IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE EITHER (1) QIBS (AS DEFINED BELOW) OR (2) PERSONS LOCATED OUTSIDE THE UNITED STATES.

IMPORTANT: You must read the following before continuing. The following applies to the Prospectus (as defined herein) following this page and you are therefore advised to read this page carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from the Issuer (as defined in the Prospectus), Deutsche Bank AG, London Branch, HSBC Bank plc or VTB Capital plc (together, the "Joint Lead Managers") as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE NOTES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION, AND THE NOTES MAY NOT BE OFFERED OR SOLD, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE ATTACHED PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER AND, IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. PERSON OR U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS. IF YOU HAVE GAINED ACCESS TO THIS TRANSMISSION CONTRARY TO ANY OF THE FOREGOING RESTRICTIONS, YOU ARE NOT AUTHORISED AND WILL NOT BE ABLE TO PURCHASE ANY OF THE NOTES DESCRIBED IN THE ATTACHED DOCUMENT.

Confirmation of your representation: In order to be eligible to view the attached Prospectus or make an investment decision with respect to the securities being offered, prospective investors must be either (1) Qualified Institutional Buyers ("QIBs") (within the meaning of Rule 144A ("Rule 144A") under the Securities Act) or (2) persons located outside the United States. This Prospectus is being sent to you at your request, and by accessing this Prospectus you shall be deemed to have represented to the Issuer and the Joint Lead Managers that (1) either (a) you and any customers you represent are QIBs or (b) you and any customers you represent are purchasing the securities being offered in an offshore transaction (within the meaning of Regulation S under the Securities Act ("Regulation S")) and the electronic mail address that you gave us and to which this e-mail has been delivered is not located in the United States, its territories and possessions, any state of the United States or the District of Columbia and (2) you consent to delivery of such Prospectus by electronic transmission.

You are reminded that this Prospectus has been delivered to you on the basis that you are a person into whose possession this Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver this Prospectus to any other person.

The materials relating to this offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer, and the Joint Lead Managers or any affiliate of the Joint Lead Managers is a licensed broker or dealer in the relevant jurisdiction, the offering shall be deemed to be made by the Joint Lead Managers or such affiliate on behalf of the Issuer in such jurisdiction.

The attached Prospectus may only be distributed to, and is directed at (a) persons who have professional experience in matters relating to investments falling within article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities falling

within articles 49(2)(a) to (d) of the Order, and other persons to whom it may be lawfully communicated, falling within article 49(1) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this document or any of its contents.

The attached Prospectus has been sent to you in electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Issuer, the Joint Lead Managers, any person who controls them (as applicable) or any director, officer, employee or agent of them (as applicable) or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from the Joint Lead Managers.

REPUBLIC OF SERBIA

(acting through the Ministry of Finance and Economy)

U.S.$750,000,000 5.250 per cent. Notes due 2017

Issue price: 99.135 per cent.

The U.S.$750,000,000 5.250 per cent. Notes due 2017 (the "Notes") to be issued by the Republic of Serbia, acting through the Ministry of Finance and Economy (the "Issuer") will mature on 21 November 2017 and, unless previously purchased and cancelled, will be redeemed at their principal amount on that date.

The Notes will bear interest at a rate of 5.250 per cent. per annum. Interest will accrue on the outstanding principal amount of the Notes from and including 21 November 2012 and will be payable semi-annually in arrear on 21 May and 21 November in each year, commencing on 21 May 2013.

All payments of principal and interest in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the Republic of Serbia (the "Republic of Serbia" or "Serbia") or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, subject to certain exceptions set out in the Conditions (as defined below).

The Notes are being offered inside the United States to QIBs (as defined below) only pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the U.S. Securities Act of 1933, as amended (the "Securities Act"). In addition, Notes are being offered outside the United States in reliance on Regulation S ("Regulation S", such Notes so offered and sold, the "Regulation S Notes") under the Securities Act.

SEE "RISK FACTORS" FOR A DISCUSSION OF CERTAIN FACTORS TO BE CONSIDERED IN CONNECTION WITH AN INVESTMENT IN THE NOTES.

The Notes have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold or delivered within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Notes are being offered, sold or delivered: (a) in the United States only to qualified institutional buyers ("QIBs") (as defined in Rule 144A ("Rule 144A") under the Securities Act) in reliance on, and in compliance with, Rule 144A; and (b) outside the United States in reliance on Regulation S. Each purchaser of the Notes is hereby notified that the offer and sale of Notes to it is being made in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A.

Prospective purchasers that are QIBs are hereby notified that the seller of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A (such Notes so offered and sold, the "Rule 144A Notes"). Transfers of Notes are subject to the restrictions described under "Form of the Notes and Transfer Restrictions".

The Notes will be offered and sold in registered form in denominations of U.S.$200,000 and integral multiples of U.S.$1,000 in excess thereof. The Regulation S Notes will be represented by beneficial interests in a global unrestricted note certificate (the "Regulation S Global Note") in registered form without interest coupons attached, which will be registered in the name of a nominee for, and deposited on or about 21 November 2012 (the "Issue Date") with Deutsche Bank AG, London Branch, as common depositary for, and in respect of interests held through, Euroclear Bank SA/NV ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg"). Beneficial interests in the Regulation S Global Notes will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg and their participants. The Rule 144A Notes will initially be represented by a global restricted note certificate (the "Rule 144A Global Note" and, together with the Regulation S Global Note, the "Global Notes") in registered form, without interest coupons attached, which will be deposited with a custodian (the "Custodian") for, and registered in the name of Cede & Co. as nominee of, The Depository Trust Company ("DTC") on or about the Issue Date. Beneficial interests in the Rule 144A Global Note will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its participants. Except as described herein, definitive note certificates evidencing holdings of Notes issued in exchange for beneficial interests in the Global Notes will be available only in certain limited circumstances. See "*Form of the Notes and Transfer Restrictions*".

The Republic of Serbia's long-term foreign currency debt has been assigned a rating of "BB-" with a negative outlook by Standard & Poor's Credit Market Services Europe Limited, a subsidiary of The McGraw-Hill Companies, Inc. ("S&P") and a rating of "BB-" with a negative outlook by Fitch Ratings Limited ("Fitch"). The Notes are expected to be assigned the same ratings. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. The credit ratings included or referred to in this prospectus (the "Prospectus") will be treated for the purposes of Regulation (EC) No 1060/2009 on credit rating agencies (the "CRA Regulation") as having been issued by S&P and Fitch. Each of S&P and Fitch is established in the European Union and registered under the CRA Regulation. Any change in the rating of the Notes may adversely affect the price that a purchaser may be willing to pay for the Notes.

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "UK Listing Authority") for the Notes to be admitted to the official list of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for the Notes to be admitted to trading on the London Stock Exchange's Regulated Market (the "Market"). References in this Prospectus to the Notes being "listed" (and all related references) shall mean that the Notes have been admitted to the Official List and have been admitted to trading on the Market. The Market is a regulated market for the purposes of Directive 2004/39/EC (the "Markets in Financial Instruments Directive").

Joint Lead Managers

Deutsche Bank **HSBC** **VTB Capital**

The date of this Prospectus is 19 November 2012

This Prospectus constitutes a prospectus for the purposes of Article 5 of the Prospectus Directive for the purpose of giving information with regard to the Issuer and the Notes which, according to the particular nature of the Issuer and the Notes, is necessary to enable investors to be able to make an informed assessment of the financial position and prospects of the Issuer and the rights attaching to the Notes. For the purposes of this Prospectus, the expression "Prospectus Directive" means Directive 2003/71/EC (and the amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State. The expression "2010 PD Amending Directive" means Directive 2010I73IEU and the expression "Relevant Member State" means any Member State of the European Economic Area which has implemented the Prospectus Directive.

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having made all reasonable enquiries and having taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Information included herein that is identified as being derived from information published by the Republic of Serbia or one of its agencies or instrumentalities is included herein on the authority of such publication as a public official document of the Republic of Serbia. All other information herein with respect to the Republic of Serbia is included herein as a public official statement made on the authority of the Ministry of Finance and Economy of the Republic of Serbia.

No person has been authorised to give any information or to make any representation other than as contained in this Prospectus in connection with the offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer or the Joint Lead Managers (as defined in "Subscription and Sale"). Neither the delivery of this Prospectus nor any offer or sale of the Notes made hereunder shall, under any circumstances, constitute a representation or create any implication that there has been no change in the financial condition or affairs of the Issuer since the date hereof. The Joint Lead Managers expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Notes or to advise any investor in Notes of any information coming to their attention. This Prospectus may only be used for the purpose for which it has been published.

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) *have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Prospectus or any applicable supplement;*

(ii) *have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;*

(iii) *have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes;*

(iv) *understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant indices and financial markets; and*

(v) *be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.*

This Prospectus does not constitute an offer to sell or an offer to buy in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction, nor does this Prospectus constitute an offer or an invitation to subscribe for or purchase any Notes and it should not be considered as a recommendation by the Issuer or any Joint Lead Manager that any recipient of this Prospectus should subscribe for or purchase any Notes. The distribution of this Prospectus and the offering, sale and delivery of the Notes in certain jurisdictions may be restricted by law. In particular, this Prospectus does not

constitute an offer of securities to the public in the United Kingdom. Consequently, this Prospectus is being distributed only to, and is directed at (a) persons who have professional experience in matters relating to investments falling within article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities falling within articles 49(2)(a) to (d) of the Order, and other persons to whom it may be lawfully communicated, falling within article 49(1) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this Prospectus or any of its contents. Persons into whose possession this Prospectus comes are required by the Issuer and the Joint Lead Managers to inform themselves about and to observe any such restrictions. None of the Issuer or the Joint Lead Managers makes any representation to any recipient of this Prospectus regarding the legality of an investment in the Notes by such recipient under applicable investment or similar laws. Each investor should consult with its own advisers as to the legal, tax, business, financial and related aspects of its purchase of the Notes. For a description of certain restrictions on offers, sales and deliveries of Notes, see "Subscription and Sale" and "Form of the Notes and Transfer Restrictions".

The Notes have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities passed upon or endorsed the merits of the offering of the Notes or approved this Prospectus or confirmed the accuracy or determined the adequacy of the information contained in this Prospectus. Any representation to the contrary is a criminal offence in the United States.

The Joint Lead Managers have not separately verified the information contained in this Prospectus. Accordingly, no representation, warranty or undertaking, express or implied, is made, and no responsibility or liability is accepted, by the Joint Lead Managers as to the accuracy or completeness of the information contained in this Prospectus or any other information provided by the Issuer in connection with the Notes or their distribution.

Each recipient of this Prospectus shall be taken to have made its own investigation and appraisal of the condition (financial or otherwise) and status of the Issuer.

IN CONNECTION WITH THE ISSUE OF THE NOTES, DEUTSCHE BANK AG, LONDON BRANCH (THE "STABILISING MANAGER") (OR ANY PERSON ACTING FOR THE STABILISING MANAGER) MAY OVER-ALLOT NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE INITIAL ALLOTMENT OF THE NOTES. ANY STABILISATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.

This Prospectus has been prepared by the Issuer for use in connection with the offer and sale of the Notes and the admission of the Notes to the Official List and to trading on the Market. The Issuer and the Joint Lead Managers reserve the right to reject any offer to purchase Notes, in whole or in part, for any reason. This Prospectus does not constitute an offer to any person in the United States other than any QIB to whom an offer has been made directly by one of the Joint Lead Managers or its U.S. broker-dealer affiliate. Distribution of this Prospectus to any person within the United States, other than any QIB and those persons, if any, retained to advise such QIB with respect thereto, is unauthorised and any disclosure without the prior written consent of the Issuer of any of its contents to any person within the United States, other than any QIB and those persons, if any, retained to advise such QIB, is prohibited.

NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("RSA 421-B") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

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SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

The Issuer is a sovereign state. It may not be possible for investors to effect service of process within the United States upon the Issuer or to enforce against the Issuer in or through courts located in the United States judgments obtained in courts located in the United States, respectively, or elsewhere, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state or territory within the United States.

It may not be possible to enforce in the courts of the Republic of Serbia any foreign court judgment (including a judgment obtained from a United States court) against the Republic of Serbia that is predicated upon the laws of a foreign jurisdiction, such as English law, without a re-examination of the merits of such judgment in the Serbian courts, although a re-examination of the merits of a judgment will generally not be conducted according to the applicable law.

There is a risk that, notwithstanding the limited waiver of sovereign immunity by the Republic of Serbia in connection with the Notes, a foreign court judgment would not be recognised in the Republic of Serbia or enforced against certain assets of the Republic of Serbia in certain jurisdictions, including the Republic of Serbia (including the imposition of any arrest order or the attachment or seizure of such assets and their subsequent sale), without the Republic of Serbia having specifically consented to such enforcement at the time when the enforcement is sought. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – A claimant may not be able to enforce a court judgment against certain assets of Serbia in certain jurisdictions*".

PRESENTATION OF ECONOMIC AND OTHER INFORMATION

All references in this Prospectus to the "Government" and the "Assembly" are to the central government and the National Assembly of the Republic of Serbia, respectively.

References in this Prospectus to "RSD", "Dinar" and "Serbian Dinar" are to the currency of Serbia; references to "U.S. Dollars" and "U.S.$" are to the currency of the United States and references to the "Euro", "Euros" and "EUR" are to the single currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended by the Treaty on the European Union.

Gross Domestic Product ("GDP") is a measure of the total value of final products and services produced in the country. Gross Value Added ("GVA") is a measure of the total value of products and services within a particular sector before taking account of taxes and subsidies. "Nominal GDP" or "nominal GVA" measure the total value in current prices. "Real GDP" or "real GVA" measure the total value in constant prices, thus allowing historical GDP or GVA comparisons that exclude the effect of inflation. For the purposes of this Prospectus, real GDP or real GVA figures are calculated by reference to 2005 prices.

References to the "Budget" are to the consolidated budget of the Republic of Serbia passed by the Assembly in accordance with the Budget System Law (Official Gazette nos. 54/2009, 73/2010, 101/2010, 101/2011 and 93/2012).

References to the "supplementary Budget" are to the Amendment to the Law on the Budget of the Republic of Serbia for the year 2012 passed by the Assembly on 25 September 2012 in accordance with the Budget System Law (Official Gazette nos. 54/2009, 73/2010, 101/2010, 101/2011 and 93/2012).

References to laws, including the Budget, refer to such laws (and the Budget), as amended from time to time.

Unless otherwise stated, all annual information, including budgetary information for the Republic of Serbia, is based on calendar years. Unless otherwise stated, all budgetary and statistical information as at and for the year ended 31 December 2011, as at and for the nine months ended 30 September 2012 and for any other period ended in 2012 is preliminary and subject to revision and amendment. Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same item of information may vary reflecting such rounding and figures which are totals may not be the sum of their components.

Statistical data appearing in this Prospectus have, unless otherwise stated, been obtained from the Office of Statistics of the Republic of Serbia (the "Office of Statistics"), the Ministry of Finance and Economy, the Government, the Assembly, the Privatisation Agency of Serbia (the "Privatisation Agency") and the National Bank of Serbia (the "National Bank"). Similar statistics may be obtained from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source. Although every effort has been made to include in this Prospectus the most reliable and the most consistently presented data, no assurance can be given that such data was compiled or prepared on a basis consistent with international standards. However, as far as the Government is aware and is able to ascertain from the information published by these entities, the information has been accurately reproduced and no facts have been omitted which would render the reproduced information inaccurate or misleading in any material respect. In this Prospectus, the data is presented as having been provided by the relevant responsible ministry. The relevant interim period in 2012 for which, and/or the relevant date in 2012 as at which, data is presented may differ depending on the most recent information available from the relevant responsible ministry.

Unless otherwise stated, all statistical data appearing in this Prospectus (save in relation to public expenditures for employees, purchase of goods and services and social welfare and transfers and the number of public sector employees) has been prepared on a basis which excludes the relevant data in respect of the autonomous province of Kosovo and Metohija. In addition, the number of public sector employees includes public sector employees in the municipalities of Kosovska Mitrovica, Zubin Potok, Leposavic, Zvecan, Gracanica, Gnjilane and Strpce in the autonomous province of Kosovo and Metohija.

The last census in Serbia was performed in 2011. Unless otherwise stated, estimates of total population, including estimates used to calculate per capita data, are based on the Office of Statistics' annual population estimates. See "*Description of Serbia – Geography and Population"* and *"Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Economic and political factors may make an investment in Serbia riskier than investing in a more developed country*".

Data Dissemination

Serbia has been a participant in the General Data Dissemination System (the "GDDS") of the International Monetary Fund ("IMF") since May 2009. The GDDS is a structured process through which IMF member countries commit voluntarily to improving the quality of the data produced and disseminated by their statistical systems over the long run to meet the needs of high-quality macroeconomic analysis. The purpose of the GDDS is to guide countries in developing sound statistical systems, with special emphasis on comprehensiveness, reliability and timeliness of data and the practice of dissemination of economic, financial and socio-demographic data. Metadata, submitted by countries participating in the GDDS, provide systematic descriptions on the content and classification of data, as well as the concepts, data sources and compilation and processing methods. GDDS lies at the core of the statistical development cycle, comprising sets of metadata divided into the real sector (national accounts, prices, production, labour market), the fiscal sector, the financial sector, the external sector and socio-demographic data (population, health, education, poverty).

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Prospectus, as well as written and oral statements that Serbia and its representatives make from time to time in reports, filings, news releases, conferences, teleconferences, web postings or otherwise are or may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the United States Securities Exchange Act of 1934, as amended (the "Exchange Act"). However, this Prospectus is not entitled to the benefit of the safe harbour created thereby. Statements that are not historical facts, including, without limitation, statements about Serbia's or the Government's beliefs and expectations, are forward-looking statements. Such statements, certain of which can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "are expected to", "intends", "will", "will continue", "should", "could", "would be", "seeks", "approximately", "estimates", "predicts", "projects", "aims" or "anticipates", or similar expressions or the negative thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans or intentions, involve a number of risks and uncertainties. These statements are based on current plans, objectives, assumptions, estimates, projections or methods that may be incorrect or imprecise and that may be incapable of being realised. Therefore, undue reliance should not be placed on them. Forward-looking statements speak only as at the date on which they are made and Serbia undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. Serbia cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to, plans with respect to the implementation of economic policies and the pace of economic and legal reforms, expectations about the behaviour of the economy if certain economic and fiscal policies are implemented, the outlook for inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts and estimates of debt repayment and debt service.

In addition to the factors described in this Prospectus, including, but not limited to, those discussed under "*Risk Factors*", the following factors, among others, could cause future outcomes to differ materially from those expressed in any forward-looking statements made herein:

- decisions of international organisations regarding the terms of their financial assistance to Serbia and, accordingly, the net flow to or from such international organisations over the life of the Notes;
- adverse external factors, such as changes in the credit rating of Serbia, higher international interest rates, low commodities prices, increases in world commodities prices or recession or low growth in Serbia's trading partners, which could each decrease Serbia's fiscal and foreign exchange revenues and could negatively affect the current account, balance of payments and international reserves and cause or contribute to recession or low growth in Serbia;
- adverse domestic factors, such as recession, decline in foreign direct investment ("FDI") and portfolio investment, high domestic inflation, high domestic interest rates, difficulties in borrowing in the domestic and foreign markets, changes in tariff and tax requirements (including tax rate changes, new tax laws and revised tax law interpretations), trade and political consensus, any of which could lead to lower growth in Serbia and lower international currency reserves;
- relations with creditors;
- decisions of international financial institutions such as the IMF, the World Bank, the European Bank for Reconstruction and Development (the "EBRD") and the European Investment Bank (the "EIB") regarding the provision of funding for new or existing projects over the life of the Notes; and
- political factors in Serbia, which may affect the timing and structure of economic reforms, the climate for FDI and the pace, scale and timing of privatisations.

See "*Risk Factors*".

EXCHANGE RATE HISTORY

For ease of presentation, certain economic and financial information included herein has been translated into U.S. Dollars or Euros.

The following table sets out certain exchange rate data for the years 2007 to 2011 and for the period ended 8 November 2012, expressed as Serbian Dinar per U.S. Dollar, as published by the National Bank:

	Serbian Dinar to U.S.$			
Year	*Low*	*High*	*Average*	*Period End*
2012 (up to and including 15 November 2012)	79.9073	97.6220	88.2946	88.4127
2012 (up to and including 30 September 2012)	79.9073	97.6220	88.3471	88.9377
2011	66.6387	82.4106	73.3382	80.8662
2010	66.8376	86.7278	77.9066	79.2802
2009	61.9332	75.6297	67.4731	66.7285
2008	48.9974	72.2647	55.7641	62.9000
2007	52.8478	62.0940	58.3934	53.7267

Source: National Bank.

As at 15 November 2012, the RSD/U.S.$ exchange rate published by the National Bank was RSD 88.4127 = U.S.$1.00.

The following table sets out certain exchange rate data for the years 2007 to 2011 and for the period ended 8 November 2012, expressed as Serbian Dinar per Euro, as published by the National Bank:

	Serbian Dinar to Euro			
Year	*Low*	*High*	*Average*	*Period End*
2012 (up to and including 15 November 2012)	103.6922	119.0723	113.1093	112.6731
2012 (up to and including 30 September 2012)	103.6922	119.0723	113.0156	115.0320
2011	96.7007	106.4947	101.9502	104.6409
2010	95.9679	107.5216	103.0431	105.4982
2009	89.5436	96.5657	93.9517	95.8888
2008	75.7543	91.6317	81.4405	88.6010
2007	76.8093	84.7540	79.9640	79.2362

Source: National Bank.

As at 15 November 2012, the RSD/Euro exchange rate published by the National Bank was RSD 112.6731 = EUR 1.00.

The following table sets out certain exchange rate data for the years 2007 to 2011 and for the period ended 8 November 2012, expressed as U.S. Dollar per Euro, as published by Bloomberg:

	U.S. Dollar to Euro			
Year	*Low*	*High*	*Average*	*Period End*
2012 (up to and including 15 November 2012)	1.2053	1.3463	1.2833	1.2773
2012 (up to and including 28 September 2012)	1.2053	1.3463	1.2819	1.2876
2011	1.2909	1.4872	1.3921	1.2940
2010	1.1923	1.4513	1.3266	1.3387
2009	1.2531	1.5134	1.3949	1.4326
2008	1.2454	1.5992	1.4712	1.3973
2007	1.2892	1.4873	1.3709	1.4591

Source: Bloomberg.

As at 15 November 2012, the U.S.$/Euro exchange rate published by Bloomberg was U.S.$1.2773 = EUR 1.00.

The rates in the above tables may differ from the actual rates used in the preparation of the information appearing in this Prospectus. The inclusion of these exchange rates is not meant to suggest that any amount of the currencies specified above has been, or could be, converted into the applicable currency at the rates indicated or at any other rate.

OVERVIEW

The following is an overview of certain information contained in this Prospectus. It does not purport to be complete and is qualified in its entirety by the more detailed information appearing elsewhere in this Prospectus. Prospective investors should also carefully consider the information set out in the section entitled "Risk Factors" in this Prospectus prior to making an investment decision. Capitalised terms not otherwise defined in this overview have the same meaning as elsewhere in this Prospectus. See "Description of Serbia", "Economy of Serbia", "External Sector", "Monetary System", "Public Finance" and "Public Debt" for a more detailed description of the Issuer.

Overview of the Republic of Serbia

General

Serbia is located in the central part of the Balkan Peninsula and occupies an area of approximately 88,361 square kilometres. By virtue of its geographic position, it controls some of the major land routes between Western Europe and Turkey and the Near East. Serbia is bordered by eight other countries: to the East by Bulgaria, to the North East by Romania, to the North by Hungary, to the West by Croatia, Montenegro and Bosnia and Herzegovina and to the South by Albania and Macedonia.

Serbia consists of 29 administrative districts as well as two autonomous provinces, Vojvodina in the north and Kosovo and Metohija in the south. Belgrade is the capital city and the administrative, economic and cultural centre of Serbia, and is where the Government and its agencies are located.

As of the date of the last census in 2011, Serbia had a total population of approximately 7.1 million (excluding Kosovo and Metohija). The Constitution divides power between (i) the executive branch, comprising the Government and the President, (ii) the legislative branch and (iii) the judicial branch. The three branches have separate but equal powers and the judiciary is fully independent. The Government is led by the Prime Minister who has a mandate, subject to approval by a majority vote of the Assembly, to determine the composition of the Government. Ivica Dacic is the current Prime Minister. The President is elected for a five-year term and may not serve more than two terms. Tomislav Nikolic is the current President. The Assembly is the unicameral parliament of Serbia and consists of 250 deputies elected in direct elections to serve four-year terms. In addition, following the adoption of the National Judicial Reform Strategy on 25 May 2006, the Government has been engaged in a comprehensive effort to reform the judiciary in order to uphold the principles of separation of powers, promote legal certainty and strengthen the rule of law. This reform effort is part of the Government's broader efforts to modernise Serbia's legal framework to bring it in line with European and other international standards.

Economy

Starting from the end of 2008, the Government and the National Bank implemented a programme of measures intended to alleviate the effects of the global financial and economic crisis and protect the Serbian economy, banking system and free market, by ensuring that the burden imposed by the crisis was effectively distributed in order to protect the impoverished segments of the population. The Government intends to continue to pursue appropriate fiscal and economic policies that facilitate the adoption of public sector reforms, and restructure the economy in order to increase exports and develop the country's infrastructure. The Government believes that sound monetary and fiscal policies will play a key role in the achievement of Serbia's development-related aims. In particular, maintaining a low and stable inflation rate, reducing unemployment, creating attractive conditions for FDI and exercising fiscal responsibility are important factors in the Government's approach.

The following selected economic information is qualified in its entirety by, and should be read in conjunction with, the detailed information appearing elsewhere in this Prospectus:

	2008	*2009*	*2010*	*2011*
Domestic Economy				
Nominal GDP (RSD billions)[1]	2,661.4	2,720.1	2,881.9	3,175.0[2]
Real GDP (growth rate) (%)[1]	3.8	(3.5)	1.0	1.6
Consumer Price Index (%)	8.6	6.6	10.3	7.0
Balance of Payments (EUR millions)[3]				
Exports of Goods (F.O.B.)	7,416.0	5,977.8	7,402.4	8,438.9
Imports of Goods (F.O.B.)	(15,917.2)	(11,096.3)	(12,176.0)	(13,757.2)
Trade Balance	(8,501.2)	(5,118.5)	(4,773.3)	(5,318.3)
Reserves assets (net)	(1,686.6)	2,363.5	(928.7)	(1,801.5)
Public Finance (RSD billions)[4]				
Public Revenues	1,142.1	1,146.5	1,223.4	1,302.5
Public Expenditure	(1,212.5)	(1,267.9)	(1,359.9)	1,460.9
Consolidated Balance	(70.4)	(121.4)	(136.5)	(158.4)
Consolidated Balance (% of nominal GDP)[1]	2.6	4.5	(4.7)	(5.0)
Public Debt (RSD billions)				
Internal Public Debt	280.1	401.3	518.2	624.9
External Public Debt	497.9	543.1	764.3	922.1
Gross Public Debt (% of nominal GDP)[1]	29.2	32.7	44.5	48.7

Source: Office of Statistics; National Bank; Ministry of Finance and Economy.

Notes:

(1) Figures adjusted according to the new methodology for calculating GDP applied as of January 2012. See "*Economy of Serbia – Gross Domestic Product*".

(2) Office of Statistics estimates.

(3) Data prepared in accordance with the IMF Balance of Payments Manual, 5th Edition.

(4) The consolidated balance sheet of the Government is prepared on a cash basis using the Government Finance Statistics Manual 1986 methodology.

Overview of Risk Factors relating to the Issuer, the Market and the Notes

Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes

- Economic and political factors may make an investment in Serbia riskier than investing in a more developed country
- Serbia may not succeed in implementing proposed economic, financial, political and other reforms, which may negatively affect its economy and ability to pay principal and interest on the Notes
- The Serbian economy is vulnerable to external shocks that may have a negative effect on the economic growth of Serbia and its ability to service its debt obligations
- Serbia may not become a member of the EU in the near to medium-term or at all
- Depreciation of the Dinar may adversely affect the Serbian economy and its public finances
- The current account deficit may undermine foreign exchange liquidity and regular servicing of external debt
- The inability of the Government to reduce public spending to generate fiscal revenues may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes

- Foreign-owned banks may diminish or discontinue their support of their subsidiaries operating in Serbia
- Other risks associated with the banking sector
- There is no guarantee that the credit rating of Serbia will not change
- Relatively high and sustained inflation may have a material adverse effect on the Serbian economy
- The corporate sector may not be able to settle debts to domestic and foreign creditors, which could have a material adverse effect on the Serbian economy
- Corruption and money laundering may adversely affect economic and social conditions in Serbia, slow down or halt progress towards EU membership and have a material adverse effect on the Serbian economy
- Serbia may not be able to refinance its debt on favourable terms, or might not be able to refinance it at all
- Official economic statistics may be less accurate or reliable than those produced in more developed countries
- Deterioration in Serbia's relations with its major energy suppliers, restricted energy supplies or increases in the price of oil or natural gas may have adverse effects on the Serbian economy
- The legal system of Serbia is not fully developed and, therefore, involves greater risk and uncertainty than in other more developed legal systems
- A claimant may not be able to enforce a court judgment against certain assets of Serbia in certain jurisdictions

Factors which are Material for the Purpose of Assessing the Market Risks Associated with the Notes

- Collective action clauses
- EU Savings Directive

Risks Related to the Notes Generally

- Modification, waivers and substitution
- Governing law
- *Pari passu* securities

Risks Related to the Market Generally

- The secondary market generally
- Exchange rate risks and exchange controls
- Interest rate risks
- Credit ratings may not reflect all risks
- Legal investment considerations may restrict certain investments

OVERVIEW OF THE TERMS AND CONDITIONS OF THE NOTES

Capitalised terms not otherwise defined in this overview have the same meaning as in the terms and conditions of the Notes (the "Conditions"). See the Conditions for a more detailed description of the Notes.

Issuer	The Republic of Serbia (acting through the Ministry of Finance and Economy).
Notes Offered	U.S.$750,000,000 principal amount of 5.250 per cent. Notes due 2017.
Issue Date	21 November 2012.
Maturity Date	21 November 2017 (the "Maturity Date").
Interest on the Notes	5.250 per cent. per annum, computed on the basis of a 360-day year of 12 30-day months.
Interest Payment Dates	The Notes will bear interest at a rate of 5.250 per cent. per annum payable semi-annually in arrear on 21 May and 21 November of each year. The first payment of interest in respect of the Notes will be made on 21 May 2013 for the period from and including 21 November 2012 to but excluding 21 May 2013. See "*Terms and Conditions of the Notes – 7. Interest*".
Issue Price	99.135 per cent. of the principal amount of the Notes.
Yield	As at the Issue Date and on the basis of the issue price the yield of the Notes is 5.450 per cent. per annum.
Redemption	The Issuer will redeem the Notes at their principal amount on the Maturity Date. See "*Terms and Conditions of the Notes – 9. Redemption and Purchase*".
Denominations	The Notes will be offered and sold, and may only be transferred, in minimum principal amounts of U.S.$200,000 and integral multiples of U.S.$l,000.
Status	The Notes will constitute direct, unconditional and (subject to the provisions of a negative pledge covenant described below) unsecured obligations of the Issuer. The Notes rank and will rank *pari passu* among themselves and at least *pari passu* in right of payment with all other present and future unsecured obligations of the Issuer, save only for such obligations as may be preferred by mandatory provisions of applicable law. The full faith and credit of the Issuer is pledged to the due and punctual payment of all amounts due in respect of the Notes. See "*Terms and Conditions of the Notes – 4. Status*".
Negative Pledge	So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement), the Issuer shall not create or permit to subsist any Security Interest upon the whole or any part of its present or future undertaking, assets or revenues to secure any of its Public Indebtedness or any Guarantee of any Public Indebtedness, unless the Issuer shall at the same time or prior thereto procure that all amounts payable in respect of the Notes are secured equally and

rateably therewith or have the benefit of such other security or arrangement as may be approved by an Extraordinary Resolution (as defined in Condition 14(c) (*Modifications*)).

See "*Terms and Conditions of the Notes – 5. Negative Pledge*".

Events of Default

The Conditions will permit the acceleration of the Notes following the occurrence of certain events of default.

Holders of not less than 25 per cent. in the aggregate principal amount of the Notes may, by written notice to the Issuer, declare the Notes immediately due and payable and all principal, interest and all additional amounts payable on the Notes will become immediately due and payable on the date the Issuer receives such written notice of the declaration.

If the Issuer receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to such declaration of acceleration is or are cured following any such declaration and that such holders wish the declaration to be withdrawn, the Issuer shall give notice thereof to the Noteholders (with a copy to the Fiscal Agent at its Specified Office), whereupon the declaration shall be withdrawn and shall have no further effect. No such withdrawal shall affect any other or any subsequent Event of Default or any right of any relevant Noteholder in relation thereto.

See "*Terms and Conditions of the Notes – 12. Events of Default*".

Form of Notes

The Notes will be in registered form, without interest coupons.

Notes sold in offshore transactions in reliance on Regulation S will initially be in the form of a Regulation S Global Note, which will be deposited outside the United States with a common depositary for Euroclear and Clearstream, Luxembourg and registered in the name of a nominee for such common depositary.

Notes sold to QIBs in reliance on Rule 144A will be issued initially in the form of a Rule 144A Global Note, which will be deposited with a custodian for, and registered in the name of a nominee of, DTC.

Taxation and Additional Amounts

All payments of principal and interest in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the Republic of Serbia or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them had no such withholding or deduction had been required, subject to certain exceptions set out in "*Terms and Conditions of the Notes – 10. Taxation*".

Modification and Amendment

A summary of the provisions for convening meetings of Noteholders and amendments is set forth under "*Terms and*

	Conditions of the Notes – 14. Meetings of Noteholders and Modification".
Use of Proceeds	The net proceeds of the issue of the Notes will be used for general Budget purposes (including, without limitation, repayment of outstanding indebtedness). See "*Use of Proceeds*".
Ratings	The Notes are expected to be assigned a rating of BB- by S&P and BB– by Fitch. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. Each of S&P and Fitch is established in the European Union and Registered under the CRA Regulation.
Listing and Admission to Trading	Application has been made to admit the Notes to the Official List of the UK Listing Authority and to trading on the Market.
Governing Law	The Notes will be governed by English law.
Transfer Restrictions	The Notes have not been and will not be registered under the Securities Act or any U.S. state securities laws. Consequently, the Notes may not be offered or sold in the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable U.S. state securities laws. See "*Form of the Notes and Transfer Restrictions*".
Fiscal Agent, Principal Paying Agent and Transfer Agent	Deutsche Bank AG, London Branch.
Registrar, Transfer Agent and Paying Agent	Deutsche Bank Luxembourg S.A.
U.S. Registrar, U.S. Transfer Agent and U.S. Paying Agent	Deutsche Bank Trust Company Americas.
ISINs	XS0856951263 Regulation S Global Note; US817477AC64 Rule 144A Global Note.
Common Codes	085695126 Regulation S Global Note; 085695096 Rule 144A Global Note.
CUSIP Number	817477AC6 for the Rule 144A Global Note.

RISK FACTORS

Investment in the Notes involves a high degree of risk. Potential investors should carefully review this entire Prospectus and, in particular, should consider all the risks inherent in making such an investment. The Issuer believes that the following factors may affect its ability to repay the principal of, and make payments of interest and other amounts due on, the Notes. The value of the Notes could decline due to any of these risks and prospective investors may lose some or all of their investment. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which the Issuer believes are material for the purpose of assessing the market risks associated with the Notes are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Notes, but the Issuer may be unable to pay interest, principal or other amounts on or in connection with the Notes for other reasons and the Issuer does not represent that the statements below regarding the risks of holding the Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and make any other enquiries they think appropriate in order to reach their own views prior to making any investment decision.

Risks Associated with Emerging Markets

Investors in securities of sovereign or corporate issuers in emerging markets, such as Serbia, should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. These greater risks include economic instability caused by a variety of factors such as a narrow export base, reliance on imports, fiscal and current account deficits, reliance on foreign investment, high unemployment and changes in the political, economic, social, legal and regulatory environment. Actions of governments may be challenged by future governments. Investors should also note that emerging economies, such as Serbia's, are subject to rapid change and that the information set out in this Prospectus may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in the light of those risks, their investment is appropriate. Generally, investment in emerging markets is suitable only for sophisticated investors who fully appreciate the significance of the risks involved. Investors are urged to consult their own legal and financial advisers before making an investment in the Notes.

The disruptions recently experienced in the international capital markets, especially in relation to sovereign debt, have led to reduced liquidity and increased credit risk premiums for certain market participants and have resulted in a reduction of available financing. Any entity located in the emerging markets may be particularly susceptible to these disruptions and reductions in the availability of credit or increases in financing costs.

In addition, the availability of credit to any entity operating within the emerging markets is significantly influenced by levels of investor confidence in such markets as a whole and so any factors that impact market confidence (for example, a decrease in credit ratings or state or central bank intervention in one market) could affect the price or availability of funding within any of these markets.

Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes

Economic and political factors may make an investment in Serbia riskier than investing in a more developed country

Investment in Serbia bears a considerably greater risk than investing in countries with more developed market economies and mature political and legal systems. Although progress has been made in reforming the economy and the political and judicial system, the Serbian legislative framework is still not in all material respects in line with the standards adopted, for example, by European Union ("EU") member states or the United States. As a result, investment in Serbia carries specific risks that are not typical for investment in

developed markets. Accordingly, investors should carefully assess the risks of the Serbian market and make their own assessment of the relevant risks.

The Serbian economy is associated with, and subject to similar risks as, the economies of the former Yugoslav republics. Economic and financial difficulties affecting such former republics and other countries in the region may negatively affect Serbia's economy. Foreign investors may also associate the difficulties experienced by these other economies with the Serbian economy, which may adversely affect investment in Serbia. Even though the Government has in recent years focussed, and it intends to continue to focus, on establishing strong connections and increased trade with developed economies in Europe, including EU member states, the effects of the global financial and economic crisis, which began in the second half of 2008, severely impacted the Serbian economy and its plans for future growth. See "*Economy of Serbia*". Serbia's economy may be adversely affected by any further financial and/or economic crises that may occur in the future, including, but not limited to, issues arising from or linked to the current situation in the Eurozone.

Serbia may not succeed in implementing proposed economic, financial, and political and other reforms, which may negatively affect its economy and ability to pay principal and interest on the Notes

Serbia has undergone significant political transformation since democratic reforms in 2000. In parallel with this political reform, Serbia has implemented a programme of economic structural reforms aimed at establishing a market-based economy through privatisation of state and Socially-Owned Enterprises (as defined below), deregulation and a shift in its trade policy aimed at increasing exports. However, this process is not yet complete and the Serbian economy has not yet reached the same standard of economic and market practices which apply in most other developed European countries. In particular, Serbia's transition to a more efficient economy with a focus on the private sector may lag behind certain other peer countries in the region. Serbia may not succeed in implementing its proposed economic, financial and other reforms, which may negatively affect its economy and its ability to pay principal and interest on the Notes.

The last parliamentary, provincial, local and early presidential elections were held on 6 May 2012. The early presidential election was called following former president Boris Tadic's early resignation in order to coincide with the parliamentary, provincial and local elections. The failure of the new Government to implement its intended programme of economic and social reforms may lead to a deterioration of general economic conditions and lack of availability of public finance to fund Budget payments obligations, including obligations to foreign and domestic investors and/or creditors which may, in turn, adversely affect future FDI inflows and foreign trade. See "*Economy of Serbia – Labour Market and Social Policy – Wages*", "*Economy of Serbia – Social Insurance System – Pensions and disability*", "*Monetary System – National Bank*" and "*Public Finance – Fiscal Policy and Reform*". There can be no assurance that the new Government will implement these and other reforms described in this Prospectus in a timely manner or at all or, if implemented, that any such reforms will successfully achieve the stated objectives or that such reforms will not be reversed.

Serbia has experienced some tensions in its relations with certain other countries as a result of its stance on the autonomous province of Kosovo and Metohija. See "*Description of Serbia – Historical Background*".

The Government has declared itself committed to the legal and political defence of Serbia's sovereignty in Kosovo. EU-sponsored and UN-supported dialogues between Belgrade and Pristina (the capital of the autonomous province of Kosovo and Metohija) on a number of issues have taken place since March 2011. However, discussions stalled and tensions heightened in the wake of border disputes in the autumn of 2011, and discussions were further delayed following Serbia's recent elections. Belgrade and Pristina resumed their dialogue in the autumn of 2012, and the most recent discussion between Belgrade and Pristina took place on 7 November 2012. See "*–Serbia may not become a member of the EU in the near to medium term or at all*" and "*Description of Serbia – Historical Background*". Any further deterioration in relations between Belgrade and Pristina and/or between Serbia and members of the international community as a result of differences over the future status of the autonomous province of Kosovo and Metohija or any part thereof and/or its residents may have an adverse effect on political and economic conditions in Serbia, its international standing and its relations with the EU and other nations.

The Serbian economy is vulnerable to external shocks that may have a negative effect on the economic growth of Serbia and its ability to service its debt obligations

The Serbian economy remains vulnerable to external shocks, such as those caused by the global financial and economic crisis which began in the second half of 2008. Since late 2008, the global financial and economic crisis has negatively affected the Serbian economy. As in other European countries with similar characteristics, the crisis has caused sharper declines in FDI inflows and exports of goods and increased growth in overall levels of government borrowing than Serbia experienced prior to such time. It has also exacerbated depreciation of the domestic currency, inflationary pressures, fiscal imbalances, high unemployment levels and the incidence of a "grey" market economy. See "*Economy of Serbia – Historical Economic Policy and Developments*".

The negative trends seen in the economy of Serbia in the second half of 2008 continued in 2009, although the Serbian economy began a gradual recovery in the second quarter of 2010. See "*Economy of Serbia – Gross Domestic Product*". Real GDP in 2011 increased by 1.6 per cent. compared to 2010, but in the first nine months of 2012 real GDP contracted by 1.8 per cent. Net FDI has fallen in recent years after reaching a record-high level of EUR 3.3 billion in 2006, largely due to the proceeds from the privatisation of Mobi 063, the second largest mobile operator in Serbia. Net FDI rose in 2011 to EUR 1.83 billion. In the first nine months of 2012, net FDI inflows amounted to EUR (0.02) billion, a decrease of EUR 1.2 billion compared to the first nine months of 2011 due to negative outflow generated by the exit of a Greek telecommunications company, OTE, from the national telecommunications company "Telecom Serbia". See "*External Sector – Foreign Direct Investment*".

Any further decrease in GDP or FDI inflows may adversely affect Serbia's ability to grow its economy sustainably based on investments in fixed capital and net exports including long-term infrastructure projects and industrial projects mainly funded by FDI.

The onset of the global financial and economic crisis in 2008 had a negative effect on Serbia's fiscal deficit, which put pressure on the value of the domestic currency and caused a drop in demand, low economic activity and rising unemployment. As a result, public finances deteriorated markedly and Government borrowing increased significantly during 2009, 2010 and 2011 in an attempt to prevent further deterioration of general economic and social conditions. Serbia's Budget deficit increased and was mainly financed by the issuance of Government securities in the domestic market. This had the effect of severely restricting access to borrowing in the capital and money markets by the private sector. At the end of 2011, the external debt (of both the public and private sectors) to GDP ratio was 77.5 per cent. as compared to 84.9 per cent. in 2010. In the first eight months of 2012, External Debt increased in absolute value by EUR 86.9 million and amounted to EUR 24.2 billion as at 31 August 2012. At the end of 2011, Serbian external debt in nominal terms amounted to EUR 24.1 billion. See "*Public Debt*". There can be no assurance that the Serbian economy will return to the levels of growth achieved prior to 2008 when growth was fuelled by substantial inflows of foreign capital through FDI, mainly attributable to privatisation of Socially-Owned Enterprises and private sector borrowing.

A significant decline in the economic growth of Serbia's main trading partners, including EU member states, could also have an adverse effect on Serbia's balance of trade and adversely affect Serbia's economic growth. In addition, because international investors' reaction to the events occurring in one market may demonstrate a "contagion" effect in which an entire region or class of investment is disfavoured by international investors, Serbia could be adversely affected by negative economic or financial developments in European and neighbouring countries. In particular, concerns about credit risk (including that of sovereigns) and the large sovereign debts and/or fiscal deficits of several European countries (such as Portugal, Italy, Ireland, Greece and Spain) have recently intensified. The default, or a significant decline in the credit rating, of one or more sovereigns or financial institutions, or any European Union and/or Eurozone exits, could cause severe stress in the financial system generally and could adversely affect the global financial markets in ways which are difficult to predict. Despite various measures adopted throughout Europe to deal with the worsening Eurozone crisis, global markets continue to record high levels of volatility and uncertainty. This is partly due to the lack of agreement between the major European governments on how to use financial measures to support the Eurozone economies that are in difficulty. The impact of these conditions could be detrimental to Serbia and could have a material adverse effect on the ability of Serbia to fund payments on its debt

obligations, including the Notes. Prospective investors should take into account the considerable uncertainty as to how the Eurozone crisis, the global financial and economic crisis, and the wider economic situation will develop over time.

Other important factors in achieving economic growth will be the reform of Serbia's Socially-Owned Enterprises, some of which currently operate at a loss and are funded by the Government, and public sector reform, in order to attract foreign investment and increase exports. If the Serbian economy is not able to generate stable and sustainable growth based on the investments in fixed capital as well as growth of its trading partners and net export, there could be a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

Serbia may not become a member of the EU in the near to medium term or at all

The first step towards Serbia's potential accession to the EU occurred in October 2005 when negotiations between the EU and the State Union of Serbia and Montenegro with respect to the Stabilisation and Association Agreement formally began. In November 2007, following the dissolution of the State Union, the Stabilisation and Association Agreement between the EU and Serbia was initialled, with formal execution taking place in April 2008. In late 2009, Serbia formally applied for membership of the EU and on 1 March 2012 the European Council granted Serbia EU candidate status.

Serbia has made considerable progress in implementing several EU harmonisation measures. See "*Description of Serbia – Foreign Relations – European Union*". Serbia's ability to attain EU candidate status and the timing of it achieving full membership of the EU will depend on a number of economic and political factors relating to both Serbia and the EU, including, but not limited to, Serbia's normalisation of relations with Kosovo as well as the stabilisation and association process in the Balkans more generally, the institutional independence of the National Bank in line with the EU's *acquis communautaire*, further reform of the judiciary, a focus on the fight against corruption and improvement of the business environment in Serbia. In addition, there can be no assurance that the majority of the Serbian population will vote in favour of EU membership in any national referendum which may be held on this matter. As a result, there can be no assurance that Serbia will become a member of the EU within any given timescale or at all.

Depreciation of the Dinar may adversely affect the Serbian economy and its public finances

As of the end of September 2012, the National Bank had sold approximately EUR 1.3 billion of foreign reserves (being approximately 11.0 per cent. of foreign reserves as at 31 December 2011) with the aim of stabilising daily volatility in the exchange rate. A significant share of Serbia's External and Internal Public Debt (as defined in "Public Debt") is denominated in foreign currency. As at 30 September 2012, 100.0 per cent. of Serbia's External Public Debt and 54.0 per cent. of Serbia's Internal Public Debt was denominated in foreign currencies. In the period since 2008, there has been an increase in the proportion of Public Debt denominated in Dinar, with the proportion of aggregate External and Internal Public Debt denominated in Dinar standing at 19.5 per cent. as at 30 September 2012. In the first nine months of 2012, the Dinar depreciated against the Euro by 9.0 per cent. in nominal terms and 2.1 per cent. in real terms, given the domestic inflation rate of 9.6 per cent. and Eurozone inflation rate of 1.8 per cent. At the same time, the Dinar depreciated against the U.S. Dollar by 9.1 per cent. in nominal terms and 2.8 per cent. in real terms. The increase of Public Debt to GDP ratio in the first nine months of 2012 was predominantly due to depreciation of the Dinar against the Euro and the U.S. Dollar, and the further depreciation will negatively affect Serbian public finances. The depreciation of the Dinar also negatively affected Serbian households and the corporate sector through the increasing effect on prices of imported goods like gas and oil derivatives. Fluctuations in exchange rates resulting in the devaluation of the Dinar against the Euro (which is the main foreign currency in use in Serbia), or other foreign currencies in which Serbia's Public Debt is denominated or payable, has resulted, and may continue to result, in an increase in the Dinar amount debt obligations denominated or payable in other currencies and an increase in the Dinar amount of Serbian public funds required for debt servicing. This reduces the amount of public funds available to fund public investment projects and service social benefits and other Budget expenditures. As a result, Serbia's economic performance, credit rating and/or its ability to service its debt may be adversely affected.

The share of foreign currency denominated loans (including loans indexed to foreign currency) in total corporate and household lending was 71.8 per cent. as at 30 September 2012. As a result, any further devaluation of the Dinar against foreign currencies (and in particular against the Euro) may negatively affect the capacity of corporate and household borrowers to repay their debts and as a result adversely affect the financial and economic condition of Serbia.

The current account deficit may undermine foreign exchange liquidity and regular servicing of external debt

Serbia's current account deficit rose from EUR 5.1 billion in 2007 (17.7 per cent. of nominal GDP) to EUR 7.1 billion in 2008 (21.6 per cent. of nominal GDP), mainly due to an increase in the foreign trade deficit. A larger decline in imports as compared to exports of goods and the resulting decrease in the trade deficit contributed to a reduction in the current account deficit to EUR 2.1 billion (7.4 per cent. of nominal GDP) in 2010. In 2011, the foreign trade deficit increased and this, combined with a decrease in the net inflow of remittances, led to a rise in the current account deficit to EUR 2.8 billion. In the first nine months of 2012, the current account deficit rose by EUR 0.5 billion compared to the same period in 2011, primarily due to a rise in imports of goods while exports remained flat and also due to rising interest payments on foreign debt. See "*– Depreciation of the Dinar may adversely affect the Serbian economy and its public finances*".

Due to the effects of the global financial and economic crisis on domestic and foreign demand, the trade deficit fell to EUR 5.1 billion in 2009 (a decrease of 39.8 per cent. compared to 2008) and EUR 4.8 billion in 2010 (a decrease of 6.7 per cent. compared to 2009). In 2011, the trade deficit was EUR 5.3 billion (an increase of 11.4 per cent. compared to 2010) due to higher volumes of imports of goods. In the first nine months of 2012, the foreign trade deficit was EUR 4.0 billion (18.9 per cent. of nominal GDP) compared to EUR 3.7 billion (16.1 per cent. of nominal GDP) in the same period in 2011, due to higher import rates and stagnating exports.

There can be no assurance that slower growth in exports compared to imports of goods will not adversely affect the capacity of Serbia's economy to generate foreign currency assets sufficient to cover liabilities arising from private external debt and External Public Debt.

The inability of the Government to reduce public spending may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes

The effects of the global financial and economic crisis in Serbia became especially severe in the last quarter of 2008, resulting in the Government and the National Bank adopting a series of measures to seek to prevent further deterioration of Serbia's net fiscal position. These measures continued to be implemented throughout 2009, but the effects of the crisis resulted in a Budget deficit that was even greater than had been expected. In 2011, the Budget deficit was RSD 158.4 billion or 5.0 per cent., exceeding the Government's projections agreed with the IMF by RSD 5 billion, or 3.3 per cent. The Ministry of Finance and Economy estimates that, without any further Budget deficit reduction measures, the Budget deficit would be approximately 7.0 per cent. of GDP in 2012. The Government aims to reduce the deficit to approximately 3.6 per cent. of GDP by 2013. However, various factors have affected Government spending in the past and could result in such level not being reached or a further widening of the Budget deficit in 2012 and in future periods beyond any currently contemplated deficits. Such factors include, but are not limited to, increased Government subsidies (specifically subsidies to the agricultural sector as a result of severe weather conditions), the dependence of Serbia's pension fund on transfers from the Budget, unfavourable demographic trends, high unemployment and the inability of the economy to utilise more labour force from the labour market. Social pressures, such as public support for increases in public sector wages, could also restrict the Government's ability to assign the same level of priority to stabilise public finances.

On 30 September 2011, the management and executive board of the IMF (the "IMF Management and Executive Board") approved a stand-by arrangement, which sought to commit policy-makers to long-delayed structural reforms. Following a review mission in November 2011 and a staff visit in early February 2012, the IMF postponed completion of its first review under the stand-by arrangement due to deviations in the 2012 budget from the underlying stand-by arrangement, in particular with regard to higher planned issuance

of Government guarantees. Following a fact-finding staff visit from 10 to 14 September 2012, the IMF called on Serbian authorities to urgently elaborate and embark on a comprehensive set of policies to credibly restore fiscal and external viability and boost growth. In particular, the IMF noted that the 2012 supplementary Budget would not achieve this objective due to higher expenditures, including new initiatives, and recommended additional spending restraint. The mission also emphasised the need for corrective measures to the new NBS Law (as defined herein). See "*– Other risks associated with the banking sector"* and *"Monetary System – National Bank*". As of the date of this Prospectus, Serbian officials have requested discussions on a new IMF-supported programme, likely in the form of a precautionary stand-by arrangement, and the IMF has said it will assess this request in the context of the Government's policy plans and implementation of such plans in the period ahead. The next meeting with the IMF is scheduled to be held in mid-November 2012 in Belgrade. The Government may not succeed in agreeing a new precautionary stand-by arrangement with the IMF or, if an agreement is reached, it may not be on terms as favourable to Serbia as the Government would wish or may be after a period of delay. Any failure to negotiate a new precautionary stand-by arrangement may adversely affect Serbia's reputation or investment environment. See "*Public Debt – Multilateral and Bilateral Development Organisations – International Monetary Fund*".

Fiscal risks arise from Serbia's pension system, which is financed on a "pay-as-you-go" basis whereby state benefits are paid out of contributions from the current work force. A higher number of pensioners, primarily due to Serbia's aging population, in combination with a decline in overall population growth, high unemployment and a significant "grey" market economy, have resulted in low pension fund contributions leading to deficits in the pension fund. These deficits have been funded by allocations from the Budget. In 2011, just over 55.9 per cent., or approximately EUR 2.3 billion (RSD 236.5 billion), of the total expenditure of Serbia's pension fund was financed by allocations from the Budget. The Government's expenditure on pensions from the Budget in this period was 7.4 per cent. of nominal GDP. Expenditure on public wages and pensions currently represents the largest single category of expenditure in the Budget and this may continue in the future. See "*Economy of Serbia – Social Insurance System – Pensions and disability"* and *"Public Finance – Consolidated General Government Budget*".

In addition, the privatisation process in Serbia began in 2001, but some large public enterprises are still in the process of being restructured and continue to receive substantial funding for their operations from the Budget. It is unlikely that in the near future these enterprises will be profitable. If the Government is unable to privatise these enterprises, they will continue to require substantial funding for their operations from the Budget. The Government subsidy scheme is concentrated on three main sectors – agriculture, Serbian Railways and manufacturing companies, with the last being subsidised through a series of direct and indirect subsidies. In the nine months ended 30 September 2012, subsidies increased by 14 per cent. in nominal terms (an increase of 8.1 per cent. in real terms) compared to the same period in 2011, mainly due to a large amount of agricultural subsidies that were paid by the Government to alleviate the effects of severe weather conditions, including severe cold in the winter months and drought, on that industry. Under the supplementary Budget passed by the Assembly in September 2012, subsidies in the amount of RSD 89.2 billion are to be paid in 2012 from the central government budget, mainly to the agricultural sector due to drought. The Government may not be able to provide additional subsidies in the future and any subsidies provided by the Government may not achieve their intended results.

