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Republic of Serbia—Second Review Under the Stand-By Arrangement and Requests for Waiver of End-September Performance Criterion, Modification of End-December Performance Criteria, Rephasing of Purchases, 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 November 3, 2009 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 December 8, 2009. 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 statement by the IMF Staff Representative on the Republic of Serbia

- A Press Release summarizing the views of the Executive Board as expressed during its December 23, 2009 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

Republic of Serbia—Second Review Under the Stand-By Arrangement and Requests for Waiver of End-September Performance Criterion, Modification of End-December Performance Criteria, Rephasing of Purchases, and Financing Assurances Review

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

Approved by Poul M. Thomsen and Michele Shannon

December 8, 2009

Stand-By Arrangement (SBA): The SBA, approved by the Executive Board on January 16, 2009, was extended to 27-month and augmented to the amount of SDR 2.6 billion (560 percent of quota, or about 10 percent of GDP) on May 15, 2009 (EBS/09/63). A purchase of SDR 700 million was made following the Board meeting. The second tranche, subject to the completion of this review amounts to SDR 319.6 million.

Program status: All end-September 2009 performance criteria, except for the ceiling on the consolidated general government overall deficit, were met. Most measures in the structural reform area were also implemented as planned. The fiscal deficit exceeded the ceiling because of revenue shortfalls owing to a weaker-than-expected economy. On the basis of the corrective fiscal actions described in the report, staff support the authorities' request for a waiver of non-observance of the end-September fiscal deficit performance criterion.

Discussions: Discussions were held in Belgrade during August 24–September 1 and October 22–November 3. The mission met with Prime Minister Cvetković, Deputy Prime Ministers Dinkić, Djelić, and Krkobabić, Minister of Finance Dragutinović, National Bank of Serbia (NBS) Governor Jelašić, other senior officials, representatives of International Financial Institutions (IFIs), the European Union (EU), and representatives of the private sector, trade unions, and think tanks. The staff team comprised Messrs. Jaeger, Floerkemeier, Mirzoev (all EUR), Mr. Dodzin (SPR), and Ms. Eble (FAD). Mr. Lissovolik (Resident Representative), Ms. Nestorović, and Mr. Kokotović (local IMF office) assisted the mission.

Publication: The Serbian authorities have consented to the publication of the staff report.

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I. Recent Developments

1. **Performance under the program has been broadly on track, except in the fiscal area**. The end-September performance criterion on the fiscal deficit was missed by ¾ percent of GDP, reflecting weaker revenue collections (Table 1). September inflation, while in line with the NBS inflation target, fell slightly below the lower program target band under the inflation consultation clause. All other quantitative performance criteria were met comfortably. Three structural benchmarks were observed, one was observed with delay, and two were partially observed (Table 2).

2. **The commitment of foreign banks to Serbia has been key to diffusing financial tensions, but a credit crunch has taken hold** (Figures 1–2). Since February, net capital inflows have recovered from the slump in 2008QIV, and, with the NBS abstaining from foreign exchange (FX) interventions, the dinar-euro exchange rate has stabilized. Foreign parent banks have rolled over their external exposure vis-à-vis Serbia, as agreed under the Bank Coordination Initiative (Box 1). But rapidly rising nonperforming loans (NPLs) and uncertainty over real sector prospects have crimped new credit, notwithstanding government efforts to support bank lending through interest subsidies and loan guarantees.

3. **The contraction in GDP has been limited relative to regional comparators, but absorption and external trade have fallen faster than expected** (Figure 3, Tables 3–7). Recent industrial production and trade indicators suggest that the output decline will likely bottom out during the second half of 2009, consistent with a full-year real GDP contraction of 3 percent. But with tight credit and corporate insolvencies rising, investment and imports have slumped, and absorption (domestic demand) in 2009 is now projected to contract by 8 percent. Relatedly, the large current account deficit has been shrinking fast. Private consumption has held up relatively well, partly reflecting the role of mattress money as a financial crisis buffer (Box 2).

4. **Inflation, while still high in regional comparison, has fallen faster than projected**. Inflation slowed to 7.3 percent (y-o-y) in September, mainly on account of decelerating food and utility prices after sharp regulated price increases earlier in the year (Figure 4). Notwithstanding the slight undershooting of the lower target band under the inflation consultation clause, there was agreement that the NBS's gradual easing strategy remains appropriate. Inflation is expected to edge up slightly toward the end of the year due to base effects, but should remain in single digits, consistent with the NBS target range of 6–10 percent.

5. **Recent structural indicators underscore Serbia's lagging reform status**. Already handicapped by an undersized private sector, Serbia trails best-performing transition peers on key business climate scores, including licensing, registering property, paying taxes, and enforcing contract (Table 8). However, there has been progress in enabling start ups, and encouragingly, there have been no reform reversals since the onset of the crisis.

Box 1. Bailing In Foreign Banks

Background: Following a meeting in Vienna on March 27, 2009, by mid-May all foreign parent banks had signed commitment letters. As part of Serbia's Financial Sector Support Program (FSSP), the banks pledged to maintain during 2009–10 their end-2008 external exposure of €8.7 billion (25 percent of GDP), mostly consisting of cross-border loans to corporations.

Rationale for bail-in: In a setting of high financial tensions, collective action can prevent a vicious downward spiral of FX depreciation, deleveraging, and escalating bank losses. However, for a bail-in to be incentive compatible, banks' bail-in benefits must exceed the costs from avoiding a currency-cum-banking crisis.

Monitoring: The NBS has been able to monitor loan-by-loan exposure for individual banks on a monthly basis, reconcile this data with parent banks and home supervisors, and resolve disagreements regarding monitoring results through cooperative consultation.

Outcomes: So far, banks have broadly honored their commitments. As of August 2009, foreign banks' overall exposure increased by 4 percent relative to December 2008. But reflecting low credit demand and tighter credit standards, the maintained exposure has mainly financed purchases of T-bills and short-term NBS securities, but was also in part maintained by holding excess liquidity on FX float accounts with parents (€0.6 billion of short-term exposure increase).

Exposure of Foreign Banks Participating in FSSP 1/
(in billions of euros)

	Dec-08	Aug-09	Change	Percent change
Total exposure	8.7	9.1	0.4	4.0
Long-term	8.0	7.7	-0.3	-4.0
Short-term	0.7	1.4	0.7	95.1

Source: National Bank of Serbia.
1/ Includes balances on FX float accounts.

What next? As agreed with banks in Vienna, the exposure commitments are due for review in early 2010. Some banks have made an early case for lowering the 100 percent exposure floor, arguing that reduced financial tensions and lower external financing needs invalidate the original bail-in rationale. There are also signs that bottling up of banks' exposure is weakening the exchange rate channel of monetary policy transmission.

Box 2. Mattress Money as a Financial Crisis Buffer

Background: Serbian residents keep sizeable FX cash holdings, with estimates of this "mattress money" scattered around some €3 billion (9 percent of GDP). The role of mattress money during this crisis was first felt in an unexpected surge in unrecorded remittances, which are estimated based on FX sales by households. As a result, unrecorded remittances in 2009 are likely to exceed earlier projections by €0.6 billion (2 percent of GDP).

Implications: First, these developments likely reflect conversion of mattress money to smooth household consumption, helping to explain the relative robustness of private consumption spending. Second, although the NBS's tight prudential stance never allowed household credit to reach the boom levels observed elsewhere in the region, the presence of mattress money also seems to mitigate risks to the banking sector, as reflected by the moderate rise in household NPLs.

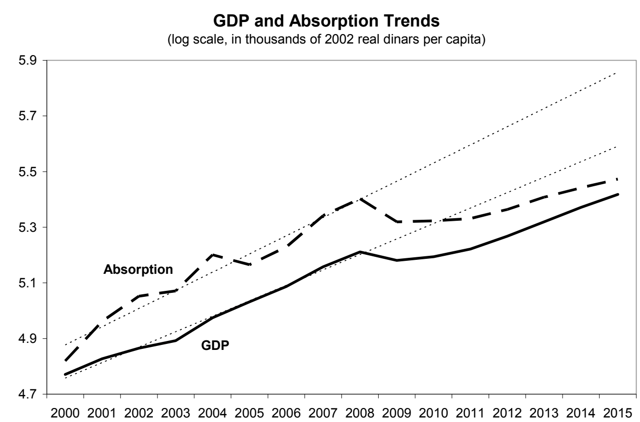
II. POLICY DISCUSSIONS

A. Macroeconomic Framework

6. **The recovery from the crisis is projected to be gradual and to leave permanent scars in the levels of GDP and, especially, absorption** (Table 9). In line with sluggish projected demand in main trading partners, export growth is projected to regain cruising speed only in 2011. Moreover, absorption growth is expected to remain flat in 2010, reflecting the combined impacts of declining real incomes and employment, drawn-out corporate deleveraging, and tight credit conditions. Robust GDP growth in line with pre-crisis trend growth is projected to resume only in 2012. But restoring external stability also requires a shift from absorption- to externally-led growth, with consumption growth in particular remaining subdued (Box 3).

Box 3. Medium-Term Output and Absorption Losses

In line with growth outcomes during earlier financial crisis, the Serbian economy is projected to suffer a one-off loss in the level of medium-term GDP, measured as the difference between the actual level of output per capita and the level that would have prevailed based on the pre-crisis trend. However, and assuming the economy manages to reach a more sustainable growth path, absorption growth rates would have to remain very low relative to pre-crisis trends for several years to narrow the trade balance deficit (the difference between GDP and absorption) to more sustainable levels.



7. **Inflation is expected to moderate in line with the gradual disinflation path targeted by the NBS**. Serbia's high inflation expectations seem firmly entrenched, and are likely to respond only slowly to persistent downward surprises in inflation outcomes. Continued disinflation is nevertheless supported by weak demand, as well as prudent monetary and fiscal policies, notably continued nominal freezes of public sector wages and pensions. Upside risks to the inflation outlook lie in faster-than-projected demand growth, high regulated price increases, and a possible surge of global energy and food prices.

8. **External financing pressures have receded, and external sustainability concerns have been mitigated** (Table 7, Appendix I). Faster-than-projected external adjustment and higher capital inflows are likely to allow some FX reserve accumulation in both 2009 and 2010. These projections assume that foreign banks will maintain their end-2008 exposures through 2010. External debt is now projected to peak at about 75 percent of GDP in 2012, although a large depreciation shock remains a risk.

Serbia: External Financing 2009-10 (cumulative, billions of Euro)

	EBS/09/63	Rev. Prog.	Change
Financing requirement	16.3	15.0	-1.3
Current account deficit	7.1	5.4	-1.7
Amortization	9.2	9.6	0.3
Available financing	12.8	11.8	-1.0
Capital inflows	12.7	13.5	0.7
Use of FX reserves (-=increase)	0.1	-1.7	-1.8
Financing gap	3.5	3.2	-0.3

Source: IMF staff projections

9. **Given the revised baseline scenario and the incipient global recovery, risks to the growth outlook appear now broadly balanced.** A stronger global economic recovery, especially in the EU, would further improve prospects for a pick-up in external demand and private capital inflows. On the downside, a delayed global recovery, or contagion events in Eastern Europe could result in weaker output than presently forecasted.

B. Fiscal Policy

10. **In the baseline projection and under unchanged fiscal policies, deficits would rise to unsustainable levels over the medium term, owing to three distinct drivers:**

- First, as the economy reduces the overhang of spending over income in the medium term, the tax-GDP ratio is projected to decline by almost 4 percent of GDP.
- Second, capital spending is planned to be stepped up significantly to upgrade Serbia's deteriorated infrastructure, a key bottleneck for achieving more balanced growth.
- Third, the interest bill on public debt as a percent of GDP will edge upward, mainly because the share of nonconcessional debt is projected to rise.

Serbia: Fiscal Projections under Unchanged Policies, 2007-15
(In percent of GDP)

	2007	2008	2009 Prog.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Revenue	42.4	40.9	38.3	37.4	36.8	36.7	36.7	36.9	37.2
Expenditure	44.2	43.4	42.8	42.5	42.7	43.0	43.4	44.0	44.9
Current primary	38.3	38.4	38.2	36.9	36.6	36.4	36.3	36.5	36.9
Interest	0.8	0.6	0.8	1.2	1.5	1.6	1.8	2.0	2.1
Capital and net lending	5.2	4.4	3.7	4.4	4.6	5.0	5.3	5.6	5.9
Fiscal balance	-1.9	-2.5	-4.5	-5.1	-5.9	-6.3	-6.6	-7.1	-7.7
Structural balance 1/	-3.6	-4.6	-4.1	-5.4	-6.3	-6.6	-7.0	-7.4	-8.0
Public debt	33.3	31.7	31.5	34.2	36.7	38.9	41.1	43.7	47.2

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

1/ Actual fiscal balance adjusted for the effects of both the output and the external absorption gaps. See IMF Country Report No. 07/390, Chapter III.

11. **To restore sustainable public finances, the government has decided on a three-pronged strategy.** Adjustment in 2009–10 will rely mainly on ad hoc nominal freezes of public wages and pensions—with large adjustment payoffs given Serbia's relatively high inflation rate—and deep cuts in discretionary spending, including capital. Extending this approach beyond 2010 will, however, not be feasible. Over the medium term, the government is committed to reduce the deficit gradually to about 1 percent of GDP based on three prongs (Table 10):

- ***Significant tax increases will be avoided,*** except as a measure of last resort. In particular, the government, backed by both trade unions and the business community, was strongly opposed to raising the VAT rate. At the same time, modernizing tax administration to improve compliance will remain a key priority (LOI, ¶10).
- ***Adjustment will come through large, but backloaded reductions in current spending.*** This will require implementing a package of structural spending reforms covering public employment, education, health care, and pensions with significant sustainable pay-offs, however, accruing only over the medium term (LOI ¶13–14).
- ***Stronger spending restraints*** through legal and procedural changes that will counteract strong procyclical deficit and spending biases, originating from high fiscal policy fragmentation (Box 4, LOI ¶16).

Serbia: Fiscal Projections under Program Policies, 2007-15
(In percent of GDP)

	2007	2008	2009 Prog.	2010 Prog.	2011 Prog.	2012 Prog.	2013 Prog.	2014 Prog.	2015 Prog.
Revenue	42.4	40.9	38.3	37.4	36.8	36.7	36.7	36.9	37.2
Expenditure	44.2	43.4	42.8	41.4	40.0	39.2	38.7	38.4	38.3
Current primary	38.3	38.4	38.2	35.8	34.0	32.7	32.0	31.4	31.0
Interest	0.8	0.6	0.8	1.2	1.4	1.5	1.4	1.4	1.4
Capital and net lending	5.2	4.4	3.7	4.4	4.6	5.0	5.3	5.6	5.8
Fiscal balance	-1.9	-2.5	-4.5	-4.0	-3.2	-2.5	-1.9	-1.5	-1.0
Structural balance 1/	-3.6	-4.6	-4.1	-4.3	-3.6	-2.7	-2.3	-1.8	-1.3
Public debt	33.3	31.7	31.4	33.0	32.8	31.1	29.3	27.1	25.1

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

1/ Actual fiscal balance adjusted for the effects of both the output and the external absorption gaps. See IMF Country Report No. 07/390, Chapter III.

12. **In staff's view, the government's preferred fiscal adjustment strategy is ambitious, but also comes with implementation risks.** With these risks in mind, the mission advocated an adjustment mix consisting of a front-loaded VAT increase combined with backloaded current spending reforms. The case for a VAT increase was seen as threefold: (i) to compensate for the projected declines in indirect tax revenue due to the rebalancing of the economy and to the agreement with the EU to cut customs tariffs; (ii) the effective VAT rate in Serbia is one of the lowest in the region; and (iii) higher VAT would support the needed shift from consumption to savings, without hindering exports. Regressive

Box 4. Increasing Fiscal Responsibility

High fiscal policy fragmentation is at the root of Serbia's struggle to maintain spending discipline, particularly during boom periods. Individual policy makers have little incentive to internalize the cost of high overall spending. Policy fragmentation in Serbia has two interacting sources: (i) high political fragmentation, reflected in large coalition governments and a multitude of spending ministries; and (ii) high procedural fragmentation, reflected in lacking overall top-down spending ceilings set by a strong Ministry of Finance (or a small government committee) that would internalize the cost of spending.

While it is difficult to reduce political fragmentation, the government has already taken measures to reduce procedural fragmentation. The recently passed Budget System Law (BSL) provides for a top-down approach toward budget formulation, and reaffirms the rule that parliament cannot increase the budget deficit proposed by government. The annual budget memorandum would set spending ceilings for next year's budget and indicative ceilings for the medium term, and the annual budget law include a tax expenditure budget.

To further reduce procedural fragmentation and ring-fence its spending-based adjustment strategy, the government is considering additional procedural changes to the budget process. This could include making spending ceilings more binding, strengthening the role of the Ministry of Finance, fully implementing pay-as-you-go principles for new fiscal initiatives to internalize cost, and putting in place a fiscal council. However, the specific design has yet to be fully fleshed out to ensure that any new rules and procedures are tailored to Serbia's specific circumstances and needs.

effects could be compensated by raising targeted social benefits. The government's preferred adjustment strategy may well be more growth-friendly, but it will also require an unusually strong and steadfast—by Serbia's past standards—implementation effort within a potentially difficult political setting.

13. **For 2009 and 2010, the revised program deficit targets of 4½ and 4 percent of GDP, respectively, are relatively high** (LOI ¶11–12). These targets would allow automatic fiscal stabilizers to operate almost fully. However, austerity measures taken in 2009 would need be maintained in 2010, particularly nominal freezes of wages and pensions, while savings from additional measures—in particular the announced downsizing of public administration—will be realized only over time. The projected deficits are fully covered by external and domestic sources. The submission of a 2010 budget consistent with the program is a prior action for this review.

14. **Provided this framework is implemented, fiscal sustainability would be restored over the medium term.** However, fiscal risks need to be monitored, including potential financial compensation obligations for property restitution claims, and rollover risks for the growing stock of government T-bills (Appendix II).

C. Financial Sector Policy

15. **Diagnostic studies and stress tests indicate that the banking system is adequately capitalized.** The onsite diagnostic studies found that capital adequacy ratios (CARs) were some 3 percentage points lower than previously reported. At the same time, capitalization of 2008 profits boosted CARs by about 2 percentage points. The stress tests, covering 2009–10, were based on a challenging downside scenario, and benefited from consultation with banks. The results—taking into account the imminent recapitalization of one domestic bank—do not suggest any urgent recapitalization needs. Diagnostic studies and stress tests for all remaining banks will be completed before end-2009 (LOI ¶3, ¶20).

Serbia: Onsite Diagnostic Studies and Stress Tests 1/
(Capital adequacy ratios (CAR), percent)

	2009	2010
Initial CAR position, end-March	20.3	
After onsite diagnostic study	17.3	
After subsequent capital increases 2/	19.2	
After stress test using downside scenario:	18.2	16.5
Memorandum items:		
Downside scenario assumptions:		
Real GDP growth, percent	-6.0	-3.5
Output gap, percent of potential output	-5.8	-8.5
Nominal depreciation, percent	12.0	10.0
Bank profits, percent of 2008 profits	60	60

1/ Aggregates for 15 largest and one state bank.
2/ Primarily reflects capitalization of the 2008 profits.

16. **Putting in place a more effective debt collection and restructuring framework is the most pressing financial sector issue.** NPLs have already more than doubled so far in 2009, exceeding 10 percent in September (Table 14). Presently, there are two basic options to collect or restructure debts: (i) blocking the debtor's bank accounts on the basis of a court order or promissory notes; and (ii) initiating bankruptcy procedures in court. Both options are fraught with serious problems (Box 5), and, beyond addressing these problems, there was agreement that an out-of-court restructuring option should be added. The objective is to establish a framework with three debt collection and restructuring tools (LOI, ¶19):

- ***Account blocking***: To remedy the problems discussed in Box 5, the authorities will introduce mandatory registration of promissory notes in a single registry, and explore options to mitigate incentives to "rush to block."
- ***Bankruptcy procedure***: Legislation has been prepared to speed up bankruptcies and lower their cost, including through prepackaged reorganization plans.
- ***Out-of-court loan workout***: A new tool for Serbia that would encourage swift out-of-court loan restructuring, but will require a legal basis.

