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Republic of Serbia: First Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, Waiver of Applicability of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review—Staff Report; Staff Supplement; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Serbia

In the context of the first review under the Stand-By Arrangement and requests for augmentation, extension of the Arrangement, rephasing of purchases, a waiver of applicability of end-March performance criterion and a modification of end-June performance criteria, and financing assurances review, the following documents have been released and are included in this package:

- The staff report for the First Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, Waiver of Applicability of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review prepared by a staff team of the IMF, following discussions that ended on March 26, 2009, with the officials of the Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 30, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of May 4, 2009, on the assessment of the risks to the Fund and the Fund's liquidity position.

- A staff statement of May 15, 2009, updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its May 15, 2009 discussion of the staff report that completed the review.

- 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 the Repulbic of Serbia*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Serbia*
Technical Memorandum of Understanding*
*Also included in the staff report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

First Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, Waiver of Applicability of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review

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

Approved by Poul M. Thomsen and Michele Shannon

April 30, 2009

Background. Since the present SBA was designed in October–November 2008, Serbia's external and financial environment—like in much of Eastern Europe—has deteriorated abruptly and relentlessly: trade flows, output, domestic demand, and, especially, fiscal revenues are now all lagging significantly behind projections. Moreover, and notwithstanding a projected more rapid narrowing of the large external imbalance, an abrupt slowing of net capital inflows is likely to open up sizable external financing gaps in 2009–11, projected to add to €3½ billion (11½ percent of GDP).

Revised program strategy. To safeguard economic stability in this markedly deteriorated environment, the authorities have revised their strategy in three key respects. First, while the fiscal deficit targets for 2009–10 have been raised, additional fiscal adjustment measures—mainly falling on recurrent spending—will be taken. Second, the main foreign parent banks have been asked to voluntarily commit to roll over their exposures to Serbia and keep their subsidiaries well capitalized. And third, the authorities are requesting additional financial support from International Financial Institutions (IFIs) and the EU to close the projected external financing gaps in 2009–11.

Revised Stand-By Arrangement (SBA). In the attached letter, the Serbian authorities request an augmentation and extension of the SBA approved on January 16, 2009, a corresponding rephasing of purchases, and completion of the first review. A waiver of applicability is needed for the end-March 2009 fiscal performance criterion. The revised SBA would be increased to SDR 2,619.12 million (560 percent of quota, about €3 billion, or US$3.9 billion, or 10 percent of GDP) and extended to a total of 27 months, to mid-April 2011. A total of SDR 701.55 million (150 percent of quota) would be available upon approval of this request.

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I. Background[1]

1. **Since September 2008, private capital inflows have slowed sharply and trade flows have plunged (Figure 1).** Net external borrowing turned negative during the last quarter of 2008; FDI has slowed to a trickle, except for the €400 million privatization of the oil company NIS in February 2009. Nominal export and import flows in euros fell in January-February by about 30 percent below last year's levels. The sharpest declines in trade were for intermediate and capital goods, reflecting the drop in both domestic and trading partner manufacturing activity, while consumer goods declined less.

2. **At the same time, the exchange rate and risk spreads have stabilized since the beginning of the year (Figure 1).** The dinar has lost some 20 percent vis-à-vis the euro since September, a welcome correction given the large external imbalance, but unhedged private foreign exchange (FX) exposures suffered. To maintain liquid and orderly FX markets, the NBS injected some €2 billion up to February through direct interventions and by lowering FX reserve requirements. The exchange rate has largely stabilized since January, and FX interventions virtually ceased in March. After surging in late-2008, Serbia's sovereign spread has since stabilized, but remains at relatively high levels.

3. **The banking system has weathered the external shocks well, but credit is slowing sharply (Figure 2).** Reflecting the NBS's tight past prudential stance, banks had large capital and liquidity buffers (Tables 8−9). Initially, they covered FX liquidity shortages caused by withdrawal of household FX deposits with external borrowing; the NBS also provided FX liquidity relief by lowering the share of required reserves to be held in FX. Increased dinar reserve requirements were met by withdrawal from NBS securities. So far, only one small bank went into receivership. Reflecting rising risks, however, credit has largely stagnated, apart from a modest pickup in February when the government launched a credit stimulus program featuring a combination of interest subsidies, co-financing, and partial credit guarantees. Alongside, the NBS lowered the reserve requirement base by the amount of loans under the stimulus program, raised the ceiling on retail loan-to-capital ratio, abolished down payment requirements for households, and abolished reserve requirements on new foreign borrowing until end-2009. Nevertheless, indirect credit risks stemming from

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[1] Discussions took place during March 16–26, 2009 in Belgrade with President Tadić, Prime Minister Cvetković, Deputy Prime Ministers Djelić, Dinkić, and Krkobabić, Minister of Finance Dragutinović, National Bank of Serbia (NBS) Governor Jelasić, other senior officials, and European Commission, IFI, and private sector representatives. Representatives of foreign banks, Serbian authorities, home supervisors and officials, World Bank Group, EBRD, EIB, EC, and ECB met in Vienna under the chairmanship of the IMF on March 27. The IMF mission team comprised Messrs. Jaeger (head), Mottu, Lissovolik, Mirzoev (all EUR), Dodzin (SPR), Chailloux (MCM), and Ms. Eble (FAD). Ms. Nestorović, from the local IMF office, assisted the mission. Mr. Antić (OED) attended all policy meetings. The mission coordinated closely with World Bank staff on structural issues. Mr. Lissovolik took up his post as the Fund's new Resident Representative in April.

high loan euroization (about 70 percent, Table 7) are elevated, reflected in a steady rise of non-performing loan (NPL) ratios to 6½ percent in February.

4. **Output is slumping, the large external imbalance is adjusting rapidly, but inflation remains high.** Output growth decelerated further to 2.8 percent (y-o-y) in the fourth quarter of 2008. In January–February 2009, industrial production dropped by almost 20 percent (y-o-y). The external current account deficit—at 17 percent of GDP one of the highest in Eastern Europe in 2008—started to shrink rapidly at the beginning of 2009. Inflation fell below 10 percent in March, inside the target band but still relatively high compared to the rest of the region. High inflation in recent months was mostly due to large exchange rate depreciation, increased indirect taxes, and higher-than-anticipated regulated prices adjustments. These factors, which appear to be tapering off, outweighed so far the mitigating effect of slowing activity and decelerating nominal wage growth. In this setting, the NBS has only recently been able to lower its high policy interest rate, from 16½ to 15 percent, to support credit and economic activity.

5. **Fiscal outturns have been weaker than expected, reflecting collapsing revenue.** The 2008 fiscal deficit was slightly higher than targeted, at 2¼ percent of GDP. However, tax collections underperformed by 1¾ percent of GDP, reflecting plunging trade and activity and emerging tax compliance problems. The significant revenue shortfall was largely offset by lower cash spending, mainly on goods and services as well as capital, but also by accumulation of some expenditure arrears. Tax collections continued to underperform during the first quarter of 2009.

Serbia: General Government Operations, 2005-08
(In percent of GDP)

	2005	2006	2007	2008	
				Country Report No. 09/20	Actual
Revenue	42.9	43.8	42.4	42.8	40.9
Expenditure	42.1	45.4	44.2	45.2	43.4
Current	39.1	40.8	39.0	40.4	39.0
Capital	3.0	4.6	5.2	4.7	4.4
Fiscal balance	0.8	-1.6	-1.9	-2.3	-2.5
Structural balance 1/	0.1	-2.3	-3.8	-4.6	-4.7

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

1/ Actual fiscal balance adjusted for the effects of both the output and the external absorption gaps. See IMF Country Report No. 07/390, Chapter III.

6. **Nevertheless, performance under the program supported by the SBA was broadly satisfactory.** While the end-December 2008 performance criterion (PC) on the ceiling on the consolidated general government deficit was missed by some ¼ percent of GDP, all other quantitative PCs, the indicative target, and the inflation target under the

inflation consultation clause for end-December 2008 were met. The two structural benchmarks on adopting business plans of the Road Company and of ten state-owned enterprises, however, were delayed and are now expected in May 2009. The end-March PCs were met, except the fiscal PC for which complete and verified information is not yet available—although early indications suggest no significant deviations.

II. THE REVISED SBA-SUPPORTED PROGRAM

A. Objectives and Strategy

7. **Given the much weaker economic environment, the revised and augmented SBA aims at facilitating an orderly rebalancing of the economy.** Serbia will face the global financial storm from a severely unbalanced external position, with high external debt levels adding to its vulnerabilities. The previously booming capital inflows have not only dried up but are also unlikely to recover to the high levels observed before September 2008. Thus, both private and public sectors will need to reduce their absorption (spending) levels in line with sustainable incomes and available external financing. The revised and augmented SBA seeks to smooth—not prevent—the needed adjustment in spending in both sectors by mobilizing external financing that would otherwise not be available, while providing a framework to launch long-delayed structural reforms to strengthen the economy's still weak supply side.

8. **Against this backdrop, the authorities' revised program strategy is three-pronged** (MEFP, ¶11):

- **Additional fiscal adjustment:** With private sector spending and income shrinking relative to their boom-related levels, tax bases are also falling. But spending in recent budgets was predicated on a continued private sector boom, and would give rise to high and unsustainable structural fiscal deficits if no measures were taken.

- **Financing assurances from foreign parent banks:** These have been asked to provide voluntary assurances to broadly maintain their exposure to Serbia and to keep their subsidiaries well capitalized, based on stress tests.

- **Additional external financing from IFIs:** The EU and the World Bank are expected to provide some additional contributions, but the bulk of the additional external financing under the program would be provided by the Fund.

9. **The three policy prongs are mutually reinforcing, with each one essential to underpin a cooperative equilibrium.** In particular, seeking financing assurances from key foreign banks should reduce uncertainty and partly compensate for the volatile external environment, thereby supporting macroeconomic and financial stability. In addition, fiscal

and financial contingency planning, including through the planned diagnostic stress tests of banks, should make the revised program strategy robust toward downside scenarios.

B. Macroeconomic Framework

10. **IMF projections of Serbia's external environment have been in flux over recent months.** In March 2009, after successive downward revisions in World Economic Outlook (WEO) forecasts, EU output was projected to decline by 3 percent in 2009 and to be essentially flat in 2010; the program framework reflects this WEO vintage. Subsequently, the published April 2009 WEO again revised European growth prospects, marking EU output growth down by a further 1 percentage point.

Successive IMF Projections of Global Environment for 2009
(Annual change in percent)

	Oct. 2008	Nov. 2008	Jan. 2009	Mar. 2009	Apr. 2009
EU growth	0.6	-0.2	-1.8	-3.1	-4.0
Euro area growth	0.2	-0.5	-2.0	-3.2	-4.2
Advanced economies' imports	1.1	-0.1	-3.1	-7.2	-12.1
Emerging and developing econ. imports	10.5	5.2	-2.2	-7.5	-8.8
Oil price	-6.3	-31.8	-48.5	-46.4	-46.4
Nonfuel commodity prices	-6.2	-18.7	-29.1	-27.9	-27.9

Source: IMF *World Economic Outlook;* and IMF staff projections.

11. **The revised program framework envisions much lower growth but also faster external adjustment** (Table 12). The downturn will now likely be deeper and more protracted than expected only a few months ago. The program assumes a drop in GDP by 2 percent in 2009, with a U-shaped recovery pattern involving no growth in 2010. The current account deficit is expected to adjust more rapidly, on account of the sharp drop in domestic demand due to the slowdown in wages and credit and some real exchange depreciation. Given the depressed international environment, exports are expected to recover only in 2011 (Table 3). Inflation is projected to remain somewhat higher than previously anticipated, reflecting the large depreciation so far, which is likely to feed further into prices despite declining commodity prices and domestic demand.

Serbia: Macroeconomic Projections, 2008-09

	2008	2009	
	Est.	Country Report 09/20	Prog.
	(Annual change, in percent)		
GDP growth	5.4	3.5	-2.0
Domestic demand	5.9	2.6	-5.6
CPI (end-period)	8.6	8.0	10.0
	(In percent of GDP)		
Current account balance	-17.1	-16.0	-13.0
Trade balance	-22.3	-21.8	-17.5
Capital and financial account	12.4	13.4	3.2
Nominal gross wage	17.8	9.7	6.3
Real effective exchange rate	5.8	-4.3	-8.9
Export volume	9.8	2.0	-10.9
Import volume	9.2	0.6	-15.8
Export prices	5.8	-7.6	-10.7
Import prices	5.8	-6.5	-10.8

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

12. **External financing for Serbia is now projected to fall significantly short of earlier SBA assumptions** (Table 5). For 2009, staff projects an average rollover rate of 85 across different private external debt categories. Assuming that financing assurances by foreign banks result in rollover rates of 100 percent, this would imply rollover rates of about 70 percent for non-bank debt categories. Projections are now also more pessimistic on remaining capital flows, including FDI. External financing in 2010 is assumed to remain tight.

13. **Despite faster external adjustment, a large external financing gap is projected to open up in 2009–11.** While financing requirements to cover the current account are projected to fall in 2009 relative to the present program, debt amortization will be higher due to the accumulation of short-term debt at end-2008. With available financing projected to shrink, this leaves a sizable cumulative financing gap during 2009−11, estimated to amount to about €3½ billion (11½ percent of annual GDP). Only a small share can be expected to be filled by prospective official financing, mainly from the EU and the World Bank.

14. **The external sustainability analysis points to significant risks** (Appendix II). Some of the risks identified previously—namely a slowdown in GDP growth and some negative balance sheet effects of exchange rate depreciation—have already partly materialized. The adverse dynamics are expected to push external debt over 90 percent of GDP by 2011, up from 63½ percent at end-2008 (Table 4). However, assuming that the strong policies and structural reforms under the program lead to a resumption of growth and improved external balances, debt ratios would start declining by 2012. The risks associated with such debt levels remain high, however, not least because of an uneven record of structural reforms in the past.

15. **A downside scenario further illustrates the risks to the program** (Table 13). The present baseline growth projection is broadly in line with other forecasts for the Southeastern European region (Figure 3). However, these forecasts have been revised downward repeatedly over the last few months, and there could be three potential triggers for this to continue. First, externally, further significant downward revisions to the global economic outlook would have important implications for Serbia's trade and capital inflows. Second, further deterioration of consumer and investor confidence in Serbia could crimp domestic spending. And third, a full-fledged credit crunch could develop as banks experience difficulties in identifying solvent private-sector borrowers. As a result

Serbia: Baseline and Downside Scenarios, 2008-09

	2008 Est.	2009 Program	2009 Downside
	(Annual change, in percent)		
Real GDP	5.4	-2.0	-6.0
Domestic demand	5.9	-5.6	-13.1
Inflation (eop)	8.6	10.0	9.0
	(In percent of GDP)		
Current account balance	-17.1	-13.0	-9.3
Capital and financial account	12.4	3.2	-0.9
Fiscal balance	-2.5	-3.0	-4.6
	(Euro billion)		
External financing gap	0.0	2.4	2.3

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

of reduced domestic demand, the external adjustment could be much faster; however, with lower capital inflows, the external financing gap would likely remain broadly unchanged (Figure 4). The fiscal position would, however, further deteriorate on account of the reduced domestic activity and trade. In this case, the policy response would likely have to involve a mix of additional budget financing and further adjustment measures. This downside scenario will also underpin the diagnostic bank-by-bank stress tests.

C. Fiscal Policy

16. **Under unchanged policies, the fiscal deficit would rise to 6¼ percent of GDP in 2009, and continue to spiral upward over the medium term.** The approved 2009 budget targeted a deficit of 1¾ percent of GDP (Table 11). The surging deficits under unchanged policies reflect two key drivers:

- **A normalizing revenue-GDP ratio as the economy rebalances**: The economy's abrupt shift from boom to bust and the rebalancing away from excess domestic demand, particularly consumption spending, over the medium term would result in a significant decline of the revenue-GDP ratio (Box 1).

- **Key budgeted spending items exhibit strong nominal inertia:** Public wages and social spending, mainly on pensions, account for about two thirds of total budget spending. During the boom years, wages and pensions soared in nominal terms. In the short term—reflecting carry-over effects—even a nominal freeze will keep these spending items at elevated levels, with nominal average pensions in fact set to expand by 13¼ percent in 2009.

Serbia: Pensions and Government Wages, 2005-09

	2005	2006	2007	2008	2009 Prog.
Average pension (change in percent) 1/	24.2	22.3	9.8	24.3	13.3
Total pension benefits (in percent of GDP)	11.3	11.5	11.0	11.9	13.0
General gov. average gross wage (change in percent)	20.3	21.4	24.6	15.9	3.2
General government wage bill (in percent of GDP)	10.2	10.3	10.1	10.5	10.2

Sources: Statistical Office, Ministry of Finance, and IMF staff estimates and projections.

1/ Average paid out pension, including payment of securitized arrears.

17. **The authorities' revised 2009–10 fiscal program limits the fiscal deficits to 3 percent of GDP in 2009 and 2½ percent in 2010** (MEFP, ¶13). Under the present macroeconomic framework, staff and the authorities viewed these deficit targets as striking a sensible compromise between three considerations: (i) the need to signal to the public and investors that fiscal sustainability will be maintained and that the burden of rebalancing the economy's spending overhang will not entirely fall on the private sector; (ii) tight constraints

on available noninflationary financing, including from IFIs and the EU; and (iii) the need to avoid a strongly procyclical fiscal stance. In view of the considerable downside risks to the macroeconomic framework, fiscal policy responses may again need to be recalibrated.

Serbia: General Government Operations, 2007-10
(In percent of GDP)

	2007	2008 Est.	2009 Country Report 09/20	2009 Unchanged policies	2009 Prog.	2010 Country Report 09/20	2010 Prog.
Revenue	42.4	40.9	42.0	38.6	39.5	41.2	38.3
Expenditure	44.2	43.4	43.8	45.0	42.5	42.2	40.9
Current	39.0	39.0	39.0	40.1	38.5	37.2	36.2
Capital and net lending	5.2	4.4	4.8	4.9	4.0	5.0	4.6
Fiscal balance	-1.9	-2.5	-1.8	-6.3	-3.0	-1.0	-2.5
Structural balance 1/	-3.8	-4.7	-3.3	-7.2	-3.9	-1.8	-2.7

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

1/ Actual fiscal balance adjusted for the effects of both the output and the external absorption gaps. See IMF Country Report No. 07/390, Chapter III.

Box 1. Serbia: The Falling Tax-to-GDP Ratio

One of the adverse surprises of the present downturn has been an unexpectedly steep fall in the tax-to-GDP ratio. Under the revised macroeconomic framework, that ratio is now expected to drop by almost 5 percent of GDP during the period 2008-14, of which only about 1 percent of GDP reflects the net effect of tax policy measures.

In advanced economies, tax-to-GDP ratios, if adjusted for policy measures, tend to be relatively stable during normal economic fluctuations. However, this rule of thumb does not apply to economies going through boom-bust cycles. In Serbia's particular case, three groups of factors explain the projected large drop in the tax ratio:

- First, the rebalancing of the Serbian economy will depress the tax-to-GDP ratio through two channels: (lower-taxed) domestic savings are projected to rise by some 12 percent of GDP during 2008-14, mainly at the expense of (higher-taxed) consumption (Table 6); and restoring external competitiveness is likely to go hand-in-hand with a lower share of (higher-taxed) wages and rising (lower-taxed) profits.

- Second, the external rebalancing of the economy will shift tax collection from relatively easy collection points (imports) to more difficult collections points (domestically produced goods and services). Strengthening of tax administration could at least partly counteract this effect.

- And third, tax compliance is suffering, particularly in the case of cash-constrained enterprises. While this effect is clearly visible in recent tax collection data, it should taper off over the medium term, particularly if counteracted by administrative measures.

18. **The authorities' revised 2009 budget plan focuses on recurrent discretionary spending measures, while protecting social spending** (MEFP, ¶14). Measures include (i) reducing the public wage bill, including in public enterprises, by freezing nominal wages, curtailing employment, and temporarily cutting very high public sector wages (½ percent of GDP); (ii) cutting discretionary spending on goods and services, subsidies, capital, and net lending across all government levels, by directly cutting allocations to ministries, reducing transfers to local governments, and cutting ministries' own resource budget (2 percent of GDP); and (iii) increases in income taxes on dividends and royalties, excise taxes, and property and car taxes, and additional dividend payments (½ percent of GDP). Social spending, however, would remain largely protected from nominal cuts. Serbia has a well developed and targeted social protection system, and the revised budget will also increase the allocation for unemployment benefits.

Serbia: Fiscal Adjustment Measures in 2009 1/

	Billions of dinars	Percent of GDP
Total	**100**	**3.4**
I. Expenditure cuts 2/	**74**	**2.5**
Wage freeze and nonfilling of positions	15	0.5
Goods and services	30	1.0
Subsidies	1	0.0
Net lending	4	0.1
Capital	23	0.8
II. Revenue increases	**26**	**0.9**
Changes to personal income tax law	5	0.2
Excises	7	0.2
Mobile phone services	3	0.1
Gasoline	1	0.0
Diesel	3	0.1
Additional dividends from public enterprises	5	0.2
Property and car taxes	3	0.1
Action plan to strengthen tax administration	7	0.2

Sources: Serbian authorities; and IMF staff estimates.

1/ Assumes measures become effective May 1.
2/ Relative to the adopted 2009 budget.

19. **If fiscal adjustment measures are sustained through 2010, this should suffice to achieve the 2½ percent of GDP deficit target.** In particular, the authorities already announced that public wages and pensions will remain frozen through 2010. For the medium term, the authorities are determined to initiate structural fiscal reforms in the health, education, pension, and public administration sectors, in part with technical assistance from IFIs and other donors. These reforms will form part of the discussions during the next program reviews.

20. **The authorities' chosen fiscal adjustment strategy reflects a mix of economic, social, and political considerations; but, in staff's view, it also carries considerable implementation risks:**

- Given the likely sharp permanent decline in the revenue-GDP ratio, there was agreement that adjustment should mainly occur through cutting and restructuring Serbia's oversized and inefficient public sector.

- Staff was concerned that the relatively large cuts in discretionary spending could prove disruptive for public service delivery, and lead to a build-up of arrears vis-à-vis an already cash-constrained non-government sector. The option of introducing a surcharge of 6 percent on all incomes, including pensions, while largely exempting lower incomes through raising the nontaxable income threshold was considered, but it was ultimately dropped by the authorities as politically infeasible.

- In defending the deep discretionary spending cuts, the authorities argued that the "fiscal fat" runs deep; moreover, they also pointed out that recurrent spending cuts of similar size were implemented in 2004–05.

21. **The authorities provided assurances that public financial management and tax administration will be strengthened to mitigate implementation risks** (MEFP, ¶18). The Ministry of Finance will strengthen its presently weak capacity to monitor and control government spending at all government levels. In particular, to avoid arrears accumulation it will establish a three-month rolling treasury plan with clear expenditure prioritization, improve arrears monitoring and reporting, and tightly control guarantees to avoid a build-up of contingent liabilities. Arrears accumulated by the state-owned road company will be cleared. The authorities also indicated that they would secure the necessary adjustment measures from local governments and social security funds. Moreover, to limit risks for revenue collections, tax administration will be strengthened, especially with respect to VAT and social security contributions.

22. **Contingent measures—already publicly committed—should help reduce risks to the program** (MEFP, ¶19). Under the present macroeconomic framework, revenue could turn out weaker than currently projected on account of growing compliance problems, while the deep cuts in budgetary allocations could result in arrears accumulation. In view of these risks, the authorities announced a set of contingency measures, including across-the-board cuts in nominal public sector wages and an increase in VAT rates. Moreover, should downside macroeconomic risks materialize, these measures could also be triggered, along with a recalibration of the mix between budget financing and adjustment.

D. Financial Sector Policies

23. **The authorities will launch a financial sector support program (FSSP)** (MEFP, ¶26). Participation in the FSSP will be voluntary and open to all banks; it will involve a mix of commitments and incentives (Box 2). The FSSP received broad support during a financial sector coordination meeting in Vienna on March 27, which involved ten large parent banks and their home supervisors. Home supervisors broadly endorsed the framework and expressed willingness to assist the NBS in cross-checking exposure data on a quarterly basis. Participating parent banks signed a public statement supporting Serbia's economic program and expressing their willingness to work toward making specific exposure commitments in the context of the FSSP. Since then, most parent banks agreed to provide detailed commitment letters required for participation in the FSSP.

24. **A proactive strengthening of the frameworks for corporate and household debt restructuring will be key to mitigating and overcoming the crisis.** The FSSP already includes a mix of commitments and incentives designed to facilitate private sector debt restructuring, but additional initiatives may be needed. Moreover, there are concerns that the bankruptcy framework would not be able to handle a sudden surge in case load. At the same time, increasing the effectiveness of the court system and the capacity of bankruptcy administrators may take time. The authorities agreed that an early review of the capacity and legal framework for debt restructuring and bankruptcy will be undertaken to identify weak spots.

25. **Several other significant actions to strengthen the financial sector have been taken or are in train.** First, a detailed crisis preparedness plan—as envisaged under the MoU on financial stability signed by the NBS, the government, and the deposit insurance agency (DIA) in December 2008—has been finalized (prior action). Second, as part of a broader effort to strengthen its debt management strategy, the Ministry of Finance will improve the T-bill auction process, by mid-2009, by making it more transparent and market-based. This would also help establish a benchmark yield curve and increase available high-quality collateral. Third, the Deposit Insurance Agency is expected to complete action plans for the remaining banks with state participation (with a merger of the four majority state-owned banks as a key option) by mid-2009. And fourth, to facilitate plans for future privatization, notably through IPOs, as well as to promote stock market development, the authorities agreed to submit to Parliament a new Securities Law conforming with EU regulations by end-2009 (MEFP, ¶27).

Box 2. Serbia: The Financial Sector Support Program (FSSP)

Serbia's FSSP involves a balanced mix of commitments and incentives designed to: (i) ensure external financing in line with program assumptions; (ii) ensure that the banking system's capital and liquidity levels remain adequate; and (iii) make it attractive for banks to participate. Specifically:

- **Parent bank commitments:** Parent banks of foreign subsidiaries participating in the FSSP have been asked to make specific commitments to: (i) maintain their exposure to Serbia at end-2008 level throughout 2009–10, subject to a review at end-2009; (ii) provide adequate capital and liquidity support to their subsidiaries; and (iii) have their subsidiaries participate in a diagnostic study involving stress tests based on IMF methodology and a downside scenario to be agreed upon between the authorities and staff. The NBS expects to complete diagnostic studies for the 12 largest banks and the 4 majority state-owned banks by end-September 2009, and for all banks by end-2009. Exposures would be monitored on a bi-weekly basis with quarterly reconciliation of data with home supervisors.

- **Domestic banks commitments:** Subsidiaries and local banks participating in the FSSP would be asked to facilitate voluntary conversion of FX and FX-linked loans into local currency loans, work with the NBS toward developing a common loan workout scheme that would avoid unnecessary blockage of delinquent but solvent borrowers' deposits, and facilitate loan restructuring under a pre-agreed framework: extension of remaining loan maturity by at least 12 months or 20 percent with reduced monthly payments, or any other restructuring lowering monthly payments by at least 20 percent.

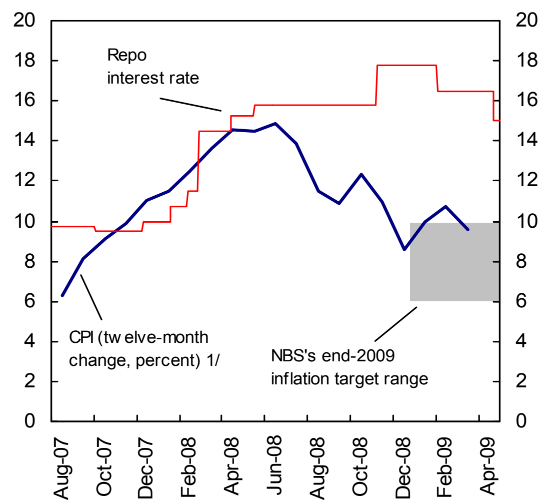
- **Incentives for participating banks:** Banks participating in the FSSP will be granted access to two new liquidity facilities to be established by the NBS: (i) an extended dinar liquidity facility and (ii) a foreign exchange swap facility. The first aims to help banks with loan restructuring and will involve provision of dinar loans with maturity of up to a year, under a broad range of collateral and with a non-penalty interest rate. The FX swap facility will offer each bank a swap line out of a designated pool of funds of up to €1 billion. Swaps will be offered with a two-week maturity and an implicit rollover guarantee.

- **General incentives for all banks:** Provided there is sufficient participation in the FSSP, the NBS plans to amend several macro-prudential regulations for the duration of the program to facilitate fulfillments of banks' commitments, including raising the limit on subordinated debt-to-Tier 1 capital ratio to 75 percent to encourage recapitalization; relaxing the FX open position limit; extending the zero reserve requirement on new foreign borrowing until end-2010; and increasing the grace period for loan restructuring made under the pre-agreed framework.

