INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/206

REPUBLIC OF SERBIA

2013 ARTICLE IV CONSULTATION

July 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Serbia, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 23, 2013, with the officials of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 14, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Staff Statement** dated July 1, 2013
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its July 1, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Serbia.

The document listed below has been or will be separately released.

Selected Issues Paper

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

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REPUBLIC OF SERBIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

June 14, 2013

KEY ISSUES

Context. The global financial crisis exposed significant external and internal vulnerabilities, reflected in sharply lower growth. Sustained implementation of sound macroeconomic policies and broad-based structural reforms is needed to complete Serbia's transition to robust growth and a stable macroeconomy.

Fiscal policy. Sizable medium-term fiscal adjustment is required to put public finances on a sustainable footing. Without additional measures, the deficit would exceed 8 percent of GDP in 2013, significantly higher than budgeted. Additional measures should thus be legislated in a supplemental 2013 budget to maintain a broadly neutral fiscal stance this year. The adjustment should be buttressed by strengthening public financial management (PFM).

Monetary policy. The inflation-targeting (IT) framework should be preserved. The National Bank of Serbia (NBS) should gradually reduce the gap between the key policy rate and the average reverse repo rate—the rate at which it absorbs liquidity—to send a consistent signal about the monetary policy stance. Further easing of monetary conditions should be kept on hold until fiscal adjustment is firmly on track.

Financial sector policy. The banking sector is broadly stable. Addressing the high stock of nonperforming loans (NPLs) should help support credit growth. A viable business plan for state-owned banks needs to be developed to address weaknesses in some banks.

Structural reforms. Sustained implementation of structural reforms—notably of public enterprises, labor markets, and the business environment—is needed to bolster the export sector and job creation, and raise potential growth.

Approved By
Aasim M. Husain and James Roaf

Discussions were held in Belgrade during May 8–20, 2013. The staff team comprised Zuzana Murgasova (head), Chris Faircloth, Dmitriy Kovtun, Eugen Tereanu (all EUR), Roland Kpodar (FAD), Cesar Serra (SPR), Bogdan Lissovolik (resident representative), Desanka Nestorovic and Marko Paunovic (Belgrade office). Aasim Husain (EUR) joined some of the policy discussions. HQ support was provided by Dustin Smith and Patricia Mendoza (EUR).

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CONTEXT

1. **Serbia's transition to a sustainable growth model and stable macroeconomy is incomplete.** Market-based reforms only began since 2000, nearly a full decade behind New Member States (NMS) of the EU. Strong growth was achieved at the expense of a buildup of internal and external imbalances (Figure 1), and many essential reforms remained unfinished. The global financial crisis exposed Serbia's unsustainable growth model and its key vulnerabilities: (i) an overreliance on the nontradable sector, (ii) weak domestic savings and excessive external borrowing, (iii) widespread euroization, and (iv) high and volatile inflation.

2. **While significant external adjustment has taken place in recent years, key economic challenges remain.** Robust growth has not taken off and economic activity is below pre-crisis levels amid widespread structural rigidities. Unemployment of well over 20 percent is a major social concern (Figure 2). Achieving low and stable inflation continues to be difficult. Fiscal and external imbalances are large due to incomplete adjustment, partly reflecting uneven policy implementation (Figure 3 and Box 1). This makes Serbia especially susceptible to shocks.

Box 1. Implementation of Past Fund Advice

While the authorities have actively engaged in policy dialogue with the Fund, implementation of Fund advice has been uneven.

- *Fiscal policy*. Prudent public wage and pension indexation rules were enacted in line with Fund advice, but little progress was made in containing government employment and ad-hoc increases in public wages. A pension reform passed in 2010 was less ambitious than initially designed. As a result, the medium-term targets (in relation to GDP) for public wages and pensions set in 2010 are now well out of reach, and key debt and deficit legal rules under the new fiscal responsibility framework, which was developed with staff's assistance, were breached in 2011-12.

- *Monetary and financial sector policy*. In line with staff's advice, the NBS embraced and improved its relatively recent IT framework, including by forcefully reacting to deviations from the tolerance band, streamlining reserve requirements, and encouraging "dinarization." While staff's advice for prudent provisioning and liquidity buffers has been largely heeded, that for improving governance in small and medium-sized domestic banks was not. Bottlenecks to NPL resolution that were pointed out by staff are being addressed, albeit with some delay.

- *NBS independence*. In line with staff's advice, the authorities took steps towards restoring NBS autonomy that was eroded as a result of amendments to the NBS Law in August 2012. They revoked an amendment requiring parliamentary approval of NBS By-Laws, instituted changes aimed at staggering the appointments of NBS officials, and improved access to courts for dismissed officials.

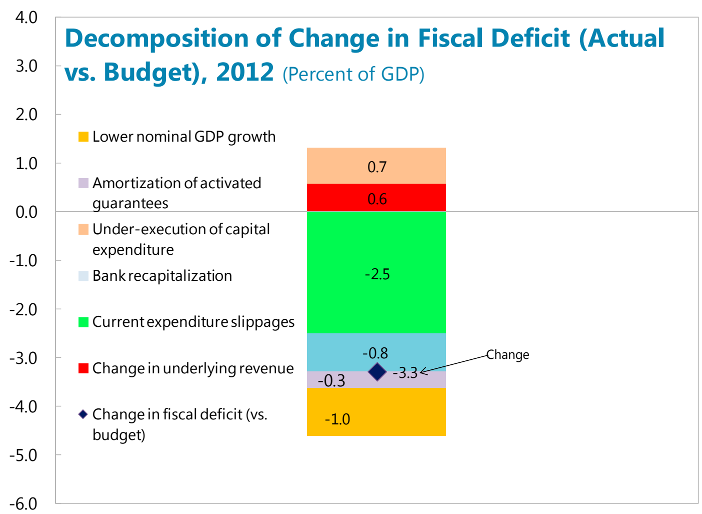
- *Structural reforms*. Staff advice focused on (i) simplifying the business environment (some progress was made in the area of product markets, but not labor markets), and (ii) privatization and reform of public enterprises (stalled, partly because of weak financial environment for asset sales).

RECENT ECONOMIC DEVELOPMENTS

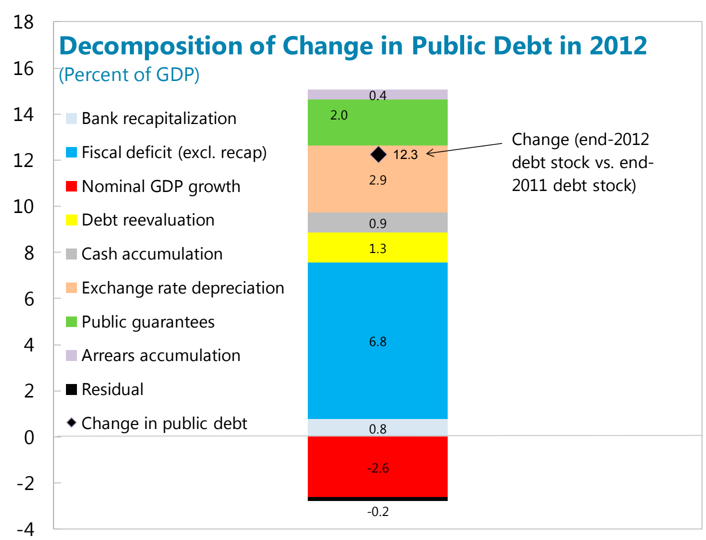
3. After a modest recovery in 2010–11, the economy slipped back into recession in 2012. The contraction of 1¾ percent was due to extreme weather shocks, the suspension of operations of a major steel plant, and weaknesses in euro area and regional activity. Yet CPI inflation of 12¼ percent at year-end well exceeded the NBS tolerance band, owing to a spike in food prices and lagged effects of dinar depreciation, and the current account deficit widened to 10½ percent of GDP in 2012. This, together with lower financial account inflows, led to a loss of foreign currency reserves of almost 10 percent relative to end-2011 (Figure 4).

4. The fiscal rules introduced in 2010 did not prevent major fiscal slippages in 2012. Election-related expenditure overruns, the recapitalization of nonviable state-owned banks, and a new fiscal decentralization law worsened the fiscal and financing situation in the first half of the year. The new government appointed in mid-2012 quickly adopted a supplementary budget with some consolidation measures, including increases in VAT, corporate and personal income tax rates, excise duties, and nontax revenues. Furthermore, wage and pension indexation was reduced in the November 2012 and April 2013 rounds. Notwithstanding these measures, the fiscal deficit of the general government reached 7¾ percent of GDP—more than 3 percentage points above the original target (a cyclical deterioration of 1½ percent). Public debt increased by about 12¼ percentage points to 62 percent of GDP—far above the legal debt ceiling of 45 percent of GDP. These slippages underscore Serbia's structural fiscal challenges (Box 2 and Selected Issues Paper "Diagnosing and Addressing Serbia's Structural Fiscal Challenges").

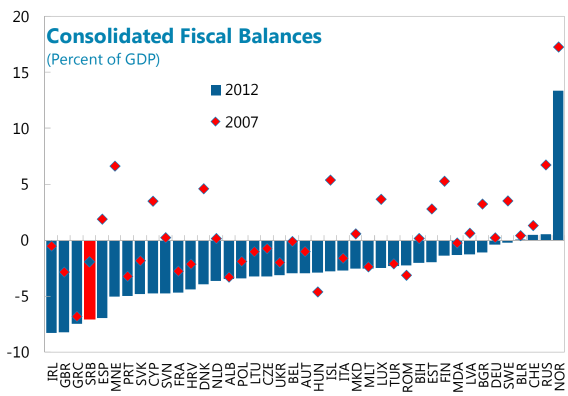
Decomposition of Change in Fiscal Deficit (Actual vs. Budget), 2012 (Percent of GDP)

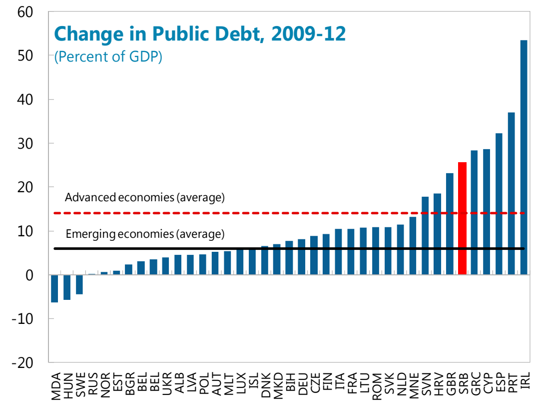


Decomposition of Change in Public Debt in 2012 (Percent of GDP)



Sources: National authorities and IMF staff estimates.

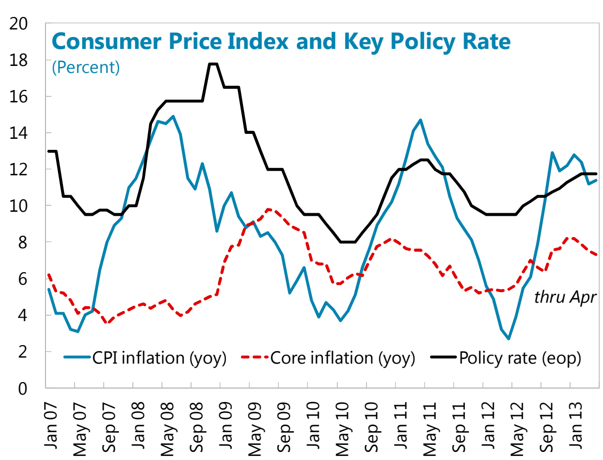


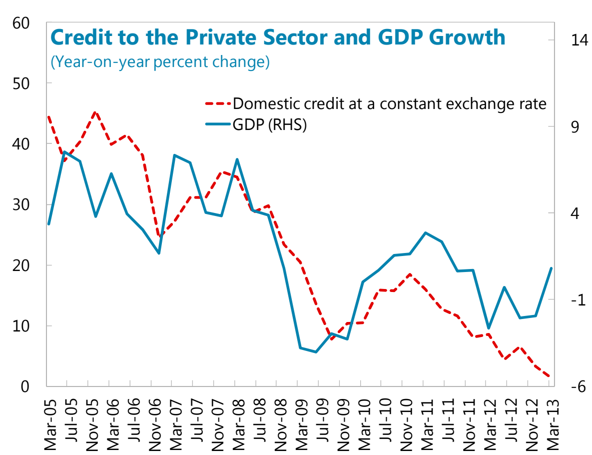


Sources: National Authorities and IMF staff estimates.

5. Monetary policy tightening strived to compensate for fiscal slippages. A deterioration in market confidence, strong dinar depreciation (13 percent in the first 8 months of 2012), and inflationary pressures in the first half of 2012 prompted repeated NBS foreign exchange (FX) interventions and monetary policy tightening (a 225 basis points increase in the key policy rate from June 2012 to February 2013 and changes to reserve requirements). This has contributed to a slowdown in domestic credit to the private sector, thus hampering the short-term recovery (Figure 5).

6. A better external financing environment improved market confidence (Figure 6). This facilitated issuance of several Eurobonds and attracted large inflows into domestic dinar securities, which reversed depreciation pressures from September 2012. Later in the year, the NBS resumed mopping up excess dinar liquidity. Dinar appreciation pressures intensified through early May, prompting NBS FX interventions.





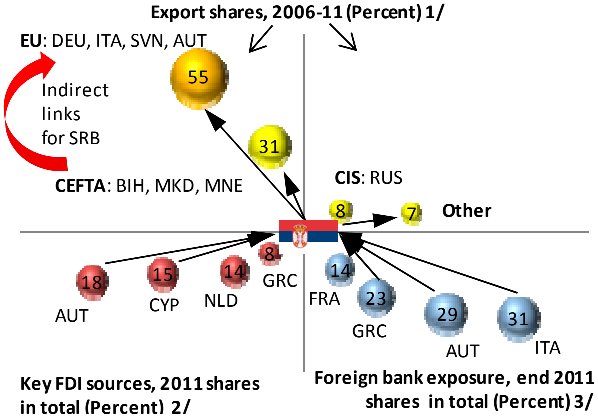
Sources: Haver Analytics, NBS and IMF staff estimates.

OUTLOOK AND RISKS

7. The authorities and staff agreed on the near-term outlook. GDP growth is expected to reach 2 percent this year due to a rebound of agriculture and the successful launch of automobile production by Fiat in 2012. Inflation is set to decelerate to 5 percent by year-end, below the upper limit of the NBS's inflation tolerance band (fixed at 4 +/–1½ percent) as base effects dissipate and domestic demand remains weak.

8. While the authorities anticipate a robust medium-term recovery, staff cautioned that this would largely depend on the strength of policy implementation. In any scenario, there are significant domestic and external risks to the outlook, including ones arising from close trade and financial linkages with the Euro Area (Annex I).

Trade and Financial Linkages



Sources: NBS, BIS and IMF staff estimates.
1/ Exports of goods, average share, NBS.
2/ Inward FDI stock, IMF CDIS.
3/ Foreign bank consolidated claims by nationality of BIS reporting bank.

- Staff noted that in an unchanged policy scenario, public debt would continue rising to high levels due to persistently large fiscal deficits (Tables 1–6). The external position would also remain vulnerable owing to significant current account deficits and an overvalued exchange rate (about 15–20 percent; Box 3 and Selected Issues Paper "External Sustainability Assessment"). A deterioration of confidence could limit market access and investment inflows, leading to wider risk premia, exchange rate pressures and a drawdown of reserves. Thus, potential growth would be limited to about 3 percent. Higher global risk aversion would exacerbate external financing risks and lead to a faster drawdown of reserve buffers.

Serbia: Medium-Term Outlook (Unchanged Policy), 2012-18 1/

	2012	2013	2014	2015	2016	2017	2018
		Proj.					
	(percent of GDP, unless otherwise noted)						
GDP growth (percent)	-1.7	2.0	2.0	2.2	2.5	2.8	3.0
Consumer price inflation (percent, average)	7.3	8.4	5.1	4.9	4.0	3.7	3.5
Overall fiscal balance	-7.6	-8.3	-7.8	-8.2	-8.8	-9.0	-9.3
Gross debt	61.8	67.5	73.5	78.0	84.3	88.8	94.8
Current account	-10.5	-8.7	-8.5	-9.0	-9.5	-10.0	-10.2
of which: Trade balance	-18.2	-15.6	-14.8	-14.8	-14.9	-14.8	-14.6
Capital and financial account	6.5	11.0	6.3	6.7	6.9	5.8	6.3
of which: Foreign direct investment	0.8	3.1	3.2	3.0	2.8	2.7	2.5
External debt (end of period)	85.8	83.1	81.9	78.7	76.2	72.8	70.1
Gross official reserves							
Billions of euros	10.9	11.0	9.7	8.8	7.8	6.2	4.5
Percent of short-term external debt	270.9	234.0	218.9	181.1	127.5	111.4	72.0

1/ This scenario is an illustrative low-growth equilibrium reflecting the impact of negative confidence effects associated with unchanged policies.

- Rebalancing macroeconomic policies would improve the economic outlook. In the illustrative adjustment scenario, sizeable fiscal consolidation would temporarily constrain GDP growth (Figure 7, and Table 7). However, reducing macroeconomic imbalances and implementing structural reforms would give rise to a virtuous circle of falling interest rates, lower exchange rate volatility, a resumption of credit growth, increased FDI inflows, improved competitiveness, and a higher long-run growth potential. The current account deficit would decline gradually to sustainable levels.

POLICY DISCUSSIONS: ACHIEVING MACROECONOMIC STABILITY AND SUSTAINED GROWTH

Article IV discussions focused on rebalancing the policy mix by launching durable fiscal adjustment and structural reforms needed to restore external sustainability and improve Serbia's growth potential.

A. Fiscal Policy: Restoring Public Debt Sustainability

9. The authorities and staff agreed that the original 2013 budget target was out of reach. The authorities pointed to lower-than-expected revenues across the board reflecting a still-soft economy (affecting CIT and VAT), increased evasion on tobacco excises, and lower nontax revenues. Staff also attributed the fiscal deterioration to weaker tax collection efforts, the impact of rushed new tax legislation (e.g., a tax amnesty and several VAT breaks) that likely dented compliance, and new unbudgeted spending initiatives, including direct government support to state enterprises and road infrastructure projects. Payment of called guarantees and state-owned bank resolution costs added to expenditure pressures. Without additional measures, staff projected the general government deficit to widen to 8¾ percent of GDP, well beyond the authorities' revised projection of 6 percent of GDP. In staff's view, additional fiscal risks stem from the planned issuance of guarantees, the likely assumption of debt of several public enterprises, and other quasi-fiscal operations. The authorities acknowledged some of the identified expenditure risks but were confident that discretionary controls (discussed below) would be effective in containing spending pressures. They also emphasized that the Budget System Law's definition of the deficit excludes bank resolution costs, arrears clearance, and the repayment of debt on called guarantees, and thus helps explain the Ministry of Finance and Economy's (MOFE) lower deficit projection.

10. The authorities are introducing additional consolidation measures of some 1 percent of GDP to contain the fiscal slippage in 2013. The government proposed broadly revenue neutral wage tax and pension contribution rate adjustments that incentivize expenditure cuts at the local government (LG) level (½ percent of GDP)[1], and additional discretionary expenditure cuts of

[1] This measure reduces LG's wage tax revenues, thus incentivizing them to reduce spending given their limited ability to borrow. Staff included these savings in their projections as this reform was legislated in May.

½ percent of GDP. Staff viewed the package as a significant step in the right direction (despite some implementation risks), but called for further measures of 1 percent of GDP to achieve at least a broadly neutral fiscal stance in structural terms in 2013, to be quickly legislated in a supplementary budget. The authorities did not preclude the possibility of additional measures, but were inclined to defer the supplementary budget until September arguing that the need for further policy action could be assessed more precisely at that time.

Fiscal Projections for 2013 1/
(percent of GDP)

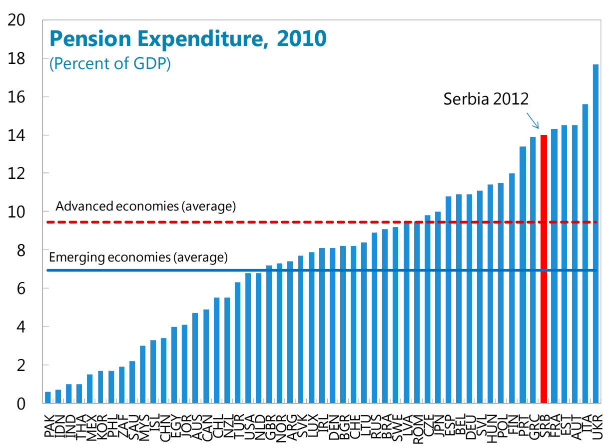
	Budget (1)	MOFE /1 (2)	IMF 1/ (3)	Difference (2-3)
Revenue	**44.1**	**40.9**	**40.0**	**1.0**
Tax	38.9	36.4	35.6	0.7
Non-tax	5.1	4.5	4.2	0.2
Grants	0.1	0.1	0.1	0.0
Expenditure	**47.7**	**46.5**	**48.3**	**-1.8**
Current	43.8	42.6	44.3	-1.8
Bank recapitalization 2/	...	...	0.2	-0.2
Arrears clearance /2	...	...	0.2	-0.2
Repayment of called guarantees /2	...	...	0.5	-0.5
Capital	3.6	3.6	3.7	-0.1
Net lending	0.3	0.4	0.3	0.1
General Government Deficit	**-3.6**	**-5.6**	**-8.3**	**2.8**
Memorandum Items:				
Nominal GDP (RSD bn)	3,679	3,761	3,745	17

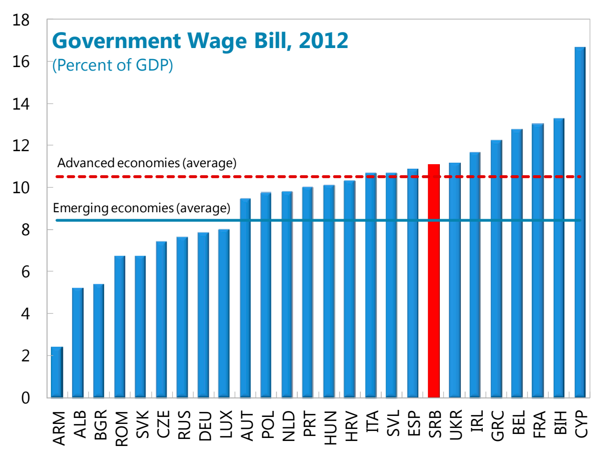
1/ Includes yields from the recently legislated wage/pension tax rate reform amounting to 0.5 percent of GDP.

2/ MOFE records these items below the line.

11. For the medium term, there was agreement that sustained structural fiscal consolidation was essential, but views differed on its size and pace. In staff's view, absent substantial additional adjustment, fiscal deficits would remain above sustainable levels and the trend increase in public debt would not be halted, let alone reversed (Table 2). Staff's illustrative adjustment scenario suggests that cumulative fiscal measures of at least 5½ percent of GDP over 2014–2016 would be needed to put public debt on a downward path, reduce the overall fiscal deficit under 3 percent by 2016, and return the debt stock to the end-2012 level by 2018 (Table 7). The authorities regarded such consolidation as infeasible and instead emphasized faster economic growth (underpinned by structural reform) and privatization receipts as the means to reduce public debt. In the medium term, the authorities intend to stabilize debt below 60 percent of GDP, but recognized the need for additional buffers and thus a lower debt ratio in the longer term. The authorities stressed that the previous objective of reducing public debt below 45 percent of GDP by 2020 was not attainable, but indicated no immediate plans to change the legal debt ceiling. Staff argued that public debt of 60 percent of GDP is too high as it would leave Serbia highly exposed to adverse shocks, and saw the 45 percent of GDP debt target as an appropriate long-term anchor beyond 2020.

12. Curbing the sizeable spending on public wages and pensions was seen as key to fiscal adjustment. Staff noted that given the rapid escalation of public wages in the past two years, a multi-year freeze had the potential to yield meaningful and durable savings (Box 4), although nominal wage cuts should not be ruled out given the magnitude of needed fiscal adjustment. In addition, staff indicated that public sector employment needs to be strictly controlled and discretionary bonuses eliminated. The authorities explained that wage and pension freezes were not feasible, citing concerns about already weak domestic demand and possible social tensions. They, however, indicated a willingness to consider revising the legal indexation formula by linking public wage growth to one-half of the private wage bill growth. In their view, such a formula could deliver fiscal savings while gradually reducing the excess of public over private wage levels. Staff cautioned against rushed changes to the indexation methodology and recommended a temporary suspension/modification of the existing mechanism pending more in depth analysis. Staff also argued for ambitious parametric reforms to contain Serbia's oversized public pension bill (Selected Issues Paper "Pension Reform"). The authorities plan to very gradually increase the retirement age by 2 years for men and women respectively, but were non-committal to staff's recommendations to unify retirement conditions for men and women and introduce meaningful actuarial penalties for early retirement.





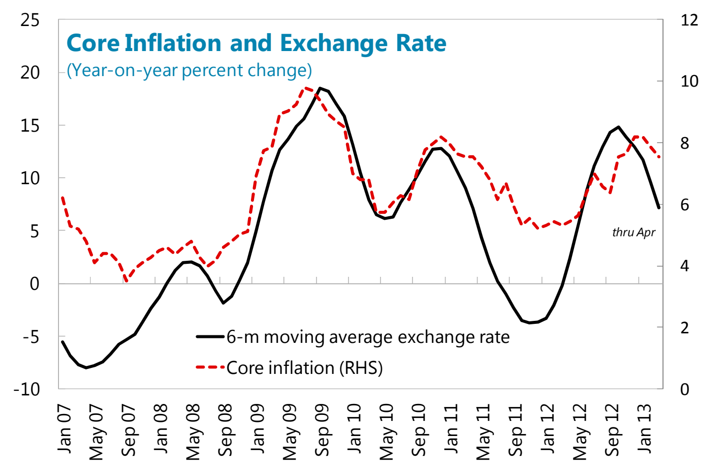
Sources: National authorities and IMF staff estimates.

