

Analysis: Real economy sector

Economic recovery or statistical effect?

At first glance, GDP growth in the first quarter of 2013 pointed to a new cycle of growth of domestic economy. However, what we had here was a low-basis statistic effect, because in the same period last year GDP had fallen by 1.7%. Therefore, the 0.9% GDP growth in the first quarter of this year represented merely a partial compensation of the last year's fall.

After four consecutive quarters of economic decline during 2012, the beginning of 2013 brought recovery and (at least formally) enabled the Republic of Srpska to exit recession. Spearheaded by positive progressions in process industry (+10.2%), in the first quarter of this year GDP increased by 0.9%. However, all other key fields of economy

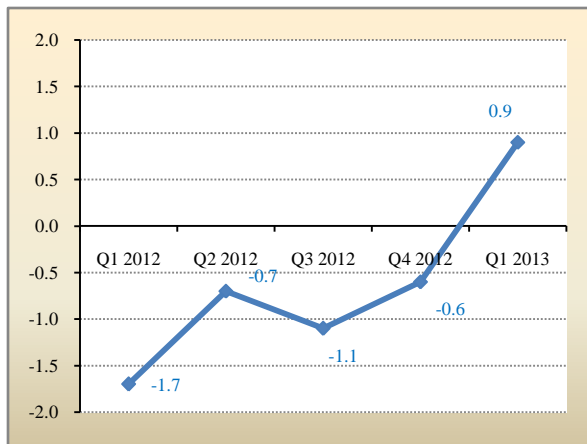
remained in the area of economic contraction: agriculture -2.0%, extraction of ore and stone -2.6%, electro-energy industry -0.3%, construction -5.6% and trade -1.7%.

At first glance, GDP growth in the first quarter of 2013 pointed to a new cycle of the growth of domestic economy. However, what we had here was a low-basis statistical effect, because in the same period last year GDP had fallen by 1.7%. Therefore, the 0.9% GDP growth in the first quarter of this year represented merely a partial compensation of the last year's fall. The best

illustration of our current position is the information that realistic GDP value from the first quarter of 2013 was 1% lower than GDP value from the first quarter of 2008.

According to the estimations of the European Central Bank, the euro zone will end 2013 also with a GDP decline of 0.6% this time. Another year in recession awaiting countries in the region, with an exemption of Serbia, which realized GDP growth of 2.1% in the first quarter of 2013 and 0.7% in the second, along with the euro zone crisis, makes it less likely that RS will realize more significant growth over next quarters. In such circumstances, due to the decline of exportation demand for domestic products, it is almost certain that there will not be a more significant contribution of exports and, thereby, indirectly, exportation-oriented industrial sectors, to the overall economic growth.

Figure 1: Realistic GDP growth rates in RS, in %



Source: Institute of Statistics of RS

Basis effect

In the period from January to March 2012, process industry declined by as high as 9.3% and that period represented a very low basis for comparison. Therefore, major portion of industrial growth in the first quarter of this year could be attributed to the low-basis effect. The basis effect had manifested during the first quarter of 2010 as well, when the 12.5% growth of process industry had been preceded by a fall of 6.2% over the same period in 2009.

According to the IMF's estimations for 2013, Croatian economy will suffer 0.2% decline, Slovenian 2.0%, while Italian economy will decline by 1.8%. Over the same period, Serbia's GDP should grow by 2.0%.

After fall, industry keeps positive growth parameters

Thanks to a significant growth in the second quarter, the industry of RS left negative zone in 2013. Following the fall by 0.2% in the first quarter this year, industrial manufacture increased by 3.0% after the first six months. In this period, process industry grew by 6.8%, electro-energy sector by 2.8%, while the extraction of ore and stone fell by 2.7%.

Production in B&H

At B&H level, physical volume of industrial production increased by 7.0% in the first six months this year. Process industry grew by 10.4%, electro-energy sector by 9.9%, while the sector of ore and stone extraction fell by 8.2%.