Any failure to successfully implement structural reforms in the public sector (including reform of the pension system, high dependence on government assistance and periodic price rises for services provided by public companies) or development and investment projects or to comply with Budget targets, as well as any negative economic or political impact resulting from austerity measures, may lead to further deterioration of public finances and may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

Foreign-owned banks may diminish or discontinue their support of their subsidiaries operating in Serbia

As at 30 September 2012, foreign-owned banks accounted for approximately 74.5 per cent. of total assets, 77.8 per cent. of total loans and 69.4 per cent. of total deposits in the Serbian banking system. See "*Monetary System – Banking Sector*". These banks may seek to rebalance their global loan portfolios in a manner adversely affecting Serbia as a result of events related or unrelated to Serbia. In addition, foreign banks may

decrease funding to their subsidiaries operating in Serbia due to actual or perceived deterioration in asset quality, particularly in the event of a weaker than expected economic performance. As a result of these or other factors or other potential shocks, foreign banks may revise their business strategies in, or relating to, Serbia and, in particular, their decision to fund their subsidiaries in Serbia. This may lead to, among other things, a loss of confidence in the Dinar which, in turn, may result in significant devaluation of the Dinar. Resulting balance sheet mismatches may negatively affect the Serbian economy and, as a result, have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

Other risks associated with the banking sector

As at 30 September 2012, the total amount of non-performing loans in the Serbian banking sector stood at approximately EUR 3.5 billion (RSD 399.5 billion), an increase of 6.1 per cent. in Euro terms (16.6 per cent. in Dinar terms) from approximately EUR 3.3 billion (RSD 342.7 billion) as at 31 December 2011. As at the same date, the ratio of non-performing loans to total loans was 19.9 per cent., an increase from 19.0 per cent. of total loans as at 31 December 2011. Corporate borrowers recorded slight decreases in the gross non-performing loans ratio in Serbia's banking sector, comprising 59.2 per cent. of total non-performing loans outstanding (excluding bankrupt entities), with a non-performing loan to total loan ratio of 23.7 per cent., a decrease of 0.9 per cent. in comparison to the ratio as at 31 December 2011. Household payment delinquencies increased as a proportion of total loans during the first nine months of 2012 and stood at 8.6 per cent. as at 30 September 2012. Expectations of further asset quality deterioration could cause banks to not be in compliance with their regulatory requirements, including capital adequacy requirements, or to reduce their lending activities and this may have an adverse effect on growth prospects for the economy as a whole and the corporate sector in particular.

On 2 August 2012, Dejan Soskic, Governor of the National Bank, resigned, citing his opposition to proposed amendments to the Law on the National Bank of Serbia (the "NBS Law") on the basis that such changes would reduce institutional independence. On 6 August 2012, Bojan Markovic, Vice-Governor of the National Bank, also resigned and the Assembly elected Jorgovanka Tabakovic, deputy leader of the Serbian Progressive Party. Later in August, amendments to the NBS Law came into effect that, among other things, established the Financial Institutions Supervisory Administration ("FISA"), and enhanced the role of the Assembly in appointing not only the Governor of the National Bank but also the Vice-Governors and the Director of FISA. See "*Monetary System – National Bank*". The amendments aim to increase the quality of supervision of the Serbian monetary system and increase transparency in National Bank operations; however, there is a risk that even with heightened supervision some banks will demonstrate increased losses and deteriorating capital adequacy.

On 25 September 2012, the Assembly confirmed two current members and named one new official, nominated by Jorgovanka Tabakovic, as vice-governors of the National Bank. Diana Dragutinovic had served as a vice-governor for the National Bank from 2004-2008, the Minister of Finance from 2008-2011, and again as a vice-governor for the National Bank since the end of 2011. Ana Gligorijevic was elected as a National Bank vice-governor in 2004, and has served in that capacity ever since. Veselin Pjescic has worked for the National Bank since 1997, and he was a member of the senior management at the time of his appointment.

Certain international observers and institutions, such as the EU, the IMF and the credit ratings agencies, have raised concerns that the institutional and legislative changes may result in less institutional independence of the National Bank or destabilised monetary policy, which could adversely affect Serbia's relations with these institutions and/or Serbia's reputation abroad.

There is no guarantee that the credit rating of Serbia will not change

Long-term debt of the Republic of Serbia is currently rated "BB-" (with a negative outlook) by Fitch. In August 2012, S&P lowered the credit rating of Serbia to "BB-" (with a negative outlook). A further downgrade of Serbia's ratings may occur again in the future in the event of a further deterioration in public finances, as a consequence of a poorer economic performance or as a result of current or proposed Government measures being perceived as insufficient or injudicious. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal by the assigning ratings organisation at any time. Any adverse change in the credit ratings applicable to the Notes may adversely affect the price that a purchaser may be willing to pay for the Notes.

Each of S&P and Fitch is established in the European Union and registered under the CRA Regulation.

Relatively high and sustained inflation may have a material adverse effect on the Serbian economy

Serbia's annual inflation, as measured by the end-of-period Consumer Price Index ("CPI"), was 7.0 per cent. in 2011 and 10.3 per cent. in 2010. For the first nine months of 2012, the index was a further 3.3 per cent. higher than its level at 31 December 2011. The Government expects that the inflation rate will, therefore, exceed the National Bank's inflation target for 2012 of 4.0 per cent. (with a tolerance band of +/– 1.5 per cent.). The National Bank's target for 2013 is 4.0 per cent. (with a tolerance band of +/– 1.5 per cent.). The National Bank estimates that inflation will be slightly above 10.0 per cent. by the end of 2012. The ability of the National Bank to control inflation will depend on a number of political and economic factors. In 2010, 2011 and the first nine months of 2012, Serbia's inflation rate was subject to increases primarily driven by increases in food prices, petroleum product prices and regulated prices. See "*Monetary System – Inflation and Interest Rates*".

High and sustained inflation may lead to market instability, a financial crisis, additional expenditures on wages and social transfers, a reduction in consumer purchasing power and erosion of consumer confidence. Any of these events could lead to a deterioration in the performance of Serbia's economy, and, as a result, have an adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes, and adversely affect the trading price of the Notes.

The corporate sector may not be able to settle debts to domestic and foreign creditors, which could have a material adverse effect on the Serbian economy

Debt owed to domestic banks denominated in Dinar increased by 38.1 per cent. in the period from 2009 to 2011, largely in the form of loans indexed to foreign currencies, principally the Euro and the Swiss Franc. The failure of the corporate sector to generate sufficient revenue to service the relevant debt obligations may adversely affect the Serbian economy and the capacity of the Government to collect corporate tax revenues. This in turn could result in an increase in levels of unemployment in the private sector, thereby increasing the pressure on the system of social benefits required to be paid out of the Budget to the unemployed. A combination of all or some of these factors may lead to a further deterioration in public finances and may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

Corruption and money laundering may adversely affect economic and social conditions in Serbia, slow down or halt progress towards EU membership and have a material adverse effect on the Serbian economy

Corruption and money laundering have been identified as significant problems in Serbia. In Transparency International's 2011 Corruption Perceptions Index survey of 180 countries, Serbia was ranked 86th, down from 78th in 2010. In 2006, in an effort to combat corruption and restore public confidence in the judicial system, the Government adopted the National Judicial Reform Strategy and began a programme of judicial reform. The Law on Prevention of Money Laundering and Terrorist Financing came into force in March 2009. There can be no assurance, however, that these judicial reform measures will be fully implemented or that all of the provisions of the Law on Prevention of Money Laundering and Terrorist Financing will be effectively applied. In June 2011, the European Commission called on Serbian authorities to review the controversial privatisation and sale of 24 companies. The European Commission expressed doubts as to whether these privatisations were carried out in accordance with all applicable laws and in a transparent manner. Should any privatisation be found to have been undertaken illegally, the Government or the Privatisation Agency may choose to reprivatise the relevant company and/or pay compensation to affected parties. In addition, these and any further allegations or evidence of corruption or money laundering in Serbia may have a negative impact on Serbia's economy and reputation abroad, especially on its ability to attract foreign investment, and could slow down or halt progress toward EU membership. A combination of all or some of these factors may lead to negative effects on economic and social conditions in Serbia which may, in turn, lead to a further deterioration in public finances and a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

Serbia may not be able to refinance its debt on favourable terms, or might not be able to refinance it at all

Serbia has a significant level of Internal and External Public Debt. As at 30 September 2012, Public Debt amounted to approximately EUR 15.8 billion (RSD 1,823.5 billion), of which External Public Debt accounted for approximately EUR 9.1 billion (RSD 1,049.9 billion), while Internal Public Debt accounted for approximately EUR 6.7 billion (RSD 773.6 billion). In the past two years, Serbia has accumulated approximately EUR 2.9 billion (RSD 344.5 billion) of Public Debt (18.9 per cent. of debt stock) in Dinar denominated treasury securities with average maturity as at September 2012 of approximately one year. As a result of the short-term nature of much of this debt, there is a risk in relation to refinancing. Any deterioration in financing conditions, as a result of market, economic or political factors that are either beyond or within the control of the Government may have a material adverse effect on the ability of Serbia to service, repay or refinance its debt, including the Notes.

Official economic statistics may be less accurate or reliable than those produced in more developed countries

Although a number of government ministries, including the Ministry of Finance and Economy, the National Bank and the Office of Statistics, produce statistics relating to Serbia and its economy, there can be no assurance that these statistics are as accurate or reliable as those produced by the relevant bodies in more developed countries. Potential investors in the Notes should be aware that the data on Serbia's GDP and other data referred to in this Prospectus may not have been prepared in accordance with international standards and/or to the same degree of accuracy as equivalent statistics produced by the relevant bodies in more developed countries.

In addition, the accuracy of statistical data can vary from one institution to another or from one period to another, due to various factors, including different methodologies having been applied. In this Prospectus, the data is presented as having been provided by the relevant responsible ministry to which it relates, and there has been no attempt to reconcile this data with the data collected by other ministries or other organisations, such as the IMF or World Bank. See "*Presentation of Economic and Other Information*".

The existence of a substantial unofficial or unrecorded economy may also affect the accuracy and reliability of statistical data. Potential investors should also be aware that none of the statistical data presented in this Prospectus has been independently verified.

Deterioration in Serbia's relations with its major energy suppliers, restricted energy supplies or increases in the price of oil or natural gas may have adverse effects on the Serbian economy

Serbia's economy depends on trade flows with certain other countries largely because Serbia imports a significant percentage of its energy requirements. Serbia imported 32.0 per cent. of its energy requirements in 2011. If bilateral trade relations with Serbia's major energy suppliers were to deteriorate or if supplies of oil or natural gas to Serbia were to be restricted, Serbia's economy could be adversely affected. In addition, an increase in the price of oil or natural gas could adversely affect Government finances and/or the pace of economic growth of Serbia. In 2011, oil prices in Serbia increased by 13.4 per cent. compared to 2010. Government finances could be adversely affected if the Government subsidises energy prices against increases in oil or natural gas prices. Any changes in relations with major energy suppliers to Serbia, restricted energy supplies or increases in the price of oil or natural gas could lead to a deterioration in the performance of Serbia's economy, and, as a result, have an adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes.

The legal system of Serbia is not fully developed and therefore involves greater risk and uncertainty than in other more developed legal systems

Since 2000, the legal system of Serbia has been undergoing continuing reforms and, therefore, involves greater risk and uncertainty than countries with more developed legal systems. In particular, the risks associated with the legal system of Serbia include: (i) the risk of potential mismatch between the Constitution and other laws and regulations of the Government; (ii) the risk of ambiguous or imprecise provisions of laws and regulations, which may result in difficulty and uncertainty in their implementation

and interpretation; and (iii) difficulties in predicting the outcome of legal cases. These and other factors influencing the legal system of Serbia may make an investment in the Notes subject to risks which may not apply to debt securities issued by countries with more developed legal systems.

A claimant may not be able to enforce a court judgment against certain assets of Serbia in certain jurisdictions

It may not be possible to effect service of process against Serbia in courts outside Serbia or in a jurisdiction to which Serbia has not explicitly submitted and the choice of jurisdiction of a foreign court (including English courts) in contractual agreements may be held to be invalid by a Serbian court in certain circumstances. It may not be possible to enforce foreign court judgments in the courts of Serbia, including English court judgments, against Serbia that are predicated upon the laws of foreign jurisdictions without a re-examination of the merits of such judgments in the Serbian courts, although a re-examination of the merits of a judgment will generally not be conducted according to the applicable law.

Serbia is a sovereign state and there is a risk that, notwithstanding the limited waiver of sovereign immunity by Serbia pursuant to the Conditions of the Notes, a claimant will not be able to enforce a court judgment against certain assets of Serbia (including the imposition of any arrest order or attachment or seizure of such assets and their subsequent sale) in certain jurisdictions (including Serbia) without Serbia having specifically consented to such enforcement at the time when the enforcement is sought. See "*Terms and Conditions of the Notes – Governing Law and Jurisdiction*". In addition, certain state-owned assets are statutorily exempt from court enforcement procedures within Serbia. Specifically, Serbia has not waived any immunity in respect of present or future: (i) "premises of the mission" as defined in the Vienna Convention on Diplomatic Relations signed in 1961; (ii) "consular premises" as defined in the Vienna Convention on Consular Relations signed in 1963 or otherwise used by a diplomat or diplomatic mission of Serbia or any agency or instrumentality thereof; or (iii) military property or military assets or property or assets of Serbia relating to any of the assets referred to in (i) and (ii).

Factors which are Material for the Purpose of Assessing the Market Risks Associated with the Notes

Collective action clauses

The Notes contain provisions regarding acceleration and voting on amendments, modifications, changes and waivers, which are commonly referred to as "collective action clauses". Under these provisions, certain key provisions of the Notes may be amended, including the maturity date, interest rate and other payment terms, with the consent of the Issuer and defined majorities of Noteholders. Each such amendment will be binding on all Noteholders, whether or not they voted in favour of such amendment or at all. See "*Terms and Conditions of the Notes – Meetings of Noteholders and Modification*".

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35.0 per cent. The transitional period is to terminate following the conclusion of certain other agreements relating to information exchange with certain other countries.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding measures) in relation to payments made by a person within their jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment is made or collected through a Member State that has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Agent (as defined in the Conditions) nor any other person is obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Under the Conditions, the Issuer is required to maintain an Agent in a Member State that would not be obliged to withhold or deduct tax pursuant to the EU Savings Directive.

Risks Related to the Notes Generally

Modification, waivers and substitution

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to authorise amendments to the Conditions so as to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. Such amendments may include a reduction or cancellation of the principal or other amounts payable under the Notes, amendment of the Events of Default, status, currency or payment dates in respect of the Notes and the modification or cancellation of the Deed of Covenant.

Governing law

The Conditions are based on English law in effect as at the date of this Prospectus. There can be no assurance as to the impact of any possible judicial decision or change in English law or administrative practice after the date of this Prospectus.

Pari passu securities

Any new securities issued by Serbia will rank equally in right of payment with the Notes. The issue of new securities may reduce the amount investors may recover in respect of the Notes in certain scenarios as the incurrence of additional debt could affect Serbia's ability to repay the principal of, and make payments of interest on, the Notes.

Risks Related to the Market Generally

The secondary market generally

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid, which may have a severely adverse effect on the market value of the Notes. The market for the Notes will be influenced by economic and market conditions in Serbia and, to varying degrees, interest rates, currency exchange rates and inflation rates in other countries, such as the United States and the Member States of the EU. In addition, liquidity may be limited if the Issuer makes large allocations to a limited number of investors. If the Notes are traded after their initial issuance, they may trade at a discount to their offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions, the political, economic or financial condition of Serbia or other factors. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Notes in U.S. Dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "Investor's Currency") other than U.S. Dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of U.S. Dollars or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to U.S. Dollars would decrease (1) the Investor's Currency equivalent yield on the Notes, (2) the Investor's Currency

equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Credit ratings may not reflect all risks

The credit rating(s) assigned to the Notes at any time may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the assigning ratings organisation at any time.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

USE OF PROCEEDS

The net proceeds of the issue of the Notes will be used for general Budget purposes (including, without limitation, repayment of outstanding indebtedness).

DESCRIPTION OF SERBIA

Geography and Population

Serbia is located in the central part of the Balkan Peninsula and occupies an area of approximately 88,361 square kilometres. By virtue of its geographic position, it controls some of the major land routes between Western Europe and Turkey and the Near East. The roads through its river valleys make up the shortest link between Western and Central Europe, on the one side, and the Middle East, Asia and Africa, on the other. Serbia is bordered by eight other countries: to the East by Bulgaria, to the North East by Romania, to the North by Hungary, to the West by Croatia, Montenegro, and Bosnia and Herzegovina and to the South by Albania and Macedonia.

Serbia consists of 29 administrative districts as well as two autonomous provinces (“AP”), Vojvodina in the north and Kosovo and Metohija in the south. Belgrade is the capital city and the administrative, economic and cultural centre of Serbia, and is where the Government and its agencies are located.

As of the date of the last census in 2011, Serbia had a total population of approximately 7.1 million (excluding Kosovo). The highest population concentration is in Belgrade, with approximately 1.6 million people, representing approximately 23.0 per cent. of the national total, according to the most recent census. Other cities have much smaller populations.

As of the 2002 census, the majority (approximately 83.0 per cent.) of the population were ethnic Serbs. There are approximately 37 other nationalities within Serbia. Other ethnic groups include Hungarians, Bosnians, Roma, Croats and Albanians.

The official language of Serbia is Serbian, with Cyrillic writing. A significant majority of the population speaks Serbian, with Albanian being spoken in Kosovo and Hungarian being spoken in Vojvodina. The main religion in Serbia is Orthodox Christianity. The Serbian Orthodox Church became autocephalous in 1219 and has played a large role historically in the evolution of national Serbian identity. Romanians, Bulgarians and a majority of the Roma population are also Orthodox Christian, although other religious communities exist in Serbia, including Islamic, Catholic, Protestant and Jewish communities.

Historical Background

The first Serbian medieval state was created in 1170 by Stefan Nemanja, whose son was canonised as St. Sava, the patron saint of the Serbian Orthodox Church. During the reign of Stefan Prvovencani, Serbia

became an independent kingdom in 1217, which reached the peak of its power in 1346 as the Empire of Tsar Stefan Dusan.

The Osmanli Turks defeated the Serbian army at the Battle of Kosovo in 1389 and imposed their rule over Serbia after the fall of Smederevo in 1459. From 1459 to 1804, Serbia was under the direct rule of the Osmanli Empire and the Austro-Hungarian Empire. In the First Serbian Uprising (1804-1813), led by Karadjordje Petrovic, Serbia sought independence from Turkish rule. The Serbian rebels briefly developed an independent state, but this was soon taken back under control by Turkish forces. The Second Serbian Uprising occurred two years later under the leadership of Milos Obrenovic. Under the Sultan's Edict of 1830, Serbia was granted autonomy and became a vassal principality of the Turkish Osmanli Empire with Milos Obrenovic as its hereditary prince. On 15 February 1835, Serbia adopted a constitution defining it as an independent principality ruled by the Obrenovic Dynasty. The Obrenovics ruled until the May Coup in 1903 (except for a brief period from 1848-1858), when King Aleksandar Obrenovic was assassinated and the Karadjordjevic Dynasty took power.

In 1867, the last Osmanli troops left Serbia and it became *de facto* independent. At the Congress of Berlin in 1878 the international community recognised Serbia's independence. In 1882 Serbia became a kingdom during the rule of Milan Obrenovic. Serbia then expanded its territory to the south after its victory against the Ottoman Empire in the First Balkan Wars in 1912.

During World War I, Serbia was occupied by Austro-Hungarian and Bulgarian forces. After the war, the collapse of the Austro-Hungarian Empire led to the formation of the Kingdom of Serbs, Croats and Slovenians on 1 December 1918 (renamed Yugoslavia in 1929) with the Karadjordjevics as the ruling dynasty, which consisted of Serbia, Montenegro and the former South Slavic provinces of the Austro-Hungarian Empire. During World War II, various parts of Yugoslavia were occupied by Germany, Italy, Hungary and Bulgaria. Following the end of the war, Bosnia and Herzegovina, Macedonia and Montenegro were given separate and equal republican status within the new socialist federation of Yugoslavia. A Yugoslav communist regime, led by Marshall Tito, then ruled Yugoslavia for more than four decades.

The 1980s coincided with the growing separatist and nationalist tensions emerging in Yugoslavia. In 1987, Slobodan Milosevic came to power and dismissed the separatist leadership of the Socialist Autonomous Province of Kosovo. Between 1991 and 1992, Slovenia, Croatia, Bosnia and Herzegovina, and Macedonia seceded from Yugoslavia. The two remaining republics, Serbia and Montenegro, declared a new state, the Federal Republic of Yugoslavia ("FRY"), in 1992. In 1997, the Kosovo Liberation Army ("KLA"), a Kosovan Albanian organisation, initiated a campaign against FRY security forces seeking the separation of Kosovo from the FRY, leading to a war between the FRY security forces and the KLA which lasted from 1998 to 1999. As a result, the North Atlantic Treaty Organisation ("NATO") intervened in March 1999, sponsoring a campaign of bombing (the "NATO bombing campaign") in the FRY that lasted 79 days, from March to June 1999. In June 1999, the mandate of the United Nations Interim Administration Mission in Kosovo ("UNMIK") was established by the United Nations Security Council pursuant to its Resolution 1244 ("UN Resolution 1244"), and the NATO bombing campaign ceased. Prior to the NATO bombing campaign, many European countries severed relations with Serbia. However, relations were re-established with many of these countries after federal elections in 2000.

On 5 October 2000, President Milosevic conceded defeat in federal elections, largely due to Serbian protests in support of the opposition party, Democratic Opposition of Serbia, led by Vojislav Kostunica, who then became President, and Zoran Djindjic, who was elected Prime Minister in December 2000.

In 2002, the former FRY government established a commission to assist in co-operation with the International Tribunal for the former Yugoslavia ("ICTY") under Resolution 827 of the U.N. Security Council. The commission began serving arrest warrants for those seeking refuge in Serbia who had been indicted for war crimes during the Yugoslav conflict in the 1990s. See "*Description of Serbia – Foreign Relations – Co-operation with the ICTY*".

In March 2002, each of Serbia and Montenegro signed the Belgrade Agreement, creating a joint State Union of Serbia and Montenegro (the "State Union"). The State Union's Constitutional Charter was ratified on 4 February 2003. The Belgrade Agreement provided for each of Serbia and Montenegro to hold a referendum

on whether to maintain the State Union three years after its creation. In May 2006, Montenegro voted for full independence by a majority of 55.4 per cent. of participating voters. Montenegro declared its independence on 3 June 2006. Serbia declared independence two days later on 5 June 2006, completing the dissolution of the State Union.

Upon Serbia's re-emergence as an independent state, the Assembly changed the name of the country to the Republic of Serbia. A referendum was held on 28-29 October 2006 to approve the new Constitution of Serbia (the "Constitution"), which came into force on 8 November 2006.

On 17 February 2008, the Kosovan Assembly (with 10 representatives of the Kosovo Serb community and one representative of the Kosovo Guarani community abstaining) issued a declaration of Kosovo's independence from Serbia purporting to establish the Republic of Kosovo. In early 2008 Serbia severed diplomatic relations with certain countries who formally recognised Kosovo as an independent state (including the United States, Canada, Australia and Japan, as well as several member states of the EU), but all of these diplomatic relationships have since been reinstated.

On 22 July 2010, following an application made to it by Serbia, the International Court of Justice ruled that the adoption of the declaration of independence of 17 February 2008 did not violate any applicable rule of international law because general international law contains no applicable prohibition of declarations of independence and the declaration was not issued by the Provisional Institutions of Self-Government of Kosovo (the local administrative bodies in Kosovo established by UNMIK), nor was it an act intended to take effect, or actually taking effect, within the legal framework under which those Provisional Institutions operated, and, therefore its authors were not bound by the framework of powers and responsibilities established to govern the conduct of those Provisional Institutions. The court explicitly did not address the legal consequences of the declaration, nor whether Kosovo had achieved the status of an independent state.

The Government has declared itself committed to the legal and political defence of Serbia's sovereignty in Kosovo. EU-sponsored, and UN-supported, dialogues between Belgrade and Pristina on a number of issues such as the civil registration of citizens of Kosovo, acceptance of academic diplomas, customs stamps and border management and telecommunications matters began in March 2011 but stalled in the wake of border disputes in autumn 2011 and Serbia's recent elections. Belgrade and Pristina resumed their dialogue in the autumn of 2012, and the most recent discussion between Belgrade and Pristina took place on 7 November 2012. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Economic and political factors may make an investment in Serbia riskier than investing in a more developed country*".

The Constitution and Government Structure

The Constitution defines Serbia as an independent state for the first time since 1918 and also establishes the autonomy of its two administrative provinces, Vojvodina and Kosovo and Metohija. The Constitution specifies the President as the Commander-in-Chief of Serbia's armed forces and grants full independence to the National Bank.

The Constitution divides power between (i) the executive branch, comprising the Government and the President, (ii) the legislative branch and (iii) the judicial branch. The three branches have separate but equal powers and the judiciary is fully independent.

Executive Branch

The Government

The Government is led by the Prime Minister who has a mandate, subject to approval by a majority vote of the Assembly, to determine the composition of the Government, which is made up of Deputy Prime Ministers and Ministers. Among its main roles, the Government proposes laws to the Assembly for adoption, expresses its opinion about laws proposed to the Assembly by other bodies, directs, co-ordinates and monitors the work of state administrative bodies, adopts regulations and other general acts necessary for the enforcement of laws and is responsible for the enforcement of law. The Government is accountable to the Assembly and is required to submit a report at least once a year, either upon the request of the Assembly or of its own initiative.

In the most recent parliamentary elections held on 6 May 2011, the coalition led by the Serbian Progressive Party received the largest number of votes, winning 73 seats in the Assembly, but this was not enough to form a majority government. Following agreement reached after the election, a governing coalition led by the Serbian Progressive Party, the Socialist Party of Serbia and the United Regions of Serbia (the "Coalition") was formed. The Coalition took office on 27 July 2012 with Ivica Dacic as Prime Minister and includes the Serbian Progressive Party, the Socialist Party of Serbia, the Party of United Pensioners of Serbia, the United Serbia Party, the United Regions of Serbia, the Social Democratic Party of Serbia, the New Serbia Party and the Party of Democratic Action of Sandzak. See "*– Legislative Branch – The Assembly*".

The following table lists the current principal officials of the Government:

Name	*Position*	*Party*
Ivica Dacic	Prime Minister and Minister of Interior	Socialist Party of Serbia
Aleksandar Vucic	First Deputy Prime Minister and Minister of Defence	Serbian Progressive Party
Rasim Ljajic	Deputy Prime Minister and Minister of Foreign and Home Trade and Telecommunication	Social Democratic Party of Serbia
Jovan Krkobabic	Deputy Prime Minister and Minister of Labour, Employment and Social Policy	Party of United Pensioners of Serbia
Verica Kalanovic	Deputy Prime Minister and Minister of Regional Development and Local Self-Government	United Regions of Serbia
Mladjan Dinkic	Minister of Finance and Economy	United Regions of Serbia
Ivan Mrkic	Minister of Foreign Affairs	Appointed on recommendation of the Serbian Progressive Party
Nikola Selakovic	Minister of Justice and Public Administration	Serbian Progressive Party

Source: The Government.

The new Government comprises 17 ministries and certain changes in the structure of the current Government have been made. In particular, the Ministry of Finance and the economic function of the Ministry for Economy and Regional Development were merged into the Ministry of Finance and Economy. The Ministry of Public Administration and Local Self-Government was divided, with the local self-government function merging with the regional development function of the former Ministry of Economy and Regional Development to form the Ministry of Regional Development and Local Self-Government and the public administration function merging with the Ministry of Justice to form the Ministry of Justice and Public Administration. The ministries responsible for infrastructure projects will be the Ministry of Transport, the Ministry of Construction and Urbanism, the Ministry of Energy, Development and Protection of Environment and the Ministry of Natural Resources, Mining and Spatial Planning. Education and research and development will be the responsibility of the Ministry of Education, Science and Technological Development and the Ministry of Youth and Sport. The new Ministry of External and Internal Trade and Telecommunication took over part of the responsibilities from the former Ministry of Economy and Regional Development. The Office for Kosovo and Metohija is a separate office of the Government.

The President

The President of Serbia is elected for a five-year term and may not serve more than two terms under the Constitution. The President is the Commander-in-Chief of Serbia's armed forces and, following the election of a new Government, proposes a candidate for Prime Minister to the Assembly. The President has authority to: (i) with a written explanation, return a proposed law to the Assembly for further consideration if he deems that the law does not accord with the Constitution or conflicts with ratified international treaties or generally accepted rules of international law; that relevant law-making procedures were not followed; or that the law does not regulate the relevant matter in the appropriate manner; (ii) dismiss the Assembly, if proposed by the Government; (iii) declare laws by decree; (iv) post and recall ambassadors; (v) appoint, promote and dismiss officers of Serbia's armed forces; and (vi) pardon criminals.

The most recent presidential election was held on 6 May 2012. The Serbian Progressive Party candidate, Tomislav Nikolic, won 25.0 per cent. of the total vote and the Democratic Party candidate and incumbent president, Boris Tadic, won 25.3 per cent. of the total vote. Since neither candidate won a majority of the total vote, a second round of voting was held on 20 May 2012 in order to decide between the first and second ranked candidates. In this second round, Tomislav Nikolic won 50.2 per cent. of the vote and was duly elected President.

The next presidential election is due to be held in May 2017.

Legislative Branch

The Assembly

The Assembly is the unicameral parliament of Serbia and consists of 250 deputies elected in direct elections to serve four-year terms. Under the Constitution, parliamentary elections are required to be called by the President 90 days before the end of the Assembly term, in order that the elections may be held within the following 60 days.

The Assembly elects the Government and is responsible for the following appointments: (i) the Governor and Vice-Governors of the National Bank and the Governor's Council as well as the Director of FISA; (ii) Serbia's Ombudsman (responsible for protecting the rights of citizens and monitoring administrative institutions, agencies and legal entities entrusted with public power); (iii) Constitutional Court judges and other members of the judiciary. The Assembly makes a final decision on the election or dismissal of judges and public prosecutors but it only acts upon the recommendation of the recently established High Judicial Council and High Prosecutorial Council (see "– *The Judiciary – Judicial reform*"), court presidents and public prosecutors. The Assembly also has the authority to proclaim a state of war. Among its other constitutional and legislative powers, the Assembly: (i) passes laws, amendments and addenda to the Constitution; (ii) approves the Budget and annual financial statements; (iii) approves the state security and defence strategy; (iv) maintains civil control over the armed forces and state security services; and (v) ratifies international agreements pursuant to the Constitution.

In order to enact a law, the proposing person or entity is required to submit the draft law in the form in which the law is intended to be adopted together with an explanation of the law and a statement certifying that (i) the draft law has been harmonised with EU legislation, (ii) there is no obligation to harmonise the draft law with EU legislation or (iii) the draft law cannot be harmonised with EU legislation. In addition to this, the Government is considering enacting a requirement to include an estimate of the financial effects of any draft legislation submitted to the Assembly that may potentially increase the deficit.

The following table shows the number and percentage of seats in the Assembly held by each political party as at the date of this Prospectus. Members of the Coalition have 144 seats or 57.6 per cent. of the number of total seats.

Name of Party	*No. of seats*	*Share of total seats (%)*
Governing Coalition	144	57.6
Serbian Progressive Party	55	22.0
Socialist Party of Serbia	24	9.6
Party of United Pensioners of Serbia	12	4.8
G17+	10	4.0
Social Democratic Party of Serbia.	9	3.6
United Serbia	8	3.2
New Serbia	7	2.8
Party of Democratic Action of Sandzak	2	0.8
Other members	17	6.8
Others	106	42.4

Name of Party	No. of seats	Share of total seats (%)
Democratic Party	48	19.2
Democratic Party of Serbia	21	8.4
Liberal Democratic Party	11	4.4
League of Social Democrats of Vojvodina	5	2.0
Alliance of Vojvodina Hungarians	5	2.0
Serbian Renewal Movement	4	1.6
Other	12	4.8
Total	250	100

Source: The Assembly.

The Judiciary

Judicial system

Article 4 of the Constitution provides that the Serbian courts are bound by the law and the Constitution. Judicial independence is secured by the division of power between the legislative, executive and judicial branches of government.

Serbia has a Continental law system with an appellate judicial system. The judiciary is divided into courts of general and special jurisdiction. Courts of general jurisdiction comprise the Supreme Court of Cassation, appellate courts, high courts and basic courts. Courts of special jurisdiction comprise commercial courts, the Commercial Appellate Court, misdemeanour courts, the High Misdemeanour Court and the Administrative Court. In addition, Serbia has a Constitutional Court and special panels for prosecuting war crimes and organised crime within the Belgrade district court.

The Supreme Court of Cassation is the court of highest instance and its functions include the uniform application of laws. With the establishment of the new appellate courts, the Supreme Court of Cassation functions as a court of cassation, rendering decisions on appeals issued by the appellate courts. The Supreme Court of Cassation also decides conflicts of jurisdiction between courts and requests for transfer of jurisdiction.

A new appellate structure organised around four courts of appeal came into effect on 1 January 2010. The courts of appeal are located in Belgrade, Kragujevac, Nis and Novi Sad. Decisions rendered by the high or basic courts in the first instance are reviewed and decided by one of these four appellate courts.

There are 34 basic courts and 26 high courts located throughout Serbia, which hear and decide cases in both civil and criminal matters. Basic courts are courts of first instance with jurisdiction over criminal offences punishable by a fine or up to 10 years of imprisonment (unless the offence falls under the jurisdiction of another court) and civil litigation (unless the subject of litigation falls under the jurisdiction of another court). The basic courts are also responsible for enforcement and non-litigious proceedings. High courts are courts of second instance hearing appeals of basic court decisions concerning motions to secure the presence of a defendant, decisions in civil disputes, judgments in cases of small monetary value and enforcement and non-litigious proceedings. High courts also decide conflicts of jurisdiction between basic courts and conduct extradition proceedings, enforce criminal judgments of foreign courts and decide cases concerning the recognition and enforcement of foreign court and arbitration proceedings (unless these fall under the jurisdiction of another court).

Specialised panels on war crimes and organised crime were established within the Serbian court system in July 2003. Following the conclusion of the Yugoslav conflict, the special panel on war crimes was established in order to decide cases concerning alleged crimes against humanity, violations of international law and related basic crimes. The special department on organised crime of the High Court in Belgrade has first instance jurisdiction over offences involving criminal conspiracies such as money laundering, human trafficking and extortion, as well as illicit trade in arms, ammunition and explosive substances. The special panel also has jurisdiction over cases related to the assassination of Prime Minister Zoran Djindjic in 2003.

The Administrative Court, established in January 2010 under Articles 13 and 89 of the Law on Organisation of Courts, has a seat in Belgrade and departments in Kragujevac, Nis and Novi Sad. Administrative cases concern matters such as customs, tax, inspections, pensions, elections, rights of prisoners and market monopoly cases. The Administrative Court conducts oral hearings in public session except where private session is required for reasons of national security, public order or morality or to protect the interests of juveniles or the privacy of the parties involved. The Supreme Court of Cassation hears appeals from decisions of the Administrative Court.

The commercial courts of Serbia are specialised courts having jurisdiction over a wide range of commercial matters, including copyright, foreign investment, unfair competition, maritime and other disputes arising out of commercial activity involving domestic and foreign entities. There are 16 commercial courts located throughout Serbia, and decisions from the commercial courts may be appealed to the Appellate Commercial Court in Belgrade, following which they may be further appealed to the Supreme Court of Cassation.

Serbia also has 45 misdemeanour courts and one High Misdemeanour Court with a seat in Belgrade and departments in Kragujevac, Nis and Novi Sad.

The Constitutional Court is an autonomous and independent state body responsible for protecting the constitution and laws as well as human rights and minority rights. It determines whether laws, regulations, and other normative acts promulgated by state bodies are in conformity with the Constitution, generally accepted principles of international law and ratified international treaties. It may also resolve conflicts of jurisdiction between courts and state bodies and between state bodies at the national, provincial and local levels. In addition, the Constitutional Court has jurisdiction to decide certain election-related disputes. The Constitutional Court consists of 15 judges elected and appointed in the manner prescribed by the Constitution and it conducts hearings in public session.

Judicial reform

Following the adoption of the National Judicial Reform Strategy on 25 May 2006, the Government has been engaged in a comprehensive effort to reform the judiciary in order to uphold the principles of separation of powers, promote legal certainty and strengthen the rule of law. This reform is part of the Government's broader efforts to modernise Serbia's legal framework to bring it in line with European and other international standards governing the protection of human rights and minority rights. In particular, in 2009, the Government adopted laws establishing the High Judicial Council and the State Prosecutorial Council (the "Councils") in order to ensure and guarantee the independence of judges and autonomy of public prosecutors, improve the process of electing judges and public prosecutors, and decide matters involving the transfer, suspension or dismissal of judges and public prosecutors. The High Judicial Council, made up of 11 members who are elected by the Assembly, makes recommendations to the Assembly regarding the election and dismissal of judges and otherwise acts to safeguard the autonomy of the courts and judges. Grounds for judicial dismissal may include commission of a major felony, negligent or unprofessional performance of duties and conviction for a criminal offence punishable with an unconditional prison sentence of a minimum of six months. The State Prosecutorial Council, also with 11 members who are elected by the Assembly, has a similar role in the election and dismissal of public prosecutors and deputy public prosecutors and guarantees their independence. An independent judicial budget was established in 2012, according to which the Councils propose the amount and structure of budgetary funds needed by the courts and public prosecutors' offices and oversee the disbursement of funds. A Judicial Academy was also established in 2009. The Judicial Academy provides initial and continuous professional education and specialisation for all members of the judiciary throughout their careers.

Moreover, in order to improve the effectiveness of the judicial system, reduce the backlog of court cases and expedite enforcement of judgments, on 5 May 2011, the Assembly adopted the Law on Public Notaries and the Law on Enforcement and Security, introducing notaries and bailiffs to the court system. In addition, a new Department for Judicial Professions was established to monitor the performance of new judicial professions and the Minister of Justice established two commissions for executing public notary and bailiff exams, respectively.

Additionally, an amended Civil Procedure Law and Criminal Procedure Code were adopted by the Assembly on 26 September 2011, each of which is meant to enhance the efficiency of the network of courts and expedite court procedures. For instance, the amended Criminal Procedure Code aims to decrease investigation time by replacing court-led investigations with prosecutorial investigations. Prosecutorial investigations have taken place in organised crime and war crime cases since 15 January 2012 and will begin for all other cases as of 15 January 2013. The amended Civil Procedure Law dictates that the court, together with the litigants, set up a time frame for hearings, taking of evidence and procedural activities in an effort to uphold the principle of trial within a reasonable time frame and reduce the length of civil proceedings. In March 2012, the Ministry of Justice established the Working Group for the application and implementation of the new Criminal Procedure Code comprising representatives of the prosecutors' offices, the courts, the Judicial Academy and the Ministry of Justice, as well as other lawyers, faculty and police.

In July 2012, the Constitutional Court overturned a review process, conducted by the Councils, of the re-appointment procedure carried out for judges and prosecutors in 2009 and 2010. The Constitutional Court ordered the reinstatement within 60 days of all judges and prosecutors that had appealed their non-reappointment. In line with EU recommendations, the Serbian authorities intend to evaluate how to further advance judicial reform, particularly in light of this ruling.

Regional Administration

Under the Law on Territorial Organisation passed by the Assembly in December 2007, Serbian territory is organised in three categories: autonomous provinces, municipalities and cities.

Serbia has two autonomous provinces: Vojvodina in the north and Kosovo and Metohija in the south. Vojvodina has 39 municipalities and six cities. The province has its own government, constituted by an executive branch as well as an Assembly. It enjoys autonomy on matters such as infrastructure, science, education and culture. Kosovo and Metohija has 28 municipalities and one city, Pristina. While according to the Serbian Constitution it remains part of Serbia, since June 1999, Kosovo and Metohija has been governed by UNMIK, established pursuant to UN Resolution 1244. Central Serbia, which contains 83 municipalities and 17 cities, is neither an autonomous province nor an administrative district and it does not have a separate regional authority.

There are 29 administrative districts in Serbia, each of which consists of several municipalities and cities. These administrative districts are regional centres of national authority and do not have any form of self-government.

Local government is primarily administered at the municipal and city level. Each municipality has its own president, municipal assembly and municipal council. Members of the municipal assembly are elected every four years in local elections. Once the assembly is elected, it will elect the president and council. Each city (except for Belgrade, which is considered a district) has a similar form of government to the municipal level, made up of a mayor and an assembly that adopts a separate city council.

Armed Forces

There are two branches of Serbia's armed forces: the air force and air defence, and the army. As of 1 January 2011, the armed forces had approximately 36,000 serving professional (as opposed to conscript) personnel. The Ministry of Defence budget for 2012 is RSD 55.5 billion (approximately 1.7 per cent. of nominal GDP), as compared to RSD 79.9 billion (approximately 2.4 per cent. of nominal GDP) in 2011.

The principal roles of Serbia's armed forces include: (i) deterring armed threats and other military challenges, risks and security threats; (ii) defending the territory, territorial waters and air space of Serbia; (iii) participating in international military co-operation under UN patronage and the system of joint security; and (iv) providing support in the case of natural disasters and catastrophes. Under the authority of the Ministry of Defence, the Supreme Defence Council determines the organisational structure and number of members of the armed forces according to need and with a view to maintaining international standards.

Foreign Relations

European Union

Serbia's main foreign policy objective is to become a member of the EU. The EU accession process follows a series of formal steps, from a pre-accession agreement to the ratification of the final accession treaty. These steps are primarily presided over by the European Commission, but the actual negotiations are conducted between EU member states and Serbia.

Before applying for membership, Serbia signed the Stabilisation and Association Agreement (the "SAA") with the EU on 29 April 2008 to help prepare it for candidacy and eventual membership of the EU. Upon signing the SAA, Serbia undertook to harmonise its national legislation with the EU's *acquis communautaire* and to apply it consistently. Serbia has successfully adopted many new legislative initiatives in order to harmonise its national legislation with EU standards. In October 2008, the Government finalised a National Programme for EU Integration. From July 2008 to June 2011, of 799 proposed regulations, 630 regulations were incorporated into national law. In particular, Serbia has focused on judicial reform guaranteeing judicial independence, prevention of organised crime and corruption and co-operation with the ICTY. In addition, fiscal and monetary harmonisation measures include implementation of monetary policy to control inflation and stabilise prices, strengthening the prudential framework to ensure stability of the financial sector, enhancing the system of international payment transactions in line with international rules and standards implementation of a system of consumer protection laws and standards, and continued liberalisation of capital flows.

On 14 July 2011, the Government adopted and implemented recommendations made in the Report on the Implementation of the Action Plan for fulfilment of priorities under the European Commission's Annual Progress Report and the plan for accelerating candidate country status. According to the report prepared by the European Integration Office, approximately 73.0 per cent. of the requirements of the Action Plan had been implemented. By March 2012, Serbia had adopted 80 per cent. of planned legal acts (816 of 1016 planned). Some important commitments that have been adopted are the Law on Public Property (which includes the property of autonomous provinces and local governments), the Restitution Law, an amended Civil Procedure Law and an amended Criminal Procedure Code (with certain provisions applicable only as of 15 January 2013).

On 22 December 2009, Serbia formally submitted its application for EU membership. When a country formally applies for membership, the Council of the European Union (the "EU Council") asks the European Commission to prepare an opinion on the country's readiness to begin negotiations. The EU Council can then either accept or reject the European Commission's opinion. On 25 October 2010 the EU Council formally forwarded Serbia's application for membership to the European Commission for consideration. The European Commissioner for Enlargement submitted the European Commission's Questionnaire to the Serbian Prime Minister and on 22 April 2011 Serbia sent the European Commission its final set of responses to the Questionnaire.

On 14 October 2011, the Commissioner for Enlargement and Neighbourhood Policy, Stephan Fule, visited Belgrade to present the European Commission's Opinion on Serbia's EU membership application. On the basis of the progress achieved in reforms, co-operation with the ICTY and regional reconciliation, the European Commission decided to recommend the granting of candidate status to Serbia upon an understanding that Belgrade re-engages in dialogue with Kosovo. On 12 December 2011, the EU Council welcomed the Commission's assessment and further noted the considerable progress Serbia has made towards fulfilling the accession political criteria. It was resolved that the EU Council would make a decision on granting Serbia candidate status in February 2012, after examining Serbia's progress in implementing in good faith agreements in its dialogue with Pristina. On 1 March 2012, the EU Council granted Serbia the status of an official candidate country to the EU, partly on the basis that Serbia had continued to show credible commitment and implement agreements reached in the dialogue with Kosovo, including on integrated border management. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Serbia may not become a member of the EU in the near to medium term or at all*". On 10 October 2012, the European Commission published its 2012 Progress Report on Serbia, which examined Serbia's progress in meeting certain political and economic criteria and its ability to take on the

obligations of EU membership. The European Commission's findings were positive in a large majority of the 33 "chapters" of law examined.

It may take several years of negotiation and further reform for Serbia to satisfy all requisite criteria for full EU membership. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Serbia may not become a member of the EU in the near to medium term or at all*". The EU Council will open negotiations on chapters for which it feels there is sufficient common ground to have constructive negotiations. The process from application for membership to full membership typically lasts close to 10 years, although some countries, notably Sweden, Finland and Austria, have gained EU membership in only a few years.

Serbia also has in place with the EU an Interim Trade Agreement (see "*External Sector – International Trade Agreements*") and further agreements concerning visa facilitation and readmission. Serbia's visa-free regime with the EU came into force on 19 December 2009. Under this regime, citizens of Serbia no longer need visas in order to travel to the 25 member states of the EU. However, an increase in the amount of asylum seekers from Serbia reaching EU member states has recently put some strain on this regime and increased the risk that it may be suspended.

Co-operation with the ICTY

The former FRY government established a commission to assist in co-operation with the ICTY in 2002. It began serving arrest warrants for those seeking refuge in Serbia who had been indicted for war crimes during the 1990's Yugoslav conflict. Co-operation increased substantially after the assassination of Prime Minister Zoran Djindjic in 2003 and several people surrendered to the ICTY in 2004 and 2005. Cooperation with the ICTY has remained productive and successful and there are currently no pending requests for assistance.

Of a total of 46 accused, whose extradition was requested by the ICTY, Serbia has extradited all except one person who died prior to extradition. Serbia completed its extradition obligations with the arrests of Bosnian Serb general, Ratko Mladic, and former Croatian Serb general, Goran Hadzic, in May and July 2011, respectively. The arrest of Goran Hadzic and Ratko Mladic was a positive development for the rule of law in Serbia and for its neighbouring countries.

United Nations ("UN")

Following the independence of Serbia and Montenegro upon the dissolution of the State Union, the Government confirmed that UN membership of Serbia and Montenegro in 2006 would be continued by Serbia. Serbia is a member of several UN bodies and specialised agencies and takes part in UN peace-keeping missions. Serbia seeks, through its UN participation, to make an appropriate contribution to safeguarding international peace and security; strengthening stability, confidence and co-operation; promoting partnerships and strategic relations; and protecting human rights in accordance with the United Nations Charter. Serbia also aims to affirm its sovereignty and territorial integrity in a manner consistent with status neutral framework as established under UN Resolution 1244.

As an active member of UN Education, Scientific and Cultural Organisation and Executive Board member from 2005 to 2009, Serbia focuses on cultural and scientific co-operation. Serbia has had an observer status in the European Organisation for Nuclear Research since January 2012. Serbia also became a member of the World Heritage Committee in 2011.

Former Minister of Foreign Affairs, Vuk Jeremic, was elected President of the 67th Session of the UN General Assembly, which is the highest office within the UN system ever held by a representative of Serbia. The term of office expires in September 2013.

World Trade Organisation ("WTO")

Serbia formally applied for accession to the WTO in December 2004. The General Council of the WTO established a working party to examine Serbia's application on 15 February 2005 (the "Working Party"). The Working Party held its twelfth and most recent meeting in respect of Serbia's application to join the WTO on 29 March 2012 and numerous bilateral consultations took place concurrently with this meeting. Serbia

has signed Bilateral Market Access Agreements on goods (including industrial and agricultural products) and services with the European Union, Honduras, Japan, Norway, the Republic of Korea, Canada and Switzerland. Bilateral market access negotiations remain in progress and Serbia expects to continue negotiations with certain member states, including the United States, in respect of agricultural products, and Ukraine, in respect of industrial and agricultural products and services. Serbia also expects to continue multilateral access negotiations, specifically in the area of genetically modified food.

The World Bank

Serbia maintains working relations with the World Bank. In the Doing Business 2013 report, released in October 2012, the World Bank and the International Finance Corporation included Serbia among the 10 global economies to have improved most on the ease of doing business over the past 12 months. Serbia has discussed with the World Bank potential reforms in the near- to medium-term, such as the adoption of amendments to the Law on Privatisation (discussed below), the creation of key performance indicators for public companies, labour market reform and mitigating social costs.

The Council of Europe

Serbia has been a member of the Council of Europe since 3 April 2003 and held a six-month Chairmanship of the Committee of Ministers of the Council of Europe in 2007. The Council of Europe consists of 47 member states across Europe, and seeks to develop common and democratic principles based on the European Convention on Human Rights and other conventions on the protection of the rights of individuals.

Euro-Atlantic Partnership Council ("EAPC")

Serbia is a partner state in EAPC along with 49 other states. EAPC acts as a multilateral forum for dialogue and consultation on political and security-related issues among NATO and partner states. It provides the overall political framework for NATO's co-operation with partner states in the Euro-Atlantic area and for the bilateral relationships developed between NATO and individual partner states under the Partnership for Peace programme.

Organisation for Security and Co-operation in Europe ("OSCE")

Serbia has maintained membership in the OSCE since 10 November 2000. According to the decision of the 18th OSCE Ministerial Council, Serbia will be the Chairman-in-office in January 2015. The OSCE is the world's largest regional security organisation with participation by 56 states from Europe, Central Asia and North America. The OSCE is a forum for political discussions and decision-making with a network of 17 field missions carrying out measures aimed at confidence- and security-building relating to early warning, conflict prevention, crisis management and post-conflict rehabilitation, among other things. The OSCE has a mission in Serbia and a mission in Kosovo.

Other regional relations

One of the most important priorities for Serbia's foreign policy agenda is to maintain good relations with neighbouring countries, as the Government believes that this co-operation safeguards and strengthens stability in the region and is likely to enhance Serbia's progress towards EU integration. Serbia participates in several important regional initiatives and organisations discussed below. In 2012, Serbia is expected to preside over regional initiatives such as the Central European Initiative, the Adriatic Ionian Initiative, the South-East Europe Co-operation Process and the Migration, Asylum and Refugees Regional Initiative. Serbia also chaired the Organisation of Black Sea Economic Co-operation from 1 January 2012 to 30 June 2012.

Russia

Serbia has developed a strategic political and economic relationship with Russia based on strong political ties at all levels of government between the two countries and successful co-operation in international and regional organisations such as the UN, OSCE and the Organisation of Black Sea Economic Co-operation. Russia is also one of Serbia's key trade partners and the two countries signed a bilateral free trade agreement in August 2000. See "*External Sector – International Trade Agreements*". Serbia has also developed solid

relations with Russia in the energy sector. In January 2008, Serbia and Russia signed the Agreement on Co-operation in the Oil and Gas Industry and in December 2008 the two countries signed a contract on the takeover of Naftna Industrija Srbije ("NTS"), the Serbian state-owned oil company, by Gazprom Neft. See "*Economy of Serbia – Privatisation Process*". In June 2010, Russia and Serbia agreed to a visa-free regime for business and tourist trips.

Broadened and intensified co-operation efforts are expected in exports to Russia. One of Russia's largest state-owned banks, Sberbank, has expressed readiness to invest an additional EUR 100 million in Serbian export companies by the end of 2012 and announced that it would provide assistance in attracting a strategic partner for Smederevo Steel Plant. Russia has recently agreed to lend Serbia U.S.$800 million for railway network projects and equipment procurement for Railways of Serbia in the medium-term. In addition, Sberbank recently bought Volks Bank International Group and became the owner of Volks Bank a.d. in Serbia.

Croatia

On 2 July 1999, the Republic of Croatia ("Croatia") filed an application against the FRY in the International Court of Justice (the "ICJ") in respect of a dispute concerning alleged violations of the Convention on the Prevention and Punishment of the Crime of Genocide (the "Genocide Convention"). The application invoked Article IX of the Genocide Convention as the basis of the jurisdiction of the ICJ. Serbia is legal successor to the FRY in this case. The ICJ found that it had jurisdiction in the case on 18 November 2008. Serbia filed its reply to Croatia's Memorial and submitted its Counter-Memorial on 4 January 2010, whereupon Croatia sent a response to the Counter-Memorial on 20 November 2010. Croatia filed its rejoinder, relating solely to Serbia's Counter-Memorial, thus ending the written phase of the proceedings. Unless an extra-judicial settlement is reached, an oral hearing on the case could be expected to be scheduled in 2014.

Central European Free Trade Agreement ("CEFTA")

On 19 December 2006 Serbia signed the Agreement on Amendment of and Accession to the Central European Free Trade Agreement between Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, Serbia and UNMIK (on behalf of Kosovo). The main objectives of the CEFTA are to expand trade in goods and services, foster investment by means of fair, stable and predictable rules, eliminate barriers to trade between parties, protect intellectual property rights in accordance with international standards and harmonise measures on modern trade policies such as competition rules and state aid. The CEFTA also includes clear and effective procedures for dispute settlement.

South-East European Co-operation Process ("SEECP")

SEECP was established in 1996 in order to promote stability, safety and co-operation in South-East Europe, and its member states comprise Serbia, Romania, Bulgaria, Greece, Turkey, Montenegro, Albania, Bosnia and Herzegovina, Macedonia, Croatia, Slovenia and Moldova. Serbia Chaired the Office of SEECP from 30 June 2011 to 30 June 2012. Priorities of this chairmanship include promoting European values in SEECP countries, prevention of organised crime, co-operation in overcoming the global financial and economic crisis and co-operation in culture, education and science.

Regional Co-operation Council ("RCC")

RCC was established on 27 February 2008 as the successor to the Stability Pact for South Eastern Europe. RCC works under the political guidance of SEECP with a focus on priority matters of economic and social development, energy and infrastructure, justice and home affairs, security co-operation and parliamentary co-operation. Goran Svilanovic's appointment as the new RCC Secretary General was endorsed at the Summit of Heads of State or Government of the SEECP Participating States held in Belgrade on 15 June 2012.

Central European Initiative ("CEI")

CEI is an initiative seeking to strengthen the capacities of non-EU countries to achieve cohesive economic and institutional development and to bring them in line with EU standards. The CEI Trust Fund at the EBRD,

supported by the Italian government, has committed financial support for CEI technical co-operation projects in Serbia in sectors such as energy efficiency and sustainable agriculture.

Migration, Asylum and Refugees Regional Initiative ("MARRI")

MARRI was established in 2003 with Albania, Bosnia and Herzegovina, Croatia, Montenegro, Macedonia and Serbia as its member states. MARRI aims to promote co-operation between its member states to achieve EU standards in relation to migration, asylum and refugees. Projects realised within the Initiative include the Programme for the Enhancement of Anti-Trafficking Responses in South Eastern Europe and the establishment of a network for co-operation among border police at international airports and border crossing points in MARRI member states.

Adriatic Ionian Initiative ("AII")

All was established in 2000. Its member states are Albania, Bosnia and Herzegovina, Croatia, Greece, Italy, Montenegro, Slovenia and Serbia. Its activities focus on tourism, culture and inter-university co-operation, transport and maritime co-operation, environmental protection and co-operation between small and medium-sized enterprises.

South-East Europe Co-operative Initiative ("SECI")

SECI is a regional initiative established in 1996 which focuses on trans-border co-operation programmes in infrastructure, trade and traffic, security, energy, environment and development of the private sector. SECI has a regional centre for the prevention and combating of cross-border crime located in Bucharest, Romania.