13. Staff stressed the overriding importance of expenditure control in all areas. Expenditures that merit rationalization include agricultural subsidies, inefficient subsidy programs (e.g., credit subsidies), and those social assistance benefits that are poorly targeted. The authorities considered agricultural and economy subsidies an integral part of their economic revitalization strategy and thus saw little scope for their reduction. Staff also recommended additional efforts to reverse the amendments to the 2011 LG financing reform (Figure 8, Box 5, and Selected Issues Paper "Has Sub-National Spending Added to Fiscal Pressures?") beyond what the May wage/pension tax rate reform package delivered. Staff advocated phasing out issuance of new guarantees, which have a large role in public debt dynamics, and accelerating PFM reforms to underpin expenditure-based adjustment and limit fiscal risks (Box 2).

14. The authorities and staff agreed that, given the already high tax burden, revenue measures should concentrate on broadening the tax base. Staff advised eliminating numerous costly tax exemptions and allowances (Selected Issues Paper "Corporate Income Tax and Other Corporate Taxes"), streamlining items that qualify for the lower VAT rate, and eliminating VAT refunds on the first purchase of residential property. While the scope for tax rate increases is limited, the reduced VAT rate could be increased from 8 to 10 percent in line with the last year's increase in the headline rate, although this would have social implications given the large weight of food among the goods subject to the 8 percent rate. Furthermore, improvements in tax administration should address the recent unanticipated weakness in revenue collection. The authorities expressed a commitment to strengthen tax administration and improve tax compliance in line with the recommendations of a recent IMF technical assistance, including by streamlining the organizational structure of Tax Administration, phasing in a modern compliance risk management approach, and upgrading information technology systems.

B. Monetary and Exchange Rate Policy: Keeping Inflation Under Control

15. The NBS affirmed its commitment to price stability. The authorities concurred with staff that the IT framework was the most appropriate for Serbia. They indentified several factors that explain inflation volatility since adopting the full-fledged IT regime in 2009, including: (i) large pass-through from periodic depreciation bouts; (ii) exceptionally high euroization that weakens the transmission mechanism of monetary policy; (iii) pronounced food price shocks that stem partly from external protection of agricultural markets (Figure 9); and (iv) fiscal dominance (Selected Issues Paper "Inflation Targeting in a Euroized Economy"). Furthermore, the NBS and staff agreed that the flexible exchange rate regime is an important shock absorber, especially given widespread price and wage rigidities. Staff supported the NBS's policy to limit FX interventions only to counteract excessive exchange rate volatility.

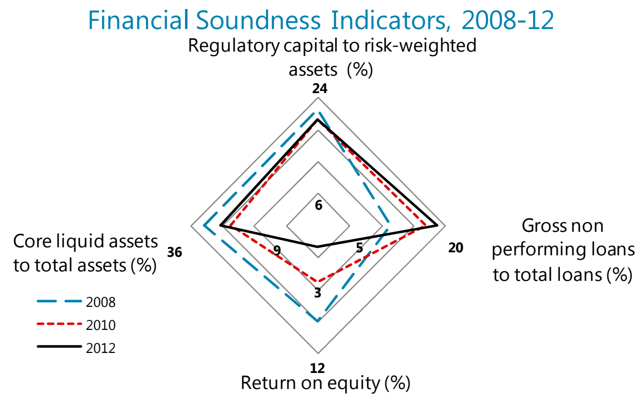


Sources: National authorities and IMF staff estimates.

16. The NBS saw some room for relaxing monetary conditions given the unbalanced policy mix and weak economy. The NBS considered the elevated level of liquidity as supportive of credit growth. Staff advised caution in relaxing monetary policy (i.e., reducing the average reverse repo rate) until fiscal consolidation firmly takes hold, provided that capital inflows continue and monthly inflation subsides as expected. If capital outflow risks and depreciation pressures re-emerge, the NBS should promptly mop up excess dinar liquidity by stepping up auction volumes. The NBS agreed with staff that the gap between the key policy rate and the average reverse repo rate sent an uncertain signal about the monetary policy stance and should be gradually eliminated (Figure 10). The NBS nevertheless reduced both the key policy rate and the reverse repo rate by 50 basis points in May, thus effectively easing monetary policy. Staff voiced concerns that relaxing monetary conditions appeared premature whereas the NBS believed that this was consistent with bringing inflation back to the IT band by year-end.

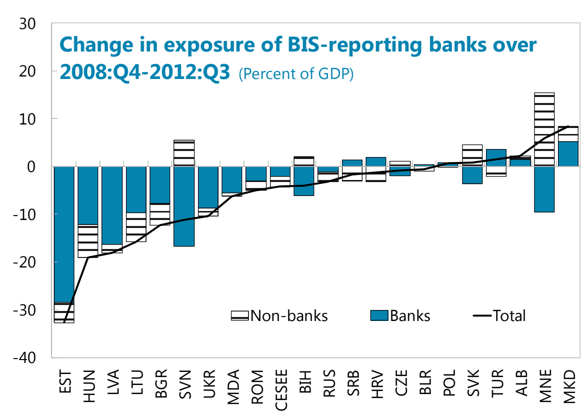
C. Financial Sector: Preserving Stability and Reviving Credit Growth

17. The authorities and staff considered the banking system as stable overall, despite weaknesses in some public banks. Capitalization and liquidity indicators of the banking system are high, and NPLs are well-provisioned, despite their sharp rise since the beginning of the crisis (Figure 11 and Table 8). However, weak management has resulted in the failure of two state-owned banks, and their resolution required considerable fiscal cost. Staff therefore advised regular communication between the MoFE, the NBS, and the Deposit Insurance Agency (DIA) to develop a strategy for state-owned banks to improve their management and minimize the need for future resolutions.



Source: NBS.

18. The authorities agreed with staff that financial sector policies should aim to reduce banking system vulnerabilities and address structural impediments to credit growth. While dominated by subsidiaries of euro area banks, Serbia's banking sector has been less impacted by deleveraging than other European peers (Box 6 and Selected Issues Paper "Macro-Financial Linkages"). The high euroization of deposits and assets is the Achilles' heel of the banking system: most borrowers are unhedged and exposed to exchange rate fluctuations, thus amplifying credit risk for banks. While sluggish demand was viewed as the main factor behind weak credit, the high level of NPLs was also seen as affecting banks' willingness to lend. Discussions focused on the following policy priorities:



Source: BIS.

- ***Addressing the high stock of NPLs.*** The authorities have already implemented several measures to address the legacy NPL stock by avoiding taxation of restructured debt, setting up a legal framework for voluntary corporate debt restructuring, and allowing sales of corporate NPLs to nonbank entities. They noted progress in NPL resolution, especially through the use of new (pre-pack) procedures under the bankruptcy law. The Belgrade Forum (March 2013) held under the auspices of the Vienna-2 Initiative provided further suggestions, such as improving the broader judicial system, promoting out-of-court debt workouts, and clarifying creditor classes in bankruptcy procedures and creditor rights under the mortgage law. Staff agreed that efforts should focus on reducing remaining bottlenecks.

- ***Implementing a comprehensive strategy of dinarization.*** The NBS and staff were of the view that deepening local currency financial markets and fostering institutions operating in these markets (pension funds and insurance companies) would increase demand for dinar assets and encourage dinarization. The NBS also emphasized the need for the involvement of other government agencies to successfully implement the strategy.

- ***Maintaining strong prudential policies.*** While Serbia's regulatory provision-to-NPL ratio is very high (Figure 11), it partly reflects the exclusion of some classified assets (such as off-balance sheet items) from the definition of NPLs. Thus, staff saw the need to preserve these vital safety cushions to guard against the resurgence of financial stress. On the other hand, NBS believed that tight prudential policies have contributed to high lending rates, thereby exacerbating constraints to credit growth. Staff advised against changes to the asset classification and provisioning framework pending results of its careful examination.

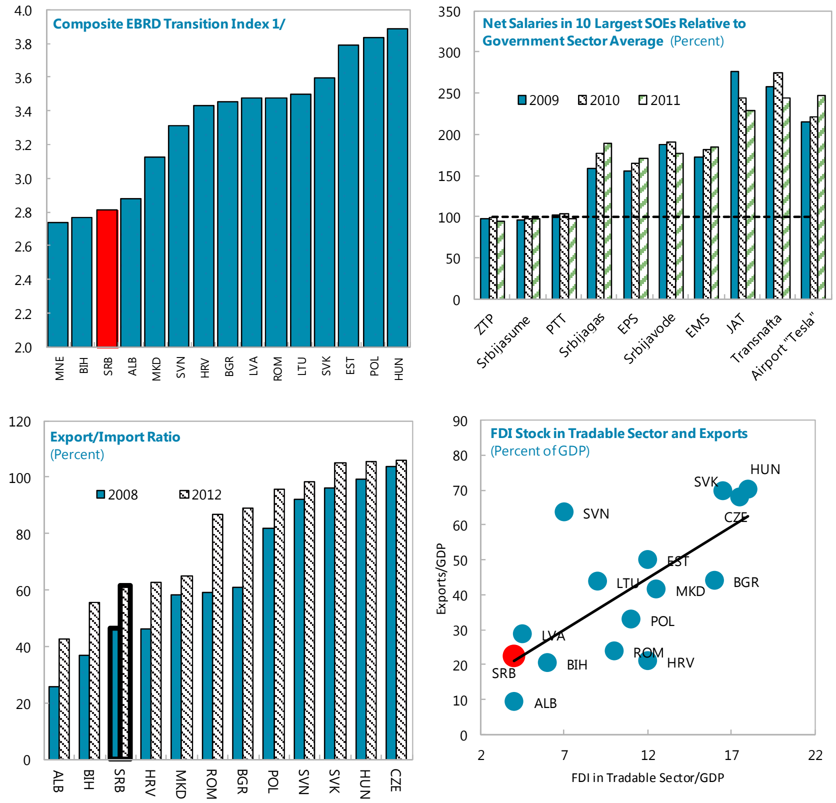
D. Structural Reform: Strengthening Competitiveness and Growth

19. The authorities recognized the need to address significant bottlenecks to private sector activity and competitiveness stemming from the delayed transition to a market economy. They agreed with staff on the need to improve non-price competitiveness, address longstanding labor market impediments, and reduce the large number of extensively subsidized and protected state and socially owned enterprises (SOEs). They pointed out that the medium-term fiscal strategy published at end-2012 outlined structural reforms needed to achieve robust and sustainable growth (Figure 12, Table 9, and Selected Issues Papers "In Search of an Effective Growth Model" and "External Competitiveness Assessment"). Staff welcomed these plans, but noted that implementation has yet to firmly take off. The authorities replied that many of these reforms are difficult and require broad-based support. Staff acknowledged these challenges and the short-term cost of reforms, but urged their steadfast implementation to unlock potential growth.

- *Labor market reforms*. Staff urged reforms to foster private sector job creation and tackle persistently high unemployment (Selected Issues Paper "Improving the Labor Market: Challenges and Options"), particularly removing disincentives for hiring and making wage bargaining and employment procedures more flexible, delinking severance payments from lifetime employment, and relaxing restrictions on the separation process, which would in turn improve incentives for hiring. Staff also cautioned against minimum wage increases that outpace productivity growth and consequently exacerbate the already high youth unemployment (now at 51 percent). The authorities are setting up a working group to prepare amendments to the Labor Law that would revisit the length of fixed-term contracts, employment termination procedures, severance pay, payroll calculation procedures, and other administrative burdens for employers.

- *Regulatory reforms.* The authorities concurred that Serbia's rigid business environment hampers foreign investment and needs an urgent overhaul. Staff recognized the recent steps to improve the complex regulatory framework, such as the reduction of parafiscal fees, but advised further progress. Policy priorities include simplifying business laws and regulations, strengthening the regulatory impact analysis of new legislation, streamlining fees and charges, modernizing tax and customs administration, effectively implementing the anti-corruption framework, as well as land and real estate reform.

- *Public enterprise reform.* The authorities recognized the need to reduce excessive state-directed intervention in public enterprises, which strains public finances (direct state support to SOEs is estimated at 2½ percent of GDP over 2010–11), and crowds out private sector activity. Jointly with the World Bank, they are preparing a comprehensive plan to privatize and corporatize SOEs and improve transparency of their operations. This includes divesting of SOEs that are currently in the portfolio of the Privatization Agency, and finding strategic partners or divesting of a number of large commercial SOEs. Staff clarified that the process should be accompanied by strict wage and employment policies in SOEs based on performance criteria, and a gradual increase of utility tariffs to cost recovery levels. Staff welcomed these plans and the potential future fiscal savings through lower subsidies and guarantees, but advised proper budgetary planning of transitory costs associated with severance payments and the assumption of some SOE debt by the government.



Sources: EBRD; WEO; Kinoshita (2011); and IMF staff estimates.
1/ Average of six EBRD transition indicators (privatization of large- and small-scale enterprises, price liberalization, governance and enterprise restructuring, trade and foreign exchange system, and competition policy.

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20. Serbia's economy is recovering from recession but faces multiple challenges. The successful launch of Fiat production in 2012 is contributing to growth this year and inflation is declining. Yet, unemployment is high and the large 2013 fiscal deficit will further exacerbate the already high public debt. Potential growth is constrained by multiple structural hurdles resulting from unfinished structural reforms—the business environment is not conducive to investment and the unreformed parts of the economy continue to drain public resources. The outlook is subject to external risks, particularly as higher global risk aversion could raise the cost of financing and erode reserve buffers.

21. Progress towards EU accession creates an opportunity to tackle these challenges. Rebalancing the policy mix and launching a comprehensive package of structural reforms are critical to unlocking Serbia's growth potential. Taking advantage of favorable market conditions could lessen the contractionary short-term effects of adjustment and reform. This would allow Serbia to realize the significant potential for convergence towards EU income levels.

22. Sustained and sizeable fiscal consolidation in the near and medium term is needed to repair public finances. In 2013, fiscal measures of 1½ percent of GDP—in addition to what has already been legislated and included in the unchanged policy scenario—are needed to maintain at least a neutral budgetary stance. In the medium term, achieving a much lower public debt ratio should be the overarching policy objective. The emphasis of adjustment should be on reducing mandatory spending, including by freezing pensions and wages, a far-reaching parametric pension reform, and public employment rationalization. Progress on a vast agenda of PFM reforms is crucial for enhancing the credibility and quality of the expenditure-based adjustment. Improving tax administration and reducing tax exemptions have the potential to supplement fiscal savings.

23. The IT framework and flexible exchange rate should be preserved. A lower level of inflation and reduced volatility would support dinarization and improve the monetary transmission mechanism. Once the fiscal adjustment process is firmly on track, cautious monetary easing would be appropriate provided inflation remains firmly on a downward trajectory and absent exchange rate pressures. In that regard, the recent reduction of the average interest rate on reverse repo operations—the main gauge of monetary conditions—appears premature. Meanwhile, the gap between the key policy rate and the average reverse repo rate should be gradually reduced in order to send consistent policy signals.

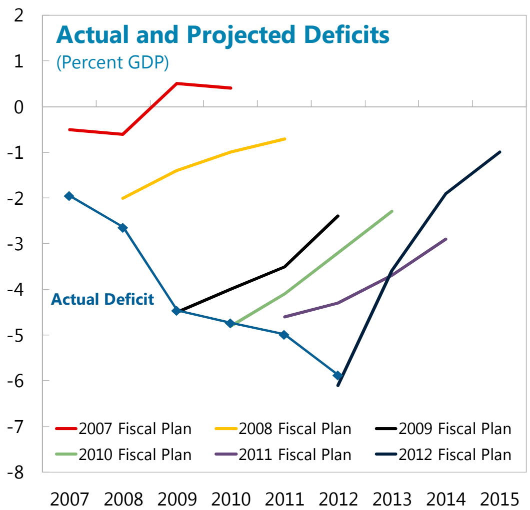
24. Reviving credit growth and maintaining financial sector stability is essential for economic recovery. Removing regulatory and tax hurdles are welcome steps that should help resolve NPLs and pave the way for boosting private sector credit. Given an unsettled external environment and downside risks, the current prudential standards should be preserved pending further examination. Recent cases where state-owned bank resolution was required underscore the need for careful supervision and a comprehensive strategy for public banks. In that regard, close coordination between NBS, the MoFE, and the DIA would be important.

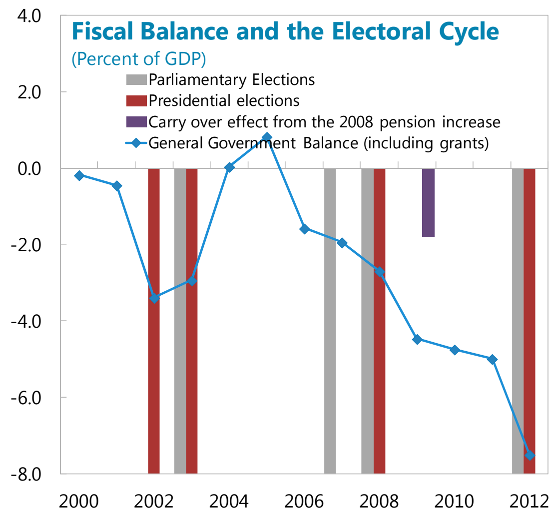
25. Sustained progress on wide-ranging structural reforms would help unlock Serbia's growth potential. Priority areas include streamlining the regulatory framework and improving the business environment, enhancing the functioning of the labor market, and restructuring of SOEs. These reforms would help boost Serbia's competitiveness and growth potential and accelerate income convergence to EU levels.

26. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Box 2. Structural Fiscal Challenges

Serbia has a relatively weak track record of meeting its own fiscal deficit targets, both in the short and long term. On average, those targets were exceeded by around 5 percent of GDP over a three-year horizon, largely due to expenditure overruns, as opposed to revenue shortfalls. Slippages reflect electoral cycles compounded by weak institutions. Fund-supported programs helped improve policy implementation, but progress tended to be undone between program periods.





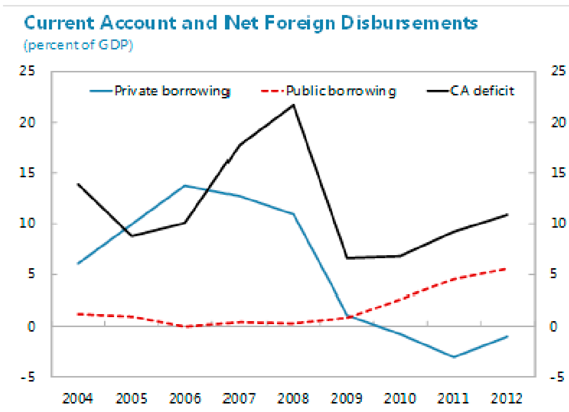
Sources: MoFE and IMF staff estimations.

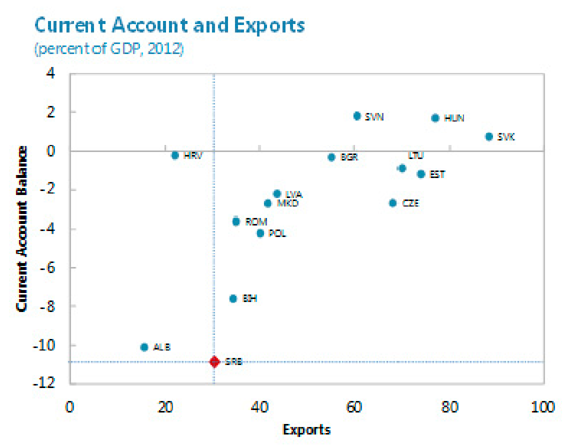
To improve policy implementation, Serbia's fiscal framework needs to be strengthened in the following areas: (i) decreasing the fragmentation of the budget process across time and the various parts of the general government; (ii) introducing an effective multi-year orientation of spending policies; (iii) improving the transparency of fiscal operations; (iv) strengthening external and internal audit procedures and follow-up; (v) reducing recourse to quasi-fiscal operations; and (vi) reducing the dominance of mandatory current spending, whose overruns cannot be fully offset by other items and crowd out more productive investment spending.

PFM reform can also bolster the fiscal framework and help improve expenditure execution. Some progress has been made in this area, such as the integration of own source accounts into the central government budget, and the creation of a public employee register (to be finalized by June) as a first step towards controlling public sector employment. Further PFM priorities, include: (i) integrating own-source accounts of indirect budget beneficiaries into the budget process; ii) developing a system to comprehensively monitor spending arrears and properly resolve their existing stock; (iii) improving implementation of existing provisions of the Budget System law for screening and containing new expenditure initiatives; (iv) introducing binding aggregate medium-term expenditure ceilings; (v) improving the financial position of social security funds and the Road Fund, and more fully integrating them into the budget process; (vi) strengthening fiscal coordination between central and local governments; (vii) containing fiscal risks from the recent public-private partnership (PPP) law; (viii) imposing strict and sustainable controls on the issuance of government guarantees; and (ix) strengthening debt management.

Box 3. External Sustainability Assessment

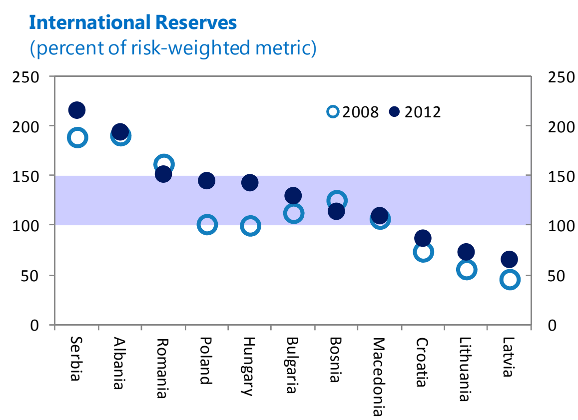
Serbia's large current account deficit partially adjusted since the onset of the global crisis. Yet at end-2012, the current account deficit was the highest in the region. Serbia's low export base has been held back by structural rigidities and a weak business environment, leading to a low share of FDI (particularly greenfield) into tradable sectors. Recent IMF research suggests that the composition of FDI matters and excessive inflows into nontradable sectors can contribute to external imbalances.[1]





Sources: NBS and IMF staff estimates.

Serbia's ample reserves somewhat mitigate the large external vulnerabilities. International reserves are adequate, exceeding all standard indicators of reserve coverage. They surpass the recommended bounds of the IMF reserve adequacy metric,[2] recording the highest reserve coverage in the region.



A fundamental change in policies is needed to reduce external vulnerabilities and ensure external sustainability.

- Under unchanged policies, staff estimates that the real exchange rate appears overvalued compared to medium-term fundamentals in the absence of fiscal consolidation and meaningful structural reforms. The macro balance (MB) and external sustainability (ES) approaches suggest overvaluation of 15–20 percent. High current account deficits and lack of external financing due to negative confidence effects would gradually deplete reserve buffers and put the international investment position on an unsustainable path.

- In contrast, sustained policy efforts in staff's illustrative adjustment scenario would help ensure external sustainability, mitigate dinar overvaluation, preserve adequate reserve buffers, and reduce Serbia's net indebtedness to the rest of the world.

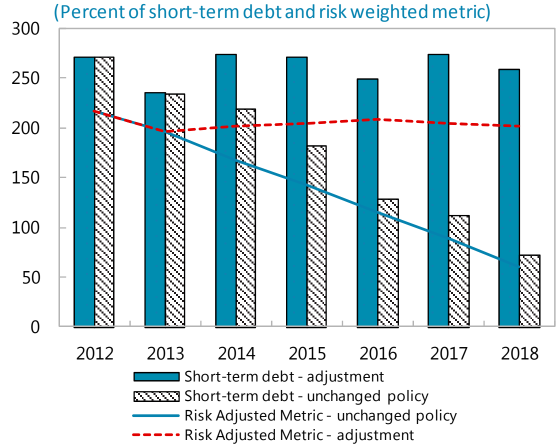
Box 3. External Sustainability Assessment (concluded)

Serbia: Exchange Rate Assessment [1/]

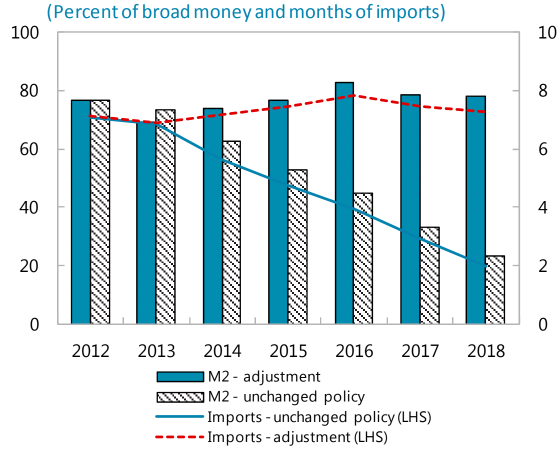
Scenario	Approach	REER misalignment (percent)
Unchanged policy	MB	20.3
	ES	17.6
Adjustment	MB	-3.4
	ES	-0.4

1/ Based on IMF CGER methodology extension in Vitek, 2012 (Vitek, Francis, "Exchange Rate Assessment Tools for Advanced, Emerging, and Developing Countries", mimeo, 2012)

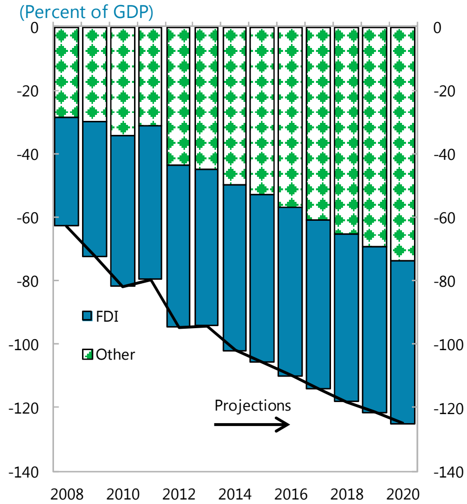
Reserves under unchanged policy and adjustment scenarios
(Percent of short-term debt and risk weighted metric)



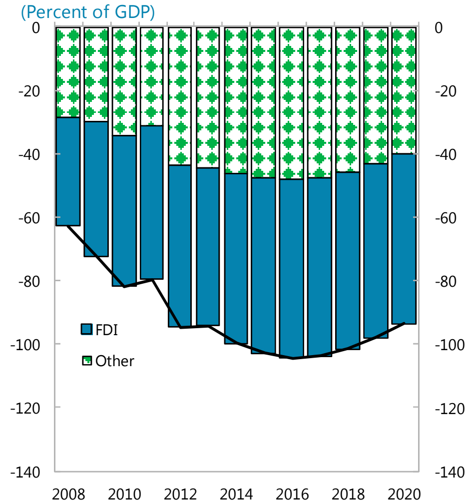
Reserves under unchanged policy and adjustment scenarios
(Percent of broad money and months of imports)



IIP Unchanged Policy Scenario
(Percent of GDP)



IIP Illustrative Adjustment Scenario
(Percent of GDP)



Sources: Serbian Authorities; IFS; WEO; and IMF staff projections.

