January 2011
IMF Country Report No. 11/9

Republic of Serbia: Sixth Review Under the Stand-By Arrangement

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 4, 2010**, with the officials of the Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on **December 8, 2010**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

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

- A Press Release summarizing the views of the Executive Board as expressed during its **December 22, 2010** discussion of the staff report for the Republic of Serbia

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

The document(s) listed below will be separately released

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

Sixth Review Under the Stand-By Arrangement

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

Approved by Adam Bennett and James Roaf

December 8, 2010

Discussions. A staff team visited Belgrade during October 21–November 4, 2010, to conduct the Sixth Review of the Stand-By Arrangement (SBA). The mission met with Prime Minister Cvetković, Deputy Prime Ministers Dinkić, Djelić, and Krkobabić, Minister of Finance Dragutinović, Labor Minister Ljajić, National Bank of Serbia (NBS) Governor Soškić, other senior officials, representatives of international financial institutions (IFIs), the European Union (EU), trade unions, and the private sector. The staff team comprised Messrs. Jaeger (head), Hobdari, Hajdenberg (all EUR), Mr. Arnason (SPR), and Ms. Jenkner (FAD). Mr. Lissovolik (Resident Representative), Ms. Nestorović, and Mr. Kokotović (local IMF office) assisted the mission. Mr. Antić (OED) attended most policy meetings.

Stand-By Arrangement (SBA). The SBA, approved by the Executive Board on January 16, 2009, was extended to 27 months and augmented to the amount of SDR 2.6 billion (560 percent of quota) on May 15, 2009 (EBS/09/63). The amount available at the completion of this review is SDR 319.6 million, but the authorities have indicated that they intend to purchase only SDR 46.7 million (10 percent of quota). The arrangement expires on April 15, 2011.

Program status. All end-September quantitative performance criteria and indicative targets were met, while inflation marginally exceeded the upper limit of the inflation consultation clause.

Key issues: The review focused on four main issues: (i) the supplementary budget for 2010; (ii) the 2011 budget; (iii) the re-submission of the draft pension law to parliament; and (iv) the appropriate monetary stance given the recent flare-up in inflation.

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EXECUTIVE SUMMARY

The export-led economic recovery has gained momentum, but external risks remain significant. GDP growth is picking up on the back of a competitive exchange rate and rebounding industrial output and exports. Growth is still projected at 1½ and 3 percent in 2010 and 2011, respectively. However, foreign financing risks remain elevated in the context of a still large trade deficit and subdued capital inflows. There are also still significant risks from fresh adverse spillovers from the region and from euro-area periphery developments.

The continued depreciation of the dinar is putting pressure on corporate balance sheets, but banks remain well buffered. The dinar has further depreciated since the Greek crisis, diverging from other flexible currencies in the region, negatively affecting unhedged corporate balance sheets. Serbia's banking system is liquid and well-provisioned against credit risks but continued vigilance is needed.

Inflation has picked up, resurfacing as a key policy concern. Inflation was consistently below the NBS' tolerance band during the first half of 2010, but has recently exceeded the band. This reflects mainly food price shocks and depreciation pass-through effects, despite slow nominal wage costs growth and a still-significant output gap. The NBS has hiked the policy rate by 250 basis points since August, and has signaled a continued tightening bias, with the objective of bringing inflation within its tolerance band by end-2011.

In November, the government adopted a 2010 supplementary budget aiming at a fiscal deficit consistent with the program target. Space created by underspending on capital and interest was re-allocated to pressing priorities, including social assistance programs.

The 2011 budget will target a deficit of about 4 percent of GDP, in line with the new fiscal responsibility framework. Achieving this target will require tight control of current spending, including moderating the indexation of public wages and pensions, as well as constraining capital spending. With government financing becoming more difficult, as evidenced by undersubscribed dinar T-bill auctions in spite of higher yields, Telekom privatization proceeds will likely be needed to cover a major part of the financing needs.

The government amended the pension reform law. While the draft law retains most elements of the reform agreed during the fourth review of the SBA, it introduced two changes aimed at strengthening protection for the most vulnerable and women. The Serbian pension system will remain one of the most expensive systems in the region, and further reforms are likely unavoidable.

I. Recent Developments

1. **The SBA is broadly on track, but fresh economic and political tensions have emerged**. All end-September performance criteria were met. But inflation has increased sharply over recent months and exceeded the upper limit of the inflation consultation target band for end-September (Tables 1–2). Depreciation pressures have continued. With elections looming, the coalition government's resolve to maintain spending discipline is wavering. Moreover, under heavy pressure from trade unions, the government re-called the draft pension law that was submitted to parliament in June as a prior action for the fourth review, and made concessions on some of the reform provisions. Re-submitting the draft pension law and submitting the 2011 budget to parliament are prior actions for the sixth review.

2. **An export-led recovery has gained momentum, but the external trade imbalance remains high.** GDP growth is picking up, led by rebounding industrial output and exports, helped by the dinar's sharp real depreciation (Tables 3–5). Exports to the EU are thriving and have recovered to near pre-crisis level (Figure 1). However, exports to Serbia's regional trading partners are lackluster, as these economies lag Serbia's recovery. Key nontradable sectors, the main drivers of the pre-crisis growth boom, remain depressed, with their mostly unhedged balance sheets hard hit by the depreciation. At the same time, and notwithstanding double-digit export growth, Serbia's large external trade deficit is projected to remain elevated, as imports have also started to recover.

3. **The dinar has continued to depreciate, notwithstanding FX interventions.** Following the depreciation triggered by the Greek crisis, the dinar has remained under pressure, diverging further from trends in other flexible currencies in the region (Figure 2). With the dinar now likely somewhat undervalued, the NBS has continued intervening in the FX market. FDI and other inflows to enterprises have come in significantly lower than expected, reflecting Serbia's relatively high country-risk premium and banks' concerns about unhedged corporate balance sheets, particularly in the nontradable sectors, which absorbed most of the pre-crisis capital inflows (Tables 5–7). Moreover, government dinar T-bill auctions have remained undersubscribed, notwithstanding high offered nominal yields.

4. **Inflation has surprised on the upside, re-emerging as a key policy concern.** Inflation was consistently below the NBS' tolerance band during the first half of 2010 (Figure 3). However, since August, inflation has accelerated sharply, reaching 8.9 percent in October, above the NBS tolerance band of 6.3±2 percent. This occurred despite the continued dampening effect of slow nominal wage costs growth, owing to a depressed labor market and the public wage freeze, and a still significant output gap. The inflation surge reflects three main factors:

- ***Food price shocks.*** Prices have risen due to the effects of bad weather and global food price trends (Serbia is a food exporter), which have been amplified by structural rigidities in domestic food markets, including high trade barriers.

- ***Depreciation pass-through effects.*** Past dinar depreciation is becoming increasingly visible in consumer prices as price setters try to restore compressed profit margins.
- ***Rising import prices in foreign currency.*** Even absent the pass-through, import prices are recovering from their crisis lows, and no longer help restrain inflation.

In response to the fresh inflation pressures, the NBS has hiked the policy rate by 250 basis points in four steps since August, while stressing in its communication the relatively persistent but temporary nature of shocks (food prices, FX pass-through) driving inflation.

5. **Dinar depreciation and a slow recovery have left many corporate balance sheets overleveraged, but Serbia's banking system is well-buffered**. The net financial position of the corporate sector vis-à-vis the banking system has deteriorated by about 15 percent of GDP since the start of the crisis, mainly reflecting the impact of dinar depreciation. Blocked corporate accounts and corporate non-performing loans have surged (Figure 4). However, reflecting conservative NBS provisioning requirements, Serbia's banking sector is exceptionally well-provisioned against credit risks, and should be able to absorb even a protracted corporate restructuring process (Table 8).

II. Policy Discussions

A. Macroeconomic Framework

6. **The export-led recovery is projected to gain further momentum, in line with a welcome rebalancing toward more sustainable growth.** Supported by a competitive exchange rate, net exports are projected to remain the main growth engine in 2011, while domestic demand will remain subdued until 2012 (Table 9). Formal-sector job growth is unlikely to turn positive before 2012.

7. **Inflation is projected to stay temporarily above the NBS's tolerance band**. Despite projected continued sub-par growth and a depressed labor market, CPI inflation is projected to hover well above the upper bound of the tolerance band for some time (Figure 3). With significant monetary tightening already in the pipeline, and as the effects of food price shocks and FX pass-through dissipate, inflation is projected to revert back into the NBS's tolerance band during the second half of 2011.

8. **The current account deficit is expected to remain relatively high, requiring significant capital inflows to maintain external balance**. While Serbia's external cost fundamentals have improved significantly, the flow fundamentals underlying the high external deficit, particularly the low private savings rate, are projected to adjust with a lag (Table 10). FDI inflows in 2011 are projected to spike, reflecting the privatization of Telekom Serbia, while other external flows, mainly to enterprises, are assumed to normalize at about 6 percent of GDP starting in 2012. Gross international reserves are projected to stabilize in 2011, following a decline in 2010. Under these assumptions, gross external debt would peak at almost 80 percent of GDP in 2010, but then decline over the medium term.

9. **While risks to short-term growth are to the upside, risks of higher inflation and external financing shortfalls have also increased.** Growth, particularly in the export sector, has been robust, and could well exceed present projections, assuming other macro stability risks do not materialize. However, this is unlikely to result in a rapid narrowing of the large external trade imbalance, and the associated high external financing requirements. Moreover, on the external side, fresh adverse shocks to the country risk premium, including from a possible new round of euro-area periphery spillovers, could cloud the external financing outlook. This could re-ignite depreciation pressures, adding to inflationary pressures, and weaken further corporate balance sheets. On the internal side, already heightened political and social tensions could spill over into looser fiscal policies. This could create a feedback loop into inflation, while fiscal loosening could also clash with tight budget financing constraints.

B. Fiscal Policy

10. **There was agreement that fiscal policy had made a key contribution to stabilizing the economy, but there were also growing signs of policy tensions and austerity fatigue.** Following a large, spending-based upfront fiscal adjustment in early-2009, the authorities have maintained a broadly neutral fiscal stance since then, allowing automatic fiscal stabilizers to operate (Table 11). Serbia seemed to have avoided a vicious circle of disappointing growth triggering fiscal tightening, which in turn would have further lowered growth. However, the mission also noted growing tensions in a number of areas: (i) an export-led recovery accompanied by low wage growth, while good for rebalancing the economy, was not providing as much boost to fiscal revenues as pre-crisis consumption-led growth; (ii) spending adjustments during 2009–10 were largely based on ad-hoc measures, nominal freezes and across-the-board cuts, while the pace of structural fiscal reforms was generally disappointing; and (iii) after two years of austerity and with elections looming, there were growing social and interest-group pressures to relax spending discipline, particularly as regards public wages, goods and services, and subsidies, while there is little effective lobbying to protect capital spending.

11. **Nevertheless, the government was determined to stick to its new fiscal responsibility framework.** In October, parliament had adopted amendments to the Budget System Law, introducing a two-tiered structure of fiscal rules. While the first-tier rules are designed to limit future fiscal deficits and debt, the second-tier rules are designed to constrain key spending items, particularly public wages and pensions (Box 1). Failure to adhere to this fiscal responsibility framework would not only raise external and internal balance risks, but could also trigger a budget financing crunch–potential creditors could hold the government accountable for changing course on its fiscal responsibility pledges.

Box 1. Serbia's Fiscal Rules and the Inflation Surge

On October 12, 2010, Serbia's parliament adopted amendments to the Budget System Law (BSL) that committed fiscal policy makers to numerical fiscal rules. This box discusses what to do if conflicts between the rules arise given unexpected large shocks to the economy, such as the recent surprise surge in the inflation rate. The box argues that deficit and debt target rules should be considered as the priority or first-tier rules, which are being underpinned by second-tier spending rules for public wages and pensions.

The first-tier rules are:

- First, an error-correction rule for the general government deficit:

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

where d is the deficit-GDP ratio, $d^*=1.0$ is the medium-term general government deficit target, g is the real GDP growth rate, $g^*=4.0$ is the assumed medium-term GDP growth rate; $\alpha=0.30$ and $\beta=0.40$ are parameters that capture how responsive the deficit would be to deviations from the target deficit and GDP fluctuations around average growth, respectively.

- Second, a ceiling on general government debt:

$$b(t) \leq 45.0,$$

where b is the gross general government debt-GDP ratio, including public guarantees.

The second-tier spending rules relate to public wages and pensions, which account for about 60 percent of general government spending. These rules prescribe numerical indexation for public pensions and wages with a view to reaching medium-term targets of reducing total spending on the two budget items to 10 and 8 percent of GDP, respectively (see fifth review, LOI ¶13–14 for details).

With inflation during the second half of 2010 now projected to surge to 5.8 percent (in September, the program projected only 2.2 percent), not capping the indexation rules would in practice have made it impossible to reach the 2011 deficit target set by the fiscal balance rule (4.1 percent of GDP). Faced with this conflict between first- and second-tier rules, the authorities opted for capping wage and pension increases in January at 2 percent.

12. **The supplementary 2010 budget, adopted in November, will maintain the agreed fiscal deficit target (Table 11, LOI ¶9–10).** The main obstacle for reaching agreement on the revised 2010 budget was how to allocate available space (resulting from projected underexecution of budgeted spending) across different ministries, with strong pressures for additional spending emerging from all sides. The mission insisted that such re-allocations should be transparently identified in the revised budget, and targeted social assistance programs for the most vulnerable groups received an additional allocation.

13. **In line with the newly adopted fiscal balance rule, the 2011 budget targets a deficit of about 4 percent of GDP (Table 11, LOI ¶11–13).** A baseline budget projection for 2011 indicated a fiscal gap of RSD 62 billion (1¾ percent of GDP). Although the measures taken to close this gap focused on recurrent spending, including capping the indexation of public wages and pensions in January 2011 at 2 percent, capital spending also suffered cutbacks. The authorities argued, however, that co-financing of FDI projects, particularly the new Fiat plant, should be seen as close substitutes to capital projects (although such spending is allocated to net lending and subsidies).

Serbia: Fiscal Adjustment Measures in 2011

	Billions of dinars	Percent of GDP
Total	**62**	**1.8**
I. Expenditure cuts	**51**	**1.5**
Wage and pension indexation capped at 2 percent in January	31	0.9
Savings in goods and services, incl. postponed census (all levels)	8	0.2
Subsidies frozen in nominal terms (Republican budget) and savings (local governments)	4	0.1
Capital expenditure (Republican budget and local governments)	6	0.2
Net lending (Republican budget)	1	0.0
II. Revenue increases	**11**	**0.3**
Telekom dividend	6	0.2
Selected items moved from reduced to general VAT rate	2	0.0
Increase in cigarette excises	2	0.1
Increase in local government property tax ceiling	1	0.0

14. **Telekom privatization proceeds will likely be needed to cover the major share of 2011 budget financing needs (LOI ¶14–15)**. Earlier plans to put Telekom privatization proceeds (projected at about 4 percent of GDP) aside to finance only "special projects" over the next few years have had to be shelved, with gross financing needs for 2011 now projected at about 6 percent of GDP. At the same time, if the sale of Telekom does not go ahead, the authorities noted that their "Plan B" would be to cover the shortfall through a eurobond complemented by additional borrowing from domestic banks and T-bill issuance. However, this alternative financing strategy would be subject to uncertainties, and it could also add the equivalent of about ¼ percent of GDP to interest payments in 2011.

15. **Under trade union pressure, the government amended the pension reform law (LOI ¶16).** The government argued that maintaining social and political stability required some concessions. The mission noted that the previously agreed pension reform law represented only a modest step toward putting Serbia's public pension system on a more sustainable footing. With spending on pensions amounting to about 14 percent of GDP and an effective pensioner-contributor ratio close to one, Serbia's pension system is one of the most expensive and demographically-exposed systems in the region. The mission suggested that further reforms to raise effective retirement ages will likely be unavoidable.

