INTERNATIONAL MONETARY FUND

IMF Country Report No. [15/161]

REPUBLIC OF SERBIA

June 2015

REPUBLIC OF SERBIA—FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT—PRESS RELEASE AND STAFF REPORT

In the context of the first review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on May 12, 2015, with the officials of Republic of Serbia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on June 11, 2015.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Republic of Serbia*
Memorandum of Economic and Financial Policies by the authorities of Republic of Serbia*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND
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Press Release No. 15/300
FOR IMMEDIATE RELEASE
June 26, 2015

International Monetary Fund
Washington, D.C. 20431 USA

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

The Executive Board of the International Monetary Fund (IMF) on June 26, 2015 completed the first review of Republic of Serbia's economic performance under the Stand-By Arrangement (SBA). Completion of the review will make available the cumulative amount of SDR 304 million (about €380 million). The Serbian authorities have indicated their intention to continue treating the arrangement as precautionary. The decision was taken without a formal meeting[1].

The program is broadly on track. All end-March 2015 performance criteria and indicative targets were met with comfortable margins. All end-March structural benchmarks were implemented, although with a delay, and all prior actions were met.

The economy has stabilized, on the back of lower oil prices and stronger than expected trading partner growth. Inflationary pressures remain subdued. The external position has strengthened. Despite monetary easing, credit growth remains sluggish and non-performing loans (NPLs) continue to pose a challenge. Risks to the program come from possible spillovers from regional developments and increase in market volatility, as well as delayed implementation of structural reforms.

The original program targets remain appropriate and any fiscal over-performance should be used to reduce the high public debt. The gradual monetary easing should continue, given the still low inflation and ongoing fiscal consolidation. Pursuing the broad financial sector agenda is crucial to strengthen financial stability, and a comprehensive strategy to resolve the high NPLs is needed for economic recovery and reducing financial vulnerabilities. Some progress has been made in advancing structural reforms. A sustained reform effort, particularly for state-owned enterprises with the goal of reducing state aid and containing

[1] The Executive Board takes decisions under its lapse-of-time procedures when it is agreed by the Board that a proposal can be considered without convening formal discussions

fiscal risks, will be key for the success of the program and for achieving stable long-term growth.

The Executive Board approved the 36-month, SDR 935.4 million (about €1.2 billion) SBA for Serbia on February 23, 2015 (see Press Release No. 15/67).

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

June 11, 2015

FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT

KEY ISSUES

Recent economic developments. The economy is slowly emerging from the 2014 recession, benefiting from low oil prices and the euro area recovery, which have helped to contain the short-term effects of fiscal consolidation. However, growth is only expected to return in 2016. Inflationary pressures remained subdued on account of low import prices and widening output gap.

Program status. The new 36-month Stand-By Arrangement (SBA) with access of SDR 935.4 million (200 percent of quota, or about €1.2 billion) approved on February 23, 2015 is broadly on track. All end-March performance criteria (PCs) and indicative targets were met. The structural benchmarks were all completed with delay reflecting implementation difficulties, particularly in the area of state-owned enterprises (SOEs). Completion of the review will make available the cumulative amount of SDR 304 million. The authorities intend to continue treating the arrangement as precautionary.

Policy recommendations. Continued efforts in advancing the agreed structural reforms, particularly for SOEs, and pursuing the planned fiscal consolidation are critical to achieving macroeconomic stability and sustainable long-term growth.

New program commitments. Three prior actions were established regarding the adoption of the financial restructuring plan for the electricity company Elektroprivreda Srbije (EPS), introduction of excise tax on electricity, and increase in electricity tariff. These prior actions were met in early June. The end-June structural benchmark on the Local Government Financing Law is proposed to be reset to end-September. New benchmarks are set in the area of nonperforming loan (NPL) resolution.

Approved By
Thanos Arvanitis and Luis Cubeddu

Discussions were held in Belgrade during April 29–May 12, 2015. The staff team comprised Zuzana Murgasova (head), Chuling Chen, Dmitriy Kovtun (all EUR), Christine Richmond (FAD), Constant Verkoren (MCM), Manrique Saenz (SPR), Daehaeng Kim (resident representative), Desanka Nestorović, and Marko Paunović (Belgrade office). James Roaf (EUR) joined some of the policy discussions. HQ support was provided by Min Kyu Song and Patricia Mendoza (EUR).

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APPENDICES

BACKGROUND

1. **The authorities have continued to advance policies and reforms to address Serbia's key vulnerabilities against the backdrop of a more favorable external environment.** The authorities remain committed to the reform agenda under the program and continue to implement the broad macroeconomic and structural reforms they started already in 2014.

2. **The program is broadly on track** (MEFP Tables 1–2). All end-March and continuous performance criteria and indicative targets were observed, and end-March structural benchmarks were implemented with delay.

- **Fiscal performance was better than programmed.** The Q1 fiscal deficit ceiling for the general government was met with a significant margin, largely due to one-off revenue overperformance and possible revenue frontloading. The ceilings on current primary expenditure of the Republican budget, issuance of guarantees, and accumulation of arrears were also observed.

- **All monetary policy targets were met**. Improved current account performance and strong capital inflows—partly resulting from the ECB quantitative easing—contributed to the higher-than-programmed accumulation of net international reserves. End-March inflation was close to the programmed center point.

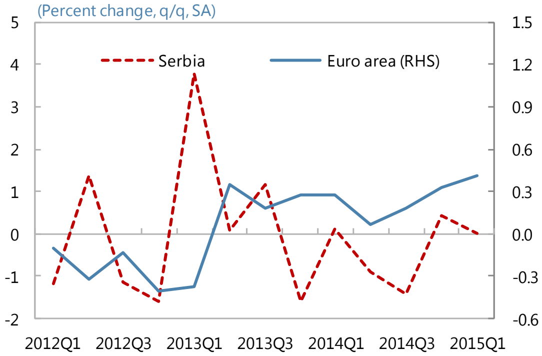
- **The end-March structural benchmarks were implemented with delay.** The decree that regulates the roles and responsibilities of the Ministry of Finance (MOF), Ministry of Economy (MOE), and line ministries with respect to monitoring SOEs and public-private partnerships (PPPs) was adopted with a short delay in April 2015. The Tax Administration Transformation Program 2015–20 was also adopted with a delay in early June due to the need to develop a realistic plan consistent with the authorities' implementation capacity. The government adopted a financial restructuring plan for Elektroprivreda Srbije (EPS) in early June 2015, which, together with a new excise tax and the regulated electricity tariff increase effective as of August 1, 2015, constitute prior actions for the first review. These prior actions were met in early June. The longer-than-expected consultation process between EPS and the government, as well as concerns about the social impact of utility price increases, were the main reasons for the delay.

- **Looking ahead, quantitative and structural targets under the program remain broadly appropriate**. However, the end-June structural benchmark on the Local Government Financing Law will be delayed because of the need for further consultations with local governments and municipalities and thus is proposed to be reset for end-September. New benchmarks are proposed to be set in the area of nonperforming loan (NPL) resolution. Quantitative targets for end-September 2015 are proposed to be set in line with the quarterly projections in the program request.

RECENT ECONOMIC DEVELOPMENTS

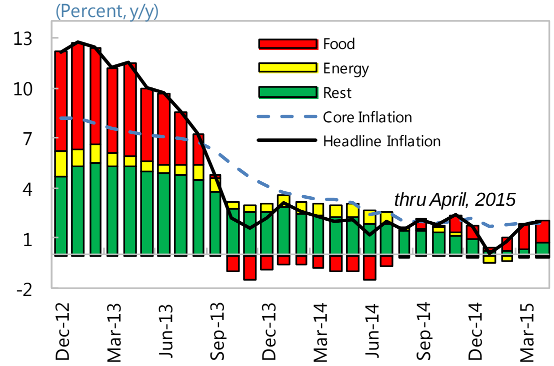
3. **The economy is showing signs of stabilization** (Tables 1–7 and Figure 1). High frequency indicators point to robust increase in industrial production and exports in early 2015, in line with stronger euro area growth. The economy was also supported by lower oil prices which generated cost savings for households and corporates (Box 1). Yet domestic demand is still weak, as the ongoing fiscal consolidation dampens consumption, and some public investment projects are delayed. Following a rebound in 2014:Q4, flash estimates suggest that real GDP remained flat in 2015:Q1.

Quarterly GDP Growth
(Percent change, q/q, SA)



Sources: World Economic Outlook database, and IMF staff calculations.

Contributions to Headline Inflation
(Percent, y/y)



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

4. **Inflation remains low.** Headline CPI inflation has been below the tolerance band since late 2013 and core inflation has declined as well (Figure 2). The widening output gap, low imported inflation, and delayed increases in some administrative prices are the main factors.

5. **Serbia's external position has strengthened in recent months** (Figures 3 and 4). The current account deficit has narrowed due to a dynamic recovery in exports. At the same time, import growth was contained by lower import prices and weak consumption. Capital inflows have been supported by the ECB quantitative easing, declining sovereign risk premia, and the rising demand for Serbia's government securities. As a result, the dinar reversed its previous depreciation trend against the euro in early 2015. International reserves are at comfortable levels.

6. **Fiscal performance was better than expected** (Figure 5). The general government fiscal deficit (previously referred to as the general government augmented fiscal deficit, see IMF Country Report 15/20, p. 70) was below the

Serbia: General Government Fiscal Operations, RSD billion

	1Q2015		
	Prog.	Actual	Diff
Total revenue	**335.8**	**365.7**	**29.9**
Tax revenue	298.9	310.0	11.1
of which: VAT	91.0	96.2	5.2
Non-tax revenue	35.3	54.2	18.9
Capital revenue	0.0	0.3	0.3
Grants	1.6	1.1	-0.5
Total expenditure	**391.5**	**386.8**	**-4.8**
Current expenditure	369.4	369.0	-0.4
Capital expenditure	16.4	10.5	-5.9
Net lending	0.7	0.5	-0.2
Amortization of activated guarantee	5.2	6.9	1.7
Fiscal balance	**-55.8**	**-21.1**	**34.7**
Memo:			
Primary current expenditure of the Republican Budget	207.4	195.4	-12.0

Sources: Ministry of Finance and IMF staff estimates.

Q1 ceiling by almost 1 percent of GDP. Revenue overperformance—both tax and non-tax—was the main contributing factor, with large one-off elements (dividends related to pre-2014 performance of SOEs and 4G license fee) and possible revenue frontloading. Tax revenue was supported by import-related taxes (VAT and international trade taxes) and higher social security contributions. Spending was under-executed on account of capital expenditure.

Box 1. Impact of the Oil Price Decline on the Serbian Economy

International oil prices have decreased steeply since June 2014, positively impacting the Serbian economy. The annual average price of oil in euros is projected to fall by 29 percent in 2015.[1] This is expected to improve terms of trade, increase real income, and reduce the oil trade deficit from 5 percent of GDP in 2014 to just under 4 percent of GDP this year.

Impact of Drop in Oil Price in 2015

Impact on terms of trade (percent change, y/y)	2.6
Impact on real income (in euro millions)	479
Impact on real income (in percent of GDP)	1.4
Oil and gas balance (in percent of GDP)	-3.9
Price of oil (in US$ per barrel)	58
percent change in oil price 2014–15	-40
Price of oil (in euros per barrel)	51
percent change in oil price 2014–15	-29
Memo items:	
Price of oil in 2014 (in US$ per barrel)	96
Price of oil in 2014 (in euros per barrel)	72

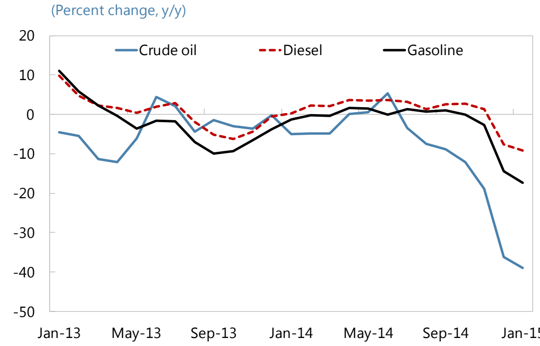
Sources: NBS and Fund staff estimates.

The impact on consumer prices is projected to be sizable, with the maximum first-round effect on annual inflation estimated at -1 percentage point. This reflects the fact that crude oil prices constitute about a half of the total retail pump price, while the remainder is related mainly to taxes and fees.

Lower oil prices are expected to boost production through three channels: (i) lower costs of production in Serbia, which increase firms' internal resources to finance investments; (ii) higher personal consumption and domestic demand in Serbia; and (iii) higher growth in the euro area, the main market for Serbian exports—this effect is estimated at 0.3–0.4 percent by April 2015 World Economic Outlook (WEO). The National Bank of Serbia (NBS) estimates the overall impact on Serbian production to be within this same order of magnitude.

The impact of lower oil prices on the financial health of key SOEs is significant. SOEs in the petrochemical sector, which incurred losses in the past, are now operating without new state aid or arrears accumulation. Lower oil prices, however, have not translated into significant cost savings for the electricity company as electricity production in Serbia is mainly based on domestically produced coal.

Price of Oil and Oil Derivatives in Euros
(Percent change, y/y)

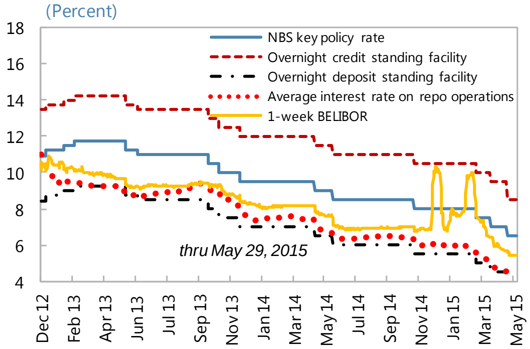


Source: Ministry of Mining and Energy, and IMF staff calculations.

1/ Based on WEO projections as of May 2015.

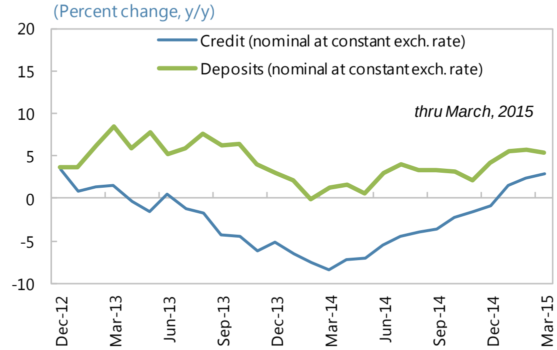
7. Subdued inflation expectations and the ongoing fiscal consolidation have enabled the easing of monetary policy (Figure 2). The NBS lowered its key policy rate by cumulative 150 bps in 2015 to a historical low of 6.5 percent, which helped reduce the one-week interbank money market interest rate (which serves as an operating target for monetary policy) below its neutral rate.[1] In May, the NBS also narrowed the interest rate corridor by 100 bps in order to reduce the volatility of money market rates. However, the monetary policy transmission mechanism is weak due to exceptionally high euroization and constrained balance sheets. As a result, credit to the private sector is still sluggish, and the expansion in 2014:H2 was largely a result of the subsidized loan programs.

Interest Rates
(Percent)



Sources: Bloomberg and NBS.

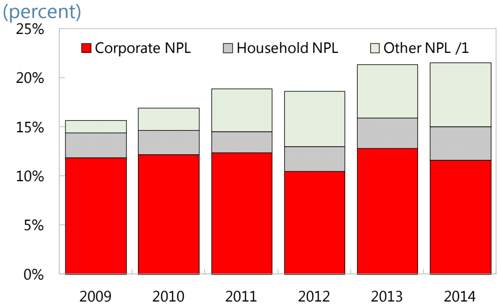
Banks' Credit to the Economy and Deposits
(Percent change, y/y)



Source: NBS and IMF staff calculations.

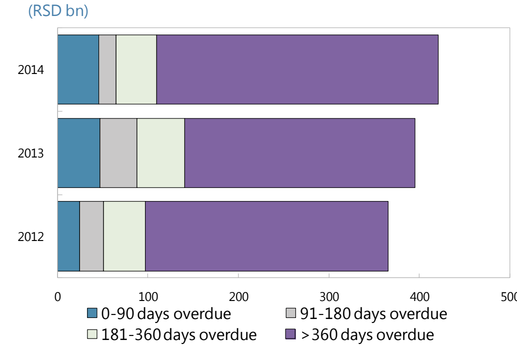
8. The financial sector remains stable, despite a continuous increase in NPLs (Table 8). Banking sector profitability has improved, regulatory capital to risk weighted assets is high, and liquidity is boosted by ongoing deposit growth. However, NPLs have been rising—particularly for corporates—and their significant aging reflects banks' inability to resolve distressed loans in a timely manner. Although robust prudential loss reserves have helped strengthen bank solvency, NPL overhang dampens the banks' financial intermediation role.

Composition of Non-Performing Loans
(percent)



Source: NBS.
1/ Including companies in bankrupcy proceeding.

Maturity Profile of Non-Performing Loans
(RSD bn)



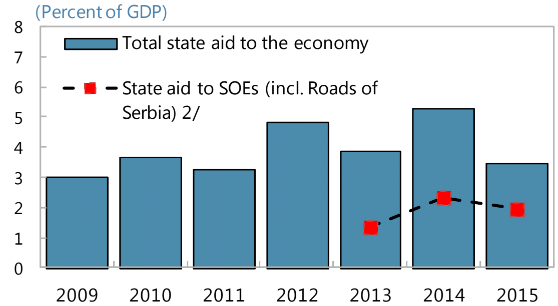
Source: NBS

[1] The neutral one-week money market interest rate is estimated to be in the range of 6½–7 percent, whereas the average actual interest rate for the latest available month (May) is about 5½ percent.

9. The authorities have taken legislative steps to improve job creation and the business climate. The Law on Employment was amended in April 2015 to better align disbursement of social benefits for the unemployed with specific training programs. Also, a new Law on Inspection Oversight was adopted in April to help fight corruption and the grey economy. A new Investment Law is being prepared and will be adopted in June 2015 to improve the investment climate (MEFP ¶34).

10. Resolution of SOEs is proceeding, but with delays. The authorities have taken a number of measures in this area. To strengthen fiscal risk management, an SOE monitoring unit was set up in the Ministry of Finance, and quarterly analysis of SOEs' financial statements started in 2015:Q1. Resolution of companies in the portfolio of the Privatization Agency is moving ahead, both through launching of bankruptcy proceedings and privatizations. However, the process has been slower than envisaged due to legal obstacles, implementation capacity, and concerns about the social impact of large layoffs. The corporate restructuring plan of Railways of Serbia has been adopted and the merger of Roads and Corridors of Serbia will be finalized in June 2015 with a delay. The financial restructuring plan for the electricity producer EPS was also adopted with delay in early June. Major debtors of Srbijagas (Azotara, MSK, Petrohemija, and Zelezara Smederevo) have been operating without state aid or accumulation of new arrears so far this year, supported by lower energy prices. Their permanent solutions are yet to be found (MEFP ¶32–33).

State Aid to the Economy and SOEs 1/
(Percent of GDP)



Source: Ministry of Finance and IMF staff calculations.
1/ State aid is defined as a sum of direct subsidies, net lending through the budget, assumption of SOE's debt, and payments under called guarantees.
2/ Data before 2013 are not available.

OUTLOOK AND RISKS

11. The medium-term economic outlook remains broadly unchanged compared to the original program, with slight modifications in 2015.

- **Real GDP growth** is now projected to remain flat, compared to a mild recession envisaged previously, partly due to the carryover from 2014:Q4. This is mostly because of a smaller contraction of private consumption and domestic demand, and higher net exports.

- **Average CPI inflation** will be somewhat lower than previously projected due to oil price pass-through and delays in some administrative price adjustments. The terms of trade improvement will result in a somewhat higher GDP deflator. Headline inflation is expected to return to the NBS tolerance band in 2015:H2 and to be close to the target by year-end.

- **The current account balance** is expected to strengthen mainly on account of a lower trade deficit on the back of better external demand.

12. Risks are tilted to the downside. Further delays of public investment would put a drag on domestic demand and growth, particularly in the face of fiscal consolidation. Additionally, many of the structural reforms are politically and socially difficult, and might face pushback from vested interest groups, making implementation more challenging. In turn, reform delays, particularly in SOE restructuring, could add pressure on public finances and hurt investment confidence and market sentiment. Yet prospects of EU accession can help catalyze reforms. Given the large financing requirements, Serbia is susceptible to possible spillovers from regional developments and changes in market volatility, particularly from developments in Greece, and possible tightening of U.S. monetary policy. Weakening of activity in major trading partners could impede the recovery. A sudden sharp rise in oil prices could undermine the nascent financial improvement in some SOEs, with fiscal implications. At the same time, the authorities believe that the growth outlook has upside potential arising from prospective large foreign-financed investment projects and faster-than-expected improvement in market confidence.

PROGRAM POLICY DISCUSSIONS

Fiscal consolidation creates space for ongoing monetary easing that should support growth. Good progress was made in financial sector reforms, though some other structural reforms have been delayed. Steadfast implementation of the program commitments is a priority to restore macroeconomic stability and strengthen Serbia's growth potential.

