INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/386

REPUBLIC OF SERBIA

December 2016

SIXTH REVIEW UNDER THE STAND-BY ARRANGEMENT AND MODIFICATION OF THE ARRANGEMENT REVIEW SCHEDULE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SERBIA

In the context of the Sixth Review under the Stand-By Arrangement, 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 16, 2016, following discussions that ended on November 2, 2016, 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 2, 2016.
- A **Statement by the Executive Director** for 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 16, 2016

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

The Executive Board of the International Monetary Fund (IMF) on December 16, 2016 completed the sixth review of Serbia's economic performance under the Stand-By Arrangement (SBA). The completion of the review will make available the cumulative amount of SDR 662.575 million (about €850.8 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. Tao Zhang, Deputy Managing Director and Acting Chair, issued the following statement:

"The Fund-supported program is delivering positive results, underpinning macroeconomic management and structural reforms in Serbia. The economy continues to strengthen, supported by the authorities' efforts to improve public finances, address structural weaknesses, and strengthen the financial sector. Employment is rising, inflation remains firmly under control, and public debt has started to decline. Full implementation and strong ownership of the reform agenda are critical to consolidate hard-won gains, improve the business climate, and support Serbia's medium-term growth.

"Significant progress has been made on fiscal consolidation in 2016, on account of strong revenue and ongoing expenditure control. Institutional reforms aim to secure fiscal sustainability and improve public services. Priorities include eliminating domestic arrears, reforming the public administration and wage system, and strengthening public investment management. Further efforts are also needed to minimize fiscal risks through a restructuring of unviable state-owned enterprises, especially in the mining, energy, and transportation sectors, while enhancing social safety nets. The authorities are taking steps to strengthen public project appraisal and implementation, and modernize the educational system.

"The reduction in the inflation target reflects improved macroeconomic fundamentals and market confidence. The lower target should support the dinarization strategy and help reduce long-term interest rates. The current cautiously accommodative monetary policy stance remains consistent with the new target.

“Financial sector reforms have strengthened the resilience of the sector. The strategy for resolving nonperforming loans has helped reduce the overall bad loan ratio, and the authorities remain committed to its full implementation, especially with respect to state-owned banks.

“Serbia has achieved notable improvement in the business environment, but more needs to be done to boost investor confidence and medium-term potential growth. Particular efforts should be made to improve the court system, strengthen the quality of the judiciary process, and facilitate the use of effective out-of-court arbitration.”

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

December 2, 2016

SIXTH REVIEW UNDER THE STAND-BY ARRANGEMENT AND MODIFICATION OF THE ARRANGEMENT REVIEW SCHEDULE

KEY ISSUES

Recent economic developments. The program remains on track and the economy continues to strengthen. Significant fiscal over-performance and renewed efforts to address structural weaknesses have helped boost confidence. This, along with a healthy credit recovery on the back of substantial monetary policy easing, has helped restore robust growth, while persistently low inflation has reinforced recovery in real incomes. Public debt has started to decline.

Program status. The 36-month Stand-By Arrangement (SBA) with access of SDR 935.4 million (143 percent of quota, or about €1.2 billion) approved on February 23, 2015 is broadly on track. All end-September 2016 performance criteria (PCs) were met, most with significant margins. Most structural benchmarks (SBs) have been met, although some with delays. Completion of the review will make available the cumulative amount of SDR 662.575 million. The authorities request to move the arrangement to a semiannual review schedule. They intend to continue treating it as precautionary.

Policy recommendations. The fiscal policy objectives set out in the 2017 budget need to be supported by strengthened implementation of public administration reform and SOE restructuring to safeguard the achieved fiscal adjustment and preserve public debt sustainability. Broader structural reforms are needed to improve the business climate and support Serbia's medium-term growth. Maintaining an easing bias in monetary policy stance is appropriate given the persistently low inflation outlook, while the reduced inflation target is in line with strengthened fundamentals. There is potential to gradually increase day-to-day exchange rate flexibility.

Approved By
Thanos Arvanitis and Petya Koeva Brooks

Discussions were held in Belgrade during October 20–November 2, 2016. The staff team comprised James Roaf (head), Ruben Atoyan, Chuling Chen, (all EUR), Christine Richmond (FAD), Constant Verkoren, Giovanni Cucinotta (both MCM), Katsiaryna Svirydzenka (SPR), Philip Stokoe (STA), Sebastian Sosa (resident representative), Desanka Nestorović and Marko Paunović (Belgrade office).
Vuk Djoković (OED) and Wiktor Krzyzanowski (COM) attended some discussions. HQ support was provided by Min Kyu Song and Patricia Mendoza (both EUR).

CONTENTS

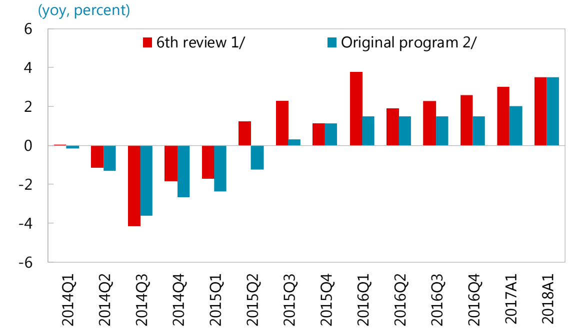
TABLES

APPENDIX

RECENT DEVELOPMENTS

1. **The economic recovery continues to gain momentum.** Growth in the first three quarters of 2016 reached 2.7 percent (yoy), supported by continued recovery of industrial production and agriculture as well as strong investment and net exports (Figure 1). The current account deficit has narrowed to around 4 percent (Figure 2) and yields on government securities continued to decline (Figure 3). Labor participation is improving, with Q2-Q3 data showing strong employment growth in both formal and informal sectors, and a sharp drop in unemployment. Private sector wages have picked up. An increase in the minimum wage of nearly 7 percent was agreed under the tripartite framework, to take effect from January 1, after two years without an increase.

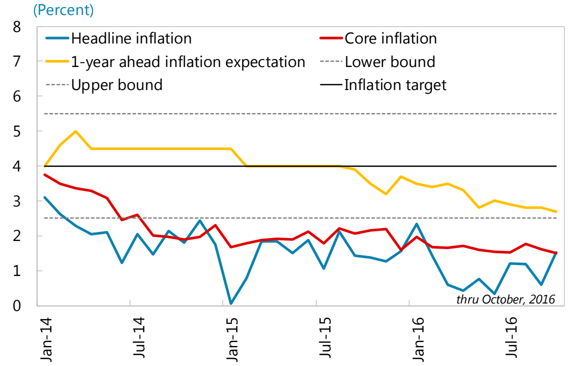
Serbia: Real GDP Growth Forecasts under SBA
(yoy, percent)



Source: IMF staff estimates.
1/ Projections from 2016Q4.
2/ Projections from 2014Q4.

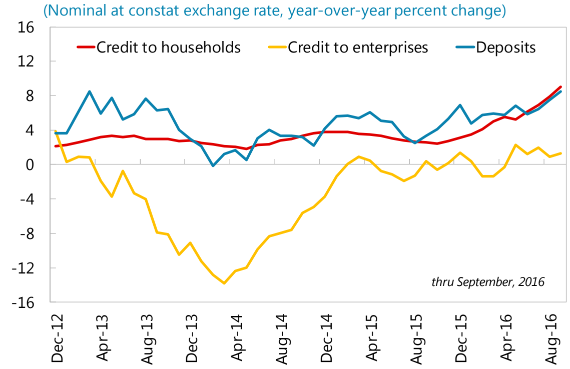
2. **Despite substantial monetary policy easing, inflation has remained persistently low.** Since the inception of the program, as fiscal adjustment took hold and external financing conditions remained stable, the NBS has reduced the key policy rate by 400 basis points. Headline inflation (1.5 percent in October) has picked up moderately, mostly due to higher food and utility prices, but remained subdued reflecting low imported inflation (Figure 4). Core inflation inched down to 1.5 percent in October, and inflation expectations have continued trending towards the lower end of the inflation target band. Interbank rates have stabilized just below 3 percent, and dinar lending interest rates have declined to historic lows (Figure 6). The accommodative monetary policy stance has supported a revival of credit growth, as demand for loans increased and banks eased their credit conditions.

Serbia: Inflation
(Percent)



Sources: Bloomberg; National Bank of Serbia (NBS); and IMF staff estimates.

Banks' Credit to the Economy and Deposits
(Nominal at constat exchange rate, year-over-year percent change)



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

3. **The external position continues to strengthen.** The current account deficit is expected to narrow in 2016 on account of strong exports suported by past investments. Net FDI is projected to remain at about 5 percent of GDP in 2016. Private sector deleveraging has continued to slow, reflecting higher rollover rates in the banking sector as well as a reduction in deposits abroad. Depreciation pressures on the dinar due to portfolio outflows in the first half of 2016 proved to be temporary and, since July, the NBS has been sporadically purchasing forex from the market.

4. **The fiscal outturn in the first nine months showed significant over-performance.** The January-September general government deficit was only RSD 4.5 billion. Tax over-performance continues to be led by VAT and excises, with CIT collection also performing well.[1] Non-tax and capital revenue were higher too, primarily due to one-off sources. On the expenditure side, higher goods and services spending was offset by underspending on interest, subsidies, and transfers. The general government gross debt-GDP ratio declined to 72 percent at end-September, partly reflecting reduced government deposits.

Serbia: General Government Fiscal Operations, RSD billion

	January - September 2016		
	Prog.	Actual	Diff.
Total revenue	**1,245.8**	**1,305.5**	**59.7**
Tax revenue	1,082.2	1,116.7	34.5
of which: VAT	321.5	331.5	10.0
of which: Social security contributions	336.8	337.0	0.3
of which: Excises	185.7	198.1	12.4
Non-tax revenue	155.7	175.0	19.3
Capital revenue	0.7	6.0	5.3
Grants	7.2	7.8	0.6
Total expenditure	**1,317.9**	**1,310.0**	**-7.9**
Current expenditure	1,208.2	1,192.9	-15.3
Capital expenditure	82.8	86.3	3.6
Net lending	2.0	2.6	0.6
Amortization of activated guarantees	24.9	28.1	3.2
Fiscal balance	**-72.1**	**-4.5**	**67.6**
Memo:			
Wage bill (excluding severance)	262.0	259.4	-2.5
Primary current expenditure of the Republican budget	628.2	622.4	-5.8
General government debt (percent of GDP)	75.0	72.0	-3.0

Sources: Ministry of Finance, IMF staff calculations.

PROGRAM PERFORMANCE

5. **Quantitative program conditionality has been met and good progress has been made on structural benchmarks** (MEFP Tables 1–2). The authorities reiterated their commitments to all program objectives and targets.

- **All quantitative and continuous PCs were observed**. The end-September PCs on NIR, the fiscal deficit, and current primary spending have all been met. While inflation has been below the NBS target, it remained within the inner consultation limit. The end-September indicative target on the ceiling on accumulation of domestic arrears by the consolidated general government was missed by a very small margin due to arrears of the Ministry of Justice.

[1] VAT over-performance can be explained by rising collection efficiency, while the margin of excise tax over-performance is more likely to be related to temporary factors.

- **Most structural benchmarks have been implemented, but some with delays and one remaining outstanding.** The authorities met the end-November structural benchmark on the completion of a special diagnostic review of Dunav Osiguranje and the end-December structural benchmark on amendments to the Criminal Code. In November, they have finalized a debt restructuring plan for Srbijagas (end-October structural benchmark). They have also issued an official explanation on tax deductibility of impairment provisions (end-October structural benchmark) but clarification of the scope of business secrecy and data protection laws remains to be completed pending further analysis of the needed legislative changes. Finally, while they have not formally adopted an action plan for implementation of the general government rightsizing plan for the second half of 2016 (end-June structural benchmark), they have over-performed the 2016 rightsizing target by strictly enforcing an employment attrition rule. However, delays continued on adopting by-laws aimed at strengthening the project appraisal process (end-December 2015 structural benchmark).

OUTLOOK AND RISKS

6. The economic outlook remains broadly in line with the fourth and fifth review scenario (Tables 1–8).

- **Real GDP growth** is projected to reach 2.7 percent in 2016 and 3 percent in 2017, with the largest contributions coming from consumption and private investment growth.

- **Inflation** is projected to average 1.1 percent in 2016, rising to 2.4 percent in 2017 on account of recovering demand and higher energy prices.

- **The current account deficit** is projected to narrow to about 4¼ percent of GDP in 2016 (on account of buoyant exports supported by recent FDI inflows to the tradable sector) and slightly further in 2017, as a worsening of terms of trade is expected to be offset by stronger export volumes.

7. The outlook is subject to a range of risks. Serbia remains susceptible to possible spillovers from regional developments and market volatility. Also, political resistance to reform from vested interests (especially in the SOE sector), possible delay in delivering on structural reforms (including in light of the presidential elections in the spring), or slippages in maintaining fiscal discipline could reduce growth prospects and compromise the quality and durability of fiscal adjustment. This, together with continued inflation undershooting, could make debt reduction harder. On the upside, growth could surprise again, outperforming projections as confidence continues to improve.

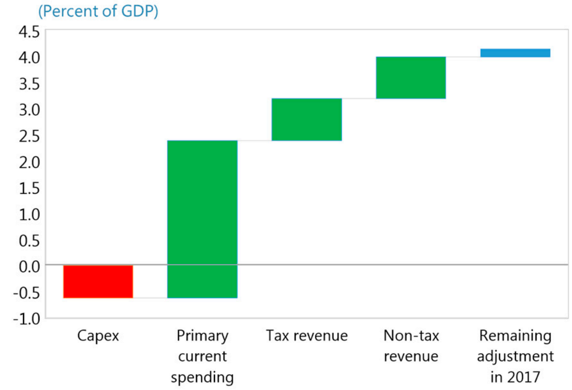
PROGRAM POLICY DISCUSSIONS

A. Fiscal Policy: Consolidation to Ensure Public Debt Sustainability

8. **The 2016 general government deficit is projected at 2.1 percent of GDP, nearly 2 percent of GDP better than in the original budget projection.** This implies a sizable structural adjustment, of 1.4 percent of GDP, achieved through strong revenue over-performance and tight control over Republican level current expenditures. Within this, there is space to advance some one-off expenditures at the end of the year: (i) assumption of debt of Petrohemija to its oil supplier in the context of the company's restructuring to eliminate future fiscal risk (0.3 percent of GDP); (ii) a one-off pension bonus (0.2 percent of GDP in net terms); (iii) some minor targeted one-off wage bonuses; and (iv) early repayment or refinancing on more favorable terms of some expensive SOE debt subject to called guarantees. The general government debt-to-GDP ratio is expected to end 2016 below 74 percent of GDP, over 2 percentage points lower than in 2015 and the first drop in the debt ratio since 2008.

9. **The authorities agreed to continue the fiscal adjustment in 2017, given the still elevated level of public debt.** The total estimated structural adjustment achieved in 2015–16 almost meets the agreed target of 4 percent of GDP for the full three-year program. To lock in these gains, and make further inroads into reducing debt, the approved 2017 budget (**prior action**) aims for a general government deficit of 1.7 percent of GDP, representing a further structural adjustment of about 0.2 percent of GDP. This is achieved by containing mandatory current spending through:

Serbia: Structural Fiscal Adjustment under SBA, 2015-17
(Percent of GDP)



Sources: IMF staff estimates.

- *Government rightsizing.* As of end-September, permanent public sector employment (including local public utilities) had been reduced by almost 22,000 employees relative to end-2014. However, this has been partially offset by higher fixed-term and contractual hiring (about 8,500). For 2017, the focus will be more on optimizing resource allocation, with action plans for education and social services administration to be approved by end-March 2017 (**new structural benchmark**) based on functional analyses developed in conjunction with the World Bank, along with continued reductions in non-medical employment in the health sector. To cement these plans, the authorities will adopt decisions under the Law on Ceilings on the Number of Employees (**new structural benchmark**) setting detailed employment limits for institutions of the general government.

- *Moderate public wage and pension increases* (Box 1). Fiscal over-performance opens space for targeted public wage and pension increases while continuing to reduce total wage and pension bills relative to GDP. The 2017 budget maintains the wage freeze for central and local administration and SOEs (nearly half of total public employment) while accommodating wage increases for selected sectors including teachers (6 percent), tertiary education (3 percent), and health, social protection, cultural institutions, police and army (5 percent). The budget also accommodates a general pension increase of 1.5 percent.

- *Wage system reform.* Adoption of the Law on Public Sector Employees Wage System in February 2016 set the stage for reduced disparities of pay for similar work across different ministries. To support implementation of the law, parliament will adopt secondary legislation for local governments and public services (health, education, culture, and social protection) by end-June (**new structural benchmark**) and for all other sectors (including police and army) by end-2017.

- *Local Government Finance reform.* In October, the parliament adopted amendments to the Law on Local Government Financing, yielding savings for the Republican budget of 0.1 percent of GDP per year from 2017.

10. Measures are also being taken to strengthen the public investment management framework. Capital spending is set to grow in 2017, but structural deficiencies in implementing public investment remain. Staff stressed the importance of establishing a single project pipeline to help with project prioritization, and adoption of by-laws aimed at strengthening the full project appraisal process (**end-December 2015 structural benchmark**). The inclusion of all project loans in the budget is an important step in this regard (see paragraph 12). Staff also urged the authorities to approve amendments to the Law on Public Private Partnerships and Concessions that would give a strengthened role to the Ministry of Finance in assessing budget affordability, limiting total fiscal risk, ensuring a competitive tender process, and assessing contracts against EU statistical standards.

11. The pace of reforms of the state tax administration (STA) needs to be accelerated. The reform agenda focuses on branch reorganization, establishing risk-based analysis, and reduction of non-core activities. A risk management unit is now operational and preparation is underway of strategic risk initiatives for inclusion in the 2017 tax compliance plan. The government will adopt by end-June a decision on a new organization plan for non-headquarter-based tax administration functions (**new structural benchmark**). Staff welcomed the adoption of amendments to the Criminal Code (**end-December structural benchmark**) to facilitate collections from illegal businesses, and advised strengthening the use of enforcement powers against tax delinquents.

12. Risks from contingent liabilities remain significant and public financial management weaknesses need to be addressed. Some public enterprises and SOEs (including Azotara, MSK, RTB Bor, and Railways), medical institutions, and local governments continued to accumulate energy arrears in 2016, amounting to at least 0.3 percent of GDP. Discussions focused on identifying actions to prevent further accumulation:

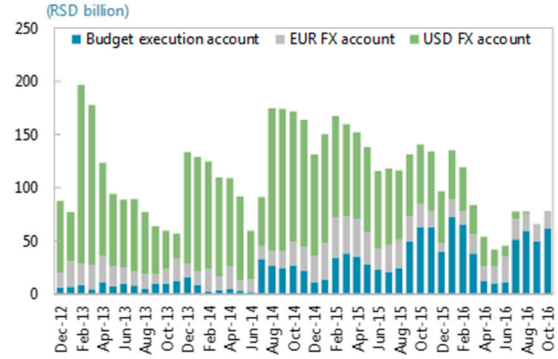
- The Law on Payments (RINO Law) is not succeeding in exposing arrears because of widespread reporting failures by budget users and public entities. The authorities have decided to develop a new e-invoice system fed by both creditors and debtors, capturing transactions outside the single treasury system. However, the new system will take time to become operational.

- To stop the current practice by some local governments of inflating revenue projections to justify excessive spending targets, the Ministry of Finance has issued specific instructions for revenue projections. As a **prior action**, the authorities have amended the budget system law to withhold transfers from local governments that fail to comply with the new instructions, as well as to bring all project loans on budget. Staff also noted the importance of including local governments in the Financial Information Management System (FMIS).

- As a **prior action**, the authorities have (i) issued a decree mandating that Srbijagas must not provide gas to delinquent companies or institutions (except in limited identified priority cases where payments will be made from the budget), (ii) instituted a system of prepayments for gas supplies to Azotara and MSK, and (iii) required monthly reporting and publishing of overdue receivables to Srbijagas and EPS of their top 20 debtors. Subsidies have been included in the Republican budget for RTB Bor to increase transparency and avoid arrears, while seeking permanent solutions to ensure the company's viability.

13. Adequate fiscal buffers are needed to guard against fiscal risks and external financial market volatility. Staff urged the authorities to rebuild cash buffers (thus accepting a slightly higher level of gross public debt) closer to levels that are judged to be broadly adequate (about RSD100 billion) and stressed the importance of a detailed cash flow analysis, including periods of stress, for refining the appropriate buffer level.[2] Staff also urged better coordination between the Treasury and NBS, via the Liquidity Committee, to avoid possible FX financing pressures. Going forward, the authorities plan to meet government financing needs primarily by domestic market borrowing with a view to establish benchmark-size RSD-denominated issuances, reduce currency risks, and lengthen maturities.

Republican budget liquid deposits
(RSD billion)



Sources: Ministry of Finance; and IMF staff calculations.

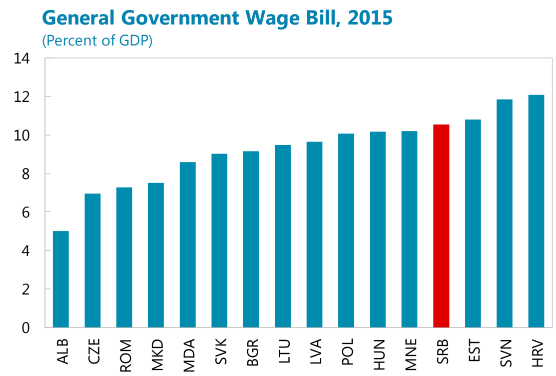
Summary Table on General Government Borrowing
(RSD billion)

	2016 Original	2016 Proj.	2017 Proj.
Financing needs	693	610	696
Use of financing			
Budget	643	553	637
Project	50	57	59
Financing sources			
Short-term	140	90	90
Medium-long term	553	460	622
Deposits	0	60	-16
Memo: Issuance of guarantees (EUR mn)	180	180	180

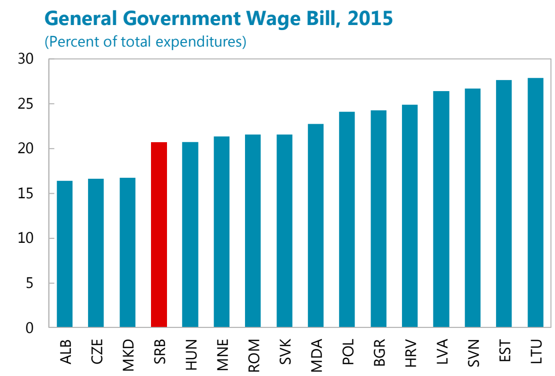
[2] The drawdown of government deposits accounts for 1.4 percentage points of the decline in the gross public debt-GDP ratio in 2016.

Box 1. Public Sector Wages

Serbia's public sector wage bill remains relatively high. Notwithstanding an across-the-board nominal wage cut of 10 percent introduced in late 2014, the public sector wage bill as a share of GDP remains high compared with other regional peers. The wage bill is more in line with regional average, however, when expressed as a share of total government expenditures. These ratios are expected to continue falling on account of continued rightsizing efforts and wage restraint.