16. **The pension law changes have raised fresh concerns about Serbia's resolve and ability to adopt and implement much-needed fiscal structural reforms.** With fiscal revenue growth likely lackluster for some time given the export-led recovery, stop-gap spending measures will not be sufficient to meet the targets mandated by the new fiscal responsibility legislation. Serious structural spending reforms would be the preferable strategy given the above-par size and below-par productivity of Serbia's government sector. But if such reforms cannot be implemented, consideration would have to be given to hefty indirect tax increases.

C. Monetary and Exchange Rate Policies

17. **Inflation risks were seen as tilted to the upside, and monetary policy has been appropriately tightened (LOI ¶19).** The recent flare-up in inflation had surprised all observers. There was agreement that idiosyncratic features of Serbia's food market, including monopolistic structures, high import duties, and agricultural policies regarding commodity reserves and subsidies, have magnified the effect of adverse weather on agricultural prices. Moreover, threshold effects from exchange rate pass-through also seem to have played a key role as price setters sought to restore profit margins. Putting the present inflation volatility in context, past deviations from the NBS's inflation targets have also been relatively large and persistent compared with advanced-economy inflation-targeting (IT) regimes—echoing the inflation experiences of several other emerging-market IT regimes, including Brazil and South Africa. Looking ahead, the NBS assessed that inflation risks were still on the upside, and it stood ready to continue its resolute tightening of the monetary stance, using all policy tools available if needed. The key to bring inflation back to target would be to contain second-round effects, particularly to wages. In this context, the NBS welcomed the envisaged capping of January indexation for public wages and pensions. More generally, with the economy recovering, it was agreed that fiscal policy, and relevant structural policies, would need to do most of the heavy lifting to restore and maintain external balance.

18. **The NBS will continue to strengthen its communication strategy (LOI ¶20).** The NBS sees effective communication as particularly important in a setting where policy credibility has still to be firmly established and where the nominal exchange rate is seen as a more natural anchor than inflation targets by many, particularly businesses with unhedged balance sheets. While the NBS views publishing minutes of policy meetings as premature, it

plans to be more open in its press releases and IT reports about the different options considered by policy makers.

19. **Given the fickleness of capital flows to the region, the authorities are rightly concerned about risks from a possible re-surge of inflows**. At this point, Serbia is more concerned about flows being insufficient to cover its still large external imbalance. However, past experience suggests that turnarounds in capital flows can happen quickly. The NBS noted that the major problem with pre-crisis capital flows was not so much their size, but that the flows had led to unbalanced risk sharing, with risks from currency and maturity mismatches mainly borne by Serbian businesses and households. If faced with a resurgence of capital inflows, the NBS has pledged to avoid a recurrence of unequal risk sharing, including, if needed, through using punitive reserve requirements and prudential tools. But the NBS also hoped that foreign investors, particularly foreign banks, would do their part to achieve a more balanced sharing of risks.

D. Financial Sector Policies

20. **Credit support programs helped shoring up credit growth during the height of the crisis, but cost-benefit considerations are arguing to phase out these programs (LOI ¶22).** With credit markets normalizing and the recovery on track, the fiscal cost and supply-side distortions of credit support programs are increasingly outweighing possible benefits. Moreover, these programs tend to counteract the NBS's efforts to tighten monetary policy. There was thus agreement that the credit support programs should be phased out, with the budgetary costs of the programs to be reduced by about 40 percent in 2011, although the pace of phase-out would differ across specific programs.

21. **The authorities have also taken steps to further reduce financial vulnerabilities:**

- The authorities have drafted the necessary amendments to existing laws for the adoption of the Basel II framework, although implementation will have to be delayed by one year (LOI ¶24).

- In addition, drawing on long-standing World Bank support, parliament has adopted amendments to a number of financial sector laws, establishing transparent procedures and tools in the event of a systemic banking crisis (LOI ¶27).

- The end-November structural benchmark regarding strengthening Serbia's debt collection and restructuring framework was only partially observed (Table 2). Legislation for an out-of-court loan workout mechanism in tune with Serbia's specific circumstances has been drafted (Box 2). But the legislation remains to be submitted to parliament, and specific tax incentives for the out-of-court mechanism still have to be agreed and costed (LOI ¶23).

E. Structural Policies

21. **The slow pace of progress on growth-oriented structural reforms remains a bottleneck (LOI ¶28–29).** The government and the main think tanks have rallied around a new "post-crisis economic growth and development model," which promises to generate average growth of 5¾ percent and 400,000 new jobs during 2011–20. However, like other countries in the region, Serbia has found it difficult to take decisive steps to address well-known shortcomings in the business environment (Table 17). There was agreement that these steps would need to be taken to implement the vision of a more export- and investment-based growth model. Towards this end, in the short term the authorities plan to focus on the unfinished agenda of pro-active and defensive steps, including the regulatory "guillotine," competition by-laws, restructuring of public utilities, and limiting the spread of fiscal levies and charges.

Box 2. Corporate Debt Restructuring: Why a Voluntary Out-of-Court Loan Workout Mechanism for Serbia?

Putting in place more effective debt collection and restructuring mechanisms is likely Serbia's most pressing financial sector issue, particularly given mounting corporate debt problems in the nontradable sectors. Bankruptcy procedures handled by the courts tend to be lengthy and costly. Using the option of blocking debtors' accounts is a relatively efficient procedure for debt collection during normal times, but provides overly strong incentives to "rush to block" in times of high uncertainty about the soundness of corporate balance sheets.

Serbia's policy response to addressing its corporate debt problems needed to balance two considerations. On the one hand, its legal culture argues for a debt restructuring framework based firmly on laws and regulations, as opposed to voluntary guidelines (as recently introduced in Latvia). On the other hand, the limited credibility of government intervention, the large informal economy, and the well-buffered banking system argued for leaving many degrees of freedom for informal, private-sector driven restructuring solutions, while arguing against the option of public asset management companies (such as used in some Asian countries in the 1990s).

Given these considerations, the approach chosen by the authorities was to establish an out-of-court debt restructuring mechanism by law to provide a legal base for voluntary agreements between debtors and creditors, to be mediated by the Chamber of Commerce. Under this approach, the government's role would be confined to providing tax and provisioning incentives to encourage debt restructuring (similar to the experiences of Mexico in 1995 and Indonesia in 1998).

III. Program Issues[1]

22. **The authorities intend to continue to make only a partial drawing of the funds available under the SBA following the completion of the sixth review.** Notwithstanding substantial FX interventions by the central bank, Serbia's gross FX reserve position appears comfortable from a cross-country perspective, although net foreign assets and net free reserves are significantly lower (Figure 5). Serbia's reserve position is projected to improve marginally in 2011 and more rapidly thereafter (Table 7).

IV. Staff Appraisal

23. **Serbia's export-led growth recovery is welcome, but macroeconomic stability risks need to be watched.** Compared with most surrounding peers, Serbia is recovering at a slow but steady pace. However, inflation has surged in recent months. Foreign financing risks remain elevated as the external trade deficit is still large, and capital inflows have become much less exuberant than before the crisis. Adverse spillovers from regional developments remain a risk, and there are renewed pressures in the euro-area periphery.

24. **Monetary policy has been appropriately tightened in the face of resurging inflation, but, with inflation risks tilted on the upside, additional tightening may be required**. Despite low nominal wage growth and a still-large output gap, a food price shock and the pass-through of the dinar's depreciation have pushed inflation above the NBS's tolerance band. Monetary policy should continue to aim at bringing inflation back within the band, especially by containing second-round effects via wages, using all available policy tools. The NBS's efforts to further strengthen its communication strategy are welcome.

25. **Fiscal performance during 2010 has remained in line with program objectives.** While revenue have performed as projected under the program, the fiscal space created by underspending in capital and interest spending has allowed the authorities to reorient spending toward more pressing priorities, including for targeted social assistance programs to the vulnerable groups, through a supplementary budget.

26. **Determined efforts will be needed to achieve the 2011 budget targets.** The targeted deficit of about 4 percent of GDP is in line with the new fiscal balance rule. This is welcome as it begins to reduce the high fiscal deficits induced by the crisis. However, with elections approaching, pressures are growing to increase spending. Such pressures should be resisted, as failure to maintain fiscal discipline could increase external and domestic balance risks, and lead to financing difficulties. Using Telekom privatization proceeds to finance the 2011 deficit is a prudent decision given the large financing requirements.

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[1] Serbia no longer has any arrears to external private creditors, with the last such arrears resolved in January 2010. Accordingly, a financing assurances review under Serbia's SBA is no longer required.

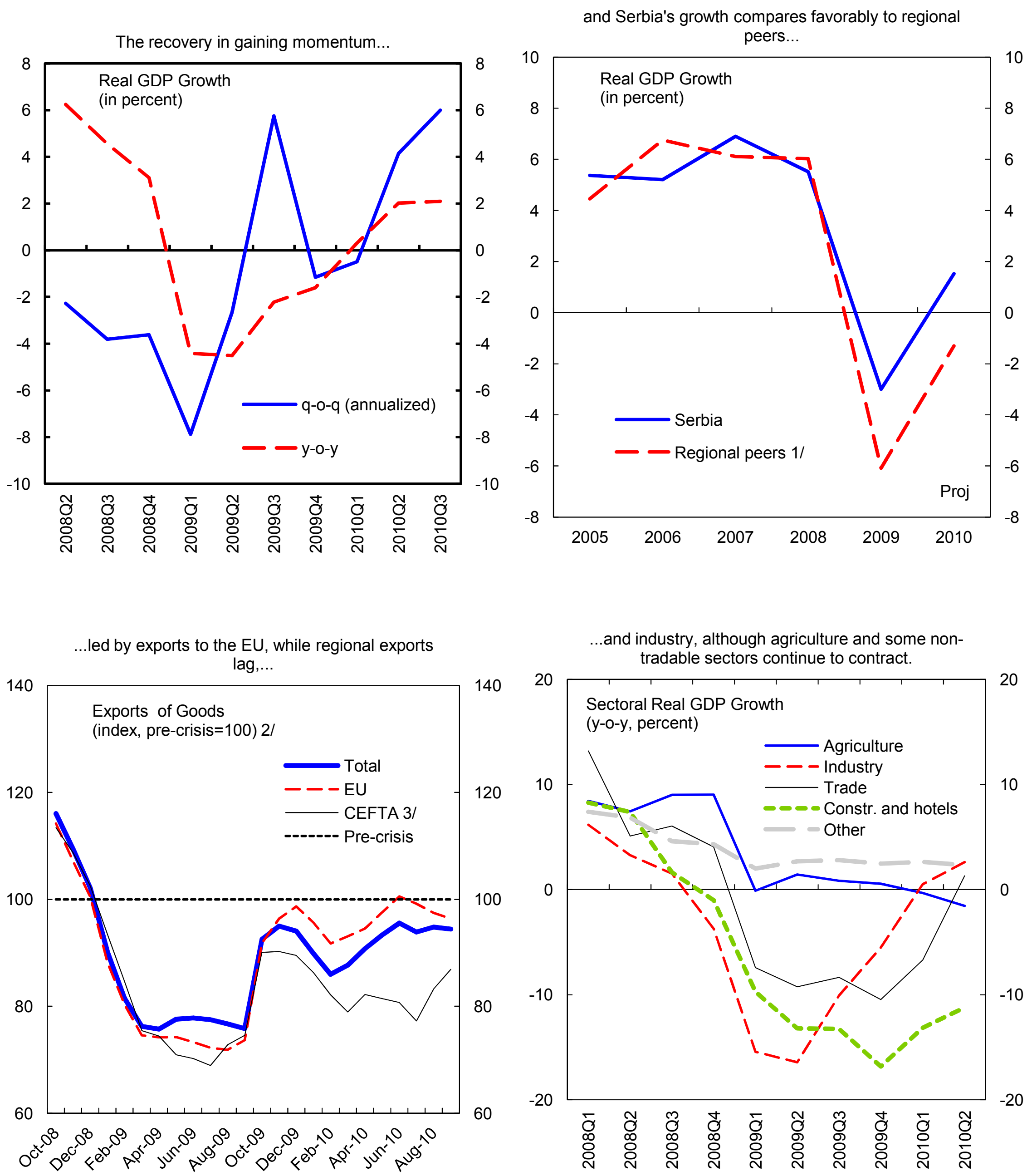
27. **The current pension reform is a step in the right direction, but further reforms will be needed in the future.** The pension reform goes some way toward putting Serbia's public pension system on a more sustainable footing. However, additional steps to increase the effective retirement ages further are likely unavoidable. The planned review of pension arrangements for professions working under difficult conditions and for protecting old-age pensioners should be based on international best practice, and any changes should be consistent with the financial sustainability of the pension system.

28. **The banking sector remains well-buffered to absorb the deterioration in corporate balance sheets.** Dinar depreciation and a slow recovery have hit hard the corporate balance sheets, leading to rising non-performing loans. While Serbia's banking sector is overall highly liquid, and also exceptionally well-provisioned against credit risks, continued vigilance is needed to deal with unexpected events, given elevated regional risks. The authorities' strategy to start phasing out credit support programs is welcome. These programs have helped shore up domestic demand, but with the recovery on track, cost-benefit considerations are arguing for phasing these programs out. Finally, a swift adoption of the legal basis for the out-of-court debt restructuring mechanism should be a priority to help deal effectively with overleveraged balance sheets of non-financial corporations.

29. **Supporting the needed rebalancing towards the tradable sector requires not only safeguarding macroeconomic stability, but also stepping up implementation of structural reforms.** The authorities should accelerate efforts to implement the unfinished structural reform agenda, including the measures identified by the regulatory "guillotine" project, restructuring public utilities, reforming public procurement, and limiting the spread of fiscal levies and charges.

30. **On the basis of Serbia's satisfactory performance under the SBA, staff supports the authorities' request for the completion of the sixth review.**

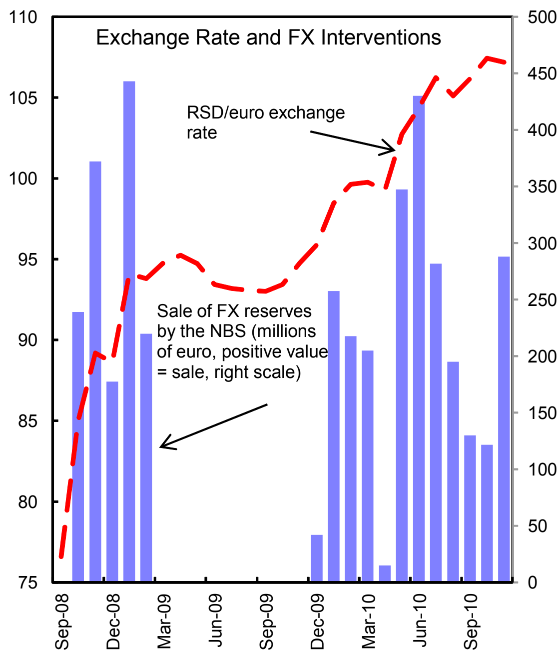
Figure 1. Serbia: Output Indicators



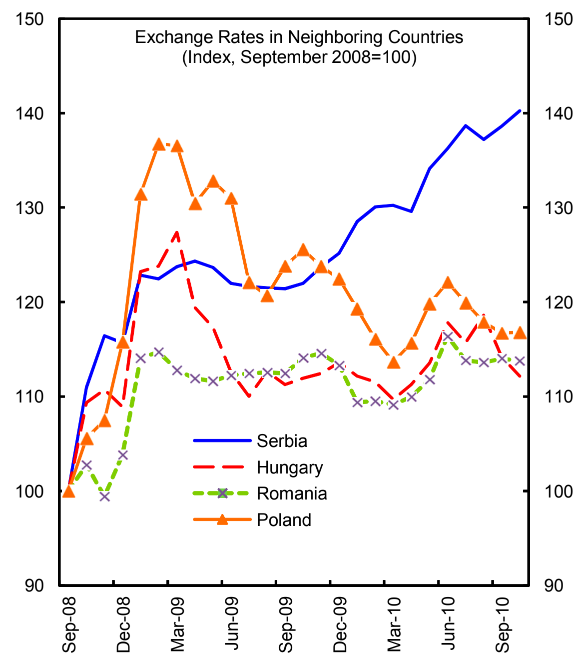
Sources: Serbian authorities and WEO October 2010.
1/ Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia FYR, and Romania.
2/ The 3-month moving averages for each month expressed in euros are compared with the same month during the pre-crisis period (defined as October 2007-September 2008).
3/ Includes Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia FYR, Moldova, Montenegro, and Serbia.

