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Republic of Serbia: Fourth Review Under the Stand-By Arrangement and Requests for Waiver of Non-Observance of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on **May 25, 2010**, with the officials of the Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on **June 11, 2010**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement by the IMF Representative on the Republic of Serbia

- A Press Release summarizing the views of the Executive Board as expressed during its June 28, 2010 discussion of the staff report for the Republic of Serbia

- A statement by the Executive Director for the Republic of Serbia

The document(s) listed below will be separately released

Letter of Intent sent to the IMF by the authorities of the Republic of Serbia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

Fourth Review Under the Stand-By Arrangement and Requests for Waiver of Non-Observance of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review

Prepared by the European Department
(In consultation with other departments)

Approved by Adam Bennett and Michele Shannon

June 11, 2010

Discussions. A staff team visited Belgrade during May 13–25 to conduct the Fourth Review of the Stand-By Arrangement (SBA). The mission met with Prime Minister Cvetković, Deputy Prime Ministers Dinkić, Djelić, and Krkobabić, Minister of Finance Dragutinović, Labor Minister Ljajić, National Bank of Serbia (NBS) Governor Jelašić, other senior officials, representatives of international financial institutions (IFIs), the European Union (EU), and the private sector. The staff team comprised Messrs. Jaeger, Floerkemeier, Hajdenberg (all EUR), Mr. Arnason (SPR), Ms. Jenkner (FAD), and Mr. Podpiera (MCM). Mr. Lissovolik (Resident Representative), Ms. Nestorović, and Mr. Kokotović (local IMF office) assisted the mission. Mr. Antić (OED) attended most meetings.

Stand-By Arrangement (SBA). The SBA, approved by the Executive Board on January 16, 2009, was extended to 27 months and augmented to the amount of SDR 2.6 billion (560 percent of quota) on May 15, 2009 (EBS/09/63). The amount available at the completion of this review is SDR 319.6 million, but the authorities have indicated that they intend to purchase SDR 46.7 million (10 percent of quota).

Program status. The general government deficit exceeded the program ceiling, but all other end-March 2010 performance criteria were met. The indicative ceiling on accumulating guarantees was also exceeded by a small amount.

Key issues: The focus of the review was on three issues: (i) an exit strategy from the nominal public wage and pension freezes; (ii) pension and fiscal responsibility legislation that could support sustained fiscal adjustment beyond the SBA horizon (April 2011); and (iii) Serbia's balance of payments needs for the remainder of the SBA horizon, with a view to determining the appropriate level of the remaining drawings under the SBA.

Publication. The Serbian authorities have consented to publishing the staff report.

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Executive Summary

Growth momentum has stalled, and the near-term outlook has deteriorated since the last review. Concerns about possible spillovers from the Greek crisis and the wider turmoil in the EU have cast a shadow over the region's and Serbia's growth prospects. A weaker and more uncertain external environment is likely to hamper exports and investment. Projected real GDP growth for 2010 has been lowered from 2 percent to 1½ percent.

Fiscal revenue has been adversely affected by the weaker-than-expected economic performance. Tax collections, particularly of indirect taxes related to imports and consumption have lagged expectations; the end-March 2010 ceiling for the general government fiscal deficit was missed by a small margin.

On a positive note, inflation has come down to the low single digit range, and immediate concerns about external financing have abated. CPI inflation is expected to undershoot the NBS's inflation target range in the first half of the year and be close to the target by year-end. The current account deficit is expected to widen again in 2010, but prospects for the financing of the external deficit and debt repayments remain favorable, notwithstanding increased uncertainty about regional developments.

The policy discussions focused on the near- and medium-term fiscal challenges. In line with the fiscal strategy, it was agreed that there would be no scope for significant additional fiscal spending in 2010–11. The automatic stabilizers would, however, be allowed to operate on the revenue side, resulting in the upward revision of the deficit targets for both years, to 4¾ percent of GDP in 2010 and to 4 percent in 2011. However, reducing the deficit to 1 percent of GDP by 2015 remains a key anchor for Serbia's fiscal consolidation strategy.

Agreement was reached on an exit strategy from the current nominal public wage and pension freezes. In 2011 and 2012, public wages and pensions will be adjusted semi-annually, indexed to CPI inflation plus one-half of the real GDP growth rate in the previous year. A draft pension law will be submitted to parliament in June, which incorporates parametric reforms and the agreed indexation mechanism for pensions. The submission of fiscal responsibility legislation to parliament, which would also incorporate the indexation rule for public wages, has been postponed until the next review.

I. Recent Developments

1. **Recovery momentum has stalled, with impulses from exports and private investment too weak to underpin a more robust expansion.** Despite high pre-crisis vulnerabilities, Serbia's output collapse in 2009 was moderate by regional standards (Figure 1). But the nascent growth recovery that was apparent in the second half of 2009 has for now lost momentum. Since early-2010, industrial production has moved sideways, while retail sales continued to contract. Exports were helped by the weaker real exchange rate, but demand from Serbia's key trading partners in the EU and the region remains lackluster. Moreover, drawn-out corporate deleveraging and tight credit conditions are crimping private investment. As a result, while first-quarter GDP growth (y-o-y) turned positive, it fell well short of the pace (about 3 percent) needed to halt further declines in formal employment (Table 3).

2. **As regards internal balance, disinflation is taking hold, but there are upside risks** (Figure 2). CPI inflation was 4¼ percent in April, below the NBS's target range, notwithstanding a series of cuts in the policy rate. The pronounced decline in actual inflation is also reflected in a gradual lowering of inflation expectations. But food price inflation has likely reached its lowest point, while exchange rate pass-through and higher energy prices will add to inflationary pressures.

3. **In the wake of the Greek crisis, the dinar came under renewed depreciation pressures** (Figure 3). With the deterioration in investor sentiment toward the region in reaction to the Greek crisis, depreciation pressures re-surfaced in most Eastern European countries, and the dinar exchange rate has breached the psychologically-important 100 dinar/euro level. The initial phase of the Greek crisis was also accompanied by limited deposit withdrawals from Greek subsidiaries.

4. **Performance under the program has been broadly on track** (Tables 1–2). Except for the ceiling on the general government deficit, all end-March 2010 performance criteria were met. The breach of the deficit ceiling was small and caused by a shortfall in tax collections, mainly indirect taxes (Table 7). The indicative ceiling on accumulating domestic guarantees was also exceeded by a small amount, but this mainly reflected substitution of a less expensive domestic guarantee for an external guarantee. Some progress has been made on structural reforms, but the end-May structural benchmarks for the pension reform law and fiscal responsibility law were missed. The pension reform law will be submitted to parliament in June, a prior action for completing the review; while the authorities have completed a first draft of the fiscal responsibility legislation, substantial work is still needed, and the legislation is now scheduled to be submitted to parliament in September.

II. Policy Discussions

A. Macroeconomic Framework

5. **Sustaining and accelerating the economic recovery has become more challenging.** The projection for GDP growth in 2010 has been scaled back to 1½ percent (LOI ¶5, Tables 3–6). The main positive impulse for GDP growth in 2010 is expected to arise from public investment, while private investment and exports are projected to gain momentum only in 2011.

6. **The outlook for inflation and external financing has improved**. Inflation is projected to rebound in the second half of 2010, ending the year close to the NBS's target of 6 percent (±2 percent) (LOI ¶6). While inflation expectations are still elevated, weak aggregate demand will likely keep inflation in check. The main risks to this projection are a larger pass-through of depreciation, a faster-than-projected recovery of domestic demand, and higher-than-projected food and fuel prices. Prospects for the financing of the current account deficit are more favorable (Tables 9–10, LOI ¶8). The external deficit is projected to be covered by FDI—including through privatization—and financing from IFIs. Gross international reserves are projected to see a small decline assuming Serbia makes only limited further drawings. Gross external debt would peak at about 78 percent of GDP in 2010, but then decline substantially over the medium term (Appendix I).

7. **Adverse spillovers from Greece are the main downside risk**. Serbia's direct trade with Greece is small (Figure 4). But Greece has been an important FDI provider to Serbia, and, with equity prices of Greek parent banks plunging over the last few months, their bank subsidiaries in Serbia have also come under increased scrutiny. However, the Greek subsidiaries are highly capitalized and liquid, and should be able to withstand even challenging adverse scenarios.

B. Fiscal Policy

8. **The authorities' fiscal strategy remains anchored by a low medium-term fiscal deficit target and a fiscal strategy focused on reducing current spending** (Table 7, LOI ¶10). The medium-term deficit target of 1 percent of GDP would ensure fiscal sustainability, with the debt-GDP ratio again falling below 40 percent over the medium term (Appendix II). A low medium-term deficit target, combined with higher capital spending, would also contribute to much-needed higher domestic savings. Containing the high public wage and pension bills will be essential to attain the medium-term deficit objective.

9. **The fiscal strategy is centered on a prudent exit from the present nominal public wage and pension freezes** (Box 1). In line with earlier understandings, it was agreed after some debate that public wages and pensions would remain frozen through 2010, while lower-income recipients would receive limited one-off relief. For 2011–12, the authorities

plan to index both public wages and pensions to CPI inflation plus ½ of real GDP growth in the previous year (LOI ¶11–12). The government will also issue a decision that administrative staff cuts will be implemented as enacted by a December 2009 law, a prior action for completing the review.

Box 1. Nominal Freezes: Why Not Exit Early?

There have been strong popular pressures to unfreeze public wages and pensions early, beginning in the second half of 2010. Moreover, some have argued that lifting the freezes early would provide the economy with much-needed demand stimulus.

The review discussions suggested, however, that an early exit could be counterproductive:

Higher public wages and pensions may mainly stimulate inflation and imports. The slack in the economy is concentrated in construction, capital goods, and intermediate goods sectors; capacity underutilization in the consumer goods and services sectors is less prevalent. Higher demand due to higher public wages and pensions might therefore mainly push up prices or leak into imports.

Higher taxes would be needed to finance higher public wages and pensions, undermining the credibility of the fiscal adjustment strategy. Raising taxes to finance higher wages and pensions would run counter to the authorities' declared fiscal strategy to adjust mainly through spending restraint, while avoiding significant tax increases.

10. **For 2010, the fiscal deficit target was raised from 4¼ to 4¾ percent of GDP, reflecting the projected shortfall in revenues** (LOI ¶14**).** This is in line with allowing automatic fiscal stabilizers on the revenue side to operate, given that there are limited concerns about constraints on financing or the possible crowding out of private investment. It was also agreed that any overperformance of revenues relative to current projections would be saved, on the principle that automatic stabilizers should be allowed to work in both directions (LOI ¶15.) For 2011, policy will be geared toward a fiscal deficit of 4 percent of GDP, with policy details to be agreed during the next reviews.

11. **Serbia's tax administration and tax structure could be improved.** Private sector representatives expressed less concern about the level of tax rates than about sudden tax policy changes and highly discretionary actions by the tax administration. Tax reform should therefore be part of a medium-term fiscal strategy, supported by stronger tax administration. The authorities have continued efforts to meet the structural benchmark on adopting a tax compliance strategy (LOI ¶17). The authorities are also considering revenue-neutral options to increase incentives of businesses and employees to operate in the formal economy by reducing Serbia's relatively high labor tax wedge while increasing indirect taxes (LOI ¶16).

12. **Although they will need more time, the authorities remain committed to introducing fiscal responsibility legislation to buttress policy credibility**. The draft law is

planned to propose numerical fiscal rules, including potentially a fiscal balance rule (Box 2), create a fiscal council, and implement further steps to improve public financial management (LOI ¶13).

Box 2. A Numerical Fiscal Balance Rule for Serbia: Should Output Fluctuations Play a Role?

A good fiscal balance rule should satisfy four criteria: (i) ensure sustainable medium-term deficit and debt levels; (ii) avoid unrealistic large adjustments; (iii) limit procyclicality; and (iv) avoid temporarily high deficits if a country has to overcome a history of fiscal dominance. A general fiscal balance rule is: 1/

$$b(t) = b(t-1) - \alpha[b(t-1) - b^*] - \beta[g(t) - g^*(t)],$$

where b is the deficit-GDP ratio, b^* is a medium-term deficit objective, g is the actual real GDP growth rate, g^* is potential growth; α and β are parameters that capture how responsive the deficit would be to deviations from the target deficit and output fluctuations around potential growth, respectively.

This rule could, however, be difficult to implement and communicate to the public due to the output fluctuation adjustment. The question therefore is: Under what circumstances would dropping the output fluctuation term be warranted?

Staff simulated this rule for Serbia assuming a starting value for the deficit b of 4¾ percent of GDP in 2010, α=0.25, β=0.40, and b^*=1 percent of GDP. Growth during 2011–15 was assumed to evolve according to a wide range of growth scenarios.

Taking account of output fluctuations resulted in superior outcomes for the first three criteria under two conditions: (i) there are significant cyclical output fluctuations; and (ii), forecasters have perfect foresight. But under plausible growth scenarios, the rule also produced temporarily high fiscal deficits in the 5-7 percent of GDP range, which could raise issues of policy credibility in the Serbian context.

However, assuming more realistically that forecasts are based on adaptive expectations, and that deficits should not exceed a threshold of 6 percent of GDP, a simplified rule that does not take into account output fluctuations provided a surprisingly robust option that fared reasonably well according to all four criteria.

1/ This rule was proposed by Marin (2002), ECB WP 193, for euro-area countries under the Stability and Growth Pact.

C. Monetary and Exchange Rate Policies

13. **There may be some scope for further cautious easing of the monetary stance** (LOI ¶19). However, the room for further cuts in the key policy rate will likely be restricted, not least in view of the dinar's breach of the 100 dinar/euro level. The authorities noted that

the recent depreciation reflects a region-wide re-assessment of domestic currency assets, and that it will not endanger meeting the inflation targets. At the same time, inflation expectations have started to converge toward the NBS target range, but remain still uncomfortably high and not well anchored. Therefore, upside inflation risks from dinar depreciation, a rebound in food prices, and a possibly faster-than-expected pick-up in economic activity need to be monitored closely. The authorities intend to maintain a flexible exchange rate regime, consistent with the inflation targeting framework (LOI ¶20).

14. **A revised NBS law has been forwarded to parliament.** The amendments will strengthen the NBS's independence in many important areas (LOI ¶21).

D. Financial Sector Policies

15. **Serbia is prepared to handle possible spillovers from Greece to the Serbian banking system** (LOI ¶25). The existing crisis management framework gives the authorities adequate tools to deal with a range of possible spillover scenarios (Box 3).

Box 3. Greek Crisis Spillover Scenarios

Notwithstanding banks' large capital and liquidity buffers, several scenarios could be considered, including:

Solvency problems at Greek parent banks: The financial stabilization fund established under Greece's SBA is seen as providing a strong first line of defense against this contingency.

Parent banks seeking to extract liquidity from subsidiaries: This scenario is considered unlikely, and would provide little liquidity relative to potential needs of parent banks, while activating corrective NBS actions to ring-fence the subsidiaries.

Deposit runs in Serbia: The authorities have considerable practical experience with handling runs, and the buffers against deposit runs are sizable.

Sale of subsidiaries: Given Serbia's unconcentrated banking market, Greek subsidiaries could be attractive acquisition targets. However, a potential complication could be large contingent liabilities of subsidiaries to parent banks arising from cross-border loans.

16. **Notwithstanding the recent lowering of exposure limits, foreign parent bank exposures have remained stable.** Effective April this year, exposure limits under the Bank Coordination Initiative were lowered from 100 percent to 80 percent of the end-2008 level. Nevertheless, end-April data indicate that banks as a whole have maintained their earlier exposures, with only a few banks falling below the new limit.

Serbia: Exposure of Foreign Parent Banks 1/
(percent of end-2008 exposure)

	Aug. 2009	Dec. 2009	Apr. 2010
Total exposure	97.5	101.6	101.2

Source: National Bank of Serbia.
1/ Excludes balances in FX float accounts.

17. **The authorities are proactive in reducing the risks from high euroization** (LOI ¶22). The authorities are focusing on measures to develop the secondary local currency bond markets and the FX-hedging market. The former is needed to establish a benchmark dinar yield curve and to provide dinar liquidity, while the latter will allow market participants to improve their currency risk management.

E. Structural Policies

18. **Structural reforms are increasingly focused on enhancing Serbia's export capacity (**(LOI ¶26–28). During the pre-crisis boom, capital inflows and foreign investment were largely channeled into non-tradable sectors—they received 80 percent of FDI and the bulk of bank loans. The authorities plan to step up reforms to shift toward a more balanced growth model:

- **Privatization.** This would boost exports and domestic savings, through higher corporate savings. Even after the envisioned privatization of a stake in Telekom, the still-large public enterprise sector offers scope for further privatization.

- **Improving the business environment.** This is crucial especially for exporters and foreign investors who tend to operate in the formal economy.

- **Increasing competition.** This would reduce margins and rents in the shielded nontradable sectors, releasing productive resources to tradable sectors.

- **Upgrading infrastructure.** This would help move goods and services across borders. The authorities are planning to increase public investment, make investment more efficient, and strengthen medium-term planning.

- **Strengthening procurement.** This would inject more competition in the economy through a larger role for competitive bids. It will also improve competitiveness by helping fiscal consolidation and improving the efficiency of public investment.

III. Program Issues

19. **While potential needs associated with regional uncertainty support maintaining programmed access at current levels, the authorities have indicated that their current needs can be met with partial drawings.** While Serbia's gross FX reserve position appears comfortable from a cross-country perspective (Figure 5), free FX net reserves, defined as net foreign assets minus the repo stock, are significantly lower (Figure 3). Moreover, while projected net capital inflows leave only relatively small financing gaps, there are considerable region-wide uncertainties attached to these flows. Following the completion of the third review, the authorities drew only half of the amount made available and indicated that they wanted to revisit access for the remainder of the arrangement, consistent with changes in their underlying circumstances. Consistent with the authorities' BOP needs, they intend to request a partial drawing of SDR 46.7 million following completion of the fourth review and, at this stage, would intend also to seek partial drawings of similar scale for the final three reviews. The EU has also indicated that disbursement of €100 million in macro-financial assistance and €50 in grants is linked to disbursements under the Fund arrangement.

IV. Financing Assurances Review

20. **Progress continues to be made toward settling remaining official external debt issues—including external arrears**. Regarding the renegotiation of restructuring agreements with Paris Club members following the break-up of the Union of Serbia and Montenegro in 2006, the authorities' estimate that in excess of 80 percent of the outstanding Paris Club debt has been reconciled, and that the remainder will be resolved in the course of 2010. Agreements have been reached with non-participants in the London Club settlement and with all but two official non-Paris Club creditors; negotiations with the latter (the Czech Republic and Libya) are ongoing. Remaining official external arrears mostly relate to debts of the former Yugoslavia.

21. **Expected disbursements from IFIs and other multilateral institutions**—such as the World Bank and the EU—provide assurances that the program is fully financed in 2010.

V. Staff Appraisal

20. **Recent economic indicators suggest that growth momentum has stalled for now, and risks to the short-term outlook have increased**. Lower trading-partner growth has diminished prospects for a quick export-led recovery, notwithstanding the more competitive exchange rate; investor uncertainty, in part related to regional spillover fears, is weighing on private investment; and employment losses in the formal labor market and protracted corporate restructuring are also slowing the recovery.

21. **Nevertheless, the current slow pace of economic recovery may well turn out to be only temporary.** The large external adjustment in 2009 has moved the Serbian economy closer to external balance, inflation is low by Serbian standards, and improvements in external competitiveness through exchange rate depreciation, structural reforms, and privatization bode well for more robust and balanced growth in the medium term.

22. **Weaker revenues in 2010 notwithstanding, fiscal policy should continue to aim at medium-term consolidation.** The breach of the general government deficit ceiling for the first quarter of 2010 was small and reflects unexpected shortfalls in revenue due to a weaker economy. Overall spending in 2010 should be broadly executed as budgeted. If the economy indeed weakens relative to present projections, automatic fiscal stabilizers on the revenue side should be allowed to operate given the absence of serious financing constraints or crowding out concerns. However, if revenue weakness persists, the authorities should adopt compensating measures. Measures to enhance revenues should focus on tax administration reform and broadening the tax base.

