April 2011
IMF Country Report No. 11/95

Republic of Serbia: Seventh Review and Inflation Consultation 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 February 22, 2011, 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 March 23, 2011. 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 April 8, 2011 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*
Inflation Consultation Letter*
*Also included in Staff Report

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

Seventh Review and Inflation Consultation Under the Stand-By Arrangement

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

Approved by Adam Bennett and James Roaf

March 23, 2011

Discussions. A staff team visited Belgrade during February 9–22, 2011, to conduct the Seventh Review of the Stand-By Arrangement (SBA). The mission met with Prime Minister Cvetković, Deputy Prime Ministers 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. Mr. Antić (OED) attended most policy meetings.

Staff team: Birgir Arnason, Alejandro Hajdenberg, Niko Hobdari, Albert Jaeger, Eva Jenkner, Srdjan Kokotović, Bogdan Lissovolik, and Desanka Nestorović.

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 2,619.12 million (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-December 2010 quantitative performance criteria and indicative targets were met, but inflation, as expected, exceeded the upper limit of the inflation consultation clause.

Key issues: The review focused on two main issues: (i) the status of the transition of Serbia's economy to a more sustainable growth model; (ii) the appropriate response to trade union pressures to hike public wages. The mission also had preliminary discussions on a potential successor arrangement.

Contents Page

Boxes

Attachments

EXECUTIVE SUMMARY

Output is recovering. In 2010, GDP grew at 1¾ percent, and is projected to accelerate further to about 3 percent in 2011. Growth is export-led, and, supported by a sharp real depreciation, the current account deficit has declined to a broadly sustainable level.

But the transition to more balanced growth has been painful. Output recovery and external rebalancing have been accompanied by large real income and job losses. Moreover, inflation unexpectedly spiked up in the second half of 2010, reflecting mainly global and local food price shocks, but also pass-through of past exchange rate depreciation.

The NBS has tightened monetary policy. The NBS has hiked its policy rate by a cumulative 425 basis points since August and has also postponed part of the previously envisaged easing of mandatory reserve requirements in early 2011. Inflation expectations remain reasonably well anchored.

Keeping fiscal consolidation on track is proving challenging in a pre-election setting. The adopted 2011 budget is consistent with the new fiscal responsibility legislation. However, while public sector workers have mostly kept their jobs, a sustained nominal freeze and relatively high inflation since 2009 have cut into their real incomes. Against the backdrop of a fragmented coalition government and regularly scheduled early 2012 elections approaching, public sector trade unions are pressing for large public wage increases, which would likely spill over into higher pensions. The 2011 budget already envisions two further indexation steps for public wages and pensions, as well as a substantial increase in resources to protect the most vulnerable. Moreover, additional but limited one-off payments to lower-income wage and pension recipients could be provided if central government revenue overperform relative to budget targets and spending remains on track. Against this backdrop, there was agreement that giving in to the trade union demands would derail fiscal discipline and add to the already uncomfortably high inflation pressures.

As the present SBA comes to an end, many of the key objectives set at the outset of the program have been achieved. A financial meltdown was avoided, the large external imbalance has normalized, external cost competitiveness was restored, and there is political consensus on the need to shift to a more sustainable growth model.

But the unfinished policy agenda remains large. It is essential to build on the achievements made so far, particularly by persevering with disciplined fiscal policies, adopting additional pension reforms to ensure the sustainability of the public pension system, restructuring of public enterprises, and providing the private sector with a more favorable business environment conducive to sustained private sector investment and job creation.

I. SBA CONTEXT

1. **The global financial crisis unmasked Serbia's unsustainable pre-crisis growth model.** Income expectations and consumption habits of the population were conditioned by unrealistic memories of past high consumption standards, as also reflected in very low pre-crisis domestic savings rates (Table 2). Moreover, the oversized public sector focused on consuming rather than investing. Meanwhile, a difficult business climate stymied formal sector growth, providing an especially unfavorable setting for tradable sector activities. However, large capital inflows, intermediated by mostly foreign-owned banks, and remittances covered the resulting large external trade deficit, and kept the exchange rate at a significantly overvalued level. Put differently, Serbia's pre-crisis external trade imbalance was entrenched, and not the result of a temporary absorption boom as in some other regional peer countries (Figure 1). Euroization was high, and, while banks were largely hedged against currency risk and well-buffered against credit risk, corporates carried large unhedged FX positions on their balance sheets.

2. **Looking backward, the SBA provided effective insurance against a financial meltdown, initiated the needed re-balancing of the economy, but could not prevent large job losses.** Exceptional access under the SBA and other official financing provided a large buffer against external downside risks, while the agreement with foreign banks to maintain their exposure vis-à-vis Serbia provided assurance against a sudden cut-off of cross-border credit lines to corporates. Over the last 2½ years, the exchange rate has depreciated to a competitive level, although the adverse impact on unhedged balance sheets hit the corporate sector hard, particularly nontradable companies. Although the economy has started to recover on the back of export-led growth, consumption has contracted through 2010 (Table 3). Moreover, while employment in the public sector was largely unaffected by the crisis during 2008–10, job losses in the private sector, both in the formal and informal segments, have been massive (Table 4).

3. **Looking forward, the transition to a more sustainable growth model remains incomplete and fragile.** The public sector is lagging behind private sector adjustment: the long-envisaged rationalization of employment levels in health, education, and public administration has not started, while public sector trade unions are seeking to restore relatively generous compensation levels after two years of nominal freezes; budgetary spending on public wage and pensions has continued to crowd out public investment; additional pension reforms, particularly to increase the effective retirement age, will be needed to ensure the sustainability of the public pension system; and the large public enterprise sector remains to be restructured, against the opposition of well-entrenched special interests. Improving the business climate has also proven an uphill battle, in large part due to public sector coordination and competence problems in a politically fragmented setting.

II. Recent Developments

4. **Except for inflation performance, the SBA remained on track.** All end-December performance criteria and indicative targets were met (Table 5); the structural benchmark on submitting a corporate debt restructuring law to parliament was also met (Table 6). However, as expected, December CPI inflation (10.3 percent) was more than 1 percentage point above the upper limit of the inflation consultation band (8 percent). In line with the SBA inflation consultation clause, the NBS has provided a letter explaining the inflation deviation and its policy response.

5. **Political and economic tensions remain elevated.** Participants in the ten-party coalition government are maneuvering to deflect blame for the widespread sense of economic malaise, while the opposition parties are clamoring for moving up the regular elections scheduled for early 2012. Disagreements in the coalition government came to a head with the recent resignation of Minister of the Economy Dinkic, which was followed by a government reshuffle.

6. **Exports have sparked an output recovery, but the massive labor shakeout continued.** Real GDP grew by an estimated 1¾ percent in 2010, led by strong export growth: a respectable performance relative to peers (Figure 2, Table 3). However, despite the ongoing recovery, employment has continued to contract (Figure 3). At the same time, trends in different labor market segments have diverged markedly (Box 1).

Box 1. Serbia's Three Labor Market Dualisms

The recession and rebalancing of the economy has hit Serbia's labor market hard, and the output recovery has so far provided little relief (Figure 3). However, the incidence of the labor shakeout has been highly uneven across different labor segments:

- ***Public versus private sector jobs***: Public sector employment not only held up, but even expanded somewhat since 2008. By contrast, private sector employment has contracted sharply as companies tried to retrench in response to shifting patterns of demand and to repair their balance sheets given tighter credit standards and the large depreciation.

- ***Formal versus informal sector jobs:*** Formal sector jobs during 2008-10 fell by about 11 percent, but informal sector jobs slumped by almost 30 percent (Table 4). Informal sector jobs are mostly low-skilled, low-paid positions in the private nontradable sectors.

- ***Tradable versus non-tradable sector jobs***: While both sectors have suffered large job losses, the available data suggest that private non-tradable sector jobs cuts have been particularly deep, especially in construction.

7. **Inflation has surged to uncomfortably high levels**. Inflation started to pick up in August, and the year-on-year figure reached 10.3 percent in December, significantly above the upper end of the NBS' inflation tolerance band (6±2 percent) (Figure 4). Three main drivers seem to account for the inflation surge: (i) depreciation pass-through from the large

cumulative dinar depreciation since end-2008; (ii) local weather-related and international food supply shocks; and (iii) rising import prices (in euros).

8. **Monetary policy has responded aggressively to keep inflation expectations anchored.** Since August, the NBS has hiked its policy rate by a cumulative 425 basis points, to 12¼ percent, one of the highest nominal policy rates among emerging markets. The forceful and quick policy response was directed at curbing inflationary pressures from the food price shock and dinar depreciation, but also seeking to bolster the NBS's policy credibility. The NBS has also postponed part of the previously-envisaged easing of mandatory reserve requirements, in part to alleviate the need for further policy rate hikes that might result in excessive capital inflows. Against this backdrop, inflation expectations have so far remained reasonably well anchored (Figure 4).

9. **Foreign investor interest in Serbia has picked up, contributing to a reversal of earlier exchange rate depreciation pressures and lowering T-bill yields.** Following previous one-sided depreciation pressures, the dinar has appreciated somewhat since December, and, for the first time under the program, the NBS's FX interventions resulted in net purchases, albeit small, in recent months (Figure 5). In addition, the demand for dinar T-bills has increased significantly, contributing to a sharp decline in T-bill yields, particularly at longer maturities.

III. Policy Discussions

A. Macroeconomic Framework

10. **The export-led recovery is expected to continue picking up steam, but labor market conditions will remain difficult.** Growth is projected to increase to about 3 percent in 2011, driven by net exports, whereas consumption growth is expected to remain subdued (Table 3). Given that the transition away from domestic absorption and toward net exports will require labor reallocation from non-tradable to tradable sectors, private sector job growth is unlikely to turn positive before 2012.

11. **Inflation is projected to stay temporarily above the NBS's tolerance target band**. Despite projected continued sub-par growth and a depressed labor market, CPI inflation is projected to remain above the upper bound of the tolerance band for some time (Figure 4). Given the monetary policy tightening and exchange rate appreciation in recent months, and as the effects of food price shocks and the earlier depreciation wear off, inflation is projected to revert back into the NBS's tolerance band at the turn of 2011–12.

12. **The current account deficit is expected to remain relatively high, requiring significant capital inflows to maintain external balance**. FDI inflows in 2011 are projected to spike, reflecting the expected privatization of Telekom Serbia, while other external flows, mainly to enterprises, are assumed to normalize (Table 7 and 8). As a result, gross international reserves are projected to stabilize in 2011, following a decline in 2010. Under

these assumptions, gross external debt would peak at about 80 percent of GDP in 2010, but then decline over the medium term (Table 9).

13. **Doubts about the government's cohesiveness and determination to resist populist fiscal policies cloud the outlook, and external risks remain a significant concern.** Given the robust export growth and increased investor interest on Serbia in recent months, GDP growth risks are on the upside. However, the heightened political and social tensions could spill over into looser fiscal policies, potentially feeding a wage-price spiral. Fresh adverse shocks to the country risk premium also remain a concern, including from a possible new round of euro-area periphery spillovers. If these risks materialize, they could reverse investors' interest in Serbia, reigniting in turn depreciation and inflationary pressures, and dampening growth prospects. Finally, further spikes in global commodity prices could complicate the NBS challenge of keeping inflation expectations anchored.

B. Fiscal Policy

14. **Amid growing austerity fatigue, public sector trade unions are demanding wage hikes.** Fiscal adjustment in Serbia was so far largely achieved through ad-hoc spending adjustments, including nominal freezes in public wage and pensions during 2009–10. In the 2011 budget, consistent with the new fiscal responsibility legislation, public wages and pensions are scheduled to be indexed to inflation (plus half of the 2010 real GDP growth) in May and November. However, with public sector jobs relatively secure, trade unions are demanding significantly larger wage adjustments than envisaged in the 2011 budget to compensate for past freezes.

15. **Despite these pressures, the government noted its determination to stick to the fiscal responsibility framework.** While improved investor confidence in Serbia has loosened the budget financing constraint, there was agreement that failure to adhere to the fiscal balance rule would undermine government credibility, and also increase future budget financing risks. Large and sustained public wage increases were also seen as risking price stability, potentially leading to a wage-price spiral. The government was therefore determined to observe the fiscal deficit target of about 4 percent of GDP under the 2011 budget (Table 10). However, in case of clear indications of revenue over-performance, the government plans to provide one-off public wage and pension payments, which would be capped at 0.35 percent of GDP, and be targeted to recipients with low incomes (LOI, ¶4). The authorities pointed out that this plan is needed to contain the risk of growing social unrest and that it is consistent with the new fiscal responsibility legislation. The mission argued that any revenue overperformance should ideally be saved, but also conceded that the deviation from the principle of full operation of automatic stabilizers was small and that there is a risk of growing social tensions.

16. **The financing strategy for 2011 will have to be adjusted depending on the timing and amount of Telekom privatization proceeds**. Completion of the Telekom sale is not expected before the second half of 2011, if at all, requiring significant debt issues in the

meantime to bridge fiscal financing needs. Should the Telekom privatization be derailed, the authorities intend to compensate for the financing shortfall mainly through the issuance of longer-term dinar-denominated T-bills, which would likely meet strong foreign investor interest, but they may also consider issuing a eurobond.

17. **More needs to be done to facilitate implementation of the fiscal responsibility legislation and to strengthen public financial management.** Immediate steps that are critical in the coming year include refining the coverage of general government and collecting the relevant fiscal performance data in a standardized way through the treasury and public debt administrations. Given that the fiscal balance target relates to the general government, a framework for effective intergovernmental fiscal coordination throughout the budget process will have to be established. Additional steps will also be required to strengthen medium-term budget planning, cash and debt management, and budget execution.

C. Monetary and Exchange Rate Policies

18. **There was agreement that monetary policy has been appropriately tightened.** The policy tightening implemented since the second half of last year has been an adequate response to the food price shock and price pressures from the currency depreciation. As the Serbian economy is highly euroized, the exchange rate channel is the main transmission mechanism from policy to inflation. In the presence of likely threshold effects in the relationship between the policy rate and the exchange rate, relatively aggressive interest rate hikes were needed to trigger an exchange rate response. Moreover, the marked recent improvement in investor sentiment has clearly lowered risks of a renewed bout of exchange rate depreciation.