Figure 2. Serbia: Exchange Rate and Sovereign Risk, 2008-10

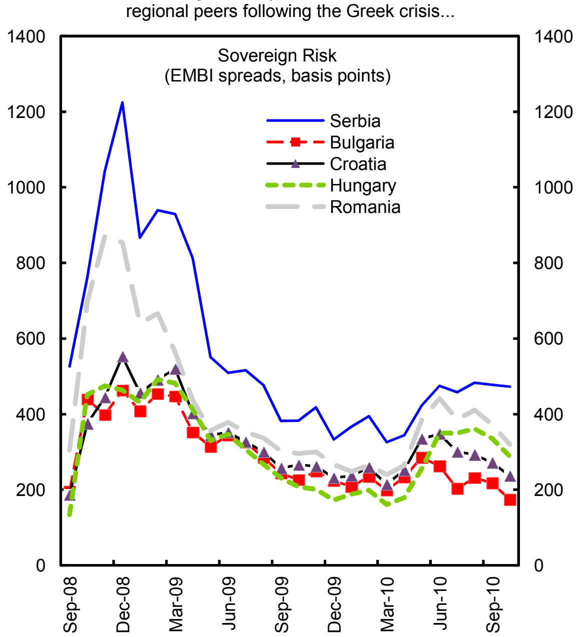
The dinar has depreciated significantly this year despite FX interventions by the NBS ...



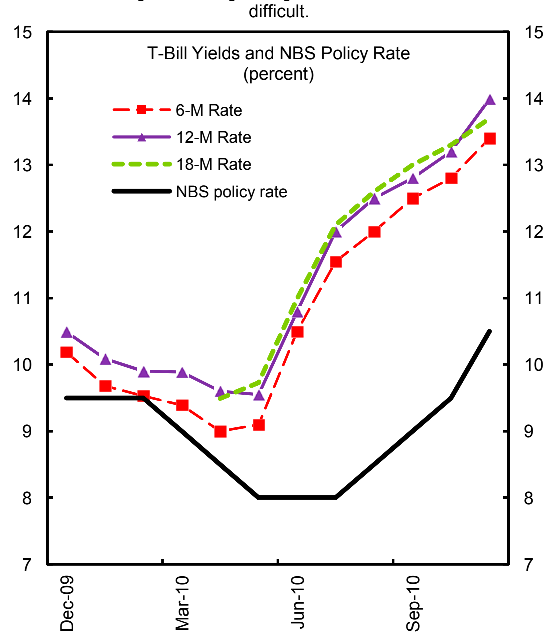
...the dinar exchange rate is diverging from other flexible regional currencies.



Serbia's sovereign country risk has increased relative to regional peers following the Greek crisis...

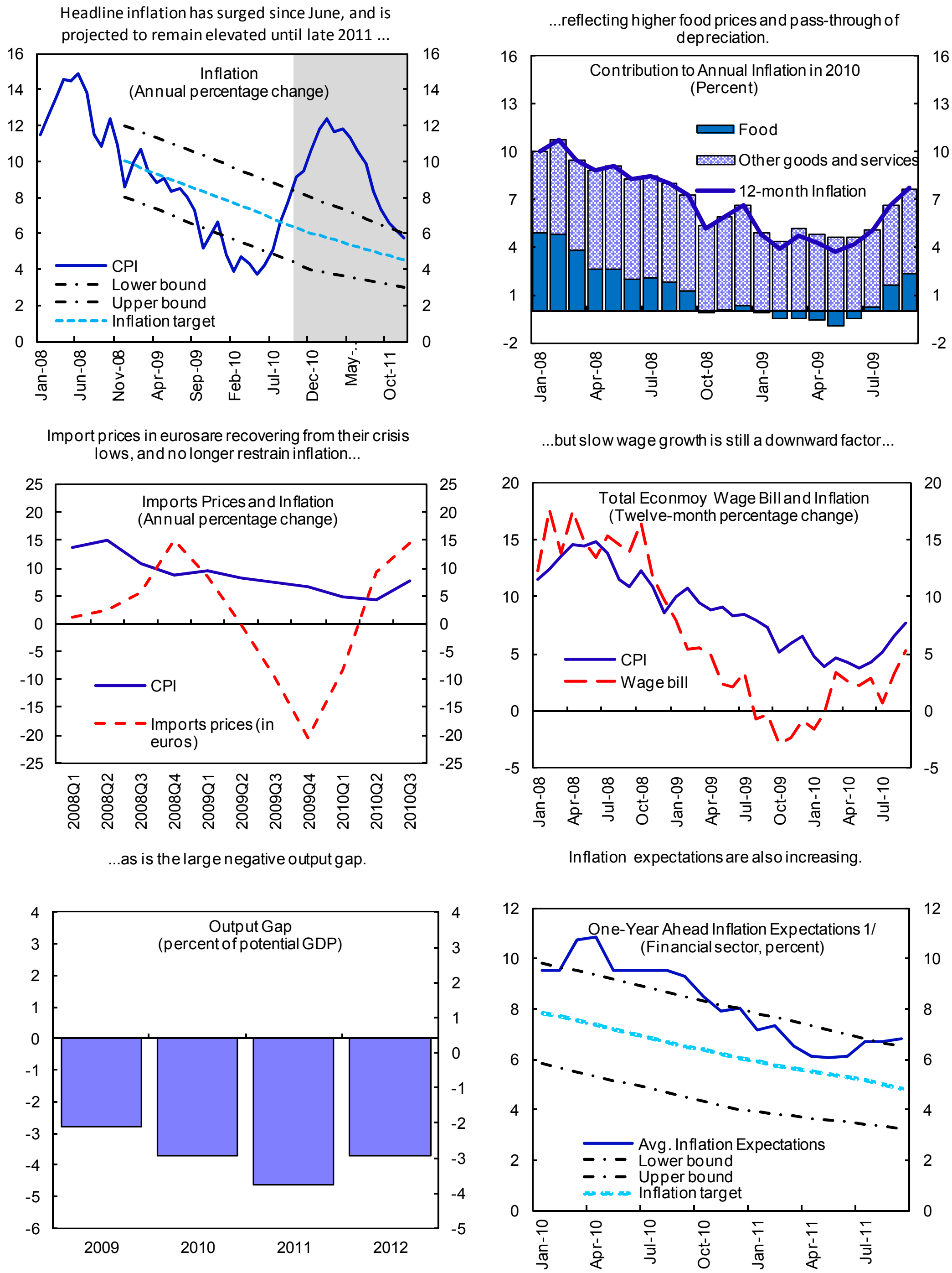


...and budget financing through T-bills has become more difficult.



Sources: National Bank of Serbia; Bloomberg; and WEO.

Figure 3. Serbia: Inflation and Monetary Policy, 2008–11

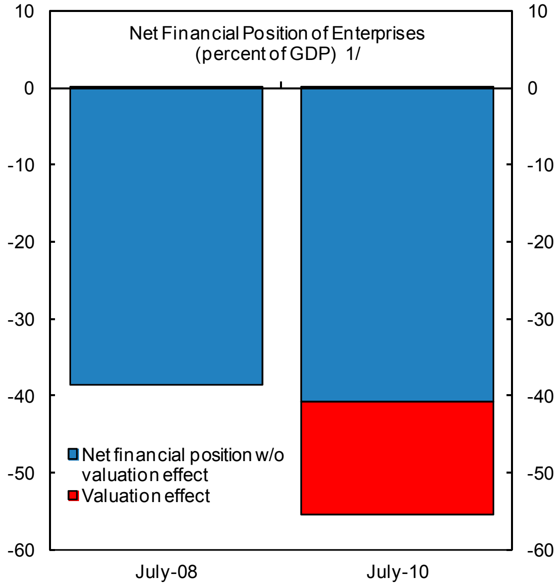


Sources: National Bank of Serbia; Statistical Office of Serbia; and IMF staff estimates and projections.

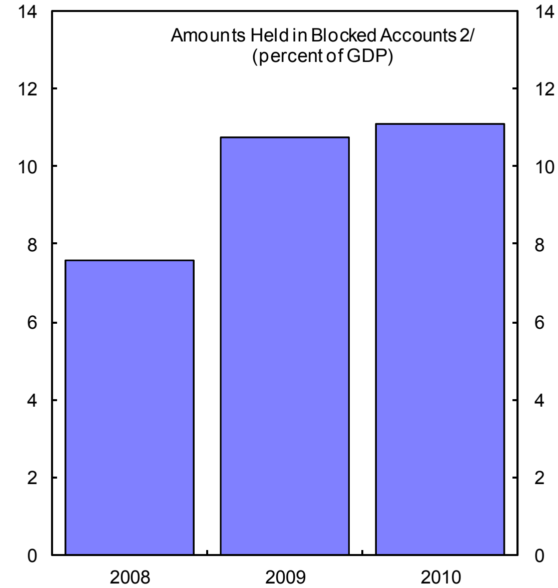
1/ Average of surveys of the financial sector.

Figure 4. Serbia: Corporate Balance Sheet and Banks' Buffers, 2008-10

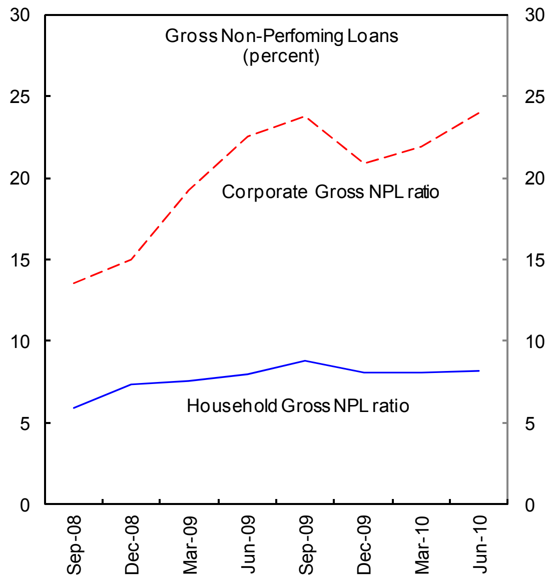
The net financial position of corporates has deteriorated, mostly due to valuation effects.



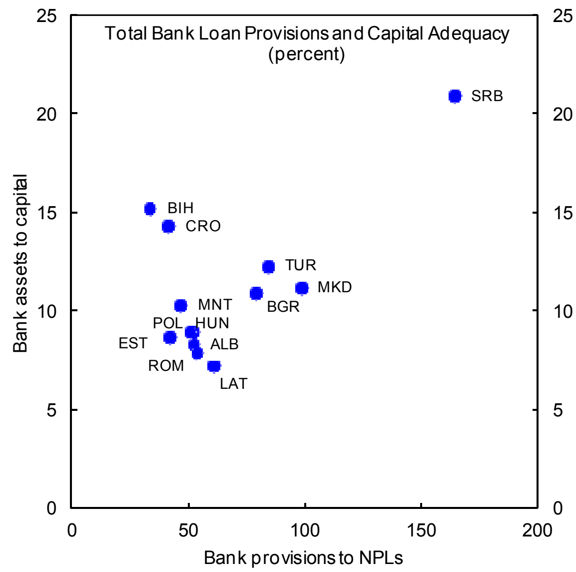
The amounts held in blocked accounts surged in 2009 and are still on the rise



Corporate NPLs are trending up ...



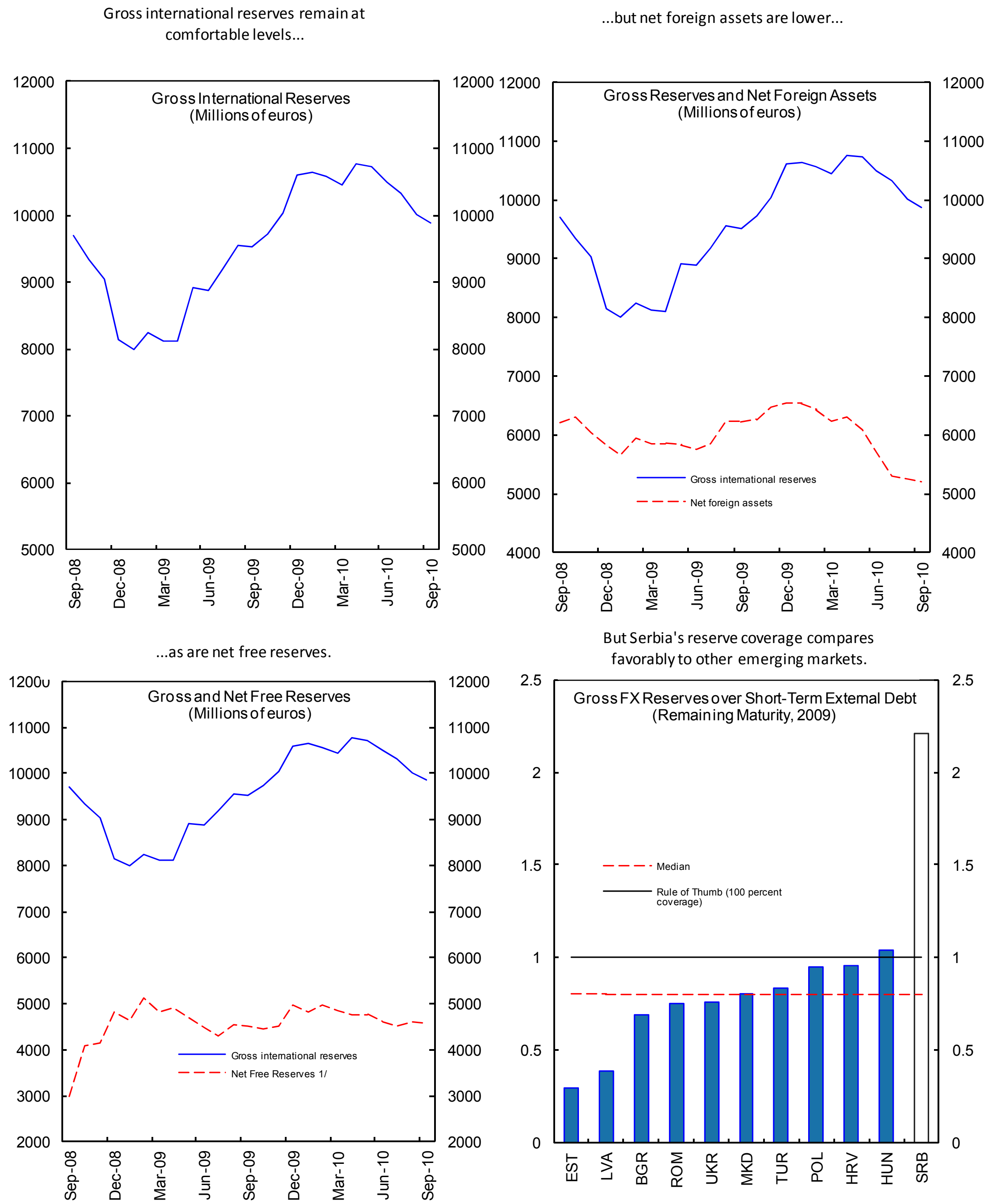
...but Serbia's banking system remains well buffered.



Source: National Bank of Serbia; and GFSR.

1/ Financial assets minus liabilities of enterprises vis-à-vis the banks, including cross-border loans. The valuation effect reflects the impact of the currency depreciation.
2/ Data for 2010 is through August.

Figure 5. Serbia: International FX Reserves, 2008-10



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

1/ Defined as net foreign assets minus the reverse repo stock held by banks with the NBS.