23. **The agreed exit strategy from the freezes on public wages and pensions is appropriate.** While there is no scope for lifting the freezes in 2010, they cannot be sustained for much longer. The plan, starting in 2011, to link public wages and pensions to the CPI and to provide a modest growth bonus, strikes an appropriate balance between the desire to lift the freezes and the need to keep medium-term fiscal consolidation on track.

24. **The authorities' intention to adopt fiscal responsibility legislation is welcome.** Clear and transparent fiscal rules are essential to support the medium-term fiscal strategy and ensure accountability. The adoption of multi-year capital budgeting is also a step in the right direction.

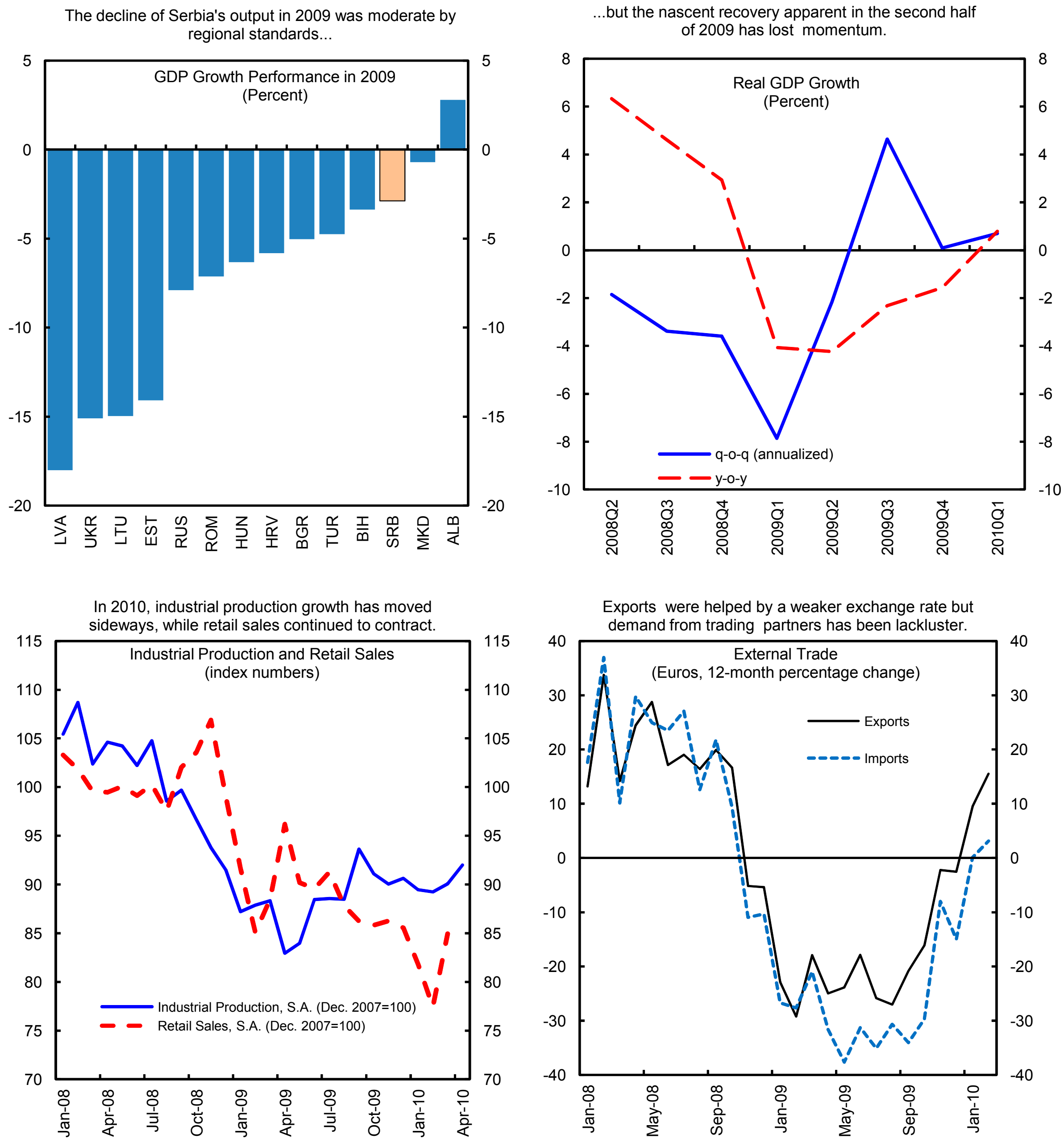
25. **The gradual monetary easing strategy pursued by the NBS remains appropriate in the short term.** However, the authorities need to be vigilant against upside risks: inflation expectations have been slow to respond to disinflation, while exchange rate pass-through, a reversal of food price declines, and regulated price increases remain sources of upside risks.

26. **Serbia is well placed to handle possible spillovers from Greece, but the situation warrants continued close monitoring.** Serbian subsidiaries of Greek banks have remained in good shape, and the authorities have adequate tools at their disposal to appropriately ring-fence them against possible adverse spillovers.

22. **The authorities' plans to restructure and privatize public enterprises are welcome.** Successful privatization of public enterprises will contribute to increasing the role of the private sector, promote technology transfer and corporate governance, and provide additional fiscal financing. While there has recently been slow progress in streamlining business regulations, the authorities' renewed push for tangible results in this area is encouraging.

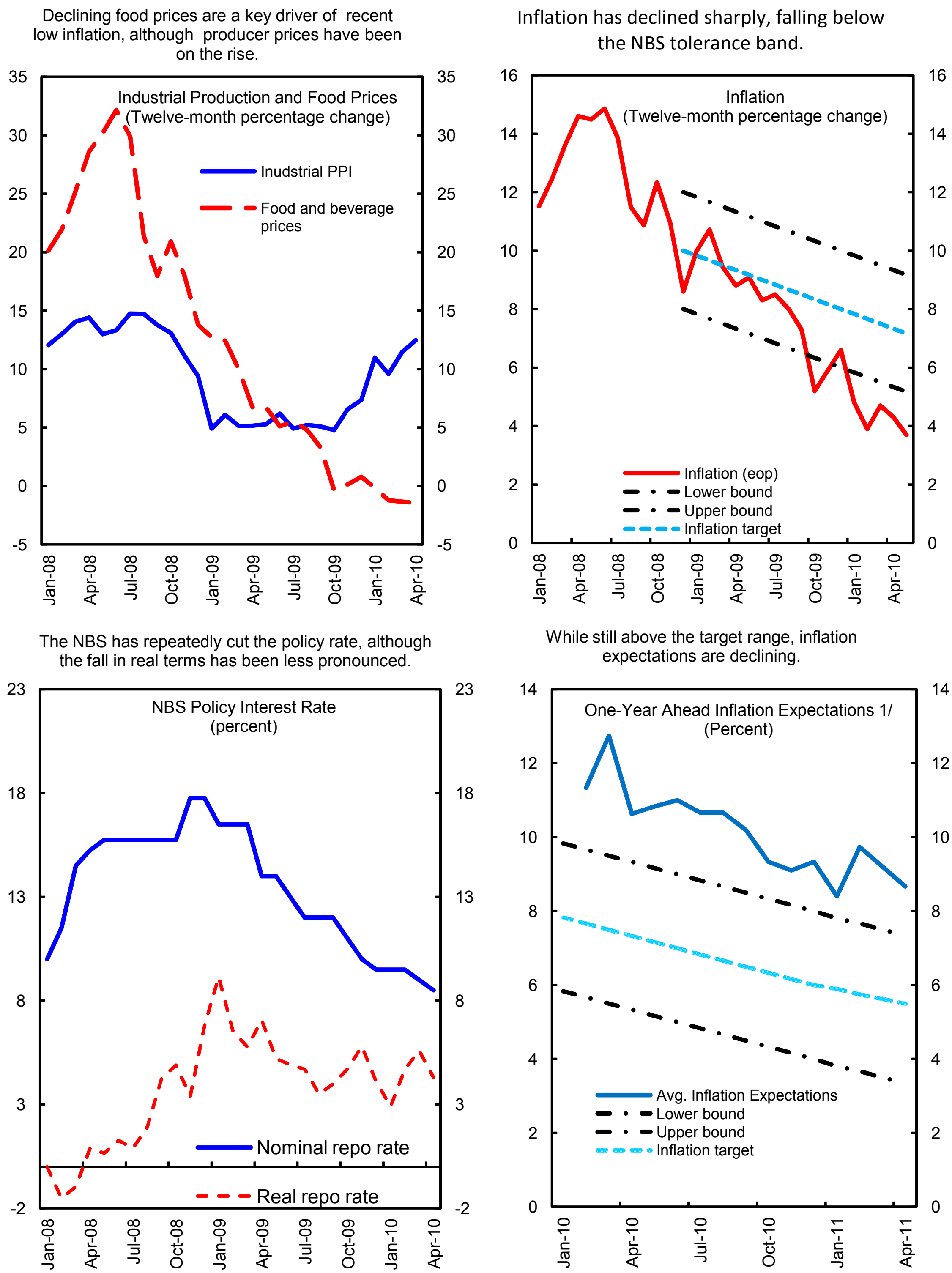
23. **On the basis of Serbia's satisfactory performance under the SBA, staff supports the authorities' request for completing the fourth review, the waiver for non-observance of a quantitative performance criterion and the financing assurances review**. Staff also recommends revising end-June quantitative conditionality and establishing quantitative conditionality for end-September 2010, as specified in the Letter of Intent (LOI Table 1).

Figure 1. Serbia: Recent Economic Indicators, 2008-10



Sources: National Bank of Serbia; Serbian Statistical Office; and Ministry of Finance.

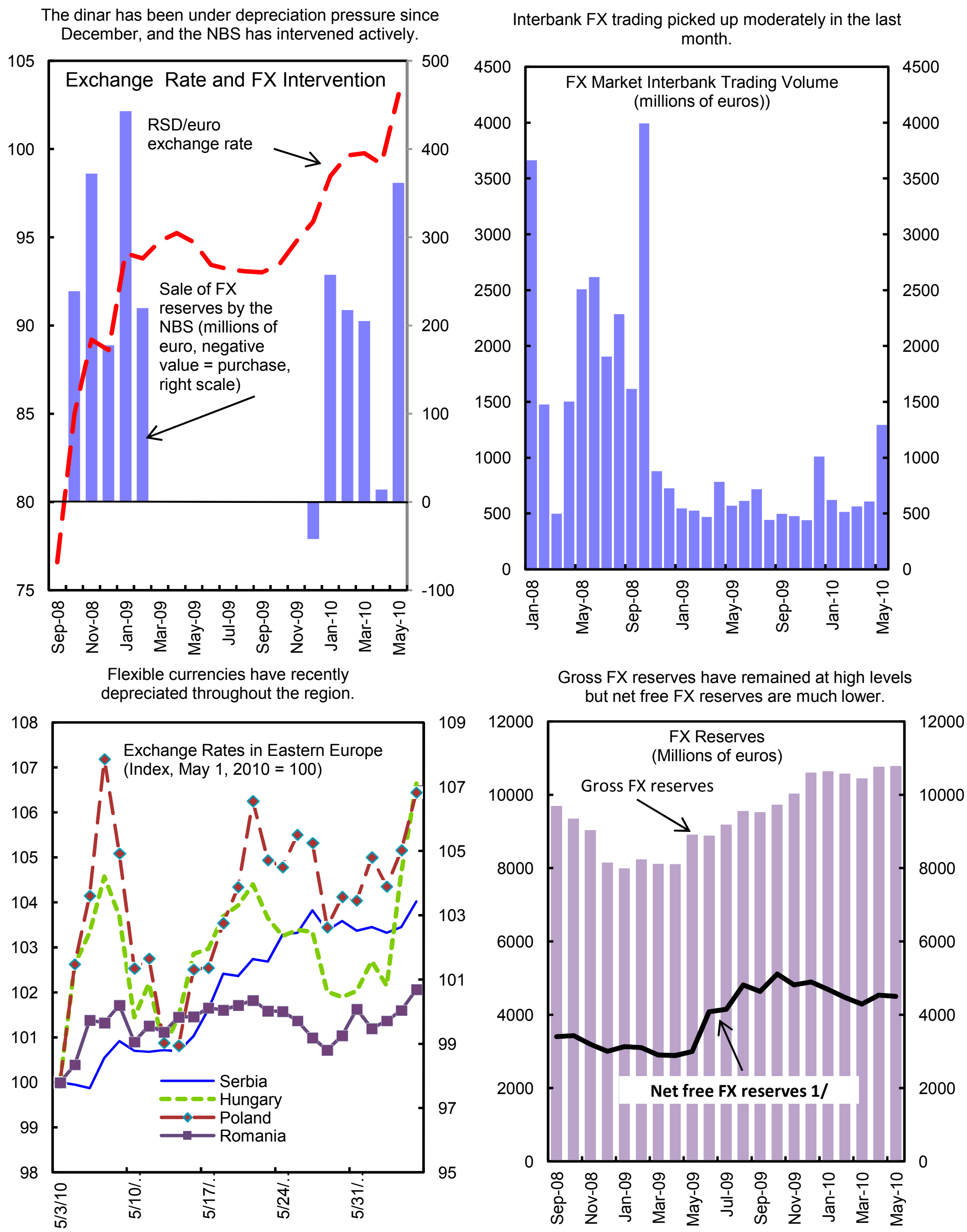
Figure 2. Serbia: Inflation and Monetary Policy, 2008–10



Sources: National Bank of Serbia; Statistical Office of Serbia.

1/ Average of surveys of the financial sector, enterprises, and the trade unions.

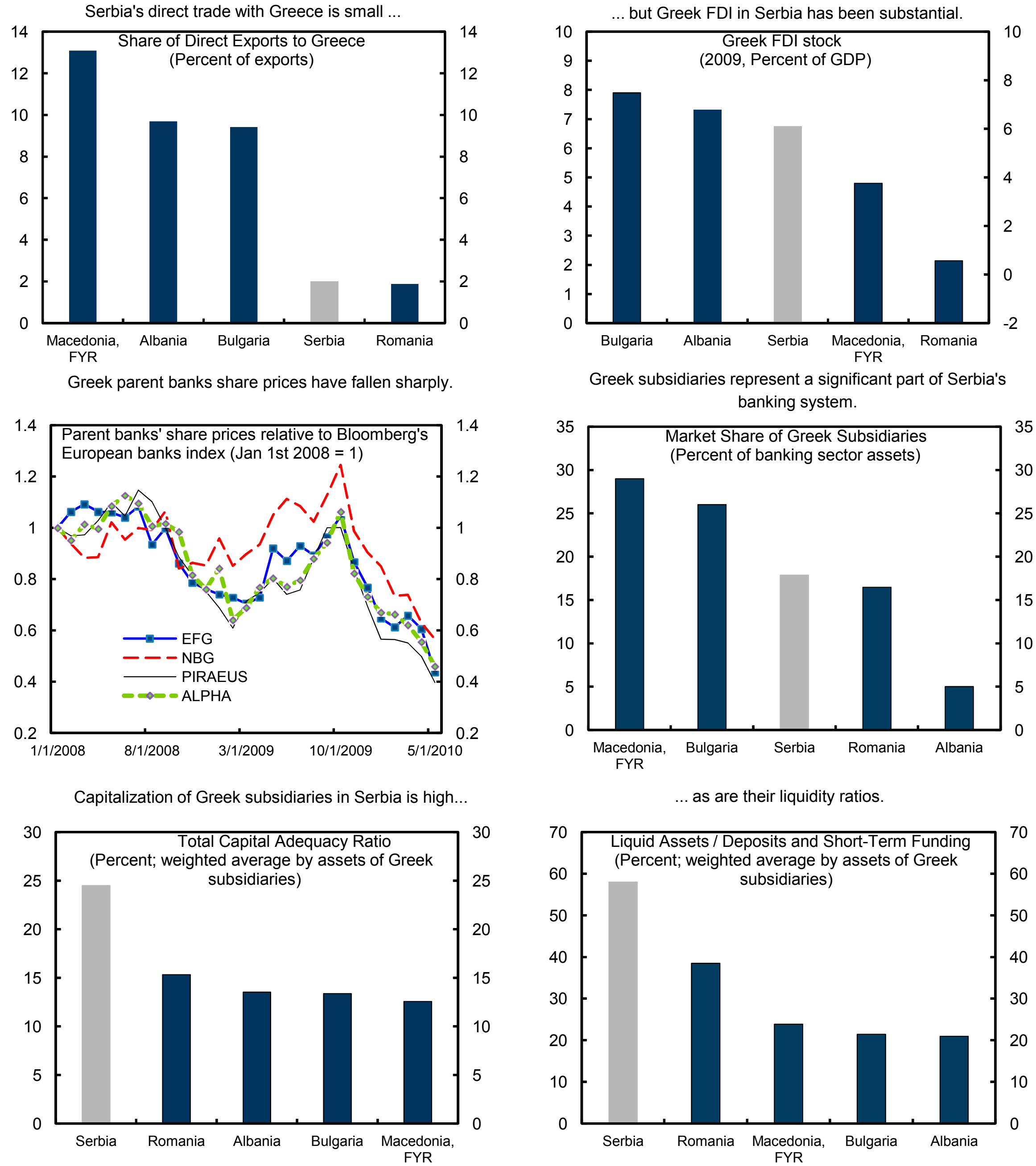
Figure 3. Serbia: Exchange Rate Developments, 2008-10



Sources: National Bank of Serbia and the IMF's Information Notice System.

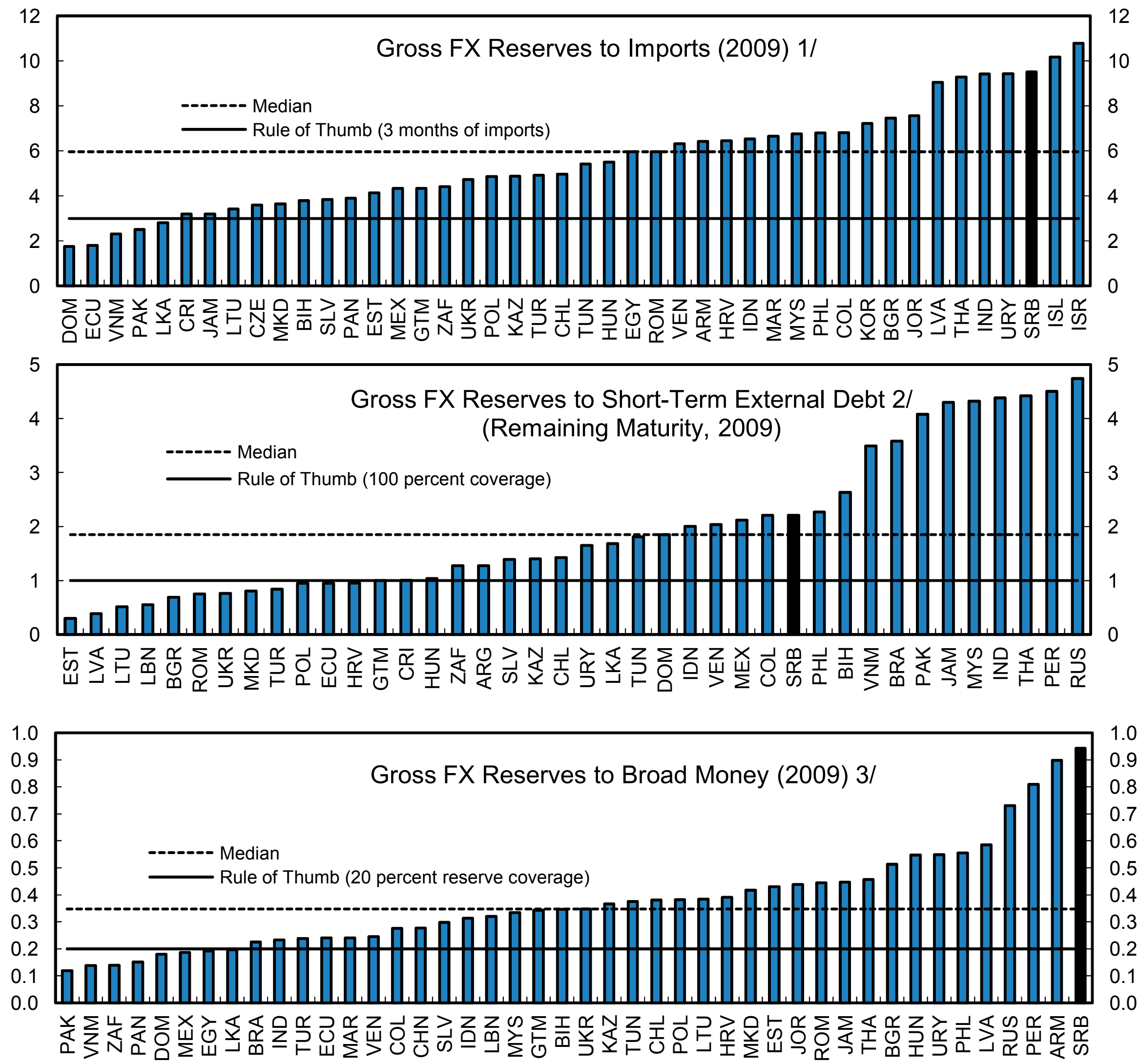
1/ Net free FX reserves are defined as Net Foreign Assets of the NBS minus the stock of repos.