A. Fiscal Policy: Staying on Course towards Public Debt Sustainability

13. The authorities and staff concurred that Q1 overperformance should be treated with caution, and the program fiscal targets for 2015 should remain unchanged (MEFP, Table 1). While the strong revenues in Q1 are encouraging, it is premature to extrapolate this trend through the remainder of the year. Also, staff cautioned that this reflects a combination of one-off factors and possible revenue front loading. The authorities reiterated their commitment to save any revenue upside and retire expensive debt in 2015. Should there be any revenue overperformance, the current program design would ensure that the extra revenues are saved given the ceiling on current primary fiscal expenditure of the Republican budget (a separate performance criterion). Staff therefore considers that the original program fiscal performance criteria remain appropriate.[2]

14. The authorities reaffirmed their plans to press ahead with fiscal consolidation to achieve public debt sustainability.

- *Electricity excise.* Introduction of an excise tax equivalent to 7½ percent, on average, was originally envisaged for April 1, but the deadline has slipped. The authorities explained that

[2] The revised annual projection assumes largely a one-off revenue overperformance in Q1, which would reduce the 2015 general government deficit relative to the original program by about ½ percent of GDP. The structural primary adjustment would remain broadly unchanged. However, public debt is expected to be somewhat higher due to exchange rate valuation effects.

additional time was needed to prepare EPS' financial restructuring plan (Section C). They submitted this measure for parliamentary approval in early June as a prior action for the first review, to become effective as of August 1. The one-off revenue loss associated with the delay is estimated at RSD 5 billion (0.1 percent of GDP), but is well compensated for with Q1 fiscal overperformance (MEFP ¶9).

- *Public sector rightsizing and wage system reforms*. The authorities reiterated their commitment to the 5:1 attrition rule and the planned targeted separations in 2015:H2 for the general government, which are needed to achieve the annual savings of the budgeted wage bill this year. They confirmed that the preparation of the wage system reform was on track (MEFP ¶10). These efforts benefit from World Bank support.

- *Reducing state aid*. Staff welcomed the authorities' efforts and commitment to reduce state aid this year, including through no new guarantees for liquidity purposes to SOEs. Staff noted that the improved payment discipline in some sectors was driven by lower energy prices, and emphasized that addressing the underlying financial viability of SOEs is needed to permanently reduce the fiscal risks and payment arrears (Section C, MEFP ¶32-33). The authorities indicated that they are closely monitoring the situation in the SOEs.

- *Local Government Financing Law*. While the authorities reiterated their commitment to this reform, they requested a three-month delay for further consultation with local governments (MEFP ¶11). The legislation is now to be adopted by end-September (structural benchmark). Partial implementation will start from January 2016 in line with expected savings from targeted rightsizing, and will be completed in 2017. Any savings shortfall arising from the delayed full implementation will be compensated for in the 2016 budget.

15. The authorities have taken steps to strengthen tax administration and public financial management (PFM).

- *PFM framework*. A special fiscal risk management unit was set up at the Ministry of Finance, and an instruction was issued to line ministries on how to calculate and report the estimated fiscal impact of all new legislative initiatives. The Fund has offered technical assistance on risk based assessments.

- *Tax administration*. The delay in adoption of the Tax Administration Transformation Program 2015–20 until early June was caused by the need to develop a realistic plan consistent with the authorities' implementation capacity. Staff urged the implementation of the plan to improve revenue collections.

B. Monetary and Financial Sector Policies: Rebalancing the Policy Mix

16. The NBS and staff saw room for further monetary policy easing. Whereas the current money market rate appears to be below its neutral rate, there is space for further reduction of the policy rate given low inflation expectations, a sizeable output gap, and the need to push inflation closer to the target. Staff emphasized that the pace of easing should be gradual and depend on external financing conditions, inflation expectations, and progress in fiscal consolidation. The NBS reaffirmed its commitment to flexible exchange rate, using interventions only for smoothing excessive volatility (Figure 3).

17. The authorities are preparing a comprehensive strategy to tackle the NPL overhang. A high-level Working Group will finalize this strategy by end-June 2015, with support from International Financial Institutions (IFIs) (MEFP ¶21). Staff recommended specific measures to enhance the regulatory treatment of NPLs (including via the introduction of more granular regulation for restructured loans and the issuance of supervisory expectations for banks' distressed loan management); foster more conservative provisioning in line with International Financial Reporting Standards (IFRS); improve the insolvency regime and procedures for voluntary out-of-court restructuring; develop proper collateral valuation standards; implement a robust oversight framework for real estate appraisers; and address tax disincentives for NPL resolution. These measures will incentivize debt restructuring. The strategy will also address efficiency of court procedures and removal of impediments for NPL markets.

18. The NBS is launching special diagnostic studies (SDS) to verify the health of individual banks (MEFP ¶22)**.** The terms of reference for the SDS have been finalized and independent audit firms to conduct the analysis have been selected. Results are expected by end-September (structural benchmark), with banks' remedial actions—where necessary—to be submitted to the NBS within two weeks of the SDS completion. Staff expects that the resulting improvement in IFRS provisioning is likely to reduce the seller/buyer price gaps in the distressed asset market, thus facilitating the sale of nonperforming loans by Serbian banks.

19. The authorities are operationalizing the new bank resolution and macroprudential frameworks (MEFP ¶23–24). The legal amendments introducing the new bank resolution regime, broadly aligned with the European Union's (EU) Bank Recovery and Resolution Directive, came into force on April 1. The NBS also established a new Financial Institutions Resolution Unit, and issued all necessary secondary regulations. Staff welcomed banks' intentions to complete their recovery plans by end-September, as well as the preparation by NBS of resolution plans for systemically important banks by end-2015. In March 2015, the NBS published a consultative document for its new macroprudential framework, outlining the objectives, instruments, and decision making process. Going forward, effective implementation of the framework will hinge on comprehensive and continuous analyses of systemic vulnerabilities, in combination with a clear communication of the NBS's policy intentions. Staff supported the NBS' efforts to develop a system for capital surcharges for systemically important banks as part of the macroprudential toolkit.

20. The NBS is taking steps to strengthen insurance sector supervision. Following the adoption of a new Insurance Law in late 2014, the NBS is finalizing detailed regulations for insurance firms on: (i) enhanced requirements of intermediaries; (ii) capital and risk management standards, including the Own Risk and Solvency Assessment (a component of the EU's Solvency II Directive); and (iii) extended reporting requirements. In addition, staff emphasized the need to prepare detailed plans for strengthening the prudential oversight of the insurance sector, in line with recent Fund technical assistance.

21. The authorities indicated that the implementation of the strategy for state-owned banks remains on track. The government has recently reached agreement with a private investor on the sale of its shares in Čačanska Banka, further reducing state presence in the financial system.

C. Structural Reforms: Stepping Up Efforts

22. The authorities reaffirmed their commitment to SOE reforms. They recognize that resolute efforts are needed in order to reduce fiscal risks and boost investor confidence. They agreed to step up efforts to rehabilitate and privatize large loss-making SOEs in the energy and transport sectors, and those in the portfolio of the Privatization Agency. These efforts are supported by intensive collaboration with the World Bank (MEFP ¶31 and 33).

- **EPS.** A comprehensive financial restructuring plan, developed together with the World Bank and the EBRD, was adopted in early June (prior action). It lays out specific measures to restore financial viability of the company, including a regulated tariff increase of 4.5 percent from August 1, 2015 (prior action), cost cutting, increasing efficiency, and improving collection rates (Box 2). The tariff hike this year is somewhat smaller than the one envisaged in the original program in order to smooth the price adjustment inclusive of the excise tax. This is expected to be compensated for by other cost-cutting measures.

- **Srbijagas.** While the corporate restructuring plan was adopted last year, it excluded divesting of noncore assets. Staff urged the authorities to pursue divestment and find permanent solutions for past debtors of Srbijagas (Azotara, MSK, and Petrohemija) whose financial situation was recently improved due to lower energy prices. The authorities reported progress in finding private investors for these companies, and confirmed their commitment to no state aid in the future. They are also proceeding with the preparation of the financial restructuring plan for the gas company.

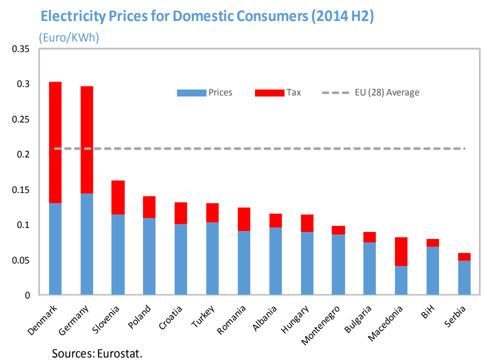
- **Railways of Serbia.** The authorities indicated that the unbundling (into passenger, cargo, infrastructure, and a holding company) will take effect in July, and the independent consultant for the preparation of the financial restructuring has been selected. Staff welcomed the authorities' commitment to secure the targeted reduction in subsidies this year through cost reduction and efficiency enhancement, and to complete the financial restructuring plan by end-September.

- **Roads and Corridors of Serbia**. The authorities plan to develop a financial restructuring plan in consultation with the World Bank, with an aim to reduce state aid in the coming years.

- **Portfolio of Privatization Agency.** The authorities indicated that the original expiration of the restructuring protection in end-May did not provide adequate time to find private investors for a number of strategic companies with large employment. As a result, and in consultation with the World Bank, the parliament has extended the deadline for 17 of these companies for up to one year. At the same time, the IFIs urged the authorities to launch the bankruptcy process for companies with weak privatization prospects.

Box 2. Electricity Tariffs in Serbia

The electricity market in Serbia is partially regulated with subsidized prices for households and low-voltage customers. Electricity prices were liberalized for high and medium voltage industrial consumers from January 1, 2013, followed by a tariff increase of 40–50 percent to reach market prices, although prices since then declined in line with market conditions. However, the market for households and small customers (about 60 percent of the total) remains regulated, with EPS as the sole supplier. The retail tariff is estimated to be around 30 percent lower than the market levels (lowest in Southeastern Europe) and is below the long-term marginal cost of power generation. This, together with inefficiencies in collections and management, poses significant risks to the financial viability of the company.



The new Energy Law sets out deregulation of the electricity market. In December 2014, Serbia adopted a new Energy Law in line with EU's Third Energy Package, allowing customers to choose their electricity supplier from January 1, 2015. However, given the regulated prices and the progressive tariff structure, most households still opt for the relatively cheaper electricity supplied by EPS. The Law stipulates that the independent regulator (Energy Agency of the Republic of Serbia, AERS) will decide by May 1, 2017 whether there is a need to keep the regulated prices.

Transition to a financial and socially sustainable electricity sector will require a gradual adjustment of tariffs and adequate mechanisms to protect the vulnerable population. The transition to a liberalized electricity market implies tariff convergence to the prevailing market levels. At the same time, restoring the long-term financial viability of EPS will require significant tariff increases in the coming years, together with other cost-saving and efficiency measures. The financial restructuring plan of EPS adopted in June includes a 4.5 percent tariff increase in 2015. Additional tariff increases will follow in 2016–17 as needed to further converge to market prices. The tariff increases will improve EPS' financial position, but significant cost savings and efficiency improvements will also be needed to ensure EPS' financial viability. The predictable path of tariff increases should be accompanied by social protection mechanisms to mitigate the social and economic impact, to be developed with the assistance of the World Bank.

23. The authorities and staff concurred that improving the investment climate and active labor market policies is important for job creation and growth (MEFP ¶29 and 34).

- *Investment climate*. The authorities are planning to rationalize their investment promotion programs and enable more efficient coordination of investment-related permits by restructuring the existing agencies (merging Serbia Investment and Export Promotion Agency and the National Agency for Regional Development).

- *Job creation*. Staff suggested that in light of public sector rightsizing, it is crucial to strengthen specific job matching and retraining programs for the work force. In addition, targeted incentives could be provided to encourage hiring of certain disadvantaged groups. The authorities indicated that the active labor market measures have become more tailored to needs of local communities. Also, they indicated that more intensive labor inspections have helped move workers from grey to formal employment and thus generated higher social contributions.

PROGRAM MODALITIES

24. Staff proposes the updated program conditionality (MEFP Tables 1–2).

- **Prior actions.** Staff proposes to set the following new prior actions for the first review:
    - The law introducing an excise tax on electricity equivalent to 7.5 percent was submitted for parliamentary approval in early June and will become effective from August 1.
    - The financial restructuring plan for EPS was adopted by the government in early June.
    - A request to increase the regulated electricity tariff by 4.5 percent effective from August 1, 2015 was submitted to the Energy Agency of the Republic of Serbia in early June.

- **Adjustors**. The severance payments adjustor for the primary current expenditure of the Republican budget is revised for September and December test dates to reflect that some of the severance payments will be executed by the Health Fund and local governments.

- **Structural benchmarks (SBs).** Staff proposes new SBs on the NPL resolution (MEFP Table 2). The authorities request modification of the target date of one end-June SB related to legislation on the local government financing to allow time for the technical preparation and consultative process. In addition, the authorities clarified that meeting the objective of this structural benchmark will require adoption of new legislation as opposed to amendment of the existing law as was required in the initial formulation of this structural benchmark.

- **Quantitative targets for end-September 2015** are proposed to be set in line with the quarterly projections in the program request.

25. Serbia's capacity to meet potential repayment obligations to the Fund is strong. The authorities confirmed their intention to treat the SBA as precautionary. The potential balance of payments need would arise from adverse trade and financial spillovers, from events such as a delay in the recovery of euro area economic activity, and tighter global liquidity conditions. In case of full drawing of the amount under the SBA (200 percent of quota) (Table 9), repayments to the Fund at the end of the projection period would remain modest at or below 1 percent of GDP, or 5½ percent of gross reserves (Tables 10–11). Public sector and external debt are expected to remain high during the program period. Public debt is projected to peak at 79 percent of GDP in 2016 and external debt at 87 percent of GDP in 2015, in a scenario without Fund disbursements. Program implementation would put both of them on a firm downward path thereafter. The authorities have demonstrated continued commitment to the program and willingness to tackle difficult structural reforms. In addition, Serbia has a strong record of repaying the Fund.

26. The latest safeguards assessment for the National Bank of Serbia was completed in April 2015. The assessment found that the NBS has maintained generally strong controls over its key operations, and amendments to the NBS Law since the previous assessment have reinforced the autonomy of the central bank and its safeguards framework. That said, governance oversight could be further strengthened through the establishment of an audit committee. The assessment also recommended: (i) enhancing procedures for the selection of the auditors to give weight to technical rather than cost criteria; and (ii) amending the charter of the NBS's internal audit function to better support its independence through a functional reporting line to the audit committee.

STAFF APPRAISAL

27. The economy has stabilized but faces downside risks. Lower oil prices and stronger than expected trading partner growth have cushioned the economic downturn. Inflationary pressures remain subdued and the current account deficit has narrowed. However, this positive momentum could be disrupted if external shocks materialize. Additional risks arise from possible difficulties in implementing program reforms.

28. The program is broadly on track. The end-March quantitative performance criteria and indicative targets were observed with comfortable margins. However, all structural benchmarks were implemented with delay, mainly caused by longer than expected technical preparation arising from capacity constraints and concerns about the social impact of the reforms.

29. Despite the fiscal overperformance, the original program design remains appropriate. Since the fiscal overperformance reflected partly potential frontloading of revenues, the original program targets remain appropriate. Any revenue overperformance should be used to reduce the still very high public debt. Quantitative targets for end-September 2015 are proposed to be set in line with the quarterly projections in the program request.

30. Strong implementation of structural reforms is key for program success. Placing the public finances on a sustainable path requires SOE reforms that will reduce state aid and contain fiscal risks. Yet successful implementation of these reforms hinges on building a broad-based social and political consensus.

31. Gradual monetary easing should continue. The still low inflation and ongoing fiscal consolidation have created space for relaxing monetary conditions to support credit growth. Staff welcomes NBS's commitment to the inflation targeting regime and flexible exchange rate policy.

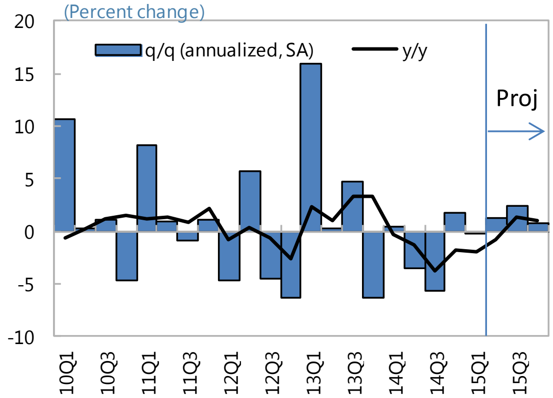
32. Pursuing the broad financial sector agenda is needed to support financial sector stability and promote intermediation. The progress with special diagnostic studies is encouraging. A comprehensive strategy to resolve NPLs is needed to support economic recovery and reduce financial vulnerabilities.

33. Staff supports the authorities' request for the completion of the First Review under the Stand-By Arrangement, given the program performance so far and the policy commitments going forward.

Figure 1. Serbia: Real Sector Developments, 2010–15

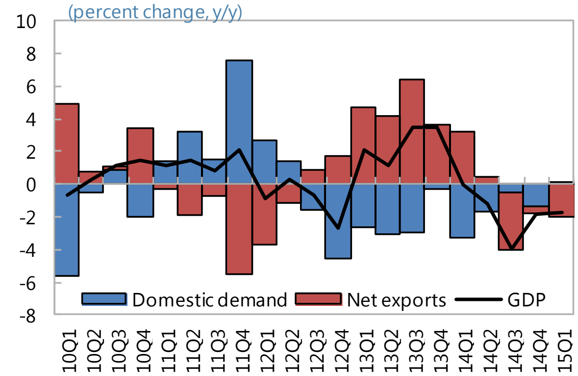
Quarterly GDP growth picked up in Q4 2014 and stabilized in Q1…

Gross Domestic Product
(Percent change)



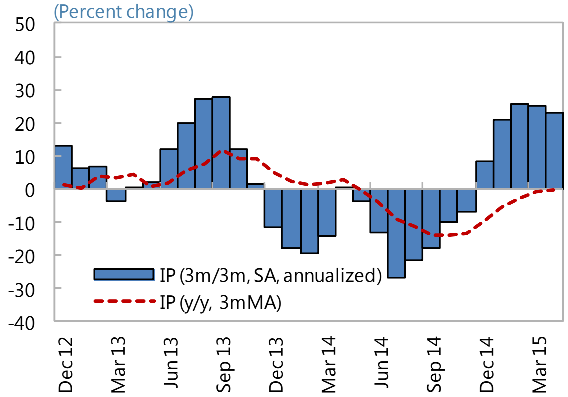
…with smaller contraction of domestic demand.

Contribution to Growth
(percent change, y/y)



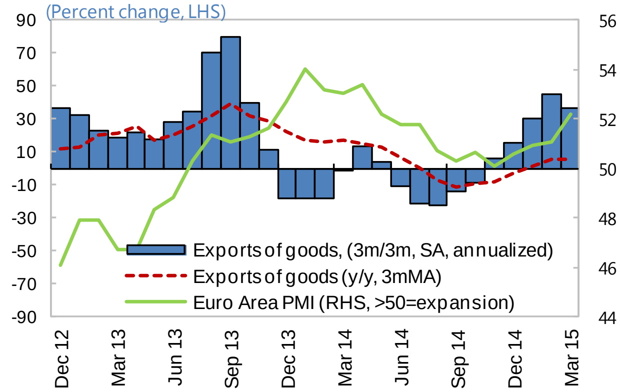
Industrial production expanded strongly in Q1 2015…

Industrial Production
(Percent change)



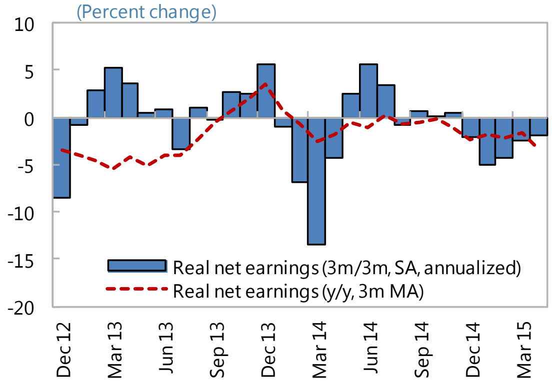
…on account of growing export demand from the euro area.

Exports of Goods and Euro Area PMI
(Percent change, LHS)



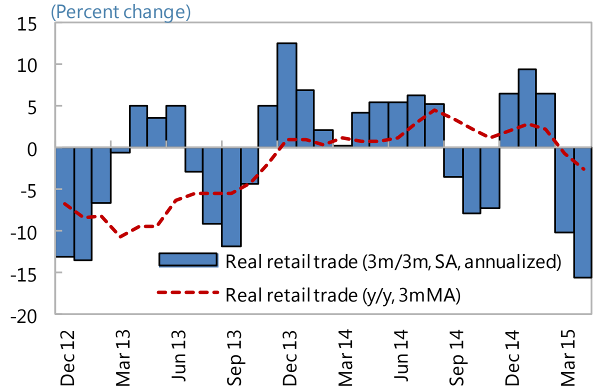
The real net earnings weakned in the recent months.

Real Net Earnings
(Percent change)



The retail trade increased in December-February, but declined recently.

