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Republic of Serbia: Fifth Review Under the Stand-By Arrangement, Request for Modification of End-September Performance Criterion, and Financing Assurances Review

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on August 31, 2010, with the officials of the Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 13, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement by the IMF Representative on the Republic of Serbia
- A Press Release summarizing the views of the Executive Board as expressed during its September 27, 2010 discussion of the staff report for the Republic of Serbia
- A statement by the Executive Director for the Republic of Serbia

The document(s) listed below will be separately released

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

Fifth Review Under the Stand-By Arrangement, Request for Modification of End-September Performance Criterion, and Financing Assurances Review

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

Approved by Adam Bennett and James Roaf

September 13, 2010

Discussions. A staff team visited Belgrade during August 19–31 to conduct the Fifth Review of the Stand-By Arrangement (SBA). The mission met with Prime Minister Cvetković, Deputy Prime Ministers Dinkić, Djelić, and Krkobabić, Minister of Finance Dragutinović, Labor Minister Ljajić, National Bank of Serbia (NBS) Governor Soškić, other senior officials, representatives of international financial institutions (IFIs), the European Union (EU), trade unions, and the private sector. The staff team comprised Messrs. Jaeger, Floerkemeier, Hajdenberg (all EUR), Messrs. Arnason, Hobdari (SPR), Ms. Jenkner (FAD), and Mr. Podpiera (MCM). Mr. Lissovolik (Resident Representative), Ms. Nestorović, and Mr. Kokotović (local IMF office) assisted the mission. Mr. Antić (OED) attended most policy meetings.

Stand-By Arrangement (SBA). The SBA, approved by the Executive Board on January 16, 2009, was extended to 27 months and augmented to the amount of SDR 2.6 billion (560 percent of quota) in May 2009 (IMF Country Report No. 09/158). The amount available at the completion of this review is SDR 319.6 million, but the authorities have indicated that they intend to purchase only SDR 46.7 million (10 percent of quota).

Program status. All end-June quantitative performance criteria and indicative targets were met.

Key issues: The review focused on four issues: (i) fiscal outlook for the remainder of 2010 and 2011; (ii) fiscal responsibility legislation; (iii) appropriate monetary stance; and (iv) assessing the benefits and cost of and desirable pace of exiting from the credit support programs.

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EXECUTIVE SUMMARY

The economy's recovery has continued, but it lacks strong momentum. Although Serbia compares well with neighboring peers, GDP growth in 2010 is unlikely to exceed 1½ percent. Moreover, growth is not yet broad based, and its pace is insufficient to generate employment growth.

Concerns about spillovers from the Greek crisis have subsided, but risk premia remain elevated. Investors remain bearish both on the dinar and on sovereign debt, as reflected in high sovereign spreads. As a consequence, demand for the government's dinar T-bills has been disappointing, with auctions on longer-term T-bills in particular undersubscribed.

Upside risks to inflation have increased, notwithstanding the weak economy. Inflation fell below the NBS lower tolerance band during the first half of 2010, but moved back within the band in July. Reflecting mainly rising food prices and the pass-through from the significant dinar depreciation in recent months, inflation is now projected to increase above the NBS's target of 6 percent at end-2010, but move toward the center of the target band in 2011. In response to these new inflation concerns, the NBS has recently reversed its easing stance, hiking the policy rate in two steps cumulatively by 100 basis points to 9 percent.

Agreement was reached to maintain fiscal deficit targets for 2010 and 2011, but to advance the unfreezing of wages and pensions from April to January 2011. The program will continue to target fiscal deficits of 4¾ percent of GDP in 2010 and 4 percent of GDP in 2011. However, it was agreed to start inflation indexation of public wages and pensions in January 2011 (instead of April 2011), within the unchanged deficit target for 2011.

New fiscal responsibility legislation should help underpin fiscal restraint over the medium term. Agreement was reached on a numerical fiscal balance rule, along with moderate indexation arrangements for public wages and pensions, both essential elements to sustaining fiscal discipline and avoiding a shift back to the pre-crisis procyclical fiscal policy behavior.

There was also agreement to phase out financial emergency arrangements put in place during the crisis. Serbia's banking system proved remarkably resilient during the crisis, and, with the risks of a financial meltdown subsiding, the authorities have been proactive in phasing out foreign parent banks' voluntary exposure commitments. Moreover, as credit markets are now operating more normally, there was also broad agreement to start phasing out transparently the credit support programs. While these programs may have buffered output during the height of the crisis, delaying the exit too long would have high budget costs and could slow the pace of needed restructuring of the economy.

I. RECENT DEVELOPMENTS

1. **The SBA is on track**. End-June data indicate that all quantitative performance criteria were met (Table 1). The structural benchmark on adopting a taxpayer compliance strategy was also met. Amendments to the Budget System Law, including fiscal responsibility provisions, will be submitted to parliament in September, and this is a prior action for completing the review (Table 2).

2. **Serbia's growth performance compares well with surrounding regional peers, but the recovery lacks strong momentum**. Output is recovering, but a continued labor market shakeout weighs on the economy (Figure 1). With both the region and key trading partners in the EU emerging only slowly from their deep recessions, exports remain well below pre-crisis levels, notwithstanding a much more competitive exchange rate. Nevertheless, Serbia's growth in 2010 has held up well when compared with the performance of regional peers. The steep exchange rate depreciation buffered domestic activity via expenditure switching effects, while credit support programs may have helped mitigate the impact on output from the boom-bust cycle in credit markets (Box 1).

Box 1. Did Credit Support Programs Buffer Serbia's Output?

Once the global financial crisis spilled over in late-2008, Serbia's credit boom turned to bust. Banks tightened credit standards, which had been excessively loose during the credit boom. Borrowers curtailed credit demand given the sudden worsening in economic prospects and higher credit cost, as well as to repair their over-leveraged and mis-matched balance sheets.

In response, the government launched an array of credit subsidy programs, and the NBS allowed banks to deduct credits provided under the subsidy programs from the reserve requirement base. Interest rates on subsidized loans were generally capped, and loan amounts were limited. As banks were keen to retain customers that requested subsidized loans at capped interest rates, banks may also have contributed an implicit subsidy.

By subsidizing a limited amount of credit per borrower, the credit support programs improved corporate cash flows at the margin, lowered borrowing costs, facilitated debt payments, and lowered insolvency rates. While accurate quantification of the effect of the credit support programs on GDP growth is not possible, rough estimates for 2010 of the growth-boosting effects of the programs cluster around ½ percent. However, there were also costs. In the 2010 budget, the subsidy cost will likely amount to ½ percent of GDP. In addition to the direct budgetary cost, and NBS income losses from reserve requirement deductibility, the credit support programs slowed the pace of deleveraging and the restructuring of nonviable companies, a supply-side cost that is likely to increase as credit market activity normalizes.

3. **Notwithstanding the weak economy, upside risks to inflation have increased.** After six consecutive months below the lower limit of the NBS's inflation tolerance band, CPI inflation moved back within the band in July, while inflation expectations remain elevated (Figure 2). Lagged exchange rate pass-through is projected to further raise inflation. Food price inflation has recently surprised on the upside, owing to a summer harvest damaged by heavy rains and soaring global wheat prices. The NBS responded by raising its policy rate in two steps from 8 percent to 9 percent, while signaling a tightening bias.

4. **Although concerns about spillovers from the Greek debt crisis have subsided, risk premia remain elevated, constraining the scope for budget financing using dinar T-bills.** The dinar/euro rate weakened substantially since May, despite stepped up FX interventions. Investors remain bearish both on the dinar and on sovereign debt, as reflected in higher EMBI spreads (Figure 3). As a consequence, demand for the government's dinar T-bills disappointed, with auctions undersubscribed, notwithstanding T-bill rates well above the NBS's policy rate.

5. **Credit growth has been picking up slowly, partly boosted by credit support programs, but credit quality has continued to deteriorate.** Domestic credit growth has picked up since late 2009, although the increase barely compensates for declining cross-border loans (Table 12, Figure 4). The share of subsidized loans in fresh lending has increased substantially. Non-performing loans (NPLs) rose further during the first half of 2010 (Table 8), but banks have large buffers, also confirmed by stress tests, to absorb potential losses.

II. Policy Discussions

A. Macroeconomic Framework

6. **The pace of economic recovery is projected to accelerate gradually**. GDP growth in 2010 continues to be projected at 1½ percent, accelerating to 3 percent in 2011, and to pre-crisis levels over the medium term (LOI ¶5, Tables 3–4). However, near-term prospects for the labor market remain poor, with further job losses expected.

7. **The outlook for inflation remains within the target range, despite the recent emergence of upside risks.** Reflecting mainly rising food prices and exchange rate pass-through, inflation is now projected to rebound in the second half of 2010, ending the year somewhat above the NBS's target of 6 percent, slowly reverting to the center of the target band toward end-2011 (LOI ¶6, Figure 2). With inflation expectations still elevated, this outlook assumes a continued moderate recovery, restraint on public wages and pensions, and no further FX premia shocks.

8. **The financing of the projected current account deficits relies on continued large private inflows**. (Tables 9–10, LOI ¶7). The external deficit is projected to be covered

mainly by private inflows, particularly FDI—including through privatization, but also resumed bank and corporate borrowing abroad. Gross international reserves are projected to see a small decline in 2010 as a result of the FX interventions, stabilize in 2011, and thereafter rise gradually. Under these assumptions, gross external debt would peak at almost 80 percent of GDP in 2010, but then decline over the medium term (Table 11).

9. **The main short-term risks are: a global double-dip, additional food price shocks, and a further ratcheting-up of risk premia.** A double-dip recession would curtail exports and dampen private investment prospects. Additional food price shocks and further exchange rate depreciation could push headline inflation above the tolerance band, even assuming a decisive and early monetary policy response. Higher FX risk premia would cloud the external financing outlook.

B. Fiscal Policy

10. **For 2010, it was agreed to maintain the fiscal deficit target at 4¾ percent of GDP.** Fiscal developments during the first half of 2010 were broadly in line with projections, and the macroeconomic framework is largely unchanged. Discussions for the remainder of 2010 therefore focused on: (i) updating the revenue forecast; (ii) identifying possible underexecution of budgeted spending; (iii) evaluating options to re-allocate such funds; and (iv) revising the financing strategy (Table 7, LOI ¶8–12). With spending underexecution expected to be relatively small, the scope for spending re-allocations is limited. Despite some internal differences, the authorities confirmed that the nominal wage and pension freezes will be maintained through 2010. The sharp rise in Serbia's risk premium has forced the authorities to revise their financing strategy for 2010. Instead of financing the programmed deficit heavily by issuing longer-dated dinar T-bills (12–24 months), the authorities have put more emphasis on the issuance of shorter-term T-bills (3–6-months) and plan to increase FX borrowing from the highly liquid domestic banking system.

11. **As part of their exit strategy from the SBA, the authorities have decided to use fiscal responsibility legislation as a key commitment device**. There was agreement that delegating the enforcement of fiscal discipline to a strong ministry of finance (or small government committee) was not an option given Serbia's high political fragmentation. At the same time, it was recognized that fiscal responsibility legislation is not a panacea, that it will need to be supported by public financial management reforms, and that any fiscal responsibility legislation will be stress-tested by the upcoming 2012 elections. The authorities opted for a combination of fiscal rules (LOI ¶13), centered around a numerical rule for the general government deficit (Box 2). Comparing the fiscal deficit path under this rule with actual fiscal policy behavior during 2003–10 suggests that the ultimate challenge for the fiscal rule will not be so much to contain high fiscal deficits during "bad times" (when growth is below average), but to enforce countercyclical fiscal policy behavior during "good times" (when growth is above average) (Figure 5). An independent fiscal council will also be

Box 2. Choosing a Fiscal Balance Rule for Serbia

Picking a numerical fiscal balance rule for Serbia for 2011–15 came down to trading off simplicity against other desirable properties of fiscal rules. In the end, the final decision had to be made between two competing choices. The first choice was a rule proposed by Marin (2002):[1/]

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

where d is the deficit-GDP ratio, d* is the medium-term deficit, g is the real GDP growth rate, g* is medium-term GDP growth; α and β are parameters that capture how responsive the deficit would be to deviations from the target deficit and GDP fluctuations around average growth, respectively.

The second choice was a simple rule, whereby the fiscal deficit would be reduced by at least 0.75 percent of GDP each year during 2011–2015.[2/]

The 0.75 percent rule has one main attraction, but also one significant drawback. On the positive side, it is simple and, therefore, easy to communicate. But this rule could also result in unduly large tightening or loosening if GDP growth turns out to be volatile. Moreover, this rule could result in an upward drifting, unanchored deficit, as experienced by several euro-area countries before the global financial crisis.

The equation rule was seen as posing communication challenges in the Serbian setting. However, it also had the advantage of potentially reducing the procyclicality of fiscal policy, while providing a framework for assessing the reasons why actual deficits deviate from targeted deficits ("Was it policy or automatic stabilizers?").

Setting the parameters as α=0.30, β=0.40, d*=1.0, and g*=4.0, both rules are consistent with a 4 percent of GDP deficit target in 2011, but with growth projected to rise well above 4 percent from 2012 onward, the equation rule implies more front-loaded fiscal adjustment than the 0.75 percent rule.

In the end, the decision was to adopt the equation rule. The equation rule was supplemented by a temporary "golden threshold rule:" public investment spending in excess of 4 percent of GDP (in 2011) or 5 percent of GDP (2012–15) will not count toward the targeted fiscal deficit, but this golden rule exemption will be capped at 2 percent of GDP. This rule was included in order to at least partially accommodate high-cost, lumpy public investments given Serbia's still large infrastructure needs coupled with the prospect of sizable privatization receipts. The fiscal council and the state audit institution will be tasked to assess whether investment spending is classified in accordance with accounting standards.

[1/] See Marin (2002), ECB Working Paper 193.
[2/] A variant of this simple rule ("reduce the cyclically-adjusted balance by at least 0.5 percent of GDP per year") was generally used to assess progress on fiscal consolidation in euro-area countries.

set up, and the procedures for budget preparation, execution, and monitoring will be strengthened.

12. **In line with the provisions of the fiscal responsibility legislation, the fiscal deficit target for 2011 was set at 4 percent of GDP** (LOI ¶14). After a contentious debate within the coalition government, it was agreed to advance the first CPI indexation increase of public wages and pensions from April to January 2011, while cancelling the one-off bonus payments in January that had previously been envisaged. The net cost of advancing the indexation increase by three months will depend on the size of the food price shock during the second half of 2010, but, on current projections, is thought to be manageable within the 2011 budget envelope. At the same time, this move was considered a balanced step to help defuse rising social tensions and trade union unrest after two years of sustained nominal freezes of public wages and pensions.

13. **The likely privatization of Telekom Srbjia in 2011 could well increase populist pressures to relax fiscal constraints, notwithstanding the fiscal responsibility legislation.** The authorities agreed that the possibly large proceeds from the sale of the state-owned telecommunications company should not affect fiscal deficit targets for 2011 and would be managed prudently (LOI ¶15).

14. **Implementation of the recently adopted tax compliance strategy should help address chronic tax administration weaknesses** (LOI ¶16). These include: (i) a lack of strategic and business planning capabilities; (ii) inadequate management information systems; (iii) insufficient application of risk management principles in audit and other enforcement work; (iv) weak audit procedures, inadequate equipment, and poor IT system support; and (v) limited taxpayer education, information dissemination, and assistance.

15. **The mission expressed its disappointment about the slow pace of structural fiscal reforms; the authorities pointed to several bottlenecks.** There has always been a consensus under the program that nominal wage freezes could only be a stop-gap measure, and that medium-term reductions in public employment will also be needed, not least in view of cross-country evidence that wage and staffing levels in Serbia's government sector are relatively high (Box 3). However, the envisaged reforms in the health care and education sectors, along the lines of recent World Bank recommendations, have made little headway. Although the authorities confirmed their commitment to these reforms (LOI ¶18), some officials noted that it was difficult to implement serious structural reforms in the middle of a crisis, others noted that the skilled personnel needed to implement such reforms is not available at present levels of public sector pay, while some doubted the very feasibility of sweeping structural reforms by a ten-party coalition government.

Box 3. Serbia's Government Wage Bill—A Regional Comparison

Serbia's government sector wage bill is significantly higher than in most new EU member countries (text table). The government wage bill as a percent of GDP (Wg*Lg/Y) can be decomposed in three (multiplicative) components: (1) government employment as a share of economy-wide formal sector employment (Lg/L); (2) the average government wage as a share of the economy-wide wage; and (3) the economy-wide wage bill as a percent of GDP (w*L/Y).

