INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/238

REPUBLIC OF SERBIA

July 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE POLICY COORDINATION INSTRUMENT—PRESS RELEASE; STAFF REPORT; INFORMATIONAL ANNEX; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF SERBIA

In the context of the Staff Report for the 2019 Article IV Consultation and Second Review under the Policy Coordination Instrument, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its July 17, 2019 consideration of the staff report on issues related to the Article IV Consultation and the Second Review under the Policy Coordination Instrument.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 17, 2019, following discussions that ended on May 21, 2019 with the officials of Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 2, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Republic of Serbia.

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

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 19/291
FOR IMMEDIATE RELEASE
July 19, 2019

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Washington, D. C. 20431 USA

IMF Executive Board Completes Second Review Under the Policy Coordination Instrument and Concludes 2019 Article IV Consultation with Republic of Serbia

- Serbia's economy has remained stable and growth in 2018 picked up to 4.3 percent, the fastest pace in 10 years.
- Fiscal performance has been strong, while important reforms took place towards modernization of the tax administration and privatization of the largest state-owned bank.
- However, Serbia remains vulnerable to spillovers from external developments, including weaker-than-expected growth in key trading partners.

On July 17, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Serbia and completed the second review of Serbia's economic performance under the Policy Coordination Instrument (PCI).

Macroeconomic stability has continued to take hold since the 2017 Article IV Consultation. After Serbia suffered a drought in 2017, growth in 2018 rebounded to 4.3 percent—its fastest pace in 10 years. Fiscal discipline has taken root, with the general government budget recording a surplus for two consecutive years and public debt falling by about 15 percent of GDP since the beginning of 2017. At the same time, unemployment has continued to decline, and employment has risen steadily, with informal employment making up a smaller share. Inflation has been kept low and the financial sector is stable, with the level of banks' non-performing loans as a share in total loans reaching 5.5 percent at end-March 2019, the lowest level since 2008. Important recent reforms have been made towards modernization of the tax administration and privatization of the largest state-owned bank, while substantial progress was made in addressing Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) shortcomings.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The near-term outlook remains positive. Growth in 2019 is projected at 3.5 percent, with a pick-up in growth expected during the second half of the year due to strong foreign direct investment (FDI), continued public investment, and assumed recovery in trading partner countries. Inflation will move within the lower half of the inflation target band, while the current account deficit as a share of GDP is expected to widen modestly and remain fully covered by FDI. However, Serbia remains vulnerable to spillovers from external developments, including weaker-than-expected growth in key trading partners. Over the medium term, policies should be geared towards ensuring that structural drivers of growth are solid. This includes efforts to limit outflow of skilled labor by creating work opportunities within Serbia, as well as improve the private investment climate through the better provision of public services and reduction of the grey economy. Strengthening governance will also be critical, including providing legal certainty, as well as improvements in governance and efficiency of State Owned Enterprises.

At the conclusion of the Executive Board meeting, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

"Serbia's macroeconomic performance, supported by the Policy Coordination Instrument, has been strong. Growth has been robust, public debt is declining, employment is rising, the financial sector is sound, and inflation is low. Continued strong program implementation and determined structural reforms are important to address the challenges and accelerate income convergence with the EU.

"Fiscal policy is appropriately focused on reducing public debt, while contributing to growth and unwinding crisis measures. Increased infrastructure spending—together with improvements in public investment management—and reducing the tax burden on labor will help raise growth and employment. Going forward, preserving fiscal sustainability should be prioritized, including through the use of prudent fiscal rules.

"The accommodative stance of monetary policy has contributed to economic activity, while inflation remained under control. Over the medium term, greater exchange rate flexibility would help develop the exchange rate market and promote dinarization.

"Reforms of state-owned financial institutions need to be implemented vigorously to improve efficiency and strengthen confidence. Following the notable progress in addressing NPLs, the focus should turn to public institutions and the successful completion of the privatization of the largest state-owned bank.

"Structural reforms are advancing, but governance issues persist. Substantial progress has been made on AML/CFT deficiencies, leading to Serbia's removal from FATF's greylist. Building on recent tax administration reforms, further modernization efforts will be critical for strengthening collections and improving the business environment. Resolution of the remaining problem state-owned enterprises (SOEs) is progressing slowly and implementation of the public wage system reform should not be further delayed. Improved governance, including better corporate governance of SOEs, can raise efficiency and economic growth."

Executive Board Assessment[2]

Executive Directors welcomed Serbia's strong macroeconomic performance supported by the Policy Coordination Instrument. Economic growth has been robust, public debt is declining, and inflation is low. Directors emphasized that continued commitment to strong policies and determined implementation of structural reforms is key to sustaining macroeconomic and financial stability, addressing external and internal challenges, fostering growth, and advancing the EU convergence agenda.

Directors underscored that maintaining a strong fiscal position and further reducing public debt, while accommodating growth enhancing measures is important. They highlighted that improving the quality and composition of spending is key for budget discipline and economic growth. Directors considered that implementation of a fiscal rule anchored on debt, reintroduction of pension indexation, reform of the wage system, and improvements in public employment frameworks, are important measures to bolster fiscal policy credibility.

Directors agreed that the accommodative monetary policy stance, under the inflation targeting framework, has been appropriate and contributed to economic activity. Noting the authorities' cautious approach, they generally considered that greater exchange rate flexibility over the medium term would help develop the exchange rate market, and enhance dinarization.

Directors noted that vigorous implementation of the reforms of state-owned financial institutions is essential to improve efficiency and strengthen confidence. They noted the good progress in addressing the nonperforming loans (NPLs) and looked forward to the successful completion of the privatization of the largest state-owned bank in a transparent manner. Directors welcomed the authorities' focus on improving capital markets and access to development finance.

Directors emphasized that stronger commitment to structural reforms is important. They commended the progress made on AML/CFT and Serbia's removal from the FATF greylist. Looking forward, Directors encouraged steps to build on the recent tax administration reforms, improving the business environment, and further reform of state-owned enterprises (SOEs). They highlighted that strengthening governance, including better corporate governance of SOEs, can raise efficiency and economic growth.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Serbia: Selected Economic Indicators, 2016-2020

	2016	2017	2018		2019		2020
			CR 18/375	Est.	CR 18/375	Proj.	Proj.
			(Percent change, unless otherwise indicated)				
Real sector 1/							
Real GDP	3.3	2.0	**4.2**	4.3	**3.5**	3.5	4.0
Real domestic demand (absorption)	1.4	3.9	**4.8**	5.8	**3.6**	4.4	3.8
Consumer prices (average)	1.1	3.1	**2.1**	2.0	**2.4**	2.2	1.9
GDP deflator	1.5	3.0	**2.4**	2.0	**3.3**	3.3	3.5
Unemployment rate (in percent) 2/	15.9	14.1	**…**	13.3	**…**	…	…
Nominal GDP (in billions of dinars)	4,521	4,754	**5,074**	5,060	**5,424**	5,408	5,819
			(Percent of GDP)				
General government finances							
Revenue 3/	40.8	41.5	**41.1**	41.6	**39.9**	40.8	40.1
Expenditure 3/	41.9	40.4	**40.6**	41.0	**40.4**	41.3	40.7
Current 3/	37.9	36.7	**36.4**	36.5	**36.0**	36.7	36.1
Capital and net lending	3.2	3.1	**3.8**	4.1	**4.1**	4.3	4.4
Amortization of called guarantees	0.9	0.6	**0.4**	0.4	**0.2**	0.2	0.2
Fiscal balance 4/	-1.2	1.1	**0.5**	0.6	**-0.5**	-0.5	-0.5
Primary fiscal balance (cash basis)	1.7	3.6	**2.6**	2.8	**1.4**	1.6	1.4
Structural primary fiscal balance 5/	1.7	3.5	**2.7**	2.9	**1.8**	1.9	1.8
Gross debt	68.9	58.7	**54.0**	54.5	**51.9**	52.3	49.3
			(End of period 12-month change, percent)				
Monetary sector							
Money (M1)	20.3	9.7	**8.1**	20.1	**9.4**	10.7	9.8
Broad money (M2)	9.8	3.3	**6.9**	15.0	**6.6**	8.8	7.5
Domestic credit to non-government 6/	1.8	4.4	**7.1**	10.1	**5.9**	7.1	5.6
			(Period average, percent)				
Interest rates (dinar)							
NBS key policy rate	3.5	3.9	…	3.1	…	…	…
Interest rate on new FX and FX-indexed loans	3.1	3.1	…	2.8	…	…	…
			(Percent of GDP, unless otherwise indicated)				
Balance of payments							
Current account balance	-2.9	-5.2	**-5.3**	-5.2	**-5.1**	-5.6	-5.1
Exports of goods	34.9	35.9	**37.1**	35.6	**38.4**	36.0	36.8
Imports of goods	-43.4	-46.1	**-48.6**	-47.9	**-49.4**	-48.8	-49.2
Trade of goods balance	-8.5	-10.2	**-11.5**	-12.3	**-11.1**	-12.8	-12.4
Capital and financial account balance	0.6	4.8	**5.7**	6.5	**5.7**	6.6	6.7
External debt (percent of GDP)	75.7	67.2	**61.3**	61.7	**57.4**	58.3	55.1
of which: Private external debt	29.4	29.8	**28.1**	29.2	**26.3**	27.6	25.9
Gross official reserves (in billions of euro)	10.2	10.0	**10.6**	11.3	**10.8**	11.8	12.5
(in months of prospective imports)	5.5	4.7	**4.5**	4.9	**4.3**	4.7	4.6
(percent of short-term debt)	412.5	262.4	**250.8**	208.9	**208.4**	167.7	178.8
(percent of broad money, M2)	58.7	53.2	**52.7**	52.2	**50.7**	51.1	50.7
(percent of risk-weighted metric)	171.5	162.1	**165.4**	163.6	**161.1**	160.4	162.4
Exchange rate (dinar/euro, period average)	123.1	121.4	…	118.3	…	…	…
REER (annual average change, in percent; + indicates appreciation)	-1.1	2.9	…	2.8	…	…	…
Social indicators							
Per capita GDP (in US$)	5,756	6,284	**7,266**	7,223	**7,688**	7,503	8,174
Real GDP per capita (percent change)	3.9	2.6	**…**	4.7	**…**	3.9	4.4
Population (in million)	7.1	7.0	**7.0**	7.0	**7.0**	7.0	6.9

Sources: Serbian authorities; and IMF staff estimates and projections.
1/ SORS released revised national accounts in November 2018.
2/ Unemployment rate for working age population (15-64).
3/ Includes employer contributions.
4/ Includes amortization of called guarantees.
5/ Primary fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending as well as one-offs.
6/ At constant exchange rates.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE POLICY COORDINATION INSTRUMENT

July 2, 2019

EXECUTIVE SUMMARY

Context. Macroeconomic stability has been maintained with robust economic growth, declining public debt, as well as low and stable inflation. While Serbia continues to address structural challenges, supported by the Policy Coordination Instrument, more determined efforts are needed to ensure faster income convergence with the EU.

Fiscal Policy. Strong fiscal performance continues, facilitating higher capital spending and a reduction of the tax burden on labor as well as faster debt reduction. Going forward, fiscal rules and continued tight control of mandatory spending can help preserve hard-won gains.

Monetary and Financial Sector Policies. The current accommodative monetary policy stance remains appropriate, but greater exchange rate flexibility is warranted over the medium term. Although the financial sector is sound, more can be done to further reduce NPLs and reform the state-owned financial institutions. Launching the privatization tender of Komercijalna Bank is an important step in this regard. Substantial progress has been made in addressing Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) shortcomings.

Structural Reforms. The reform of the tax administration is advancing, but the resolution of problem SOEs faces ongoing delays and further actions are needed to strengthen SOE governance. Stronger commitment to the implementation of planned structural reforms is needed to boost potential growth and improve the private investment climate.

Risks. Risks to the program are moderate. Serbia remains vulnerable to spillovers from external developments, including weaker-than-expected growth in key trading partners. Domestic risks center on resistance to structural reforms.

Program Performance. The program remains broadly on-track. Performance through 2018 was in line with the end-year indicators, except for a minor deviation on domestic arrears, while all end-March 2019 Quantitative Targets (QTs) were observed. Most Reform Targets have been implemented, albeit with some delays. Staff recommends completion of the second review under the Policy Coordination Instrument and establishment of QTs for 4Q2019.

Approved By
Philip Gerson (EUR) and Petya Koeva Brooks (SPR)

Discussions were held in Belgrade during May 9–21, 2019. The staff team comprised Jan Kees Martijn (head), Christine Richmond, Marina Marinkov (all EUR), Pietro Dallari (FAD), Rachid Awad (MCM), Juliana Araujo (SPR), Sebastian Sosa (resident representative), Desanka Obradović and Marko Paunović (Belgrade office). Vuk Djoković (OED) attended some discussions. HQ support was provided by Piotr Kopyrski and Brett Stewart (both EUR).

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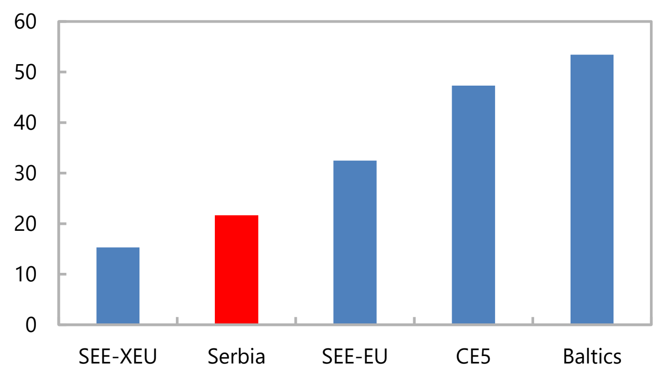
CONTEXT

1. **After successfully completing the 2015-18 SBA, Serbia still needs to further reduce public debt while addressing structural and institutional weaknesses hampering faster, more inclusive growth.** Macroeconomic stability has continued to take hold since the 2017 Article IV consultation (Box 1). Growth rebounded last year, reaching its fastest pace in 10 years. Fiscal discipline has taken root, with public debt falling by about 15 percent of GDP since the beginning of 2017. At the same time, unemployment has continued to decline, and employment has risen steadily, with a smaller share of informal employment. Inflation has been kept low and the financial sector is stable.

2. **Nevertheless, structural reforms are needed to ensure faster income convergence with the EU.** Improving the private investment climate through the better provision of public services and reducing the grey economy should remain government priorities. Creating opportunities for skilled workers within Serbia is critical to limit 'brain drain'. Fiscal achievements need to be better anchored to preserve hard-won gains. Fighting corruption and improving governance frameworks can also bring positive economic dividends, particularly for State-Owned Enterprises (SOEs). The 30-month Policy Coordination Instrument (PCI) approved in July 2018 is supporting the authorities' program to address vulnerabilities and create conditions for accelerated growth.

Nominal GDP per capita, 2018

(Percent of EU nominal GDP per capita; weighted averages)



Sources: IMF, WEO database, and IMF Staff estimates.
Note: CE5: CZE, HUN, POL, SVK, SVN; Baltics: EST, LVA, LTU; SEE-EU: BGR, HRV, ROU; and SEE-XEU: ALB, BIH, MKD, MNE, KOS.

3. **The ruling SNS party's mandate extends to 2020.** President Vučić, the leader of the SNS party, confirmed the government's commitment to economic reform and continued EU integration. Kosovo introduced a 100 percent tariff on Serbian imports in 2018, and in recent months, discussions on normalizing relations between Serbia and Kosovo have stalled.

Box 1. Implementation of Past Fund Advice

Implementation of past Article IV advice has been strong, supported by the PCI and Fund technical assistance in several areas.

Fiscal policy. Fund advice centered on safeguarding the 2015-17 fiscal consolidation to keep public debt on a firm downward path while supporting growth. The general government posted two consecutive years of overall surplus in 2017-18. The authorities also continued to contain current spending while accommodating higher capital spending and unwinding the crisis-era temporary measures, in line with Fund recommendations. Progress has been made—supported by IMF technical assistance (TA)—in reforming the tax administration and strengthening public investment management frameworks, but the public wage system reform has yet to be implemented.

Monetary and financial sector policies. The Fund recommended further strengthening monetary and exchange rate frameworks; promoting dinarization; further enhancing financial safety nets; and reforming state-owned financial institutions. Supported by IMF TA, the authorities have improved liquidity management. Dinarization has increased, albeit at a slow pace. The exchange rate has remained broadly in line with fundamentals, but staff has continued to recommend increased day-to-day flexibility. An updated NPL resolution strategy was adopted with a focus on state institutions. The privatization of Komercijalna Bank is ongoing, but reforms of other state-owned financial institutions have progressed slowly. Substantial progress has been made in addressing Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) deficiencies.

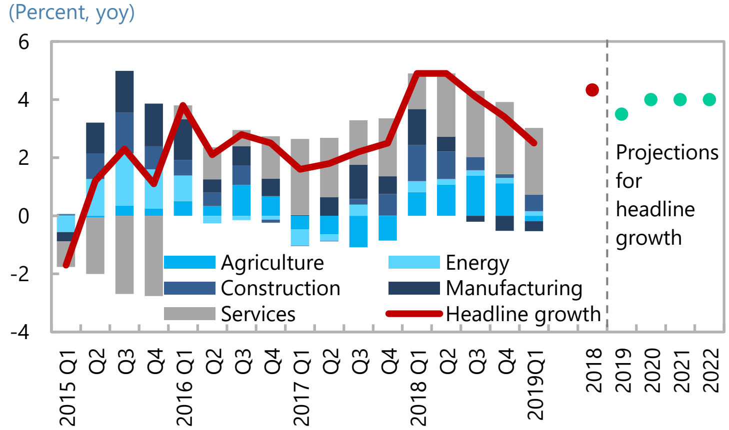
Structural policies. Fund advice focused on reducing informality and completing the restructuring and/or privatization of SOEs. Measures have been taken to improve the inspection system, modernize tax administration, and strengthen incentives for voluntary tax and social contributions compliance. The resolution of problematic SOEs has continued, with some delays: RTB Bor and PKB were privatized and Azotara's bankruptcy was initiated, but Petrohemija, MSK, and Resavica are yet to be resolved. Reforms to enhance corporate governance and management of the large public utility companies have been modest and plans to change EPS' legal status to a joint-stock company have been delayed. Good progress has been achieved in improving the quality of national statistics, supported by Fund technical assistance.

RECENT ECONOMIC DEVELOPMENTS

4. **Macroeconomic performance in 2018 was strong (Figures 1-7).** Real GDP growth reached 4.3 percent—the fastest rate in 10 years—supported by robust performance of agriculture and services. Recent activity indicators are mixed, with strong retail trade but weaknesses in other sectors, including manufacturing. Growth decelerated to 2.5 percent yoy in 1Q2019, in part due to 2018 base effects, but also because of slower activity in electricity generation (related to the

Contributions to Growth

(Percent, yoy)

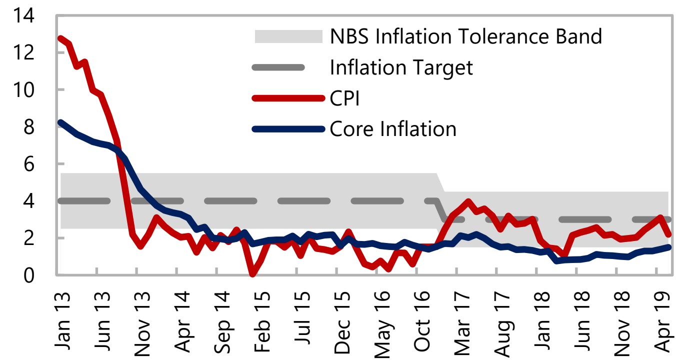


Sources: SORS, IMF staff calculations and projections.

overhaul of infrastructure) and lower export growth. The authorities have reinforced efforts to attain near-term growth objectives through the high-level GDP council. Labor market conditions continue to firm: the unemployment rate fell to 12.7 percent in March and employment rose to 58.7 percent, while informal employment remains below 20 percent.

5. Headline inflation and core inflation remain subdued. Inflation reached 2.2 percent yoy in May, with core inflation at at 1.5 percent. Inflation expectations of the financial and corporate sectors remain well-anchored, close to the 3 percent center of the inflation band (Figure 4). The NBS has kept the policy rate on hold at 3 percent since April 2018, citing persistent uncertainty in the international environment. Favorable credit conditions have continued, resulting in robust credit growth to households and corporates corporates (12 percent yoy and 8 percent yoy, respectively, in April).

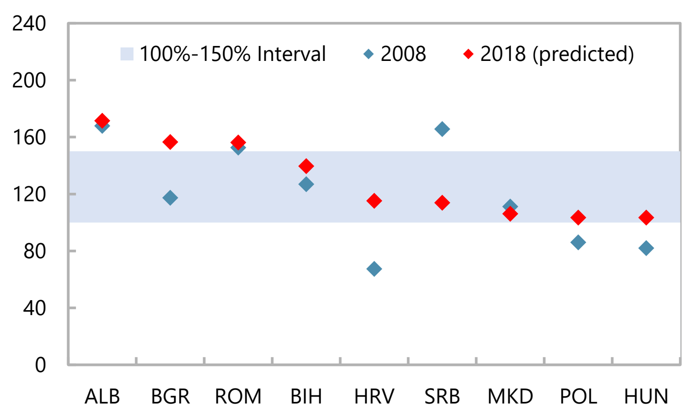
Inflation
(Percent, yoy)



Sources: NBS, and IMF staff calculations.

6. The external position remains stable. The current account deficit was unchanged at 5.2 percent of GDP in 2018. Net FDI flows reached 7½ percent of GDP in 2018, the highest level since 2012 and more than fully covering the 2018 current account deficit. FDI reached about 2½ percent of GDP in Jan-Apr 2019. Yields on government securities remain near record lows (Figure 3). Appreciation pressures versus the euro experienced in 2018 recurred beginning February 2019, and the NBS has been a net purchaser of forex from the market (€580 million up to June 10, 2019). International reserves stood at €11.3 billion at end-2018, and rose to €11.5 billion at end-March.

International Reserves
(Percent of risk-weighted metric)



Source: IMF Staff calculations.

7. Strong fiscal performance has continued. In 2018, the general government registered an overall surplus of 0.6 percent of GDP. Robust non-tax revenues (boosted by one-offs) and excise taxes and lower interest payments offset higher execution of capital expenditure and lower VAT revenue resulting from a reduction of refund delays. Public debt fell to 54.5 percent of GDP by end-2018, a decline of about 4 percentage points relative to 2017, driven by fiscal consolidation, economic growth, and early redemptions of expensive debt (the euro bond issued in June 2019 should allow for further debt redemptions). In 1Q2019, the general government registered a surplus of 0.2 percent of GDP, as robust tax collection and one-off revenues offset strong investment spending. Corporate income tax and non-tax revenues were boosted by the Belgrade airport concession agreement and by profits transferred from the NBS to the budget (together about 0.3 percent of GDP).[1]

Serbia: General Government Fiscal Operations, RSD billion

	January - December 2018			January - March 2019		
	Prog. /1	Act.	Diff.	Prog. /1	Act.	Diff.
Total revenue	**2,085.7**	**2,105.3**	**19.6**	**490.5**	**526.0**	**35.5**
Tax revenue	1,816.8	1,822.2	5.5	442.9	459.4	16.5
of which: VAT	505.0	499.8	-5.2	132.1	128.7	-3.4
of which: Social security contributions	617.9	619.7	1.7	149.5	152.2	2.7
of which: Excises	285.1	290.0	4.9	67.8	69.8	2.0
Non-tax revenue	257.4	262.6	5.1	45.1	64.6	19.6
Capital revenue	0.0	5.8	5.8	0.0	1.1	1.1
Grants	11.5	14.7	3.2	2.5	1.6	-1.0
Total expenditure	**2,057.7**	**2,073.0**	**15.4**	**509.5**	**512.1**	**2.6**
Current expenditure	1,844.8	1,845.1	0.3	472.5	473.0	0.5
Capital expenditure	183.7	199.3	15.6	30.3	36.1	5.8
Net lending	9.2	8.9	-0.2	1.4	0.7	-0.7
Amortization of activated guarantees	20.0	19.7	-0.3	5.2	2.3	-2.9
Fiscal balance	**28.0**	**32.2**	**4.2**	**-19.0**	**14.0**	**32.9**
Memo:						
Wage bill	468.9	468.8	-0.1	116.9	123.8	6.9
Primary current expenditure of the Republican budget	909.4	899.3	-10.1	221.9	219.2	-2.7
General government debt (percent of GDP)	54.0	54.5	0.5	52.9	51.8	-1.0

Sources: Ministry of Finance, IMF staff calculations.
1/ Programmed as of the 1st review.

PROGRAM PERFORMANCE

8. The program is broadly on track (Program Statement (PS) Tables 1-2).

- **Implementation of the 2018 budget was in line with the end-December Indicators, except for a minor deviation on domestic arrears, while all end-March 2019**

[1] Since January 2019, data for thirteen extrabudgetary units of the Ministry of Labor and Social Affairs have been consolidated into the budgetary central and local government accounts. The overall impact of these changes is expected to be neutral, as higher budgeted expenditures are compensated by the units' own source of revenues.

Quantitative Targets (QTs) were observed. The fiscal deficit ceilings for the general government were met as well as the ceilings on current primary expenditure of the Republican budget. Inflation remains within the band limit of the inflation consultation clause. The end-December ceiling on accumulation of domestic arrears by the consolidated general government was missed by a slight margin due to arrears of Roads of Serbia and the Ministry of Justice, but was met at end-March.

- **Most Reform Targets (RTs) have been implemented, albeit with some delays.** The updated dinarization strategy was approved in a timely manner (**end-December 2018 RT**), while the action plan to address AML/CFT weaknesses was implemented according to the agreed timeline (**end-February 2019 RT**). In December the government and DIA approved a time-bound action plan to resolve the Deposit Insurance Agency's (DIA) portfolio of bad assets; however the legal conclusion of the first phase of the sale has taken longer than expected (**end-December 2018 RT**). By early July the authorities plan to issue the rulebook to the 2017 Capital Project Regulation (**end-January 2019 RT**) and adopt a new decree on public investment projects, as needed to make the Capital Investment Commission (established in April) operational (**end-April 2019 RT**). The tender of Komercijalna Banka has been launched (**end-June 2019 RT**) based on a government decision issued in March, and at end-May the government invited investors to submit expressions of interest. However, the authorities did not yet launch a privatization tender for Petrohemija (**end-February 2019 RT**).

- **The authorities have made progress on the remaining RTs for end-June.** The restructuring of the Serbian Tax Administration (STA) core activities into fewer offices is proceeding; and draft amendments to the Law on Deposit Insurance Agency and the Law on Deposit Insurance have been prepared.

OUTLOOK AND RISKS

9. The economic outlook remains positive (Tables 1-8). The economy is projected to grow 3.5 percent in 2019, with a small negative output gap. The composition of growth has changed on account of weaker external demand being fully offset by stronger domestic demand. During the remainder of 2019, growth is expected to be supported by strong FDI, continued public investment, and an assumed recovery in trading partner countries. Strong wage growth and bank credit to households should also support consumption. Economic growth is expected to gradually accelerate to 4 percent in 2020. The authorities were more optimistic about the economic outlook, arguing that growth may even be higher in 2019 due to strong domestic performance, and they broadly concurred with risks identified by staff. Authorities and staff project inflation to be at the midpoint of the target band by 2023. The current account deficit is expected to decline to around 4 percent of GDP over the medium term, as FDI inflows moderate and export performance gradually picks up.

10. The external stability assessment suggests that Serbia's external position is broadly consistent with fundamentals and desirable policy settings (Annex 3). The EBA-Lite methodology delivers a current account gap of -0.9 percent. Vulnerabilities linked to the large negative net international investment position (NIIP) persist but public sector deleveraging in 2016-2018 improved the NIIP (estimated at -85.9 percent of GDP in 2018). The NIIP's composition is favorable, with a high share of net FDI liabilities (70.3 percent of GDP in 2018). This further mitigates external vulnerabilities, even if the projected external debt path is sensitive to real exchange rate shocks (Annex 5). FX reserves remain adequate (113 percent of the ARA metric).[2].

11. The outlook is subject to domestic and external risks, which are tilted to the downside (Annex 1). The slowdown in the euro area starting in 2H2018—especially in Serbia's most important trade partners—has already affected economic activity and may continue to do so because of lagged effects (Box 2). Sustained weaker-than-expected growth in key trading partners would prolong the adverse effects on investment and growth in Serbia. Rising protectionism could further hamper growth through its impact on global trade. Higher risk premia for the region would raise funding costs. On the domestic side, consumption is expected to remain strong, but domestic demand may turn out weaker if planned investments are not realized. Hesitation to deliver on structural reforms or loss of fiscal discipline, could reduce growth longer-term prospects and compromise the quality and durability of the fiscal adjustment.

[2] Assuming the current stabilized de facto arrangement classification.

Box 2. Growth Spillovers

Global economic activity slowed down in the second half of 2018, with a pronounced downturn in the Euro area impacting the Serbian economy.

As a small open economy, Serbia is vulnerable to external spillovers. Exports of goods amounted to about 36 percent of GDP in 2018. About two-thirds of exports were to EU countries, Germany and Italy being Serbia's key trading partners. FDI inflows have increased steadily in recent years, reaching €3.5 billion, or around 8 percent of GDP, in 2018. Similar to exports, most FDI inflows came from the Euro area.

Serbia: External linkages with major partners, 2018

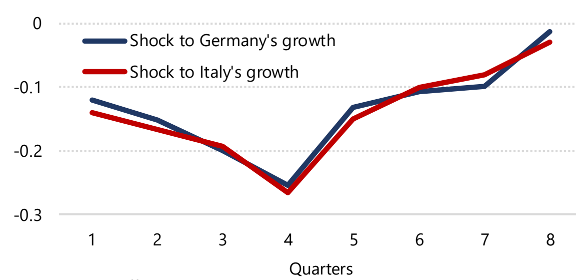
	Exports		FDI inflows	
	Value (EUR million)	Share of total	Value (EUR million)	Share of total
Europe	15,163	93.2	2,468	70.6
EU countries	10,900	67.0	2,118	60.6
Germany	1,942	11.9	264	7.5
Italy	1,987	12.2	154	4.4
France	449	2.8	711	20.3
Netherlands	324	2.0	318	9.1
Rest of Europe	4,263	26.2	350	10.0
Other countries	1,108	6.8	1,028	29.4

Source: NBS, IMF staff calculations

Staff analysis confirmed the importance of negative real spillovers to Serbia through the trade and FDI channels. Several spillover channels, including trade, FDI, remittance and business confidence were investigated, using quarterly data over the 1Q2002-4Q2018 period and several VAR specifications. [1] The results indicate that trade and FDI channels are the most robust.

The impact of a slowdown in Serbia's key trading partners peaks after four quarters at about a quarter of the size of the initial shock. Staff analysis[2] suggests that a one percentage point one-off adverse shock to Germany or Italy's growth would cause Serbia's (quarterly, yoy) growth to decline by 0.12 percentage points after one quarter. However, the maximum impact would be 0.25 percentage points, felt after four quarters. The impact of a shock to the entire Euro area is much larger, given its share in Serbia's total exports: a one percentage point adverse shock would cause Serbia's growth to decline by about 0.65 percentage points, with maximum impact of 1.4 percentage points after four quarters. This implies that despite some signs of euro area recovery in the first quarter of 2019, the impact of the 2018 slowdown may still manifest in Serbia throughout the year because of lagged effects including for FDI (which has been strong thus far).

Impulse Response of Serbia's growth
(percentage points)



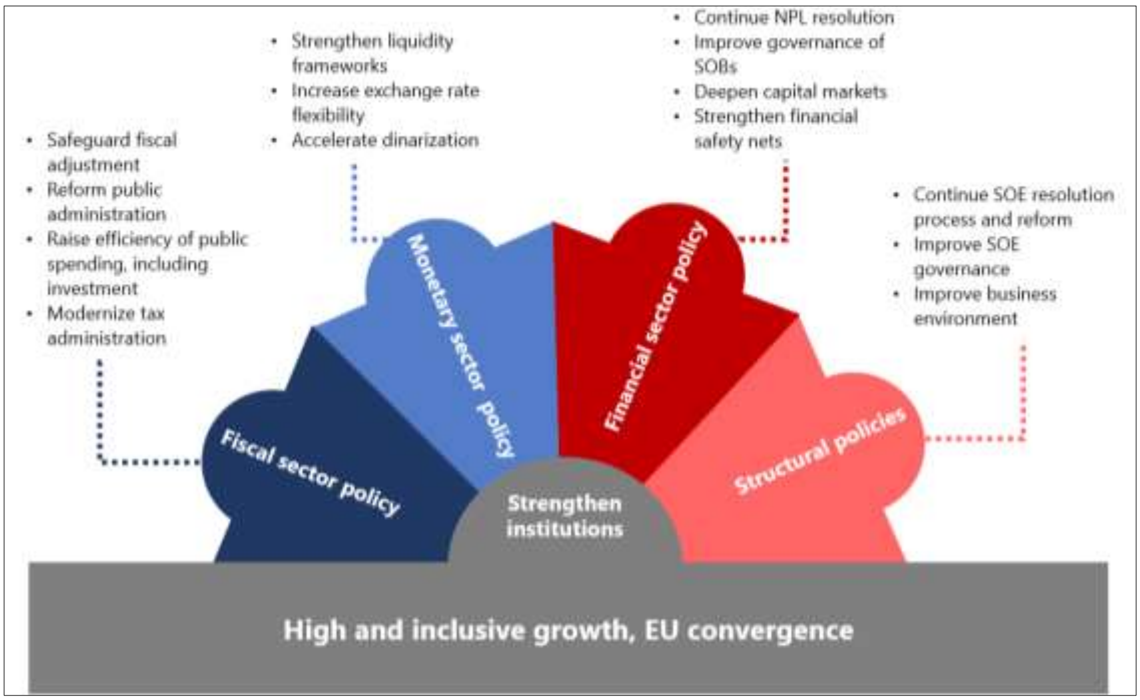
Source: IMF staff calculations.

[1] Traditional Choleski ordering was used to identify the various channels. As an illustration, for an FDI shock originating in Germany, Germany's FDI (and sometimes other key German indicators) would be ordered first, followed by key variables for Serbia such as growth.

[2] The analysis relies on a structural VAR-X model and quarterly data covering 1Q2002-4Q2018 to investigate the impact on Serbia's growth from a slowdown in its main trading partners. The model includes key domestic indicators (such as growth, inflation, interest rate and exchange rate) as endogenous variables. The key exogenous variable is constructed as a trade-weighted GDP, meant to capture the relative importance of main trading partners' growth dynamics. VAR-X models incorporate the impact of unmodelled exogenous variables into a VAR. This type of model is appropriate for small open economies with large trading partners, such as Serbia. It is also relatively simple with less need to impose restrictions.

POLICY DISCUSSIONS

The Article IV discussions focused on the stance of macroeconomic policies and on strengthening institutions to nurture robust private sector-led economic growth. The program review discussions built on the Article IV assessment and stressed the need to make progress in five priority areas: (i) advancing structural reform efforts, (ii) cementing hard-won macroeconomic and fiscal gains, (iii) improving the quality of public administration, (iv) strengthening governance of state-owned institutions, and (v) further strengthening financial stability. If risks to growth materialize, staff advised that automatic fiscal stabilizers should be allowed to operate. Provided inflation remains low, monetary policy could also play a role. However, in the case of tighter financial conditions, the planned fiscal path should be maintained.

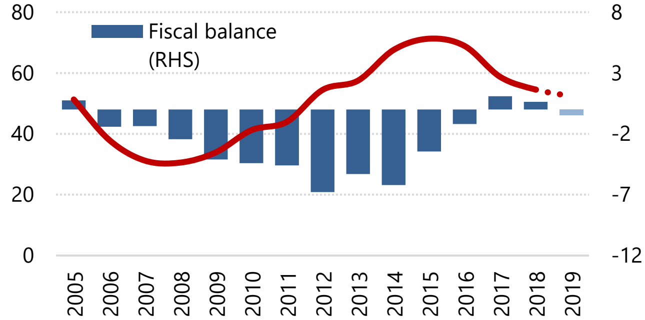


A. Fiscal Policy

Background

12. The successful fiscal consolidation since late 2014—largely achieved through ad-hoc measures—has provided space for both faster debt reduction and higher capital investment. Supported through early 2018 by the SBA, the authorities have restored fiscal sustainability, putting public debt firmly on a downward path. To realize the fiscal adjustment, the authorities introduced a hiring freeze, public sector wage reductions, and crisis-related temporary cuts in higher-end pensions (that have since been unwound). In addition, the fiscal rule that limits the deficit has not been effective since 2012 when the debt anchor was breached. Under the PCI, the fiscal space that has been created should be used to address Serbia's large developmental needs and support private sector employment, while still supporting the reduction of public debt to about 50 percent of GDP by the end of the program. In addition, to lock in the improvement in fiscal discipline the authorities are preparing new or revised systems and rules for controlling current spending and the fiscal balance.

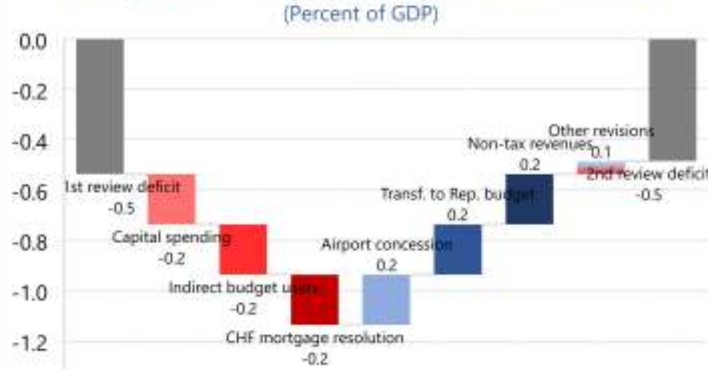
Fiscal Balance and Debt
(Percent of GDP)



Source: MOF, IMF staff calculations.