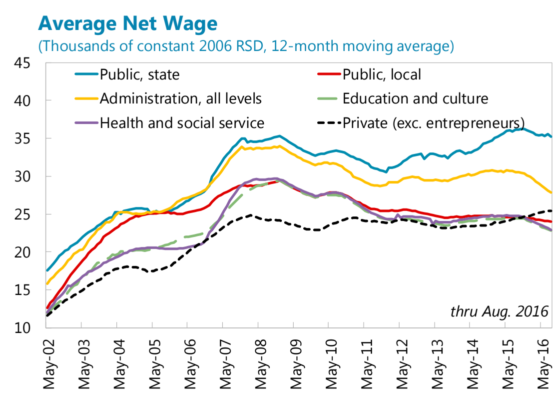


Sources: Ministry of Finance; IMF Wage database; IMF WEO database; and IMF staff calculations.



Sources: Ministry of Finance; IMF Wage database; IMF WEO database; and IMF staff calculations.

Considerable disparities exist in public sector wages. Public sector wage levels tend to be higher than those of the private sector (in terms of simple averages). Also, wage levels vary significantly within the public sector. Education and health sectors are at the bottom of the public sector wage spectrum, and differentials between these two sectors and the rest tended to increase through 2014. Pay increases in 2016 and 2017 targeted towards health and education will help narrow this gap. Further, while real public sector wages have been generally on a declining path since mid-2015, real wages in the private sector are increasingly exhibiting healthy growth, reflecting strengthening economic recovery and improving labor markets.

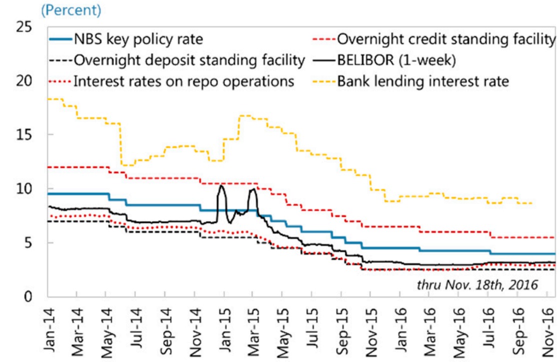


Sources: Statistical Office of the Republic of Serbia; and IMF staff calculations.

B. Monetary Policy: Cautious Easing and Strengthening Operational Frameworks

14. Staff and the NBS agreed that a cautiously accommodative monetary policy stance is appropriate. Guided by low inflation expectations and the relatively stable financial conditions, the NBS has cut the key policy rate twice this year, accompanied by a narrowing of the interest rate corridor intended to strengthen the signaling role of the policy rate, reduce market uncertainty, and improve transparency. More aggressive easing of the monetary policy stance, however, has been constrained by lingering external uncertainties, including on Fed and ECB policy moves. Further policy easing would be appropriate if inflation fails to pick up as projected or appreciation pressures build up. Staff and the authorities discussed gradually reducing the very high required reserve ratio on FX deposits and moving towards fulfilling reserve requirements on FX deposits solely in foreign exchange, as market conditions allow.

Serbia: Interest Rates
(Percent)



Sources: Haver Analytics; and National Bank of Serbia.

15. Staff supported the NBS decision to reduce the inflation target from the current 4±1.5 percent to 3±1.5 percent effective January 1, 2017. This lower inflation target is justified on account of improved fundamentals and other medium-term considerations (Box 2). In staff's view, the lower inflation target will help anchor inflation expectations, reduce interest rates, contribute to dinarization, and support Serbia's medium-term potential growth.

16. Allowing bolder exchange rate flexibility would be appropriate, as market conditions improve. The NBS remains committed to its managed float exchange rate policy, which it believes has worked well in the recent period. Staff suggested that with the economy strengthening, the frequency of interventions could be reduced over time, allowing the exchange rate to be more market-based, with the NBS interventions limited to preventing excessive volatility. This would help develop the forex market and counteract perceptions of tight exchange rate management. The stock of international reserves remains comfortable, above 150 percent of the IMF metric.

Box 2. Reasons for a Lower Inflation Target

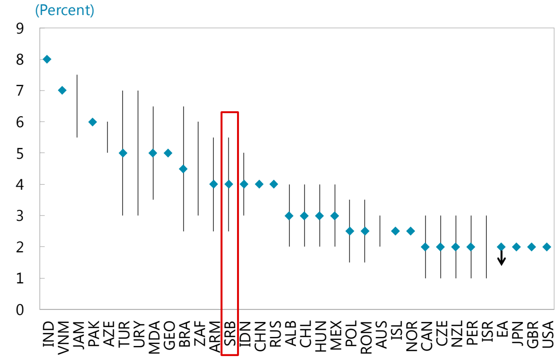
The reduction in the inflation target from the current 4±1.5 percent to 3±1.5 percent from 2017 reflects a number of considerations:

- ***Improved fundamentals.*** Serbia's macro policy framework has strengthened considerably since the previous target was set in 2012, with much reduced inflation and inflation expectations, stronger credibility of the NBS, and major fiscal consolidation.

- ***Consistency with other IT peers.*** The current target was higher than in most peer countries in CESEE.

- ***Consistency with trading partners.*** With eurozone (Serbia's key trading partner and the benchmark for domestic financial asset/liability pricing) inflation projected to remain below 2 percent (in line with the ECB target), hitting the current NBS target would likely imply consistent devaluation against the euro, which could have a negative effect on confidence, the de-euroization strategy, and worsen near-term public debt dynamics.

Inflation Targets
(Percent)



Source: http://www.centralbanknews.info

- ***Support for potential growth.*** By anchoring inflation expectations down to more realistic levels, a lower target may help reduce nominal and real longer-term interest rates. This would support credit recovery and the medium-term potential growth outlook.

The new reduced target will remain higher than in advanced economies, leaving room for higher non-tradable price growth due to Balassa-Samuelson effects and still needed administrative price adjustments. Preserving the current width of the inflation band is also appropriate, especially given the higher weight of volatile commodity and food prices in the index compared with other peers with tighter inflation bands.

C. Financial Sector Policies: Buttressing Soundness and Improving Intermediation

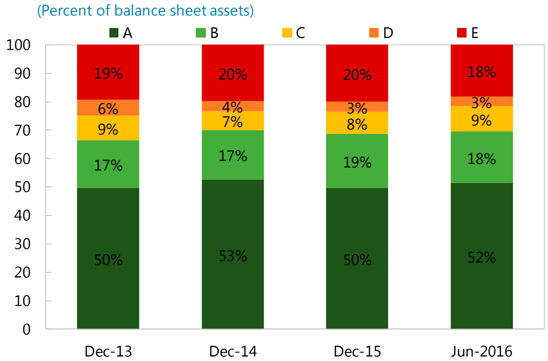
17. Banking sector conditions remain stable. Data for the second quarter of 2016 points to continued resilience in the wake of last year's asset quality review, with an average capital ratio exceeding 21 percent and a gradual improvement in asset quality (as illustrated by the change in the composition of classified assets). Banking sector profitability continues to improve year-on-year, with the reduction in credit losses outpacing the decline in banks' net interest income. Measures taken to address the distressed debt overhang are starting to yield results, with the aggregate stock of NPLs falling both in nominal terms and relative to total loans. Still, progress made by individual banks is uneven, underscoring the importance of concerted supervisory action—in particular by scrutinizing banks' strategies for reducing NPL stocks to acceptable levels, and encouraging write-offs of exposures deemed uncollectable. To underpin long-term stability of the Serbian banking system, and to ensure harmonization of the regulatory framework with EU standards, the NBS is pushing ahead with the implementation of Basel III (Box 3).

Serbia: Asset Quality Developments

Asset quality is improving…

Classified Assets

(Percent of balance sheet assets)

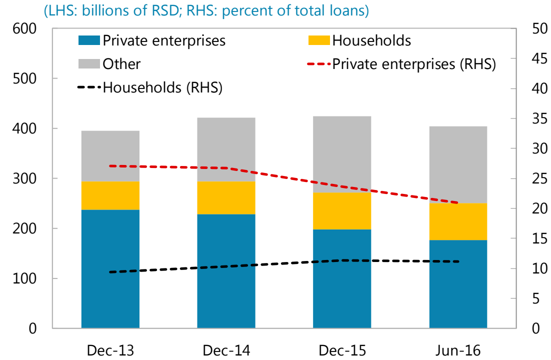


Source: National Bank of Serbia.

…and NPLs are on a downward trajectory.

Non-Performing Loans

(LHS: billions of RSD; RHS: percent of total loans)



Source: National Bank of Serbia.

18. The authorities have made important progress in the implementation of the NPL action plan. The draft amendments of the corporate insolvency law, which underwent public consultations in October and are expected to be submitted to Parliament shortly (**end-December structural benchmark**), will strengthen the rights of secured creditors and facilitate a more efficient liquidation of assets. In addition, adoption of the law regulating the profession of real estate appraisers (**end-December structural benchmark**) will help ensure that collateral valuations are sufficiently conservative, and thus contribute to adequate provisioning. Staff welcomed the government's official explanations on the tax deductibility of impairment provisions (**end-September structural benchmark**) but encouraged the authorities to monitor closely the application of the tax amendments that were adopted in December 2015 and stand ready to provide further clarification of the scope and application of these amendments, if needed. Similarly, efforts remain necessary to ensure that data protection rules do not hamper thorough due diligence in the context of NPL sales.

19. Further efforts are needed to complete the reforms of state-owned financial institutions. Strategic guidelines for Banka Poštanska Štedionica—to reorient the bank's strategy towards retail, entrepreneurs, and small companies—were adopted in August, and the MoF is closely monitoring their implementation. Staff recommended decisive action to strengthen the bank's governance and risk management framework, and urged further steps to address the overhang of distressed assets. Strategic options for the smaller state-owned banks remain to be identified, and should aim at addressing financial fragilities and divesting (or winding-down) non-strategic participations. Remedial actions to strengthen the resilience of Dunav Osiguranje—

Box 3. Initiatives to Enhance the Serbian Regulatory Framework

Following the implementation of Basel II during 2011, the NBS has been considering further enhancements of the regulatory framework in Serbia, aligned with the roll-out of the Basel III framework in the EU.

In December 2013, the NBS adopted a strategy for further regulatory reform that envisaged (i) the preparation of a **gap analysis** (completed in February 2015) between the regulatory framework in Serbia and the enhancements of the Basel II framework (the so-called Basel 2.5 standards) and the Basel III framework; (ii) the estimation of the **quantitative impact** (completed by end-2015) of new regulatory standards on capital adequacy and liquidity across the Serbian banking system (completed by end-2015); and (iii) the initiation of a **public consultation process** of new regulations (started in August 2016).

The authorities' detailed timetable envisages **implementation of revised regulations** from end-June 2017, with test reporting due in April 2017. As a result, and in line with the EU regulatory framework, minimum capital requirements will be reduced from 12 percent to 8 percent while capital buffers (countercyclical capital buffer, systemic risk buffer, capital buffer for systemically important banks, and a revised capital conservation buffer) will be introduced simultaneously to safeguard the resilience of the banking system and help mitigate systemic or macroprudential risks. Similar to EU requirements, a non-risk-weighted leverage ratio will be introduced as a monitoring tool until consensus has been reached at the international level on the definition and calibration of this ratio.

The **required reserve for estimated losses** will be phased out as part of the Basel III implementation, albeit only as of January 1, 2019 in view of risks associated with still high NPLs. In anticipation of this phase-out, the NBS has already made changes to the Decision concerning the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, allowing banks to reduce the required reserve in accordance with improvements of their NPL ratios.

Based on end-2014 data, the **quantitative impact studies** indicated that the aggregate level of capitalization of the banking system would be sufficient to meet Basel III requirements. At the time, the banking sector's total capital ratio under Basel III rules was estimated at 20.7 percent (Common Equity Tier 1 ratio of 17.7 percent), with a capital surplus of RSD 217bn. Similarly, the analysis demonstrated compliance with the leverage ratio. With regard to the new liquidity requirements, the impact study (using data as of end-June 2015) showed a liquidity coverage ratio—measured as an aggregate for all currencies, as per EU requirements—above 100 percent. However, the analysis also indicated that banks are exposed to some currency mismatches in CHF and USD, which may require changes in the currency composition of their liquid assets.

Serbia's largest insurance company—will also be needed, following the completion of the independent diagnostic review of the company in November (**structural benchmark**). The selection of an independent consultant to conduct the independent analysis of the Development Fund and the export promotion agency (AOFI) should be finalized shortly, allowing for the completion of the assessment by end-April 2017 (**new structural benchmark**).

20. Litigation related to Swiss franc mortgages needs to be monitored closely, in view of potential financial sector implications. CHF indexed loans comprise less than 5 percent of bank credit to non-government, and the authorities have thus far relied on market-based restructuring options—having already halted the origination of new CHF indexed loans to natural persons in May 2011. But the uptake of restructuring proposals has been limited (the estimated restructuring rate is about 15 percent) and a recent court decision to terminate a CHF loan, based on significantly changed circumstances since its origination, could have broader implications for the banking sector.

21. Efforts to strengthen the implementation of the AML/CFT framework are ongoing. Based on the findings of the MONEYVAL's assessment of Serbia's AML/CFT regime against the revised FATF standard, the authorities—via the Standing Coordination Group—are in the process of developing an action plan for the remediation of the identified AML/CFT deficiencies, with a view to make sufficient progress in its implementation by September 2017.

D. Structural Reforms: Regaining the Momentum

22. Progress has been made in reforming large public enterprises. Discussions focused on speeding up the implementation of reform plans, including the large energy and transport companies, as well as the portfolio of the former Privatization Agency.

- **Elektroprivreda Srbije (EPS).** After considerable delay, the rightsizing plan with a total target of 5,000 for 2016-19 was finalized in August. By end-October, more than 1,900 employees applied for voluntary separation, exceeding the 2016 target. EPS will continue voluntary separation in 2017 by expanding eligibility criteria, and will prepare an updated systemization plan and close two inefficient power plants by end-June 2017 (**new structural benchmark**). Staff emphasized that the systemization plan should reflect the optimal medium term company structure and staffing needs, to guide the ongoing rightsizing efforts. Staff recommended that after the phase of voluntary separation, plans for mandatory separation need to be developed to ensure the overall target will be achieved by end-2019. Household electricity tariffs were increased by 3.8 percent in October, helping bring prices more in line with regional peers.

- **Srbijagas.** Srbijagas has been a major source of fiscal risks in recent years.[3] In consultation with the World Bank, the authorities adopted a financial consolidation plan in March 2016,

[3] Annual fiscal support to Srbijagas in the form of state guarantees reached RSD 22bn in 2015, accounting for a third of the total state aid to all SOEs and public enterprises. By end-2015, total liabilities of Srbijagas reached

(continued)

and developed a debt restructuring plan for more than €600 million commercial debt of Srbijagas in November (**end-October structural benchmark**). This debt restructuring plan aims to prepay or refinance existing government-guaranteed commercial debt on more favorable terms that reflect Serbia's improved credit standing. Staff recommended the transfer of Srbijagas' stakes in some of its customers acquired through past debt-to-equity transactions to the state in order to clean the company's balance sheet, and emphasized that no further debt-to-equity swaps should occur. Staff welcomed efforts with the World Bank to develop methodology to assess capital expenditure projects and establish a committee to oversee internal controls, internal audit and external audit.

- **Railways of Serbia.** The systemization plan with rightsizing targets for 2016 and 2017 (2,700 and 3,000, respectively) was adopted in June, and specific plans for each of the four companies were adopted in August. As of mid-November, about 3,000 employees surveyed responded favorably to voluntary separation. Closure of around 1,100 kilometers of rail lines has been initiated in 2016. The authorities acknowledged the need to resolve historical arrears and reiterated their commitment to permanently reduce state aid to the Railway companies. Since June, private operators have started to participate in the cargo market, improving efficiency and competition.

- **Roads of Serbia.** To remove rigidities in pricing maintenance contracts, performance-based contracts covering 1,500 kilometers have been tendered for 2016 and similar tenders for another 1,500 kilometers are planned for 2017. Staff welcomed the decision to increase the toll rate by 10 percent from January 2017 to allow adequate infrastructure maintenance, and urged future toll increases to be based on an assessment of the adequacy of toll rates, conducted in coordination with the World Bank.

- **SOEs in the former Privatization Agency portfolio.** By October 2016, redundancy packages were disbursed to more than 24,000 employees in about 270 of the original 500-plus companies. 172 companies with around 45,000 employees remained to be resolved. 11 out of the 17 strategic companies whose bankruptcy protection was removed in May 2016 still remained to be fully resolved, among which seven have adopted or are in the process of adopting prearranged reorganization plans, one is on the public invitation for strategic partners, and three are in the process of negotiating with creditors or have made specific consolidation plans. Staff welcomed the authorities' decision to resolve in 2017 some large employers in the mining industry through either inviting strategic partners (RTB Bor) or scaling down unviable operations (Resavica) to reduce needed fiscal support, while taking into account social and environmental considerations. In the context of their assumption of Petrohemija's debt to its oil supplier, the authorities are negotiating a long-term oil supply

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more than €1.6 billion (around 5 percent of GDP), resulting in negative equity of more than €500 million. Low collection rates from commercial users contributed to the large operating losses: as of September 2016, more than half of total accounts receivables were from three petrochemical companies and two district heating companies. Poor collection in the past led to debt-to-equity swaps between Srbijagas and some of its debtors, bringing additional burdens to Srbijagas' balance sheet.

contract to ensure the viability of the company without recourse to future fiscal resources. They will seek a strategic investor by March 2017 before considering further investment in the company.

- **Other loss-making SOEs.** Staff welcomed the authorities' commitment to find permanent resolution—through privatization or regular bankruptcy—for Azotara and MSK by end-March 2017 (**new structural benchmark**).

23. The authorities continue efforts to improve the business climate and increase employment. Staff welcomed the progress reflected in the latest World Bank Doing Business Indicators, in which Serbia climbed from 54th to 47th place. However, Serbia's ranking slipped in contract enforcement and protecting minority investors—weaknesses that are also reflected in other surveys of the business environment, highlighting the importance of legal system reform. Staff supported the authorities' continued efforts combat the gray economy by implementing new campaigns and initiatives in 2017 and 2018, and encouraged more coordinated actions across government to ensure better implementation of these activities. Staff also emphasized the importance of reducing regulatory burdens and making fees and charges more transparent and predictable. Staff welcomed the progress on the new Law on Social Protection and encouraged continued efforts to improve targeting and efficiency of social benefits.

PROGRAM MODALITIES

24. Staff supports the authorities' request to move the arrangement to a semiannual review schedule. Under the proposed schedule, reviews would be concluded based on end-March and end-September test dates and conditionality. Purchases will remain quarterly, with interim purchases based on meeting performance criteria in June and December (Table 9). The schedule of purchases has been revised accordingly.

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

- **Prior actions** were set on (i) the adoption by the National Assembly of the 2017 budget (to ensure consistency with fiscal program objectives), (ii) the adoption of amendments to the budget system law to bring all project loans on budget and to withhold transfers from local governments not complying with the new instructions on revenue projections, and (iii) prohibiting Srbijagas gas supplies to delinquent users, mandating prepayments for gas supplies to Azotara and MSK, and publishing the list of top 20 debtors to Srbijagas and EPS (to strengthen the energy arrears framework).

- **Performance criteria** are proposed for March, June, September, and December 2017, in line with quarterly projections. An additional adjuster is set to exclude concession or PPP receipts from the general government fiscal deficit.

- **New structural benchmarks** are proposed with a view to support the renewed structural reform focus of the new government in 2017: for **end-March** on (i) the adoption of time-bound action plans for administrative restructuring in education and social services, (ii) the adoption of 2017 decisions under the Law on Ceilings on the Number of Employees, (iii) the resolution of Azotara and MSK; for **end-April** on (iv) the completion of the independent assessments of the Development Fund and the export promotion agency; for **end-June** on (v) the closure by EPS of two inefficient power plants and preparation of an updated systematization plan, (vi) the adoption of an organization plan for the non-headquarters-based tax administration functions, and (vii) the adoption of the secondary wage system legislation for local governments and public services.

26. Serbia's capacity to meet potential repayment obligations to the Fund is strong. In case of full drawing of the amount under the SBA (Table 9), repayments to the Fund at the end of the projection period would remain modest at 1.3 percent of GDP, or 8.2 percent of gross reserves (Table 11). Although public debt is expected to remain high during the program period, strong program implementation would keep it on a firm downward path. Serbia has a strong record of repayment to the Fund. Staff does not expect Serbia to draw on its SBA arrangement given its high level of reserves.

27. The NBS has implemented all the recommendations from the 2015 safeguards assessment. The FY 2015 external audit was completed on a timely basis and the annual financial statements have been published.

28. Serbia has small sovereign arrears outstanding. It intends to resolve US$45 million in arrears to Libya, which arose in 1981 due to unsettled government obligations related to a loan for importing crude oil, after establishing the appropriate government counterpart. Staff urged the authorities to resolve arrears to Libya as soon as possible.

STAFF APPRAISAL

29. The program continues to provide a strong policy anchor. The authorities have broadly delivered the fiscal adjustment agreed under the program, and public debt is falling a year ahead of schedule. Growth continues to accelerate and labor market conditions have improved. Inflation remains subdued and improved fundamentals provide credibility to the reduced medium-term inflation target. Structural reforms have gained momentum, following the recent elections. These are important accomplishments and show the authorities' continued commitment to the broader objectives of the program.

30. The modest additional fiscal adjustment targeted in the 2017 budget is appropriate. The 2017 budget deficit—based on cautious revenue assumptions—will lock in fiscal consolidation achieved so far and will be the lowest in Serbia for 10 years. Fiscal performance so far opened space for moderate increases in public wages and pensions, while maintaining their clear downward paths as shares of GDP. Capital spending is projected to increase modestly, taking account of implementation capacity constraints. Careful debt management strategy is projected to reduce overall interest costs as well as reducing risks.

31. Institutional reforms, however, remain critical to entrench the durability of the fiscal improvement. Notwithstanding progress made in recent years, fiscal controls remain weak, evidenced by the recent accumulation of domestic payment arrears in some municipalities, the health sector, and SOEs. Public administration reforms have also made limited headway, with employment reductions achieved through simple headcount control rather than well-planned resource optimization, and delayed implementation of public wage system reform. Finally, public investment remains hampered by weaknesses in planning and execution. It is essential that the intended reforms in these areas are implemented more forcefully, firstly to cement the fiscal improvement and reduce fiscal risks, and secondly to improve the quality of public services and the contribution of the public sector to economic growth. Critical tests include resolution or restructuring of unviable mining and energy sector SOEs, substantive education reform to reflect reduced pupil numbers and modern learning priorities, and strengthened public project appraisal and implementation.