19. **Against this background, inflation risks around the baseline projection seem now more balanced.** Unless inflation continues to surprise on the upside, significant additional rate hikes could risk making exchange rate appreciation a one-way bet. This could lead to an undershooting of the tolerance target band for inflation in 2012, and could also put at risk the external rebalancing toward a more sustainable current account. While there was agreement that upside risks from food and international commodity prices and downside risks from the exchange rate were roughly canceling out, the NBS also saw a new upside risk from potential public wage and pension hikes, and indicated that its bias was still for some further policy tightening.

20. **If capital inflows accelerate further, policies may need to respond to stem an excessive exchange rate appreciation.** The dinar was seen as somewhat undervalued relative to fundamentals, and there was agreement that some appreciation would be welcome given the inflation challenge. However, once the scope for appreciation narrows, some sterilized foreign exchange intervention to stem rapid dinar appreciation would seem appropriate, also to rebuild foreign exchange reserves. If pressures remain strong, further discretionary fiscal tightening should also be considered, but this will be difficult in a pre-election year. At the same time, the authorities have pledged to use reserve requirements

and prudential tools to counteract capital inflows that lead to unbalanced risk sharing, whereby risks from currency and maturity mismatches are mainly borne by Serbian businesses and households.

D. Financial Sector Policies

21. **Conservative NBS provisioning requirements have been key to the banking sector's resilience.** Serbia's corporate sector, which was excessively leveraged at the start of the crisis, was hit hard by the significant dinar depreciation. The sharp contraction in consumption since the crisis has in particular forced the restructuring of operations of many companies operating in the nontradable sector. As a result, non-performing loans have increased significantly since the beginning of the crisis, although they have stabilized since mid-2010. Nevertheless, a significant part of private enterprises in financial difficulties are judged to be well-managed and fundamentally viable. Reflecting conservative NBS provisioning requirements, Serbia's banking sector is exceptionally well-provisioned against credit risks (Table 11).

22. **A swift adoption by parliament of the out-of-court corporate debt workout legislation would help the banking sector deal more effectively with overleveraged corporate balance sheets**. The draft law before parliament will expand the scope for voluntary workouts, and help avoid costly bankruptcies and nurse viable enterprises back to financial health. While the package of supervisory and tax incentives would be relatively modest, the authorities and banks—who are the main creditors in the system—felt that the framework offered by the law would help overcome existing coordination and information bottlenecks to voluntary debt restructuring.

23. **The agreement to maintain foreign bank exposures lapsed at end-2010; foreign banks as a group have honored their exposure commitments.** Large cross-border exposures to foreign banks were Serbia's financial Achilles heel when the global financial crisis began to spill over to the country in late 2008. Exposure limits under the agreement were reduced from 100 percent to 80 percent in April 2010. For Serbia, the agreement is widely considered to have met its objectives with flying colors (Box 2).

Serbia: Exposure of Foreign Parent Banks
(Billions of euros)

	Dec-08	Dec-10	Change	Percent change
Total exposure	8.7	8.5	-0.2	-2.4
Long term	8.0	7.4	-0.6	-7.6
Short term	0.7	1.1	0.4	57.5

Source: National Bank of Serbia.

Box 2. Post Mortem on Serbia's Bank Exposure Agreement [1/]

On March 27, 2009, the ten largest foreign banks operating in Serbia committed in Vienna to maintaining their credit exposures vis-à-vis Serbia at the end-2008 level. Experience with private sector involvement in earlier Fund programs suggested that conditions for a coordinated rollover agreement should be propitious: there were only a small number of foreign banks to coordinate; no sovereign debt rollover was involved; there were no interbank credit lines; moral hazard issues were absent; and there seemed no need for high-frequency data monitoring.

At the same time, the incentives for banks to voluntarily agree to a coordinated rollover were fairly compelling: failure to roll over could have triggered a vicious deleveraging spiral, potentially ending in a currency-cum-banking crisis, which would likely have left the foreign banks as a group much worse off than under a coordinated rollover.

At the same time, BIS data on foreign bank exposures vis-à-vis Serbia and other emerging Europe countries suggest that foreign banks took a somewhat differentiated approach toward maintaining or cutting pre-crisis exposures across the region (Figure 6).[2/] The reasons for the observed dispersion in cross-country rollover experiences seem to include: (i) extent of a country's external stability risks (with high risks providing incentives to coordinate); (ii) degree of foreign bank ownership (with high ownership rate facilitating coordination); and (iii) degree of credit euroization (with high euroization increasing incentives to coordinate).

One additional, Serbia-specific reason why rollovers may have remained at a comparatively high level throughout the SBA period may have been the NBS's above-par capacity to monitor agreed bank-by-bank exposure floors, reflecting detailed reporting requirements for foreign banks. These reporting requirements allowed early and reliable detection of free rider behavior among individual banks; during 2009–10, only one foreign bank was found to be consistently in breach of its rollover commitments.

[1/] *Later subsumed under the umbrella of the European Bank Coordination Initiative (EBCI).*
[2/] *However, BIS exposure data, while comparable across countries, may not capture consistently and accurately the country-specific exposure definitions agreed under the EBCI.*

E. Structural Policies

24. **Despite an uptick in reform efforts in 2010, lagging structural reforms remain the key growth bottleneck.** The authorities pointed to encouraging recent progress, including on: (i) adopting new company and securities laws; (ii) further streamlining of regulations; and (iii) the opening up of the telecommunications sector. In response to the massive labor market shakeout, the authorities have also strengthened an already well-targeted social safety net and stepped up active labor market policies. Still, it was agreed that poor public infrastructure and the uncertain legal framework for property and construction permits—a clear outlier in Serbia's already-weak cross-country rankings—severely limited potential for both foreign and domestic investments (Table 12).

25. **With electoral pressures intensifying, sweeping new structural reform initiatives were seen as unlikely.** In the short term, the authorities plan to be selective, focusing on additional active labor market measures, FDI promotion, and privatization of Telekom Serbia as key priorities. In their view, scope for stepping up privatizations was limited, in part because of public anger about botched past privatizations. And while the authorities sought to deregulate product and labor markets, including through injecting more competition among

enterprises and through reducing firing costs by curtailing severance benefits, they believed that the social and political conditions were not opportune for such reforms before elections. Still, with increasing awareness of the inefficiencies of the bloated public enterprises, the authorities were open to jumpstarting reforms in the key energy sector. In this context, and given the on-going shift to a new growth model, the mission argued for an across-the-board reform acceleration, not ruling out further major privatizations and pointing to synergies between structural reforms and the qualification requirements for EU accession.

IV. Program Issues

26. **The authorities intend to continue to make only a partial drawing of the funds available under the SBA following the completion of the seventh review.** Serbia's gross FX reserve position remains comfortable, 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 8).

27. **A broad coalition of stakeholders expressed interest in a successor arrangement.** Key government officials see a new precautionary SBA as a valuable commitment device to bolsters fiscal discipline. The NBS has called for a new arrangement to serve as a coordination device for the continued transition to the export-led growth model and to provide insurance against external risks. Foreign and domestic investors seem to see a new program as the best option to discipline and constrain the present and next governments. Finally, trade unions representatives also noted that a new program could provide valuable checks and balances.

V. Staff Appraisal

28. **The ongoing export-led recovery is encouraging, but the transition toward more balanced growth has taken its toll on the labor market.** When the global financial crisis spilled over to Serbia in late 2008, the economy was clearly on an unsustainable growth path. Since then, much has been achieved: the large external deficit has narrowed to a more sustainable level; the exchange rate has depreciated to a competitive level; and public finances remain in reasonably good shape. However, the adjustment has taken its toll on private sector jobs, with the shakeout particularly severe for lower-skilled nontradable sector jobs. The outlook is for continued recovery in 2011 and an end to job losses.

29. **Locking in more sustainable growth will require additional, politically difficult reforms.** Key ingredients for assuring the transition to a more sustainable growth model still have to fall in place: adjustment in the oversized public sector is lagging well behind private-sector adjustment, the pension indexation rules adopted under the program need to be followed up by reforms to increase the effective retirement age in order to ensure the sustainability of the public pension system, and far-reaching reforms to rationalize employment and impose hard budget constraints on public enterprises are needed. Moreover, without reforms, Serbia's difficult business climate will remain a key obstacle for formal

sector activities. Much of this politically difficult reform agenda could be anchored in an EU accession perspective.

30. **Keeping public finances on an even keel in a pre-election year will not be easy**. The authorities have a strong record in meeting announced budget targets, and the 2010 fiscal deficit target was met with a significant margin to spare. But given high political fragmentation and the prospects of elections this or early next year, the new fiscal responsibility legislation will likely be subjected to an early stress test. For now, the government has rightly resisted pressures from public sector trade unions to hike wages well beyond the indexation steps already envisaged in the 2011 budget.

31. **With inflation surprising on the upside, the NBS has appropriately stepped on the monetary brakes.** Recent double-digit inflation rates with the economy still operating at a depressed level have been an unpleasant surprise. The NBS's quick and determined policy response has been appropriate, and it has succeeded in keeping inflationary expectations reasonably well anchored.

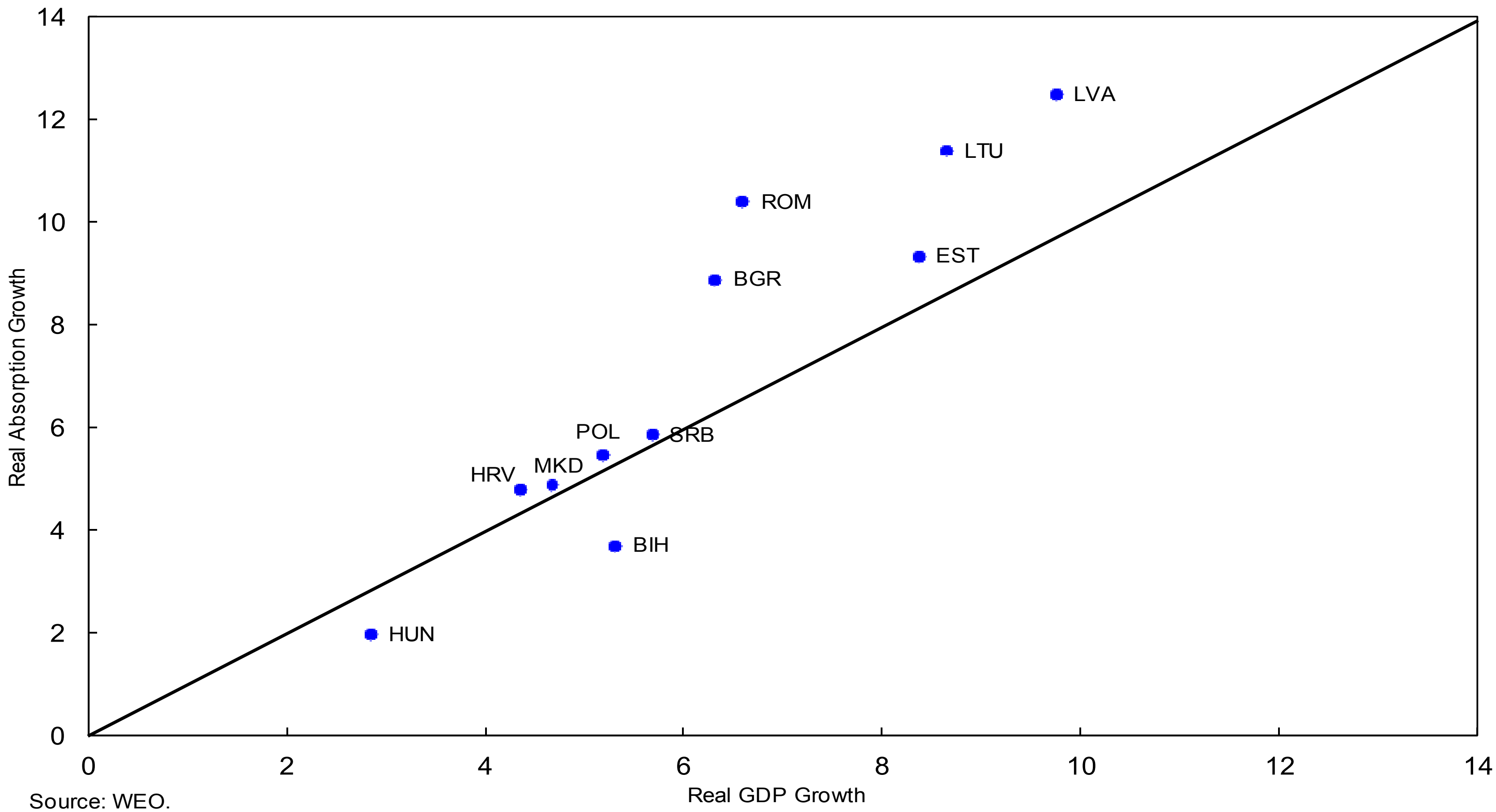
32. **The case for significant further monetary policy tightening seems weak for now, but the balance of risk could change quickly.** Risks to the inflation outlook seem balanced, although the situation is fluid. Upside risks that require close monitoring are international commodity prices and trade union pressures to hike public wages, which in turn would likely trigger similar hikes in public pensions. On the other hand, if capital inflows accelerate, excessive exchange rate appreciation could also emerge as a concern.

33. **The banking sector remains well-capitalized, providing a re-assuring backdrop to much-needed corporate restructuring.** The conservative NBS provisioning requirements helped build comfortable capital buffers in the banking sector prior to the crisis. However, given the adverse effects of the sharp depreciation on corporate balance sheets and the needed re-allocation of productive resources in the economy to shift to more sustainable growth, many companies will need to undergo restructuring or, as the ultimate option, go into bankruptcy. Over the last two years, the authorities have made strong efforts to put in place a new set of tools to facilitate corporate restructuring, and the framework will be complete once parliament adopts a voluntary out-of-court corporate debt restructuring option.