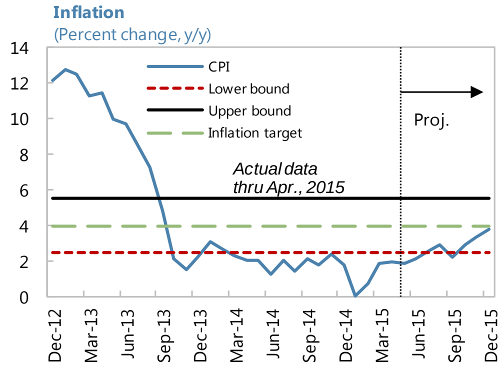
The Retail Turnover
(Percent change)



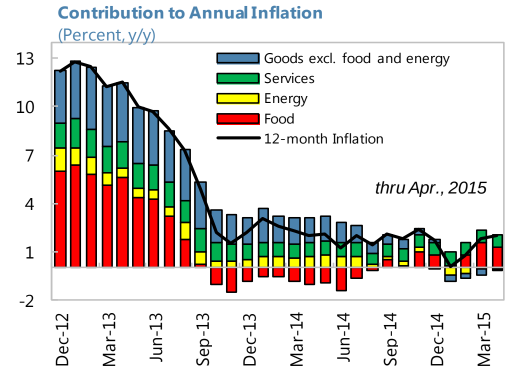
Sources: Haver, SORS and IMF staff calculations.

Figure 2. Serbia: Inflation and Monetary Policy, 2012–15

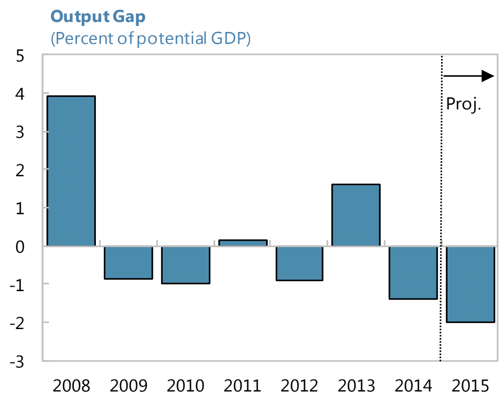
Headline inflation has been below NBS's inflation tolerance band since late 2013...



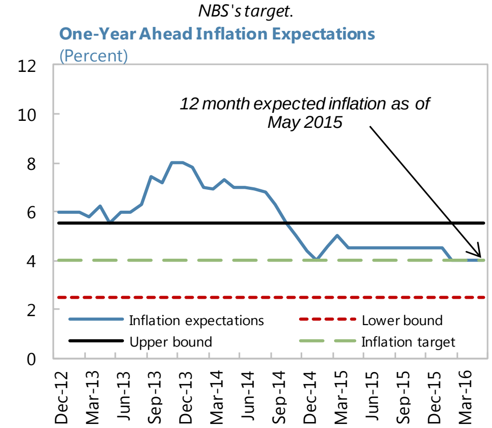
...on account of falling food prices and energy prices...



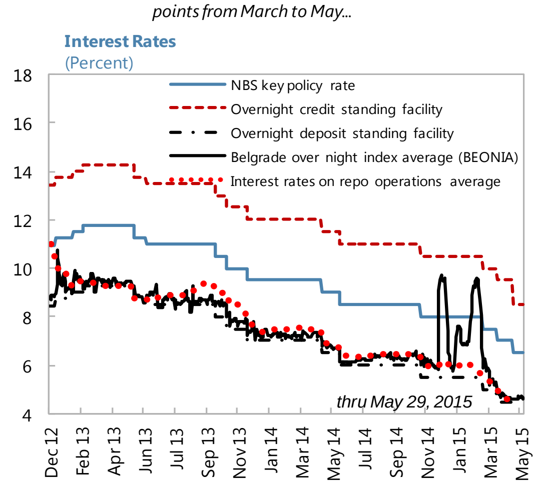
...as well as disinflation pressures coming from output gap.



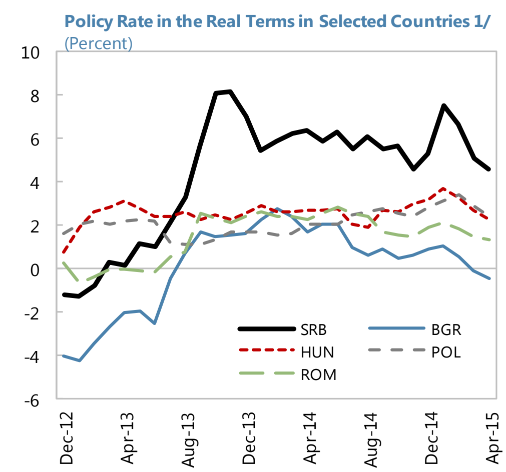
Inflation expectations remained anchored around the NBS's target.



The NBS has reduced the key policy rate by 150 basis points from March to May...



...but the key policy rate remains higher than in peer countries.

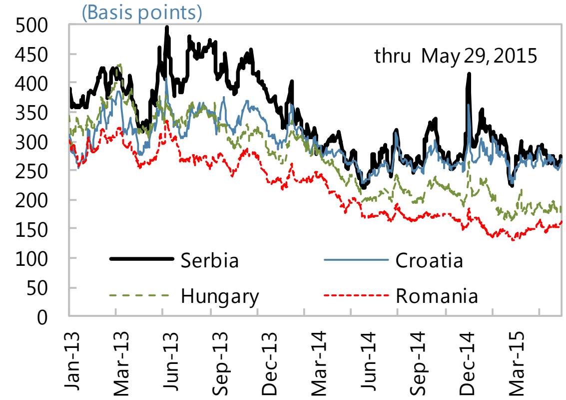


Sources: Haver; Bloomberg; National Bank of Serbia (NBS); SORS; and IMF staff estimates and projections.
1/ Nominal policy rate adjusted by inflation over the past 12 months.

Figure 3. Serbia: Recent Financial and Exchange Rate Developments, 2013–15

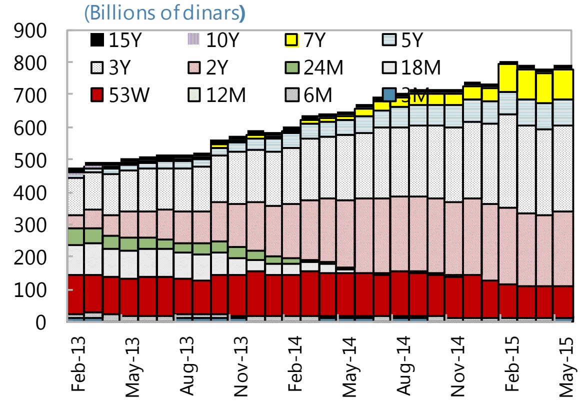
Following the approval of the program, the EMBI spread declined...

Sovereign Risk -EMBI spreads
(Basis points)



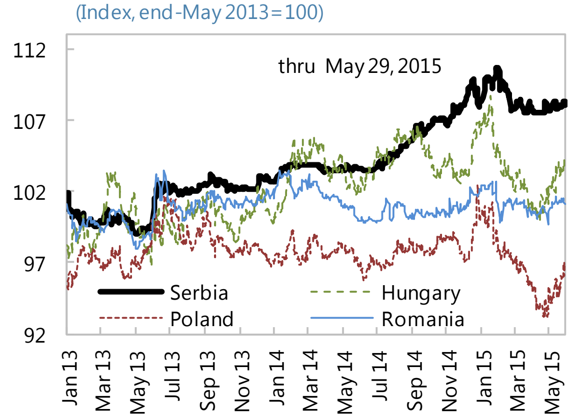
...and the issuance of Serbia's securities strengthened.

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



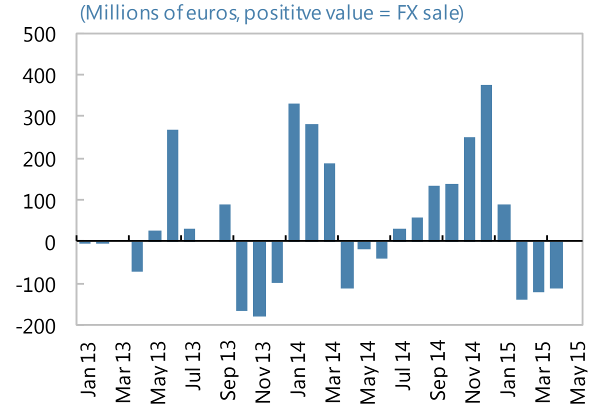
Appreciation pressures in Q1 2015...

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



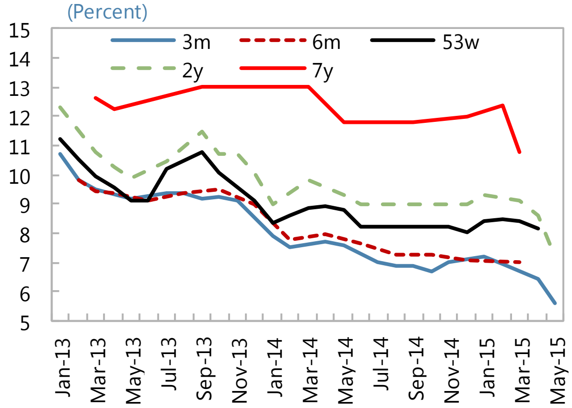
....prompted NBS purchases of FX from the market.

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



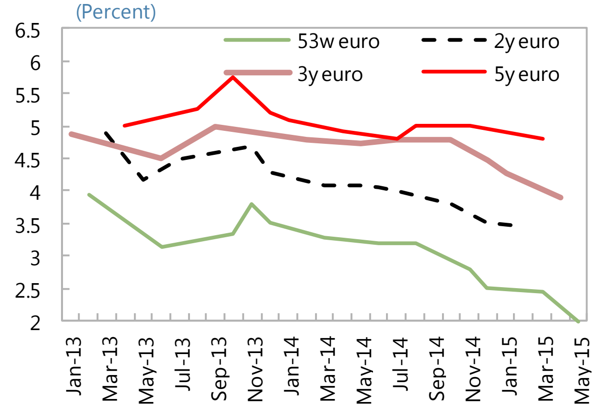
Yields on domestic securities have been declining in the dinar segment of the market...

Yields on Dinar-Denominated Domestic Securities
(Percent)



...as well as in euro-denominated segment of the market.

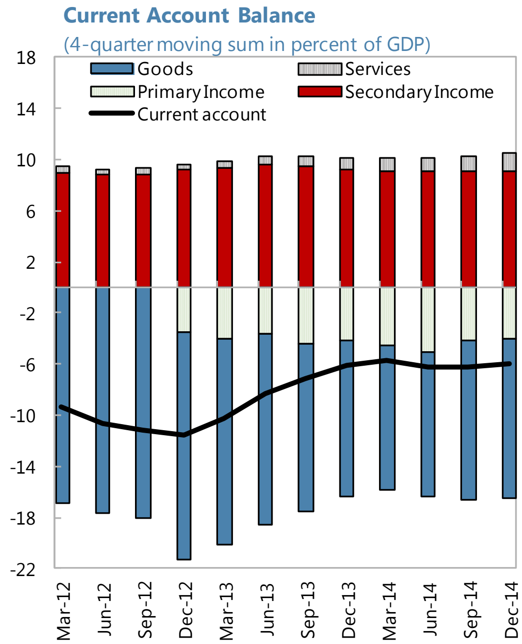
Yields on Euro-Denominated Domestic Securities
(Percent)



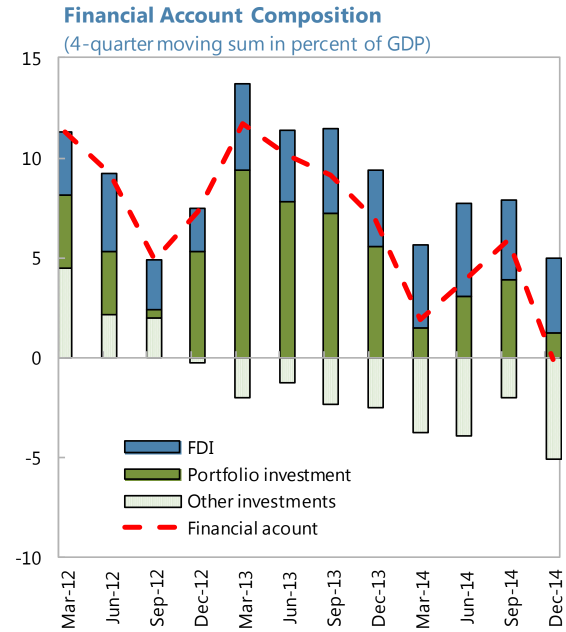
Sources: Serbian Authorities; Bloomberg; and Haver.
1/ Sum of dinar and FX-denominated securities at current exchange rate.

Figure 4. Serbia: Balance of Payments and NIR, 2012–15

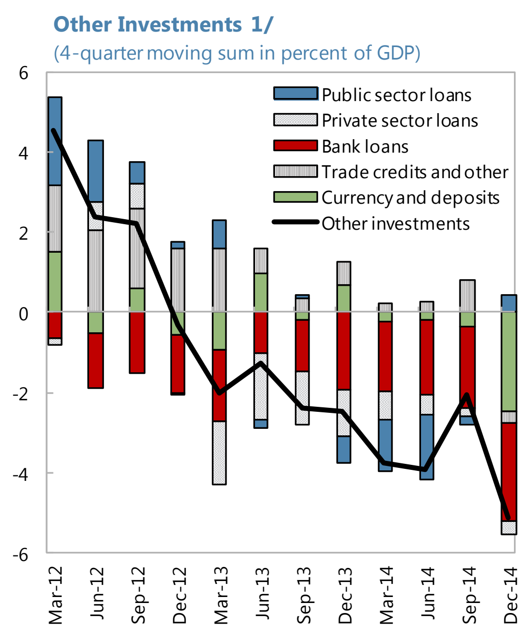
The current account balance marginally improved in Q4 2014...



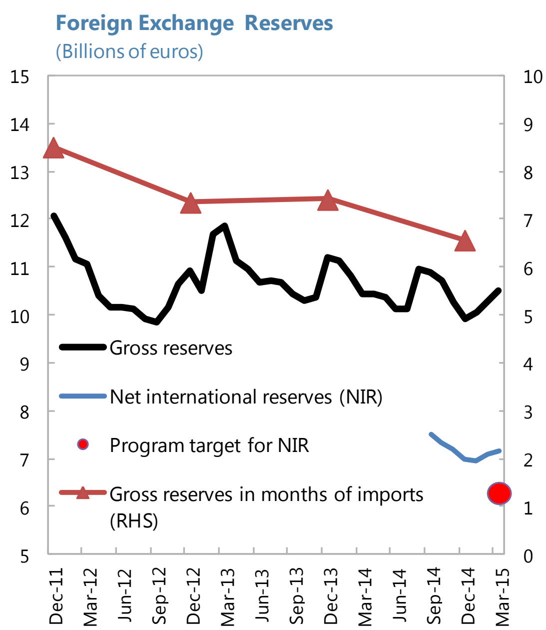
...while the large outflow in other investments reduced net inflows in the financial account to zero.



The outflows were driven by the banking system.



International reserves remain at comfortable levels.

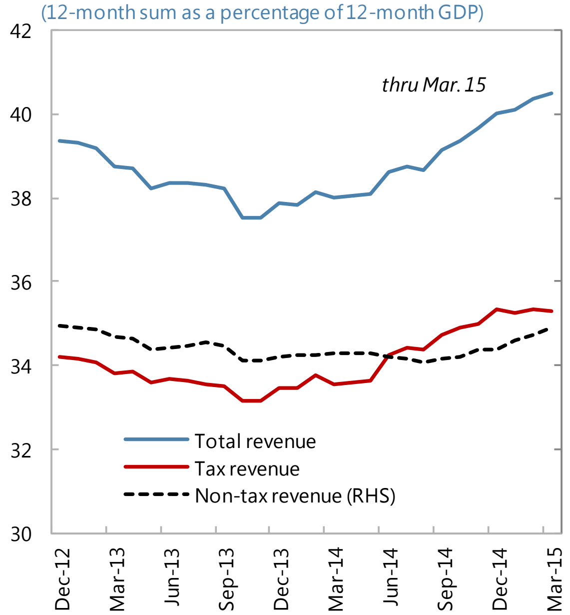


Sources: Haver; and IMF staff calculations.
1/ BPM5 data spliced with BPM6 going forward starting March 2013.

Figure 5. Serbia: Fiscal Developments, 2012–15

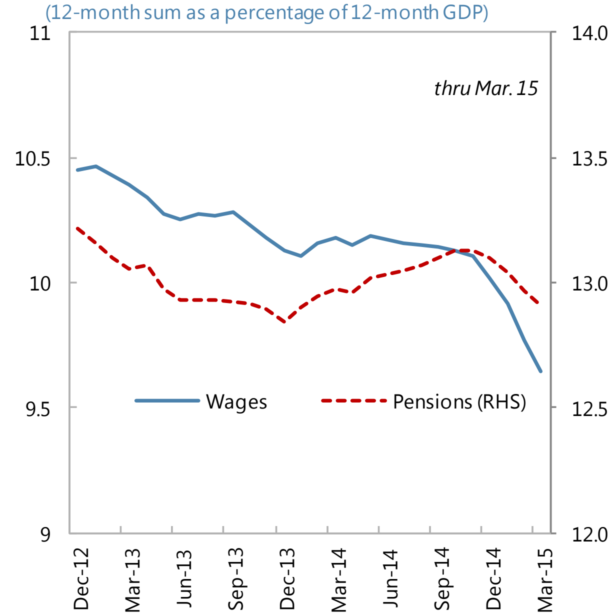
Revenues have been increasing as a share of GDP, with a large contribution from non-tax revenues in Q1 2015...

Total Revenue and its Composition
(12-month sum as a percentage of 12-month GDP)



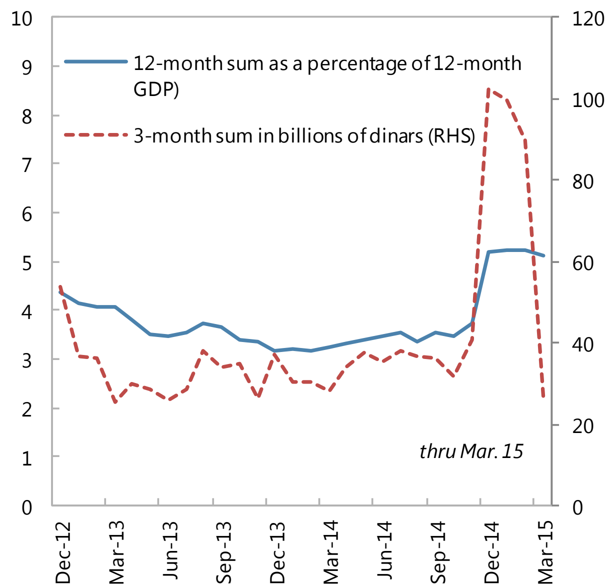
...while wages and pensions began to fall as a share of GDP.

Wages and Pensions
(12-month sum as a percentage of 12-month GDP)



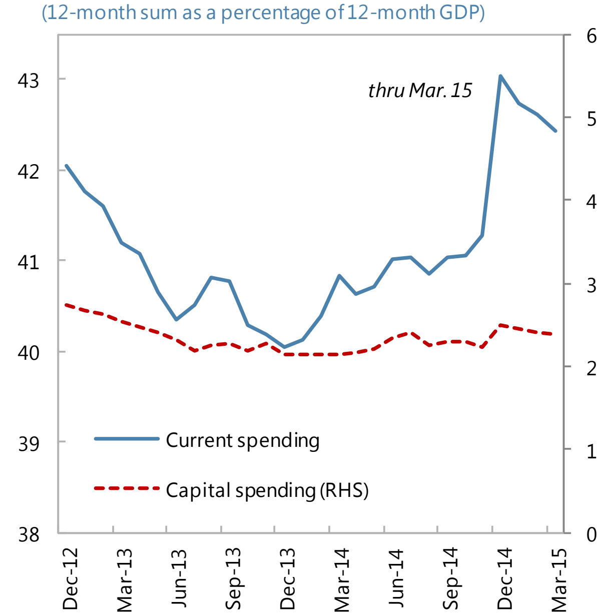
State aid increased in late 2014 due to one-off items, and subsided thereafter...

State Aid 1/



...and the current spending started to adjust in Q1.

