



HYPO ALPE ADRIA
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March 2016

February 2016

January 2016

December 2015

November 2015

October 2015

September 2015

August 2015

ECONOMIC DIGEST

Finance and Market Trends Guide

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Design and prepress:

ImageTeam d.o.o.

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Overview

Early 2016 was characterized by weakening optimism at world markets, plausibly in line with increasing geopolitical tensions, but also by decreasing growth and demand in some large emerging economies, such as Brazil, China or Russia. Thus early 2016 saw decrease of indices at key European and Asian stock markets, while US ones recovered along March. In the same time, economic activity in the Eurozone – Serbia's key trade partner – has been cooling down along past months, all in sync with strong deflationary pressures, and in spite of ECB's accommodative measures. In these conditions, ECB leadership decided to increase volume of its QE program to EUR 80 bn from EUR 60 bn a month, and to extend it at least until 2017, while cutting key rate by 5bp to 0% in March. In the same time, Fed hiked its key rate in late 2015, leading to divergence of its monetary policy in comparison to ECB, and to a consequential spillover of capital on US markets due to widening of interest rate differential vis-à-vis the European and peripheral debt and capital markets. More Fed tightening in the rest of the year is possible, but in conditions of rising uncertainties at global markets, it is plausible that it would be milder than initially expected.

Serbia's economy crawled out of recession last year by growing by 0.7%, driven by recovery of investment activity at several infrastructure projects, as well as due to mild growth of net exports, in line with a timid increase of Eurozone demand. On the other hand, these effects were somewhat curbed by prolonged weakening of household and government demand. Judging by high frequency data, economic growth in Q1 2016 continued to speed up, mostly on the back of the prolonged intensification of investments and activity in some export-oriented industrial activities. Thus January 2016 saw strong growth of production in tobacco industry (+48% yoy), chemical (+18%), electrical equipment (+16%) and construction materials (+16%), the latter reflecting a gradual recovery of construction sector activity. Given the strong growth of construction permits (+26% in 2015, +21% yoy in Jan-16), and due to aforementioned growth of production of construction materials, we could possibly expect a prolonged growth of investment activity in the coming months. This would be in the same time the key generator of economic growth in the coming period, while positive effect of net exports could be somewhat diluted due to decreasing Eurozone market optimism, against the backdrop of the extended outlook of depressed domestic demand. This said we could expect the economic growth to attain app. 1.5% at the level of 2016.

In conditions of last year's improvement of external demand, and due to stronger net inflows of remittances, current account deficit narrowed by app. a fifth along 2015, as suggest the 11M 2015 data. Thus external deficit in this period attained app. 4.5% of GDP, but although narrowed, it remains one of the largest ones in the Central and Eastern Europe. It was adequately covered by net capital inflows along 2015, which led to, as it seems, relative dinar stability along most of last year. However, late 2015 and possibly early 2016 witnessed relatively strong outflows of portfolio investments, of which most are carry trades in local T-bills and T-bonds issued by Ministry of Finance.

Plausibly in line with these net capital outflows, dinar weakened by app. 1% ytd (until 21.3) against euro, which is also recorded in most other regional free floating currencies. In order to stem these depreciation pressures, NBS intervened in the same time by a net sale of EUR 510 million. However, given that the external deficit remains relatively strong, in the midterm it is possible to expect gradual nominal dinar depreciation.

In line with weak domestic demand and decrease of global commodity prices, previous months featured the continuation of trend of low inflationary pressures. Thus annual inflation in February reached only 1.5%, which makes more than two years below the NBS' targeted band of 4% +/- 1.5%. The aforementioned deflationary pressures would seemingly persist in the coming months, while key inflationary pressures would stem from potential increases of administered prices and these renewed depreciation pressures.

Despite these low inflationary pressures, NBS refrained from key rate cuts in March, after cutting by 0.25pp to 4.25% in February. This is largely a consequence of aforementioned ongoing external risks at key global markets, and expectations of normalization – tightening of Fed's policy in the remainder of 2016, which would effectively lead to capital spill over from peripheral to US debt market.

After starting fiscal consolidation measures in late 2014, fiscal policy gained an increasingly restrictive character. Thus consolidated state fiscal deficit was slashed by app. 40% along 2015, by reaching the level of 3.7% of GDP. This trend was continued in January 2016, when a fiscal surplus of app EUR 245 million was attained, largely as a result of strong growth of incomes, consequence of a surge in excise duty and non-tax incomes. Given that the relatively good realization of budget in beginning of a year is largely due to a seasonal effect, at the level of 2016 it is possible to expect a budget deficit similar to one attained in 2015. Thus the state's needs for financing of this deficit and maturities of earlier debt issuances would attain app EUR 5-5.5 bn, which would be largely met through emissions of T-bills and T-bonds, and somewhat less through international financial organizations and governments, while the 2016 Law on Budget permit a potential issuance of a Eurobond.

Last year's exit from recession, external rebalancing and decrease of fiscal deficit, plausibly led to an improvement in Serbia's sovereign credit rating. Namely, outlook for improvement of credit rating were improved with all three major agencies – Standard&Poor's, Fitch and Moody's – in late 2015 and Q1 2016. In the same time, the IMF mission visited Serbia in February 2016, while a formal continuation of the discussion on fourth review of the precautionary stand-by arrangement would take place only after the new government is forged following the snap parliamentary election in April.

Macroeconomic Trends

Table 1 Macroeconomic overview

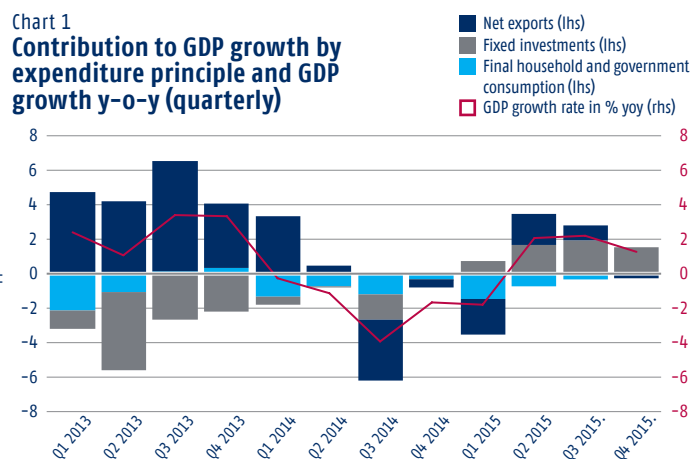
	Dec 12	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Jan 16	Feb 16	Mar 16	Dec 16*
Economic Activity											
GDP in EUR billion	31.7	34.3	33.1	8.2	16.4	24.6	33.0	...	...	...	33.3
Real GDP growth in % yoy (cumulative)	-1.0	2.6	-1.8	-1.8	0.1	0.9	0.7	...	...	...	1.5
GDP per capita, EUR	4,401	4,783	4,626	...	...	...	4,615	...	...	...	4,666
Industrial production, growth in % yoy (cumulative)	-2.9	5.5	-7.0	-2.0	4.8	7.6	8.4	8.6	...	...	4.3
Prices and FX Exchange											
Inflation CPI, in % yoy	12.2	2.2	1.7	1.9	1.9	1.4	1.5	2.4	1.5	...	2.8
EUR/RSD (end of period)	113.7	114.6	121.0	120.2	120.6	119.7	121.6	123.2	123.5	...	125.1
Labor Market											
Unemployment rate, ILO definition, annual avg.	24.0	22.1	18.9	...	...	...	17.9	...	...	...	18.2
Average wage growth, yoy, EUR basis	-0.5	5.3	-1.5	-2.6	-3.4	-4.0	-3.4	-2.6	...	...	1.1
Foreign Trade and Balance of Payments											
Goods and services exports, in EUR billion (cumulative)	11.5	13.9	14.5	3.5	7.5	11.6	15.6	...	...	...	16.3
Goods and services imports, in EUR billion (cumulative)	17.0	17.8	18.1	4.4	9.2	13.9	18.9	...	...	...	19.4
Trade deficit, in EUR billion (cumulative)	-5.5	-3.8	-3.6	-0.9	-1.7	-2.3	-3.3	...	...	...	-3.2
Trade deficit, in % of GDP	-17.4	-11.2	-11.0	-11.0	-10.2	-9.5	-9.9	...	...	...	-9.5
Current account deficit, in EUR billion (cumulative)	-3.6	-2.1	-2.0	-0.5	-0.8	-1.1	-1.6	...	...	...	-1.5
Current account deficit, in % of GDP	-11.5	-6.1	-6.0	-6.2	-4.9	-4.6	-4.8	...	...	...	-4.4
Net FDI in EUR million (cumulative)	0.7	1.3	1.2	0.3	0.8	1.3	1.8	...	...	...	1.9
Net FDI in % of GDP (cumulative)	2.1	3.8	3.7	4.1	4.7	5.2	5.4	...	...	...	5.7
Fiscal Data											
Fiscal deficit of the consolidated state, in RSD billion (cumulative)	-245.2	-212.1	-258.1	-21.1	-35.1	-51.2	-148.7	30.0	...	...	-173.3
Fiscal deficit of the consolidated state, in % of GDP	-6.8	-5.5	-6.7	-2.2	-1.8	-1.7	-3.7	9.3	...	...	-4.2
Public debt in EUR billion	17.7	20.1	22.8	24.2	23.8	24.1	24.8	24.8	...	...	26.4
Public debt in % of GDP	55.9	58.8	68.6	74.0	73.6	73.3	75.0	77.0	...	...	79.4
Monetary Data											
Domestic loans, EUR billion	16.5	16.1	15.9	16.0	15.9	16.0	16.3	16.2	...	...	16.6
Domestic loans, yoy growth, EUR basis	-1.0	-1.4	-1.2	1.7	0.0	1.0	2.4	2.1	...	...	2.7
NBS key rate, end of period	11.25	9.50	8.00	7.50	6.00	5.00	4.50	4.50	4.25	4.25	5.25
International Data											
Real GDP growth in Eurozone, in % yoy	-0.8	-0.3	0.9	1.3	1.6	1.6	1.6	...	...	...	1.5
EUR/CHF, end of period	1.21	1.23	1.20	1.04	1.04	1.09	1.09	1.11	1.09	...	1.10
EUR/USD, end of period	1.32	1.37	1.21	1.07	1.11	1.12	1.09	1.08	1.09	...	1.08
ECB key rate, end of period	0.75	0.25	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.00	0.00
SNB key rate, end of period	0.00	0.00	-0.25	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
3M Euribor, end of period	0.19	0.29	0.08	0.02	-0.01	-0.04	-0.13	-0.16	-0.21	...	-0.40
Libor CHF 3M, end of period	0.01	0.02	-0.06	-0.81	-0.79	-0.73	-0.76	-0.76	-0.81	...	-0.77

* forecasts

Source: National Bank of Serbia, Serbian Statistics Office, Ministry of Finance, Bloomberg, Ekonomska istraživanja Hypo Alpe-Adria-bank (u daljem tekstu: Hypo Research)

Economic activity

- In Q4 2015, economic growth decelerated to 1.2% y-o-y (vis-à-vis +2.3% in Q3), so GDP rose by 0.7% in real terms at the level of 2015.
- Last year's economic growth was driven by a rise in net exports and investment, in line with the modest recovery of external demand and construction works on infrastructural projects, while the household and government demand still exerts a negative effect on growth, most likely due to the implementation of fiscal consolidation measures.
- Economic growth slowed down somewhat in Q4 2015, most probably due to the weakening of external demand in the euro area, Serbia's main foreign trade partner, as was the case over the past months.
- It is likely that 2016 will see economic activity pick up to approximately 1.5%, in line with a further intensification of works under construction projects, while net exports and household consumption will give a neutral contribution.



