International Monetary Fund

Republic of Serbia
and the IMF

Press Release:
IMF Executive Board Concludes 2017 Article IV Consultation with Serbia
September 6, 2017

Country's Policy Intentions Documents

Republic of Serbia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

August 4, 2017

The following item is a Letter of Intent and a Memorandum of Economic Policies of the government of Serbia. It is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that Serbia is implementing in the framework of a staff-monitored program. A members's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

Republic of Serbia. Letter of Intent

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

Belgrade, August 4, 2017

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-March and end-June PCs on NIR, the fiscal deficit, and current primary spending have all been met, by considerable margins. Inflation has remained within the NBS target band and within the inner limit of the program inflation consultation clause. As a prior action for the review, we adopted a new job catalog to support the implementation of the Law on Public Sector Employees Wage System. In June, we adopted a decree aimed at strengthening the project appraisal process, establishing a single project pipeline (end-December 2015 structural benchmark). We met the end-December structural benchmarks on the amendments to the Law on Tax Procedure and strengthening real estate appraisal frameworks. In early August, we submitted the amendments to the corporate insolvency law to the National Assembly (end-December structural benchmark). In June, we adopted the 2017 decisions under the Law on Ceilings on the Number of Employees (end-March structural benchmarks). In August, the independent assessments of the Development Fund and the export promotion agency will be completed (end-April structural benchmark).

We recognize that accelerating structural reforms is critical for achieving program objectives. In this context, the policies under our program will continue to focus on consolidating fiscal gains and reducing public debt, 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. 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 combined 2017 Article IV Consultation and seventh review under the SBA. We therefore authorize their publication and posting on the IMF website, upon the Executive Board’s completion of the review. These documents will also be posted on the official website of the Serbian government.

Sincerely,

/s/
Ana Brnabić
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 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 maintaining 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 continues**. Growth reached 2.8 percent (yoy) in 2016, supported by stronger net exports and private investment. The labor market continues to strengthen, with employment rising and unemployment falling. The headline CPI inflation has picked up (3.6 percent, yoy, in June) mainly on account of higher food and energy prices, while core inflation remains moderate (2 percent, yoy, in June). The external current account deficit continued to narrow in 2016 and remains fully covered by foreign direct investment. Yields on government securities and bank lending rates have declined markedly since the start of the NBS easing cycle.

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**.

- **Real GDP** is expected to expand at 3 percent in 2017 and to gradually rise to 4 percent over the medium term, on account of 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 3.4 percent in 2017, supported by a pick-up in import prices and a narrowing output gap. And in the medium term, inflation is expected to stay within the inflation target range.
- **The current account deficit** is expected to remain at about 4 percent of GDP in 2017 and over the medium term, as strong exports offset increased consumption and

investment. External financing will continue to rely mostly on FDI as well as on bilateral and project loans.

6. **The program scenario faces domestic and external risks.** Serbia remains exposed to external risks, including regional spillovers and renewed episodes of global market volatility. Delays in implementing structural reforms, particularly in the area of SOE restructuring, could compromise sustainability of the fiscal adjustment. This, in turn, could slow down the reduction of public debt and deteriorate growth prospects.

Economic Policies

A. Fiscal Policies

7. **We are committed to preserve the hard-won fiscal gains to put the still high public debt-to-GDP ratio firmly on a downward path.** The estimated structural fiscal adjustment in 2015–2016 amounted to 4.5 percent of GDP, exceeding the target of 4 percent of GDP for the full three-year program. This sizeable adjustment has been driven by stronger revenues and tight control of current spending. Given the still elevated level of public debt, we intend to build on this adjustment in 2017, aiming for a headline deficit of 1.1 percent of GDP.

8. **The fiscal outturn in 2016 showed significant overperformance.** At 1.3 percent of GDP, the general government deficit was nearly 0.9 percentage points lower than projected in the sixth review, and the lowest record since 2005. The public debt-to-GDP by end-2016 was at about 74 percent, about 2 percentage points below the end-2015 figure.

9. **Strong fiscal performance continued in the first half of 2017.** The general government recorded a surplus of RSD 11.8 billion in Q1, overperforming the adjusted program target by RSD 45.9 billion (1 percent of annual GDP), and we recorded a surplus of RSD44.1 billion in H1, overperforming the adjusted program target by RSD79.2 billion (1.8 percent of annual GDP). These good results are largely on account of strong revenue, temporary under-execution of capital expenditure, and lower interest rate bill.