E. Monetary and Exchange Rate Policies

26. **The NBS will continue to focus on inflation as the nominal anchor and strengthen the monetary policy framework, including improving coordination of regulated price adjustment** (MEFP, ¶22). Since mid-2008, rapidly declining aggregate demand pressures, falling food and energy prices, and a tight monetary stance helped reduce inflation. However, Serbia's inflation remains one of the highest in the region, mostly due to persistently high inflation expectations and large increases in regulated prices. So far in 2009, adjustment of regulated prices has been higher than envisaged under the MoU signed between the government and the NBS last December. These trends have raised end-2009 projected inflation to 10 percent—the upper bound of the NBS's pre-announced inflation target range, although inflation would be lower in a downside scenario. Going forward, close coordination between the NBS and the government will be critical. Furthermore, the authorities plan to strengthen the central bank's legal framework in line with best EU practices and consistent with the recent safeguards assessment, by prohibiting lending to the public sector, clarifying procedures for central bank recapitalization, and enhancing central bank independence (MEFP, ¶24).

Monetary Policy and Inflation



Source: NBS.
1/ March inflation data is preliminary.

27. **Due to high inflation, the NBS has kept its policy rate at a relatively high level, but scope for some easing may open up should downside risks materialize.** The repo interest rate remains one of the highest in the region due to persistent inflation and concerns over capital outflow. In April, the NBS cut its policy interest rate in two steps by 250 basis points to 14 percent, following broad stability of the exchange rate and regulated prices since end-February, and data pointing to inflation easing to single digits. Going forward, continuation of these trends should ease inflation pressures and provide grounds for additional interest rate cuts.

28. **But the implementation of monetary policy in 2009−10 could be challenging and may require use of auxiliary policy instruments and strong communication.** Main concerns stem from four factors: (i) high uncertainty resulting in stubbornly high inflation expectations; (ii) weakened monetary policy transmission mechanism due to recent financial market developments; (iii) potentially worse inflation-output tradeoff; and (iv) temporary deviations of inflation from pre-announced targets due to measures to support financial stability, which—along with policy plans to return inflation within the target range—would need to be properly communicated to the public. In this context, staff and the NBS also

agreed that temporary and targeted use of reserve requirements, foreign exchange interventions, and other macro-prudential regulations may be needed to support the interest rate in achieving the inflation objectives.

29. **The authorities remain committed to maintaining the managed floating exchange rate regime** (MEFP, ¶23). While exchange rate flexibility has been instrumental in helping the economy absorb external shocks, staff and the authorities agreed that limited and targeted interventions may be needed in the short term to smooth shocks, preserve financial stability, and support the policy interest rate in achieving inflation objectives.

F. Structural Policies

30. **The authorities and private sector counterparts noted that intensifying economic difficulties highlight the urgent need for Serbia to strengthen competitiveness** (MEFP, ¶29–32). At least with hindsight, it is all too clear that Serbia's undersized private sector constrains domestic saving, export capacity, and productivity, while its oversized public sector encourages consumption, social entitlements, and excessive wage growth. The authorities saw the present difficulties as an opportunity for reform, particularly as regards restructuring the public sector. However, they also noted that prospects for privatization of large public utilities had deteriorated along with global financial turmoil.

III. Revised Program Modalities

31. **The authorities request augmenting and extending the existing SBA, and rephasing purchases accordingly** (Box 3). Specifically, they request increasing access to exceptional levels (560 percent of quota, of which 410 percent available in 2009), and extending the SBA's duration to 27 months (from 15). Moreover, the SBA would no longer be treated as precautionary, and the strengthened program would be accompanied by reinforced conditionality focused on core program objectives.

A. Exceptional Access

32. **Under the revised SBA, access would be increased to about €3.0 billion to fill part of the projected external financing gap.** This takes into account prospective additional contributions from the EU and the World Bank in 2009–10. Access of SDR 2,619.12 million would correspond to 560 percent of quota (about €3 billion or about $3.9 billion) and requires exceptional access procedures because cumulative annual access would exceed 200 percent of quota. Fund resources would be used to finance the balance of payments gap, including through foreign exchange interventions and swaps, with some further drawdown of official reserves consistent with adequate reserve coverage of imports and short-term external debt. Staff will monitor reserve developments on an ongoing basis and discuss with the authorities any abrupt changes.

Box 3: Stand-By Arrangement: Revised Parameters

Access. 560 percent of quota, equivalent to SDR 2,619.12 million or about €3 billion or $3.9 billion at current exchange rates. The SBA would no longer be treated as precautionary.

Phasing. A 27-months Stand-By Arrangement from January 16, 2009 to April 15, 2011. Under the current SBA, SDR 233.85 million (50 percent of quota) were made available on January 16 upon the Executive Board's approval of the arrangement. A further SDR 23.385 million (5 percent of quota) were made available on March 15, conditional on observance of the end-December 2008 PCs and completion of a financing assurances review. Upon Board approval of the revised arrangement in mid-May 2009, a further SDR 444.315 million (95 percent of quota) would be made available, provided prior actions are met (see below), end-March 2009 PCs are observed, and a financing assurances review is completed, making a total of SDR 701.55 million (150 percent of quota) available. Moreover, a total of SDR 1,917.57 million (410 percent of quota) would be made available by end-2009.

Financing assurances reviews. Because Serbia still has official external arrears under negotiation, disbursements will continue to be subject to financing assurances reviews.

33. **Staff's assessment is that Serbia meets the four exceptional access criteria**:

- **Criterion 1: Exceptional balance of payments pressures.** Global financial turmoil has resulted in loss of reserves and pressure on the currency, as well as a projected sudden contraction in external financing to levels insufficient to cover the mainly private external debt service and the still large current account deficit. These pressures could be exacerbated in case of a loss in confidence that would result in a deposit run and a banking crisis.

- **Criterion 2: Sustainable public debt position in the medium term.** The debt sustainability analysis suggests that while public debt-to-GDP ratios will rise over the next two years, peaking in 2010 at about 38 percent of GDP (from 31½ percent at end-2008), the public debt position is sustainable in the medium term, with resumption of catch-up growth combined with continued reforms bringing debt ratios back on a declining trend by 2011. However, the debt path is sensitive to particular assumptions and is subject to significant risks, including fiscal contingencies.

- **Criterion 3: Access to private capital markets.** Serbia has good prospects of regaining full access to private capital markets by the end of the program period, provided that the global financial system normalizes by then.

- **Criterion 4: Strong adjustment program.** The program provides reasonably strong prospect of success, including considering the institutional and political capacity to deliver the adjustment. While there are considerable implementation risks, not least because of the magnitude of the adjustment being contemplated, so far the authorities have demonstrated a capacity to broadly deliver on their commitments. The measures envisaged under the program were accepted by all parties of the governing coalition, and their implementation will be front-loaded via passage of a supplementary budget.

B. Program Extension and Rephasing of Purchases

34. **The duration of the SBA would be extended to take into account the longer projected time span of the global downturn and the associated slowdown in Serbia and the region.** The authorities request a one-year extension of the 15-month SBA (to a total of 27 months), which would prolong the program to April 2011 and cover the 2011 budget cycle. They also request a rephasing of purchases over the period of the arrangement, while front-loading purchases to correspond to the identified financing gap, projected to be greater in 2009 (Table 14).

C. Conditionality and Monitoring

35. **Conditionality will be strengthened in the fiscal and financial sectors** (Box 4). Program monitoring will shift to quarterly reviews for the duration of the arrangement. The new program framework also requires modification of the June 2009 PCs. Conditionality on the 2010 budget will be set during the next review.

D. Capacity to Repay and Safeguards Assessment

36. **Serbia's capacity to repay the Fund is expected to be adequate, although structural external imbalances and high external debt could pose significant risks.** By the end of the arrangement, Fund credit outstanding is projected to reach 9½ percent of GDP and 34 percent of gross reserves, while debt service to the Fund would peak at 11½ percent of exports of goods and nonfactor services during the repayment period (Table 15). While external debt is expected to rise to close to 90½ percent of GDP over the program period (Table 4, Appendix II), public debt should remain manageable at around 38 percent of GDP (Appendix I). Serbia's excellent record for timely service of its obligations to the Fund and the expected improvement in global financing conditions in coming years provide assurances that Serbia will be in a position to discharge its obligations to the Fund in a timely manner.

37. **Safeguards assessment.** An updated safeguards assessment, conducted in March 2009, found that the NBS's safeguards framework had been considerably strengthened and the quality of financial statements and internal audit had improved markedly since the initial assessment in 2001. Key recommendations include strengthening external oversight of NBS operations and amending the NBS law to increase operational and financial independence.

Box 4: Conditionality Under the Revised SBA

New prior actions

- **Fiscal policy.** Government to submit to Parliament revised Republican and social security funds budgets for the remainder of 2009 consistent with program understandings, including provisions ensuring a freeze in public sector wages in 2009.
- **Fiscal policy.** Government to submit to Parliament legal provisions that ensure tax measures as per program understandings.
- **Financial sector.** Parties to finalize the appendix to the MoU on Financial Sector Stability detailing contingency measures and respective roles of the NBS, the government, and the Deposit Insurance Agency.

Quantitative performance criteria

- Floor on net foreign assets of the NBS.
- Ceiling on the consolidated general government overall deficit
- Ceiling on contracting or guaranteeing by the public sector of new short-term external debt.
- Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt.
- Ceiling on accumulation of government external payment arrears.

Inflation consultation clause

- Inflation targets (deviations of ±2 percent trigger consultation with staff; deviations of ±3 percent trigger consultation with the Board and interrupt drawing rights).

Indicative targets

- Ceiling on current expenditure of the Republican budget.
- Ceiling on accumulation of domestic guarantees extended by the Republican budget, the Guarantee fund, and the Development fund, and domestic borrowing by the Guarantee and Development funds (new).

Structural benchmarks

- **Budget framework.** Government to adopt the business plan of the Road company consistent with the program (*Rationale*: ensures full coverage of general government in fiscal conditionality, especially given past spending overruns in this state-owned company included by staff and the authorities under general government).

- **Budget framework and wage policy.** Government to adopt the business plans of 10 state-owned enterprises that conform to general government wage and employment policies in 2009 and ensure profit transfers to the state (*Rationale*: broadens the wage and employment policies to the public sector, to help achieve wage moderation, and to ensure profit transfers to the government budget)

- **Budget management.** Ministry of Finance to prepare a three-month rolling cash flow plan for the Republican budget consistent with the annual budget targets (*Rationale*: ensure implementation of the budget, avoid accumulation of arrears in the current tight liquidity situation, and ensure that prioritization of expenditure will take place in case of revenue shortfalls) (new).

- **Revenue administration.** Ministry of Finance to finalize an internal report on the reasons for the sharp increase in VAT refunds and credits in 2008. (*Rationale*: ensure tax revenue collections following the sharp increase in VAT refunds, excess input credits, and tax-exempt sales that could potentially point to compliance issues, and could threaten revenue going forward) (new).

- **Financial sector.** Deposit Insurance Agency to adopt detailed action plans for the remaining banks with state participation. (*Rationale*: ensure a sustainable strategy for state-owned banks, thereby minimizing potential needs for budget support) (new).

- **Financial sector.** NBS to complete a diagnostic study of the 12 largest banks and the four banks with majority state ownership. (*Rationale:* identify the most vulnerable banks and assess potential recapitalization needs in the downside scenario in support of financial sector stability) (new).

38. **Notwithstanding the strength of the authorities' policy commitments, Serbia's capacity to repay the fund could be impaired if significant downside risks materialize.** These risks are related to the international environment and to domestic policy implementation. A deeper and more prolonged global recession could lower trade and capital flows more sharply than projected and reduce official reserves below projected levels. Moreover, a loss of depositor confidence could trigger a deposit run, a deeper and longer recession, and further pressure on the currency. This would adversely affect the balance sheets of corporates and households, especially those with unhedged FX positions, and could severely test the banking sector's capital and liquidity buffers. Fiscal contingent liabilities could materialize, putting strains on public finances. Finally, in the context of a coalition government, political risks could jeopardize the authorities' capacity to implement the program.

E. Financing Assurances Review

39. **Negotiations on settling remaining official external debt issues—including external arrears—are ongoing, albeit at a slow pace.** Renegotiation of restructuring agreements with Paris Club members following the breakup of the Union of Serbia and Montenegro in 2006 is proceeding; the authorities estimate that around three-quarters of the outstanding Paris Club debt has been reconciled. Remaining official external arrears mostly relate to debts of the former Socialist Federal Republic of Yugoslavia (SFRY). Negotiations with non-participants in the London Club settlement, as well as with other official non-Paris Club creditors are progressing, albeit at a relatively slow pace given unresolved succession issues related to the SFRY and some of the creditor states themselves.

40. **Expected disbursements from IFIs and other multilateral institutions**—such as the World Bank and the European Union—to support structural reforms provide assurances that the program is fully financed for the first year.

IV. Staff Appraisal

41. **The external downside risks highlighted in the authorities' SBA request of December 2008 have materialized.** Since September 2008, net capital inflows to Serbia have largely dried up, and FX reserves have been used to bridge the gap between required and available external financing. The exchange rate vis-à-vis the euro depreciated sharply. With much of the global economy in recession, Serbia's exports and import flows have plunged since November 2008.

42. **Given these external shocks, the outlook for growth and external financing has deteriorated markedly, while the large external imbalance has started to correct.** Output growth has decelerated sharply, and real activity is now likely to shrink in 2009, with limited prospects of recovery in 2010. But with the economy's spending shrinking significantly faster than income, Serbia's large current account deficit has started to decline toward more

sustainable levels. Still, a sizeable external financing gap of some €3½ billion is now projected to emerge during 2009–11.

43. **This already gloomy outlook is still subject to downside risks.** Projections for the global economy may continue to be revised downward relative to the March 2009 assumptions, crimping Serbian exports and growth further; Serbian consumers and investors' confidence could take a further hit, leading to further cutbacks in spending; and banks may find it increasingly difficult to find solvent borrowers.

44. **Against this backdrop, the authorities have rightly revised their program strategy in three key respects.** First, with fiscal revenues falling sharply, they have taken strong spending-based adjustment measures to keep public finances on a sound footing. Second, a financial sector support program has been put in place, which includes voluntary assurances by foreign banks to maintain their exposures vis-à-vis Serbia. And third, the authorities have asked IFIs and the EU to provide additional financial support to help bridge the emerged external financing gap, with the Fund's support for the revised SBA, however, likely accounting for the lion share of this additional support.

45. **Full and consistent implementation of the agreed fiscal adjustment measures will be key to the success of the revised SBA.** To avoid sharply procyclical fiscal policies, the revised SBA envisages significantly higher fiscal deficit targets for 2009–10, notwithstanding tight financing constraints. Moreover, with the economy projected to rebalance to more sustainable levels of absorption over the medium term, the revenue-to-GDP ratio is likely to drop permanently to a significantly lower level. Against this backdrop, there is broad agreement that adjustment should mainly take place on the spending side. The authorities have decided to contain deficits in the short run mainly through nominal freezes of wages and pensions and large cuts in discretionary recurrent spending. They have assured staff that they consider these freezes and cuts politically feasible and implementable without significant disruption of vital public sector services or a build-up of spending arrears. Moreover, this adjustment strategy largely protects social spending. Nevertheless, the Ministry of Finance should carefully monitor the implementation of adopted spending measures. In particular, it needs to ensure broadly balanced budgets at the local government level as well as avoid the accumulation of arrears through tight management of spending commitments and cash planning. At the same time, given that many of these measures are of a temporary nature, they will need to be replaced by permanent fiscal reforms that align medium-term spending with a lower revenue envelope. These permanent fiscal measures will be discussed in the context of future reviews.

46. **The newly adopted financial sector support program should help underpin financial stability.** While past tight prudential policies have clearly paid off in buffering the banking system against the initial financial crisis spillovers, the authorities' proactive approach to maintaining financial stability is commendable. The financial sector support plan seeks voluntary commitments from foreign parent banks to maintain their exposures vis-à-vis

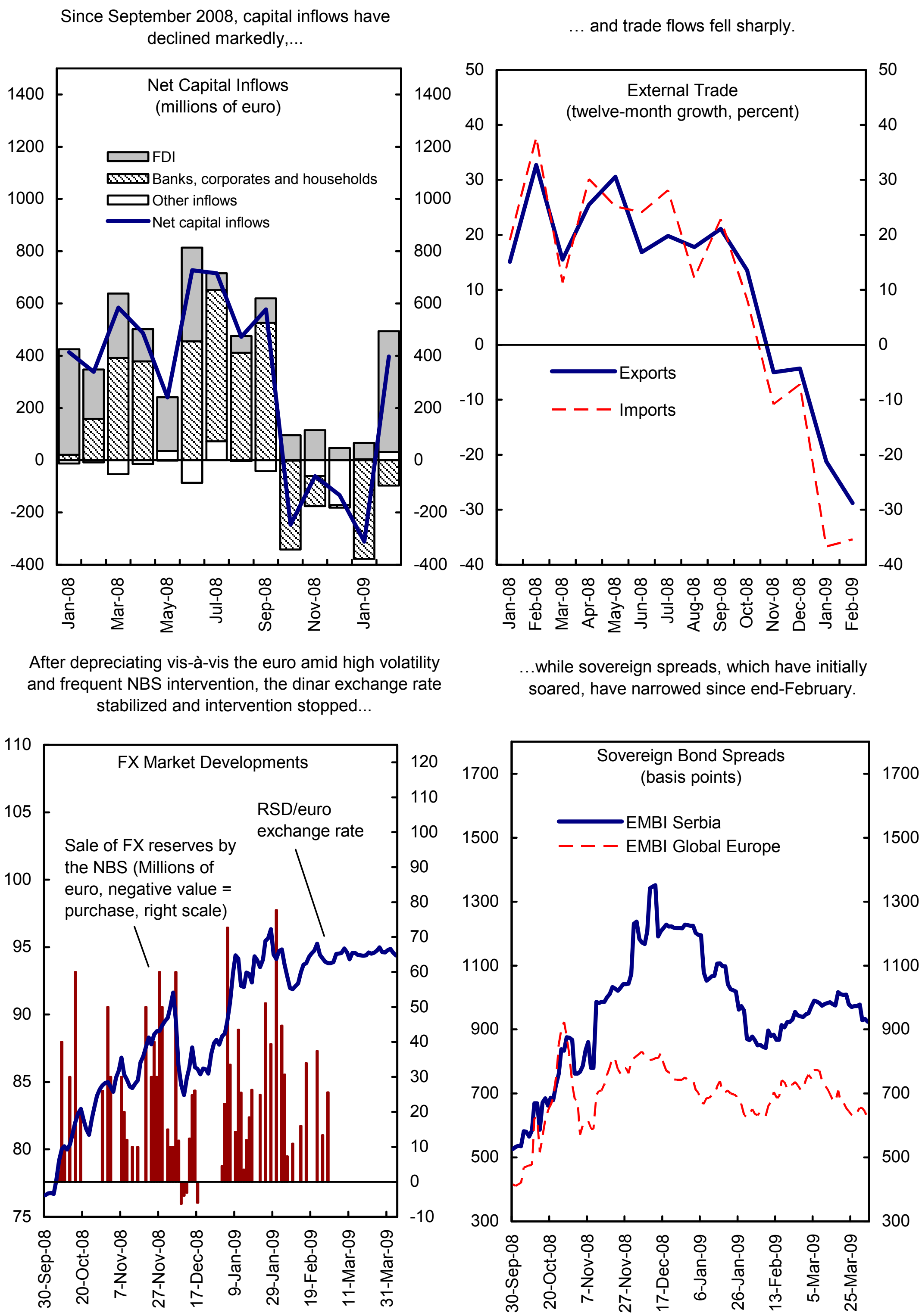
Serbia and keep their subsidiaries well capitalized and liquid. The plan would also secure commitments from banks to facilitate the restructuring of corporate and household loans. At the same time, the plan offers incentives to participating banks, particularly if there is sufficient participation. The adoption of a detailed financial crisis response plan is also welcome.

47. **Monetary policy should continue to focus on inflation, and, with the economy slumping, some scope for easing may be opening up.** While headline inflation rates remain elevated, mainly because of hikes in regulated prices, core inflation has continued to moderate given the deepening slump in the real economy. With public wages and pensions well anchored under the program, the NBS may increasingly have scope to lower its high policy rate, but will need to proceed cautiously to keep inflationary expectations in check. In this context, the managed floating exchange rate regime, which has served well, should be continued.

48. **The current difficulties present an opportunity to tackle long-delayed structural reforms.** While the global financial crisis may not be particularly conducive to pushing ahead with the still extensive privatization agenda, this should not deter the authorities from bold structural reforms. With vested interests likely off balance, this may indeed be an opportune time to tackle long-standing—politically difficult—issues such as streamlining business regulations and resolving the problems of land ownership and restitution. Particular attention will need to be given to improving the effectiveness of the bankruptcy framework, which will likely be tested during this downturn.

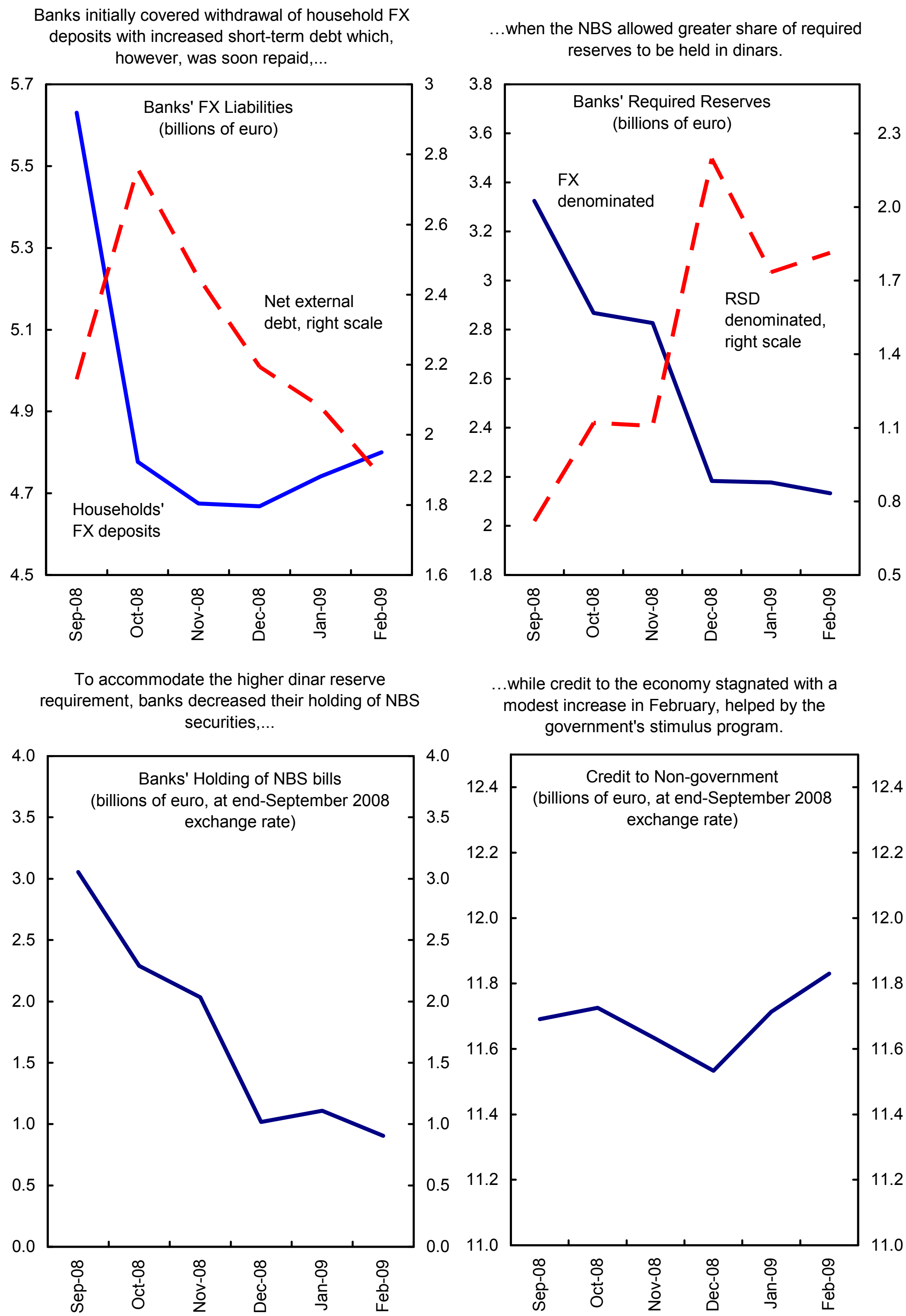
49. **Staff supports the authorities' request for an augmentation and extension of the SBA, a rephasing of purchases, and completion of the first program review and the financing assurances review.** Staff also supports the authorities' requests for a waiver of applicability for the end-March 2009 fiscal PC—as complete and verified information is not yet available, but early indications suggest no significant deviations. Staff believes that provided the authorities implement their program in full and the global environment does not deteriorate further than anticipated, the Serbian economy is poised to overcome the current difficulties. In this regard, financing from the Fund—complemented by funding from other international and regional institutions—will be instrumental in supporting an orderly rebalancing of the economy in this difficult period while containing crisis risks.

Figure 1. Serbia: External Developments Since September 2008.



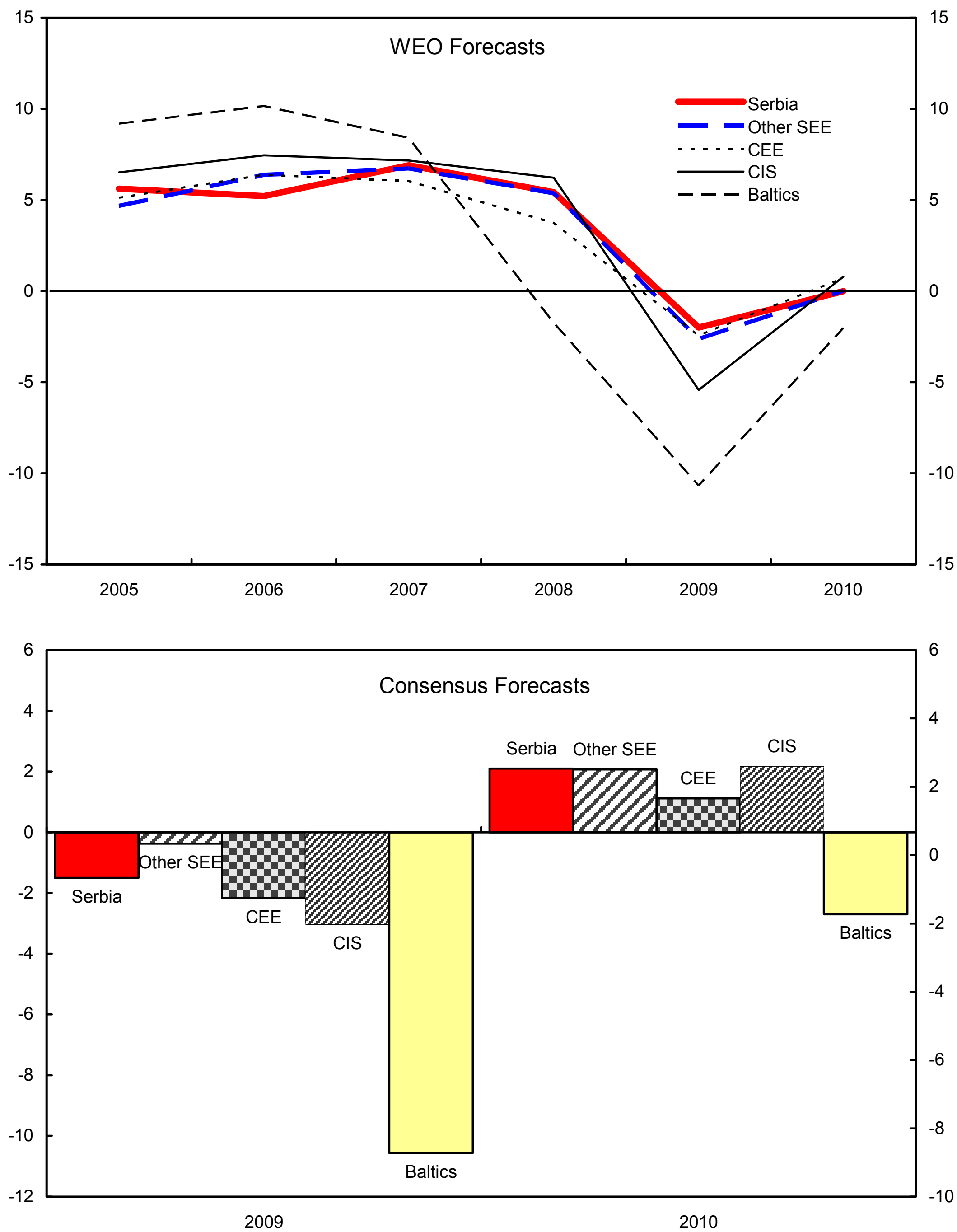
Sources: National Bank of Serbia; and Bloomberg.

Figure 2. Serbia: Banking Sector Developments Since September 2008.



