12.1	12.3	12.3	12.8	12.5

Note: Interruption in the 2021 series, revised data for the period Q1 2021–Q1 2023.
Source: SORS, LFS

Table D3-2. Average net wages and employer's costs in EUR

	2018	2019	2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023
Average net wages, total, (€)	420	466	511	541	553	552	595	613	628	634	676	709	726	725	773
Average net wages, industry, (€)	413	454	485	502	519	514	546	553	575	579	617	644	666	660	702
Labour costs, total (€)	684	754	827	869	890	888	955	981	1006	1017	1080	1126	1154	1153	1226
Labour costs, industry (€)	672	734	784	807	835	828	877	884	923	930	988	1022	1060	1051	1117

Note: Industry includes activities B, C, and D, weighted average wages. Exchange rate of the dinar against the euro, period average (NBS).
Source: Author's calculations using SORS and NBS data.

4. Balance of Payments and Foreign Trade

In Q1 2024, the current account deficit amounted to 395 million euros, or 2.3% of GDP. Compared to Q1 2023, there was a slight increase in the current account deficit as a net result of a more significant decrease in the surplus on the secondary income and services account on one side and a decrease in the goods deficit on the other side, while the deficit on the primary income account remained at last year's level. In the first three months of 2024, exports and imports of both goods and goods and services have significantly converged. Expressed as a percentage of GDP, goods exports account for 41%, and goods imports for 51%, while in the case of goods and services, exports account for 61%, and imports for 66%. Thus, the coverage of imports by exports of goods and services reaches approximately 92%, while the coverage of imports by exports of goods is almost 82%. In Q1 2024, there was a year-on-year decrease in the value of exported goods by 1.9% and imported goods by 3.9%, while April data indicate a reversal of the declining trend and a significant year-on-year growth in the achieved value. During the first three months of 2024, a modest net capital inflow of 75 million euros was recorded, and foreign exchange reserves decreased by 320 million euros. Significant inflow was achieved based on FDI (1.11 billion euros, net), with a simultaneous net outflow on the accounts of other and portfolio investments.

In Q1 2024, the current account deficit 395 million euros, or 2.3% of GDP

In Q1 2024, the current account deficit amounted to 395 million euros, or 2.3% of GDP. This share of the deficit in GDP is at the level achieved in 2023 (2.6% of GDP) but slightly above the deficit of the first three months of 2023 (1.1% of GDP, Table T4-1). The increase in the current account deficit compared to Q1 2023 is the result of a more significant decrease in inflows from secondary income[1] and the surplus on the services account, which is partly compensated by a reduction in the goods deficit. The deficit on the primary income account[2] is at the level of Q1 2023.

The level of the foreign trade deficit is still at a decade low: 914 million euros, or 5.4% of GDP...

The level of the foreign trade deficit in Q1 2024 was 914 million euros, i.e., 5.4% of GDP. Thus, at the very beginning of 2024, the foreign trade deficit is at a similar level as in 2023 (5.2% of GDP), which is still historically low compared to its share in GDP over the past decade (Table T4-1 and Graph T4-2). Compared to Q1 2023, the foreign trade exchange deficit is lower by 0.8 pp of GDP (from 6.3% of GDP to 5.4% of GDP), despite a significant reduction in the surplus on the services account (by 1.5 pp of GDP).

Share of current and foreign trade deficit in GDP at last year's level

During Q1 2024, the value of exports of goods and services was at the level of 10.2 billion euros, which is 61% of the quarterly GDP. At the same time, the value of imports of goods and services amounted to 11.1 billion euros, representing 66% of GDP. Thus, in the first three months of 2024, the values of imports and exports of goods and services have significantly converged, i.e., the coverage of imports by exports of goods and services reached approximately 92% (while the coverage of imports by exports of goods was almost 82%).

Values of imports and exports have significantly converged - coverage of imports by exports of goods and services reaches approximately 92%

In Q1 2024, a surplus on the services account of 633 million euros, or 3.8% of GDP, was achieved. This value of net inflow based on the exchange of services was lower by 1.5 pp of GDP compared to the same quarter one year earlier (Table T4-1). During Q1 2024, the goods deficit amounted to 1.55 billion euros, which is 9.2% of the quarterly GDP value. This amount is 211 million euros below the value of the goods deficit from Q1 of the previous year, i.e., 2.3 pp of GDP. Exports of goods amounted to 6.96 billion euros, which is 41.3% of GDP. Thus, goods exports[3] recorded a year-on-year decrease of 1.9%. At the same time, imports reached the level of 8.50 billion euros, representing 50.5% of GDP. The year-on-year decrease in imports is even more pronounced

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1 This item in the balance of payments encompasses remittances, donations, and other types of transfers.
2 This item in the balance of payments includes compensation of employees, dividends, reinvested earnings, interests, and other income from factors of production.
3 The NBS data on the import and export of goods, as well as the trade balance, differ from the SORS data (which we use in the following sections of the text: *Exports and Imports*) because they do not include goods in processing (see Box 1 on the change in the methodology of calculating the Balance of Payments in *QM37*). Therefore, there is a certain difference in the levels of exports and imports, as well as growth rates, depending on whether the data source is NBS or SORS.

Table T4-1. Serbia: Balance of Payments

	2022	2023	2023				2024
			Q1	Q2	Q3	Q4	Q1
CURRENT ACCOUNT	-4,162	-1,810	-162	-404	-208	-1,037	-395
Goods	-9,364	-6,604	-1,758	-1,521	-1,244	-2,082	-1,547
Credit	26,928	27,930	7,088	7,102	6,759	6,980	6,956
Debit	36,292	34,534	8,847	8,622	8,003	9,062	8,502
Services	2,314	3,017	801	770	581	865	633
Credit	11,076	13,079	2,942	3,129	3,430	3,578	3,268
Debit	8,761	10,062	2,140	2,359	2,850	2,713	2,636
Primary income	-3,001	-3,860	-598	-1,112	-1,053	-1,097	-674
Credit	748	1,058	206	269	273	309	310
Debit	3,750	4,918	805	1,382	1,326	1,406	985
Secondary income	5,889	5,637	1,393	1,459	1,508	1,277	1,194
Credit	7,256	6,934	1,697	1,815	1,808	1,614	1,502
Debit	1,368	1,297	304	356	300	337	308
Personal transfers, net [1]	4,630	4,602	1,050	1,248	1,333	970	1,043
Of which: Workers' remittances	3,776	3,719	855	997	1,118	749	831
CAPITAL ACCOUNT - NET	-25	1	-5	-10	27	-11	40
FINANCIAL ACCOUNT	-4,325	-1,331	-123	-320	-37	-852	-300
Direct investment - net	-4,328	-4,220	-781	-1,245	-965	-1,228	-1,107
Portfolio investment	12	-918	-1,239	2	147	173	424
Financial derivatives	-99	-73	-13	-22	-38	-1	4
Other investment	-2,830	-1,225	47	-321	-595	-356	698
Other equity	-1	-15	-1	-1	-10	-3	-5
Currency and deposits	-26	39	14	-353	-35	413	768
Loans	-3,340	-1,368	-85	-477	-285	-521	-305
Central banks	-987	0	0	0	0	0	0
Deposit-taking corporations,	-40	656	90	214	355	-3	109
General government	-1,634	-1,367	-105	-419	-527	-316	-30
Other sectors	-679	-657	-71	-272	-113	-201	-385
Insurance, pension, and standardized	2	0	0	0	0	0	0
Trade credit and advances	535	119	119	511	-265	-246	240
Other accounts receivable/payable	0	0	0	0	0	0	0
SDR (Net incurrence of liabilities)	0	0	0	0	0	0	0
Reserve assets	2,919	5,104	1,863	1,267	1,414	560	-320
ERRORS AND OMISSIONS, net	-138	478	43	94	143	196	55
PRO MEMORIA							
Current account	-6.9	-2.6	-1.1	-2.3	-1.2	-5.4	-2.3
Balance of goods	-15.5	-9.5	-11.5	-8.8	-7.0	-10.9	-9.2
Exports of goods	44.6	40.2	46.5	41.1	37.8	36.5	41.3
Imports of goods	60.1	49.7	58.1	50.0	44.8	47.4	50.5
Balance of goods and services	-11.7	-5.2	-6.3	-4.3	-3.7	-6.4	-5.4
Personal transfers, net	7.7	6.6	6.9	7.2	7.5	5.1	6.2
GDP in euros [2]	60,429	69,515	15,239	17,260	17,879	19,136	16,835

Note: The balance of payments of the Republic of Serbia is aligned with the international guidelines contained in the IMF Balance of Payments Manual no.6 (BPM6). Source: NBS 1) Personal transfers represent current transfers between resident and non-resident households. 2) Quarterly values. The conversion of annual GDP into euros was done at the average annual exchange rate (average of the NBS official daily average exchange rates).

than the decline in exports, i.e., the value of imports is 3.9% lower than last year. If we consider seasonally adjusted quarterly values, the data indicate an increase in exports of 1.7% and imports of 2.1% compared to the previous quarter (Q4 2023), as well as an increase in the goods deficit (see Graph T4-3). According to available SORS data[4], the value of both imports and exports recovered in April and recorded a year-on-year increase of 15.8% and 10.1%, respectively.

Since the beginning of 2024, there has been a year-on-year decrease in both import and export prices (4.5% and 6.5%, respectively), while terms of trade have slightly deteriorated (the ratio of export to import prices is 2.2% below the level from Q1 of the previous year, Graph T4-4).

In Q1, the deficit on the primary income account was 674 million euros, or 4.0% of GDP

In Q1, the deficit on the primary income account amounted to 674 million euros, which is 4.0% of GDP. Compared to Q1 2023, the share of this deficit in GDP remained almost unchanged. The surplus on the secondary income account in Q1 2024 was 1,194 million euros (7.1% of GDP), which is significantly lower (by 2.1 percentage points of GDP) compared to the recorded net inflow in Q1 of the previous year (Table T4-1).

During the first three months of 2024, a modest net capital inflow of 75 million euros was recorded (see Table T4-1)[5]. This result is due to a net capital inflow from Foreign Direct

4 See *Exports and Imports* below
5 20 million euros without *Errors and omissions*

Trends

…the surplus on the secondary income account was 1,194 million euros, or 7.1% of GDP

*Modest net capital inflow of 75 million euros*

Significant inflow was achieved through FDI: 1.11 billion euros, net

Decrease in foreign exchange reserves

The year-on-year decline in exports, present since mid-2023, continued into Q1 2024, but there was growth in exported value in April
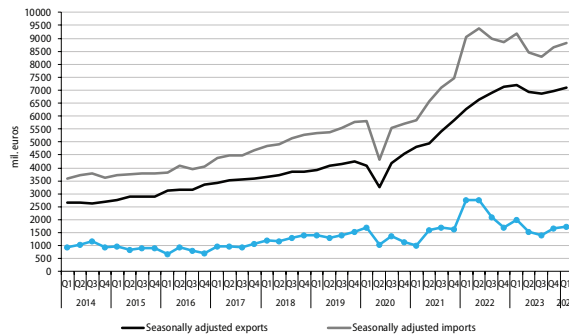
In Q1, exports of Capital and Other products increased, while in April, all export groups except Energy recorded growth in exported value

Graph T4-2. Serbia: Current and Foreign Trade Deficit, 2012–Q1 2024
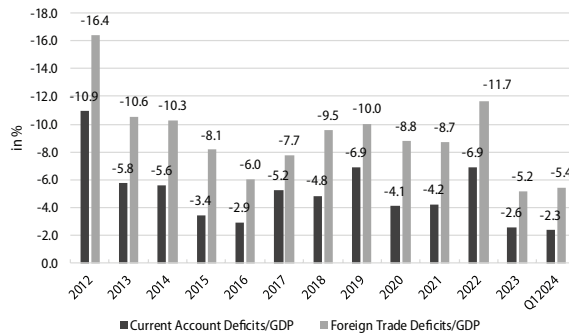
Source: NBS, *QM*

Graph T4-3. Serbia: Seasonally Adjusted Exports and Imports, quarterly values, 2014- Q1 2024

Source: NBS, SORS, *QM*

Graph T4-4. Terms of Trade Index, January 2012- April 2024, June 2012=100

Source: MMF, *QM*

Investment (FDI) amounting to 1.11 billion euros, alongside a simultaneous net outflow from other investments (698 million euros) and portfolio investments (424 million euros), with a modest outflow in Financial Derivatives (4 million euros). The net inflow from FDI in Q1 amounted to 1.107 billion euros (6.6% of GDP). Within other investments, there was an increase in borrowing through loans amounting to 305 million euros, on one hand, while simultaneously, there was a net outflow from *Cash and Deposits* (768 million euros) and *Trade Credits and Advances* (240 million euros). As a result, there was a decrease in foreign exchange reserves of 320 million euros in the first three months of 2024.

Exports

Since the beginning of 2024, Serbia's exports have reached 7.12 billion euros during Q1 and 2.58 billion euros in April. There has been a year-on-year decrease in export value since mid-2023 (-2.4%, -2.6%, and -2.4%[6] in Q3 2023, Q4 2023, and Q1 2024, respectively), but April saw a year-on-year growth in exported value by 10.1% (see Table T4-5).

The value of *Exports excluding road vehicles* shows a similar trend: a year-on-year decrease has been present since mid-2023 (-3.4% in Q3 and -3.4% in Q4), continuing into early 2024 (-2.8% in Q1), but it halted in April when exports saw a year-on-year growth (of 10.6%). The unit value (price) of domestic exports in Q1 was 6.6% lower than the previous year, which partly contributed to the results achieved in the first three months of 2024. An important factor influencing the export performance since the beginning of the year is the weak economic growth in the EU, which is Serbia's most important export market.

In comparison to Q1 2023, a significant decrease in exported value in Q1 2024 was observed for *Energy*, with smaller declines noted for *Non–durable and Durable consumer goods*, as well as *Intermediate products*, while exports of *Capital and Other products* saw growth. In April, all export groups except *Energy* recorded an increase in exported value (see Table T4-5). The year-on-year decrease in Energy exports (55.7% in Q1 and 65.7% in April) is primarily due to reduced export

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6 Within goods exports, growth continued in the manufacturing industry (3.9% year-on-year), driven by previous investments. The largest contributions to this growth came from exports of basic metals, vehicles, motor vehicles and trailers, metal products, and electrical equipment, and there was also a recovery in agricultural product exports (due to a good agricultural season last year). On the other hand, declines in exports of electrical energy and mining sector products contributed to a slowdown in overall export growth, Inflation Report, May 2024, p. 3.

volumes (as energy prices slightly increased year-on-year), i.e. a high base from the previous year and reduced exports from the mining sector.

Table T4-5. Serbia: Exports, Year-on-Year Growth Rates, 2021– April 2024

	Exports share in 2023	2022	2023	2023		2024		2023		2024	
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	in %			in mil. euros				in %			
Total	100.0	27,606	28,632	6,853	7,059	7,123	2,583	-2.4	-2.6	-2.4	10.1
Total excluding road vehicles	96.2	26,759	27,554	6,589	6,780	6,849	2,493	-3.4	-3.4	-2.8	10.6
Energy	6.1	1,506	1,741	376	327	241	79	-6.0	-24.8	-55.7	-65.7
Intermediate products	41.2	12,096	11,797	2,818	2,802	3,007	1,116	-6.0	-7.1	-1.6	19.7
Capital products	23.0	5,462	6,576	1,558	1,746	1,755	597	16.0	8.4	10.6	12.9
Capital products excluding road vehicles	19.2	4,615	5,499	1,294	1,467	1,480	508	13.1	6.6	11.1	15.7
Durable consumer goods	5.0	1,309	1,435	340	358	351	138	-1.5	-1.2	-0.8	15.1
Non-durable consumer goods	20.4	5,673	5,839	1,461	1,460	1,407	531	-4.1	-2.6	-4.1	17.0
Other	4.3	1,561	1,243	301	368	362	123	-26.7	11.3	25.1	52.2

Source: SORS

In Q1 2024, exports of *Intermediate products*, which constitute 41% of total exports, declined by 1.6% compared to the same period last year, while in April, they were 20% above the level from April 2023. *Capital goods*, the second most significant export group, saw a year-on-year growth of 10.6% in Q1 and 12.9% in April. *Non-durable consumer goods for mass consumption*, the third largest export group (with a 20% share in total exports), were 4.1% lower in Q1 2024 compared to Q1 2023, but in April, they were 17% higher than the previous year. Exports of *Durable consumer goods for mass consumption* were only 0.8% below the level from Q1 and 15% higher in April compared to April 2023. *Other exports* (unclassified products) increased by a quarter in Q1 2024 and by half in April compared to the same periods last year.

Despite low economic growth in both the EU and CEE in Q1 2024, clear positive signs of economic recovery present since the beginning of the year[7], represent a good signal for an increase in domestic exports in the coming period.

Imports

During Q1 2024, imports amounted to 9.1 billion euros, which is 3.8% below the value from Q1 2023. The trend of year-on-year decline in imports, present since Q2 2023 (see Table T4-6), reversed in April, when imports recorded a year-on-year increase of 15.8%. World prices of imported products are lower than last year's (by 4.5%), contributing somewhat to the observed dynamics.

The value of energy imports saw a significant decrease in Q1, which continued into April. During Q1 2024, the imported value of these products was a quarter lower than a year earlier, and in April, it was a third lower. The year-on-year decline in the value of *Energy* has been present since early 2023, when global prices began to decline y-o-y. However, the trend of falling prices has reversed, with world oil prices rising since the beginning 2024 compared to the beginning of 2023 levels. During Q1, world energy prices in euros were 1% above those of Q1 2023, and in April, they were 10% higher than April of the previous year[8]. This suggests that energy imports into Serbia in the first four months of 2024 were significantly reduced year-on-year, by 27% in Q1 and 39% in April.

Year-on-year increase in imported value across most production groups...

