REPUBLIC OF SERBIA

Ministry of Finance – Public Debt Administration

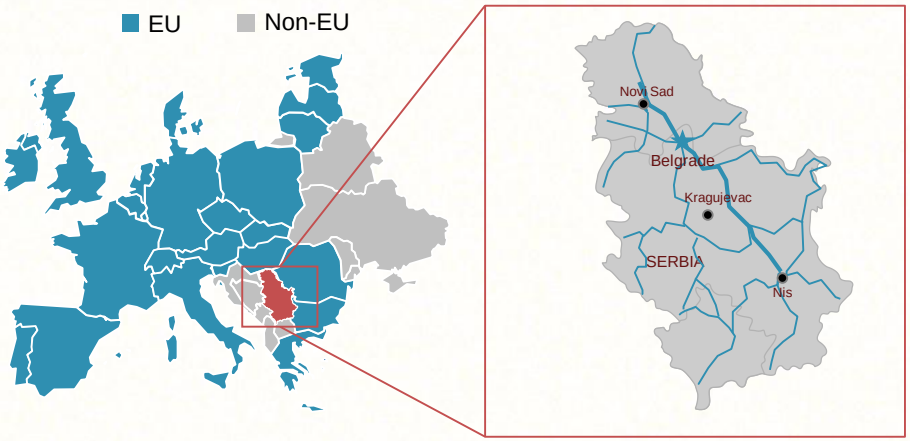
DEBT SUSTAINABILITY - PUBLIC DEBT MANAGEMENT STRATEGY

Serbia at a Glance

Resilient economy on the path to full integration with Europe

Key Facts

- Form of Government: Parliamentary Republic
- Territory: 88,361 sq. km
- Capital: Belgrade
- Population: 7.2 million[1,2]
- GDP per capita: EUR 4,626[1,2]
- Nominal GDP: EUR 32.9bn[1,2]
- Credit ratings: BB-/BB-/B1
- Currency: Serbian Dinar (RSD)



[1] National Statistics Office as of 2015 , [2] Excluding Kosovo and Metohija

Recent Milestones and Progress to EU accession

- 2009 – EU membership application
- 2011 – Responses to the European Commission's Questionnaire
- 2012 – EU candidate status awarded
- 2013 – EC agrees to start Serbia's EU accession negotiations in January 2014
- Jan 2014 – Serbia started EU accession negotiations
- April 2014 – Formation of new Government
- Nov 2014 – Serbia reached IMF agreement
- Dec 2015 – Serbia opened chapters 32 and 35 in the process of EU accession
- July 2016 – Serbia opened chapters 23 and 24 in the process of EU accession
- August 2016 – Formation of new Government

Economic Policy – Fiscal Policy – Debt Sustainability

Economic Policy → Fiscal Strategy/Policy → Debt Sustainability → Debt Management

- Economic policy in period 2011-2014 caused acceleration of budget deficit levels
- Flexible fiscal policy caused by populistic measures, state owned enterprises, banking sector
- In September 2014 Government announced new Fiscal Consolidation Program – prospects of the country fiscal position were very pessimistic – (Q1 2014 budget deficit more than 9.0% GDP)
- Without 2014 Fiscal Consolidation Program the Republic of Serbia in 2016 will be indebted more than 82% GDP, on the end of September 2016 general government debt is below 73% GDP
- Hard budget constraint policy is crucial for debt sustainability
- Public support and permanent communication with public – adoption of measures
- Structural reforms necessary for fiscal measures successful implementation
- Clear prospects that Serbia will join EU with the public debt-GDP ratio below 60% in 2020