34. **On the basis of Serbia's satisfactory performance under the SBA, staff supports the authorities' request for the completion of the seventh review and inflation consultation under the SBA.**

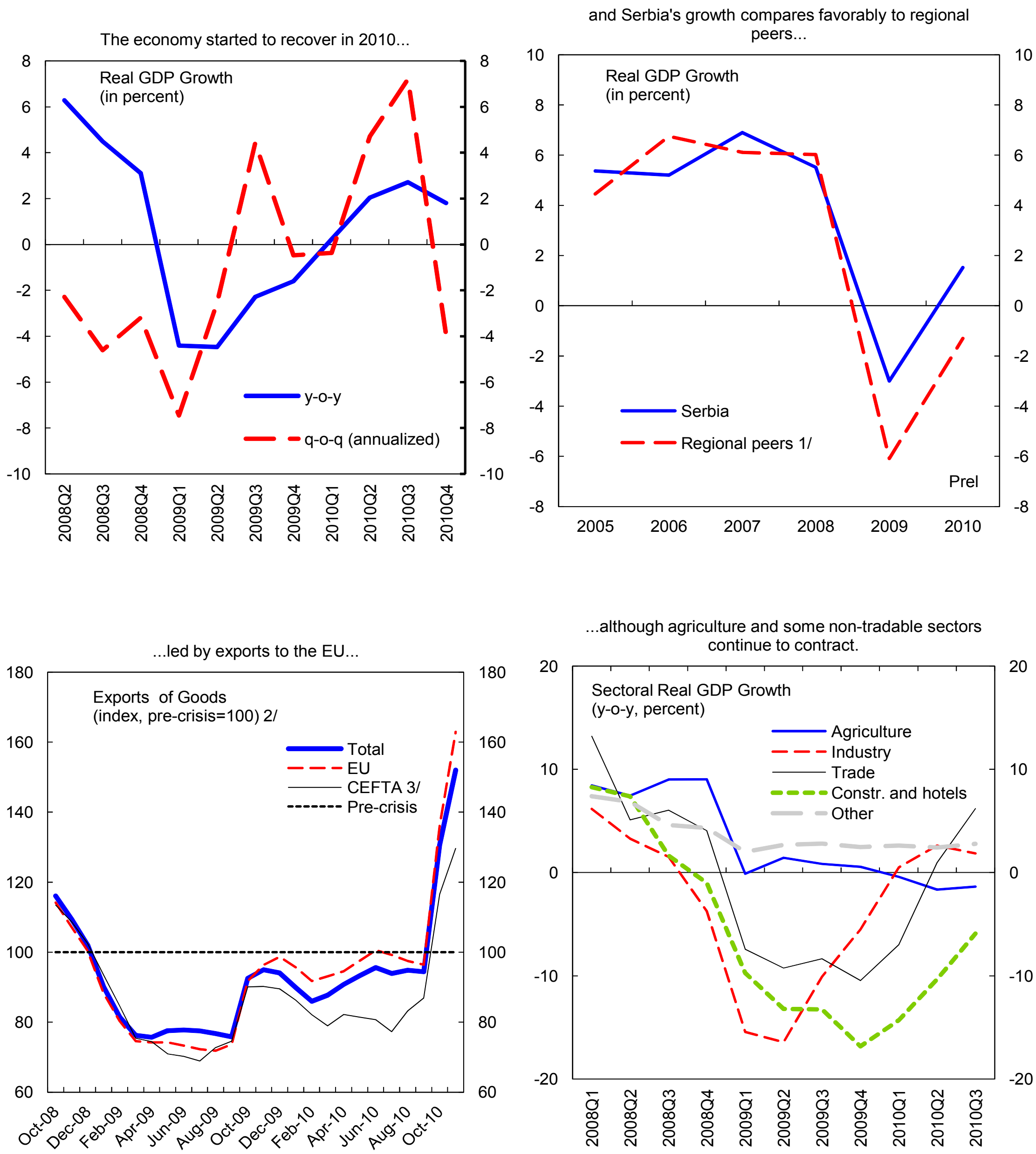
Figure 1. Real GDP and Real Absorption Growth, 2003-08 1/
(average annual percent change)

Serbia's large pre-crisis trade imbalance was entrenched and not the result of a temporary absorption boom relative to GDP, as was the case in the Baltics, Bulgaria, and Romania



Source: WEO.
1/ Estonia, Latvia, Lithuania calculated 2003-07.

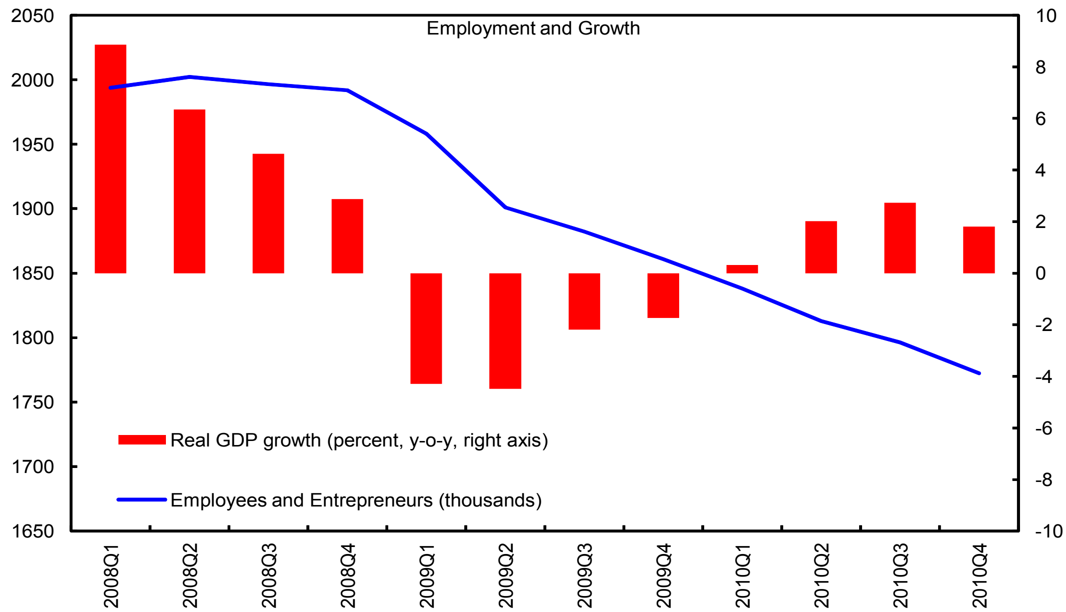
Figure 2. Serbia: Output Indicators



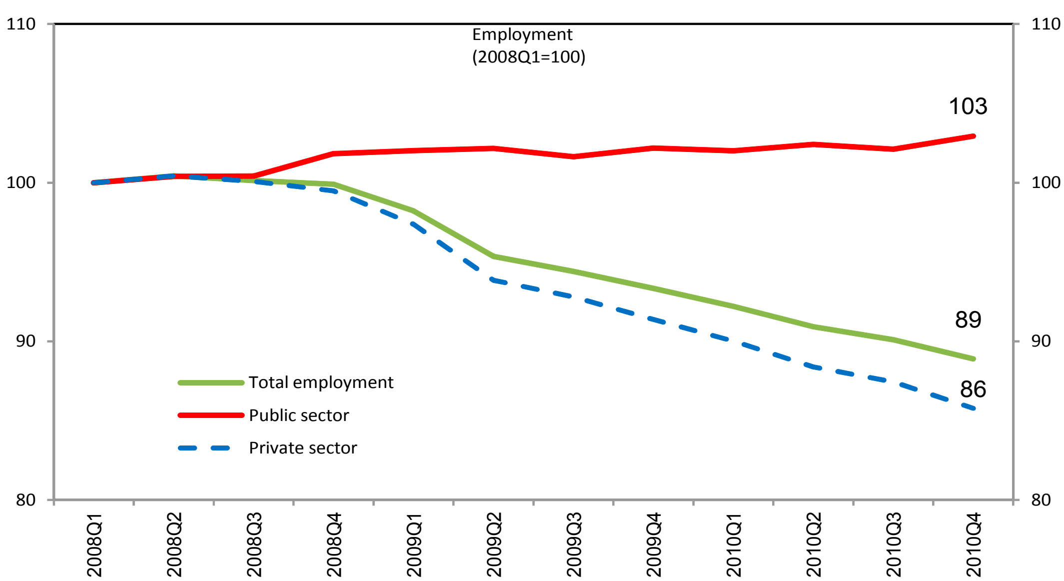
Sources: Serbian authorities and WEO.
1/ Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia FYR, and Romania.
2/ The 3-month moving averages for each month expressed in euros are compared with the same month during the pre-crisis period (defined as October 2007-September 2008).
3/ Includes Albania,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

Figure 3. Serbia: Labor Market Developments, 2008-10

Despite the growth recovery, employment has continued to contract sharply...

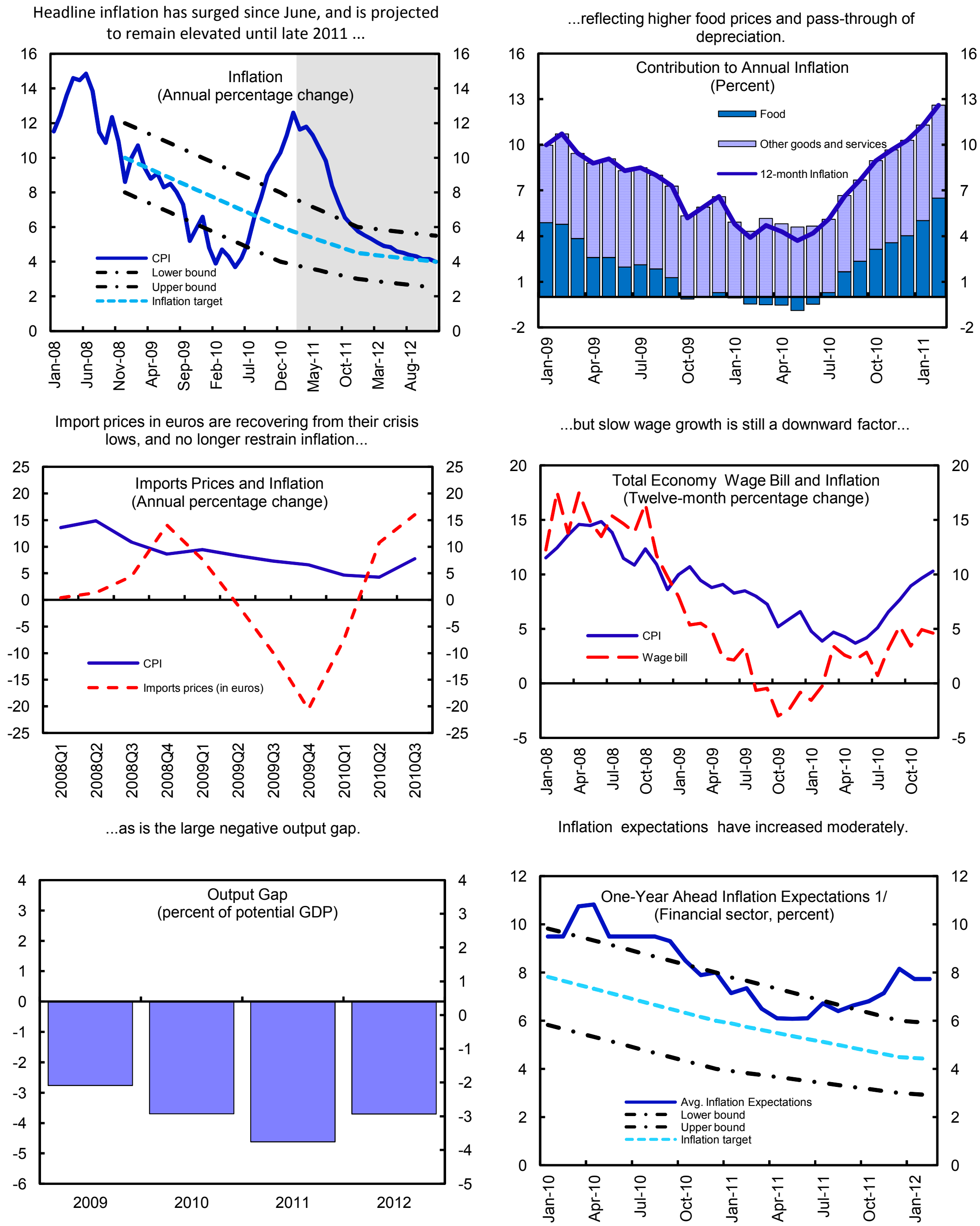


...with losses coming exclusively from the private sector, particularly the enterpreneurship sector, whereas public sector employment actually increased.



Source: Serbian Statistics Office and IMF staff calculations.