Central and Eastern Europe: Comparison of Government Wages and Employment, 2008 1/

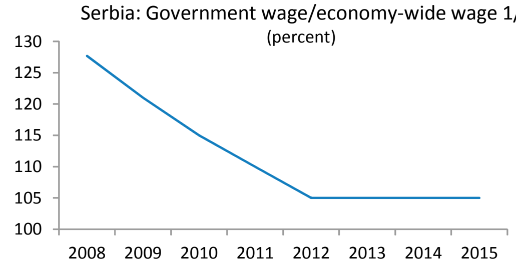
	Government wage bill 2/ (in percent of GDP)		Government employment (in percent of economy-wide formal sector employment)		Average government wage (in percent of economy-wide wage bill)		Economy-wide wage bill (in percent of GDP)
	W_g*L_g/Y	=	L_g/L	x	W_g/W	x	w*L/Y
Serbia	12.7		22.2		127.7		44.7
Latvia	12.0		20.3		119.1		49.6
Hungary	11.6		21.5		107.7		50.0
Estonia	11.4		19.1		103.2		57.7
Slovenia	11.1		19.1		112.7		51.6
Lithuania	10.8		21.4		102.1		49.4
Poland	10.0		19.3		103.2		50.4
Romania	10.0		14.0		120.3		59.5
Bulgaria	9.0		17.9		119.4		42.1
Czech Republic	7.6		18.3		100.6		41.2
Slovakia	6.6		19.8		85.1		39.2
Average (New Member States 10)	10.0		19.1		107.3		49.1

Sources: Eurostat for 10 New Member States; Statistical Office of the Republic of Serbia.

1/ Government sector defined as sum of public administration and defense, education, and health (NACE-Rev.2).
2/ Compensation of employees and employers' social contributions.

Serbia's relatively high government wage bill reflects relatively high government wages, and, to a lesser extent, relatively high government employment.

Serbia: Government wage/economy-wide wage 1/
(percent)



1/ Agreed wage-indexation formula until 2012; government wages indexed to private sector wages afterwards.

Reducing the high government wage bill is one of the key anchors in the Serbian authorities' efforts to cut high fiscal deficits. Structural fiscal reforms, particularly in the health and education sectors, aim at rationalizing staffing, and the regional comparison suggests that overstaffing provides indeed some scope for "doing more with less." At the same time, nominal freezes (2009–10) and moderate indexation (2011–12) are expected to moderate average government wages. But could the nominal freezes and the planned indexation schemes lead to an excessive reduction of the ratio of average government wages relative to economy-wide pay? While there is no straightforward answer to this question, by 2013, the ratio would still be close to the average of the ratio for the new member states in 2008 (text chart).

C. Monetary and Exchange Rate Policies

16. **With inflation risks now clearly tilted to the upside, the monetary policy stance has appropriately shifted to a tightening bias** (LOI ¶19)**.** Mostly on account of the prospect of higher food prices and still elevated FX risk premia, the authorities were of the view that policy rate increases, coupled with a tightening bias, were needed to signal the NBS's commitment to its inflation target. Staff agreed that upside risks have increased. But it was less clear whether this called for immediate, pre-emptive actions on the policy rate. For their part, the authorities argued forcefully that Serbia's inflation targeting regime still needed to build credibility. They therefore believed, and staff concurred, that decisive and early action was warranted.

17. **The authorities noted that the recent dinar depreciation reflected multiple factors, which are difficult to separate and quantify.** The turbulence surrounding the Greek crisis raised Serbia's FX premia, prompting dinar depreciation. Once the dinar broke for good through the 100 dinar/euro threshold, a feedback loop was triggered, whereby non-residents unwound their carry-trade positions, domestic banks hedged their dinar exposure, and households were reluctant to convert FX cash holdings into dinars. In addition, the surge in dinar loans, extended mostly under the credit support programs, may have put additional pressure on the exchange rate, as these loans were used to a large extent to repay existing FX loans or finance imports. Finally, depreciation pressures may also have stemmed from the phased lowering of reserve requirements introduced in March (LOI ¶21).

D. Financial Sector Policies

18. **There was agreement that the time has come to begin phasing out financial emergency arrangements put in place during the crisis, particularly in two areas:**

- ***Exposure commitments under the European Banking Coordination Initiative (EBCI):*** Foreign parent banks as a whole have honored their commitment to maintain their exposures vis-à-vis Serbia (Figure 6). But the collective action rationale for avoiding a financial meltdown has faded, allowing the authorities to reduce the floor on bank exposures to 80 percent since April 2010 (LOI ¶22).

- ***Credit support programs*:** While these programs may have helped prevent corporate insolvencies in the wake of the global financial crisis, delaying the exit from such programs for too long has high budget costs and could slow the pace of restructuring of the economy (LOI ¶23).

19. **The authorities are strengthening the debt collection and restructuring framework.** Specifically, progress has been made on blocked-accounts issue (TMU, ¶23), the out-of-court debt restructuring option, and the framework for prepackaged restructuring plans has already proven its worth (LOI ¶24).

20. **The authorities are also taking steps to further reduce financial vulnerabilities:**

- ***Introducing Basel II framework:*** The authorities noted that adoption of the Basel II framework on January 1, 2011, is on track (LOI ¶25).

- ***Facilitating de-euroization:*** The main stakeholders (authorities, banks, and IFIs) have forged a coordinated tripartite strategy to address the risks from high euroization (LOI ¶26). The authorities are focusing on domestic market development and on amending legislation to enable FX-hedging. Banks have expressed willingness to refrain from risky unhedged lending practices, while helping to develop FX hedging markets. And some IFIs are expected to issue local currency instruments. There was, however, also agreement that the key bottleneck for successful de-euroization remains the unwillingness of the Serbian public to accumulate dinar savings, which is ultimately constrained by the public's long-standing distrust of the local currency and an exceptionally low savings rate.

- ***Improving financial crisis resolution tools:*** The authorities, drawing on long-standing World Bank support in this area, plan to amend relevant laws to establish transparent procedures and tools in the event of a systemic banking crisis.

E. Structural Policies

21. **As in the case of structural fiscal reforms, progress on growth-oriented structural reform has remained slow** (LOI ¶27–28)**.** On the positive side, there have been no retrograde steps on structural reforms, although proliferating charges and levies imposed by many ministries and local governments to address funding shortages have riled foreign investors. But the crisis could have been used as an opportunity for far-reaching pro-growth reforms. This said, restructuring of the inefficient public enterprise sector has been hampered by the heavy influence of political parties in the sector. Attempts to improve the business climate often got stymied by coordination problems among ministries controlled by different members of the governing coalition. Upgrading of the legal framework on key growth-related issues was also much slower than expected, often due to opposition of special interests, especially in the areas of competition and public procurement.

III. Program Issues

22. **Consistent with Serbia's balance of payments needs, the authorities intend to continue to request only a partial drawing under the SBA following the completion of the Fifth Review.** Serbia's gross FX reserve position appears comfortable from a cross-country perspective, but net foreign assets and net free reserves are significantly lower (Figure 7). Moreover, while projected net capital inflows leave only small financing gaps in 2010 and 2011, there are considerable uncertainties attached to these flows. With 68.4 percent of quota available for drawing following completion of the Fourth Review, the authorities drew only 10 percent of quota and stated that they intended also to seek partial

drawings of a similar scale for the final three reviews. In line with their decision in the context of the Fourth Review, the authorities have confirmed that they intend to request a further partial drawing of SDR 46.7 million following the completion of the Fifth Review. The EU has confirmed that the release of €100 million in macro-financial assistance and disbursement of a €50 million budget support grant remain contingent upon continued drawings under the Fund arrangement.

IV. Financing Assurances Review

23. **Serbia continues to make good-faith efforts to settle remaining official external debt issues—including external arrears.** Regarding the renegotiation of restructuring agreements with Paris Club members following the break-up of the Union of Serbia and Montenegro in 2006, the authorities estimate that in excess of 80 percent of the outstanding Paris Club debt has been reconciled, and that the remainder will be resolved before end-2010. Agreements have been reached with nonparticipants in the London Club settlement and with all but two official non-Paris Club creditors; negotiations with the latter (the Czech Republic and Libya) are ongoing. Remaining official external arrears mostly relate to debts of the former Yugoslavia.

V. Staff Appraisal

24. **The Serbian economy is recovering, albeit at a pace that is insufficient to generate employment growth.** While growth is not yet broad based, earlier concerns about renewed instability triggered by the Greek crisis have dissipated for now. But, with growth projected at 3 percent in 2011, short-term prospects for sustained job creation remain poor. Medium-term growth and employment prospects also hinge crucially on adequate capital inflows through the resumption of foreign direct investment and external borrowing.

25. **The modest short-term outlook for output and employment growth underscores the imperative of structural reforms.** However, implementation of measures to streamline business regulations has been slow and, despite the likely sale of the government's stake in Telekom early next year, slow progress has been made regarding the privatization and restructuring of public enterprises.

26. **Notwithstanding the modest pace of economic recovery, inflation risks have increased**. Lagged exchange rate pass-through and a disappointing summer harvest have pushed inflation back within the NBS's tolerance band, and upside risks for inflation have increased. In this context, the recent decisions to tighten the monetary stance were appropriate given the NBS's inflation-targeting framework, and the need to bolster the credibility of this framework.

27. **An unchanged fiscal deficit target for 2010 of 4¾ percent of GDP remains appropriate.** This is the case both from a fiscal sustainability perspective and in view of the difficulties encountered recently in securing financing through the sale of dinar T-bills.

Revenues are unlikely to over-perform significantly in 2010 and under-execution of spending is set to be limited, leaving only marginal scope for re-allocation of spending within the budgeted envelope. Meanwhile, it is important to ensure that adequate resources are made available to protect the most vulnerable groups of the population.

28. **The new fiscal responsibility legislation should help underpin fiscal restraint over the medium term, particularly if the economy expands faster than presently projected**. The envisaged numerical fiscal balance rule, along with the indexation arrangements for public wages and pensions, is essential to sustaining fiscal discipline once the program with the Fund expires in early-2011. Much effort has been expended to tailor the fiscal responsibility legislation to Serbia's circumstances. As illustrated by Serbia's procyclical fiscal policy behavior before the crisis, the ultimate challenge will be to enforce countercyclical behavior when growth runs above average. At the same time, it will be important to avoid abusing the limited golden rule exemption for public investment by mis-classifying current spending as investment spending. The envisaged independent fiscal council is likely to prove helpful in monitoring the implementation of the fiscal responsibility legislation.

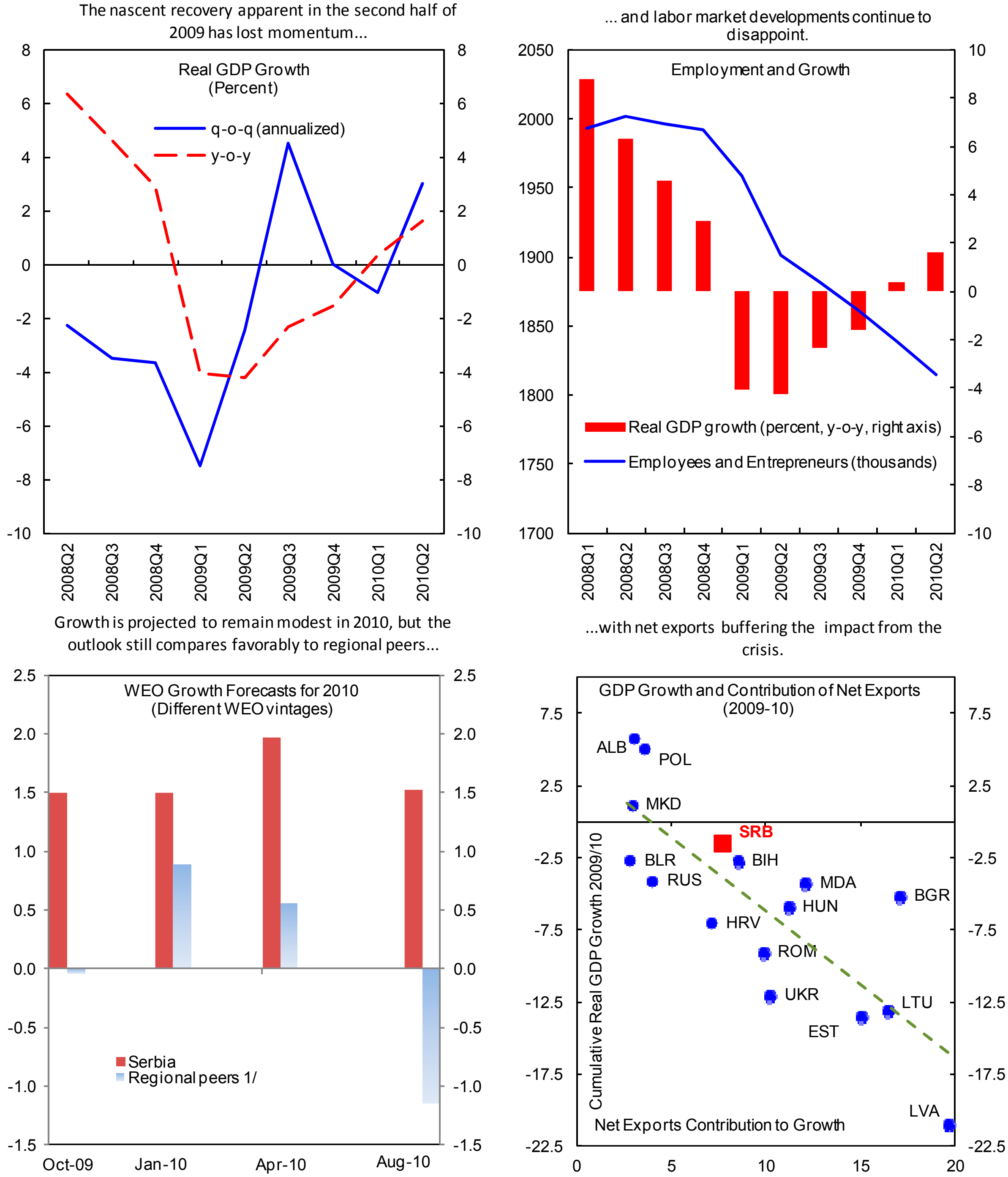
29. **Consistent with the provisions of the fiscal responsibility legislation, a deficit target for 2011 of 4 percent of GDP is appropriate**. Within this target, there is scope to gradually exit from the freezes of nominal public wages and pensions, beginning in January 2011. However, given the likely downward pressure on revenues and the desirability of maintaining public investment at least at current levels relative to GDP, the constraint on current spending will be tight. The authorities' intent to stick to the fiscal deficit target for 2011 irrespective of possible large privatization proceeds is welcome.

30. **The adoption of the tax compliance strategy is welcome**. This strategy should help address some of the key weaknesses in tax administration. At the same time, the proliferation of earmarked levies on both the Republican and local government levels is of increasing concern, as it risks compromising the business environment and mars the transparency of the tax system. Instead, measures to enhance revenue should focus on tax administration reform and the broadening of tax bases.

31. **With the financial sector emerging from the global financial turmoil relatively unscathed, the authorities should gradually phase out emergency arrangements.** Serbian banks have proved remarkably resilient during the crisis, and voluntary exposure commitments under the EBCI have been largely honored. The authorities have rightly been proactive in phasing out these exposure floor commitments. Moreover, as credit markets are operating more normally following the recent boom-bust cycle, it is also time to phase out in a transparent manner the credit support programs put in place during the height of the global financial crisis.

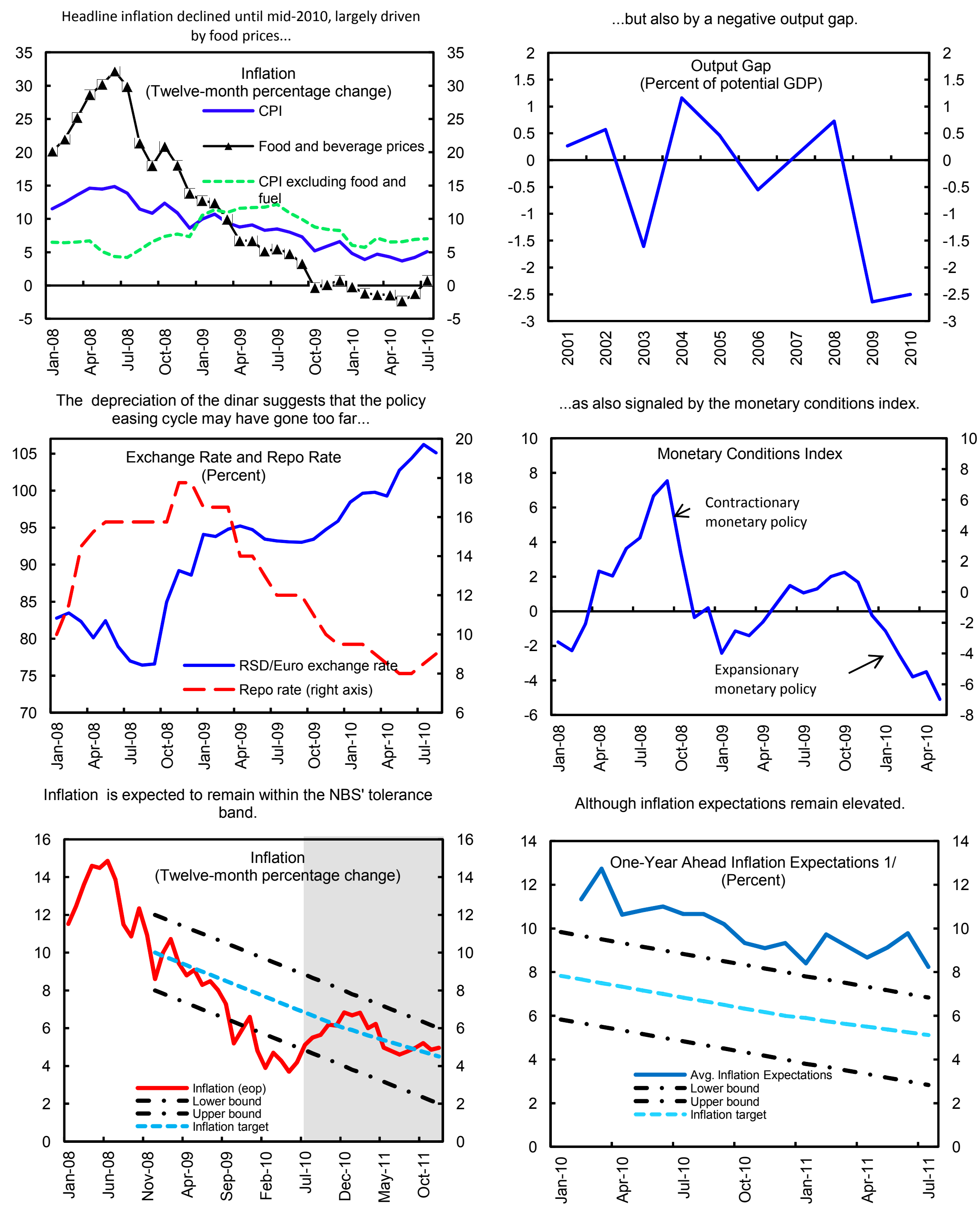
32. **On the basis of Serbia's satisfactory performance under the SBA, staff supports the authorities' request for the completion of the Fifth Review and the financing assurances review**. Staff also recommends revising end-September quantitative conditionality and establishing quantitative conditionality for end-December 2010, as specified in the Letter of Intent (LOI Table 1).