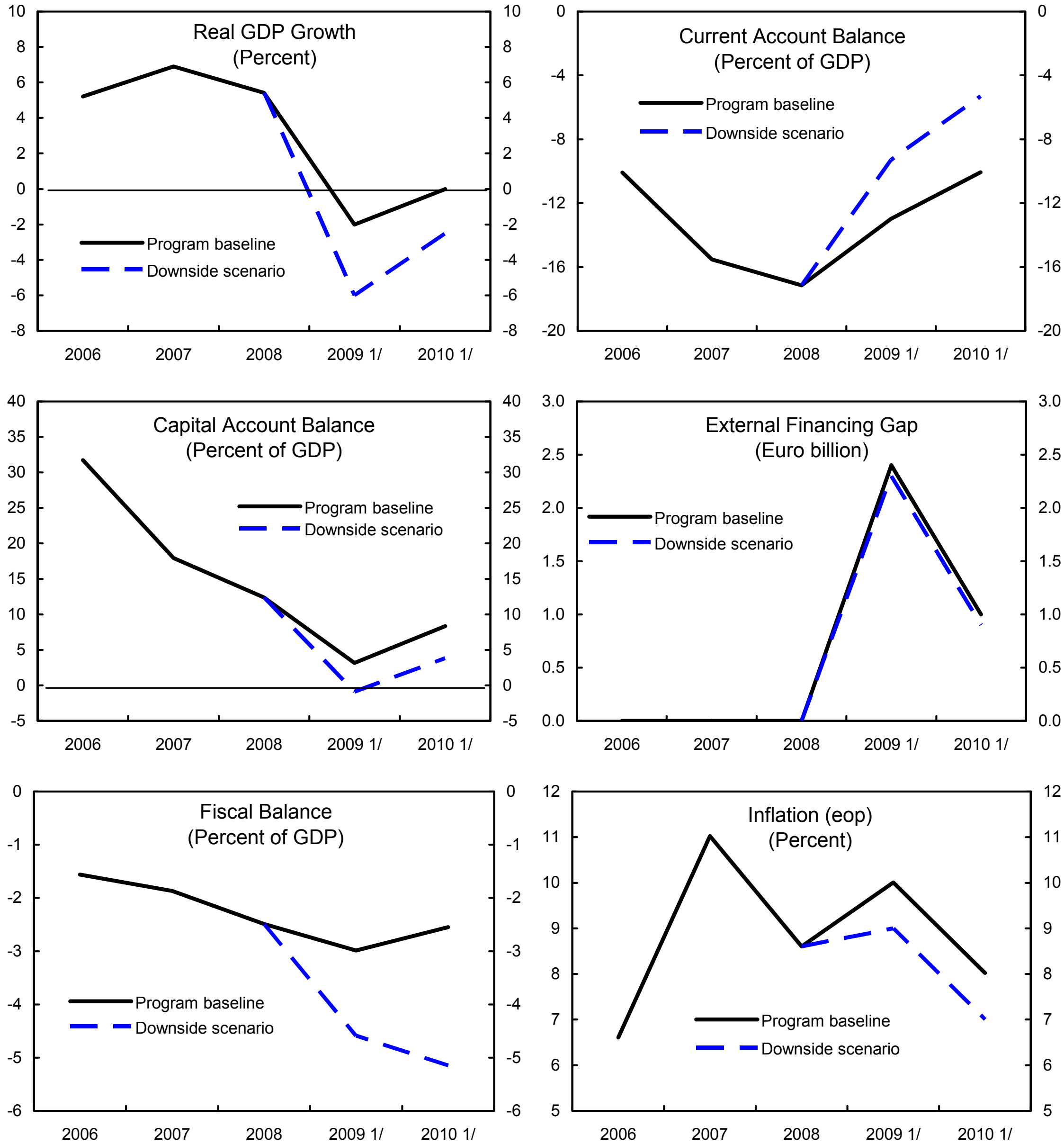
Source: NBS.

Figure 3. Growth in Selected Eastern European Countries, 2005-10 1/
(Real GDP Growth, in percent)



Source: IMF World Economic Outlook, April 2009; Eastern Europe Consensus Forecasts, April 2009.
1/ Other SEE: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Bulgaria, Romania. CEE: Czech Rep., Hungary, Poland, Slovak Rep. CIS: Belarus, Moldova, Russia, Ukraine. Baltics: Estonia, Latvia, Lithuania.

Figure 4. Serbia: Program Baseline and Downside Scenarios, 2006-10



Sources: Serbian authorities; and IMF staff estimates and projections.
1/ Projections.

Table 1. Serbia: Selected Economic and Social Indicators, 2005–10 1/

	2005	2006	2007	2008 Est.	2009 Country Report 09/20	2009 Prog.	2010 Prog.
	(Change in percent, unless otherwise indicated)						
Output, prices, and labor market							
Real GDP	5.6	5.2	6.9	5.4	3.5	-2.0	0.0
Real GDP excluding agricultural sector	7.2	6.0	8.8	5.0	3.9	-2.2	0.0
Real domestic demand (absorption)	-3.8	6.2	11.5	5.9	2.6	-5.6	-4.6
Consumer prices (average) 2/	17.3	12.7	6.5	11.7	7.9	10.0	8.2
Consumer prices (end of period) 2/	17.7	6.6	11.0	8.6	8.0	10.0	8.0
Core retail prices (average) 3/	14.8	10.2	3.8	9.0	...	...	...
Core retail prices (end of period) 3/	14.5	5.9	5.4	10.1	...	...	...
Nominal gross wage	24.3	24.4	21.9	17.8	9.7	6.3	4.2
Real net wage	6.5	11.0	19.9	5.4	1.6	-3.4	-3.7
Net wage in euro	8.3	23.3	33.9	15.8	…	…	…
Unemployment rate (in percent)	21.8	21.6	18.8	14.0	…	…	…
Nominal GDP (in billions of dinars)	1,688	1,980	2,363	2,791	3,060	2,995	3,242
	(In percent of GDP)						
General government finances							
Revenue	42.9	43.8	42.4	40.9	42.0	39.5	38.3
Expenditure	42.1	45.4	44.2	43.4	43.8	42.5	40.9
Current	39.1	40.8	39.0	39.0	39.0	38.5	36.2
Capital and net lending	3.0	4.6	5.2	4.4	4.8	4.0	4.6
Fiscal balance (cash basis)	0.8	-1.6	-1.9	-2.5	-1.8	-3.0	-2.5
Structural fiscal balance 4/	0.1	-2.3	-3.8	-4.7	-3.3	-3.9	-2.7
Gross debt	56.1	42.6	33.3	31.6	30.9	34.8	37.8
	(End of period 12-month change, in percent)						
Monetary sector							
Money (M1)	31.0	37.1	25.3	-3.8	18.2	-19.2	34.1
Broad money (M2) 5/	43.1	38.4	44.5	9.6	5.2	0.1	19.5
Domestic credit to non-government	51.2	17.1	36.9	35.0	6.1	11.0	15.7
	(End of period, in percent)						
Interest rates (dinar)							
NBS repo rate	19.2	14.0	10.0	17.8	…	…	…
Deposit rate	3.7	5.1	4.1	6.4	…	…	…
	(In percent of GDP, unless otherwise indicated)						
Balance of payments							
Current account balance	-8.7	-10.1	-15.5	-17.1	-16.0	-13.0	-10.1
Exports of goods	19.6	21.8	21.6	21.6	20.5	19.1	20.4
Imports of goods	40.6	42.9	44.1	43.9	42.3	36.6	34.8
Trade of goods balance	-20.9	-21.2	-22.5	-22.3	-21.8	-17.5	-14.4
Capital and financial account balance	18.6	31.7	17.9	12.4	13.4	3.2	8.1
External debt (end of period; billions of euro)	13.1	14.9	17.8	21.8	24.7	23.5	26.1
(In percent of GDP)	64.1	63.3	60.2	63.6	71.6	76.3	85.6
of which: Private external debt	26.3	36.0	39.5	45.0	50.8	47.0	52.6
Gross official reserves (in billions of euro)	4.0	8.7	9.5	8.1	8.1	7.9	8.4
(In months of prospective imports of GNFS)	4.0	6.6	6.3	7.0	5.1	6.9	7.5
Exchange rate (dinar/euro, period average)	82.9	84.2	80.0	81.5	…	…	…
REER (annual average change, in percent; + indicates appreciation)	-3.1	6.6	7.2	5.8	-4.3	-8.9	-2.3
Social indicators							
Per capita GDP (2008): US$6,782. Population (2008): 7.4 million. Poverty rate (poverty line is US$5 per day, 2007): 6.6 percent.							

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

1/ Excluding Kosovo (with the exception of external debt).
2/ Retail prices until 2006.
3/ Non-administered prices, representing about half of the retail basket. Monitoring discontinued in 2009.
4/ Fiscal balance adjusted for the automatic effects of both the output gap and the external absorption gap on the fiscal position; see IMF Country Report No. 07/390 for details.
5/ Excluding frozen foreign currency deposits.

Table 2. Serbia: Real GDP Growth Components, 2005-10
(In percent)

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.
	(Real growth rate by expenditure category)					
Gross Domestic Product (GDP)	5.6	5.2	6.9	5.4	-2.0	0.0
Domestic demand (absorption)	-3.8	6.2	11.5	5.9	-5.6	-4.6
Non-government	-4.5	5.1	9.3	5.3	-4.4	-5.1
Government	-0.6	11.0	20.0	8.2	-9.8	-2.8
Consumption	0.2	6.6	5.6	12.3	-4.6	-4.8
Non-government	0.7	7.3	2.3	11.8	-3.1	-4.1
Government	-1.5	4.2	18.3	13.8	-9.5	-7.2
Investment	-16.3	4.6	33.8	-13.2	-9.6	-3.8
Gross fixed capital formation	2.7	14.5	25.6	-7.7	-11.5	-3.4
Non-government	2.1	7.3	25.1	-5.7	-11.6	-9.2
Government	6.4	58.8	28.0	-15.7	-11.4	23.1
Change in inventories 1/	-5.5	-1.7	2.7	-2.1	0.1	-0.2
Net exports of goods and services 1/	10.4	-1.9	-6.3	-1.7	4.8	5.4
Exports of goods and services	14.4	4.9	17.2	9.8	-10.9	0.9
Imports of goods and services	-13.6	7.8	26.0	9.2	-15.8	-11.6
	(Contribution to real growth by expenditure category)					
Gross Domestic Product (GDP)	5.6	5.2	6.9	5.4	-2.0	0.0
Domestic demand (absorption)	-4.7	7.1	13.2	7.1	-6.8	-5.4
Non-government	-4.6	4.7	8.6	5.0	-4.2	-4.7
Government	-0.1	2.4	4.6	2.1	-2.6	-0.7
Consumption	0.2	6.0	5.1	11.1	-4.4	-4.5
Non-government	0.6	5.2	1.6	8.2	-2.2	-3.0
Government	-0.3	0.8	3.5	2.9	-2.2	-1.5
Investment	-5.0	1.1	8.1	-4.0	-2.4	-0.9
Gross fixed capital formation	0.5	2.8	5.4	-1.9	-2.5	-0.7
Non-government	0.4	1.2	4.3	-1.1	-2.1	-1.5
Government	0.2	1.6	1.2	-0.8	-0.5	0.8
Change in inventories	-5.5	-1.7	2.7	-2.1	0.1	-0.2
Net exports of goods and services	10.4	-1.9	-6.3	-1.7	4.8	5.4
Exports of goods and services	3.6	1.3	4.6	2.9	-3.3	0.3
Imports of goods and services	-6.8	3.2	10.9	4.5	-8.1	-5.1
	(Contribution to real GDP growth by production category)					
Gross Domestic Product (GDP)	5.6	5.2	6.9	5.4	-2.0	0.0
Gross Value-Added	4.3	5.4	5.6	5.0	-1.7	0.0
Agriculture	-0.7	0.0	-0.9	0.9	0.0	0.0
Industry	0.2	0.9	0.8	0.3	-1.1	-0.3
Services	6.1	4.3	7.0	4.3	-0.9	0.3
Wholesale and retail trade	1.9	1.0	2.0	0.8	-0.1	-0.1
Construction	0.1	0.2	0.3	0.1	-0.1	0.0
Transport and communications	1.9	2.8	2.4	1.7	-0.3	0.3
Financial services	0.4	0.4	0.6	0.4	-0.2	0.0
Other	0.5	0.1	0.4	0.8	0.0	0.1
Taxes minus subsidies	1.7	0.0	1.5	0.7	-0.3	0.0
Memorandum items:						
Non-agriculture GDP	6.3	5.2	7.8	4.5	-2.0	0.0
Non-agriculture value added	4.9	5.5	6.5	4.1	-1.7	0.0

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

1/ Contributions to GDP growth.

Table 3. Serbia: Balance of Payments, 2006-14 1/

	2006	2007	2008 Est..	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
					(In billions of euro)				
Current account balance	**-2.4**	**-4.6**	**-5.9**	**-4.0**	**-3.1**	**-2.8**	**-2.6**	**-2.3**	**-2.0**
Trade of goods balance	-5.0	-6.6	-7.6	-5.4	-4.4	-3.9	-3.5	-3.2	-2.9
Exports of goods	5.1	6.4	7.4	5.9	6.2	6.8	7.5	8.2	8.9
Imports of goods	-10.1	-13.0	-15.0	-11.3	-10.6	-10.7	-11.0	-11.4	-11.9
Services balance	0.0	-0.3	-0.2	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3
Exports of nonfactor services	1.8	2.3	2.7	2.4	2.4	2.5	2.7	3.0	3.3
Imports of nonfactor services	-1.9	-2.6	-2.9	-2.6	-2.6	-2.7	-2.9	-3.2	-3.6
Income balance	-0.3	-0.6	-0.9	-1.2	-1.2	-1.4	-1.6	-1.8	-2.0
Net interest	-0.3	-0.5	-0.7	-1.0	-0.9	-1.0	-1.1	-1.1	-1.1
Others, including reinvested earnings 1/	0.0	-0.1	-0.2	-0.2	-0.3	-0.4	-0.5	-0.7	-0.9
Current transfer balance	3.0	2.9	2.9	2.7	2.7	2.7	2.7	3.0	3.3
Official grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Others, including private remittances	2.8	2.7	2.6	2.5	2.5	2.5	2.5	2.8	3.0
Capital and financial account balance	**7.5**	**5.3**	**4.2**	**1.0**	**2.5**	**3.9**	**3.9**	**3.8**	**3.4**
Capital transfer balance	0.7	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	3.4	1.8	1.8	1.0	1.2	1.4	1.9	2.3	2.6
Portfolio investment balance	0.4	0.7	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance	3.0	3.1	2.5	0.0	1.2	2.5	2.0	1.5	0.8
General governement	-0.2	0.1	0.1	0.3	-0.1	0.3	0.3	0.3	0.3
Domestic banks	1.6	-0.4	0.5	0.6	0.0	0.3	0.1	-0.1	-0.1
Other private sector	1.6	3.4	2.0	-0.9	1.3	1.9	1.5	1.2	0.6
Errors and omissions	-0.3	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**4.8**	**0.9**	**-1.8**	**-3.0**	**-0.6**	**1.1**	**1.3**	**1.4**	**1.4**
Financing	**-4.8**	**-0.9**	**1.8**	**3.0**	**0.6**	**-1.1**	**-1.3**	**-1.4**	**-1.4**
Gross international reserves (increase, -)	-4.2	-1.0	1.8	0.6	-0.5	-1.2	-1.0	-0.2	-0.2
Prospective drawings	…	…	…	2.4	1.1	0.1	…	…	…
EU	…	…	…	0.1	0.3	…	…	…	…
World Bank	…	…	…	0.2	0.1	…	…	…	…
IMF	…	…	…	2.2	0.8	0.1	0.0	0.0	0.0
Prospective repayments (IMF)	…	…	…	…	…	…	-0.3	-1.2	-1.2
					(In percent of GDP)				
Current account balance	**-10.1**	**-15.5**	**-17.1**	**-13.0**	**-10.1**	**-8.8**	**-7.5**	**-6.2**	**-4.8**
Trade of goods balance	-21.2	-22.5	-22.3	-17.5	-14.4	-12.3	-10.2	-8.6	-7.1
Exports of goods	21.8	21.6	21.6	19.1	20.4	21.6	21.9	21.6	21.4
Imports of goods	-42.9	-44.1	-43.9	-36.6	-34.8	-34.0	-32.1	-30.2	-28.5
Services balance	-0.2	-0.9	-0.5	-0.5	-0.7	-0.7	-0.7	-0.7	-0.7
Income balance	-1.4	-1.9	-2.7	-3.8	-3.9	-4.3	-4.6	-4.9	-4.9
Current transfer balance	12.7	9.7	8.3	8.8	8.9	8.6	8.0	8.0	7.8
Official grants	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.5
Others, including private remittances	11.9	9.1	7.7	8.1	8.2	7.9	7.3	7.3	7.3
Capital and financial account balance	**31.7**	**17.9**	**12.4**	**3.2**	**8.1**	**12.3**	**11.3**	**10.0**	**8.2**
Capital transfers balance	2.9	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment balance	14.4	6.2	5.3	3.2	4.0	4.5	5.5	6.1	6.3
Portfolio investment balance	1.5	2.3	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance	12.9	10.5	7.3	-0.1	4.1	7.8	5.8	3.9	1.8
General governement	-0.9	0.4	0.2	0.9	-0.2	1.0	0.9	0.8	0.7
Domestic banks	6.9	-1.4	1.4	1.9	0.0	0.9	0.4	-0.2	-0.3
Other private sector	6.9	11.6	5.8	-2.9	4.3	6.0	4.5	3.2	1.4
Errors and omissions	-1.1	0.7	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**20.5**	**3.1**	**-5.1**	**-9.8**	**-2.0**	**3.5**	**3.8**	**3.8**	**3.3**
Memorandum items:					(In percent, unless otherwise indicated)				
Export growth	28.0	24.7	16.2	-20.4	5.3	9.9	9.8	8.9	9.1
Import growth	22.3	28.9	15.6	-24.9	-6.1	1.1	2.5	3.9	3.8
Export volume growth	4.9	17.2	9.8	-10.9	0.9	6.0	6.1	6.0	6.2
Import volume growth	7.8	26.0	9.2	-15.8	-11.6	-2.7	0.0	1.8	2.1
Export prices growth	22.0	6.4	5.8	-10.7	4.3	3.7	3.5	2.7	2.7
Import prices growth	13.5	2.3	5.8	-10.8	6.2	3.9	2.4	2.0	1.7
Change in terms of trade	7.5	4.0	-0.1	0.1	-1.8	-0.1	1.0	0.7	0.9
GDP (euro billion)	23.5	29.5	34.3	30.9	30.5	31.6	34.3	37.8	41.7

Sources: NBS; and IMF staff estimates and projections.

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

Table 4. Serbia: External Balance Sheet, 2006-14 1/

	2006	2007	2008 Est.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
				(In billions of euro)					
International investment position 2/	**-16.0**	**-18.7**	**-25.8**	**-31.2**	**-34.3**	**-37.1**	**-39.6**	**-42.0**	**-44.0**
Public sector 3/	2.7	3.0	1.4	0.8	1.4	2.3	3.0	2.9	2.8
Private sector 3/	-18.8	-22.3	-27.2	-29.3	-31.9	-35.5	-39.0	-42.5	-45.6
FDI and portfolio investment (net) 4/	-8.4	-9.6	-12.4	-13.4	-14.6	-16.0	-17.9	-20.2	-22.8
External debt (net) 4/	-14.4	-18.2	-22.2	-23.9	-26.5	-28.9	-30.6	-30.7	-30.2
Gross external debt	**-14.9**	**-17.8**	**-21.8**	**-23.5**	**-26.1**	**-28.6**	**-30.2**	**-30.3**	**-29.8**
General government	-6.4	-6.1	-6.4	-6.7	-6.6	-6.9	-7.2	-7.5	-7.8
Private sector	-8.5	-11.7	-15.4	-14.5	-16.0	-18.1	-19.7	-20.7	-21.1
Banks	-3.9	-4.0	-3.9	-3.8	-4.1	-4.4	-4.6	-4.5	-4.4
Other private sector	-5.0	-7.7	-11.5	-10.7	-11.9	-13.7	-15.1	-16.2	-16.7
Liabilities from prospective drawings from EU, WB and IMF				-2.4	-3.5	-3.6	-3.3	-2.1	-0.9
Gross external assets	0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other, net (inc. commercial banks foreign assets)	-1.9	-1.0	0.6	-1.5	-1.3	-1.4	-1.5	-1.6	-1.6
Central bank gross international reserves	8.7	9.5	8.1	7.9	8.4	9.6	10.6	10.8	11.0
				(In percent of GDP)					
International investment position 2/	**-68.2**	**-63.3**	**-75.3**	**-101.1**	**-112.4**	**-117.3**	**-115.6**	**-111.0**	**-105.5**
Public sector 3/	11.6	10.2	4.0	2.7	4.7	7.4	8.9	7.7	6.8
Private sector 3/	-79.8	-75.4	-79.4	-95.0	-104.5	-112.3	-113.8	-112.4	-109.4
FDI and portfolio investment (net) 4/	-35.9	-32.5	-36.1	-43.3	-47.8	-50.6	-52.2	-53.4	-54.8
External debt (net) 4/	-61.4	-61.5	-64.8	-77.5	-86.9	-91.6	-89.1	-81.2	-72.5
Gross external debt	**-63.3**	**-60.2**	**-63.6**	**-76.3**	**-85.6**	**-90.4**	**-88.0**	**-80.2**	**-71.5**
General government	-27.3	-20.7	-18.6	-21.6	-21.6	-21.8	-21.0	-19.9	-18.8
Private sector	-36.0	-39.5	-45.0	-47.0	-52.6	-57.3	-57.4	-54.8	-50.6
Banks	-16.5	-13.4	-11.4	-12.3	-13.6	-14.0	-13.3	-11.9	-10.5
Other private sector	-21.3	-26.0	-33.6	-34.7	-39.0	-43.3	-44.1	-42.9	-40.2
Liabilities from prospective drawings from EU, WB, and IMF				-7.7	-11.5	-11.4	-9.6	-5.5	-2.1
Gross external assets	1.9	-1.3	-1.1	-1.2	-1.3	-1.2	-1.1	-1.0	-0.9
Other, net (inc. commercial banks reserves)	-7.9	-3.5	1.7	-4.7	-4.1	-4.3	-4.3	-4.1	-3.9
Central bank gross international reserves	37.0	32.3	23.8	25.5	27.5	30.4	31.0	28.6	26.5
o/w central bank free net reserves	23.3	20.7	17.0	18.0	19.9	23.0	24.2	22.5	20.9
o/w commercial banks required FX reserves and other residents' FX deposits held with NBS	13.6	11.5	6.8	7.5	7.6	7.6	7.6	7.6	7.6
Memorandum items:									
				(In billions of euro, unless otherwise noted)					
Central bank international reserves									
Gross reserves (in months of next year's imports)	6.6	6.3	7.0	7.1	7.5	8.3	8.7	8.4	8.1
Free net reserves (in months of next year's imports)	4.2	4.1	5.0	5.0	5.4	6.3	6.8	6.6	6.4
Short term external debt by original maturity	0.8	0.9	2.0	1.8	1.8	2.0	2.1	2.2	2.3
(in percent of central bank net reserves)	9.6	9.9	24.9	23.1	21.7	20.9	20.1	20.4	20.8
(in percent of total debt)	5.6	5.3	9.3	7.7	7.0	7.0	7.1	7.3	7.7
(in percent of GDP)	3.5	3.2	5.9	5.9	6.0	6.3	6.2	5.8	5.5
Short term external debt by remaining maturity	3.0	3.6	4.8	4.6	5.3	6.8	8.0	8.7	9.4
(in percent of central bank net reserves)	34.0	37.7	58.8	58.2	63.6	71.2	75.4	80.4	85.1
(in percent of total debt)	19.8	20.2	22.0	19.4	20.4	23.9	26.5	28.7	31.5
(in percent of GDP)	12.6	12.2	14.0	14.8	17.5	21.6	23.4	23.0	22.5
GDP (billions of euro)	23.5	29.5	34.3	30.9	30.5	31.6	34.3	37.8	41.7

Sources: NBS; and IMF staff estimates and projections.

1/ NBS estimates for gross external debt and international reserves. Stock data for other items are staff estimates based on flows since the beginning of transition. Household holdings of FX cash are currently not included due to difficulties in identification.

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

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

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

Table 5. Serbia: External Financing Requirements and Sources, 2006-14

(In billions of euro)

	2006	2007	2008 Est.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
1. Gross financing requirements	**9.24**	**8.59**	**9.49**	**8.99**	**7.86**	**8.99**	**10.18**	**11.12**	**11.40**
Current account deficit	2.37	4.59	5.88	4.01	3.07	2.78	2.56	2.34	2.02
Debt amortization	1.89	2.84	3.62	4.98	4.26	5.00	6.31	7.35	8.00
Medium- and long-term debt	1.13	2.04	2.67	2.96	2.75	3.49	4.80	5.84	6.49
Public sector 1/	0.13	0.10	0.12	0.13	0.23	0.24	0.30	0.36	0.38
Commercial banks	0.31	0.80	0.54	0.08	0.18	0.36	0.59	0.84	0.85
Corporate sector	0.69	1.14	2.01	2.75	2.34	2.88	3.91	4.64	5.27
Short-term debt 2/	0.76	0.80	0.94	2.01	1.51	1.51	1.51	1.51	1.51
Commercial banks	…	…	…	1.32	1.32	1.32	1.32	1.32	1.32
Corporate sector	…	…	…	0.69	0.19	0.19	0.19	0.19	0.19
Accumulation of gross reserves	4.38	0.98	0.00	0.00	0.53	1.21	1.03	0.20	0.20
IMF repurchases and repayments 3/	0.60	0.18	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Repayment of prospective IMF credits	...	...	...	...	...	...	0.28	1.23	1.18
2. Available financing	**9.24**	**8.59**	**9.49**	**6.61**	**6.73**	**8.90**	**10.18**	**11.12**	**11.40**
Capital transfers	0.87	-0.31	0.01	0.00	0.00	0.00	0.00	0.00	0.00
Foreign direct investment (net)	3.39	1.82	1.81	1.00	1.22	1.42	1.88	2.31	2.64
Portfolio investment (net)	0.36	0.68	-0.09	0.00	0.00	0.00	0.00	0.00	0.00
Debt financing	5.10	5.75	5.93	4.44	5.71	7.36	8.20	8.73	8.68
Medium- and long-term debt	4.27	4.95	4.86	2.93	4.20	5.85	6.69	7.22	7.17
Public sector 1/	0.26	0.21	0.18	0.40	0.16	0.55	0.61	0.68	0.68
Commercial banks	1.82	0.69	0.23	0.08	0.50	0.64	0.74	0.77	0.72
Corporate sector	2.19	4.05	4.46	2.45	3.53	4.66	5.35	5.77	5.77
Short-term debt	0.83	0.80	1.07	1.51	1.51	1.51	1.51	1.51	1.51
Commercial banks	…	…	…	1.32	1.32	1.32	1.32	1.32	1.32
Corporate sector	…	…	…	0.19	0.19	0.19	0.19	0.19	0.19
IMF purchases 3/	0.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Drawdown of gross reserves	0.00	0.00	1.61	0.63	0.00	0.00	0.00	0.00	0.00
Other flows 5/	-0.55	0.66	0.22	0.55	-0.20	0.12	0.10	0.09	0.08
3. Financing gap	**0.00**	**0.00**	**0.00**	**2.37**	**1.13**	**0.09**	**0.00**	**0.00**	**0.00**
European Union (prospective)	…	…	…	0.05	0.25	…	…	…	…
World Bank (prospective)	…	…	…	0.15	0.08	…	…	…	…
IMF (prospective)	…	…	…	2.17	0.80	0.09	…	…	…
Memorandum items:									
Debt service	2.38	3.34	4.35	5.94	5.18	6.00	7.41	9.00	9.64
Interest	0.49	0.49	0.73	0.97	0.93	1.00	1.10	1.65	1.64
Amortization	1.89	2.84	3.62	4.98	4.26	5.00	6.31	7.35	8.00
Debt service (in percent of exports)	34.2	38.4	42.8	71.3	60.1	64.3	72.5	80.7	79.0
Ratio of new disbursements to repayments (in percent)									
Total debt	270	202	164	89	134	147	130	119	108
Medium- and long-term debt	377	242	182	99	153	167	139	124	110
Public sector (excl. prospective disbursments)	197	204	142	307	68	224	203	189	180
Commercial banks	592	86	42	100	285	177	125	91	85
Corporate sector	316	355	222	89	151	161	137	124	110
Short-term debt	110	100	114	75	100	100	100	100	100
Commercial banks	…	…	…	100	100	100	100	100	100
Corporate sector	…	…	…	27	100	100	100	100	100

Sources: NBS; and IMF staff estimates and projections.

1/ Excluding the IMF.
2/ Original maturity of less than 1 year. Stock at the end of the previous period.
3/ Under the current precautionary Stand-By Arrangement.
4/ Includes both loans and grants.
5/ Includes all other net financial flows, and errors and omissions.