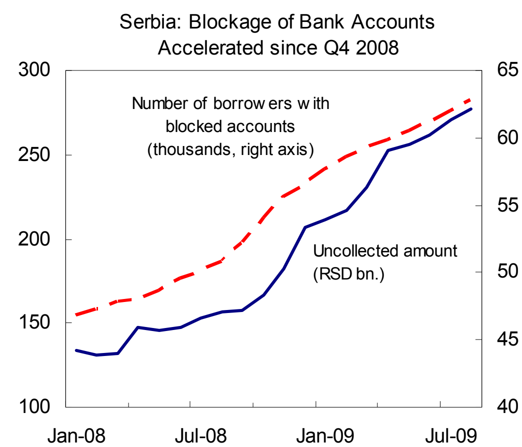
17. **Following the recent FSAP Update, the mission discussed additional financial sector issues that need to be addressed**. First, to strengthen the recently adopted crisis preparedness framework, the authorities are preparing a set of legal amendments to make it fully operational (LOI ¶17). Second, as regards the macro-prudential framework, there was agreement on the scope for streamlining, simplifying, and—in some areas—relaxing regulations (LOI ¶18). And third, there is a need to continue developing the T-bill market

with a medium-term goal of greater reliance on T-bills in the conduct of monetary policy (LOI ¶21).

Box 5. Problems with Debt Collection and Restructuring

Blocking debtors' accounts: A blockage, administered by the NBS, can be effected quickly and is instantaneously applied to all bank accounts of the delinquent borrower, allowing rapid collection when balances on the bank accounts are sufficient. Despite its general usefulness, the system has two key drawbacks: (i) creditors are unable to verify the number of borrowers' outstanding promissory notes which led to excessive issuance and limited value of notes; (ii) creditors are paid out in the chronological order of their blockage requests, giving rise to a "first-mover" advantage and providing a strong incentive to "rush to block" in times of heightened uncertainty while complicating loan restructuring. When accounts are blocked, creditors also tend to activate early loan recall provisions and, as a result, temporary borrower illiquidity often leads to insolvency.

Initiating bankruptcy: The present bankruptcy process is lengthy and costly, and therefore rarely used. The requirement that the petitioner finances bankruptcy proceedings, which typically last for years, together with one of the lowest recovery rates in the region—also owing to difficult enforcement of judgments on collateral—make the bankruptcy option unattractive and loan recovery difficult.



D. Monetary and Exchange Rate Policies

18. **Conventional monetary policy easing will be hampered by a weak monetary policy transmission mechanism, warranting the use of auxiliary measures.** With disinflation on track, there is scope for further gradual monetary policy easing (LOI ¶22). However, high loan euroization already weakens the traditional interest rate and credit channels, leaving the exchange rate channel as the main transmission mechanisms for cuts in the policy rate. At the same time, the established exposure floors under the FSSP imply a low interest rate elasticity of capital inflows, and bottling up foreign banks' exposures has had only a limited impact on credit to the private economy. In this setting, there is scope to gradually relax—and simplify by removing various exemptions—the high reserve requirements which were imposed in the past to deter excessive capital inflows. Alongside this, a gradual lowering of exposure floors under the FSSP could be considered at the next review meeting, planned for early 2010. Looking beyond the immediate crisis, the authorities expressed strong interest in designing a comprehensive approach to achieve tangible de-euroization.

E. Public Enterprises and Other Structural Policies

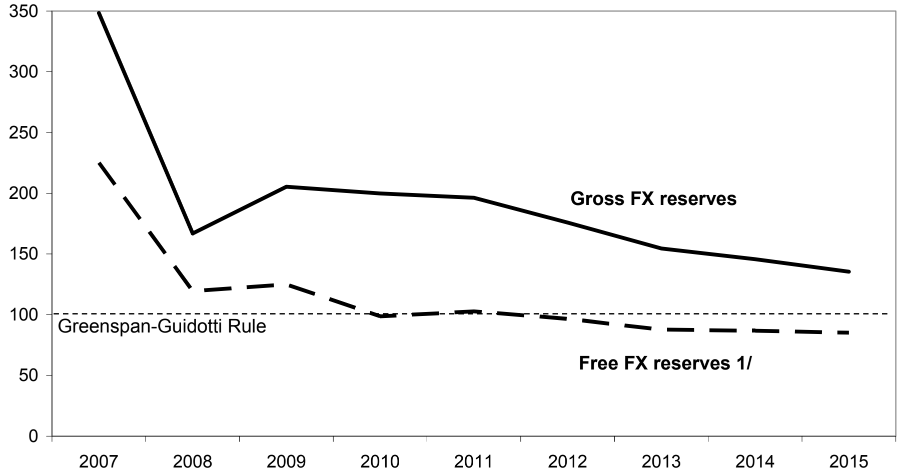
19. **Serbia's still large public enterprise sector remains an obstacle toward more robust and balanced medium-term growth.** Public enterprises act as unfunded wage leaders, have little incentive to raise productivity, and their pricing and employment policies are subject to non-economic constraints. High quasi-fiscal deficits, low productive efficiency, particularly as regards energy use, and status-quo bias against reforms have been the consequence, with systemic impact on the overall economy. While, due to unfavorable market conditions, no actual privatizations took place in the second half of 2009, the authorities continue to prepare enterprises for eventual privatization, and first tenders are expected in early 2010 (LOI ¶24). In the meantime, the authorities will enforce stricter budgetary discipline in public enterprises to limit the build-up of large contingent fiscal liabilities. In particular, business plans to be adopted for ten large state enterprises will entail wage bill freezes and tight financial monitoring (LOI ¶15).

20. **A better investment climate is also needed to facilitate the shift to a more externally-led growth strategy.** The lesson of the last few years has been that absorption-led catch-up growth is difficult to reconcile with maintaining external stability. The authorities stressed their commitment to push ahead with their structural reform agenda to complete the transition to a market economy, despite the less favorable economic and political environment due to the economic downturn (LOI ¶25).

F. Program Issues

21. **Program modalities**. The second review under the SBA was delayed to give the authorities more time to firm up political consensus on medium-term spending reforms. The Fund arrangement remains adequate to meet Serbia's balance of payment needs through end-2010, alongside financing commitments from the EU and the World Bank. While projected external financing needs for 2009–10 have declined significantly, the fragility of the stabilization process warrants continued precautionary FX reserve accumulation. In fact, free FX reserves are significantly lower than gross FX reserves and high levels of short-term external debt. In this context, the authorities have requested that the remaining disbursements be rephased into six equal tranches over the remaining program period (Table 16). The authorities intend to draw the amount available at the completion of the review (SDR 319.6 million).

Serbia: FX Reserve Coverage
(In percent of short-term external debt)



1/ Free FX reserves = Gross FX reserves excluding liabilities to foreign residents and liabilities to domestic residents in foreign currency. Short-term external debt: on remaining maturity basis.
Sources: NBS and Fund staff estimates and projections.

22. **SDR allocation**. Given the relatively comfortable FX reserve position, the authorities have decided to use the full amount of the SDR allocation for budget purposes.

23. **IMF funds and direct budget financing.** Notwithstanding earlier staff discussions on the possible use of part of IMF funds for direct budget financing, it was agreed that under the present macroeconomic framework fiscal deficits in 2009–10 can be financed at reasonable cost and that the envisaged financing mix between domestic and external sources does not raise crowding out problems for private sector credit.

24. **New structural conditionality under the program will continue to focus on the fiscal and financial sector areas** (LOI Table 2). The authorities committed to implement additional legislation and measures to strengthen fiscal responsibility and reform the pension system to safeguard medium-term sustainability. It was also agreed that specific measures to modernize the tax administration will be defined during the next review, pending an assessment of progress achieved so far. Measures in the financial area aim at ensuring banking sector soundness and improving corporate debt workout procedures.

G. Financing Assurances Review

25. **Negotiations on settling remaining official external debt issues—including external arrears—are ongoing**. Regarding the renegotiation of restructuring agreements with Paris Club members following the breakup of the Union of Serbia and Montenegro in 2006, the authorities estimate that around three-quarters of the outstanding Paris Club debt has been reconciled. Remaining official external arrears mostly relate to debts of the former Socialist Federal Republic of Yugoslavia (SFRY). Negotiations with non-participants in the London Club settlement and with other official non-Paris Club creditors are progressing only slowly given unresolved succession issues related to the SFRY and some creditor states.

III. Staff Appraisal

26. **Financial tensions have dissipated, and the economic downturn—although deeper than originally envisaged—appears to have bottomed out.** With domestic demand contracting sharply, external adjustment has proceeded at a faster-than-expected pace, easing earlier pressures on external financing, the exchange rate, and inflation, but also resulting in a higher fiscal deficit due to revenue shortfalls. With recent economic indicators starting to point upward, the short-term outlook for growth and external financing is now less worrisome, but fiscal and external vulnerabilities remain high.

27. **Against this backdrop, the authorities' strategy remains broadly appropriate.** Fiscal policy—while allowing automatic stabilizers to operate—is geared toward restoring sound public finances over the medium term; monetary and financial policies focus on maintaining macro-financial stability; and the structural reform agenda aims at supporting the needed shift away from absorption-led growth through downsizing the public sector and improving the investment climate.

28. **Implementing sound and credible fiscal adjustment measures is the key policy challenge.** The proposed policies for 2010 and the medium term strike a balance between supporting the fledgling economic recovery and containing high structural fiscal deficits. But the authorities' spending-based consolidation strategy carries significant implementation risks, not least in view of Serbia's historically weak track record in implementing difficult spending reforms, notably in areas like public wages and pensions. Also, short-term fiscal adjustment has mainly relied on low-quality, ad-hoc cuts and freezes that are unlikely to be sustainable beyond 2010. The authorities' commitment to add credibility to their fiscal strategy through strengthening budget procedures in the context of a Budget System and Responsibility Law tailored to Serbia's specific circumstances is therefore welcome.

29. **A continued disinflation trend would provide scope for further gradual easing of monetary policy.** The inflation targeting regime has proved successful so far despite persistently high euroization, but the monetary transmission mechanism has further weakened in the crisis. In the period ahead, the monetary authorities will have to balance the risks from continued high inflation expectations with the impact of weak absorption growth and the agreed nominal freeze of public wages and pensions.

30. **The authorities' financial sector support program has helped safeguard financial stability, but challenges remain.** Going forward, with NPLs likely to continue to rise further, there is a need to improve the framework for debt collection and restructuring to address problems with the existing options to block delinquent borrowers' bank accounts and bankruptcy procedures. Furthermore, there is scope for streamlining macro-prudential regulations, strengthening the newly adopted crisis preparedness framework, and developing domestic securities markets.

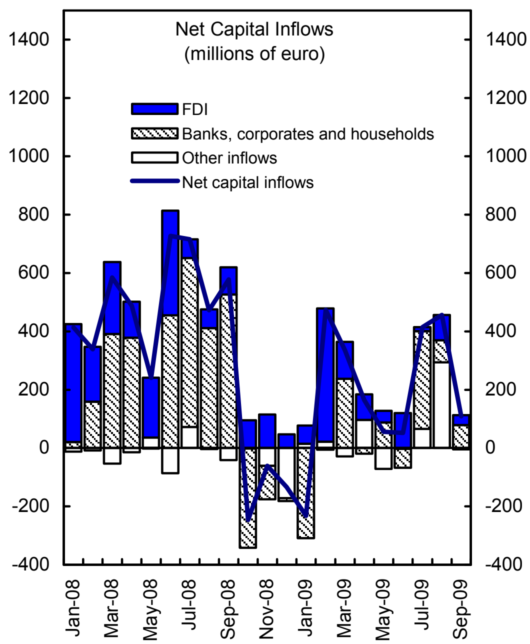
31. **Structural reform progress has remained slow, in particular with respect to public enterprise restructuring and privatization.** Staff welcomes the authorities efforts to

streamline business laws and regulations in the context of the regulatory guillotine project, and encourages the authorities to push ahead more forcefully with privatization, modernizing public enterprises and utilities, and long-delayed structural reforms to improve the business environment and support private sector development.

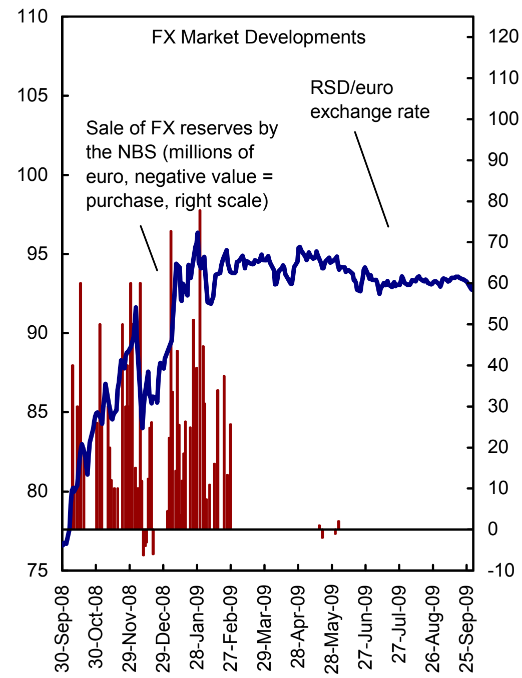
32. **On the basis of Serbia's solid performance under the SBA, staff supports the authorities' request for completing the second review,** including a waiver for the nonobservance of the end-September 2009 performance criterion on the general government deficit, and the financing assurances review. Staff also recommends establishment of quantitative conditionality for end-March 2010, approval of the modification of program conditionality, as specified in the Letter of Intent (¶4, and LOI Tables 1 and 2), and a rephasing of the remaining purchases under the program.

Figure 1. Serbia: Financial Market Developments Since September 2008

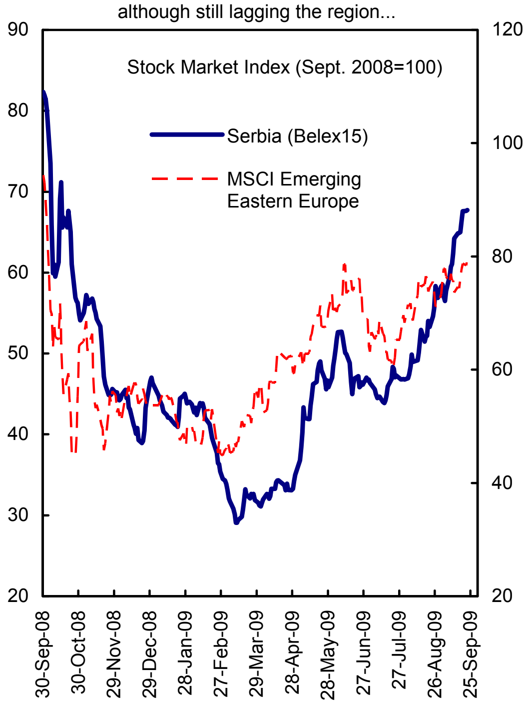
Capital inflows have turned positive again since February 2009,...



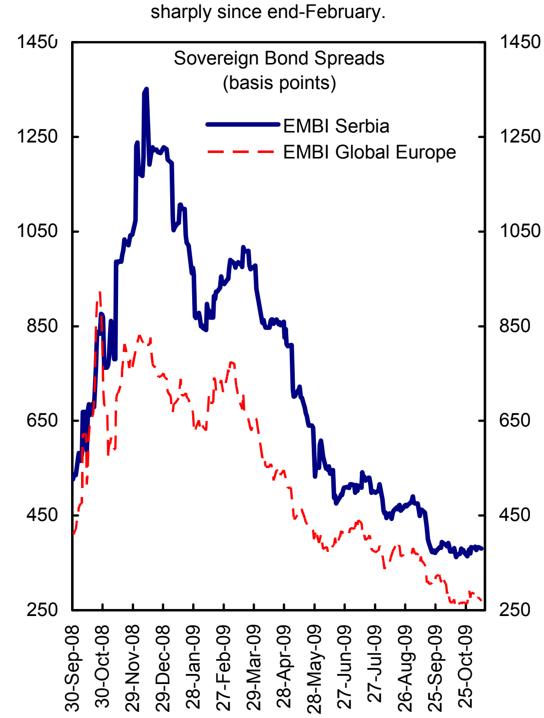
...and the dinar exchange rate stabilized without the need for NBS foreign exchange market intervention...



The local stock market has started to recover, although still lagging the region...

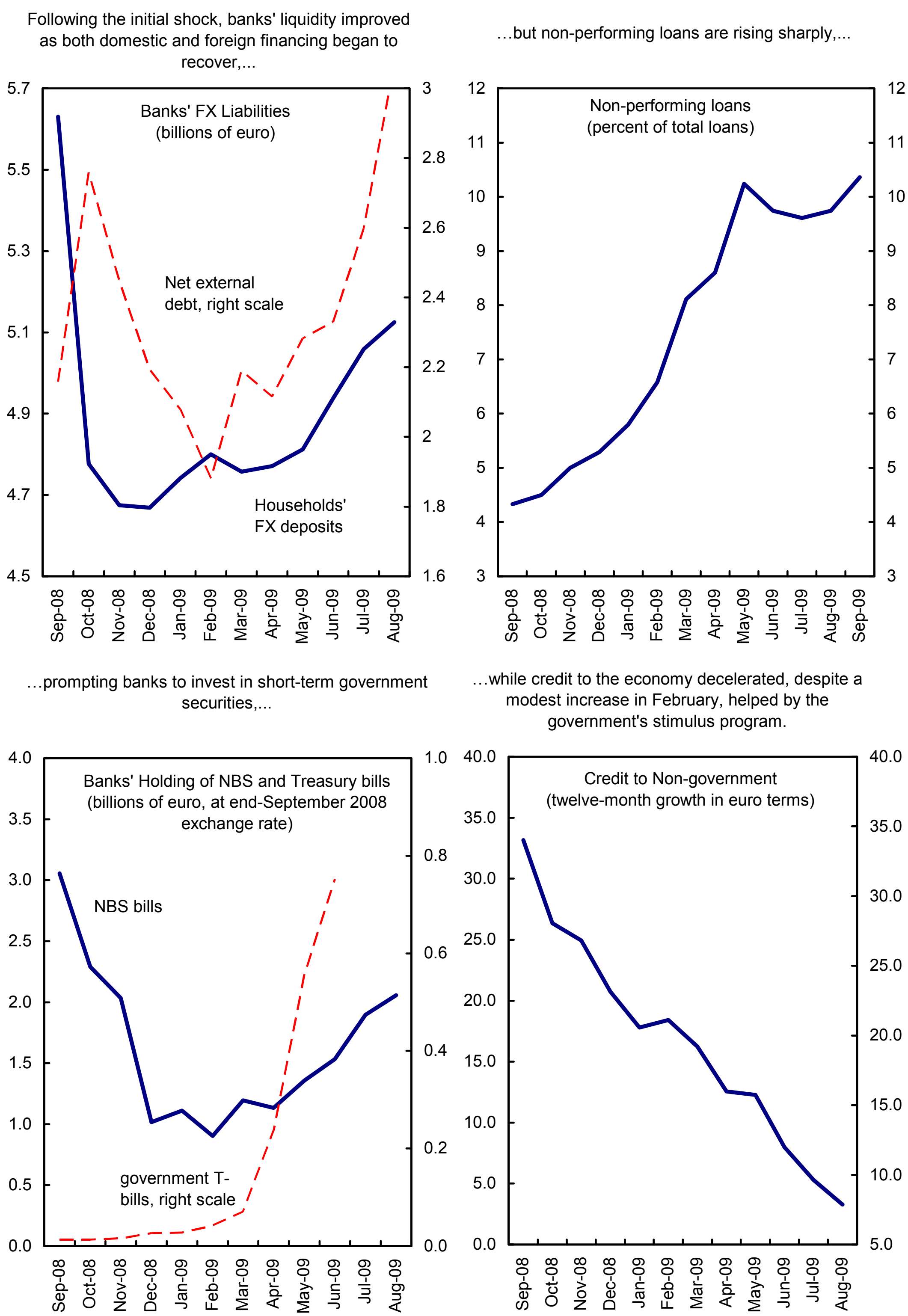


...while sovereign spreads have narrowed sharply since end-February.



