INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/296

# REPUBLIC OF SERBIA

October 2015

## SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR WAIVERS OF APPLICABILITY OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SERBIA

In the context of the Second Review under the Stand-By Arrangement and Request for Waivers of Applicability of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 23, 2015, following discussions that ended on September 1, 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 October 7, 2015.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Serbia.

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**
**Washington, D.C.**

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FOR IMMEDIATE RELEASE
October 23, 2015

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes Second Review of Stand-By Arrangement with Serbia**

The Executive Board of the International Monetary Fund (IMF) on October 23, 2015 completed the second review of Republic of Serbia's economic performance under the Stand-By Arrangement (SBA). The completion of the review will make available the cumulative amount of SDR 420.93 million (about €531.8 million). The Serbian authorities have indicated their intention to continue treating the arrangement as precautionary.

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

Following the Executive Board's decision, Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"Serbia continues to make good progress under the precautionary Stand-by Arrangement. Growth has turned positive despite the significant fiscal tightening this year, the current account deficit has narrowed to a sustainable level, and confidence has improved. At the same time, this good performance remains vulnerable to downside risks. Decisive implementation of all program measures is essential for achieving public debt sustainability, bolstering financial sector resilience and improving competitiveness.

"Fiscal over-performance so far this year is encouraging, and sets the stage for achieving the necessary consolidation to place the high public debt firmly on a downward path. In this regard, the space for pension and public sector wage increases is limited and any targeted increases should be contingent on timely progress in public sector rightsizing which is needed for bringing mandatory expenditure to sustainable levels. At the same time, execution of capital expenditure should be improved in order to support Serbia's growth potential.

"The gradual easing of monetary policy by the NBS has been appropriate in view of still low inflation and ongoing fiscal consolidation. The NBS's commitment to the inflation targeting regime and exchange rate flexibility is welcome.

"Substantial advancement of the financial sector agenda opens a window of opportunity to improve financial sector resilience and improve financial intermediation. The authorities should follow-up on the special diagnostic studies of banks, including by embedding lessons learned in the supervisory and regulatory framework. Decisive implementation of the recently adopted NPL resolution strategy and the strategy for state-owned banks will be critical for clearing the lending channel and reducing remaining vulnerabilities.

"Continued efforts in implementing the identified structural reforms are key for reducing fiscal risks and supporting competitiveness and growth. The development of the strategies and action plans across the full range of public institutions and SOEs is encouraging. Looking forward, the achievement of program objectives will depend critically on implementation."

INTERNATIONAL MONETARY FUND

# REPUBLIC OF SERBIA

October 7, 2015

## SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR WAIVERS OF APPLICABILITY OF PERFORMANCE CRITERIA

## KEY ISSUES

**Recent economic developments.** The economy is gradually recovering from the 2014 recession, supported by strong export performance coupled with a smaller-than-expected fall in consumption. Inflation has remained below the NBS tolerance band due mainly to low imported inflation.

**Program status.** The 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-June performance criteria (PCs) and indicative targets were met with significant margins. Data for end-September PCs are not available, but they are expected to be comfortably met. However, implementation of end-June and end-September structural benchmarks (SBs) has faced delays. Completion of the review will make available the cumulative amount of SDR 420.93 million. The authorities intend to continue treating the arrangement as precautionary.

**Policy recommendations.** Cautious treatment of the fiscal over-performance in 2015 and continued commitment to fiscal consolidation are critical for restoring public debt sustainability. Steadfast implementation of the program commitments, including on structural reforms, is essential for achieving program objectives of maintaining macroeconomic stability, including public debt sustainability, and strengthening Serbia's growth potential.

**New program commitments.** New benchmarks are proposed in the areas of public investment management, the financial sector, and state-owned enterprise (SOE) reform. End-December targets are proposed, based on updated quarterly projections.

Approved By
**Thanos Arvanitis and Petya Koeva Brooks**

Discussions were held in Belgrade during August 20–September 1, 2015. The staff team comprised James Roaf (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). Daniel Heller and Vuk Djokovic (OED) joined some of the policy discussions. HQ support was provided by Min Kyu Song and Patricia Mendoza (both EUR).

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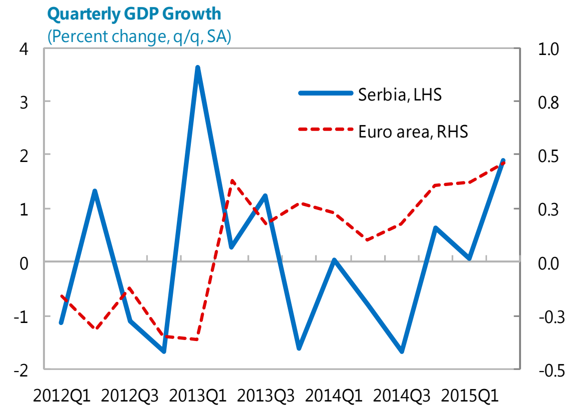
**APPENDIX**

# RECENT ECONOMIC DEVELOPMENTS

1. **The economy is emerging from the 2014 recession** (Tables 1–7 and Figure 1). GDP rebounded strongly in Q2, partly due to earlier-than-expected recovery of the mining and energy sectors from last year's flood, a catch-up in investment, and smaller-than-expected fall in private consumption—in turn reflecting lower oil prices and robust private sector wages and remittances. Low oil prices attenuated the effects of fiscal tightening. Strong industrial production growth continued in Q2 and into Q3, supported by growth in Serbia's trading partners.



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

2. **Inflationary pressures have been low.** At 2.1 percent (y/y) in August, headline inflation remained below the NBS's tolerance band, and core inflation remained broadly stable at about 2 percent on account of low imported inflation and still negative output gap (Figure 2). Anchored inflation expectations and the fiscal consolidation have enabled substantial easing of monetary policy. The NBS reduced its key policy rate by cumulative 300 bps this year to a historic low of 5 percent, which helped reduce the one-week interbank rate (currently at 3¾ percent) below its estimated neutral level of about 6½ percent. While the cuts helped reduce the interest rate on dinar lending, the transmission mechanism to inflation is attenuated by widespread euroization: FX interest rates, which apply to the bulk of credit in Serbia, are driven by the external risk premium and other factors more than by the policy rate.

3. **The external position continues to strengthen and the dinar has appreciated somewhat against the euro** (Figures 3 and 4). Stronger exports and remittances led to a narrower current account deficit in H1, despite higher imports caused by strengthening domestic demand. Along with the unwinding of the subsidized dinar lending program, this has contributed to appreciation pressures, despite heightened uncertainty in the region, prompting NBS interventions.[1] Nevertheless the real effective exchange rate (REER) continued to depreciate due to the realignment of major currencies.

4. **Fiscal over-performance continues** (Figure 5). Through June, the general government deficit was below the adjusted program ceiling by 1½ percent of annual GDP. Total expenditure

[1] The subsidized lending program of 2014:H2 committed to providing 0.2 percent of GDP in interest rate subsidies to support lending in local currency to corporates and SMEs. Its subsequent unwinding resulted in a substitution of dinar credit with FX-indexed credit, prompting banks to reduce net foreign assets to avoid a change in their net position.

was lower than programmed, driven largely by under-execution of capital spending (which is unlikely to fully catch up by year-end) and lower transfers. Revenue continued to over-perform due to higher tax (VAT and social security contributions) and non-tax revenues (super-dividends from SOE profits accrued before 2014 and debt recoveries).[2] July and August data show a similar trend. Public debt, including guarantees, increased to 73.6 percent of GDP in June.

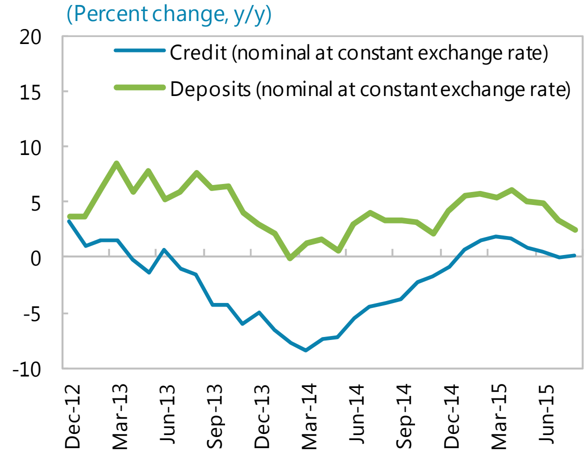
Serbia: General Government Fiscal Operations, RSD billion

| | January-June 2015 | | |
|---|---|---|---|
| | Prog. | Actual | Diff. |
| **Total revenue** | **720.8** | **774.2** | **53.5** |
| Tax revenue | 641.1 | 662.6 | 21.5 |
| of which: VAT | 185.3 | 196.3 | 11.0 |
| of which: Social security contributions | 199.0 | 210.6 | 11.6 |
| Non-tax revenue | 76.6 | 107.5 | 30.9 |
| Capital revenue | 0.0 | 1.1 | 1.1 |
| Grants | 3.1 | 3.0 | -0.1 |
| **Total expenditure** | **817.3** | **809.5** | **-7.8** |
| Current expenditure | 764.2 | 758.8 | -5.4 |
| Capital expenditure | 40.3 | 34.3 | -6.0 |
| Net lending | 1.8 | 1.4 | -0.4 |
| Amortization of activated guarantees | 11.1 | 15.0 | 4.0 |
| **Fiscal balance** | **-96.3** | **-35.3** | **61.0** |
| ***Memo:*** | | | |
| Primary current expenditure of the Republican budget | 429.2 | 405.2 | -24.0 |

Sources: Ministry of Finance, IMF staff calculations

**5. After a brief period of expansion driven by the subsidized lending program, credit growth started to slow down** (Table 7a). Credit to the economy was higher in 2015:H1 (in y/y terms) mainly on account of the carryover effect of the 2014:H2 subsidized lending program that reduced interest rates on dinar loans. However, with the termination of the program, credit is projected to contract again this year. The banking system appears well capitalized and liquid, although high NPLs continue to be a significant challenge (Table 8).

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




Source: NBS and IMF staff calculations.

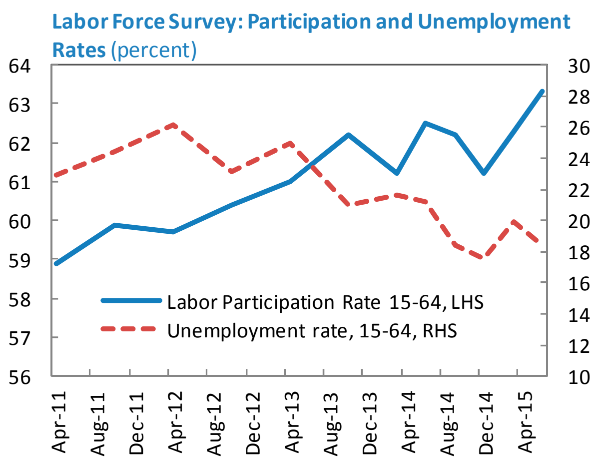
**6. Financial stability has been maintained, including throughout the latest episode of Greece-related volatility.** Enhanced monitoring, established in combination with tighter prudential requirements, has allowed the authorities to closely monitor developments, while robust liquidity and capital buffers helped avoid the need for any public assistance. The continued growth of overall banking system deposits indicates that spillover effects were contained.

**7. Labor market conditions are improving.** Participation and employment rates have risen, and unemployment, while still very high, has been on a downward trend. More locally tailored active labor market measures are being implemented, and the coverage for these

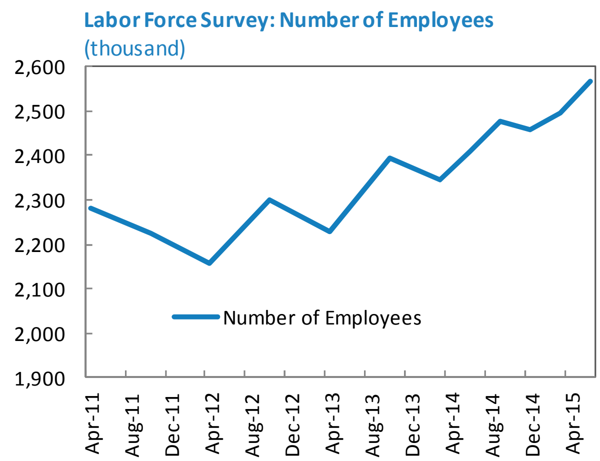
[2] Super-dividends refer to payments which are much higher than relevant operating profits or accrued from previous years (GFSM2001 ¶5.87). Staff estimates these receipts at 0.4 percent of GDP in 2015. Debt recoveries relate to reimbursements by SOEs of debt previously assumed by the government.

measures have been expanded.[3] Labor inspections have been intensified since 2014 to address widespread informal employment in the economy.

**8. The flow of migrants poses challenges.** So far migrants have generally been traveling through Serbia en route to Western Europe. This has presented logistical challenges but not major fiscal costs. However, the situation is likely to become more difficult if migrants find themselves unable to pass on to EU countries, and need to remain longer in Serbia.



Source: Statistical Office of the Republic of Serbia (SORS).



Source: SORS.

# PROGRAM PERFORMANCE

**9. The comprehensive adjustment program is broadly on track** (MEFP Tables 1–2). The authorities remain committed to all program objectives and targets.

- **All end-June and continuous PCs and indicative targets were observed.** The June fiscal deficit ceiling for the general government was met by a large margin, and the ceilings on current primary expenditure of the Republican budget, issuance of guarantees, and accumulation of arrears were also observed. Reserve accumulation meant the net international reserves (NIR) target was comfortably met. While inflation has been below the NBS target band, it remained within the inner limit of the program inflation clause. Data for end-September PCs are not available, but they are all expected to be met.

- **One of the end-June SBs was implemented with delay, and the other was substantially implemented, also with delay.** The National Assembly approved the changes to the Law on Payments in Commercial Transactions in July 2015. The registry of public employees was largely finalized, with headcount and wage data validated for the general government workforce in July. There was agreement that SOE data can be tracked in the context of

[3] Measures include training and counseling, as well as hiring incentives targeting young, less qualified and redundant workers.

specific SOE restructuring plans and therefore does not need to be fully integrated into the registry.

- **The authorities continue to advance the structural agenda for end-September, but also with some delay.** Regarding SBs, the financial restructuring plan for railways is expected to be adopted by the government with a slight delay, in mid-October; the special diagnostic studies of bank asset quality (SDS) are expected to be completed by October, with slight delay due to operational complexities; and the Local Government Financing Law faces further delays caused by the complexity of aligning numerous stakeholders and conducting public debate. Across the broader structural agenda, some reforms face technical capacity constraints or pushback from vested interests.

# OUTLOOK AND RISKS

**10. The economic outlook is slightly improved from the first review scenario** (Tables 1–7).

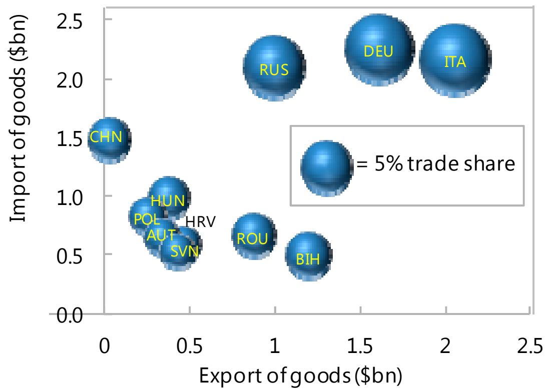
- **Real GDP** is now projected to grow by ½ percent in 2015, compared to zero previously. The change is mostly because of the smaller contraction of private consumption and higher private investment.

- **Average CPI inflation,** at 1.6 percent, will however be lower than previously projected, due to declining prices of oil and other commodities, and a decline in fruit and vegetable prices in July.

- **The current account deficit** is projected to narrow to around 4 percent of GDP in 2015.

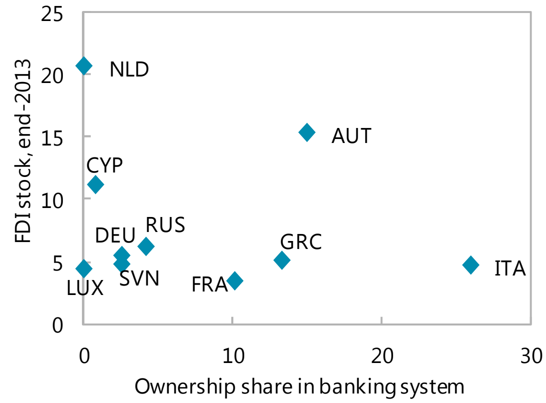
**11. Risks remain tilted to the downside.** Delays in developing specific plans for several structural reforms and fiscal measures—particularly in the area of SOE restructuring and continued reduction of mandatory fiscal expenditure—suggest that the implementation of these reforms, which are politically difficult but critical for reaching program objectives, may be pushed back and/or watered down. If these risks materialize, they could delay public debt stabilization agreed under the program and compromise the quality of fiscal adjustment. Continued inflation undershooting could also make debt reduction harder. Given its considerable international linkages and large financing requirements, Serbia also remains susceptible to possible spillovers from regional developments and changes in market volatility, particularly from developments in Greece, possible tightening of US monetary policy, or slowdowns in major emerging markets (while direct links with China are limited, the slowdown in China could produce spillovers through impacts on the EU or general market confidence effects). The flow of migrants poses risks on a number of fronts, including fiscal costs and potential disruptions to trade flows. On the positive side, fiscal revenues could continue to over-perform projections and low commodity prices could have a stronger positive effect on growth.

**Trade Linkages** 1/
(Average, 2012-14)




1/ Size of bubble shows total trade share, (X+M)/GDP.
Sources: Direction of Trade Statistics; World Economic Outlook database; IMF staff calculations.

**Financial Linkages**
(Shares in total, percent)




Sources: Coordinated Direct Investment Survey; National Bank of Serbia; and IMF staff calculations.

# PROGRAM POLICY DISCUSSIONS

*Ongoing fiscal consolidation creates space for further monetary easing to support growth. Good progress has been made in financial sector reforms, but some other structural reforms have been delayed. Steadfast implementation of the program commitments is essential to maintain macroeconomic stability, including public debt sustainability, and strengthen Serbia's growth potential.*

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

**12. The authorities reiterated their commitment towards fiscal consolidation required to place public debt firmly on a downward path by 2017.** The discussions focused on policies to achieve these objectives in view of substantial fiscal over-performance in 2015:H1 and, at the same time, on the considerable policy implementation risks:

- The general government fiscal deficit is projected to be 4.0 percent of GDP, compared to 5.3 percent of GDP in the first review. About half of this improvement is due to one-off non-tax revenues and the shortfall in the capital spending, with the remainder due to better tax performance. Primary structural adjustment in 2015 is estimated at about 2 percent of GDP, setting the stage for a cumulative adjustment of over 4 percent of GDP over the program period. Despite the lower deficit, the public debt ratio continues to rise substantially in 2015, in part due to a lower GDP deflator and the impact of the stronger U.S. dollar on the debt stock. Debt is projected to rise to 78½ percent of GDP in 2016 and fall thereafter.

- For 2015, the authorities and staff agreed that the fiscal over-performance should be used for debt reduction as a priority.

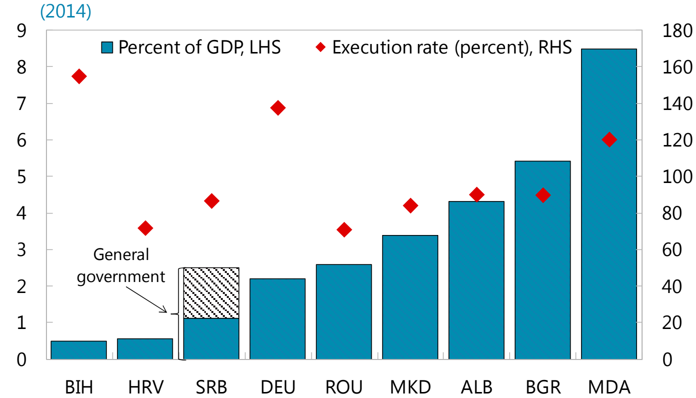
- For 2016, the scope for any additional spending relative to initial program projections will be assessed in the context of the 2016 budget discussions at the time of the third SBA review. This assessment would take into account program objectives of debt reduction and lowering mandatory expenditure as a share of GDP and broad policy implementation risks for the program. Possible areas for increased expenditures may include targeted wage increases consistent with convergence under the wage system reform, a small targeted pension increase, a subsidized SME lending program (subject to further analysis of the effectiveness and additionality of past subsidized lending programs, MEFP ¶29), and high-priority public investment. Staff stressed the importance of keeping wage and pension spending on a firm downward path relative to GDP, to bring them closer in line with regional peers.

- Staff raised the need to ensure adequate social protection. With Serbia's overall spending on social programs roughly comparable with peer countries, and given fiscal constraints, this could best be achieved by redirecting resources from existing universal to targeted programs (Box 1). The authorities acknowledged this potential, but felt it was not the most pressing priority at this stage and considered that focusing efforts on increasing employment were more appropriate.

**13. Staff urged the authorities to proceed expeditiously with the public sector rightsizing and wage system reforms.** While the 2015 wage bill target appears achievable, largely through the continued application of the 5:1 attrition rule, a shortfall in targeted separations would make it more difficult to contain the wage bill in future years. In addition, staff emphasized that the rightsizing should be done in conjunction with reorganization of the public sector to assure quality of public sector services. The authorities acknowledged the challenges to implementing rightsizing, but recommitted to achieving the original objectives. They agreed to adopt the umbrella Law on Wages of State Employees by mid-October and to adopt the regulations to implement the new wage system soon thereafter.

**14. Staff urged more effective execution of capital expenditure as well as to undertake efforts to raise overall investment levels.** Compared to other countries in the region, Serbia's level of capital expenditure is low. In the authorities' view, problems stem mainly from poor project planning. In the short run, they are working towards improving coordination between stakeholders and monitoring day-to-day progress of large projects. To improve the medium-term outlook, the MOF, with support from USAID, is working on new regulations and guidelines for public investment management aimed at strengthening

**Central Government Capital Expenditure 1/**
(2014)




1/ All central government except ROU and DEU (general government); BIH: domestically financed expenditure.
Sources: Country authorities and IMF staff estimates.

the project appraisal process, including new by-laws to be adopted by end-December 2015 (structural benchmark). Attention will next turn to developing specific methodologies to appraise projects and providing training to relevant line ministries. Staff supported these efforts and also encouraged the authorities to strengthen multi-year budget frameworks.

## Box 1. Social Protection in Serbia[1]

Spending on social assistance programs amounts to about 2.1 percent of GDP, which is broadly in line with other CEE countries. However, only about 30 percent is means tested, targeting poor families. The rest is designed to support specific categories of citizens regardless of income level.