Excluding energy products, imports were modestly above last year's levels (by 0.9%), while in April, they recorded an increase of 24.2%.

... and significant acceleration in imports in April

Apart from energy products, another group of products - *Intermediate products* - has also seen a decline in imports from Q1 2023 to Q1 2024. In fact, *Intermediate products* contribute significantly to the dynamics of total import growth, accounting for more than a third of its value. During Q1 2024, imports of *Intermediate products* were 7.2% lower than in Q1 of the previous year, but their import rebounded in April, recording a year-on-year growth of 15.3%.

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7 See section *Economic Activity* in this issue of *QM*

8 In dollars, the year-on-year increase in global *Brent* crude oil prices was 2.1% in Q1 and 7.1% in April. The source for the increase in energy prices in euros and the decrease in quantities is the calculation made by the author based on *World Bank* data.

Therefore, except for energy and intermediate products in Q1 2024, and energy products in April, all other production groups recorded a year-on-year increase in imported value, along with significant acceleration in April (Graph T4-6).

Table T4-6. Serbia: Imports, Year-on-Year Growth Rates, 2021- April 2024

	Imports share in 2023	2022	2023	2023		2024		2023		2024	
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	in %			in mil. euros				in %			
Total	100.0	39,014	36,860	8,527	9,624	9,082	3,331	-9.1	-4.1	-3.8	15.8
Energy	13.9	6,828	5,122	988	1,241	1,210	286	-36.0	-17.2	-26.1	-32.8
Intermediate products	34.3	13,581	12,626	2,966	3,107	3,062	1,188	-9.4	-8.6	-7.2	15.3
Capital products	18.2	6,733	6,696	1,518	1,920	1,703	647	-9.7	11.6	11.7	37.7
Durable consumer goods	1.9	699	698	155	192	175	71	-6.9	-0.5	2.3	29.9
Non-durable consumer goods	16.0	5,849	5,906	1,421	1,585	1,450	582	0.7	-8.0	2.1	28.5
Other	15.8	5,325	5,812	1,479	1,580	1,481	557	13.6	4.8	6.9	25.6
Imports excluding energy	86.1	32,187	31,737	7,540	8,383	7,872	3,045	-3.8	-1.9	0.9	24.2

Source: SORS

There has been an increase in the import value of *Capital goods* by 11.7% in Q1 and even 37.7% in April. Imports of *Durable consumer goods for mass consumption* increased by 2.3% during the first quarter and by 29.9% in April. Similarly, imports of *Non-durable consumer goods for mass consumption* were up by 2.1% in Q1 2024 and by 28.8% in April compared to the previous year. The category of *Other* (unclassified products) recorded a year-on-year growth of 6.9% in Q1, accelerating to 25.6% in April.

It is expected that the growth in domestic demand, primarily driven by investments and personal consumption, although modestly reflected in import growth in Q1[9], will contribute to an increase in imports in the remaining quarters of 2024.

External Debt

At the end of 2023, Serbia's external debt was 45.38 billion euros, i.e. 65.3% of GDP

At the end of 2023, Serbia's external debt amounted to 45.38 billion euros, which is 65.3% of GDP (Table T4-7)[10]. Of this, the external debt of the public sector was 24.71 billion euros (35.5% of GDP), while the debt of the private sector amounted to 20.67 billion euros (29.7% of GDP), with the majority of this debt being long-term debt of the economy totalling nearly 16.43 billion euros.

During 2023, net borrowing from abroad increased by 3.48 billion euros. This increase was largely due to increased borrowing by the public sector, contributing three-quarters to the total external debt increase, while approximately one-quarter of the growth was attributable to additional borrowing by the private sector.

During 2023, the external debt of the public sector increased by 2.58 billion euros (Table T4-7). At the same time, the private sector increased its indebtedness by 900 million euros, which is a net result of the increase in long-term external debt of the private sector (2.43 billion euros), accompanied by a simultaneous decrease in the amount of short-term debt (1.53 billion euros). The long-term external debt of corporations increased by 1.75 billion euros, while banks increased their debt by 681 million euros. Short-term debt of banks at the end of December 2023 was lower by 1.33 billion euros compared to the previous year, while there was also a decrease in short-term debt of the private sector by 201 million euros.

In the last quarter of 2023, total external debt increased by 614 million euros. During this period, the public sector increased its foreign indebtedness by 111 million euros, while the private sector increased its indebtedness by 503 million euros. The increase in public sector indebtedness in this quarter is the result of long-term borrowing in the mentioned amount. In the case of the private sector, there was an increase in long-term debt (by 1.14 billion euros, because of additional

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9 See analysis in section *Economic Activity* in this issue of *QM*
10 The source of data for external debt and international investment position is the National Bank of Serbia (NBS), with the latest available data for December 2023.

borrowing by banks and businesses) and a decrease in short-term debt (by 639 million euros) at the end of 2023 compared to the situation three months earlier (see Table T4-7).

Table T4-7. Serbia: Foreign Debt Trend Dynamic, 2020 –April

	2020	2021	2022	2023			
				Mar.	June	Sep.	Dec.
				stocks, in EUR millions, end of the period			
Total foreign debt	30,787	36,488	41,895	43,528	44,318	44,763	45,378
(in % of GDP) [4)]	*65.8*	*68.4*	*69.3*	*69.4*	*68.2*	*66.6*	*65.3*
Public debt[1)]	14,978	19,144	22,123	23,633	23,937	24,595	24,706
(in % of GDP) [4)]	*32.0*	*35.9*	*36.6*	*37.7*	*36.8*	*36.6*	*35.5*
Long term	14,978	19,144	22,123	23,633	23,937	24,595	24,706
o/w: to IMF	0	0	982	0	0	0	0
o/w: Government obligation under IMF SDR allocation	455	480	1,269	1,254	1,246	1,259	1,232
Short term	0	0	0	0	0	0	0
Private debt[2)]	15,809	17,345	19,772	19,895	20,381	20,168	20,672
(in % of GDP) [4)]	*33.8*	*32.5*	*32.7*	*31.7*	*31.4*	*30.0*	*29.7*
Long term	14,223	15,732	17,366	17,795	18,569	18,654	19,796
o/w: Banks debt	2,348	2,629	2,657	2,684	2,636	2,657	3,338
o/w: Enterprises debt	11,859	13,082	14,687	15,089	15,907	15,970	16,432
o/w: Others	17	21	22	22	26	26	26
Short term	1,585	1,612	2,405	2,099	1,811	1,515	876
o/w: Banks debt	1,473	1,356	1,672	1,542	1,380	1,018	343
o/w: Enterprises debt	112	256	733	557	431	497	532
Foreign debt, net 3), (in% of GDP) [4)]	37.0	37.6	37.2	35.3	33.4	30.6	29.4

Note: Republic of Serbia's foreign debt is calculated according to the principle of "maturing debt", which includes the amount of debt per principal and the amount of accrued interest not paid at the moment of the agreed maturity.
Source: NBS, QM
1) The foreign debt of the Republic of Serbia's public sector includes the debt of the state (which includes the debt of Kosovo and Metohija for loans concluded before the arrival of the KFOR mission, unregulated debt to Libya and clearing debt to the former Czechoslovakia), of the National Bank of Serbia, local self-government units, funds and agencies founded by the state and the debt for which the state guarantee was issued.
2) The foreign debt of the Republic of Serbia's private sector includes the debt of banks, enterprises and other sectors, for which a state guarantee has not been issued. Private sector's foreign debt does not include loans concluded before December 20, 2000 for which no payments are made (EUR 948,6 million, of which EUR 422,7 million refers to domestic banks, and EUR 525,9 million to domestic enterprises).
3) Total foreign debt reduced by NBS foreign reserves.
4) The sum of the GDP of the observed quarter and the previous three quarterly GDP values is used.

Serbia's IIP at the end of 2023 - 50.0 billion euros

Graph T4-8. Serbia: Net International Investment Position, in billions of euros
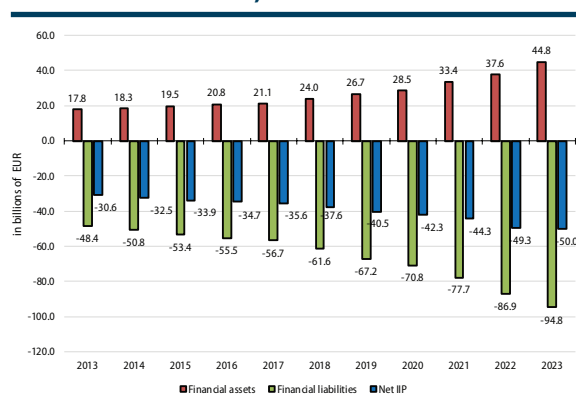
Source: NBS
Note: Net financial liabilities are shown as a negative value on the graph

International Investment Position

The International Investment Position (IIP) of Serbia at the end of 2023 amounted to 50.0 billion euros. This value represents the balance of Serbia's claims and liabilities towards foreign countries, where claims amount to 44.8 billion euros and liabilities to 94.8 billion euros (Graph T4-8). During 2023, there was a significant increase in both claims and liabilities. Financial assets increased by 7.23 billion euros, while financial liabilities increased by 7.96 billion euros, resulting in a total growth of the IIP by 726.6 million euros.

Within the net financial liabilities, at the end of 2023, foreign direct investment (FDI) liabilities reached 54.8 billion euros, representing an increase of 4.6 billion euros during 2023. Total loan liabilities amounted to 24.15 billion euros, an increase of 1.12 billion euros compared to the end of the previous year. A significant increase was also recorded in portfolio investment liabilities, which rose by 1.11 billion euros during 2023, reaching a total of 9.9 billion euros at the end of the year.

5. Prices and The Exchange Rate

Year-on-year inflation dropped to 4.5% in May, and so for the first time in almost three years, it was at the upper limit of the NBS target interval (3 ± 1.5%). The greatest impact on the inflation slowdown in the past year was made by the stabilization of food prices, whose contribution to growth of consumer prices in Serbia decreased from 6.8 p.p. in May last year at only 0.2 p.p. The prices of energy products also contributed to this, primarily due to the exclusion of last year's two increases in electricity and gas prices for households from the annual inflation calculation. Core inflation (measured by the consumer price index excluding food, energy, alcohol and tobacco) was also on a downward path, but it is falling more slowly and is currently slightly above total inflation (about 5%). Unlike the previous period, when the main inflationary factors in Serbia were the volatile prices of food and energy, now more than half of the growth in consumer prices comes from products and services that are included in core inflation calculation. Despite the favourable inflationary trends since the beginning of the year, Serbia is still in the group of countries with the highest inflation in Europe (just behind Romania and Montenegro), with a noticeably higher growth in consumer prices than in the Eurozone (2.6%) and in the CEE and Western Balkans region (average 2.8%). The return of year-on-year inflation within the limits of the target corridor and the beginning of monetary policy relaxation by the ECB encouraged the NBS to start reducing the restrictiveness of its policy in June. After a year at the level of 6.5%, the key policy rate was reduced by 25 basis points and currently stands at 6.25%. In the rest of the year, we expect a further decrease in year-on-year inflation, due to the easing of global cost pressures and still quite restrictive monetary conditions, but at a slower pace than in previous months. Namely, since July, the disinflationary effect of last year's high base is gradually being exhausted, and the high real growth of private consumption generates pressures on the demand side that slow down the reduction of base inflation. Resilient core inflation and relatively high growth in service prices, which is a consequence of strong growth in labour costs, are currently the main obstacle to reducing inflation in most European countries. According to our central projection, inflation should drop to around 3.5% at the end of the year, which means that average inflation in the current year will most likely end up in the 4-4.5% range. Bearing that in mind, we expect that the NBS will continue with the gradual relaxation of monetary policy until the end of the year, and the total reduction of the key policy rate could be around 1 percentage point. An additional argument for such a policy, in addition to the slowdown in inflation, are pronounced appreciation pressures on the dinar. Despite the fact that the National Bank net bought EUR 635 million on IFEM by the end of May, the nominal dinar strengthened slightly against the euro (by 0.1%).

After almost three years, inflation returned to the target interval of the NBS, which was the signal for the beginning of gradual relaxation in monetary policy

According to May data, year-on-year inflation in Serbia amounted to 4.5% (Table T5-1) and thus for the first time since August 2021, it returned to the upper limit of the NBS target interval (3 ± 1.5%). In the previous edition of QM, we announced the continuation of the gradual slowdown of year-on-year inflation and its return to the target corridor by the middle of 2024, which eventually happened in May. The most significant contribution to the reduction of inflation in the past year, both globally and in Serbia, comes from the prices of food and energy, whose growth rate is currently below multi-year average. General weakening of price pressures on the supply side (eg, resolving the supply chain bottlenecks and lower import prices), as well as the disinflationary effect on the demand side due to monetary policy tightening by all central banks in the previous period should be added to this. Analysing the contributions of individual groups of products to the total inflation, we confirmed these assessments on the example of Serbia - quantitatively, the biggest contribution to the decline in year-on-year inflation was made by the stabilization of prices in food market, followed by energy and products and services that enter into the calculation of base inflation (GraphT5-3). Favourable data on inflation in May influenced the NBS to start relaxing the monetary policy in June, so that the key policy rate (KPR) was reduced by 25 basis points - from 6.5 to 6.25%. In accordance with our previous expectations, the NBS probably waited for the ECB's decision to correct the domestic monetary policy, which a few days earlier also started the cycle of gradual

Table T5-1. Consumer price index and inflation, 2020-2024

Consumer Price Index

	Base index (avg. 2006 =100)	Y-o-Y growth	Cumulative index	Monthly growth	Quarterly growth
2020					
dec	201.1	1.3	1.3	0.0	-0.2
2021					
dec	216.9	7.9	7.9	0.4	2.5
2022					
mar	222.9	9.1	2.8	0.8	2.4
jun	232.8	11.9	7.3	1.6	3.8
sep	241.7	14.0	11.4	1.5	3.9
dec	249.7	15.1	15.1	0.4	4.1
2023					
jan	253.2	15.8	1.4	1.4	-
feb	256.7	16.1	2.8	1.4	-
mar	258.9	16.2	3.7	0.9	3.3
apr	260.6	15.2	4.4	0.7	-
may	262.9	14.8	5.3	0.9	-
jun	264.8	13.7	6.0	0.7	2.5
jul	264.7	12.5	6.0	0.0	-
aug	265.6	11.5	6.4	0.3	-
sep	266.4	10.2	6.7	0.3	1.1
oct	267.1	8.5	7.0	0.3	-
nov	268.4	8.0	7.5	0.5	-
dec	268.8	7.6	7.6	0.1	1.0
2024					
jan	269.6	6.5	0.3	0.3	-
feb	271.1	5.6	0.9	0.6	-
mar	271.8	5.0	1.1	0.3	1.0
apr	273.6	5.0	1.8	0.7	-
may	274.7	4.5	2.2	0.4	-

Note: Quarterly growth is the rate of inflation in the current quarter compared to the average of the previous quarter.
Source: SORS and *QM* estimate.

Quarterly inflation in Q1 was relatively low, but that slight rise in prices affected much of the consumer basket

monetary easing. Bearing in mind that inflation is expected to slow further in the rest of the year, as well as pronounced appreciation pressures on the dinar, the June correction of the KPR was most likely only the first of several that can be expected by the end of this year.

At the beginning of 2024, similar inflationary trends continued as in the second half of last year. Consumer price growth in Q1 compared to the average of the previous quarter was 1%, which is an almost unchanged quarterly rate compared to Q3 and Q4 2023 (Table T5-1). Observed on a monthly basis, inflation was 0.3% both in January and March and 0.6% in February. That's significantly lower monthly price growth compared to the same period last year (reflecting the slowdown in year-on-year inflation), but it was roughly close to the monthly rates at the end of 2023.