32. The reduction in the NBS inflation target is a welcome step that both reflects and reinforces improved macroeconomic confidence. The lower target should support the dinarization strategy and help reduce long-term interest rates. The current cautiously accommodative monetary policy stance remains consistent with the new target. Gradually increasing the day-to-day flexibility of the exchange rate would continue to be desirable.

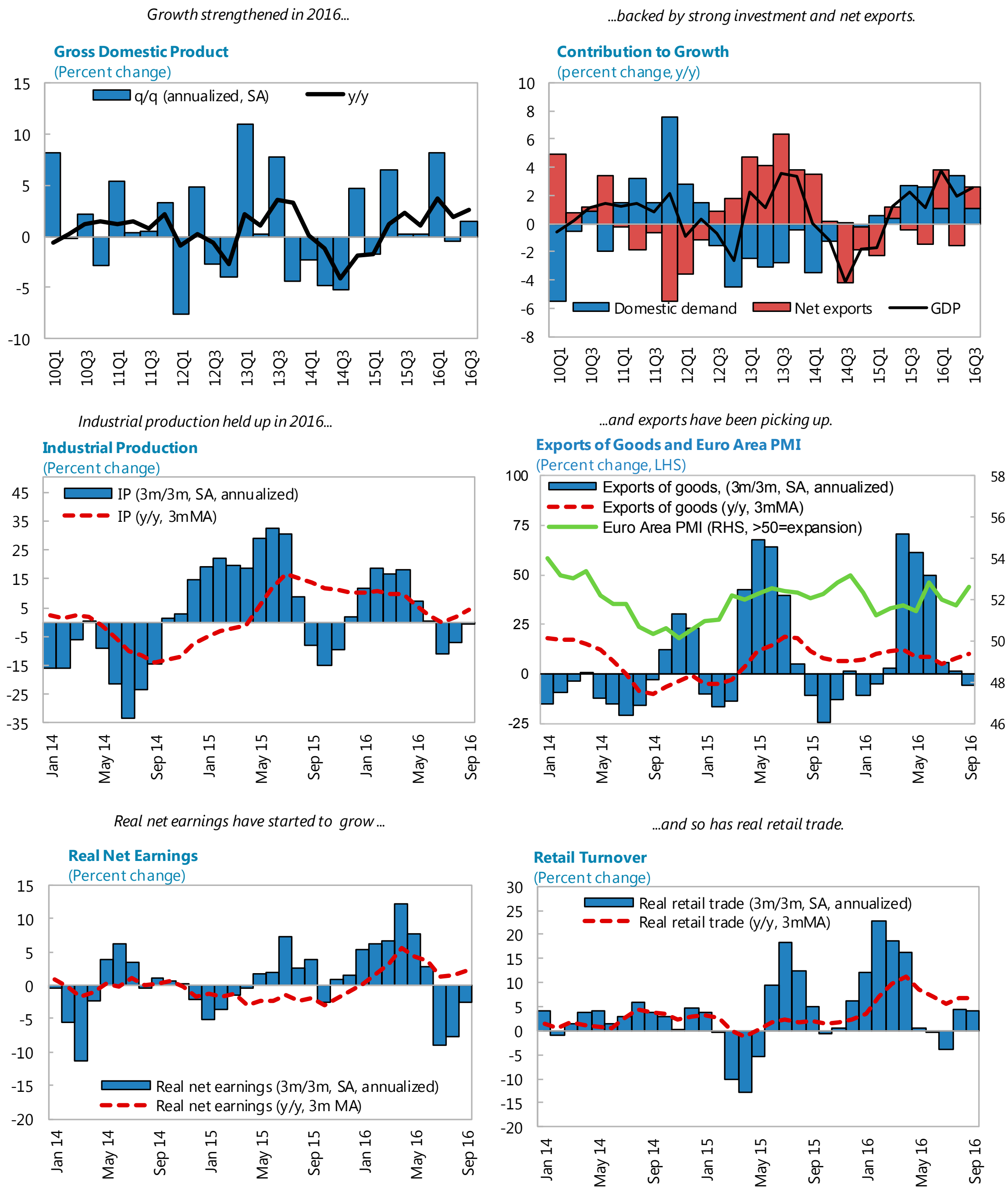
33. Financial sector reforms under the program have strengthened the resilience of the sector. The NPL strategy has contributed to a welcome reduction in the overall bad loan ratio, but full implementation of the strategy remains essential, including in state-owned banks. Close monitoring of Swiss franc mortgage-related litigations is warranted in view of potential financial sector implications.

34. The business environment shows important improvement, but the court system stands out increasingly starkly as the weak link. Serbia's improved ranking in business surveys goes hand-in-hand with strong investment growth, including FDI. But perceptions of civil and criminal court procedures and corruption remain very poor. Serbia needs to address these issues, including by strengthening the quality of the judiciary and through greater availability and use of effective out-of-court arbitration.

35. Strong program implementation will mitigate risks from domestic and external factors. Serbia remains vulnerable to external risks, and political resistance to reform from vested interests could reduce growth prospects and put gains in fiscal and financial stability at risk. The new government has reconfirmed its commitments to the very ambitious reform agenda set out in its programs with the Fund, with other IFIs, and under the EU accession process. It now needs to demonstrate the sustained acceleration in reform implementation that will be required to achieve these objectives.

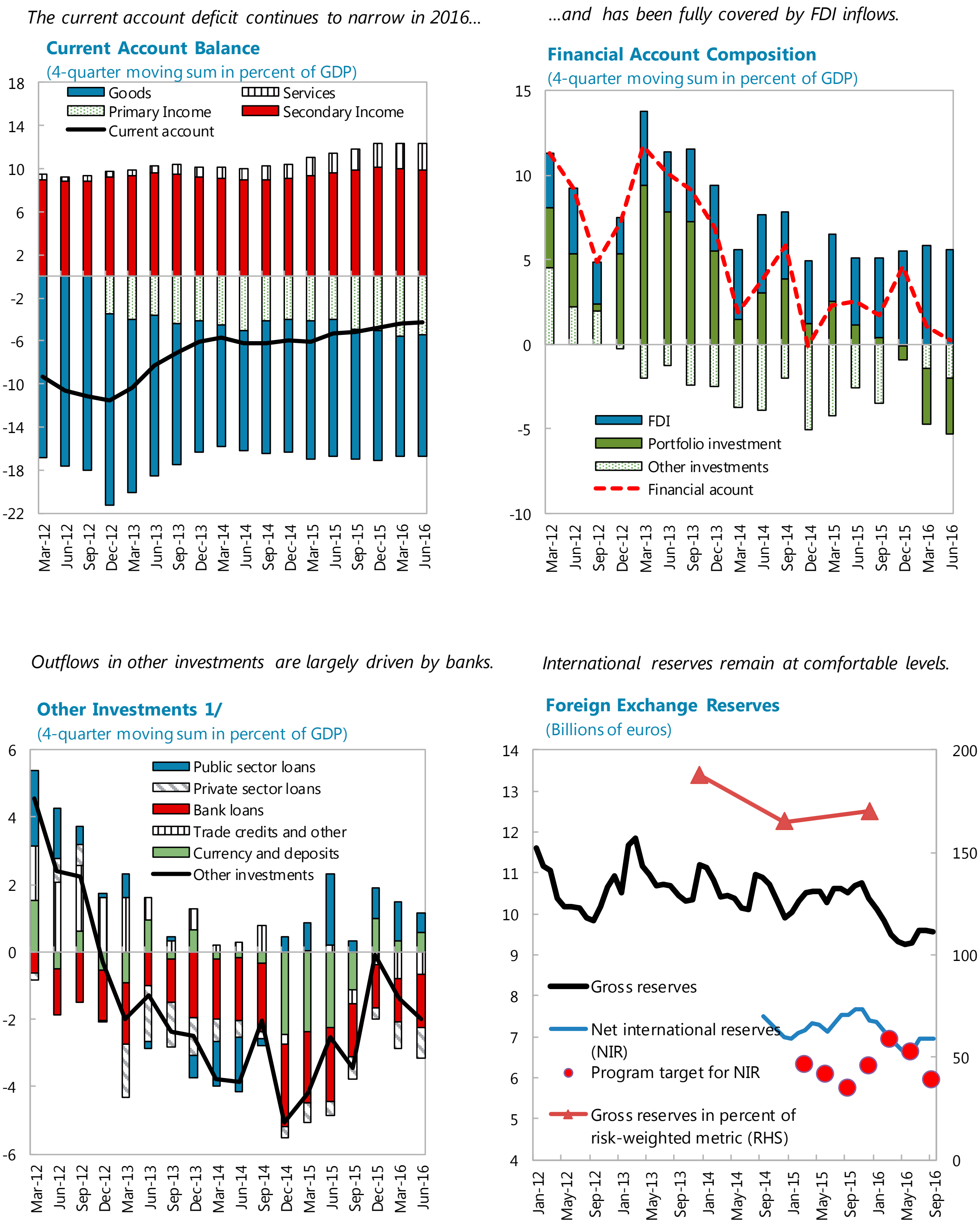
36. Staff supports the authorities request for the completion of the Sixth Review under the Stand-By Arrangement, and the shifting of the arrangement to a semi-annual review schedule, given the program performance so far and the policy commitments going forward. The move to semi-annual review is warranted given the improved fiscal and financial situation, and the increasing focus on longer-term structural reform implementation.

Figure 1. Serbia: Real Sector Developments, 2010–16



Sources: Haver, SORS and IMF staff calculations.

Figure 2. Serbia: Balance of Payments and NIR, 2012–16



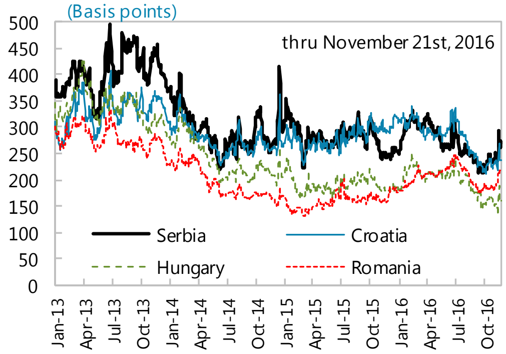
Sources: Haver; and IMF staff calculations.

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

Figure 3. Serbia: Recent Financial and Exchange Rate Developments, 2013–16

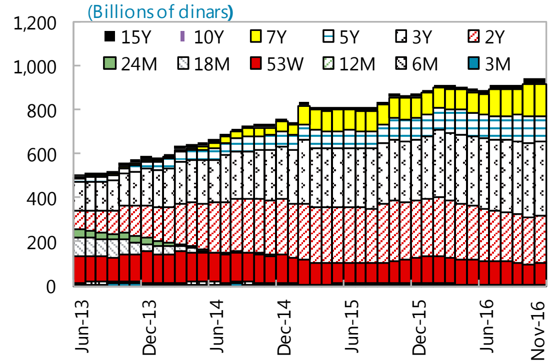
The EMBI spreads declined recently.

Sovereign Risk -EMBI spreads
(Basis points)



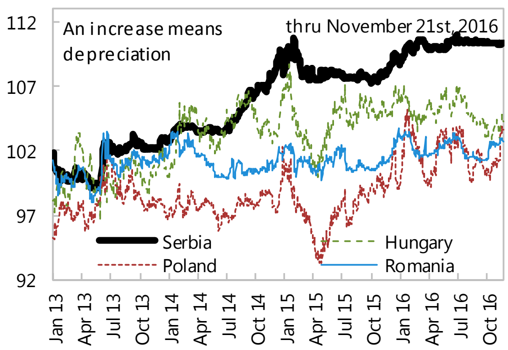
The authorities continued to lengthen the maturity of domestic securities.

T-Bill & T-Bond Stock 1/
(Billions of dinars)



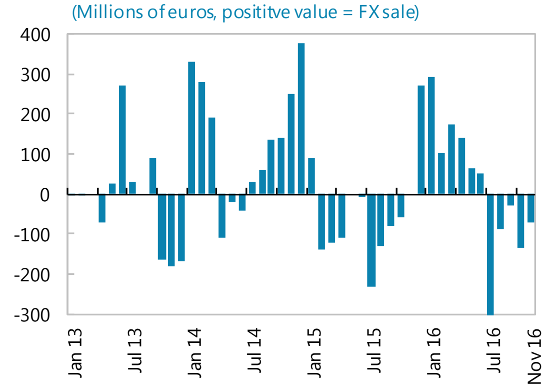
The exchange rate has been stable through 2016...

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



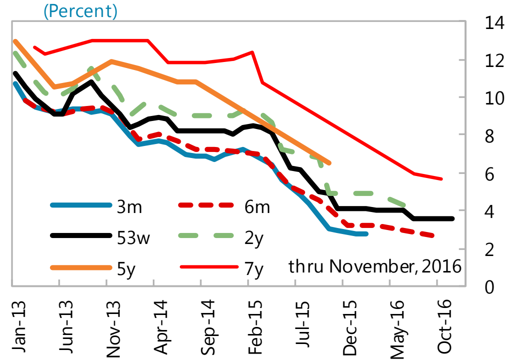
....although some of the pressure was absorbed by intervention.

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



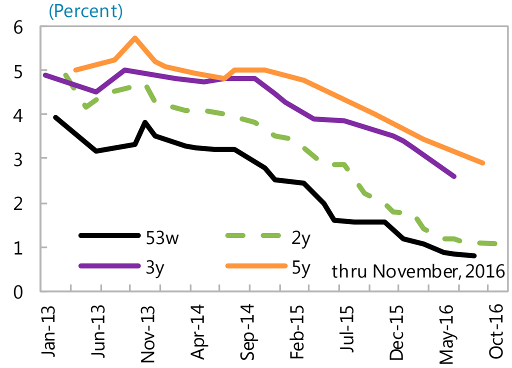
Yields in dinar denominated securities have been declining ...

Yields on Dinar-Denominated Domestic Securities
(Percent)



...as well as in euro-denominated securities.

Yields on Euro-Denominated Domestic Securities
(Percent)

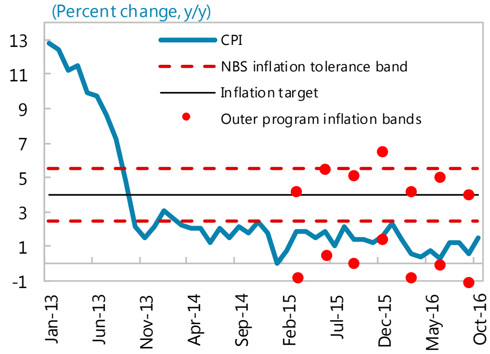


Sources: Serbian Authorities; Bloomberg; and Haver.
1/ Sum of dinar and FX-denominated securities at current exchange rate.

Figure 4. Serbia: Inflation and Monetary Policy, 2013–16

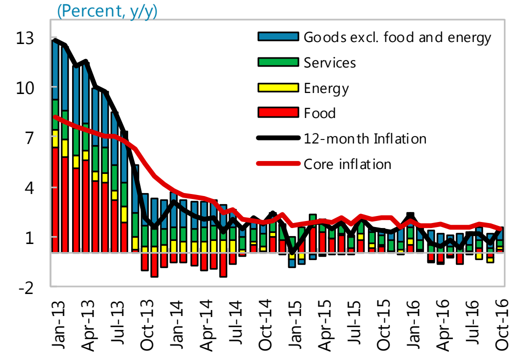
Headline inflation remained low…

Inflation
(Percent change, y/y)



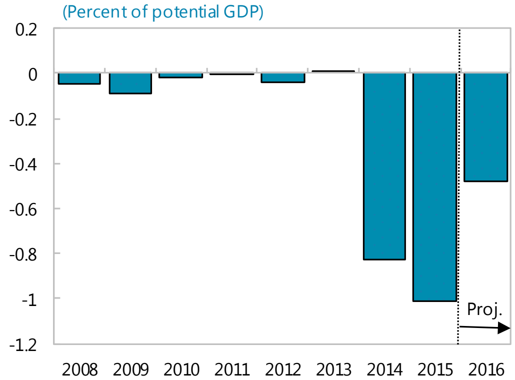
…mainly due to weak food and energy prices.

Contribution to Annual Inflation
(Percent, y/y)



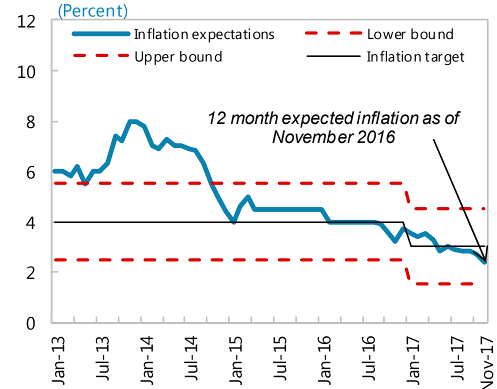
Still open output gap contributes to low inflationary pressures…

Output Gap
(Percent of potential GDP)



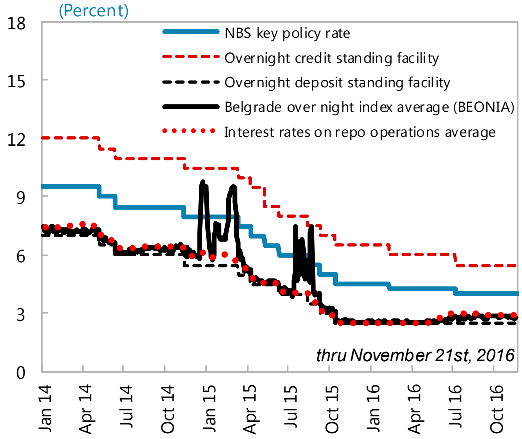
…and inflation expectations continue to drop.

One-Year Ahead Inflation Expectations
(Percent)



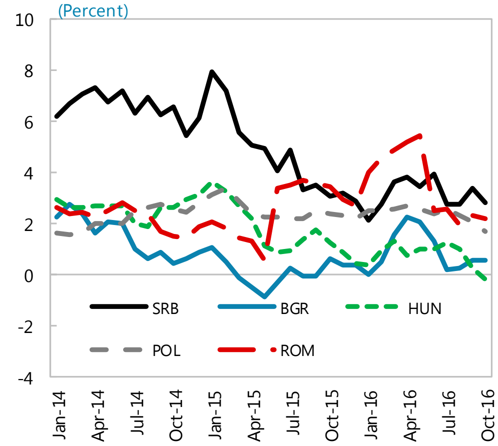
The NBS has reduced the key policy rate to a historic low…

Interest Rates
(Percent)



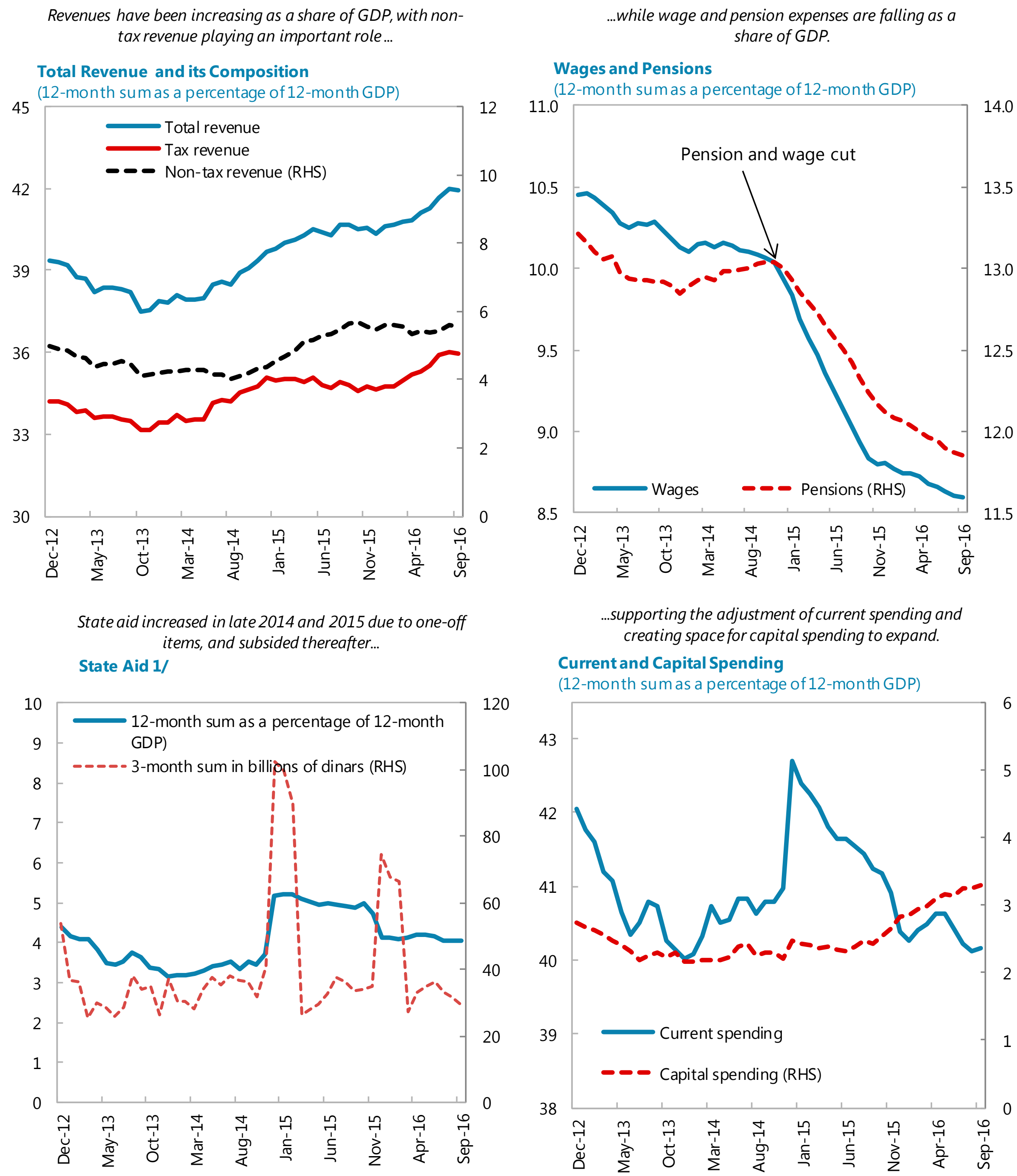
…bringing it closer to peer countries in real terms.

Policy Rate in Real Terms in Selected Countries 1/
(Percent)



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 5. Serbia: Fiscal Developments, 2012–16



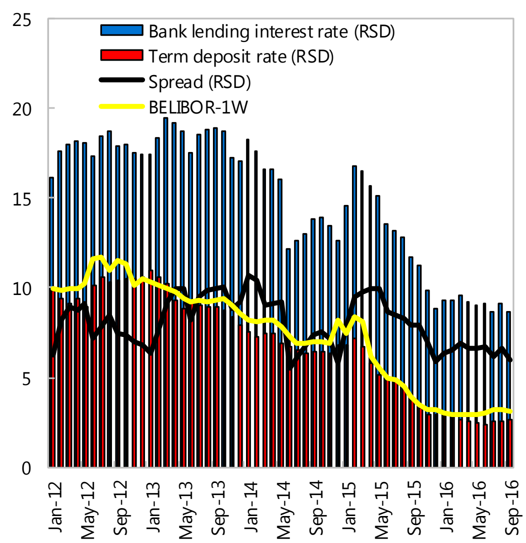
Sources: Ministry of Finance; and IMF staff calculations.