**Financial social assistance (FSA)** is a means-tested program for poverty reduction covering about 100,000 of the poorest families. Benefits make up the difference between actual family income and an administratively set threshold. The level of the benefit is mostly seen as adequate, but the coverage, primarily due to a very restrictive property threshold, is rather low, especially for the rural population. The total cost is about 0.3 percent of GDP.

**The child allowance program** is also means tested, with the main goal to assist poor families with children (about 380,000 children in about 200,000 families). The income eligibility threshold is RSD 8,155 per family member, and the level of the monthly benefit is about RSD 2,600 per child. Total cost is about 0.3 percent of GDP.

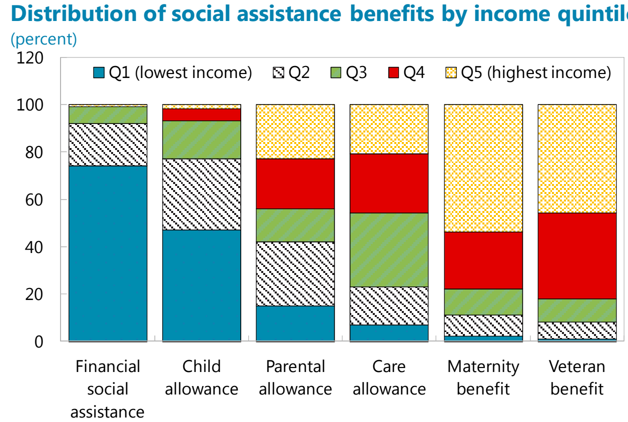
**The maternity leave allowance** is the largest social assistance program (0.7 percent of GDP), fully compensating lost wages during 12 months of maternity leave. The level of benefit is capped at five average monthly wages.

**Parental benefit** is a population policy measure which supports childbirth. The cost of the program is about 0.16 percent of GDP.

**Other programs** including veteran and disability benefits, allowance for care, foster care, etc, amount to about 0.6 percent of GDP.

Data on the allocation of the program funds by income quintiles (chart) indicate that means-tested programs mostly benefit poorer quintiles; parental allowance and allowance for care are more evenly distributed, while maternity benefit and war veteran benefit are mostly allocated to wealthier citizens.

**Distribution of social assistance benefits by income quintiles**




Source: World Bank, Serbia Public Finance Review, 2015.

1/ This box draws on Serbia Public Finance Review, World Bank, 2015.

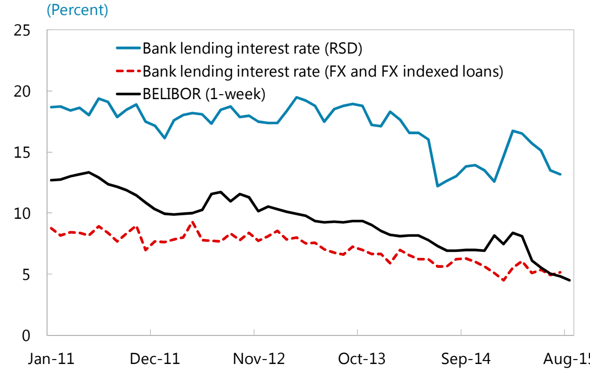
15. **The authorities reported progress on their Public Financial Management (PFM) and tax administration reform agenda.** The recent appointment of an external PFM advisor will help advance the *Public Financial Management Reform Program* for 2015–17, with the draft program expected to be finalized by end-November. In early June the government adopted the *Tax Administration Transformation Program* for 2015-20, including implementation deadlines. A key element of the short-term agenda will be to develop a staff recruitment and retention plan,

given TA staffing constraints. Staff urged the authorities to implement previous FAD recommendations to improve the handling of tax-related debts, including write-off of uncollectible debts; to avoid repetition of tax amnesty schemes; to focus collection efforts on new and large debts; to utilize installment agreement options for old debts concerning viable businesses; and to ensure that debt collection is facilitated by a modern IT system.

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

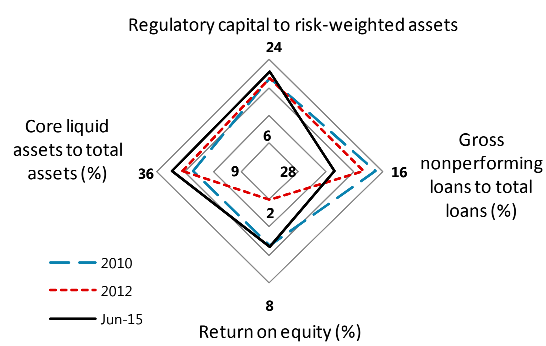
**16. Accommodative monetary policy remains appropriate.** Despite the more expansionary monetary policy stance, inflation is expected to remain below NBS's inflation tolerance band this year. Staff agreed with the NBS that accommodative monetary policy, together with the ongoing efforts to address the NPL overhang, would be beneficial for reducing dinar lending rates and restarting credit growth—thereby supporting gradual return of inflation to the 4-percent target by end-2016. In addition, the current environment presents an opportunity to reduce the reserve requirements on FX deposits, which are much higher than in peer group countries.[4] There was agreement, however, that monetary policy easing should be conditional on the external financing environment, inflation expectations, and the progress in fiscal consolidation. The NBS reconfirmed its commitment to continue to follow a policy of exchange rate flexibility, using interventions only for smoothing excessive volatility.

**Selected interest rates**
(Percent)




Source: National Bank of Serbia.

**Financial Soundness Indicators, 2010-15**




**17. Addressing the overhang of distressed debt remains central to achieving a more robust financial system and sustained growth.** NPLs continue to rise, albeit at a slower pace, reaching nearly 23 percent in end-June 2015. While regulatory reserves amounted to 113 percent of NPLs in end-June, the increases in realized credit losses are adversely impacting bank profitability and constraining lending activity.

[4] The NBS announced a reduction of the required reserve ratio from 26 (19) percent to 20 (13) percent for FX deposits under (over) two years maturity, implemented in six equal steps over September-February.

**18. Staff welcomed the finalization of the NPL resolution strategy, while noting that its effectiveness hinges on strong commitment of all stakeholders**. The multifaceted strategy (Box 2), adopted and published by the government in August 2015, aims to (i) identify and address legal, tax, institutional and other impediments that hamper debt resolution and/or the materialization of a market for distressed assets; (ii) reinforce incentives for viable but distressed debtors and creditors to participate in viable restructuring; and (iii) strengthen prudential oversight. The strategy reflects international experience in resolving NPLs and incorporates findings from a NBS survey covering the reasons for the accumulation of NPLs, impediments to resolution, and banks' own strategies to address the problem. To aid in implementation, the inter-institutional Working Group that developed the strategy has been tasked with monitoring progress, including through biannual reporting to the government.

**19. The special diagnostic studies of bank asset quality, conducted by independent consultants, are nearing completion** (end-September structural benchmark). The NBS expects to complete the exercise by end-October, the slight delay being dictated by logistical constraints and the need for further methodological refinement. Once the analyses of asset reclassifications and provisioning shortfalls are available, banks facing a capital shortfall (if any) will be given two weeks to submit recapitalization plans and six months for their implementation. Staff urged the NBS to ensure timely follow up of the SDS findings, including by embedding the lessons learned in the supervisory framework.

**20. Efforts to strengthen financial sector supervision continue apace.**

- Technical assistance has indicated scope to increase efficiency and effectiveness by introducing a more risk-sensitive supervisory cycle, in combination with fuller integration of the supervisory review and evaluation process (in line with European Banking Authority guidelines).

- In parallel, the NBS has prepared an action plan for strengthening the regulation and supervision of the insurance sector, which is small (5 percent of GDP) but growing rapidly.

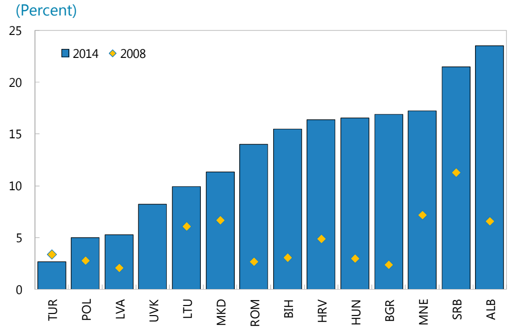
- The preparation of regulations consistent with Basel III is underway, following a first impact study indicating that Serbian banks would be able to satisfy the new capital requirements. The exact timetable for the introduction of Basel III will be determined once the impact of all amendments has been thoroughly assessed.

## Box 2. NPL Resolution Strategy

**High NPL levels, exceeding most regional peers, pose significant challenges for Serbia.** In particular, corporate sector loans show elevated signs of distress, reflecting weak economic fundamentals. While the NPL ratio for households is relatively stable, the amount of distressed household debt increased by 35 percent between 2012 and 2014.

**Aging of the NPL portfolio reflects obstacles to timely debt resolution.** At end-2014, almost 75 percent of the NPL portfolio was overdue for more than 360 days, while more than 50 percent of the total NPL portfolio was overdue for more than two years. Also, loan restructurings are lagging, with banks reporting a mere 6 percent of total loans as restructured. Slow resolution of the stock of NPLs can be attributed to cumbersome insolvency proceedings, weaknesses in the enforcement of creditor rights and failures in creditor coordination, as well as an undeveloped market for distressed assets.

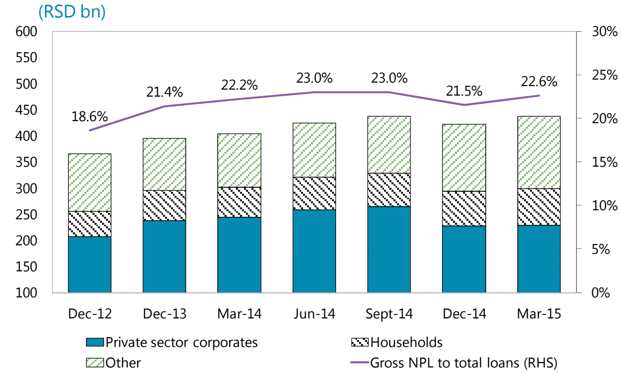
Nonperforming loans to total loans
(Percent)




Source: IMF Financial Stability Indicators

**The authorities, with assistance from the IFIs, tasked a Working Group with the preparation and implementation monitoring of a comprehensive NPL resolution strategy.** The strategy is to be implemented through action plans for the Government and the NBS that, aim to (i) identify and address legal, tax, institutional and other impediments to debt resolution and the development of distressed asset markets; (ii) reinforce incentives for viable but distressed debtors to participate in meaningful restructuring; and (iii) ensure timely loss recognition.

Composition of nonperforming loans
(RSD bn)




Sources: NBS and IMF staff calculations

**The strategy includes the following elements:**

•*Supervisory policies.* Enhance supervisory oversight over provisioning practices, improve collateral valuation (aided by new regulation of the appraiser profession), limit interest accrual over distressed debt and encourage tighter write-off policies. The NBS will take steps to strengthen banks' distressed management capabilities, tighten the regulatory treatment of restructured receivables and enhance disclosure of asset quality.

•*Insolvency reforms.* Strengthen safeguards for secured creditors, improve capacity of the judiciary and bankruptcy administrators, and facilitate speedy and orderly corporate workouts through out-of-court restructuring.

•*Distressed asset markets.* Address obstacles to the sale of NPLs and the establishment and operations of privately-owned asset management companies. Review potential modalities for liberalizing the sale of retail receivables.

•*Tax policy.* Introduce amendments regarding (among others) the recognition of write-offs for tax purposes and the treatment of debt forgiveness for personal income tax purposes.

- The authorities intend to introduce regulatory amendments that are necessary to fully assemble its macroprudential toolkit as part of the Basel III introduction. The NBS has already initiated analytical work on countercyclical capital buffers and capital surcharges for the systemically important banks which were identified in accordance with the NBS's new methodology.

- The NBS is reviewing banks' recovery plans, prepared in accordance with its new Decision on recovery planning, and expects to finalize resolution plans for systemically important banks by end-2015.

**21. Staff urged decisive implementation of the strategy for state-owned banks.** The recent appointment of a privatization advisor for Komercijalna Banka is an important step towards privatization of the bank. Other priorities relate to the forthcoming privatization of state-owned insurance company Dunav Osiguranje and the strategic reorientation of Banka Postanska Stedionica—which has experienced a rapid rise in NPLs, in part stemming from the assumption of corporate portfolios from failed banks. Finally, strategic options for three smaller state-owned banks will need to be determined in the coming months in line with the overarching objective of reducing public involvement in the financial sector.

## C. Structural Reforms: Overcoming Implementation Challenges

**22. Staff and authorities concurred that SOE reform is critical for spurring growth and reducing fiscal risks.** Delays in SOE reforms could increase fiscal risks and undermine debt sustainability. Staff stressed importance of reforms in the energy and transport sectors, to ensure permanent reduction of state aid:

- **Elektroprivreda Srbije (EPS).** After the comprehensive financial restructuring plan was adopted in June, the regulated tariff increased by 4.5 percent from August 1, together with introduction of 7.5 percent excise duty. The legal changes to reorganize 14 subsidiaries into 3 companies for generation, transmission and distribution were completed in July 2015, and amendment to the collective agreement will be done by end-2015 (structural benchmark) to allow for the implementation of the rightsizing identified in the restructuring plans. Other cost saving and efficiency improving measures are planned in 2016.

- **Srbijagas.** The financial condition of Srbijagas has improved through better payment discipline, which is expected to improve further with implementation of the Law on Commercial Payment Transactions next year. The new organizational structure consisting of transmission and distribution subsidiaries became effective in August. In consultation with the World Bank, a financial restructuring plan is being prepared to be adopted by the government by end-January, 2016 (structural benchmark).

- **Railways of Serbia.** The legal unbundling of the company into passenger, freight, infrastructure companies took effect in July 2015. Cost-saving measures have been implemented to achieve the planned reduction of state subsidies. The new financial restructuring plan, prepared by external consultants, will lay out the strategy to reduce state aid for these companies, including a retrenchment plan.

- **Roads and Corridors of Serbia.** The authorities have started to introduce performance-based contracts to reduce pricing rigidities. The corporate and financial restructuring plans for Roads of Serbia will be developed in close consultation with the World Bank.

**23. Staff stressed the importance of timely resolution of companies in the portfolio of the Privatization Agency.** Staff underscored the need to resolve the 17 strategically important companies that received an extension of bankruptcy protection until May 2016. Viable companies should be privatized as soon as possible while for others bankruptcy proceedings need to be initiated. The authorities committed that at least seven companies will be resolved via privatization or bankruptcy by end-2015 (structural benchmark). For other companies in the Portfolio of Privatization Agency, as of end-September the authorities have started bankruptcy proceedings for 134 companies, and privatization tenders for 40 companies.

**24. The authorities reiterated their commitment to improve the investment climate and labor market efficiency** (MEFP ¶¶31, 36). Staff concurred that progress in these areas will be important to boost employment and stimulate growth.

- *Investment climate*. The new Investment Law will broaden the scope of the Foreign Investment Law to include domestic investment and provide a legal basis to streamline the operations of existing investment and export promotion agencies and programs. The authorities have modified regulations to enable more efficient issuance of construction permits and a new law was adopted in June to regulate the conversion of land usage into ownership rights. A new Law on Fees and Charges is being prepared to replace existing laws and bylaws and regulate fees at all levels of government with greater transparency and predictability.

- *Job creation*. Staff acknowledged the role of enhanced labor inspections in helping to expand the formal economy, improve labor market efficiency and increase social contributions. They urged continued efforts on this front and noted that active labor market measures could be further expanded to accommodate needs arising from the planned public sector rightsizing.

# PROGRAM MODALITIES

**25. Staff proposes the updated program conditionality** (MEFP Tables 1–2):

- The fiscal primary current expenditure target has been set in line with previous indicative targets. The target on the fiscal deficit has been tightened, consistent with the aim of applying savings from revenue over-performance and shortfalls in capital expenditure to debt reduction. The NIR target for end-December reflects higher reserve accumulation during the first half of 2015 than originally programmed. Staff proposes to re-center the program inflation consultation bands for December at the NBS's inflation target.

- Six new SBs are proposed aimed at: improving public investment quality and execution; resolving SOEs through privatization or bankruptcy; amending collective agreements in the electricity company to allow for rightsizing; incentivizing NPL resolution; improving distressed asset management; and improving business plans at state banks.

- The SB on adoption by the National Assembly of the Local Government Financing Law is proposed to be replaced by the posting of the draft law for public debate by end-October 2015, as the complexity of the consultation process will require extending the timeframe for its adoption through early 2016.

- The missed end-September SB on the finalization of the banks' special diagnostics studies, is proposed to be reset for end-October 2015 in view of slight delays stemming from operational complexities.

- The end-October SB on the financial restructuring plan for Srbijagas is proposed to be reset to January 2016, under the World Bank's advice to prepare a more comprehensive restructuring plan than previously planned.

**26. 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, including from countries in the region, or from 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 about 1 percent of GDP, or 7¼ percent of gross reserves (Tables 10–11). Public sector and external debt stocks are expected to remain high during the program period. Public debt is projected to peak at 78½ percent of GDP in 2016 and external debt at 86 percent of GDP in 2015, in a scenario without Fund disbursements. Program implementation would put both of these on a firm downward path thereafter. The authorities have demonstrated continued commitment to the program. In addition, Serbia has a strong record of repaying the Fund.

# STAFF APPRAISAL

**27. Serbia's Fund-supported program is broadly on track.** The end-June quantitative performance criteria and indicative targets were observed with comfortable margins. The agreed structural agenda is being implemented however with delays.

**28. The program is also delivering good results.** Growth has turned positive and there has been an improvement in labor market conditions, notwithstanding the significant fiscal tightening in 2015. The program has also helped improve confidence, allowing a reduction in interest rates while helping insulate Serbia from the effects of developments in Greece and in emerging markets in recent months. The current account deficit has narrowed to a sustainable level, helped by strong export performance. Inflationary pressures remain subdued.

**29. However, this good performance remains highly vulnerable to downside risks.** Policy slippages and delays in structural reforms would damage growth prospects and defeat the central objective of restoring fiscal sustainability and placing the (still rising) public debt onto a downward path. On the external front, downside risks could arise from renewed regional uncertainties, further weakness in euro area growth, commodity price increases or changing external monetary policy conditions.

**30. Fiscal over-performance is encouraging but should be utilized with caution.** More than half the expected deficit improvement in 2015, compared to the original program, arises from one-off revenues and an unwelcome shortfall in capital expenditure. The authorities' commitment to assign over-performance in 2015 to debt reduction is welcome. Looking forward, the space for permanent current expenditure increases—such as the targeted wage and pension increases favored by the authorities—appears limited, although staff will make a final assessment in the context of the third review taking into account progress toward meeting the fiscal and debt objectives of the program. Any wage increases in 2016 should be contingent on progress in public sector rightsizing and consistent with the gradual transition to the new wage system. Also, execution of capital expenditure needs to be improved, including through the authorities' efforts to improve project planning.

**31. Gradual monetary easing should continue.** The still low inflation and ongoing fiscal consolidation create space for further relaxing monetary conditions to support credit growth, while taking account of external conditions. Staff welcomes NBS's commitment to the inflation targeting regime and exchange rate flexibility.

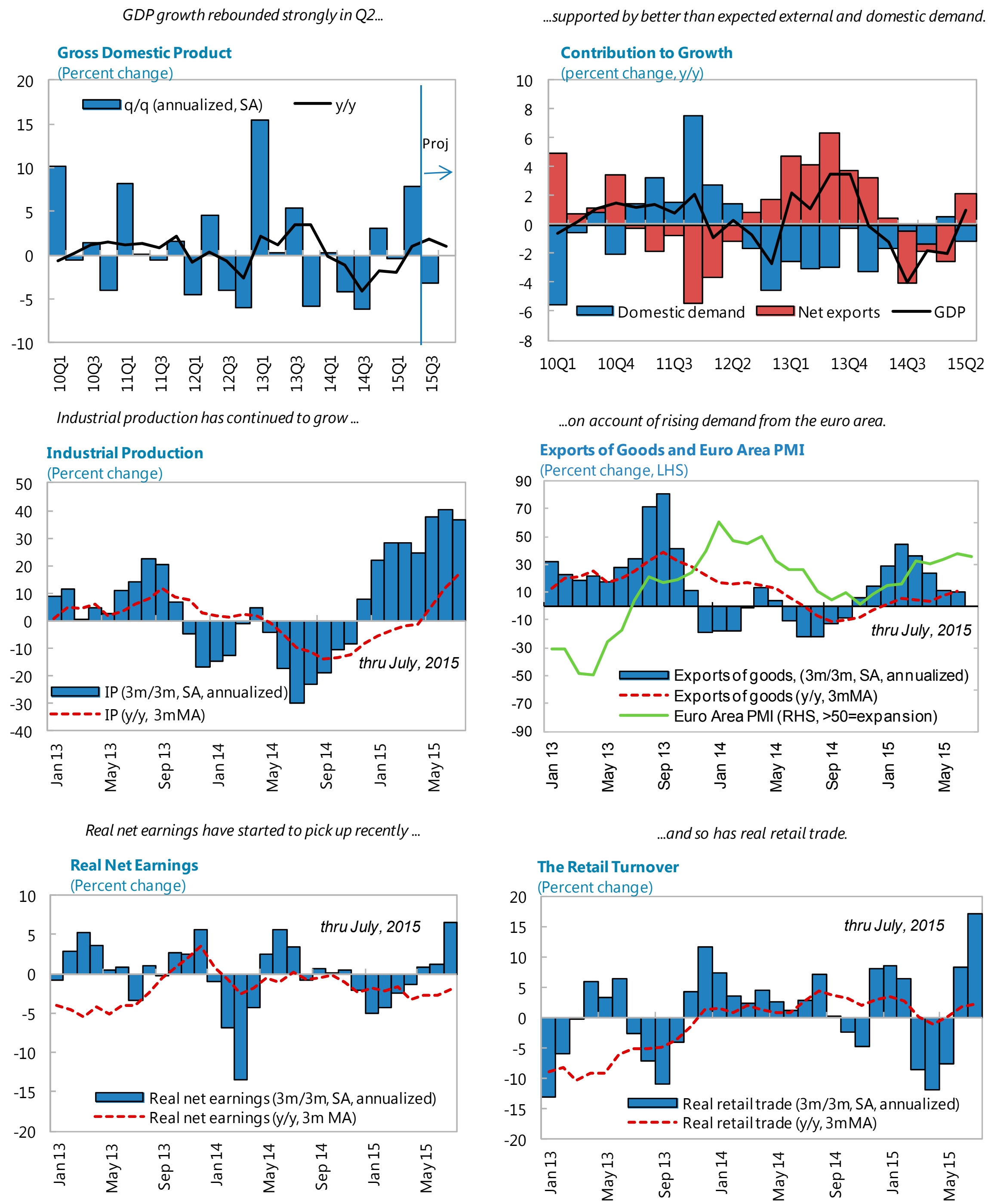
**32. The financial sector agenda is important to maintain financial stability and strengthen bank intermediation.** The comprehensive strategy to resolve NPLs and the (slightly delayed) completion of the SDS are milestones in improving banking sector soundness—but both require determined follow-up and implementation in coming months. In this context, staff welcomes the authorities' intentions to organize implementation monitoring via the NPL Working Group, led by the Ministry of Finance.