Southeast European Law Enforcement Centre ("SELEC")

SELEC was established in 1999. Signatory States to the SELEC convention are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Hungary, the Former Yugoslav Republic of Macedonia, Moldova, Montenegro, Romania, Serbia, Slovenia and Turkey. The objective of SELEC, within the framework of co-operation among competent authorities, is to provide support for member states and enhance coordination in preventing and combating crime, including serious and organised crime, where such crime involves or appears to involve an element of trans-border activity.

EU Strategy for the Danube Region ("EUSDR")

EUSDR is a macro-regional strategy adopted by the European Commission in December 2010 and endorsed by the European Council in 2011. The strategy was jointly developed by the Commission, together with the Danube Region countries and stakeholders, in order to address common challenges together. The strategy seeks to create synergies and coordination between existing policies and initiatives taking place across the Danube Region. Serbia adopted the decision to set up a working group for co-operation with the EUSDR on 24 September 2009. Serbia has been designated by the EUSDR to coordinate two priority areas in the Danube: (a) infrastructure: rail, road and air transport (together with Slovenia); and (b) science, knowledge and economy (together with Slovakia). These projects are in the process of being negotiated and are expected to be 85 per cent. financed through European Union grants and 15 per cent. financed by Serbia.

Other key bilateral relations

United States

Serbia has strengthened its relationship with the United States by deepening cooperation in all areas, including support by the United States of Serbia's EU membership. The United States is one of the largest foreign direct investors in Serbia and the trade exchange between Serbia and the United States is constantly on the rise. The United States' "Most Favoured Nation" status was restored to Serbia in 2003, and in 2005 Serbia was reinstated into the list of the Generalized System of Preferences (GSP). The United States and Serbia have strategic police and military cooperation arrangements to fight against organised crime and terrorism.

United Kingdom

Serbia and the United Kingdom have a good strategic political relationship and their economic cooperation is improving with Serbia's increased efforts to attract foreign investments from the United Kingdom. The United Kingdom and Serbia maintain continuing cooperation in the fight against organised crime and terrorism.

Germany

Germany is one of the major foreign trade partners and one of the leading investors in Serbia, in part through close economic cooperation between Serbia and the German provinces of Bavaria and Baden-Würtemberg. The German Development Bank (KfW) is funding a number of projects in Serbia.

Legal Proceedings

Serbia is a party to a number of legal proceedings mainly relating to commercial and investment disputes and foreign trade as well as claims against the Privatisation Agency.

ECONOMY OF SERBIA

Historical Economic Policy and Developments

In the 1990s, the Serbian economy was negatively affected by the disintegration of the unified Yugoslav market, the Yugoslav conflict, the NATO bombing campaign and the resulting sanctions imposed by the international community. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Economic and political factors may make an investment in Serbia riskier than investing in a more developed country*". The adverse effects of these events had a negative effect on GDP and industrial output and aggravated existing economic and social conditions. During this period, the Serbian economy was characterised by a decline in economic activity, hyperinflation, low domestic savings, insolvency in the banking sector, frozen foreign exchange deposits, unstable exchange rates, lack of confidence in the national currency, restrictive foreign trade trends, a non-transparent taxation system, a "grey" market economy, high unemployment and low living standards. In January 2001, the first democratic Government introduced economic stabilisation measures and embarked upon a programme of reforms to create a market-led economy, with its key stated strategic priority being to gain accession for Serbia to the EU. In line with this objective, Serbia sought to adopt an economic policy that would achieve economic stability, sustainable growth, increased levels of employment and living standards and uniform regional development. Economic reforms undertaken included Serbia's programme with the IMF, debt rescheduling, development of a privatisation model, increasing the country's foreign exchange reserves and reforms in the banking sector, as well as to the country's taxation and foreign trade systems.

The average annual rate of real GDP growth in the period from 2001 to 2008 was 4.9 per cent. driven primarily by the services sector, which is unusual for an emerging market country such as Serbia. Growth in the services sector resulted in a higher demand for imported goods as compared to the supply of goods for export.

In early 2000, inflation was relatively high by international standards. The growing fiscal deficit and levels of Public Debt also posed a threat to economic stability and growth. The national currency was consolidated and the exchange rate stabilised towards the end of 2000. The Government carried out an initial phase of stabilisation using the exchange rate as the nominal anchor for slowing inflation. A managed, flexible exchange rate regime was introduced, followed by the convertibility of current transactions pursuant to Article VIII of the IMF Articles of Agreement. As a result, inflationary expectations were lowered and inflation reduced considerably. The National Bank increased the level of foreign exchange reserves and began auditing transactions. This was followed by the bankruptcy and liquidation of certain large insolvent domestic banks and the entry of foreign banks into the Serbian banking market.

The Government introduced reforms to the public finance system at the beginning of the transition period in order to improve efficiency of the collection of revenue and control of money flows and public expenditures. Sales tax rates were unified when VAT was introduced on 1 January 2005.

Liberalisation of foreign trade in this period resulted in the abolition of the non-tariff barriers to imports, the reduction and simplification of customs rates and the simplification of foreign trade transactions. However, the average tariff rate remained higher than that in other countries in the region. On 28 August 2000, Serbia signed a free trade agreement with the Russian Federation and in November 2000, Serbia established preferential treatment for trade with EU member states. Several years later, in October 2007, Serbia established free trade with other countries in the region, including Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova and Montenegro.

In 2005, the Government introduced a new labour law (the "Labour Law") providing more flexibility in the formal labour market and a more effective employment policy. It reformed the pension and disability insurance system to provide for regular payment of pensions and payment of accumulated arrears. In addition, a voluntary pension insurance system was introduced by the adoption of the Law on Voluntary Pension Funds and Pension Schemes in September 2005.

As a result of the first decade of transition to a market-based economy, the Government believes that Serbia has made significant progress in adopting a "first generation" of financial sector reforms. However, in light

of the macroeconomic trends and the overall macroeconomic environment, as well as its aim to achieve EU accession, the Government believes that Serbia must continue to work towards creating an attractive environment for domestic and foreign investment, providing for full protection of property and contractual rights, modernising its taxation system, developing relations between the private and public sectors, especially in the infrastructure sector, improving the management and transparency of public enterprises, increasing labour market flexibility to support private sector job creation, improving relations between employers and employees, curbing corruption and reforming the public sector and banking system to make them more efficient. However, certain initiatives were delayed or suspended due to the onset of the global financial crisis in late 2008.

The following table shows key indicators of economic development for the years 2007 to 2011 and the nine months ended 30 September 2012:

	Year ended 31 December					*Nine months ended 30 September (unless otherwise indicated)*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
Nominal GDP (EUR billions) [1][2]	28.5	32.7	29.0	28.0	31.1	14.1[9]
Real GDP growth (%)[2]	5.4	3.8	(3.5)	1.0	1.6	(1.6)[9]
End of year retail price increase (%)	10.1	6.8	6.6[10]	10.3[10]	7.0[10]	9.6[10]
Trade balance (% of GDP)[2][3]	(24.8)	(26.0)	(17.7)	(17.0)	(17.7)	(18.9)
Current account deficit (% of GDP)[1][2]	(17.7)	(21.6)	(7.2)	(7.4)	(8.9)	(11.5)
Net FDI (EUR billions)[4]	1.8	1.8	1.4	0.9	1.8	(0.1)
FDI (% of GDP)[2]	6.4	5.6	4.7	3.1	5.9	–
Average rate of employment (Y-O-Y)(%)[5]	(1.1)	(0.1)	(5.5)	(4.9)	(2.8)	(1.3)
Real growth in average net wage (%)	19.5	3.9	0.2	0.7	0.2	3.2
Labour productivity real growth (%)	6.6	3.9	2.1	6.2	4.5	(0.3)
ILO unemployment rate (persons of age 15 and over)(%)[6]	18.8	13.6	16.1	19.2	23.0	25.5[12]
Registered unemployment rate[7]	29.8	27.5	28.2	29.2	30.1	30.6
Public spending consolidated financial statement balance (% of GDP)[2]	(2.0)	(2.6)	(4.5)	(4.7)	(5.0)	–
Foreign debt (EUR billions)[8]	17.1	21.1	22.5	23.8	24.1	24.2[11]
Foreign debt (% of GDP)[2]	60.2	64.6	77.7	84.9	77.5	79.0[9]
Foreign debt/goods & services exports (%)	197.3	207.6	265.3	236.2	210.3	208.8[11]

Source: Office of Statistics; National Bank.

Notes:

(1) Recalculated by the Ministry of Finance and Economy based on the average RSD/EUR, RSD/U.S.$ or U.S.$/EUR exchange rate, as relevant, for the relevant period. See "*Exchange Rate History*".

(2) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "– *Gross Domestic Product*".

(3) Imports and exports of goods are presented as free on board (F.O.B.).

(4) As of 1 January 2007, the National Bank records foreign exchange remittances as current account inflows. On this basis, it has adjusted the ratio of current account deficit to GDP for the years 2007 and 2008.

(5) In March 2009, the Office of Statistics adjusted the rate of employment as at January 2009 due to, among other things, the Office of Health Insurance records being updated.

(6) According to International Labour Organisation Methodology. See "*Labour Market and Social Policy – Employment*" for a discussion of this methodology.

(7) According to "registered unemployment" rate. See "*Labour Market and Social Policy – Employment*" for a discussion of this methodology.

(8) The foreign debt statistics methodology was changed in September 2010 in order to include as external Public Debt obligations under the IMF Special Drawing Rights allocation (EUR 472.2 million) as well as capitalised interest to Paris Club creditors (EUR 51.0 million) and to exclude from external debt the private sector loans concluded before 20 December 2000, under which the payments have not been made (EUR 913.5 million, of which EUR 428.7 million relates to domestic banks and EUR 484.8 million to domestic enterprises). Preliminary data as of 31 August 2012.

(9) Figures are presented for the first six months of 2012 because nine-month data is not available.

(10) In January 2009, the Office of Statistics began using the Consumer Price Index as its main measure of inflation rather than the Retail Price Index, which was previously used.

(11) Figures are presented for the first eight months of 2012 because nine-month data is not available.

(12) Labour Force Survey, April 2012.

Macroeconomic Policy

The global financial and economic crisis which began in the second half of 2008 resulted in a decline in domestic and export demand and an overall reduction in output and trade. The crisis also impeded access to foreign capital, slowed the lending activity of banks, reduced spending and investment in the private sector and resulted in an increased number of corporate insolvencies. In the period from the end of 2008 to mid-2012, the Government and the National Bank implemented a programme of measures intended to alleviate these consequences, to protect the Serbian economy, banking system and free market and to attempt to ensure that the burden imposed by the crisis was distributed in order to protect impoverished segments of the population. These measures included, among others:

- in October 2008, when the first effects of the global financial and economic crisis began to be felt in Serbia, the Government and the National Bank introduced a series of measures aimed at strengthening Serbia's financial and macroeconomic stability and mitigating the effects of the crisis. These measures implemented by the National Bank were primarily aimed at improving the liquidity of banks, reducing currency risk exposure and mitigating depreciation and inflationary pressures (see "*Monetary System – Monetary Policy*");

- in January 2009, the IMF Management and Executive Board approved a 15-month stand-by arrangement to support Serbia's economic programme aimed at maintaining macroeconomic and financial stability. In May 2009, the IMF Management and Executive Board agreed to increase its financial support and extend the stand-by-arrangement by one year to mid-April 2011. Further performance reviews were completed in December 2009 and March, June, September and December 2010, with the IMF making additional special drawing rights available in each instance. Serbia only drew down 1,367.7 million special drawing rights (approximately EUR 1.5 billion or U.S.$2.1 billion), which amounted to 52 per cent. of the total amount available to Serbia under the stand-by-arrangement(see "*Public Debt – Multilateral and Bilateral Development Organisations*");

- in March 2009, the Government adopted the Plan for Economic Stability of Serbia and allocated funding of EUR1.2 billion to implement the Plan. In late April 2009, on the recommendation of the Government, the Assembly adopted a revised 2009 Budget, which provided for a reduction of approximately RSD100.0 billion (EUR1.05 billion) in public spending, with the main fiscal policy change being the freezing of public sector wages and pensions during 2009 and 2010, affecting approximately 725,000 public sector employees and approximately 1.6 million pensioners, as well as a significant reduction in a number of other categories of public expenditure;

- the IMF's approval of credit arrangements including a programme of measures seeking to maintain investor and market confidence made it possible for the Government to similarly secure considerable additional financial support from other international financial organisations, such as the World Bank, EBRD and the EU, as well as bilateral financial support to fund the Budget and infrastructure projects (see "*Public Debt – Multilateral and Bilateral Development Organisations*");

- in mid-April 2009, an agreement was reached in Vienna with the largest foreign banks operating in Serbia (the "Vienna Initiative") under which they agreed to maintain their level of exposure in Serbia as of December 2008 until the end of 2010 (see "*Monetary System – Banking Sector – The Vienna Initiative*");

- in June 2009, the Government implemented a plan for the maintenance of social security for newly unemployed persons who lost their jobs during the global financial and economic crisis through the Budget Fund for Resolving Problems Caused by the Negative Effects of the World Economic Crisis. This fund was financed by a 10.0 per cent. tax on the wages of public sector employees who earned RSD 40,000 to RSD 100,000 monthly and a 15.0 per cent. tax on the wages of public sector employees who earned more than RSD 100,000 monthly;

- in October 2009, the Government implemented a plan for subsidising housing credits according to which the Government provided housing credits of up to 20.0 per cent. of real estate value to citizens earning salaries less than RSD 120,000. The Government loans were provided at 0.0 per cent. interest and the borrower is obliged to repay after 20 years in five-year instalments;

- in March 2010, a decision of the National Bank with respect to obligatory reserves came into force adopting a new reserve rate in order to stimulate bank lending activities as well as improve levels of deposits and foreign borrowing. The base for the calculation of required reserves was modified so that the Dinar base would include only non-indexed liabilities, while the base of foreign currency liabilities was extended by including foreign currency-indexed Dinar liabilities. The percentage allocation of foreign currency reserves in Dinar was reduced from 40.0 per cent. to 20.0 per cent., thus allowing banks to allocate less than the Dinar equivalents of the calculated required reserve in Euro in order to improve Dinar liquidity in the banking sector;

- in July 2010, the Government implemented measures indirectly supporting the construction industry by directly subsidising interest rates on consumer loans for the purchase of construction material and short-term and long-term mortgages and, in December 2011, the Assembly adopted amendments to the Law on Stimulating the Construction Industry of the Republic of Serbia and the Government adopted a decree on subsidies for housing loans;

- in March 2011, a reform-oriented Social Protection Law was adopted and, more broadly, in 2011, reforms were introduced to stabilise the welfare system, and to ensure the regular payment of benefits and the payment of accumulated arrears, resulting in improvements to the system of financial support for families with children and the disabled;

- in June 2011, the Government made a recommendation to commercial banks to allow rescheduling of loans extended to enterprises for the purposes of reducing the risk of widespread insolvencies in certain industries;

- in July 2011, reform of the health care system improved the financial position of health care workers and secured investment in equipping health care institutions;

- in December 2011, the National Bank adopted a new Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (which was amended in June 2012). In seeking to achieve adequate and efficient management of credit risk exposure of banks, this decision specifies the balance sheet assets and off-balance sheet items subject to classification, the criteria for classification, as well as the manner of calculating reserves for estimated losses that may arise in connection with bank receivables;

- in January 2012,the Government adopted measures to further support the economy and mitigate the negative effects of the economic crisis, including assistance to local companies that manufacture trucks and buses, a subsidy programme for tourism and measures for credit support for businesses, such as start-ups and small and medium-sized enterprises, through the Serbian Development Fund;

- in March 2012, the Government adopted a new programme of austerity measures seeking savings of RSD 15.7 billion to cut the budget deficit. The new programme includes measures redirecting own

source revenues of RSD 10.9 billion and reducing discretionary expenditure of RSD 4.8 billion. Under the new programme, the Government introduced a maximum limitation to the debt by setting guarantees at EUR 120 million (instead of EUR 432.5 million as envisaged in the Budget), while the debt of local creditors would be set at EUR 17.5 million (instead of EUR 115 million as envisaged in the budget). The measures do not cover salaries, pensions and other social benefits, nor do they reduce incentives necessary for economic growth. The Government also recommended implementation of these saving measures to all other bodies included in the consolidated general government budget, such as the Autonomous Province of Vojvodina, local governments and social security funds, and entities included in the broader public sector, such as public enterprises, regulatory bodies and public agencies;

- in April 2012, the National Bank adopted amendments to the Decision on Banks' Required Reserves (which was subsequently amended several times in 2012). The amendments envisage lowering the foreign exchange reserve requirement ratio by 1 percentage point to 29 per cent. for funding sources of up to two years and by 3 percentage points to 22 per cent. for sources of over two years. In June 2012, the share of foreign exchange required reserves allocated in Dinar was raised to 27 per cent. for funding sources of up to two years and to 19 per cent. for sources of over two years. Also, Dinar and/or foreign currency liabilities under the financial support provided by the Deposit Insurance Agency are exempted from the Dinar and/or foreign currency required reserve base. The measure aims to contribute to the stabilisation of inflation and foreign exchange market movements, to support moderate lowering of borrowing costs and facilitate refinancing, and to stimulate banks to use longer-term sources of funding; and

- in August 2012, the Executive Board decided to raise the dinar share of allocations under foreign exchange required reserves from 27 per cent. to 32 per cent. for sources of funding with maturity of up to two years, and from 19 per cent. to 24 per cent. for sources of funding with maturity of over two years. Required reserve ratios will remain unchanged. These measures are expected to lend further support to price stability and contribute to the stabilisation of movements in the foreign exchange market.

The programme of measures outlined above began to produce positive results in 2010 and 2011 with GDP increasing by 1.0 per cent. and 1.6 per cent., respectively, in real terms. However, GDP declined by 1.6 per cent. in real terms in the six months ended 30 June 2012.

Current Economic Reform

The Government intends to continue to pursue appropriate fiscal, economic and monetary policies in order to achieve, among other aims, reduced unemployment, attractive conditions for FDI, increased exports, a low and stable inflation rate, and development of the country's infrastructure. Such current and expected policies include, among others;

- in August 2012, the Government adopted an agriculture support programme, which includes two decrees to mitigate the negative effects of the drought in Serbia in mid-2012: the Fuel Refund Decree and the Agriculture Product Decree;

- in August 2012, the Government adopted a subsidy programme for exporters under which the Government will subsidise interests on loans provided by commercial banks to exporters. In order to receive the loan, a company must retain all employees with no lay-offs;

- in September 2012, the Assembly passed a supplementary Budget including revenue-enhancing measures and limits on mandatory spending indexation. The most important anti-crisis measures include an increase in VAT from 18 per cent. to 20 per cent., abolishing 138 para-fiscal duties and levies as well as limitation of salaries in the public sector to below RSD 162,000. See "*Public Finance – Fiscal Policy and Reform – Supplementary 2012 Budget*"; and

- in October 2012, the Government adopted the central government budget for 2013 (the "2013 Budget"). This document envisages reduction of the central government deficit to 3.3 per cent. of GDP in 2013. See *"Public Finance – Fiscal Policy and Reform – 2013 Budget"*.

- the 2013 Budget is designed to limit growth in Public Debt with projected economic growth of 2.0 per cent. According to the IMF's World Economic Outlook (October 2012), Serbia's real GDP will contract by 2 per cent. in 2012 but will recover to a positive 2.0 per cent. in 2013;
- the draft Fiscal Strategy that is expected to be adopted by the Government at the end of November, after consultation with the IMF mission will include measures aimed at achieving medium-term fiscal consolidation and debt reduction with the objective of reducing the general government deficit to 1.0 per cent. of GDP by 2015 and reducing Public Debt to 58.4 per cent. of GDP by 2015. Further steps will be taken to reduce Public Debt to 45.0 per cent. of GDP by 2018 as the long-term strategic goal; and
- the Government plans to continue talks with the IMF, World Bank and other international financial institutions and organisations in order to achieve macroeconomic stability and sustainable economic development.

The Government believes that the above policies will play a key role in the achievement of Serbia's economic and development-related aims and, in particular, economic growth is expected to be driven by net exports. In addition, the fulfilment of the conditions for Serbia's accession into the EU is a priority for the Government, which aims to accelerate the process of European integration and make best efforts to obtain a date for beginning negotiations with the EU. The Government will adopt systemic measures and fulfil criteria that the EU Council considers necessary in the process of stabilisation and association.

See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The inability of the Government to reduce public spending may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes*".

Gross Domestic Product

The Office of Statistics published revised rates of GDP growth for the periods from 2001 to 2010 in January 2011. The data for nominal GDP (in RSD, U.S.$ and EUR) in the periods from 2006 to 2009 was also restated. This restatement was made due to a change in the classification of business activities made to bring the method of calculation of statistics in line with EU standards and standards of the European Statistical System. Harmonisation with these standards requires a larger number of categories in each classification level, transition from fixed base accounting to accounting in the previous year's prices and revision of the indicators used in accounting in permanent prices to meet international statistics recommendations.

Serbia's trade system monitoring now has a broader concept of exports and imports covering all goods that are imported and exported except goods in transit and transactions involving temporary goods. This change in methodology significantly increased the quality of statistical data and indicated that imports of goods were previously underestimated and GDP was previously overestimated. The new statistical methodology will include figures in relation to the "grey" market economy.

The following table shows Serbia's real and nominal GDP, as well as RSD/EUR and RSD/U.S.$ exchange rates, for the years 2007 to 2011 and for the six months ended 30 June 2011 and 2012, respectively:

	Year ended 31 December					*Six months ended 30 June*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012E*[(1)]
Nominal GDP (RSD billions)[(2)]	2,276.9	2,661.4	2,720.1	2,881.9	3,175.0	1,509.0	1,564.1
Nominal GDP (EUR millions)[(2)(3)]	28,467.9	32,668.2	28,956.6	28,006.1	31,143.0	14,811.5	14,101.2
GDP per capita (EUR)[(2)(3)]	3,856.6	4,444.5	3,955.0	3,841.0	4,288.0	–	–
Real GDP growth (per cent.)[(2)]	5.4	3.8	(3.5)	1.0	1.6	2.7	(1.6)
RSD/EUR (end of period)	79.24	88.60	95.89	105.50	104.64	102.46	115.82
RSD/EUR (period average)[(4)]	79.96	81.44	93.95	103.04	101.95	101.88	110.92
RSD/U.S.$ (end of period)	53.73	62.90	66.73	79.28	80.87	70.64	92.15
RSD/U.S.$ (period average)[(4)]	58.39	55.76	67.47	77.91	73.34	72.67	85.57
U.S.$/EUR (end of period)	0.7	0.7	0.7	0.8	0.8	0.7	0.8
U.S.$/EUR (period average)[(4)]	0.7	0.7	0.7	0.8	0.7	0.7	0.8

Source: Office of Statistics; National Bank.

Notes:

(1) Office of Statistics estimate.

(2) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See " – *Gross Domestic Product*".

(3) Recalculated by the Ministry of Finance and Economy using average exchange rate for the period. See "*Exchange Rate History*".

(4) Calculation of average exchange rates is based on NBS daily data of exchange rates.

In the second half of 2008, the global financial and economic crisis adversely affected trends in GDP. The crisis caused a slow down and then a decline in economic activity and foreign trade as a consequence of declining foreign and domestic demand. In 2008, the real GDP growth rate was 3.8 per cent., which was 1.6 percentage points lower than in 2007. Following the high real growth rates registered in the first and second quarters of 2008, the rate of GDP growth decreased in real terms in the third and final quarters, in each case compared to the same periods in 2007. In addition to declining domestic and foreign demand, the crisis also led to lower foreign capital inflows because of increased investor caution and uncertain conditions in the global financial markets.

The negative trends in the Serbian economy towards the end of 2008 intensified in the first half of 2009, caused by further reduced external and domestic demand. Real GDP fell in the first and second quarters of 2009. However, the rate of decrease in real GDP slowed in the third and final quarters of 2009, in each case compared to the same periods in 2008. Overall, in 2009, real GDP was 3.5 per cent. lower compared to 2008.

In the first quarter of 2010, real GDP continued to fall. Growth resumed, however, in the remaining three quarters of 2010. Overall, in 2010, real GDP grew by 1.0 per cent. compared to the previous year, with the growth primarily coming from increased exports, real RSD depreciation and a recovery in the level of private sector investments.

The Serbian economy continued to recover in the first half of 2011. In this period, real GDP grew by approximately 2.8 per cent. compared to the first half of 2010. This represented the largest inter-annual real GDP growth rate experienced since the third quarter of 2008. GDP expanded by 1.6 per cent. in 2011, fuelled mostly by exports to the EU. After a brief period of recovery, however, a slowdown in economic activity was recorded during the second half of 2011, reflecting the economic slowdown in the Eurozone and south-east Europe, which are Serbia's main foreign trade partners, and more generally the deepening of the Eurozone crisis, which affected investment in Serbia and Serbia's net exports. The greatest positive contribution to the GDP growth in 2011 resulted from industrial production and information and communications. The greatest negative contributions resulted from wholesale and retail trade.

GDP performance in the first half of 2012 declined by 1.6 per cent. in real terms, due in part to a sharp fall in industrial output caused by extremely cold weather in February and the suspension of operations in the Smederevo Steel Plant. The most significant sectors contributing to growth in the first half of 2012 were information and communication (11.3 per cent.) and building and construction (4.8 per cent.), while agriculture declined by 18.0 per cent., industry by 1.5 per cent. and transport by 0.5 per cent.

Drought-induced contraction in agricultural production and a deterioration of the growth prospects in the Eurozone, including in the economies of Serbia's main trading partners, led the Ministry of Finance and Economy to adjust Serbia's GDP growth forecasts downward to 2.0 per cent. for 2012. It is expected that net exports will be one of the main contributors to growth in the next quarter, given the implementation of previous investments, most notably in the automotive industry, such as the launch of Fiat Group Automobiles S.p.A. car production. See "*External Sector – Foreign Direct Investment ("FDI")*".

Gross Value Added

Serbia measures the value of goods and services produced in a sector of the economy using the measure of GVA. GVA plus taxes on products and services and fewer subsidies on products and services is equal to GDP. GVA is used to measure the growth in output of each sector of the Serbian economy because information about taxes and subsidies on products and services is not available for individual sectors.

The following table shows GVA in current prices of the sectors of the Serbian economy for the years 2007 to 2011 and for the six months ended 30 June 2011 and 2012:

	Year ended 31 December					*Six months ended 30 June*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(RSD billions)			
Agriculture, forestry and fisheries	195.4	237.5	218.0	245.1	284.2	124.3	113.8
Industry	435.4	502.6	521.9	556.1	630.6	301.8	308.2
Building and construction	99.2	125.7	111.7	114.5	127.8	48.8	51.1
Wholesale and retail trading; motor vehicle and motorcycle repair	230.2	277.8	258.5	268.0	292.3	136.8	150.9
Transport and storage	107.9	122.5	126.6	132.6	141.9	70.3	68.3
Information and communications	85.5	106.1	114.4	123.8	135.8	64.8	74.7
Finance and insurance	62.9	77.9	85.1	94.8	106.5	52.5	57.8
Other[(1)]	717.4	839.8	897.1	941.8	1,019.1	503.0	532.1
Total GVA	1,933.8	2,289.9	2,333.4	2,476.7	2,738.2	1,302.3	1,356.9
FISIM (Financial Intermediation Service Indirectly Measured)	43.6	59.9	68.7	76.7	86.7	42.3	47.4
Gross value added	1,890.2	2,230.0	2,264.7	2,400.0	2,651.5	1,259.9	1,309.5
Taxes less subsidies for products	386.7	431.4	455.4	481.9	523.5	249.1	254.5
Total GDP	2,276.9	2,661.4	2,720.1	2,881.9	3,175.0	1,509.0	1,564.1

Source: Office of Statistics.

Note:

(1) Comprises: accommodation and meal services, real estate business, professional, scientific and technical business, administrative and supporting services, Government administration and national defence, obligatory social security, education, health care and social welfare, arts, entertainment and recreation, other services, households in the capacity of employer, households producing/providing goods and services for own needs.

The following table shows nominal GVA growth rates measured in current prices of the sectors of the Serbian economy for the years 2007 to 2011 and for the six months ended 30 June 2011 and 2012:

	Year ended 31 December					*Six months ended 30 June*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(%)			
Agriculture, forestry and fisheries	6.1	21.5	(8.2)	12.4	16.0	27.3	(8.4)
Industry	10.4	15.4	3.8	6.6	13.4	17.5	2.1
Building and construction	23.2	26.7	(11.1)	2.5	11.6	10.3	4.7
Wholesale and retail trading; motor vehicle and motorcycle repair	10.6	20.7	(6.9)	3.7	9.1	13.1	10.3
Transport and storage	16.0	13.5	3.3	4.7	7.0	9.6	(2.8)
Information and communications	17.4	24.1	7.8	8.2	9.7	8.3	15.4
Finance and insurance	30.2	23.8	9.2	11.4	12.3	14.4	10.2
Other[(1)]	21.1	17.1	6.8	5.0	8.2	9.6	5.8
Total GVA growth rate	15.5	18.4	1.9	6.1	10.6	13.4	4.2
FISIM (Financial Intermediation Service Indirectly Measured)	14.4	37.4	14.7	11.6	13.0	15.3	12.0
Gross value added	15.6	18.0	1.6	6.0	10.5	13.3	3.9
Taxes less subsidies for products	18.5	11.6	5.6	5.8	8.6	10.6	2.2
Total GDP growth rate	16.0	16.9	2.2	5.9	10.2	12.9	3.6

Source: Office of Statistics.

Note:

(1) Comprises: accommodation and meal services, real estate business, professional, scientific and technical business, administrative and supporting services, Government administration and national defence, obligatory social security, education, health care and social welfare, arts, entertainment and recreation, other services, households in the capacity of employer, households producing/providing goods and services for own needs.

The following table shows GVA in constant previous year prices, reference year 2005, of the sectors of the Serbian economy for the years 2007 to 2011 and for the six months ended 30 June 2011 and 2012:

	Year ended 31 December					*Six months ended 30 June*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(RSD billions)			
Agriculture, forestry and fisheries	154.6	168.1	169.3	168.6	170.1	70.5	57.8
Industry	360.5	365.2	323.1	323.1	331.8	159.8	157.4
Building and construction	78.4	82.1	65.9	61.3	67.6	27.9	29.2
Wholesale and retail trading; motor vehicle and motorcycle repair	220.9	235.8	218.0	221.7	207.3	99.6	99.5
Transport and storage	88.8	86.5	77.9	84.3	86.8	43.2	43.0
Information and communications	97.2	107.7	118.5	124.9	138.2	67.0	74.6
Finance and insurance	48.2	54.7	57.7	61.9	61.8	31.3	31.9
Other[(1)]	501.9	520.8	532.8	537.0	543.0	268.5	264.2
Total GVA	1,550.7	1,620.9	1,563.2	1,582.8	1,606.7	767.8	757.7
FISIM (Financial Intermediation Service Indirectly Measured)	39.2	44.5	47.9	51.8	51.5	25.8	26.3
Gross value added	1,511.5	1,576.8	1,516.0	1,531.9	1,556.1	742.4	731.8
Taxes less subsidies for products	325.9	330.4	324.8	327.7	332.9	155.5	151.5
Real GDP	1,837.2	1,907.4	1,840.5	1,859.3	1,888.6	897.9	883.5

Source: Office of Statistics.

Note:

(1) Comprises: accommodation and meal services, real estate business, professional, scientific and technical business, administrative and supporting services, Government administration and national defence, obligatory social security, education, health care and social welfare, arts, entertainment and recreation, other services, households in the capacity of employer, households producing/providing goods and services for own needs.

The following table shows real GVA growth rates of the sectors of the Serbian economy for the years 2007 to 2011 and for the six months ended 30 June 2011 and 2012:

	Year ended 31 December					*Six months ended 30 June*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(%)			
Agriculture, forestry and fisheries	(7.8)	8.7	0.8	(0.4)	0.9	(0.3)	(18.0)
Industry	4.1	1.3	(11.5)	0.0	2.7	5.1	(1.5)
Building and construction	10.8	4.7	(19.7)	(7.1)	10.4	9.1	4.8
Wholesale and retail trading; motor vehicle and motorcycle repair	15.1	6.7	(7.5)	1.7	(6.5)	(4.1)	0.0
Transport and storage	4.1	(2.6)	(10.0)	8.2	2.9	5.6	(0.5)
Information and communications	16.7	10.8	10.0	5.4	10.7	9.9	11.3
Finance and insurance	8.6	13.4	5.5	7.2	(0.1)	2.1	2.1
Other[(1)]	1.3	3.8	2.3	0.8	1.1	1.9	(1.6)
Total real GVA growth rate	4.4	4.5	(3.6)	1.3	1.5	2.6	(1.3)
FISIM (Financial Intermediation Service Indirectly Measured)	7.2	13.6	7.6	8.0	(0.6)	1.9	1.8
Gross value added	4.3	4.3	(3.9)	1.0	1.6	2.7	(1.4)
Taxes less subsidies for products	10.7	1.4	(1.7)	0.9	1.6	2.7	(2.5)
Total real GDP growth rate	5.4	3.8	(3.5)	1.0	1.6	2.7	(1.6)

Source: Office of Statistics.

Note:

(1) Comprises: accommodation and meal services, real estate business, professional, scientific and technical business, administrative and supporting services, Government administration and national defence, obligatory social security, education, health care and social welfare, arts, entertainment and recreation, other services, households in the capacity of employer, households producing/providing goods and services for own needs.

Agriculture, forestry and fisheries

Serbia occupies approximately 88,361 square kilometres (including Kosovo and Metohija). Utilised agricultural land occupies over 5,000,000 hectares (0.69 hectares per capita, excluding Kosovo and Metohija).

Land and climate conditions are highly conducive to the development of agriculture. The plains of Vojvodina, Pomoravlje, Posavina, Tamnava, Krusevac and Leskovac provide favourable conditions for mechanised field crop farming and vegetable production. Rolling hills and foothills support fruit and wine production and livestock breeding. The mountains of Zlatibor, Rudnik, Stara Planina, Kopaonik and Sar are attractive for sheep and cattle production and forestry.

As of the last agricultural census in 2002, Serbia had a total agricultural labour force of 0.82 million, comprising 10.9 per cent. of the total population of Serbia in 2002. The agricultural labour force is employed as follows: livestock breeding (43.0 per cent.), field crop farming (42.0 per cent.), fruit and wine production (12.0 per cent.), other crops (3.0 per cent.). The next agricultural census is scheduled for 1 October to 15 December 2012.

The National Agricultural Programme of the Republic of Serbia for 2010-2013 and Serbia's National Agriculture Strategy, according to the Law on Government, define short-term and long-term agricultural initiatives, the strategies and deadlines for accomplishing these initiatives, expected results, and the form, purpose and volume of individual state incentives. The main areas of focus are technological modernisation of agricultural production, changes to production structure to create a greater share of large farms, adjustment to meet European market requirements and health and safety standards and the implementation of a system of support for agricultural producers. Other strategic goals include environmental protection related to the harmful effects of agricultural technology processes, preparation for WTO accession and reform of the corporate food production sector.

According to the supplementary 2012 Budget, the Government will provide additional agricultural subsidies in the amount of RSD 9.8 billion in 2012 as additional resources to regular agricultural programmes and to minimise the effects of drought in Serbia. Drought has led to decreased production of certain crops, such as sugar beet, sunflower seed and soy bean. As a result, the Government has taken measures to limit export of such crops in order to ensure domestic demand is satisfied.

In 2009, the agriculture, forestry and fisheries sector represented 9.3 per cent. of total GVA measured in current prices. The GVA of this sector in 2009 fell by 8.2 per cent. (RSD 19.5 billion) measured in current prices but grew by 0.7 per cent. (RSD 1.2 billion) in real terms compared to 2008.

The share of GVA of the agriculture, forestry and fisheries sector in total GVA in 2010 rose slightly to 9.9 per cent. measured in current prices. In 2010, the GVA of this sector grew by 10.4 per cent. measured in current prices (a reduction of 0.4 per cent. in real terms), an increase from RSD 218.0 billion in 2009 to RSD 245.1 billion in 2010.

In 2011, the agriculture, forestry and fisheries sector represented 10.4 per cent. of total GVA measured in current prices. The growth of this sector's GVA measured in current prices was 16 per cent. (RSD 39.1 billion), or 0.9 per cent. (RSD 1.5 billion) in real terms, compared to 2010.

In the six months ended 30 June 2012, the agriculture, forestry and fisheries sector represented 8.4 per cent. of total GVA measured in current prices. The decline of this sector's GVA measured in current prices in the six months ended 30 June 2012 was 8.4 per cent. (RSD 10.4 billion), while it declined by 18.0 per cent. in real terms, compared to the same period in 2011.

Industry

Serbia aims to achieve dynamic growth and development of the industry sector, especially manufacturing. Development of this sector is in part dependent upon FDI. Despite the declining trend in FDI during the global financial and economic crisis, a number of foreign investors, including Italian car manufacturer Fiat Group Automobiles S.p.A. and Ball Packaging Europe Belgrade Ltd, have recently announced the expansion of operations in Serbia. See "*External Sector – Foreign Direct Investment ("FDI")*" and "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The Serbian economy is vulnerable to external shocks that may have a negative effect on the economic growth of Serbia and its ability to service its debt obligations*". Strengthening medium and high tech business (including the chemical industry, equipment production, traffic equipment production, electronic industry and food production) would provide higher value added thus increasing the contribution of the Industry sector to GDP. Measures that have the potential to stimulate growth include diversification of production, technological improvements to industrial fixed assets, increased efficiency and privatisation of State- and Socially-Owned Enterprises.

In respect of the mining industry, Serbia had approximately 270 registered legal entities in the field of mineral extraction as of 31 December 2011 and approximately EUR 50 million was spent on investment in the mining sector in 2011. The majority of registered entities are small- and medium-sized enterprises, with a smaller share of major mining facilities operating as part of Bor copper mining basin, PE "Electric Power Industry of Serbia" and EPS "Public Enterprise for Underground Coal Mining". Mining company Rio-Tinto has announced large investments in the production of lithium during the next few years.

Serbia seeks to improve the position of its mining sector by increasing security and safety and modernising technologies in order to provide conditions for higher inflow of foreign capital for the development of existing infrastructure and the new mines and thermal power plants. In February 2012, Serbia adopted its Mineral Resources Management Strategy, which aims to achieve national energy security and growth of potential mineral resources based on strategic management of the mining sector and sustainable mining development. The Mineral Resources Management Strategy sets a long-term goal of increasing the share of the mining industry in overall GDP from 2.0 per cent. in 2012 to over 5.0 per cent. by 2020. The Ministry of Natural Resources, Mining and Spatial Planning is in the process of preparing Serbia's strategy for restructuring mines as of the date of this Prospectus. This strategy is expected to provide for the gradual closing of mines that no longer contain any reserves and the development of mines with current reserves.

RWE AG and Edison S.p.A., electric power producers from Germany and Italy, respectively, have signed an agreement with the Electric Power Industry of Serbia, the state-owned power company, for the construction of new hydropower plants on the Morava and Drina rivers, and an additional thermo energy power plant Nikola Tesla 3. Electric Power Industry of Serbia is seeking to increase production capacity and improve ecological standards. In addition, the Ministry of Energy, Development and Environmental Protection is developing several potential projects in the energy sector, including, but not limited to: (i) the first phase of an investment project worth U.S.$1.06 billion involving the construction of a desulphurisation plant in a thermal power plant, rehabilitation of Thermal Power Plant Kostolac B and construction of port, railway tracks and road; the first phase of this project amounted to U.S.$344.63 million and funding has been provided through a credit agreement between Serbia and Exim bank of China; (ii) the second phase of the above-mentioned project is estimated to amount to approximately U.S.$715.6 million to be spent on construction of a new block in the Thermal Power Plant Kostolac B3 of installed output power of approximately 350 MW, with net efficiency of approximately 40 per cent. and expansion of the Open Pit Mine Drmno; (iii) a planned investment estimated to cost approximately EUR 650 million for the construction of a thermal power plant at the Stavalj site and the construction of a mine in the same site with a production capacity sufficient to feed this thermal power plant, where the estimated ore reserves are approximately 70 million tons of lignite, which has been estimated to be sufficient for construction of a 350 MW thermal power plant with planned annual consumption of 1.7 million tons of lignite; and (iv) the first phase of construction of cogeneration of thermoelectric power and heat energy in gas steam cycle CHPP Novi Sad at a cost of approximately EUR 320 million.

The following table shows growth rates of industrial production (physical scope) for the years 2007 to 2011 and for the nine months ended 30 September 2012:

	Year ended 31 December					Nine months ended 30 September
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(%)			
Industrial production, physical scope	4.1	1.4	(12.6)	2.5	2.1	(3.8)
Mining	0.2	5.3	(3.8)	5.8	10.4	(1.7)
Manufacturing	4.6	1.1	(16.1)	3.9	(0.5)	(3.3)
Electricity, gas, steam	3.2	2.0	0.8	(4.4)	9.7	(7.2)

Source: Office of Statistics.

In 2009, the industry sector represented 22.4 per cent. of total GVA measured in current prices. The GVA of this sector in 2009 grew by 3.8 per cent. (RSD 19.3 billion) measured in current prices but fell by 11.5 per cent. (RSD 42.1 billion) in real terms compared to 2008.

The share of total GVA, in the industry sector, in 2010 increased to 22.5 per cent. measured in current prices. The growth of GVA in current prices in 2010 was 6.6 per cent. (0.0 per cent. in real terms), an increase from RSD 521.9 billion in 2009 to RSD 583.0 billion in 2010.

In 2011, the industry sector represented 23 per cent. of total GVA measured in current prices. The growth of this sector's GVA measured in current prices in 2011 was 13.4 per cent. (RSD 74.5 billion), or 2.7 per cent. (RSD 8.7 billion) in real terms, compared to 2010.

In the six months ended 30 June 2012, the industry sector represented 22.7 per cent. of total GVA measured in current prices. This sector's GVA grew by 3.1 per cent. in current prices, but declined by 1.5 per cent. in real terms, compared to the same period in 2011.

The manufacturing sub-sector represented 69.0 per cent. of the total industry sector and the share of manufacturing in total GVA was 15.7 per cent. measured in current prices during the period. In the six months ended 30 June 2012, the GVA of the manufacturing sub-sector grew by 1.7 per cent. (RSD 3.5 billion) measured in current prices, an increase of 0.3 per cent. in real terms, compared to the same period in 2011.

Industrial output declined as compared to the corresponding period of the prior year due to severe weather conditions in February and the suspension of operations in the Smederevo Steel Plant. As of the date of this prospectus, operations at the Smederevo Steel Plant remain at a minimum. In addition, electricity, gas and steam output declined because the extreme cold negatively impacted the operations at thermal power plants and the drought during the summer months adversely affected operations at hydro power plants.

Building and construction

Prior to the global financial and economic crisis, the building and construction sector experienced GVA growth in current prices and in real terms, principally as a result of modernisation of the nation's three largest cities – Belgrade, Nis and Novi Sad. This sector was, however, affected significantly by the crisis due to decreased domestic demand as well as reduced lending activity and FDI, resulting in an overall shortage of funds for existing and new investments. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The Serbian economy is vulnerable to external shocks that may have a negative effect on the economic growth of Serbia and its ability to service its debt obligations*". Growth in this sector going forward will be dependent upon the availability of multilateral and bilateral external funding in order to support national and regional infrastructure projects.

The project for the construction and refurbishing of "Corridor X", the transport route that runs from the Bulgarian to the Hungarian border, is expected to increase activity in this sector. The National Investment

Plan calls for RSD 38.3 billion to be spent on infrastructure projects in 2012, comprising RSD 24.9 billion from Budget revenues and RSD 13.4 billion by way of loans from international financial institutions. RSD 30.3 billion was spent on infrastructure projects in 2011, comprising RSD 18.4 billion from Budget revenues and RSD 11.9 billion by way of loans from international financial institutions. Major projects include the refurbishment and modernisation of certain sections of the Corridor X road network (EUR 50 million financed by EIB and EUR 30 million financed by EBRD), the refurbishment of 14 kilometres of railway from Belgrade Central Station through Rakovica to Resnik, the renewal of approximately 50 kilometres of other key sections of the Corridor X road network (EUR 95 billion financed by EBRD), the construction of approximately 24 kilometers of the E 763, within the Corridor XI network, between Obrenovac and Ub and approximately 26 kilometers from Lajkovac to Ljig will be built (EUR 300 million financed from the Export-Import bank of China loan) and 40 kilometers from Ljig to Preljina (financed by a loan from the Azerbaijan, secured on the basis of an international agreement on cooperation between Azerbaijan and the Republic of Serbia, which amounts to EUR 308 million). See "*External Sector – Foreign Direct Investment ("FDI") – Bilateral co-operation infrastructure projects*".

Potential growth in the building and construction sector in the coming years will in part depend upon appropriate future policy measures. Amendments to the Law on Planning and Construction are currently being prepared by the newly founded Ministry of Construction and Urbanism. Amendments may include the conversion of construction land from public into private ownership and economic measures such as the Government short-term measures in 2010 aimed at indirectly supporting the construction industry by directly subsidising interest rates on consumer loans for the purchase of construction material and short-term and long-term mortgages. In addition, the Spatial Plan of the Republic of Serbia from 2010 to 2020 aims to ensure fast approval of construction permits and efficient project development by organising areas of urban planning and building and construction activity.

In 2009, the building and construction sector represented 4.8 per cent. of total GVA measured in current prices as compared to 5.5 per cent. in 2008. In 2009, GVA fell by 11.1 per cent. (RSD 14.0 billion) measured in current prices, or 19.7 per cent. (RSD 16.2 billion) in real terms, compared to 2008.

The share of GVA of the building and construction sector in total GVA in 2010 fell to 4.6 per cent. measured in current prices. In 2010, GVA measured in current prices grew by 2.5 per cent. (a decrease of 7.0 per cent. in real terms), an increase from RSD 111.7 billion in 2009 to RSD 114.5 billion in 2010.

In 2011, this sector represented 4.7 per cent. of total GVA measured in current prices. GVA of the building and construction sector in 2011 grew by 11.6 per cent. (RSD 13.3 billion) measured in current prices, and by 10.4 per cent. (RSD 6.4 billion) in real terms, compared to 2010.

In the six months ended 30 June 2012, the building and construction sector represented 3.8 per cent. of total GVA measured in current prices. This sector's GVA grew by 4.7 per cent. (RSD 2.3 billion) measured in current prices, or 4.8 per cent. (RSD 1.3 billion) in real terms, compared to the same period in 2011.

Wholesale and retail trade and motor vehicle and motorcycle repair

Despite the global financial and economic crisis, the wholesale and retail trade and motor vehicle and motorcycle repair sector grew in real and nominal terms from 2008 through the three months ended 31 March 2012, with the exception of a fall in 2009 (in real and nominal terms), 2010 (in real terms), due to a decrease in domestic demand and employment and slow growth in average total wages, and a slight decline in real terms in the three months ended 31 March 2012.

Serbia's strategy for trade development aims to stabilise and develop the domestic market, promote market competition and enhance consumer protection and the quality of goods in line with EU standards. The Trade Law adopted in July 2010, which is in accordance with the EU regulations, governs trade in goods and services, trade conditions, new modes of trade (long distance trade, personal offering trade, auction and stock market trade), unfair market practice, trade limitations and trade supervision. Serbia's Consumer Protection Law harmonises consumer protection with EU standards and creates legal bases for the implementation of consumer protection instruments similar to those that exist in more developed EU countries.

In 2009, this sector represented 11.1 per cent. of total GVA measured in current prices. The GVA of the sector in 2009 fell by 6.9 per cent. (RSD 19.3 billion) measured in current prices, or 7.5 per cent. (RSD 17.8 billion) in real terms, compared to 2008.

The share of GVA of this sector in total GVA in 2010 fell slightly to 10.8 per cent. measured in current prices. In 2010, the growth of GVA measured in current prices was 3.7 per cent. (1.7 per cent. in real terms), an increase from RSD 258.5 billion in 2009 to RSD 268.0 billion in 2010.

In 2011, this sector represented 10.7 per cent. of total GVA measured in current prices. The growth of this sector's GVA measured in current prices in 2011 was 9.1 per cent. (RSD 24.3 billion). The GVA of the sector measured in current prices fell by 5.5 per cent. (RSD 12.1 billion) compared to 2010.

In the six months ended 30 June 2012, the wholesale and retail trade and repair of motor vehicles and motorcycles sector represented 11.1 per cent. of total GVA measured in current prices. The GVA of this sector grew by 10.3 per cent. measured in current prices, and remained on the same level in real terms, compared to the same period in 2011.

Transport and storage

The transport and storage sector was affected significantly by the global financial and economic crisis due to a shortage of funds for renewing the road network and acquiring new means of transport. However, Serbia's geographic location as a transport route connecting Western Europe and Turkey and the Middle East encourages the development of this sector including modernising transport infrastructure, increasing transport capacities, and enhancing traffic safety.

Transport activities include land transport, inland waterway transport and air transport. Land transport includes railway, road, urban and pipeline transport. In 2010, the physical volume of transportation services increased by 7.8 per cent. compared to 2009. In 2011, the physical volume of transportation service increased by 8.9 per cent. compared to 2010. All types of transportation recorded a growth in the volume of services in this period. Road transport grew by 4.4 per cent., air transport grew by 22.4 per cent. and railway transport grew by 2.7 per cent.

Serbia seeks to increase the scope and quality of transport services and efficiency of all types of transport by organising and developing modern traffic infrastructure and equipment. The construction and refurbishment of Corridor X, including another two roadways toward the south, a ring-road around Belgrade and part of a highway near Pirot, is an important part of achieving these aims. Serbia also seeks to modernise its existing railway network, and a new investment by Russian Railways to assist in modernising Serbia's railways has been announced, under which Serbia is expected to receive U.S.$800 million. Growth in this sector is partly dependent upon foreign investment and co-operation with neighbouring countries; the share of inter-modality transportation will increase in the overall transportation of goods by more intensive use of river and railway transportation. The Government has passed the General Transport Master Plan for Serbia, which aims to create modern pan-European transportation lines.

The current Draft Law on Railways, which the Government expects to adopt by the end of 2012, provides for further harmonisation of the Serbian railway legislation with the EU regulations (EU directives: 91/440, 95/18, 95/19, 2001/12, 2001/13, 2001/14 and Regulation 1370/2007) mainly in the following fields: access and use of infrastructure, licensing, public service obligations and activities of the Directorate for Railways with a clear definition of its functions in the field of the regulation of the railway services market. The current Draft Law on Railway Safety and Interoperability, also expected to be adopted by the end of 2012, also provides for harmonisation with the EU regulations (EU directives: 2004/49, 2007/59 and 2008/57), particularly in the areas of implementation of technical specifications of interoperability, establishment of a national safety authority, safety certificates, activities of investigation body and notification body, keeping of vehicle and infrastructure register and notification of national safety rules.

In 2009, the transport and storage sector represented 5.4 per cent. of total GVA measured in current prices. The GVA of the transport and storage sector in 2009 grew by 3.3 per cent. (RSD 4.1 billion) measured in current prices but fell by 9.9 per cent. (RSD 8.6 billion) in real terms, compared to 2008.

The sector recovered in 2010. This sector represented 5.4 per cent. of total GVA in 2010 and grew to 4.7 per cent. measured in current prices (8.2 per cent. in real terms), an increase from RSD 126.6 billion in 2009 to RSD 132.6 billion in 2010.

In 2011, this sector represented 5.2 per cent. of total GVA measured in current prices. This sector grew by 7 per cent. (RSD 9.3 billion) in current prices, or 2.9 per cent. (RSD 2.5 billion) in real terms, compared to 2010.

In the six months ended 30 June 2012, the transportation and storage sector represented 5.0 per cent. of total GVA measured in current prices. The GVA of this sector declined by 2.8 per cent. measured in current prices, and 0.5 per cent. in real terms, compared to the same period in 2011.

Information and communications

The information and communications sector comprises information technologies and construction, maintenance, use, and lease of public communication networks and equipment as well as electronic communication services. In February 2010, the Government, which previously held full ownership of the fixed telecommunication network, issued a licence to Telenor Serbia to operate fixed telephone services. Mobile phones are the most profitable of all telecommunications and the Government introduced a tax on the use of mobile phones in July 2009 (which raised an additional RSD 2.7 billion) and was applied throughout 2010. The information and communications sector has grown in both nominal and real terms in each year since 2008 due to advances in the development of telecommunications. In particular, expansion of mobile phone services increased the total number of call minutes and SMS and MMS messages recorded. As at 31 December 2011, the total number of mobile phone users in Serbia reached 10.2 million. Mobile phone users generated call traffic of 10.1 billion call minutes, which was a 14.8 per cent. increase compared to 2010. Mobile phone penetration in 2011 was 143 per cent. Signal coverage of the territory and the population is high but still not complete. More recently, strong growth of Internet service providers and users has also been recorded, resulting in higher revenues from Internet services and consequently growth in tax revenues.

In 2009, the information and communications sector represented 4.9 per cent. of total GVA measured in current prices. The GVA of this sector in 2009 grew by 7.8 per cent. (RSD 8.3 billion) measured in current prices, or 10.0 per cent. (RSD 10.8 billion) in real terms, compared to 2008.

The information and communications sector continued to grow in 2010 but at a slightly lower rate than in 2009. This is attributable to the rapid expansion of Serbia's mobile network in 2009 with the rate of expansion slowing in 2010 due to an already well-developed market. The share of GVA of the information and communications sector in total GVA in 2010 grew to 5.0 per cent. measured in current prices. In 2010, this sector's GVA growth measured in current prices was 8.2 per cent. (5.4 per cent. in real terms), an increase from RSD 114.4 billion in 2009 to RSD 123.8 billion in 2010.

In 2011, GVA growth in this sector was 9.7 per cent. (RSD 12 billion) measured in current prices, or 8.3 per cent. (RSD 10.4 billion) in real terms, compared to 2010.In the six months ended 30 June 2012, the information and communications sector represented 5.5 per cent. of total GVA measured in current prices. This sector's GVA grew by 15.4 per cent. measured in current prices, or 11.3 per cent. in real terms, compared to the same period in 2011.

Finance and insurance

According to National Bank statistics, at the end of 2011 Serbia had 33 banks (of which 21 are under foreign ownership), 28 insurance companies (of which 21 are under foreign ownership) and 17 leasing companies (of which 10 are under foreign ownership and one is 50 per cent. foreign-owned). As at 30 September 2012, the balance value was RSD 2,844 billion for the banking sector, RSD 140.7 billion for insurance companies and RSD 75.6 billion for leasing companies. In the period from 2009 to the end of the first nine months of 2012, the finance sector has experienced consistent growth.

In 2009, the finance and insurance sector represented 3.6 per cent. of total GVA measured in current prices. The GVA of this sector in 2009 grew by 9.2 per cent. (RSD 7.2 billion) measured in current prices, or 5.5 per cent. (RSD 3 billion) in real terms, compared to 2008.

The share of GVA of the total GVA in 2010 grew slightly to 3.8 per cent. measured in current prices. In 2010, GVA growth measured in current prices was 11.4 per cent. (7.3 per cent. in real terms), an increase from RSD 85.1 billion in 2009 to RSD 94.8 billion in 2010.

In 2011, this sector represented 3.9 per cent. of total GVA measured in current prices. This sector's GVA grew by 12.3 per cent. (RSD 11.7 billion) measured in current prices, and remained on the same level in real terms, compared to 2010.

In the six months ended 30 June 2012, this sector represented 4.3 per cent. of total GVA. This sector grew by 10.2 per cent. in current prices, and 2.1 per cent. in real terms, compared to the same period in 2011.

Other sectors

The largest sectors comprising the "other" category are real estate, health and social protection, state administration and defence, and mandatory social insurance.