Source: Serbian Statistics Office, Hypo Research

Table 2 Real GDP growth, by sector of activity

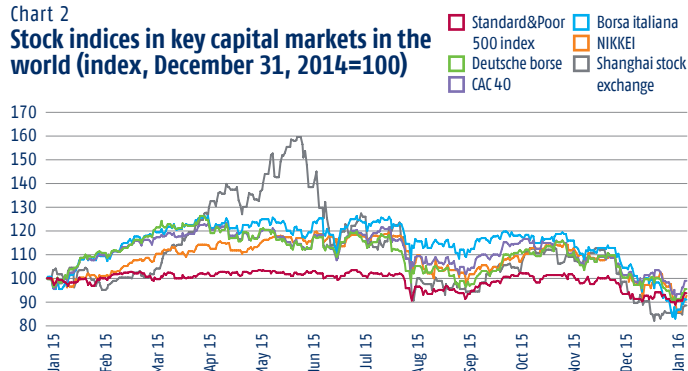
	2012	2013	2014	1Q 2015	2Q 2015	3Q 2015	4Q 2015	2012	2013	2014	1Q 2015	2Q 2015	3Q 2015	4Q 2015
	Annual growth rate in %							Contribution to GDP growth in pp						
Agriculture, forestry, fishing	-17.3	20.9	2.0	-8.4	-9.8	-6.0	-6.7	-1.5	1.5	0.2	-0.6	-0.8	-0.6	-0.6
Mining, manufacturing, electricity, steam water supply	5.6	6.0	-7.6	-3.9	8.1	8.4	6.8	1.1	1.2	-2.1	-0.8	1.6	1.6	1.3
Construction	-9.8	-3.9	-1.5	-1.8	17.3	18.9	8.0	-0.5	-0.2	0.2	-0.1	0.7	0.8	0.4
Wholesale, retail trade, transportation, storage, accommodation	-0.7	2.3	1.1	0.3	0.4	1.2	0.7	-0.1	0.3	0.0	0.0	0.1	0.2	0.1
Information and communication	2.8	-0.1	-3.9	-3.5	-0.5	2.9	-0.4	0.1	0.0	-0.1	-0.2	0.0	0.1	0.0
Financial and insurance activities	-8.0	-9.5	-2.8	1.6	-1.3	5.0	4.1	-0.3	-0.3	-0.1	0.0	0.0	0.1	0.1
Real estate activities	1.0	1.0	-1.3	-0.2	-0.6	-1.0	-0.6	0.1	0.1	-0.1	0.0	-0.1	-0.1	-0.1
Professional, scientific, technical, administration and support services	3.9	-2.4	0.9	-0.5	-0.7	0.8	-0.7	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Public administration, defence, education, human health, and social work	1.9	1.2	0.1	-3.6	-2.9	0.5	0.7	0.2	0.2	0.1	-0.5	-0.4	0.1	0.1
Arts and recreation, other service activities, household activities	1.0	-3.3	2.3	0.4	-1.1	0.4	-5.2	0.0	-0.1	0.1	0.0	0.0	0.0	-0.1
Gross value added (GVA)	-0.8	3.3	-2.0	-2.3	1.6	2.8	1.5	-0.7	2.7	-2.0	-1.9	1.3	2.3	1.2
Net taxes	-2.1	-1.0	-0.9	0.6	-1.3	-0.1	0.0	-0.3	-0.2	-0.1	0.1	-0.2	0.0	0.0
GROSS DOMESTIC PRODUCT (GDP)	-1.0	2.6	-1.8	-1.8	1.1	2.3	1.2	-1.0	2.6	-2.0	-1.8	1.1	2.3	1.2

Source: Serbian Statistics Office

International environment

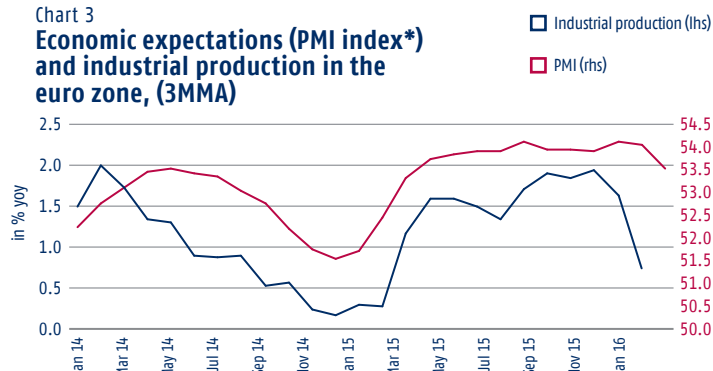
- Trends at the beginning of the current year were marked primarily by (i) rising geopolitical tensions, and (ii) economic slowdown and gradual transition to a growth model based on private and government consumption instead of exports and investment, in some of the large emerging economies, such as China.
- It would appear that these factors resulted in a global economic slowdown, drop in stock exchange indices and strong disinflationary pressures.
- It is amid such conditions that the ECB announced it would extend its QE programme at least until March 2017, while the Fed, after the tightening late last year, hinted at the possibility of no further increase in its policy rate.
- It could be expected that inflation, and key policy and market rates in the leading markets will stay at a relatively low level in the upcoming months.

Chart 2
Stock indices in key capital markets in the world (index, December 31, 2014=100)



Source: Bloomberg

Chart 3
Economic expectations (PMI index*) and industrial production in the euro zone, (3MMA)



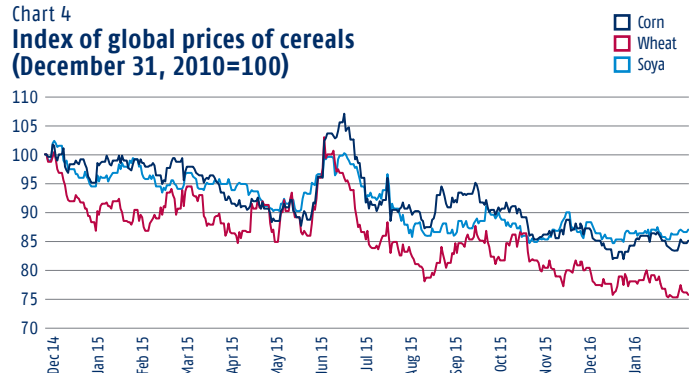
*PMI (Purchasing Managers' Index) is a monthly index of the processing industry purchasing managers' sentiment who report in surveys whether their operation is (i) improved, (ii) deteriorated, or (iii) unchanged m-o-m. The score x of the index for country i ranges $0 \leq x_i \leq 100$, where the values $0 \leq x_i < 50$ represent deterioration, $x_i = 50$ represents no change and $50 < x_i \leq 100$ represent improvement.

Source: Bloomberg, Hypo Research

Agricultural production

- Winter months saw relatively warm weather with scarce snow compared to the multiannual average. Despite this fact, the growth and development of autumn crops and perennials is not threatened for now.
- Last year's agricultural season was relatively modest, primarily due to the summer drought that hit spring crops the hardest.
- In terms of these crops, the volume of production of maize dropped by nearly 10% compared with the multiannual average, and that of beet by as much as nearly 30%.
- Unlike domestic, last year's global agricultural production stayed within the range of the multiannual average, which contributed to further decline in world stock exchange prices of agricultural raw materials.
- Amid weak inventories formed last year, coupled with low global prices of these commodities, it is possible that the agriculture sector would record a relatively weak growth along 2016.

Chart 4
Index of global prices of cereals (December 31, 2010=100)



Source: Bloomberg, Hypo Research

Table 3. The volume of production of major crops

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-2015	The growth rate in 2015 compared to the 10 year average
Corn	Harvested area, ha	1,004,611	962,636	992,941	1,048,815	994,612	1,014,570	1,036,859	976,020	980,334	1,057,877	1,010,227	1,007,227	0.3
	Total return, t	7,085,366	6,016,765	3,904,825	6,158,122	6,396,262	7,207,191	6,479,564	3,532,602	5,864,419	7,951,583	5,454,841	6,004,685	-9.2
	Yield, t/ha	7.1	6.3	3.9	5.9	6.4	7.1	6.2	3.6	6.0	7.5	5.4	5.9	-9.2
Wheat	Harvested area, ha	630,255	607,123	625,912	612,256	636,434	619,403	619,612	603,275	631,640	604,748	589,922	616,416	-4.3
	Total return, t	2,522,565	2,367,911	2,342,244	2,632,091	2,598,182	2,085,529	2,609,188	2,399,225	2,690,266	2,387,202	2,428,203	2,460,237	-1.3
	Yield, t/ha	4.0	3.9	3.7	4.3	4.1	3.4	4.2	4.0	4.3	3.9	4.1	4.0	2.7
Soya	Harvested area, ha	130,936	156,680	146,988	143,684	144,386	170,255	165,253	162,714	159,724	154,249	184,841	156,337	18.2
	Total return, t	368,023	429,639	303,950	350,946	349,193	540,859	440,847	280,638	385,214	545,898	454,431	404,513	12.3
	Yield, t/ha	2.8	2.7	2.1	2.4	2.4	3.2	2.7	1.7	2.4	3.5	2.5	2.6	-3.2
Sunflower	Harvested area, ha	197,843	186,431	154,793	187,822	157,337	169,384	174,270	185,918	188,189	175,366	166,192	176,686	-5.9
	Total return, t	350,762	384,945	294,502	454,282	377,549	378,409	432,020	366,020	512,839	509,250	437,084	408,878	6.9
	Yield, t/ha	1.8	2.1	1.9	2.4	2.4	2.2	2.5	2.0	2.7	2.9	2.6	2.3	12.2
Sugar beet	Harvested area, ha	68,400	76,130	84,085	51,261	65,354	70,968	59,221	69,069	66,527	64,112	42,123	65,205	-35.4
	Total return, t	3,297,583	3,391,570	3,412,089	2,454,605	2,977,781	3,551,074	3,004,237	2,482,962	3,180,008	3,507,441	2,183,194	3,040,231	-28.2
	Yield, t/ha	48.2	44.6	40.6	47.9	45.6	50.0	50.7	35.9	47.8	54.7	51.8	47.1	10.0

Source: Serbian Statistics Office, Hypo Research

Retail trade

- The rise in retail trade accelerated its pace slightly in the latter half of 2015, thus posting a relatively modest growth of 1.8% in real terms at the level of 2015.
- This rise was most pronounced in trade of non-food products (except gasoline), whose turnover rose in real terms by 2.2%, followed by food, drinks and tobacco (+1.8%) and gasoline (+1.1%).