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

	2009								2010							
	March		June		Sept.		Dec.		March		June			Sept.		Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Act	Prog.
Quantitative Performance Criteria																
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.2	4.9	4.9	5.4	4.6	5.0	4.0
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	69	55	109	84	148
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20	0	20	20	18	20	18	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550	550	140	600	170	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Inflation Consultation Bands (in percent)																
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0	4.0	4.2	5.3	7.7	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0	6.0	n.a.	7.3	n.a.	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0	2.0	n.a.	3.3	n.a.	4.0
Indicative Targets																
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354	354	353	548	543	750
Ceiling on gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50	50	32	50	19	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 Sixth Review

Measure	Target Date	Comment
Quantitative performance criteria		
1. Floor on net foreign assets of the NBS	September 2010	Observed
2. Ceiling on consolidated general government overall deficit	September 2010	Observed
3. Ceiling on contracting or guaranteeing by the public sector of new short-term external debt	September 2010	Observed
4. Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt	September 2010	Observed
5. Ceiling on accumulation of government external payment arrears	September 2010	Observed
Indicative targets		
1. Ceiling on current expenditures of the Serbian Republican budget	September 2010	Observed
2. Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development Funds	September 2010	Observed
Inflation consultation clause	September 2010	Not observed[1]
Structural benchmark		
1. Authorities to adopt or submit to parliament amendments to relevant laws and regulations strengthening the debt collections and restructuring framework (LOI ¶23, IMF Country Report No. 10/308).	November 2010	Partially observed[2]

[1] While the inflation number marginally exceeded the upper limit of the inflation consultation clause, it did not exceed the 1 percentage point deviation that would require a Board consultation.

[2] Remaining reforms related to this structural benchmark to be completed by end-February 2011 (TMU ¶22).

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

	2006	2007	2008	2009	2010 Proj.	2011 Proj.
	(Percent change, unless otherwise indicated)					
Real GDP	5.2	6.9	5.5	-3.1	1.5	3.0
Real domestic demand (absorption)	6.2	11.5	6.3	-6.8	-0.2	1.0
Consumer prices (average)	12.7	6.5	12.4	8.1	6.2	9.4
Consumer prices (end of period)	6.6	11.0	8.6	6.6	10.6	5.8
Import prices (dinars, average)	15.3	-2.8	7.7	3.0	16.8	7.8
Nominal gross wage	23.2	22.4	16.9	7.4	4.6	8.3
Real net wage	10.6	19.9	4.9	-0.7	-1.5	-1.0
Average net wage (in euros per month)	359	454	457	414	…	…
Net wage in euro	27.4	26.4	16.9	-9.4	…	…
Registered employment	-3.4	-2.1	-1.7	-4.6	-2.3	0.0
Unemployment rate (in percent)	21.6	18.8	14.7	17.4	…	…
Nominal GDP (in billions of dinars)	1,962	2,302	2,722	2,815	3,034	3,419
	(Percent of GDP)					
General government finances						
Revenue	44.2	43.5	41.9	40.7	40.0	38.7
Expenditure	45.8	45.4	44.5	45.0	44.9	42.8
Current	41.1	40.1	40.0	41.0	40.2	38.3
Capital and net lending	4.6	5.3	4.5	4.0	4.7	4.5
Fiscal balance (cash basis)	-1.6	-1.9	-2.6	-4.3	-4.9	-4.1
Structural fiscal balance 1/	-2.3	-0.4	-2.9	-3.2	-3.2	-2.2
Gross debt	43.0	35.2	33.4	36.8	43.5	40.9
	(End of period 12-month change, percent)					
Monetary sector						
Money (M1)	37.1	25.3	-3.8	8.7	1.9	18.3
Broad money (M2)	38.4	44.5	9.6	21.8	11.1	16.9
Domestic credit to non-government	17.1	36.9	35.0	8.9	16.1	15.5
	(End of period, percent)					
Interest rates (dinar)						
NBS repo rate	14.0	10.0	17.8	9.5	…	…
Deposit rate	5.1	4.1	6.4	5.1	…	…
	(Percent of GDP, unless otherwise indicated)					
Balance of payments						
Current account balance	-10.2	-15.9	-17.6	-6.9	-9.3	-8.6
Exports of goods	22.0	22.2	22.2	20.0	24.6	25.7
Imports of goods	43.3	45.2	45.0	37.1	41.4	40.4
Trade of goods balance	-21.4	-23.1	-22.8	-17.1	-16.7	-14.7
Capital and financial account balance	32.0	18.4	12.7	10.7	3.0	9.4
External debt	63.3	61.8	65.2	76.5	79.6	73.3
of which: Private external debt	36.0	39.5	46.1	52.0	52.6	47.2
Gross official reserves (in billions of euro)	8.7	9.5	8.2	10.6	9.4	9.7
(In months of prospective imports of GNFS)	6.6	6.3	7.7	8.8	7.3	6.9
(Percent of short-term debt)	294.5	268.4	162.3	200.7	178.4	184.1
(in percent of broad money, M2)	112.4	84.5	72.7	74.9	76.5	76.5
Exchange rate (dinar/euro, period average)	84.2	80.0	81.5	93.9	…	…
REER (annual average change, in percent; + indicates appreciation)	7.0	7.4	4.5	-5.0	-8.3	4.4
Social indicators						
Per capita GDP (2009): US$5,821. Population (2009): 7.4 million. Poverty rate (national poverty estimate, 2009): 6.9 percent.						

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

1/ Fiscal balance adjusted for the automatic effects of both the output gap on the fiscal position and for social transfers associated with the financial crisis.

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

	2004	2005	2006	2007	2008	2009	2010 Proj.	2011 Proj.
	(Real growth rate by expenditure category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.5	3.0
Domestic demand (absorption)	13.6	-3.8	6.2	11.5	6.3	-6.8	-0.2	1.0
Non-government	17.4	-4.5	5.0	9.3	8.5	-6.8	-0.1	2.1
Government	-0.6	-0.6	11.1	20.0	-1.8	-7.1	-0.3	-3.8
Consumption	2.0	0.2	6.4	7.0	6.2	-3.5	-0.8	0.3
Non-government	3.3	0.7	6.9	4.0	7.6	-3.0	-0.2	1.3
Government	-2.6	-1.5	4.3	18.2	1.6	-5.0	-2.7	-3.5
Investment	76.0	-16.3	5.5	28.3	6.6	-17.3	2.0	3.3
Gross fixed capital formation	27.8	2.7	14.5	25.6	1.9	1.0	2.0	3.3
Non-government	29.6	2.1	7.3	25.1	6.3	4.8	0.1	4.8
Government	17.2	6.4	58.8	28.0	-16.2	-18.4	14.6	-5.0
Change in inventories 1/	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services 1/	-8.0	10.4	-1.9	-6.3	-2.0	5.2	1.7	1.9
Exports of goods and services	5.7	14.4	4.9	17.2	8.9	-12.4	11.0	12.4
Imports of goods and services	21.0	-13.6	7.8	26.0	9.3	-17.3	3.0	4.0
	(Contribution to real growth by expenditure category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.5	3.0
Domestic demand (absorption)	16.3	-4.8	7.1	13.2	7.6	-8.3	-0.2	1.1
Non-government	16.4	-4.6	4.6	8.6	8.0	-6.5	-0.1	2.0
Government	-0.2	-0.1	2.4	4.6	-0.5	-1.7	-0.1	-0.9
Consumption	2.0	0.2	5.8	6.4	5.6	-3.2	-0.7	0.3
Non-government	2.6	0.5	4.9	2.9	5.3	-2.2	-0.2	0.9
Government	-0.6	-0.3	0.8	3.5	0.3	-1.0	-0.5	-0.7
Investment	14.3	-5.0	1.3	6.9	1.9	-5.1	0.5	0.8
Gross fixed capital formation	4.7	0.5	2.8	5.4	0.5	0.2	0.5	0.8
Non-government	4.3	0.4	1.2	4.3	1.3	1.0	0.0	1.0
Government	0.4	0.2	1.6	1.2	-0.8	-0.7	0.5	-0.2
Change in inventories	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services	-8.0	10.4	-1.9	-6.3	-2.0	5.2	1.7	1.9
Exports of goods and services	1.4	3.6	1.3	4.6	2.6	-3.7	3.0	3.7
Imports of goods and services	9.4	-6.8	3.2	10.9	4.6	-8.9	1.3	1.8
	(Contribution to real GDP growth by production category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.5	3.0
Gross Value Added	7.0	4.3	5.4	5.6	5.2	-2.1	1.2	2.6
Agriculture	2.3	-0.7	0.0	-0.9	0.8	0.1	-0.1	0.2
Industry	1.3	0.2	0.9	0.8	0.3	-2.1	0.7	0.5
Services	4.6	6.1	4.3	7.0	4.4	-1.1	0.9	2.3
Wholesale and retail trade	1.3	1.9	1.0	2.0	0.8	-1.0	-0.1	0.4
Construction	0.1	0.1	0.2	0.3	0.1	-0.5	-0.1	0.1
Transport and communications	1.2	1.9	2.8	2.4	1.7	0.9	0.6	0.5
Financial services	0.2	0.4	0.4	0.5	0.5	0.2	0.0	0.1
Other	0.5	0.5	0.1	0.4	1.0	0.4	0.2	0.8
Taxes minus subsidies	1.5	1.7	0.0	1.5	0.6	-0.9	0.3	0.5
Memorandum items:								
Tradables GDP	4.2	0.1	0.9	0.4	1.3	-2.4	0.7	0.8
Non-tradables GDP	4.1	5.5	4.3	6.5	4.2	-0.8	0.8	2.2

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

1/ Contributions to GDP growth.

Table 5. Serbia: Balance of Payments, 2008–15 1/

	2008	2009	2010		2011	2012	2013	2014	2015
		Est.	Fifth Review	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of euros)								
Current account balance	-6.1	-2.1	-2.7	-2.7	-2.8	-2.4	-2.3	-2.5	-2.6
Trade of goods balance	-7.6	-5.1	-4.9	-4.9	-4.7	-4.2	-4.5	-4.8	-4.9
Exports of goods	7.4	6.0	6.7	7.2	8.2	9.9	11.3	12.7	14.2
Imports of goods	-15.0	-11.1	-11.7	-12.1	-12.9	-14.2	-15.8	-17.5	-19.0
Services balance	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-0.9	-0.5	-0.8	-0.8	-1.0	-1.2	-1.1	-1.1	-1.2
Current transfer balance	2.6	3.5	3.0	3.0	2.9	3.0	3.3	3.4	3.4
Capital and financial account balance	4.2	3.2	1.4	0.9	3.0	3.6	4.0	4.0	3.7
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.8	1.4	1.0	1.0	2.8	1.4	1.6	1.7	1.9
Portfolio investment balance	-0.1	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other investment balance	2.5	1.9	0.4	-0.2	0.2	2.2	2.4	2.3	1.8
General governement	0.1	0.7	0.3	-0.1	0.4	0.3	0.3	0.3	0.4
Domestic banks	0.5	1.6	0.4	0.2	0.1	0.4	0.2	0.4	0.2
Other private sector	2.0	-0.4	-0.4	-0.3	-0.3	1.5	1.8	1.6	1.2
Errors and omissions	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.7	1.2	-1.3	-1.9	0.2	1.2	1.7	1.5	1.0
Financing	1.7	-1.2	1.3	1.9	-0.2	-1.2	-1.7	-1.5	-1.0
Gross international reserves (increase, -)	1.7	-2.4	0.7	1.2	-0.3	-1.0	-1.0	-1.0	-1.0
Prospective drawings	…	1.1	0.7	0.6	0.1	0.0	0.0	0.0	0.0
EU	…	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
World Bank	…	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0
IMF	…	1.1	0.4	0.3	0.1	0.0	0.0	0.0	0.0
Prospective repayments (IMF)	…	…	…	…	…	-0.2	-0.7	-0.5	0.0
	(Percent of GDP)								
Current account balance	-18.3	-6.9	-9.0	-9.3	-8.6	-7.0	-6.0	-5.9	-5.7
Trade of goods balance	-22.8	-17.1	-16.2	-16.7	-14.7	-12.2	-11.7	-11.3	-10.7
Exports of goods	22.2	20.0	22.2	24.6	25.7	28.5	29.4	30.1	30.9
Imports of goods	-45.0	-37.1	-38.4	-41.4	-40.4	-40.7	-41.1	-41.4	-41.5
Services balance	-0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-2.8	-1.7	-2.6	-2.7	-3.1	-3.3	-2.8	-2.6	-2.6
Current transfer balance	7.8	11.8	9.7	10.1	9.2	8.5	8.5	8.0	7.5
Capital and financial account balance	12.7	10.7	4.8	3.0	9.4	10.4	10.3	9.5	8.0
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	5.4	4.6	3.3	3.4	8.8	4.1	4.1	4.1	4.1
Portfolio investment balance	-0.3	-0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Other investment balance	7.5	6.4	1.3	-0.6	0.6	6.3	6.2	5.4	3.9
Errors and omissions	0.6	0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.1	4.1	-4.4	-6.3	0.8	3.5	4.4	3.6	2.2
	(Percent, unless otherwise indicated)								
Memorandum items:									
Export volume growth	8.9	-12.4	5.7	11.0	12.4	14.2	13.0	11.9	10.6
Import volume growth	9.3	-17.3	-2.3	3.0	4.0	8.7	9.6	9.5	8.2
Trading partner import growth	5.9	-17.8	3.5	3.5	5.1	5.5	5.5	5.2	5.2
Export prices growth	6.7	-8.0	6.8	8.9	0.9	6.2	0.5	0.8	0.5
Import prices growth	5.7	-10.9	7.6	6.3	2.1	1.2	1.5	1.3	0.6
Change in terms of trade	1.0	3.2	-0.7	2.5	-1.2	5.0	-1.0	-0.5	-0.1
GDP (billiions of euros)	33.4	29.9	30.3	29.3	31.9	34.9	38.4	42.2	45.9

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.

Table 6. Serbia: External Financing Requirements and Sources, 2008–15

(Billions of euros, unless otherwise indicated)

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
1. Gross financing requirements	9.75	8.68	6.12	8.23	8.87	10.10	10.85	11.58
Current account deficit	6.13	2.06	2.74	2.76	2.43	2.29	2.51	2.63
Debt amortization	3.62	4.25	4.59	5.17	5.23	6.13	6.85	7.93
Medium- and long-term debt	2.67	2.65	2.98	3.57	3.62	4.52	5.24	6.32
Public sector 1/	0.12	0.14	0.25	0.29	0.30	0.36	0.37	0.37
Commercial banks	0.54	0.12	0.21	0.35	0.37	0.67	0.69	1.01
Corporate sector	2.01	2.39	2.52	2.93	2.95	3.49	4.17	4.94
Short-term debt 2/	0.94	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44
Accumulation of gross reserves	0.00	2.36	-1.21	0.30	1.00	1.00	1.00	1.00
Repayment of prospective IMF credits	...	...	...	...	0.21	0.68	0.50	0.02
2. Available financing	9.75	7.52	5.47	8.18	8.87	10.10	10.85	11.58
Capital transfers	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Foreign direct investment (net)	1.81	1.37	1.00	2.80	1.43	1.57	1.73	1.88
Portfolio investment (net)	-0.09	-0.06	0.06	0.00	0.00	0.00	0.00	0.00
Debt financing	5.53	4.75	4.41	5.17	7.44	8.52	9.12	9.70
Medium- and long-term debt	4.86	3.14	2.80	3.56	5.83	6.91	7.51	8.09
Public sector 1/	0.18	0.39	0.20	0.65	0.61	0.68	0.68	0.75
Commercial banks	0.23	0.90	0.40	0.24	0.74	0.90	1.10	1.20
Corporate sector	4.46	1.85	2.20	2.67	4.48	5.33	5.73	6.14
Short-term debt 2/	0.67	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44
3. Financing gap	0.00	1.16	0.65	0.06	0.00	0.00	0.00	0.00
European Union (prospective)	…	0.00	0.10	0.00	0.00	0.00	0.00	0.00
World Bank (prospective)	…	0.04	0.20	0.00	0.00	0.00	0.00	0.00
IMF	…	1.12	0.35	0.06	…	…	…	…
Memorandum items:								
Debt service	4.35	4.89	5.65	6.22	6.20	7.18	7.96	9.11
Interest	0.73	0.63	1.06	1.04	0.97	1.06	1.12	1.18
Amortization	3.62	4.25	4.59	5.17	5.23	6.13	6.85	7.93

Sources: NBS; and Fund staff estimates and projections.