Figure 4. Serbia: Greek Crisis Spillovers



Source: Bankscope, Bloomberg, National Bank of Serbia, Bank of Greece; and IMF staff calculations.

Figure 5. Emerging Markets; Reserve Adequacy Measures, 2009



Sources: WEO; and IMF staff estimates.
1/ Excluding Peru, Lebanon, Iceland, Brazil, Russia, China, Algeria (ratio over 10).
2/ Excluding Egypt, Morocco, Panama, Jordan, Armenia, China, Algeria (ratio over 5).
3/ Excluding Algeria.

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2009–10 1/

	2009								2010				
	March		June		Sept.		Dec.		March		June	Sept.	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Proj.
Quantitative Performance Criteria													
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.2	4.9	4.8	4.6
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	109	149
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20	0	20	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550	600	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0	0	0
Inflation Consultation Bands (in percent)													
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0	5.3	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0	7.3	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0	3.3	4.0
Indicative Targets													
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354	546	737
Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development funds (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50	50	50

1/ As defined in the Letter of Intent, the Memorandum on Economic and Financial Policies, and the Technical Memorandum of Understanding.

2/ Cumulative from January 1.

3/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, KfW, Eurofima, CEB, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements.

Table 2. Serbia: Performance for Fourth Review

Measure	Target Date	Comment
Quantitative performance criteria		
1. Floor on net foreign assets of the NBS	March 2010	Observed
2. Ceiling on consolidated general government overall deficit	March 2010	Not observed
3. Ceiling on contracting or guaranteeing by the public sector of new short-term external debt	March 2010	Observed
4. Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt	March 2010	Observed
5. Ceiling on accumulation of government external payment arrears	March 2010	Observed
Indicative targets		
1. Ceiling on current expenditures of the Serbian Republican budget	March 2010	Observed
2. Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development Funds	March 2010	Not observed
Inflation consultation clause	March 2010	Observed
Structural benchmarks		
1. Authorities to adopt large state enterprises' business plans that conform to general government wage and employment policy in 2010 and ensure profit transfers to the state (TMU ¶19).	February 2010	Partially observed
2 Government to submit to parliament a draft pension reform law including measures as specified in TMU (¶21).	May 2010	Not observed
3. Government to submit to parliament a draft Budget System and Responsibility Law, including supporting legislation (TMU ¶22).	May 2010	Not observed

Table 3. Serbia: Selected Economic and Social Indicators, 2006–11

	2006	2007	2008	2009	2010		2011
				Est.	3rd Rev.	Prog.	Proj.
			(Percent change, unless otherwise indicated)				
Real GDP	5.2	6.9	5.5	-3.0	2.0	1.5	3.0
Real GDP excluding agricultural sector	5.9	8.8	5.2	-3.4	2.0	2.0	3.1
Real domestic demand (absorption)	6.2	11.5	6.3	-7.5	0.4	-1.8	2.2
Consumer prices (average)	12.7	6.5	12.4	8.1	4.8	4.6	4.4
Consumer prices (end of period)	6.6	11.0	8.6	6.6	6.0	6.0	4.5
Nominal gross wage	23.2	22.4	16.9	7.4	4.8	3.5	6.5
Real net wage	10.6	19.9	4.9	-0.7	0.0	-1.1	2.0
Average net wage (in euros per month) 1/	359	454	457	414	…	…	…
Net wage in euro 1/	27.4	26.4	16.9	-9.4	…	…	…
Registered employment	-3.4	-2.1	-1.7	-4.6	-1.2	-1.8	1.0
Unemployment rate (in percent)	21.6	18.8	14.7	17.4	…	…	…
Nominal GDP (in billions of dinars)	1,962	2,302	2,722	2,905	3,139	3,086	3,318
				(Percent of GDP)			
General government finances							
Revenue	44.2	43.5	41.9	39.5	38.4	38.6	37.8
Expenditure	45.8	45.4	44.5	43.6	42.5	43.4	41.6
Current	41.1	40.1	40.0	39.8	38.2	39.0	37.6
Capital and net lending	4.6	5.3	4.5	3.8	4.3	4.4	4.0
Fiscal balance (cash basis)	-1.6	-1.9	-2.6	-4.1	-4.1	-4.8	-3.9
Structural fiscal balance 2/	-2.3	-0.4	-4.6	-3.4	-4.4	-4.6	-3.7
Gross debt	43.0	35.2	33.4	35.6	36.0	39.1	41.1
			(End of period 12-month change, percent)				
Monetary sector							
Money (M1)	37.1	25.3	-3.8	8.7	14.5	14.5	13.8
Broad money (M2)	38.4	44.5	9.6	21.8	10.7	10.7	13.5
Domestic credit to non-government	17.1	36.9	35.0	15.9	16.0	16.0	21.1
				(End of period, percent)			
Interest rates (dinar)							
NBS repo rate	14.0	10.0	17.8	9.5	…	…	…
Deposit rate	5.1	4.1	6.4	5.1	…	…	…
			(Percent of GDP, unless otherwise indicated)				
Balance of payments							
Current account balance	-10.2	-15.9	-17.6	-5.6	-8.5	-8.5	-8.0
Exports of goods	22.0	22.2	22.2	19.4	19.8	20.8	21.3
Imports of goods	43.3	45.2	45.0	34.9	34.5	34.7	34.4
Trade of goods balance	-21.4	-23.1	-22.8	-15.5	-14.7	-13.9	-13.1
Capital and financial account balance	32.0	18.4	12.7	11.7	4.2	4.7	4.8
External debt	63.3	61.8	65.2	75.8	79.5	77.2	73.3
of which: Private external debt	36.0	39.5	46.1	51.6	48.5	49.8	46.4
Gross official reserves (in billions of euro)	8.7	9.5	8.2	10.6	11.3	10.2	9.2
(In months of prospective imports of GNFS)	6.6	6.3	7.7	9.6	9.2	8.8	7.4
(Percent of short-term debt)	294.5	268.4	167.5	177.1	217.9	188.3	169.9
(in percent of broad money, M2)	112.4	84.5	72.7	74.9	76.5	76.5	76.5
Exchange rate (dinar/euro, period average)	84.2	80.0	81.5	93.9	…	…	…
REER (annual average change, in percent; + indicates appreciation)	6.6	7.2	6.4	-7.1	-0.3	-0.9	2.0
Social indicators							
Per capita GDP (2009): US$5,821. Population (2009): 7.4 million. Poverty rate (national poverty estimate, 2009): 6.9 percent.							

Sources: Serbian authorities; and IMF staff estimates and projections.

1/ Change in definition of private sector labor force. Nominal net euro wages according to new definition; growth rate reported consistent with old definition.

2/ Fiscal balance adjusted for the automatic effects of both the output gap and the current account gap.

Table 4. Serbia: Real GDP Growth Components, 2004–11
(Percent)

	2004	2005	2006	2007	2008	2009 Est.	2010 Proj.	2011 Proj.
	(Real growth rate by expenditure category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Domestic demand (absorption)	13.8	-4.0	6.2	11.5	6.3	-7.5	-1.8	2.2
Non-government	17.7	-4.7	5.0	9.3	8.5	-7.6	-1.8	3.3
Government	-0.6	-0.6	11.1	20.0	-1.8	-7.1	-1.8	-2.2
Consumption	2.2	0.0	6.4	7.0	6.2	-3.2	-2.8	1.2
Non-government	3.6	0.5	6.9	4.0	7.6	-2.7	-2.5	2.5
Government	-2.6	-1.5	4.3	18.2	1.6	-5.0	-3.9	-3.8
Investment	76.1	-16.4	5.5	28.3	6.6	-20.8	2.1	5.9
Gross fixed capital formation	27.8	2.7	14.5	25.6	1.9	-3.3	2.1	5.9
Non-government	29.6	2.1	7.3	25.1	6.3	-0.4	0.7	5.8
Government	17.2	6.4	58.8	28.0	-16.2	-18.4	11.4	6.3
Change in inventories 1/	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services 1/	-8.0	10.3	-1.9	-6.3	-2.0	6.1	3.6	0.6
Exports of goods and services	5.7	14.4	4.9	17.2	8.9	-11.0	2.6	9.0
Imports of goods and services	21.0	-13.6	7.8	26.0	9.3	-18.3	-6.6	4.9
	(Contribution to real growth by expenditure category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Domestic demand (absorption)	16.5	-5.0	7.1	13.2	7.6	-9.1	-2.0	2.4
Non-government	16.7	-4.8	4.6	8.6	8.0	-7.3	-1.6	2.9
Government	-0.2	-0.1	2.4	4.6	-0.5	-1.7	-0.4	-0.5
Consumption	2.2	0.0	5.8	6.4	5.6	-2.9	-2.5	1.0
Non-government	2.8	0.3	4.9	2.9	5.3	-1.9	-1.8	1.7
Government	-0.6	-0.3	0.8	3.5	0.3	-1.0	-0.8	-0.7
Investment	14.3	-5.0	1.3	6.9	1.9	-6.1	0.5	1.4
Gross fixed capital formation	4.7	0.5	2.8	5.4	0.5	-0.8	0.5	1.4
Non-government	4.3	0.4	1.2	4.3	1.3	-0.1	0.1	1.2
Government	0.4	0.2	1.6	1.2	-0.8	-0.7	0.4	0.2
Change in inventories	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services	-8.0	10.3	-1.9	-6.3	-2.0	6.1	3.6	0.6
Exports of goods and services	1.4	3.5	1.3	4.6	2.6	-3.3	0.7	2.5
Imports of goods and services	9.4	-6.8	3.2	10.9	4.6	-9.4	-2.8	2.0
	(Contribution to real GDP growth by production category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Gross Value-Added	7.3	4.0	5.4	5.6	5.2	-1.8	1.4	2.6
Agriculture	2.3	-0.7	0.0	-0.9	0.8	0.3	0.0	0.2
Industry	1.6	0.0	0.9	0.8	0.3	-2.0	0.5	0.5
Services	4.6	6.1	4.3	7.0	4.4	-1.3	1.0	2.3
Wholesale and retail trade	1.3	1.9	1.0	2.0	0.8	-1.0	-0.1	0.4
Construction	0.1	0.1	0.2	0.3	0.1	-0.5	0.1	0.1
Transport and communications	1.2	1.9	2.8	2.4	1.7	0.8	0.6	0.5
Financial services	0.2	0.4	0.4	0.5	0.5	0.2	0.1	0.1
Other	0.5	0.5	0.1	0.4	1.0	0.4	0.2	0.8
Taxes minus subsidies	1.5	1.7	0.0	1.5	0.6	-0.8	0.4	0.5
Memorandum items:								
Tradables GDP	4.5	-0.1	0.9	0.4	1.3	-2.0	0.6	0.8
Non-tradables GDP	4.1	5.5	4.3	6.5	4.2	-1.0	0.9	2.2

Sources: Serbian Statistical Office; and IMF staff estimates and projections.

1/ Contributions to GDP growth.

Table 5. Serbia: Medium-Term Program Scenario, 2008–15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
GDP and prices (percent change)								
GDP growth (real)	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand growth (real)	6.3	-7.5	-1.8	2.2	4.0	4.8	4.5	3.5
Domestic demand minus imports (real)	4.1	0.5	1.1	0.7	1.9	2.0	1.3	0.1
Consumer price inflation (end of period)	8.6	6.6	6.0	4.5	4.0	4.0	4.0	4.0
Savings and investment (percent of GDP)								
Savings - investment balance	-17.6	-5.6	-8.6	-8.0	-7.5	-6.3	-6.1	-5.4
Non-government	-15.6	-2.0	-4.4	-4.5	-4.7	-4.4	-4.9	-4.6
Government	-2.0	-3.7	-4.1	-3.5	-2.8	-2.0	-1.3	-0.7
General government (percent of GDP)								
Overall fiscal balance	-2.6	-4.1	-4.8	-3.9	-3.0	-2.2	-1.5	-1.0
Revenue	41.9	39.5	38.6	37.8	37.3	37.1	37.0	37.0
Expenditure	44.5	43.6	43.4	41.6	40.3	39.3	38.5	38.0
Current	40.0	39.8	39.0	37.6	36.1	35.0	33.7	32.8
of which: Wages and salaries	10.8	10.4	10.1	9.6	9.2	8.8	8.3	7.9
of which: Pensions	12.2	13.3	12.9	12.5	12.1	11.8	11.5	11.2
of which: Goods and services	7.6	7.3	6.8	6.3	6.0	6.0	6.0	6.0
Capital and net lending	4.5	3.8	4.4	4.0	4.2	4.3	4.9	5.2
Structural fiscal balance	-4.6	-3.4	-4.6	-3.7	-3.2	-2.3	-1.5	-0.9
Output gap	0.7	-2.6	-2.5	-1.8	0.0	0.0	0.0	0.0
Absorption gap	11.3	-0.5	2.3	1.8	1.4	0.3	0.1	-0.7
Gross debt	33.4	35.6	39.1	41.1	40.6	39.1	37.2	36.1
Balance of payments (percent of GDP)								
Current account	-17.6	-5.6	-8.5	-8.0	-7.4	-6.3	-6.1	-5.3
of which: Trade balance	-22.8	-15.5	-13.9	-13.1	-12.4	-11.9	-11.3	-10.2
of which: Current transfers, net (excl. grants)	7.8	10.7	8.8	8.0	7.4	8.0	7.5	7.1
Capital and financial account	12.7	11.7	4.7	4.8	9.5	10.5	9.5	7.6
of which: Foreign direct investment	5.4	4.4	4.5	4.1	4.1	4.1	4.1	4.1
External debt (end of period)	65.2	75.8	77.2	73.3	72.5	70.5	68.2	66.0
of which: Private external debt	46.1	51.6	49.8	46.4	47.3	48.4	48.5	47.2
Gross official reserves (billions of euros)	8.2	10.6	10.2	9.2	9.7	10.7	11.7	12.7
REER (ann. av. change; + = appreciation)	6.4	-7.1	-0.9	2.0	1.5	2.8	2.7	1.6

Sources: Serbian authorities; and IMF staff estimates and projections.
1/ Definitions and coverage as in previous tables.

Table 6. Serbia: Savings-Investment Balances, 2004–15
(Percent of GDP)

	2004	2005	2006	2007	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Domestic demand	126.6	121.0	121.6	123.9	123.4	115.4	114.2	113.4	112.8	112.3	111.6	110.6
Consumption	96.8	97.2	97.4	95.7	94.7	92.6	91.0	89.3	87.1	85.4	83.6	82.1
Non-government	77.1	78.5	78.5	75.4	75.1	73.7	73.0	72.3	70.9	69.6	68.3	67.2
Government	19.8	18.8	18.9	20.3	19.6	18.9	18.1	17.0	16.3	15.8	15.3	14.9
Gross domestic savings	3.2	2.8	2.6	4.3	5.3	7.4	9.0	10.7	12.9	14.6	16.4	17.9
Non-government	0.1	-1.3	-0.6	0.9	3.0	7.6	9.1	9.9	11.1	12.0	12.5	13.2
Government	3.1	4.1	3.2	3.4	2.3	-0.2	-0.2	0.7	1.7	2.6	3.8	4.7
Net factor receipts and transfers	14.4	12.3	11.4	7.9	5.8	9.8	5.7	5.4	5.3	5.9	5.5	5.2
Non-government	15.2	13.1	12.1	8.4	6.2	10.1	6.2	6.0	5.9	6.5	6.0	5.7
Government	-0.8	-0.8	-0.8	-0.5	-0.5	-0.3	-0.5	-0.6	-0.6	-0.6	-0.5	-0.5
Gross national savings	17.6	15.0	13.9	12.2	11.0	17.2	14.6	16.1	18.2	20.5	21.9	23.1
Non-government	15.3	11.8	11.5	9.3	9.2	17.7	15.3	16.0	17.1	18.5	18.6	18.9
Government	2.3	3.3	2.4	2.9	1.8	-0.5	-0.7	0.1	1.1	2.0	3.3	4.2
Gross domestic investment	29.7	23.7	24.1	28.2	28.6	22.8	23.2	24.1	25.6	26.9	28.0	28.5
Non-government	27.1	21.1	20.0	23.5	24.8	19.7	19.7	20.4	21.8	22.9	23.4	23.5
Gross fixed capital formation	16.6	16.3	16.9	19.2	19.4	19.6	19.6	20.4	21.7	22.8	23.4	23.5
Change in inventories	10.5	4.7	3.1	4.2	5.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Government	2.6	2.7	4.1	4.8	3.8	3.1	3.5	3.6	3.9	4.0	4.6	4.9
Overall savings-investment balance	-12.1	-8.7	-10.2	-16.0	-17.6	-5.6	-8.6	-8.0	-7.5	-6.3	-6.1	-5.4
Non-government	-11.8	-9.3	-8.5	-14.2	-15.6	-2.0	-4.4	-4.5	-4.7	-4.4	-4.9	-4.6
Government	-0.3	0.6	-1.7	-1.9	-2.0	-3.7	-4.1	-3.5	-2.8	-2.0	-1.3	-0.7
Foreign savings	12.1	8.7	10.2	16.0	17.6	5.6	8.6	8.0	7.5	6.3	6.1	5.4
Memorandum items:												
Net exports of goods and services 1/	-26.6	-21.0	-21.6	-23.9	-23.4	-15.4	-14.2	-13.4	-12.8	-12.3	-11.6	-10.6
Current account balance	-12.1	-8.7	-10.2	-15.9	-17.6	-5.6	-8.5	-8.0	-7.4	-6.3	-6.1	-5.3
General government fiscal balance	0.0	0.8	-1.6	-1.9	-2.6	-4.1	-4.8	-3.9	-3.0	-2.2	-1.5	-1.0

Sources: Statistics Office; National Bank of Serbia; Ministry of Finance; and IMF staff estimates and projections.

1/ Equal to GDP minus domestic demand.