13. The general government is projected to post a deficit of 0.5 percent of GDP in 2019, broadly in line with the first review projections. The moderately expansionary fiscal stance remains appropriate to stimulate domestic investment and thereby support income convergence towards EU levels. The 2019 budget also reduced the fiscal burden on labor by eliminating the employers' part of the unemployment contribution. Compared to the approved 2019 budget, capital expenditures have been revised up by 0.2 percent of GDP on account of strong execution during 1Q2019 and accelerated investments in road maintenance and construction. The incorporation of indirect budget users (mostly social institutions) into general government budget accounts is estimated to raise spending by about 0.2 percent of GDP. However, this spending will be offset by own source revenues. Payments from the government to banks in the context of the solution for Swiss-franc mortgages (the estimated maximum cost is 0.2 percent of GDP, see Box 3) are expected to materialize in 3Q2019, and will be more than offset by revenues from the Belgrade airport concession agreement.[3] Additional funds have also been allocated for the settlement of

Budget Revisions Relative to the First Review
(Percent of GDP)



Sources: MOF, IMF staff estimates.

[3] The dividend payment of €501 million from VINCI, the successful concessionaire, was made to the Serbian public nonfinancial corporation (Belgrade Nikola Tesla Airport) that previously owned and operated the airport in 2018. In March, the payment was transferred to the owners of the public corporation (the Serbian government and Serbian households). The Serbian government received approximately €416 million, corresponding to its ownership share of 83 percent. The super-dividend test under the ESA 2010 and GFSM 2014 methodologies was applied, and RSD 2.5 billion will be recorded above the line as dividend, while the rest will be recorded below the line as withdrawal of equity. Corporate income tax revenue associated with the dividend payment is expected to be RSD 9 billion.

arbitration cases against the Republic of Serbia and to adequately fund social programs, including parental allowances for families with children (about 0.2 percent of GDP in total).[4]

Policy Discussions

14. The authorities and staff agreed that preserving fiscal sustainability is a key priority. The projected medium-term deficit of 0.5 percent of GDP remains appropriate, keeping the primary balance well above its debt-stabilizing level of -0.5 percent of GDP and public debt on a declining path (see Annex 4). This provides some fiscal space, which should be prioritized towards productive capital investments and a reduction of the tax burden on labor and businesses. A faster decline in public debt would provide more space for countercyclical fiscal policy.

15. Continued tight control of mandatory spending, through well-designed and transparent rules and frameworks, is a priority:

- **Wage system reform.** The objective of the reform—originally launched in 2015—is to provide equal pay for equal work across the public administration, and create a transparent, rule-based mechanism to set public wages. The authorities intend to adopt the decree specifying wage coefficients (**end-September 2018 RT; reset to end-May 2020**) to be implemented by 2H2020. Staff expressed disappointment about the further delay and stressed that wage increases introduced in 2020 should be based on available fiscal space, while preventing an increase of the general government wage bill as a share of GDP.[5] Staff emphasized that given the importance of this reform to the program, its implementation should not be postponed any more. It also advised that salary increases for police and armed forces should be aligned with other sectors, and the authorities foresaw that these sectors would be brought into the new wage system during 2021.

- **Public employment frameworks.** The authorities stated that the existing framework to control general government employment based on the Law on the Maximum Number of Employees would expire at end-2019, but that they intend to keep the government Employment Commission to scrutinize hiring decisions. Over the medium term they plan to replace this centralized and rigid control mechanism with a new system based on personnel planning for all public sector entities, including public enterprises. Until the new system is in place, it was agreed to instruct the Employment Commission to approve hiring of staff to replace departures, within institutions' employment and budget limits. Staff urged the authorities to analyze staffing needs within key ministries to support medium-term workforce

[4] In accordance with Serbian law these changes will not require passage of a supplementary budget and will be accommodated within existing spending envelopes.

[5] However, wage bill increases to account for the recently introduced indirect budget users will be accommodated.

planning. The authorities intend to adopt a government decision on a revised public employment framework along these lines effective 2020 (**end-September 2019 RT**).

- **Pensions.** The authorities confirmed their intention to reintroduce indexation beginning January 2020, moving away from the discretionary increases granted in recent years. It was agreed that the so-called Swiss indexation formula will be adopted. Accordingly, annual pension growth will be the sum of 50 percent of inflation and 50 percent of the average nominal wage growth. The authorities planned to include a ceiling on pension spending as a share of GDP, while staff encouraged the inclusion of an additional lower ceiling that once breached would lower indexation to only inflation.

16. The authorities agreed that small but persistent domestic arrears need to be settled. The authorities reported the accumulation of domestic arrears in the amount of RSD 0.8 billion in 4Q2018, marking the third consecutive quarterly accumulation. The main sources of arrears have been Roads of Serbia and the Ministry of Justice. To address the former, the authorities plan to increase road tolls by 12 percent in June and allocate additional funds to cover road maintenance and construction expenses (about 0.3 percent of GDP). The authorities reported that Ministry of Justice arrears were cleared in 1Q2019, but staff called for greater attention to prevent a new accumulation. Staff also urged the authorities to expedite payments of parental allowances for families with children, and to ensure that this program is adequately funded going forward to help prevent arrears.

17. The authorities and staff agreed that a strong fiscal framework can help preserve hard-won gains, while paving the way for further reforms. Staff supported the authorities' intention to publish the Fiscal Strategy by mid-July, to more closely align with the budget calendar. Staff noted the importance of moving to a Medium-Term Fiscal Framework (MTFF), to improve budget planning and credibility as well as assess fiscal space available for new policies.

- **Public investment management.** Having in place a strong process of appraisal and selection of public investment projects is a priority given Serbia's large infrastructure needs and long pipeline of future projects. Staff stressed the importance of building capacity in relevant ministries to support the new system and decision-making by the Capital Investment Commission. The authorities are developing a Public Investment Management Information System (PIMIS) with World Bank support, which will allow registration, evaluation, monitoring and reporting on implementation of capital projects.

- **Fiscal Risks Unit.** The authorities confirmed that the head of the Fiscal Risks Unit at the Ministry of Finance (MOF) had been appointed, and the unit has been staffed. Supported by World Bank technical assistance, the authorities intend to prepare a strategy and methodology to properly monitor fiscal risks by June 2020 and publish a fiscal risk statement as part of the 2020 Fiscal Strategy. Staff recommended prioritizing the assessment of fiscal risks stemming from (i) SOEs; (ii) local governments; (iii) public-private partnerships; and (iv) litigation.

- **Fiscal rules.** The authorities committed to continue analytical work towards a new fiscal rule, with a view to finalizing a proposal by end-2019. In line with previous staff advice[6], they intend for the new rule to be anchored on public debt, to provide guidance for medium-term fiscal expectations and to ensure the long-term sustainability of public finances.

- **Tax policy.** The authorities aimed to review options to lower the labor tax wedge and rationalize the presumptive tax system in the context of the 2020 budget preparations, conditional on the availability of fiscal space.

18. Tax administration modernization is critical for revenue mobilization and improving the business climate. Serbia's STA reform is reaching a critical milestone, with the split between core and non-core activities and consolidation of core activities into fewer sites (**end-June 2019 RT**). The authorities committed to reaching a decision on a preferred approach to the IT system upgrade (**new end-October 2019 RT**). To support revenue mobilization, the authorities agreed to strengthen the staffing and operations of the large taxpayer office (LTO), with a goal to increase the share of revenues collected by the LTO to at least 45 percent of total tax revenues by end-2020. Staff welcomed the reduction in VAT refund processing times.

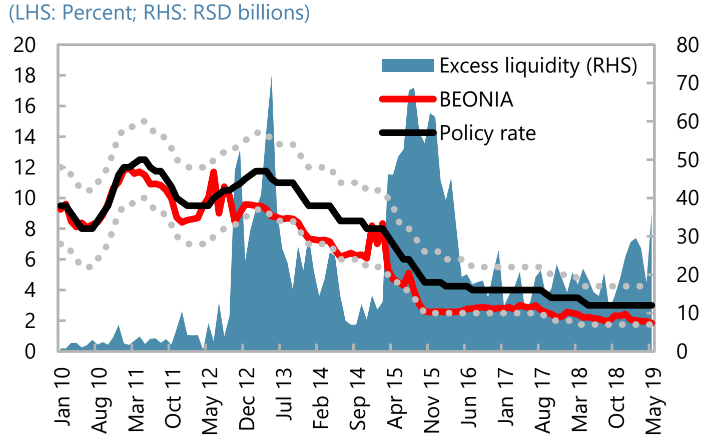
B. Monetary and Exchange Rate Policies

Background

19. Inflation has mostly been in the lower half of the inflation tolerance band since late-2017. At the same time, core inflation has remained low—at 1-1½ percent—despite healthy wage growth and strong private consumption. Over the same period, the exchange rate to the euro has moved within a 2pp band, with interventions in the forex market mostly aimed to offset strong appreciation pressures. Excess dinar liquidity, which spiked at end-2018, has since declined but the overnight BEONIA rate remains close to the floor of the interest rate corridor.

Interest Rate Corridor and Excess Liquidity

(LHS: Percent; RHS: RSD billions)

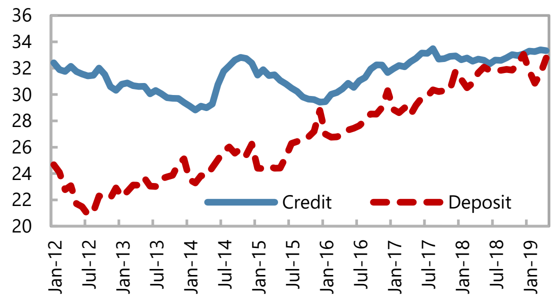


Sources: NBS, and IMF staff calculations.

[6] Annex II, CR 17/263

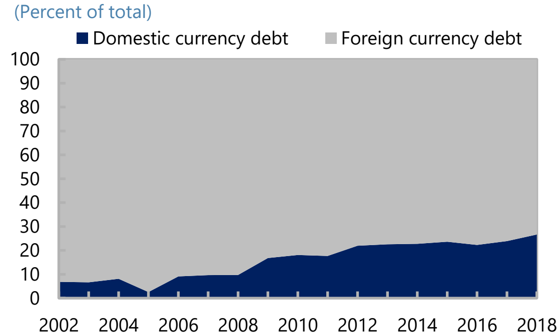
20. Dinarization has slowed, especially in the case of credit, due to increasing forex borrowing by corporates. Compared to 2012 when the first dinarization strategy was adopted, the share of total corporate and household credit denominated in dinars rose 5pp to 33.3 percent, while deposit dinarization rose 9.5 pp to 30.5 percent at end-March. At the same time, the MOF has increased the domestic currency share of its borrowing by more than 6pp to 25.8 percent.

Deposit and Credit Dinarization
(Percent)



Sources: NBS, IMF staff calculations.

Composition of Public Debt
(Percent of total)



Sources: MOF, IMF staff calculations.

Policy Discussions

21. The NBS and staff agreed that the current accommodative monetary policy stance remains appropriate in light of low inflation. The NBS also pointed to the uncertainty in international markets. They explained that since January FX swap auctions were used to reduce interest rates at the short-end of the yield curve. The instrument had been used to counter temporary liquidity imbalances between banks and prevent what the NBS considered to be unjustified increases in short-term interest rates. Staff recommended the gradual mopping up of excess liquidity in the banking system through repo operations and moving the NBS repo rate closer to the key policy rate to improve the signaling role of policy rates and further develop the interbank market.

22. With macroeconomic stability entrenched, greater exchange rate flexibility is warranted. Staff reiterated its long-standing call for greater two-way exchange rate movement to be developed gradually over the medium term, which could help further develop the forex market and promote awareness of the risks due to open currency positions. The NBS noted these priorities, and indicated that relative exchange rate stability was important, especially with growing international market uncertainty. They also noted that with still-low levels of dinarization, preserving financial stability is especially important and that the NBS will stand ready to react to market developments.

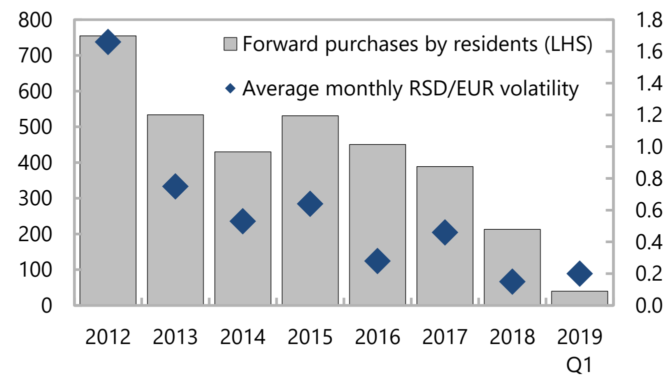
23. The authorities adopted an updated dinarization strategy in December 2018 (end-December 2018 RT) with four key aims:

- **Preserving macroeconomic stability.** The authorities noted the strong role of macroeconomic stability in contributing to dinarization. Staff agreed with this view, but noted that dinarization of credit, loans, and deposits had still stagnated and that given exchange rate stability the incentive to hold dinars remains low.

- **Increasing dinar-denominated debt.** The authorities reiterated their intention to achieve benchmark-size dinar bond issues as well as to lengthen the maturity of dinar borrowing. The authorities are also committed to establishing a primary dealership system, with support from the IMF and World Bank. A working group has been established comprising representatives of the PDA, MOF, primary dealers, and other relevant institutions to address gaps in the legal framework and debt office operations and to prepare the first phase of the primary dealer market in 2H2019.

- **Managing forex exposures and developing hedging.** The NBS has launched a survey of banks' exposures to unhedged borrowers in April. The aim is to understand how banks assess hedging by clients (including natural versus financial hedging), the extent of unhedged borrowing, and how banks manage the borrowers. Staff welcomed this activity noting that under Basel III capital standards higher risk weights should be applied to unhedged foreign currency exposures. Based on the survey, the authorities will consider possible regulations in 2020. Staff reiterated that without forex volatility the incentive to hedge will remain low.

FX Hedging and RSD/EUR Volatility
(LHS: EUR million; RHS: Percent)



Sources: NBS, IMF staff calculations.

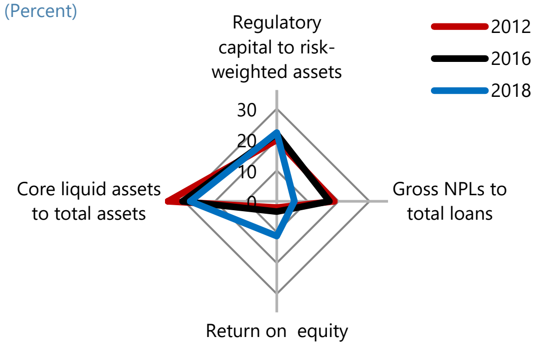
- **Improving coordination between the MOF, NBS, and PDA.** The authorities have formalized the communication between the NBS and MOF—through a Service Level Agreement concerning exchange of information. A Consultative Committee on Liquidity Management was also established to strengthen the management and oversight of the Consolidated Treasury Account balance and improve the quality of liquidity forecasting.

C. Financial Sector Policies

Background

24. Financial sector conditions remain sound. Since the 2017 Article IV Consultation, the financial sector has shown improved resilience. As of February 2019, banks' capital adequacy was stable at 22.3 percent, well above the regulatory minima, while asset quality is improving. Banks' profitability remains robust with return on assets and return on equity ratios of 1.9 percent and 10.6 percent, respectively, in February.

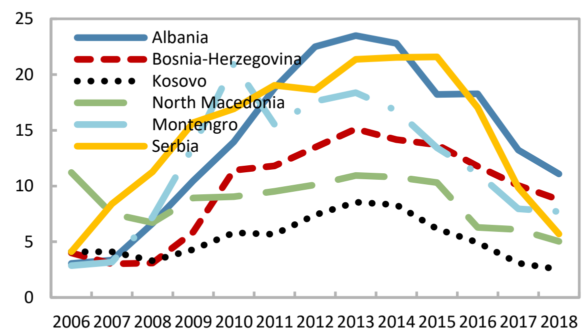
Financial Soundness Indicators
(Percent)



Source: NBS

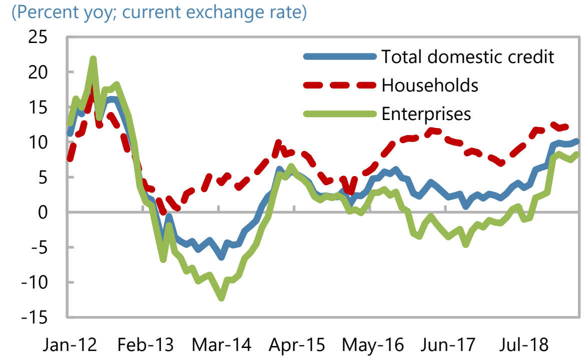
25. The NPL ratio fell to 5.5 percent in March 2019, the lowest level since 2008 and down more than 16pp from its peak in 2015. However, progress remains uneven, with state-owned banks (SOBs) continuing to lag. While the sharp reduction since 2015 was largely driven by the NBS's decision on the mandatory accounting write-off of fully impaired loans in 2017, a significant portion of this reduction was also achieved through NPL sales, mainly by private banks.

Nonperforming Loans
(Percent of total loans)



Sources: Central Bank of Montenegro, IMF, FSI, and IMF Staff

Credit Growth
(Percent yoy; current exchange rate)



Sources: NBS, IMF staff calculations.

26. Credit activity is expanding robustly, supported by record-low interest rates, stable bank credit conditions, and strong consumer confidence. Credit to households has been growing at a double-digit pace since 2H2016, while corporate lending (mostly to SMEs) turned positive in 3Q2018. To address risks associated with rising long-term household cash loans in dinars, in December 2018 the NBS adopted new regulations to limit cash loan maturities greater than 8 years and imposed a 60 percent debt-to-income limit on consumer loans.

27. Serbia has made substantial progress on AML/CFT deficiencies. Serbia addressed all the components of its AML/CFT action plan with the FATF (**end-February 2019 RT**). An onsite visit by FATF in May confirmed that the action plan items have been addressed and that implementation is underway. In June, Serbia was removed from the FATF monitoring process.

28. The authorities continue to implement their capital account liberalization strategy. Many capital account transactions, such as FDI and long-term flows, have already been liberalized. Further steps were taken in 2018 to liberalize the capital account including portfolio flows and derivative transactions by eliminating constraints on non-deliverable derivatives.[7] Transactions outside the regulated market are allowed for hedging purposes only.[8] To limit balance of payments pressures, the further capital account liberalization required in the context of EU accession will be gradual, particularly in removing restrictions on short-term capital flows and the ability of residents to open deposit accounts abroad.

Policy Discussions

29. The state-owned financial institutions (SOFI) agenda is progressing, albeit unevenly:

- **Komercijalna Banka.** The authorities have launched the tender process for the privatization of the largest state-owned bank, with the intent to sell no less than a 50.1 percent stake. Letters of interest to participate in the bidding process must be submitted by late-June. Staff welcomed the launch of the tender and stressed the importance of following a competitive and transparent privatization process.

- **Banka Poštanska Štedionica (BPS).** The bank signed an MOU protocol in March to improve accountability to the MOF. Staff underscored the importance of closer monitoring of the bank's activities and performance by the MOF, and stressed the need to move quickly with the delayed implementation of the new IT system procurement. Staff also stressed the need to address pending issues, including concerning management compensation, in the government conclusion on BPS.

- **Smaller state-owned banks.** State and Deposit Insurance Agency (DIA) shares in Jubmes Bank were sold in May. Staff welcomed the transaction, noting that it was in line with the government strategy on SOBs. After recurrent delays, a working group for the transformation of Srpska Bank into a specialized financial institution was established. Staff also welcomed this development and urged the authorities to proceed expeditiously in implementing the strategy to transform the bank.

- **Governance.** To help ensure strong corporate governance in SOFIs, staff urged the authorities to adopt a government conclusion incorporating relevant international best practices and in line with guidelines issued by the NBS. This conclusion should focus on

[7] Decision RS Official Gazette, No 76/2018.

[8] Residents are allowed to perform transactions in financial derivatives freely in the regulated market and multilateral trading platform. Residents may not perform financial derivative transactions with non-residents which include dinar payments/collections.

establishing a transparent appointment process for the members of the boards of directors and a composition that enhances their independence and objectivity, as well as introducing a mechanism to avoid conflicts of interests and limit scope for political interference. The authorities noted that with the upcoming sale of Komercijalna Banka the SOFI footprint will shrink dramatically, making this less of a priority.

30. Efforts to strengthen the financial safety nets are progressing:

- **International Association of Deposit Insurers (IADI) core principles assessment.** An IADI core principle assessment was conducted in 2018, highlighting the need to clarify the role of the DIA in bank resolution procedures, and to develop business continuity and system-wide contingency plans. In addition, a review of the appropriate parameters of the deposit insurance fund (DIF) target was performed by the World Bank. The authorities committed to addressing the concerns of the IADI assessment and review and are incorporating amendments to the Law on Deposit Insurance Agency and Law on Deposit Insurance Fund (**end-June 2019 RT**).

- **Deposit Insurance Fund.** The authorities and staff agreed on the importance of a robust, adequately funded DIF. The authorities concurred that the basis for computing deposit insurance premiums and targets should be changed from eligible to insured deposits. Staff also urged the authorities to contain the—currently very high—premium levels, by extending the deadline to raise DIF funding to its target level. Staff also urged the authorities to explore backstop funding opportunities, as recommended by the IADI assessment.

- **Coordination.** Staff noted the need for better coordination across all financial safety net partners and the authorities agreed to update the 2015 MOU between the NBS and DIA to ensure the necessary information sharing on banks' risk profiles and resolution plans, and the joint development of a least cost test (**new end-December 2019 RT**).

31. The authorities reported they facilitated a solution for Swiss-franc mortgage borrowers (Box 3). The state's involvement came after a ruling by the Supreme Court of Cassation on Swiss-franc mortgage loans that could void the existing contracts. Staff noted that the solution may serve to address this longstanding issue and the consequences of the Supreme Court's ruling in a way that is acceptable to all parties. However, staff highlighted that the decision to provide budget support to facilitate the conversion of existing contracts raises moral hazard concerns and could weaken market discipline. and should not set a precedent for the resolution of conflicts within the private sector. Staff urged the authorities to consider the implications for the business environment—including legal certainty and investor confidence.

32. The recent broadening of the NPL resolution strategy's scope to focus on state institutions shows the authorities' commitment to tackle the problem comprehensively:

- **NPL resolution strategy.** In December 2018 the authorities adopted an updated NPL resolution strategy, with an expanded focus on state institutions, improvement of the bankruptcy framework, and prevention of new NPLs. Staff welcomed the updated strategy, with close attention NPL prevention.

- **DIA bad asset portfolio.** The authorities reported they expect to complete the sale of the DIA's first portfolio of bad assets by end-June. Staff urged the authorities to promptly implement the time-bound action plan to resolve the remaining portfolio of the bad assets managed by the DIA. The authorities intend to launch a tender for the second, larger portfolio in line with the action plan (**end-September 2019 RT**), expecting to close it in early 2020, while taking into accounts lessons from the first portfolio sale.

Box 3. Swiss-Franc Mortgages

A new court interpretation of Swiss-franc indexed mortgages coincided with the state promising a solution for Swiss-franc mortgage borrowers. The bulk of these mortgages were contracted before 2008 and service costs have spiked with the appreciation of the franc. In April, the Supreme Court of Cassation ruled that indexation clauses of Swiss-franc indexed mortgages were void if banks did not provide proof of a closed Swiss-franc forex position at the time the loans were contracted or did not disclose all the associated risks. All on-going enforcement cases were halted.

After prompt negotiations with banks and mortgage borrowers, the government prepared a law to convert Swiss-franc mortgage loans into Euros with a 38 percent haircut and capped interest rates. The state will compensate the banks for 15 percent of the losses on converted Swiss-franc loans. Banks will also receive a 2 percent tax credit over ten years. Therefore, the cost will be ultimately shared by banks and the State. The law became effective on May 7. Banks are obliged to submit to their client an offer to convert their Swiss-franc indexed loans within 30 days of the law's promulgation, with clients having 30 days to accept the offer made by their bank.

16 banks had Swiss-franc indexed housing loans at the end of February 2019. The stock of outstanding Swiss-franc indexed mortgages is about €540 million, affecting about 17,000 mortgage holders. While the solution will have an impact on the profitability of banks and the overall banking sector, the authorities asserted that this impact will not undermine the financial stability of the banking system and that impacted banks will continue to meet regulatory ratios, including the minimum capital adequacy ratio.

The maximum estimated cost to the state and banks are up to 0.2 and 0.25 percent of GDP, respectively. The impact for the state will be about RSD 9.75 billion, with additional costs of about RSD 2.5 billion stemming from the tax credit that the banks will get. The authorities plan to finance this operation through the issuance of a five-year government bond directly to banks that will be tradable. According to GFSM 2014, the operation should be recorded as a capital grant to financial institutions, above the line.

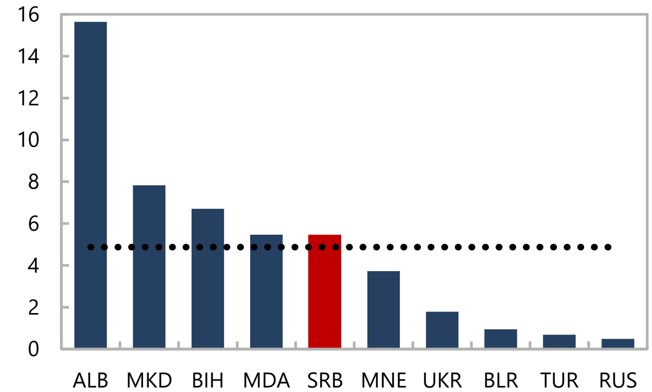
33. **The authorities and staff agreed that capital markets development and development finance are important priorities for Serbia's economic progress.** While the macro-fundamental prerequisites are in place, capital markets remain shallow and incomplete, in part because the liquid and competitive banking sector provides sufficient funding for most firms. At the same time, development finance is lacking and segments of the population (e.g., SMEs and agriculture) do not have adequate access. A working group on development finance has been established and a strategy is to be adopted by end-December 2019. In addition, a capital markets development task force, led by the MOF, has been created with the aim of preparing a capital market strategy and action plan guided by a recent World Bank diagnostic study.

D. Structural Policies

Background

34. The labor market is showing signs of improvement, but Serbia is facing headwinds related to skilled labor migration, while female labor force participation still lags. The unemployment rate has continued to decline, reaching 12.7 percent in 1Q2019— the lowest rate since 2011— while the employment rate has been rising steadily since 2014 and informal employment is declining. However, some 400,000 people (about 5.5 percent of 2016 population) have emigrated from Serbia to OECD countries between 2008 and 2016. This significant outflow of labor (including skilled labor) reduces the labor force and productivity in Serbia, negatively affecting growth and income convergence with the EU. In addition, the growth in female employment has decelerated more sharply compared to male employment over the last two years, and the gender gap in labor participation persists at around 11 percent (similar to other countries in the region).

Total Immigration into OECD countries, 2008-2016
(Percent of 2016 population, or latest value)



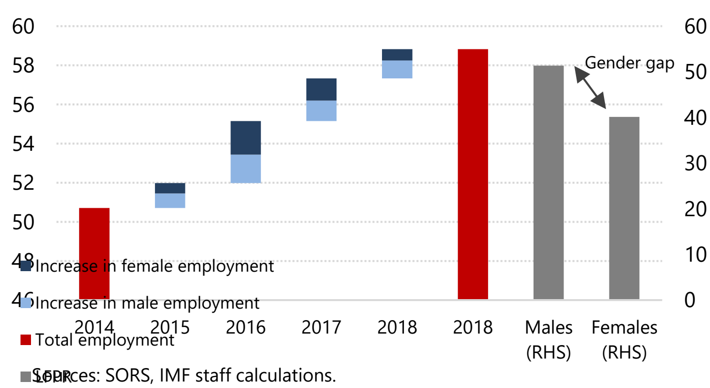
Sources: OECD, IMF staff calculations.

35. Progress is being made in addressing SOEs in the former Privatization Agency portfolio, but some strategic enterprises remain to be resolved. Since September 2017, more than 35 companies entered bankruptcy and 9 were privatized. Of the 17 strategic companies identified in the 2015-18 SBA, 9 have entered bankruptcy or prepack reorganization and 3 were privatized or found a strategic partner, leaving 5 to still be resolved.

Policy Discussions

36. Adverse impacts of skilled labor migration and lagging female labor force participation need to be mitigated. Staff noted that ensuring opportunities for skilled workers within Serbia will be critical to limit migration of skilled labor, with efforts aimed at strengthening institutions and improving the business environment. The authorities agreed with staff that education and training opportunities to prepare students and workers for the modern economy will be key, together with regulations that address business needs. They also noted that a coordinating body on migration issues, led by the Ministry of Labor, is working

Serbia: Employment and Labor Force Participation Rates
(Percent)

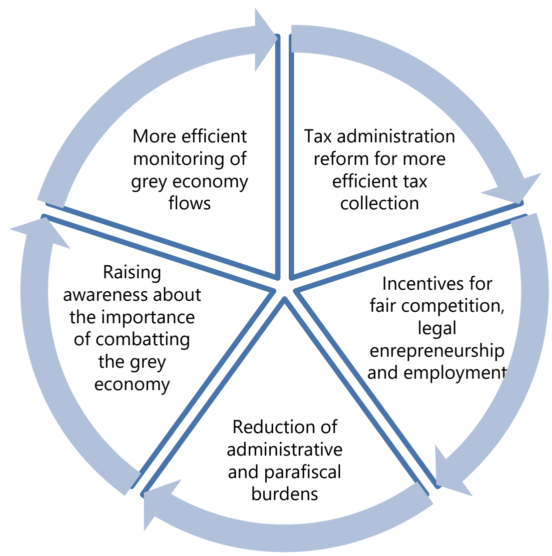


Sources: SORS, IMF staff calculations.

on a strategy and action plan to prevent 'brain drain' in Serbia. Staff saw scope for greater ownership of the National Gender Equality Strategy, with policies that encourage female entrepreneurship and address hurdles that discourage women from participating in the labor force, including lack of shared family care responsibilities.

37. Reducing the footprint of the informal economy is crucial to raising growth prospects. The authorities reaffirmed their commitment to curb the grey economy with the adoption of a new action plan, focusing on five key areas. The authorities acknowledged that despite limited progress in the past, their efforts in curbing the grey economy are beginning to pay off, including with the registration of seasonal workers in the agricultural sector and digital fiscalization.

Serbia's Action Plan for Curbing the Grey Economy – key focus areas



38. Serbia has made progress in defining its sustainable development platform. This platform accounts for the ongoing EU accession process and the related reforms critical to attaining the objectives of Agenda 2030. Progress has already been made towards several sustainable development goals (SDGs, Table 10). The authorities' next step is to establish the institutional framework to monitor achievement of SDGs.

39. Staff urged the authorities to press ahead with resolution and reform of the SOE sector, taking advantage of favorable market conditions. The authorities noted that despite delays in this area, they are still committed to the SOE reform agenda, with about 80 companies still needing to be resolved:

- **Nikola Tesla airport.** In December 2018 the authorities signed a 25-year concession to airport operator VINCI to manage Belgrade international airport. As the new concessionaire, VINCI's role will cover maintenance, expansion and upgrading of the existing airport terminal and landing strip.

- **Petrohemija.** The authorities have not yet launched a privatization tender for Petrohemija (**end-February 2019 RT**). Staff noted that there are risks surrounding the firm's long-term viability from deteriorating market conditions and expiration of favorable contracts, stressed the importance of credible engagement with potential buyers, and encouraged the issuance of the sale tender. The authorities argued that Petrohemija's strong cash position provides sufficient time to find a suitable buyer, and they expect to launch the tender by end-2019.

- **Elektroprivreda Srbije (EPS).** In March, the authorities adopted a time-bound action plan for corporate governance reforms of the power company, developed with the EBRD. They reiterated their commitment to changing the legal status of EPS to a joint stock company by end-1Q20201 and as interim steps will: (i) adopt a government decision establishing ownership rights of all property and assets by end-July; and (ii) launch a tender for the valuation of EPS property and assets (**new end-December 2019 RT**). Staff called on the authorities to raise electricity tariffs at least in line with inflation, with the view of depoliticizing annual price increases.

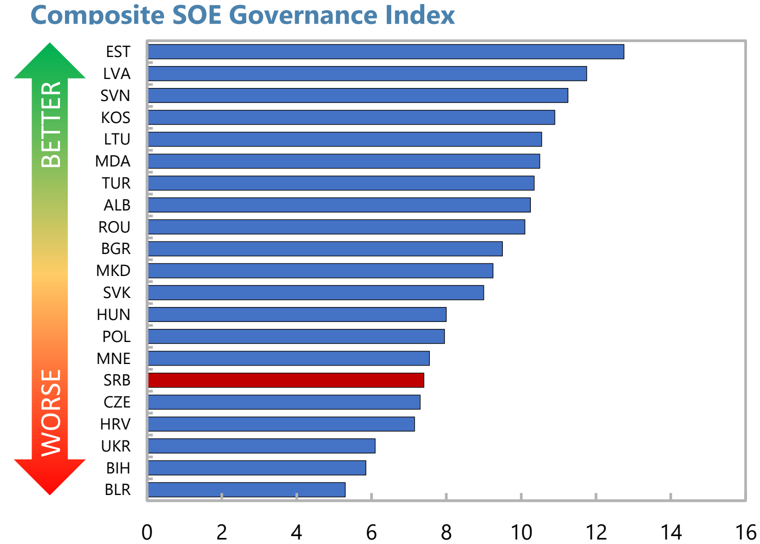
- **Srbijagas.** The authorities adopted a capital expenditure plan in line with their new investment appraisal methodology in December 2018. Given Srbijagas's improved financial position, staff called on the authorities to reduce government debt servicing support. Staff also advised the authorities to sell the tile company Toza Markovic, which Srbijagas had acquired, and to provide any financial support in a transparent manner, through the budget.

- **Resavica.** The government has not yet adopted a plan to close four unviable coal mines, noting strong concerns about the social impact in the region. Staff noted the ongoing accumulation of arrears to EPS and reminded the authorities of their obligation to cover the arrears through transparent subsidies in the budget. The authorities acknowledged the complexity of resolving Resavica and saw a need to create a working group with all partners.

- **Lasta.** The authorities indicated they intend to privatize the bus company by end-2019. The company's value has already been appraised and the first tender is expected to be issued by end-July.

40. Serbia's large SOE sector, saddled by poor performance and weak corporate governance, is constraining growth (Annex 2). Compared to the CESEE region, Serbia performs poorly in SOE governance, particularly in the areas of ownership policy and fiscal oversight.[9] The authorities pointed out that the aggregate SOE sector recorded a second consecutive year of profitability in 2018 but recognized that cross-subsidization is a concern

Composite SOE Governance Index



Source: Richmond et al. (2019).

[9] The SOE governance index covers ownership policy, financial oversight, and fiscal and policy interactions. It provides a snapshot of stated policies (self-assessed by country authorities) in place in 2018.

and that the large SOE presence may hinder competition in some sectors. The authorities agreed it was important to focus on improving governance of key public enterprises with a public-interest component. As a first step, the authorities agreed to publish a comprehensive list of SOEs with at least a 10 percent government stake and engaged in commercial activities, covering all levels of government (**new end-October 2019 RT**) and saw merit in adopting an ownership policy document covering ownership objectives, financial and public policy targets, reporting guidelines, and guidelines for boards of directors (**new end-February 2020 RT**). Staff also recommended that the authorities adopt a formal dividend policy and set monitorable key performance indicators (KPIs).

41. **Serbia's anti-corruption measures need to be strengthened.** The authorities reported that a new law on prevention of corruption was adopted in May 2019. However, further efforts are needed to strengthen the asset disclosure regime for high-level public officials, to enhance the capacity of anticorruption institutions, and to ensure credible prosecutions of false asset disclosures and of other corruption offenses. Staff encouraged the authorities to address the outstanding recommendations from the Group of States against corruption (GRECO) fourth evaluation round and concerns about undue influence over the judiciary. Building on the recent amendments to strengthen the AML/CFT framework, the authorities should improve the effectiveness of the AML measures that support anticorruption efforts, including verification of the accuracy of beneficial ownership information submitted to the Business Registry Agency. The authorities informed that the on-going e-government initiative should help reduce corruption by increasing transparency and limiting face-to-face contact with public administration.

PROGRAM MODALITIES

42. **The program will continue to be monitored on a semi-annual basis.** Serbia does not need the Fund's financial assistance under the baseline and is not seeking financial assistance from the Fund as the program is fully financed. Reviews are set out in Table 11. QTs for the key set of macroeconomic variables monitored under the PCI are set out in PS Table 1. RTs are reflected in PS Table 2; they aim to support the authorities' structural reform agenda in the areas of public financial management, tax administration, the financial sector, and the business environment.

43. **Program conditionality is to be updated (PS Tables 1-2):**

- Fiscal QTs on the general government deficit and primary expenditure for end-September 2019 are proposed to be modified and QTs for end-March 2020 are set. The ceiling on the accumulation of domestic payment arrears is modified to accommodate very small, temporary deviations. The inflation consultation band has been re-centered to reflect changes in inflation projections.

- Additional adjustors for the general government deficit and the current primary spending are set on one-off expenditures associated with the resolution of Swiss-franc mortgage litigation by the Republican budget.

- The following new RTs are being proposed: (i) publishing a comprehensive list of SOEs as of December 31, 2018 with at least 10 percent government ownership stake (covering all levels of government including consolidated ownership and including information on main economic activity); (ii) reaching a decision on a preferred approach to the STA IT system upgrade; (iii) launching a tender for the valuation of EPS property and assets; (iv) signing an updated MOU between the DIA and NBS to reflect new resolution tools given to the NBS and the need for information sharing; and (v) government adoption of an ownership policy document covering ownership objectives (including criteria for divestment), financial and public policy targets, reporting and monitoring guidelines, and procedural guidelines for boards of directors.

44. Serbia has small sovereign arrears outstanding. The authorities have been in contact with their Libyan counterparts to resolve its arrears to Libya, which arose in 1981 due to unsettled government obligations related to a loan for importing crude oil. Staff urged the authorities to continue their efforts to resolve these arrears as soon as possible.

STAFF APPRAISAL

45. Macroeconomic stability has continued to take hold in Serbia since the 2017 Article IV Consultation. Growth has recovered, inflation is in the target range, fiscal discipline is enabling a rapid decline in public debt, and the current account deficit is fully covered by FDI. This has supported rising investment and employment, while the financial sector remains sound and interest rates are near record lows.

46. Fiscal achievements need to remain anchored to preserve hard-won gains. With a growing sense of the need to give back to the population after years of austerity, pressure to increase spending is growing. Improving the quality and composition of spending will be important for budget discipline as well as to support growth. This can be facilitated by reintroducing pension indexation, improving workforce planning and control, and implementing the overdue reform of the wage system. Although the recent increases in investment spending will help close Serbia's large infrastructure gaps, they highlight the need for rigorous selection and appraisal procedures to ensure that the investments offer the greatest boost to potential growth. Introducing a fiscal rule anchored on debt will be key to cement fiscal policy credibility.