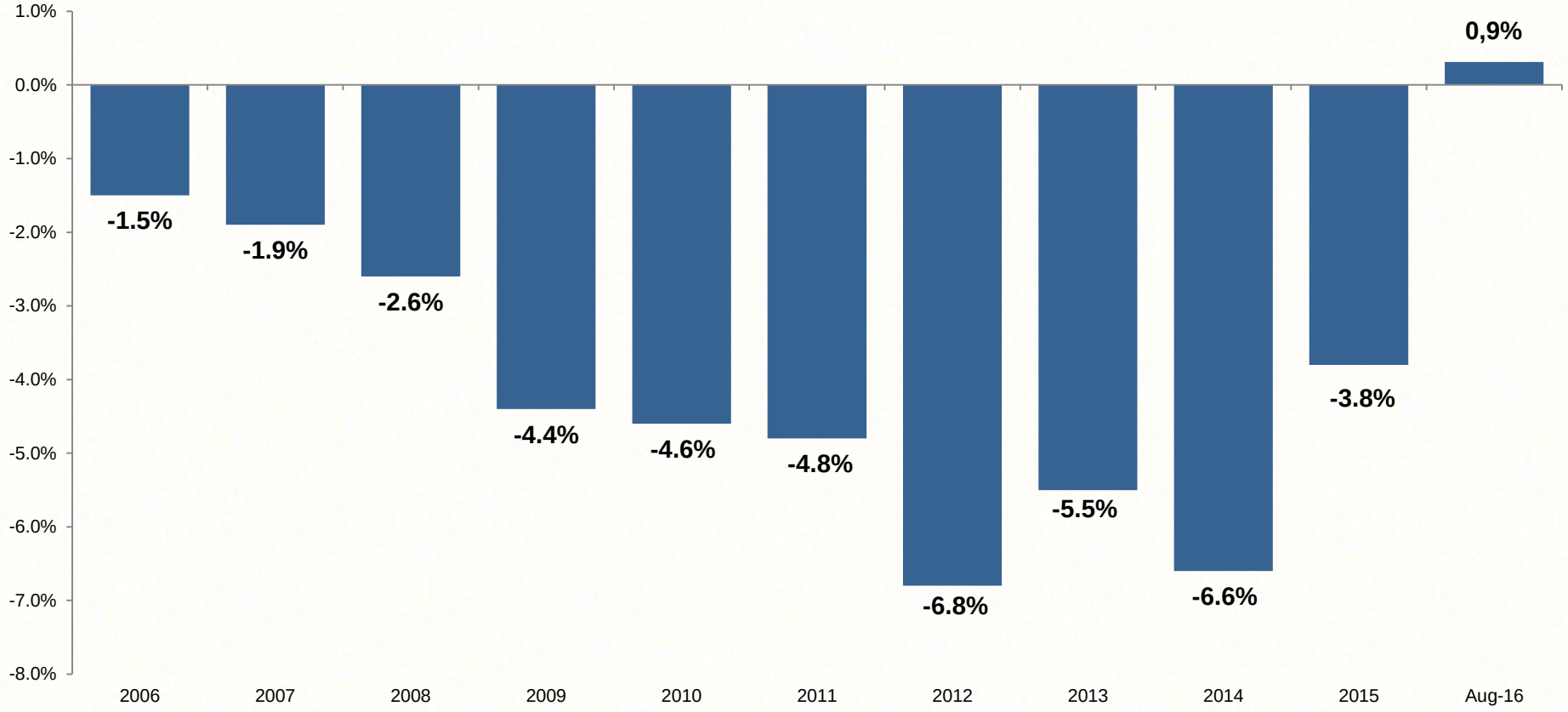
Economic Policy ← Fiscal Strategy/Policy ← Debt Sustainability ← Debt Management

Fiscal Policy Measures

Urgent Fiscal Measures in Serbia 2014 – Necessary for Debt Sustainability

- Public sector wage bill (including public enterprises) reduced by about 10%
- Average reduction of pensions by up to 10% with progressive rates
- Decrease in subsidies to SOEs
- Reduction of discretionary expenditures (goods and services)
- Reform of tax administration and public revenue system
- Reform of public enterprises
- Public administration reform and rightsizing
- Improvement of capital expenditure planning and execution
- Permanent need for new set of measures – structural reforms
- Five successful IMF program reviews during 2015-2016