1/ Excluding IMF.

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

Table 7. Serbia: External Balance Sheet, 2008-15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Bllions of euros)				
International investment position 2/	-23.3	-23.5	-26.0	-28.7	-31.2	-33.4	-35.9	-38.6
Public sector 3/	1.8	3.0	1.5	1.4	2.3	3.7	4.9	5.5
Private sector 3/	-25.1	-26.5	-27.5	-30.1	-33.4	-37.1	-40.8	-44.1
FDI and portfolio investment (net) 4/	-12.2	-13.2	-14.3	-17.1	-18.5	-20.1	-21.8	-23.7
External debt (net) 4/	-21.8	-23.2	-23.7	-23.8	-25.8	-27.5	-29.3	-31.0
Gross external debt	-21.8	-22.8	-23.4	-23.4	-25.4	-27.1	-28.9	-30.6
General government	-6.4	-6.1	-6.1	-6.4	-6.7	-7.1	-7.4	-7.7
Private sector	-15.4	-15.6	-15.4	-15.1	-17.0	-19.0	-21.0	-22.4
Banks	-3.9	-4.7	-4.9	-4.8	-5.1	-5.4	-5.8	-6.0
Other private sector	-11.5	-10.9	-10.5	-10.3	-11.8	-13.7	-15.2	-16.4
Liabilities from drawings under the SBA		-1.1	-1.5	-1.5	-1.3	-0.6	-0.1	-0.1
Gross external assets (SDR holdings in excess of allocations)		-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other, net (inc. commercial banks foreign assets)	2.6	2.3	2.3	2.0	2.0	2.0	2.0	2.0
Central bank gross international reserves	8.2	10.6	9.4	9.7	10.7	11.7	12.7	13.7
				(Percent of GDP)				
International investment position 2/	-69.7	-78.6	-88.5	-90.0	-89.3	-87.2	-85.1	-84.1
Public sector 3/	5.3	10.1	5.2	4.4	6.6	9.5	11.5	12.0
Private sector 3/	-75.0	-88.7	-93.6	-94.3	-95.9	-96.7	-96.6	-96.1
FDI and portfolio investment (net) 4/	-36.6	-44.3	-48.7	-53.6	-53.1	-52.4	-51.7	-51.7
External debt (net) 4/	-65.2	-77.5	-80.9	-74.5	-73.9	-71.7	-69.3	-67.6
Gross external debt	-65.2	-76.2	-79.6	-73.3	-72.8	-70.7	-68.4	-66.8
General government	-19.1	-20.5	-20.7	-20.1	-19.3	-18.4	-17.4	-16.9
Private sector	-46.1	-52.0	-52.6	-47.2	-48.6	-49.6	-49.7	-48.8
Banks	-11.7	-15.7	-16.6	-14.9	-14.7	-14.0	-13.7	-13.0
Other private sector	-34.4	-36.3	-35.9	-32.2	-33.9	-35.6	-36.1	-35.8
Liabilities from drawings under the SBA		-3.8	-5.0	-4.8	-3.8	-1.7	-0.3	-0.2
Gross external assets	0.0	-1.3	-1.3	-1.2	-1.1	-1.0	-0.9	-0.8
Other, net (inc. commercial banks reserves)	7.7	7.5	7.7	6.4	5.9	5.3	4.8	4.5
Central bank gross international reserves	24.4	35.6	32.2	30.5	30.8	30.6	30.2	29.9
Memorandum items:								
				(Billions of euros, unless otherwise indicated)				
Central bank international reserves								
Gross reserves (months of next year's imports)	7.7	8.8	7.3	6.9	6.9	6.8	6.7	6.6
Free net reserves (months of next year's imports)	4.5	4.1	4.1	2.7	3.1	3.3	3.6	3.8
Short term external debt by original maturity due	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
(in percent of central bank gross reserves)	19.7	15.1	17.1	16.5	15.0	13.7	12.6	11.7
(in percent of central bank free net reserves)	33.4	32.4	30.3	42.4	33.5	27.8	23.7	20.6
(percent of total debt)	7.4	7.1	6.9	6.9	6.3	5.9	5.6	5.3
(percent of GDP)	4.8	5.4	5.5	5.0	4.6	4.2	3.8	3.5
Short term external debt by remaining maturity	5.0	5.3	5.3	5.3	5.3	5.3	5.3	5.3
(percent of central bank gross reserves)	61.6	49.8	56.1	54.3	49.3	45.1	41.5	38.5
(percent of central bank free net reserves)	104.5	106.7	99.6	139.3	110.3	91.2	77.8	67.8
(percent of total debt)	23.1	23.3	22.7	22.6	20.8	19.5	18.3	17.3
(percent of GDP)	15.0	17.7	18.0	16.6	15.2	13.8	12.5	11.5
GDP	33.4	29.9	29.3	31.9	34.9	38.4	42.2	45.9

Sources: NBS; and IMF staff estimates and projections.

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

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

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

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

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

	2005	2006	2007	2008	2009	2010 Mar	2010 Jun	2010 Sep
Capital Adequacy								
Regulatory capital to risk-weighted assets	26.0	24.7	27.9	21.9	21.3	21.5	20.7	20.1
Capital to assets	16.2	18.5	21.0	23.6	21.0	21.0	20.4	20.2
Asset Quality								
Gross non performing loans to total loans	...	...	...	11.3	15.5	16.5	17.5	17.8
Specific provisions to gross non-performing loans	...	...	...	56.9	49.5	49.3	46.8	46.5
Total provisions to gross non-performing loans 1/	...	...	...	188.0	168.0	163.0	149.0	144.0
Non performing loans net of provisions to tier I capital	...	...	...	14.8	25.5	27.0	32.0	34.2
Loans to shareholders and parent companies to total loans	...	...	2.1	2.2	...	...	...	...
Large exposures to tier I capital	82.5	49.6	46.1	36.6	...	...	36.8	43.6
Specific provisions to gross loans	10.3	11.0	8.4	7.1	9.2	9.8	9.7	9.7
Profitability								
Return on assets (ROA)	1.1	1.7	1.7	2.1	1.3	1.3	1.4	1.2
Return on equity (ROE)	6.5	9.7	8.5	9.3	5.7	6.1	6.6	5.9
Net interest margin to gross operating income 2/	…	…	…	…	62.6	65.4	63.5	64.9
Non-interest expenses to gross operating income 3/	…	…	…	…	84.5	82.4	81.6	83.2
Non-interest expenses to average assets	…	…	…	…	6.9	5.9	6.0	6.0
Personnel expenses to non-interest expenses	…	…	…	…	28.7	30.0	29.2	29.4
Liquidity and Foreign Exchange Risk								
Core liquid assets to total assets 4/	30.5	40.7	37.3	30.3	31.9	30.0	26.0	23.5
Core liquid assets to short-term liabilities	47.1	69.0	58.9	48.0	49.0	48.4	41.6	37.6
Liquid assets to total assets 5/	19.8	22.9	46.7	43.3	40.7	40.3	36.5	36.4
Liquid assets to short term liabilities	30.6	38.8	73.7	68.6	62.6	65.1	58.3	58.1
FX-denominated loans and FX-indexed loans to total loans	...	...	...	78.0	84.1	84.3	82.4	80.2
FX- deposits to total deposits	70.7	65.9	64.2	69.0	75.5	76.7	77.1	77.0
FX- liabilities to total liabilities	74.7	72.4	67.8	72.1	75.9	78.1	78.2	77.9
Deposits to assets	62.5	57.0	61.4	57.7	60.0	57.3	56.8	57.5
Loans to deposits	94.9	86.7	89.3	104.3	92.5	100.2	106.0	108.1
FX- loans to FX-deposits (including indexed)	…	…	…	113.3	103.1	110.0	113.4	112.7
Sensitivity to Market Risk								
Net open FX position (overall) as percent of tier I capital	18.6	21.7	14.5	7.4	3.2	2.9	4.2	3.4
Off-balance sheet operations as percent of assets 6/	26.4	41.0	49.2	56.2	45.9	40.9	37.3	34.7

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

Table 9. Serbia: Medium-Term Program Scenario, 2008–15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
GDP and prices (percent change)								
GDP (real)	5.5	-3.1	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand growth (real)	6.3	-6.8	-0.2	1.0	3.8	4.8	5.0	4.4
Consumer price inflation (end of period)	8.6	6.6	10.6	5.8	4.0	4.0	4.0	4.0
Savings and investment (percent of GDP)								
Savings - investment balance	-17.6	-6.9	-9.3	-8.6	-7.0	-6.0	-6.0	-5.8
Non-government	-15.6	-3.1	-5.3	-5.5	-4.7	-4.6	-5.2	-5.5
Government	-2.0	-3.8	-4.1	-3.1	-2.3	-1.4	-0.7	-0.3
General government (percent of GDP)								
Overall fiscal balance	-2.6	-4.3	-4.9	-4.1	-2.8	-1.7	-0.8	-0.5
Revenue	41.9	40.7	40.0	38.7	38.3	38.3	38.4	38.5
Expenditure	44.5	45.0	44.9	42.8	41.1	39.9	39.2	39.0
Current	40.0	41.0	40.2	38.3	37.0	35.8	34.6	33.7
of which: Wages and salaries	10.8	10.7	10.2	9.5	9.2	8.7	8.3	7.9
of which: Pensions	12.2	13.8	13.0	12.2	11.9	11.6	11.3	11.0
of which: Goods and services	7.6	7.5	7.4	7.2	6.9	6.9	6.9	7.0
Capital and net lending	4.5	4.0	4.7	4.5	4.1	4.1	4.6	5.3
Structural fiscal balance	-2.9	-3.2	-3.2	-2.2	-1.3	-0.7	-0.5	-0.5
Output gap	0.7	-2.8	-3.7	-4.6	-3.7	-2.3	-0.9	0.0
Gross debt	33.4	36.8	43.5	40.9	39.9	38.0	35.5	33.2
Balance of payments (percent of GDP)								
Current account	-17.6	-6.9	-9.3	-8.6	-7.0	-6.0	-6.0	-5.8
of which: Trade balance	-22.8	-17.1	-16.7	-14.7	-12.2	-11.7	-11.3	-10.7
of which: Current transfers, net (excl. grants)	7.8	11.0	10.1	9.2	8.5	8.5	8.0	7.5
Capital and financial account	12.7	10.7	2.9	9.3	10.5	10.4	9.5	8.0
of which: Foreign direct investment	5.4	4.6	3.4	8.8	4.1	4.1	4.1	4.1
External debt (end of period)	65.2	76.5	79.5	73.1	72.7	70.6	68.4	66.8
of which: Private external debt	46.1	52.0	52.4	49.3	50.6	51.5	51.5	50.5
Gross official reserves (billions of euros)	8.2	10.6	9.4	9.7	10.7	11.7	12.7	13.7
REER (ann. av. change; + = appreciation)	4.5	-5.0	-8.3	4.4	2.1	2.2	2.2	1.2

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

Table 10. Serbia: Savings-Investment Balances, 2004–15
(Percent of GDP)

	2004	2005	2006	2007	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Domestic demand	126.6	121.0	121.6	123.9	123.4	117.0	116.7	114.7	112.2	111.7	111.3	110.7
Consumption	96.8	97.2	97.4	95.7	94.7	92.4	91.8	89.5	87.4	85.6	83.9	82.4
Non-government	77.1	78.5	78.5	75.4	75.1	72.9	72.9	71.6	70.2	68.9	67.7	66.6
Government	19.8	18.8	18.9	20.3	19.6	19.5	18.9	17.8	17.2	16.7	16.3	15.8
Gross domestic savings	3.2	2.8	2.6	4.3	5.3	7.6	8.2	10.5	12.6	14.4	16.1	17.6
Non-government	0.1	-1.3	-0.6	0.9	3.0	7.8	8.1	9.6	10.6	11.2	11.6	12.1
Government	3.1	4.1	3.2	3.4	2.3	-0.2	0.1	1.0	2.1	3.2	4.5	5.5
Net factor receipts and transfers	14.4	12.3	11.4	7.9	5.8	10.1	7.4	6.1	5.1	5.7	5.3	4.9
Non-government	15.2	13.1	12.1	8.4	6.2	10.4	7.9	6.7	6.0	6.5	6.0	5.6
Government	-0.8	-0.8	-0.8	-0.5	-0.5	-0.3	-0.5	-0.6	-0.8	-0.8	-0.7	-0.6
Gross national savings	17.6	15.0	13.9	12.2	11.0	17.7	15.6	16.6	17.8	20.1	21.4	22.5
Non-government	15.3	11.8	11.5	9.3	9.2	18.2	16.0	16.3	16.5	17.6	17.6	17.7
Government	2.3	3.3	2.4	2.9	1.8	-0.5	-0.4	0.3	1.2	2.4	3.8	4.8
Gross domestic investment	29.7	23.7	24.1	28.2	28.6	24.6	25.0	25.3	24.8	26.1	27.4	28.3
Non-government	27.1	21.1	20.0	23.5	24.8	21.4	21.3	21.8	21.3	22.2	22.9	23.1
Gross fixed capital formation	16.6	16.3	16.9	19.2	19.4	21.3	21.2	21.8	21.2	22.2	22.8	23.0
Change in inventories	10.5	4.7	3.1	4.2	5.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Government	2.6	2.7	4.1	4.8	3.8	3.2	3.7	3.4	3.5	3.8	4.5	5.2
Overall savings-investment balance	-12.1	-8.7	-10.2	-16.0	-17.6	-6.9	-9.3	-8.6	-7.0	-6.0	-6.0	-5.8
Non-government	-11.8	-9.3	-8.5	-14.2	-15.6	-3.1	-5.3	-5.5	-4.7	-4.6	-5.2	-5.5
Government	-0.3	0.6	-1.7	-1.9	-2.0	-3.8	-4.1	-3.1	-2.3	-1.4	-0.7	-0.3
Foreign savings	12.1	8.7	10.2	16.0	17.6	6.9	9.3	8.6	7.1	6.0	6.0	5.8
Memorandum items:												
Net exports of goods and services 1/	-26.6	-21.0	-21.6	-23.9	-23.4	-17.0	-16.7	-14.7	-12.2	-11.7	-11.3	-10.7
Current account balance	-12.1	-8.7	-10.2	-15.9	-17.6	-6.9	-9.3	-8.6	-7.0	-6.0	-6.0	-5.8
General government fiscal balance	0.0	0.8	-1.6	-1.9	-2.6	-4.3	-4.9	-4.1	-2.8	-1.7	-0.8	-0.5

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

1/ Equal to GDP minus domestic demand.