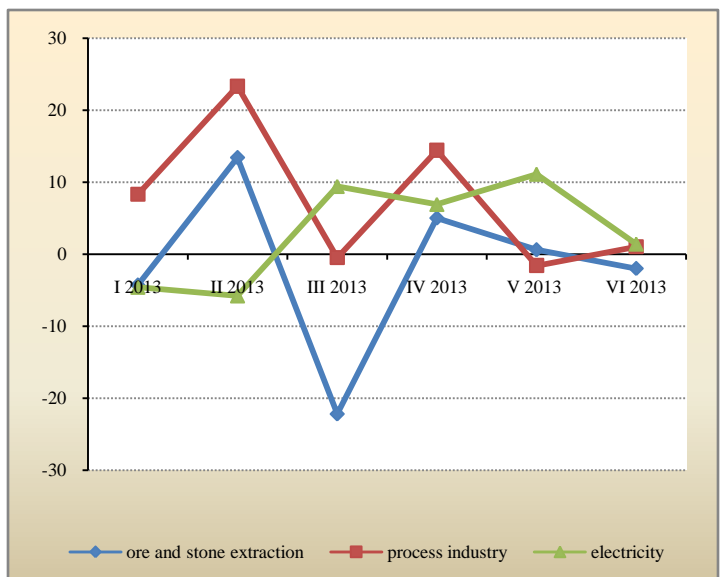
As in the case of total economic growth, positive industrial results were related to the last year's low basis for reference. Therefore, strong growth of textile industry over the first six months of 2013 by 25.9% was preceded by the fall of almost 50% over the same period in 2012. After the last year's stagnation, wood processing industry realized growth of 15.6%, while almost identical statistical effect was present in the case of food (+16.7%) and beverage production (+13.6%) as well.

2013 has brought further strengthening of negative economic tendencies in the area (EU, neighboring countries), which certainly does not positively affect the domestic business activity. It is only the beginning of growth predicted for European economy over the next year that should contribute to the recovery of the entire region, including our country.

"Motor" dying out?

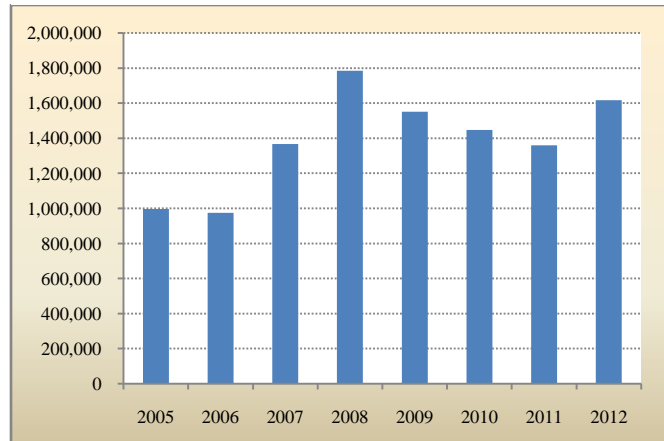
Former "motor" of the industrial growth of RS – oil sector – after the fall of 14.3% in 2012 continued with negative results in 2013 (-11.0%).

Figure 2: Growth of industrial sectors in RS, in %



Source: Institute of Statistics of RS

Figure 3: Investments in fixed assets, in 000 BAM



Source: Institute of Statistics of RS

Three-year fall of investments stops

The three-year period of constant decrease of investments in RS stopped in 2012. In the last year, investments in fixed assets grew by the inter-year rate of 18.9%. The decrease of investment in buildings of 7.5% was compensated by the increase of investment in machines and equipment of 15.7% and other investments of almost 380%.

In the structure of investments, public sector dominated with 19.4%, followed by ore and stone extraction with 16.5% and electro-energy sector with 15.1%. Sector structure of realized investments directly reflected the lack of competitiveness of domestic economy structure, as well as extremely great relative significance of public sector and its domination in overall social and economic tendencies.

In the first six months of 2013, according to revised data from the Ministry of foreign trade and economic relations of B&H, direct foreign investments in B&H amounted to 117.65 million BAM, out of which almost 77 million BAM related to electro-energy sector. However, in comparison to the same period last year, total foreign investments in B&H economy decreased by over 60%.

Foreign investments in the electro-energy sector of RS

In the first half of 2013 ETF Rudnik and Power Plant Stanari Ltd. invested 67.4 million BAM and "Comsar energy" RS invested 9.5 million BAM.