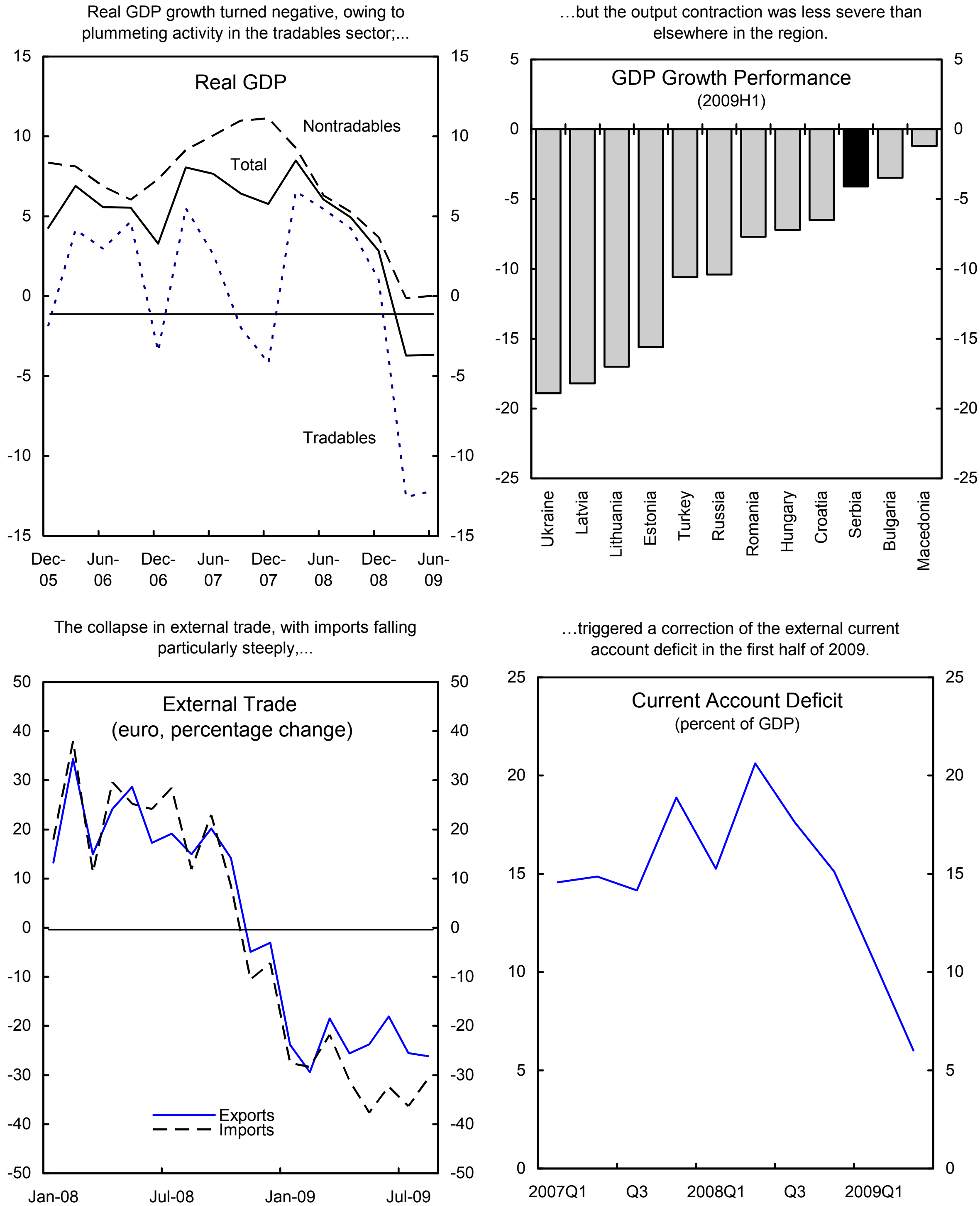
Sources: National Bank of Serbia; and Bloomberg.

Figure 2. Serbia: Banking Sector Developments Since September 2008



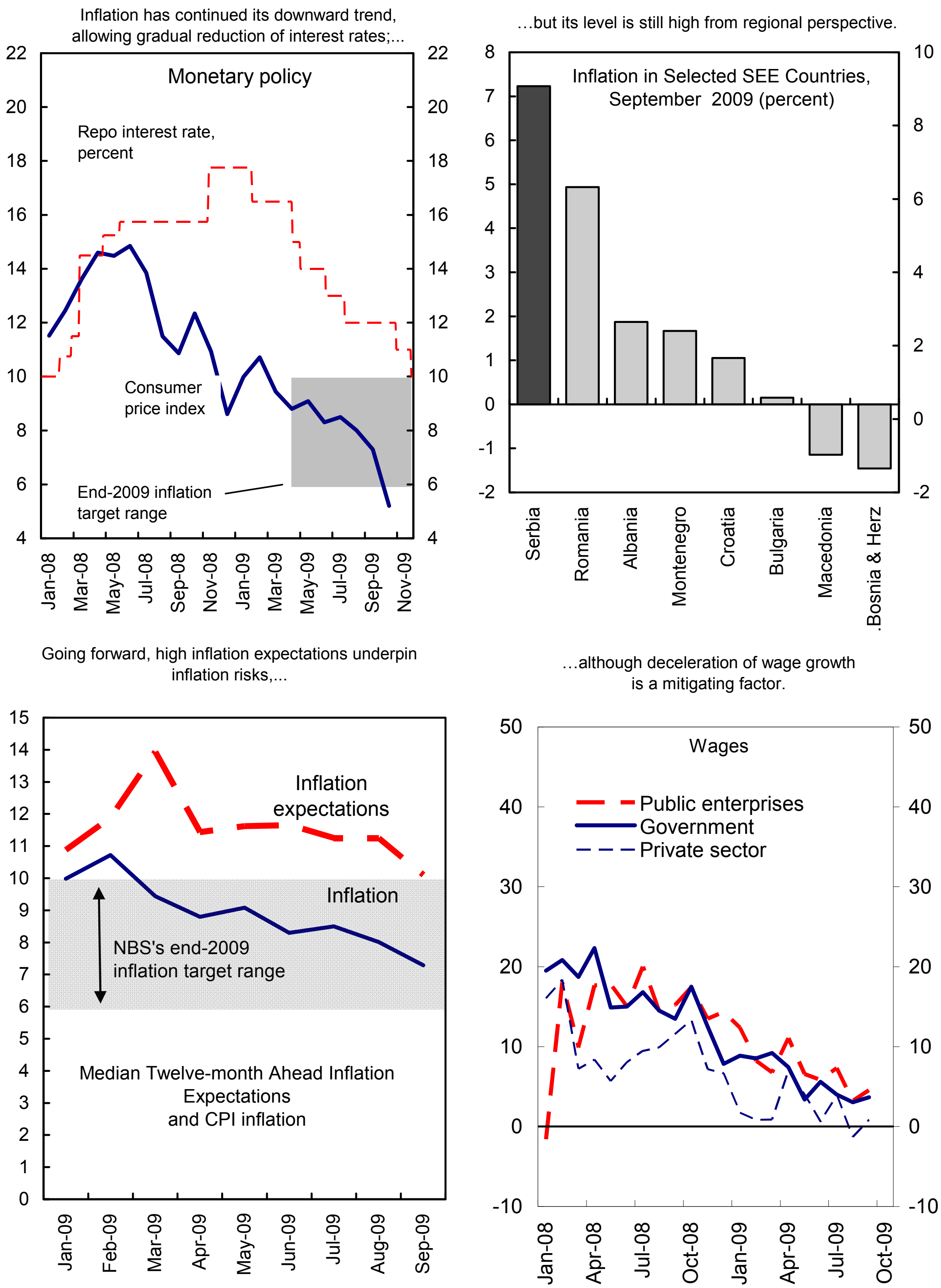
Source: National Bank of Serbia.

Figure 3. Serbia: Real and External Sector Developments, 2006--2009
(Twelve-month growth, in percent)



Sources: National Bank of Serbia; Statistical Office of Serbia and International Financial Statistics (IFS).

Figure 4. Serbia: Inflation and Wage Developments, 2008–09
(Twelve-month growth, percent)



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

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2008–10 1/

	2008		2009							2010	
	Dec.		March		June		Sept.		Dec.	March	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Rev. Prog.	Prog.	Proj.
Quantitative Performance Criteria											
Floor on net foreign assets of the NBS (in billions of euro)	5.0	6.1	5.1	6.0	4.4	5.9	3.6	5.3	4.3	4.0	3.5
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	64	69	15	12	34	55	58	79	134	23	129
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	0	0	10	0	10	1.6	10	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/	50	0	200	0	550	100	550	100	550	200	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
Inflation Consultation Bands (in percent)											
Central point	10.0	8.6	9.2	9.4	8.0	8.3	9.5	7.3	7.5	5.4	6.5
Band, upper limit	12.0	n.a.	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	7.4	8.5
Band, lower limit	8.0	n.a.	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	3.4	4.5
Indicative Targets											
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	635	633	190	152	335	331	520	506	695	182	729
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.	n.a.	n.a.	50	7	50	15	50	13	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 Second Review

Measure	Target Date	Comment
Quantitative performance criteria		
1. Floor on net foreign assets of the NBS	September 2009	Observed
2. Ceiling on consolidated general government overall deficit	September 2009	Not observed
3. Ceiling on contracting or guaranteeing by the public sector of new short-term external debt	September 2009	Observed
4. Ceiling on accumulation of government external payment arrears	September 2009	Observed
Indicative targets		
1. Ceiling on current expenditures of the Serbian Republican budget	September 2009	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	September 2009	Observed
Inflation consultation clause	September 2009	Observed
Structural benchmarks		
1. Budget framework. Government to adopt the business plan of the Road Company of Serbia consistent with the program.	May 2009	Observed
2. Budget framework and wage policy. Government to adopt state enterprises' business plans that conform to general government wage and employment policy in 2009 and ensure profit transfers to the state.	May 2009	Partially observed (wage freeze not enforced in all state enterprises)
3. Budget management. Ministry of Finance to prepare a three-month rolling cash flow plan for the Republican budget consistent	June 2009	Observed
4. Revenue administration. Ministry of Finance to charge a specific unit to review the reasons for the sharp increase in VAT refunds and credits in 2008.	June 2009	Observed with two month delay
5. Financial sector. Deposit Insurance Agency to adopt detailed action plans for the remaining banks with state participation.	June 2009	Observed
6. Financial sector. NBS to complete a diagnostic study of the 12 largest banks and the four banks with majority state ownership.	September 2009	Partially observed; observed for 12 largest banks; 4 majority state-owned banks to be completed by December 2009

Table 3. Serbia: Selected Economic and Social Indicators, 2005–10 1/

	2005	2006	2007	2008	2009		2010	
					EBS/09/63	Proj.	EBS/09/63	Proj.
	(Change in percent, unless otherwise indicated)							
Output, prices, and labor market								
Real GDP	5.6	5.2	6.9	5.5	-2.0	-3.0	0.0	1.5
Real GDP excluding agricultural sector	7.2	6.0	8.8	5.2	-2.2	-3.6	0.0	1.4
Real domestic demand (absorption)	-3.8	6.2	11.5	6.3	-5.6	-8.0	-4.6	0.5
Consumer prices (average) 2/	17.3	12.7	6.5	11.7	10.0	9.0	8.2	5.1
Consumer prices (end of period) 2/	17.7	6.6	11.0	8.6	10.0	7.5	8.0	6.5
Nominal gross wage	24.3	24.4	21.9	17.8	6.3	5.0	4.2	5.7
Real net wage	5.5	10.6	19.9	4.9	-3.4	-3.7	-3.7	0.6
Net wage in euro	8.3	23.3	33.9	15.8	…	…	…	…
Unemployment rate (in percent)	21.8	21.6	18.8	14.0	…	…	…	…
Nominal GDP (in billions of dinars)	1,688	1,980	2,363	2,791	2,995	2,974	3,242	3,230
	(In percent of GDP)							
General government finances								
Revenue	42.9	43.8	42.4	40.9	39.5	38.3	38.3	37.4
Expenditure	42.1	45.4	44.2	43.4	42.5	42.8	40.9	41.4
Current	39.1	40.8	39.0	39.0	38.5	39.1	36.2	37.0
Capital and net lending	3.0	4.6	5.2	4.4	4.0	3.7	4.6	4.4
Fiscal balance (cash basis)	0.8	-1.6	-1.9	-2.5	-3.0	-4.5	-2.5	-4.0
Structural fiscal balance 3/	0.1	-2.3	-3.6	-4.6	-3.9	-4.1	-2.7	-4.3
Gross debt	56.1	42.6	33.3	31.7	34.8	31.4	37.8	33.0
	(End of period 12-month change, in percent)							
Monetary sector								
Money (M1)	31.0	37.1	25.3	-3.8	-19.2	-9.7	34.1	11.7
Broad money (M2) 4/	43.1	38.4	44.5	9.6	0.1	7.2	19.5	9.8
Domestic credit to non-government	51.2	17.1	36.9	35.0	11.0	10.0	15.7	11.9
	(End of period, in percent)							
Interest rates (dinar) 5/								
NBS repo rate	19.2	14.0	10.0	17.8	…	…	…	…
Deposit rate	3.7	5.1	4.1	6.4	…	…	…	…
	(In percent of GDP, unless otherwise indicated)							
Balance of payments								
Current account balance	-8.7	-10.1	-15.5	-17.1	-13.0	-7.2	-10.1	-9.3
Exports of goods	19.6	21.8	21.6	21.6	19.1	18.7	20.4	18.3
Imports of goods	40.6	42.9	44.1	43.9	36.6	33.4	34.8	32.8
Trade of goods balance	-20.9	-21.2	-22.5	-22.3	-17.5	-14.7	-14.4	-14.5
Capital and financial account balance	18.6	31.7	17.9	12.4	3.2	5.7	8.1	6.1
External debt (end of period; billions of euro)	13.1	14.9	17.8	21.8	23.5	22.5	26.1	25.1
(In percent of GDP)	64.1	63.3	60.2	63.6	76.3	70.9	85.6	74.1
of which: Private external debt	26.3	36.0	39.5	45.0	47.0	45.8	52.6	44.2
Gross official reserves (in billions of euro)	4.0	8.7	9.5	8.1	7.9	9.0	8.4	9.8
(In months of prospective imports of GNFS)	4.0	6.6	6.3	7.7	6.9	7.3	7.5	8.1
Exchange rate (dinar/euro, period average)	82.9	84.2	80.0	81.5	…	…	…	…
REER (annual average change, in percent; + indicates appreciation)	-3.1	6.6	7.2	5.8	-8.9	-5.9	-2.3	2.6
Social indicators								
Per capita GDP (2008): US$6,782. Population (2008): 7.4 million. Poverty rate (poverty line is US$5 per day, 2007): 6.6 percent.								

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

1/ Excluding Kosovo (with the exception of external debt).
2/ Retail prices until 2006.
3/ Fiscal balance adjusted for the automatic effects of both the output gap and the external absorption gap on the fiscal position; see IMF Country Report No. 07/390 for details.
4/ Excluding frozen foreign currency deposits.
5/ Actual data. Repo rate is as of end-July 2009, and the deposit rate is as of end-June 2009.

Table 4. Serbia: Real GDP Growth Components, 2007–15
(In percent)

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
	(Real growth rate by expenditure category)								
Gross Domestic Product (GDP)	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand (absorption)	11.5	6.3	-8.0	0.5	1.1	3.5	4.7	3.6	3.4
Non-government	9.3	5.7	-7.8	1.7	1.4	3.5	4.4	3.0	2.9
Government	20.0	8.2	-8.9	-3.7	-0.3	3.8	5.7	6.1	5.1
Consumption	5.6	12.8	-4.0	-2.8	-0.7	2.2	3.4	3.0	2.4
Non-government	2.3	12.4	-2.9	-1.8	0.6	2.4	3.1	2.6	2.0
Government	18.3	13.8	-7.3	-6.2	-5.1	1.0	4.5	4.5	3.9
Investment	33.8	-13.2	-23.7	16.7	8.1	8.7	9.3	5.7	6.6
Gross fixed capital formation	25.6	-7.7	-25.0	19.1	8.8	9.1	9.8	5.7	6.8
Non-government	25.1	-5.7	-26.6	20.7	5.0	7.5	9.7	4.0	6.1
Government	28.0	-15.7	-17.9	12.7	25.2	15.1	10.0	11.5	9.0
Change in inventories 1/	2.7	-2.1	-0.4	0.0	0.1	0.1	0.1	0.1	0.1
Net exports of goods and services 1/	-6.3	-2.0	6.7	0.9	1.8	1.1	0.3	1.5	1.4
Exports of goods and services	17.2	9.1	-11.6	3.8	13.1	18.2	17.7	17.9	14.2
Imports of goods and services	26.0	9.4	-19.9	0.4	4.5	10.7	12.9	11.3	9.5
	(Contribution to real growth by expenditure category)								
Gross Domestic Product (GDP)	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand (absorption)	13.2	7.5	-9.7	0.6	1.2	3.9	5.2	4.0	3.6
Non-government	8.6	5.4	-7.3	1.5	1.3	3.1	3.9	2.6	2.5
Government	4.6	2.1	-2.4	-0.9	-0.1	0.9	1.3	1.4	1.2
Consumption	5.1	11.5	-3.8	-2.6	-0.6	1.9	2.9	2.5	2.0
Non-government	1.6	8.6	-2.2	-1.3	0.4	1.7	2.1	1.7	1.3
Government	3.5	2.9	-1.7	-1.3	-1.0	0.2	0.8	0.8	0.7
Investment	8.1	-4.0	-5.9	3.3	1.8	2.0	2.3	1.4	1.7
Gross fixed capital formation	5.4	-1.9	-5.4	3.2	1.7	1.9	2.1	1.3	1.5
Non-government	4.3	-1.1	-4.7	2.8	0.8	1.2	1.6	0.7	1.0
Government	1.2	-0.8	-0.7	0.4	0.9	0.7	0.5	0.6	0.5
Change in inventories	2.7	-2.1	-0.4	0.0	0.1	0.1	0.1	0.1	0.1
Net exports of goods and services	-6.3	-2.0	6.7	0.9	1.8	1.1	0.3	1.5	1.4
Exports of goods and services	4.6	2.6	-3.5	1.1	3.7	5.6	6.1	6.9	6.1
Imports of goods and services	10.9	4.6	-10.2	0.2	1.9	4.5	5.8	5.4	4.8
	(Contribution to real GDP growth by production category)								
Gross Domestic Product (GDP)	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Gross Value-Added	5.6	5.2	-2.3	1.3	2.6	4.3	4.8	4.8	4.3
Agriculture	-0.9	0.8	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Industry	0.8	0.3	-1.8	0.2	0.5	0.8	1.0	1.0	1.0
Services	7.0	4.4	-1.4	1.1	2.3	4.0	4.3	4.3	3.8
Wholesale and retail trade	2.0	0.8	-0.7	0.2	0.5	0.7	0.8	0.8	0.8
Construction	0.3	0.1	-0.2	0.0	0.1	0.2	0.2	0.2	0.2
Transport and communications	2.4	1.7	0.3	0.3	0.4	0.9	1.0	1.0	0.7
Financial services	0.6	0.5	0.0	0.1	0.1	0.2	0.2	0.2	0.2
Other	0.4	1.0	-0.3	0.4	0.8	1.3	1.4	1.4	1.3
Taxes minus subsidies	1.5	0.6	-0.8	0.2	0.5	0.8	0.9	0.9	0.8
Memorandum items:									
Tradables GDP	0.4	1.3	-1.8	0.4	0.8	1.3	1.4	1.4	1.4
Non-tradables GDP	6.5	4.2	-1.2	1.1	2.2	3.7	4.1	4.1	3.6

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

1/ Contributions to GDP growth.