Table 11a. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Billions of RSD)

	2009	2010 Budget	2010 Fifth Review	2010 Prog.	2011 Baseline	2011 Prog.	2012 Proj.
Revenue	1,147	1,208	1,203	1,214	1,313	1,323	1,442
Taxes	1,000	1,061	1,044	1,052	1,148	1,154	1,256
Personal income tax	133	142	137	137	150	150	163
Social security contributions	319	336	321	322	347	347	377
Taxes on profits	31	24	32	32	37.4	37.4	47
Value-added taxes	297	325	325	321	355	357	385
Excises	135	148	142	150	172	174	189
Taxes on international trade	48	44	42	43	40	40	41
Other taxes	37	43	46	47	47	49	54
Non-tax revenue	138	145	152	156	162	167	184
Capital revenue	1	0	0	0	0	0	0
Grants	7	2	6	6	1	2	2
Expenditure	1,268	1,344	1,350	1,362	1,515	1,463	1,547
Current expenditure	1,154	1,206	1,213	1,220	1,354	1,310	1,394
Wages and salaries	302	313	310	310	335	323	345
Goods and services	211	213	216	226	256	248	261
Interest	22	39	37	34	51	51	54
Subsidies	63	69	73	74	82	78	80
Transfers	556	572	578	576	631	610	654
Pensions	387	396	398	394	435	416	450
Other transfers 2/	168	176	180	182	196	194	204
Capital expenditure	93	111	103	112	124	117	134
Net lending	20	26	28	30	37	36	19
Unidentified measures					62	0	0
Fiscal balance (cash basis)	-121	-136	-148	-148	-140	-140	-105
Financing	121	...	148	148	140	140	105
Privatization proceeds	59	...	4	4	150	150	0
Equity investment	0	…	0	0	-4	-4	0
Domestic	22	...	113	118	-89	-41	93
Banks	-60	...	104	105	-46	-30	92
Central bank	-60	...	15	40	-50	-50	0
Commerical banks	0	...	89	65	4	20	92
Securities	109	...	43	50	0	32	40
Amortization	27	...	34	38	43	43	38
External	40	...	31	25	83	35	11
Program	42	...	45	34	50	52	25
Project	11	...	17	17	20	20	22
Bonds	0	...	0	0	50	0	0
Amortization	13	...	31	26	37	37	36
Memorandum items:							
Augmented fiscal balance 3/	-142.5	…	-156	-149	-145	-145	-105
Nominal GDP (billions of dinars)	2,815	3,230	3,099	3,034	3,419	3,419	3,765

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

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

Table 11b. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Percent of GDP)

	2009	2010 Budget	2010 Fifth Review	2010 Prog.	2011 Baseline	2011 Prog.	2012 Proj.
Revenue	40.7	37.4	38.8	40.0	38.4	38.7	38.3
Taxes	35.5	32.8	33.7	34.7	33.6	33.8	33.4
Personal income tax	4.7	4.4	4.4	4.5	4.4	4.4	4.3
Social security contributions	11.3	10.4	10.3	10.6	10.2	10.2	10.0
Taxes on profits	1.1	0.7	1.0	1.0	1.1	1.1	1.3
Value-added taxes	10.5	10.1	10.5	10.6	10.4	10.4	10.2
Excises	4.8	4.6	4.6	4.9	5.0	5.1	5.0
Taxes on international trade	1.7	1.4	1.4	1.4	1.2	1.2	1.1
Other taxes	1.3	1.3	1.5	1.6	1.4	1.4	1.4
Non-tax revenue	4.9	4.5	4.9	5.2	4.8	4.9	4.9
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.1	0.2	0.2	0.0	0.0	0.0
Expenditure	45.0	41.6	43.6	44.9	44.3	42.8	41.1
Current expenditure	41.0	37.3	39.2	40.2	39.6	38.3	37.0
Wages and salaries	10.7	9.7	10.0	10.2	9.8	9.5	9.2
Goods and services	7.5	6.6	7.0	7.4	7.5	7.2	6.9
Interest	0.8	1.2	1.2	1.1	1.5	1.5	1.4
Subsidies	2.2	2.1	2.3	2.4	2.4	2.3	2.1
Transfers	19.7	17.7	18.6	19.0	18.4	17.9	17.4
Pensions	13.8	12.3	12.8	13.0	12.7	12.2	11.9
Other transfers 2/	6.0	5.4	5.8	6.0	5.7	5.7	5.4
Capital expenditure	3.3	3.4	3.3	3.7	3.6	3.4	3.5
Net lending	0.7	0.8	0.9	1.0	1.1	1.0	0.5
Unidentified measures					1.8	0	0
Fiscal balance (cash basis)	-4.3	-4.2	-4.8	-4.9	-4.1	-4.1	-2.8
Financing	4.3	…	4.8	4.9	4.1	4.1	2.8
Privatization proceeds	2.1	…	0.1	0.1	4.4	4.4	0.0
Equity investment	0.0	…	0.0	0.0	-0.1	-0.1	0.0
Domestic	0.8	…	3.6	3.9	-2.6	-1.2	2.5
Banks	-2.1	…	3.4	3.5	-1.3	-0.9	2.4
Central bank	-2.1	…	0.5	1.3	-1.5	-1.5	0.0
Commerical banks	0.0	…	2.9	2.1	0.1	0.6	2.4
Securities	3.9	…	1.4	1.6	0.0	0.9	1.1
Amortization	1.0	…	1.1	1.2	1.3	1.3	1.0
External	1.4	…	1.0	0.8	2.4	1.0	0.3
Program	1.5	…	1.4	1.1	1.5	1.5	0.7
Project	0.4	…	0.5	0.6	0.6	0.6	0.6
Bonds	0.0		0.0	0.0	1.5	0.0	0.0
Amortization	0.5	…	1.0	0.8	1.1	1.1	0.9
Memorandum items:							
Structural fiscal balance 3/	-3.2	…	-3.6	-3.2	-2.2	-2.2	-1.3
Output gap 4/	-2.8	…	-2.5	-3.7	-4.6	-4.6	-3.7
Augmented fiscal balance 5/	-5.1	…	-5.0	-4.9	-4.2	-4.2	-2.8
Gross debt	36.8	…	40.5	43.5	40.9	40.9	39.9
Nominal GDP (billions of dinars)	2,815	3,230	3,099	3,034	3,419	3,419	3,765

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

1/ Includes the republican budget, local governments, social security funds, and the Road fund.
2/ Excluding foreign currency deposit payments to households, reclassified below the line.
3/ Fiscal balance adjusted for the automatic effects of the output gap on the fiscal position and for social transfers associated with the financial crisis.
4/ Percentage deviation of actual from potential GDP.
5/ Including clearance of arrears of the Road Company and of farmer pension arrears.

Table 11c. Serbia: Intergovernmental Fiscal Operations, 2011 Program

	Gen. Gov.	Republican budget	Own budgets	Local gov. and V.	Road company	Social security funds	Pension Fund	Health Fund	Labor Fund	Netting operations
Total revenue	1323	724	48	162	36	411	255	140	17	-58
Current revenue	1322	724	47	162	36	411	255	140	17	-58
Tax revenue	1154	676	0	113	18	406	252	137	17	-58
Personal income tax	150	81		69						
Social security contributions	347			0		406	252	137	17	-58
Corporate income tax	37	35		3						
VAT	357	357	0							
Excises	174	156			18					
Taxes on international trade	40	40								
Other taxes	49	8	0	41						
Extrabudgetary taxes	0						0	0	0	
Nontax revenue	167	47	47	49	18	6	3	2	0	
Capital revenue	0	0	0	0	0	0	0	0	0	
Grants	2	0	1	1	0	0	0			
Total expenditure and net lending	1463	531	48	242	38	663	443	194	26	-58
Current expenditure	1310	464	35	184	24	661	443	194	25	-58
Expenditure on goods and services	571	252	32	129	22	195	7	185	3	-58
Wages and salaries	323	162	7	62	1	92	3	87	2	
Employer contribution	0	30	1	11	0	16	1	15	0	-58
Social funds	0			0		0	0	0	0	
Local tax	0			0		0	0	0	0	
Goods and services	248	60	24	57	21	87	3	83	1	
Interest payment	51	47	0	2	2	1	0	1	0	
Subsidies and other current transfers	688	165	4	53		466	436	8	22	
Subsidies	519	48	4	26		442	416	7	18	
Transfers to households	169	117	0	27		25	20	1	4	
Other current expenditure	0					0	0	0	0	
Capital expenditure	117	33	13	56	14	1	0	1	0	
Own resource	97	27	13	49	7	1	0	1	0	
Foreign financed	20	6		7	7					
Net lending	36	34	0	1		0	0	0	0	
Fiscal balance (before transfers)	-140	192	0	-79	-1	-252	-189	-54	-9	0
Transfers from other levels of government	384	0	0	67	0	317	241	57	20	0
Republican budget	319			67	0	252	231	1	20	
Local governments and Vojvodina	0	0	0	0	0	0				
Social security funds	66					66				
Pension Fund	52					52		52		
Health Fund	2					2	2	0		
Labor Fund	11					11	8	4		
Road fund	0	0				0		0		
Transfers to other levels of government	384	319	0	0	0	66	52	2	11	0
Federal budget	0					0				
Republican budget	0					0		0		
Local governments and Vojvodina	67	67				0				
Social security funds	317	252	0	0	0	66				
Pension Fund	241	231				10		2	8	
Health Fund	57	1				56	52	0	4	
Labor Fund	20	20				0				
Road fund	0					0	0		0	
Net transfer to other levels of government	0	-319	0	67	0	252	189	54	9	0
Fiscal balance	-140	-126	0	-12	-1	0	0	0	0	0

Sources: Ministry of Finance; and IMF staff estimates.

Tabie 12. Serbia: Monetary Survey, 2007–11

(Billions of dinars, unless otherwise indicated; end of period) 1/

	2007	2008	2009	2010 Q1	2010 Q2	2010 Q3	2010 Q4 Proj.	2011 Proj.
Net foreign assets 2/	563	484	571	559	563	550	558	602
in billions of euro	7.1	5.5	5.9	5.6	5.4	5.2	5.3	5.6
Foreign assets	877	847	1,185	1,224	1,268	1,257	1,265	1,316
NBS	766	725	1,023	1,049	1,104	1,056	1,066	1,118
Commercial banks	111	123	163	174	164	201	199	198
Foreign liabilities (-)	-314	-364	-615	-664	-705	-708	-706	-715
NBS	-14	-14	-115	-124	-164	-163	-168	-178
Commercial banks	-300	-350	-500	-540	-540	-544	-538	-536
Net domestic assets	320	484	608	632	708	733	749	886
Domestic credit	701	1,048	1,276	1,368	1,541	1,603	1,739	1,981
Government, net	-112	-53	-4	4	42	43	126	76
NBS	-100	-50	-101	-106	-100	-96	-61	-111
Banks	-12	-4	97	110	143	140	187	187
Local governments, net	-14	-16	-14	-14	-11	-8	-17	-15
Non-government sector	827	1,117	1,295	1,378	1,510	1,568	1,630	1,920
Households	306	382	419	443	491	515	537	640
Enterprises	508	711	851	904	984	1,018	1,054	1,235
Other	13	23	25	30	35	35	39	45
Other assets	78	56	111	7	48	16	16	19
Capital and reserves (-)	-356	-505	-633	-586	-710	-709	-824	-881
NBS	-7	-63	-166	-107	-210	-200	-276	-261
Banks	-350	-442	-467	-479	-500	-509	-548	-621
Provisions (-)	-104	-115	-146	-157	-170	-177	-182	-232
Broad money (M2)	883	968	1,179	1,192	1,272	1,283	1,307	1,488
Dinar-denominated M2	370	371	412	378	394	380	420	494
M1	239	230	250	218	227	237	250	293
Currency in circulation	77	90	96	86	88	90	99	111
Demand deposits	162	140	154	132	139	147	151	182
Time and saving deposits	131	141	162	160	167	143	170	201
Foreign currency deposits	513	597	767	814	878	903	887	994
in billions of euro	6.5	6.7	7.8	8.2	9.0	9.1	8.4	9.2
Memorandum items:								
Twelve-month growth:								
M1	25.3	-3.8	8.7	12.2	8.5	7.3	0.0	17.5
M2	44.5	9.6	21.8	22.2	24.5	21.8	10.9	13.9
Total credit to non-government	48.6	48.7	9.4	6.7	15.8	18.5	17.4	13.2
Domestic	36.9	35.0	15.9	16.8	24.3	27.5	25.9	17.8
Households	50.3	25.0	9.5	11.8	24.7	29.1	28.2	19.2
Enterprises	33.2	40.0	19.6	15.1	24.2	25.1	23.8	17.2
External	68.0	67.2	2.2	-1.6	5.3	8.3	6.9	6.5
Total real credit to non-government	33.8	36.9	2.6	2.0	11.1	10.1	6.2	7.0
Domestic	23.3	24.3	8.8	11.6	19.4	18.4	13.9	11.4
Households	35.3	15.1	2.8	6.8	19.7	19.9	16.0	12.7
Enterprises	20.0	28.9	12.2	10.0	19.2	16.2	12.0	10.8
External	51.4	54.0	-4.1	-6.0	1.1	0.5	-3.4	0.7
Velocity (M1)	9.4	11.9	11.3	13.2	12.9	12.6	12.2	11.7
Velocity (M2)	2.5	2.8	2.4	2.4	2.3	2.3	2.3	2.3

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

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

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

Table 13. Serbia: Balance Sheet of the NBS, 2007–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2007	2008	2009	2010				2011
				Q1	Q2	Q3	Q4	
							Proj.	Proj.
Net foreign assets 2/	482	517	628	623	597	546	551	635
in billions of euro	6.1	5.8	6.6	6.2	5.7	5.2	5.2	5.9
Gross foreign reserves	766	725	1,023	1,049	1,104	1,056	1,066	1,118
Gross reserve liabilities (-)	-284	-208	-394	-426	-507	-510	-515	-483
Net domestic assets	-323	-208	-382	-415	-416	-366	-333	-437
Net domestic credit	-316	-145	-216	-308	-206	-166	-57	-176
Government	-100	-50	-101	-106	-100	-96	-61	-111
Claims	11	11	11	11	1	1	1	1
RSD	11	11	11	11	1	1	1	1
foreign currency	0	0	0	0	0	0	0	0
Liabilities (-)	-111	-60	-112	-117	-102	-98	-62	-112
RSD	-29	-20	-63	-58	-53	-46	-13	-63
foreign currency	-82	-41	-49	-59	-49	-52	-49	-49
Other public sector	-11	-15	-12	-15	-18	-11	-13	-11
Banks	-218	-88	-151	-139	-102	-62	-39	-57
Claims	1	2	1	1	14	2	1	3
Liabilities (-)	-219	-90	-152	-140	-117	-65	-40	-60
Other sectors	13	7	48	-49	15	4	56	3
Capital accounts (-)	-7	-63	-166	-107	-210	-200	-276	-261
Reserve money	159	309	247	208	181	202	218	199
Currency in circulation	77	90	96	86	88	111	99	111
Commercial bank reserves	82	219	151	122	93	90	119	87
Required reserves	30	165	112	117	85	72	75	38
Excess reserves	45	5	7	1	1	3	5	5
Vault cash and giro accounts	7	48	32	5	7	15	39	44

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

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

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

Table 14. Serbia: Balance Sheet of Commercial Banks, 2007-10 1/
(Billions of dinars, unless otherwise indicated)

	2007	2008	2009	2010		
				Q3	Billions of euros	Percent of GDP
Assets	1,678	1,925	2,342	2,620	24.7	86.4
Foreign exchange	111	123	163	201	1.9	6.6
Claims on NBS	569	508	583	502	4.7	16.6
Dinar cash and reserves	80	219	151	90	0.9	3.0
Foreign exchange reserves	270	194	279	346	3.3	11.4
NBS bills and other claims	219	95	153	66	0.6	2.2
Claims on government	8	9	108	160	1.5	5.3
Claims on other sectors	827	1,118	1,299	1,575	14.8	51.9
Households	305	382	418	515	4.8	17.0
Enterprises	507	710	849	1,016	9.6	33.5
Other institutions	15	27	31	45	0.4	1.5
Fixed assets	75	88	99	103	1.0	3.4
Other assets	88	78	90	80	0.8	2.6
Liabilities	1,678	1,925	2,342	2,620	24.7	86.4
Foreign liabilities	300	350	500	544	5.1	17.9
Dinar deposits	319	301	338	311	2.9	10.3
Demand deposits	162	140	155	148	1.4	4.9
Time and saving deposits	142	154	178	160	1.5	5.3
Government deposits	16	7	5	4	0.0	0.1
Foreign currency deposits	517	599	770	914	8.6	30.1
Enterprises	116	140	145	160	1.5	5.3
Households	382	414	565	682	6.4	22.5
Government	4	6	7	16	0.2	0.5
Other institutions	15	40	53	56	0.5	1.9
Other deposits	3	1	2	48	0.5	1.6
Liabilities to NBS	2	6	1	2	0.0	0.1
Other liabilities	95	122	128	124	1.2	4.1
Provisions	93	103	135	168	1.6	5.5
Capital and reserves	350	442	467	509	4.8	16.8
Memorandum items:						
Provisions against credit losses	75.8	98.8	133.2	163.6	1.5	5.4
in percent of credit	9.2	8.8	10.3	10.4	10.4	...
Enterprises	58.8	72.5	99.8	123.7	1.2	4.1
in percent of credit	11.6	10.2	11.7	12.2	...	...
Households	10.8	17.2	23.3	27.2	0.3	0.9
in percent of credit	3.5	4.5	5.6	5.3	...	...
Off-balance sheet items 2/	1,580	2,157	2,305	2,584	24.3	85.2
External debt (billions of euros)	4.0	3.9	4.7	4.4	...	11.6
medium- and long-term	2.8	2.3	2.7	3.3	...	8.6
short-term	1.2	1.6	2.0	1.1	...	3.0

Source: National Bank of Serbia.