47. The NBS's accommodative monetary policy stance has been appropriate, but there is a need for greater exchange rate flexibility. Monetary policy has supported domestic demand and bank credit growth in recent years, while succeeding in keeping inflation well under control. However, with macroeconomic stability firmly entrenched, a move towards greater exchange rate flexibility over the medium-term would help develop the exchange rate market and promote dinarization. Serbia's external position is broadly consistent with fundamentals and desirable policy settings, but is subject to vulnerabilities related to the large negative net international position.

48. **The financial sector is sound, but more can be done to increase its resilience and to ensure it plays a supportive role for future growth.** Systemwide NPLs are now below pre-crisis levels, but ongoing efforts are needed to reduce NPLs in SOBs. The adoption of an updated NPL resolution strategy with a focus on state-owned institutions is important in this regard as are the efforts to prevent new accumulation of NPLs. A key test for the SOFI reform agenda will be the forthcoming privatization of Komercijalna Banka, which should be conducted in a competitive and transparent manner. The state's decision to facilitate a solution between banks and Swiss-franc mortgage borrowers raises moral hazard concerns and should not set a precedent for the resolution of conflicts within the private sector. Improving capital markets and access to development finance will be important to support the private sector's expansion and dynamism.

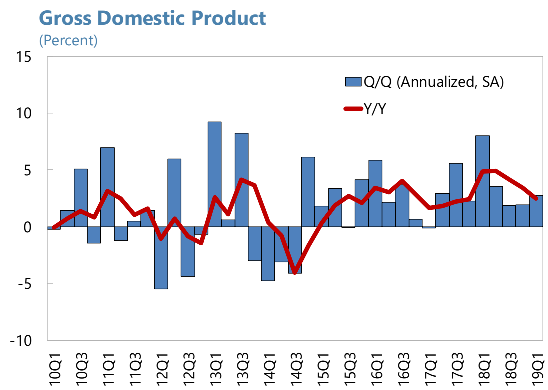
49. **Stronger commitment to implement planned structural reforms is needed to boost potential growth.** Efforts to improve the business climate should focus on the main drivers of growth over the medium term: labor skills, the quality of government services and regulations, infrastructure, and the rule of law. Resolution of problem SOEs is progressing slowly. In addition, key steps to improve the performance of the largest public enterprises must be taken without delay. The reform of the tax administration is advancing, with the critical milestone of splitting core and non-core activities to support the streamlining and modernization of tax administration imminent.

50. **Strong governance is critical and can raise efficiency and economic growth.** Substantial progress has been achieved on AML/CFT deficiencies and the authorities have agreed to improve the corporate governance of SOEs, with an initial focus in the areas of ownership policy and fiscal oversight. At the same time, other anti-corruption efforts and provision of legal certainty need to be strengthened.

51. **In light of the progress so far and the authorities' policy commitments going forward, staff supports the completion of the second review under the Policy Coordination Instrument.** It is recommended that the next Article IV consultation with Serbia be held on the 24-month cycle, in accordance with Decision No. 14747-(1096) on consultation cycles.

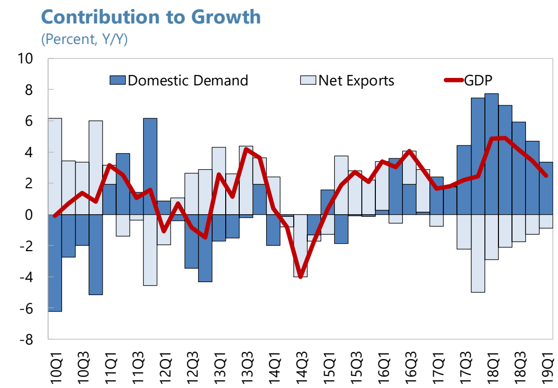
Figure 1. Serbia: Real Sector Developments, 2010–19

Growth decelerated in the second half of 2018…



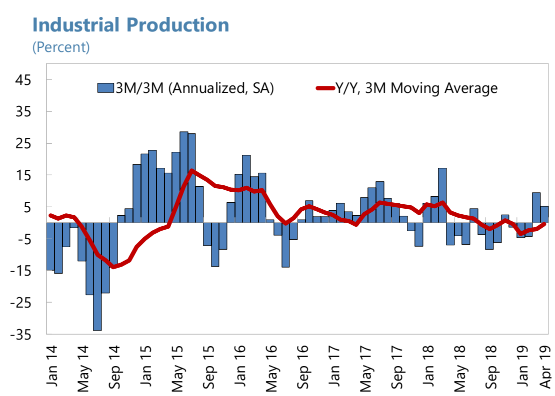
Sources: Haver Analytics; SORS; and IMF staff calculations.

…as domestic demand slowed.



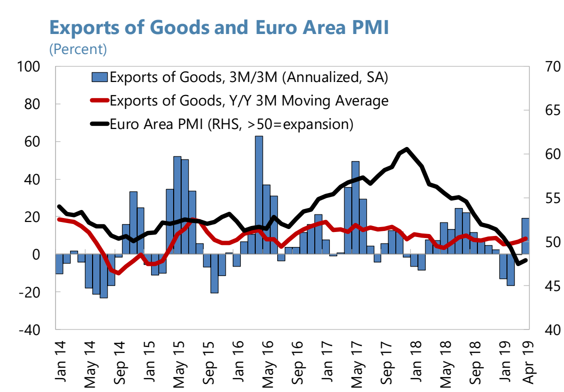
Sources: Haver Analytics; SORS; and IMF staff calculations.

Industrial production growth declined….



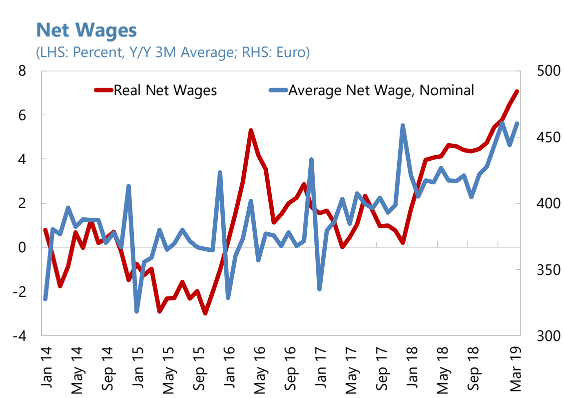
Sources: Haver Analytics; SORS; and IMF staff calculations.

….as export growth slowed along with activity in Europe.



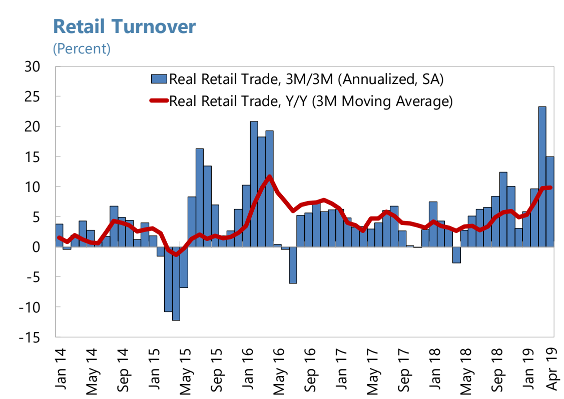
Sources: Haver Analytics; SORS; and IMF staff calculations.

Growth in real net wages accelerated in 2018…



Sources: Haver Analytics; SORS; and IMF staff calculations.

…supporting real retail trade.



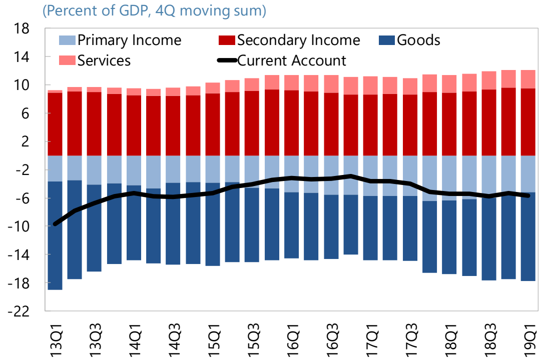
Sources: Haver Analytics; SORS; and IMF staff calculations.

Figure 2. Serbia: Balance of Payments and NIR, 2012–19 1/

The current account has improved slightly in 2018 Q4…

Current Account Balance

(Percent of GDP, 4Q moving sum)

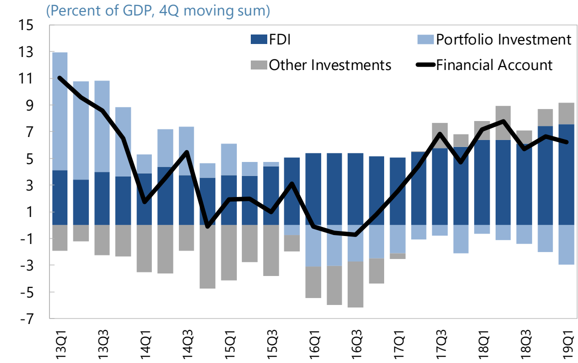


Sources: Haver Analytics; and IMF Staff calculations.

…and remains fully covered by FDI flows.

Financial Account Composition

(Percent of GDP, 4Q moving sum)

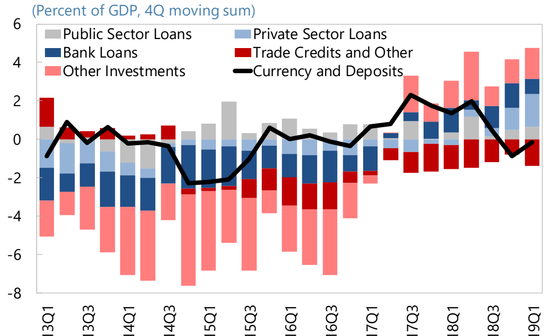


Sources: Haver Analytics; and IMF Staff calculations.

Outflows in other investments continue to be driven by trade credits.

Other Investments 1/

(Percent of GDP, 4Q moving sum)



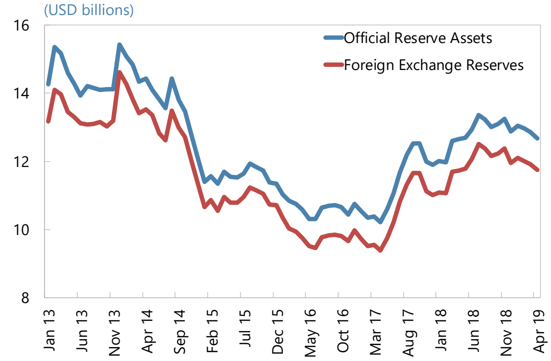
Sources: Haver Analytics; and IMF Staff calculations.

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

International reserves remain at comfortable levels.

Reserves

(USD billions)



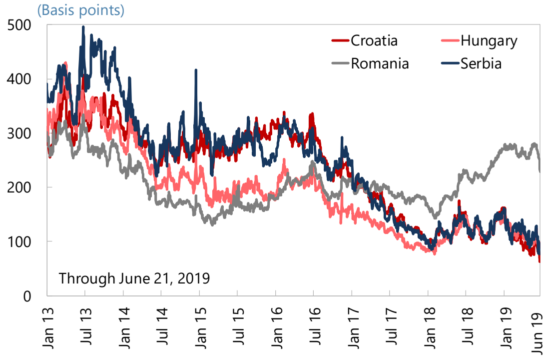
Sources: Haver Analytics; and IMF Staff calculations.

Figure 3. Serbia: Recent Financial and Exchange Rate Developments, 2013–19

EMBI spreads remain at low levels…

Sovereign Risk - EMBI Spreads

(Basis points)

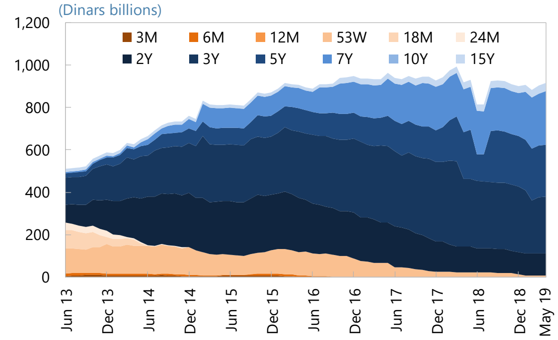


Source: Bloomberg.

…while efforts to lengthen the maturity of domestic securities continue.

T-Bill & T-Bond Stock 1/

(Dinars billions)



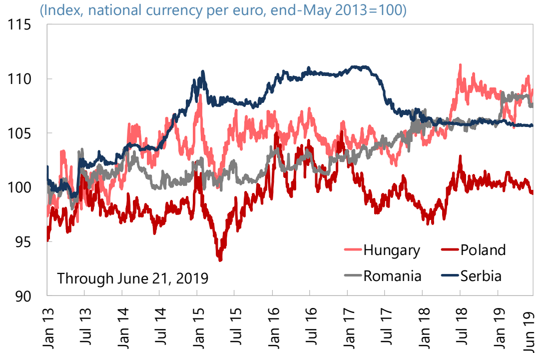
Source: National Bank of Serbia.

1/ Sum of dinar and FX-denominated securities at current exchange rate.

The exchange rate against the euro has remained broadly stable since early 2018…

Exchange Rates in the Region

(Index, national currency per euro, end-May 2013=100)

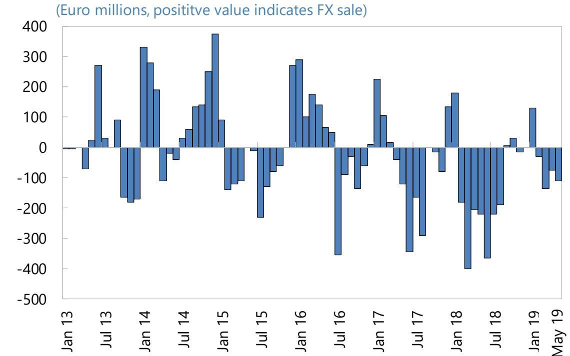


Sources: Bloomberg.

….while the NBS foreign exchange interventions have abated since mid-2018.

FX Interventions by NBS

(Euro millions, posititve value indicates FX sale)

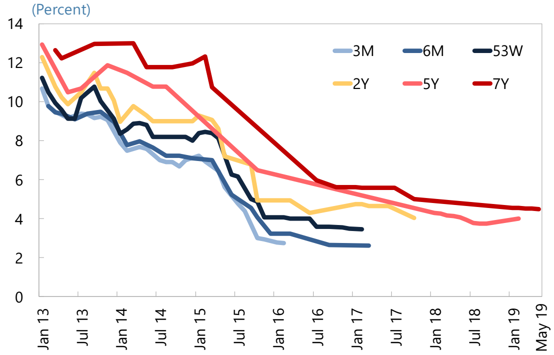


Sources: National Bank of Serbia.

Yields for dinar-denominated securities remain low…

Yields on Dinar-Denominated Domestic Securities

(Percent)

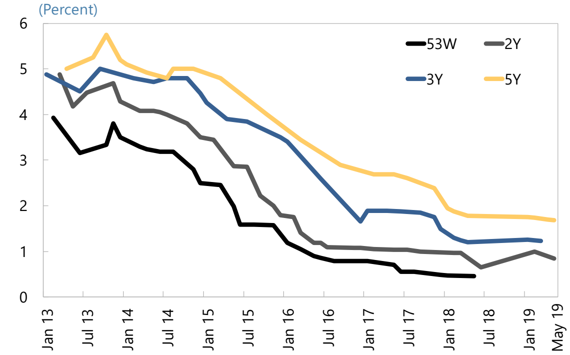


Sources: National Bank of Serbia.

…as are the yields for euro-denominated securities.

Yields on Euro-Denominated Domestic Securities

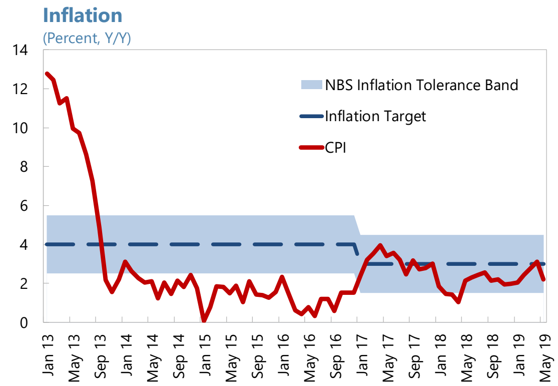
(Percent)



Sources: National Bank of Serbia.

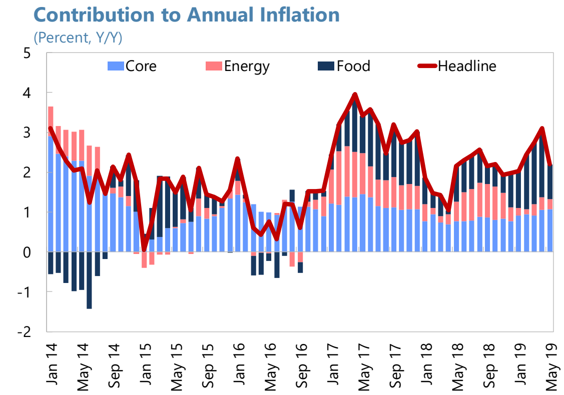
Figure 4. Serbia: Inflation and Monetary Policy, 2013–19

Headline inflation has reached the midpoint of the NBS tolerance band…



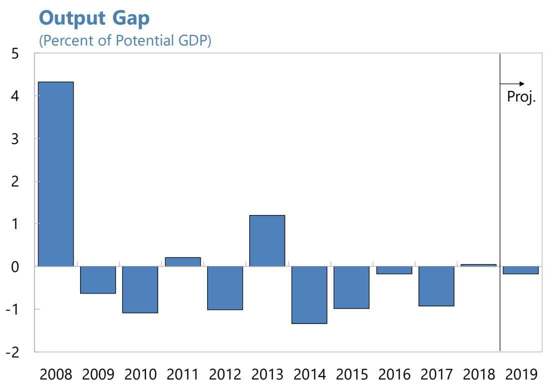
Source: National Bank of Serbia; and IMF staff calculations.

…supported by food prices.



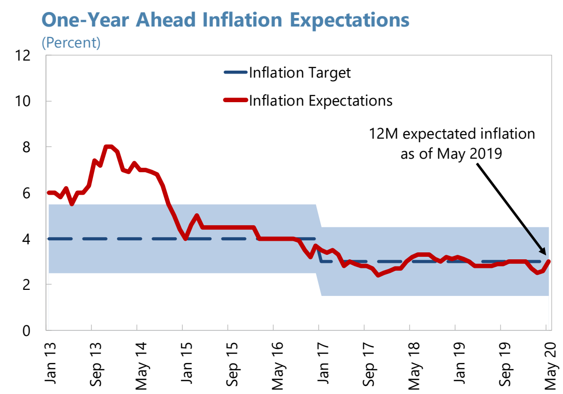
Source: SORS.

The output gap for 2018 was close to zero, similar to projections for 2019…



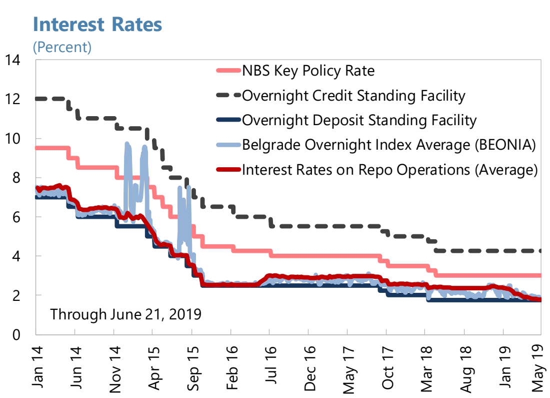
Sources: National Bank of Serbia; and IMF staff projections.

…and inflation expectations remain contained.



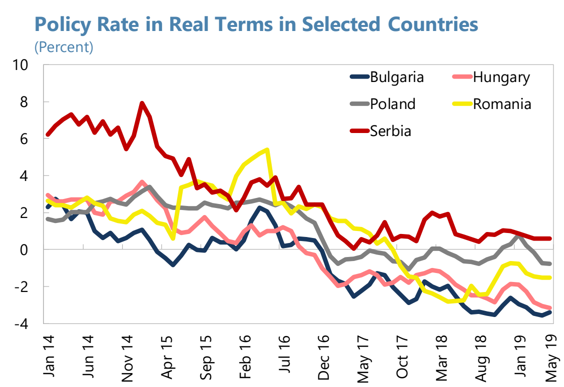
Sources: Bloomberg; SORS; and IMF staff projections.

The key policy rate has remained unchanged since April 2018…



Sources: National Bank of Serbia; and Haver Analytics.

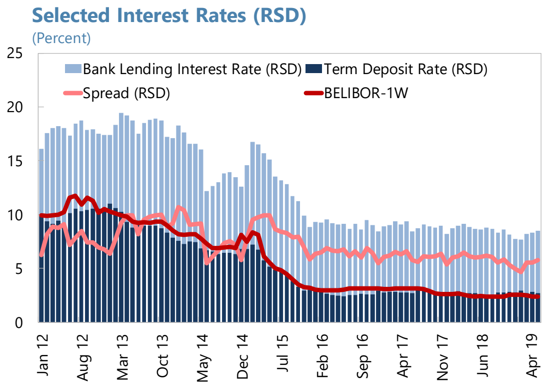
…and remains above peer countries in real terms.



Source: Haver Analytics.
Nominal policy rates adjusted by inflation over the past 12 months.

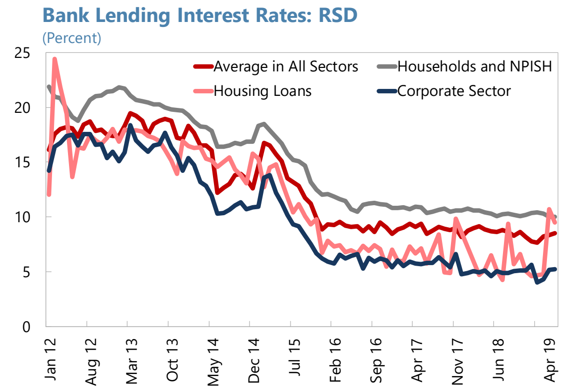
Figure 5. Serbia: Selected Interest Rates, 2012–19

Monetary policy easing resulted in a decline in dinar interest rates…



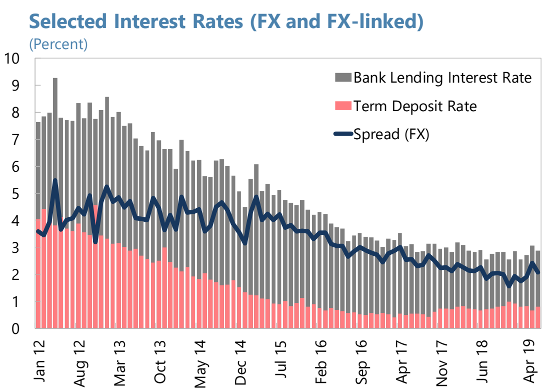
Source: National Bank of Serbia.

…for corporates and housing loans.



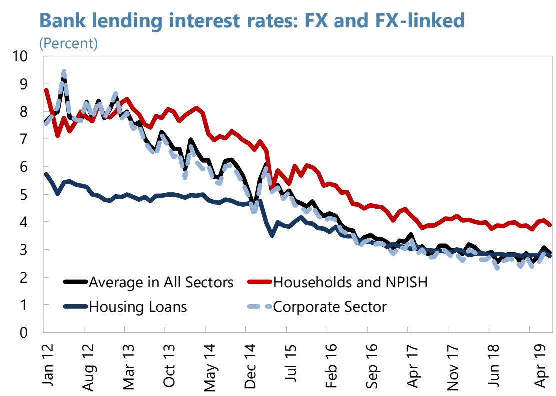
Source: National Bank of Serbia.

FX (and FX-linked) interest rates remain low…



Source: National Bank of Serbia.

…because of lower lending rates to corporates.

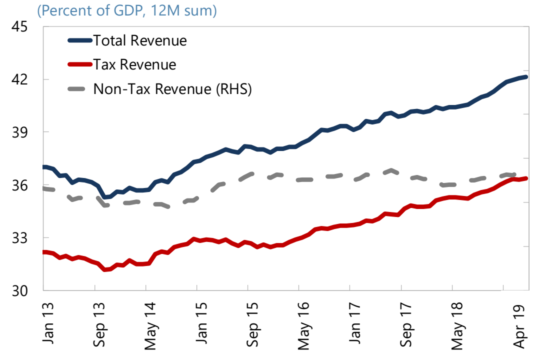


Source: National Bank of Serbia.

Figure 6. Serbia: Fiscal Developments, 2012–19

Tax revenues have stabilized as a share of GDP.

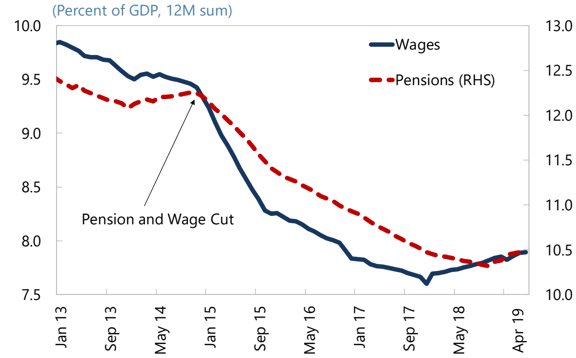
Total Revenue Composition
(Percent of GDP, 12M sum)



Sources: Ministry of Finance; and IMF staff calculations.

Pension and wage spending are in line with projections.

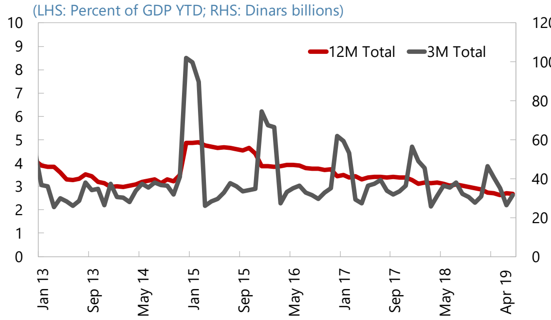
Wages and Pensions
(Percent of GDP, 12M sum)



Sources: Ministry of Finance; and IMF staff calculations.

State aid continues to decline...

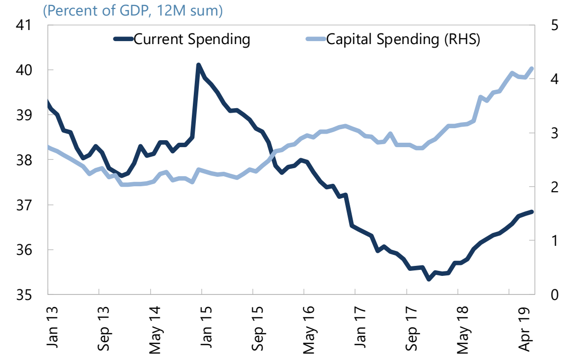
State Aid 1/
(LHS: Percent of GDP YTD; RHS: Dinars billions)



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

...creating space for capital spending to expand.

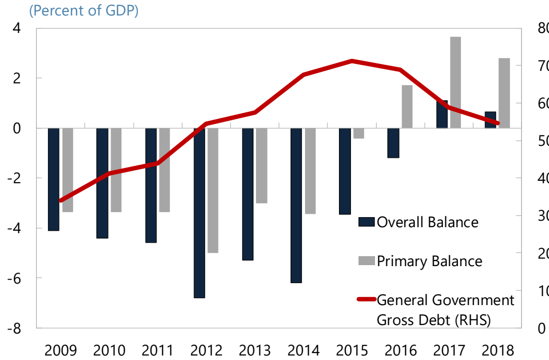
Current and Capital Spending
(Percent of GDP, 12M sum)



Sources: Ministry of Finance; and IMF staff calculations.

Government debt continues to decline together with improvements in fiscal balance...

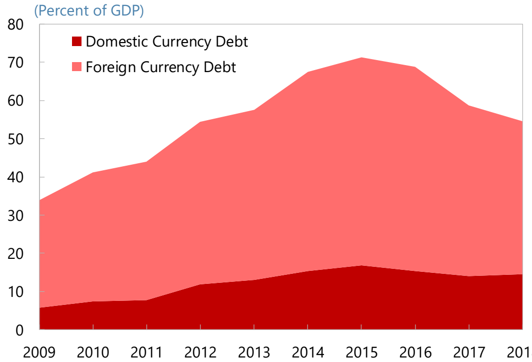
Fiscal Balance and Debt
(Percent of GDP)



Sources: Ministry of Finance; and IMF staff calculations.

...but majority of total debt is denominated in foreign currency.

Public Debt
(Percent of GDP)



Sources: Ministry of Finance; and IMF staff calculations.

Figure 7. Serbia: Labor Market Developments, 2008-19

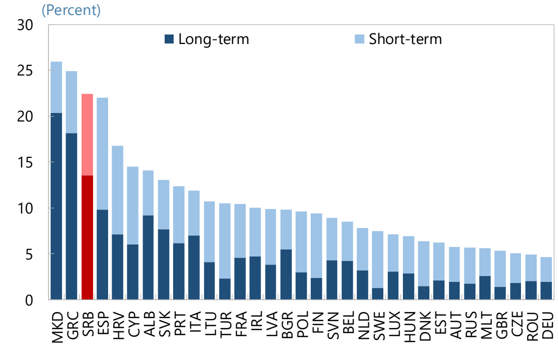
Unemployment continues to decline....

Unemployment Rate
(Percent, 15+ years old)

Sources: Haver Analytics.

...but long-term unemployment persists.

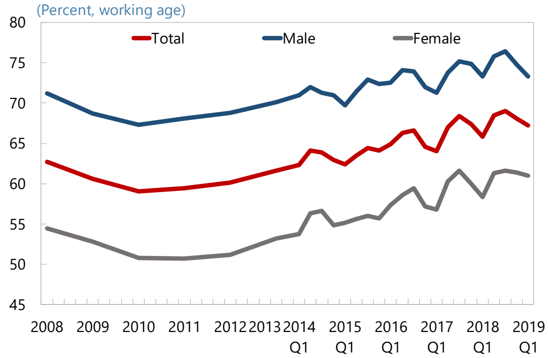
Unemployment Rate, 2017
(Percent)



Sources: International Labour Organization; OECD database; Republic of Serbia National Employment Service; and IMF staff calculations.

Labor market participation continues to rise, though female participation rate is persistently lower.

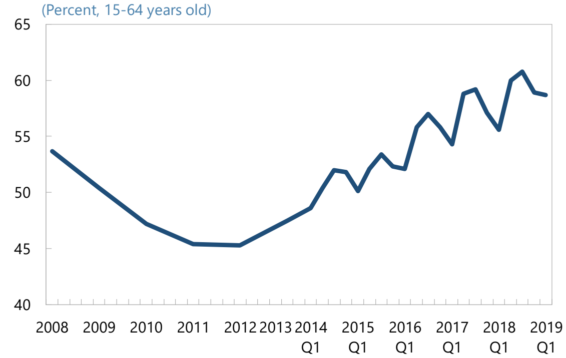
Labor Participation Rate
(Percent, working age)



Sources: SORS.

Employment continues its increasing trend.

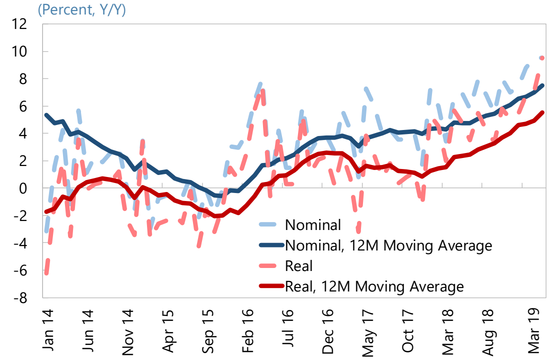
Employment Rate
(Percent, 15-64 years old)



Sources: SORS.

Net wage continues to grow...

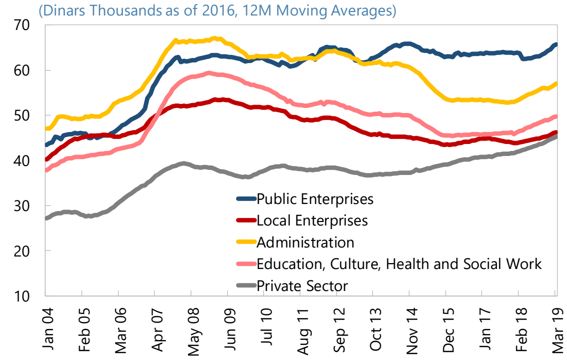
Net Wage Growth
(Percent, Y/Y)



Sources: SORS.

...and public sector wages remain above private sector wages.

Average Monthly Net Real Wages
(Dinars Thousands as of 2016, 12M Moving Averages)



Sources: SORS; and IMF staff calculations.

Table 1. Serbia: Selected Economic and Social Indicators, 2016–20

	2016	2017	2018		2019		2020
			CR 18/375	Est.	CR 18/375	Proj.	Proj.
			(Percent change, unless otherwise indicated)				
Real sector 1/							
Real GDP	3.3	2.0	**4.2**	4.3	**3.5**	3.5	4.0
Real domestic demand (absorption)	1.4	3.9	**4.8**	5.8	**3.6**	4.4	3.8
Consumer prices (average)	1.1	3.1	**2.1**	2.0	**2.4**	2.2	1.9
GDP deflator	1.5	3.0	**2.4**	2.0	**3.3**	3.3	3.5
Unemployment rate (in percent) 2/	15.9	14.1	**...**	13.3	**...**	...	...
Nominal GDP (in billions of dinars)	4,521	4,754	**5,074**	5,060	**5,424**	5,408	5,819
			(Percent of GDP)				
General government finances							
Revenue 3/	40.8	41.5	**41.1**	41.6	**39.9**	40.8	40.1
Expenditure 3/	41.9	40.4	**40.6**	41.0	**40.4**	41.3	40.7
Current 3/	37.9	36.7	**36.4**	36.5	**36.0**	36.7	36.1
Capital and net lending	3.2	3.1	**3.8**	4.1	**4.1**	4.3	4.4
Amortization of called guarantees	0.9	0.6	**0.4**	0.4	**0.2**	0.2	0.2
Fiscal balance 4/	-1.2	1.1	**0.5**	0.6	**-0.5**	-0.5	-0.5
Primary fiscal balance (cash basis)	1.7	3.6	**2.6**	2.8	**1.4**	1.6	1.4
Structural primary fiscal balance 5/	1.7	3.5	**2.7**	2.9	**1.8**	1.9	1.8
Gross debt	68.9	58.7	**54.0**	54.5	**51.9**	52.3	49.3
			(End of period 12-month change, percent)				
Monetary sector							
Money (M1)	20.3	9.7	**8.1**	20.1	**9.4**	10.7	9.8
Broad money (M2)	9.8	3.3	**6.9**	15.0	**6.6**	8.8	7.5
Domestic credit to non-government 6/	1.8	4.4	**7.1**	10.1	**5.9**	7.1	5.6
			(Period average, percent)				
Interest rates (dinar)							
NBS key policy rate	3.5	3.9	...	3.1	...	...	...
Interest rate on new FX and FX-indexed loans	3.1	3.1	...	2.8	...	...	...
			(Percent of GDP, unless otherwise indicated)				
Balance of payments							
Current account balance	-2.9	-5.2	**-5.3**	-5.2	**-5.1**	-5.6	-5.1
Exports of goods	34.9	35.9	**37.1**	35.6	**38.4**	36.0	36.8
Imports of goods	-43.4	-46.1	**-48.6**	-47.9	**-49.4**	-48.8	-49.2
Trade of goods balance	-8.5	-10.2	**-11.5**	-12.3	**-11.1**	-12.8	-12.4
Capital and financial account balance	0.6	4.8	**5.7**	6.5	**5.7**	6.6	6.7
External debt (percent of GDP)	75.7	67.2	**61.3**	61.7	**57.4**	58.3	55.1
of which: Private external debt	29.4	29.8	**28.1**	29.2	**26.3**	27.6	25.9
Gross official reserves (in billions of euro)	10.2	10.0	**10.6**	11.3	**10.8**	11.8	12.5
(in months of prospective imports)	5.5	4.7	**4.5**	4.9	**4.3**	4.7	4.6
(percent of short-term debt)	412.5	262.4	**250.8**	208.9	**208.4**	167.7	178.8
(percent of broad money, M2)	58.7	53.2	**52.7**	52.2	**50.7**	51.1	50.7
(percent of risk-weighted metric)	171.5	162.1	**165.4**	163.6	**161.1**	160.4	162.4
Exchange rate (dinar/euro, period average)	123.1	121.4	...	118.3	...	...	...
REER (annual average change, in percent; + indicates appreciation)	-1.1	2.9	...	2.8	...	...	...
Social indicators							
Per capita GDP (in US$)	5,756	6,284	**7,266**	7,223	**7,688**	7,503	8,174
Real GDP per capita (percent change)	3.9	2.6	**...**	4.7	**...**	3.9	4.4
Population (in million)	7.1	7.0	**7.0**	7.0	**7.0**	7.0	6.9

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

1/ SORS released revised national accounts in November 2018.
2/ Unemployment rate for working age population (15-64).
3/ Includes employer contributions.
4/ Includes amortization of called guarantees.
5/ Primary fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending as well as one-offs.
6/ At constant exchange rates.

