INTERNATIONAL MONETARY FUND

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REPUBLIC OF SERBIA

December 2015

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SERBIA

In the context of the Third Review under the Stand-By Arrangement and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 18, 2015, following discussions that ended on November 11, 2015, with the officials of Republic of Serbia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 4, 2015.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Serbia.

The documents listed below have been or will be separately released.

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

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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December 18, 2015

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IMF Executive Board Completes Third Review of Serbia's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) on December 18, 2015 completed the third review of Republic of Serbia's economic performance under the Stand-By Arrangement (SBA). The completion of the review will make available the cumulative amount of SDR 491.085 million (about €627 million). The Serbian authorities have indicated their intention to continue treating the arrangement as precautionary.

The Executive Board approved the 36-month, SDR 935.4 million (about €1.2 billion at the time of approval) SBA for Serbia on February 23, 2015 (see Press Release No. 15/67).

Following the Executive Board's decision, Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"The Fund-supported program is delivering good results. The economy continues to recover on the back of efforts to strengthen public finances, address structural weaknesses, and improve the business climate. However, risks remain. Full implementation of program commitments is needed to achieve program objectives of maintaining macroeconomic stability, restoring public debt sustainability, and strengthening growth potential.

"The fiscal over-performance achieved so far this year is commendable and allows clearance of some past liabilities and inclusion of a modest and targeted increase in public wages and pensions in 2016 budget. At the same time, to place public debt on a firm downward path requires further structural adjustment of around 1.5 percent of GDP in 2016–17. In this regard, the second phase of public sector rightsizing needs to be prepared and implemented expeditiously. In order to improve Serbia's growth potential, public investment projects need to be well-prioritized and planned, underpinned by feasibility studies and fiscal risk analysis to ensure that projects contribute to growth potential without incurring excessive public debt.

"The fiscal consolidation has provided space for substantial monetary easing. Persistent inflation undershooting in the context of the current uncertain environment calls for cautiously accommodative monetary policy. The NBS's continued commitment to the inflation targeting regime and exchange rate flexibility is welcome.

"Progress in the financial sector area is encouraging. The completion of the special diagnostic studies of Serbia's largest banks contributes strongly to financial sector soundness and confidence, while highlighting remaining issues which require further action. In addition, the coordinated actions across government, the NBS and banks envisaged under the NPL resolution strategy will help clear lending channels and reduce remaining vulnerabilities.

"Keeping momentum in implementing the identified structural reforms is essential for reducing fiscal risks and supporting competitiveness and growth. In particular, it is important to take decisive actions toward implementing the commitments in the area of large SOEs, especially in the energy and transport sectors, and timely resolution of enterprises in the portfolio of the Privatization Agency."

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

December 4, 2015

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Recent economic developments. The program is delivering good results. Significant fiscal tightening and efforts to address structural weaknesses and improve the business climate have helped restore growth and boost confidence and FDI. While monetary easing has led to considerable reduction of lending rates, inflation remains below the NBS tolerance band due to low imported inflation, one-off factors, and still subdued domestic demand.

Program status. The 36-month Stand-By Arrangement (SBA) with access of SDR 935.4 million (200 percent of quota, or about €1.2 billion) approved on February 23, 2015 is broadly on track. All end-September performance criteria (PCs) were met with significant margins. However, there was a minor deviation in the indicative criterion on domestic arrears, and implementation of structural benchmarks (SBs) has faced delays. Completion of the review will make available the cumulative amount of SDR 491.09 million. The authorities intend to continue treating the arrangement as precautionary. Modifications of the end-December fiscal performance criteria are proposed to allow recognition of past liabilities.

Policy recommendations. Full implementation of program commitments is needed to achieve program objectives of maintaining macroeconomic stability and strengthening Serbia's growth potential. Correcting the delays in public sector rightsizing is needed to achieve required fiscal consolidation. Keeping momentum in resolving loss-making state-owned enterprises (SOEs) and reforming energy and transportation sectors is important for limiting fiscal risks. Following the completion of special diagnostic studies (SDS) of bank asset quality, it will be important to incorporate lessons and practices in the supervisory framework and mitigate vulnerabilities in some banks. Further structural reforms are required to improve the business climate and support Serbia's medium-term growth.

New program commitments. New benchmarks are proposed in the areas of public sector rightsizing, tax administration, energy sector reform, and resolution of SOEs. March and June 2016 performance criteria are proposed based on 2016 quarterly projections. Prior actions were set on certain key budget and structural measures.

Approved By
Thanos Arvanitis and Petya Koeva Brooks

Discussions were held in Belgrade during October 29–November 11, 2015. The staff team comprised James Roaf (head), Chuling Chen, Dmitriy Kovtun (all EUR), Christine Richmond (FAD), Natalia Stetsenko (LEG), Constant Verkoren (MCM), Manrique Saenz (SPR), Daehaeng Kim (resident representative), Desanka Nestorović and Marko Paunović (Belgrade office). Vuk Djokovic (OED) joined the policy discussions. HQ support was provided by Min Kyu Song and Patricia Mendoza (both EUR).

CONTENTS

APPENDIX

RECENT ECONOMIC DEVELOPMENTS

1. **The recovery continues, supported by stronger private investment** (Tables 1–7 and Figure 1). Low oil prices have continued to offset the effects of fiscal tightening. The flash Q3 GDP estimate shows 2 percent (y/y) growth, although almost flat in seasonally adjusted q/q terms. Industrial production in the first nine months of 2015 grew 8 percent relative to the same period of the last year. Recent indicators point to a robust expansion of private investment on the back of strengthened confidence about Serbia's outlook.

2. **Despite substantial monetary easing, inflation continues to undershoot the NBS target.** In 2015, the NBS has cut the key policy rate by 350 basis points to a historic low of 4.5 percent (Figure 2), pushing the one week interbank money market rate under 3¼ percent (Figure 3). Easing of the policy rate percolated to the credit markets—bank lending interest rates fell substantially and credit volumes picked up, resulting in a slight (y/y) growth of credit to economy, mostly driven by lending to enterprises. Nevertheless, headline inflation in October (1.4 percent) remained below the NBS inflation tolerance band, mostly due to low import prices as well as an unexpected fall in fruit and vegetable prices in the summer. However, core inflation edged up to 2.2 percent in October.

3. **The external position continues to strengthen, although less than envisaged in the second review** (Figure 5)**.** While both exports and imports have preserved the strong levels attained during the first half of 2015, net exports in Q3 have contributed less to growth than originally envisaged, partly due to stronger imports for equipment. Remittances in the third quarter continued to grow strongly. While the deficit in the income balance increased, this reflected, to a large extent, strong FDI profits—a large part of which were reinvested. Gross FDI in the first nine months of 2015 was nearly 20 percent higher than in the same period of 2014. While manufacturing (motor vehicles) is the sector contributing the most, FDI growth in agriculture, mining, and air transport was also significant. The effective exchange rate remained relatively stable in the first nine months of 2015, both in nominal and real terms.

4. **Fiscal over-performance continued in the third quarter, although public sector rightsizing has been delayed.** Through September the general government fiscal deficit was only one-third of that programmed at the time of program

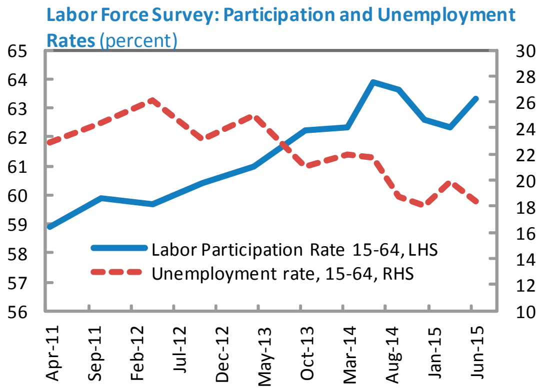
Serbia: General Government Fiscal Operations, RSD billion

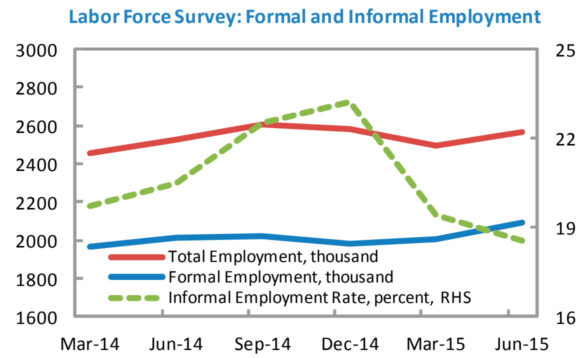
	January-September 2015		
	Prog.	Actual	Diff.
Total revenue	**1,108.2**	**1,191.1**	**82.9**
Tax revenue	978.9	1,020.2	41.3
of which: VAT	284.2	304.5	20.2
of which: Social security contributions	305.1	321.5	16.4
Non-tax revenue	123.9	164.1	40.3
Capital revenue	0.0	1.8	1.8
Grants	5.4	4.9	-0.5
Total expenditure	**1,261.6**	**1,242.2**	**-19.4**
Current expenditure	1,166.8	1,153.6	-13.2
Capital expenditure	73.7	64.0	-9.7
Net lending	2.5	2.0	-0.5
Amortization of activated guarantees	18.5	22.6	4.0
Fiscal balance	**-153.4**	**-51.1**	**102.3**
Memo:			
Primary current expenditure of the Republican budget	657.2	614.5	-42.7
General government debt (percent of GDP)	…	73.4	…

Sources: Ministry of Finance, IMF staff calculations.

approval. Revenue contributed about 80 percent to the over-performance, almost equally split between tax and non-tax revenue.

5. **Revised Labor Force Survey indicators showed improvement in the labor market.** Participation and employment rates have risen, and unemployment, while still very high, has declined since Q1. The informal employment rate has declined, possibly reflecting stronger labor inspection efforts.





Source: Statistical Office of the Republic of Serbia (SORS).

PROGRAM PERFORMANCE

6. **The comprehensive adjustment program is broadly on track** (MEFP Tables 1–2). The authorities reiterated their commitments to all program objectives and targets.

- **All end-September and continuous PCs were observed, with a minor setback in the indicative target on domestic arrears**. The September fiscal deficit ceiling for the general government was met by a large margin, and the ceilings on current primary expenditure of the Republican budget, issuance of guarantees were also observed. However, the central government accumulated some domestic arrears due to a one-off development. The NIR target was also comfortably met on the back of moderate reserve accumulation. While inflation has been below the NBS target band, it remained within the inner limit of the program inflation clause.

- **The authorities are committed to accelerate their efforts to correct delays in the implementation of some structural benchmarks.** The posting of the local government financing law (structural benchmark for end-October) has been set as a prior action for the third review. The adoption by the government of a restructuring plan for Srbijagas (structural benchmark for January 2016) has been replaced by a prior action to finalize the terms of reference for hiring an independent audit firm to prepare a clean baseline for the financial position of the company, which would serve as a basis for a restructuring plan to be adopted in 2016. The adoption of a corporate and financial restructuring plan by Railways of Serbia and the completion of the banks' special diagnostic studies (end-September structural benchmarks) were implemented with one and two month delays, respectively.

- **The authorities have made important progress in the structural reform agenda for end-December.** As of end-October, insolvency proceedings or public tenders for privatization have started for 320 out of 500 enterprises in the portfolio of the Privatization Agency. Good progress is being made in the resolution (through privatization or bankruptcy) of at least seven of the 17 identified strategically important companies. The amendment to the EPS collective agreement to allow for the implementation of the rightsizing identified in the restructuring plans may face opposition and is already lagging. Draft by-laws aimed at strengthening the project appraisal process have been prepared but will likely face government adoption delays due to a full Parliamentary agenda in December. The financial sector reform agenda is generally on track to meet end-December conditions, although two structural benchmarks are proposed to be reset to March 2016.

OUTLOOK AND RISKS

7. **The economic outlook has further improved compared to the second review scenario** (Tables 1–7).

- **Real GDP growth** was revised to ¾ percent in 2015 from ½ percent expected in the second review, and to 1¾ percent in 2016, mostly on account of stronger private investment and further improvement of private consumption prospects.

- **Average CPI inflation,** at 1½ percent in 2015, will be somewhat lower than previously projected. Inflation is projected to return to the inflation tolerance band in H2 2016 on account of stronger demand and administrative price and excise increases.

- **The current account deficit** is projected to narrow marginally in 2016, reflecting continued dynamism in exports benefiting from recent FDI in the tradable sectors and remittances. This was partially offset by a higher deficit in the income balance due to higher profits in foreign-owned corporates.

8. **Despite the good macro performance, risks ahead are sizable and require the authorities' steadfast commitment to strong policies**. On the downside: (i) delays to structural reforms and fiscal measures—particularly in the area of SOE restructuring and public sector rightsizing—could compromise the quality of fiscal adjustment; (ii) discussions on large infrastructure projects without adequate cost-benefit analysis could pose fiscal risks in the medium term; (iii) continued inflation undershooting could make debt reduction harder; (iv) Serbia remains susceptible to possible spillovers from regional developments and changes in market volatility, particularly from developments in Greece, likely tightening of U.S. monetary policy, or continued sluggishness in the euro area and slowdowns in major emerging markets; and (v) the flow of migrants poses risks on a number of fronts, including fiscal costs and potential

disruptions to trade flows.[1] On the positive side, resumption of credit and investment could point to stronger GDP growth in 2016.

PROGRAM POLICY DISCUSSIONS

The policy changes implemented so far produced a substantial structural fiscal adjustment, well ahead of the program, allowing significant relaxation of monetary policy. They also provided space for targeted wage and pension increases, which supported by the rightsizing of the public sector will maintain the planned structural adjustment on track and place public debt firmly on the downward path over the medium-term. Strong reform and resolution of SOEs is critical to limit fiscal risks.

A. Fiscal Policy: Staying on Course towards Public Debt Sustainability

9. The authorities reiterated their resolve for moving ahead with fiscal consolidation required to place public debt firmly on a downward path by 2017. The discussions focused on policies to achieve these objectives in view of substantial fiscal over-performance in the first nine months of the year and, at the same time, on correcting delays in public sector rightsizing and mitigating fiscal risks stemming from SOEs.

- Staff projects the headline general government deficit in 2015 to shrink to 4.1 percent of GDP, reflecting sizable revenue over-performance—including about 1.1 percent of GDP in one-off factors such as debt recovery and excess SOE dividends—as well as under-execution of capital expenditure. The authorities used part of the over-performance to clear past liabilities and for one-off expenses, including small education sector wage bonuses, unforeseen agricultural subsidy claims, assumption of debts of Srbijagas to NIS (the energy company majority-owned by Gazprom), and settlement of pension liabilities arising from a recent Constitutional Court ruling in favor of military pensioners (MEFP para ¶10).[2] After accounting for one-off and cyclical factors, staff estimates a primary structural adjustment of 2.5 percent of GDP in 2015 (against 1.7 percent targeted under the original program). Public sector debt is expected to end the year at just below 76 percent of GDP, slightly better than earlier projected.

- The 2016 budget is consistent with a further primary structural adjustment of 0.7 of GDP (to remain on track for a cumulative three-year adjustment of at least 4 percent of

Summary Table on Public Borrowing (RSD billion)

	2015	2016
Financing needs	680	693
Uses of debt financing		
Budget financing	636	643
Project financing	44	50
Financing sources		
Short term	129	140
Medium-Long Term	551	553

[1] Expected fiscal costs are low at 0.1 percent of GDP or less in 2015 and 2016, but could rise if migrants remain in Serbia for prolonged periods rather than transiting the country. Disputes over the handling of the flow led to a brief closure of the border with Croatia in early October.

[2] In 2016, the government expects to assume about EUR100 million of old debt owed by Petrohemija to its oil supplier, NIS, in the context of privatization or other resolution of Petrohemija that eliminates further fiscal risks.

GDP). After including one-off expenditures for severance pay and upfront co-participation in a rail project loan, the general government fiscal deficit is aimed at 4.0 percent of GDP. Major policy measures include a reduction in subsidies for two public broadcasting companies; tightened legislation and control of agricultural subsidies; a modest 1.25 percent pension increase; continued government rightsizing, and targeted wage increases for selected public employees, aimed at narrowing wage gaps.[3] The wage and pension increases will be partially covered by increases in excises on petroleum products, projected to generate RSD 6 billion, on top of the originally planned adjustment for inflation (MEFP ¶12).

10. The authorities remain committed to public sector rightsizing and agreed to correct reform delays. In December the authorities adopted decisions under the Law on Maximum Number of Employees, setting detailed separation targets for each institution of the general government and local utility companies, representing a reduction of about 14,500 permanent positions compared to end-2014.[4] The authorities will adopt another decision in 2016 to set employment ceilings for the year representing a further cut of 20,000, utilizing findings from the World Bank's in-depth functional analysis, to preserve the quality of public services, while building towards a leaner, more efficient, and better paid public sector. The authorities committed to tightening controls on temporary employment to help ensure the effectiveness of the rightsizing program.

11. Staff stressed that better implementation of capital expenditure projects is needed to support Serbia's growth potential. Staff underscored the need for better proritization and planning to allow the timely execution of various projects. In view of discussions with bilateral creditors for large infrastructure projects, staff also stressed the importance of adequate feasibility studies and fiscal risk analysis to ensure that these projects contribute to Serbia's growth potential without incurring excessive debt.[5] The authorities pointed to efforts being spearheaded by the Ministry of Finance to establish a clear budget framework for improved prioritization, planning, and oversight of multi-year investment projects, but acknowledged that systemic improvement will take time.

[3] The wage increases comprise 2 percent for Ministry of Interior and Defense (partially offset by reductions in allowances and overtime caps), 2 percent for higher education, 4 percent for other education, and 3 percent for health sector and social workers.

[4] This is equivalent to a net employment reduction of about 9,000 positions compared to end-September 2015.

[5] A number of projects are under way, or being discussed, for the construction of transport infrastructure supported by financing from bilateral creditors, including Azerbaijan, China, and Russia.

Serbia: Fiscal Consolidation Measures, 2015-17 (Percent of GDP) 1/

	2015	2016	2017	Cumulative 2015-17
Reducing pensions and public sector wages	1.62	0.00	0.00	1.62
Wages	0.99	0.00	0.00	0.99
General government	0.64	0.00	0.00	0.64
Public enterprises	0.36	0.00	0.00	0.36
Pensions	0.63	0.00	0.00	0.63
Partial freeze to wages and pensions in 2015-17	0.31	0.26	0.75	1.33
Wages	0.13	0.07	0.30	0.50
Pensions	0.18	0.19	0.45	0.83
Rightsizing the public sector	0.18	0.26	0.55	0.98
Reduction of subsidies	0.27	0.29	0.05	0.61
Eliminating of agricultural subsidies (for land over 20 hectares)	0.00	0.19	0.00	0.19
Reducing subsidy to Srbijagas (network fees to pay for called guarantees)	0.18	0.00	0.00	0.18
Removing subsidy to RTS/RTV in 2015	0.05	0.10	0.05	0.19
Reducing subsidy for Serbia railways	0.05	0.00	0.00	0.05
Other measures	0.18	0.44	0.30	0.92
Reducing mark-up on domestic goods and services	0.06	0.00	0.00	0.06
Amending the local government financing law	0.00	0.00	0.18	0.18
Revenue effects of electricity price increases	0.12	0.29	0.00	0.42
Revenue effect of oil excise increase	0.00	0.15	0.00	0.15
Pharmaceutical savings from procurement of generic drugs	0.00	0.00	0.11	0.11
Total headline consolidation measures	**2.57**	**1.25**	**1.64**	**5.46**

Source: Ministry of Finance and Fund staff estimates.
1/ The column for 2015 includes measures implemented in late 2014 (wage and pension cuts).

B. Monetary and Financial Sector Policies: Rebalancing the Policy Mix and Reducing Vulnerabilities

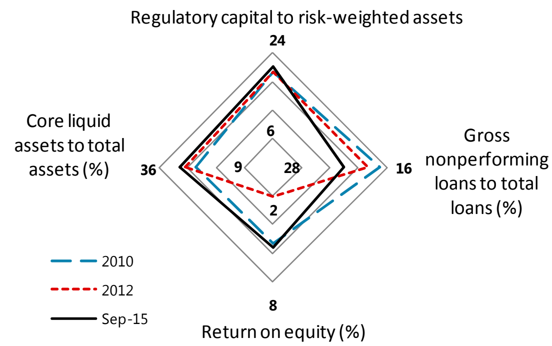
12. Staff and the NBS agreed that monetary policy should remain cautiously accommodative until inflation is closer to target. Despite a reduction of the key policy rate to a historic low of 4.5 percent, headline and core inflation remain low and only gradually moving into the target band as excises and regulated prices are increased and domestic demand strengthens. Staff agreed with the NBS that monetary policy should remain accommodative, taking into account the external financing environment, inflation expectations, and progress in fiscal consolidation. The planned reduction of the reserve requirements on FX deposits, which are much higher than in peer group countries, will provide a modest further easing of the monetary policy stance.[6] The NBS reconfirmed its commitment to continue to follow a policy of exchange rate flexibility, using interventions only for smoothing excessive volatility. Staff suggested limit interventions to avoid signaling a policy of excessive exchange rate management.

13. The banking sector remains stable amidst difficult operating conditions. The overall capital adequacy of the banking sector increased to 21.2 percent at end-September, partly due to a nominal increase of bank capital. Banks' liquidity ratios continue to increase, amply exceeding minimum requirements. Banking sector profitability has improved but remains negative for some of the smallest banks.

[6] The NBS is reducing the required reserve ratios on FX deposits from 26 (19) percent to 20 (13) percent under (over) two-year maturity, implemented in six equal steps over September-February.

14. Determined action to address the overhang of distressed debt remains key to achieving a more robust financial system and sustained growth. At end-September, gross nonperforming loans (NPLs) accounted for 22 percent of total loans. Corporate NPLs continue to decrease, led by better performance of the manufacturing sector—even though findings from the diagnostic studies may prompt the recognition of additional NPLs. At the same time, available data suggests that household NPLs (comprising about one quarter of total NPLs) have not yet peaked, as NPLs for housing loans continue to increase steadily. While regulatory reserves provide ample coverage, credit losses are adversely impacting bank profitability and constraining lending activity. Staff underscored the importance of steady implementation of the NPL resolution strategy[7], partly in response to delays in the finalization of some measures (MEFP ¶22), and welcomed the publication of the progress reports for Q3:2015.

Financial Soundness Indicators, 2010-15



Source: National Bank of Serbia

15. The Special Diagnostic Studies (SDS) exercise identified vulnerabilities but confirmed the adequate capitalization of the banking system. The exercise comprised an extensive review of the credit portfolios and provisioning practices of the fourteen largest banks, representing 88 percent of banking system assets (Box 1). Staff urged the NBS to ensure timely follow-up of the SDS findings, including by encouraging timely implementation of remedial actions highlighted in the detailed reports, continued scrutiny of provisioning practices and extensive engagement with external auditors. The development of supervisory guidance for loan loss provisioning under IAS39 (end-December structural benchmark) —similar to developments in other jurisdictions—is an important milestone.

16. Staff welcomed ongoing initiatives to strengthen financial sector supervision. The NBS is taking steps to strengthen its supervisory practices via the development of a more risk-sensitive supervisory cycle that is intended to be rolled out from 2016 (MEFP ¶24). In parallel, the NBS is implementing Fund technical assistance recommendations on recovery and resolution planning and strengthening the regulation and supervision of the insurance sector in line with the agreed action plan. Regulatory amendments consistent with Basel III are under preparation. Finally, efforts to further strengthen the NBS' macroprudential toolkit are continuing, including analysis of new capital buffers as part of the transition towards Basel III.

[7] See Box 2 in IMF Country Report No. 15/296.

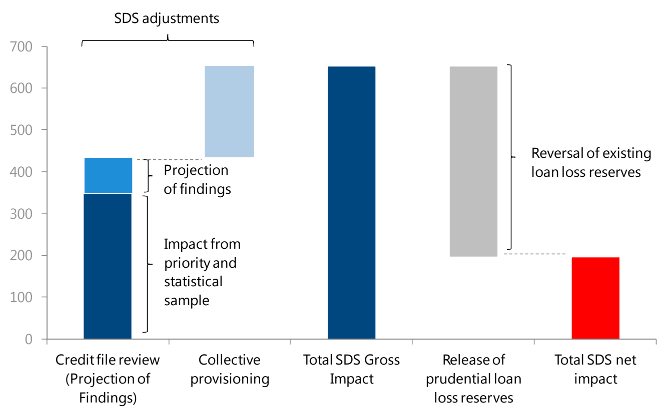
Box 1. Results of the Special Diagnostic Studies of Bank Asset Quality

The SDS comprise a key component of the financial sector policy agenda. The studies aim to verify the health of the banking system, dispel uncertainty about asset quality, and guide regulatory and supervisory policies. By assessing the adequacy of provisioning, they contribute to ongoing efforts to address elevated levels of distressed assets that have been built up in the Serbian banking system during past years.[1]

The exercise provided in-depth assessment of provisioning practices of 14 Serbian banks, accounting for 88 percent of banking system assets. In line with the ECB's 2014 comprehensive assessment, the SDS comprised (i) a qualitative review of banks' relevant processes and procedures; (ii) a comprehensive credit file review; and (iii) a review of banks' collective provisioning practices. To ensure impartiality, the exercise was conducted by independent auditors, subject to quality assurance by the NBS. For participants' corporate portfolios, 1,870 clients (around 77 percent of the total SDS exposure) were subjected to individual file analysis. The auditors were supported by six appraiser companies, selected to (re)appraise banks' real estate collateral, in accordance with recognized International Valuation Standards—resulting in independent (re)appraisals of more than 4,000 real estate properties.