Fiscal Position of the Republic of Serbia



Public Debt Manangement Strategy

Fiscal Policy (Fiscal Strategy) ↔ Public Debt Management Policy (PDM Strategy)

- Public Debt Manangement Strategy is a part of the Fiscal Strategy: historical data overview, main principles of debt management, projections of main public debt indicators for following three years period, financial risks list, financial risks impacts (stress scenarios) and objectives for local government securities market development
- The main principles of the Public Debt Management Strategy define the need for transparent and predictable process of borrowing with the permanent development of the government securities market and acceptable level of exposure to financial risks
- The general objectives and principles are:
  - ✓ to ensure the financing of the fiscal deficit and regular financing of liabilities based on the public debt of the Republic of Serbia
  - ✓ to define an acceptable risk level that should be defined in terms of a targeted debt portfolio structure
  - ✓ to uphold the development of a market of government securities issued in the domestic and international market
  - ✓ to ensure that borrowing process is transparent and predictable
- The main objective is financing through the issue of mainly dinar-denominated securities in the domestic market

Public Debt Management Strategy – Long term strategic framework

- The basic strategic objectives which are to be acquired in the following long-term period, in order to minimize the risk of increased debt and public debt servicing costs are the following:

✓ The share of dinar-denominated debt should be about 20-25% of the overall public debt in the medium-term period

✓ The share of euro-denominated debt in the public debt should be at least 60% of the foreign currency debt, including future borrowings and transactions

✓ The share of floating interest rate should drop to below 20% in the mid-term period

✓ Average time to refixing (ATR) should remain at a level of at least 4.5 years, in accordance with the above mentioned measure of gradual decrease of floating interest rate debt share

✓ Weighted average interest rate (WAIR) for internal public debt shall not exceed 10% in short-term and mid-term debts

✓ The share of the short-term debt (whose maturity is up to a year) shall be up to 15% of the overall public debt

✓ The average maturity time (ATM) of internal debt shall be at a level of at least 4 years in mid-term

✓ The average maturity time (ATM) of external debt shall remain at a level of from 6 ± 0.5 years in the same time framework.

Financial risk management measures

- In order to reduce the exposure to financial risks, the following measures should be taken:

1. **Refinancing risks**

✓ Greater share of medium-term and long-term dinar-denominated financial instruments on the domestic financial market

✓ Equal liabilities distribution based on public debt on an annual level and during the fiscal year in the following long-term period

✓ Extension of average debt maturity issued in securities

2. **Foreign currency risk**

✓ Tendency to reduce the foreign currency-denominated debt share regarding the new debt costs (cost of debt dinarization)

✓ Utilization of financial derivatives to limit the effects of the reference currencies exchange rates changes

✓ Tendency to have external debt in EUR mainly and to use the US dollar-denominated debt only if financing in dollars in the international market is less expensive, with the additional use of limiting the financial derivatives risk

3. **Market risk (interest rate risk, inflation risk)**

✓ Tendency to extend the duration of the internal dinar-denominated debt;

✓ Issue of indexed bonds (interest rates indexation);

✓ Risk based on external debt interest rate does not jeopardise the long-term objective of minimising public debt costs

Financial risk management measures

4. Liquidity risk

- ✓ Permanent sustainability of cash on Serbia's accounts at a level that enables smooth liabilities financing for at least four months and that enables amortization of possible minor inflows based on borrowing according to the plan
- ✓ Adequate management of free cash assets available on the accounts of the Republic of Serbia, according to the asset-liability management principles
- ✓ Consolidation of foreign currency assets, apart from dinar assets, in the consolidated Treasury system at the NBS, and the use of foreign currency assets to actively manage liquidity of the dinar account of the budget execution

5. Credit and operative risks

- ✓ Financial derivatives transactions can only be carried out with the financial institution of high credit rating
- ✓ The use of financial instruments that limit the credit risk
- ✓ Granting guarantees and new loans to local government only if there has been an adequate analysis of a relatively low possibility of realizing the guarantee in the medium-term period
- ✓ Introduction of adequate control in all the business activities in the Public Debt Administration and expanding the employees' knowledge, which requires expanding limit of the number of employees and approving adequate budget funds
- ✓ Upgrade and improve the existing information system that monitors the public debt and the operations related to it