Table 7a. Serbia: General Government Fiscal Operations, 2009–2011 1/
(Billions of RSD)

	2009	2010 Budget	2010 Third Review	2010 Q1 Third Review	2010 Q1 Est.	2010 Q2 Prog.	2010 Q3 Prog.	2010 Q4 Proj.	2010 Proj.	2011 Proj.
Revenue	1,147	1,208	1,205	277	267	285	305	335	1,191	1253
Taxes	1,000	1,061	1,053	243	236	249	263	289	1,037	1102
Personal income tax	133	142	138	33	31	35	35	37	138	147
Social security contributions	319	336	327	75	75	82	82	86	325	348
Taxes on profits	31	24	23	9	12	5	5	5	27	29
Value-added taxes	297	325	326	77	72	73	79	92	316	337
Excises	135	148	151	29	27	34	39	44	144	155
Taxes on international trade	48	44	45	11	9	11	11	12	44	40
Other taxes	37	43	43	9	10	9	11	12	43	46
Non-tax revenue	140	145	145	33	30	34	39	45	147	149
Capital revenue	0	0	0	0	0	0	0	0	0	0
Grants	6	2	6	1	0	2	2	2	6	1
Expenditure	1,267	1,344	1,334	299	291	332	342	375	1,340	1381
Current expenditure	1,155	1,206	1,201	279	272	299	311	322	1,205	1248
Wages and salaries	301.8	313	308	74	72	80	80	80	312	319
Goods and services	212.2	213	212	42	44	50	52	63	210	210
Interest	22.4	39	39	10	8	7	12	10	37	47
Subsidies	63.1	69	69	13	11	17	21	20	69	69
Transfers	555.6	572	572	141	137	145	146	149	577	603
Pensions	387.3	396	396	99	97	100	100	100	398	414
Other transfers 2/	168.3	176	176	42	40	45	46	49	179	188
Capital expenditure	91.1	111	109	12	14	24	26	44	107	120
Net lending	20.5	26	24	9	5	10	5	9	28	13
Fiscal balance (cash basis)	-120	-136	-129	-23	-24	-48	-37	-40	-149	-128
Financing	120	...	129	24	24	48	37	40	149	128
Privatization proceeds	59	...	4	0	2	0	1	1	4	0
Domestic	21	...	70	24	27	40	9	15	91	114
Banks	-61	...	13	15	19	39	-19	-23	17	57
Central bank	-61	...	-6	-4	19	22	-19	-23	0	0
Commerical banks	0	...	19	19	0	17	0	0	17	57
Non-bank	82	...	57	10	8	1	27	38	74	56
External	40	...	54	-1	-6	8	28	24	54	15
Program	42	...	64	0	0	11	30	25	66	22
Project	11	...	17	4	1	4	4	8	17	18
Amortization	13	...	27	5	6	8	6	8	29	26
Memorandum items:										
Augmented fiscal balance 3/	-141	…	-131	…	…	…	…	…	-157	-128
Nominal GDP (billions of dinars)	2,905	3,230	3,139	3,230	3,086	3,086	3,086	3,086	3,086	3318

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Includes the republican budget, local governments, social security funds, and the Road Company.
2/ Excluding foreign currency deposit payments to households, reclassified below the line.
3/ Including clearance of arrears of the Road Company as well as of farmer pension arrears.

Table 7b. Serbia: General Government Fiscal Operations, 2009–2011 1/
(Percent of GDP)

	2009	2010 Budget	2010 Third Review	2010 Q1 Third Review	2010 Q1 Est.	2010 Q2 Prog.	2010 Q3 Prog.	2010 Q4 Proj.	2010 Proj.	2011 Proj.
Revenue	39.5	37.4	38.4	8.8	8.6	9.2	9.9	10.9	38.6	37.8
Taxes	34.4	32.8	33.6	7.8	7.6	8.1	8.5	9.4	33.6	33.2
Personal income tax	4.6	4.4	4.4	1.1	1.0	1.1	1.1	1.2	4.5	4.4
Social security contributions	11.0	10.4	10.4	2.4	2.4	2.7	2.7	2.8	10.5	10.5
Taxes on profits	1.1	0.7	0.7	0.3	0.4	0.2	0.2	0.2	0.9	0.9
Value-added taxes	10.2	10.1	10.4	2.5	2.3	2.4	2.6	3.0	10.3	10.2
Excises	4.6	4.6	4.8	0.9	0.9	1.1	1.3	1.4	4.7	4.7
Taxes on international trade	1.7	1.4	1.4	0.3	0.3	0.3	0.4	0.4	1.4	1.2
Other taxes	1.3	1.3	1.4	0.3	0.3	0.3	0.4	0.4	1.4	1.4
Non-tax revenue	4.8	4.5	4.6	1.1	1.0	1.1	1.3	1.4	4.8	4.5
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.1	0.2	0.0	0.0	0.1	0.1	0.1	0.2	0.0
Expenditure	43.6	41.6	42.5	9.5	9.4	10.8	11.1	12.2	43.4	41.6
Current expenditure	39.8	37.3	38.2	8.9	8.8	9.7	10.1	10.4	39.0	37.6
Wages and salaries	10.4	9.7	9.8	2.3	2.3	2.6	2.6	2.6	10.1	9.6
Goods and services	7.3	6.6	6.8	1.3	1.4	1.6	1.7	2.0	6.8	6.3
Interest	0.8	1.2	1.2	0.3	0.3	0.2	0.4	0.3	1.2	1.4
Subsidies	2.2	2.1	2.2	0.4	0.4	0.5	0.7	0.7	2.2	2.1
Transfers	19.1	17.7	18.2	4.5	4.4	4.7	4.7	4.8	18.7	18.2
Pensions	13.3	12.3	12.6	3.2	3.1	3.3	3.3	3.3	12.9	12.5
Other transfers 2/	5.8	5.4	5.6	1.3	1.3	1.4	1.5	1.6	5.8	5.7
Capital expenditure	3.1	3.4	3.5	0.4	0.4	0.8	0.8	1.4	3.5	3.6
Net lending	0.7	0.8	0.8	0.3	0.1	0.3	0.2	0.3	0.9	0.4
Fiscal balance (cash basis)	-4.1	-4.2	-4.1	-0.7	-0.8	-1.6	-1.2	-1.3	-4.8	-3.9
Financing	4.1	…	4.1	0.8	0.8	1.6	1.2	1.3	4.8	3.9
Privatization proceeds	2.0	…	0.1	0.0	0.1	0.0	0.0	0.0	0.1	0.0
Domestic	0.7	…	2.2	0.8	0.9	1.3	0.3	0.5	2.9	3.4
Banks	-2.1	…	0.4	0.5	0.6	1.3	-0.6	-0.7	0.5	1.7
Central bank	-2.1	…	-0.2	-0.1	0.6	0.7	-0.6	-0.7	0.0	0.0
Commerical banks	0.0	…	0.6	0.6	0.0	0.6	0.0	0.0	0.6	1.7
Non-bank	2.8	…	1.8	0.3	0.3	0.0	0.9	1.2	2.4	1.7
External	1.4	…	1.7	0.0	-0.2	0.3	0.9	0.8	1.8	0.4
Program	1.4	…	2.0	0.0	0.0	0.4	1.0	0.8	2.1	0.7
Project	0.4	…	0.5	0.1	0.0	0.1	0.1	0.2	0.6	0.6
Amortization	0.5	…	0.9	0.2	0.2	0.2	0.2	0.3	0.9	0.8
Memorandum items:										
Structural fiscal balance 3/	-3.4	…	-4.4	…	…	…	…	…	-4.6	-3.7
Absorption gap 4/	-0.5	…	2.5	…	…	…	…	…	2.3	1.8
Output gap 5/	-2.6	…	-0.5	…	…	…	…	…	-2.5	-1.8
External gap	2.1	…	3.0	…	…	…	…	…	4.8	3.6
Augmented fiscal balance 6/	-4.9	…	-4.2	…	…	…	…	…	-5.1	-3.9
Gross debt	35.6	…	36.0	…	…	…	…	…	39.1	41.1
Nominal GDP (billions of dinars)	2,905	3,230	3,139	3,139	3,086	3,086	3,086	3,086	3,086	3,318

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Includes the republican budget, local governments, social security funds, and the Road fund.
2/ Excluding foreign currency deposit payments to households, reclassified below the line.
3/ Actual fiscal balance adjusted for the automatic effects of both the output gap (internal imbalance) and the current account gap (external imbalance) on the fiscal position.
4/ Percentage deviation between actual absorption and the level consistent with external balance.
5/ Percentage deviation of actual from potential GDP.
6/ Including clearance of arrears of the Road Company and of farmer pension arrears.

Serbia 7c: Intergovernmental Fiscal Operations, 2010 Program

	Gen. Gov.	Republican budget	Own budgets	Local gov. and V.	Road company	Social security funds	Pension Fund	Health Fund	Labor Fund	Netting operations
Total revenue	1191	652	33	144	33	386	242	129	16	-56
Current revenue	1185	647	31	144	33	386	242	129	16	-56
Tax revenue	1038	599	0	97	16	382	239	127	15	-56
Personal income tax	138	74		64						
Social security contributions	326			0		382	239	127	15	-56
Corporate income tax	27	25		2						
VAT	316	316	0							
Excises	144	129			16					
Taxes on international trade	44	44								
Other taxes	43	11	0	31						
Nontax revenue	147	49	31	46	17	5	3	2	0	
Capital revenue	0	0	0	0	0	0	0	0	0	
Grants	6	5	1	0	0	0	0			
Total expenditure and net lending	1397	469	31	223	36	638	424	185	29	-56
Current expenditure	1261	406	24	174	21	636	423	184	29	-56
Expenditure on goods and services	578	230	21	120	19	187	7	177	4	
Wages and salaries	312	153	8	58	1	92	3	86	2	
Employer contribution	0	29	2	10	0	16	1	15	0	-56
Social funds	0			0		0	0	0	0	
Local tax	0			0		0	0	0	0	
Goods and services	210	48	11	53	18	80	3	76	1	
Interest payment	37	33	0	2	2	1	0	1	0	
Subsidies and other current transfers	646	144	2	52		448	416	7	25	
Subsidies	495	43	2	24		426	398	6	22	
Transfers to households	151	101	0	28		22	18	1	4	
Other current expenditure	0					0	0	0	0	
Capital expenditure	107	38	6	47	15	2	1	1	0	
Own resource	91	32	6	41	10	2	0	1	0	
Foreign financed	17	7		6	5					
Net lending	28	24	2	2		0	0	0	0	
Fiscal balance (before transfers)	**-205**	183	1	-79	-3	-252	-182	-56	-13	0
Transfers from other levels of government	371	0	0	59	0	312	232	55	26	0
Republican budget	307			59	0	249	222	1	26	
Local governments and Vojvodina	0	0	0	0	0	0				
Social security funds	64					64				
Transfers to other levels of government	371	306	1	0	0	64	50	1	13	0
Republican budget	0					0		0		
Local governments and Vojvodina	58	58				0				
Social security funds	312	248	0	0	0	64				
Net transfer to other levels of government	0	-306	-1	59	0	249	182	53	13	0
Fiscal balance	-149	-123	1	-21	-3	-3	0	-3	0	0

Sources: Ministry of Finance; and IMF staff estimates.

Table 8. Serbia: Banking Sector Financial Soundness Indicators, 2005-10

	2005	2006	2007	2008	2009	2010 March
Capital Adequacy						
Regulatory capital to risk-weighted assets	26.0	24.7	27.9	21.9	21.3	21.5
Capital to assets	16.2	18.5	21.0	23.6	21.0	21.0
Asset Quality						
Gross non performing loans to total loans	...	...	...	11.3	15.5	16.5
Specific provisions to gross non-performing loans	...	...	...	56.9	49.5	49.3
Non performing loans net of provisions to tier I capital	...	...	...	14.8	25.5	27.0
Loans to shareholders and parent companies to total loans	...	...	2.1	2.2	...	...
Large exposures to tier I capital	82.5	49.6	46.1	36.6	...	...
Specific provisions to gross loans	10.3	11.0	8.4	7.1	9.2	9.8
Profitability						
Return on assets (ROA)	1.1	1.7	1.7	2.1	1.3	1.3
Return on equity (ROE)	6.5	9.7	8.5	9.3	5.7	6.1
Net interest margin to gross operating income 1/	…	…	…	…	62.6	65.4
Non-interest expenses to gross operating income 2/	…	…	…	…	84.5	82.4
Non-interest expenses to average assets	…	…	…	…	6.9	5.9
Personnel expenses to non-interest expenses	…	…	…	…	28.7	30.0
Liquidity and foreign exchange risk						
Core liquid assets to total assets 3/	30.5	40.7	37.3	30.3	31.9	30.0
Core liquid assets to short-term liabilities	47.1	69.0	58.9	48.0	49.0	48.4
Liquid assets to total assets 4/	19.8	22.9	46.7	43.3	40.7	40.3
Liquid assets to short term liabilities	30.6	38.8	73.7	68.6	62.6	65.1
FX-denominated loans and FX-indexed loans to total loans	...	...	...	78.0	84.1	84.3
FX- deposits to total deposits	70.7	65.9	64.2	69.0	75.5	76.7
FX- liabilities to total liabilities	74.7	72.4	67.8	72.1	75.9	78.1
Deposits to assets	62.5	57.0	61.4	57.7	60.0	57.3
Loans to deposits	94.9	86.7	89.3	104.3	92.5	100.2
FX- loans to FX-deposits (including indexed)	…	…	…	113.3	103.1	110.0
Sensitivity to Market Risk						
Net open FX position (overall) as percent of tier I capital	18.6	21.7	14.5	7.4	3.2	2.9
Off-balance sheet operations as percent of assets 5/	26.4	41.0	49.2	56.2	45.9	40.9

Source: National Bank of Serbia.
1/ Gross operating income in this ratio excludes FX gains due to their volatility and distortionary impact.
2/ Non-interest expenses in the calculation of this ratio abstracts from FX losses.
3/ Cash, repos, t-bills, and mandatory reserves.
4/ Sum of first- and second-degree liquid receivables of the bank.
5/ Includes only risk-classified off-balance sheet items.

Table 9. Serbia: Balance of Payments, 2008–15 1/

	2008	2009 Est.	2010 3rd Rev.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Billions of euros)					
Current account balance	-5.9	-1.7	-2.7	-2.7	-2.6	-2.7	-2.5	-2.7	-2.5
Trade of goods balance	-7.6	-4.8	-4.7	-4.4	-4.3	-4.5	-4.7	-4.9	-4.8
Exports of goods	7.4	6.0	6.3	6.5	7.1	7.7	8.8	10.1	11.5
Imports of goods	-15.0	-10.8	-11.0	-10.9	-11.4	-12.2	-13.5	-15.0	-16.3
Services balance	-0.2	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Income balance	-0.9	-0.5	-0.9	-1.0	-0.9	-0.8	-0.9	-0.9	-1.0
Current transfer balance	2.9	3.5	2.9	2.8	2.7	2.7	3.2	3.3	3.4
Capital and financial account balance	4.2	3.6	1.3	1.5	1.6	3.4	4.1	4.1	3.6
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.8	1.4	1.4	1.4	1.4	1.5	1.6	1.8	1.9
Portfolio investment balance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other investment balance	2.5	2.3	0.0	0.1	0.3	2.0	2.6	2.4	1.7
General governement	0.1	0.7	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Domestic banks	0.5	2.0	0.0	0.0	-0.1	0.4	0.2	0.4	0.2
Other private sector	2.0	-0.4	-0.3	-0.2	0.1	1.3	2.0	1.7	1.1
Errors and omissions	0.0	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.6	1.9	-1.4	-1.2	-1.1	0.7	1.7	1.5	1.1
Financing	1.8	-1.2	1.4	1.2	1.1	-0.7	-1.7	-1.5	-1.0
Gross international reserves (increase, -)	1.8	-2.4	-0.7	0.4	1.0	-0.5	-1.0	-1.0	-1.0
Prospective drawings	…	1.1	2.1	0.8	0.1	0.0	0.0	0.0	0.0
EU	…	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0
World Bank	…	0.0	0.3	0.3	0.00	0.0	0.0	0.0	0.0
IMF	…	1.1	1.6	0.4	0.1	0.0	0.0	0.0	0.0
Prospective repayments (IMF)	…	…	…	…	…	-0.2	-0.7	-0.5	0.0
				(Percent of GDP)					
Current account balance	-17.6	-5.6	-8.5	-8.5	-8.0	-7.4	-6.3	-6.1	-5.3
Trade of goods balance	-22.8	-15.5	-14.7	-13.9	-13.1	-12.4	-11.9	-11.3	-10.2
Exports of goods	22.2	19.4	19.8	20.8	21.2	21.5	22.4	23.3	24.4
Imports of goods	-45.0	-34.9	-34.5	-34.7	-34.3	-33.9	-34.3	-34.6	-34.6
Services balance	-0.5	0.1	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Income balance	-2.8	-1.6	-3.0	-3.3	-2.8	-2.2	-2.2	-2.1	-2.1
Current transfer balance	8.5	11.4	9.1	9.0	8.2	7.5	8.1	7.6	7.2
Capital and financial account balance	12.7	11.7	4.2	4.7	4.8	9.5	10.5	9.5	7.6
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	5.4	4.4	4.4	4.5	4.1	4.1	4.1	4.1	4.1
Portfolio investment balance	-0.3	-0.2	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Other investment balance	7.5	7.5	0.1	0.4	0.9	5.5	6.6	5.5	3.6
Errors and omissions	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-4.9	6.1	-4.3	-3.8	-3.2	2.0	4.2	3.4	2.3
				(Percent, unless otherwise indicated)					
Memorandum items:									
Export volume growth	8.9	-11.0	6.5	2.6	9.0	12.5	13.1	13.7	13.4
Import volume growth	9.3	-18.3	0.6	-6.6	4.9	7.9	9.6	9.5	8.2
Export prices growth	6.7	-9.4	-0.3	5.9	-0.3	-2.8	1.0	0.7	0.5
Import prices growth	5.7	-12.5	2.0	8.0	0.2	-1.0	1.4	1.3	0.4
Change in terms of trade	1.0	3.5	-2.2	-1.9	-0.4	-1.8	-0.4	-0.7	0.1
GDP (billiions of euros)	33.4	30.9	32.0	31.3	33.3	35.9	39.5	43.4	47.2

Sources: NBS; and IMF staff estimates and projections.

1/ Some estimates, in particular for private remittances and reinvested earnings, are subject to significant uncertainty. In addition, intercompany loan transactions are not identified and are recorded as debt flows rather than FDI flows.

2/ Includes SDR allocations.

Table 10. Serbia: External Financing Requirements and Sources, 2008–15

(Billions of euros, unless otherwise indicated)

	2008	2009 Est.	2010 3rd Rev.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
1. Gross financing requirements	9.49	8.36	8.54	7.36	6.82	8.66	10.26	10.98	11.48
Current account deficit	5.88	1.74	2.72	2.67	2.65	2.66	2.49	2.65	2.51
Debt amortization	3.62	4.25	5.12	5.12	5.17	5.29	6.11	6.84	7.94
Medium- and long-term debt	2.67	2.65	3.51	3.51	3.57	3.68	4.51	5.24	6.33
Public sector 1/	0.12	0.14	0.25	0.25	0.29	0.30	0.36	0.37	0.39
Commercial banks	0.54	0.12	0.21	0.21	0.35	0.37	0.67	0.69	1.01
Corporate sector	2.01	2.39	3.06	3.06	2.93	3.01	3.48	4.17	4.93
Short-term debt 2/	0.94	1.61	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44	0.44
Accumulation of gross reserves	0.00	2.36	0.70	-0.43	-1.00	0.50	1.00	1.00	1.00
Repayment of prospective IMF credits	...	...	...	...	...	0.20	0.65	0.48	0.02
2. Available financing	9.49	7.20	6.44	6.61	6.77	8.66	10.26	10.98	11.48
Capital transfers	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Foreign direct investment (net)	1.81	1.37	1.40	1.41	1.36	1.47	1.62	1.78	1.93
Portfolio investment (net)	-0.09	-0.06	-0.11	-0.06	-0.06	-0.06	-0.06	-0.06	-0.06
Debt financing	5.53	4.75	5.05	5.13	5.34	7.14	8.57	9.12	9.51
Medium- and long-term debt	4.86	3.14	3.44	3.52	3.73	5.53	6.96	7.51	7.90
Public sector 1/	0.18	0.39	0.60	0.60	0.60	0.61	0.68	0.68	0.75
Commercial banks	0.23	0.90	0.17	0.17	0.24	0.74	0.90	1.10	1.20
Corporate sector	4.46	1.85	2.67	2.75	2.89	4.19	5.38	5.73	5.95
Short-term debt 2/	0.67	1.61	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44	0.44
3. Financing gap	0.00	1.16	2.10	0.76	0.05	0.00	0.00	0.00	0.00
European Union (prospective)	…	0.00	0.20	0.10	0.00	0.00	0.00	0.00	0.00
World Bank (prospective)	…	0.04	0.30	0.30	0.00	0.00	0.00	0.00	0.00
IMF	…	1.12	1.60	0.36	0.05	…	…	…	…
Memorandum items:									
Debt service	4.35	4.89	6.19	6.18	6.23	6.29	7.17	7.97	9.13
Interest	0.73	0.64	1.07	1.06	1.05	1.00	1.06	1.12	1.18
Amortization	3.62	4.25	5.12	5.12	5.17	5.29	6.11	6.84	7.94

Sources: NBS; and Fund staff estimates and projections.