1/ Kinoshita, Yuko, "Sectoral Composition of FDI and External Vulnerability in Eastern Europe," International Monetary Fund, Working Paper 11/123, 2011.
2/ The suggested appropriate range is 100–150 percent. See IMF, "Assessing Reserve Adequacy," 2011.

Box 4. Experience with Containing the Public Wage Bill

Serbia's past experience with containing mandatory spending pressures has been mixed. Mandatory spending—mainly public wage and pension expenditures—comprises ⅔ of consolidated government expenditures and is therefore an important source of fiscal pressure. Serbia's nominal public wage freeze (2009–10) introduced at the onset of financial crisis succeeded in reducing the public wage bill by 0.3 percent of GDP over 2009–11—less than in most other emerging and advanced European economies. In 2012, Serbia's public wage bill grew more rapidly than in the average European country, eliminating previous consolidation gains.

Adherence to the indexation rule has been a challenge. In 2010, Serbia adopted a semi-annual CPI wage-indexation mechanism (April/October) based on the previous 6-months inflation rate where the April wage adjustment is augmented by half of real GDP growth in the previous year if positive. Although the indexation rule was designed to trend the public wage bill down gradually over time in relation to GDP, wage bill growth has consistently exceeded the percentage implied by the rule by a wide margin. This was due to one-off increases (e.g. ad hoc wage bonuses) and a stubborn wage and employment drift. Furthermore, this contributed to a sustained wedge between public and private sector wages.

Recent Public Wage Measures in Selected European Economies
2012-2013 (unless otherwise identified)

	Change in Wage Bill (2009-12) percent GDP	Wage Measures	Personnel Measures	Average Public Debt (2009-11) percent GDP
Hungary	-1.6	General wage freeze (2012-13).	Hiring freeze for Central Government (since 2010).	81
Ireland	-1.4	Progressive wage cuts: average of 13½ percent in 2009-10; about 6½ percent expected in 2013.	Moratorium on recruitment and promotions (since 2009); Targeted voluntary-redundancy scheme (2013).	88
Italy	-0.7	Wage freeze (2010-14).	Attrition rule (1:5).	119
Poland	-0.7	Wage bill freeze (Central Government since 2010).	-	54
Portugal	-2.8	Average wage cut (5 percent, 2011).	Promotions and hiring freeze (2011); Staff reductions (2 percent per year 2011-14).	95
Romania	-2.4	Wages cut (25 percent, 2010).	Attrition rule 7:1 (2010, ongoing).	29
Serbia	**0.3**	**Wage freeze (2009 and 2010); Cap on indexation (2012-13).**	**-**	**44**
Slovakia	-0.8	Wage bill cut (5 percent, 2013).	-	40

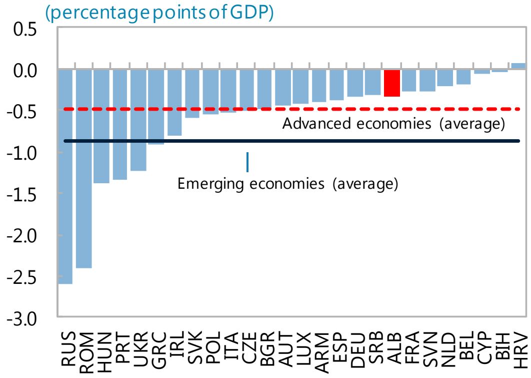
Source: WEO and IMF staff estimates.

Europe's recent experience with wage austerity offers important policy insights for Serbia at the current juncture. Meaningful reductions in public wage bills have been achieved primarily on the basis of multi-year nominal public wage freezes and/or explicit upfront wage cuts. Measures to eliminate wage bonuses and allowances, promotion freezes, and attrition rules have also been effective. In Serbia, widespread public sector downsizing would exacerbate the already very high unemployment. However, a temporary suspension of indexation can yield powerful savings as it contains both wage and pension expenditures. An illustrative three-year nominal wage freeze is estimated to deliver cumulative fiscal consolidation of around 1¾ percent of GDP. When combined with measures to eliminate wage drift over the same period, potential savings increased to around 2½ percent of GDP. Additional fiscal savings could be achieved if indexation measures were extended to pensions.

Box 4. Experience with Containing the Public Wage Bill (concluded)

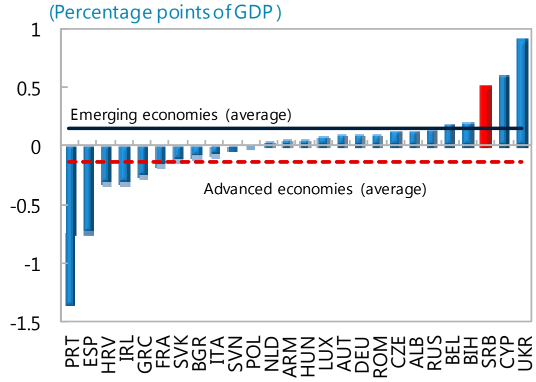
Nominal wage freezes helped reduce Serbia's wage bill post crisis but the fiscal adjustment was relatively small...

Cumulative Change in Public Wage Bill, 2009-2011
(percentage points of GDP)



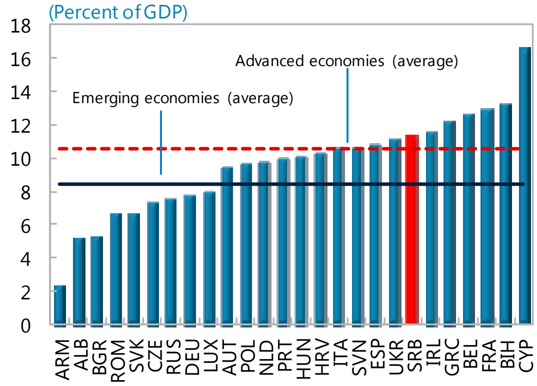
...and recent wage increases have outpaced the average European economy, eliminating previous fiscal savings.

Change in Public Wage Bill, 2011-2012
(Percentage points of GDP)



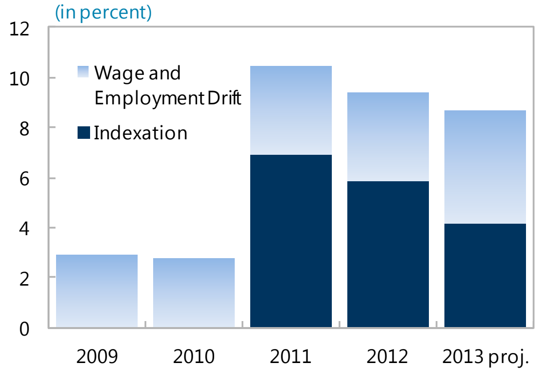
Consequently, Serbia's wage bill is among the highest in Europe.

Government Wage Bill, 2012
(Percent of GDP)



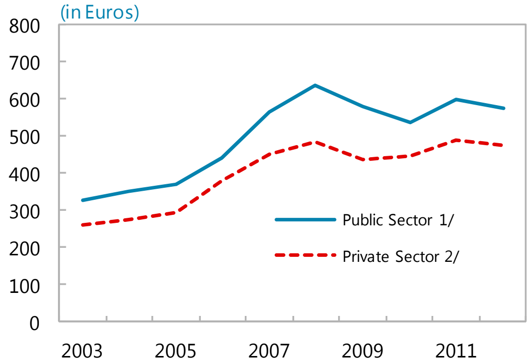
Adhering to indexation has proven difficult due to employment and wage drift, partly associated with ad hoc bonuses...

Growth in Nominal Public Wage Bill (2009-2013)
(in percent)



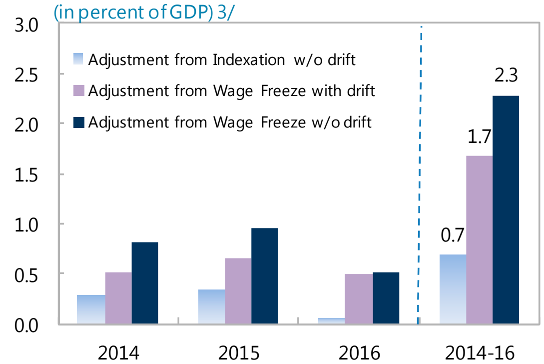
...that has help sustain a distortionary wedge between public and private-sector wages.

Average Monthly Gross Wage
(in Euros)



Nominal wage freezes combined with measures to limit wage and employment drift can deliver substantial fiscal savings.

Simulated Prospective Wage Consolidation Yields
(in percent of GDP) 3/



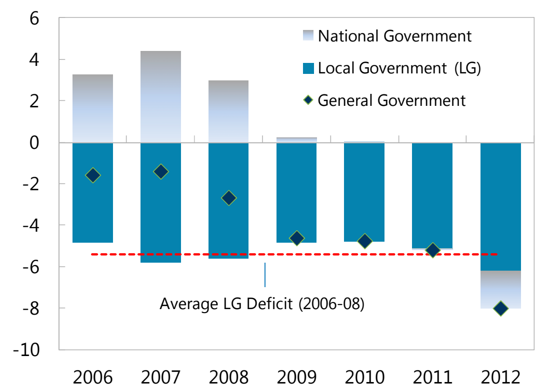
Source: Statistical Organization of the Republic of Serbia, national authorities, and IMF staff estimates.
1/ Public administration (all levels), education, culture and social services.
2/ Excluding entrepreneurs and enterprises with social and mixed ownership.
3/ Fiscal savings are estimated by applying indexation measures to public wages only. Consolidation yields would increase if indexation modifications were also extended to pensions as has been the case previously.

Box 5. Local Government Spending

Fiscal decentralization can reduce the size of the public sector, but efficiency savings are not necessarily assured. Savings do not materialize when decentralizations are financed primarily through resource transfers and/or borrowing, as is the case in Serbia.[1] This gives rise to vertical fiscal imbalances (VFIs)—a gap between subnational spending and "own" revenues (excluding transfers and shared revenues from central government)—that empirical studies associate with weaker expenditure discipline at the local level. In Serbia, the past decade has seen a shift away from self-financed local government expenditure and VFI's have thus increased. Own source deficits of LGs averaged 5¼ percent of GDP over 2006–10, implying that subnational operations have been a drag on overall public finances.

The 2011 amendments to the Law on Local Government Financing contributed to deterioration in the general government deficit. The reform was motivated by a perceived need to compensate LGs for a reduction in discretionary transfers during 2009–10. The main change was an increase in the LG share of payroll tax receipts from 40 percent to 80 percent—effectively boosting revenue sharing from the center—without a matching devolution of expenditure responsibilities. This is problematic from several perspectives. It replaced previous discretionary transfers with relatively permanent (legislated) revenues, and implied a structural shift in deficit to the republican budget (Figure 8). In addition, it over-compensated LGs, as both their revenues and expenditures are now above pre-crisis levels. Efficiency savings have not materialized, as the revenue windfall to LGs (1½ percent of GDP) was matched by an increase in discretionary spending, implying an increase in Serbia's VFI. The fiscal (and structural) deterioration associated with the 2011 reform is estimated at around 30-40 billion dinars (1-1¼ percent of GDP).

Own Balance of by Level of Government
(in percent GDP)



Sources: Ministry of Finance and Fund staff estimates.

Rolling-back the 2011 decentralization reform merits consideration given overall fiscal consolidation needs. The recently approved wage/pension tax rate reform aims to indirectly claw back a portion of the revenues shared with LGs, but the estimated savings (½ percent of GDP) involve risks and are smaller than those associated with a full repeal of 2011 amendments. Furthermore, decentralization reforms should be complemented by targeted measures to improve fiscal outcomes at the LG level. Priorities include boosting "own" revenues through property tax and service fee increases, scaling back large subsidies to municipal public entities (by increasing fees to cost-recovery levels and/or measures to reduce operating costs), wage and employment restraint, and better-targeting of subnational social assistance programs.

[1] Expenditure decentralization is defined as the ratio of subnational to consolidated government spending.

Box 6. Macro-Financial Linkages

Domestic credit to the private sector has been slowing down continuously from 2010. The 12-month growth rate of private credit in early 2013 was close to zero and creates a drag on economic activity. The slowdown has been associated with a weaker growth of domestic deposits and crowding out by the public sector. Net foreign liabilities did not play a significant role, as they remained broadly stable.

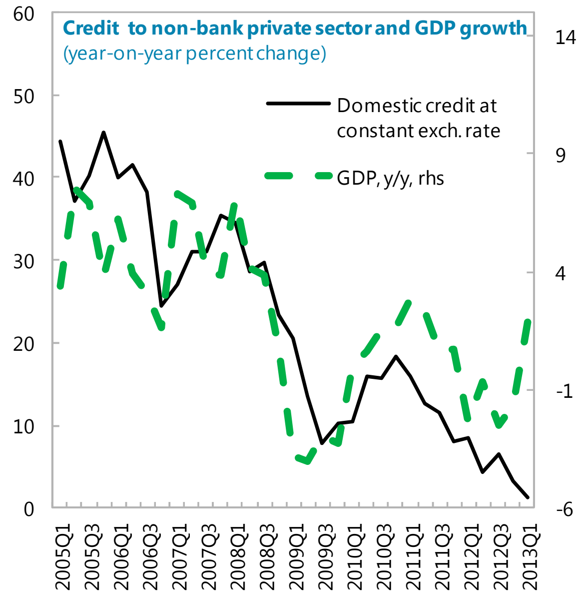
Both supply and demand factors were important for the credit slowdown. In 2012, demand for credit was affected by the recession. At the same time, the average interest rate on FX and FX-linked loans—that constitute the bulk of lending in Serbia—fluctuated within a narrow band of 7–9 percent. This is consistent with the demand for and supply of credit both changing simultaneously. Persistently high lending interest rates despite a fall in credit demand suggest a rise in the risk premium and credit supply constraints.

Interest rates on bank loans in Serbia are higher than those in peer countries. This is partly explained by the external risk premium (as there is a positive relationship between the EMBI spread and real lending rates). However, the EMBI spread does not account for the entire difference in lending rates. Significant lending risk, arising from the high share of NPLs, is priced in by banks, thus leading to tighter lending standards. In addition, the strict required reserve ratio and prudential policies—needed to preserve financial stability—add to the cost of credit.

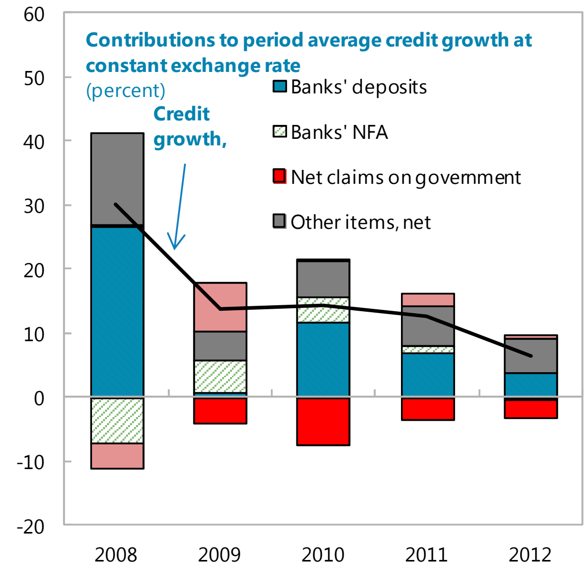
Macroeconomic stabilization and reduced credit risk would help alleviate supply-side constraints and accommodate a demand-driven increase in credit growth. Macroeconomic stabilization would reduce external risk premia and the "crowding out" effect by the public sector, thereby providing scope for easing monetary policy. Resolving the high stock of NPLs and thus repairing corporate and bank balance sheets would reduce credit risk. These factors would reduce interest rates, making credit more affordable.

Box 6. Macro-Financial Linkages (concluded)

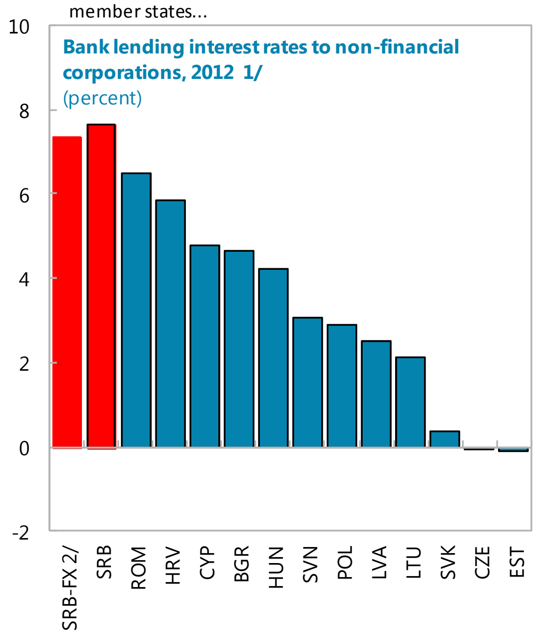
Domestic credit growth has slowed down to low single digits.



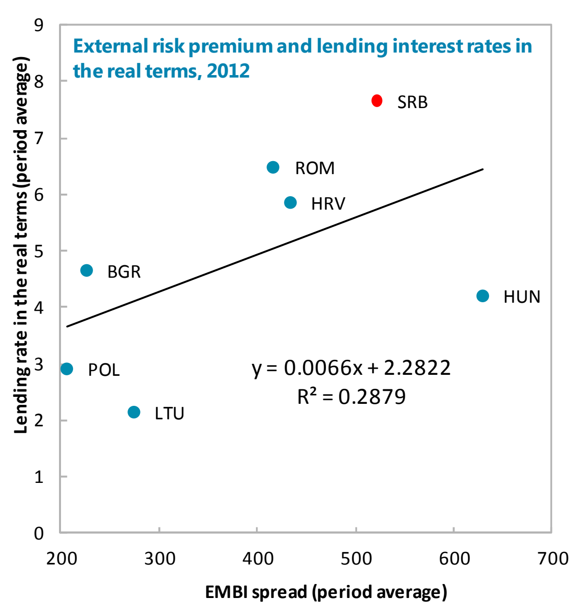
Credit slowdown reflected slower growth of deposits and crowding out by the public sector.



Lending interest rates are higher than in new member states...



...partly explained by the external risk premium.

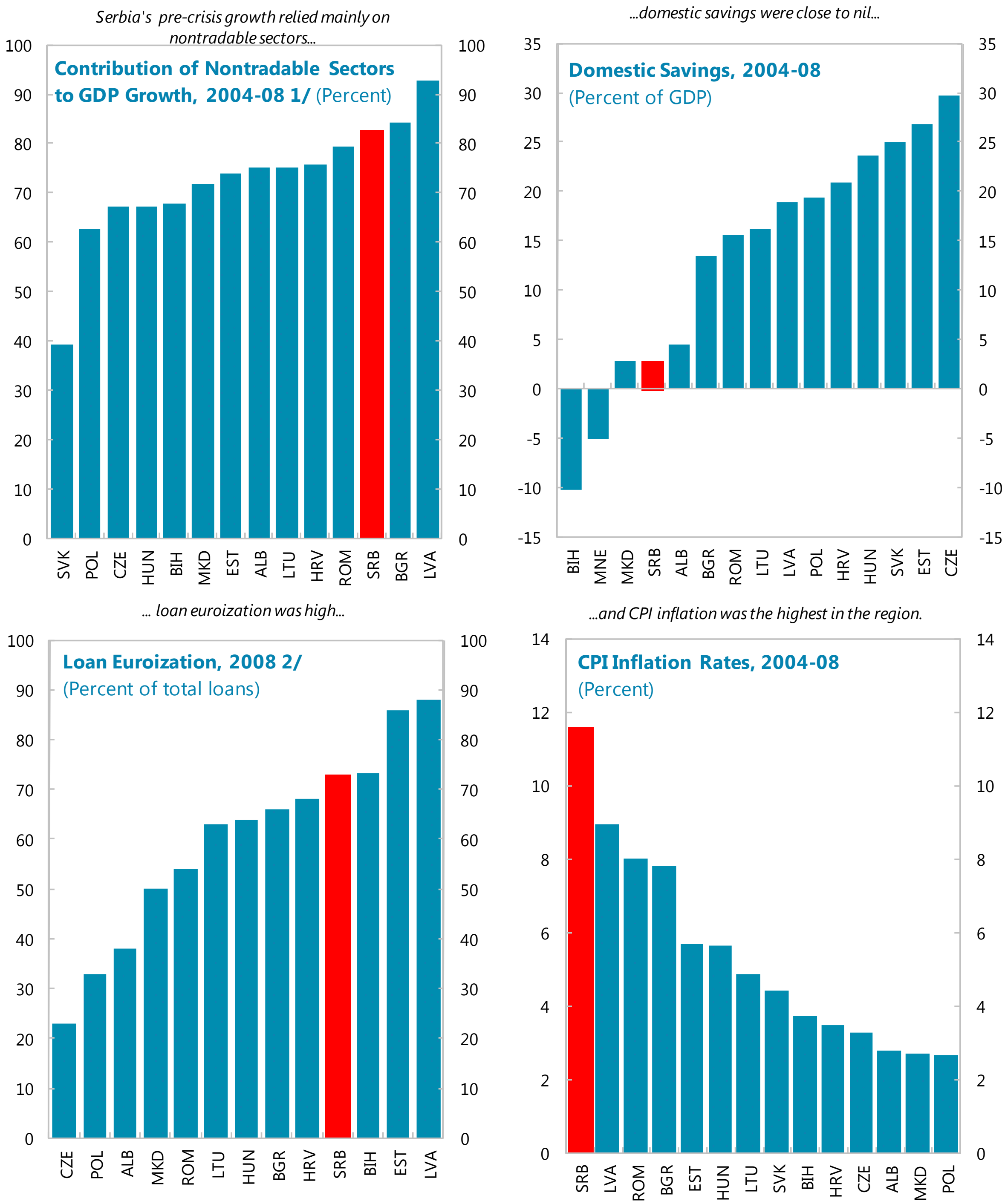


Source: NBS, IFS, and Fund staff estimations.

1/ Nominal interest rates on loans in local currency adjusted for CPI inflation.

2/ Interest rate on FX loans to non-financial corporations.

Figure 1. Emerging Europe: Symptoms of Unsustainable Growth Accelerations, 2004-08



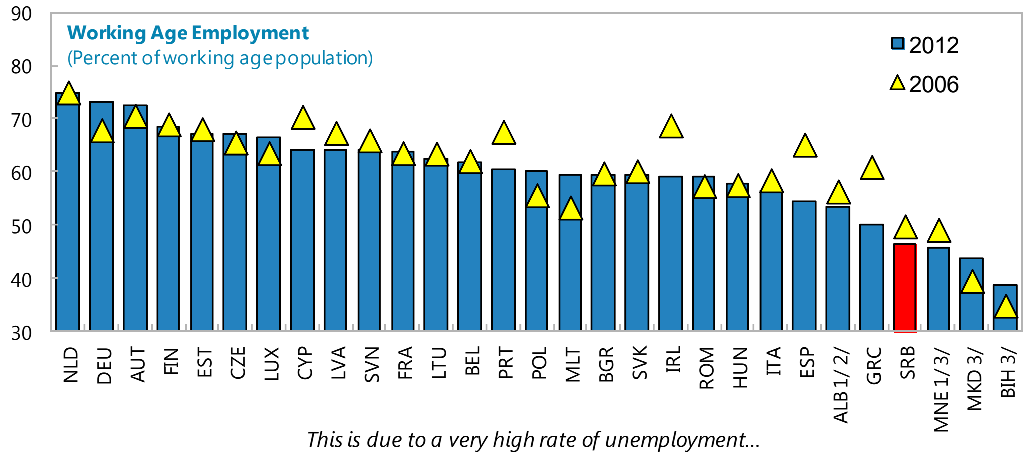
Source: WEO.

1/ Tradable sectors defined as agriculture, mining, manufacturing, and tourism. Nontradable sectors defined as including all other services, utilities, and construction.

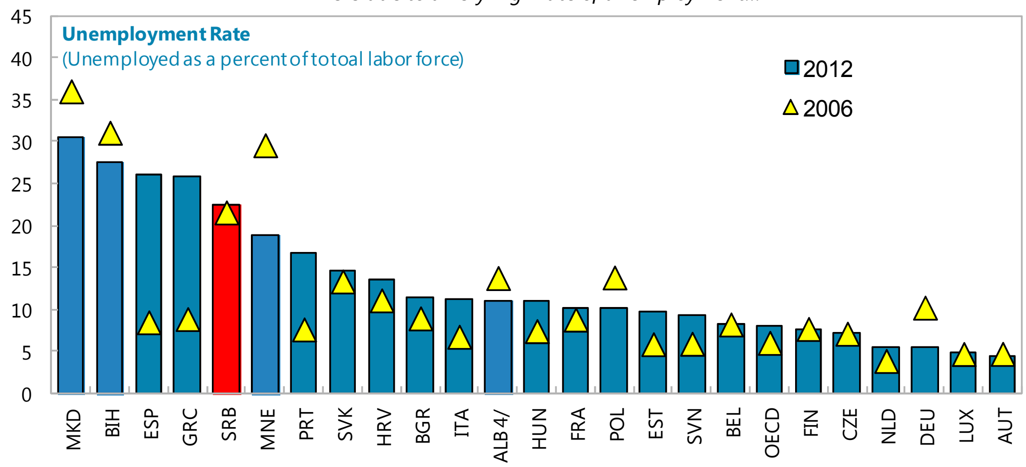
2/ Excluding cross-border loans to Serbian corporates; including cross-border loans, loan euroization would amount to about 83 percent.