Financial risk management measures

6. Risks tied to the servicing costs distribution

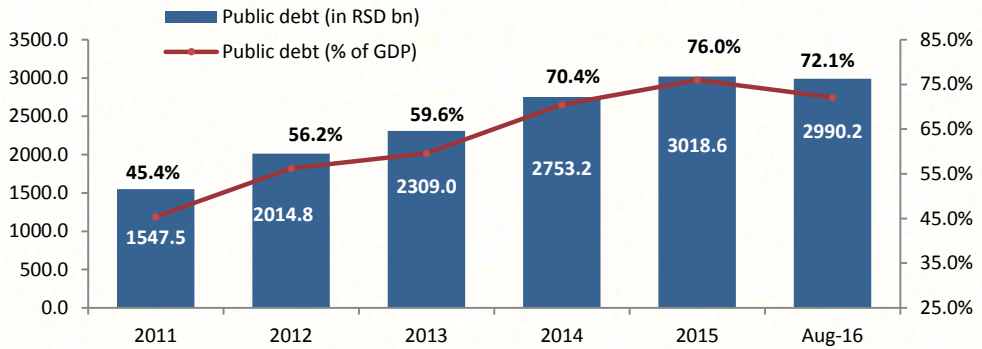
- ✓ Adequately planned annual borrowing and equal distribution for the following years and during the fiscal year to avoid the risk of high concentration of refinancing obligations
- ✓ Avoiding the obligations concentration based on the public debt on a monthly level, which could not be amortized by free cash assets on the accounts of the Republic of Serbia

Learned lessons:

- **Foreign currency risk dominant**
- Hedging – swap of USD exposure to EUR exposure (financial risk but in Serbian case also operational risk) – increase of debt in dinar terms, interest bill increased due to not hedged position of USD denominated debt
- National Bank monetary policy determines borrowing costs in local currency
- Operational risks – coordination between government institutions
- Crucial importance of the World Bank and IMF technical assistance
- Public Debt Management - Learning process not only for debt managers but for all stakeholders on fiscal side
- **Refinancing risk – not to forget**

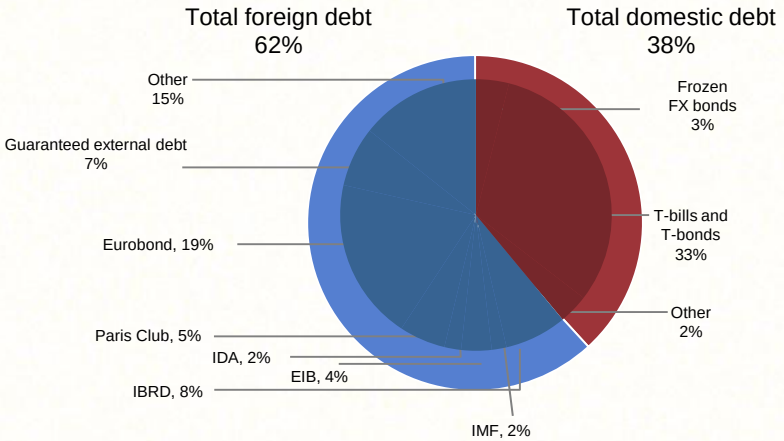
Active Debt Management Has Produced Stable Funding Base