In the period January-March 2024, the average consumer basket cumulatively rose in price by 1.1%, with a general assessment that the growth in prices of products and services was relatively mild, but was recorded in almost all categories of the consumer price index (Table T5-2). The prices of food and non-alcoholic beverages rose by an average of 0.8% (contribution of 0.3 percentage points), and the prices of oils, fats and vegetables rose the most (around 3% each). Alcohol and tobacco products rose in price by 2.5% (contribution of 0.2 p.p.) due to a regular January increase in excise duties, which, along with the rise in world oil prices, was one of the causes of the price increase in fuel for passenger vehicles by 4.1% (contribution of 0, 3

Table T5-2. Selected components of the consumer price index and contribution to inflation growth

	Share in CPI (in %)	price increase in Q1 2024.	Contribution to overall CPI increase (in p.p.)	price increase in april 2024.	Contribution to overall CPI increase (in p.p.)	price increase in may 2024.	Contribution to overall CPI increase (in p.p.)
Total	100.0	1.1	1.1	0.7	0.7	0.4	0.4
Food and non-alcoholic beverages	31.4	0.8	0.3	0.8	0.3	-0.3	-0.1
Food	27.9	0.7	0.2	0.9	0.2	-0.3	-0.1
Alcoholic beverages and tobacco	7.1	2.5	0.2	0.1	0.0	1.9	0.1
Tobacco	4.5	2.7	0.1	0.0	0.0	2.6	0.1
Clothing and footwear	4.5	-2.3	-0.1	2.0	0.1	0.9	0.0
Housing, water, electricity and other fuels	13.6	0.9	0.1	-0.1	0.0	0.6	0.1
Electricity	5.1	0.0	0.0	0.0	0.0	0.0	0.0
Furniture, household equipment, routine maintenance	4.3	0.7	0.0	0.6	0.0	0.4	0.0
Health	5.5	1.6	0.1	0.6	0.0	0.4	0.0
Transport	12.7	2.3	0.3	1.7	0.2	0.7	0.1
Oil products	6.2	4.1	0.3	3.1	0.2	0.6	0.0
Communications	5.6	2.7	0.2	-0.2	0.0	-0.2	0.0
Other items	15.4		0.1		0.1		0.1

Source: SORS and *QM* estimate

p.p.). Products and services within the Communications group rose in price on average by 2.7% (contribution of 0.2 p.p.) primarily due to the fact that all three mobile operators (MTS, A1 and Yettel) have raised the prices of their services since March. At the beginning of 2024, there was also an increase in price of communal services by an average of 4.4% (water supply, garbage collection and waste water removal), with a contribution to the total inflation by 0.1 p.p. We note a similar contribution due to the increase in prices in the categories Health, Restaurants and hotels, and Other personal items and services. In Q1, only clothing and footwear prices dropped by 2.3% on average (contribution -0.1 p.p.), which is seasonally usual for this part of the year.
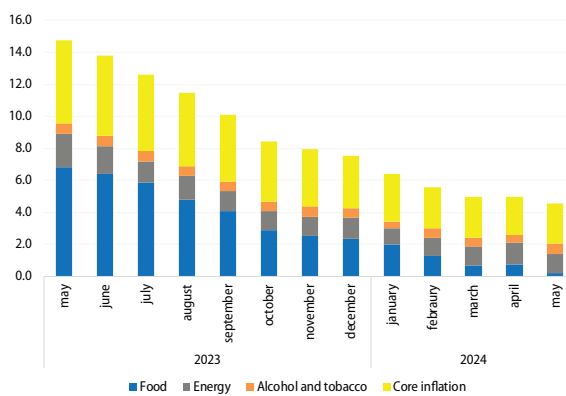
Similar trends continued in the following two months, with food prices having a disinflationary effect after a long time in May

In April, the monthly inflation amounted to a relatively high 0.7%, the same as in April last year, which temporarily stopped the decline of year-on-year inflation in this month (Table T5-2). The slight increase in prices of food and non-alcoholic beverages continued (0.8%, with a contribution of 0.3 percentage points), primarily due to higher prices of fresh meat and vegetables. Also, in April, there was an additional increase in price of fuel for passenger vehicles by 3.4%, so products and services from the *Transport* category contributed to inflation by 0.2 p.p. The increase in price of oil derivatives that we recorded in first few months of this year was mainly a consequence of the increase in oil prices on the world market. We remind you that from December 2023 to mid-April of this year, the price of oil rose by about 25%, but since then oil prices have been in a slight decline and this has contributed to the stabilization of domestic prices of oil derivatives as of May. In line with the usual seasonal pattern, clothing and footwear prices rose by around 2% in April, contributing by 0.1 p.p. to total inflation. In May, monthly inflation slowed to 0.4%, and the key change is the disinflationary impact of food prices with the arrival of the new agricultural season. Their contribution to total inflation was negative (-0.1 percentage point), mostly due to the 5.4% lower price of vegetables on average. The biggest positive contribution to inflation (over 0.1 p.p.) was made by the increase in price of alcohol and tobacco products by 1.9%. After the regular increase in excise duties in January, their additional correction occured in May due to adjustment to the inflation rate in previous year. The prices of other products and services rose slightly on average, with a contribution to total inflation of around 0.3 p.p.

Year-on-year inflation slowdown in the past year was mostly contributed by a low growth in the prices of food

In the period from May 2023 to May of the current year, year-on-year inflation decreased by over 10 percentage points - from 14.8 to 4.5% (Table T5-1). If we look at the contribution of individual categories of products and services, we come to the conclusion that quantitatively, by far the biggest contribution to slowing inflation comes from food prices. As can be seen in Graph T5-3, the contribution of food prices to total inflation decreased month by month – from 6.8 p.p. in May of the last year (almost half of the total inflation) to only 0.2 p.p. in May of this year. In addition to favourable developments on the global food market, this was contributed by a relatively good domestic agricultural season last year and the effect of a high base with which food prices were compared in previous months. The contribution of energy prices decreased from 2.1 to 1.2 percentage points, as a result of two divergent trends. On the one hand, the gradual exit from the calculation of last year's electricity and gas price increases for households contributed to the slowdown of year-on-year inflation (there is only one more remaining from November 2023). The increase in the prices of oil derivatives on the domestic market acted in opposite direction; it's contribution to the total inflation in the past year increased from -0.3 p.p. to 0.7 p.p. The movement of the prices of alcohol and cigarettes was mainly determined by the dynamics of the adjustment of excise duties on these products, which is why their contribution to inflation was stable and amounted to about 0.6 p.p. The contribution of the remaining products and services

Graph T5-3: Contributions to total inflation in Serbia in the period May 2023 - May 2024 (in percentage points)
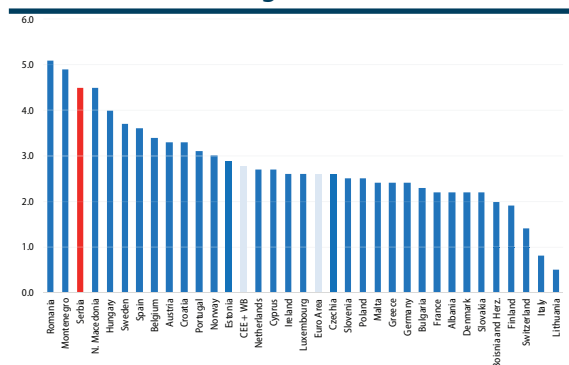

Source: SORS and *QM* calculation

included in core inflation calculation also decreased, from 5.2 to 2.5 percentage points. Unlike the previous period, when most of the inflation came from the movement of volatile food and energy prices, now the key factor is actually the movement of core inflation, which contributes to the growth of consumer prices by over 50%.

Core inflation has also been declining since the beginning of 2024, but at a slower pace than total inflation

Graph T5-4. Year-on-year rate, underlying inflation and NBS target corridor, 2016-24


Source: SORS and *QM* calculation

Core inflation (measured by the consumer price index excluding food, energy, alcohol and tobacco) dropped to around 5% in February 2024 and remained at that level until May. Due to the slower decline of core inflation, it was above total inflation in May for the first time since February 2021 (Graph T5-4), which is another confirmation that inflationary trends in Serbia are no longer predominantly conditioned by the movement of volatile food and energy prices. Within the core inflation, the highest year-on-year price increase is recorded in the service sector: Restaurants and hotels by 9.4% (contribution of 0.3 p.p.), Recreation and culture by 6.5% (contribution of 0.4 p.p.) and Health by about 7% (0.4 p.p.). The relatively large increase in the prices of various services in the previous period is largely due to the increase in labour costs, which have a high share in the structure of costs in the service sector. A similar phenomenon has been registered in the EU, where inflation is slowly decreasing due to rising prices of services, which is a consequence of rising labour costs. The fact that price pressures on the demand side weakened less than those on the supply side contributes to the slower decline in core inflation. Namely, since the beginning of 2024, we have recorded robust growth in private consumption, which in Q1 grew by 4.4% in real terms - the highest in the last two years. This is primarily the result of a significant real increase in its main sources of financing - in the period January-April, net wages increased in real terms by over 8% year-on-year, and pensions by about 15% (first, in the fall of 2023, they were extraordinarily increased by 5.5% and then the regular increase in January amounted to 14.6% - (a total of more than 20% nominally). Summary of the above leads to the fact that labour costs affect inflation through two channels. The first channel is the faster growth of wages than the growth of productivity, which affects the growth of unit labour costs, and the second is the impact of the growth of wages on the faster growth of aggregate demand than the growth of aggregate supply.

Inflation has visibly slowed down in all European countries, and Serbia is still in the group of countries with the highest growth in consumer prices.

Graph T5-5: Europe: year-on-year inflation in May 2024, in %
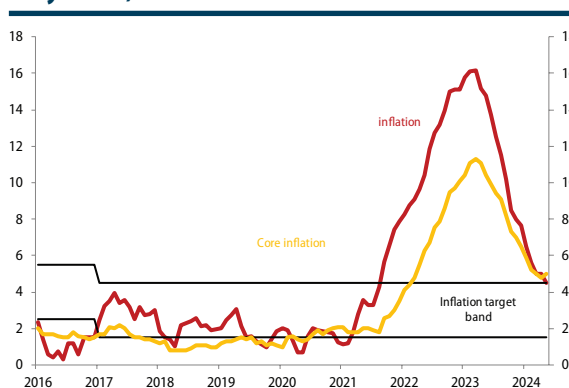
Source: Eurostat and national statistical offices

In 2024, inflation continued to decelerate in all European countries, even somewhat faster than in Serbia. Year-on-year growth in consumer prices in the Eurozone decreased to 2.6% in May, while average inflation in the CEE and Western Balkan countries was 2.8% (Graph T5-5). Despite the favourable inflation trends in the domestic economy, in terms of consumer price growth, Serbia is still at the very top of Europe - right behind Romania (5.1%) and Montenegro (4.9%). Bearing in mind that core inflation in the CEE countries is at a similar level as in Serbia (about 5%), the question naturally arises why the overall inflation in Serbia is still noticeably higher than in the countries of the region? The first important difference comes from the movement of energy prices. First of all, Serbia was late in raising the prices of electricity, gas and heating services compared to CEE countries, which is why their annual growth is still significant in our country (about 5%), while their contribution to inflation in the

countries of the region has already been negative for some time. Also, the increase in price of fuel for passenger vehicles in Serbia was twice as high as in region - by around 10% compared to an average of 5% in CEE countries. Another difference comes from the contribution of food prices to total inflation, which in Serbia is significantly reduced but still positive - while in CEE there was no year-on-year increase in food prices. Comparatively speaking, only the growth of service prices in Serbia was slightly less pronounced than in CEE, but the movement of service prices in the previous few months indicates that this difference is gradually decreasing. In general, the movement of service prices is currently in the centre of attention in most European countries, because their growth makes it difficult to fight inflation. For example, the growth in prices of goods in the Eurozone has already decreased to below 1.5%, while the prices of services increased by 4.1% year-on-year.

Most of the European central banks have already started the cycle of relaxation of monetary conditions, and the NBS joined them in June

Graph T5-6. NBS key policy rate and year-on-year inflation rate, in %, 2016-24

Source: SORS and *QM* calculation

After almost a year of key policy rate resting at the level of 6.5% (Graph T5-6), at the June session of the NBS Executive Board, a decision was made to reduce it by 25 basis points - to 6.25%. Such a decision is not surprising, bearing in mind the months-long downward trend of domestic inflation, which in May fell to the upper limit of the NBS target interval (3 ± 1.5%), and its forecasted further slowdown by the end of the year. An additional factor that influenced the beginning of the cycle of relaxation in monetary conditions in Serbia was ECB's decision, which in June also decided to reduce the base interest rate from 4 to 3.75%

- which was the first relaxation in the past five years. In this way, the NBS joined the majority of other central banks in CEE that are in inflation targeting mode and have already started the cycle of easing monetary conditions. Considering that the inflation in Hungary from the beginning of 2024 has been in the target interval of its central bank (2-4%), the KPR was already reduced by 5 percentage points in the period from October last year (from 12.25 to 7.25%)). The Czech Central Bank started relaxing its monetary policy in December last year and the KPR has since been reduced from 7 to 5.25%. In Poland, the KPR has been reduced from 6.75 to 5.75% since last September. Among the countries in the region, only Romania has not yet begun monetary easing, but given the favourable inflation trends since the beginning of the year, such a decision can be expected soon. Within the leading central banks, the American FED is the only one that has not started to reduce the restrictiveness of its monetary policy and the basic interest rate in June was kept at the multi-decade maximum (5.25-5.5%). The latest announcement that the FED could undertake only one interest rate cut this year has important implication for the financing conditions of developing countries, which could remain relatively unfavourable for a little longer despite the global easing of inflation. The FED's decision not to cut interest rates yet is a consequence of the fact that inflation in the USA has been in the range of 3 to 3.5% since October last year, which is above the target level, but also the relatively good performance of the American economy in terms of the unemployment rate and growth of economic activity.

Until the end of 2024, we expect a continuation of the reduction in year-on-year inflation, but at a slower pace due to the exhaustion of the disinflationary influence of last year's high base

The easing of global cost pressures, the drop in inflation in the international environment and a still restrictive monetary conditions will contribute to an additional slowdown in inflation in Serbia by the end of this year. However, this drop in year-on-year inflation should be less pronounced than in the previous year. First of all, the effect of last year's high base in the prices of many products and services, which led to a noticeable decrease in year-on-year inflation, has largely been exhausted since July. Similar to other European countries, the reduction of total inflation will apparently be slowed down by the still relatively high core inflation and the movement of service prices. As we previously stated, the main driver of the growth of service prices is the strong growth of labour costs, therefore, to stop inflation, it is important to match the growth of wages with the movement of productivity. According to our central projection, we

estimate that by the end of the year, it is realistic to expect a decrease in year-on-year inflation by an additional 1 percentage point - that is, to the level of 3.5%. The NBS came out with a similar forecast in its May inflation report, according to which inflation in December 2024 should amount to 3.6%. With that in mind, we maintain our previous estimate that average inflation this year will be in the range of 4-4.5%. The main risks for the realization of this forecast from the international environment relate to the impact of geopolitical tensions on the movement of energy prices and other primary products, but also the considerable resistance of core inflation at the global level, which could slow down the fall in import prices. Among the domestic factors, apart from the increase in labour costs, an additional risk is the outcome of the current agricultural season, especially when taking into account the announcement of relatively unfavourable meteorological conditions (high temperatures for longer periods during the summer months and less precipitation). Bearing in mind the forecasted inflation movement, as well as appreciation pressures on the dinar, it is expected that the NBS will further reduce the key policy rate in the second half of the year. At this point, it is still difficult to reliably assess the pace of monetary easing in Serbia, but for now it appears that the KPR could be reduced by a total of around 100 basis points by the end of 2024.

The Exchange Rate

Despite pronounced appreciation pressures, the exchange rate remained stable thanks to the interventions of the National Bank of Serbia

From the beginning of 2024, there was mostly an excess supply of euros on the interbank foreign exchange market (IFEM), which continuously created pressures for the nominal strengthening of the domestic currency (except in January, when there were mild depreciation pressures). Foreign direct investments (FDI) accounted for the largest part of foreign exchange inflows on the financial account of the balance of payments, which in Q1 significantly exceeded the realized current account deficit. The inflow of FDI in Q1 amounted to 1.3 billion euros (about 1.1 billion euros in the net amount), and according to preliminary estimates, by June they already reached 2 billion euros - which is about 10% more than last year. In addition, a significant inflow of foreign currency was realized on the basis of borrowing by the economy and the state. The increase in the supply of euros in the domestic banking system was also contributed by non-residents who bought a significant amount of dinar securities on the domestic financial market - primarily the so-called EXPO 2027 bond (maturity 8 years, coupon rate 7%). In order to preserve the stability of the exchange rate, the National Bank of Serbia mainly sold foreign currency on the IFEM during January, and in the other months it intervened on the side of buying foreign currency. Since the beginning of 2024, the NBS has made a net purchase of 635 million euros and thus prevented a stronger strengthening of the dinar exchange rate against the euro.

Graph T5-7. Nominal and real dinar/euro exchange rate, monthly average, 2014-2024
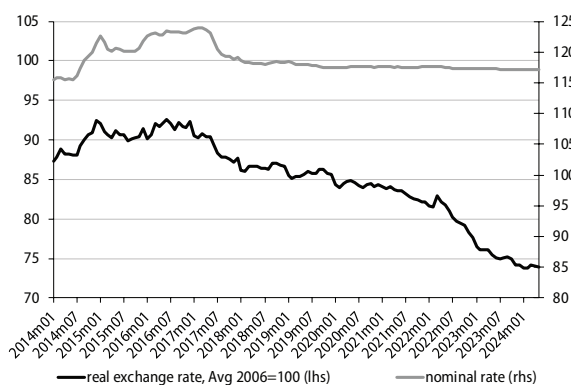
Source: NBS, SORS, Eurostat and QM estimate.
Note: Increase represents depreciation of the exchange rate.

At the end of May, the exchange rate was 117.1 dinars per euro, which means that the local currency has nominally strengthened by 0.1% in the first five months of this year (Graph T5-7). Given that the euro weakened against the dollar, the dinar also nominally lost its value against the American currency by a total of 2.2%. We note opposite tendencies in the movement of the exchange rate of the euro and the Swiss franc, so that the domestic currency has nominally strengthened in relation to Switzerland by 4.7%. Similar trends are recorded in other CEE countries with a similar exchange rate regime. The Czech crown and the Romanian lev kept their nominal value almost unchanged compared to the end of last year, the Hungarian forint weakened slightly (by 1.6%), while the Polish zloty strengthened nominally by 1.7%. When it comes to the real exchange rate, there was no pronounced trend in 2024 due to relatively close inflation rates in Serbia and the Eurozone.

Trends

6. Fiscal Flows and Policy

At the beginning of 2024 – in Q1, public revenues continued their real year-on-year growth (by 7.7%), which was broadly spread across almost all tax and non-tax revenues. The growth of tax revenues in Q1 is the result of real growth in income and consumption due to increased economic activity and declining inflation, and possibly due to more agile actions to curb the grey economy. Public expenditures in Q1, after declining in the previous four quarters, recorded a significant real year-on-year increase (by 6.5%) due to a substantial increase in all types of current expenditures, which is predominantly due to the indexation of wages and pensions at the beginning of the year, the signing of new contracts for the procurement of goods and services, and rising interest expenses due to increased interest rates and indebtedness. On the other hand, capital expenditures in Q1 recorded a slight real year-on-year decline, amounting to around 4.9% of quarterly GDP. Given the described trends in revenues and expenditures, a fiscal deficit of 18 billion dinars (0.9% of quarterly GDP) was realized in Q1. In April, the growth of both revenues and expenditures accelerated, with a moderate deficit. The fiscal deficit realized in the first four months of 2024 is significantly lower than planned, partly due to significantly better public revenue collection than expected and partly due to seasonal factors. If these trends continue, they should be used to further reduce the fiscal deficit below the planned level, rather than for extraordinary increases in current expenditures. At the end of Q1 2024, public debt amounted to 36.3 billion euros (51.1% of GDP), which is 190 million euros more than at the end of 2023.