Continuation of depression in construction sector

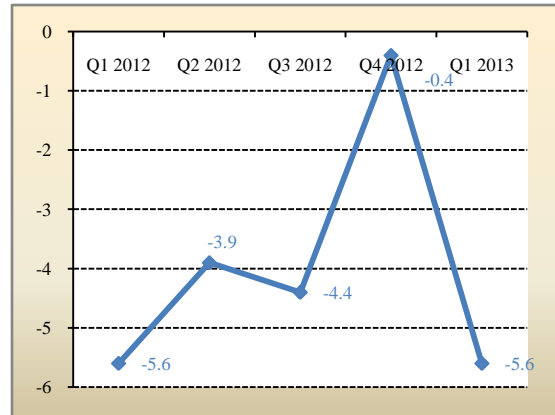
For the fifth consecutive year the construction sector of RS scored negative results. In the first six months of this year the value of performed construction works decreased by additional 3.4%, while the number of hired workers was less by 5.7%. Several years of bad results led to continuous weakening of relative significance of this sector of economy, whose share in GDP decreased from 6.1% in 2008 to 4.3% in 2012.

The level of construction activity well portrayed tendencies of investment and individual consumption of this economy sector and general population.

Construction in decline

The GDP growth during 2010 and 2011 of 0.8% did not bring the recovery of the construction sector of RS as well. Quite contrary, the decline of 8.8% or 5.4% respectively was registered.

Figure 4: Realistic growth rates of the construction sector of RS



Source: Institute of Statistics of RS

However, experience has told us that moderate recovery of overall economic activity, realized over the first quarter, did not also mean a change of tendencies in construction sector. In fact, what is needed to stop the multiyear depression in this

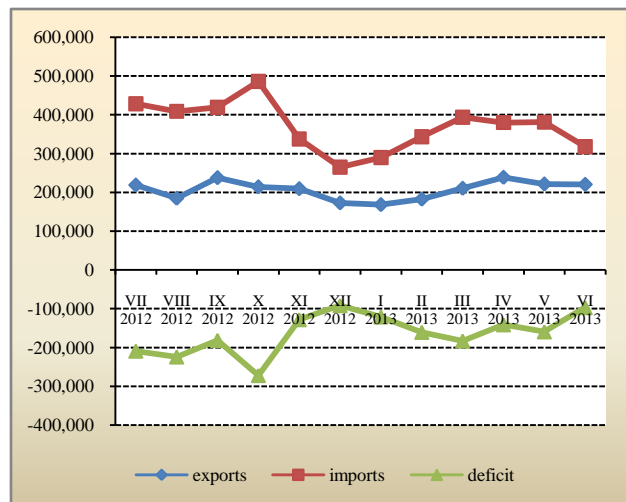
sector is stronger economic growth with signals of its longer sustainability.

Exports-imports ratio improves

Following the last year's contraction of 7.3%, exports from RS increased by 5.1% over the first six months of this year. On the other hand, influenced by the decrease of domestic consumption, imports declined by 1.9% on inter-year level. Semi-annual foreign trade results improved the rate of covering imports with exports, which increased from 52.9% in 2012 to 59.0%.

Slowdown of economic activity and declined demand in most important trading partner countries resulted in 7.3% decrease in the exports of raw materials. Besides that, in visible trade of these cyclically extremely sensitive products, since the beginning of the year, RS realized profit of over

Foreign trade activity of RS in 000 BAM



Source: Institute of Statistics of RS

150 million BAM.

The decline in the production and consumption of oil and oil derivatives affected the imports of mineral fuels and lubricants, especially for the needs of process capacities in RS. Under such circumstances, imports of this product category, which made 1/3 of total imports, decreased by 11%.

Fuel turnover declines

In the first quarter of 2013 the value of fuel turnover in retail in RS decreased by 25.4% in comparison to the last quarter of last year.

Over the next period, foreign trade results will depend on the dynamics of domestic market recovery and on economic recovery of countries in the region, including the EU, as the most important trading partner of RS and B&H.