1/ Excluding IMF.

2/ Original maturity of less than 1 year. Stock at the end of the previous period.

Table 11. Serbia: External Balance Sheet, 2008-15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Bllions of euros)				
International investment position 2/	-25.8	-28.3	-31.0	-33.6	-36.3	-38.8	-41.4	-44.0
Public sector 3/	1.4	2.8	1.3	-0.1	0.3	1.6	2.8	3.4
Private sector 3/	-27.2	-31.1	-32.2	-33.5	-36.6	-40.4	-44.2	-47.5
FDI and portfolio investment (net) 4/	-12.4	-13.7	-15.0	-16.3	-17.7	-19.3	-21.0	-22.9
External debt (net) 4/	-22.2	-23.8	-24.5	-24.8	-26.4	-28.2	-30.0	-31.5
Gross external debt	-21.8	-23.4	-24.2	-24.4	-26.0	-27.8	-29.6	-31.2
General government	-6.4	-6.3	-6.6	-6.9	-7.2	-7.6	-7.9	-8.2
Private sector	-15.4	-15.9	-15.6	-15.4	-17.0	-19.1	-21.1	-22.3
Banks	-3.9	-5.2	-5.1	-5.0	-5.4	-5.6	-6.0	-6.2
Other private sector	-11.5	-10.8	-10.5	-10.4	-11.6	-13.5	-15.1	-16.1
Liabilities from prospective drawings from IFIs and the EU		-1.2	-2.0	-2.0	-1.8	-1.2	-0.7	-0.7
Gross external assets	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other, net (inc. commercial banks foreign assets)	0.6	-1.5	-1.6	-1.7	-1.9	-2.0	-2.1	-2.3
Central bank gross international reserves	8.2	10.6	10.2	9.2	9.7	10.7	11.7	12.7
Liabilities from drawings to close the gap								
				(Percent of GDP)				
International investment position 2/	-77.2	-91.7	-98.9	-101.1	-101.1	-98.3	-95.4	-93.3
Public sector 3/	4.2	9.0	4.0	-0.3	0.8	4.1	6.4	7.3
Private sector 3/	-81.4	-100.7	-102.9	-100.7	-101.9	-102.4	-101.8	-100.6
FDI and portfolio investment (net) 4/	-37.0	-44.3	-48.0	-49.1	-49.4	-48.9	-48.4	-48.5
External debt (net) 4/	-66.4	-77.0	-78.4	-74.5	-73.6	-71.5	-69.1	-66.9
Gross external debt	-65.2	-75.8	-77.2	-73.3	-72.5	-70.5	-68.2	-66.0
General government	-19.1	-20.3	-21.1	-20.8	-20.1	-19.1	-18.1	-17.4
Private sector	-46.1	-51.6	-49.8	-46.4	-47.3	-48.4	-48.5	-47.2
Banks	-11.7	-16.7	-16.4	-15.1	-15.0	-14.2	-13.9	-13.2
Other private sector	-34.4	-34.9	-33.4	-31.3	-32.3	-34.2	-34.7	-34.1
Liabilities from prospective drawings from IFIs and the EU		-3.9	-6.3	-6.1	-5.1	-2.9	-1.6	-1.4
Gross external assets	-1.1	-1.2	-1.2	-1.2	-1.1	-1.0	-0.9	-0.8
Other, net (inc. commercial banks reserves)	1.7	-4.8	-5.1	-5.2	-5.2	-5.0	-4.9	-4.8
Central bank gross international reserves	24.4	34.5	32.6	27.7	27.1	27.1	27.0	26.9
Memorandum items:								
				(Billions of euros, unless otherwise indicated)				
Central bank international reserves								
Gross reserves (months of next year's imports)	7.7	9.6	8.8	7.4	7.0	7.0	6.9	6.9
Free net reserves (months of next year's imports)	4.5	4.5	3.8	3.1	3.1	3.5	3.7	4.0
Short term external debt by original maturity due	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
(in percent of central bank gross reserves)	19.7	15.1	15.8	17.5	16.6	15.0	13.7	12.7
(in percent of central bank free net reserves)	33.4	32.4	36.7	42.4	37.4	30.4	25.6	22.1
(percent of total debt)	7.4	6.9	6.7	6.6	6.2	5.8	5.4	5.2
(percent of GDP)	4.8	5.2	5.1	4.8	4.5	4.1	3.7	3.4
Short term external debt by remaining maturity	4.9	6.0	5.4	5.4	5.4	5.4	5.4	5.4
(percent of central bank gross reserves)	59.7	56.4	53.1	58.9	55.8	50.6	46.3	42.7
(percent of central bank free net reserves)	101.2	120.8	123.6	142.7	126.1	102.3	86.1	74.3
(percent of total debt)	22.3	25.7	22.4	22.2	20.8	19.5	18.3	17.4
(percent of GDP)	14.6	19.5	17.3	16.3	15.1	13.7	12.5	11.5
GDP	33.4	30.9	31.3	33.3	35.9	39.5	43.4	47.2

Sources: NBS; and IMF staff estimates and projections.

1/ NBS estimates for gross external debt and international reserves. Stock data for other items are staff estimates based on flows since

2/ + denotes a net asset position, - a net liability.

3/ Staff estimates (available data on gross external debt assets and other items is not sufficient to accurately estimate the breakdown pul

4/ Intercompany loans cannot be identified and are included in external debt rather than in FDI position.

Tabie 12. Serbia: Monetary Survey, 2006–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2006	2007	2008	2009	2010				2011
					Q1	Q2	Q3	Q4	
						Proj.	Proj.	Proj.	Proj.
Net foreign assets 2/	408	563	484	571	559	552	544	536	463
in billions of euro	5.2	7.1	5.5	5.9	5.6	5.6	5.5	5.5	4.6
Foreign assets	771	877	847	1,185	1,224	1,203	1,182	1,162	1,102
NBS	715	766	725	1,023	1,049	1,032	1,015	999	937
Commercial banks	56	111	123	163	174	171	167	163	165
Foreign liabilities (-)	-363	-314	-364	-615	-664	-651	-638	-625	-638
NBS	-56	-14	-14	-115	-124	-124	-124	-124	-128
Commercial banks	-308	-300	-350	-500	-540	-527	-514	-501	-510
Net domestic assets	203	320	484	608	632	662	693	725	986
Domestic credit	481	701	1,048	1,276	1,368	1,400	1,465	1,528	1,948
Government, net	-104	-112	-53	-4	4	5	32	59	164
NBS	-107	-100	-50	-101	-106	-129	-115	-101	-101
Banks	2	-12	-4	97	110	134	147	160	265
Local governments, net	-19	-14	-16	-14	-14	-16	-16	-18	-17
Non-government sector	604	827	1,117	1,295	1,378	1,411	1,450	1,488	1,801
Households	204	306	382	419	443	445	449	453	542
Enterprises	381	508	711	851	904	935	969	1,003	1,220
Other	19	13	23	25	30	31	32	32	39
Other assets	70	78	56	111	58	78	98	118	142
Capital and reserves (-)	-242	-356	-505	-633	-636	-646	-689	-728	-866
NBS	-7	-7	-63	-166	-157	-159	-193	-224	-359
Banks	-235	-350	-442	-467	-479	-487	-496	-504	-507
Provisions (-)	-106	-104	-115	-146	-157	-169	-181	-193	-238
Broad money (M2)	611	883	968	1,179	1,192	1,214	1,237	1,261	1,449
Dinar-denominated M2	255	370	371	412	378	400	422	446	534
M1	191	239	230	250	218	231	246	261	315
Currency in circulation	68	77	90	96	86	91	96	101	112
Demand deposits	122	162	140	154	132	140	150	159	203
Time and saving deposits	65	131	141	162	160	169	176	185	218
Foreign currency deposits	355	513	597	767	814	814	815	815	915
in billions of euro	4.5	6.5	6.7	7.8	8.2	8.3	8.2	8.3	9.0
Memorandum items:									
Twelve-month growth:									
M1	37.1	25.3	-3.8	8.7	12.2	10.4	11.7	4.4	21.0
M2	38.4	44.5	9.6	21.8	22.2	18.8	17.5	7.0	14.9
Total credit to non-government	23.1	48.6	48.7	8.9	6.6	2.3	5.8	7.9	14.0
Domestic	17.1	36.9	35.0	15.9	16.8	10.8	12.0	14.9	21.1
Households	54.1	50.3	25.0	9.5	11.8	8.3	7.2	8.1	19.6
Enterprises	2.9	33.2	40.0	19.6	15.1	11.4	13.9	17.8	21.7
External	34.6	68.0	67.2	1.2	-1.9	-8.2	-2.0	-0.9	3.6
Total real credit to non-government	15.5	33.8	36.9	2.2	1.9	-1.5	0.5	1.7	9.1
Domestic	9.8	23.3	24.3	8.8	11.6	6.6	6.4	8.4	15.8
Households	44.5	35.3	15.1	2.8	6.8	4.2	1.9	7.0	14.4
Enterprises	-3.5	20.0	28.9	12.2	10.0	7.2	8.2	11.1	16.4
External	26.3	51.3	54.0	-5.0	-6.2	-11.7	-6.9	-6.5	-0.8
Velocity (M1)	10.4	9.4	11.9	11.6	13.5	13.0	12.3	11.8	10.5
Velocity (M2)	3.3	2.5	2.8	2.5	2.5	2.5	2.5	2.4	2.3

Sources: National Bank of Serbia; and IMF staff estimates and projections.

1/ Foreign exchange denominated items are converted at contemporaneous exchange rates.

2/ Excluding undivided assets and liabilities of the FSRY and liabilities to banks in liquidation.

Table 13. Serbia: Balance Sheet of the NBS, 2006–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2006	2007	2008	2009	2010				2011
					Q1	Q2 Proj.	Q3 Proj.	Q4 Proj.	Proj.
Net foreign assets 2/	406	482	517	628	623	602	585	569	538
in billions of euro	5.1	6.1	5.8	6.6	6.2	6.1	6.3	5.9	5.3
Gross foreign reserves	715	766	725	1,023	1,049	1,032	1,015	999	937
Gross reserve liabilities (-)	-309	-284	-208	-394	-426	-431	-430	-429	-399
Net domestic assets	-272	-323	-208	-382	-415	-400	-394	-355	-337
Net domestic credit	-264	-316	-145	-216	-258	-241	-201	-131	23
Government	-107	-100	-50	-101	-106	-129	-115	-101	-101
Claims	16	11	11	11	11	11	11	11	11
RSD	16	11	11	11	11	11	11	11	11
foreign currency	0	0	0	0	0	0	0	0	0
Liabilities (-)	-123	-111	-60	-112	-117	-141	-127	-112	-112
RSD	-20	-29	-20	-63	-58	-60	-61	-63	-63
foreign currency	-103	-82	-41	-49	-59	-81	-65	-49	-49
Other public sector	-10	-11	-15	-12	-15	-12	-12	-13	-11
Banks	-151	-218	-88	-151	-139	-126	-134	-149	-148
Claims	0	1	2	1	1	2	2	2	3
Liabilities (-)	-152	-219	-90	-152	-140	-128	-136	-152	-152
Other sectors	4	13	7	48	2	27	61	132	283
Capital accounts (-)	-7	-7	-63	-166	-157	-159	-193	-224	-359
Reserve money	134	159	309	247	219	201	192	214	201
Currency in circulation	68	77	90	96	96	91	96	101	112
Commercial bank reserves	65	82	219	151	122	110	95	113	89
Required reserves	34	30	165	112	117	99	84	69	40
Excess reserves	22	45	5	7	1	1	1	5	5
Vault cash and giro accounts	9	7	48	32	5	10	10	39	44

Sources: National Bank of Serbia; and IMF staff estimates and projections.

1/ Foreign exchange denominated items are converted at contemporaneous exchange rates.

2/ Excluding undivided assets and liabilities of the FSRY and liabilities to banks in liquidation.

Table 14. Serbia: Balance Sheet of Commercial Banks, 2006-10 1/
(Billions of dinars, unless otherwise indicated)

	2006	2007	2008	2009	2010 Q1		
						Billions of euros	Percent of GDP
Assets	1,274	1,678	1,925	2,342	2,424	24.3	78.5
Foreign exchange	56	111	123	163	174	1.7	5.7
Claims on NBS	468	569	508	583	564	5.7	18.3
Dinar cash and reserves	63	80	219	151	122	1.2	4.0
Foreign exchange reserves	254	270	194	279	302	3.0	9.8
NBS bills and other claims	152	219	95	153	140	1.4	4.5
Claims on government	18	8	9	108	120	1.2	3.9
Claims on other sectors	594	827	1,118	1,299	1,382	13.9	44.8
Households	203	305	382	418	443	4.4	14.3
Enterprises	380	507	710	849	902	9.0	29.2
Other institutions	11	15	27	31	37	0.4	1.2
Fixed assets	66	75	88	99	99	1.0	3.2
Other assets	71	88	78	90	84	0.8	2.7
Liabilities	1,274	1,678	1,925	2,342	2,424	24.3	78.5
Foreign liabilities	308	300	350	500	540	5.4	17.5
Dinar deposits	213	319	301	338	314	3.1	10.2
Demand deposits	122	162	140	155	133	1.3	4.3
Time and saving deposits	79	142	154	178	179	1.8	5.8
Government deposits	12	16	7	5	2	0.0	0.1
Foreign currency deposits	359	517	599	770	814	8.2	26.4
Enterprises	84	116	140	145	145	1.4	4.7
Households	261	382	414	565	605	6.1	19.6
Government	4	4	6	7	8	0.1	0.3
Other institutions	10	15	40	53	56	0.6	1.8
Other deposits	2	3	1	2	2	0.0	0.1
Liabilities to NBS	0	2	6	1	1	0.0	0.0
Other liabilities	70	95	122	128	127	1.3	4.1
Provisions	87	93	103	135	148	1.5	4.8
Capital and reserves	235	350	442	467	479	4.8	15.5
Memorandum items:							
Provisions against credit losses	...	75.8	98.8	133.2	142.8	1.4	4.6
in percent of credit	...	9.2	8.8	10.3	10.3	10.3	...
Enterprises	54.8	58.8	72.5	99.8	107.3	1.1	3.5
in percent of credit	14.4	11.6	10.2	11.7	11.9	...	...
Households	7.5	10.8	17.2	23.3	24.6	0.2	0.8
in percent of credit	3.7	3.5	4.5	5.6	5.6	...	...
Off-balance sheet items 2/	1,163	1,580	2,157	2,305	2,584	...	...
External debt (billions of euros)	3.9	4.0	3.9	4.5	4.5	...	14.5
medium- and long-term	2.9	2.8	2.3	2.7	2.7	...	8.7
short-term	0.9	1.2	1.6	1.8	1.8	...	5.7

Source: National Bank of Serbia.

1/ Numbers are on a gross basis; credit numbers include provisions.

2/ As of December 2009, about 16 percent of off-balance sheet items represented various guarantees, mostly on cross-border loans. Other off-balance sheet items include collateral against loans and repo contracts, undrawn credit lines, and derivative contracts. Figures in euros and in percent of GDP correspond to the latest available observation.

Table 15. Serbia: Indicators of Capacity to Repay the Fund, 2009–15 1/

	2009	2010	2011	2012	2013	2014	2015
Fund repurchases and charges							
In millions of SDRs	5	38	58	234	967	1,151	395
In millions of euro	5	43	65	263	1,087	1,297	445
In percent of exports of goods and NFS	0.1	0.5	0.7	2.5	9.3	9.8	2.9
In percent of GDP	0.0	0.1	0.2	0.7	2.8	3.0	0.9
In percent of quota	1.0	8.1	12.5	50.0	206.7	246.0	84.4
In percent of total external debt service	0.1	0.9	1.4	5.3	16.3	16.9	5.6
In percent of gross international reserves	0.0	0.4	0.7	2.7	10.1	11.1	3.5
Fund credit outstanding (end-period)							
In millions of SDRs	1,021	2,300	2,619	2,444	1,693	599	40
In millions of euro	1,154	2,598	2,933	2,744	1,903	675	45
In percent of exports of goods and NFS	13.6	29.4	30.9	26.4	16.2	5.1	0.3
In percent of GDP	3.7	8.3	8.8	7.6	4.8	1.6	0.1
In percent of quota	218.3	491.7	560.0	522.5	362.1	128.1	8.5
In percent of total external debt	4.9	10.8	12.0	10.5	6.8	2.3	0.1
In percent of gross international reserves	10.8	25.4	31.8	28.3	17.8	5.8	0.4
Memorandum items:		(Millions of euros, unless otherwise indicated)					
Exports of goods and NFS	8,473	8,847	9,497	10,378	11,729	13,292	15,331
Quota (in millions of SDRs)	468	468	468	468	468	468	468
Total external debt service	3,591	4,614	4,684	4,940	6,651	7,655	7,963
Public sector external debt (end-period)	7,471	8,576	8,942	9,050	8,715	8,540	8,878
Total external debt stock (end-period)	23,396	24,158	24,375	26,028	27,829	29,621	31,164
Gross international reserves	10,644	10,210	9,210	9,710	10,710	11,710	12,710

Source: Fund staff estimates.

1/ Assuming actual purchase of projected available amounts.

Table 16. Serbia: Proposed Schedule of Purchases Under the Stand-By Arrangement, 2009–11

	Available on or after	Amount of Purchase: In millions of SDR	Amount of Purchase: In percent of quota 1/	Conditions
1.	Purchased	233.850	50.0	Board approval of the arrangement.
2.	Purchased	23.385	5.0	Observance of end-December 2008 performance criteria and completion of financing assurances review.
3.	Purchased	444.315	95.0	Board approval of augmentation of the arrangement, observance of end-March performance criteria, and completion of the first program review (including financing assurances review).
4.	Purchased	319.595	68.3	Observance of end-September 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
5.	Purchased	159.798	34.2	Observance of end-December 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
	Undrawn	159.798	34.2	
6.	May 25, 2010	319.595	68.3	Observance of end-March 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
7.	August 25, 2010	319.595	68.3	Observance of end-June 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
8.	November 25, 2010	319.595	68.3	Observance of end-September 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
9.	February 25, 2011	319.595	68.3	Observance of end-December 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
	Total	2,619.120	560.0	

1/ The quota is SDR 467.7 million.

APPENDIX I. SERBIA: EXTERNAL DEBT SUSTAINABILITY

The external debt dynamics are virtually unchanged relative to the previous analysis. On current baseline projections, total external debt is expected to peak in 2010, at 77.5 percent of GDP. On the assumption that growth will gradually accelerate and the current account deficit will stabilize in nominal terms, the external debt-to-GDP ratio would start to decline in 2011 and recede to 66.3 percent of GDP by 2015, only marginally above its 2008 level. Standard tests yield similar results, except for the exchange rate shock, which raises the external debt-to-GDP ratio sharply.