**33. Continued efforts in implementing agreed structural reforms are key to reducing fiscal risks and support growth.** So far, the structural agenda has (appropriately) been focused largely on developing strategies and action plans across the full range of public institutions and state-owned enterprises, supported by the IFIs and other consultants. While there have been delays, mainly related to limited technical capacity, the overall scope and progress of this work has been impressive. Looking forward, the priority will increasingly shift to implementation of these plans – which is likely to be even more challenging from both a technical and political perspective. While some delays in particular areas are to be expected, the achievement of program objectives will depend critically on the authorities' success in moving the broad reform agenda forward convincingly.

**34. The authorities need to remain vigilant in view of a potential resurgence of external risk, including from Greece.** While direct exposures to Greece are negligible, the banking system is susceptible to spillovers via Greek-owned bank subsidiaries, together representing about 12 percent of banking system assets. To date risks have been mitigated by large foreign exchange reserves and a well-capitalized and liquid banking system, with the Fund arrangement providing an additional buffer in case of negative shocks. Along with other external risks from emerging markets, U.S. monetary policy and the flow of migrants, the authorities need to monitor developments closely and prepare in-depth contingency plans with a particular view towards the protection of public finances.

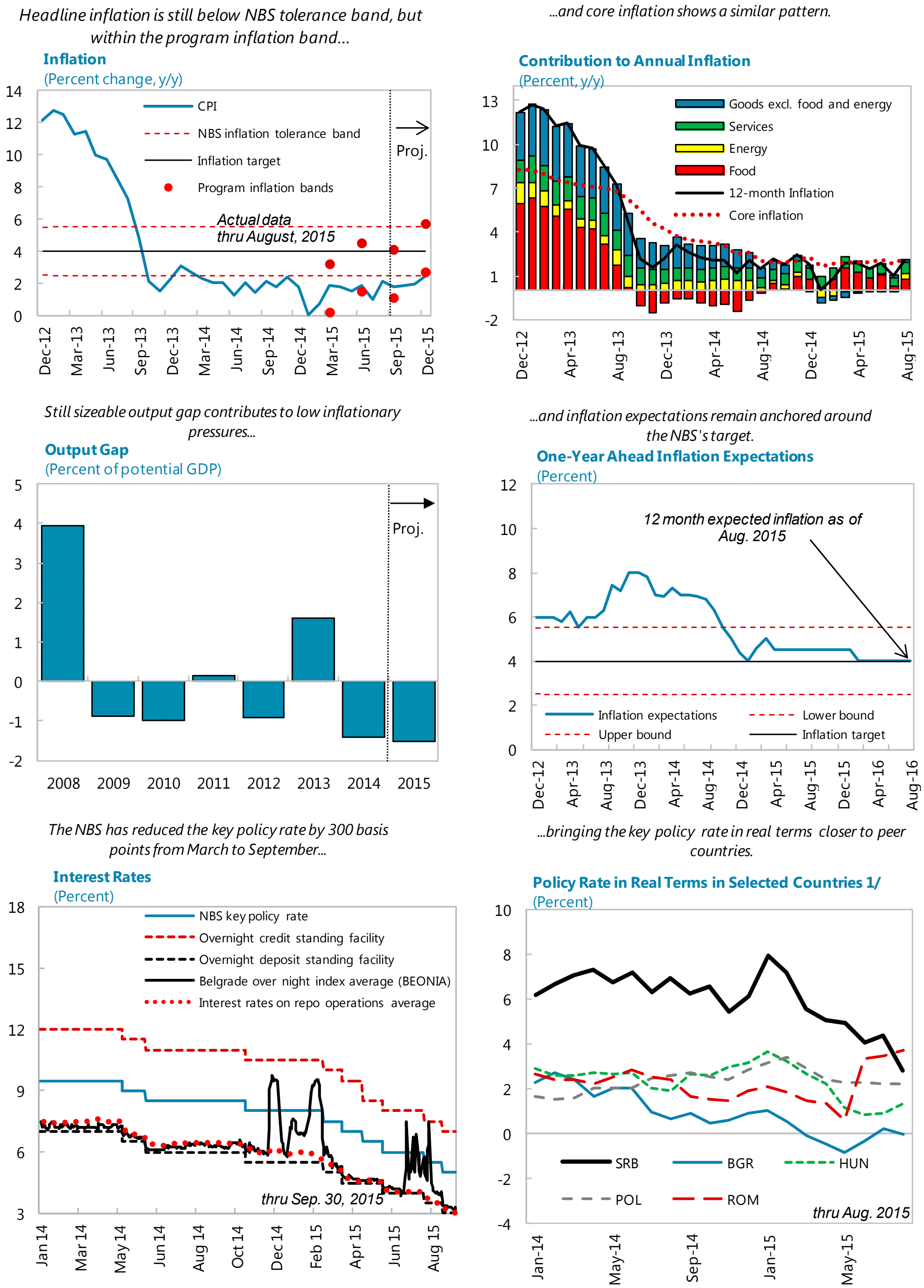
**35. Staff supports the authorities' request for the completion of the Second Review under the Stand-By Arrangement,** given the program performance so far and the policy commitments going forward. Staff also supports the request for a waiver of applicability with respect to end-September performance criteria, given that final data are not yet available and there are no indications that these criteria have not been met.

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




Sources: Haver, SORS and IMF staff calculations.

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

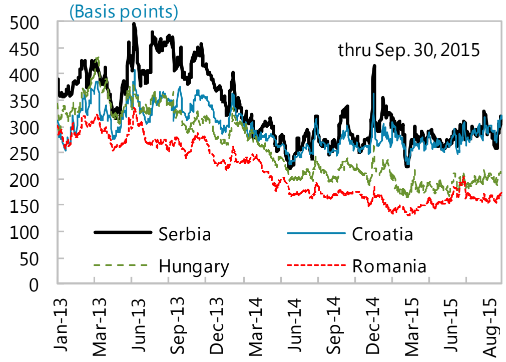



Sources: Haver; Bloomberg; National Bank of Serbia (NBS); SORS; and IMF staff estimates and projections.
1/ Nominal policy rate adjusted by inflation over the past 12 months.

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

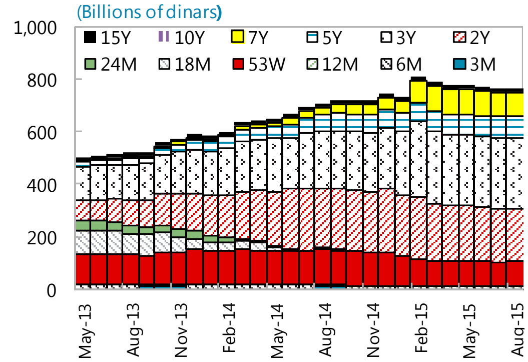
*The EMBI spread increased in the summer, following the trends in the region.*

**Sovereign Risk -EMBI spreads**
(Basis points)



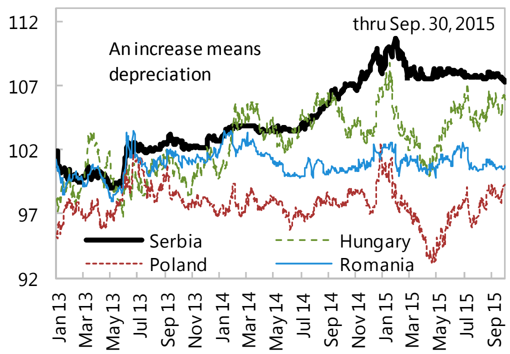

*The authorities continued to lengthen the maturity of domsetic securities.*

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



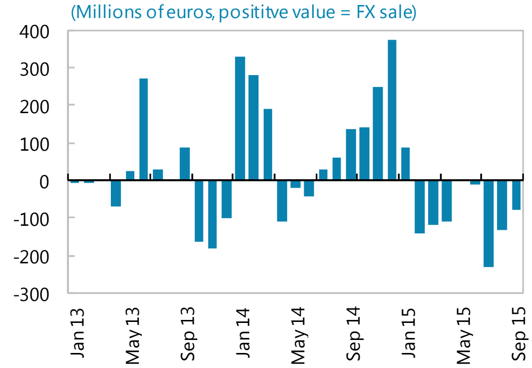

*Appreciation pressures in 2015...*

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



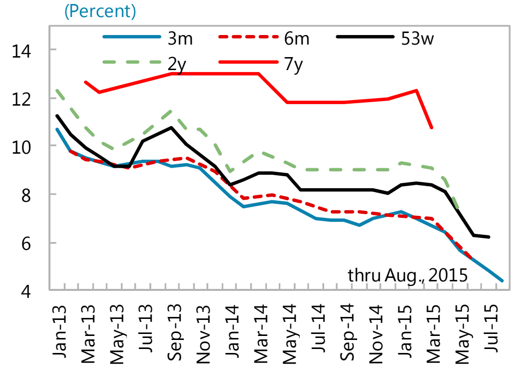

*...prompted NBS purchases of FX from the market.*

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



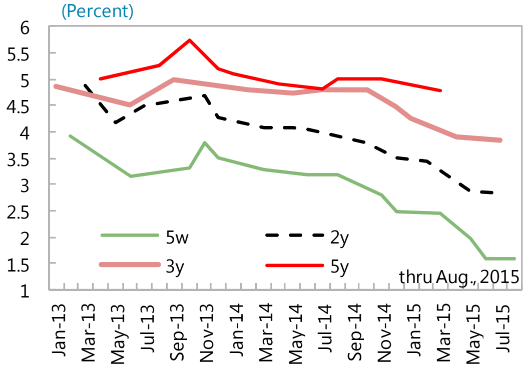
*Yields on domestic securities have been declining in the dinar segment of the market...*

**Yields on Dinar-Denominated Domestic Securities**
(Percent)



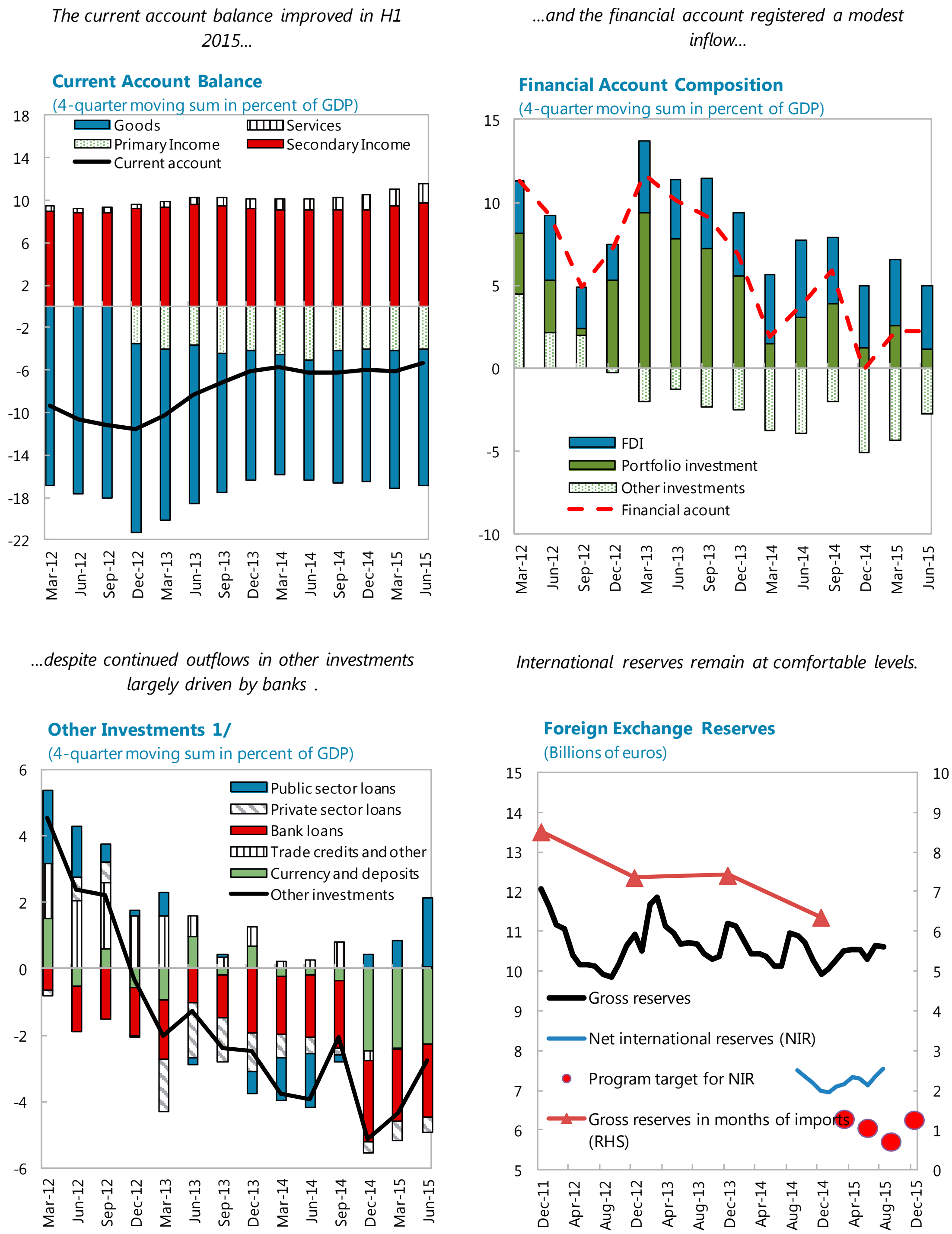

*...as well as in euro-denominated segment of the market.*

**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.

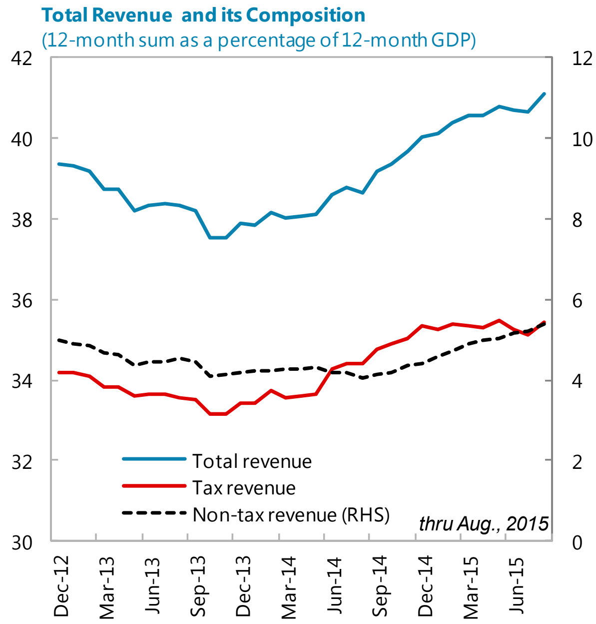
## Figure 4. Serbia: Balance of Payments and NIR, 2012–15



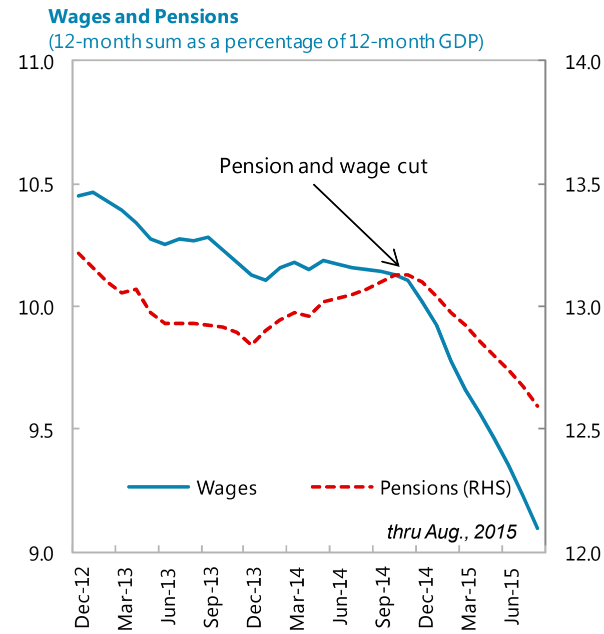

Sources: Haver; and IMF staff calculations.
1/ BPM5 data spliced with BPM6 going forward starting March 2013.

## Figure 5. Serbia: Fiscal Developments, 2012–15

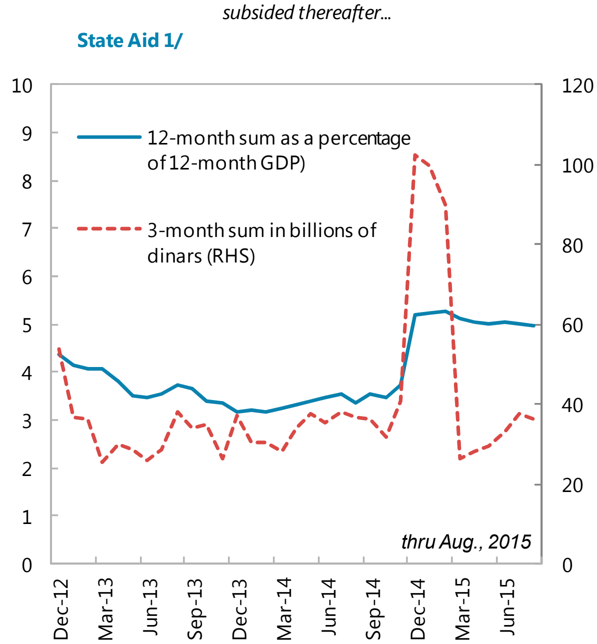
*Revenues have been increasing as a share of GDP, with non-tax revenue continuing to play an important role…*



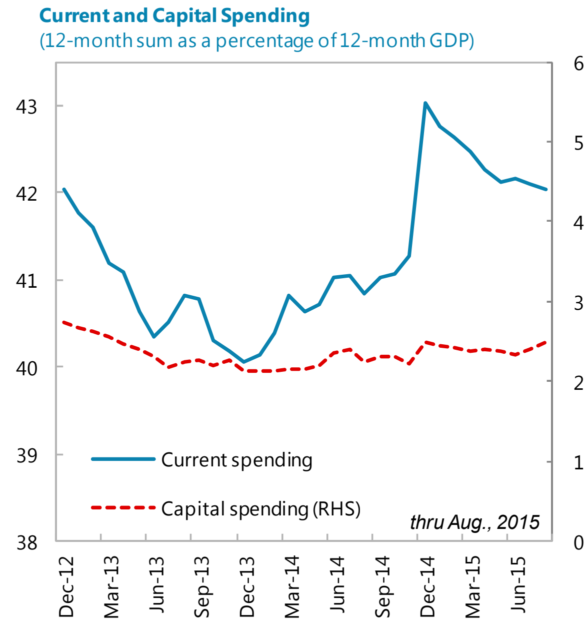

*…while wage and pension expenses are falling as a share of GDP.*




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




*…supporting the adjustment of current spending.*




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 |
|---|---|---|---|---|---|---|---|
| | | | | | 1st rev. | Proj. | Proj. |
| | | | (Percent change, unless otherwise indicated) | | | | |
| Real sector | | | | | | | |
| Real GDP | 1.4 | -1.0 | 2.6 | -1.8 | 0.0 | 0.5 | 1.5 |
| Real domestic demand (absorption) | 3.1 | -0.5 | -1.9 | -1.5 | -2.1 | -0.1 | 0.9 |
| Consumer prices (average) | 11.1 | 7.3 | 7.7 | 2.1 | 2.2 | 1.6 | 3.4 |
| GDP deflator | 9.6 | 6.3 | 5.4 | 1.9 | 3.0 | 2.0 | 2.9 |
| Unemployment rate (in percent) 1/ | 23.6 | 24.6 | 23.0 | 19.7 | ... | 19.2 | ... |
| Nominal GDP (in billions of dinars) 2/ | 3,408 | 3,584 | 3,876 | 3,878 | 3,994 | 3,976 | 4,153 |
| | | | (Percent of GDP) | | | | |
| General government finances | | | | | | | |
| Revenue | 38.2 | 39.4 | 37.9 | 40.0 | 38.9 | 40.1 | 39.0 |
| Expenditure | 43.1 | 46.6 | 43.5 | 46.7 | 44.2 | 44.1 | 42.9 |
| Current | 38.9 | 42.5 | 40.8 | 43.0 | 40.3 | 40.6 | 39.3 |
| Capital and net lending | 4.1 | 3.8 | 2.5 | 2.9 | 3.1 | 2.8 | 2.9 |
| Amortization of called guarantees | 0.2 | 0.3 | 0.2 | 0.8 | 0.8 | 0.7 | 0.7 |
| Fiscal balance 3/ | -4.9 | -7.2 | -5.6 | -6.7 | -5.3 | -4.0 | -3.9 |
| Primary fiscal balance (cash basis) | -3.6 | -5.3 | -3.2 | -3.7 | -1.9 | -0.6 | 0.0 |
| Structural primary fiscal balance 4/ | -3.6 | -4.0 | -3.2 | -2.5 | -0.7 | -0.3 | 0.6 |
| Gross debt | 46.6 | 58.3 | 61.4 | 72.2 | 77.3 | 76.7 | 78.4 |
| | | | (End of period 12-month change, percent) | | | | |
| Monetary sector | | | | | | | |
| Money (M1) | 16.8 | 3.8 | 23.7 | 9.7 | 13.4 | 9.4 | 11.4 |
| Broad money (M2) | 10.4 | 9.2 | 4.2 | 8.3 | 5.9 | 5.0 | 6.7 |
| Domestic credit to non-government 5/ | 8.1 | 3.3 | -5.1 | -1.0 | -1.1 | -0.9 | -0.4 |
| | | | (Period average, percent) | | | | |
| Interest rates (dinar) | | | | | | | |
| NBS key policy rate 6/ | 11.5 | 10.1 | 11.0 | 9.0 | 7.8 | 6.8 | ... |
| Interest rate on new FX and FX-indexed loans 6/ | 8.2 | 8.0 | 7.3 | 6.0 | 5.4 | 5.2 | ... |
| Interest rate on new dinar deposits 6/ | 10.8 | 9.9 | 9.3 | 7.1 | 6.3 | 6.0 | ... |
| | | | (Percent of GDP, unless otherwise indicated) | | | | |
| Balance of payments | | | | | | | |
| Current account balance | -8.6 | -11.5 | -6.1 | -6.0 | -4.3 | -4.0 | -3.8 |
| Exports of goods | 25.3 | 26.5 | 30.8 | 32.2 | 34.2 | 35.1 | 36.7 |
| Imports of goods | -41.2 | -44.2 | -42.9 | -44.6 | -44.9 | -46.2 | -47.5 |
| Trade of goods balance | -15.9 | -17.8 | -12.1 | -12.4 | -10.7 | -11.1 | -10.8 |
| Capital and financial account balance | 13.3 | 7.9 | 9.4 | 1.4 | 6.9 | 6.2 | 5.8 |
| External debt (percent of GDP) | 74.5 | 84.3 | 79.3 | 83.8 | 86.9 | 86.3 | 85.9 |
| *of which:* Private external debt | 40.0 | 42.7 | 36.8 | 35.2 | 32.3 | 32.7 | 29.5 |
| Gross official reserves (in billions of euro) | 12.1 | 10.9 | 11.2 | 9.9 | 10.6 | 10.8 | 11.4 |
| (in months of prospective imports) | 8.5 | 7.4 | 7.4 | 6.4 | 6.7 | 6.6 | 6.6 |
| (percent of short-term debt) | 322.2 | 207.5 | 269.4 | 259.8 | 307.6 | 320.8 | 279.2 |
| (percent of broad money, M2) | 85.2 | 76.8 | 76.2 | 65.8 | 67.1 | 68.8 | 69.5 |
| (percent of risk-weighted metric) | ... | ... | 229.4 | 201.5 | 211.1 | 216.3 | 216.0 |
| Exchange rate (dinar/euro, period average) 7/ | 102.0 | 113.0 | 113.1 | 117.2 | 121.0 | 120.7 | ... |
| REER (annual average change, in percent; + indicates appreciation) | 9.3 | -7.4 | 7.8 | -2.0 | -2.1 | -2.1 | 2.8 |
| Social indicators | | | | | | | |
| Per capita GDP (in US$) | 6,426 | 5,658 | 6,354 | 6,123 | 5,216 | 5,102 | 5,268 |
| 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). 2015 value shows period average for the first half of the year.
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 as well as one-offs.
5/ At program exchange rates.
6/ 2015 values show period average for January-August 2015.
7/ 2015 values show period average for Q1-Q3.