After adjusting for SDS results, the capital adequacy ratios for all participating banks exceed minimum regulatory requirements of 12 percent. Robust capital buffers, buoyed by prudential loan loss reserves, allowed all participants to fully accommodate identified adjustments. On aggregate, the SDS adjustments amounted to an estimated gross decline of regulatory capital of about €650 million. However, part of this impact can be absorbed by banks' existing prudential loan loss reserves. When this counterbalancing effect is included, the SDS result in an estimated net decline of capital of around €200 million (corresponding to a decline of the total capital ratio of all participants by 1.8 percentage points).

Impact of special diagnostic studies on the capital of the banking system
(million euros)



Source: National Bank of Serbia

Following the completion of the exercise, banks are expected to analyze how the findings of the SDS are to be reflected in their statutory accounts for 2015. In doing so, banks will need to focus on (i) individually assessed impairment shortfalls, notably those reflecting inaccurate collateral valuations; and (ii) collectively estimated impairments that, in the view of SDS consultants, do not reflect the letter and spirit of IFRS. In parallel, banks will need to address other highlighted weaknesses in relevant policies and procedures, including accounting policies that are not deemed compliant with the letter and spirit of IFRS, gaps in risk management and lending standards and corrections due to misalignment with prudential regulations of the NBS. The NBS, in turn, will embed methodological aspects of the SDS in its supervisory procedures, and foster a conservative application of IFRS standards via the issuance of supervisory guidance for impairment provisioning under IAS39 (structural benchmark for end-December 2015).

[1] See Staff Discussion Note 15/19 (http://www.imf.org/external/pubs/cat/longres.aspx?sk=43286) for an analysis of the benefits of enhanced provisioning in the context of NPL resolution.

17. Staff urged decisive implementation of the strategy for state-owned banks. Preparations for the privatization of Komercijalna Banka, Serbia's second-largest bank and Dunav Osiguranje, the state-owned insurance company, are continuing. The authorities, in their capacity of controlling shareholder of Banka Postanska Stedionica, will need to oversee the bank's strategic reorientation towards retail activities and the finalization of its updated three-year business plan (end-December structural benchmark), incorporating remedial actions prompted by the results of the SDS. Decisions on the course of actions for the remaining state-owned banks will need to be taken by end-December 2015, as part of the update of the strategy for state-owned banks (MEFP ¶27).

C. Structural Reforms: Overcoming Implementation Challenges

18. While progress is being made in SOE reform planning, the decisive implementation of the reform agenda is key to revitalize the SOEs and reduce their dependence on the budget. Implementation challenges could cause further delays in SOE reforms, which could increase fiscal risks. Discussions focused on the specific action plans for reforming the energy and transport sectors:

- **Elektroprivreda Srbije (EPS).** The process of reorganizing the 14 EPS subsidiaries according to the EU energy sector unbundling requirement, and centralizing management functions, is due to be completed by end-2015. EPS is preparing a business plan that specifies financial consolidation measures during 2016–18 to improve collection rates, reduce electricity losses, rationalize the workforce, optimize generation capacities and improve operational and organizational efficiency. As a first step in staff rationalization, amendments to the collective agreement will be finalized by end-2015 (structural benchmark), which will define the level of severance payment for a targeted reduction of 1,000 employees in 2016. A further electricity tariff increase will be proposed for May 2016, to continue gradual convergence towards market levels in the region.

- **Srbijagas.** While legal unbundling of the company has been effective since August, the operational separation has not started, partly due to the need to prepare a comprehensive financial restructuring plan. In consultation with the World Bank, the company and the Ministry of Energy has finalized the terms of reference for selecting an independent auditor to prepare a clean baseline for the financial position of the company, which would serve as a basis for a restructuring plan of Srbijagas (prior action). The restructuring plan will address the company's large stock of debt from past arrears. While some of the largest debtors to Srbijagas (including Azotara, MSK, and Petrohemija) have been operating without state aid or further accumulations of arrears this year, staff urged timely and permanent resolutions of these companies to avoid future risk of arrears or state aid. In parallel, a diagnostic study of the gas distribution system is being conducted to improve the efficiency of the natural gas sector.

- **Railways of Serbia.** Railways were split into cargo, passenger, and infrastructure companies, and a fourth company was established to absorb non-core assets and redundant workers in the railway sector. Legal unbundling took place in July, and assets and liabilities will be split among four companies by December, enabling the three new companies to start operating with clean balance sheets in 2016. An independent audit of asset inventory and separation will be carried out by June 2016. In line with the new financial restructuring plan, the Government Steering Committee will adopt a decision by March 2016 to reduce at least 2,700 staff positions in 2016 (structural benchmark).

- **Roads of Serbia and Corridors of Serbia**. The cost saving and efficiency improvement measures to remove rigidities in pricing maintenance contracts are being developed, in order to lower the future budget support. Concession options are being explored for the Corridors.

19. Staff urged timely resolution of the companies in the portfolio of the Privatization Agency. The authorities reiterated their determination to resolve by end-2015 seven out of the 17 "strategic" companies that are under extended protection from debt enforcement (structural benchmark), and the remaining 10 companies by end-May 2016 (structural benchmark). Staff underscored that the resolution of the companies should be market-based without involving additional fiscal costs. The resolution of the rest of the portfolio of the Privatization Agency is ongoing, with 160 companies sent to bankruptcy proceedings and another 160 with public tender initiated by end-October.

20. Staff supported the authorities' labor market policies and plans to improve the efficiency of the social programs. Staff welcomed the expansion of the formal economy as a result of intensified labor inspections, and supported the active labor market policy measures specified in the National Action Plan for Employment for 2016, adopted by the government in September. Staff welcomed the plans to improve targeting and control of child support and maternity benefits. Staff also supported the authorities' plans to increase financial support for vulnerable energy users hit by electricity tariff increases.

21. Reforms to improve the business climate are underway, and staff encouraged the authorities to continue efforts in this area. Staff welcomed the progress made in facilitating the issuance of construction permits, registration of properties, and rationalization of investment incentives, which has helped improve Serbia's business environment and competitiveness (Box 2).

Box 2. Improving the Business Climate Through Structural Reforms

The weak business climate has been a challenge to boosting private sector investment in Serbia. Serbia has ranked consistently lower than regional peers in terms of indicators measuring business climate, competitiveness and economic transition. The main reported obstacles in doing business include institutional deficiencies in areas such as construction permits and property registration, inefficient government bureaucracy and overregulation, lack of access to finance and insufficient investor protection.

Doing Business and Competitiveness Indicators

	Ranking in 2016 Doing Business Indicators	Change from Previous year	Ranking in 2015-16 Global Competitiveness Indicators	Change from Previous year
Serbia	**59**	**9**	**94**	**0**
Albania	97	-35	93	4
Bosnia and Herzegovina 1/	79	3	111	-24
Bulgaria	38	-6	54	0
Croatia	40	-1	77	0
Kosovo	66	-2	n.a.	n.a.
Macedonia, FYR	12	2	60	3
Montenegro	46	1	70	-3
Romania	37	0	53	6

1/ Change of Global Competitivness Indicators from 2013-14 ranking.
Sources: World Bank Doing Business 2016; The World Economic Forum Global Competitiveness Report 2015-16. A positive change in rankings indicates improvement.

EBRD Transition Indicators, 2014

	Large scale privatisation	Small scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade & Forex system	Competition Policy
Serbia	**2.7**	**3.7**	**2.3**	**4.0**	**4.0**	**2.3**
Albania	3.7	4.0	2.3	4.3	4.3	2.3
Bosnia and Herzegovina	3.0	3.0	2.0	4.0	4.0	2.3
Bulgaria	4.0	4.0	2.7	4.3	4.3	3.0
Croatia	3.7	4.3	3.3	4.0	4.3	3.3
Kosovo	1.7	3.3	2.0	4.0	4.0	2.3
Macedonia, FYR	3.3	4.0	2.7	4.3	4.3	2.7
Montenegro	3.3	3.7	2.3	4.0	4.3	2.3
Romania	3.7	3.7	2.7	4.3	4.3	3.3
Average	*3.2*	*3.7*	*2.5*	*4.1*	*4.2*	*2.7*

Sources: EBRD.The indicators ranges from 1 to 4+, where 1 represents little or no change from a rigid centrally planned economy and 4+ represents the standards of an industrialised market economy.

Serbia has started a broad structural reform agenda to tackle the business environment issues and reinvigorate growth. Its ranking on the most recent World Bank Doing Business Indicators has improved from 68 to 59, mainly due to improvement in construction permits and paying taxes. Recent structural reforms have focused in the following areas:

- *Facilitate the issuance of constructions permits, recognition of land ownership rights, and registration of properties*. After the Law on Planning and Construction became effective from March 2015, the issuance of construction permits has increased by 56 percent between March and August as compared to the same period in 2014. A new law was adopted in June 2015 to facilitate the conversion into personal property rights of publicly-owned building land. Legislation is being adopted to simplify the procedure of cadastre registry.

- *Improve investment promotion programs and legal framework for business activities*. The Investment Law was adopted in October to broaden the scope of the Foreign Investment Law and streamline the existing investment and export promotion agencies and programs. In addition, reorganization for the Development Fund and the Serbian Export Credit and Insurance Agency (AOFI) is planned for 2016. A new Law on Public Enterprises will be adopted in December to strengthen the institutional framework for monitoring public enterprises, and a new Company Law will be adopted in early 2016 to improve the legal framework for private companies.

- *Strengthen the legal framework for resolution of companies*. A new Privatization Law, adopted in 2014 introduced new flexible methods and models of privatization to facilitate the long-stalled privatization process of state- and socially-owned enterprises. Insolvency legislation has been strengthened, and is undergoing further amendment to improve secured creditor rights. Bankruptcy procedures and administration will be centralized and a new bankruptcy agency will be established by May 2016.

Continued efforts and broader reforms are needed to fundamentally change the business climate. As well as the remaining obstacles in areas discussed above, inefficient bureaucracy—reflected in the large number of regulations and complicated procedures—has generated high operating costs. The weak judicial system, as reflected by uneven enforcement of property rights, limited access to legal information, insufficient capacity of judiciary staff, high attorney and court fees, and uneven provision of legal aid to the poor, has been an obstacle to basic business operations. Broader reforms to improve public sector and judiciary efficiency and encourage small and medium sized enterprises are needed to bring fundamental changes in the business climate and stimulate private investment.

PROGRAM MODALITIES

22. Staff proposes the updated program conditionality (MEFP Tables 1–2):

- Five prior actions are set including passage of the 2016 budget in line with the program, posting of the draft Local Government Financing Law, finalizing the terms of reference for Srbijagas' audit, adoption of government decisions to reduce employment in the general government (excluding the armed forces) and local utility companies by 14,500 employees relative to December 2014, and an amendment to the law on agricultural subsidies to ensure they remain within budget limits.

- The fiscal performance criteria for end-December 2015 are proposed to be modified by including an adjustor, and performance criteria and indicative targets for March and June of 2016 are proposed in line with quarterly projections. An additional adjustor for the end-December fiscal deficit and current primary expenditure ceilings, capped at RSD 20 billion, is proposed to account for uncertain one-off expenditures related to takeover of debt from Srbijagas and recognition of liabilities to military pensioners. The end-March and end-June 2016 fiscal deficit and current primary expenditure ceiling performance criteria are proposed to be adjusted for a possible debt takeover from Petrohemija, capped at RSD 12.3 billion, and for cumulative severance payments. In addition, adjustors for the 2016 deficit ceiling are also proposed to account for uncertain revenues from debt issuance at a premium and higher-than-programmed dividends, receipts from debt recovery and from telecom 4G frequency auctions. The end-March and end-June 2016 ceiling on gross issuance of new guarantees for project and corporate restructuring loans is proposed to be adjusted by the amount of a loan from the EBRD to the EPS in case it is delayed to 2016.

- End-December structural benchmarks for the introduction of a new legal and operational framework for transparent real estate appraisals and for the review of the corporate insolvency law and submission of amendments to the National Assembly are proposed to be reset to March 2016 due to their complexity and the need for further consultation.

- The following new structural benchmarks are being proposed: amend the Law on Tax Procedures and the Criminal Code to enable the audit of unregistered businesses and improve the function of the tax police, adopt a government decision for targeted separations in Railways of Serbia, resolve the remainder of the 17 strategically important companies protected by debt moratorium until May 2016, and finalize an action plan for the 2016 rightsizing based on functional reviews of selected areas of the public sector.

23. Serbia's capacity to meet potential repayment obligations to the Fund is strong. The authorities confirmed their intention to treat the SBA as precautionary. The potential balance of payments need could arise from adverse trade and financial spillovers, including from countries in the region, or from tighter global liquidity conditions. In case of full drawing of the amount under the SBA (200 percent of quota) (Table 9), repayments to the Fund at the end of the projection period would remain modest at or below 1.1 percent of GDP, or 9.3 percent of gross reserves (Tables 10–11). Public sector and external debt stocks are expected to remain high during the program period. Public debt is projected to peak at 78 percent of GDP in 2016 and external debt is expected to continue decreasing from its 2014 peak of 84 percent of GDP, in a scenario without Fund disbursements. Program implementation would put both of these on a firm downward path thereafter. The authorities have demonstrated continued commitment to the program. In addition, Serbia has a strong record of repaying the Fund.

STAFF APPRAISAL

24. **Serbia's Fund-supported program is broadly on track, and is producing strong results.** Macroeconomic conditionality has been comfortably met, and results for 2015 are much better than expected relative to the original program scenario, with growth overperforming by more than one percentage point, led by exports and private investment, fiscal overperformance of nearly 2 percent of GDP, and improvement in labor market indicators. With inflation remaining very low, investor confidence has improved and interest rates have fallen sharply. The picture has been more mixed in terms of structural reform: there have been important advances in financial sector policies and enterprise reforms; but delays in reform of the public sector and public transport and energy sectors.

25. **Fiscal policies for 2016 are set to press ahead with restoring public debt sustainability.** Further structural adjustment of 1.5 percent of GDP over 2016–17 is needed to put public debt on a firm downward path within the program period. The 2016 budget is consistent with this objective. The needed further fiscal consolidation arises from containing the wage and pension bills, reductions in subsidies, and an increase in fuel excises to capture some of the gains of lower oil prices. To limit risks associated with large infrastructure projects, proper feasibility studies and fiscal risk analysis are vital. The modest and targeted increase in public wages and pensions can be accommodated while still ensuring these spending categories decline relative to GDP. It would now be important to maintain the agreed wage discipline until public sector reforms are more advanced and budget deficit has been reduced to more sustainable levels.

26. **Advancing public sector and SOE reform will be critical in 2016.** Correcting the delays in the initial stage of public sector rightsizing will be crucial to continued adjustment of mandatory expenditure. It is important to move faster in wage system reform and in identifying areas for staff reductions, including key areas such as education and health. This will avoid the need for arbitrary cuts via attrition or an across-the-board approach, and will help improve the quality of public services, while building towards a leaner, more efficient, and better-paid public sector. It is vital to resolve loss-making firms in a way that ensures they will no longer represent a burden on the state, and to push through the restructuring and rightsizing of large SOE in the energy and and public transport companies. Slippages in these areas could seriously compromise the fiscal and growth objectives of the program.

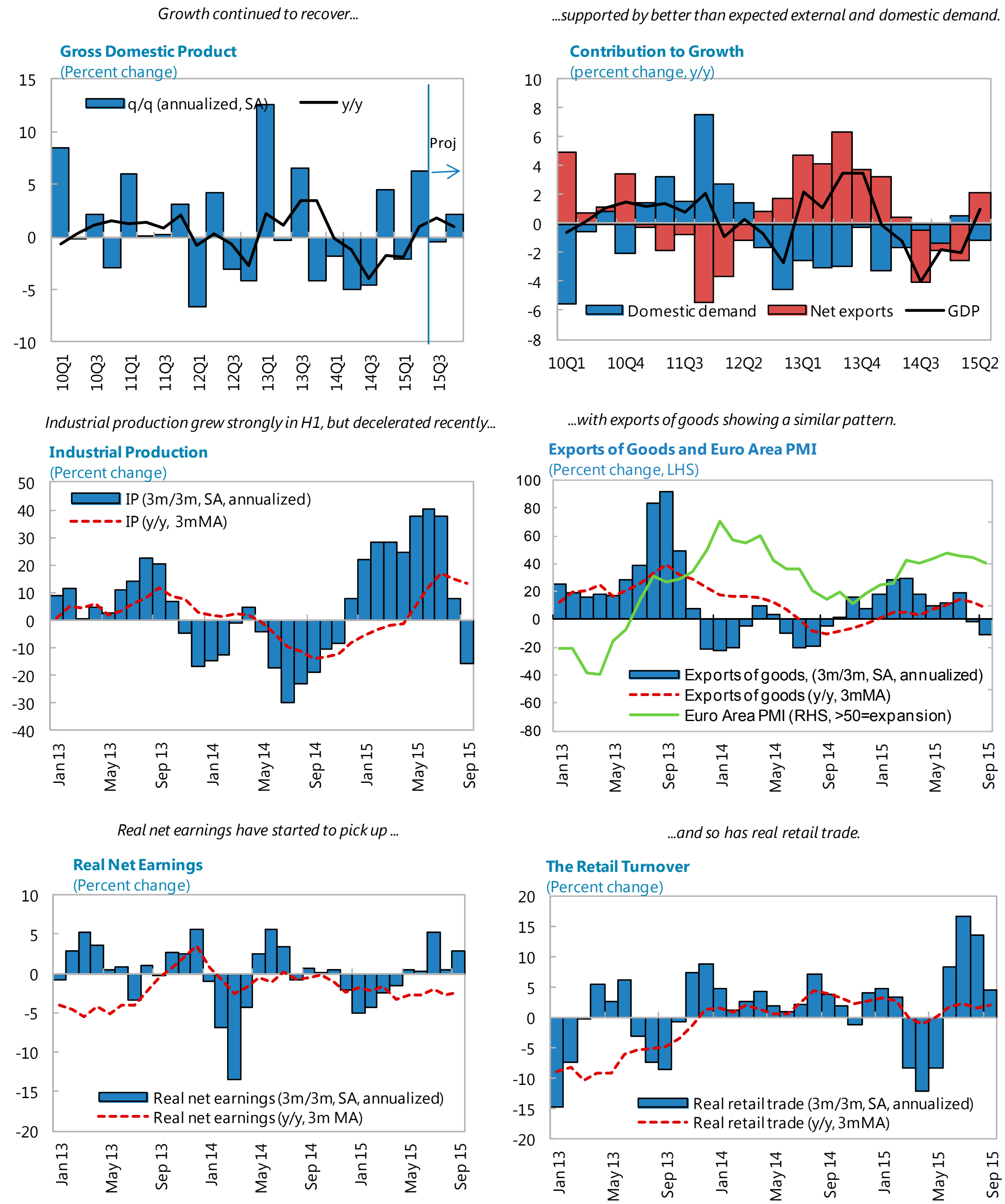
27. Cautious monetary policy is warranted in the current uncertain environment. Fiscal consolidation and low imported inflation have allowed a major reduction in interest rates. Further cuts may be warranted if inflation fails to pick up as projected, while paying due attention to a potentially fast-moving external environment. The NBS's commitment to the inflation targeting regime and exchange rate flexibility is welcome, although over time more tolerance of short-term fluctuations in the dinar would be appropriate.

28. Financial sector reforms are off to a good start but need determined follow-through. The NPL strategy requires coordinated actions across government, the NBS and the banks. The completion of the SDS contributes strongly to financial sector soundness and confidence, but highlights issues in some banks which require expeditious action.

29. The program continues to face significant risks, from both domestic and external factors. These include political resistance to institutional reform, and pressure for renewed subsidies or exposure of hidden liabilities, as hard budget constraints and transparency are brought to bear on SOEs. Potential external risks include global monetary policy asymmetries, conditions in emerging markets, longer-than-expected period of slow growth in the euro area, renewed crisis in Greece, and intensification of the refugee crisis. This risks are addressed by close monitoring under the program, caution in budget assumptions, Serbia's high foreign exchange reserves and well-capitalized banking system, and the additional buffer represented by the Fund arrangement.

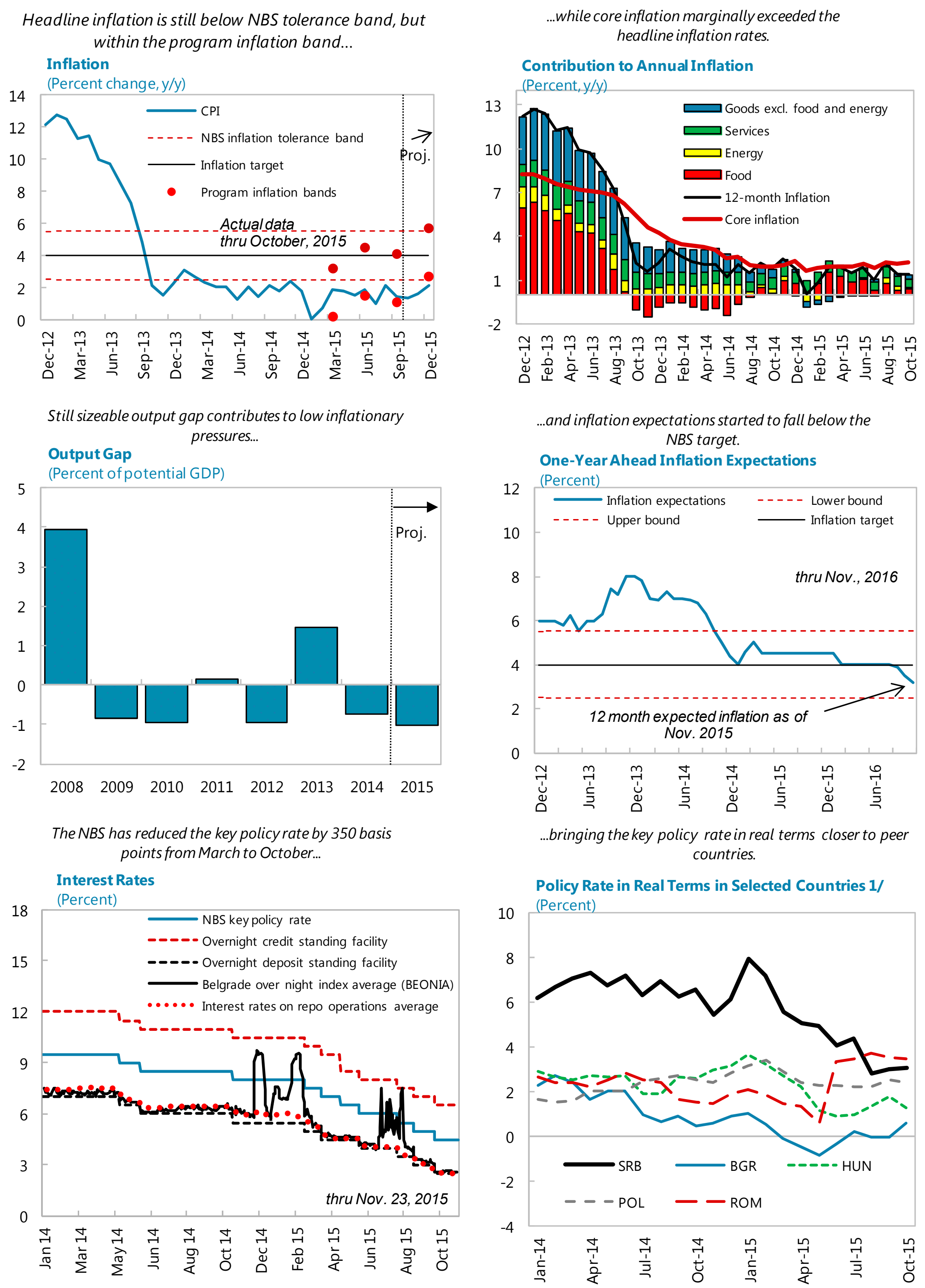
30. Staff supports the authorities' request for the completion of the Third Review under the Stand-By Arrangement and modification of performance criteria, given the program performance so far and the policy commitments going forward.

Figure 1. Serbia: Real Sector Developments, 2010–15



Sources: Haver, SORS and IMF staff calculations.

Figure 2. Serbia: Inflation and Monetary Policy, 2012–15

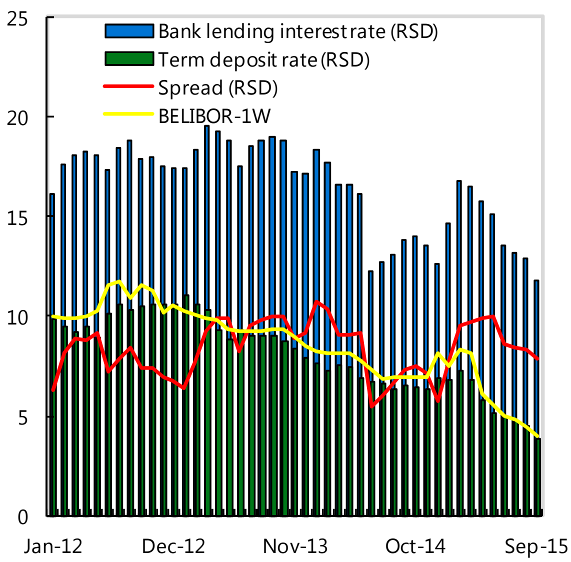


Sources: Haver; Bloomberg; National Bank of Serbia (NBS); SORS; and IMF staff estimates and projections.
1/ Nominal policy rate adjusted by inflation over the past 12 months.