Table 5. Serbia: Savings-Investment Balances, 2007–15 1/
(In percent of GDP)

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Domestic demand	123.3	122.8	115.1	115.1	113.9	113.1	112.9	111.9	111.4
Consumption	94.7	99.4	96.8	94.2	91.9	90.1	88.9	87.6	86.5
Non-government	74.9	78.1	76.6	75.7	74.7	73.3	72.0	70.7	69.5
Government	19.8	21.3	20.2	18.5	17.2	16.8	16.9	17.0	17.0
Gross domestic savings	5.3	0.6	3.2	5.8	8.1	9.9	11.1	12.4	13.5
Non-government	2.0	-1.7	3.3	4.8	6.0	6.6	7.1	7.6	8.2
Government	3.3	2.3	-0.1	1.0	2.1	3.2	4.0	4.8	5.3
Net factor receipts and transfers from abroad	7.7	5.6	7.9	5.8	5.9	5.4	4.6	3.8	3.4
Non-government	8.2	6.1	8.7	6.5	6.7	6.2	5.4	4.5	4.0
Government	-0.5	-0.4	-0.7	-0.7	-0.8	-0.8	-0.7	-0.7	-0.6
Gross national savings	13.0	6.2	11.1	11.6	14.0	15.3	15.8	16.2	16.9
Non-government	10.2	4.4	11.9	11.3	12.7	12.8	12.5	12.1	12.2
Government	2.8	1.8	-0.8	0.2	1.3	2.5	3.3	4.1	4.7
Gross domestic investment 1/	28.6	23.4	18.3	20.8	22.1	23.0	24.0	24.3	24.9
Non-government	24.0	19.7	15.2	17.4	17.9	18.4	19.1	19.1	19.6
Gross fixed capital formation	18.7	16.7	12.5	14.8	15.2	15.7	16.5	16.4	17.0
Change in inventories	5.2	3.0	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Government	4.6	3.7	3.1	3.4	4.2	4.6	4.9	5.2	5.3
Overall savings-investment balance	-15.6	-17.2	-7.2	-9.3	-8.1	-7.8	-8.3	-8.1	-8.0
Non-government	-13.8	-15.3	-3.2	-6.1	-5.2	-5.6	-6.6	-7.0	-7.4
Government	-1.8	-1.9	-3.9	-3.2	-2.9	-2.2	-1.6	-1.1	-0.6
Foreign savings	15.6	17.2	6.9	9.3	8.1	7.8	8.3	8.1	8.0
Foreign savings excluding official grants	16.3	17.8	7.6	9.9	8.7	8.4	8.9	8.6	8.6
Memorandum items:									
Net exports of goods and services 2/	-23.3	-22.8	-15.1	-15.1	-13.9	-13.1	-12.9	-11.9	-11.4
Current account balance (incl. grants)	-15.5	-17.1	-7.2	-9.3	-8.1	-7.8	-8.3	-8.1	-8.0
General government fiscal balance	-1.9	-2.5	-4.5	-4.0	-3.2	-2.5	-1.9	-1.5	-0.9

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

1/ Including changes in inventories.

2/ Equal to the absoption gap (GDP minus domestic demand).

Table 6. Serbia: Balance of Payments, 2007–15 1/

	2007	2008	2009 EBS/09/63	2009 Proj.	2010 EBS/09/63	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
(In billions of euro)											
Current account balance	-4.6	-5.9	-4.0	-2.3	-3.1	-3.1	-2.9	-3.0	-3.6	-3.8	-4.1
Trade of goods balance	-6.6	-7.6	-5.4	-4.6	-4.4	-4.9	-4.8	-4.9	-5.3	-5.4	-5.5
Exports of goods	6.4	7.4	5.9	5.9	6.2	6.2	7.2	8.6	10.2	12.2	14.2
Imports of goods	-13.0	-15.0	-11.3	-10.6	-10.6	-11.1	-12.0	-13.5	-15.5	-17.6	-19.7
Services balance	-0.3	-0.2	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3
Exports of nonfactor services	2.3	2.7	2.4	2.3	2.4	2.3	2.4	2.6	2.8	3.1	4.1
Imports of nonfactor services	-2.6	-2.9	-2.6	-2.5	-2.6	-2.5	-2.6	-2.8	-3.1	-3.4	-4.4
Income balance	-0.6	-0.9	-1.2	-0.8	-1.2	-1.0	-1.0	-1.0	-1.2	-1.5	-1.7
Net interest	-0.5	-0.7	-1.0	-0.8	-0.9	-1.0	-1.1	-1.1	-1.2	-1.3	-1.3
Others, including reinvested earnings	-0.1	-0.2	-0.2	0.0	-0.3	0.0	0.1	0.1	0.0	-0.2	-0.3
Current transfer balance	2.9	2.9	2.7	3.3	2.7	2.9	3.1	3.1	3.2	3.3	3.4
Official grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.3
Others, including private remittances	2.7	2.6	2.5	3.1	2.5	2.7	2.9	2.9	2.9	3.1	3.1
o/w unrecorded remittances	1.5	1.4		1.9		1.4	1.5				
Capital and financial account balance	5.3	4.2	1.0	1.8	2.5	2.1	3.1	3.8	5.0	5.9	5.7
Capital transfer balance	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.8	1.8	1.0	1.2	1.2	1.2	1.4	1.7	2.6	3.0	3.2
Portfolio investment balance	0.7	-0.1	0.0	-0.1	0.0	-0.1	-0.3	-0.3	-0.4	-0.5	-0.5
Other investment balance	3.1	2.5	0.0	0.7	1.2	1.0	2.0	2.5	2.8	3.3	3.0
General governement	0.1	0.1	0.3	0.2	-0.1	0.3	0.3	0.3	0.3	0.3	0.4
Domestic banks	-0.4	0.5	0.6	0.8	0.0	0.2	0.1	0.3	0.2	0.4	0.1
Other private sector	3.4	2.0	-0.9	-0.7	1.3	0.6	1.7	1.8	2.3	2.7	2.5
Other 2/				0.4							
Errors and omissions	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.9	-1.8	-3.0	-0.5	-0.6	-1.1	0.2	0.8	1.4	2.1	1.6
Financing	-0.9	1.8	3.0	0.5	0.6	1.1	-0.2	-0.8	-1.4	-2.1	-1.6
Gross international reserves (increase, -)	-1.0	1.8	0.6	-0.9	-0.5	-0.8	-0.6	-0.6	-0.6	-0.8	-1.0
Prospective drawings	…	…	2.4	1.3	1.1	1.9	0.4	…	…	…	
EU	…	…	0.1	0.1	0.3	0.3	…	…	…	…	
World Bank	…	…	0.15	0.1	0.1	0.1	…	…	…	…	
IMF	…	…	2.2	1.1	0.8	1.6	0.41	0.0	0.0	0.0	
Prospective repayments (IMF)	…	…		…	…	…	…	-0.2	-0.8	-1.2	-0.6
(In percent of GDP)											
Current account balance	-15.5	-17.1	-13.0	-7.2	-10.1	-9.3	-8.1	-7.8	-8.3	-8.1	-8.0
Trade of goods balance	-22.5	-22.3	-17.5	-14.7	-14.4	-14.5	-13.4	-12.6	-12.4	-11.4	-10.7
Exports of goods	21.6	21.6	19.1	18.7	20.4	18.3	20.0	21.8	23.7	25.9	27.4
Imports of goods	-44.1	-43.9	-36.6	-33.4	-34.8	-32.8	-33.4	-34.4	-36.1	-37.3	-38.1
Services balance	-0.9	-0.5	-0.5	-0.4	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7
Income balance	-1.9	-2.7	-3.8	-2.5	-3.9	-2.8	-2.7	-2.6	-2.8	-3.1	-3.2
Current transfer balance	9.7	8.3	8.8	10.4	8.9	8.6	8.6	8.0	7.4	7.0	6.6
Official grants	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5
Others, including private remittances	9.1	7.7	8.1	9.8	8.2	7.9	8.0	7.4	6.8	6.5	6.1
Capital and financial account balance	17.9	12.4	3.2	5.7	8.1	6.1	8.6	9.8	11.6	12.5	11.1
Capital transfers balance	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0
Foreign direct investment balance	6.2	5.3	3.2	3.7	4.0	3.4	3.8	4.4	6.0	6.4	6.2
Portfolio investment balance	2.3	-0.3	0.0	-0.2	0.0	-0.4	-0.8	-0.8	-0.9	-1.0	-0.9
Other investment balance	10.5	7.3	-0.1	2.3	4.1	3.1	5.7	6.3	6.5	7.1	5.8
General governement	0.4	0.2	0.9	0.6	-0.2	0.9	0.7	0.8	0.7	0.6	0.7
Domestic banks	-1.4	1.4	1.9	2.6	0.0	0.6	0.3	0.8	0.4	0.8	0.3
Other private sector	11.6	5.8	-2.9	-2.3	4.3	1.6	4.7	4.7	5.3	5.7	4.8
Errors and omissions	0.7	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	3.1	-5.1	-9.8	-1.4	-2.0	-3.2	0.6	2.1	3.3	4.4	3.1
Memorandum items:											
(in percent, unless otherwise indicated)											
Export growth	24.7	16.2	-20.4	-20.1	5.3	4.5	16.0	19.1	19.2	20.1	15.6
Import growth	28.9	15.6	-24.9	-29.7	-6.1	5.0	8.1	12.5	15.0	13.6	11.7
Export volume growth	17.2	9.1	-10.9	-11.6	0.9	3.8	13.1	18.2	17.7	17.9	14.2
Import volume growth	26.0	9.4	-15.8	-19.9	-11.6	0.4	4.5	10.7	12.9	11.3	9.5
Export prices growth	6.4	6.5	-10.7	-9.6	4.3	0.7	2.5	0.8	1.3	1.8	1.2
Import prices growth	2.3	5.7	-10.8	-12.2	6.2	4.6	3.4	1.6	1.8	2.1	2.1
Change in terms of trade	4.0	0.8	0.1	3.0	-1.8	-3.7	-0.8	-0.8	-0.5	-0.2	-0.8
Gross official reserves (in billions of euro)	9.6	8.1	7.9	9.0	8.4	9.8	10.4	11.1	11.6	12.4	13.4
(In months of prospective imports of GNFS)	6.4	7.7	6.9	8.0	7.5	8.1	7.7	7.1	6.6	6.2	6.0
(in percent of short-term debt)	268.4	173.0	…	188.9	…	190.3	165.7	137.0	122.7	121.0	120.9
(in percent of broad money, M2)	86.5	74.6	…	79.4	…	83.1	…	…	…	…	…
GDP (euro billion)	29.5	34.3	30.9	31.7	30.5	33.9	36.0	39.3	43.0	47.2	51.6

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 7. Serbia: External Financing Requirements and Sources, 2007–15

(In billions of euro, unless otherwise indicated)

	2008	2009 EBS/09/63	2009 Proj.	2010 EBS/09/63	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
1. Gross financing requirements	9.49	8.99	7.94	7.86	8.73	8.67	9.96	12.18	14.10	15.38
Current account deficit	5.88	4.01	2.27	3.07	3.15	2.90	3.04	3.56	3.82	4.12
Debt amortization	3.62	4.98	4.79	4.26	4.79	5.17	6.11	7.22	8.21	9.63
Medium- and long-term debt	2.67	2.96	2.78	2.75	3.03	3.41	4.35	5.46	6.45	7.87
Public sector 1/	0.12	0.13	0.15	0.23	0.26	0.29	0.30	0.36	0.37	0.39
Commercial banks	0.54	0.08	0.12	0.18	0.20	0.31	0.42	0.72	0.74	1.05
Corporate sector	2.01	2.75	2.51	2.34	2.56	2.81	3.63	4.38	5.34	6.43
Short-term debt 2/	0.94	2.01	2.01	1.51	1.76	1.76	1.76	1.76	1.76	1.76
Commercial banks	…	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32
Corporate sector	…	0.69	0.69	0.19	0.44	0.44	0.44	0.44	0.44	0.44
Accumulation of gross reserves	0.00	0.00	0.88	0.53	0.80	0.60	0.61	0.55	0.82	0.99
Repayment of prospective IMF credits	...	...	...	...	...	...	0.20	0.84	1.24	0.63
2. Available financing	9.49	6.61	6.61	6.73	6.85	8.27	9.96	12.18	14.10	15.38
Capital transfers	0.01	0.00	0.00	0.00	0.00	-0.01	-0.02	-0.03	-0.02	0.01
Foreign direct investment (net)	1.81	1.00	1.16	1.22	1.16	1.37	1.73	2.60	3.02	3.22
Portfolio investment (net)	-0.09	0.00	-0.06	0.00	-0.12	-0.30	-0.33	-0.40	-0.46	-0.47
Debt financing	5.93	4.44	4.14	5.71	5.52	7.10	8.45	9.89	11.43	12.48
Medium- and long-term debt	4.86	2.93	2.38	4.20	3.76	5.34	6.69	8.13	9.67	10.72
Public sector 1/	0.18	0.40	0.33	0.16	0.55	0.55	0.61	0.68	0.68	0.75
Commercial banks	0.23	0.08	0.08	0.50	0.20	0.40	0.74	0.90	1.10	1.20
Corporate sector	4.46	2.45	1.97	3.53	3.00	4.39	5.35	6.55	7.89	8.77
Short-term debt 2/	1.07	1.51	1.76	1.51	1.76	1.76	1.76	1.76	1.76	1.76
Public sector		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Commercial banks	…	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32
Corporate sector	…	0.19	0.44	0.19	0.44	0.44	0.44	0.44	0.44	0.44
Drawdown of gross reserves	1.61	0.63	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other flows 3/	0.22	0.55	1.37	-0.20	0.30	0.11	0.12	0.12	0.13	0.14
3. Financing gap	0.00	2.37	1.33	1.13	1.88	0.41	0.00	0.00	0.00	0.00
European Union (prospective)	…	0.05	0.05	0.25	0.25	…	…	…	…	0.00
World Bank (prospective)	…	0.15	0.15	0.08	0.07	…	…	…	…	0.00
IMF	…	2.17	1.14	0.80	1.56	0.41	…	…	…	…
Memorandum items:										
Debt service	4.35	5.94	5.58	5.18	5.79	6.26	7.28	8.47	9.51	11.02
Interest	0.73	0.97	0.78	0.93	1.01	1.09	1.17	1.25	1.29	1.39
Amortization	3.62	4.98	4.79	4.26	4.79	5.17	6.11	7.22	8.21	9.63
Ratio of new disbursements to repayments (in percent)										
Total debt	164	89	86	134	115	137	138	137	139	130
Medium- and long-term debt	182	99	86	153	124	157	154	149	150	136
Public sector	142	307	220	68	212	189	203	189	182	194
Commercial banks	42	100	66	285	100	130	177	125	148	114
Corporate sector	222	89	79	151	117	156	147	149	148	136
Short-term debt	114	75	87	100	100	100	100	100	100	100
Public sector										
Commercial banks	…	100	100	100	100	100	100	100	100	100
Corporate sector	…	27	63	100	100	100	100	100	100	100

Sources: NBS; and IMF staff estimates and projections.

1/ Excluding IMF.
2/ Original maturity of less than 1 year. Stock at the end of the previous period.
3/ Includes all other net financial flows, SDR allocations, and errors and omissions.

Table 8. Serbia: Rankings of Selected Competitiveness and Structural Indicators 1/

	Serbia		Best performers 2/				Distance 3/	
	2008	2009	Country	2008	Country	2009	2008	2009
World Bank Doing Business survey 4/	48	52	Estonia	88	Estonia	87	-40	-35
Starting a business	41	60	Macedonia	93	Macedonia	97	-52	-37
Dealing with licenses	6	5	Estonia	90	Estonia	89	-84	-84
Employing workers	50	49	Bulgaria	67	Czech Rep.	86	-18	-38
Registering property	46	43	Lithuania	98	Lithuania	98	-51	-55
Getting credit	85	98	Bulgaria	97	BGR, LVA, SRB	98	-13	0
Protecting investors	61	60	Albania	92	Albania	92	-31	-32
Paying taxes	30	25	Macedonia	85	Macedonia	86	-55	-61
Trading across borders	66	62	Estonia	97	Estonia	98	-31	-36
Enforcing contracts	47	47	Latvia	98	Hungary	92	-51	-45
Closing a business	45	44	Lithuania	81	Lithuania	80	-36	-36
Transparency International								
Corruption Perception Index	34	…	Slovenia	67	…	…	-33	…
EBRD transition indicators	66	67		92		92	-27	-26
Large scale privatization	62	62		92		92	-31	-31
Small scale privatization	85	85		100		100	-15	-15
Enterprise restructuring	54	54		85		85	-31	-31
Price liberalization	92	92		100		100	-8	-8
Trade and foreign exchange system	85	92		100		100	-15	-8
Competition policy	46	46		85		85	-39	-39
Banking reform	69	69		92		92	-23	-23
Non-bank financial institutions	46	46		92		92	-46	-46
Overall infrastructure reform	54	54		85		85	-31	-31

Sources: EBRD; Transparency International; World Bank; World Economic Forum; and IMF staff calculations.

1/ For comparability, all indices normalized so that they range from 0 (lowest) to 100 (best).

2/ Country name and index of best performers among: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, Serbia, Slovak Republic, and Slovenia. Country names are not shown for EBRD transition indicators due to the presence of multiple entries.

3/ Distance of Serbia from best performer for each index.

4/ As pointed out in an independent evaluation of the Doing Business survey (see www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants which tend to overstate the indicators' coverage and explanatory power.

Table 9. Serbia: Medium-Term Program Scenario, 2007–15 1/

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
GDP and prices (annual percent change)									
GDP growth (real)	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand growth (real)	11.5	6.3	-8.0	0.5	1.1	3.5	4.7	3.6	3.4
Consumer price inflation (end of period)	11.0	8.6	7.5	6.5	5.5	5.0	4.5	4.5	4.0
Savings and investment (in percent of GDP)									
Savings - investment balance	-15.6	-17.2	-7.2	-9.3	-8.1	-7.8	-8.3	-8.1	-8.0
Non-government	-13.8	-15.3	-3.2	-6.1	-5.2	-5.6	-6.6	-7.0	-7.3
Government	-1.8	-1.9	-3.9	-3.2	-2.9	-2.2	-1.6	-1.1	-0.7
General government (in percent of GDP)									
Overall fiscal balance	-1.9	-2.5	-4.5	-4.0	-3.2	-2.5	-1.9	-1.5	-1.0
Revenue	42.4	40.9	38.3	37.4	36.8	36.7	36.7	36.9	37.2
Expenditure	44.2	43.4	42.8	41.4	40.0	39.2	38.7	38.4	38.3
Current	39.0	39.0	39.1	37.0	35.4	34.1	33.4	32.8	32.4
Capital and net lending	5.2	4.4	3.7	4.4	4.6	5.0	5.3	5.6	5.8
Structural fiscal balance	-3.6	-4.6	-4.1	-4.3	-3.5	-2.7	-2.3	-1.8	-1.3
Output gap	0.1	0.8	-2.6	-1.1	0.0	-0.1	-0.1	0.0	0.0
Absorption gap	9.5	11.3	1.0	3.2	2.1	1.7	2.3	2.1	2.0
Gross debt	33.3	31.7	31.4	32.9	32.7	31.1	29.2	27.2	25.8
Balance of payments (in percent of GDP)									
Current account	-15.5	-17.1	-7.2	-9.3	-8.1	-7.8	-8.3	-8.1	-8.0
of which: Trade balance	-22.5	-22.3	-14.7	-14.5	-13.4	-12.6	-12.4	-11.4	-10.7
of which: Remittances, net	9.1	7.7	9.8	7.9	8.0	7.4	6.8	6.5	6.1
Capital and financial account	17.9	11.7	5.7	6.1	8.6	9.8	11.6	12.5	11.1
of which: Foreign direct investment	6.2	5.3	3.7	3.4	3.8	4.4	6.0	6.4	6.3
External debt (end of period)	60.2	63.6	70.9	74.1	76.3	75.3	73.0	70.7	68.9
of which: Private external debt	39.5	45.0	45.8	44.2	46.3	47.6	48.9	50.7	51.2
Gross official reserves (in billions of euro)	9.5	8.1	9.0	9.8	10.4	11.1	11.6	12.4	13.4
REER (ann. av. change; + = appreciation)	7.2	5.8	-5.9	2.6	2.1	2.8	2.4	2.4	2.3

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

1/ Definitions and coverage as in previous tables.