Table 6. Serbia: Savings-Investment Balances, 2005–14 1/
(In percent of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
					Projection					
Domestic demand	120.9	121.4	123.3	122.8	118.0	115.1	113.0	110.9	109.3	107.7
Consumption	97.2	97.6	94.7	99.4	96.3	94.2	91.0	87.3	84.6	82.7
Non-government	78.5	78.9	74.9	78.1	76.5	75.9	73.6	70.4	67.7	65.7
Government	18.7	18.7	19.8	21.3	19.8	18.3	17.4	17.0	16.9	16.9
Gross domestic savings	2.8	2.4	5.3	0.6	3.7	5.8	9.0	12.7	15.4	17.3
Non-government	-1.3	-0.8	2.0	-1.7	2.0	2.7	5.1	8.0	10.3	12.2
Government	4.1	3.2	3.3	2.3	1.7	3.1	3.9	4.6	5.0	5.1
Net factor receipts and transfers from abroad	12.3	11.3	7.7	5.6	5.0	5.0	4.2	3.4	3.1	2.9
Non-government	13.1	12.0	8.2	6.1	5.7	6.1	5.2	4.3	4.0	3.7
Government	-0.8	-0.8	-0.5	-0.4	-0.8	-1.0	-1.0	-0.9	-0.9	-0.8
Gross national savings	15.0	13.6	13.0	6.2	8.7	10.8	13.2	16.1	18.5	20.2
Non-government	11.7	11.2	10.2	4.4	7.8	8.8	10.3	12.4	14.3	16.0
Government	3.3	2.4	2.8	1.8	0.9	2.1	3.0	3.7	4.2	4.3
Gross domestic investment 1/	23.7	23.7	28.6	23.4	21.7	20.9	22.0	23.5	24.7	25.1
Non-government	21.0	19.7	24.0	19.7	18.3	16.7	17.8	18.9	19.5	19.7
Gross fixed capital formation	16.3	16.8	18.7	16.7	15.1	13.7	15.0	16.3	17.1	17.5
Change in inventories	4.7	2.9	5.2	3.0	3.2	3.0	2.8	2.6	2.4	2.2
Government	2.7	4.1	4.6	3.7	3.4	4.1	4.3	4.6	5.2	5.4
Overall savings-investment balance	-8.7	-10.1	-15.6	-17.2	-13.0	-10.1	-8.8	-7.5	-6.2	-4.8
Non-government	-9.3	-8.4	-13.8	-15.3	-10.6	-8.0	-7.5	-6.6	-5.2	-3.8
Government	0.6	-1.6	-1.8	-1.9	-2.4	-2.1	-1.3	-0.9	-1.0	-1.1
Foreign savings	8.7	10.1	15.6	17.2	13.0	10.1	8.8	7.5	6.2	4.8
Foreign savings excluding official grants	10.0	10.9	16.3	17.8	13.6	10.7	9.5	8.1	6.8	5.3
Memorandum items:										
Net exports of goods and services 2/	-20.9	-21.4	-23.3	-22.8	-18.0	-15.1	-13.0	-10.9	-9.3	-7.7
Current account balance (incl. grants)	-8.7	-10.1	-15.5	-17.1	-13.0	-10.1	-8.8	-7.5	-6.2	-4.8
General government fiscal balance	0.8	-1.6	-1.9	-2.5	-3.0	-2.5	-1.7	-1.2	-1.2	-1.2

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

1/ Including changes in inventories.

2/ Equal to the absoption gap (GDP minus domestic demand).

Table 7. Serbia: Monetary Survey, 2006-10.
(In RSD billions, unless indicated otherwise; end of period) 1/

	2006	2007	2008 Sept.	2008	2009 Jan.	2009 Feb	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Proj.
Net foreign assets 2/	408	563	536	484	505	535	533	496	452	391	453
in billions of euro	5.2	7.1	7.0	5.5	5.4	5.7	5.6	5.1	4.6	3.9	4.1
Foreign assets	771	877	828	847	855	876	876	902	932	962	1,159
NBS	715	766	745	725	755	775	771	764	756	753	902
Commercial banks	56	111	83	123	100	100	105	138	176	210	257
Foreign liabilities (-)	-363	-314	-292	-364	-350	-341	-343	-406	-480	-571	-706
NBS	-56	-14	-13	-14	-16	-16	-17	-79	-152	-224	-280
Commercial banks	-308	-300	-279	-350	-334	-324	-326	-327	-328	-348	-426
Net domestic assets	203	320	412	484	473	446	447	496	536	578	705
Domestic credit	481	701	887	1,048	1,094	1,074	1,078	1,144	1,162	1,188	1,400
Government, net	-104	-112	-94	-53	-56	-70	-68	-15	-12	1	-17
NBS	-107	-100	-85	-50	-54	-69	-68	-20	-23	-15	-26
Banks	2	-12	-9	-4	-2	-1	0	5	11	16	9
Local governments, net	-19	-14	-28	-16	-18	-36	-36	-41	-47	-52	-18
Non-government sector	604	827	1,010	1,117	1,168	1,180	1,183	1,201	1,222	1,240	1,434
Households	204	306	334	382	400	397	398	401	406	409	477
Enterprises	381	508	652	711	744	760	762	775	789	802	925
Other	19	13	23	23	24	23	23	25	27	29	33
Other assets	70	78	43	56	-21	-24	-25	-26	-28	-29	-45
Capital and reserves (-)	-242	-356	-414	-505	-478	-475	-478	-491	-462	-442	-489
NBS	-7	-7	12	-63	-55	-59	-63	-84	-65	-52	-74
Banks	-235	-350	-426	-442	-423	-416	-415	-407	-398	-390	-415
Provisions (-)	-106	-104	-105	-115	-122	-129	-129	-132	-136	-139	-161
Broad money (M2)	611	883	948	968	978	981	981	982	983	969	1,158
Dinar-denominated M2	255	370	344	371	342	344	342	337	331	311	398
M1	191	239	206	230	200	197	197	197	196	186	249
Currency in circulation	68	77	72	90	82	83	82	82	81	70	85
Demand deposits	122	162	135	140	118	115	115	115	115	116	164
Time and saving deposits	65	131	137	142	142	146	145	140	135	125	149
Foreign currency deposits	355	513	604	597	636	638	639	645	652	658	760
in billions of euro	4.5	6.5	7.9	6.7	6.8	6.8	6.7	6.6	6.5	6.5	6.8
Memorandum items:											
Twelve-month growth:											
M1	37.1	25.3	4.8	-3.8	-9.5	-10.7	-4.5	-4.7	-6.4	-19.2	34.1
M2	38.4	44.5	25.6	9.6	7.6	8.1	3.4	4.5	1.6	0.1	19.5
Total credit to non-government	23.1	48.6	40.6	48.7	47.0	43.8	34.1	30.1	24.2	9.6	19.7
Domestic	17.1	36.9	29.3	35.0	33.9	33.1	31.3	26.9	21.0	11.0	15.7
Households	54.1	50.3	16.9	25.0	23.8	20.4	19.2	16.7	21.3	7.1	16.5
Enterprises	2.9	33.2	37.4	40.0	39.1	39.9	37.8	32.0	21.0	12.7	15.4
External	34.6	68.0	57.4	67.2	64.1	57.6	46.4	39.7	30.5	8.0	24.2
Total real credit to non-government	15.5	33.8	26.8	36.9	33.6	29.9	22.9	19.4	13.5	-0.4	10.8
Domestic	9.8	23.3	16.7	24.3	21.8	20.2	20.2	16.4	10.5	0.9	7.1
Households	44.5	35.3	5.4	15.1	12.5	8.8	9.2	7.0	10.8	-2.7	7.8
Enterprises	-3.5	20.0	23.9	28.9	26.4	26.4	26.2	21.1	10.5	2.4	6.8
External	26.3	51.3	42.0	54.0	49.2	42.3	34.1	28.2	19.2	-1.8	14.9
Velocity (M1)	10.4	9.8	12.9	12.2	14.0	14.3	14.9	15.0	15.2	16.1	13.0
Velocity (M2)	3.3	2.6	2.8	2.9	2.9	2.9	3.0	3.0	3.0	3.1	2.8
Deposit euroization 3/	66	64	69	68	71	71	71	72	72	73	71
Credit euroization 4/	80	74	66	68	69	69	68	66	64	62	65

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

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

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

3/ Share of non-government foreign currency deposits in total non-government deposits at commercial banks.

4/ Share of net (excl. provisions) fx-indexed and fx-denominated bank credit in total bank credit to non-government.

Table 8. Serbia: Balance Sheet of Commercial Banks, 2006-09 1/
(In RSD billions, unless indicated otherwise)

	2006	2007	2008 Sept.	2008 Oct.	2008 Nov.	2008 Dec.	2009 Jan	February 2009		
									in bn. of euro	in percent of GDP
Assets	1,274	1,678	1,838	1,906	1,943	1,925	1,949	1,941	20.7	68.8
Foreign exchange	56	111	83	91	103	123	100	100	1.1	3.6
Claims on NBS	468	569	579	551	542	508	486	467	5.0	16.6
Dinar cash and reserves	63	80	77	117	119	219	182	187	2.0	6.6
Foreign exchange reserves	254	270	255	244	253	194	205	201	2.1	7.1
NBS bills and other claims	152	219	246	190	169	95	99	79	0.8	2.8
Claims on government	18	8	8	8	9	9	10	11	0.1	0.4
Claims on other sectors	594	827	1,011	1,103	1,131	1,118	1,169	1,181	12.6	41.8
Households	203	305	334	372	381	382	399	396	4.2	14.0
Enterprises	380	507	651	705	724	710	743	759	8.1	26.9
Other institutions	11	15	26	26	26	27	27	26	0.3	0.9
Fixed assets	66	75	84	85	85	88	89	89	1.0	3.2
Other assets	71	88	73	68	73	78	96	92	1.0	3.3
Liabilities	1,274	1,678	1,838	1,906	1,943	1,925	1,949	1,941	20.7	68.8
Foreign liabilities	308	300	279	356	358	350	334	324	3.5	11.5
Dinar deposits	213	319	305	300	298	301	281	282	3.0	10.0
Demand deposits	122	162	135	130	129	140	119	115	1.2	4.1
Time and saving deposits	79	142	158	160	160	154	157	161	1.7	5.7
Government deposits	12	16	12	10	9	7	6	6	0.1	0.2
Foreign currency deposits	359	517	605	594	619	599	638	640	6.8	22.7
Enterprises	84	116	137	145	157	140	145	144	1.5	5.1
Households	261	382	431	406	417	414	446	450	4.8	15.9
Government	4	4	5	6	6	6	6	6	0.1	0.2
Other institutions	10	15	32	37	39	40	41	40	0.4	1.4
Other deposits	2	3	2	2	1	1	1	1	0.0	0.0
Liabilities to NBS	0	2	0	4	3	6	4	2	0.0	0.1
Other liabilities	70	95	125	124	122	122	169	159	1.7	5.6
Provisions	87	93	95	95	104	103	114	116	1.2	4.1
Capital and reserves	235	350	426	432	436	442	409	416	4.4	14.7
Memorandum items:										
Provisions against credit losses:										
Enterprises	54.8	57.9	65.5	70.7	72.9	71.6	79.0	80.9	0.9	2.9
in percent of credit	65.0	49.7	47.9	48.6	46.3	51.3	54.4	56.2	...	...
Households	7.5	10.8	15.1	16.1	16.4	17.2	19.0	19.4	0.2	0.7
in percent of credit	2.9	2.8	3.5	4.0	3.9	4.1	4.3	4.3	...	...
Off-balance sheet items 2/	1,163	1,580	2,053	...	...	2,157	...	...	...	...
External debt (bn. of euros)	3.4	3.5	3.1	3.5	3.3	3.5	2.9	2.8	...	...
medium- and long-term	2.8	2.6	2.2	2.3	2.2	2.2	2.2	2.2	...	...
short-term	0.6	0.9	0.8	1.2	1.0	1.3	0.7	0.7	...	...

Source: National Bank of Serbia.

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

2/ As of September 2008, about 18 percent of off-balance sheet items represented various guarantees, mostly on cross-border loans. Other off-balance sheet items include collateral against loans and repo contracts, undrawn credit lines, and derivative contracts. Figures in euros and in percent of GDP correspond to the latest available observation.

Table 9. Serbia: Banking Sector Financial Soundness Indicators, 2004-09
(End-of-period, in percent)

	2004	2005	2006	2007	2008 Sept.	2008 Dec.	2009 Feb. Preliminary
Capital Adequacy							
Regulatory capital to risk-weighted assets 1/	27.9	26.0	24.7	27.9	23.4	22	...
Tier 1 capital to risk-weighted assets	25.6	22.2	24.2	28.5	24.5	22.9	...
Total regulatory capital to total assets	18.8	16.0	15.6	17.1	20.3	20.5	...
Liquidity							
Liquid assets to total assets	21.0	28.8	41.4	38.0	35.1	30.5	...
Asset Quality							
Nonperforming loans to total loans (net of provisions) 2/	...	...	4.11	3.81	4.33	5.29	6.58
Share of risky loans to total loans 3/	22.2	23.8	23.1	24.7	...	...	...
FX denominated and FX indexed loans to total loans 2/	69.9	88.1	83.5	77.2	72.1	74.4	...
Earnings and Profitability							
Net income to average assets (ROA)	-1.2	1.1	1.7	1.7	2.7	2.1	...
Net income to average capital (ROE)	-5.3	6.7	10.0	10.2	14.3	10.6	...
Net interest income to average total assets	6.4	6.3	6.6	6.9	8.6	8.8	...
Noninterest expense to gross income 4/	132.9	117.6	104.9	98.6	97.6	98.3	...
Personnel expense to gross income 4/	9.3	9.0	6.5	4.8	4.3	3.6	...
Interest income to gross income 4/	22.6	24.1	19.4	17.8	19.0	15.9	...
Noninterest income to gross income 4/	77.4	75.9	80.6	82.2	81.0	84.1	...
Personnel expenses to noninterest expenses	7.0	7.6	6.2	4.9	4.5	3.7	...
Customer deposits to total loans	97.5	99.4	109.2	113.6	94.2	89.7	...

Source: National Bank of Serbia.

1/ Regulatory capital excludes, among other things, investments in other banks in excess of 10 percent of total capital.
2/ Net of provisions. NPL data before June 2008 is based on a survey of nine largest banks.
3/ Assets (net of provisions) classified by the NBS as receivables in C, D, and E risk categories with provisioning requirements of 25 percent, 50 percent, and 100 percent, respectively.
4/ Gross income excludes income from indirect write-offs.

Table 10. Serbia: Balance Sheet of the NBS, 2006-10
(In RSD billions, unless indicated otherwise; end of period) 1/

	2006	2007	2008 Sept.	2008 Dec.	2009 Jan.	2009 Feb.	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Proj.
Net foreign assets 2/	406	482	476	517	533	558	560	493	413	345	414
in billions of euro	5.1	6.1	6.2	5.8	5.7	6.0	5.9	5.0	4.1	3.5	3.7
Gross foreign reserves	715	766	745	725	755	775	771	764	756	753	902
Gross reserve liabilities (-)	-309	-284	-269	-208	-222	-217	-211	-271	-343	-407	-488
Net domestic assets	-272	-323	-327	-208	-270	-289	-289	-220	-136	-76	-93
Net domestic credit	-264	-316	-340	-145	-215	-229	-227	-136	-72	-24	-20
Government	-107	-100	-85	-50	-54	-69	-68	-20	-23	-15	-26
Claims	16	11	11	11	11	11	11	10	10	9	9
RSD	16	11	11	11	11	11	11	10	10	9	9
foreign currency	0	0	0	0	0	0	0	0	0	0	0
Liabilities (-)	-123	-111	-96	-60	-65	-80	-79	-30	-33	-24	-35
RSD	-20	-29	-61	-20	-29	-25	-24	-20	-14	-10	-15
foreign currency	-103	-82	-35	-41	-36	-55	-55	-11	-18	-14	-20
Other public sector	-10	-11	-20	-15	-16	-33	-33	-50	-53	-54	-26
Banks	-151	-218	-246	-88	-94	-76	-79	-29	30	80	55
Claims	0	1	1	2	3	3	8	44	85	120	115
Liabilities (-)	-152	-219	-246	-90	-97	-79	-88	-73	-55	-40	-60
Other sectors	4	13	11	7	-51	-51	-46	-37	-25	-34	-23
Capital accounts (-)	-7	-7	12	-63	-55	-59	-63	-84	-65	-52	-74
Reserve money	134	159	149	309	263	270	270	273	277	269	321
Currency in circulation	68	77	72	90	82	83	82	82	81	70	85
Commercial bank reserves	65	82	77	219	181	187	188	191	196	199	236
Required reserves	34	30	65	165	175	170	171	173	177	179	206
Excess reserves	22	45	5	5	1	0	1	4	7	10	10
Vault cash and giro accounts	9	7	7	48	6	17	16	14	12	10	20

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

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

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

Table 11a. Serbia: General Government Fiscal Operations, 2006–11 1/
(In billions of RSD)

	2006	2007	2008 Country Report 09/20	2008 Est.	2009 Country Report 09/20	2009 Unchanged Policies	2009 Q1 Proj.	2009 Q2 Prog.	2009 Q3 Prog.	2009 Q4 Prog.	2009 Prog.	2010 Prog.	2011 Prog.
Revenue	**867**	**1,001**	**1,173**	**1,142**	**1,284**	**1,157**	**256**	**295**	**305**	**326**	**1,183**	**1,242**	**1,363**
Taxes	756	870	1,031	999	1,115	1,007	228	253	261	281	1,023	1,082	1,186
Personal income tax	119	116	140	136	147	140	31	35	37	42	145	151	167
Social security contributions	231	270	323	312	358	323	72	80	82	88	323	339	379
Taxes on profits	18	30	42	39	50	39	13	9	8	9	39	32	36
Value-added taxes	225	265	308	302	339	299	69	77	76	80	302	328	357
Excises	87	99	111	110	130	124	25	31	36	39	131	152	172
Taxes on international trade	45	57	70	65	51	43	11	11	10	10	43	34	25
Other taxes	30	33	36	36	40	40	7	10	11	12	41	45	50
Non-tax revenue	99	119	125	141	168	148	28	42	44	45	159	159	176
Capital revenue	10	12	17	0	0	0	0	0	0	0	0	0	0
Grants	2	1	1	1	1	1	0	0	0	0	1	1	1
Expenditure	**898**	**1,045**	**1,237**	**1,211**	**1,339**	**1,347**	**272**	**311**	**331**	**358**	**1,272**	**1,325**	**1,423**
Current expenditure	807	922	1,107	1,089	1,193	1,200	259	284	297	315	1,154	1,174	1,255
Wages and salaries	204	238	281	293	320	320	70	77	78	79	304	300	317
Other goods and services	157	193	225	207	224	224	36	46	52	60	194	201	208
Interest	30	18	22	17	28	35	7	7	13	9	35	36	54
Subsidies	56	64	83	78	66	66	11	15	16	23	64	65	61
Transfers	361	409	496	493	556	557	136	138	138	144	557	574	615
Pensions	228	260	332	331	389	389	97	97	97	97	389	389	419
Other transfers 2/	132	150	164	162	167	167	39	41	41	46	167	184	196
Capital expenditure	80	110	112	103	124	124	13	23	29	36	101	134	153
National investment plan	9	39	20	15	...	...	...	...	...	...	...	...	...
Other	71	70	92	89	...	...	...	...	...	...	...	...	...
Net lending	11	13	18	19	22	22	1	5	5	8	18	16	15
Fiscal balance (cash basis)	**-31**	**-44**	**-64**	**-69**	**-55**	**-190**	**-16**	**-16**	**-26**	**-32**	**-90**	**-83**	**-60**
Financing	**31**	**44**	**64**	**69**	**55**	**190**	**16**	**16**	**26**	**32**	**90**	**83**	**60**
Privatization proceeds	143	65	20	33	70	64	19	18	11	17	64	12	8
Domestic	-123	-38	31	59	-25	72	-1	-29	16	-15	-28	48	19
Bank	-99	5	10	55	0	100	0	-15	26	-12	0	88	62
Non-bank	-34	-43	21	4	-25	-28	-1	-14	-10	-3	-28	-40	-43
External	11	17	12	-23	10	54	-3	27	-1	30	54	23	33
Program	...	...	...	...	13	56	0	28	0	28	56	34	44
Project	...	...	...	...	12	12	2	3	4	4	12	17	19
Amortization	...	...	...	...	15	14	4	4	4	2	14	28	30
Memorandum item:													
Augmented fiscal balance 3/						-210	-16	-16	-46	-32	-110	-84	-61

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

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

Table 11b. Serbia: General Government Fiscal Operations, 2006–11 1/
(In percent of GDP)

	2006	2007	2008 Country Report 09/20	2008 Est.	2009 Country Report 09/20	2009 Unchanged Policies	2009 Q1 Proj.	2009 Q2 Prog.	2009 Q3 Prog.	2009 Q4 Prog.	2009 Prog.	2010 Prog.	2011 Prog.
Revenue	**43.8**	**42.4**	**42.8**	**40.9**	**42.0**	**38.6**	**39.0**	**40.3**	**39.1**	**39.6**	**39.5**	**38.3**	**37.9**
Taxes	38.2	36.8	37.6	35.8	36.4	33.6	34.8	34.5	33.4	34.1	34.2	33.4	33.0
Personal income tax	6.0	4.9	5.1	4.9	4.8	4.7	4.7	4.8	4.8	5.1	4.8	4.7	4.7
Social security contributions	11.7	11.4	11.8	11.2	11.7	10.8	11.0	10.9	10.5	10.7	10.8	10.5	10.6
Taxes on profits	0.9	1.3	1.5	1.4	1.6	1.3	2.0	1.2	1.0	1.1	1.3	1.0	1.0
Value-added taxes	11.4	11.2	11.2	10.8	11.1	10.0	10.6	10.5	9.7	9.7	10.1	10.1	9.9
Excises	4.4	4.2	4.1	3.9	4.3	4.1	3.7	4.2	4.6	4.7	4.4	4.7	4.8
Taxes on international trade	2.3	2.4	2.6	2.3	1.7	1.4	1.7	1.4	1.3	1.3	1.4	1.0	0.7
Other taxes	1.5	1.4	1.3	1.3	1.3	1.3	1.1	1.4	1.5	1.5	1.4	1.4	1.4
Non-tax revenue	5.0	5.0	4.6	5.0	5.5	4.9	4.2	5.8	5.6	5.5	5.3	4.9	4.9
Capital revenue	0.5	0.5	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**45.4**	**44.2**	**45.2**	**43.4**	**43.8**	**45.0**	**41.4**	**42.4**	**42.4**	**43.4**	**42.5**	**40.9**	**39.6**
Current expenditure	40.8	39.0	40.4	39.0	39.0	40.1	39.4	38.7	38.0	38.2	38.5	36.2	34.9
Wages and salaries	10.3	10.1	10.3	10.5	10.1	10.7	10.6	10.6	10.0	9.6	10.2	9.2	8.8
Other goods and services	7.9	8.2	8.2	7.4	7.7	7.5	5.4	6.3	6.6	7.3	6.5	6.2	5.8
Interest	1.5	0.8	0.8	0.6	0.9	1.2	1.0	0.9	1.7	1.1	1.2	1.1	1.5
Subsidies	2.8	2.7	3.0	2.8	2.1	2.2	1.7	2.0	2.0	2.7	2.1	2.0	1.7
Transfers	18.2	17.3	18.1	17.7	18.2	18.6	20.7	18.9	17.7	17.4	18.6	17.7	17.1
Pensions	11.5	11.0	12.1	11.9	12.7	13.0	14.8	13.3	12.5	11.8	13.0	12.0	11.7
Other transfers 2/	6.7	6.3	6.0	5.8	5.4	5.6	5.9	5.6	5.3	5.6	5.6	5.7	5.4
Capital expenditure	4.1	4.6	4.1	3.7	4.0	4.1	2.0	3.1	3.8	4.4	3.4	4.1	4.3
National investment plan	0.5	1.7	0.7	0.5	...	...	...	...	...	...	...	...	...
Other	3.6	3.0	3.4	3.2	...	...	...	...	...	...	...	...	...
Net lending	0.5	0.6	0.6	0.7	0.7	0.7	0.1	0.7	0.6	0.9	0.6	0.5	0.4
Fiscal balance (cash basis)	**-1.6**	**-1.9**	**-2.3**	**-2.5**	**-1.8**	**-6.3**	**-2.4**	**-2.2**	**-3.3**	**-3.9**	**-3.0**	**-2.5**	**-1.7**
Financing	**1.6**	**1.9**	**2.3**	**2.5**	**1.8**	**6.3**	**2.4**	**2.2**	**3.3**	**3.9**	**3.0**	**2.5**	**1.7**
Privatization proceeds	7.2	2.8	0.7	1.2	2.3	2.1	3.0	2.4	1.4	2.0	2.1	0.4	0.2
Domestic	-6.2	-1.6	1.1	2.1	-0.8	2.4	-0.1	-3.9	2.1	-1.8	-0.9	1.5	0.5
Bank	-5.0	0.2	0.4	2.0	0.0	3.3	0.0	-2.0	3.3	-1.4	0.0	2.7	1.7
Non-bank	-1.7	-1.8	0.8	0.1	-0.8	-0.9	-0.1	-2.0	-1.3	-0.4	-0.9	-1.2	-1.2
External	0.5	0.7	0.5	-0.8	0.3	1.8	-0.4	3.7	-0.1	3.6	1.8	0.7	0.9
Program	...	...	...	...	0.4	1.9	0.0	3.8	0.0	3.4	1.9	1.0	1.2
Project	...	...	...	...	0.4	0.4	0.2	0.4	0.4	0.5	0.4	0.5	0.5
Amortization	...	...	...	...	0.5	0.5	0.6	0.5	0.5	0.3	0.5	0.9	0.8
Memorandum items:													
Structural fiscal balance 3/	-2.3	-3.8	-4.6	-4.7	-3.3	-7.2	...	...	...	...	-3.9	-2.7	-1.6
Output gap 4/	0.0	0.9	1.1	1.1	1.9	-0.7	...	...	...	...	-0.7	-2.0	-2.3
Absorption gap 5/	4.1	9.7	11.3	11.3	6.7	6.9	...	...	...	...	6.9	3.9	2.8
Augmented fiscal balance 6/	...	...	...	...	...	-7.0	-2.4	-2.2	-5.9	-3.9	-3.7	-2.6	-1.7
Gross debt	42.6	33.3	33.8	31.6	30.9	38.2	...	...	...	...	34.8	37.8	36.3
Nominal GDP (in billions of dinars)	1,980	2,363	2,740	2,791	3,060	2,995	657	733	781	824	2,995	3,242	3,595

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

1/ Includes the republican budget, local governments, social security funds, and the Road fund.
2/ Excluding foreign currency deposit payments to households, reclassified below the line.
3/ Actual fiscal balance adjusted for the automatic effects of both the output gap and the external absorption gap on the fiscal position; see IMF Country Report No. 07/390 for details.
4/ Percentage deviation of actual from potential GDP.
5/ Percentage deviation between actual absorption and the level consistent with external balance.
6/ Including clearance of arrears of the Road Company.

Table 11c. Serbia: Intergovernmental Fiscal Operations, 2009 Program
(In billions of RSD)

	Gen. Gov.	Republican budget	Own budgets	Local governments	Province of Vojvodina	Road company	Pension Fund	Health Fund	Labor Fund	Netting operations
Total revenue	**1,183**	**649**	**23**	**139**	**14**	**31**	**240**	**126**	**16**	**-56**
Current revenue	**1,182**	649	23	138	14	31	240	126	16	-56
Tax revenue	**1,023**	586	0	91	9	13	238	125	15	-56
Personal income tax	**145**	81	0	58	5		0			
Social security contributions	**323**		0	0			238	125	15	-56
Corporate income tax	**39**	35	0	0	4		0			
VAT	**302**	302	0	0			0			
Excises	**131**	117	0	0		13	0			
Taxes on international trade	**43**	43	0	0			0			
Other taxes	**41**	8	0	33			0	0	0	
Nontax revenue	**159**	63	23	47	5	18	2	1	0	
Capital revenue	**0**	0	0	0	0	0	0	0	0	
Grants	**1**	0		1	0	0	0			
Total expenditure and net lending	**1,272**	**430**	**23**	**175**	**46**	**35**	**414**	**178**	**27**	**-56**
Current expenditure	**1,154**	381	21	134	37	19	413	178	26	-56
Expenditure on wages	**304**	180	10	38	26	1	4	99	2	-56
Wages and salaries	**304**	152	9	32	22	1	3	83	2	
Employer contribution	**0**	28	1	6	4	0	1	16	0	-56
Goods and services	**194**	43	6	47	4	17	3	74	1	
Interest payment	**35**	31	0	2		2	0	0	0	
Subsidies	**64**	34	5	18	7		0	0	0	
Transfers to households	**557**	93	0	30	1		406	5	23	
Capital expenditure	**101**	32	2	41	8	16	1	1	0	
Net lending	**18**	17	0	1	0	0	0	0	0	
Fiscal balance (before transfers)	**-90**	**220**	**0**	**-36**	**-31**	**-4**	**-175**	**-52**	**-11**	**0**
Transfers from other levels of government	**354**	**0**	**0**	**32**	**25**	**0**	**221**	**53**	**22**	**0**
Republican budget	**293**			32	25	0	213	1	22	
Local governments	**0**									
Province of Vojvodina	**0**	0		0				0		
Pension Fund	**48**							48		
Health Fund	**1**						1	0		
Labor Fund	**11**						7	4		
Transfers to other levels of government	**354**	**293**	**0**	**0**	**0**	**0**	**48**	**1**	**11**	**0**
Republican budget	**0**							0		
Local governments	**32**	32								
Province of Vojvodina	**25**	25			0		0		0	
Pension Fund	**220**	213						0	7	
Health Fund	**53**	1					48		4	
Labor Fund	**23**	22						1		
Net transfer to other levels of government	**0**	**-293**	**0**	**32**	**25**	**0**	**173**	**52**	**11**	**0**
Fiscal balance	**-90**	**-74**	**0**	**-4**	**-6**	**-4**	**-1**	**0**	**0**	**0**

Source: Ministry of Finance; and IMF staff estimates.