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

| | 2012 | 2013 | 2014 | 2015 | | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | (percent change) | | | | | | |
| Real sector | | | | | | | | | | |
| GDP growth | -1.0 | 2.6 | -1.8 | 0.0 | 0.5 | 1.5 | 2.0 | 3.5 | 3.5 | 4.0 |
| Domestic demand (contribution) | -0.6 | -2.2 | -1.6 | -2.3 | -0.1 | 1.0 | 2.1 | 3.1 | 4.0 | 4.7 |
| Net exports (contribution) | -0.4 | 4.8 | -0.2 | 2.3 | 0.6 | 0.5 | -0.1 | 0.4 | -0.5 | -0.7 |
| Consumer price inflation (average) | 7.3 | 7.7 | 2.1 | 2.2 | 1.6 | 3.4 | 4.0 | 4.0 | 4.0 | 4.0 |
| Consumer price inflation (end of period) | 12.2 | 2.2 | 1.8 | 3.8 | 2.5 | 4.1 | 4.0 | 4.0 | 4.0 | 4.0 |
| Output gap (in percent of potential) | -0.9 | 1.6 | -1.4 | -2.0 | -1.5 | -1.2 | -0.8 | -0.4 | -0.2 | 0.0 |
| Potential GDP growth | 0.0 | 0.0 | 1.2 | 0.6 | 0.6 | 1.2 | 1.6 | 3.1 | 3.3 | 3.8 |
| Domestic credit to non-gov. (program exchange rate) 1/ | 3.3 | -5.1 | -1.0 | -1.1 | -0.9 | -0.4 | 7.5 | 8.3 | 9.7 | 10.7 |
| | | | | (percent of GDP, unless otherwise indicated) | | | | | | |
| General government | | | | | | | | | | |
| Revenue | 39.4 | 37.9 | 40.0 | 38.9 | 40.1 | 39.0 | 38.3 | 37.9 | 37.8 | 37.7 |
| Expenditure | 46.6 | 43.5 | 46.7 | 44.2 | 44.1 | 42.9 | 41.3 | 40.2 | 39.9 | 39.6 |
| Current | 42.5 | 40.8 | 43.0 | 40.3 | 40.6 | 39.3 | 37.6 | 36.6 | 36.3 | 36.1 |
| *of which:* Wages and salaries | 10.5 | 10.1 | 10.0 | 9.0 | 9.1 | 8.3 | 7.5 | 7.3 | 7.2 | 7.1 |
| *of which:* Pensions | 13.2 | 12.8 | 13.1 | 12.3 | 12.4 | 12.0 | 11.5 | 11.1 | 11.0 | 11.0 |
| *of which:* Goods and services | 8.0 | 7.2 | 8.0 | 7.6 | 7.7 | 7.6 | 7.3 | 7.3 | 7.3 | 7.3 |
| Capital and net lending | 3.8 | 2.5 | 2.9 | 3.1 | 2.8 | 2.9 | 3.1 | 3.2 | 3.2 | 3.2 |
| Amortization of called guarantees | 0.3 | 0.2 | 0.8 | 0.8 | 0.7 | 0.7 | 0.5 | 0.4 | 0.4 | 0.4 |
| Fiscal balance 2/ | -7.2 | -5.6 | -6.7 | -5.3 | -4.0 | -3.9 | -3.0 | -2.3 | -2.1 | -2.0 |
| *change (+ = consolidation)* | *-2.3* | *1.6* | *-1.0* | *1.3* | *2.7* | *0.1* | *0.9* | *0.7* | *0.2* | *0.1* |
| Primary fiscal balance | -5.3 | -3.2 | -3.7 | -1.9 | -0.6 | 0.0 | 1.0 | 1.8 | 1.9 | 1.9 |
| *change (+ = consolidation)* | *-1.8* | *2.1* | *-0.5* | *1.8* | *3.1* | *0.6* | *1.0* | *0.7* | *0.2* | *0.0* |
| One-off fiscal items, net 3/ | -1.0 | -0.6 | -0.7 | -0.5 | 0.2 | -0.2 | -0.4 | 0.0 | 0.0 | 0.0 |
| Structural primary balance | -4.0 | -3.2 | -2.5 | -0.7 | -0.3 | 0.6 | 1.7 | 1.9 | 2.0 | 1.9 |
| *change (+ = consolidation)* | *-0.4* | *0.9* | *0.7* | *1.7* | *2.1* | *0.9* | *1.1* | *0.2* | *0.1* | *-0.1* |
| Gross debt | 58.3 | 61.4 | 72.2 | 77.3 | 76.7 | 78.4 | 77.7 | 75.2 | 71.8 | 68.6 |
| Effective interest rate on government borrowing (percent) | 3.8 | 4.3 | 4.5 | 4.9 | 4.8 | 5.3 | 5.5 | 5.6 | 5.8 | 5.8 |
| Domestic borrowing (including FX) | 4.9 | 5.6 | 5.9 | 6.3 | 6.2 | 6.9 | 7.1 | 7.9 | 8.3 | 8.4 |
| External borrowing | 2.9 | 3.3 | 3.5 | 3.9 | 3.8 | 4.4 | 4.6 | 4.5 | 4.6 | 4.7 |
| | | | | (percent of GDP, unless otherwise indicated) | | | | | | |
| Balance of payments | | | | | | | | | | |
| Current account | -11.5 | -6.1 | -6.0 | -4.3 | -4.0 | -3.8 | -3.9 | -3.9 | -4.0 | -4.0 |
| *of which:* Trade balance | -17.8 | -12.1 | -12.4 | -10.7 | -11.1 | -10.8 | -10.8 | -10.3 | -10.3 | -10.1 |
| *of which:* Current transfers, net (excl. grants) | 9.0 | 9.1 | 8.8 | 8.6 | 9.2 | 9.2 | 9.2 | 8.2 | 8.3 | 8.0 |
| Capital and financial account | 7.9 | 9.4 | 1.4 | 6.9 | 6.2 | 5.8 | 4.2 | 4.4 | 3.1 | 2.6 |
| *of which:* Foreign direct investment | 2.1 | 3.6 | 3.7 | 3.9 | 4.0 | 3.9 | 4.0 | 4.2 | 4.2 | 4.2 |
| External debt (end of period) | 84.3 | 79.3 | 83.8 | 86.9 | 86.3 | 85.9 | 82.6 | 77.5 | 71.4 | 64.9 |
| *of which:* Private external debt | 42.7 | 36.8 | 35.2 | 32.3 | 32.7 | 29.5 | 27.5 | 25.1 | 22.7 | 20.6 |
| Gross official reserves | | | | | | | | | | |
| (in billions of euros) | 10.9 | 11.2 | 9.9 | 10.6 | 10.8 | 11.4 | 11.6 | 11.7 | 11.3 | 10.8 |
| (in percent of short-term external debt) | 207.5 | 269.4 | 259.8 | 307.6 | 320.8 | 279.2 | 241.2 | 284.1 | 213.3 | 202.2 |
| REER (ann. av. change; + = appreciation) | -7.4 | 7.8 | -2.0 | -2.1 | -2.1 | 2.8 | 1.4 | 1.6 | 1.5 | 1.5 |

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

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

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 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | (Percent change, unless otherwise noted) | | | | | | |
| **Real** | | | | | | | | | | |
| Gross Domestic Product (GDP) | -1.0 | 2.6 | -1.8 | 0.0 | 0.5 | 1.5 | 2.0 | 3.5 | 3.5 | 4.0 |
| Domestic demand | -0.5 | -1.9 | -1.5 | -2.1 | -0.1 | 0.9 | 1.9 | 2.8 | 3.7 | 4.2 |
| Consumption | -1.2 | -0.7 | -1.0 | -3.4 | -1.2 | 0.1 | 0.6 | 2.2 | 3.1 | 3.7 |
| Non-government | -2.0 | -0.6 | -1.3 | -3.0 | -0.8 | 0.5 | 1.5 | 1.5 | 2.6 | 3.0 |
| Government | 1.9 | -1.1 | 0.1 | -5.2 | -3.0 | -1.8 | -3.1 | 5.4 | 5.3 | 6.6 |
| Investment | 2.9 | -7.2 | -3.5 | 4.6 | 5.5 | 4.7 | 7.4 | 4.9 | 5.8 | 6.3 |
| Gross fixed capital formation | 19.1 | -16.3 | -2.7 | 4.8 | 5.6 | 4.8 | 7.4 | 5.2 | 5.9 | 6.4 |
| Non-government | 21.3 | -13.0 | -4.8 | 2.5 | 4.5 | 5.0 | 6.5 | 5.0 | 6.0 | 6.5 |
| Government | 7.6 | -35.8 | 13.6 | 19.6 | 12.5 | 3.3 | 13.2 | 6.7 | 5.2 | 5.7 |
| Exports of goods and services | 0.8 | 21.3 | 3.9 | 7.9 | 9.0 | 4.8 | 6.7 | 8.2 | 6.7 | 8.1 |
| Imports of goods and services | 1.4 | 5.0 | 3.3 | 2.0 | 5.9 | 3.0 | 5.6 | 6.0 | 6.5 | 7.9 |
| | | | | (contributions to GDP, percent) | | | | | | |
| Gross Domestic Product (GDP) | -1.0 | 2.6 | -1.8 | 0.0 | 0.5 | 1.5 | 2.0 | 3.5 | 3.5 | 4.0 |
| Domestic demand (absorption) | -0.6 | -2.2 | -1.6 | -2.3 | -0.1 | 1.0 | 2.1 | 3.1 | 4.0 | 4.7 |
| Net exports of goods and services | -0.4 | 4.8 | -0.2 | 2.3 | 0.6 | 0.5 | -0.1 | 0.4 | -0.5 | -0.7 |
| Consumption | -1.2 | -0.6 | -1.0 | -3.2 | -1.2 | 0.0 | 0.6 | 2.0 | 2.7 | 3.3 |
| Non-government | -1.6 | -0.4 | -1.0 | -2.2 | -0.6 | 0.4 | 1.1 | 1.1 | 1.9 | 2.2 |
| Government | 0.4 | -0.2 | 0.0 | -1.0 | -0.6 | -0.3 | -0.5 | 0.9 | 0.9 | 1.1 |
| Investment | 0.6 | -1.5 | -0.7 | 0.9 | 1.0 | 0.9 | 1.5 | 1.1 | 1.3 | 1.4 |
| Gross fixed capital formation | 3.7 | -3.8 | -0.5 | 0.9 | 1.0 | 0.9 | 1.5 | 1.1 | 1.3 | 1.4 |
| Non-government | 3.4 | -2.5 | -0.8 | 0.4 | 0.7 | 0.8 | 1.1 | 0.9 | 1.1 | 1.2 |
| Government | 0.2 | -1.2 | 0.3 | 0.5 | 0.3 | 0.1 | 0.4 | 0.2 | 0.2 | 0.2 |
| 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 | 3.5 | 3.9 | 2.3 | 3.3 | 4.2 | 3.6 | 4.5 |
| Imports of goods and services | 0.7 | 2.6 | 1.8 | 1.1 | 3.3 | 1.8 | 3.4 | 3.7 | 4.1 | 5.2 |
| | | | | (Percent change, unless otherwise noted) | | | | | | |
| **Nominal** | | | | | | | | | | |
| Gross Domestic Product (GDP) | 5.2 | 8.2 | 0.0 | 3.0 | 2.5 | 4.5 | 5.7 | 7.7 | 7.7 | 8.3 |
| Domestic demand (absorption), contribution to GDP growth | 7.3 | 3.1 | -0.7 | 1.4 | 1.7 | 4.2 | 6.1 | 7.6 | 8.3 | 8.7 |
| Net exports of goods and services, contribution to GDP growth | -2.1 | 5.1 | 0.8 | 1.6 | 0.8 | 0.2 | -0.4 | 0.2 | -0.6 | -0.4 |
| Consumption | 5.6 | 5.2 | 1.4 | -1.0 | -0.4 | 3.1 | 4.3 | 5.8 | 6.7 | 7.3 |
| Non-government | 5.2 | 5.6 | 1.3 | -0.9 | 0.8 | 3.9 | 5.6 | 5.6 | 6.7 | 7.2 |
| Government | 7.4 | 3.5 | 2.3 | -1.4 | -5.6 | -0.6 | -1.9 | 6.7 | 6.7 | 8.0 |
| Investment | 9.9 | -9.1 | -11.8 | 14.7 | 13.7 | 8.1 | 12.5 | 12.9 | 12.4 | 11.4 |
| Gross fixed capital formation | 21.1 | -11.9 | -0.4 | 8.6 | 6.7 | 7.2 | 9.9 | 7.7 | 8.4 | 9.0 |
| Non-government | 23.5 | -8.1 | -2.0 | 6.2 | 5.8 | 7.4 | 9.1 | 7.5 | 8.5 | 9.1 |
| Government | 7.6 | -35.8 | 13.6 | 27.3 | 13.9 | 5.6 | 15.9 | 9.2 | 7.7 | 8.3 |
| Exports of goods and services | 14.3 | 20.7 | 7.7 | 8.6 | 10.8 | 9.1 | 8.1 | 8.9 | 7.5 | 7.8 |
| Imports of goods and services | 14.2 | 4.7 | 4.6 | 4.0 | 7.4 | 7.3 | 7.6 | 7.4 | 7.5 | 7.5 |
| **Memorandum items:** | | | | | | | | | | |
| GDP deflator (percent) | 6.3 | 5.4 | 1.9 | 3.0 | 2.0 | 2.9 | 3.6 | 4.1 | 4.1 | 4.1 |

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

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

(In billions of euros)

| | 2012 | 2013 | 2014 | 2015 | | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Prel. | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | | (Billions of euros) | | | | | |
| Current account balance | -3.6 | -2.1 | -2.0 | -1.4 | -1.3 | -1.3 | -1.4 | -1.5 | -1.6 | -1.7 |
| Trade of goods balance | -5.6 | -4.2 | -4.1 | -3.5 | -3.6 | -3.6 | -3.8 | -3.9 | -4.1 | -4.4 |
| Exports of goods | 8.4 | 10.5 | 10.6 | 11.3 | 11.5 | 12.4 | 13.2 | 14.3 | 15.2 | 16.2 |
| Imports of goods | -14.0 | -14.7 | -14.8 | -14.8 | -15.2 | -16.0 | -17.0 | -18.1 | -19.3 | -20.6 |
| Services balance | 0.1 | 0.3 | 0.5 | 0.9 | 0.7 | 0.8 | 0.9 | 1.0 | 1.1 | 1.2 |
| Exports of nonfactor services | 3.1 | 3.4 | 3.8 | 4.1 | 4.2 | 4.5 | 4.8 | 5.2 | 5.6 | 5.9 |
| Imports of nonfactor services | -3.0 | -3.1 | -3.3 | -3.3 | -3.5 | -3.7 | -3.9 | -4.2 | -4.5 | -4.8 |
| Income balance | -1.1 | -1.4 | -1.3 | -1.7 | -1.5 | -1.7 | -1.8 | -1.8 | -1.9 | -2.0 |
| Net interest | -0.8 | -0.9 | -0.9 | -1.0 | -1.0 | -1.0 | -1.1 | -1.1 | -1.1 | -1.1 |
| Current transfer balance | 2.9 | 3.2 | 3.0 | 3.0 | 3.1 | 3.2 | 3.3 | 3.2 | 3.3 | 3.5 |
| Others, including private remittances | 2.9 | 3.1 | 2.9 | 2.8 | 3.0 | 3.1 | 3.2 | 3.1 | 3.3 | 3.5 |
| Capital and financial account balance 1/ | 2.5 | 3.2 | 0.5 | 2.3 | 2.1 | 2.0 | 1.5 | 1.6 | 1.2 | 1.1 |
| 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 | 1.4 | 0.4 | 1.3 | 0.7 | 0.7 | 0.1 | 0.1 |
| of which: debt liabilities | 1.7 | 2.0 | 0.4 | 1.4 | 0.4 | 1.3 | 0.7 | 0.7 | 0.1 | 0.1 |
| Other investment balance | 0.2 | 0.1 | -1.1 | -0.4 | 0.3 | -0.7 | -0.6 | -0.6 | -0.5 | -0.8 |
| Public sector 1/ 2/ | 0.5 | 0.4 | 0.7 | 0.7 | 1.3 | 0.1 | -0.3 | -0.4 | -0.2 | -0.6 |
| Domestic banks | -0.4 | -0.5 | -1.5 | -0.7 | -0.7 | -0.6 | -0.1 | 0.0 | 0.0 | 0.0 |
| Other private sector 3/ | 0.1 | 0.1 | -0.4 | -0.4 | -0.3 | -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 | 0.9 | 0.7 | 0.7 | 0.1 | 0.2 | -0.4 | -0.6 |
| Financing | 0.9 | -1.3 | 1.2 | -0.9 | -0.7 | -0.7 | -0.1 | -0.2 | 0.4 | 0.6 |
| Gross international reserves (increase, -) | 1.1 | -0.7 | 1.8 | -0.7 | -0.6 | -0.7 | -0.1 | -0.2 | 0.4 | 0.6 |
| 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/ Excluding net use of IMF resources.

2/ Includes SDR allocations in 2009.

3/ Includes trade credits (net).