Figure 3. Serbia: Selected Interest Rates, 2012–15

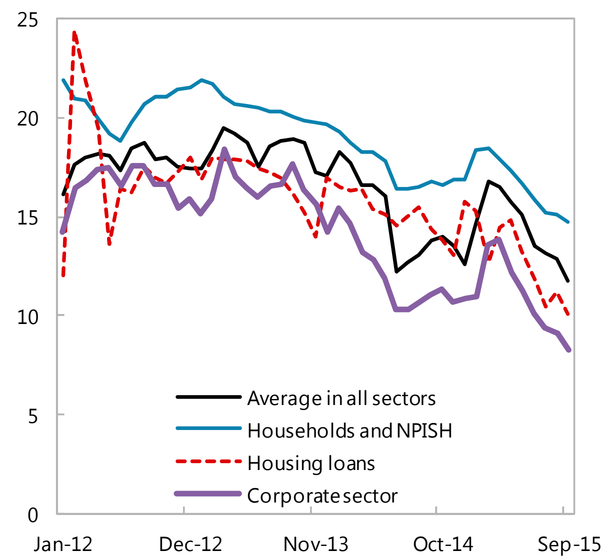
Easing of monetary policy has led to a decline in dinar interest rates...

Selected interest rates (RSD)
(Percent)



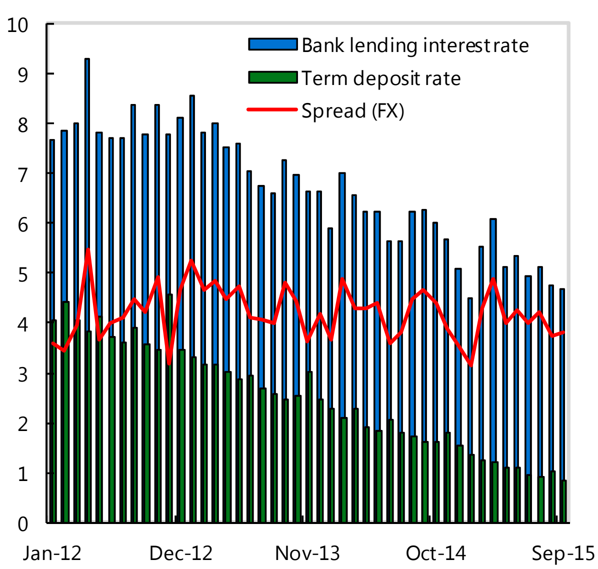
...in both corporate and household markets.

Bank lending interest rates: RSD
(Percent)



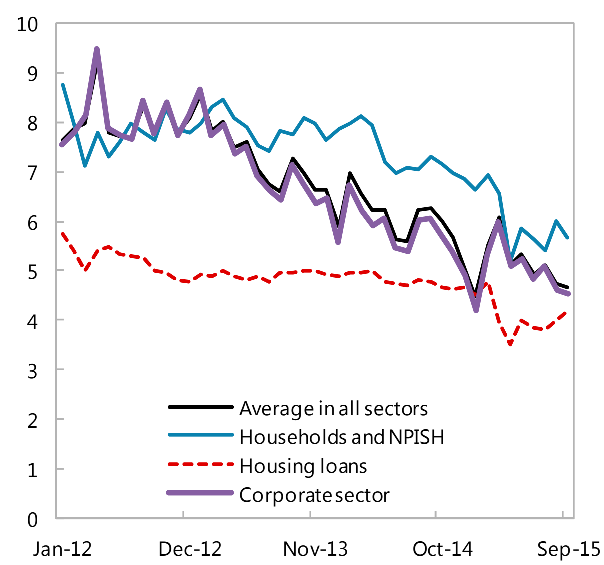
FX (or FX-linked) interest rates have been declining, too...

Selected interest rates (FX and FX-linked)
(Percent)



...most recently on account of lower lending rates to the corporate sector.

Bank lending interest rates: FX and FX-linked
(Percent)

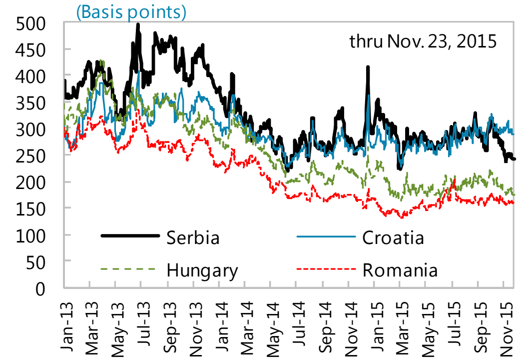


Source: NBS.

Figure 4. Serbia: Recent Financial and Exchange Rate Developments, 2013–15

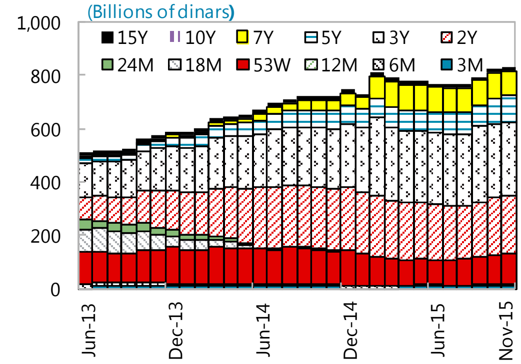
The EMBI spreads remained volatile, but declined recently.

Sovereign Risk -EMBI spreads
(Basis points)



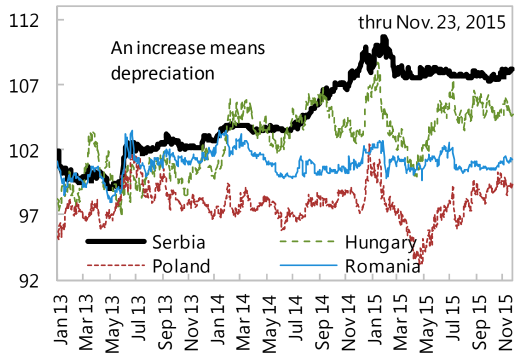
The authorities continued to lengthen the maturity of domsetic securities.

T-Bill & T-Bond Stock
(Billions of dinars)



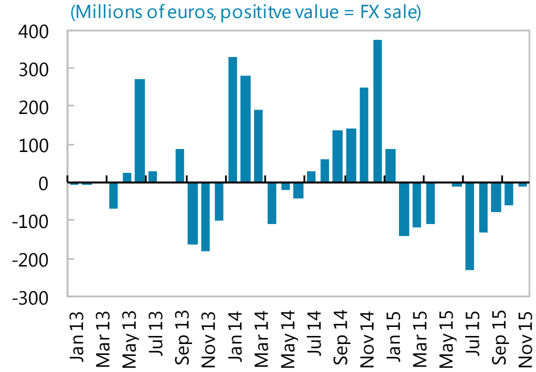
Exchange rate remained stable...

Exchange Rates in the Region
(Index, end-May 2013=100)



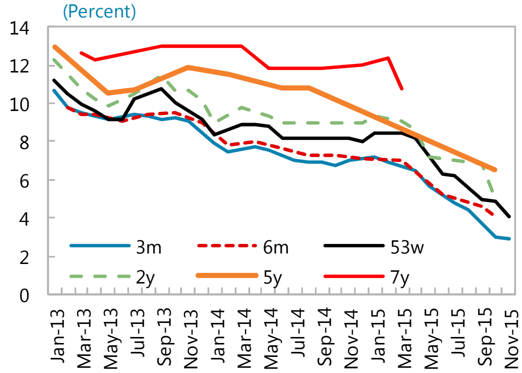
....in part due to NBS purchases of FX from the market, which counteracted appreciation pressures.

FX Interventions by NBS
(Millions of euros, positive value = FX sale)



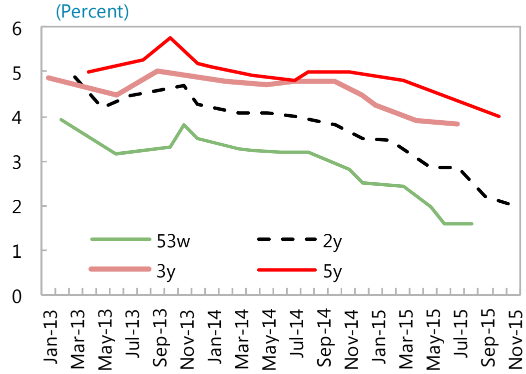
Yields on domestic securities have been declining in the dinar segment of the market...

Yields on Dinar-Denominated Domestic Securities
(Percent)



...as well as in euro-denominated segment of the market.

Yields on Euro-Denominated Domestic Securities
(Percent)



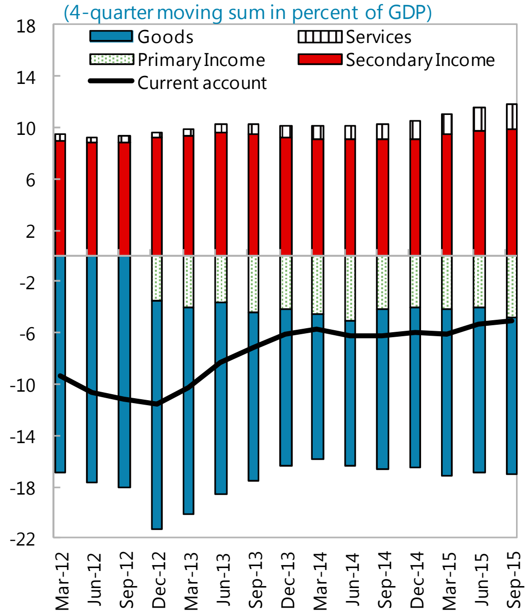
Sources: Serbian Authorities; Bloomberg; and Haver.
1/ Sum of dinar and FX-denominated securities at current exchange rate.

Figure 5. Serbia: Balance of Payments and NIR, 2012–15

The current account balance improved in Q1-Q3 2015…

Current Account Balance

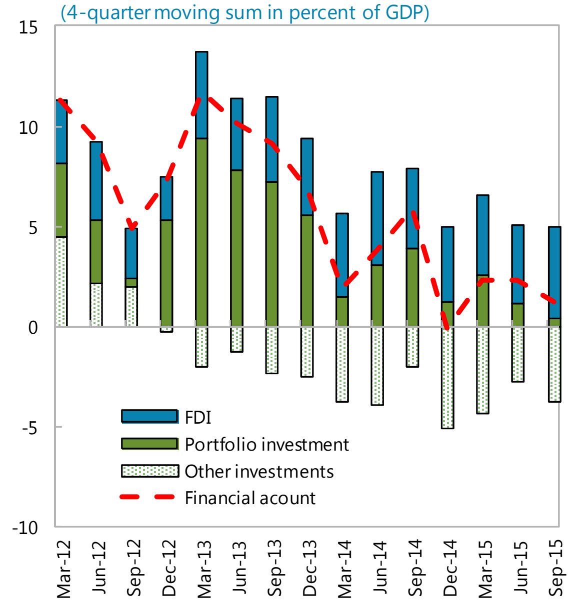
(4-quarter moving sum in percent of GDP)



…and the financial account registered a modest inflow…

Financial Account Composition

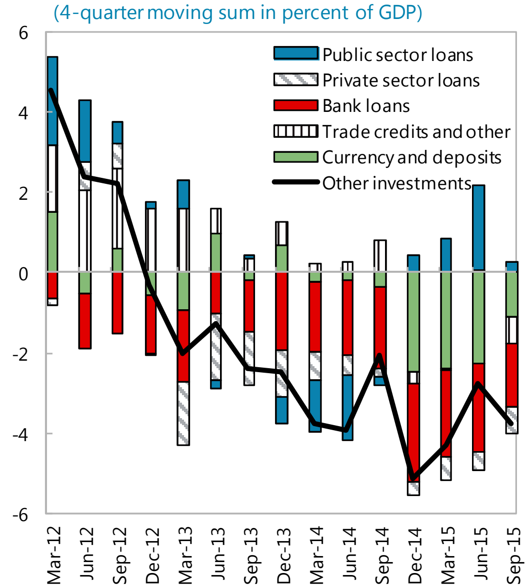
(4-quarter moving sum in percent of GDP)



…despite continued outflows in other investments largely driven by banks .

Other Investments 1/

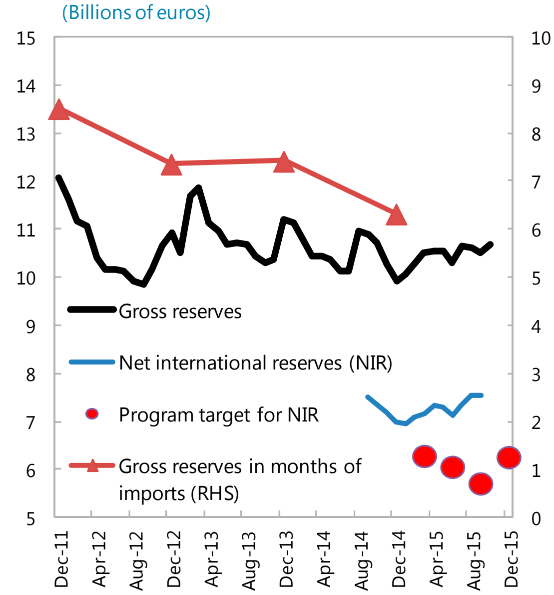
(4-quarter moving sum in percent of GDP)



International reserves remain at comfortable levels.

Foreign Exchange Reserves

(Billions of euros)



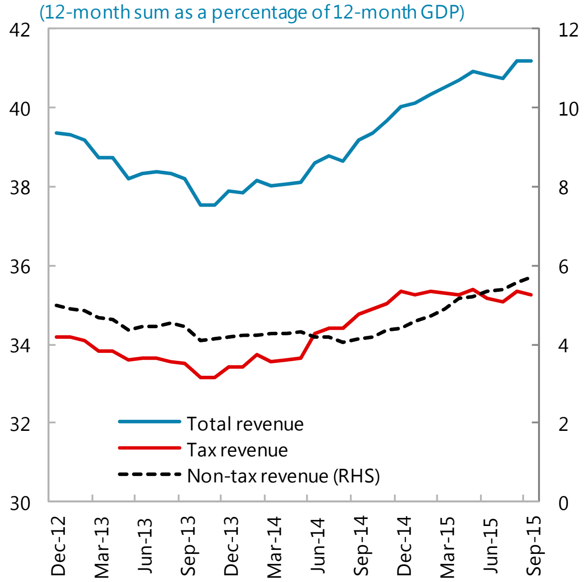
Sources: Haver; and IMF staff calculations.

1/ BPM5 data spliced with BPM6 going forward starting March 2013.

Figure 6. Serbia: Fiscal Developments, 2012–15

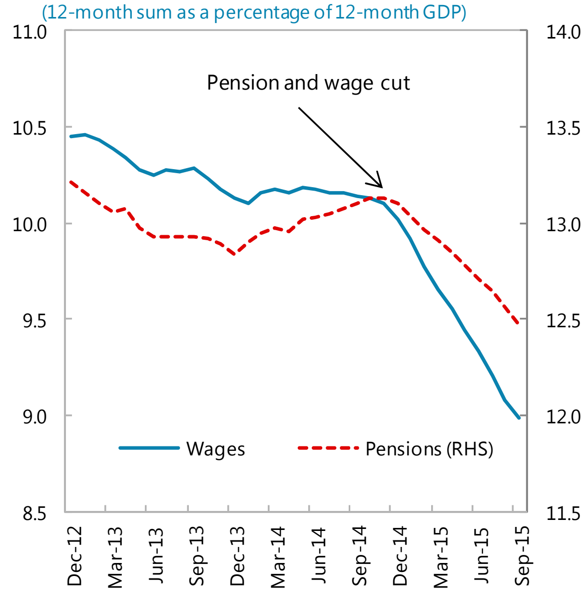
Revenues have been increasing as a share of GDP, with non-tax revenue continuing to play an important role…

Total Revenue and its Composition
(12-month sum as a percentage of 12-month GDP)



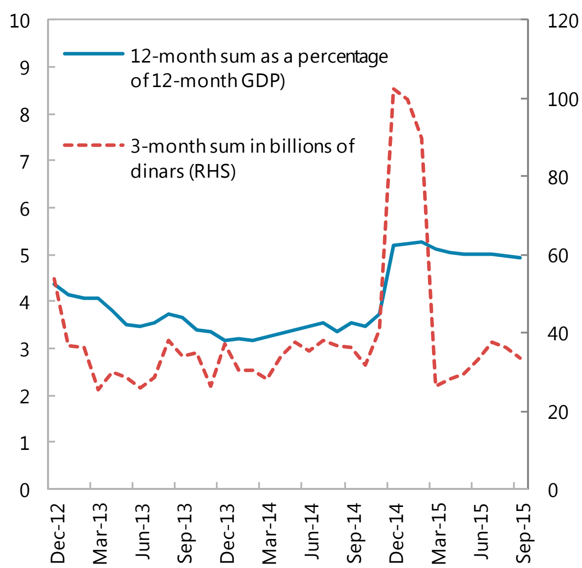
…while wage and pension expenses are falling as a share of GDP.

Wages and Pensions
(12-month sum as a percentage of 12-month GDP)



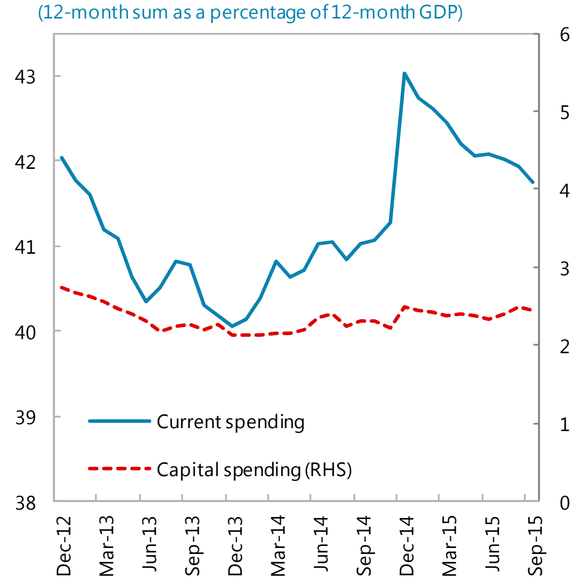
State aid increased in late 2014 due to one-off items, and subsided thereafter…

State Aid 1/



…supporting the adjustment of current spending.

Current and Capital Spending
(12-month sum as a percentage of 12-month GDP)



Sources: Ministry of Finance; and IMF staff calculations.
1/ State aid includes direct subsidies, net lending through the budget, assumption of SOE's debt, and the service of guaranteed debt called by creditors.

Table 1. Serbia: Selected Economic and Social Indicators, 2011–16

	2011	2012	2013	2014	2015		2016	
					2nd rev.	Proj.	2nd rev.	Proj.
	(Percent change, unless otherwise indicated)							
Real sector								
Real GDP	1.4	-1.0	2.6	-1.8	0.5	0.8	1.5	1.8
Real domestic demand (absorption)	3.1	-0.5	-1.9	-1.5	-0.1	0.7	0.9	1.4
Consumer prices (average)	11.1	7.3	7.7	2.1	1.6	1.5	3.4	2.8
GDP deflator	9.6	6.3	5.4	1.9	2.0	1.5	2.9	2.6
Unemployment rate (in percent) 1/	23.6	24.6	23.0	18.9	19.2	19.2	...	...
Nominal GDP (in billions of dinars) 2/	3,408	3,584	3,876	3,878	3,976	3,964	4,153	4,138
	(Percent of GDP)							
General government finances								
Revenue	38.2	39.4	37.9	40.0	40.1	40.6	39.0	39.8
Expenditure	43.1	46.6	43.5	46.7	44.1	44.7	42.9	43.8
Current	38.9	42.5	40.8	43.0	40.6	41.3	39.3	40.1
Capital and net lending	4.1	3.8	2.5	2.9	2.8	2.7	2.9	2.9
Amortization of called guarantees	0.2	0.3	0.2	0.8	0.7	0.7	0.7	0.8
Fiscal balance 3/	-4.9	-7.2	-5.6	-6.7	-4.0	-4.1	-3.9	-4.0
Primary fiscal balance (cash basis)	-3.6	-5.3	-3.2	-3.7	-0.6	-0.7	0.0	-0.5
Structural primary fiscal balance 4/	-3.6	-4.0	-3.1	-2.7	-0.3	-0.3	0.6	0.5
Gross debt	46.6	58.3	61.4	72.2	76.7	75.9	78.4	78.1
	(End of period 12-month change, percent)							
Monetary sector								
Money (M1)	16.8	3.8	23.7	9.7	9.4	10.8	11.4	11.4
Broad money (M2)	10.4	9.2	4.2	8.3	5.0	5.2	6.7	7.3
Domestic credit to non-government 5/	8.1	3.3	-5.1	-1.0	-0.9	0.1	-0.4	2.5
	(Period average, percent)							
Interest rates (dinar)								
NBS key policy rate 6/	11.5	10.1	11.0	9.0	6.8	6.6	...	...
Interest rate on new FX and FX-indexed loans 6/	8.2	8.0	7.3	6.0	5.2	5.1	...	...
Interest rate on new dinar deposits 6/	11.8	10.0	9.3	6.9	6.0	5.5	...	...
	(Percent of GDP, unless otherwise indicated)							
Balance of payments								
Current account balance	-8.6	-11.5	-6.1	-6.0	-4.0	-4.7	-3.8	-4.6
Exports of goods	25.3	26.5	30.8	32.2	35.1	34.7	36.7	36.5
Imports of goods	-41.2	-44.2	-42.9	-44.6	-46.2	-46.4	-47.5	-47.9
Trade of goods balance	-15.9	-17.8	-12.1	-12.4	-11.1	-11.8	-10.8	-11.4
Capital and financial account balance	13.3	7.9	9.4	1.4	6.2	4.3	5.8	6.6
External debt (percent of GDP)	74.5	84.3	79.3	83.8	86.3	83.4	85.9	83.4
of which: Private external debt	40.0	42.7	36.8	35.2	32.7	33.4	29.5	30.2
Gross official reserves (in billions of euro)	12.1	10.9	11.2	9.9	10.8	10.4	11.4	11.0
(in months of prospective imports)	8.5	7.4	7.4	6.3	6.6	6.2	6.6	6.3
(percent of short-term debt)	322.2	207.5	269.4	272.1	320.8	313.5	279.2	273.8
(percent of broad money, M2)	85.2	76.8	76.2	65.8	68.8	65.6	69.5	66.1
(percent of risk-weighted metric)	...	...	229.4	202.9	216.3	212.4	216.0	211.5
Exchange rate (dinar/euro, period average) 7/	102.0	113.0	113.1	117.2	120.7	120.5	...	...
REER (annual average change, in percent; + indicates appreciation)	9.3	-7.4	7.8	-2.0	-2.1	-1.6	2.8	0.2
Social indicators								
Per capita GDP (in US$)	6,426	5,658	6,354	6,123	5,102	5,101	5,268	5,273
Population (in million)	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2

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

1/ Unemployment rate for working age population (15-64). 2015 value shows period average for the first half of the year.
2/ The GDP series were revised in October 2014 based on ESA 2010 methodology and resulted in an increase of average 7 percent.
3/ Includes amortization of called guarantees.
4/ Primary fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending as well as one-offs.
5/ At program exchange rates.
6/ 2015 values show period average for Q1-Q3 2015.
7/ 2015 values show period average for January-October 2015.