Public Debt



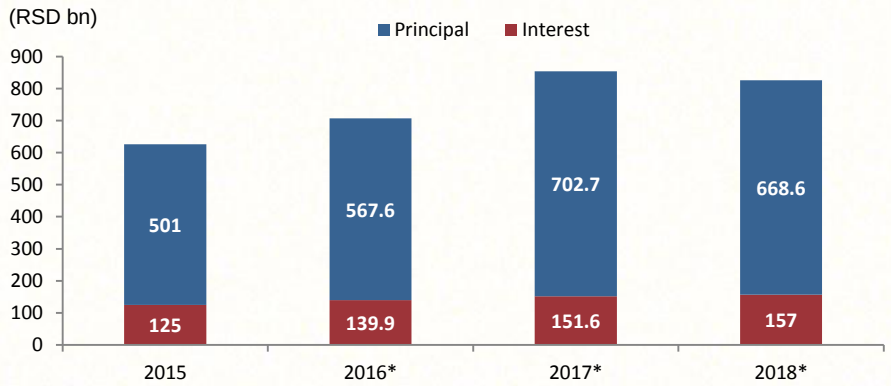
Source: Ministry of Finance

Description of the Debt Structure (As of 31 August 2016)



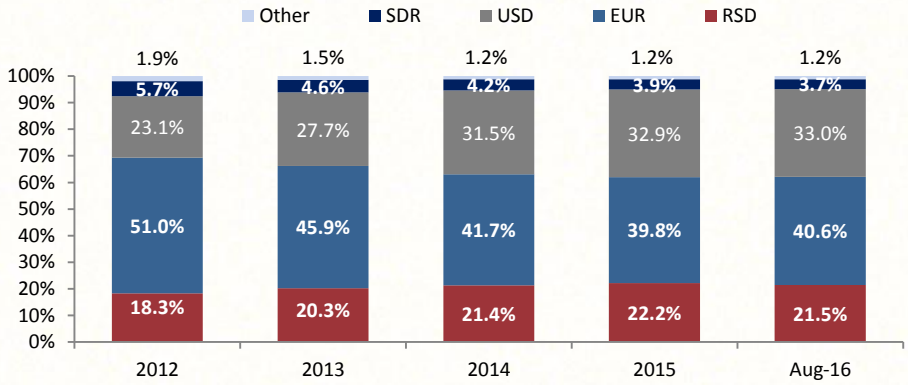
Source: Ministry of Finance

Public Debt Service (RSD bn)



Source: Ministry of Finance
*In accordance with the Fiscal Strategy for 2016 with projections of 2017 and 2018