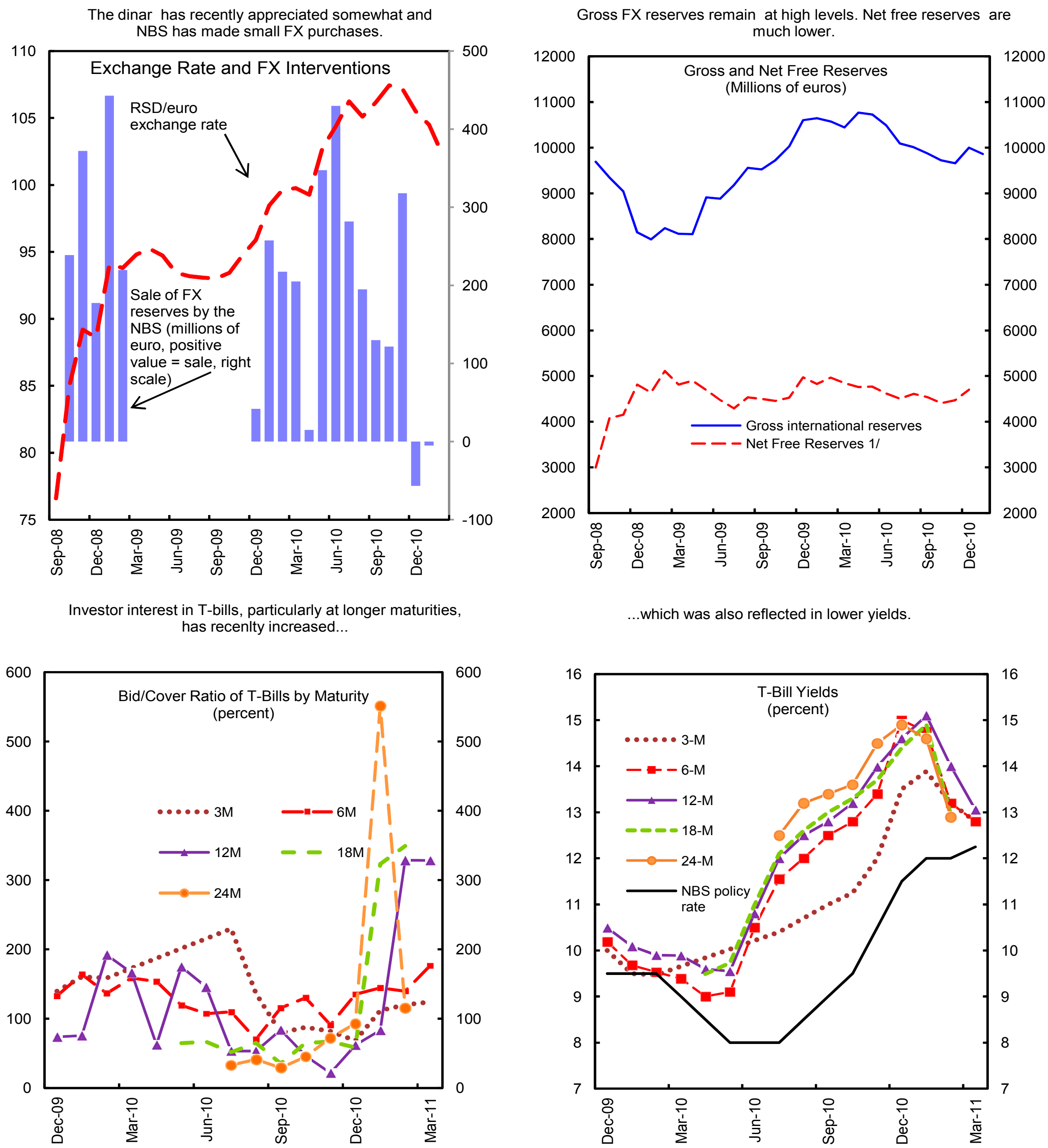
Figure 4. Serbia: Inflation and Monetary Policy, 2008–12



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

1/ Average of surveys of the financial sector.

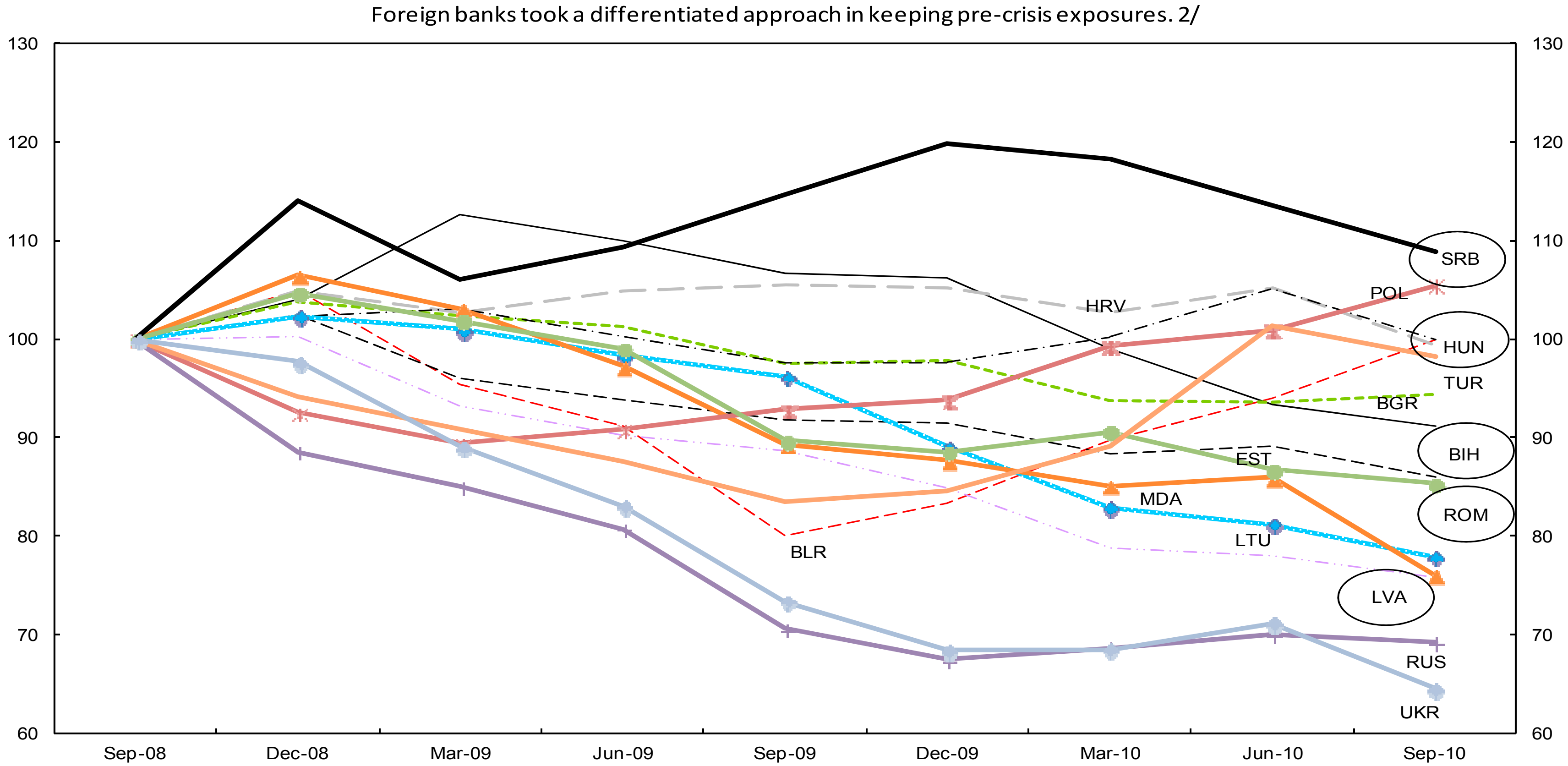
Figure 5. Serbia: Exchange Rate and T-Bill Market developments, 2008-11



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

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

Figure 6: Total Exposure of Foreign Banks vis-a-vis Emerging European Countries, 2008-10 1/
(2008Q3 = 100)



Sources: BIS; and IMF staff calculations.
1/ Countries with a ◯ participated in the European Banking Coordination Initiative (EBCI).
2/ As measured by BIS data, which may not consistently and comprehensively capture the country-specific exposure definitions agreed under the EBCI.

Table 1 Serbia: Selected Economic and Social Indicators, 2006–11

	2006	2007	2008	2009	2010 Est.	2011 Proj.
	(Percent change, unless otherwise indicated)					
Real GDP	5.2	6.9	5.5	-3.1	1.8	3.0
Real domestic demand (absorption)	6.2	11.5	6.3	-8.7	-1.5	0.2
Consumer prices (average)	12.7	6.5	12.4	8.1	6.2	9.7
Consumer prices (end of period)	6.6	11.0	8.6	6.6	10.3	6.0
Import prices (dinars, average)	15.3	-2.8	13.9	3.0	16.0	7.8
Nominal gross wage	23.2	22.4	16.9	7.4	7.3	8.6
Real net wage	10.6	19.9	4.9	-0.7	1.1	-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	-4.8	-4.9	0.2
Unemployment rate (in percent)	21.6	18.8	14.7	17.4	20.0	…
Nominal GDP (in billions of dinars)	1,962	2,302	2,722	2,815	3,041	3,436
	(Percent of GDP)					
General government finances						
Revenue	44.2	43.5	41.9	40.7	40.3	38.9
Expenditure	45.8	45.4	44.5	45.0	44.8	42.9
Current	41.1	40.1	40.0	41.0	40.3	38.6
Capital and net lending	4.6	5.3	4.5	4.0	4.4	4.3
Fiscal balance (cash basis)	-1.6	-1.9	-2.6	-4.3	-4.5	-4.1
Structural fiscal balance 1/	-2.3	-0.4	-2.9	-3.2	-2.9	-2.3
Gross debt	43.0	35.2	33.4	36.8	44.0	41.1
	(End of period 12-month change, percent)					
Monetary sector						
Money (M1)	37.1	25.3	-3.8	8.7	-2.2	23.7
Broad money (M2)	38.4	44.5	9.6	21.8	13.9	26.7
Domestic credit to non-government	17.1	36.9	35.0	15.9	29.0	14.5
	(End of period, percent)					
Interest rates (dinar)						
NBS repo rate	14.0	10.0	17.8	9.5	11.5	…
Deposit rate	5.1	4.1	6.4	5.1	5.6	…
	(Percent of GDP, unless otherwise indicated)					
Balance of payments						
Current account balance	-10.2	-15.9	-20.9	-6.9	-7.1	-7.4
Exports of goods	22.0	22.2	22.2	20.0	25.2	27.9
Imports of goods	43.3	45.2	47.6	37.1	41.4	42.0
Trade of goods balance	-21.4	-23.1	-25.4	-17.1	-16.2	-14.1
Capital and financial account balance	32.0	18.4	16.3	10.7	2.4	7.6
External debt	63.3	61.8	65.2	76.5	80.7	75.6
of which: Private external debt	36.0	39.5	46.1	52.0	52.4	48.4
Gross official reserves (in billions of euro)	8.7	9.5	8.2	10.6	9.7	10.0
(In months of prospective imports)	6.6	6.3	7.7	8.6	7.2	6.7
(Percent of short-term debt)	294.5	268.4	162.3	200.7	183.6	186.2
(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	103.5	…
REER (annual average change, in percent; + indicates appreciation)	7.0	7.4	4.5	-5.0	-7.7	6.5
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 the output gap both on revenue and spending.

Table 2. Serbia: Savings-Investment Balances, 2004–15
(Percent of GDP)

	2004	2005	2006	2007	2008	2009	2010 Est.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Domestic demand	126.6	121.0	121.6	123.9	126.0	117.0	116.2	114.1	112.1	111.3	110.9	110.4
Consumption	96.8	97.2	97.4	95.7	97.3	94.9	94.3	92.3	88.9	87.9	86.9	86.0
Non-government	77.1	78.5	78.5	75.4	77.7	75.4	75.4	74.1	71.3	70.6	70.0	69.3
Government	19.8	18.8	18.9	20.3	19.6	19.5	18.9	18.2	17.7	17.2	16.9	16.6
Gross domestic savings	3.2	2.8	2.6	4.3	2.7	5.1	5.7	7.7	11.1	12.1	13.1	14.0
Non-government	0.1	-1.3	-0.6	0.9	0.4	5.3	5.6	6.9	9.6	9.5	9.5	9.5
Government	3.1	4.1	3.2	3.4	2.3	-0.2	0.1	0.8	1.4	2.7	3.6	4.5
Net factor receipts and transfers	14.4	12.3	11.4	7.9	5.0	10.1	9.1	6.7	5.6	5.3	5.1	4.9
Non-government	15.2	13.1	12.1	8.4	5.5	10.4	9.5	7.3	6.4	5.9	5.7	5.5
Government	-0.8	-0.8	-0.8	-0.5	-0.5	-0.3	-0.4	-0.6	-0.7	-0.7	-0.6	-0.6
Gross national savings	17.6	15.0	13.9	12.2	7.7	15.2	14.8	14.4	16.7	17.4	18.3	19.0
Non-government	15.3	11.8	11.5	9.3	5.9	15.7	15.2	14.2	16.0	15.4	15.3	15.0
Government	2.3	3.3	2.4	2.9	1.8	-0.5	-0.3	0.2	0.7	2.0	3.0	4.0
Gross domestic investment	29.7	23.7	24.1	28.2	28.6	22.1	21.9	21.8	23.2	23.4	24.1	24.5
Non-government	27.1	21.1	20.0	23.5	24.8	18.8	18.4	18.3	19.8	19.9	20.3	20.1
Government	2.6	2.7	4.1	4.8	3.8	3.3	3.5	3.5	3.4	3.5	3.7	4.4
Overall savings-investment balance	-12.1	-8.7	-10.2	-16.0	-20.9	-6.9	-7.1	-7.4	-6.5	-6.0	-5.8	-5.5
Non-government	-11.8	-9.3	-8.5	-14.2	-19.0	-3.1	-3.3	-4.1	-3.8	-4.5	-5.1	-5.1
Government	-0.3	0.6	-1.7	-1.9	-2.0	-3.8	-3.8	-3.3	-2.7	-1.5	-0.7	-0.4
Foreign savings	12.1	8.7	10.2	16.0	20.9	6.9	7.1	7.4	6.5	6.0	5.8	5.5
Memorandum items:												
Net exports of goods and services 1/	-26.6	-21.0	-21.6	-23.9	-26.0	-17.0	-16.2	-14.1	-12.1	-11.3	-10.9	-10.4
Current account balance	-12.1	-8.7	-10.2	-15.9	-20.9	-6.9	-7.1	-7.4	-6.5	-6.0	-5.8	-5.5
General government fiscal balance	0.0	0.8	-1.6	-1.9	-2.6	-4.3	-4.5	-4.1	-2.7	-1.6	-0.8	-0.5

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

1/ Equal to GDP minus domestic demand.