Table 2. Serbia: Medium-Term Framework, 2012–20

	2012	2013	2014	2015		2016		2017		2018	2019	2020
				2nd rev.	Proj.	2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.
						(percent change)						
Real sector												
GDP growth	-1.0	2.6	-1.8	0.5	0.8	1.5	1.8	2.0	2.2	3.5	3.5	4.0
Domestic demand (contribution)	-0.6	-2.2	-1.6	-0.1	0.7	1.0	1.6	2.1	1.5	2.7	3.2	3.9
Net exports (contribution)	-0.4	4.8	-0.2	0.6	0.0	0.5	0.1	-0.1	0.7	0.8	0.3	0.1
Consumer price inflation (average)	7.3	7.7	2.1	1.6	1.5	3.4	2.8	4.0	3.9	3.9	3.9	3.9
Consumer price inflation (end of period)	12.2	2.2	1.8	2.5	2.1	4.1	3.5	4.0	3.9	3.9	3.9	3.9
Output gap (in percent of potential)	-0.9	1.5	-0.7	-1.5	-1.0	-1.2	-0.8	-0.8	-0.6	-0.3	-0.2	-0.1
Potential GDP growth	0.1	0.1	0.4	0.6	1.0	1.2	1.5	1.6	2.0	3.2	3.4	3.9
Domestic credit to non-gov. (program exchange rate) 1/	3.3	-5.1	-1.0	-0.9	0.1	-0.4	2.5	7.5	9.8	9.6	12.3	11.6
						(percent of GDP, unless otherwise indicated)						
General government												
Revenue	39.4	37.9	40.0	40.1	40.6	39.0	39.8	38.3	39.0	38.5	38.4	38.2
Expenditure	46.6	43.5	46.7	44.1	44.7	42.9	43.8	41.3	41.6	40.4	40.2	39.8
Current	42.5	40.8	43.0	40.6	41.3	39.3	40.1	37.6	38.0	36.9	36.8	36.4
of which: Wages and salaries	10.5	10.1	10.0	9.1	9.1	8.3	9.0	7.5	8.0	7.5	7.4	7.3
of which: Pensions	13.2	12.8	13.1	12.4	12.7	12.0	12.3	11.5	11.8	11.4	11.3	11.3
of which: Goods and services	8.0	7.2	8.0	7.7	7.5	7.6	7.5	7.3	7.2	7.3	7.3	7.2
Capital and net lending	3.8	2.5	2.9	2.8	2.7	2.9	2.9	3.1	3.0	3.1	3.1	3.1
Amortization of called guarantees	0.3	0.2	0.8	0.7	0.7	0.7	0.8	0.5	0.5	0.4	0.4	0.4
Fiscal balance 2/	-7.2	-5.6	-6.7	-4.0	-4.1	-3.9	-4.0	-3.0	-2.6	-1.8	-1.8	-1.6
change (+ = consolidation)	*-2.3*	*1.6*	*-1.0*	*2.7*	*2.6*	*0.1*	*0.1*	*0.9*	*1.3*	*0.8*	*0.1*	*0.2*
Primary fiscal balance	-5.3	-3.2	-3.7	-0.6	-0.7	0.0	-0.5	1.0	0.9	1.9	2.1	2.2
change (+ = consolidation)	*-1.8*	*2.1*	*-0.5*	*3.1*	*3.0*	*0.6*	*0.2*	*1.0*	*1.3*	*1.1*	*0.2*	*0.1*
One-off fiscal items, net 3/	-1.0	-0.6	-0.7	-0.4	-0.1	-0.5	-0.6	-0.4	-0.2	0.0	0.0	0.0
Structural primary balance	-4.0	-3.1	-2.7	-0.3	-0.3	0.6	0.5	1.7	1.3	2.0	2.2	2.2
change (+ = consolidation)	*-0.4*	*0.9*	*0.4*	*2.1*	*2.5*	*0.9*	*0.7*	*1.1*	*0.8*	*0.7*	*0.1*	*0.0*
Gross debt	58.3	61.4	72.2	76.7	75.9	78.4	78.1	77.7	76.3	73.2	70.6	67.1
Effective interest rate on government borrowing (percent)	3.8	4.3	4.5	4.8	4.7	5.3	4.8	5.5	4.7	5.3	5.8	5.7
Domestic borrowing (including FX)	4.9	5.6	5.9	6.2	6.2	6.9	6.3	7.1	6.6	7.1	7.9	8.0
External borrowing	2.9	3.3	3.5	3.8	3.8	4.4	3.9	4.6	3.7	4.4	4.6	4.7
						(percent of GDP, unless otherwise indicated)						
Balance of payments												
Current account	-11.5	-6.1	-6.0	-4.0	-4.7	-3.8	-4.6	-3.9	-4.3	-4.2	-4.2	-4.2
of which: Trade balance	-17.8	-12.1	-12.4	-11.1	-11.8	-10.8	-11.4	-10.8	-11.1	-10.6	-10.2	-9.9
of which: Current transfers, net (excl. grants)	9.0	9.1	8.8	9.2	9.6	9.2	9.4	9.2	9.2	8.4	8.2	8.0
Capital and financial account	7.9	9.4	1.4	6.2	4.3	5.8	6.6	4.2	3.0	4.2	3.7	2.6
of which: Foreign direct investment	2.1	3.6	3.7	4.0	4.9	3.9	4.7	4.0	4.2	4.2	4.2	4.2
External debt (end of period)	84.3	79.3	83.8	86.3	83.4	85.9	83.4	82.6	78.6	73.6	68.3	61.9
of which: Private external debt	42.7	36.8	35.2	32.7	33.4	29.5	30.2	27.5	28.0	25.5	22.9	20.7
Gross official reserves												
(in billions of euros)	10.9	11.2	9.9	10.8	10.4	11.4	11.0	11.6	10.6	10.6	10.3	9.6
(in percent of short-term external debt)	207.5	269.4	272.1	320.8	313.5	279.2	273.8	241.2	225.0	266.5	214.3	199.6
REER (ann. av. change; + = appreciation)	-7.4	7.8	-2.0	-2.1	-1.6	2.8	0.2	1.4	1.3	1.6	1.5	1.5

Sources: NBS, MoF, SORS and IMF staff estimates and projections.

1/ Using program dinar/euro and dinar/swiss franc exchange rates for converting FX and FX-indexed loans to dinars.

2/ Includes amortization of called guarantees.

3/ Calculated as one-off revenue items minus one-off expenditure items. Negative sign indicates net expenditure.

Table 3. Serbia: Growth Composition, 2012–20

	2012	2013	2014	2015		2016		2017	2018	2019	2020
				2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Percent change, unless otherwise noted)							
Real											
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	0.5	0.8	1.5	1.8	2.2	3.5	3.5	4.0
Domestic demand	-0.5	-1.9	-1.5	-0.1	0.7	0.9	1.4	1.4	2.4	2.9	3.6
Consumption	-1.2	-0.7	-1.0	-1.2	-0.8	0.1	0.3	0.2	1.7	2.4	3.2
Non-government	-2.0	-0.6	-1.3	-0.8	-0.5	0.5	0.2	1.0	2.0	2.4	3.2
Government	1.9	-1.1	0.1	-3.0	-2.2	-1.8	0.9	-2.8	0.3	2.2	3.1
Investment	2.9	-7.2	-3.5	5.5	7.9	4.7	6.3	6.0	5.5	4.9	5.0
Gross fixed capital formation	19.1	-16.3	-2.7	5.6	8.2	4.8	6.6	6.2	5.5	4.9	5.0
Non-government	21.3	-13.0	-4.8	4.5	8.5	5.0	6.0	6.0	5.5	5.0	5.0
Government	7.6	-35.8	13.6	12.5	5.9	3.3	10.7	7.7	5.8	4.3	4.8
Exports of goods and services	0.8	21.3	3.9	9.0	7.8	4.8	7.7	7.0	6.7	6.9	6.9
Imports of goods and services	1.4	5.0	3.3	5.9	6.0	3.0	5.8	4.4	4.3	5.3	5.7
				(contributions to GDP, percent)							
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	0.5	0.8	1.5	1.8	2.2	3.5	3.5	4.0
Domestic demand (absorption)	-0.6	-2.2	-1.6	-0.1	0.7	1.0	1.6	1.5	2.7	3.2	3.9
Net exports of goods and services	-0.4	4.8	-0.2	0.6	0.0	0.5	0.1	0.7	0.8	0.3	0.1
Consumption	-1.2	-0.6	-1.0	-1.2	-0.8	0.0	0.3	0.2	1.5	2.1	2.7
Non-government	-1.6	-0.4	-1.0	-0.6	-0.4	0.4	0.1	0.7	1.4	1.7	2.2
Government	0.4	-0.2	0.0	-0.6	-0.4	-0.3	0.2	-0.5	0.1	0.4	0.5
Investment	0.6	-1.5	-0.7	1.0	1.5	0.9	1.3	1.3	1.2	1.1	1.2
Gross fixed capital formation	3.7	-3.8	-0.5	1.0	1.5	0.9	1.3	1.3	1.2	1.1	1.1
Non-government	3.4	-2.5	-0.8	0.7	1.4	0.8	1.0	1.1	1.0	1.0	1.0
Government	0.2	-1.2	0.3	0.3	0.1	0.1	0.3	0.2	0.2	0.1	0.1
Change in inventories	-3.1	2.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	0.3	7.4	1.6	3.9	3.4	2.3	3.6	3.4	3.5	3.6	3.8
Imports of goods and services	0.7	2.6	1.8	3.3	3.4	1.8	3.5	2.7	2.7	3.3	3.7
				(Percent change, unless otherwise noted)							
Nominal											
Gross Domestic Product (GDP)	5.2	8.2	0.0	2.5	2.2	4.5	4.4	5.8	7.6	7.6	8.2
Domestic demand (absorption), contribution to GDP growth	7.3	3.1	-0.7	1.7	2.3	4.2	4.0	5.9	7.6	7.7	8.5
Net exports of goods and services, contribution to GDP growth	-2.1	5.1	0.8	0.8	-0.1	0.2	0.4	-0.1	0.1	0.0	-0.3
Consumption	5.6	5.2	1.4	-0.4	0.0	3.1	3.0	3.8	5.7	6.4	7.2
Non-government	5.2	5.6	1.3	0.8	1.0	3.9	3.0	4.9	6.0	6.4	7.2
Government	7.4	3.5	2.3	-5.6	-4.1	-0.6	3.2	-0.9	4.2	6.2	7.1
Investment	9.9	-9.1	-11.8	13.7	15.1	8.1	6.9	13.3	13.1	10.4	10.7
Gross fixed capital formation	21.1	-11.9	-0.4	6.7	9.3	7.2	9.0	9.3	8.9	8.3	8.3
Non-government	23.5	-8.1	-2.0	5.8	9.6	7.4	8.4	9.1	8.9	8.4	8.4
Government	7.6	-35.8	13.6	13.9	6.9	5.6	13.3	10.9	9.2	7.6	8.2
Exports of goods and services	14.3	20.7	7.7	10.8	9.4	9.1	10.1	8.2	7.4	7.5	6.3
Imports of goods and services	14.2	4.7	4.6	7.4	7.9	7.3	7.7	7.1	6.2	6.5	6.0
Memorandum items:											
GDP deflator (percent)	6.3	5.4	1.9	2.0	1.5	2.9	2.6	3.5	4.0	4.0	4.0

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

Table 4a. Serbia: Balance of Payments, 2012–20

(In billions of euros)

	2012	2013	2014	2015		2016		2017	2018	2019	2020
			Prel.	2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of euros)						
Current account balance	-3.6	-2.1	-2.0	-1.3	-1.5	-1.3	-1.6	-1.5	-1.6	-1.7	-1.8
Trade of goods balance	-5.6	-4.2	-4.1	-3.6	-3.9	-3.6	-3.8	-3.9	-4.0	-4.1	-4.3
Exports of goods	8.4	10.5	10.6	11.5	11.4	12.4	12.3	13.2	14.1	15.0	15.9
Imports of goods	-14.0	-14.7	-14.8	-15.2	-15.3	-16.0	-16.2	-17.1	-18.1	-19.1	-20.1
Services balance	0.1	0.3	0.5	0.7	0.7	0.8	0.8	0.9	1.0	1.1	1.2
Exports of nonfactor services	3.1	3.4	3.8	4.2	4.2	4.5	4.6	4.9	5.2	5.5	5.9
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.5	-3.6	-3.7	-3.8	-4.0	-4.2	-4.4	-4.7
Income balance	-1.1	-1.4	-1.3	-1.5	-1.6	-1.7	-1.8	-1.8	-1.9	-2.0	-2.2
Net interest	-0.8	-0.9	-0.9	-1.0	-0.9	-1.0	-1.0	-1.0	-1.0	-1.1	-1.2
Current transfer balance	2.9	3.2	3.0	3.1	3.3	3.2	3.3	3.4	3.3	3.3	3.5
Others, including private remittances	2.9	3.1	2.9	3.0	3.2	3.1	3.2	3.2	3.1	3.3	3.5
Capital and financial account balance 2/	2.5	3.2	0.5	2.1	1.4	2.0	2.2	1.1	1.6	1.5	1.1
Foreign direct investment balance	0.7	1.2	1.2	1.3	1.6	1.3	1.6	1.5	1.6	1.7	1.8
Portfolio investment balance	1.7	1.9	0.4	0.4	0.0	1.3	1.3	0.6	0.9	0.6	0.0
of which: debt liabilities	1.7	2.0	0.4	0.4	0.0	1.3	1.3	0.6	0.9	0.6	0.0
Other investment balance	0.2	0.1	-1.1	0.3	-0.2	-0.7	-0.7	-1.1	-1.0	-0.8	-0.7
Public sector 2/ 3/	0.5	0.4	0.7	1.3	0.3	0.1	0.2	-0.7	-0.7	-0.4	-0.4
Domestic banks	-0.4	-0.5	-1.5	-0.7	-0.2	-0.6	-0.4	-0.1	0.0	0.0	0.0
Other private sector 4/	0.1	0.1	-0.4	-0.3	-0.3	-0.2	-0.5	-0.2	-0.3	-0.4	-0.2
Errors and omissions	0.2	0.2	0.3	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	0.7	0.3	0.7	0.7	-0.4	0.0	-0.2	-0.7
Financing	0.9	-1.3	1.2	-0.7	-0.3	-0.7	-0.7	0.4	0.0	0.2	0.7
Gross international reserves (increase, -)	1.1	-0.7	1.8	-0.6	-0.1	-0.7	-0.7	0.4	0.0	0.2	0.7
Use of Fund credit, net	-0.2	-0.6	-0.6	-0.1	-0.1	0.0	-0.01	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	-0.1	0.0	-0.01	0.0	0.0	0.0	0.0

Sources: NBS; and IMF staff estimates and projections.

1/ Some estimates, in particular for private remittances and reinvested earnings, are subject to significant uncertainty.

2/ Excluding net use of IMF resources.

3/ Includes SDR allocations in 2009.

4/ Includes trade credits (net).

Table 4b. Serbia: Balance of Payments, 2012–20
(Percent of GDP)

	2012	2013	2014	2015		2016		2017	2018	2019	2020
			Prel.	2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.	Proj.
					(Percent of GDP)						
Current account balance	-11.5	-6.1	-6.0	-4.0	-4.7	-3.8	-4.6	-4.3	-4.2	-4.2	-4.2
Trade of goods balance	-17.8	-12.1	-12.4	-11.1	-11.8	-10.8	-11.4	-11.1	-10.6	-10.2	-9.9
Exports of goods	26.5	30.8	32.2	35.1	34.7	36.7	36.5	37.4	37.3	37.2	36.6
Imports of goods	-44.2	-42.9	-44.6	-46.2	-46.4	-47.5	-47.9	-48.5	-47.9	-47.4	-46.5
Services balance	0.4	0.9	1.4	2.2	2.0	2.5	2.3	2.5	2.6	2.7	2.7
Income balance	-3.4	-4.1	-4.1	-4.7	-4.8	-5.1	-5.3	-5.1	-4.9	-5.0	-5.0
Current transfer balance	9.3	9.2	9.1	9.6	9.9	9.6	9.7	9.5	8.7	8.2	8.0
Capital and financial account balance 2/	7.9	9.4	1.4	6.2	4.3	5.8	6.6	3.0	4.2	3.7	2.6
Foreign direct investment balance	2.1	3.6	3.7	4.0	4.9	3.9	4.7	4.2	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	1.3	0.1	4.0	3.9	1.8	2.5	1.4	0.0
Other investment balance	0.5	0.3	-3.4	0.9	-0.7	-2.0	-2.0	-3.0	-2.5	-1.9	-1.6
Public sector 2/ 3/	1.5	1.2	2.2	3.8	0.9	0.2	0.6	-2.1	-1.8	-1.0	-1.0
Domestic banks	-1.3	-1.3	-4.5	-2.1	-0.6	-1.6	-1.3	-0.2	0.0	0.0	0.0
Other private sector 4/	0.4	0.4	-1.1	-0.9	-1.0	-0.6	-1.4	-0.7	-0.7	-0.9	-0.6
Errors and omissions	0.6	0.5	0.9	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	2.2	0.9	2.0	2.0	-1.3	0.0	-0.5	-1.6
Memorandum items:											
Export growth	-0.5	25.6	1.0	8.4	7.0	7.3	8.5	6.9	6.5	6.7	5.7
Import growth	2.0	4.7	0.4	2.9	3.4	5.5	6.2	5.8	5.4	5.8	5.4
Export volume growth	-0.8	21.9	1.7	8.4	7.0	4.8	7.7	7.0	6.7	6.9	6.9
Import volume growth	0.8	2.7	1.9	5.5	5.5	3.0	5.8	4.4	4.3	5.3	5.7
Trading partner import growth	-0.2	1.6	3.6	2.8	1.3	5.2	5.1	5.1	5.4	4.5	4.5
Export prices growth	0.3	3.0	-0.7	0.0	0.0	2.4	0.7	-0.1	-0.2	-0.1	-1.1
Import prices growth	1.2	2.0	-1.5	-2.5	-2.0	2.5	0.3	1.4	1.0	0.5	-0.3
Change in terms of trade	-0.9	1.0	0.8	2.6	2.0	-0.1	0.4	-1.4	-1.2	-0.6	-0.8
Gross official reserves (in billions of euro)	10.9	11.2	9.9	10.8	10.4	11.4	11.0	10.6	10.6	10.3	9.6
(In months of prospective imports of GNFS)	7.4	7.4	6.3	6.6	6.2	6.6	6.3	5.7	5.4	5.0	4.4
(in percent of short-term debt)	207.5	269.4	272.1	320.8	313.5	279.2	273.8	225.0	266.5	214.3	199.6
(in percent of broad money, M2)	76.8	76.2	65.8	68.8	65.6	69.5	66.1	60.2	56.5	51.7	44.8
(in percent of risk-weighted metric)	...	229.4	202.9	216.3	212.4	216.0	211.5	195.6	196.5	182.9	170.3

Sources: NBS; and IMF staff estimates and projections.
1/ Some estimates, in particular for private remittances and reinvested earnings, are subject to significant uncertainty.
2/ Excluding net use of IMF resources.
3/ Includes SDR allocations in 2009.
4/ Includes trade credits (net).

Table 5. Serbia: External Financing Requirements, 2012–20

	2012	2013	2014 Prel.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
	(percent of GDP)								
1. Gross financing requirements	19.7	23.5	13.1	16.2	16.4	14.4	16.6	13.5	13.7
Current account deficit	11.5	6.1	6.0	4.7	4.6	4.3	4.2	4.2	4.2
Debt amortization	11.8	15.3	12.6	11.1	9.8	11.4	12.5	9.8	11.1
Medium and long-term debt	9.8	13.9	12.0	10.8	9.2	11.1	12.2	9.6	10.9
Public sector	2.2	7.0	7.1	6.4	4.8	7.2	8.5	4.9	7.7
Of which: IMF	0.7	1.8	1.7	0.4	0.0	0.0	0.0	0.0	0.0
Of which: Eurobonds	0.0	0.0	0.0	0.1	0.1	2.0	2.5	0.1	3.2
Of which: Domestic bonds (non-residents)	n.a.	2.6	3.5	3.8	2.6	2.4	2.6	1.7	1.6
Commercial banks	1.8	3.2	2.8	2.3	1.9	1.3	1.1	1.3	1.0
Corporate sector	5.7	3.7	2.1	2.1	2.4	2.6	2.6	3.4	2.1
Short-term debt	2.0	1.4	0.6	0.3	0.6	0.3	0.3	0.3	0.2
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	1.8	1.2	0.5	0.2	0.4	0.2	0.2	0.1	0.1
Corporate sector	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change in gross reserves (increase=+)	-3.6	2.0	-5.4	0.4	2.0	-1.3	0.0	-0.5	-1.6
2. Available financing	19.7	23.5	13.1	16.2	16.4	14.4	16.6	13.5	13.7
Capital transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	2.1	3.6	3.7	4.9	4.7	4.2	4.2	4.2	4.2
Portfolio investment (net) 1/	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt financing	15.2	17.9	11.7	10.6	12.1	10.2	12.4	9.3	9.5
Medium and long-term debt	13.6	17.4	11.4	10.0	11.8	9.9	12.2	9.1	9.3
Public sector 2/	6.5	12.2	9.0	7.4	9.4	6.9	9.1	5.3	6.7
Of which: Eurobonds	4.4	5.6	0.0	0.0	3.0	2.8	3.3	1.2	2.9
Of which: Domestic bonds (non-residents)	n.a.	3.9	4.9	4.4	3.7	3.4	4.2	2.0	1.8
Commercial banks	1.0	1.7	0.6	0.8	0.7	1.1	1.1	1.3	1.0
Corporate sector	6.1	3.5	1.8	1.8	1.8	1.9	1.9	2.5	1.6
Short-term debt	1.6	0.6	0.3	0.6	0.3	0.3	0.3	0.3	0.2
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	1.3	0.5	0.2	0.5	0.2	0.2	0.2	0.1	0.1
Corporate sector	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other net capital inflows 3/	2.4	2.1	-2.2	0.8	-0.5	0.0	0.0	0.0	0.0
o/w currency and deposits and trade credit	1.1	2.0	2.9	2.8	0.4	0.0	0.0	0.0	0.0
3. Total financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Debt service	14.5	18.1	15.0	13.7	12.4	13.9	15.0	12.4	13.5
Interest	2.7	2.7	2.5	2.7	2.6	2.5	2.6	2.5	2.4
Amortization	11.8	15.3	12.6	11.1	9.8	11.4	12.5	9.8	11.1

Sources: NBS; and Fund staff estimates and projections.

1/ Only includes equity securities and financial derivatives.
2/ Excluding IMF.
3/ Includes all other net financial flows and errors and omissions.

Table 6a. Serbia: General Government Fiscal Operations, 2012–20 1/

(In billions of RSD)

	2012	2013	2014	2015		2016		2017		2018	2019	2020
				2nd rev.	Proj.	2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.
						(Billions of RSD)						
Revenue	1,411	1,468	1,552	1,595	1,610	1,620	1,647	1,679	1,706	1,816	1,948	2,096
Taxes	1,226	1,296	1,370	1,382	1,389	1,433	1,453	1,488	1,508	1,610	1,734	1,874
Personal income tax	165	156	146	144	144	147	150	151	151	160	171	182
Social security contributions	379	418	440	435	442	449	457	468	481	519	565	615
Taxes on profits	55	61	73	64	63	66	64	68	67	72	78	85
Value-added taxes	367	381	410	415	412	427	427	444	443	473	512	556
Excises	181	205	212	230	230	248	254	256	261	277	293	311
Taxes on international trade	36	33	31	33	33	34	35	36	37	37	40	43
Other taxes	43	43	57	62	65	62	65	64	67	72	77	82
Non-tax revenue	180	163	171	203	211	178	184	182	187	195	203	211
Capital revenue	1	5	2	1	0	0	0	0	0	0	0	0
Grants	3	3	9	9	10	9	11	9	11	11	11	11
Expenditure	1,669	1,686	1,810	1,753	1,773	1,781	1,811	1,812	1,821	1,903	2,039	2,182
Current expenditure	1,523	1,582	1,669	1,612	1,639	1,632	1,660	1,651	1,665	1,739	1,864	1,995
Wages and salaries 2/	375	393	389	360	362	345	372	328	350	355	374	399
Goods and services	287	278	310	305	297	316	312	321	317	342	368	397
Interest	68	95	115	134	134	161	145	178	153	178	198	206
Subsidies	145	130	158	107	136	102	111	108	115	121	131	141
Transfers	647	687	697	706	710	708	720	717	731	743	794	852
Pensions 3/	474	498	508	493	502	498	508	503	515	539	575	617
Other transfers 4/	174	189	189	214	208	210	212	214	216	204	219	234
Capital expenditure	119	83	97	110	103	116	117	135	130	142	152	165
Net lending	16	13	15	3	3	3	2	3	3	3	3	3
Amortization of activated guarantees	11	9	30	28	28	30	32	23	24	20	20	19
Fiscal balance	-259	-218	-258	-158	-162	-161	-164	-132	-115	-87	-91	-86
Financing	259	218	258	158	162	161	164	132	115	87	91	86
Privatization proceeds	22	3	2	0	0	0	0	0	0	0	0	0
Equity investment	-39	-18	0	0	0	0	0	0	0	0	0	0
Domestic	116	42	123	-21	93	40	25	9	48	15	78	-19
Banks	130	33	83	-7	47	19	2	-4	17	-13	-21	-24
Government deposits ((-) means accumulation)	-30	-100	-56	-3	49	14	1	-18	6	-9	-33	-3
Securities held by banks (net)	98	56	118	4	7	10	5	19	15	8	35	1
Other domestic bank financing	63	76	22	-8	-9	-5	-4	-5	-4	-12	-23	-22
Non-banks (incl. non-residents)	-14	8	40	-14	46	21	23	13	30	28	99	5
Securities held by non-banks (non-residents, net)	34	56	97	49	74	75	90	19	46	33	104	10
Others (incl. amortization)	-48	-48	-58	-62	-28	-55	-67	-6	-16	-5	-5	-5
External	160	192	133	179	70	121	139	123	68	72	12	105
Program	0	0	0	11	11	0	0	0	0	0	0	0
Project	43	36	66	47	44	50	50	67	41	49	64	68
Bonds and loans	159	234	88	170	58	140	158	161	131	182	104	198
Amortization	-41	-78	-20	-49	-44	-69	-69	-105	-105	-160	-156	-161
Memorandum items:												
Wages and salaries excluding severance payments	375	393	389	351	361	332	354	315	336	355	374	399
Arrears accumulation (domestic)	9	-5	-14	0	0	0	0	0	0	0	0	0
Quasi-fiscal support to SOEs (gross new issuance of guarantees)	134	112	120	13	13	5	5	15	15	17	17	17
Gross public debt	2090	2381	2802	3050	3007	3255	3231	3407	3338	3447	3579	3679
Gross public debt (including restitution)	2090	2381	3080	3330	3250	3536	3474	3688	3581	3690	3801	3880
Nominal GDP (billions of dinars)	3584	3876	3878	3976	3964	4153	4138	4388	4377	4712	5072	5485

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

1/ Includes the republican budget, local governments, social security funds, and the Road Company, but excludes indirect budget beneficiaries (IBBs) that are reporting only on an annual basis.