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.

Figure 6. Serbia: Selected Interest Rates, 2012–16

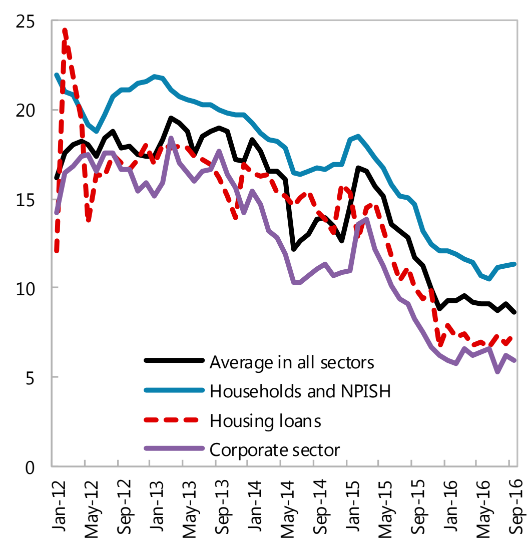
Easing of monetary policy has led to a decline in dinar interest rates...

Selected interest rates (RSD)
(Percent)



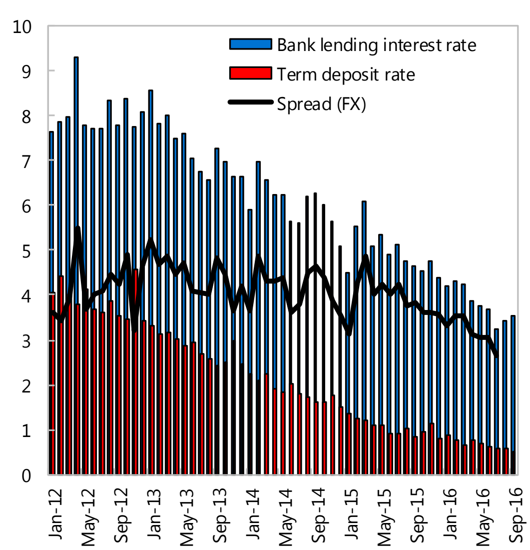
...in both corporate and household markets.

Bank lending interest rates: RSD
(Percent)



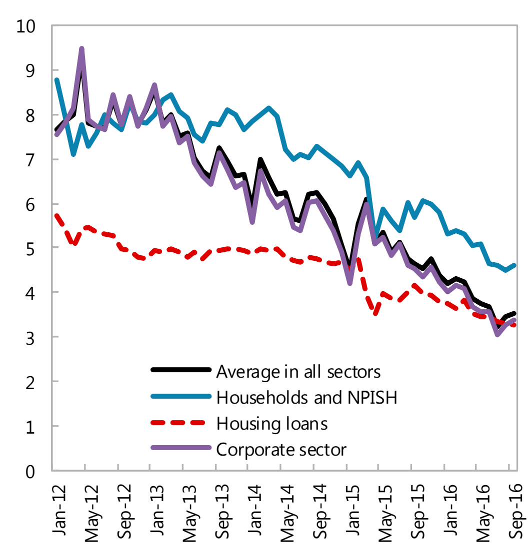
FX (or FX-linked) interest rates have been declining, too...

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.

Table 1. Serbia: Selected Economic and Social Indicators, 2011–17

	2011	2012	2013	2014	2015	2016		2017	
						4th/5th	Proj.	4th/5th	Proj.
	(Percent change, unless otherwise indicated)								
Real sector									
Real GDP	1.4	-1.0	2.6	-1.8	0.8	2.5	2.7	2.8	3.0
Real domestic demand (absorption)	3.1	-0.5	-1.9	-1.1	1.4	1.7	1.8	2.1	2.2
Consumer prices (average)	11.1	7.3	7.7	2.1	1.4	1.3	1.1	3.2	2.4
GDP deflator	9.6	6.3	5.4	2.7	2.7	1.8	1.3	2.5	1.6
Unemployment rate (in percent) 1/	23.6	24.6	23.0	20.1	18.5	...	...	...	...
Nominal GDP (in billions of dinars) 2/	3,408	3,584	3,876	3,908	4,043	4,147	4,203	4,369	4,397
	(Percent of GDP)								
General government finances									
Revenue	38.2	39.4	37.9	39.7	40.4	41.3	41.8	40.4	40.9
Expenditure	43.1	46.6	43.5	46.3	44.0	43.7	43.9	42.6	42.6
Current	38.9	42.5	40.8	42.7	40.4	39.9	39.8	38.5	38.5
Capital and net lending	4.1	3.8	2.5	2.8	2.9	3.0	3.2	3.5	3.3
Amortization of called guarantees	0.2	0.3	0.2	0.8	0.7	0.8	0.9	0.7	0.8
Fiscal balance 3/	-4.9	-7.2	-5.6	-6.6	-3.7	-2.5	-2.1	-2.2	-1.7
Primary fiscal balance (cash basis)	-3.6	-5.3	-3.2	-3.7	-0.5	1.0	1.2	1.3	1.4
Structural primary fiscal balance 4/	-3.6	-4.3	-2.6	-2.6	-0.1	0.9	1.3	1.3	1.5
Gross debt	46.6	57.9	61.1	71.9	76.0	76.8	73.7	75.1	72.4
	(End of period 12-month change, percent)								
Monetary sector									
Money (M1)	16.8	3.8	23.7	9.7	17.0	13.9	17.5	12.5	10.5
Broad money (M2)	10.4	9.2	4.2	8.3	7.2	8.8	9.2	8.2	5.3
Domestic credit to non-government 5/	8.5	3.3	-5.3	-1.1	2.8	4.5	5.5	6.0	3.8
	(Period average, percent)								
Interest rates (dinar)									
NBS key policy rate	11.5	10.1	11.0	9.0	6.1	...	...		...
Interest rate on new FX and FX-indexed loans	8.2	8.0	7.3	6.0	5.0	...	...		...
	(Percent of GDP, unless otherwise indicated)								
Balance of payments									
Current account balance	-8.6	-11.5	-6.1	-6.0	-4.7	-4.2	-4.2	-3.9	-3.9
Exports of goods	25.3	26.5	30.8	31.9	33.9	36.2	35.9	38.3	37.9
Imports of goods	-41.2	-44.2	-42.9	-44.3	-45.8	-47.1	-46.5	-49.2	-48.5
Trade of goods balance	-15.9	-17.8	-12.1	-12.3	-11.9	-10.9	-10.6	-10.9	-10.7
Capital and financial account balance	13.3	7.9	9.5	1.4	4.5	3.5	1.1	4.4	3.9
External debt (percent of GDP)	74.5	84.3	79.4	83.1	85.1	84.0	79.3	80.9	75.7
of which: Private external debt	40.0	42.7	36.8	34.6	33.3	31.0	30.1	28.9	28.2
Gross official reserves (in billions of euro)	12.1	10.9	11.2	9.9	10.4	10.1	9.3	10.3	9.3
(in months of prospective imports)	8.5	7.4	7.4	6.3	6.4	5.7	5.3	5.4	5.0
(percent of short-term debt)	259.8	208.9	278.8	258.0	269.3	248.9	249.7	244.5	257.9
(percent of broad money, M2)	85.2	76.8	76.2	65.8	64.6	59.1	53.9	161.7	50.0
(percent of risk-weighted metric)	...	...	187.8	163.2	169.6	163.4	154.2	161.5	152.3
Exchange rate (dinar/euro, period average)	102.0	113.0	113.1	117.2	120.8	...	...	...	...
REER (annual average change, in percent; + indicates appreciation)	9.3	-7.4	7.8	-2.0	-1.6	-0.8	-0.6	1.0	0.3
Social indicators									
Per capita GDP (in US$)	6,424	5,656	6,352	6,199	5,211	5,316	5,369	5,587	5,617
Population (in million)	7.2	7.2	7.2	7.1	7.1	7.1	7.1	7.1	7.1

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

1/ Unemployment rate for working age population (15-64).
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.

Table 2. Serbia: Medium-Term Framework, 2012–21

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
				Actual	4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
					(percent change)							
Real sector												
GDP growth	-1.0	2.6	-1.8	0.8	2.5	2.7	2.8	3.0	3.5	3.5	4.0	4.0
Domestic demand (contribution)	-0.6	-2.2	-1.2	1.6	1.9	2.0	2.3	2.5	3.2	3.5	4.6	4.7
Net exports (contribution)	-0.4	4.8	-0.6	-0.8	0.6	0.6	0.5	0.5	0.3	0.0	-0.6	-0.7
Consumer price inflation (average)	7.3	7.7	2.1	1.4	1.3	1.1	3.2	2.4	3.0	3.0	3.0	3.0
Consumer price inflation (end of period)	12.2	2.2	1.8	1.6	2.0	1.5	3.5	2.8	3.0	3.0	3.0	3.0
Output gap (in percent of potential)	0.0	0.0	-0.8	-1.0	-0.4	-0.5	-0.3	-0.3	-0.2	-0.1	0.0	0.0
Potential GDP growth	-1.0	2.5	-1.0	0.9	1.8	2.1	2.7	2.8	3.4	3.4	3.9	4.0
Domestic credit to non-gov. (program exchange rate) 1/	3.3	-5.3	-1.1	2.8	4.5	5.5	6.0	3.8	6.5	5.4	6.1	5.6
					(percent of GDP, unless otherwise indicated)							
General government												
Revenue	39.4	37.9	39.7	40.4	41.3	41.8	40.4	40.9	40.7	40.5	40.3	39.9
Expenditure	46.6	43.5	46.3	44.0	43.7	43.9	42.6	42.6	42.0	41.5	41.2	41.0
Current	42.5	40.8	42.7	40.4	39.9	39.8	38.4	38.5	38.1	37.5	37.1	36.9
of which: Wages and salaries	10.5	10.1	9.9	8.8	8.6	8.6	8.2	8.4	8.3	8.1	8.0	8.0
of which: Pensions	13.2	12.8	13.0	12.1	12.1	12.0	11.6	11.6	11.4	11.2	11.0	11.0
of which: Goods and services	8.0	7.2	7.9	7.5	7.9	8.0	7.6	8.0	8.0	8.0	8.0	7.9
Capital and net lending	3.8	2.5	2.8	2.9	3.0	3.2	3.5	3.3	3.5	3.5	3.7	3.7
Amortization of called guarantees	0.3	0.2	0.8	0.7	0.8	0.9	0.7	0.8	0.4	0.4	0.4	0.4
Fiscal balance 2/	-7.2	-5.6	-6.6	-3.7	-2.5	-2.1	-2.2	-1.7	-1.3	-1.0	-1.0	-1.0
change (+ = consolidation)	*-2.3*	*1.6*	*-1.0*	*2.9*	*1.3*	*1.6*	*0.3*	*0.4*	*0.4*	*0.3*	*0.0*	*-0.1*
Primary fiscal balance	-5.3	-3.2	-3.7	-0.5	1.0	1.2	1.3	1.4	1.8	2.0	2.0	1.8
change (+ = consolidation)	*-1.8*	*2.1*	*-0.5*	*3.2*	*1.5*	*1.6*	*0.2*	*0.3*	*0.4*	*0.2*	*0.0*	*-0.2*
change (+ = consolidation)	*-1.4*	*1.2*	*-0.5*	*2.3*	*0.8*	*1.3*	*0.5*	*0.3*	*0.1*	*0.4*	*0.1*	*1.6*
One-off fiscal items, net 3/	-1.0	-0.6	-0.7	0.0	0.2	0.0	0.0	0.1	0.3	0.2	0.1	0.1
Structural primary balance	-4.3	-2.6	-2.6	-0.1	0.9	1.3	1.3	1.5	1.6	1.8	1.8	1.7
change (+ = consolidation)	*-0.8*	*1.7*	*0.0*	*2.6*	*1.0*	*1.4*	*0.4*	*0.2*	*0.1*	*0.2*	*0.0*	*-0.1*
Structural primary balance net of capital expenditures	-1.0	-0.5	-0.2	2.8	3.9	4.4	4.7	4.7	5.0	5.3	5.5	5.4
Gross debt	57.9	61.1	71.9	76.0	76.8	73.7	75.1	72.4	70.4	67.4	64.4	61.5
Effective interest rate on government borrowing (percent)	3.8	4.3	4.5	4.4	4.7	4.5	4.7	4.5	4.6	4.5	4.6	4.5
Domestic borrowing (including FX)	4.9	5.7	5.9	5.8	6.1	5.9	6.1	6.0	5.8	5.6	5.7	5.7
External borrowing	2.9	3.3	3.5	3.5	3.7	3.6	3.8	3.5	3.8	3.8	3.9	3.9
					(percent of GDP, unless otherwise indicated)							
Balance of payments												
Current account	-11.5	-6.1	-6.0	-4.7	-4.2	-4.2	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
of which: Trade balance	-17.8	-12.1	-12.3	-11.9	-10.9	-10.6	-10.9	-10.7	-10.3	-9.9	-10.0	-10.1
of which: Current transfers, net (excl. grants)	9.0	9.1	8.7	9.5	9.0	9.0	9.2	8.9	8.3	7.9	7.9	7.9
Capital and financial account	7.9	9.5	1.4	4.5	3.5	1.1	4.4	3.9	4.2	4.7	4.9	4.8
of which: Foreign direct investment	2.1	3.6	3.7	5.4	4.7	5.2	4.2	4.8	4.3	4.2	4.2	4.2
External debt (end of period)	84.3	79.4	83.1	85.1	84.0	79.3	80.9	75.7	71.3	67.6	64.0	60.4
of which: Private external debt	42.7	36.8	34.6	33.3	31.0	30.1	28.9	28.2	25.9	24.1	22.5	21.0
Gross official reserves												
(in billions of euros)	10.9	11.2	9.9	10.4	10.1	9.3	10.3	9.3	9.4	9.7	10.1	10.5
(in percent of short-term external debt)	208.9	278.8	258.0	269.3	248.9	249.7	244.5	257.9	279.3	223.3	232.8	242.1
REER (ann. av. change; + = appreciation)	-7.4	7.8	-2.0	-1.6	-0.8	-0.6	1.0	0.3	1.3	1.1	1.2	1.1

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, 2012–21

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
					4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
					(Percent change, unless otherwise noted)							
Real												
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	0.8	2.5	2.7	2.8	3.0	3.5	3.5	4.0	4.0
Domestic demand	-0.5	-1.9	-1.1	1.4	1.7	1.8	2.1	2.2	2.9	3.1	4.2	4.2
Consumption	-1.2	-0.7	-1.2	0.1	0.7	1.3	0.9	1.4	2.3	2.8	3.9	4.0
Non-government	-2.0	-0.6	-1.3	0.5	0.4	0.6	1.3	1.4	2.2	2.9	4.0	4.2
Government	1.9	-1.1	-0.6	-1.5	1.9	3.9	-1.1	1.6	2.6	2.3	3.3	3.3
Investment	2.9	-7.2	-0.4	7.7	6.4	3.9	7.2	5.4	5.4	4.5	5.3	4.8
Gross fixed capital formation	19.1	-16.3	-3.6	5.6	6.7	6.4	7.7	5.7	5.7	4.9	5.6	5.0
Non-government	21.3	-13.0	-5.8	3.9	6.5	5.0	6.0	5.5	5.0	5.0	5.0	5.0
Government	7.6	-35.8	13.6	17.0	7.7	14.7	17.4	7.0	9.5	4.1	8.5	5.5
Exports of goods and services	0.8	21.3	5.7	10.2	9.9	9.2	8.8	7.7	7.7	7.6	7.4	7.3
Imports of goods and services	1.4	5.0	5.6	9.3	6.8	6.2	6.4	5.3	5.8	6.3	7.1	7.1
					(contributions to GDP, percent)							
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	0.8	2.5	2.7	2.8	3.0	3.5	3.5	4.0	4.0
Domestic demand (absorption)	-0.6	-2.2	-1.2	1.6	1.9	2.0	2.3	2.5	3.2	3.5	4.6	4.7
Net exports of goods and services	-0.4	4.8	-0.6	-0.8	0.6	0.6	0.5	0.5	0.3	0.0	-0.6	-0.7
Consumption	-1.2	-0.6	-1.1	0.1	0.6	1.2	0.8	1.3	2.0	2.5	3.4	3.6
Non-government	-1.6	-0.4	-1.0	0.3	0.3	0.5	1.0	1.0	1.6	2.1	2.8	3.0
Government	0.4	-0.2	-0.1	-0.3	0.3	0.7	-0.2	0.3	0.5	0.4	0.6	0.6
Investment	0.6	-1.5	-0.1	1.5	1.3	0.8	1.6	1.2	1.2	1.0	1.2	1.1
Gross fixed capital formation	3.7	-3.8	-0.7	1.0	1.3	1.2	1.6	1.2	1.2	1.0	1.2	1.1
Non-government	3.4	-2.5	-1.0	0.6	1.1	0.8	1.1	0.9	0.9	0.9	0.9	0.9
Government	0.2	-1.2	0.3	0.4	0.2	0.4	0.5	0.2	0.3	0.1	0.3	0.2
Change in inventories	-3.1	2.2	0.6	0.5	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	0.3	7.4	2.3	4.5	4.7	4.5	4.5	4.0	4.1	4.2	4.3	4.4
Imports of goods and services	0.7	2.6	3.0	5.4	4.1	3.8	4.0	3.4	3.9	4.2	4.9	5.1
					(Percent change, unless otherwise noted)							
Nominal												
Gross Domestic Product (GDP)	5.2	8.2	0.8	3.5	4.4	4.0	5.4	4.6	6.4	6.6	7.1	7.1
Domestic demand (absorption), contribution to GDP growth	7.3	3.1	1.1	2.7	3.1	2.4	5.5	4.7	6.2	6.5	7.6	7.6
Net exports of goods and services, contribution to GDP growth	-2.1	5.1	-0.2	0.8	1.3	1.5	-0.1	-0.1	0.2	0.1	-0.5	-0.5
Non-government	5.2	5.6	1.3	2.2	1.6	1.7	4.6	3.8	5.3	6.0	7.1	7.3
Government	7.4	3.5	0.6	-5.3	3.7	5.5	0.6	2.4	5.4	5.4	6.4	6.4
Investment	9.9	-9.1	-0.1	11.5	7.1	1.1	11.0	8.4	7.8	7.0	7.8	7.1
Gross fixed capital formation	21.1	-11.9	-2.4	9.7	6.7	5.5	10.5	7.9	9.0	8.0	8.8	8.2
Non-government	22.7	-7.6	-5.0	8.2	6.5	4.0	8.7	7.6	8.1	8.1	8.2	8.1
Government	13.7	-33.5	15.1	18.6	7.7	13.5	20.4	9.2	12.7	7.2	11.8	8.7
Exports of goods and services	14.3	20.7	6.2	11.3	9.0	9.4	11.6	9.5	9.2	9.4	9.1	9.1
Imports of goods and services	14.2	4.7	5.3	7.7	5.3	5.0	10.1	8.4	7.6	8.1	8.9	8.9
Memorandum items:												
GDP deflator (percent)	6.3	5.4	2.7	2.7	1.8	1.3	2.5	1.6	2.8	3.0	3.0	3.0

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

Table 4a. Serbia: Balance of Payments, 2012–21 1/

(In billions of euros)

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
					4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of euros)							
Current account balance	-3.6	-2.1	-2.0	-1.6	-1.4	-1.5	-1.4	-1.4	-1.5	-1.5	-1.7	-1.8
Trade of goods balance	-5.6	-4.2	-4.1	-4.0	-3.7	-3.6	-3.8	-3.8	-3.9	-4.0	-4.3	-4.6
Exports of goods	8.4	10.5	10.6	11.4	12.2	12.3	13.5	13.5	14.7	16.1	17.5	19.0
Imports of goods	-14.0	-14.7	-14.8	-15.4	-15.9	-15.9	-17.3	-17.2	-18.6	-20.0	-21.8	-23.6
Services balance	0.1	0.3	0.5	0.7	0.9	0.9	1.1	1.1	1.2	1.4	1.5	1.6
Exports of nonfactor services	3.1	3.4	3.8	4.3	4.6	4.5	5.1	4.8	5.1	5.6	6.1	6.6
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.5	-3.7	-3.6	-4.0	-3.7	-3.9	-4.2	-4.6	-5.0
Income balance	-1.1	-1.4	-1.3	-1.7	-1.8	-1.9	-1.9	-1.9	-2.0	-2.1	-2.3	-2.4
Net interest	-0.8	-0.9	-0.9	-1.0	-0.9	-0.9	-0.8	-0.8	-0.9	-0.9	-1.0	-1.1
Current transfer balance	2.9	3.2	3.0	3.3	3.1	3.1	3.3	3.3	3.2	3.2	3.4	3.6
Others, including private remittances	2.9	3.1	2.9	3.2	3.0	3.1	3.2	3.2	3.1	3.2	3.4	3.6
Capital and financial account balance 2/	2.5	3.3	0.5	1.5	1.2	0.4	1.6	1.4	1.6	1.9	2.1	2.2
Foreign direct investment balance	0.7	1.2	1.2	1.8	1.6	1.8	1.5	1.7	1.6	1.7	1.8	1.9
Portfolio investment balance	1.7	1.9	0.4	-0.3	0.4	-0.7	0.8	-0.3	0.2	0.6	0.3	0.3
of which: debt liabilities	1.7	2.0	0.4	-0.2	0.4	-0.7	0.8	-0.3	0.2	0.6	0.3	0.3
Other investment balance	0.2	0.1	-1.1	0.0	-0.8	-0.7	-0.8	0.0	-0.3	-0.4	0.0	0.0
Public sector 2/ 3/	0.5	0.4	0.7	0.5	-0.1	0.2	-0.5	0.2	0.0	-0.3	0.0	0.0
Domestic banks	-0.4	-0.5	-1.5	-0.1	-0.4	-0.7	-0.1	0.0	0.0	0.0	0.0	0.0
Other private sector 4/	0.1	0.1	-0.4	-0.4	-0.3	-0.2	-0.2	-0.3	-0.2	-0.1	0.0	0.0
Errors and omissions	0.2	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	0.3	-0.2	-1.1	0.2	0.0	0.1	0.3	0.4	0.4
Financing	0.9	-1.3	1.2	-0.3	0.2	1.1	-0.2	0.0	-0.1	-0.3	-0.4	-0.4
Gross international reserves (increase, -)	1.1	-0.7	1.8	-0.2	0.2	1.1	-0.2	0.0	-0.1	-0.3	-0.4	-0.4
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Use of Fund credit, net	-0.2	-0.6	-0.6	-0.1	-0.01	-0.01	0.00	0.0	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	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	-0.01	-0.01	0.00	0.0	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, 2012–21 1/

(Percent of GDP)