Table 2. Serbia: Medium-Term Framework, 2016–24

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
						(percent change)						
Real sector												
GDP growth 1/	3.3	2.0	4.2	4.3	3.5	3.5	4.0	4.0	4.0	4.0	4.0	4.0
Domestic demand (contribution)	1.5	4.1	5.1	6.3	3.8	4.8	4.2	4.2	3.9	4.0	3.8	3.8
Net exports (contribution)	1.9	-2.1	-0.9	-2.0	-0.3	-1.3	-0.2	-0.2	0.1	0.0	0.2	0.2
Consumer price inflation (average)	1.1	3.1	2.1	2.0	2.4	2.2	3.0	1.9	2.5	2.8	3.0	3.0
Consumer price inflation (end of period)	1.5	3.0	2.6	2.0	2.4	2.0	3.0	2.2	2.5	2.8	3.0	3.0
Output gap (in percent of potential)	-0.2	-0.9	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Potential GDP growth	2.5	2.8	3.3	3.3	3.5	3.7	4.0	3.8	4.0	4.0	4.0	4.0
Domestic credit to non-gov. (constant exchange rate) 2/	1.8	4.4	7.1	10.1	5.9	7.1	5.7	5.6	5.0	2.8	2.5	1.6
						(percent of GDP, unless otherwise indicated)						
General government												
Revenue 3/	40.8	41.5	41.1	41.6	39.9	40.8	39.7	40.1	39.8	39.6	39.4	39.3
Expenditure 3/	41.9	40.4	40.6	41.0	40.4	41.3	40.2	40.7	40.4	40.2	40.0	39.8
Current 3/	37.9	36.7	36.4	36.5	36.0	36.7	35.9	36.1	35.9	35.7	35.7	35.6
of which: Wages and salaries 3/	9.2	9.0	9.2	9.3	9.2	9.4	9.2	9.3	9.3	9.3	9.3	9.2
of which: Pensions	11.1	10.7	10.5	10.4	10.4	10.4	10.3	10.3	10.3	10.3	10.3	10.3
of which: Goods and services	7.5	7.7	8.1	8.1	8.0	8.3	8.0	8.2	8.1	8.0	8.0	7.9
Capital and net lending	3.2	3.1	3.8	4.1	4.1	4.3	4.1	4.4	4.3	4.2	4.1	4.1
Amortization of called guarantees	0.9	0.6	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Fiscal balance 4/	-1.2	1.1	0.5	0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
change (+ = consolidation)	*2.3*	*2.3*	*-0.6*	*-0.5*	*-1.0*	*-1.1*	*0.1*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*
Primary fiscal balance	1.7	3.6	2.6	2.8	1.4	1.6	1.6	1.4	1.4	1.4	1.4	1.5
change (+ = consolidation)	*2.1*	*1.9*	*-1.0*	*-0.9*	*-1.2*	*-1.2*	*0.1*	*-0.2*	*0.0*	*0.0*	*0.0*	*0.1*
One-off fiscal items, net 5/	0.1	0.5	-0.1	-0.1	-0.4	-0.3	-0.1	-0.4	-0.4	-0.4	-0.3	-0.3
Structural primary balance	1.7	3.5	2.7	2.9	1.8	1.9	1.6	1.8	1.8	1.7	1.7	1.7
change (+ = consolidation)	*1.7*	*1.8*	*-0.8*	*-0.6*	*-0.9*	*-1.0*	*-0.1*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*
Structural primary balance net of capital expenditures	4.8	6.3	6.3	6.8	5.8	6.1	5.6	6.1	5.9	5.8	5.7	5.7
Gross debt	68.9	58.7	54.0	54.5	51.9	52.3	48.9	49.3	46.4	44.0	41.6	39.2
Effective interest rate on government borrowing (percent)	4.3	4.1	3.8	3.9	3.9	4.0	4.2	3.9	4.1	4.4	4.7	5.2
Domestic borrowing (including FX)	5.2	4.8	4.9	5.1	4.7	4.9	4.8	5.0	5.0	5.0	5.0	5.0
External borrowing	3.3	3.2	3.1	3.1	3.3	3.4	3.4	3.5	3.5	3.5	3.5	3.5
						(percent of GDP, unless otherwise indicated)						
Balance of payments												
Current account	-2.9	-5.2	-5.3	-5.2	-5.1	-5.6	-4.8	-5.1	-5.1	-4.7	-4.3	-4.2
of which: Trade balance	-8.5	-10.2	-11.5	-12.3	-11.1	-12.8	-10.7	-12.4	-11.9	-11.5	-11.2	-10.9
of which: Current transfers, net (excl. grants)	8.4	8.6	9.2	9.1	8.6	8.7	8.2	8.7	8.1	8.0	8.0	7.7
Capital and financial account	0.6	4.8	5.7	6.5	5.7	6.6	5.2	6.7	5.8	4.8	4.5	4.4
of which: Foreign direct investment	5.2	6.2	6.2	7.5	5.7	6.1	5.4	5.9	5.4	5.4	5.4	5.4
External debt (end of period)	75.7	67.2	61.3	61.7	57.4	58.3	53.2	55.1	51.8	47.7	43.7	39.8
of which: Private external debt	29.4	29.8	28.1	29.2	26.3	27.6	24.5	25.9	24.5	22.9	21.3	19.6
Gross official reserves												
(in billions of euros)	10.2	10.0	10.6	11.3	10.8	11.8	11.0	12.5	12.9	12.9	13.1	13.2
(in percent of short-term external debt)	412.5	262.4	250.8	208.9	208.4	167.7	212.2	178.8	184.4	184.8	186.9	188.8
REER (ann. av. change; + = appreciation)	-1.1	2.9	…	2.8	…	…	…	…	…	…	…	…

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

1/ SORS released revised national accounts in November 2018.

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

3/ Includes employer contributions.

4/ Includes amortization of called guarantees.

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

Table 3. Serbia: Growth Composition, 2016–24 1/

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent change, unless otherwise noted)											
Real												
Gross Domestic Product (GDP)	3.3	2.0	4.2	4.3	3.5	3.5	4.0	4.0	4.0	4.0	4.0	4.0
Domestic demand	1.4	3.9	4.8	5.8	3.6	4.4	3.9	3.8	3.6	3.6	3.5	3.5
Consumption	1.3	2.2	3.4	3.3	2.8	3.8	3.4	3.3	3.3	3.3	3.2	3.1
Non-government	1.3	1.9	3.1	3.3	3.0	3.9	3.8	4.0	3.8	3.7	3.7	3.6
Government	1.3	3.3	4.6	3.6	2.1	3.4	1.5	0.5	1.3	1.3	0.9	0.9
Investment	2.0	11.5	11.0	16.4	6.6	6.5	5.9	5.7	4.4	4.9	4.6	4.9
Gross fixed capital formation	5.4	7.3	12.4	9.2	7.5	7.4	6.2	6.5	5.0	5.4	5.1	5.5
Non-government	2.5	10.4	9.0	2.5	6.0	5.5	6.5	7.0	6.0	6.0	6.0	6.0
Government	20.8	-6.2	34.0	44.4	15.3	14.5	4.9	4.7	1.3	3.2	1.7	3.5
Exports of goods and services	11.9	8.2	10.5	8.9	9.0	7.2	8.7	8.4	8.7	8.8	8.9	8.9
Imports of goods and services	6.7	11.1	10.8	11.1	8.4	8.1	8.0	7.5	7.3	7.6	7.6	7.7
	(contributions to GDP, percent)											
Gross Domestic Product (GDP)	3.3	2.0	4.2	4.3	3.5	3.5	4.0	4.0	4.0	4.0	4.0	4.0
Domestic demand (absorption)	1.5	4.1	5.1	6.3	3.8	4.8	4.2	4.2	3.9	4.0	3.8	3.8
Net exports of goods and services	1.9	-2.1	-0.9	-2.0	-0.3	-1.3	-0.2	-0.2	0.1	0.0	0.2	0.2
Consumption	1.1	1.9	2.9	2.9	2.4	3.3	2.9	2.8	2.8	2.8	2.7	2.6
Non-government	0.9	1.3	2.2	2.2	2.1	2.7	2.7	2.7	2.6	2.6	2.5	2.5
Government	0.2	0.6	0.8	0.6	0.3	0.6	0.2	0.1	0.2	0.2	0.2	0.1
Investment	0.4	2.2	2.2	3.4	1.4	1.5	1.3	1.4	1.1	1.2	1.1	1.2
Gross fixed capital formation	1.0	1.3	2.2	1.8	1.5	1.5	1.3	1.4	1.1	1.2	1.1	1.2
Non-government	0.4	1.6	1.4	0.4	1.0	0.9	1.1	1.1	1.0	1.0	1.0	1.1
Government	0.6	-0.2	0.8	1.4	0.5	0.6	0.2	0.2	0.1	0.1	0.1	0.2
Change in inventories	-0.6	0.8	0.0	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	5.4	4.0	5.4	4.6	4.9	3.9	5.0	4.7	5.1	5.4	5.7	6.0
Imports of goods and services	3.5	6.1	6.4	6.6	5.3	5.1	5.2	4.9	5.0	5.4	5.5	5.8
	(Percent change, unless otherwise noted)											
Nominal												
Gross Domestic Product (GDP)	4.9	5.2	6.7	6.4	6.9	6.9	7.5	7.6	7.4	7.4	7.4	7.4
Domestic demand (absorption), contribution to GDP growth	2.9	7.3	9.6	10.2	6.9	7.7	7.5	7.7	7.3	7.5	7.5	7.5
Net exports of goods and services, contribution to GDP growth	1.9	-2.1	-2.9	-3.7	0.0	-0.8	0.0	-0.1	0.1	-0.2	-0.1	-0.1
Non-government	3.3	5.0	5.3	5.3	5.2	5.8	6.8	5.9	6.3	6.6	6.7	6.6
Government	2.0	6.5	11.2	11.2	7.3	7.9	6.5	6.5	6.8	6.7	6.5	6.5
Investment	1.1	15.0	20.7	23.6	9.5	10.0	7.7	11.0	7.8	8.0	7.9	8.3
Gross fixed capital formation	6.0	10.1	15.7	10.4	10.3	9.4	7.7	11.5	8.0	8.1	8.0	8.3
Non-government	3.0	13.2	11.6	3.2	8.5	8.0	8.0	12.0	9.1	8.7	8.9	8.9
Government	21.7	-3.9	37.2	48.9	18.0	14.5	6.4	9.6	4.2	5.8	4.5	6.3
Exports of goods and services	12.6	9.3	7.0	4.5	10.9	8.6	10.7	10.3	10.5	10.6	10.8	10.8
Imports of goods and services	7.2	12.5	11.2	10.6	9.3	8.6	9.2	8.8	8.7	9.4	9.6	9.7
Memorandum items:												
GDP deflator (percent)	1.5	3.0	2.4	2.0	3.3	3.3	3.4	3.5	3.3	3.2	3.3	3.3
Nominal GDP (billions of dinars)	4521	4754	5074	5060	5424	5408	5832	5819	6252	6713	7210	7743

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

1/ SORS released revised national accounts in November 2018.

Table 4a. Serbia: Balance of Payments, 2016–24 1/

(In billions of euros)

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
						(Billions of euros)						
Current account balance	-1.1	-2.1	**-2.3**	-2.2	**-2.4**	-2.5	**-2.4**	-2.5	-2.7	-2.7	-2.6	-2.7
Trade of goods balance	-3.1	-4.0	**-4.9**	-5.2	**-5.1**	-5.8	**-5.2**	-6.1	-6.2	-6.5	-6.7	-7.0
Exports of goods	12.8	14.1	**15.9**	15.2	**17.6**	16.5	**19.4**	18.1	19.9	22.0	24.3	26.8
Imports of goods	-15.9	-18.1	**-20.8**	-20.5	**-22.6**	-22.3	**-24.6**	-24.1	-26.1	-28.4	-31.0	-33.8
Services balance	0.9	1.0	**1.2**	1.1	**1.3**	1.3	**1.4**	1.5	1.7	1.9	2.1	2.3
Exports of nonfactor services	4.6	5.2	**5.8**	6.0	**6.5**	6.6	**7.2**	7.3	8.0	8.9	9.8	10.8
Imports of nonfactor services	-3.7	-4.3	**-4.7**	-4.9	**-5.3**	-5.3	**-5.8**	-5.8	-6.3	-7.0	-7.7	-8.5
Income balance	-2.0	-2.5	**-2.4**	-2.2	**-2.5**	-2.1	**-2.6**	-2.3	-2.4	-2.6	-2.8	-3.0
Net interest	-1.0	-0.9	**-0.6**	-0.7	**-0.6**	-0.6	**-0.6**	-0.7	-0.7	-0.8	-0.8	-0.9
Current transfer balance	3.2	3.5	**3.9**	4.1	**3.9**	4.1	**4.0**	4.4	4.3	4.5	4.8	5.0
Others, including private remittances	3.1	3.4	**3.9**	3.9	**3.9**	4.0	**4.0**	4.3	4.3	4.5	4.8	0.0
Capital and financial account balance 2/	0.2	1.9	**2.4**	2.8	**2.6**	3.0	**2.6**	3.3	3.1	2.7	2.7	2.8
Foreign direct investment balance	1.9	2.4	**2.6**	3.2	**2.6**	2.8	**2.7**	2.9	2.8	3.0	3.3	3.5
Portfolio investment balance	-0.9	-0.8	**-0.7**	-0.9	**0.2**	0.1	**0.2**	0.1	0.1	-0.2	-0.3	-0.4
of which: debt liabilities	-0.9	-0.8	**-0.7**	-0.9	**0.2**	0.1	**0.2**	0.1	0.1	-0.2	-0.3	-0.4
Other investment balance	-0.7	0.3	**0.5**	0.5	**-0.2**	0.1	**-0.3**	0.2	0.1	-0.1	-0.2	-0.3
Public sector 2/ 3/	0.3	0.0	**0.3**	0.2	**-0.2**	0.0	**-0.3**	0.1	-0.1	-0.1	-0.2	-0.1
Domestic banks	-0.5	0.9	**0.1**	0.2	**0.1**	0.1	**0.1**	0.1	0.1	-0.1	-0.1	-0.2
Other private sector 4/	-0.5	-0.6	**0.1**	0.1	**-0.1**	0.1	**-0.1**	0.0	0.1	0.1	0.1	0.0
Errors and omissions	0.5	0.4	**0.0**	0.5	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.3	0.2	**0.1**	1.1	**0.3**	0.5	**0.2**	0.8	0.4	0.0	0.1	0.1
Financing	0.3	-0.2	**-0.1**	-1.1	**-0.3**	-0.5	**-0.2**	-0.8	-0.4	0.0	-0.1	-0.1
Gross international reserves (increase, -)	0.3	-0.2	**-0.1**	-1.1	**-0.3**	-0.5	**-0.2**	-0.8	-0.4	0.0	-0.1	-0.1
Financing Gap	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Use of Fund credit, net	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Repurchases	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0

Sources: NBS; and IMF staff estimates and projections.

1/ SORS released revised 2016 BOP in October 2017.

2/ Excluding net use of IMF resources.

3/ Includes SDR allocations in 2009.

4/ Includes trade credits (net).

Table 4b. Serbia: Balance of Payments, 2016–24 1/
(Percent of GDP)

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
						(Percent of GDP)						
Current account balance	-2.9	-5.2	**-5.3**	-5.2	**-5.1**	-5.6	**-4.8**	-5.1	-5.1	-4.7	-4.3	-4.2
Trade of goods balance	-8.5	-10.2	**-11.5**	-12.3	**-11.1**	-12.8	**-10.7**	-12.4	-11.9	-11.5	-11.2	-10.9
Exports of goods	34.9	35.9	**37.1**	35.6	**38.4**	36.0	**39.4**	36.8	37.9	39.0	40.3	41.5
Imports of goods	-43.4	-46.1	**-48.6**	-47.9	**-49.4**	-48.8	**-50.1**	-49.2	-49.7	-50.5	-51.4	-52.4
Services balance	2.5	2.5	**2.7**	2.6	**2.7**	2.9	**2.9**	3.1	3.3	3.4	3.5	3.6
Income balance	-5.5	-6.5	**-5.7**	-5.2	**-5.4**	-4.6	**-5.3**	-4.7	-4.6	-4.6	-4.6	-4.7
Current transfer balance	8.6	9.0	**9.2**	9.7	**8.6**	8.9	**8.2**	8.9	8.1	8.0	8.0	7.7
Official grants	0.2	0.4	**0.1**	0.6	**0.0**	0.2	**0.0**	0.2	0.0	0.0	0.0	0.0
Others, including private remittances	8.4	8.6	**9.2**	9.1	**8.6**	8.7	**8.2**	8.7	8.1	8.0	8.0	0.0
Capital and financial account balance 2/	0.6	4.8	**5.7**	6.5	**5.7**	6.6	**5.2**	6.7	5.8	4.8	4.5	4.4
Capital transfers balance	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	5.2	6.2	**6.2**	7.5	**5.7**	6.1	**5.4**	5.9	5.4	5.4	5.4	5.4
Portfolio investment balance	-2.5	-2.1	**-1.6**	-2.1	**0.4**	0.3	**0.4**	0.3	0.2	-0.4	-0.5	-0.6
Other investment balance	-2.0	0.8	**1.1**	1.2	**-0.4**	0.3	**-0.6**	0.5	0.2	-0.2	-0.3	-0.4
Public sector 2/ 3/	0.8	0.0	**0.6**	0.4	**-0.4**	0.1	**-0.6**	0.3	-0.1	-0.2	-0.3	-0.1
Domestic banks	-1.4	2.2	**0.2**	0.5	**0.2**	0.1	**0.2**	0.2	0.2	-0.2	-0.2	-0.3
Other private sector 4/	-1.5	-1.4	**0.2**	0.3	**-0.2**	0.1	**-0.2**	0.1	0.2	0.2	0.2	0.0
Errors and omissions	1.5	1.0	**0.0**	1.3	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.8	0.6	**0.3**	2.6	**0.6**	1.1	**0.4**	1.6	0.8	0.0	0.2	0.2
Memorandum items:												
Export growth	11.9	9.8	**13.0**	8.3	**10.5**	8.1	**10.3**	9.7	10.2	10.3	10.5	10.5
Import growth	5.5	13.4	**15.4**	13.4	**8.5**	8.9	**8.8**	8.2	8.4	8.8	9.0	9.1
Export volume growth	12.7	8.5	**11.0**	6.6	**8.6**	6.7	**8.5**	8.1	8.7	8.8	8.9	8.9
Import volume growth	11.0	10.0	**12.0**	10.5	**7.7**	8.5	**7.8**	7.1	7.2	7.3	7.3	7.4
Trading partner import growth	5.7	7.7	**6.6**	4.8	**5.2**	4.0	**5.2**	4.0	4.0	4.0	4.0	4.0
Export prices growth	-0.7	1.2	**1.8**	1.6	**1.7**	1.3	**1.7**	1.5	1.4	1.4	1.5	1.5
Import prices growth	-4.9	3.1	**3.0**	2.6	**0.8**	0.4	**1.0**	1.0	1.1	1.4	1.6	1.6
Change in terms of trade	4.4	-1.8	**-1.2**	-1.0	**1.0**	0.9	**0.7**	0.4	0.3	0.0	-0.1	-0.1
Gross official reserves (in billions of euro)	10.2	10.0	**10.6**	11.3	**10.8**	11.8	**11.0**	12.5	12.9	12.9	13.1	13.2
(In months of prospective imports of GNFS)	5.5	4.7	**4.5**	4.9	**4.3**	4.7	**4.0**	4.6	4.4	4.0	3.7	3.8
(in percent of short-term debt)	412.5	262.4	**250.8**	208.9	**208.4**	167.7	**212.2**	178.8	184.4	184.8	186.9	188.8
(in percent of broad money, M2)	58.7	53.2	**52.7**	52.2	**50.7**	51.1	**48.0**	50.7	48.8	45.7	43.2	40.7
(in percent of risk-weighted metric, float) 5/	171.5	162.1	**165.4**	163.6	**161.1**	160.4	**156.8**	162.4	166.9	164.5	162.6	160.4
(in percent of risk-weighted metric, other) 5/	115.4	109.7	**111.4**	111.9	**108.8**	110.8	**105.8**	112.2	112.4	109.1	106.6	103.9
GDP (billions of euros)	36.7	39.2	**42.8**	42.8	**45.8**	45.7	**49.1**	49.1	52.6	56.3	60.3	64.6

Sources: NBS; and IMF staff estimates and projections.

1/ SORS released revised 2016 BOP in October 2017.

2/ Excluding net use of IMF resources.

3/ Includes SDR allocations in 2009.

4/ Includes trade credits (net).

5/ Although Serbia was reclassified as crawl-like exchange rate regime in 2018, Serbia does not target any specific exchange rate.

Table 5. Serbia: External Financing Requirements, 2016–24

(In billions of euros)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.			
					(Billions of euros)				
1. Total financing requirement	**3.9**	**4.7**	**7.1**	**8.4**	**10.3**	**10.9**	**9.1**	**8.8**	**7.4**
Current account deficit	1.1	2.1	2.2	2.5	2.5	2.7	2.7	2.6	2.7
Debt amortization	3.1	2.5	3.8	5.4	7.0	7.9	6.4	6.0	4.6
Medium and long-term debt	2.8	1.8	2.9	3.9	5.5	6.4	4.9	4.5	3.1
Public sector	1.0	0.6	1.9	1.7	2.4	3.1	1.8	1.7	1.4
Of which: Eurobonds	0.2	0.7	1.0	0.0	1.2	1.7	0.0	0.0	0.0
Of which: Domestic bonds (non-residents)	0.0	0.0	0.0	0.8	0.5	0.6	0.8	0.8	0.7
Commercial banks	1.0	1.2	0.3	1.0	1.5	1.4	1.6	1.7	1.1
Corporate sector	0.8	0.0	0.7	1.2	1.7	1.9	1.6	1.2	0.5
Short-term debt	0.3	0.7	0.9	1.5	1.5	1.5	1.5	1.5	1.5
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	0.2	0.6	0.8	1.3	1.3	1.3	1.3	1.3	1.3
Corporate sector	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Change in gross reserves (increase=+)	-0.3	0.2	1.1	0.5	0.8	0.4	0.0	0.1	0.1
2. Total financing sources	**3.9**	**4.7**	**7.1**	**8.4**	**10.3**	**10.9**	**9.1**	**8.8**	**7.4**
Capital transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	1.9	2.4	3.2	2.8	2.9	2.8	3.0	3.3	3.5
Portfolio investment (net) 1/	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt financing	2.7	2.9	4.3	5.6	7.4	8.1	6.1	5.5	3.9
Medium and long-term debt	2.0	2.0	2.8	4.1	5.9	6.6	4.6	4.0	2.4
Public sector 2/	1.1	0.0	1.1	1.8	2.7	3.1	1.4	1.2	1.0
Of which: Eurobonds	0.0	0.0	0.0	0.0	1.0	1.8	0.0	0.0	0.0
Of which: Domestic bonds (non-residents)	0.0	0.0	0.0	0.9	0.8	0.6	0.6	0.5	0.4
Commercial banks	0.3	1.1	0.5	1.0	1.5	1.5	1.5	1.6	0.9
Corporate sector	0.6	0.8	1.2	1.3	1.7	2.0	1.7	1.3	0.6
Short-term debt	0.7	0.9	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	0.6	0.8	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Corporate sector	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other net capital inflows 3/	-0.6	-0.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
o/w trade credit and currency and deposits	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
3. Total financing needs	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Debt service	4.1	3.3	4.5	6.0	7.7	8.6	7.2	6.9	5.5
Interest	0.9	0.8	0.7	0.6	0.7	0.7	0.8	0.8	0.9
Amortization	3.1	2.5	3.8	5.4	7.0	7.9	6.4	6.0	4.6

Sources: NBS; and Fund staff estimates and projections.

1/ Only includes equity securities and financial derivatives.

2/ Excluding IMF.

3/ Includes all other net financial flows and errors and omissions.

Table 6a. Serbia: General Government Fiscal Operations, 2016–24 1/
(In billions of RSD)

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	1,843	1,973	2,086	2,105	2,162	2,208	2,317	2,334	2,490	2,660	2,843	3,043
Taxes	1,586	1,718	1,817	1,822	1,916	1,949	2,072	2,086	2,226	2,381	2,545	2,727
Personal income tax	155	168	176	179	188	196	201	209	220	233	246	267
Social security contributions 2/	527	567	618	620	653	657	702	711	755	808	868	931
Taxes on profits	80	112	115	112	120	129	128	126	142	152	163	175
Value-added taxes	454	479	505	500	539	548	586	592	630	676	723	777
Excises	266	280	285	290	291	293	318	312	335	359	382	403
Taxes on international trade	36	40	43	44	47	47	51	52	56	61	65	69
Other taxes	67	72	75	77	77	78	86	83	88	93	99	106
Non-tax revenue	239	241	257	263	231	244	232	233	247	262	279	299
Capital revenue	8	6	0	6	0	0	0	0	0	0	0	0
Grants	9	9	11	15	15	15	13	15	16	17	19	17
Expenditure	1,897	1,921	2,060	2,073	2,191	2,234	2,344	2,366	2,523	2,697	2,882	3,085
Current expenditure	1,715	1,745	1,847	1,845	1,954	1,986	2,093	2,099	2,242	2,397	2,574	2,759
Wages and salaries 3/	418	426	469	469	502	507	538	543	582	623	668	716
Goods and services	339	365	413	412	434	449	466	475	504	537	576	614
Interest	132	121	107	109	106	111	118	111	119	129	140	157
Subsidies	113	113	110	110	125	132	133	130	140	150	161	173
Transfers	714	720	748	746	786	787	839	840	897	958	1,029	1,100
Pensions 4/	503	506	531	525	563	563	602	602	643	690	744	799
Other transfers 5/	211	214	217	221	223	224	237	238	254	269	286	301
Capital expenditure	139	134	184	199	217	228	230	250	260	275	288	306
Net lending	3	13	9	9	7	7	8	8	8	9	10	11
Amortization of activated guarantees	39	29	20	20	13	13	12	9	13	15	11	10
Fiscal balance	-54	52	26	32	-29	-26	-27	-32	-33	-37	-39	-43
Financing	54	-52	-26	-32	29	26	27	32	33	37	39	43
Privatization proceeds	5	2	20	0	0	15	0	0	0	0	0	0
Equity investment	0	0	0	0	0	0	0	0	0	0	0	0
Domestic	20	-38	38	81	49	7	43	23	20	34	50	51
Banks	148	-66	-42	71	11	17	13	12	12	11	-5	34
Government deposits ((-) means accumulation)	35	5	-1	5	-7	-14	-8	-4	-6	-5	-4	-12
Securities held by banks (net)	99	-3	-30	36	23	41	45	48	45	44	24	69
Other domestic bank financing	14	-68	-11	30	-5	-10	-24	-31	-27	-28	-24	-22
Non-banks (incl. non-residents)	-128	28	80	10	38	-10	30	10	8	23	56	17
Securities held by non-banks (non-residents, net)	-37	43	93	19	45	7	30	10	8	23	56	17
Others (incl. amortization)	-91	-15	-13	-9	-7	-16	0	0	0	0	0	0
External	29	-16	-84	-113	-20	4	-17	9	13	3	-11	-9
Program	0	61	0	0	0	0	0	0	0	0	0	0
Project	73	60	66	79	45	62	67	95	80	76	63	54
Bonds and loans	23	0	48	40	32	41	131	127	218	27	22	23
Amortization	-67	-137	-198	-231	-97	-98	-214	-214	-284	-100	-96	-86
Memorandum items:												
Wages and salaries excluding severance payments	418	426	469	469	502	507	538	543	582	623	668	716
Gross 1 wages and salaries	354	361	396	397	428	431	459	463	497	532	570	611
Arrears accumulation (domestic)	-1	-1	-1	1	-1	-1	0	-1	0	0	0	0
Quasi-fiscal support to SOEs (gross new issuance of guarantees)	86	54	8	38	30	30	15	15	5	5	0	0
Government deposits (stock)	107	102	103	97	110	111	118	115	122	127	131	143
Gross public debt	3114	2792	2741	2760	2817	2831	2854	2871	2902	2952	3003	3038
Gross public debt (including restitution)	3357	3035	2984	3003	3060	3074	3077	3094	3105	3136	3167	3181
Nominal GDP (billions of dinars)	4521	4754	5074	5060	5424	5408	5832	5819	6252	6713	7210	7743

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

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

2/ Includes employer contributions.

3/ Including severence payments. Includes employer contributions.

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

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

Table 6b. Serbia: General Government Fiscal Operations, 2016–24 1/
(Percent of GDP)

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	40.8	41.5	**41.1**	41.6	**39.9**	40.8	**39.7**	40.1	39.8	39.6	39.4	39.3
Taxes	35.1	36.1	**35.8**	36.0	**35.3**	36.0	**35.5**	35.8	35.6	35.5	35.3	35.2
Personal income tax	3.4	3.5	**3.5**	3.5	**3.5**	3.6	**3.4**	3.6	3.5	3.5	3.4	3.4
Social security contributions 2/	11.7	11.9	**12.2**	12.2	**12.0**	12.1	**12.0**	12.2	12.1	12.0	12.0	12.0
Taxes on profits	1.8	2.4	**2.3**	2.2	**2.2**	2.4	**2.2**	2.2	2.3	2.3	2.3	2.3
Value-added taxes	10.0	10.1	**10.0**	9.9	**9.9**	10.1	**10.0**	10.2	10.1	10.1	10.0	10.0
Excises	5.9	5.9	**5.6**	5.7	**5.4**	5.4	**5.4**	5.4	5.4	5.3	5.3	5.2
Taxes on international trade	0.8	0.8	**0.8**	0.9	**0.9**	0.9	**0.9**	0.9	0.9	0.9	0.9	0.9
Other taxes	1.5	1.5	**1.5**	1.5	**1.4**	1.4	**1.5**	1.4	1.4	1.4	1.4	1.4
Non-tax revenue	5.3	5.1	**5.1**	5.2	**4.3**	4.5	**4.0**	4.0	3.9	3.9	3.9	3.9
Capital revenue	0.2	0.1	**0.0**	0.1	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.2	**0.2**	0.3	**0.3**	0.3	**0.2**	0.3	0.3	0.3	0.3	0.2
Expenditure	41.9	40.4	**40.6**	41.0	**40.4**	41.3	**40.2**	40.7	40.4	40.2	40.0	39.8
Current expenditure	37.9	36.7	**36.4**	36.5	**36.0**	36.7	**35.9**	36.1	35.9	35.7	35.7	35.6
Wages and salaries 3/	9.2	9.0	**9.2**	9.3	**9.2**	9.4	**9.2**	9.3	9.3	9.3	9.3	9.2
Goods and services	7.5	7.7	**8.1**	8.1	**8.0**	8.3	**8.0**	8.2	8.1	8.0	8.0	7.9
Interest	2.9	2.5	**2.1**	2.1	**2.0**	2.1	**2.0**	1.9	1.9	1.9	1.9	2.0
Subsidies	2.5	2.4	**2.2**	2.2	**2.3**	2.4	**2.3**	2.2	2.2	2.2	2.2	2.2
Transfers	15.8	15.1	**14.7**	14.7	**14.5**	14.6	**14.4**	14.4	14.3	14.3	14.3	14.2
Pensions 4/	11.1	10.7	**10.5**	10.4	**10.4**	10.4	**10.3**	10.3	10.3	10.3	10.3	10.3
Other transfers 5/	4.7	4.5	**4.3**	4.4	**4.1**	4.1	**4.1**	4.1	4.1	4.0	4.0	3.9
Capital expenditure	3.1	2.8	**3.6**	3.9	**4.0**	4.2	**4.0**	4.3	4.2	4.1	4.0	3.9
Net lending	0.1	0.3	**0.2**	0.2	**0.1**	0.1	**0.1**	0.1	0.1	0.1	0.1	0.1
Amortization of activated guarantees	0.9	0.6	**0.4**	0.4	**0.2**	0.2	**0.2**	0.2	0.2	0.2	0.1	0.1
Fiscal balance	-1.2	1.1	**0.5**	0.6	**-0.5**	-0.5	**-0.5**	-0.5	-0.5	-0.5	-0.5	-0.5
Financing	1.2	-1.1	**-0.5**	-0.6	**0.5**	0.5	**0.5**	0.5	0.5	0.5	0.5	0.5
Privatization proceeds	0.1	0.0	**0.4**	0.0	**0.0**	0.3	**0.0**	0.0	0.0	0.0	0.0	0.0
Equity investment	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Domestic	0.4	-0.8	**0.8**	1.6	**0.9**	0.1	**0.7**	0.4	0.3	0.5	0.7	0.7
Banks	3.3	-1.4	**-0.8**	1.4	**0.2**	0.3	**0.2**	0.2	0.2	0.2	-0.1	0.4
Government deposits ((-) means accumulation)	0.8	0.1	**0.0**	0.1	**-0.1**	-0.3	**-0.1**	-0.1	-0.1	-0.1	-0.1	-0.2
Securities held by banks (net)	2.2	-0.1	**-0.6**	0.7	**0.4**	0.8	**0.8**	0.8	0.7	0.7	0.3	0.9
Other domestic bank financing	0.3	-1.4	**-0.2**	0.6	**-0.1**	-0.2	**-0.4**	-0.5	-0.4	-0.4	-0.3	-0.3
Non-banks (incl. non-residents)	-2.8	0.6	**1.6**	0.2	**0.7**	-0.2	**0.5**	0.2	0.1	0.3	0.8	0.2
Securities held by non-banks (non-residents, net)	-0.8	0.9	**1.8**	0.4	**0.8**	0.1	**0.5**	0.2	0.1	0.3	0.8	0.2
Others (incl. amortization)	-2.0	-0.3	**-0.3**	-0.2	**-0.1**	-0.3	**0.0**	0.0	0.0	0.0	0.0	0.0
External	0.6	-0.3	**-1.7**	-2.2	**-0.4**	0.1	**-0.3**	0.2	0.2	0.0	-0.2	-0.1
Program	0.0	1.3	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Project	1.6	1.3	**1.3**	1.6	**0.8**	1.1	**1.1**	1.6	1.3	1.1	0.9	0.7
Bonds and loans	0.5	0.0	**0.9**	0.8	**0.6**	0.8	**2.2**	2.2	3.5	0.4	0.3	0.3
Amortization	-1.5	-2.9	**-3.9**	-4.6	**-1.8**	-1.8	**-3.7**	-3.7	-4.5	-1.5	-1.3	-1.1
Memorandum items:												
Wages and salaries excluding severance payments	9.2	9.0	**9.2**	9.3	**9.2**	9.4	**9.2**	9.3	9.3	9.3	9.3	9.2
Gross 1 wages and salaries	7.8	7.6	**7.8**	7.9	**7.9**	8.0	**7.9**	8.0	7.9	7.9	7.9	7.9
Arrears accumulation (domestic)	0.0	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0
Government deposits (stock)	2.4	2.1	**2.0**	1.9	**2.0**	2.1	**2.0**	2.0	1.9	1.9	1.8	1.9
Gross financing need	12.3	9.0	**8.4**	9.2	**7.8**	8.2	**7.6**	8.0	7.7	6.5	6.2	6.2
Gross public debt	68.9	58.7	**54.0**	54.5	**51.9**	52.3	**48.9**	49.3	46.4	44.0	41.6	39.2
Gross public debt (including restitution)	74.3	63.8	**58.8**	59.4	**56.4**	56.8	**52.8**	53.2	49.7	46.7	43.9	41.1
Nominal GDP (billions of dinars)	4,521	4,754	**5,074**	5,060	**5,424**	5,408	**5,832**	5,819	6,252	6,713	7,210	7,743

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

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

2/ Includes employer contributions.

3/ Including severence payments. Includes employer contributions.