Current and Capital Spending
(12-month sum as a percentage of 12-month GDP)



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

Table 1. Serbia: Selected Economic and Social Indicators, 2011–16

	2011	2012	2013	2014	2015		2016
					Prog.	Proj.	Proj.
	(Percent change, unless otherwise indicated)						
Real sector							
Real GDP	1.4	-1.0	2.6	-1.8	-0.5	0.0	1.5
Real domestic demand (absorption)	3.1	-0.5	-1.9	-1.5	-2.4	-2.1	0.6
Consumer prices (average)	11.1	7.3	7.7	2.1	2.7	2.2	3.8
GDP deflator	9.6	6.3	5.4	1.9	2.7	3.0	3.9
Unemployment rate (in percent) 1/	23.6	24.6	23.0	19.7	...	...	...
Nominal GDP (in billions of dinars) 2/	3,408	3,584	3,876	3,878	3,967	3,994	4,214
	(Percent of GDP)						
General government finances							
Revenue	38.2	39.4	37.9	40.0	38.7	38.9	37.5
Expenditure	43.1	46.6	43.5	46.7	44.6	44.2	42.1
Current	38.9	42.5	40.8	43.0	40.6	40.3	38.3
Capital and net lending	4.1	3.8	2.5	2.9	3.2	3.1	3.1
Amortization of called guarantees	0.2	0.3	0.2	0.8	0.8	0.8	0.7
Fiscal balance 3/	-4.9	-7.2	-5.6	-6.7	-5.9	-5.3	-4.6
Primary fiscal balance (cash basis)	-3.6	-5.3	-3.2	-3.7	-2.4	-1.9	-0.8
Structural primary fiscal balance 4/	-3.6	-4.0	-3.2	-2.5	-0.7	-0.7	0.0
Gross debt	46.6	58.3	61.4	72.4	76.4	77.3	78.8
	(End of period 12-month change, percent)						
Monetary sector							
Money (M1)	16.8	3.8	23.7	9.7	6.9	13.4	13.9
Broad money (M2)	10.4	9.2	4.2	8.4	4.0	5.9	9.7
Domestic credit to non-government 5/	8.3	3.3	-5.2	-0.9	-0.1	-1.1	0.9
	(Period average, percent)						
Interest rates (dinar)							
NBS key policy rate 6/	11.5	10.1	11.0	9.0	...	7.8	...
Interest rate on new FX and FX-indexed loans 6/	8.2	8.0	7.3	6.0	...	5.4	...
Interest rate on new dinar deposits 6/	10.8	9.9	9.3	7.1	...	6.3	...
	(Percent of GDP, unless otherwise indicated)						
Balance of payments							
Current account balance	-8.6	-11.5	-6.1	-6.0	-4.7	-4.3	-4.1
Exports of goods	25.3	26.5	30.8	32.2	33.9	34.2	35.1
Imports of goods	-41.2	-44.2	-42.9	-44.6	-45.0	-44.9	-45.4
Trade of goods balance	-15.9	-17.8	-12.1	-12.4	-11.1	-10.7	-10.4
Capital and financial account balance	13.3	7.9	9.4	1.4	7.3	6.9	6.7
External debt (percent of GDP)	74.5	84.3	79.3	84.4	88.2	86.9	86.7
of which: Private external debt	40.0	42.7	36.8	35.8	34.1	32.3	30.1
Gross official reserves (in billions of euro)	12.1	10.9	11.2	9.9	10.6	10.6	11.5
(in months of prospective imports)	8.5	7.4	7.4	6.6	7.0	6.7	6.9
(percent of short-term debt)	322.2	207.5	269.4	281.1	372.4	307.6	269.6
(percent of broad money, M2)	85.2	76.8	76.2	65.7	67.4	67.1	67.5
(percent of risk-weighted metric)	...	...	229.4	203.8	218.0	211.1	213.1
Exchange rate (dinar/euro, period average) 6/	102.0	113.0	113.1	117.2	...	121.0	...
REER (annual average change, in percent; + indicates appreciation)	9.3	-7.4	7.8	-2.0	-2.2	-2.1	2.8
Social indicators							
Per capita GDP (in US$)	6,426	5,658	6,354	6,123	5,649	5,216	5,416
Population (in million)	7.2	7.2	7.2	7.2	7.2	7.2	7.2

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

1/ Unemployment rate for working age population (15-64).
2/ The GDP series were revised in October 2014 based on ESA 2010 methodology and resulted in an increase of average 7 percent.
3/ Includes amortization of called guarantees.
4/ Primary fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending.
5/ At program exchange rates.
6/ 2015 values show period average for the actual available data.

Table 2. Serbia: Medium-Term Framework, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(percent change)					
Real sector										
GDP growth	-1.0	2.6	-1.8	-0.5	0.0	1.5	2.0	3.5	3.5	4.0
Domestic demand (contribution)	-0.6	-2.2	-1.6	-2.7	-2.3	0.7	1.6	3.6	3.9	4.8
Net exports (contribution)	-0.4	4.8	-0.2	2.2	2.3	0.8	0.4	-0.1	-0.4	-0.8
Consumer price inflation (average)	7.3	7.7	2.1	2.7	2.2	3.8	4.0	4.0	4.0	4.0
Consumer price inflation (end of period)	12.2	2.2	1.8	4.2	3.8	4.0	4.0	4.0	4.0	4.0
Output gap (in percent of potential)	-0.9	1.6	-1.4	-2.6	-2.0	-1.5	-1.0	-0.6	-0.3	0.0
Potential GDP growth	0.0	0.0	1.2	0.2	0.6	1.0	1.4	3.1	3.2	3.7
Domestic credit to non-gov. (program exchange rate) 1/	3.3	-5.2	-0.9	-0.1	-1.1	0.9	1.9	5.8	5.8	9.5
					(percent of GDP, unless otherwise indicated)					
General government										
Revenue	39.4	37.9	40.0	38.7	38.9	37.5	36.7	36.5	36.4	36.3
Expenditure	46.6	43.5	46.7	44.6	44.2	42.1	40.4	39.7	39.3	38.8
Current	42.5	40.8	43.0	40.6	40.3	38.3	36.8	36.1	35.8	35.3
of which: Wages and salaries	10.5	10.1	10.0	9.1	9.0	8.2	7.3	7.2	7.0	7.0
of which: Pensions	13.2	12.8	13.1	12.4	12.3	11.8	11.2	10.9	10.6	10.3
of which: Goods and services	8.0	7.2	8.0	7.6	7.6	7.4	7.3	7.3	7.3	7.3
Capital and net lending	3.8	2.5	2.9	3.2	3.1	3.1	3.1	3.1	3.1	3.1
Amortization of called guarantees	0.3	0.2	0.8	0.8	0.8	0.7	0.5	0.5	0.4	0.4
Fiscal balance 2/	-7.2	-5.6	-6.7	-5.9	-5.3	-4.6	-3.7	-3.2	-2.9	-2.4
change (+ = consolidation)	*-2.3*	*1.6*	*-1.0*	*1.6*	*1.3*	*0.7*	*1.0*	*0.5*	*0.3*	*0.5*
Primary fiscal balance	-5.3	-3.2	-3.7	-2.4	-1.9	-0.8	0.3	1.0	1.4	1.7
change (+ = consolidation)	*-1.8*	*2.1*	*-0.5*	*2.0*	*1.8*	*1.1*	*1.1*	*0.7*	*0.4*	*0.3*
One-off fiscal items, net 3/	-1.0	-0.6	-1.4	0.7	-0.5	-0.3	-0.3	0.0	0.0	0.0
Structural primary balance	-4.0	-3.2	-2.5	-0.7	-0.7	0.0	0.9	1.2	1.5	1.7
change (+ = consolidation)	*-0.4*	*0.9*	*0.7*	*1.7*	*1.7*	*0.7*	*0.9*	*0.3*	*0.3*	*0.2*
Gross debt	58.3	61.4	72.4	76.4	77.3	78.8	78.3	76.8	74.4	72.6
Effective interest rate on government borrowing (percent)	3.8	4.3	4.5	5.1	4.9	5.2	5.3	5.7	5.9	5.9
Domestic borrowing (including FX)	4.9	5.6	5.9	6.8	6.3	6.7	6.9	7.8	8.0	8.1
External borrowing	2.9	3.3	3.5	3.8	3.9	4.3	4.4	4.5	4.7	4.8
					(percent of GDP, unless otherwise indicated)					
Balance of payments										
Current account	-11.5	-6.1	-6.0	-4.7	-4.3	-4.1	-4.0	-3.8	-3.7	-3.6
of which: Trade balance	-17.8	-12.1	-12.4	-11.1	-10.7	-10.4	-10.2	-9.9	-9.9	-10.0
of which: Current transfers, net (excl. grants)	9.0	9.1	8.8	9.3	8.6	8.5	8.3	7.8	8.1	8.1
Capital and financial account	7.9	9.4	1.4	7.3	6.9	6.7	5.3	4.0	3.7	2.9
of which: Foreign direct investment	2.1	3.6	3.7	4.0	3.9	3.8	4.0	4.2	4.2	4.2
External debt (end of period)	84.3	79.3	84.4	88.2	86.9	86.7	84.1	78.7	73.4	67.2
of which: Private external debt	42.7	36.8	35.8	34.1	32.3	30.1	28.0	25.8	23.6	21.6
Gross official reserves										
(in billions of euros)	10.9	11.2	9.9	10.6	10.6	11.5	12.0	12.1	12.1	11.8
(in percent of short-term external debt)	207.5	269.4	281.1	372.4	307.6	269.6	284.0	294.1	238.4	232.6
REER (ann. av. change; + = appreciation)	-7.4	7.8	-2.0	-2.2	-2.1	2.8	1.4	1.6	1.5	1.5

Sources: NBS, MoF, SORS and IMF staff estimates and projections.
1/ Using the September 2014 dinar/euro exchange rate as the base for converting FX and FX-indexed loans to dinars (assuming that all FX loans are in euros).
2/ Includes amortization of called guarantees.
3/ Calculated as one-off revenue items minus one-off expenditure items. Negative sign indicates net expenditure.

Table 3. Serbia: Growth Composition, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Percent change, unless otherwise noted)						
Real										
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	-0.5	0.0	1.5	2.0	3.5	3.5	4.0
Domestic demand (absorption), contribution to GDP growth	-0.6	-2.2	-1.6	-2.7	-2.3	0.7	1.6	3.6	3.9	4.8
Net exports of goods and services, contribution to GDP growth	-0.4	4.8	-0.2	2.2	2.3	0.8	0.4	-0.1	-0.4	-0.8
Consumption	-1.2	-0.7	-1.0	-3.9	-3.4	-0.2	0.7	2.4	2.5	3.6
Non-government	-2.0	-0.6	-1.3	-4.0	-3.0	1.0	1.7	2.3	2.5	3.5
Government	1.9	-1.1	0.1	-3.6	-5.2	-4.9	-3.7	2.7	2.7	3.9
Investment	2.9	-7.2	-3.5	4.6	4.6	4.3	4.9	7.1	7.9	7.6
Gross fixed capital formation	19.1	-16.3	-2.7	4.8	4.8	4.6	5.1	7.0	7.9	8.0
Non-government	21.3	-13.0	-4.8	3.0	2.5	5.0	6.0	7.5	8.5	8.5
Government	7.6	-35.8	13.6	16.8	19.6	2.0	-0.3	4.2	4.2	4.7
Exports of goods and services	0.8	21.3	3.9	3.1	7.9	5.3	6.8	8.1	7.3	8.3
Imports of goods and services	1.4	5.0	3.3	-1.5	2.0	2.9	5.0	7.0	7.0	8.5
				(contributions to GDP, percent)						
Gross Domestic Product (GDP)	-1.0	2.6	-1.8	-0.5	0.0	1.5	2.0	3.5	3.5	4.0
Consumption	-1.2	-0.6	-1.0	-3.7	-3.2	-0.2	0.6	2.1	2.2	3.1
Non-government	-1.6	-0.4	-1.0	-3.0	-2.2	0.7	1.2	1.7	1.8	2.5
Government	0.4	-0.2	0.0	-0.6	-1.0	-0.9	-0.6	0.4	0.4	0.6
Investment	0.6	-1.5	-0.7	0.9	0.9	0.9	1.0	1.5	1.7	1.8
Gross fixed capital formation	3.7	-3.8	-0.5	1.0	0.9	0.9	1.0	1.5	1.7	1.8
Non-government	3.4	-2.5	-0.8	0.5	0.4	0.8	1.0	1.3	1.6	1.7
Government	0.2	-1.2	0.3	0.4	0.5	0.1	0.0	0.1	0.1	0.1
Change in inventories	-3.1	2.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	0.3	7.4	1.6	1.4	3.5	2.5	3.3	4.1	3.9	4.6
Imports of goods and services	0.7	2.6	1.8	-0.9	1.1	1.6	2.9	4.2	4.3	5.4
				(Percent change, unless otherwise noted)						
Nominal										
Gross Domestic Product (GDP)	5.2	8.2	0.0	2.2	3.0	5.5	6.2	7.6	7.6	8.2
Domestic demand (absorption), contribution to GDP growth	7.3	3.1	-0.7	0.5	1.4	5.3	6.2	7.8	8.1	8.9
Net exports of goods and services, contribution to GDP growth	-2.1	5.1	0.8	1.7	1.6	0.2	-0.1	-0.2	-0.4	-0.7
Consumption	5.6	5.2	1.4	-1.3	-1.0	3.7	4.7	6.5	6.6	7.7
Non-government	5.2	5.6	1.3	-1.4	-0.9	4.8	5.8	6.4	6.6	7.7
Government	7.4	3.5	2.3	-1.0	-1.4	-1.2	0.1	6.8	6.8	8.1
Investment	9.9	-9.1	-11.8	9.7	14.7	11.6	11.0	11.2	11.7	10.6
Gross fixed capital formation	21.1	-11.9	-0.4	8.0	8.6	8.2	8.7	10.6	11.6	11.7
Non-government	23.5	-8.1	-2.0	5.9	6.2	8.6	9.5	11.1	12.1	12.1
Government	7.6	-35.8	13.6	20.1	27.3	5.5	3.0	7.6	7.6	8.2
Exports of goods and services	14.3	20.7	7.7	6.4	8.6	8.2	8.3	8.8	7.8	8.0
Imports of goods and services	14.2	4.7	4.6	2.0	4.0	6.7	7.3	8.1	7.6	8.3
Memorandum items:										
GDP deflator (percent)	6.3	5.4	1.9	2.7	3.0	3.9	4.1	4.0	4.0	4.0

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

Table 4a. Serbia: Balance of Payments, 2012–20 1/

(In billions of euros)

	2012	2013	2014	2015		2016	2017	2018	2019	2020
			Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of euros)					
Current account balance	-3.6	-2.1	-2.0	-1.5	-1.4	-1.4	-1.4	-1.4	-1.5	-1.6
Trade of goods balance	-5.6	-4.2	-4.1	-3.6	-3.5	-3.6	-3.6	-3.8	-4.0	-4.4
Exports of goods	8.4	10.5	10.6	11.0	11.3	12.0	12.8	13.8	14.7	15.8
Imports of goods	-14.0	-14.7	-14.8	-14.6	-14.8	-15.6	-16.5	-17.6	-18.8	-20.1
Services balance	0.1	0.3	0.5	0.5	0.9	1.0	1.1	1.2	1.3	1.4
Exports of nonfactor services	3.1	3.4	3.8	3.6	4.1	4.4	4.7	5.1	5.4	5.8
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.1	-3.3	-3.4	-3.6	-3.9	-4.1	-4.4
Income balance	-1.1	-1.4	-1.3	-1.6	-1.7	-1.9	-2.0	-2.0	-2.1	-2.1
Net interest	-0.8	-0.9	-0.9	-0.9	-1.0	-1.2	-1.2	-1.2	-1.2	-1.2
Current transfer balance	2.9	3.2	3.0	3.2	3.0	3.0	3.1	3.1	3.3	3.5
Others, including private remittances	2.9	3.1	2.9	3.0	2.8	2.9	3.0	3.0	3.3	3.5
Capital and financial account balance 2/	2.5	3.2	0.5	2.4	2.3	2.3	1.9	1.5	1.5	1.3
Foreign direct investment balance	0.7	1.2	1.2	1.3	1.3	1.3	1.4	1.6	1.7	1.8
Portfolio investment balance	1.7	1.9	0.4	1.7	1.4	0.9	0.4	0.1	0.1	-0.1
of which: debt liabilities	1.7	2.0	0.4	1.7	1.4	0.9	0.4	0.1	0.1	-0.1
Other investment balance	0.2	0.1	-1.1	-0.6	-0.4	0.1	0.0	-0.2	-0.3	-0.4
Public sector 2/ 3/	0.5	0.4	0.7	0.3	0.7	0.5	0.3	0.0	0.0	-0.2
Domestic banks	-0.4	-0.5	-1.5	-0.7	-0.7	-0.2	-0.1	0.0	0.0	0.0
Other private sector 4/	0.1	0.1	-0.4	-0.3	-0.4	-0.2	-0.2	-0.2	-0.3	-0.2
Errors and omissions	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	0.8	0.9	0.9	0.5	0.1	0.0	-0.3
Financing	0.9	-1.3	1.2	-0.8	-0.9	-0.9	-0.5	-0.1	0.0	0.3
Gross international reserves (increase, -)	1.1	-0.7	1.8	-0.7	-0.7	-0.9	-0.5	-0.1	0.0	0.3
Use of Fund credit, net	-0.2	-0.6	-0.6	-0.1	-0.1	-0.01	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	-0.1	-0.01	0.0	0.0	0.0	0.0

Sources: NBS; and IMF staff estimates and projections.

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

Table 4b. Serbia: Balance of Payments, 2012–20 1/
(Percent of GDP)

	2012	2013	2014	2015		2016	2017	2018	2019	2020
			Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(Percent of GDP)					
Current account balance	-11.5	-6.1	-6.0	-4.7	-4.3	-4.1	-4.0	-3.8	-3.7	-3.6
Trade of goods balance	-17.8	-12.1	-12.4	-11.1	-10.7	-10.4	-10.2	-9.9	-9.9	-10.0
Exports of goods	26.5	30.8	32.2	33.9	34.2	35.1	35.8	36.1	36.2	36.2
Imports of goods	-44.2	-42.9	-44.6	-45.0	-44.9	-45.4	-45.9	-46.1	-46.1	-46.2
Services balance	0.4	0.9	1.4	1.6	2.7	2.9	3.0	3.1	3.2	3.1
Income balance	-3.4	-4.1	-4.1	-5.0	-5.3	-5.5	-5.6	-5.2	-5.1	-4.8
Current transfer balance	9.3	9.2	9.1	9.8	9.1	8.9	8.7	8.2	8.1	8.1
Capital and financial account balance 2/	7.9	9.4	1.4	7.3	6.9	6.7	5.3	4.0	3.7	2.9
Foreign direct investment balance	2.1	3.6	3.7	4.0	3.9	3.8	4.0	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	5.2	4.2	2.7	1.2	0.2	0.2	-0.3
Other investment balance	0.5	0.3	-3.4	-1.9	-1.2	0.3	0.1	-0.5	-0.7	-1.0
Public sector 2/ 3/	1.5	1.2	2.2	1.0	2.0	1.3	0.8	0.0	0.0	-0.5
Domestic banks	-1.3	-1.3	-4.5	-2.1	-2.1	-0.5	-0.2	0.0	0.0	0.0
Other private sector 4/	0.4	0.4	-1.1	-0.8	-1.1	-0.5	-0.5	-0.5	-0.7	-0.4
Errors and omissions	0.6	0.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	2.5	2.6	2.7	1.3	0.2	0.0	-0.7
Memorandum items:										
Export growth	-0.5	25.6	1.0	2.3	6.0	6.4	6.8	7.7	6.7	7.0
Import growth	2.0	4.7	0.4	-2.0	0.5	4.9	5.8	6.9	6.6	7.3
Export volume growth	-0.8	21.9	1.7	3.1	7.2	5.3	6.8	8.1	7.3	8.3
Import volume growth	0.8	2.7	1.9	-1.5	2.6	2.9	5.0	7.0	7.0	8.5
Trading partner import growth	0.7	0.7	3.0	4.6	0.7	5.7	5.2	5.1	4.7	4.7
Export prices growth	0.3	3.0	-0.7	-0.8	-1.1	1.1	0.0	-0.4	-0.5	-1.2
Import prices growth	1.2	2.0	-1.5	-0.5	-2.0	2.0	0.7	-0.1	-0.4	-1.1
Change in terms of trade	-0.9	1.0	0.8	-0.3	0.9	-0.9	-0.7	-0.3	-0.2	-0.1
Gross official reserves (in billions of euro)	10.9	11.2	9.9	10.6	10.6	11.5	12.0	12.1	12.1	11.8
(In months of prospective imports of GNFS)	7.4	7.4	6.6	7.0	6.7	6.9	6.7	6.3	5.9	5.4
(in percent of short-term debt)	207.5	269.4	281.1	372.4	307.6	269.6	284.0	294.1	238.4	232.6
(in percent of broad money, M2)	76.8	76.2	65.7	67.4	67.1	67.5	66.5	63.3	59.5	54.2
(in percent of risk-weighted metric)	...	229.4	203.8	218.0	211.1	213.1	216.1	214.1	203.4	198.5

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 5. Serbia: External Financing Requirements, 2012–20

	2012	2013	2014 Prel.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
				(percent of GDP)					
1. Gross financing requirements	19.7	23.5	13.1	17.2	16.8	17.2	15.0	13.8	14.6
Current account deficit	11.5	6.1	6.0	4.3	4.1	4.0	3.8	3.7	3.6
Debt amortization	11.8	15.3	12.6	10.7	10.1	11.9	11.1	10.1	11.6
Medium and long-term debt	9.8	13.9	12.0	10.3	9.8	11.6	10.8	9.8	11.4
Public sector	2.2	7.0	7.1	5.4	5.0	7.9	7.3	5.2	8.1
Of which: IMF	0.7	1.8	1.7	0.4	0.0	0.0	0.0	0.0	0.0
Of which: Eurobonds	0.0	0.0	0.0	0.1	0.1	1.7	2.1	0.1	2.7
Of which: Domestic bonds (non-residents)	n.a.	2.6	3.5	2.9	2.9	3.5	1.8	1.7	1.6
Commercial banks	1.8	3.2	2.8	2.1	2.0	1.2	1.1	1.3	1.1
Corporate sector	5.7	3.7	2.1	2.8	2.7	2.6	2.3	3.3	2.2
Short-term debt	2.0	1.4	0.6	0.3	0.3	0.3	0.3	0.3	0.3
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	1.8	1.2	0.5	0.2	0.2	0.2	0.1	0.1	0.1
Corporate sector	0.2	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Change in gross reserves (increase=+)	-3.6	2.0	-5.4	2.2	2.6	1.3	0.2	0.0	-0.7
2. Available financing	19.7	23.5	13.1	17.2	16.8	17.2	15.0	13.8	14.6
Capital transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	2.1	3.6	3.7	3.9	3.8	4.0	4.2	4.2	4.2
Portfolio investment (net) 1/	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt financing	15.2	17.9	11.7	13.8	13.0	13.2	10.9	9.6	10.4
Medium and long-term debt	13.6	17.4	11.4	13.5	12.7	12.9	10.6	9.3	10.1
Public sector 2/	6.5	12.2	9.0	11.2	8.9	9.9	7.6	5.4	7.3
Of which: Eurobonds	4.4	5.6	0.0	3.0	2.2	1.7	2.1	0.0	2.2
Of which: Domestic bonds (non-residents)	n.a.	3.9	4.9	4.1	3.4	4.6	2.1	2.0	1.8
Commercial banks	1.0	1.7	0.6	0.3	1.5	1.0	1.1	1.3	1.1
Corporate sector	6.1	3.5	1.8	1.9	2.2	2.1	1.9	2.6	1.8
Short-term debt	1.6	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	1.3	0.5	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Corporate sector	0.2	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Other net capital inflows 3/	2.4	2.1	-2.3	-0.6	0.0	0.0	0.0	0.0	0.0
o/w currency and deposits and trade credit	1.1	2.0	2.9	2.2	0.0	0.0	0.0	0.0	0.0
3. Total financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Debt service	14.5	18.1	15.0	13.3	12.9	14.8	13.7	12.6	14.0
Interest	2.7	2.7	2.5	2.7	2.8	2.8	2.7	2.6	2.4
Amortization	11.8	15.3	12.6	10.7	10.1	11.9	11.1	10.1	11.6

Sources: NBS; and Fund staff estimates and projections.