Table 12. Serbia: Medium-Term Program Scenario, 2005–14 1/

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
					Projections					
GDP and prices (annual percent change)										
GDP growth (real)	5.6	5.2	6.9	5.4	-2.0	0.0	3.0	5.0	5.5	5.5
Domestic demand growth (real)	-3.8	6.2	11.5	5.9	-5.6	-4.6	0.3	3.0	4.1	4.2
Consumer price inflation (end of period)	17.7	6.6	11.0	8.6	10.0	8.0	7.0	5.5	5.0	4.5
Savings and investment (in percent of GDP)										
Savings - investment balance	-8.7	-10.1	-15.6	-17.2	-13.0	-10.1	-8.8	-7.5	-6.2	-4.8
Non-government	-9.3	-8.4	-13.8	-15.3	-10.6	-8.0	-7.5	-6.6	-5.2	-3.8
Government	0.6	-1.6	-1.8	-1.9	-2.4	-2.1	-1.3	-0.9	-1.0	-1.1
General government (in percent of GDP)										
Overall fiscal balance	0.8	-1.6	-1.9	-2.5	-3.0	-2.5	-1.7	-1.2	-1.2	-1.2
Revenue	42.9	43.8	42.4	40.9	39.5	38.3	37.9	37.6	37.5	37.4
Expenditure	42.1	45.4	44.2	43.4	42.5	40.9	39.6	38.8	38.8	38.7
Current	39.1	40.8	39.0	39.0	38.5	36.2	34.9	33.9	33.3	33.1
Capital and net lending	3.0	4.6	5.2	4.4	4.0	4.6	4.7	4.9	5.4	5.6
Structural fiscal balance	0.1	-2.3	-3.8	-4.7	-3.9	-2.7	-1.6	-1.0	-1.0	-1.0
Output gap	0.8	0.0	0.9	1.1	-0.7	-2.0	-2.3	-1.9	-0.9	-0.4
Absorption gap	2.7	4.1	9.7	11.3	6.9	3.9	2.8	1.4	0.1	-1.2
Gross debt	56.1	42.6	33.3	31.6	34.8	37.8	36.3	34.2	32.0	30.1
Balance of payments (in percent of GDP)										
Current account	-8.7	-10.1	-15.5	-17.1	-13.0	-10.1	-8.8	-7.5	-6.2	-4.8
of which: Trade balance	-20.9	-21.2	-22.5	-22.3	-17.5	-14.4	-12.3	-10.2	-8.6	-7.1
of which: Remittances, net	12.2	11.9	9.1	7.7	8.1	8.2	7.9	7.3	7.3	7.3
Capital and financial account	18.6	31.7	17.9	12.4	3.2	8.1	12.3	11.3	10.0	0.5
of which: Foreign direct investment	6.1	14.4	6.2	5.3	3.2	4.0	4.5	5.5	6.1	6.3
External debt (end of period)	64.1	63.3	60.2	63.6	76.3	85.6	90.4	88.0	80.2	71.5
of which: Private external debt	26.3	36.0	39.5	45.0	47.0	52.6	57.3	57.4	54.8	50.6
Gross official reserves (in billions of euro)	4.0	8.7	9.5	8.1	7.9	8.4	9.6	10.6	10.8	11.0
REER (ann. av. change; + = appreciation)	-3.1	6.6	7.2	5.8	-8.9	-2.3	-0.9	1.5	2.5	2.5

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

1/ Definitions and coverage as in previous tables.

Table 13. Serbia: Program Baseline and Downside Scenarios, 2008–10 1/

	2008	2009	2010
		Projections	
		Program Baseline	
GDP and prices (percent change)			
GDP growth (real)	5.4	-2.0	0.0
Domestic demand growth (real)	5.9	-5.6	-4.6
Consumer price inflation (end of period)	8.6	10.0	8.0
General government (in percent of GDP)			
Overall fiscal balance	-2.5	-3.0	-2.5
Revenue	40.9	39.5	38.3
Expenditure	43.4	42.5	40.9
Balance of payments (in percent of GDP)			
Current account	-17.1	-13.0	-10.1
of which: Trade balance	-22.3	-17.5	-14.4
Capital and financial account	12.4	3.2	8.1
of which: Debt financing, net	7.3	-0.1	4.1
Overall balance of payments	-5.1	-9.8	-2.0
External financing gap (in billions of euro)	0.0	2.4	1.1
Rollover of total debt (in percent of repayments)	164	89	134
Gross official reserves (in billions of euro)	8.1	7.9	8.4
		Downside Scenario	
GDP and prices (percent change)			
GDP growth (real)	5.4	-6.0	-2.5
Domestic demand growth (real)	5.9	-13.1	-8.2
Consumer price inflation (end of period)	8.6	9.0	7.0
General government (in percent of GDP)			
Overall fiscal balance	-2.5	-4.6	-5.1
Revenue	40.9	39.0	38.0
Expenditure	43.4	43.6	43.1
Balance of payments (in percent of GDP)			
Current account	-17.1	-9.3	-5.3
of which: Trade balance	-22.3	-14.5	-10.5
Capital and financial account	12.4	-0.9	3.8
of which: Debt financing, net	7.3	-4.5	-1.2
Overall balance of payments	-5.1	-10.2	-1.5
External financing gap (in billions of euro)	0.0	2.3	0.9
Rollover of total debt (in percent of repayments)	164	68	91
Gross official reserves (in billions of U.S. dollars)	8.1	7.9	8.4

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

1/ Definitions and coverage as in previous tables.

Table 14. Serbia: Proposed Schedule of Purchases
Under the Stand-By Arrangement, 2009-11

	Available on or after	Amount of Purchase In millions of SDRs	In percent of quota 1/	Conditions
1.	January 16, 2009	233.850	50.0	Board approval of the arrangement.
2.	March 15, 2009	23.385	5.0	Observance of end-December 2008 performance criteria and completion of financing assurances review.
3.	May 15, 2009	444.315	95.0	Board approval of augmentation of the arrangement, observance of end-March performance criteria, and completion of the first program review (including financing assurances review).
4.	August 25, 2009	608.010	130.0	Observance of end-June 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
5.	November 25, 2009	608.010	130.0	Observance of end-September 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
6.	February 25, 2010	187.080	40.0	Observance of end-December 2009 performance criteria and completion of the quarterly program review (including financing assurances review).
7.	May 25, 2010	187.080	40.0	Observance of end-March 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
8.	August 25, 2010	140.310	30.0	Observance of end-June 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
9.	November 25, 2010	116.925	25.0	Observance of end-September 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
10.	February 25, 2011	70.155	15.0	Observance of end-December 2010 performance criteria and completion of the quarterly program review (including financing assurances review).
	Total	2,619.120	560.0	

1/ The quota is SDR 467.7 million.

Table 15. Serbia: Indicators of Capacity to Repay the Fund, 2009-14 1/

	2009	2010	2011	2012	2013	2014
Fund repurchases and charges						
In millions of SDRs	18	56	70	321	1,142	1,064
In millions of euro	20	64	78	361	1,284	1,200
In percent of exports of goods and NFS	0.2	0.7	0.8	3.5	11.5	9.8
In percent of GDP	0.1	0.2	0.2	1.1	3.4	2.9
In percent of quota	3.8	12.0	14.9	68.7	244.2	227.6
In percent of total external debt service	0.5	1.7	1.7	5.6	15.3	13.4
In percent of gross international reserves	0.3	0.8	0.8	3.4	11.9	10.9
Fund credit outstanding (end-period)						
In millions of SDRs	1,918	2,549	2,619	2,368	1,274	225
In millions of euro	2,167	2,880	2,933	2,659	1,433	254
In percent of exports of goods and NFS	26.0	33.4	31.5	26.0	12.8	2.1
In percent of GDP	7.0	9.4	9.3	7.8	3.8	0.6
In percent of quota	410.0	545.0	560.0	506.2	272.5	48.1
In percent of total external debt	9.2	11.0	10.3	8.8	4.7	0.9
In percent of gross international reserves	27.6	34.3	30.6	25.0	13.2	2.3
Memorandum items:	(In millions of euro, unless otherwise indicated)					
Exports of goods and NFS	8,343	8,625	9,325	10,211	11,159	12,206
Quota (in millions of SDRs)	468	468	468	468	468	468
Total external debt service	4,070	3,854	4,687	6,390	8,407	8,969
Public sector external debt (end-period)	9,031	10,082	10,473	10,499	9,590	8,709
Total external debt stock (end-period)	23,540	26,116	28,559	30,169	30,314	29,811
Gross international reserves	7,859	8,387	9,593	10,622	10,822	11,022

1/ Assuming actual purchase of projected available amounts.

Appendix I. Serbia: Public Debt Sustainability

General government debt in Serbia remains sustainable under the revised program scenario, which envisages a higher deficit in 2009–10 against the backdrop of a slowdown in growth. However, while the overall level of public debt and rollover risks are low compared to other emerging market economies, its sensitivity to shocks—exchange rate and growth shocks in particular—highlights potential vulnerabilities in the context of the current economic downturn. Further, sustainability is less assured if contingent costs from financial sector vulnerabilities, linked to its large exposures to exchange rate risk and off-balance sheet transactions, are taken into consideration. Contingent liabilities from government support to the private sector and state- and socially owned enterprises could pose additional risks.

1. **Under the revised program scenario, general government gross debt would increase to 38 percent in 2010 (from 32 percent in 2008) before declining to 30 percent by 2014** (Table A1).[1] This compares to a drop in the debt ratio to 22 percent of GDP in the original program scenario (IMF Country Report 09/20). The upward revision mainly reflects the weaker fiscal balances in 2009–10, a more depreciated real exchange rate, and lower growth.

2. **However, in an unchanged policies scenario, the public debt-to-GDP ratio would increase to 63 percent of GDP in 2014.** If policies were not adjusted as envisaged under the program, the fiscal deficit would increase to 6½ percent of GDP in 2009, reflecting the impact of automatic stabilizers on fiscal revenue, and debt ratios would rise. In contrast, assuming key variables at their historical averages, the public debt-to GDP ratio would decline to 17 percent, reflecting a history of robust growth in the catch up phase of transition, relatively strong fiscal surpluses in earlier years, and low real interest rates.

3. **Standardized bound tests show that Serbia's debt is particularly exposed to exchange rate and growth shocks (Figure A1)**. A 30 percent real depreciation of the exchange rate would increase the debt-to-GDP ratio to 43 percent by 2014, given that 90 percent of the debt is denominated in foreign currency (comprising mainly frozen currency deposit bonds and debt to multilaterals and Paris Club creditors). Also, assuming half a standard-deviation shocks to growth and the primary fiscal balance, the public debt stock would increase to 33 percent of GDP. However, a similar shock to interest rates would leave debt-to-GDP at 31 percent by 2014.

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[1] The debt stock includes gross general government and government-guaranteed debt of the Republic of Serbia, including debt to non-Paris Club official creditors under negotiation and in nonconvertible currencies. It excludes prospective borrowing from the Fund by the NBS.

4. **Further risks to the debt outlook come from large contingent liabilities**. These relate to:

- **Financial sector stability costs**. In the context of the global financial crisis, there are potentially large contingent liabilities for the public sector from financial sector distress. Tentative estimates of the cost of facilities to support financial sector stability suggest costs up to 1 percent of GDP for bank recapitalization.

- **Government support to the economy**. The package to support domestic credit passed in February 2009 could carry risks up to about 2 percent of GDP. This includes state-guaranteed IFI loans to SMEs (1½ percent of GDP), and loans through the National Development Fund and commercial banks (½ percent of GDP).

- **Public enterprises**. With state-owned and socially owned enterprises receiving explicit or implicit subsidies (through lower taxes and utility tariffs) and most public enterprise debt included in the general government debt stock (since they require state guarantees), their current costs are implicitly included in the debt projections. However, with the deepening recession and delays in utility price adjustments, risks of built up of contingent fiscal liabilities have increased.

- **Restitution**. The government's 2007 plan to provide restitution for confiscated assets after World War II, with a contemplated ceiling at the time of €4 billion (over 13 percent of GDP) would significantly increase the public debt stock. Moreover, should compensation be granted in foreign currency bonds, the foreign exchange exposure of the government would increase.

5. **On the upside, privatization proceeds could prove higher than the minimal amounts conservatively projected in the medium term.** Given the current international environment, minimal privatization proceeds were projected. However, should the authorities' plans to privatize some of the remaining state-owned companies move forward over the next few years, the debt outlook would be significantly more favorable.

Table A1. Serbia: Public Sector Debt Sustainability Framework, 2006-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008			2009	2010	2011	2012	2013	2014	**Debt-stabilizing primary balance 10/**
1 **Baseline: Public sector debt 1/**	42.6	33.3	31.6			**34.8**	**37.8**	**36.3**	**34.2**	**32.0**	**30.1**	**-1.6**
o/w foreign-currency denominated	38.7	29.8	28.6			31.4	33.8	30.5	27.4	25.0	22.8	
2 Change in public sector debt	-13.5	-9.3	-1.7			3.2	3.0	-1.4	-2.2	-2.2	-1.9	
3 Identified debt-creating flows (4+7+12)	-17.5	-7.7	-0.8			-1.3	-0.5	-2.3	-2.4	-2.3	-1.8	
4 Primary deficit	0.0	1.1	1.9			1.8	1.4	0.2	-0.3	-0.2	-0.2	
5 Revenue and grants	43.8	42.4	40.9			39.5	38.3	37.9	37.6	37.5	37.4	
6 Primary (noninterest) expenditure	43.8	43.5	42.8			41.3	39.8	38.1	37.3	37.3	37.3	
7 Automatic debt dynamics 2/	-9.8	-6.0	-1.5			-1.0	-1.5	-2.2	-1.9	-1.9	-1.6	
8 Contribution from interest rate/growth differential 3/	-6.8	-6.1	-4.5			-1.0	-1.5	-2.2	-1.9	-1.9	-1.6	
9 Of which contribution from real interest rate	-4.3	-3.7	-3.0			-1.6	-1.5	-1.2	-0.3	-0.3	0.0	
10 Of which contribution from real GDP growth	-2.5	-2.5	-1.5			0.6	0.0	-1.0	-1.6	-1.7	-1.6	
11 Contribution from exchange rate depreciation 4/	-3.0	0.1	3.0			...	...	...	...	...	...	
12 Other identified debt-creating flows	-7.8	-2.8	-1.2			-2.1	-0.4	-0.2	-0.2	-0.1	0.0	
13 Privatization receipts (negative)	-7.8	-2.8	-1.2			-2.1	-0.4	-0.2	-0.2	-0.1	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	4.0	-1.6	-0.9			4.5	3.4	0.8	0.3	0.0	0.0	
Public sector debt-to-revenue ratio 1/	97.3	78.7	77.4			88.1	98.6	95.8	90.9	85.2	80.4	
Gross financing need 6/	3.3	3.3	4.1			3.1	5.4	3.5	2.3	2.5	3.5	
in billions of euro	0.8	1.0	1.4			1.0	1.6	1.1	0.8	1.0	1.5	
Scenario with key variables at their historical averages 7/						**34.8**	**32.2**	**27.7**	**23.4**	**19.7**	**16.6**	**-2.5**
Scenario with no policy change (constant primary balance) in 2009-2013 8/						**34.8**	**47.7**	**53.4**	**57.3**	**60.2**	**63.2**	**-3.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline				5-Year Historical Average	5-Year Standard Deviation							
Real GDP growth (in percent)	5.2	6.9	5.4	6.3	1.3	-2.0	0.0	3.0	5.0	5.5	5.5	
Average nominal interest rate on public debt (in percent) 9/	3.2	2.1	2.2	2.5	0.5	4.0	3.4	4.4	4.6	4.7	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-8.3	-9.5	-9.9	-10.2	1.6	-5.5	-4.8	-3.3	-0.6	-0.5	0.1	
Nominal appreciation (increase in euro value of local currency, in percent)	7.8	-0.3	-10.6	-4.8	8.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	11.5	11.6	12.0	12.7	1.6	9.5	8.2	7.7	5.1	5.2	4.7	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.5	6.0	3.7	5.7	4.6	-5.4	-3.8	-1.3	2.8	5.6	5.4	
Primary deficit	0.0	1.1	1.9	-0.1	1.7	1.8	1.4	0.2	-0.3	-0.2	-0.2	

1/ Includes general government and guaranteed debts (gross).

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of euro).

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

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

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

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

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

8/ Assumes the original program scenario for 2009 (Country Report 09/20) under unchanged policies.

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

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

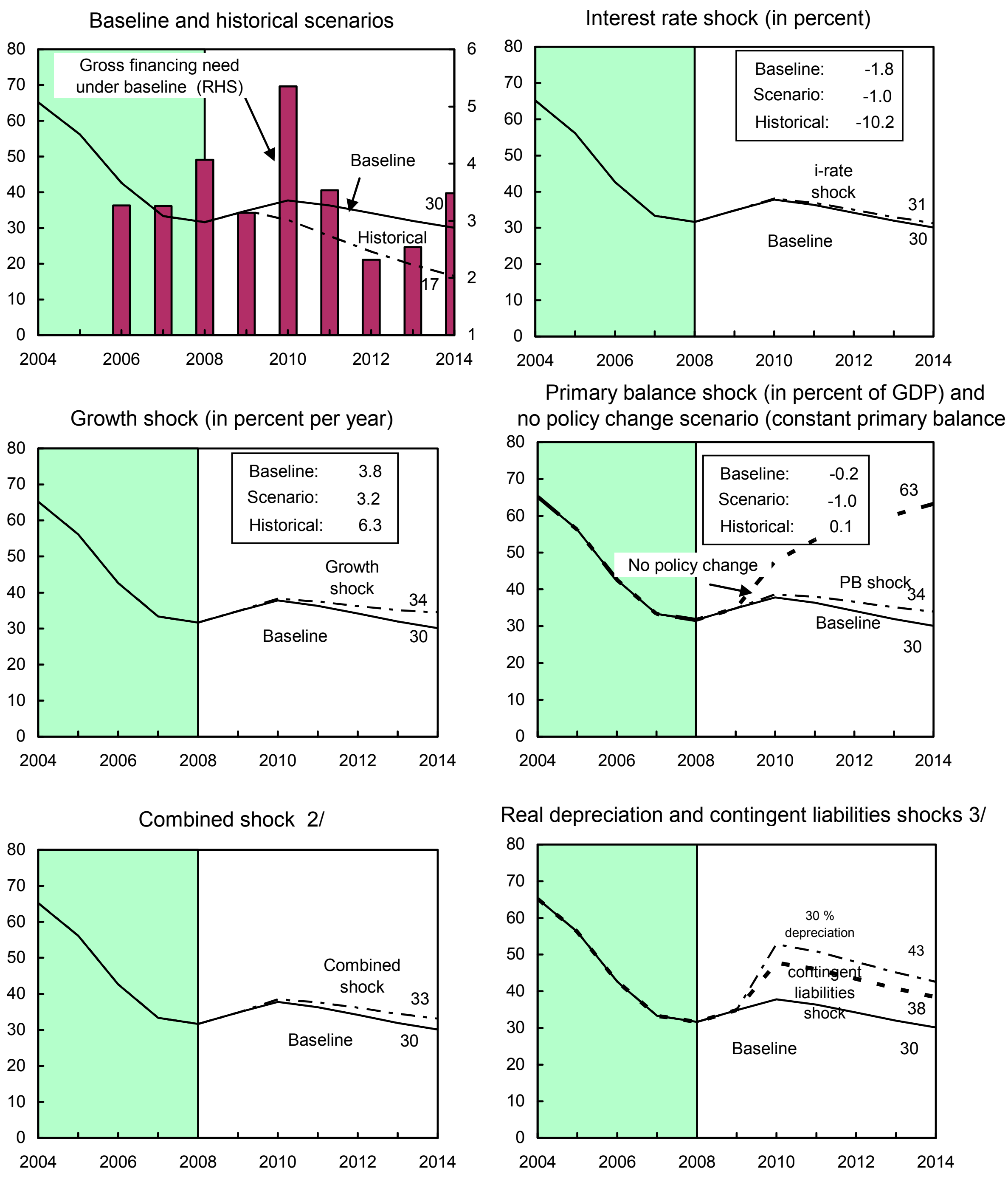
Table A2. Serbia: Government and Government-Guaranteed Debt, 2000–08
(End-period stock by creditor, in percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross debt (excluding IMF)	**241.7**	**114.5**	**81.2**	**77.3**	**65.2**	**56.1**	**42.6**	**33.3**	**31.6**
Domestic	**80.6**	**39.5**	**33.3**	**33.1**	**30.5**	**22.8**	**17.6**	**13.6**	**12.4**
Foreign currency-denominated	62.2	30.1	24.3	23.6	21.2	17.7	13.0	10.4	9.3
Frozen Foreign Currency Deposits	62.2	30.1	24.3	23.6	21.0	17.5	12.9	10.3	9.3
Other	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.0	0.0
Local currency-denominated	18.4	9.4	9.0	9.5	9.3	5.1	4.6	3.2	3.1
T-bills	0.0	0.0	0.0	0.2	0.5	0.3	0.3	0.2	0.1
Long-term loans	0.5	0.3	1.9	1.8	1.5	1.2	0.9	0.5	0.4
Credit from the banking system	4.0	2.2	2.5	2.1	2.2	1.4	1.1	0.7	0.8
Domestic arrears	13.9	7.0	4.6	5.5	5.2	2.3	2.3	1.9	1.9
External	**161.1**	**75.0**	**47.9**	**44.2**	**34.7**	**33.3**	**24.2**	**19.7**	**19.3**
Multilateral (excluding IMF)	31.9	16.0	14.6	14.8	15.2	14.3	11.3	9.9	9.7
IBRD	27.7	14.2	11.5	10.9	10.3	9.1	6.4	5.4	5.0
IDA	0.0	0.0	1.0	1.3	1.8	2.0	1.7	1.4	1.5
EIB	0.0	0.0	0.7	0.8	1.1	1.3	1.4	1.5	1.5
EBRD	0.0	0.0	0.0	0.2	0.5	0.6	0.7	0.7	0.8
EU+CEB	4.2	1.8	1.4	1.6	1.5	1.4	1.2	1.0	0.9
Official Bilateral	83.1	38.6	18.5	16.4	15.0	14.4	9.6	7.4	7.1
Paris Club	75.4	33.5	14.6	12.9	11.7	11.0	7.0	5.6	5.3
Other bilateral	0.2	0.1	0.3	0.4	0.5	0.5	0.4	0.3	0.3
Debt under negotiation 1/	7.5	5.0	3.6	3.0	2.7	2.9	2.2	1.4	1.5
Commercial	46.0	20.4	14.8	13.0	4.5	4.6	3.3	2.4	2.4
London Club	46.0	20.4	14.8	13.0	4.5	4.6	3.3	2.4	2.4
Memorandum items:									
Debt to IMF	2.5	2.4	3.4	4.4	4.0	3.7	0.8	0.0	0.0
Government deposits	2.5	2.0	3.8	4.1	3.8	5.1	8.0	6.4	3.3
Net debt (excl. IMF)	239.2	112.5	77.4	73.1	61.4	51.1	33.8	26.9	28.3
Kosovo debt	17.8	9.2	6.1	5.8	4.8	4.3	3.6	2.9	2.6
Share in total gross debt of:									
Foreign currency-denominated debt	92.4	91.8	88.9	87.7	85.7	90.8	89.3	90.4	90.2
Short-term debt	0.0	0.0	0.0	0.2	0.7	0.5	0.6	0.5	0.2
Debt at variable interest rates	44.4	43.3	36.2	36.6	42.4	46.0	44.7	47.5	48.0
Debt to official creditors	47.6	47.7	40.7	40.4	46.2	51.2	50.1	51.9	53.2

Source: Ministry of Finance; and Fund staff estimates.

1/ Bilateral credits concluded before 2000; non-regulated London Club debt; debt in non-convertible currencies.

Figure A1. Serbia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in euro value of local currency) minus domestic inflation (based on GDP deflator).

Appendix II. Serbia: External Debt Sustainability

The risks identified in previous debt sustainability analyses—a slowdown in GDP growth and negative balance sheet effects of exchange rate depreciation—have materialized in part. This adverse dynamics is expected to worsen in 2009–10, pushing external debt over 90 percent of GDP by 2011 (from about 63½ percent at end-2008). However, assuming that the strong policies and structural reforms under the program eventually lead to a resumption of growth and improved current account balances, debt ratios would start declining by 2012. The associated risks remain high, nevertheless.

1. **Serbia's external debt has been rising since 2004, resulting in high vulnerabilities.** Following persistently large external imbalances—and despite rescheduling operations and early repayments to some multilateral creditors, including the Fund—external debt reached €21.8 billion in December 2008. The rise was due to private debt, which tripled since early 2006. In particular, nonbank private debt rose sharply, as prudential regulation on bank activity became tighter and companies switched to direct foreign borrowing, often with domestic commercial banks acting as intermediaries. While this trend was interrupted in Q4 of 2008, external debt remained at €21.5 billion in February 2009 (Tables A1, A2).

Serbia: Structure of External Debt, 2005-09

	Dec-05	Dec-06	Dec-07	Dec-08	Feb-09
			(Percent of total debt)		
Public	59	43	34	29	31
Private	41	57	66	71	69
Banks	17	26	22	18	15
Other private	24	31	43	53	54
Total	100	100	100	100	100

Source: NBS and staff estimates.

2. **External debt dynamics have worsened compared to expectations at end-2008 on account of the more severe global financial crisis a deteriorated domestic growth outlook.** In particular, the debt-to-GDP ratio (including prospective liabilities to the Fund) is expected to exceed 76 percent by 2009, mainly on account of the large financing requirements, the projected decline in real GDP, and higher exchange rate depreciation. Moreover, rollover risks in 2009 and onward have risen in the context of the deteriorated international financial environment, which entails reduced financing available for Serbia and higher risk aversion of lenders. Given these adverse developments, external debt under the baseline scenario is projected to rise significantly to about 90½ percent of GDP in 2011–12, before returning to a declining path.

3. **With improved global and domestic conditions from 2011 onward, external debt ratios are expected to decline by 2012.** GDP is expected to recover, the current account to

improve due to the reallocation of resources from nontradeable to tradable sectors, and FDI to resume. As a result, the debt-to-GDP ratio would start declining in 2012 and return to around 71½ percent of GDP in 2014.

4. **Standard stress tests point to sizable risks.** A further 30 percent depreciation would push external debt to about 128 percent of GDP. While the temporary shocks considered suggest that debt would nevertheless return to a declining path in 2012–13, such dynamics crucially depends on the assumptions of higher growth and current account adjustment in the medium term.

5. **While the baseline scenario would allow for the steady decline in debt in the medium term, the margin of error is small; further adverse developments and less favorable medium-term growth and external prospects could result in an unsustainable path.** This underscores the need for strong policy action, close monitoring, and readiness to implement further measures, if needed, should outcomes be worse than projected.