Table 3. Serbia: Real GDP Growth Components, 2004–11
(Percent)

	2004	2005	2006	2007	2008	2009	2010 Est.	2011 Proj.
	(Real growth rate by expenditure category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.8	3.0
Domestic demand (absorption)	13.6	-3.8	6.2	11.5	6.3	-8.7	-1.5	0.2
Non-government	18.0	-4.6	4.9	9.1	8.7	-9.2	-1.6	0.4
Government	-1.1	-0.6	11.1	20.0	-1.8	-7.0	-1.3	-0.6
Consumption	1.7	0.2	6.2	6.6	6.3	-3.2	-1.9	-0.2
Non-government	3.3	0.8	6.8	3.1	7.9	-2.5	-1.8	0.2
Government	-3.0	-1.5	4.3	18.2	1.6	-5.1	-2.4	-1.5
Investment	72.0	-15.4	6.1	28.2	6.3	-24.7	-0.1	1.6
Gross fixed capital formation	27.2	2.6	14.5	25.6	1.9	-9.3	-0.1	1.6
Non-government	29.0	2.1	7.3	25.1	6.3	-7.9	-1.0	1.1
Government	16.6	6.4	58.8	28.0	-16.2	-16.4	5.1	4.2
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	7.5	3.5	2.8
Exports of goods and services	5.7	14.4	4.9	17.2	8.9	-12.4	19.1	17.0
Imports of goods and services	21.0	-13.6	7.8	26.0	9.3	-21.8	4.1	6.2
	(Contribution to real growth by expenditure category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.8	3.0
Domestic demand (absorption)	16.3	-4.8	7.1	13.2	7.6	-10.6	-1.7	0.2
Non-government	16.6	-4.6	4.5	8.2	8.1	-8.8	-1.4	0.3
Government	-0.3	-0.2	2.6	5.0	-0.5	-1.8	-0.3	-0.2
Consumption	1.7	0.2	5.5	5.9	5.6	-2.9	-1.7	-0.2
Non-government	2.4	0.5	4.6	2.2	5.2	-1.7	-1.2	0.1
Government	-0.8	-0.3	0.9	3.8	0.4	-1.1	-0.5	-0.3
Investment	14.6	-4.9	1.6	7.3	1.9	-7.7	0.0	0.4
Gross fixed capital formation	5.0	0.6	3.1	5.9	0.5	-2.4	0.0	0.4
Non-government	4.6	0.4	1.3	4.6	1.4	-1.7	-0.2	0.2
Government	0.5	0.2	1.7	1.2	-0.9	-0.7	0.2	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	7.5	3.5	2.8
Exports of goods and services	1.4	3.6	1.3	4.6	2.6	-3.7	5.2	5.4
Imports of goods and services	9.4	-6.8	3.2	10.9	4.6	-11.2	1.7	2.6
	(Contribution to real GDP growth by production category)							
Gross Domestic Product (GDP)	8.3	5.6	5.2	6.9	5.5	-3.1	1.8	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	1.2	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	1.1	2.2

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

1/ Contributions to GDP growth.

Table 4. Serbia: Employment Developments, 2008-10

	Oct-08	Oct-10	Change
	Thousands of persons		(in percent)
Total employment	2,822	2,382	-15.6
Formal sector employment	2,159	1,914	-11.3
Tradable sectors	758	610	-19.5
Agriculture, forestry and fishing	232	163	-29.9
Industry	526	447	-14.9
Mining and quarrying	33	26	-21.5
Manufacturing	463	389	-16.0
Electricity, gas, and steam	31	33	8.1
Nontradable sectors	1,401	1,304	-6.9
Water supply	39	37	-3.7
Construction	121	91	-25.3
Wholesale and retail trade	357	302	-15.4
Transportation and storage	124	125	0.6
Hotel and food service	67	65	-3.9
Information and communication	56	45	-19.4
Financial and insurance activities	61	45	-25.4
Professional, scientific and technical activities	55	55	-0.3
Public administration, education, health and defense	420	429	2.0
Other	100	110	9.8
Informal sector employment	663	468	-29.4

Source: Labor Force Surveys, Serbian Statistical Office.

Table 5. 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.	Adj.	Prel.
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	4.0	4.9
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	152	137
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	0	20	0	20	20	0
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	600	180
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	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	6.0	10.3
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	8.0	n.a.
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	4.0	n.a.
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	750	747
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	18	50	18	50	50	38

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 6. Serbia: Performance for Seventh Review

Measure	Target Date	Comment
Quantitative performance criteria		
1. Floor on net foreign assets of the NBS	End-December 2010	Observed
2. Ceiling on consolidated general government overall deficit	End-December 2010	Observed
3. Ceiling on contracting or guaranteeing by the public sector of new short-term external debt	End-December 2010	Observed
4. Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt	End-December 2010	Observed
5. Ceiling on accumulation of government external payment arrears	End-December 2010	Observed
Indicative targets		
1. Ceiling on current expenditures of the Serbian Republican budget	End-December 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	End-December 2010	Observed
Inflation consultation clause	December 2010	Not observed 1/
Structural benchmark		
1. Government to submit to parliament package of laws strengthening the corporate debt and restructuring framework (LOI ¶23, IMF Country Report No. 11/9).	End-February 2011	Observed

1/ For the reasons for the deviation and the NBS's policy response, see NBS letter in Attachment III.

Table 7. Serbia: Balance of Payments, 2008–15 1/

	2008	2009	2010		2011		2012	2013	2014	2015
		Est.	Sixth Revlew	Est.	Sixth Review	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of euros)					
Current account balance	-7.0	-2.1	-2.7	-2.1	-2.4	-2.4	-2.3	-2.4	-2.5	-2.6
Trade of goods balance	-8.5	-5.1	-4.9	-4.8	-4.8	-4.6	-4.4	-4.4	-4.7	-5.0
Exports of goods	7.4	6.0	7.2	7.4	9.0	9.1	10.7	12.1	13.5	15.2
Imports of goods	-15.9	-11.1	-12.1	-12.2	-13.8	-13.7	-15.1	-16.5	-18.3	-20.2
Services balance	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-0.9	-0.5	-0.8	-0.7	-1.0	-0.8	-1.1	-1.3	-1.3	-1.4
Net interest	-0.7	-0.6	-0.8	-0.6	-1.0	-0.8	-1.1	-1.3	-1.3	-1.4
Others, including reinvested earnings	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current transfer balance	2.6	3.5	3.0	3.4	3.4	3.0	3.2	3.3	3.5	3.7
Capital and financial account balance	5.5	3.2	0.9	0.7	2.6	2.5	3.3	3.4	3.5	3.6
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.8	1.4	1.0	0.9	2.8	1.9	1.5	1.6	1.8	2.0
Portfolio investment balance	-0.1	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other investment balance	3.7	1.9	-0.2	-0.2	-0.3	0.6	1.8	1.7	1.6	1.6
General governement	0.1	0.7	-0.1	0.7	0.4	0.5	0.3	0.3	0.3	0.4
Domestic banks	0.5	1.6	0.2	0.3	0.1	0.6	0.4	0.2	0.4	0.2
Other private sector	3.2	-0.4	-0.3	-1.3	-0.7	-0.5	1.1	1.1	0.9	1.0
Errors and omissions	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.7	1.2	-1.9	-1.4	0.2	0.1	1.0	1.0	1.0	1.0
Financing	1.7	-1.2	1.9	1.4	-0.2	-0.1	-1.0	-1.0	-1.0	-1.0
Gross international reserves (increase, -)	1.7	-2.4	1.2	0.9	-0.3	-0.3	-0.8	-0.3	-0.5	-1.0
Prospective drawings	…	1.1	0.6	0.5	0.1	0.2	0.0	0.0	0.0	0.0
EU	…	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0
World Bank	…	0.0	0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0
IMF	…	1.1	0.3	0.3	0.1	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	-20.9	-6.9	-9.3	-7.1	-7.4	-7.4	-6.5	-6.0	-5.8	-5.5
Trade of goods balance	-25.4	-17.1	-16.7	-16.2	-15.0	-14.1	-12.1	-11.2	-10.9	-10.4
Exports of goods	22.2	20.0	24.6	25.2	28.2	27.8	29.8	30.5	31.1	31.9
Imports of goods	-47.6	-37.1	-41.4	-41.4	-43.2	-41.9	-42.0	-41.8	-42.0	-42.4
Services balance	-0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-2.8	-1.7	-2.7	-2.3	-3.1	-2.4	-3.2	-3.2	-3.0	-2.8
Current transfer balance	7.8	11.8	10.1	11.4	10.8	9.1	8.8	8.5	8.1	7.8
Capital and financial account balance	16.3	10.7	3.0	2.4	8.1	7.6	9.2	8.5	8.0	7.6
Capital transfers balance	0.0	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	3.4	2.9	8.8	5.7	4.1	4.1	4.1	4.1
Portfolio investment balance	-0.3	-0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other investment balance	11.1	6.4	-0.6	-0.7	-0.8	1.7	4.9	4.2	3.7	3.3
Errors and omissions	-0.4	0.3	0.0	-0.1	0.0	0.1	0.1	-0.1	0.1	0.1
Overall balance	-5.1	4.1	-6.3	-4.8	0.8	0.2	2.8	2.4	2.3	2.1
					(Percent, unless otherwise indicated)					
Memorandum items:										
Export volume growth	8.9	-12.4	11.0	19.1	12.4	17.0	10.0	16.0	15.9	15.4
Import volume growth	9.3	-21.8	3.0	4.1	4.0	6.2	9.2	9.6	10.7	10.1
Trading partner import growth	5.9	-17.8	3.5	3.5	5.1	5.1	5.5	5.5	5.2	5.2
Export prices growth	6.7	-8.0	8.9	4.0	10.8	5.0	7.0	-2.9	-3.4	-2.2
Import prices growth	11.8	-10.9	6.3	5.5	9.2	6.0	0.7	-0.1	-0.1	0.6
Change in terms of trade	-4.6	3.2	2.5	-1.4	1.4	-0.9	6.2	-2.8	-3.3	-2.8
GDP (billiions of euros)	33.4	29.9	29.3	29.4	31.9	32.7	35.9	39.5	43.5	47.7

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

(Billions of euros, unless otherwise indicated)

	2008	2009	2010 Est.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
1. Gross financing requirements	8.13	7.22	6.24	7.90	8.51	8.95	9.97	11.58
Current account deficit	7.00	2.06	2.07	2.42	2.33	2.36	2.52	2.62
Debt amortization	3.62	4.25	4.33	5.19	5.38	6.28	6.95	7.96
Medium- and long-term debt	2.67	2.65	2.72	3.58	3.77	4.67	5.34	6.35
Public sector 1/	0.12	0.14	0.24	0.30	0.30	0.36	0.37	0.35
Commercial banks	0.54	0.12	0.47	0.35	0.37	0.67	0.69	1.01
Corporate sector	2.01	2.39	2.01	2.93	3.10	3.65	4.27	4.99
Short-term debt	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	-0.93	0.30	0.80	0.30	0.50	1.00
Repayment of prospective IMF credits	...	...	...	...	0.20	0.67	0.49	0.02
Other outflows, net 2/	-2.48	-1.46	0.76	0.00	0.00	0.00	0.00	0.00
2. Available financing	7.26	6.06	5.77	7.75	8.51	8.95	9.97	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	0.86	1.85	1.47	1.62	1.78	1.96
Portfolio investment (net)	-0.09	-0.06	0.07	0.07	0.07	0.07	0.07	0.07
Debt financing	5.53	4.75	4.84	6.09	7.47	8.29	8.92	9.93
Medium- and long-term debt	4.86	3.14	3.32	4.48	5.86	6.68	7.31	8.32
Public sector 1/	0.18	0.39	0.97	0.80	0.61	0.68	0.68	0.75
Commercial banks	0.23	0.90	1.12	0.94	0.74	0.90	1.10	1.20
Corporate sector	4.46	1.85	1.22	2.74	4.51	5.11	5.54	6.37
Short-term debt	0.67	1.61	1.52	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	0.47	0.15	0.00	0.00	0.00	0.00
European Union	…	0.00	0.00	0.10	0.00	0.00	0.00	0.00
World Bank	…	0.04	0.13	0.07	0.00	0.00	0.00	0.00
IMF	…	1.12	0.34	0.05	…	…	…	…
Memorandum items:								
Debt service	4.35	4.89	5.01	5.97	6.52	7.55	8.25	9.31
Interest	0.73	0.63	0.68	0.78	1.15	1.27	1.31	1.36
Amortization	3.62	4.25	4.33	5.19	5.38	6.28	6.95	7.96

Sources: NBS; and Fund staff estimates and projections.

1/ Excluding IMF.

2/ Includes all other net financial flows, SDR allocations, and errors and omissions.