1/ Only includes equity securities and financial derivatives.
2/ Excluding IMF.
3/ Includes all other net financial flows and errors and omissions.

Table 6a. Serbia: General Government Fiscal Operations, 2012–20 1/
(In billions of RSD)

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(Billions of RSD)					
Revenue	1,411	1,468	1,552	1,535	1,553	1,580	1,642	1,758	1,888	2,038
Taxes	1,226	1,296	1,370	1,348	1,352	1,390	1,445	1,553	1,674	1,816
Personal income tax	165	156	146	141	142	144	149	159	170	182
Social security contributions	379	418	440	421	426	426	443	481	522	571
Taxes on profits	55	61	73	76	73	79	85	92	100	108
Value-added taxes	367	381	410	399	404	410	429	461	500	543
Excises	181	205	212	227	222	244	249	266	282	301
Taxes on international trade	36	33	31	29	30	30	29	30	32	34
Other taxes	43	43	57	54	56	57	61	65	70	76
Non-tax revenue	180	163	171	178	192	181	188	196	204	212
Capital revenue	1	5	2	0	0	0	0	0	0	0
Grants	3	3	9	9	9	9	9	10	10	10
Expenditure	1,669	1,686	1,810	1,767	1,766	1,775	1,806	1,911	2,037	2,174
Current expenditure	1,523	1,582	1,669	1,611	1,610	1,612	1,647	1,740	1,856	1,980
Wages and salaries 2/	375	393	389	360	360	345	328	346	365	393
Goods and services	287	278	310	303	303	310	328	354	381	412
Interest	68	95	115	137	136	160	176	200	220	232
Subsidies	145	130	158	104	104	98	105	113	122	132
Transfers	647	687	697	706	706	699	710	728	769	812
Pensions 3/	474	498	508	491	491	496	501	526	551	577
Other transfers 4/	174	189	189	214	214	202	209	202	218	235
Capital expenditure	119	83	97	123	123	130	134	144	155	168
Net lending	16	13	15	3	3	3	3	3	3	4
Amortization of activated guarantees	11	9	30	31	31	30	23	23	23	23
Fiscal balance	-259	-218	-258	-232	-213	-195	-164	-152	-149	-136
Financing	259	218	258	232	213	195	164	152	149	136
Privatization proceeds	22	3	2	0	0	0	0	0	0	0
Equity investment	-39	-18	0	0	0	0	0	0	0	0
Domestic	116	42	123	-14	49	107	107	121	216	115
Banks	130	33	85	0	32	76	58	46	112	14
Government deposits ((-) means accumulation)	-30	-100	-56	-22	27	62	12	-34	-2	-91
Securities held by banks (net)	98	56	120	22	7	15	50	75	104	101
Other domestic bank financing	63	76	22	-1	-2	-1	-5	4	10	5
Non-banks (incl. non-residents)	-14	8	38	-14	16	32	50	75	104	101
Securities held by non-banks (non-residents, net)	34	56	95	20	80	108	50	75	104	101
Others (incl. amortization)	-48	-48	-58	-35	-64	-76	-1	0	0	0
External	160	192	133	247	164	88	57	31	-66	21
Program	0	0	0	0	11	0	0	0	0	0
Project	43	36	66	52	53	56	67	79	83	88
Bonds and loans	159	234	88	243	150	103	98	116	27	147
Amortization	-41	-78	-20	-48	-49	-71	-108	-164	-177	-214
Memorandum items:										
Arrears accumulation (domestic)	9	-5	-14	0	0	0	0	0	0	0
Quasi-fiscal support to SOEs (gross new issuance of guarantees)	134	112	120	14	14	24	22	20	20	19
Gross public debt	2090	2381	2808	3030	3089	3319	3504	3700	3859	4073
Gross public debt (including restitution)	2090	2381	3086	3308	3370	3599	3784	3981	4139	4354
Nominal GDP (billions of dinars)	3584	3876	3878	3967	3994	4214	4474	4816	5184	5607

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

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

2/ Including severence payments.

3/ Excluding military pension payments from the Republican budget.

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

Table 6b. Serbia: General Government Fiscal Operations, 2012–20 1/

(Percent of GDP)

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(percent of GDP)					
Revenue	39.4	37.9	40.0	38.7	38.9	37.5	36.7	36.5	36.4	36.3
Taxes	34.2	33.4	35.3	34.0	33.8	33.0	32.3	32.2	32.3	32.4
Personal income tax	4.6	4.0	3.8	3.6	3.5	3.4	3.3	3.3	3.3	3.2
Social security contributions	10.6	10.8	11.4	10.6	10.7	10.1	9.9	10.0	10.1	10.2
Taxes on profits	1.5	1.6	1.9	1.9	1.8	1.9	1.9	1.9	1.9	1.9
Value-added taxes	10.3	9.8	10.6	10.1	10.1	9.7	9.6	9.6	9.6	9.7
Excises	5.1	5.3	5.5	5.7	5.6	5.8	5.6	5.5	5.4	5.4
Taxes on international trade	1.0	0.8	0.8	0.7	0.8	0.7	0.7	0.6	0.6	0.6
Other taxes	1.2	1.1	1.5	1.4	1.4	1.3	1.4	1.4	1.3	1.4
Non-tax revenue	5.0	4.2	4.4	4.5	4.8	4.3	4.2	4.1	3.9	3.8
Capital revenue	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Expenditure	46.6	43.5	46.7	44.6	44.2	42.1	40.4	39.7	39.3	38.8
Current expenditure	42.5	40.8	43.0	40.6	40.3	38.3	36.8	36.1	35.8	35.3
Wages and salaries 2/	10.5	10.1	10.0	9.1	9.0	8.2	7.3	7.2	7.0	7.0
Goods and services	8.0	7.2	8.0	7.6	7.6	7.4	7.3	7.3	7.3	7.3
Interest	1.9	2.4	3.0	3.5	3.4	3.8	3.9	4.2	4.2	4.1
Subsidies	4.1	3.3	4.1	2.6	2.6	2.3	2.3	2.3	2.3	2.3
Transfers	18.1	17.7	18.0	17.8	17.7	16.6	15.9	15.1	14.8	14.5
Pensions 3/	13.2	12.8	13.1	12.4	12.3	11.8	11.2	10.9	10.6	10.3
Other transfers 4/	4.8	4.9	4.9	5.4	5.4	4.8	4.7	4.2	4.2	4.2
Capital expenditure	3.3	2.1	2.5	3.1	3.1	3.1	3.0	3.0	3.0	3.0
Net lending	0.5	0.3	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Amortization of activated guarantees	0.3	0.2	0.8	0.8	0.8	0.7	0.5	0.5	0.4	0.4
Fiscal balance (incl. amortization of called guarantees)	-7.2	-5.6	-6.7	-5.9	-5.3	-4.6	-3.7	-3.2	-2.9	-2.4
Financing	7.2	5.6	6.7	5.9	5.3	4.6	3.7	3.2	2.9	2.4
Privatization proceeds	0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity investment	-1.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	3.2	1.1	3.2	-0.4	1.2	2.5	2.4	2.5	4.2	2.1
Banks	3.6	0.9	2.2	0.0	0.8	1.8	1.3	0.9	2.2	0.3
Government deposits ((-) means accumulation)	-0.8	-2.6	-1.5	-0.5	0.7	1.5	0.3	-0.7	0.0	-1.6
Securities held by banks (net)	2.7	1.5	3.1	0.6	0.2	0.3	1.1	1.6	2.0	1.8
Other domestic bank financing	1.8	2.0	0.6	0.0	0.0	0.0	-0.1	0.1	0.2	0.1
Non-banks (incl. non-residents)	-0.4	0.2	1.0	-0.4	0.4	0.7	1.1	1.6	2.0	1.8
Securities held by non-banks (non-residents, net)	0.9	1.4	2.5	0.5	2.0	2.6	1.1	1.6	2.0	1.8
Others (incl. amortization)	-1.3	-1.2	-1.5	-0.9	-1.6	-1.8	0.0	0.0	0.0	0.0
External	4.5	5.0	3.4	6.2	4.1	2.1	1.3	0.6	-1.3	0.4
Program	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Project	1.2	0.9	1.7	1.3	1.3	1.3	1.5	1.6	1.6	1.6
Bonds and loans	4.4	6.0	2.3	6.1	3.8	2.4	2.2	2.4	0.5	2.6
Amortization	-1.2	-2.0	-0.5	-1.2	-1.2	-1.7	-2.4	-3.4	-3.4	-3.8
Memorandum items:										
Arrears accumulation (domestic)	0.2	-0.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Quasi-fiscal support to SOEs (gross new issuance guarantees)	3.7	2.9	3.1	0.4	0.3	0.6	0.5	0.4	0.4	0.3
Gross financing need	15.9	16.2	15.9	16.9	17.1	14.9	14.3	17.1	15.5	17.0
Gross public debt	58.3	61.4	72.4	76.4	77.3	78.8	78.3	76.8	74.4	72.6
Gross public debt (including restitution)	58.3	61.4	79.6	83.4	84.4	85.4	84.6	82.7	79.8	77.6
Nominal GDP (billions of dinars)	3,584	3,876	3,878	3,967	3,994	4,214	4,474	4,816	5,184	5,607

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

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

2/ Including severence payments.

3/ Excluding military pension payments from the Republican budget.

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

Table 7a. Serbia: Monetary Survey, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/									
Net foreign assets 2/	673	847	1037	1079	1224	1382	1464	1488	1504	1480
in billions of euro	5.9	7.4	8.6	8.9	10.0	11.1	11.7	11.7	11.7	11.5
Foreign assets	1420	1427	1475	1535	1576	1720	1802	1839	1870	1862
NBS	1250	1291	1208	1291	1308	1442	1516	1540	1557	1533
Commercial banks	169	136	267	244	269	278	286	299	313	328
Foreign liabilities (-)	-747	-580	-438	-456	-352	-338	-338	-352	-366	-382
NBS	-166	-87	-27	-9	-10	-8	-8	-8	-8	-8
Commercial banks	-581	-493	-412	-447	-342	-330	-330	-344	-358	-374
Net domestic assets	943	836	787	804	708	738	799	927	1,118	1,301
Domestic credit	2,027	1,886	2,005	2,041	2,027	2,141	2,248	2,420	2,666	2,906
Government, net	95	49	121	134	153	229	287	334	446	462
NBS	-160	-236	-258	-277	-232	-172	-161	-196	-199	-291
Claims on government	1	1	1	1	1	1	1	1	1	1
Liabilities (deposits)	161	237	259	278	233	173	162	197	200	293
Banks	255	285	379	411	386	401	448	529	645	753
Claims on government	290	336	457	469	464	480	528	610	727	835
Liabilities (deposits)	36	51	78	58	78	79	80	81	81	82
Local governments, net	6	1	-6	1	-6	-6	-6	-6	-6	-6
Non-government sector	1,926	1,837	1,890	1,906	1,880	1,918	1,967	2,093	2,226	2,450
Households	654	675	725	754	736	766	785	835	889	978
Enterprises	1,226	1,111	1,140	1,099	1,119	1,127	1,156	1,230	1,309	1,440
Other	47	51	25	53	25	25	26	27	29	32
Other assets, net	-1,084	-1,050	-1,218	-1,236	-1,319	-1,403	-1,450	-1,493	-1,548	-1,605
Capital accounts (-)	-876	-830	-928	-903	-892	-939	-957	-978	-1,000	-1,023
NBS	-264	-217	-307	-284	-271	-287	-305	-325	-346	-370
Banks	-611	-613	-621	-619	-621	-652	-653	-653	-653	-654
Provisions (-)	-237	-257	-278	-313	-313	-338	-359	-377	-399	-423
Other assets	28	37	-12	-20	-114	-126	-133	-138	-149	-158
Broad money (M2)	1616	1683	1824	1883	1932	2120	2263	2415	2622	2781
Dinar-denominated M2	455	515	574	610	651	742	831	929	1041	1149
M1	296	366	402	434	456	519	582	650	728	803
Currency in circulation	111	122	130	145	148	168	189	211	236	261
Demand deposits	186	244	271	289	308	350	393	439	491	542
Time and saving deposits	159	149	173	176	196	223	250	279	313	345
Foreign currency deposits	1161	1169	1250	1273	1281	1378	1431	1486	1582	1633
in billions of euro	10.2	10.2	10.3	10.5	10.5	11.1	11.4	11.7	12.3	12.6
Memorandum items:	(year-on-year change unless indicated otherwise)									
M1	3.8	23.7	9.7	6.9	13.4	13.9	12.1	11.8	12.0	10.4
M2	9.2	4.2	8.4	4.0	5.9	9.7	6.7	6.7	8.6	6.1
Velocity (Dinar part of money supply)	7.9	7.5	6.8	6.5	6.1	5.7	5.4	5.2	5.0	4.9
Velocity (M2)	2.2	2.3	2.1	2.1	2.1	2.0	2.0	2.0	2.0	2.0
Deposits at program exchange rate	3.6	2.9	4.3	3.8	4.7	8.1	5.5	5.7	7.6	5.2
Credit to non-gov. (program exchange rate) 3/	0.8	-3.8	0.5	-1.6	-3.0	-0.2	0.4	3.1	2.8	6.0
Domestic	3.3	-5.2	-0.9	-0.1	-1.1	0.9	1.9	5.8	5.8	9.5
Households	0.1	2.4	2.2	3.9	0.6	2.3	1.5	5.4	5.3	9.1
Enterprises	3.9	-9.8	-1.5	-2.7	-2.4	-0.6	1.7	5.6	5.6	9.3
External	-3.9	-1.1	3.0	-4.3	-6.5	-2.3	-2.4	-2.3	-3.6	-2.6
Credit to non-gov. (real terms) 4/	-4.1	-5.3	3.1	-5.6	-6.0	-2.8	-2.6	-0.2	-0.4	2.4
Domestic credit to non-gov. (real terms)	-2.6	-6.7	1.2	-4.1	-4.2	-1.9	-1.4	2.3	2.3	5.8
Households	-3.3	1.0	5.7	-0.3	-2.3	0.0	-1.4	2.3	2.3	5.8
Enterprises	-2.1	-11.3	0.8	-6.6	-5.4	-3.2	-1.4	2.3	2.3	5.8
External	-6.9	-2.4	6.8	-8.1	-9.1	-4.4	-5.1	-5.2	-6.3	-5.5
Deposit euroization (percent of total) 5/	77.1	74.9	73.8	73.2	71.8	70.6	69.0	67.4	66.3	64.8
Credit euroization (percent of total) 5/	69.7	70.6	67.6	66.0	66.6	65.6	64.6	63.6	62.6	61.6

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

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

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

3/ Using program dinar/euro exchange rate as the base for converting FX and FX-indexed loans to dinars (assuming that all FX loans are in euros).

4/ Calculated as nominal credit at current exchange rates deflated by the change in the 12-month CPI index.

5/ Using current exchange rates.

Table 7b. Serbia: NBS Balance Sheet, 2012–20

	2012	2013	2014	2015		2016	2017	2018	2019	2020
				Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Billions of dinars, unless otherwise indicated; end of period) 1/									
Net foreign assets	1085	1204	1182	1282	1298	1434	1508	1532	1549	1525
(In billions of euro)	9.5	10.5	9.8	10.6	10.6	11.6	12.0	12.1	12.1	11.8
Gross foreign reserves	1250	1291	1208	1291	1308	1442	1516	1540	1557	1533
Gross reserve liabilities (-)	-166	-87	-27	-9	-10	-8	-8	-8	-8	-8
Net domestic assets	-470	-584	-602	-678	-686	-779	-818	-806	-775	-716
Net domestic credit	-206	-368	-296	-393	-415	-492	-514	-481	-428	-346
Net credit to government	-160	-236	-258	-277	-232	-172	-161	-196	-199	-291
Claims on government	1	1	1	1	1	1	1	1	1	1
Liabilities to government (-)	-161	-237	-259	-278	-233	-173	-162	-197	-200	-293
Liabilities to government (-): local currency	-55	-89	-105	-39	-100	-100	-100	-100	-100	-100
Liabilities to government (-): foreign currency	-106	-148	-154	-239	-134	-74	-63	-97	-100	-193
Net credit to local governmens	-18	-31	-46	-34	-46	-46	-46	-46	-46	-46
Net claims on banks	-39	-110	-7	-93	-152	-289	-321	-254	-198	-24
Capital accounts (-)	-264	-217	-307	-284	-271	-287	-305	-325	-346	-370
Reserve money	614	620	580	604	612	655	689	726	774	809
Currency in circulation	111	122	130	145	148	168	189	211	236	261
Commercial bank reserves	186	200	210	218	238	244	249	254	259	261
Required reserves	140	145	158	194	179	183	187	191	195	196
Excess reserves	45	55	52	24	59	60	62	63	64	65
FX deposits by banks, billions of euros	2.8	2.6	2.0	2.0	1.8	2.0	2.0	2.1	2.2	2.2

Sources: National Bank of Serbia; and IMF staff estimates and projections.
1/ Foreign exchange denominated items are converted at current exchange rates.

Table 8. Serbia: Banking Sector Financial Soundness Indicators, 2011–15

	2011	2012	2013	2014		2015
				Nov.	Dec.	Feb.
Capital adequacy						
Regulatory capital to risk-weighted assets	19.1	19.9	20.9	19.4	20.0	20.0
Regulatory Tier 1 capital to risk-weighted assets	18.1	19.0	19.3	16.7	17.6	17.6
Nonperforming loans net of provisions to capital	30.8	31.0	32.7	33.7	31.0	30.9
Capital to assets	20.6	20.5	20.9	20.6	20.7	21.1
Large exposures to capital	65.0	61.9	90.4	105.5	130.5	130.5
Regulatory capital to total assets	12.2	12.2	12.2	10.7	…	…
Asset quality						
Nonperforming loans to total gross loans	19.0	18.6	21.4	22.5	21.5	21.8
Sectoral distribution of loans (percent of total loans)						
Deposit takers	0.1	0.3	0.3	0.7	…	…
Central bank	7.2	2.3	5.8	0.8	…	…
General government	3.8	3.2	2.3	2.0	…	…
Other financial corporations	1.6	1.6	1.6	1.2	…	…
Nonfinancial corporations	52.5	56.5	54.1	54.9	…	…
Agriculture	2.0	2.9	2.7	3.3	3.5	3.2
Industry	17.1	18.0	18.4	18.4	19.2	18.8
Construction	6.2	5.5	4.6	4.3	4.2	4.1
Trade	14.8	15.2	13.5	14.0	13.9	13.6
Other loans to nonfinancial corporations	12.3	14.8	14.9	15.0	…	…
Households and NPISH	33.1	34.1	34.8	38.1	…	…
Households and NPISH of which: mortgage loans to total loans	16.1	17.3	16.8	18.1	…	…
Foreign sector	1.7	2.0	1.1	2.3	…	…
Specific provision for NPLs to gross NPLs	51.0	50.0	50.9	52.9	54.9	54.9
Specific and general provisions for NPLs to gross NPLs	111.7	111.1	105.5	109.5	…	…
Specific and general provisions for balance sheet losses to NPLs	121.4	120.7	113.8	115.9	114.5	113.0
Specific and general provisions to NPLs	129.2	126.5	117.9	119.3	…	…
Specific provision of total loans to total gross loans	10.8	10.2	11.9	12.8	12.7	12.9
Earnings and Profitability						
Return on assets	0.0	0.4	-0.1	0.5	0.1	1.5
Return on equity	0.2	2.0	-0.4	2.2	0.6	7.2
Interest margin to gross income	69.0	65.6	69.2	68.0	…	…
Noninterest expenses to gross income	65.9	69.8	69.4	68.3	…	…
Personnel expenses to noninterest expenses	37.6	34.4	35.3	33.1	…	…
Liquidity						
Liquid assets (core) to total assets	25.4	23.9	26.1	25.5	…	…
Liquid assets (core) to short-term liabilities	60.4	57.2	63.2	66.9	…	…
Customer deposits to total (noninterbank) loans	91.8	93.2	103.4	108.2	…	…
Foreign-currency-denominated loans to total loans	69.8	74.1	71.6	70.5	…	…
Average monthy liquidity ratio	2.2	2.1	2.4	2.0	…	…
Average monthy narrow liquidity ratio	1.5	1.6	1.8	1.6	…	…
Sensitivity to Market Risk						
Net open position in foreign exchange to capital	2.5	2.7	3.3	1.8	…	…
Foreign-currency-denominated liabilities to total liabilities	79.0	80.1	76.7	75.7	74.5	74.6
Total off-balance sheet items to total assets	110.5	103.5	111.0	113.0	207.1	218.9
Classified off-balance sheet items to classified balance sheet assets	32.0	26.1	28.7	27.3	27.6	27.6

Source: National Bank of Serbia.