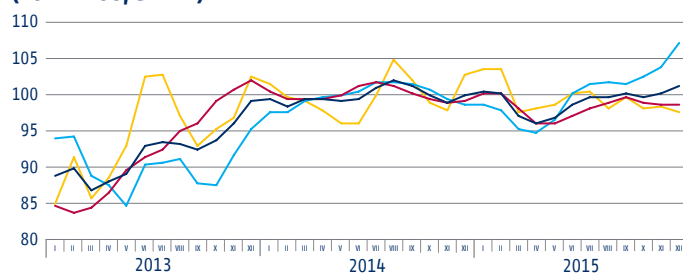
Construction

- Owing to the intensification of construction works on infrastructure facilities and some projects of buildings construction, since mid-2015 construction has been on a recovery path.
- In 2015, construction works performed in the country rose in real terms by 16.4%, of which increase in the areas of construction of other structures (mainly infrastructure) equalled 16.5%, and in the case of construction of buildings 16.1%.

Industrial production

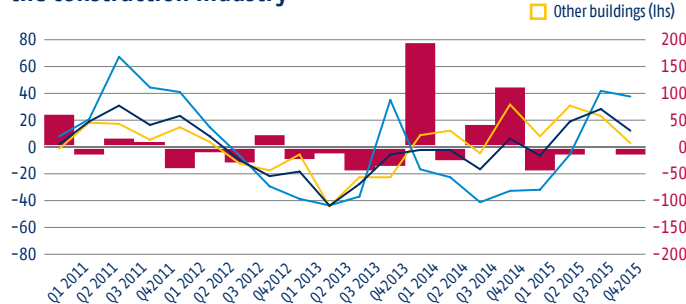
- The volume of industrial production expanded by 8.2% in 2015, recovering thus from its contraction recorded in 2014.
- This industrial recovery was primarily propelled by a stronger external demand in the euro area, and by the low base effect in the energy sector, whose production recuperated last year, having faced flooding in May 2014.
- Still, recent months saw the growth of industrial production slow down, most likely due to weaker demand in the euro area which stems from a drop in activity, and optimism of market participants which was initially felt at the turn of the year.
- Observed by branch of industry, apart from the energy sector, the key driver of the 2015 rise were exports-oriented segments of manufacturing, primarily tobacco industry (whose volume of production surged by 57.7%), pharmaceutical products (+16.3%) and base metals (20.6%).
- On the other hand, the volume of motor vehicles production, dominated by the largest domestic exporter FIAT automobiles Serbia, fell during the review period by 4.6% in y-o-y terms, most likely due to the mild weakening of demand for the model of this manufacturer in markets abroad.

Chart 5
Index of turnover in retail trade by main product categories (2014=100, 3MMA)



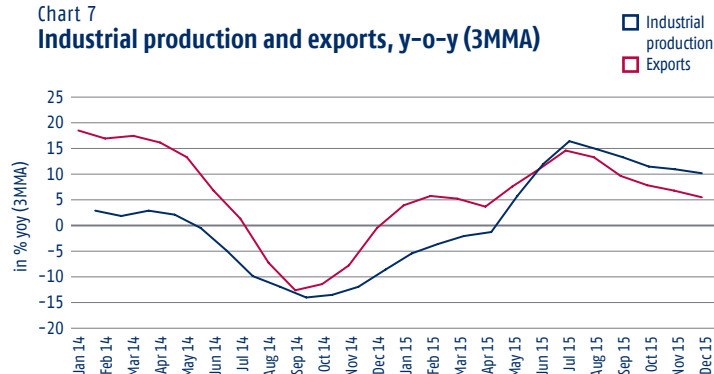
Source: Serbian Statistics Office, Hypo Research

Chart 6
The yoy growth rate of the contractors in the construction industry



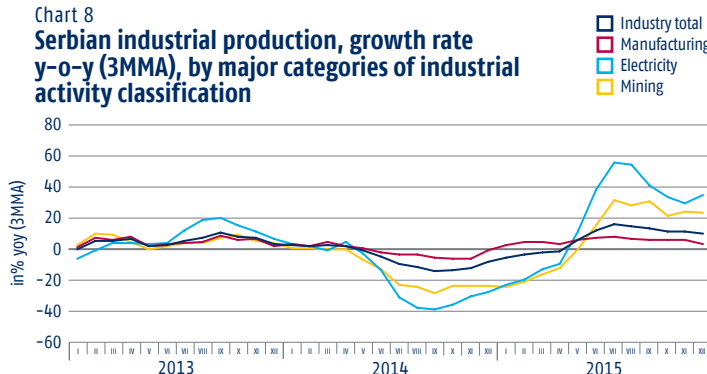
Source: Serbian Statistics Office, Hypo Research

Chart 7
Industrial production and exports, y-o-y (3MMA)



Source: Serbian Statistics Office, Hypo Research

Chart 8
Serbian industrial production, growth rate y-o-y (3MMA), by major categories of industrial activity classification



Source: Serbian Statistics Office, Hypo Research

Table 4 Industrial production growth, y-o-y

	2013	2014	Jan-Mar 2015	Jan-Jun 2015	Jan-Sep 2015	2015
The yoy growth rate of industrial production						
INDUSTRY TOTAL	5.5	-6.5	-2.0	4.8	7.6	8.2
Manufacturing Industry	5.3	-16.7	-16.0	-3.4	6.5	10.5
Mining and quarrying	8.1	-20.1	-13.0	3.9	13.4	18.8
Electricity, gas, steam and air conditioning supply	4.8	-1.4	4.2	6.1	6.1	5.3
Food products	-4.6	4.4	5.1	4.8	3.7	0.0
Beverages	-7.3	-0.6	-3.1	3.3	5.8	4.6
Tobacco products	-7.3	-2.5	157.0	75.2	80.8	57.7
Textiles	-2.3	-19.3	8.3	61.5	46.3	24.6
Clothing	-5.0	-0.6	-5.6	-2.3	-4.4	-4.4
Leather and related products	-5.8	-12.6	-9.5	-14.0	-19.0	-16.1
Wood and products of wood, except furniture	-0.3	12.4	-17.3	-10.4	-10.2	-7.2
Paper and paper products	-0.1	1.5	3.8	7.6	7.6	5.9
Printing and reproduction of recorded media	-3.4	-4.6	-11.8	6.1	12.6	10.8
Coke and refined petroleum products	48.2	-1.7	1.1	0.4	8.2	7.9
Chemicals and chemical products	23.9	-12.9	-3.2	1.1	-2.7	4.2
Basic pharmaceutical products	4.7	0.3	20.1	13.4	16.5	16.3
Rubber and plastic products	-7.9	-0.2	-0.2	4.0	5.7	7.3
Other non-metallic mineral products	-13.7	3.1	-7.7	1.1	1.3	3.0
Basic metals	-7.8	8.5	9.5	25.1	23.5	20.6
Fabricated metal products, except machinery	5.3	-24.7	5.1	6.0	4.0	6.8
Computer, electronic and optical products	-44.4	8.6	-14.1	-23.1	-29.3	-22.2
Electrical equipment	11.2	-2.4	-7.3	-7.5	-2.3	2.3
Machinery and equipment n.e.c.	-34.4	29.0	116.5	102.3	53.5	19.1
Motor vehicles, trailers and semi-trailers	139.3	-2.9	-1.0	-2.5	-4.0	-4.6
Other transport equipment	-33.5	-3.3	-3.6	-19.9	-21.8	-14.9
Furniture	-1.4	-4.4	-4.5	3.2	-0.7	0.9
Other manufacturing	19.9	-7.9	3.2	21.0	28.6	44.9
Repair and installation of machinery and equipment	0.4	-15.0	-7.5	-0.3	2.1	6.6

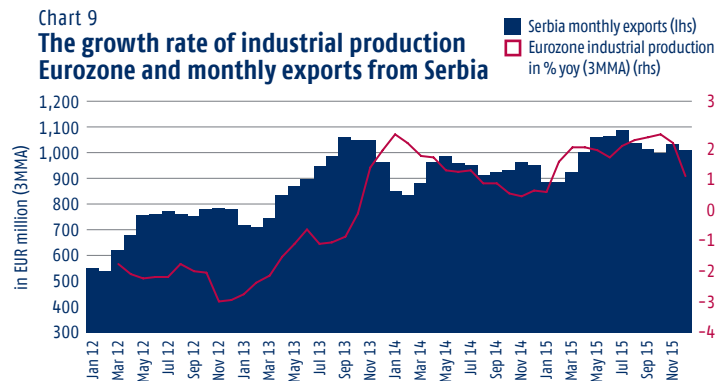
Source: Serbian Statistics Office, Hypo Research

Foreign trade and balance of payments

- The year 2015 saw rise in exports pick up, most likely owing to a rise in external demand in the euro area.
- Reaching EUR 12 billion, exports inched up by 7.8% (+1.4% in 2014) in 2015, but their growth rate has been slowing down in recent months, in accordance with the weakening of economic activity and lower optimism in the euro area, Chart 9.
- Observed by sector, it was base metals that gave the key contribution to last year's rise in exports, which may be attributed to the rise in the volume of production in the Smederevo steel plant, as well as in Impol and Sevojno copper mill.
- Tobacco manufacturing (*Philip Morris* in particular) also acted as a very strong fillip of the rise in exports, followed by manufacturing of automotive parts, chiefly electrical, rubber and plastic products (particularly pronounced in the case of *Yura*, *Tigar* tyres and *Leoni*).
- The main negative contribution to the rise in exports came from the automobile sector, which may be put down to the said reduction in manufacturing of vehicles in the FIAT factory in Kragujevac, Chart 11.
- On the other hand, imports of goods also rose in 2015, chiefly owing to higher imports of goods still unsorted according to the statistical classification, which is why it is not possible to fully determine the nature of stronger imports.
- Apart from unclassified goods (whose imports reached as much as EUR 2 billion or 12% of total imports), the key contribution to the rise in imports came from the imports of computer and electrical equipment, and industrial machines which measured 11% relative to 2014, which could be attributed to an 8% y-o-y rise in fixed investment in real terms (first three quarters of 2015), and to an almost 50% y-o-y rise in net FDI (recorded during the first eleven months of 2015).