In 2009, these sectors represented 38.4 per cent. of total GVA measured in current prices. The GVA of other sectors in 2009 grew by 6.8 per cent. (RSD 57.3 billion) measured in current prices, or 2.3 per cent. (RSD 12 billion) in real terms, compared to 2008.

The share of GVA of other sectors in total GVA in 2010 decreased slightly to 38.0 per cent. measured in current prices. In 2010, the growth of GVA in other sectors measured in current prices was 5.0 per cent. (0.8 per cent. in real terms), an increase from RSD 897.1 billion in 2009 to RSD 941.8 billion in 2010.

In 2011, these sectors represented 37.2 per cent. of total GVA measured in current prices. GVA in other sectors grew by 8.2 per cent. (RSD 77.3 billion) in current prices, or 1.1 per cent. (RSD 6.0 billion) in real terms, compared to 2010.

In the six months ended 30 June 2012, these sectors represented 39.2 per cent. of total GVA measured in current prices. The GVA of other sectors grew by 5.8 per cent. in current prices, but declined by 1.6 per cent. in real terms, compared to the same period in 2011.

Labour Market and Social Policy

Wages

The following table shows the average gross wage in RSD and the average net wage in RSD and EUR for the years 2007 to 2011 and for the nine months ended 30 September 2012:

	Year ended 31 December[1]					*Nine months ended 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
	(period average)					
Average monthly gross wage (RSD).	38,744	45,674	44,147	47,450	52,733	56,373
Average monthly net wage (RSD)	27,759	32,746	31,733	34,142	37,976	40,629
Public sector employees (RSD)[2]	32,392	37,284	38,885	39,810	43,506	45,666
Private sector employees (RSD)	26,314	31,307	29,324	32,129	35,945	38,751
Average monthly gross wage (EUR)[3]	485	561	470	460	517	499
Average monthly net wage (EUR)[3]	347	402	338	331	373	359

Source: Office of Statistics.

Notes:

(1) Since January 2009, in addition to the wages paid to employees of legal entities, the wages of self-proprietors are now also taken into account in calculating the average wage.

(2) Excluding military and police.

(3) Calculated using the average RSD/EUR exchange rate for the relevant period. See "*Exchange Rate History*".

The average monthly net wage per employee in 2009 was RSD 31,733, representing 0.2 per cent. real growth compared to 2008. In 2010, the average monthly net wage per employee was RSD 34,142, representing 0.7 per cent. real growth compared to 2009. However, in Euros, the average monthly net wage per employee amounted to EUR 331 in 2010, as compared to EUR 338 in 2009, representing a 2.1 per cent. decrease in Euros compared to 2009. In 2011, average monthly net wages in Euros increased by 12.7 per cent. compared to 2010 mainly due to exchange rate appreciation. In the first nine months of 2012, average monthly net wages in Euros decreased by 1.9 per cent. compared to the same period of 2011, primarily due to exchange rate depreciation.

The real growth rates in wages in 2009 and 2010 were affected by frozen public sector wages. See "*Public Finance – Fiscal Developments in 2009*". As a result of this freeze, the average net wage per public sector employee in 2009 was RSD 38,885, representing a 4.0 per cent. decrease in real terms compared to 2008. In 2010, the average net wage per public sector employee was RSD 39,810, representing a 4.1 per cent. decline in real terms compared to 2009. In 2011, the average net wage per public sector employee was RSD 43,506, representing a 1.5 per cent. decline in real terms compared to 2010.

In 2009, the highest average net wages were in the following sectors: financial services (RSD 67,899), production of electricity, gas and water (RSD 44,239) and ore and stone extraction (RSD 43,650). The lowest net wages in 2009 were in the following sectors: hotels and restaurants (RSD 18,176) and fisheries (RSD 19,569). In 2010, the highest average net wage was again in the financial services sector (RSD 73,382) and the lowest average net wage was in the hotels and restaurants sector (RSD 18,910). In 2011 and in the first nine months of 2012, the highest average wages were also in the financial services sector (RSD 71,938 and RSD 75,369, respectively).

In 2011, the average net wage increased by 0.2 per cent. in real terms, while the average net wage in the public sector decreased by 1.5 per cent. in real terms. In the first nine months of 2012, the average net wage amounted to RSD 40,629 (EUR 359) representing a 3.2 per cent. increase in real terms compared to the same period in 2011, while the average net wage in the public sector increased by 1.2 per cent. in real terms. Across the industries, real net wages increased most in agriculture, forestry and fishing, professional, scientific and technical activities, as well as information and communication. Real wages declined in real estate activities and in arts, entertainment and recreation. While the overall level of public sector employment has largely been maintained, the freeze on public sector wages combined with relatively high inflation since 2009 has severely affected the incomes and living standards of public sector employees. As a result, public sector wages, although they were unfrozen in January 2011, are on average lower than those in several other countries in the region.

The minimum wage from June 2011 to March 2012 was RSD 102 per hour and it was raised to RSD 115 in April 2012.

The Government's special fiscal rules, which were adopted in 2010, set movements in wages in the public sector during the period from 2011 to 2015, with wages in the public sector in 2011 to 2015 indexed according to inflation plus half of real GDP growth in the previous year. This rule is to be applied until wages in the public sector decrease to 8.0 per cent. of real GDP.

On 25 September 2012, the Assembly passed a supplementary 2012 Budget under which wages are indexed according to a fixed percentage rate of 2.0 per cent. (rather than six month inflation), which is lower than the special fiscal rule prescribes. Starting in October 2013, public sector wages will be indexed according to inflation and GDP growth. In addition, the supplementary 2012 Budget limits salaries in the public sector to below RSD 162,000.

Employment

Since 2008, Serbia's labour market has been characterised by growing levels of unemployment due to a number of factors including macroeconomic conditions and decreased demand for labour.

In 2009 to 2011, the Government implemented several policy measures aimed at increasing employment levels, including:

- an employment programme for first-time employees, "The First Chance 2010", with the aim of providing basic proficiency training to approximately 17,000 unemployed young people without previous relevant work experience;
- the attendance at training programmes by approximately 5,000 people (of which 54.6 per cent. were women);
- the allocation of a self-employment subsidy to approximately 3,000 people;
- the allocation of an employers' subsidy for the creation of approximately 6,000 new jobs; and
- the introduction of 352 public works projects and the hiring of approximately 5,000 people (of which 38.5 per cent. were women) for these projects.

The Government has also introduced significant subsidies to encourage the creation of new jobs by foreign employers. See "*External Sector – Trade Policy*".

The following table shows key employment statistics for the years 2007 to 2011 and January to April 2011 and 2012:

	Year ended 31 December					*January to April*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(period average)			
Labour force[1]	2,852,347	2,755,410	2,635,690	2,539,996	2,498,976	2,511,385	2,494,512
Employed persons[2]	2,002,344	1,999,476	1,889,085	1,795,774	1,746,138	1,754,058	1,730,912
Public sector	475,985	481,335	475,883	470,660	469,006	469,455	470,142
Private sector	1,526,360	1,518,141	1,413,202	1,325,114	1,277,133	1,284,603	1,260,770
Unemployed persons[3]	850,003	755,934	746,605	744,222	752,838	757,327	763,600
Persons actively seeking employment[4]	928,325	819,55	821,746	829,732	829,954	831,755	864,047
Change in average rate of employment (Y-O-Y) (%)[5]	(1.1)	(0.1)	(5.5)	(4.9)	(2.8)	(3.4)	(1.3)
Employment rate (%)[6]	41.8	44.4	41.2	37.9	35.8	36.2	34.3
Unemployment rate (%)[6]	18.1	13.6	16.1	19.2	23.0	22.2	25.5
GDP/employed person (RSD)[7]	1,137,117	1,331,049	1,439,904	1,604,823	1,818,298	–	–
GDP/employed person (EUR)[7]	14.217	16.338	15.328	15.596	17.835	–	–

Source: Office of Statistics.

Notes:

(1) Labour force includes employed and unemployed persons.

(2) Excludes the military and police.

(3) The term "unemployed" refers to a person aged 15 or older, until he or she has fulfilled the pension requirements or turns 65, who is capable and willing to work immediately, who has not established a work relation or exercised his or her right to work in any other form, who is registered in the unemployment register and who is actively seeking employment.

(4) "Persons actively seeking employment" are those persons who are actively seeking to change jobs or find employment.

(5) In March 2009, the Office of Statistics adjusted the rate of employment starting as at January 2009 due to, among other things, the Office of Health Insurance records being updated.

(6) Calculated based on persons of age 15 and over.

(7) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*– Gross Domestic Product*".

The Office of Statistics Labour Force Survey includes rates of unemployment based on the "registered unemployment" methodology. The main difference between the "registered unemployment" methodology and the International Labour Organisation Methodology is that only data on persons officially registered as

unemployed is taken into account when using the "registered unemployment" methodology; whereas, in the case of the International Labour Organisation Methodology, data is obtained from surveys rather than the official registry.

The following table shows the average unemployment rates calculated using the "registered unemployment" methodology and the International Labour Organisation Methodology for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012 (except as otherwise specified):

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
	(period average)						
ILO unemployment rate (ages 15 and over)	18.1	13.6	16.1	19.2	23.0	22.2[(1)]	25.5[(1)]
Registered unemployment rate	29.8	27.5	28.2	29.2	30.1	30.2	30.6

Source: Office of Statistics.

Notes:

(1) Labour Force Survey is conducted in April of the respective year.

In 2009, the average number of employed persons decreased by 5.5 per cent. compared to 2008. Due to a revision of certain employee data by the Office of Statistics in March 2009 (to include, as at January 2009, sole proprietors and their employees in the overall number of employees), the number of employees of legal entities (excluding sole proprietors and their employees) provides a more accurate indicator of movements in the labour market in this period as compared to 2008, prior to the adjustment. According to this indicator, in 2009, employment decreased by 2.2 per cent. compared to 2008. In 2010, the average number of employed persons amounted to 1,795,774, representing a 4.9 per cent. decrease compared to 2009. In 2011, the average number of employed persons decreased by 2.8 per cent. compared to 2010.

Both the public and private sectors experienced a decline, of 1.1 per cent. and 6.9 per cent., respectively, in the average number of employed persons in 2009 compared to 2008. In 2010 and 2011, the public sector declined by 1.1 per cent. and 0.4 per cent., respectively, as compared to the prior year, while the declines in the private sector were 6.2 per cent. and 3.6 per cent., respectively, as compared to the prior year. In the first nine months of 2012, the average number of employed persons in the public sector slightly increased by 0.1 per cent. while the average number of employed persons in the private sector decreased by 1.9 per cent.

According to the Office of Statistics Labour Force Survey conducted in 2009, the rate of unemployment of persons aged 15 and over was 16.1 per cent., representing an increase of 2.5 percentage points compared to 2008, while the rate of employment was 41.2 per cent., representing a decrease of 3.2 per cent. compared to 2008. According to the Labour Force Survey conducted in 2010, the unemployment rate was 19.2 per cent., representing an increase of 3.1 per cent. compared to 2009. In 2010, the rate of employment was 37.9 per cent., representing a decrease of 3.3 per cent. compared to 2009. In 2011, the unemployment rate increased to 23 per cent. from 19.2 per cent. in 2010, while the employment rate decreased from 37.9 per cent. in 2010 to 35.8 per cent. in 2011. According to the Labour Force Survey from April 2012, the employment rate declined to 34.3 per cent. from 36.2 per cent. in April 2011, while the unemployment rate increased by 3.3 per cent. to 25.5 per cent. Although informal employment remained relatively high, it decreased by 2.9 per cent. compared to April 2011 (from 19.9 per cent. to 17.0 per cent.).

The Office of Statistics does not keep official records or estimates of the "grey" market economy. The Government believes the "grey" market economy may employ a significant percentage of persons of employable age. The Government aims to reduce the grey market economy by increasing the reporting obligations under the Law on Auditing and Accounting in the first half of 2013 and with the recently adopted changes to the Law on Tax Procedure and Tax Administration, both laws are aimed at reducing unreported income.

Social Insurance System

Unemployment

The Law on Employment and Insurance in Case of Unemployment, amended and supplemented in 2009 and 2010, regulates active labour market policy, passive labour market policy and workers' rights to

unemployment insurance. The National Employment Service assists workers to find employment and protects workers' rights by keeping a record of employment and performing other professional, organisational and administrative functions related to employment and unemployment insurance.

The Law on Employment and Insurance in Case of Unemployment stipulates that in cases of unemployment the compulsory insurance shall be provided in respect of unemployment benefits as well as health insurance and pension and disability insurance.

A person covered by compulsory insurance is entitled to unemployment benefits if they were insured for at least 12 months continuously or intermittently within the past 18 months. Insurance with an interruption shorter than 30 days is also deemed continuous insurance.

An unemployed person is entitled to cash benefits where employment is terminated or compulsory insurance is terminated on the basis of:

- dismissal by the employer due to technological, economic or organisational changes, the need to discontinue a particular job or due to a decrease in the volume of business. The above is not valid for persons who have, pursuant to the Decision of the Government on Determining Programmes for Solving the Issue of Redundancies in the Process of Rationalisation, Restructuring and Preparation for Privatisation, out of their own free will, opted for cash allowance or special cash allowance in an amount higher than the amount of the dismissal payment stipulated by the Labour Law, or if the employee does not deliver working results, that is, has no necessary knowledge or skills for performing the activities stipulated by his position;
- termination of a time-limited employment, temporary employment or "odd job", as well as trial work;
- termination of office of an elected, nominated or appointed person, if rights to dormancy of employment or salary compensation are not exercised;
- transmission of founder's rights of a business owner or member;
- initiating bankruptcy, dissolution proceedings or other cases of cessation of the business of an employer;
- transferring a spouse to another post; and
- termination of employment abroad.

The contribution rate for unemployment insurance is 1.5 per cent. of gross wage deducted at source according to Article 44 of the Law on Contributions for Mandatory Social Insurance.

Monetary compensation provided to an unemployed person is 50.0 per cent. of the gross wage during the last six months prior to the month in which the person became unemployed. Additionally, this compensation cannot be higher than 160.0 per cent. or lower than 80.0 per cent. of the minimum wage.

Pensions and disability

The pension and disability system in Serbia is regulated by the Law on Pension and Disability Insurance.

Serbia currently has a system of compulsory pension and disability insurance based on current financing. The compulsory national system offers insurance against three basic types of risk: old age, occurrence of a disability and death. The employer pays half of this contribution and the employee pays the remaining half.

In 2006, Serbia introduced voluntary pension insurance based on individual capitalised savings. Currently, approximately 160,000 people participate in the voluntary pension insurance system. Serbia has not yet introduced a system of compulsory pension and disability insurance based on individual capitalised savings.

Prior to 2008, pension and disability insurance was organised in three separate state funds: the Fund for Pension and Disability Insurance of Employed Persons, the Fund for Pension and Disability Insurance of Self-Employed Persons and the Fund for Pension and Disability Insurance of Farmers. These three funds were merged for administration purposes in 2008 and complete financial consolidation occurred in 2011.

Pension and disability insurance for those serving in the armed forces was integrated into this fund from 1 January 2012. The current retirement age in Serbia is 65 years for men with at least 15 years of service and 60 years for women with at least 15 years of service. As of the date of this Prospectus, men of 53 years and eight months of age, or with at least 40 years of service are entitled to a pension and women of 53 years of age, or with at least 35 years of service are also entitled to a pension. The total number of pensioners in Serbia as of 30 September 2012 was approximately 1.7 million and approximately 2.6 million persons were making pension contributions. The contribution rate for pension and disability insurance is 22.0 per cent. of gross wage deducted at source.

The following table shows pension fund finances for the years 2007 to 2011 and the nine months ended 30 September 2012:

	Year ended 31 December					*Nine months ended 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(RSD billions)			
Current revenues	316.04	375.55	459.46	466.47	501.25	412.76
Social security contributions	196.89	228.13	235.41	261.68	267.20	203.90
Grants and transfers	110.06	137.79	213.77	193.48	223.62	201.21
Other revenues	9.09	9.63	10.28	11.32	10.43	7.24
Receipts	4.27	12.99	3.24	1.09	0.65	0.38
Current expenditures	308.17	392.81	459.78	466.86	500.44	413.94
Expenditures for employees	3.06	3.30	3.71	3.53	3.68	2.86
Purchase of goods and services	2.42	2.37	2.72	2.53	2.51	1.78
Interest	0.39	0.07	0.09	0.05	0.05	0.06
Grants and transfers	–	–	–	–	–	0.01
Social transfers	302.05	386.97	453.16	460.72	493.67	407.87
Other expenditures	0.24	0.10	0.10	0.03	0.04	1.35
Capital expenditures	0.41	0.43	0.23	0.28	0.38	0.21
Net lending	2.20	2.17	3.52	0.38	0.12	1.15
Repayment	0.03	–	–	–	–	–

Source: Ministry of Finance and Economy.

Primarily due to Serbia's aging population combined with a decrease in overall population, pension and disability fund revenues from contributions are currently not sufficient to cover the liabilities of the fund. The fund is therefore subsidised by allocations from the Budget. In 2011, 47.3 per cent. (RSD 236.5 billion) of the fund's total expenditure was financed by allocations from the Budget (of which RSD 224.2 billion was allocated as a transfer and the remaining portion was allocated through the Special Government Programme for Unpaid Contributions to Pensions), compared to 47.3 per cent. (RSD 221.0 billion) in 2010 and 47.0 per cent. (RSD 216.0 billion) in 2009. The Government's expenditure on pensions from the Budget in 2011 was 7.4 per cent. of nominal GDP. Expenditure on public wages and pensions currently represents the largest single category of expenditure in the Budget. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The inability of the Government to reduce public spending may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes"* and *"Public Finance – Consolidated General Government Budget*".

In late April 2009, the Assembly adopted a revised 2009 Budget with the main fiscal policy change being the freezing of public sector wages and pensions during 2009 and 2010, affecting approximately 1.6 million pensioners. The freeze on pensions ended in 2011.

The special fiscal rules adopted in 2010 set movements in pensions during the period from 2011 to 2015, with average pensions for 2011 to 2012 indexed according to inflation plus half of real GDP growth in the previous year and average pensions from 2013 to 2015 indexed according to inflation plus GDP growth over 4.0 per cent.

On 25 September 2012, the Assembly passed a supplementary 2012 Budget, together with relevant amendments to the Law on Pension and Disability Insurance, under which pensions are indexed according to a fixed percentage rate of 2.0 per cent. (rather than six month inflation), which is lower than special fiscal rule prescribes. Starting in October 2013, pensions will be indexed according to inflation and GDP growth.

Health insurance

The Law on Health Insurance regulates mandatory health insurance policy, voluntary health insurance policy, rights and obligations of patients, activities of participants and institutions providing health care services and other important health care issues. The Law on Health Insurance established the Republic Institute for Health Insurance, a national, public and non-profit organisation responsible for co-ordinating health insurance. The Institute is financed by mandatory health insurance contributions.

The contribution rate for mandatory health insurance is 12.3 per cent. of the gross wage. Article 22 of the Law on Health Insurance provides a list of categories of people for whom health insurance contributions are paid from the Budget if not otherwise covered, including all persons belonging to population groups with a high risk of illness, persons whose health care is necessary with respect to prevention and early-stage diagnoses and treatment of diseases of social and medical importance and persons belonging to socially vulnerable population groups. The Law on Health Insurance also provides that the insured persons shall include the persons to whom a competent authority has assigned the status of a refugee or a displaced person from one of the former Yugoslav republics if they meet legally prescribed conditions and reside within Serbia. In addition, the Law on Health Insurance provides health care to those with disabilities incurred during military service.

In the nine months ended 30 September 2012, revenues from health insurance amounted to RSD 152.3.0 billion and expenditures amounted to RSD 143.5 billion (a surplus of RSD 8.8 billion). In 2011, revenues were RSD 193.7 billion, compared to RSD 182.1 billion and RSD 178.6 billion in 2010 and 2009, respectively. Expenditures were RSD 191.4 billion in 2011 (a surplus of RSD 2.1 billion), compared to RSD 180.2 billion (a surplus of 1.9 billion) and RSD 176.5 billion (a surplus of 2.1 billion) in 2010 and 2009, respectively.

Privatisation Process

In 2001, a programme of restructuring and privatising the large public enterprise sector was introduced under the Law on Privatisation. A number of enterprises owned by all citizens of Serbia ("Socially-Owned Enterprises") and enterprises owned and managed by the Government ("State-Owned Enterprises") have been privatised, with foreign investors actively participating in the privatisation process. The privatisation programme is nearly complete, but is ongoing with a number of entities yet to be privatised when market conditions are suitable.

The Government plans to establish a working group to assess the viability, management and the ability of Socially-Owned Enterprises to operate without Budget subsidy. The Government also aims to improve the governance, transparency and efficiency of State-Owned Enterprises by requiring the regular publication of financial results and improving the management and accountability of Socially-Owned Enterprises with a view to an eventual sale of such enterprises to strategic investors.

The Ministry of Finance and Economy performs sales of state-owned capital, assets and property comprising power utilities, railways, road networks, airports and airlines, telecommunications and the gas network. The most recent significant privatisation was the sale of a 51.0 per cent. stake in NIS, an oil company, to Gazprom Neft in 2008. In April 2011, the Ministry of Finance and Economy cancelled its planned sale of a 51.0 per cent. stake in Telekom Srbije after it was unable to secure the EUR 1.4 billion it had set as a minimum bid. The Ministry of Finance and Economy may decide to sell further state-owned capital in the near to medium-term including the Telekom Srbije, JAT Airways and Galenika A.D. The Ministry of Finance and Economy has an open tender for a strategic partner in Smederevo Steel Plant and expects to choose this strategic partner by the end of 2012.

The Privatisation Agency is a specialised agency of the Government authorised to perform activities necessary for selling socially-owned capital, assets and property. Its activities include the promotion, planning, implementation and monitoring of all privatisation projects in Serbia. The Privatisation Agency

also serves as receiver in bankruptcy for state-owned companies. The Privatisation Agency has been appointed as bankruptcy administrator in over 1,000 cases since the enactment of the Law on Bankruptcy Procedure on 2 February 2005. According to Privatisation Agency data, it sold a total of 979 Socially-Owned Enterprises between 2006 and 30 September 2012, and, as at 30 September 2012, approximately 600 companies were still to be privatised, comprising 249 Socially-Owned Enterprises with 24,361 employees, 167 state-owned companies with 49,134 employees and 172 companies where capital was transferred to the Privatisation Agency after termination of a sale and purchase agreement with 22,447 employees. The Privatisation Agency estimates that there may be buyers for approximately 200 of these companies. Some Socially-Owned Enterprises are not profit-making enterprises and rely on funding from the Government, which, together with prevailing macroeconomic conditions, may make it difficult to continue to operate or privatise these enterprises in the future.

The Privatisation Agency performs several preparatory activities in advance of implementing a privatisation project. These activities include:

- analysing the financial standing, business operations, legal status, business organisation, management and human resource capacities of the candidate company;
- informing and educating company management and representatives of relevant trade unions about the privatisation process;
- deciding the method of privatisation and preparing a restructuring programme;
- registering the privatisation initiative and publicly disclosing the initiative in the press;
- inviting letters of interest from potential investors; and
- engaging financial and legal advisers.

The Privatisation Agency adopts one of two main privatisation methods – open tender or sale by auction. The Privatisation Agency's monitoring and control function includes activities such as eligibility control and verification of applications for auctions and open tenders, implementation of progress control for individual phases of open tender and auction sales, restructuring processes and invoicing of companies. The Privatisation Agency is also responsible for the execution of sales agreements and monitoring performance of obligations undertaken by the buyer once it has signed the sales agreement, which may include an investment plan, social programme, disposal of property of the privatised legal entity or an environmental protection programme.

According to the Law on Bankruptcy Procedure that came into effect on 2 February 2005 and was replaced by the Law on Bankruptcy in early 2010, the Privatisation Agency also performs the tasks of a receiver in bankruptcy of state-owned companies. The Privatisation Agency has been appointed as bankruptcy administrator in over 1,000 cases since 2 February 2005. Privatisation of a bankrupt company requires financial, organisational and legal restructuring of the company.

The Government intends to amend the Law on Privatisation in the near future. The amendments may require that enterprises in the process of restructuring that have not been appropriately restructured by mid-2014 go into bankruptcy.

The following table shows the results of the privatisation of Socially-Owned Enterprises for the years 2007 to 2011 and for the nine months ended 30 September 2012:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2012*	*Total*
No. of companies sold	297	256	93	33	18	12	709
No. of employees	38,131	25,873	9,115	1,922	2,484	1,964	79,489
Selling price (EUR millions)	370.4	243.7	48.8	18.8	19.0	8.1	708.8
Investments (EUR millions)	37.9	61.5	24.6	1.2	4.3	1.0	130.5

Source: Privatisation Agency.

In June 2011, the European Commission called on Serbian authorities to review the controversial privatisation and sale of 24 companies, as the European Commission expressed doubts as to whether these privatisations were carried out in accordance with all applicable laws and in a transparent manner. The privatisations were brought to the European Commission's attention by Serbia's Anti-Corruption Agency, which looks into all privatisations where it receives complaints from interested parties.

Serbian authorities, including relevant legal authorities, are currently investigating the privatisations. See *"Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Corruption and money laundering may adversely affect economic and social conditions in Serbia, slow down or halt progress towards EU membership and have a material adverse effect on the Serbian economy"*.

EXTERNAL SECTOR

Balance of Payments

The following table shows Serbia's current account, capital account and financial account balances for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
Current account balance	(5,052.5)	(7,054.2)	(2,084.4)	(2,082.2)	(2,770.0)	(1,925.2)	(2,458.9)
Goods (net)	(7,068.7)	(8,501.2)	(5,118.5)	(4,773.6)	(5,318.4)	(3,677.0)	(4,027.3)
Services (net)	(261.1)	(184.7)	18.3	5.3	163.2	53.5	62.8
Income (net)	(598.7)	(921.8)	(502.5)	(669.9)	(758.0)	(560.0)	(595.9)
Current transfers	2,876.1	2,553.6	3,518.2	3,356.0	3,143.1	2,258.3	2,101.5
Capital account balance	(313.9)	13.2	1.6	0.9	(2.5)	(2.1)	(8.9)
Financial account balance	5,175.6	7,133.3	2,206.9	1,985.5	2,553.9	1,711.1	2,155.8
Direct investments (net)	1,820.8	1,824.4	1,372.5	860.1	1,826.9	1,227.2	(21.0)
Portfolio investments (net)	678.2	(90.9)	(51.0)	38.8	1,6191	1,636.7	65.3
Other investments (net)	3,148.7	3,713.2	3,248.9	158.0	909.3	125.4	(243.6)
Reserves assets (net)	(742.1)	1,686.6	(2,363.5)	928.7	(1,801.5)	(1,278.3)	2,355.3
Errors and omissions (net)	190.8	(92.3)	(124.1)	95.7	218.6	216.2	312.0

Source: Office of Statistics; National Bank.

The following table shows Serbia's current account, capital account and financial account balances as a percentage of nominal GDP for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December					*Nine months ended 30 September*	
	2007[(1)]	*2008[(1)]*	*2009[(1)]*	*2010[(2)]*	*2011[(2)]*	*2011[(2)]*	*2012[(2)(3)]*
				(% of GDP)[(4)]			
Current account balance	(17.7)	(21.6)	(7.2)	(7.4)	(8.9)	(8.4)	(11.5)
Goods (net)	(24.8)	(26.0)	(17.7)	(17.0)	(17.1)	(16.1)	(18.9)
Services (net)	(0.9)	(0.6)	0.1	0.0	0.5	0.2	0.3
Income (net)	(2.1)	(2.8)	(1.7)	(2.4)	(2.4)	(2.5)	(2.8)
Current transfers	10.1	7.8	12.1	12.0	(10.1)	9.9	9.8
Capital account balance	(1.1)	–	–	–	–	0.0	0.0
Financial account balance	18.2	21.8	7.6	7.3	8.2	7.5	10.1
Direct investments (net)	6.4	5.6	4.7	3.1	5.9	5.4	(0.1)
Portfolio investments (net)	2.4	(0.3)	(0.2)	0.1	5.2	7.2	0.3
Other investments (net)	12.0	11.4	11.2	0.7	2.9	0.5	(1.1)
Reserves assets (net)	(2.6)	5.2	(8.2)	3.3	(5.8)	(5.6)	11.0
Errors and omissions (net)	0.7	(0.3)	(0.4)	0.1	0.7	0.9	1.5

Source: Office of Statistics; National Bank.

Notes:

(1) Calculated using yearly nominal GDP figures in Euro provided by the Office of Statistics.

(2) Calculated using quarterly nominal GDP figures in Dinar converted into Euro.

(3) Calculated using nominal GDP figures based on National Bank projections.

(4) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

Serbia has experienced an improving trend in the movement of its balance of payments since the global financial and economic crisis. The current account deficit has decreased as a result of a greater decline in import demand compared to the decrease in demand for exports and higher remittances, contraction in FDIs, large outflows of capital on account of the repayment of long-term credit in the corporate sector

(accompanied by a small increase in short- and long-term borrowing by banks) and growth in the National Bank's foreign exchange reserves.

During the period between 2006 and 2008, Serbia's current account deficit increased from 10.1 per cent. of nominal GDP in 2006 to 21.6 per cent. in 2008. Serbia's current account deficit increased by 114.0 per cent. from EUR 2,356.0 million in 2006 to EUR 5,052.5 million in 2007 and by a further 39.6 per cent. to EUR 7,054.2 million in 2008, primarily due to a 41.93 per cent. and 20.3 per cent. increase in the trade deficit in 2007 and 2008, respectively.

Since 2009, Serbia's economy has undergone a substantial balance of payments adjustment as a result of lower domestic demand and reduced credit availability. Serbia's current account deficit decreased by 70.5 per cent. from EUR 7,054.2 million in 2008 to EUR 2,084.4 million in 2009 (or by 68.4 per cent., excluding official grants (current transfers in cash or in kind with foreign governments and international organisations)) and amounted to 7.2 per cent. of nominal GDP in 2009 compared to 21.6 per cent. in 2008. The adjustment was primarily driven by a decline in Serbia's trade deficit of 39.8 per cent. as a result of imports falling more than exports, with a 30.3 per cent. decrease in imports compared to a 19.4 per cent. decrease in exports. The export-to-import ratio increased to 53.9 per cent., and terms of trade improved by 4.9 per cent. relative to 2008 as a result of the global financial and economic crisis, which led to a decline in nominal GDP and external financing requirements. Net current transfers increased by EUR 964.6 million, or 37.8 per cent., during the same year mainly due to remittances.

Serbia's loan and deposit disbursements increased in 2009, due to the disbursement of its IMF loan and the allocation of IMF special drawing rights. See *"Public Debt – Multilateral and Bilateral Development Organisations – International Monetary Fund"*. Foreign currency savings withdrawn by households in late 2008 (approximately EUR 1.0 billion) were returned to deposits during 2009, and disbursement of financial loans decreased by 60.7 per cent. in the same year. Long-term borrowing decreased by 31.3 per cent., excluding the IMF loan (EUR 1.1 billion). Under the Vienna Initiative, pursuant to which participating foreign-owned banks agreed to maintain their exposure to Central and Eastern Europe countries affected by the global financial and economic crisis, banks made a net disbursement of EUR 869.1 million, while enterprises registered a capital outflow of EUR 853.0 million by way of foreign debt repayments.

The National Bank's foreign exchange reserves increased by EUR 2.4 billion in 2009 as a result of the drawdown of the IMF loan (EUR 1.1 billion) and special drawing rights ("SDR") allocation (EUR 424.6 million), as well as an increase in banks' foreign exchange allocations in respect of reserve requirements. Foreign exchange reserves held by commercial banks rose by EUR 505.2 million during the year.

As a result of greater capital outflows, the maturity profile of banks' foreign sources of funding deteriorated and the share of short-term loans increased. Banks increased their short-term borrowing by EUR 395.0 million, while enterprises reduced their short-term liabilities in the same period by EUR 211.4 million.

During 2010, Serbia's current account deficit continued to decrease to EUR 2,082.2 million, primarily due to a 6.7 per cent. reduction in the trade deficit. Exports of goods and services were equivalent to approximately 34.7 per cent. of nominal GDP in 2010 and 29.4 per cent. in 2009, compared to 31.1 per cent. in 2008. The trade deficit also improved, albeit less markedly, to approximately 17.0 per cent. of nominal GDP from 17.7 per cent. in 2009. Furthermore, despite the impact of lower FDI flows during 2010, on which Serbia had relied to finance its current account deficit prior to the global financial and economic crisis, Serbia's gross external financing needs (current account payments plus short-term debt by remaining maturity) are estimated to have decreased to 118.0 per cent. of current account receipts and usable foreign exchange reserves from 131.0 per cent. in 2009. Serbia's total narrow net external debt position (which excludes non-bank private sector external assets) remained broadly flat in 2010, decreasing to 79.0 per cent. of current account receipts from 92.8 per cent. in 2009.

In 2011, Serbia's current account deficit rose to EUR 2,770.0 million (8.9 per cent. of nominal GDP) with a 11.4 per cent. growth in the trade deficit (17.1 per cent. of nominal GDP). Exports and imports of goods and services reached 36.8 per cent. (53.4 per cent. of nominal GDP), with a growth rate of 13.9 per cent. and

13.5 per cent., respectively. Relatively large inflow from the financial account, driven by FDI (EUR 1,826.9 million) and portfolio investments (EUR 1,619.1 million), financed an additional current account deficit and contributed to substantial growth of foreign exchange reserves of the National Bank (EUR 1,801.5 million).

Serbia's loan and deposit net disbursements decreased EUR 291.0 million in 2011 due to capital outflow in the private sector. Banks registered a capital outflow of EUR 633.6 million, driven by a repayment of short-term loans, enterprises registered net outflow of EUR 416.1 million by way of foreign debt repayments and the Government made a net disbursement of EUR 687.5 million.

In the first nine months of 2012, Serbia's current account deficit increased to EUR 2,458.9 million compared to a current account deficit of EUR 1,925.2 million in the same period in 2011. Serbia's trade deficit rose by 9.5 per cent. Exports increased by 1.5 per cent. while imports increased by 4.4 per cent. The trade deficit rose by EUR 350.3 million mainly because of growth in gas imports (EUR 100.0 million), growth in gas import prices (21.8 per cent. for the period from January to August), and higher import of electricity (EUR 69.5 million), as well as due to the growth in imports of investment goods. The lower growth in exports is a result of the decrease in the export of basic metals (influenced by decreased demand mainly from the Euro zone), however, this decrease was compensated by the growth in demand for other products (mainly cereals, but also machinery and transport equipment).

The balance of services increased by EUR 9.3 million to EUR 62.8 million. Serbia's net income deficit increased by 6.4 per cent., primarily due to an increase of 27.1 per cent. in the withdrawal of profit from FDI and an increase of 4.0 per cent. in interest payments. A decrease of 6.9 per cent. in net inflows from current transfers over the same period was primarily driven by a decrease of 8.9 per cent. in remittances.

Net capital inflow from financial account was insufficient for financing an additional current account deficit. Capital outflow in net FDI (EUR 21 million) was primarily due to the Government's repurchase of the national telecommunications company "Telecom Serbia" and the partial withdrawal of capital in the mobile provider, "Telenor", while net inflow from portfolio investments (EUR 65.3 million) was relatively small compared to the same period in 2011. Disbursements of loans and deposits were negative (EUR 272.2 million). Banks had a capital outflow of EUR 487.2 million and enterprises made a net disbursement of EUR 167.7 million. Foreign exchange reserves of banks increased by EUR 155.6 million. The current account deficit was financed by a decrease of EUR 2,355.3 million in foreign exchange reserves of the National Bank.

Foreign Trade

The following table shows Serbia's trade balance for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
Trade balance	(7,068.7)	(8,501.2)	(5,118.5)	(4,773.6)	(5,318.4)	(3,677.0)	(4,027.3)
Exports of goods[2]	6,382.5	7,416.0	5,977.8	7,402.4	8,439.7	6,287.4	6,379.8
Imports of goods[2]	(13,451.3)	(15,917.2)	(11,096.3)	(12,176.0)	(13,758.1)	(9,964.4)	(10,407.2)

Source: Office of Statistics; National Bank.

Notes:

(1) Data prepared in accordance with the IMF Balance of Payments Manual, 5th Edition.

(2) Imports and exports presented on a F.O.B. basis.

The following table shows Serbia's trade balance as a percentage of nominal GDP for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1]:

	Year ended 31 December 2011					Nine months ended 30 September	
	2007[2]	2008[2]	2009[2]	2010[2]	2011	2011[3]	2012[4]
				(% of GDP)[6]			
Trade balance	(24.8)	(26.0)	(17.7)	(17.0)	(17.1)	(16.1)	(18.9)
Exports of goods[5]	22.4	22.7	20.6	26.4	27.1	27.6	29.9
Imports of goods[5]	(47.2)	(48.7)	(38.3)	(43.5)	(44.2)	(43.7)	(48.8)

Source: Office of Statistics; National Bank.

Notes:

(1) Data prepared in accordance with the IMF Balance of Payments Manual, 5th Edition.

(2) Calculated using yearly nominal GDP figures in Euro provided by the Office of Statistics.

(3) Calculated using quarterly nominal GDP figures in Dinar converted into Euro.

(4) Calculated using nominal GDP figures based on National Bank projections.

(5) Imports and exports presented on an F.O.B. basis.

(6) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

Serbia's foreign trade has been affected by the global financial and economic crisis. In 2009, foreign trade volumes were considerably lower than in 2008 as a result of lower aggregate demand and the depreciation of the Dinar in real terms. The value of exported and imported goods decreased in Euro terms by 19.4 per cent. and 30.3 per cent., respectively. The greater decrease in imports compared to exports resulted in a reduction of the foreign trade deficit to EUR 5,118.5 million for 2009 and an export/import coverage ratio of 53.9 per cent., compared to EUR 8,501.2 million and 46.6 per cent., respectively, in 2008. Remittances amounted to EUR 3,247.8 million in 2009, as a result of financial system inflows (exchange office transactions through bank accounts and a net increase in foreign exchange savings), a 38.7 per cent. increase compared to 2008. The net capital inflows in 2009 were sufficient to cover the narrower deficit achieved in that year. In 2009, net financial credit inflows amounted to EUR 1,389.0 million and net foreign direct investment amounted to EUR 1,373 million. The banking sector's net debits in that period amounted to EUR 869.1 million, of which EUR 394.9 million were short-term loans (with a maturity of less than 12 months). In addition, the corporate sector made net repayments on foreign debt in an aggregate amount of EUR 853.0 million during 2009.

Since 2010, according to the foreign trade statistics methodology of the Office of Statistics (exports on an F.O.B. basis and imports on a C.I.F. basis), Serbia has experienced a gradual recovery of its foreign trade, primarily driven by an increase in foreign demand and rising export prices. Exports recovered faster than imports, but in the second half of 2011 exports slowed while imports gained pace. In 2011, exported goods amounted to EUR 8,441.4 million, an increase of 14.2 per cent. compared to 2010, and imported goods increased by 12.9 per cent. from EUR 12,622.1 million in 2010 to EUR 14,250.0 million in 2011. As a result, the trade deficit in 2011 increased by 11.1 per cent. to EUR 5,808.6 million from EUR 5,228.6 million in 2010. The growth in exports was primarily driven by an increase in foreign demand and rising export prices (10.0 per cent.). Growth in imports resulted from higher import prices (which rose by 6.3 per cent.) and the modest growth of domestic demand (investment and export-oriented production). The export/import coverage ratio improved from 58.6 per cent. in 2010 to 59.2 per cent. in 2011. The trade deficit continued at a level that required significant external borrowing.

In the nine months ended 30 September 2012, exports amounted to approximately EUR 6.399.3 million and imports amounted to approximately EUR 10.778.5 million, representing a 1.9 per cent. increase in exports and a 4.5 per cent. increase in imports, compared to the same period in 2011. The main sectors driving export growth during the period were food, live animals, machinery and transport equipment (starting in August 2012, the export of Fiat automobiles contributed to growth in exports of transport equipment). Growth in exports of other sectors (beverages and tobacco, animal and vegetable oils, fats and waxes, chemicals and related products, miscellaneous manufactured articles and non-classified products) was slower. A significant

decline in exports of iron and steel and a somewhat smaller decline in exports of non-ferrous metals (sector of manufactured products) resulted from the combination of falling world demand and internal developments such as lower exports of iron and steel due to the withdrawal of U.S. Steel from Serbia. These movements are attributable to the economic crisis and falling demand in Serbia's key export markets (primarily Italy, but also other EU and CEFTA countries). On the other hand, the drop in exports of metal products to Germany was offset by the growth in exports of equipment resulting from FDI inflows in the previous years. Imports were primarily driven by imports of non-classified commodities and chemical products. The food and live animals sector enjoyed the largest surplus, with a balance of EUR 645.2 million, while mineral foods, lubricants and related materials, chemical products and machinery and transport equipment accounted for the largest trade deficits (EUR 1,686.6 million, EUR 1,251.1 million and EUR 1,126.9 million, respectively).

Serbia's largest foreign trade partners in 2011 were EU member states, which collectively accounted for 57.7 per cent. of total exports and 55.5 per cent. of total imports. Serbia recorded a surplus of EUR 1,061.8 million in trade with Bosnia and Herzegovina, Montenegro and Macedonia, collectively. By contrast, Serbia had a trade deficit with certain other countries, in particular Russia (EUR 1,338.3 million) due to imports of fuel and energy supplies.

These trends continued in the nine months ended 30 September 2012. Trade with EU member states accounted for 57.5 per cent. of Serbia's total exports and 58.2 per cent. of total imports, compared to 58.1 per cent. of total exports and 55.9 per cent. of total imports in the same period in 2011. The largest trade deficits were with Russia and China, which together amounted to EUR 1,395.4 million. There was a surplus of EUR 925.2 million in trade with Bosnia and Herzegovina, Montenegro, Macedonia and Romania. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The Serbian economy is vulnerable to external shocks that may have a negative effect on the economic growth of Serbia and its ability to service its debt obligations*".

Imports

The following table shows the value of Serbia's imports of goods by product category for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
Food and live animals	471	590	538	662	758	539	585
Beverages and tobacco	66	74	82	130	142	92	106
Crude materials (inedible), except fuels	442	571	328	515	566	431	345
Mineral fuels, lubricants and related materials	2,257	2,972	1,712	2,457	2,851	1,995	1,908
Animal and vegetable oils, fats and waxes	20	32	32	30	32	23	24
Chemicals and related products not elsewhere specified	1,551	1,769	1,456	1,862	2,131	1,601	1,787
Manufactured goods[2]	2,554	2,642	1,891	2,502	2,750	2,701	2,000
Machinery and transport equipment	2,943	3,220	2,320	2,724	3,250	2,330	2,420
Miscellaneous manufactured articles[3]	1,072	1,228	945	1,013	1,083	787	802
Commodities and transactions not specified in SITC Rev. 4[4]	2,576	3,380	2,201	727	687	447	802
Total	13,952	16,478	11,505	12,622	14,250	10,316	10,779

Source: Office of Statistics.

Notes:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. In July 2012, the Office of Statistics released final 2011 data. In addition to regular corrections, some adjustments for imports have been made due to methodological harmonisation with Eurostat. Namely, one customs procedure relating to customs warehousing was excluded from processing. This customs procedure affects the value of imported goods, and therefore Serbian import figures were revised. The same methodological adjustments will be applied to 2009 and 2010 data. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

(2) Manufactured goods classified chiefly by material, including leather, leather manufactures not elsewhere specified and dressed fur skins, rubber manufactures not elsewhere specified, cork and wood manufactures (excluding furniture), paper, paperboard and articles of paper, pulp of paper, or of paper board, textile yarn, fabrics, made-up articles not elsewhere specified and related products, non-metallic mineral manufactures not elsewhere specified, iron and steel, non-ferrous metals and manufactures of metals not elsewhere specified.

(3) Includes prefabricated buildings; sanitary, plumbing, heating and lighting fixtures, furniture and parts thereof, bedding, mattresses, cushions and similar products, travel goods, handbags and similar containers, articles of apparel and clothing accessories, footwear, professional, scientific and controlling instruments and apparatus, photographic apparatus, equipment and supplies, optical goods not elsewhere specified and miscellaneous manufactured articles not elsewhere specified.

(4) Standard International Trade Classification, Revision 4; includes coins, gold (excluding gold ores and concentrates) and other unclassified goods including army goods, storage goods with no customs tariff marked and motor vehicle parts and aircraft parts for those imported/exported with the transport mean. For the years 2010 and 2011, the Office of Statistics reclassified the goods from the unclassified category, where they were, initially, in appropriate categories.

The following table shows the value of Serbia's imports of goods by product category as a percentage of total imports for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1].

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(% of total imports)			
Food and live animals	3.4	3.6	4.7	5.2	5.3	5.2	5.4
Beverages and tobacco	0.5	0.5	0.7	1.0	1.0	0.9	1.0
Crude materials (inedible), except fuels	3.2	3.5	2.9	4.1	4.0	4.2	3.2
Mineral fuels, lubricants and related materials	16.2	18.0	14.9	19.5	20.0	19.4	17.7
Animal and vegetable oils, fats and waxes	0.1	0.2	0.3	0.2	0.2	0.2	0.2
Chemicals and related products not elsewhere specified	11.1	10.7	12.7	14.8	15.0	15.5	16.6
Manufactured goods[2]	18.3	16.0	16.4	19.8	19.3	20.1	18.6
Machinery and transport equipment	21.1	19.5	20.2	21.6	22.8	22.6	22.5
Miscellaneous manufactured articles[3]	7.7	7.5	8.2	8.0	7.6	7.6	7.4
Commodities and transactions not specified in SITC Rev. 4[4]	18.4	20.5	19.1	5.8	4.9	4.3	7.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Office of Statistics.

Notes:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. In July 2012, the Office of Statistics released final 2011 data. In addition to regular corrections, some adjustments for imports have been made due to methodological harmonisation with Eurostat. Namely, one customs procedure relating to customs warehousing was excluded from processing. This customs procedure affects the value of imported goods, and therefore Serbian import figures were revised. The same methodological adjustments will be applied to 2009 and 2010 data. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

(2) Manufactured goods classified chiefly by material, including leather, leather manufactures not elsewhere specified and dressed fur skins, rubber manufactures not elsewhere specified, cork and wood manufactures (excluding furniture), paper, paperboard and articles of paper, pulp of paper, or of paper board, textile yarn, fabrics, made-up articles not elsewhere specified and related products, non-metallic mineral manufactures not elsewhere specified, iron and steel, non-ferrous metals and manufactures of metals not elsewhere specified.

(3) Includes prefabricated buildings; sanitary, plumbing, heating and lighting fixtures, furniture and parts thereof, bedding, mattresses, cushions and similar products, travel goods, handbags and similar containers, articles of apparel and clothing accessories, footwear, professional, scientific and controlling instruments and apparatus, photographic apparatus, equipment and supplies, optical goods not elsewhere specified and miscellaneous manufactured articles not elsewhere specified.

(4) Standard International Trade Classification, Revision 4; includes coins, gold (excluding gold ores and concentrates) and other unclassified goods including army goods, storage goods with no customs tariff marked and motor vehicle parts and aircrafts parts for those imported/exported with the transport mean. For the years 2010 and 2011, the Office of Statistics reclassified the goods from the unclassified category, where they were, initially, in appropriate categories.

The level of Serbia's imports in 2011 did not rise to the level reached prior to the global financial and economic crisis, primarily due to the slower dynamics of imports of mineral fuels, lubricants and related materials, miscellaneous manufactured articles and crude materials (inedible), except fuels and non-classified commodities. The value of imported goods increased by EUR 1,628 million to EUR 14,250 million in 2011 from EUR 12,622 million in 2010. Mineral fuels, lubricants and related materials and machinery and transport equipment experienced the highest levels of growth, increasing by 16.0 per cent. and 19.3 per cent., respectively. Mineral fuels, lubricants and related materials, manufactured goods and machinery and transport equipment accounted for 62.1 per cent. of total imports. Foods and live animals, beverages and tobacco and animal and vegetable oils, fats and waxes generated an aggregate trade surplus of EUR 911 million.

In the nine months ended 30 September 2012, imports amounted to EUR 10,779 million, increasing by 4.5 per cent. from EUR 10,316 million in the same period in 2011. Imports of chemical products and non-classified commodities experienced the highest levels of growth while imports of crude materials (inedible), except fuels, manufactured products and mineral fuels, lubricants and related materials decreased.

Since 2009, there has been a significant increase in the value of imported energy supplies. Imports of mineral fuels, lubricants and related products (including coal, coke and briquettes, petroleum, petroleum products and related materials, natural and manufactured gas and electric current) reached EUR 2,851 million in 2011, increasing by 16.0 per cent. from EUR 2,457 million in 2010. In the nine months ended 30 September 2012 imports of mineral fuels, lubricants and related materials amounted to EUR 1,908 million, decreasing by 4.3 per cent. from EUR 1,995 million in the same period in 2011. The value of petroleum-related products imported increased by 20.0 per cent. from EUR 1,343 million in 2010 to EUR 1,612 million in 2011. In the nine months ended 30 September2012, imports of petroleum-related products amounted to EUR 1,006 million, an 12.6 per cent. decrease from EUR 1,151 million in the same period in 2011.

The following table shows the value of Serbia's imports by country of origin for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[(1)]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
EU	7,687	9,073	6,533	7,069	7,907	5,769	6,275
Germany	1,629	1,970	1,409	1,334	1,539	1,142	1,200
Italy	1,349	1,505	1,111	1,079	1,272	884	1,004
Romania	309	489	376	450	634	478	467
Slovenia	522	505	377	383	422	309	346
France	439	514	375	363	385	281	302
Hungary	578	709	462	607	652	478	539
Other	2,861	3,381	2,423	2,853	3,003	2,197	2,417
CEFTA	1,141	1,291	932	1,095	1,218	878	878
Bosnia and Herzegovina	382	440	319	421	480	353	290
Montenegro	104	146	128	124	95	71	73

	Year ended 31 December					Nine months ended 30 September	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
Croatia	405	410	305	323	350	247	295
Macedonia	230	259	165	206	230	160	165
Other	20	36	15	21	63	47	55
CIS	2,384	2,983	1,666	1,959	2,395	1,687	1,614
Russia	1,947	2,391	1,416	1,630	1,906	1,332	1,088
Other CIS countries	437	592	250	329	489	355	526
Other Countries	2,741	3,131	2,375	2,499	2,730	1,982	2,012
China	1,021	1,128	814	904	1,069	778	800
USA	274	314	256	193	207	148	179
Other	1,446	1,689	1,305	1402	1,454	1,056	1,033
Total	13,952	16,478	11,505	12,622	14,250	10,316	10,779

Source: Office of Statistics.

Note:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. In July 2012, the Office of Statistics released final 2011 data. In addition to regular corrections, some adjustments for imports have been made due to methodological harmonisation with Eurostat. Namely, one customs procedure relating to customs warehousing was excluded from processing. This customs procedure affects the value of imported goods, and therefore Serbian import figures were revised. The same methodological adjustments will be applied to 2009 and 2010 data. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

The following table shows the value of Serbia's imports by country of origin as a percentage of total imports for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[(1)]:

	Year ended 31 December					Nine months ended 30 September	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(% of total imports)			
EU	55.1	55.1	56.8	56.0	55.5	55.9	58.2
Germany	11.7	12.0	12.2	10.6	10.8	11.1	11.1
Italy	9.7	9.1	9.7	8.5	8.9	8.6	9.3
Romania	2.2	3.0	3.3	3.6	4.4	4.6	4.3
Slovenia	3.7	3.1	3.3	3.0	3.0	3.0	3.2
France	3.1	3.1	3.3	2.9	2.7	2.7	2.8
Hungary	4.1	4.3	4.0	4.8	4.6	4.6	5.0
Other	20.6	20.5	21.0	22.6	21.1	21.3	22.5
CEFTA	8.2	7.8	8.1	8.7	8.6	8.5	8.1
Bosnia and Herzegovina	2.7	2.7	2.8	3.3	3.4	3.4	2.7
Montenegro	0.7	0.9	1.1	1.0	0.7	0.7	0.7
Croatia	2.9	2.5	2.7	2.6	2.4	2.4	2.7
Macedonia	1.7	1.6	1.4	1.6	1.6	1.5	1.5
Other	0.2	0.1	0.1	0.2	0.4	0.5	0.5
CIS	17.1	18.1	14.5	15.5	16.8	16.4	15.0
Russia	14.0	14.5	12.3	12.9	13.4	12.9	10.1
Other CIS countries	3.1	3.6	2.2	2.6	3.4	3.5	4.9
Other Countries	19.6	19.0	20.6	19.8	19.2	19.2	18.7
China	7.3	6.8	7.1	7.2	7.5	7.6	7.4
USA	2.0	1.9	2.2	1.5	1.5	1.4	1.7
Other	10.3	10.3	11.3	11.1	10.2	10.2	9.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Office of Statistics.

Note:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. In July 2012, the Office of Statistics released final 2011 data. In addition to regular corrections, some adjustments for imports have been made due to methodological harmonisation with Eurostat. Namely, one customs procedure relating to customs warehousing was excluded from processing. This customs procedure affects the value of imported goods, and therefore Serbian import figures were revised. The same methodological adjustments will be applied to 2009 and 2010 data. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

Serbia sources the majority of its imports from EU member states, which collectively accounted for approximately 55.5 per cent. of Serbia's total imports in 2011. Germany and Italy were the largest exporters to Serbia, together accounting for 35.5 per cent. of imports from EU member states and 19.7 per cent. of total imports. Serbia also imports a significant amount of goods from CEFTA countries, which collectively accounted for 8.6 per cent. of Serbia's total imports in 2011. Bosnia and Herzegovina and Croatia are the main exporters to Serbia, together accounting for 68.2 per cent. of total imports from CEFTA countries. Outside the EU and CEFTA countries, China accounted for 7.5 per cent. of total imports in 2011 and Russia accounted for 13.4 per cent. of total imports, mainly due to imports of fuels and energy supplies.

In the nine months ended 30 September2012, the share of Serbia's imports from EU member states increased from 55.9 per cent. to 58.2 per cent., while the share of imports from countries forming part of the Commonwealth of Independent States (the "CIS") decreased from 16.4 per cent. to 15.0 per cent. Russia's share of Serbia's total imports decreased to 10.1 per cent., primarily due to a decrease in the value of fuels and energy supplies imported.

Exports

The following table shows the value of Serbia's exports of goods by product category for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1]:

	Year ended 31 December					*30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
Food and live animals	987	1,015	1,076	1,331	1,503	1,063	1,230
Beverages and tobacco	128	169	178	176	196	145	166
Crude materials (inedible), except fuels	299	306	208	350	469	360	347
Mineral fuels, lubricants and related materials	168	254	276	379	353	281	221
Animal and vegetable oils, fats and waxes	69	100	86	109	144	105	120
Chemicals and related products not elsewhere specified	667	752	473	662	718	527	536
Manufactured goods[2]	2,257	2,423	1,557	2,147	2,492	1,937	1,562
Machinery and transport equipment	914	1,288	1,054	1,199	1,406	1,016	1,293
Miscellaneous manufactured articles[3]	912	1,054	962	932	1,083	798	871
Commodities and transactions not specified in SITC Rev. 4[4]	32	68	91	108	77	46	53
Total	6,433	7,429	5,961	7,393	8,441	6,278	6,399

Source: Office of Statistics.

Notes:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary

exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

(2) Manufactured goods classified chiefly by material, including leather, leather manufactures not elsewhere specified and dressed fur skins, rubber manufactures not elsewhere specified, cork and wood manufactures (excluding furniture), paper, paperboard and articles of paper, pulp of paper, or of paper board, textile yarn, fabrics, made-up articles not elsewhere specified and related products, non-metallic mineral manufactures not elsewhere specified, iron and steel, non-ferrous metals and manufactures of metals not elsewhere specified.