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

2/ As of September 2010, about 14 percent of off-balance sheet items represented various guarantees, mostly on cross-border loans. Other off-balance sheet items include collateral against loans and repo contracts, undrawn credit lines, and derivative contracts. Figures in euros and in percent of GDP correspond to the latest available observation.

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

	2009	2010	2011	2012	2013	2014	2015
Fund repurchases and charges							
In millions of SDRs	5	38	21	196	584	511	119
In millions of euro	5	43	23	220	657	575	134
In percent of exports of goods and NFS	0.1	0.4	0.2	1.7	4.6	3.6	0.7
In percent of GDP	0.0	0.1	0.1	0.6	1.7	1.4	0.3
In percent of quota	1.0	8.1	4.5	41.9	124.9	109.2	25.4
In percent of total external debt service	0.1	1.0	0.5	4.4	10.1	7.9	1.7
In percent of gross international reserves	0.0	0.5	0.2	2.1	5.6	4.5	1.0
Fund credit outstanding (end-period)							
In millions of SDRs	1,021	1,321	1,368	1,192	624	122	6
In millions of euro	1,154	1,493	1,532	1,339	702	137	7
In percent of exports of goods and NFS	13.6	15.4	14.3	10.5	4.9	0.9	0.0
In percent of GDP	3.9	5.1	4.8	3.8	1.8	0.3	0.0
In percent of quota	218.3	282.5	292.4	254.9	133.5	26.0	1.2
In percent of total external debt	5.1	6.5	6.7	5.3	2.6	0.5	0.0
In percent of gross international reserves	10.8	15.8	15.7	12.5	6.0	1.1	0.0
Memorandum items:		(Millions of euros, unless otherwise indicated)					
Exports of goods and NFS	8,473	9,674	10,727	12,693	14,299	16,039	18,007
Quota (in millions of SDRs)	468	468	468	468	468	468	468
Total external debt service	3,591	4,080	4,615	5,024	6,492	7,253	8,033
Public sector external debt (end-period)	7,245	7,543	7,210	7,309	6,945	6,749	7,104
Total external debt stock (end-period)	22,801	22,970	23,016	25,038	26,767	28,558	30,320
Gross international reserves	10,644	9,438	9,738	10,738	11,738	12,738	13,738

Source: Fund staff estimates.

1/ Assuming actual purchase of projected available amounts.

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

	Available on or After	Amount Available		Amount of Purchase		Conditions
		In Millions of SDR	In Percent of Quota 1/	In Millions of SDR	In Percent of Quota 1/	
1.	January 16, 2009	233.85	50	233.85	50	Board approval of the arrangement.
2.	May 15, 2009	23.385	5	23.385	5	Observance of end-December 2008 performance criteria and completion of financing assurances review.
3.	May 15, 2009	444.315	95	444.315	95	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.	December 21, 2009	319.595	68.3	319.595	68.3	Observance of end-September 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
5.	March 31, 2010	319.595	68.3	159.798	34.2	Observance of end-December 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
6.	June 28, 2010	319.595	68.3	46.7	10	Observance of end-March 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
7.	September 27, 2010	319.595	68.3	46.7	10	Observance of end-June 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
8.	December 22, 2010	319.595	68.3	...	...	Observance of end-September 2010 performance criteria and completion of the quarterly program review.
9.	February 25, 2011	319.595	68.3	...	...	Observance of end-December 2010 performance criteria and completion of the quarterly program review.
	Total	2,619.12	560	1,274.34	272.50	

1/ The quota is SDR 467.7 million.

Table 17. Serbia: Rankings of Selected Competitiveness and Structural Indicators 1/

	Serbia		Best performers 2/				Distance 3/	
	2009	2010		2009		2010	2009	2010
EBRD transition indicators	67	68		92		92	-26	-25
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	92	92		100		100	-8	-8
Competition policy	46	54		85		85	-39	-31
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
Transparency International								
Corruption Perception Index	35	35	Slovenia	66	Estonia	65	-31	-30
World Bank Doing Business survey 4/	51	51	Estonia	91	Estonia	91	-40	-39
Starting a business	59	55	FYR Macedonia	96	FYR Macedonia	97	-37	-43
Dealing with licenses	5	4	Estonia	90	Estonia	87	-85	-83
Registering property	43	45	Lithuania	96	Lithuania	96	-54	-51
Getting credit	92	92	Albania	97	Albania	97	-4	-5
Protecting investors	60	60	Albania	92	Albania	92	-32	-32
Paying taxes	27	25	Estonia	84	Estonia	84	-57	-59
Trading across borders	61	60	Estonia	98	Estonia	98	-37	-38
Enforcing contracts	49	49	Latvia	92	Latvia	92	-44	-44
Closing a business	45	53	Lithuania	80	Slovak Republic	82	-36	-29

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, 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.

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

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

Belgrade, December 9, 2010

Dear Mr. Strauss-Kahn:

1. Our program has continued to perform satisfactorily. All end-September 2010 performance criteria were observed (Table 1). However, inflation was marginally above the inflation consultation clause's upper limit. While we have postponed the end-November structural benchmark on submitting to parliament draft laws to facilitate a more effective corporate debt collection and restructuring framework; the laws, as well as additional regulatory and legislative changes will be submitted in the next few weeks. We have revised the 2010 budget in line with our program targets and prepared the draft 2011 budget consistent with the fiscal balance rule in the recently revised Budget System Law. The submission of the 2011 budget to parliament is a prior action for the IMF Executive Board meeting in late-December (Table 2). We have recalled the draft pension law, which was submitted to parliament as a prior action in June, and re-submission of the law to parliament will be a prior action for the late-December Board meeting.

2. Recent economic developments leave little doubt that we continue to face significant challenges. On the one hand, the economy has continued to recover, and Serbia's growth performance in 2010 will compare favorably with regional peers. Growth is fuelled by an export recovery, supported by the dinar's sharp real depreciation. Reflecting the export-led recovery and a weak labor market, fiscal revenue growth remains, however, subdued. At the same time, inflation, driven by food price shocks and exchange-rate pass-through, has unexpectedly re-surfaced as a key policy concern. The recovery has been accompanied by an increase in the current account deficit. With capital inflows remaining well below pre-crisis levels as the corporate sector struggles to repair its balance sheets, this has put persistent depreciation pressures on the exchange rate.

3. We remain determined to respond to these challenges and tensions with appropriate policies. Foremost, we intend to implement the 2010 budget as previously agreed, and we will tighten fiscal policy in 2011 to counteract inflationary pressures and support needed external rebalancing. Monetary policy will likely have to tighten further to anchor medium-term inflation expectations. Our banking sector is well-capitalized and has built up large credit provisioning buffers, and corporate balance sheet repair will be facilitated by the

reformed corporate debt restructuring framework. Finally, comprehensive structural reforms will be needed to achieve faster productivity growth in a more export-based economy.

4. In consideration of our good implementation record and our continued commitment to the program's objectives, we request the completion of the sixth review under the Stand-By Arrangement (SBA) and that SDR 319.6 million be made available. However, in view of our limited balance-of-payments needs at present, we again intend to purchase only SDR 46.7 million at this time. The seventh and last program review, assessing performance relative to end-December 2010 performance criteria and benchmarks is envisaged for February 2011.

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.

Revised Macroeconomic Framework for 2010–11

6. Our real GDP projections for 2010 (1½ percent) and 2011 (3 percent) remain unchanged, but growth could well surprise on the upside. We have revised significantly upward our short-term inflation outlook given recent food price shocks and continued pass-through of dinar depreciation. Inflation is projected to remain temporarily at an elevated level for the next half year or so, and we now project that inflation will end-2010 above the upper bound of our tolerance band (6±2 percent), returning within the band (4½ percent±1.5 percent) only toward end-2011.

7. We continue to expect an external current account deficit of about 9 percent of GDP in 2010, and a gradual narrowing over the medium term, reflecting the significant competitiveness gains from depreciation, tight fiscal policies, and structural reform efforts, which include efforts to attract greenfield and brownfield FDI inflows to stimulate manufacturing exports.

8. We do not anticipate major challenges in covering our external financing requirements during 2011, in part reflecting expected inflows from Telekom Srbija privatization proceeds. As corporate restructuring and balance sheet repair restore investor confidence, private capital inflows to Serbia should resume over the medium term. However, given our still high external financing needs, the availability of sufficient sustainable inflows will need to be monitored carefully, and additional policy measures could be needed to ensure external balance. Conversely, we believe that we have adequate prudential and regulatory tools at our disposal to address possible risks emerging from a possible resurge of capital inflows in excess of our external financing requirements. The foreign exchange reserves remain at an adequate level, and should be sufficient to deal with challenging external scenarios.

Fiscal Policy

9. The fiscal program for 2010 is on track, and the deficit target for September was met by a comfortable margin. Total revenue collections have been in line with projections: while VAT collections were below expectations, higher excises have more than compensated for shortfalls. Apart from continued under execution of capital projects, spending programs have been implemented broadly in line with the fiscal program, although the one-off payment to pensioners in October (RSD 6½ billion) exceeded earlier plans significantly.

10. A supplementary budget for 2010 in line with the fiscal program has been submitted to parliament. The revised budget is consistent with the general government deficit target of RSD 148 billion (4.9 percent of GDP). The main upward revisions on the expenditure side reflect higher spending on public pensions and wages due to one-off payments to low-income employees and pensioners and additional social protection spending, mainly on targeted social assistance programs. The main compensating downward revisions on the expenditure side reflect lower execution of spending on capital and interest payments. We will execute the rebalanced budget transparently in line with approved allocations.

11. The 2011 budget will be in line with the adopted fiscal balance rule. Based on our macroeconomic framework, the fiscal balance rule prescribes to target a general government deficit that does not exceed 4.1 percent of GDP.

12. General government revenues in 2011 are projected to decline by 1⅓ percent of GDP relative to 2010. Revenue losses due to discretionary measures include lower customs collections (RSD 8 billion) reflecting the phasing in of the Stabilization and Association Agreement (SAA) with the EU and the elimination of the mobile phone tax (RSD 6 billion). Moreover, the 2011 budget will not be able to benefit from EU grants (RSD 5 billion in 2010). At the same time, we plan to request distributing the Telekom dividend for 2010 (RSD 6 billion), notwithstanding the expected sale of the company in 2011. We are considering a few smaller revenue measures, including a specific excise on cigarettes and a shift to a higher VAT rate on hotels, personal computers, and some high-end food products. We will also take measures to improve compliance on paying social contributions by integrating the collection of all wage-related taxes and contributions during 2011.

13. Given the targeted 2011 deficit and the projected revenue envelope, general government spending in 2011 will have to be contained to 42¾ percent of GDP, a decline by about 2 percent of GDP relative to 2010. To keep spending within the tight spending envelope, we have taken the following six main measures.

- First, we will cap the first indexation step for public pensions and wages in January 2011 at 2 percent. The two additional indexation steps in 2011 will be implemented in May (to the CPI inflation rate for the previous 3 months) and in November (to the CPI inflation rate for previous 6 months and half of 2010 GDP growth), respectively.

We do not plan an increase in the overall number of employees in the general government in 2011.

- Second, we will start to only gradually restore transfers to local governments to pre-crisis target levels. In particular, the level of transfers to municipalities is expected to increase by nearly 25 percent relative to what was originally budgeted for 2010.

- Third, we will freeze the amount of subsidies in 2011 at their nominal level of 2010, with exception of subsidies to ZTP (Railroad company) and Resavica (coal mine), which will grow in line with the indexation adopted for public wages.

- Fourth, the costs of the credit support programs in the 2011 budget will be considerably reduced, including by phasing out cash loans and curtailing the subsidy rate for liquidity loans.

- Fifth, Republican-level capital spending financed from domestic resources would be limited to RSD 27 billion, with priority given to the large infrastructure projects. Implementation of foreign-financed infrastructure projects will be substantially improved.

- And sixth, we plan to use most of the projected Telekom privatization proceeds for budget financing to reduce interest payments. In particular, we will pre-pay a portion of our high-interest debt, as well as use the Telekom proceeds to limit the issuance of Treasury bills for net financing purposes.

14. In executing the 2011 budget, we will faithfully implement the new fiscal rules included in the “fiscal responsibility” amendments to the Budget System Law. In particular, in line with the principles of a countercyclical fiscal policy implied by the fiscal balance rule, we will save any revenue overperformance. As regards spending, we will execute it strictly in line with budgeted allocations, with the exception of the “automatic stabilizers” operating on the expenditure side of the budget, such as unemployment benefits and targeted social assistance.

15. We plan to cover most of our 2011 general government gross financing needs of RSD 224 billion using Telekom Srbija privatization proceeds, domestic bank loans, and external sources, particularly the World Bank. We project that the level of gross public debt at end-2011 will be around 41 percent of GDP, leaving relatively little margin relative to the debt ceiling (45 percent of GDP) established by the revised Budget System Law.

16. We have revised the draft amendments to the law on pension and disability insurance. While we have retained most elements of the pension reform agreed during the fourth review of the SBA, we have introduced two changes aimed at strengthening protection for the most vulnerable and women. In particular, for non-farmer pensions, the law will

incorporate a clause whereby the minimum pension during 2011–15 would not fall below 27 percent of the net average wage. We have also postponed the gradual phasing out of the working credit for women by 2 years relative to the original schedule. At the same time, we have committed to setting up two working groups to: (i) study retirement arrangements for coal miners and other professions working under difficult conditions, and elaborate fair and efficient retirement options for these professions, taking into account best international practice; and (ii) assess options for introducing a protection clause for the old-age pension entitlement of a "standard pensioner" at the beginning of retirement, i.e., a pensioner who contributed for 40 years to the pension fund, also taking into account best international practice. Given the time needed to study these issues, we anticipate that further changes to the pension law will not be introduced before 2013, and will be combined with an updated assessment of the financial sustainability of the pension system.

17. While overall government arrears have declined during the program period, fresh arrears problems have emerged, especially in the health fund and at the local government level. To stop and reverse arrears accumulation, we have strengthened our planning procedures and ex-ante controls over commitments. In particular, we have upgraded our Treasury data management and control systems, whereby all budget beneficiaries will be required to submit their spending requests by the 5th day of each month for the following month. We will also strengthen the arrears monitoring system, extending it to local governments and increasing the quality and frequency of reporting.

18. Notwithstanding slow progress over the last two years, we remain committed to implementing structural reforms in the health and education sectors to lend more credibility to our medium-term fiscal targets, with support from the World Bank and other donors. Efforts to reform the pay-and-grading system in these sectors will need to be in line with our objective to reduce the public sector wage bill to below 8 percent of GDP over the medium term.

Monetary and Exchange Rate Policy

19. With inflation projected to remain above the pre-announced target tolerance band during most of 2011, the focus of monetary policy will remain to keep medium-term inflation expectations anchored. We have already raised the policy rate by a cumulative 250 basis points since August, and have continued to signal a possible tightening in our monetary stance. At the same time, we reckon that inflation risks remain tilted to the upside. Pressures in the foreign exchange market persist, and past depreciation of the dinar will continue to feed through into higher domestic prices for some time, which, together with the unfreezing of public sector wages and pensions in January, will likely dampen the disinflationary impact of still weak private demand. Looking ahead, we will use the full array of our policy tools available, if needed, including monetary reserve requirements, to maintain a monetary stance consistent with bringing inflation back into the tolerance band.