Figure 2. Serbia: Labor Market Selected Indicators, 2006–12

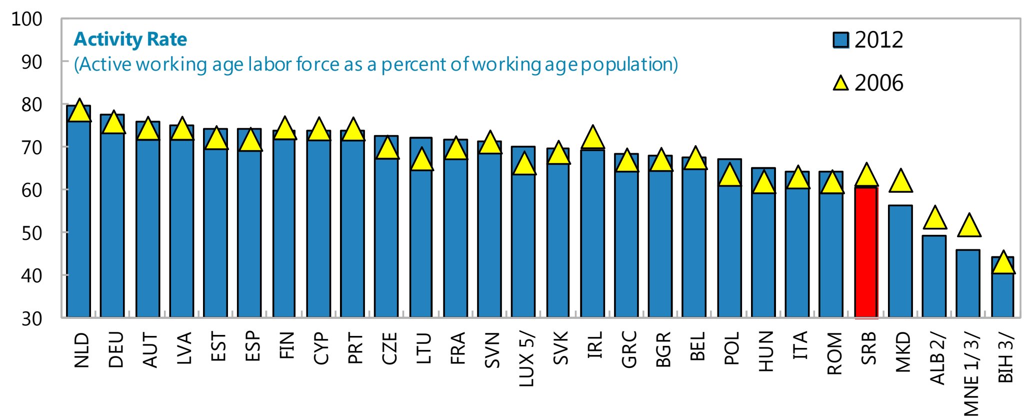
The employment rate in Serbia is one of the lowest in Europe.



This is due to a very high rate of unemployment...

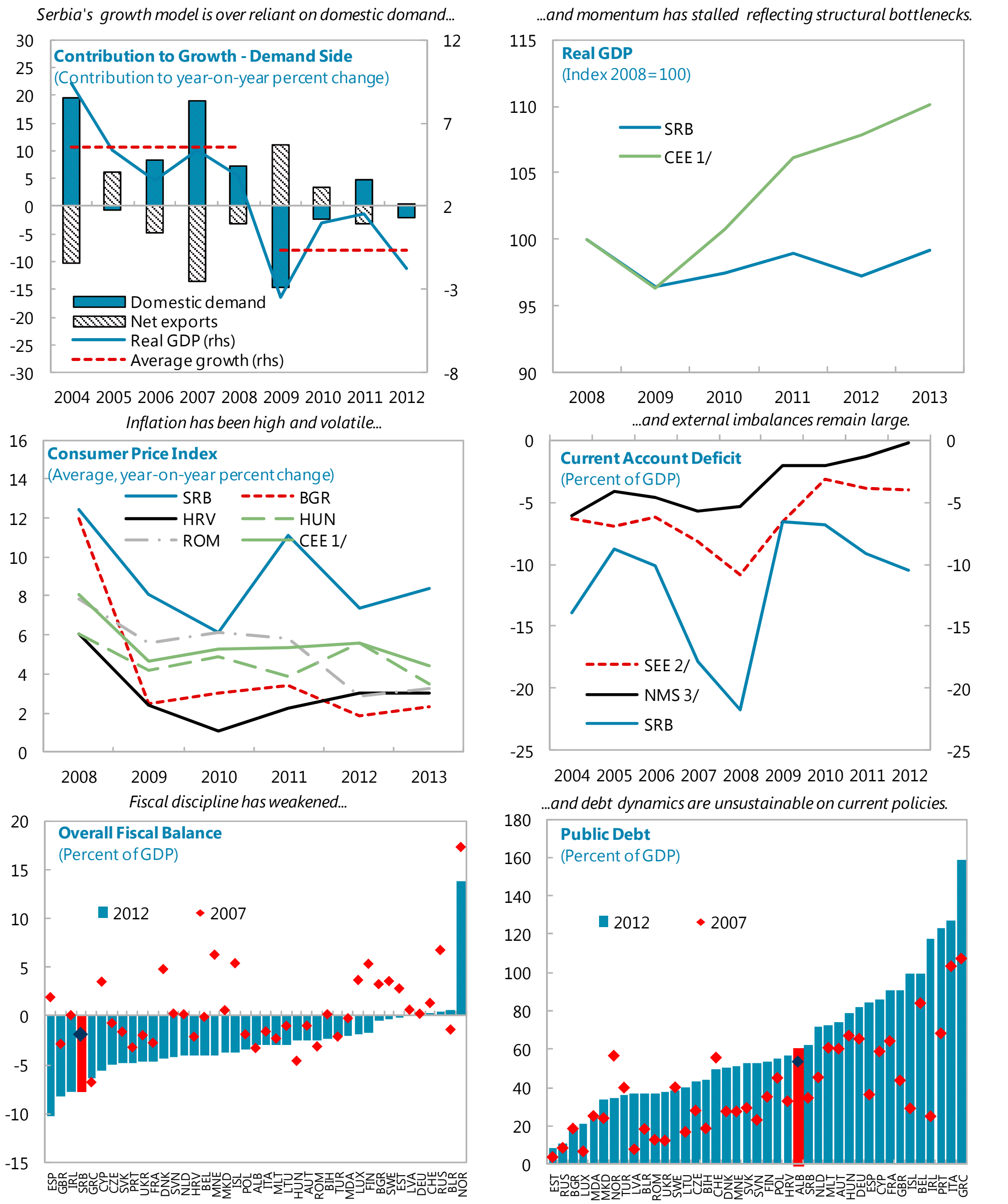


...as well as a low labor force participation rate.



Sources: Country authorities; OECD; Haver; Eurostat; CEA, and IMF staff calculations.
1/ 2007 data used in place of 2006 data.
2/ 2010 data used in place of 2012Q3 data.
3/ 2011 data used in place of 2012Q3 data.
4/ Registered unemployment used in place of labor force data.
5/ 2007Q2 data used in place of 2006.

Figure 3. Serbia: Policy Challenges, 2004–13



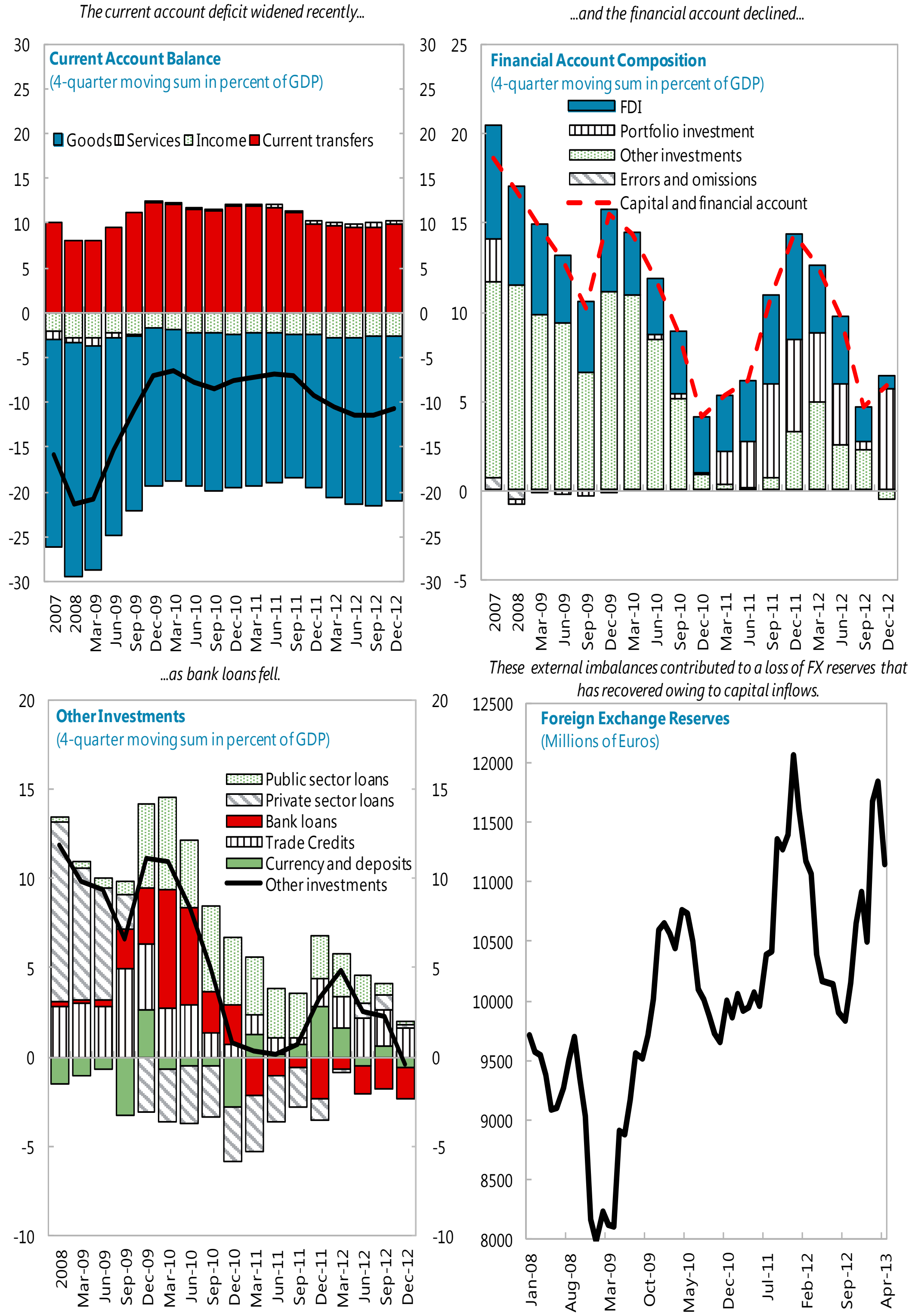
Source: State Statistical Office; WEO; and IMF staff calculations.

1/ Central and Eastern European countries include: ALB, BIH, BGR, HRV, HUN, UVK, LVA, LTU, MKD, MNE, POL, ROM, SRB, TUR.

2/ Weighted average of ALB, BIH, HRV, MKD.

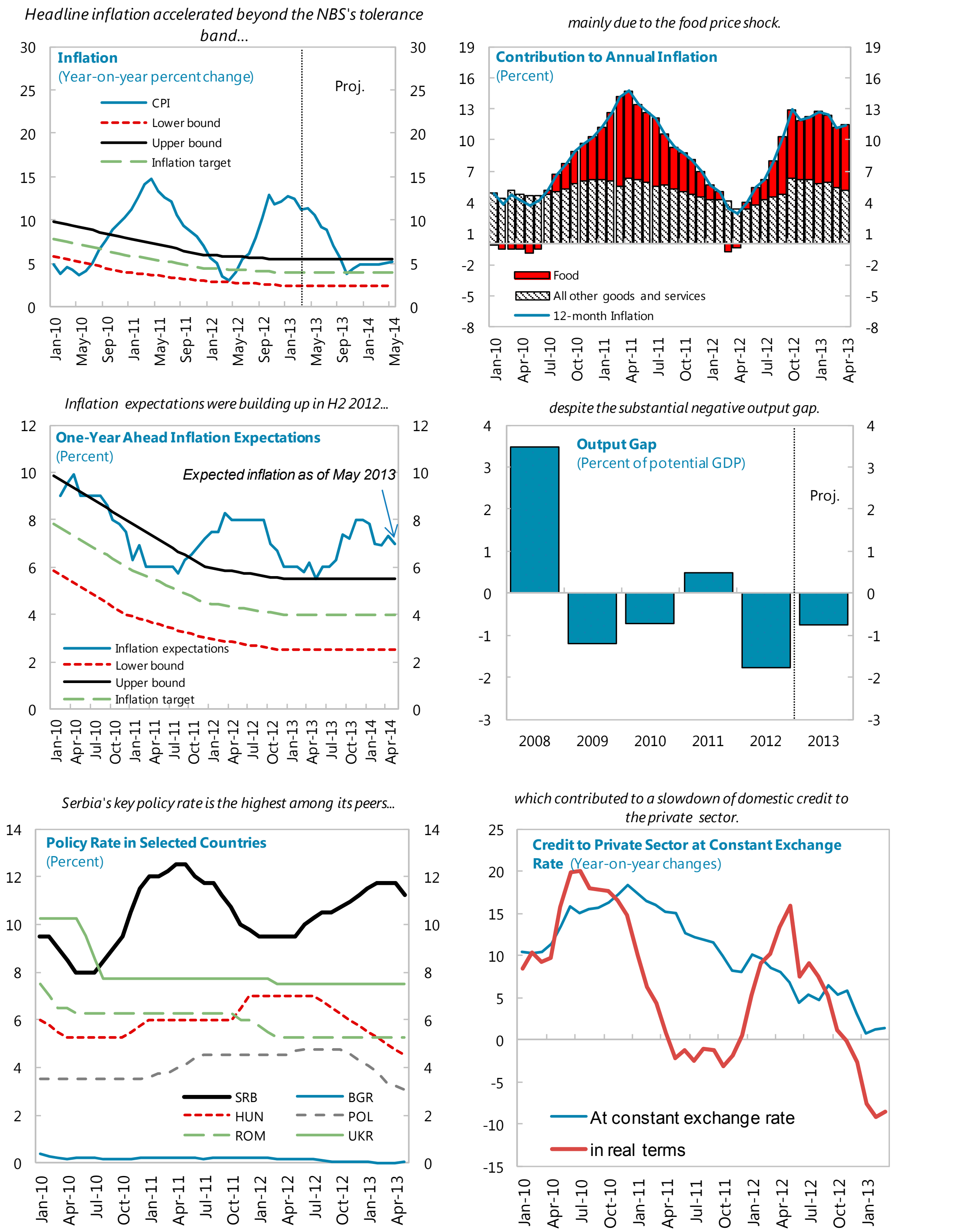
3/ Weighted average of new member states of the EU excluding Baltics.

Figure 4. Serbia: Balance of Payments, 2007-13



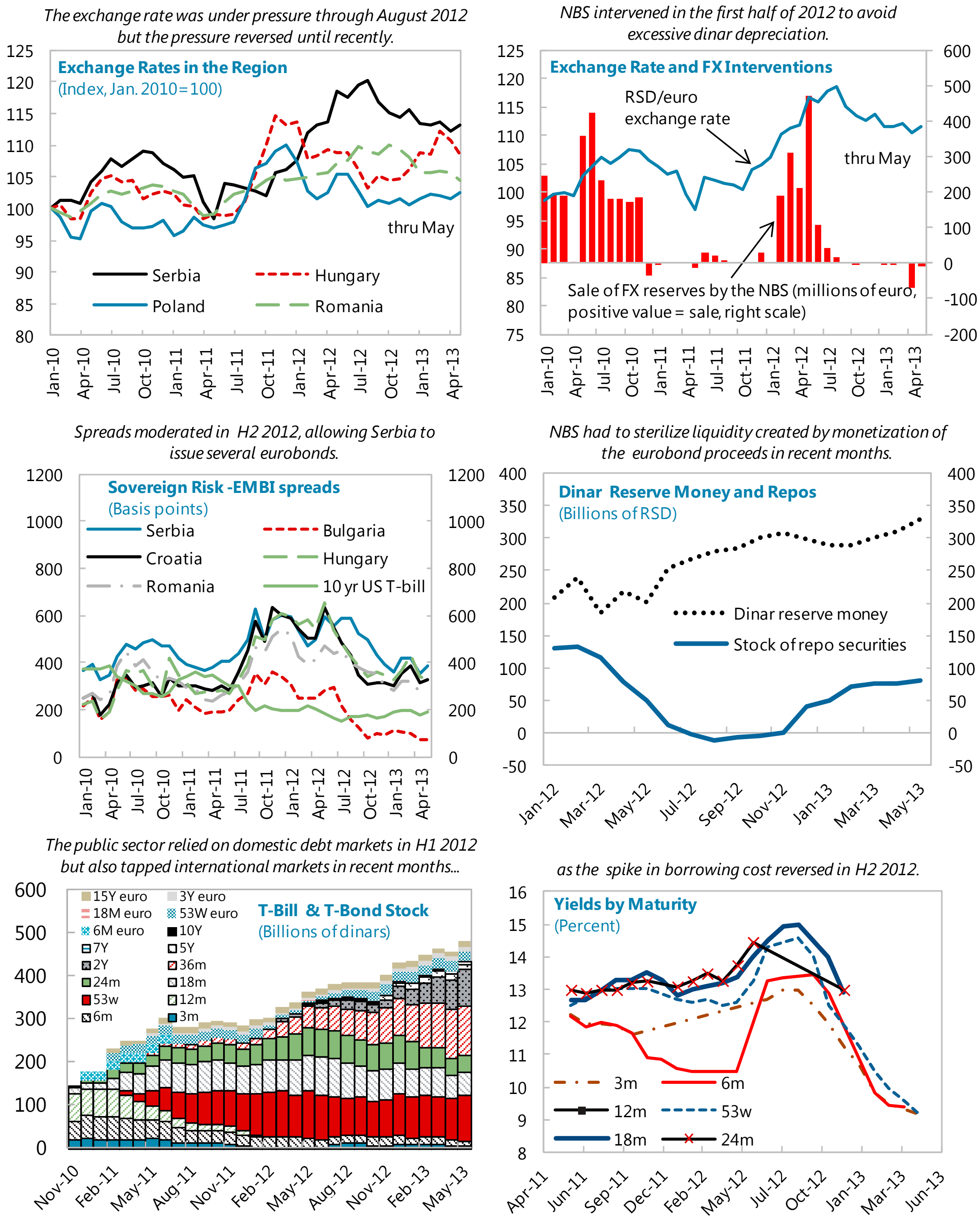
Sources: Haver; and IMF staff calculations.

Figure 5. Serbia: Inflation and Monetary Policy, 2010–13



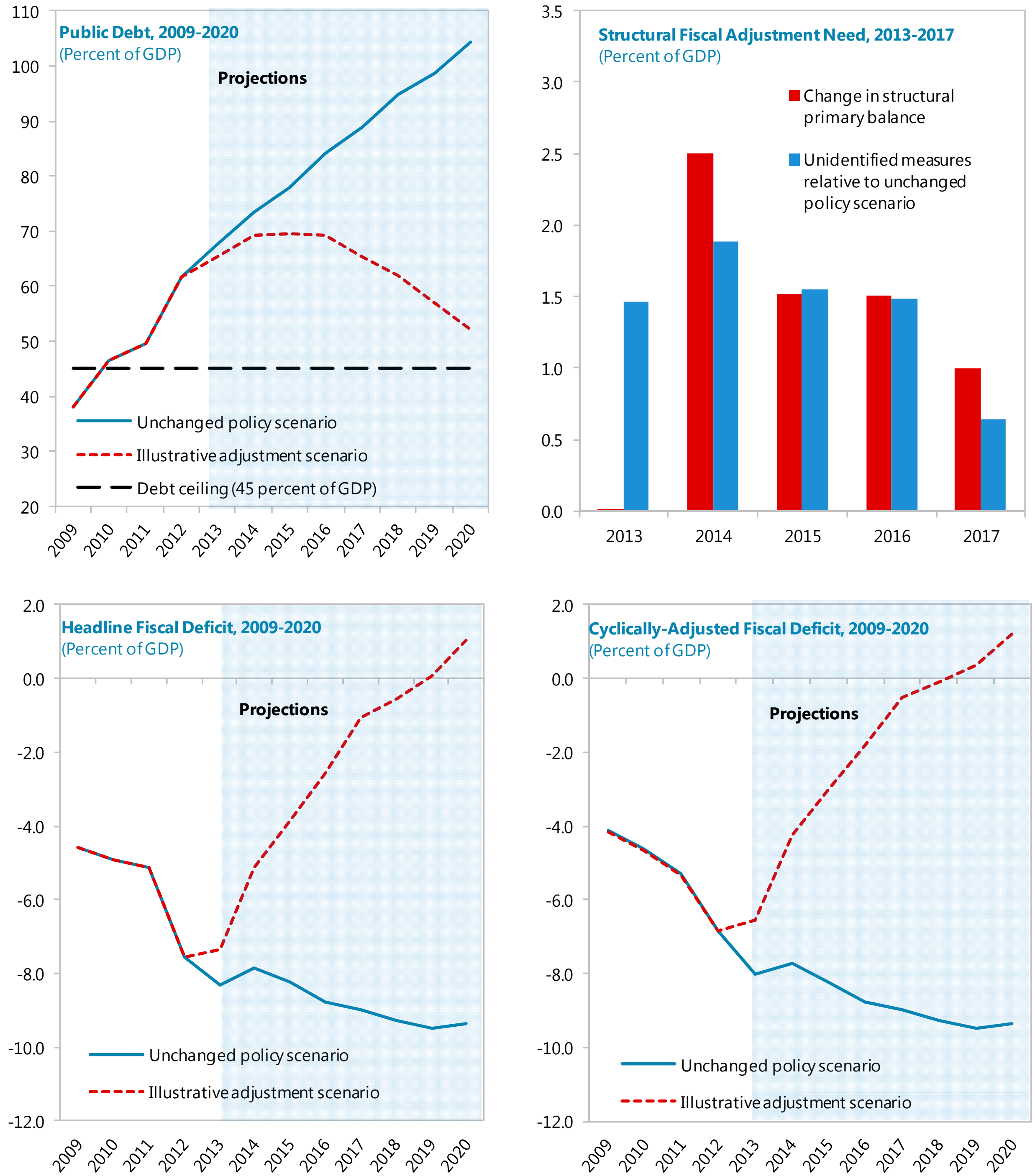
Sources: Haver; Bloomerg; National Bank of Serbia; Serbian Statistical Office; and IMF staff estimates and projections.

Figure 6. Serbia: Recent Financial and Exchange Rate Developments, 2010-13



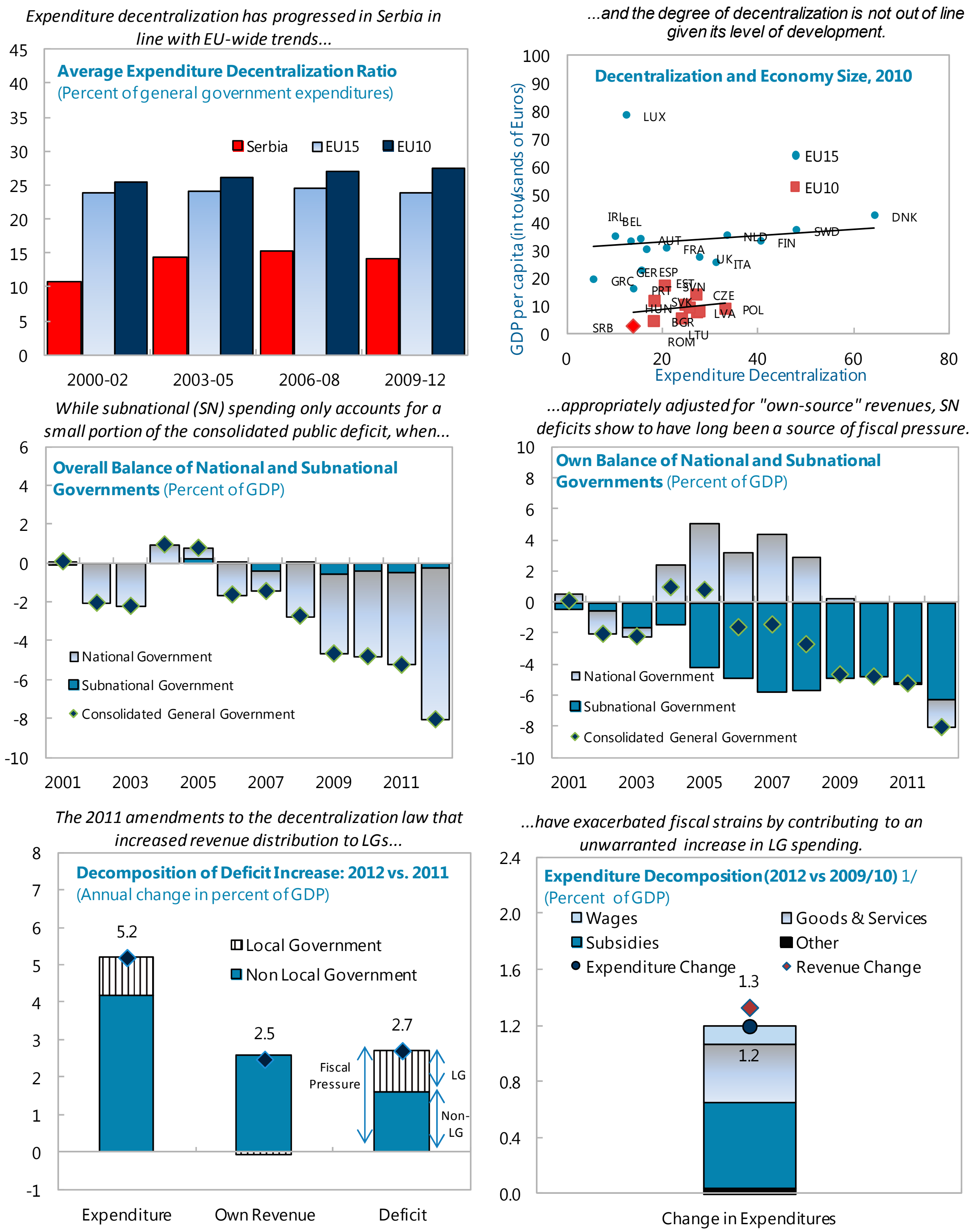
Sources: Serbian Authorities; Bloomberg; and Haver.