General Fiscal Trends

In Q1, the trend of recovering public revenues continued and accelerated...

In Q1 2024, the trend of recovering public revenues that began in Q4 2023, after a decline over several quarters, continued, with growth further accelerating in Q1. Thus, public revenues in Q1 were 7.7% higher in real terms compared to the same quarter of 2023, and a real seasonally adjusted growth (by 1.8%) was also achieved compared to Q4 2023. The growth of public revenues in Q1 was broadly spread across almost all tax and non-tax revenues.

and almost all public expenditures also recorded growth

After declining during 2023, public expenditures recorded a real year-on-year growth of 6.5% in Q1 2024 due to a substantial increase in current expenditures, a slight decline in capital expenditures, and a significant reduction in budget loan expenditures. However, compared to Q4 2023, public expenditures recorded a real seasonally adjusted decline (by 3.9%), primarily due to the slowdown in capital expenditures and expenditures on goods and services.

In Q1, a fiscal deficit of 18 billion dinars (0.9% of GDP) was realized

Grafikon T6-1. Serbia: Consolidated fiscal balance and primary balance (% GDP)
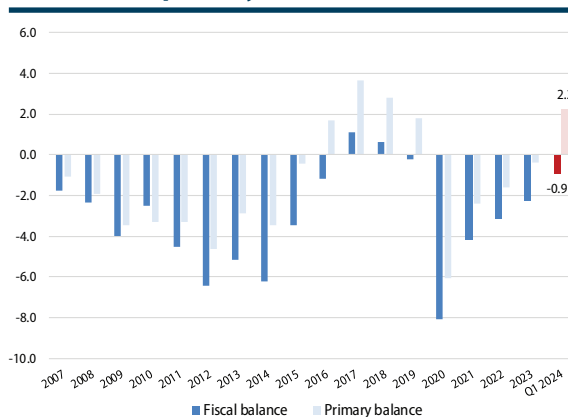
Source: *QM* calculations using MFIN data

...which is lower than the planned deficit, primarily due to higher than planned revenues

As a result of the described dynamics of revenues and expenditures, a fiscal deficit of 18 billion dinars (0.9% of quarterly GDP) was realized in Q1 2024, while excluding interest expenses, a primary surplus of 44.2 billion dinars (2.2% of quarterly GDP) was achieved.

Based on the usual intra-annual dynamics of fiscal trends in previous years and actual developments in the current year, it is estimated that public revenues in Q1 were collected in a significantly higher amount than expected, and that public expenditures were also somewhat higher than planned. Accordingly, the realized fiscal deficit in Q1 was about 30 billion dinars lower than planned.

The positive dynamics of public revenue collection continued in April 2024, with further acceleration in growth. Public revenues collected in April this year were 24.8% higher in real

In April, the growth of revenues further accelerated, but so did expenditures

terms compared to the same month last year, due to a strong increase in all tax revenues. On the other hand, in April 2024, there was also a significant acceleration in the growth of public expenditures, which increased by 27.7% year-on-year in real terms, due to increases in all types of current and capital expenditures, particularly expenditures on subsidies, which can also be attributed to increased spending during the pre-election period. As a result of the described dynamics of revenues and expenditures, a slight fiscal deficit of 6 billion dinars was realized in April, while a cumulative fiscal deficit of about 24 billion dinars was realized for the first four months of 2024. The fiscal deficit in the first four months of this year is similar to that realized in the same period last year.

If better revenue collection continues, it should be used to reduce the fiscal deficit

If these trends continue for the rest of the year, it is possible that the fiscal deficit in 2024, under unchanged conditions, could be lower than the planned 2.2% of GDP. In the event of continued better-than-planned revenue collection, this should be used to reduce the fiscal deficit instead of for extraordinary increases in current spending, as has been the practice in previous years. This would partially offset the negative effect of last year's extraordinary permanent increases in key types of current expenditures on the increase in the structural fiscal deficit, which, according to data from the Ministry of Finance, increased by over 2 percentage points of GDP in 2023 (to 2.1% of GDP).

Grafikon T6-2. Serbia: Consolidated public revenues and public expenditures (% GDP)
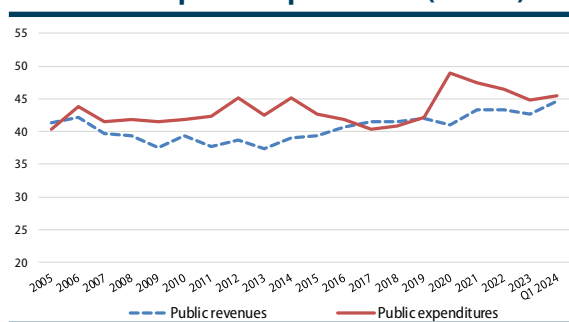
Source: *QM* calculations using MFIN data

Grafikon T6-3. Serbia: Public Revenue Real Year-On-Year Growth Rates in Q1 2024 (%)
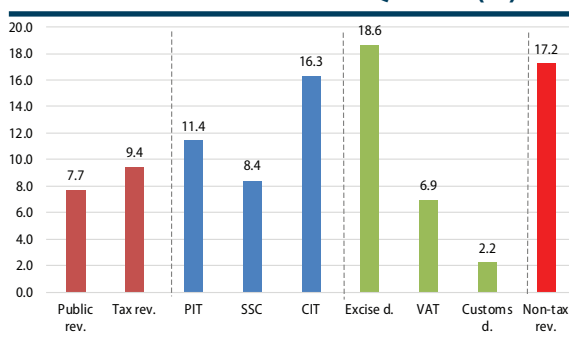
Source: *QM* calculations using MFIN data

Tax revenues in Q1 accelerated growth, which was broadly spread across all taxes

Dynamics of Public Revenues

The continued growth of public revenues in Q1 is the result of the growth of almost all tax and non-tax revenues.

Tax Revenues

After a prolonged period of decline, primarily due to inflation, tax revenues recorded real growth in Q4 2023, which continued and accelerated in Q1 2024. Thus, in Q1 of the current year, tax revenues recorded a strong real year-on-year growth (by 12.6%), and a real seasonally adjusted growth (by 2.6%) compared to the previous quarter. The recovery in the dynamics of tax revenues was broadly spread. The positive dynamics of tax revenues are the result of declining inflation, positive movements in relevant macroeconomic aggregates – primarily incomes and consumption, and possibly more agile state actions to curb the grey economy.

VAT revenues grow - due to increased consumption and reduced grey economy

Revenues from consumption taxes in Q1 recorded a significant increase. Thus, VAT revenues, a category that experienced a real decline during most of 2023 due to various factors (inflation, growth of the grey economy), began to grow year-on-year at the end of last year, which continued at the beginning of 2024. VAT revenues in Q1 2024 recorded solid real year-on-year growth (Graph T6-3), although somewhat slower than in Q4 last year, resulting in real seasonally adjusted VAT revenues in Q1 being slightly lower (by 0.8%) compared to the previous quarter. The growth in VAT revenues can be explained by the real growth in consumption primarily due to declining inflation, and possibly more agile actions to curb the grey economy, given that VAT collection efficiency was declining for most of last year.

In Q1 2024, the year-on-year real growth of excise revenues further accelerated, recording a strong seasonally adjusted growth (by 8.5%) compared to the previous quarter. The growth in

Excise revenues grow mainly due to tax rate increases

excise revenues is due to the low base for comparison (in Q1 2023, the government's decision to reduce excise rates on petroleum products was still in effect), the regular increase in excise rates at the beginning of the year, and possibly the real increase in consumption due to rising incomes and potentially reduced tolerance for the grey economy.

Income tax and contributions revenues continue to grow

In Q1, all major categories of revenues from taxes on factors of production recorded strong real year-on-year growth, as well as seasonally adjusted growth compared to the previous quarter. The growth in income tax and contributions revenues is the result of a stable labour market and real income growth at the beginning of the year, partly due to the indexation of public sector wages and declining inflation.

Corporate profit tax revenues continued dynamic growth in Q1, further accelerating compared to the positive trends during 2023, mainly due to increased profits in certain sectors of the economy.

Tax revenues in Q1 were collected in a significantly higher amount compared to the plan

Grafikon T6-4. Serbia: Public Spending Year-On-Year Real Growth Rates in Q1 2024 (%)

Source: *QM* calculations using MFIN data

Based on the usual intra-annual dynamics of tax revenues under normal conditions in previous years, it is estimated that tax revenues collected in Q1 were about 50 billion dinars higher than planned.

Non-Tax Revenues

In Q1 2024, there was also a strong real growth in non-tax revenues, following their decline during 2023. The growth in non-tax revenues is significantly influenced by the policy of profit distribution of public enterprises and state institutions, as well as the collection of other non-tax revenues (fees, charges, etc.).

Dynamics of Public Expenditures

In Q1, public spending increased due to the growth of current expenditures

After a continuous decline over the previous four quarters, Q1 2024 a moderate year-on-year real growth in public expenditures was recorded due to a significant increase in current expenditures, while capital expenditures and net budget loans declined (Graph T6-4).

Current Expenditures

After a long period, current expenditures strongly increased in Q1

Current expenditures in Q1 2024 recorded a strong real year-on-year growth (by 12%), and a real seasonally adjusted growth (by 1.8%) was also achieved compared to the previous quarter. The growth of current expenditures was broadly spread, as a real year-on-year increase was recorded in all categories of current public expenditures.

Expenditures on wages and pensions, which constitute half of public spending, significantly increase in Q1 due to indexation

The overall dynamics of current expenditures were predominantly influenced by the strong real year-on-year growth of expenditures on wages of public sector employees and pensions, which together constitute half of consolidated public expenditures (Graph T6-4). The growth of these two types of expenditures is the result of wage increases for public sector employees from January of the current year, as well as multiple pension increases in the second half of last year and the beginning of this year, which significantly increased the structural fiscal deficit in the previous period.

Expenditures on goods and services also grow

Expenditures on goods and services also recorded a significant year-on-year growth in Q1, which, among other things, may represent a consequence of the implementation of new procurement contracts in the new year, which incorporated the expected price growth.

The highest relative growth in Q1 2024 was recorded in interest expenses, continuing the trend of their strong growth observed throughout 2023. The growth of interest expenses is the result of

increased interest rates at which the state borrows to finance the deficit and repay earlier debts, as well as the increase in the total amount of debt. Given the general conditions in the international and domestic markets and the expectation that there will be no significant decline in interest rates soon, the growth of interest expenses will continue in the coming period. Therefore, it is necessary to slow down state borrowing through a policy of low fiscal deficit to prevent future high fiscal deficits generated by rising interest expenses, which would further increase state borrowing.

Expenditures on subsidies also grow, but slower than in the previous year due to the high base effect

Expenditures on subsidies continued to record real year-on-year growth in Q1, but this growth was significantly slower than during 2023, which can be attributed to the high base effect, since there was a substantial increase in expenditures on subsidies during 2023.

Capital Expenditures

Capital expenditures slightly decline in Q1 but achieve strong growth in the first four months

After moderate growth in the second half of last year, capital expenditures recorded a slight real year-on-year decline in Q1. We consider this decline temporary because, when adding data for April, it shows that capital expenditures in the first four months of this year increased by 9% in real terms. High variations in public expenditures throughout the year are due to the fact that they are not calculated based on invoiced realization but on the payment dynamics by the state. Based on state plans and experience from the past few years we expect that capital expenditures in 2024 will be realized approximately in line with the planned amount of 6.8% of GDP. Additionally, in the context of the impact of public investment policy on economic growth and social welfare, the issue of efficiency and transparency in the selection, design, contracting, and implementation of investment projects remains open, an issue we have been pointing out for a long time.

Public Debt

Public debt at the end of Q1 2024 amounted to 36.3 billion euros (51.1% of GDP)

At the end of Q1 2024, Serbia's public debt amounted to 36.3 billion euros (51.1% of GDP), which is about 190 million euros more than at the end of 2023. The increase in public debt in Q1 is the result of direct state borrowing, while indirect debt almost stagnated. The increase in public debt in Q1 is somewhat higher than the deficit realized in that period (which amounted to about 150 million euros), due to the depreciation of the dinar against the USD.

Depreciation of the dinar against the dollar in Q1 increased debt by about 100 million euros

The exchange rate of the dinar against the euro continued to nominally stagnate in Q1, while against the US dollar, the dinar nominally depreciated slightly (by about 2.7%) in Q1, which increased the nominal amount of debt by about 100 million euros.[1]

Tabela T6-5. Serbia: Public Debt[1] 2000-2024 (billions of euros)[1]

	2000	2008	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Q1 2024
I. Total direct debt	**14.2**	**7.9**	**15.1**	**17.3**	**20.2**	**22.4**	**22.7**	**21.4**	**21.5**	**22.5**	**25.2**	**28.8**	**31.8**	**34.3**	**34.5**
Domestic debt	4.1	3.2	6.5	7.0	8.2	9.1	8.8	9.1	9.4	9.8	11.2	11.3	11.3	10.3	10.4
Foreign debt	10.1	4.7	8.6	10.2	12.0	13.4	13.9	12.4	12.1	12.6	14.0	17.4	20.5	24.1	24.2
II. Indirect debt	-	**0.9**	**2.6**	**2.8**	**2.5**	**2.4**	**2.1**	**1.8**	**1.5**	**1.5**	**1.4**	**1.4**	**1.55**	**1.82**	**1.81**
III. Total debt (I+II)	**14.2**	**8.8**	**17.7**	**20.1**	**22.8**	**24.8**	**24.8**	**23.2**	**23.0**	**23.9**	**26.7**	**30.1**	**33.3**	**36.2**	**36.3**
Public debt / GDP (QM)³	**169.3%**	**28.3%**	**56.1%**	**55.9%**	**66.2%**	**70.0%**	**68.0%**	**57.8%**	**53.7%**	**52.0%**	**57.0%**	**56.5%**	**55.1%**	**52.0%**	**51.1%**

Source: *QM* calculations using MFIN data

The relative level of public debt declines in Q1 despite its nominal growth

Despite the increase in absolute terms, the public debt-to-GDP ratio in Q1 further declined by 0.9% of GDP compared to the end of 2023. The divergent trends of the absolute level of debt, which is rising, and the relative level of public debt, which is declining, are primarily due to the nominal GDP growth, driven by inflation and real growth, as well as the unchanged exchange rate of the dinar against the euro.

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1 According to the Law on Public Debt, public debt includes the debt of the Republic arising from contracts concluded by the Republic, based on securities, contracts, i.e. agreements reprograming the obligations assumed by the Republic under previously concluded contracts, as well as securities issued according to special laws, the debt of the Republic that arises from the guarantee issued by the Republic or from directly assuming the obligation in the capacity of the debtor to pay the debt on the basis of the issued guarantee, i.e. on the basis of the counter-guarantee issued by the Republic, the debt of the local government for which the Republic has issued a guarantee.

Trends

Effective interest rates on Serbia's public debt are relatively high

Grafikon T6-6. Srbija: Public Debt Dynamic (% GDP)

Source: *QM* calculations using MFIN data

Although the relative level of public debt in Serbia is moderate, interest costs in Serbia are relatively high compared to other European countries, even compared to those with higher debt levels. The average interest rate at which interest was paid in 2023 (interest costs/average level of debt) in Serbia was around 3.3%, while in EU countries it averaged around 1.9%, although the debt-to-GDP ratio in the EU is on average over 30 percentage points higher than in Serbia. Given the rise in interest rates, further increases in interest costs can be expected in the coming period, which will squeeze fiscal space for more productive expenditures or tax reductions. Therefore, to mitigate this effect, fiscal policy needs to be conducted in accordance with fiscal rules in the coming period.

In June 2024, Serbia issued ten-year dollar bonds in the amount of 1.5 billion US dollars, with an interest rate of 4.75% (with a swap arrangement). This borrowing is done in advance to finance obligations that will mature in the coming period. The interest rate at which the bond issuance was conducted is significantly higher than the existing average interest rate, largely due to the general rise in interest rates in global markets due to restrictive monetary policies and global risks, as well as the country's credit rating.