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

	Available on or after	Amount of Purchase: In millions of SDR	Amount of Purchase: In millions of euros 1/	Amount of Purchase: In percent of quota 2/	Cumulative: In percent of quota 2/	Conditions
1	2/23/2015	187.080	231.7	40	40	Board approval of arrangement.
2	6/7/2015	116.925	146.1	25	65	Observance of continuous and end-March 2015 performance criteria, and completion of the review.
3	9/7/2015	116.925	146.1	25	90	Observance of continuous and end-June 2015 performance criteria, and completion of the review.
4	12/7/2015	70.155	87.6	15	105	Observance of continuous and end-September 2015 performance criteria, and completion of the review.
5	3/7/2016	70.155	87.6	15	120	Observance of continuous and end-December 2015 performance criteria, and completion of the review.
6	6/7/2016	46.770	58.4	10	130	Observance of continuous and end-March 2016 performance criteria, and completion of the review.
7	9/7/2016	46.770	58.4	10	140	Observance of continuous and end-June 2016 performance criteria, and completion of the review.
8	12/7/2016	46.770	58.3	10	150	Observance of continuous and end-September 2016 performance criteria, and completion of the review.
9	3/7/2017	46.770	58.3	10	160	Observance of continuous and end-December 2016 performance criteria, and completion of the review.
10	6/7/2017	46.770	58.2	10	170	Observance of continuous and end-March 2017 performance criteria, and completion of the review.
11	9/7/2017	46.770	58.2	10	180	Observance of continuous and end-June 2017 performance criteria, and completion of the review.
12	12/7/2017	46.770	58.1	10	190	Observance of continuous and end-September 2017 performance criteria, and completion of the review.
13	2/15/2018	46.770	58.0	10	200	Observance of continuous and end-December 2017 performance criteria, and completion of the review.
	Total	935.400	1,165.2	200	200	

Source: FIN, WEO.
1/ At projected WEO exchange rates.
2/ Serbia's quota is SDR 467.7 million.

Table 10. Serbia: Balance of Payments (Precautionary SBA Shock Scenario), 2012–20 1/

	2012	2013	2014 Prel.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
				(Billions of euros)					
Current account balance	-3.6	-2.1	-2.0	-2.0	-2.1	-2.1	-1.9	-1.8	-1.6
Trade of goods balance	-5.6	-4.2	-4.1	-4.2	-4.3	-4.3	-4.3	-4.3	-4.4
Exports of goods	8.4	10.5	10.6	10.7	11.3	12.2	13.3	14.5	15.8
Imports of goods	-14.0	-14.7	-14.8	-14.8	-15.6	-16.5	-17.6	-18.8	-20.1
Services balance	0.1	0.3	0.5	0.9	1.0	1.1	1.2	1.3	1.4
Exports of nonfactor services	3.1	3.4	3.8	4.1	4.4	4.7	5.1	5.4	5.8
Imports of nonfactor services	-3.0	-3.1	-3.3	-3.3	-3.4	-3.6	-3.9	-4.1	-4.4
Income balance	-1.1	-1.4	-1.3	-1.7	-1.9	-2.0	-2.0	-2.1	-2.1
Net interest	-0.8	-0.9	-0.9	-1.0	-1.2	-1.2	-1.2	-1.2	-1.2
Others, including reinvested earnings	-0.3	-0.5	-0.5	-0.7	-0.7	-0.8	-0.8	-0.8	-0.9
Current transfer balance	2.9	3.2	3.0	3.0	3.0	3.1	3.1	3.3	3.5
Official grants	0.1	0.0	0.1	0.2	0.2	0.2	0.2	0.0	0.0
Others, including private remittances	2.9	3.1	2.9	2.8	2.9	3.0	3.0	3.3	3.5
Capital and financial account balance 2/	2.5	3.2	0.5	0.7	1.2	1.9	1.5	1.5	1.3
Capital transfer balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	0.7	1.2	1.2	1.3	1.3	1.4	1.6	1.7	1.8
Portfolio investment balance	1.7	1.9	0.4	0.9	0.5	0.4	0.1	0.1	-0.1
of which: debt liabilities	1.7	2.0	0.4	0.9	0.5	0.4	0.1	0.1	-0.1
Other investment balance	0.2	0.1	-1.1	-1.5	-0.6	0.0	-0.2	-0.3	-0.4
Public sector 2/ 3/	0.5	0.4	0.7	0.7	0.5	0.3	0.0	0.0	-0.2
Domestic banks	-0.4	-0.5	-1.5	-1.5	-0.7	-0.1	0.0	0.0	0.0
Other private sector 4/	0.1	0.1	-0.4	-0.7	-0.4	-0.2	-0.2	-0.3	-0.2
Errors and omissions	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	1.3	-1.2	-1.3	-0.9	-0.2	-0.4	-0.3	-0.3
Financing	0.9	-1.3	1.2	1.3	0.9	0.2	0.4	0.3	0.3
Gross international reserves (increase, -)	1.1	-0.7	1.8	0.9	0.7	-0.1	0.4	0.6	0.7
Use of Fund credit, net	-0.2	-0.6	-0.6	0.5	0.2	0.2	-0.1	-0.4	-0.4
Purchases	0.0	0.0	0.0	0.6	0.3	0.2	0.1	0.0	0.0
Repurchases	-0.2	-0.6	-0.6	-0.1	0.0	0.0	-0.1	-0.4	-0.4
				(Percent of GDP)					
Current account balance	-11.5	-6.1	-6.0	-6.1	-6.2	-5.7	-5.0	-4.3	-3.6
Trade of goods balance	-17.8	-12.1	-12.4	-12.6	-12.5	-11.9	-11.1	-10.5	-10.0
Exports of goods	26.5	30.8	32.2	32.3	32.9	34.0	34.9	35.6	36.2
Imports of goods	-44.2	-42.9	-44.6	-44.9	-45.4	-45.9	-46.1	-46.1	-46.2
Services balance	0.4	0.9	1.4	2.7	2.9	3.0	3.1	3.2	3.1
Income balance	-3.4	-4.1	-4.1	-5.3	-5.5	-5.6	-5.2	-5.1	-4.8
Current transfer balance	9.3	9.2	9.1	9.1	8.9	8.7	8.2	8.1	8.1
Official grants	0.3	0.1	0.3	0.5	0.4	0.4	0.4	0.0	0.0
Others, including private remittances	9.0	9.1	8.8	8.6	8.5	8.3	7.8	8.1	8.1
Capital and financial account balance 2/	7.9	9.4	1.4	2.1	3.6	5.3	4.0	3.7	2.9
Capital transfers balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	2.1	3.6	3.7	3.9	3.8	4.0	4.2	4.2	4.2
Portfolio investment balance	5.3	5.6	1.1	2.7	1.6	1.2	0.2	0.2	-0.3
Other investment balance	0.5	0.3	-3.4	-4.5	-1.8	0.1	-0.5	-0.7	-1.0
Public sector 2/ 3/	1.5	1.2	2.2	2.0	1.3	0.8	0.0	0.0	-0.5
Domestic banks	-1.3	-1.3	-4.5	-4.5	-2.0	-0.2	0.0	0.0	0.0
Other private sector 4/	0.4	0.4	-1.1	-2.0	-1.1	-0.5	-0.5	-0.7	-0.4
Errors and omissions	0.6	0.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	3.9	-3.7	-4.0	-2.6	-0.4	-1.0	-0.6	-0.7
Memorandum items:				(percent change unless indicated otherwise)					
Export growth	-0.5	25.6	1.0	0.3	5.5	8.3	9.4	8.5	8.9
Import growth	2.0	4.7	0.4	0.5	4.9	5.8	6.9	6.6	7.3
Export volume growth	-0.8	21.9	1.7	1.4	4.4	8.3	9.8	9.0	10.2
Import volume growth	0.8	2.7	1.9	2.6	2.9	5.0	7.0	7.0	8.5
Trading partner import growth	0.7	0.7	3.0	4.0	5.7	5.2	5.1	4.7	4.7
Export prices growth	0.3	3.0	-0.7	-1.1	1.1	0.0	-0.4	-0.5	-1.2
Import prices growth	1.2	2.0	-1.5	-2.0	2.0	0.7	-0.1	-0.4	-1.1
Change in terms of trade	-0.9	1.0	0.8	0.9	-0.9	-0.7	-0.3	-0.2	-0.1
Gross official reserves (in billions of euro)	10.9	11.2	9.9	9.0	8.4	8.5	8.0	7.4	6.8
(In months of prospective imports of GNFS)	7.4	7.4	6.6	5.7	5.0	4.7	4.2	3.6	3.3
(in percent of short-term debt)	207.5	269.4	281.1	261.5	196.1	200.5	195.6	146.4	133.5
(in percent of broad money, M2)	76.8	76.2	65.7	57.1	49.1	47.0	42.1	36.5	31.1
(in percent of IMF risk-weighted metric)	224.6	229.4	203.8	190.4	164.9	156.8	143.8	125.1	114.1
GDP (billions of euros)	31.7	34.3	33.1	33.0	34.2	35.8	38.2	40.7	43.6

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 11. Serbia: Indicators of Capacity to Repay the Fund, 2013–20 1/

	2013	2014	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
Fund repurchases and charges								
In millions of SDRs	579	502	121	19	9	101	298	300
In millions of euro	663	574	151	23	11	125	367	370
In percent of exports of goods and NFS	4.7	4.0	1.0	0.1	0.1	0.7	1.8	1.7
In percent of GDP	1.9	1.7	0.5	0.1	0.0	0.3	0.9	0.8
In percent of quota	123.8	107.3	25.8	4.0	1.9	21.5	63.6	64.2
In percent of total external debt service	10.7	11.6	3.4	0.5	0.2	2.4	7.1	6.1
In percent of gross international reserves	5.9	5.8	1.7	0.3	0.1	1.6	4.9	5.5
Fund credit outstanding (end-period)								
In millions of SDRs	624	128	503	702	889	845	555	260
In millions of euro	701	151	628	875	1103	1044	682	320
In percent of exports of goods and NFS	5.0	1.0	4.2	5.6	6.5	5.7	3.4	1.5
In percent of GDP	2.0	0.5	1.9	2.6	3.1	2.7	1.7	0.7
In percent of quota	133.5	27.3	107.5	150	190	181	119	56
In percent of total external debt	2.6	0.5	2.3	3.1	3.9	3.7	2.4	1.2
In percent of gross international reserves	6.3	1.5	6.9	10.4	13.0	13.0	9.2	4.7
Memorandum items:								
Exports of goods and NFS	13,963	14,451	14,821	15,678	16,910	18,414	19,885	21,553
Quota (in millions of SDRs)	468	468	468	468	468	468	468	468
GDP	34,277	33,075	33,011	34,239	35,839	38,179	40,688	43,582
Total external debt service	6,194	4,965	4,403	4,427	5,298	5,248	5,143	6,090
Public sector external debt	14,596	16,080	18,110	19,360	20,319	20,366	20,082	19,372
Total external debt	27,194	27,924	27,686	27,868	28,563	28,426	27,867	26,966
Total external debt stock excluding IMF	26,497	27,772	27,067	26,994	27,456	27,149	26,233	24,970
Gross international reserves	11,189	9,907	9,042	8,388	8,463	8,026	7,414	6,762

Source: Fund staff estimates.

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

Appendix I. Letter of Intent

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

Belgrade, June 11, 2015

Dear Ms. Lagarde:

Our economic program, supported by the Stand-By Arrangement (SBA) approved by the IMF Executive Board on February 23, 2015, has been instrumental in reducing Serbia's long-standing internal and external economic imbalances and we remain fully committed to the policies envisaged in this program. The attached Memorandum of Economic and Financial Policies (MEFP) reviews progress made so far and sets out the economic policies that the Government of the Republic of Serbia and the National Bank of Serbia (NBS) intend to implement under the SBA. Our program continues to be fully supported by all coalition partners in the government, indicating strong commitment to and ownership of envisaged policies.

The program performance has been good. All quantitative performance criteria and indicative targets for end-March were met with a margin, and inflation was well within the inner band envisaged under the inflation consultation clause. We have encountered some challenges in implementing the end-March structural benchmarks on time. In order to rectify the delay in the adoption of the Financial Restructuring Plan for the electricity producer EPS (end-March structural benchmark) and the implementation of the measures in the Plan, we submitted the request for the electricity tariff increase to the Energy Agency of the Republic of Serbia, submitted the amendment of Law on Excises to introduce an electricity excise, and adopted the Plan as prior actions for the first review.

The policies under our program will continue to focus on reducing fiscal imbalances, pursuing a wide financial sector agenda, and implementing broad-based structural reforms. We will fine-tune our public communications to ensure that they are fully in line with the objectives of the program. In order to support our efforts to combat non-performing loans (NPLs), we specified three additional structural benchmarks in this area. In view of the need for more comprehensive consultations with local governments than previously anticipated, and the need to prepare a new law rather than amending the existing one, we propose to reset the structural benchmark on legislating the new Local Government Financing Law to end-September.

Given Serbia's comfortable international reserve position and continued access to external financing, we intend to treat the arrangement as precautionary. Therefore, we would not make the purchases when they become available upon completion of reviews. The implementation of our program will continue to be monitored through prior actions, quantitative performance criteria, indicative targets, structural benchmarks, and an inflation consultation clause, as described in the attached MEFP and Technical Memorandum of Understanding (TMU).

We believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of our economic program, and we will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. And we will provide all information requested by the Fund to assess implementation of the program.

We wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the first review of the SBA. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official website of the Serbian government.

Sincerely,

/s/
Aleksandar Vučić
Prime Minister

/s/
Jorgovanka Tabaković
Governor of the National Bank of Serbia

/s/
Dušan Vujović
Minister of Finance

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This memorandum sets out our economic program for 2015–17 that will address short-term as well as medium-term economic challenges that Serbia is facing. The economic program has three main objectives:

- First, address macroeconomic imbalances and vulnerabilities, most notably by placing public sector debt on a sustainable path.
- Second, bolster resilience of the financial sector and improve its intermediation function necessary to support economic growth.
- Third, improve competitiveness and reduce key growth bottlenecks through vigorous implementation of comprehensive structural and SOE reforms.

2. To this end, significant progress has been made so far this year. We have initiated bold fiscal consolidation which is beginning to bear fruit, we have launched reforms in the financial sector, and we have started comprehensive restructuring in the state-owned enterprises with a view to increasing their efficiency and creating jobs.

3. These goals are compatible with our aspirations to become an EU member after having started the accession process in January 2014. Implementing this program would allow Serbia to realize the significant potential for convergence towards EU income levels.

Recent Economic Developments and Outlook

4. Serbia's economic recovery continues, but still faces a number of challenges. Modest recovery started in 2014:Q4. The somewhat better economic activity than projected earlier reflects the effects of lower oil prices on domestic demand, and more favorable external environment. The headline CPI inflation has remained below the NBS inflation tolerance band most of the time since late 2013, on account of temporary factors with a disinflationary effect, such as low prices of primary commodities (particularly energy prices) and weak administered price growth, as well as the anchored inflation expectations and the still negative output gap. Inflation is expected to return to the tolerance band in the second half of 2015. The current account deficit declined with the recovery of exports, and capital inflows increased amid ECB quantitative easing and improved risk premia for the government debt.

5. We will continue to consistently implement policy actions and reforms envisaged under this economic program. We expect that this will give rise to a virtuous cycle of boosting confidence, improving growth and private sector vibrancy. Reflecting the recent developments, we envisage the following revisions to the macroeconomic scenario under the program:

- **Real GDP** is expected to remain flat in 2015, compared to a small contraction projected previously. Despite sizeable fiscal consolidation, the decline of domestic demand will be limited, and offset by stronger external demand. Growth will gradually accelerate over the medium term on account of smaller fiscal adjustment, recovering market confidence and credit growth, and positive effects of structural reforms.

- **Headline CPI inflation** is projected to return close to the inflation target of 4 percent by the end of 2015, but the annual average inflation is revised down to 2.2 percent, reflecting price developments so far this year amid lower oil prices and delays in the administered price increases. Thereafter, inflation is expected to stay within the inflation tolerance band (4±1½ percent), supported by the inflation targeting regime.
- **The current account deficit** is expected to decline to 4¼ percent of GDP this year and decrease further to close to 3½ percent of GDP over the medium term. External financing will rely mostly on FDI, eurobond issuance, and project loans with some possibility of another bilateral concessional loan.

6. **The program scenario continues to face downside exogenous risks, but the Serbian economy has considerable buffers to withstand them.** Possible spillovers from regional developments and a protracted period of slow growth in trading partners would have a negative impact on Serbia. Continued deleveraging by foreign bank subsidiaries, which dominate our financial sector, could pose challenges. However, as the first line of defense, we have large foreign exchange reserves and a well-capitalized and liquid banking system. The Fund arrangement provides an additional buffer to help us cope with negative shocks, and we are prepared to further adjust policies as necessary.

Economic Policies

A. Fiscal Policies

7. **We remain committed to implementing a set of fiscal consolidation policies that will reverse the rise in public debt by 2017 and put it firmly on a downward path thereafter.** We believe that a credible three-year adjustment requires significant frontloading. To this end, we agreed to implement gross fiscal measures amounting to 4¾ percent of GDP during 2015–17, over half of which has already been implemented or will be implemented this year. The measures focus primarily on containing public expenditures, namely on scaling down public sector wage and pension bills and reducing state aid to state-owned enterprises (SOEs).

8. **The fiscal outturn in the first quarter of 2015 was within the program targets.** The general government fiscal deficit (previously referred to as the general government "augmented fiscal deficit," see IMF Country Report 15/20, p. 70) amounted to RSD 21.1 billion, well below the adjusted program target of RSD 53.2 billion, mainly owing to improved revenue collections—almost two thirds were from non-tax revenues. Current expenditures were broadly in line with the budget, but capital investment continues to be underexecuted. The measures effective since 2014—wage and pension cuts and the 5:1 attrition rule for the general government employment—have been implemented as committed, and the current primary expenditure of

the Republican budget amounted to RSD 195.4 billion, below the adjusted program target of RSD 203.5 billion. Despite stronger revenue collections in recent months, prevailing uncertainty about the economic outlook and the largely one-off nature of the revenue improvement warrant maintaining conservative fiscal projections and the existing fiscal targets for the full year.

9. We remain committed to the expenditure measures introduced so far. The government has been implementing the measures as envisaged in the 2015 budget, with a view to reducing the general government deficit (quantitative performance criterion) to about 5.3 percent of GDP this year, below the original target:

- We have suspended the indexation of public sector wages in years in which the share of general government salaries (excluding severance payments) is expected to exceed 7 percent of GDP. We have also suspended indexation of pensions in years in which the share of pensions is expected to be above 11 percent of GDP. We modified the Budget System Law and Pension Insurance Law accordingly in December 2014.

- We amended the Procurement Law in early February 2015 to lower the mark up on public procurement from domestic suppliers from 15 percent to 5 percent in 2015, and eventually plan to eliminate it by 2018. This has supported savings in goods and service expenditures envisaged in the 2015 budget. This will also help reduce the cost of capital spending.

- We eliminated agricultural subsidies for land over 20 hectares and for land leased from the Government of Serbia. We modified the Law on Agriculture accordingly in December 2014.

- We reduced state aid to SOEs, including subsidies, net lending, and payments from the budget for guaranteed and nonguaranteed debt of the SOEs, and will continue to do so during the program period. We adjusted network fees on natural gas distributed by Srbijagas to generate €60 million on an annual basis, effective from February 1, 2015, until the government finds alternative measures with the same revenue effects, in consultation with the IMF staff. This additional revenue will enable Srbijagas to pay a part of its debt obligations, and will correspondingly reduce the payments of its called guarantees from the budget.

- Railways of Serbia are implementing cost saving measures in line with the reduced subsidies and payments for the electricity bills this year.

- The Law on Excises was submitted to the National Assembly for amendment in early June 2015, to introduce an electricity excise of 7.5 percent on total electricity charge (excluding VAT) effective from August 1, 2015 (prior action) in order to reduce inefficiency of consumption.

- We reduced budget allocations for subsidies to public broadcasting companies in 2015 and will eliminate them in 2016.

- To ensure proper protection of the vulnerable segments of the population, the existing social safety net will be maintained.

10. We will continue with reforms of the general government employment and wage system in 2015. The employment reduction and wage system reform will be key for achieving savings envisaged in the 2015 budget and beyond. The preparation of these reforms is supported by the World Bank.

- We will continue applying the attrition rule throughout 2015, and start to implement targeted separations in July 2015, in order to achieve budgeted savings in the annual wage bill equivalent to the reduction of the general government employment by 5 percent. The government will adopt the Law on Ceilings on the Number of Employees by end-June, which will lay the legal basis for annual capping (2015–18) of the number of employees in individual institutions, in line with expected advancements in their productivity to be accomplished through reorganization. Severance payments for targeted separations will be determined in line with the current Civil Service Law and Labor Law.