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

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

Table 7. Serbia: Monetary Survey, 2016–24

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/237	Est.	CR 18/237	Proj.	CR 18/237	Proj.	Proj.	Proj.	Proj.	Proj.
			(Billions of dinars, unless otherwise indicated; end of period) 1/									
Net foreign assets 2/	1156	986	**985**	1116	**1006**	1170	**1019**	1255	1295	1316	1355	1401
in billions of euro	9.4	8.3	**8.3**	9.4	**8.5**	9.9	**8.6**	10.6	10.9	11.0	11.3	11.7
Foreign assets	1512	1391	**1399**	1616	**1433**	1676	**1458**	1773	1823	1832	1855	1876
NBS	1271	1191	**1200**	1342	**1233**	1402	**1259**	1498	1548	1556	1578	1599
Commercial banks	241	200	**199**	273	**199**	274	**200**	275	275	276	277	278
Foreign liabilities (-)	-356	-405	**-414**	-500	**-427**	-507	**-440**	-518	-528	-516	-501	-476
NBS	-6	-4	**-4**	-3	**-4**	-3	**-4**	-3	-3	-3	-3	-3
Commercial banks	-350	-401	**-410**	-497	**-423**	-504	**-436**	-514	-525	-513	-497	-473
Net domestic assets	989	1,231	**1,386**	1,435	**1,522**	1,605	**1,679**	1,728	1,876	1,991	2,081	2,130
Domestic credit	2,321	2,362	**2,499**	2,552	**2,650**	2,725	**2,798**	2,886	3,033	3,132	3,200	3,240
Government, net	341	353	**352**	346	**372**	357	**387**	380	398	416	410	401
NBS	-210	-215	**-216**	-233	**-223**	-239	**-232**	-248	-253	-259	-264	-261
Claims on government	4	4	**4**	5	**4**	5	**4**	5	5	5	5	5
Liabilities (deposits)	214	219	**220**	238	**227**	244	**235**	253	258	265	269	266
Banks	551	568	**568**	578	**595**	595	**619**	628	650	675	674	662
Claims on government	638	630	**630**	641	**658**	659	**681**	691	714	738	737	726
Liabilities (deposits)	87	63	**62**	63	**62**	63	**62**	63	63	64	64	63
Local governments, net	-20	-31	**-31**	-28	**-31**	-28	**-31**	-28	-28	-28	-28	-28
Non-government sector	2,000	2,040	**2,177**	2,235	**2,308**	2,396	**2,441**	2,534	2,664	2,744	2,818	2,867
Households	840	905	**1,004**	1,018	**1,095**	1,117	**1,158**	1,204	1,296	1,355	1,398	1,437
Enterprises	1,127	1,103	**1,138**	1,188	**1,177**	1,249	**1,245**	1,298	1,334	1,354	1,384	1,394
Other	34	32	**34**	29	**36**	31	**39**	33	34	35	36	37
Other assets, net	-1,332	-1,131	**-1,112**	-1,117	**-1,128**	-1,119	**-1,118**	-1,157	-1,158	-1,140	-1,119	-1,110
Capital accounts (-)	-1,016	-963	**-959**	-997	**-945**	-997	**-932**	-1,011	-1,008	-976	-938	-911
NBS	-391	-298	**-283**	-324	**-269**	-324	**-256**	-324	-308	-262	-210	-168
Banks	-625	-664	**-676**	-673	**-676**	-673	**-676**	-686	-700	-714	-728	-743
Provisions (-)	-281	-161	**-145**	-121	**-174**	-124	**-178**	-148	-151	-166	-183	-201
Other assets	-34	-7	**-8**	1	**-8**	2	**-9**	2	2	2	2	2
Broad money (M2)	2146	2217	**2371**	2551	**2528**	2775	**2698**	2983	3171	3308	3436	3531
M1	566	621	**671**	745	**734**	825	**789**	906	983	1056	1146	1211
Currency in circulation	159	164	**177**	183	**194**	202	**208**	222	241	259	281	297
Demand deposits	407	457	**494**	563	**540**	623	**581**	684	742	797	865	914
Time and saving deposits	195	196	**212**	220	**232**	243	**249**	267	290	312	338	357
Foreign currency deposits	1385	1400	**1488**	1585	**1562**	1707	**1659**	1811	1898	1940	1951	1963
in billions of euro	11.2	11.8	**12.6**	13.4	**13.2**	14.4	**14.0**	15.2	15.9	16.2	16.3	16.3
Memorandum items:			(year-on-year change unless indicated otherwise)									
M1	20.3	9.7	**8.1**	20.1	**9.4**	10.7	**7.5**	9.8	8.5	7.4	8.5	5.7
M2	9.8	3.3	**6.9**	15.0	**6.6**	8.8	**6.7**	7.5	6.3	4.3	3.9	2.8
Velocity (Dinar part of money supply)	5.9	5.8	**5.7**	5.2	**5.6**	5.1	**5.6**	5.0	4.9	4.9	4.9	4.9
Velocity (M2)	2.1	2.1	**2.1**	2.0	**2.1**	1.9	**2.2**	2.0	2.0	2.0	2.1	2.2
Deposits at constant exchange rate	8.5	5.9	**7.2**	15.9	**6.3**	8.5	**6.6**	7.2	6.0	3.8	3.3	2.4
Credit to non-gov. (current exchange rate)	2.6	2.0	**4.7**	6.5	**3.8**	5.2	**3.7**	4.2	4.0	2.6	2.4	1.4
Credit to non-gov. (constant exchange rates) 3/	1.5	4.8	**5.1**	7.1	**3.6**	5.0	**3.6**	4.0	3.9	2.3	2.2	1.2
Domestic	1.8	4.4	**7.1**	10.1	**5.9**	7.1	**5.7**	5.6	5.0	2.8	2.5	1.6
Households	9.8	9.8	**11.3**	12.9	**8.9**	9.6	**5.7**	7.6	7.5	4.4	3.0	2.6
Enterprises and other sectors	-3.3	0.5	**3.8**	7.9	**3.3**	5.0	**5.6**	3.8	2.6	1.3	2.0	0.6
External	0.9	5.6	**1.1**	1.2	**-1.3**	0.5	**-1.2**	0.3	1.2	1.1	1.4	0.2
Credit to non-gov. (real terms) 4/	1.0	-1.0	**2.0**	4.5	**1.3**	3.1	**0.7**	2.0	1.5	-0.2	-0.6	-1.5
Domestic credit to non-gov. (real terms)	1.1	-1.0	**4.0**	7.4	**3.5**	5.1	**2.7**	3.5	2.5	0.2	-0.3	-1.2
Households	8.8	4.6	**8.2**	10.3	**6.5**	7.6	**2.7**	5.4	5.0	1.7	0.2	-0.2
Enterprises and other sectors	-3.8	-5.1	**0.6**	5.1	**1.0**	3.0	**2.7**	1.7	0.2	-1.3	-0.8	-2.2
External	0.8	-1.1	**-2.0**	-1.5	**-3.4**	-1.3	**-3.9**	-1.6	-1.1	-1.3	-1.3	-2.4
12-m change in NBS's NFA, billions of euros	0.1	-0.2	**0.0**	0.6	**0.2**	0.8	**0.2**	0.7	0.3	0.0	0.2	0.1
Deposit euroization (percent of total) 5/	69.7	68.2	**67.8**	66.9	**66.9**	66.3	**66.6**	65.6	64.8	63.6	61.9	60.7
Credit euroization (percent of total) 5/	68.3	67.1	**66.6**	66.9	**65.8**	66.3	**64.8**	65.5	64.7	63.9	62.9	61.9

Sources: National Bank of Serbia; and IMF staff estimates and projections.
1/ Foreign exchange denominated items are converted at current exchange rates.
2/ Excluding undivided assets and liabilities of the FSRY and liabilities to banks in liquidation.

3/ Using constant program dinar/euro and dinar/swiss franc exchange rates for converting FX and FX-indexed loans to dinars agreed under 2015-17 SBA.
4/ Calculated as nominal credit at current exchange rates deflated by the change in the 12-month CPI index.
5/ Using current exchange rates.

Table 8. Serbia: NBS Balance Sheet, 2016–24

	2016	2017	2018		2019		2020		2021	2022	2023	2024
			CR 18/375	Est.	CR 18/375	Proj.	CR 18/375	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/											
Net foreign assets	1265	1187	**1196**	1339	**1230**	1399	**1255**	1495	1545	1553	1575	1595
(In billions of euro)	10.3	10.0	**10.1**	11.3	**10.4**	11.8	**10.6**	12.6	13.0	13.0	13.2	13.3
Gross foreign reserves	1271	1191	**1200**	1342	**1233**	1402	**1259**	1498	1548	1556	1578	1599
Gross reserve liabilities (-)	-6	-4	**-4**	-3	**-4**	-3	**-4**	-3	-3	-3	-3	-3
Net domestic assets	-663	-596	**-605**	-607	**-625**	-636	**-639**	-652	-633	-580	-523	-477
Net domestic credit	-272	-298	**-321**	-282	**-356**	-311	**-383**	-328	-325	-318	-313	-309
Net credit to government	-210	-215	**-216**	-233	**-223**	-239	**-232**	-248	-253	-259	-264	-261
Claims on government	4	4	**4**	5	**4**	5	**4**	5	5	5	5	5
Liabilities to government (-)	-214	-219	**-220**	-238	**-227**	-244	**-235**	-253	-258	-265	-269	-266
Liabilities to government (-): local currency	-95	-118	**-118**	-137	**-118**	-137	**-118**	-137	-137	-137	-137	-137
Liabilities to government (-): foreign currency	-119	-101	**-102**	-101	**-109**	-107	**-118**	-116	-121	-127	-132	-129
Net credit to local governments	-43	-48	**-50**	-46	**-50**	-48	**-50**	-48	-48	-48	-48	-48
Net claims on banks	-33	-45	**-65**	-16	**-93**	-37	**-111**	-44	-37	-23	-14	-13
Capital accounts (-)	-391	-298	**-283**	-324	**-269**	-324	**-256**	-324	-308	-262	-210	-168
Reserve money	602	591	**591**	732	**604**	764	**616**	842	912	974	1052	1118
Currency in circulation	159	164	**177**	183	**194**	202	**208**	222	241	259	281	297
Commercial bank reserves	221	232	**207**	269	**193**	307	**176**	350	388	425	480	529
Required reserves	147	156	**165**	171	**174**	184	**185**	196	205	209	211	212
Excess reserves	73	76	**41**	98	**19**	122	**-8**	155	183	216	270	317
FX deposits by banks, billions of euros	1.8	1.6	**1.7**	2.4	**1.8**	2.2	**1.9**	2.3	2.4	2.4	2.4	2.4

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

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

Table 9. Serbia: Banking Sector Financial Soundness Indicators, 2012–19

	2012	2013	2014	2015	2016	2017	2018				2019
							Mar	Jun	Sep	Dec	Feb
Capital adequacy											
Regulatory capital to risk-weighted assets	19.9	20.9	20.0	20.9	21.8	22.6	22.7	22.9	22.8	22.3	22.3
Regulatory Tier 1 capital to risk-weighted assets	19.0	19.3	17.6	18.8	20.0	21.6	21.8	22.1	21.9	21.1	21.1
Nonperforming loans net of provisions to capital	52.3	55.9	56.0	44.0	27.1	17.7	15.4	12.7	10.3	9.7	9.5
Regulatory Tier 1 capital to assets	11.6	11.2	10.1	10.7	11.6	13.7	13.9	14.3	14.2	13.5	13.4
Large exposures to capital	104.5	90.4	130.5	115.7	86.0	69.3	73.3	68.6	68.2	77.4	77.4
Regulatory capital to total assets	12.2	12.2	11.4	11.9	12.7	14.4	14.5	14.8	14.9	14.2	14.2
Asset quality											
Nonperforming loans to total gross loans	18.6	21.4	21.5	21.6	17.0	9.8	9.2	7.8	6.4	5.7	5.6
Sectoral distribution of loans (percent of total loans)											
Deposit takers	0.3	0.3	0.8	0.1	0.5	0.3	0.2	0.3	0.4	0.4	0.2
Central bank	2.1	5.8	0.4	1.6	1.7	2.1	1.9	3.0	1.8	0.7	1.8
General government	3.0	2.3	2.3	1.7	1.5	1.3	1.2	1.2	1.2	1.1	1.1
Other financial corporations	1.6	1.6	0.5	0.7	0.9	0.9	0.7	0.8	0.9	0.8	0.8
Nonfinancial corporations	58.2	54.1	56.3	55.9	52.6	50.5	50.6	49.1	49.0	50.0	49.6
Agriculture	3.0	2.7	3.5	3.7	3.6	3.5	3.4	3.5	3.6	3.5	3.4
Industry	17.9	18.4	19.2	18.4	16.5	16.2	16.3	16.2	15.9	16.5	16.4
Construction	5.8	4.6	4.2	3.8	4.1	4.0	4.1	4.1	4.2	4.2	4.3
Trade	15.0	13.5	13.9	13.9	14.3	14.6	14.9	14.2	14.5	14.0	14.1
Other loans to nonfinancial corporations	16.5	14.9	15.6	16.2	14.1	12.2	11.9	11.0	10.7	11.8	11.5
Households and NPISH	33.0	34.8	38.3	39.1	41.5	42.9	43.8	43.7	44.7	44.3	44.4
Households and NPISH of which: mortgage loans to total l	16.1	16.8	18.0	18.1	17.9	16.9	17.2	16.8	17.0	16.8	16.8
Foreign sector	1.9	1.1	1.4	0.9	1.4	2.0	1.6	1.9	2.2	2.6	2.1
IFRS provision for NPLs to gross NPLs	50.0	50.9	54.9	62.3	67.8	58.1	60.8	60.9	61.3	60.2	60.4
IFRS provision of total loans to total gross loans	10.2	11.9	12.7	14.4	12.4	6.6	6.7	5.8	5.0	4.5	4.5
Earnings and Profitability											
Return on assets	0.4	-0.1	0.1	0.3	0.7	2.1	2.1	2.1	2.1	2.2	1.9
Return on equity	2.0	-0.4	0.6	1.5	3.3	10.5	10.5	10.6	10.7	11.3	10.6
Liquidity											
Customer deposits to total (noninterbank) loans	84.9	92.3	95.7	99.7	108.1	106.9	105.4	106.8	105.3	110.6	109.6
Foreign-currency-denominated loans to total loans	74.1	71.6	70.1	72.3	69.4	67.5	67.3	67.0	67.8	68.5	67.5
Average monthy liquidity ratio	2.1	2.4	2.2	2.1	2.1	2.0	2.2	2.1	2.1	2.0	2.2
Average monthy narrow liquidity ratio	1.6	1.8	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.7	1.9
Sensitivity to Market Risk											
Foreign-currency-denominated liabilities to total liabilities	80.1	76.7	74.7	72.7	71.1	69.7	70.2	69.8	69.4	69.3	70.4
Classified off-balance sheet items to classified balance sheet a	26.1	28.7	27.6	30.6	32.4	36.4	36.0	37.1	37.6	36.8	36.8

Source: National Bank of Serbia.

Table 10. Serbia: Indicators for Monitoring Progress Towards SDGs, 2005–15

Goals	2005	2010	2015
Poverty			
Employed population below international poverty line (%)	0.5	0.0	...
Proportion of population living below the national poverty line (%)	...	...	26.5
Proportion of population covered by social assistance programs (%)	...	11.7	...
Proportion of total government spending on essential services, education (%)	...	10.5	9.2
Prevalence of undernourishment (%)	...	5.9	5.6
Health and Education			
Maternal mortality ratio	15	12	17
Under-five mortality rate (deaths per 1,000 live births)	8.9	7.6	5.7
Number of new HIV infections per 1,000 uninfected population (per 1,000 uninfected population)	0.0	0.0	0.0
Proportion of population using safely managed drinking water services (%)	77.8	83.1	88.1
Proportion of population using safely managed sanitation services (%)	28.4	26.2	24.0
Mortality rate attributed to cardiovascular disease, cancer, diabetes or chronic respiratory disease (probability)	26.1	22.5	20.1
Minimum proficiency in mathematics (%)	...	...	90.6
Gender parity index for achievement in mathematics (ratio)	...	...	1.0
Inclusion			
Number of seats held by women in national parliaments (number)	...	54	85
Proportion of women in managerial positions (%)	24.8	33.3	29.2
Proportion of population with access to electricity (%)	99.7	99.7	100.0
Unemployment rate (%)	20.9	19.2	17.9
Proportion of informal employment in non-agriculture employment (%)	...	8.36	13.69
Proportion of youth not in education, employment or training (%)	...	21.2	20.1
Climate			
Carbon dioxide emissions per unit of manufacturing value added (kilogrammes of CO2 per constant 2010 US dollars)	1.4	0.8	0.6
Global Parnership			
Total official development assistance (gross disbursement) for technical cooperation (millions of 2016 US dollars)	268.7	167.5	169.3

Source: UN SDG Indicators Global Database; National Authorities

Table 11. Serbia: Schedule of Reviews Under the Policy Coordination Instrument, 2018-20

Program Review	Proposed Date
Board discussion of a PCI request	July 18, 2018
First Review	December 1, 2018
Second Review	June 1, 2019
Third Review	December 1, 2019
Fourth Review	June 1, 2020
Fifth Review	December 1, 2020

Source: IMF staff.

Annex I. Risk Assessment Matrix 1/

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
EXTERNAL				
Rising protectionism and retreat from multilateralism. In the near term, escalating and sustained trade actions threaten the global trading system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	High	Short to Medium Term	Medium • Reduced upside from deeper integration into global and European supply chains, reduced trade and FDI, and increased capital flows volatility would adversely impact Serbian economy.	*Short term:* • Flexible exchange rate should serve as a first line of defense. • Progress on structural reforms should anchor confidence and improve competitiveness. *Medium term:* • Make use of growth-supportive fiscal policy measures (reducing labor tax wedge, infrastructure spending). • Maintain financial stability to weather external shocks.
Sharp tightening of global financial conditions. *This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn.* **Sustained rise in risk premium.** This would be in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	Medium	Short Term	Medium • Worsening market sentiment and lower investor demand for Serbia's assets resulting in increased funding costs or reduced capital inflows/outflows. • Sovereign and banks' borrowing costs increase.	*Short term:* • Flexible exchange rate should serve as a first line of defense. • If needed, liquidity support for the banking sector. If pressures persist, interest rates should be increased to stem capital outflows. • Decisive progress on structural reforms should anchor confidence and improve competitiveness.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

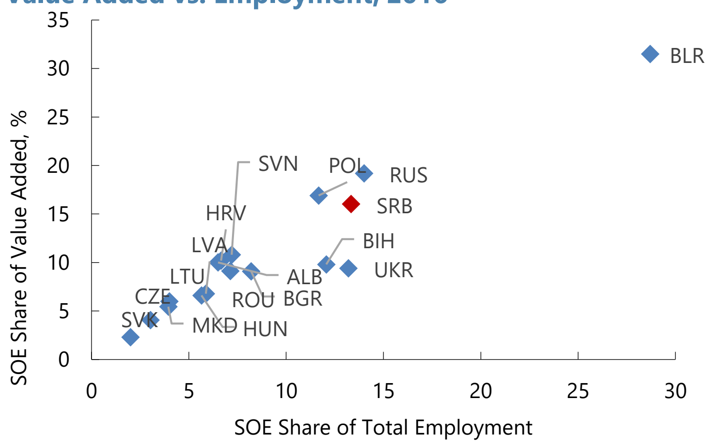
Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Weaker-than-expected global growth. *The global growth slowdown could be synchronized as weakening outlooks in the US, Europe, and China feed off each other and impact on earnings, asset prices, and credit performance.*				*Short term:* • Ease monetary policy stance, make use of exchange rate flexibility. • Fiscal policy should allow automatic stabilizers to work as needed; with possible adjustments in related quantitative conditionality. • If needed, liquidity support for the banking sector. *Medium term:* • Make use of growth-supportive fiscal policy measures (reducing labor tax wedge, infrastructure spending). • Maintain financial stability to weather external shocks, tight supervision to monitor banking risks. • Accelerate structural reforms to improve competitiveness.
Europe. In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens growth. A disorderly Brexit could cause market disruption with negative spillovers. In the medium term, disregard for the common fiscal rules and rising sovereign yields for high-debt countries test the euro area policy framework, with adverse impact on confidence and growth.	**High**	**Short to Medium Term**	**High** • Significant trade linkages with Europe would weaken growth in Serbia through lower exports and adverse confidence effects. • Asset quality of the banking system would deteriorate as growth slows.	
China. In the short term, intensification of trade tensions and/or a housing market downturn prompt a slowdown, which is not fully offset by policy easing. Deleveraging is delayed and financial stresses, including capital outflow and exchange rate pressures, emerge. In the medium term, insufficient progress on deleveraging and rebalancing reduces growth and raises the probability of a larger disruptive adjustment. There would be negative spillovers on the global economy through trade volumes, commodity prices, and financial markets.	**Medium**	**Short to Medium Term**	**Medium** • Direct investment and indirect (through EU supply chains) trade linkages to China would lower investments to and exports from Serbia. • Financial volatility raises risk aversion, causing capital outflows from	

			emerging markets, including Serbia.	
Source of Risks	**Relative Likelihood**	**Time Horizon**	**Expected Impact**	**Policy Response**
Large swings in energy prices. Risks to prices are broadly balanced, reflecting offsetting – but large and uncertain – supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	Medium	**Short to Medium Term**	Medium • Higher energy prices could weaken SOE financial positions, especially if not permitted to pass along price increases, leading the central government to provide financial support. • Higher headline inflation.	*Short term:* • Allow energy prices increases to be passed through to end-users. • Complete resolution of unviable SOEs and improve fiscal risk assessments, monitoring, and corporate governance of remaining SOEs. *Medium term:* • Maintain financial stability to weather external shocks.
DOMESTIC				
Domestic policy errors and political uncertainty: • Loss of fiscal discipline. • Political resistance or hesitation to delivering on specific structural reforms. **Weakening outlook for EU accession affecting economic prospects.**	Medium/ High Medium/ High	**Short to Medium Term** **Medium to Long Term**	High • Weaker fiscal discipline could compromise the quality and durability of fiscal adjustment; expose debt sustainability risks. • Unfinished structural reform agenda would reduce growth prospects, preserve over-reliance on the public sector and large informal economy, and leave unaddressed contingent liabilities.	• Maintain strong policies and strengthen institutions as a foundation of strong and sustainable growth. • Complete resolution of unviable SOEs and improve corporate governance of remaining SOEs. • Resist pressures to weaken fiscal discipline, strengthen institutional framework for fiscal rule. • Foster more inclusive growth through higher female labor market participation and better targeted social assistance.

Annex II. Reassessing the Role of State-Owned Enterprises in Serbia: Governance and Performance[1]

1. Serbia has a large SOE sector compared to most of the CESEE region in terms of both employment and output, with SOEs operating in all sectors of the economy.[2] This is despite the state's footprint shrinking by about 10 percentage points since 2005. The state's largest presence is in the electricity and water supply sectors (about 80 percent of employment and value-added) but the state is also present in less typical areas such as horse farms, spas, and textbooks.

Value Added vs. Employment, 2016



Sources: National country authorities, IMF staff calculations, Richmond et al. (2019)

2. In recent years, the authorities have renewed their privatization efforts, successfully privatizing more than 50 companies since end-2014. Steps have also been taken to reduce losses and lower fiscal risks from the SOE sector as a whole, including systemic enterprises. However, contingent liabilities stemming froma unfinished reforms of SOEs could arise and broader governance reform of the state-owned sector would be a major step in achieving a level playing field for business, improving efficiency of public resource use and managing fiscal risks. Improved governance will also help advance the EU accession agenda.

Governance

3. During Summer 2018 staff in the IMF's European Department conducted a survey with CESEE countries on SOE governance practices, using the World Bank Corporate Governance Toolkit and OECD SOE best practices as a benchmark.[3] The results capture *de jure* SOE governance in countries, while *de facto* SOE governance may be somewhat different. Questions are categorized into three groups: (i) ownership and governance frameworks, which looks at the rationale for ownership, strategic relevance, and management oversight; (ii) financial oversight, which looks at financial reporting as well as setting and evaluating targets; and (iii) fiscal and policy interactions with government, which examines fiscal risks assessments and financing arrangements.

[1] Prepared by C. Richmond and M. Paunovic.

[2] This annex is based on Richmond et al. (2019) and Benkovskis and Richmond (2019). The methodologies used in this analysis are described in Richmond et al. (2019).

[3] World Bank (2014) and OECD (2015).

Ownership and Governance Framework

4. Best practices call for SOEs engaged in commercial activities to be strategically relevant, with no legal preferences (e.g., regulatory, tax, and insolvency). Countries should have an ownership policy document with stated objectives for SOEs and publish—with regular updates—a complete list of SOEs covering all levels of government (central and local) and consolidated ownership information. SOE management oversight should be centralized (not spread across multiple ministries) to ensure consistent oversight and concentrate experts on key issues in one place. Lastly, board members should be selected by a central body or committee and independent directors should meet minimum, relevant expertise requirements.

5. Serbia's reported objectives for SOEs are to (i) supply specific goods and services and (ii) support national economic and strategic interests. However, Serbia does not have an ownership policy document with stated objectives, making it impossible to determine whether objectives are being met. This is especially the case when one tries to assess the objectives of SOEs such as horse farms and ski resorts.[4]

6. At the same time, Serbia does not keep a single, comprehensive list of all SOEs. It keeps multiple SOE lists for various reasons (e.g., statistical, employment, former Privatization Agency portfolio, etc.), which are not always kept updated or made public. There are also two categories of SOEs: (i) regular SOEs, which are governed in line with the general Company Law; and (ii) Public Enterprises (PEs), which operate in industries that have been defined as general interest in the Law on PE, such as mining and energy, transportation, and textbook production. PEs have much less autonomy than regular SOEs and need to get government (or municipal) prior approval for business decisions such as price changes, investments in other companies, and sales of valuable assets.

7. While all SOEs at the national level are subject to ministerial oversight, this has not been centralized. Currently, energy and mining related SOEs are overseen Ministry of Energy, while other PEs are managed by relevant line ministries (mainly Trade and Transportation) and the rest of the national level SOEs are overseen by the Ministry of Economy. Local public enterprises are owned and overseen by local governments.

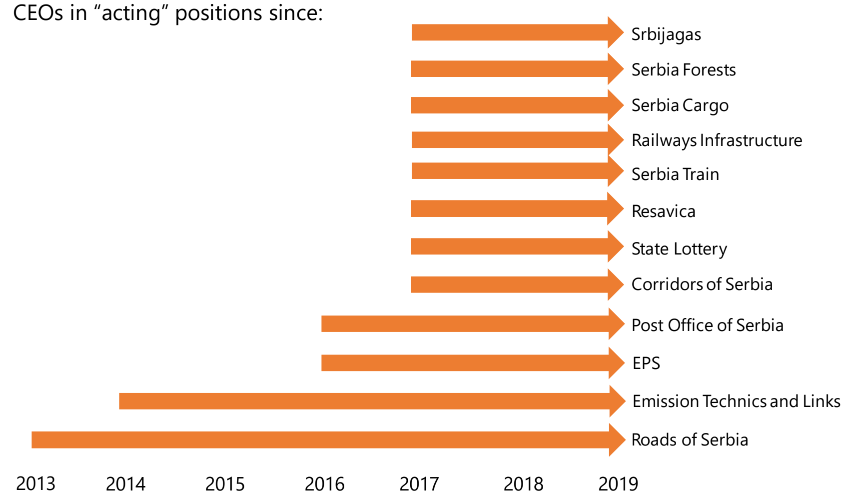
8. The strategic relevance of many SOEs (and some PEs) is not obvious. In many instances, the same public policy goals (e.g., universal coverage) could be achieved by other, less distortionary policies. Additionally, there are legal preferences for PEs (particularly used for bankruptcy protection), while bankruptcy protection and prevention of forced collection for SOEs undergoing restructuring were lifted in 2015, during the previous SBA.

[4] Ljubičevo stable (https://en.wikipedia.org/wiki/Ljubi%C4%8Devo_stable), Ski Resorts of Serbia (https://shop.skijalistasrbije.rs/user/page.jsp?f_shop_id=58&f_lang_id=2&f_page=front&f_partner_id=0).

9. Along the dimension of management and board members, a number of shortcomings exist. For example, out of 20 of the largest SOEs, 12 have CEOs in acting positions, and often for very long periods of time. This contradicts the Law on PE, which stipulates that acting status can last no longer than 12 months (acting CEOs can be appointed twice on 6-month terms). Management often faces political conflicts, either by serving as members of the National Assembly or holding a membership in a ruling political party. The Law however does envisage that one Board member is independent, with no links to the company or a political party.

Status of Serbia Public Enterprise CEOs

CEOs in "acting" positions since:



Sources: National sources; IMF staff calculations.

Financial Oversight

10. Best practices call for financial and operational performance targets to be set, with ex-post evaluations against the targets made. Financial statements should follow international accounting standards, be independently audited, published, and reviewed. Additionally, an aggregate SOE report should be published on a regular basis, including an SOE sector overview, disclosure of individual SOE mandates, individual performance and risk assessments, financial transactions with the government, and an assessment of ownership policy.

11. While Serbia conducts ex-post evaluations against some targets set in the SOE annual plans, formal financial or operational performance targets are not set. Financial statements are prepared according to international accounting standards, are audited, and published, but are not reviewed. Some information is publicly available and the annual financial statements can be accessed through the Serbian Business Registry Agency. However, Serbia does not produce an aggregate SOE report on the entire sector.

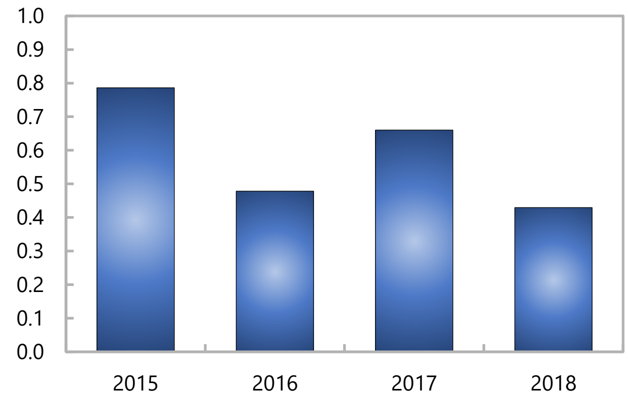
Fiscal and Policy Interactions

12. Best practices include assessing fiscal risks stemming from SOEs. There should be an explicit dividend policy outlining how much money will be transferred to the government budget and under what conditions. The government should also have an arms-length relationship regarding SOE financing. That is, SOEs should not receive budget or quasi-fiscal support. Lastly, non-commercial mandates should be explicitly spelled out in legislation.

13. Despite dividends being an important source of non-tax revenue for the budget, Serbia does not have an explicit dividend policy in place. Currently the percent of profits that should be paid into the budget (50 percent as of 2019) is defined in the annual Budget Law, and the Law does not define any exceptions or criteria. At the same time the Government may allow individual companies, on an ad hoc basis, to pay less than required if the funds are to be used for investments or to cover losses from previous years. Beginning in 2015 the authorities actively began to collect unpaid dividends from earlier years, reporting the proceeds as revenue above-the-line. However, according to ESA2010 accounting standards these are super-dividends, not revenue, and should be reported below-the-line as a withdrawal of equity.

SOE Dividends Paid to the Republican Budget

(Percent of GDP)



Sources: MOF Serbia, IMF staff calculations.

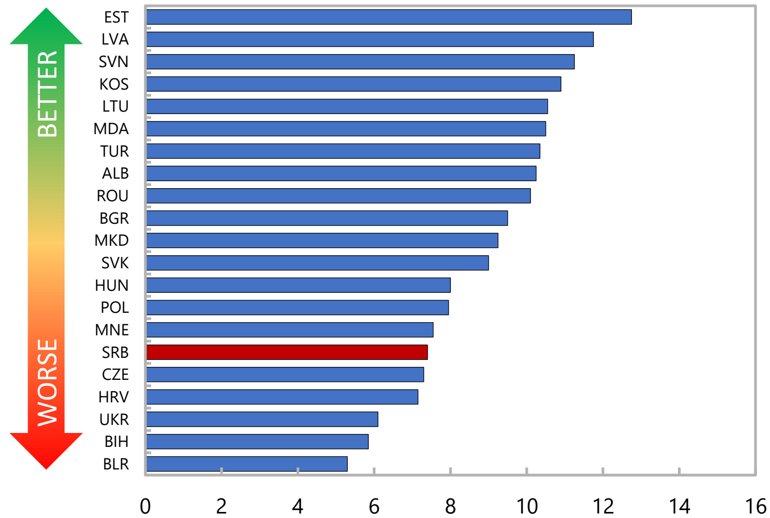
14. Serbia established a fiscal risk unit within the Ministry of Finance in 2015 and SOEs submit financial reports, but the full range of risks stemming from SOEs have not been assessed.[5] To date, key performance indicators (KPIs) have not been established, set, or monitored. The country does not have an arms-length financial relationship with SOEs and over the last 10 years SOEs have annually cost the budget about 1.9 percent of GDP (see Budget Costs below).[6] Finally, Serbia does not have explicit legislation regarding non-commercial mandates of SOEs.

[5] The Fiscal Strategy includes some information about the financial status of Republican-level public enterprises as part of the fiscal risks section. An analysis of 26 republican level public enterprises was written (but not published) in May 2016 as a one-off exercise.

[6] In net terms, SOEs cost the budget about 1.5 percent of GDP per year.

15. Overall, Serbia performs poorly in SOE governance. In a composite index created by IMF staff, Serbia received a score of 7.4 out of a maximum of 16.5.[7] Serbia exhibits shortcomings in all three areas, with the largest gaps in ownership and governance frameworks and fiscal and policy interactions.

Composite SOE Governance Index

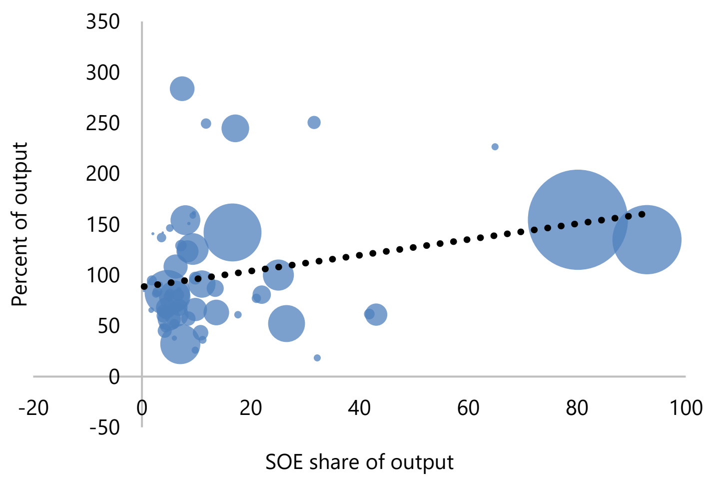


Source: Richmond et al. (2019).

SOE Performance

16. Across the CESEE region, we find that large SOE presence contributes to more resource misallocation.[8] Within sectors, we find a positive relationship between the degree of misallocation[9] and the share of output produced by SOEs. This relationship also holds when the SOE footprint is measured as the SOE share of total employment and is present across both industrial and service sectors. This indicates that by reducing, or eliminating, distortions in SOEs there can be large potential TFP and output gains.

Serbia: Misallocation



Note: Each bubble is a NACE rev2 (2-digit) Bubble size is SOE value-added of the NACE rev2 (2-digit) sector.
Sources: SBRA, Benkovskis and Richmond (2019), Richmond et al. (2019), IMF staff calculations.

17. Labor misallocation is a larger problem for SOEs. In aggregate terms, in 2016 SOEs should have reduced capital by about 20 percent and reduced labor by around 30 percent. The reduction of each factor is non-trivial and suggests a large downsizing of

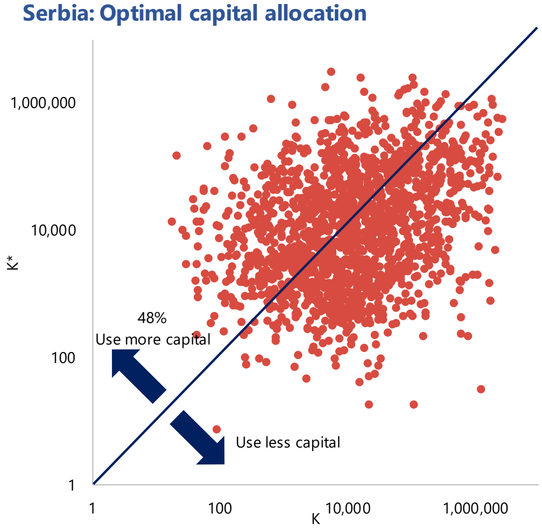
[7] The SOE governance index covers ownership policy, financial oversight, and fiscal and policy interactions. It provides a snapshot of stated policies (self-assessed by country authorities) in place in 2018. See Richmond et al. (2019), Annex 9 for further details.

[8] This analysis follows the methodology of Hsieh and Klenow (2009).

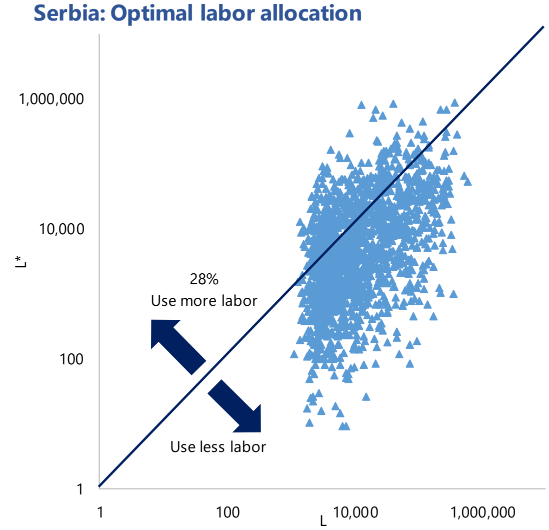
[9] Misallocation is presented as the potential output gains from reallocation.

the state's capital and labor footprint is needed. At the individual SOE level, 48 percent of SOEs should increase capital, while only 28 percent of SOEs should expand labor inputs. Our result is in line with the findings of higher wages and overall employment cost shares compared to the private sector. It is also consistent with the general view that political considerations influence hiring decisions at all levels and leads to overstaffing—particularly unskilled workers—while greater job security results in less motivated employees and contributes to lower labor productivity.

Serbia: Optimal capital allocation



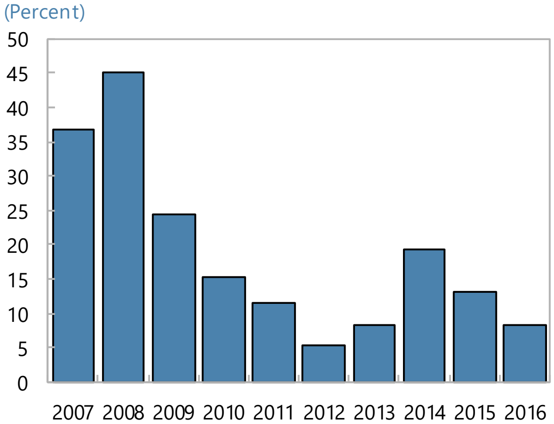
Serbia: Optimal labor allocation



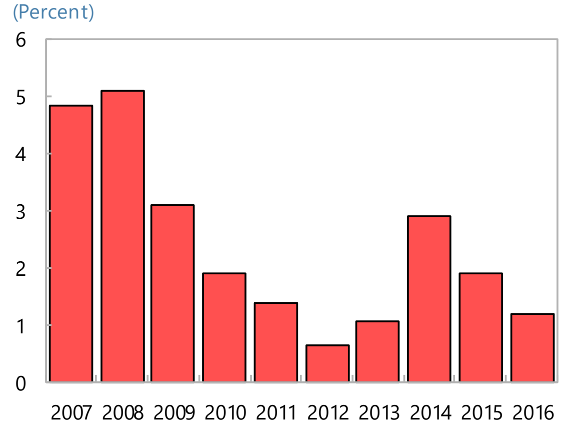
Source: SBRA; Benkovskis and Richmond (2019); Richmond et al. (2019).
Note: Each dot represents an individual SOE. SOEs above the 45 degree line should utilize more of the factor of production.

18. There can be large output gains from improving SOEs. We calculate the output gains under a hypothetical exercise of SOEs adopting the same revenue productivity (TFPR) distribution

Serbia: SOE output gains from moving to private TFPR
(Percent)



Serbia: Aggregate output gains from moving to private TFPR
(Percent)



Sources: SBRA, IMF staff calculations based on Benkovskis and Richmond (2019).

as private firms.[10] We find a large effect on SOE output—in 2016, gains would have been about 8 percent—and economywide there would be a 1 percent permanent increase in aggregate output. These findings underscore the view that if SOEs are to continue to operate inefficiently, the costs and benefits of SOEs should be better assessed.

Budget Costs

19. At the same time, SOEs and SOBs have imposed large fiscal costs to the budget. During the past ten years, Serbia has relied on five main fiscal mechanisms to support SOEs and SOBs:

i. *Direct budget subsidies.* The largest beneficiary were the railways, followed by coal mines. Subsidies to companies undergoing privatization have falling significantly over the period, as some of the most problematic companies have been either sold or bankrupted.

ii. *Municipalities also provide large subsidies to SOEs.* These mostly relate to local public enterprises, such as public transportation, water and waste disposal companies, reflecting poor collection and, sometimes, low prices for services.