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

| | 2012 | 2013 | 2014 | 2015 | | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Prel. | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | (Percent of GDP) | | | | | | | | | |
| Current account balance | -11.5 | -6.1 | -6.0 | -4.3 | -4.0 | -3.8 | -3.9 | -3.9 | -4.0 | -4.0 |
| Trade of goods balance | -17.8 | -12.1 | -12.4 | -10.7 | -11.1 | -10.8 | -10.8 | -10.3 | -10.3 | -10.1 |
| Exports of goods | 26.5 | 30.8 | 32.2 | 34.2 | 35.1 | 36.7 | 37.5 | 37.9 | 37.8 | 37.6 |
| Imports of goods | -44.2 | -42.9 | -44.6 | -44.9 | -46.2 | -47.5 | -48.3 | -48.2 | -48.1 | -47.7 |
| Services balance | 0.4 | 0.9 | 1.4 | 2.7 | 2.2 | 2.5 | 2.6 | 2.7 | 2.7 | 2.7 |
| Income balance | -3.4 | -4.1 | -4.1 | -5.3 | -4.7 | -5.1 | -5.1 | -4.9 | -4.8 | -4.6 |
| Current transfer balance | 9.3 | 9.2 | 9.1 | 9.1 | 9.6 | 9.6 | 9.5 | 8.5 | 8.3 | 8.0 |
| Capital and financial account balance 2/ | 7.9 | 9.4 | 1.4 | 6.9 | 6.2 | 5.8 | 4.2 | 4.4 | 3.1 | 2.6 |
| Foreign direct investment balance | 2.1 | 3.6 | 3.7 | 3.9 | 4.0 | 3.9 | 4.0 | 4.2 | 4.2 | 4.2 |
| Portfolio investment balance | 5.3 | 5.6 | 1.1 | 4.2 | 1.3 | 4.0 | 1.9 | 1.9 | 0.2 | 0.3 |
| Other investment balance | 0.5 | 0.3 | -3.4 | -1.2 | 0.9 | -2.0 | -1.7 | -1.7 | -1.3 | -1.9 |
| Public sector 2/ 3/ | 1.5 | 1.2 | 2.2 | 2.0 | 3.8 | 0.2 | -0.9 | -1.1 | -0.5 | -1.3 |
| Domestic banks | -1.3 | -1.3 | -4.5 | -2.1 | -2.1 | -1.6 | -0.2 | 0.0 | 0.0 | 0.0 |
| Other private sector 4/ | 0.4 | 0.4 | -1.1 | -1.1 | -0.9 | -0.6 | -0.6 | -0.6 | -0.8 | -0.5 |
| 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 | 2.6 | 2.2 | 2.0 | 0.3 | 0.5 | -0.9 | -1.4 |
| Memorandum items: | | | | | | | | | | |
| Export growth | -0.5 | 25.6 | 1.0 | 6.0 | 8.4 | 7.3 | 6.7 | 8.0 | 6.6 | 6.9 |
| Import growth | 2.0 | 4.7 | 0.4 | 0.5 | 2.9 | 5.5 | 6.2 | 6.5 | 6.6 | 6.7 |
| Export volume growth | -0.8 | 21.9 | 1.7 | 7.2 | 8.4 | 4.8 | 6.7 | 8.2 | 6.7 | 8.1 |
| Import volume growth | 0.8 | 2.7 | 1.9 | 2.6 | 5.5 | 3.0 | 5.6 | 6.0 | 6.5 | 7.9 |
| Trading partner import growth | -0.1 | 1.6 | 3.5 | 0.7 | 2.8 | 5.2 | 4.8 | 4.8 | 4.8 | 4.8 |
| Export prices growth | 0.3 | 3.0 | -0.7 | -1.1 | 0.0 | 2.4 | -0.1 | -0.2 | -0.1 | -1.1 |
| Import prices growth | 1.2 | 2.0 | -1.5 | -2.0 | -2.5 | 2.5 | 0.6 | 0.4 | 0.2 | -1.1 |
| Change in terms of trade | -0.9 | 1.0 | 0.8 | 0.9 | 2.6 | -0.1 | -0.7 | -0.6 | -0.3 | 0.0 |
| Gross official reserves (in billions of euro) | 10.9 | 11.2 | 9.9 | 10.6 | 10.8 | 11.4 | 11.6 | 11.7 | 11.3 | 10.8 |
| (In months of prospective imports of GNFS) | 7.4 | 7.4 | 6.4 | 6.7 | 6.6 | 6.6 | 6.2 | 5.9 | 5.4 | 4.8 |
| (in percent of short-term debt) | 207.5 | 269.4 | 259.8 | 307.6 | 320.8 | 279.2 | 241.2 | 284.1 | 213.3 | 202.2 |
| (in percent of broad money, M2) | 76.8 | 76.2 | 65.8 | 67.1 | 68.8 | 69.5 | 66.6 | 63.6 | 57.6 | 50.8 |
| (in percent of risk-weighted metric) | ... | 229.4 | 201.5 | 211.1 | 216.3 | 216.0 | 208.3 | 211.4 | 193.4 | 183.3 |

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
(In billions of euros)

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Prel. | | | Proj. | | | |
| 1. Total financing requirements | 6.2 | 8.0 | 4.3 | 5.7 | 5.3 | 5.6 | 6.4 | 5.4 | 6.5 |
| Current account deficit | 3.6 | 2.1 | 2.0 | 1.3 | 1.3 | 1.4 | 1.5 | 1.6 | 1.7 |
| Debt amortization | 3.7 | 5.3 | 4.2 | 3.8 | 3.4 | 4.1 | 4.8 | 4.1 | 5.3 |
| Medium and long-term debt | 3.1 | 4.8 | 4.0 | 3.7 | 3.2 | 4.0 | 4.7 | 4.0 | 5.2 |
| Public sector | 0.7 | 2.4 | 2.4 | 1.9 | 1.4 | 2.5 | 3.2 | 2.0 | 3.7 |
| Of which: IMF | 0.2 | 0.6 | 0.6 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Of which: Eurobonds | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.7 | 0.9 | 0.0 | 1.4 |
| Of which: Domestic bonds (non-residents) | n.a. | 0.9 | 1.2 | 1.1 | 0.7 | 0.8 | 1.0 | 0.7 | 0.7 |
| Commercial banks | 0.6 | 1.1 | 0.9 | 0.7 | 0.7 | 0.4 | 0.4 | 0.5 | 0.4 |
| Corporate sector | 1.8 | 1.3 | 0.7 | 1.1 | 1.1 | 1.0 | 1.1 | 1.5 | 1.1 |
| Short-term debt | 0.6 | 0.5 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Public sector | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Commercial banks | 0.6 | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Corporate sector | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in gross reserves (increase=+) | -1.1 | 0.7 | -1.8 | 0.6 | 0.7 | 0.1 | 0.2 | -0.4 | -0.6 |
| 2. Total financing sources | 6.2 | 8.0 | 4.3 | 5.7 | 5.3 | 5.6 | 6.4 | 5.4 | 6.5 |
| Capital transfers | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign direct investment (net) | 0.7 | 1.2 | 1.2 | 1.3 | 1.3 | 1.4 | 1.6 | 1.7 | 1.8 |
| Portfolio investment (net) 1/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt financing | 4.8 | 6.1 | 3.9 | 4.5 | 4.0 | 4.2 | 4.9 | 3.7 | 4.7 |
| Medium and long-term debt | 4.3 | 5.9 | 3.8 | 4.4 | 3.9 | 4.1 | 4.7 | 3.6 | 4.5 |
| Public sector 2/ | 2.1 | 4.2 | 3.0 | 3.5 | 2.8 | 2.9 | 3.5 | 1.9 | 3.3 |
| Of which: Eurobonds | 1.4 | 1.9 | 0.0 | 0.0 | 1.0 | 1.0 | 1.0 | 0.0 | 1.4 |
| Of which: Domestic bonds (non-residents) | n.a. | 1.3 | 1.6 | 1.5 | 1.1 | 1.2 | 1.6 | 0.8 | 0.8 |
| Commercial banks | 0.3 | 0.6 | 0.2 | 0.1 | 0.2 | 0.4 | 0.4 | 0.5 | 0.4 |
| Corporate sector | 1.9 | 1.2 | 0.6 | 0.8 | 0.9 | 0.8 | 0.9 | 1.2 | 0.9 |
| Short-term debt | 0.5 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Public sector | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Commercial banks | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Corporate sector | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other net capital inflows 3/ | 0.8 | 0.7 | -0.7 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| o/w trade credit and currency and deposits | 0.4 | 0.7 | 0.9 | 1.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 3. Total financing needs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Memorandum items:** | | | | | | | | | |
| Debt service | 4.6 | 6.2 | 5.0 | 4.7 | 4.4 | 5.2 | 5.8 | 5.2 | 6.4 |
| Interest | 0.8 | 0.9 | 0.8 | 0.9 | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 |
| Amortization | 3.7 | 5.3 | 4.2 | 3.8 | 3.4 | 4.1 | 4.8 | 4.1 | 5.3 |

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 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | | (Billions of RSD) | | | | | |
| Revenue | 1,411 | 1,468 | 1,552 | 1,553 | 1,595 | 1,620 | 1,679 | 1,793 | 1,926 | 2,077 |
| Taxes | 1,226 | 1,296 | 1,370 | 1,352 | 1,382 | 1,433 | 1,488 | 1,594 | 1,719 | 1,862 |
| Personal income tax | 165 | 156 | 146 | 142 | 144 | 147 | 151 | 161 | 172 | 184 |
| Social security contributions | 379 | 418 | 440 | 426 | 435 | 449 | 468 | 509 | 553 | 605 |
| Taxes on profits | 55 | 61 | 73 | 73 | 64 | 66 | 68 | 73 | 79 | 87 |
| Value-added taxes | 367 | 381 | 410 | 404 | 415 | 427 | 444 | 474 | 514 | 557 |
| Excises | 181 | 205 | 212 | 222 | 230 | 248 | 256 | 272 | 288 | 307 |
| Taxes on international trade | 36 | 33 | 31 | 30 | 33 | 34 | 36 | 37 | 40 | 43 |
| Other taxes | 43 | 43 | 57 | 56 | 62 | 62 | 64 | 68 | 73 | 79 |
| Non-tax revenue | 180 | 163 | 171 | 192 | 203 | 178 | 182 | 190 | 197 | 205 |
| Capital revenue | 1 | 5 | 2 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| Grants | 3 | 3 | 9 | 9 | 9 | 9 | 9 | 10 | 10 | 10 |
| Expenditure | 1,669 | 1,686 | 1,810 | 1,766 | 1,753 | 1,781 | 1,812 | 1,901 | 2,034 | 2,186 |
| Current expenditure | 1,523 | 1,582 | 1,669 | 1,610 | 1,612 | 1,632 | 1,651 | 1,730 | 1,851 | 1,990 |
| Wages and salaries | 375 | 393 | 389 | 360 | 360 | 345 | 328 | 346 | 365 | 393 |
| Goods and services | 287 | 278 | 310 | 303 | 305 | 316 | 321 | 347 | 374 | 404 |
| Interest | 68 | 95 | 115 | 136 | 134 | 161 | 178 | 192 | 207 | 214 |
| Subsidies | 145 | 130 | 158 | 104 | 107 | 102 | 108 | 116 | 125 | 135 |
| Transfers | 647 | 687 | 697 | 706 | 706 | 708 | 717 | 730 | 780 | 843 |
| Pensions 2/ | 474 | 498 | 508 | 491 | 493 | 498 | 503 | 527 | 562 | 608 |
| Other transfers 3/ | 174 | 189 | 189 | 214 | 214 | 210 | 214 | 203 | 218 | 235 |
| Capital expenditure | 119 | 83 | 97 | 123 | 110 | 116 | 135 | 147 | 159 | 172 |
| Net lending | 16 | 13 | 15 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |
| Amortization of activated guarantees | 11 | 9 | 30 | 31 | 28 | 30 | 23 | 21 | 21 | 21 |
| Fiscal balance | -259 | -218 | -258 | -213 | -158 | -161 | -132 | -108 | -108 | -109 |
| Financing | 259 | 218 | 258 | 213 | 158 | 161 | 132 | 108 | 108 | 109 |
| 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 | 49 | -21 | 40 | 9 | 33 | 133 | 3 |
| Banks | 130 | 33 | 83 | 32 | -7 | 19 | -4 | 4 | 76 | 0 |
| Government deposits ((-) means accumulation) | -30 | -100 | -56 | 27 | -3 | 14 | -18 | -25 | 20 | 4 |
| Securities held by banks (net) | 98 | 56 | 118 | 7 | 4 | 10 | 19 | 34 | 62 | 0 |
| Other domestic bank financing | 63 | 76 | 22 | -2 | -8 | -5 | -5 | -4 | -5 | -5 |
| Non-banks (incl. non-residents) | -14 | 8 | 40 | 16 | -14 | 21 | 13 | 29 | 57 | 3 |
| Securities held by non-banks (non-residents, net) | 34 | 56 | 97 | 80 | 49 | 75 | 19 | 34 | 62 | 8 |
| Others (incl. amortization) | -48 | -48 | -58 | -64 | -62 | -55 | -6 | -5 | -5 | -5 |
| External | 160 | 192 | 133 | 164 | 179 | 121 | 123 | 75 | -25 | 106 |
| Program | 0 | 0 | 0 | 11 | 11 | 0 | 0 | 0 | 0 | 0 |
| Project | 43 | 36 | 66 | 53 | 47 | 50 | 67 | 81 | 85 | 90 |
| Bonds and loans | 159 | 234 | 88 | 150 | 170 | 140 | 161 | 155 | 51 | 223 |
| Amortization | -41 | -78 | -20 | -49 | -49 | -69 | -105 | -160 | -162 | -207 |
| **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 | 13 | 5 | 15 | 18 | 18 | 18 |
| Gross public debt | 2090 | 2381 | 2802 | 3089 | 3050 | 3255 | 3407 | 3555 | 3659 | 3781 |
| Gross public debt (including restitution) | 2090 | 2381 | 3080 | 3370 | 3330 | 3536 | 3688 | 3835 | 3939 | 4062 |
| Nominal GDP (billions of dinars) | 3584 | 3876 | 3878 | 3994 | 3976 | 4153 | 4388 | 4728 | 5094 | 5515 |

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

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

2/ Excluding military pension payments from the Republican budget.

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

## Table 6b. Serbia: General Government Fiscal Operations, 2012–20 1/
(Percent of GDP)

| | 2012 | 2013 | 2014 | 2015 | | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | (percent of GDP) | | | | | | |
| Revenue | 39.4 | 37.9 | 40.0 | 38.9 | 40.1 | 39.0 | 38.3 | 37.9 | 37.8 | 37.7 |
| Taxes | 34.2 | 33.4 | 35.3 | 33.8 | 34.8 | 34.5 | 33.9 | 33.7 | 33.7 | 33.8 |
| Personal income tax | 4.6 | 4.0 | 3.8 | 3.5 | 3.6 | 3.5 | 3.4 | 3.4 | 3.4 | 3.3 |
| Social security contributions | 10.6 | 10.8 | 11.4 | 10.7 | 10.9 | 10.8 | 10.7 | 10.8 | 10.8 | 11.0 |
| Taxes on profits | 1.5 | 1.6 | 1.9 | 1.8 | 1.6 | 1.6 | 1.6 | 1.5 | 1.6 | 1.6 |
| Value-added taxes | 10.3 | 9.8 | 10.6 | 10.1 | 10.4 | 10.3 | 10.1 | 10.0 | 10.1 | 10.1 |
| Excises | 5.1 | 5.3 | 5.5 | 5.6 | 5.8 | 6.0 | 5.8 | 5.7 | 5.7 | 5.6 |
| Taxes on international trade | 1.0 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Other taxes | 1.2 | 1.1 | 1.5 | 1.4 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 |
| Non-tax revenue | 5.0 | 4.2 | 4.4 | 4.8 | 5.1 | 4.3 | 4.1 | 4.0 | 3.9 | 3.7 |
| 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 | 44.2 | 44.1 | 42.9 | 41.3 | 40.2 | 39.9 | 39.6 |
| Current expenditure | 42.5 | 40.8 | 43.0 | 40.3 | 40.6 | 39.3 | 37.6 | 36.6 | 36.3 | 36.1 |
| Wages and salaries | 10.5 | 10.1 | 10.0 | 9.0 | 9.1 | 8.3 | 7.5 | 7.3 | 7.2 | 7.1 |
| Goods and services | 8.0 | 7.2 | 8.0 | 7.6 | 7.7 | 7.6 | 7.3 | 7.3 | 7.3 | 7.3 |
| Interest | 1.9 | 2.4 | 3.0 | 3.4 | 3.4 | 3.9 | 4.0 | 4.1 | 4.1 | 3.9 |
| Subsidies | 4.1 | 3.3 | 4.1 | 2.6 | 2.7 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Transfers | 18.1 | 17.7 | 18.0 | 17.7 | 17.8 | 17.1 | 16.3 | 15.4 | 15.3 | 15.3 |
| Pensions 2/ | 13.2 | 12.8 | 13.1 | 12.3 | 12.4 | 12.0 | 11.5 | 11.1 | 11.0 | 11.0 |
| Other transfers 3/ | 4.8 | 4.9 | 4.9 | 5.4 | 5.4 | 5.1 | 4.9 | 4.3 | 4.3 | 4.3 |
| Capital expenditure | 3.3 | 2.1 | 2.5 | 3.1 | 2.8 | 2.8 | 3.1 | 3.1 | 3.1 | 3.1 |
| 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 | 0.7 | 0.7 | 0.5 | 0.4 | 0.4 | 0.4 |
| Fiscal balance (incl. amortization of called guarantees) | -7.2 | -5.6 | -6.7 | -5.3 | -4.0 | -3.9 | -3.0 | -2.3 | -2.1 | -2.0 |
| Financing | 7.2 | 5.6 | 6.7 | 5.3 | 4.0 | 3.9 | 3.0 | 2.3 | 2.1 | 2.0 |
| 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 | 1.2 | -0.5 | 1.0 | 0.2 | 0.7 | 2.6 | 0.1 |
| Banks | 3.6 | 0.9 | 2.1 | 0.8 | -0.2 | 0.5 | -0.1 | 0.1 | 1.5 | 0.0 |
| Government deposits ((-) means accumulation) | -0.8 | -2.6 | -1.5 | 0.7 | -0.1 | 0.3 | -0.4 | -0.5 | 0.4 | 0.1 |
| Securities held by banks (net) | 2.7 | 1.5 | 3.0 | 0.2 | 0.1 | 0.2 | 0.4 | 0.7 | 1.2 | 0.0 |
| Other domestic bank financing | 1.8 | 2.0 | 0.6 | 0.0 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Non-banks (incl. non-residents) | -0.4 | 0.2 | 1.0 | 0.4 | -0.3 | 0.5 | 0.3 | 0.6 | 1.1 | 0.1 |
| Securities held by non-banks (non-residents, net) | 0.9 | 1.4 | 2.5 | 2.0 | 1.2 | 1.8 | 0.4 | 0.7 | 1.2 | 0.1 |
| Others (incl. amortization) | -1.3 | -1.2 | -1.5 | -1.6 | -1.6 | -1.3 | -0.1 | -0.1 | -0.1 | -0.1 |
| External | 4.5 | 5.0 | 3.4 | 4.1 | 4.5 | 2.9 | 2.8 | 1.6 | -0.5 | 1.9 |
| Program | 0.0 | 0.0 | 0.0 | 0.3 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Project | 1.2 | 0.9 | 1.7 | 1.3 | 1.2 | 1.2 | 1.5 | 1.7 | 1.7 | 1.6 |
| Bonds and loans | 4.4 | 6.0 | 2.3 | 3.8 | 4.3 | 3.4 | 3.7 | 3.3 | 1.0 | 4.0 |
| Amortization | -1.2 | -2.0 | -0.5 | -1.2 | -1.2 | -1.7 | -2.4 | -3.4 | -3.2 | -3.7 |
| **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 | 0.3 | 0.3 | 0.1 | 0.3 | 0.4 | 0.4 | 0.3 |
| Gross financing need | 15.9 | 16.2 | 15.9 | 17.1 | 16.2 | 14.0 | 14.1 | 16.7 | 15.0 | 17.2 |
| Gross public debt | 58.3 | 61.4 | 72.2 | 77.3 | 76.7 | 78.4 | 77.7 | 75.2 | 71.8 | 68.6 |
| Gross public debt (including restitution) | 58.3 | 61.4 | 79.4 | 84.4 | 83.8 | 85.2 | 84.0 | 81.1 | 77.3 | 73.7 |
| Nominal GDP (billions of dinars) | 3,584 | 3,876 | 3,878 | 3,994 | 3,976 | 4,153 | 4,388 | 4,728 | 5,094 | 5,515 |

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

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

2/ Excluding military pension payments from the Republican budget.