(3) Includes prefabricated buildings; sanitary, plumbing, heating and lighting fixtures, furniture and parts thereof, bedding, mattresses, cushions and similar products, travel goods, handbags and similar containers, articles of apparel and clothing accessories, footwear, professional, scientific and controlling instruments and apparatus, photographic apparatus, equipment and supplies, optical goods not elsewhere specified and miscellaneous manufactured articles not elsewhere specified.

(4) Standard International Trade Classification, Revision 4; includes coins, gold (excluding gold ores and concentrates) and other unclassified goods including army goods, storage goods with no customs tariff marked and motor vehicle parts and aircrafts parts for those imported/exported with the transport mean. For the years 2010 and 2011, the Office of Statistics reclassified the goods from the unclassified category, where they were, initially, in appropriate categories.

The following table shows the value of Serbia's exports of goods by product category as a percentage of total exports for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[(1)]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
	(% of total exports)						
Food and live animals	15.3	13.7	18.0	18.0	17.8	16.9	19.2
Beverages and tobacco	2.0	2.3	3.0	2.4	2.3	2.3	2.6
Crude materials (inedible), except fuels	4.6	4.1	3.5	4.7	5.6	5.7	5.4
Mineral fuels, lubricants and related materials	2.6	3.4	4.6	5.1	4.2	4.5	3.5
Animal and vegetable oils, fats and waxes	1.1	1.3	1.5	1.5	1.7	1.7	1.9
Chemicals and related products not elsewhere specified	10.4	10.1	7.9	9.0	8.5	8.4	8.4
Manufactured goods[(2)]	35.1	32.6	26.1	29.0	29.5	30.9	24.4
Machinery and transport equipment	14.2	17.4	17.7	16.2	16.7	16.2	20.2
Miscellaneous manufactured articles[(3)]	14.2	14.2	16.1	12.6	12.8	12.7	13.6
Commodities and transactions not specified in SITC Rev. 4[(4)]	0.5	0.9	1.5	1.5	0.9	0.7	0.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Office of Statistics.

Notes:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

(2) Manufactured goods classified chiefly by material, including leather, leather manufactures not elsewhere specified and dressed fur skins, rubber manufactures not elsewhere specified, cork and wood manufactures (excluding furniture), paper, paperboard and articles of paper, pulp of paper, or of paper board, textile yarn, fabrics, made-up articles not elsewhere specified and related products, non-metallic mineral manufactures not elsewhere specified, iron and steel, non-ferrous metals and manufactures of metals not elsewhere specified.

(3) Includes prefabricated buildings; sanitary, plumbing, heating and lighting fixtures, furniture and parts thereof, bedding, mattresses, cushions and similar products, travel goods, handbags and similar containers, articles of apparel and clothing accessories, footwear, professional, scientific and controlling instruments and apparatus, photographic apparatus, equipment and supplies, optical goods not elsewhere specified and miscellaneous manufactured articles not elsewhere specified.

(4) Standard International Trade Classification, Revision 4; includes coins, gold (excluding gold ores and concentrates) and other unclassified goods including army goods, storage goods with no customs tariff marked and motor vehicle parts and aircrafts parts for those imported/exported with the transport mean. For the years 2010 and 2011, the Office of Statistics reclassified the goods from the unclassified category, where they were, initially, in appropriate categories.

In 2011, exports of several products were at levels higher than in the period before the global financial and economic crisis. This growth in exports was primarily driven by the recovery of sectors that had traditionally accounted for a substantial percentage of exports prior to the crisis, such as manufactured goods and machinery and transport equipment. Together, these accounted for 46.2 per cent. of Serbia's total exports in 2011. Exports of manufactured goods and machinery and transport equipment increased 16.1 per cent. and 17.3 per cent., respectively, compared to 2010. Other sectors that also experienced high growth during 2011 include crude materials, except fuels (34.0 per cent.), chemicals and related products (8.5 per cent.), food and live animals (12.9 per cent.) and miscellaneous manufactured articles (16.2 per cent.). These sectors collectively accounted for 47.5 per cent. of export growth in 2011. By contrast, exports of mineral fuels, lubricants and related materials and non-classified commodities decreased by 6.9 per cent. and 28.4 per cent., respectively, in 2011.

The following table shows the value of Serbia's exports by destination for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[(1)]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(EUR millions)			
EU	3,603	4,029	3,196	4,235	4,868	3,647	3,682
Germany	684	773	624	760	953	719	753
Italy	799	763	586	844	936	718	600
Romania	193	273	343	491	583	442	546
Slovenia	298	339	245	321	377	281	257
France	212	233	178	209	222	170	165
Hungary	182	222	183	229	249	169	168
Other	1,235	1,426	1,037	1,381	1,548	1,148	1,193
CEFTA	2,072	2,458	1,881	2,126	2,298	1,074	1,665
Bosnia and Herzegovina	760	907	725	822	853	630	629
Montenegro	692	866	599	609	636	485	469
Croatia	241	294	199	232	336	235	229
Macedonia	318	334	306	360	376	276	276
Other	61	57	52	103	97	78	62
CIS	455	545	408	599	777	571	624
Russia	326	374	249	403	568	416	480
Other CIS countries	129	171	159	196	209	155	144
Other Countries	303	397	476	433	498	356	428
China	4	4	7	5	11	8	12
USA	58	44	48	53	57	40	52
Other	241	349	421	375	430	308	364
Total	6,433	7,429	5,961	7,393	8,441	6,278	6,399

Source: Office of Statistics.

Note:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

The following table shows the value of Serbia's exports by destination as a percentage of total exports for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012[1]:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(% of total imports)			
EU	56.0	54.2	53.6	57.3	57.7	58.1	57.5
Germany	10.6	10.4	10.5	10.3	11.3	11.5	11.8
Italy	12.4	10.3	9.8	11.4	11.1	11.4	9.4
Romania	3.0	3.7	5.8	6.6	6.9	7.0	8.5
Slovenia	4.6	4.6	4.1	4.3	4.5	4.5	4.0
France	3.3	3.1	3.0	2.8	2.6	2.7	2.6
Hungary	2.8	3.0	3.1	3.1	3.0	2.7	2.6
Other	19.3	19.1	17.3	18.8	18.3	18.3	18.6
CEFTA	32.2	33.1	31.6	28.8	27.2	27.1	26.0
Bosnia and Herzegovina	11.8	12.2	12.2	11.1	10.1	10.0	9.8
Montenegro	10.8	11.7	10.0	8.2	7.5	7.7	7.3
Croatia	3.7	4.0	3.3	3.1	4.0	3.8	3.6
Macedonia	4.9	4.5	5.1	4.9	4.4	4.4	4.3
Other	1.0	0.7	1.0	1.5	1.2	1.2	1.0
CIS	7.1	7.3	6.8	8.1	9.2	9.1	9.8
Russia	5.1	5.0	4.2	5.5	6.7	6.6	7.5
Other CIS countries	2.0	2.3	2.6	2.6	2.5	2.5	2.3
Other Countries	4.7	5.3	8.0	5.9	5.9	5.7	6.7
China	0.1	0.1	0.1	0.1	0.1	0.1	0.2
USA	0.9	0.6	0.8	0.7	0.7	0.7	0.8
Other	3.7	4.6	7.1	5.1	5.1	4.9	5.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Office of Statistics.

Note:

(1) Data prepared in accordance with foreign trade statistics methodology of the Office of Statistics; International Merchandise Trade Statistics: Concepts and Definitions 2010, UN. As of 1 January 2010, the Office of Statistics became applicable to the general trade system, which includes all goods entering or leaving the country's economic territory. Goods in transit or temporary exports/imports (goods exhibited at fairs, samples, etc.) were excluded. In accordance with these amendments, the Office of Statistics has released adjusted data from 2007 onwards.

EU member states are the main importers of goods from Serbia, collectively representing 57.7 per cent. of Serbia's total exports in 2011. There were signs of recovery in exports in 2011, after a decreasing trend during 2008 and 2009 as a result of the global financial and economic crisis. In 2011, the share of Serbia's exports to CEFTA countries dropped to 27.2 per cent. of Serbia's total exports from 28.8 per cent. in 2010, primarily driven by a decrease in total exports to Montenegro and Bosnia and Herzegovina. However, Bosnia and Herzegovina has remained Serbia's main export destination within CEFTA countries, accounting for 37.1 per cent. of exports to CEFTA countries. Other than EU member states and CEFTA countries, the highest growth rate in exports in 2011 occurred in exports to Russia, which increased by 40.7 per cent. from EUR 403 million in 2010 to EUR 568 million in 2011. Exports to Russia represented 6.7 per cent. of Serbia's total exports and consisted primarily of industrial products, classified as intermediate goods, as well as of parts of transport equipment, consumer durables and primary foods and food preparations.

In the nine months ended 30 September 2012, the share of exports to EU member states decreased to 57.5 per cent. of total exports. The share of exports to Germany increased from 11.5 per cent. to 11.8 per cent. and the share of exports to Italy decreased from 11.4 per cent. to 9.4 per cent., compared to the same period in 2011. The crisis in Italy has had a significant impact on demand and, thereby, on Serbia's exports of base metals and chemicals to that market. The prices of base metals dipped, pushing the value of exports down further (unit values of the exports of base metals declined by 6.1 per cent. in the period from January – August 2012 relative to the same period in 2011), while unit values of the exports of chemicals and chemical products increased by 0.6 per cent. in the same period. The decrease in exports of

base metals and chemicals to Italy was caused, to some extent, by exports of Fiat automobiles that started in August 2012. Lower exports of base metals to Germany were offset by higher exports of electric equipment, motor vehicles and trailers.

The share of exports to CEFTA countries decreased to 26.0 per cent. in the nine months ended 30 September 2012 from 27.1 per cent. of total exports during the same period in 2011. Russia's share of Serbia's exports in this period increased, while the share of exports to China remained broadly flat.

Trade Policy

Serbia's economic growth model focuses on the development of an export-oriented and competitive industry.

In the last few years, with a view to attracting foreign investments, the government introduced tax reliefs, abolished tax on income and retained earnings for a two-year period, and allowed tax reductions in payment of taxes and contributions. Since 2008, the Government has increased investment in construction and improvement of roads and infrastructure with the aim of attracting foreign investments. The Government also introduced significant subsidies to encourage the creation of new jobs by both local and foreign employers (up to EUR 10,000 per each new employee) and incentives for business in free industrial zones. The Serbia Investment and Export Promotion Agency is responsible for facilitating and financing the promotion of small and medium-sized enterprises in foreign markets, as well as providing assistance in relation to cluster formation, branding and obtaining the required certifications to participate in certain export markets, among other things.

The Government's recent measures aimed at reducing the fiscal deficit (see "*Public Finance – Fiscal Policy and Reform*") are expected to lead to a decrease in imports, notably of consumer goods, and to an increase in exports in 2013. However, as a result of the drought induced decrease in production of certain crops, such as sugar beet, sunflower seed and soy bean, the Government has taken measures to limit the export of such crops in order to ensure the satisfaction of domestic demand. The Government will subsidise interest on bank loans approved to exporters. FX-indexed loans will be extended at 3.5 per cent., while interest rates on Dinar loans will range up to the level of NBS key policy rate. The Government has also announced incentives for new export-oriented foreign direct investments.

Another key aspect of Serbia's trade policy is maintaining and entering into new free trade agreements with its trading partners. See "*– International Trade Agreements*".

Serbia achieved relatively high growth of exports of goods and services in the period from 2006 to 2011, increasing by 65.1 per cent. during that period. Exports of goods as a percentage of Serbia's nominal GDP increased from 21.9 per cent. as at 31 December 2006 to 27.1 per cent. as at 31 December 2011. The coverage of commodity imports with exports amounted to 60.5 per cent. in 2011. The export structure of Serbia is typical of less developed countries. See "*– Foreign Trade*". Serbia's goal is to transition to a more export-oriented economy, increasing economic growth through growth in exports of goods and services.

In order to reduce its foreign trade deficit and increase the contribution of exports to GDP, Serbia is seeking to increase the contribution of higher value added tradable goods (such as motor vehicles, pharmaceutical products, metals and machinery, among others) to exports, while at the same time decreasing the share of food, beverages, tobacco and oil distillery. This is likely to result in an increase in the share of the machinery and transport equipment sector as a percentage of total exports, while other sectors are likely to remain broadly flat or experience a small decline, such as the beverages and tobacco sector. In addition, Serbia aims to strengthen small- and medium-sized enterprises, transnational companies seeking to invest in new projects and technologically developed large public production companies.

In relation to exports of services, tourism and transportation were the largest contributors to exports of services in Serbia in 2011, with a 23.4 per cent. and 22.3 per cent. share of total exports of services, respectively. The Ministry of Tourism, together with other tourism organisations, is responsible for the promotion of Serbia as an attractive leisure and entertainment destination for tourists. In addition to tourism and transport, other business services are also expected to contribute significantly to the growth of exports of services, having increased by 7.3 per cent. in 2011.

While no significant changes are expected in Serbia's main import and export destinations, Serbia is seeking to strengthen economic relations with former Yugoslav republics as part of its trade policy, as well as rebuilding business relations and trade with the Near and Middle East countries and North Africa.

In order to achieve an increase in the share of exports of goods and services in GDP, Serbia will also continue to pursue other macro-economic policy goals, including: EU integration, intensification of economic co-operation with the CEFTA region maximising exports to Russia, OPEC and Mediterranean countries, attracting FDIs, simplifying conditions to doing business in Serbia and educating local producers about potential export markets.

International Trade Agreements

Serbia has free trade agreements with its main trade partners, including the EU, CEFTA, the European Free Trade Association ("EFTA") and Turkey, under which Serbia benefits from the application of country of origin principles. In 2009, Serbia entered into free trade agreements with CIS countries, including Russia, Belarus and Kazakhstan. In addition, Serbia is in negotiations to join the World Trade Organisation.

Serbia signed the SAA with the EU in April 2008. In addition, on 16 October 2008, Serbia adopted a decision to unilaterally implement the Interim Trade Agreement and initiated its implementation in Serbia on 1 January 2009. The Interim Trade Agreement then came into force between the EU and Serbia on 1 February 2010. The Interim Trade Agreement provides for the establishment of a free trade area between the EU and Serbia, regulates certain aspects of economic activity, notably in relation to business competition and state aid, and guarantees that the EU market will remain open to most Serbian products. Full implementation of the Interim Trade Agreement involves gradually abolishing customs duties and other restrictions on the importation of products from the EU, which are classified in three groups by degree of sensitivity, in addition to a group of industrial products for which restrictions on trade have already been removed as part of the implementation process. Implementation also allows Serbia to benefit from the principle of "diagonal cumulation of origin", which allows products with their originating status in one partner country to be further processed or added to products originating in another participating country as if the products had been originated in the latter country. This principle is particularly important as preferential conditions for exports to the EU market may be enjoyed only for goods of known origin, which would otherwise cause potential problems in connection with goods produced in more than one country within the region. The Interim Trade Agreement then came into force between the EU and Serbia on 1 February 2010. The Government expects the Interim Trade Agreement and the SAA to attract foreign investment and strengthen economic links with the EU, as well as increasing the productivity and competitiveness of Serbia's export sector.

Serbia's free trade agreement with Russia was entered into in August 2000. The trade agreement stipulates that the importing country regulates the rules of origin, in accordance with WTO principles, meaning that goods produced and with prevailing value added in Serbia are considered to be of Serbian origin, and are therefore free of customs when entering the Russian market. The list of products not covered by the duty-free agreement is updated annually and it currently includes fresh and processed produce, poultry, sugar, chocolate, alcoholic beverages, soap, cotton, carpets, wooden furniture, household appliances, and motor vehicles. This free trade agreement is the first such agreement Russia has signed with any country outside the CIS.

Foreign Direct Investment ("FDI")

The Government has announced and implemented several measures in the recent years aimed at creating a favourable environment for foreign direct investment. See "– *Trade Policy*".

The following table shows the net FDI in Serbia for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
FDI (net) (EUR millions)	1,821	1,824	1,372	860	1,827	1,227	(21)
FDI (net) (% of nominal GDP)[1]	6.4	5.6	4.7	3.1	5.9	5.4	(0.1)

Source: Office of Statistics; National Bank.

Note:

(1) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

Prior to the global financial and economic crisis, net FDI into Serbia reached approximately EUR 3,323 million in 2006. In 2007, net FDI decreased by 45.2 per cent. to EUR 1,821 million, primarily driven by the privatisation of Mobile Telecommunication Company, MOBI063 in the previous year. In 2008, net FDI remained broadly flat at EUR 1,824 million. The crisis had an adverse impact on FDI levels, with net FDI decreasing by 24.8 per cent. to EUR 1,372 million in 2009 and by a further 37.3 per cent. to EUR 860.0 million in 2010. In 2011, net FDI amounted to EUR 1,827 million, increasing by over 100 per cent. of the amount of net FDI in 2010.

In 2011, nearly 60 per cent. of all FDI inflow in Serbia was invested in three branches of activities: retail trade (34.5 per cent.), financial services (16.7 per cent.) and basic metals (7.3 per cent.). The most significant investment was from Delhaize in the retail chain company Maxi.

Despite the declining trend in FDI, a number of foreign investors, including Italian car manufacturer Fiat Group Automobiles S.p.A., Ball Packaging Europe Belgrade Ltd. and Delhaize Group (through its recent acquisition of Delta Maxi) are expanding operations in Serbia. One of the most significant FDI projects in Serbia is the new automobile manufacturing facility by Fiat Automobiles Serbia, which is almost entirely export-oriented and predominantly targets the EU market. The first automobiles produced under this project were delivered in September 2012. The EIB provided a EUR 500 million (U.S.$625 million) loan to Fiat for the new plant in Serbia. In respect of the project, Serbia will pay to Fiat EUR 50 million in 2012 and EUR 30 million in 2013.

In addition, broadened and intensified co-operation efforts are expected in exports to Russia. Sberbank has expressed readiness to invest an additional EUR 100 million in Serbian export companies by the end of 2012 and Gazpromneft has invested approximately EUR 1.5 billion in Serbia. Construction of the South Stream gas pipeline is expected to commence before the end of 2012 under a joint venture between the state-owned gas operator, Srbijagas, and Gazprom. The project includes the construction of 470 kilometres of pipeline through Serbia with 40 billion m^3 capacity per year. A new investment by Russian Railways to assist in modernising Serbia's railways has been announced, under which Serbia is expected to receive U.S.$800 million. In addition, mining company Rio-Tinto has announced large investments in the production of lithium during the next few years and electric power producers from Italy and Germany have signed an agreement with Serbia for building new electrical power plants on the Morava and Drina rivers, and an additional thermo energy power plant Nikola Tesla 3.

Moreover, in order to further develop the energy sector, Electric Power Industry of Serbia, the state-owned power company, is partnering with RWE AG and Edison S.p.A for the construction of new hydro power plants on the Morava and Drina rivers and an additional thermo energy power plant Nikola Tesla 3. The Government aims to attract FDI in the manufacturing, energy, infrastructure, telecommunications and agriculture sectors and, in support of this objective, is adopting initiatives to improve the ease of conducting business in Serbia and simplifying administrative processes, for example by cutting 138 para-fiscal duties and levies, introducing subsidies for the creation of new jobs by foreign employers and subsidising interest on corporate loans granted by local commercial banks. In 2013, FDI growth is expected mainly from the automotive and energy sectors. The National Bank estimates that FDI will reduce Serbia's current account deficit as a percentage of nominal GDP by 2.7 per cent. annually between 2012 and 2014, increasing export growth rates by 8.5 per cent. on an annual basis. On this basis, the National Bank estimates that Serbia's

current account deficit will decrease from 11.4 per cent. of nominal GDP in 2012 to 6.0 per cent. in 2014. The National Bank estimates that the increase in net exports resulting from the investment in Fiat Automobiles Serbia will result in an increase in nominal GDP by an additional 1.0 per cent. in 2013.

The following table shows the net inflow of FDI in Serbia by industry for the years 2008 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December				*Nine months ended 30 September*	
	2008	*2009*	*2010*	*2011*	*2011*	*2012*(1)
	(EUR millions)					
Agriculture	38	21	11	10	5	6
Fishing	–	–	5	–	–	–
Mining and quarrying	20	405	4	57	49	12
Manufacturing	388	533	338	441	306	1,072
Electricity, gas and water supply	2	5	8	24	21	10
Construction	56	28	29	93	65	88
Wholesale and retail trade, repair	276	222	194	883	552	170
Hotels and restaurants	16	5	2	15	12	5
Transport, storage and communications	168	118	75	69	64	22
Financial intermediation	861	156	285	406	157	39
Real estate, renting and business activities	588	240	177	186	129	68
Public administration and defence; compulsory social security	2			19	16	2
Education	–	–	1	1	1	0
Health and social work	–	–	–	–	0	1
Other communal, social and personal.	18	18	10	31	24	29
Unclassified(2)	–	58	–	1	–	33
Total investment by non-residents	2,434	1,810	1,139	2,236	1,401	1,557
Total inflow from withdrawing resident investment abroad	96	58	33	53	47	45
Outflow from withdrawing non-resident investment in Serbia	(416)	(400)	(136)	(287)	(131)	(1,547)
Investment of domestic capital abroad	(289)	(96)	(176)	(175)	(90)	(76)
Total FDI	1,824	1,372	860	1,827	1,227	(21)

Source: Office of Statistics; National Bank.

Notes:

(1) Preliminary data.

(2) Includes FDI in kind not otherwise included in another category.

In 2011, portfolio investment inflows were important to Serbia's balance of payments. As the Government began selling long-term (maturity over one year) debt securities, non-residents obtained a legal right to buy Government bonds. In 2011, net portfolio liabilities (domestic securities bought by non-residents) amounted to EUR 1,619 million. In the nine months ended 30 September 2012, net portfolio liabilities amounted to EUR 178.0 million, which was 88.6 per cent. lower than in the same period in 2011.

In the nine months ended 30 September 2012, the trend in FDI changed due to the Government's repurchase of the national telecommunications company "Telekom Serbia" from the Greek telecommunications company, OTE, and the partial withdrawal of capital in the mobile provider, "Telenor". The withdrawal of non-residents resulted in negative net FDI of EUR 21 million in the nine months ended 30 September 2012. In this period, 31.6 per cent. of FDI inflow was invested in manufacturing, 24.6 per cent. in wholesale and retail trade and nearly 12.8 per cent. in construction.

The following table shows the net inflow of FDI in Serbia by country of origin for the years 2008 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December				*Nine months ended 30 September*	
	2008	*2009*	*2010*	*2011*	*2011*	*2012*[1]
			(EUR millions)			
Austria	267	234	146	156	137	57
Belgium	26	2	3	6	5	0
British Virgin Islands	27	13	(2)	6	5	(1)
Bulgaria	14	13	9	4	1	28
Croatia	97	19	42	21	2	51
Cyprus	44	29	52	44	24	37
France	53	5	16	112	48	12
Germany	58	41	34	76	71	39
Greece	34	46	24	10	8	(355)
Hungary	21	19	15	67	21	8
Ireland	1	11	5	(1)	(1)	(3)
Italy	330	167	41	131	27	68
Lithuania	4	–	2	–	–	0
Luxembourg	49	6	6	813	430	21
Montenegro	29	7	1	7	3	(11)
Netherlands	359	178	206	242	229	0
Poland	15	1	2	–	0	1
Romania	12	1	–	3	3	1
Russia	19	401	3	50	69	12
Slovakia	–	24	32	(5)	11	(11)
Slovenia	72	39	96	(69)	(18)	4
Spain	11	6	14	50	48	10
Switzerland	82	63	53	58	20	77
United Kingdom	12	51	54	30	19	22
United States of America	34	12	54	24	20	18

Source: National Bank.

The Netherlands is the largest contributor to FDI in Serbia, accounting for 17.8 per cent., 12.6 per cent., 20.5 per cent. and 12.6 per cent. of net inflow of FDI in Serbia in the years ended 31 December 2008, 2009, 2010 and 2011, respectively. Historically, Dutch companies have invested predominantly in Serbia's manufacturing industry (basic metals and production of food and beverage).

In the nine months ended 30 September 2012, the most significant movement in the FDI account was the withdrawal of a Greek telecommunications company, OTE, from "Telekom Serbia". OTE had 20 per cent. of equity capital in the Serbian telecommunications company, which is now 100.0 per cent. owned by the Government. During the third quarter of 2012, a Serbian brewery and a bank changed foreign owners, this had a neutral effect on net FDI, but can be seen in the break down of FDI by activity and country. In the nine months ended 30 September 2012, the largest FDI inflows were from Switzerland, Croatia and Austria.

Bilateral co-operation infrastructure projects

The Government has inter-governmental contracts for bilateral co-operation in infrastructure projects that are designed to facilitate the development and financing of infrastructure projects in Serbia. Through these agreements, Serbia aims to promote co-operation and attract foreign investment in infrastructure development.

China

The Agreement on Economic and Technical Co-operation in the Area of Infrastructure between Serbia and China was signed on 20 August 2009 in Beijing and came into force in June 2010. The following documents have been signed pursuant to this Agreement:

- Contract on Construction (design and construction works) of the Zemun – Borca Bridge entered into on 15 April 2010 between Serbia as the Contracting Authority, the City of Belgrade as the beneficiary and the China Road and Bridge Corporation (CRBC) as the subcontractor party tasked with the construction works, for total consideration amounting to U.S.$255 million (EUR 182.1 million);

- Contract on Supply of X-Ray Inspection System for Serbia's Customs Administration, entered into in December 2009 between Serbia (acting through the Ministry of Finance and Economy) and NUCTECH CO. Pic Beijing, in December 2009 in Beijing, for total consideration amounting to U.S.$45 million (EUR 32.0 million); and

- Memorandum of Understanding for the Package Project Kostolac Implementation, entered into in February 2010 between the Electric Power Industry of Serbia Public Enterprise and China National Machinery & Equipment Import & Export Corporation, for total consideration amounting to U.S.$1.2 billion (EUR 0.86 billion). The Contract Agreement for the execution of Phase I of the Package Project Kostolac-B Power Plant Projects was entered into on 8 December 2010 between the Electric Power Industry of Serbia Public Enterprise and Subsidiary Company "Termoelektrane i kopovi Kostolac" d.o.o, and a consortium consisting of CMEC and Subsidiary Company "Termoelektrane i kopovi Kostolac" d.o.o, for total consideration amounting to U.S.$344.63 million.

The 2013 Budget provides for a U.S.$ 1.2 billion loan from the Export-Import bank of China. The loan is expected to be signed in 2013.

Azerbaijan

On 25 January 2012, the governments of the Republic of Azerbaijan and Serbia signed the Agreement on Economic and Technological Co-operation, which sets out the principles of economic co-operation between the two countries. The following documents have been signed pursuant to this Agreement:

- Construction contract between "Koridori Srbije" d.o.o. Beograd and "Azvirt" Limited Liability Company, Azerbaijan, signed in April 2012, for the purchase of goods and services for the construction of sections of Corridor Eleven (Ljig-Boljkovci, Boljkovci-Takovo, Takovo-Preljina) in Serbia, in the amount of up to EUR 308.0 million; and

- Loan Agreement between Serbia and the Republic of Azerbaijan, signed on 2 February 2012, providing for a loan facility to finance the construction contract above, in the amount of up to EUR 300.0 million.

MONETARY SYSTEM

National Bank

The status, organisation, mandate and functions of the National Bank, as well as the relationship between the National Bank and other Serbian governmental bodies and international organisations and institutions, are regulated by the NBS Law.

The National Bank is independent and autonomous in fulfilling its functions as stipulated by the Law on the National Bank (and other related legislation) and is accountable for its work to the Assembly. The primary objective of the National Bank is to achieve and maintain price stability and contribute to the safeguarding and strengthening of the stability of the financial system. The governing bodies of the National Bank consist of the Executive Board, the Governor and the Council of the Governor. The National Bank's headquarters are located in Belgrade and the National Bank also has branch offices in Belgrade, Novi Sad, Nis, Kragujevac and Uzice and is responsible for the Institute for Manufacturing Banknotes and Coins in Topcider.

Reform of the NBS Law

Under recent amendments to the NBS Law that came into effect as of 5 August 2012, the new administration, FISA, will operate within the National Bank to perform the functions of supervision of the financial institutions, as defined under the NBS Law. The amendments aim to increase the quality of supervision of the Serbian monetary system and increase transparency in National Bank operations; however, there is a risk that even with heightened supervision some banks will demonstrate increased losses and deteriorating capital adequacy. FISA can propose to the Executive Board by-laws and issuance of licences to financial institutions, and FISA must deliver a report to the Council of the Governor each quarter. The Director of FISA is appointed by the Assembly on proposal of the Assembly committee in charge of finance for a six-year renewable term of office, and the Director sits on the Executive Board. FISA and its mandate will be regulated in detail by the NBS law.

Also, according to the amendments to the NBS Law, the Assembly will appoint the Vice-Governors of the National Bank, whereas previously only the Governor was appointed by the Assembly. The Council of the Governor has two new duties under the amendments: (i) to decide on the National Bank's foreign exchange reserves management strategy on the proposal of the Executive Board; and (ii) to decide on National Bank membership in international financial institutions and organisations. The NBS Law also regulates the internal audit unit in the National Bank, and the head of this unit is elected by the Council of the Governor after public procedure. While there have been certain changes in the personnel at the NBS, specifically the resignation of the governor and vice-governor and the appointment of three vice-governors, the day to day teams remain unchanged. For further discussion see "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Other risks associated with the banking sector*".

On 6 November 2012, further amendments to the NBS came into effect, which are intended to strengthen the position of the National Bank and address concerns raised by the IMF, EU and rating agencies about the earlier August amendments to the NBS Law by further securing the independence of the National Bank. These most recent amendments include a system of staggered appointments of National Bank officials (except for the Governor) so that continuity of personnel within the National Bank is maintained, and allow for the decision to dismiss a National Bank official to be challenged before the Constitutional Court. In addition, the NBS law was amended to specifically prescribe as one of the National Bank's powers the protection of consumers of financial services.

The National Bank is currently in the process of drafting new provisions within its by-laws (the core internal document that defines organisational structure and operations of the National Bank) (the "By-law"). The Council adopts the By-law upon proposal of the Executive Board. In order to address concerns about the independence of the National Bank, the November 2012 amendments to the NBS Law eliminated the requirement that the By-law be confirmed by the Assembly. It is expected that the new provisions of the By-

law will relate to internal organisation of the National Bank, organisation of working processes and systematisation of jobs.

National Bank Procedure and Functions

The National Bank has the following functions:

- determining and implementing monetary and foreign exchange policies;
- managing foreign exchange reserves;
- establishing and implementing activities and measures under its remit, relating to the preservation and strengthening of financial stability;
- granting and revoking operating licences, supervising bank solvency and legality of operations and performing other activities in line with the Law on Banks;
- granting and revoking operating licences and/or authorisations to insurance companies, supervising these companies and performing other activities in line with the Law on Insurance;
- granting and revoking operating licences to voluntary pension fund management companies, supervising these companies and performing other activities in line with the Law on Voluntary Pension Funds;
- granting and revoking operating licences to financial leasing companies, supervising these companies and performing other activities in line with the Law on Financial Leases;
- protecting rights and interests of beneficiaries of services performed by banks, financial leasing companies, insurance companies and voluntary pension fund management companies, pursuant to the law;
- issuing banknotes and coins and managing cash flows;
- regulating, controlling and promoting the uninterrupted functioning of the payment system, domestically and abroad; and
- other matters prescribed under Serbian law or by treaties.

The Executive Board shall consist of the Governor, the Director of FISA and Vice-Governors. The Executive Board establishes measures and activities pertaining to the National Bank's remit for the purpose of maintaining and strengthening financial stability, as well as measures for maintaining bank liquidity. The Executive Board determines monetary and foreign exchange policies, and, in particular, it determines the conditions applicable to, and method for issuing securities, the terms and manner in which the National Bank carries out open market operations and discount operations, short-term lending policy, Dinar exchange rate policy, strategy foreign currency reserves management policy, the key policy rate and other interest rates of the National Bank, the base for calculating required reserves and the reserve requirement ratio. On proposal of FISA, the Executive Board also makes decisions on the granting and revocation of operating licences for financial institutions. Also, on proposal of FISA, the Executive Board adopts regulations in the field of supervision of financial institutions in line with the NBS Law.

Acting on proposals made by the Executive Board and with the Government's consent, the Council of the Governor establishes the Dinar exchange rate regime, adopts the National Bank's By-Law and the National Bank's development strategy, and monitors its implementation. The Council of the Governor adopts the strategy of foreign reserves management on proposal of the Executive Board. Additionally, the Council of the Governor decides on membership of international financial institutions and organisations. The Council of the Governor adopts the financial plan and annual financial statements of the National Bank, appoints the external auditor and discusses the auditor's report. The Council of the Governor also supervises the National Bank's financial reporting system, assesses the adequacy of its accounting policies and procedures and supervises and adopts its annual internal audit plan and appoints the manager of the organisational unit in charge of internal audit. In addition, the Council of the Governor submits to the Assembly a report on its operations, at least twice a year, as well as the annual statement of accounts along with the certified auditor's report by no later than 30 June of the following year.

Monetary Policy

Overview

Serbia's monetary policy during recent years has focused on stabilising the inflation rate and maintaining the stability of the foreign exchange markets and the country's financial system.

The main monetary policy instrument of the National Bank is the key policy rate – the interest rate applied in its main open market operations. On 18 July 2012, the National Bank changed its main open market operations to one-week repo transactions from two-week reverse repo transactions. The key policy rate is set in response to changes in economic developments and the inflation outlook. Other monetary policy instruments have a supporting role, including modifying reserve requirements and intervening in the foreign exchange market.

Prior to the introduction of formal inflation targeting in January 2009, the National Bank's monetary policy focused on core inflation, which is calculated on the basis of changes in retail prices, excluding regulated prices and the prices of agricultural products. The National Bank sought to maintain price stability within its predetermined inflationary corridor and achieve its core inflation targets by modifying the key policy rate based on an analysis of the then current economic situation coupled with assessments of inflation movements and mid-term inflation projections. By modifying its key policy rate and interest rate corridors, the National Bank was able to influence short-term interest rates in the interbank market and, as a consequence, aggregate demand, production and prices.

Between 2006 and October 2008, Serbia experienced significant capital and investment inflows from abroad. As a result, there was an increase in the foreign exchange reserves held by the National Bank, as well as an appreciation of the Dinar. In order to prevent the increase in capital inflows from affecting the overall domestic demand and leading to an increase in price levels, the National Bank sought to restrict the usage of bank surpluses of liquid funds by engaging in extensive open market operations, as well as through its mandatory reserves mechanism.

In October 2008, when the first effects of the global financial and economic crisis were experienced in Serbia, the National Bank introduced a series of measures aimed at strengthening Serbia's financial and macroeconomic stability and mitigating the effects of the crisis. These measures were primarily aimed at improving the liquidity of banks, reducing currency risk exposure and mitigating depreciation and inflationary pressures. At the end of 2008, the National Bank signed the Agreement on Inflation Targeting with the Government. Pursuant to this Agreement, the National Bank adopted a *Memorandum on Inflation Targeting as Monetary Strategy*, which defined the main principles of the inflation targeting regime as the official monetary policy strategy from January 2009 onwards. The setting of inflation targets from 82 percentage points through 2009 to 41.5 percentage points through 2014 demonstrates Serbia's commitment to work towards achieving mid-term price stability and EU prices and income levels.

In 2009, the National Bank began to address headline inflation, as opposed to focusing only on core inflation, by planning changes to regulated prices. By targeting headline inflation, the National Bank sought to improve communication with the public in order to influence and stabilise inflation expectations, which are crucial to decision-making in the corporate and financial sectors, as well as in households. Inflation targets are set by the National Bank in co-operation with the Government, on the basis of an analysis of the current and expected macroeconomic movements and the medium-term expectations of changes in prices under direct or indirect Government regulation. As a result, responsibility for control of inflation is shared between the National Bank and the Government.

In 2009, the National Bank also switched from Retail Price Index to Consumer Price Index targeting, an approach that had been adopted internationally by other countries with inflation targeting policies. For the first time in January 2009, the inflation target was set as a linearly declining band of annual changes in consumer prices. The band was set with a midpoint for each month of the year, in order to assess whether inflation targets were being met throughout the year, rather than only at year end.

Implementation of Serbia's Monetary Policy

The instruments presently used by the National Bank to implement Serbia's targeted inflation monetary policy are divided into four categories: (i) open market operations; (ii) reserve requirements; (iii) lending and deposit facilities (standing facilities); and (iv) interventions in the foreign exchange market.

Open market operations

The National Bank uses open market operations to manage banks' liquidity and short-term interest rates in the money markets.

In the period from 2006 to October 2008, the National Bank restricted the surplus of Serbian banks' liquid funds, generated from the massive inflow of capital and investment from abroad, by selling substantial amounts of its own securities in the open market. From September 2006 to October 2008, the amount outstanding under securities issued by the National Bank increased by RSD 167.2 billion. At the end of the first nine months of 2008, the aggregate amount outstanding under securities of the National Bank stood at RSD 242.7 billion.

From September 2006 to February 2009, the National Bank sold six-month T-bills in order to stimulate the secondary market for such securities and to influence the yield curve of transactions with longer maturities in the interbank market. The sale of six-month bills by the National Bank stopped in February 2009, with the sale of three-month bills issued by the Ministry of Finance and Economy.

Between October 2008 and December 2010, there was a decrease of RSD 195.8 billion in the outstanding amount under bills issued by the National Bank, which stood at RSD 46.9 billion as at 31 December 2010. As at 30 June 2011, the amount outstanding under National Bank bills stood at RSD 73.9 billion, increasing by 57.6 per cent. from the end of 2010.

As at 30 June 2011, the amount outstanding under National Bank bills was RSD 73.9 billion, increasing by 57.6 per cent. from the end of 2010. The outstanding amount under securities of the National Bank continued to rise in the second half of 2011, and as at 31 December 2011 it was RSD 120.6 billion. This was mainly driven by spending government foreign currency deposits. The outstanding amount under National Bank bills remained on a similar level throughout the first quarter of 2012 and amounted to RSD 116.2 billion as at 31 March 2012. This gradually declined in the second quarter of 2012 primarily due to National Bank foreign exchange sales in the interbank foreign exchange market and changes in required reserves regulation. On 18 July 2012, the National Bank began direct repurchase auctioning of government securities. As at 30 September 2012, the outstanding amount of liquidity provided via the one week direct repo transactions stood at RSD 8.0 billion. As at 25 July 2012, the outstanding amount under National Bank bills had been completely exhausted.

Reserve requirements

By changing the reserve ratio, the National Bank affects the ability of commercial banks to lend and thus influences the liquidity of the market.

During the period between 2006 and 2008, the National Bank used the reserve requirements as a means to encourage banks to hold local currency assets by applying lower reserve requirements to Dinar exposures relative to foreign-currency exposures. In order to contain foreign capital inflows and control the resulting increase in lending by banks, the National Bank increased the required reserve ratio and expanded the base for its calculation to include foreign currency liabilities, subordinated foreign currency liabilities, foreign currency deposits and credits received from abroad with repayment terms of up to two years. Furthermore, the mandatory deposits required to be maintained by leasing companies with banks was increased from 10.0 per cent. to 20.0 per cent., while banks were required to calculate the required reserves on such funds at the rate of 100.0 per cent. The required reserve ratio on Dinar deposits and loans with terms of over two years, received from abroad, was also increased. In addition, the limit on the daily usage of the required reserve funds was abolished, allowing banks to manage liquid funds without any restrictions. In order to promote strengthening and increased use of the Dinar, the National Bank also reduced reserve requirements on the Dinar liabilities of the banks and introduced a differentiated ratio which was lower on Dinar term deposits for a period of over one month.

In October 2008, the National Bank introduced certain changes in reserve requirements for banks, prompted by the withdrawals of foreign savings deposits and overall outflow of foreign capital as a result of the global financial and economic crisis. The new measures allowed banks to use, as a base for calculating reserve requirements in respect of deposits and loans originated abroad and subordinated foreign currency liabilities, the average daily net book value of such liabilities in September 2008, should the average daily average net book value of such liabilities in the preceding month be lower than that in September 2008. This measure was applied until March 2010. In addition, in order to mitigate depreciation pressures, banks were required to allocate a specified portion of the foreign currency required reserve in Dinar (40.0 per cent.).

In the first three months of 2009, the Government introduced the Government Programme of Measures for Mitigating Negative Effects of the Global Economic Crisis in the Republic of Serbia (the "Government Programme"). In conjunction with the Government Programme, the National Bank made certain changes to the calculation of required reserves, including, among other things, reducing the base for the calculation of required reserves by the amount of credits granted to the corporate sector to finance investments and the amount of consumer loans granted for the purchase of durables produced in Serbia. Furthermore, the percentage allocation of foreign currency reserves in Dinar was reduced from 40.0 per cent. to 20.0 per cent., thus allowing banks to allocate less than the Dinar equivalent of the calculated required reserve in Euro in order to improve Dinar liquidity in the banking sector.

In March 2010, the National Bank modified the base for the calculation of required reserves so that the Dinar base would include only non-indexed liabilities, while the base of foreign currency liabilities was extended by including foreign currency indexed Dinar liabilities. In addition, the rate at which banks calculated required reserves ratios was unified and reduced to 5.0 per cent. on Dinar liabilities and to 25.0 per cent. on the foreign currency base. The new model for the calculation reserves was introduced after a one-year transition period.

In January 2011, the National Bank proposed changes to the required reserve ratios in order to give support to Dinar liquidity and long-term sources of funding. This was accomplished through differentiation of the required reserves ratio in accordance with the maturity structure of the source (in line with the policy of the European Central Bank) and differentiation of percentage allocation of foreign currency reserves in Dinar. The proposed changes were implemented in February 2011. The required reserves ratios on Dinar liabilities of up to two years remained at the level of 5.0 per cent., while the required reserve ratios were reduced to 0.0 per cent. for maturities longer than two years. The required reserve ratios on foreign currency base for maturities of up to two years were set to 30.0 per cent., while the required reserve ratio remained at 25.0 per cent. for maturities longer than two years. After implementation of these measures, the maturity structure of foreign currency sources of funding gradually improved. The share of longer-term sources rose from 10.0 per cent. to 14.0 per cent. in a one-year period.

In April 2012, required reserves ratios on foreign currency sources of funding were reduced to 29.0 per cent. and 22.0 per cent., respectively, while the percentage allocation of foreign currency reserves in Dinar increased depending on source maturity to 20.0 per cent. and 15.0 per cent., respectively. In June 2012, the National Bank increased the required reserve ratios on the Dinar liabilities with a foreign currency clause to 50.0 per cent. (the share of foreign currency-indexed deposits in total foreign currency deposits is less than 3.5 per cent.), while the required reserve ratios on other foreign currency sources of funding remained unchanged (29.0 per cent. and 22.0 per cent., respectively). At the same time, the National Bank increased the percentage allocation of foreign currency reserves in Dinar depending on sources maturity to 27.0 per cent. and 19.0 per cent., respectively, while in August 2012, the percentage allocation of foreign currency reserves in Dinar was further increased to 32.0 per cent. and 24.0 per cent., respectively. The measures aimed to contribute to stabilisation in the foreign exchange market and further stimulate banks to obtain longer-term sources of funding.

Standing and other loan facilities

Standing facilities involve the use of collateralised loans to maintain daily liquidity and depositing banks' excess liquid balances with the National Bank. Interest rates on the standing facilities are set to create a symmetrical interest rate corridor, which enables liquidity control and eases fluctuations of short-term interest rates in the interbank money markets. The symmetrical interest rate corridor was implemented

in September 2006. During the period between September 2006 and March 2007, interest rates on standing facilities were 4 percentage points above and below the key policy rate. By the end of March 2007, the corridor was narrowed to 2.5 percentage points above and below the key policy rate, following a reduction of the key policy rate.

From 2006 to mid-2008, the National Bank permitted banks the use of short-term loans collateralised with certain securities (known as "Lombard" loans) in order to maintain liquidity. Banks were permitted to use such loans for up to 45 business days continuously and/or up to 60 days intermittently during a period of 120 days. Banks used these loans mainly on an intra-day basis by withdrawing and repaying the loan on the same day, since this form of loan withdrawal was interest-free. In early June 2008, the National Bank implemented the *Decision on the Conditions and the Manner of Extending Daily Liquidity Loans against a Collateral of Securities* (the "Decision"). According to the Decision, banks are allowed to use a liquidity loan as an intra-day liquidity loan or as an overnight liquidity loan. On the portion of the withdrawn and repaid intra-day loan, banks pay no interest to the National Bank, while on the amount of overnight loan banks pay interest equal to the key policy rate plus 2.5 per cent. In 2011, the National Bank amended the Decision by excluding foreign currency government securities from the collateral. In March 2011, the Dinar securities collateral was further favoured, as maturity for discount government securities was extended from two to three years and coupon government securities, regardless of their residual maturity, were introduced as possible collateral.

Other Instruments

Other instruments used by the National Bank to implement Serbia's monetary policy include foreign exchange swaps, liquidity loans and short-term Dinar loan auctions.

Credit Aggregates

The following table shows the liquidity and credit aggregates for the Serbian banking sector as at 31 December in each of the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(RSD millions)			
Liquid assets (core)[1]	350,715	412,757	430,224	436,700	485,013	397,342	486,438
Liquid assets (broad measure)[2]	558,766	490,595	581,965	483,626	605,632	498,372	486,438
Short-term liabilities	182,163	152,696	166,493	173,166	192,293	175,480	204,178
Total loans	853,451	1,145,224	1,425,203	1,850,888	1,987,658	1,916,337	2,278,397
Loans to public sector	44,261	55,082	180,974	281,611	323,158	310,058	413,214
Loans to private sector (excluding loans to other financial institutions)[3]	802,529	1,070,609	1,225,453	1,533,844	1,620,744	1,562,689	1,816,733
Loans to other financial institutions[3]	6,659	19,533	18,776	35,433	43,758	43,590	48,450

Source: National Bank.

Notes:

(1) Core liquid assets include currency, deposits and other financial assets that are available either on demand or within three months or less.

(2) The broad measure of liquid assets includes: (i) currency; (ii) deposits and other financial assets that are available either on demand or within three months or less; and (iii) securities that are traded in liquid markets (including repo markets) that can be readily converted into cash with insignificant risk of change in value under normal business conditions.

(3) Pursuant to the new Decree on the Classification of Activities that came into force in August 2010, loans to financial holding corporations were reclassified from loans to the private sector to loans to other financial institutions.

In 2009, total loans increased by 24.4 per cent. to RSD 1,425,203 million as at 31 December 2009, primarily driven by a 14.5 per cent. increase in loans to the private sector. Loans to the public sector also recorded significant growth, increasing by 228.6 per cent. from RSD 55,082 million as at 31 December 2008 to RSD 180,974 million as at 31 December 2009, primarily due to an increase in the outstanding amount of Government debt resulting from the issuance of T-bills and bank credit facilities. In contrast, loans to other financial institutions stood at RSD 18,776 million at the end of 2009, decreasing by 3.9 per cent. from RSD 19,533 million at the end of 2008. Liquid assets (broad measure) increased by 18.6 per cent. in 2009, reaching RSD 581,965 million as at 31 December 2009 compared to RSD 490,595 million as at 31 December 2008, driven by increased investment in repo transactions. Short-term liabilities also increased by 9.0 per cent. reaching RSD 166,493 at the end of 2009.

In 2010, total loans increased by 29.9 per cent. to RSD 1,850,888 million as at 31 December 2010, primarily driven by a 25.2 per cent. increase in loans to the private sector. Loans to other financial institutions grew significantly, increasing by 88.7 per cent. to RSD 35,433 million at the end of 2010 from RSD 18,776 million at the end of 2009, due to an increase in their financing needs and the reclassification of loans to financial holding companies as loans to other financial institutions. Loans to the public sector also increased by 55.6 per cent. from RSD 180,974 million as at 31 December 2009 to RSD 281,611 million as at 31 December 2010, primarily due to the continuing rise in the amount of Government debt outstanding and, to a lesser extent, due to an increase in the debt of public enterprises and local governments. Liquid assets (broad measure) decreased by 16.9 per cent. to RSD 483,626 million as at 31 December 2010, driven by withdrawals from repo transactions. Short-term liabilities also increased by 4.0 per cent.

In 2011, lending rose at a slower pace. Total loans increased by 7.4 per cent. to RSD 1,987,658 million as at 31 December 2011, primarily driven by a 5.7 per cent. increase in loans to the private sector. Loans to other financial institutions increased by 23.5 per cent. to RSD 43,758 million as at 31 December 2011. Loans to the public sector also increased by 14.8 per cent. from RSD 281,611 million as at 31 December 2010 to RSD 323,158 million as at 31 December 2011, primarily due to an increase in borrowings by public enterprises. In financing credit activity, banks primarily relied on domestic sources, mainly deposits. At the same time, banks opted to invest part of available funds in repo and government securities. The corporate sector primarily used current asset loans, while an encouraging trend was seen in the rising share of investment loans. Subsidised lending was pronounced in the first six months of 2011. Subsidised lending decreased by approximately 50.0 per cent., compared to 2010, with RSD 107,896 million of extended loans. Liquid assets (broad measure) increased by 25.2 per cent. to RSD 605,632 million as at 31 December 2011, mostly driven by rising investment in repo transactions. Short-term liabilities increased by 11.0 per cent. reaching RSD 192,293 million as at 31 December 2011.

The declining trend continued in the first nine months of 2012. Total loans increased in nominal terms by 14.6 per cent. to RSD 2,278,397 million as at 30 September 2012, mainly due to a 12.1 per cent. increase in loans to the private sector. However, due to a high share of foreign currency indexed loans, a significant part of this nominal increase was a result of Dinar depreciation during the first eight months of 2012. Loans to other financial institutions increased by 10.7 per cent. as at 30 September 2012. Claims to the public sector increased by 27.9 per cent., primarily due to the fact that banks mainly invest in government securities. Banks continued to rely predominantly on domestic sources of finance, mostly through increases in deposits and withdrawal from repo transactions. On the other hand, due to rises in claims and a decrease in foreign liabilities, banks did not use foreign sources in financing lending activity. Liquid assets (broad measure) decreased by 19.7 per cent. to RSD 486,438 million as at 30 September 2012, driven by withdrawal from repo transactions and the decrease in foreign currency deposits and gyro accounts held by the National Bank. Short-term liabilities increased by 6.2 per cent. reaching RSD 204,178 million as at 30 September 2012.

Compared to previous years, the subsidised segment of the credit market saw significantly lower activity in the first eight months of 2012, since fewer funds were allocated for these purposes in the budget. Up until August, banks approved only RSD 12,868 million of these loans, mostly in the second quarter. Among the loans disbursed, a majority were agricultural (RSD 5,527 million) and housing (RSD 5,224 million) loans. Almost all funds earmarked for interest rate subsidies in 2012 were disbursed in the first half of 2012.

In September 2012, the Ministry of Finance and Economy implemented a new programme of subsidised lending, under which banks are able to grant liquidity, working assets and export loans to enterprises. These loans can also be used to refinance already existing loans. In the first two months of the programme, banks have granted EUR 812.2 million (app. RSD 93,389.9 million) of these loans, which improved overall lending activity in this period. Along with loans granted under other programmes, total activity in the subsidised market amounted to RSD 101,279.5 million in 2012.

Monetary Aggregates

The following table shows certain statistics relating to monetary aggregates as at 31 December for the years 2008 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
	(RSD millions, unless otherwise indicated)						
Narrow money (Ml)	248,873	240,744	258,427	253,286	293,694	256,417	290,193
Broad money (M2)	390,485	395,025	436,768	410,495	487,914	433,841	467,426
Broad money (M3)	903,871	992,151	1,205,570	1,360,777	1,500,444	1,412,180	1,607,585
Broad money (M3) year-on-year growth rate (%)	42.5	9.8	21.5	12.9	10.3	8.1	13.8
Broad money (M3) share of GDP[(1)](%)	39.7	37.3	44.4	47.2	47.3	45.3	49.3
Reserve money	439,172	514,125	533,776	537,338	607,722	503.793	612,500
Growth rate (%)	10.6	17.1	3.8	0.7	13.1	(5.4)	21.6
Deposits in RSD	319,435	301,401	338,315	313,791	369,834	337,431	352,202
Deposits in foreign currencies	517,009	599,180	769,925	961,977	1,021.951	987,647	1,162,107
Loans in RSD[(2)]	777,655	1,054,569	1,332,339	1,717,322	1,840,421	1,774,026	2,076,023
Loans in foreign currencies[(2)]	84,060	90,655	92,864	133,566	147,238	142,313	202,376

Source: National Bank.

Notes:

(1) Calculated as a percentage of Nominal GDP. Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

(2) Includes claims on public non-financial corporations, other non-financial corporations and individuals.

In 2009, narrow money (Ml) increased by 7.3 per cent. from RSD 240,744 million as at 31 December 2008 to RSD 258,427 million as at 31 December 2009. Broad money supply (M2) increased by 10.6 per cent. from RSD 395,025 million at the end of 2008 to RSD 436,768 million at the end of 2009, while the broader money supply (M3) measure increased by 21.5 per cent. from RSD 992,151 million to RSD 1,205,570 million in the same period. Foreign currency deposits experienced greater growth than Dinar deposits in 2009, recording increases of 28.5 per cent. and 12.2 per cent. and reaching RSD 769,925 million and RSD 338,315 million, respectively, at the end of 2009. In contrast, Dinar-denominated loans recorded a greater growth rate than loans denominated in foreign currencies, increasing by 26.3 per cent. and 2.4 per cent., respectively. Dinar-denominated loans stood at RSD 1,332,339 million at the end of 2009, while loans denominated in foreign currencies amounted to RSD 92,864 million.

In 2010, narrow money (Ml) decreased by 2.0 per cent. to RSD 253,286 million at the end of the year. Broad money M2 fell by 6.0 per cent. to RSD 410,495 million and broad money M3 increased by 12.9 per cent. to RSD 1,360,777 million. Foreign currency deposits continued to record positive growth in 2010, increasing by 24.9 per cent. to RSD 961,977 million as at 31 December, whereas Dinar deposits decreased by 7.2 per cent. to RSD 313,791 million in the same year. Foreign currency loans exhibited significantly greater growth relative to Dinar-denominated loans increasing by 43.8 per cent. and 28.9 per cent., respectively. As at 31 December 2010, foreign currency loans and Dinar loans stood at RSD 133,566 million and RSD 1,717,322 million, respectively.

The decline in money supply beginning in 2010 halted during 2011. Increased Government spending in the fourth quarter of 2011 contributed to acceleration of growth in money supply. As at 31 December 2011, Ml, M2 and M3 increased by 16.0 per cent., 18.9 per cent. and 10.3 per cent. to RSD 293,694 million, RSD 487,914 million and RSD 1,500,444 million, respectively. Dinar deposits rose by 17.9 per cent. to RSD 369,834 million as at 31 December 2011, primarily due to rises in household and corporate deposits. Foreign currency deposits increased by 6.2 per cent. to RSD 1,021,951 million as at 31 December 2011, partly as the

result of a rise in household savings and partly due to one trade chain sale to a foreign investor. Foreign currency loans and Dinar-denominated loans increased by 10.2 per cent. and 7.2 per cent., reaching RSD 147,238 million and RSD 1,840,421 million, respectively, as at 31 December 2011.

In the nine months ended 30 September 2012, narrow and broad money measures declined, with Ml and M2 decreasing by 1.2 per cent. and 4.2 per cent., while M3 increased by 7.1 per cent. mostly due to Dinar depreciation. Money supply continued to rise year-on-year, with slight acceleration in year-on-year growth rates in September. Dinar deposits declined in the nine months ended 30 September 2012 by 4.8 per cent. to RSD 352,202 million, while foreign currency deposits increased by 13.7 per cent. to RSD 1,162,107 million. All categories of corporate deposits, both Dinar and in foreign currency, declined due to lower activity. Household savings continued to rise and reaching EUR 7.7 billion as at 30 September 2012.