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
					4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-11.5	-6.1	-6.0	-4.7	-4.2	-4.2	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
Trade of goods balance	-17.8	-12.1	-12.3	-11.9	-10.9	-10.6	-10.9	-10.7	-10.3	-9.9	-10.0	-10.1
Exports of goods	26.5	30.8	31.9	33.9	36.2	35.9	38.3	37.9	39.1	40.1	40.9	41.6
Imports of goods	-44.2	-42.9	-44.3	-45.8	-47.1	-46.5	-49.2	-48.5	-49.4	-50.1	-50.9	-51.7
Services balance	0.4	0.9	1.4	2.2	2.7	2.7	3.0	3.0	3.3	3.5	3.6	3.6
Income balance	-3.4	-4.1	-4.0	-5.0	-5.3	-5.4	-5.5	-5.5	-5.3	-5.3	-5.3	-5.4
Current transfer balance	9.3	9.2	9.0	10.0	9.3	9.1	9.5	9.2	8.4	7.9	7.9	7.9
Official grants	0.3	0.1	0.3	0.5	0.3	0.1	0.3	0.3	0.1	0.0	0.0	0.0
Others, including private remittances	9.0	9.1	8.7	9.5	9.0	9.0	9.2	8.9	8.3	7.9	7.9	7.9
Capital and financial account balance 2/	7.9	9.5	1.4	4.5	3.5	1.1	4.4	3.9	4.2	4.7	4.9	4.8
Capital transfers balance	0.0	0.0	0.0	-0.1	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	5.4	4.7	5.2	4.2	4.8	4.3	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	-0.9	1.1	-2.0	2.4	-0.7	0.6	1.5	0.7	0.7
Other investment balance	0.5	0.3	-3.4	0.0	-2.2	-2.1	-2.2	-0.1	-0.7	-1.0	0.0	0.0
Public sector 2/ 3/	1.5	1.2	2.2	1.4	-0.3	0.5	-1.3	0.7	-0.1	-0.8	0.0	0.0
Domestic banks	-1.3	-1.3	-4.5	-0.2	-1.1	-2.0	-0.2	-0.1	0.0	0.0	0.0	0.0
Other private sector 4/	0.4	0.4	-1.1	-1.2	-0.8	-0.6	-0.6	-0.8	-0.7	-0.3	-0.1	0.0
Errors and omissions	0.7	0.5	0.8	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	0.9	-0.7	-3.2	0.6	0.0	0.3	0.8	1.0	0.9
Memorandum items:												
Export growth	-0.5	25.6	1.0	6.7	7.6	8.4	10.2	9.4	9.4	9.0	8.8	8.9
Import growth	2.0	4.7	0.4	4.1	3.5	3.8	8.8	8.3	7.8	7.7	8.7	8.7
Export volume growth	-0.8	21.9	1.7	8.7	9.9	9.9	8.8	8.6	8.3	7.6	7.4	7.3
Import volume growth	0.8	2.7	1.9	8.8	6.8	6.5	6.4	6.3	6.4	6.3	7.1	7.0
Trading partner import growth	-0.8	2.6	4.3	1.4	3.3	3.7	5.1	5.1	4.9	4.4	4.4	4.4
Export prices growth	0.3	3.0	-0.7	-1.9	-2.1	-1.4	1.3	0.7	1.0	1.3	1.4	1.5
Import prices growth	1.2	2.0	-1.5	-4.3	-3.1	-2.6	2.3	1.9	1.3	1.4	1.5	1.6
Change in terms of trade	-0.9	1.0	0.8	2.6	1.0	1.2	-1.0	-1.2	-0.3	0.0	-0.1	-0.1
Gross official reserves (in billions of euro)	10.9	11.2	9.9	10.4	10.1	9.3	10.3	9.3	9.4	9.7	10.1	10.5
(In months of prospective imports of GNFS)	7.4	7.4	6.3	6.4	5.7	5.3	5.4	5.0	4.7	4.4	4.2	4.2
(in percent of short-term debt)	208.9	278.8	258.0	269.3	248.9	249.7	244.5	257.9	279.3	223.3	232.8	242.1
(in percent of broad money, M2)	76.8	76.2	65.8	64.6	59.1	53.9	56.0	50.0	47.1	45.8	44.7	43.4
(in percent of risk-weighted metric) 5/	...	187.8	163.2	169.6	163.4	154.2	161.7	152.3	151.5	148.8	149.2	150.1

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).

5/ Formulas for calculation revised as compared to the third review.

Table 5. Serbia: External Financing Requirements, 2012–21

	2012	2013	2014	2015	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.
				(percent of GDP)						
1. Gross financing requirements	22.5	23.4	12.6	16.7	12.3	14.4	13.8	13.1	15.1	15.1
Current account deficit	11.5	6.1	6.0	4.7	4.2	3.9	3.9	3.9	3.9	3.9
Debt amortization	14.6	15.2	12.0	11.5	11.2	10.5	9.6	8.4	10.2	10.3
Medium and long-term debt	12.6	13.8	11.4	11.2	10.5	9.5	8.6	7.5	9.4	9.5
Public sector	5.1	6.9	6.6	7.2	5.2	6.5	6.1	3.8	6.3	6.9
Of which: IMF	0.7	1.8	1.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Eurobonds	0.0	0.0	0.0	0.1	0.5	2.3	2.3	0.0	3.0	3.9
Of which: Domestic bonds (non-residents)	n.a.	2.5	3.0	4.5	2.5	0.7	1.5	1.8	1.6	1.5
Commercial banks	1.8	3.2	2.8	2.2	2.7	0.9	0.8	1.2	1.3	1.0
Corporate sector	5.7	3.7	2.0	1.8	2.6	2.0	1.7	2.5	1.8	1.6
Short-term debt	2.0	1.4	0.6	0.3	0.7	1.0	0.9	0.9	0.8	0.8
Public sector	0.0	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	0.6	0.6	0.5	0.5	0.5
Corporate sector	0.2	0.2	0.1	0.1	0.4	0.3	0.3	0.3	0.3	0.3
Change in gross reserves (increase=+)	-3.6	2.0	-5.4	0.5	-3.2	0.0	0.3	0.8	1.0	0.9
2. Available financing	22.5	23.4	12.6	16.7	12.3	14.4	13.8	13.1	15.1	15.1
Capital transfers	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	2.1	3.6	3.7	5.4	5.2	4.8	4.3	4.2	4.2	4.2
Portfolio investment (net) 1/	-0.1	-0.1	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Debt financing	19.0	17.8	11.3	10.7	7.5	9.6	9.5	8.9	10.9	10.9
Medium and long-term debt	17.5	17.3	11.0	9.9	6.5	8.7	8.6	8.0	10.1	10.1
Public sector 2/	10.3	12.1	8.6	7.8	3.8	6.6	6.7	4.5	7.1	7.6
Of which: Eurobonds	4.4	5.5	0.0	0.0	0.0	0.0	2.7	1.3	3.5	4.4
Of which: Domestic bonds (non-residents)	n.a.	3.9	4.5	4.3	1.0	2.3	1.7	2.0	1.9	1.8
Commercial banks	1.0	1.7	0.6	0.7	1.2	0.8	0.8	1.2	1.3	1.0
Corporate sector	6.1	3.5	1.8	1.4	1.5	1.3	1.1	2.3	1.7	1.6
Short-term debt	1.6	0.6	0.3	0.8	1.0	1.0	0.9	0.9	0.8	0.8
Public sector	0.0	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	0.4	0.6	0.6	0.6	0.5	0.5	0.5
Corporate sector	0.2	0.1	0.1	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Other net capital inflows 3/	1.5	2.1	-2.3	0.9	-0.4	0.0	0.0	0.0	0.0	0.0
o/w currency and deposits and trade credit	1.1	2.0	2.8	-0.3	0.3	0.0	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	0.0
Memorandum items:										
Debt service	17.0	17.7	14.5	14.2	13.8	12.7	11.9	10.8	12.5	12.6
Interest	2.3	2.4	2.5	2.7	2.6	2.2	2.3	2.3	2.3	2.3
Amortization	14.6	15.2	12.0	11.5	11.2	10.5	9.6	8.4	10.2	10.3

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, 2012–21 1/

(In billions of RSD)

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
					4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of RSD)							
Revenue	1,411	1,468	1,552	1,632	1,712	1,755	1,765	1,799	1,904	2,019	2,150	2,286
Taxes	1,226	1,296	1,370	1,400	1,476	1,510	1,545	1,573	1,672	1,779	1,904	2,028
Personal income tax	165	156	146	147	153	155	161	163	174	184	197	210
Social security contributions	379	418	440	443	463	462	494	488	523	561	601	641
Taxes on profits	55	61	73	63	64	78	67	81	85	92	99	106
Value-added taxes	367	381	410	416	435	447	454	467	497	531	569	604
Excises	181	205	212	236	260	265	265	270	284	296	315	336
Taxes on international trade	36	33	31	33	36	36	38	39	40	43	47	51
Other taxes	43	43	57	63	66	66	67	65	69	72	76	81
Non-tax revenue	180	163	171	221	223	226	209	212	219	226	233	243
Capital revenue	1	5	2	3	0	6	0	0	0	0	0	0
Grants	3	3	9	7	13	13	11	13	13	14	14	15
Expenditure	1,669	1,686	1,810	1,780	1,814	1,844	1,859	1,874	1,967	2,069	2,202	2,345
Current expenditure	1,523	1,582	1,669	1,633	1,654	1,671	1,679	1,693	1,781	1,871	1,984	2,110
Wages and salaries 2/	375	393	389	356	359	359	356	370	387	404	429	458
Goods and services	287	278	310	303	327	338	334	350	373	398	425	451
Interest	68	95	115	130	144	139	149	139	147	150	157	162
Subsidies	145	130	158	134	112	120	110	108	113	120	129	138
Transfers	647	687	697	710	712	715	729	725	761	799	845	902
Pensions 3/	474	498	508	490	502	505	508	510	534	561	590	629
Other transfers 4/	174	189	189	219	210	210	221	215	227	239	255	273
Capital expenditure	119	83	97	115	123	130	148	143	161	173	193	210
Net lending	16	13	15	3	2	3	3	4	4	4	4	4
Amortization of activated guarantees	11	9	30	30	34	39	30	35	21	21	20	20
Unidentified measures (cumulative)	…	…	…	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal balance without amortization of activated guarante	-248	-210	-228	-118	-68	-50	-64	-40	-42	-29	-31	-38
Fiscal balance	-259	-218	-258	-149	-102	-89	-94	-75	-63	-50	-52	-59
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0	0	0
Financing	259	218	258	149	102	89	94	75	63	50	52	59
Privatization proceeds	22	3	2	1	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	120	27	113	83	154	51	10	37	44
Banks	130	33	83	164	92	202	49	53	17	-15	-20	-11
Government deposits ((-) means accumulation)	-30	-100	-56	32	0	60	2	-16	-22	1	-2	2
Securities held by banks (net)	98	56	118	92	107	140	58	78	58	10	11	11
Other domestic bank financing	63	76	22	39	-15	2	-11	-9	-19	-26	-29	-24
Non-banks (incl. non-residents)	-14	8	40	-44	-65	-90	34	101	34	26	57	55
Securities held by non-banks (non-residents, net)	34	56	97	35	28	4	50	116	39	31	62	60
Others (incl. amortization)	-48	-48	-58	-80	-93	-93	-16	-16	-5	-5	-5	-5
External	160	192	133	28	75	-24	11	-78	12	40	15	14
Program	0	0	0	17	0	11	0	25	0	0	0	0
Project	43	36	66	55	54	57	61	59	53	40	45	61
Bonds and loans	159	234	88	12	124	22	204	116	179	88	232	272
Amortization	-41	-78	-20	-56	-103	-114	-255	-278	-221	-88	-262	-318
Residual Financing gap/Discrepancy	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:												
Wages and salaries excluding severance payments	375	393	389	356	356	356	354	368	387	404	429	458
Arrears accumulation (domestic)	-7	1	-6	-3	0	0	0	0	0	0	0	0
Quasi-fiscal support to SOEs (gross new issuance of guarantees)	134	112	120	105	4	4	19	23	18	18	17	20
Government deposits (stock)	113	167	174	142	142	82	140	98	120	119	121	119
Gross public debt	2074	2370	2812	3074	3186	3099	3281	3183	3295	3363	3438	3522
Gross public debt (including restitution)	2074	2370	3090	3317	3430	3342	3524	3426	3538	3585	3640	3703
Nominal GDP (billions of dinars)	3584	3876	3908	4043	4147	4203	4369	4397	4678	4987	5342	5723

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, 2012–21 1/
(Percent of GDP)

	2012	2013	2014	2015	2016		2017		2018	2019	2020	2021
					4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
					(percent of GDP)							
Revenue	39.4	37.9	39.7	40.4	41.3	41.8	40.4	40.9	40.7	40.5	40.3	39.9
Taxes	34.2	33.4	35.0	34.6	35.6	35.9	35.4	35.8	35.7	35.7	35.6	35.4
Personal income tax	4.6	4.0	3.7	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Social security contributions	10.6	10.8	11.3	10.9	11.2	11.0	11.3	11.1	11.2	11.2	11.2	11.2
Taxes on profits	1.5	1.6	1.9	1.5	1.6	1.9	1.5	1.8	1.8	1.8	1.8	1.8
Value-added taxes	10.3	9.8	10.5	10.3	10.5	10.6	10.4	10.6	10.6	10.6	10.6	10.5
Excises	5.1	5.3	5.4	5.8	6.3	6.3	6.1	6.1	6.1	5.9	5.9	5.9
Taxes on international trade	1.0	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other taxes	1.2	1.1	1.5	1.6	1.6	1.6	1.5	1.5	1.5	1.4	1.4	1.4
Non-tax revenue	5.0	4.2	4.4	5.5	5.4	5.4	4.8	4.8	4.7	4.5	4.4	4.2
Capital revenue	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	46.6	43.5	46.3	44.0	43.7	43.9	42.6	42.6	42.0	41.5	41.2	41.0
Current expenditure	42.5	40.8	42.7	40.4	39.9	39.8	38.4	38.5	38.1	37.5	37.1	36.9
Wages and salaries 2/	10.5	10.1	9.9	8.8	8.6	8.6	8.2	8.4	8.3	8.1	8.0	8.0
Goods and services	8.0	7.2	7.9	7.5	7.9	8.0	7.6	8.0	8.0	8.0	8.0	7.9
Interest	1.9	2.4	2.9	3.2	3.5	3.3	3.4	3.2	3.1	3.0	2.9	2.8
Subsidies	4.1	3.3	4.0	3.3	2.7	2.9	2.5	2.5	2.4	2.4	2.4	2.4
Transfers	18.1	17.7	17.8	17.6	17.2	17.0	16.7	16.5	16.3	16.0	15.8	15.8
Pensions 3/	13.2	12.8	13.0	12.1	12.1	12.0	11.6	11.6	11.4	11.2	11.0	11.0
Other transfers 4/	4.8	4.9	4.8	5.4	5.1	5.0	5.1	4.9	4.9	4.8	4.8	4.8
Capital expenditure	3.3	2.1	2.5	2.8	3.0	3.1	3.4	3.3	3.4	3.5	3.6	3.7
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	0.8	0.9	0.7	0.8	0.4	0.4	0.4	0.4
Unidentified measures (cumulative)	...	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal balance without guarantees (cash basis)	-6.9	-5.4	-5.8	-2.9	-1.6	-1.2	-1.5	-0.9	-0.9	-0.6	-0.6	-0.7
Fiscal balance (incl. amortization of called guarantees)	-7.2	-5.6	-6.6	-3.7	-2.5	-2.1	-2.2	-1.7	-1.3	-1.0	-1.0	-1.0
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Financing	7.2	5.6	6.6	3.7	2.5	2.1	2.2	1.7	1.3	1.0	1.0	1.0
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	3.1	3.0	0.7	2.7	1.9	3.5	1.1	0.2	0.7	0.8
Banks	3.6	0.9	2.1	4.1	2.2	4.8	1.1	1.2	0.4	-0.3	-0.4	-0.2
Government deposits ((-) means accumulation)	-0.8	-2.6	-1.4	0.8	0.0	1.4	0.0	-0.4	-0.5	0.0	0.0	0.0
Securities held by banks (net)	2.7	1.5	3.0	2.3	2.6	3.3	1.3	1.8	1.2	0.2	0.2	0.2
Other domestic bank financing	1.8	2.0	0.6	1.0	-0.4	0.1	-0.3	-0.2	-0.4	-0.5	-0.5	-0.4
Non-banks (incl. non-residents)	-0.4	0.2	1.0	-1.1	-1.6	-2.1	0.8	2.3	0.7	0.5	1.1	1.0
Securities held by non-banks (non-residents, net)	0.9	1.4	2.5	0.9	0.7	0.1	1.1	2.6	0.8	0.6	1.2	1.0
Others (incl. amortization)	-1.3	-1.2	-1.5	-2.0	-2.2	-2.2	-0.4	-0.4	-0.1	-0.1	-0.1	-0.1
External	4.5	5.0	3.4	0.7	1.8	-0.6	0.2	-1.8	0.2	0.8	0.3	0.3
Program	0.0	0.0	0.0	0.4	0.0	0.3	0.0	0.6	0.0	0.0	0.0	0.0
Project	1.2	0.9	1.7	1.4	1.3	1.3	1.4	1.3	1.1	0.8	0.8	1.1
Bonds and loans	4.4	6.0	2.2	0.3	3.0	0.5	4.7	2.6	3.8	1.8	4.4	4.7
Amortization	-1.2	-2.0	-0.5	-1.4	-2.5	-2.7	-5.8	-6.3	-4.7	-1.8	-4.9	-5.6
Residual Financing gap/Discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Wages and salaries excluding severance payments	10.5	10.1	9.9	8.8	8.6	8.5	8.1	8.4	8.3	8.1	8.0	8.0
Arrears accumulation (domestic)	-0.2	0.0	-0.2	-0.1	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	2.6	0.1	0.1	0.4	0.5	0.4	0.4	0.3	0.4
Government deposits (stock)	3.2	4.3	4.5	3.5	3.4	2.0	3.2	2.2	2.6	2.4	2.3	2.1
Gross financing need	15.9	16.2	16.2	16.5	15.6	15.4	17.0	16.0	14.5	11.1	14.1	14.9
Gross public debt	57.9	61.1	71.9	76.0	76.8	73.7	75.1	72.4	70.4	67.4	64.4	61.5
Gross public debt (including restitution)	57.9	61.1	79.1	82.0	82.7	79.5	80.6	77.9	75.6	71.9	68.1	64.7
Nominal GDP (billions of dinars)	3,584	3,876	3,908	4,043	4,147	4,203	4,369	4,397	4,678	4,987	5,342	5,723

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, 2012–21

	2012	2013	2014	2015	2016			2017		2018	2019	2020	2021
					Sept	4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/												
Net foreign assets 2/	673	847	1037	1087	1091	1147	1063	1189	1070	1088	1135	1191	1253
in billions of euro	5.9	7.4	8.5	8.9	8.9	9.2	8.6	9.5	8.6	8.7	9.1	9.5	10.0
Foreign assets	1420	1427	1475	1480	1434	1503	1408	1538	1413	1433	1480	1537	1599
NBS	1250	1291	1208	1272	1188	1322	1165	1355	1169	1188	1235	1292	1353
Commercial banks	169	136	267	208	245	181	243	182	243	244	245	246	246
Foreign liabilities (-)	-747	-580	-438	-393	-343	-356	-345	-349	-343	-344	-345	-346	-346
NBS	-166	-87	-27	-8	-5	-6	-5	-6	-5	-5	-5	-5	-5
Commercial banks	-581	-493	-412	-385	-338	-350	-340	-343	-338	-339	-340	-341	-341
Net domestic assets	943	836	785	874	950	976	1,071	1,096	1,178	1,317	1,417	1,519	1,624
Domestic credit	2,027	1,886	2,005	2,164	2,305	2,367	2,428	2,528	2,564	2,728	2,840	2,971	3,106
Government, net	95	49	123	223	306	301	373	349	426	444	429	409	398
NBS	-160	-236	-256	-228	-213	-229	-215	-227	-231	-254	-253	-255	-253
Claims on government	1	1	1	1	1	1	1	1	1	1	1	1	1
Liabilities (deposits)	161	237	258	229	214	230	216	228	233	255	254	257	255
Banks	255	285	379	451	519	530	588	576	658	698	682	665	651
Claims on government	290	336	457	538	612	619	681	666	751	791	776	758	745
Liabilities (deposits)	36	51	78	87	93	89	93	90	93	94	94	94	94
Local governments, net	6	1	-8	-7	-14	-7	-19	-7	-19	-19	-19	-19	-19
Non-government sector	1,926	1,837	1,890	1,948	2,012	2,073	2,074	2,186	2,158	2,303	2,430	2,581	2,727
Households	654	675	725	760	825	801	839	845	882	941	993	1,055	1,114
Enterprises	1,226	1,111	1,140	1,162	1,155	1,244	1,207	1,312	1,247	1,331	1,404	1,492	1,576
Other	47	51	25	26	32	28	28	29	29	31	33	35	37
Other assets, net	-1,084	-1,050	-1,220	-1,291	-1,354	-1,391	-1,356	-1,432	-1,386	-1,412	-1,423	-1,452	-1,482
Capital accounts (-)	-876	-830	-927	-952	-989	-980	-982	-1,007	-998	-1,007	-1,005	-1,019	-1,033
NBS	-264	-217	-307	-341	-360	-355	-351	-362	-351	-351	-351	-351	-351
Banks	-611	-613	-620	-610	-629	-626	-631	-645	-647	-656	-653	-667	-681
Provisions (-)	-237	-257	-279	-317	-310	-348	-323	-362	-336	-349	-360	-371	-382
Other assets	28	37	-14	-23	-56	-62	-51	-62	-51	-55	-58	-63	-67
Broad money (M2)	1616	1683	1823	1955	2041	2123	2134	2285	2248	2405	2551	2710	2877
M1	296	366	402	470	521	527	553	591	611	675	734	803	878
Currency in circulation	111	122	130	140	145	157	156	176	172	190	207	226	247
Demand deposits	186	244	271	330	376	370	397	415	439	485	528	577	631
Time and saving deposits	159	149	173	192	165	216	198	242	218	241	262	287	314
Foreign currency deposits	1161	1169	1248	1292	1356	1380	1384	1453	1419	1488	1555	1621	1685
in billions of euro	10.2	10.2	10.3	10.6	11.0	11.1	11.2	11.6	11.5	12.0	12.5	13.0	13.5
Memorandum items:	(year-on-year change unless indicated otherwise)												
M1	3.8	23.7	9.7	17.0	24.8	12.1	17.5	12.1	10.5	10.6	8.7	9.3	9.4
M2	9.2	4.2	8.3	7.2	10.7	8.6	9.2	7.6	5.3	7.0	6.1	6.2	6.1
Velocity (Dinar part of money supply)	7.9	7.5	6.8	6.1	6.1	5.6	5.6	5.2	5.3	5.1	5.0	4.9	4.8
Velocity (M2)	2.2	2.3	2.1	2.1	2.0	2.0	2.0	1.9	2.0	1.9	2.0	2.0	2.0
Deposits at program exchange rate	3.7	2.8	3.8	7.2	8.5	6.7	7.9	6.8	4.8	6.4	5.7	5.9	5.8
Credit to non-gov. (current exchange rate)	7.1	-3.5	3.2	1.2	4.4	3.1	3.1	2.8	1.7	3.9	3.6	4.5	4.3
Credit to non-gov. (program exchange rates) 3,	0.3	-4.2	-1.5	1.0	2.4	1.7	2.0	2.3	1.5	3.6	3.5	4.4	4.2
Domestic	3.3	-5.3	-1.1	2.8	4.4	5.5	5.5	4.9	3.8	6.5	5.4	6.1	5.6
Households	2.1	2.4	3.8	4.7	9.0	5.5	9.7	5.0	4.9	6.5	5.3	6.1	5.6
Enterprises and other sectors	4.0	-9.3	-4.0	1.7	1.3	5.4	2.7	4.9	3.1	6.5	5.4	6.2	5.7
External	-5.0	-2.1	-2.2	-2.4	-1.3	-5.8	-5.0	-3.6	-3.6	-3.5	-1.6	-0.6	0.0
Credit to non-gov. (real terms) 4/	-4.5	-5.5	1.4	-0.3	3.8	0.8	1.6	-0.6	-1.0	0.8	0.6	1.5	1.2
Domestic credit to non-gov. (real terms)	-2.6	-6.7	1.2	1.5	5.5	4.1	4.9	1.9	1.2	3.7	2.4	3.1	2.6
Households	-3.3	1.0	5.7	3.1	9.8	3.1	8.8	1.9	2.2	3.7	2.4	3.1	2.6
Enterprises and other sectors	-2.2	-10.7	-1.5	0.4	2.7	4.7	2.3	1.9	0.5	3.7	2.4	3.1	2.6
External	-8.1	-3.2	1.8	-3.7	0.6	-5.8	-5.1	-6.2	-6.0	-5.9	-4.2	-3.2	-2.8
12-m change in NBS's NFA, billions of euros	-0.1	1.5	-0.2	0.3	0.0	0.5	-0.8	0.1	0.1	0.2	0.3	-9.1	0.0
Deposit euroization (percent of total) 5/	77.1	74.9	73.8	71.2	71.5	70.2	70.0	68.9	68.3	67.2	66.3	65.2	64.1
Credit euroization (percent of total) 5/	69.7	70.6	67.6	70.6	68.1	69.3	68.5	68.8	68.0	67.0	66.0	65.0	64.0