1. **In the years before the onset of the global financial crisis, Serbia's external debt rose rapidly, resulting in increased vulnerabilities.** Following persistently large external imbalances—and despite rescheduling operations and early repayments to some multilateral creditors, including the Fund—external debt reached 21.8 billion euros in December 2008. The rise was mainly due to increased private sector borrowing. In particular, nonbank private debt rose sharply, as prudential regulation on bank activity became tighter and companies switched to direct foreign borrowing, often with domestic commercial banks acting as intermediaries. This trend was interrupted toward the end of 2008, when private sector debt started to decline. Nevertheless, external debt remained high at about 23.4 billion euros at end-2009. The external debt-to-GDP ratio also rose in response to the depreciation of the exchange rate in late 2009 and early 2009.

Serbia: Structure of External Debt, 2005-09
(Percent of total debt)

	2005	2006	2007	2008	2009
Public	59	43	34	29	32
Private	41	57	66	71	68
Banks	17	26	22	18	22
Other private	24	31	43	53	46
Total	100	100	100	100	100

Sources: NBS and IMF staff estimates.

2. **Gradually improving prospects for GDP growth and faster adjustment of the current account balance point to a reversal in the external debt dynamics in coming years. compared to the previous analysis.** In particular, the debt-to-GDP ratio (including prospective liabilities to the Fund) is expected to peak in 2010 at 77.5 percent of GDP percent before embarking on a declining path (Table A1).

3. **With global and domestic conditions beginning to improve gradually in 2010, external debt ratios are expected to start declining already in 2011 under the baseline scenario.** GDP growth is expected to recover gradually, the current account deficit to stabilize in nominal terms, and FDI inflows to resume. As a result, the debt-to-GDP ratio is projected to decline to 66.3 percent of GDP in 2015.

4. **Standard stress tests point to some risks associated with a currency depreciation.** With a real depreciation of 30 percent, the external debt-to-GDP ratio would initially rise to

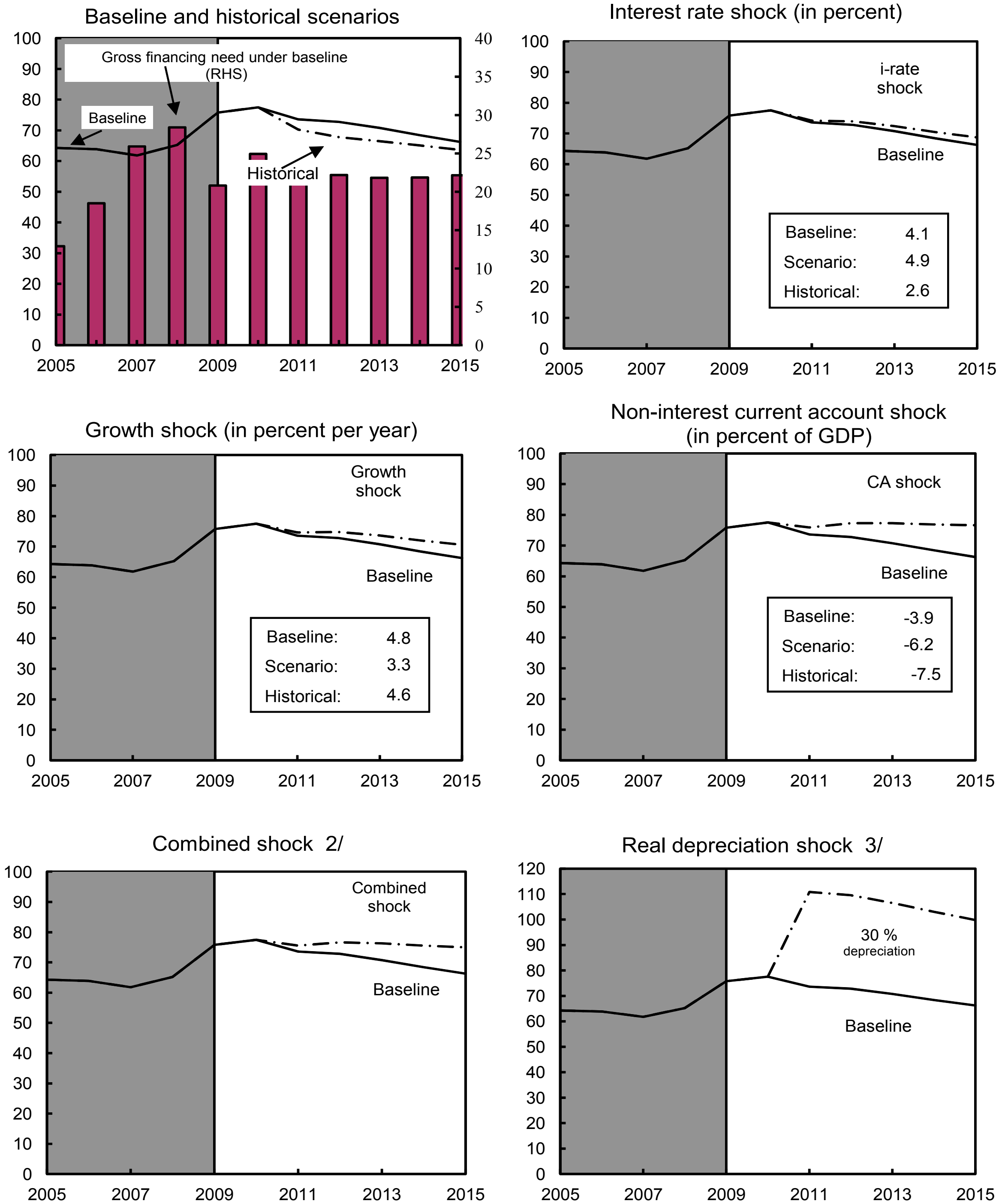
110.8 percent, but decline thereafter. However, with the real exchange rate already relatively depressed, a further large real exchange rate depreciation is regarded as highly unlikely. Under the other standard shocks, external debt would rise to close to 80 percent of GDP before returning to a declining path. However, such dynamics crucially depend on the assumptions of gradually rising growth and current account adjustment in the medium term.

Table A1. Country: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	64.3	63.9	61.8	65.2	75.8	**77.5**	**73.6**	**72.8**	**70.8**	**68.4**	**66.3**	**-6.8**
Change in external debt	10.0	-0.4	-2.1	3.4	10.6	1.7	-3.9	-0.8	-2.0	-2.3	-2.2	
Identified external debt-creating flows (4+8+9)	3.3	-3.0	-4.9	3.9	6.8	3.1	1.8	0.1	-1.3	-1.4	-1.8	
Current account deficit, excluding interest payments	7.0	8.1	13.5	15.0	3.5	4.9	4.8	4.6	3.6	3.5	2.8	
Deficit in balance of goods and services	21.0	21.6	23.9	23.4	15.4	14.2	13.3	12.7	12.2	11.6	10.5	
Exports	26.2	29.9	30.2	30.4	27.5	28.3	28.6	28.9	29.7	30.6	32.5	
Imports	47.2	51.4	54.1	53.7	42.9	42.5	41.9	41.6	41.9	42.2	43.0	
Net non-debt creating capital inflows (negative)	-2.1	-4.9	-8.7	-5.1	-4.2	-4.3	-3.9	-3.9	-4.0	-4.0	-4.0	
Automatic debt dynamics 1/	-1.6	-6.2	-9.7	-6.0	7.6	2.5	1.0	-0.6	-1.0	-1.0	-0.6	
Contribution from nominal interest rate	1.7	2.1	2.4	2.6	2.2	3.7	3.2	2.8	2.7	2.6	2.5	
Contribution from real GDP growth	-2.9	-2.9	-3.6	-2.9	2.1	-1.1	-2.2	-3.4	-3.6	-3.5	-3.1	
Contribution from price and exchange rate changes 2/	-0.4	-5.4	-8.6	-5.6	3.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.7	2.6	2.8	-0.4	3.8	-1.4	-5.8	-0.9	-0.7	-1.0	-0.4	
External debt-to-exports ratio (in percent)	245.6	213.8	204.8	214.7	276.1	274.2	257.7	251.8	238.1	223.6	203.9	
Gross external financing need (in billions of US dollars) 4/	2.6	4.3	7.5	9.5	6.4	7.8	7.8	8.0	8.6	9.5	10.5	
in percent of GDP	12.9	18.5	25.9	28.4	20.8	24.9	23.5	22.2	21.8	21.9	22.2	
Scenario with key variables at their historical averages 5/						**77.5**	**70.2**	**67.8**	**66.5**	**65.1**	**63.6**	**-10.3**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.6	5.2	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0	
GDP deflator in US dollars (change in percent)	0.8	9.1	15.5	10.0	-4.8	-0.1	3.2	2.8	4.2	4.3	3.5	
Nominal external interest rate (in percent)	3.3	3.7	4.7	4.9	3.1	4.9	4.3	4.1	4.1	4.0	4.0	
Growth of exports (US dollar terms, in percent)	18.9	31.0	24.8	16.9	-16.5	4.4	7.3	9.3	13.0	13.3	15.3	
Growth of imports (US dollar terms, in percent)	0.4	25.2	30.0	15.3	-26.3	0.5	4.8	7.2	10.8	10.8	10.6	
Current account balance, excluding interest payments	-7.0	-8.1	-13.5	-15.0	-3.5	-4.9	-4.8	-4.6	-3.6	-3.5	-2.8	
Net non-debt creating capital inflows	2.1	4.9	8.7	5.1	4.2	4.3	3.9	3.9	4.0	4.0	4.0	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Serbia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

APPENDIX II. SERBIA: PUBLIC DEBT SUSTAINABILITY

1. **General government debt in Serbia remains sustainable**. However, rollover risks will rise as the stock of domestic-currency T-bills is expected to increase from 3 percent of GDP in 2009 to about 7 percent of GDP during 2010-15. At the same time, the large FX share of public debt implies significant vulnerability to a depreciation of the dinar. Additional fiscal risks derive from contingent liabilities associated to off-balance sheet transactions, from quasi-fiscal losses of state- and socially owned enterprises, from government support to the private sector, and the eventual payment of restitution debt.

2. **Gross general government debt is projected to increase to 39 percent of GDP in 2010, from 35½ percent of GDP in 2009, and is expected to fall to 36 percent of GDP in 2015** (Table A1).[1] The projected increase in gross debt in 2010 mainly reflects the following factors: (i) a significant increase in the stock of dinar-denominated T-bills; (ii) external borrowing; and iii) exchange rate depreciation. The overall debt stock is also higher than previously estimated due to the higher fiscal deficit caused by automatic stabilizers on the revenue side and lower-than-expected growth.

3. **In an unchanged policies scenario, the public debt-to-GDP ratio would increase to 49 percent of GDP in 2015**. The large increase is mainly due to the elevated primary deficit in 2010 (3½) and does not reflect the expected expenditure-based adjustment. By contrast, under the assumption that key variables remain at their historical averages, the public debt-to GDP ratio would decline to 23 percent, reflecting high growth during the absorption boom coupled with low real interest rates.

4. **Standardized bound tests show that Serbia's debt is particularly sensitive to growth and exchange rate shocks (Figure A1)**. Imposing half a standard-deviation shock to GDP growth increases the public debt stock to 50 percent of GDP in 2015. Also, given that around 80 percent of the debt is denominated in foreign currency (comprising mainly frozen currency deposit bonds and debt to multilaterals and Paris Club creditors), a 30 percent real depreciation of the dinar would put the debt-to-GDP ratio at 47 percent in 2015. Similar shocks to the primary balance and interest rates would leave debt-to-GDP at 41 percent of GDP and 38 percent of GDP, respectively.

5. **Further risks to the debt outlook come from large contingent liabilities, in particular those related to public enterprises.** The main sources of risk are the following:

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[1] The debt stock includes gross general government and government-guaranteed debt of the Republic of Serbia, including debt to non-Paris Club official creditors under negotiation and in non-convertible currencies. It excludes any borrowing from the Fund by the NBS.

- **Public enterprises**. Some state-owned and socially owned enterprises are running large quasi-fiscal deficits. With most public enterprise debt included in the general government debt stock (since they carry government guarantees), and with enterprises receiving explicit or implicit subsidies through lower taxes and utility tariffs to cover their operations, their past and regular losses are implicitly covered. However, there are risks from delays in utility price adjustments, large investment plans and needs, and provision of new loan guarantees to nonviable enterprises.

- **Financial sector stability.** Financial sector distress could lead to the need for public sector support of the financial system, with high euroization and potential spillovers from the Greek crisis constituting major risks. However, staff assesses the financial system to be well-capitalized and liquid and well placed to handle possible external shocks.

- **Government support to the economy.** The domestic credit support program launched in February of 2009, and continued in 2010, could add up to 2 percent of GDP to public debt. Risks derive from state-guaranteed IFI loans to small and medium-sized enterprises (1½ percent of GDP), and loans granted through the National Development Fund and commercial banks (½ percent of GDP).

- **Restitution.** A plan formulated by the government in 2007 to provide compensation for assets confiscated by the communist government after World War could increase debt by up to about 16 percent of 2010 GDP. Moreover, the sensitivity of public debt to the exchange rate would be adversely affected if the restitution bonds were to be denominated in foreign currency.

Table A2. Serbia: Public Sector Debt Sustainability Framework, 2005-2015
(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	**56.1**	**42.6**	**34.3**	**33.4**	**35.6**	**39.1**	**41.1**	**40.6**	**39.1**	**37.2**	**36.1**	**-1.5**
o/w foreign-currency denominated	45.4	36.6	33.8	29.3	28.4	28.4	26.7	23.7	20.8	18.2	17.1	
Change in public sector debt	-9.1	-13.5	-8.3	-0.9	2.2	3.5	2.0	-0.5	-1.4	-2.0	-1.0	
Identified debt-creating flows (4+7+12)	-11.1	-17.4	-7.7	0.4	2.3	2.6	1.1	-0.6	-1.4	-2.0	-2.1	
Primary deficit	-2.3	0.0	1.1	2.0	3.4	3.6	2.4	1.5	0.7	0.1	-0.4	
Revenue and grants	42.9	43.8	42.4	41.9	39.5	38.6	37.8	37.3	37.1	37.0	37.0	
Primary (noninterest) expenditure	40.6	43.8	43.5	43.9	42.8	42.2	40.2	38.8	37.8	37.1	36.6	
Automatic debt dynamics 2/	-6.3	-9.6	-6.1	-0.4	1.0	-0.9	-1.3	-2.1	-2.1	-2.1	-1.8	
Contribution from interest rate/growth differential 3/	-10.2	-6.8	-6.1	-3.9	-1.3	-0.9	-1.3	-2.1	-2.1	-2.1	-1.8	
Of which contribution from real interest rate	-7.4	-4.3	-3.7	-2.3	-2.3	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1	
Of which contribution from real GDP growth	-2.9	-2.5	-2.5	-1.6	0.9	-0.5	-1.1	-1.9	-2.0	-2.0	-1.7	
Contribution from exchange rate depreciation 4/	3.9	-2.9	0.1	3.5	2.3	...	...	...	...	...	...	
Other identified debt-creating flows	-2.5	-7.8	-2.8	-1.2	-2.0	-0.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-2.5	-7.8	-2.8	-1.2	-2.0	-0.1	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.0	3.8	-0.6	-1.3	-0.1	0.9	0.9	0.0	0.0	0.0	1.1	
Public sector debt-to-revenue ratio 1/	130.8	97.3	81.0	79.8	90.1	101.3	108.8	108.8	105.5	100.4	97.6	
Gross financing need 6/	0.3	3.3	3.3	5.1	5.7	10.0	11.8	11.4	11.5	9.9	9.5	
in billions of euro	0.1	0.8	1.0	1.7	1.7	3.1	3.9	4.1	4.5	4.3	4.5	
Scenario with key variables at their historical averages 7/						**39.1**	**35.4**	**31.4**	**28.0**	**25.0**	**23.4**	**-3.0**
Scenario with no policy change (constant primary balance) in 2010-2015						**39.1**	**42.4**	**44.3**	**45.6**	**46.8**	**49.2**	**-2.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.4	5.2	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0	
Average nominal interest rate on public debt (in percent) 8/	2.8	3.2	2.1	2.1	2.5	3.6	3.9	3.9	4.1	4.0	4.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-13.0	-8.3	-9.5	-7.1	-7.5	-1.0	-0.4	-0.3	0.1	0.0	0.0	
Nominal appreciation (increase in euro value of local currency, in percent)	-7.4	7.8	-0.3	-10.6	-7.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	15.7	11.5	11.6	9.2	10.0	4.6	4.4	4.3	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	3.0	13.5	6.0	6.4	-5.2	0.0	-1.9	1.4	2.8	3.6	3.6	
Primary deficit	-2.3	0.0	1.1	2.0	3.4	3.6	2.4	1.5	0.7	0.1	-0.4	

Source: Ministry of Finance and IMF staff estimates.

1/ Includes general government and guaranteed debts (gross).

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of euro).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

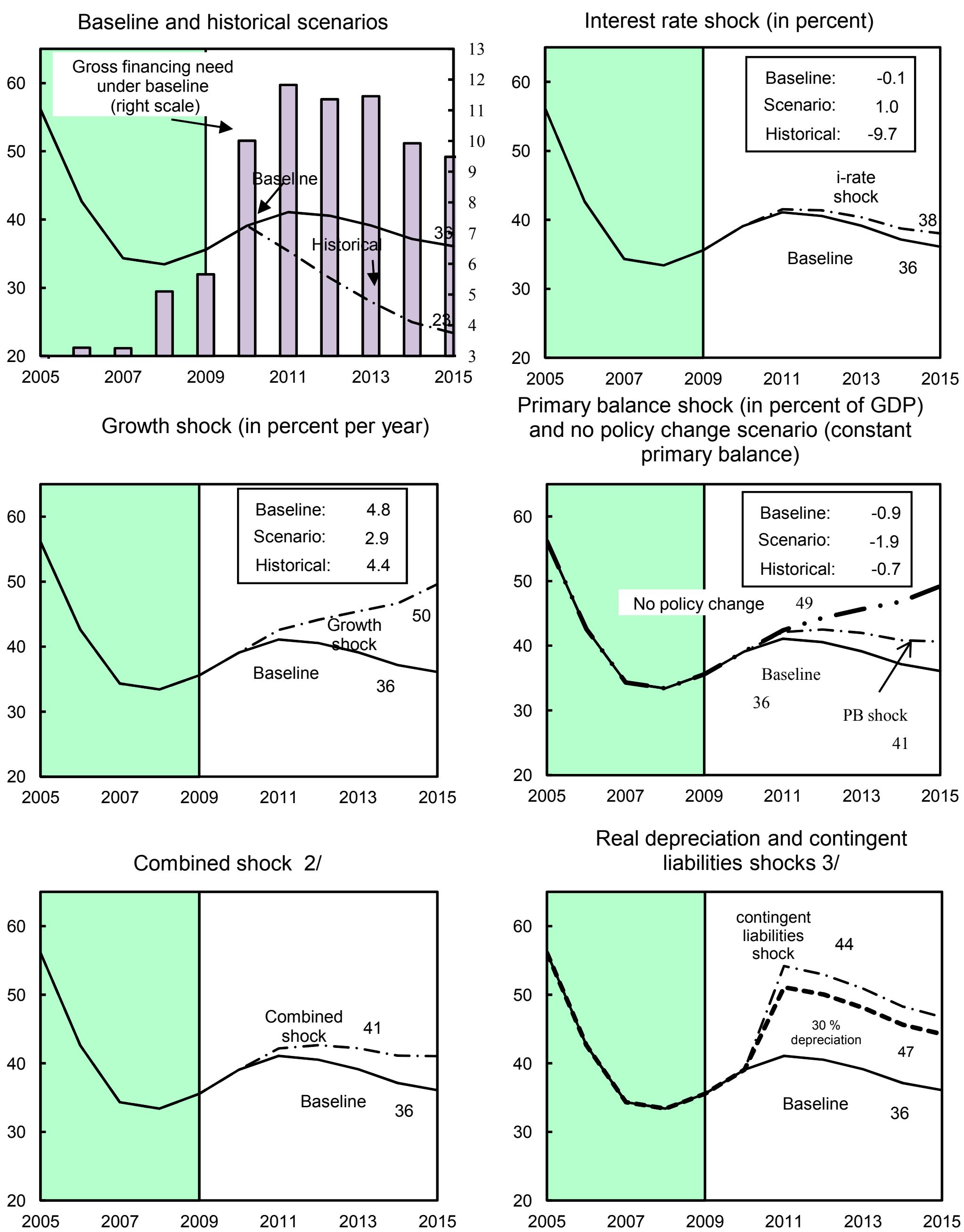
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A2. Serbia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ATTACHMENT I. REPUBLIC OF SERBIA: LETTER OF INTENT (LOI)

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Belgrade, June 10, 2010

Dear Mr. Strauss-Kahn:

1. Our program has continued to perform satisfactorily. All but one end-March 2010 quantitative performance criteria were observed (Table 1). The ceiling on the general government deficit was exceeded by a small margin owing to shortfalls in revenues. We have also made progress on the structural benchmarks for end-May. As a prior action for the Board meeting in late June, the revised pension law will be submitted to Parliament. We have also prepared draft fiscal responsibility legislation in line with the agreed benchmark to discipline fiscal policy beyond 2010, but the remaining important details regarding the numerical fiscal rules and the fiscal council still need to be settled.