- We have initiated a comprehensive public wage system reform to improve quality and efficiency by aligning base wages, unifying pay grades across comparable jobs, streamlining the structure of coefficients, and integrating other elements of pay into base wages across all general government sector entities. A single Law on Wages of State Employees will replace a battery of laws setting the key principles and parameters of the new system for most sectors (excluding public enterprises and elected and appointed officials), including the principle of same pay for generic jobs across all sectors. The draft Law will be submitted for public debate by June, and submitted to the National Assembly by July for the Law to be effective from September 2015. Implementing regulations will be adopted by end-October 2015, mapping every existing job into a new classification and specifying non-linear wage adjustment rules that will enable the introduction of new wage grades while respecting the financial envelope set by this program. Each general government employee will be assigned a "notional" wage grade under the new wage system, and the timeframe and modalities for the transition to the new system will be determined in the course of 2015.

11. We will implement additional fiscal measures during 2016–17. Our primary focus will be on the continued reduction of mandatory expenditures through the following measures:

- We will continue reducing the cost and increasing the efficiency of the general government, through its organizational and functional restructuring, in accordance with the new Public Administration Reform Strategy, adopted by the government in January 2014. As a first step, we conducted in April a benchmark review of the public administration system based on relevant comparative countries, which suggests that the health, local governments, police, judiciary and compulsory social insurance organizations have the highest potential for efficiency gains and employment reduction. Most of these will then undergo in-depth functional reviews, producing estimates of additional savings to be attained through restructuring by end-October 2015, in time for incorporation in the 2016 budget. Throughout 2015, we will also advance the data and legal infrastructure necessary to accomplish additional savings in 2016 and 2017 by introducing e-government. We are thus committed to attaining a further reduction of the general government wage bill and other labor associated costs budgeted under goods and services by 5 percent in both 2016 and 2017.

- The National Assembly will adopt the new Local Government Financing Law, which will rationalize transfers and the revenue-sharing mechanism to local governments and provide incentives to raise their own revenues. This law will be adopted by end-September 2015 (originally end-June structural benchmark). Partial adjustment of transfers will be implemented from January 1, 2016, in line with expected savings from targeted rightsizing at the local levels, and full implementation of the new law will start from January 1, 2017. Diagnostic work conducted earlier this year revealed that current system requires broader scope of changes than initially envisaged, and that these changes have to be supported with an entirely new law rather than amendments to the existing one. Full alignment of numerous stakeholders involved in the legal drafting (Ministry of Finance, Ministry of Public Administration and Local Self-Government, Standing Conference of Towns and Municipalities, etc) also justifies extension of the deadline. Due to the implementation delays we will analyze the fiscal performance to determine whether there is a need for compensatory measures to offset the one-off shortfall of savings in 2016.

- We will introduce an excise tax on non-alcoholic drinks (excluding water).

12. We will aim to reduce fiscal risks and will prepare contingency measures as needed. In this regard, we will not rely on short-term external debt financing (quantitative performance criterion), and we will not accumulate public sector external debt payment arrears (continuous performance criterion). We will also refrain from accumulating domestic payment arrears (indicative target). Our efforts to reduce public spending will continue being monitored through a ceiling on the current primary expenditure, excluding capital spending and interest payments, of the Serbian Republican budget (quantitative performance criterion). If revenues are reduced due to an exogenous shock, we will consider contingency measures, such as raising the VAT rate and gasoline excise tax. On the other hand, if the revenue collection exceeds the projected amounts in 2015, the gains would be used to repay public debt in 2015. If the revenue gains are sustainable, a portion could also be used, in consultation with the Fund, for high priority infrastructure projects in future years.

B. Structural Fiscal Policies

13. To underpin the fiscal consolidation, limit risks, and strengthen institutions, we will pursue the following structural policies in the fiscal area:

- To increase fiscal transparency, we classified as "spending above the line" all payments for guarantees serviced by the government, repayment of debt taken over, payments for arrears, and costs related to resolution of financial institutions in the 2015 Budget.

- We will review and clearly define the coverage of general government to be compatible with European System of Accounts (ESA) 2010, and will include social security funds with all health fund indirect beneficiaries, road and corridor funds, and own-source revenue and expenditures of indirect budget beneficiaries (excluding education and local governments) within the 2016 budget documentation. We will include education and local governments in the budget documentation by end-2016. In parallel, we will include all indirect budget beneficiaries of the central government in the Financial Management Information System gradually by end-2016, taking into account their technical and technological capacity.

- We are committed to performing a fiscal impact analysis of all new legislative initiatives under the "pay-as-you-go" rule of Article 48 of the Budget System Law. For this, we issued an instruction to line ministries on how to calculate and report the estimated fiscal impact in March 2015.

- The National Assembly approved in the 2015 Budget Law the overall three-year expenditure ceilings of the Republican budget (without indirect budget beneficiaries) that are aligned with the general government expenditures, as specified in the program and the Fiscal Strategy for 2015-17 adopted in January 2015. We will also improve the planning of the contingency reserve to support the credibility of the ceilings.

- We re-established the Liquidity Committee in March 2015, to strengthen cash management of the government. The Committee includes representatives of the MOF (the Treasury, Tax Administration, Public Debt Administration, Budget Preparation Department and, Macro-Fiscal Analysis and Projections Department) and the NBS.

- To strengthen the control of the public sector wage bill, we created a task force in early June 2015, consisting of representatives from the Ministry of Public Administration and Local Self-Government, MOF, and other relevant institutions to improve the coverage and reliability of the public sector employee registry. We will finalize and validate this registry by end-June 2015 (structural benchmark). For this we will adopt a legal framework necessary to ensure full coverage of the public sector employees—all employees at the republican and local government levels, in public agencies and institutions, and relevant SOEs. We will amend Article 93 of the Budget System Law to allow the necessary data submissions and all responsible agencies to be specified in a special law.

- We will ensure that a full assessment of all proposed Public-Private Partnerships (PPPs) is reviewed by the Ministry of Finance (MOF), including the PPPs' key financing features, cost-benefit analysis, and risk sharing arrangements with the government. We will also include a fiscal risk statement on all PPPs from the 2016 budget onwards. In this regard, we set up a special fiscal risks management unit at the MOF in March 2015, supported by the World Bank. Furthermore, to improve control of fiscal implications and risks, we will amend the existing Law on Public-Private Partnership and Concessions by June 2015 to mandate that all PPPs are submitted to the government for consideration only with prior approval by the MOF.

- We will implement recommendations of the World Bank and IMF TA missions on Public Debt Administration organizational structure and changes in the Law on Public Debt, including setting up a department for asset management.

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

- We will create a strong and stable institutional framework for monitoring SOEs. As a first step, we adopted with a slight delay a government decree that regulates the roles and responsibilities of the MOF, Ministry of Economy (MOE), and line ministries with respect to monitoring, supporting best governance practices, financial reporting, and transparency of SOEs, in April 2015 (end-March structural benchmark). We started quarterly provision of financial statements of SOEs to both the MOE and MOF from 2015:Q1. We will continue to strengthen the SOE monitoring unit in the MOE, which will, in collaboration with the relevant line ministries, focus on corporate strategy and governance, and operational efficiency of SOEs. In agreement with the MOE, the SOE financial monitoring function has been created in the fiscal risks management unit in the MOF (see also ¶13), which focuses on reviewing and compiling the financial reports and statements of SOEs and evaluate the fiscal implications.

- To enhance the payment discipline between public sector entities, we will broaden the scope of the Law on Payments in Commercial Transactions, to include transactions between public entities (including SOEs), in consultation with the IMF, by June 2015 (structural benchmark). This law will define monitoring and enforcement mechanisms for improving payment discipline in the public sector, to be implemented from January 2016, including the conditions under which transfers from the budget can be reduced. Between the adoption and the implementation of the Law, the MOF will raise awareness and publicly promote the importance of the Law urging all budget users to respect the payment obligations, especially to SOEs, including the utility companies.

- We have been strictly limiting issuance of state guarantees since January 1, 2015. In this regard, we will not issue any new state guarantees for liquidity support (continuous performance criterion). We reflected this in the Budget Law for 2015 and will modify the Public Debt Law accordingly by June 2015. Furthermore, we set limits on issuance of new state guarantees for viable project loans (quantitative performance criterion) in annual budgets, in line with the overarching debt sustainability objective, and consult the Fund staff before authorizing the issuance of guarantees. To avoid any misuse of guaranteed project loans, the fiscal risks management unit at the MOF will monitor their implementation.

- We changed the Law on Development Fund in January 2015 to remove the article which stipulates that all guarantees issued by the Development Fund (DF) are backed by the Republic of Serbia. We established an indicative ceiling on the below-the-line lending by the Republican Government. In addition, we will only provide such loans to public entities with high probability of repayment. We will also proceed with the diagnostic analysis of the DF, followed by proposals to improve governance and operational procedures of the DF by end-2015.

15. In order to raise the efficiency of revenue collection, we are committed to improving tax administration based on recommendations of the September 2014 IMF technical assistance mission. We appointed the Acting Director of Serbia's Tax Administration in February 2015, and we have transferred responsibility for investigation of economic crime cases to a relevant agency in May 2015. We adopted in early June 2015 and will start to implement the *Tax Administration Transformation Program 2015–20* as the official medium-term reform program (end-March structural benchmark). The delay was caused by the need to develop a realistic plan to fit within our implementation capacity. Our priorities are to (i) strengthen the Tax Administration's governance, (ii) streamline organizational structures of headquarters and field offices, including by reallocating employees to facilitate compliance efforts, (iii) phase in a modern compliance risk management approach, (iv) strengthen arrears management, including write-off procedures, (v) modernize information technology systems and business processes, and (vii) improve coordination and information exchange with other government agencies.

C. Monetary and Exchange Rate Policies

16. We see the current inflation targeting framework as the most viable option for maintaining stable inflation and protecting the economy against external shocks. We remain committed to the objective of keeping inflation within the inflation tolerance band (4±1½ percent). Inflation developments will be monitored via a consultation clause with consultation bands set symmetrically around the central projection of headline CPI (Table 1). As the fiscal adjustment takes hold and external financing conditions stabilize, we have reduced the policy rate, in line with the inflation outlook and financial stability. Further easing, however, will be gradual and will depend on macroeconomic environment, including external financing conditions.

17. We will maintain the existing managed float exchange rate regime in line with the inflation targeting framework. We believe that exchange rate flexibility provides a needed buffer against external shocks. In light of this, foreign exchange interventions will be limited to smoothing excessive exchange rate volatility without targeting a specific level or path for the exchange rate, while considering the implications for financial sector stability and meeting the inflation target. The current level of gross international reserves is above the levels determined by most reserve metrics and we will maintain adequate coverage throughout the program, which will be monitored by a floor on net international reserves (quantitative performance criterion).

18. In order to reduce risks to macroeconomic stability, we will continue capital account liberalization in a gradual way. Many of the capital account transactions, such as FDI and long-term flows, have already been liberalized, with the remaining restrictions related broadly to short-term capital and deposit flows. In order to limit balance of payments pressures under the program, the capital account liberalization required in the context of EU accession will be gradual, particularly in removing restrictions on short-term foreign inflows to domestic securities and the ability of residents to open deposit accounts abroad.

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

D. Financial Sector Policies

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

21. We are finalizing a comprehensive strategy for addressing the NPL overhang. We established an inter-institutional Working Group—which includes representatives from the Ministries of Finance, Economy and Justice, the National Bank of Serbia and staff of the IMF, IFC, WB, and EBRD—with a mandate to prepare the NPL resolution strategy by end-June 2015 and monitor its implementation thereafter. As part of the strategy's implementation, we will:

- prepare, by end-December 2015, supervisory guidance setting forth expectations for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (structural benchmark);
- strengthen the capacity of the NBS in the area of International Financial Reporting Standards;
- enhance the regulatory framework on the treatment of NPLs and restructured loans;
- amend tax legislation by end-December 2015 to better incentivize NPL resolution;
- introduce, by end-December 2015, a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on residential and commercial real estate collateral valuations filed according to pre-established criteria; and (iii) legislation providing for proper supervision of the licensed appraisers (structural benchmark);
- by end-December 2015 in consultation with stakeholders, conduct a review of the corporate insolvency law and submit proposed amendments to the National Assembly, in line with recommendations from IMF technical assistance, aimed to ensure: (i) adequate safeguards for the secured creditors rights, and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (structural benchmark);
- facilitate out-of-court enforcement. To this end, we will amend the Mortgage Law to facilitate out-of-court sales of mortgaged assets by end-July 2015. We will further ensure that any future amendments of the Enforcement Law would not impede or disincentivize out-of-court enforcement.

While we remain committed to removing potential impediments to, and providing incentives for, timely NLP resolution, we will encourage market-based solutions.

22. We have initiated the SDS of banks operating in Serbia. We finalized terms of reference and it is our expectation that the selected auditors will commence credit file reviews on the basis of a comprehensive manual before end-June 2015. Any provisioning shortfalls, as determined by the auditors on the basis of applicable accounting standards (as assessed on an individual or collective basis), and guided by the manual, are to be reflected in banks' financial statements by end-2015 at the latest. Where SDS-adjusted capital ratios fall short of the applicable regulatory minimum, participating banks are required to provide, within two weeks of the presentation of the SDS results, remedial actions for addressing such shortfalls. We expect that robust implementation of the SDS will support implementation of the NPL strategy. The diagnostic studies are to be completed by end-September (structural benchmark).

23. We will enhance the supervisory, regulatory, and macroprudential frameworks. The NBS published a consultation document on the framework for macro-prudential policy in March 2015, outlining the main objectives, instruments, and decision-making process. The NBS also implemented the Basel II framework in late 2011 and is planning to introduce the Basel III framework in the medium term. In preparation, the NBS has benchmarked its prudential standards against the EU's CRD IV package, and is currently preparing proposals for the implementation of Basel III standards (to be finalized by end-December 2015). In doing so, the NBS will, *inter alia:*

- finalize and adopt the methodology for the identification of systemically important banks;
- introduce a framework for the calibration of additional capital buffers in proportion to the degree of systemic importance of individual banks;
- incorporate the relevant macro-prudential instruments into relevant NBS regulation in due course, in consultation with the IMF staff;
- intensify its supervisory cycle, ensuring that systemically important banks and institutions with the highest risk rating are subjected to on-site inspections on an annual basis;
- prepare, by end-September 2015, detailed plans for strengthening the prudential oversight over the insurance sector, with particular focus on the supervisory framework for insurance market conduct and insurance stress testing, incorporating recommendations from recent Fund technical assistance.

24. We undertook several legislative changes to strengthen the bank resolution framework and financial sector safety net. We legislated comprehensive revisions of the bank resolution framework, and the new framework became effective from April 1, 2015. In view of Serbia's ongoing EU accession process, the new framework is broadly guided by the Bank Recovery and Resolution Directive. All necessary secondary regulations, as prescribed by the amended legislation, have entered into force from April 1, 2015. A new agreement for information-sharing between the NBS, in its capacity as resolution authority, and the Deposit Insurance Agency was finalized at end-May 2015. Banks are required to submit recovery plans by end-September 2015, while the NBS will prepare resolution plans for, initially, systemically important banks, by end-December 2015.

25. Implementation of the strategy for state-owned banks is on track. We are strengthening our oversight over financial institutions that are, in whole or in part, state-owned, and planning to reduce state presence in the financial sector. Where necessary, we will initiate reviews of the business models and strategies of state-owned institutions that have not been earmarked for privatization in the medium term, with the aim to finalize conclusions by end-December 2015. In parallel, we will strengthen corporate governance and risk control frameworks, in accordance with international best practices.

26. We will continue to implement our dinarization strategy. This strategy is based on three pillars: (i) maintaining overall macroeconomic stability; (ii) creating favorable conditions for developing the dinar bond market; and (iii) promoting hedging instruments. In this regard, since November 2013 we have liberalized borrowing in dinars by the IFIs, and further increased maturity of dinar-denominated securities in the local market by successfully placing a 10-year dinar denominated T-bond.

27. We will support credit to SMEs. Given the importance of SMEs for Serbia's economy and the limited access to credit by this sector, we will support lending to SMEs through EIB's credit lines ("Apex loans"). To this end, we streamlined loan approval procedures for the Apex loans by altering the role of the Government Loan Steering Committee to ex-post assessment of the effectiveness of the loans.

E. Structural Policies

28. We have initiated and will implement a number of comprehensive structural reforms to attract investment, support growth, and rebalance the economy on its path towards EU integration. We will focus on specific policies that (i) sustain job creation, (ii) reform state-owned enterprises, and (iii) improve the overall business environment.

29. Job creation is a central element of our economic policies. In 2014, we made legislative changes to support labor market flexibility and job creation, including amendments to the Labor Law in July and adoption of National Employment Action Plan for 2015 (NEAP 2015) in October. We also aligned public sector collective agreements and a decision on social program for redundant employees in SOEs for 2015 with the new Labor Law. Many of the programs under NEAP 2015 will continue to be developed in close consultation with the World Bank and EU partners. To support implementation of NEAP, we amended the Law on Employment in April 2015, which better aligns the disbursement of social benefits for the unemployed with specific training programs. Further, with the aim of improving the social dialogue, we are currently analyzing the Labor Law and other regulations to determine if it is necessary to adopt a new Law on Social Partnership and Collective Bargaining.

30. We have initiated wide-ranging reforms of socially-owned and state-owned enterprises to improve their operational viability and limit fiscal risks. A clear priority is to significantly reduce state aid to SOEs through (i) curtailed direct or indirect subsidies, (ii) limited issuance of new guarantees, and (iii) enhanced accountability, transparency and monitoring of these enterprises. To this end, we started implementing strategies for two broad categories of state-owned companies. First, we are addressing companies in the portfolio of the Privatization Agency, most of which were protected under a bankruptcy moratorium until end-May 2015. For a small group of 17 companies with high privatization prospects, the moratorium was extended for up to 1 year in late May, and the Ministry of Economy will define in a Ministry Decision the deadlines for the resolution of individual companies within the extended timeframe. The second group includes other large SOEs including the electricity, gas, railways, and road companies. The reforms of the socially-owned and state-owned enterprises are supported by the World Bank and EBRD.

31. **We started the resolution of over 500 enterprises in the portfolio of the Privatization Agency through either privatization or bankruptcy, in accordance with the recently revised Privatization Law.** Since August 2014, we have collected letters of interest for these companies, and we have adopted an action plan for bankruptcy procedures for 188 companies in early February 2015. As of end-May, we have submitted to the court requests for bankruptcy proceedings for 49 companies with little privatization prospects, and initiated the public tenders for privatization of 12 companies. We intend to finish the bankruptcy process of additional 139 companies by end-2015, and privatization procedures for an additional 80 companies under restructuring by end-October 2015, through either bankruptcy or privatization. Adequate resources for social benefits for the redundant workers are provided in the 2015 budget. These benefits are equivalent to severance payments in the Labor Law.

32. **We aim to privatize or find strategic partners for a number of SOEs and concession projects.** We will use the proceeds primarily for reducing the stock of public debt but possibly also for funding future financially viable and high return investment projects. The size of investment funding will be determined in consultation with the Fund staff. To support the operation of the telecommunication sector on a strictly market basis, we will launch a privatization tender for Telekom Serbia during the course of 2015. We entered a management contract for Železara Smederevo, a steel producer, with HPK engineering, a Netherlands-based company in March 2015. This has ensured the operation of the steel company without state aid this year—including budget subsidies, government guarantees, lending from the budget or any other forms of public support—and without further accumulation of arrears. At the same time, we will continue to explore long-term concession partnerships for managing the Belgrade airport and operating Corridor XI.

33. **We have started and are committed to restructuring the large SOEs to contain the additional fiscal costs that would arise without a change in policies.** We will also ensure adequate service provision. In particular, we have focused on the electricity, gas, railways, and road companies which are among the largest public enterprises. To implement the needed corporate and financial restructuring in each of these companies over the medium term, we have taken the following steps:

- **Elektroprivreda Srbije (EPS).** In November 2014, we adopted a corporate restructuring plan that focuses on streamlining the organizational structure and management as a first step to enable a financially self-sustaining EPS in the future, and thus avoiding the need for state aid. This new organizational structure will be effective from August 1, 2015. In consultation with the World Bank and EBRD, we adopted the financial restructuring plan for EPS in early June 2015 (end-March structural benchmark, prior action for the first review). The delayed delivery of the restructuring plan was due to longer than expected consultation process between the government and EPS. The plan includes: (1) increases in revenues through enhanced bill collections, reduced technical and commercial losses, and a regulated tariff increase of 4.5 percent from August 1, 2015 consistent with the provisions of the Energy Law, and (ii) a reduction of costs including through increased operational efficiency, optimization of the supply mix, and other measures to reduce operational costs in line with the restructuring plan. The request to increase the regulated electricity tariff by 4.5 percent was submitted to the Energy Agency of the Republic of Serbia in early-June (prior action). Achieving EPS financial sustainability will require the implementation of this full package of measures. The tariff increase and a new excise tax on electricity (to be effective from August 1) would result in a total price increase of 12 percent for the consumers in the regulated market. Additional tariff adjustments will follow in 2016 and 2017 as needed to allow electricity prices to further converge to the market level. Following the ongoing corporate restructuring process and financial consolidation, we will seek minority private investment participation that could further enhance the corporate governance and viability of the company and ensure its professional management. These plans will continue to be implemented through 2016–2017.