Inflation and Interest Rates

Inflation policy and trends

The following table shows the year-on-year percentage change in consumer prices by type of product or service for the years ended 31 December 2007 to 2011 and for the year ended 30 September 2012:

			Year ended 31 December			*Year ended 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(% change)			
Fruit and vegetables	46.5	4.2	2.8	20.4	(11.0)	40.3
Regulated prices	12.3	8.3	11.2	12.0	10.5	5.3
Electricity	15.0	12.5	–	11.5	13.5	–
Gas for households	(2.5)	57.2	(0.6)	–	10.3	10.3
Utility-housing services	9.4	6.6	22.7	22.9	10.1	6.8
Social welfare services	14.2	4.8	15.4	6.5	0.8	0.1
Transport services (regulated)	4.8	8.0	27.2	4.2	18.1	4.8
Postal and telecommunications services	0.5	0.7	12.2	0.5	9.2	–
Cigarettes	24.7	10.4	15.0	16.3	12.8	20.4
Medications	5.8	(2.9)	16.7	10.2	4.0	0.6
Other	13.4	9.9	10.5	14.3	1.0	2.5
Petroleum products	16.5	(18.8)	45.9	12.3	13.4	20.6
Core inflation[1]	7.9	10.8	3.6	8.6	7.0	8.6
Total inflation	11.0	8.6	6.6	10.3	7.0	10.3
Food	20.1	14.7	(0.2)	10.9	6.0	15.0
Energy	10.5	4.6	14.2	13.0	11.1	8.2
Services	4.3	6.5	9.2	8.9	5.4	6.1

Source: National Bank.

Note:

(1) Core inflation is an indicator measuring market determined prices that do not display high and seasonal volatility. It excludes regulated prices, prices of petroleum products and fruit and vegetables.

The following table shows the contribution by product or service to the year-on-year change in consumer prices for the years 2007 to 2011 and for the year ended 30 September 2012:

			Year ended 31 December			*Year ended 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(% change)			
Fruit and vegetables	2.2	0.3	0.2	1.3	(0.6)	2.4
Regulated prices	2.6	1.8	2.4	2.5	2.3	1.2
Electricity	1.0	0.9	–	0.8	0.9	–
Gas for households	–	0.2	–	–	0.1	0.1
Utility-housing services	0.3	0.2	0.6	0.6	0.3	0.2
Social welfare services	0.1	–	0.1	–	–	–
Transport services (regulated)	0.1	0.3	–	0.2	–	–
Postal and telecommunications services	–	–	0.2	–	0.2	–
Cigarettes	1.0	0.5	0.6	0.6	0.5	0.8
Medications	0.2	(0.1)	0.4	0.3	0.1	–
Other	0.1	0.1	0.1	0.1	–	–
Petroleum products	0.7	(0.8)	1.5	0.6	0.5	1.0
Core inflation[(1)]	5.6	7.3	2.5	5.9	4.8	5.7
Total inflation	11.0	8.6	6.6	10.3	7.0	10.3
Food	6.1	4.9	(0.1)	3.6	2.1	5.2
Energy	1.7	0.7	2.2	2.1	1.9	1.4
Services	0.8	1.2	1.7	1.7	1.0	1.1

Source: National Bank.

Note:

(1) Core inflation is an indicator measuring market determined prices that do not display high and seasonal volatility. It excludes regulated prices, prices of petroleum products and fruit and vegetables.

Serbia's inflation rate in 2009, measured by reference to the CPI, was 6.6 per cent., against an inflation target of 8.0 per cent. (with a tolerance band of 2.0 per cent.), and was driven primarily by a 11.2 per cent. increase in regulated prices, particularly in petroleum product prices, which increased by 45.9 per cent., representing 22.7 per cent. of the overall increase in regulated prices during that year. Prices remained relatively stable throughout 2009, primarily due to low aggregate demand and decreasing food prices. The deflationary pressure of such factors was set against the inflationary impact of short-lived fluctuations in the exchange rate of the Dinar and inflation expectations.

In 2010, Serbia's inflation rate increased to 10.3 per cent., against an inflation target of 6.0 per cent. (with a tolerance band of 2.0 per cent.), driven by the cumulative impact of a 10.9 per cent. increase in food prices (representing 35.0 per cent. of the overall increase in Serbia's inflation rate) as well as a nominal depreciation of the Dinar due to an increase in Serbia's country risk premium. The increase in prices experienced in 2010 resulted primarily from an increase in core inflation, which reached 8.6 per cent., and a 12.0 per cent. increase in regulated prices. See "*Risk Factors – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Relatively high and sustained inflation may have a material adverse effect on the Serbian economy*".

The rising trend in Serbia's inflation rate continued in the first four months of 2011, driven by an increase in regulated prices and food prices. Inflation peaked at 14.7 per cent. in April 2011, following which it decreased to 7.0 per cent. as at 31 December 2011. Compared to prices as at 31 December 2010, consumer prices remained 3.3 percentage points lower as at 31 December 2011, mainly as a result of reduced pressures on food prices, low aggregate demand and restrictive monetary policy measures.

In the first nine months of 2012, consumer prices increased by 9.6 per cent., primarily due to an increase in unprocessed food prices (34.6 per cent.) and fresh fruit and vegetable prices (37.3 per cent.). Year-on-year inflation moved within the target tolerance band in the first half of the year, except in April when it touched slightly below the lower bound of the target tolerance band (2.7 per cent.). The downward trend in year-on-year inflation beginning in April 2011 was reversed in May 2012 primarily due to a new agricultural season.

The downward trend in year-on-year inflation that began in April 2011 was reversed in May 2012 with the beginning of a new agricultural season. In September year-on-year inflation was 10.3 per cent. It was the third month in a row that year-on-year inflation was above the upper bound of the target tolerance band (5.63 per cent. in September). Year-on-year inflation is expected to rise in the coming months due to a further increase in processed food prices, VAT and excise increases and low monthly rates in the same period of the previous year. Inflation is expected to peak in the first half of 2013, and then subside and settle within the bounds of the target tolerance band by the end of 2013.

The National Bank targets annual inflation continuously based on the CPI. See "– *Monetary Policy – Overview*". Targets are also defined for every month, so that the success in reaching the target can be continuously monitored. The setting of inflation targets from 8.0 per cent. + 2 percentage points through 2009 to 4.0 per cent. +1.5 percentage points through 2014 demonstrates Serbia's commitment to work toward achieving mid-term price stability and EU prices and income levels. Inflation targets have been set to achieve low and stable inflation that will not trigger macroeconomic instability. In setting inflation targets up to 2014, the degree of the real and nominal convergence of Serbia and Eurozone countries, among other things, was taken into account. During this transitional phase, the National Bank expects a comparatively lower difference in productivity between tradable and non-tradable sectors relative to those in the Eurozone, and, consequently, a lower impact on inflation. Even though productivity differentials affect inflation (due to faster increases of non-tradable prices), the National Bank believes that the impact will be lower than in the earlier stages of the transition.

In the next two years, the National Bank expects that the reduced impact of productivity on inflation will aid price levels in Serbia to catch-up with price levels in the Eurozone, because much of the related price adjustment will have already been completed. The choice of a deflationary path was also based on the assumption that regulated prices will show slower growth (particularly in electricity and gas prices), because the gap between end-user prices and cost recovery prices will have been considerably reduced. The fact that some price adjustments remain to be completed is reflected in the level of the set targets. These targets will remain higher in the period ahead than those set in developed countries (2.0 per cent. or 2.5 per cent.).

Key factors in achieving a targeted deflationary path are a fiscal consolidation, appropriate incomes policies and growth-oriented structural reforms (increasing competition, downsizing the Government, reforming taxes, etc.).

The following table shows the monthly inflation targets and tolerance bands for the years 2012 and 2013:

	2012		*2013*	
	Inflation Target	*Tolerance Band*	*Inflation Target*	*Tolerance Band*
		(%)		
January	4.5	+1.5	4.0	+1.5
February	4.4	+1.5	4.0	+1.5
March	4.4	+1.5	4.0	+1.5
April	4.3	+1.5	4.0	+1.5
May	4.3	+1.5	4.0	+1.5
June	4.2	+1.5	4.0	+1.5
July	4.2	+1.5	4.0	+1.5
August	4.2	+1.5	4.0	+1.5
September	4.1	+1.5	4.0	+1.5
October	4.1	+1.5	4.0	+1.5
November	4.0	+1.5	4.0	+1.5
December	4.0	+1.5	4.0	+1.5

Source: National Bank.

Interest Rates

The following table shows the monthly weighted average interest rates for total new deposits in Serbian banks for each month for the years ended 31 December 2007 to 2011 and for the year ended 30 September 2012[(1)]:

	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(%)			
January	5.31	4.33	7.67	4.94	6.53	6.76
February	5.34	5.04	8.39	5.48	7.07	6.60
March	4.69	5.20	8.05	4.94	7.00	6.54
April	4.60	5.63	7.68	4.98	7.30	6.30
May	4.32	5.82	7.30	4.57	6.86	5.74
June	3.59	6.14	6.90	4.60	6.93	6.20
July	3.83	6.31	6.42	4.44	6.62	6.27
August	3.96	6.31	6.30	4.44	6.62	6.57
September	3.96	6.40	6.51	5.33	6.89	6.65
October	4.44	6.69	6.30	5.96	6.71	–
November	4.60	7.18	5.87	6.47	6.07	–
December	4.08	7.32	5.06	6.65	6.35	–

Source: National Bank.

Note:

(1) These figures include interest rates on new deposits for both Dinar and foreign currency deposits, as well as interest rates for both individual depositors and institutional and corporate depositors.

During the first nine months of 2012, interest rates on new business Dinar-denominated loans to households increased by 1.4 percentage points to 21.0 per cent. compared to 31 December 2011, while the price of loans denominated and indexed in Euro decreased from 10.0 per cent. to 7.9 per cent. Interest rates on housing loans denominated and indexed in Euro decreased from 5.6 per cent. to 5.2 per cent. and decreased from 9.2 per cent. to 7.1 per cent. on consumer loans. The price on Dinar-denominated loans to non-financial corporations increased by 0.4 percentage points, to 16.6 per cent., compared to the end of 2011, while the loans denominated and indexed in Euro decreased by 0.2 percentage points to 7.7 per cent. Interest rates on the most expensive loans (revolving loans, overdrafts and convenience and extended credit card debt) increased for the households sector from by 0.1 percentage points to 25.8 per cent. and for non-financial corporations by 0.5 percentage points to 11.4 per cent.

Interest rates paid on Dinar-denominated household term deposits increased from 9.7 per cent. in December 2011 to 10.1 per cent. in September 2012, while the rates on deposits denominated and indexed in Euro decreased by 0.7 percentage points to 4.0 per cent. Interest rates on non-financial corporation deposits denominated in Dinar increased by 0.6 percentage points to 10.4 per cent., while the rates on new deposits denominated and indexed in Euro decreased by 1.1 percentage points to 2.8 per cent.

Exchange Rates and Exchange Rate Policy

Serbia operates a managed floating exchange rate regime, under which the exchange rate of the Dinar is not fixed against the exchange rate of any other foreign currency or basket of currencies. The Dinar exchange rate is determined by demand and supply forces operating in the foreign exchange markets. While the National Bank does not set a specific range of exchange rate values within which the Dinar must be maintained, it may intervene in the interbank foreign exchange market in order to mitigate excessive exchange rate volatility and preserve the financial stability of Serbia by conducting open market operations affecting foreign exchange rates or through the use of other monetary policy instruments, such as modifying reserve requirements for banks.

The National Bank aims to maintain the stability of the Dinar/Euro exchange rate in order to meet its primary monetary policy objective of maintaining price stability in Serbia. There are significant Euro capital inflows into Serbia and the role and circulation of the Euro is substantial in the Serbian economy. As a result,

domestic prices are very sensitive to movements in the exchange rate of the Dinar against the Euro and exchange rate movements materially impact inflationary expectations.

The following table shows the exchange rate history for the years 2007 to 2011 and for the period ended 8 November 2012, expressed in Dinar per Euro and not adjusted for inflation:

	Serbian Dinar to Euro[1]			
	Low	*High*	*Average*	*Period End*
2012 (up to and including 15 November 2012)	103.6922	119.0723	113.1093	112.6731
2012 (up to and including 30 September 2012)	103.6922	119.0723	113.0156	115.0320
2011	96.7007	106.4947	101.3577	72.6811
2010	95.9679	107.5216	103.0431	105.4982
2009	89.5436	96.5657	93.9517	95.8888
2008	75.7543	91.6317	81.4405	88.6010
2007	76.8093	84.7540	79.9640	79.2362

Source: National Bank.

Note:

(1) Not adjusted for inflation.

The following table shows the exchange rate history for the years 2007 to 2011 and for the period ended 8 November 2012, expressed in Dinar per U.S. Dollar and not adjusted for inflation:

	Serbian Dinar to U.S.$[1]			
	Low	*High*	*Average*	*Period End*
2012 (up to and including 15 November 2012)	79.9073	97.6220	88.2946	88.4127
2012 (up to and including 30 September 2012)	79.9073	97.6220	88.3471	88.9377
2011	66.6387	82.4106	73.3382	80.8662
2010	66.8376	86.7278	77.9066	79.2802
2009	61.9332	75.6297	67.4731	66.7285
2008	48.9974	72.2647	55.7641	62.9000
2007	52.8478	62.0940	58.3934	53.7267

Source: National Bank.

Note:

(1) Not adjusted for inflation.

In 2009, the Dinar depreciated against the Euro by 7.6 per cent. in nominal terms. Given the domestic inflation rate of 6.6 per cent. and Eurozone inflation of 0.9 per cent., it lost 2.4 per cent. in real terms (as compared to 4.4 per cent. in 2008). At the same time, the Dinar depreciated against the U.S. Dollar by 5.7 per cent. in nominal terms or 2.2 per cent. in real terms, taking account of inflation in Serbia of 6.6 per cent. and in the United States of 2.7 per cent. Real depreciation of the Dinar against the U.S. Dollar, including the concurrent depreciation of the Dinar against the Euro, was achieved against the background of a weakened U.S. Dollar against the Euro in global markets at 2.0 per cent. in 2009.

In January and February of 2009, the National Bank intervened in the foreign exchange market in an attempt to minimise the spill-over effects of the global financial and economic crisis on the local currency, selling EUR 556.4 million of Euro reserves in order to reduce excessive daily volatility of the foreign exchange rate.

In the period from March to December 2009, the stability of foreign exchange rates was restored, primarily as a result of lower demand for foreign currencies and thus lower pressure on the foreign exchange liquidity of Serbian banks. The Dinar experienced strong depreciation pressures again in early December 2009, as well as a considerable increase in Dinar liquidity at the end of that month, primarily due to the conversion into Dinar of the funds received from the IMF in order to make payments to Budget beneficiaries, leading to several interventions in the foreign exchange market for a total amount of EUR 100.5 million.

The value of the Dinar fluctuated in 2010, reflecting the uncertainties of the financial markets triggered by the emerging sovereign debt crises of Greece and other Eurozone countries. During 2010, the Dinar

experienced a nominal depreciation of 9.1 per cent. against the Euro compared to the end of the previous year, whereas the depreciation in real terms was 1.9 per cent., based on inflation figures for Serbia and the Eurozone. During the year, the National Bank intervened in the interbank foreign exchange market by selling foreign exchange in the amount of EUR 2,569.7 million and purchasing EUR 236.5 million in order to ease excessive daily fluctuations of the Dinar foreign exchange rate. At the end of the year, the Dinar strengthened due to increased foreign exchange inflows from non-residents, driven by the change in the outlook of Serbia's credit rating by Fitch from "negative" to "stable" and a reduction in Serbia's country risk premium (Fitch reversed its outlook from "stable" to "negative" in August 2012).

During the first six months of 2011, the Dinar appreciated against the Euro by 3.0 per cent., primarily driven by higher capital inflows in the form of portfolio investment and the decrease in Serbia's country risk premium from 16 March 2011, when S&P raised its long-term local and foreign-currency sovereign credit rating from BB- to BB (reaffirming the B short-term local and foreign-currency credit ratings). The strengthening of the Dinar against the Euro was followed by depreciation pressures in early June, driven by market uncertainty as a result of the economic difficulties suffered in the Eurozone periphery and the rise in Serbia's country risk premium, as well as the Government's decision not to renew the issue of six-month Euro-indexed bonds amounting to about EUR 200 million. These factors impacted the exchange rate of the Dinar, which depreciated on average 1.6 per cent. against the Euro in June.

In the second half of 2011, the foreign exchange market was stabilised due to FDI inflow and the precautionary stand-by arrangement agreed with the IMF. The market also reacted positively to Serbia's issuance of a 10-year Eurobond on the international financial markets. In the final two months of 2011, increased Dinar liquidity and increased demand for foreign exchange due to higher imports of energy resulted in the Dinar depreciating against the Euro. In 2011, the Dinar appreciated in nominal terms against the Euro by 0.8 per cent. In order to ease excessive daily fluctuations of the Dinar foreign exchange rate, the National Bank intervened in the interbank foreign exchange market by selling foreign exchange in the amount of EUR 90 million and purchasing EUR 45 million.

In the first nine months of 2012, the Dinar depreciated against the Euro by 9.0 per cent. in nominal terms and 2.1 per cent. in real terms, given the domestic inflation rate of 9.6 per cent. and Eurozone inflation rate of 1.8 per cent. At the same time, the Dinar depreciated against the U.S. Dollar by 9.1 per cent. in nominal terms and 2.8 per cent. in real terms. In the first quarter of 2012, increases in demand were primarily caused by the need to provide foreign exchange funding for energy imports, which swelled on account of extremely cold weather. The Dinar weakened, primarily due to postponement of the stand-by arrangement with the IMF, which increased Government spending as well as US Steel's departure from Serbia and a downward revision of the economic growth forecast for 2012. Foreign capital inflows were also low. The greatest monthly depreciation of the Dinar since the beginning of 2012 occurred in May 2012 (4.0 per cent.), and the National Bank sold the largest monthly amount of foreign exchange (EUR 472.7 million) in the same month. Depreciation pressures eased in June 2012, as a result of National Bank measures to raise the Dinar share of allocations under foreign exchange required reserves and to raise the key policy rate. However, Serbia's risk premium continued to rise in July and this increase was mainly driven by uncertainty regarding fiscal consolidation. The combination of this higher risk premium, Standard & Poor's downgrade of Serbia's credit rating and Fitch's revision of Serbia's outlook to "negative" in August, coupled with modest capital inflows prolonged the depreciation pressures. The exchange rate of the Dinar stabilised by the end of August and the Dinar started appreciating in September. At the end of September, it was 3.0 per cent. stronger than at end of August. The factors contributing to the stability of the exchange rate and the strengthening of the Dinar were: fiscal consolidation, increased foreign exchange supply fuelled by foreign currency-indexed subsidised lending, changes in reserve requirements, a successful Eurobond issue, restrictive monetary policy and liquidity dosing.

In order to ensure smooth functioning of the foreign exchange market and to ease excessive daily volatility of the exchange rate, the National Bank intervened in the interbank foreign exchange market by selling approximately EUR 1.3 billion in the first nine months of 2012.

De-euroisation strategy

In order to reduce the euroisation of the Serbian economy, the National Bank and the Government signed a Memorandum on Dinarisation Strategy in April 2012. The Dinarisation strategy is classified in three pillars in accordance with the different objectives of the process.

The first pillar of Serbia's strategy focuses on strengthening the macroeconomic environment by lowering and stabilising inflation through a flexible exchange rate, alongside sustainable economic growth and a stable financial system. In this respect, the National Bank will continue to maintain its inflation targeting regime.

The second pillar consists of measures aimed at creating favourable conditions for the development of Dinar-denominated instruments and markets, many of which have already been implemented. The Government increases the Dinar share in Public Debt by issuing securities denominated in Dinar on a regular basis. The Dinar yield curve has been extended to five years. Since May 2010, state-subsidised cash and liquidity loans are also granted in Dinar. In addition, monetary policy favours the local currency, for example, by applying a significantly lower required reserve ratio on Dinar sources of funding.

The third pillar of the strategy consists of promoting the use of hedging instruments, both in the inter-bank market and in client transactions against foreign exchange risk. The National Bank has also introduced regular foreign exchange swap auctions, organised a series of foreign exchange risk hedging conferences, launched a website for the promotion of foreign exchange risk hedging and has produced a Report on Dinarisation of the Serbian Financial System on a quarterly basis.

The combination of the measures and activities undertaken by the National Bank and the Government since 2009 has led to an increase in credit Dinarisation, with the share of Dinar-denominated loans in corporate and household lending increasing from 24.5 per cent. as at 31 January 2010 to 28.2 per cent. as at 30 September 2012.

The risk arising from foreign exchange exposure for Serbian entities lies primarily with their debt servicing ability. The government regards those segments which are indebted yet non-hedged (i.e. cashflow from operations with regards to corporations and personal income with regards to households generated in Dinars) as exposed to risk. These are entities that have a majority of their revenues denominated in Dinars and their liabilities denominated in foreign currency, since the beginning of the credit expansion process (rapid expansion started around 2006). Overall, Serbian households are net savers, while the corporate and government sectors are net borrowers. Even though the level of euroisation is high (around 70 per cent. on both loans and deposits), the strategy of Dinarisation implemented by NBS and the Government has contributed to an increase in newly-granted loans denominated in Dinars. The share of Dinar debt in total Public Debt is around 19 per cent. as at 30 September 2012. Observed by sector, the share of Dinar in total deposits is significantly higher in the corporate (42.8 per cent.) than in the household sector (8.7 per cent.). The share of Dinar lending within total corporate and household lending remained almost unchanged in the last few months and amounted to 28.2 per cent. as at 30 September 2012 (24.7 per cent. for corporate and 34.8 per cent. for households). The share of Dinars in newly granted loans was around 31.3 per cent. as at 30 September 2012.

From the regulatory perspective the potential problems were identified in time which led to the assignment of additional risk to this class of borrower by the banks, followed by additional collateralisation requests by the banks. As such, the realisation of foreign exchange risks could result in decreased real income, investment potential and purchasing power due to expected high discipline in debt servicing.

Although foreign exchange risks have risen considerably, due to pressure on the domestic currency in light of potential banking sector deleveraging the worst case scenarios that are being considered in Europe, the Government considers it is unlikely that any worsening of loan portfolios due to an inability to repay obligations will cause a systemic crisis as due measures have already been put in place, and significant amounts of provision have been made for potential losses within the banking system.

Foreign Assets

The following table shows the foreign assets of the National Bank as at 31 December for the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
	(RSD millions, except where otherwise indicated)					
Net foreign assets	561,232	480,171	570,504	507,330	670,091	550,797
Gross official reserves	763,328	723,147	1,016,607	1,055,151	1,261,730	1,131,120
Use of IMF resources			106,593	161,654	170,143	175,570
Gold	17,365	22,273	31,078	47,130	58,700	75,758
Foreign exchange reserves (months of imports)[(1)]	7.22	5.20	9.36	8.09	8.60	6.90

Source: National Bank.

Note:

(1) Calculated as Gross Official Reserves excluding holdings of SDRs, in months of imports of goods and services.

The National Bank's net foreign assets are predominantly composed of foreign currency reserves, which are held in a mixture of foreign currencies. SDRs and reserves from the IMF also contribute to net foreign assets.

The upward trend in foreign exchange reserves of the National Bank experienced since 2001 came to an end in 2008 as a result of the impact of the global financial and economic crisis in Serbia. In 2008, the National Bank responded to the decreasing foreign exchange liquidity of banks resulting from bank deposit withdrawals and tightening credit conditions experienced during the global financial and economic crisis by allowing banks to withdraw RSD 102,378.5 million (EUR 1,155.5 million) from previously allocated required reserves.

This was a key driver of the decrease in foreign exchange reserves recorded in 2008, from RSD 763,328.0 million (EUR 9,633.6 million) at the end of 2007 to RSD 723,147.0 million (EUR 8,161.8 million) at the end of 2008. Another factor contributing to the decrease in foreign exchange reserves was the foreign exchange outflow resulting from the net sale of foreign currency in the interbank foreign exchange market by the National Bank amounting to RSD 104,682.1 million (EUR 1,181.5 million), aimed at increasing supply in the foreign exchange market and countering excessive daily oscillations of the Dinar exchange rate against the Euro. Foreign exchange reserves were also lowered by the servicing of international debts in the amount of RSD 23,798.2 million (EUR 268.6 million), as well as obligations under frozen foreign currency savings and the Economic Development Loan of RSD 19,634.0 million (EUR 221.6 million).

In 2009, foreign exchange reserves increased by RSD 233,978.3 million (EUR 2,440.1 million) primarily due to the disbursement of two tranches of the IMF loan totalling RSD 109,035.2 million (EUR 1,137.1 million). The inflow was also generated based on the allocation of special drawing rights ("SDR") to Serbia amounting to RSD 40,714.4 million (EUR 424.6 million), while another RSD 23,291.4 million (EUR 242.9 million) came from the loans extended by EIB, World Bank, Council of Europe Development Bank and domestic banks. Privatisation was also a significant source of foreign exchange inflow. Out of RSD 39,410.3 million (EUR 411 million) of privatisation receipts, RSD 38,355.5 million (EUR 400 million) came through the privatisation of NIS.

In 2010, foreign exchange reserves decreased by RSD 63,330.6 million (EUR 600.3 million) primarily due to the interventions of the National Bank in order to dampen volatility in the foreign exchange markets, resulting in outflows amounting to RSD 248,100.1 million (EUR 2,351.7 million). Another factor leading to the decline in foreign exchange reserves included a decrease in privatisation receipts (from RSD 43,359.8 million or EUR 411.0 million to RSD 485.3 million or EUR 4.6 million), allocation of banks' required reserves (RSD 34,687.8 million or EUR 328.8 million), the National Bank's full withdrawal from exchange operations (RSD 611.9 million or EUR 5.8 million), and an increase in loan repayments (from RSD 28,685.0 million or EUR 271.9 million to RSD 41,566.3 million or EUR 394.0 million).

In 2011, foreign exchange reserves of the National Bank increased RSD 215,152.2 million (EUR 2,056.1 million), primarily due to the proceeds from sale of Euro-denominated government securities worth RSD 131,617.3 million (EUR 1.257,8 million), of which RSD 55,825.9 million (EUR 533.5 million) was from the domestic market and RSD 75,791.4 million (EUR 724.3 million) was from the international financial markets. The disbursement of credits taken by Serbia increased the National Bank foreign exchange reserves by RSD 61,392.8 million (EUR 586.7 million). Under the stand-by arrangement with the IMF, the last credit tranche, amounting to RSD 5,409.9 million (EUR 51.7 million), was disbursed. Temporary payment operations with Kosovo and Metohija also resulted in a considerable foreign currency inflow of RSD 29,016.9 million (EUR 277.3 million). Banks' required reserve allocations in 2011 amounted to RSD 24,789.4 million (EUR 236.9 million). Foreign currency inflow from donations amounted to RSD 10,746.6 million (EUR 102.7 million). National Bank interventions in the interbank foreign exchange market generated a net outflow of RSD 12,347.6 million (EUR 118.0 million). Obligations toward foreign creditors were settled throughout the year, with payments amounting to RSD 48,490.6 million (EUR 463.4 million), while obligations under frozen foreign exchange savings resulted in a total payment of RSD 23,638.4 million (EUR 225.9 million).

In the nine months ended 30 September 2012, foreign exchange reserves of the National Bank decreased by RSD 130,610.0 million. As of 30 September 2012, foreign exchange reserves stood at RSD 1,131,120.0 million (EUR 9,833.1 million), covering monetary aggregate (Ml) by 389.8 per cent., short term debt by 2,710.3 per cent. and around seven months of imports of goods and services. The net effect of foreign exchange transactions was negative, in the amount of RSD 270,900.4 million (EUR 2,355.0 million), while the net positive market effects amounted to RSD 15,000.2 million (EUR 130.4 million).

The largest outflow from foreign exchange reserves in the nine months ended 30 September 2012 was recorded in respect of the National Bank interventions in the interbank foreign exchange market, amounting to EUR 1.3 billion.

In the nine months ended 30 September 2012, outflow from foreign exchange reserves in respect of the release of the required foreign exchange reserves net amounted to RSD 108,969.8 million (EUR 947.3 million), primarily due to new regulations pertaining to banks' balance sheet data effective as of 31 December 2011. At the end of December 2011, banks voluntarily allocated RSD 63,842.8 million (EUR 555.0 million) in required reserves and placed them in accounts with the National Bank, outperforming the level prescribed by National Bank regulations. Thus, after temporarily increasing to RSD 1,261,730 million (EUR 12,057.7 million) as at 31 December 2011, in January 2012 the foreign exchange reserves returned to approximately the same level as in early December 2011, as banks' required reserve allocations were reduced to the mandated level.

In the nine months ended 30 September 2012, payments under Euro-denominated government securities amounted to RSD 23,489.5 million (EUR 204.2 million), the settlement of obligations to foreign creditors amounted to RSD 52,868.7 million (EUR 459.6 million), the IMF debt amortisation paid out RSD 12,331.4 million (EUR 107.2 million) and the settlement of obligations under frozen foreign currency savings amounted to RSD 26,860.0 million (EUR 233.5) million.

The largest inflow over the same period originated from the sale of Euro-denominated government securities, amounting to RSD 50,740.6 million (EUR 441.1 million). The disbursement of credits taken by Serbia through the National Bank amounted to RSD 29,103.1 million (EUR 253.0 million). More substantial inflows came from interest and coupon payments of RSD 12,066.9 million (EUR 104.9 million) and other inflows amounted to RSD 26,675.9 million (EUR 231.9 million). Significant foreign exchange inflows also came from grants of RSD 7,442.5 million (EUR 64.7 million) and privatisation receipts resulted in a total inflow of RSD 2,139.6 million (EUR 18.6 million), as guarantees were called for payment after termination of sales contracts for three enterprises.

Banking Sector

Overview

The following table shows a balance sheet of Serbia's banking sector and indicates the foreign ownership of the banks by country as at 30 September 2012:

	Pre-tax result (RSD millions)	*Assets (net)*	*Equity (book value)*	*Loans*	*Deposits*	*Number of employees*
				(% of sector total)		
Greek banks	(1,766.5)	14.7	14.8	13.5	16.0	18.2
Italian banks	11,220.1	22.7	23.0	23.8	21.3	14.5
French banks	(191.5)	9.4	8.1	11.4	8.6	9.3
Austrian banks	7,054.3	16.1	17.5	17.1	14.5	12.7
German banks	1,477.8	2.3	1.9	3.0	2.1	4.5
Belgian banks	(319.0)	1.1	0.7	1.3	1.3	1.7
Slovenian banks	(497.3)	2.1	1.8	1.4	2.1	3.4
Hungarian banks	(722.5)	1.5	1.9	1.6	0.8	2.4
Cypriot banks	(106.5)	0.9	0.9	1.1	0.7	1.2
USA banks	16.2	0.2	0.2	0.3	0.2	0.7
Russian banks	1,286.8	3.5	3.6	3.5	1.7	2.0
Serbian banks	(5,484.1)	25.5	25.8	22.2	30.7	29.4
Total banks	11,967.8	100.0	100.0	100.0	100.0	100.0

Source: National Bank.

As at 30 September 2012, there were 33 banks operating in Serbia, of which 21 banks were under foreign-ownership (i.e. have a foreign majority owner or a foreign single largest shareholder), three banks were under domestic ownership and nine banks were state-owned. Foreign-owned banks account for 74.5 per cent. of total assets, 77.8 per cent. of total loans and 69.4 per cent. of total deposits. Foreign-owned banks are members of banking groups from 11 countries and significantly contributed to the growth and development of the banking sector in Serbia, introducing new banking products and rationalising operational costs.

As at 30 September 2012, Serbia's banking sector assets and capital amounted to RSD 2,844 billion (EUR 24,720 million) and RSD 574 billion (EUR 4,989 million), respectively, and employed approximately 30,000 people within the entire banking network, which comprised approximately 2,300 business units, branches, branch offices and teller units.

With a large number of banks holding small shares in total assets, lending, deposits and income, the Serbian banking sector is fragmented. The market share of the top five banks in Serbia is 47.4 per cent. for assets, 49.8 per cent. for lending and 49.1 per cent. for deposits. The share of the top 10 banks is 71.7 per cent. for assets, 72.0 per cent. for lending and 73.4 per cent. for deposits.

The average regulatory liquidity ratio for the Serbian banking sector as at 30 September 2012 was 2.10, indicating that the liquid assets (core and receivables maturing in the next 30 days) are twice as large as liabilities without maturity and liabilities that mature within 30 days. Liquid assets comprised over 32.4 per cent. of total assets and amounted to 54.1 per cent. of total short-term liabilities. At the same time, the loan-to-deposit ratio for the banking sector is believed to be at a conservative level, since Dinar lending is nearly fully financed from deposits.

The growth rate of own funding sources was sufficient to maintain the proportion of own funds to total liabilities at 20.1 per cent. The new set of by-laws harmonising capital adequacy and risk management rules with Basel II standards became effective as of 31 December 2011. The capital adequacy ratio amounted to 19.1 per cent. as of 31 December 2011 and 16.4 per cent. as of 30 September 2012. The lower capital adequacy ratio in 2012 mainly resulted from higher loan loss reserves (deducted from regulatory capital) caused by deterioration of the quality of the banking sector portfolio, but also by the fact that the capital

adequacy ratio has been calculated in accordance with Basel II standards since 31 December 2011. Since 30 September 2012, Nova Agrobanka AD Beograd, (which was founded in May as a special purpose bridge bank according to the Law on Banks), NLB bank AD Beograd, Univerzal bank AD Beograd and Razvoina banka Vojvodine AD Nova Sad have breached the capital adequacy ratio.

The overall pre-tax net profit of Serbia's banking sector was RSD 11.9 billion (approximately EUR 104 million) in the nine months ended 30 September 2012, a 52.3 per cent. decrease compared to RSD 25.1 billion in the same period in 2011. The decrease in profitability was primarily driven by an increase of over RSD 6.6 billion in directly written off loans. Net interest income and net fees were key components and drivers of operating income, comprising 90.1 per cent. of operating income (68.8 per cent. and 21.3 per cent., respectively). Operating expenditures were increased by RSD 8.7 million compared to the same period in 2011, primarily due to an increase in directly written-off loans.

The net interest margin (as a percentage of total average assets) slightly decreased to 4.2 per cent. in the first nine months of 2012, compared to 4.7 per cent. in the same period in 2011. The efficiency of the sector decreased by reference to cost-to-income ratio, which was 66.7 per cent. as at 30 September 2012, compared to 63.5 per cent. as at 30 September 2011. Along with higher credit risk related losses, return-on-assets decreased to 0.6 per cent. and return-on-equity to 2.9 per cent., compared to a return on assets of 1.3 per cent. and a return on equity of 6.5 per cent., as at 30 September 2011. A relatively low level of leverage in the banking sector made it more difficult for banks to substantially increase their return on invested capital. On the other hand, capital reserves helped stabilise the system against adverse movements in macroeconomic variables.

Within the Serbia banking sector, there is a strong trend toward decreasing reliance on foreign funding sources, especially short-term sources. The share of short-term liabilities from parent banks decreased to 1.9 per cent. of all liabilities on 30 September 2012 from 12.1 per cent., 9.1 per cent. and 3.2 per cent. in 2009, 2010 and 2011, respectively. Although the presence of Greek and Italian banks is quite significant in Serbia, the share of Serbia-hosted banks within the banking groups is rather small (less than 1 per cent.). The larger subsidiaries of these banks are consistently profitable and certain of the parent banks have revised their funding strategies to rely on international financial institutions and their local deposit markets for funds, therefore it is improbable that excess funds of the subsidiaries of those banks in Serbia would significantly contribute to potential funding needs of the parent banks. Further, banks are obligated to seek consent from the NBS before making dividend payouts in excess of 10 per cent. of their capital.

Recent changes in foreign ownership structure of the Serbian banking sector include:

- following recapitalisation by Serbia, Privredna banka Beograd AD became a state-owned bank (previously a privately-owned bank);
- Sberbank, a Russian bank, became a major owner of Volksbank AD Beograd; and
- the National Bank revoked the operating licence from Poljoprivredna banka Agrobanka a.d. Beograd ("Agrobanka") on 25 May 2012. In parallel, the National Bank appointed Serbia's Deposit Insurance Agency (the "Deposit Insurance Agency") as Agrobanka's administrator. With a view to ensuring continuity of Agrobanka's business activities and full protection of interests of its depositors and other creditors, on the same day, the Deposit Insurance Agency submitted to the National Bank an application to licence a bank which would operate under the name "Nova Agrobanka a.d. Beograd" ("Novo Agrobanka") and to which all deposits of Agrobanka (not only insured deposits) would be transferred, as well as a part of its other liabilities and receivables. On 26 May 2012, the National Bank issued the licence, which gave Novo Agrobanka six months to meet all relevant banking regulations and capital requirements. However, the bank was unable to replenish its capital base and outflows continued. On 27 October 2012, the National Bank revoked Novo Agrobanka's operating licence and appointed the Deposit Insurance Agency as its administrator. Serbia's state-run Poštanska štedionica took over the assets and clients of Nova Agrobanka on 29 October 2012. This purchase and assumption transaction – valued at around EUR 400 million – was organised to resolve the liquidity issues of Nova Agrobanka and preserve the financial stability of the banking sector.

In addition, in August 2012, the Special Prosecutor's Office for Organised Crime launched an investigation of certain officials of Agrobanka and certain companies in connection with loans allegedly issued in violation of relevant banking laws and as of the date of this Prospectus the investigation is ongoing. Further, as of the date of this Prospectus, the Special Prosecutor's Office has not brought any formal charges in connection with the investigations.

Non-performing loans

Serbia classifies a loan as non-performing where: (i) payments of principal or interest are past due by 90 days or more; (ii) at least 90 days of interest payments have been capitalised, refinanced or delayed by agreement; or (iii) payments of principal or interest are overdue by less than 90 days, but there are other good reasons to doubt that payments will be made in full.

The following table shows certain information in relation to non-performing loans in the banking sector in Serbia as at 31 December 2011 and as at 30 September 2012:

	Gross NPLs			*Gross NPL ratio*		
	As at 31 December 2011	*As at 30 September 2012*	*% Change*	*As at 31 December 2011*	*As at 30 September 2012*	*Percentage Point Change*
	(RSD billions)			*(%)*		
Sector breakdown						
Total	342.7	399.5	16.6	19.0	19.9	0.9
Corporate[1]	223.3	236.5	5.9	22.3	21.7	(0.6)
Households	42.2	50.0	18.5	7.9	8.6	0.7
Other sectors	77.2	113.0	46.5	28.8	34.2	5.4
NPLs in relation to bank size						
Large[2]	154.4	208.1	34.8	13.9	16.4	2.5
Medium[3]	171.7	176.3	2.7	28.7	26.4	(2.3)
Small[4]	16.6	15.1	(9.1)	17.8	20.5	2.7
NPLs in relation to ownership structure						
State owned	89.3	82.6	(7.5)	28.1	23.6	(4.5)
Privately held	33.8	34.7	2.6	26.9	28.7	1.8
Foreign owned	219.6	282.2	28.5	16.2	18.4	2.2
NPLs in relation to country of origin						
Austria	64.5	69.7	8.1	19.6	20.7	1.1
France	21.8	24.5	12.2	11.9	11.5	(0.4)
Germany	1.5	2.2	44.9	3.1	3.9	0.8
Italy	40.1	65.7	63.7	9.6	14.6	4.9
Greece	55.5	62.7	13.0	20.9	21.8	0.9
Other foreign countries[5]	36.3	57.4	58.1	31.8	29.9	(1.9)
Serbia	123.0	117.3	(4.6)	27.8	24.9	(2.9)
NPL of corporate sector (privately owned) – industry breakdown						
Agriculture	16.8	13.5	(19.6)	29.8	21.6	(8.2)
Manufacturing	76.5	80.8	5.6	24.5	23.6	(0.9)
Trade	62.8	52.2	(16.9)	22.5	18.2	(4.3)
Construction	27.4	45.7	66.8	26.7	42.4	15.7
Other	39.0	44.3	13.6	25.4	22.2	(3.2)
Total	222.5	236.50	6.3	24.6	23.7	(0.9)

	Gross NPLs			Gross NPL ratio		
	As at 31 December 2011	*As at 30 September 2012*	*% Change*	*As at 31 December 2011*	*As at 30 September 2012*	*Percentage Point Change*
	(RSD billions)			*(%)*		
NPLs of retail products						
Cash loans	11.6	15.0	28.8	8.8	10.6	1.8
Credit cards	4.0	4.7	19.2	10.8	12.1	1.3
Overdrafts	2.8	3.5	26.8	13.8	13.7	(0.1)
Consumer loans	3.1	3.0	(4.0)	7.0	15.1	8.1
Mortgage loans	16.1	19.9	23.7	5.8	6.4	0.6
NPLs coverage overview (% covered)						
NPL IFRS provisions	–	–	–	51.0	47.6	(3.4)
Total IFRS provisions	–	–	–	57.0	52.3	(4.7)
Regulatory provisions (balance sheet)	–	–	–	121.4	122.1	0.7
Total regulatory provisions	–	–	–	129.2	125.7	(3.5)

Source: National Bank.

Notes:

(1) Including public and private companies.

(2) Banks with assets accounting for more than 5.0 per cent. of total assets in Serbia's banking sector.

(3) Banks with assets accounting for between 1.0 per cent. and 5.0 per cent. of total assets in Serbia's banking sector.

(4) Banks with assets accounting for less than 1.0 per cent. of total assets in Serbia's banking sector.

(5) Other foreign countries includes Belgium, Cyprus, Hungary, Russia, Slovenia and the United States.

As at 30 September 2012, non-performing loans in the Serbian banking sector amounted to RSD 399.5 billion, or approximately EUR 3.5 billion, an increase of 16.6 per cent. from RSD 342.7 billion as at 31 December 2011. During the same period, the non-performing loan ratio increased by 0.9 percentage points to 19.9 per cent. The non-performing loan ratio of corporate borrowers (in private ownership), comprising 59.2 per cent. of total non-performing loans outstanding (excluding bankrupt entities), slightly decreased to 23.7 per cent. as at 30 September 2012 from 24.6 per cent. as at 31 December 2011. Household payment delinquencies increased by 0.7 percentage points compared to 31 December 2011 to reach a non-performing loan ratio of 8.6 per cent. as at 30 September 2012. Entities undergoing bankruptcy procedures, representing 20.8 per cent. of total non-performing loans, also had a significant impact, with a non-performing loan ratio of 99.7 per cent. as at 30 September 2012.

State-owned banks recorded substantial asset quality improvement, with a non-performing loan ratio that decreased by 4.5 percentage points to 23.6 per cent. as at 30 September 2012. Privately-held banks and foreign-owned banks alike experienced increases in their non-performing loan ratio, although for privately-held banks this was at a much higher level (with 28.7 per cent. out of the total outstanding loans in the non-performing category as at 30 September 2012). On average, foreign-owned banks appeared better equipped to manage the quality of their lending portfolio than domestic banks, with an increase in non-performing loan ratio of 2.2 percentage points to 18.4 per cent. in the first nine months of 2012.

By country of origin, most banks recorded an increase in their non-performing loan ratio in the first nine months of 2012, except for Serbia, France and the other foreign countries category, which decreased by 2.9, 0.4 and 1.9 percentage points to a ratio of 24.9 per cent.,11.5 per cent. and 29.9 per cent., respectively, as at 30 September 2012. Serbian banks, on average, had the poorest lending portfolio quality (with one third of all non-performing loans), evidenced by the non-performing loan ratio of 24.9 per cent. as at 30 September 2012, but also the highest provisioning and write offs. Another third of all non-performing loans in banks is in respect of Austrian and Greek banks, each with an average non-performing loan ratio of above 20 per cent. as at 30 September 2012.

The trade and manufacturing sectors accounted for 56.2 per cent. of the outstanding non-performing loans to corporate as at 30 September 2012. The construction sector experienced an increase in non-performing loan ratio of 15.7 percentage points over the first nine months of 2012 to 42.4 per cent. as at 30 September 2012. This sector and real estate, professional, scientific and technical activities, administrative and support service activities, and arts, entertainment and recreation sectors had the highest non-performing loan ratios.

Non-performing loans in the households sector were significantly below the aggregate sector average. Overdrafts and loans for agriculture had non-performing loan ratios of 13.7 per cent. and 14.0 per cent., respectively, as at 30 September 2012. As at 30 September 2012, cash loans, credit cards, consumer loans and mortgage loans had non-performing loan ratios of 10.6 per cent., 12.1 per cent., 15.1 per cent. and 6.4 per cent., respectively. The deterioration of mortgage loans was primarily driven by a significant increase in the unemployment rate, stagnation of salaries and Dinar depreciation.

Despite the relative size of the non-performing share of lending portfolios in Serbia's banking sector, significant provisioning has been established both by means of International Financial Reporting Standards ("IFRS") rules and local asset classification rules. Banks have provisioned, according to IFRS, 52.3 per cent. of non-performing loans. Additionally, according to National Bank asset classification rules, banks are required to set up a potential loan losses reserve out of their regulatory capital, in order to sufficiently cover potential losses due to troubled loans. As a result, non-performing loans are fully provisioned (122.1 per cent.) given that loan loss reserves for categories D (receivables from a borrower whose financial position indicates significant problems in operation and receivables overdue by 91 to 180 days) and E (doubtful or disputable receivables, receivables from a borrower in liquidation or bankruptcy proceedings, receivables past due for more than 181 days, among others) are approximately equal to the outstanding balance of non-performing loans.

As at 30 September 2012, the amount of established total (balance and off-balance) regulatory provisions covered 125.7 per cent. of the outstanding stock of non-performing loans (December 2011 – 129.1 per cent.), and the largest banks in Serbia have indicators of large exposures significantly below the prescribed regulatory maximum.

The following table shows selected banking sector performance indicators as at 31 December for the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December				*As at 30 September*
	2008	*2009*	*2010*	*2011*	*2012*
Capital Adequacy					
Regulatory capital to risk-weighted assets	21.9	21.4	19.9	19.1	16.4
Tier I capital to risk weighted assets	17.9	16.5	15.9	18.1	15.6
Capital to assets	23.6	20.7	19.7	20.2	20.1
Asset Quality					
Gross non-performing loans (NPL) to total gross loans	11.3	15.7	16.9	19.0	19.9
IFRS provisions of total loans to gross non-performing loans (NPL)	73.2	61.4	53.9	57.0	52.3
Regulatory provisions to gross non-performing loans (NPL)	153.6	142.5	133.6	121.4	122.1
Non-performing loans (NPL) net of IFRS provisions to capital	13.4	22.1	29.0	31.5	36.6
Non-performing loans net of regulatory provisions to capital[(1)]	(11.5)	(15.8)	(14.5)	(12.3)	(13.8)

		As at 31 December			As at 30 September
	2008	*2009*	*2010*	*2011*	*2012*
Profitability					
Return on assets (ROA)	2.1	1.0	1.1	1.2[(2)]	0.6
Return on equity (ROE)	9.3	4.6	5.4	6.0[(2)]	2.9
Net interest margin to average balance sheet assets	5.7	5.1	4.6	4.6	4.2
Net interest margin to gross operating income	64.2	67.0	68.3	72.0	68.8
Operating expenses to gross operating income	59.0	62.6	63.5	61.8	66.2
Operating expenses to average balance sheet assets	5.2	4.8	4.3	3.9	4.0
Personnel expenses to operating expenses	41.2	41.9	41.1	41.9	38.3
Liquidity and Foreign Exchange Risk					
Liquid assets to total assets	43.3	41.5	35.1	37.8	32.4
Liquid assets to short-term liabilities	68.6	63.6	56.4	62.8	54.1
Liquid assets (core) to total assets	31.1	28.7	23.8	27.5	25.4
Liquid assets (core) to short-term liabilities	49.3	43.9	38.1	45.6	42.4
Loans to deposits	125.3	124.8	125.9	127.0	122.6
Sensitivity to Market Risk					
Net open FX position (overall) to regulatory capital	7.1	3.4	3.8	6.2	5.7

Source: National Bank

Notes:

(1) Negative indicator value is caused by negative value of numerator (i.e. non-performing loans net of regulatory provisions, where regulatory provisions are higher than non-performing loans).

(2) Without one bank with the highest loss in 2011.

The Vienna Initiative

Following the successful financial sector coordination meeting on Serbia held in Vienna on 27 March 2009, and in accordance with Serbia's arrangement with the IMF, the National Bank drew up special facilities in support of the country's financial stability with the aim of upholding confidence in its banking sector and preserving financial and macroeconomic stability. The facilities were designed to enable continuous access to sources of Dinar and foreign exchange liquidity, stabilise the foreign exchange market, maintain the quality of bank assets by establishing the framework for the rescheduling of loan repayment terms for bank clients, as well as to reduce the outflow of foreign exchange and alleviate depreciation pressures.

Special facilities were available to those banks that, together with their majority shareholders, assumed certain commitments. The majority shareholders of signatory banks, under this agreement, committed to maintain their level of exposure in Serbia as of December 2008 until the end of 2010 and to keep bank capital adequacy and liquidity ratios at the levels prescribed, while the National Bank will assess the future movements in capital adequacy ratios in accordance with the IMF methodology. In return, banks had to commit to enable borrowers to convert their foreign currency loans and foreign currency clause-indexed loans into Dinar loans, and to provide for the rescheduling of loan repayment terms under the framework defined.

Banks that met these conditions gained access to new liquidity sources, including Dinar loans with a repayment period of no longer than 12 months, and short-term foreign exchange swap transactions, including the abolition of reserve requirements for deposits and loans received from abroad from October 2008 to December 2010 until their maturity date. Banks could also include in their capital, for regulatory purposes, subordinated liabilities of up to 75.0 per cent. of their core capital. In addition, when calculating arrears on

loans whose repayment terms were rescheduled under the framework defined, and for the purposes of their classification requirements, banks were permitted to apply the subsequently agreed maturity date and raise foreign exchange risk ratio from 10.0 per cent. to 20.0 per cent. of their capital.

These special facilities ceased to be effective as of 1 January 2011. At the end of 2011, the aggregate net exposure of the participating banks was above the agreed 80.0 per cent. of the net aggregate exposure of the participating banks at the end of 2008. On 12 and 13 March 2012, a meeting of the fourth Full Forum of the European Bank Coordination ("Vienna 2.0" Initiative) was held in Brussels. It was concluded that the stability of the financial sector and ensuring orderly credit conditions in emerging European countries are in the shared interest of both the private sector and home and host countries. To this effect, eight basic principles were adopted, which aimed at boosting coordination between home and host countries on cross-border banking activities, as well as avoiding disorderly deleveraging in emerging European countries. The agreement aims to better coordinate banking sector regulation and supervision and to mitigate negative spill-overs between the Eurozone and emerging European countries. It emphasises the central role of European institutions and international financial institutions in facilitating this coordination. The full forum also considered the reports of its two working groups on the impact of Basel III rules on emerging European countries and on the resolution of non-performing loans.

Banking Supervision

In 2009, the National Bank took measures to mitigate the effects of the global financial and economic crisis on the Serbian banking sector and to ensure the stability of its banks and the country's overall financial structure. The National Bank's goals were to increase lending activity, to improve public confidence and to increase the levels of foreign exchange deposits available in the banking system.

In 2009, the regulatory activities of the National Bank within its supervision remit centred on the creation of a legal framework adapted to support the new macroeconomic environment. Regulatory measures were aimed at giving support to banks to overcome the global financial and economic crisis, particularly to ensure a solid liquidity position and manage increasing credit and foreign exchange risks. In addition to regular off-site supervision activities (monitoring operations and the financial position of banks, via bank reports and other externally and internally available) and on-site supervision, the National Bank also focused on enhancing the monitoring of bank liquidity and included stress tests in relation to credit risk. More recently, stress tests conducted in collaboration with the IMF showed that Serbian banks have relatively high resilience to potential negative economic shocks.

In May 2011, the National Bank adopted the Decision on Measures for Safeguarding and Strengthening Stability of the Financial System aimed at safeguarding and strengthening stability of the financial system by decreasing systemic risk arising from the high share of foreign currency denominated and indexed loans. The decision entered into force in June 2011 and introduced a set of measures regarding foreign currency denominated and indexed lending to individuals, including the following measures: (i) foreign currency denominated and indexed loans may be approved only subject to a down payment or placement of deposit of no less than 30 per cent. of the loan amount (but this rule does not apply to housing loans); (ii) the loan-to-value of foreign currency denominated and indexed mortgage loans is limited to a maximum of 80 per cent.; and (iii) loans may be indexed only to the Euro (i.e. banks can no longer grant loans indexed to the Swiss Franc or other currencies).

In addition to the above Decision, the Government adopted the Programme of Measures to Safeguard the Financial Stability of Banks in December 2011 and amendments thereto in April 2012. The Programme envisages participation of three institutions – the National Bank, the Deposit Insurance Agency and the Government, and establishes individual responsibilities and competences of each participant. The Programme also establishes the manner of its implementation in two cases – coverage of potential losses (NPL purchases) and banks' recapitalisation.

There are two measures used to preserve the financial stability of banks under the Programme: (i) a takeover of a bank's bad assets at appraised value (net value) by Serbia in exchange for Serbian bonds and/or (ii) a bank's recapitalisation through the issue of Serbian bonds.The Serbian bonds have a maturity of five to 10 years with semi-annual principal amortisation, inflation-indexed clause, interest of 2 per cent. per year

and semi-annual coupon payments. The maximum value of the issue under the Programme is RSD 40 billion. In the case of a takeover of bank's bad assets, issued bonds are not transferable. The Deposit Insurance Agency manages bad assets on behalf of Serbia. The banks are permitted to apply for participation in the Programme in the first two years following its adoption.

Two banks have taken part in the Programme with the total fiscal cost of RSD 11 billion. In addition, outside the auspices of the Programme, the Government has applied a similar model in recapitalising the bridge bank Nova Agrobanka through the issuance of Government bonds.

The National Bank instruments available for banks as liquidity support are Dinar liquidity loans with maturities of up to one year and Dinar liquidity loans with the National Bank as the lender of last resort. With respect to the latter instrument, the National Bank may extend liquidity loans to banks having temporary liquidity problems, provided they have already exhausted all other sources of liquidity available in the market and have adopted an action plan for overcoming such problems. The loans are extended with maturities of up to 12 months, against the collateral of securities, foreign exchange, gold, accounts receivable and a first ranking mortgage on the bank's titled property. For the purposes of safeguarding financial stability, liquidity loans may also be extended against other forms of collateral, including collateral of bank allocations in foreign exchange required reserves and a guarantee issued by Serbia.

In June 2011, the Executive Board of the National Bank adopted a set of six decisions introducing Basel II standards. The decisions, which harmonise capital adequacy and risk management rules with Basel II standards and strengthen the transparency of bank operations, include:

- Decision on Bank Capital Adequacy, which implements Pillar 1 of Basel II;
- Decision on Reporting on Bank Capital Adequacy, which prescribes frequent reporting requirements for banks to the National Bank in connection with capital adequacy, bringing Serbia in line with the COREP (Common Reporting) regime implemented by all EU member countries;
- Decision on Risk Management by Banks, which implements Pillar 2 of Basel II standards and prescribes the obligations of banks to manage all risks to which they are exposed or may be exposed in their operations, as well as requiring banks to maintain their capital reserves at a level that covers such risks;
- Decision on Disclosure of Data and Information by Banks, which promotes market transparency by imposing an obligation on banks to disclose data and information relating to their capital and risk exposures, among other things, in accordance with Pillar 3 of Basel II standards;
- Decision on Consolidated Supervision of Banking Group, which permits the implementation of new regulation based on Basel II, on a consolidated level; and
- Decision on Bank Reporting Requirements.

The Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items was enacted in December 2011 and effective from 31 December 2011. The main objectives of adopting the new Decision were to alleviate the burden of supervisory provisions in accordance with the current phase of the business cycle and to harmonise the new Decision with a Basel II compliant regulatory framework.

The new regulations were fully implemented as of 31 December 2011, save for the provisions relating to eligibility criteria for recognition of credit ratings issued by external credit assessment institutions which were applied as from 1 September 2011 and certain provisions which were applied over a transition period. Furthermore, banks have been required to submit trial reports to the National Bank as of 30 September 2011.

In June 2012, the Executive Board adopted the Decision on Supplements to the Decision on the Classification of Bank Balance Sheet Assets and Off balance Sheet Items, and in July 2012, the Executive Board adopted the Decision on Amendments and Supplements to the Decision on External Bank Audit, with the aim of further improving the regulatory framework. In September 2012, amendments to the Decision on Bank Reporting Requirements were adopted with the aim of improving data quality and quantity.

On 27 October 2012, the Law on the Assumption of Assets and Liabilities of Certain Banks for the purpose of Maintaining the Stability of the Financial System of the Republic of Serbia entered into force and will remain in effect until 31 December 2014. The purpose of this law is to allow for the timely transfer of assets and liabilities of banks (including bridge banks and banks under administration proceedings) owned wholly or partially by Serbia or Vojvodina, before the revocation of that bank's licence and the initiation of the bankruptcy proceedings, thus ensuring the protection of bank's depositors, avoiding costs for the taxpayers, and maintaining the stability of the financial system. The transfer, which is subject to consent from the National Bank, is conducted on the basis of a contract between the bank whose assets and liabilities are being transferred and the transferee bank.

In addition to the set of regulations implementing Basel II standards already in application, the National Bank is currently analysing the most suitable manner and timetable for the implementation of Basel III in Serbia. The strategy for Basel III implementation will cover all relevant issues under the new set of standards and will put forward a timetable for adoption of particular requirements regarding capital and liquidity standards, in addition to measures that have already been implemented. Taking into account recent delays in the adoption of regulations implementing Basel III in the EU (i.e. CRD IV and CRR (previously scheduled for June 2012)), which might lead to some changes to what is currently expected to be in the final regulations, including, but not limited to, the proposed timetable for the implementation, the National Bank of Serbia has postponed the deadline for the adoption of its strategy for Basel III implementation and the strategy is now expected to be formalised in 2013.

Some elements of Basel III have already been introduced by the above-mentioned regulation based on Basel II standards, such as: (i) exclusion of Tier 3 capital from the total regulatory capital; and (ii) introduction of a capital conservation buffer which effectively disallows banks with a capital adequacy ratio of below 14.5 per cent. (or banks that would fall below a capital adequacy ratio of 14.5 per cent. if dividends were to be paid) to pay out dividends.

In addition, Serbia has increased its co-operation with foreign supervisory authorities, particularly through its participation in supervisory colleges. During 2010, the bank distress resolution framework was reviewed and updated in line with sound international practices.

Capital adequacy

The Decision on Bank Capital Adequacy, which implements Pillar 1 of Basel III, sets out the method of calculating the capital of a bank, as well as its capital adequacy ratio and all elements thereof. In line with Pillar 1 requirements, the Decision prescribes minimum capital requirements for three types of risk: credit, market and operational risk. The most significant changes concerning capital adequacy, compared to the previous Decision on Bank Capital Adequacy and its amendments, are new methods for calculating capital requirements for credit risk and the introduction of capital requirements for operational risk. Furthermore, this Decision provides banks with more sophisticated, internal approaches to calculating capital requirements for credit, market and operational risks taking into account the specific risk profile and other characteristics of each individual bank, subject to prior approval of the National Bank.

The Decision defines the capital adequacy ratio of a bank as the ratio between the bank's capital and its risk-weighted assets, which are defined as the sum of credit risk-weighted assets plus capital requirement for market risks multiplied by the reciprocal value of the capital adequacy ratio and capital requirements for operational risk multiplied by the reciprocal value of the capital adequacy ratio. Banks are currently required to maintain their capital adequacy ratio at a level of at least 12.0 per cent. In addition, the National Bank has introduced a capital conservation buffer of 2.5 per cent., which allows the National Bank the discretion to prevent any bank with a capital adequacy ratio below 14.5 per cent. from distributing profits.

The National Bank may set a higher capital adequacy ratio if it is deemed necessary for maintaining the safety and soundness of a bank's operations or the fulfilment of a bank's obligations towards its creditors. The decision must be based on the assessment of:

- the amount of the bank's capital needed to cover all risks to which it is, or may be, exposed and, in particular, risks which are not included in the calculation of the capital adequacy ratio;

- the comprehensiveness and reliability of the bank's risk management system and its compatibility with the bank's risk profile;
- the significance of the possible influence of irregularities found in the bank's risk management system on the financial position of the bank;
- the adequacy of the bank's internal capital adequacy assessment process, its consistent application and the results of those assessments; and
- the influence of significant changes in the bank's business strategy or the scope of its business, as well as the effects of departure from the strategy to the bank's risk profile or its financial position.

Risk management

The Decision on Risk Management by Banks, which implements Pillar 2 of Basel II, sets out the manner of identifying, measuring and assessing risks (excluding compliance risk, which is regulated by another Decision) to which a bank is exposed or might be exposed in its operations, as well as conditions for the management of these risks, including the method of calculating specific business indicators relating to risk management and setting limits pertaining to such risks.

In accordance with this Decision, a bank is exposed or may be exposed to liquidity risk, credit risk, interest rate risk, foreign exchange risk and other market risks, concentration and exposure risks, investment risks, country risk, operational risk (including legal risk) and strategic and other risks. Each bank is thus required to establish a comprehensive and reliable system of risk management integrated in all its business activities that ensures that the bank's risk profile is in line with its propensity for such risks. The risk management system must be proportionate to the nature, volume and complexity of the bank's operations and/or its risk profile.

The key changes introduced by this Decision include: (i) establishing a comprehensive and reliable risk management system for banks; (ii) prescribing a strategy for risk management, strategy, policy and procedure for banks; (iii) imposing an obligation on banks to implement the internal capital adequacy assessment process and precisely defined requirements regarding maintaining business continuity of the bank (a business continuity plan and disaster recovery plan) as well as outlining the responsibilities of bank management in the process; (iv) setting out criteria relating to risk management arising from outsourcing activities; and (v) introducing remuneration policies governing wages and bonuses.

Regarding liquidity risk, the Decision on Risk Management by Banks, which sets out the method, terms and manner of identifying, measuring and assessing liquidity risk to which banks are exposed in their operations, as well as liquidity levels, defines the liquidity ratio for a bank as the ratio of the sum of first- and second-degree liquid receivables of the bank and the sum of prescribed percentages of liabilities payable on demand with no agreed maturity and liabilities falling due within a month from the date of the liquidity ratio calculation.

Banks are required to maintain a liquidity ratio equal to at least: (i) 1.0, if calculated as the average liquidity ratio for all business days in a month; (ii) 0.9, if calculated for more than three consecutive business days; and (iii) 0.8, if calculated for one business day only. A critically low level of liquidity is indicated by the liquidity ratio below these levels in which case the bank is under an obligation to notify the National Bank within one business day.

A bank is deemed to have a large exposure where the exposure of the bank to a single person or a group of related persons is equal to or exceeds 10.0 per cent. of the bank's capital. The exposure of a bank to a single person or a group of related persons must not exceed 25.0 per cent. of the bank's capital. The exposure of a bank to a person related to the bank must not exceed 5.0 per cent. of the bank's capital. The aggregate exposure of the bank to persons related to the bank may not exceed 20.0 per cent. of the bank's capital. In accordance with the Decision on Risk Management by Banks, the sum of large exposures that a bank may hold may not be less than 400.0 per cent. of the bank's capital.

In accordance with Article 34 of the Law on Banks, an investment by a bank in a single non-financial sector person must not exceed 10.0 per cent. of the bank's capital. Total investments by a bank in non-financial persons and fixed assets of the bank must not exceed 60.0 per cent. of the bank's capital. Such investments do not include acquisition of shares with a view to their further sale in the period of six months after the date of acquisition.

Enforcement of financial regulation

Where a bank has breached applicable laws or regulations of the National Bank or other regulations or standards of prudent banking activities, and/or the safety and soundness of such bank is at risk, the National Bank has power to impose orders and measures on such bank in order to eliminate the established irregularities and, under certain circumstances, may revoke the operating licence of such bank or invoke receivership, where appropriate.

In determining the appropriate action to be taken in respect of a bank where irregularities in operation have been established of the National Bank may take into account: (i) the gravity of the irregularities; (ii) the demonstrated readiness and competence of the bank's bodies to eliminate the established irregularities; and (iii) the extent to which such bank jeopardises financial discipline and unimpeded operation of the banking system.

The National Bank shall revoke a bank's operating licence if it establishes that: (i) a bank, other than a systematically important one, is critically undercapitalised, unless it is in receivership; (ii) a bank has been placed into receivership and its shareholders have failed to devise or implement an adequate and effective plan of activities to improve the financial condition of the bank within the prescribed deadline; or (iii) a bank ceases to receive deposits or grant loans continuously over the period of six months (unless this was ordered by the corrective measure imposed by the National Bank), among other things.

The National Bank also has discretion to revoke a bank's operating licence if, among other things, it determines that: (i) an undercapitalised bank fails to meet any of the performance indicators set forth by the Law on Banks or a regulation of the National Bank; (ii) a bank has committed gross or persistent violations of the law or other regulation or fails to act in compliance with orders issued by the National Bank; (iii) a bank has failed to pay deposit insurance premium in compliance with the law governing deposit insurance; (iv) a bank will not be able to settle its obligations to depositors and other creditors; or (v) a bank fails to enable the National Bank to perform prudential supervision and verify the legality of the bank's operations.

In addition, the National Bank may impose a fine on a bank or on a member of the board of directors or executive board of a bank. Under the Law on Banks, fines imposed on banks must be declared for an amount between 0.1 per cent. and 5.0 per cent. of the prescribed pecuniary portion of the initial capital, while fines imposed on a member of the board of directors and executive board of a bank must be declared for an amount between one and 12 times the salary of the person being fined.

Receivership

In accordance with Article 117 of the Law on Banks, the National Bank shall render a resolution on placing a bank into receivership if:

- it is likely that a bank will be critically undercapitalised;
- it is established that a systemic important bank is critically undercapitalised;
- supervision of business activities of such bank has established acting and/or failure to act, which are in breach of regulations or standards of safe and sound banking business activities that have jeopardised its financial condition or interests of depositors; or
- the financial situation of the bank has deteriorated during the period before the deadline for carrying out the orders in the resolution on orders and measures.

The National Bank shall render the resolution if it assesses that a change in a manner of governing and managing the bank might result in elimination of irregularities in its business activities, improve its financial situation and secure interests of its depositors. Official receivership may last for no longer than six months, but the National Bank may prolong the duration of a receivership in a bank for another three months if it assesses that such prolongation is necessary for completing activities initiated in order to achieve goals of the receivership. Official receivership in a bank may be terminated before expiry of the deadline specified in the resolution if official receivers or the National Bank assesses that the introduction of receivership has not caused an improvement of the bank's financial situation or that the financial situation of that bank has improved to such an extent that the official receivership is no longer needed.

Money Laundering and Corruption

The Administration for the Prevention of Money Laundering (the "Administration") is a financial intelligence unit established in 2002 as the Federal Commission for the Prevention of Money Laundering. In 2005, the Federal Commission became an administrative body within the Ministry of Finance and Economy and changed its name to the Administration for the Prevention of Money Laundering, in line with the 2005 Law on the Prevention of Money Laundering. The Administration collects and analyses data and information from financial institutions, banks and other entities in order to identify potential money laundering or terrorist financing and notify competent state authorities, as necessary. On 27 March 2009, the Law on the Prevention of Money Laundering and the Financing of Terrorism was adopted, and together with amendments which were adopted in 2009 and 2010, this law has been fully implemented by the Third Directive (Directive 2005/60/EC of the European Parliament).

The Administration has also been a member of an international association of financial intelligence units called the Egmont Group of Financial Intelligence Units since July 2003. As part of its membership, the Administration is able to efficiently and safely exchange financial intelligence with global counterparts. All data provided to these counterparts is confidential and may only be used as prescribed by law.

A Serbian delegation (the Administration, National Bank of Serbia, Ministry of Interior and Ministry of Justice) actively participates in the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ("Moneyval") of the Council of Europe. Moneyval performs mutual evaluations of member states to ensure that they have in place effective systems to counter money laundering and terrorist financing and comply with the relevant international standards in these fields.

The National Bank also acts both as a regulator and supervisor in the prevention of money laundering and terrorist financing. The National Bank prepares and takes part in ensuring certain laws and by-laws aimed at the prevention of money laundering and financing of terrorism are met by financial institutions supervised by the National Bank, such as banks, voluntary pension fund management companies, financial leasing providers and insurance companies.

After the issuance of operating licences, the National Bank supervises financial institutions by checking whether regulations are properly implemented and by assessing the adequacy of anti-money laundering systems and systems for combatting the financing of terrorism. If the National Bank identifies weaknesses or more serious irregularities in implementation of these systems, it takes corrective measures or sanctions in line with regulations. Furthermore, the National Bank issues recommendations for the upgrade of the anti-money laundering and combatting financing of terrorism system at the national level; it co-operates with the Administration and other domestic institutions involved in relevant activities; and it co-operates with international institutions in the field and participates in the operations of relevant international bodies and organisations, particularly Moneyval.

In addition, one of the Government's main priorities is the fight against organised crime and corruption. A Special Prosecutor's Office for Organised Crime, a special branch within the Ministry of Justice, called the Directorate for Management of Seized and Confiscated Assets, and an independent body called the Anti-Corruption Agency have been established in an effort to combat organised crime and corruption.

The following table shows Serbia's ranking in Transparency International's 2011 Corruption Perception Index as compared to other countries in the region:

Over Rank	Regional Rank	Country/Territory	Corruption Perceptions Index 2010 Score
61	1	Turkey	4.2
64	2	Georgia	4.1
66 (equal)	3 (equal)	Croatia	4.0
66 (equal)	3 (equal)	Montenegro	4.0
69	4	FYR Macedonia	3.9
86	5	Serbia	3.3
91	6	Bosnia and Herzegovina	3.2
95	7	Albania	3.1

Source: Transparency International.

Stock Market

The Belgrade Stock Exchange (the "BSE") was established in 1894 as a closed joint stock company and is the only recognised stock exchange in Serbia.

The following table shows certain statistics regarding trading on the BSE and the over-the-counter market reported to the BSE for the years 2007 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December					Nine months ended 30 September	
	2007	2008	2009	2010	2011	2011	2012
Number of Trades at BSE	301,210	119,001	77,215	725,550	2,887,538	2,717,883	351,729
Average Number of Trades Per Month	25,101	9,917	6,435	60,463	240,628	301,987	39,081
Average Number of Trades Per Trading Session	1,200	469	304	2,891	11,413	14,457	1,891
Securities Traded at BSE (millions of shares)	249.7	111.1	87.5	67.7	74.7	44.4	46.6
Average Securities Traded Per Month (millions)	20.8	9.3	7.3	5.6	6.2	4.9	5.2
Average Trade Size (volume in no. of securities/no. of transactions)	829.4	933.6	1,133.9	93.3	25.9	16.3	132.6
Trading Volume at BSE (RSD millions)	164,991	71,854	41,779	23,017	28,585	22,254	20,310
Year-on-Year change (%)	64.0	(56.4)	(41.9)	(44.9)	24.19	61.6	(8.73)
Average Trading Volume Per Month	13,749	5,988	3,482	1,918	2,382	2,473	2,257
Average Trade Size (Total trading value in RSD/no. of transactions)	533,347.3	603,808.2	541,067.0	31,723.8	9,899.3	8,188	5,745
BSE Total Market Capitalisation (RSD millions)	1,440,485	916,595	932,333	933,466	817,462	853,526	746,253
Year-on-Year Change (%)	78.1	(36.4)	1.7	0.1	(12.43)	(8.56)	(12.57)
BSE Total Market Cap/GDP[(1)] (%)	63.3	34.4	34.4	31.2	25.7	26.9	22.7
Number of Trading Sessions	251	254	254	251	253	188	186
Stocks Traded on the BSE	1,742	1,841	1,775	1,604	1,356	1,412	1,143
Year-on-Year Change (%)	49.7	5.7	(3.6)	(9.6)	(15.5)	(14.06)	(19.05)
Trading Volume on the OTC Market (RSD millions)	143,319	62,159	33,871	14,431	14,496	11,393	–[(2)]
Year-on-Year change (%)	64.2	(56.6)	(45.5)	(57.4)	0.45	24.65	–[(2)]
Average Trading Volume Per Month (millions)	11,943	5,180	2,823	1,203	1,208	1,266	–[(2)]
Securities Traded on the OTC Market (number of shares, millions)	40.9	19.5	14.8	11.5	11.37	8,998	–[(2)]
Year-on-Year change (%)	49.3	(52.3)	(24.3)	(21.9)	(1.57)	4.28	–[(2)]
Average Securities Traded Per Month (millions)	3.4	1.6	1.2	1.0	0.9	1	–[(2)]

Source: Ministry of Finance and Economy.

Notes:

(1) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

(2) According to the 2012 Law on the Capital Market, trading data from the OTC market is not available to the BSE.

The capital market in Serbia is regulated predominantly by the Law on the Capital Markets (Official Gazette of RS No 31/2011). The Securities Commission regulates participants involved in the trading process, including the Belgrade Stock Exchange, Central Securities Depository, commercial banks, brokerage companies and the public enterprises whose shares are traded on the BSE.

Shares are traded on the BSE, from both the regulated market and MTP. The regulated market is further segmented into the prime and standard listing and open market, according to a specific set of requirements. The most frequently traded companies on the Belgrade stock exchange are blue-chip companies which comprise the reference index "Belex 15".

Government frozen foreign currency savings bonds are traded both on the Belgrade stock exchange and over-the-counter, with a majority of trading carried out over-the-counter. These bonds are zero-coupon, denominated in EUR, and are issued by the Republic of Serbia to settle obligations arising from citizens' foreign currency savings. The bonds mature on 31 May every year, until 2016.

Following the impact of the world financial crisis, all major indices on the Belgrade stock exchange have been decreasing. In comparison with other regional capital markets, liquidity is still very low. However, the volume of traded securities increased in 2011, largely as a result of free disbursement of shares of the National Oil Company to the Serbian citizens (over 4.8 million citizens), before decreasing again in the first nine months of 2012.

Insurance Sector

Overview

In the overall financial sector (which includes banks, leasing, insurance and voluntary pension funds), the insurance sector ranked second based on its balance sheet total, capital and employment levels in 2010 and 2011. As at 30 September 2012, a total of 28 insurance companies were operating in the Serbian insurance market. Of these, 24 were engaged in insurance and four engaged in reinsurance activities. Seven companies carried on life insurance business and 11 engaged in non-life insurance business, while six engaged in both life and non-life insurance businesses. 21 insurance companies were majority foreign-owned, while seven were majority domestically-owned.

Foreign-owned insurance companies (of which 13 have been established since 2005) had the dominant market shares in 2011, with 92.0 per cent. of the total life insurance premiums, 60.1 per cent. of the total non-life insurance premiums and 67.9 per cent. of total assets, and also employing 65.4 per cent. of total employees in the insurance sector.

In the first and second quarters of 2012, foreign-owned insurance companies continued to have dominant market shares, with 90.3 per cent. and 90.7 per cent., respectively, of total life insurance premiums, and 56.9 per cent. and 57.7 per cent., respectively, of total non-life insurance premiums. In the first, second and third quarters of 2012, foreign-owned insurance companies had 67.9 per cent., 67.7 per cent. and 68.5 per cent., respectively, of total assets, and also employed 65.0 per cent., 65.2 per cent. and 64.7 per cent., respectively, of total employees in the insurance sector.

Insurance portfolio structure

In 2010, the total insurance premiums for the Serbian insurance sector amounted to RSD 56.5 billion (EUR 536 million), an increase of 5.6 per cent. compared to the previous year. The total premium generated by the insurance sector in 2011 reached RSD 57.3 billion (EUR 548 million) which resulted in a 1.4 per cent. increase, compared to 2010. The share of non-life insurance in the total premium in 2011 was 82.6 per cent., while the share of the life insurance premium was 17.4 per cent.

In the first and second quarters of 2012, total insurance premiums amounted to RSD 14.9 billion (EUR 134 million) and RSD 32.5 billion (EUR 281 million), respectively, with non-life insurance premiums accounting for 82.8 per cent. and 83.0 per cent., respectively, and life insurance premiums accounting for 17.2 per cent. and 17.0 per cent., respectively.

The insurance premium structure in 2011 changed little from the same period in the previous year. Vehicle liability insurance accounted for the largest share of the total insurance premiums at 32.6 per cent., followed

by property insurance against fire and other hazards and other property insurance, life insurance and full coverage motor vehicle insurance, with shares of 22 per cent., 17.4 per cent. and 12.5 per cent., respectively.

The insurance premium structure in the first and second quarters of 2012 generally remained the same as the same quarters in 2011. The largest share of total premiums was vehicle liability insurance, accounting for 27.6 per cent. and 29.1 per cent., respectively, followed by property insurance against fire and other hazards and other property insurance (27.3 per cent. and 26.1 per cent., respectively), life insurance premiums (17.2 per cent. and 17.0 per cent., respectively) and full coverage motor vehicle insurance (11.0 per cent., and 11.3 per cent., respectively).

The following table shows a breakdown of the total insurance premium in Serbia by type of insurance for the years 2008 to 2011 and the first six months of 2011 and 2012:

	Year ended 31 December				*Six months ended 30 June*	
	2008	*2009*	*2010*	*2011*	*2011*	*2012*
				(%)		
Property insurance	24.7	22.6	22.1	22.0	27.2	26.1
Motor vehicle insurance	16.2	14.2	13.5	12.5	12.4	11.3
Life insurance	12.2	14.7	16.5	17.4	15.4	17.0
Motor vehicle liability	31.7	34.1	33.3	32.6	29.2	29.1
Other non-life insurance	15.3	14.5	14.6	15.4	15.8	16.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Bank.

Balance sheet total and balance sheet structure

The balance sheet total of the Serbian insurance sector amounted to RSD 125.7 billion (EUR 1.22 billion) as at 31 December 2011, representing an increase of 7.3 per cent. compared to 31 December 2010. Current assets represented 52.3 per cent. of total assets in the insurance sector, of which 26.2 per cent. were short-term financial investments and 11.3 per cent. were receivables. Fixed assets accounted for 47.7 per cent. of total assets, of which 30.3 per cent. were long-term financial investments and 15.9 per cent. were real estate.

As at 30 September 2012, the balance sheet total of the Serbian insurance sector amounted to RSD 140.7 billion (EUR 1.2 billion). Current assets represented 49.2 per cent. of total assets in the insurance sector, of which 21.0 per cent. were short-term financial investments and 12.6 per cent. were receivables. Fixed assets accounted for 50.8 per cent. of total assets, of which 35.3 per cent. were long-term financial investments and 14.2 per cent. were real estate.

As at 31 December 2011, technical reserves accounted for 61.1 per cent. and capital and reserves for 26.5 per cent. of total liabilities. A year-on-year comparison of the composition of liabilities indicates that technical reserves kept their dominant share. Allocation to technical reserves in 2011 rose by 7.9 per cent. and amounted to RSD 76.8 billion (EUR 0.73 billion). Mathematical reserves grew at the rate of 19.8 per cent. compared to the same period in the previous year.

As at 30 September 2012, capital and reserves accounted for 23.5 per cent. of total liabilities and technical reserves accounted for 64.4 per cent. (RSD 89.6 billion, EUR 779 million), which was an increase of 18.8 per cent. compared to the same period in 2011. Mathematical reserves grew at a rate of 34.1 per cent.

The substantial growth in technical reserves is a result of activities taken by the National Bank, including the establishment of technical reserves calculation criteria, the strict monitoring of the adequacy of allocations into technical reserves, as well as the acceptance of a more realistic assessment of these reserves by the insurance companies and, as a result, better protection of the interests of insured persons and insurance beneficiaries.

Performance indicators

As at 31 December 2011, the solvency margin for the Serbian insurance sector was RSD 14.8 billion (EUR 141 million) and the guarantee reserve amounted to RSD 27.8 billion (EUR 265 million). The ratio of guarantee reserve to solvency margin stood at 195.20 per cent. for non-life insurance companies and at 185.63 per cent. for life insurance companies.

As at 30 June 2012, the solvency margin for the Serbian insurance sector was RSD 16.5 billion (EUR 143 million) and the guarantee reserve was RSD 29.5 billion (EUR 255 million), with the ratio of guarantee reserve to solvency margin of 187.45 per cent. for non-life insurance companies and 173.32 per cent. for life insurance companies.

Coverage of technical reserves by prescribed types of assets as at 31 December 2011 was 99.35 per cent. for non-life insurance and 101.51 per cent. for life insurance. As at 30 June 2012, coverage of technical reserves by prescribed types of assets was 94.27 per cent. for non-life insurance and 100.82 per cent. for life insurance.

The ratio of short-term assets (current assets less inventories) to short-term liabilities for companies engaged primarily in non-life insurance in 2011 was 105.17 per cent., while for companies engaged primarily in life insurance the ratio was 179.77 per cent. The ratio of short-term assets to short-term liabilities for companies engaged primarily in non-life insurance in the second and third quarter of 2012 was 102.89 per cent. and 100 per cent., respectively, while for companies engaged primarily in life insurance the ratio was 167.87 per cent. and 158.57 per cent., respectively. Movement in this indicator indicates the adequacy of liquid assets for the settlement of short-term liabilities.

PUBLIC FINANCE

Introduction

The consolidated general government budget (the "Budget") comprises: (i) the central government budget and extra budgetary funds of the central government consisting of the Fund for Pension and Disability Insurance, the Institute for Health Insurance and National Employment Service and Public Enterprise Roads of Serbia ("PE Putevi Srbije"), an extra-budgetary fund financed since 2012 from toll roads and Government subsidies, and (ii) the local government budgets. Reports in relation to the consolidated fiscal position are prepared on a cash basis. The Budget is passed in accordance with the Budget System Law.

Serbia operates a rule-based fiscal responsibility framework that seeks to balance the pace of further fiscal adjustment with the avoidance of an excessively pro-cyclical stance. Serbia's fiscal deficit rule prescribes the minimum fiscal adjustment required by the fiscal responsibility framework. In 2010, amendments and supplements to the Budget System Law introduced general and special fiscal rules applicable to the public sector. These amendments and supplements were discussed and prepared in joint co-operation between the Ministry of Finance and Economy and the IMF. General rules require the maintenance of a target annual fiscal deficit and set a maximum debt-to-GDP ratio. The special fiscal rules prescribe a system for regulating wages and pensions in the public sector, which currently accounts for the highest individual category of Government expenditure. The special fiscal rules also restrict the deficit that may be incurred by local governments. Specific policy measures for limiting the deficit and debt levels in the medium-term future are described below.

Budgetary Process

The integrity of the Serbian Budget system is ensured by uniform Budget classification, the use of Budget documentation for the preparation of draft budgets and financial plans, an appropriate system of budgetary accounting and strict criteria for budgetary control and audit.

The process of drafting and enacting the Budget is carried out in accordance with detailed Budget calendars prescribed by the Budget System Law, which sets out key dates for budget actions by central and local authorities, respectively. The Fiscal Strategy is delivered to the Fiscal Council in mid-May. If approved by the Fiscal Council, the Government adopts the Report in mid-June and delivers it to the Assembly for further consideration.

After the adoption of the Fiscal Strategy, the Ministry of Finance and Economy commences preparation of a detailed Budget for the next fiscal year. If changes to the current fiscal year budget are required, a supplementary Budget must be adopted by the Government and the Assembly, which usually takes place in September of the relevant fiscal year. At the beginning of October, the Government adopts a revised Fiscal Strategy containing an updated macroeconomic framework. The Government has until 1 November to adopt the Draft Budget Law and Decisions on Approving Financial Plans of Organisations for Mandatory Social Insurance. The Assembly then has until 15 December to adopt the Budget Law and approve these Financial Plans. The deadline for the assemblies of local authorities to adopt the Decision on the Budget of Local Authorities is 20 December, following which the adopted Decision is delivered to the Ministry of Finance and Economy.

Fiscal Policy and Reform

General and Special Fiscal Rules

The Government's general fiscal rules under the current Budget System Law set a target for the medium-term fiscal deficit and a maximum ratio of debt to GDP with the aim of ensuring long-term sustainability. The general fiscal objectives are to:

- achieve an annual fiscal deficit of 1.0 per cent. of GDP; and
- achieve a ratio of Public Debt, excluding obligations arising from restitution, to GDP below 45.0 per cent.

The special fiscal rules set movements in public sector wages and pensions and the way in which public investments will be covered in calculating the fiscal deficit and public expenditures during the period from 2011 to 2015. Public sector wages and pensions in 2011 and April 2012 were indexed according to inflation plus half of real GDP growth in the previous year. Indexation in October 2012 and April 2013 will be fixed at 2.0 per cent. as part of the fiscal consolidation.

The special fiscal rules also restrict the deficits that may be incurred by local governments.

Supplementary 2012 Budget

The Budget deficit reached RSD 148.1 billion in the first nine months of 2012, or 4.5 per cent. of estimated GDP. The Ministry of Finance and Economy estimates that, without any further Budget deficit reduction measures, the Budget deficit would be approximately 7.0 per cent. of GDP in 2012. For more information on factors contributing to the Budget deficit, see "*– Fiscal Developments in 2011*" and "*– Fiscal Developments in the Nine Months ended 30 September 2012*". The Government aims to reduce the deficit to 3.6 per cent. of GDP by 2013.

The Government recognises the need for comprehensive reform of the fiscal system through fiscal consolidation. A programme of critical measures aimed at cutting the Budget deficit, incorporated in 17 laws, and a supplementary 2012 Budget was adopted by the Government on 10 September 2012 and was passed by the Assembly in substantially the same form on 25 September 2012. According to the supplementary 2012 Budget, together with the relevant changes to Serbian laws adopted concurrently therewith, the following measures in respect of Budget revenues came into effect on 1 October 2012:

- an increase in rate of VAT from 18.0 per cent. to 20.0 per cent.;
- an increase in excise taxes on oil-gas and liquid petroleum gas to RSD/liter 42 and RSD/liter 30, respectively;
- an increase in specific excise taxes per pack of cigarettes from RSD 33 to RSD 43;
- a decrease of ad valorem excise from 34.0 per cent. to 33.0 per cent.;
- an increase in the rate of tax on dividends and interest from 10.0 per cent. to 15.0 per cent.; and
- own sources of Budget beneficiaries will be considered as a general revenue of the Budget.

In addition, the following measures in respect of Budget expenditures came into effect from 1 October 2012:

- public sector wages and pensions are indexed at a fixed rate of 2.0 per cent. (rather than six-month inflation), which is lower than the special fiscal rules prescribe;
- social assistance is provided to all pensioners receiving minimal pension; and
- additional agricultural subsidies to be provided in the amount of RSD 9.8 billion as additional resources to regular agricultural programmes and to minimise the effects of drought in Serbia.

2013 Budget

On 25 October 2012, the Government adopted the 2013 Budget and sent it to the Assembly. The deadline for adoption of the 2013 Budget is 15 December 2012. The 2013 Budget forms part of the medium-term fiscal consolidation programme that aims to reduce the general government deficit to 1.9 per cent. and 1.0 per cent. of GDP in 2014 and 2015, respectively.

According to the 2013 Budget:

- the general government deficit is projected to be 3.6 per cent. of GDP and the budget deficit is projected to be 3.3 per cent. of GDP in 2013; and
- projected total revenue is estimated to be RSD 956.4 billion, and expenditures are planned at RSD 1,078.3 billions with a deficit of RSD 121.9 billion.

The 2013 Budget is designed to limit growth in Public Debt, and expected economic growth is 2.0 per cent.

The 2013 Budget is based on the adoption of measures effecting savings on expenditures and changes to tax policy and tax rates. Many of these measures were implemented in the supplementary 2012 Budget. Measures affecting revenues that are yet to be adopted include a change in corporate income tax law which will increase the tax rate from 10.0 per cent. to 15.0 per cent. and the abolishment of certain tax exemptions. The effects of these changes are taken into account in the 2013 Budget.

Fiscal strategy

The draft Fiscal Strategy is expected to be adopted by the Government at the end of November after consultation with the IMF mission, and will include measures aimed at achieving medium-term fiscal consolidation and debt reduction with the objective of reducing the general government deficit to 1.0 per cent. of GDP by 2015 and reducing Public Debt to 58.4 per cent. of GDP by 2015. Further steps will be taken to reduce Public Debt to 45.0 per cent. of GDP by 2018 as a long-term strategic goal.

The measures will aim to reduce bureaucracy and eliminate state expenditures while also being socially responsible in terms of protection of the most vulnerable layers of society. The programme seeks to achieve fiscal consolidation by increasing Budget revenues and adopting measures to limit tax evasion and improve the collection of VAT. The Government is also considering reform of the pension system.

In addition, the draft Law on Deadlines for Payment is expected to be adopted in March 2013, and is intended to regulate the terms of settlement of financial obligations in commercial transactions. Under this law, Government entities are obliged to make payment on any commercial transactions with the private sector within 45 days. The law includes a special provision for when the borrower is the Republican Fund for Health Insurance, granting the fund 90 days to make payments, this special provision is expected to be in force by January 2015.

Consolidated General Government Budget

The following table shows the actual consolidated general government budget revenues and expenditures for the years 2007 to 2011, and the preliminary execution figures for the nine months ended 30 September 2012 compared to the actual revenues and expenditures for the nine months ended 30 September 2011.

	Year ended 31 December					*Nine months ended 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(RSD millions)			
Public revenues	1,004,130.4	1,142,113.5	1,146,509.5	1,223,402.7	1,302,508.3	936,206.7	1,007,518.7
Current revenues	997,498.1	1,139,045.8	1,139,849	1,214,494.3	1,297,847.2	934,056.3	1,003,400.8
Tax revenues	870,036.0	1,000,368.0	1,000,321.2	1,056,460.3	1,130,946.1	817,875.9	889,994.5
Personal income tax	115,772.0	136,450.8	133,481.8	139,051.5	150,824.4	108,489.0	118,517.0
Corporate income tax	29,686.4	39,006.9	31,213.1	32,593.0	37,806.0	29,511.5	44,075.2
Value added tax	265,464.7	301,689.5	296,9272	319,369.4	342,445.7	246,789.1	264,145.3
Excise tax(2)	98,600.6	110,137.0	134,781.1	152,166.6	170,949.1	122,102.5	130,119.6
Customs	57,380.9	64,784.3	48,039.8	44,285.5	38,804.7	28,180.2	25,965.2
Other tax revenues	32,820.0	35,567.7	37,072.2	45,979.6	43,542.6	32,080.7	32,209.8
Social contributions	270,311.4	312,731.8	318,8061	323,014.8	346,573.6	250,722.9	274,962.6
Non-tax revenues	127,462.1	138,677.8	139,528.0	158,034.0	166,901.0	116,180.4	113,406.3
Capital revenues	5,330.4	1,538.2	187.0	1,518.8	2,014.7	878.8	2,748.5
Grants	1,301.9	1,529.6	6,473.3	7,389.6	2,646.4	1,271.7	1,369.4
Public expenditures	1,048,527.1	1,212,536.2	1,267,905.3	1,359,872.3	1,460,870.6	1,049,396.1	1,155,658.1
Current expenditures	919,038.3	1,087,312.9	1,154,156.4	1,224,773.2	1,324,709.8	960,326.8	1,065,320.7
Expenditures for employees	238,325.3	293,132.5	301,846.3	308,051.2	342,478.8	251,493.5	271,037.8
Purchase of goods and services	168,130.3	181,075.5	186,412.2	202,544.6	216,294.9	148,179.3	167,933.3
Interest repayments	17,893.5	16,324.3	22,377.9	34,193.0	44,806.4	33,131.3	52,037.0
Subsidies	63,697.5	77,984.4	63,075.9	77,858.6	80,480.6	58,934.4	67,244.9
Social welfare and transfers	409,284.3	496,805.4	555,632.2	579,184.2	608,969.2	444,753.8	479,481.9
Of which: Pensions unemployment	259,858.2	331,027.9	387,306.0	394,035.4	422,815.9	311,617.5	349,543.9
Benefits	14,694.1	16,718.5	19,348.5	21,865.1	17,573.7	13,271.4	10,081.2
Sick leave benefits	4,997.4	6,070.7	6,767.0	6,770.1	6,299.8	4,695.0	5,232.9
Other transfers to households	129,734.6	142,988.3	142,210.8	156,513.6	162,279.8	115,169.9	114,624.0
Other current expenditures	21,707.2	21,990.7	24,811.8	22,941.7	31,679.9	23,834.5	27,585.8
Capital expenses	114,155.0	105,906.3	93,270.8	105,105.1	111,150.7	68,839.4	77,594.3
Net lending	15,333.8	19,317.0	20,478.0	29,993.9	25,010.2	20,229.8	12,743.2

	Year ended 31 December					Nine months ended 30 September	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
				(RSD millions)			
Consolidated balance	(44,396.7)	(70,422.7)	(121,395.7)	(136,469.6)	(158,362.3)	(113,189.3)	(148,139.4)
Other receivables	61,630.3	70,716.3	330,586.4	383.180.1	505,872.4	463,015.1	371,425.6
Privatisation	49,658.9	37,527.4	37,925.9	6,492.5	5,080.3	3,622.2	21,129.5
Receivables stemming from approved loans	78.1	11,534.5	1,907.3	1,287.2	1,198.2	1,170.1	5,632.8
Domestic borrowings(3)	5,638.8	15,475.8	243,196.7	304,777.5	344,472.8	319,921.6	315,845.7
Foreign borrowings	6,209.5	6,178.6	6,725.1	70,623.0	156,669.8	138,301.2	28,817.6
Proceeds withdrawn from IMF	–	–	40,888.4	–	–	–	–
Other expenditures	38,779.4	44,784.7	171,708.21	256,595.2	308,419.2	248,197.0	264,889.2
Repayment of principal to domestic creditors(4)	32,964.1	32,533.9	155,348.1	229,912.0	276,566.6	226,783.5	208,594.4
Repayment of principal to foreign creditors	5,694.2	9,000.8	3,535.0	1,000.0	4,909.1	19,913.4	33,179.9
Procurement of financial assets	121.1	3,250.0	3,535.0	1,000.0	4,909.1	1,500.0	23,114.9

Source: Office of Statistics; National Bank.

Notes:

(1) The consolidated balance sheet of the Government is prepared on a cash basis using the Government Finance Statistics Manual (the "GFSM") 1986 methodology.

(2) Excise tax revenues include excises on oil derivatives that have been assigned to the PE "Putevi Srbije" from1 January 2006 until 31 December 2011.

(3) Out of RSD 39.5 billion of domestic borrowing in July 2009, RSD 16.9 billion comprises the debt of PE "Putevi Srbije" which used these proceeds to repay debts to suppliers from previous years.

(4) Includes repayment of frozen foreign currency savings, deposits and loan for economic revival as well as RSD 21.1 billion payment to PE "Putevi Srbije" which used these proceeds in 2009 to repay debts to suppliers from previous years.

The following table shows the actual public revenues and expenditures against the central government budget for the years 2009 to 2011 and actual public revenues and expenditures for the nine months ended 30 September 2012 against the central government budget for 2012:

	Year ended 31 December							Nine months ended 30 September
	2009		*2010*		*2011*		*2012*	*2012*
	Budget	*Executed*	*Budget*	*Executed*	*Budget*	*Executed*	*Budget*	*Executed*(1)
					(RSD millions)			
Public revenues	614,987	626,700	659,600	664,550	707,345	694,255	829,596	561,576
Current revenues	614,987	626,700	654,600	659,232	707,345	694,255	827,998	560,580
Tax revenues	570,914	574,480	613,000	616,412	657,845	646,406	700,643	497,247
Personal income tax	71,000	71,308	73,500	75,175	71,100	70,285	45,800	32,560
Corporate income tax	29,500	23,495	29,100	29,892	35,100	34,208	48,000	39,291
Value added tax	296,514	296,862	321,000	319,271	341,355	342,367	372,167	264,145
Excise tax	117,400	119,820	133,600	135,589	161,625	152,425	192,100	129,650
Customs	47,500	48,040	43,300	44,285	39,765	38,805	35,000	25,965
Other tax revenues	9,000	8,956	12,500	12,200	8,900	8,316	7,576	5,635
Non-tax revenues	44,073	52,220	41,600	42,820	49,500	47,849	127,355	63,333
Capital revenues	–	–	–	–	–	–	–	–
Grants	–	–	5,000	5,381	–	–	1,599	996
Public expenditures	719,854	713,167	779,723	769,565	850,092	832,885	1,033,170	706,802
Current expenditures	674,965	672,505	726,086	722,081	801,144	785,166	975,863	675,711
Expenditures for employments	180,690	177,662	184,029	182,890	204,128	202,798	249,269	176,078
Purchase of goods and services	35,967	37,846	45,101	43,877	47,529	46,845	92,522	50,832
Interest repayments	30,483	20,076	30,247	30,127	42,112	40,337	65,896	48,262
Subsidies	34,527	37,199	45,134	44,649	54,389	51,921	89,244	51,146
Social welfare and transfers	392,187	400,104	421,574	420,537	452,207	429,058	461,613	328,175

	Year ended 31 December							Nine months ended 30 September
	2009		2010		2011		2012	2012
	Budget	*Executed*	*Budget*	*Executed*	*Budget*	*Executed*	*Budget*	*Executed*[(1)]
					(RSD millions)			
To other levels of government other transfers to pensions	213,200	216,184	220,100	220,037	238,100	236,476	273,400	201,882
Unemployment	22,000	19,975	21,800	21,800	16,700	14,940	12,300	8,228
Sick leave benefits	588	2,035	588	588	615	564	615	881
Other transfers	93,783	97,212	112,197	111,545	117,499	113,065	96,977	67,148
Other current expenses	6,650	7,194	7,604	7,756	13,624	13,125	16,349	14,068
Capital expenses	27,788	23,849	26,449	22,423	23,432	19,740	42,771	19,629
Net lending	17,101	16,814	27,188	25,060	25,516	27,987	14,537	11,462
Budget balance	(104,867)	(86,467)	(120,123)	(105,014)	(142,747)	(138,629)	(203,574)	(145,226)

Source: Ministry of Finance and Economy.

Note:

(1) Without indirect Budget users.

The following table shows year-on-year nominal changes in certain Government revenues and expenditures for the years 2010 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December		Nine months ended 30 September	
	2010	2011	2011	2012
		(% change)		
Personal income tax	4.2	8.5	8.4	9.2
Corporate income tax	4.4	16.0	19.7	49.3
Value added tax	7.6	7.2	6.2	7.0
Excise tax	12.9	12.3	16.5	6.6
Customs duties	(7.8)	(12.4)	(11.4)	(7.9)
Other tax revenues	24.0	(5.3)	(3.1)	0.4
Social contributions	1.3	7.3	7.1	9.7
Non-tax revenues	13.3	4.7	9.8	(2.4)
Capital revenues and grants	33.7	1.9	(0.8)	91.5
Public expenditures	7.3	7.4	10.1	10.1
Expenditures for employees	2.1	11.2	11.8	7.8
Purchase of goods and services	8.7	6.8	8.4	13.3
Interest repayments	52.8	31.0	35.5	57.1
Subsidies	23.4	3.4	14.0	14.1
Social welfare and other transfers to citizens	4.2	5.1	5.0	7.8
Capital expenses	12.7	5.8	21.9	12.7
Net lending	46.5	(16.6)	3.7	(37.0)

Source: Ministry of Finance and Economy.

The following table shows year-on-year real changes in certain Government revenues and expenditures for the years 2010 to 2011 and for the nine months ended 30 September 2011 and 2012:

	Year ended 31 December		*Nine months ended 30 September*	
	2010	*2011*	*2011*	*2012*
	(% change)			
Personal income tax	(2.2)	(2.3)	(3.5)	3.5
Corporate income tax	(2.0)	4.5	6.6	41.4
Value added tax	1.0	(3.4)	(5.4)	1.4
Excise tax	6.0	1.2	3.7	0.9)
Customs duties	(13.4)	(21.1)	(21.1)	(12.7)
Other tax revenues	16.5	(14.7)	(13.7)	(4.9)
Social contributions	(4.9)	(3.3)	(4.6)	3.9
Non-tax revenues	6.4	(5.7)	(2.2)	(7.6)
Capital revenues and grants	25.6	(8.2)	(11.7)	81.3
Public expenditures	0.7	(3.2)	(2.0)	4.3
Expenditures for employees	(4.2)	0.2	(0.5)	2.1
Purchase of goods and services	2.0	(3.8)	(3.4)	7.3
Interest repayments	43.5	18.1	20.7	48.7
Subsidies	15.9	(6.9)	(1.5)	8.1
Social welfare and other transfers to citizens	(2.1)	(5.3)	(6.5)	2.1
Capital expenses	5.8	(4.7)	8.5	6.7
Net lending	37.5	(24.9)	(7.6)	(40.3)

Source: Ministry of Finance and Economy.

Fiscal Developments in 2009

The global financial and economic crisis affected Serbia severely in the last quarter of 2008. In 2009, the fiscal position of Serbia deteriorated further due to the large fall in revenues which, together with the high volume and unfavourable structure of public spending, resulted in a substantial increase in the fiscal deficit and Public Debt. Serbia negotiated and then revised a stand-by arrangement with the IMF. As part of this arrangement, the general government deficit was planned at 4.5 per cent. of GDP. The increased level of deficit, combined with a freeze on public sector salaries and pensions, allowed the Government to introduce some incentives for companies (such as subsidised liquidity loans and investment loans) and citizens (such as subsidised consumer loans for domestic products and subsidised housing loans), as well as some increases in unemployment and social welfare benefits.

The deficit stood at RSD 121.4 billion, or 4.5 per cent. of GDP, by the end of 2009, which was the targeted level for the year. Increased borrowings for the purpose of debt servicing led to the growth in Public Debt as a proportion of GDP, from 29.2 per cent. at the end of 2008 to 34.8 per cent. at the end of 2009.

In 2009, general government revenues fell sharply due to reduced tax receipts as a consequence of the effects of the downturn in the Serbian economy. The Government acted to offset the overall fall in revenues by increasing excise taxes on oil derivatives and the introduction of a tax on the use of mobile phones, thereby having, in the Government's opinion, a smaller negative impact on overall growth than if it had increased VAT or decreased public sector wages.

Current revenues in 2009 were 7.8 per cent. lower than in 2008 in real terms. Tax revenues fell in real terms by 7.8 per cent., whereas non-tax revenues fell by 8.1 per cent. Revenues were boosted by financial aid from the EU of RSD 4.8 billion (see "*Description of Serbia – Foreign Relations – European Union*"). Revenues from direct taxes and contributions for mandatory social insurance represented a lower proportion of GDP (17.8 per cent.) than in relation to the previous year (18.3 per cent.). Frozen public sector wages, as well as the growth of unemployment, were the main reasons for this decrease.

Personal income tax

The real level of generated income arising from personal income taxes fell by 2.2 per cent. in nominal terms (9.8 per cent. in real terms) compared to 2008, primarily due to a decline in the overall level of employment in 2009. A decline in other types of income taxes (revenues from self-employed persons, royalties, annual income tax, etc.) also contributed to the fall in personal income tax collections.

Corporate income tax

The nominal fall in the corporate income tax (which comprised approximately 84.0 per cent. of total income tax) was 20.0 per cent. (26.2 per cent. in real terms) compared to 2008. Other income taxes (tax on distributed profits, tax on corporate profits, tax on interest, royalties and capital gains paid to non-residents and tax on profits from rented or leased movable or immovable property) recorded a nominal decrease of 5.3 per cent. (13.6 per cent. in real terms) compared to 2008.

Value added tax

Revenues from value added tax ("VAT") fell by 1.6 per cent. in nominal terms and 9.2 per cent. in real terms in 2009 compared with the previous year, primarily due to a decline in trade volumes leading to lower VAT collections on imports and exports.

Excise tax

Excise tax recorded a nominal increase of 22.4 per cent. (12.9 per cent. in real terms) and was the only tax which increased as a proportion of GDP compared to the previous year as a result of changes in the excise tax policy in the course of 2009. The increase in 2009 was primarily driven by higher revenues from excise taxes on oil derivatives (22.9 per cent. in nominal terms and 13.3 per cent. in real terms) and from excise taxes on tobacco products (28.6 per cent. in nominal terms and 18.7 per cent. in real terms), resulting from increases to the excise tax charged on these products in 2009.

Customs duties

Revenues from customs duties decreased by 25.8 per cent. in nominal terms (31.6 per cent. in real terms) in 2009 compared to the previous year, primarily as a result of the decrease in import volumes in the first half of the year and the loss in customs revenues resulting from the unilateral implementation of the terms of the SAA relating to trade.

Other tax revenues

In 2009, other tax revenues increased nominally by 4.2 per cent. but decreased by 3.8 per cent. in real terms, primarily driven by a decrease in revenues from property tax by 11.7 per cent. in nominal terms (19.4 per cent. in real terms), resulting from lower collections of annual taxes on real estate and a decrease in tax receipts from property transfers due to a downturn in real estate sales.

Social contributions

In 2009, the nominal level of revenues from social contributions was 1.9 per cent. (6.0 per cent. in real terms) less than in 2008, in line with the decrease in revenues from taxes on salaries.

Non-tax revenues

Non-tax revenues fell by 0.3 per cent. in nominal terms (8.1 per cent. in real terms) compared to 2008, primarily driven by a decrease of 15.1 per cent. in nominal terms (21.7 per cent. in real terms) in non-tax revenues collected at the local government level (such as various stamp duties and commissions), which comprise the largest portion of non-tax revenues. The largest fall was in commissions for the development of city construction land affected by the decline in the building industry.

Capital revenues and grants

Capital revenues and grants recorded a nominal increase of 117.1 per cent. (108.0 per cent. in real terms), but do not ordinarily contribute a significant proportion of total revenues at the central government level.

In December 2009, however, the EU contributed non-returnable financial aid for financing the Budget deficit in the amount of RSD 4.8 billion.

Public expenditures

Public expenditures increased nominally by 4.4 per cent. (a 3.6 per cent. decline in real terms) in 2009. However, public expenditure was reduced by 0.4 per cent. of GDP in nominal terms compared to 2008, as part of the reduction in the Budget deficit targeted under the stand-by arrangement with the IMF (see "*Public Debt – Multilateral and Bilateral Development Organisations – International Monetary Fund*"). All categories of expenditures recorded reductions in real terms compared to 2008, with the exception of interest repayments and social welfare and benefit payments.

Expenditures for employees

In 2009, the overall amount of public sector wages increased by 3.0 per cent. in nominal terms but decreased by 5.0 per cent. in real terms compared to the previous year as a consequence of savings measures agreed in the programmes with the IMF, which included the freezing of salaries and restrictions on new recruitment.

Purchase of goods and services

The level of expenditure on the purchase of goods and services in 2009 was 2.9 per cent. higher in nominal terms but decreased by 5.0 per cent. in real terms compared to 2008. These savings were achieved not only at the central government level, but also at the local government level by limiting transfers of funds.

Interest repayments

Interest repayments in 2009 nominally increased by 37.1 per cent. (26.5 per cent. in real terms) compared to 2008 as a result of the payment of interest on Government bonds issued to finance the deficit.

Subsidies

Subsidies recorded a nominal decrease of 19.1 per cent. (25.4 per cent. in real terms) compared to 2008, primarily due to a significant decrease in subsidies paid from the central government budget.

Social welfare and other transfers to citizens

Transfers to citizens increased by 11.8 per cent. in nominal terms (3.2 per cent. in real terms) compared to 2008, mainly as a result of the growth of pensions in the previous year, with the largest portion of transfers to citizens comprising pensions, as well as by an increase in unemployment benefits paid as a result of an increase in the number of unemployed.

Capital expenses

Capital expenses for 2009 nominally decreased by 11.9 per cent. (18.8 per cent. in real terms) compared to the previous year. The greatest falls in capital expenses were recorded at the central government and AP Vojvodina levels with the other local authorities recording capital expenditure at levels similar to those of 2008.

Net lending

Net lending increased nominally by 6.8 per cent., but decreased by 1.5 per cent. in real terms. Net lending recorded the lowest real fall of all categories of expenditures, although there was a significant difference in the purpose of lending in 2009 compared to 2008. In 2008, a greater proportion of Budget lending went towards the recapitalisation of some banks and financial institutions owned by the Government, while in 2009, lending was principally to provide support to companies and industries affected by the global financial and economic crisis.

The largest deficit was at the central government level, amounting to RSD 93.6 billion, with the deficits of local authorities such as cities and municipalities amounting to RSD 15.2 billion and with that of AP Vojvodina standing at RSD 10.2 billion. The Mandatory Social Insurance Fund generated a deficit of RSD 0.8 billion and PE "Putevi Srbije" recorded a deficit of RSD 1.6 billion.

In previous years, privatisation proceeds had been the main source of deficit financing, but, in 2009, the main source of financing was domestic borrowing in the form of the issuance of T-bills, with RSD 202.8 billion being borrowed and RSD 107.9 billion repaid, leaving a net increase in debt of RSD 94.9 billion. Privatisation revenues of RSD 39.8 billion, principally from the sale of NIS Jugopetrol, were applied to finance the Budget deficit of AP Vojvodina. The deposit growth at the end of the year was the result of substantial inflows in December as the result of withdrawal of funds allocated by the IMF for special drawing rights and the payment of non-refundable financial aid by the EU.

Both the public debt and acquired financial assets in the amount of RSD 171.6 billion have been repaid. The repayment of debt to domestic creditors amounted to RSD 155.3 billion, out of which the repayment of debt arising from Government bonds was RSD 107.9 billion and payment of obligations for frozen foreign currency saving deposits and the loan for economic revival were RSD 22.1 billion.

In 2009, arrears were reduced, primarily as the result of the reduced debts of the PE "Putevi Srbije", whose liabilities fell from RSD 28.7 billion at the end of 2008 to RSD 1.1 billion at the end of 2009. The increased amount of arrears was mostly the result of arrears of the Republic Institute for Health Insurance, whose debt increased from RSD 4.4 billion at the end of 2008 to RSD 9.5 billion at the end of 2009.

Fiscal Developments in 2010

The recovery of revenues in the second half of 2010 and the freezing of the largest categories of public spending, together with careful control of expenditures and improved collection of revenues in the last quarter of 2010, resulted in a deficit at the end of 2010, which was lower than had been budgeted. The deficit amounted to RSD 136.5 billion or 4.6 per cent. of GDP, which was less than the planned deficit of 4.8 per cent. of GDP.

Positive macroeconomic movements, including growth in GDP, industrial production, foreign trade and average wages, in the second half of the year gave rise to fiscal improvements. Revenues recorded moderate growth compared to 2009 and the recovery in economic activities had a positive effect on indirect taxes (in particular, VAT and excise tax). In 2010, the Government made no further significant changes to its taxation policy or its expenditure policy (other than those adopted in the course of 2009) as described above.

Public revenues grew by 6.7 per cent. in nominal terms (staying almost flat in real terms) compared to 2009. Current revenues grew only by the level of average inflation, with no growth in real terms. Tax revenues fell by 0.8 per cent. in real terms while non-tax revenues grew by 6.4 per cent. in real terms.

Personal income tax

Revenues from personal income tax grew by 4.2 per cent. in nominal terms (although falling by 2.2 per cent. in real terms) compared to the previous year, despite decreasing numbers of employed persons in 2010, driven by an increase in nominal wages of 7.6 per cent. Growth in other types of income taxes (revenues from self-employed persons, royalties, annual income tax, etc.) also contributed to the overall increase in personal income tax collections.