Figure 1. Serbia: Economic Indicators, 2008-10



Sources: National Bank of Serbia; Serbian Statistical Office; Ministry of Finance; and IMF Staff calculations.
1/ Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia FYR, and Romania.

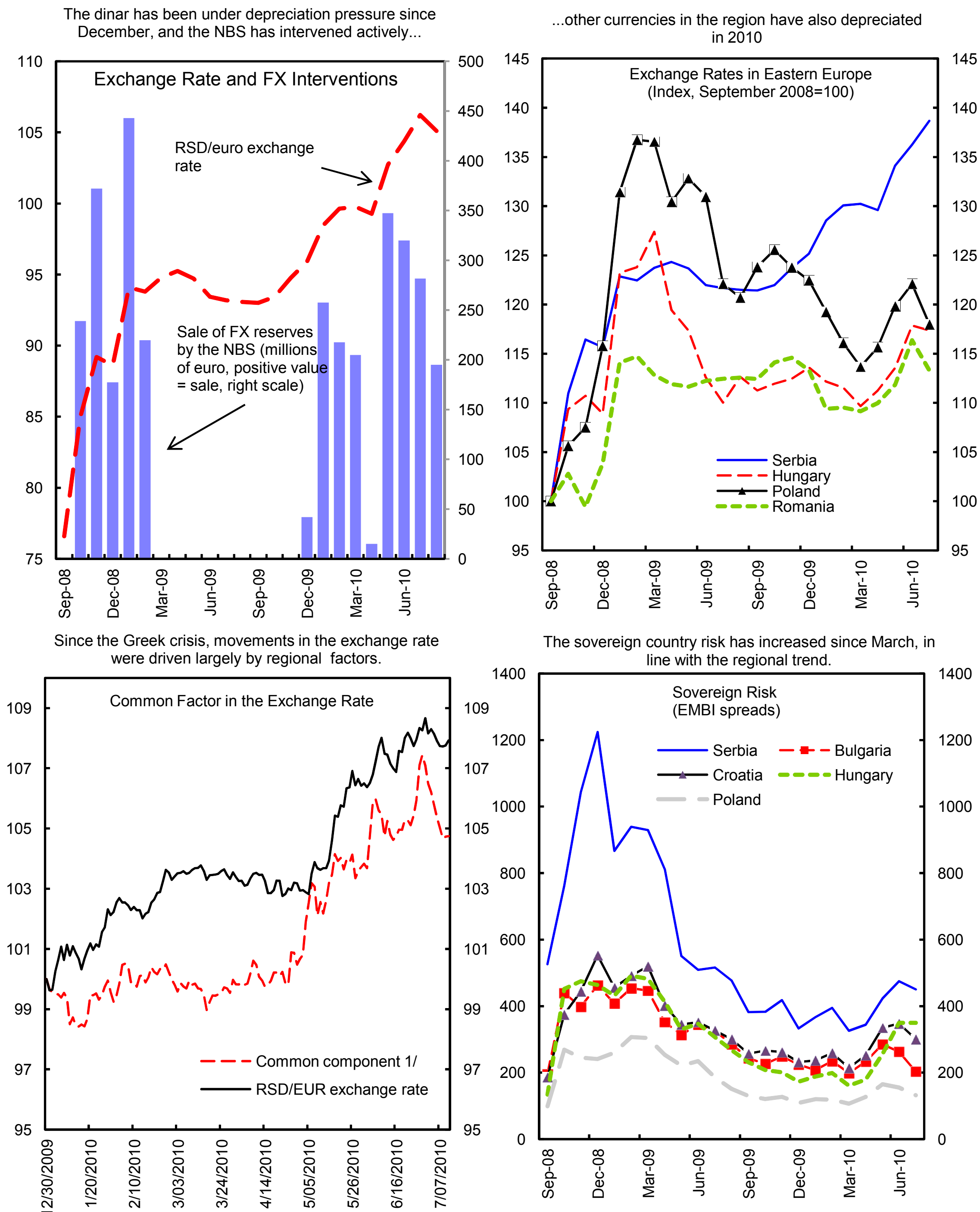
Figure 2. Serbia: Inflation and Monetary Policy, 2008–11



Sources: National Bank of Serbia; Statistical Office of Serbia.

1/ Average of surveys of the financial sector, enterprises, and the trade unions.

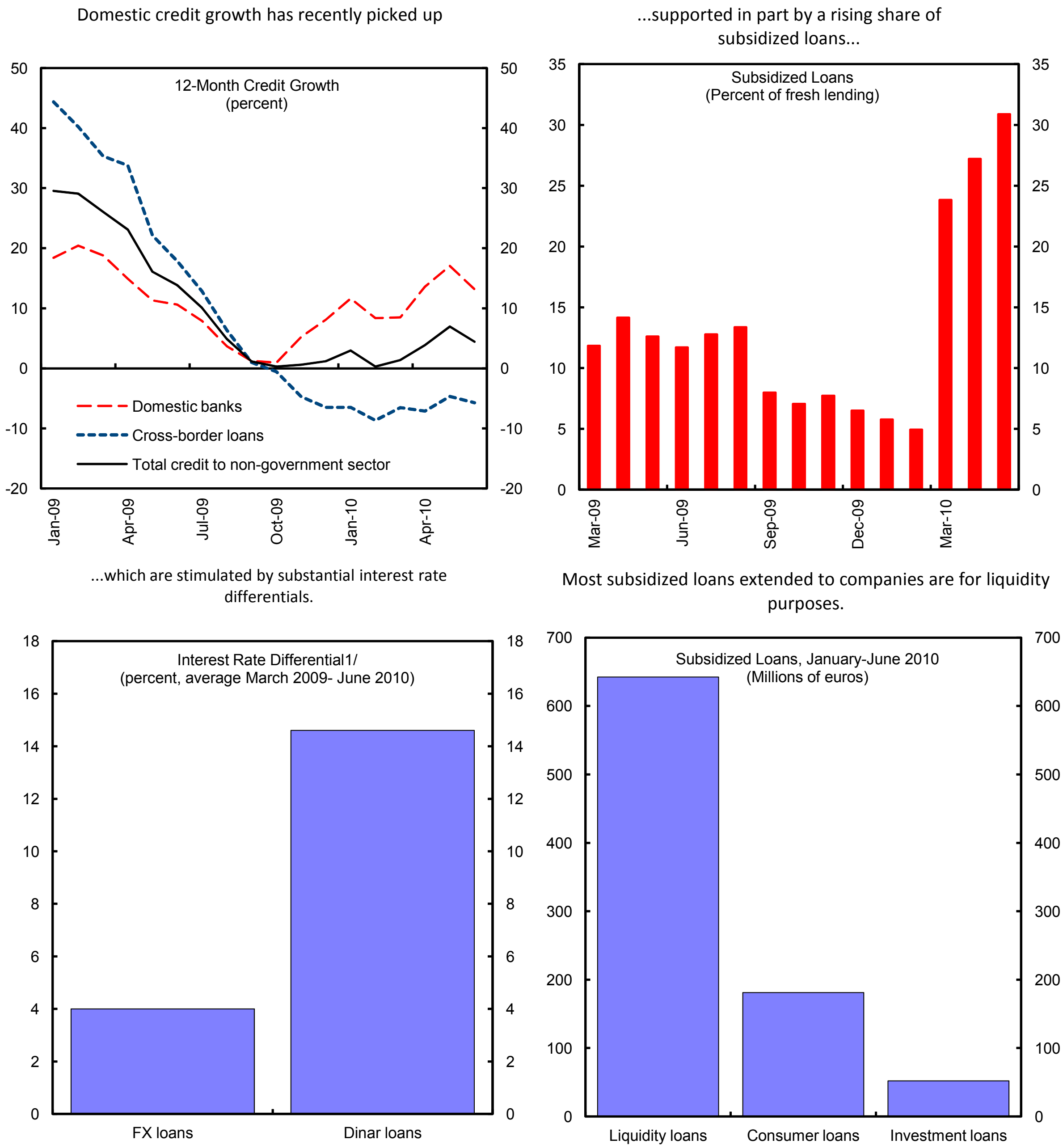
Figure 3. Serbia: Exchange Rate Developments, 2008-10



Sources: National Bank of Serbia and the IMF's Information Notice System.

1/ The sample includes Serbia, Hungary and Romania.

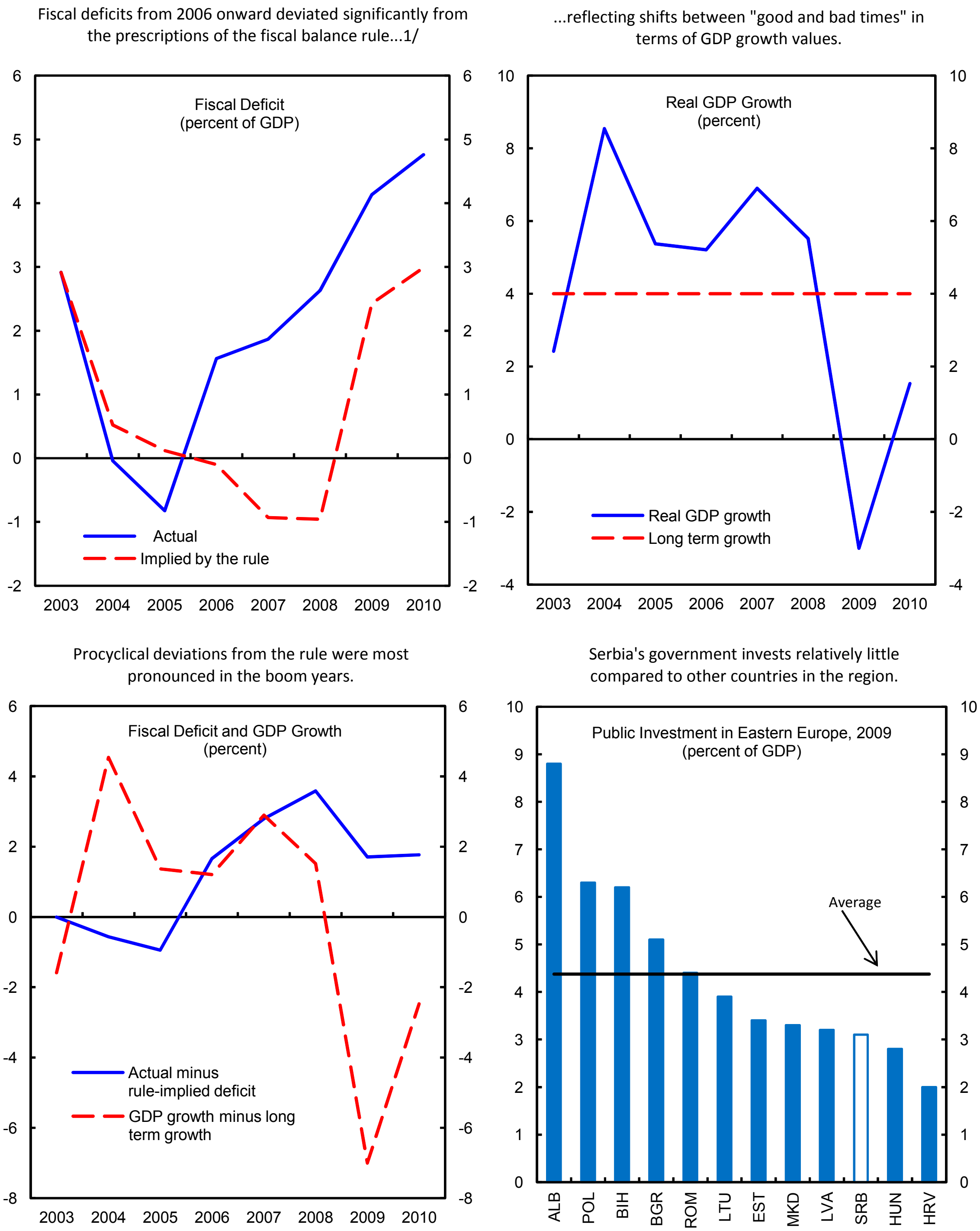
Figure 4. Serbia: Credit Market Developments and Credit Subsidies, 2009-10



Source: National Bank of Serbia.

1/ Difference between interest rates paid by borrowers on subsidized and non-subsidized loans.

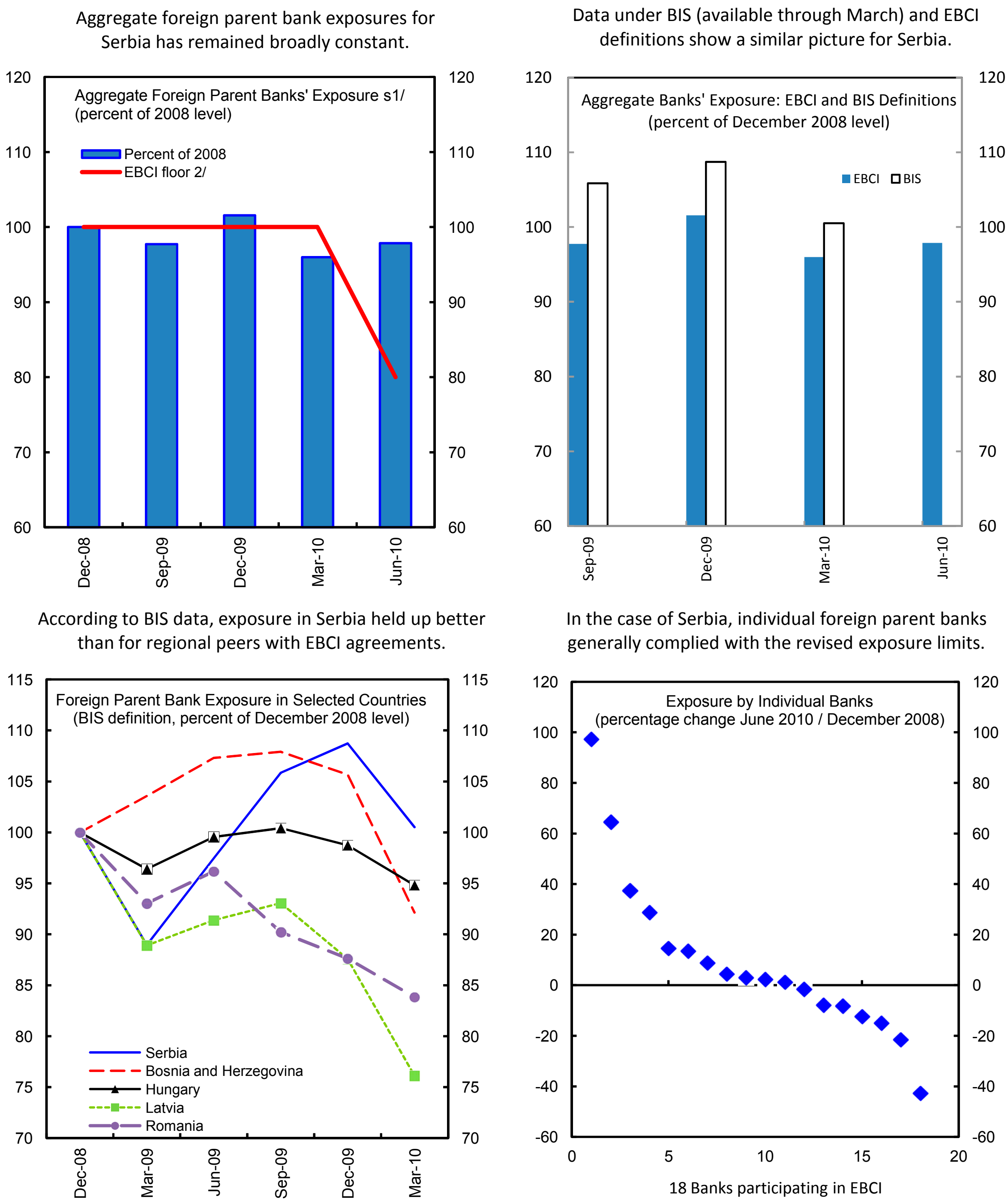
Figure 5. Serbia: Fiscal Policy Behavior, 2003-10



Source: Serbian authorities; and IMF staff calculations.