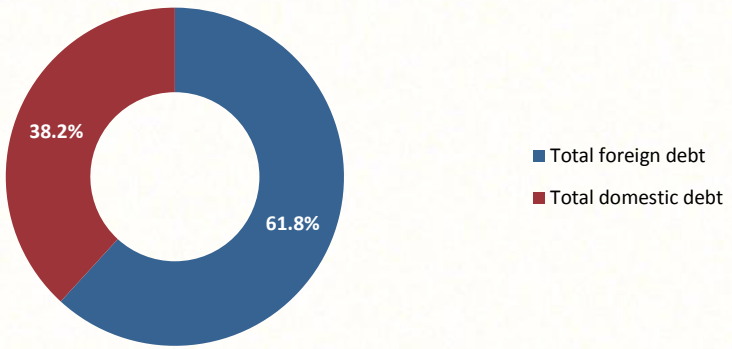
Development of the Currency Structure



Source: Ministry of Finance

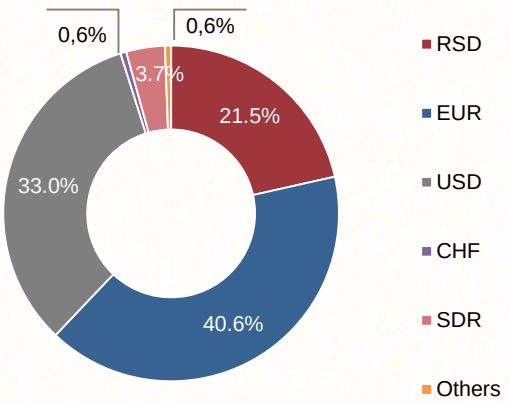
Debt Mix and Currency Structure

Internal vs External Debt



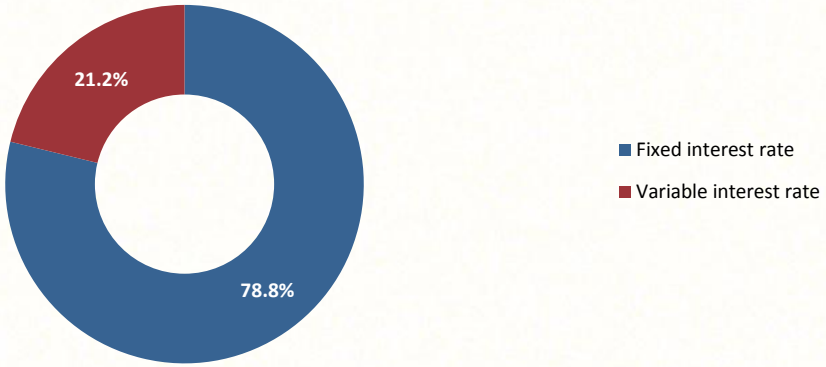
Source: Ministry of Finance, as of 31 August 2016

Currency Breakdown



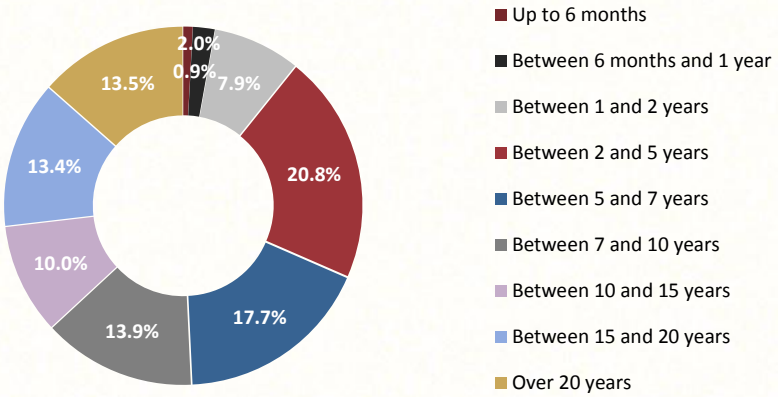
Source: Ministry of Finance, as of 31 August 2016