Appendices

Annex 1. Serbia: Consolidated General Government Fiscal Operations, 2010-2024 (bn RSD)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022 Q1	Q2	Q3	Q4	Q1-Q4	2023 Q1	Q2	Q3	Q4	Q1-Q4	2024 Q1
I PUBLIC REVENUES	**1,472.1**	**1,538.1**	**1,620.8**	**1,694.8**	**1,842.7**	**1,973.4**	**2,105.3**	**2,278.6**	**2,255.0**	**2,711.9**	**678.6**	**802.8**	**771.8**	**821.9**	**3,075.8**	**772.9**	**904.2**	**839.4**	**956.6**	**3,473.3**	**880.0**
1. Current revenues	1,393.8	1,461.3	1,540.8	1687.6	1833.3	1964.9	2090.6	2263.7	2243.8	2692.6	676.5	799.9	766.9	816.0	3060.1	752.1	900.0	834.4	944.0	3430.6	875.9
Tax revenue	1,225.9	1,296.4	1,369.9	1463.6	1585.8	1717.9	1822.2	1993.7	1990.8	2420.1	616.9	734.2	682.5	726.1	2759.7	680.8	823.2	740.4	834.4	3078.7	787.3
Personal income taxes	35.3	156.1	146.5	146.8	155.1	167.9	179.4	203.7	204.2	255.9	63.5	84.8	71.2	83.0	302.4	72.6	98.6	80.3	96.2	347.7	85.4
Corporate income taxes	54.8	60.7	72.7	62.7	80.4	111.8	112.5	126.7	122.9	159.5	35.7	87.6	43.5	42.5	209.3	44.4	123.5	52.7	51.5	272.2	54.6
VAT and retail sales tax	367.5	380.6	409.6	416.1	453.5	479.3	499.8	550.6	549.3	658.9	181.4	201.3	196.4	200.4	779.5	197.5	198.9	202.2	244.3	842.9	223.2
Excises	181.1	204.8	212.5	235.8	265.6	279.9	290.0	306.5	306.0	330.0	84.3	80.0	86.8	86.6	337.8	82.0	90.4	97.5	97.0	366.9	102.8
Custom duties	35.8	32.5	31.2	33.3	36.4	39.7	43.6	48.1	51.9	62.0	18.4	19.0	19.9	21.7	79.0	19.4	19.5	20.1	22.0	81.1	21.0
Other taxes	42.6	43.5	57.3	63.3	67.3	71.9	77.1	82.1	82.7	91.8	22.7	24.4	24.9	27.6	99.6	26.1	28.0	25.4	27.6	107.1	26.8
Social contributions	378.9	418.3	440.3	505.5	527.5	567.4	619.7	675.9	673.7	862.0	211.0	237.1	239.8	264.4	952.2	238.8	264.2	262.6	295.3	1060.0	273.5
Non-tax revenue	37.9	34.9	170.9	224.0	247.5	247.0	268.4	270.0	253.0	272.5	59.6	65.7	84.4	89.9	300.4	71.4	76.8	94.0	109.6	351.9	88.6
II TOTAL EXPENDITURE	**-1,717.3**	**-1,750.2**	**-1,878.9**	**-1,844.0**	**-1,899.7**	**-1,921.1**	**-2,073.0**	**-2,289.7**	**-2,697.7**	**-2,971.3**	**-746.7**	**-750.3**	**-708.1**	######	######	**-797.9**	**-834.3**	**-868.7**	######	######	**-898.0**
1. Current expenditures	-1,479.9	-1,549.8	-1,628.0	-1696.6	-1,717.9	-1745.3	-1847.2	-2001.7	-2352.9	-2445.5	-661.7	-619.6	-593.5	-686.3	-2565.5	-666.8	-713.6	-742.6	-868.6	-2988.6	-789.6
Wages and salaries	-374.7	-392.7	-388.6	-419.2	-417.7	-426.3	-468.8	-516.3	-578.9	-629.0	-168.9	-173.5	-168.0	-173.1	-683.5	-185.1	-194.3	-191.0	-204.3	-774.9	-220.2
Expenditure on goods and services	-235.7	-236.9	-256.8	-257.6	-283.6	-301.6	-343.4	-379.3	-441.0	-490.3	-109.8	-131.8	-118.7	-175.9	-540.2	-122.0	-142.8	-152.3	-213.9	-628.1	-139.5
Interest payment	-68.2	-94.5	-115.2	-129.9	-131.6	-121.2	-108.6	-108.9	-110.2	-108.7	-53.2	-21.0	-22.8	-10.0	-107.0	-47.7	-38.9	-33.5	-29.1	-149.3	-62.2
Subsidies	-111.5	-101.2	-117.0	-134.7	-112.7	-113.3	-109.7	-121.2	-251.5	-206.3	-38.5	-31.5	-34.1	-56.3	-160.5	-34.0	-43.2	-64.5	-72.0	-213.8	-36.8
Social transfers	-652.5	-687.6	-696.8	-710.0	-716.8	-720.1	-746.0	-782.9	-806.3	-850.0	-249.6	-222.6	-220.8	-235.7	-929.0	-254.7	-264.4	-262.4	-317.2	-1098.6	-298.7
o/w: pensions	*-473.8*	*-498.0*	*-508.1*	*-490.2*	*-494.2*	*-497.8*	*-525.2*	*-559.3*	*-583.5*	*-608.7*	*-156.8*	*-159.0*	*-158.5*	*-163.4*	*-637.8*	*-186.9*	*-193.4*	*-193.2*	*-200.5*	*-774.0*	*-224.7*
2. Capital expenditures	-126.3	-84.0	-96.7	-114.5	-139.3	-133.9	-199.3	-266.3	-293.2	-466.6	-76.4	-122.0	-94.3	-215.1	-508.2	-92.6	-100.4	-117.5	-255.4	-568.6	-95.9
3. Called guarantees	-3.7	-7.9	-29.7	-30.1	-39.1	-28.8	-19.7	-10.8	-7.5	-7.7	-1.5	-3.1	-6.9	-6.2	-17.7	-6.0	-5.2	-6.3	-6.3	-23.8	-6.8
4. Buget lendng	-38.2	-35.6	-55.4	-2.7	-3.3	-13.2	-6.8	-10.9	-44.2	-51.5	-7.1	-5.6	-13.4	-179.5	-205.6	-32.5	-15.1	-2.4	-23.4	-73.3	-5.8
CONSOLIDATED BALANCE	**-245.2**	**-212.1**	**-258.1**	**-149.1**	**-57.1**	**52.3**	**32.2**	**-11.1**	**-442.8**	**-259.4**	**-68.1**	**52.5**	**63.8**	**-265.2**	**-221.2**	**-24.9**	**69.9**	**-29.3**	**-196.9**	**-181.1**	**-18.0**

Source: *QM* calculations based on the MoF data

Annex 2. Serbia: Consolidated General Government Fiscal Operations, 2012-2024 (real growth rates, %)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 Q1	Q2	Q3	Q4	Q1-Q4	2024 Q1
I PUBLIC REVENUES	**0.6**	**-2.2**	**3.2**	**3.1**	**7.5**	**4.0**	**4.6**	**6.2**	**-2.6**	**15.5**	**1.4**	**-2.7**	**-2.4**	**-3.4**	**6.7**	**-0.2**	**7.7**
1. Current revenues	0.1	-2.6	3.3	3.3	7.4	4.1	4.3	6.3	-2.4	15.3	1.6	-5.0	-2.5	-3.3	6.1	-0.9	10.2
Tax revenue	1.0	-1.7	3.5	0.3	7.2	5.2	4.0	7.4	-1.7	16.8	1.9	-4.9	-2.1	-2.6	6.4	-0.5	9.4
Personal income taxes	2.1	-12.2	-8.1	-1.2	4.5	5.1	4.8	11.4	-1.4	20.4	5.6	-1.4	1.6	1.3	7.3	2.6	11.4
Corporate income taxes	35.1	2.9	17.4	-15.0	26.9	35.0	-1.3	10.6	-4.5	24.7	17.3	7.3	23.2	8.6	12.3	16.0	16.3
VAT and retail sales tax	0.0	-3.8	5.4	0.2	7.8	2.6	2.2	8.1	-1.8	15.3	5.7	-6.2	-13.7	-7.6	12.9	-3.5	6.9
Excises	-1.2	5.1	1.6	9.4	11.4	2.3	1.6	3.7	-1.7	3.6	-8.5	-16.1	-1.4	0.3	4.2	-3.1	18.6
Custom duties	-14.0	-15.6	-6.5	5.9	8.1	5.8	7.8	8.1	6.3	14.7	13.9	-9.0	-10.3	-9.4	-5.9	-8.5	2.2
Other taxes	-8.8	-5.2	29.2	8.9	5.1	4.4	5.2	4.5	-0.9	6.6	-3.1	-1.0	0.0	-8.4	-7.3	-4.1	-2.7
Social contributions	1.9	2.6	3.1	-2.1	3.2	3.8	7.1	7.0	-1.9	22.9	-1.3	-2.4	-2.7	-1.7	3.4	-0.6	8.4
Non-tax revenue	-6.2	-8.7	1.5	27.9	9.3	-3.1	6.5	-1.3	-7.8	3.5	-1.5	-6.3	-6.7	-8.3	3.7	-4.1	17.2
II TOTAL EXPENDITURE	**4.3**	**-0.3**	**5.2**	**-3.2**	**1.9**	**-1.7**	**5.8**	**8.4**	**16.0**	**5.8**	**-0.8**	**-10.0**	**-3.0**	**7.8**	**-2.0**	**-2.0**	**6.5**
1. Current expenditures	4.1	-2.7	2.9	-1.4	0.2	-1.2	3.8	6.3	15.7	-0.1	-6.2	-14.8	0.6	10.2	17.8	3.4	12.0
Wages and salaries	2.0	-2.6	-3.1	-9.7	-1.4	-0.9	7.8	8.1	10.4	4.4	-2.9	-7.0	-3.8	0.3	7.5	-0.5	12.6
Expenditure on goods and services	-6.8	-6.6	6.2	-1.1	8.9	3.3	11.6	8.4	14.5	6.8	-1.5	-14.6	-5.1	1.1	13.1	0.6	8.2
Interest payment	41.9	28.8	19.3	11.2	0.2	-10.6	-12.1	-1.6	-0.4	-5.2	-12.0	-22.7	61.3	31.5	167.7	24.2	23.3
Subsidies	29.1	-15.6	13.2	13.6	-17.3	-2.3	-5.1	8.4	104.3	-21.2	-30.5	-23.9	19.8	69.6	18.4	18.8	2.4
Social transfers	-0.1	-2.1	-0.7	0.5	-0.3	-2.1	1.6	3.0	1.4	1.3	-2.3	-11.8	3.9	6.8	25.1	5.8	10.9
o/w: pensions	*4.4*	*-2.3*	*-0.1*	*-4.8*	*-0.3*	*-2.2*	*3.4*	*4.5*	*2.7*	*0.2*	*-6.4*	*2.7*	*6.2*	*9.4*	*13.6*	*8.3*	*13.8*
2. Capital expenditures	6.0	-38.2	12.7	16.8	20.3	-6.7	45.9	31.1	8.4	52.9	-2.7	-1.5	-28.1	7.6	6.6	-3.6	-2.0
3. Called guarantees	-3.7	248.7	267.8	0.1	28.5	-28.5	-32.9	-46.3	-31.8	-1.6	107.2	233.7	49.1	-17.4	-7.3	19.8	6.6
4. Buget lending	-38.2	44.2	52.2	-95.1	20.8	283.9	-49.3	57.0	299.3	12.0	256.7	296.9	135.3	-84.2	-87.9	-68.2	-83.1

Source: *QM* calculations based on the MoF data

7. Monetary Trends and Policy

Inflation continued to slow in the first five months of the year with y.o.y. inflation standing at 4.5 percent in May. The National Bank of Serbia (NBS) did not change its key policy rate until mid-June when it was lowered from 6.5 percent to 6.25 percent. The FX Market reported a weakening of appreciation pressure causing the NBS to intervention to a much lesser extent than in Q1 to purchase hard currency. The reduced purchase of hard currency on the FX Market caused the NBS net own reserves to grow slightly compared to the previous quarter. Despite the growth of net own reserves, net domestic assets recorded an evident drop which led to a reduction of primary money from the start of the year. A look at the monetary aggregate trends shows that the nominal growth of the M2 slowed down slightly but it remains in double digits while the real y.o.y. growth of the M2 picked up speed due to the additional drop in inflation in Q1. Even with the lower inflation, the real growth of loans to companies and households was negative again due to the insufficient growth of credit activity since the the start of the year. Net placements to banks increased in Q1 mainly thanks to the growth of placements in REPO and increased net placements to households. At the same time, companies repaid domestic banks with a significant rise in repayments of cross-border loans taking the overall credit activities of companies and households at quarterly level above the values of quarters in the previous year. The credit potentials of banks dropped from the start of the year even though deposits by households recorded an increase. The drop in overall sources for new placements was caused by a significant reduction of the capital and reserves of business bank with a drop in company deposits and repayments made by business banks to creditors abroad. Q1 saw a slight rise of NPLs mainly due to an increase of the share with companies and a continuing rise in the absolute level of NPLs in April. Despite the relatively unchanged nominal interest rates on Dinar loans, the drop in inflation caused real interest rates to show a growth compared to the previous quarter while interest rates on indexed loans were, on average, at a similar level compared to the end of 2023. The European Central Bank's lowering of the key policy rate and the subsequent drop in the Euribor will cause a slight reduction of the interest rates on indexed loans in Serbia.

Central Bank: Balance and Monetary Policy

Inflation continued to drop in Q1 towards the upper level of the target framework …

… with the NBS keeping its key policy rate unchanged until mid-June

The slowing of inflation continued in Q1 and the overall growth of prices stood at 5 percent y.o.y. at the end of that quarter. According to the latest data, inflation in April remained at the same level and dropped to 4.5 percent in May. Data for Q1 showed that base inflation is equal to the overall level of prices growth in March and was lower in April but rose to 5 percent in May. Given the lowering of key policy rates by the European Central Bank and the drop of inflation to the upper level of the target framework for this year of 3±1,5%, the NBS decided to lower its key policy rate by 25 base points at a meeting in mid-June. That decision is the first reduction of the key policy rate following its constant raising at monthly level between April 2022 and July 2023 and was kept at the level of 6.5 percent until mid-June. The NBS decision was not surprising even though there were arguments in favor of taking the decision in a month or two when inflation stabilizes within the upper level of the target corridor. In the period of growing inflation, a rise of the key policy rate was postponed to delay the negative

Graph T7-1. Deviation from projected inflation3 and 6 months in advance of the real state 2013-2023

Source: NBS

Table T7-2. NBS interventions and hard currency reserves 2020-2023

	2022				2023				2024
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Repo stock (in milions of euros)	163.86	71.79	407.18	978.31	2,563.86	3,198.11	3,782.17	3,511.99	3,820.29
NBS interest rate	1.00	2.50	3.50	5.00	5.75	6.25	6.50	6.50	6.50
NBS interest rate	-8.21	-15.28	-13.43	-1.10	-2.74	-2.28	2.74	5.23	2.74
NBS interest rate	1.00	2.50	3.50	5.00	5.75	6.25	6.50	6.50	6.50
NBS interventions on FX market (in milions of euros)	2,115.00	1,790.00	425.00	-1,000.00	465.00	1,860.00	3,385.00	3,940.00	320.00
INCREASE	in millions of euros, cumulative from the beginning of the year								
NBS own resreves[1]	-1347.40	-907.08	572.43	1,630.58	1,095.69	2,387.74	4,239.01	5,073.22	321.22
NDA	912.15	260.68	-517.48	-323.11	-1,547.15	-3,290.03	-3,652.36	-3,309.77	-1,160.12
Government, dinar deposits[2]	-58.14	-605.39	-1091.07	-753.31	132.81	-1,001.34	-325.83	-74.10	-241.63
Repo transactions[3]	276.49	315.13	-27.66	-558.82	-1,619.71	-2,216.63	-2,815.45	-2,518.16	-342.66
Other items , net[4]	693.80	550.94	601.25	989.02	-60.25	-72.06	-511.08	-717.51	-575.83
H	-435.25	-646.41	54.95	1,307.47	-451.46	-902.29	586.66	1,763.45	-838.90
o/w: currency in circulation	-163.54	-227.18	-108.23	132.66	-155.02	-82.70	121.62	499.25	-179.16
o/w: excess liquidity	-336.15	-473.83	13.76	958.95	-339.36	-906.26	-620.89	95.62	-754.66
	in millions of euros, cumulative from the beginning of the year								
NBS, net	-2116.45	-1644.96	83.94	2,014.96	2,950.89	4,155.17	5,767.51	6,491.83	6,514.34
Gross foreign reserves	-2149.45	-1678.88	51.62	2,966.20	1,967.37	3,171.92	4,782.31	5,506.72	5,529.12
Foreign liabilities	33.01	33.92	32.32	-951.24	983.52	983.26	985.20	985.11	985.22
IMF	33.17	33.17	33.17	-948.74	981.91	981.91	981.91	981.88	981.88
Other liabilities	-0.17	0.74	-0.85	-2.50	1.61	1.34	3.29	3.23	3.34
NBS, NET RESERVES-STRUCTURE									
1. NBS, net	-2116.45	-1644.96	83.94	2,014.96	2,950.89	4,155.17	5,767.51	6,491.83	22.51
1.1 Commercial banks deposits	17.14	-129.68	-209.78	-264.04	-92.75	-213.51	-7.75	59.52	-102.06
1.2 Government deposits	751.90	867.55	698.27	-120.35	-1,762.44	-1,553.92	-1,520.75	-1,478.13	400.77
1.3 **NBS own reserves**	-1347.40	-907.08	572.43	1,630.58	1,095.69	2,387.74	4,239.01	5,073.22	321.22
(1.3 = 1 - 1.1 - 1.2)									

Source: NBS.
1) Definition of NBS net own reserves is given in section 8 Monetary Trends and Policy, Frame 4, *QM* No. 5.
2) State includes all levels of government: republic and local administration .
3) This category includes NBS Treasury Bonds and repo operations.
4) Other net domestic assets include: domestic loans (net bank debts not including treasury bonds and repo transactions; net company debts) along with other assets (capital and reserves; items on the balance: other asserts) and corrected by changes to the exchange rate.

effects on demand for loans and economic activity which was paid for later with higher inflation rates in Serbia compared to other countries and its drop to single digits later. Despite good results on the labor market, the US FED decided not to lower its key policy rates and the ECB said that it could have just one reduction of the key policy rate instead of the expected three by the end of the year. Bearing in mind the uncertainty on global markets and the expenses pressure on the labor market, it would be irresponsible for the NBS to reduce the key policy rate further before inflation definitively drops to a level of around 3 percent annually.