Table A1. Serbia: External Debt Sustainability Framework, 2007-14
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	54.3	64.1	63.3	60.2	63.6	**76.3**	**85.6**	**90.4**	**88.0**	**80.2**	**71.5**	**-9.5**
2	Change in external debt	-7.8	9.8	-0.8	-3.1	3.4	12.6	9.4	4.8	-2.4	-7.8	-8.7	
3	Identified external debt-creating flows (4+8+9)	6.9	5.3	-0.1	-5.8	3.8	11.2	6.1	1.8	-2.2	-4.3	-5.5	
4	Current account deficit, excluding interest payments	10.9	7.0	8.0	13.2	14.6	9.3	5.9	4.3	2.9	1.8	0.9	
5	Deficit in balance of goods and services	26.6	20.9	21.4	23.3	22.8	18.0	15.1	13.0	10.9	9.3	7.7	
6	Exports	23.4	26.1	29.6	29.4	29.6	27.0	28.3	29.5	29.8	29.5	29.3	
7	Imports	50.0	47.0	51.0	52.7	52.4	45.0	43.4	42.5	40.6	38.8	37.0	
8	Net non-debt creating capital inflows (negative)	0.0	0.0	-1.5	-8.5	-5.0	-3.2	-4.0	-4.5	-5.5	-6.1	-6.3	
9	Automatic debt dynamics 1/	-3.9	-1.8	-6.6	-10.6	-5.8	5.1	4.2	2.0	0.4	0.0	-0.1	
10	Contribution from nominal interest rate	1.2	1.7	2.1	2.3	2.5	3.7	4.2	4.5	4.6	4.4	3.9	
11	Contribution from real GDP growth	-3.8	-2.9	-2.9	-3.5	-2.8	1.4	0.0	-2.5	-4.2	-4.4	-4.0	
12	Contribution from price and exchange rate changes 2/	-1.4	-0.6	-5.7	-9.4	-5.5	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	-14.7	4.6	-0.8	2.8	-0.4	1.5	3.3	3.0	-0.2	-3.5	-3.2	
	External debt-to-exports ratio (in percent)	231.6	245.6	213.8	204.8	214.7	282.2	302.8	306.3	295.5	271.7	244.2	
	Gross external financing need (in billions of euros) 4/	3.3	2.6	4.3	7.5	9.5	9.0	7.3	7.8	8.9	9.7	10.0	
	in percent of GDP	17.2	12.9	18.3	25.3	27.7	29.2	24.0	24.6	25.9	25.6	24.0	
	Scenario with key variables at their historical averages 5/						**76.3**	**77.7**	**79.6**	**80.6**	**79.7**	**78.9**	**-10.5**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	6.7	5.6	5.2	6.9	5.4	-2.0	0.0	3.0	5.0	5.5	5.5	
	GDP deflator in euros (change in percent)	2.3	1.1	9.8	17.5	10.0	-8.1	-1.2	0.5	3.4	4.5	4.5	
	Nominal external interest rate (in percent)	2.2	3.3	3.7	4.7	4.9	5.2	5.5	5.5	5.5	5.5	5.4	
	Growth of exports (euro terms, in percent)	15.9	18.9	31.0	24.8	16.9	-17.8	3.4	8.1	9.5	9.3	9.4	
	Growth of imports (euro terms, in percent)	31.7	0.4	25.2	30.0	15.3	-22.7	-4.7	1.6	3.7	5.2	5.3	
	Current account balance, excluding interest payments	-10.9	-7.0	-8.0	-13.2	-14.6	-9.3	-5.9	-4.3	-2.9	-1.8	-0.9	
	Net non-debt creating capital inflows	0.0	0.0	1.5	8.5	5.0	3.2	4.0	4.5	5.5	6.1	6.3	

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

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

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

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

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

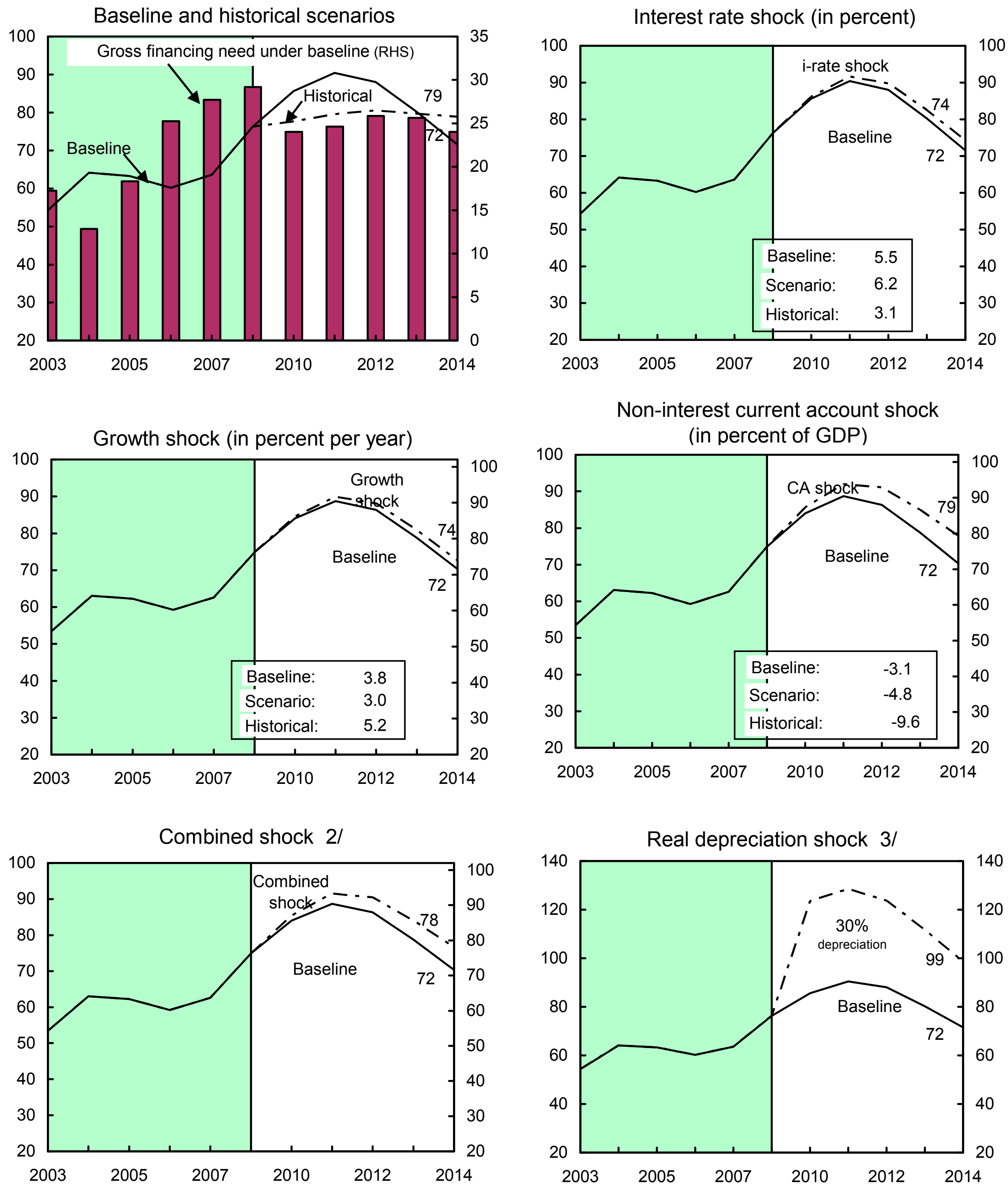
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table A2. Serbia: External Debt, February, 28 2009
(In millions of euros)

Creditor	Outstanding Debt (incl. principal arrears)	Principal Arrears	Interest Arrears	Late Interest	Total
Total External Debt	20,688	1,792	367	469	21,523
Public sector borrowing	6,275	338	174	211	6,660
Medium and long-term debt	6,255	338	174	211	6,640
International financial organizations	3,293	0	0	0	3,293
IBRD	1,588	0	0	0	1,588
IDA	489	0	0	0	489
European Community	273	0	0	0	273
EIB	498	0	0	0	498
EUROFOND - CEB	28	0	0	0	28
EBRD	303	0	0	0	303
EUROFIMA	114	0	0	0	114
Governments Paris Club	1,675	0	0	0	1,675
Other Governments	322	289	149	199	670
London Club	870	26	25	12	908
Other Creditors	70	0	0	0	70
Debt in non-convertible currency	24	24	0	0	24
Short-term Debt	20	0	0	0	20
Private sector borrowing	14,413	1,454	193	258	14,864
Medium and long-term debt	12,630	1,006	184	258	13,072
Banks	2,212	101	15	49	2,276
International financial organizations	365	7	4	6	376
Governments - Permanent Paris Club members	148	0	0	0	148
Other Creditors	1,699	94	11	43	1,753
Enterprises	10,418	905	169	209	10,796
International financial organizatoins	308	0	0	0	309
Governments - Permanent Paris Club members	27	0	0	0	27
Other Governments	13	13	4	6	23
Other Creditors	10,020	842	155	203	10,378
Debt in non-convertible currency	49	49	10	0	59
Short-term Debt	1,783	448	9	0	1,792
Banks	973	310	0	0	973
Enterprises	810	138	9	0	819

Source: National Bank of Serbia

Figure A1. Serbia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Seven-year historical average for the variable is also shown.
2/ Permanent 1/2 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

Attachment I. Republic of Serbia: Letter of Intent

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC

Belgrade, April 30, 2009

Dear Mr. Strauss-Kahn:

We have implemented strong macroeconomic policies over the past months and have received the support of the IMF for our program through a Stand-By Arrangement (SBA) for a period of 15 months in the amount of SDR 350.775 million (75 percent of quota), approved by the Executive Board of the IMF on January 16, 2009. At the time, in view of Serbia's comfortable international reserves position and continued, if reduced, access to external financing, we intended to treat the arrangement as precautionary—and indeed, we did not draw on the amounts made available.

Since then, however, both the global economic environment and domestic activity in Serbia have deteriorated more sharply than anticipated. Output weakness will likely be deeper and more protracted. Therefore, after careful review, we have revised the macroeconomic framework guiding our policies and have adjusted our policy response to the changed circumstances. We have also reached understandings with foreign banks and their home supervisors on rollover of current exposures, and we are seeking assurances of additional financial support from the European Union and the World Bank.

The attached Memorandum of Economic and Financial Policies (MEFP) outlines the revised economic policies that the Government of the Republic of Serbia and the National Bank of Serbia intend to implement during the remainder of 2009 and in 2010 to safeguard Serbia's macroeconomic and financial stability.

In particular, we will revise the 2009 budget to adjust to the much lower revenues and limit the deficit to 3 percent of GDP, consistent with available non-inflationary financing, while ensuring a fair distribution of the adjustment. We are determined to curb recurrent spending at all levels of government, including by freezing public wages and pensions in nominal terms from now on throughout 2010 and by cutting discretionary spending. On the revenue side, we envisage moderate increases in excise taxes. These and other temporary measures will help adjust to the tight financing constraints in the short term, while we engage in durable structural reforms that bring public expenditure in line with the new constraints imposed by the international economic outlook. Moreover, we will set up a comprehensive financial sector support program to prevent and limit financial instability; continue to conduct monetary policy in a prudent way to contain inflation; and implement structural reforms to boost the economy's potential output.

In support of our strengthened program, we request (i) augmentation of the SBA, namely by increasing access to SDR 2,619.120 million (equivalent to about €3 billion, or 560 percent of our quota in the IMF) to help fill the external financing gap projected for 2009–11; (ii) extension of the SBA by one year to mid-April 2011 (for a total duration of 27 months); and (iii) rephasing of access accordingly, with SDR 1,917.570 million (about €2.2 billion, or 410 percent of quota) made available in 2009.

We also request: (i) completion of the first review under the SBA; (ii) modification of the June 2009 performance criteria; (iii) a waiver of applicability of the end-March 2009 performance criterion on the overall fiscal deficit (as complete and verified information is not yet available); (iv) completion of the financing assurances review; and (v) the purchase of SDR 701.550 million (about €0.8 billion, or 150 percent of quota) made available under the existing SBA and following approval of its modification.

Implementation of our program will be monitored through quantitative performance criteria, structural benchmarks, and an inflation consultation clause, as described in the attached MEFP and Technical Memorandum of Understanding. There will be quarterly program reviews of the arrangement by the IMF; the second one will be scheduled to be completed by mid-September 2009, to assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives. Further quarterly program reviews will be scheduled for completion by mid-December 2009 and mid-March 2010. Moreover, each purchase under the SBA will be subject to financing assurances reviews.

We believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of our economic program, but we will take any further measures that may become appropriate for this purpose. We will consult with the IMF 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 IMF to assess implementation of the program.

Sincerely,

/s/

Mirko Cvetković
Prime Minister

/s/

Radovan Jelašić
Governor of the National
Bank of Serbia

/s/

Diana Dragutinović
Minister of Finance

Attachment II

REPUBLIC OF SERBIA

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

April 30, 2009

I. INTRODUCTION

1. This memorandum updates and supplements the Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) attached to our Letter of Intent of December 25, 2008. It reports on recent developments under the program supported by the Stand-By Arrangement (SBA) approved by the IMF in January 2009, and updates our economic objectives and policy agenda.

2. **Performance under the program supported by the SBA was broadly satisfactory.** Most quantitative performance criteria (PCs), the indicative target, and the inflation target under the inflation consultation clause for end-December 2008 and end-March 2009 were met. However, the PC on the ceiling on the consolidated general government deficit for end-December 2008 was missed by some ¼ percent of GDP; and the relevant fiscal information is not yet fully available for end-March 2009. The two structural benchmarks on adopting business plans of the Road Company and of state-owned enterprises will be completed only with delays in May 2009.

II. ECONOMIC AND POLICY DEVELOPMENTS

3. **Since the SBA was negotiated in November 2008, Serbia's external and financial environment has deteriorated abruptly and relentlessly; domestic activity is slumping**. As elsewhere in the region, nominal exports and imports started to contract in November 2008. Net external borrowing and domestic credit have slowed sharply. In January 2009, over the previous year, industrial production dropped by 17 percent, and exports and imports in euro terms fell by 24 and 38 percent, respectively.

4. **Projections of trading partner growth and regional capital flow projections have continued to be downgraded.** As of end-March 2009, the IMF projected a 3 percent decline in the EU's output in 2009, with growth essentially flat in 2010. Prospects for net capital flows to Eastern Europe beyond rollover of existing liabilities are also increasingly dim.

5. **Inflation has been broadly in line with the revised inflation targeting framework.** CPI inflation reached 10.7 percent in February, still inside the target band for end-March. However, the sharply slowing economy seems to have had little mitigating pressures on prices yet, partly owing to the large depreciation and regulated price increases. With inflation

pressures remaining high, the NBS has maintained a relatively high policy interest rate at 16½ percent.

6. **The 2008 fiscal outturn was weaker than expected.** While the program's headline fiscal deficit of 2½ percent of GDP was missed by a relatively small margin, indirect taxes and social security contributions underperformed significantly (by 1 percent of GDP), reflecting dismal trade data and mounting problems of tax compliance. The revenue shortfall was largely offset by lower cash spending, but also by accumulation of expenditure arrears. The government finalized the sale of a majority share of the NIS oil company in February 2009, yielding 1¼ percent of GDP.

7. **A number of supportive policies aimed at softening the credit slowdown were adopted.** The government launched a program of interest subsidies and loan guarantees aimed at stimulating bank loans to the economy of up to 4 percent of GDP. Some bank loans extended under this program are also supported by relief from reserve requirements. In addition, the NBS has relaxed some capital and down-payment requirements for bank lending and announced an exemption from reserve requirements of new foreign borrowing by banks contracted after October 2008.

III. Economic Objectives and Outlook

8. **The main objective of the program remains safeguarding macroeconomic and financial stability amid a rapidly and sharply deteriorating global financial and economic environment.** Serbia faces the double burden of reducing a very large external imbalance, while exports and external finance have been curtailed by what will likely be the deepest global economic downturn since World War II. In this difficult setting, the program seeks to put in place reinforced policies that will lead to orderly adjustments of production, demand, credit, and external financing flows. These policies should enable the economy to emerge more balanced and ready to resume sustainable real convergence growth toward EU income levels, which is Serbia's ultimate economic objective.

9. **The program's revised macroeconomic framework reflects the short-term economic and financial adjustments that are likely to occur during the program period:**

- **Real GDP** is now projected to decline by 2 percent in 2009, and, in line with global and regional growth assumptions, is set to be flat in 2010. This already markedly more pessimistic projection is still subject to downside risks, regarding both the depth and duration of the slowdown, reflecting mainly uncertainty over international developments.

- **Inflation** is now projected to remain around 10 percent throughout 2009, and to start declining to 8 percent by end-2010. The disinflationary forces of a slowdown in domestic demand will be counteracted by pass-through effects from the recent nominal exchange rate depreciation.

- The **external current account deficit** is now projected to decline more rapidly, to about 13 percent of GDP in 2009, from close to 17 percent last year. Export growth is expected to recover only in 2011, and the external current account deficit is projected to normalize at about 5 percent of GDP over the medium term.

- Available **external financing** is now projected to fall well short of previous assumptions. Foreign direct investment and new external loans are expected to be much smaller than last year, resulting in net capital inflows of only 2 percent of GDP in 2009, compared with 12½ percent in 2008.

10. **Despite the sizeable adjustment in domestic demand, we now project external financing gaps of about €2.4 billion in 2009 (7½ percent of GDP) and €1 billion in 2010 (3¼ percent of GDP).** Compared with previous projections, financing requirements are projected to shrink due to the lower current account deficit, but debt amortization is higher due to the rise in short-term debt, and available financing is projected to be lower.

IV. Economic Policies

11. **To achieve our program objectives, we have revised our strategy in three key respects:**

- **First, we are targeting significantly larger fiscal adjustment.** The slumping revenues can only partly be compensated by increasing fiscal deficit targets, reflecting both tight constraints on available non-inflationary financing and the reversion of the revenue-to-GDP ratio back to a lower, sustainable level consistent with the correction of the large external imbalance. Containing the fiscal deficit will require additional fiscal adjustment measures. In the short term, we will need to rely largely on temporary and, in part, distortionary measures, including nominal spending cuts. However, we will use the breathing space provided by these measures to design more structurally sound policies—with support and advice from International Financial Institutions (IFIs)—to align spending plans with a sustainable revenue envelope over the medium term.

- **Second, we are seeking financing assurances from foreign banks to at least maintain their exposures to Serbia.** In particular, it will be crucial to obtain specific commitments from parent bank groups to keep their exposure vis-à-vis Serbia and to keep their subsidiaries sufficiently capitalized to withstand an even sharper downturn than we presently project.

- **Third, we are requesting additional financial support from IFIs.** The macroeconomic adjustment needed to close the projected financing gap would, in our view, put an undue stress on the economy and the financial system, given the high euroization of corporate and household liabilities. Thus, we are requesting that the IMF and other international lenders step up significantly their financial support.

A. Revised Fiscal Policy

12. **Under unchanged policies, fiscal deficits in 2009–10 would surge to 6–7 percent of GDP.** In 2009, the sharp widening of the deficit by some 4 percent of GDP is due to the carry-over of the 2008 revenue shortfall (1 percent of GDP), automatic fiscal stabilizers (1½ percent of GDP), but also a deteriorating structural fiscal position as underlying growth has slowed markedly (1½ percent of GDP).

13. **We will limit the 2009 fiscal deficit to 3 percent of GDP.** The implied moderate relaxation in the fiscal target (from 1¾ percent of GDP) avoids shifting to a strongly procyclical stance, while signaling that public finances remain on a sound footing. Importantly, this represents the maximum deficit that can be financed in a noninflationary way. Additional budget support, including from the World Bank and the European Union, will still be required. To achieve the revised deficit target, the government will submit to Parliament a supplementary 2009 budget for the Republic and the social security funds consistent with the revised program, including the necessary legal provisions on supporting measures (prior actions).

14. **On the expenditure side, our strategy aims at a wide and balanced distribution of the adjustment effort across all levels of government and budget institutions.** We will focus on tightening recurrent spending on wages, pensions, and discretionary spending at all levels. In particular, we will: (i) freeze all general government and public enterprise wages and salaries in nominal terms in 2009 and 2010; (ii) extend the nominal freeze of pension benefits to end-2010; and (iii) freeze hiring at all levels of government, including for temporary contracts, with only duly motivated and limited exceptions. Moreover, we will cut spending by (i) cutting discretionary budget allocations in all ministries of the Republican budget by 40 billion out of the originally budgeted 155 billion dinars; (ii) returning to the Republican budget 40 percent of own resources of budgetary institutions in 2009; (iii) reducing transfers to local governments (while ensuring that this fully translates into spending cuts); and (iv) cutting transfers to the health fund, with a corresponding reduction in its budget on goods and services. Each of these institutions will determine the required policy changes and savings measures needed to adjust to the tighter budget resources. Social and priority capital spending will be protected, however. In addition, we will aim at accelerating the implementation of IFI-financed capital projects to provide some stimulus to growth. Given the high implementation risks, we will take all necessary steps to enforce these measures. Deviations from the strict nominal wage and pension freezes envisaged for

2010 under our program will only be considered if growth and budget revenues in 2010 exceed significantly present program projections, and after consulting with the IMF.

15. **Revenue-raising measures, with limited adverse impact on growth, will include:** (i) raising excise taxes on gasoline (to 43.5 dinars) and diesel (to 30 dinars); (ii) introducing a new excise tax on mobile phone services; (iii) raising levies on cars; and (iv) taking steps to broaden the base and improve collection of the property tax. In addition, we will require higher dividend payments by profitable public enterprises in 2009.

16. **We will also take determined action to improve revenue administration and compliance.** This will involve steps to reinforce audit processes, but also to improve taxpayer services. Importantly, we will assign a specific unit to monitor VAT collection and review the reasons for the sharp increase in VAT refunds and credits in 2008 by end-June 2009 (structural benchmark, see TMU) and adopt new procedures for VAT verification and audits by end-2009.

17. **These emergency measures will be supplemented by more lasting structural reforms to ensure the durability of fiscal adjustment**. To this end, we will initiate education, health, and pension systems reforms, focusing on permanently reducing the level of public spending while improving service delivery. Details on specific reform plans will form part of the discussions at the next program review.

18. **Coordination across all levels of government, as well as strengthening of public financial management, will be key to successful program implementation.** Local governments and the health fund will need to play an important role in the fiscal consolidation by targeting balanced budgets. Thus, key municipalities and the province of Vojvodina will contribute to the consolidation effort. Further, should policies on wages and spending not be in line with the adjustment targets, we will promptly cut their transfers. To avoid arrears accumulation, the Ministry of Finance will prepare three-month rolling treasury plans with clear expenditure prioritization by June 2009 (structural benchmark). It will strengthen ex ante controls over commitments, and set up a monitoring system for arrears at the general government level tracking spending from the commitment to the payment stage on a monthly basis. We will promptly clear the arrears of the Road Company of Serbia and stay recurrent in our payment obligations going forward. We will tightly control the provision of additional guarantees by the Guarantee and National Development Funds and by the Republican budget (indicative target).

19. **Despite these measures, achieving the revised 2009 fiscal target may prove to be challenging in view of downside risks.** The government stands ready to take measures to preserve program objectives, including by increasing VAT rates and cutting nominal wages.

20. **For 2010, we plan to reduce the general government deficit to 2½ percent of GDP given continued tight financing constraints.** This adjustment largely reflects the full-

year effect of our 2009 measures, including the extension of the nominal freeze in pension benefits and public sector wages through end-2010.

21. **We will improve fiscal data monitoring and reporting.** We are still facing shortcomings in the reporting of fiscal data by local government and social and other funds, as well as the treatment of foreign-financed projects which are not paid through the single treasury account. To reduce risks of inadvertent misreporting of fiscal data, we will—with technical support from the IMF—review and amend our fiscal reporting procedures for different levels of government, and ensure that all Project Implementation Units and the NBS inform the Treasury immediately about all transactions related to foreign loans. Monitoring of arrears will be strengthened. Finally, we will include a projected amount of 12 billion dinars of foreign-financed projects on the spending side of the revised 2009 budget.

B. Monetary and Exchange Rate Policies

22. **Monetary policy will remain focused on achieving low and stable inflation.** The NBS will seek to maintain a monetary policy stance consistent with the announced inflation targets, using its policy interest rate and other auxiliary instruments. Should the projected overshooting of our inflation targets for end-2009 materialize—due to past exchange rate depreciation and larger-than-anticipated adjustment of regulated price—the NBS will communicate to the public the reasons for such overshooting and an outline of planned corrective policy actions. Developments in monetary and credit aggregates, including net domestic assets of the central bank, will be monitored as a cross-check of the NBS's inflation analysis. In line with standard EU practices, the NBS will not extend credit to the public sector, either directly or through primary market purchases of government debt obligations, except for potential operations to be agreed under the financial stability framework (see ¶26). Under the program, inflation developments will be monitored using a standard consultation clause (see TMU).

23. **In line with this framework, we will maintain the present managed float exchange rate regime.** The NBS will use limited and targeted interventions aimed at smoothing shocks and preserving financial stability, in a way that will remain consistent with achieving the inflation targets. Recognizing the importance of maintaining an adequate level of international reserves as a buffer against external and financial sector vulnerabilities, the NBS will not allow its net foreign assets, valued at program exchange rates, to fall below the agreed program floors throughout 2009.

24. **We will continue to strengthen the monetary policy framework during the program period.** With the government's support and consistent with EU *acquis* requirements, the NBS will propose amendments to the Law on the NBS by end-2009 to prohibit NBS lending to the public sector, clarify procedures for the recapitalization of the central bank, and, more generally, enhance the independence of the NBS. Other measures

will include strengthening the NBS's policy decision making capacity, including by upgrading the inflation modeling and forecasting framework.

C. Financial Sector Policies

25. **In the financial sector area, we will continue to enhance our preparedness to deal with consequences of the global financial turmoil.** We will put in place a detailed crisis response plan specifying the roles and responsibilities of the government, the NBS, and the Deposit Insurance Agency (DIA) in reacting to various contingencies (prior action). In support of this plan, the NBS will conduct a comprehensive review of the legal framework for collateral and debt restructuring in the next few months.

26. **To further support financial stability, the government and the NBS will introduce a comprehensive financial sector support program (FSSP).** Aiming at stabilizing market conditions and softening the impact of the crisis on private sector balance sheets, the FSSP will offer banks access to new liquidity facilities while creating incentives for loan restructuring under a common framework, promoting de-euroization of loans, and discouraging early recalls of non-delinquent loans. In parallel, in the context of the Vienna Initiative, the NBS is intensifying cooperation with foreign supervisors, notably to facilitate fulfillment of commitments to be obtained from key foreign banks to maintain their exposure to Serbia. Moreover, the NBS, in consultation with IMF, will complete diagnostic studies of all banks, including sensitivity analyses based on a downside scenario. Diagnostic studies for the 12 largest banks and the 4 banks with majority state ownership will be completed by end-September 2009, and for all banks by end-2009 (structural benchmarks).

27. **Looking ahead, developing the dinar bond market remains a key medium-term priority.** By mid-2009, the Ministry of Finance will strengthen the institutions charged with implementing its public debt management strategy. To help step up the regular issuance of government bonds, it will fine-tune the T-bill auction procedure by increasing transparency and market determination of interest rates.

28. **State ownership in banks and the remaining insurance company will be phased out as soon as market conditions permit.** Due to difficult market conditions, we are still exploring options for the remaining banks with state participation. We plan to adopt detailed action plans for these banks, with consolidation of the four majority-owned state banks into a single bank before privatization as a key option, by end-June 2009 (structural benchmark). To facilitate our overall privatization plans, as well as to promote stock market development, by end-2009, the government will also submit to Parliament a new Securities Law conforming with EU regulations.

D. Structural Policies

29. **We will continue to restructure state-owned enterprises, increase private sector participation, and improve the investment climate.** The ongoing economic crisis will not deter us from pursuing our structural reform agenda to complete the transition to a market economy. On the contrary, we will take measures to: (i) privatize, restructure, put in bankruptcy, or liquidate a wide range of public enterprises, utilities, non-core companies spun off from public utilities, and socially owned enterprises; and (ii) eliminate, clarify, or reconcile rules and regulations that undermine the predictability of the business environment or significantly raise the cost of doing business. While actual sales of large state-owned enterprises will likely be postponed due to unfavorable market conditions, we will continue to prepare enterprises for eventual privatization. We have started a regulatory review aimed at streamlining business regulations. Importantly, we will also strive to resolve the still pending, but politically very difficult, issues of land ownership and restitution. To improve the bankruptcy framework and help liquidate loss-making enterprises, we will also amend the bankruptcy law.

30. **Our goal is to modernize public enterprises and utilities by opening them to private sector participation.**

- **Large state enterprises.** Based on case-by-case studies, we will move ahead with corporatization (when necessary) followed by full or partial privatization, joint ventures, or a private management contract. The restructuring of the airline company JAT has started, following the failed tender, with the objectives of rationalizing costs and reorganizing operations. The privatization process of the pharmaceutical company Galenika has also started, with the privatization advisor developing a strategy; a tender for selling 70 percent of the capital is expected to be launched in the second half of 2009. We expect to make a decision this year on the privatization model for the telecom company, and to launch a tender for a privatization advisor for the Belgrade airport. We will accelerate the restructuring of the railway company. To increase transparency, we will publish audited annual financial statements of state enterprises.

- **Local enterprises.** The government will launch, in collaboration with municipalities, a comprehensive review of the business and financial conditions of all locally owned companies and utilities, with a view to reducing losses and budget transfers, while improving service delivery and preparing for private sector participation. The Ministry of Economy and Regional Development will prepare a strategy for transforming locally owned utilities and determining ways and modalities of private capital involvement.

31. **We plan to complete the privatization program of socially owned enterprises.** The Ministry of Economy aims at finalizing in 2009 the privatization or liquidation of some

800 socially owned enterprises and non-core companies spun off from public utilities. Regarding the remaining large socially owned enterprises, we have set up a joint venture between the car manufacturer Zastava and Fiat, and will try a similar approach for RTB Bor (copper mining company), which failed twice to be sold through tender.

32. **We will ensure the same wage discipline in public enterprises as in the general government.** To avoid adverse wage dynamics and encourage rationalization, the government will adopt state enterprises' business plans that conform to general government wage and employment policies by end-May 2009. It will adopt all necessary decrees to ensure a wage freeze similar to that in the general government, and will subsequently closely monitor wage bill developments in these enterprises (TMU, ¶19).