10. **For the remainder of 2017, our primary focus is the continued restraint of mandatory expenditures in line with the budget**. We remain committed to further reduce the general government wage and pension bill as a share of GDP. Any space created by revenue overperformance will be directed to priority capital spending and repayment of expensive debt, while allowing current primary spending up to the program ceiling. Rightsizing efforts will continue in line with the objectives of public administration reform (see paragraph 12). We will submit the amendments to the law on financial support to families with children by end-September 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 further 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 fiscal buffers at least to the end-2016 level. 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-April 2017, public sector permanent employment (including local public utilities) had been reduced by about 26,000 employees compared to the end-2014 level, mostly through attrition. To support these efforts and provide guidance for further rightsizing efforts, in June we adopted the 2017 Decision of the Maximum Number of Employees in the Public Sector under the Law on Ceilings on the Number of Employees setting detailed limits on positions for each institution of the general government (excluding professional soldiers) and local utility companies, (**end-March 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, by end-September we will adopt an action plan for administrative restructuring in the education sector based on functional reviews developed in conjunction with the World Bank (**end-March structural benchmark, modified and reset to end-September**). For education, the plan will identify primary and secondary schools to be closed or merged at the start of the academic year 2018-19. It will also better align educational profiles with demographic changes and workforce needs and include closing intake of at least 25 percent of current TVET profiles (i.e., 106 profiles).

- 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 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, the government adopted a new job catalog (**prior action**) in July and the parliament will approve by end-September the necessary secondary legislation for local governments and public services (health, education, culture, and social protection) (**end-June 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 review and clearly define the coverage of general government to be compatible with European System of Accounts (ESA) 2010 and GFSM 2014 by 2018. As in 2016, we will submit 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 (FMIS) gradually by end-2019. Throughout 2017, we are continuing to work to upgrade the budget execution system to be able to support the integration of new users. To meet our 2018 goal to include prisons and cultural institutions in FMIS, we plan to hold training sessions in 2017Q4. In 2019, social protection institutions will be integrated, having in mind that they are the most numerous and diverse and will need to upgrade their capacities over the period 2017-2019.

- To improve budget discipline and transparency we amended in 2016 the Budget System Law to include all currently extra-budgetary project loans within the budget, starting in 2017, and 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 have also worked to improve budget planning and execution in health institutions.

- We have introduced new regulations and guidelines to improve public investment management. In particular, in June we adopted a decree 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. By end-2017 we will adopt additional amendments to the Law aimed at limiting overall fiscal exposure, ensuring a competitive tender process.

- In the health sector, the number of employees in the public sector has been reduced from about 123,000 in 2010 to about 113,000 in 2016 (8 percent reduction), through a combination of attrition and targeted redundancies focused on nonmedical staff. The projected number of employees in health sector for 2017 is 112,331, which includes 2,500 new staff to be contracted by the HIF by end 2017. The next key next step is to implement health financing reforms, including a transition toward financing based on outputs and outcomes. In the hospital sector, first 14 hospitals will be contracted on partial financing by case payments for inpatient care using Diagnostic Related Groups (DRGs) as of January 1, 2018. The remaining 56 hospitals (including clinical centers) will undergo training, capacity building and information system support so as to be ready to be contracted on partial financing based on DRG by January 1, 2019. Implementation of performance-based financing for primary care is expected to take place by end-2017.

14. To secure savings from the corporate and financial restructuring of public enterprises and SOEs, we are introducing a set 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), starting in January 2016. We are working on a new e-invoice system covering the public sector based on a unique invoice code that would be required at the time of invoicing. The contract for the first steps to establish the new system, envisaging the procurement of required IT resources, has been signed. To stop accumulation of arrears to EPS and Srbijagas, since late-2016 (i) 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) any gas supplies to Azotara or MSK will only be provided on the basis of prepayment, and (iii) we have been publishing monthly reporting of overdue receivables to Srbijagas and EPS of their top 20 debtors 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). The Government will continue to refrain from issuing any implicit state guarantees.

- The diagnostic analysis of the Development Fund (DF) and the export promotion agency (AOFI) by an independent consultant will be completed in August (**end-April structural benchmark**). Based on this study, by end-October supervisory boards of these institutions will adopt Decisions fully recognizing losses on the credit portfolio, taking measures to prevent further deterioration in asset quality, and identifying solutions to resolve impaired assets **(new structural benchmark)**. The supervisory board will adopt a decision to fully recognize losses to safeguard DF's capital, we will refrain from providing any financing without high-quality collateral to SOEs. By end-2017, we will identify needs and options for development finance activities.

15. To raise the efficiency of revenue collection, we are committed to improve tax administration. This work continues 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, (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.

- Due to implementation constraints, we have not been able to adopt 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 (**end-June structural benchmark**). As a first step, in August we will adopt a new systematization plan establishing a risk management unit and a taxpayer service department. We will develop a plan to address our archive and accommodation transition needs.