Interest Rate Mix



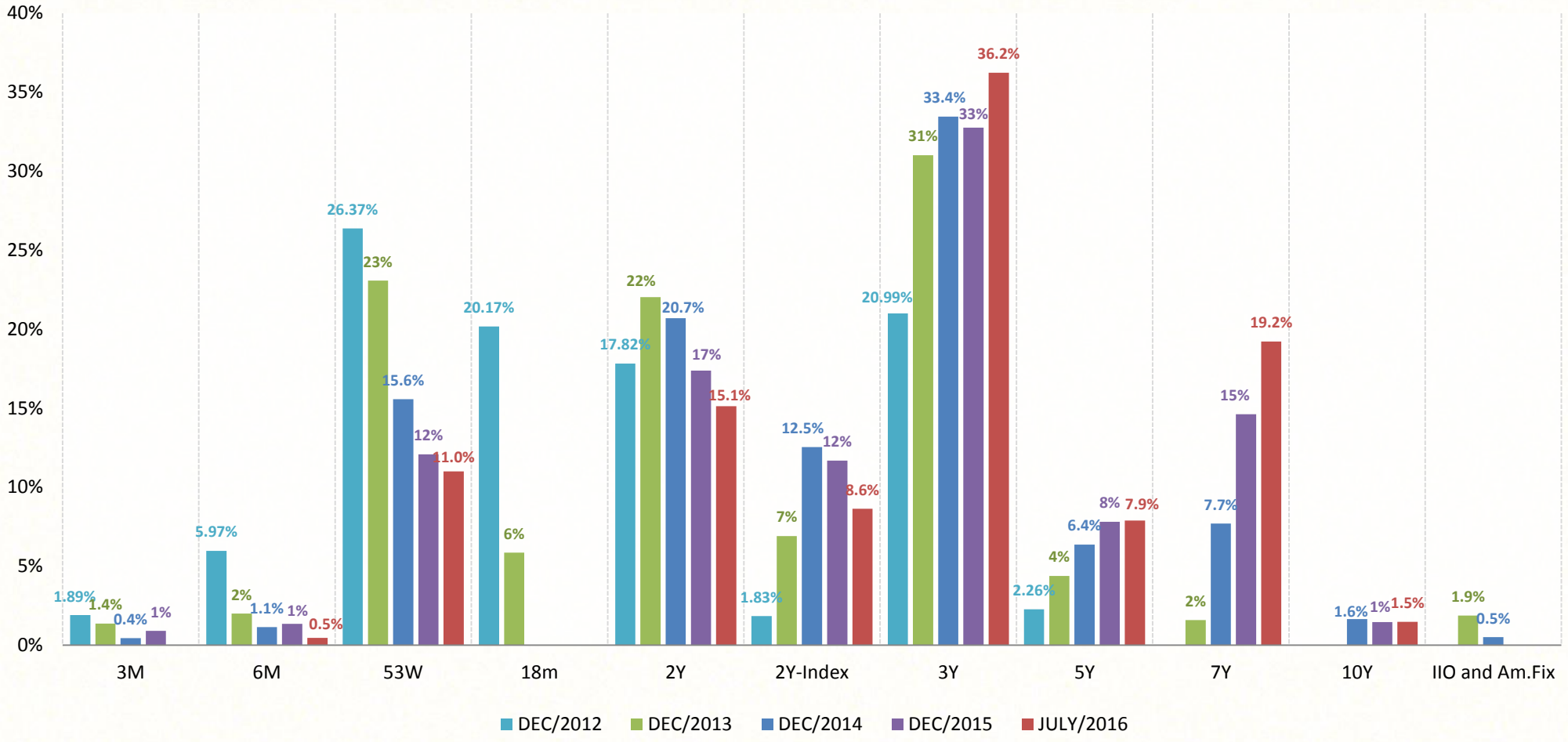
Source: Ministry of Finance, as of 31 August 2016

Public Debt Residual Maturity Structure



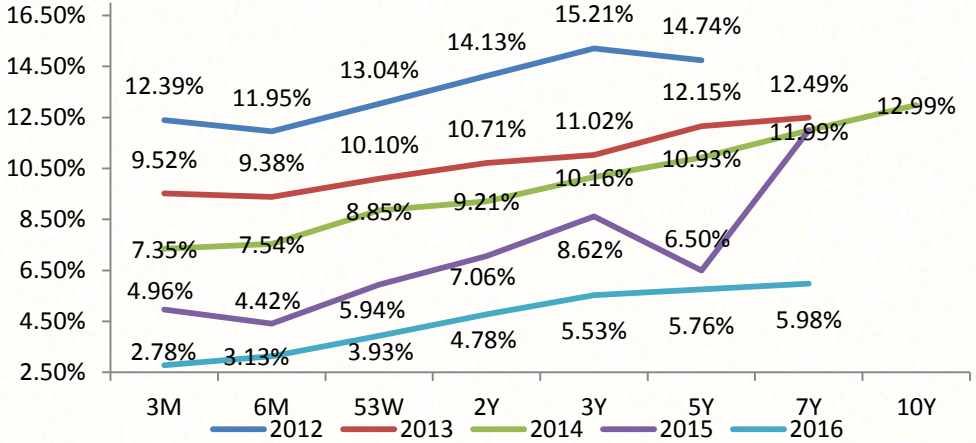
Source: Ministry of Finance, as of 31 August 2016