V. PROGRAM MONITORING

33. Progress in the implementation of the policies under this program will be monitored through quarterly quantitative performance criteria (PCs) and indicative targets, structural benchmarks, and an inflation consultation clause. These are detailed in Tables 1 and 2. The attached TMU contains definitions and adjustors. Quantitative targets through December 2009 are PCs. Conditionality, including related to the 2010 budget, will be added to the program at the time of the next review.

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2008-09 1/

	2008 2/		2009 2/				
	End-Dec.		End-March		End-June	End-Sept.	End-Dec.
	Program Targets	Prelim. Actual	Program Targets	Prelim. Actual	Revised Program Targets	Program Targets	Program Targets
Quantitative Performance Criteria							
Floor on net foreign assets of the NBS (in billions of euro)	5.0	6.1	5.1	6.0	4.4	3.6	2.5
Ceiling on consolidated general government overall deficit (in billions of dinars)	64	69	15	...	35	60	90
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro)	0	0	0	0	10	10	10
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 3/	50	0	200	0	550	550	550
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0
Inflation Consultation Bands							
Central point	10.0	8.6	9.2	9.4	8.0	9.5	10.0
Band, upper limit	12.0	n.a.	11.2	n.a.	10.0	11.5	12.0
Band, lower limit	8.0	n.a.	7.2	n.a.	6.0	7.5	8.0
Indicative Target							
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars)	635	633	190	...	335	520	691
Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development funds	n.a.	n.a.	n.a.	n.a.	50	50	50

1/ As defined in this Letter of Intent, Memorandum on Economic and Financial Policies, and Technical Memorandum of Understanding.
2/ Cumulative from January 1.
3/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, KfW, Eurofima, CEB, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements.

Table 2. Serbia: Structural Conditionality, 2009

Action	Timing	Status
Prior actions		
1. **Fiscal policy.** Government to submit to Parliament revised Republican and social security funds budgets for the remainder of 2009 consistent with the program, including provisions ensuring a freeze in public sector wages in 2009.	Before Board meeting	
2. **Fiscal policy.** Government to submit to Parliament legal provisions that ensure tax measures as per program understandings.	Before Board meeting	
3. **Financial sector.** Parties to finalize the Appendix to the MoU on Financial Sector Stability detailing contingency measures and respective roles of the NBS, the government, and the DIA.	Before Board meeting	
Structural benchmarks		
1. **Budget framework.** Government to adopt the business plan of the Road Company of Serbia consistent with the program.	End-January 2009.	Rescheduled for end-May 2009.
2. **Budget framework and wage policy.** Government to adopt state enterprises' business plans that conform to general government wage and employment policy in 2009 and ensure profit transfers to the state.	End-January 2009.	Rescheduled for end-May 2009.
3. **Budget management.** Ministry of Finance to prepare a three-months rolling cash flow plan for the Republican budget consistent with the annual budget targets.	End-June 2009	
4. **Revenue administration.** Ministry of Finance to charge a specific unit to review the reasons for the sharp increase in VAT refunds and credits in 2008.	End-June 2009	
5. **Financial sector.** Deposit Insurance Agency to adopt detailed action plans for the remaining banks with state participation.	End-June 2009	
6. **Financial sector.** NBS to complete a diagnostic study of the 12 largest banks and the four banks with majority state ownership.	End-September 2009	

Attachment III

TECHNICAL MEMORANDUM OF UNDERSTANDING

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

A. Floor for Net Foreign Assets of the NBS

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

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

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

Cross Exchange Rates and Gold Price for Program Purposes 1/

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

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

6. On March 20, 2009 the NBS's net foreign assets, evaluated at program exchange rates, were euro 6,022 million; foreign reserve assets amounted to euro 8,255.5 million, and foreign reserve liabilities amounted to euro 2,233.5 million.

7. **Adjustors.** For program purposes, NFA will be adjusted upward *pari passu* to the extent that: (i) after March 20, 2009, the NBS has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as Serbian commercial banks abroad; and (ii) the restructuring of the banking sector by the Deposit Insurance Agency involves a write-off of NBS foreign exchange-denominated liabilities to resident banks. The NFA floor will also be adjusted upward by any privatization revenue in foreign exchange received after March 20, 2009. Privatization receipts are defined in this context as the proceeds from sale or lease of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS, either directly, or through Treasury.

B. Inflation Consultation Mechanism

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

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

C. Ceiling on External Debt Service Arrears

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

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

D. Ceilings on External Debt

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

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

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

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

E. Fiscal Conditionality

16. **The general government fiscal balance,** on a cash basis, is defined as the difference between total general government revenue (including grants but excluding budget support grants from the European Union or any of its components) and total general government expenditure (irrespective of the source of financing) as presented in the "GFS classification

table" and including expenditure financed from foreign project loans. For program purposes, the consolidated general government comprises the Serbian Republican budget (on-budget and own revenue), local governments, the pension fund (employees, self-employed, and farmers), the health fund, the National Agency for Employment, and the Road Company (JP Putevi Srbije) and any of its subsidiaries. Any new extrabudgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Revenues of the Republican budget exclude profit transfers from the NBS. Expenditures exclude the clearance of arrears of the Road company accumulated up to end-2008.

17. **Adjusters.** The deficit ceiling will be adjusted upward for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework (MEFP, ¶25), following consultation with IMF staff. It will be increased (respectively reduced) in 2009 by the amount of project loans disbursed by foreign institutions listed in TMU ¶13 above to the general government in excess of (respectively, lower than) the program projections indicated in the table below, in consultation with IMF staff, on the basis of actual disbursements as jointly reported by the Ministry of Finance and the NBS. This adjustment does not apply to program loans and general budget support.

Disbursements of project loans by foreign institutions

From January 1, 2009 to:	Program projections (billions of dinars)
March 31, 2009	1.7
June 30, 2009	4.2
September 30, 2009	7.1
December 31, 2009	12.0

18. **Government current expenditure of the Republican budget** (excluding expenditure financed by own sources) includes wages, subsidies, goods and services, interest payments, transfers to local governments and social security funds, social benefits from the budget, other current expenditure, and net lending. It does not include capital spending. The ceiling will be adjusted for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework (MEFP, ¶25).

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

20. **Action plan on tax administration.** The specific plan is understood to include the following elements:

- **Short term.** (i) Conducting a review (for March 2009) comparing VAT input credit claims on imports for each taxpayer with the customs records of imports by the taxpayer during the same period. (ii) Conducting an in-depth analysis and preparing a report on the sources for growth in VAT refunds and excess VAT credit since 2005 to determine if these volumes are legitimate and what changes are required in procedures. (iii) Charging a specific unit in headquarters with the ongoing responsibility for monitoring the overall performance of the VAT, analyzing trends and potential threats to revenue, and recommending actions to improve the performance (structural benchmark for end-June 2009).

- **Medium term.** (i) Redesigning the VAT refund risk-based selection system placing emphasis on the value of each claim and more reliance on the compliance history of the claimant, fast track refunds for claimants with good compliance history, and concentrating audits on new claimants and those with poor compliance history. (ii) Developing procedures to systematically verify input credits claimed in the domestic VAT on imported goods with customs import records on an ongoing basis (end-December 2009).

21. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget, the Guarantee Fund, and the Development Fund.** The ceiling also includes the contracting of any domestic loans by the Development and the Guarantee Funds. It excludes any guarantees extended under the financial stability framework (MEFP, ¶25), unless such loans or guarantees are extended to entities other than financial sector institutions.

INTERNATIONAL MONETARY FUND

Republic of Serbia—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Michele Shannon

May 4, 2009

1. **This note assesses the risks to the Fund arising from the proposed augmented Stand-By Arrangement (SBA) for Serbia and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities request an augmentation and extension of the SBA approved on January 16, 2009, and a rephasing of purchases. Total access under the augmented 27-month SBA would be about SDR 2.6 billion (560 percent of quota), with front-loaded access of SDR 0.7 billion available upon approval of the augmentation, and two further purchases of about SDR 0.6 billion in the remainder of 2009, followed by five purchases as shown in Table 1. Access during the first year of the arrangement (from the date of approval of the existing SBA) would reach over 400 percent of quota, and the last purchase under the arrangement would be available in February 2011.

Table 1. Serbia: Proposed Augmented SBA—Access and Phasing

				Percent of quota	
Availability	Date	SDR mn		Purchase	Cumulative
2009	May (approval) 1/	701.550	1/	150.0	150.0
	August	608.010		130.0	280.0
	November	608.010		130.0	410.0
2010	February	187.080		40.0	450.0
	May	187.080		40.0	490.0
	August	140.310		30.0	520.0
	November	116.925		25.0	545.0
2011	February	70.155		15.0	560.0
	Total	2,619.120		560.0	560.0

Source: Finance Department.

1/ The total amount that would be available on approval of the augmentation, comprising SDR 233.85 million made available on approval of the existing SBA, SDR 23.385 million available on the completion of the first review, and SDR 444.315 million made available on approval of the augmentation.

[1] See *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy* (3/5/03).

I. Background

2. **Serbia had two Fund arrangements since 1992 prior to the current SBA, and in both cases access was well below the annual and cumulative access limits (Table 2).**[2] In 2000, Serbia made a purchase under the post-conflict emergency assistance policy, using part of the resources to clear its arrears to the Fund. All available purchases were made under a 12-month SBA that was approved in 2001. Before this SBA expired, an Extended Arrangement (EA) under the Extended Fund Facility (EFF) was approved in 2002, originally for 36-months. Reflecting mixed program implementation, the EA was extended twice (to a total of 45 months) to allow completion of the last two reviews, and the full amount available under the arrangement was drawn. Following the completion of the EA, Serbia was subject to post-program monitoring (PPM) as its outstanding credit to the Fund exceeded the PPM threshold at the time of 100 percent of quota. Serbia made two voluntary advance repurchases in June and September 2006, respectively, bringing outstanding GRA credit below to the PPM threshold (Figure 1). This notwithstanding, Serbia remained in PPM for a longer period until it had fully extinguished its outstanding GRA credit in March 2007.

3. **The current 15-month SBA for Serbia was approved on January 16, 2009, in an amount of SDR 351 million (75 percent of quota).** At the time of approval, the authorities indicated that they did not intend to draw on Fund resources unless the need arose. To date, no drawings have been made under the arrangement, and performance under the program has been broadly satisfactory. However, Serbia's external and financial environment has deteriorated, with an abrupt slowing of net capital inflows likely to open up significant external financing gaps in 2009 and 2010, such that the authorities envisage making drawings under the proposed augmented arrangement.

[2] The supplement provides information on Serbia's Fund arrangements from 1992 onwards. The Federal Republic of Yugoslavia succeeded to the membership in the Fund of the former Socialist Federal Republic of Yugoslavia (SFRY) on December 20, 2000, effective December 14, 1992. The Federal Republic of Yugoslavia became the State Union of Serbia and Montenegro on February 4, 2003. Following Montenegro's secession from the State Union, Serbia is the continuing member of the Fund.

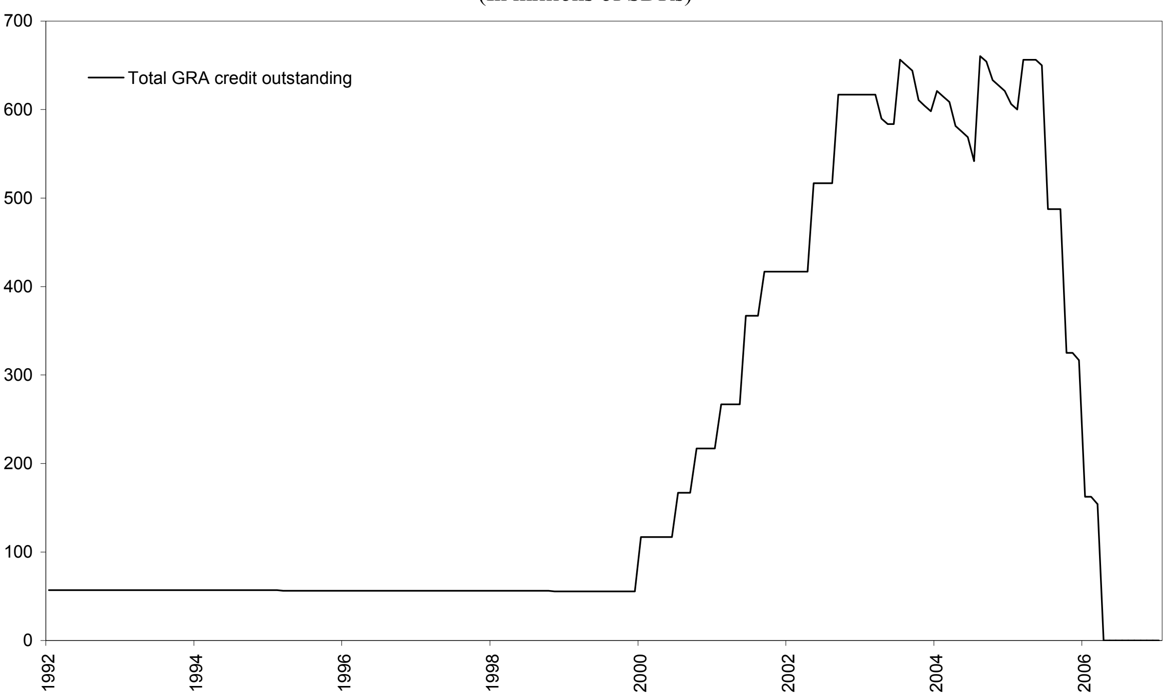
Table 2. Serbia: IMF Financial Arrangements, 1992–2016 1/
(In millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Arrangement as a Percent of Quota	Amount Drawn	Purchases	Repurchases	Fund Exposure 1/
1992							56.8 2/	--	56.8 2/
1993							--	--	56.8
1994							--	--	56.8
1995							--	0.0	56.8
1996							--	0.8	56.1
1997							--	--	56.1
1998							--	--	56.1
1999							--	0.4	55.6
2000							116.9 3/	55.6	116.9
2001	SBA	11-Jun-01	31-May-02	200.0	42.8	200.0	100.0	--	216.9
2002	EFF	14-May-02	28-Feb-06	650.0	139.0	650.0	200.0	--	416.9
2003							200.0	--	616.9
2004							162.5	158.5	621.0
2005							125.0	139.7	606.3
2006							62.5	506.3	162.5
2007							--	162.5	--
2008							--	--	--
2009 4/	*SBA 5/*	*15-May-09*		*2,619.1*	*560.0*		*1917.6*	--	*1917.6*
2010 4/							*631.4*	--	*2549.0*
2011 4/							*70.2*	--	*2619.1*
2012 4/							--	*251.4*	*2367.7*
2013 4/							--	*1093.3*	*1274.5*
2014 4/							--	*1049.4*	*225.1*
2015 4/							--	*216.3*	*8.8*
2016 4/							--	*8.8*	--

Source: Finance Department.

1/ As of end-December.
2/ Federal Republic of Yugoslavia's (Serbia/Montenegro's) share of the GRA liabilities in the Fund.
3/ Disbursement under Post-Conflict Emergency Assistance.
4/ Figures under the proposed program in italics.
5/ A 15-month SBA was initially approved for SDR 350.8 million (75 percent of quota) on January 16, 2009.

Figure 1. Serbia: IMF Credit Outstanding, 1992–2007
(In millions of SDRs)



Source: Finance Department.

4. **Serbia's external debt is relatively high, with private sector debt accounting for the largest share.** At end 2008, Serbia's total external debt stood at about 64 percent of GDP, and it has been relatively stable overall in recent years, partly on account of successive debt reduction operations in the context of the London Club and the Paris Club of creditors (Table 3). Private sector debt stood at 45 percent of GDP and consists mainly of medium and longer term debt owed by corporations (Figure 2a). The private sector share of total external debt has risen steeply in recent years to more than 70 percent in 2008. Serbia's total external debt as a ratio of GDP is the fourth highest among the recent exceptional access cases, while its public sector component is close to the median of the recent exceptional access cases (Figure 3, Panels A and B).[3] Reflecting the country's relatively high debt stock, Serbia's external debt service ratio to exports of goods and services is relatively high vis-à-vis other recent exceptional access cases (Figure 3, Panel C).

Table 3. Serbia: Total External Debt, 2005–08 1/

	2005	2006	2007	2008
	(In Millions of Euros)			
Total External Debt	13,064	14,884	17,789	21,801
of which:				
Public	7,714	6,420	6,130	6,387
Private	5,346	8,464	11,659	15,414
Banks	2,183	3,871	3,965	3,906
Other Private	3,164	4,593	7,694	11,508
	(In Percent of GDP)			
Total External Debt	64.2	63.3	60.2	63.6
of which:				
Public	37.9	27.3	20.7	18.6
Private	26.3	36.0	39.5	45.0
Banks	10.7	16.5	13.4	11.4
Other Private	15.5	19.5	26.0	33.6

Source: Serbian authorities and IMF staff estimates.

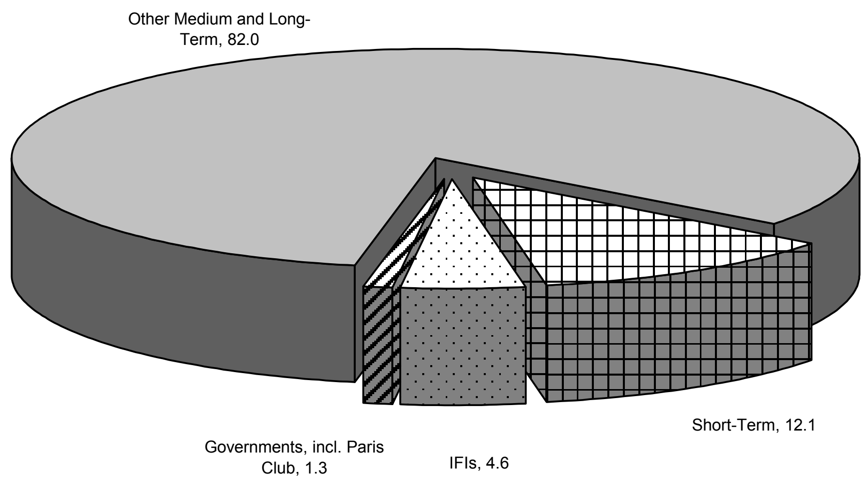
1/ End of year unless otherwise indicated.

5. **Total public debt is moderate and the bulk of it is denominated in foreign currency.** At end-2008, total public debt, i.e., government and government-guaranteed debt, was estimated at 31.6 percent of GDP, close to the median value for the recent exceptional access cases (Figure 3, Panel D). Over 60 percent of the public debt was owed to external creditors and about three-quarters of domestic debt was accounted for by foreign currency denominated debt related to frozen foreign currency deposits (see Table A2 in the Staff Report). Public sector external debt stood at about 19 percent of GDP, and is owed mainly to

[3] The exceptional access cases used as comparators in this paper are the recent SBAs approved or proposed since September 2008.

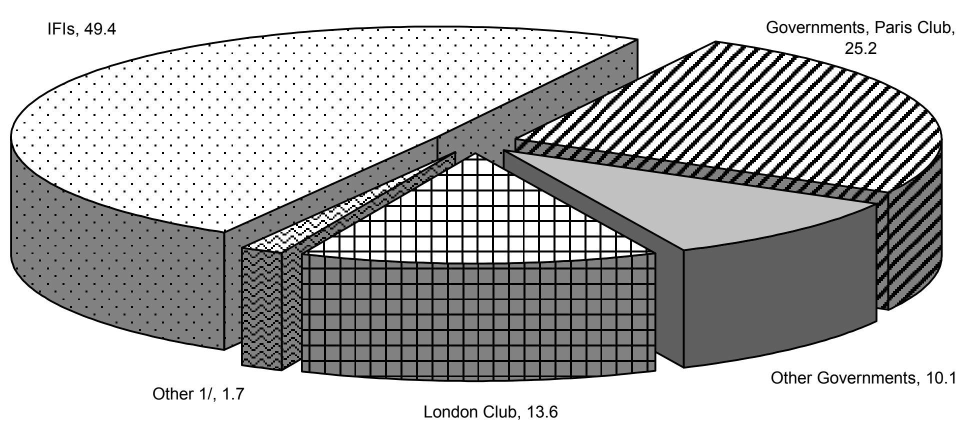
multilateral institutions and to official bilateral creditors (Figure 2b). In 2008, the public sector accounted for only about 10 percent of total external debt service, reflecting in part the large share of multilateral and bilateral official creditors.

Figure 2a. Serbia: Composition of Private External Debt by Creditor, end-February 2009
(In percent)



Source: Serbian authorities and IMF staff estimates.

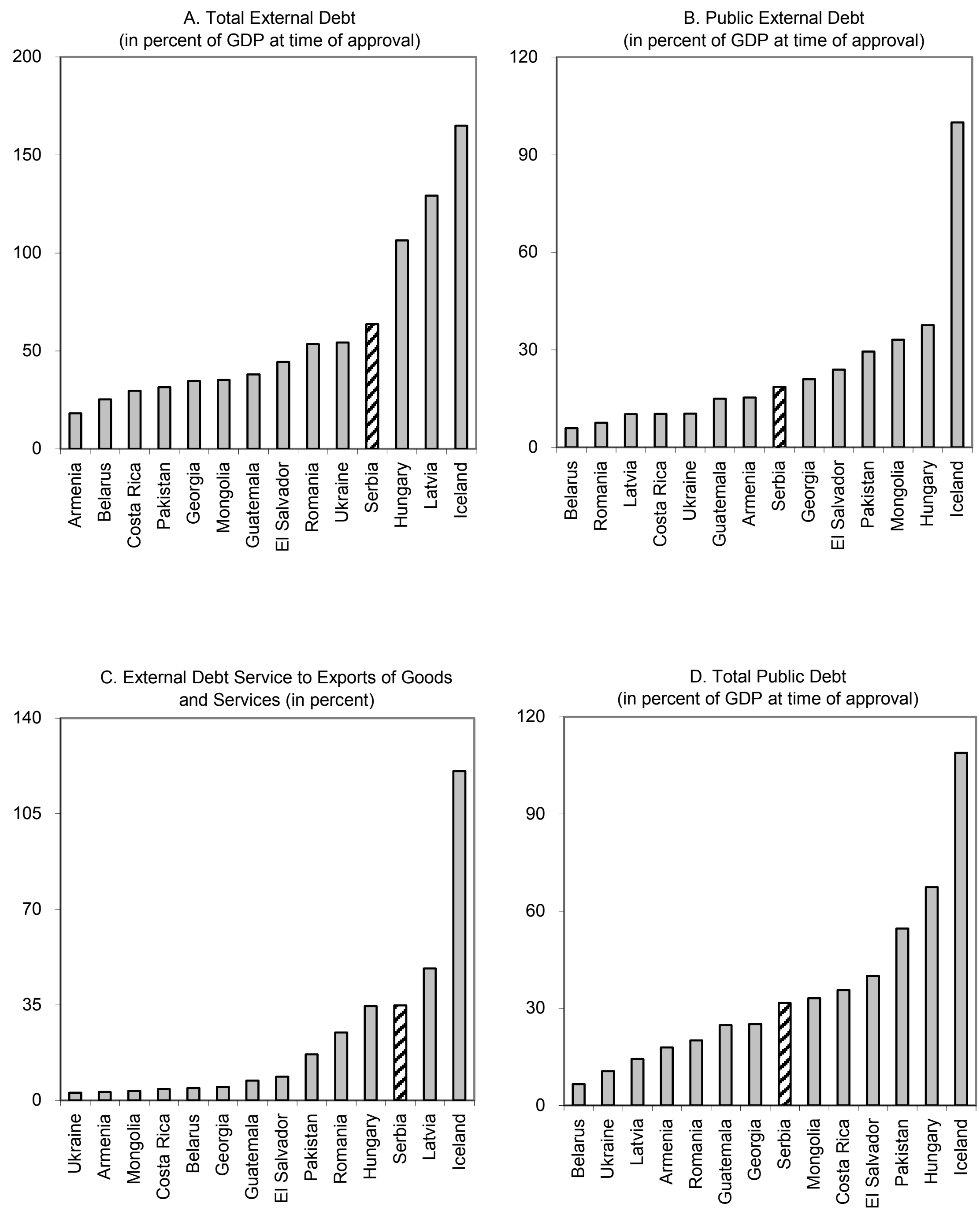
Figure 2b. Serbia: Composition of Public External Debt by Creditor, end-February 2009
(In percent)



Source: Serbian authorities and IMF staff estimates.

1/ Includes short-term debt.

Figure 3. Debt Ratios for Recent Exceptional Access Arrangements 1/



Source: Serbian authorities and IMF staff estimates, and World Economic Outlook.

1/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement. Ratios generated using end-2008 data.

II. The Augmented Stand-By Arrangement—Risks and Impact on Fund's Finances

A. Risks to the Fund

6. **Access under the proposed arrangement would exceed by far that in previous arrangements for Serbia and would surpass the annual access limit.**[4]

- If all purchases were made as scheduled, Serbia's outstanding credit would rise to 410 percent of quota at the end of the first year of the arrangement, and peak at 560 percent of quota in February 2011. In terms of quota, this projected peak exposure would be above the median value, but less than half of the highest values, when compared with recent exceptional access cases (Figure 4).

- If the SBA is fully disbursed, GRA credit outstanding to Serbia would be almost 10 percent of GDP by 2010 and just over one-third of gross international reserves (Table 4). At its peak, outstanding Fund credit would be about 11 percent of total external debt, and just under 30 percent of public external debt. Peak Fund exposure would be fifth highest among recent and proposed exceptional access SBAs with respect to GDP, while the peak ratios with regard to reserves and total external debt would be somewhat below the median values for the comparator group (Figure 5).

- In terms of SDRs, the projected peak GRA exposure of about SDR 2.6 billion would be about four times higher than Serbia's previous peaks in Fund credit outstanding reached in 2004–05. It would also be the fifth highest among recent and proposed exceptional access cases (Figure 6, Panel A).

7. **Debt service to the Fund will be high, amid a relatively total high external debt service.** If all purchases under the proposed SBA were made as scheduled, Serbia's projected debt service to the Fund would peak at about SDR 1.1 billion in 2013, accounting for 11.5 percent of exports of good and services, the highest among recent and proposed exceptional access cases (see Figure 5).[5] Peak total external debt service in percent of exports of goods and services, at about 75 percent, would be third highest among recent exceptional access cases, below only Latvia and Iceland.

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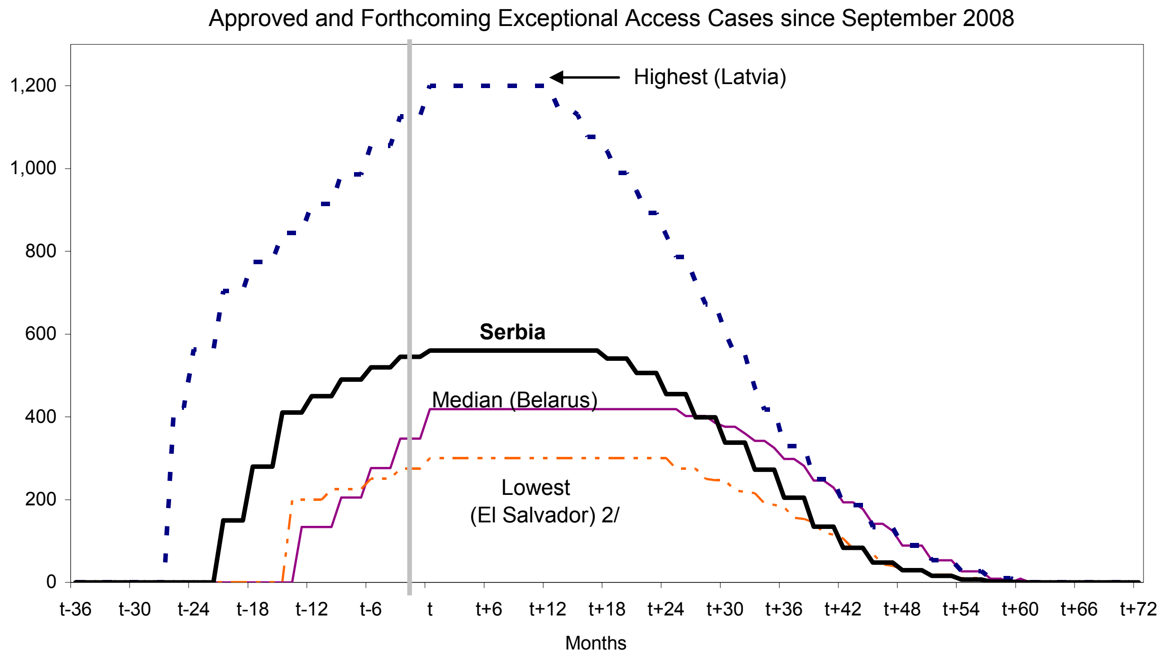
[4] The proposed access during the first year of the arrangement, from the date of the approval of the existing SBA, is 410 percent of quota.

[5] Debt service to the Fund is calculated assuming that all repurchases are made as scheduled, i.e., each purchase is repurchased in eight quarterly installments, beginning in 3¼ years after each purchase and ending after 5 years. As for level-based surcharges, they are calculated according to the current schedule: 100 basis points for credit outstanding over 200 percent of quota and 200 basis points for credit outstanding above 300 percent of quota. The new system of surcharges, which applies to credit outstanding above 300 percent of quota, will go into effect on August 1, 2009, subject to grandfathering at the member's request.