1/ Refers to the numerical fiscal rule as described in Box 2.

Figure 6. Serbia: Foreign Parent Banks' Exposures under the EBCI

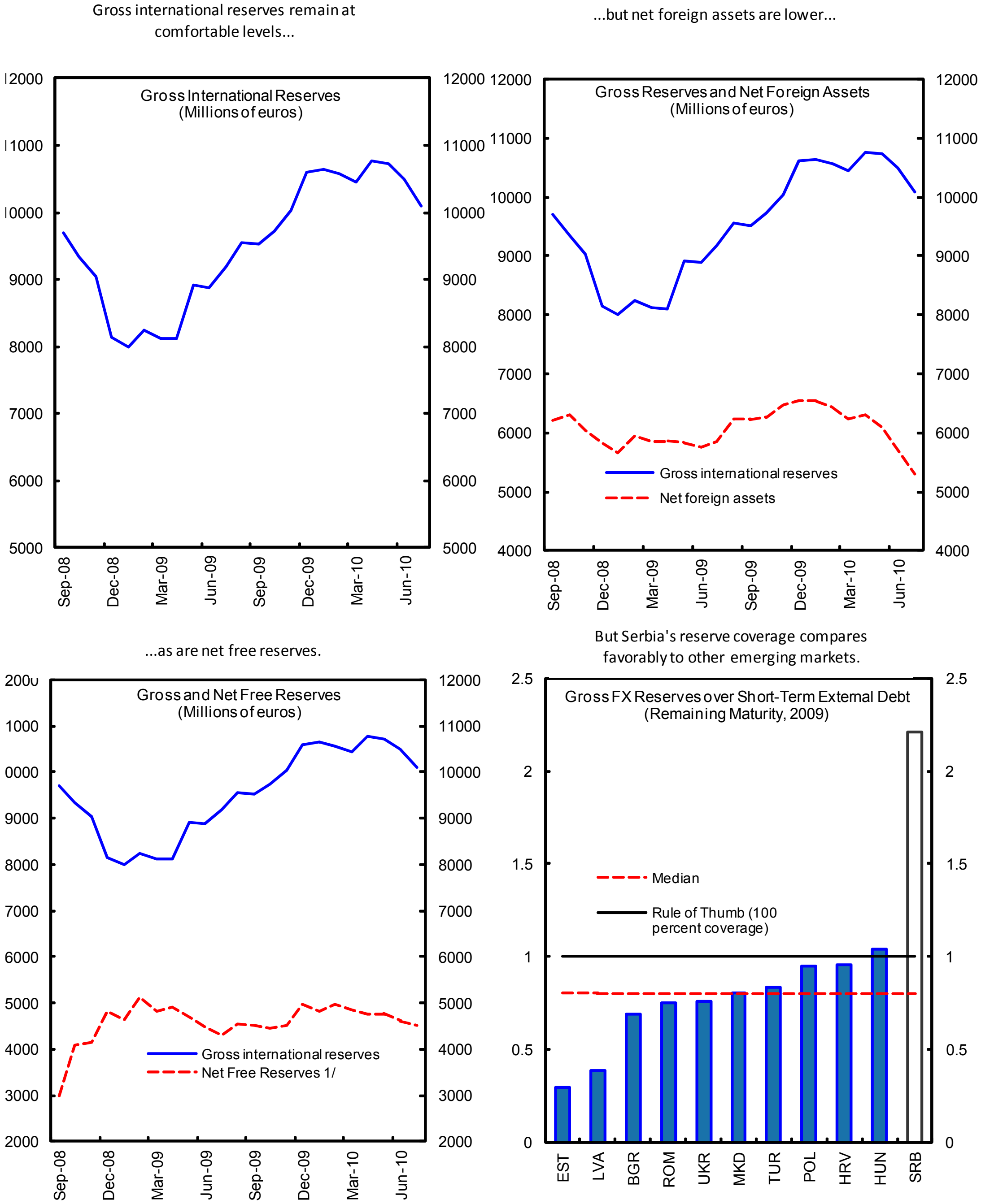


Sources: National Bank of Serbia; BIS (Banking Statistics, Table 6A); and IMF staff calculations.

1/ Excludes balances in FX float (nostro) accounts held by subsidiaries at parent banks.

2/ Under the European Bank Coordination Initiative, the floor of foreign banks' exposures to Serbia was set to 100 percent of the end-2008 level as of March 2009, and reduced to 80 percent as of April 2010.

Figure 7. Serbia: International FX Reserves, 2008-10



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

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

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

	2009								2010						
	March		June		Sept.		Dec.		March		June			Sept.	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Prog.
Quantitative Performance Criteria															
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.1	4.9		5.4	4.6	4.0
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	69	55	109	148
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20	0	20		0	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550		140	600	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0		0	0	0
Inflation Consultation Bands (in percent)															
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0		4.2	5.3	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0		n.a.	7.3	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0		n.a.	3.3	4.0
Indicative Targets															
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354		353	548	750
Ceiling on gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50		32	50	50

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

2/ Cumulative from January 1.

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

Table 2. Serbia: Performance for Fifth Review

Measure	Target Date	Comment
Quantitative performance criteria		
1. Floor on net foreign assets of the NBS	June 2010	Observed
2. Ceiling on consolidated general government overall deficit	June 2010	Observed
3. Ceiling on contracting or guaranteeing by the public sector of new short-term external debt	June 2010	Observed
4. Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt	June 2010	Observed
5. Ceiling on accumulation of government external payment arrears	June 2010	Observed
Indicative targets		
1. Ceiling on current expenditures of the Serbian Republican budget	June 2010	Observed
2. Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development Funds	June 2010	Observed
Inflation consultation clause	June 2010	Observed
Prior action		
1. Government to submit to parliament a draft Budget System and Responsibility Law (TMU ¶20)	September 2010	
Structural benchmark		
1. Risk management unit at tax administration to establish an integrated taxpayer compliance strategy.	July 2010	Observed

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

	2006	2007	2008	2009	2010	2011
				Est.	Prog.	Proj.
	(Percent change, unless otherwise indicated)					
Real GDP	5.2	6.9	5.5	-3.0	1.5	3.0
Real GDP excluding agricultural sector	5.9	8.8	5.2	-3.4	2.0	3.1
Real domestic demand (absorption)	6.2	11.5	6.3	-6.7	-0.9	1.3
Consumer prices (average)	12.7	6.5	12.4	8.1	5.1	5.4
Consumer prices (end of period)	6.6	11.0	8.6	6.6	6.8	5.0
Import prices (dinars, average)	15.3	-2.8	7.7	3.0	16.7	5.6
Nominal gross wage	23.2	22.4	16.9	7.4	3.8	7.4
Real net wage	10.6	19.9	4.9	-0.7	-1.2	1.9
Average net wage (in euros per month) 1/	359	454	457	414	…	…
Net wage in euro 1/	27.4	26.4	16.9	-9.4	…	…
Registered employment	-3.4	-2.1	-1.7	-4.6	-2.2	0.1
Unemployment rate (in percent)	21.6	18.8	14.7	17.4	…	…
Nominal GDP (in billions of dinars)	1,962	2,302	2,722	2,905	3,099	3,364
	(Percent of GDP)					
General government finances						
Revenue	44.2	43.5	41.9	39.5	38.8	38.0
Expenditure	45.8	45.4	44.5	43.6	43.6	42.0
Current	41.1	40.1	40.0	39.8	39.3	37.8
Capital and net lending	4.6	5.3	4.5	3.8	4.2	4.2
Fiscal balance (cash basis)	-1.6	-1.9	-2.6	-4.1	-4.8	-4.0
Structural fiscal balance 2/	-1.4	-1.9	-2.9	-3.0	-3.6	-3.3
Gross debt	43.0	35.2	33.4	35.6	40.5	41.6
	(End of period 12-month change, percent)					
Monetary sector						
Money (M1)	37.1	25.3	-3.8	8.7	1.9	18.3
Broad money (M2)	38.4	44.5	9.6	21.8	11.1	16.9
Domestic credit to non-government	17.1	36.9	35.0	8.9	16.1	15.5
	(End of period, percent)					
Interest rates (dinar)						
NBS repo rate	14.0	10.0	17.8	9.5	…	…
Deposit rate	5.1	4.1	6.4	5.1	…	…
	(Percent of GDP, unless otherwise indicated)					
Balance of payments						
Current account balance	-10.2	-15.9	-17.6	-6.7	-9.0	-8.8
Exports of goods	22.0	22.2	22.2	19.4	22.2	23.7
Imports of goods	43.3	45.2	45.0	35.9	38.4	38.6
Trade of goods balance	-21.4	-23.1	-22.8	-16.6	-16.2	-14.9
Capital and financial account balance	32.0	18.4	12.7	11.7	4.8	8.6
External debt	63.3	61.8	65.2	74.2	78.8	76.2
of which: Private external debt	36.0	39.5	46.1	50.4	51.4	49.4
Gross official reserves (in billions of euro)	8.7	9.5	8.2	10.6	10.0	10.0
(In months of prospective imports of GNFS)	6.6	6.3	7.7	9.1	7.9	7.6
(Percent of short-term debt)	294.5	268.4	162.3	200.7	188.2	188.2
(in percent of broad money, M2)	112.4	84.5	72.7	74.9	76.5	76.5
Exchange rate (dinar/euro, period average)	84.2	80.0	81.5	93.9	…	…
REER (annual average change, in percent; + indicates appreciation)	6.6	7.2	6.4	-7.1	-4.0	3.0
Social indicators						
Per capita GDP (2009): US$5,821. Population (2009): 7.4 million. Poverty rate (national poverty estimate, 2009): 6.9 percent.						

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

1/ Change in definition of private sector labor force. Nominal net euro wages according to new definition; growth rate reported consistent with old definition.

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

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

	2004	2005	2006	2007	2008	2009 Est.	2010 Proj.	2011 Proj.
	(Real growth rate by expenditure category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Domestic demand (absorption)	13.8	-4.0	6.2	11.5	6.3	-6.7	-0.9	1.3
Non-government	17.7	-4.7	5.0	9.3	8.5	-6.6	-0.6	2.0
Government	-0.6	-0.6	11.1	20.0	-1.8	-7.1	-2.0	-1.6
Consumption	2.2	0.0	6.4	7.0	6.2	-3.4	-2.6	0.7
Non-government	3.6	0.5	6.9	4.0	7.6	-3.0	-2.4	1.7
Government	-2.6	-1.5	4.3	18.2	1.6	-5.0	-3.5	-2.9
Investment	76.1	-16.4	5.5	28.3	6.6	-17.1	5.4	3.2
Gross fixed capital formation	27.8	2.7	14.5	25.6	1.9	1.3	5.5	3.2
Non-government	29.6	2.1	7.3	25.1	6.3	5.1	5.2	2.8
Government	17.2	6.4	58.8	28.0	-16.2	-18.4	7.0	5.5
Change in inventories 1/	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services 1/	-8.0	10.3	-1.9	-6.3	-2.0	5.2	2.5	1.6
Exports of goods and services	5.7	14.4	4.9	17.2	8.9	-12.4	5.7	13.7
Imports of goods and services	21.0	-13.6	7.8	26.0	9.3	-17.3	-2.3	5.4
	(Contribution to real growth by expenditure category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Domestic demand (absorption)	16.5	-5.0	7.1	13.2	7.6	-8.2	-1.0	1.4
Non-government	16.7	-4.8	4.6	8.6	8.0	-6.4	-0.5	1.8
Government	-0.2	-0.1	2.4	4.6	-0.5	-1.7	-0.5	-0.4
Consumption	2.2	0.0	5.8	6.4	5.6	-3.1	-2.4	0.6
Non-government	2.8	0.3	4.9	2.9	5.3	-2.1	-1.7	1.2
Government	-0.6	-0.3	0.8	3.5	0.3	-1.0	-0.7	-0.6
Investment	14.3	-5.0	1.3	6.9	1.9	-5.0	1.4	0.8
Gross fixed capital formation	4.7	0.5	2.8	5.4	0.5	0.3	1.4	0.8
Non-government	4.3	0.4	1.2	4.3	1.3	1.0	1.1	0.6
Government	0.4	0.2	1.6	1.2	-0.8	-0.7	0.2	0.2
Change in inventories	9.6	-5.5	-1.5	1.5	1.4	-5.3	0.0	0.0
Net exports of goods and services	-8.0	10.3	-1.9	-6.3	-2.0	5.2	2.5	1.6
Exports of goods and services	1.4	3.5	1.3	4.6	2.6	-3.7	1.5	3.9
Imports of goods and services	9.4	-6.8	3.2	10.9	4.6	-8.9	-1.0	2.3
	(Contribution to real GDP growth by production category)							
Gross Domestic Product (GDP)	8.5	5.4	5.2	6.9	5.5	-3.0	1.5	3.0
Gross Value-Added	7.3	4.0	5.4	5.6	5.2	-1.8	1.4	2.6
Agriculture	2.3	-0.7	0.0	-0.9	0.8	0.3	0.0	0.2
Industry	1.6	0.0	0.9	0.8	0.3	-2.0	0.5	0.5
Services	4.6	6.1	4.3	7.0	4.4	-1.3	1.0	2.3
Wholesale and retail trade	1.3	1.9	1.0	2.0	0.8	-1.0	-0.1	0.4
Construction	0.1	0.1	0.2	0.3	0.1	-0.5	0.1	0.1
Transport and communications	1.2	1.9	2.8	2.4	1.7	0.8	0.6	0.5
Financial services	0.2	0.4	0.4	0.5	0.5	0.2	0.1	0.1
Other	0.5	0.5	0.1	0.4	1.0	0.4	0.2	0.8
Taxes minus subsidies	1.5	1.7	0.0	1.5	0.6	-0.8	0.4	0.5
Memorandum items:								
Tradables GDP	4.5	-0.1	0.9	0.4	1.3	-2.0	0.6	0.8
Non-tradables GDP	4.1	5.5	4.3	6.5	4.2	-1.0	0.9	2.2

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

1/ Contributions to GDP growth.