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

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

| | 2012 | 2013 | 2014 | 2015 | | | | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Jul | Aug | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | (Billions of dinars, unless otherwise indicated; end of period) 1/ | | | | | | | | | | | |
| Net foreign assets 2/ | 673 | 847 | 1037 | 1095 | 1088 | 1224 | 1254 | 1425 | 1461 | 1495 | 1459 | 1394 |
| in billions of euro | 5.9 | 7.4 | 8.6 | 9.1 | 9.0 | 10.0 | 10.3 | 11.5 | 11.7 | 11.8 | 11.5 | 10.9 |
| Foreign assets | 1420 | 1427 | 1475 | 1507 | 1498 | 1576 | 1605 | 1712 | 1741 | 1777 | 1743 | 1680 |
| NBS | 1250 | 1291 | 1208 | 1288 | 1286 | 1308 | 1328 | 1430 | 1457 | 1490 | 1454 | 1389 |
| Commercial banks | 169 | 136 | 267 | 220 | 212 | 269 | 277 | 282 | 284 | 287 | 289 | 291 |
| Foreign liabilities (-) | -747 | -580 | -438 | -412 | -410 | -352 | -351 | -286 | -280 | -282 | -284 | -286 |
| NBS | -166 | -87 | -27 | -11 | -11 | -10 | -10 | -8 | -8 | -8 | -8 | -8 |
| Commercial banks | -581 | -493 | -412 | -401 | -399 | -342 | -341 | -278 | -272 | -274 | -276 | -278 |
| Net domestic assets | 943 | 836 | 785 | 729 | 739 | 708 | 661 | 618 | 709 | 833 | 1,057 | 1,321 |
| Domestic credit | 2,027 | 1,886 | 2,005 | 2,010 | 2,017 | 2,027 | 1,990 | 2,020 | 2,171 | 2,355 | 2,658 | 2,931 |
| Government, net | 95 | 49 | 123 | 143 | 147 | 153 | 115 | 134 | 129 | 133 | 209 | 209 |
| NBS | -160 | -236 | -256 | -245 | -239 | -232 | -261 | -249 | -268 | -295 | -277 | -273 |
| Claims on government | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Liabilities (deposits) | 161 | 237 | 258 | 247 | 241 | 233 | 262 | 251 | 270 | 296 | 278 | 275 |
| Banks | 255 | 285 | 379 | 388 | 386 | 386 | 376 | 383 | 398 | 428 | 486 | 483 |
| Claims on government | 290 | 336 | 457 | 468 | 467 | 464 | 454 | 462 | 478 | 509 | 567 | 564 |
| Liabilities (deposits) | 36 | 51 | 78 | 80 | 81 | 78 | 78 | 79 | 80 | 80 | 81 | 81 |
| Local governments, net | 6 | 1 | -8 | -16 | -18 | -6 | -8 | -8 | -8 | -8 | -8 | -8 |
| Non-government sector | 1,926 | 1,837 | 1,890 | 1,884 | 1,888 | 1,880 | 1,883 | 1,895 | 2,050 | 2,229 | 2,457 | 2,729 |
| Households | 654 | 675 | 725 | 747 | 747 | 736 | 744 | 771 | 834 | 908 | 1,000 | 1,111 |
| Enterprises | 1,226 | 1,111 | 1,140 | 1,114 | 1,115 | 1,119 | 1,114 | 1,099 | 1,188 | 1,293 | 1,425 | 1,583 |
| Other | 47 | 51 | 25 | 23 | 26 | 25 | 25 | 25 | 27 | 29 | 32 | 36 |
| Other assets, net | -1,084 | -1,050 | -1,220 | -1,281 | -1,278 | -1,319 | -1,329 | -1,403 | -1,462 | -1,522 | -1,601 | -1,610 |
| Capital accounts (-) | -876 | -830 | -927 | -967 | -958 | -892 | -999 | -1,046 | -1,085 | -1,130 | -1,185 | -1,193 |
| NBS | -264 | -217 | -307 | -337 | -325 | -271 | -350 | -371 | -392 | -418 | -447 | -452 |
| Banks | -611 | -613 | -620 | -630 | -634 | -621 | -649 | -675 | -693 | -712 | -738 | -740 |
| Provisions (-) | -237 | -257 | -279 | -288 | -289 | -313 | -303 | -327 | -345 | -359 | -381 | -381 |
| Other assets | 28 | 37 | -14 | -26 | -30 | -114 | -28 | -30 | -32 | -33 | -35 | -36 |
| Broad money (M2) | 1616 | 1683 | 1823 | 1825 | 1828 | 1932 | 1915 | 2043 | 2171 | 2327 | 2516 | 2715 |
| Dinar-denominated M2 | 455 | 515 | 574 | 573 | 574 | 651 | 616 | 686 | 763 | 852 | 952 | 1050 |
| M1 | 296 | 366 | 402 | 411 | 422 | 456 | 440 | 489 | 544 | 607 | 679 | 749 |
| Currency in circulation | 111 | 122 | 130 | 127 | 123 | 148 | 133 | 148 | 165 | 184 | 205 | 227 |
| Demand deposits | 186 | 244 | 271 | 285 | 298 | 308 | 307 | 341 | 379 | 424 | 473 | 522 |
| Time and saving deposits | 159 | 149 | 173 | 162 | 152 | 196 | 177 | 197 | 219 | 244 | 273 | 301 |
| Foreign currency deposits | 1161 | 1169 | 1248 | 1252 | 1254 | 1281 | 1298 | 1357 | 1408 | 1476 | 1564 | 1665 |
| in billions of euro | 10.2 | 10.2 | 10.3 | 10.4 | 10.4 | 10.5 | 10.6 | 10.9 | 11.2 | 11.7 | 12.3 | 13.0 |
| **Memorandum items:** | ( year-on-year change unless indicated otherwise) | | | | | | | | | | | |
| M1 | 3.8 | 23.7 | 9.7 | 7.5 | 6.7 | 13.4 | 9.4 | 11.4 | 11.2 | 11.6 | 11.8 | 10.3 |
| M2 | 9.2 | 4.2 | 8.3 | 5.3 | 3.6 | 5.9 | 5.0 | 6.7 | 6.2 | 7.2 | 8.1 | 7.9 |
| Velocity (Dinar part of money supply) | 7.9 | 7.5 | 6.8 | 6.9 | 6.9 | 6.1 | 6.5 | 6.1 | 5.8 | 5.6 | 5.4 | 5.3 |
| Velocity (M2) | 2.2 | 2.3 | 2.1 | 2.2 | 2.2 | 2.1 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Deposits at program exchange rate | 3.6 | 2.9 | 4.1 | 3.2 | 2.5 | 4.7 | 4.7 | 5.2 | 5.2 | 6.4 | 7.3 | 7.3 |
| Credit to non-gov. (program exchange rates) 3/ | 0.3 | -4.0 | -1.2 | -1.1 | ... | -3.0 | -1.9 | -1.2 | 4.1 | 4.8 | 5.7 | 7.1 |
| Domestic | 3.3 | -5.1 | -1.0 | -0.1 | 0.2 | -1.1 | -0.9 | -0.4 | 7.5 | 8.3 | 9.7 | 10.7 |
| Households | 2.1 | 2.8 | 3.8 | 2.8 | 2.7 | 0.6 | 2.1 | 2.7 | 7.6 | 8.3 | 9.7 | 10.7 |
| Enterprises and other sectors | 3.9 | -9.1 | -3.7 | -1.9 | -1.3 | -2.4 | -2.8 | -2.4 | 7.5 | 8.3 | 9.7 | 10.8 |
| External | -5.0 | -1.8 | -1.7 | -2.9 | ... | -6.5 | -3.7 | -2.7 | -2.7 | -3.1 | -4.3 | -3.3 |
| Credit to non-gov. (real terms) 4/ | -4.5 | -5.5 | 1.4 | 0.7 | ... | -6.0 | -3.7 | -3.9 | 0.8 | 1.2 | 2.1 | 3.3 |
| Domestic credit to non-gov. (real terms) | -2.6 | -6.7 | 1.2 | 1.6 | 0.1 | -4.2 | -2.8 | -3.3 | 4.0 | 4.6 | 6.0 | 6.8 |
| Households | -3.3 | 1.0 | 5.7 | 5.4 | 3.2 | -2.3 | 0.1 | -0.4 | 4.0 | 4.6 | 6.0 | 6.8 |
| Enterprises and other sectors | -2.2 | -10.7 | -1.5 | -0.7 | -1.8 | -5.4 | -4.7 | -5.2 | 4.0 | 4.6 | 6.0 | 6.8 |
| External | -8.0 | -3.2 | 1.9 | -1.1 | ... | -9.1 | -5.2 | -5.0 | -5.6 | -6.1 | -7.2 | -6.4 |
| Deposit euroization (percent of total) 5/ | 77.1 | 74.9 | 73.8 | 73.7 | 73.6 | 71.8 | 72.9 | 71.6 | 70.2 | 68.8 | 67.7 | 66.9 |
| Credit euroization (percent of total) 5/ | 69.7 | 70.6 | 67.6 | 69.5 | 69.8 | 66.6 | 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 and dinar/swiss franc exchange rates for converting FX and FX-indexed loans to dinars.
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 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Aug | 1st rev. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| | (Billions of dinars, unless otherwise indicated; end of period) 1/ | | | | | | | | | | |
| Net foreign assets | 1085 | 1204 | 1182 | 1275 | 1298 | 1318 | 1422 | 1449 | 1482 | 1446 | 1381 |
| (In billions of euro) | 9.5 | 10.5 | 9.8 | 10.6 | 10.6 | 10.8 | 11.5 | 11.6 | 11.7 | 11.4 | 10.8 |
| Gross foreign reserves | 1250 | 1291 | 1208 | 1286 | 1308 | 1328 | 1430 | 1457 | 1490 | 1454 | 1389 |
| Gross reserve liabilities (-) | -166 | -87 | -27 | -11 | -10 | -10 | -8 | -8 | -8 | -8 | -8 |
| Net domestic assets | -470 | -584 | -601 | -656 | -686 | -739 | -840 | -839 | -838 | -762 | -657 |
| Net domestic credit | -206 | -368 | -294 | -331 | -415 | -389 | -469 | -447 | -419 | -315 | -205 |
| Net credit to government | -160 | -236 | -256 | -239 | -232 | -261 | -249 | -268 | -295 | -277 | -273 |
| Claims on government | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Liabilities to government (-) | -161 | -237 | -258 | -241 | -233 | -262 | -251 | -270 | -296 | -278 | -275 |
| Liabilities to government (-): local currency | -55 | -89 | -103 | -105 | -100 | -98 | -98 | -98 | -98 | -98 | -98 |
| Liabilities to government (-): foreign currency | -106 | -148 | -154 | -135 | -134 | -164 | -152 | -171 | -198 | -179 | -176 |
| Net credit to local governmens | -18 | -31 | -46 | -54 | -46 | -55 | -55 | -55 | -55 | -55 | -55 |
| Net claims on banks | -39 | -110 | -7 | -54 | -152 | -87 | -179 | -138 | -84 | 2 | 109 |
| Capital accounts (-) | -264 | -217 | -307 | -325 | -271 | -350 | -371 | -392 | -418 | -447 | -452 |
| Reserve money | 614 | 620 | 581 | 619 | 612 | 579 | 582 | 610 | 644 | 685 | 724 |
| Currency in circulation | 111 | 122 | 130 | 123 | 148 | 133 | 148 | 165 | 184 | 205 | 227 |
| Commercial bank reserves | 186 | 200 | 212 | 258 | 238 | 234 | 233 | 237 | 242 | 248 | 251 |
| Required reserves | 140 | 145 | 158 | 162 | 179 | 132 | 117 | 122 | 128 | 135 | 144 |
| Excess reserves | 45 | 55 | 54 | 96 | 59 | 102 | 116 | 115 | 114 | 112 | 107 |
| FX deposits by banks, billions of euros | 2.8 | 2.6 | 2.0 | 2.0 | 1.8 | 1.7 | 1.6 | 1.7 | 1.7 | 1.8 | 1.9 |

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, 2012–15

| | 2012 | 2013 | 2014 | 2015 | | |
|---|---|---|---|---|---|---|
| | | | | Mar | Jun | Jul |
| Capital adequacy | | | | | | |
| Regulatory capital to risk-weighted assets | 19.9 | 20.9 | 20.0 | 20.3 | 21.4 | 21.4 |
| Regulatory Tier 1 capital to risk-weighted assets | 19.0 | 19.3 | 17.6 | 17.8 | 18.9 | 18.9 |
| Nonperforming loans net of provisions to capital | 31.0 | 32.7 | 31.0 | 31.3 | 30.4 | 29.6 |
| Capital to assets | 20.5 | 20.9 | 20.7 | 21.2 | 21.2 | 21.4 |
| Large exposures to capital | 61.9 | 90.4 | 130.5 | 130.4 | 113.8 | 113.8 |
| Regulatory capital to total assets | 12.2 | 12.2 | 11.4 | 11.6 | 11.9 | 11.9 |
| Asset quality | | | | | | |
| Nonperforming loans to total gross loans | 18.6 | 21.4 | 21.5 | 22.6 | 22.8 | 22.4 |
| Sectoral distribution of loans (percent of total loans) | | | | | | |
| Deposit takers | 0.3 | 0.3 | 0.8 | 0.5 | 0.5 | 0.1 |
| Central bank | 2.3 | 5.8 | 0.4 | 0.0 | 1.1 | 1.8 |
| General government | 3.2 | 2.3 | 2.3 | 2.2 | 2.0 | 1.9 |
| Other financial corporations | 1.6 | 1.6 | 0.5 | 0.4 | 0.5 | 0.5 |
| Nonfinancial corporations | 56.5 | 54.1 | 56.3 | 56.1 | 55.1 | 54.8 |
| Agriculture | 2.9 | 2.7 | 3.5 | 3.4 | 3.4 | 3.3 |
| Industry | 18.0 | 18.4 | 19.2 | 18.8 | 18.4 | 18.2 |
| Construction | 5.5 | 4.6 | 4.2 | 4.1 | 4.2 | 4.1 |
| Trade | 15.2 | 13.5 | 13.9 | 13.6 | 13.0 | 13.4 |
| Other loans to nonfinancial corporations | 14.8 | 14.9 | 15.6 | 16.2 | 16.1 | 15.7 |
| Households and NPISH | 34.1 | 34.8 | 38.3 | 39.0 | 39.4 | 39.1 |
| Households and NPISH of which: mortgage loans to total loans | 17.3 | 16.8 | 18.1 | 18.7 | 18.7 | 18.4 |
| Foreign sector | 2.0 | 1.1 | 1.4 | 1.7 | 1.5 | 1.8 |
| Specific provision for NPLs to gross NPLs | 50.0 | 50.9 | 54.9 | 55.4 | 56.1 | 55.9 |
| Specific and general provisions for NPLs to gross NPLs | 111.1 | 105.5 | 107.6 | 105.7 | 105.7 | 107.9 |
| Specific and general provisions for balance sheet losses to NPLs | 120.7 | 113.8 | 114.5 | 113.0 | 113.2 | 115.5 |
| Specific and general provisions to NPLs | 126.5 | 117.9 | 118.4 | 116.7 | 116.9 | 119.3 |
| Specific provision of total loans to total gross loans | 10.2 | 11.9 | 12.7 | 13.4 | 13.6 | 13.4 |
| Earnings and Profitability | | | | | | |
| Return on assets | 0.4 | -0.1 | 0.1 | 1.0 | 1.1 | 1.3 |
| Return on equity | 2.0 | -0.4 | 0.6 | 4.7 | 5.4 | 6.2 |
| Liquidity | | | | | | |
| Liquid assets (core) to total assets | 23.9 | 26.1 | ... | ... | ... | ... |
| Liquid assets (core) to short-term liabilities | 57.2 | 63.2 | ... | ... | ... | ... |
| Customer deposits to total (noninterbank) loans | 93.2 | 103.4 | 108.5 | 108.2 | 110.6 | 110.4 |
| Foreign-currency-denominated loans to total loans | 74.1 | 71.6 | 70.1 | 71.3 | 71.3 | 71.2 |
| Average monthy liquidity ratio | 2.1 | 2.4 | 2.2 | 2.2 | 2.3 | 2.4 |
| Average monthy narrow liquidity ratio | 1.6 | 1.8 | 1.7 | 1.8 | 1.9 | 1.9 |
| Sensitivity to Market Risk | | | | | | |
| Net open position in foreign exchange to capital | 2.7 | 3.3 | ... | ... | ... | ... |
| Foreign-currency-denominated liabilities to total liabilities | 80.1 | 76.7 | 74.5 | 75.3 | 74.3 | 73.5 |
| Total off-balance sheet items to total assets | 103.5 | 111.0 | 207.1 | 242.0 | 238.6 | 242.5 |
| Classified off-balance sheet items to classified balance sheet assets | 26.1 | 28.7 | 27.6 | 27.9 | 27.7 | 27.7 |

Source: National Bank of Serbia.

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

| | Available on or after | Amount of Purchase | | | Cumulative | Conditions |
|---|---|---|---|---|---|---|
| | | In millions of SDR | In millions of euros 1/ | In percent of quota 2/ | In percent of quota 2/ | |
| 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

| | 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 | -1.7 | -1.8 | -1.8 | -1.8 | -1.8 | -1.7 |
| Trade of goods balance | -5.6 | -4.2 | -4.1 | -4.1 | -4.1 | -4.2 | -4.1 | -4.3 | -4.4 |
| Exports of goods | 8.4 | 10.5 | 10.6 | 11.1 | 11.9 | 12.8 | 14.0 | 15.0 | 16.2 |
| Imports of goods | -14.0 | -14.7 | -14.8 | -15.2 | -16.0 | -17.0 | -18.1 | -19.3 | -20.6 |
| Services balance | 0.1 | 0.3 | 0.5 | 0.7 | 0.8 | 0.9 | 1.0 | 1.1 | 1.2 |
| Exports of nonfactor services | 3.1 | 3.4 | 3.8 | 4.2 | 4.5 | 4.8 | 5.2 | 5.6 | 5.9 |
| Imports of nonfactor services | -3.0 | -3.1 | -3.3 | -3.5 | -3.7 | -3.9 | -4.2 | -4.5 | -4.8 |
| Income balance | -1.1 | -1.4 | -1.3 | -1.5 | -1.7 | -1.8 | -1.8 | -1.9 | -2.0 |
| Net interest | -0.8 | -0.9 | -0.9 | -1.0 | -1.0 | -1.1 | -1.1 | -1.1 | -1.1 |
| Others, including reinvested earnings | -0.3 | -0.5 | -0.5 | -0.6 | -0.7 | -0.8 | -0.8 | -0.8 | -0.9 |
| Current transfer balance | 2.9 | 3.2 | 3.0 | 3.1 | 3.2 | 3.3 | 3.2 | 3.3 | 3.5 |
| Official grants | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Others, including private remittances | 2.9 | 3.1 | 2.9 | 3.0 | 3.1 | 3.2 | 3.1 | 3.3 | 3.5 |
| Capital and financial account balance 1/ | 2.5 | 3.2 | 0.5 | 1.0 | 0.8 | 1.5 | 1.6 | 1.2 | 1.1 |
| 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 | 0.4 | 0.8 | 0.7 | 0.7 | 0.1 | 0.1 |
| of which: debt liabilities | 1.7 | 2.0 | 0.4 | 0.4 | 0.8 | 0.7 | 0.7 | 0.1 | 0.1 |
| Other investment balance | 0.2 | 0.1 | -1.1 | -0.8 | -1.4 | -0.6 | -0.6 | -0.5 | -0.8 |
| Public sector 1/ 2/ | 0.5 | 0.4 | 0.7 | 1.3 | 0.1 | -0.3 | -0.4 | -0.2 | -0.6 |
| Domestic banks | -0.4 | -0.5 | -1.5 | -1.5 | -1.1 | -0.1 | 0.0 | 0.0 | 0.0 |
| Other private sector 3/ | 0.1 | 0.1 | -0.4 | -0.6 | -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 | -0.8 | -1.0 | -0.3 | -0.1 | -0.5 | -0.6 |
| Financing | 0.9 | -1.3 | 1.2 | 0.8 | 1.0 | 0.3 | 0.1 | 0.5 | 0.6 |
| Gross international reserves (increase, -) | 1.1 | -0.7 | 1.8 | 0.3 | 0.8 | 0.1 | 0.1 | 0.9 | 1.1 |
| Use of Fund credit, net | -0.2 | -0.6 | -0.6 | 0.5 | 0.2 | 0.2 | 0.1 | -0.4 | -0.5 |
| 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 | 0.0 | -0.4 | -0.5 |
| | (Percent of GDP) | | | | | | | | |
| Current account balance | -11.5 | -6.1 | -6.0 | -5.3 | -5.3 | -5.0 | -4.7 | -4.4 | -4.0 |
| Trade of goods balance | -17.8 | -12.1 | -12.4 | -12.3 | -12.3 | -12.0 | -11.0 | -10.6 | -10.1 |
| Exports of goods | 26.5 | 30.8 | 32.2 | 33.9 | 35.2 | 36.4 | 37.1 | 37.4 | 37.6 |
| Imports of goods | -44.2 | -42.9 | -44.6 | -46.2 | -47.5 | -48.3 | -48.2 | -48.1 | -47.7 |
| Services balance | 0.4 | 0.9 | 1.4 | 2.2 | 2.5 | 2.6 | 2.7 | 2.7 | 2.7 |
| Income balance | -3.4 | -4.1 | -4.1 | -4.7 | -5.1 | -5.1 | -4.9 | -4.8 | -4.6 |
| Current transfer balance | 9.3 | 9.2 | 9.1 | 9.6 | 9.6 | 9.5 | 8.5 | 8.3 | 8.0 |
| Official grants | 0.3 | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.0 | 0.0 |
| Others, including private remittances | 9.0 | 9.1 | 8.8 | 9.2 | 9.2 | 9.2 | 8.2 | 8.3 | 8.0 |
| Capital and financial account balance 1/ | 7.9 | 9.4 | 1.4 | 2.9 | 2.2 | 4.2 | 4.4 | 3.1 | 2.6 |
| 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 | 4.0 | 3.9 | 4.0 | 4.2 | 4.2 | 4.2 |
| Portfolio investment balance | 5.3 | 5.6 | 1.1 | 1.3 | 2.5 | 1.9 | 1.9 | 0.2 | 0.3 |
| Other investment balance | 0.5 | 0.3 | -3.4 | -2.5 | -4.1 | -1.7 | -1.7 | -1.3 | -1.9 |
| Public sector 1/ 2/ | 1.5 | 1.2 | 2.2 | 3.8 | 0.2 | -0.9 | -1.1 | -0.5 | -1.3 |
| Domestic banks | -1.3 | -1.3 | -4.5 | -4.5 | -3.1 | -0.2 | 0.0 | 0.0 | 0.0 |
| Other private sector 3/ | 0.4 | 0.4 | -1.1 | -1.8 | -1.2 | -0.6 | -0.6 | -0.8 | -0.5 |
| 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 | -2.4 | -3.1 | -0.8 | -0.3 | -1.3 | -1.4 |
| **Memorandum items:** | (percent change unless indicated otherwise) | | | | | | | | |
| Export growth | -0.5 | 25.6 | 1.0 | 4.5 | 6.8 | 7.8 | 9.1 | 7.7 | 8.0 |
| Import growth | 2.0 | 4.7 | 0.4 | 2.9 | 5.5 | 6.2 | 6.5 | 6.6 | 6.7 |
| Export volume growth | -0.8 | 21.9 | 1.7 | 4.5 | 4.3 | 7.8 | 9.3 | 7.8 | 9.2 |
| Import volume growth | 0.8 | 2.7 | 1.9 | 5.5 | 3.0 | 5.6 | 6.0 | 6.5 | 7.9 |
| Trading partner import growth | -0.1 | 1.6 | 3.5 | 4.0 | 5.2 | 4.8 | 4.8 | 4.8 | 4.8 |
| Export prices growth | 0.3 | 3.0 | -0.7 | 0.0 | 2.4 | -0.1 | -0.2 | -0.1 | -1.1 |
| Import prices growth | 1.2 | 2.0 | -1.5 | -2.5 | 2.5 | 0.6 | 0.4 | 0.2 | -1.1 |
| Change in terms of trade | -0.9 | 1.0 | 0.8 | 2.6 | -0.1 | -0.7 | -0.6 | -0.3 | 0.0 |
| Gross official reserves (in billions of euro) | 10.9 | 11.2 | 9.9 | 9.6 | 8.8 | 8.7 | 8.7 | 7.8 | 6.7 |
| (In months of prospective imports of GNFS) | 7.4 | 7.4 | 6.4 | 5.8 | 5.0 | 4.7 | 4.4 | 3.7 | 3.2 |
| (in percent of short-term debt) | 207.5 | 269.4 | 259.8 | 285.0 | 214.7 | 182.5 | 210.5 | 146.6 | 126.5 |
| (in percent of broad money, M2) | 76.8 | 76.2 | 65.8 | 61.1 | 53.4 | 50.4 | 47.1 | 39.6 | 31.8 |
| (in percent of IMF risk-weighted metric) | 224.6 | 229.4 | 201.5 | 199.2 | 175.6 | 161.8 | 157.2 | 131.6 | 113.6 |
| GDP (billions of euros) | 31.7 | 34.3 | 33.1 | 32.9 | 33.8 | 35.2 | 37.6 | 40.2 | 43.2 |

Sources: NBS; and IMF staff estimates and projections.
1/ Excluding net use of IMF resources.
2/ Includes SDR allocations in 2009.
3/ 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 | 119 | 19 | 9 | 10 | 298 | 392 |
| In millions of euro | 663 | 574 | 150 | 24 | 11 | 13 | 372 | 489 |
| In percent of exports of goods and NFS | 4.7 | 4.0 | 1.0 | 0.1 | 0.1 | 0.1 | 1.8 | 2.2 |
| In percent of GDP | 1.9 | 1.7 | 0.5 | 0.1 | 0.0 | 0.0 | 0.9 | 1.1 |
| In percent of quota | 123.8 | 107.3 | 25.5 | 4.0 | 1.9 | 2.2 | 63.8 | 83.7 |
| In percent of total external debt service | 10.7 | 11.6 | 3.2 | 0.5 | 0.2 | 0.2 | 7.2 | 7.6 |
| In percent of gross international reserves | 5.9 | 5.8 | 1.6 | 0.3 | 0.1 | 0.1 | 4.8 | 7.3 |
| Fund credit outstanding (end-period) | | | | | | | | |
| In millions of SDRs | 624 | 128 | 503 | 702 | 889 | 935 | 646 | 260 |
| In millions of euro | 701 | 151 | 634 | 883 | 1114 | 1169 | 804 | 324 |
| In percent of exports of goods and NFS | 5.0 | 1.0 | 4.1 | 5.4 | 6.3 | 6.1 | 3.9 | 1.5 |
| In percent of GDP | 2.0 | 0.5 | 1.9 | 2.6 | 3.2 | 3.1 | 2.0 | 0.7 |
| In percent of quota | 133.5 | 27.3 | 107.5 | 150 | 190 | 200 | 138 | 56 |
| In percent of total external debt | 2.6 | 0.5 | 2.3 | 3.2 | 4.0 | 4.2 | 3.0 | 1.2 |
| In percent of gross international reserves | 6.3 | 1.5 | 6.6 | 10.0 | 12.7 | 13.5 | 10.3 | 4.8 |
| Memorandum items: | | | | | | | | |
| Exports of goods and NFS | 13,963 | 14,451 | 15,338 | 16,407 | 17,632 | 19,182 | 20,596 | 22,187 |
| Quota (in millions of SDRs) | 468 | 468 | 468 | 468 | 468 | 468 | 468 | 468 |
| GDP | 34,277 | 33,075 | 32,856 | 33,761 | 35,216 | 37,612 | 40,196 | 43,187 |
| Total external debt service | 6,194 | 4,965 | 4,686 | 4,360 | 5,161 | 5,842 | 5,209 | 6,403 |
| Public sector external debt | 14,596 | 16,083 | 18,247 | 19,405 | 19,996 | 20,345 | 19,851 | 18,933 |
| Total external debt | 27,194 | 27,723 | 27,879 | 27,571 | 27,878 | 27,996 | 27,187 | 26,040 |
| Total external debt stock excluding IMF | 26,497 | 27,571 | 27,262 | 26,697 | 26,771 | 26,831 | 25,661 | 24,035 |
| Gross international reserves | 11,189 | 9,907 | 9,592 | 8,804 | 8,745 | 8,688 | 7,796 | 6,728 |

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, October 6, 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) describes progress made so far and sets out the economic policies that the Government of the Republic of Serbia and the National Bank of Serbia (NBS) intend to implement under the SBA. Our program continues to be fully supported by all coalition partners in the government, indicating strong commitment to and ownership of envisaged policies.