20. Effective communication of our inflation outlook and policy decisions with the public remains important to keep medium-term inflation expectations anchored. To increase the transparency of decision making and provide equal access to information to all actors in the financial markets, we have reduced the number of policy meetings, announced a firm meeting calendar, and will follow best practices regarding the timing of communications before and after policy meetings. We will also strive to further increase in our publications the information content on the policy options considered by the NBS's Executive Board.

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

Financial Sector Policies

22. Our credit support programs have helped sustain the supply of credit and domestic demand during the height of the crisis. With credit markets now functioning more normally, we are phasing these programs out. In particular, we have already eliminated subsidies for cash loans to consumers and will substantially reduce the subsidy rate for liquidity loans in 2011.

23. We are strengthening the framework for dealing with the significant increase in payment problems, particularly in the corporate sector. The mandatory registration of promissory notes envisioned in the draft law on payments transactions will help make debtors' liabilities more transparent and gradually reduce the role of account blockages, thus facilitating debt restructuring. Despite recent improvements in court-mediated options, such as bankruptcy and pre-packaged re-organization procedures, their use has been constrained by the still slow and inefficient court system. Although there have been delays owing to the complex legal nature of the issues involved, we will soon submit to parliament a law on an out-of-court corporate debt restructuring mechanism. Participation in the mechanism would be voluntary and based on the parties' agreements, with mediation by the Chamber of Commerce. The law will be supplemented by tax and supervisory incentives to encourage expeditious agreements. In particular, supervisory incentives would include a shortening of the testing period for loan classification upgrades from 6 to 3 months. As regards tax-related incentives, the tax administration could be allowed to defer the tax liabilities up to 60 months on the basis of a debtor's request supplemented by an agreement with creditors on the restructuring. We are exploring options to introduce additional tax incentives, but this will need to be done in a deficit-neutral fashion, with one option being considered a gradual withdrawal of present corporate tax preferences.

24. Adoption of the Basel II framework remains a key priority in our strategy to strengthen further financial sector supervision. To that end, the NBS is finalizing the set of by-laws in line with Basel II framework. Also, together with the Ministry of Finance, the

NBS has prepared amendments to the law on banks that align the disclosure requirements with EU and Basel II standards, and also strengthen legal grounds for the NBS to issue relevant by-laws. However, given that adoption of amendments to the Banking Law has been delayed in order to reach agreement among stakeholders on amendments related to financial crisis resolution reforms, we have decided to extend the originally planned deadline for the implementation of the Basel II accord. The full implementation of the set of by-laws will be scheduled for December 31, 2011, with the test reporting period as of September 30, 2011. This decision is also consistent with the banks' proposals presented to the NBS.

25. As agreed in Vienna in March 2009, the commitments by foreign parent banks to maintain their exposures vis-à-vis Serbia, as well as related incentives to participating banks, will expire at end-2010. Observance of these commitments by nearly all banks has been a key ingredient for the successful stabilization of the financial sector after the global financial crisis spilled over into Serbia in late-2008. We will continue to use the cooperative framework under the Vienna initiative for dealing with key outstanding banking sector issues, particularly to coordinate the strategy for reducing financial stability risks from high euroization.

26. We remain committed to our de-euroization strategy. In particular, we have continued our campaign to increase the awareness of risks from unhedged foreign exchange borrowing through a series of foreign exchange hedging conferences. Developing a deeper dinar bond market also remains a priority, notwithstanding the present difficult environment. In this context, we are studying the option of allowing inclusion of T-bills with remaining maturity of more than one month in banks' regulatory liquidity ratio subject to a haircut.

27. To deal effectively with potential systemic banking crises in the future, parliament has adopted amendments to several financial sector laws—including on deposit insurance, banks, and bankruptcy and liquidation of banks and insurance companies. These will enable us to introduce temporary measures to improve the protection of depositors. In particular, the Deposit Insurance Agency (DIA) will have a larger toolkit for bank resolution, including through the establishment of the bridge banks or asset and liability purchase-and-assumption. The DIA will be empowered to introduce risk-based deposit insurance while the NBS will have the option of introducing temporary administration in a bank that is or is expected to become critically undercapitalized.

Structural Policies

28. We are making gradual progress on growth-oriented structural reforms. The restructuring of several key public enterprises, in particular JAT (airline) and ZTP (railways), and the privatization of Telekom Srbija is proceeding. During the remainder of the program, we will take steps to accelerate our structural reform agenda. In the energy sector, the current working group will propose recommendations on utility pricing and restructuring of public sector enterprises, including the sale of non-core assets and restraints on their wage bills,

which will be adopted by the government. We will further implement the "guillotine" project and step up our efforts to improve other aspects of the business environment. In particular, we will take steps to fully implement the laws on competition and submit to parliament the company and securities laws by end-2010. We are also reviewing recent charges and levies imposed by all levels of government and aim to discontinue many of such practices in 2011.

29. We have drafted a strategy of structural reforms for the 2011–20 period, and aim to adopt and implement its main elements as government acts. The strategy, initially produced by a group of Serbian economists, aims to anchor the transformation of the Serbian economy toward an export- and investment-based model. Among other steps, the strategy envisions an acceleration of reforms in labor and product markets, business environment, and the public enterprise sector.

/s/
Mirko Cvetkovic
Prime Minister

/s/
Dejan Soskic
Governor of the National Bank
of Serbia

/s/
Diana Dragutinovic
Minister of Finance

Attachment

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

	2009								2010							
	March		June		Sept.		Dec.		March		June			Sept.		Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Act	Prog.
Quantitative Performance Criteria																
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.2	4.9	4.9	5.4	4.6	5.0	4.0
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	69	55	109	84	148
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20	0	20	20	18	20	18	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550	550	140	600	170	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Inflation Consultation Bands (in percent)																
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0	4.0	4.2	5.3	7.7	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0	6.0	n.a.	7.3	n.a.	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0	2.0	n.a.	3.3	n.a.	4.0
Indicative Targets																
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354	354	353	548	543	750
Ceiling on gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50	50	32	50	19	50

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

2/ Cumulative from January 1.

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

Table 2. Serbia: Structural Conditionality, 2010

Measure	Target Date	Comment
Prior actions		
1. Government to submit to parliament a 2011 budget consistent with the program, including supporting legislation.	Before Board meeting	To support macroeconomic stability and bolster the credibility of fiscal policy.
2. Government to re-submit to parliament the pension law with only two changes (TMU ¶21).	Before Board meeting	To safeguard medium-term fiscal sustainability.
Structural benchmark		
1. Government to submit to parliament package of laws strengthening the corporate debt and restructuring framework (TMU ¶22).	End-February 2011	To foster out-of-court debt workouts to minimize unnecessary and costly bankruptcies and improve the allocation of resources in the economy.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

REPUBLIC OF SERBIA

Technical Memorandum of Understanding

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

A. Floor for Net Foreign Assets of the NBS

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

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

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

Cross Exchange Rates and Gold Price for Program Purposes 1/

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

1/ March 11, 2009.

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

6. On September 30, 2010 the NBS's net foreign assets, evaluated at program exchange rates, were €5,063 million; foreign reserve assets amounted to €9,842 million, and foreign reserve liabilities amounted to €4,839 million.

7. **Adjustors.** For program purposes, the NFA target will be adjusted upward *pari passu* to the extent that: (i) after September 30, 2010, the NBS has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as Serbian commercial banks abroad; and (ii) the restructuring of the banking sector by the Deposit Insurance Agency involves a write-off of NBS foreign exchange-denominated liabilities to resident banks. The NFA floor will also be adjusted upward by any privatization revenue in foreign exchange received after September 30, 2010. Privatization receipts are defined in this context as the proceeds from sale or lease of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS, either directly, or through the Treasury.

B. Inflation Consultation Mechanism

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

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

C. Ceiling on External Debt Service Arrears

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

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

D. Ceilings on External Debt

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

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

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

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

E. Fiscal Conditionality

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

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

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

Disbursements of project loans by foreign creditors

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

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

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

20. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget and the Development Fund.** The ceiling also includes the contracting

of any domestic loans by the Development Fund. It excludes any guarantees extended under the financial stability framework, unless such loans or guarantees are extended to entities other than financial sector institutions.

21. **Pension reform.** The revised amendments to the law on pension and disability insurance will be resubmitted to parliament. Changes compared to the version submitted to parliament in June 2010, apart from the modified indexation arrangements for 2011, would be strictly confined to the following two changes. First, the envisioned phasing out of the service credit for women from 15 to 6 percent—coupled with the corresponding increase in the years of service required for their full pension from 35 to 38—would be done over the period of 2013–2021, instead of 2011–19. Second, for pensions paid to former employees and the self-employed (but excluding pensions paid to farmers), a protection clause would be introduced, effective during 2011–15, whereby the minimum pension would not be allowed to fall below 27 percent of the economy-wide net average wage (prior action).

22. **Debt collection and restructuring**. The Ministry of Economy, in consultation with the Ministry of Finance and the NBS, will submit draft legislation establishing a voluntary out-of-court restructuring mechanism for government approval by end-December 2010. The government will submit a package of the legislative changes, including legislation required to provide tax incentives, to parliament by end-February 2011 (structural benchmark)**.**

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 45 days after the end of each quarter. 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.

Data Reporting for Quantitative Performance Criteria

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

Statement by the IMF Staff Representative on the Republic of Serbia
Executive Board Meeting
December 22, 2010

This statement provides information that has become available since the issuance of the staff report (EBS/10/231). The new information does not alter the thrust of the staff appraisal.

1. The prior actions for the sixth review have been completed. On December 16, the government re-submitted to parliament the pension law with only two changes with respect to the initial submission, in line with the terms of the prior action (see TMU, ¶21). The government has also submitted to parliament the 2011 budget law and supportive legislation consistent with the program.

2. **In line with program projections, CPI inflation rose further in November, and the NBS has again hiked the policy rate.** Inflation rose to 9.6 percent (y-o-y) in November, compared with 8.9 percent in October. Higher inflation continues to reflect mainly increases in processed food prices and pass-through of currency depreciation. In its latest policy meeting, the NBS increased the policy rate by 100 basis points, taking the cumulative increase since the tightening cycle began in August to 350 basis points.

3. **In the past week the dinar appreciated, and the NBS purchased foreign exchange.** In contrast to the trend observed in the last few months, the dinar at one point appreciated by about 3 percent relative to its lowest recent value, and the NBS intervened by buying €116 million, but the foreign exchange market remains volatile.

Press Release No. 10/513
FOR IMMEDIATE RELEASE
December 22, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Sixth Review Under Stand-By Arrangement with Serbia and Approves €373 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the sixth review of Serbia's economic performance under the program supported by a Stand-By Arrangement (SBA). The completion of the review enables the immediate disbursement of SDR 319.595 million (about €373 million, or US$489 million). Drawing the full amount would bring total disbursements under the SBA to SDR 1.59 billion (about €1.9 billion, or US$2.4 billion).

Serbia's initial 15-month SBA was approved on January 16, 2009, in the amount of SDR 350.8 million (about €409.5 million, or US$536.9 million). On May 15, 2009, the arrangement was extended by one year and augmented to SDR 2.6 billion (about €3 billion, or US$4 billion) to support the government's economic program amid a sharper than expected impact from the global financial crisis (see Press Release No. 09/169).

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

"The Serbian authorities' implementation of the IMF-supported program has been broadly satisfactory, and an export-led recovery has gained momentum. Continued vigilance will be critical as macroeconomic stability risks have increased, including from a surge in inflation, continued high trade deficits, and potential adverse spillovers from regional developments.

"The authorities have appropriately tightened monetary policy in line with the inflation-targeting framework. With inflation risks remaining tilted on the upside, the authorities should continue to use all tools available to contain inflation expectations and bring inflation back within the National Bank of Serbia's tolerance band.

"Fiscal policy has remained in line with the program, and the 2011 budget targets a deficit consistent with the new fiscal responsibility framework. Determined efforts will be needed to achieve the 2011 fiscal targets, in view of growing pressures for higher spending. It will be important to pursue structural fiscal reforms. The current pension reform is a step in the right direction. Further reforms will be needed in future to ensure the sustainability of the pension system.

“Banking sector reforms have been commendable, and Serbia’s banking system is well buffered to absorb the deterioration in corporate balance sheets. Continued vigilance is needed given elevated external risks. Swift adoption of the legal framework for the out-of-court debt restructuring mechanism will be important.

“Accelerating structural reform will be critical to rebalancing the Serbian economy toward the tradable sector. In particular, efforts in deregulation and the restructuring of public utilities should be stepped up”.

Statement by Mr. Weber and Mr. Antic on Republic of Serbia
December 22, 2010

1. We thank staff for the accurate assessment and the candid and helpful policy dialogue with our Serbian authorities. The staff report well highlights the policy options for mitigating numerous domestic and regional risks, subject to the constraints of a subdued recovery. The Stand-By Arrangement (SBA) continues to be an effective anchor for economic and financial policies in a difficult external and internal environment and staff's advice is highly appreciated. The Serbian government is committed to the implementation of this advice and of the program conditions as the program enters its last stages.

2. The SBA remains fully on track as all end-September quantitative performance criteria and indicative targets have been met. The two prior actions for this review (parliamentary approval of the 2011 budget, re-submission of the revised pension law to parliament) have also been fulfilled. However, the inflation rate has marginally exceeded the upper limit agreed under the inflation consultation clause, triggering further consultations with staff. As in the last three reviews, the authorities intend to draw only partially on the resources made available from this review, in the amount of 10 percent of quota.

3. The Serbian economy is recovering at a restrained but favorable pace relative to its regional peers. Exports are becoming the main engine of growth, reflecting improved competitiveness. The current account deficit is edging up nevertheless, but remains significantly lower than before the crisis. The key preoccupation of the authorities is the rapid rise in inflation that is driven by a sharp increase in food prices and delayed exchange rate pass-through. The exchange rate has proved effective in absorbing external shocks and has contributed to the rebalancing of the economy. The interventions of the National Bank of Serbia (NBS) in the foreign exchange market have aimed at smoothing volatility in the relatively shallow market. The managed floating exchange rate regime continues to serve the country well.

4. The fiscal policy parameters for 2010 are in conformity with the program. Revenues have performed according to projections, but with changes in composition (excises have compensated for lagging VAT collection). On the expenditure side, capital spending and interest payments were lower than planned. This underspending has allowed a rebalancing of the budget towards priority and social protection spending.

5. The budget for 2011 will be the first governed by the newly adopted fiscal balance rule. Fiscal policy will be tightened to reduce the deficit at the general government level to 4.1 percent of GDP. As revenues are declining—due to lower external grants, the elimination of the "crisis" tax on mobile phones, and lower custom revenues—, reaching this deficit target for 2011 implies significant expenditure cuts (of 2 percent of GDP relative to 2010). A set of measures will keep public spending within the agreed tight envelope. Wage and pension increases in January 2011 prescribed by the indexation rules will be capped at 2

percent, while transfers to local governments will be gradually restored to pre-crisis levels. Subsidies will be limited to their 2010 nominal level with two exceptions, while capital spending will cover only large infrastructure projects. The authorities plan to use privatization revenues for budget financing in order to reduce the interest burden.

6. The NBS has tightened its monetary policy stance in response to manifest inflation pressure. The policy rate has been raised significantly in the second half of the year, and the NBS has continued to signal further monetary tightening. The NBS stands ready to use its full set of monetary policy instruments, including reserve requirements, to bring inflation back into the tolerance band in 2011.

7. The authorities are progressing with their structural reform agenda. The privatization of Telekom Srbija has been initiated, while two other large public companies are to be restructured. The business environment will be improved with the implementation of a regulatory "guillotine" project and of the laws on competition. It is expected that the government will submit the company and securities laws to parliament before the end of the year. The pension law was submitted to parliament with two amendments that aim at enhancing the protection of the most vulnerable and of women. The key elements of the pension reform discussed during the fourth review of the SBA were preserved.

8. The authorities value the advice provided in the context of the program and will continue their close cooperation with the staff. They intend to consult with management on their future relationship with the Fund beyond this arrangement.