Table 10a. Serbia: General Government Fiscal Operations, 2007–10 1/
(In billions of RSD)

	2007	2008	2009: Q1–Q3		2009		2010					
			EBS/09/63	Actual	EBS/09/63	Prog.	EBS/09/63	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Proj.
Revenue	1,001	1,142	858	823	1,183	1,140	1,242	276	292	310	330	1,208
Taxes	870	999	742	724	1,023	999	1,082	241	258	269	291	1,060
Personal income tax	116	136	103	98	145	134	151	32	35	35	38	141
Social security contributions	270	312	234	234	323	321	339	76	83	84	92	335
Taxes on profits	30	39	29	24	39	31	32	9	4	4	5	23
Value-added taxes	265	302	223	213	302	297	328	75	79	81	90	326
Excises	99	110	92	93	131	132	152	29	36	41	42	147
Taxes on international trade	57	65	32	35	43	47	34	11	11	11	11	44
Other taxes	33	36	29	26	41	37	45	9	9	12	14	44
Non-tax revenue	119	141	115	98	159	139	159	34	33	40	37	144
Capital revenue	12	0	0	0	0	0	0	0	0	0	0	0
Grants	1	1	1	1	1	2	1	1	1	2	1	5
Expenditure	1,045	1,211	916	902	1,272	1,274	1,326	299	330	331	377	1,337
Current expenditure	922	1,089	842	836	1,154	1,162	1,175	275	295	302	324	1,196
Wages and salaries	238	293	226	218	304	306	300	72	75	72	82	301
Other goods and services	193	207	134	145	194	199	202	39	51	54	58	202
Interest	18	17	26	17	35	25.0	36	9	9	10	11	39
Subsidies	64	78	42	44	64	68	65	12	16	21	24	73
Transfers	409	493	413	411	557	564	574	142	143	145	150	580
Pensions	260	331	292	291	389	389	389	99	99	99	99	396
Other transfers 2/	150	162	121	120	167	174	184	43	44	46	51	184
Capital expenditure	110	103	64	53	101	92	134	14	22	24	50	111
Net lending	13	19	10	13	18	19	16	11	12	6	3	31
Fiscal balance (cash basis)	-44	-69	-59	-79	-90	-134	-84	-23	-37	-21	-48	-129
Financing	44	69	32	56	90	134	84	23	37	21	51	129
Privatization proceeds	65	33	37	62	64	62	12	0	0	0	0	0
Domestic	-38	59	-29	-4	-28	11	49	24	31	-20	40	72
Banks	5	55	-14	-45	0	-39	89	14	38	-20	34	64
Central bank	...	...	…	…	…	-55	…	-5	38	-20	34	45
Commerical banks	...	...	…	…	…	16	…	19	0	0	0	19
Non-bank	-43	4	-15	41	-28	50	-40	10	-8	0	6	8
External	17	-23	24	-2	54	60	23	-1	7	41	11	57
Program	...	...	28	0	56	62	34	0	10	43	14	67
Project	...	...	4	6	12	12	17	4	4	4	4	17
Amortization	...	...	8	8	14	14	28	5	8	6	7	26
Memorandum item:												
Augmented fiscal balance 3/			-32	-79	-110	-154	-85	…	…	…	…	-131
Nominal GDP (in billions of Dinar)	2,363	2,791	2,995	2,974	2,995	2,974	3,242	3,230	3,230	3,230	3,230	3,230

Sources: Ministry of Finance; and Fund 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.

Table 10b. Serbia: General Government Fiscal Operations, 2008–10 1/
(In percent of GDP)

	2008	Q1-Q3 2009		2009		2010					
		EBS/09/63	Actual	EBS/09/63	Prog.	EBS/09/63	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Proj.
Revenue	40.9	28.6	27.7	39.5	38.3	38.3	8.5	9.0	9.6	10.2	37.4
Taxes	35.8	24.8	24.3	34.2	33.6	33.4	7.5	8.0	8.3	9.0	32.8
Personal income tax	4.9	3.4	3.3	4.8	4.5	4.7	1.0	1.1	1.1	1.2	4.4
Social security contributions	11.2	7.8	7.9	10.8	10.8	10.5	2.4	2.6	2.6	2.8	10.4
Taxes on profits	1.4	1.0	0.8	1.3	1.0	1.0	0.3	0.1	0.1	0.2	0.7
Value-added taxes	10.8	7.4	7.2	10.1	10.0	10.1	2.3	2.5	2.5	2.8	10.1
Excises	3.9	3.1	3.1	4.4	4.4	4.7	0.9	1.1	1.3	1.3	4.6
Taxes on international trade	2.3	1.1	1.2	1.4	1.6	1.0	0.3	0.3	0.3	0.4	1.4
Other taxes	1.3	1.0	0.9	1.4	1.3	1.4	0.3	0.3	0.4	0.4	1.4
Non-tax revenue	5.0	3.8	3.3	5.3	4.7	4.9	1.0	1.0	1.2	1.1	4.4
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1
Expenditure	43.4	30.6	30.3	42.5	42.8	40.9	9.3	10.2	10.3	11.7	41.4
Current expenditure	39.0	28.1	28.1	38.5	39.1	36.3	8.5	9.1	9.3	10.0	37.0
Wages and salaries	10.5	7.6	7.3	10.2	10.3	9.2	2.2	2.3	2.2	2.5	9.3
Other goods and services	7.4	4.5	4.9	6.5	6.7	6.2	1.2	1.6	1.7	1.8	6.3
Interest	0.6	0.9	0.6	1.2	0.8	1.1	0.3	0.3	0.3	0.3	1.2
Subsidies	2.8	1.4	1.5	2.1	2.3	2.0	0.4	0.5	0.6	0.7	2.3
Transfers	17.7	13.8	13.8	18.6	18.9	17.7	4.4	4.4	4.5	4.6	18.0
Pensions	11.9	9.7	9.8	13.0	13.1	12.0	3.1	3.1	3.1	3.1	12.3
Other transfers 2/	5.8	4.0	4.0	5.6	5.9	5.7	1.3	1.4	1.4	1.6	5.7
Capital expenditure	3.7	2.1	1.8	3.4	3.1	4.1	0.4	0.7	0.8	1.6	3.4
Net lending	0.7	0.3	0.4	0.6	0.6	0.5	0.3	0.4	0.2	0.1	1.0
Fiscal balance (cash basis)	-2.5	-2.0	-2.7	-3.0	-4.5	-2.6	-0.7	-1.2	-0.7	-1.5	-4.0
Financing	2.5	1.1	1.9	3.0	4.5	2.6	0.7	1.2	0.7	1.6	4.0
Privatization proceeds	1.2	1.2	2.1	2.1	2.1	0.4	0.0	0.0	0.0	0.0	0.0
Domestic	2.1	-1.0	-0.1	-0.9	0.4	1.5	0.7	0.9	-0.6	1.2	2.2
Banks	2.0	-0.5	-1.5	0.0	-1.3	2.8	0.4	1.2	-0.6	1.0	2.0
Central bank	...	…	…	…	-1.9	…	-0.2	1.2	-0.6	1.0	1.4
Commerical banks	...	…	…	…	0.5	…	0.6	0.0	0.0	0.0	0.6
Non-bank	0.1	-0.5	1.4	-0.9	1.7	-1.2	0.3	-0.2	0.0	0.2	0.2
External	-0.8	0.8	-0.1	1.8	2.0	0.7	0.0	0.2	1.3	0.3	1.8
Program	...	0.9	0.0	1.9	2.1	1.0	0.0	0.3	1.3	0.4	2.1
Project	...	0.1	0.2	0.4	0.4	0.5	0.1	0.1	0.1	0.1	0.5
Amortization	...	0.3	0.3	0.5	0.5	0.9	0.1	0.2	0.2	0.2	0.8
Memorandum items:											
Structural fiscal balance 3/	-4.6	…	…	-3.9	-4.1	-2.7	…	…	…	…	-4.3
Output gap 4/	0.8	…	…	-0.7	-2.6	-2.0	…	…	…	…	-1.1
Absorption gap 5/	11.3	…	…	6.9	1.0	3.9	…	…	…	…	3.2
Augmented fiscal balance 6/	...	…	…	-3.7	-5.2	-2.6	…	…	…	…	-4.0
Gross debt	31.7	…	…	34.8	31.4	36.6	…	…	…	…	32.9
Nominal GDP (in billions of dinars)	2,791	2,995	2,974	2,995	2,974	3,242	3,230	3,230	3,230	3,230	3,230

Sources: Ministry of Finance; and Fur

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 and the external absorption gap on the fiscal position; see IMF Country Report No. 07/390 for details.
4/ Percentage deviation of actual from potential GDP.
5/ Percentage deviation between actual absorption and the level consistent with external balance.
6/ Including clearance of arrears of the Road Company.

Table 10c. Serbia: Intergovernmental Fiscal Operations, 2010 Program
(in billions of dinars)

	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	1,208	659	30	147	32	395	249	130	16	-56
Current revenue	1,203	656	29	146	32	395	249	130	16	-56
Tax revenue	1,059	611		99	15	391	247	129	16	-56
Personal income tax	141	76		65						
Social security contributions	335			0		391	247	129	16	-56
Corporate income tax	23	22		1						
VAT	326	326								
Excises	147	132			15					
Taxes on international trade	44	44								
Other taxes	44	11		33						
Nontax revenue	144	46	29	47	18	4	2	1	0	
Capital revenue	0	0	0	0	0	0	0	0	0	
Grants	5	3	1	1	0	0	0			
Total expenditure and net lending	1,393	479	30	219	35	629	422	180	28	-56
Current expenditure	1,251	406	28	171	20	627	421	179	27	-56
Wages and salaries	301	152	8	53	1	86	3	81	2	
Employer contribution	0	29	1	10	0	16	1	15	0	-56
Goods and services	202	42	13	51	17	80	3	76	1	
Interest payment	39	35	0	2	2	0	0	0	0	
Subsidies and transfers	498	43	6	24		425	396	7	22	
Transfers to households	155	105	0	30		20	17	1	2	
Capital expenditure	111	43	3	48	15	2	1	1	0	
Own resource	91	34	3	42	11	2	0	1	0	
Foreign financed	20	10		6	5					
Net lending	31	30		1		0	0	0	0	
Fiscal balance (before transfers)	-185	180	0	-72	-3	-235	-173	-50	-12	0
Transfers from other levels of government	354	0	0	57	0	297	222	53	22	0
Republican budget	293			57	0	236	215	0	22	
Local governments and Vojvodina	0	0	0	0	0	0				
Social security funds	61					61				
Transfers to other levels of government	354	293	0	0	0	61	49	1	10	0
Republican budget	0					0		0		
Local governments and Vojvodina	57	57				0				
Social security funds	297	236	0	0	0	61				
Net transfer to other levels of government	0	-293	0	57	0	236	173	52	12	0
Fiscal balance	-129	-113	0	-15	-3	2	0	2	0	0

Source: Ministry of Finance; and IMF staff estimates.

Table 11. Serbia: Monetary Survey, 2006–10

(In RSD billions, unless indicated otherwise; end of period) 1/

	2006	2007	2008	2009 Q1	2009 Q2	2009 Q3	2009 Proj.	2010 Proj.
Net foreign assets 2/	408	563	484	504	487	518	490	486
in billions of euro	5.2	7.1	5.5	5.3	5.2	5.6	5.2	5.0
Foreign assets	771	877	847	866	920	1,017	960	1,051
NBS	715	766	725	773	833	888	852	963
Commercial banks	56	111	123	93	87	128	108	87
Foreign liabilities (-)	-363	-314	-364	-361	-434	-499	-470	-565
NBS	-56	-14	-14	-16	-82	-80	-88	-157
Commercial banks	-308	-300	-350	-346	-351	-419	-382	-409
Net domestic assets	203	320	484	471	535	535	548	654
Domestic credit	481	701	1,048	1,100	1,164	1,216	1,193	1,431
Government, net	-104	-112	-53	-76	-15	5	-11	76
NBS	-107	-100	-50	-73	-64	-59	-107	-71
Banks	2	-12	-4	-3	49	64	95	147
Local governments, net	-19	-14	-16	-30	-31	-24	-25	-20
Non-government sector	604	827	1,117	1,206	1,209	1,236	1,229	1,375
Households	204	306	382	397	393	399	395	419
Enterprises	381	508	711	786	792	814	803	919
Other	19	13	23	24	24	23	31	37
Other assets	70	78	56	-5	63	61	61	50
Capital and reserves (-)	-242	-356	-505	-490	-551	-596	-556	-625
NBS	-7	-7	-63	-57	-105	-139	-111	-170
Banks	-235	-350	-442	-432	-446	-456	-445	-455
Provisions (-)	-106	-104	-115	-134	-140	-146	-150	-201
Broad money (M2)	611	883	968	975	1,022	1,053	1,038	1,140
Dinar-denominated M2	255	370	371	339	362	383	367	412
M1	191	239	230	194	209	221	207	232
Currency in circulation	68	77	90	78	81	83	76	80
Demand deposits	122	162	140	116	128	138	131	152
Time and saving deposits	65	131	142	145	153	162	159	180
Foreign currency deposits	355	513	597	637	660	670	671	729
in billions of euro	4.5	6.5	6.7	6.7	7.1	7.1	7.0	7.5
Memorandum items:								
Twelve-month growth:								
M1	37.1	25.3	-3.8	-7.1	1.4	5.2	-9.7	11.7
M2	38.4	44.5	9.6	6.1	8.7	8.8	7.2	9.8
Total credit to non-government	23.1	48.6	48.7	43.4	32.9	22.9	4.4	10.3
Domestic	17.1	36.9	35.0	33.8	27.7	22.4	10.0	11.9
Households	54.1	50.3	25.0	18.9	14.3	19.4	3.4	6.1
Enterprises	2.9	33.2	40.0	42.0	35.0	24.7	12.9	14.4
External	34.6	68.0	67.2	55.8	39.4	23.5	-1.7	8.2
Total real credit to non-government	15.5	33.8	36.9	31.1	22.7	14.5	-2.9	3.5
Domestic	9.8	23.3	24.3	22.3	18.0	14.0	2.3	5.0
Households	44.5	35.3	15.1	8.6	5.6	11.3	-3.8	-0.4
Enterprises	-3.5	20.0	28.9	29.7	24.7	16.2	5.0	7.4
External	26.3	51.3	54.0	42.4	28.7	15.1	-8.6	1.6
Velocity (M1)	10.4	9.8	12.2	14.6	14.1	13.4	14.3	13.9
Velocity (M2)	3.3	2.6	2.9	2.9	2.9	2.8	2.9	2.8
Deposit euroization 3/	66	64	68	71	70	69	70	69
Credit euroization 4/	80	74	68	70	71	73	73	73

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

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.

3/ Share of non-government foreign currency deposits in total non-government deposits at commercial banks.

4/ Share of gross fx-indexed and fx-denominated bank credit in total bank credit to non-government.

Table 12. Serbia: Balance Sheet of the NBS, 2006–10

(In RSD billions, unless indicated otherwise; end of period) 1/

	2006	2007	2008	2009 Q1	2009 Q2	2009 Q3	2009 Proj.	2010 Proj.
Net foreign assets 2/	406	482	517	555	538	579	538	477
in billions of euro	5.1	6.1	5.8	5.9	5.8	6.2	5.8	4.9
Gross foreign reserves	715	766	725	773	833	888	852	963
Gross reserve liabilities (-)	-309	-284	-208	-218	-295	-310	-314	-486
Net domestic assets	-272	-323	-208	-295	-295	-359	-351	-313
Net domestic credit	-264	-316	-145	-238	-190	-220	-240	-143
Government	-107	-100	-50	-73	-64	-59	-107	-71
Claims	16	11	11	11	11	11	11	10
RSD	16	11	11	11	11	11	11	10
foreign currency	0	0	0	0	0	0	0	0
Liabilities (-)	-123	-111	-60	-83	-75	-69	-117	-81
RSD	-20	-29	-20	-32	-26	-19	-20	-20
foreign currency	-103	-82	-41	-51	-49	-50	-98	-62
Other public sector	-10	-11	-15	-19	-16	-10	-6	-13
Banks	-151	-218	-88	-96	-117	-159	-139	-122
Claims	0	1	2	3	2	1	1	3
Liabilities (-)	-152	-219	-90	-99	-119	-160	-140	-125
Other sectors	4	13	7	-49	7	8	11	63
Capital accounts (-)	-7	-7	-63	-57	-105	-139	-111	-170
Reserve money	134	159	309	260	242	220	187	164
Currency in circulation	68	77	90	78	81	83	76	80
Commercial bank reserves	65	82	219	182	161	137	111	84
Required reserves	34	30	165	170	150	135	105	80
Excess reserves	22	45	5	1	1	1	5	2
Vault cash and giro accounts	9	7	48	11	11	1	1	2

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

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 Commercial Banks, 2006–09 1/
(In RSD billions, unless indicated otherwise)

	2006	2007	2008	2009 Q1	2009 Q2	2009 Q3	2009 Q3 in bn. of euro	2009 Q3 in percent of GDP
Assets	1,274	1,678	1,925	1,959	2,024	2,136	23.0	73.0
Foreign exchange	56	111	123	93	87	128	1.4	4.4
Claims on NBS	468	569	508	483	495	527	5.7	18.0
Dinar cash and reserves	63	80	219	182	162	137	1.5	4.7
Foreign exchange reserves	254	270	194	201	213	230	2.5	7.8
NBS bills and other claims	152	219	95	99	120	161	1.7	5.5
Claims on government	18	8	9	13	66	78	0.8	2.7
Claims on other sectors	594	827	1,118	1,208	1,212	1,240	13.3	42.3
Households	203	305	382	396	393	399	4.3	13.6
Enterprises	380	507	710	784	791	812	8.7	27.8
Other institutions	11	15	27	27	29	29	0.3	1.0
Fixed assets	66	75	88	90	92	93	1.0	3.2
Other assets	71	88	78	73	72	69	0.7	2.4
Liabilities	1,274	1,678	1,925	1,959	2,024	2,136	23.0	73.0
Foreign liabilities	308	300	350	346	351	419	4.5	14.3
Dinar deposits	213	319	301	295	317	335	3.6	11.4
Demand deposits	122	162	140	117	129	140	1.5	4.8
Time and saving deposits	79	142	154	168	178	186	2.0	6.4
Government deposits	12	16	7	11	10	9	0.1	0.3
Foreign currency deposits	359	517	599	639	664	674	7.2	23.0
Enterprises	84	116	140	141	152	141	1.5	4.8
Households	261	382	414	451	461	483	5.2	16.5
Government	4	4	6	6	6	6	0.1	0.2
Other institutions	10	15	40	42	44	45	0.5	1.5
Other deposits	2	3	1	1	1	2	0.0	0.1
Liabilities to NBS	0	2	6	2	2	1	0.0	0.0
Other liabilities	70	95	122	122	112	112	1.2	3.8
Provisions	87	93	103	121	130	136	1.5	4.7
Capital and reserves	235	350	442	432	446	456	4.9	15.6
Memorandum items:								
Provisions against credit losses	...	75.8	98.8	116.9	123.4	129.9	1.3	...
in percent of credit	...	9.2	8.8	9.7	10.2	10.5	...	...
Enterprises	54.8	58.8	72.5	86.1	92.5	97.9	1.0	...
in percent of credit	14.4	11.6	10.2	11.0	11.7	12.1	...	...
Households	7.5	10.8	17.2	21.0	22.6	23.4	0.2	...
in percent of credit	3.7	3.5	4.5	5.3	5.7	5.9	...	...
Off-balance sheet items 2/	1,163	1,580	2,157	2,411	2,712	...	...	...
External debt (bn. of euros)	3.4	3.5	3.5	3.0	2.9	3.7	...	...
medium- and long-term	2.8	2.6	2.2	2.2	2.2	2.4	...	...
short-term	0.6	0.9	1.3	0.9	0.7	1.3	...	...

Source: National Bank of Serbia.

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

2/ As of September 2008, about 18 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 14. Serbia: Banking Sector Financial Soundness Indicators, 2004–09
(End-of-period, in percent)

	2004	2005	2006	2007	2008	2009 Q1	2009 Q2	2009 Q3
Capital Adequacy								
Regulatory capital to risk-weighted assets 1/	27.9	26.0	24.7	27.9	21.9	20.8	21.2	21.3
Tier 1 capital to risk-weighted assets	25.6	22.2	24.2	28.5	22.8	22.7	23.7	24.2
Total regulatory capital to total assets	18.8	16.0	15.6	17.1	20.5	19.6	18.9	17.8
Liquidity								
Liquid assets to total assets	21.0	28.8	41.4	38.0	30.5	28.6	30.3	32.5
Asset Quality								
Nonperforming loans to total loans (net of provisions) 2/	...	...	4.11	3.81	5.29	8.1	9.7	10.4
Share of risky loans to total loans 3/	22.2	23.8	23.1	24.7	...	...	...	...
FX denominated and FX indexed loans to total loans 2/	69.9	88.1	83.5	77.2	74.4	74.8	76.2	77.4
Earnings and Profitability								
Net income to average assets (ROA)	-1.2	1.1	1.7	1.7	2.1	1.5	1.0	1.1
Net income to average capital (ROE)	-5.3	6.7	10.0	10.2	10.7	7.8	5.0	5.8
Net interest income to average total assets	6.4	6.3	6.6	6.9	8.8	9.2	9.0	8.5
Noninterest expense to gross income 4/	132.9	117.6	104.9	98.6	98.4	101.0	101.4	101.0
Personnel expense to gross income 4/	9.3	9.0	6.5	4.8	3.6	2.8	3.9	4.6
Interest income to gross income 4/	22.6	24.1	19.4	17.8	15.9	12.3	17.0	20.2
Noninterest income to gross income 4/	77.4	75.9	80.6	82.2	84.1	87.7	83.0	79.2
Personnel expenses to noninterest expenses	7.0	7.6	6.2	4.9	3.7	2.8	3.8	4.6
Customer deposits to total loans	97.5	99.4	109.2	113.6	89.9	85.3	84.7	86.1

Source: National Bank of Serbia.