Q1 records weakening of appreciation pressure and lower purchases of hard currency by NBS…

The weakening of appreciation pressure noted in the previous quarter continued during the first three months of 2024 and data from April and May showed that there were no great changes on the FX Market. Net interventions on the FX Market in Q1 by the NBS totaled 320 million Euro to buy hard currency (in Q4 2023, the NBS was a net buyer of hard currency totaling some 555 million Euro, Graph T7-3). Net

… causing net own reserves to show a slight increase

Graph T7-3. NBS interventions on FX Market 2010-2023

Source: NBS

purchases of hard currency in Q1 reflected positively on the level of NBS net own reserves which recorded an increase of some 320 million Euro at quarterly level. Along with the increase in net own reserves, Q1 saw a significant drop in Net Domestic Assets (NDA) caused by the combined effects of the growth of placements in REPO by business bank, growth on state Dinar deposit accounts and an increase in other NDA. The NDA dropped by some 1.16 bilion Euro from the start of the year with a drop of 575 million Euro caused by the increase of other NDA. Since the drop

in the NDA was greater than the growth of net own reserves, primary money recorded a drop of 839 million Euro in Q1 (in Q4 2023, primary money grew by 1.18 billion Euro).
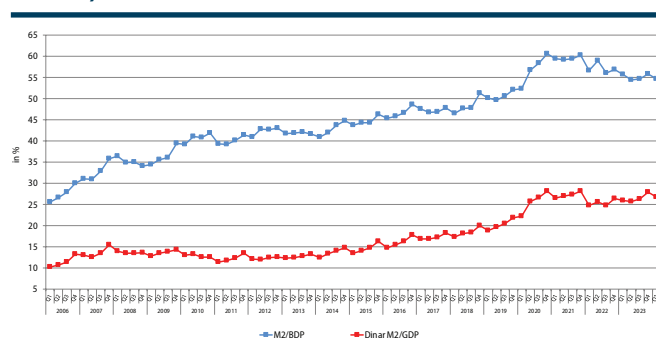
Monetary System: Structure and Money Mass Trends

Nominal growth of money mass remains in double digits in Q1…

…with a faster real growth due to weakening inflation

From the start of the year, the nominal growth of the M2[1] money mass slowed down slightly compared to the end of 2023 with the latest data showing that faster growth was recorded in April this year. In Q1 the nominal growth of M2 recorded double digit growth of 11.2 percent y.o.y. which is 0.7 percentage point less than growth in the same period of the previous year or 1.5 percentage points less compared to growth in the previous quarter (Table T7-5). At quarterly level, growth was positive and the M2 recorded a growth of 0.3 percent compared to the end of 2023. That low quarterly growth of the M2 was caused by the sizable growth of the Net Foreign Assets which contributed 1.3 percentage points and the parallel drop in the NDA of 1 percentage point at the level of Q1. Despite the slight slowing of the nominal growth of the M2, the significantly more pronounced slowing of inflation caused the real growth rate of the M2 to speed up to 5.8 percent y.o.y. in Q1. Something similar was noted in the real growth of loans to the non-state sector with their rate continuing to be negative at -3.6 percent but with a clear trend towards positive values during the next quarter or Q3 at the latest. The weaker recovery of credit activity caused a drop in the real growth rate of loans to companies and households to -4.6 percent and -2.4 percent y.o.y. respectively. We can expect those rates to return to the positive zone in the second half of the year along with slower inflation in coming quarters with continued growth of credit placements.

Graph T7-4. Money mass trends as percentage of GDP, 2005-2022

Source: *QM* calculation

Table T7-5. Growth of money and contributing aggregates, 2020–2023

	2022				2023			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	y-o-y, in %							
M2[1]	8.3	6.0	6.8	6.9	11.9	12.2	11.8	12.7
Credit to the non-government sector[2]	11.6	12.7	11.2	7.1	3.7	0.9	0.1	1.1
Credit to the non-government sector[2], adjusted[3]	11.5	12.8	11.4	7.3	4.0	1.0	0.2	1.2
Households	10.4	9.7	8.3	6.2	4.5	2.7	1.7	1.2
Enterprises	12.3	15.5	14.1	8.2	3.5	-0.4	-1.0	1.1
	real y-o-y, in %							
M2[1]	-0.7	-5.1	-6.1	-7.1	-3.7	-1.5	1.2	4.6
Credit to the non-government sector[2], adjusted[3]	8.3	0.9	-2.2	-6.9	-10.8	-11.5	-9.4	-6.2
Households	7.4	-1.9	-4.9	-7.8	-10.3	-9.9	-8.0	-6.1
Enterprises	9.0	3.3	0.2	-6.1	-11.1	-12.7	-10.4	-6.3
	in bilions of dinars, end of period							
M2[1]	3666.1	3699.1	3858.2	4037.4	4103.0	4150.6	4312.8	4548.2
M2[1] dinars	1608.4	1607.1	1707.1	1876.5	1910.3	1957.3	2074.5	2281.0
Fx deposits (enterprise and housholds)	2057.7	2092.0	2151.1	2160.8	2192.6	2193.3	2238.3	2267.2
	quarterly growth M2[4] and shares							
M2[1]	-3.0	0.9	4.3	4.6	1.6	1.2	3.9	5.5

Source: NBS
1) Money mass: components – see Analytical and Notation Conventions QM.
2) Loans to non-state sector – loans to companies (including local administration) and households.
3) Trends are corrected by changes to the exchange rate. Corrections are based on the assumption that 70% of loans to non-state sector (households and companies) are indexed against the Euro.
4) Trends are corrected by changes to the exchange rate. Corrections are based on the assumption that 70% of loans to non-state sector (households and companies) are indexed against the Euro.

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1 Monetary aggregate M2 in section Monetary Trends and Policy includes the lesser aggregate M1, savings and timed deposits as well as hard currency deposits with business banks. The aggregate M2 observed here is equal to the monetary aggregate M3 in NBS.

Nominal growth of M2 based mainly through Dinar channels …

… dok rast deviznih depozita objašnjava manje od trećine ukupnog povećanja

The y.o.y nominal growth of the M2 monetary aggregate divided into its main elements shows that more than 60 percent of the growth in Q1 was generated through Dinar channels. The greatest contribution in Q1, as in the previous three quarters, was from the lowest monetary aggregate M1 which accounts for 6.9 percentage points of the total of 11.2 percent of the nominal y.o.y. growth of the M2. The relatively pronounced contribution was based on the increase of hard currency deposits which accounts for some 3.3 percentage points of the overall growth which is about 30 percent of the nominal growth of the M2 at the level of the previous quarter. The smallest contribution came from savings and timed deposits accounting for 0.96 percentage points which is a change compared to all of 2023 when they were usually at the level of growth of hard currency deposits or slightly above them.

Banking Sector: Placements and Sources of Financing

Net placements by business banks in Q1 increased mainly due to the growth of REPO placements…

…with a positive contribution to the growth of net placements to households while companies repaid loans

Placements by business banks at the start of the year recorded a significantly lower growth as usual but the data from April suggests that at the level of that month alone, the total growth from all of Q1 transferred over. In the first three months of 2024 we noted a growth of net placements by business banks of 351 million Euro (in Q4 2023, the growth of net placements in bank balances totaled 552 million Euro, Table T7-7). That positive contribution to the growth of overall bank placements came from placements to companies and households, viewed as a whole, but evident opposite trends within those two groups of clients. As in the same period a year earlier, companies repaid their debts to domestic banks to a total of 90 million Euro which is the amount that the repayments on earlier loans surpassed new loans in that period. The reduction in company debts in Q1 was partly the consequence of seasonal conditions and the expectation of lower interest rate to take new loans. Following a relatively slight growth of credit activity towards households which totaled 160 million Euro in all of 2023, Q1 saw an evident growth of net placements to households by 335 million Euro. Data for April showed that a similar trend continued with the growth of net placements of 140 million Euro at the level of that month while net placements to companies showed a slight rise of 52 million Euro (in Q4 2023, companies to 187 million Euro in loans and households repaid 32 million Euro). Along with the contribution based on the growth of net placements to households and companies, the greatest contribution to the growth of overall net placements by business banks comes from the growth of REPO placements of 309 million Euro. That amount is significantly lower compared to the first three quarters of the previous year but the change but does mark a change in regard to the withdrawal of business banks from REPO operations recorded at the end of 2023. The only element which contributed negatively to the growth of credit activity in Q1 are net loans to the state which has increased its funds in accounts with business banks by 202 million Euro, partly neutralizing the growth of bank placements to households and REPO operation.

Graph T7-6. Growth of new loans to companies and households, 2005-2023
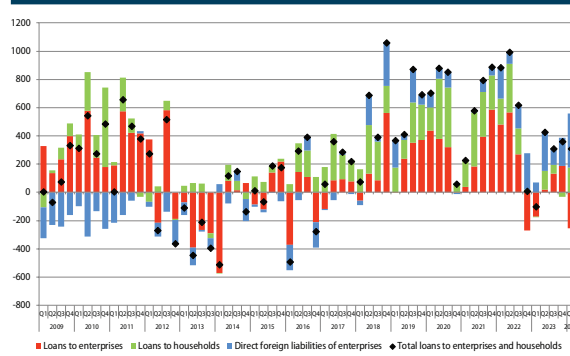
Source: *QM* calculation
See footnote 1 in Table T7-5

Significant increase in cross-border loans raises credit activity in Q1

Although the economy recorded net repayments to domestic banks from the start of the year, foreign banks recorded the highest growth of net loans at quarterly level in the past 15 years. Companies showed a growth of 385 million Euro in repayments to foreign banks and that amount was higher than the amount of loans taken in the first half of the previous year (in Q4 2023, companies made net rapayments abroad of 201 million Euro, Graph T7-6). A pronounced growth of net loans taken abroad by companies compensated the repayments to domestic banks in Q1 with the overal amount of net loans to companies and households increasing by 629 million Euro. Domestic companies were oriented towards taking loans abroad because interest rates

abroad were much lower than interest rates on indexed loans in Serbia. Foreign loans are available primarily to multi-national companies operating in Serbia and large domestic companies.

Credit standards expected to be relaxed further this year

Data from the latest poll on bank credit activity showed that, contrary to expectations in the previous quarter, business banks eased the standards to approve loans to companies for the first time since mid-2021. That was caused by the easing of standards to approve Dinar loans with even stricter standards for indexed loans. A further relaxation of the conditions is expected in the next quarter along with higher demand for loans by companies with lower costs of sources of financing, competition in the banking sector and a positive perception of the overall economic situation as elements having a positive effect on the easing of credit standards. The households sector recorded a slight easing of conditions under which loans are approved with the expectation of something similar continuing into the next quarter. The positive perception of the overall economic situation caused the easing of the credit standards for the households segment while lower readiness by banks to take risks, problem debts and the slowing of turnover on the real estate market slowed down further easing of standards.

Table T7-7. Bank operations – sources and structure of placements, corrected1) trends, 2020-2023

	2022				2023				Mar
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	
	in millions of euros, cumulative from the beginning of the year								
Funding(-, increase in liabilities)	1,153	457	-1,448	-3,031	-25	-562	-2,061	-4,329	-3,868
Domestic deposits	871	673	-605	-2,039	-606	-826	-2,195	-4,000	-4,269
Households deposits	646	264	2	-535	-65	-295	-810	-1,783	-2,192
dinar deposits	716	646	459	-21	-2	-192	-521	-1,211	-1,268
fx deposits	-70	-383	-457	-514	-63	-103	-290	-572	-924
Enterprise deposits	225	409	-606	-1,504	-541	-531	-1,385	-2,217	-2,078
dinar deposits	548	762	223	-628	-376	-503	-1,046	-1,882	-1,620
fx deposits	-323	-353	-829	-876	-165	-28	-338	-334	-457
Foreign liabilities	-22	-377	-862	-773	170	211	439	350	412
Capital and reserves	303	162	19	-218	411	53	-304	-679	-10
Gross foreign reserves(-,decline in assets)	-12	-328	54	-239	-27	-175	-43	397	1,294
Credits and Investment[1]	16	368	1,386	1,939	1,081	2,091	2,089	2,641	2,880
Credit to the non-government sector, total	663	1,583	2,036	1,785	-176	-24	169	324	244
Enterprises	475	1,052	1,320	1,049	-174	-157	-23	164	-90
Households	188	531	716	736	-2	132	192	160	335
Placements with NBS (Repo transactions and treasury bills)	-221	-314	22	593	1,585	2,219	2,801	2,529	2,838
Government, net[2]	-426	-902	-672	-438	-328	-103	-881	-212	-202
MEMORANDUM ITEMS									
Required reserves and deposits	89	154	729	1,566	-111	-626	338	503	-3,742
Other net claims on NBS[3]	-836	-596	-627	-383	-372	30	393	880	3,316
o/w: Excess reserves	-443	-487	-420	-173	188	-150	-3	580	3,118
Other items[4]	-421	-35	-67	174	-843	-751	-706	-80	-1,169
Effective required reserves (in %)[5]	16	16	17	19	17	17	19	18	9

Source: NBS

1) Calculating growth is based on the assumption that 70% of overall placements are indexed against the Euro. Growth for originally Dinar deposits are calculated based on the average exchange rate for the period. For hard currency deposits – as the difference calculated based on the exchange rate at the ends of the period. Capital and reserves are calculated based on the Euro exchange rate at the ends of periods and do not include the effects of exchange rate changes in calculating the remaining balance.
2) NBS bonds include state bonds and NBS Treasury Bonds which are sold at repo rates and at rates set by the market for permanent auction sale with a due date greater than 14 days.
3) Net loans to the state: loans approved to the state reduced by state deposits in business banks; a negative prefix designates a higher growth of deposits than of loans. State includes all levels of government: republic and local administration.
4) Other NBS debts (net): the difference between NBS debts based on cash and free reserves and debts to the NBS.
5) Items on bank balances other assets, deposits by companies in receivership, inter-banking relations (net) and other assets not including capital and reserves.
6) Effective mandatory reserves is the share of mandatory reserves and deposits in the overall deposits (households and companies) and bank debts abroad. The basis to calculate mandatory reserves does not include subordinate debt because that data is not available.

Credit potential in line with seasonal trends drops in Q1 …

Following the strong growth in credit potential in the previous two quarters, sources for new placements by business banks recorded a drop in Q1 as they did in previous years. The credit potential of the banking sector dropped by 461 million Euro since the start of the year with an increase recorded in domestic deposits (in Q4 2023, the growth of sources for new placements stood at 2.27 billion Euro, Table T7-7). Although far below the growth in previous quarters, net domestic deposits rose by 269 million Euro in Q1 with a divergent trend in terms of the growth

… with domestic depostits recorded growth

of deposits by households and companies. The growth of domestic deposits was caused solely by the increase in household deposits which totaled 409 million Euro in Q1 while company deposits dropped by 139 million Euro, but with the liquidity of companies remaining high. Viewed in terms of hard currency structure in Q1, domestic hard currency deposits increased for both companies and households by a total of 475 million Euro, while Dinar growth was negative with 205 million Euro, mainly thanks to the companies sector where net Dinar deposits dropped by 262 million Euro. Despite the increase in domestic deposits since the start of the year, the remaining sources for new placements by business banks recorded a drop in Q1 mainly due to a drop in the capital and reserves of business bank by 669 million Euro. Domestic banks also made net repayments on foreign loans totaling 62 million Euro which, along with the drop in capital and reserves, completely annuled the effects of the growth of domestic deposits on the credit potential of banks in Q1.

Table T7-8. Share of NPLs according to debtor type, 2008-2023

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019				2020				2021				2022				2023				2024
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Q4	Q4	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
														balance at the end of period																	
Corporate	12.14	14.02	17.07	19.06	27.76	25.5	24.40	19.48	13.83	9.63	9.57	9.07	8.35	7.69	6.90	6.32	6.08	5.90	5.66	5.04	5.16	4.91	4.13	4.22	4.25	4.16	4.18	3.98	3.82	3.83	4.41
Entrepreneurs	11.21	15.8	17.07	15.92	20.82	43.29	29.92	27.42	16.96	9.07	8.82	8.57	8.67	7.82	7.82	6.93	6.42	6.10	5.64	5.32	5.03	6.01	6.08	6.48	6.51	6.41	6.38	6.76	6.88	6.82	6.96
Individuals	6.69	6.71	7.24	8.32	8.59	9.97	10.53	9.66	6.43	4.72	4.66	4.62	4.46	4.36	4.43	3.36	3.55	3.46	3.69	3.63	3.84	3.90	3.6	3.69	3.93	3.85	3.42	3.76	3.95	3.74	3.38
Ammount of dept by NPL (in bilions of euros)	1.58	1.94	2.63	3.19	4.09	3.70	3.52	2.83	2.16	1.52	1.51	1.46	1.43	1.38	1.32	1.18	1.22	1.19	1.20	1.13	1.19	1.21	1.08	1.14	1.19	1.16	1.11	1.14	1.15	1.13	1.18

Source: *QM* calculation

Share of NPLs shows slight growth since start of year …

… with greatest growth in companies segment

Following the record low share of NPLs in the overall placements during 2023, a slight rise in their share was recorded in the first quarter of 2024 with the growth in the share reported in two of the three individual groups of debtors. Credit Bureau data and QM methodology[2] showed that the share of NPLs compared to the overall loans placed increased by 4.01 percent in Q1 which is a growth of 0.16 percentage points compared to the end of the previous year (Graph T7-9). The biggest effect on the rise in the overall share came from the increase in NPLs placed to companies which grew by 4.41 percent at the end of Q1 or 0.58 percentage points, more than at the end of the previous quarter (Table T7-8). NPLs placed to entrepreneurs showed a slight growth of 0.14 percentage points to 6.96 percent which, because of their relatively low amount in the overall mass of loans placed, had very little effect on the growth of the overall number of NPLs. The households/individuals segment recorded the only additional drop in NPLs by 0.36 percentage points creating a new lowest level of the share of NPLs in this segment of 3.38 percent. According to data for April, the share of NPLs showed a slight growth in that segment but at the same time we noted a drop amoung companies and entrepreneurs bringing the overall share at April level to below the level of Q1. Viewed in terms of the absolute value of loans fallen late by more than 90 days at the level of Q1, we noted a similar trend as with the share and in April the situation was somewhat different with the overall value of NPLs increasing by some 30 million but still recording a drop because of the rise in credit activity in that month.