Figure 7. Public Debt, Adjustment Need, and Fiscal Deficit Under the Fiscal Scenarios, 2009-20



Sources: National authorities, IMF, and staff estimates

Figure 8. Serbia: Subnational Government Spending, 2000-12

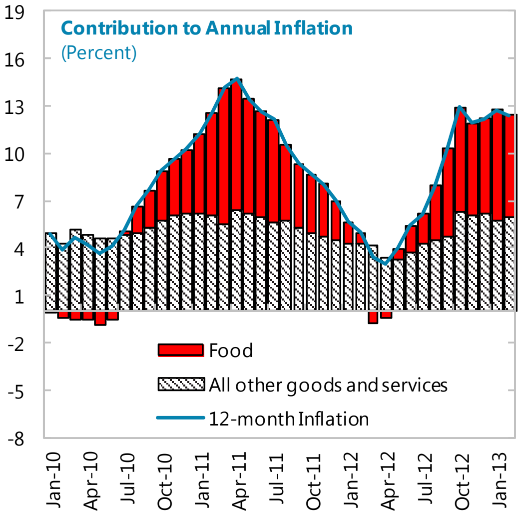


Source: Ministry of Finance, Eurostat, and Fund staff estimates.

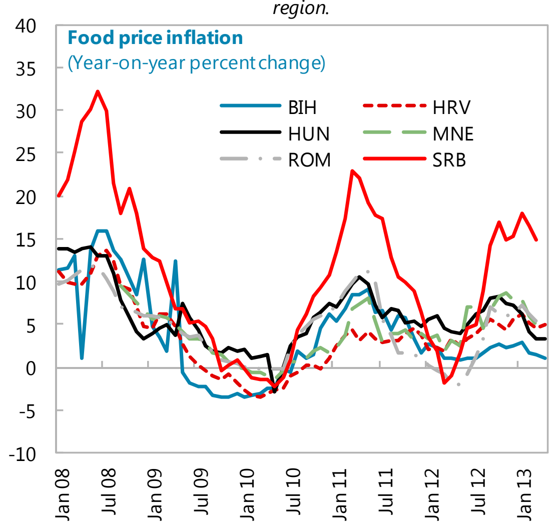
1/ Change in 2012 expenditures relative to the average prevailing in 2009 and 2010.

Figure 9. Serbia: Food Price Volatility, 2008-2013

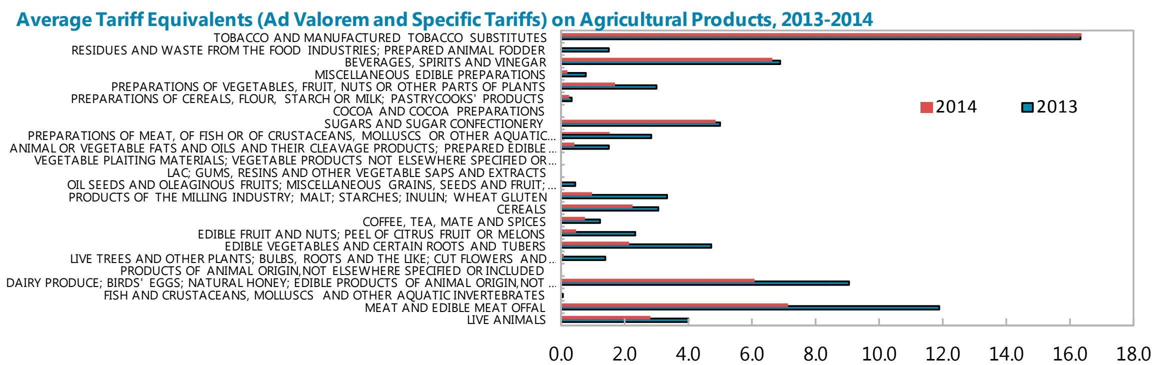
Food price shocks contribute to inflation volatility...



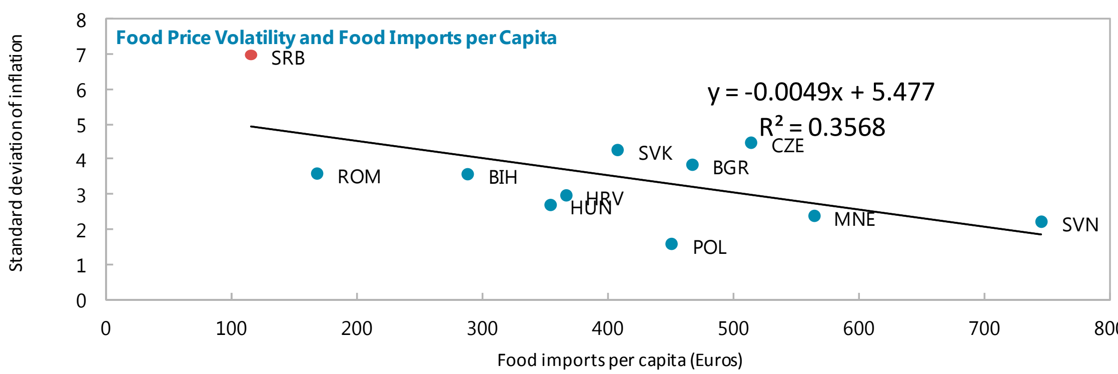
...as food prices in Serbia are more volatile than in the region.



This is partly explained by high trade protection of agricultural markets: despite liberalization under the Stabilization and Association Agreement with the EU, many important food items remain subject to high tariffs.

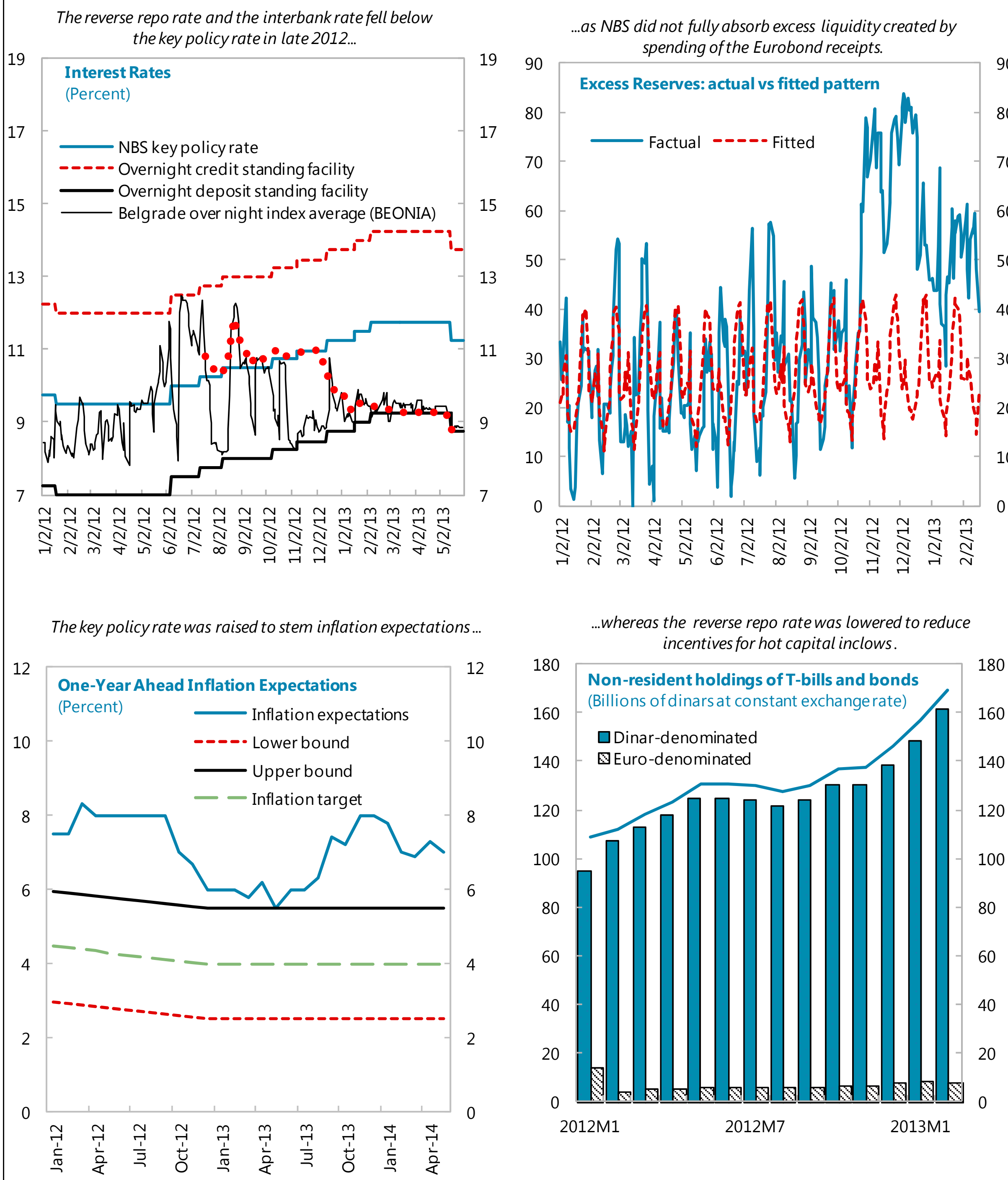


This is reflected in low imports of food per capita, which is negatively correlated with food price volatility.



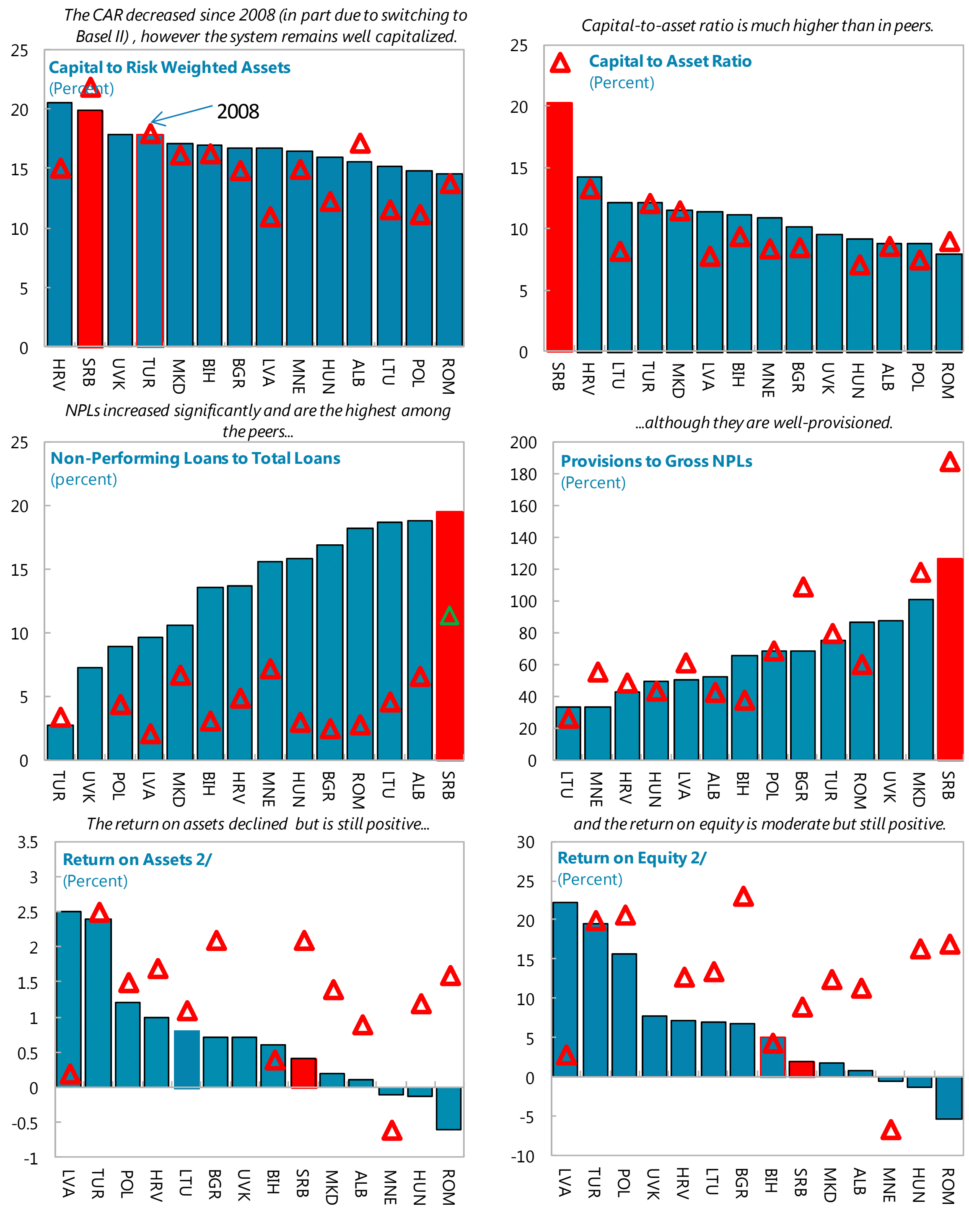
Source: Customs Tariff Law, Haver, and Fund staff calculations.

Figure 10. Serbia: Monetary Policy, 2012–13



Source: NBS, MoF, Bloomberg and IMF staff calculations.

Figure 11. Serbia: Selected Financial Soundness Indicators, 2012 1/

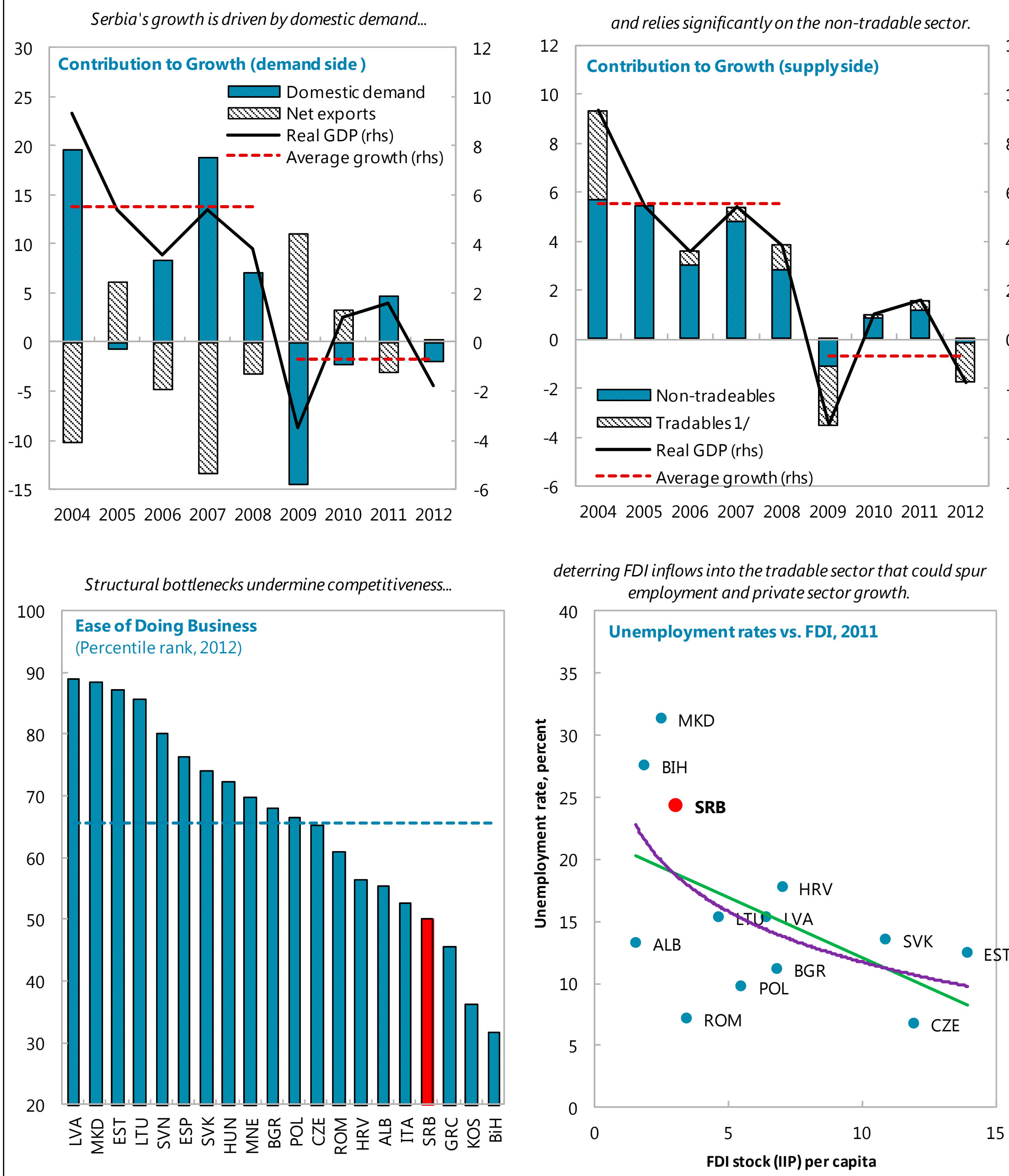


Sources: National Bank of Serbia, IMF

1/ Data for Albania and Montenegro are as of end-2011, and for Latvia as of March 2012.

2/ Profitability indicators for Serbia in 2012 are affected by the outliers (Agrobanka, New Agrobanka and RBV that have been resolved).

Figure 12. Serbia: Growth Composition and Structural Bottlenecks, 2004–12



Source: State Staistical Office; World Bank; and IMF staff estimates.
1/ Tradables include agriculture, manufacturing, mining and tourism.

Table 1. Serbia: Selected Economic and Social Indicators (Unchanged Policy Scenario), 2008–13

	2008	2009	2010	2011	2012	2013 Proj.
			(Percent change, unless otherwise indicated)			
Real GDP	3.8	-3.5	1.0	1.6	-1.7	2.0
Real domestic demand (absorption)	5.3	-10.6	-1.8	3.8	-1.6	0.6
Consumer prices (average)	12.4	8.1	6.2	11.1	7.3	8.4
Consumer prices (end of period)	8.6	6.6	10.3	7.0	12.2	4.9
GDP deflator	12.6	5.9	4.9	9.6	7.4	8.4
Import prices (dinars, average)	13.7	0.8	17.2	4.8	12.1	2.5
Unemployment rate (in percent)	14.7	17.4	20.0	24.4	23.1	23.0
Nominal GDP (in billions of dinars)	2,661	2,720	2,882	3,209	3,386	3,745
			(Percent of GDP)			
General government finances						
Revenue	42.8	42.2	42.5	40.6	41.7	40.0
Expenditure	45.5	46.8	47.4	45.7	49.2	48.3
Current	40.9	42.4	42.6	41.2	44.9	44.0
Capital and net lending	4.6	4.3	4.9	4.5	4.3	4.3
Fiscal balance (cash basis)	-2.7	-4.6	-4.9	-5.1	-7.6	-8.3
Primary fiscal balance (cash basis)	-2.0	-3.8	-3.7	-3.7	-5.6	-5.7
Structural fiscal balance 1/	-4.1	-4.1	-4.4	-5.3	-5.8	-7.9
Gross debt	33.4	38.1	46.5	49.5	61.8	67.5
			(End of period 12-month change, percent)			
Monetary sector						
Money (M1)	-3.9	8.8	-2.2	16.8	3.8	5.4
Broad money (M2)	9.6	22.0	13.7	10.4	9.2	9.3
Domestic credit to non-government 2/	23.3	10.3	18.4	8.1	3.2	-6.0
			(Period average, percent)			
Interest rates (dinar)						
NBS key policy rate 3/	17.8	9.5	11.5	9.8	10.1	11.7
Interest rate on new FX and FX-indexed loans 3/	…	…	8.5	8.2	8.0	8.4
			(Percent of GDP, unless otherwise indicated)			
Balance of payments						
Current account balance	-21.7	-6.6	-6.8	-9.1	-10.5	-8.7
Exports of goods	22.8	20.7	26.6	26.8	29.4	30.3
Imports of goods	-49.0	-37.8	-43.0	-43.8	-47.6	-45.9
Trade of goods balance	-26.2	-17.1	-16.5	-16.9	-18.2	-15.6
Capital and financial account balance	16.9	11.3	2.0	14.1	6.5	11.0
External debt (Percent of GDP)	64.9	77.8	85.4	76.7	85.8	83.1
of which: Private external debt	44.8	50.9	52.8	42.5	45.2	41.1
Gross official reserves (in billions of euro)	8.2	10.6	10.0	12.1	10.9	11.0
(In months of prospective imports)	7.3	8.7	7.2	8.4	7.1	6.8
(Percent of short-term debt)	166.0	221.5	199.8	328.4	270.9	234.0
(in percent of broad money, M2)	74.8	86.1	78.6	85.2	76.8	73.6
Exchange rate (dinar/euro, period average)	81.9	94.1	103.5	102.0	113.0	…
REER (annual average change, in percent; + indicates appreciation)	6.5	-6.6	-8.0	9.3	-7.4	6.3
Social indicators						
Per capita GDP (in US$)	6,485	5,497	5,030	6,030	5,309	…
Population (in million)	7.4	7.3	7.3	7.3	7.3	…
Absolute poverty rate (in percent)	6.1	6.9	9.2	…	…	…

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

1/ Fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending.
2/ At constant exchange rates.
3/ Latest actual data.

Table 2. Serbia: Medium-Term Scenario (Unchanged Policy Scenario), 2009–18 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Proj.					
	(percent change)									
Real growth and inflation										
GDP growth	-3.5	1.0	1.6	-1.7	2.0	2.0	2.2	2.5	2.8	3.0
Domestic demand growth	-10.6	-1.8	3.8	-1.6	0.6	1.1	2.6	3.2	3.1	3.3
Consumer price inflation (end of period)	6.6	10.3	7.0	12.2	4.9	4.8	4.0	4.0	3.5	3.5
	(percent of GDP, unless otherwise indicated)									
General government										
Overall fiscal balance	-4.6	-4.9	-5.1	-7.6	-8.3	-7.8	-8.2	-8.8	-9.0	-9.3
Revenue	42.2	42.5	40.6	41.7	40.0	40.4	40.7	40.5	40.4	40.3
Expenditure	46.8	47.4	45.7	49.2	48.3	48.2	48.9	49.3	49.4	49.6
Current	42.4	42.6	41.2	44.9	44.0	43.8	44.4	44.6	44.7	44.9
Capital and net lending	4.2	4.9	4.5	4.3	4.3	4.5	4.5	4.7	4.7	4.7
Primary fiscal balance	-3.8	-3.7	-3.7	-5.6	-5.7	-4.6	-4.6	-4.7	-4.4	-4.1
change (+ = consolidation)	*-1.7*	*0.1*	*0.0*	*-1.8*	*-0.2*	*1.1*	*0.1*	*-0.1*	*0.4*	*0.2*
Structural fiscal balance	-4.1	-4.4	-5.3	-5.8	-7.9	-7.9	-8.4	-8.8	-9.0	-9.3
Structural primary balance	-3.3	-3.2	-3.9	-3.8	-5.3	-4.7	-4.7	-4.7	-4.4	-4.1
change (+ = consolidation)	*0.2*	*0.0*	*-0.7*	*0.1*	*-1.5*	*0.6*	*0.0*	*0.0*	*0.4*	0.2
Output gap	-1.2	-0.7	0.5	-1.8	-0.7	-0.3	0.0	0.0	0.0	0.0
Gross debt	38.1	46.5	49.5	61.8	67.5	73.5	78.0	84.3	88.8	94.8
	(percent of GDP, unless otherwise indicated)									
Balance of payments										
Current account	-6.6	-6.8	-9.1	-10.5	-8.7	-8.5	-9.0	-9.5	-10.0	-10.2
of which: Trade balance	-17.1	-16.5	-16.9	-18.2	-15.6	-14.8	-14.8	-14.9	-14.8	-14.6
of which: Current transfers, net (excl. grants)	11.5	11.4	9.0	9.3	8.8	8.6	8.2	7.7	7.3	6.9
Capital and financial account	11.3	2.0	14.1	6.5	11.0	6.3	6.7	6.9	5.8	6.3
of which: Foreign direct investment	4.7	3.1	5.8	0.8	3.1	3.2	3.0	2.8	2.7	2.5
External debt (end of period)	77.8	85.4	76.7	85.8	83.1	81.9	78.7	76.2	72.8	70.1
of which: Private external debt	50.9	52.8	42.5	45.2	41.1	42.2	41.4	40.7	39.6	38.5
Gross official reserves (billions of euros)										
Billions of euros	10.6	10.0	12.1	10.9	11.0	9.7	8.8	7.8	6.2	4.5
Percent of short-term external debt	221.5	199.8	328.4	270.9	234.0	218.9	181.1	127.5	111.4	72.0
REER (ann. av. change; + = appreciation)	-6.6	-8.0	9.3	-7.4	6.3	-2.5	1.5	1.1	1.1	1.0

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

1/ Illustrative low-growth equilibrium scenario reflecting the impact of negative confidence effects associated with unchanged policies.