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, 2012–21

	2012	2013	2014	2015	2016			2017		2018	2019	2020	2021
					Sept	4th/5th	Proj.	4th/5th	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/												
Net foreign assets	1085	1204	1182	1265	1183	1316	1160	1349	1164	1183	1230	1286	1348
(In billions of euro)	9.6	10.5	9.7	10.4	9.6	10.6	9.4	10.8	9.4	9.5	9.8	10.3	10.8
Gross foreign reserves	1250	1291	1208	1272	1188	1322	1165	1355	1169	1188	1235	1292	1353
Gross reserve liabilities (-)	-166	-87	-27	-8	-5	-6	-5	-6	-5	-5	-5	-5	-5
Net domestic assets	-470	-584	-601	-647	-659	-705	-639	-702	-645	-621	-628	-639	-653
Net domestic credit	-206	-368	-294	-305	-299	-350	-288	-340	-294	-270	-276	-288	-301
Net credit to government	-160	-236	-256	-228	-213	-229	-215	-227	-231	-254	-253	-255	-253
Claims on government	1	1	1	1 1	1	1	1	1	1	1	1	1	1
Liabilities to government (-)	-161	-237	-258	-229	-214	-230	-216	-228	-233	-255	-254	-257	-255
Liabilities to government (-): local currency	-55	-89	-103	-125	-122	-125	-131	-125	-131	-131	-131	-131	-131
Liabilities to government (-): foreign currency	-106	-148	-154	-103	-92	-105	-85	-103	-102	-124	-124	-126	-124
Net credit to local governmens	-18	-31	-46	-61	-37	-65	-46	-65	-46	-46	-46	-46	-46
Net claims on banks	-39	-110	-7	-30	-64	-68	-41	-61	-30	16	9	0	-15
Capital accounts (-)	-264	-217	-307	-341	-360	-355	-351	-362	-351	-351	-351	-351	-351
Reserve money	614	620	581	618	524	612	521	648	519	562	602	647	695
Currency in circulation	111	122	130	140	145	157	156	176	172	190	207	226	247
Commercial bank reserves	186	200	212	248	188	256	171	262	147	163	177	193	211
Required reserves	140	145	158	145	143	142	146	149	149	157	164	171	177
Excess reserves	45	55	54	103	46	114	25	113	-2	6	13	23	34
FX deposits by banks, billions of euros	2.8	2.6	2.0	1.9	1.5	1.6	1.6	1.7	1.6	1.7	1.8	1.8	1.9

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, 2012–16

	2012	2013	2014	2015				2016		
				Mar	Jun	Sep	Dec	Mar	Jun	Aug
Capital adequacy										
Regulatory capital to risk-weighted assets	19.9	20.9	20.0	20.2	21.4	21.2	20.9	21.5	21.6	21.6
Regulatory Tier 1 capital to risk-weighted assets	19.0	19.3	17.6	17.8	18.9	18.8	18.8	19.5	19.6	19.6
Nonperforming loans net of provisions to capital	31.0	32.7	31.0	31.3	30.4	28.4	25.9	23.5	22.1	21.1
Capital to assets	20.5	20.9	20.7	21.2	21.2	21.4	20.3	20.7	20.5	20.7
Large exposures to capital	61.9	52.8	72.1	71.2	63.6	64.6	68.2	65.4	66.1	65.0
Regulatory capital to total assets	12.2	12.2	11.4	11.6	11.9	11.9	11.9	12.3	12.4	12.4
Asset quality										
Nonperforming loans to total gross loans	18.6	21.4	21.5	22.6	22.8	22.0	21.6	20.9	20.2	19.6
Sectoral distribution of loans (percent of total loans)										
Deposit takers	0.3	0.3	0.8	0.5	0.5	0.2	0.1	0.1	0.6	0.4
Central bank	2.1	5.8	0.4	0.0	1.1	3.1	1.6	1.6	1.4	2.7
General government	3.0	2.3	2.3	2.2	2.0	1.8	1.7	1.6	1.6	1.4
Other financial corporations	1.6	1.6	0.5	0.4	0.5	0.5	0.7	0.7	0.8	0.8
Nonfinancial corporations	58.2	54.1	56.3	56.1	55.1	54.1	55.9	54.7	54.2	53.0
Agriculture	3.0	2.7	3.5	3.4	3.4	3.6	3.7	3.6	3.5	3.3
Industry	17.9	18.4	19.2	18.8	18.4	17.9	18.4	17.9	17.5	17.2
Construction	5.8	4.6	4.2	4.1	4.2	3.9	3.8	3.8	3.9	3.9
Trade	15.0	13.5	13.9	13.6	13.0	13.2	13.9	13.4	13.5	13.2
Other loans to nonfinancial corporations	16.5	14.9	15.6	16.2	16.1	15.5	16.2	15.9	15.8	15.4
Households and NPISH	33.0	34.8	38.3	39.0	39.4	38.4	39.1	40.1	40.4	40.1
Households and NPISH of which: mortgage loans to total loans	16.1	16.8	18.0	18.6	18.6	17.8	18.1	18.3	18.0	17.6
Foreign sector	1.9	1.1	1.4	1.7	1.5	1.9	0.9	1.2	1.0	1.5
Specific provision for NPLs to gross NPLs	50.0	50.9	54.9	55.4	56.1	57.0	62.3	63.5	65.1	65.3
Specific and general provisions for NPLs to gross NPLs	111.1	105.5	107.6	105.7	105.7	107.5	106.4	106.6	105.3	107.9
Specific and general provisions for balance sheet losses to NPLs	120.7	113.8	114.5	113.0	113.2	115.0	114.2	114.9	114.7	117.5
Specific and general provisions to NPLs	126.5	117.9	118.4	116.7	116.9	118.8	118.2	118.9	118.6	121.5
Specific provision of total loans to total gross loans	10.2	11.9	12.7	13.4	13.6	13.4	14.4	14.2	14.1	13.7
Earnings and Profitability										
Return on assets	0.4	-0.1	0.1	1.0	1.1	1.2	0.3	1.9	1.3	1.5
Return on equity	2.0	-0.4	0.6	4.7	5.4	5.6	1.5	9.2	6.5	7.3
Liquidity										
Customer deposits to total (noninterbank) loans	93.2	103.4	108.1	107.8	110.1	110.1	114.4	114.4	115.7	116.9
Foreign-currency-denominated loans to total loans	74.1	71.6	70.1	71.3	71.3	71.1	72.3	71.8	70.7	69.2
Average monthy liquidity ratio	2.1	2.4	2.2	2.2	2.3	2.3	2.1	2.2	2.1	2.2
Average monthy narrow liquidity ratio	1.6	1.8	1.7	1.8	1.9	1.9	1.7	1.8	1.7	1.8
Sensitivity to Market Risk										
Foreign-currency-denominated liabilities to total liabilities	80.1	76.7	74.7	75.6	74.6	73.8	72.7	73.5	72.2	72.1
Total off-balance sheet items to total assets	103.5	111.0	207.3	242.2	239.2	235.7	234.1	231.5	227.1	228.8
Classified off-balance sheet items to classified balance sheet assets	26.1	28.7	27.6	27.9	27.7	28.7	30.6	30.1	30.5	31.0

Source: National Bank of Serbia.

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

	Available on or after	Amount of Purchase: In millions of SDR	Amount of Purchase: In millions of euros 1/	Amount of Purchase: In percent of quota 2/	Cumulative: In percent of quota 2/	Conditions
1	2/23/2015	187.080	233.4	29	29	Board approval of arrangement.
2	6/7/2015	116.925	147.9	18	46	Observance of continuous and end-March 2015 performance criteria, and completion of the review.
3	9/7/2015	116.925	147.4	18	64	Observance of continuous and end-June 2015 performance criteria, and completion of the review.
4	12/7/2015	70.155	89.1	11	75	Observance of continuous and end-September 2015 performance criteria, and completion of the review.
5	3/7/2016	70.155	88.4	11	86	Observance of continuous and end-December 2015 performance criteria, and completion of the review.
6	6/7/2016	46.770	58.4	7	93	Observance of continuous and end-March and end-June 2016 performance criteria, and completion of the review.
7	12/7/2016	54.565	68.1	8	101	Observance of continuous and end-September 2016 performance criteria, and completion of the review.
8	3/7/2017	54.565	68.0	8	110	Observance of continuous and end-December 2016 performance criteria.
9	6/7/2017	54.565	67.9	8	118	Observance of continuous and end-March 2017 performance criteria, and completion of the review.
10	9/7/2017	54.565	67.9	8	126	Observance of continuous and end-June 2017 performance criteria.
11	12/7/2017	54.565	67.8	8	135	Observance of continuous and end-September 2017 performance criteria, and completion of the review.
12	2/15/2018	54.565	67.8	8	143	Observance of continuous and end-December 2017 performance criteria.
	Total	935.400	1,172.1	143	143	

Source: FIN, WEO.
1/ At projected WEO exchange rates.
2/ Serbia's current quota is SDR 654.8 million.

Table 10. Serbia: Balance of Payments (Precautionary SBA Shock Scenario), 2012–21 1/

	2012	2013	2014	2015	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.
					(Billions of euros)					
Current account balance	-3.6	-2.1	-2.0	-1.6	-2.3	-2.1	-2.1	-2.0	-1.9	-1.8
Trade of goods balance	-5.6	-4.2	-4.1	-4.0	-4.5	-4.5	-4.5	-4.4	-4.5	-4.6
Exports of goods	8.4	10.5	10.6	11.4	11.5	12.7	14.1	15.6	17.2	19.0
Imports of goods	-14.0	-14.7	-14.8	-15.4	-15.9	-17.2	-18.6	-20.0	-21.8	-23.6
Services balance	0.1	0.3	0.5	0.7	0.9	1.1	1.2	1.4	1.5	1.6
Exports of nonfactor services	3.1	3.4	3.8	4.3	4.5	4.8	5.1	5.6	6.1	6.6
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.5	-3.6	-3.7	-3.9	-4.2	-4.6	-5.0
Income balance	-1.1	-1.4	-1.3	-1.7	-1.9	-1.9	-2.0	-2.1	-2.3	-2.4
Net interest	-0.8	-0.9	-0.9	-1.0	-0.9	-0.8	-0.9	-0.9	-1.0	-1.1
Others, including reinvested earnings	-0.3	-0.5	-0.5	-0.7	-1.0	-1.2	-1.1	-1.2	-1.3	-1.4
Current transfer balance	2.9	3.2	3.0	3.3	3.1	3.3	3.2	3.2	3.4	3.6
Official grants	0.1	0.0	0.1	0.2	0.0	0.1	0.0	0.0	0.0	0.0
Others, including private remittances	2.9	3.1	2.9	3.2	3.1	3.2	3.1	3.2	3.4	3.6
Capital and financial account balance 1/	2.5	3.3	0.5	1.5	-0.1	1.0	1.6	1.9	2.1	2.2
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	0.7	1.2	1.2	1.8	1.8	1.7	1.6	1.7	1.8	1.9
Portfolio investment balance	1.7	1.9	0.4	-0.3	-0.7	-0.3	0.2	0.6	0.3	0.3
of which: debt liabilities	1.7	2.0	0.4	-0.2	-0.7	-0.3	0.2	0.6	0.3	0.3
Other investment balance	0.2	0.1	-1.1	0.0	-1.2	-0.4	-0.3	-0.4	0.0	0.0
Public sector 1/ 2/	0.5	0.4	0.7	0.5	0.2	0.2	0.0	-0.3	0.0	0.0
Domestic banks	-0.4	-0.5	-1.5	-0.1	-0.9	-0.2	0.0	0.0	0.0	0.0
Other private sector 3/	0.1	0.1	-0.4	-0.4	-0.5	-0.5	-0.2	-0.1	0.0	0.0
Errors and omissions	0.2	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	0.3	-2.4	-1.1	-0.5	-0.1	0.2	0.4
Financing	0.9	-1.3	1.2	-0.3	2.4	1.1	0.5	0.1	-0.2	-0.4
Gross international reserves (increase, -)	1.1	-0.7	1.8	-0.2	1.6	0.8	0.4	0.1	0.3	0.2
Use of Fund credit, net	-0.2	-0.6	-0.6	-0.1	0.8	0.3	0.1	0.0	-0.5	-0.6
Purchases	0.0	0.0	0.0	0.0	0.8	0.3	0.1	0.0	0.0	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	0.0	0.0	0.0	0.0	-0.5	-0.6
				(Percent of GDP)						
Current account balance	-11.5	-6.1	-6.0	-4.7	-6.7	-6.0	-5.5	-5.0	-4.5	-3.9
Trade of goods balance	-17.8	-12.1	-12.3	-11.9	-13.0	-12.7	-11.8	-11.0	-10.6	-10.1
Exports of goods	26.5	30.8	31.9	33.9	33.4	35.8	37.5	39.1	40.3	41.6
Imports of goods	-44.2	-42.9	-44.3	-45.8	-46.5	-48.5	-49.4	-50.1	-50.9	-51.7
Services balance	0.4	0.9	1.4	2.2	2.7	3.0	3.3	3.5	3.6	3.6
Income balance	-3.4	-4.1	-4.0	-5.0	-5.4	-5.5	-5.3	-5.3	-5.3	-5.4
Current transfer balance	9.3	9.2	9.0	10.0	9.1	9.2	8.4	7.9	7.9	7.9
Official grants	0.3	0.1	0.3	0.5	0.1	0.3	0.1	0.0	0.0	0.0
Others, including private remittances	9.0	9.1	8.7	9.5	9.0	8.9	8.3	7.9	7.9	7.9
Capital and financial account balance 1/	7.9	9.5	1.4	4.5	-0.3	2.9	4.2	4.7	4.9	4.8
Capital transfers balance	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	2.1	3.6	3.7	5.4	5.2	4.8	4.3	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	-0.9	-2.0	-0.7	0.6	1.5	0.7	0.7
Other investment balance	0.5	0.3	-3.4	0.0	-3.4	-1.2	-0.7	-1.0	0.0	0.0
Public sector 1/ 2/	1.5	1.2	2.2	1.4	0.5	0.7	-0.1	-0.8	0.0	0.0
Domestic banks	-1.3	-1.3	-4.5	-0.2	-2.6	-0.5	0.0	0.0	0.0	0.0
Other private sector 3/	0.4	0.4	-1.1	-1.2	-1.3	-1.4	-0.7	-0.3	-0.1	0.0
Errors and omissions	0.7	0.5	0.8	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	0.9	-7.0	-3.1	-1.3	-0.3	0.4	0.9
Memorandum items:				(percent change unless indicated otherwise)						
Export growth	-0.5	25.6	1.0	6.7	0.9	11.1	11.0	10.5	10.4	10.4
Import growth	2.0	4.7	0.4	4.1	3.8	8.3	7.8	7.7	8.7	8.7
Export volume growth	-0.8	21.9	1.7	8.7	2.4	10.3	9.9	9.1	8.9	8.8
Import volume growth	0.8	2.7	1.9	8.8	6.5	6.3	6.4	6.3	7.1	7.0
Trading partner import growth	-0.8	2.6	4.3	4.0	3.7	5.1	4.9	4.4	4.4	4.4
Export prices growth	0.3	3.0	-0.7	-1.9	-1.4	0.7	1.0	1.3	1.4	1.5
Import prices growth	1.2	2.0	-1.5	-4.3	-2.6	1.9	1.3	1.4	1.5	1.6
Change in terms of trade	-0.9	1.0	0.8	2.6	1.2	-1.2	-0.3	0.0	-0.1	-0.1
Gross official reserves (in billions of euro)	10.9	11.2	9.9	10.4	8.8	8.0	7.6	7.5	7.2	7.0
(In months of prospective imports of GNFS)	7.4	7.4	6.3	6.4	5.0	4.3	3.8	3.4	3.3	2.9
(in percent of short-term debt)	208.9	278.8	258.0	269.3	237.1	221.8	225.0	171.3	164.9	161.1
(in percent of broad money, M2)	76.8	76.2	65.8	64.6	51.2	43.0	37.9	35.2	31.7	28.9
(in percent of IMF risk-weighted metric)	186.5	187.8	163.2	169.6	146.4	131.0	122.0	114.2	105.7	99.9
GDP (billions of euros)	31.7	34.3	33.3	33.5	34.3	35.5	37.7	40.0	42.7	45.7

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, 2013–21 1/ 2/

	2013	2014	2015	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.
Fund repurchases and charges									
In millions of SDRs	579	502	117	15	9	12	12	383	467
In millions of euro	663	574	147	19	12	14	14	472	576
In percent of exports of goods and NFS	4.7	4.0	0.9	0.1	0.1	0.1	0.1	2.0	2.2
In percent of GDP	1.9	1.7	0.4	0.1	0.0	0.0	0.0	1.1	1.3
In percent of quota	88.5	76.6	17.9	2.3	1.4	1.8	1.8	58.4	71.3
In percent of total external debt service	10.9	11.9	3.1	0.4	0.3	0.3	0.3	8.8	10.0
In percent of gross international reserves	5.9	5.8	1.4	0.2	0.1	0.2	0.2	6.6	8.2
Fund credit outstanding (end-period)									
In millions of SDRs	624	128	12	663	881	935	935	563	102
In millions of euro	701	151	15	826	1095	1161	1155	695	126
In percent of exports of goods and NFS	5.0	1.0	0.1	5.2	6.2	6.0	5.4	3.0	0.5
In percent of GDP	2.0	0.5	0.0	2.4	3.1	3.1	2.9	1.6	0.3
In percent of quota	95.3	19.5	1.8	101	135	143	143	86	16
In percent of total external debt	2.6	0.5	0.1	3.0	4.0	4.3	4.2	2.6	0.5
In percent of gross international reserves	6.3	1.5	0.1	9.4	13.7	15.3	15.5	9.7	1.8
Memorandum items:									
Exports of goods and NFS	13,963	14,451	15,631	15,993	17,532	19,267	21,217	23,330	25,663
Quota (in millions of SDRs)	655	655	655	655	655	655	655	655	655
GDP	34,277	33,335	33,484	34,283	35,528	37,656	39,994	42,736	45,701
Total external debt service	6,057	4,840	4,749	4,742	4,507	4,480	4,300	5,353	5,756
Public sector external debt	14,633	16,151	17,364	17,703	17,976	18,261	18,559	18,435	18,156
Total external debt	27,231	27,694	28,506	27,563	27,160	27,188	27,376	27,213	26,935
Total external debt stock excluding IMF	26,534	27,543	28,499	26,731	26,055	26,016	26,204	25,582	24,735
Gross international reserves	11,189	9,907	10,377	8,810	7,982	7,570	7,458	7,179	7,012

Source: Fund staff estimates.

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

2/ Serbia chose to be grandfathered for the calculation of commitment fees and surcharges, therefore, Serbia's old quota of SDR 467.7 million is used for the purpose of calculating surcharges in this table. It does not make a difference if the current quota were used, with surcharges being zero under both old and current quo Serbia's current quota is SDR 654.8 million.

Appendix I. Letter of Intent

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

Belgrade, December 2, 2016

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. 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 newly formed government, indicating strong commitment to and ownership of envisaged policies.

Quantitative program conditionality has been fully met and progress has been made on structural benchmarks. The end-September PCs on NIR, the fiscal deficit, and current primary spending have all been met, by considerable margins. Inflation has been below the NBS target but remained within the inner limit of the program inflation clause. As prior actions for the review, we (i) will adopt the 2017 budget, (ii) will amend the budget system law to bring all project loans on budget and withhold transfers from local governments not complying with the new instructions on revenue projections, and (iii) have strengthened the energy arrears framework by prohibiting Srbijagas gas supplies to delinquent users, mandating prepayments for gas supplies to Azotara and MSK, and publishing the list of top 20 debtors to Srbijagas and EPS. We met the end-November structural benchmark on the completion of special diagnostics review of Dunav Osiguranje and end-December structural benchmark on amendments to the Criminal Code. In November, we finalized a debt restructuring plan for Srbijagas (end-October structural benchmark). While clarification of the scope of business secrecy and data protection laws remains to be completed, we issued an official interpretation on the application of banking secrecy rules (in July) and an official explanation on tax deductibility of impairment provisions (end-October structural benchmark).