Government Securities Structure denominated in RSD



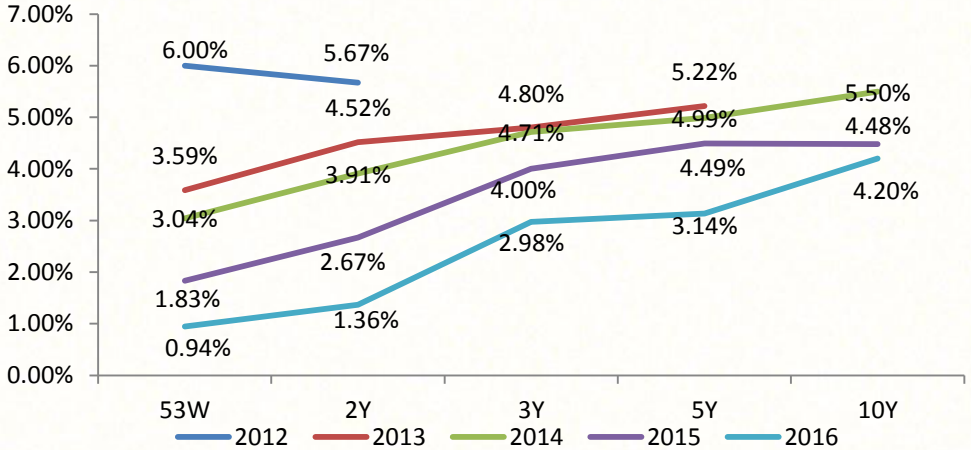
Government Securities – Domestic Market

RSD weighted average accepted rate on primary auctions



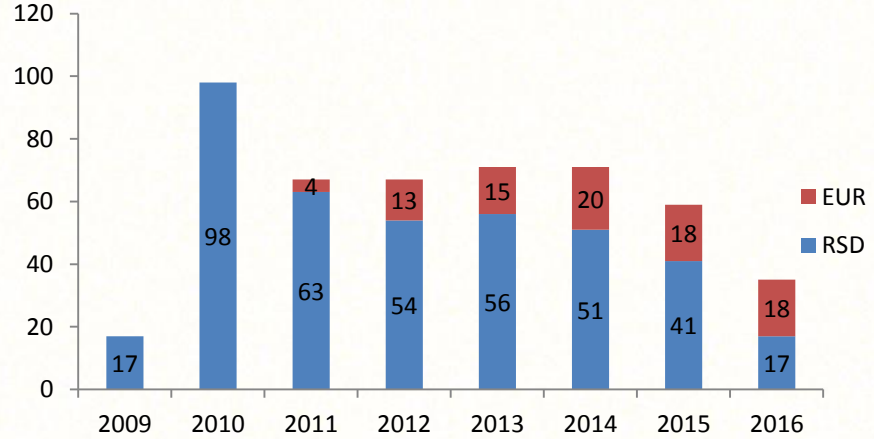
Source: Ministry of Finance

EUR weighted average accepted rate on primary auctions



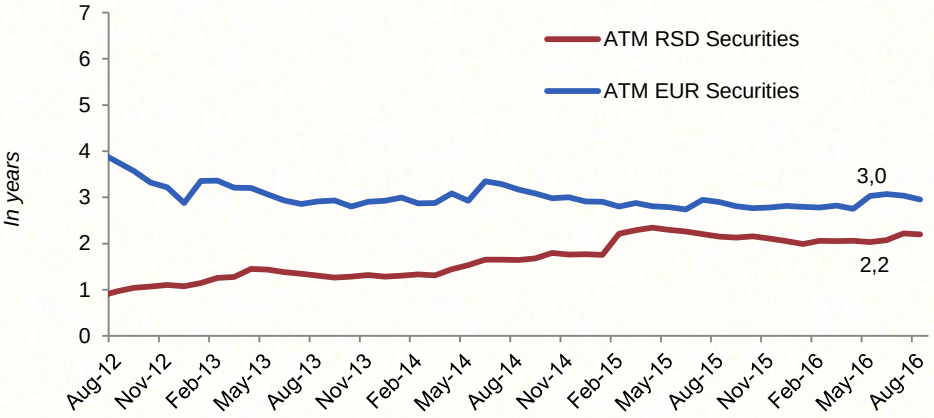
Source: Ministry of Finance

Number of auctions



Source: Ministry of Finance

ATM of Government securities



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