1/ Regulatory capital excludes, among other things, investments in other banks in excess of 10 percent of total capital.
2/ Net of provisions. NPL data before June 2008 is based on a survey of nine largest banks.
3/ Assets (net of provisions) classified by the NBS as receivables in C, D, and E risk categories with provisioning requirements of 25 percent, 50 percent, and 100 percent, respectively.
4/ Gross income excludes income from indirect write-offs.

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	10	38	58	234	967	1,151	395
In millions of euro	11	43	65	263	1,087	1,297	445
In percent of exports of goods and NFS	0.1	0.5	0.7	2.4	8.3	8.4	2.4
In percent of GDP	0.0	0.1	0.2	0.7	2.5	2.7	0.9
In percent of quota	2.1	8.1	12.5	50.0	206.7	246.0	84.4
In percent of total external debt service	0.3	1.0	1.4	4.5	13.9	14.3	4.6
In percent of gross international reserves	0.1	0.4	0.6	2.4	9.4	10.4	3.3
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	14.0	30.6	30.7	24.6	14.6	4.4	0.2
In percent of GDP	3.6	7.7	8.2	7.0	4.4	1.4	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	5.1	10.4	10.7	9.3	6.1	2.0	0.1
In percent of gross international reserves	12.8	26.4	28.1	24.8	16.4	5.4	0.3
Memorandum items:	(In millions of euro, unless otherwise indicated)						
Exports of goods and NFS	8,261	8,491	9,561	11,147	13,035	15,357	18,236
Quota (in millions of SDRs)	468	468	468	468	468	468	468
Total external debt service	3,741	4,075	4,563	5,779	7,796	9,042	9,702
Public sector external debt (end-period)	7,952	10,127	10,791	10,903	10,380	9,442	9,170
Total external debt stock (end-period)	22,479	25,091	27,429	29,577	31,399	33,374	35,583
Gross international reserves	9,042	9,841	10,444	11,054	11,605	12,426	13,416

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.	January 16, 2009 (purchased May 15, 2009)	233.850	50.0	Board approval of the arrangement.
2.	March 15, 2009 (purchased May 15, 2009)	23.385	5.0	Observance of end-December 2008 performance criteria and completion of financing assurances review.
3.	May 15, 2009 (purchased May 15, 2009)	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.	November 25, 2009	319.595	68.3	Observance of end-September 2009 performance criteria and completion of the second program review (including financing assurances review).
5.	February 25, 2010	319.595	68.3	Observance of end-December 2009 performance criteria and completion of the third program review (including financing assurances review).
6.	May 25, 2010	319.595	68.3	Observance of end-March 2010 performance criteria and completion of the fourth 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 fifth 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 sixth 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 seventh 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

Better prospects for GDP growth and faster adjustment of current account led to some improvement of external debt dynamic compared to earlier analysis. Nevertheless, external debt is expected to rise in the near term (to more than 76 percent of GDP by 2011). Assuming that the strong policies and structural reforms under the program eventually lead to a resumption of growth and improved current account balances, debt ratios would start declining by 2012 and return to the level of 2009 (about 71 percent of GDP) by 2014. The associated risks remain, however.

1. **Serbia's external debt has been rising since 2004, resulting in high 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 in December 2008. The rise was due to private debt, which tripled since early 2006. 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 in the end of 2008, an retrenchment of the private sector has been ongoing through the first half of 2009. Nevertheless, external debt remained high at about €22 billion in September 2009 (Tables A1, A2).

Serbia: Structure of External Debt, 2005-09

	Dec-05	Dec-06	Dec-07	Dec-08	Mar-09	Jun-09	Sep-09
	(Percent of total debt)						
Public	59	43	34	29	33	33	31
Private	41	57	66	71	67	67	69
Banks	17	26	22	18	15	15	19
Other private	24	31	43	53	52	52	50
Total	100	100	100	100	100	100	100

Source: NBS and staff estimates.

2. **Better prospects for GDP growth and faster adjustment of current account led to some improvement of external debt dynamic compared to earlier analysis. Nevertheless, external debt is expected to rise in the near term.** In particular, the debt-to-GDP ratio (including prospective liabilities to the Fund) is expected to rise close to more than 76 percent percent by 2011 before returning to a declining path.

3. **With improved global and domestic conditions from 2011 onward, external debt ratios are expected to start declining by 2012.** GDP is expected to recover, the current account to improve due to the reallocation of resources from nontradable to tradable sectors, and FDI to resume. As a result, the debt-to-GDP ratio would start declining in 2012 and return to below 70 percent of GDP in 2015.

4. **Standard stress tests point to sizable risks.** A further 30 percent depreciation would push external debt close to 113 percent of GDP. While the temporary shocks considered suggest that debt would nevertheless return to a declining path in 2012–13, such dynamics crucially depends on the assumptions of higher growth and current account adjustment in the medium term.

5. **While the baseline scenario would allow for the steady decline in debt in the medium term, there are substantial risks; further adverse developments and less favorable medium-term growth and external prospects could result in an unsustainable path.** This underscores the need for strong policy action, close monitoring, and readiness to implement further measures, if needed, should the outcomes be worse than projected.

Table A1. Serbia: External Debt Sustainability Framework, 2007-14
(In percent of GDP, unless otherwise indicated)

		Actual					Projections								
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015		Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	54.3	64.1	63.3	60.2	63.6	**70.9**	**74.1**	**76.3**	**75.3**	**73.0**	**70.7**	**68.9**		**-9.0**
2 Change in external debt	-7.8	9.8	-0.8	-3.1	3.4	7.3	3.1	2.2	-1.0	-2.3	-2.3	-1.8	0.0	
3 Identified external debt-creating flows (4+8+9)	6.9	5.3	-0.1	-5.8	3.8	5.8	5.2	3.0	0.7	-0.6	-1.0	-0.6	0.0	
4 Current account deficit, excluding interest payments	10.9	7.0	8.0	13.2	14.6	4.6	6.3	5.0	4.8	5.4	5.4	5.3	9.0	
5 Deficit in balance of goods and services	26.6	20.9	21.4	23.3	22.8	15.1	15.1	13.9	13.1	12.9	11.9	11.4		
6 Exports	23.4	26.1	29.6	29.4	29.6	26.1	25.1	26.6	28.4	30.3	32.5	35.3		
7 Imports	50.0	47.0	51.0	52.7	52.4	41.2	40.1	40.5	41.5	43.2	44.5	46.7		
8 Net non-debt creating capital inflows (negative)	0.0	0.0	-1.5	-8.5	-5.0	-3.5	-3.1	-3.0	-3.6	-5.1	-5.4	-5.3	-5.4	
9 Automatic debt dynamics 1/	-3.9	-1.8	-6.6	-10.6	-5.8	4.6	2.0	0.9	-0.5	-0.9	-0.9	-0.5	-3.6	
10 Contribution from nominal interest rate	1.2	1.7	2.1	2.3	2.5	2.6	3.0	3.0	3.0	2.9	2.7	2.7	2.6	
11 Contribution from real GDP growth	-3.8	-2.9	-2.9	-3.5	-2.9	2.1	-1.0	-2.1	-3.5	-3.8	-3.7	-3.2	-3.5	
12 Contribution from price and exchange rate changes 2/	-1.4	-0.6	-5.7	-9.4	-5.4	...	...	...	...	...	...	...	-2.7	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-14.7	4.6	-0.8	2.8	-0.4	1.5	-2.1	-0.8	-1.6	-1.7	-1.3	-1.2	0.0	
External debt-to-exports ratio (in percent)	231.6	245.6	213.8	204.8	214.7	272.1	295.5	286.9	265.3	240.9	217.3	195.1		
Gross external financing need (in billions of euros) 4/	3.3	2.6	4.3	7.5	9.5	7.1	7.9	8.1	9.2	10.8	12.0	13.8		
in percent of GDP	17.2	12.9	18.3	25.3	27.7	22.3	23.4	22.5	23.3	25.1	25.5	26.6		
Scenario with key variables at their historical averages 5/						**70.9**	**72.3**	**73.3**	**74.0**	**74.5**	**75.1**	**75.8**		**-10.1**
Key Macroeconomic Assumptions Underlying Baseline													For debt stabilization	
Real GDP growth (in percent)	6.7	5.6	5.2	6.9	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0	5.5	
GDP deflator in euros (change in percent)	2.3	1.1	9.8	17.5	9.9	-4.6	5.3	3.0	4.0	3.8	4.0	4.2	4.0	
Nominal external interest rate (in percent)	2.2	3.3	3.7	4.7	4.9	3.7	4.5	4.3	4.3	4.2	4.1	4.2	4.1	
Growth of exports (euro terms, in percent)	15.9	18.9	31.0	24.8	16.9	-18.6	2.8	12.6	16.6	16.9	17.8	18.7		
Growth of imports (euro terms, in percent)	31.7	0.4	25.2	30.0	15.3	-27.3	4.1	7.2	11.9	14.0	12.9	14.8		
Current account balance, excluding interest payments	-10.9	-7.0	-8.0	-13.2	-14.6	-4.6	-6.3	-5.0	-4.8	-5.4	-5.4	-5.3		
Net non-debt creating capital inflows	0.0	0.0	1.5	8.5	5.0	3.5	3.1	3.0	3.6	5.1	5.4	5.3		

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in euro terms, g = real GDP growth rate, e = nominal appreciation (increase in euro value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 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; euro deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

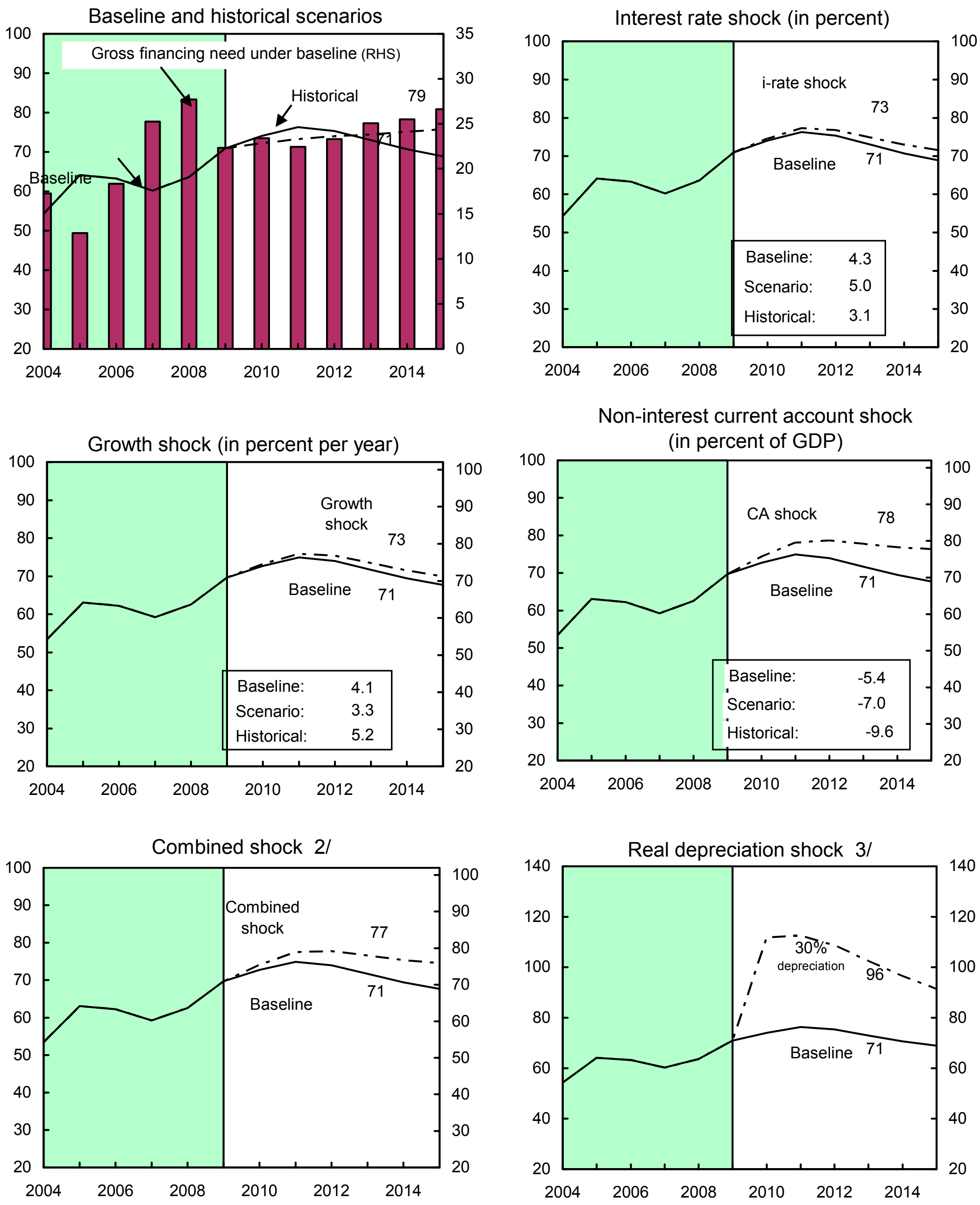
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table A2. Serbia: External Debt, September, 30 2009
(In millions of euros)

Creditor	Outstanding Debt (incl. principal arrears)	Principal Arrears	Interest Arrears	Late Interest	Total
Total External Debt	21,051	1,659	364	368	21,784
Public sector borrowing	6,572	161	118	134	6,824
Medium and long-term debt	6,553	161	118	134	6,805
International financial organizations	3,762	0	0	0	3,762
IMF	757	0	0	0	757
IBRD	1,236	0	0	0	1,236
IDA	463	0	0	0	463
European Community	273	0	0	0	273
EIB	562	0	0	0	562
EUROFOND - CEB	26	0	0	0	26
EBRD	346	0	0	0	346
EUROFIMA	99	0	0	0	99
Governments Paris Club	1,557	0	0	0	1,557
Other Governments	285	117	95	121	501
London Club	758	22	23	13	793
Other Creditors	171	0	0	0	171
Debt in non-convertible currency	21	21	0	0	21
Short-term Debt	19	0	0	0	19
Private sector borrowing	14,479	1,498	247	234	14,960
Medium and long-term debt	12,547	1,103	238	234	13,019
Banks	2,488	47	14	47	2,549
International financial organizations	387	8	4	6	397
Governments - Permanent Paris Club members	169	0	0	0	169
Other Creditors	1,933	40	9	40	1,982
Enterprises	10,059	1,056	224	188	10,471
International financial organizatoins	336	5	4	0	340
Governments - Permanent Paris Club members	37	0	0	0	37
Other Governments					
Other Creditors	9,643	1,009	211	188	10,042
Debt in non-convertible currency	42	42	9	0	51
Short-term Debt	1,932	395	9	0	1,941
Banks	1,530	273	0	0	1,530
Enterprises	402	122	9	0	411

Source: National Bank of Serbia

Figure A1. Serbia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



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

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. Seven-year historical average for the variable is also shown.
2/ Permanent 1/2 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

Appendix II. Serbia: Public Debt Sustainability

1. **General government debt in Serbia remains sustainable under the revised program scenario**, which envisages a higher deficit in 2009–10 against the backdrop of a somewhat deeper economic downturn. However, rollover risks have increased with the use of short-term treasury bills to finance the budget. Further, its sensitivity to exchange rate shocks highlights potential vulnerabilities in the context of the current economic downturn. Sustainability is less assured if contingent costs linked to its large exposures to exchange rate risk and off-balance sheet transactions, are taken into consideration. Contingent liabilities from large quasi-fiscal losses of state- and socially owned enterprises and government support to the private sector could pose additional risks.

2. **Under the revised program scenario, general government gross debt would increase to 33 percent in 2010 (from 32 percent in 2008) before declining to 27 percent by 2014** (Table A1).[1] This compares to a drop in the debt ratio to 22 percent of GDP in the original program scenario (EBS/08/162), but would broadly stay at the same level as at the last review. Somewhat weaker fiscal balances and weaker growth in 2009–10 are largely compensated by of the assumption of $550 million World Bank debt by Kosovo. Further, rollover risks have increase with the launch of short-term treasury bills to finance the budget, from an average of about 2.5 percent of GDP to about 8 percent during the period 2010–14.

3. **However, in an unchanged policies scenario, the public debt-to-GDP ratio would increase to 44 percent of GDP in 2014.** If policies were not adjusted as envisaged under the proposed program, the fiscal deficit would increase to 5 percent of GDP in 2010 and further widen to 7 percent by 2014, reflecting the impact of automatic stabilizers on fiscal revenue and spending pressures in the areas of pensions and wages, and debt ratios would rise. In contrast, assuming key variables at their historical averages, the public debt-to GDP ratio would decline to 11 percent, reflecting a history of robust growth in the catch up phase of transition, relatively large fiscal surpluses in earlier years, and low real interest rates.

4. **Standardized bound tests show that Serbia's debt is particularly exposed to exchange rate shocks (Figure A1)**. A 30 percent real depreciation of the exchange rate would increase the debt-to-GDP ratio to 41 percent by 2014, given that 90 percent of the debt is denominated in foreign currency (comprising mainly frozen currency deposit bonds and debt to multilaterals and Paris Club creditors). Assuming half a standard-deviation shocks to growth and the primary fiscal balance, the public debt stock would increase to 31 percent of

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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.

GDP. However, a similar shock to interest rates would leave debt-to-GDP at 28 percent by 2014.

5. **Further risks to the debt outlook come from large contingent liabilities mainly related to public enterprises.** These are:

- **Public enterprises**. Some state-owned and socially owned enterprises are running large quasi-fiscal deficits, mainly because of overly high wages and pricing below cost. With most public enterprise debt included in the general government debt stock (since they require state 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, with the deepening recession, delays in utility price adjustments, large investment plans and needs, risks of built up of contingent fiscal liabilities going forward have increased.

- **Financial sector stability costs**. In the context of the global financial crisis, there are potentially contingent liabilities for the public sector from financial sector distress.

- **Government support to the economy**. The package to support domestic credit passed in February 2009 could carry risks up to about 2 percent of GDP. This includes state-guaranteed IFI loans to SME (1½ percent of GDP), and loans through the National Development Fund and commercial banks (½ percent of GDP).