2/ Including severence payments.

3/ Includes RSD10 billion military pension payment in 2015 following a Constitution Court ruling.

4/ Excluding foreign currency deposit payments to households, reclassified below the line.

Table 6b. Serbia: General Government Fiscal Operations, 2012–20 1/

(Percent of GDP)

	2012	2013	2014	2015		2016		2017		2018	2019	2020
				2nd rev.	Proj.	2nd rev.	Proj.	2nd rev.	Proj.	Proj.	Proj.	Proj.
						(percent of GDP)						
Revenue	39.4	37.9	40.0	40.1	40.6	39.0	39.8	38.3	39.0	38.5	38.4	38.2
Taxes	34.2	33.4	35.3	34.8	35.0	34.5	35.1	33.9	34.5	34.2	34.2	34.2
Personal income tax	4.6	4.0	3.8	3.6	3.6	3.5	3.6	3.4	3.5	3.4	3.4	3.3
Social security contributions	10.6	10.8	11.4	10.9	11.2	10.8	11.0	10.7	11.0	11.0	11.1	11.2
Taxes on profits	1.5	1.6	1.9	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.5	1.6
Value-added taxes	10.3	9.8	10.6	10.4	10.4	10.3	10.3	10.1	10.1	10.0	10.1	10.1
Excises	5.1	5.3	5.5	5.8	5.8	6.0	6.1	5.8	6.0	5.9	5.8	5.7
Taxes on international trade	1.0	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Other taxes	1.2	1.1	1.5	1.6	1.6	1.5	1.6	1.5	1.5	1.5	1.5	1.5
Non-tax revenue	5.0	4.2	4.4	5.1	5.3	4.3	4.4	4.1	4.3	4.1	4.0	3.8
Capital revenue	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Expenditure	46.6	43.5	46.7	44.1	44.7	42.9	43.8	41.3	41.6	40.4	40.2	39.8
Current expenditure	42.5	40.8	43.0	40.6	41.3	39.3	40.1	37.6	38.0	36.9	36.8	36.4
Wages and salaries 2/	10.5	10.1	10.0	9.1	9.1	8.3	9.0	7.5	8.0	7.5	7.4	7.3
Goods and services	8.0	7.2	8.0	7.7	7.5	7.6	7.5	7.3	7.2	7.3	7.3	7.2
Interest	1.9	2.4	3.0	3.4	3.4	3.9	3.5	4.0	3.5	3.8	3.9	3.8
Subsidies	4.1	3.3	4.1	2.7	3.4	2.5	2.7	2.5	2.6	2.6	2.6	2.6
Transfers	18.1	17.7	18.0	17.8	17.9	17.1	17.4	16.3	16.7	15.8	15.7	15.5
Pensions 3/	13.2	12.8	13.1	12.4	12.7	12.0	12.3	11.5	11.8	11.4	11.3	11.3
Other transfers 4/	4.8	4.9	4.9	5.4	5.3	5.1	5.1	4.9	4.9	4.3	4.3	4.3
Capital expenditure	3.3	2.1	2.5	2.8	2.6	2.8	2.8	3.1	3.0	3.0	3.0	3.0
Net lending	0.5	0.3	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Amortization of activated guarantees	0.3	0.2	0.8	0.7	0.7	0.7	0.8	0.5	0.5	0.4	0.4	0.4
Fiscal balance (incl. amortization of called guarantees)	-7.2	-5.6	-6.7	-4.0	-4.1	-3.9	-4.0	-3.0	-2.6	-1.8	-1.8	-1.6
Financing	7.2	5.6	6.7	4.0	4.1	3.9	4.0	3.0	2.6	1.8	1.8	1.6
Privatization proceeds	0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity investment	-1.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	3.2	1.1	3.2	-0.5	2.3	1.0	0.6	0.2	1.1	0.3	1.5	-0.3
Banks	3.6	0.9	2.1	-0.2	1.2	0.5	0.0	-0.1	0.4	-0.3	-0.4	-0.4
Government deposits ((-) means accumulation)	-0.8	-2.6	-1.5	-0.1	1.2	0.3	0.0	-0.4	0.1	-0.2	-0.6	-0.1
Securities held by banks (net)	2.7	1.5	3.0	0.1	0.2	0.2	0.1	0.4	0.3	0.2	0.7	0.0
Other domestic bank financing	1.8	2.0	0.6	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.5	-0.4
Non-banks (incl. non-residents)	-0.4	0.2	1.0	-0.3	1.2	0.5	0.6	0.3	0.7	0.6	2.0	0.1
Securities held by non-banks (non-residents, net)	0.9	1.4	2.5	1.2	1.9	1.8	2.2	0.4	1.0	0.7	2.1	0.2
Others (incl. amortization)	-1.3	-1.2	-1.5	-1.6	-0.7	-1.3	-1.6	-0.1	-0.4	-0.1	-0.1	-0.1
External	4.5	5.0	3.4	4.5	1.8	2.9	3.4	2.8	1.5	1.5	0.2	1.9
Program	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project	1.2	0.9	1.7	1.2	1.1	1.2	1.2	1.5	0.9	1.0	1.3	1.2
Bonds and loans	4.4	6.0	2.3	4.3	1.5	3.4	3.8	3.7	3.0	3.9	2.1	3.6
Amortization	-1.2	-2.0	-0.5	-1.2	-1.1	-1.7	-1.7	-2.4	-2.4	-3.4	-3.1	-2.9
Memorandum items:												
Wages and salaries excluding severance payments	10.5	10.1	10.0	8.8	9.1	8.0	8.6	7.2	7.7	7.5	7.4	7.3
Arrears accumulation (domestic)	0.2	-0.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Quasi-fiscal support to SOEs (gross new issuance guarantees)	3.7	2.9	3.1	0.3	0.3	0.1	0.1	0.3	0.4	0.4	0.3	0.3
Gross financing need	15.9	16.2	15.9	16.2	16.4	14.0	14.1	14.1	13.6	16.1	14.5	15.9
Gross public debt	58.3	61.4	72.2	76.7	75.9	78.4	78.1	77.7	76.3	73.2	70.6	67.1
Gross public debt (including restitution)	58.3	61.4	79.4	83.8	82.0	85.2	84.0	84.0	81.8	78.3	75.0	70.7
Nominal GDP (billions of dinars)	3,584	3,876	3,878	3,976	3,964	4,153	4,138	4,388	4,377	4,712	5,072	5,485

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

1/ Includes the republican budget, local governments, social security funds, and the Road Company, but excludes indirect budget beneficiaries (IBBs) that are reporting only on an annual basis.

2/ Including severence payments.

3/ Includes RSD10 billion military pension payment in 2015 following a Constitution Court ruling.

4/ Excluding foreign currency deposit payments to households, reclassified below the line.

Table 7a. Serbia: Monetary Survey, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Sep	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/									
Net foreign assets 2/	673	847	1037	1092	1138	1291	1257	1265	1245	1163
in billions of euro	5.9	7.4	8.6	9.1	9.4	10.5	10.1	10.1	9.9	9.2
Foreign assets	1420	1427	1475	1501	1511	1604	1562	1573	1555	1474
NBS	1250	1291	1208	1269	1268	1370	1326	1334	1315	1233
Commercial banks	169	136	267	232	243	234	236	238	240	241
Foreign liabilities (-)	-747	-580	-438	-409	-373	-313	-305	-308	-310	-311
NBS	-166	-87	-27	-9	-10	-8	-8	-8	-8	-8
Commercial banks	-581	-493	-412	-400	-364	-304	-297	-300	-302	-303
Net domestic assets	943	836	785	751	780	767	930	1,079	1,285	1,576
Domestic credit	2,027	1,886	2,005	2,034	2,059	2,128	2,350	2,555	2,838	3,136
Government, net	95	49	123	155	169	171	189	176	155	131
NBS	-160	-236	-256	-259	-208	-209	-204	-214	-248	-252
Claims on government	1	1	1	1	1	1	1	1	1	1
Liabilities (deposits)	161	237	258	260	210	211	205	215	249	253
Banks	255	285	379	414	378	380	393	390	403	383
Claims on government	290	336	457	492	456	460	472	470	483	463
Liabilities (deposits)	36	51	78	78	78	79	80	80	80	81
Local governments, net	6	1	-8	-18	-8	-8	-8	-8	-8	-8
Non-government sector	1,926	1,837	1,890	1,897	1,898	1,965	2,169	2,387	2,691	3,013
Households	654	675	725	747	743	784	866	953	1,074	1,202
Enterprises	1,226	1,111	1,140	1,123	1,130	1,155	1,276	1,404	1,582	1,771
Other	47	51	25	27	25	26	28	31	35	39
Other assets, net	-1,084	-1,050	-1,220	-1,284	-1,279	-1,361	-1,420	-1,476	-1,552	-1,560
Capital accounts (-)	-876	-830	-927	-954	-954	-989	-1,027	-1,068	-1,119	-1,125
NBS	-264	-217	-307	-320	-320	-336	-355	-379	-404	-409
Banks	-611	-613	-620	-635	-635	-654	-672	-690	-715	-716
Provisions (-)	-237	-257	-279	-290	-286	-300	-317	-330	-350	-350
Other assets	28	37	-14	-39	-39	-72	-76	-78	-84	-86
Broad money (M2)	1616	1683	1823	1843	1917	2058	2187	2344	2531	2738
Dinar-denominated M2	455	515	574	585	624	695	774	864	966	1075
M1	296	366	402	417	445	496	552	616	689	767
Currency in circulation	111	122	130	126	134	149	166	186	207	231
Demand deposits	186	244	271	292	311	347	386	431	481	536
Time and saving deposits	159	149	173	168	179	199	222	248	277	308
Foreign currency deposits	1161	1169	1248	1258	1293	1363	1412	1480	1565	1663
in billions of euro	10.2	10.2	10.3	10.5	10.6	11.0	11.3	11.8	12.4	13.1
Memorandum items:	(year-on-year change unless indicated otherwise)									
M1	3.8	23.7	9.7	8.6	10.8	11.4	11.4	11.6	11.7	11.3
M2	9.2	4.2	8.3	3.8	5.2	7.3	6.2	7.2	8.0	8.2
Velocity (Dinar part of money supply)	7.9	7.5	6.8	6.7	6.4	6.0	5.7	5.5	5.3	5.1
Velocity (M2)	2.2	2.3	2.1	2.1	2.1	2.0	2.0	2.0	2.0	2.0
Deposits at program exchange rate	3.6	2.9	4.1	3.3	5.1	5.9	5.3	6.3	7.3	7.6
Credit to non-gov. (program exchange rates) 3/	0.3	-4.0	-1.2	-0.8	-1.0	0.7	5.6	5.6	7.6	8.0
Domestic	3.3	-5.1	-1.0	1.2	0.1	2.5	9.8	9.6	12.3	11.6
Households	2.1	2.8	3.8	2.6	2.2	4.6	9.9	9.6	12.3	11.6
Enterprises and other sectors	3.9	-9.1	-3.7	0.4	-1.1	1.2	9.8	9.6	12.3	11.7
External	-5.0	-1.8	-1.7	-4.5	-3.2	-2.8	-3.3	-3.6	-5.2	-3.7
Credit to non-gov. (real terms) 4/	-4.5	-5.5	1.4	-1.2	-2.7	-1.6	2.2	2.2	3.9	4.2
Domestic credit to non-gov. (real terms)	-2.6	-6.7	1.2	0.9	-1.7	0.0	6.3	5.9	8.5	7.8
Households	-3.3	1.0	5.7	2.8	0.3	2.0	6.3	5.9	8.5	7.8
Enterprises and other sectors	-2.2	-10.7	-1.5	-0.3	-2.9	-1.2	6.3	5.9	8.5	7.8
External	-8.0	-3.2	1.9	-5.1	-4.7	-4.7	-6.1	-6.5	-8.2	-6.7
Deposit euroization (percent of total) 5/	77.1	74.9	73.8	73.3	72.5	71.4	69.9	68.6	67.4	66.3
Credit euroization (percent of total) 5/	69.7	70.6	67.6	70.2	66.6	65.6	64.6	63.6	62.6	61.6

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

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

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

3/ Using program dinar/euro and dinar/swiss franc exchange rates for converting FX and FX-indexed loans to dinars.

4/ Calculated as nominal credit at current exchange rates deflated by the change in the 12-month CPI index.

5/ Using current exchange rates.

Table 7b. Serbia: NBS Balance Sheet, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Sep	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/									
Net foreign assets	1085	1204	1182	1260	1259	1362	1318	1326	1307	1225
(In billions of euro)	9.5	10.5	9.8	10.5	10.4	11.0	10.6	10.6	10.4	9.6
Gross foreign reserves	1250	1291	1208	1269	1268	1370	1326	1334	1315	1233
Gross reserve liabilities (-)	-166	-87	-27	-9	-10	-8	-8	-8	-8	-8
Net domestic assets	-470	-584	-601	-678	-689	-787	-716	-690	-632	-507
Net domestic credit	-206	-368	-294	-358	-369	-452	-360	-311	-228	-98
Net credit to government	-160	-236	-256	-259	-208	-209	-204	-214	-248	-252
Claims on government	1	1	1	1	1	1	1	1	1	1
Liabilities to government (-)	-161	-237	-258	-260	-210	-211	-205	-215	-249	-253
Liabilities to government (-): local currency	-55	-89	-103	-134	-98	-98	-98	-98	-98	-98
Liabilities to government (-): foreign currency	-106	-148	-154	-126	-111	-112	-107	-117	-150	-155
Net credit to local governmens	-18	-31	-46	-55	-51	-51	-51	-51	-51	-51
Net claims on banks	-39	-110	-7	-59	-125	-206	-120	-61	56	190
Capital accounts (-)	-264	-217	-307	-320	-320	-336	-355	-379	-404	-409
Reserve money	614	620	581	581	569	574	602	636	676	718
Currency in circulation	111	122	130	126	134	149	166	186	207	231
Commercial bank reserves	186	200	212	224	238	237	241	246	252	258
Required reserves	140	145	158	158	124	110	114	120	127	135
Excess reserves	45	55	54	66	114	127	127	127	126	123
FX deposits by banks, billions of euros	2.8	2.6	2.0	1.9	1.6	1.5	1.6	1.6	1.7	1.8

Sources: National Bank of Serbia; and IMF staff estimates and projections.
1/ Foreign exchange denominated items are converted at current exchange rates.

Table 8. Serbia: Banking Sector Financial Soundness Indicators, 2012–15

	2012	2013	2014	2015		
				Mar	Jun	Sep
Capital adequacy						
Regulatory capital to risk-weighted assets	19.9	20.9	20.0	20.3	21.4	21.2
Regulatory Tier 1 capital to risk-weighted assets	19.0	19.3	17.6	17.8	18.9	18.8
Nonperforming loans net of provisions to capital	31.0	32.7	31.0	31.3	30.4	28.4
Capital to assets	20.5	20.9	20.7	21.2	21.2	21.4
Large exposures to capital	61.9	90.4	130.5	130.4	113.8	116.2
Regulatory capital to total assets	12.2	12.2	11.4	11.6	11.9	11.9
Asset quality						
Nonperforming loans to total gross loans	18.6	21.4	21.5	22.6	22.8	22.0
Sectoral distribution of loans (percent of total loans)						
Deposit takers	0.3	0.3	0.8	0.5	0.5	0.2
Central bank	2.3	5.8	0.4	0.0	1.1	3.1
General government	3.2	2.3	2.3	2.2	2.0	1.8
Other financial corporations	1.6	1.6	0.5	0.4	0.5	0.5
Nonfinancial corporations	56.5	54.1	56.3	56.1	55.1	54.1
Agriculture	2.9	2.7	3.5	3.4	3.4	3.6
Industry	18.0	18.4	19.2	18.8	18.4	17.9
Construction	5.5	4.6	4.2	4.1	4.2	3.9
Trade	15.2	13.5	13.9	13.6	13.0	13.2
Other loans to nonfinancial corporations	14.8	14.9	15.6	16.2	16.1	15.5
Households and NPISH	34.1	34.8	38.3	39.0	39.4	38.4
Households and NPISH of which: mortgage loans to total loans	17.3	16.8	18.1	18.7	18.7	17.8
Foreign sector	2.0	1.1	1.4	1.7	1.5	1.9
Specific provision for NPLs to gross NPLs	50.0	50.9	54.9	55.4	56.1	57.0
Specific and general provisions for NPLs to gross NPLs	111.1	105.5	107.6	105.7	105.7	107.5
Specific and general provisions for balance sheet losses to NPLs	120.7	113.8	114.5	113.0	113.2	115.0
Specific and general provisions to NPLs	126.5	117.9	118.4	116.7	116.9	118.8
Specific provision of total loans to total gross loans	10.2	11.9	12.7	13.4	13.6	13.4
Earnings and Profitability						
Return on assets	0.4	-0.1	0.1	1.0	1.1	1.2
Return on equity	2.0	-0.4	0.6	4.7	5.4	5.6
Liquidity						
Customer deposits to total (noninterbank) loans	93.2	103.4	108.5	108.2	110.6	110.7
Foreign-currency-denominated loans to total loans	74.1	71.6	70.1	71.3	71.3	70.6
Average monthy liquidity ratio	2.1	2.4	2.2	2.2	2.3	2.3
Average monthy narrow liquidity ratio	1.6	1.8	1.7	1.8	1.9	1.9
Sensitivity to Market Risk						
Foreign-currency-denominated liabilities to total liabilities	80.1	76.7	74.5	75.3	74.3	73.5
Total off-balance sheet items to total assets	103.5	111.0	207.1	242.0	238.6	234.5
Classified off-balance sheet items to classified balance sheet assets	26.1	28.7	27.6	27.9	27.7	28.7

Source: National Bank of Serbia.

Table 9. Serbia: Schedule of Purchases under the Stand-By Arrangement

	Available on or after	Amount of Purchase			Cumulative	Conditions
		In millions of SDR	In millions of euros 1/	In percent of quota 2/	In percent of quota 2/	
1	2/23/2015	187.080	231.7	40	40	Board approval of arrangement.
2	6/7/2015	116.925	146.1	25	65	Observance of continuous and end-March 2015 performance criteria, and completion of the review.
3	9/7/2015	116.925	146.1	25	90	Observance of continuous and end-June 2015 performance criteria, and completion of the review.
4	12/7/2015	70.155	87.6	15	105	Observance of continuous and end-September 2015 performance criteria, and completion of the review.
5	3/7/2016	70.155	87.6	15	120	Observance of continuous and end-December 2015 performance criteria, and completion of the review.
6	6/7/2016	46.770	58.4	10	130	Observance of continuous and end-March 2016 performance criteria, and completion of the review.
7	9/7/2016	46.770	58.4	10	140	Observance of continuous and end-June 2016 performance criteria, and completion of the review.
8	12/7/2016	46.770	58.3	10	150	Observance of continuous and end-September 2016 performance criteria, and completion of the review.
9	3/7/2017	46.770	58.3	10	160	Observance of continuous and end-December 2016 performance criteria, and completion of the review.
10	6/7/2017	46.770	58.2	10	170	Observance of continuous and end-March 2017 performance criteria, and completion of the review.
11	9/7/2017	46.770	58.2	10	180	Observance of continuous and end-June 2017 performance criteria, and completion of the review.
12	12/7/2017	46.770	58.1	10	190	Observance of continuous and end-September 2017 performance criteria, and completion of the review.
13	2/15/2018	46.770	58.0	10	200	Observance of continuous and end-December 2017 performance criteria, and completion of the review.
	Total	935.400	1,165.2	200	200	

Source: FIN, WEO.
1/ At projected WEO exchange rates.
2/ Serbia's quota is SDR 467.7 million.

Table 10. Serbia: Balance of Payments (Precautionary SBA Shock Scenario), 2012–20 1/

	2012	2013	2014 Prel.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
				(Billions of euros)					
Current account balance	-3.6	-2.1	-2.0	-1.5	-2.4	-2.2	-2.2	-2.1	-2.0
Trade of goods balance	-5.6	-4.2	-4.1	-3.9	-4.7	-4.7	-4.6	-4.5	-4.5
Exports of goods	8.4	10.5	10.6	11.4	11.5	12.5	13.5	14.6	15.6
Imports of goods	-14.0	-14.7	-14.8	-15.3	-16.2	-17.1	-18.1	-19.1	-20.1
Services balance	0.1	0.3	0.5	0.7	0.8	0.9	1.0	1.1	1.2
Exports of nonfactor services	3.1	3.4	3.8	4.2	4.6	4.9	5.2	5.5	5.9
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.6	-3.8	-4.0	-4.2	-4.4	-4.7
Income balance	-1.1	-1.4	-1.3	-1.6	-1.8	-1.8	-1.9	-2.0	-2.2
Net interest	-0.8	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-1.1	-1.2
Others, including reinvested earnings	-0.3	-0.5	-0.5	-0.7	-0.8	-0.8	-0.9	-0.9	-1.0
Current transfer balance	2.9	3.2	3.0	3.3	3.3	3.4	3.3	3.3	3.5
Official grants	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Others, including private remittances	2.9	3.1	2.9	3.2	3.2	3.2	3.1	3.3	3.5
Capital and financial account balance 1/	2.5	3.2	0.5	1.4	1.3	0.0	1.6	1.5	1.1
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	0.7	1.2	1.2	1.6	1.6	1.5	1.6	1.7	1.8
Portfolio investment balance	1.7	1.9	0.4	0.0	0.8	0.1	0.9	0.6	0.0
of which: debt liabilities	1.7	2.0	0.4	0.0	0.8	0.1	0.9	0.6	0.0
Other investment balance	0.2	0.1	-1.1	-0.2	-1.1	-1.6	-1.0	-0.8	-0.7
Public sector 1/ 2/	0.5	0.4	0.7	0.3	0.2	-0.7	-0.7	-0.4	-0.4
Domestic banks	-0.4	-0.5	-1.5	-0.2	-0.5	-0.3	0.0	0.0	0.0
Other private sector 3/	0.1	0.1	-0.4	-0.3	-0.8	-0.6	-0.3	-0.4	-0.2
Errors and omissions	0.2	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	0.3	-1.1	-2.2	-0.6	-0.6	-0.9
Financing	0.9	-1.3	1.2	-0.3	1.1	2.2	0.6	0.6	0.9
Gross international reserves (increase, -)	1.1	-0.7	1.8	-0.1	0.2	2.0	0.5	1.0	1.4
Use of Fund credit, net	-0.2	-0.6	-0.6	-0.1	0.9	0.2	0.1	-0.4	-0.5
Purchases	0.0	0.0	0.0	0.0	0.9	0.2	0.1	0.0	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	0.0	0.0	0.0	-0.4	-0.5
				(Percent of GDP)					
Current account balance	-11.5	-6.1	-6.0	-4.7	-7.1	-6.3	-5.7	-5.2	-4.7
Trade of goods balance	-17.8	-12.1	-12.4	-11.8	-13.9	-13.2	-12.1	-11.2	-10.4
Exports of goods	26.5	30.8	32.2	34.7	34.0	35.3	35.8	36.2	36.1
Imports of goods	-44.2	-42.9	-44.6	-46.4	-47.9	-48.5	-47.9	-47.4	-46.5
Services balance	0.4	0.9	1.4	2.0	2.3	2.5	2.6	2.7	2.7
Income balance	-3.4	-4.1	-4.1	-4.8	-5.3	-5.1	-4.9	-5.0	-5.0
Current transfer balance	9.3	9.2	9.1	9.9	9.7	9.5	8.7	8.2	8.0
Official grants	0.3	0.1	0.3	0.3	0.3	0.3	0.3	0.0	0.0
Others, including private remittances	9.0	9.1	8.8	9.6	9.4	9.2	8.4	8.2	8.0
Capital and financial account balance 1/	7.9	9.4	1.4	4.3	3.9	0.1	4.2	3.7	2.6
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	2.1	3.6	3.7	4.9	4.7	4.2	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	0.1	2.4	0.4	2.5	1.4	0.0
Other investment balance	0.5	0.3	-3.4	-0.7	-3.2	-4.5	-2.5	-1.9	-1.6
Public sector 1/ 2/	1.5	1.2	2.2	0.9	0.6	-2.1	-1.8	-1.0	-1.0
Domestic banks	-1.3	-1.3	-4.5	-0.6	-1.6	-0.8	0.0	0.0	0.0
Other private sector 3/	0.4	0.4	-1.1	-1.0	-2.3	-1.6	-0.7	-0.9	-0.6
Errors and omissions	0.6	0.5	0.9	1.3	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	0.9	-3.2	-6.2	-1.6	-1.6	-2.1
Memorandum items:				(percent change unless indicated otherwise)					
Export growth	-0.5	25.6	1.0	7.0	1.1	8.5	8.0	8.2	7.2
Import growth	2.0	4.7	0.4	3.4	6.2	5.8	5.4	5.8	5.4
Export volume growth	-0.8	21.9	1.7	7.0	0.4	8.6	8.3	8.4	8.4
Import volume growth	0.8	2.7	1.9	5.5	5.8	4.4	4.3	5.3	5.7
Trading partner import growth	-0.2	1.6	3.6	4.0	5.1	5.1	5.4	4.5	4.5
Export prices growth	0.3	3.0	-0.7	0.0	0.7	-0.1	-0.2	-0.1	-1.1
Import prices growth	1.2	2.0	-1.5	-2.0	0.3	1.4	1.0	0.5	-0.3
Change in terms of trade	-0.9	1.0	0.8	2.0	0.4	-1.4	-1.2	-0.6	-0.8
Gross official reserves (in billions of euro)	10.9	11.2	9.9	10.4	10.1	8.2	7.6	6.6	5.2
(In months of prospective imports of GNFS)	7.4	7.4	6.3	6.2	5.8	4.4	3.9	3.2	2.5
(in percent of short-term debt)	207.5	269.4	272.1	313.5	252.0	174.0	192.9	137.9	108.7
(in percent of broad money, M2)	76.8	76.2	65.8	65.6	60.8	46.5	40.9	33.3	24.4
(in percent of IMF risk-weighted metric)	224.6	229.4	202.9	212.4	199.9	157.7	142.2	115.9	91.4
GDP (billions of euros)	31.7	34.3	33.1	32.8	33.8	35.3	37.7	40.3	43.3

Sources: NBS; and IMF staff estimates and projections.