Table 3. Serbia: Macroeconomic Assumptions (Unchanged Policy Scenario), 2011–18

	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
	(Percent change, unless otherwise noted)							
Gross Domestic Product (GDP)	1.6	-1.7	2.0	2.0	2.2	2.5	2.8	3.0
Domestic demand (absorption)	3.8	-1.6	0.6	1.1	2.6	3.2	3.1	3.3
Consumption	-0.7	-1.2	-0.9	0.3	2.2	2.7	2.6	2.8
Non-government	-1.1	-1.9	-0.8	0.0	1.9	2.8	2.7	2.9
Government	1.0	1.8	-1.3	1.7	3.3	2.3	2.4	2.7
Investment	25.2	-3.2	6.6	3.8	3.8	5.0	4.7	4.6
Gross fixed capital formation	8.4	-3.4	7.4	4.1	4.1	5.5	5.0	4.9
Non-government	11.4	-5.0	6.0	4.0	4.0	5.0	5.0	5.0
Government	-6.5	5.6	15.0	4.5	4.7	7.7	4.8	4.2
Change in inventories 1/	3.6	-0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net exports of goods and services 1/	-3.1	0.3	1.2	0.7	-1.0	-1.5	-1.1	-1.1
Exports of goods and services	3.4	4.5	10.4	9.1	8.2	6.9	6.8	6.7
Imports of goods and services	7.0	2.3	4.6	5.0	6.9	6.7	6.0	6.0
	(Contribution to real growth by expenditure category)							
Gross Domestic Product (GDP)	1.6	-1.7	2.0	2.0	2.2	2.5	2.8	3.0
Domestic demand (absorption)	4.6	-2.0	0.8	1.3	3.2	4.0	3.8	4.1
Consumption	-0.7	-1.2	-0.9	0.3	2.1	2.6	2.5	2.7
Non-government	-0.9	-1.5	-0.7	0.0	1.4	2.1	2.0	2.2
Government	0.2	0.4	-0.3	0.3	0.7	0.5	0.5	0.5
Investment	5.4	-0.8	1.7	1.0	1.1	1.4	1.3	1.3
Gross fixed capital formation	1.8	-0.8	1.6	0.9	1.0	1.3	1.2	1.2
Non-government	2.0	-0.9	1.1	0.8	0.8	1.0	1.0	1.0
Government	-0.2	0.2	0.5	0.2	0.2	0.3	0.2	0.2
Change in inventories	3.6	-0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net exports of goods and services	-3.1	0.3	1.2	0.7	-1.0	-1.5	-1.1	-1.1
Exports of goods and services	1.3	1.8	4.4	4.1	4.0	3.6	3.6	3.8
Imports of goods and services	4.4	1.5	3.1	3.5	5.0	5.0	4.7	4.8
Nominal GDP (bn dinars)	3,209	3,386	3,745	4,013	4,301	4,585	4,886	5,209
GDP deflator (percent change)	9.6	7.4	8.4	5.1	4.9	4.0	3.7	3.5
CPI inflation average (percent change)	11.1	7.3	8.4	5.1	4.9	4.0	3.7	3.5
Exchange rate, dinar/EUR (period average)	102	113	113	120	122	124	125	126

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

1/ Contributions to GDP growth.

Table 4. Serbia: Balance of Payments (Unchanged Policy Scenario), 2009–18 1/

	2009	2010	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
					(Billions of euros)					
Current account balance	-1.9	-1.9	-2.9	-3.2	-2.9	-2.8	-3.2	-3.5	-3.9	-4.2
Trade of goods balance	-4.9	-4.6	-5.3	-5.4	-5.2	-4.9	-5.2	-5.5	-5.8	-6.1
Exports of goods	6.0	7.4	8.4	8.8	10.0	11.0	11.9	12.9	14.0	15.1
Imports of goods	-10.9	-12.0	-13.8	-14.3	-15.2	-15.9	-17.1	-18.4	-19.8	-21.2
Services balance	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Exports of nonfactor services	2.5	2.7	3.0	3.1	3.4	3.6	3.8	4.0	4.2	4.5
Imports of nonfactor services	-2.5	-2.7	-2.9	-2.9	-3.2	-3.4	-3.6	-3.8	-4.0	-4.2
Income balance	-0.5	-0.7	-0.8	-0.8	-0.9	-1.1	-1.1	-1.2	-1.3	-1.4
Net interest	-0.6	-0.6	-0.7	-0.7	-0.9	-0.8	-1.0	-1.1	-1.2	-1.3
Others, including reinvested earnings	0.1	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1
Current transfer balance	3.5	3.4	3.0	2.9	3.0	3.0	3.0	3.0	3.0	2.9
Official grants	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Others, including private remittances	3.3	3.2	2.8	2.8	2.9	2.9	2.9	2.9	2.9	2.8
Capital and financial account balance 2/	3.3	0.5	4.4	1.9	3.6	2.1	2.4	2.6	2.3	2.6
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	1.4	0.9	1.8	0.2	1.0	1.1	1.1	1.0	1.0	1.0
Portfolio investment balance	-0.1	0.0	1.6	1.7	1.6	0.2	0.4	0.5	0.5	0.5
of which: debt liabilities	-0.1	0.0	1.5	1.7	1.6	0.2	0.3	0.4	0.4	0.4
Other investment balance	1.9	-0.4	1.0	0.1	1.0	0.9	0.9	1.0	0.8	1.1
Public sector 2/ 3/	0.7	0.7	0.7	0.3	0.5	-0.1	0.0	0.1	-0.2	0.1
Domestic banks	1.7	-0.1	0.2	-0.7	0.0	0.4	0.4	0.4	0.4	0.4
Other private sector 4/	-0.4	-1.0	0.1	0.5	0.5	0.5	0.5	0.6	0.6	0.6
Errors and omissions	-0.1	0.1	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.2	-1.3	1.7	-0.9	0.8	-0.7	-0.8	-1.0	-1.6	-1.6
Financing	-1.2	1.3	-1.7	0.9	-0.8	0.7	0.8	1.0	1.6	1.6
Gross international reserves (increase, -)	-2.4	0.9	-1.8	1.1	-0.1	1.3	0.9	1.0	1.6	1.6
Use of Fund credit, net	1.1	0.3	0.1	-0.2	-0.6	-0.6	-0.1	0.0	0.0	0.0
Purchases	1.1	0.3	0.1	0.0						
Repurchases	0.0	0.0	0.0	-0.2	-0.6	-0.6	-0.1	0.0	0.0	0.0
					(Percent of GDP)					
Current account balance	-6.6	-6.8	-9.1	-10.5	-8.7	-8.5	-9.0	-9.5	-10.0	-10.2
Trade of goods balance	-17.1	-16.5	-16.9	-18.2	-15.6	-14.8	-14.8	-14.9	-14.8	-14.6
Exports of goods	20.7	26.6	26.8	29.4	30.3	32.9	33.8	34.7	35.6	36.5
Imports of goods	-37.8	-43.0	-43.8	-47.6	-45.9	-47.7	-48.6	-49.6	-50.4	-51.1
Services balance	0.1	0.0	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Income balance	-1.7	-2.4	-2.4	-2.7	-2.9	-3.2	-3.3	-3.3	-3.3	-3.3
Current transfer balance	12.2	12.1	9.7	9.8	9.2	8.9	8.5	8.0	7.6	7.1
Official grants	0.7	0.7	0.7	0.5	0.3	0.3	0.3	0.3	0.3	0.2
Others, including private remittances	11.5	11.4	9.0	9.3	8.8	8.6	8.2	7.7	7.3	6.9
Capital and financial account balance 2/	11.3	2.0	14.1	6.5	11.0	6.3	6.7	6.9	5.8	6.3
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	4.7	3.1	5.8	0.8	3.1	3.2	3.0	2.8	2.7	2.5
Portfolio investment balance	-0.2	0.1	5.1	5.6	4.9	0.6	1.1	1.3	1.3	1.2
Other investment balance	6.7	-1.3	3.2	0.2	3.0	2.6	2.6	2.8	1.9	2.6
Public sector 2/ 3/	2.3	2.6	2.2	0.8	1.4	-0.2	-0.1	0.2	-0.5	0.2
Domestic banks	5.7	-0.5	0.8	-2.4	0.1	1.2	1.2	1.2	0.9	0.9
Other private sector 4/	-1.3	-3.4	0.2	1.7	1.5	1.5	1.5	1.5	1.5	1.5
Errors and omissions	-0.4	0.2	0.6	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	4.3	-4.6	5.6	-3.1	2.3	-2.1	-2.2	-2.6	-4.2	-4.0
					(Percent, unless otherwise indicated)					
Memorandum items:										
Export growth	-19.4	23.8	14.0	4.5	13.7	9.7	8.2	8.2	8.2	8.5
Import growth	-31.4	9.7	14.8	3.7	6.5	4.9	7.4	7.5	7.4	7.3
Export volume growth	-8.8	16.8	3.6	4.2	10.9	10.6	8.6	7.6	7.4	7.4
Import volume growth	-21.7	2.9	8.0	2.5	3.9	5.1	7.0	7.0	6.3	6.2
Trading partner import growth	-17.2	11.1	6.7	-1.1	2.7	4.8	5.3	5.6	5.6	5.8
Export prices growth	-11.6	6.0	10.0	0.3	2.5	-0.8	-0.4	0.6	0.8	1.1
Import prices growth	-12.3	6.6	6.3	1.2	2.5	-0.2	0.3	0.4	1.0	1.0
Change in terms of trade	0.8	-0.6	3.5	-0.9	0.0	-0.6	-0.7	0.2	-0.2	0.1
Gross external financing requirement	6.8	6.7	7.9	6.6	6.3	7.0	7.5	8.4	10.0	9.8
(percent of GDP)	23.6	24.0	25.0	22.1	18.9	20.9	21.2	22.6	25.6	23.6
o/w debt amortization	4.9	4.8	5.0	3.5	3.4	4.1	4.3	4.8	6.1	5.6
(percent of GDP)	17.0	17.2	15.9	11.5	10.2	12.4	12.2	13.1	15.6	13.4
Medium and long term	2.8	2.8	3.2	2.8	2.9	3.6	3.8	4.4	5.6	5.1
Short term	2.1	2.0	1.8	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Gross official reserves (in billions of euro)	10.6	10.0	12.1	10.9	11.0	9.7	8.8	7.8	6.2	4.5
(In months of prospective imports of GNFS)	8.7	7.2	8.4	7.1	6.8	5.6	4.8	3.9	2.9	2.0
(in percent of short-term debt)	221.5	199.8	328.4	270.9	234.0	218.9	181.1	127.5	111.4	72.0
(in percent of broad money, M2)	86.1	78.6	85.2	76.8	73.6	62.6	53.0	45.1	33.4	23.4
(in percent of risk-weighted metric)					196.6	167.7	142.3	115.7	88.9	61.0

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

Table 5a. Serbia: General Government Fiscal Operations (Unchanged Policy Scenario), 2009–18 1/ (billion RSD)

	2009	2010	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	1,146	1,225	1,303	1,411	1,497	1,621	1,750	1,859	1975	2101
Taxes	1,000	1,057	1,131	1,226	1,335	1,445	1,558	1666	1771	1885
Personal income tax	133	139	151	165	160	161	174	185	197	210
Social security contributions	319	324	347	379	426	472	508	540	574	611
Taxes on profits	31	33	38	55	54	60	64	69	73	78
Value-added taxes	297	319	342	367	400	441	478	516	551	589
Excises	135	152	171	181	215	228	245	262	278	299
Taxes on international trade	48	44	39	36	34	35	39	39	38	35
Other taxes	37	46	44	43	45	48	52	55	59	62
Non-tax revenue	138	159	169	180	159	174	188	189	200	211
Capital revenue	1	1	0	1	0	0	0	0	0	0
Grants	7	7	3	3	3	3	4	4	4	4
Expenditure	1,272	1,366	1,467	1,667	1,809	1,936	2,104	2,261	2,415	2,584
Current expenditure	1,154	1,226	1,322	1,520	1,648	1,756	1,909	2,047	2186	2338
Wages and salaries	302	310	342	375	407	441	483	512	543	575
Goods and services	211	227	245	285	298	313	334	357	381	406
Interest	22	34	45	68	98	128	157	186	227	268
Subsidies	63	78	80	145	149	147	157	168	179	190
Transfers	556	577	609	647	696	727	778	824	857	899
Pensions 2/	387	394	423	474	502	527	565	596	612	637
Other transfers 3/	168	183	186	174	195	200	213	228	245	262
Capital expenditure	93	105	114	119	137	152	165	180	192	204
Net lending	20	30	25	16	11	12	13	15	16	17
Amortization of activated guarantees	4	5	6	11	12	16	18	20	22	24
Fiscal balance (cash basis)	-121	-136.6	-158	-245	-299	-299	-336	-383	-418	-459
Augmented fiscal balance (incl. amortization of called guarantees)	-125	-141	-164	-256	-312	-314	-354	-402	-440	-483
	0									
Financing	125	141	164	256	312	314	354	402	440	483
Privatization proceeds	59	7	3	22	0	0	0	0	0	0
Equity investment	0	-1	-3	-14	0	0	0	0	0	0
Domestic	26	101	25	78	101	293	330	373	408	447
Banks	32	144	-30	98	150	329	366	408	408	447
Treasury Account (internal borrowing)	-56	15	-50	0	0	0	0	0	0	0
Domestic banking system	0	72	14	6	126	305	342	384	408	447
Securities held by banks (net)	87	58	6	91	24	24	24	24	..	..
Non-banks (incl. non-residents)	-6	-43	56	-20	-50	-36	-37	-35	..	..
Securities held by non-banks (net)	22	1	97	38	16	16	16	16	..	..
Others (incl. amortization)	-27	-44	-41	-58	-66	-52	-53	-51	..	..
External	40	35	139	171	211	21	24	29	31	36
Program	42	39	17	0	25	9	9	10	10	10
Project	11	21	39	41	54	60	65	70	75	80
Bonds and loans	0	0	103	159	238	..	..	..	..	..
Amortization	-13	-25	-20	-30	-106	-47	-50	-51	-53	-54
Memorandum items:										
Quasi-fiscal support to SOEs (guarantees)				134	77	56	61	65	71	76
Nominal GDP (billions of dinars)	2,720	2,882	3,209	3,386	3,745	4,013	4,301	4,585	4,886	5,209

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/ Excluding military pension payments from the Republican budget.
3/ Excluding foreign currency deposit payments to households, reclassified below the line.

Table 5b. Serbia: General Government Fiscal Operations (Unchanged Policy Scenario), 2009–18 1/ (percent of GDP)

	2009	2010	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	42.1	42.5	40.6	41.7	40.0	40.4	40.7	40.5	40.4	40.3
Taxes	36.8	36.7	35.2	36.2	35.6	36.0	36.2	36.3	36.2	36.2
Personal income tax	4.9	4.8	4.7	4.9	4.3	4.0	4.0	4.0	4.0	4.0
Social security contributions	11.7	11.2	10.8	11.2	11.4	11.8	11.8	11.8	11.8	11.7
Taxes on profits	1.1	1.1	1.2	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Value-added taxes	10.9	11.1	10.7	10.9	10.7	11.0	11.1	11.3	11.3	11.3
Excises	5.0	5.3	5.3	5.3	5.7	5.7	5.7	5.7	5.7	5.7
Taxes on international trade	1.8	1.5	1.2	1.1	0.9	0.9	0.9	0.8	0.8	0.7
Other taxes	1.4	1.6	1.4	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Non-tax revenue	5.1	5.5	5.3	5.3	4.2	4.3	4.4	4.1	4.1	4.1
Capital revenue	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure	46.7	47.4	45.7	49.2	48.3	48.2	48.9	49.3	49.4	49.6
Current expenditure	42.4	42.6	41.2	44.9	44.0	43.8	44.4	44.6	44.7	44.9
Wages and salaries	11.1	10.8	10.7	11.1	10.9	11.0	11.2	11.2	11.1	11.0
Goods and services	7.8	7.9	7.6	8.4	8.0	7.8	7.8	7.8	7.8	7.8
Interest	0.8	1.2	1.4	2.0	2.6	3.2	3.6	4.1	4.6	5.1
Subsidies	2.3	2.7	2.5	4.3	4.0	3.7	3.7	3.7	3.7	3.7
Transfers	20.4	20.0	19.0	19.1	18.6	18.1	18.1	18.0	17.5	17.3
Pensions 2/	14.2	13.7	13.2	14.0	13.4	13.1	13.1	13.0	12.5	12.2
Other transfers 3/	6.2	6.4	5.8	5.1	5.2	5.0	5.0	5.0	5.0	5.0
Capital expenditure	3.4	3.6	3.6	3.5	3.7	3.8	3.8	3.9	3.9	3.9
Net lending	0.8	1.0	0.8	0.5	0.3	0.3	0.3	0.3	0.3	0.3
Amortization of activated guarantees	0.1	0.2	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.5
Fiscal balance (cash basis)	-4.5	-4.7	-4.9	-7.2	-8.0	-7.4	-7.8	-8.3	-8.6	-8.8
Augmented fiscal balance (incl. amortization of called guarantees)	-4.6	-4.9	-5.1	-7.6	-8.3	-7.8	-8.2	-8.8	-9.0	-9.3
Financing	4.6	4.9	5.1	7.6	8.3	7.8	8.2	8.8	9.0	9.3
Privatization proceeds	2.2	0.2	0.1	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Equity investment	0.0	0.0	-0.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	1.0	3.5	0.8	2.3	2.7	7.3	7.7	8.1	8.4	8.6
Banks	1.2	5.0	-0.9	2.9	4.0	8.2	8.5	8.9	8.4	8.6
Treasury Account (internal borrowing)	-2.1	0.5	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic banking system	0.0	2.5	0.4	0.2	3.4	7.6	8.0	8.4	8.4	8.6
Securities held by banks (net)	3.2	2.0	0.2	2.7	0.6	0.6	0.6	0.5	..	..
Non-banks (incl. non-residents)	-0.2	-1.5	1.7	-0.6	-1.3	-0.9	-0.9	-0.8	..	..
Securities held by non-banks (net)	0.8	0.0	3.0	1.1	0.4	0.4	0.4	0.3	..	..
Others (incl. amortization)	-1.0	-1.5	-1.3	-1.7	-1.8	-1.3	-1.2	-1.1	..	..
External	1.5	1.2	4.3	5.0	5.6	0.5	0.6	0.6	0.6	0.7
Program	1.5	1.3	0.5	0.0	0.7	0.2	0.2	0.2	0.2	0.2
Project	0.4	0.7	1.2	1.2	1.4	1.5	1.5	1.5	1.5	1.5
Bonds and loans	0.0	0.0	3.2	4.7	6.4	..	..	..	..	..
Amortization	-0.5	-0.9	-0.6	-0.9	-2.8	-1.2	-1.2	-1.1	-1.1	-1.0
Memorandum items:										
Quasi-fiscal support to SOEs (guarantees)	..	..	..	4.0	2.1	1.4	1.4	1.4	1.4	1.5
Cyclically-adjusted fiscal balance	-4.1	-4.6	-5.3	-6.9	-8.0	-7.7	-8.2	-8.8	-9.0	-9.3
Structural fiscal balance	-4.1	-4.4	-5.3	-5.8	-7.9	-7.9	-8.4	-8.8	-9.0	-9.3
Structural primary balance	-3.3	-3.2	-3.9	-3.8	-5.3	-4.7	-4.7	-4.7	-4.4	-4.1
Primary balance	-3.8	-3.7	-3.7	-5.6	-5.7	-4.6	-4.6	-4.7	-4.4	-4.1
Output gap 4/	-1.2	-0.7	0.5	-1.8	-0.7	-0.3	0.0	0.0	0.0	0.0
Gross debt 5/	38.1	46.5	49.5	61.8	67.5	73.5	78.0	84.3	88.8	94.8
Nominal GDP (billions of dinars)	2,720	2,882	3,209	3,386	3,745	4,013	4,301	4,585	4,886	5,209

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/ Excluding military pension payments from the Republican budget.
3/ Excluding foreign currency deposit payments to households, reclassified below the line.
4/ Percentage deviation of actual from potential GDP.
5/ For the purposes of this table, the definition of public debt is broader than the definitions in the BSL and in the Public Debt Law. It includes government arrears, local government debt, and debt under negotiation.

Table 6. Serbia: Monetary Survey (Unchanged Policy Scenario), 2009–13 1/

	2009	2010	2011	2012	2013	
					Mar Prel.	Dec Proj.
Net foreign assets 2/	571	507	670	673	791	784
in billions of euro	5.9	4.8	6.4	5.9	7.1	6.6
Foreign assets	1,185	1,287	1,396	1,420	1,470	1,478
NBS	1,023	1,063	1,270	1,250	1,335	1,299
Commercial banks	162	224	126	169	135	179
Foreign liabilities (-)	-614	-780	-726	-747	-679	-695
NBS	-115	-170	-178	-166	-147	-84
Commercial banks	-500	-610	-548	-581	-532	-611
Net domestic assets	609	834	810	931	804	971
Domestic credit	1,276	1,703	1,798	2,015	1,899	2,106
Government, net	-4	66	30	95	-7	253
NBS	-101	-106	-148	-160	-248	-26
Claims on government	11	1	1	1	1	1
Liabilities (deposits)	112	108	-149	-161	-249	-27
Banks	97	172	177	255	241	279
Claims on government	108	193	198	290	283	314
Liabilities (deposits)	-11	-21	-21	-36	-42	-36
Local governments, net	-14.1	-1.3	5.6	-6	3	-6
Non-government sector	1,295	1,639	1,763	1,926	1,904	1,859
Households	463	572	603	654	650	631
Enterprises	807	1,031	1,115	1,226	1,205	1,183
Other	25	36	45	47	49	46
Other assets	63	27	17	28	-21	31
Capital and reserves (-)	-583	-722	-779	-876	-834	-901
NBS	-123	-202	-209	-264	-197	-264
Banks	-460	-520	-570	-611	-637	-637
Provisions (-)	-147	-174	-226	-237	-240	-264
Broad money (M2)	1,180	1,342	1,481	1,616	1,590	1,767
Dinar-denominated M2	412	392	469	455	446	480
M1	250	244	285	296	297	312
Currency in circulation	96	92	114	111	102	117
Demand deposits	154.1	152.4	171.1	185.5	195.2	195.5
Time and saving deposits	162.0	147.7	183.4	159.4	148.9	168.0
Foreign currency deposits	769	950	1,012	1,161	1,144	1,287
in billions of euro	8.0	9.0	9.7	10.2	10.2	10.9
Memorandum items:						
M1	8.8	-2.2	16.8	3.8	16.9	5.4
M2	22.0	13.7	10.4	9.2	8.0	9.3
Deposits (constant exchange rates)	17.2	7.6	10.0	3.4	8.6	6.5
Credit to non-gov. (current exchange rates)	9.5	15.7	1.9	8.1	-0.1	-1.0
Domestic	16.0	26.6	7.6	9.3	1.8	-3.5
Households	8.0	23.5	5.4	8.5	3.3	-3.5
Enterprises	21.5	27.8	8.2	9.9	0.9	-3.5
External	2.1	1.6	-7.3	5.9	-3.6	3.8
Credit to non-gov. (constant exchange rates) 3/	2.6	6.9	2.5	1.2	-0.5	-3.9
Domestic	10.3	18.4	8.1	3.2	1.3	-5.9
External	-5.7	-7.6	-6.5	-2.5	-4.1	0.0
Domestic credit to non-gov. (real terms)	8.9	14.8	0.5	-2.6	-8.5	-8.0
Velocity (M1)	10.9	11.8	11.2	11.4	11.7	12.0
Velocity (M2)	2.3	2.1	2.2	1.8	1.9	1.8

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 the December 2011 dinar/euro rate as the base for converting FX and FX-indexed loans to dinars for the period 2008-12. Assumes all FX loans are in euros.