- In November 2016, the National Assembly approved amendments (**end-December 2016 structural benchmark**) to the Criminal Code to extend the investigations powers and competences of tax authorities to enable the audit of unregistered businesses and strengthen the function of the tax police.

- To enhance the effectiveness of the review of tax appeals, we have established and operationalized the second instance appeal unit at the MoF, while maintaining an independent and substantive review function within the tax administration. We have also institutionalized the dissemination of case details by the MoF when issuing tax opinions.

- To reignite our reform efforts, by end-2017 we will update our Transformation Program so that it focuses on the concrete transformation objectives and reflects the recommendations of recent IMF technical assistance. We will also adopt a government decision by end-October (**new structural benchmark**), which identifies non-core STA activities to be transferred or separately managed within the STA with deadlines to complete the moves. The aim is that by June 2019 all remaining non-core STA activities will be managed separately, while core STA tasks are consolidated into no more than 36 offices.

C. Monetary and Exchange Rate Policies

16. We see the current inflation targeting framework as the most viable option for maintaining stable inflation and protecting the economy against external shocks. In November 2016, we 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 reduced the key policy rate by 400 basis points by mid-2016, to 4 percent, to support returning of headline inflation into the tolerance band. Since July 2016, we have kept the policy rate unchanged at that level, taking into account the inflation outlook and external environment.

17. 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 short-term 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).

18. 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 to support the dinar instruments, and we will further communicate the importance of the dinarization for overall financial stability. Macroeconomic imbalances have been reduced significantly and inflation has remained low and stable on the back of an inflation targeting regime with a relatively stable exchange rate, coupled with fiscal discipline, which should all support dinarization. In the last few years, we have also introduced several measures to increase dinarization, such as higher reserve requirements on and lower remuneration of FX deposits, requirement of partial dinar allocation for reserve requirements on FX deposits, and mandatory down-payment ratios for FX loans. Meanwhile, we have increased the share of public debt in domestic currency, issuing dinar securities at longer maturities. By end-2016, dinarization of deposits has increased to 30 percent, while dinarization has also increased for household lending. The dinarization strategy will be further improved based on recommendations of the recent Fund staff technical assistance, aiming at promoting the development of money and security markets in dinars and foreign exchange risk hedging markets, promoting banks' funding in local currency, and addressing underpricing of FX risk by unhedged borrowers.

19. 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. 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.

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

D. Financial Sector Policies

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

22. The implementation of the NPL resolution strategy is yielding positive results, with NPL ratios falling by more than 7 percentage points since the 2015 peak. 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 Law on Real Estate Appraisers was adopted by the National Assembly in December 2016 (**structural benchmark**). Further amendments to the regime that regulates the profession of court-sworn experts, to be implemented during 2018, 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.

- In early August, we submitted the amendments of the corporate insolvency law to parliament (**end-December 2016 structural benchmark**) with a view to be adopted by end-October 2017.

- To resolve legal ambiguity related to the transfer of the seller's rights to the buyer in the context of distressed assets' sales, in July we submitted to parliament an authentic interpretation of article 48 of the Law on Enforcement and Security, with a view to be adopted by parliament by end-September.

- 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.

23. Banks have continued to improve their reporting framework. The NBS is working with banks and their external auditors to prepare for implementation of IFRS9 starting January 1, 2018, and discuss the implications for banks' financial positions and systems.

24. 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, has become effective as of end-June 2017. Minimum capital requirements have been reduced from 12 percent to 8 percent, while additional capital buffers have been introduced—in line with the EU's Capital Requirement 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. 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 to dealing with sudden shocks.

25. The NBS continues to enhance its macroprudential policy framework. Regulatory amendments for the introduction of new macroprudential instruments have been developed and adopted as part of the implementation of Basel III. The NBS has enhanced its framework for implementation of its macroprudential instruments, in line with recommendations of with IMF technical assistance. Specifically, in June 2017 the NBS has adopted (i) the Decision establishing countercyclical capital buffers (currently set at 0 percent); (ii) the Decision prescribing a systemic risk buffer rate of 3 percent on FX and FX-linked lending to corporates and households to be applied to banks based on their contributions to risks related to euroization; and (iii) the Decision determining the list of systemically important banks and their required capital buffers of 1 or 2 percent.

26. The NBS continues to strengthen its bank resolution capabilities. Guidelines for independent valuation in the context of bank resolutions are being finalized and the preparation of a Resolution Manual is progressing.