Table 5. Serbia: Medium-Term Program Scenario, 2008–15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
GDP and prices (percent change)								
GDP growth (real)	5.5	-3.0	1.5	3.0	5.0	5.5	5.5	5.0
Domestic demand growth (real)	6.3	-6.7	-0.9	1.3	4.0	4.9	5.1	4.5
Domestic demand minus imports (real)	4.1	1.0	0.0	-1.2	1.0	1.7	1.9	1.5
Consumer price inflation (end of period)	8.6	6.6	6.8	5.0	4.0	4.0	4.0	4.0
Savings and investment (percent of GDP)								
Savings - investment balance	-17.6	-6.7	-9.0	-8.8	-6.6	-5.6	-5.7	-5.5
Non-government	-15.6	-3.0	-5.0	-5.4	-4.1	-4.1	-4.9	-5.1
Government	-2.0	-3.7	-4.1	-3.4	-2.6	-1.5	-0.8	-0.4
General government (percent of GDP)								
Overall fiscal balance	-2.6	-4.1	-4.8	-4.0	-2.7	-1.6	-0.8	-0.5
Revenue	41.9	39.5	38.8	38.0	37.4	37.1	36.9	36.7
Expenditure	44.5	43.6	43.6	42.0	40.1	38.7	37.7	37.1
Current	40.0	39.8	39.3	37.8	36.3	35.0	33.6	32.7
of which: Wages and salaries	10.8	10.4	10.0	9.5	9.2	8.8	8.3	7.9
of which: Pensions	12.2	13.3	12.8	12.4	12.1	11.8	11.4	11.2
of which: Goods and services	7.6	7.3	7.0	6.6	6.3	6.3	6.3	6.3
Capital and net lending	4.5	3.8	4.2	4.2	3.8	3.7	4.1	4.4
Structural fiscal balance	-4.6	-3.4	-4.7	-4.0	-3.2	-2.0	-1.2	-0.8
Output gap	0.7	-2.6	-2.5	-1.8	0.0	0.0	0.0	0.0
Absorption gap	11.3	-0.5	3.1	2.6	2.8	2.5	2.6	2.3
Gross debt	33.4	35.6	40.5	41.6	40.4	38.3	35.7	34.3
Balance of payments (percent of GDP)								
Current account	-17.6	-6.7	-9.0	-8.8	-6.6	-5.6	-5.7	-5.5
of which: Trade balance	-22.8	-16.6	-16.2	-14.9	-11.8	-11.3	-11.1	-10.5
of which: Current transfers, net (excl. grants)	7.8	10.7	9.7	9.2	8.5	8.5	8.0	7.5
Capital and financial account	12.7	11.7	4.8	8.6	8.6	9.8	9.1	7.7
of which: Foreign direct investment	5.4	4.4	3.3	5.5	4.1	4.1	4.1	4.1
External debt (end of period)	65.2	74.2	78.8	76.2	73.6	71.0	68.4	66.5
of which: Private external debt	46.1	50.4	51.4	49.4	48.8	49.2	49.0	48.0
Gross official reserves (billions of euros)	8.2	10.6	10.0	10.0	10.5	11.5	12.5	13.5
REER (ann. av. change; + = appreciation)	6.4	-7.1	-4.0	3.0	2.9	2.8	2.7	1.6

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

Table 6. Serbia: Savings-Investment Balances, 2004–15
(Percent of GDP)

	2004	2005	2006	2007	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Domestic demand	126.6	121.0	121.6	123.9	123.4	116.5	116.2	114.9	111.8	111.3	111.1	110.5
Consumption	96.8	97.2	97.4	95.7	94.7	92.6	91.1	89.6	87.4	85.7	83.9	82.4
Non-government	77.1	78.5	78.5	75.4	75.1	73.7	73.0	72.3	70.9	69.6	68.3	67.2
Government	19.8	18.8	18.9	20.3	19.6	18.9	18.1	17.3	16.6	16.1	15.6	15.2
Gross domestic savings	3.2	2.8	2.6	4.3	5.3	7.4	8.9	10.4	12.6	14.3	16.1	17.6
Non-government	0.1	-1.3	-0.6	0.9	3.0	7.6	9.1	9.7	11.0	11.7	12.4	13.3
Government	3.1	4.1	3.2	3.4	2.3	-0.2	-0.2	0.7	1.6	2.6	3.7	4.3
Net factor receipts and transfers	14.4	12.3	11.4	7.9	5.8	9.8	7.2	6.1	5.1	5.8	5.4	5.0
Non-government	15.2	13.1	12.1	8.4	6.2	10.1	7.6	6.7	5.7	6.3	5.9	5.5
Government	-0.8	-0.8	-0.8	-0.5	-0.5	-0.3	-0.5	-0.6	-0.6	-0.5	-0.5	-0.5
Gross national savings	17.6	15.0	13.9	12.2	11.0	17.2	16.0	16.5	17.7	20.1	21.5	22.6
Non-government	15.3	11.8	11.5	9.3	9.2	17.7	16.8	16.5	16.7	18.0	18.2	18.7
Government	2.3	3.3	2.4	2.9	1.8	-0.5	-0.7	0.1	1.0	2.1	3.2	3.9
Gross domestic investment	29.7	23.7	24.1	28.2	28.6	23.9	25.1	25.3	24.4	25.7	27.2	28.1
Non-government	27.1	21.1	20.0	23.5	24.8	20.8	21.7	21.9	20.8	22.1	23.2	23.9
Gross fixed capital formation	16.6	16.3	16.9	19.2	19.4	20.7	21.7	21.8	20.7	22.0	23.1	23.8
Change in inventories	10.5	4.7	3.1	4.2	5.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Government	2.6	2.7	4.1	4.8	3.8	3.1	3.3	3.5	3.6	3.6	4.0	4.3
Overall savings-investment balance	-12.1	-8.7	-10.2	-16.0	-17.6	-6.7	-9.0	-8.8	-6.6	-5.6	-5.7	-5.5
Non-government	-11.8	-9.3	-8.5	-14.2	-15.6	-3.0	-5.0	-5.4	-4.1	-4.1	-4.9	-5.1
Government	-0.3	0.6	-1.7	-1.9	-2.0	-3.7	-4.1	-3.4	-2.6	-1.5	-0.8	-0.4
Foreign savings	12.1	8.7	10.2	16.0	17.6	6.7	9.0	8.8	6.6	5.6	5.7	5.5
Memorandum items:												
Net exports of goods and services 1/	-26.6	-21.0	-21.6	-23.9	-23.4	-16.5	-16.2	-14.9	-11.8	-11.3	-11.1	-10.5
Current account balance	-12.1	-8.7	-10.2	-15.9	-17.6	-6.7	-9.0	-8.8	-6.6	-5.6	-5.7	-5.5
General government fiscal balance	0.0	0.8	-1.6	-1.9	-2.6	-4.1	-4.8	-4.0	-2.7	-1.6	-0.8	-0.5

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

1/ Equal to GDP minus domestic demand.

Table 7a. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Billions of RSD)

	2009	2010 Budget	2010 H1 Fourth Review	2010 H1 Est.	2010 Fourth Review	2010 Proj.	2011 Proj.	2012 Proj.
Revenue	1,147	1,208	552	560	1,191	1,203	1,277	1,379
Taxes	1,000	1,061	486	492	1,037	1,044	1,123	1,211
Personal income tax	133	142	66	66	138	137	147	159
Social security contributions	319	336	157	154	325	321	347	375
Taxes on profits	31	24	16	18	27	32	34	44
Value-added taxes	297	325	145	149	316	325	349	375
Excises	135	148	62	62	144	142	155	165
Taxes on international trade	48	44	21	20	44	42	41	39
Other taxes	37	43	19	22	43	46	50	55
Non-tax revenue	140	145	63	67	147	152	152	167
Capital revenue	0	0	0	0	0	0	0	0
Grants	6	2	2	1	6	6	1	1
Expenditure	1,267	1,344	623	615	1,340	1,350	1,413	1,480
Current expenditure	1,155	1,206	572	573	1,205	1,213	1,273	1,339
Wages and salaries	302	313	152	149	312	310	321	339
Goods and services	212	213	94	97	210	216	223	232
Interest	22	39	15	16	37	37	45	48
Subsidies	63	69	28	30	69	73	76	77
Transfers	556	572	282	281	577	578	608	642
Pensions	387	396	197	197	398	398	418	447
Other transfers 2/	168	176	85	84	179	180	190	195
Capital expenditure	91	111	37	31	107	103	116	132
Net lending	20	26	14	11	28	28	24	8
Reallocated expenditure						6		
Fiscal balance (cash basis)	-120	-136	-72	-55	-149	-148	-136	-101
Financing	120	...	72	…	149	148	136	101
Privatization proceeds	59	...	2	…	4	4	0	0
Domestic	21	...	66	…	91	113	113	89
Banks	-61	...	50	…	17	104	106	76
Central bank	-61	...	33	…	0	15	0	0
Commerical banks	0	...	17	…	17	89	106	76
Non-bank	82	...	15	…	74	9	7	13
External	40	...	3	…	54	31	23	12
Program	42	...	12	…	66	45	33	24
Project	11	...	5	…	17	17	18	20
Amortization	13	...	14	…	29	31	28	33
Memorandum items:								
Augmented fiscal balance 3/	-141.2	…	…	…	-157	-156	-136	-101
Nominal GDP (billions of dinars)	2,905	3,230	3,086	3,086	3,086	3,099	3,364	3,690

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

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

Table 7b. Serbia: General Government Fiscal Operations, 2009–2012 1/
(Percent of GDP)

	2009	2010 Budget	2010 H1 Fourth Review	2010 H1 Est.	2010 Fourth Review	2010 Proj.	2011 Proj.	2012 Proj.
Revenue	39.5	37.4	17.9	18.1	38.6	38.8	38.0	37.4
Taxes	34.4	32.8	15.8	15.9	33.6	33.7	33.4	32.8
Personal income tax	4.6	4.4	2.1	2.1	4.5	4.4	4.4	4.3
Social security contributions	11.0	10.4	5.1	5.0	10.5	10.3	10.3	10.2
Taxes on profits	1.1	0.7	0.5	0.6	0.9	1.0	1.0	1.2
Value-added taxes	10.2	10.1	4.7	4.8	10.3	10.5	10.4	10.2
Excises	4.6	4.6	2.0	2.0	4.7	4.6	4.6	4.5
Taxes on international trade	1.7	1.4	0.7	0.7	1.4	1.4	1.2	1.1
Other taxes	1.3	1.3	0.6	0.7	1.4	1.5	1.5	1.5
Non-tax revenue	4.8	4.5	2.1	2.2	4.8	4.9	4.5	4.5
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.1	0.1	0.0	0.2	0.2	0.0	0.0
Expenditure	43.6	41.6	20.2	19.9	43.4	43.6	42.0	40.1
Current expenditure	39.8	37.3	18.5	18.6	39.0	39.2	37.8	36.3
Wages and salaries	10.4	9.7	4.9	4.8	10.1	10.0	9.5	9.2
Goods and services	7.3	6.6	3.1	3.2	6.8	7.0	6.6	6.3
Interest	0.8	1.2	0.5	0.5	1.2	1.2	1.3	1.3
Subsidies	2.2	2.1	0.9	1.0	2.2	2.3	2.3	2.1
Transfers	19.1	17.7	9.1	9.1	18.7	18.6	18.1	17.4
Pensions	13.3	12.3	6.4	6.4	12.9	12.8	12.4	12.1
Other transfers 2/	5.8	5.4	2.7	2.7	5.8	5.8	5.7	5.3
Capital expenditure	3.1	3.4	1.2	1.0	3.5	3.3	3.5	3.6
Net lending	0.7	0.8	0.5	0.4	0.9	0.9	0.7	0.2
Reallocated expenditure						0.2		
Fiscal balance (cash basis)	-4.1	-4.2	-2.3	-1.8	-4.8	-4.8	-4.0	-2.7
Financing	4.1	…	2.3	…	4.8	4.8	4.0	2.7
Privatization proceeds	2.0	…	0.1	…	0.1	0.1	0.0	0.0
Domestic	0.7	…	2.1	…	2.9	3.6	3.4	2.4
Banks	-2.1	…	1.6	…	0.5	3.4	3.2	2.0
Central bank	-2.1	…	1.1	…	0.0	0.5	0.0	0.0
Commerical banks	0.0	…	0.6	…	0.6	2.9	3.2	2.0
Non-bank	2.8	…	0.5	…	2.4	0.3	0.2	0.4
External	1.4	…	0.1	…	1.8	1.0	0.7	0.3
Program	1.4	…	0.4	…	2.1	1.4	1.0	0.6
Project	0.4	…	0.2	…	0.6	0.5	0.5	0.5
Amortization	0.5	…	0.5	…	0.9	1.0	0.8	0.9
Memorandum items:								
Structural fiscal balance 3/	-3.0	…	…	…	-3.7	-3.6	-3.3	-2.7
Output gap 4/	-2.6	…	…	…	-2.5	-2.5	-1.8	0.0
Augmented fiscal balance 5/	-4.9	…	…	…	-5.1	-5.0	-4.0	-2.7
Gross debt	35.6	…	…	…	39.1	40.5	41.6	40.4
Nominal GDP (billions of dinars)	2,905	3,230	3,086	3,086	3,086	3,099	3,364	3,690

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

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

Serbia 7c: Intergovernmental Fiscal Operations, 2010 Program

	Gen. Gov.	Republican budget	Own budgets	Local gov. and V.	Road company	Social security funds	Pension Fund	Health Fund	Labor Fund	Netting operations
Total revenue	1,202.6	659.4	42.1	143.9	32.0	381.2	237.5	128.3	15.4	-56.0
Current revenue	1,195.9	654.4	40.9	143.4	31.9	381.2	237.5	128.3	15.4	-56.0
Tax revenue	1,043.7	608.5	0.2	98.6	15.7	376.7	235.0	126.5	15.2	-56.0
Personal income tax	136.6	73.4		63.2						
Social security contributions	320.7			0.0		376.7	235.0	126.5	15.2	-56.0
Corporate income tax	31.6	29.5		2.2						
VAT	324.6	324.5	0.1							
Excises	141.9	126.2			15.7					
Taxes on international trade	42.5	42.5								
Other taxes	45.8	12.5	0.1	33.2						
Nontax revenue	152.2	45.9	40.7	44.7	16.3	4.5	2.5	1.8	0.2	
Capital revenue	0.5	0.0	0.4	0.1	0.0	0.0	0.0	0.0	0.0	
Grants	6.3	5.0	0.8	0.5	0.0	0.0	0.0			
Total expenditure and net lending	1,406.2	475.7	42.1	220.3	34.6	633.5	423.5	181.7	28.4	-56.0
Current expenditure	1,269.2	409.3	34.1	171.2	22.4	632.2	422.9	181.1	28.2	-56.0
Expenditure on goods and services	582.2	231.7	27.0	119.4	20.7	183.4	6.5	173.8	3.1	
Wages and salaries	310.1	155.6	8.0	58.2	1.0	87.4	3.2	82.4	1.8	
Employer contribution	0.0	28.7	1.7	10.4	0.2	15.0	0.5	14.3	0.2	-56.0
Social funds	0.0			0.0		0.0	0.0	0.0	0.0	
Local tax	0.0			0.0		0.0	0.0	0.0	0.0	
Goods and services	216.0	47.4	17.3	50.8	19.5	81.1	2.8	77.1	1.2	
Interest payment	36.9	33.0	0.0	1.4	1.7	0.8	0.1	0.6	0.0	
Subsidies and other current transfers	650.1	144.6	7.1	50.4		448.0	416.3	6.6	25.1	
Subsidies	498.1	42.5	7.0	23.0		425.6	398.0	6.1	21.5	
Transfers to households	152.0	102.1	0.1	27.4		22.4	18.3	0.5	3.6	
Other current expenditure	0.0					0.0	0.0	0.0	0.0	
Capital expenditure	103.4	36.5	6.0	47.8	12.2	1.0	0.2	0.6	0.1	
Own resource	86.4	30.0	6.0	41.8	7.7	1.0	0.0	0.6	0.1	
Foreign financed	17.0	6.5		6.0	4.5					
Net lending	27.9	24.3	2.0	1.3		0.4	0.4	0.0	0.0	
Reallocated expenditure	5.6	5.6								
Fiscal balance (before transfers)	-203.5	183.7	0.0	-76.4	-2.6	-252.3	-185.9	-53.4	-13.0	0.0
Transfers from other levels of government	374.1	0.0	0.0	59.0	0.0	315.1	235.4	54.0	25.7	0.0
Republican budget	310.5			59.0	0.0	251.5	225.8	0.0	25.7	
Local governments and Vojvodina	0.0	0.0	0.0	0.0	0.0	0.0				
Social security funds	63.6					63.6				
Transfers to other levels of government	374.1	310.5	0.0	0.0	0.0	63.6	49.5	1.4	12.7	0.0
Republican budget	0.0					0.0		0.0		
Local governments and Vojvodina	59.0	59.0				0.0				
Social security funds	315.1	251.5	0.0	0.0	0.0	63.6				
Net transfer to other levels of government	0.0	-310.5	0.0	59.0	0.0	251.5	185.9	52.6	13.0	0.0
Fiscal balance	-147.5	-126.8	0.0	-17.4	-2.6	-0.8	0.0	-0.8	0.0	0.0

Sources: Ministry of Finance; and IMF staff estimates.

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

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

Source: National Bank of Serbia.

1/ Gross operating income in this ratio excludes FX gains due to their volatility and distortionary impact.

2/ Non-interest expenses in the calculation of this ratio abstracts from FX losses.

3/ Cash, repos, t-bills, and mandatory reserves.

4/ Sum of first- and second-degree liquid receivables of the bank.

5/ Includes only risk-classified off-balance sheet items.