We recognize that accelerating reform is critical for achieving program objectives. In this context, 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. We request to move the arrangement to a semiannual review schedule. 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 sixth 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/
Jorgovanka Tabaković
Governor of the National Bank of Serbia

/s/
Dušan Vujović
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 the remainder of 2016 and 2017.** The program aims to maintain a foundation for healthy economic growth by addressing Serbia's short-term and medium-term economic challenges. 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, has taken place, 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. **Serbia's economic recovery has gained speed**, notwithstanding significant fiscal consolidation. Growth reached 2¾ percent (yoy) in the first three quarters of 2016, supported by stronger domestic demand and net exports. Private consumption is recovering, benefiting from improved labor market conditions and a pick-up in consumer lending growth. Despite substantial monetary policy easing, headline CPI inflation has remained below the NBS inflation target range (1.5 percent, yoy, in October), mainly on account of low imported inflation and a further reduction in fruit and vegetable prices. Core inflation has remained subdued (1.5 percent in October) and the near-term inflation expectations have continued trending down. The external current account deficit has narrowed and is fully covered by foreign direct investment. Sovereign bond yields as well as bank lending rates have continued to decline.

5. **We expect the consistent implementation of the policy actions and reforms envisaged under our economic program to maintain the virtuous cycle of boosting confidence, improving private sector dynamism, and fostering economic growth**. Reflecting recent developments, we envisage the following revisions to the baseline macroeconomic scenario under the program:

- **Real GDP** is expected to expand at 2.7 percent in 2016 and to gradually rise over the medium term on account of a less contractionary fiscal stance, improved market confidence, stronger private sector employment and real wages and credit growth, and the positive effects of structural reforms.
- **Annual headline CPI inflation** is projected to average 1.1 percent in 2016 and to gradually rise to 2.4 percent in 2017, supported by rising import prices and recovering

domestic demand. In the medium term, inflation is expected to stay within the inflation target range.

- **The current account deficit** is expected to further narrow to about 4¼ percent of GDP in 2016 and to continue improving in 2017, reflecting continued strong export performance. The current account deficit is projected to remain around 4 percent of GDP over the medium term. External financing will continue to rely mostly on FDI as well as on bilateral and project loans.

6. **The program scenario faces downside and upside risks.** Serbia remains exposed to significant external risks, including regional spillovers and renewed episodes of global market volatility, and a resumption of large immigrant flows. Notwithstanding strengthened buffers, delays in implementing structural reforms, particularly in the area of SOE restructuring, may compromise sustainability of the fiscal adjustment, which in turn could hamper reduction of the public debt, and deteriorate growth prospects. On the other hand, growth could surprise on the upside again as confidence continues to improve.

Economic Policies

A. Fiscal Policies

7. **We remain committed to maintain fiscal consolidation policies to put the public debt-to-GDP ratio, which has started to decline in 2016 but is still high, firmly on a downward path.** The structural fiscal adjustment targeted under the program, of 4 percent of GDP during 2015–17, will be almost fully implemented by end 2016. The measures focus primarily on containing public expenditures, namely on scaling down public sector wage and pension bills towards more sustainable levels, and reducing fiscal costs of state-owned enterprises (SOEs). The adjustment has also been supported by a structural improvement in tax revenue performance in 2015 and 2016.

8. **The fiscal outturn in the first three quarters of 2016 remained within the program targets.** The 2015 general government fiscal deficit was 3.7 percent of GDP, more than 2 percent of GDP below our initial projection, and our lowest deficit recorded since 2008. Strong performance has continued in 2016: the general government fiscal deficit was RSD 4.5 billion, compared to the original program target of RSD 81.3 billion (adjusted program target of RSD 60.5 billion) through September. Most of the over-performance in 2016 is driven by revenues, with about half of it coming from non-tax revenues (mostly from the 4G spectrum frequency sale), and the rest from better than expected VAT and excises collection and good CIT performance. Meanwhile, current expenditures stayed within the program targets. The public debt-to-GDP ratio fell to 72 percent at end-September and is expected to finish the year at below 74 percent, over 2 percentage points below the end-2015 figure.

9. Fiscal adjustment in 2016 has over-performed program targets allowing for one-off expenditures while remaining under the expenditure ceiling. The government has been implementing the measures envisaged in the 2016 budget and the general government deficit is projected at 2.1 percent of GDP, well below the original target of 4 percent of GDP this year. Part of the fiscal space created by strong fiscal performance in 2016 will be used to advance some one-off expenditures. In the context of the resolution of the state-owned petrochemical product company, Petrohemija, in a manner that ensures no further fiscal support to the company, the government will assume debt of €105 million owed to its oil supplier, NIS, which was subject to implicit government guarantees. In December, we intend to grant a one-off pension bonus of RSD 5,000 (in net terms) to all pensioners (about RSD 10 billion in gross terms) and small wage bonuses in selected sectors (about RSD 1 billion in gross terms). Finally, we will implement before end-2016 an early repayment on more favorable terms of some expensive SOE debt that the government is currently paying under called guarantees.

10. For 2017, our primary focus remains the continued reduction of mandatory expenditures through the following measures, while using structural revenue gains in 2015-16 for targeted wage and moderate general pension increases. As a **prior action**, we will adopt the 2017 budget consistent with program fiscal parameters.

- We remain committed to further reduce the general government wage and pension bill as a share of GDP. Rightsizing efforts will continue in 2017 (see paragraph 12). Continued fiscal over-performance has opened space in 2017 for: (i) targeted public wage increases totaling RSD 15.9 billion in gross terms (including 6 percent for primary and secondary school teachers, 3 percent for tertiary education, 5 percent for selected sectors including health, social protection, cultural institutions, administrative staff at courts and prosecutors office, scientists, police and army, while maintaining the wage freeze for central and local administration and SOEs); and (ii) a general pension increase of 1.5 percent (costing RSD 8.4 billion in gross terms).

- Amendments to the Local Government Financing Law were adopted by the government in August (prior action for last review) and by the National Assembly in October 2016. The amendments are expected to generate annual fiscal savings of RSD 4.8 billion from 2017.

- We submitted amendments (effective January 1, 2017) to increase parental allowances, while eliminating VAT refunds for baby items, with a view to provide benefits earlier and reduce the tax administration burden.

11. 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 rebuild an adequate level of fiscal buffers. 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

12. We are progressing with reforms of the general government employment and wage system.

- As of end-September 2016, public sector permanent employment (including local public utilities) had been reduced by about 22,000 employees compared to the end-2014 level, mostly through attrition. This progress is consistent with our objective to reduce public sector employment (including local public utilities) by at least 6,500 staff in 2016H2. To support these efforts and provide guidance for further rightsizing efforts in 2017, we will, by end-March, adopt 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, consistent with the employment reduction plans for education, social funds, and other sectors (**new structural benchmark**). We will continue to apply an employment freeze, with exceptions managed through the Employment Commission, taking into account individual institutions' employment ceilings, budgetary envelopes, and specialist staffing needs.

- Going forward, rightsizing efforts will be guided by detailed systemization plans and availability of fiscal space at the institutional level. To this end, we plan to adopt time-bound action plans for administrative restructuring in the education sector and social services administration based on functional reviews developed in conjunction with the World Bank (**new end-March structural benchmark**). For education, the plan will envisage a reduction of employment of at least 3 percent in primary and secondary schools (from September 2016 to September 2017) through changes in the law and bylaws that would establish a protocol for redundant teachers to leave the school system, regulate the number of employees (particularly in secondary schools) as well as change the core and elective classes. Starting from September 2017, further reduction of employment can be expected, by at least 3 percent, through medium and long-term actions which are described in the Ministry's Strategic Document for Rationalization. This will include closing intake of at least 12 percent of current TVET profiles (i.e., 30 profiles) with the start of the school year. For social services administration, the plan will involve significant staff savings through elimination of duplication of data collection and verification efforts by the Pension Fund, Health Insurance Fund, and National Employment Service.

- Since 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.

- To support implementation of the Law on Public Sector Employees Wage System, adopted in February 2016, the parliament will adopt the necessary secondary legislation for local governments and public services (health, education, culture, and social protection) by end-June 2017 (**new structural benchmark**). Secondary legislation for all other sectors (including police and armed forces) will be adopted by end-2017.

13. To underpin fiscal consolidation, limit risks, and strengthen institutions:

- We will implement the second round of centralized pharmaceutical procurement reform by April 2017, to adopt the best international practice of drug tendering and to reduce the cost of patented and innovative drugs in consultation with the World Bank. These reforms are expected to yield significant savings starting in 2018.

- We will review and clearly define the coverage of general government to be compatible with European System of Accounts (ESA) 2010 and GFSM 2014 by 2018. We have submitted financial plans of social security funds with estimates for 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-2019. Our original plans to include prisons, cultural institutions, and social protection institutions by end-2016, education by end-2017, and local governments over 2017–18 in FMIS have proved to be overly ambitious and we are lagging behind due to administrative, technical and technological capacity constraints both on the side of the budget execution system and on the side of indirect budget beneficiaries and the respective direct budget beneficiaries in charge of providing the administrative and technical capacities for their IBBs to be integrated in budget execution system. Throughout the 2016, we have worked on upgrading the budget execution system to be able to support the integration of new users. In 2017, we will provide necessary trainings to prisons and cultural institutions, as they also upgrade their administrative, technical and technological infrastructure. In 2018, prisons and cultural institutions will be included in the system. In 2019, social protection institutions will be integrated, having in mind that they are the most numerous and diverse, they will need to upgrade their capacities over the period 2017-2019.

- The National Assembly approved in the 2017 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 2017–19 adopted in December 2016. The deviation of the 2017 budget expenditures from the earlier ceiling is discussed in the explanatory note for the 2017 Budget.

- In order to improve budget discipline and transparency, as a **prior action**, we will amend the Budget System Law to (i) include all currently extra-budgetary project loans within the budget, starting in 2017, and (ii) withhold transfers from local governments not complying with the new instructions on how to project their revenues on the basis of current year receipts. We will also work to improve budget planning and execution in health institutions.

- We are working on new regulations and guidelines for public investment management. In particular, we are preparing a set of by-laws aimed at strengthening the project appraisal process (**structural benchmark for December 2015**), to establish a unique project pipeline and clearly define its links with multi-annual planning and annual budget procedures.

- We are committed to 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. In this regard, we set up a special fiscal risks management unit at the MOF and included a fiscal risk statement on all PPPs in the Medium-Term Fiscal Strategy from the 2017 budget. Furthermore, to improve control of fiscal implications and risks, we amended the existing Law on Public-Private Partnership and Concessions mandating that PPPs larger than EUR 50 million are submitted to the government for consideration only after receiving the MOF's consent. We have prepared additional amendments to the Law aimed at limiting overall fiscal exposure, ensuring a competitive tender process to be adopted by mid-2017.

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

- 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. This law defines monitoring and enforcement mechanisms for improving payment discipline in the public sector, and administrative penalties for responsible individuals. The implementation started in January 2016. We will establish a new e-invoice system covering the public sector based on a unique invoice code that would be required at the time of invoicing. As a **prior action** for this review, (i) we have issued a decree mandating that Srbijagas must not provide gas to delinquent companies or institutions (except in limited identified priority cases where gas payments will be made out of the budget reserve), (ii) Srbijagas management has issued instructions specifying that any supplies to Azotara or MSK will only be provided on the basis of prepayment, and (iii) we have instituted monthly reporting of overdue receivables to Srbijagas and EPS of their top 20 debtors, published on the companies' web pages.

- 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 former Privatization Agency (continuous performance criterion). In the context of the resolution of the state-owned petrochemical product company, Petrohemija, the government will assume debts of about €105m (after restructuring) in December 2016 owed to its oil supplier, NIS, which were subject to implicit government guarantees via "comfort letters" from the Government. Given that Petrohemija's resolution ensures that the company will make no further calls on budgetary resources, this debt assumption is accommodated in the program via adjustors (capped at RSD 13 billion) to the deficit and expenditure ceilings. The Government has not issued any other comfort letters or other implicit guarantees and will refrain from issuing further such guarantees.

- We initiated the selection of an independent consultant and plan to initiate the diagnostic analysis of the Development Fund and the export promotion agency (AOFI) in December 2016. This diagnostic analysis will be completed by end-April 2017 (**new structural benchmark**) and followed by proposals to improve their governance and operational procedures.

15. In order to raise the efficiency of revenue collection, we are committed to improve tax administration. This work will continue to be based on recommendations of the September 2014 IMF technical assistance mission and the Tax Administration Diagnostic Assessment Tool review. We are implementing 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 reducing the number of main field offices from 178 to 36, (iii) reduce non-core activities, (iv) phase in a modern compliance risk management approach, (v) strengthen arrears management, including write-off procedures, (vi) modernize information technology systems and business processes, and (vii) improve coordination and information exchange with other government agencies.

- We will adopt, in consultation with the IMF, a government decision on an organization plan for the non-headquarter based tax administration functions consistent with business needs of modern tax administrations and determining the physical location and staffing numbers for these functions (**new end-June structural benchmark**). In parallel, we will also develop a plan to address our archive and accommodation transition needs.

- The National Assembly approved amendments—adopted by the government (**end-December structural benchmark**) in November—to 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.

- We will consider, in consultations with the IMF, options for strengthening the independence and effectiveness of review of tax appeals.

16. We will increase efforts to pursue tax debt. The government provided temporary concessions for tax rescheduling. Following the closure of this window on July 4, the tax administration is stepping up enforcement of tax debt collection against delinquent taxpayers who did not apply or qualify for the scheme. In particular, we will require evidence of tax payment for renewal of taxi licenses, through the adoption of a new Law on Taxi Services.

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 have lowered the inflation target from 4±1½ percent to 3±1½ percent for 2017-18, which we consider better aligned with improved macroeconomic fundamentals and our medium-term objectives. We remain committed to the objective of keeping inflation within the inflation tolerance band and inflation developments will continue to be monitored via a consultation clause with consultation bands set around the central projection (Table 1). Since the inception of the program in early 2015, as fiscal adjustment took hold and external financing conditions remained stable, we have reduced the key policy rate by 400 basis points, to 4 percent, 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 with a view to supporting credit activity. We will consider further gradual reduction of the dinar portion of reserve requirement on foreign currency deposits, to bring it closer in line with regional peers.

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 continue to be used to smoothing excessive exchange rate volatility without targeting a specific level or path for the exchange rate, while considering the implications for financial sector and price stability. 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, monitored by a floor on net international reserves (quantitative performance criterion).

19. 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. We will continue to use our monetary policy and prudential framework in order to support the dinar instruments, and we will further communicate the importance of the dinarization for overall financial stability. Further improvements of the dinarization strategy will be considered following Fund staff technical assistance, expected for Q1-2017.

20. 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 capital flows and the ability of residents to open deposit accounts abroad.

21. 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

22. Our policies will support financial sector stability and enhance the financial 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; (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.

23. The implementation of actions envisaged in the NPL resolution strategy is progressing. Following various regulatory initiatives during 2016 (including the introduction of enhanced reporting requirements for NPLs and more stringent prudential standards for restructured loans), the NBS is reviewing the implementation of recently introduced supervisory requirements on distressed asset management, including the preparation of bank-specific NPL resolution strategies. To this end, the NBS will discuss banks' medium-term operational targets for reducing NPLs to acceptable targets. In addition:

- The draft law on regulation of the profession of real estate appraisers has been submitted to the National Assembly with a view to be adopted by end-December (**structural benchmark**). Further amendments to the regime that regulates the profession of court-sworn experts, to be implemented during 2017, will ensure that the technical standards and rules for professional conduct envisaged under the Real Estate Appraiser Law will also be applied to real estate appraisals prepared in the context of enforcement procedures under the Law on Enforcement and Security.

- Public consultation of the proposed amendments of the corporate insolvency law concluded at the end of October. The proposals, adjusted as needed in light of feedback received to ensure optimal alignment with the stated objectives of the reforms, will be submitted to parliament (**end-December structural benchmark**) with a view to be adopted by end-February 2017.

- Following an extensive study on impediments and disincentives towards the sale of NPLs, the NBS has published an official interpretation on the application of banking secrecy rules. In addition, an official interpretation (**end-September structural benchmark**) of the treatment of impairment provisions for corporate income tax purposes has been issued by the Ministry of Finance in October; further steps, however, may be needed to clarify the scope of business secrecy and data protection rules in the context of NPL sales, with the aim to facilitate comprehensive due diligence.

- The prudential framework for non-deposit taking financial institutions that is currently under consideration could also enable the sale of nonperforming retail receivables to regulated investors outside the banking sector.

24. Banks are implementing the findings of the special diagnostic studies (SDS). The NBS expects banks' external auditors to independently assess the observance of its guidelines on the application of International Accounting Standard 39 (IAS 39), issued in February 2016, as part of their financial statement audits. The NBS has embedded methodological aspects of the SDS in its supervisory procedures and is strengthening its analytical and supervisory capacity in the area of IFRS.

25. We continue to strengthen financial sector supervision. Implementation of Basel III-compliant regulatory standards on capital, liquidity, and risk management, as well as updated standards on disclosure and regulatory reporting, will be applicable as of end-June 2017. From that date, minimum capital requirements will be reduced from 12 percent to 8 percent, while additional capital buffers will be introduced—in line with the EU's Capital Adequacy Directive—to ensure that banks will remain well capitalized. The required reserves for estimated loan losses will remain in force until 2019, but recent amendments allow banks to reduce the required reserve in accordance with improvements of their NPL ratios. Multi-year action plans for strengthening the NBS' prudential oversight over the insurance and banking sectors are being implemented, which include the introduction of a more risk-sensitive supervisory cycle for banks. To ensure sufficient resources are available to carry out its duties, the NBS will continue to fill critical vacancies. The review of banks' recovery plans will provide the NBS with further insights in the critical functions and intra-group linkages of banks, as well as banks' preparedness for dealing with sudden shocks.

26. The NBS continues to enhance its macroprudential policy framework. Draft regulatory amendments for the introduction of new macroprudential instruments are being developed as part of the implementation of Basel III. The NBS is considering further enhancements of its framework for implementation of its macroprudential instruments, in line with recommendations of with the IMF technical assistance mission.

27. The NBS continues to strengthen its bank resolution capabilities. Draft guidelines for independent valuation in the context of bank resolutions are being finalized and the preparation of a Resolution Manual is progressing. By end-March 2017, inter-departmental instructions will be prepared that (i) define the participation and the role of the Bank Resolution Department in the assessment of recovery plans, (ii) specify data and documentation that will be exchanged continuously and (iii) operationalize legal provisions governing the initiation of, and exit from, resolution procedures.

28. Reforms of state-owned financial institutions are progressing. We are strengthening our oversight over financial institutions with state-ownership. External consultants will support the implementation of the new strategy for Banka Postanska Stedionica, with a particular focus on (i) the bank's commercial reorientation towards retail banking, entrepreneurs, micro-enterprises and small enterprises, (ii) improvements of the bank's internal organization, corporate governance and risk management, (iii) enhancement of its IT infrastructure and (iv) preparation of a business plan for the period 2017-2019. New Board members have been nominated with dedicated responsibilities for finance (CFO) and risk management (CRO). The government will update the 2014 strategy for state-owned banks by end-December 2016, with the aim to identify strategic options for the smaller banks. The diagnostic review of Dunav Osiguranje (**structural benchmark for end-November**) has been completed and remedial actions will be implemented, as needed. Finally, the privatization of Komercijalna Banka, the second-largest bank, remains on track, with an expected completion by end-2017.

29. We will support credit to SMEs. Given the importance of SMEs for Serbia's economy and the limited access to financing by this sector, we will introduce the framework for functioning of non-deposit financial institutions and 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 are being 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 continue implementing a number of comprehensive structural reforms to attract investment, support growth, and rebalance the economy on its path towards EU integration. We will continue to focus on policies that (i) promote job creation, (ii) reform state and socially-owned enterprises, and (iii) improve the overall business environment and private investment climate.

31. We are improving the targeting of social protection programs. We are preparing a new Law of Social Protection which will replace the existing legislations that governs the eligibility and conditions to receive social assistance, with the aim to improve the effectiveness and targetedness of the cash welfare allowances and family allowance programs.

32. We have initiated wide-ranging reforms of socially-owned and state-owned enterprises to improve their operational viability and limit fiscal risks. Our priority is to significantly reduce fiscal costs of SOEs through (i) curtailing direct or indirect subsidies, (ii) strictly limiting issuance of new guarantees, and (iii) enhancing accountability, transparency and monitoring of these enterprises. To this end, we are implementing strategies for three broad categories of state-owned companies:

- Large public enterprises, such as electricity, gas, railways, and road companies (see below). These reforms are supported by the World Bank and EBRD.

- 17 strategic companies in the portfolio of the former Privatization Agency. We have fully resolved 6 companies and are forcefully pursuing resolution of the remaining ones through either privatization tender or initiating insolvency (including pre-pack bankruptcy).

- Other (over 500) enterprises in the portfolio of the former Privatization Agency.

33. We are committed to continue restructuring large public utilities and transport companies to enhance efficiency and contain additional fiscal costs. 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 consultation with the World Bank and EBRD, we adopted the financial restructuring plan for EPS in June 2015. The plan includes: (i) increases in revenues through enhanced bill collections, reduced technical and commercial losses, and regulated tariff increases and (ii) a reduction of operational cost including through increased efficiency, optimization of the supply mix, and staff reduction. Consistent with the five-year rightsizing target specified in the financial restructuring plan, the EPS supervisory board has adopted, in consultation with the World Bank, a credible 2016-19 optimization plan. By end-October, about 1,900 employees voluntarily applied for the severance package. By end-June 2017, EPS will have closed two inefficient power generation plants and prepared an updated systematization plan severance options for additional rightsizing for 2017-19 (**new structural benchmark**). We plan to close two further generation plants by end-2017. Following a household tariff increase of 4.5 percent in August 2015, another increase of 3.8 percent became effective in October 2016, which will help reducing the financing gap and narrow the difference between domestic and regional market levels. By July 1, 2017, we will change the legal status of EPS to a joint stock company, in line with the ongoing corporate restructuring process and financial consolidation, aiming to attract minority private investment participation that could further enhance corporate governance, improve the viability of the company, and ensure its professional management. We will adopt amendments to the Criminal Code which define the offence of electricity theft.

- **Srbijagas.** A new organizational structure consisting of subsidiaries for transmission and distribution became effective in August 2015, with a view to complete physical unbundling by end 2017. In line with the fiscal program, we have divested part of Srbijagas' non-core assets and are pursuing permanent resolution of the companies which were a major source of arrears in the past—Azotara, MSK, and Petrohemija—in such a way that ensures no further budget support or accumulation of arrears. More generally, payment discipline has improved following the adoption of the financial consolidation plan for Srbijagas in March. We have prepared a debt restructuring plan (**end-October structural benchmark**), and will implement measures to (i) eliminate further debt-to-equity swaps; (ii) improve collection rates to prevent future accumulation of arrears—including through disconnection—and using explicit government subsidies in strategically important cases where disconnection is not warranted; and (iii) rationalize investment plans in consultation with the World Bank. These measures will improve Srbijagas' financial position and put the company on a sustainable path, thus containing the need for additional state aid.