27. Reforms of state-owned financial institutions are progressing. We are strengthening our oversight over financial institutions with state-ownership. In May, we hired external consultants to 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 2018-20. Final reports on these issues will be completed by end-August (end-October in the case of the business plan). In early August, the government updated the 2014 strategy for state-owned banks, with the aim to identify strategic options for the smaller banks. The diagnostic review of Dunav Osiguranje (**end-November structural benchmark**) was completed and remedial actions are being implemented; and government decisions on privatization of socially-owned and state-owned capital will be adopted by end-December. We selected a privatization advisor for Komercijalna Bank, the second largest bank in Serbia, and plan to publish tenders for expressions of interest by September, with a view to completing the privatization by end-June 2018, subject to market conditions.

28. We will continue to support credit to SMEs. Given the importance of SMEs for Serbia's economy and the limited access to financing by this sector, we have been supporting lending to SMEs through EIB's credit lines ("Apex loans"), and we have established an NBS working group to consider the introduction of the framework for functioning of non-deposit financial institutions.

29. We have established a working group on capital market development. We will prepare a diagnostic report, in consultation with the World Bank, with a view to inform the government's strategy to enhance capital markets.

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 legislation that governs the eligibility and conditions to receive social assistance, with the aim to improve the effectiveness and targetedness of the cash welfare allowances.

32. We continue implementing 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 several steps and plan to take the following ones:

- **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. In 2016, about 2,000 employees left the company, of which approximately 1,500 through voluntary separation and the rest through attrition. We have established the criteria for the second round of rightsizing in consultation with the World Bank and in line with the labor optimization plan, and a new window to apply for voluntary separation will be opened in August, aiming at reducing the number of employees by 1,000 by end-2017; and by end- 2017, EPS will complete the closure of two inefficient power generation plants, which are already not operating (end-June **structural benchmark**). Following a household tariff increase of 4.5 percent in August 2015 and 3.8 percent in October 2016, another increase of at least 2 percent will be effective in October, which will help ensuring adequate resources for needed maintenance investments. We have engaged the World Bank with a view to enhance corporate governance, management, and procurement and planning frameworks of EPS. 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 improve the viability of the company and ensure its professional management.

- **Srbijagas.** A new organizational structure consisting of subsidiaries for transmission and distribution became effective in August 2015. 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 2017 and the implementation of measures in November 2016 to improve collection rates to prevent future accumulation of arrears. A new investment appraisal methodology, proposed by the World Bank based on an economic and financial cost-benefit framework and including other relevant appraisal criteria, will be adopted by end-October. The new methodology will be used to assess all future projects as well as projects currently in the pipeline. These measures will help improve Srbijagas' financial position and put the company on a sustainable path, thus containing the need for additional state aid.

- **Railways of Serbia**. 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 allowed network access to private operators since February 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 adopted in October 2015 and developed in consultation with the World Bank, EBRD and EU. An updated labor rightsizing plan has been adopted in June, based on new organizational structure proposals prepared in consultation with the World Bank. Following a reduction of 3,146 positions in late 2016 the plan targets additional 2,394 positions by end-2017. In addition, we have closed 422 km of railway lines in 2016 and additional 669 km in April. Railway companies have also fully assigned responsibilities for electricity payments, and will ensure no reemergence of arrears to EPS.

- **Roads of Serbia.** We have increased toll rates by 10 percent, from January 1, 2017 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 2018. We have adopted a plan to remove rigidities in pricing maintenance contracts, which will cover 3,000 km in 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 in 2017 and 2018 in close consultation with the World Bank.

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

- We have re-initiated the privatization tender for PKB, with a view to finalize the process by end-December 2017.
- We have launched a call for a privatization advisor for RTB Bor, and discussions with potential investors are ongoing, including on addressing environmental risks. We expect to launch the tender for privatization by end-October. So far in 2017, the company has been meeting all liabilities, including on taxes, wages, and electricity, as per the pre-pack agreement. No additional subsidies beyond the budgeted RSD2 billion, will be allocated to the company in 2017 and 2018.
- We are developing, with the assistance of the World Bank, an action plan for Resavica mines, identifying the closure timetable for at least 4 unviable mines starting in 2017; allowing for reduction of subsidies from the budget; including rightsizing targets and measures to minimize social costs. In December 2016, we settled long-standing wage arrears.
- We have restructured Petrohemija to eliminate any fiscal risks (including through securing a long-term supply contract from NIS) and have launched a public call for Letters of Interest for a strategic investor in March. In April, the company filed for bankruptcy proceedings in accordance with a pre-pack. This process will be completed by mid-August and we expect to launch a public call for privatization by end-September.
- We have received a number of expressions of interest from potential strategic investors for Azotara and MSK, and expect to receive binding offers by end-September. If the privatization process does not succeed we will initiate bankruptcy procedures by end-October (**end-March structural benchmark**). In the meantime, since January 2017 we have ensured that Srbijagas will not provide any gas to these companies except on the basis of prepayment.
- We have reached an agreement with Galenika's bank creditors and will adopt a government decision by end-July with a view to launch a new privatization tender by end-August a to complete privatization process by the end of the year.