Graph T7-9. Share of NPLs in overall placement, 2008-2023

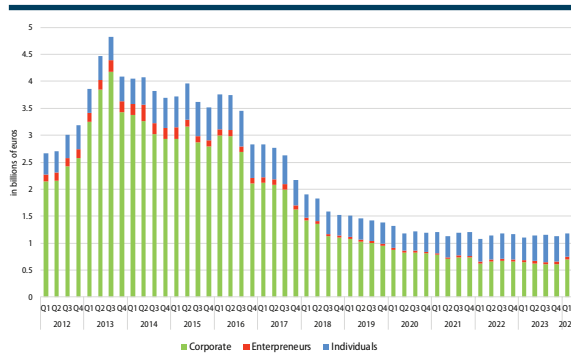Source: *QM* calculation

Interest rates: State and Trends

FED continues to delay reduction of interest rates while ECB cuts interest rates

At their latest meetings in June, the FED and ECB showed different approaches to the issue of relaxing monetary policy following a long period of struggling to lower inflation. FED officials concluded that inflation dropped additionally to their target level of 2 percent in the previous months but they indicated that they expect to lower the key policy rate just once this year. That assessment is much more conservative than their previous projection of three reductions and was explained with the fact that inflation persistently remains above the target level despite a drop

2 For details on how share of NPL is calculated see QM 6 – Spotlight On 1: NPLs in Serbia – what is the true measure?

over the previous two months. FED officials said that economic activity continued to grow at a satisfactory pace while signals from the labor market indicated that the number of new jobs increased with a low unemployment rate. The FED said it intends to keep the interest rates at the current level up to the moment that the economy sends a clear signal that they need to be lowered – either because inflation is slowing convincingly or unemployment is growing. On the other side of the Atlantic, the European Central Bank decided to lower its key policy rates by 0.25 percentage points. The interest rate on key refinancing operations was lowered to 4.25 percent after 14 months of constant raising and nine months at the historically highest level over the past two decades. Switzerland and Sweden have lowere their key policy rates since the start of the year and Canada lowered its key policy rate in June for the first time in four years and three months. It seems that the slow recovery of the European economy and recession in some countries in 2023 had a greater effect on the ECB decision to lower its key policy rate than the slowing of inflation and that the ECB decided to lower interest rates to stimulate economic activity. The lowering of the key policy rate by the ECB will reduce the cost of loans in Serbia but only partly because of the National Bank of Serbia decision, in place since Septembar 2023, to temporarily limit the interest rates on housing loans which are almost entirely linked to the Euribor.

Graph T7-10. Remaining debt on loans fallen late, 2012-2023

Source: *QM* calculation

Real interest rates on Dinar loans continue to grow despite lower inflation

As said in the previous issue of *QM*, the further slowing of inflation since the start of the year caused a rise in real interest rates on Dinar loans despite the drop in nominal interest rates. The average real weighted interest rate on Dinar current asset loans was raised by 2.4 percentage points compared to the end of 2023 (Graph T7-11a) placing it at the level of 3.1 percent at the end of March. At the same time, the average real weighted interest rate on Dinar investment loans was increased in Q1 by 2.25 percentage points to stand at 4.06 percent. The changes in the average weighted rates on Dinar loans were caused solely by the change in business bank policies due to the unchanged inflation rate in April with current asset loans recording a minimal drop in the nominal interest rates while those rates continued rising for investment loans. The average weighted interest rate on indexed housing loans rose in Q1 by 0.1 percentage points and the increase would have been much higher without the NBS decision to limit interest rates and bank rates which are in force to the end of 2024 (Graph T7-11b). The average weighted interest rate on indexed current asset loans recorded a drop in Q1 of 0.22 percentage points to the current 6.74 percent. There were no changes to the weighted interest rate on investment loans compared to the previous year but the interest on those loans rose by 0.17 percent in April. The lowering of the ECB key policy rate and possible relaxation of monetary policy by the end of the year could have a positive effect on the cost of borrowing in Serbia but not enough to expect any significant overall drop in interest rates in this or next year by between 1-1.5 percentage points.

Graph T7-11. Interest rates on Dinar and indexed loans, 2016–2023

Source: QM calculation
* real interest rates

HIGHLIGHTS

Highlight 1. The Role of Chinese Multinational Companies in the Global Market

Prof. Dušan Marković [1]

Since the economic opening and gradual integration into the world economy more than four decades ago, the Chinese economy has recorded impressive economic results, unmatched even by the so-called "Asian Tigers" in the last quarter of the 20th century. Today, China represents the only economic competitor to the USA. An illustrative fact, although it should not be interpreted in isolation from other economic indicators, is that according to IMF analyses, the GDP of the USA at purchasing power parity constitutes only 83% of China's GDP and this ratio is incrementally but consistently increasing in favour of China.

The accelerated economic growth of China in the previous period has influenced the change in the structure of the Chinese economy. Today, private companies dominate the Chinese economy, and an increasing number of companies are internationally oriented, although the domestic market offers significant opportunities. Notably, Chinese companies are gradually transitioning from simpler to increasingly complex forms of internationalization. Although exports remain the dominant form of business internationalization, a growing number of Chinese companies possess the competencies to implement complex and technologically intensive projects abroad for local clients (e.g., construction of high-speed railways, telecommunications networks, electric battery factories, chemical plants, etc.) or to independently establish subsidiaries abroad or acquire foreign companies through acquisitions. The global expansion of Chinese companies through wholly-owned subsidiaries, and less frequently through joint ventures, represents a qualitative leap in business that allows the Chinese economy to simultaneously address several potential issues: where to invest funds accumulated due to the balance of payments surplus, control of critical activities in the supply chain, and acquisition of necessary intangible resources for further competitiveness growth.

Although the business operations of Chinese multinational companies havs been a topic of research in recent years, it has attracted a large number of researchers from the academic and business communities. Most studies emphasize that the operations of Chinese

multinational companies are greatly influenced by technological innovations in certain industries and the impact of institutional factors from domestic and foreign markets. The way and intensity of these factors' impact have changed over time and vary from industry to industry.

Sources of Competitiveness of Chinese Multinational Companies

For a long time, research on multinational companies focused on Triad[2] countries. Multinational companies from developing countries were in the background. This is evidenced by Vernon's theories of the product life cycle, according to which innovations arise in developed countries, while the production of products in the final phase of the life cycle moves to less developed countries. According to this theory, companies from emerging markets like China can eventually be partners in producing mature products. However, the growth in the number and revenue of primarily Chinese multinational companies has questioned this theory. From Graph 1, we see that the number of Chinese multinational companies on the Global Fortune 500 list, measured by revenue, has increased over time, while the number of companies on the list from the USA has slightly decreased from 2017 to 2022, only to return to the 2017 level in 2023. The increase in the number of Chinese companies on the list results from the declining relative influence of Japanese and European companies.

Graph 1. Number of Multinational Companies on the Fortune 500 List
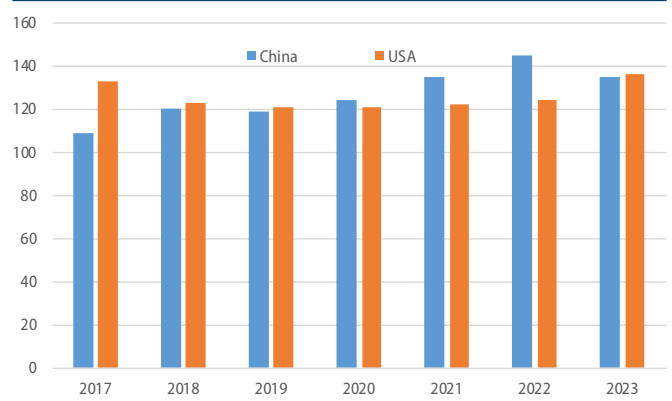
Source: Fortune 500

In 2023, three of the top 10 companies on the list were from China, and all three were from the energy sector, which also accounts for the largest number of companies in the top 10. The largest Chinese company, State Grid, ranks third on the list with annual business revenues of USD 530 billion. Besides the energy sector, Chinese companies on the list are predominantly

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from the financial sector, the automotive industry and parts manufacturers, computer and smartphone manufacturers, telecommunications, and e-commerce platforms. The growing influence of Chinese multinational companies is also reflected in the value of Chinese investments abroad and their share in the total value of foreign direct investments.

In the last 15 years, the value of Chinese FDI has significantly increased, from USD 104 billion in 2008 to nearly USD 278 billion in 2021, although this growth has not been linear. Changes in China's influence are also reflected in the data on the share of Chinese investments in global FDI. Thus, the average share of Chinese FDI in the period from 2008 to 2010 was 9% of global FDI, while in the period from 2020 to 2022, it averaged 23%. The peak share of Chinese FDI was achieved in 2020, almost 35%, when Chinese FDI remained stable despite the pandemic, while investments from other countries were postponed, leading to a relative increase in the share of Chinese FDI in total global FDI. Chinese investments abroad remained relatively stable over the next two years, while investments in other countries returned to pre-crisis levels, resulting in the share of Chinese investments dropping to 16%-17% of global FDI.

Graph 2. Chinese FDI in Million USD
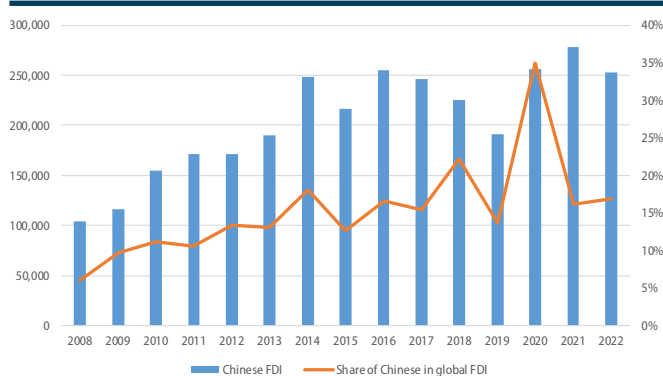
Source: UNCTAD World Investment Report Database

In the 21st century, Chinese investments abroad have gone through different phases. At the beginning of this century, state authorities lifted most restrictive measures aimed at discouraging domestic companies from investing abroad. The lifting of these measures corresponded with the emergence of Chinese companies specializing in serving price-sensitive customers, especially for non-technologically intensive products. During this period, these companies had the competencies to operate in conditions of relatively limited business infrastructure, characteristic of certain continental parts of China. Additionally, these companies utilized abundant domestic, relatively cheap labour and had experience operating in an inefficient

institutional environment. Finally, their experience with domestic customers with limited budgets helped them develop products and services tailored to their needs, known as frugal products. These products and services were less complex and cheaper due to economies of scale, cheaper resources, process automation, and more efficient business organization[3]. Possessing these competencies, these Chinese companies gradually penetrated other emerging markets, primarily in Asia, to serve poorer consumer segments. These investments were driven purely by market motives.

However, over time, emerging and developing markets have gained an additional role for Chinese multinational companies. **The first role** relates to controlling sources of natural resource supply. Chinese investments in Africa, Latin America, and even Serbia are particularly significant for controlling upstream supply chain activities, such as oil extraction, copper mining, or lithium mining[4]. It is important to note that these investments were accompanied by investments in complementary infrastructure and projects aimed at local communities to reduce political and business risk. These types of investments can count on support from the home country, either through financial means or by providing negotiation support with local governments. The Chinese government views these investments as a vital segment of national industrial policy, which is why Chinese companies are willing to invest in some high-risk projects that companies from developed countries avoid. A typical example is the investment of Chinese companies in the Sudanese oil industry, which many companies have avoided due to frequent armed conflicts.

The second role of these markets emerged with the intensification of economic relations between the USA and China. Some Chinese companies establish subsidiaries in emerging markets to serve the US market and avoid additional tariffs on Chinese products imposed by the last two presidential administrations. These subsidiaries typically handle only part of the production, particularly lower value-added stages. As a result, the number of Chinese companies headquartered in Vietnam, India, and even Mexico is increasing. For example, one of the largest Chinese furniture manufacturers, Man Wah, moved part of its production to Mexico to address rising transportation costs to the US market, increasing tariff burdens, and rising labour costs in China.

When it comes to developed markets, their role for Chinese companies is different. Initially, these markets

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3 Khanna, T., & Palepu, K. G. (2010). *Winning in emerging markets: A road map for strategy and execution*. Harvard Business Press.
4 Thus, Chinese companies have invested in the oil sector in Venezuela and Nigeria, as well as in mining projects in Niger and South Africa.

were merely sales locations. Chinese companies managed to position themselves as producers of very cheap products for the poorest consumers, gradually transitioning to the "value for money" segment. This segment consists of consumers who are somewhat price-sensitive but require products to have solid quality. This segment grows during crises, such as the "Great Recession" and "Covid-19." In this segment, Chinese companies position themselves by offering technologically intensive products at moderate prices (e.g., home appliance manufacturers), offering additional services and modifications typically offered by premium manufacturers, and expanding small premium segments into mass segments. All this is possible thanks to competencies in low-cost production and economies of scale in the domestic market, as well as developed domestic business ecosystems.[5]

A number of Chinese companies have aimed from the beginning to develop their own global brands. These companies leverage lower production costs in the domestic market and then aggressively invest surplus funds into R&D, gradually improving the quality of their products. In the initial stages, these companies often target small, neglected segments and then expand into mass and premium segments. In their foreign ventures, they also use international acquisitions to gain strategic intangible assets such as brands, management knowledge, technology, etc.

Graph 3. Number of International Acquisitions by Chinese Companies
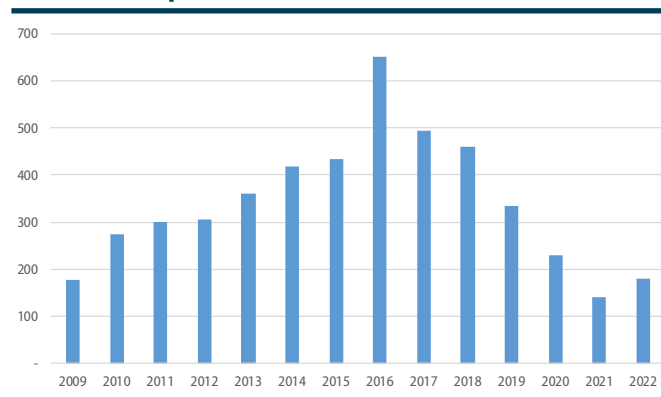
Source: UNCTAD World Investment Report Database

A typical case is the Chinese company Haier, which in 2016 acquired GE's home appliance division for $5.4 billion. Lenovo purchased IBM's computer and server manufacturing divisions and Motorola, the smartphone manufacturer, from Google. Additionally, Volvo bought the car company Volvo, which was part of the Ford group, for nearly $2 billion. Naturally, the increase in the number of Chinese acquisitions in developed countries,

5 Williamson, P. J. (2010). Cost innovation: preparing for a 'value-for-money' revolution. *Long Range Planning*, 43(2-3), 343-353.

particularly in technologically intensive sectors, led to reactions from national governments. Thus, from the mid-2010s, these governments introduced certain restrictions on Chinese acquisitions, as illustrated in Graph 3. It is evident that the number of transactions increased until 2016, reaching a peak of 650 acquired firms, which accounted for just over 10% of global international acquisitions that year.

Some researchers in the West were optimistic, believing that once restrictions on Chinese acquisitions were introduced, Chinese companies would be left without a significant source of knowledge. They based this belief on the view that Chinese culture is inherently collectivist and that state institutions are inefficient, which would leave Chinese companies as followers without the ability to create radical innovations. Reality has disproved them. Today, the largest number of patents is registered in China (Graph 4), and some Chinese companies are leaders in technologically intensive industries. This has been aided by state actions in several areas: 1. the state has tightened regulations and their enforcement in the field of intellectual property protection, 2. the state has provided significant funding for innovative solutions, and 3. the state encourages cooperation between young innovative companies and established technology companies, and companies deemed too large and accused of abusing their dominant position to hinder innovation face significant sanctions. An illustrative case involves two technology giants, Ant Group and Tencent Holding, which had to pay fines of over a billion USD each in 2023 due to abuse of dominant positions following several regulatory changes at the beginning of the third decade of the 21st century.

Graph 4. Number of Registered Patents in thousands
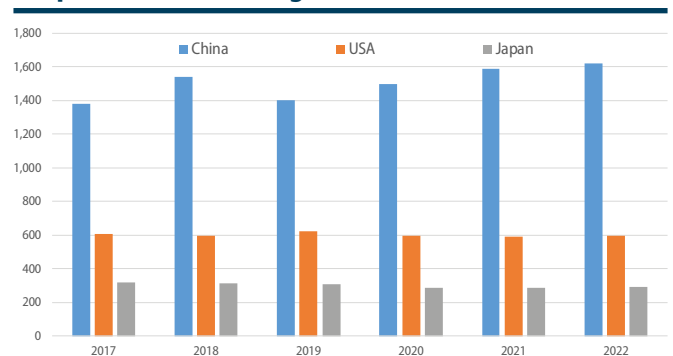
Source: World Intellectual Property Organization Database

Chinese Multinational Companies in the Automotive Industry

In China's development plans, the automotive industry has been identified as one of the sectors that should drive economic development and ensure the creation

of innovative technological solutions. According to these plans, the Chinese automotive industry has gone through several phases. In the early stages of opening up, until the "Great Recession," the state insisted that foreign companies could invest in the Chinese market only through joint ventures. The goal was to protect domestic companies from competition and ensure that foreign companies facilitated the transfer of technology and innovations. The results were very poor because, apart from reverse engineering foreign products, Chinese companies lacked the competencies to independently develop products that could find their way to developed markets.