Chart 9

The growth rate of industrial production Eurozone and monthly exports from Serbia



Source: Serbian Statistics Office, Hypo Research

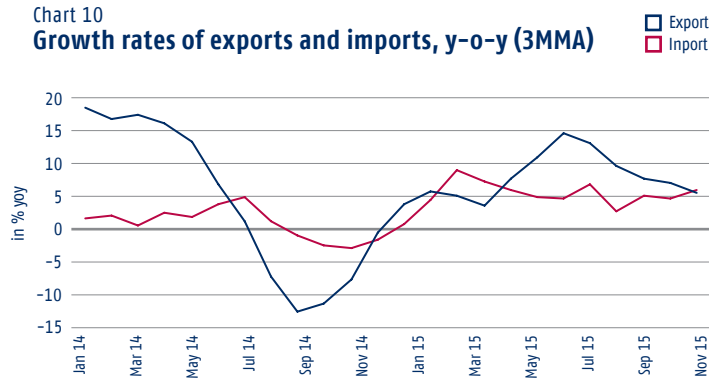
- However, the vigorous increase in imports was limited last year by relatively weak domestic demand and a drop in global prices of raw products, which has, over the past years, particularly strongly reflected on lower costs from imports of oil, petroleum products and natural gas, Chart 12.
- Imports of goods in 2015 rose by 5.6% (vs +0.4% in 2014), reaching almost EUR 16.4 billion.
- Owing to such trends, the foreign trade deficit in 2015 stayed at the level of that recorded in 2014, reaching EUR 4.4 billion (13.2% of GDP), while the level of coverage of imports with exports came at 73.4%.

Table 5 Growth rates of exports of certain categories, cumulative

Export by segment	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15
Total exports, in EUR million						
Agricultural and food products	1,900.2	2,057.5	513.2	1,090.0	1,664.3	2,229.5
Energy and ores	271.1	121.8	17.9	66.7	111.1	133.1
Coke and oil derivatives	305.7	346.9	52.5	123.1	192.0	252.2
Chemicals	657.8	561.3	133.9	313.8	471.7	620.6
Rubber and plastics	761.1	776.6	197.3	426.0	660.9	879.2
Base metals	816.0	831.9	246.5	512.4	755.4	972.0
Electrical equipment	744.5	794.8	161.0	361.3	614.2	859.6
Motor vehicles	1,960.7	1,866.1	496.3	1,005.1	1,378.0	1,800.6
Other	3,581.9	3,800.1	954.5	2,064.4	3,155.6	4,281.6
TOTAL EXPORTS	10,999.0	11,157.0	2,773.1	5,962.8	9,003.2	12,028.4

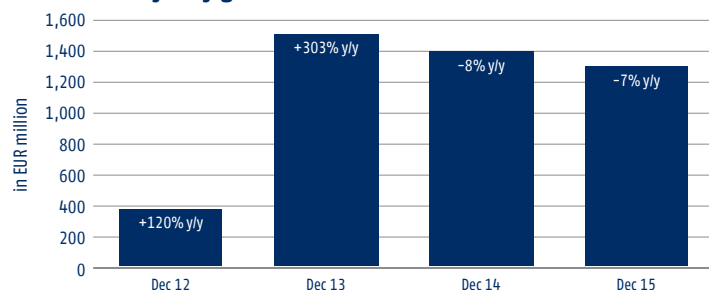
Source: Serbian Statistics Office, Hypo Research

Chart 10 Growth rates of exports and imports, y-o-y (3MMA)



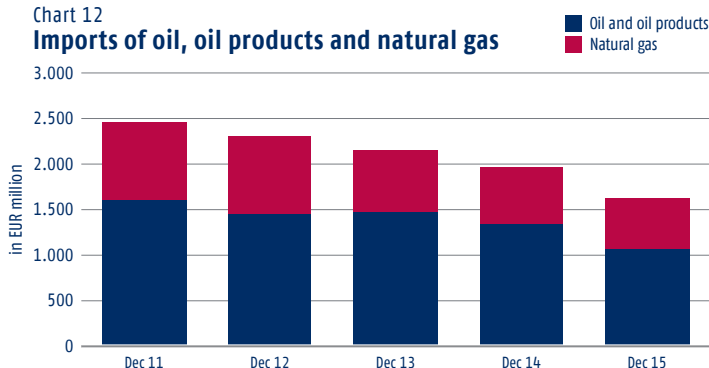
Source: Serbian Statistics Office, Hypo Research

Chart 11 Exports of road vehicles in absolute terms and y-o-y growth rates



Source: Serbian Statistics Office, Hypo Research

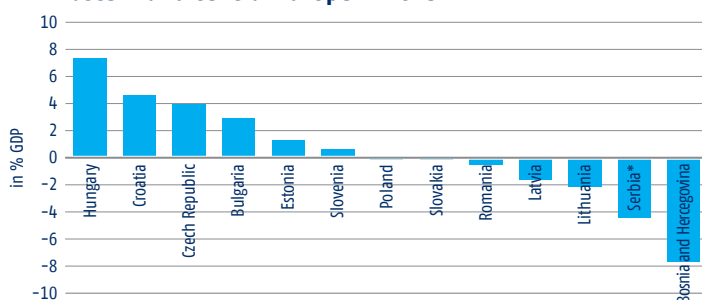
Chart 12 Imports of oil, oil products and natural gas



Source: National Bank of Serbia, Hypo Research

- Although foreign trade deficit stayed relatively unchanged from 2014, the balance of payments deficit was slashed last year by nearly a fifth (in y-o-y terms, during the first eleven months of 2015).
- What propelled this contraction vis-à-vis 2014 was primarily a rise in net inflow of remittances and higher surplus in trade of services.
- Consequently, the balance of payments deficit reached EUR 1.3 billion (around 4.5% of GDP) during the first eleven months of 2015, which, although significantly lower, remains among the highest in Eastern and Central Europe, Chart 13.
- In addition to having been reduced, the external deficit was adequately covered by net capital inflow higher than in 2014, which also enabled stabilisation of the dinar throughout a better part of the previous year.
- These higher net capital inflows were largely sparked by (i) higher net inflow of foreign direct investment of 46% in y-o-y terms (EUR 1.6 billion in the first eleven months of 2015), directed primarily at the financial sector, manufacturing (food, textile and automobile industry), and by (ii) a drop in net capital outflow rising from the banking sector's deleveraging of 55% in y-o-y terms (-EUR 320 million), Chart 14.
- Still, recent months saw a relatively strong net outflow of portfolio investment (present primarily in the domestic debt market), which may be put down to the tightening of the US monetary policy and lower attractiveness of peripheral versus the US debt and capital market.

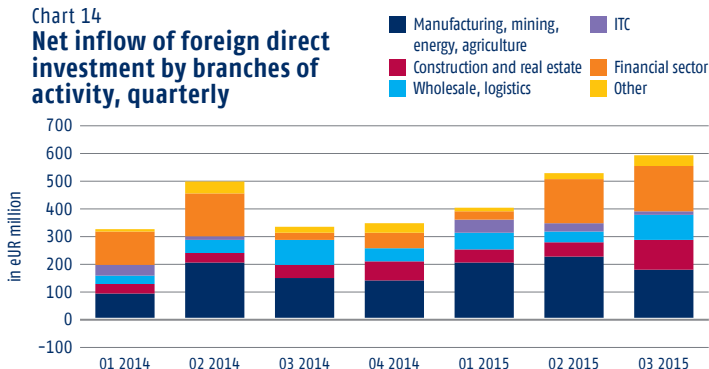
Chart 13 Current account balance of payments of countries in Eastern and Central Europe in 2015



* Data for Serbia covers the first 11 months of 2015.

Source: Bloomberg, National Bank of Serbia, Hypo Research

Chart 14 Net inflow of foreign direct investment by branches of activity, quarterly



Source: Serbian Statistics Office, Hypo Research

Table 6 **Serbian balance of payments***

	Dec 13	Dec 14	Jun 15	Sep 15	Nov 15	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Nov 15
	in EUR million, cumulative					in % of GDP					
I CURRENT ACCOUNT	-2,098.3	-1,984.7	-778.4	-1,082.5	-1,346.0	-6.1	-6.0	-6.4	-4.8	-4.5	-4.5
1. Goods	-4,158.7	-4,110.7	-1,918.8	-2,810.5	-3,535.5	-12.1	-12.4	-12.7	-11.9	-11.7	-11.7
Exports	10,515.0	10,641.0	5,588.4	8,467.7	10,403.1	30.7	32.2	31.8	34.6	35.3	34.4
Imports	14,673.7	14,751.7	7,507.2	11,278.2	13,938.6	42.8	44.6	44.5	46.5	47.1	46.1
2. Services	313.5	465.3	250.5	465.4	621.3	0.9	1.4	1.7	1.6	1.9	2.1
Exports	3,422.0	3,809.6	1,931.2	3,098.5	3,811.1	10.0	11.5	11.3	11.9	12.9	12.6
Of what: transport	811.8	884.8	471.4	745.2	919.1	2.4	2.7	2.8	2.9	3.1	3.0
Tourism	792.1	863.3	360.6	684.9	840.3	2.3	2.6	1.9	2.2	2.9	2.8
Construction	197.4	304.7	127.3	188.2	210.5	0.6	0.9	0.9	0.8	0.8	0.7
IT	436.9	486.8	282.4	427.3	541.4	1.3	1.5	1.6	1.7	1.8	1.8
Imports	3,108.6	3,344.4	1,680.6	2,633.0	3,189.8	9.1	10.1	9.7	10.4	11.0	10.6
Of what: transport	840.8	895.3	458.5	702.8	872.3	2.5	2.7	2.8	2.8	2.9	2.9
Tourism	841.2	888.6	448.8	770.1	906.9	2.5	2.7	2.4	2.8	3.2	3.0
Construction	83.0	136.3	49.7	73.4	88.7	0.2	0.4	0.3	0.3	0.3	0.3
IT	278.1	287.0	136.4	203.9	251.5	0.8	0.9	0.9	0.8	0.9	0.8
3. Primary income (net)	-1,418.6	-1,342.6	-745.8	-1,200.0	-1,460.0	-4.1	-4.1	-3.8	-4.6	-5.0	-4.8
Of what: net income from direct investments	-918.7	-795.3	-410.5	-703.7	-917.1	-2.7	-2.4	-1.4	-2.5	-2.9	-3.0
Net income from portfolio investments	-251.2	-375.2	-269.7	-398.9	-453.6	-0.7	-1.1	-1.9	-1.7	-1.7	-1.5
4. Secondary income (net)	3,165.6	3,003.3	1,635.7	2,462.6	3,028.2	9.2	9.1	8.5	10.1	10.3	10.0
Of what: net remittances	2,102.6	1,794.6	1,004.7	1,509.5	1,853.5	6.1	5.4	5.1	6.2	6.3	6.1
II CAPITAL TRANSACTIONS (net)	15.3	6.5	3.7	4.5	3.0	0.0	0.0	0.1	0.0	0.0	0.0
III FINANCIAL ACCOUNT	1,630.1	1,705.1	468.9	654.6	847.1	4.8	5.2	4.9	2.9	2.7	2.8
1. Direct investments (net)	1,298.1	1,236.3	761.1	1,231.4	1,572.2	3.8	3.7	4.3	4.7	5.1	5.2
2. Portfolio investments (net)	1,882.7	368.9	132.7	27.6	-194.3	5.5	1.1	5.8	0.8	0.1	-0.6
3. Other investments	-854.7	-1,702.8	-340.3	-227.2	-165.4	-2.5	-5.2	-3.8	-2.1	-0.9	-0.5
3.1. Trade credits (net)	203.8	-116.4	8.6	-61.3	-146.9	0.6	-0.4	-0.1	0.1	-0.3	-0.5
3.2. Credits (net)*	-1,285.9	-756.7	-200.8	-150.6	-142.3	-3.8	-2.3	-2.9	-1.2	-0.6	-0.5
National Bank of Serbia	-656.7	-574.3	-112.4	-138.7	-146.0	-1.9	-1.7	-0.7	-0.7	-0.6	-0.5
Government	444.9	728.3	148.9	220.2	328.8	1.3	2.2	-0.8	0.9	0.9	1.1
Banks	-813.7	-862.9	-165.9	-184.6	-321.9	-2.4	-2.6	-1.0	-1.0	-0.8	-1.1
Other sectors	-389.0	-114.9	-40.9	-47.1	-5.5	-1.1	-0.3	-0.2	-0.3	-0.2	0.0
3.3. Currency and deposits (net)	227.5	-829.7	-148.1	-15.3	123.8	0.7	-2.5	-0.8	-0.9	-0.1	0.4
3.4. Other	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV ERRORS AND OMISSIONS (net)	453.0	273.1	305.8	423.3	495.8	1.3	0.8	1.4	1.9	1.8	1.6
V NET FX RESERVES CHANGE with out funds reserve in National Bank of Serbia	696.7	-1,796.7	78.7	378.4	367.7	2.0	-5.4	1.3	0.5	1.6	1.2