Table 9. Serbia: Balance of Payments, 2008–15 1/

	2008	2009 Est.	2010 4th Rev.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Billions of euros)					
Current account balance	-5.9	-2.1	-2.7	-2.7	-2.9	-2.4	-2.2	-2.4	-2.6
Trade of goods balance	-7.6	-5.1	-4.4	-4.9	-4.8	-4.2	-4.4	-4.8	-4.9
Exports of goods	7.4	6.0	6.5	6.7	7.7	8.8	9.9	11.1	12.3
Imports of goods	-15.0	-11.1	-10.9	-11.7	-12.5	-13.0	-14.3	-15.9	-17.2
Services balance	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-0.9	-0.5	-1.0	-0.8	-1.0	-1.2	-1.1	-1.1	-1.2
Current transfer balance	2.9	3.5	2.8	3.0	3.0	3.0	3.3	3.4	3.5
Capital and financial account balance	4.2	3.6	1.5	1.4	2.8	3.1	3.8	3.9	3.6
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.8	1.4	1.4	1.0	1.8	1.5	1.6	1.8	1.9
Portfolio investment balance	-0.1	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other investment balance	2.5	2.3	0.1	0.4	1.0	1.6	2.2	2.1	1.7
General governement	0.1	0.7	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Domestic banks	0.5	2.0	0.0	0.4	0.1	0.4	0.2	0.4	0.2
Other private sector	2.0	-0.4	-0.2	-0.4	0.6	0.9	1.7	1.4	1.1
Errors and omissions	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.8	1.2	-1.2	-1.3	-0.1	0.7	1.6	1.5	1.0
Financing	1.8	-1.2	1.2	1.3	0.1	-0.7	-1.6	-1.5	-1.0
Gross international reserves (increase, -)	1.8	-2.4	0.4	0.7	0.0	-0.5	-1.0	-1.0	-1.0
Prospective drawings	…	1.1	0.8	0.7	0.1	0.0	0.0	0.0	0.0
EU	…	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
World Bank	…	0.0	0.3	0.2	0.0	0.0	0.0	0.0	0.0
IMF	…	1.1	0.4	0.4	0.1	0.0	0.0	0.0	0.0
Prospective repayments (IMF)	…	…	…	…	…	-0.2	-0.6	-0.5	0.0
				(Percent of GDP)					
Current account balance	-17.6	-6.7	-8.5	-9.0	-8.8	-6.6	-5.6	-5.7	-5.5
Trade of goods balance	-22.8	-16.6	-13.9	-16.2	-14.9	-11.8	-11.3	-11.1	-10.5
Exports of goods	22.2	19.4	20.8	22.2	23.7	24.7	25.4	25.9	26.4
Imports of goods	-45.0	-35.9	-34.7	-38.4	-38.6	-36.5	-36.7	-36.9	-36.8
Services balance	-0.5	0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Income balance	-2.8	-1.6	-3.3	-2.6	-3.1	-3.4	-2.7	-2.6	-2.5
Current transfer balance	8.5	11.4	9.0	9.7	9.2	8.5	8.5	8.0	7.5
Capital and financial account balance	12.7	11.7	4.7	4.8	8.6	8.6	9.8	9.1	7.7
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	5.4	4.4	4.5	3.3	5.5	4.1	4.1	4.1	4.1
Portfolio investment balance	-0.3	-0.2	-0.2	0.2	0.0	0.0	0.0	0.0	0.0
Other investment balance	7.5	7.5	0.4	1.3	3.0	4.5	5.7	5.0	3.6
Errors and omissions	-0.4	-1.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.3	4.0	-3.8	-4.4	-0.2	2.0	4.2	3.4	2.2
				(Percent, unless otherwise indicated)					
Memorandum items:									
Export volume growth	8.9	-12.4	2.6	5.7	13.7	13.9	13.0	11.9	10.5
Import volume growth	9.3	-17.3	-6.6	-2.3	5.4	8.8	9.6	9.5	8.2
Trading partner import growth	5.9	-17.8	2.3	3.5	5.0	5.5	5.5	5.2	5.2
Export prices growth	6.7	-8.0	5.9	6.8	0.3	0.1	0.1	0.2	0.1
Import prices growth	5.7	-10.9	8.0	7.6	2.0	-5.0	1.1	1.1	0.1
Change in terms of trade	1.0	3.2	-1.9	-0.7	-1.6	5.4	-1.0	-0.9	0.0
GDP (billiions of euros)	33.4	30.9	31.3	30.3	32.5	35.5	39.1	43.0	46.7

Sources: NBS; and IMF staff estimates and projections.

1/ Some estimates, in particular for private remittances and reinvested earnings, are subject to significant uncertainty. In addition, intercompany loan transactions are not identified and are recorded as debt flows rather than FDI flows.

2/ Includes SDR allocations.

Table 10. Serbia: External Financing Requirements and Sources, 2008–15

(Billions of euros, unless otherwise indicated)

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
1. Gross financing requirements	9.49	8.69	6.68	8.04	8.50	10.06	10.86	11.63
Current account deficit	5.88	2.07	2.74	2.86	2.36	2.18	2.44	2.57
Debt amortization	3.62	4.25	4.63	5.17	5.44	6.24	6.94	8.03
Medium- and long-term debt	2.67	2.65	3.02	3.57	3.83	4.63	5.33	6.42
Public sector 1/	0.12	0.14	0.25	0.29	0.30	0.36	0.37	0.39
Commercial banks	0.54	0.12	0.21	0.35	0.37	0.67	0.69	1.01
Corporate sector	2.01	2.39	2.56	2.93	3.17	3.60	4.27	5.02
Short-term debt 2/	0.94	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44
Accumulation of gross reserves	0.00	2.36	-0.69	0.00	0.50	1.00	1.00	1.00
Repayment of prospective IMF credits	...	...	...	...	0.20	0.64	0.47	0.02
2. Available financing	9.49	7.53	6.03	7.98	8.50	10.06	10.86	11.63
Capital transfers	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Foreign direct investment (net)	1.81	1.37	1.00	1.80	1.46	1.60	1.76	1.91
Portfolio investment (net)	-0.09	-0.06	0.06	0.00	0.00	0.00	0.00	0.00
Debt financing	5.53	4.75	5.01	5.95	7.04	8.46	9.09	9.71
Medium- and long-term debt	4.86	3.14	3.40	4.34	5.43	6.85	7.48	8.10
Public sector 1/	0.18	0.39	0.60	0.60	0.61	0.68	0.68	0.75
Commercial banks	0.23	0.90	0.60	0.24	0.74	0.90	1.10	1.20
Corporate sector	4.46	1.85	2.20	3.50	4.08	5.27	5.70	6.15
Short-term debt 2/	0.67	1.61	1.61	1.61	1.61	1.61	1.61	1.61
Commercial banks	…	1.17	1.17	1.17	1.17	1.17	1.17	1.17
Corporate sector	…	0.44	0.44	0.44	0.44	0.44	0.44	0.44
3. Financing gap	0.00	1.16	0.65	0.05	0.00	0.00	0.00	0.00
European Union (prospective)	…	0.00	0.10	0.00	0.00	0.00	0.00	0.00
World Bank (prospective)	…	0.04	0.20	0.00	0.00	0.00	0.00	0.00
IMF	…	1.12	0.35	0.05	…	…	…	…
Memorandum items:								
Debt service	4.35	4.89	5.69	6.23	6.47	7.31	8.06	9.21
Interest	0.73	0.63	1.06	1.05	1.02	1.07	1.12	1.18
Amortization	3.62	4.25	4.63	5.17	5.44	6.24	6.94	8.03

Sources: NBS; and Fund staff estimates and projections.

1/ Excluding IMF.

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

Table 11. Serbia: External Balance Sheet, 2008-15 1/

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
				(Bllions of euros)				
International investment position 2/	-23.3	-23.5	-26.0	-28.8	-31.2	-33.4	-35.8	-38.4
Public sector 3/	1.8	3.0	1.6	1.3	1.6	3.0	4.1	4.8
Private sector 3/	-25.1	-26.5	-27.6	-30.1	-32.8	-36.3	-40.0	-43.2
FDI and portfolio investment (net) 4/	-12.2	-13.2	-14.3	-16.1	-17.6	-19.2	-20.9	-22.8
External debt (net) 4/	-21.8	-23.2	-24.3	-25.1	-26.5	-28.1	-29.8	-31.4
Gross external debt	-21.8	-22.8	-23.9	-24.7	-26.1	-27.7	-29.4	-31.1
General government	-6.4	-6.1	-6.5	-6.8	-7.1	-7.4	-7.7	-8.1
Private sector	-15.4	-15.6	-15.6	-16.0	-17.3	-19.2	-21.1	-22.4
Banks	-3.9	-4.7	-5.1	-5.0	-5.3	-5.6	-6.0	-6.2
Other private sector	-11.5	-10.9	-10.5	-11.1	-12.0	-13.7	-15.1	-16.2
Liabilities from drawings under the SBA		-1.1	-1.5	-1.5	-1.3	-0.7	-0.2	-0.2
Gross external assets (SDR holdings in excess of allocations)		-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other, net (inc. commercial banks foreign assets)	2.6	2.3	2.3	2.0	2.0	2.0	2.0	2.0
Central bank gross international reserves	8.2	10.6	10.0	10.0	10.5	11.5	12.5	13.5
				(Percent of GDP)				
International investment position 2/	-69.7	-76.2	-85.7	-88.8	-87.8	-85.5	-83.3	-82.2
Public sector 3/	5.3	9.8	5.4	3.9	4.6	7.6	9.6	10.3
Private sector 3/	-75.0	-86.0	-91.1	-92.7	-92.5	-93.1	-93.0	-92.5
FDI and portfolio investment (net) 4/	-36.6	-42.9	-47.1	-49.6	-49.4	-49.1	-48.7	-48.9
External debt (net) 4/	-65.2	-75.1	-80.1	-77.4	-74.7	-72.0	-69.3	-67.3
Gross external debt	-65.2	-73.9	-78.8	-76.2	-73.6	-71.0	-68.4	-66.5
General government	-19.1	-19.8	-21.3	-20.9	-20.0	-19.0	-17.9	-17.3
Private sector	-46.1	-50.4	-51.4	-49.4	-48.8	-49.2	-49.0	-48.0
Banks	-11.7	-15.2	-16.7	-15.3	-15.0	-14.3	-13.9	-13.2
Other private sector	-34.4	-35.2	-34.6	-34.1	-33.8	-35.0	-35.1	-34.8
Liabilities from drawings under the SBA		-3.6	-4.9	-4.7	-3.8	-1.8	-0.5	-0.4
Gross external assets	0.0	-1.2	-1.3	-1.2	-1.1	-1.0	-0.9	-0.8
Other, net (inc. commercial banks reserves)	7.7	7.3	7.4	6.3	5.8	5.2	4.8	4.4
Central bank gross international reserves	24.4	34.5	32.8	30.6	29.4	29.3	29.0	28.8
Memorandum items:								
				(Billions of euros, unless otherwise indicated)				
Central bank international reserves								
Gross reserves (months of next year's imports)	7.7	9.1	7.9	7.6	7.2	7.2	7.1	7.1
Free net reserves (months of next year's imports)	4.5	4.2	4.2	2.9	3.0	3.3	3.6	3.8
Short term external debt by original maturity due	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
(in percent of central bank gross reserves)	19.7	15.1	16.2	16.2	15.4	14.0	12.9	12.0
(in percent of central bank free net reserves)	33.4	32.4	30.3	42.4	37.4	30.4	25.6	22.1
(percent of total debt)	7.4	7.1	6.7	6.5	6.2	5.8	5.5	5.2
(percent of GDP)	4.8	5.2	5.3	5.0	4.5	4.1	3.7	3.4
Short term external debt by remaining maturity	5.0	5.3	5.3	5.3	5.3	5.3	5.3	5.3
(percent of central bank gross reserves)	61.6	49.8	53.1	53.1	50.6	46.2	42.5	39.3
(percent of central bank free net reserves)	104.5	106.7	99.6	139.3	123.1	99.9	84.0	72.5
(percent of total debt)	23.1	23.3	22.1	21.4	20.2	19.1	18.0	17.0
(percent of GDP)	15.0	17.2	17.4	16.3	14.9	13.5	12.3	11.3
GDP	33.4	30.9	30.3	32.5	35.5	39.1	43.0	46.7

Sources: NBS; and IMF staff estimates and projections.

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

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

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

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

Tabie 12. Serbia: Monetary Survey, 2006–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2006	2007	2008	2009	2010				2011
					Q1	Q2	Q3	Q4	
							Proj.	Proj.	Proj.
Net foreign assets 2/	408	563	484	571	559	563	575	555	561
in billions of euro	5.2	7.1	5.5	5.9	5.6	5.4	5.5	5.4	5.4
Foreign assets	771	877	847	1,185	1,224	1,268	1,276	1,253	1,262
NBS	715	766	725	1,023	1,049	1,104	1,115	1,094	1,104
Commercial banks	56	111	123	163	174	164	162	159	157
Foreign liabilities (-)	-363	-314	-364	-615	-664	-705	-702	-698	-701
NBS	-56	-14	-14	-115	-124	-164	-170	-175	-185
Commercial banks	-308	-300	-350	-500	-540	-540	-532	-523	-517
Net domestic assets	203	320	484	608	632	708	717	754	970
Domestic credit	481	701	1,048	1,276	1,368	1,541	1,547	1,559	1,898
Government, net	-104	-112	-53	-4	4	42	32	74	179
NBS	-107	-100	-50	-101	-106	-100	-115	-86	-86
Banks	2	-12	-4	97	110	143	147	160	265
Local governments, net	-19	-14	-16	-14	-14	-11	-13	-18	-17
Non-government sector	604	827	1,117	1,295	1,378	1,510	1,528	1,503	1,736
Households	204	306	382	419	443	491	491	477	544
Enterprises	381	508	711	851	904	984	1,005	996	1,157
Other	19	13	23	25	30	35	33	30	35
Other assets	70	78	56	111	58	104	110	116	116
Capital and reserves (-)	-242	-356	-505	-633	-636	-767	-762	-735	-812
NBS	-7	-7	-63	-166	-157	-266	-254	-218	-277
Banks	-235	-350	-442	-467	-479	-500	-509	-517	-535
Provisions (-)	-106	-104	-115	-146	-157	-170	-178	-186	-233
Broad money (M2)	611	883	968	1,179	1,192	1,272	1,291	1,309	1,531
Dinar-denominated M2	255	370	371	412	378	394	409	422	501
M1	191	239	230	250	218	227	242	254	301
Currency in circulation	68	77	90	96	86	88	90	92	103
Demand deposits	122	162	140	154	132	139	152	162	198
Time and saving deposits	65	131	141	162	160	167	167	168	200
Foreign currency deposits	355	513	597	767	814	878	882	887	1,030
in billions of euro	4.5	6.5	6.7	7.8	8.2	9.0	8.9	8.6	9.9
Memorandum items:									
Twelve-month growth:									
M1	37.1	25.3	-3.8	8.7	12.2	8.5	9.6	1.9	18.3
M2	38.4	44.5	9.6	21.8	22.2	24.5	22.6	11.1	16.9
Total credit to non-government	23.1	48.6	48.7	9.4	6.7	15.6	8.6	10.6	11.7
Domestic	17.1	36.9	35.0	15.9	16.8	24.3	18.0	16.1	15.5
Households	54.1	50.3	25.0	9.5	11.8	24.7	17.1	13.9	14.1
Enterprises	2.9	33.2	40.0	19.6	15.1	24.2	18.0	17.1	16.1
External	34.6	68.0	67.2	2.2	-1.6	4.8	-3.1	3.8	6.4
Total real credit to non-government	15.5	33.8	36.9	2.6	2.0	11.2	3.2	4.3	6.4
Domestic	9.8	23.3	24.3	8.8	11.6	19.6	12.2	9.5	10.0
Households	44.5	35.3	15.1	2.8	6.8	20.0	11.3	12.4	8.7
Enterprises	-3.5	20.0	28.9	12.2	10.0	19.5	12.2	10.4	10.6
External	26.3	51.4	54.0	-4.1	-6.0	0.9	-7.9	-2.1	1.4
Velocity (M1)	10.4	9.4	11.9	11.6	13.6	13.2	12.6	12.2	11.2
Velocity (M2)	3.3	2.5	2.8	2.5	2.5	2.4	2.4	2.4	2.2

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

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

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

Table 13. Serbia: Balance Sheet of the NBS, 2006–11
(Billions of dinars, unless otherwise indicated; end of period) 1/

	2006	2007	2008	2009	2010				2011
					Q1	Q2	Q3	Q4	
							Proj.	Proj.	Proj.
Net foreign assets 2/	406	482	517	628	623	597	597	567	612
in billions of euro	5.1	6.1	5.8	6.6	6.2	5.7	5.7	5.5	5.9
Gross foreign reserves	715	766	725	1,023	1,049	1,104	1,115	1,094	1,104
Gross reserve liabilities (-)	-309	-284	-208	-394	-426	-507	-517	-527	-492
Net domestic assets	-272	-323	-208	-382	-415	-416	-422	-363	-422
Net domestic credit	-264	-316	-145	-216	-258	-150	-168	-145	-145
Government	-107	-100	-50	-101	-106	-100	-115	-86	-86
Claims	16	11	11	11	11	1	11	11	11
RSD	16	11	11	11	11	1	11	11	11
foreign currency	0	0	0	0	0	0	0	0	0
Liabilities (-)	-123	-111	-60	-112	-117	-102	-127	-97	-97
RSD	-20	-29	-20	-63	-58	-53	-61	-48	-48
foreign currency	-103	-82	-41	-49	-59	-49	-65	-49	-49
Other public sector	-10	-11	-15	-12	-15	-18	-18	-20	-18
Banks	-151	-218	-88	-151	-139	-102	-51	-39	-57
Claims	0	1	2	1	1	14	9	1	3
Liabilities (-)	-152	-219	-90	-152	-140	-117	-60	-40	-60
Other sectors	4	13	7	48	2	71	16	-1	16
Capital accounts (-)	-7	-7	-63	-166	-157	-266	-254	-218	-277
Reserve money	134	159	309	247	208	181	175	203	191
Currency in circulation	68	77	90	96	86	88	90	92	103
Commercial bank reserves	65	82	219	151	122	93	86	111	88
Required reserves	34	30	165	112	117	85	77	68	39
Excess reserves	22	45	5	7	1	1	1	5	5
Vault cash and giro accounts	9	7	48	32	5	7	7	39	44

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

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

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

Table 14. Serbia: Balance Sheet of Commercial Banks, 2006-10 1/
(Billions of dinars, unless otherwise indicated)