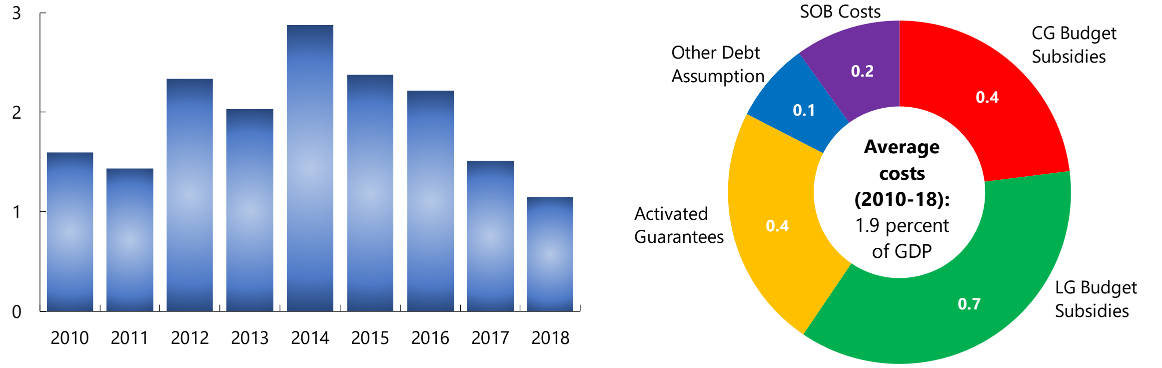
iii. *In several cases, the government opted to provide bank guarantees.* Sometimes this reflected a belief in the firm's creditworthiness, but more often to reduce subsidies from the budget and record a lower fiscal deficit. However, under IMF-supported programs since 2015, the government has treated called guarantees as part of the deficit and guaranteed debt is recorded in general government debt.

iv. *In a few cases, the government took on SOE debts even when no guarantee had been issued.* This was either done to facilitate a strategic partnership agreement (Air Serbia), or to continue the supply of energy for key companies. Under IMF-supported programs, these transactions were recorded above the line.

v. *SOBs have had direct budget costs.* During 2012-14 the fiscal cost of resolution of four failed banks reached nearly 2 percent of GDP, with the government paying out all insured and uninsured deposits in an effort to minimize contagion.

[10] See Richmond et al. (2019), Annex 4. This exercise does not take into account the general equilibrium effects of improving SOE productivity, which could result in the SOE sector becoming larger.

Serbia: Total Fiscal Cost of SOEs/SOBs
(Percent of GDP)



Sources: Ministry of Finance Serbia; IMF staff calculations.

20. SOE arrears are also tolerated. For example, the largest SOEs have accumulated about 0.3 percent of GDP in tax and contribution arrears during 2016-2018, and arrears of the 10 largest SOEs to the state electricity company amount to 0.4 percent of GDP. Many SOEs were also legally protected from all creditors (between 2001 and 2015).

Policy Recommendations and Conclusions

21. Serbia has a relatively large SOE sector, which has been a drag on growth and brought large fiscal costs. At the same time, Serbia's SOE governance shows significant gaps against OECD best practices, with room to improve SOE governance frameworks across all dimensions. In general, more transparency, assessment, and reporting are needed. At the end of the day improving the governance and performance of SOEs will be challenging and will require a strong political commitment.

22. Some actions that should be considered in the short- and medium-run are:

- Take stock and publish a comprehensive list of SOEs because without knowing the full picture it will be difficult to make fully-informed decisions regarding SOE operations.
- Adopt an ownership policy document, including ownership objectives, financial and public policy targets, reporting guidelines, and guidelines for boards of directors.
- Adopt a formal dividend policy.
- Expand capacity to analyze fiscal risks of SOEs and set monitorable KPIs.
- Justify objectives better and reassess at regular intervals to ensure that public policy objectives are being met.

- Permit hiring of competent staff (not based on political affiliation) and reduce redundant staff to improve performance.

- Implement existing legislation and appoint permanent, professional management.

- Reevaluate government presence in at least some sectors, making use of ownership information and objectives. In cases where there is no viable future, operations should be wound down or privatized (especially during good times). In the case of strategic national interests, better, professional management should be employed to improve efficiency and performance.

- Open some sectors to competition (as has already happened in telecommunications and oil production).

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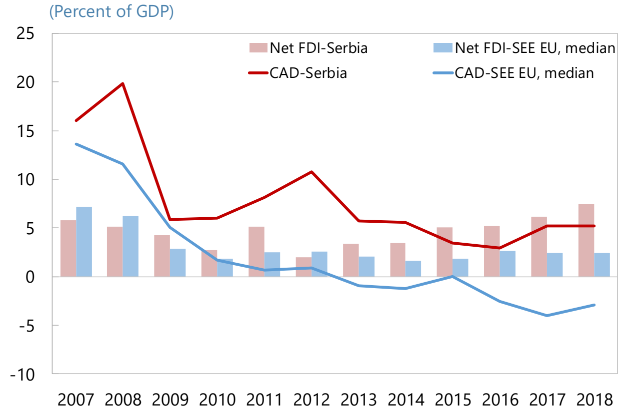
Annex III. External Sustainability Assessment

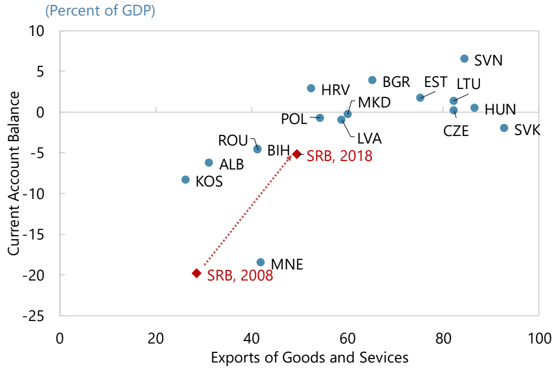
1. **Serbia's external balances have improved significantly since the global financial crisis, although the trend has somewhat reversed in the most recent years, partially on the back of ongoing investment cycle.** The current account deficit substantially narrowed following the global financial crisis—due mainly to higher exports—from 21 percent of GDP in 2008 to a low of 2.9 percent of GDP in 2016. Since then, Serbia's current account deficit inched up to 5.2 percent of GDP with FDI consistently exceeding the current account deficit for the past four years. In addition, private transfers remain substantial and stood at 8 percent of GDP in 2018. While diversified and stable, half of private transfers originate from Germany, Switzerland and Austria.

Current Account Deficit and Foreign Direct Investment
(Percent of GDP)



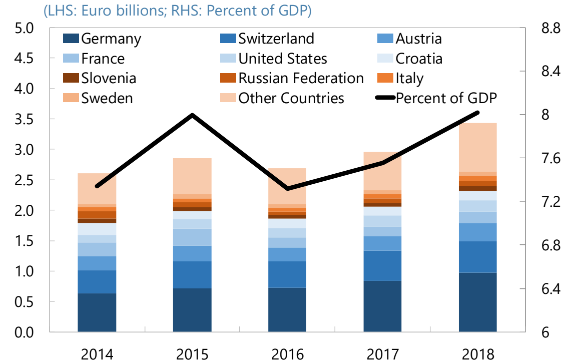
Sources: IMF, WEO database; and IMF staff calculations.

Current Account and Exports of Goods and Services, 2018
(Percent of GDP)



Source: IMF, WEO database.

Total Personal Transfers
(LHS: Euro billions; RHS: Percent of GDP)

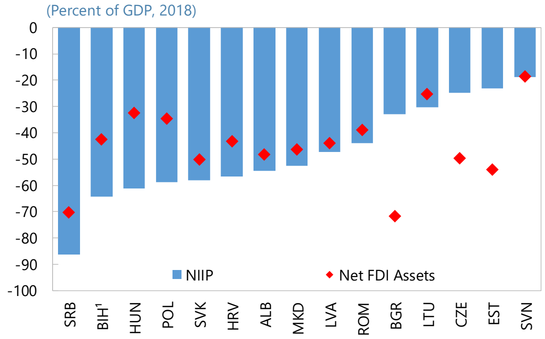


Sources: Haver Analytics; National Bank of Serbia; and IMF staff calculations.

2. **Serbia's net international investment position (NIIP) remains highly negative but has improved recently.** Serbia's NIIP is estimated at -87 ½ percent of GDP in 2018 after reaching -95 percent in 2015 and remains below the average for countries in the region (-55 percent of GDP). Yet, the structure has to be taken into account. FDI inflows have contributed to the buildup of equity with net FDI liabilities—the main IIP component—standing at 74 percent of GDP in 2018. The recent decrease in Serbia's net foreign liabilities has been largely driven by a significant drop in total gross external debt to 62 percent of GDP in 2018 (see Annex 5). Meanwhile, FDI inflows also contributed to intercompany lending with intercompany debt amounting to 13 percent of GDP in 2018 (1/5 of external debt). Local currency debt held by non-residents remained at or below 6 percent of GDP. In terms of maturity, nearly all net foreign

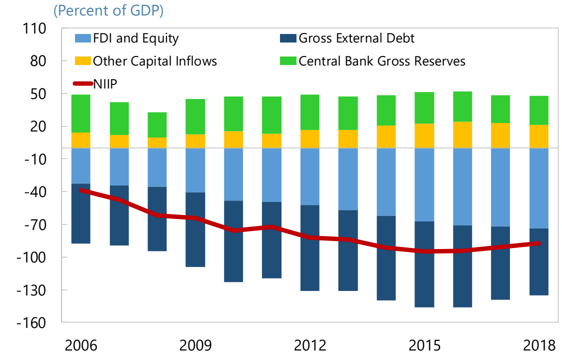
liabilities in Serbia are long-term. Despite the absence of significant short-term rollover risks, an average of 7 ½ percent of GDP is scheduled to be repaid each year during 2019-2021. Finally, Serbia's has an adequate international reserve position with official reserves within the recommended bounds of the IMF reserve adequacy metric.[1]

Net International Investment Position
(Percent of GDP, 2018)



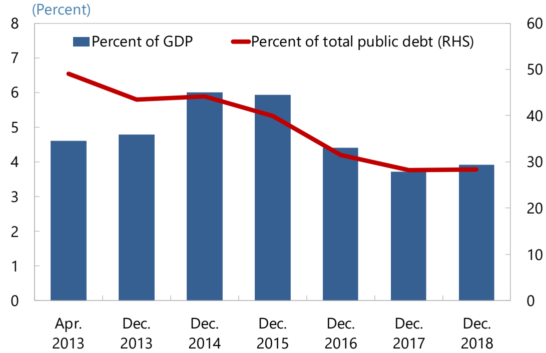
Sources: IMF, BOP and IIP Database; IMF, WEO Database; and IMF Staff calculations.
1/ Data for 2017.

Serbia: Net International Investment Position
(Percent of GDP)



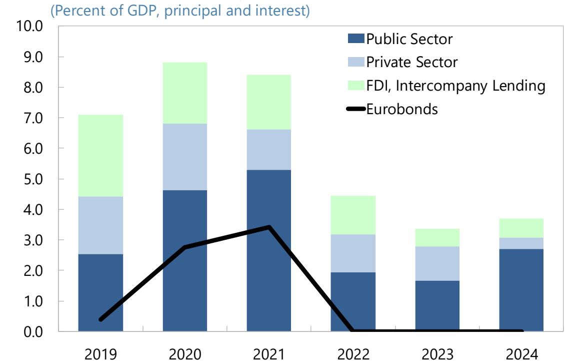
Sources: Country Authorities; and IMF Staff calculations.

Non-Resident Participation in LC Debt
(Percent)



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

External Debt: Repayment Schedule
(Percent of GDP, principal and interest)



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

3. The EBA-Lite methodology suggests that the external position is broadly consistent with fundamentals and desirable policy settings, but subject to vulnerabilities.

[1] Gross reserves at end-2018 correspond to 113 percent of the ARA metric (assuming the current stabilized de facto exchange rate classification). Reserves in the range of 100-150 percent of the composite metric are considered adequate for precautionary purposes. See IMF, "Assessing Reserve Adequacy", 2011,"Assessing Reserve Adequacy-Further Considerations", 2013 and "Assessing Reserve Adequacy—Specific Proposals", 2015.

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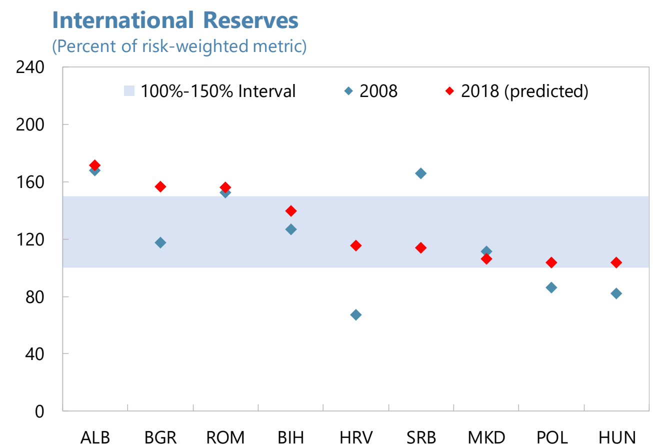
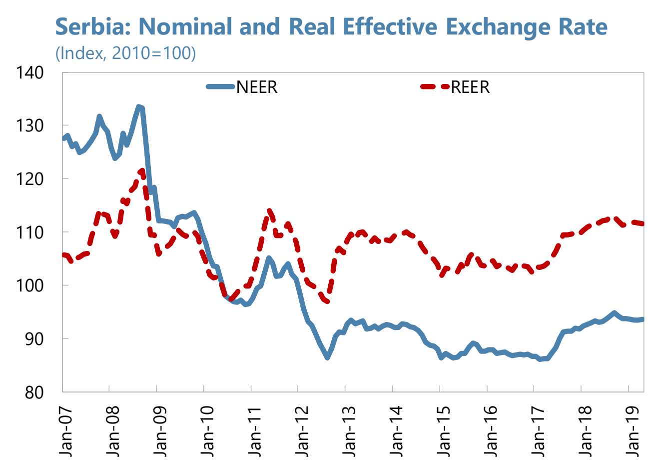
- **The current account (CA) approach.** This approach estimates Serbia's current account norm at -4.6 percent of GDP, suggesting an exchange rate broadly consistent with fundamentals. The model predicts a slightly negative current account balance mostly due to (i) low productivity relative to others which contributes to a greater current account deficit, (ii) a negative NFA position contributing to higher income expenses[2], (iii) which is partially offset by low actual public health expenditure which contributes to a narrower current account deficit. Public health expenditures are a *proxy* for social insurance policies which tend to be low in developing economies. This policy gap helps account for the estimated current account norm.



Source: IMF Staff calculations.

- **The real effective exchange rate (REER) approach.** Consistent with the CA approach, the REER approach yields a positive real exchange rate gap and points to the need for a slightly more depreciated exchange rate (though there is no contribution from a policy gap).

- **The external stability (ES) approach.** This approach focuses on the scenario where the goal is to bring the NIIP close to regional level of -55 percent of GDP[3]. This methodology takes into account the currency of denomination of assets (100 percent) and liabilities (55 percent). This methodology suggests that a real exchange rate depreciation of 3 percent would help stabilize the NIIP at lower levels.



Source: IMF, INS database.

[2] The regression behind this model suggests a small positive coefficient between NFA and current account putting more weight on the theory that high external liability position suggest higher income expenses and, therefore, higher current account deficit.

[3] Consistent with the revised External Sustainability methodology (deterministic approach).

EBA-Lite Estimates of Current Account Norm and Exchange Rate Gap

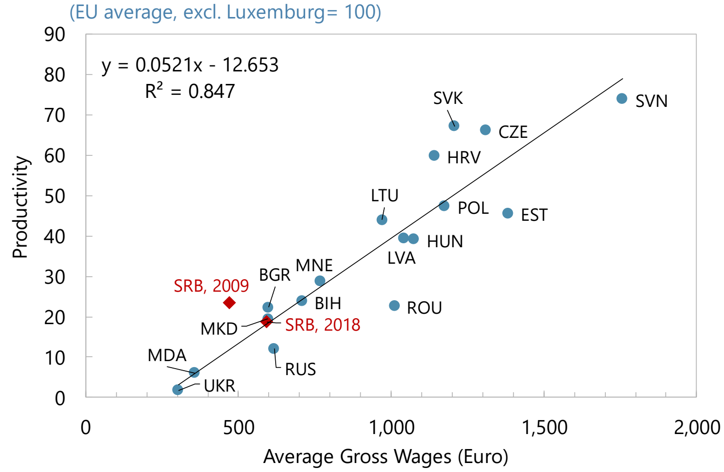
	External Sustainability 1/	Current Account	Real Effective Exchange Rate
Underlying current account	-	-5.5	-
Current account norm	-	-4.6	-
REER gap	3.0	2.1	12.1

Note: The underlying CA is the 2018 cyclically adjusted CA.
1/ Stabilizing NFA/GDP at the regional level of -55%.

4. Further reducing the share of net foreign *debt* liabilities in Serbia's NIIP position requires continuous effort to reduce the current account deficit, attract foreign investment and improve competitiveness. In staff's view, this could be supported by structural reforms that can further improve export competitiveness, widen the export base and increase the currently low labor productivity. Furthermore, continuing with reforms to ease doing business would help attract more foreign direct investment, which could also increase the productivity of the tradable sector. These reforms should be supported by a prudent fiscal policy over the medium term to increase public savings and preserve wage competitiveness.

Wages and Labor Productivity, 2018

(EU average, excl. Luxemburg= 100)



Sources: Haver Analytics; IMF, World Economic Outlook; and IMF staff calculations.

Annex IV. Public Debt Sustainability Analysis

Staff assesses Serbia's public debt to be sustainable with high probability. After a material reduction in 2017 (-10 percentage points compared to 2016), debt continued to fall in 2018 and is projected to remain on a firm downward path. Public gross financing needs have moderated and are expected to continue decreasing as a prudent fiscal deficit target is maintained. Projections are subject to risks stemming from a possible loss of fiscal discipline, slowdown in growth, and pressures on the exchange rate.

1. General government debt has been on a downward trajectory since 2016.[1] General government debt increased rapidly following the global financial crisis, due to a combination of expansionary fiscal policies, sluggish output growth, a rise in government guarantees, high real interest rates and a significant exchange rate depreciation. Public debt peaked at 76 percent of GDP in 2015, and fell thereafter, in part as a result of the fiscal adjustment achieved under the precautionary SBA and continued fiscal discipline under the current program. At end-2018, public debt stood at 54.4 percent of GDP, compared to 58.4 projected in the last DSA.[2] The fiscal primary surplus and economic growth contributed the most to debt reduction. The authorities repaid a USD 1 billion Eurobond maturing at end-2018 and conducted two buy-back operations of (expensive) three-years bonds maturing in 2019 worth approximately RSD 20 billion. The stock of outstanding external indirect liabilities was reduced also through commercial operations, including the sale of the mining company RTB.

2. The shares of foreign currency debt and debt held by non-residents are high, but mitigating factors matter. Debt held by non-residents accounted for 58 percent of the total, and the share of debt denominated in foreign currencies for 73 percent. While these ratios are high vis-à-vis risk assessment benchmarks, they have been consistently declining since 2016. Also, the majority of external debt is owed to multilateral and bilateral creditors, mitigating rollover risks. The share of total debt with fixed interest rates is around 81 percent, and the residual maturity is above 2 years for about 73 percent of outstanding debt. Gross financing needs have been declining, owing to fiscal prudence and an ongoing shift towards longer-term debt instruments.

3. The DSA baseline is in line with staff macroeconomic projections. Real GDP grew by 4.3 percent in 2018, the fastest rate in 10 years. Growth projections in 2019 and beyond remain unchanged compared to the previous DSA, though downside risks have increased reflecting a slowdown in Serbia's main trading partners. The output gap is expected to close in the medium-term and inflation to stay within the tolerance band of the NBS. The primary fiscal balance recorded a surplus of 0.6 percent of GDP in 2018, in line with staff projections. The 2019 budget

[1] General government debt includes public guarantees covering SOE debt, local governments, and other entities.

[2] Revised national accounts data were released in October 2018, resulting in about 6 percent higher nominal GDP over 2015–2017 (see Box 1 in Country Report 18/375). This explains part of the difference compared to the previous DSA.

is consistent with a planned medium-term fiscal deficit of approximately 0.5 percent of GDP. This target aims to reduce public debt to about 50 percent of GDP by 2021 – and keep it under 50 percent thereafter – and increase fiscal buffers, while allowing for adequate capital spending to address Serbia's large infrastructure needs.

4. Macro-fiscal stress tests highlight risks from low growth, loose fiscal policy, and a weak exchange rate. Under the baseline, debt and gross financing needs ratios are projected to continue declining. Alternative stress tests scenarios suggest that shocks to growth, the primary balance and the exchange rate would have the largest impact, while consequences from shocks to the interest rate are minor. The positive outlook for both debt and financing needs hinges on continued fiscal discipline. Reverting to the average fiscal stance of the last 10 years would result in a significant worsening of these metrics, as illustrated in the historical scenario of the DSA. This conclusion is underscored also by the asymmetric distribution of debt fan charts assuming no positive shocks to the primary balance.

5. Forecast errors are in line with other market access countries under a program, and the envisaged fiscal stance is realistic. Past forecast errors for real GDP growth are explained by sharp output contractions amid the global financial crisis in 2009, and by severe weather shocks with negative repercussions for agricultural output and energy production in 2012 and 2014. Forecast errors in primary balance projections have been positive in recent years, reflecting larger consolidation than budgeted. The DSA assumes a fiscal multiplier of 0.5, approximately in the middle of the range of values found in the literature, and appropriate for economies that are smaller and more open. The projected 3-year average level of the cyclically adjusted primary balance remains comfortably below the top quartile of the distribution, while the projected adjustment is around zero, in line with a broadly neutral fiscal impulse over the medium-term.

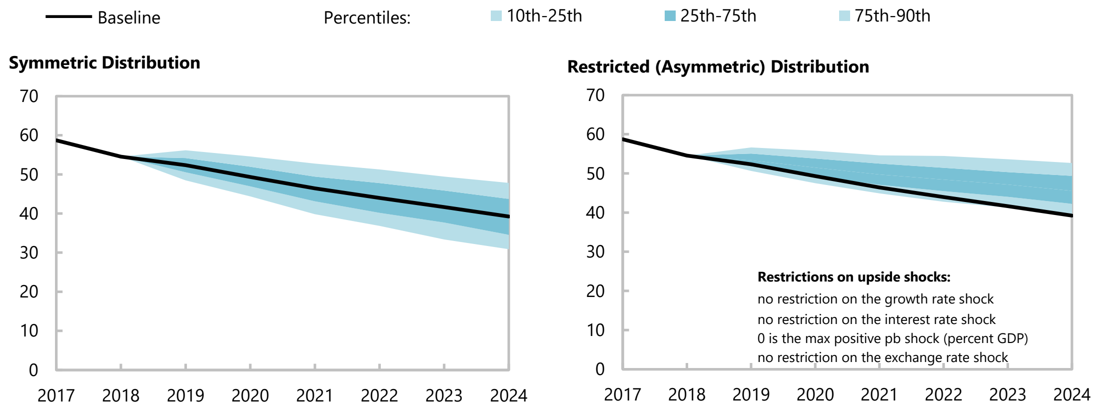
Figure 1. Serbia: Public Sector Debt Sustainability Analysis (DSA) – Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

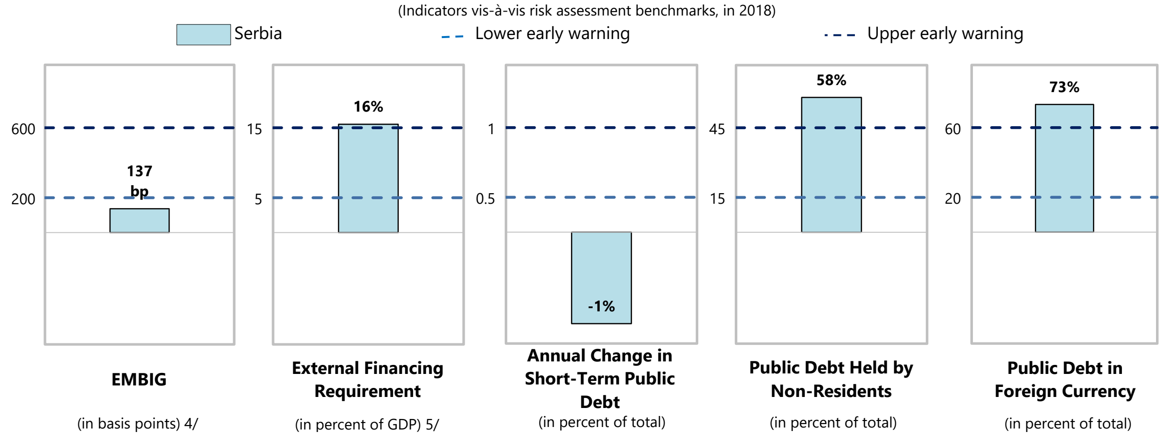
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

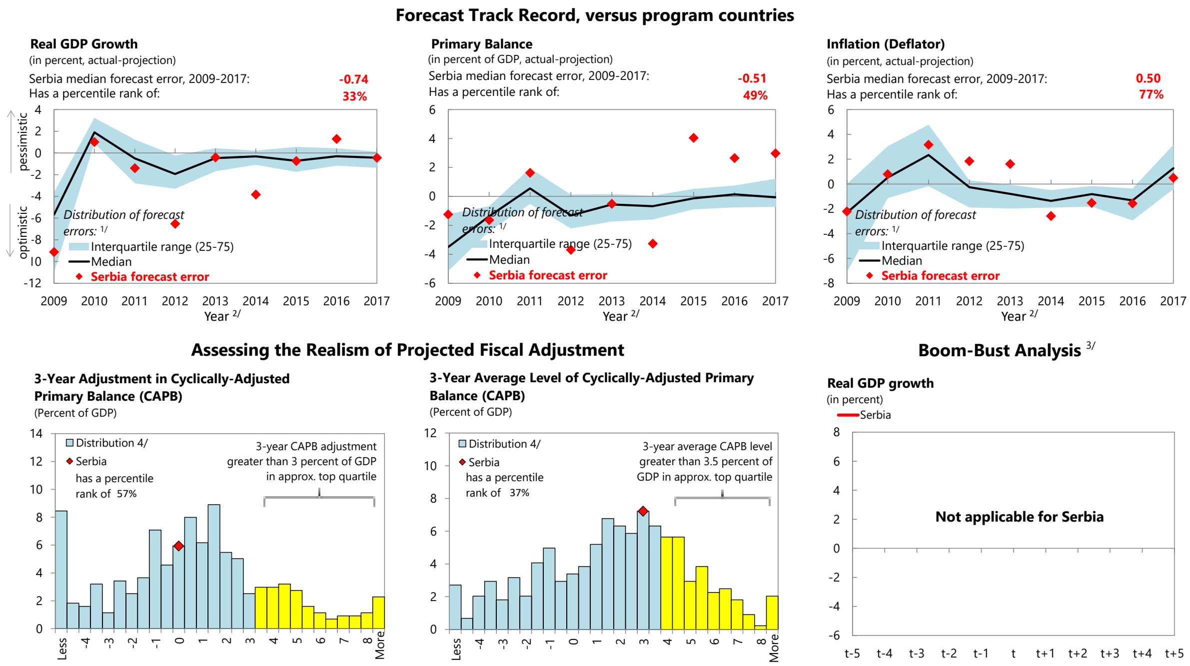
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 13-Dec-18 through 13-Mar-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Serbia: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Serbia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Serbia: Public DSA – Baseline Scenario

(in percent of GDP unless otherwise indicated)

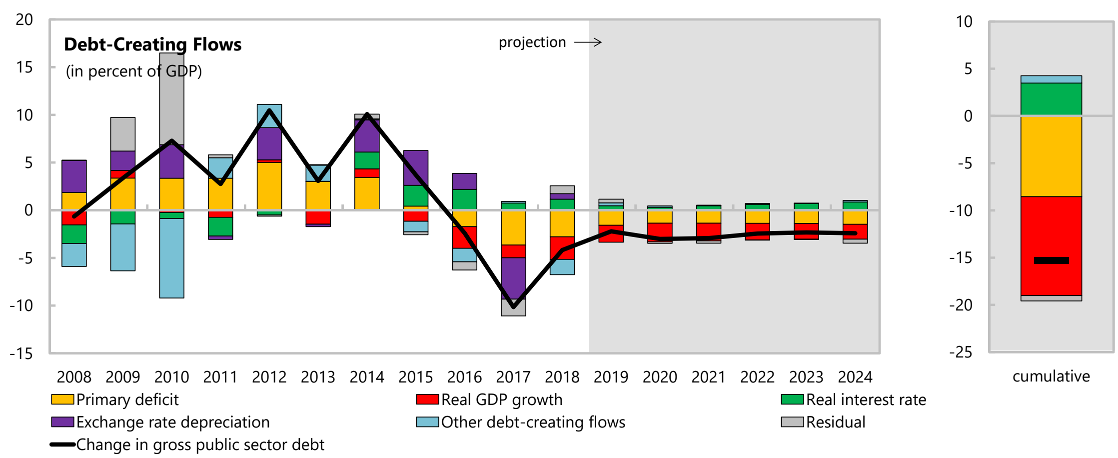
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2008-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	52.2	58.7	54.5	52.3	49.3	46.4	44.0	41.6	39.2
Of which: guarantees	6.1	4.4	3.6	4.2	3.9	3.6	3.3	3.1	2.9
Public gross financing needs	12.3	9.0	9.4	8.2	8.3	8.0	6.8	6.4	6.3
Real GDP growth (in percent)	1.3	2.0	4.3	3.5	4.0	4.0	4.0	4.0	4.0
Inflation (GDP deflator, in percent)	5.4	3.0	2.0	3.3	3.5	3.3	3.2	3.3	3.3
Nominal GDP growth (in percent)	6.8	5.2	6.4	6.9	7.6	7.4	7.4	7.4	7.4
Effective interest rate (in percent) [4]	4.3	4.3	4.2	4.3	4.3	4.5	4.8	5.1	5.6

As of March 13, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		131
5Y CDS (bp)		104
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	BB	BB
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	4.2	-10.2	-4.2	-2.2	-3.0	-2.9	-2.4	-2.3	-2.4	-15.3	
Identified debt-creating flows	2.8	-8.4	-5.0	-2.6	-2.8	-2.7	-2.4	-2.3	-2.0	-14.8	
Primary deficit	2.5	-3.6	-2.8	-1.6	-1.4	-1.4	-1.4	-1.4	-1.5	-8.5	-0.5
Primary (noninterest) revenue and grant	39.2	41.5	41.6	40.8	40.1	39.8	39.6	39.4	39.3	239.1	
Primary (noninterest) expenditure	41.6	37.9	38.8	39.3	38.7	38.5	38.3	38.0	37.8	230.6	
Automatic debt dynamics [5]	1.6	-4.9	-0.6	-1.3	-1.6	-1.4	-1.1	-0.9	-0.7	-7.0	
Interest rate/growth differential [6]	-0.6	-0.6	-1.2	-1.3	-1.6	-1.4	-1.1	-0.9	-0.7	-7.0	
Of which: real interest rate	0.0	0.8	1.2	0.5	0.3	0.5	0.6	0.7	0.9	3.5	
Of which: real GDP growth	-0.6	-1.3	-2.4	-1.8	-1.9	-1.8	-1.7	-1.6	-1.6	-10.5	
Exchange rate depreciation [7]	2.3	-4.3	0.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.3	0.2	-1.6	0.3	0.1	0.1	0.1	0.0	0.2	0.8	
Privatization/Drawdown of Deposits (+	-2.0	1.4	-1.0	0.0	0.1	0.1	0.1	0.0	0.2	0.4	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify) (+ i	0.7	-1.2	-0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.4	
Residual, including asset changes [8]	1.4	-1.8	0.8	0.4	-0.2	-0.3	0.0	0.0	-0.4	-0.5	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as .

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

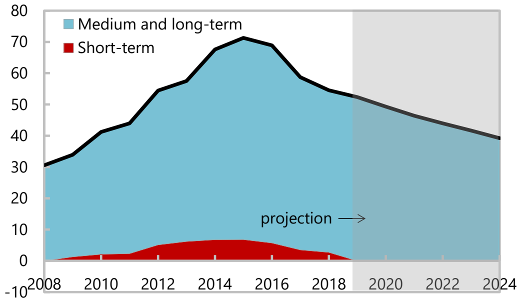
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

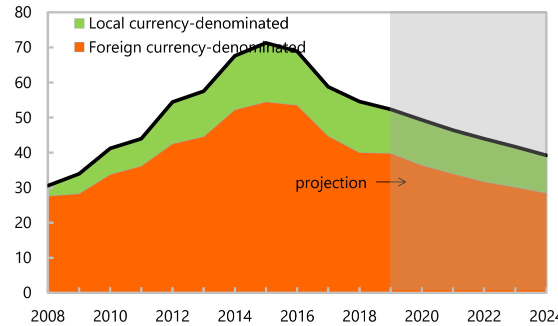
Figure 4. Serbia: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



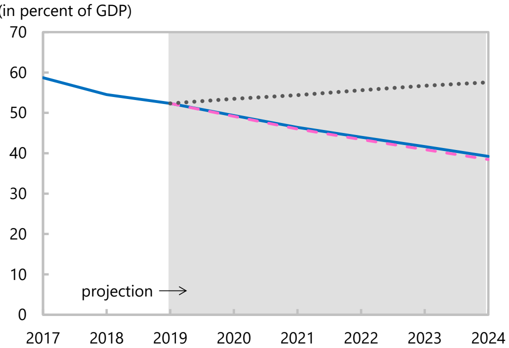
By Currency
(in percent of GDP)



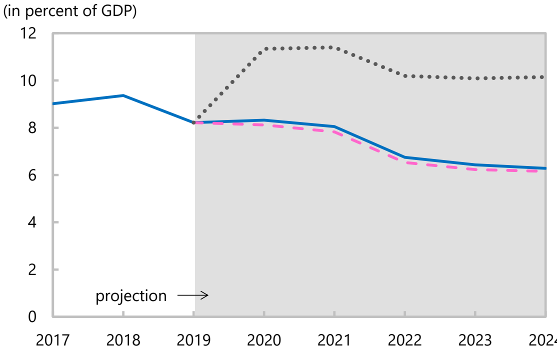
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

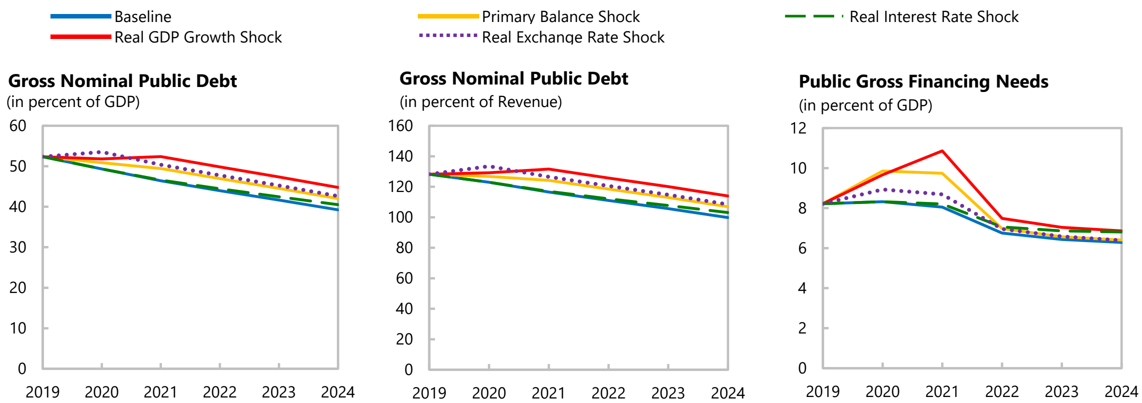
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.5	4.0	4.0	4.0	4.0	4.0
Inflation	3.3	3.5	3.3	3.2	3.3	3.3
Primary Balance	1.6	1.4	1.4	1.4	1.4	1.5
Effective interest rate	4.3	4.3	4.5	4.8	5.1	5.6
Constant Primary Balance Scenario						
Real GDP growth	3.5	4.0	4.0	4.0	4.0	4.0
Inflation	3.3	3.5	3.3	3.2	3.3	3.3
Primary Balance	1.6	1.6	1.6	1.6	1.6	1.6
Effective interest rate	4.3	4.3	4.5	4.8	5.2	5.7

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.5	1.2	1.2	1.2	1.2	1.2
Inflation	3.3	3.5	3.3	3.2	3.3	3.3
Primary Balance	1.6	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	4.3	4.3	4.1	4.0	3.9	4.0

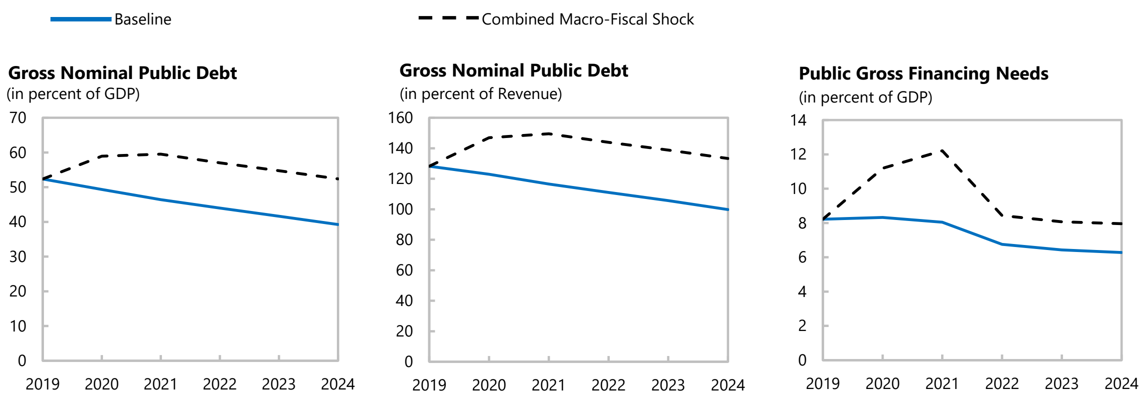
Source: IMF staff.

Figure 5. Serbia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	3.5	4.0	4.0	4.0	4.0	4.0
Inflation	3.3	3.5	3.3	3.2	3.3	3.3
Primary balance	1.6	-0.2	-0.2	1.4	1.4	1.5
Effective interest rate	4.3	4.3	4.5	4.8	5.1	5.6
Real Interest Rate Shock						
Real GDP growth	3.5	4.0	4.0	4.0	4.0	4.0
Inflation	3.3	3.5	3.3	3.2	3.3	3.3
Primary balance	1.6	1.4	1.4	1.4	1.4	1.5
Effective interest rate	4.3	4.3	4.9	5.5	6.1	6.9
Combined Shock						
Real GDP growth	3.5	1.7	1.7	4.0	4.0	4.0
Inflation	3.3	2.9	2.7	3.2	3.3	3.3
Primary balance	1.6	-0.2	-0.8	1.4	1.4	1.5
Effective interest rate	4.3	4.6	4.6	5.2	5.7	6.4

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	3.5	1.7	1.7	4.0	4.0	4.0
Inflation	3.3	2.9	2.7	3.2	3.3	3.3
Primary balance	1.6	0.3	-0.8	1.4	1.4	1.5
Effective interest rate	4.3	4.3	4.5	4.8	5.1	5.5
Real Exchange Rate Shock						
Real GDP growth	3.5	4.0	4.0	4.0	4.0	4.0
Inflation	3.3	7.7	3.3	3.2	3.3	3.3
Primary balance	1.6	1.4	1.4	1.4	1.4	1.5
Effective interest rate	4.3	4.6	4.3	4.6	4.9	5.4

Source: IMF staff.