- **Srbijagas.** We adopted corporate restructuring plans for Srbijagas in December 2014, which include a framework for unbundling of its distribution section. In line with the fiscal program, we will divest part of Srbijgas' noncore assets and continue pursuing a permanent resolution for the companies which were a major source of arrears in the past: Azotara, MSK, and Petrohemija. These companies have been operating without state aid or further accumulation of arrears this year, and the government is fully committed to no state aid to those companies going forward. More generally, payment discipline of Srbijagas' clients has improved. We hired an independent consultant to develop a financial restructuring plan based on improving collection and increasing the transit and network fees, and the plan will be adopted by end-October 2015, in time for incorporation in the 2016 budget (structural benchmark). The terms of reference for the financial restructuring plan will be prepared with the assistance of the World Bank and the EBRD. These measures will ensure that Srbijagas' financial position does not deteriorate further, thus containing the need for additional state aid in line with the fiscal program.

- **Railways of Serbia**. We established a Railway Reform Steering Committee, led by the Deputy Prime Minister and including senior representatives from relevant Ministries and entities, IFIs, and EU, to provide overall direction of the reforms. The unbundling of the company into separate passenger, freight, infrastructure, and a holding company was approved by the Railway Assembly and the government in May 2015. The decision will be effective from July 1, 2015. In consultation with the World Bank, Railways will identify and implement measures to generate savings to compensate for the reduction of subsidies (€15 million) and servicing of electricity bills. The corporate restructuring plan will be centered on asset disposal, network re-optimization, and staff rationalization.

Importantly, the freight section will receive no further subsidies and will operate on a pure commercial basis from January 2018. To support market competition, an infrastructure usage fee will be introduced by end-December 2015. We will also continue with the reorganization and improvement of business plans for the holding company, the state-owned passenger and infrastructure companies to strictly limit the amount of state aid disbursed over the medium term. We cooperate closely with the World Bank, EBRD and EU in determining the optimal corporate and financial restructuring plans, with the help of independent consultants, who started the consultancy in early May. These plans will be adopted by the government by end-September 2015 (structural benchmark).

- **Roads of Serbia.** The decision of the merger of Roads of Serbia with Corridors of Serbia will be finalized in June 2015, resulting in a single company tasked with road construction and maintenance in Serbia. Formal legal proceedings will be completed by July 2015. While we expect efficiency gains from the consolidation of operations, we will also take action on the revenue side by revisiting the adequacy of toll rates and on the expenditure side by removing rigidities in pricing maintenance contracts in the first half of 2016. The savings should result in lower budget support in the future. We will also explore concession options for the construction and maintenance of Corridor XI. The corporate and financial restructuring plans will be developed in close consultation with the World Bank.

34. We will develop a comprehensive program to enhance Serbia's competiveness and business environment to support investment, job creation and private sector development. The program will be developed in close consultation with the World Bank and EBRD (including through the Investment Climate and Governance Initiative) and will ensure that growth-supporting policies are well coordinated and targeted. Specific actions will focus on the following areas:

- The Law on Planning and Construction, with the goal of significantly speeding up the issuance of construction permits was adopted in December 2014, and a unified procedure is applicable since March 1, 2015. We will also adopt the framework that regulates the conversion of land usage into ownership rights and cadastre regulation by end-June 2015.

- To enhance predictability and reduce corruption and the grey economy, we adopted a new Law on Inspection Oversight in April 2015.

- We will adopt a new Investment Law in June 2015, which replaced and broadened the scope of the Foreign Investment Law to include domestic investment. In addition, the new law provides legal basis for Serbian Development Agency (SDA) to become a one-stop shop for national investment projects, and Investment Offices at municipal level for local investment projects.

- We will adopt a new Company Law by end-2015 to include the public enterprises, which is currently governed by a separate Law on Public Enterprises.
- We will develop plans for the rationalization of investment promotion programs, in particular the Development Fund, and their agencies, including a reform of the two agencies administering investment incentives and export financing programs (Serbian Export Credit and Insurance Agency (AOFI) and Serbia Investment and Export Promotion Agency (SIEPA)), by end-December 2015. We will merge SIEPA with the National Agency for Regional Development (RASME) in August 2015. In addition, we will reorganize the Privatization Agency by end-December 2015.
- We have established a working group to implement the action plan to improve the business environment for SMEs based on the SME strategy for 2015–2020 prepared by the MOE, which was adopted by the Government in March 2015.
- We will work to enhance innovation capacity through stepping up the work of the Innovation Fund and reform the system of financing research institutions.
- As part of our job creation initiatives, we will improve efficiency of Active Labor Market Policies and implement rationalization and reorganization of the National Employment Service.

Program Monitoring

35. Progress in the implementation of the policies under this program will be monitored through quarterly quantitative performance criteria (PCs) and indicative targets (ITs)—including an inflation consultation clause, continuous performance criteria (CPCs) and structural benchmarks (SBs). These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding. Quantitative targets are set for end-June, September, and December 2015.

Table 1. Serbia: Quantitative Program Targets 1/

	2015								
	Mar			Jun		Sep		Dec	
	Prog.	Adj. Prog.	Act.	Prog. CR 15/20 2/	Prog.	Proj. CR 15/20 2/	Prog.	Proj. CR 15/20 2/	Rev Proj.
I. Quantitative performance criteria (quarterly)									
1 Floor on net international reserves of the NBS (in millions of euros)	6,290	...	7,155	6,063	6,063	5,718	5,718	5,835	5,835
2 Ceiling on the general government fiscal deficit 3/ 4/ (in billions of dinars)	55.7	53.2	21.1	96.3	96.3	153.1	153.1	232.1	232.1
3 Ceiling on current primary expenditure of the Serbian Republican Budget excluding capital expenditure and interest payments (in billions of dinars) 3/	207.4	203.5	195.4	429.2	429.2	657.2	657.2	906.3	906.3
4 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget for project and corporate restructuring loans (in millions of euros) 3/	0	...	0	121	121	401	401	481	481
5 Ceiling on contracting or guaranteeing of new short-term external debt by the General Government, Development Fund, and AOFI (up to and including one year, in millions of euros)	0	...	0	0	0	0	0	0	0
II. Continuous performance criteria									
6 Ceiling on gross issuance of new guarantees by the Serbian Republican Budget and the Development Fund for liquidity support (in billions of dinars)	0	...	0	0	0	0	0	0	0
7 Ceiling on accumulation of external debt payment arrears by General Government, Development Fund, and AOFI (in billions of euros)	0	...	0	0	0	0	0	0	0
III. Indicative targets (quarterly)									
8 Ceiling on gross accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars)	0	...	-0.66	0	0	0	0	0	0
9 Ceiling on borrowing by the Development Fund and AOFI (in billions of dinars)	0	...	0	0	0	0	0	0	0
10 Ceiling on new below-the-line lending by the Republican Government (in millions of euros) 3/	176	...	4.2	250	250	314	314	384	384
IV. Inflation consultation band (quarterly)									
Outer band (upper limit, 2.5 percent above center point)	4.2	...	...	5.5	5.5	5.1	5.1	6.7	6.7
Inner band (upper limit, 1.5 percent above center point)	3.2	...	...	4.5	4.5	4.1	4.1	5.7	5.7
End of period inflation, center point 5/	*1.7*	...	*1.9*	*3.0*	*3.0*	*2.6*	*2.6*	*4.2*	*4.2*
Inner band (lower limit, 1.5 percent below center point)	0.2	...	...	1.5	1.5	1.1	1.1	2.7	2.7
Outer band (lower limit, 2.5 percent below center point)	-0.8	...	...	0.5	0.5	0.1	0.1	1.7	1.7

1/ As defined in the Letter of Intent, the Memorandum of Economic and Financial Policies, and the Technical Memorandum of Understanding.
2/ Original program targets as specified in IMF Country Report 15/20.
3/ Cumulative since 01-01-2015.
4/ Refers to the fiscal balance on a cash basis, including the amortization of called guarantees.
5/ Defined as the change over 12 months of the end-of-period consumer price index, as measured and published by the Serbian Statistics Office.

Table 2. Serbia: Prior Actions and Structural Benchmarks

Measures	Target date	Status	Remarks
Prior Actions			
1 Submission to the National Assembly the amendment of the Law on Excises to introduce an electricity excise tax of 7.5 percent, to be effective from August 1 (MEFP ¶9).		Met	Met on June 10, 2015
2 Submission to the Energy Agency of the Republic of Serbia a request to increase the regulated electricity tariff by 4.5 percent, to be effective from August 1 (MEFP ¶33).		Met	Met on June 10, 2015
3 Adoption of the EPS financial restructuring plan by the Government (MEFP ¶33).		Met	Met on June 8, 2015
Structural Benchmarks			
Fiscal			
1 Adoption by the Government of a decree that regulates the role and responsibility of the Ministry of Finance, Ministry of Economy and the line ministries with respect to monitoring SOEs and PPPs (MEFP ¶14).	March 31, 2015	Met with a delay in April, 2015	
2 Adoption of the Tax Administration Transformation Program 2015-20 developed by the MoF as the official medium term reform program (MEFP ¶15). 1/	March 31, 2015	Met with a delay in June, 2015	
3 Adoption of the EPS financial restructuring plan by the Government (MEFP ¶33).	March 31, 2015	Met with a delay in June, 2015	Prior action for the 1st review
4 Adoption by the National Assembly of a new Local Government Financing Law (MEFP ¶11). 2/	June 30, 2015	Proposed to be reset to September, 2015	
5 Finalization and validation of a full registry of public employees, including all employees at the republican and local government levels, in public agencies and institutions, and relevant SOEs (MEFP ¶13).	June 30, 2015		
6 Approval by the National Assembly of changes to the Law on Payments in Commercial Transactions to include transactions between public entities including SOEs (MEFP ¶14).	June 30, 2015		
7 Adoption by the Government of a corporate and financial restructuring plan for Railways of Serbia, to be prepared by an independent consultant (MEFP ¶33).	September 30, 2015		
8 Adoption by the Government of a financial restructuring plan for Srbijagas, to be prepared by an independent consultant (MEFP ¶33).	October 31, 2015		
Financial			
9 Completion of special diagnostic studies of banks (MEFP ¶22).	September 30, 2015		
10 Preparation of supervisory guidance setting forth expectations for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (MEFP ¶21).	December 31, 2015		New benchmark
11 Introduction of a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on real estate valuations filed according to pre-established criteria; and (iii) legislation providing proper supervision of the licensed appraisers. (MEFP ¶21).	December 31, 2015		New benchmark
12 Conduct of a review of the corporate insolvency law and submission of proposed amendments to the National Assembly, in line with recommendations from IMF technical assistance, aimed to ensure: (i) adequate safeguards for the secured creditors rights; and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (MEFP ¶21).	December 31, 2015		New benchmark

1/ This corrects a typo in the original program, which specified as the Tax Administration Transformation Program 2014-19.

2/ The authorities clarified that meeting the objective of this structural benchmark will require adoption of new legislation as opposed to amendment of the existing law as was required in the initial formulation of this structural benchmark.

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definition of indicators used to monitor developments under the program. To that effect, the authorities will provide the necessary data to the European Department of the IMF as soon as they are available. As a general principle, all indicators will be monitored on the basis of the methodologies and classifications of monetary, financial, and fiscal data in place on December 31, 2014, except as noted below.

A. Floor for Net International Reserves of the NBS

	In millions of euro
Outstanding stock:	
End-December 2014	7,008
Floor on international reserves:	
End-March 2015 (performance criterion)	6,290
End-June 2015 (performance criterion)	6,063
End-September 2015 (performance criterion)	5,718
End-December 2015 (indicative target)	5,835

2. **Net international reserves** (NIR) of the NBS are defined as the difference between reserve assets and reserve liabilities, measured at the end of the quarter.

3. For purposes of the program, **reserve assets** are readily available claims on nonresidents denominated in foreign convertible currencies. They include the NBS holdings of monetary gold, SDRs, foreign currency cash, foreign currency securities, deposits abroad, and the country's reserve position at the Fund. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered (e.g., pledged as collateral for foreign loans or through forward contracts, guarantees and letters of credit), NBS' claims on resident banks and nonbanks, as well as subsidiaries or branches of Serbian commercial banks located abroad, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than monetary gold, domestically acquired gold without international certificates, assets in nonconvertible currencies, and illiquid assets.

4. For purposes of the program, **reserve liabilities** are defined as all foreign exchange liabilities to residents and nonresidents with a maturity of less than one year, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options, including any portion of the NBS gold that is collateralized), and all credit outstanding from the Fund. Excluded from reserve liabilities are government foreign exchange deposits with NBS, and amounts received under any SDR allocations received after August 20, 2009.

5. For purposes of the program, all foreign currency-related assets will be valued in euros at **program exchange rates** as specified below. The program exchange rates are those that prevailed on September 30, 2014. Monetary gold will be valued at the average London fixing market price that prevailed on September 30, 2014.

Cross Exchange Rates and Gold Price for Program Purposes, September 30, 2014

	Valued in:				
	RSD	Euro	USD	SDR	GBP
Currency:					
RSD	1.0000	0.0084	0.0107	0.0072	0.0066
Euro	118.8509	1.0000	1.2695	0.8563	0.7808
USD	93.6202	0.7877	1.0000	0.6745	0.6150
SDR	138.7994	1.1678	1.4826	1.0000	0.9119
GBP	152.2168	1.2807	1.6259	1.0967	1.0000
Gold	113,888.97	958.25	1,216.50	820.53	748.20

Source: NBS

6. Adjustors. For program purposes, the NIR target will be adjusted upward by the value of long-term assets and foreign-exchange-denominated claims on resident banks and nonbanks as well as Serbian commercial banks abroad, recovered by the NBS since December 31, 2014. The NIR floor will be adjusted upward by the full amount of any eurobond issuance proceeds cumulative since December 31, 2014. The NIR floor will also be adjusted upward by the value of domestically acquired gold for which certification was obtained after December 31, 2014. The NIR floor will also be adjusted upward by any privatization revenue in foreign exchange received after December 31, 2014. Privatization receipts are defined in this context as the proceeds from sale, lease, or concession of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS either directly or through the Treasury.

B. Inflation Consultation Mechanism

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

8. Breaching the inflation consultation inner band limits (specified in MEFP, Table 1) at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response. Breaching the outer limits would trigger a consultation with the IMF's Executive Board on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA.

C. Fiscal Conditionality

9. The general government fiscal deficit (previously referred to as the general government augmented fiscal deficit, see IMF Country Report 15/20, p. 70), on a cash basis, is defined as the difference between total general government expenditure (irrespective of the source of financing) including expenditure financed from foreign project loans, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeover if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law) and total general government revenue (including grants). For program purposes, the consolidated general government comprises the Serbian Republican government (without indirect budget beneficiaries), local governments, the Pension Fund, the Health Fund, the Military Health Fund, the National Agency for Employment, the Roads of Serbia Company (JP Putevi Srbije) and any of its subsidiaries, and the company Corridors of Serbia. Any new extra budgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Privatization receipts are classified as a financial transaction and are recorded "below the line" in the General Government fiscal accounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concession of all or portions of entities and properties held by the public sector.

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

Adjustors

- The quarterly ceilings on **the general government fiscal deficit and the primary current expenditure of the Republican budget** will be adjusted upward (downward) to the extent that cumulative severance payments by the general government for the former and the Republican budget level for the latter (including payments from the Transition Fund) exceed (fall short of) the programmed levels up to the yearly budgeted amount.

Cumulative Programmed Severance Payments
(In billions of dinars)

	End-Mar. 2015	End-Jun. 2015	End-Sep. 2015	End-Dec. 2015
Programmed cumulative severance payments by the general government fiscal deficit)	3	10	19	29
Programmed cumulative severance payments (of the Republican budget)	3	10	15.6	25.6

- The quarterly ceilings on the **primary current expenditure of the Republican budget** will be adjusted upward (downward) to the extent that (i) cumulative earmarked grant receipts exceed (fall short of) the programmed levels and (ii) cumulative proceeds from small-scale disposal of assets (the sale of buildings, land, and equipment) recorded as non-tax revenues exceed the programmed levels up to a cumulative annual amount of 2 billion dinars in 2015. For the purposes of the adjustor, grants are defined as noncompulsory current or capital transfers received by the Government of Serbia, without any expectation of repayment, from either another government or an international organization including the EU.

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

	End-Mar. 2015	End-Jun. 2015	End-Sep. 2015	End-Dec 2015
Programmed cumulative ear-marked grants receipts	2.5	5	7.5	10
Programmed cumulative receipts from small-scale disposal of assets	0	0	0	0

11. Ceiling on the gross issuance of debt guarantees by the Republican Budget for project and for liquidity support. Guarantees for liquidity support are defined in this context as guarantees related to loans provided without any pre-specified purpose other than satisfying funding needs of the company that ensure its normal production and business activities. Guarantees for viable project loans are defined in this context as guarantees related to loans with high probability of repayment provided with a pre-specified objective establishing that all funding should be used for well-defined investment or corporate restructuring projects, confirmed by a reliable feasibility study and/or the investment or restructuring plan endorsed by the government.

12. Ceiling on below-the-line lending by the Republican Government. Below-the-line lending is defined as the lending by the Republican Government which is used to provide financing to entities outside the General Government coverage. Below-the-line lending by the Republican Government will only be provided in cases where the probability of repayment is assessed to be high. These entities include the Deposit Insurance Agency (DIA), beneficiaries of the APEX lending program, and EPS, among others.

13. Ceiling on borrowing by the Development Fund and the Export Credit and Insurance Agency (AOFI). Borrowing by the Development Fund and AOFI is defined as gross accumulation of financial claims on these entities.

14. The amendments to the Budget System Law will involve a modification specifying the following wage and pension indexation rule:

Fiscal sustainability rule imposes that the share of general government salaries in GDP do not exceed 7 percent, and that the share of pensions in GDP do not exceed 11 percent.

After 2014, salaries and/or pensions will not be increased in the years in which the share of general government salaries in GDP is above 7 percent, and/or share of pensions in GDP is above 11 percent.

In years in which it is expected that the share of general government salaries in GDP will be below 7 percent, indexation will take place twice a year. In April, salaries will be indexed by the previous 6-month CPI inflation and previous year annual real GDP growth above 3 percent, and in October, salaries will be indexed by the previous 6-month CPI inflation, but taking into account that after these indexations the share of general government salaries in GDP must be below 7 percent.

In years in which it is expected that general government pension payments will be below 11 percent, indexation will take place twice a year. In April, pensions will be indexed by the previous 6-month CPI inflation and previous year annual real GDP growth above 3 percent, and in October, pensions will be indexed by the previous 6-month CPI inflation, but taking into account that after these indexations the share of general government pensions in GDP must be below 11 percent.

15. Domestic arrears. For program purposes, domestic arrears are defined as the belated settlement of a debtor's liability which is due under the obligation (contract) for more than 60 days, or the creditor's refusal to receive a settlement duly offered by the debtor. The program will include indicative targets on the change in domestic arrears of (i) all consolidated general government entities as defined in ¶9 above, except local governments; (ii) the Development Fund, and (iii) AOFI. Arrears to be covered include outstanding payments on wages and pensions; social security contributions; obligations to banks and other private companies and suppliers; as well as arrears to other government bodies.

D. Ceilings on External Debt

16. Definitions. The ceilings on contracting or guaranteeing of short-term external debt (with maturities up to one year) consolidated general government, the AOFI, and the Development Fund applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are normal short-term import credits. For program purposes, debt is classified as external when the residency of the creditor is not Serbian. For new debt to budgetary users, the day the debt is contracted will be the relevant date for program purposes. For new debt to non-budgetary users, the day the first guarantee is signed will be the relevant date. Contracting or guaranteeing of new debt will be converted into euros for program purposes at the program cross exchange rates described in this TMU.

E. Ceiling on External Debt Service Arrears

17. Definition. External debt-service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the consolidated general government, the Export Credit and Insurance Agency (AOFI), and the Development Fund, except on debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement on public sector or public sector guaranteed debts. The authorities are committed to continuing negotiations with creditors to settle all remaining official external debt-service arrears.

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

F. Reporting

19. General government revenue data and the Treasury cash position table will be submitted weekly; updated cash flow projections for the Republican budget for the remainder of the year fourteen calendar days after the end of each month; and the stock of spending arrears as defined in ¶16 45 days after the end of each quarter. General government comprehensive fiscal data (including social security funds) would be submitted by the 25th of each month.

Data Reporting for Quantitative Performance Criteria		
Reporting Agency	Type of Data	Timing
NBS	Net international reserves of the NBS (including data for calculating adjustors)	Within one week of the end of the month
Statistical Office and NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Fiscal deficit of the consolidated general government	Within 25 days of the end of the month
Ministry of Finance	Current primary expenditure of the Republican budget excluding capital expenditure and interest payments	Within 25 days of the end of the month
Ministry of Finance	Gross issuance of new guarantees by the Republican Government for (i) project and corporate restructuring loans and (ii) gross issuance of new guarantees by the Serbian Republican Government for liquidity support	Within three weeks of the end of the month
Ministry of Finance	New short-term external debt contracted or guaranteed by the general government, the Development Fund and AOFI	Within four weeks of the end of the quarter
Ministry of Finance	External debt payment arrears by general government, Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Gross accumulation of domestic payment arrears by the general government (without local government, the Development Fund, and AOFI)	Within 45 days of the end of the quarter
Ministry of Finance	Borrowing by the Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Cumulative below-the-line lending by the Republican Government	Within 25 days of the end of the month
Ministry of Finance	Severance payments by general government, with a breakdown by government level.	Within four weeks of the end of the quarter
Ministry of Finance	Earmarked grants and receipts from small-scale disposal of assets	Within four weeks of the end of the quarter