	2006	2007	2008	2009	2010		
					Q2	Billions of euros	Percent of GDP
Assets	1,274	1,678	1,925	2,342	2,544	25.5	82.1
Foreign exchange	56	111	123	163	164	1.6	5.3
Claims on NBS	468	569	508	583	529	5.3	17.1
Dinar cash and reserves	63	80	219	151	93	0.9	3.0
Foreign exchange reserves	254	270	194	279	328	3.3	10.6
NBS bills and other claims	152	219	95	153	107	1.1	3.5
Claims on government	18	8	9	108	158	1.6	5.1
Claims on other sectors	594	827	1,118	1,299	1,514	15.2	48.9
Households	203	305	382	418	490	4.9	15.8
Enterprises	380	507	710	849	981	9.8	31.7
Other institutions	11	15	27	31	43	0.4	1.4
Fixed assets	66	75	88	99	99	1.0	3.2
Other assets	71	88	78	90	79	0.8	2.6
Liabilities	1,274	1,678	1,925	2,342	2,544	25.5	82.1
Foreign liabilities	308	300	350	500	540	5.4	17.4
Dinar deposits	213	319	301	338	326	3.3	10.5
Demand deposits	122	162	140	155	140	1.4	4.5
Time and saving deposits	79	142	154	178	184	1.8	5.9
Government deposits	12	16	7	5	2	0.0	0.1
Foreign currency deposits	359	517	599	770	879	8.8	28.4
Enterprises	84	116	140	145	154	1.5	5.0
Households	261	382	414	565	651	6.5	21.0
Government	4	4	6	7	13	0.1	0.4
Other institutions	10	15	40	53	61	0.6	2.0
Other deposits	2	3	1	2	2	0.0	0.1
Liabilities to NBS	0	2	6	1	2	0.0	0.1
Other liabilities	70	95	122	128	134	1.3	4.3
Provisions	87	93	103	135	160	1.6	5.2
Capital and reserves	235	350	442	467	500	5.0	16.1
Memorandum items:							
Provisions against credit losses	...	75.8	98.8	133.2	156.0	1.6	5.0
in percent of credit	...	9.2	8.8	10.3	10.3	10.3	...
Enterprises	54.8	58.8	72.5	99.8	118.3	1.2	3.8
in percent of credit	14.4	11.6	10.2	11.7	12.1	...	...
Households	7.5	10.8	17.2	23.3	25.9	0.3	0.8
in percent of credit	3.7	3.5	4.5	5.6	5.3	...	...
Off-balance sheet items 2/	1,163	1,580	2,157	2,305	2,656	26.6	85.7
External debt (billions of euros)	3.9	4.0	3.9	4.7	4.9	...	16.3
medium- and long-term	2.9	2.8	2.3	2.7	3.3	...	10.9
short-term	0.9	1.2	1.6	2.0	1.6	...	5.4

Source: National Bank of Serbia.

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

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

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

	2009	2010	2011	2012	2013	2014	2015
Fund repurchases and charges							
In millions of SDRs	5	38	58	234	967	1,151	395
In millions of euro	5	43	65	263	1,087	1,297	445
In percent of exports of goods and NFS	0.1	0.5	0.6	2.3	8.4	9.0	2.7
In percent of GDP	0.0	0.1	0.2	0.7	2.8	3.0	1.0
In percent of quota	1.0	8.1	12.5	50.0	206.7	246.0	84.4
In percent of total external debt service	0.1	1.0	1.4	5.1	16.0	16.7	5.5
In percent of gross international reserves	0.0	0.4	0.7	2.5	9.5	10.4	3.3
Fund credit outstanding (end-period)							
In millions of SDRs	1,021	2,300	2,619	2,444	1,693	599	40
In millions of euro	1,154	2,598	2,933	2,744	1,903	675	45
In percent of exports of goods and NFS	13.6	28.3	28.7	23.8	14.7	4.7	0.3
In percent of GDP	3.7	8.6	9.0	7.7	4.9	1.6	0.1
In percent of quota	218.3	491.7	560.0	522.5	362.1	128.1	8.5
In percent of total external debt	5.1	11.0	12.0	10.7	7.0	2.3	0.1
In percent of gross international reserves	10.8	26.1	29.5	26.2	16.6	5.4	0.3
Memorandum items:		(Millions of euros, unless otherwise indicated)					
Exports of goods and NFS	8,473	9,190	10,221	11,527	12,937	14,429	16,228
Quota (in millions of SDRs)	468	468	468	468	468	468	468
Total external debt service	3,591	4,118	4,681	5,120	6,789	7,752	8,047
Public sector external debt (end-period)	7,245	7,947	8,313	8,426	8,106	7,941	8,280
Total external debt stock (end-period)	22,801	23,534	24,359	25,758	27,336	29,016	30,673
Gross international reserves	10,644	9,956	9,956	10,456	11,456	12,456	13,456

Source: Fund staff estimates.

1/ Assuming actual purchase of projected available amounts.

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

	Available on or After	Amount of Purchase: In Millions of SDR	Amount of Purchase: In Percent of Quota 1/	Conditions
1.	Purchased	233.850	50.0	Board approval of the arrangement.
2.	Purchased	23.385	5.0	Observance of end-December 2008 performance criteria and completion of financing assurances review.
3.	Purchased	444.315	95.0	Board approval of augmentation of the arrangement, observance of end-March performance criteria, and completion of the first program review (including financing assurances review).
4.	Purchased	319.595	68.3	Observance of end-September 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
5.	Purchased	159.798	34.2	Observance of end-December 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
	Undrawn	159.798	34.2	
6.	May 25, 2010	46.7	10.0	Observance of end-March 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
	Undrawn	272.895	58.3	
7.	August 25, 2010	319.595	68.3	Observance of end-June 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
8.	November 25, 2010	319.595	68.3	Observance of end-September 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
9.	February 25, 2011	319.595	68.3	Observance of end-December 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
	Total	2,619.120	560.0	

1/ The quota is SDR 467.7 million.

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

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

Belgrade, September 9, 2010

Dear Mr. Strauss-Kahn:

1. Our program continues to perform satisfactorily. All end-June 2010 quantitative performance criteria were observed (Table 1). We have also met the structural benchmark on drafting a taxpayer compliance strategy. The fiscal responsibility amendments to the Budget System Law have been drafted, and we will submit the revised law to parliament as a prior action for the IMF Executive Board meeting in late-September (Table 2).

2. The economy is recovering, albeit at a slower pace than we had hoped. Economic indicators for the second quarter of 2010 suggest that growth momentum has strengthened, although employment continued to decline. We expect that the economy will pick up speed during the second half of 2010, in line with the program's projection of moderate but accelerating growth during 2010–11. After inflation had remained below the target tolerance band for six consecutive months, July inflation was within the band. Going forward, we expect to durably stabilize inflation in the low single digit range, although we are concerned about the possible second-round effects of food price increases. Reflecting the adverse spillovers from the Greek crisis, capital flows were disappointing during the second quarter and sovereign risk premia shot up across the region, putting pressure on the exchange rate and constraining our ability to cover budget financing requirements through the issuance of dinar T-bills. With concerns about the Greek crisis subsiding, we also expect that risk premia will gradually normalize across the region, although we have to remain alert to the possibility of new external shocks.

3. In consideration of our good implementation record in a difficult environment and our continued commitment to the program's objectives, we request the completion of the fifth review under the Stand-By Arrangement (SBA) and that SDR 319.6 million be made available. However, in view of our limited balance-of-payments needs at present, we again intend to purchase only SDR 46.7 million at this time. We also request the completion of the financing assurances review. The sixth program review, assessing performance relative to end-September 2010 performance criteria and benchmarks, and a financing assurances review are envisaged for October 2010. The seventh and last program review, assessing

performance relative to end-December 2010 performance criteria and benchmarks, and a financing assurances review are envisaged for February 2011.

4. We believe that the policies and measures set forth in this memorandum are adequate to achieve the objectives of the program, and stand ready to take any additional measures that may be appropriate for this purpose. The Government of the Republic of Serbia will consult with the IMF in advance on the adoption of such additional measures in accordance with the IMF's policies on such consultations.

Revised Macroeconomic Framework for 2010–11

5. We continue to expect real GDP to grow at 1½ percent in 2010 and 3 percent in 2011. This pace will likely be insufficient to generate positive employment growth in the near term. But, given nominal wage restraint over the last two years and the recent dinar depreciation, we believe that our labor costs are now sufficiently competitive to underpin broad and balanced growth, which should, albeit with a lag, pay off in sustainable employment increases and higher labor productivity over the medium term.

6. Inflation was below the NBS's target tolerance band throughout the first half of 2010, reflecting persistently low aggregate demand and falling food prices. While we eased monetary policy to counteract the disinflationary impact of these factors on projected inflation, a more forceful policy response to bring inflation back within the tolerance band more quickly was not advisable given the country's high risk premium and financial stability concerns. However, with agricultural product prices surprising on the upside during recent months, due to a poor summer harvest and increased international wheat prices, we believe that risks to inflation are now tilted to the upside. Inflation is projected to increase gradually in the second half of 2010, and should end this year somewhat above the NBS target of 6 percent, but well within the present tolerance band (±2 percent). We project inflation to remain in the upper half of the target tolerance band during most of 2011, moderating toward the end-year target of 4½ percent (±1.5 percent).

7. We expect the external current account deficit to widen again in 2010, following a drop of more than 10 percent of GDP in 2009. The still high trade deficit is from now on expected to narrow only slowly, notwithstanding strong growth in exports. Higher external interest and dividend payments and lower current transfers, especially remittances, will contribute to the widening of the external gap in 2010. In 2011, we expect the current account deficit to stabilize. We do not anticipate any major challenges in covering our external financing requirements during the remainder of 2010 and in 2011. Relative to the first half of 2010, and as confidence in the region returns, our central projection assumes that private inflows will recover. But, given our still high external financing needs, the availability of sufficient sustainable inflows will need to be monitored carefully. Our foreign-exchange (FX) reserves remain at an adequate level, and should be sufficient to deal even with challenging external scenarios.

Fiscal Policy

8. Our fiscal performance was firmly on track during the second quarter, after we narrowly missed the deficit target in March. The deficit target for June was met by a comfortable margin. Revenue collection exceeded plans, helped by stronger-than-projected imports in dinar terms, while expenditure execution remained below plans.

9. For the year 2010 as a whole, we now envisage a small overperformance of general budget revenues (1½ billion dinars). We plan to save this overperformance, in line with a deficit target of RSD 148 billion (4¾ percent of GDP) for 2010. The own-resource budgets of ministries and other government agencies are now projected to receive significantly higher revenue (RSD 10 billion) than earlier projected, but these funds are difficult to monitor and control in our complex budget system, and will probably be spent. At the same time, expenditure underexecution, in particular in the capital budget, could create some scope for budgetary re-allocations later in the year. At this point, we estimate this amount at about RSD 6 billion. However, the sum of demands for additional spending by the Ministry of Economy (mainly for credit and other stimulus measures), the Pension Fund (to allow a prompt and fair one-off payment to pensioners), and the Ministry of Agriculture (to address shortages in milk supply) are likely to significantly exceed the eventual sum available for budgetary re-allocations. We will therefore have to prioritize, and a decision will likely be reached at the time of the next review in October.

10. As a matter of priority the Ministry of Finance will ensure that the increased allocation of RSD 1½ billion for targeted social assistance programs (including RSD 880 million for soup kitchens, delivery of lunch packages for the elderly, and programs for poor municipalities) will be available for implementation starting in October at the latest. A new Social Welfare Law will take effect starting in 2011 and should help appreciably improve the living standards of the most vulnerable parts of the population.

11. Should revenues in 2010 exceed present projections, we remain fully committed to saving the additional revenue overperformance, in line with the principle that automatic fiscal stabilizers should be allowed to operate in both directions.

12. The somewhat weaker market appetite for dinar-denominated T-bills, combined with possible delays in the disbursement of some external loans, will likely impact our financing strategy for 2010. Although this strategy will need to remain flexible, we now project a reduced net volume of T-bill sales relative to what we expected during the previous review, tilted toward shorter maturities. We also may draw down a small portion of our comfortable deposit buffer, while euro-denominated bank financing will be tapped to cover the remaining financing gap.

13. To strengthen budgetary discipline beyond 2010, we will incorporate in our Budget System Law several fiscal responsibility provisions (TMU, ¶20), including:

- A fiscal rule constraining the general government deficit. This rule will set a medium-term deficit target of 1 percent of GDP. If persistent deviations from this medium-term target arise, they will need to be corrected over time at a minimum by about one third per year, but taking into account the economy's pace of growth. Growth exceeding (falling short of) a 4 percent benchmark would allow for faster (slower) correction of the fiscal gap.

- "Golden rule" thresholds to facilitate temporarily high public investment. In particular, given Serbia's still large public investment needs, and given the considerable scope for privatization proceeds, the deficit will be allowed to exceed the maximum thresholds implied by the fiscal balance rule by the amount of public investment exceeding 4 percent of GDP in 2011 and 5 percent of GDP annually during 2012–15. However, the portion of public investment above these ceilings that can be reflected in a higher consolidated general government deficit relative to the general fiscal rule cannot exceed 2 percent of GDP.

- A debt limit. The fiscal balance rule will be supplemented by a limit on the amount of gross public debt, including public guarantees, of 45 percent of GDP, but excluding future liabilities related to restitution.

- Special rules governing public wages and pensions. As specified in the pension law already submitted to parliament, the nominal pension freeze will be maintained through end-2010, with nominal public wages treated in a symmetric manner. Starting in 2011, and through April 2012, increases in pensions and public wages will continue to be treated symmetrically (for details, see TMU ¶20).

- The establishment of an independent fiscal council. The council will be composed of three members in charge of overseeing the implementation of the fiscal responsibility provisions, including preventing possible abuse of the public investment thresholds by shifting current spending to public investment spending.

14. For 2011, and in line with the fiscal responsibility provisions, we plan to achieve a general government deficit target of 4 percent of GDP. As projected revenue is likely to decline further by almost 1 percent of GDP, and since we plan to keep the allocation for public investment at least at the 2010 level (3½ percent of GDP), the available envelope for current expenditure and net lending will be tight. As regards the indexation of public pensions and wages, we now plan to move the first semi-annual CPI inflation indexation step from April 2011 forward to January 2011, while canceling the earlier planned one-off payment to public sector employees and pensioners in January of RSD 4 billion. This modified indexation plan will allow an earlier compensation for possible food price increases during the second half of 2010. The next CPI inflation indexation step in April 2011 will then cover only the prior three months (plus a growth bonus), while the October CPI inflation

adjustment will take place as previously envisaged. We presently estimate the net cost of shifting indexation forward to January at about RSD 4 billion.

15. We have initiated the privatization tender of Telekom Srbija, with potentially significant implications for our fiscal policies during the years ahead. However, in the event that large-scale privatization receipts materialize from this transaction early next year, we are determined to stick to our fiscal deficit targets for 2011 and beyond, consistent with the fiscal responsibility legislation. In particular, Telekom privatization receipts will not be used to finance increases in recurrent spending and net lending operations.

16. In line with the structural benchmark under the program, we have adopted a taxpayer compliance strategy. A separate unit responsible for risk analysis and audit of large taxpayers will be established. We have also adopted an overall tax administration strategy, which envisions the creation of a centralized accounting system with single taxpayer accounts, an introduction of e-filing and e-payments, a centralized database, and a system for efficient human resource management.

17. Starting with the 2011 budget, the Ministry of Finance will be in charge of implementing multiyear budget planning, with a view to improving the planning and execution of priority programs, in particular much-needed infrastructure investments.

18. Notwithstanding repeated delays, we remain committed to implementing structural reforms in the health and education sectors to lend more credibility to our fiscal responsibility target to reduce the general government wage bill to 8 percent of GDP by 2015, with support from the World Bank. Efforts to reform the pay-and-grading system in these sectors will need to be in line with the wage bill target.

Monetary and Exchange Rate Policy

19. Monetary policy will remain focused on keeping inflation within the pre-announced target tolerance bands centered on a 6 percent target for end-2010 and 4½ percent for end-2011. Key risks to our inflation projection arise from uncertainties regarding food prices, exchange rate pass-through to prices, the FX risk premium, and the speed of the euro area's economic recovery. Based on the current inflation outlook and our assessment of inflation risks, we have signaled a possible tightening in our monetary stance.

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

21. Implementation of the changes to the reserve requirement system adopted in March is proceeding as planned. Through increased credit activity, the effective FX reserve

requirement rate has already declined from a starting level of 40 percent to below 35 percent. By the time the transition to the new system is completed, in April of 2011, the new reserve requirement rate will have fallen to 25 percent on FX liabilities. The simplified system will result in enhanced transparency and efficiency gains, while restoring reserve requirements as an effective monetary policy instrument.