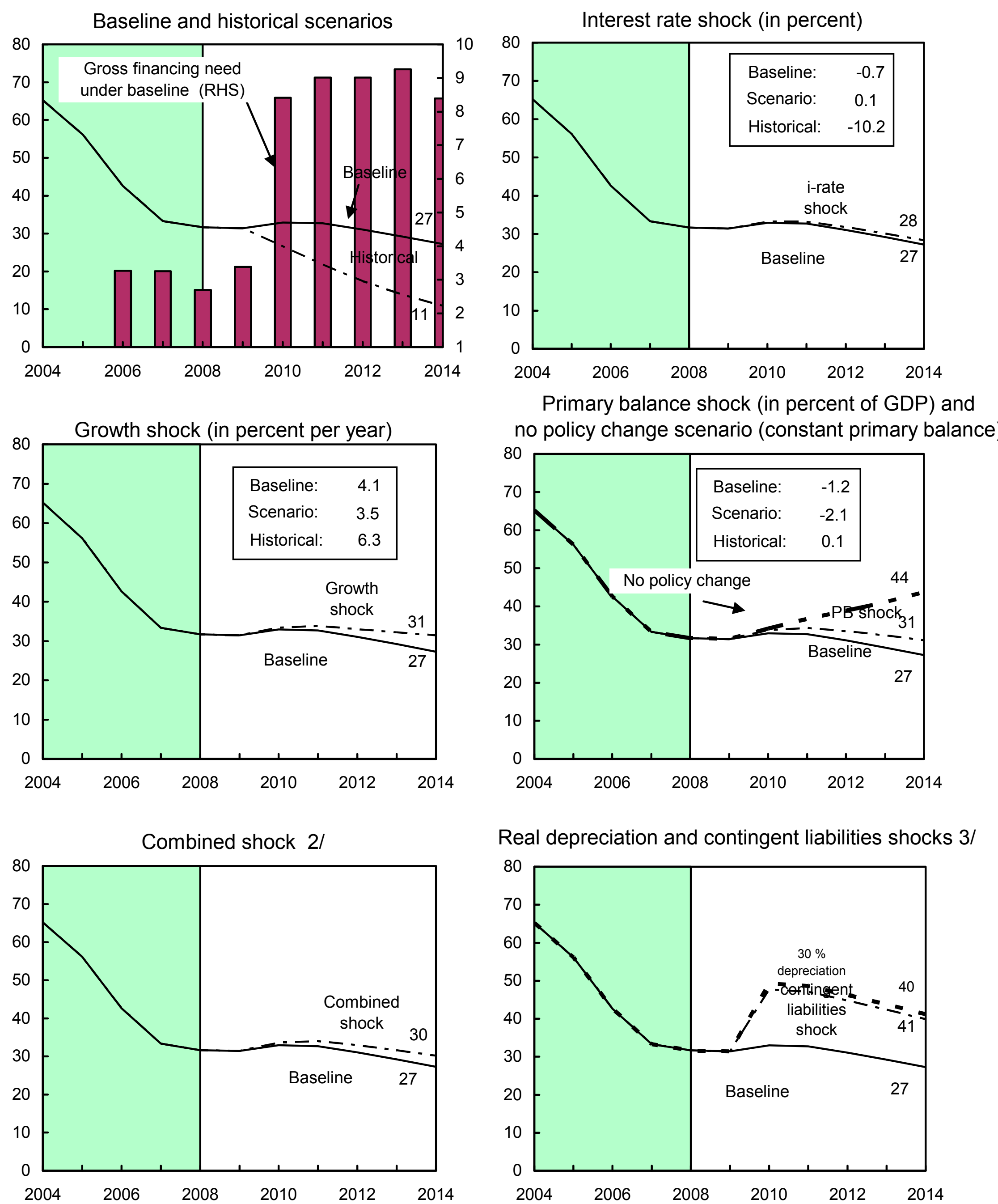
- **Restitution.** Restitution for confiscated assets after World War II of property seized or expropriated by the former communist governments remains pending. The government's 2007 plan contemplated a ceiling of €4 billion (over 16 percent of 2010 GDP) and would significantly increase the public debt stock. Moreover, should compensation be granted in foreign currency bonds, the foreign exchange exposure of the government would increase.

Table A1. Serbia: Public Sector Debt Sustainability Framework, 2006-2014
(In percent of GDP, unless otherwise indicated)

	Actual 2006	2007	2008	5-Year Historical Average	5-Year Standard Deviation	Projections 2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 10/
1 **Baseline: Public sector debt 1/**	42.6	33.3	31.7			**31.4**	**32.9**	**32.7**	**31.1**	**29.2**	**27.2**	**-1.1**
o/w foreign-currency denominated	38.7	29.8	28.6			28.4	29.5	27.6	24.1	21.3	18.6	
2 Change in public sector debt	-13.5	-9.3	-1.7			-0.2	1.5	-0.2	-1.6	-1.9	-2.0	
3 Identified debt-creating flows (4+7+12)	-17.5	-7.7	-0.8			0.5	1.0	0.4	-0.9	-1.4	-1.3	
4 Primary deficit	0.0	1.1	1.9			3.7	2.8	1.8	1.0	0.5	0.0	
5 Revenue and grants	43.8	42.4	40.9			38.3	37.4	36.8	36.7	36.7	36.9	
6 Primary (noninterest) expenditure	43.8	43.5	42.8			42.0	40.2	38.5	37.7	37.2	36.9	
7 Automatic debt dynamics 2/	-9.8	-6.0	-1.5			-1.1	-1.3	-1.4	-1.7	-1.5	-1.3	
8 Contribution from interest rate/growth differential 3/	-6.8	-6.1	-4.5			-1.1	-1.3	-1.4	-1.7	-1.5	-1.3	
9 Of which contribution from real interest rate	-4.3	-3.7	-2.9			-2.0	-0.8	-0.5	-0.2	0.1	0.2	
10 Of which contribution from real GDP growth	-2.5	-2.5	-1.6			0.9	-0.4	-0.9	-1.5	-1.5	-1.5	
11 Contribution from exchange rate depreciation 4/	-3.0	0.1	3.0			...	...	...	...	...	...	
12 Other identified debt-creating flows	-7.8	-2.8	-1.2			-2.1	-0.5	0.0	-0.3	-0.4	0.0	
13 Privatization receipts (negative)	-7.8	-2.8	-1.2			-2.1	-0.5	0.0	-0.3	-0.4	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	4.0	-1.6	-0.9			-0.7	0.5	-0.6	-0.7	-0.5	-0.7	
Public sector debt-to-revenue ratio 1/	97.3	78.7	77.4			82.0	88.1	89.0	84.7	79.5	73.8	
Gross financing need 6/	3.3	3.3	2.7			3.4	8.4	9.0	9.0	9.3	8.4	
in billions of euro	0.8	1.0	0.9			1.1	2.8	3.2	3.5	4.0	4.0	
Scenario with key variables at their historical averages 7/						**31.4**	**26.6**	**21.8**	**17.4**	**13.8**	**11.0**	**-1.6**
Scenario with no policy change in 2010-2014 8/						**31.5**	**34.2**	**36.7**	**38.9**	**41.1**	**43.7**	**-1.9**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline				5-Year Historical Average	5-Year Standard Deviation							
Real GDP growth (in percent)	5.2	6.9	5.5	6.3	1.3	-3.0	1.5	3.0	5.0	5.5	5.5	
Average nominal interest rate on public debt (in percent) 9/	3.2	2.1	2.2	2.5	0.5	2.8	4.2	4.8	4.9	5.1	5.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-8.3	-9.5	-9.7	-10.2	1.6	-7.0	-2.8	-1.5	-0.5	0.5	0.9	
Nominal appreciation (increase in euro value of local currency, in percent)	7.8	-0.3	-10.6	-4.8	8.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	11.5	11.6	11.9	12.7	1.6	9.9	7.0	6.3	5.5	4.7	4.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.5	6.0	3.8	5.7	4.6	-4.8	-2.9	-1.2	2.8	4.1	4.7	
Primary deficit	0.0	1.1	1.9	-0.1	1.7	3.7	2.8	1.8	1.0	0.5	0.0	

1/ Includes general government and guaranteed debts (gross).
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = 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 $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
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/ Based on the unchanged policy scenarios under the program.
9/ Derived as nominal interest expenditure divided by previous period debt stock.
10/ 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 A1. Serbia: Public Debt Sustainability: Bound Tests 1/
(Public 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 primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in euro value of local currency) minus domestic inflation (based on GDP deflator).

Table A2. Serbia: Government and Government-Guaranteed Debt, 2000–09
(End-period stock by creditor, in percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 June
Gross debt (excluding IMF)	**241.7**	**114.5**	**81.2**	**77.3**	**65.2**	**56.1**	**42.6**	**33.3**	**31.7**	**32.7**
Domestic	**80.6**	**39.5**	**33.3**	**33.1**	**30.5**	**22.8**	**17.6**	**13.6**	**12.4**	**13.8**
Foreign currency-denominated	62.2	30.1	24.3	23.6	21.2	17.7	13.0	10.4	9.3	8.6
Frozen Foreign Currency Deposits	62.2	30.1	24.3	23.6	21.0	17.5	12.9	10.3	9.3	8.6
Other	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.0	0.0	0.0
Local currency-denominated	18.4	9.4	9.0	9.5	9.3	5.1	4.6	3.2	3.1	5.2
T-bills	0.0	0.0	0.0	0.2	0.5	0.3	0.3	0.2	0.1	2.1
Long-term loans	0.5	0.3	1.9	1.8	1.5	1.2	0.9	0.5	0.4	0.4
Credit from the banking system	4.0	2.2	2.5	2.1	2.2	1.4	1.1	0.7	0.8	0.8
Domestic arrears	13.9	7.0	4.6	5.5	5.2	2.3	2.3	1.9	1.9	1.9
External	**161.1**	**75.0**	**47.9**	**44.2**	**34.7**	**33.3**	**24.2**	**19.7**	**19.3**	**18.9**
Multilateral (excluding IMF)	31.9	16.0	14.6	14.8	15.2	14.3	11.3	9.9	9.7	9.9
IBRD	27.7	14.2	11.5	10.9	10.3	9.1	6.4	5.4	5.0	5.0
IDA	0.0	0.0	1.0	1.3	1.8	2.0	1.7	1.4	1.5	1.5
EIB	0.0	0.0	0.7	0.8	1.1	1.3	1.4	1.5	1.5	1.6
EBRD	0.0	0.0	0.0	0.2	0.5	0.6	0.7	0.7	0.8	0.9
EU+CEB	4.2	1.8	1.4	1.6	1.5	1.4	1.2	1.0	0.9	0.9
Official Bilateral	83.1	38.6	18.5	16.4	15.0	14.4	9.6	7.4	7.2	6.6
Paris Club	75.4	33.5	14.6	12.9	11.7	11.0	7.0	5.6	5.3	5.1
Other bilateral	0.2	0.1	0.3	0.4	0.5	0.5	0.4	0.3	0.3	0.4
Debt under negotiation 1/	7.5	5.0	3.6	3.0	2.7	2.9	2.2	1.4	1.5	1.1
Commercial	46.0	20.4	14.8	13.0	4.5	4.6	3.3	2.4	2.4	2.4
London Club	46.0	20.4	14.8	13.0	4.5	4.6	3.3	2.4	2.4	2.4
Memorandum items:										
Debt to IMF	2.5	2.4	3.4	4.4	4.0	3.7	0.8	0.0	0.0	2.4
Government deposits	2.5	2.0	3.8	4.1	3.8	5.1	8.2	6.4	3.5	4.4
Net debt (excl. IMF)	239.2	112.5	77.4	73.1	61.4	51.1	33.6	26.9	28.2	28.3
Kosovo debt	17.8	9.2	6.1	5.8	4.8	4.3	3.6	2.9	2.6	2.6
Share in total gross debt of:										
Foreign currency-denominated debt	92.4	91.8	88.9	87.7	85.7	90.8	89.3	90.4	90.2	84.2
Short-term debt	0.0	0.0	0.0	0.2	0.7	0.5	0.6	0.5	0.2	6.4
Debt at variable interest rates	44.4	43.3	36.2	36.6	42.4	46.0	44.7	47.5	48.0	52.6
Debt to official creditors	47.6	47.7	40.7	40.4	46.2	51.2	50.1	51.9	53.2	50.4

Source: Ministry of Finance; and Fund staff estimates.

1/ Bilateral credits concluded before 2000; non-regulated London Club debt; debt in non-convertible currencies.

Attachment I. Letter of Intent (LOI)

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

Belgrade, December 3, 2009

Dear Mr. Strauss-Kahn:

1. On most fronts, our program is working well. Financial tensions have eased, GDP and exports have been broadly in line with what was anticipated at the time of the first review of our Stand-by Arrangement (SBA), and inflation is receding faster than projected. However, in some areas the fallout from the global financial crisis for our economy has been worse than anticipated. In particular, with the pre-crisis boom in domestic and cross-border credit abruptly brought to a halt, corporate payment problems and insolvencies are rising. Employment is falling, and domestic demand and imports are contracting more sharply than projected. As a consequence, while the large external current account deficit is narrowing much faster than expected, fiscal revenues have been falling short of what was programmed.

2. Notwithstanding these challenges, we have implemented the program in most areas (Tables 1-2): The end-September 2009 performance criteria on the floor on net foreign assets of the National Bank of Serbia (NBS), the ceiling on new short-term external debt, and the ceiling on external payment arrears were all observed, as were the indicative targets on the ceilings on current expenditures and accumulation of domestic guarantees by the budget. September inflation was only slightly below the program target range. However, the performance criterion on the general government deficit for end-September 2009 was missed, reflecting revenue shortfalls.

3. Most structural reforms were also implemented as planned. Specifically, three benchmarks were fully observed: (i) adopting an action plan for the remaining banks with majority state ownership; (ii) preparing a three-month rolling cash flow plan for the Republican budget; and (iii) adopting a business plan for the Road Company of Serbia. The benchmark on adopting business plans with wage increases for ten large state enterprises in 2009 conforming to those of the general government was mostly met. Planned actions in the revenue administration reform were completed. Finally, while the NBS conducted onsite diagnostic studies and stress tests for the fifteen largest banks and one majority state-owned bank, studies for the three other banks with majority state ownership were postponed to end-2009 owing to the incipient merger of two of the banks.

4. In consideration of this performance and given our continued commitment to macroeconomic stability and structural reforms, we request a waiver for the nonobservance

of the end-September 2009 performance criterion on the general government deficit, the completion of the second review of the SBA, and the disbursement of SDR 319.6 million. In view of the changed macroeconomic outlook, we also request a modification of the quantitative performance criteria for the remainder of the year, in particular an increase of the ceiling on the general government deficit, a reduction in the inflation target for end-2009, and a rephasing of the remaining purchases under the program. The next review and financing review, assessing end-March performance criteria, is envisaged for late May 2010. Our commitment to the program is underscored by the coalition government's decision to implement an ambitious spending-based fiscal adjustment program, including through continued nominal freezes of public wages and pensions in 2010, a significant downsizing of public administration in 2010 and beyond, and our commitment to undertake key reforms in the pensions, education, and health areas.

5. 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. As usual, we intend to make these understandings public, and agree with the publication of the staff report and this letter.

Macroeconomic Framework for the Remainder of 2009 and 2010

6. Despite our efforts to sustain economic activity, the economic outlook deteriorated somewhat further relative to earlier program projections. We now expect a 3 percent decline of real GDP this year, with a modest recovery of 1.5 percent real GDP growth in 2010. This year, domestic demand, particularly investment spending, is expected to slump, in part reflecting tight credit market conditions. While easing external financing pressures, the subdued demand has also put strains on the fiscal position, mainly through lowering tax revenues. Along with the expected improvement in the external environment, activity is expected to stabilize in the remainder of the year and begin to recover in 2010. Recent data on industrial production are encouraging in this regard. But uncertainties about the strength of the economy remain.

7. Inflation is expected to remain on a declining trend. Weak domestic demand and moderating wage growth have substantially eased inflation pressures in recent months, and we expect CPI inflation to end the year somewhat below the lower band under the inflation consultation clause, although within the NBS target range of 6–10 percent. Consequently, we propose to lower the bands under the inflation consultation clause by 2.5 percentage points in 2009. In 2010, inflation is expected to decline further to mid-single digits.

8. External adjustment has proceeded faster than expected, owing to the sharp contraction of domestic demand. The external current account deficit is now projected to decline to 8 percent of GDP in 2009. Export growth is expected to regain strength only in

2011, and the external current account deficit is projected to stabilize at about 8 percent of GDP over the medium term.

9. The external financing situation has improved and financial flows appear to have stabilized. Going forward, we expect external financing flows to be sufficient to accommodate reduced financing needs. Foreign parent banks are expected to maintain their exposures to Serbia. Private inflows, financing from the IMF, other international financial institutions, and the EU, together with the new SDR allocation should be sufficient to meet all external financing needs in 2009.

Fiscal Policy

10. Our preferred fiscal adjustment strategy for 2009–10 and beyond reflects a broad consensus within our coalition government. The strategy aims at restoring sound public finances over the medium term, mainly through coordinated and balanced restraints on spending on public wages and pensions. Our strategy can be summarized in seven points:

- First, for 2009, we plan to achieve the fiscal deficit target of 4½ percent of GDP.

- Second, for 2010, we aim at a revised deficit target of 4 percent of GDP. This will require us to maintain most of the fiscal measures put in place in 2009—particularly the nominal freezes of public pensions and wages.

- Third, looking beyond 2010, we will continue with structural spending reforms, to reduce the share of current spending in GDP to 32½ percent by 2015. At the same time, we will improve the targeting of social benefits. Moreover, we envisage increases in capital spending, in line with the strategic priorities set by the National Infrastructure Council.

- Fourth, we will undertake further efforts to modernize our tax administration, with specific benchmarks to be agreed during the next review, and broaden tax bases. However, significant tax rate increases, including VAT increases, will only be considered as measures of last resort to achieve fiscal consolidation.

- Fifth, to contain contingent fiscal liabilities, we will closely monitor and maintain financial discipline in state enterprises, while preparing most of them for privatization as soon as market conditions allow. Potential obligations related to property restitution claims will have to respect our tight budget constraints.

- Sixth, we will put in place more effective legal and procedural constraints and sanctions against procyclical and electoral spending pressures.

- And seventh, we will improve debt management with a view to developing the domestic debt market, while lowering rollover risks.

11. We plan to contain the fiscal deficit in 2009 to 4½ percent of GDP by strictly observing the overall general government spending envelope of about 1,270 billion dinars programmed earlier in the year. Reflecting weaker revenues, the fiscal deficit during the first nine months of 2009 was ¾ percent of GDP higher than programmed. The revenue shortfalls reflected mainly lower indirect tax collections, due to weaker consumption and imports, and lower non-tax revenue. Spending execution has been tight, and spending arrears have been kept in check. The larger-than-programmed fiscal deficit was mainly financed by issuing short-term T-bills.

12. For 2010, we plan to reduce the fiscal deficit to 4 percent of GDP. This relatively high deficit target reflects our somewhat backloaded spending-based adjustment strategy, as well as a compromise between supporting the expected weak recovery and keeping the already high structural fiscal deficit in check. However, should the recovery in economic activity be stronger than presently expected, we will save cyclical revenue overperformance. We have aim to secure additional funding from the World Bank and the EU, and plan to further tap the T-bills market. The 2010 budget will be based on the following spending policies:

- As regards the 2010 public wage bill, we plan to freeze all general government wages and salaries in nominal terms; public administration staff at the Republican and local level will be reduced by about 10 percent at the beginning of 2010; these measures will be accompanied by a hiring freeze at all levels of government, including for temporary contracts. We estimate that these measures will contain the general government wage bill in 2010 at about 300 billion dinars (9¼ percent of GDP).

- The nominal freeze on pensions will be extended through 2010, with the next indexation adjustment scheduled for April 2011. This measure should contain net spending by pension funds in 2010 to about 395 billion dinars (12¼ percent of GDP). Other non-targeted social benefits will remain frozen in nominal terms. Targeted social benefits (family and child allowances) will not only be indexed but also likely increase owing to a heavier case load.

- We will maintain the 2009 discretionary spending cuts, including the reduction in transfers to local governments, and plan to gradually phase out the credit subsidy programs introduced in 2009.

- As regards capital spending and net lending, we will aim to protect productive investment and accelerate the implementation of foreign-financed capital projects. At the same time, the joint project with Fiat to restructure Zastava car factory will cost the budget almost ½ percent of GDP in 2010.

13. Starting in 2010, additional reforms will be put in place to constrain public wage costs durably over time. In particular, our medium-term objective is to reduce the general

government wage bill to about 8 percent of GDP. This will require additional structural reforms in the education and health sectors, along the lines of the recent recommendations by the World Bank.

14. By end-February 2010, we will submit a draft law to Parliament to reform the pension system (structural benchmark). Building on earlier reform efforts and anticipating considerable demographic pressures on pension finances, this new law will put Serbia's pension system on a more sustainable financial basis. Our overall guiding objective for reform and cost containment is to reduce net spending by pension funds to about 10 percent of GDP by 2015, from an estimated level of 13 percent of GDP in 2009. Key elements of the new law will include: (i) increasing the minimum retirement ages for both men and women from 53 to 58 years; (ii) limiting strictly extra service credits to a limited number of eligible job positions; (iii) increasing the minimum contribution period and phasing out more than half of the extra service credit for women; and (iv) tightening the eligibility for survivor pensions. These measures will need to be implemented at a gradual pace but will be designed to become fully effective around 2020. However, as demographic and migration trends become clearer over the next few years, additional parametric reforms of retirement ages, minimum contribution periods, and early retirement incentives will likely have to be considered. We also plan to strengthen contribution collection efficiency, including by registration of all social security payers in a single central registry. In 2011, to also balance parallel efforts to contain the public sector wage bill, we plan to resume inflation indexation as envisaged under present law. To allow pensioners to share some of the upside potential in our economy, and consistent with our medium-term objective to reduce the share of pension spending in GDP, should real GDP growth exceed a threshold of 4 percent, pensions will in addition be increased by the excess of growth over the threshold.