Annex V. External Sector Debt Sustainability Analysis

External debt is assessed to be sustainable over the medium term, but subject to risks. In a scenario of continued fiscal adjustment, the current account deficit would decline further and would be fully financed by foreign direct investment inflows. This would allow the country to continue to put external debt on a firm downward path over the medium term. External financing needs would nevertheless remain high and constitute a risk. Moreover, the debt path is particularly sensitive to real exchange rate shocks, given that most of external debt is denominated in foreign currency. A reversal in fiscal adjustment could also deteriorate debt dynamics as interest rates and the current account deficit would increase, and economic activity would likely slow down.

1. **Total external debt has declined to its pre-crises level after peaking at almost 80 of GDP in 2012 and is projected to gradually decrease further over the medium-term.** With a lasting private sector deleveraging that took place over 2010-2015 coming to a halt, public sector deleveraging took over during the 2016-2018 period. Supported by fiscal consolidation, public sector borrowing is projected to continue to decelerate while the private sector resumes its deleveraging trend. Overall, total external debt and gross financing needs are expected to decrease gradually over the medium term, reaching 39.9 and 11.3 percent of GDP respectively by 2024.

2. **The main driver of the projected reduction in external debt is a contraction in the current account deficit.** In the medium term, the current account deficit before interest is assumed to decrease from 4.2 percent of GDP in 2019 to 2.8 percent of GDP in 2024. FDI is projected to remain above 5 percent of GDP throughout the medium term while economic growth is expected to recover reaching a level of 4 percent. As shown in alternative scenarios, if the current account, growth, interest rates, and real exchange rate depreciation remain at historical levels, external debt would be expected to remain on an increasing trajectory throughout the projection period, reaching 66.7 percent of GDP by 2024.

3. **The external debt path is particularly sensitive to real exchange rate depreciation shocks.** As shown in the shock scenarios, a 30 percent real depreciation would cause external debt to reach 81.5 percent of GDP during the first year and to stabilize at 58.8 percent of GDP by 2024.

4. **A reversion in fiscal adjustment measures could also have a significant impact on external debt dynamics.** This could lead to higher current account deficits, higher interest rates and a slowdown in economic activity, a situation illustrated by the combined shock scenario. An exchange rate depreciation, also likely in the absence of fiscal adjustment, would deteriorate prospects of external debt sustainability even further.

Serbia: External Debt Sustainability Framework, 2014–2025

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6
1 **Baseline: External debt**	77.9	78.7	75.7	67.2	61.7			**58.3**	**55.1**	**51.8**	**47.8**	**43.8**	**39.9**	**-7.0**
2 Change in external debt	3.5	0.9	-3.0	-8.5	-5.5			-3.4	-3.2	-3.3	-4.0	-4.0	-3.9	
3 Identified external debt-creating flows (4+8+9)	4.1	11.8	-4.2	-6.7	-10.4			-2.6	-3.0	-2.4	-2.6	-2.9	-2.8	
4 Current account deficit, excluding interest payments	3.3	0.9	0.3	3.1	3.6			4.2	3.7	3.7	3.4	2.9	2.8	
5 Deficit in balance of goods and services	10.3	8.2	6.0	7.7	9.7			9.9	9.3	8.6	8.1	7.7	7.2	
6 Exports	40.7	44.0	47.3	49.3	49.6			50.4	51.7	53.2	54.8	56.6	58.4	
7 Imports	51.0	52.2	53.4	57.1	59.4			60.3	61.0	61.7	62.9	64.2	65.6	
8 Net non-debt creating capital inflows (negative)	-3.5	-4.9	-5.1	-6.1	-7.3			-6.1	-5.9	-5.4	-5.4	-5.4	-5.4	
9 Automatic debt dynamics 1/	4.2	15.8	0.5	-3.7	-6.7			-0.7	-0.8	-0.7	-0.5	-0.4	-0.2	
10 Contribution from nominal interest rate	2.3	2.6	2.6	2.1	1.6			1.4	1.4	1.4	1.4	1.4	1.4	
11 Contribution from real GDP growth	1.2	-1.6	-2.6	-1.4	-2.5			-2.1	-2.1	-2.0	-1.9	-1.8	-1.6	
12 Contribution from price and exchange rate changes 2/	0.7	14.9	0.5	-4.4	-5.7			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.6	-10.9	1.2	-1.8	4.9			-0.8	-0.2	-0.9	-1.4	-1.1	-1.1	
External debt-to-exports ratio (in percent)	191.2	178.8	159.9	136.2	124.2			115.5	106.5	97.4	87.2	77.4	68.3	
Gross external financing need (in billions of US dollars) 4	8.0	4.0	4.6	5.1	7.1			9.1	11.0	12.3	10.6	10.1	8.6	
in percent of GDP	16.9	10.0	11.4	11.5	14.0	10-Year	10-Year	17.5	19.3	20.1	16.1	14.3	11.3	
Scenario with key variables at their historical averages 5/								**58.3**	**61.3**	**63.4**	**64.6**	**66.1**	**67.7**	**-2.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-1.6	1.8	3.3	2.0	4.3	1.5	2.6	3.5	4.0	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	-1.2	-17.3	-0.8	6.4	9.8	-1.0	12.8	0.0	4.3	3.6	3.6	3.4	3.6	
Nominal external interest rate (in percent)	3.0	2.8	3.4	3.1	2.7	3.0	0.3	2.4	2.5	2.7	2.9	3.1	3.4	
Growth of exports (US dollar terms, in percent)	3.4	-8.9	10.2	13.1	15.2	6.3	14.6	5.1	11.2	10.9	11.0	11.0	11.2	
Growth of imports (US dollar terms, in percent)	1.6	-13.8	4.8	16.1	19.1	2.1	16.2	5.1	9.7	9.1	9.8	9.7	10.1	
Current account balance, excluding interest payments	-3.3	-0.9	-0.3	-3.1	-3.6	-3.7	2.3	-4.2	-3.7	-3.7	-3.4	-2.9	-2.8	
Net non-debt creating capital inflows	3.5	4.9	5.1	6.1	7.3	4.4	1.6	6.1	5.9	5.4	5.4	5.4	5.4	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP

3/ For projection, line includes the impact of price and exchange rate changes.

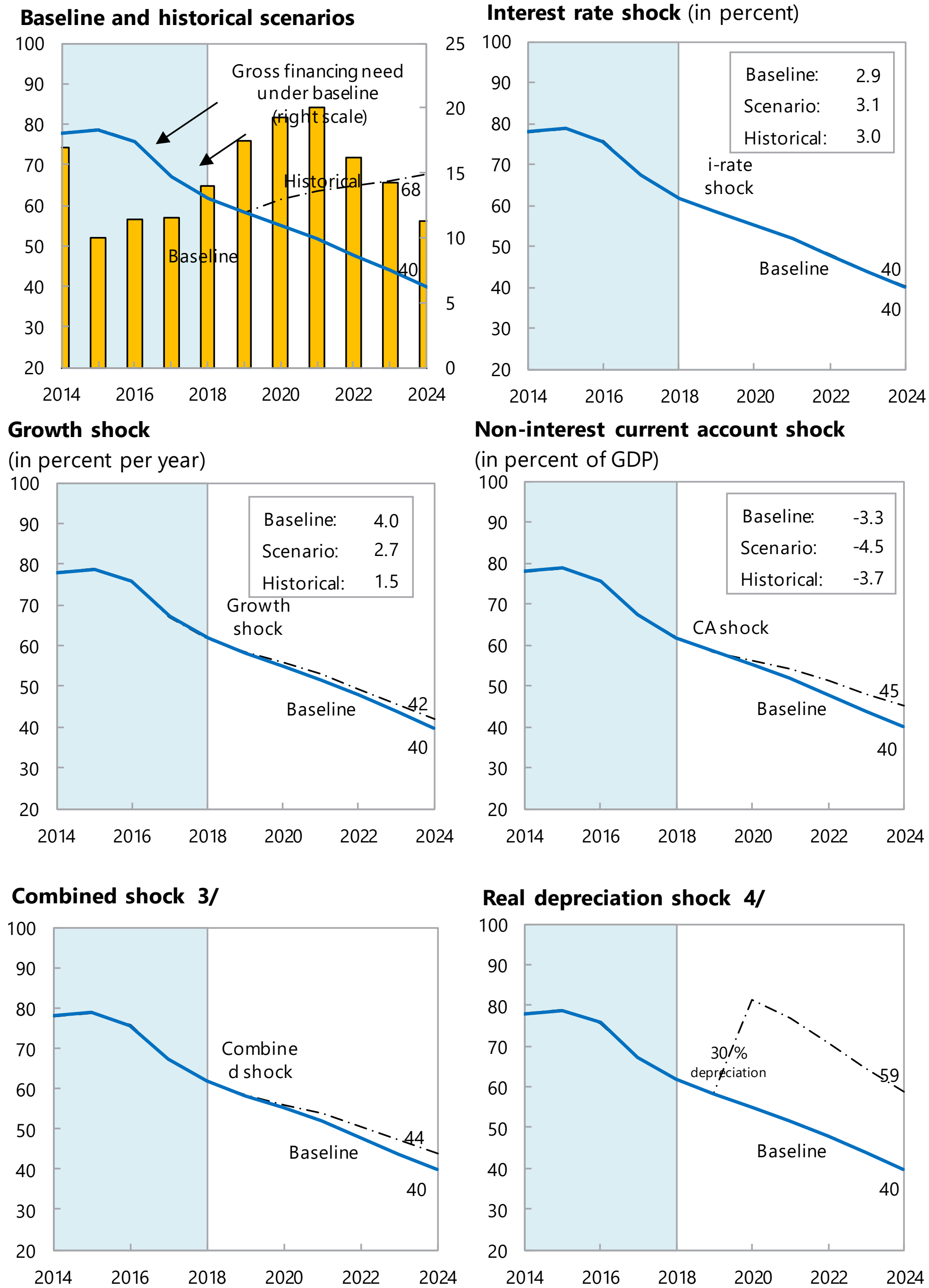
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Serbia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Appendix I. Program Statement

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

Belgrade, June 27, 2019

Dear Ms. Lagarde:

Our economic program, supported by a Policy Coordination Instrument (PCI) approved by the IMF Executive Board on July 18, 2018, aims at maintaining macroeconomic and financial stability and advancing an ambitious structural and institutional reform agenda to foster rapid and inclusive growth, job creation and improved living standards. This Program Statement (PS) describes progress made so far and sets out the economic policies that the Government and the National Bank of Serbia (NBS) intend to implement under the PCI.

End-March quantitative program targets (QTs)—including on the fiscal balance and current primary spending—have been met and good progress has been made on reform targets. Inflation has remained within the NBS target band and within the inner limit of the program inflation consultation clause.

The implementation of our program will continue to be monitored through quantitative, standard continuous, and reform targets, and an inflation consultation clause, as described in the PS and the attached Technical Memorandum of Understanding (TMU). Reviews by the Fund will continue to be completed on a semi-annual basis to assess program implementation progress and reach understandings on additional measures that may be needed to achieve its objectives.

We believe that the policies set forth in this PS are adequate to achieve the objectives of the PCI-supported program, and we will promptly take any additional measures that may become appropriate for this purpose. We will consult with the Fund before adopting any such measures or in advance of revisions to the policies contained in this PS. Moreover, we will provide all information requested by the Fund to assess implementation of the program.

In line with our commitment to transparency, we wish to make this letter available to the public, along with the PS and TMU, as well as the IMF staff report on the second review. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official website of the Serbian government.

Sincerely,

/s/
Ana Brnabić
Prime Minister

/s/	/s/
Jorgovanka Tabaković	Siniša Mali
Governor of the National Bank of Serbia	Minister of Finance

Attachments: Technical Memorandum of Understanding
Program Statement

Program Statement

1. **This program statement sets out our economic program for the rest of 2019 and 2020.** The program aims to strengthen the foundation for healthy economic growth by addressing Serbia's short-term and medium-term economic challenges. To this end, the program focuses on policies to ensure macroeconomic stability, most notably by maintaining fiscal sustainability, bolster financial sector resilience, and improve competitiveness.

2. **Our policies focus on maintaining macro and financial stability while supporting growth.** We are projecting a small overall fiscal deficit in 2019 and public debt is on a firm downward path. The external position remains broadly in line with fundamentals. Monetary policy has kept inflation under control, while supporting economic activity and maintaining broad exchange rate stability. Strong business and consumer confidence have bolstered private investment, employment, and growth.

3. **We will continue to advance our structural reform agenda.** We have made progress in reforming tax administration, strengthening public financial management, resolving SOEs, and addressing AML/CFT weaknesses. We plan further measures to reduce the shadow economy, reform public administration, and restructure state-owned utilities and financial institutions. We will continue to implement reforms in public finance and tax administration, while strengthening public investment management frameworks.

4. **The goals of the program are compatible with our aspirations to join the EU.** Implementing this program will allow Serbia to realize the sizable potential for convergence towards EU-income levels.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

5. **Macroeconomic performance remains strong.** Growth reached 4.3 percent in 2018, the highest rate in a decade, supported by robust private consumption, investment and exports. Labor market conditions continue to improve, with higher formal employment and lower unemployment, while wages are rising steadily. Headline inflation has remained within the inflation target range (at 2.2 percent yoy in May), while core inflation remains low and stable at 1.5 percent in May.

6. **We envisage the consistent implementation of the policy measures and reforms envisaged under our program to continue to improve private sector dynamism, and foster job creation and growth**.

- **Real GDP growth** is projected at 3.5 percent in 2019 and 4 percent in 2020 and over the medium term. Full implementation of our structural reform agenda will further boost Serbia's growth potential.

- **Inflation** is projected to be in the lower half of the inflation target band in the second half of 2019 and to gradually converge to 3 percent by 2021.
- **The current account deficit** in 2019 is projected to remain at a level similar to that observed in 2018 driven by investment-related imports, falling below 4 percent of GDP over the medium term. The projected deficit will continue to be fully financed by net FDI. External financing will continue to consist mostly of FDI, and bilateral and infrastructure project loans.

ECONOMIC POLICIES

A. Fiscal Policies

7. Strong fiscal performance continued in 2018. The general government recorded a surplus of 0.6 percent of GDP. Capital spending execution was strong, while current spending, including mandatory spending on wages and pensions, grew in line with expectations. Public debt fell to 54 percent of GDP in December 2018, while yields on government securities have remained broadly stable near record-low levels.

8. We are committed to maintain fiscal discipline to keep the public debt-to-GDP ratio on a firm downward trajectory, while supporting growth. For 2019, we target a general government deficit of ½ percent of GDP. Public debt is projected to decline further to 51 percent of GDP, while the debt profile will continue to improve, with increased maturity and a higher share of dinar-denominated debt. The fiscal stance in 2019 is moderately expansionary to allow for an increase in capital spending; a moderate reduction of the labor tax burden; the unwinding of the crisis-era temporary pension cuts; and a gradual unwinding of the crisis-era wage cuts for public enterprises and SOEs. Our measures will ensure that both the pension and general government wage bills do not increase in percent of GDP compared to 2018. For 2020 onwards, we will aim at maintaining an overall deficit of ½ percent of GDP, which would bring public debt below 40 percent of GDP by 2024.

9. We will aim to further reduce fiscal risks and will prepare contingency measures as needed. We will maintain an adequate liquidity buffer and will not accumulate public sector external debt payment arrears (continuous target). We will also refrain from accumulating domestic payment arrears. Our efforts to contain public spending will continue to be monitored through a ceiling on current primary spending of Serbia's Republican budget, excluding capital spending and interest payments (quantitative target).

B. Structural Fiscal Policies

10. We are committed to modernize tax administration to strengthen revenue collection and improve the business environment. Our reform efforts are based on IMF technical assistance and the Tax Administration Diagnostic Assessment Tool review.

- We are committed to implement the Transformation Action Plan (TAP, 2018-23), which provides strategic guidance and a time-bound action plan to create a modern tax administration utilizing electronic business processes, improved taxpayer services, and a risk-based approach to compliance.
- By end-June, we will complete (i) the separation of core and non-core activities of the STA, supported by separate organizational structures with their own program budget allocation, headquarters design, business plans, management structures, and reporting lines; and (ii) the consolidation of core tax administration functions into fewer sites (**end-June 2019 reform target**). This first round of consolidation envisages a reduction to 37 branch offices and a large taxpayers office.
- A senior leader has been appointed to manage the non-core business stream. The head of the non-core business stream, reporting directly to the Director-General and supported with a small headquarters-based team, is now responsible for leading the design and implementation of the new non-core business stream organization and management arrangements. This will help to ensure that the focus for the Transformation project team is on the administration reform of the core taxes.
- The next phase of reforms aims at modernizing IT and records management systems and business process re-engineering. A decision on the preferred approach to redeveloping the IT system will be adopted with the assistance of an external consultant (**new end-October 2019 reform target**). This is based on recommendations agreed at an IT reform workshop held in late-2018 jointly facilitated by the IMF and the World Bank.
- Measures to reduce the average processing time for VAT refunds are yielding positive results. Refunds are processed according to the legally prescribed timelines and the STA takes a cautious approach to minimize fraud. In the future, STA will continue to process the VAT refunds within the deadlines prescribed by the law (15/45 days for exporters and others, respectively), but it will strive to refund VAT earlier to low-risk taxpayers.
- To increase the share of revenues collected by the large taxpayer office (LTO) to at least 45 percent of total tax revenues by end-2020, the STA will develop measures to assess the level of compliance of this taxpayer segment; expand the risk profiling of taxpayers overseen by the LTO; and increase the LTO staffing levels.
- To enhance revenue mobilization, following the adoption of the Law on Origin of Assets—planned to be adopted by end-December 2019—the STA will create a special unit to analyze the level of noncompliance of high net worth individuals, including by applying indirect audit methods, and start implementing a response strategy.
- A World Bank Tax Administration Modernization Project was approved in April 2019. This project will have four components: (i) a review of the legal environment; (ii) improvement of the STA organization and operations, which include business process re-engineering; (iii) ICT system and record management modernization, including the implementation of an e-fiscalization system and (iv) project management and change management.

11. We plan to complete the general government employment and wage system reforms, which are critical for improving the efficiency of public services and containing current expenditure.

- **Public wage system reform.** The 2016 Law on Public Sector Employees Wage System sets the stage for a new system where employees are granted equal pay for equal work across the public sector, in a more transparent and systematic manner. Secondary legislation for local governments and public services (health, education, culture, and social protection) was approved in December 2017. Secondary legislation for all other sectors will be approved by end-2019. However, the police and army will be included in the new system only from 2021. We have also updated the new job matrix to expand the initial coverage and to include more detailed information from health and education sectors. We plan to apply the new wage system to all public sector employees (excluding the police and army) during 2020. To prepare for this, we will adopt the decree specifying the coefficients under the new wage system (**end-September 2018 reform target, reset to end-May 2020**). We are currently assessing the fiscal implications of bringing all employees into the new wage system next year. Based on this, we will set the base under the new system to prevent an increase of the general government wage bill as a share of GDP. We will closely monitor the possible emergence of problems of staff retention and/or bottlenecks in hiring new employees in specific segments.

- **General government employment framework.**

  - The current framework is governed by (i) the Law on the Maximum Number of Employees in the Public Sector, and annual decisions on the maximum number of permanent employees in public administration, public services, the Autonomous Government of Vojvodina, and local self-governments, which set the employment ceiling on permanent staff at the institution level; and (ii) and a Budget law, which regulates an employment freeze, with exceptions managed through the government Employment Commission. This system, which includes local public enterprises, has helped to reduce public employment, but also resulted in reliance on fixed-term and contractual positions and staffing shortages in some areas.

  - Over the medium term, we plan to replace this existing framework based on the Law on the Maximum Number of Employees in the Public Sector with a new system based on personnel planning for all public sector entities according to the law. The new system should ensure medium-term workforce planning by all public sector institutions as well as alignment with budgetary constraints. Once this new system is sufficiently effective and comprehensive we aim to phase out the controls through the hiring freeze and the Employment Commission.

  - In the meantime, the Commission will allow the hiring of staff to replace departures, within the institutions' employment and budget limits.

- We will adopt a government decision on a revised public employment framework along these lines effective 2020 (**end-September 2019 RT**). We are also developing a new electronic public employment registry starting with a pilot for the Ministry of Finance.

12. We are strengthening the public investment management framework. This will help to reduce infrastructure gaps—both in terms of quantity and quality.

- We have made progress in improving capital spending execution, but further efforts are warranted. We will continue to include all project loans in the budget.

- In line with the 2018 Planning System Law, which established a national planning framework, we will prepare a National Development Plan and a corresponding Investment Plan by 2020. Based on IMF and World Bank technical assistance, by mid-July 2019 we expect to issue a detailed guideline as a Rule Book to regulate capital expenditure projects covering project appraisal and selection (**end-January 2019 reform target**).

- In April 2019, we established the Capital Investment Commission (CIC) and by mid-July we will update the decree on public investment project appraisal to (i) clarify the roles of the MOF, CIC, and other line ministries; and (ii) remove the exclusion of IPA-funded projects as well as those financed through government-to-government agreements (**end-April 2019 reform target**).

- We will develop a single project pipeline of ongoing and future projects by end-May 2020.

- We are developing a Public Investment Management System (PIMIS)—including an integrated database of public investment projects. An IT specialist has been hired to establish the IT requirements for the database.

13. We will consider, based on existing fiscal space, possible new measures to support growth and improve the business climate. Following the abolishment—effective January 2019—of the employers' part of the unemployment contribution, we will explore the possibility of further reducing the labor tax wedge in the 2020 annual budget. We have introduced a set of measures to promote innovation and R&D, including revised depreciation allowances, full recognition of marketing costs, relief of tax burden on earnings in the form of stock options, tax relief on recreational benefits for employees, increased tax deduction of R&D costs, and IP box tax incentives. We will conduct timely assessments of these incentive schemes and introduce modifications as needed. We are evaluating options to rationalize the presumptive tax system, with a view to introduce specific changes effective in 2020.

14. We will strengthen fiscal frameworks, including tax policy, intergovernmental fiscal relationships, fiscal rules, and the pension system. Tax policy changes will focus on strengthening competitiveness and rationalizing revenue sharing and transfers to local government. By end-2019, we will finalize a deficit-based rule anchored on public debt to achieve: (i) a more transparent and credible operational rule; (ii) improved accountability and facilitate transition towards the EU fiscal framework; and (iii) retain a strong role of the Fiscal Council. To ensure a more rules-based pension system, we will reintroduce the indexation of pensions for 2020 and refrain from any additional ad-hoc pension increases. The new annual indexation formula will link pension growth to 50 percent of inflation and 50 percent of the average nominal wage growth. For this purpose, inflation is measured as the annual average increase in the consumer price index (CPI), published by SORS. Average nominal wage growth is defined as average growth of wages in the economy as published by SORS.

15. We will continue to enhance public financial management.

- To prevent arrears to public enterprises, we will continue the publication of monthly reporting of overdue receivables to Srbijagas and EPS of their top-20 debtors on the companies' websites.

- We will continue to strictly limit the issuance of state guarantees. We will not issue any new state guarantees for liquidity support, or state guarantees for any company in the portfolio of the former Privatization Agency. The Government will continue to refrain from issuing any implicit state guarantees.

- We will continue to submit financial plans of social security funds with estimates for their indirect beneficiaries to the National Assembly, in parallel with the Republican budget. We have gradually been including all indirect budget beneficiaries of the central government (except for indirect budget beneficiaries of the Ministry of Education, Science and Technological Development) in the Information System for Budget Execution (ISIB) with a view to complete the process by end-2019. We have upgraded the budget execution system to be able to support the integration of new users. In 2019, we have also included social protection institutions in ISIB.

- We are committed to ensure that a full assessment of all proposed Public-Private Partnerships (PPPs) is reviewed by the Ministry of Finance (MOF), including PPPs' key financing features, cost-benefit analysis, and risk sharing arrangements with the government. To improve control of fiscal implications and risks, the existing legislation requires that PPPs over EUR 50 million are submitted to the government for consideration only after receiving the MOF's consent.

- We have developed a new software for the Public Debt Administration aiming at establishing a custom-made debt management system to enable efficient and precise debt recording and reporting. This system is serving as the foundation for risk management and a tool for strategic analysis.

- By mid-July we will appoint the head of the fiscal risks management unit at the MOF and we have staffed the unit with three employees. We will prepare, supported by World Bank technical assistance, a strategy and methodology to properly monitor fiscal risks by June 2020 and publish a fiscal risk statement as part of the 2020 Fiscal Strategy.

- We will make plans to move to a medium-term budget orientation and a stricter adherence to the budget calendar. In this regard, we published our fiscal strategy for 2020 in June. We will also publish past financial statements by end-2019 and the 2019 financial statement by end-October 2020.

- We will promptly resolve recent small domestic arrears and address the underlying factors to prevent the emergence of new ones, including by ensuring sufficient budgetary resources for maternity benefits.

C. Monetary and Exchange Rate Policies

16. Inflation has remained low and the exchange rate to the euro relatively stable. Headline inflation has stayed within the inflation target range. Core inflation remains low and inflation expectations are well-anchored—one-year ahead inflation expectations of the financial and corporate sectors are below the 3 percent target.

17. The current inflation targeting framework remains appropriate for maintaining stable inflation and protecting the economy against external shocks. We remain committed to the objective of keeping inflation within the tolerance band (3 percent ±1½ percentage points). This target was renewed in December 2018 for the period January 2019 through December 2021. Inflation developments will continue to be monitored via a consultation clause with consultation bands set around the central projection (Table 1). Reflecting internal and external conditions, we have kept the key policy rate unchanged since April 2018.

18. We will maintain the current managed float exchange rate regime in line with the inflation targeting framework. We believe that well-managed exchange rate flexibility provides a needed buffer against external shocks. Therefore, foreign exchange interventions will continue to be used to smooth excessive short-term exchange rate volatility without targeting a specific level or path for the exchange rate, while considering the implications for financial sector and price stability. We assess the current level of gross international reserves as comfortable for precautionary purposes.

19. Promoting dinarization remains an important objective. The dinarization strategy adopted in 2012—and updated in 2018—is based on three pillars: (i) maintaining overall macroeconomic stability; (ii) creating favorable conditions for developing the dinar bond market; and (iii) promoting hedging instruments. Macroeconomic conditions have remained stable, which should support dinarization. Several measures to foster dinarization have been in place, such as higher reserve requirements on FX deposits and mandatory down-payment ratios for FX loans. We have enhanced our communication to the public on the risks of unhedged FX borrowing, need of prudent management of FX risks, availability of hedging instruments, and promoting dinar savings. We have increased the share of public debt in local currency, issuing dinar securities at longer maturities (up to 10 years). In October 2018, we introduced a new instant payment system, which will encourage broader use of dinar mobile payments and help reduce informality. Since April, banks are required to enable instant payments on all available channels that they provide (at the counter, through m-banking/e-banking applications, at the point of sale, etc.). By April 2019, deposit and credit dinarization reached 32 percent and 33 percent, respectively.

20. Our updated dinarization strategy aims to further strengthen liquidity management and develop local currency debt and hedging markets.

- We are introducing measures to (i) further develop local and foreign currency derivative markets, and (ii) encourage prudent pricing of credit risks of unhedged foreign currency borrowing.

- We continue to strengthen public debt management. We plan to establish a primary dealer system and develop adequate supervisory framework. We are also improving the PDA's operational framework and setting up a Debt Market Committee comprising of representatives of the PDA and the MOF. We have set up a working group comprising of representatives of the PDA, MOF, primary dealers, and other relevant institutions to implement the primary dealership system.

- We are further enhancing the liquidity management framework. We have formalized the communication between the NBS and the Ministry of Finance—through a Service Level Agreement—concerning exchange of information. We have also established a Consultative Committee for Liquidity Monitoring and Exchange of Information aimed at strengthening the management and oversight of the Consolidated Treasury Account balance and improving the quality of liquidity forecasting.

- We have conducted a survey of banks' exposures to unhedged foreign currency borrowers and based on the results, we will consider introducing stricter prudential requirements for unhedged exposures.

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

D. Financial Sector Policies

22. We will continue to strengthen financial sector regulatory and supervisory frameworks, to fully align them with international standards. The NBS has adopted in December 2018 regulatory measures that limit banks' portfolio of long-term cash and consumer loans and set debt-to-income limits on loans to individuals. We will continue to enhance the prudential framework for banks and insurance companies to ensure full compliance with international standards and EU requirements. We will further harmonize our financial legal framework with EU Acquis taking into account the specificities of the Serbian financial market.

23. We will further enhance financial safety nets. Significant progress has been achieved in strengthening the bank resolution, deposit insurance, and crisis management frameworks.

- We will further align the deposit insurance scheme with international standards. A review of the appropriate parameters of the deposit insurance fund and a IADI core principles assessment has been conducted by the World Bank. Key recommendations include clarifying the role of the Deposit Insurance Agency (DIA) in financing resolution, updating the information-sharing agreements between the DIA and the NBS as well as other stakeholders, developing a business continuity plan for the DIA and a system-wide contingency plan.

- To address the findings of the review and allow for introduction of risk-based premia, by end-June we expect to submit to parliament amendments to the Law on Deposit Insurance Agency and the Law on Deposit Insurance (**end-June 2019 reform target**). The amendments will, among other things, establish backstop funding, modify the basis for the computation of deposit insurance premiums and targets from eligible to insured deposits, while extending the deadline the reach the target fund level.

- In line with these amendments, we plan to ensure a significant reduction in the average effective premium.

- We will update the 2015 MoU between the DIA and NBS to enhance the information sharing between both institution on banks' risk profiles and resolution plans, and the joint development of a least cost test (**new end-December 2019 reform target**).

24. The reduction of NPL ratios has been impressive. As of March, the NPL ratio reached 5.5 percent, the lowest level since 2008. However, NPLs in some SOBs remain at relatively higher levels, although they are fully covered by regulatory reserves for estimated losses and significant improvements have been made driven primarily by write-offs. In December 2018, we updated our NPL resolution strategy, focusing on measures to prevent accumulation of new NPLs and accelerate NPL resolution in SOBs, while broadening the scope to include the export credit agency (AOFI), the Development Fund (DF), and the bad assets managed by the Deposit Insurance Agency (DIA) on behalf of the State and the bankruptcy estates of banks in liquidation. In line with the updated strategy, we approved a time-bound action plan to resolve the DIA portfolio of bad assets by end-2020 through a tendering process implemented in two phases; and by end-June the first phase of the sale is expected to be completed (**end-December 2018 reform target**). We will hire external consultants to prepare and implement the second phase of the tender process based on the portfolio of bad assets. We will launch the tender for the sale of the second, larger portfolio, in line with the time-bound action plan **(end-September 2019 reform target)**. If needed, we will also develop a time-bound plan to resolve the residual assets of the DIA portfolio before end-2020.

25. We will continue to implement our state-owned financial institutions reform agenda. We are strengthening our oversight over financial institutions with state-ownership.

- In February, we hired a privatization advisor for Komercijalna Bank. In March we adopted a formal government decision to initiate privatization and on May 31 we published a public call for expressions of interest, launching the privatization tender process (**end-June 2019 reform target**) with a view to complete the sale by end-December. Meanwhile, in April the bank's shareholders appointed two members of the board of directors, which is now fully formed.

- We continue to implement the new strategy for Banka Postanska Stedionica (BPS). The strategy focuses on (i) the bank's commercial reorientation towards retail banking, entrepreneurs, micro-enterprises and small enterprises, (ii) improvements of the bank's internal organization, corporate governance and risk management, (iii) enhancement of its IT infrastructure, and (iv) a business plan for the period 2018-20. At the end of May 2019, BPS approved the decision to procure a new core banking system, supported by external consultants. In addition, the bank signed a protocol with the Ministry of Finance to strengthen accountability and proper oversight of the business plan implementation.

- We are implementing strategic options for the smaller banks, based on the updated government strategy for state-owned banks. In May, we completed the sale of the State's shares in Jubmes Bank, which was expanded to include the shares of bankrupt banks managed by the DIA.

- The DF and AOFI have continued to implement (i) the supervisory boards' decisions recognizing losses on their credit portfolios and (ii) the government conclusion to restrict the institutions' exposures to SOEs, enhance risk management frameworks, prevent further deterioration in asset quality, and resolve impaired assets.

26. We are strengthening the AML/CFT framework in line with the FATF action plan. We have addressed the shortcomings identified in the 2016 MONEYVAL AML/CFT mutual evaluation report through an inter-agency working group by the January 2019 deadlines agreed with the FATF. In 2018, we adopted a Law on Anti-Money Laundering defining notaries as a new obliged entity and providing a clear legal base for the STA to start inspection in two casinos and completed a targeted National Risk Assessment (NRA), with World Bank support. We have also passed numerous other laws, regulations, and guidelines addressing specific recommendations in the MONEYVAL report, including on politically exposed persons, public notaries, correspondent banking, beneficial ownership, supervision of groups and foreign branches, and sanctioning regimes. We implemented all measures listed in the action plan to address the AML/CFT weaknesses identified by the FATF by February (**end-February 2019 reform target**). Progress has been acknowledged by MONEYVAL and FATF in a report in January and an onsite assessment mission in May.

27. We will develop strategies for capital market deepening and development finance. Serbia's capital markets remain underdeveloped with limited stock-market activity, nascent domestic bond market volumes, and a virtually nonexistent corporate bond market. Alternative sources of financing such as private equity or venture capital, are negligible. We have prepared, with World Bank support, a diagnostic assessment focused on developing capital markets and diversifying sources of long-term financing. Based on the main findings of this report, a working group, chaired by the Minister of Finance, will develop a strategy and an action plan to enhance Serbia's capital markets. A working group was established to draft, with the World Bank support, a strategy for development finance by end-December 2019. The World Bank has prepared a report on access to finance for micro, small and medium enterprises in Serbia, which will further support efforts under the development finance strategy.

E. Structural Policies

28. We will continue to implement structural reforms to improve the business environment and support higher private sector-led growth. Our focus is on policies to improve the investment climate, reduce informality, enhance competitiveness, promote job creation, and complete the resolution of public and state-owned enterprises.

29. We are implementing measures to fight the grey economy. We are implementing the Action Plan on the National Program for Countering the Grey Economy. Our priorities include improvements in the inspection system, modernization of Tax Administration (risk-based audits, trainings, reorganization, and better control of trading in excise goods), strengthening of incentives for voluntary compliance, and improving the business environment to encourage entrepreneurship and innovation. In this regard, in 2018 we amended the Law on Inspection Supervision and aligned all sectoral laws and introduced new inspection tools to permit supervision of unregistered activities. We are improving coordination across inspections by developing e-inspection software, which provides a horizontal e-platform facilitating full implementation of a risk-based approach to inspection oversight. We are advancing reforms to boost the use of electronic fiscal services, facilitated by use of enhanced STA software, and will amend the legal framework to prevent abuse of special tax regimes—particularly presumptive taxation.

30. We are implementing measures to further increase labor force participation:

- We have adopted the Law on Simplified Seasonal Employment in Specific Industries defining rights and obligations in the context of seasonal work and allowing simplified registration of seasonal workers in agriculture.

- By September 2019, the government plans to adopt the Law on Work Through Temporary Employment Agencies, aimed at improving labor conditions for agency employees working in beneficiary companies, eliminate unfair competition in this area, and increase employment.

- We have amended the Law on Financial Support for Families with Children to increase the bonuses for child birth aimed at raising fertility rates, completing the replacement of the previous entitlement to VAT reimbursement for baby food and equipment.

- We will advance measures to address constraints for women labor force participation, based on the National Gender Equality Strategy 2016–20. We will implement measures aimed at ensuring a more equal participation of women and men in parenting and economy of care, as well as those that will improve women's economic and labor market status, particularly for women in vulnerable groups.

31. We are committed to continue restructuring large public utilities companies to enhance efficiency and contain fiscal costs and risks. We remain fully committed to implement the corporate and financial restructuring in these companies over the medium term.

- **Elektroprivreda Srbije (EPS).** We have continued to implement the 2016–19 labor optimization plan. We have engaged the World Bank and the EBRD to support our plan to enhance corporate governance, management, and procurement and planning frameworks. A time-bound action plan prepared by the EBRD to improve corporate governance was adopted in March 2019. In 2020, we will change the legal status of EPS to a joint stock company, in line with the ongoing corporate restructuring process and financial consolidation, aiming to improve the viability of the company and ensure its professional management. We will soon adopt a government decision to establish ownership rights of all property and assets of EPS. We will launch a tender for the valuation of the company's properties and assets (**new end-December 2019 reform target**). By end-August 2019, we will update our assessment of the need for an electricity tariff increase, with the support of the World Bank.

- **Srbijagas.** Payment discipline has improved, and an investment appraisal methodology proposed by the World Bank has been adopted. We will ensure phasing out Srbijagas' reliance on government support for servicing debt by the end of the program period.

32. We will make progress on the few strategic companies in the portfolio of the former Privatization Agency for which resolution is still pending:

- Negotiations with potential investors are ongoing regarding Petrohemija and we intend to launch a privatization tender following ongoing discussions with potential investors (**end-February 2019 reform target**).

- After the unsuccessful second tender to privatize MSK, we continue to explore options for potential strategic investments or partnerships.

- In May 2019, we completed the privatization of the Port of Novi Sad.

- We have appointed a privatization advisor for Lasta and plan to launch the privatization tender by end-June 2019, with a view to complete the transaction by end-December.

- We have developed, with the assistance of the World Bank, a time-bound action plan for Resavica mines, that foresees the closure of four unviable mines, while developing a voluntary social program and labor optimization plan. We will ensure sufficient resources in the budget to transparently support Resavica through subsidies and to prevent further accumulation of arrears to EPS.