Figure 4. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(In percent of quota)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.
2/ The authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.

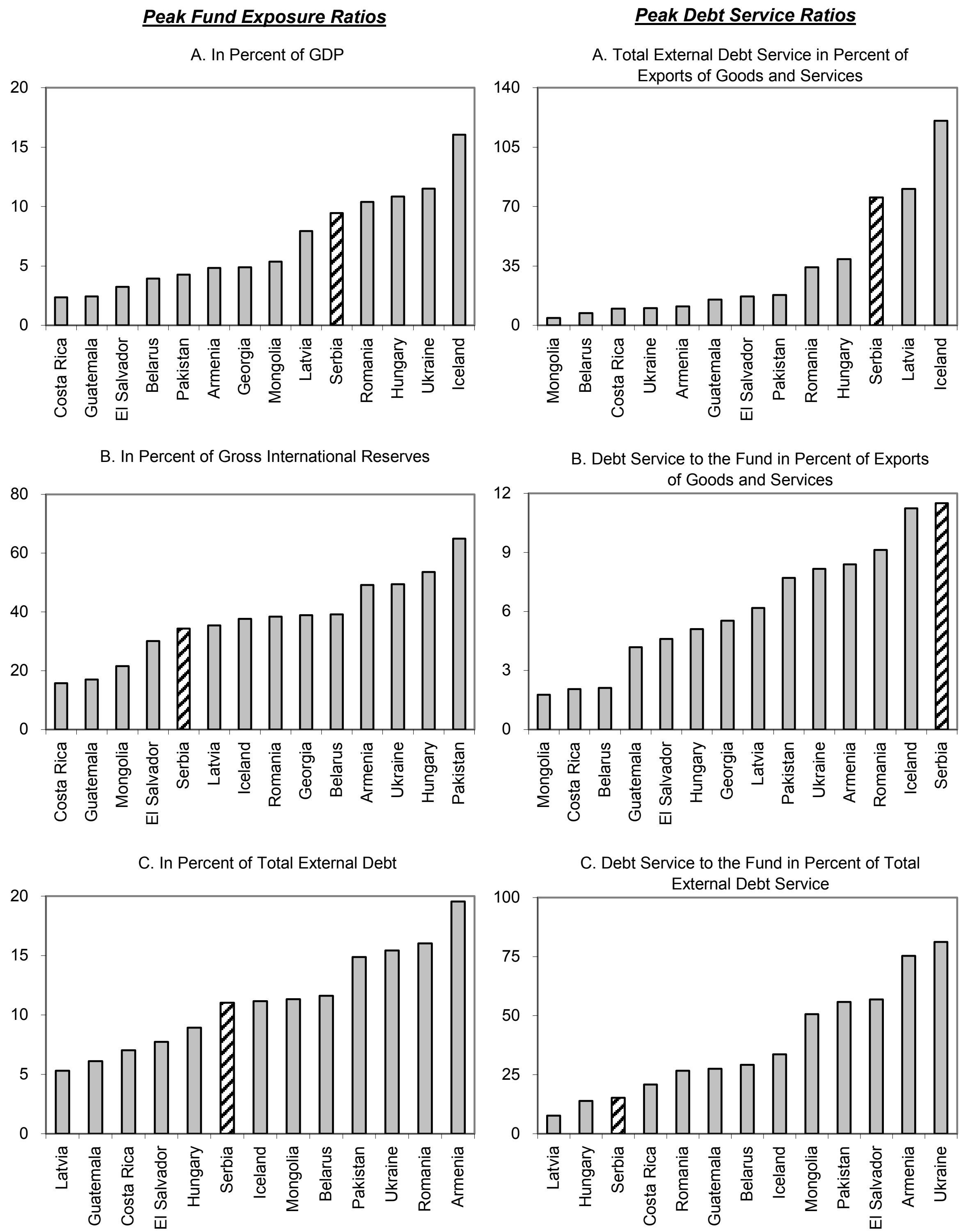
Table 4. Serbia—Capacity to Repay Indicators 1/

	May-09	2009	2010	2011	2012	2013	2014	2015	2016
Exposure and Repayments (In SDR millions)									
GRA credit to Serbia	701.6	1,917.6	2,549.0	2,619.1	2,367.7	1,274.5	225.1	8.8	0.0
(In percent of quota)	(150.0)	(410.0)	(545.0)	(560.0)	(506.2)	(272.5)	(48.1)	(1.9)	(0.0)
Charges due on GRA credit 2/		17.8	56.3	69.9	70.0	49.0	14.9	2.2	0.1
Debt service due on GRA credit 2/		17.8	56.3	69.9	321.4	1,142.3	1,064.3	218.5	8.8
Debt and Debt Service Ratios 3/									
In percent of GDP									
Total external debt	63.6	76.3	85.6	90.4	88.0	80.2	71.5	66.2	62.2
External debt, public	18.6	29.3	33.1	33.2	30.6	25.4	20.9	19.1	17.8
GRA credit to Serbia	2.3	7.0	9.4	9.3	7.8	3.8	0.6	0.0	0.0
Total external debt service	10.3	13.2	12.6	14.8	18.6	22.2	21.5	18.0	17.6
Public external debt service	1.0	1.3	2.1	2.2	3.0	5.3	4.6	1.5	1.3
Debt service due on GRA credit		0.1	0.2	0.2	1.1	3.4	2.9	0.5	0.0
In percent of Gross International Reserves									
Total external debt	267.6	299.5	311.4	297.7	284.0	280.1	270.5	249.8	232.6
External debt, public	78.4	114.9	120.2	109.2	98.8	88.6	79.0	72.0	66.6
GRA credit to Serbia	9.7	27.6	34.3	30.6	25.0	13.2	2.3	0.1	0.0
In percent of Exports of Goods and Services									
Total external debt service	34.8	48.8	44.7	50.3	62.6	75.3	73.5	62.8	62.7
Public external debt service	3.3	4.7	7.6	7.4	10.1	18.1	15.7	5.1	4.8
Debt service due on GRA credit		0.2	0.7	0.8	3.5	11.5	9.8	1.9	0.1
In percent of Total External Debt									
GRA credit to Serbia	3.6	9.2	11.0	10.3	8.8	4.7	0.9	0.0	0.0
In percent of Total External Debt Service									
Debt service due on GRA credit		0.5	1.7	1.7	5.6	15.3	13.4	3.0	0.1
In percent of Total Public External Debt									
GRA credit to Serbia	12.4	24.0	28.6	28.0	25.3	14.9	2.9	0.1	0.0
In percent of Total Public External Debt Service									
Debt service due on GRA credit		5.2	9.7	11.4	34.9	63.7	62.5	36.4	1.4

Sources: Serbian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings.
2/ Includes surcharges and service fees.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For May 2009, projections for external debt, GDP, gross international reserves, and exports of goods and services are as of end-December 2008.

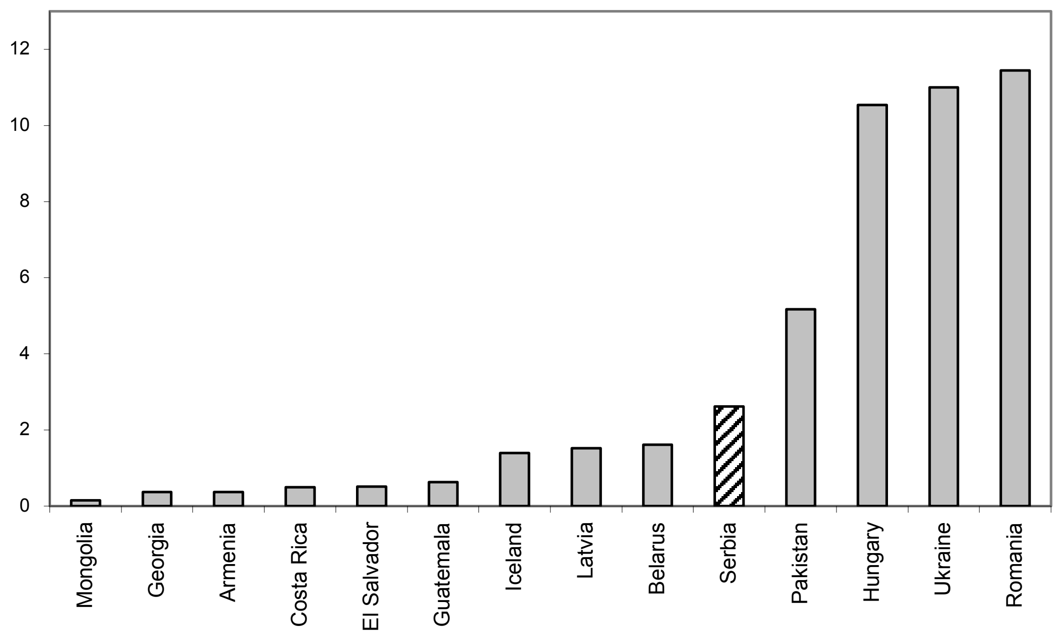
Figure 5. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Cases



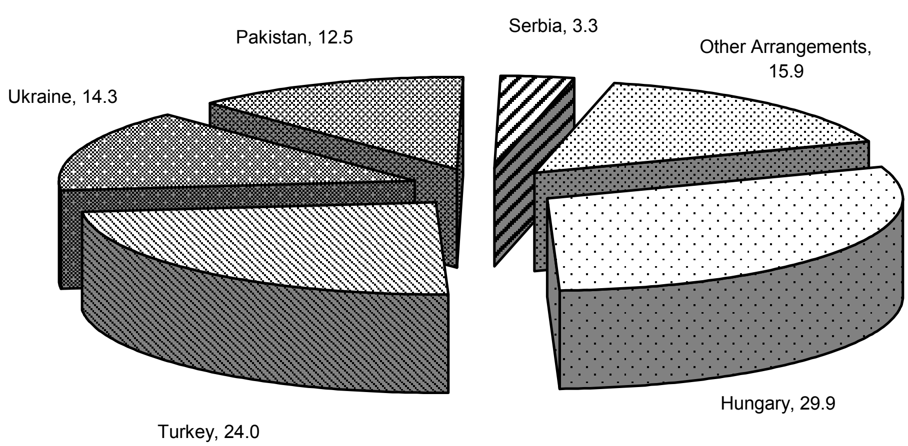
Source: Serbian authorities and IMF staff estimates, and World Economic Outlook.

Figure 6. Exceptional Access Levels and Credit Concentration

A. Total Access of Recent Exceptional Access Arrangements
(In billions of SDRs)



B. Credit Concentration of Fund GRA Exposure 1/
(As a percentage of total credit outstanding)



Source: Finance Department.

1/ Credit outstanding as of April 22, 2009 plus the first purchase under the proposed arrangement with Serbia.

B. Impact on the Fund's Liquidity Position and Risk Exposure

8. **Consistent with the level of access under the arrangement, the impact on the Fund's liquidity and credit risk exposure is moderate.**

- **The proposed arrangement would reduce Fund liquidity by about 4 percent (Table 5)**. Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC), which currently stands at SDR 66.7 billion, by about SDR 2.6 billion.[6] [7]

- **If the first purchase is made, Fund credit to Serbia would be slightly over 3 percent of total GRA Fund credit (Figure 5, Panel B)**, making Serbia the fifth largest user of Fund resources. The share of the top five users of Fund resources of total outstanding credit would increase slightly to about 84 percent (see Table 5).[8]

- **In the event Serbia were to fully draw on resources available under the proposed SBA, and to incur arrears on the charges accruing to its GRA obligations, the Fund's burden sharing mechanism would be largely exhausted.**[9] Charges on the GRA obligations would equal about SDR 18 million in 2009, or about 89 percent of the current estimated residual burden-sharing capacity (see Table 5).[10] Nonetheless, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would be expected to decline to the extent the demand for Fund resources continues to expand.

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[6] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months. See *The Fund's Liquidity Position—Review and Outlook* (10/14/02).

[7] This FCC is determined on the basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and US$100 billion under the borrowing agreement with Japan.

[8] The figures on credit concentration are based on data as of April 22, plus the first purchase by Serbia. Given the possibility of new financing operations, including some that will involve exceptional access, the concentration of the Fund's lending portfolio is likely to change in coming months.

[9] Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge.

[10] Burden sharing capacity has declined recently, despite the increase in credit outstanding, reflecting the steep decline in the SDR interest rate.

- **Potential GRA exposure to Serbia would be significant in relation to the current level of the Fund's precautionary balances**. After the first purchase, Fund credit to Serbia would be about 10 percent of the Fund's current precautionary balances (see Table 5), and the total access amounts to about 38 percent of current precautionary balances.

Table 5. Serbia—Impact on GRA Finances

	as of 04/22/2009
Liquidity measures	
One-year Forward Commitment Capacity (FCC) (in millions of SDRs) 1/	66,706.7
Japan borrowing agreement, available resources (in millions of SDRs)	67,110.5
Serbia's impact on FCC 2/	(2,619.1)
Prudential measures	
Fund GRA credit outstanding to Serbia (percent of current precautionary balances)	10.1
Serbia's annual GRA charges (percent of Fund's residual burden sharing capacity)	88.9
Fund GRA credit outstanding to Serbia (percent of total GRA credit outstanding) 4/	3.3
Memorandum items	
Fund's precautionary balances (in millions of SDRs) 3/	6,938.6
Fund's residual burden sharing capacity (in millions of SDRs) 5/	20.0
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 4/	84.1

Sources: Serbian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources minus undrawn balances under existing arrangements plus repurchases one-year forward minus a prudential balance. The FCC is determined on basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and $US100 billion under the borrowing arrangement with Japan.
2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.
3/ As of end-April 2008.
4/ Reflects total Fund credit outstanding plus the first purchase by Serbia.
5/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

III. ASSESSMENT

9. **Serbia's revised Fund-supported program aims to safeguard economic stability in an environment that has deteriorated markedly since the existing SBA was designed.** The proposed access, and the substantial and front-loaded financing under the augmented arrangement, complemented by funding from other international and regional institutions, aims to support an orderly rebalancing of the economy in this difficult period while containing crisis risks.

10. **The significant risks related to program, both to the external environment and to domestic policy implementation, could negatively affect Serbia's capacity to repay Fund.** A deeper and more prolonged global recession could lower trade and capital flows more sharply than projected and reduce official reserves below projected levels. Moreover, a loss of depositor confidence could trigger a deposit run, a deeper and longer recession, and further pressure on the currency. This would adversely affect the balance sheets of corporates and households, especially those with unhedged FX positions, and could severely test the banking sector's capital and liquidity buffers. Voluntary assurances obtained from foreign banks to maintain their exposure to Serbia—a key element of the program strategy—partly mitigate these risks. However, fiscal contingent liabilities could materialize, putting strains on public finances. Finally, in the context of a coalition government, political risks could jeopardize the authorities' capacity to implement the program.

11. **Overall, there are significant financial risks associated with the proposed arrangement for Serbia.** Potential Fund exposure to Serbia will be the fifth highest among recent SBA-supported programs. In terms of some relevant metrics such as economic size, Fund exposure will peak at a higher level than those reached in most recent exceptional access cases. Peak debt service to the Fund in relation to exports of goods and services would be the highest among recent exceptional access cases, and the total debt service burden is also high. The relatively low level of public debt is a mitigating factor although there are significant fiscal contingent liabilities that would put strain on public finances if they were to be realized. The authorities' commitment to take further measures that may be needed to achieve the objectives of the program, Serbia's excellent record for timely service of its obligations to the Fund since it succeeded to the membership of the SFRY, and the expected improvement in global financing conditions in coming years provide assurances that Serbia will be in a position to discharge its obligations to the Fund in a timely manner.

Statement by the IMF Staff Representative on the Republic of Serbia
May 15, 2009

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

Macroeconomic developments. While most of the high-frequency economic indicators confirm that output dropped sharply in the first quarter of the year, some indicators (industrial production, credit) suggest a leveling off in the decline of economic activity in March. Nevertheless, downside risks remain dominant. Preliminary April data point to an only slight easing of inflationary pressures. The government recently expanded earlier measures to promote lending to corporates and households, with a view to mobilizing up to 6 percent of credit through a combination of interest subsidies, co-financing, and partial credit guarantees. The cost of interest subsidies (0.2 percent of GDP) is included in the revised 2009 budget, and the revised arrangement includes an indicative ceiling on additional public sector guarantees.

Fiscal policy. Preliminary fiscal data received from the authorities for the first quarter of 2009 suggest that the end-March fiscal performance criterion (PC) was met. However, the full data on the observance of the PC and the fiscal indicative target are not yet available.

Financial sector. By May 10, all ten foreign banks that participated in the financial sector coordination meeting in Vienna in late March had provided commitment letters to the National Bank of Serbia (NBS) and will participate in the Financial Sector Support Program. In these letters, the parent banks committed to maintain their external exposure vis-à-vis Serbia, which includes cross-border credit lines, at least at the end-December 2008 level throughout 2009 and 2010, subject to a review at end-2009. Most other foreign banks have also either provided or indicated their intent to provide similar letters. In addition, the NBS, based on end-March 2009 data, will conduct stress tests for all banks operating in Serbia using a uniform methodology and a downside scenario. The need and options for pre-emptive recapitalization will be explored with banks on the basis of these tests. Completion by end-September 2009 of the stress tests for the 12 largest banks (including all foreign bank subsidiaries present at the Vienna meeting) and the four banks with majority state ownership is a structural benchmark under the revised Stand-By Arrangement.

The EBRD recently announced an investment of €45 million in UniCredit Group’s units operating in Serbia to boost credit to small and medium-sized enterprises, as part of a broader program for Central and Eastern Europe.

Press Release No. 09/169
FOR IMMEDIATE RELEASE
May 15, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Serbia's Stand-By Arrangement and Increases Financial Support to €2.9 Billion

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Serbia's performance under the Stand-By Arrangement (SBA) and increased the IMF's financial support to SDR 2.62 billion (about €2.942 billion, or about US$4 billion), equivalent to 560 percent of Serbia's quota or close to 10 percent of its GDP. The Board also extended the SBA by one year to mid-April 2011. These decisions enable the immediate release of SDR 701.55 million (about €788 million). The Board also granted a waiver of applicability for the end-March fiscal performance criterion.

The revised arrangement will support the government's economic program amid a sharper than expected impact from the global financial crisis. The original 15-month, SDR 350.8 million (about €394 million) SBA was approved on January 16, 2009 (see Press Release No. 09/12).

Since the original SBA was designed in late 2008, Serbia's external and financial environment—like in much of Eastern Europe—has deteriorated abruptly and relentlessly: Trade flows, output, domestic demand, and, especially, fiscal revenues are now lagging significantly behind initial projections. Moreover, an abrupt slowing of net capital inflows is likely to open up sizable external financing gaps in 2009–11, projected to add to about €3.5 billion (11½ percent of GDP), despite a projected rapid narrowing of the large current account deficit.

To safeguard economic stability in this markedly deteriorated environment, the authorities have revised their strategy in three key respects:

- The fiscal deficit targets for 2009–10 have been raised, but additional fiscal adjustment measures—mainly falling on recurrent spending—are also being taken;

- The main foreign parent banks have voluntarily committed to roll over their exposures to Serbia and keep their subsidiaries well capitalized;

- The authorities have requested additional financial support from International Financial Institutions and the European Union to close the projected external financing gaps in 2009–11.

Following the Executive Board's discussion on Serbia, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"The downside risks highlighted a few months ago at the start of Serbia's IMF economic program supported by a precautionary SBA are now materializing. With the global economy in recession, Serbia's exports and imports have plunged, and capital flows have largely dried up. The outlook has deteriorated markedly and remains subject to downside risks. Economic activity is likely to shrink this year, with limited prospects of recovery in 2010.

"The authorities' strengthened strategy to deal with these renewed challenges is commendable, and deserves further support from the international community. For its part, the IMF is stepping up significantly its financial assistance under the Stand-By Arrangement to help cushion the economic downturn. With strong implementation of the program by the authorities, this provides confidence that Serbia will overcome the current difficulties.

"The higher fiscal deficit targets for 2009–10 balance the goal of avoiding excessively procyclical fiscal policies with the need to start adjusting to an environment of lower revenues, as the economy rebalances over the medium term. Looking forward, many of the short-term adjustment measures will need to be replaced by permanent fiscal reforms to improve the efficiency of the public sector. Implementation of the agreed fiscal adjustment measures will be key. The authorities are encouraged to tightly manage spending commitments and cash planning to avoid a build-up of spending arrears, while protecting social spending.

"The authorities' financial sector support program should help underpin financial stability. Following a successful financial sector coordination meeting, all attending foreign parent banks provided voluntary commitments to maintain their exposure to Serbia and keep their subsidiaries well capitalized and liquid, and take part in the planned stress testing exercise. Similar commitments are expected from other banks, while domestic banks are expected to commit to facilitating the restructuring of corporate and household loans. At the same time, the plan offers incentives to participating banks.

"Monetary policy should continue to focus on inflation. Given the still high inflation rate, the authorities will need to proceed with caution to keep inflationary expectations in check.

"The long-delayed structural reforms need to be tackled. While the global financial crisis may not be conducive to privatization, particular attention should be given to preparing public enterprises for private participation and to streamlining business regulations," Mr. Portugal said.

Serbia: Selected Economic and Social Indicators, 2006–10 1/

	2006	2007	2008 Est.	2009 Proj.	2010 Proj.
	(Change in percent, unless otherwise indicated)				
Output, prices, and labor market					
Real GDP	5.2	6.9	5.4	-2.0	0.0
Real GDP excluding agricultural sector	6.0	8.8	5.0	-2.2	0.0
Real domestic demand (absorption)	6.2	11.5	5.9	-5.6	-4.6
Consumer prices (end of period) 2/	6.6	11.0	8.6	10.0	8.0
	(In percent of GDP)				
General government finances					
Revenue	43.8	42.4	40.9	39.5	38.3
Expenditure	45.4	44.2	43.4	42.5	40.9
Fiscal balance	-1.6	-1.9	-2.5	-3.0	-2.5
Gross debt	42.6	33.3	31.6	34.8	37.8
	(End of period 12-month change, in percent)				
Monetary sector					
Money (M1)	37.1	25.3	-3.8	-19.2	34.1
Broad money (M2)	38.4	44.5	9.6	0.1	19.5
Domestic credit to non-government	17.1	36.9	35.0	11.0	15.7
	(In percent of GDP, unless otherwise indicated)				
Balance of payments					
Current account balance	-10.1	-15.5	-17.1	-13.0	-10.1
Exports of goods	21.8	21.6	21.6	19.1	20.4
Imports of goods	42.9	44.1	43.9	36.6	34.8
Trade of goods balance	-21.2	-22.5	-22.3	-17.5	-14.4
Capital and financial account balance	31.7	17.9	12.4	3.2	8.1
External debt (end of period)	63.3	60.2	63.6	76.3	85.6
of which: Private external debt	36.0	39.5	45.0	47.0	52.6
Gross official reserves (in billions of euro)	8.7	9.5	8.1	7.9	8.4
(In months of prospective imports of GNFS)	6.6	6.3	7.0	6.9	7.5
Exchange rate (dinar/euro, period average)	84.2	80.0	81.5	…	…
Real effective exchange rate (annual average change, in percent; + indicates appreciation)	6.6	7.2	5.8	…	…

Social indicators

Per capita GDP (2008): US$6,782. Poverty rate (poverty line is US$5 per day, 2007): 6.6 percent.
Unemployment rate (2008): 14 percent.

Sources: Serbian authorities; and IMF staff estimates and projections.
1/ Excluding Kosovo (with the exception of external debt).
2/ Retail prices until 2006.

Statement by Thomas Moser, Executive Director for the Republic of Serbia, and Srboljub Antic, Senior Advisor to the Executive Director
May 15, 2009

1. We thank the staff for the comprehensive set of documents, which present a well-balanced picture of the difficult economic situation in Serbia. The report spells out clearly the significant challenges that the authorities are facing, as external shocks hit an economy already vulnerable due to external and internal imbalances. On behalf of the authorities, we would like to thank the staff and Management for their close involvement with the country, materializing in three staff and one Management visit within 7 months. The very constructive policy discussions and staff's valuable recommendations have been highly appreciated by the Serbian authorities.

2. Since the approval of the Stand-By Arrangement in mid-January, which our Serbian authorities have continued to treat as precautionary, the external and financial environment has further deteriorated. The first signs of crisis came in October with the withdrawal of FX deposits from the banking sector, and the contraction of nominal exports and imports in November. Net external borrowing and domestic credit have slowed sharply, while the exchange rate came under pressure. The decline of economic activity continued in Q1 of this year, with industrial production falling 17 percent over the same period last year, while exports and imports in euro terms declined by 24 percent and 26 percent, respectively.

3. The Serbian authorities have adjusted policies to the changed circumstances to counter financial pressures, restore confidence, and introduce structural changes that will stabilize the economy in the long run. Even though external imbalances are shrinking fast, macroeconomic adjustment and the approved access under the current SBA cannot close the financing gap in a situation when capital inflows stop without undue stress on the economy and the financial system. Our authorities would therefore like to request an augmentation of access under the SBA from SDR 350.775 million (75 percent of quota) to SDR 2,619.120 (560 percent of quota). At the same time, the authorities would like to extend the SBA from 15 to 27 months, and rephase access accordingly.

4. The revised and strengthened economic policies that Serbia intends to implement during the remainder of 2009 and in 2010 should safeguard macroeconomic and financial stability. Particularly, the authorities (i) revised fiscal policy, targeting larger fiscal adjustment through both revenue and expenditure measures, (ii) reached agreement with foreign banks and their home supervisors on at least a rollover of current exposures, (iii) and they are seeking additional financial support.

5. Under unchanged fiscal policies, fiscal deficits in 2009-2010 would rise to unsustainable levels of 6-7 percent of GDP. In order to prevent this, the authorities adopted a

rebalanced budget in May 2009 that will limit the fiscal deficit to 3 percent of GDP in 2009. The rebalancing of the budget comes mainly from expenditure cuts, while the rise of revenues is modest. The Serbian authorities are aware that these fiscal measures may prove insufficient if the economic situation deteriorates further, and they stand ready to take additional measures to preserve program objectives.

6. On the expenditure side, adjustment efforts are distributed across all levels of government and budgetary institutions. The focus is on recurrent spending on wages, pensions and discretionary expenditures. The authorities' income policy is based on a freeze of all general government and public enterprise wages in nominal terms in 2009 and 2010, an extension of the nominal freeze of pensions to end 2010, and a freeze of new hiring. Discretionary spending is cut by lower allocations to all Ministries of the Republican government, a reduction of transfers to local governments, and a transfer to the Republican budget of a part of revenues from all budgetary institutions. The authorities will protect social spending and try to find additional external financing for capital projects. On the revenue side, excise taxes were raised and steps to broaden the base of the property tax and improve VAT collection were introduced. It is also envisaged that public utilities contribute dividends to the budget.

7. A successful implementation of the program will depend on coordination across all levels of government. To prevent arrears, the Ministry of Finance will use three-month rolling treasury plans to determine expenditure prioritization. Tight control will be implemented over expenditures of key municipalities and over provision of government guaranties. Our Serbian authorities are well aware that these are temporary emergency measures, which will have to be supplemented and followed up with structural reforms in order to insure the durability of fiscal adjustment. A permanent reduction of fiscal expenditures will require education, health and pension system reforms.

8. The National Bank of Serbia (NBS) will stay focused on achieving stable and low inflation. In an environment of relatively high inflation expectations and recent large increases of regulated prices, the level of inflation remains one of the highest in the region. For this reason, the NBS has kept its policy rate at a relatively high level. Recent data on inflation has enabled the NBS to cut its policy rate to 14 percent.

9. In line with the inflation targeting framework the NBS will maintain the managed floating exchange rate regime. Excessive volatility of the exchange rate at the end of last, and the beginning of this year required targeted interventions. However, the exchange rate has stabilized since the end of February and the NBS has not intervened since then.

10. The Serbian authorities have introduced a Financial sector support program (FSSP), with the objective to stabilize market conditions and soften the impact on private sector balance sheets. The banking sector in Serbia continues to be well capitalized and liquid, and

is dominated by foreign-owned banks. The FSSP offers banks access to new liquidity facilities, promotes de-indexation of loans and creates incentives for loan restructuring. In this context, key foreign parent banks have provided commitments to maintain their exposure to Serbia. In addition, the NBS, in consultation with IMF staff, will produce diagnostic studies of all banks, including comprehensive sensitivity analyses taking into account downward scenarios. We thank the staff for their involvement in this initiative.

11. Improvements in the investment climate and efforts to increase the share of the private sector will continue. Legislations and rules that regulate the business environment will be streamlined or eliminated. The authorities will also strive to resolve still pending issues of land ownership and restitution. Public utilities will be open for private sector participation, while other enterprises still under the auspice of the Privatization agency will be privatized or liquidated.

12. In conclusion, the authorities are aware of the challenges and the significant risks under this program, as pointed out by the staff in the report and in Supplement 1. They are ready to continue to implement difficult measures and are prepared to introduce new ones, in close consultation with the staff, should downside risks materialize.