Program performance has been good. All quantitative performance criteria (PCs) and indicative targets for end-June were met with a margin, and inflation was within the inner band of the inflation consultation clause. We have finalized the registry of public employees (end-June structural benchmark), except for the element of validation of SOE employment data. The National Assembly approved the changes to the Law on Payments in Commercial Transactions in July 2015 (end-June structural benchmark). The financial restructuring plan for Serbia railways (end-September structural benchmark) will be adopted by the Government Steering Committee in mid-October, with a slight delay due to the need for additional technical work. The special diagnostic studies of bank asset quality (SDS) (end-September structural benchmark) are expected to be completed by end-October, with a slight delay due to operational complexities. Adoption of the new Local Government Financing Law (end- September structural benchmark) is delayed due to the need for additional consultations; a draft is intended to be posted for public debate by end-October 2015 (new structural benchmark). Due to lack of availability of final data by the time of this review, we request waivers of applicability for the end-September 2015 PCs on (i) the net international reserves of the NBS, (ii) the general government fiscal deficit, (iii) the current primary expenditure of the Republican budget, (iv) issuance of new guarantees by the republican budget for project and corporate restructuring loans, and (v) contracting or guaranteeing of new short-term external debt by the general government, Development Fund and the Export Credit and Insurance Agency. We are confident that these PCs will be met, once data become available.

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 additional structural benchmarks in this area for December 2015 and March 2016. We propose to make a minor revision to the inflation consultation clause for December 2015 to bring it in line with the NBS inflation tolerance band.

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 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 second 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. The program aims to establish a foundation for healthy economic growth by addressing short-term as well as medium-term economic challenges that Serbia is facing. To this end, the program focuses on policies to ensure macroeconomic stability, most notably by restoring fiscal sustainability, bolster resilience of the financial sector, and improve competitiveness of the economy.

**2.** Significant progress has been made since the economic program started. Bold fiscal consolidation, which started in late 2014, is beginning to bear fruit, reforms in the financial sector are progressing as planned, and the initiation of comprehensive restructuring in the state-owned enterprises is starting to yield positive impacts on their efficiency and financial discipline.

**3.** The goals of the economic program are compatible with our aspirations to become an EU member, having started the accession process in January 2014. Implementing this program will allow Serbia to realize the significant potential for convergence towards EU income levels.

## Recent Economic Developments and Outlook

**4. The Serbian economy is emerging from the recession last year.** The recovery that started in 2014:Q4 continues, notwithstanding significant fiscal tightening. The somewhat better economic activity than projected earlier reflects the effects of lower oil prices and stronger private sector wages on domestic demand, and more favorable external environment. Despite the gradual monetary policy easing, headline CPI inflation has remained below the NBS inflation tolerance band most of the time since late 2013, mainly on account of weak demand, low prices of primary commodities (particularly energy prices) and delay in administered price adjustments. Inflation is expected to approach the lower bound of the tolerance band in December and reach the target by the end of 2016. The current account deficit declined with the recovery of exports to the level covered by FDI, and capital inflows increased amid ECB quantitative easing and improved risk premia for government debt.

**5. We will continue to consistently implement policy actions and reforms envisaged under our 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 grow at ½ percent in 2015, compared to zero growth projected previously. Despite sizeable fiscal consolidation, the decline of domestic demand is 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 remain below the inflation target of 4 percent through 2015, and annual average inflation is revised down to 1.6 percent, reflecting

price developments so far this year amid lower oil prices and favorable fruit and vegetable prices. In the medium term, 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 4 percent of GDP this year and remain broadly around this level over the medium term. External financing will rely mostly on FDI, but also on eurobond issuance, and bilateral and project loans.

6. **The program scenario continues to face downside exogenous risks, but the Serbian economy has considerable buffers to withstand them.** A resurgence of Greece-related turbulence could expose Serbia to spillovers through a confidence channel (Greek bank subsidiaries account for 13 percent of banking system assets) and an indirect real channel (slow growth in trading partners). However, as the first line of defense, Serbia has 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 are implementing a structural fiscal adjustment of over 4 percent of GDP during 2015–17, about half of which is being achieved this year. The measures focus primarily on containing public expenditures, namely on scaling down public sector wage and pension bills towards our medium-term objectives of 7 and 11 percent of GDP, respectively, and reducing state aid to state-owned enterprises (SOEs).

8. **The fiscal outturn in the first half of 2015 was well within the program targets.** The general government fiscal deficit amounted to RSD 35.3 billion, well below the adjusted program target of RSD 90.8 billion, owing to both conservative projections and improved revenue collection (about 85 percent) and the under-execution of expenditure (15 percent). While current expenditures are broadly in line with the budget, we recognize that persistent under-execution of capital expenditure will be detrimental to Serbia's long-run potential growth. With support from USAID, we are working on new regulations and guidelines for public investment management. In particular, we will adopt a set of by-laws aimed at strengthening the project appraisal process by end-December 2015 (structural benchmark). Current expenditure measures effective since 2014—wage and pension cuts and the 5:1 attrition rule for general government permanent employees—have been implemented as committed, and the current primary expenditure of the Republican budget amounted to RSD 405.2 billion, below the adjusted program target of RSD 421.2 billion. We will tighten the fiscal deficit target for

2015, reflecting developments so far while keeping a reasonable fiscal buffer, to ensure that the improved revenue performance is assigned to our priority of reducing debt.

**9. We remain committed to the expenditure measures introduced so far, but will consider using part of the one-off fiscal windfall in 2015 to cover one-off expenses.** While revenues are over-performing earlier projections, 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 4.0 percent of GDP this year, below the original target of 5.9 percent of GDP:

- We have suspended the indexation of public sector wages and pensions, according to the Budget System Law and Pension Insurance Law modified 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 the 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 amended in June 2015 to introduce an electricity excise of 7.5 percent on total electricity charge (excluding VAT) effective from August 1, 2015 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.

- We have introduced an excise tax on electronic cigarettes.

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

- We have received one-off dividend receipts from SOEs of RSD 22 billion in 2015. We will consider using some of this for certain one-off expenses that would be agreed with IMF staff in the context of the third review, without any implications for future spending. If necessary, in the third review, we will add adjustors to expenditure and deficit performance criteria for end-December 2015 to cover these expenses.

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

- 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 adopted the Law on Registry on July 31 setting out the necessary data submissions and all responsible agencies. We have adopted a legal framework necessary to ensure full coverage of public sector employees. We finalized and validated the general government employment and wage data in the registry in July (end-June structural benchmark). The registry also includes employment and wage data for key SOEs, but not separately validated. These will be addressed in individual restructuring plans for major SOEs (¶¶ 35).

- We will continue applying the attrition rule throughout 2015, and based on the Law on the Ceiling on Public Sector Employees approved on July 31, we will finalize the first round of targeted separations by end November 2015. In the first half of 2015, general government permanent employment was reduced by about 3,000 via attrition, which is expected to continue in the second half. With about 5,000 more early retirements than usual bunched at end-2014 due to the introduction of an early retirement penalty in January 2015, targeted separations of 9,000 in the second half will be consistent with the budgeted savings in the annual wage bill—equivalent to the reduction of general government employment by 5 percent. The Law on Ceilings on the Number of Employees adopted in July laid the legal basis for an 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 both targeted and voluntary separations have been determined in line with the current Civil Service Law and Labor Law.

- We have initiated a comprehensive public wage system reform intended to improve transparency, efficiency and manageability of the currently unwieldy system. A job catalogue reducing the number of jobs and titles from several thousand to around 500 for all state employees other than the Armed forces was completed by end-September, with the mapping of jobs reflected in the Registry by end-November. This will make it possible to compare the current remuneration of state employees across general government sector entities. An umbrella Law on Wages of State Employees establishing the key principles of the new system and setting out a timeline for its gradual adoption will be posted to public debate by mid-October with the intention for the Law to be effective from January 1, 2016. The base for all wages will be unified and the structure of coefficients and elements of pay will be partly simplified by year-end. By April 2016, we will adopt separate wage laws and other necessary legislation for large sectors of the general government, which will operationalize transition to the new job classification, unification of pay grades across comparable jobs and alignment of base wages beginning by June 2016. The timeframe and modalities for the full transition to the new system will be determined in the course of 2016. Any wage increases proposed for 2016 would be targeted to sectors with the largest wage gaps, such as medical staff in the health sector and teaching staff in the primary and secondary education.

**11. For 2016-17 our primary focus remains 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 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 government, 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-December 2015. We are thus committed to attaining a further reduction of the general government wage bill by 5 percent in both 2016 and 2017 (excluding the impact of severance payments and any wage increases agreed as per para 12). This can be achieved via wage reductions and reductions of other labor-associated costs budgeted in goods in services. Throughout 2015, we will also advance the data and legal infrastructure necessary to accomplish additional savings in 2016 and 2017 by introducing e-government.

- 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 (end-September structural benchmark). Given the complexity of aligning numerous stakeholders and conducting public debate, we need to further extend the timeframe for finalization of the law. As a new structural benchmark, we will post the draft law for public debate by end-October. 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.

**12. We intend to explore the possibility of using a small part of the structural revenue gains in 2015 to relax expenditures in 2016**. The total envelope for additional spending will be confirmed in the 2016 budget in consultation with Fund staff, after further careful analysis of a few more months of revenue data. Possible areas for increased expenditures include targeted wage increases consistent with convergence under the wage system reform, a one-off pension increase, a subsidized SME lending program, and high-priority public investment. Any additional spending would remain consistent with our goals for debt reduction and for reducing wage and pension expenditures as a share of GDP.

**13. 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.

## B. Structural Fiscal Policies

**14. 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, in the 2015 Budget 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.

- We will review and clearly define the coverage of general government to be compatible with European System of Accounts (ESA) 2010. We will submit financial plans of social security funds with all their indirect beneficiaries to the National Assembly, in parallel with Republican budget. We will include all indirect budget beneficiaries of the central government in the Financial Management Information System gradually by end-2017. More specifically, we will include courts, public prosecutors and other judicial institutions by end 2015. Prisons, cultural institutions and social protection institution will be included by end 2016. Education and local governments will be included by end 2017, taking into account their technical and technological capacity. This will accommodate more realistic planning of indirect budget beneficiaries' revenues and expenditure in the central government budget.

- 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.

- We will ensure that a full assessment of all proposed Public-Private Partnerships (PPPs) is reviewed by the Ministry of Finance (MOF), including PPPs' key financing features, cost-benefit analysis, and risk sharing arrangements with the government. We will also include a fiscal risk statement on all PPPs in the Medium-Term Fiscal Strategy 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. Further technical assistance for analytical capacity building will be provided by IMF. Furthermore, to improve control of fiscal implications and risks, we will amend the existing Law on Public-Private Partnership and Concessions by September 2015 to mandate that all PPPs are submitted to the government for consideration only with prior approval of the MOF.

- We have implemented 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.

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

- We are creating a strong and stable institutional framework for monitoring SOEs. As a first step, we adopted 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 ¶14), 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 broadened the scope of the Law on Payments in Commercial Transactions, to include transactions between public entities (including SOEs) in July 2015 (end-June structural benchmark). This law defines 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 and administrative penalties for responsible individuals applied. 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 modified the Public Debt Law accordingly in July 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 will consult 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.

**16. 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 confirmed the Director of Serbia's Tax Administration in June 2015. We adopted in early June, and have started to implement, the *Tax Administration Transformation Program 2015–20* as the official medium-term reform program (prior action for the completion of the first review). 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. We are acutely aware of the need to recruit and train new staff (for example, in the Large Taxpayer Office) and will finalize a staff recruitment and retention plan which will be approved by government by end-March 2016, with overall staffing remaining consistent with the public sector right-sizing objectives.

## C. Monetary and Exchange Rate Policies

**17. 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 under the original program, although we propose to make a minor revision of the inflation consultation clause for December 2015 to bring it in line with the NBS inflation tolerance band (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.

**18. 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 well above the level that could be considered as necessary for precautionary purposes. We will maintain adequate coverage throughout the program, which will be monitored by a floor on net international reserves (quantitative performance criterion).

**19. 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.

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

## D. Financial Sector Policies

**21. Our policies will support financial sector stability and enhance the 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.

22. **We finalized our comprehensive strategy for addressing the NPL overhang.** The strategy, published on August 13, 2015, was prepared by an inter-institutional Working Group that included representatives from the Ministries of Finance, Economy and Justice, the NBS and Deposit Insurance Agency (DIA), with staff of the IMF, IFC, WB, and EBRD participating as observers. By the end of December 2015, we will, among others (i) submit amendments to tax legislation to the National Assembly to remove disincentives for timely NPL resolution; (ii) introduce a new legal and operational framework for transparent real estate appraisals and improved regulation of the appraisal profession; and (iii) prepare amendments to the Bankruptcy Law that, in line with recommendations from IMF technical assistance, strengthen safeguards for secured creditors and allow for better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (all structural benchmarks). In addition, the NBS will prepare more granular NPL reporting requirements for banks, together with enhanced supervisory standards for restructured receivables and distressed asset management by end-March 2016 (structural benchmark). While we remain committed to removing potential impediments to, and providing incentives for, timely NPL resolution, we will continue to focus on market-based solutions.

23. **We have largely completed the detailed assessment of asset quality and provisioning practices of banks operating in Serbia** In order to assure quality of the exercise, and in view of operational complexities, the original timeframe for the SDS has been slightly extended. Banks whose SDS-adjusted capital ratios fall short of the applicable regulatory minimum are expected to provide, within two weeks of the presentation of the results of the exercise, remedial actions for addressing such shortfalls in line with SDS Terms of Reference. We expect banks to have implemented such actions by end-March 2016 or in exceptional circumstances by end-June 2016 (conditional on prior approval of IMF and NBS) and will closely monitor progress. To maintain a conservative application of International Financial Reporting Standards (IFRS) following the SDS, the NBS will prepare, by end-December 2015, supervisory guidance for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (structural benchmark). In parallel, the NBS will embed methodological aspects of the SDS in its supervisory procedures and strengthen its analytical capacity in the area of IFRS.

24. **We will enhance the microprudential supervisory and regulatory framework.** Effects to strengthen financial sector supervision continue apace. Preparations for the implementation of the Basel III framework are progressing, aided by a gap analysis that compared the current regulatory framework to the new Basel standards, as well as quantitative impact studies on capital, risk weighted assets, leverage and liquidity. The NBS has finalized plans for strengthening its prudential oversight over the insurance sector, benefiting from IMF technical assistance, and will prepare proposals for strengthening its practices for banking supervision. As part of the latter, the NBS will introduce a more risk-sensitive supervisory cycle that will help increase the intensity of supervision for systemically important banks and institutions with the

highest risk rating. To ensure sufficient resources are available to carry out its duties, the NBS will continue to hire additional staff. Finally, the preparation of contingency measures for banks whose viability is at risk will help to buttress financial stability.

25. **The NBS continues to develop its macroprudential policy framework.** Systemically important banks have been identified using the internally developed methodological framework, based on the final EBA Guidelines. A proposal for the determination of capital surcharges for such institutions has been prepared. The necessary regulatory amendments for the introduction of other macroprudential instruments will be adopted in accordance with the transposition of the Basel III framework. Our aim is to use the new regulatory opportunities to maintain and strengthen financial stability without losing current advantages in terms of the banking sector high capital and liquidity position.

26. **The NBS continues to implement the amended bank resolution framework and financial sector safety net.** The new Bank Resolution Department is operational and information- and data-sharing arrangements with other NBS functions, as well as the DIA, are in place. Banks have submitted their initial recovery plans, and a decision on reporting for resolution planning purposes has been adopted by the NBS' Executive Board, following a public consultation process. Resolution plans for systemically important banks are expected to be available by end-December 2015. In addition, the NBS has updated its policy framework for Emergency Liquidity Assistance.

27. **Implementation of the strategy for state-owned banks is progressing.** We are strengthening our oversight over financial institutions that are, in whole or in part, state-owned. We will reorient the business strategy of Banka Postanska Stedionica towards retail activities, for which a new business plan will be adopted by the Government (structural benchmark). In parallel, we will identify measures to strengthen the bank's risk control framework, in line with international best practices. The privatization advisor for Komercijalna Banka, the second-largest bank, has been appointed and the privatization process for Dunav Osiguranje, Serbia's largest insurance company, will be initiated once the privatization advisor has been selected. Decisions on the course of action for the remaining small state-owned banks will be taken by December 2015, as part of the update of the strategy for state-owned banks.

28. **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.

29. **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 improve Apex program efficiency, the Ministry of Economy has prepared guidance – developed in accordance with EIB criteria – regarding prioritization of loan

allocations. Beginning from the October 2015 tranche, financing proposals in line with this guidance will be submitted for EIB's approval without pre-approval by Steering Committee. Instead, the Committee will perform ex-post review of loan utilization. We intend to prepare a detailed analysis of past subsidized lending programs, with a view towards assessing their effectiveness and additionality in consideration of a potential reintroduction (subject to the availability of fiscal space) in 2016.

## E. Structural Policies

**30. We have initiated 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.

**31. 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 programs for redundant employees in SOEs for 2015 with the new Labor Law. Many of the programs under NEAP 2015 and 2016 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 conducted an analysis of the Labor Law and other regulations, and decided to legislate a new Law on Social Partnership and Collective Bargaining in 2016.

**32. 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, a large number of which were protected under a bankruptcy moratorium until end-May 2015. For a small group of 17 companies the moratorium was extended for up to one year in late May. We are committed to resolve at least 7 of these through either privatization or bankruptcy by end-2015 (structural benchmark), with the rest to be resolved by the end-May 2016 deadline. 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.

**33. 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-August, the court has opened bankruptcy proceedings for 133 companies with little privatization prospects, and initiated the public tenders for privatization of 98 companies. We intend to finish the bankruptcy process of about an additional 40 companies by end-2015, and privatization procedures for an additional 40 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 and are being disbursed to the eligible recipients. These benefits are consistent with severance payments in the Labor Law.

**34. We aim to privatize or find strategic partners for a number of SOEs and concession projects.** We will use the proceeds primarily for reducing the stock of public debt but possibly also for funding future financially viable and high return investment projects. The size of investment funding will be determined in consultation with IMF staff. To support the operation of the telecommunication sector on a strictly market basis, we have launched an invitation for non obligatory offers for the privatization of Telekom Serbia in July 2015, and we are in the process of evaluating the offers. We also selected a privatization advisor for Komercijalna Bank, the second largest bank in Serbia, with a view to completing the privatization in 2017. 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. Going forward, we will continue preparations for privatization of the company complying with the EU requirements. At the same time, we have hired advisors to explore long-term concession partnerships for managing the Belgrade airport and continue to explore options for operating Corridor XI.

**35. We are committed to continue 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 July 2015, a new organizational structure consisting of subsidiaries for electricity generation, distribution and supply, as specified in the corporate restructuring plan adopted in November 2014, became effective. This aims to streamline the organizational structure and management as a first step to enable a financially self-sustaining EPS in the future, thus avoiding the need for state aid. In consultation with the World Bank and EBRD, we adopted the financial restructuring plan for EPS in early June 2015. 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, and (ii) a reduction of operational cost including through increased efficiency, optimization of the supply mix, and staff rightsizing. Achieving EPS financial sustainability will require the implementation of this full package of measures. We established an inter-ministerial working group to identify bottlenecks arising during implementation and take corrective action requiring concerted Government efforts. As a first tangible step in the implementation of the plan, the tariff increase and a new excise tax on electricity became effective from August 1, resulting 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 levels to facilitate the transition to a competitive market, in accordance with the Energy Law. By end-2015, we will finalize the amendment to the collective agreement in order to allow for the implementation of the rightsizing identified in the restructuring plans, in consultation with the World Bank (structural benchmark). We will fully implement the new management structure specified in the corporate restructuring plan adopted in November 2014 by eliminating one layer of management in all three lines of business (generation, mining and distribution) by the end of 2015. Following the ongoing corporate restructuring process and financial consolidation, we will change the legal status of EPS to a joint stock company by July 1, 2016, with an aim to attract minority private investment participation that could further enhance the corporate governance and viability of the company and ensure its professional management. These and other measures set out in the plan will continue to be implemented through 2016–2017.

- **Srbijagas.** A new organizational structure consisting of subsidiaries for transmission and distribution, following the corporate restructuring plan adopted by government in December 2014, became effective in August 2015. In line with the fiscal program, we have divested part of Srbijgas' non-core 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, increasing the transit and network fees, addressing the large stock of historical debts, and improving the corporate governance and viability of the company. The plan will be adopted by end-January 2016 (structural benchmark moved from end-October), with delay due to the need to prepare a more comprehensive restructuring plan. The terms of reference for the financial restructuring plan have been prepared. These measures will ensure that Srbijagas' financial position does not deteriorate further, and put the company on a sustainable path, 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 fourth company was approved by the Railway Assembly and the government in May 2015, and became effective from July 2, 2015. In consultation with the World Bank, Railways has identified and is implementing 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 purely commercial basis from January 2018. The freight section will make its best efforts to avoid state subsidies even before the mentioned date. To support market competition, an infrastructure usage fee will be introduced by end-December 2015. We will also continue the reorganization and improvement of business plans for the state-owned passenger and infrastructure companies and the fourth company, to strictly limit the amount of state aid disbursed over the medium term. We are cooperating 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 on the Project of reform of railways. These plans will be adopted with a slight delay by the Government Steering Committee by mid-October 2015, due to the need for additional discussion with IFIs (end-September structural benchmark). The restructuring targets in the plans, including redundancy programs during 2016, 2017, and 2018-2020, will be set in agreement with the World Bank and IMF staff. We will start implementation of labor retrenchment immediately after adoption of these plans by the Government Steering Committee.