2. Unfortunately, our economy is unlikely to recover as quickly as we had hoped for, and we see risks of further adverse spillovers to the region from the Greek debt crisis and economic tensions in the euro area. Available indicators for the first quarter suggest that growth momentum remains insufficient and too uneven to revive the labor market, mostly reflecting lack of external demand impulses and depressed investment; at the same time, we are encouraged by clear signs that the economy has been rebalancing in the right direction, relying less on consumption-driven and debt-driven growth than before the crisis. We remain hopeful that the economy will begin to pick up speed later in the year in line with our baseline growth projection, but will conduct our policies with downside risks firmly in mind. More positive has been the pronounced decline in inflation, which provides us with an opportunity to durably stabilize inflation in the low single digit range. Also, our international reserve position has strengthened, creating ample scope for the National Bank of Serbia to maintain stable conditions in the foreign exchange (FX) market.

3. In consideration of our satisfactory implementation record in a difficult environment and our continued commitment to the program's objectives, we request the completion of the fourth review under the Stand-By Arrangement (SBA) and that SDR 319.6 million be made available. However, in view of our strengthened reserve position, we intend to purchase only SDR 46.7 million at this time. We also request a waiver for the non-observance of the missed performance criterion and the completion of the financing assurances review. The fifth program review, assessing performance relative to end-June 2010 performance criteria and benchmarks, and a financing assurances review are envisaged for September 2010. The sixth

program review, assessing performance relative to end-September 2010 performance criteria and benchmarks, and a financing assurances review are envisaged for November 2010.

4. We believe that the policies and measures set forth in this memorandum are adequate to achieve the objectives of the program, and stand ready to take any additional measures that may be appropriate for this purpose. The Government of the Republic of Serbia will consult with the IMF in advance on the adoption of such additional measures in accordance with the IMF's policies on such consultations.

Revised Macroeconomic Framework for 2010–11

5. We expect real GDP to grow at 1½ percent in 2010 and 3 percent in 2011, with employment growth turning positive only in 2011. Reflecting the need to rebalance our economy away from consumption-led growth, our policies are aimed at creating conditions conducive for investment and exports to act as important drivers of growth. The slower pace of the economic recovery, in combination with sluggish consumption and imports, will negatively impact tax revenues and result in higher fiscal deficits than previously planned. Nevertheless, we are confident that we will be able to maintain discipline on the spending side of the budget, which will also be important to assure our population and foreign investors that we are keeping our fiscal house in order.

6. Inflation has persistently undershot the NBS target over the last few months, reflecting low aggregate demand, falling food prices, and weak pass-through of exchange rate depreciation. But we project inflation to increase gradually in the second half of 2010 given the low base in the previous year, exchange rate pass-through, and more stable food prices, and inflation should end the year close to the NBS target of 6 percent (±2 percent). We project inflation to decline further in 2011, to around 4½ percent.

7. We expect the external current account deficit to remain contained, with the continued narrowing of the trade deficit offset by higher external interest and dividend payments and by lower remittances. Following a contraction in 2009, export volume growth is expected to turn positive in 2010 but to regain double-digit strength only in 2012.

8. The external financing situation is projected to remain favorable in 2010 and beyond. Foreign parent banks are expected to broadly maintain their exposure to Serbia, notwithstanding the relaxation of the exposure floors from 100 percent to 80 percent in April 2010. Other private inflows, including foreign direct investment, along with financing from international financial institutions and the EU, should be sufficient to meet all external financing needs in 2010. We expect FX reserves to decline modestly but to remain at an adequate level.

Fiscal Policy

9. The slow and uneven economic recovery has put new pressures on the public finances. The program ceiling for the fiscal deficit in the first quarter was missed by a narrow margin. This was mainly due to lower revenues, particularly indirect taxes, relative to the end-2009 revenue forecast, which was based on higher GDP growth and import projections. The shortfall was partly compensated by under-execution of spending. At the same time, some spending ministries and local governments have made significant demands for larger spending allocations covering a wide range of purposes.

10. In this difficult setting, we remain committed to our stated fiscal strategy under the program. In particular, fiscal consolidation efforts will remain focused on containing current spending in the budget, particularly on public wages and pensions, while creating room for higher capital spending. Tax policies will remain steady and predictable, while revenue shortfalls that reflect a slower-than-projected recovery of the economy will be accommodated through higher fiscal deficit targets to avoid a pro-cyclical bias. At the same time, we will step up our efforts to protect the most vulnerable parts of the population from the consequences of the economic downturn through targeted programs. We recognize that this strategy will require continued difficult policy choices, perseverance, and coordination, with all spending ministries required to strictly observe their agreed budget ceilings and to avoid accumulating arrears.

11. Reducing by 2015 the general government wage bill to about 8 percent of GDP and net pension spending to about 10 percent remain key anchors in our efforts to restore sounder public finances. To share the burden of fiscal consolidation fairly, we plan to implement the following specific wage and pension policies:

- The nominal public wage freeze will be maintained through 2010. Regular semi-annual indexation of public wages will start in 2011, with adjustments in April 2011 and April 2012, based on CPI inflation during the previous six months and ½ of the real GDP growth rate (if positive) achieved in the previous year, and the October 2011 adjustment based on CPI inflation during the previous six months.

- The nominal pension freeze will also be maintained through 2010. Regular semi-annual indexation of pensions through April 2012 will be based on the same rule as specified for public wages. After the April 2012 indexation, pensions will continue to be indexed semi-annually to CPI inflation, and, starting in April 2013, an annual real GDP growth bonus will be equal (if positive) to real GDP growth achieved in the previous year minus 4 percent. This indexation formula will be maintained until net pension spending falls to about 10 percent of GDP.

- To soften the adverse consequences of the crisis on public wage and pension recipients with lower incomes in 2010 after two years of nominal freeze, we have mobilized RSD 4 billion dinars of additional resources mainly using higher dividend transfers from profitable state-owned enterprises to provide targeted one-off relief during the second half of 2010.

- In the 2011 budget, we plan to provide only limited one-off payments amounting to about RSD 4 billion dinars to public sector employees and pensioners in January.

- A draft pension law including parametric pension reforms that tighten early retirement rules and limit extra service credits and the agreed new pension indexation arrangements (TMU, ¶21) will be submitted to Parliament as a prior action for completing the fourth review.

- The implementation of the public administration staff cuts at central and local government levels enacted by law in December 2009 could not be implemented at the pace and scope envisaged. We recognize that non-implementation of these cuts, or implementation in an uneven manner across budgetary institutions, could severely undermine the credibility of any further structural reform initiatives to rationalize public employment. We will therefore issue a government decision to ensure that staff cuts at the central level will be implemented as mandated by law, a prior action for completing this review.

- Over the coming months, we will continue to work closely with the World Bank to design reform measures to reduce employment in the health and education sectors, while raising efficiency; efforts to reform the pay-and-grading system in these sectors will need to observe the agreed public wage bill limits.

12. The continued fallout from the crisis on the more vulnerable parts of our population requires us to mobilize additional fiscal resources to provide targeted relief. After significant improvements over the past decade, poverty is estimated to have increased again to 6.9 percent in 2009, from 6.1 percent in 2008. Apart from the measures for lower-income public wage and pension recipients already mentioned, we plan to transfer RSD 1 billion to the poorest municipalities and increase the allocation for targeted social assistance programs in 2010 by about RSD 1½ billion, while a reform of these programs to improve their targeting and coverage will go into effect in 2011. Given that recent increases in poverty rates are particularly concentrated and severe in rural areas, we also plan to clear the long-standing farmer pension arrears (about RSD 7 billion) ahead of schedule in 2010.

13. We will strengthen the credibility of our budgetary commitments through fiscal responsibility legislation. The working group formed for this purpose has reached preliminary agreement that draft legislation should include the following key elements:

- Fiscal rules for public wages and pensions: The draft law incorporates the agreed public wage and pension indexation rules; in addition, public wage and employment policies during 2012–15 will be constrained by a rule to gradually reduce the general government wage bill to 8 percent of GDP and pension bill to about 10 percent of GDP by 2015.

- Rule for fiscal balance: One of the options under consideration is a numerical rule that the planned general government fiscal deficit for the coming year can at most amount to the estimate of the deficit for the current year minus a correction factor that would take into account the distance between the estimated deficit for the current year and the medium-term deficit target (1 percent of GDP).

- Rule for public debt and guarantees: The draft law will likely impose limits on the accumulation of public guarantees and a binding upper ceiling on the amount of debt and guarantees that the general government can incur.

- Fiscal council: The draft law envisages the creation of a council in charge of implementing the fiscal responsibility legislation. Combining the fiscal council with the recently set up state audit institution is one of the options under consideration.

- The Ministry of Finance will also consider other amendments to the Budget System Law and other laws: To strengthen budget preparation, execution, and monitoring, some of the concepts and definitions in the law will be clarified; the budget calendar will support a top-down approach to the budget process; own resource revenues will be better integrated in the budget and the Treasury Single Account (TSA); and more flexibility in the budget execution will be reached.

The Budget Memorandum for 2010–12, planned to be issued by July 15, will already reflect some of these elements. We now plan to submit the fiscal responsibility legislation to parliament by September 15, before the completion of the fifth review.

14. Against this backdrop, we will implement the spending side of the 2010 budget largely as budgeted, with a higher fiscal deficit target of 4¾ percent of GDP accommodating the revenue shortfall due to the weaker-than expected economy. In particular, relative to budget plans, we expect that spending will be under-executed by about RSD 10 billion, while higher-than-budgeted non-tax revenue of about RSD 6.5 billion will provide the scope for financing the planned additional spending. For 2011, we plan to reduce the fiscal deficit to below 4 percent of GDP.

15. Should revenues in 2010 exceed present projections, we are fully committed to save the revenue over-performance in line with the principle that automatic fiscal stabilizers should be allowed to operate in both directions.

16. We are also studying further reforms of the tax system. The main objective is to reduce the direct tax wedge on labor arising from social security contributions and wage taxation, while offsetting resulting revenue losses through adjustments in indirect taxation. In

line with our fiscal strategy, (i) the tax reform will be broadly revenue neutral; (ii) tax administration will be appropriately strengthened to implement the reform; (iii) key stakeholders will be consulted early to avoid undue surprises; and (iv) if reform measures turn out to be regressive on balance, we will provide adequate targeted social assistance.

17. With regard to tax administration reform, we remain committed to adopting an integrated taxpayer compliance strategy by end-July, which will: (i) be developed in full consultation with internal and external stakeholders; (ii) include an in-depth analysis of compliance risks and mitigation options; and (iii) establish the direction for each functional department's operational plans.

18. We also see an urgent need to adopt a multiyear approach to budgeting. Multiyear investment planning would ensure a predetermined envelope of resources, avoid excessive fragmentation of tender procedures, and minimize transaction costs. This multi-year investment planning will be integrated in the yearly multi-annual budget process, ensuring consistency between current and capital spending.

Monetary and Exchange Rate Policy

19. Monetary policy will remain focused on keeping inflation close to the pre-announced 6 percent (±2 percent) target for 2010 and 4.5 percent in 2011. We see some scope for continued easing of the monetary stance, including through the gradual phasing in of lower reserve requirements. But we will remain attentive to upside inflation risks associated with exchange rate pass-through from depreciation, a reversal of food price declines, an increase in Serbia's FX risk premium, and a possibly faster-than-expected recovery of aggregate demand. Under the program, inflation developments will continue to be monitored using a standard consultation clause.

20. In line with our inflation targeting framework, we will maintain the existing managed float exchange rate regime. FX interventions will continue to be used to smooth out excessive exchange rate volatility or to provide liquidity to the market as needed to ensure its smooth operation, without targeting a specific level or path for the exchange rate.

21. We have adopted several amendments to the NBS law to harmonize it with the 2006 Constitution and align it with international best practices. The amendments will strengthen the NBS's independence in many important areas. In particular, the NBS will determine the exchange rate regime, with the government's consent, and implement the exchange rate policy. The tasks performed by the NBS for the Republic of Serbia as well as the NBS's scope for providing credit to the public sector have been clearly delineated. The amendments also clarify the procedure for the treatment of NBS profits and the coverage of potential NBS losses. Finally, the amended law will strengthen the system of checks and balances, as well as transparency and auditing procedures.

Financial Sector Policies

22. Fostering the use of the local currency in financial transactions is a policy priority, as unhedged currency exposures can undermine financial stability and the effectiveness of monetary policy. We are following a three-pronged strategy to reduce euroization of Serbia's economy: (i) maintaining macroeconomic stability, thus providing an environment of low and stable inflation; (ii) developing the primary and secondary local currency bond markets; and (iii) developing the FX hedging market. To this end, we have: (i) reduced the dinar reserve requirements; and (ii) raised the local currency share in government debt. To foster secondary market development, we have introduced regular reporting on secondary trade in government securities. Finally, we limited some of the government credit support programs to dinars only. Shortly, we will adopt changes in the FX law to foster development of the FX hedging market. Possible regulatory measures include further promotion of dinar lending through reserve requirement policy.

23. We have made progress in improving the corporate debt restructuring and collection framework. The by-law on prepackaged reorganisation plans was adopted in May. Its provisions aim to provide sufficient protection for creditors, set more clear requirements for debtors and thus minimize uncertainties for all parties, and streamline procedures. We are also in the process of submitting revised amendments to the law on payments transactions, with a view to creating a centralized registry for promissory notes, thus improving the transparency of these instruments. The Working Group on out-of-court debt restructuring has started to meet and is on track to produce a strategy note by end-June.

24. The Ministry of Finance is revising the banking sector regulations. The legislative initiative seeks to establish transparent procedures and tools in the event of a systemic banking crisis and seeks also to improve procedures for dealing with problem banks in normal times. Our aim is to have the legislation enacted by end-September 2010.

25. We are closely monitoring developments in the banking system and stand ready to intervene, should action be required. Any such intervention will be guided by our crisis management framework and will be closely coordinated among the NBS, Ministry of Finance, and the Deposit Insurance Agency. As indicated by recent diagnostic studies and stress tests, the Serbian banking system—including the subsidiaries of Greek banks—remains highly liquid and well capitalized.

Structural Policies

26. We are committed to structural reforms that address the key bottlenecks for shifting to a more export-led model of growth. Improvements in the business environment of the formal economy, as well as more and better public infrastructure, are crucial for export-oriented companies. We launched a comprehensive regulatory "guillotine" project to

do away with unnecessary business regulations, with an estimated annual cut in the costs of doing business of RSD 20 billion. After some delays, there has been renewed progress, and we expect that the project will be finalized by July 2010. Upon completion of the guillotine, we will step up "impact analysis" of all new business-relevant legislation, with a focus on creating a business-friendly environment. Among relatively recent legislative actions are laws that aim to strengthen competition and improve public procurement. However, implementation of these laws has lagged, and we intend to rectify that as soon as possible. In particular, we will take steps to make the hitherto weak Competition Commission fully operational and to appoint members of the Commission for Protection of Bidders' Rights. We will also align the Company Law with EU rules on corporate governance and establishment.

27. To maximize the gains from a more trade-oriented economy, we are vigorously pursuing efforts to improve Serbia's international trade environment. We started the implementation of the interim trade agreement with the EU in January 2009, followed by the EU putting it into force in February 2010. We are committed to finalizing Serbia's WTO accession process and are hopeful that accession will take place in 2011. We plan to resolve outstanding issues, mainly related to the provision of some financial services and trade in some agricultural products, through bilateral discussions in the coming months.

28. We are convinced that privatization has to be a critical ingredient in the export- and domestic savings-based growth model. We believe, on the basis of evidence from other countries, that privatization contributes to export growth and the generation of domestic savings, the latter mainly through higher corporate savings. If market conditions allow, we intend to privatize a 40 percent stake in Srbija Telekom in 2010. We also continue preparations for the sale of the airline company JAT. For now, we have had to suspend the privatization of pharmaceutical company Galenika due to the lack of interest from qualified bidders. We will, however, resume our efforts to privatize Galenika once market conditions improve. We are also pursuing the privatization or forced liquidation of a large number of smaller companies and state assets. Moreover, we intend to corporatize all large state enterprises, including state utilities and the railway company, by end-2010**.**

/s/
Mirko Cvetkovic
Prime Minister

/s/
Radovan Jelasic
Governor of the National Bank
of Serbia

/s/
Diana Dragutinovic
Minister of Finance

Attachment

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2009–10 1/

	2009								2010					
	March		June		Sept.		Dec.		March			June	Sept.	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Prog.	Proj.
Quantitative Performance Criteria														
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0		6.2	4.9	4.8	4.6
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	21	24	72	109	149
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20		0	20	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200		0	550	600	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0		0	0	0	0
Inflation Consultation Bands (in percent)														
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4		4.7	4.0	5.3	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4		n.a.	6.0	7.3	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4		n.a.	2.0	3.3	4.0
Indicative Targets														
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182		165	354	546	737
Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development funds (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13		16	50	50	50

1/ As defined in the Letter of Intent, the Memorandum on Economic and Financial Policies, and the Technical Memorandum of Understanding.

2/ Cumulative from January 1.

3/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, KfW, Eurofima, CEB, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements.

Table 2. Serbia: Structural Conditionality, 2010

Measure	Target Date	Comment
Prior actions		
1. Government to submit to parliament a comprehensive pension law, incorporating both parametric reforms and a revised indexation formula, effective April 2011 (TMU ¶21).	Before Board meeting	To support the medium-term fiscal consolidation strategy.
2. Government to issue a decision to ensure that public administration staff cuts at the central government level will be implemented as enacted by law in December 2009 (TMU ¶20).	Before Board meeting	To support the medium-term fiscal consolidation strategy.
Structural benchmarks		
3. Risk management unit at tax administration to establish an integrated taxpayer compliance strategy (TMU ¶23).	July 2010	To address tax noncompliance and improve voluntary compliance.
4. Government to submit to parliament a draft Budget System and Responsibility Law (TMU ¶22).	September 15, 2010	To anchor authorities' medium-term fiscal adjustment plans and commitments to safeguard fiscal sustainability.
5. Authorities to adopt or submit to parliament amendments to relevant laws and regulations strengthening the corporate debt collection and restructuring framework (TMU ¶26).	September 2010	To address the issue of account blockages and foster out-of-court loan workouts to minimize unnecessary and costly bankruptcies and enhance banks' ability to deal with rising NPLs.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

REPUBLIC OF SERBIA

Technical Memorandum of Understanding

1. This memorandum sets out the understandings regarding the definition of indicators used to monitor developments under the program. To that effect, the authorities will provide the necessary data to the European Department of the IMF as soon as they are available. As a general principle, all indicators will be monitored on the basis of the methodologies and classifications of monetary, financial, and fiscal data in place on October 1, 2008, except as noted below.

A. Floor for Net Foreign Assets of the NBS

2. **Net foreign assets** (NFA) of the NBS consist of foreign reserve assets minus foreign reserve liabilities, measured at the end of the quarter.