1/ Excluding net use of IMF resources.
2/ Includes SDR allocations in 2009.
3/ Includes trade credits (net).

Table 11. Serbia: Indicators of Capacity to Repay the Fund, 2013–20 1/

	2013	2014	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
Fund repurchases and charges								
In millions of SDRs	579	502	119	18	9	10	299	392
In millions of euro	663	574	150	23	11	13	373	489
In percent of exports of goods and NFS	4.7	4.0	1.0	0.1	0.1	0.1	1.9	2.3
In percent of GDP	1.9	1.7	0.5	0.1	0.0	0.0	0.9	1.1
In percent of quota	123.8	107.3	25.5	3.9	1.9	2.2	63.8	83.8
In percent of total external debt service	10.7	11.6	3.3	0.6	0.2	0.2	7.5	8.4
In percent of gross international reserves	5.9	5.8	1.5	0.2	0.1	0.2	5.6	9.3
Fund credit outstanding (end-period)								
In millions of SDRs	624	128	503	702	889	935	646	260
In millions of euro	701	151	634	883	1114	1169	804	324
In percent of exports of goods and NFS	5.0	1.0	4.1	5.5	6.4	6.3	4.0	1.5
In percent of GDP	2.0	0.5	1.9	2.6	3.2	3.1	2.0	0.7
In percent of quota	133.5	27.3	107.5	150	190	200	138	56
In percent of total external debt	2.6	0.5	2.3	3.1	4.1	4.3	3.0	1.3
In percent of gross international reserves	6.3	1.5	6.1	8.7	13.6	15.3	12.1	6.2
Memorandum items:								
Exports of goods and NFS	13,963	14,451	15,583	16,061	17,352	18,672	20,128	21,485
Quota (in millions of SDRs)	468	468	468	468	468	468	468	468
GDP	34,277	33,075	32,843	33,790	35,315	37,699	40,289	43,309
Total external debt service	6,194	4,965	4,512	4,190	4,902	5,670	4,976	5,847
Public sector external debt	14,596	16,083	16,431	18,333	17,978	18,296	18,100	17,167
Total external debt	27,194	27,723	27,399	28,139	26,923	26,968	26,398	25,214
Total external debt stock excluding IMF	26,497	27,571	27,393	27,265	25,816	25,803	24,871	23,209
Gross international reserves	11,189	9,907	10,357	10,138	8,174	7,638	6,646	5,241

Source: Fund staff estimates.

1/ Based on the assumption of full drawing under the Precautionary SBA shock scenario.

Appendix I. Letter of Intent

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Belgrade, December 2, 2015

Dear Ms. Lagarde:

Our economic program, supported by the Stand-By Arrangement (SBA) approved by the IMF Executive Board on February 23, 2015, has been instrumental in reducing Serbia's long-standing internal and external economic imbalances and we remain fully committed to the policies envisaged in this program. The attached Memorandum of Economic and Financial Policies (MEFP) describes progress made so far and sets out the economic policies that the Government of the Republic of Serbia and the National Bank of Serbia (NBS) intend to implement under the SBA. Our program continues to be fully supported by all coalition partners in the government, indicating strong commitment to and ownership of envisaged policies.

Program performance has been good. All quantitative performance criteria (PCs) and all but one indicative targets for end-September were met with significant margins, and inflation was within the inner band of the inflation consultation clause. We posted the new Local Government Financing Law for public debate in December (prior action). The Government Steering Committee adopted a financial restructuring plan for Serbia Railways (end-September structural benchmark) in mid-October. The special diagnostic studies of bank asset quality (SDS) (end-September structural benchmark) were completed by end-November, with a delay due to operational complexities.

The policies under our program will continue to focus on reducing fiscal imbalances, pursuing a wide financial sector agenda, and implementing broad-based structural reforms. In support of the program, we have specified additional structural benchmarks for the coming period.

Given Serbia's comfortable international reserve position and continued access to external financing, we intend to treat the arrangement as precautionary. Therefore, we would not make the purchases when they become available upon completion of reviews. The implementation of our program will continue to be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and an inflation consultation clause, as described in the attached MEFP and Technical Memorandum of Understanding (TMU).

We believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of our economic program, and we will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. And we will provide all information requested by the Fund to assess implementation of the program.

We wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the third review of the SBA. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official website of the Serbian government.

Sincerely,

/s/
Aleksandar Vučić
Prime Minister

/s/	/s/
Jorgovanka Tabaković	Dušan Vujović
Governor of the National Bank of Serbia	Minister of Finance

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This memorandum sets out our economic program for 2015–17. The program aims to establish a foundation for healthy economic growth by addressing short-term as well as medium-term economic challenges that Serbia is facing. To this end, the program focuses on policies to ensure macroeconomic stability, most notably by restoring fiscal sustainability, bolster resilience of the financial sector, and improve competitiveness of the economy.

2. Significant progress has been made since the economic program started. Bold fiscal consolidation, which started in late 2014, is beginning to bear fruit, reforms in the financial sector are progressing as planned, and the initiation of comprehensive restructuring in the state-owned enterprises is starting to yield positive impacts on their efficiency and financial discipline.

3. The goals of the economic program are compatible with our aspirations to become an EU member, having started the accession process in January 2014. Implementing this program will allow Serbia to realize the significant potential for convergence towards EU income levels.

Recent Economic Developments and Outlook

4. **The Serbian economy is emerging from the recession last year.** The recovery continues to strengthen, notwithstanding significant fiscal tightening. Growth benefits from an earlier-than-expected recovery of the mining and energy sectors, a catch-up in investment, and smaller-than-expected fall in private consumption (which in turn reflects lower oil prices and robust private sector wages and remittances). Despite the gradual monetary policy easing, headline CPI inflation has remained below the NBS inflation tolerance band most of the time since late 2013, mainly on account of weak demand, low prices of primary commodities (particularly energy prices) and delay in administered price adjustments. Inflation is expected to stabilize within the tolerance band in the second half of 2016. The current account deficit declined with the recovery of exports to the level covered by FDI, and capital inflows increased amid ECB quantitative easing and improved risk premia for government debt.

5. **We will continue to consistently implement policy actions and reforms envisaged under our economic program.** We expect that this will give rise to a virtuous cycle of boosting confidence, improving growth and private sector vibrancy. Reflecting the recent developments, we envisage the following revisions to the macroeconomic scenario under the program:

- **Real GDP** is expected to grow at ¾ percent in 2015, compared to ½ percent projected previously, and to gradually accelerate over the medium term on account of smaller fiscal adjustment, recovering market confidence and credit growth, and the positive effects of structural reforms.
- **Headline CPI inflation** is projected to average 1.5 percent, reflecting price developments so far this year amid lower oil prices and favorable fruit and vegetable prices. In the

medium term, inflation is expected to stay within the inflation tolerance band (4±1½ percent), supported by the inflation targeting regime.

- **The current account deficit** is expected to decline to 4.7 percent of GDP this year and to narrow to around 4 percent of GDP over the medium term. External financing will rely mostly on FDI, but also on bilateral and project loans.

6. **The program scenario continues to face downside exogenous risks, but the Serbian economy has considerable buffers to withstand them.** A resurgence of Greece-related turbulence could expose Serbia to spillovers through a confidence channel (Greek bank subsidiaries account for 13 percent of banking system assets) and an indirect real channel (slow growth in trading partners). We are also susceptible to changes in market volatility from possible tightening of US monetary policy, or slowdowns in major emerging markets that could affect our external demand. However, as the first line of defense, Serbia has large foreign exchange reserves and a well-capitalized and liquid banking system. The Fund arrangement provides an additional buffer to help us cope with negative shocks, and we are prepared to further adjust policies as necessary.

Economic Policies

A. Fiscal Policies

7. **We remain committed to implementing a set of fiscal consolidation policies that will reverse the rise in public debt by 2017 and put it firmly on a downward path thereafter.** We believe that a credible three-year adjustment requires significant frontloading. To this end, we are implementing a structural fiscal adjustment of about 4 percent of GDP during 2015–17, of which about 2.5 percent of GDP will be implemented this year. The measures focus primarily on containing public expenditures, namely on scaling down public sector wage and pension bills towards our medium-term objectives of 7 and 11 percent of GDP, respectively, and reducing state aid to state-owned enterprises (SOEs).

8. **The fiscal outturn in the first three quarters of 2015 was well within the program targets.** The general government fiscal deficit amounted to RSD 51.1 billion, well below the adjusted program target of RSD 143.6 billion, owing to both conservative projections and improved revenue collection (about 80 percent) and the under-execution of expenditure (20 percent). While current expenditures are broadly in line with the budget, we recognize that under-execution of capital expenditure continues, which will be detrimental to Serbia's long-run potential growth. We are working on new regulations and guidelines for public investment management. In particular, we will adopt a set of by-laws aimed at strengthening the project appraisal process by end-December 2015 (**structural benchmark**). Current expenditure measures effective since 2014—wage and pension cuts and the 5:1 attrition rule for general government permanent employees—have been implemented as committed, and the current primary expenditure of the Republican budget amounted to RSD 614.5 billion, below the

adjusted program target of RSD 648.6 billion. We are confident that we will meet the end-December fiscal deficit target, which was tightened in the context of the second review, reflecting developments by that time while keeping a reasonable fiscal buffer, to ensure that the improved revenue performance is assigned to our priority of reducing debt.

9. We remain committed to the expenditure measures introduced so far, while revenues are over-performing earlier projections. The government has been implementing the measures as envisaged in the 2015 budget, and the general government deficit (quantitative performance criterion) will be 4.1 percent of GDP, slightly above projection of about 4.0 percent of GDP, but well below the original target of 5.9 percent of GDP this year:

- We suspended the indexation of public sector wages and pensions in 2015, according to the Budget System Law and Pension Insurance Law modified in December 2014.

- We amended the Procurement Law in early February 2015 to lower the mark up on public procurement from domestic suppliers from 15 percent to 5 percent in 2015, and eventually plan to eliminate it by 2018. This will also help reduce the cost of capital spending.

- We eliminated agricultural subsidies for land over 20 hectares and for land leased from the Government of Serbia. We modified the Law on Agriculture accordingly in December 2014. However, abuse of the subsidy system means that savings from this measure will fall short of the budget estimates (by RSD 8 billion). Follow-up legislation is being introduced to ensure the intended savings are achieved in 2016 (see also ¶12).

- We reduced state aid to SOEs, including subsidies, net lending, and payments from the budget for guaranteed and nonguaranteed debt of the SOEs, and will continue to do so during the program period. We adjusted network fees on natural gas distributed by Srbijagas to generate €60 million on an annual basis, effective from February 1, 2015, enabling Srbijagas to pay a part of its debt obligations, and will correspondingly reduce the payments of its called guarantees from the budget.

- Railways of Serbia are implementing cost saving measures in line with the reduced subsidies and payments for the electricity bills in 2015.

- The Law on Excises was amended in June 2015 to introduce an electricity excise of 7.5 percent on total electricity charge (excluding VAT) effective from August 1, 2015 in order to reduce inefficiency of consumption.

- We have introduced an excise tax on electronic cigarettes.

- To ensure proper protection of the vulnerable segments of the population, the existing social safety net will be maintained. In order to mitigate the impact of electricity tariff increases implemented in 2015, and further increases foreseen in the future, we will expand the coverage of the existing Program for Energy Vulnerable Consumers at an additional cost to the budget of RSD 1 billion. Over time, the budget impact will be increasingly offset by savings through better targeting and control of the existing social assistance programs.

- We have received one-off dividend receipts from SOEs of RSD 22 billion in 2015.

10. We will use a part of fiscal over-performance in 2015, including the one-off fiscal windfall, to cover certain one-off expenses. The government intends to clear historical debts of Srbijagas to NIS—the petroleum company majority-owned by Gazprom—amounting to about EUR 200 million. Other one-off expenses include the settlement of the pension liabilities arising from the Constitutional Court ruling in favor of the military pensioners whose pensions were not indexed in line with the regular ones in 2008 (about RSD 10 billion) and bonus payments to the education sector workers (total about RSD 1 billion, or net RSD 7,000 per employee). Due to their one-off nature, these expenses will not have any implications for future spending. The comprehensive audit and diagnostic of Srbijagas (see para 35) will help avoid similar liabilities emerging in the future.

11. We are progressing with reforms of the general government employment and wage system in 2015.

- To strengthen the control of the public sector wage bill, we created a task force in early June 2015, consisting of representatives from the Ministry of Public Administration and Local Self-Government, MOF, and other relevant institutions to improve the coverage and reliability of the public sector employee registry. We adopted the Law on Registry on July 31 setting out the necessary data submissions and all responsible agencies. We have adopted a legal framework necessary to ensure full coverage of public sector employees. We finalized and validated the general government employment and wage data in the registry in July (**end-June structural benchmark**). The registry also includes employment and wage data for key SOEs, but not separately validated. These will be addressed in individual restructuring plans for major SOEs (¶ 35).

- The Law on Ceilings on the Number of Employees adopted in July laid the legal basis for an annual capping (2015–18) of the number of employees in individual institutions, in line with expected advancements in their productivity to be accomplished through reorganization. The Law on Ceilings of the Number of Employees determines severance payments for both targeted and voluntary separations in line with current labor regulations. We have continued to apply the 5:1 attrition rule throughout 2015, leading to a reduction of about 4,200 in general government permanent employment in the first nine months of the year. As a **prior action**, we adopted Decisions, under the Law on Ceilings on the Number of Employees, setting detailed limits on positions for each institution of the general government (excluding the Ministry of Defense) and local utility companies, representing a reduction of at least 14,500 permanent employees (as defined in the Law and the Decisions) compared to the level at end-December 2014, and closing corresponding positions. We will take measures to ensure that temporary employment is brought down to the limit of 10 percent of permanent employment. The actual separations will be completed within two months after the adoption of the Decisions.

- We have initiated a comprehensive public wage system reform intended to improve transparency, efficiency and manageability of the currently unwieldy system. An umbrella Law on Wages of State Employees establishing the key principles of the new system and setting out a timeline for its gradual implementation will be adopted by the end of the year and will be effective from January 1, 2016. As a result, the base for all wages will be unified and the structure of coefficients and elements of pay will be partly simplified. In order to support the reform, a draft job catalogue reducing the number of jobs and titles from several thousand to less than 1,000 for all state employees other than the armed forces and police was completed in September, and will be adopted together with the umbrella Law on Wages of State Employees (a separate catalogue for police will be developed and adopted in line with the new Law on Police). By end-February, the public sector employee registry will include job description data in line with the new job catalogue, and user interface will be improved in accordance with World Bank recommendations. This will allow for the reliable comparison of employee remunerations across general government sector entities. By April 2016, we will adopt separate wage laws and other necessary legislation for large sectors of the general government, which will operationalize transition to the new job classification, unification of pay grades across comparable jobs and alignment of base wages beginning by June 2016. The timeframe and modalities for the full transition to the new system will be determined in the course of 2016.

12. For 2016-17 our primary focus remains the continued reduction of mandatory expenditures through the following measures, while using structural revenue gains in 2015 and additional expenditure cuts in 2016 for small targeted wage and general pension increases in 2016. As a **prior action**, we will adopt the 2016 budget consistent with program fiscal parameters.

- We will continue reducing the cost and increasing the efficiency of the general government, through its organizational and functional restructuring, in accordance with the Public Administration Reform Strategy, adopted by the government in January 2014. As a first step, we conducted in April 2015 a benchmark review of the public administration system based on relevant comparative countries, which suggests that the health, local government, police, judiciary and compulsory social insurance organizations have the highest potential for efficiency gains and employment reduction. By end-February 2016, we will produce a vision document outlining key strategic choices in large sectors regarding further increases in the productivity of the general government. Most of these sectors will undergo in-depth functional reviews in cooperation with the World Bank, which will be used for producing estimates of additional savings to be attained through restructuring, by end-June 2016.

- We are thus committed to attaining a further reduction of the general government employment by additional 20,000 in 2016, which, together with the targeted separations in early 2016 (¶ 11), is consistent with annual savings in the wage bill in 2016 of 3 percent (excluding the impact of severance payments and wage increases agreed as per para 12). To this end, we will extend the 5:1 attrition rule to 2016 for state-level SOEs, which can also be replaced by detailed rightsizing plans of SOEs under restructuring. From January 2016, for the entities subject to the Law on Ceilings, the renewal of the fixed or temporary contracts will be permitted only if entities are complying with the ceilings stated by the Law and if the share of the temporary employees is below 10 percent of the number of permanent employees or in the exceptional cases defined in the Law. By end-June, we will finalize an action plan for implementation of 2016 general government rightsizing targets based on in-depth functional reviews conducted by World Bank (**end-June structural benchmark**).

- The general government wage bill will be reduced by another 5 percent in 2017. We will also advance the data and legal infrastructure necessary to accomplish additional savings in 2016 and 2017 by introducing e-government.

- Subsidies to public broadcasting companies (RTS and RTV) of RSD 8 billion will be reduced to 4 billion from January 2016, supplemented by a user fee of RSD 150 per month. To ensure that the risk of revenue shortfall does not fall on the budget, we will evaluate the yield of the new fee after 6 months and identify any needed remedial actions.

- We will increase gasoline excise by RSD 1.5 per liter and gas oil excise by RSD 3 per liter from January 1, 2016, on top of the regular indexation (RSD 1 per liter).

- As a **prior action**, the Law on Agriculture will be amended to allow the Ministry of Agriculture to adjust the level of subsidy per hectare according to the total number of actual applications received by a deadline of June 30, 2016. This will ensure the total subsidy payments stay within the budget allocation, which will be about RSD 8 billion lower than the estimated outturn in 2015.

- We will implement the second round of pharmaceutical procurement reform to adopt the best international practice of drug tendering and prescription issuance, and reforms to reduce the cost of patented drugs in consultation with the World Bank. These reforms are expected to yield significant savings from 2017.

- The government will grant modest targeted wage increases from January 2016, aimed at narrowing the wage gaps in the general government. Primary and secondary education will receive a 4 percent and higher education will receive 2 percent. Health and social protection workers will receive a 3 percent increase. The police and army will receive a 2 percent increase, largely offset by reductions in allowances and overtime. Pensions will be increased by 1.25 percent from January 1, 2016. Wages in other sectors will continue to be frozen in nominal terms, except for optional increases up to 4 percent for pre-school teachers, to be determined by local governments and covered within their budgeted wage bills. The overall budget impact of the wage and pension increases will be RSD 10.8 billion (0.3 percent of GDP). The wage and pension bills will continue to decline towards our medium-term target of 7 and 11 percent of GDP respectively.

- Any additional savings achieved in 2016 with respect to our budget projections will be used for debt reduction and/or priority public investment.

- The draft of the new Local Government Financing Law, which will rationalize transfers and the revenue-sharing mechanism to local governments and provide incentives to raise their own revenues, has been posted for public debate (**prior action**), with the intention for its adoption by the National Assembly by end-March 2016 (**structural benchmark**). Full implementation of the new law will start from January 1, 2017. Nevertheless, from January 1, 2016, local governments will reduce their wage bill in line with planned staff reduction. Expected savings from this targeted rightsizing will be used as severance payments.

13. We will aim to reduce fiscal risks and will prepare contingency measures as needed. In this regard, we will not rely on short-term external debt financing (quantitative performance criterion), and we will not accumulate public sector external debt payment arrears (continuous performance criterion). We will also refrain from accumulating domestic payment arrears (indicative target). Our efforts to reduce public spending will continue being monitored through a ceiling on the current primary expenditure, excluding capital spending and interest payments, of the Serbian Republican budget (quantitative performance criterion). If revenues are reduced due to an exogenous shock, we will consider contingency measures, such as raising the VAT rate and gasoline excise tax.

B. Structural Fiscal Policies

14. To underpin the fiscal consolidation, limit risks, and strengthen institutions, we will pursue the following structural policies in the fiscal area:

- To increase fiscal transparency, from the 2015 Budget we classified as spending "above the line" all payments for guarantees serviced by the government, assumption of debt, payments for arrears, and costs related to resolution of financial institutions.

- We will review and clearly define the coverage of general government to be compatible with European System of Accounts (ESA) 2010 by 2018. We have submitted financial plans of social security funds with all their indirect beneficiaries to the National Assembly, in parallel with Republican budget. We will include all indirect budget beneficiaries of the central government in the Financial Management Information System gradually by end-2018. More specifically, we will include courts, public prosecutors and other judicial institutions by end-2015. Prisons, cultural institutions and social protection institution will be included by end-2016. Education will be included by end-2017, and local governments will be included over 2017–18, taking into account their technical and technological capacity and the need to upgrade and rebuild the FMIS system. This will accommodate more realistic planning of indirect budget beneficiaries' revenues and expenditure in the central government budget.

- We are committed to performing a fiscal impact analysis of all new legislative initiatives under the "pay-as-you-go" rule of Article 48 of the Budget System Law. For this, we issued an instruction to line ministries on how to calculate and report the estimated fiscal impact in March 2015.

- The National Assembly approved in the 2015 Budget Law the overall three-year expenditure ceilings of the Republican budget (without indirect budget beneficiaries) that are aligned with the general government expenditures, as specified in the program and the Fiscal Strategy for 2015–17 adopted in January 2015. The three-year ceilings will be updated in the context of the 2016 budget for 2016–18. The deviation of the 2016 budget expenditures from the earlier ceiling will be explained in the explanatory note for the 2016 Budget. We will also continue to improve the planning of the contingency reserve to support the credibility of the ceilings.

- We re-established the Liquidity Committee in March 2015, to strengthen cash management of the government. The Committee includes representatives of the MOF (the Treasury, Tax Administration, Public Debt Administration, Budget Preparation Department and, Macro-Fiscal Analysis and Projections Department) and the NBS.

- We will ensure that a full assessment of all proposed Public-Private Partnerships (PPPs) is reviewed by the Ministry of Finance (MOF), including PPPs' key financing features, cost-benefit analysis, and risk sharing arrangements with the government. We will also include a fiscal risk statement on all PPPs in the Medium-Term Fiscal Strategy from the 2016 budget onwards. In this regard, we set up a special fiscal risks management unit at the MOF in March 2015, supported by the World Bank. Further technical assistance for analytical capacity building will be provided by IMF in early 2016. Furthermore, to improve control of fiscal implications and risks, we will amend the existing Law on Public-Private Partnership and Concessions by February 2016 to mandate that all PPPs are submitted to the government for consideration only with prior approval of the MOF.

15. To secure savings from the corporate and financial restructuring of major SOEs, we are introducing a number of public financial management changes.

- We are creating a strong and stable institutional framework for monitoring SOEs. As a first step, we adopted a government decree that regulates the roles and responsibilities of the MOF, Ministry of Economy (MOE), and line ministries with respect to monitoring, supporting best governance practices, financial reporting, and transparency of SOEs, in April 2015. We started quarterly provision of financial statements of SOEs to both the

MOE and MOF from 2015:Q1. We will continue to strengthen the SOE monitoring unit in the MOE, which will, in collaboration with the relevant line ministries, focus on corporate strategy and governance, and operational efficiency of SOEs. In agreement with the MOE, the SOE financial monitoring function has been created in the fiscal risks management unit in the MOF (see also ¶14), which focuses on reviewing and compiling the financial reports and statements of SOEs and evaluate the fiscal implications.

- To enhance the payment discipline between public sector entities, we broadened the scope of the Law on Payments in Commercial Transactions, to include transactions between public entities (including SOEs) in July 2015 (**end-June structural benchmark**). This law defines monitoring and enforcement mechanisms for improving payment discipline in the public sector, to be implemented from January 2016, including the conditions under which transfers from the budget can be reduced and administrative penalties for responsible individuals applied. Between the adoption and the implementation of the Law, the MOF has been raising awareness and publicly promote the importance of the Law urging all budget users to respect the payment obligations, especially to SOEs, including the utility companies.