Table 9. Serbia: External Balance Sheet, 2008-15 1/

	2008	2009	2010 Est.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Bllions of euros)				
International investment position 2/	-23.3	-23.5	-25.7	-27.9	-30.2	-32.6	-35.1	-37.7
Public sector 3/	1.8	3.0	1.0	0.8	1.4	2.1	2.8	3.4
Private sector 3/	-25.1	-26.5	-26.7	-28.6	-31.6	-34.7	-37.8	-41.1
FDI and portfolio investment (net) 4/	-12.2	-13.2	-14.2	-16.1	-17.6	-19.3	-21.2	-23.2
External debt (net) 4/	-21.8	-23.2	-24.1	-25.1	-27.0	-28.3	-29.8	-31.7
Gross external debt	-21.8	-22.8	-23.7	-24.7	-26.6	-27.9	-29.4	-31.4
General government	-6.4	-6.1	-6.9	-7.4	-7.7	-8.0	-8.3	-8.7
Private sector	-15.4	-15.6	-15.4	-15.8	-17.6	-19.3	-21.0	-22.5
Banks	-3.9	-4.7	-5.1	-5.7	-6.1	-6.3	-6.7	-6.9
Other private sector	-11.5	-10.9	-10.3	-10.1	-11.5	-13.0	-14.3	-15.6
Liabilities from drawings under the SBA		-1.1	-1.5	-1.5	-1.3	-0.7	-0.2	-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	2.9	3.2	3.6	3.9	4.3	4.7
Central bank gross international reserves	8.2	10.6	9.7	10.0	10.8	11.1	11.6	12.6
o/w central bank free net reserves	4.8	5.0	4.7	4.9	5.7	6.0	6.5	7.5
				(Percent of GDP)				
International investment position 2/	-69.7	-78.6	-87.3	-85.4	-84.1	-82.5	-80.6	-78.9
Public sector 3/	5.3	10.1	3.4	2.3	4.0	5.3	6.4	7.1
Private sector 3/	-75.0	-88.7	-90.8	-87.7	-88.1	-87.8	-87.0	-86.1
FDI and portfolio investment (net) 4/	-36.6	-44.3	-48.2	-49.3	-49.1	-48.9	-48.7	-48.6
External debt (net) 4/	-65.2	-77.5	-82.0	-76.7	-75.1	-71.6	-68.5	-66.5
Gross external debt	-65.2	-76.2	-80.7	-75.6	-74.0	-70.6	-67.6	-65.7
General government	-19.1	-20.5	-23.3	-22.5	-21.3	-20.2	-19.1	-18.2
Private sector	-46.1	-52.0	-52.4	-48.4	-49.0	-48.8	-48.2	-47.2
Banks	-11.7	-15.7	-17.3	-17.4	-16.9	-15.9	-15.4	-14.4
Other private sector	-34.4	-36.3	-35.1	-31.0	-32.1	-32.9	-32.8	-32.8
Liabilities from drawings under the SBA		-3.8	-5.0	-4.7	-3.7	-1.6	-0.4	-0.3
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	9.9	9.9	10.0	9.9	9.8	9.8
Central bank gross international reserves	24.4	35.6	33.1	30.7	30.1	28.1	26.7	26.4
o/w central bank free net reserves	14.4	16.6	16.0	15.1	15.9	15.2	15.0	15.8
Memorandum items:								
				(Billions of euros, unless otherwise indicated)				
Central bank international reserves								
Gross reserves (months of next year's imports)	7.7	8.6	7.2	6.7	6.6	6.2	5.8	5.7
Free net reserves (months of next year's imports)	4.5	4.0	3.5	3.3	3.5	3.4	3.2	3.4
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	16.6	16.1	14.9	14.5	13.9	12.8
(in percent of central bank free net reserves)	33.4	32.4	34.2	32.7	28.1	26.7	24.7	21.4
(percent of total debt)	7.4	7.1	6.8	6.5	6.1	5.8	5.5	5.1
(percent of GDP)	4.8	5.4	5.5	4.9	4.5	4.1	3.7	3.4
Short term external debt by remaining maturity	5.0	5.3	5.3	5.4	6.3	6.9	8.0	9.1
(percent of central bank gross reserves)	61.6	49.8	54.5	53.7	58.1	62.5	68.5	72.3
(percent of central bank free net reserves)	104.5	106.7	112.5	109.3	109.8	115.3	122.0	121.2
(percent of total debt)	23.1	23.3	22.3	21.8	23.7	24.9	27.1	29.1
(percent of GDP)	15.0	17.7	18.0	16.5	17.5	17.6	18.3	19.1
GDP	33.4	29.9	29.4	32.7	35.9	39.5	43.5	47.7

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 10a. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Billions of RSD)

	2009	2010	2010	2010	2010	2011	2011	2011	2012
		Budget	Fifth Review	Sixth Review	Prel.	Sixth Review	Budget	Proj.	Proj.
Revenue	1,146	1,208	1,203	1,214	1,225	1,323	1,325	1,335	1,431
Taxes	1,000	1,061	1,044	1,052	1,057	1,154	1,153	1,156	1,235
Personal income tax	133	142	137	137	139	150	148	150	162
Social security contributions	319	336	321	322	324	347	345	346	372
Taxes on profits	31	24	32	32	33	37.4	38	37	45
Value-added taxes	297	325	325	321	319	357	356	354	373
Excises	135	148	142	150	152	174	179	181	192
Taxes on international trade	48	44	42	43	44	40	40	41	40
Other taxes	37	43	46	47	46	49	48	46	50
Non-tax revenue	138	145	152	156	159	167	171	177	194
Capital revenue	1	0	0	0	1	0	0	0	0
Grants	7	2	6	6	7	2	2	2	2
Expenditure	1,268	1,344	1,350	1,362	1,361	1,463	1,466	1,475	1,535
Current expenditure	1,154	1,206	1,213	1,220	1,226	1,310	1,319	1,326	1,402
Wages and salaries	302	313	310	310	310	323	329	331	352.7
Goods and services	211	213	216	226	227	248	253	255	270
Interest	22	39	37	34	34	51	50	49	50
Subsidies	63	69	73	74	78	78	84	87	82
Transfers	556	572	578	576	577	610	603	605	647
Pensions	387	396	398	394	394	416	417	418	452
Other transfers 2/	168	176	180	182	183	194	186	187	195
Capital expenditure	93	111	103	112	105	117	119	121	127
Net lending	20	26	28	30	30	36	28	28	5
Fiscal balance (cash basis)	-121.4	-136	-148	-148	-137	-140	-140	-140	-103
Financing	121	...	148	148	137	140	140	140	103
Privatization proceeds	59	...	4	4	7	150	3	89	0
Equity investment	0	…	0	0	-1	-4	-4	-4	0
Domestic	22	...	113	118	96	-41	99	16	91
Banks	-60	...	104	105	81	-30	83	8	88
Treasury Account	-60	...	15	40	15	-50	0	0	0
Commerical banks	0	...	89	65	67	20	83	8	88
Securities	109	...	43	50	58	32	68	60	40
Amortization	27	...	34	38	44	43	52	52	37
External	40	...	31	25	35	35	42	38	12
Program	42	...	45	34	39	52	54	18	24
Project	11	...	17	17	21	20	20	20	22
Bonds and loans	0	...	0	0	0	0	0	32	0
Amortization	13	...	31	26	25	37	32	32	33
Memorandum items:									
Augmented fiscal balance 3/	-142.5	…	-156	-149	-138	-145	-145	-145	-103
Nominal GDP (billions of dinars)	2,815	3,230	3,099	3,034	3,041	3,419	3,419	3,436	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 10b. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Percent of GDP)

	2009	2010 Budget	2010 Sixth Review	2010 Prel.	2011 Sixth Review	2011 Budget	2011 Proj.	2012 Proj.
Revenue	40.7	37.4	40.0	40.3	38.7	38.8	38.9	38.0
Taxes	35.5	32.8	34.7	34.8	33.8	33.7	33.7	32.8
Personal income tax	4.7	4.4	4.5	4.6	4.4	4.3	4.4	4.3
Social security contributions	11.3	10.4	10.6	10.7	10.2	10.1	10.1	9.9
Taxes on profits	1.1	0.7	1.0	1.1	1.1	1.1	1.1	1.2
Value-added taxes	10.5	10.1	10.6	10.5	10.4	10.4	10.3	9.9
Excises	4.8	4.6	4.9	5.0	5.1	5.2	5.3	5.1
Taxes on international trade	1.7	1.4	1.4	1.5	1.2	1.2	1.2	1.1
Other taxes	1.3	1.3	1.6	1.5	1.4	1.4	1.3	1.3
Non-tax revenue	4.9	4.5	5.1	5.2	4.9	5.0	5.2	5.2
Capital revenue	0.0	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	0.1	0.1	0.0
Expenditure	45.0	41.6	44.9	44.8	42.8	42.9	42.9	40.8
Current expenditure	41.0	37.3	40.2	40.3	38.3	38.6	38.6	37.2
Wages and salaries	10.7	9.7	10.2	10.2	9.5	9.6	9.6	9.4
Goods and services	7.5	6.6	7.4	7.5	7.2	7.4	7.4	7.2
Interest	0.8	1.2	1.1	1.1	1.5	1.5	1.4	1.3
Subsidies	2.2	2.1	2.4	2.6	2.3	2.5	2.5	2.2
Transfers	19.7	17.7	19.0	19.0	17.9	17.6	17.6	17.2
Pensions	13.8	12.3	13.0	13.0	12.2	12.2	12.2	12.0
Other transfers 2/	6.0	5.4	6.0	6.0	5.7	5.5	5.4	5.2
Capital expenditure	3.3	3.4	3.7	3.5	3.4	3.5	3.5	3.4
Net lending	0.7	0.8	1.0	1.0	1.0	0.8	0.8	0.1
Fiscal balance (cash basis)	-4.3	-4.2	-4.9	-4.5	-4.1	-4.1	-4.1	-2.7
Financing	4.3	…	4.9	4.5	4.1	4.1	4.1	2.7
Privatization proceeds	2.1	…	0.1	0.2	4.4	0.1	2.6	0.0
Equity investment	0.0	…	…	…	-0.1	-0.1	-0.1	0.0
Domestic	0.8	…	3.9	3.2	-1.2	2.9	0.5	2.4
Banks	-2.1	…	3.5	2.7	-0.9	2.4	0.2	2.3
Treasury Account	-2.1	…	1.3	0.5	-1.5	0.0	0.0	0.0
Commerical banks	0.0	…	2.2	2.2	0.6	2.4	0.2	2.3
Securities	3.9	…	1.6	1.9	0.9	2.0	1.7	1.1
Amortization	1.0	…	1.2	1.4	1.3	1.5	1.5	1.0
External	1.4	…	0.8	1.1	1.0	1.2	1.1	0.3
Program	1.5	…	1.1	1.3	1.5	1.6	0.5	0.6
Project	0.4	…	0.6	0.7	0.6	0.6	0.6	0.6
Bonds and loans	0.0	…	…	…	0.0	0.0	0.9	0.0
Amortization	0.5	…	0.8	0.8	1.1	0.9	0.9	0.9
Memorandum items:								
Structural fiscal balance 3/	-3.2	…	-3.2	-2.9	-2.2	…	-2.3	-1.4
Output gap 4/	-2.8	…	-3.7	-3.5	-4.6	…	-4.4	-3.5
Augmented fiscal balance 5/	-5.1	…	-5.1	-4.5	-4.2	-4.3	-4.2	-2.7
Gross debt	36.8	…	41.0	44.0	40.9	…	41.1	40.2
Nominal GDP (billions of dinars)	2,815	3,230	3,034	3,041	3,419	3,419	3,436	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 10c. 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	1335	729	54	162	37	415	256	141	18	-61
Current revenue	1334	729	53	161	37	415	256	141	18	-61
Tax revenue	1156	681	0	110	19	408	253	138	17	-61
Personal income tax	150	82		69						
Social security contributions	346			0		408	253	138	17	-61
Corporate income tax	37	34		3						
VAT	354	354	0							
Excises	181	162			19					
Taxes on international trade	41	41								
Other taxes	46	8	0	38						
Extrabudgetary taxes	0						0	0	0	
Nontax revenue	177	48	53	51	18	7	3	3	1	
Capital revenue	0	0	0	0	0	0	0	0	0	
Grants	2	0	1	1	0	0	0			
Total expenditure and net lending	1475	537	54	242	39	664	444	194	26	-61
Current expenditure	1326	473	40	188	24	663	443	194	26	-61
Expenditure on goods and services	585	261	34	132	22	198	7	187	4	-61
Wages and salaries	331	167	7	63	1	92	3	87	2	
Employer contribution	0	31	1	12	0	17	1	16	0	-61
Social funds	0			0		0	0	0	0	
Local tax	0			0		0	0	0	0	
Goods and services	255	62	25	57	21	89	3	84	2	
Interest payment	49	45	0	2	2	0	0	0	0	
Subsidies and other current transfers	692	168	6	54		465	437	6	22	
Subsidies	527	55	6	26		440	418	6	16	
Transfers to households	165	113	0	28		25	19	0	7	
Other current expenditure	0					0	0	0	0	
Capital expenditure	121	38	14	53	15	1	1	0	0	
Own resource	101	32	14	46	8	1	0	0	0	
Foreign financed	20	6		7	7					
Net lending	28	27	0	1		0	0	0	0	
Fiscal balance (before transfers)	-140	191	0	-80	-2	-250	-188	-53	-8	0
Transfers from other levels of government	381	0	0	67	0	313	240	56	18	0
Republican budget	317			67	0	250	231	1	18	
Local governments and Vojvodina	0	0	0	0	0	0				
Social security funds	63					63				
Pension Fund	51					51		51		
Health Fund	2					2	2	0		
Labor Fund	10					10	6	4		
Road fund	0	0				0		0		
Transfers to other levels of government	381	317	0	0	0	63	51	2	10	0
Federal budget	0					0				
Republican budget	0					0		0		
Local governments and Vojvodina	67	67				0				
Social security funds	313	250	0	0	0	63				
Pension Fund	240	231				8		2	6	
Health Fund	56	1				55	51	0	4	
Labor Fund	18	18				0				
Road fund	0					0	0		0	
Net transfer to other levels of government	0	-317	0	67	0	250	188	54	8	0
Fiscal balance	-140	-126	0	-13	-2	0	0	0	0	0

Sources: Ministry of Finance; and IMF staff estimates.

Table 11. 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 12. Serbia: Rankings of Selected Competitiveness and Structural Indicators 1/

	Serbia		Best performers 2/				Distance 3/	
	2008	2010		2008		2010	2008	2010
EBRD transition indicators	66	68		92		92	-27	-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	85	92		100		100	-15	-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	34	35	Slovenia	67	Estonia	65	-33	-30
World Bank Doing Business survey 4/	48	51	Estonia	88	Estonia	91	-40	-39
Starting a business	41	55	Macedonia	93	FYR Macedonia	97	-52	-43
Dealing with licenses	6	4	Estonia	90	Estonia	87	-84	-83
Registering property	46	45	Lithuania	98	Lithuania	96	-51	-51
Getting credit	85	92	Bulgaria	97	Albania	97	-13	-5
Protecting investors	61	60	Albania	92	Albania	92	-31	-32
Paying taxes	30	25	Macedonia	85	Estonia	84	-55	-59
Trading across borders	66	60	Estonia	97	Estonia	98	-31	-38
Enforcing contracts	47	49	Latvia	98	Latvia	92	-51	-44
Closing a business	45	53	Lithuania	81	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.