Note: Since May 2014, the National Bank of Serbia presents the balance of payment statistics according to a new methodology and therefore, certain figures within the balance of payments have been changed in relation to previous releases.

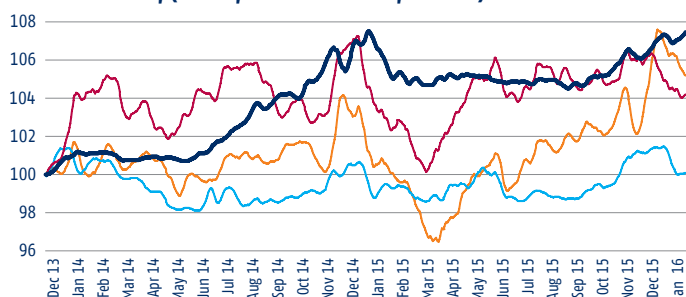
Source: National Bank of Serbia, Hypo Research

Exchange rate

- Depreciation pressures on the dinar, as well as on other regional currencies in the floating exchange rate regime, built up in late 2015 and early 2016, and were brought about primarily by a net outflow of portfolio investment from the domestic debt market.
- In the year to 29 February 2016, the dinar lost 1.5% vis-à-vis the euro.
- To cushion these depreciation pressures, the NBS intervened so far in 2016 (as at 29 February) by net selling EUR 390 million, (versus EUR 520 million worth of net purchase in 2015), Chart 16.

- In nominal terms, the dinar may depreciate in the medium run, given the relatively significant external deficit, which renders the domestic currency more sensitive to possible episodes of net capital outflow in case of risks in international markets.

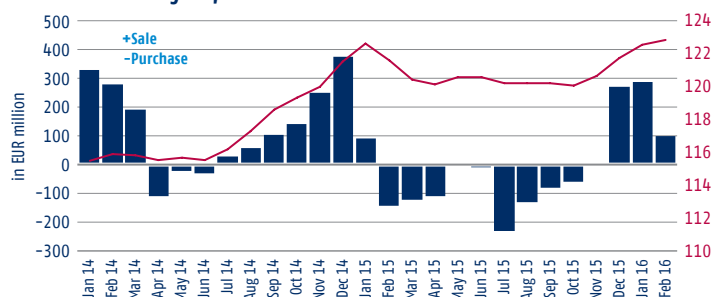
Chart 15
Regional currencies against EUR
until Feb 2016, (index, Dec 2013.=100, 10DMA)*



* The increasing index values indicate depreciation, declining the value of the appreciation of the domestic currency against the euro.

Source: Bloomberg, National Bank of Serbia, Hypo Research

Chart 16
NBS FX market interventions
until February 23, 2016

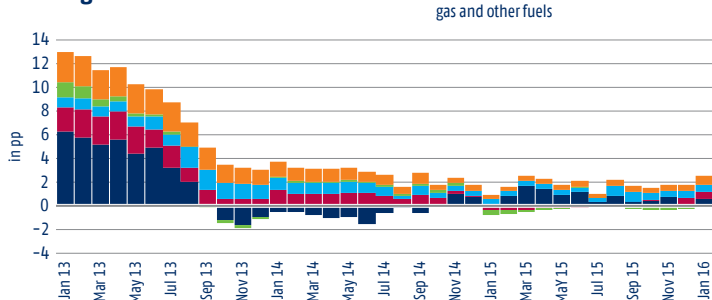


Source: National Bank of Serbia, Hypo Research

Prices

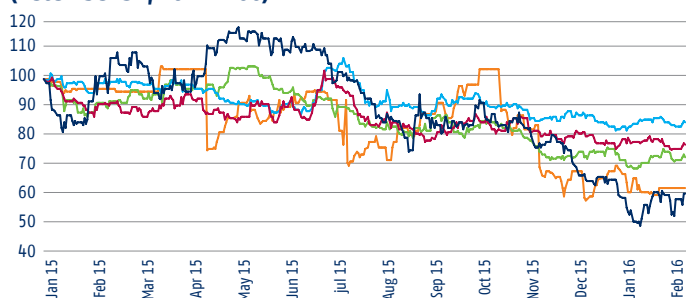
- Over the last few months, the domestic economy has been facing relatively strong disinflationary pressures, most likely due to: (i) weak domestic demand, (ii) sharp drop in global prices of raw materials, lasting from the previous year.
- Annual inflation reached only 2.4% at end-January 2016 (vs. +1.4% at end-2015 and +1.7% at end-2014), staying for over two years below the lower bound of the NBS target tolerance band ($4 \pm 1.5\%$), Chart 9.
- Annual inflation in the following months will most likely stay relatively low due to: (i) weak domestic demand, (ii) prolonged prospects of low global prices of raw materials, while some inflationary pressures could still come from the re-emerged depreciation of the dinar, as well as from the low base effect.

Chart 18
Contribution of key price
categories to annual inflation



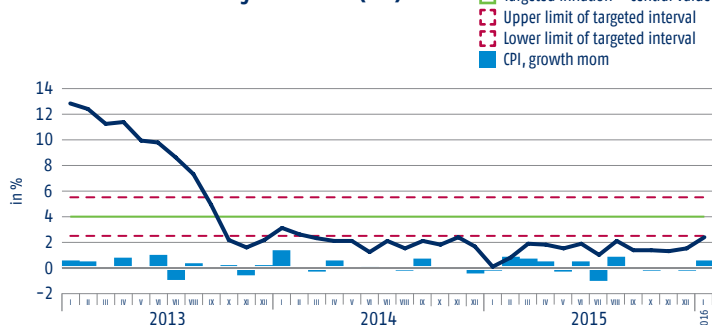
Source: Serbian Statistics Office, Hypo Research

Chart 17
World prices of key commodities
(December 31, 2014=100)



Source: Bloomberg, Hypo Research

Chart 19
Annual and monthly inflation (CPI)



Source: Serbian Statistics Office, Hypo Research

Wages

- In 2015, average wages inched up in real terms by 1.5% from a year earlier (when expressed in dinars), posting a drop of around 3.4% in nominal terms (when expressed in euros), Chart 19.

Table 7 Average cumulative* wage in Serbia

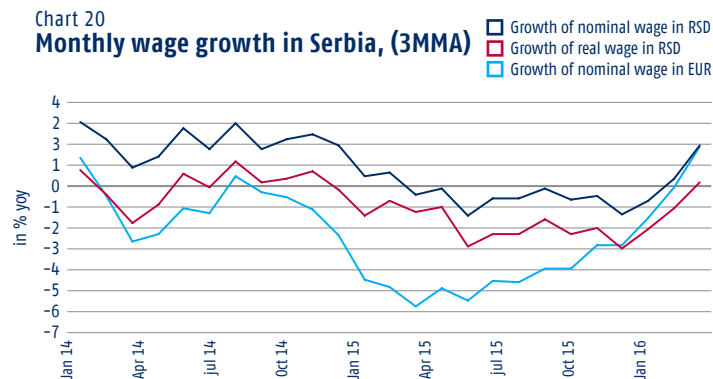
	Dec 11	Dec 12	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15
Average cumulative wage, in RSD	43,887	46,923	50,820	49,970	43,121	44,583	43,925	51,485
Average cumulative wage, in EUR	426	413	443	411	358	370	365	423

* Cumulative wage is an average of monthly wages in all previous months of the year.

Source: Serbian Statistics Office, Hypo Research

Chart 20

Monthly wage growth in Serbia, (3MMA)



Source: Serbian Statistics Office, Hypo Research

Serbia's external debt

- Serbia's total external debt in the first nine months of 2015 rose by around EUR 460 million, reaching the level of around EUR 26.3 billion. The largest part of this increase relates to the rise in government debt of around EUR 740 million, while enterprises and banks deleveraged in the amount of around EUR 275 million, Table 8.