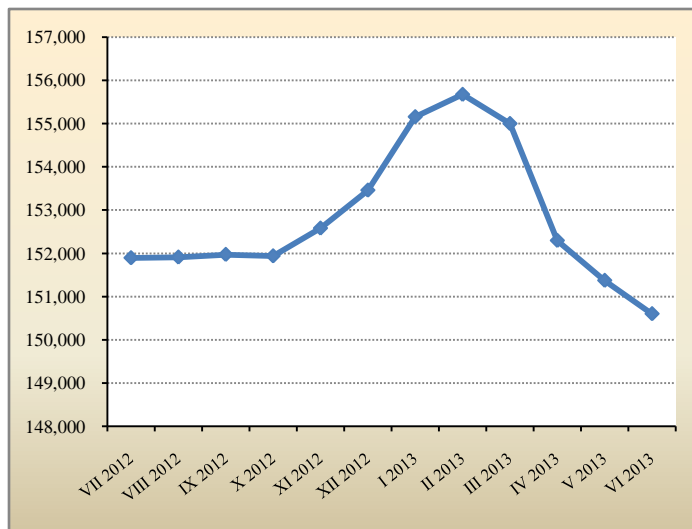
Besides that, the change of trade regime with Croatia, which has come into force as this country has become an EU member, represents a chance for the domestic economy in terms of increasing its internal competitiveness, but also for attracting new investments, including Croatian, thanks to the advantage B&H still has as a member of CEFTA.

Chronical problem remains – record unemployment rate reached

Since the beginning of this year, the number of unemployed persons in RS dropped by 2%. Thanks to this positive trend, which was influenced by

the opening of temporary and season jobs in spring and summer, the number of the unemployed registered by the Employment Bureau of RS decreased to 150 601 persons (in comparison to almost 156 000 from the beginning of last year).

The number of unemployed persons in RS



However, the effects of the decrease in the number of unemployed persons were not sufficient for the improvement of already grim

The number of the employed drops

In March 2013, in RS there were 236 975 employed persons, which was 0.8% less than in September last year (238 836).

Source: Institute of Statistics of RS

image at the domestic labor market. On the contrary, in a situation with continuous decrease in the number of employed persons, the unemployment rate in RS reached new record of 27.0%, which only confirmed that the initial RS Government’s expectations, according to which this rate should have been decreased from 25.6% in 2012 to 25.5% in 2013, had been over-optimistic.

Income less than living costs

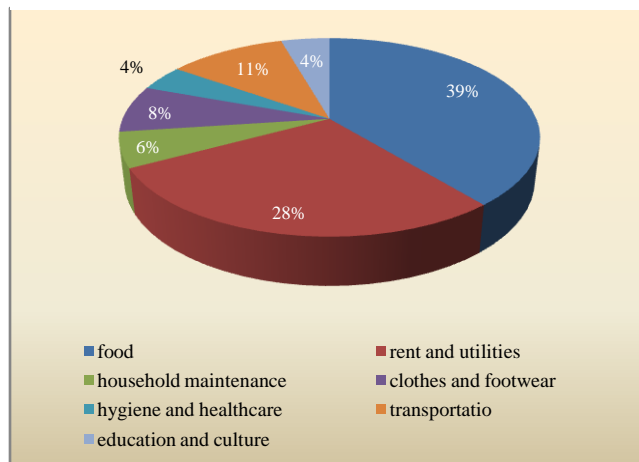
Average nett wage in RS in June amounted to 816 BAM, which was in realistic terms 1.1% less than in the same period last year. In nine of totally 19 areas of business, average wages were not sufficient to cover even food costs, which amounted to 705 BAM, according to the consumer basket. In this period, an average of “the best paid sector”, financial sector, (1320 BAM) covered only 70% of elementary living costs of a four-member family in RS (1809 BAM).

Entity authorities

In public bodies of entity authorities of RS in 2012 there were 34 421 employees, with the total of 722.6 million BAM spent on their wages.

The decline of purchasing power and living standard of general population, with extremely high unemployment rate, represents one of the greatest problems of the domestic economy. Additional employment in public sector certainly is not going to solve this problem. Even though RS made obligation to the IMF in the Letter of Intent from September 2012 that it would...“decrease allocations for gross wages and allowances share of GDP over a midterm period...”, the Government of RS adopted a decision, after an initial 10% decrease, that wages of all budget users were to be increased by 5% in the second half of 2013. However, in this moment it seems a little unlikely that this year’s economic growth will be sufficient for absorbing on the basis of this increased public expenditure.