33. We continue to resolve enterprises in the portfolio of the former Privatization Agency through either privatization or bankruptcy, in accordance with the revised Privatization Law. By March 2019, more than 310 companies entered bankruptcy, and 54 were privatized since end-2014. About 34,800 employees from 336 companies have received severance payments. 86 companies with nearly 39,000 employees remain.

34. We will develop a new ownership and governance strategy for SOEs. The strategy will provide an integrated approach to oversight and monitoring of SOE operations, financial consolidation, restructuring or divestment plans, and measures to improve governance and institutional frameworks. The strategy will complement ongoing efforts to better monitor and tackle fiscal risks and enhance efficiency. To support this work, we will publish a comprehensive list of public enterprises (PEs) and SOEs covering all levels of government as of end-2018 (central and local) where the government has at least 10 percent stake and include consolidated ownership cases where PEs or SOEs own other companies (**new end-October 2019 reform target**). This list will be based on information available as of end-2018 and will mention the main sector of economic activity the company is involved in. We will also adopt an ownership policy document to provide a strategic vision to state ownership, covering ownership objectives (including criteria for divestment), financial and public policy targets, reporting and monitoring guidelines and procedural guidelines for boards of directors (**new end-February 2020 reform target**). In parallel we will identify the key performance indicators (KPIs) to monitor as part of our efforts to enhance surveillance of SOEs and adopt a dividend policy by end-December that fits with our long-run views of the key PEs and SOEs. We will also make efforts to promptly resolve the excessive reliance on acting directors in state-owned companies.

35. We will continue to improve the quality and transparency of national statistics:

- We remain committed to comprehensive, timely, and automatic data sharing across relevant compiling agencies (including SORS and NBS) for statistical purposes. To ensure compilation efficiency and consistency of outputs, and to further strengthen cooperation and coordination across statistical authorities, by end-September 2019 we will update the Memorandum of Cooperation signed between SORS, MOF (Macro-fiscal unit, Treasury, PDA), and NBS. The updated Memorandum will reflect best practices and describe the roles and responsibilities of each reporting agency with regards to current and envisaged fiscal reporting both within the national legal context and official reporting to international institutions.

- By the end of the program, the Serbian Statistical Agency (SORS) will submit monthly GFSM 2014 fiscal accounts to the Enhanced General Data Dissemination System (eGDDS), covering the budgetary government and Roads and Corridors of Serbia.

- We will resume reporting of the GFS Yearbook to the IMF Statistics Department by end-2019.

- In June 2018, we subscribed to the IMF's eGDDS. In December 2018, we started to publish a 12-month ahead data release calendar for the Ministry of Finance, supporting our goal of achieving the top threshold of eGDDS by the end of the program period. In December 2018, we also subscribed to the World Bank/IMF Public Sector Debt Statistics Database covering core debt of the budgetary central government. Public sector debt data has been transmitted on a quarterly basis for loans and debt securities covering budgetary central government units valued at face value.

- In conjunction with Eurostat and the IMF, we have continued to upgrade our national accounts. In 2018, we released revised annual and quarterly GDP time series for the period 2015–17. We also developed and improved metadata to support compilation processes, in particular the informal economy, making new metadata available on the SORS website. We continue to develop supply and use tables (SUT) for 2015-17, to be disseminated by September 2019.

PROGRAM MONITORING

36. Progress in the implementation of the policies under this program will be monitored through quantitative targets (QTs)—including an inflation consultation clause, continuous targets (CTs) and reform targets (RTs). These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding.

Table 1a. Serbia: Quantitative Program Targets 1/

	2018						2019						2020	
	Sep.			Dec.			Mar.			Jun.	Sep.	Dec.	Mar.	Jun.
	Prog. QT	Adj. Prog.	Act.	IT 7/	Adj. IT	Act.	Prog. QT	Adj. Prog.	Act.	IT 7/	Prog. QT	IT 7/	Prog. QT	IT 7/
	CR 18/237			CR 18/375			CR 18/375			CR 18/375				
I. Quarterly Quantitative Targets (QT)														
1 Ceiling on the general government fiscal deficit 2/ 3/ (in billions of dinars)	-31.3	-48.9	-54.5	-1.6	-26.9	-32.2	18.9	26.0	-11.2	2.2	4.5	26.2	33.7	15.1
2 Ceiling on current primary expenditure of the Serbian Republican Budget excluding capital expenditure and interest payments (in billions of dinars) 2/	648.7	647.9	639.8	921.3	922.2	899.3	221.9	221.1	219.2	457.8	718.4	988.4	232.9	480.4
3 Ceiling on accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars) 4/	0.0	...	0.2	0.0	...	0.8	0.5	...	-0.4	0.5	0.5	0.5	1.0	1.0
II. Continuous Targets														
4 Ceiling on accumulation of external debt payment arrears by General Government, Development Fund, and AOFI (in billions of euros)	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
III. Inflation consultation band (quarterly) 5/														
Upper band limit (1.5 percent above center point)	3.0			4.1			4.4			3.5	3.4	3.5	3.5	3.1
End of period inflation, center point 6/	*1.5*	...	*2.1*	*2.6*	...	*2.0*	*2.9*	...	*2.8*	*2.0*	*1.9*	*2.0*	*2.0*	*1.6*
Lower band limit (1.5 percent below center point)	0.0			1.1			1.4			0.5	0.4	0.5	0.5	0.1

1/ As defined in the Program Statement and the Technical Memorandum of Understanding.
2/ Cumulative since the beginning of a calendar year.
3/ Refers to the fiscal balance on a cash basis, including the amortization of called guarantees.
4/ Quarterly changes for numbers in 2018. Cumulative change since December 31, 2018 for numbers starting in 2019.
5/ Staff level consultation is required upon breach of the band limits.
6/ Defined as the change over 12 months of the end-of-period consumer price index, as measured and published by the Serbian Statistics Office.
7/ Indicative targets are not monitored as part of the program conditionality.

Table 1b. Serbia: Standard Continuous Targets

Not to impose or intensify restrictions on the making of payments and transfers for current international transactions.
Not to introduce or modify multiple currency practices.
Not to conclude bilateral payments agreements which are inconsistent with Article VIII.
Not to impose or intensify import restrictions for balance of payments reasons.

Table 2. Serbia: Prior Actions and Reform Targets

	Actions	Target Date	Status	Objective
	Reform Targets			
	Fiscal			
1	Approve a government decree defining wage coefficients under the new Public Sector Employee Wage System for local governments, public services, and public administration.	End-September, 2018	Not met. Reset to end-May 2020.	Rationalize pay and improve incentives across public sector.
2	Submit to the National Assembly a draft Law on Charges.	End-October, 2018	Not met. Submitted in November 2018.	Improve transparency and predictability, reduce parafiscal tax burden on businesses.
3	Issue a detailed rule book to the 2017 Capital Project Regulation, covering methodology for project appraisal and selection.	End-January, 2019	Not met.	Unifies methodology for the project and cost-benefit analysis and raise transparency.
4	Establish Capital Investment Commission (CIC) and update Capital Project Regulation to (i) clarify roles of MoF, CIC, and other line ministries, (ii) remove the exclusion of IPA-funded projects, and (iii) expand the coverage to government-to-government agreements.	End-April, 2019	Not met. CIC established in April 2019.	Improve selection, appraisal, and implementation of public infrastructure projects.
5	Complete consolidation of core STA activities into fewer sites.	End-June, 2019		Advance reforms of the State Tax Administration.
6	Adopt a government decision on a revised public employment framework for 2020.	End-September, 2019		Improve employment flexibility while containing fiscal pressures.
	Financial			
7	Approve a time-bound action plan to resolve part of the DIA portfolio of bad assets by end-2020 through a tendering process implemented in two phases (agreed with the World Bank); and complete the first phase of the sale.	End-December, 2018	Not met. Action plan adopted in December 2018.	Resolve bad assets and address fiscal risks.
8	Approve an updated Dinarization Strategy in line with the IMF recommendations.	End-December, 2018	Met.	Strengthen financial stability and increase dinarization.
9	Submit to the National Assembly amendments to the Law on Public Debt with a view to update legal foundation of debt management.	End-December, 2018	Met.	Strengthen public debt management.
10	Implement items listed in Serbia's action plan to address the significant AML/CFT weaknesses identified by the FATF.	End-February, 2019	Met.	Remove Serbia from FATF listing and prevent pressures on capital inflows and correspondent banking relationships.
11	(i) Submit to the National Assembly amendments to the Law on Deposit Insurance Agency and the Law on Deposit Insurance to incorporate the findings of IADI assessment and update parametrization; and (ii) introduce risk-based premia.	End-June, 2019		Align deposit insurance scheme with international standards.
12	Launch a privatization tender for Komercijalna Banka.	End-June, 2019	Met.	Reduce state involvement in the financial sector and reduce fiscal risks.
13	Issue tenders for the second phase of DIA asset sales, in line with the time-bound action plan.	End-September, 2019		Resolve bad assets.
	Structural			
14	Adopt a government decision to launch a privatization tender for Petrohemija.	End-February, 2019	Not met.	Reduce fiscal risks.
15	Approve amendments to the Law on Inspection Supervision.	End-September, 2018	Not met. Approved in December 2018.	Reduce grey economy.
	Proposed New Reform Targets			
16	Publication of a comprehensive list of SOEs as of December 31, 2018 (covering all levels of government including consolidated ownership; include information on main economic activity; at least 10 percent government ownership stake).	End-October, 2019		Improve SOE governance.
17	Reach decision on a preferred approach to the STA IT system upgrade.	End-October, 2019		Advance reforms of the State Tax Administration.
18	Launch a tender for the valuation of EPS property and assets.	End-December, 2019		Improve SOE governance.
19	Sign an updated MOU between the DIA and NBS to reflect new resolution tools given to the NBS and the need for information sharing.	End-December, 2019		Strengthen financial safety nets.
20	Government adoption of an ownership policy document covering ownership objectives (including criteria for divestment), financial and public policy targets, reporting and monitoring guidelines, and procedural guidelines for boards of directors.	End-February, 2020		Improve SOE governance.

Attachment I. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definition of indicators used to monitor developments under the program. To that effect, the authorities will provide the necessary data to the European Department of the IMF as soon as they are available. As a general principle, all indicators will be monitored on the basis of the methodologies and classifications of monetary, financial, and fiscal data in place on May 18, 2018, except as noted below.

A. Fiscal Conditionality

2. **The general government fiscal deficit** is defined as the difference between total general government expenditure (irrespective of the source of financing) including expenditure financed from foreign project loans, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeover if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law) and total general government revenue (including grants). For program purposes, the consolidated general government comprises the Serbian Republican government (without indirect budget beneficiaries), local governments, the Pension Fund, the Health Fund, the Military Health Fund, the National Agency for Employment, the Roads of Serbia Company (JP Putevi Srbije) and any of its subsidiaries, and the company Corridors of Serbia. Any new extra budgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Privatization receipts are classified as a financial transaction and are recorded "below the line" in the General Government fiscal accounts. Privatization receipts are defined in this context as financial transactions.

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

Adjustors

- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward (upward) to the extent that cumulative non-tax revenues of the General Government from dividends exceed (fall short of) programmed levels.
- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward to the extent that cumulative non-tax revenues of the General Government from debt recovery receipts, debt issuance premiums, and concession and Public Private Partnership

(PPP) receipts recorded above-the-line exceed programmed levels. The IMF Statistics Department will determine the proper statistical treatment of any concession or PPP transaction signed during the IMF program.

Cumulative Programmed Revenues of the General Government from Dividends, Debt Recovery Receipts, and Debt Issuance at a Premium

(In billions of dinars)

	End-Sep. 2018	End-Dec. 2018	End-Mar. 2019	End-Jun. 2019	End-Sep. 2019	End-Dec. 2019
Programmed cumulative dividends	17.1	17.1	17.1	17.1	17.1	17.1
Programmed cumulative debt recovery receipts	0	0	2.5	2.5	2.5	2.5
Programmed cumulative debt issuance at a premium	0	0	0	0	0	0
Programmed concession and PPP receipts recorded above the line	0	0	0	0	0	0

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

- The quarterly ceilings on the **general government fiscal deficit** and the **primary current expenditure of the Republican budget** in 2019 will be adjusted downward to the extent that the Republican budget expenditures associated with the resolution of CHF mortgage litigation falls short of the maximum of RSD 9.75 billion direct government expenditure assumed in the context of resolution. For the purpose of calculating the adjustor, these expenditures will be converted from euros into dinars using the National Bank of Serbia's middle RSD/EUR exchange rate prevailing on the day of Ministry of Finance issues a 5-year bond to the banks.

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

	End-Sep. 2018	End-Dec. 2018	End-Mar. 2019	End-Jun. 2019	End-Sep. 2019	End-Dec. 2019
Programmed cumulative ear-marked grants receipts	7.6	14.2	2.5	5.5	9.3	13.9
Programmed cumulative receipts from small-scale disposal of assets	0	0	0	0	0	0

4. **Domestic arrears.** For program purposes, domestic arrears are defined as the belated settlement of a debtor's liability which is due under the obligation (contract) for more than 60 days, or the creditor's refusal to receive a settlement duly offered by the debtor. The program will include a quantitative target on the change in total domestic arrears of (i) all consolidated general government entities as defined in ¶2 above, except local governments; (ii) the Development Fund, and (iii) AOFI. Arrears to be covered include outstanding payments on wages and pensions; social security contributions; obligations to banks and other private companies and suppliers; as well as arrears to other government bodies. This quantitative target will be measured as the change in the stock of domestic arrears relative to the stock at December 31, 2018, which stood at RSD 3.41 billion.

5. **Debt issued at a premium.** For program purposes, debt issued at a premium refers to proceeds accruing to the government that are recorded as revenue when the government issues debt at a premium. It most commonly occurs when a bond with an above-market coupon is reopened ahead of a coupon payment.

B. Ceiling on External Debt Service Arrears

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

subject to rescheduling or restructuring.[1] The program requires that no new external arrears be accumulated at any time under the arrangement on public sector or public sector guaranteed debts. The authorities are committed to continuing negotiations with creditors to settle all remaining official external debt-service arrears.

7. **Reporting.** The accounting of external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within four weeks after the end of each month.

C. Inflation Consultation Mechanism

8. Inflation is defined as the change over 12 months of the end-of-period consumer price index (CPI), base index (2006=100), as measured and published by the Serbian Statistics Office (SORS). Where the official press release differs from the index calculation, the index calculation will be used.

9. Breaching the inflation consultation band limits (specified in Program Statement, Table 1) at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response.

D. Reporting

10. General government revenue data and the Treasury cash position table will be submitted weekly; and the stock of spending arrears as defined in ¶6 45 days after the end of each quarter. General government comprehensive fiscal data (including social security funds) will be submitted within 35 days of the end of each month.

11. The stock of spending arrears (> 60 days past due) as reported in the MOF e-invoice system will be submitted within 14 calendar days after the end of each month.

12. Gross issuance of new guarantees by the Republican budget for project and corporate restructuring loans will be submitted within 35 days of the end of each month.

13. Cumulative below-the-line lending by the Republican budget will be submitted within 35 days of the end of each month.

14. Borrowing by the Development Fund and AOFI will be submitted within four weeks of the end of each month.

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

15. New short-term external debt (maturities less than one year) contracted or guaranteed by the general government, the Development Fund, and AOFI will be submitted within four weeks of the end of each month.

16. Monthly average VAT refund time, stock of pending VAT refunds, and the value of the VAT refunds provided each month will be submitted by the Serbian Tax Administration within 14 calendar days after the end of each month.

17. Receivables of the top 20 debtors to Srbijagas and EPS will be submitted in the agreed-upon templates within 30 calendar days after the end of each month as well as published on the company websites.

Data Reporting for Quantitative Targets		
Reporting Agency	Type of Data	Timing
Statistical Office and NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Fiscal deficit of the consolidated general government	Within 35 days of the end of the month
Ministry of Finance	Current primary expenditure of the Republican budget excluding capital expenditure and interest payments	Within 35 days of the end of the month
Ministry of Finance	External debt payment arrears by general government, Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Gross accumulation of domestic payment arrears by the general government (without local government, the Development Fund, and AOFI)	Within 45 days of the end of the quarter
Ministry of Finance	Earmarked grants and receipts from small-scale disposal of assets	Within four weeks of the end of the quarter

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

June 28, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE POLICY COORDINATION INSTRUMENT—INFORMATIONAL ANNEX

Prepared By

European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(as of June 21, 2019)

Membership Status

Joined December 14, 1992 (succeeding to membership of the former Socialist Federal Republic of Yugoslavia); accepted Article VIII on May 15, 2002. Serbia continues the membership in the Fund of the former state union of Serbia and Montenegro—previously the Federal Republic of Yugoslavia—since July 2006.

General Resources Account

	SDR Million	Percent Quota
Quota	654.80	100.00
Fund Holdings of Currency	608.04	92.86
Reserve Position	46.78	7.14

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	445.04	100.00
Holdings	9.27	2.08

Outstanding Purchases and Loans

None.

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Feb 23, 2015	Feb 22, 2018	935.40	0.00
Stand-By	Sep 29, 2011	Mar 28, 2013	935.40	0.00
Stand-By	Jan 16, 2009	Apr 15, 2011	2,619.12	1,367.74
EFF	May 14, 2002	Feb. 28, 2006	650.00	650.00

Projected Payments to the Fund

	Forthcoming (SDR Million)				
	2019	2020	2021	2022	2023
Principal					
Charges / Interest	2.45	4.85	4.84	4.84	4.84
Total	2.45	4.85	4.84	4.84	4.84

Implementation of HIPC Initiative

Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Safeguards Assessment

Not applicable.

Exchange Arrangement

Serbia accepted the obligations under Article VIII, Sections 2, 3, and 4, on May 15, 2002, and maintains a system free of restrictions on payments and transfers for current international transactions, except with respect to blocked pre-1991 foreign currency savings deposits (IMF Country Report No. 02/105). The de jure exchange rate arrangement is a floating system since January 1, 2001. According to the 2009 Monetary Policy Program, the National Bank of Serbia (NBS) implements a managed floating exchange rate regime. The de facto exchange rate arrangement was reclassified to "stabilized" from "crawl-like" (effective March 2, 2018).

Last Article IV Consultation

Concluded on September 6, 2017 (IMF Country Report No. 17/263).

FSAP Participation

Serbia participated in the Financial Sector Assessment Program in 2005, and the Executive Board discussed the Financial System Stability Assessment in February 2006 (IMF Country Report No. 06/96). An update under the Financial Sector Assessment Program was conducted in 2009 and the Executive Board discussed the Financial System Stability Assessment in March 2010 (IMF Country Report No. 10/147).

Technical Assistance since Last Article IV consultation (September 2017)[1]

Department	Timing	Purpose
STA	May 2019	Government Finance Statistics
FAD	March 2019	Public Investment Management Database
STA	March 2019	Government Finance Statistics
STA	February 2019	Government Finance Statistics
FAD	November 2018	Public Investment Management Database
FAD	November 2018	Revenue Administration – Action Plan for IT Reform
STA	November 2018	Government Finance Statistics
FAD	November 2018	Public Investment Management Systems
FAD	October 2018	Revenue Administration – Improving the Audit Function
FAD	October 2018	Revenue Administration – Taxpayers Services Function
FAD	October 2018	Revenue Administration – Compliance Risk Management
STA	September 2018	Government Finance Statistics
FAD	September 2018	Tax Policy
FAD	September 2018	Revenue Administration – Tax Administration Reform
FAD	September 2018	Revenue Administration – Tax Investigations Function
FAD	August 2018	Tax Administration – Large Taxpayers Office
STA	August 2018	National Accounts
STA	June 2018	Government Finance Statistics
STA	May 2018	Government Finance Statistics
MCM	May 2018	Monetary Operations – Dinarization Strategy
FAD	April 2018	Public Investment Management
FAD	April 2018	Revenue Administration – Compliance Risk Management
FAD	February 2018	Revenue Administration – Tax Audit Reform
STA	December 2017	Government Finance Statistics
MCM	December 2017	Monetary and Forex Operations
FAD	November 2017	Revenue Administration – Compliance Risk Management
FAD	October 2017	Revenue Administration – Debt Collection Function
FAD	September 2017	Revenue Administration – Tax Audit Reform
MCM	September 2017	Setup of a Primary Dealership System

In addition, technical assistance was available through resident advisors covering tax administration, public financial management, and government finance statistics.

Resident Representative

Mr. Sebastian Sosa took his position as Resident Representative in July 2016.

[1] The list does not include visits by regional advisors.

COLLABORATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

As of June 21, 2019, Serbia has collaborations with the World Bank Group, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank, and the Council of Europe Development Bank.

International Financial Institution	**Hyperlink**
The World Bank Group	https://www.worldbank.org/en/country/serbia/overview#4
The European Bank for Reconstruction and Development (EBRD)	https://www.ebrd.com/serbia.html
The European Investment Bank	https://www.eib.org/en/projects/regions/enlargement/the-western-balkans/serbia/index.htm
Council of Europe Development Bank	https://coebank.org/en/about/member-countries/serbia/

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

General

Data provision is broadly adequate for surveillance with some key data shortcomings in the government finance statistics.

National Accounts

The real sector data are compiled by the Statistical Office of the Republic of Serbia (SORS). The GDP data are compiled using expenditure and production methods. National accounts statistics of the Republic of Serbia are based on conceptual framework of the 2008 SNA/ESA 2010. Data on GDP and its components are disseminated at current prices, previous year's prices in absolute values (RSD millions), and as chain-linked volume measures (reference year 2010). Quarter-to-quarter growth rates are derived from seasonally adjusted data. Annual and quarterly data are available from 1995 onwards.

Procedures for the compilation of annual GDP estimates by production are in line with internationally recommended practices. Production account estimates are compiled with an adequate methodology and at very detailed levels.

Sources and method for the compilation of GDP by expenditures are in general, adequate.

Reconciliation between the independent annual GDP estimates based on the production and expenditure approaches is being made at an aggregate level, although the original differences are not significant. The gap between the quarterly estimates of GDP by expenditure and production approaches is closed by a residual covering the statistical discrepancy plus changes in inventories and net acquisition of valuables. There are no reliable independent estimates of changes in inventories on a quarterly basis.

The SORS has recently revised GDP data going back to 2005. This is part of an ongoing project to enhance the national accounts compilation process and produce more robust and accurate GDP estimates. Compilation of supply and use tables is ongoing (2015-2017) and is expected to be completed in the second half of 2019.

Price Statistics

The SORS compiles and disseminates monthly indices for consumer prices, producer prices, industrial production, as well as unit-value indices for imports and exports. Concepts and methods used to compile the CPI, as well as other price statistics, attempt to reflect international standards and best practices.

External Sector Statistics

Balance of payments statistics are compiled by the NBS and reported to STA for re-dissemination in the IFS and the Balance of Payments Statistics Yearbook. Since April 2014, BOP data have been compiled in accordance with the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6). The first BPM6 data were introduced in 2014 starting with Q1 2007 (balance of payments) and Q4 2013 (IIP).

A January 2017 TA mission found that the source data and compilation system are sound. However, additional efforts are needed to (i) pursue the ongoing program of modernization of NBS's database management system to strengthen the basis for the ESS compilation, and (ii) improve the compilation techniques in some areas, including trade-related statistics and financial flows and stocks accrual recording. In particular, adjustments to trade in goods and services are needed to properly record the fob values of trade, incorporate the estimates of illegal and shuttle trade, and identify the companies involved in the processing and merchanting activity to gather information on their gross flows.

Government Finance Statistics

Monthly fiscal data are compiled and published by the Ministry of Finance on a cash basis, broadly following the methodology of the Manual on Government Finance Statistics 1986 (GFSM 86). The sector coverage is not fully in line with the definitions of central and general government in the IMF GFSM 2014 Manual, mainly because it excludes extrabudgetary units. Principal data sources are the Republican Treasury and budgetary execution reports, local government, social security funds, the Road Fund, and the 'Koridori' Fund. Since 2001, Serbia has made efforts to bring the existing budget reporting system in line with the GFSM 2001, and since 2018, GFSM 2014 methodology. The MOF, with technical assistance from the IMF Statistics Department, is upgrading its IMF fiscal surveillance reporting to the GFSM 2014 framework. A significant portion of this relates to implementing the updated bridge from the chart of accounts to the GFSM 2014 classification, bringing the presentation in line with the GFSM 2014 framework, including financing items, as well as improving reconciliation and consolidation methods.

The above data form the basis for the cash-based annual GFS data previously transmitted to the IMF for the GFS Yearbook (GFSY) based on the Government Finance Statistics Manual 2001 (GFSM 2001), the last data reported are for 2012. SORS will resume reporting of the GFS

Yearbook data to the IMF Statistics Department by end-2019. These data will be compiled in line with data reported to Eurostat explained below.

SORS and NBS are working on a GFS implementation project, with technical assistance from the IMF Statistics Department and Eurostat, to prepare comprehensive GFS data conform ESA 2010 and GFSM 2014 for official statistics reporting to Eurostat and the IMF Statistics Department. This includes the comprehensive classification of general government units (completed), including accrual estimates, ensuring internal accounting consistency within the GFS framework, aligning with the national accounts, and developing COFOG data. To date, SORS has disseminated annual revenue and expenditure, detailed tax revenue, and Excessive Deficit Procedure notification tables – largely on an experimental basis – to Eurostat. Work is ongoing to compile comprehensive financial accounts data that will included government sector data.

Since January 2019, NBS is reporting budgetary central government debt data on loans and securities to the World Bank/IMF Quarterly Public Sector Debt Database. Although source data are available, NBS has not committed to expand reporting to cover all debt instruments and to the public sector nor even general government.

Monetary and Financial Statistics

Monetary and financial statistics are compiled by the NBS, broadly following the methodology set forth in the Monetary and Financial Statistics Manual, 2000 (MFSM), and meeting the GDDS recommendations with respect to periodicity and timeliness for financial sector data. Monetary data are reported to the Fund using Standardized Report Forms beginning December 2013.

The coverage of monetary statistics includes the central bank and the other depository corporations (ODCs) and could be improved by including remaining ODCs (including banks in liquidation) and other financial corporations.

Serbia has yet to compile and submit to STA Financial Soundness Indicators for publication on the IMF website.

II. Data Standards and Quality

Serbia participates in the General Data Dissemination System (GDDS)/enhanced GDDS (e-GDDS) and its metadata were posted on the IMF Data Dissemination Bulletin Board on May 1, 2009. ROSC report on Fiscal Transparency was published in May 2009.

Table of Common Indicators Required for Surveillance

(As of June 21, 2019)

	Date of latest observation	Date received	Frequency of data [4]	Frequency of reporting [4]	Frequency of publication [4]
Exchange rates	Jun 20, 2019	Jun 21, 2019	D and M	D and M	D and M
International reserve assets and reserve liabilities of the monetary authorities [1]	Jun 20, 2019	Jun 21, 2019	D	D	M
Reserve/base money	Jun 20, 2019	Jun 21, 2019	D and M	W and M	W and M
Broad money	May 2019	Jun 24, 2019	M	M	M
Central bank balance sheet	May 2019	Jun 24, 2019	M	M	M
Consolidated balance sheet of the banking system	May 2019	Jun 24, 2019	M	M	M
Interest rates [2]	Jun 20, 2019	Jun 21, 2019	D	D	D
Consumer price index	May 2019	Jun 12, 2019	M	M	M
Revenue, expenditure, balance and composition of financing – general government	April 2019	Jun 4, 2019	M	M	M
Revenue, expenditure, balance and composition of financing – central government	April 2019	Jun 4, 2019	M	M	M
Stocks of central government and central government-guaranteed debt [3]	April 2019	Jun 4, 2019	M	M	M
External current account balance	April 2019	Jun 19, 2019	M	M	M
Exports and imports of goods and services	April 2019	Jun 19, 2019	M	M	M
GDP/GNP	2019, Q1	Jun 7, 2019	Q	Q	Q
Gross external debt	April 2019	May 27, 2019	M	M	M
International investment position [5]	April 2019	May 27, 2019	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Including currency and maturity composition.

[4] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Semi-annually (SA), Annually (A), Irregular (I), or Not Available (NA).

[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by the Staff Representative on the Republic of Serbia
July 17, 2019

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

2. The consolidation of core tax administration activities into fewer sites has been completed (end-June 2019 reform target). Starting July 1, Serbia's tax administration is operating under a new organizational structure, with the number of sites reduced to 37 from the initial 138.

3. Since the launch of the Komercijalna Banka tender (end-June 2019 reform target), the authorities have received letters of interest from six potential buyers. In the second half of July, potential buyers meeting the qualification criteria defined in the public call will be invited to make nonbinding offers.

4. On June 27, Serbia opened negotiations with the European Union on Chapter 9, which covers the field of financial services. This takes the total number of open EU accession chapters to seventeen, of which two have been provisionally closed.

5. The deadline for conversion of Swiss-franc mortgages expired on July 7, although some banks may allow short extensions. According to unofficial estimates by banks, around 90 percent of borrowers have agreed to convert their loans into euros.

6. On July 8, the Parliament adopted a bill amending the law on fees for use of public goods that increases toll fees by 12 percent. The new fees should enter into force on July 15.

7. Year-through-July 5, the NBS has made net purchases in the foreign exchange market of EUR 1.29 billion, of which EUR 710 million was purchased since June 10. Since late-May, the dinar has been under renewed appreciation pressures mostly as a result of strong demand from foreign portfolio investors investing in long-term dinar Treasury bonds as well as strong FDI inflows. Year-to-July 8 the dinar has appreciated 0.4 percent against the euro.

Statement by Mr. Inderbinen and Mr. Djokovic on Republic of Serbia
July 17, 2019

On behalf of the Serbian authorities, we thank staff for their engagement, constructive interactions and sound policy advice, as well as for a comprehensive and balanced report. The authorities are also grateful to the Executive Board and management for their continued guidance and support. The ongoing candid dialogue between Serbia and the Fund is highly valued. The Policy Coordination Instrument remains pivotal in guiding macroeconomic policies and structural reforms, with the overarching goal of fostering growth, while preserving macro and financial stability. The sustained reform momentum under the program is all the more relevant for Serbia in the context of the EU integration process.

Recent economic developments

Serbia's macroeconomic performance continues to be strong. Real GDP growth reached 4.3 percent in 2018, the fastest pace in the past 10 years, supported by robust private consumption, investments, and exports. Both credit and private sector wages have continued to grow at healthy rates and have supported domestic demand. Formal employment and labor market participation has continued to expand, while unemployment is declining. Inflation remains low and within the target band. The external position is consistent with fundamentals and policy settings. The current account had temporarily widened on the back of strong investment-related imports and is expected to fall below 4 percent over the medium term.

Fiscal policy

Over the past four years, Serbia has achieved substantial structural fiscal adjustment of about 5.5 percent cumulatively, which has been key for restoring debt sustainability, and for strengthening credibility of policies and confidence. Over the same period, public debt declined from its peak of about 76 percent to about 54 percent at end-2018. Public debt is expected to fall below 50 percent by 2020.

Supported by strong economic activity and rising incomes, the primary surplus reached 2.8 percent of GDP in 2018, contributing to the decline in public debt of about 4.2 percent. In 2019 and over the medium-term, fiscal policy will be geared towards a less restrictive stance, with a headline deficit of about 0.5 percent of GDP. This will allow for the accommodation of Serbia's development needs, including higher infrastructure investments, while ensuring a continuous decline in the debt-to-GDP ratio. The projected fiscal trajectory does not require additional structural adjustment and will allow public wages and pensions to grow in line with output..

The authorities agree that a further strengthening of the fiscal framework is warranted to cement the achieved fiscal gains, guide expectations and improve predictability. Tighter control of current spending will be key in this regard, and the authorities are planning to revamp and modernize the current debt-based fiscal rule, introduce binding targets, and strengthen accountability by the end of the year. This will entail redefining the indexation of public pensions by introducing the so-called Swiss indexation formula, which links pension increases with the average of inflation and wage growth. Management of the public sector wage bill hinges on the implementation of the comprehensive reform of public sector wages, which aims to modernize the system and ensure equal pay for equal work across the sector. Most preparatory milestones have been reached, and the full implementation of this reform is set for the first half of 2020.

The authorities are well aware of Serbia's infrastructure gap, and the pivotal role that infrastructure plays in fostering faster economic growth and income convergence. Public capital investment has already been stepped up substantially, in line with the available fiscal space, form 2.8 percent in 2017 to 4.1 percent of GDP in 2019, without jeopardizing the ongoing consolidation. The authorities take good note of the previous Article IV finding that the execution of infrastructure projects that are already in the pipeline would, over the long run, increase GDP per capita by close to 2 percentage points. The increase in capital spending is underpinned by the ongoing strengthening of the institutional framework for public investment management, aimed at improving coordination, oversight and investment efficiency. Notable progress with PIM-related reforms has been achieved over the past few years, including by bringing all project loans into the budget, creating a single project pipeline and issuing the Capital Project Regulation to enhance project appraisal. In April this year, the Capital Investment Commission was established, with the main task of prioritizing infrastructure projects. In addition, public investment in Serbia will be further bolstered by the Public Investment Management Information System, which is being developed with World Bank support.

Tax policy reforms are geared towards supporting private sector growth and employment by reducing the fiscal burden on labor and modernizing corporate taxation by reassessing depreciation schedules and deductible expenses. Reform of the revenue administration, which aims at improving the efficiency of tax collection, is progressing in line with the 2018-2023 Transformation Action Plan developed with the support of FAD TA. Separation of the STA core from non-core activities and the rationalization of the office network have been successfully completed. Going forward, reforms will focus on overhauling and modernizing the IT systems and reinforcing the role and capacity of the large taxpayer office. The STA reform is one of the key priorities and is backed by the Fund's TA and the World Bank.

Public debt management is being continuously strengthened—the amended Public Debt Law, which was adopted at the end of 2018, has modernized the legal basis for debt management, including through the introduction of a system of primary dealers. Debt management is being further strengthened by the implementation of a new, customized software, which will also serve as a tool for risk management and strategic analysis.

Monetary policy

In 2019, inflation remained low, within the NBS tolerance band (3 percent ±1½ percentage points). In May 2019, inflation stood at 2.2 percent. Against the background of low inflationary pressures, the benign domestic environment, and the development of global financing conditions, the NBS decided to cut the key interest rate by 25 bp, to 2.75 percent in July 2019. This was the first rate cut since April 2018. Inflation expectations of the financial and industrial sector remain well-anchored.

The current level of international reserves is high, both by standard and ARA metrics, and is expected to continue to increase. Strong bouts of portfolio and FDI inflows in 2019 led to appreciation pressures. In June, the NBS purchased about EUR 650 million. By end-June, the FX reserves reached the record maximum of EUR 12.1 bn.

Advancing dinarization remains a prioritiy for the NBS. The high euroization in Serbia is a long-standing, deeply ingrained issue, rooted in high inflation during the 1980s and in the hyperinflation of the early 1990s. A range of measures has been implemented over the past several years to foster dinarization, including: i) macro-prudential measures; ii) tax incentives; iii) developing a dinar-denominated domestic sovereign market; and iv) extending sovereign bond maturities and building a dinar yield curve. These efforts, paired with declining interest rate differentials and the relatively stable exchange rate, are gradually delivering results. Deposit dinarization reached 32 percent in April, while credit dinarization stood at 33 percent. Under the PCI, the authorities have updated the 2012 dinarization strategy, based on three pillars: i) overall macroeconomic stability; ii) developing a dinar bond market; and iii) promoting hedging instruments. Moreover, the share of the dinar-denominated portion of public debt has increased to about 26 percent, while the maturities of sovereign dinar bonds have been extended up to 10 years.

Financial sector

Serbia's financial sector is dominated by banks. The banking system is well capitalized, liquid, and profitable. The capital adequacy ratio stood at 22.3 percent at the end of the first quarter of 2019. In parallel, financial intermediation has continued to improve. Provision of credit to the economy continues to grow at about 10 percent annually, on the back of strengthened asset quality, accommodative monetary policy and increased confidence. The decisive implementation of the NPL Resolution Strategy has yielded significant results. Since 2015, gross NPLs have declined by as much as 16.8 percent and have fallen below the pre-crisis level—at present, the gross NPL-to-total-loans ratio stands at 5.5 percent. Moreover, NPLs are fully covered by regulatory reserves for estimated losses. Also, the sale of the loan portfolio of the Deposit Insurance Agency is ongoing. This legacy portfolio stems from the DIA's dual legal mandate as a deposit insurer and as the bankruptcy and liquidation administrator. The authorities intend to overhaul DIA's legal framework to align it with the IADI core principles. The privatization process of Komercijalna bank, the third largest bank in Serbia by assets, is advancing according to plan. This sale will reduce the size of the state's footprint in the banking sector to below 7 percent. The implementation of the state-owned Banka Poštanska Štediondcia's new strategy is ongoing, and the Ministry of Finance has enhanced its oversight of the bank and the implementation of its business plan.

AML/CFT

Addressing the shortcomings identified in the 2016 MONEYVAL AML/CFT mutual evaluation report has been the utmost priority for the Serbian authorities. Serbia has successfully implemented measures to strengthen the effectiveness of its AML/CFT regime and has addressed the related technical deficiencies. This has been acknowledged by MONEYVAL and FATF in a report in January 2019 and an onsite assessment mission in May 2019. While Serbia is no longer subject to FATF's monitoring process, the authorities will continue to work with MONEYVAL to further improve Serbia's AML/CFT regime.

State-owned enterprises

Over the past years, Serbia has made significant progress in implementing SOE reforms to improve their operational viability and to contain fiscal risks, while substantially reducing state aid. At this point, the financial position of critical public network utilities, including Serbia Gas, the electricity generation and distribution company EPS, and Railways of Serbia has strengthened. This is thanks to comprehensive financial and corporate restructuring, appropriate regulatory price adjustments, and enhanced revenue collection. Under the PCI-supported program, the authorities have focused on resolving four big non-strategic SOEs, which will reduce the associated fiscal risks. RTB Bor, a copper mine, has been sold to a Chinese strategic partner; and the fertilizer plant Azotara has been entered into bankruptcy. The authorities are actively seeking a buyer for MSK and Petrohemija; these two companies recorded positive operating results in 2018 and are not receiving state support. At the same time, the Resavica coal mines, which comprise several mine shafts in undeveloped parts of eastern Serbia, present a challenge from a political economy standpoint. The authorities have, with the support of the World Bank, developed an action plan that envisages the closure of four non-viable mines. In addition, the authorities are, with the support of EBRD, stepping up efforts to change EPS's legal status into a joint-stock company, and to reform its corporate governance.