Table 7. Serbia: Illustrative Medium-Term Adjustment Scenario, 2009–18

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(percent change)					
Real growth and inflation										
GDP growth	-3.5	1.0	1.6	-1.7	1.1	1.6	2.5	3.2	3.7	3.7
Domestic demand growth	-10.6	-1.8	3.8	-1.6	-0.5	0.6	1.3	1.9	2.2	2.3
Consumer price inflation (end of period)	6.6	10.3	7.0	12.2	3.7	3.8	4.0	4.0	3.5	3.5
					(percent of GDP, unless otherwise indicated)					
General government										
Overall fiscal balance	-4.6	-4.9	-5.1	-7.6	-7.3	-5.1	-3.9	-2.6	-1.1	-0.6
Revenue	42.2	42.5	40.6	41.7	40.1	40.6	40.5	40.5	40.5	40.5
Expenditure	46.8	47.4	45.7	49.2	47.5	45.8	44.4	43.1	41.6	41.0
Primary fiscal balance	-3.8	-3.7	-3.7	-5.6	-4.7	-2.0	-0.5	1.0	2.1	2.6
change (+ = consolidation)	*-1.7*	*0.1*	*0.0*	*-1.8*	*0.9*	*2.7*	*1.5*	*1.4*	*1.2*	*0.4*
Structural fiscal balance	-4.1	-4.5	-5.3	-5.8	-6.5	-4.4	-3.2	-1.8	-0.5	-0.1
Structural primary balance	-3.3	-3.3	-4.0	-3.8	-3.8	-1.3	0.2	1.7	2.7	3.1
change (+ = consolidation)	*0.2*	*0.0*	*-0.7*	*0.1*	*0.0*	*2.5*	*1.5*	*1.5*	*1.0*	0.3
Output gap	-1.1	-0.6	0.6	-1.8	-1.9	-2.2	-2.1	-1.9	-1.5	-1.2
Gross debt	38.1	46.5	49.5	61.8	65.4	69.4	69.6	69.1	65.2	61.8
					(percent of GDP, unless otherwise indicated)					
Balance of payments										
Current account	-6.6	-6.8	-9.1	-10.5	-8.5	-8.1	-8.6	-7.3	-5.9	-4.6
of which: Trade balance	-17.1	-16.5	-16.9	-18.2	-15.2	-14.0	-12.5	-10.7	-9.1	-7.4
of which: Current transfers, net (excl. grants)	11.5	11.4	9.0	9.3	8.7	8.3	7.7	7.2	6.8	6.2
Capital and financial account	11.3	2.0	14.1	6.5	11.0	12.9	12.6	12.0	6.8	6.7
of which: Foreign direct investment	4.7	3.1	5.8	0.8	3.1	5.2	4.5	4.0	3.5	3.1
External debt (end of period)	77.8	85.4	76.7	85.8	83.2	80.5	77.2	74.3	70.5	67.0
of which: Private external debt	50.9	52.8	42.5	45.2	41.2	41.4	40.5	39.5	38.1	36.6
Gross official reserves (billions of euros)										
Billions of euros	10.6	10.0	12.1	10.9	11.1	12.1	13.4	15.2	15.6	16.5
Percent of short-term external debt	221.5	199.8	328.4	270.3	235.5	272.9	270.7	248.7	273.8	258.1
REER (ann. av. change; + = appreciation)	-6.6	-8.0	9.3	-7.4	7.0	-0.1	1.6	1.1	1.1	1.5

Source: IMF staff calculations

Table 8. Serbia: Banking Sector Financial Soundness Indicators, 2009–13

	2009	2010	2011	2012 Mar	2012 Jun	2012 Sep	2012 Dec	2013 Feb
Capital Adequacy								
Regulatory capital to risk-weighted assets	21.4	19.9	19.1	17.3	17.2	16.4	19.9	19.9
Tier I capital to risk-weighted assets	16.5	15.9	18.1	16.3	16.3	15.6	19.0	19.0
Capital to assets	20.7	19.7	20.6	20.6	20.2	20.2	20.5	21.3
Asset Quality								
Sectoral distribution of loans to total loans								
Agriculture	3.1	3.0	2.8	2.8	2.9	3.2	3.0	2.9
Industry	17.9	19.3	17.2	17.2	17.2	18.2	17.9	17.9
Trade	17.3	16.6	14.7	14.2	14.5	15.0	15.0	14.6
Construction	5.3	6.9	6.2	6.0	6.2	6.1	5.8	5.7
Other loans to enterprizes	9.8	9.7	10.9	12.1	13.2	12.9	12.8	12.3
Households	32.9	34.1	32.4	32.2	34.6	33.9	33.6	33.3
Of which: Mortgage loans	13.8	15.4	15.0	15.3	16.5	16.2	16.1	15.9
Other sectors	13.8	10.5	15.7	15.5	11.4	10.7	12.0	13.4
Gross non performing loans to total loans	15.7	16.9	19.0	20.4	19.5	19.9	18.6	20.0
IFRS provisions to gross loans 1/	9.6	9.1	10.8	10.9	10.2	10.4	10.2	10.6
IFRS provisions to gross non-performing loans 1/	61.4	53.9	57.0	53.8	52.2	52.3	54.9	52.6
Total regulatory provisions to gross non-performing loans 2/	142.5	133.6	121.4	118.7	124.4	122.1	120.7	115.1
Non-performing loans net of IFRS provisions to capital	22.1	29.0	30.8	35.5	35.5	36.4	31.0	33.1
Large exposures to regulatory capital	37.4	43.3	110.1	138.4	148.8	140.2	104.5	104.5
Profitability								
Return on assets (ROA) 3/	1.0	1.1	0.0	1.4	0.7	0.6	0.4	1.6
Return on equity (ROE) 3/	4.6	5.3	0.2	6.9	3.6	2.8	2.0	7.5
Net interest margin to gross operating income	67.0	68.3	72.0	69.3	68.8	68.8	69.2	70.8
Operating expenses to gross operating income	62.6	63.5	61.8	59.7	68.6	66.2	66.1	60.9
Operating expenses to average balance sheet assets	4.8	4.3	3.9	3.8	4.2	4.0	4.1	3.4
Personnel expenses to operating expenses	41.9	41.1	41.9	42.5	37.0	38.3	38.3	42.4
Liquidity and Foreign Exchange Risk								
Liquid assets to total assets 4/	41.5	35.1	37.8	34.8	34.0	32.4	34.5	35.1
Liquid assets to short term liabilities	63.6	56.4	62.8	59.3	57.5	54.1	57.5	58.9
Core liquid assets to total assets 5/	28.7	23.8	27.5	25.2	26.2	25.4	26.8	27.0
Core liquid assets to short-term liabilities	43.9	38.1	45.6	42.9	44.3	42.4	44.8	45.4
FX and FX-indexed loans to total loans 6/	75.3	69.5	70.8	72.1	72.2	71.8	72.1	71.5
FX and FX-indexed deposits to total deposits 6/	75.0	80.7	78.9	81.3	82.7	81.7	81.1	81.3
Loans of non-financial sectors to deposits of non-financial sectors	118.4	131.3	129.9	137.5	131.6	134.7	128.8	128.4
FX- loans to FX-deposits of households and corporates (including indexed)	130.3	119.3	120.4	126.1	118.1	121.9	117.2	116.3
Household and corporate deposits to total assets	45.2	45.5	48.2	47.3	48.8	48.5	49.3	49.1
FX and FX-indexed liabilities to total liabilities	77.7	81.8	79.0	80.8	80.9	79.7	80.1	80.1
Sensitivity to Market Risk								
Net open FX position (overall) as percent of regulatory capital	1.1	1.6	4.2	1.7	2.5	3.6	4.6	3.5
Classified off-balance sheet items to classified balance sheet assets	43.3	33.9	32.0	31.5	30.1	27.6	26.1	26.1

Source: National Bank of Serbia.

1/ Provisions only for the loan portfolio.

2/ Ratio of total provisions for potential losses for on and off-balance sheet exposures to gross NPLs.

3/ Profitability indicators in 2011-12 are affected by the outliers (Agrobanka, New Agrobanka and RBV that have been resolved).

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

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

6/ Households and corporates.

Table 9. Serbia: Rankings of Selected Competitiveness and Structural Indicators 1/

	Serbia		Best performers 2/				Distance 3/	
	2008	2012	2008		2012		2008	2012
EBRD transition indicators	71	73		92		94	-22	-21
Large scale privatization	62	62		92		92	-31	-31
Small scale privatization	85	85		100		100	-15	-15
Enterprise restructuring	54	54		85		85	-31	-31
Price liberalization	92	92		100		100	-8	-8
Trade and foreign exchange system	85	92		100		100	-15	-8
Competition policy	46	54		77		85	-31	-31
Transparency International								
Corruption Perception Index	34	39	Slovenia	67	Estonia	64	-33	-25
World Bank Doing Business survey 4/	48	49	Estonia	88	Estonia	90	-40	-41
Starting a business	41	51	FYR Macedonia	93	FYR Macedonia	97	-52	-46
Dealing with licenses	6	4	Estonia	90	Estonia	82	-84	-78
Registering property	46	78	Lithuania	98	Lithuania	97	-51	-19
Getting credit	85	79	Bulgaria	97	Latvia	98	-13	-18
Protecting investors	61	57	Albania	92	FYR Macedonia	91	-31	-34
Paying taxes	30	22	FYR Macedonia	85	FYR Macedonia	87	-55	-65
Trading across borders	66	50	Estonia	97	Estonia	98	-31	-48
Enforcing contracts	47	45	Latvia	98	Lithuania	92	-51	-47
Closing a business	45	35	Lithuania	81	Latvia	82	-36	-47

Sources: EBRD; Transparency International; World Bank; World Economic Forum; and IMF staff calculations.

1/ For comparability, all indices normalized so that they range from 0 (lowest) to 100 (best).

2/ Country name and index of best performers among: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, Serbia, Slovak Republic, and Slovenia. Country names are not shown for EBRD transition indicators due to the presence of multiple entries.

3/ Distance of Serbia from best performer for each index.

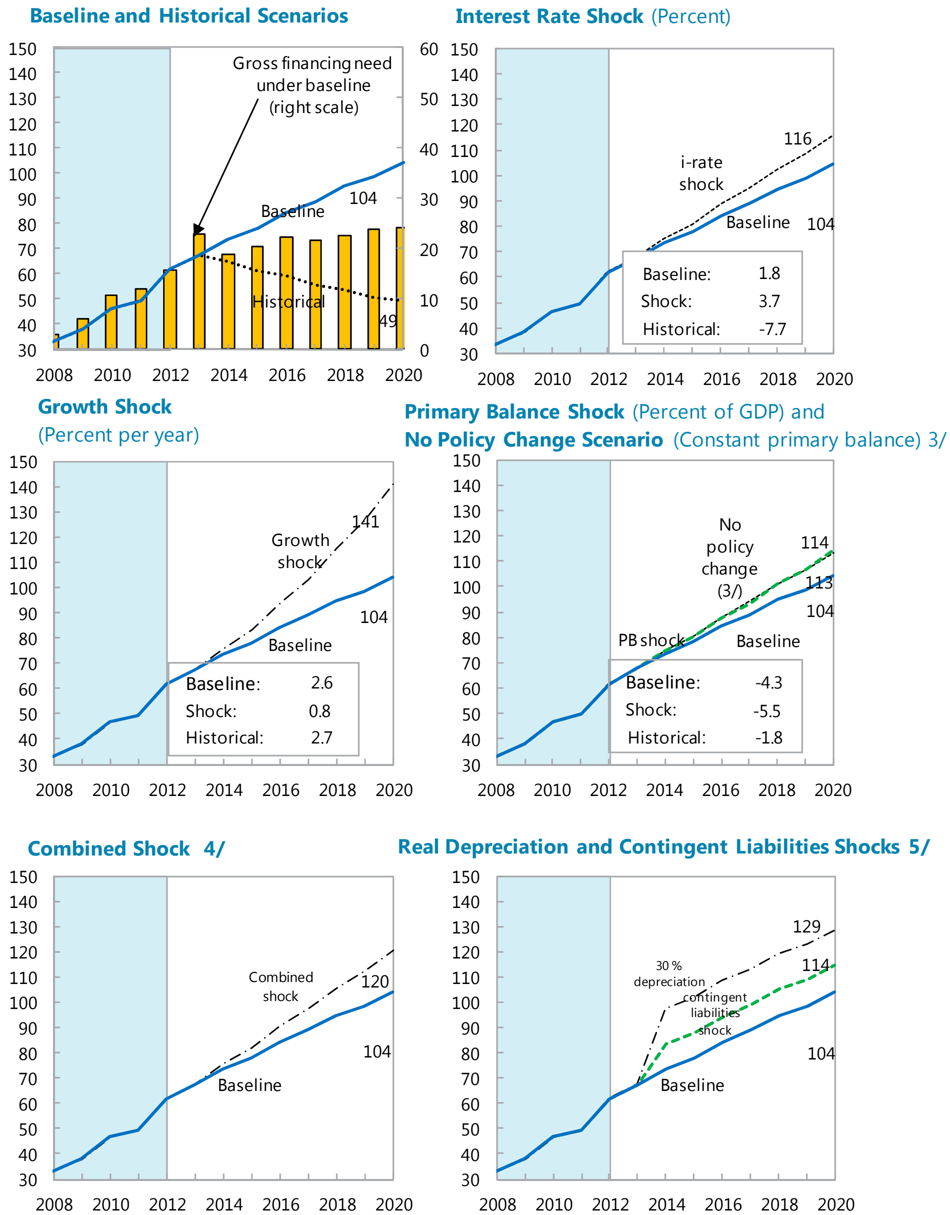
4/ As pointed out in an independent evaluation of the Doing Business survey (see www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants which tend to overstate the indicators' coverage and explanatory power.

Table 10. Serbia: Capacity to Repay Indicators, 2013–18

	2013	2014	2015	2016	2017	2018
Fund repurchases and charges						
In millions of SDRs	448	502	117	12	0	0
In millions of euro	512	576	135	14	0	0
In percent of exports of goods and NFS	3.8	3.9	0.9	0.1	0.0	0.0
In percent of GDP	1.5	1.7	0.4	0.0	0.0	0.0
In percent of quota	95.8	107.3	25.0	2.5	0.0	0.0
In percent of total external debt service	10.3	10.3	2.5	0.2	0.0	0.0
In percent of gross international reserves	4.7	5.9	1.5	0.2	0.0	0.0
Fund credit outstanding (end-period)						
In millions of SDRs	624	128	12	0	0	0
In millions of euro	712	146	13	0	0	0
In percent of exports of goods and NFS	5.3	1.0	0.1	0	0	0
In percent of GDP	2.1	0.4	0.0	0	0	0
In percent of quota	133.5	27.3	2.5	0	0	0
In percent of total external debt	2.6	0.5	0.0	0	0	0
In percent of gross international reserves	6.5	1.5	0.2	0	0	0
Memorandum items:						
Exports of goods and NFS	13,477	14,583	15,714	16,897	18,185	19,621
Quota (in millions of SDRs)	468	468	468	468	468	468
GDP	33,150	33,451	35,250	37,109	39,190	41,466
Total external debt service	4,975	5,610	5,493	6,013	7,375	6,897
Public sector external debt	13,905	13,291	13,138	13,191	13,014	13,108
Total external debt	27,539	27,395	27,733	28,285	28,529	29,063
Total external debt stock excluding the Fund	26,799	27,226	27,697	28,285	28,529	29,063
Gross international reserves	11,016	9,728	8,808	7,813	6,184	4,543

Source: Fund staff estimates.

Figure 13. Serbia: Public Debt Sustainability: Bound Tests 1/ 2/
(Public 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 adjustment scenario 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/The no policy change scenario reflects constant primary balance from 2013, and is different from the no policy change scenario presented in the staff report.
4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
5/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 11. Serbia: Public Debt Sustainability Framework, 2008–20
(In percent of GDP, unless otherwise indicated)

	Actual					Projections								
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	33.4	38.1	46.5	49.5	61.8	**67.5**	**73.5**	**78.0**	**84.3**	**88.8**	**94.8**	**98.7**	**104.2**	**0.7**
o/w foreign-currency denominated	30.1	31.7	38.1	40.7	48.0	52.9	56.3	58.3	62.2	65.3	69.9	72.4	76.6	
Change in public sector debt	-1.2	4.7	8.4	3.0	12.3	5.8	6.0	4.4	6.3	4.6	6.0	3.9	5.5	
Identified debt-creating flows (4+7+12)	1.1	3.5	8.2	-0.4	9.4	2.6	3.3	3.3	3.9	3.8	3.8	3.6	3.5	
Primary deficit	2.0	3.8	3.7	3.7	5.6	5.7	4.6	4.6	4.7	4.4	4.1	4.0	3.7	
Revenue and grants	42.8	42.2	42.5	40.6	41.7	40.0	40.4	40.7	40.5	40.4	40.3	40.3	40.2	
Primary (noninterest) expenditure	44.9	45.9	46.2	44.3	47.2	45.7	45.1	45.3	45.3	44.8	44.5	44.2	43.9	
Automatic debt dynamics 2/	0.2	1.9	4.8	-4.0	3.7	-3.3	-1.3	-1.3	-0.8	-0.6	-0.4	-0.4	-0.2	
Contribution from interest rate/growth differential 3/	-4.4	0.1	-1.0	-3.3	-0.6	-3.3	-1.3	-1.3	-0.8	-0.6	-0.4	-0.4	-0.2	
Of which contribution from real interest rate	-3.2	-1.0	-0.6	-2.7	-1.4	-2.2	-0.1	0.2	1.1	1.6	2.1	2.3	2.6	
Of which contribution from real GDP growth	-1.1	1.1	-0.4	-0.7	0.8	-1.1	-1.3	-1.5	-1.8	-2.2	-2.5	-2.7	-2.8	
Contribution from exchange rate depreciation 4/	4.6	1.8	5.7	-0.7	4.3	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.2	-2.2	-0.2	-0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-1.2	-2.2	-0.2	-0.1	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-2.2	1.2	0.2	3.4	2.9	3.2	2.7	1.1	2.3	0.8	2.2	0.3	2.0	
Public sector debt-to-revenue ratio 1/	78.0	90.3	109.4	121.9	148.3	168.9	182.0	191.6	207.8	219.8	235.1	245.2	259.1	
Gross financing need 6/	2.8	6.1	10.8	11.9	15.9	22.8	19.0	20.6	22.2	21.6	22.7	23.8	24.1	
in billions of U.S. dollars	1.4	2.5	4.0	5.2	6.1	10.1	8.4	9.5	10.7	10.9	12.1	13.5	14.5	
Scenario with key variables at their historical averages 7/						**67.5**	**65.2**	**61.5**	**59.3**	**55.7**	**53.9**	**50.6**	**49.3**	**-4.8**
Scenario with no policy change (constant primary balance) in 2013-2018						**67.5**	**74.6**	**80.2**	**87.4**	**93.4**	**101.0**	**106.6**	**114.2**	**0.0**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.8	-3.5	1.0	1.6	-1.7	2.0	2.0	2.2	2.5	2.8	3.0	3.0	3.0	
Average nominal interest rate on public debt (in percent) 8/	2.2	2.5	3.3	3.3	4.3	4.7	5.1	5.3	5.5	5.9	6.2	6.2	6.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-10.4	-3.4	-1.6	-6.3	-3.1	-3.7	0.0	0.4	1.5	2.1	2.7	2.7	2.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-14.6	-5.7	-15.8	1.9	-9.7	...	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	12.6	5.9	4.9	9.6	7.4	8.4	5.1	4.9	4.0	3.7	3.5	3.5	3.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	3.2	-1.2	1.6	-2.6	4.6	-1.3	0.6	2.7	2.5	1.7	2.2	2.4	2.2	
Primary deficit	2.0	3.8	3.7	3.7	5.6	5.7	4.6	4.6	4.7	4.4	4.1	4.0	3.7	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

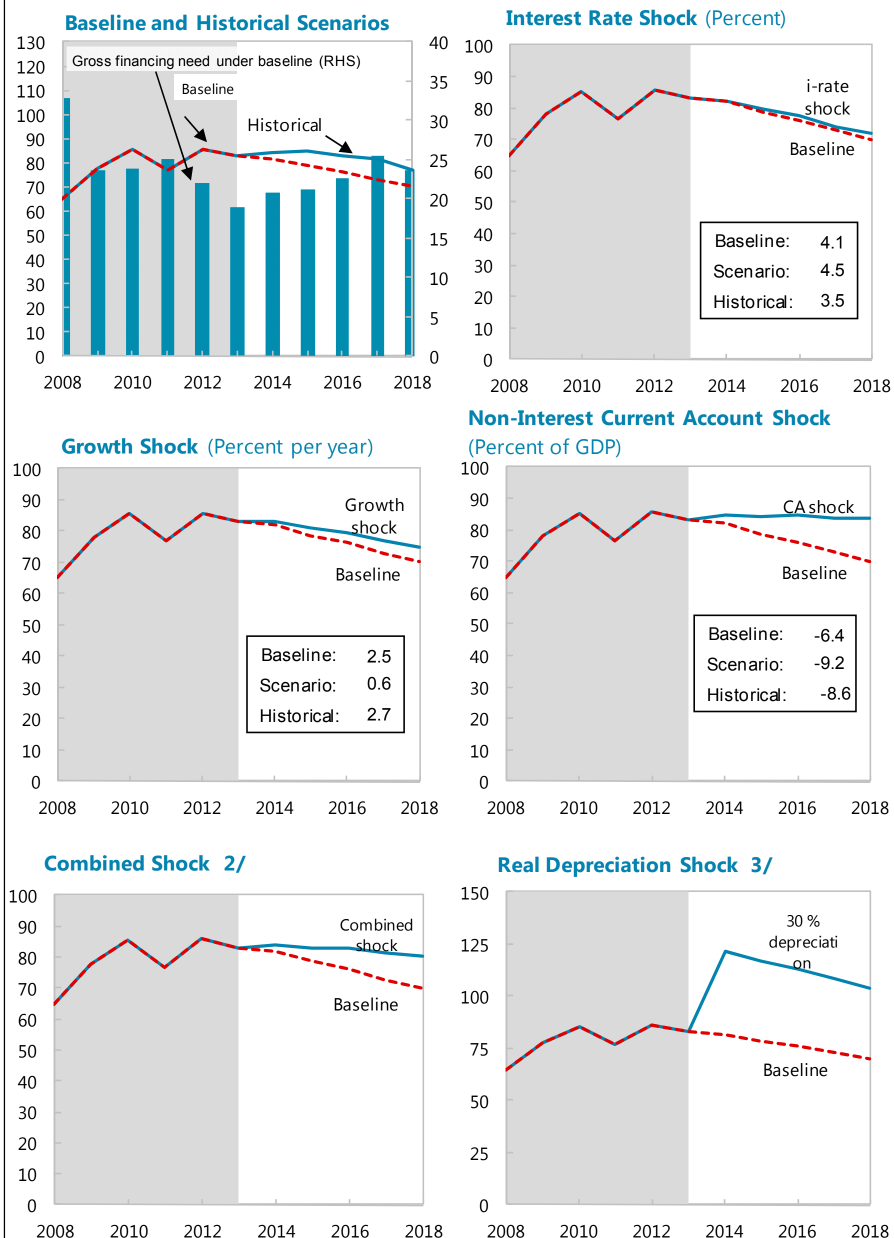
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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 14. Serbia: External Debt Sustainability: Bound Tests 1/
(Baseline Scenario, 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2013.

Table 12. Serbia: External Debt Sustainability Framework, 2008–18
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	64.9	77.8	85.4	76.7	85.8	**83.1**	**81.9**	**78.7**	**76.2**	**72.8**	**70.1**	**-7.0**
Change in external debt	4.6	12.9	7.6	-8.7	9.1	-2.8	-1.2	-3.2	-2.5	-3.4	-2.7	
Identified external debt-creating flows (4+8+9)	13.9	5.5	6.7	-6.4	12.2	4.0	3.5	4.1	4.8	5.2	5.6	
Current account deficit, excluding interest payments	19.1	4.3	4.3	6.6	7.8	5.9	5.8	6.0	6.4	6.8	7.0	
Deficit in balance of goods and services	26.7	17.0	16.4	16.4	17.7	15.0	14.2	14.2	14.3	14.2	14.0	
Exports	31.3	29.3	36.2	36.5	39.8	40.7	43.6	44.6	45.5	46.4	47.3	
Imports	58.0	46.4	52.6	52.9	57.4	55.7	57.8	58.8	59.8	60.6	61.3	
Net non-debt creating capital inflows (negative)	-5.4	-4.8	-3.1	-6.2	-0.6	-3.2	-3.3	-3.1	-2.9	-2.8	-2.6	
Automatic debt dynamics 1/	0.3	6.0	5.4	-6.8	5.0	1.3	1.0	1.2	1.2	1.2	1.2	
Contribution from nominal interest rate	2.9	2.2	2.4	2.5	2.7	3.0	2.6	2.9	3.1	3.1	3.3	
Contribution from real GDP growth	-2.2	2.4	-0.8	-1.2	1.4	-1.6	-1.6	-1.7	-1.9	-2.0	-2.1	
Contribution from price and exchange rate changes 2/	-0.4	1.4	3.8	-8.1	0.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-9.3	7.4	0.9	-2.3	-3.0	-6.8	-4.7	-7.3	-7.2	-8.6	-8.3	
External debt-to-exports ratio (in percent)	207.6	265.3	236.2	210.3	215.9	204.3	187.9	176.5	167.4	156.9	148.1	
Gross external financing need (in billions of euros) 4/	10.7	6.8	6.7	7.9	6.6	6.3	7.0	7.5	8.4	10.0	9.8	
in percent of GDP	32.9	23.6	24.0	25.0	22.1	18.9	20.9	21.2	22.6	25.6	23.6	
Scenario with key variables at their historical averages 5/						**83.1**	**84.4**	**85.2**	**83.2**	**81.4**	**77.0**	**-8.6**
Key Macroeconomic Assumptions Underlying Baseline												For debt stabilization
Real GDP growth (in percent)	3.8	-3.5	1.0	1.6	-1.7	2.0	2.0	2.2	2.5	2.8	3.0	
GDP deflator in euros (change in percent)	0.7	-2.1	-4.7	10.5	-1.2	4.5	1.7	4.7	1.6	4.2	1.5	
Nominal external interest rate (in percent)	5.0	3.2	3.0	3.3	3.4	3.7	3.3	3.8	4.1	4.4	4.7	
Growth of exports (euro terms, in percent)	16.9	-16.5	18.8	13.9	3.8	13.1	8.2	7.8	7.5	7.6	7.9	
Growth of imports (euro terms, in percent)	17.6	-28.9	9.2	13.6	3.5	7.2	4.8	7.2	7.1	7.1	7.0	
Current account balance, excluding interest payments	-19.1	-4.3	-4.3	-6.6	-7.8	-5.9	-5.8	-6.0	-6.4	-6.8	-7.0	
Net non-debt creating capital inflows	5.4	4.8	3.1	6.2	0.6	3.2	3.3	3.1	2.9	2.8	2.6	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

3/ Large negative values in the projection period reflects the drawdown of international reserves. The line also 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.

Appendix I. Serbia: Risk Assessment Matrix[1]

Source of Main Threats	Relative Likelihood of Threat (high, medium, or low)	Expected Impact if Threat is Realized (high, medium, or low)
Short-Term Risks		
1. Insufficient implementation of needed domestic adjustment	**Medium** Required adjustment is large and needs to be sustained, implying that implementation could be a challenge.	**High** Even in the absence of external shocks, fiscal slippages and mounting debt would result in: • higher cost of public and private sector financing. • possible BOP pressures. • rising NPLs and strains in the banking system. **Mitigating factor**: The international reserves coverage is relatively high.
2. Spillovers from stalled or incomplete delivery of Euro area (EA) policy commitments	**Medium** Incomplete delivery of policy commitments at the national or EA level could trigger a re-emergence of financial stress and re-intensification of bank-sovereign-real economy links.	**High** • Significant presence of EA banks in Serbia and trade links entail direct channels of contagion. • Deteriorating market confidence and flight to quality would reduce capital inflows, creating BOP pressures. **Mitigating factor**: The international reserves coverage is relatively high.
3. Global oil price shock	**Low** Geopolitical risks in the Middle East could precipitate a sharp fall in oil supply thus pushing oil prices higher.	**Medium** The oil price shock would increase inflation, curtail domestic demand, raise imports and weaken economic recovery in Serbia.
Medium-Term Risks		
1. Partial implementation of structural reforms	**Medium** The process of implementation of structural reforms could be derailed in the absence of broad-based support.	**High** Lack of implementation of structural reforms could constrain potential growth in Serbia.
2. Protracted period of slower European growth	**Medium** The adverse impact of the ongoing public and private sector deleveraging on the real economy may be larger than currently expected.	**Medium** • A slowdown in Europe would reduce Serbia's exports and growth due to strong trade linkages. • Lower growth would jeopardize the process of achieving debt sustainability. • Lower growth would increase NPLs and reduce

[1] The RAM shows events that could materially alter the baseline path.

		profitability of Serbian banks.
3. Excessive pace of parent bank deleveraging	**Medium** Parent banks in the EA may continue deleveraging, including by reducing balance sheets in subsidiaries in Emerging Europe.	**Medium** Given the large presence of EA-based banks in Serbia, excessive deleveraging would increase deposit/lending interest rates, stifle credit and domestic demand and create BOP pressures. **Mitigating factor:** Low share of short-term debt of Serbian banks and relatively high international foreign reserves mitigate the potential impact.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 14, 2013

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of May 31, 2013)

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	467.70	100.00
Fund Holdings of Currency	1,444.73	308.90
Reserve Position	0.00	0.00

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	445.04	100.00
Holdings	177.29	39.84

Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Stand-by arrangement	977.02	208.90

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
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 Obligations to Fund
(In millions of SDR)

	Forthcoming				
	2013	2014	2015	2016	2017
Principal	352.70	496.81	115.84	11.68	
Charges/Interest	4.88	4.81	1.02	0.21	0.16
Total	357.58	501.62	116.86	11.89	0.16

Implementation of HIPC Initiative: Not Applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable.