Tabie 13. Serbia: Monetary Survey, 2007–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2007	2008	2009	2010	2011 Proj.
Net foreign assets 2/	563	484	571	507	498
in billions of euro	7.1	5.5	5.9	4.8	4.7
Foreign assets	877	847	1,185	1,287	1,329
NBS	766	725	1,023	1,063	1,090
Commercial banks	111	123	163	224	239
Foreign liabilities (-)	-314	-364	-615	-780	-831
NBS	-14	-14	-115	-170	-180
Commercial banks	-300	-350	-500	-610	-651
Net domestic assets	320	484	608	835	1,001
Domestic credit	701	1,048	1,276	1,708	1,995
Government, net	-112	-53	-4	67	110
NBS	-100	-50	-101	-105	-105
Banks	-12	-4	97	172	215
Local governments, net	-14	-16	-14	-1	4
Non-government sector	827	1,117	1,295	1,643	1,881
Households	306	382	419	528	605
Enterprises	508	711	851	1,078	1,234
Other	13	23	25	36	41
Other assets	78	56	111	29	34
Capital and reserves (-)	-356	-505	-633	-726	-810
NBS	-7	-63	-166	-202	-248
Banks	-350	-442	-467	-524	-561
Provisions (-)	-104	-115	-146	-176	-218
Broad money (M2)	883	968	1,179	1,343	1,498
Dinar-denominated M2	370	371	412	392	457
M1	239	230	250	244	283
Currency in circulation	77	90	96	92	104
Demand deposits	162	140	154	152	179
Time and saving deposits	131	141	162	148	175
Foreign currency deposits	513	597	767	951	1,041
in billions of euro	6.5	6.7	7.3	9.1	9.9
Memorandum items:					
Twelve-month growth:					
M1	25.3	-3.8	8.7	-2.2	23.7
M2	44.5	9.6	21.8	13.9	26.7
Credit to non-gov. (actual exchange rates)	48.6	48.7	9.4	15.4	7.1
Domestic	36.9	35.0	15.9	29.0	14.5
Households	50.3	25.0	9.5	26.1	14.6
Enterprises	33.2	40.0	19.6	26.7	14.5
External	68.0	67.2	2.2	1.1	-4.3
Credit to non-gov. (constant exchange rates) 3/	43.3	35.9	2.5	8.6	8.8
Domestic	36.8	25.9	9.5	21.0	16.0
Households	…	…	…	…	…
Enterprises	…	…	…	…	…
External	53.3	49.6	-5.5	-8.1	-3.9
Velocity (M1)	9.4	11.9	11.3	12.5	10.9
Velocity (M2)	2.5	2.8	2.4	2.3	2.1

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.

3/ Using the August 2008 dinar/euro rate as the base for converting FX and FX-indexed loans to dinars for the period 2077-11. Assumes all FX loans are in euros.

Table 14. Serbia: Balance Sheet of the NBS, 2007–11

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

	2007	2008	2009	2010	2011 Proj.
Net foreign assets 2/	482	517	628	543	577
in billions of euro	6.1	5.8	6.6	5.1	5.5
Gross foreign reserves	766	725	1,023	1,063	1,090
Gross reserve liabilities (-)	-284	-208	-394	-520	-513
Net domestic assets	-323	-208	-382	-364	-374
Net domestic credit	-316	-145	-216	-162	-126
Government	-100	-50	-101	-105	-105
Claims	11	11	11	1	1
RSD	11	11	11	1	1
foreign currency	0	0	0	0	0
Liabilities (-)	-111	-60	-112	-107	-107
RSD	-29	-20	-63	-54	-54
foreign currency	-82	-41	-49	-53	-53
Other public sector	-11	-15	-12	-15	-13
Banks	-218	-88	-151	-46	-59
Claims	1	2	1	1	1
Liabilities (-)	-219	-90	-152	-47	-60
Other sectors	13	7	48	5	51
Capital accounts (-)	-7	-63	-166	-202	-248
Reserve money	159	309	247	179	203
Currency in circulation	77	90	96	92	104
Commercial bank reserves	82	219	151	87	99
Required reserves	30	165	112	65	82
Excess reserves	45	5	7	11	5
Vault cash and giro accounts	7	48	32	11	12

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

	2007	2008	2009	2010		
					Billions of euros	Percent of GDP
Assets	1,678	1,925	2,342	2,747	26.0	90.3
Foreign exchange	111	123	163	224	2.1	7.4
Claims on NBS	569	508	583	484	4.6	15.9
Dinar cash and reserves	80	219	151	87	0.8	2.9
Foreign exchange reserves	270	194	279	349	3.3	11.5
NBS bills and other claims	219	95	153	48	0.5	1.6
Claims on government	8	9	108	193	1.8	6.3
Claims on other sectors	827	1,118	1,299	1,652	15.7	54.3
Households	305	382	418	528	5.0	17.3
Enterprises	507	710	849	1,076	10.2	35.4
Other institutions	15	27	31	49	0.5	1.6
Fixed assets	75	88	99	107	1.0	3.5
Other assets	88	78	90	87	0.8	2.9
Liabilities	1,678	1,925	2,342	2,747	26.0	90.3
Foreign liabilities	300	350	500	610	5.8	20.1
Dinar deposits	319	301	338	314	3.0	10.3
Demand deposits	162	140	155	153	1.4	5.0
Time and saving deposits	142	154	178	157	1.5	5.2
Government deposits	16	7	5	4	0.0	0.1
Foreign currency deposits	517	599	770	962	9.1	31.6
Enterprises	116	140	145	159	1.5	5.2
Households	382	414	565	731	6.9	24.0
Government	4	6	7	17	0.2	0.5
Other institutions	15	40	53	55	0.5	1.8
Other deposits	3	1	2	51	0.5	1.7
Liabilities to NBS	2	6	1	1	0.0	0.0
Other liabilities	95	122	128	120	1.1	3.9
Provisions	93	103	135	166	1.6	5.5
Capital and reserves	350	442	467	524	5.0	17.2
Memorandum items:						
Provisions against credit losses	75.8	98.8	133.2	163.0	1.5	5.4
in percent of credit	9.2	8.8	10.3	9.9	9.9	...
Enterprises	58.8	72.5	99.8	124.4	1.2	4.1
in percent of credit	11.6	10.2	11.7	11.6	...	...
Households	10.8	17.2	23.3	26.3	0.2	0.9
in percent of credit	3.5	4.5	5.6	5.0	...	...
Off-balance sheet items 2/	1,580	2,157	2,305	2,656	25.2	87.3
External debt (billions of euros)	4.0	3.9	4.7	9.6	...	24.8
medium- and long-term	2.8	2.3	2.7	9.5	...	24.6
short-term	1.2	1.6	2.0	0.1	...	0.3

Source: National Bank of Serbia.

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

2/ As of December 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 16. 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	15	16	191	579	507	117
In millions of euro	5	17	18	222	676	595	138
In percent of exports of goods and NFS	0.1	0.2	0.2	1.6	4.5	3.5	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	3.2	3.4	40.8	123.9	108.4	25.0
In percent of total external debt service	0.1	0.6	0.4	4.3	10.2	8.2	1.8
In percent of gross international reserves	0.0	0.2	0.2	2.0	6.1	5.1	1.1
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	1,521	1,582	1,384	728	143	7
In percent of exports of goods and NFS	13.6	15.1	13.6	10.3	4.8	0.8	0.0
In percent of GDP	3.9	5.2	4.8	3.9	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	6.4	6.4	5.2	2.6	0.5	0.0
In percent of gross international reserves	10.8	15.7	15.8	12.8	6.6	1.2	0.1
Memorandum items:		(Millions of euros, unless otherwise indicated)					
Exports of goods and NFS	8,473	10,070	11,624	13,460	15,073	16,817	19,248
Quota (in millions of SDRs)	468	468	468	468	468	468	468
Total external debt service	3,591	2,739	4,379	5,137	6,620	7,240	7,841
Public sector external debt (end-period)	7,245	8,323	8,877	8,982	8,636	8,454	8,830
Total external debt stock (end-period)	22,801	23,724	24,683	26,569	27,914	29,406	31,355
Gross international reserves	10,644	9,715	10,015	10,815	11,115	11,615	12,615

Source: Fund staff estimates.

1/ Assuming a 10 percent of quota purchase in connection with the 7th review.

Table 17. 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	46.7	10	Observance of end-September 2010 performance criteria and completion of the quarterly program review.
9.	April 1, 2011 2/	319.595	68.3	46.7	10	Observance of end-December 2010 performance criteria and completion of the quarterly program review.
	Total	2,619.12	560	1,367.74	292.5	

1/ The quota is SDR 467.7 million.
2/ Date of purchase availability under the SBA.

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, March 21, 2011

Dear Mr. Strauss-Kahn:

1. Our program has continued to perform well. All end-December 2010 performance criteria were observed (Table 1). In particular, the 2010 fiscal deficit target was met by a considerable margin. We also fulfilled the program's structural benchmark, as the *Law on Voluntary Corporate Financial Restructuring* has been submitted to Parliament. As expected previously, December inflation exceeded the upper program band by 2¼ percentage points. In line with the inflation consultation clause, the National Bank of Serbia (NBS) sent a letter that explains the reasons for relatively high inflation and the monetary policy response.

2. GDP growth has remained on track, but the much-needed transition from consumption-led to more export-led growth is proving more painful than expected. Growth is estimated to have reached 1¾ percent in 2010, and is projected to increase to 3 percent in 2011. The sharp real depreciation over the last two years has leveled the playing field for companies in our tradable sector, as reflected in the rebound of exports to the EU. But the depreciation has also adversely affected the balance sheets of companies with unhedged foreign exchange loans. Small- and medium-sized companies in the nontradable sectors are going through a particularly wrenching economic adjustment, and employment in both the formal and informal segments of the private sector has contracted sharply. Although job security in the public sector remained high, nominal wage and pension freezes sustained through 2009–10 have cut into real incomes of public sector workers and pensioners.

3. Inflation remained high during recent months, reflecting mainly global and local food price shocks, but also the cumulative impact of nominal exchange rate depreciation. The 2010 current account deficit is estimated at 7 percent of GDP, significantly better than expected, mainly due to higher remittances, but also a narrower trade deficit. Capital inflows have reversed course over the last few months, responding to relatively high nominal T-bill yields. But foreign investors are also attracted by sounder economic fundamentals and our improved policy framework, including the new fiscal responsibility legislation. This has been reflected in some appreciation of the dinar and no need for official interventions in the foreign exchange market.

4. We remain determined to use fiscal and monetary policies appropriately to respond to the challenges confronting us:

- As regards fiscal policy, we will implement policies in 2011 and beyond that are consistent with the fiscal responsibility legislation. We are determined to resist trade union pressures for large, sustained increases in wages in excess of the two additional indexation steps already envisaged for May and November 2011. Such wage increases would put fiscal and price stability at risk. To protect the most vulnerable segments of our population, we have already allocated substantial additional resources in the 2011 budget. At the same time, if revenues at the consolidated central government level (Republican budget and social security funds, but excluding own resource budgets) overperform relative to target and overall spending remains in line with budget projections, we plan to use part of the revenue overperformance to provide limited, targeted, and one-off payments to public wage and pension recipients. However, these additional one-off payments will be capped at 0.35 percent of GDP.

- As regards monetary policy, we have responded to the inflation surprise in a measured but determined manner, increasing the policy rate by 425 basis points since August 2010, as well as by scaling back the scheduled easing of reserve requirements during the first quarter of 2011. We will continue to use the full array of our policy tools to ensure that inflation expectations remain reasonably anchored and to bring inflation back into our announced tolerance target band by at the turn of 2011/12.

5. In consideration of our good implementation record, we request the completion of the seventh and last 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, we intend to purchase only SDR 46.7 million.

6. As the SBA comes to an end, we consider that many of the key objectives set at the outset of the program have been achieved, but we also recognize that much remains to be done to lock in a more sustainable growth model. In particular, the SBA has helped contain adverse spillover effects from the global financial crisis that erupted in September 2008. Serbia's economy has so far weathered the crisis better than most of its neighboring peers, and the transition to more export-led growth is making progress. Notwithstanding the large shocks, the financial sector proved highly resilient, and financial crisis preparedness was enhanced. However, the crisis has also taken its toll, especially in the private sector part of the labor market. We intend to build on our achievements by persevering with disciplined macroeconomic policies and by accelerating the pace of structural reforms in the period ahead to secure greater economic prosperity.

/s/

Mirko Cvetkovic
Prime Minister

/s/

Dejan Soskic
Governor of the National Bank
of Serbia

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.	Adj.	Prel.
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	4.0	4.9
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	152	137
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	0	20	0	20	20	0
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	600	180
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	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	6.0	10.3
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	8.0	n.a.
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	4.0	n.a.
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	750	747
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	18	50	18	50	50	38

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.

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. **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.

20. **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.

ATTACHMENT III. REPUBLIC OF SERBIA: INFLATION CONSULTATION LETTER

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund

March 16, 2011

Dear Mr. Strauss Kahn,

1. In December 2010, CPI inflation rose to 10.3 percent, breaching the upper limit of the inflation consultation band (8 percent) agreed under the SBA by more than 1 percentage point. This letter explains: (1) the reasons why inflation has breached the upper limit of the inflation consultation band agreed under the SBA by a significant margin; (2) discusses the policy response; and (3) the outlook for inflation.

2. To summarize, the surprise increase in inflation in the second half of 2010 was mainly driven by three factors: significant shocks to food prices; pass-through from higher than expected dinar depreciation; and rising import prices. In response, starting in August 2010, the NBS has tightened its monetary policy stance substantially. The policy rate has been hiked in seven steps by a total of 425 basis points; moreover, an earlier announced easing of reserve requirements during the first half of 2011 has been largely put off until the inflation outlook is again in line with NBS targets. These measures have succeeded in keeping inflation expectations reasonably anchored, and earlier one-sided depreciation pressures have reversed. Given our policy response so far, our readiness to take further action if needed, and the expectation that most of the shocks will taper off, inflation should gradually return to the NBS' tolerance band at the turn of 2011/12.