Financial Sector Policies

22. As agreed in Vienna in March 2009, foreign parent banks have maintained their exposures vis-à-vis Serbia, providing a key ingredient for the successful stabilization of the financial sector after the global financial crisis spilled over into Serbia in late-2008. With the crisis having subsided, these exposure commitments have lost much of their urgency, and we reduced the bank-by-bank exposure floors from 100 percent to 80 percent of their end-2008 level beginning in April 2010. At the same time, our regulations require that we will continue to hold banks participating in our Financial Sector Support Program (FSSP) accountable for observing their commitments, including to keep banks well capitalized and liquid, and FSSP incentives will only be available to banks that remain compliant.

23. Our credit support programs helped mitigate the fallout from the sudden bust in credit markets. But we also recognize that credit markets are now functioning more normally and that there is a case for gradually phasing out these programs, which should be announced well in advance. But we also believe that the phase-out should be contingent on a sustained economic recovery. Thus, by the time of the next review, and coordinated with the 2011 budget planning exercise, we intend to announce an exit strategy that will provide borrowers and banks with the details needed to make informed business plans.

24. We have made substantial progress on improving our debt collection and restructuring framework. First, following the adoption of the by-law on prepackaged reorganization plans in May, the first cases were successfully negotiated and concluded. Second, we will soon submit revised amendments to the Law on Payment Transactions to parliament. And third, the working group on out-of-court debt restructuring has drafted a package of legal amendments. However, further discussions between the stakeholders will be necessary to reach full agreement on the complex legal changes involved, and we need to postpone achieving the structural benchmark (TMU, ¶23) to end-November.

25. The implementation of the Basel II framework is on track, and banks will be obliged to use the new accord starting on January 1, 2011. Following two years of preparatory work, the NBS issued the relevant documentation in the first half of this year. Comments received from most banks confirmed their readiness for the new framework. But we still have to align reporting guidelines with EU standards and to issue the loan classification rules.

26. Finally, reducing the financial stability risks from high euroization remains a key priority, and we have moved from general talk to specific actions. The working group on

local currency market development has agreed on specific steps to reduce risks from FX lending. To facilitate FX hedging, we will move ahead with changes in the FX Law and launch a public awareness campaign on the need to hedge. The bank representatives in the group have committed to develop a standardized forward contract. Finally, international financial institutions (IFIs) participating in the group have confirmed their interest in issuing local currency bonds.

Structural Policies

27. We have made some further progress on growth-oriented structural reforms. Given the difficult financial market environment, privatization has been put on hold, with the exception of the preparation for sale of Telekom Srbjia. The restructuring of several key public enterprises, in particular JAT (airline) and ZTP (railway), is proceeding. The recommendations of the guillotine project of cutting unnecessary regulations have only been partially implemented. At the same time, the by-laws and institutions needed to implement the law on competition remain to be put fully in place, and the long-pending company and securities laws have yet to be adopted. In this context, we recognize that the recent proliferation of various charges and levies imposed by various ministries and local governments, and earmarked for their spending, has adversely impacted the business climate.

28. During the remainder of the program, we will take steps to accelerate our structural reform agenda. After assessing all the circumstances, we have decided to sell the majority stake in Telekom Srbjia. We are committed to accelerating the restructuring of JAT and ZTP. We will continue implementing guillotine project and step up our efforts to improve other aspects of the business environment. In particular, we will take steps to fully implement the laws on competition and public procurement, and submit to parliament the company and securities laws by end-2010. We will also review all recent charges and levies imposed by all levels of government and discontinue these practices in the 2011 budget.

/s/
Mirko Cvetkovic
Prime Minister

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

/s/
Diana Dragutinovic
Minister of Finance

Attachment

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

	2009								2010						
	March		June		Sept.		Dec.		March		June			Sept.	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Prog.
Quantitative Performance Criteria															
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.1	4.9		5.4	4.6	4.0
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	69	55	109	148
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	10	0	10	2	10	2	20	0	20		0	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550		140	600	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0		0	0	0
Inflation Consultation Bands (in percent)															
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0		4.2	5.3	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0		n.a.	7.3	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0		n.a.	3.3	4.0
Indicative Targets															
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354		353	548	750
Ceiling on gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50		32	50	50

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

2/ Cumulative from January 1.

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

Table 2. Serbia: Structural Conditionality, 2010

Measure	Target Date	Comment
Prior action		
1.Government to submit to parliament a draft Budget System and Responsibility Law (TMU ¶20).	Before Board meeting	To anchor the authorities' medium-term fiscal adjustment plans and commitments to safeguard fiscal sustainability.
Structural benchmarks		
2. Authorities to adopt or submit to parliament amendments to relevant laws and regulations strengthening the corporate debt collection and restructuring framework.	November 2010	To address the issue of account blockages and foster out-of-court loan workouts to minimize unnecessary and costly bankruptcies and enhance banks' ability to deal with rising NPLs.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

REPUBLIC OF SERBIA

Technical Memorandum of Understanding

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

A. Floor for Net Foreign Assets of the NBS

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

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

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

Cross Exchange Rates and Gold Price for Program Purposes 1/

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

1/ March 11, 2009.

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

6. On June 30, 2010 the NBS's net foreign assets, evaluated at program exchange rates, were €5,442 million; foreign reserve assets amounted to €10,170 million, and foreign reserve liabilities amounted to €4,728 million.

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

B. Inflation Consultation Mechanism

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

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

C. Ceiling on External Debt Service Arrears

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

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

D. Ceilings on External Debt

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

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

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

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

E. Fiscal Conditionality

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

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

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

Disbursements of project loans by foreign creditors

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

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

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

20. **Fiscal responsibility legislation**. Amendments to the present Budget System Law (BSL) have been adopted by the government, and will be submitted to Parliament in September 2010 as a prior action for the fifth review. These amendments include the following main provisions:

- Target a medium-term deficit target for the general government of 1 percent of GDP.
- Set a debt ceiling of 45 percent of GDP for the general government, which includes direct debt and guarantees issued by the general government, but excludes obligations based on restitution.
- Establish a rule to ensure that the actual fiscal deficit is on average equal to the medium-term deficit target, by setting the fiscal deficit target each year equal to the previous year actual deficit, minus 30 percent of the difference between the previous year actual deficit and the medium-term deficit target, minus 40 percent of the difference between the projected growth rate of the economy for that year and a benchmark growth rate of 4 percent per year.
- Set "golden rule" thresholds to facilitate temporarily high public investment. The deficit will be allowed to exceed the maximum thresholds implied by the fiscal balance rule by the amount of public investment exceeding 4 percent of GDP in 2011 and 5 percent of GDP annually during 2012–15. However, the portion of public investment above these ceilings that can be reflected in a higher consolidated general government deficit relative to the general fiscal rule cannot exceed 2 percent of GDP.
- Establish an independent fiscal council consisting of 3 members in charge of monitoring the implementation of the fiscal responsibility provisions.
- Establish special rules governing the indexation of pensions and public sector wages and pensions as follows:

    (i) Individual public sector salaries and pensions would increase in January 2011 by the amount of consumer prices growth in the previous six months. In April 2011 and April 2012, these salaries and pensions would increase by the amount of consumer prices growth in the previous three and six months respectively, both augmented by half of GDP growth in the previous year if that growth was positive.

    (ii) In October 2011 and October 2012 the salaries and pensions would increase by the inflation growth in the previous six months.

    (iii) During 2013–2015 the public sector wage bill shall grow at the consumer prices growth rate increased by a half GDP growth in the previous year.

(iv) During 2013–2015 average pensions shall grow at the consumer prices growth rate increased by the GDP growth over 4 percent.

(v) Fiscal rules regulating the development of pensions and salaries shall continue to apply after 2015, until pensions reach 10 percent of GDP and salaries reach 8 percent of GDP.

21. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget and the Development Fund.** The ceiling also includes the contracting of any domestic loans by the Development Fund. It excludes any guarantees extended under the financial stability framework, unless such loans or guarantees are extended to entities other than financial sector institutions.

22. **Reporting.** General government revenue data and the Treasury cash situation table will be submitted weekly on Wednesday; updated cash flow projections for the Republican budget for the remainder of the year five days after the end of each month; and the stock of spending arrears of the Republican budget, the Road company, and the social security funds 15 days after the end of each month. General government comprehensive fiscal data (including social security funds) would be submitted by the 25th of each month. The large state-owned enterprises listed in paragraph 19 will submit quarterly accounts and the wage bill data 45 days after the end of the quarter.

F. Financial Sector Conditionality

23. **Improvements to the framework for debt collection and restructuring will focus on two areas: account blockages based on promissory notes and out-of-court loan workouts**. As regards the first area, the NBS, in consultation with the government, will finalize amending the law on payments transactions to introduce registration of promissory notes using a uniform format—containing essential loan details and blockage conditions—in a single registry. The Ministry of Economy, together with the NBS, will explore alternatives to the first-mover advantage in account blockages. As regards out-of-court loan workouts, the Ministry of Economy and the NBS, in consultation with the Ministry of Finance and banks, shall (i) establish an out-of-court restructuring mechanism working group comprising representatives of the Ministries of Finance and Economy, NBS, tax authorities and selective bank representatives; (ii) draft a corporate debt restructuring strategy note proposing the main features of an out-of-court restructuring mechanism (such as the form of the framework, coverage of debtors, and role of the NBS) and identify the legal changes needed to support such a mechanism by end-June 2010; (iii) submit draft legislative changes for government approval by end-October 2010; and (iv) submit the package of the legislative changes to Parliament by end-November 2010 (structural benchmark)**.**

Data Reporting for Quantitative Performance Criteria

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

Statement by the IMF Staff Representative on the Republic of Serbia

September 27, 2010

This statement provides information that has become available since the issuance of the staff report (EBS/10/174). The new information does not alter the thrust of the staff appraisal.

1. **The prior action for the fifth review has been completed.** The government submitted to parliament on September 17 an amended Budget System Law, introducing a numerical fiscal balance rule and a ceiling on gross public debt, including public guarantees, as well as supporting spending rules limiting the growth of public wages and pensions (for additional details see LOI, ¶13, and TMU, ¶20).

2. **A one-off payment to pensioners will likely take place in October.** Top coalition leaders have agreed that much of the available sum for budgetary re-allocations in the 2010 budget (about RSD 6 billion or 0.2 percent of GDP, resulting from underexecution of spending) will be allocated to a one-off payment to pensioners. Pensioners eligible for this payment will be those whose monthly pensions fall below a threshold of some €300. Including a previously agreed amount of RSD 2 billion, the total one-off payment to pensioners is projected at about RSD 6½ billion (about €50 per eligible pensioner). As indicated in the LOI (¶9), this decision will leave little scope to satisfy additional spending demands.

3. **The August inflation release surprised somewhat on the upside.** Inflation rose to 6.6 percent year-on-year in August, compared with 5.1 percent in July. This largely reflected increases in processed food prices, particularly of meat, dairy products, and edible oils. Assuming some persistence in food price inflation during the remainder of the year, inflation at the end of 2010 could be close to 8 percent—the upper bound of the NBS's target band—instead of 6¾ percent as currently projected. However, given the recent steps to tighten the monetary stance, the NBS's end-2011 target band (4.5±1.5 percent) remains well within reach.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fifth Review Under Stand-By Arrangement with Serbia and Approves €366.5 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Serbia's economic performance under the program supported by a Stand-By Arrangement (SBA). The completion of the review enables the immediate disbursement of SDR 319.595 million (about €366.5 million, or US$494.0 million). Drawing the full amount would bring total disbursements under the program to SDR 1.55 billion (about €1.77 billion, or US$2.39 billion). In completing the review the Board also approved Serbia's request for a modification of the end-September quantitative performance criterion. The Board also completed the financing assurances review.

Serbia's initial 15-month SBA was approved on January 16, 2009, in the amount of SDR 350.8 million (about €402.3 million, or US$ 542.2 million). On May 15, 2009, the arrangement was extended by one year and augmented to SDR 2.6 billion (about €2.98 billion, or US$4.02 billion to support the government's economic program amid a sharper than expected impact from the global financial crisis (see Press Release No. 09/169). Following the Executive Board's discussion on Serbia, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"Serbia's commendable performance under its economic program supported by the Fund's Stand-By Arrangement has helped in addressing the spillovers from the global financial crisis while establishing a moderate economic recovery. An accelerated pace of structural reforms will help to strengthen medium-term growth and employment prospects, supported by the resumption of adequate capital inflows, in particular through foreign direct investment.

"Despite the moderate recovery, inflation has accelerated, mainly as a result of increasing food prices. The authorities have appropriately tightened the monetary stance in line with their inflation-targeting framework and to bolster the framework's credibility.

"The fiscal responsibility legislation submitted to Parliament seeks to anchor fiscal policy over the medium term once the program with the Fund expires. The fiscal program appropriately envisages a budgetary target with some scope for a gradual exit from the freezes of nominal public wages and pensions beginning in January of 2011.

"It is now timely to gradually phase out emergency arrangements introduced to support economic activity as the financial sector is emerging from the global financial crisis. Exposure commitments under the European Bank Coordination Initiative have been adequately relaxed. It is also time to start phasing out credit support programs introduced in the wake of the crisis.

"A strong commitment to the implementation of structural reforms in the areas of tax administration, the business environment, privatization and restructuring of public enterprises will strengthen medium-term growth and employment prospects".

Statement by Mr. Weber and Mr. Antic on Republic of Serbia
September 27, 2010

1. We thank staff for the constructive policy dialogue and the productive meetings during their visit to Belgrade in August. The staff report provides a balanced and realistic picture of the Serbian economy and of the policy challenges faced by the authorities in the short and medium term. The authorities concur with staff's diagnostics and recommendations, which they value highly.

2. The Stand-by Arrangement (SBA) continues to be fully on track. All end-June 2010 quantitative performance criteria have been met and amendments to the Budget System Law designed to strengthen fiscal responsibility—a prior action for completing this review—were submitted to parliament in mid-September. As at the last review, the authorities intend to draw only partially (10 percent of quota) on the resources made available under this fifth review, given limited short-term balance-of-payments needs. At this point, they expect to make similar partial drawings for the remainder of the program.

3. The Serbian economy has started to recover at a moderate pace, but, in contrast with several neighboring countries, there has been so far no need to revise downward significantly 2010 growth prospects. Real activity is expected to grow at 1.5 percent in 2010 and at 3 percent in 2011. However, private-sector employment continues to decline and the pace of growth is insufficient to stabilize it. Inflation has recently moved higher than expected, but the authorities share the staff's view that it can be brought down in 2011 and will remain within the target band. Recent export growth is encouraging and the current account has stabilized on a much lower level than before the crisis. Foreign exchange reserves remain robust.

4. The fiscal deficit target for end-June was met with a comfortable margin. Revenue collection overperformed somewhat, mainly due to higher indirect taxes, while expenditures have been below budget. The authorities will set priorities for budget re-allocations in October, but—as indicated in the staff statement—the scope for this will be limited given the recent decision to top up the agreed one-off payment to pensioners to relieve social hardship. The financing strategy will remain flexible, but will rely more on foreign exchange loans from domestic banks, drawdown of deposits, and, at the margin, dinar T-bills of shorter maturity.

5. Budget discipline will be strengthened through incorporation of fiscal responsibility provisions into the Budget System Law. The authorities opted for a combination of a numerical fiscal rule for the general government deficit (medium-term deficit target of 1 percent of GDP) to avoid a repeat of past procyclical fiscal policies, a limit on gross public debt including guarantees (45 percent of GDP), and a rule that allows temporarily higher deficits to accommodate public investment above certain thresholds. In addition, these provisions will be supplemented by special rules governing the indexation of public wages and pensions. An independent fiscal council will be established to oversee the implementation of the fiscal responsibility provisions.

6. Owing to the difficult market environment, the privatization process is temporarily on hold, with the exception of preparations for the sale of Telekom Srbjia. Two large loss making state enterprises (airline JAT, railway ZTP) will be restructured. Large-scale privatization receipts from the sale of state-owned enterprises could have significant implications for fiscal policy in the next few years, but the authorities are committed to stick to the relevant fiscal responsibility provisions in such a scenario. Specifically, privatization revenues will not be used to finance an increase in current spending and net lending.

7. The monetary and exchange rate framework has served the country well. The focus of monetary policy will be to keep inflation within pre-announced limits centered at 6 percent for 2010 and 4.5 percent for 2011. Owing to the current higher inflation outlook and the upside risks to inflation, the National Bank of Serbia (NBS) recently raised the policy rate and signaled a possible tightening bias. The significant exchange rate depreciation since the beginning of the crisis has helped absorb external shocks and supported the rebalancing of the economy, but is also contributing to upward inflationary pressures. Interventions of the NBS in the foreign exchange market have been used to smooth excess volatility or to provide liquidity to the market, without targeting a specific level of the dinar exchange rate.

8. The maintenance of the exposure of foreign parent banks to Serbia has helped forestall significant capital outflows during the height of the crisis. These voluntary commitments have lost their urgency and are expected to be phased out fully. The authorities will also have to decide on a phasing-out of their credit support program, depending on signs whether the economic recovery can be sustained.

9. The authorities are aware that the policy agenda under the program, and beyond, remains challenging. They will adhere to sound macroeconomic policies and are ready to implement further difficult structural measures to remove administrative bottlenecks and improve the business environment, which should spur growth in a sustained manner. The authorities are grateful for the Fund's advice and financial support in reaching this objective.