- We have been strictly limiting issuance of state guarantees since January 1, 2015. In this regard, we will not issue any new state guarantees for liquidity support, or state guarantees for any company in the portfolio of the Privatization Agency (continuous performance criterion). We reflected this in 2016 Budget Law and modified the Public Debt Law accordingly in July 2015. Furthermore, we set limits on issuance of new state guarantees for viable project loans (**quantitative performance criterion**) in annual budgets, in line with the overarching debt sustainability objective, and will consult Fund staff before authorizing the issuance of guarantees. To avoid any misuse of guaranteed project loans, the fiscal risks management unit at the MOF will monitor their implementation. In the context of the resolution of the state-owned petrochemical product company, Petrohemija, the government expects to assume debts of up to €100m (after restructuring) in 2016 owed to its oil supplier, NIS, which were subject to implicit government guarantees via "comfort letters" from the Government. Provided Petrohemija's resolution ensures that the company will make no further calls on budgetary resources, this debt assumption will be accommodated in the program via adjustors (capped at RSD 12 billion) to the deficit and expenditure ceilings in 2016. The Government has not issued any other comfort letters or other implicit guarantees and will refrain from issuing further such.

- We changed the Law on Development Fund in January 2015 to remove the article which stipulates that all guarantees issued by the Development Fund (DF) are backed by the Republic of Serbia. We established an indicative ceiling on the below-the-line lending by the Republican Government. In addition, we will only provide such loans to public entities with high probability of repayment. We will also proceed with the diagnostic analysis of the DF, followed by proposals to improve governance and operational procedures of the DF by end-March 2016.

16. In order to raise the efficiency of revenue collection, we are committed to improving tax administration based on recommendations of the September 2014 IMF technical assistance mission. We confirmed the Director of Serbia's Tax Administration in June 2015. We adopted in early June, and have started to implement, the *Tax Administration Transformation Program 2015–20* as the official medium-term reform program. Our priorities are to (i) strengthen the Tax Administration's governance, (ii) streamline organizational structures of headquarters and field offices, including by reallocating employees to facilitate compliance efforts, (iii) phase in a modern compliance risk management approach, (iv) strengthen arrears management, including write-off procedures, (v) modernize information technology systems and business processes, and (vii) improve coordination and information exchange with other government agencies. By end-June 2016, the government will prepare and approve draft amendments to the Law on Tax Procedure and the Criminal Code to extend the investigations powers and competences of tax authorities in order to enable the audit of unregistered businesses and strengthen the function of the tax police (**structural benchmark**), with a view to adoption by the National Assembly soon thereafter. We are acutely aware of the need to recruit and train new staff (for example, in the Large Taxpayer Office) and will finalize a staff recruitment and retention plan *by the end of the first quarter 2016, as the deadline determined in the Tax Administration Transformation Program 2015–2020. The Plan will be approved by the* Permanent Management Committee for Organizational Transformation, with overall staffing remaining consistent with the public sector right-sizing objectives.

C. Monetary and Exchange Rate Policies

17. We see the current inflation targeting framework as the most viable option for maintaining stable inflation and protecting the economy against external shocks. We remain committed to the objective of keeping inflation within the inflation tolerance band (4±1½ percent). Inflation developments will continue to be monitored via a consultation clause with consultation bands set around the central projection (Table 1). As fiscal adjustment took hold and external financing conditions remained stable, we have reduced the key policy rate by 350 basis points in order to support returning of headline inflation into the tolerance band. This has also been supported by a gradual reduction of the reserve requirements on foreign exchange liabilities from 26 (19) percent to 20 (13) percent on liabilities with maturities below 2 (over 2) years.

18. We will maintain the existing managed float exchange rate regime in line with the inflation targeting framework. We believe that exchange rate flexibility provides a needed buffer against external shocks. In light of this, foreign exchange interventions will be limited to smoothing excessive exchange rate volatility without targeting a specific level or path for the exchange rate, while considering the implications for financial sector stability and meeting the inflation target. The current level of gross international reserves is well above the level that could be considered as necessary for precautionary purposes. We will maintain adequate coverage throughout the program, which will be monitored by a floor on net international reserves (quantitative performance criterion).

19. In order to reduce risks to macroeconomic stability, we will continue capital account liberalization in a gradual way. Many of the capital account transactions, such as FDI and long-term flows, have already been liberalized, with the remaining restrictions related broadly to short-term capital and deposit flows. In order to limit balance of payments pressures under the program, the capital account liberalization required in the context of EU accession will be gradual, particularly in removing restrictions on short-term foreign inflows to domestic securities and the ability of residents to open deposit accounts abroad.

20. During the period of the SBA we will not, without IMF approval, impose or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payment agreements that are inconsistent with Article VIII of the IMF's Articles of Agreement. Moreover, we will not impose or intensify import restrictions for balance of payments reasons.

D. Financial Sector Policies

21. Our policies will support financial sector stability and enhance the banking sector's ability to cope with shocks, while improving financial intermediation. Priority will be given to: (i) addressing the overhang of nonperforming loans (NPLs); (ii) assessing asset quality and provisioning practices via special diagnostic studies (SDS); (iii) strengthening the supervisory and regulatory framework in line with EU standards; (iv) operationalizing the new bank resolution framework; and (v) implementing the strategy for state-owned banks.

22. We finalized our comprehensive strategy for addressing the NPL overhang. The strategy, published on August 13, 2015, was prepared by an inter-institutional Working Group that included representatives from the Ministries of Finance, Economy and Justice, the NBS and Deposit Insurance Agency (DIA), with staff of the IMF, IFC, IBRD and EBRD participating as observers. Implementation of the strategy is largely on track. However, due to extensive coordination between agencies and the broad consultations with various stakeholders, the implementation of the December-2015 benchmarks on strengthening the insolvency framework and introducing a new framework for real estate valuation are delayed. To allow time to better refine the relevant proposals, we are proposing to reset these benchmarks to end-March 2016. Banks have commenced the submission of standardized reports on collateral valuation data for the NBS' new collateral database. In parallel, the preparation of various items from the NBS' action plan continue to advance, including the introduction of more granular reporting requirements for banks and enhanced supervisory standards for restructured receivables and distressed asset management (**end-March structural benchmark**). By end-December, we will submit to the National Assembly of tax law amendments to remove disincentives for timely NPL resolution (**structural benchmark**). While we remain committed to removing potential impediments to, and providing incentives for, timely NPL resolution, we will continue to focus on market-based solutions.

23. We have finalized the detailed assessment of asset quality and provisioning practices of banks operating in Serbia (end-September structural benchmark). Despite adjustments to regulatory capital, overall capitalization of the banking system remains high. Bank management and their external auditors are expected to closely review the findings of the SDS, with the aim to incorporate necessary impairment reinforcements in the banks' statutory accounts as of end-December 2015. To maintain a conservative application of International Financial Reporting Standards (IFRS) following the SDS, the NBS will prepare, by end-December 2015, supervisory guidance for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (**structural benchmark**). In parallel, the NBS will embed methodological aspects of the SDS in its supervisory procedures and strengthen its analytical capacity in the area of IFRS.

24. We will enhance the microprudential supervisory and regulatory framework. Effects to strengthen financial sector supervision continue apace. Preparations for the gradual implementation of the Basel III framework are progressing, aided by a gap analysis that compared the current regulatory framework to the new Basel standards, as well as quantitative impact studies on capital, risk weighted assets, leverage and liquidity. A multi-year action plan for strengthening its prudential oversight over the insurance sector, benefiting from IMF technical assistance, is being implemented and the NBS is preparing proposals for improving the banking supervision process, allowing for implementation of an intensified supervisory cycle as of 2016. As part of the latter, the NBS will introduce a more risk-sensitive supervisory cycle that will help increase the intensity of supervision for systemically important banks and institutions with the highest risk rating. To ensure sufficient resources are available to carry out its duties, the NBS will continue to hire additional staff. Finally, the preparation of contingency measures for banks whose viability is at risk will help to buttress financial stability.

25. The NBS continues to develop its macroprudential policy framework. Systemically important banks have been identified using the internally developed methodological framework, based on the final EBA Guidelines. A proposal for the determination of capital surcharges for such institutions is being finalized. The necessary regulatory amendments for the introduction of other macroprudential instruments, including countercyclical capital buffers and systemic risk buffers, are being developed and will be adopted in accordance with the transposition of the Basel III framework.

26. The NBS continues to implement the amended bank resolution framework and financial sector safety net. The new Bank Resolution Department is operational and information- and data-sharing arrangements with other NBS functions, as well as the DIA, are in place. Banks have submitted their initial recovery plans, and banks have submitted data for resolution planning purposes, as per the new decision on resolution planning that was adopted by the NBS' Executive Board in September 2015. Preliminary resolution plans for systemically important banks are expected to be available by end-December 2015, and will be refined during

2016, as needed. In addition, the NBS has updated its policy framework for Emergency Liquidity Assistance.

27. Implementation of the strategy for state-owned banks is progressing. We are strengthening our oversight over financial institutions that are, in whole or in part, state-owned. We will reorient the business strategy of Banka Postanska Stedionica towards retail activities, for which a new three-year business plan will be adopted by the Government (in its capacity of controlling shareholder) by end-December 2015 (**structural benchmark**). In parallel, we will, in collaboration and consultations with the bank's management bodies, identify measures to strengthen the bank's risk control framework, in line with international best practices. The privatization advisor for Komercijalna Banka, the second-largest bank, has been appointed and the privatization process for Dunav Osiguranje, Serbia's largest insurance company, is expected to commence with the initiation of the selection process for the privatization advisor. Decisions on the course of action for the remaining small state-owned banks will be taken by December 2015, as part of the update of the strategy for state-owned banks.

28. We will continue to implement our dinarization strategy. This strategy is based on three pillars: (i) maintaining overall macroeconomic stability; (ii) creating favorable conditions for developing the dinar bond market; and (iii) promoting hedging instruments. In this regard, since November 2013 we have liberalized borrowing in dinars by the IFIs, and further increased maturity of dinar-denominated securities in the local market by successfully placing a 10-year dinar denominated T-bond.

29. We will support credit to SMEs. Given the importance of SMEs for Serbia's economy and the limited access to credit by this sector, we will support lending to SMEs through EIB's credit lines ("Apex loans"). To improve Apex program efficiency, the Ministry of Economy has prepared guidance – developed in accordance with EIB criteria – regarding prioritization of loan allocations. Beginning from the October 2015 tranche, financing proposals in line with this guidance will be submitted for EIB's approval without pre-approval by Steering Committee. Instead, the Committee will perform ex-post review of loan utilization.

E. Structural Policies

30. We have initiated a number of comprehensive structural reforms to attract investment, support growth, and rebalance the economy on its path towards EU integration. We will focus on specific policies that (i) sustain job creation, (ii) reform state-owned enterprises, and (iii) improve the overall business environment.

31. Job creation is a central element of our economic policies. In 2014, we made legislative changes to support labor market flexibility and job creation, including amendments to the Labor Law in July. We have adopted the National Employment Action Plan for 2016. We will amend the Law on Financial Support of Families with Children to improve the targeting and integrity of the social assistance programs by ensuring child support beneficiaries are attending school and by strengthening controls on maternity benefits. We will also improve the efficiency of social assistance programs..

32. We have initiated wide-ranging reforms of socially-owned and state-owned enterprises to improve their operational viability and limit fiscal risks. A clear priority is to significantly reduce state aid to SOEs through (i) curtailed direct or indirect subsidies, (ii) strictly limited issuance of new guarantees, and (iii) enhanced accountability, transparency and monitoring of these enterprises. To this end, we started implementing strategies for two broad categories of state-owned companies. First, we are addressing companies in the portfolio of the Privatization Agency, a large number of which were protected under a bankruptcy moratorium until end-May 2015. For a small group of 17 companies the moratorium was extended up to May 2016. We are committed to initiate resolution at least seven of these through either launch of privatization tender or initiating insolvency or debt collection procedures by end-2015 (**structural benchmark**), with the rest to be resolved by end-May 2016 (**structural benchmark**). The second group includes other large SOEs including the electricity, gas, railways, and road companies. The reforms of the socially-owned and state-owned enterprises are supported by the World Bank and EBRD.

33. We started the resolution of over 500 enterprises in the portfolio of the Privatization Agency through either privatization or bankruptcy, in accordance with the recently revised Privatization Law. Since August 2014, we have collected letters of interest for these companies, and we adopted an action plan for bankruptcy procedures for 188 companies in early February 2015. As of end-October, insolvency proceedings have been launched for 160 companies with little privatization prospects, and public tenders for privatization of 160 companies have been announced. Adequate resources for social benefits for the redundant workers are provided in the 2015 and 2016 budget and are being disbursed to the eligible recipients. These benefits are consistent with severance payments in the Labor Law.

34. We aim to privatize or find strategic partners for a number of SOEs and concession projects. We will use the proceeds primarily for reducing the stock of public debt but possibly also for funding future financially viable and high return investment projects. The size of investment funding will be determined in consultation with IMF staff. To support the operation of the telecommunications sector on a strictly market basis, we are in the process of privatizing Telekom Serbia. We also selected a privatization advisor for Komercijalna Bank, the second largest bank in Serbia, with a view to completing the privatization in 2017. We entered a management contract for Železara Smederevo, a steel producer, with HPK engineering, a Netherlands-based company in March 2015. This has ensured the operation of the steel company without state aid this year—including budget subsidies, government guarantees, lending from the budget or any other forms of public support—and without further accumulation of arrears. Currently we are in privatization negotiations of the company complying with the EU requirements. At the same time, we have hired advisors to explore long-term concession partnerships for managing the Belgrade airport and continue to explore options for operating Corridor XI.

35. We are committed to continue restructuring large public utilities and transport companies to contain the additional fiscal costs that would arise without a change in policies. We will also ensure adequate service provision. In particular, we have focused on the electricity, gas, railways, and road companies which are among the largest public enterprises. To implement the needed corporate and financial restructuring in each of these companies over the medium term, we have taken the following steps:

- **Elektroprivreda Srbije (EPS).** In July 2015, a new organizational structure consisting of subsidiaries for electricity generation, distribution and supply, as specified in the corporate restructuring plan adopted in November 2014, became effective. This aims to streamline the organizational structure and management as a first step to enable a financially self-sustaining EPS in the future, thus avoiding the need for state aid. In consultation with the World Bank and EBRD, we adopted the financial restructuring plan for EPS in early June 2015. The plan includes: (i) increases in revenues through enhanced bill collections, reduced technical and commercial losses, and a regulated tariff increase of 4.5 percent from August 1, 2015, and (ii) a reduction of operational cost including through increased efficiency, optimization of the supply mix, and staff rightsizing. Achieving EPS financial sustainability will require the implementation of this full package of measures. We established an inter-ministerial working group to identify bottlenecks arising during implementation and take corrective action requiring concerted Government efforts. As a first tangible step in the implementation of the plan, the tariff increase and a new excise tax on electricity became effective from August 1, resulting in a total price increase of 12 percent for the consumers in the regulated market. An additional tariff increase will follow in May 2016, and in 2017 as needed to allow electricity prices to further converge to the market levels to facilitate the transition to a competitive market, in accordance with the Energy Law. By end-2015, the Government will finalize the amendment to the collective agreement in order to allow for the implementation of the rightsizing identified in the restructuring plans, in consultation with the World Bank (**structural benchmark**). Consistent with the five year rightsizing target specified in the financial restructuring plan, we will make a net reduction of 1,000 staff positions in 2016, making maximum use of natural attrition. We have implemented the new management structure specified in the corporate restructuring plan by eliminating one layer of management in all three lines of business (generation, mining and distribution). Following the ongoing corporate restructuring process and financial consolidation, we will change the legal status of EPS to a joint stock company by July 1, 2016, with an aim to attract minority private investment participation that could further enhance the corporate governance and viability of the company and ensure its professional management.

- **Srbijagas.** A new organizational structure consisting of subsidiaries for transmission and distribution, following the corporate restructuring plan adopted by government in December 2014, became effective in August 2015. In line with the fiscal program, we have divested part of Srbijagas' non-core assets and continue pursuing a permanent resolution for the companies which were a major source of arrears in the past: Azotara, MSK, and Petrohemija. These companies have been operating without state aid or further accumulation of arrears this year, and the government is fully committed to no state aid to those companies going forward. More generally, payment discipline of Srbijagas' clients has improved. We initiated the preparation of a comprehensive restructuring plan, in consultation with the World Bank, with the objective of defining measures and reforms that would be necessary to achieve longer term financial viability and competitiveness of Srbijagas. The restructuring plan will be completed by the end of the first quarter of 2016. In parallel, Srbijagas and the Ministry of Energy have finalized the terms of reference for hiring an independent audit firm (**prior action**), to establish a credible baseline for the financial position of Srbijagas, based on which specific measures outlined in the restructuring plan can be implemented in 2016. We are also initiating a diagnostic of the gas distribution sector, to address the fragmentation in the sector and identify options for how to achieve greater efficiency and economies of scale. These measures will ensure that Srbijagas' financial position does not deteriorate further, and put the company on a sustainable path, thus containing the need for additional state aid in line with the fiscal program.

- **Railways of Serbia**. We established a Railway Reform Steering Committee, led by the Deputy Prime Minister and including senior representatives from relevant Ministries and entities, IFIs, and EU, to provide overall direction of the reforms. The unbundling of the company into separate passenger, freight, infrastructure, and a fourth company became effective from August 2015. In consultation with the World Bank, Railways has identified and is implementing measures to generate savings to compensate for the reduction of subsidies (€15 million) and servicing of electricity bills. The corporate restructuring plan is centered on asset disposal, network re-optimization, and staff rationalization. Importantly, the freight section will receive no further subsidies and will operate on a purely commercial basis from January 2018. The freight section will make its best efforts to avoid state subsidies even before the mentioned date. To support market competition, we will introduce an infrastructure usage fee in January 2016. We will also continue the reorganization and improvement of business plans for the state-owned passenger and infrastructure companies and the fourth company, to strictly limit the amount of state aid disbursed over the medium term. With the help of independent consultants, and in close cooperation with the World Bank, EBRD and EU, we developed and adopted in October 2015 a comprehensive framework financial restructuring plan (**end-September structural benchmark**). The indicative restructuring targets in the framework plans, including redundancy programs for 2016 (reducing around 2,800 employees) and 2017–2020 were identified together with the World Bank and IMF staff. The Government Steering Committee will adopt a decision on net employment reduction in 2016 of at least 2,700 employees in Railways of Serbia by end-March 2016 (**structural benchmark**). Severance payments (estimated at around RSD 2.5 billion) will be financed by potential savings on wages and other expenditures and, if needed, by the World Bank and EBRD support. Activities related to the provision of funds for settling the surplus employees will be coordinated with the Ministry of Finance. We have finished the inventory of assets and liabilities of the Railways. We will identify their allocation among the companies under the new corporate structure, in order for these to start with new balance sheets from January 1, 2016, An independent audit of asset inventory and separation will be carried out by June 2016. Railway companies have also fully assigned responsibilities for electricity payments , and will ensure no reemergence of arrears to EPS. Finally, we will proceed with the recruitment and appointment of top management for the three operating companies on the basis of the Terms of Reference prepared by the consultants for the corporate and financial restructuring plans.

- **Roads of Serbia.** We will revisit the adequacy of toll rates and on the expenditure side by adopting a plan for removing rigidities in pricing maintenance contracts in the second half of 2016 and implementing it for 1,000 km. The savings may result in lower budget support in the future. We will also explore concession options for the construction and maintenance of Corridor XI. The corporate and financial restructuring plans for Roads of Serbia will be developed during 2016 in close consultation with the World Bank.

36. We will develop a comprehensive program to enhance Serbia's competiveness and business environment to support investment, job creation and private sector development. The program will be developed in close consultation with the World Bank and EBRD (including through the Investment Climate and Governance Initiative) and will ensure that growth-supporting policies are well coordinated and targeted. Specific actions will focus on the following areas:

- The Law on Planning and Construction, with the goal of significantly speeding up the issuance of construction permits, was adopted in December 2014, and a unified procedure is applicable since March 1, 2015. We also adopted the Law on Conversion for a Fee of the Right of Use of Construction Land into Ownership in July 2015 and amendments to the Law on State Survey and Cadastre in November 2015 or by the end of 2015 at the latest. Since these legislative changes, the issuance of the construction permits has been expedited significantly, leading to an increase by 56.4 percent of construction permits from March 1st to August 31st, 2015 as compared to the same period last year. We will also implement the electronic permit issuance starting from 2016.

- To enhance predictability and reduce corruption and the grey economy, we adopted a new Law on Inspection Oversight in April 2015, and improved labor inspection has already started contributing to the reduction of informal jobs and increases in social contribution collections.

- We adopted a new Investment Law in October2015, which will replace and broaden the scope of the Foreign Investment Law to include domestic investment. We have initiated reform and consolidation of our investment and export promotion agencies and programs. With the adoption of the new Investment Law, we will establish by end-2015 new Serbian Development Agency, by merging the Serbia Investment and Export Promotion Agency (SIEPA) and National Agency for Regional Development (NARD), integrating and streamlining their operations. The new Law will also put in place a clearer legislative framework for administering investment incentives. We also plan to reform the Development Fund, and the Serbian Export Credit and Insurance Agency (AOFI) in 2016. These agencies will be either reorganized or replaced with new institutions performing similar functions in a more efficient manner. We amended the Law on Consensual Financial Restructuring and Law on the Agency for Bankruptcy Administrators Licensing in October 2015 to centralize all bankruptcy procedures and administration. A new bankruptcy agency was established based on amendments of the Law on the Agency for Bankruptcy Administrators Licensing in October 2015. The Agency will change the name from the Agency for Bankruptcy Administrators Licensing into Bankruptcy Agency of Serbia, following the adoption of amendments to the Bankruptcy Law by, at the latest, March 2016.

- We will send the draft of the new Law on Fees and Charges for public debate by end-2015, which will replace existing laws and by-laws to regulate fees at all levels of government, to ensure greater predictability and transparency. The Law will be effective from January 1, 2017.

- We will adopt a new Company Law in 2016 and the government will propose a new Law on Public Enterprises by end December 2015 to improve the efficiency of the public enterprises and create a strong framework for monitoring them.

- We have established a working group to implement the action plan to improve the business environment for SMEs based on the SME strategy for 2015–20 prepared by the MOE, which was adopted by the Government in March 2015.

- As part of our job creation initiatives, we are expanding the coverage of active labor market policies and will initiate the reform of the National Employment Service by end-2015, supported by the Competitiveness and Jobs project, to improve the efficiency of its programs and enhance the quality of services provided both to unemployed and employers.

Program Monitoring

37. Progress in the implementation of the policies under this program will be monitored through quarterly quantitative performance criteria (PCs) and indicative targets (ITs)—including an inflation consultation clause, continuous performance criteria (CPCs) and structural benchmarks (SBs). These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding.

Table 1. Serbia: Quantitative Program Targets 1/

	2015										2016			
	Mar			Jun			Sep			Dec	Mar	Jun	Sep	Dec
	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Prog.	Prog.	Proj.	Proj.
I. Quantitative performance criteria (quarterly)														
1 Floor on net international reserves of the NBS (in millions of euros)	6,290	...	7,155	6,063	...	7,122	5,718	...	7,538	6,266	6,912	6,599	6,557	6,627
2 Ceiling on the general government fiscal deficit 3/ 4/ (in billions of dinars)	55.7	53.2	21.1	96.3	90.8	35.3	153.1	143.6	51.1	165.0	53.9	78.3	115.2	163.8
3 Ceiling on current primary expenditure of the Serbian Republican Budget excluding capital expenditure and interest payments (in billions of dinars) 3/	207.4	203.5	195.4	429.2	421.2	405.2	657.2	648.6	614.5	906.3	206.1	426.6	644.9	897.4
4 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget for project and corporate restructuring loans (in millions of euros) 3/	0	...	0	121	...	0	401	...	0	481	35	35	100	180
5 Ceiling on contracting or guaranteeing of new short-term external debt by the General Government, Development Fund, and AOFI (up to and including one year, in millions of euros)	0	...	0	0	...	0	0	...	0	0	0	0	0	0
II. Continuous performance criteria														
6 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget and the Development Fund for liquidity support (in billions of dinars)	0	...	0	0	...	0	0	...	0	0	0	0	0	0
7 Ceiling on accumulation of external debt payment arrears by General Government, Development Fund, and AOFI (in billions of euros)	0	...	0	0	...	0	0	...	0	0	0	0	0	0
8 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget and the Development Fund to any company in the portfolio of the Privatization Agency (in billions of dinars).	...	...	...	...	...	...	...	...	...	0	0	0	0	0
III. Indicative targets (quarterly)														
9 Ceiling on accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars)	0.0	...	-0.66	0.0	...	-0.56	0.0	...	0.39	0.0	0.0	0.0	0.0	0.0
10 Ceiling on borrowing by the Development Fund and AOFI (in billions of dinars)	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
11 Ceiling on new below-the-line lending by the Republican Government (in millions of euros) 3/	176	...	15.0	250	...	148	314	...	177	384	128	160	262	364
IV. Inflation consultation band (quarterly)														
Outer band (upper limit, 2.5 percent above center point)	4.2	...	...	5.5	...	...	5.1	...	...	6.5	4.2	5.0	5.5	6.0
Inner band (upper limit, 1.5 percent above center point)	3.2	...	...	4.5	...	...	4.1	...	...	5.5	3.2	4.0	4.5	5.0
End of period inflation, center point 5/	*1.7*	...	*1.9*	*3.0*	...	*1.9*	*2.6*	...	*1.4*	*4.0*	*1.7*	*2.5*	*3.0*	*3.5*
Inner band (lower limit, 1.5 percent below center point)	0.2	...	...	1.5	...	...	1.1	...	...	2.5	0.2	1.0	1.5	2.0
Outer band (lower limit, 2.5 percent below center point)	-0.8	...	...	0.5	...	...	0.1	...	...	1.5	-0.8	0.0	0.5	1.0

1/ As defined in the Letter of Intent, the Memorandum of Economic and Financial Policies, and the Technical Memorandum of Understanding.
2/ Original program targets as specified in IMF Country Report 15/20.
3/ Cumulative since 01-01-2015.
4/ Refers to the fiscal balance on a cash basis, including the amortization of called guarantees.
5/ Defined as the change over 12 months of the end-of-period consumer price index, as measured and published by the Serbian Statistics Office.