- **Roads of Serbia.** We will take action on the revenue side by revisiting the adequacy of toll rates and on the expenditure side by adopting a plan for removing rigidities in pricing maintenance contracts in the second half of 2016 and implementing it for 1,000 km. 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 for Roads of Serbia will be developed during 2016 in close consultation with the World Bank.

**36. 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 also adopted the Law on Conversion for a Fee of the Right of Use of Construction Land into Ownership in July 2015 and will adopt amendments to the Law on State Survey and Cadastre by end-2015. Since these legislative changes, the issuance of the construction permits has been expedited significantly and we are preparing for the full implementation of the electronic permit issuance starting from 2016.

- To enhance predictability and reduce corruption and the grey economy, we adopted a new Law on Inspection Oversight in April 2015, and improved labor inspection has already started contributing to the reduction of informal jobs and increases in social contribution collections.

- We will adopt a new Investment Law in September2015, which will replace and broaden the scope of the Foreign Investment Law to include domestic investment. We have initiated reform and consolidation of our investment and export promotion agencies and programs. With the adoption of the new Investment Law, we will establish new Serbian Development Agency, by merging the Serbia Investment and Export Promotion Agency (SIEPA) and National Agency for Regional Development (NARD), integrating and streamlining their operations. The new Law will also put in place a clearer legislative framework for administering investment incentives. By the end of the year, we also plan to reform the Development Fund, and the Serbian Export Credit and Insurance Agency (AOFI). These agencies will be either reorganized or replaced with new institutions performing similar functions in a more efficient manner.

- We will amend the Law on Consensual Financial Restructuring and Law on the Agency for Bankruptcy Administrators Licensing by end-September 2015 to centralize all bankruptcy procedures and administration. We will establish a new bankruptcy agency by May 2016 following the amendment to the Bankruptcy Law in December 2015.

- We will adopt by end-2015 a new Law on Fees and Charges, which will replace existing laws and by-laws to regulate fees at all levels of government, to ensure greater predictability and transparency. The Law will be effective from January 1, 2017.

- 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 have established a working group to implement the action plan to improve the business environment for SMEs based on the SME strategy for 2015–20 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 are expanding the coverage of active labor market policies and will start reforming the National Employment Service, supported by the Competitiveness and Jobs project, to improve the efficiency of its programs and enhance the quality of services provided both to unemployed and employers.

## Program Monitoring

**37.** 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- September, and December 2015.

## Table 1. Serbia: Quantitative Program Targets 1/

| | 2015 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Mar | | | Jun | | | Sep | | Dec | |
| | Prog. | Adj. Prog. | Act. | Prog. | Adj. Prog. | Act. | Proj. CR 15/20 2/ | Prog. | Proj. CR 15/20 2/ | Prog. |
| **I. Quantitative performance criteria (quarterly)** | | | | | | | | | | |
| 1 Floor on net international reserves of the NBS (in millions of euros) | 6,290 | ... | 7,155 | 6,063 | ... | 7,122 | 5,718 | 5,718 | 5,835 | 6,266 |
| 2 Ceiling on the general government fiscal deficit 3/ 4/ (in billions of dinars) | 55.7 | 53.2 | 21.1 | 96.3 | 90.8 | 35.3 | 153.1 | 153.1 | 232.1 | 165.0 |
| 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 | 421.2 | 405.2 | 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 | ... | 0 | 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 accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars) | 0.0 | ... | -0.66 | 0.0 | ... | -0.56 | 0.0 | 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 | 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 | ... | 128 | 314 | 314 | 384 | 384 |
| **IV. Inflation consultation band (quarterly)** | | | | | | | | | | |
| Outer band (upper limit, 2.5 percent above center point) | 4.2 | ... | ... | 5.5 | ... | ... | 5.1 | 5.1 | 6.7 | 6.5 |
| Inner band (upper limit, 1.5 percent above center point) | 3.2 | ... | ... | 4.5 | ... | ... | 4.1 | 4.1 | 5.7 | 5.5 |
| *End of period inflation, center point 5/* | *1.7* | ... | *1.9* | *3.0* | ... | *1.9* | *2.6* | *2.6* | *4.2* | *4.0* |
| Inner band (lower limit, 1.5 percent below center point) | 0.2 | ... | ... | 1.5 | ... | ... | 1.1 | 1.1 | 2.7 | 2.5 |
| Outer band (lower limit, 2.5 percent below center point) | -0.8 | ... | ... | 0.5 | ... | ... | 0.1 | 0.1 | 1.7 | 1.5 |

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: Structural Benchmarks

| Measures | Target date | Status |
|---|---|---|
| **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 | Not met, implemented 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 ¶16). | March 31, 2015 | Not met, implemented with a delay as a prior action for the 1st review. |
| 3 Adoption of the EPS financial restructuring plan by the Government (MEFP ¶35). | March 31, 2015 | Not met, implemented with a delay as a prior action for the 1st review. |
| 4 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 ¶10). | June 30, 2015 | Not met. Fully implemented for the general government. |
| 5 Approval by the National Assembly of changes to the Law on Payments in Commercial Transactions to include transactions between public entities including SOEs (MEFP ¶15). | June 30, 2015 | Not met, implemented with a delay in July, 2015. |
| 6 Adoption by the National Assembly of a new Local Government Financing Law (MEFP ¶11). | September 30, 2015 | Not met. New structural benchmark on posting of a draft law to public debate is set for end-October, 2015. |
| 7 Adoption by the Government Steering Committee of a corporate and financial restructuring plan for Railways of Serbia, to be prepared by an independent consultant (MEFP ¶35). | September 30, 2015 | Not met, expected to be implemented in October 2015. |
| 8 Adoption by the Government of a financial restructuring plan for Srbijagas, to be prepared by an independent consultant (MEFP ¶35). | October 31, 2015 | Proposed to be reset to January 2016. |
| 9 Posting of draft Local Government Financing Law for public debate (MEFP ¶11). | October 31, 2015 | New benchmark |
| 10 Adoption by the government of by-laws aimed at strengthening the project appraisal process (MEFP ¶8). | December 31, 2015 | New benchmark |
| 11 Resolution through either privatization or bankruptcy of at least 7 of the 17 strategically important companies that received protection from debt enforcement until May 2016 (MEFP ¶32). | December 31, 2015 | New benchmark |
| 12 Amendment to the EPS collective agreement to allow for the implementation of the rightsizing identified in the restructuring plans (MEFP ¶35). | December 31, 2015 | New benchmark |
| **Financial** | | |
| 13 Completion of special diagnostic studies of banks (MEFP ¶21). | September 30, 2015 | Not met, implemented with a delay in October, 2015. |
| 14 Preparation of supervisory guidance setting forth expectations for loan loss provisioning under IAS 39, in consultation with IMF staff and relevant domestic stakeholders (MEFP ¶23). | December 31, 2015 | |
| 15 Introduction of a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on real estate valuations filed according to pre-established criteria; and (iii) legislation providing proper supervision of the licensed appraisers. (MEFP ¶22). | December 31, 2015 | |
| 16 Conduct of a review of the corporate insolvency law and submission of proposed amendments to the National Assembly, in line with recommendations from IMF technical assistance, aimed to ensure: (i) adequate safeguards for the secured creditors rights; and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation (MEFP ¶22). | December 31, 2015 | |
| 17 Submission to the National Assembly of tax law amendments to remove disincentives for timely NPL resolution (MEFP ¶22). | December 31, 2015 | New benchmark |
| 18 Adoption by the Government of retail-oriented business plan for Banka Postanska Stedionica (MEFP ¶27). | December 31, 2015 | New benchmark |
| 19 Develop enhanced supervisory standards for restructured receivables and distressed asset management by banks (MEFP ¶22). | March 31, 2016 | New 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 (performance criterion) | 6,266 |

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

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

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

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

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

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

Source: NBS

**6.** Adjustors. For program purposes, the NIR target will be adjusted upward by the value of long-term assets and foreign-exchange-denominated claims on resident banks and nonbanks as well as Serbian commercial banks abroad, recovered by the NBS since December 31, 2014. The NIR floor will be adjusted upward by the full amount of proceeds from any eurobond issuance and external bilateral budget loans to the General Government since September 30, 2015. External bilateral budget loans, in this context, are loans to the Republican budget provided without any pre-specified purpose other than satisfying funding needs of the public sector. The NIR floor will also be adjusted upward by the value of domestically acquired gold for which certification was obtained after December 31, 2014. The NIR floor will also be adjusted upward by any privatization revenue in foreign exchange received after December 31, 2014. Privatization receipts are defined in this context as the proceeds from sale, lease, or concession of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS either directly or through the Treasury.

## B. Inflation Consultation Mechanism

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

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

## C. Fiscal Conditionality

**9. The general government fiscal deficit** (previously referred to as the general government augmented fiscal deficit, see IMF Country Report 15/20, p. 70), on a cash basis, is defined as the difference between total general government expenditure (irrespective of the source of financing) including expenditure financed from foreign project loans, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeover if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law) and total general government revenue (including grants). For program purposes, the consolidated general government comprises the Serbian Republican government (without indirect budget beneficiaries), local governments, the Pension Fund, the Health Fund, the Military Health Fund, the National Agency for Employment, the Roads of Serbia Company (JP Putevi Srbije) and any of its subsidiaries, and the company Corridors of Serbia. Any new extra budgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Privatization receipts are classified as a financial transaction and are recorded "below the line" in the General Government fiscal accounts. Privatization receipts are defined in this context as 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. Domestic arrears.** For program purposes, domestic arrears are defined as the belated settlement of a debtor's liability which is due under the obligation (contract) for more than 60 days, or the creditor's refusal to receive a settlement duly offered by the debtor. The program will include an indicative target on the change in total domestic arrears of (i) all consolidated general government entities as defined in ¶9 above, except local governments; (ii) the Development Fund, and (iii) AOFI. Arrears to be covered include outstanding payments on wages and pensions; social security contributions; obligations to banks and other private companies and suppliers; as well as arrears to other government bodies.

## D. Ceilings on External Debt

**15. Definitions.** The ceilings on contracting or guaranteeing of short-term external debt (with maturities up to one year) consolidated general government, the AOFI, and the Development Fund applies not only to debt as defined in point 8 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are normal short-term import credits. For program purposes, debt is classified as external when the residency of the creditor is not Serbian. For new debt to budgetary users, the day the debt is contracted will be the relevant date for program purposes. For new debt to non-budgetary users, the day the first guarantee is signed will be the relevant date. Contracting or guaranteeing of new debt will be converted into euros for program purposes at the program cross exchange rates described in this TMU.

## E. Ceiling on External Debt Service Arrears

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

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

## F. Reporting

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

INTERNATIONAL MONETARY FUND

# REPUBLIC OF SERBIA

October 21, 2015

## SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR WAIVERS OF APPLICABILITY OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

| | |
|---|---|
| Prepared By | European Department |

**This supplement provides information that has become available since the Staff Report was circulated to the Executive Board on October 8, 2015.** The information does not alter the thrust of the staff appraisal.

**The end-September performance criterion on net international reserves (NIR) has been met with a large margin and headline inflation remained within program bands:**

- The end-September NIR outcome was €7,538 compared to the program floor of €5,718 million (Table 1). As final NIR data is now available, a waiver of applicability for this performance criterion is not needed.
- Headline inflation in September was 1.4 percent, which is lower than projected in the staff report, but still within the inner program band (Table 1).

## Table 1. Serbia: Quantitative Program Targets 1/

| | 2015 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar | | | Jun | | | Sep | | | Dec | |
| | Prog. | Adj. Prog. | Act. | Prog. | Adj. Prog. | Act. | Proj. CR 15/20 2/ | Prog. | Act. | Proj. CR 15/20 2/ | Prog. |
| **I. Quantitative performance criteria (quarterly)** | | | | | | | | | | | |
| 1 Floor on net international reserves of the NBS (in millions of euros) | 6,290 | ... | 7,155 | 6,063 | ... | 7,122 | 5,718 | 5,718 | 7,538 | 5,835 | 6,266 |
| 2 Ceiling on the general government fiscal deficit 3/ 4/ (in billions of dinars) | 55.7 | 53.2 | 21.1 | 96.3 | 90.8 | 35.3 | 153.1 | 153.1 | ... | 232.1 | 165.0 |
| 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 | 421.2 | 405.2 | 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 | ... | 0 | 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 accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars) | 0.0 | ... | -0.66 | 0.0 | ... | -0.56 | 0.0 | 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 | 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 | ... | 128 | 314 | 314 | ... | 384 | 384 |
| **IV. Inflation consultation band (quarterly)** | | | | | | | | | | | |
| Outer band (upper limit, 2.5 percent above center point) | 4.2 | ... | ... | 5.5 | ... | ... | 5.1 | 5.1 | ... | 6.7 | 6.5 |
| Inner band (upper limit, 1.5 percent above center point) | 3.2 | ... | ... | 4.5 | ... | ... | 4.1 | 4.1 | ... | 5.7 | 5.5 |
| *End of period inflation, center point 5/* | *1.7* | ... | *1.9* | *3.0* | ... | *1.9* | *2.6* | *2.6* | *1.4* | *4.2* | *4.0* |
| Inner band (lower limit, 1.5 percent below center point) | 0.2 | ... | ... | 1.5 | ... | ... | 1.1 | 1.1 | ... | 2.7 | 2.5 |
| Outer band (lower limit, 2.5 percent below center point) | -0.8 | ... | ... | 0.5 | ... | ... | 0.1 | 0.1 | ... | 1.7 | 1.5 |

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.

**Statement by Daniel Heller, Executive Director for the Republic of Serbia and Vuk Djokovic, Senior Advisor to the Executive Director**
**October 23, 2015**

On behalf of the Serbian authorities, we would like to thank staff for the constructive policy dialogue as well as for their recognition of the substantial progress made under the Stand-by Arrangement (SBA). The arrangement plays a key role in supporting the authorities' reform agenda which aims at ensuring macroeconomic stability by putting public finances on sustainable footing, strengthening the resilience of the financial sector, and implementing comprehensive structural reforms. Moreover, Fund's engagement is helping catalyze support from other international financial institutions (IFIs), including technical assistance (TA), and improve investor confidence. Under the program, the Serbian authorities have implemented a broad range of bold and politically difficult policies to (i) reduce current expenditures, including public wages and pensions, (ii) minimize contingent fiscal risks stemming from unsound state-owned enterprises (SOEs), (iii) strengthen financial sector stability and intermediation, and (iv) improve the investment environment. These policies, which demonstrate the strong ownership by the Serbian authorities, are starting to yield tangible results such as the return to positive growth, continued fiscal over-performance, lower unemployment and further strengthening of the external position. Our authorities reiterate their strong commitment to the program and confirm their intention to treat it as precautionary.

## Outlook

The recovery of the Serbian economy is underway. Since the inception of the program, the economic outlook has been revised upwards twice and growth is now projected to be positive in 2015. The driving factors are (i) strong export performance, (ii) better-than-expected response of domestic consumption to fiscal consolidation, (iii) a rebound in investment, and (iv) declining energy prices. The Serbian authorities are confident that the recovery will strengthen in 2015. Inflation remains below the inflation tolerance band, mostly as a consequence of low imported inflation, relatively stable exchange rate, and delays in increases of regulated prices. Headline CPI inflation is projected to reach 2.2 percent in December and return within the inflation tolerance band in early 2016. The current account deficit has narrowed to around four percent, financed by strong capital inflows, in particular foreign direct investments. While exports continue to grow, net exports were slightly weaker than expected in Q3, mostly as a consequence of higher equipment imports. Growth is expected to further accelerate in 2016, building on the sound macroeconomic policies, the ongoing structural reforms, the relatively stable external environment and increased confidence. Regarding the EU integration, Serbia continues to make important progress towards EU membership. After obtaining the candidate status in 2012, the formal membership negotiations have started in 2014 and the screening phase for all chapters of *acquis communautaire* has been successfully completed. The opening of the negotiation of the first chapters is expected in late 2015 or in early 2016.

**Fiscal policy**

Serbia has recorded noteworthy progress in fiscal consolidation since the initial measures were implemented in 2014 and has over-performed by a sizable margin the fiscal targets agreed under the SBA. The authorities' strong ownership and policy implementation have led to fiscal outcomes that largely exceeded expectations. In the first half of the year, fiscal performance has been strong. The projected fiscal deficit for 2015 was reduced to four percent of GDP, down from 5.9 percent assumed at the inception of the program. Also, the central government has been recording a primary surplus in the first eight months of 2015. This substantial fiscal over-performance is mainly stemming from stronger-than-expected revenues, resulting from stronger tax collection and improved discipline in SOEs' profit transfers to the government—together with the containment of expenditures and the control of state aid to SOEs. Fiscal revenues additionally benefited from the authorities' strong effort to introduce legal changes that allowed for broader labor inspection and more effective fight against gray economy activities.

Looking forward, the authorities remain committed to the overarching fiscal policy objectives of stabilizing public finances, putting the public debt on a downward trend and increasing the efficiency of public sector. In particular, the Serbian authorities remain committed to rationalize and rightsize the public sector as well as reduce the public sector wage bill. The rightsizing exercise will be supported by the public sector employment registry, created to better monitor and control the employment in the public sector, including the identification of areas of over-employment. The government will adopt the plan for targeted separation for 2015 by end-November, in line with the program objectives, building on the 5 to 1 attrition rule that has been already yielding substantial results in reducing employment in the public sector. These measures will be complemented by fiscal structural reforms to strengthen tax administration and public financial management.

The strong policies implemented by the Serbian authorities have yielded additional fiscal space. The authorities are considering using part of it to support the recovery, without jeopardizing program objectives and in close consultations with the Fund. The authorities and staff have agreed on a new deficit target for 2015 of four percent of GDP, considered appropriate to keep with the strong consolidation momentum. In structural terms, this corresponds to an adjustment of two percent of GDP.

**Monetary and exchange rate policies**

Accommodative monetary policy remains appropriate, as pointed out by staff's analysis. Headline CPI inflation is projected to remain below the National Bank of Serbia (NBS) inflation tolerance band as average inflation was revised down to 1.6 percent. Such low inflation rates, paired with fiscal consolidation and benign external conditions, allowed the NBS to continue with the easing cycle. Since the beginning of 2015, the reference rate has been lowered in seven consecutive steps of 50 basis points and currently stands at its historic minimum of 4.5 percent. Inflation is expected to return in the band in early 2016 and reach the target of four percent by mid 2016. The NBS is also gradually lowering the statutory reserve requirements, which remain relatively high in Serbia compared with the peer countries. These policies will help reduce the cost of refinancing and support lending.

The NBS also continues to be committed to the managed floating exchange rate regime for the dinar and to reduce euroization. As the exchange rate flexibility provides a buffer against external shocks, foreign exchange interventions will be limited to smoothing excessive exchange rate volatility without targeting a specific level or path for the exchange rate. The current level of gross international reserves is very comfortable and the central bank will maintain adequate coverage throughout the program. The Serbian authorities are also considering additional measures to promote dinar lending—as opposed to prevailing euro-indexed loans—in particular in the context of buoyant euro zone liquidity and low euro interest rate. Steady increase of share of dinar lending is pivotal to strengthen monetary policy transmission and prevent buildup of balance sheet risks within the economy.

**Financial sector**

The Serbian banking sector remains stable and well capitalized. Regulatory capital to risk weighted assets is high, and liquidity is supported by continuous growth of deposit. However, the banking sector is burdened by a large stock of non-performing loans (NPL), mostly within the corporate portfolio. While the NPLs are broadly covered by large prudential loss reserves, the NPL overhang represents a source of vulnerability and constrains banks' intermediation function. The authorities are well aware that reducing NPLs will play a key role in re-launching much-needed credit to the private sector.

The Serbian authorities have recently adopted a comprehensive strategy to tackle the broad range of issues which hamper NPL resolution. The strategy includes measures to (i) enhance the regulatory treatment of NPLs, (ii) improve the insolvency framework and procedures for voluntary out-of-court restructuring, (iii) introduce collateral valuation standards, (iv) remove tax disincentives which impede NPL resolution, (v) speed-up procedures and increase efficiency in bankruptcy cases, and (vi) promote creditor coordination in cases of debt restructuring for large corporates. The strategy was developed based on the TA provided by the Fund. While this work is ongoing, progress has already been made in number of areas, including the legal changes in areas of mortgage and tax legislation. Given the complexity and scope of envisaged measures to be introduced, a high level inter-institutional Working Group was established to coordinate all efforts.

To further evaluate the health of individual banks and accurately assess possible capital shortfalls, the authorities have launched special diagnostic studies (asset quality reviews) which are expected to be completed by end-October. The results of these studies will also support efforts to improve banking supervision.

**Structural policies**

The Serbian authorities are pursuing a comprehensive structural reform agenda including the restructuring of SOEs and the resolution of socially owned companies in the portfolio of the Privatization Agency. They take good note of staff's assessment that "the overall scope and progress of this work has been impressive".

The authorities are well aware of the need to (i) address organizational, financial and governance issues in SOEs, (ii) minimize fiscal risks, and (iii) reduce state aid to SOEs substantially and on a systematic basis. The three most important SOEs (the electricity company EPS, Srbijagas and Serbian Railways) already went through organizational changes, while the financial restructuring is ongoing. These companies also benefited from enhanced monitoring by line ministries, as well as from the continuous support from IFIs including the World Bank and EBRD. Regarding the socially owned companies in the portfolio of the Privatization Agency, only 17 of them remain protected under a bankruptcy moratorium. Seven of them will be resolved before year end and the remaining ones before May 2016. The bankruptcy moratorium has been revoked in May 2015 for all other companies in the portfolio of the Privatization Agency. Many of them are either in process of bankruptcy or tender privatization. The recently approved changes to the Law on Payments in Commercial Transactions will strengthen the payment discipline in the public sector, including SOEs. The investment climate is further benefiting from the enactment of the new Investment Law, the improvements in regulation regarding construction permits, and the labor market flexibility embedded in recently amended Labor Law.

**Conclusion**

The Serbian authorities remain committed to the agreed upon policies and consider them adequate to reach the program objectives. The implemented policies are yielding good results—fiscal adjustment has been strong, the economy started to grow and unemployment is declining. The strong performance created some fiscal space for growth enhancing measures, which will be discussed with staff in the context of the 2016 budget during the third program review. The public debt stabilization agreed under the program, supported by the high quality fiscal adjustment, remains the authorities' overarching objective. The authorities are aware of the risks and remaining vulnerabilities, in particular stemming from politically difficult SOE reform. The authorities keep a strong track record in implementing difficult reforms, and remain committed to SOE restructuring. If new measures are needed to achieve the program objectives, the authorities stand ready to consider such measures in consultation with the Fund.