The consumer basket structure in June 2013



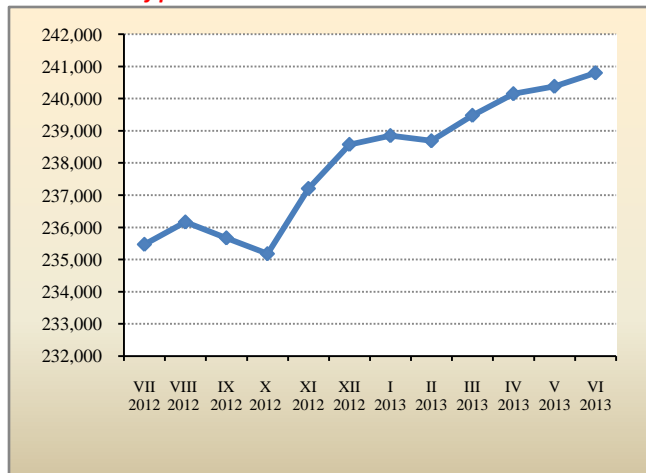
Source: Alliance of Independent Trade Unions of RS

Growth of pensioner population continues

At the end of the half of 2013, almost 1/5 of population in RS was pensioners. In June, more than 72.8 million BAM was paid to 240 800 pensioners, out of which 13 million BAM was ensured from the budget of RS.

In RS, ratio of pensioners and insured persons has been exposed to continuous distortion thanks to which this ratio is currently 1:0.98 in favor of the pensioner population! The fall of overall

The number of pensioners in RS



Source: Fund for Pension and Disabled Persons Insurance of RS

employment negatively affected the payment ability of the Fund for Pension and Disabled Persons Insurance of RS. During 2012, income derived from wage contributions decreased for over 20 million BAM, and for additional 2 million BAM in the first six months of 2013.

Ratio of average pension and average wage

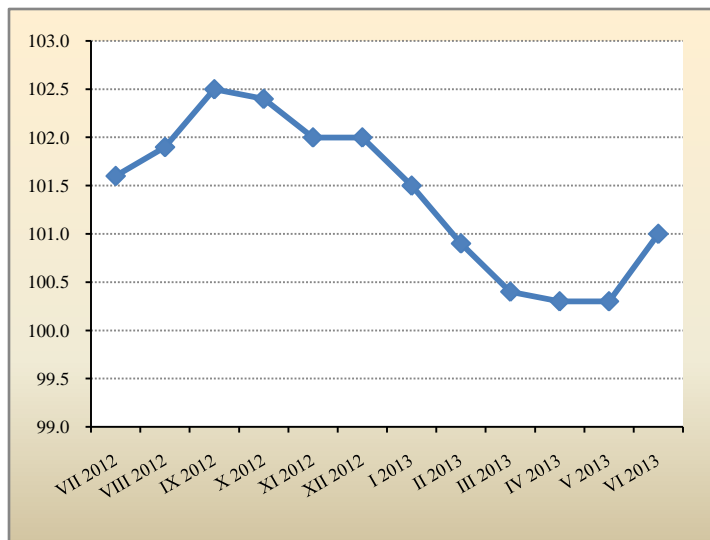
In RS the average pension made 38.16% of the average wage, in the Federation of B&H 42.25%, in Serbia 60.22%, in Slovenia 56.99%, in Croatia 39.29%, in Montenegro 56.64% and in Macedonia 52.02%.

Stable growth of the pensioner population represents a serious pressure for the sustainability of the pension system of RS. Already low pensions do not leave space for new cuts on the account of this socially vulnerable population category.

Inflation slows down, but food gets more expensive

Influenced by weakened domestic demand and purchasing power of the population there was a significant slowdown of inflation tendencies in RS. Hence, general level of prices rose only 0.7% in the first half of 2013, which was the lowest inflation rate since 2009, taking into consideration its annual values.

Consumer prices index in RS



Source: Institute of Statistics of RS

First half of the year was characterized by the growth of prices of food by 2.7%, tobacco 7.5% and utilities by 4.7%. Anyway, price growth in the product categories and services mentioned represented a direct attack onto the living standard of RS citizens. On the other hand, “cheaper” were only clothes (-6.1%), footwear (-10.9%) and electricity (-0.2%), while oil price fall at world stock markets (-6.5% since the beginning of the year) enabled moderate decrease of transportation costs by 0.6%.

According to the estimations of the IMF and World Bank, prices of energy and food at world markets will decrease during 2013. Such development of global tendencies should surely reflect on domestic price tendencies as well, since these are predominantly determined by external factors. However, since April, a trend of more intense growth of prices of food products in RS has been registered, which could, if it continues, represent an additional impulse to overall inflation tendencies in the upcoming months.