Table 2. Serbia: Prior Actions and Structural Benchmarks

Measures	Target date	Status
Prior Actions		
1 Approval by the National Assembly of the 2016 budget consistent with the program fiscal parameters (MEFP ¶12).		In progress
2 Posting of draft Local Government Financing Law for public debate (MEFP ¶12).		Met
3 Finalize the terms of reference for hiring an independent audit firm to establish a credible baseline for the financial position of Srbijagas (MEFP ¶35).		Met
4 Adoption by the Government of Decisions, under the Law on Ceilings on the Number of Employees, setting detailed limits on positions for each institution of the general government (excluding the Ministry of Defense) and local utility companies, representing a reduction of at least 14,500 permanent employees (as defined in the Law and the Decisions), compared to the level at end-December 2014, and closing corresponding positions (MEFP ¶11).		Met
5 Amend the Law on Agriculture to allow the Ministry of Agriculture to adjust the level of subsidy per hectare according to the total number of actual applications received by a deadline of June 30, 2016 (MEFP ¶12).		In progress
Structural Benchmarks		
Fiscal		
6 Adoption by the Government Steering Committee of a corporate and financial restructuring plan for Railways of Serbia, to be prepared by an independent consultant (MEFP ¶35).	September 30, 2015	Not met, implemented with a delay in October 2015.
7 Posting of draft Local Government Financing Law for public debate (MEFP ¶12).	October 31, 2015	Not met, concept note published; posting of full draft for public debate set as a prior action.
8 Adoption by the government of by-laws aimed at strengthening the project appraisal process (MEFP ¶8).	December 31, 2015	
9 Resolution through either privatization or initiation of bankruptcy procedures of at least 7 of the 17 strategically important companies that received protection from debt enforcement until May 2016 (MEFP ¶32).	December 31, 2015	
10 Amendment to the EPS collective agreement to allow for the implementation of the rightsizing identified in the restructuring plans (MEFP ¶35).	December 31, 2015	
11 Adoption by the Government of a financial restructuring plan for Srbijagas, to be prepared by an independent consultant (MEFP ¶35).	January 31, 2016	Proposed to be replaced by a prior action on TOR for comprehensive audit and diagnostic of Srbijagas.
12 Government adoption of amendments to the Law on Tax Procedure and the Criminal Code to extend the powers and competences of tax investigation, in order to enable the audit of unregistered businesses and improve the function of the tax police (MEFP ¶16).	March 31, 2016	new benchmark
13 Adoption by the Government Steering Committee of a decision on net employment reduction in 2016 of at least 2700 employees in Railways of Srbija (MEFP ¶35).	March 31, 2016	new benchmark
14 Resolution through either privatization of or initiation of bankruptcy procedures for the remainder of 17 strategically important companies that received protection from debt enforcement until May 2016 (MEFP ¶32).	May 31, 2016	new benchmark
15 Finalize an action plan for implementation of 2016 general government rightsizing targets based on in-depth functional reviews conducted by World Bank (MEFP ¶12).	June 30, 2016	new benchmark
Financial		
16 Completion of special diagnostic studies of banks (MEFP ¶23).	September 30, 2015	Not met, implemented with a delay in November 2015.
17 Preparation of supervisory guidance setting forth expectations for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (MEFP ¶23).	December 31, 2015	
18 Introduction of a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on real estate valuations filed according to pre-established criteria; and (iii) legislation providing proper supervision of the licensed appraisers. (MEFP ¶22).	December 31, 2015	Proposed to be reset to March 2016.
19 Conduct of a review of the corporate insolvency law and submission of proposed amendments to the National Assembly, in line with recommendations from IMF technical assistance, aimed to ensure: (i) adequate safeguards for the secured creditors rights; and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (MEFP ¶22).	December 31, 2015	Proposed to be reset to March 2016.
20 Submission to the National Assembly of tax law amendments to remove disincentives for timely NPL resolution (MEFP ¶22).	December 31, 2015	
21 Adoption by the Government (in its capacity of controlling shareholder) of retail-oriented three-year business plan for Banka Postanska Stedionica (MEFP ¶27).	December 31, 2015	
22 Develop enhanced supervisory standards for restructured receivables and distressed asset management by banks (MEFP ¶22).	March 31, 2016	

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) 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 December 31, 2014, except as noted below.

A. Floor for Net International Reserves of the NBS

	In Millions of Euro
Outstanding stock:	
End-December 2014	7,008
Floor on international reserves:	
End-December 2015 (performance criterion)	6,266
End-March 2016 (performance criterion)	6,912
End-June 2016 (performance criterion)	6,599

2. **Net international reserves** (NIR) of the NBS are defined as the difference between reserve assets and reserve liabilities, measured at the end of the quarter.

3. For purposes of the program, **reserve assets** are readily available claims on nonresidents denominated in foreign convertible currencies. They include the NBS holdings of monetary gold, SDRs, foreign currency cash, foreign currency securities, deposits abroad, and the country's reserve position at the Fund. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered (e.g., pledged as collateral for foreign loans or through forward contracts, guarantees and letters of credit), NBS' claims on resident banks and nonbanks, as well as subsidiaries or branches of Serbian commercial banks located abroad, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than monetary gold, domestically acquired gold without international certificates, assets in nonconvertible currencies, and illiquid assets.

4. For purposes of the program, **reserve liabilities** are defined as all foreign exchange liabilities to residents and nonresidents with a maturity of less than one year, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options, including any portion of the NBS gold that is collateralized), and all credit outstanding from the Fund. Excluded from reserve liabilities are government foreign exchange deposits with NBS, and amounts received under any SDR allocations received after August 20, 2009.

5. For purposes of the program, all foreign currency-related assets will be valued in euros at **program exchange rates** as specified below. The program exchange rates are those that prevailed on September 30, 2014. Monetary gold will be valued at the average London fixing market price that prevailed on September 30, 2014.

Cross Exchange Rates and Gold Price for Program Purposes, September 30, 2014

	Valued in:				
	RSD	Euro	USD	SDR	GBP
Currency:					
RSD	1.0000	0.0084	0.0107	0.0072	0.0066
Euro	118.8509	1.0000	1.2695	0.8563	0.7808
USD	93.6202	0.7877	1.0000	0.6745	0.6150
SDR	138.7994	1.1678	1.4826	1.0000	0.9119
GBP	152.2168	1.2807	1.6259	1.0967	1.0000
Gold	113,888.97	958.25	1,216.50	820.53	748.20

Source: NBS

6. Adjustors. For program purposes, the NIR target will be adjusted upward by the value of long-term assets and foreign-exchange-denominated claims on resident banks and nonbanks as well as Serbian commercial banks abroad, recovered by the NBS since December 31, 2014. The NIR floor will be adjusted upward by the full amount of proceeds from any eurobond issuance and external bilateral budget loans to the General Government since September 30, 2015. External bilateral budget loans, in this context, are loans to the Republican budget provided without any pre-specified purpose other than satisfying funding needs of the public sector. The NIR floor will also be adjusted upward by the value of domestically acquired gold for which certification was obtained after December 31, 2014. The NIR floor will also be adjusted upward by any privatization revenue in foreign exchange received after December 31, 2014. Privatization receipts are defined in this context as the proceeds from sale, lease, or concession 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

7. 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.

8. Breaching the inflation consultation inner band limits (specified in MEFP, Table 1) at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response. Breaching the outer limits 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. Fiscal Conditionality

9. The general government fiscal deficit (previously referred to as the general government augmented fiscal deficit, see IMF Country Report 15/20, p. 70), on a cash basis, is defined as the difference between total general government expenditure (irrespective of the source of financing) including expenditure financed from foreign project loans, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeover if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law) and total general government revenue (including grants). For program purposes, the consolidated general government comprises the Serbian Republican government (without indirect budget beneficiaries), local governments, the Pension Fund, the Health Fund, the Military Health Fund, the National Agency for Employment, the Roads of Serbia Company (JP Putevi Srbije) and any of its subsidiaries, and the company Corridors of Serbia. Any new extra budgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Privatization receipts are classified as a financial transaction and are recorded "below the line" in the General Government fiscal accounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concession of all or portions of entities and properties held by the public sector.

10. Government primary current expenditure of the Republican budget (without indirect budget beneficiaries) includes wages, subsidies, goods and services, transfers to local governments and social security funds, social benefits from the budget, other current expenditure, net lending, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeovers if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law). It does not include capital spending and interest payments.

Adjustors

- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward (upward) to the extent that cumulative non-tax revenues of the General Government from dividends exceed (fall short of) programmed levels.

- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward to the extent that cumulative non-tax revenues of the General Government from debt recovery receipts, debt issuance premiums and receipts from telecom 4G frequency auctions exceed programmed levels.

- The quarterly ceilings on **the general government fiscal deficit and the primary current expenditure of the Republican budget** will be adjusted upward (downward) to the extent that cumulative severance payments by the general government for the former and the Republican budget level for the latter (including payments from the Transition Fund) exceed (fall short of) the programmed levels up to the yearly budgeted amount.

- The quarterly ceilings on **the general government fiscal deficit and the primary current expenditure of the Republican Budget** will be adjusted upward by a maximum of RSD 20 billion for 2015, to the extent that the Republican Budget assumes (i) debt of Serbia Gas to NIS and (ii) pensions owed to the military personnel according to Constitutional Court Decision, and by a maximum of RSD 12.3 billion for 2016 to the extent that the Republican Budget assumes the debt of Petrohemija to NIS in the context of the former's resolution in a manner that ensures no further fiscal support.

Cumulative Programmed Severance Payments
(In billions of dinars)

	End-Dec. 2015	End-Mar. 2016	End-Jun. 2016
Programmed cumulative severance payments by the general government fiscal deficit)	29	9.4	11.4
Programmed cumulative severance payments (of the Republican budget)	25.6	7.3	9.3

Cumulative Programmed Revenues of the General Government from Dividends, Debt Recovery Receipts, and Debt Issuance at a Premium
(In billions of dinars)

	End-Mar. 2016	End-Jun. 2016
Programmed cumulative dividends	9.6	9.6
Programmed cumulative debt recovery receipts	0	0
Programmed cumulative debt issuance at a premium	0	0
Programmed cumulative receipts from telecom 4G frequency auctions	0	0

- The quarterly ceilings on the **primary current expenditure of the Republican budget** will be adjusted upward (downward) to the extent that (i) cumulative earmarked grant receipts exceed (fall short of) the programmed levels and (ii) cumulative proceeds from small-scale disposal of assets (the sale of buildings, land, and equipment) recorded as non-tax revenues exceed the programmed levels up to a cumulative annual amount of 2 billion dinars in each of 2015 and 2016. For the purposes of the adjustor, grants are defined as noncompulsory current or capital transfers received by the Government of Serbia, without any expectation of repayment, from either another government or an international organization including the EU.

Cumulative Receipts from Earmarked Grants and Small-scale Asset Disposal
(In billions of dinars)

	End-Dec. 2015	End-Mar. 2016	End-Jun. 2016
Programmed cumulative ear-marked grants receipts	10	1.8	4.0
Programmed cumulative receipts from small-scale disposal of assets	0	0	0

11. Ceiling on the gross issuance of debt guarantees by the Republican Budget for project and for liquidity support. Guarantees for liquidity support are defined in this context as explicit or implicit guarantees, including comfort letters, related to loans provided without any pre-specified purpose other than satisfying funding needs of the company that ensure its normal production and business activities. Guarantees for viable project loans are defined in this context as explicit or implicit guarantees, including comfort letters, related to loans with high probability of repayment provided with a pre-specified objective establishing that all funding should be used for well-defined investment or corporate restructuring projects, confirmed by a reliable feasibility study and/or the investment or restructuring plan endorsed by the government.

Adjustor

- The quarterly 2016 ceilings on **gross issuance of new guarantees by the Republican Budget for project and corporate restructuring loans** will be adjusted upward to the extent that the new EUR 200 million guarantee by the Republican Budget on a loan from the EBRD to the EPS originally planned for 2015 takes place in 2016.

12. Ceiling on below-the-line lending by the Republican Government. Below-the-line lending is defined as the lending by the Republican Government which is used to provide financing to entities outside the General Government coverage. Below-the-line lending by the Republican Government will only be provided in cases where the probability of repayment is assessed to be high. These entities include the Deposit Insurance Agency (DIA), beneficiaries of the APEX lending program, and EPS, among others.

13. Ceiling on borrowing by the Development Fund and the Export Credit and Insurance Agency (AOFI). Borrowing by the Development Fund and AOFI is defined as gross accumulation of financial claims on these entities.

14. Domestic arrears. For program purposes, domestic arrears are defined as the belated settlement of a debtor's liability which is due under the obligation (contract) for more than 60 days, or the creditor's refusal to receive a settlement duly offered by the debtor. The program will include an indicative target on the change in total domestic arrears of (i) all consolidated general government entities as defined in ¶9 above, except local governments; (ii) the Development Fund, and (iii) AOFI. Arrears to be covered include outstanding payments on wages and pensions; social security contributions; obligations to banks and other private companies and suppliers; as well as arrears to other government bodies.

D. Ceilings on External Debt

15. Definitions. The ceilings on contracting or guaranteeing of short-term external debt (with maturities up to one year) consolidated general government, the AOFI, and the Development Fund applies not only to debt as defined in point 8 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended, 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. 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.

E. Ceiling on External Debt Service Arrears

16. Definition. External debt-service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the consolidated general government, the Export Credit and Insurance Agency (AOFI), and the Development Fund, 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.

17. Reporting. The accounting of non-reschedulable 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.

F. Reporting

18. General government revenue data and the Treasury cash position table will be submitted weekly; updated cash flow projections for the Republican budget for the remainder of the year fourteen calendar days after the end of each month; and the stock of spending arrears as defined in ¶16 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.

Data Reporting for Quantitative Performance Criteria		
Reporting Agency	Type of Data	Timing
NBS	Net international reserves of the NBS (including data for calculating adjustors)	Within one week of the end of the month
Statistical Office and NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Fiscal deficit of the consolidated general government	Within 25 days of the end of the month
Ministry of Finance	Current primary expenditure of the Republican budget excluding capital expenditure and interest payments	Within 25 days of the end of the month
Ministry of Finance	Gross issuance of new guarantees by the Republican Government for (i) project and corporate restructuring loans and (ii) gross issuance of new guarantees by the Serbian Republican Government for liquidity support	Within three weeks of the end of the month
Ministry of Finance	New short-term external debt contracted or guaranteed by the general government, the Development Fund and AOFI	Within four weeks of the end of the quarter
Ministry of Finance	External debt payment arrears by general government, Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Gross accumulation of domestic payment arrears by the general government (without local government, the Development Fund, and AOFI)	Within 45 days of the end of the quarter
Ministry of Finance	Borrowing by the Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Cumulative below-the-line lending by the Republican Government	Within 25 days of the end of the month
Ministry of Finance	Severance payments by general government, with a breakdown by government level.	Within four weeks of the end of the quarter
Ministry of Finance	Earmarked grants and receipts from small-scale disposal of assets	Within four weeks of the end of the quarter

Statement by the Staff Representative on the Republic of Serbia
December 18, 2015

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

1. **Four of the five prior actions were met in the manner contemplated in the staff report.** Three prior actions were met before circulating the staff report to the Board, and another was met on December 12 when the National Assembly passed the 2016 budget consistent with the program fiscal parameters.

2. **With respect to the fifth prior action, the authorities—with the agreement of staff—decided to change the modality of implementation after the staff report was circulated**. Instead of adjusting individual subsidies according to the number of applications received by June 30, 2016 (as specified in the original prior action), the authorities proposed to calculate the level of the subsidy based on actual land data in the land registry as of end-December 2015. The registry data will also provide the basis for eligibility for the subsidy. In staff's view, this method provides at least as much protection against overruns as the original formulation, and is therefore consistent with the objectives of the prior action and the program as a whole. Amendments to the Law on Agriculture implementing this approach were passed by the National Assembly on December 12.

3. **Macroeconomic developments are broadly in line with the framework presented in the staff report.** GDP increased by 2.2 percent in year-on-year terms in Q3, somewhat stronger than suggested by the flash estimate, although October industrial production and investment indicators softened. Core inflation remained at 2.2 percent in November, while headline inflation reached 1.3 percent, which was somewhat weaker than projected (and increasing the risk that December inflation will undershoot the outer consultation band under the program, of 1.5-5.5 percent). The fiscal over-performance continued in October, with the general government deficit in the first ten months of 2015 amounting to 63.3 billion dinars and current primary expenditure of the Republican Budget amounting to 687 billion dinars, indicating that the authorities are likely to meet the end-December fiscal targets.

Statement by Daniel Heller, Executive Director for the Republic of Serbia and Vuk Djokovic, Senior Advisor to the Executive Director December 18, 2015

On behalf of the Serbian authorities, we thank staff for the constructive policy dialogue and the productive meetings during their visit to Belgrade in early November. The staff report provides a thorough assessment of the latest developments in the Serbian economy and the policies implemented under the program. The Serbian authorities concur with staff's analysis and recommendations, which they highly value. The policies implemented under the program are yielding strong results, in particular in the area of fiscal consolidation and the financial sector reform. The economic recovery is underway, supported by growing confidence and strong investments. The authorities remain committed to the program objectives of restoring fiscal sustainability and putting the public debt firmly on a downward path. They consider the program as an important anchor to strengthen the credibility of fiscal policies and ensure macroeconomic stability. They are also well aware that further fiscal and structural reforms will be needed. Four of the five prior actions for this review have been met, including the adoption of a budget for 2016 consistent with the program. As regards the fifth prior action, the authorities decided—in agreement with staff—to change the implementation modality. Thus the program remains on track, and the authorities continue to treat it as a precautionary.

EU integration

Serbia is steadily advancing towards EU membership. On December 14, 2015, the country reached an important milestone, with the opening of the first two chapters in its EU accession talks, marking the beginning of a new stage in the European integration process.

Fiscal policy

The authorities continue to over-perform in the area of fiscal consolidation. The fiscal deficit target for the end-September was met with a comfortable margin. Since the start of the program, strong policy implementation has led to a fiscal adjustment that largely exceeded objectives. In the first three quarters of 2015, Serbia achieved a primary surplus, and the deficit of the general government was reduced to 1.9 percent of GDP, i.e., to one third of the program target. The estimate for the 2015 headline deficit was reduced to 4.1 percent of GDP down from 5.9 percent of GDP, agreed at the inception of the program. Such fiscal over-performance is by and large the result of the adopted policies and improved fiscal discipline. In this context, the Fiscal Council recently estimated that improvements in the tax collection generated additional revenues in the amount of about one percent of GDP. In structural terms, the primary fiscal adjustment for 2015 is projected to reach 2.5 percent of GDP, from 1.7 percent agreed at the inception of the program. The fiscal space provided by the fiscal over-performance will allow the authorities to support the recovery by means of targeted and modest increases in wages and pensions—done in close consultation with the Fund and without jeopardizing the program objectives. The authorities are committed to achieve a deficit adjustment of 0.7 percent per year in structural terms in 2016 and 2017, in order to reach a cumulative structural adjustment of 4 percent of GDP at the end of program, which will firmly place public debt on a downward path.

The ongoing reduction of mandatory expenditures is underpinned by a rightsizing and rationalization of public sector employment aimed at reducing the public sector wage bill and increasing efficiency. The umbrella legislation that cap employment in the public sector (The Law on Ceilings on the Number of Employees) was enacted in mid-2015, and the government has recently adopted a decision to permanently reduce public employment by 14,500 positions compared to December 2014. By mid-2016, the authorities will implement further measures, which will be based on the functional analysis of public employment conducted by the World Bank, in order to achieve a 3 percent reduction in the public sector wage bill. The 5 to 1 attrition rule will also be extended in 2016.

Going forward, the substantial progress in fiscal consolidation will be supported by further structural fiscal and public financial management reforms. Parallel to the stepped-up collection efforts, the Tax Administration is undergoing a broad transformation and modernization reform, guided by the government's multiyear Tax Administration Transformation Program 2015-2020, with the objectives of: (i) strengthening governance, (ii) streamlining organizational structures, (iii) introducing modern compliance risk management, (iv) enhancing arrears management and write-offs, (v) upgrading IT systems and business processes, and (vii) improving coordination with other government agencies. The transformation program has been supported by Fund TA, and its implementation is progressing as planned. The authorities are committed to address weaknesses in the execution of capital spending by improving procedures and removing bottlenecks in the appraisal, planning, budgeting and oversight of infrastructure projects.

Monetary and exchange rate policies

Accommodative monetary policy remains appropriate, as pointed out by staff's analysis. The authorities continue to see the inflation targeting regime as the most adequate framework for reaching the objective of low and stable inflation. Low inflation, tight fiscal policy and benign external conditions allowed the National Bank of Serbia (NBS) to maintain an accommodative monetary stance. The reference rate remains at its historic minimum of 4.5 percent. Headline CPI inflation remains below the inflation tolerance band and is expected to return to the corridor by mid-2016. The NBS is also gradually lowering the mandatory reserve requirements, which remain relatively high in Serbia compared with peer countries. These policies will help reduce the cost of refinancing and support the provision of credit. The authorities are also considering measures to reduce euroization in order to improve monetary policy transmission.

The NBS remains committed to a managed floating exchange rate regime for the dinar. The exchange rate flexibility is an important buffer against external shocks, and foreign exchange interventions are geared only towards smoothing excessive volatility, without targeting a particular level or path for the exchange rate. Gross international reserves remain well above the standard reserve adequacy metric. The NBS will keep the reserves at or above this level throughout the program.

Financial sector policies

The banking sector remains well capitalized and liquid—the capital adequacy ratio stood at 21.2 percent at the end of a third quarter. The authorities are making noteworthy progress in implementing financial sector reforms to enhance its resilience and maintain stability. The bank resolution framework has been substantially strengthened in 2015 in order to make bank resolutions more effective and less costly. Moreover, the implementation of the comprehensive strategy adopted in August to address the large share of distressed assets within the banking system is broadly on track, and the World Bank and other IFIs are supporting the implementation and monitoring progress. Going forward, the relevant legal amendments to further strengthen the insolvency framework, improve secured creditors rights, and introduce a new framework for real estate appraisal will be adopted in the first quarter of 2016. Furthermore, the government is updating its strategy for the remaining state-owned banks and the preparation for the privatization of Komercijalna banka—the second largest bank in Serbia—has been initiated.

An important achievement was the conclusion of the special diagnostic studies (SDS) of the asset quality of 14 major banks in Serbia. The objective of this exercise—analogue to similar initiatives in many EU countries—was to provide better insight into banks' policies and procedures for dealing with distressed loans, help properly assess the capital adequacy, and strengthen the supervisory and regulatory framework. The SDS indentified some weaknesses, which implies a 1.8 percentage point decrease in the capital adequacy of participating banks. However, the SDS findings confirmed that the capitalization of the Serbian banking system remains strong—i.e., none of the examined banks' capital adequacy went below statutory minimum of 12 percent. The SDS findings will also help the NBS develop the guidelines for conservative provisioning, while strengthening its supervisory practices, including the shift towards a more risk-based supervision.

State owned enterprises (SOE) reforms

The authorities are making progress in implementing the comprehensive reform agenda to restructure SOEs and resolve socially-owned companies in the portfolio of the Privatization Agency. The purpose of these reforms is to (i) minimize fiscal risks stemming from unrestructured SOEs, (ii) improve SOE governance and increase efficiency, and (iii) complete protracted privatization or resolution of socially-owned companies. The three most important SOEs—the power generating utility EPS, Srbijagas, and Serbian Railways—are going through significant reorganizations and financial restructuring. These three companies also benefited from enhanced monitoring by line ministries as well as from the continuous support of IFIs including the World Bank and EBRD. In addition, there is a continuous progress in resolving socially-owned companies in the Privatization Agency portfolio. Out of 17 large socially-owned companies the Privatization Agency portfolio that still remain protected by the bankruptcy moratorium seven will be resolved before year-end, and the remaining will be resolved before May 2016. Moreover, 320 out of the remaining 500 companies in the Agency portfolio are in the process of either bankruptcy or privatization.

Conclusion

The program is on track and is yielding strong results, for instance continued over-performance in the fiscal area, and substantial improvement in the macroeconomic outlook. Serbia is also making tangible progress in the EU integration process by opening the first two chapters of the EU accession talks. The authorities remain committed to fiscal discipline and to the policy agenda agreed under the program, which remains key to restore medium-term fiscal sustainability. Mindful of the existing risks and remaining vulnerabilities, particularly stemming from politically difficult SOE reforms, the authorities stand ready to take all necessary measures to achieve the program objectives, in consultation with the Fund.