Table 8 Serbian external debt, private and public

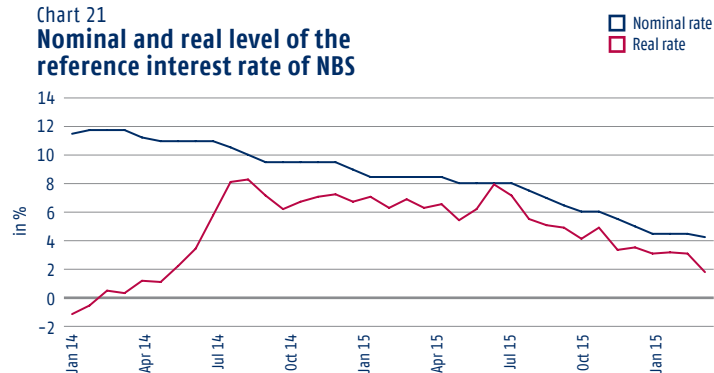
	Dec 11	Dec 12	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15
in EUR million							
State	10,773	12,185	13,166	14,189	15,101	14,918	14,926
out of that: IMF	2,077	1,841	1,131	614	567	538	514
Private sector	13,352	13,460	12,579	11,637	11,649	11,591	11,362
Banks	4,364	4,150	3,400	2,566	2,459	2,408	2,417
Companies	8,988	9,310	9,179	9,071	9,189	9,183	8,945
Total Serbian foreign debt	24,125	25,645	25,745	25,826	26,750	26,509	26,288
in % GDP							
State	32.2	38.4	38.4	42.9	46.0	45.5	45.4
Private sector	40.0	42.4	36.7	35.2	35.5	35.3	34.6
Banks	13.1	13.1	9.9	7.8	7.5	7.3	7.4
Companies	26.9	29.4	26.8	27.4	28.0	28.0	27.2
Total Serbian foreign debt	72.2	80.9	75.1	78.1	81.5	80.8	80.0

Source: National Bank of Serbia, Hypo Research

Monetary sector

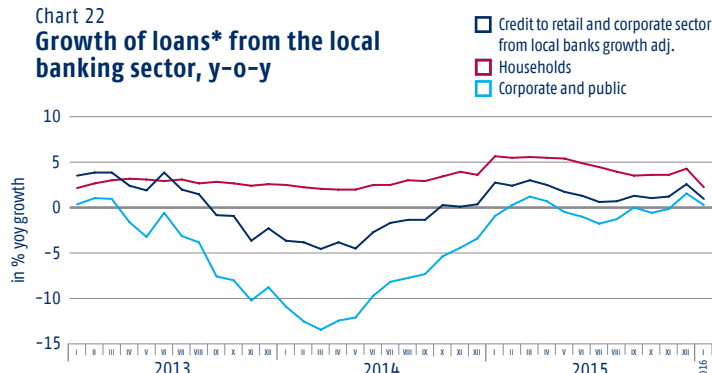
- Mindful of the weak inflationary pressures and hints of extension of the accommodative cycle of the leading central banks in the world, in February the NBS cut the key policy rate by 0.25 pp to 4.25%, after a pause that lasted since November 2015, Chart 21.
- Having in mind the lasting prospects of low inflation, in the upcoming months the NBS could have more room for further, gradual, monetary easing, but this decision will seemingly be influenced by further steps of the leading central banks in the world.
- Amid relatively weak domestic demand, the stock of undue loans recorded a rather modest rise, which at the end of January measured only 1.7% y-o-y (+2.6% at end-2015, +0.4% at end-2014).
- The key positive contribution to this increase came from the rise in household sector lending (+2.9% y-o-y at end-January 2016), while lending to private and public enterprises decreased by 1%, Chart 22.
- In the meantime, the annual rise in household savings is relatively modest, and at EUR 8.8 billion at end-January 2016, it recorded an increase of only 2% in y-o-y terms (versus +1.7% at end-2015 and +1.5% at end-2014) Table 10.

Chart 21
Nominal and real level of the reference interest rate of NBS



Source: National Bank of Serbia, Hypo Research

Chart 22
Growth of loans* from the local banking sector, y-o-y



* Adjusted by the effect of the change of the RSD exchange rate for indexed loans and the amount of unrecoverable placements of banks in bankruptcy. Source: National Bank of Serbia, Hypo Research

Table 9 Consolidated balance of commercial banks

in EUR million

	Dec 12	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Jan 16
TOTAL ASSETS	27,775	27,485	27,352	27,403	27,687	27,947	28,196	27,896
Liquid assets	7,799	8,365	8,328	8,253	8,596	8,675	8,641	8,325
Cash and deposits with NBS	4,431	4,340	3,724	3,979	4,030	3,785	3,929	3,371
of which: mandatory reserve (allocated FX reserve+calculated RSD reserve)	4,036	3,868	3,289	3,326	3,359	3,245	3,086	2,834
FX liquid assets	1,489	1,184	2,203	2,053	2,088	1,932	1,706	1,915
Placements to repo, NBS and RS t-bills	1,879	2,842	2,401	2,220	2,478	2,958	3,005	3,039
Placements	18,176	17,305	17,319	17,516	17,431	17,633	17,934	17,917
Companies	10,762	9,684	9,379	9,351	9,210	9,322	9,547	9,416
Households	5,739	5,876	5,991	6,108	6,183	6,202	6,238	6,251
Other	1,674	1,744	1,949	2,057	2,038	2,109	2,149	2,249
Fixed and other assets	1,800	1,815	1,706	1,634	1,660	1,639	1,622	1,654
TOTAL LIABILITIES	27,775	27,485	27,352	27,403	27,687	27,947	28,196	27,896
Deposits	13,623	14,099	14,618	14,588	14,760	14,885	15,506	15,110
Liabilities to Government	313	444	683	688	676	645	718	719
Transaction deposits	1,632	2,129	2,249	2,090	2,253	2,439	2,725	2,542
Dinar term deposits	1,513	1,407	1,516	1,425	1,412	1,485	1,629	1,369
FX term deposits	10,166	10,119	10,169	10,385	10,419	10,316	10,435	10,479
Foreign liabilities (foreign borrowing + non.res.)	5,109	4,301	3,395	3,359	3,245	3,322	3,167	3,219
Reserves for potential losses	1,986	2,082	2,183	2,400	2,360	2,346	2,472	2,532
Equity and reserves	5,377	5,429	5,198	5,040	5,196	5,275	5,126	4,980
Other liabilities	1,680	1,573	1,960	2,016	2,125	2,119	1,924	2,055

Source: National Bank of Serbia, Hypo Research

Table 10 Total household savings

in EUR million

	Dec 12	Dec 13	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Jan 16
TOTAL SAVINGS	8,156	8,439	8,568	8,664	8,708	8,622	8,712	8,800
Total RSD savings	155	294	315	304	332	350	373	380
Short term	143	269	284	271	280	287	284	289
A vista	41	55	63	57	67	73	85	89
Up to one month	9	9	9	10	21	19	6	7
Up to three months	27	48	42	45	26	27	34	33
Up to six months	21	36	40	35	48	48	49	49
Up to one year	45	122	130	124	118	119	110	111
Long term	12	24	31	33	52	63	89	91
Up to two years	6	15	13	15	31	37	61	62
Up to five years	6	9	17	17	20	26	27	27
Over five years	0	0	1	0	0	0	2	2
Total FX savings	8,001	8,146	8,253	8,360	8,376	8,273	8,339	8,420
Short term	6,432	6,458	6,432	6,475	6,372	6,162	5,766	5,823
A vista	1,669	2,067	2,677	2,841	3,046	3,139	3,465	3,565
Up to one month	58	19	23	24	32	32	15	13
Up to three months	475	207	201	222	134	127	126	128
Up to six months	570	421	436	372	383	361	326	323
Up to one year	3,659	3,744	3,095	3,015	2,776	2,503	1,835	1,794
Long term	1,569	1,687	1,821	1,885	2,004	2,111	2,573	2,597

Source: National Bank of Serbia, Hypo Research

Fiscal flows and public debt

- Budget deficit of the central government in 2015 contracted by around 42%, reaching approximately RSD 150 billion (EUR 1.2 billion) or around 3.7% of GDP.
- This narrowing of fiscal deficit vis-à-vis 2014 was primarily propelled by the 4.6% y-o-y rise in revenues, chiefly in the category of non-tax revenues, whose y-o-y surge of as much as 30% was mainly brought about by the payment of corporate profit tax of some public and state-owned enterprises.
- Liabilities however recorded a decline of 1.9% in y-o-y terms, primarily as a result of reduced costs arising from public sector wages (-9.7%) and pensions (-3.5%).
- Budget execution in January 2016 indicates a relatively significant fiscal surplus of nearly RSD 30 billion, which is line with the better budget execution typical for the month of January, Chart 23.
- January result came primarily as a result of a 12.6% y-o-y rise in revenues, while liabilities also rose by 1.8%.
- This vigorous rise in revenues came almost entirely from (i) a 46% rise in revenues from excises, in y-o-y terms, owing to regulatory changes of deadlines for their payment into the budget and (ii) a 33% rise in non-tax revenues, mostly due to the sale of usage rights of additional frequencies to domestic mobile operators, according to the Fiscal Council analysis.