Safeguards Assessment: The latest safeguards assessment for the NBS has been completed in December 2011. The assessment found that the NBS has implemented several recommendations of the 2009 assessment that have further strengthened its financial safeguards. Multi-year external auditor appointment has been introduced and an independent external assessment of the internal audit function has been conducted. Governance has been strengthened with the Council's new role, which provides oversight of external and internal audits, financial reporting, and the system of internal controls. The assessment recommended improvements in external audit procedures, disclosures in financial statements, and data compilation procedures. Subsequent to the assessment completion, amendments to the NBS Law, which included inter-alia dismissal of the Council members, have raised concerns about NBS autonomy. In line with staff's advice, the authorities subsequently took steps towards restoring NBS autonomy.

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.

Last Article IV Consultation: Concluded on March 31, 2010 (IMF Country Report No. 10/93).

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 in the Past 12 Months:

Department	**Timing**	**Purpose**
STA	Apr. 2013	National Accounts
FAD	Apr. 2013	Tax Administration – Arrears Management
FAD	Apr. 2013	Tax Administration - IT
LEG	Mar. 2013	Corporate Debt Restructuring and NPLs
FAD	Feb. 2013	Tax Administration – Audit
FAD	Feb. 2013	Tax Administration – Taxpayer Services
MCM	Dec. 2012	Hedging International Bonds
FAD	Oct. 2012	Tax Administration – Compliance LTO
MCM	Oct. 2012	Bank Resolution
MCM	July-Aug. 2012	Banking Supervision and Resolution Framework
FAD	Aug.-Sep. 2012	Public Financial Management

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

Resident Representative:

Mr. Bogdan Lissovolik took his position as Resident Representative in April 2009.

WORLD BANK GROUP RELATIONS

A. Partnership with Serbia's Development Strategy

The World Bank has been discussing the policy reform agenda with successive governments, and has been actively engaged with the new Government since winning a mandate and assuming office in mid-2012. Support for the government's development strategy from the World Bank and the IMF follow the agreed upon division of responsibilities between the two institutions.

The Fund takes the lead on macroeconomic policies (fiscal, monetary, and exchange rate) aimed at facilitating sustainable growth, while the Bank takes the lead on structural policy aimed at medium to long-term adjustment. In areas of direct interest to the Fund, the Bank leads the policy dialogue in: (i) public expenditure management; (ii) pension, health, and education; (iii) social safety net reform and the monitoring of the impact of the crisis on the poor; and (iv) reforms with a bearing on the business environment, including labor markets and the performance of publicly owned enterprises. The Bank and the Fund have jointly led the policy dialogue in the financial sector.

The World Bank

Total IDA credits and grants committed to the Republic of Serbia (Serbia) by the Bank since 2001 amount to approximately $740 million, with an additional $846,5 million in IBRD commitments (as of May 2013). The Bank has assisted Serbia to make progress against key objectives set out in the Country Partnership Strategy (CPS) for FY12–15: (i) encouraging a more competitive economy; (ii) and improving the efficiency and outcomes of social spending. The Government has made progress on these two priorities with the support of World Bank financial and analytical products.

The CPS was discussed by the World Bank Board of Executive Directors on November 15, 2011. IBRD financing during the first two years of the CPS was expected to amount to US$340 million. The authorities requested total lending during the CPS period of US$800 million. The lending amount for the final two years of the CPS is to be discussed with Bank management at the time of the CPS Progress Report, scheduled for mid-CY13.

As of May 2013, Serbia has a portfolio of 7 Bank-supported projects under implementation with a total commitment value of $670 million (including IDA, IBRD and GEF). Investment support focuses on (i) transport and energy infrastructure aimed at encouraging regional integration and spurring economic growth; (ii) agricultural, environment, and irrigation investments to improve production and help Serbia meet EU standards; (iii) pension, education and health sector reform to strengthen the quality of service and improve financial sustainability; (iv) strengthened land administration; (v) energy efficiency; and (vi) regional development in the economically depressed former mining region of Bor. The Bank is also preparing policy lending to enhance the contribution of the public enterprise sector to the competitiveness of the Serbian economy.

IFC

As of April 2013, the IFC's committed portfolio in Serbia was US$753 million in 25 projects. Equity investments account for 9% of committed portfolio. IFC has significantly increased its financing in Serbia in FY12-13. In FY12 IFC invested US$ 504 million (including mobilization) in 7 projects and in FY13 is expected to invest $500 million (including mobilization) in 5 projects. In the financial sector, in FY12-13 IFC invested US$375 million at own account and mobilized about US$ 330 million through MIGA supporting the banking sector to expand its financing to MSMEs, agribusiness, trade finance, and housing sectors. Although the financial sector has been the focus, during FY12–13 IFC has also increased its presence in the real sectors investing US$290 million. Through its investments IFC has supported projects in the agribusiness sector, including in meat processing and juice production. Also, to improve private companies' competitiveness and their exports, IFC invested in one of the largest private companies in Serbia with activities in agribusiness, manufacturing and mining. Also, IFC financed a green-field metal stamping facility. In addition IFC invested about US$100 million in two regional projects in the cement and insurance sectors, with operations in the Balkans including in Serbia. In addition to providing financing, IFC is supporting Serbia through a number of advisory projects with focus on Investment Climate, Corporate Governance and Renewable Energy/Energy Efficiency.

MIGA

As of May 2013, MIGA's outstanding portfolio in Serbia consisted of 6 contracts of guarantee with total gross exposure of $176 million. All but one project are in support of foreign banks' loans to their Serbian subsidiaries, half of them in the aftermath of the 2008-09 global financial crisis. MIGA's continuing support to these projects signals the Agency's efforts to continue to underwrite projects in Serbia, encourage inward FDI, and add to the World Bank Group's strategy of encouraging private sector development in the country.

Prepared by World Bank staff. Questions may be addressed to Anthony Gaeta at (202) 473-1798 or Marina Wes at + 381 11 3023 706.

STATISTICAL ISSUES

Economic statistics in Serbia have faced many challenges in recent years but data provision is broadly adequate for surveillance. The statistical system has been successfully upgraded in recent years with the assistance of the IMF[1] and other bilateral and multilateral institutions. Although international standards are not yet fully met, official data for all sectors are sufficiently good to support key economic analysis and surveillance. In many areas, including monetary, balance of payments, and real sectors, internationally accepted reporting standards have been introduced. A page for the Republic of Serbia was introduced in the October 2006 issue of the *International Financial Statistics (IFS)*.

Serbia participates in the General Data Dissemination System (GDDS) and its metadata were posted on the IMF Data Dissemination Bulletin Board on May 1, 2009. The metadata identify plans for improvement, which are being used to guide further progress.

A. Real Sector Statistics

The real sector data are compiled by the Statistical office of the Republic of Serbia (SORS). Annual and quarterly nominal and volume measures of GDP by activity are available from 1997 onwards. Nominal annual GDP estimates by expenditure are available from 1997, while the respective volume measures estimates have been disseminated only starting with the data for 2003. Quarterly GDP estimates by expenditure both at current prices and in volume measures are available from 2003 onwards.

The national accounts statistics of the Republic of Serbia are based on the conceptual framework of 1993 SNA/ESA 95. Work is progressing on the transition to the most updated international recommendations of the 2008 SNA/ESA 2010. In the last two years significant methodological changes were introduced in the compilation of volume measures of GDP as the SORS adopted a system of chain-linked volume measures, thus replacing the previous estimates with a fixed base. Also the scope of the estimates were recently extended with the compilation of annual volume measures of GDP by expenditures on final uses and the compilation of expenditure-based quarterly GDP, both at current prices and in volume terms. These estimates were disseminated for the first time on March 29, 2013.

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

Sources and method for the compilation of GDP by expenditures, are in general adequate but, the adjustment to domestic household consumption expenditure for net expenditures of residents abroad

[1] Recent examples of STA technical assistance missions include the SDDS assessment and the national accounts missions of FY 2011, as well as national accounts missions in FY 2012 and FY 2013, respectively.

differs from the corresponding estimates in the balance of payments compiled by the National Bank of the Republic of Serbia (NBS) thus implying an internal inconsistency within GDP by expenditure. Weaknesses in the estimates of gross fixed capital formation are due to the lack of coverage of the unincorporated enterprises in the survey on investments, but starting in 2013 these enterprises are included in the survey. Separate estimates of changes in inventories are disseminated from 2007.

Reconciliation between the independent annual GDP estimates based on the production and expenditure approach is being made at aggregate levels, although the original differences are not significant. The gap between the quarterly estimates of GDP by expenditure and GDP by production 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 RSSO compiles and disseminates monthly indices for retail and consumer prices, producer prices, industrial production, as well as unit-value indices for imports and exports. Concepts and methods used to compile the CPI, introduced in 2007, as well as other price statistics, attempt to reflect international standards and best practices.

B. Balance of Payments Statistics

Balance of payments statistics are compiled by the National Bank of Serbia (NBS). The compilation procedures are generally appropriate; however, the source data for compiling various current account transactions could be further improved. In particular, additional programs should be developed to collect data to estimate unrecorded trade, travel, and private transfers (workers' remittances).

The NBS has improved the source data for estimating transactions relating to direct investment by conducting direct surveys of direct investment enterprises. However, there is a backlog of data to be processed and direct investment transactions in the balance of payments statistics have not been adjusted based on the survey data.

The staff levels are not commensurate with the statistical program and the NBS may face some difficulty in conducting all the requisite data collection exercises and implementing the majority of the recommendations if staffing is not increased.

Serbia reports balance of payments statistics to STA for publication in the IFS and the *Balance of Payments Statistics Yearbook*.

C. Government Finance Statistics

Government finance statistics are compiled by the Ministry of Finance and reported on a monthly basis. Principal data sources are the Republican Treasury and budgetary execution reports of the spending ministries and first-level budget units.

Since 2001, Serbia has made efforts to bring the existing budget reporting system in line with the *Government Finance Statistics Manual 2001 (GFSM 2001)* methodology. Full compliance has yet to be achieved as implementation of the new chart of accounts, generally consistent with the classifications of the *GFSM 2001*, has not been completed. The classification of all expenditure of the "National Investment Plan" as capital needs to be brought in line with international standards. While the data on the clearance of arrears are available on a monthly basis, information on the accumulation of new arrears is not available. The reconciliation of fiscal and monetary data is not conducted on a regular basis.

D. 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.

Some improvements could still be made. The coverage of monetary statistics could be improved by including banks in liquidation (as their data are not available on a timely or comparable, International Accounting Standard-specified, basis).

Table of Common Indicators Required for Surveillance

(As of May 31, 2013)

	Date of Latest Observation	Date Received	Frequency of Data[4]	Frequency of Reporting[4]	Frequency of Publication[4]
Exchange rates	May 30, 2013	May 31, 2013	D and M	D and M	D and M
International reserve assets and reserve liabilities of the monetary authorities[1]	May 30, 2013	May 31, 2013	D	D	M
Reserve/base money	May 30, 2013	May 31, 2013	D and M	W and M	W and M
Broad money	Apr. 2013	May 24, 2013	M	M	M
Central bank balance sheet	Apr. 2013	May 24, 2013	M	M	M
Consolidated balance sheet of the banking system	Apr. 2013	May 24, 2013	M	M	M
Interest rates[2]	May 30, 2013	May 31, 2013	D	D	D
Consumer price index	Apr. 2013	May 12, 2013	M	M	M
Revenue, expenditure, balance and composition of financing – general government	Apr. 2013	May 15 2013	M	M	M
Revenue, expenditure, balance and composition of financing– central government	Apr. 2013	May 15 2013	M	M	M
Stocks of central government and central government-guaranteed debt[3]	Apr. 2013	May 2013	M	M	M
External current account balance	Apr. 2013	May 2013	M	M	M
Exports and imports of goods and services	Apr. 2013	May 30, 2013	M	M	M
GDP/GNP	2012:Q4	Mar. 29, 2013	Q	Q	Q
Gross external debt	Apr. 2013	May 2013	M	M	M
International Investment Position[5]	Dec. 2012	Mar. 2013	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 IMF Staff Representative on the Republic of Serbia
July 1, 2013

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

1. **The government has adopted a draft supplementary 2013 budget and proposed legislation to reduce mandatory spending indexation in 2014.** The draft budget—expected to be enacted in early July—aims to generate savings of about 1 percent of GDP in 2013, mainly through discretionary cuts in current expenditures (largely subsidies) and public investment. For 2014, the government has proposed legislative changes to limit the annual indexation of public wages and pensions to 1½ percent compared to staff calculations in the unchanged policy scenario of 5½ and 4½ percent for wages and pensions respectively based on the current indexation formula. Beyond 2014, wage indexation will be harmonized with pensions. The 2013 package, however, is insufficient to achieve a neutral fiscal stance in structural terms this year as recommended by staff, and, in staff's view, the underlying measures are of poor quality as they are largely one-off in nature and subject to significant implementation risks that will likely compromise saving yields. On balance, the overall package of proposed consolidation, while a step in the right direction, is by itself insufficient to reverse the upward trend in the public debt-to-GDP ratio over the medium term.

2. **The NBS has further eased monetary conditions despite market pressures.** In June, the NBS lowered the key policy rate by 25 basis points to 11 percent citing a better inflation outlook, weak demand, and potential positive confidence effects from the planned fiscal consolidation package. While moving to increase somewhat its operations to absorb liquidity, the NBS has allowed the average repo rate—the true gauge of monetary conditions—to also ease further. Meanwhile, pressures in the foreign exchange market have intensified, in line with global market trends, with the dinar depreciating by about 3 percent over the past month despite NBS foreign exchange sales of some €275 million (less than 3 percent of the reserve stock). In the same period, the EMBI spread for Serbia has widened by 160 basis points and recent T-bill and bond auctions have been significantly undersubscribed.

3. **The government has taken steps to advance selected structural reforms.** An action plan aimed at resolving formerly socially-owned enterprises that was developed with support from the World Bank is expected to be adopted by the government on June 27. The authorities also unveiled plans to accelerate privatization of a few public enterprises and streamline procedures for construction permits. At the same time, while some labor market reform is now envisaged by end-2013, pension reform is not included in the latest reform package, reflecting a lack of broad-based social and political consensus.

INTERNATIONAL MONETARY FUND
Public Information Notice

Public Information Notice (PIN) No. 13/76
FOR IMMEDIATE RELEASE
July 3, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Serbia

On July 1, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Serbia.[1]

Background

The Serbian economy is recovering from a recession but faces multiple challenges. Robust growth in automotive exports is underpinning the recovery in 2013 and the double-digit inflation is subsiding. However, unemployment well above 20 percent is a major social concern and large fiscal and current account deficits constitute key vulnerabilities. Structural bottlenecks continue to undermine overall competitiveness and constrain Serbia's growth potential.

Despite some consolidation measures implemented in the second half of 2012, the general government deficit rose to 7¾ percent of GDP in 2012 in part due to bank resolution costs, clearance of arrears, and payments for called guarantees. As a result, public debt reached 62 percent of GDP at end-2012, well above the legal ceiling of 45 percent of GDP. The National Bank of Serbia (NBS) tightened monetary policy to compensate for the fiscal slippage.

The favorable global financial markets situation since late 2012 eased Serbia's financing and balance of payments pressures, creating scope for a successful placement of several Eurobonds and large foreign inflows into local government securities. This contributed to a reduction of government yields and an appreciation of the exchange rate.

[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. 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.

The financial system remains stable overall. Capitalization and liquidity indicators are high and non-performing loans (NPLs) are well-provisioned despite their relatively high level. However, there are pockets of vulnerabilities as two medium-sized public banks had to be recently resolved. The significant euroization of the economy and the large stock of corporate NPLs pose significant challenges as the balance sheet constraints hamper financial intermediation and the economic recovery.

Executive Board Assessment

Executive Directors concurred that strong policies are required to tackle long-standing challenges facing the economy, recently exacerbated by the adverse external environment. Priorities include sustained fiscal consolidation and a rebalancing of monetary policy to reduce external and domestic vulnerabilities, and a comprehensive package of structural reforms to unlock Serbia’s growth potential.

Directors agreed that reversing the rapid rise in the public debt-to-GDP ratio is key to rebalancing the economy. They welcomed the effort embodied in the draft supplementary budget and the authorities’ plans to reduce wage and pension indexation. Most Directors, however, considered that additional measures are necessary. In particular, Directors emphasized the need to contain the public sector wage bill and to undertake a comprehensive pension reform. They also noted that improving tax administration and reducing tax exemptions can contribute significantly to the consolidation effort, and called for more rapid progress on public financial management reforms.

Directors concurred that the inflation targeting framework has served Serbia well, despite the difficulties of implementing inflation targeting in an economy where the bulk of deposits and loans are either in or linked to foreign currencies. They agreed that lower and less volatile inflation would support a greater role for the dinar in domestic transactions and as a store of value, and improve monetary transmission. Against this background, Directors noted that the recent easing of monetary conditions may have been premature, and called on the central bank to step up liquidity absorption to bring money market interest rates closer to the policy rate. Directors agreed that room for additional monetary easing could open up only once fiscal adjustment is well underway and exchange rate pressures subside.

Directors stressed the importance of maintaining financial sector stability and current prudential standards. They considered that improvements in banks’ balance sheets are necessary to boost private sector credit and support the economic recovery, and welcomed recent measures to facilitate the resolution of non-performing loans. Directors also underscored the importance of continued careful supervision and a comprehensive strategy to improve the management of public banks.

Directors emphasized that more reforms are necessary to increase labor force participation, reduce persistent unemployment, and improve competitiveness. Priority areas include labor market reforms, streamlining regulations, and improving the business environment. Directors also welcomed the authorities’ plans for restructuring state-owned enterprises.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Republic of Serbia: Selected Economic Indicators

	2008	2009	2010	2011	2012	2013 Proj.
Output, prices and labor market						
Real GDP	3.8	-3.5	1.0	1.6	-1.7	2.0
Real domestic demand (absorption)	5.3	-10.6	-1.8	3.8	-1.6	0.6
Consumer prices (average)	12.4	8.1	6.2	11.1	7.3	8.4
Consumer prices (end of period)	8.6	6.6	10.3	7.0	12.2	4.9
GDP deflator	12.6	5.9	4.9	9.6	7.4	8.4
Import prices (dinars, average)	13.7	0.8	17.2	4.8	12.1	2.5
Unemployment rate (in percent)	14.7	17.4	20.0	24.4	23.1	23.0
Nominal GDP (in billions of dinars)	2,661	2,720	2,882	3,209	3,386	3,745
General government finances						
Revenue	42.8	42.2	42.5	40.6	41.7	40.0
Expenditure	45.5	46.8	47.4	45.7	49.2	48.3
Current	40.9	42.4	42.6	41.2	44.9	44.0
Capital and net lending	4.6	4.3	4.9	4.5	4.3	4.3
Fiscal balance (cash basis)	-2.7	-4.6	-4.9	-5.1	-7.6	-8.3
Primary fiscal balance (cash basis)	-2.0	-3.8	-3.7	-3.7	-5.6	-5.7
Structural fiscal balance 1/	-4.1	-4.1	-4.4	-5.3	-5.8	-7.9
Gross debt	33.4	38.1	46.5	49.5	61.8	67.5
Monetary sector						
Money (M1)	-3.9	8.8	-2.2	16.8	3.8	5.4
Broad money (M2)	9.6	22.0	13.7	10.4	9.2	9.3
Domestic credit to non-government 2/	23.3	10.3	18.4	8.1	3.2	-6.0
Interest rates (dinar)						
NBS key policy rate 3/	17.8	9.5	11.5	9.8	10.1	11.7
Interest rate on new FX and FX-indexed loans 3/	…	…	8.5	8.2	8.0	8.4
Balance of payments						
Current account balance	-21.7	-6.6	-6.8	-9.1	-10.5	-8.7
Exports of goods	22.8	20.7	26.6	26.8	29.4	30.3
Imports of goods	-49.0	-37.8	-43.0	-43.8	-47.6	-45.9
Trade of goods balance	-26.2	-17.1	-16.5	-16.9	-18.2	-15.6
Capital and financial account balance	16.9	11.3	2.0	14.1	6.5	11.0
External debt (Percent of GDP)	64.9	77.8	85.4	76.7	85.8	83.1
of which: Private external debt	44.8	50.9	52.8	42.5	45.2	41.1
Gross official reserves (in billions of euro)	8.2	10.6	10.0	12.1	10.9	11.0
(In months of prospective imports)	7.3	8.7	7.2	8.4	7.1	6.8
(Percent of short-term debt)	166.0	221.5	199.8	328.4	270.9	234.0
(in percent of broad money, M2)	74.8	86.1	78.6	85.2	76.8	73.6
Exchange rate (dinar/euro, period average)	81.9	94.1	103.5	102.0	113.0	113.0
REER (annual average change, in percent; + indicates appreciation)	6.5	-6.6	-8.0	9.3	-7.4	6.3

Sources: Serbian authorities; and IMF staff estimates and projections

1/ Fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending.
2/ At constant exchange rates.
3/ Latest actual data.

Statement by Mr. Dominik Radziwill and Mr. Vuk Djokovic on Republic of Serbia
July 1, 2013

On behalf of our Serbian authorities we would like to thank staff for useful discussions during the IMF mission and for a broadly fair and objective report. The assessment points to the moderate recovery of the Serbian economy. Some challenges have emerged, but our authorities reiterate their commitment to address the issue of creating an investment friendly environment and tackling the rising deficit. In this regard, the report adequately delineates the delicate policy challenges that our authorities are facing.

On the political side, we would like to emphasize that Serbia has taken strategic steps towards its future in the European Union by successfully reaching an agreement with Kosovo to normalize mutual relations, paving the way for Serbia to begin negotiations with the European Commission on full EU membership.

Outlook

Following the recession in 2012, this year Serbia's economy is expected to grow by two percent, driven by strong exports and a rebound in agriculture. In the first four months of 2013, the manufacturing recorded growth of five percent, while the exports increased by 25 percent. Our authorities consider that this reinvigorated growth, based on export-oriented FDIs, is pivotal for reducing unemployment and balancing public finances. To attract high quality FDIs, the government has put in place a set of supporting measures, including tax exemptions and employment subsidies. In order to preserve this growth momentum, our authorities are committed to underpin it with further structural reforms and an improved business environment.

Fiscal policy

The policy priority of our authorities is to achieve fiscal sustainability and decrease public debt, while also preserving social safety network. Cognizant of the unexpected underperformance of revenues during the first half of the year, our authorities have taken decisive measures aimed at addressing the rising deficit. This week the government approved and submitted to parliament a supplementary budget which plans public spending cuts (e.g., mostly on subsidies, goods and services and other discretionary spending) by one percent of GDP this year. Our authorities made a difficult decision in containing growth of public wages and pensions. This is a particularly sensitive issue in Serbia if one bears in mind that the pensions in Serbia are low and the purchasing power of the average pension has been declining since 2009. Although wages and pensions will not be frozen in nominal terms, by changing the indexation formula their growth will be limited well below projected inflation. Moreover, in order to better control the sizable public sector wage bill, the Serbian government is introducing the central registry of public employees, which will allow better monitoring and controlling of new employment and promotions in the public sector.

Monetary and exchange rate policy

Monetary policy will continue to use inflation targeting to achieve low and stable inflation as its main objective. After the spike in inflation caused by the rise of food prices in 2012, inflation is gradually declining. The authorities expect that inflation will revert by October to the projected target range of between 2.5 to 5.5 percent. As the inflation expectations are declining—notably from an elevated level—the National Bank of Serbia (NBS) is continuing to ease its monetary stance, and the policy rate was recently lowered to 11 percent. In order to strengthen the inflation targeting framework and to allow for better monetary transmission mechanisms, the NBS is continuously working to promote de-euroization of Serbia.

The NBS continues to be committed to the managed floating exchange rate regime. The dinar recently depreciated against the euro as a consequence of capital outflows. However, similar trends have been observed in numerous emerging countries. Earlier this year, the NBS intervened in the foreign exchange market, to prevent excessive daily volatility in the relatively shallow market. Under usual metrics, the NBS foreign exchange reserves remains robust.

Financial sector

Overall, Serbia's financial sector is stable, well capitalized and profitable. The share of non-performing loans is high, however those are well provisioned. In order to preserve confidence and financial sector stability, the government took decisive measures to address weaknesses in two mismanaged state owned banks. The resolution of those banks came at significant fiscal cost. Our authorities are determined to preserve financial sector stability by continuing to closely monitor the banking system, strengthen prudential supervision, and improve corporate governance.

Structural reforms

Lastly, our authorities are steadfastly working to improve the investment climate in order to attract FDIs. Among other measures, our authorities are drafting the new urbanism and construction law, which is expected to streamline and simplify the process to obtain building permits and reduce red tape in the construction sector. Furthermore, with support from the World Bank, our government has approved the Action Plan for disposition of enterprises in restructuring, which envisages the resolution by sale or bankruptcy of 175 socially owned enterprises.