- **Railways of Serbia**. The unbundling of the company into separate passenger, freight, infrastructure, and a fourth company became effective in August 2015. The corporate restructuring plan is centered on asset disposal, network re-optimization, and staff rationalization. Importantly, the freight section has received no further subsidies and has operated on a purely commercial basis from August 2015. To support market competition, we have adopted all the necessary acts in order to allow network access to private operators in February 2016, and the first contract with a private operator was signed in June 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. We are implementing the financial restructuring plan which was adopted in October 2015 and developed in consultation with the World Bank, EBRD and EU. The Railways Reform Steering Committee adopted a conclusion in June 2016 defining the rightsizing targets for 2016 (2,700 staff positions). In September, boards of directors of railway companies adopted the optimization plans and by mid-November about 3,000 of employees have expressed an intention to apply for voluntary separation. In addition, we have closed about 430 km of railway lines and started a legal procedure for closing additional 660 km. Severance payments for 2016 (estimated at around RSD 2.7 billion) will be coordinated with the Ministry of Finance and made available this year in line with rightsizing targets. We finished the inventory of assets and liabilities of the Railways, and allocated them among the companies under the new corporate structure. Railway companies have also fully assigned responsibilities for electricity payments, and will ensure no reemergence of arrears to EPS. By end-December 2016, 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 increase toll rates by 10 percent, to take effect from January 1, 2017 in order to allow adequate infrastructure maintenance. Further increases will be gradually phased in based on an assessment of the adequacy of toll rates prepared with the assistance of the World Bank by end-February 2017. We have adopted a plan to remove rigidities in pricing maintenance contracts, which will cover 1,500 km in both 2016 and 2017. 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.

34. Regarding the few strategic companies for which resolution is still pending:

- We will re-initiate the privatization tender for PKB.

- We have initiated management change at RTB Bor and agreed in principle the sale of the company to strategic investors, allowing for substantial staff reduction and addressing environmental risks while covering temporary losses through the 2017 budget. From January 1, 2017, we will provide budget subsidies to RTB Bor conditioned on the company meeting all current liabilities, including on taxes, wages, and electricity.

- By end March 2017, we will develop an action plan for Resavica mines that (i) identifies the closure timetable for at least 4 unviable mines starting in 2017, (ii) allows for reduction of subsidies from the budget, and (iii) settles wage arrears.

- We have restructured Petrohemija to eliminate any fiscal risks (including through securing a long-term supply contract from NIS); and we will launch a tender to find a strategic investor by end-March 2017.

- We will resolve by end-March 2017 Azotara and MSK through privatization or regular bankruptcy (**new structural benchmark**), and in the meantime we have ensured that Srbijagas will not provide any gas to these companies except on the basis of prepayment.

35. We continue to resolve the 500 plus enterprises in the portfolio of the former Privatization Agency through either privatization or bankruptcy, in accordance with the revised Privatization Law. By October 2016, we have resolved around 330 companies through either bankruptcy or privatization, and severance packages in the amount of 13.9 billion dinars have been paid to around 24,474 employees. 172 companies with 45,000 employees are still in the process to be resolved, including some of the largest strategic enterprises.

36. 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. We selected a privatization advisor for Komercijalna Bank, the second largest bank in Serbia, with a view to completing the privatization by end-2017, subject to market conditions. The privatization of Železara Smederevo, a steel producer was completed in June 2016. This will ensure the operation of the steel company without state aid or further accumulation of arrears in the future. 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.

37. We continue enhance Serbia's competiveness and business environment to support investment, job creation and private sector development. Supported by the World Bank and EBRD, specific actions will focus on the following areas:

- An all-electronic system for issuing construction permits has been in place since January 2016. To simplify the procedures of registering properties and reduce the costs we are working on a digitalization project of ownership register entry.

- We have prepared a draft Law on Fees and Charges, which will replace existing laws and by-laws to regulate fees and charges at all levels of government, to ensure greater predictability and transparency. We will submit the law to the National Assembly by end 2017 with a view to have it adopted in early 2018.

- We have declared 2017-18 as years of the fight against gray economy, pursuing the national program adopted in late 2015.

- We will adopt amendments to the Company Law in 2017 in order to harmonize with EU legislation, including to provide the legal framework for cross-border mergers of companies operating in the EU.

- Supported by the World Bank's Competitiveness and Jobs project, we are expanding the coverage of active labor market policies and reforming the National Employment Service, to improve the efficiency of its programs and enhance the quality of services provided both to unemployed and employers.

- We will also advance the data and legal infrastructure necessary to accomplish savings in 2017 by introducing e-government and reducing staff in non-core functions.

Program Monitoring

38. We request to move the arrangement to a semiannual review schedule. Under the new schedule, reviews will be concluded based on end-March and end-September test dates and conditionality, with interim purchases in June and December made available based on meeting performance criteria. 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/

	2016 2/										2017			
	Mar			Jun			Sep			Dec	Mar	Jun	Sep	Dec
	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Prog.	Prog.	Prog.	Prog.
I. Quantitative performance criteria (quarterly)														
1 Floor on net international reserves of the NBS (in millions of euros)	6,912	...	6,942	6,599	...	6,616	5,932	...	6,944	5,511	5,262	5,044	5,358	5,674
2 Ceiling on the general government fiscal deficit 3/ 4/ (in billions of dinars)	53.9	38.4	15.9	78.3	61.7	18.2	81.3	60.5	4.5	112.0	32.0	36.1	51.6	75.2
3 Ceiling on current primary expenditure of the Serbian Republican Budget excluding capital expenditure and interest payments (in billions of dinars) 3/	206.1	200.3	197.6	426.6	420.5	416.0	637.0	639.4	622.4	885.0	212.2	433.5	647.4	893.9
4 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget for project and corporate restructuring loans (in millions of euros) 3/	35	...	0	35	...	0	100	...	0	180	80	160	180	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 Former Privatization Agency (in billions of dinars).	0	...	0	0	...	0	0	...	0	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) 5/	0.0	...	0.0	0.0	...	-0.7	0.0	...	0.2	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/	128	...	31	160	...	82	262	...	103	364	91	208	334	446
IV. Inflation consultation band (quarterly)														
Outer band (upper limit, 2.5 percent above center point)	4.2	...	...	5.0	...		4.0	...		4.5	4.7	5.0	5.3	5.3
Inner band (upper limit, 1.5 percent above center point)	3.2	...	...	4.0	...		3.0	...		3.5	3.7	4.0	4.3	4.3
End of period inflation, center point 6/	*1.7*	...	*0.6*	*2.5*	...	*0.9*	*1.5*	...	*0.6*	*2.0*	*2.2*	*2.5*	*2.8*	*2.8*
Inner band (lower limit, 1.5 percent below center point)	0.2	...	...	1.0	...		0.0	...		0.5	0.7	1.0	1.3	1.3
Outer band (lower limit, 2.5 percent below center point)	-0.8	...	...	0.0	...		-1.0	...		-0.5	-0.3	0.0	0.3	0.3

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 15/347.
3/ Cumulative since the beginning of a calendar year.
4/ Refers to the fiscal balance on a cash basis, including the amortization of called guarantees.
5/ Through the 3rd review, the authorities reported all outstanding accounts payable (>1 day past due), a more stringent definition than per the TMU.
6/ 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		
Adoption by the National Assembly of the 2017 budget consistent with the program fiscal parameters (MEFP ¶10).		
Amend the Budget System Law to (i) include extra-budgetary project loans within the budget, and (ii) withhold transfers from local governments not complying with the new revenue instructions. (MEFP ¶13, fourth bullet).		
Strengthen the energy arrears framework by (i) prohibiting Srbijagas gas supplies to delinquent users, (ii) mandating prepayments for gas supplies to Azotara and MSK, and (iii) publishing the list of top 20 debtors to Srbijagas and EPS (MEFP ¶14, first bullet).		
Structural Benchmarks		
Fiscal		
1 Adoption by the government of by-laws aimed at strengthening the project appraisal process (MEFP ¶8, third review).	December 31, 2015	Not met.
2 Finalize an action plan for implementation of 2016 general government rightsizing targets based on in-depth functional reviews conducted by World Bank (MEFP ¶12, second bullet, third review).	June 30, 2016	Not met. Replaced with SB#9.
3 Adopt, in consultation with World Bank, debt restructuring plan for Srbijagas (MEFP ¶33, second bullet).	October 31, 2016	Not met. Finalized in November.
4 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 ¶15, second bullet).	December 31, 2016	Met.
Financial		
5 Issue official explanations on the tax deductability of distressed debt write-offs and clarify the scope of business secrecy and data protection laws (MEFP ¶23, third bullet).	September 30, 2016	Not met. Tax deductability explanation issued in October.
6 Complete special diagnostic review of Dunav Osiguranje (MEFP ¶28)	November 30, 2016	Met.
7 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 ¶23, first bullet).	December 31, 2016	
8 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 ¶23, second bullet).	December 31, 2016	
Proposed new benchmarks		
9 Adoption by the government of time-bound action plans for administrative restructuring in education sector and social services administration, based on World Bank functional reviews (MEFP ¶12, second bullet).	March 31, 2017	
10 Adoption by the government of 2017 decisions under the Law on Ceilings on the Number of Employees (MEFP ¶12, first bullet).	March 31, 2017	
11 Resolution of Azotara and MSK through privatization or regular bankruptcy procedure (MEFP ¶34, fifth bullet).	March 31, 2017	
12 Complete the independent assessments of the Development Fund and the export promotion agency (AOFI) (MEFP ¶14, third bullet).	April 30, 2017	
13 Closure by EPS of two inefficient power plants and preparation of an updated systematization plan with severance options for additional rightsizing for 2017-19 (MEFP ¶33, first bullet).	June 30, 2017	
14 Adoption by the government, in consultation with the IMF, a decision on an organization plan for the non-headquarter based tax administration functions and determining the physical location and staffing numbers for these functions (MEFP ¶15, first bullet).	June 30, 2017	
15 Adoption by the National Assembly of the secondary legislation for local governments and public services (health, education, culture, and social protection) needed to support implementation of the Law on Public Sector Employees Wage System (MEFP ¶12, fourth bullet).	June 30, 2017	

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
End-September 2016 (performance criterion)	5,932
End-December 2016 (performance criterion)	5,511
End-March 2017 (performance criterion)	5,262
End-June 2017 (performance criterion)	5,044
End-September 2017 (performance criterion)	5,358
End-December 2017 (performance criterion)	5,674

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 financial transactions.

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, receipts from telecom 4G frequency auctions, and concession and Public Private Partnership (PPP) receipts recorded above-the-line exceed programmed levels. The IMF Statistics Department will determine the proper statistical treatment of any concession or PPP transaction signed during the IMF program.

- 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. Severance payments by the Health Fund will be considered made at the point the funds have been transferred by the Health Fund to the Health Institution (for both general government and Republican budget adjustors).

- 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 (i) by a maximum of RSD 13 billion for 2016 or 2017 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, (ii) by a maximum of RSD 25 billion to on-lend or issue a new guarantee to Serbia Gas for the repayment of expensive debt in 2016 or 2017; (iii) by a maximum of RSD 6.75 billion to on-lend or issue a new guarantee to Galenika for the repayment of expensive debt in 2016 or 2017; and (iv) by a maximum of RSD 0.6 billion to on-lend or issue a new guarantee to Jat Tehnika for the repayment of expensive debt in 2016 or 2017.

Cumulative Programmed Severance Payments

(In billions of dinars)

	End-Mar. 2016	End-Jun. 2016	End-Sep. 2016	End-Dec. 2016	End-Mar. 2017	End-Jun. 2017	End-Sep. 2017	End-Dec. 2017
Programmed cumulative severance payments (of general government)	9.4	11.4	5.0	5.5	1.4	2.75	4.1	5.5
Programmed cumulative severance payments (of Republican budget)	7.3	9.3	4.5	5.0	1.3	2.6	3.9	5.2

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	End-Sep. 2016	End-Dec. 2016	End-Mar. 2017	End-Jun. 2017	End-Sep. 2017	End-Dec. 2017
Programmed cumulative dividends	9.6	9.6	9.6	9.6	17.1	17.1	17.1	17.1
Programmed cumulative debt recovery receipts	0	0	0	0	0	0	0	0
Programmed cumulative debt issuance at a premium	0	0	0	0	0	0	0	0
Programmed cumulative receipts from telecom 4G frequency auctions	0	0	0	0	0	0	0	0
Programmed concession and PPP receipts recorded above the line					0	0	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, 2016, and 2017. 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-Mar. 2016	End-Jun. 2016	End-Sep. 2016	End-Dec. 2016	End-Mar. 2017	End-Jun. 2017	End-Sep. 2017	End-Dec. 2017
Programmed cumulative ear-marked grants receipts	1.8	4.0	6.5	11.4	2.0	4.3	7.3	11.9
Programmed cumulative receipts from small-scale disposal of assets	0	0	0	0	0	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.

- The quarterly 2017 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 a new EUR 30 million guarantee by the Republican Budget on a loan from the EBRD to Railways occurs.

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.[1] 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.

[1] Debt subject to rescheduling or restructuring includes the US$44.7 million in arrears to Libya.

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.

19. Receivables of the top 20 debtors to Srbijagas and EPS will be submitted in the agreed-upon templates within fourteen calendar days after the end of each month as well as published on the company websites.

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 Miroslaw Panek, Executive Director for the Republic of Serbia and Vuk Djokovic, Senior Advisor to the Executive Director
December 16, 2016

On behalf of the Serbian authorities, we thank staff for the candid policy dialogue and the productive meetings during their visit to Belgrade in late October. The staff report provides a fair assessment of the latest developments in the Serbian economy and the policies implemented under the SBA-supported economic program. The arrangement continues to be instrumental in underpinning and strengthening macroeconomic management and keeping structural reforms on track. Under the program, the authorities have implemented a range of bold and politically difficult reforms to: (i) ensure fiscal sustainability by reducing current expenditures, including public wages and pensions, (ii) minimize contingent fiscal risks stemming from unreformed state-owned enterprises (SOEs), (iii) strengthen the stability of the financial sector and bolster intermediation, and (iv) improve the investment environment.

The implemented policies, underpinned by strong ownership, are continuing to yield tangible results: recovery is ongoing and growth is gaining momentum, the external current account deficit is narrowing, employment and the participation rate are growing, and the financial sector resilience and intermediation have strengthened. Fiscal outcomes have continuously over-performed relative to the targets set under the program. The objective of a 4 percent structural adjustment is expected to be broadly achieved a year ahead of schedule, on the back of high quality and durable structural fiscal measures. Public debt has already reached a turning point in 2015 and is placed on a firm downward path. The Serbian authorities consider the program as an important anchor to strengthen the credibility of macroeconomic policies. They remain firmly committed to the program and its objectives, and confirm their intention to treat it as precautionary.

Recent developments

The growth recovery is well underway, driven by investments, net exports and domestic consumption, and supported by improved sentiment and credit growth. Credible fiscal consolidation and implemented labor market, and other reforms have led to improved confidence and investment sentiment. Further, the resurgence of economic activity and the measures against informality are driving growth of formal employment (3.2 percentage points y-o-y). In parallel, the unemployment rate declined to its lowest level in the past 15 years. The GDP projections for 2016 and 2017 have been revised upwards for the third consecutive time, to 2 ¾ and 3 percent, respectively. Domestic consumption is bolstered by higher private wages and employment growth. The current account deficit continues to narrow, driven by the rebound in exports. The FDI inflows in 2016 remain high at 5 ½ percent of GDP, and are well diversified. The financial account has been hit by global investor repositioning in the first half of the year and increased volatility in global financial markets following the Brexit vote; however, flows have reversed in the second half of the year.

The authorities agree on the risks to the outlook, but consider that they are symmetrical. Key downside risks stem from an activity slowdown in major trade partners, adverse trends in international commodity and financial markets, along with unfavorable agrometeorological conditions. This said, the macroeconomic policies implemented under the program have reduced internal and external imbalances, thus strengthening the economy's resilience to adverse shocks.

Fiscal policy

The fiscal adjustment continues to be at the core of Serbia's arrangement with the Fund. The fiscal consolidation delivered good results in 2016, and continues to over-perform by a substantial margin the targets set under the program. Further, consolidation remains critical for restoring fiscal sustainability and placing public debt on a firm downward path. The authorities remain strongly committed to maintain fiscal discipline and to implement policies aimed at reducing public debt to a more sustainable level.

The overall fiscal deficit at the end of Q3 was only 0.1 percent of GDP, while for 2016 it is expected to reach 2.1 percent, substantially lower than envisaged under the program. The noteworthy fiscal result in 2016 is mostly driven by strong tax and non-tax revenues, in particular VAT, excises, and CIT. In addition to the strong economic activity, the better tax collection is due to improved compliance, reduction in informality and progress in implementing the Tax Administration Transformation Agenda. On the expenditure side, the current budget outlays remain in line with projections, while the execution of capital spending has improved substantially in comparison with previous years. This is particularly relevant from the point of view of the needed upgrade of transport infrastructure. Going forward, the authorities plan to address identified weaknesses in the public sector investment framework, including by setting up a single pipeline for all infrastructure projects, strengthening project prioritization and streamlining appraisal, planning, and execution. The wages and public sector pension expenses continued to gradually decline in real terms during 2016, as a result of the hiring freeze, rationalization in the public sector, and the effects of parametric pension system reform introduced in 2014.

The 2017 budget aims at solidifying fiscal policy gains, and targets additional structural adjustment of 0.2 percent of GDP. Strong fiscal consolidation and the ongoing economic recovery have provided fiscal space for a targeted increase of public wages in critical sectors and the modest increase in pensions—relevant in a context of distributing the gains of difficult reforms. The share of public wages and pensions in GDP will continue to decline in 2017.

The authorities plan to continue with pushing ahead with structural fiscal and PFM reforms, including the further progress in rightsizing the public sector employment, advancing in implementing Tax Administration Transformation Agenda, and improving budget execution by enhancing the coverage of the Financial Management Information System, among other measures.

As a result of prudent fiscal policies, the public debt has already started to decline. It reached a turning point in 2015, and the authorities aim to cement it on a firm downward path. Public debt reached 72 percent of GDP in Q3−2016, form 76 percent at the end of 2015. Public debt at the end of 2016 is expected to be slightly below 74 percent of GDP.

Monetary and exchange rate policies

The monetary policy remains accommodative, consistent with the price stability objective of the National Bank of Serbia. On December 8, the NBS Executive Board decided to keep the reference rate unchanged at 4 percent. Notwithstanding declining inflation expectations, NBS considers that cautious monetary policy is warranted, given uncertainties in global financial and commodities markets, as well as the dynamics of monetary policies of the US Fed and ECB and their impact to global capital flows.

In early November, the NBS announced that it will lower its inflation target from currently 4 to 3 percent, effective from January 2017. The inflation tolerance band will remain unchanged at ± 1.5 percentage points. The key reasons for the revision of the inflation target were the improved macroeconomic fundamentals and outlook, in particular the sustainable narrowing of external and internal imbalances, and the decline of risk premia for Serbia. The decision to lower the inflation target was further informed by stable and low inflation over the past three years, and declining inflation expectations. The NBS expects that inflation will return to the tolerance band by the early 2017. In November, headline CPI inflation stood at 1.5 percent.

Driven by the accommodative monetary stance, credit activity grew by 4.3 percent in Q3. Lending rates continued to decline in Q3 both for lending in dinars, as well as for euro-indexed lending, owing to monetary easing, a decline in sovereign risk premia, increased competition between banks, and low euro-area interest rates. Underpinned by progress in achieving macroeconomic stability and by the authorities' dinarization strategy, credit denominated in dinars is continuing to increase. The share of dinar-denominated credit reached 31 percent of the total credit stock in Q3, about 2.7 percentage points higher than at end-2015. The share of foreign currency deposits in the Serbian banking sector stands at 74 percent.

The Serbian authorities remain committed to the inflation targeting regime. The current level of international reserves is high by standard metrics. The central bank remains committed to maintain an adequate reserves level throughout the program. Further, given the high euroization of the economy, volatility of capital flows and the financial stability concerns, the exchange rate regime continues to be a managed float, with the foreign exchange interventions aimed at smoothing excessive exchange rate volatility, without targeting a specific level or path of the exchange rate.

Financial sector

The Serbian banking sector remains robust, with large liquidity and capital buffers. Capital adequacy is high, at 21.6 percent, well above the regulatory minimum of 12 percent and above the regional average. Profitability of the sector is on the rise, driven by declining credit losses. NPLs have declined by about 3 percent, supported by the comprehensive set of measures implemented under the authorities' NPL reduction strategy. While the NPLs still remain high, they are fully provisioned.

The NPL strategy continues to be implemented and is delivering good results. The NBS implemented a range of prudential and regulatory measures envisaged under the NPL strategy, including the introduction of additional provisioning practices, enhanced asset quality reporting, and guidance for preparation of the NPL resolution strategies for individual banks. NBS has also issued an official interpretation of the application of banking secrecy rules, while the Ministry of Finance issued the official interpretation of the treatment of the impairment provision for CIT purposes. Further, the law on regulation of real estate appraisers is expected to be enacted by end-December. The law will unify technical standards and rules and will provide a uniform and sufficiently conservative valuation of real estate for collateral purposes.

The government is also updating its strategy for the remaining state-owned banks and is strengthening the oversight over the financial institutions with state-ownership. The privatization of Komercijalna Banka—the second largest bank by assets—remains on track. The government also issued a guidance to the state-owned Banka Poštanska Štedionica, to gear its business model towards retail and SME market segments. Due diligence of Dunav Osiguranje, the biggest Serbian insurer, has been completed and the remedial measures will be implemented, as needed.

Structural reforms, state-owned (SOE) and socially-owned enterprise reforms

Notable progress in improving the business climate has been achieved over the last two years. In the latest Doing Business Report, Serbia was ranked 47th place out of 190 economies. In addition, Serbia was among the ten economies that most improved over the 2015/16 in areas tracked by Doing Business. The authorities remain committed to further

improve the business environment. They continue to be supported by the World Bank and the EBRD in this endeavor.
As pointed out by staff, the authorities are working towards resolving remaining socially-owned companies in the portfolio of the former Privatization Agency (PA). Bankruptcy moratorium for the 17 strategic socially-owned companies under moratorium protection was lifted in May 2016. Six of those companies have been fully resolved. Out of about 500 companies in the former PA portfolio, around 330 has been resolved, while 172 companies with 45,000 employees remain to be resolved, either through bankruptcy or privatization. The government is actively searching for strategic partners for the biggest companies.

The Serbian authorities are well aware of contingent fiscal risks stemming from the large, unstructured SOEs. They continue to work with the support of IFIs, including World Bank and the EBRD in advancing SOE restructuring agenda, with the following objectives: (i) address organizational, financial and governance issues in SOEs, (ii) minimize fiscal risks, and (iii) reduce state aid to SOEs substantially and on a systematic basis. The focus is on major companies in the electricity, mining, gas distribution and transportation sectors. Financial and corporate restructuring plans, and the rightsizing plans for the electricity utility EPS and the Serbian Railways have been adopted and are in process of implementation. Organizational restructuring and a debt restructuring plan for the gas distribution utility Srbijagas were adopted, and the financial consolidation of the company has been initiated.