Table 11 The implementation of the budget consolidated state

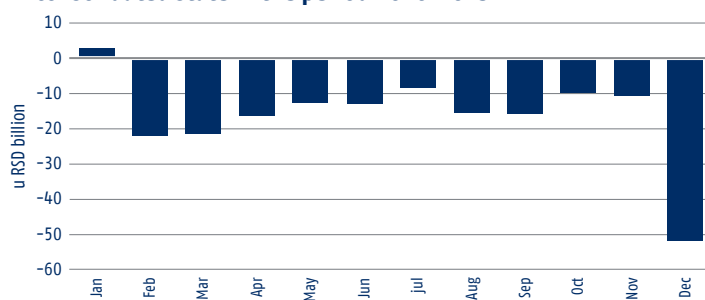
	Dec 14	Jan 15	Mar 15	Jun 15	Sep 15	Dec 15	Jan 16	Dec 14	Jan 15	Mar 15	Jun 15	Sep 15	Dec 15	Jan 16
	In EUR million							In % of GDP						
I PUBLIC REVENUES (incl. Grants)	13,336.4	1,036.3	3,159.5	6,676.7	10,290.9	13,917.8	1,167.9	41.8	39.2	39.0	40.9	41.6	42.5	44.2
1. Current revenues	13,262.9	1,034.4	3,150.8	6,652.0	10,250.2	13,858.5	1,167.2	41.6	39.2	38.9	40.8	41.5	42.3	44.2
1.1. Tax revenues	11,841.2	876.1	2,697.1	5,753.2	8,873.6	12,021.1	956.8	37.1	33.2	33.3	35.3	35.9	36.7	36.2
Personal income tax	1,205.4	83.1	270.0	565.0	879.1	1,205.5	80.7	3.8	3.1	3.3	3.5	3.6	3.7	3.1
Wage tax	888.2	60.4	204.7	431.5	657.9	894.7	62.2	2.8	2.3	2.5	2.6	2.7	2.7	2.4
Other personal income tax	317.1	22.7	65.3	133.5	221.2	310.8	18.5	1.0	0.9	0.8	0.8	0.9	0.9	0.7
Corporate income tax	598.6	30.6	107.6	322.7	419.4	514.7	28.5	1.9	1.2	1.3	2.0	1.7	1.6	1.1
Value added tax	3,370.1	291.8	798.6	1,628.3	2,532.3	3,417.3	298.3	10.6	11.0	9.9	10.0	10.2	10.4	11.3
Excises	1,748.3	154.3	384.5	858.6	1,391.7	1,936.6	225.8	5.5	5.8	4.7	5.3	5.6	5.9	8.5
Excises on petroleum	998.4	55.6	196.3	464.2	759.9	1,046.2	84.3	3.1	2.1	2.4	2.8	3.1	3.2	3.2
Excises on tobacco	638.3	92.3	167.8	339.2	540.1	741.4	123.6	2.0	3.5	2.1	2.1	2.2	2.3	4.7
Other	111.7	6.5	20.4	55.2	91.7	149.0	17.9	0.3	0.2	0.3	0.3	0.4	0.5	0.7
Customs	255.3	16.3	65.4	131.1	200.5	273.7	16.8	0.8	0.6	0.8	0.8	0.8	0.8	0.6
Other tax revenues	471.6	19.4	111.2	244.2	388.2	519.9	21.0	1.5	0.7	1.4	1.5	1.6	1.6	0.8
Social contributions	4,191.9	280.5	959.7	2,003.4	3,062.4	4,153.5	285.7	13.1	10.6	11.8	12.3	12.4	12.7	10.8
1.2. Non-tax revenues	1,421.7	158.3	453.7	898.8	1,376.5	1,837.4	210.4	4.5	6.0	5.6	5.5	5.6	5.6	8.0
2. Grants	73.6	1.9	8.7	24.7	40.7	59.3	0.7	0.2	0.1	0.1	0.2	0.2	0.2	0.0
II PUBLIC EXPENDITURES	15,460.4	906.8	3,334.3	6,967.7	10,716.6	15,139.2	923.3	48.4	34.3	41.1	42.7	43.4	46.2	34.9
1. Current expenditures	13,965.4	872.9	3,186.2	6,547.1	9,982.1	13,930.9	873.9	43.8	33.0	39.3	40.1	40.4	42.5	33.1
Expenditures for employees	3,766.3	236.7	820.1	1,666.7	2,508.1	3,395.8	231.3	11.8	9.0	10.1	10.2	10.1	10.4	8.7
Purchase of goods and services	2,112.9	99.4	422.3	923.8	1,490.6	2,162.4	115.9	6.6	3.8	5.2	5.7	6.0	6.6	4.4
Interest payment	947.7	53.1	336.7	607.6	878.9	1,066.6	32.1	3.0	2.0	4.2	3.7	3.6	3.3	1.2
Subsidies	962.8	39.8	155.5	352.8	564.0	1,102.2	41.0	3.0	1.5	1.9	2.2	2.3	3.4	1.6
Social grants and transfers	5,734.0	432.6	1,384.1	2,825.0	4,284.1	5,828.9	441.0	18.0	16.4	17.1	17.3	17.3	17.8	16.7
of which: Pensions	4,180.6	320.1	1,004.1	2,022.1	3,043.3	4,026.3	318.8	13.1	12.1	12.4	12.4	12.3	12.3	12.1
Contributions for unemployed persons	103.7	8.4	25.6	50.4	74.1	103.0	7.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Sick leave	72.2	6.7	18.7	38.6	59.2	79.9	7.0	0.2	0.3	0.2	0.2	0.2	0.2	0.3
Social assistance	1,157.2	81.5	280.8	600.4	928.9	1,363.8	85.7	3.6	3.1	3.5	3.7	3.8	4.2	3.2
Other transfers to households	220.4	15.9	54.9	113.5	178.6	255.9	22.2	0.7	0.6	0.7	0.7	0.7	0.8	0.8
Other current expenditures	441.7	11.2	67.4	171.2	256.3	375.0	12.6	1.4	0.4	0.8	1.0	1.0	1.1	0.5
2. Capital expenditures	795.4	21.1	86.9	284.7	530.1	938.6	33.4	2.5	0.8	1.1	1.7	2.1	2.9	1.3
3. Activated guarantees	244.0	12.8	57.1	124.7	187.6	247.3	14.0	0.8	0.5	0.7	0.8	0.8	0.8	0.5
4. Net lending	455.6	0.0	4.0	11.2	16.8	22.4	2.1	1.4	0.0	0.0	0.1	0.1	0.1	0.1
III CONSOLIDATED BALANCE (I - II)	-2,124.0	129.6	-174.8	-291.0	-425.7	-1,221.4	244.6	-6.7	4.9	-2.2	-1.8	-1.7	-3.7	9.3
IV PRIMARY BALANCE (III - interest repayments)	-1,176.3	182.7	161.9	316.6	453.3	-154.8	276.7	-3.7	6.9	2.0	1.9	1.8	-0.5	10.5

Source: Ministry of Finance, Hypo Research

- The government need to finance deficit and maturity of previously issued debt stood at EUR 5 billion in 2015, and were chiefly serviced through borrowing, more so through issuing T-bills/bonds in the domestic market, and significantly less through borrowing from foreign governments and institutions and privatisation.
- The 2016 Budget Law envisages that this year's government financing need, measuring around EUR 5-5.5 billion (16%-17% of GDP) will be serviced through: (i) issuing T-bills/bonds in the domestic market (around 3.5 billion), (ii) issuing debt securities in the foreign market (around 1 billion), (iii) borrowing from foreign government and international financial organisations (around EUR 700 million).
- In accordance with such financing of the government needs, and given the recent strengthening of the US dollar, public debt at end-January 2016 rose by around EUR 2 billion from end-2014, reaching nearly EUR 24.8 billion or approximately 75% of GDP.
- Investors' interest for T-bills and T-bonds has been relatively strong along early 2016 in line with restricted investment alternatives. Thus the stock of these securities rose by app. EUR 200 m during 2M 2016.

Chart 23

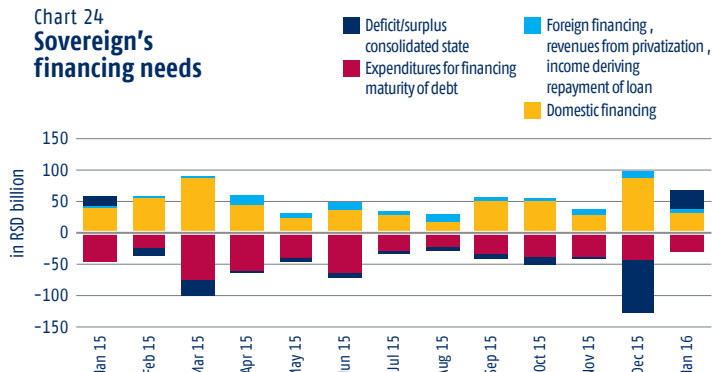
Average monthly budget execution consolidated state in the period 2010-2015



Source: Ministry of Finance, Hypo Research

Chart 24

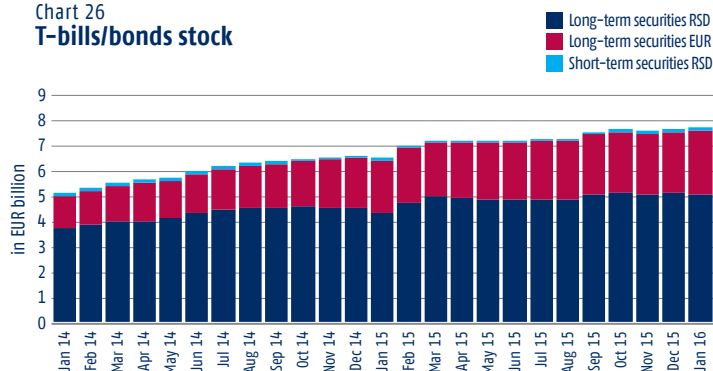
Sovereign's financing needs



Source: Ministry of Finance, Hypo Research

Chart 26

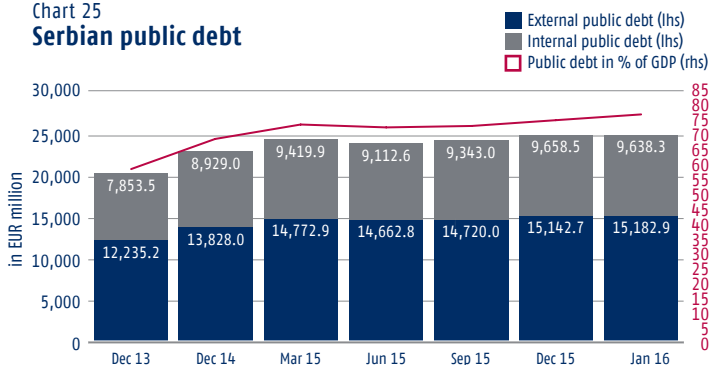
T-bills/bonds stock



Source: Ministry of Finance, Hypo Research

Chart 25

Serbian public debt



Source: Ministry of Finance, Hypo Research

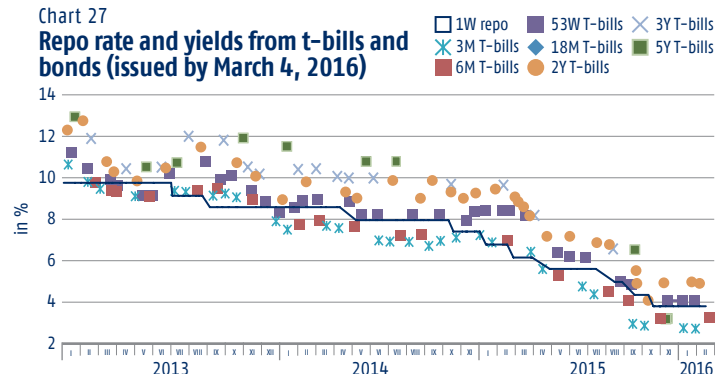
Money Market

T-bill/bond auction overview

- Having halted in late 2015 and early 2016, yields on T-bills/bonds followed further their slight downward path in the course of recent weeks, in line with the reintroduced cycle of monetary easing of the NBS, Chart 27.
- At the same time, foreign markets witnessed stagnation in yields on Serbian Eurobonds, while Eurobonds of other countries in the region saw a slight downward correction in recent weeks, Chart 28.
- Yields on Serbian Eurobonds, along with the Croatian ones, remain among the highest in Central and Eastern Europe, which might indicate still-higher risk perception of foreign portfolio investors in respect of the domestic economy.