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 June 2017, more than 275 companies entered bankruptcy, and more than 45 were privatized since end-2014. About 26,000 employees from around 320 companies have received severance payments. Around 150 companies with near 52,000 employees remain to be resolved, including the 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 have received letter of interests for long-term concession partnerships for managing the Belgrade Airport, with a deadline to submit binding offers by end-October and to sign a concession agreement by early 2018.

37. We continue to enhance Serbia's competitiveness 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.
- By end-November, we will initiate public debate on a draft Law on Charges **(new structural benchmark)**, which will replace existing laws and by-laws to regulate charges at all levels of government, to ensure greater predictability and transparency. We aim to adopt the new Law by end-2017.
- We have declared 2017-18 as years of the fight against the gray economy, and have updated the national program adopted in late 2015.
- We will submit amendments to the Company Law to the National Assembly by end-September with a view to adopt it by end-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. An action plan to implement the government strategy on e-government has been designed, to support this process.

Program Monitoring

38. The arrangement has shifted 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.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	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	...	7,196	5,262	...	6,885	5,044	...	7,076	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	100.3	54.2	32.0	34.1	-11.8	36.1	35.0	-44.1	-0.2	48.7
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	899.2	887.7	212.2	212.1	198.5	433.5	431.6	413.6	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	380	200	80	...	20	160	...	80	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	...	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	...	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	...	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	...	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	...	-0.3	0.0	...	-0.2	0.0	...	-0.4	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	...	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	...	117	91	...	6.4	208	...	18.6	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*	...	*1.5*	*2.2*	...	*3.5*	*2.5*	...	*3.6*	*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		
1 Adoption by the government of a new job catalog to support implementation of the Law on Public Sector Employees Wage System (MEFP ¶12, fourth bullet).		Met.
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. Adopted in June.
2 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.
3 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	Not met. Modified and reset to end-September.
4 Adoption by the government of 2017 decisions under the Law on Ceilings on the Number of Employees (MEFP ¶12, first bullet).	March 31, 2017	Not met. Adopted in June.
5 Resolution of Azotara and MSK through privatization or regular bankruptcy procedure (MEFP ¶34, fifth bullet).	March 31, 2017	Not met.
6 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	Not met. Draft systematization plan was completed in February; power plants are not operating.
7 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	Not met.
8 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	Not met. Job catalog adopted (PA#1).
Financial		
9 Introduction of a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on real estate valuations filed according to pre-established criteria; and (iii) legislation providing proper supervision of the licensed appraisers. (MEFP ¶22, first bullet).	December 31, 2016	Met.
10 Conduct of a review of the corporate insolvency law and submission of proposed amendments to the National Assembly, in line with recommendations from IMF technical assistance, aimed to ensure: (i) adequate safeguards for the secured creditors rights; and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (MEFP ¶22, second bullet).	December 31, 2016	Not met. Amendments submitted to the National Assembly in August.
11 Complete the independent assessments of the Development Fund and the export promotion agency (AOFI) (MEFP ¶14, third bullet).	April 30, 2017	Not met. Diagnostic assessments will be completed in August.
Proposed New Benchmarks		
12 Adoption by the government of time-bound action plan for administrative restructuring in education sector, based on World Bank functional reviews (MEFP ¶12, second bullet).	September 30, 2017	
13 Based on results of diagnostic analysis of the Development Fund and the export promotion agency (AOFI), supervisory boards of these institutions adopt decisions to (i) fully recognize losses on credit portfolio, (ii) take measures to prevent further deterioration in asset quality, and (iii) identfy solutions to resolve impaired assets (MEFP ¶14, third bullet).	October 31, 2017	
14 Submission to the National Assembly of a new Law on Charges aimed at ensuring greater predictability and transparency by regulating fees and charges at all levels of government (MEFP ¶37, second bullet).	October 31, 2017	
15 Adoption by the government a decision that identifies the non-core activities of the STA to be transferred or separately managed within the STA with deadlines to complete the move (MEFP ¶15, fourth bullet).	October 31, 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; (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; and (v) by a maximum of RSD2 billion to on-lend or issue a new guarantee to RTB Bor for the repayment of expensive debt in 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	7.1	11.5
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.

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[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.

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