Reasons for exceeding the target

3. CPI inflation (year-on-year) remained very low during the first half of 2010, but upside risks surfaced shortly thereafter. Developments through June were driven by low aggregate demand and declining processed food prices. Nevertheless, risks from depreciation pass-through and from the impact of a weak agricultural summer season, resulting in a lower seasonal decline of fruits and vegetables, and large increase in other agricultural prices (wheat, corn etc), were already apparent in July and flagged in the Inflation Report issued in August.

4. The second half of 2010 saw a sharp and unexpectedly strong surge in inflation, leading to the breach of the upper limit of the tolerance band (6±2 percent). The increase in inflation observed since July was driven mainly by three factors:

- *Food price shocks due to bad weather and rising international food prices*. The increase of food prices (food and beverages represents 37.8 percent of the CPI) evident since August was a key contributor to inflation.

- *Depreciation pass-through*. The recent increase in inflation also reflects the weakness of the dinar, fuelled by the euro zone crisis this summer, and possibly combined with a non-linear propagation mechanism. In particular, the observed acceleration of inflation would be consistent with price setters adjusting prices upwards to restore their depleted profit margins after the exchange rate crosses a certain threshold. The dinar depreciated around 40 percent since the start of the global crisis and (on average) by 10 percent last year, while inflation had remained relatively subdued during this period.

- *Recovering import prices*. Falling import prices had contributed to restrain inflation, but they have now recovered strongly contributing to upward inflation pressure. Serbia's import prices rose significantly in the last three quarters of 2010.

5. While initially higher inflation was led by recovering food prices, in recent months, price increases have become more broad-based. The measure of core inflation monitored by the NBS (consisting of CPI exclusive of regulated and agricultural prices) has been steadily increasing, reaching 8.8 percent in December. Core inflation exclusive of other volatile elements, such as processed foods and fuel, had a similar year-on-year increase, although in the second half of the year, the contribution of non-food elements of core inflation was much less than that of processed food.

6. Food prices are on the rise around the globe, but the effect has been particularly pronounced in Serbia. As discussed in the November Inflation Report, food prices in Serbia's neighboring countries rose much less (or even declined) even though they were also facing rising primary agricultural commodity prices. Several steps could help reduce food price volatility in Serbia. The country's efforts to join the EU will support boosting competition in the food market. In addition, high customs duties on food imports will decline and eventually disappear in 2015 with the implementation of the Stabilization and Association Agreement. Finally, the government, in communication with the NBS, is studying measures related to commodity reserves, minimum prices, premium setting, subsidies, which will also seek to reduce food price volatility.

Policy response

7. As a result of the higher inflation, the NBS has taken steps to bring future inflation back into its target range. Specifically, the policy rate has been hiked in seven steps by a total of 425 basis points between August 2010 and March of this year. The NBS has also partially suspended earlier announced decreases in reserve requirements to complement the rate hikes

and reduce the need for additional hikes. As a result of these measures, the policy stance has been significantly tightened.

Inflation outlook

8. Economic activity is expected to recover gradually but there is still a sizeable output gap. The economy is estimated to have grown by around 1¾ percent in 2010 and is projected to grow by 3 percent in 2011 and by 4–5 percent in subsequent years. Under this scenario, an output gap is projected to remain negative over the next few years. Unemployment stands at close to 19 percent, also pointing to significant slack in the economy. The recovery is being led by exports, while domestic demand is expected to start recovering in 2011. The prospects on the external demand front is somewhat clouded by uncertainty surrounding developments in peripheral EU countries. A slowdown in the euro area would dampen prospects for growth in Serbia. On the domestic front, the unfreezing of public wages and pensions starting in January, will give a small boost to demand.

9. Inflation expectations have been consistently above NBS targets but have remained reasonably stable in the face of the acceleration of inflation**.** The various surveys show that one-year-ahead expectations of the financial sector, have risen in recent months, but far less than actual inflation, and remain somewhat above the NBS' target band. For other sectors, expectations are higher.

10. Fiscal policy in 2011 will impart a contractionary impulse, and the budgeted partial indexation of public wages and pensions will also help reduce inflationary pressures. In line with the fiscal responsibility framework, the structural fiscal balance is projected to improve by about 1 percent of GDP. Public wages and pensions were unfrozen after two years, with only moderate nominal increases in January, April, and October. However, as regards regulated prices, higher cigarette excises and energy tariffs will produce a temporary spike in inflation in early 2011.

11. Since late December 2010, the dinar has been on a moderate appreciation trend. Since the trough hit in November, the dinar has appreciated by about 4 percent and is now hovering at around RSD 103 per euro. Since December, NBS interventions in the FX market resulted in a small net purchase of reserves for the first time. The appreciation seems to be the result of a change in market sentiment towards Serbia. Specifically, contrary to what occurred in late 2010, government T-bill auctions have been significantly oversubscribed, and the country risk premium declined.

12. After overshooting the target tolerance band for most of 2011, inflation is expected to decline towards the target by the end of the year. The cost push pressure on food prices and a hefty rise in regulated prices will keep inflation elevated in the first half of 2011 (along with a low base effect) despite low demand and recent appreciation of the dinar. Inflation is expected to fall sharply in the second half of the year and early 2012 on the back of anticipated relative drop in food prices, and low aggregate demand (along with a high base

effect). Given the transmission mechanism, monetary tightening was undertaken since August 2010 is expected to reach its maximum disinflationary impact in the second half of 2011.

13. The NBS will continue to pursue monetary policy in line with targeted inflation in the medium term. The NBS will therefore continue monitoring all relevant inflation factors and will respond in a timely fashion as necessary. The achievement of targeted inflation rates and, more generally, price stability will contribute to a macroeconomic environment conducive to sustainable economic growth and employment, which are the overarching economic policy objectives of the Government of Serbia.

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

Statement by the IMF Staff Representative on the Republic of Serbia
Executive Board Meeting
April 8, 2011

This statement provides information that has become available since the issuance of the staff report (EBS/11/47). The new information does not alter the thrust of the staff appraisal.

1. **Standard & Poor's upgraded Serbia's rating on long term sovereign local and foreign currency debt from BB- to BB.** The upgrade was justified by Serbia's improving economic policy implementation, and its new momentum regarding fiscal consolidation, structural reform, and economic rebalancing. The upgrade also points to political consensus supportive of EU integration, but cautions that a downgrade could be in the offing if major political maneuvering before or after the upcoming parliamentary elections causes backtracking from fiscal targets.

2. **A broad political consensus has emerged that the upcoming parliamentary elections should only be held after the EU's decision on Serbia's EU candidate status.** The EU is expected to decide on Serbia's EU candidate status during the last quarter of 2011.

3. **The Serbian government introduced a three-month ban on wheat exports** (subsequently modified to allow for a quota for flour exports)**.** The decision reflected concerns about rising bread prices in the domestic market. Serbia's decision follows similar measures taken by other countries in the region, and is likely to add to scarcity in the international wheat market and reduce incentives for producers to expand production

4. **There was only one bid for the acquisition of the 51 percent of Telekom and the offer was below the government's minimum price.** In line with tender procedures, the government has given Telekom Austria a 15-day period to improve its bid.

5. **Parliament has taken several important actions.** These include: i) adoption of a new social welfare law to allow expanded coverage of social programs; ii) the appointment of the fiscal council envisaged under the new fiscal responsibility law; and iii) the modification of the construction law, aiming at simplifying the issuance of construction permits and clarifying property rights.

Press Release No. 11/125
FOR IMMEDIATE RELEASE
April 8, 2011

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Seventh and Final Review Under Stand-By Arrangement with Serbia and Approves €353.5 Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the seventh and final review of Serbia's economic performance under the program supported by a Stand-By Arrangement (SBA). Completion of the review enables the immediate disbursement of SDR 319.595 million (about €353.5 million or US$509 million), although the authorities have indicated that they intend to purchase only SDR 46.7 million (about €51.6, US$74.4 million, or 10 percent of the country's IMF quota), bringing total disbursements under the program to SDR 1.368 billion (about €1.5 billion or US$2.2 billion).

Serbia's initial 15-month SBA was approved on January 16, 2009, in the amount of SDR 350.8 million (about €388 million, or US$558.7 million). On May 15, 2009, the arrangement was extended by one year and augmented to SDR 2.62 billion (about €2.9 billion, or US$4.2 billion) to support the government's economic program amid a sharper than expected impact from the global financial crisis (see Press Releases No. 09/12 and No. 09/169). The arrangement expires on April 15, 2011. Serbia joined the IMF in December 1992 and has a Fund quota of SDR 467.70 million.

Following the Executive Board's discussion of Serbia, IMF Managing Director Dominique Strauss-Kahn, made the following statement:

"Serbia's satisfactory performance under its economic program supported by the Fund's Stand-by arrangement contributed to reducing vulnerabilities and helped avert a financial meltdown during the global crisis. The growth outlook is favorable, although inflationary pressures are rising. Serbia is making progress toward a more balanced economic growth model, but the adjustment is proving difficult, as indicated by strong pressures to hike public wages and significant private sector job losses.

"Politically difficult reforms will be needed to entrench more sustainable growth. The outstanding reform agenda includes addressing the oversized public sector, following up on the recent pension reform, rationalizing the public enterprises, and improving the business environment.

"The authorities have so far successfully managed pressures to relax public spending. Keeping public finances under control and complying with the fiscal responsibility legislation is essential to support balanced-growth.

"Although there is still excess capacity in the economy, inflation has surged as a result of higher food prices and the pass-through of the exchange rate depreciation. The National Bank of Serbia has decisively tightened monetary policy, keeping inflation expectations from rising significantly.

"Serbia's banking system remains liquid and well capitalized. These buffers are adequate to withstand the much-needed restructuring of the corporate sector. To complement recent efforts to facilitate corporate restructuring, the authorities should finalize the new framework on the voluntary out-of-court financial restructuring and a corresponding package of tax and provisioning incentives."

Statement by Mr. Weber and Mr. Antic on Republic of Serbia
April 8, 2011

1. We thank staff for this comprehensive overview of what was achieved under the Stand-By Arrangement (SBA) and what challenges lie ahead for Serbia. The staff report well maps the desirable course of policy action in order to move from recovery to sustainable growth and to ensure longer-term fiscal sustainability. We share staff's assessment, including on the constraints regarding policy implementation.

2. The Serbian authorities consider the SBA to have been an adequately flexible framework to deal with crisis shocks and related adjustment processes as well as a useful commitment and coordination device. They would like to highlight a number of major achievements under the program: (i) forestalling a financial crisis, helped by the establishment of the European Bank Coordination Initiative (EBCI); (ii) tight control of public wages and pensions and implementation of a significant parametric pension reform; (iii) introduction of numerical fiscal responsibility rules and creation of a Fiscal Council; and (iv) setting in motion the process of rebalancing the economy towards a growth model based on more robust exports, savings, and better hedged FX risks on private-sector balance sheets. The SBA thus addressed not only potential spillovers from the global financial crisis but also a number of long-standing structural issues. As the program focus shifted from the prevention of financial contagion effects in the early phase to preserving fiscal sustainability and fostering the necessary wage and entitlement reforms later on, some flexibility in program design was required.

3. All end-December performance criteria under the program have been observed. With the submission of the Law on Voluntary Corporate Financial Restructuring to Parliament, an important structural benchmark was also met. However, inflation at end-December was above the upper program band, triggering the inflation consultation clause. Due to limited short-term balance-of-payments needs, the authorities again intend to draw only partially, in the amount of 10 percent of quota, on the resources made available after this final review.

4. Serbia's economy is expected to grow by 3 percent in 2011 in real terms, led by strong export performance, which is, however, not enough to make a significant impact on unemployment. Inflation remains in double digits, but the authorities are confident that it will start to decline in the second quarter of this year. Foreign exchange reserves remain robust.

5. Revenue collection was better that projected, while expenditures, especially capital spending and net lending, were lower. The financing strategy will stay flexible due to uncertainty regarding privatization revenues, relying on loans from the IFIs, foreign exchange loans from domestic banks, and the issuance of dinar T-bills. The fiscal responsibility legislation will shape and constrain fiscal policy in 2011 and beyond. The authorities are determined to continue with the agreed prudent wage and pension indexation

schemes and have pledged to resist union pressure for higher increases. Should revenues overperform, the authorities plan to provide limited, targeted, and one-off payments to public employees and pensioners.

6. The National Bank of Serbia (NBS) has responded to the sharp rise in inflation in a measured but determined way. The policy rate has been raised by 425 basis points since August 2010 and the scheduled easing of reserve requirements was scaled back. The NBS will continue to use all available instruments to bring inflation back into the announced target band at the end of 2011.

7. Due to conservative NBS provisioning requirements, the banking sector in Serbia has proved resilient. Although non-performing loans increased significantly, it is expected that the new Law on Voluntary Corporate Financial Restructuring will be conducive to effectively deal with cases of corporate insolvency. The authorities are pleased that foreign banks generally respected their commitments under the now elapsed European Bank Coordination Initiative (EBCI).

8. The authorities acknowledge that difficult economic and political challenges lie ahead as Serbia transitions to a sustainable growth model. They agree that its agenda for action should include reforming public sector administration, restructuring of utilities, continuation of pension reform, and improving the business environment as a matter of priority. In the short term, the focus will be on streamlining regulation, active labor market measures, and the promotion of FDI.

9. The completion of this review ends an intensive phase of cooperation of Serbia with the Fund. However, the authorities feel that—although the macroeconomic situation is improving—the country still faces significant external risks and needs to address high inflation, persistent unemployment, and an array of structural shortcomings. They clearly see the merits of continuing with a Fund supported program, but have not made a decision whether to request a successor arrangement. Such an arrangement would likely be precautionary. On behalf of our Serbian authorities, we thank staff and management for their valuable advice during the program period. This advice has served as an important anchor not only for the conduct of prudent macroeconomic policies but also for the implementation of necessary structural reforms.