Chart 27

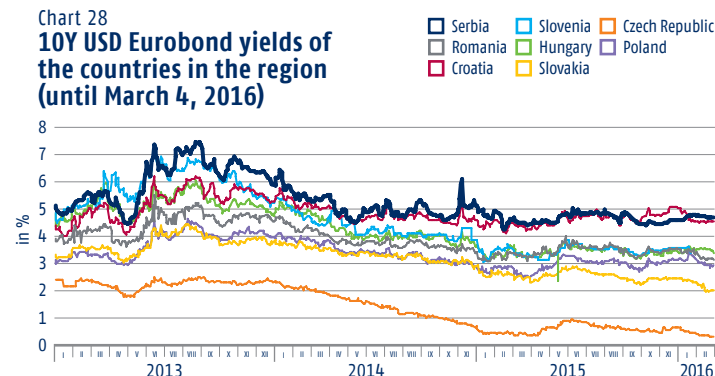
Repo rate and yields from t-bills and bonds (issued by March 4, 2016)



Source: Ministry of Finance, Hypo Research

Chart 28

10Y USD Eurobond yields of the countries in the region (until March 4, 2016)



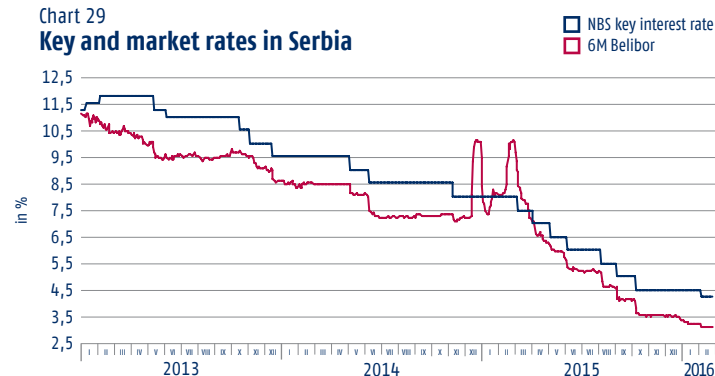
Source: Ministry of Finance, Hypo Research

Local money market and NBS open market operations

- In line with continued monetary easing cycle of the NBS, and excessive liquidity in the domestic banking system, market interest rates on dinar funds (Belibor) continued decreasing in early 2016, Chart 29.
- NBS' REPO stock gradually decreased during Q1 2016, reaching around RSD 20 billion in early March relative to around RSD 30 billion recorded at end-2015, Chart 30.

Chart 29

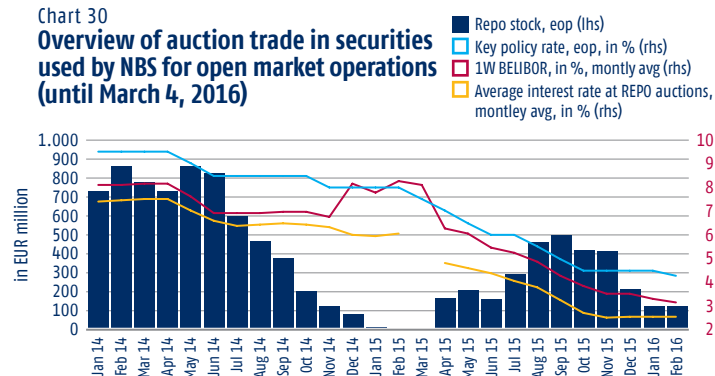
Key and market rates in Serbia



Source: Bloomberg

Chart 30

Overview of auction trade in securities used by NBS for open market operations (until March 4, 2016)

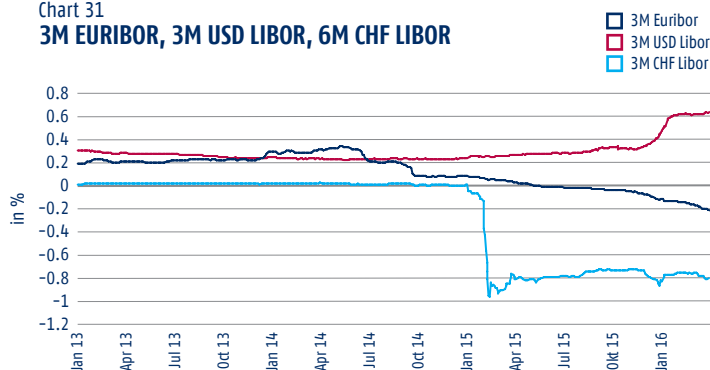


Source: National Bank of Serbia

International money market

- The gap between interest rates on the euro and dollar (USD Libor, Euribor, respectively) has widened significantly since December 2015, in line with (i) a hike in the US policy rate in late 2015, and (ii) extension of the ECB's QE programme in early 2016, Chart 31.
- The said trend of increasingly greater interest differences between market rates in the euro area and the USA will seemingly last into the upcoming months, given the relatively modest results of the ECB's QE programme and market expectations that this programme will expand and prolong.
- At the same time, the Swiss Libor continues treading in the negative zone, in line with a rather accommodative monetary policy of the Swiss National Bank.

Chart 31
3M EURIBOR, 3M USD LIBOR, 6M CHF LIBOR

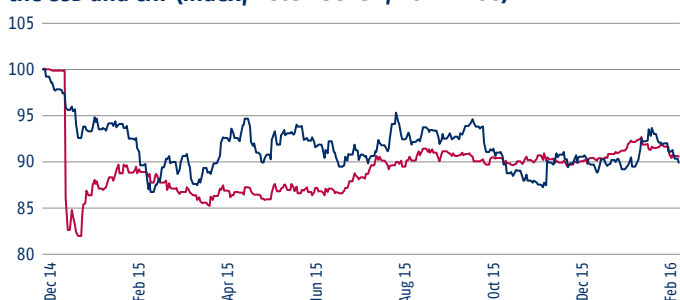


Source: Bloomberg

Major world currencies overview

- Having been relatively stable at the turn of the year, the euro has been gradually depreciating over the recent weeks vis-à-vis the US dollar and Swiss franc.
- The euro's weakening revamped most likely due to expectations of further diverging of interest differences between European and the US and Swiss market interest rates, so it is likely that the euro's depreciation trend will prolong into the weeks to come.

Chart 32
Movement in value of the euro* in relation to the USD and CHF (index, December 31, 2014=100)



* Values below 100 indicative of USD depreciation and values above 100 indicative of appreciation, in pp, relative to 2013 end.

Source: Bloomberg, Hypo Research

Table 12 Forecast of central bank interest rates, market interest rates and exchange rates (at March 5, 2016)

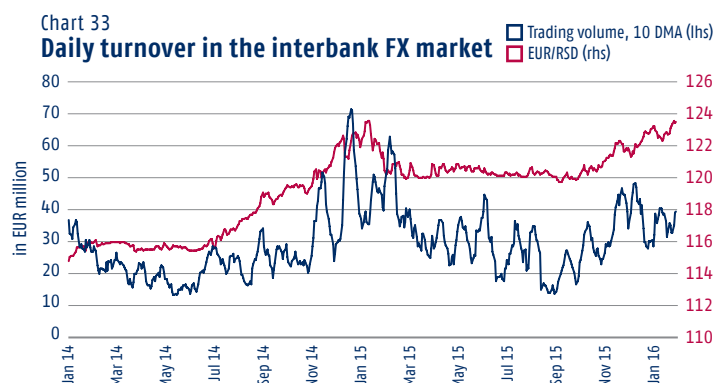
	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
central bank interest rates, in %					
ECB	0.05	0.05	0.05	0.05	0.05
FED	0.65	0.85	1.05	1.30	1.50
SNB	-0.65	-0.65	-0.70	-0.65	-0.65
market interest rates, in %					
3M Euribor	-0.14	-0.16	-0.15	-0.15	-0.16
3M USD Libor	0.69	0.92	1.12	1.33	1.58
3M CHF Libor	-0.76	-0.76	-0.77	-0.74	-0.65
exchange rates					
EUR / USD	1.06	1.05	1.04	1.05	1.05
EUR / CHF	1.08	1.09	1.11	1.11	

Source: Bloomberg contributor composite

FX Market

Volume of trading in the interbank FX market (IFEM)

- Early 2016 saw turnover in the interbank market rise, in line with the re-emerged depreciation pressures on the dinar, following the period of stability that lasted for the better part of 2015, Chart 33.



Capital Market

- Domestic, regional and European capital markets reported a slight drop in indices in early 2016, most likely in line with dampened market optimism worldwide.
- In such a surrounding, the turnover in the Belgrade SE in the first two months of 2016 reached nearly EUR 40 million, almost doubling from the

same period year earlier. Foreign investors accounted for nearly 40% of the amount, with AIK bank shares being traded the most.

- Market players' expectations for March 2016, expressed through the Belex Sentiment index, are relatively favourable, Chart 35.

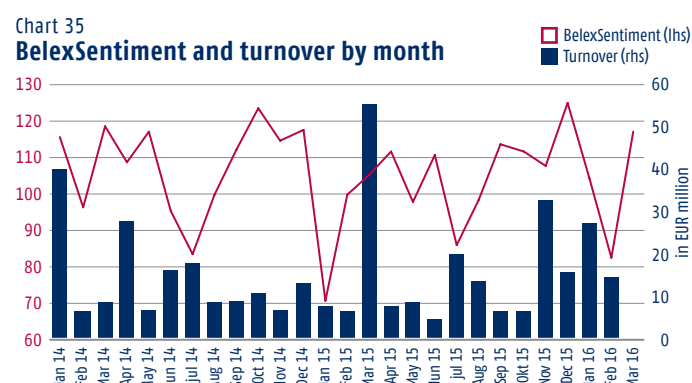
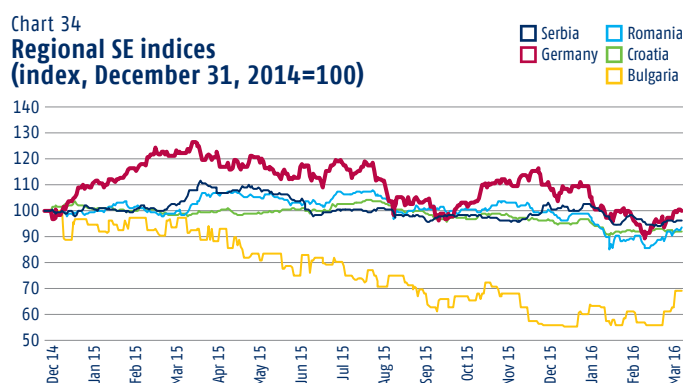


Table 13 **Most traded shares in 2 months of 2016**

Symbol	Issuer	Closing price (RSD)	Change (%)	Turnover (EUR)	Share in total turnover YTD (%)
AIKB	AIK banka a.d. Beograd	1,800	-2.1	5,197,858.1	12.4
NIIS	NIS a.d. Novi Sad	539	-10.2	1,442,035.3	3.4
ENHL	Energoprojekt holding a.d. Beograd	928	-10.5	793,847.6	1.9
MTLC	Metalac a.d. Gornji Milanovac	2,621	7.0	641,936.6	1.5
IMLK	Imlek a.d. Beograd	5,106	-1.4	289,745.4	0.7
AERO	Aerodrom Nikola Tesla a.d. Beograd	935	-18.9	263,774.9	0.6
FITO	Galenika Fitofarmacija a.d. Zemun	2,202	-7.3	257,799.4	0.6
TGAS	Messer Tehnogas a.d. Beograd	8,150	-6.3	163,480.6	0.4
KMBN	Komercijalna banka a.d. Beograd	1,499	-7.7	146,588.4	0.4
ALFA	Alfa plam a.d. Vranje	33,500	-1.3	145,003.8	0.3

Source: Belgrade SE