3. For purposes of the program, **foreign reserve assets** shall be defined as monetary gold, holdings of SDRs, the reserve position in the IMF, and NBS holdings of foreign exchange in convertible currencies. Any such assets shall only be included as foreign reserve assets if they are under the effective control of, and readily available to, the NBS. In particular, excluded from foreign reserve assets are: undivided assets of the former Socialist Federal Republic of Yugoslavia (SFRY), long-term assets, NBS' claims on resident banks and nonbanks, as well as subsidiaries or branches of Serbian commercial banks located abroad, any assets in nonconvertible currencies, encumbered reserve assets (e.g., pledged as collateral for foreign loans or through forward contracts), and precious metals other than monetary gold.

4. For purposes of the program, all foreign currency-related assets will be evaluated in Euros at **program exchange rates** as specified below. For the remainder of 2010, the program exchange rates are those that prevailed on March 11, 2009. Monetary gold will be valued at the average London fixing market price that prevailed on March 11, 2009.

Cross Exchange Rates and Gold Price for Program Purposes 1/

	Valued in			
	RSD	euro	USD	SDR
Currency:				
RSD	1.0000	0.0106	0.0134	0.0093
euro	94.0972	1.0000	1.2647	0.8715
USD	74.4028	0.7907	1.0000	0.6891
SDR	107.9718	1.1475	1.4512	1.0000
Gold		727.35	919.875	633.88

1/ March 11, 2009.

5. For purposes of the program, **foreign reserve liabilities** are defined as any foreign-currency-denominated short-term loan or deposit (with a maturity of up to and including one year); NBS liabilities to residents and nonresidents associated with swaps (including any portion of the NBS gold that is collateralized) and forward contracts; IMF purchases; and loans contracted by the NBS from international capital markets, banks or other financial institutions located abroad, and foreign governments, irrespective of their maturity. Undivided foreign exchange liabilities of the SFRY are excluded. Also excluded are the amounts received under any SDR allocations received after August 20, 2009.

6. On March 31, 2010 the NBS's net foreign assets, evaluated at program exchange rates, were €6,152 million; foreign reserve assets amounted to €10,445 million, and foreign reserve liabilities amounted to €4,293 million.

7. **Adjustors.** For program purposes, the NFA target will be adjusted upward *pari passu* to the extent that: (i) after March 31, 2010, the NBS has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as Serbian commercial banks abroad; and (ii) the restructuring of the banking sector by the Deposit Insurance Agency involves a write-off of NBS foreign exchange-denominated liabilities to resident banks. The NFA floor will also be adjusted upward by any privatization revenue in foreign exchange received after March 31, 2010. Privatization receipts are defined in this context as the proceeds from sale or lease of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS, either directly, or through the Treasury.

B. Inflation Consultation Mechanism

8. Inflation is defined as the change over 12 months of the end-of-period consumer price index (CPI), as measured and published by the Serbian Statistics Office.

9. Breaching the inflation consultation band limits at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response. A deviation of more than 1 percentage point from either the upper or the lower band specified in Table 1 would trigger a consultation with the IMF's Executive Board on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA.

C. Ceiling on External Debt Service Arrears

10. **Definition.** External debt-service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the public sector, except on debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement on public sector or public sector-guaranteed debts. The authorities are committed to continuing negotiations with creditors to settle all remaining official external debt-service arrears.

11. **Reporting.** The accounting of nonreschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within two weeks of the end of each month. Data on other arrears, which can be rescheduled, will be provided separately.

D. Ceilings on External Debt

12. **Definitions.** The ceilings on contracting or guaranteeing of new nonconcessional external debt by the public sector with original maturity of more than one year and short term external debt (with maturities up to one year) applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85)) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are normal short-term import credits. For program purposes, debt is classified as external when the residency of the creditor is not Serbian.

13. Excluded from the ceilings are loans from the IMF, EBRD, EIB, EU, IBRD, KfW, CEB, Eurofima, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements. For the purpose of this performance criterion, the public sector comprises the consolidated general government, the Export Credit and Insurance Agency (AOFI), and the Development Fund.

14. For new debt to budgetary users, the day the debt is contracted will be the relevant date for program purposes. For new debt to non-budgetary users, the day the first guarantee is signed will be the relevant date. Contracting or guaranteeing of new debt will be converted into Euros for program purposes at the program cross exchange rates described in this TMU. Concessionality will be based on a currency-specific discount rate based on the ten-year average of the OECD's commercial interest reference rate (CIRR) for loans or leases with maturities greater than 15 years and on the six-month average CIRR for loans and leases maturing in less than 15 years. Under this definition of concessionality, only debt with a grant element equivalent to 35 percent or more will be excluded from the debt limit.

15. **Reporting.** A debt-by-debt accounting of all new concessional and nonconcessional debt contracted or guaranteed by the public sector, including the original debt documentation, details on debt service obligations, as well as all relevant supporting materials, will be transmitted on a quarterly basis, within four weeks of the end of each quarter.

E. Fiscal Conditionality

16. **The general government fiscal balance,** on a cash basis, is defined as the difference between total general government revenue (including grants) and total general government expenditure (irrespective of the source of financing) as presented in the "GFS classification table" and including expenditure financed from foreign project loans. For program purposes,

the consolidated general government comprises the Serbian Republican budget (on-budget and own revenue), local governments, the pension fund (employees, self-employed, and farmers), the health fund, the National Agency for Employment, and the Road Company (JP Putevi Srbije) and any of its subsidiaries. Any new extrabudgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Expenditures exclude the clearance of arrears of the Road Company accumulated up to end-2008.

17. **Adjusters.** The deficit ceiling will be adjusted upward for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework, following consultation with IMF staff. It will be increased (respectively reduced) in 2010 by the amount of project loans disbursed by foreign creditors listed in TMU ¶13 above to the general government in excess of (respectively, lower than) the program projections indicated in the table below, in consultation with IMF staff, on the basis of actual disbursements as jointly reported by the Ministry of Finance and the NBS. This adjustment does not apply to program loans and general budget support.

Disbursements of project loans by foreign creditors

From January 1, 2010 to:	Program projections (billions of dinars)
March 31, 2010	4.3
June 30, 2010	8.5
September 30, 2010	12.8
December 31, 2010	17.0

18. **Government current expenditure of the Republican budget** (excluding expenditure financed by own sources) includes wages, subsidies, goods and services, interest payments, transfers to local governments and social security funds, social benefits from the budget, other current expenditure, and net lending. It does not include capital spending. The ceiling will be adjusted for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework.

19. The **large public enterprises** monitored under the program include the following 10 enterprises or their successors: JP Elektroprivreda Srbije (EPS), JP Elektromreza Srbije (EMS), JP Transnafta, JP Srbijagas, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zeleznice Srbije, JP Srbijasume, JP Aerodrom Nikola Tesla Beograd, JVP Srbijavode. This list excludes JP Putevi Srbije (the Road Company), which is considered part of general government, JP Naftna Industrija Srbije (NIS), which is in majority private ownership, and JP Srbija Telekom, which competes with other telecommunication service providers. Going forward, the program will include monitoring of the aggregate wage bill of local utilities.

20. **Reduction in the number of public employees.** In line with the Law No 104/09, the government will: (i) adopt a separate act for 11 remaining agencies that would set the limit of permanently employed public employees in each agency within the aggregate limit of 28,400 employees in the Republican Administration; (ii) adopt an act on specifying total number of "fixed-term employees due to increased workload," persons employed under a service contract, and those under contract on temporary and occasional jobs, those employed through youth and student associations, and persons employed on other basis; (iii) finalize systematization plans in all Ministries and Agencies in the Republican Administration; and (iv) adopt a decision by the government that starting from September salaries from the Republic of Serbia budget for the Ministries and Agencies subject to the Law will be paid only for the maximum number of employees determined in line with this Law (prior action, June 2010).

21. **Pension law**. The new pension draft law should be submitted to Parliament in June. This draft law should tighten early retirement rules, including by (i) gradually increasing the minimum early retirement age from currently 53 years to 58 years for both men and women by 2023, (ii) restricting retirement before the minimum early retirement age to only a limited number of occupations; (iii) increasing the minimum service requirement for retirement for women from 35 to 38 years and gradually phasing out more than one-half of extra service credit for women; and (iv) raising the eligibility age for survivor's pensions to 58 years for men and to 53 for women. Further, the draft law will impose strict limits on extra service credits to a limited number of eligible professions. Contribution collection efficiency would also be strengthened, including by registering all social security payers in a single central registry. The draft law will also contain a revised pension indexation rule, effective from April 2011. Under the indexation formula the semi-annual CPI-based indexation formula would be augmented to include (i) ½ of the real GDP growth rate (if positive) achieved in the previous year in April 2011 and April 2012; and (ii) from April 2013 onwards an annual growth premium if the previous year's GDP growth rate exceeded 4 percent. The growth premium will be calculated as the difference between the actual growth rate in the previous year and the 4 percent threshold (prior action, June 2010).

22. **Fiscal responsibility legislation**. The present Budget System Law (BSL) will be amended to further strengthen fiscal discipline. Amendments to all relevant public finance legislation should be adopted by the government and submitted to parliament that: (i) establish a simple and transparent rule that strengthens control over the medium-term fiscal framework; (ii) strengthen fiscal procedures of the current BSL; and (iii) establish effective fiscal monitoring and enforcement mechanisms, potentially including by setting up an independent fiscal council. Further, binding ceilings on pension and general government wage spending for 2010-12 should be included in the fiscal responsibility framework (structural benchmark, September 15, 2010).

23. **Tax administration reform**. The risk management unit at the tax administration agency should adopt a fully integrated taxpayer compliance strategy that has been developed in full consultation with all internal and external stakeholders and is based on the identification of the major risks to revenue and appropriate resource allocation to ensure the highest impact on collections. The strategy should focus on improving voluntary compliance and reducing noncompliance (structural benchmark, end-July 2010).

24. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget and the Development Fund.** The ceiling also includes the contracting of any domestic loans by the Development Fund. It excludes any guarantees extended under the financial stability framework, unless such loans or guarantees are extended to entities other than financial sector institutions.

25. **Reporting.** General government revenue data and the Treasury cash situation table will be submitted weekly on Wednesday; updated cash flow projections for the Republican budget for the remainder of the year five days after the end of each month; and the stock of spending arrears of the Republican budget, the Road company, and the social security funds 15 days after the end of each month. General government comprehensive fiscal data (including social security funds) would be submitted by the 25th of each month. The large state-owned enterprises listed in paragraph 19 will submit quarterly accounts and the wage bill data 45 days after the end of the quarter.

F. Financial Sector Conditionality

26. **Improvements to the framework for debt collection and restructuring will focus on two areas: account blockages based on promissory notes and out-of-court loan workouts.** As regards the first area, the NBS, in consultation with the government, will finalize amending the law on payments transactions to introduce registration of promissory notes using a uniform format—containing essential loan details and blockage conditions—in a single registry. The Ministry of Economy, together with the NBS, will explore alternatives to the first-mover advantage in account blockages. As regards out-of-court loan workouts, the Ministry of Economy and the NBS, in consultation with the Ministry of Finance and banks, shall (i) establish an out-of-court restructuring mechanism working group comprising representatives of the Ministries of Finance and Economy, NBS, tax authorities and selective bank representatives; (ii) draft a corporate debt restructuring strategy note proposing the main features of an out-of-court restructuring mechanism (such as the form of the framework, coverage of debtors, and role of the NBS) and identify the legal changes needed to support such a mechanism by end-June 2010; (iii) submit draft legislative changes for government approval by end-August 2010; and (iv) submit the package of the legislative changes to Parliament by end-September 2010 (structural benchmark).

Data Reporting for Quantitative Performance Criteria

Reporting Agency	Type of Data	Timing
NBS	Net foreign assets of the NBS (including adjustors)	Within one week of the end of the month
Ministry of Finance	Consolidated government overall deficit	Within 25 days of the end of the month
NBS and Ministry of Finance	New short-term external debt contracted or guaranteed by the public sector	Within four weeks of the end of the quarter
NBS and Ministry of Finance	New nonconcessional external debt contracted or guaranteed by the public sector	Within four weeks of the end of the quarter
Ministry of Finance	Government external payment arrears	Within two weeks of the end of the month
Statistical Office and NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Current expenditure of the Serbian Republican budget	Within 25 days of the end of the month
Ministry of Finance	Gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund	Within eight weeks of the end of the month

Statement by the IMF Staff Representative on the Republic of Serbia
June 28, 2010

This statement provides information that has become available since the issuance of the staff report (EBS/10/118). The new information does not alter the thrust of the staff appraisal.

1. **Prior actions for the fourth review have been completed.** The government submitted to parliament on June 17 a comprehensive pension law, incorporating both parametric reforms and a revised indexation formula, effective April 2011 (*prior action*). Also on June 17, the government issued several decisions to ensure that reductions in public administration headcounts at the central government level will be implemented in line with the law passed in December 2009 (*prior action*).

2. **Recent data releases have been in line with the economic outlook in the staff report.** Inflation declined further to 3.7 percent year-on-year in May, compared with 4.3 percent in April, largely reflecting food price movements and base effects. The current account deficit narrowed again in April, reflecting an improved trade balance, but also continued strong remittances.

3. **Serbia's EU candidacy hopes remain on track.** EU foreign ministers gave the go-ahead on June 14 for the Stabilization and Association Agreement (SAA) to be considered by parliaments for ratification. Serbian officials hope that Serbia might gain candidate member status next year.

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Press Release No. 10/265
FOR IMMEDIATE RELEASE
June 28, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under Stand-By Arrangement with Serbia and Approves US$472.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Serbia's economic performance under a program supported by a Stand-By Arrangement (SBA). The completion of the review enables the immediate disbursement of SDR 319.595 million (about €383.2million, or US$472.9million). Drawing the full amount would bring total disbursements under the program to SDR 1.50 billion (about €1.80 billion, or US$2.22 billion).

In completing the review the Board also approved Serbia's request for a waiver of non-observance of the end-March quantitative performance criterion on the consolidated general government overall deficit. The Board also completed the financing assurances review.

Serbia's initial 15-month SBA was approved on January 16, 2009, in the amount of SDR 350.8 million (about €420.6 million, or US$ 519.0 million). On May 15, 2009, the arrangement was extended by one year and augmented to SDR 2.6 billion (about €3.14 billion, or US$3.88 billion to support the government's economic program amid a sharper than expected impact from the global financial crisis (see Press Release No. 09/169).

Following the Executive Board's discussion on Serbia, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"Economic performance continues to be broadly satisfactory, in spite of a weaker macroeconomic environment during the first half of 2010. Serbia's external financing position has improved markedly, the reserve position is broadly comfortable, and inflation remains in check. Notwithstanding these positive developments, Serbia remains vulnerable to adverse financial spillovers from the region.

“The authorities’ fiscal adjustment strategy continues to focus on medium-term consolidation. Automatic stabilizers will be allowed to operate in the short term in response to a shortfall in tax revenues. The planned fiscal responsibility legislation will further enhance policy credibility.

“The continued disinflation has allowed a gradual easing of monetary policy. Nevertheless, vigilance is called for, given still unanchored inflation expectations and the potential for increased pass-through of recent exchange rate depreciation. The authorities have developed a strategy for reducing risks from high euroization.

“The Serbian financial sector has proved resilient, and foreign parent banks’ exposures have remained stable despite the recent lowering of exposure limits under the Bank Coordination Initiative.

“The authorities remain strongly committed to the structural reform agenda aimed at improving the business environment, promoting private investment, and enhancing the country’s export capacity, including through privatization and upgrading of infrastructure.”

Statement by Mr. Weber and Mr. Antic on Republic of Serbia
June 28, 2010

1. We thank staff for the comprehensive report that accurately captures the current economic and policy challenges for Serbia. It clearly spells out the desirable course of policy action for the authorities as they are called to address renewed uncertainties and risks to growth, and as they strive to ensure longer term fiscal sustainability. Our authorities share the staff's views on the main policy issues and highly value their constructive policy advice and recommendations.

2. Serbia has met two prior actions on time for this review. All end-March 2010 quantitative performance criteria have been met, except for a small breach of the ceiling on the consolidated general government deficit, caused by lower than projected tax revenue. Since Serbia is on track with the implementation of the Stand-By Arrangement, the authorities ask the Board to support the completion of this review and the request for a waiver. The authorities are of the view that the Fund program has proved to be a usefully constraining, but sufficiently flexible framework in light of crisis related shocks and subsequent adjustment processes in the Serbian economy over the past year. This adaptive program design has been particularly adequate with respect to the program's objectives and agreed drawings.

3. Although the loss of output during the crisis was moderate in comparison with other countries in the region, achieving a sustained economic recovery has proved elusive. Risks of adverse regional spillovers as well as a weaker growth outlook for the euro area are bound to dampen the speed of the recovery. Available indicators for the first five months of this year show that domestic economic activity was somewhat fragile. While staying vigilant due to apparent downside risks, the authorities expect that growth will gain speed in the second half of the year. Inflation remains subdued, which provides the authorities with an opportunity to lastingly stabilize it in the low single digits. Recent export growth is encouraging and the current account has stabilized on a much lower level that before the crisis. Foreign exchange reserves, given external financing including from the Fund, are at an adequate level. These are encouraging signs that the Serbian economy is rebalancing, relying less on consumption-led growth and more on investment- and export-driven growth.

4. Fiscal adjustment continues to be at the core of the program with the Fund. This adjustment is to be achieved by containing current expenditures, while retaining fiscal space for higher capital spending. The tax environment, on the other hand, will stay steady and predictable. Should the recovery be slower than anticipated, the authorities intend to accommodate revenue shortfalls through higher fiscal deficits, while also targeting social expenditures to those most affected by the economic downturn. Should revenues exceed expectations, however, these additional revenues will be saved.

5. The authorities are fully aware of the need to ensure the long-term success of their fiscal consolidation strategy through politically difficult structural fiscal measures. An important milestone has been reached in that the freeze on public wages and pensions will give way to a new adjustment mechanism starting in April 2011. Both public wages and pensions will be indexed semi-annually to CPI inflation. A mark-up based on GDP growth in the preceding year will be added, but there will not be a link between public wages and pensions. To support public employees and pensioners with low incomes, the authorities decided to distribute two one-off payments during the remaining time of the freeze. The fiscal responsibility legislation in preparation is intended to provide a credible underpinning for fiscal discipline. Its elements under consideration include a fiscal balance rule, a rule for public debt and guarantees, and the establishment of a fiscal council that would be mandated to implement the legislation. The legislation will also buttress the agreed indexation rules for wages and pensions and will help to gradually reduce the general government wage bill to 8 percent of GDP and the pension bill to about 10 percent of GDP by 2015.

6. The National Bank of Serbia (NBS) expects that end-year inflation will be well within the pre-announced target band (6 percent +/- 2 percent) and sees some scope for further gradual monetary easing. The NBS continues to be committed to the managed floating exchange rate regime for the dinar. Relatively large exchange rate fluctuations have helped absorbing external shocks and have been supportive of the direction of the economic rebalancing. Recent interventions of the NBS in the foreign exchange market were aimed at smoothing excess volatility, without targeting a specific level for the dinar exchange rate. The draft for a revised NBS law currently debated in parliament will enhance the independence of the NBS and harmonize the law with the 2006 Constitution and international best practice.

7. It is notable that the recent lowering of foreign parent banks' exposure limits to 80 percent of the end-2008 level has not resulted in capital outflows and that exposures have been maintained. Should regional spillover effects through the banking system as outlined in Box 3 materialize, the authorities are prepared to intervene if necessary.

8. Structural reforms are oriented towards supporting export-led growth. Improvements in the business environment through the introduction of a "guillotine" project to abolish unnecessary business regulations, the implementation of the interim trade agreement with the EU, and the expected WTO accession in 2011 should spur foreign and domestic investment activity. The sale of 40 percent of Srbija Telekom is envisaged for this year, while the privatization of the airline company JAT is also in the pipeline. Other planned sales of state-owned companies had to be delayed due to insufficient interest of qualified buyers in a difficult market environment.