The second phase begins with the "Great Recession" when the Chinese company Geely acquired ownership of Volvo, which had been part of the Ford group until then. Through this acquisition, Geely gained a valuable brand and, with a wise strategy, broke into the premium segment, gaining access to innovative technology and management competencies in organizing global operations. On the other hand, Geely provided Volvo with access to the Chinese market, relatively cheap financial resources to refinance old debts, and competencies in low-cost production. As a result, Volvo has become a recognizable medium-sized premium brand behind the big German trio (Mercedes, BMW, and Audi), with a global presence. On the other hand, Geely improved its competencies and became a recognizable "value for money" brand in the domestic and some emerging markets. The integration approach involved the gradual integration of the acquired company, retaining top management after the acquisition, and granting a high degree of autonomy. This prevented the outflow of employees with specific knowledge. Driven by successful acquisitions, Geely made several acquisitions of innovative startup companies, and then attempted to gradually acquire shares in Daimler, the pride of the German auto industry. In 2018, the owner of Geely acquired nearly 9% ownership of Daimler for almost USD 9 billion, becoming the largest single shareholder. However, further share purchases by the Chinese investor were prevented by swift government intervention. From the position of a minority investor, Geely established a joint venture with Daimler in 2020, where both companies work on developing small electric vehicles under the Smart brand. This example shows how international acquisitions become the basis for the global growth of Chinese companies, but also how government regulation can be an obstacle to that growth.

The third phase of the development of the Chinese automotive industry is linked to the end of the second decade of the 21st century and the beginning of the third decade, which have been marked by the rapid development of the electric vehicle segment, regulatory changes, and global political crises. During this period, the Chinese market became the largest in the world, and in 2023, 30 million new vehicles were sold in China, accounting for nearly 38% of the global market. The share of the Chinese market in global new vehicle sales is more than twice as large as China's share of the world's population, indicating growing unmet demand.

**Graph 5. Number of Vehicles Sold in China (000) and Share in the Global Market**
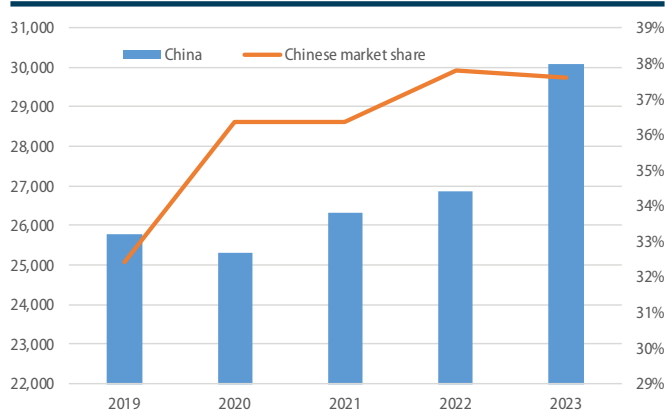
Source: OICS database

To leverage the growth of the domestic market and enhance the competitiveness of local companies, the Chinese government has taken several steps. The first step was to encourage consolidation among traditional domestic auto companies, as at one point, around 150 companies were operating in the Chinese market, with the aim of achieving the necessary economy of scale in production. The second measure involves promoting innovative startups, which are expected to secure breakthroughs in the fields of autonomous driving and electrification. The third measure pertains to lifting restrictions on foreign investment in the form of joint ventures. This measure aims to expose domestic companies to competition, encouraging them to improve their competencies and break the dependence on the inflow of foreign technology.

The fourth measure involves direct and indirect subsidies for the purchase of electric vehicles, aimed at addressing environmental problems in the country and gaining an advantage in technologies that will dominate the automotive industry in the future. Thanks to these measures, the Chinese market dominates the global electric vehicle market, with over 8 million vehicles sold in 2023, accounting for nearly 60% of the global market.

Graph 6. Number of Electric Vehicles Sold in Thousands
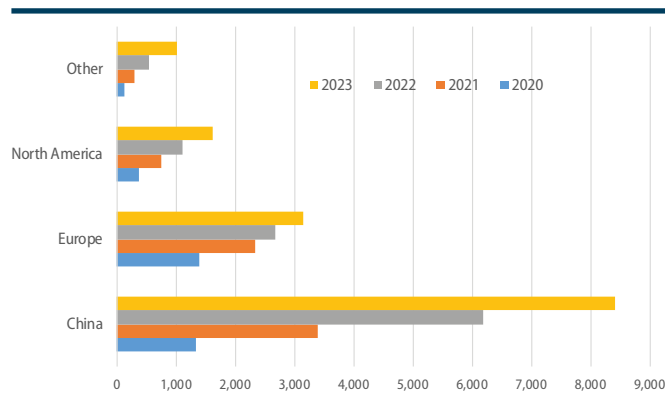
Source: EV-volume database

From Graphs 6 and 5, it is evident that the Chinese market dominates both the electric and traditional vehicle segments. This dominance is even more pronounced in the electric vehicle segment compared to traditional vehicles. Among the top 5 companies by the number of electric vehicles sold, the Chinese company BYD leads, along with two other Chinese competitors, together producing around 4.6 million electric vehicles. Considering the market structure and the dominance of Chinese companies in the electric vehicle segment, it is not surprising that domestic brands accounted for over 56% of sales in the Chinese market in 2023, with that percentage increasing in 2024.

Graph 7. Manufacturers of Electric Vehicles and Plug-in Hybrids in Thousands of Units
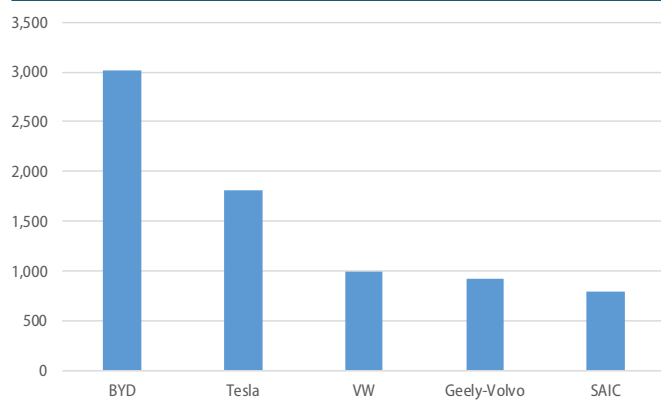
Source: EV-volume database

The superiority of Chinese companies in the electric vehicle segment stems from two main factors. First, China has a comprehensive business ecosystem necessary for the development of these vehicles. Through a network of state-owned and domestically strategically significant companies, Chinese auto companies control upstream activities in the supply chain6. Although China is only the third largest extractor of lithium ore, it

6https://www.businessinsider.com/china-crushing-us-america-battle-energy-evs-batteries-tech-war-2023-5

controls over 75% of lithium processing capacity, nearly 80% of battery production, and close to 90% of anode production for batteries, among other things7. Access to upstream activities is not available to companies from Europe, the USA, and Japan, which puts them at a competitive disadvantage. Second, Chinese electric vehicle manufacturers have mastered the technology for producing electric vehicles, domestic demand is increasing due to government subsidies and regulations, leading to economy of scale. As a result, the electric vehicle segment is being "democratized," transitioning from a premium to a mass market segment. Chinese companies are currently building a global "value for money" segment for electric vehicle users, resulting in models of solid quality at low prices. For instance, Chinese BYD has already launched the electric model Seagull, which would cost $12,000 in Europe.

Dominance in this segment has created an opportunity for Chinese companies to enter the global market. According to the Chinese Association of Automobile Manufacturers, over 4.9 million cars were exported from China in 2023, of which 1.2 million were electric vehicles. This figure includes foreign brands that, attracted by the advanced ecosystem in China, have located their production in the country with the aim of serving other markets from there.

Further expansion of Chinese auto companies will depend on several factors. Given that Western auto companies have exited the Russian market, where 1.3 million vehicles were sold in 2023, Chinese companies are gradually expanding their operations in this market, either through exports or by opening local plants. This trend is expected to continue. In Europe, there has been ongoing debate about imposing additional tariffs on Chinese electric vehicles, but there is currently no unified stance. Moreover, European consumers are generally brand loyalists who care about the country of origin of the brand, so Chinese companies will face a tough challenge despite improvements in quality and lower prices. This is evidenced by the fact that the Chinese company Great Wall decided to close its European headquarters in Munich and cancel its expansion plans in Europe due to very poor sales on the continent in 2023. In the USA, although sales of Chinese companies are negligible, the country has already imposed additional tariffs on Chinese vehicles and declared them a potential threat to national security, which will make it difficult for Chinese companies to enter this market. Therefore, the only way for Chinese companies to enter the US market might be to license their battery technology. However, political tensions

7Bloomberg https://www.bloomberg.com/toaster/v2/charts/b096ac18e3814ffc96915c8c1324c0b4.html

may also make these projects impossible. The announced project by Ford and the Chinese company CATL, worth USD 3.5 billion, to produce electric lithium batteries in Michigan using CATL technology, has not yet entered the implementation phase due to numerous legal and political obstacles in the USA.

Chinese Multinational Companies in the Microchip Industry

The microchip industry is a strategic and technologically intensive sector with significant influence on developments in many other industries, which is why national governments are interested in its development. Over the past two decades, this industry has grown at an average annual rate of 6%, and it is expected to reach a sales value of USD 655 billion by 2025. In this industry, companies based in the USA play the most significant role, controlling nearly 50% of the market value. These companies dominate in research and development, design, and production of microprocessors. They also possess competencies in the production of the software necessary for microchip manufacturing. Although Chinese companies have a growing market share, they controlled only 7.2% of global sales in 2023, a similar percentage to that of Taiwan. The main customers of microchips are computer and laptop manufacturers, smartphone manufacturers, and automotive companies. In the future, it is expected that the use of microchips will increase in household appliances, industrial and agricultural machinery. The primary market for companies in this industry is the Asia-Pacific region, where sales amounted to USD 290 billion in 2023, with the Chinese market dominating at 53% of regional sales. This distribution of demand is expected as vehicle and various technical device manufacturers dominate this region.

Graph 8. Market Value of Microchips in Billions of USD
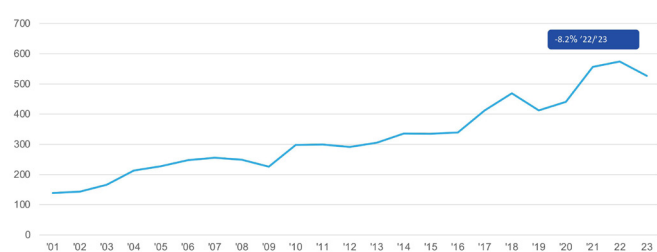
Source: Semiconductor Industry Association 2024 Factbook

A fundamental characteristic of this industry is the extremely complex supply chain, where certain companies and countries control specific activities, making it uncertain for any single country to bring the entire supply chain under its control. For example, the Dutch company ASML almost completely controls the production of lithographic machines necessary for microchip manufacturing. Companies from the USA control software solutions and design, while the Taiwanese company TSMC is positioned as the main manufacturer of various types of microchips, controlling over 90% of the production of advanced microchips below 7 nm.

However, in this industry, we are witnessing attempts by the USA to control the development of the sector through allied countries and allied political entities that are not internationally recognized (Taiwan) due to its significance for the development of artificial intelligence and 5G telecommunications networks. The USA has a history of extraterritorial application of its decisions in this sector. Towards the end of the second decade of the 21st century, the USA imposed restrictions on cooperation between American companies and citizens with Chinese companies in the fields of telecommunications and microchip development. A large number of Chinese companies were placed on the list, but ZTE and Huawei stood out due to their size and importance for the Chinese economy and industrial policy. Both companies were leaders in the production of telecommunications equipment and smartphones and were gradually entering the microchip production segment. The restrictions included a ban on the sale of goods and services produced in the USA, as well as goods and services from foreign companies that collaborate with US suppliers. Additionally, US citizens and those in the process of obtaining a "green card" were prohibited from working in Chinese companies in the microchip sector, with the aim of slowing down the development of this sector in China. The results of these measures were devastating for Chinese companies, resulting in financial losses and a loss of competencies. ZTE was completely pushed out of the international market, and many countries severed cooperation with Huawei in the telecommunications field. Huawei faced immense pressure and fell from being the second-largest smartphone manufacturer, controlling 18% of global sales in 2019, to a marginal market share. The company's revenues, which were USD 123 billion in 2019, dropped by 29% the following year. It was only in 2023 that the company managed to achieve revenues of nearly USD 100 billion, thanks to the development of its own operating system, Honor OS, the development of accompanying applications, and breakthroughs in microchip development.

Recognizing that domestic companies would lose the competitive battle due to US sanctions, Chinese companies, in coordination with Chinese state authorities, are developing a development strategy aimed at achieving industry self-sustainability. State

measures took several directions and were largely similar to those proven effective in the development of the automotive industry. The first goal was to encourage consolidation within the industry to create so-called "champions" strong enough to innovate in this field. With state incentives, several mergers between local companies have been realized over the past decade, and from these processes, the Chinese company SMIC emerged as a local leader, with a market capitalization of over USD 29 billion at the beginning of 2024. However, compared to foreign competitors, the company's value is incomparably smaller.

Graph 9. Market Capitalization of Companies in the Microchip Industry in Billions of USD
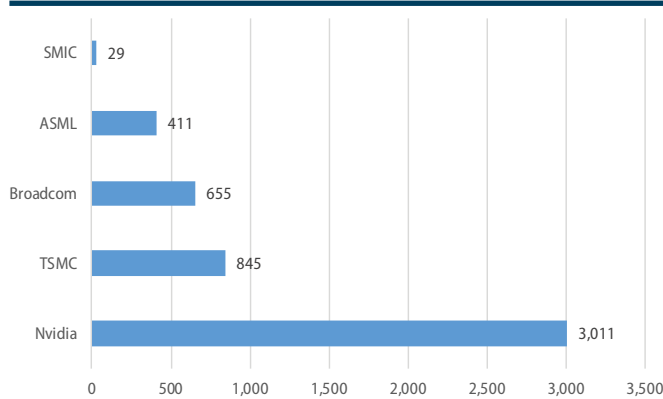
Source: Statista

The second direction of action was to encourage cooperation among Chinese companies within the business ecosystem, so today SMIC is working with Huawei on developing advanced microchips below 7 nm. The third direction of action involves efforts to prevent dependency on the sole supplier of lithographic machines, the Dutch company ASML. To this end, before the company agreed to comply with US sanctions, Chinese companies sought to procure as many new and used machines as possible. In 2023, China imported over half of all lithographic machines sold by ASML that year, including older models. The purchase of these machines aims to bridge the period of total sanctions that began in 2024 and to serve as a foundation for incremental innovations. The fourth direction is to leverage the advantages of the domestic market to achieve economies of scale and direct revenues to domestic companies. In this regard, state authorities decided to cease purchasing foreign microchips in the state sector, aiming to stimulate domestic production. National security concerns are used as an excuse. The fifth measure is to provide financial support for investments in risky R&D projects. In 2024, the National Integrated Circuit Industry Investment Fund, through which the Chinese state finances strategic projects, provided USD 47 billion in subsidies for developing the microchip industry.

Counting on this type of support, Chinese companies have devised a new competitive strategy. Specifically, Chinese companies are focusing their business on microchips in the mature phase of development, such as the 28 nm chips, which entered production in 2010, up to the 14 nm chips, which entered mass production in 2014. This segment represents about 70% of sales, and it is expected that Chinese companies will increase their market share in this segment from 29% to 33% by 2027. This can only be achieved by lowering prices through economy of scale and increasing production volumes. Therefore, it is not surprising that in addition to the 44 active production plants in China during 2023, the construction of another 32 plants is expected, which will become operational in the next few years. In this way, Chinese companies generate additional funds for investment in R&D, achieve economy of scale, and also reduce the cash flow of foreign competitors based on mature technologies that do not require significant R&D investments.

At the end of 2023, it was announced that the new Huawei smartphone model Pura 70 uses an advanced version of the 7 nm microprocessor. Initial suspicions that these were illegally imported foreign chips were dispelled by information that it was a product developed by Huawei in collaboration with SMIC. This represented a significant technological breakthrough for Chinese companies, causing concern among proponents of sanctions in the USA. However, despite this technological breakthrough, Chinese companies lag behind TSMC by two generations of microchips. In addition to the technological gap, Chinese companies also lag in process efficiency, as the development costs of this technology for Chinese companies are several times higher than TSMC's costs. By 2024, Huawei's management emphasized that the company's efforts would focus more on increasing efficiency in the production of 7 nm microchips rather than developing 5 nm chip technology. All this indicates the strategic patience of Chinese companies in this industry.

The conclusion that emerges is that currently, in the field of microchips, Chinese companies are second-tier competitors who are actively working on improving their competitiveness. In the near future, it can be expected that Chinese competitors will increase their pressure on traditional competitors in the segment of mature technologies, while only gradually reducing their lag in the latest technologies. It has also been shown that the imposed restrictions by the US government do not have as much impact on Chinese companies as they did just five years ago. Despite difficulties, Chinese companies manage to innovate and compete with Western companies in certain segments, and the Chinese market

is slowly moving towards self-sustainability. Chinese companies in this segment will primarily focus on domestic needs, and any potential entry into the global market will come in the more distant future, depending on geopolitical developments. The consequences of developments in this industry could be the creation of two independent technological-business ecosystems that will compete for customers and allies based on exclusivity, which will have negative consequences on global economic growth.

Highlights

Quarterly Monitor
of Economic Trends and Policies in Serbia

QM is a bulletin of the Faculty of Economics at the University of Belgrade, FREN, which, since 2005, objectively and methodologically, analyses trends and policies using modern methods of economic analysis. The editorial board, as well as the committee, are mostly composed of professors and associates of the Faculty of Economics at the University of Belgrade.

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Faculty of Economics at the University of Belgrade is an educational and scientific institution with a history of over 80 years. Today, it is the most prestigious institution of its kind in the country, with about 130 faculty members, of whom 55 full professors. Its alumni include over 48,000 BScs, 3,800 MAs, and some 820 PhDs. The Faculty has developed close ties with a large number of universities and institutes around the world, including USA, UK, Russia, France, Italy and Greece, and collaborates with many enterprises on joint projects.

Foundation for the Advancement of Economics (FREN)

FREN is an independent research center whose team of associates monitors regularly economic trends in Serbia, conducts in-depth economic research and encourages and facilitates exchange of information and availability of economic data within economic research community in Serbia.

The founder of FREN is the Faculty of Economics in Belgrade. FREN was founded in 2005.

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