15. We will ensure wage discipline in public enterprises. The government will adopt for ten large state enterprises business plans for 2010 consistent with a nominal freeze of wage bills by end-February 2010 (structural benchmark). Moreover, we will adopt all necessary measures to ensure a wage bill freeze at the level of local government utilities by end-March 2010.

16. To maintain fiscal discipline beyond 2010 in line with our spending-based adjustment strategy, we will need to strengthen significantly budget rules and procedures. The recently adopted Budget System Law (BSL) already introduces medium-term spending ceilings over the next three years, and envisages improved transparency through tax expenditure budgets. Our intention is to make concerted efforts to implement the current law by enhancing budget preparation, execution, and reporting capacities, but we also intend to transform the present BSL into a Budget System and Responsibility Law (BSRL) tailored to Serbia's specific circumstances and needs. To this end, the Ministry of Finance has appointed a working group consisting of local experts, which will provide a detailed proposal on how to further strengthen the present legal rules, procedures, and enforcement penalties to effectively guard

against spending and deficit biases by end-February 2010. A draft BSRL should be adopted by the government and forwarded to parliament by end-April 2010 (structural benchmark).

Financial Sector Policies

17. We will build further on the substantial improvement of our contingency planning made under the program. Regarding the legal framework underpinning the recently adopted financial crisis preparedness plan, the NBS in cooperation with the government is preparing a set of legal amendments to make the framework fully operational.

18. We will maintain our Financial Sector Support Program (FSSP), which proved vital for safeguarding financial stability. The NBS will continue to simplify, and—in a limited number of areas—relax macro-prudential regulations, notably as regards to provisioning, and asset classification rules. Onsite diagnostic studies and stress tests are on pace to be finalized for the remaining banks by end-2009 (structural benchmark). In parallel, the NBS will continue to work with foreign supervisors and parent banks to facilitate fulfillment of the commitments by key foreign banks to maintain their exposure to Serbia. Given the eased financial sector tensions and lower external financing needs, we are studying the feasibility of gradual lowering the exposure commitments ahead of the next bank coordination meeting, tentatively planned for early 2010. It is not expected that this course of action would significantly affect the availability of domestic financing for the government.

19. Meanwhile, there is a critical need to improve the framework for debt restructuring in view of the rapid growth of corporate loan delinquencies (structural benchmark). To deal with the issue of blockages of bank accounts on the basis of promissory notes, by end-March 2010, the NBS will introduce mandatory registration of promissory notes in a single database and explore options to replace the first-come-first-served payout procedure from blocked accounts with an alternative envisaging more equitable payouts. Alongside, the Ministry of Economy and the NBS will lead efforts to establish an out-of-court loan workout framework.

20. State ownership in banks will be phased out as soon as feasible. However, the planned privatization of the four banks with majority state ownership has been postponed owing to the unfavorable market environment. Nevertheless, by June 2010 we plan to merge Postanska Stedionica bank with Privredna bank and Pancevo bank and finalize negotiations on privatization of Credy bank with a private investor. As regards Srpska bank, we are still evaluating our options. In addition, by end-2009, we will seek to work with other shareholders to complete the recapitalization of Kommercialna bank by end-2009.

21. Looking ahead, developing the financial market remains a key medium-term priority. We will continue improving the T-bills auction procedures, which has already resulted in a substantially higher demand for government securities by both banks and other institutions. To foster the development of a meaningful yield curve—an important reference for the financial market—we plan to gradually widen the maturity spectrum and increase the weighted average maturity of treasury securities. In the upcoming months, we will also study

options to develop secondary bond markets, and to guard against the refinancing risks associated with the relatively short maturity of T-bills, we will strengthen budget cash and debt management.

Monetary and Exchange Rate Policy

22. Monetary policy will remain focused on maintaining inflation within the pre-announced 2010 target range of 4-8 percent. The NBS expects to continue easing monetary policy, albeit with caution given the risks of persistent inflation expectations, the potential for faster-than-expected recovery of aggregate demand, further increases in international energy prices, and the planned upward adjustments of regulated prices. Under the program, inflation developments will continue to be monitored using a standard consultation clause. In line with the monetary policy framework, we will maintain the existing managed float exchange rate regime.

23. We plan to improve coordination between the government and the NBS regarding plans for regulated price adjustment. The government's preliminary plan envisaging the 2010 adjustment of regulated prices by on average 9 ± 2 percent needs to be analyzed and elaborated further, as it provides a critical input for the NBS inflation forecast. In particular, price changes need to be scrutinized based on a careful analysis of the financial situation of state-owned energy companies and local government finances. In the coming weeks, we plan to assign this task to a new working group comprising technical experts from the NBS, Ministry of Finance, and other relevant ministries and agencies.

Structural Policies

24. **We continue to strive to modernize public enterprises and utilities by opening them to private participation:**

- **Large state enterprises.** Based on case-by-case studies, we will move ahead with corporatization, when necessary, followed by full or partial privatization, joint ventures, or a private management contract. Car manufacturer Zastava has been absorbed in a joint venture with Fiat, which has started a major investment program to modernize and expand production. We have embarked on an ambitious restructuring of the airline company JAT, and we hope to privatize the pharmaceutical company Galenika through a tender offer in early 2010. The restructuring of the railway company will also be accelerated with a view to reduce the need for continuous large-scale subsidies in the medium term. To increase transparency, we will publish audited annual financial statements of state enterprises.

- **Local enterprises.** By end-March 2010, the government will launch, in collaboration with municipalities, a comprehensive review of the business and financial conditions of all locally owned companies and utilities, with a view to reducing losses and budget transfers, while improving service delivery and preparing for private sector participation. The Ministry of Economy and Regional Development will prepare a strategy for transforming locally owned utilities and determining ways and modalities of private capital involvement.

- **We plan to continue the privatization program of socially owned enterprises in 2010.** We aim at privatizing or liquidating the majority of the remaining socially-owned enterprises and non-core companies spun off from public utilities.

25. **Efforts will continue to improve the business environment and foster private sector development.** We have launched a regulatory review aimed at streamlining business regulations by eliminating, clarifying, or reconciling rules and regulations that undermine the predictability of the business environment or significantly raise the cost of doing business. Importantly, we have created a new anti-corruption agency with new expanded powers and responsibilities. The agency will become operational as of January 1, 2010, and replace the present committee for the resolution of conflict of interest. We are also considering various initiatives to strengthen the competitive environment in domestic markets and in the import sector, and intend to reduce wasteful subsidies where possible. Furthermore, we will also strive to resolve the still pending, but potentially very difficult, issues of land ownership and restitution.

/s/
Mirko Cvetković
Prime Minister

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

/s/
Diana Dragutinović
Minister of Finance

Attachments

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2008-10 1/

	2008		2009							2010	
	Dec.		March		June		Sept.		Dec.	March	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Rev. Prog.	Prog.	Proj.
Quantitative Performance Criteria											
Floor on net foreign assets of the NBS (in billions of euro)	5.0	6.1	5.1	6.0	4.4	5.9	3.6	5.3	4.3	4.0	3.5
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	64	69	15	12	34	55	58	79	134	23	129
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	0	0	10	0	10	1.6	10	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/	50	0	200	0	550	100	550	100	550	200	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
Inflation Consultation Bands (in percent)											
Central point	10.0	8.6	9.2	9.4	8.0	8.3	9.5	7.3	7.5	5.4	6.5
Band, upper limit	12.0	n.a.	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	7.4	8.5
Band, lower limit	8.0	n.a.	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	3.4	4.5
Indicative Targets											
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	635	633	190	152	335	331	520	506	695	182	729
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.	n.a.	n.a.	50	7	50	15	50	13	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: Proposed New Conditionality

Measure	Target Date	Rationale for Conditionality
Prior action		
1. Government to submit to parliament a 2010 budget consistent with the program, including supporting legislation.	Before Board date	To commit to a credible fiscal adjustment package
Structural benchmarks		
1. Government to submit to parliament a draft pension reform law including measures as specified in TMU (¶ 20).	February 2010	To safeguard medium-term fiscal sustainability
2. Government to submit to parliament a draft Budget System and Responsibility Law, including supporting legislation (TMU ¶21).	April 2010	To anchor authorities' medium-term fiscal adjustment plans and commitments to safeguard fiscal sustainability
3. Authorities to adopt amendments to relevant credit enforcement laws and regulations strengthening the corporate debt restructuring framework (TMU ¶24).	March 2010	To address the issue of account blockages, which have triggered unnecessary bankruptcies, and enhance banks' ability to deal with rising NPLs
4. 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	To limit build-up of contingent liabilities by ensuring consistent wage and employment policies and profit transfers to the government budget

Attachment II. Technical Memorandum of Understanding

REPUBLIC OF SERBIA

Technical Memorandum of Understanding

1. This memorandum sets out the understandings regarding the definitions 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 SDR, 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 2009, 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

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 SFRY are excluded. Also excluded are the amounts received under any SDR allocations received after August 20, 2009.

6. On September 30, 2009 the NBS's net foreign assets, evaluated at program exchange rates, were Euro 6,450 million; foreign reserve assets amounted to Euro 9,848 million, and foreign reserve liabilities amounted to Euro 3,398 million.

7. **Adjustors.** For program purposes, the NFA target will be adjusted upward *pari passu* to the extent that: (i) after September 30, 2009, 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 September 30, 2009. 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 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 are reschedulable, 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.

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), the Development Fund, and the Guarantee 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. Revenues of the Republican budget exclude profit transfers from the NBS. 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 (LOI, ¶18), following consultation with IMF staff. It will be increased (respectively reduced) in 2009 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, 2009 to:	Program projections (billions of dinars)
December 31, 2009	12.0

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 (LOI, ¶18).

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 providers. Going forward, the program will include monitoring of the aggregate wage bill of local utilities.

20. **Pension law**. The new pension draft law should be submitted to Parliament by end-February 2010. 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 2020, (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 a half 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 of all social security payers in a single central registry. In the new draft law, indexation of pensions from the year 2011 onward will be limited to CPI indexation augmented to include a growth bonus, in line with the medium-term objective to reduce net spending of pension funds to about 10 percent of GDP. Specifically, semi-annual indexation of pensions to the CPI as under the current law will resume in April 2011, and, should the previous year's real GDP growth rate exceed a threshold of 4 percent, the pension increase would be augmented by the difference between the actual growth rate in the previous year and the threshold (end-February 2010).

21. **Fiscal responsibility legislation**. The present Budget System Law (BSL) will be amended to further strengthen fiscal discipline. Amendments 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, potentially including by setting up an independent fiscal council; and (iii) establish effective fiscal monitoring and enforcement mechanisms (end-April 2010).

22. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget, the Guarantee Fund, and the Development Fund.** The ceiling also includes the contracting of any domestic loans by the Development and the Guarantee Funds. It excludes any guarantees extended under the financial stability framework (LOI, ¶18), unless such loans or guarantees are extended to entities other than financial sector institutions.

23. **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

24. **Amendments to the legal framework for debt restructuring shall focus on two areas: account blockages based on promissory notes and an out-of-court loan workouts.** As regards to the first area: (i) the NBS will establish mandatory registration of promissory notes using a uniform format—containing essential loan details and blockage conditions, and early recall options—in a single registry; and (ii) as regards out-of-court loan workouts, the Ministry of Economy and the NBS, in consultation with the Ministry of Finance and banks, shall prepare the necessary legal and regulatory amendments to establish a framework allowing key creditors—based on their relative exposure—to quickly initiate and implement out-of-court workouts of corporate loans. These changes are to be adopted by the government by end-March 2010 (structural benchmark). Also, the Ministry of Economy, together with the NBS, will explore options to replace the first-mover advantage in account blockages with a more equitable payout**.**

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
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, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development Funds	Within eight weeks of the end of the month

Statement by the IMF Staff Representative on Republic of Serbia
December 21, 2009

1. This statement provides information that has become available since the issuance of the staff report. The additional information does not change the thrust of the staff appraisal.

2. **The key parameters of the draft 2010 budget submitted to parliament are in line with the program, but there were some changes in the structure of spending.** Higher allocations for wages and goods and services (about ¾ percent of GDP), which are mostly related to EU commitments including liberalization of the visa regime, were compensated by lower spending on subsidies, net lending, and capital.

3. **As expected, annual inflation rose to 5.9 percent (y-o-y) in November, up from 5.2 percent in October**. The end-year inflation forecast of 7.5 percent made at the time of the mission is still within reach due to the base effect from an unusually low inflation figure in December 2008. At its December 14 meeting, the NBS's Monetary Policy Committee left the policy rate unchanged at 10 percent, describing the current monetary stance as consistent with the inflation target.

4. **On December 4, the NBS intervened for the first time in nine months in the FX market on account of increased exchange rate volatility**. The one-off move was reportedly designed to compensate for a temporary surge in end-year FX demand, when many firms traditionally repay loans. The dinar has depreciated slightly against the euro, but there are currently no indications of fundamental exchange rate pressures going forward.

5. **EU foreign ministers agreed to unfreeze the interim trade deal with Serbia**, which represents the trade-related part of the Stabilization and Association Agreement (SAA). The interim trade deal had remained frozen since its signature in April 2008. The decision to unfreeze the agreement came after the Netherlands, which had previously blocked the trade pact, viewed the latest report on Serbia's cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) as positive.

6. **Standard & Poor's (S&P) upgraded the outlook on Serbia's credit ratings from negative to stable**, citing eased external pressures amid the ongoing narrowing of the country's current account deficit and its commitment to consolidate the budget in the medium-term in line with the SBA with the IMF. S&P affirmed 'BB-' long-term and 'B' short-term sovereign credit ratings for Serbia. S&P suggested that the outlook could be further upgraded if Serbia follows up with reforms of its public administration and pension system, making public finances more sustainable.

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FOR IMMEDIATE RELEASE
December 23, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under Serbia's Stand-By Arrangement and Approves €349.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Serbia's economic performance under a program supported by a Stand-By Arrangement (SBA). The completion of the review enables the immediate release of SDR 319.6 million (about €349.6 million or US$499.7 million), bringing total disbursements under the program to SDR 1.02 billion(about €1.12 billion or US$1.6 billion).

In completing the review, the Executive Board also granted a waiver for the non-observance of the end-September general government deficit performance criterion, and approved a modification of the end-December quantitative performance criteria in relation to the general government deficit and the 2009 inflation targets.

Serbia's initial 15-month SBA was approved on January 16, 2009 (see Press Release No. 09/12) for SDR 350.8 million (about €384.1 million or US$548.4 million). The arrangement was extended by one year and augmented to SDR 2.62 billion (about €2.87 billion or US$4.01 billion) on May 15, 2009 (see Press Release No. 09/169) to support the government's economic program amid a sharper than expected impact from the global financial crisis.

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

"The impact of the global financial and economic crisis on Serbia has so far been successfully contained. The authorities' policies supported by the SBA—along with their actions to stabilize the markets—boosted international reserves, eased pressures in the foreign exchange market, and helped mobilize significant international financial assistance in support of Serbia's budget and economic recovery. Although the decline in domestic demand has been significant, the contraction in output has been limited.

“The authorities’ program aims to help address the challenges posed by the economic downturn, and to restore sustainable public finances over the medium term. This will be crucial to continue safeguarding financial stability, and to create the conditions for a return to dynamic—yet sustainable—economic growth.

“To this end, the authorities have embarked on an ambitious fiscal adjustment strategy focusing on structural spending reforms covering public administration, education, health care, and pensions. While these reforms are expected to yield significant and sustainable pay-offs, savings will accrue only over the medium term, and strengthened budget rules will be needed to contain implementation risks.

“The central bank’s monetary and exchange rate policies have been prudent, as reflected in continued disinflation. While there might be scope for further gradual easing of the monetary stance should favorable inflation developments continue, upside risks from high inflation expectations need to be monitored carefully.

“The authorities’ financial sector support program has successfully safeguarded financial stability during the market turmoil. The authorities are committed to continued vigilance in the face of high and rising non-performing loans, and to improve Serbia’s debt restructuring framework.

“Further progress will have to be achieved in the area of structural reforms, notably as regards privatization and the business environment, in order to lift Serbia’s economy on a high and sustainable growth path in the period ahead.”

Statement by Thomas Moser, Executive Director for Serbia
and Srboljub Antic, Senior Advisor to the Executive Director
December 17, 2009

1. Our Serbian authorities would like to thank staff for a constructive policy dialog and productive meetings during their visits to Belgrade. The staff report provides a balanced picture of the economic situation in the country, and rightly points to the challenges that authorities continue to face. Let us state from the outset that the authorities share the staff's views on the main economic problems and the orientation of the policy response.

2. The implementation of the Fund-supported program is on track and has clearly contributed to the stabilization of the economy. Financial tensions have eased and inflation is declining, while GDP and exports have been broadly in line with projections. However, due to the strong contraction of domestic demand, the current account deficit has been declining much faster and revenue has been lower than projected. The revenue shortfall resulted in a higher fiscal deficit, for which the authorities are requesting a waiver. All other performance criteria and indicative targets were met.

3. The clear signs of economic stabilization have received further support from the political side through the unfreezing of the trade agreement with the EU and the cancellation of visa restrictions for most EU countries. Those measures will provide important relieve for the population and create opportunities for the real sector of Serbian economy.

4. Fiscal adjustment continues to be at the core of the program. The sharp contraction of GDP in the first half of 2009 has significantly widened the fiscal gap. The authorities decided against an increase of taxes during the crisis but rather implemented coordinated and balanced restraints on spending. A broad consensus within the ruling coalition enables the authorities to maintain the nominal freezes of wages and pensions for two years, and to execute discretionary cuts. The authorities are now trying to achieve a fiscal deficit target of 4.5 percent of GDP in 2009, and 4 percent of GDP in 2010.

5. Significant budget outlays for pensions put the whole pension system under scrutiny. The authorities intend to submit a new pension law to parliament in the first quarter of next year, which will increase the minimum retirement age, limit extra service credits to a small number of jobs, increase the minimum contribution period, and tighten eligibility for survivor pensions. Although the full effect of these changes will only be felt in the medium and longer term, this parametric reform is important and will lower the estimated level of pensions from 13 percent GDP in 2009 to 10 percent in 2015.

6. The costly experience of a strong influence of the political cycle on fiscal expenditures has created incentives to strengthen budget rules and procedures. More rules oriented policy should help maintain fiscal discipline after 2010, when many short-term measures will expire. The recently approved Budget System Law introduces medium-term spending ceilings over the next three years and increases transparency. Also, the authorities appointed a working group with the task to formulate proposals to strengthen

the present legal rules and procedures and the enforcement of penalties to guard against spending and deficit biases. It is expected that proposals for a new Budget System and Responsibility Law will be ready for parliament by the end of April next year.

7. The inflation targeting framework has served the country well in a very turbulent period. The National Bank of Serbia (NBS) has managed to maintain inflation in the target range despite significant exchange rate volatility in the first quarter of this year. In the second part of the year the NBS has started a monetary easing that is expected to continue, albeit with caution due to persistent inflation expectations and possible increases in the oil price and in regulated prices.

8. In line with the inflation targeting framework the NBS will continue the managed floating exchange rate regime. Since the first quarter of this year, the exchange rate has been relatively stable. The NBS has recently intervened, for the first time in months, to prevent excessive volatility.

9. Serbia's banking is adequately capitalized and liquid. The timely introduction of the Financial Sector Support Program (FSSP) proved vital for safeguarding financial stability. The main foreign banks contributed to financial stability by maintaining their exposure to Serbia. The authorities are currently working on improvements to the present debt restructuring and bankruptcy legislation, given the increase in corporate loan delinquencies.

10. Improvements in the business environment, and especially in the investment climate, are main objectives of the government's policy in the real sector. A review was prepared for the elimination of rules and regulations that are raising the costs of doing business in Serbia. Also, the privatization program will continue, despite unfavorable market conditions. The objective for 2010 is to privatize or liquidate the remaining companies in the privatization portfolio. The utility sector at both the republican and the local level is open for private participation under different modalities.

11. Finally, the authorities believe that the agreed policies are adequate to reach the objectives defined in the Letter of Intent, and to put the country on more balanced growth path after the expiration of the program. If new measures are needed to achieve the program objectives, the authorities stand ready to introduce them in consultation with the IMF.