Corporate income tax

Corporate income tax accounted for approximately 84.0 per cent. of total income tax revenues in 2010 and grew in nominal terms by 4.4 per cent. (a 2.0 per cent. decrease in real terms) compared to 2009. Revenues from other income taxes grew by 20.0 per cent. in nominal terms (10.5 per cent. in real terms).

Value added tax

Revenues from VAT nominally increased by 7.6 per cent. (1.0 per cent. in real terms) in 2010, mainly due to VAT collections on increasing exports volumes driven by strong growth in foreign demand in 2010. VAT from imports also recorded nominal growth of 19.8 per cent. (12.4 per cent. in real terms).

Excise tax

Revenues from excise taxes grew in both nominal (12.9 per cent.) and real terms (6.0 per cent.) in 2010, largely as a result of an increase in the rate of excise tax applied to tobacco products in accordance with Serbia's action plan for the implementation of CEFTA, an increase in the amount of excise tax collected on oil derivatives and tobacco in the second half of 2009, and as a result of the regular process of synchronisation in January 2010 (whereby in January of each year excise taxes are indexed to the inflation rate in the previous year).

Customs duties

In 2010, revenues from customs duties fell by 7.8 per cent. in nominal terms (13.4 per cent. in real terms) compared to the previous year as a result of lower imports and the effects of the Interim Trade Agreement with the EU.

Other tax revenues

Other tax revenues grew by 24.0 per cent. in nominal terms (16.5 per cent. in real terms) compared to 2009, primarily driven by an increase in property tax collected by local authorities of 17.6 per cent. in nominal terms (10.4 per cent. in real terms), which is the largest component of other tax revenues. The introduction of the tax on the use of mobile telephones in July 2009 also contributed to the increase in other tax revenues.

Social contributions

Social contributions in 2010 grew in nominal terms by 1.3 per cent. but decreased by 4.9 per cent. in real terms compared to 2009, primarily driven by a decline in social contributions for pension and disability insurance of employees.

Public expenditures

In 2010, public spending nominally increased by 7.3 per cent. (0.7 per cent. in real terms). The modest growth came from the increase in the level of public investments while current public spending was lower in real terms than the previous year as a result of nominal "freezing" of salaries and pensions which make up the two largest categories of current public spending. The reductions in these categories of expenditures created capacity in the Budget for an increase in fiscal incentives such as subsidies and "soft" budgetary credits for businesses and citizens.

Expenditures for employees

Total public sector wages increased by 2.1 per cent. in nominal terms (a 4.2 per cent. decrease in real terms) compared to 2009, as the result of the salary freeze.

Purchase of goods and services

Expenditure on the purchase of goods and services increased by 8.7 in nominal terms (2.0 per cent. in real terms) compared to the previous year. This growth came across the budgets of the central government, local governments and the Republic Institute for Health Insurance, with expenditure for PE "Putevi Srbije" decreasing.

Interest repayments

Total interest repayments were 52.8 per cent. higher in nominal terms (43.5 per cent. in real terms) compared to 2009 as a result of the increase in the interest-servicing costs of Government bonds issued to finance the deficit.

Subsidies

Subsidies increased by 23.4 per cent. in nominal terms (15.9 per cent. in real terms) compared to 2009. Subsidies paid from the Budget increased 21.1 per cent. in nominal terms (13.7 per cent. in real terms) while subsidies at the local government level grew by 29.3 per cent. in nominal terms (21.4 per cent. in real terms),

largely as a result of subsidies provided by the City of Belgrade to the city's thermal power plants in order to repay an overdue debt to PE "Srbijagas", a Serbian gas company, in an amount of RSD 3.0 billion.

Social welfare and other transfers to citizens

Transfers to citizens nominally increased by 4.2 per cent. (a 2.1 per cent. decrease in real terms) compared to 2009. The largest part of transfers to citizens was accounted for by pensions. In the course of 2009 and 2010, individual state pensions were frozen at the levels which applied at the end of 2008. As a result, expenditures for pensions recorded in 2010 fell by 4.5 per cent. compared to the previous year. Other transfers to citizens and various types of social welfare benefits increased by 10.0 per cent. in nominal terms (3.3 per cent. in real terms).

Capital expenses

Capital expenses for 2010 increased by 12.7 per cent. in nominal terms (5.8 per cent. in real terms) compared to the previous year as a result of increased public investment in the country's road infrastructure financed by the central government budget and the budget of AP Vojvodina. The highest rates of growth were recorded by PE "Putevi Srbije".

Net lending

Net lending increased significantly by 46.5 per cent. in nominal terms (37.5 per cent. in real terms) with a major portion of the expenditure being targeted towards mitigating the effects of the global financial and economic crisis.

The largest deficit was at the central government level amounting to RSD 10.1 billion, with significant deficits also in the budget of the AP Vojvodina, budgets of the local authorities and PE "Putevi Srbije", while the social security funds showed a small surplus.

In the course of 2010, in addition to regular Budget expenses, RSD 229.9 billion of outstanding Public Debt was repaid with almost 90.0 per cent. of this amount accounted for by the repayment of debt owed to domestic creditors, of which RSD 185.6 billion comprised repayment on maturity of Government bonds. A further RSD 392.1 billion was required for deficit financing and debt repayment in the first half of the year, the largest part of which was funded by the issue of Government securities.

In the course of 2010, arrears remained virtually unchanged.

Fiscal Developments in 2011

By the end of 2011, the deficit stood at RSD 158.4 billion, an increase of RSD 22 billion compared to 2010, primarily due to the unfreezing of public sector wages and pensions as well as increases in interest payments and other current expenditures. Revenues increased by 6.3 per cent. in nominal terms, although both revenues and expenditures were lower in real terms compared to 2010.

Personal income tax

Revenues from personal income tax increased by 8.5 per cent. in nominal terms (a decrease of 2.3 per cent. in real terms) compared to 2010, primarily driven by an increase in revenues from taxes on salaries of 9.2 per cent. in nominal terms (a decrease of 1.6 per cent. in real terms), which comprised approximately 77.0 per cent. of the total personal income tax revenue, despite a decline in overall levels of employment during this period. Other types of income tax (including revenue from self-employed persons, royalties and annual income tax) also increased by 5.7 per cent. in nominal terms (a decrease of 4.8 per cent. in real terms).

Corporate income tax

Corporate income tax accounted for approximately 81.0 per cent. of total income tax for the period and increased in nominal terms by 24.5 per cent. (12.2 per cent. in real terms) compared to 2010. Revenues from other types of income taxes decreased by 10.8 per cent. in nominal terms (19.7 per cent. in real terms).

Value added tax

Revenues from VAT increased by 7.2 per cent. in nominal terms (a decrease of 3.4 per cent. in real terms) compared to 2010. Gross collections underperformed in 2011, decreasing by 6.5 per cent. in real terms (a 7.2 per cent. increase in nominal terms). A 14.3 per cent. nominal and 12.9 per cent. real increase in VAT returns led to a rise in revenues from domestic VAT of 4.0 per cent. in nominal terms (a decline of 6.3 per cent. in real terms). The increase in returns was primarily driven by a significant increase in the value of exports and imports of intermediate and capital goods.

Excise taxes

Revenues from excise taxes increased by 12.3 per cent. in nominal terms (1.2 per cent. in real terms) compared to 2010, mainly due to an inflation indexation in January 2011 and also partly due to amendments to the structure of excise rates on oil derivatives in July 2011.

Customs duties

In 2011, the reduction of customs rates required by the Interim Trade Agreement with the EU led to a decrease in revenues from customs duties of 12.4 per cent. in nominal terms (21.1 per cent. in real terms) despite the growth in imports during this period.

Other tax revenues

Other tax revenues decreased by 5.3 per cent. in nominal terms (14.7 per cent. in real terms) compared to 2010. The largest portion of other tax revenues was accounted for by property taxes collected by local authorities, which increased by 6.9 per cent. in nominal terms, but decreased by 3.7 per cent. in real terms. Another contributing factor to the decrease of other tax revenues was the abolition of the tax on mobile phones, which had been introduced in the second half of 2009 and was applied throughout 2010.

Social contributions

Revenues from social contributions increased by 7.3 per cent. in nominal terms but fell by 3.3 per cent. in real terms compared to 2010, resulting from an increase in wages.

Public expenditures

Public spending grew by 7.4 per cent. in nominal terms but decreased by 3.2 per cent. in real terms compared to 2010. The nominal increase in public spending was driven by nominal growth in current spending (8.2 per cent. in nominal terms) and capital expenses (5.8 per cent. in nominal terms).

Expenditures for employees

Public sector wages increased by 11.2 per cent. in nominal terms (0.2 per cent. in real terms) compared to 2010. The freeze on public sector wages came to an end in January, which resulted in a nominal increase throughout 2011. Wages were increased three times during 2011 in accordance with fiscal rules: by 2 per cent. in January, by 5.5 per cent. in April and by 1.2 per cent. in October.

Purchase of goods and services

Expenditure on the purchase of goods and services increased by 6.8 per cent. in nominal terms (a decrease of 3.8 per cent. in real terms) compared to 2010.

Interest repayments

Interest repayments increased by 31 per cent. in nominal terms (19.1 per cent. in real terms) compared to 2010 as a result of the sluggish economy and the need for capital investments financed through loans from international financial organisations.

Subsidies

Subsidies increased by 3.4 per cent. in nominal terms (a decrease of 6.9 per cent. in real terms) compared to 2010. Subsidies paid from the Budget increased by 13.7 per cent. in nominal terms (a decrease of

2.4 per cent. in real terms) while the subsidies paid out of local government budgets decreased by 9.2 per cent. in nominal terms (18.2 per cent. in real terms), with a small fall recorded in the relevant amount paid out of the AP Vojvodina budget, which represented a relatively small proportion of the total amount of subsidies in the consolidated Budget.

Social welfare and other transfers to citizens

Transfers to citizens increased by 5.1 per cent. in nominal terms but decreased by 5.3 per cent. in real terms, compared to 2010, driven by a decrease in the overall public sector pension bill. The largest proportion of the overall amount of transfers to citizens comprised pensions which had been frozen for the previous two years but were effectively unfrozen by special fiscal rules relating to public sector salaries and pensions implemented in January 2011. However, during 2011, moderate growth both in nominal and real terms occurred. Nominal falls were also recorded in sickness and unemployment benefits.

Capital expenses

Capital expenses increased by 5.8 per cent. in nominal terms (a decrease of 4.7 per cent. in real terms) compared to 2010. Nominal growth was recorded at both the central government and local government levels.

Net lending

Net lending decreased significantly by 16.6 per cent. in nominal terms (24.9 per cent. in real terms) compared to 2010.

The Government aims to monitor arrears more closely in order to reduce accumulation of arrears at the local government level. Potential policies may include reporting of arrears on a monthly basis by all consolidated general government entities and requiring payment of all outstanding loans overdue by more than 60 days by law and through sanctioning mechanisms.

Fiscal Developments in the Nine Months ended 30 September 2012

In the nine months ended 30 September 2012, the deficit stood at RSD 148.1 billion. Revenues increased by 7.6 per cent. in nominal terms and 1.9 per cent. in real terms compared to the same period in 2011.

Personal income tax

Revenues from personal income taxes increased by 9.2 per cent. in nominal terms (3.5 per cent. in real terms) compared to the same period in 2011, primarily driven by an increase in revenues from taxes on salaries of 8.0 per cent. in nominal terms (2.3 per cent. in real terms), which comprised approximately 77.0 per cent. of the total personal income tax revenue, despite a decline in overall levels of employment during this period. Other types of income tax (including revenue from self-employed persons, royalties and annual income tax) also increased by 13.8 per cent. in nominal terms (7.8 per cent. in real terms).

Corporate income tax

Corporate income tax accounted for approximately 86.0 per cent. of total income tax for the period and increased in nominal terms by 55.4 per cent. (47.2 per cent. in real terms) compared to the same period in 2011. Revenues from other types of income tax increased by 20.7 per cent. in nominal terms (14.3 per cent. in real terms). As a result of higher corporate income reported in 2011, higher corporate income tax was collected in 2012.

Value added tax

Revenues from VAT increased by 7.0 per cent. in nominal terms (1.4 per cent. in real terms) compared to the same period in 2011. Gross collections in the nine months ended 30 September 2012 increased by 1.9 per cent. in real terms (7.6 per cent. in nominal terms). An increase of 11.8 per cent. in nominal terms (5.8 per cent. in real terms) in VAT refunds led to a decline in revenues from domestic VAT of 2.0 per cent. in real terms (an increase of 3.5 per cent. in nominal terms). The increase in VAT refunds was of a technical nature, as approximately RSD 4.2 billion of refunds from 2011 were actually paid in January 2012. Revenues

from VAT on imports rose by 9.0 per cent. in nominal (3.2 per cent. in real terms) compared to the same period in 2011.

Excise taxes

Revenues from excise taxes increased by 6.6 per cent. in nominal terms (0.9 per cent. in real terms) compared to the same period in 2011. In May 2012, due to lower oil substitution for heating oil (which was not an excise good), the Government adopted the Regulation on Incurring Excise Duty on Heating Oil, allowing use of heating oil without excise duty only for heating and industry. Other excise goods increased in nominal and real terms (especially tobacco products).

Customs duties

In the nine months ended 30 September 2012, the reduction of customs rates required by the Interim Trade Agreement with the EU led to a decrease in revenues from customs duties of 7.9 per cent. in nominal terms (12.7 per cent. in real terms) despite the growth in imports during the period.

Other tax revenues

Other tax revenues increased by 9.7 per cent. in nominal terms (a decrease of 4.9 per cent. in real terms) compared to the same period in 2011. The largest portion of other tax revenues was accounted for by property taxes collected by local authorities, which increased by 12.7 per cent. in nominal terms and 6.7 per cent. in real terms.

Social contributions

Revenues from social contributions increased by 9.7 per cent. in nominal terms and 3.9 per cent. in real terms compared to the same period in 2011, which was driven by an increase in wages.

Public expenditures

Public spending grew by 10.1 per cent. in nominal terms and 4.3 per cent. in real terms, compared to the same period in 2011. The nominal increase in public spending was primarily due to nominal growth in current spending (10.9 per cent. in nominal terms) and capital expenses (12.7 per cent. in nominal terms).

Expenditures for employees

Public sector wages increased by 7.8 per cent. in nominal terms (2.1 per cent. in real terms) compared to the same period in 2011.

Purchase of goods and services

Expenditure on the purchase of goods and services increased by 13.3 per cent. in nominal terms (7.3 per cent. in real terms) compared to the same period in 2011.

Interest repayments

Interest repayments increased by 57.1 per cent. in nominal terms (48.7 per cent. in real terms) as a result of the sluggish economy and need for capital investments financed through loans from international financial organisations.

Subsidies

Subsidies increased by 14.1 per cent. in nominal terms (an increase of 8.1 per cent. in real terms) compared to the same period in 2011. Subsidies paid from the Budget increased by 4.8 per cent. in nominal terms (a decrease of 0.7 per cent. in real terms), mainly due to a large amount of agricultural subsidies, while the subsidies paid out of local government budgets increased by 32.6 per cent. in nominal terms (25.6 per cent. in real terms). Agricultural subsidies were paid during the summer months in previous years, but in 2012 most of these subsidies were paid during the first half of the year.

Social welfare and other transfers to citizens

Transfers to citizens increased by 7.8 per cent. in nominal terms and by 2.1 per cent. in real terms, driven by an increase in the overall public sector pension bill of 6.2 per cent. in real terms compared to the previous year. Pensions (which included military pensions paid from the unified fund starting from January 2012) comprised the largest proportion of the overall amount of transfers to citizens. The increase in pensions (without military pensions) was 0.8 per cent. in real terms. Nominal and real increases were recorded in sick-leave, while unemployment benefits declined in real and nominal terms.

Capital expenses

Capital expenses increased by 12.7 per cent. in nominal terms (6.7 per cent. in real terms) compared to the same period in 2011. Nominal growth was recorded at both the central government and local government levels.

Net lending

Net lending decreased significantly by 37.0 per cent. in nominal terms (40.3 per cent. in real terms) compared to the same period in 2011.

Taxation Policy

Serbia's tax structure includes both direct taxation through personal income taxes and corporation taxes and indirect taxation through value added tax. In addition, Serbia collects excise duties, taxes on property, taxes on non-life insurance premiums and taxes on the usage, storage and transportation of certain commodities. Income taxes are assessed on an individual basis.

From 1 October 2011, 20.0 per cent. of wage tax collected is used to finance the central government budget and 80.0 per cent. of wage tax is used to finance local government budgets. This is expected to reduce central government revenue by approximately RSD 10.6 billion and increase local government revenue by the same amount.

Personal income tax

A resident taxpayer is required to pay tax on income generated in Serbia or in any other country, whereas a non-resident taxpayer is taxed only on income generated in Serbia. Personal income is taxed regardless of whether the income is generated in money, in kind, in services or otherwise. The tax is levied on private individuals whether Serbian resident or non-resident. The Law on Personal Income Tax also provides for an annual personal income tax, which is an additional tax levied on Serbian residents who generate income in any calendar year exceeding the non-taxable threshold. The threshold is reset each year and is equal to three times the average annual salary per employee in Serbia. In 2011, the threshold amount was RSD 1.9 million. Annual personal income is taxed in bands at rates between 10.0 per cent. and 15.0 per cent.

According to the supplementary 2012 Budget and related amendments to the Law on Personal Income Tax, the personal income tax rate on dividends and interest increased from 10.0 per cent. to 15.0 per cent. as of 6 October 2012.

As of the date of this Prospectus, personal income tax was levied on the sources of income and at the rates indicated in the following table:

Source of income	*Rate*
Salary	12.0 per cent. (with a fixed non-taxable monthly total of RSD 7,822 in 2012)
Agriculture and forestry	10.0 per cent.
Independent entrepreneurship	10.0 per cent.
Copyrights and similar rights and 20.0 per cent. (with recognition expenses totalling 50.0 per cent., 43.0 per cent. or 34.0 per cent. of the industrial property rights)	20.0 per cent. (with recognition expenses totalling 50.0 per cent., 43.0 per cent. or 34.0 per cent. of the gross income depending on the copyrighted work)

Source of income	*Rate*
Capital yield	15.0 per cent.
Immovables.	20.0 per cent. (with recognition expenses totalling 20.0 per cent.)
Capital gains	15.0 per cent.
Dividends and interest	15.0 per cent.
Other income	20.0 per cent. (with recognition expenses totalling 20.0 per cent. (income from lease of movable property and other income) or 50.0 per cent. (athletes and experts))

Source: Ministry of Finance and Economy.

Corporate income tax

Corporate income tax is payable by resident and non-resident legal entities, including any company or enterprise incorporated as a joint stock company or partnership. A co-operative or other legal entity that generates income by marketing its own products or by providing services for a fee is also required to pay corporate income tax.

Legal entities resident in Serbia are liable to pay corporate income tax on all profits generated in Serbia and/or any other country, while non-resident legal entities are liable to pay corporate tax only on profits generated through a branch located in Serbia.

Non-resident entities are also required to pay withholding tax at a rate of 20.0 per cent. of gross income (unless otherwise regulated under an applicable international double taxation agreement) where this income is generated directly from a Serbian resident taxpayer (without intermediation by a permanent branch office) by means of dividend distribution, company profit sharing, copyright royalties and similar rights, industrial property rights and interest and fees from the lease of immovable or movable property. Withholding tax is also levied and charged on income generated by non-resident taxpayers through entertainment, artistic activities, sports or any similar performance in Serbia that is not taxable as personal income in accordance with personal income tax regulations. In addition, non-residents are required to pay tax on certain capital gains at a rate of 20.0 per cent. The Law on Corporate Income Tax also provides for tax incentives in order to stimulate economic growth, small business development and concession investments.

Property tax

Static property tax, inheritance and gift tax and tax on the transfer of absolute rights is regulated by the Law on Property Tax (the "LPT").

Static property tax rates are determined at the local level, with the maximum rate set by the LPT. In 2011, the maximum rates were 0.4 per cent. for property rights on immovable property for taxpayers that keep business books, 0.3 per cent. for land rights for taxpayers that do not keep business books and progressive tax rates up to 2.0 per cent. apply for rights on other immovable property for taxpayers that do not keep business books depending on the tax base.

Inheritance and gift tax is levied on public building land lease rights, state-owned agricultural land lease rights and public building land usage rights regardless of the surface area. Inheritance and gift tax is also levied on the total surface area of immovable property that is subject to static property tax. In addition, inheritance and gift tax is levied on cash, savings deposits, bank deposits, cash receivables, intellectual property rights, title to most categories of secondhand motor vehicles, second-hand boats and second-hand self-powered aircraft (except state-owned), and other movable objects, except equity in a company or securities that are VAT-exempt.

The inheritance and gift tax rate for heirs or other beneficiaries who are second in the order of inheritance is 1.5 per cent., while the tax rate for heirs or other beneficiaries who are third place or lower in the order of inheritance and not related to the bequeather or gift-giver is 2.5 per cent. Beneficiaries who are first in the order of inheritance are not taxed.

Tax on the transfer of absolute rights is levied at a rate of 2.5 per cent. on transfers, for a fee, of title to immovable property, intellectual property rights, title to most categories of second-hand motor vehicles,

second-hand boats and second-hand self-powered aircraft (except state-owned), building land usage rights regardless of the surface area and rights to expropriated immovable property if granted to enable the construction of residential or commercial buildings, and is VAT-exempt. In addition, this type of tax is charged on any lease of a public building land for a period longer than one year or indefinitely for building construction. The LPT also lists other types of transfers subject to the tax.

Tax on usage, storage and transportation of certain commodities

Taxes on motor vehicle usage, boat usage, aircraft usage and the ownership of registered guns is regulated by the Law on Taxes on Usage, Keeping and Carrying of Commodities.

Value added tax

VAT is a general consumption tax levied on the supply of goods and services in Serbia for a fee as part of the taxpayer's regular business, as well as on the supply of goods imported into Serbia, unless otherwise regulated. VAT is regulated by the Law on Value Added Tax (the "VAT law").

The general VAT rate for the supply of goods and services or import of goods is 20.0 per cent. as of 1 October 2012 as a result of related amendments to the VAT law. A special VAT rate of 8.0 per cent. applies to certain goods and services and imports of goods, including specified foodstuffs, drinking water (except bottled water), medicines, orthodontic and prosthetic devices, fertilisers and pesticides, textbooks and teaching aids, personal computers and daily newspapers, cinema and theatre tickets, natural gas and initial transfers of rights to dispose of residential units. Since 1 October 2012, the special VAT rate applies to the supply of the following services: services preceding the delivery of potable water, water supply network, refinery and discharge of atmospheric and waste water, municipal waste management, maintaining cleanliness in public areas, looking after public green areas and the coastal zone, transport of passengers in public and commuter traffic, cemetery management and funeral services, as well as the supply of goods, and the use of thermal energy for heating.

The VAT law specifies three categories of tax exemption: (i) exemptions on goods and services supplied after deduction of previous tax, such as international sales where the contract contains a clause under which tax expenses are not settled from the contract fee; (ii) exemptions on goods and services supplied before deduction of previous tax, such as turnover of cash and capital; and (iii) exemptions on certain imported goods, such as humanitarian aid or goods previously exported and then returned to Serbia unsold.

Excise taxes

Excise taxes are regulated by the Law on Excise Tax, which was adopted in 2001. Excise taxes are currently levied on oil derivatives, tobacco products, alcoholic beverages and coffee produced in Serbia or imported into the country. Domestic and imported excise products are treated equally.

The following table shows the rate of excise tax for certain products as of 1 January 2012 (unless otherwise indicated):

Product	*Excise Rate*
Oil derivatives	
Leaded petrol	55.00 RSD/litre
Unleaded petrol	49.60 RSD/litre
Gas oils	42.00 RSD/litre
Kerosene	62.00 RSD/litre
Other oil derivatives with a distillation range of up to 380ºC	62.00 RSD/litre
Liquid petroleum gas	30.00 RSD/litre
Alcoholic beverages	
Schnapps (rakija)	104.52 RSD/litre
Fruit based, grape based, special types	265.17 RSD/litre
Grain based and other agricultural products	169.96 RSD/litre
Strong alcoholic drinks and liqueurs	17.45 RSD/litre
Low-alcohol drinks	19.76 RSD/litre
Beer	30.0 per cent.

Product	*Excise Rate*
Coffee	
Green coffee	80.00 RSD/kg
Roasted coffee	100.00 RSD/kg
Coffee cocoons and membranes	110.00 RSD/kg
Coffee extracts, essences and concentrates	150.00 RSD/kg
Other types of coffee – Contents of coffee in the finished product	300.00 RSD/kg
Tobacco products	
Cigarettes from 1 October to 30 June 2013	33.0 per cent. on MSRP +43.00 RSD/pack
From 1 July 2013	33.0 per cent. on MSRP +45.00 RSD/pack
Cigars and cigarillos	18.78 RSD/pc.
Smoking tobacco and other tobacco products (i.e. cut tobacco, pipe tobacco, chewing 35.0 per cent. on MSRP tobacco and snuff)	35.0 per cent. on MSRP

Source: Ministry of Finance and Economy.

According to the supplementary 2012 Budget and related amendments to the Law on Excise Tax, the following changes to the above rates of excise came into effect as of 1 October 2012:

- an increase in excise taxes on oil-gas and liquid petroleum gas to RSD/litre 42 and RSD/litre 30, respectively; and
- an increase in specific excise taxes per pack of cigarettes from RSD 33 to RSD 43.

In addition, the ad valorem excise tax rate decreased from 34.0 per cent. to 33.0 per cent. as of 1 October 2012.

PUBLIC DEBT

Introduction

The Public Debt Law defines the state debt of Serbia (the "Public Debt") as all direct and indirect liabilities incurred or guaranteed by the Government on the domestic and foreign markets. The Government may incur or guarantee debt on the domestic and foreign markets for the purposes of financing the Budget, refinancing outstanding debts, financing capital projects or settling liabilities arising out of guarantee obligations.

In the period from 2009 to 2011, Serbia increased its borrowings in order to finance the increased Budget deficit as the global financial and economic crisis had a negative impact on the Serbian economy. During this period, the Ministry of Finance and Economy also introduced a series of provisions to the Budgetary System Law setting out general and special fiscal rules in order to provide for a long-term, sustainable fiscal policy. See "*Public Finance – Fiscal Policy and Reform*". In managing Public Debt, the Ministry of Finance and Economy seeks to, among other things, secure sufficient liquidity for the Government in the medium- and long-term to finance the fiscal deficit and service and refinance maturing debt more effectively; determine appropriate risk parameters for the currency mix, interest rates and maturity profile of Public Debt; support the development of the local Government debt market and "dinarisation" of the economy; and provide transparency and continuity of the funding process.

Public Debt amounted to 55.4 per cent. of GDP as at 30 September 2012, which was above the Government's fiscal target of 45.0 per cent. of GDP (and the level set in the Budget System Law). The Ministry of Finance estimates that Public Debt will rise to approximately 60.0 per cent. of GDP as at 31 December 2012 in the absence of further policy measures. The Government therefore intends to implement measures to reduce the debt level in the near and medium-term, which will be defined in the revised Fiscal Strategy to be adopted by the end of 2012. For more information, see "*Public Finance – Fiscal Policy and Reform*".

The Public Debt excludes Serbia's restitution commitments on which Serbia will begin making payments in 2015. The Draft Law of Property Restitution and Compensation regulates the terms and conditions and method and procedure of Serbia's restitution commitments to citizens whose property was nationalised after World War II. The property will be returned in kind or by means of compensation in the form of Government bonds ("restitution bonds") or cash. Serbia's total restitution commitments will amount to approximately EUR 2 billion. A special law is expected to be passed by 31 December 2014 regulating the issue, circulation and use of restitution bonds as well as the total amount of these bonds. The restitution bonds are expected to mature within 15 years and be repaid in annual instalments starting from 2015. Serbia may also make advance payment of compensation up to the amount of EUR 10,000 per individual decision.

The following table shows Serbia's outstanding internal and external debt, and internal and external debt as a percentage of nominal GDP, as at 31 December for the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(RSD billions)			
Public Debt	703.2	778.0	944.4	1,282.5	1,547.0	1,823.5
Internal Public Debt	270.4	280.1	401.3	518.2	624.9	773.6
External Public Debt	432.8	497.9	543.1	764.3	922.1	1,049.9
			(% of nominal GDP)[(1)]			
Public Debt	30.9	29.2	34.8	44.5	48.7	55.4[(2)]
Internal Public Debt	11.9	10.5	14.8	18.0	19.7	23.5[(2)]
External Public Debt	19.0	18.7	20.0	26.5	29.0	31.9[(2)]

Source: Ministry of Finance and Economy.

Notes:

(1) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

(2) Nominal GDP figures used in the computation of Public Debt as a percentage of GDP are based on Ministry of Finance and Economy estimates.

The following table shows certain key statistics with regard to Serbia's outstanding direct and indirect liabilities, and direct and indirect liabilities as a percentage of nominal GDP, as at 31 December in the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(RSD billions)			
Public Debt	703.2	778.0	944.4	1,282.5	1,547.0	1,823.5
Direct liabilities, of which	636.2	695.7	810.9	1,101.9	1,326.3	1,545.5
Internal Public Debt	270.5	280.1	388.4	482.3	568.8	705.0
External Public Debt	365.7	415.6	422.5	619.6	757.5	840.5
Indirect liabilities[3], of which	67.0	82.3	133.5	180.6	220.7	278.0
Internal Public Debt	–	–	12.9	35.8	56.0	68.6
External Public Debt	67.0	82.3	120.6	144.8	164.7	209.4
			(% of nominal GDP)[1]			
Public Debt	30.9	29.2	34.8	44.5	48.7	55.4[2]
Direct liabilities, of which	27.9	26.1	29.9	38.2	41.8	46.9[2]
Internal Public Debt	11.9	10.5	14.3	16.7	17.9	21.4[2]
External Public Debt	16.0	15.6	15.6	21.5	23.9	25.5[2]
Indirect liabilities[3], of which	3.0	3.1	4.9	6.3	6.9	8.5[2]
Internal Public Debt	–	–	0.5	1.3	1.7	2.1[2]
External Public Debt	3.0	3.1	4.4	5.0	5.2	6.4[2]

Source: Ministry of Finance and Economy.

Notes:

(1) Figures adjusted according to the new methodology for calculating GDP applied as of January 2011. See "*Economy of Serbia – Gross Domestic Product*".

(2) Nominal GDP figures used in the computation of Public Debt as a percentage of GDP are based on Ministry of Finance and Economy estimates.

(3) Serbia issues guarantees of loans to publicly owned enterprises. If the publicly owned enterprise is unable to repay the relevant loan, it becomes a direct obligation of Serbia. As at 30 September 2012, these guarantees amounted to EUR 2,417 million (RSD 278.0 billion).

Pursuant to the Budget Law for 2012, Serbia expects to borrow an additional RSD 562.7 billion, comprising RSD 453.2 billion of Government securities and RSD 109.5 billion of other debt (including loans from commercial banks, international organisations and foreign governments), which will be used to refinance existing debt and finance the Budget deficit.

As at 30 September 2012, RSD 49.5 billion (EUR 430.3 million) of indirect liabilities had been disbursed under Serbia's guarantees. This amount comprised RSD 9.4 billion (EUR 81.7 million) to EIB and EBRD relating to Public Enterprise Roads of Serbia, RSD 8.1 billion (EUR 70.4 million) to domestic commercial banks relating to Galenika A.D., a Serbia pharmaceutical company, RSD 7.5 billion (EUR 65.2 million) to EIB relating to Fiat Group Automobiles S.p.A. car production, RSD 5.2 billion (EUR 45.2 million) to Export Canada Development relating to the Bor mining complex and RSD 19.3 billion (EUR 167.8 million) to other creditors in respect of the Electric Power Industry of Serbia, Railways of Serbia, the City of Belgrade, the Flight Control Agency, Yugoimport-SDPR (the state-owned intermediary agency for the export and import of defence-related equipment) and the Building Directorate of Serbia.

During 2010 and 2011, Serbia also issued guarantees for a total amount of EUR 900.0 million in respect of loans to Railways of Serbia, Srbijagas and Electric Power Industry of Serbia, Jat Airways, Fiat Automobili Serbia and Bor Mining Complex. In the first nine months of 2012, Serbia issued guarantees to Electric Power Industry of Serbia, Galenika ad, JAT Airways, Building Directorate of Serbia, City of Belgrade and Jat tehnika for a total amount of EUR 608 million in respect of loans.

Internal Public Debt

According to the Public Debt Law, internal Public Debt ("Internal Public Debt") comprises direct and indirect liabilities originally issued, incurred or guaranteed by the Government on the domestic market. The following table shows the composition of Serbia's outstanding Internal Public Debt as at 31 December for the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December					*As at 30 September*
	2007	*2008*	*2009*	*2010*	*2011*	*2012*
			(RSD billions)			
Internal Public Debt	270.5	280.1	401.4	518.2	624.9	773.6
Government Securities	253.8	265.5	363.8	430.8	526.2	655.3
T-bills and T-bonds	3.8	1.4	100.7	178.2	302.0	439.0
Frozen foreign currency bonds	238.3	252.7	251.6	251.8	223.4	216.3
Long-term Securities (Debt-NBS)	10.7	10.7	10.7	–	–	–
Loans for rehabilitation	1.0	0.7	0.8	0.8	0.8	0.9
Others[1]	16.7	14.6	37.6	87.4	98.7	117.4

Source: Ministry of Finance and Economy.

Note:

(1) Serbia issues guarantees of loans to publicly owned enterprises. If the publicly owned enterprise is unable to repay the relevant loan, it becomes a direct obligation of Serbia. As at 30 September 2012, these guarantees amounted to EUR 2,417 million (RSD 278.0 billion).

As at 30 September 2012, Internal Public Debt comprised mainly Government securities ("T-bills" and "T-bonds") (RSD 439.0 billion) and frozen foreign currency bonds (RSD 216.3 billion), which are foreign currency deposits converted into Government bonds issued under the Law on the Settlement of the Public Debt of the FRY Arising from the Citizens' Foreign Exchange Savings.

The Government first issued securities in 2003 but the overall amount of securities outstanding remained relatively low until the end of 2008. However, in the period from 2009 to 2012, the volume of issuance increased substantially, as the Budget deficit grew and proceeds of privatisation decreased, largely as a result of the negative effects on the Serbian economy of the global financial and economic crisis.

The share of Internal Public Debt held by foreign investors increased from 0.8 per cent. at the end of 2010 to 15.7 per cent. (EUR 0.85 billion or RSD 97.9 billion) at the end of 2011. As at 30 September 2012, the share of Internal Public Debt held by foreign investors reached 16.4 per cent. (EUR 1.1 billion or RSD 126.5 billion) of total outstanding Internal Public Debt, according to preliminary auctions data.

The following table shows the total nominal value of T-bills and T-bonds outstanding as at 31 December for the years 2010 and 2011 and as at 30 September 2012:

	As at 31 December				*As at 30 September*	
	2010		*2011*		*2012*	
	(%)	*(RSD billions)*	*(%)*	*(RSD billions)*	*(%)*	*(RSD billions)*
T-bills (3-month maturity)	12.1	21.5	1.3	4.0	2.6	11.0
T-bills (6-month maturity)	30.9	55.1	9.0	27.1	4.1	18.1
T-bills (6-month maturity (EUR indexed))	11.8	21.0	–	–	–	–
T-bills (12-month maturity)	34.0	60.6	3.3	10.0		
T-bills (53-week maturity)	–	–	28.1	84.8	20.7	90.7
T-bills (53-week maturity (EUR denominated))	–	–	7.0	20.9	4.1	18.1
T-bills (18-month maturity)	8.4	15.0	21.2	64.1	16.1	70.6
T-bills (18-month maturity (EUR denominated))	–	–	5.2	15.7	9.1	40.1
T-bills (24-month maturity)	2.8	5.0	13.2	39.9	14.2	62.3
Government bonds (2-year maturity (RSD amortising))	–	–	–	–	1.5	6.7
Government bonds (2-year maturity (EUR denominated))	–	–	–	–	2.9	12.9
Government bonds (3-year maturity)	–	–	4.7	14.2	14.9	65.4
Government bonds (3-year maturity (CPI indexed))	–	–	–	–	2.6	11.5
Government bonds (3-year maturity (EUR denominated))	–	–	2.0	6.2	1.6	6.8
Government bonds (5-year maturity)	–	–	–	–	0.7	3.2
Government bonds (10-year maturity (CPI indexed))	–	–	–	–	1.1	5.0
Government bonds (15-year maturity (EUR denominated))	–	–	5.0	15.1	3.8	16.6
Total	100.0	178.2	100.0	302.0	100.0	439.0

Source: Ministry of Finance and Economy.

As at 31 December 2011, the outstanding amount of debt represented by T-bills and Government bonds increased to RSD 302.0 billion from RSD 178.2 billion as at 31 December 2010. Twelve-month T-bills comprised 3.3 per cent. of this total, and six-month and three-month T-bills comprised 9.0 per cent. and 1.3 per cent., respectively. In order to expand the domestic capital market, the Ministry of Finance and Economy began issuing 18-month and 24-month T-bills in March 2010.

As at 31 December 2011, the outstanding amount of debt represented by T-bills and Government bonds increased further to RSD 302.0 billion. One-year maturity (12-month and 53-week) T-bills comprised 38.4 per cent. of this total, and 18-month T-bills comprised 26.4 per cent. In order to develop the domestic capital market, Serbia issued a 15-year bond denominated in Euros in February 2011, and in March 2011 Serbia began issuing RSD three-year maturity bonds.

As at 30 September 2012, outstanding debt represented by T-bills and Government bonds amounted to RSD 439.0 billion. Eighteen-month T-bills comprised 25.2 per cent. of this total and one-year (53-week) T-bills comprised 24.8 per cent. of the total. In order to develop the domestic capital market, in January 2012, Serbia issued an RSD bond with five-year maturity for the first time. In March 2012, Serbia issued a CPI indexed bond for the first time as well as a two-year RSD amortising bond in August 2012.

The Public Debt Administration of Serbia (the "Public Debt Administration") estimates that Serbia will disburse approximately EUR 240.0 million under its Internal Public Debt guarantees in 2012, as compared to EUR 228.8 million, EUR 221.5 million and EUR 135.0 million as at 31 December 2011, 2010 and 2009, respectively.

External Public Debt

According to the Public Debt Law, external Public Debt ("External Public Debt") comprises direct and indirect liabilities incurred or guaranteed by the Government to foreign investors and lenders.

The following table shows Serbia's External Public Debt structure as at 31 December for the years 2007 to 2011 and as at 30 September 2011 and 2012:

	As at 31 December					*As at 30 September*	
	2007	*2008*	*2009*	*2010*	*2011*	*2011*	*2012*
	(RSD billions)						
Multilateral creditors	357.6	405.5	404.0	532.8	538.4	504.0	597.5
Paris Club	132.7	148.2	153.8	170.6	165.5	157.6	172.1
IBRD	127.0	140.7	118.7	143.3	150.4	136.9	167.2
EIB	6.4	8.4	15.2	38.8	42.3	39.2	61.3
London Club	57.8	67.7	71.8	79.6	75.4	72.3	79.7
IDA	33.7	40.5	44.5	53.1	55.4	52.0	62.0
IMF	–	–	–	47.4	48.1	45.4	53.2
EBRD	–	–	–	–	1.3	0.6	2.0
Bilateral creditors	6.4	7.6	14.7	63.2	85.1	74.8	99.4
Switzerland	0.5	0.3	–	–	–	–	–
Italy	2.0	2.9	3.2	3.5	4.8	4.6	4.9
EU	3.9	4.4	4.7	5.2	15.6	15.1	17.2
China	–	–	6.8	8.9	13.6	11.8	22.3
Russia	–	–	–	15.9	16.2	14.9	16.4
Other(1)	–	–	–	29.8	34.9	28.4	38.6
Eurobond	–	–	–	–	80.9	74.7	88.9
Other Indebtedness(2)	1.7	2.5	3.8	23.5	53.0	52.4	54.7
Guaranteed External Public Debt(3)	67.1	82.3	120.6	144.8	164.7	159.6	209.4
Total External Public Debt	432.8	497.9	543.1	764.3	922.1	865.5	1,049.9

Source: Ministry of Finance and Economy.

Notes:

(1) Other bilateral creditors comprise Kuwait, France and Libya.

(2) Other indebtedness comprises debt from commercial banks, Council of Europe Development Bank and Kreditanstalt für Wiederaufbau.

(3) Serbia issues guarantees of loans to publicly owned enterprises. If the publicly owned enterprise is unable to repay the relevant loan, it becomes a direct obligation of Serbia. As at 30 September 2012, these guarantees amounted to EUR 2,417 million (RSD 278,056 million).

The following table shows Public Debt by currency as at 31 December in the years 2007 to 2011 and as at 30 September 2012:

	As at 31 December										*As at 30 September*	
	2007		*2008*		*2009*		*2010*		*2011*		*2012*	
	(RSD billions)	*(%)*	*(RSD billions)*	*(%)*	*(RSD billions)*	*(%)*	*(RSD billions)*	*(%)*	*(RSD billions)*	*(%)*	*(RSD billions)*	*(%)*
Special Drawing Rights	33.7	4.8	40.9	5.3	45.0	4.8	101.4	7.9	104.6	6.8	117.0	6.4
EUR	532.1	75.6	586.6	75.4	625.8	66.2	770.0	60.0	874.8	56.5	997.1	54.7
U.S.$	97.0	13.8	112.4	14.5	124.5	13.2	188.7	14.7	284.9	18.4	316.4	17.4
CHF	–	–	–	–	18.0	1.9	22.3	1.8	21.0	1.4	23.4	1.2
RSD	25.7	3.7	19.9	2.6	120.6	12.8	187.1	14.6	248.5	16.1	355.5	19.5
Other	14.7	2.1	18.2	2.3	10.5	1.1	13.0	1.0	13.2	0.8	14.1	0.8
Total	703.2	100.0	778.0	100.0	944.4	100.0	1,282.5	100.0	1,547.0	100.0	1,823.5	100.0

Source: Ministry of Finance and Economy.

The Public Debt Administration estimates that Serbia will disburse EUR 417.7 million, USD 40.9 million, CHF 25.7 million and SDR7.1 million under its External Public Debt related guarantees in 2012, as compared to EUR 280.2 million, USD 41.0 million, CHF 3.3 million and SDR2.9 million as at 31 December 2011. EUR 177.4 million and EUR 262.4 million were disbursed as at 31 December 2010 and 2009, respectively.

Debt Service

The following table shows the historic Public Debt service payments with respect to principal and interest for the years 2007 to 2011:

	Year ended 31 December				
	2007	*2008*	*2009*	*2010*	*2011*
			(RSD billions)		
Principal Payments	35.9	42.6	144.0	245.1	290.6
Interest Payments	14.8	13.7	20.1	30.1	40.3
Total	50.7	56.3	164.1	275.3	330.9

Source: Ministry of Finance and Economy.

The following table shows the projected Public Debt service payments with respect to principal and interest (before taking account of any payment obligations in respect of the issue of the Notes described in this Prospectus) for the years 2012 to 2016, according to the Budget Law for 2012 and the Draft Budget Law for 2013, based on outstanding debt as at 30 September 2012:

	Year ended 31 December				
	2012	*2013*	*2014*	*2015*	*2016*
			(RSD billions)		
Principal	328.2	403.6	176.6	168.3	105.9
Interest	65.9	90.1	54.8	44.2	35.8
Total	394.1	493.7	231.4	212.5	141.7

Source: Ministry of Finance and Economy.

Multilateral and Bilateral Development Organisations

International Monetary Fund

Under Serbia's prior stand-by arrangement with the IMF from 2009 to 2011, Serbia only drew down 1,367.7 million SDRs (approximately EUR 1.5 billion), which amounted to 52 per cent. of the total amount available to Serbia under the stand-by arrangement. The disbursements under the stand-by arrangement were used to finance foreign exchange reserves of the National Bank.

In addition, Serbia disbursed funds under allocations of SDRs for an amount of 388.4 million in order to finance its budget deficit and service its debt.

On 31 August 2011, during the visit of the IMF mission to Serbia, an agreement was reached, subject to approval by IMF Management and Executive Board, on an economic programme that could be supported by a total of 935 million special drawing rights (approximately EUR 1.0 billion) under an 18-month stand-by arrangement. The IMF Management and Executive Board approved the new arrangement on 30 September 2011.

In November 2011, the IMF mission and the Serbian authorities reached a staff-level agreement, subject to approval by IMF Management and the Executive Board, on policies needed to complete the first review under the precautionary stand-by arrangement. For 2012, a fiscal deficit target of 4.25 per cent. of GDP was agreed, which was below the 4.5 per cent. level prescribed by the fiscal deficit rule. To achieve the 2012 deficit target, the authorities intended to implement several measures amounting to 0.75 per cent. of GDP, mostly on the revenue side but also including cuts in goods and services spending, in addition to steps agreed in August. The submission of the 2012 budget, in line with the precautionary stand-by arrangement, was designated as a prior action for the IMF's first review.

In February 2012, the IMF mission made a second staff visit in respect of the precautionary stand-by arrangement and the main conclusions were as follows:

- performance against the end-2011 targets was broadly in line with the precautionary stand-by arrangement, although the target on the general government deficit was missed by a small amount, as additional spending restraint did not fully compensate for revenue shortfalls;
- the GDP real growth rate was reduced at the level of 0.5 per cent. for 2012 because of lower economic activities in the Euro area, with high and rising unemployment being a key concern;
- inflation has been slowing down and is expected to return within the National Bank's target during 2012;
- as a consequence of the lower GDP growth rate, the 2012 fiscal deficit will be significantly higher than targeted under the 2012 budget in the absence of additional efforts; and
- as the Public Debt to GDP ratio is projected to be above the legal limit of 45 per cent. of GDP at the end of 2012, the mission pointed out that maintaining debt sustainability requires effective and credible medium-term fiscal consolidation.

Following a fact-finding staff visit from 10 to 14 September 2012, the IMF called on Serbian authorities to urgently elaborate and embark on a comprehensive set of policies to credibly restore fiscal and external viability and boost growth. In particular, the IMF stated that the 2012 supplementary Budget, although it includes appropriate revenue-enhancing measures and limited mandatory spending indexation, will not restore fiscal and external viability and boost growth as these measures would be offset by higher expenditures, including new initiatives. The IMF therefore recommended additional spending restraint and tangible consolidation in the fiscal area. The IMF agreed with the Government's 2013 deficit target of 4.0 per cent. of GDP but felt achieving it would also require significant additional measures. In addition, the IMF called for prompt adoption of a clear and realistic medium-term fiscal consolidation programme to reduce the Public Debt below 45.0 per cent. of GDP, as required by the Budget System Law; as well as wide ranging and ambitious structural reform to unlock growth potential. The IMF also emphasised the need for corrective measures to the new NBS Law to help strengthen NBS autonomy (see "*Risk Factors – Risks Associated with Emerging Markets – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – Other risks associated with the banking sector*" and "*Monetary System – National Bank*"). Serbian officials requested discussions on a new IMF-supported programme and the next meeting with the IMF is scheduled for mid-November 2012 in Belgrade. See "*Risk Factors – Risks Associated with Emerging Markets – Factors that May Affect the Issuer's Ability to Fulfil its Obligations Under the Notes – The inability of the Government to reduce public spending to generate fiscal revenues may have a material adverse effect on the ability of Serbia to fund payments on its debt obligations, including the Notes*".

International Bank for Reconstruction and Development ("IBRD")

The current programme of assistance by the IBRD for 2008–2011, the "Country Partnership Strategy for the Republic of Serbia", is consistent with Serbia's EU accession agenda. The outstanding debt to the IBRD as at 30 September 2012 stood at EUR 1.45 billion, of which EUR 1.1 billion was outstanding under loans disbursed in the 1970s and 1980s.

In 2011, the IBRD provided U.S.$100 million under its Second Programmatic Public Expenditure Development Loan. In 2011, Serbia and the IBRD reached an agreement on a six-year guarantee for up to U.S.$400 million of programme-based borrowing by Serbia.

European Bank for Reconstruction and Development

Since 2001, the EBRD has approved nearly EUR 1.0 billion by way of funding to Serbia. As at 30 September 2012, the total amount of outstanding debt under EBRD loans was EUR 372.7 million, of which EUR 17.7 million comprised direct liabilities. The funds disbursed under EBRD loans are mainly used to finance infrastructure projects managed by Electric Power Industry of Serbia, Electric Networks of Serbia, Roads of Serbia and Railways of Serbia.

European Investment Bank

From the start of co-operation with the EIB in 2001 through to the end of 2009, the EIB had approved approximately EUR 1.6 billion by way of funding to Serbia. As at 30 September 2012, the total amount of outstanding debt under EIB loans was EUR 1,387.1 million, of which EUR 533.0 million comprised direct liabilities. The funds disbursed were used to finance projects involving the construction and improvement of schools, hospitals, research centres, roads and railways.

Paris Club

As at 30 September 2012, liabilities to Paris Club creditors amounted to EUR 1.50 billion (RSD 172.1 billion).

Following dissolution of the State Union of Serbia and Montenegro in 2006, the National Bank has continued efforts to conclude new agreements with Paris Club creditors. New bilateral agreements have been concluded with the United States, the Swiss Confederation and Japan Bank for International Co-operation. The National Bank has also participated in the negotiations of amendments to the agreements already concluded with France and Finland.

London Club

As at 30 September 2012, liabilities to London Club creditors amounted to EUR 693.0 million (RSD 79.7 billion).

In 2009, an agreement was reached regarding the regulation of Serbia's outstanding debt under API bonds that remained unregulated following the restructuring of Serbia's debt to London Club creditors in 2005. Pursuant to the restructuring agreement, Serbia paid RSD 2.1 billion (EUR 21.4 million) on the API bonds.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and conditions of the Notes which, except for the text in italics, will be endorsed on each Definitive Note Certificate (if issued).

The U.S.$750,000,000 5.250 per cent. Notes due 2017 (the "Notes") of the Republic of Serbia (acting through its Ministry of Finance and Economy) (the "Issuer") are (a) subject to, and have the benefit of, a deed of covenant dated 21 November 2012 (as amended or supplemented from time to time, the "Deed of Covenant") of the Issuer and (b) are issued pursuant to a fiscal agency agreement dated 21 November 2012 (as may be amended or supplemented from time to time, the "Fiscal Agency Agreement") between the Issuer, Deutsche Bank AG, London Branch, as fiscal agent and principal paying agent (the "Fiscal Agent", which expression includes any successor fiscal agent and principal paying agent appointed from time to time in connection with the Notes) and as transfer agent, the other paying and transfer agents named therein (together with the Fiscal Agent, the "Agents", which expression includes any successor or additional paying and transfer agents appointed from time to time in connection with the Notes), Deutsche Bank Trust Company Americas, in its capacity as U.S. paying agent, U.S. transfer agent and U.S. registrar (the "U.S. Registrar") and Deutsche Bank Luxembourg S.A., in its capacity as registrar (the "Luxembourg Registrar") (the U.S. Registrar and the Luxembourg Registrar, each a "Registrar", which expression shall mean both the Luxembourg Registrar and the U.S. Registrar taken together, as the context so requires and which expression shall be deemed to include any successor registrar appointed from time to time in connection with the Notes).

Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement and are subject to its detailed provisions. The Noteholders are bound by, and are deemed to have notice of, all provisions of the Fiscal Agency Agreement. Copies of the Fiscal Agency Agreement are available for inspection during normal business hours at the Specified Offices (as defined in the Fiscal Agency Agreement) of the Agents. References to "Conditions" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

1. Form, Denomination and Title

(a) *Form and denomination*

The Notes are in registered form, serially numbered and will be issued in minimum denominations of U.S.$200,000 or any amount in excess thereof which is an integral multiple of U.S.$l,000 (an "Authorised Holding").

(b) *Title*

Title to the Notes will pass by transfer and registration as described in Conditions 2 (*Registration*) and 3 (*Transfer of Notes*). The holder (as defined below) of any Note will (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as its absolute owner for all purposes whether or not it is overdue and regardless of any notice of ownership, trust or any other interest in it, any writing thereon by any Person (as defined below) (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof; and no Person will be liable for so treating the holder.

In these Conditions, "Person" means any individual, company, corporation, firm, partnership, joint venture, association, unincorporated organisation, trust or other judicial entity, including, without limitation, any state or agency of a state or other entity, whether or not having separate legal personality, "Noteholder" or "holder" means the Person in whose name a Note is for the time being registered in the Register (as defined below) (or, in the case of joint holders, the first named thereof) and "holders" shall be construed accordingly. A Definitive Note Certificate (as defined below) will be issued to each Noteholder in respect of its registered holding.

Notes sold to QIBs in the United States in reliance on Rule 144A under the Securities Act will be represented by a Rule 144A Global Note. Notes sold to investors outside the United States in reliance on Regulation S under the Securities Act will be represented by the Regulation S Global Note. Interests in the Regulation S Global Note and the Rule 144A Global Note will be exchangeable for notes in

definitive form ("Definitive Note Certificates") in the limited circumstances specified in the Regulation S Global Note and the Rule 144A Global Note, respectively. The Regulation S Global Note will be deposited with, and registered in the name of a nominee for, a common depositary for Euroclear Bank SA/NV ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg"). The Rule 144A Global Note will be deposited with a custodian for, and registered in the name of Cede & Co. as nominee of DTC.

Ownership of beneficial interests in the Rule 144A Global Note will be limited to Persons that have accounts with DTC or Persons that may hold interests through such participants. Ownership of beneficial interests in the Regulation S Global Note will be limited to Persons that have accounts with Euroclear or Clearstream, Luxembourg or Persons that may hold interests through such participants. Beneficial interests in the Global Notes will be shown on, and transfers thereof will be effected through, records maintained in book entry form by DTC and its participants or by Euroclear, Clearstream, Luxembourg and their participants, as applicable.

(c) ***Third party rights***

No Person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

2. Registration

The Issuer will cause a register (the "Register") to be kept at the Specified Office of each Registrar in which will be entered the names and addresses of the holders of the Notes and the particulars of the Notes held by them and all transfers and redemptions of the Notes.

3. Transfer of Notes

(a) ***Transfer***

Each Note may, subject to the terms of the Fiscal Agency Agreement and to Conditions 3(b) (*Formalities Free of Charge*), 3(c) (*Closed Periods*) and 3(e) (*Regulations Concerning Transfer and Registration*), be transferred in whole or in part in an Authorised Holding by lodging the relevant Definitive Note Certificate (with the endorsed form of application for transfer in respect thereof duly executed and duly stamped where applicable) at the Specified Office of the relevant Registrar or any Paying and Transfer Agent. A Note may be registered only in the name of, and transferred only to, a named Person or Persons. No transfer of a Note will be valid unless and until entered on the Register.

The Registrar will within five Business Days (as defined below) of any duly made application for the transfer of a Note, register the transfer and deliver a new Definitive Note Certificate to the transferee (and, in the case of a transfer of part only of a Note, deliver a Definitive Note Certificate for the untransferred balance to the transferor), at the Specified Office of the relevant Registrar, or (at the risk and, if mailed at the request of the transferee or, as the case may be, the transferor otherwise than by ordinary mail, at the expense of the transferee or, as the case may be, the transferor) mail the Definitive Note Certificate by uninsured mail to such address as the transferee or, as the case may be, the transferor may request.

(b) ***Formalities Free of Charge***

Such transfer will be effected without charge subject to (i) the Person making such application for transfer paying or procuring the payment of any taxes, duties and other governmental charges in connection therewith, (ii) the Registrar being satisfied with the documents of title and/or identity of the Person making the application, and (iii) such reasonable regulations as the Issuer may from time to time agree with the Registrar.

(c) ***Closed Periods***

Neither the Issuer nor the Registrar will be required to register the transfer of any Note (or part thereof) during the period of 15 days immediately prior to the due date for any payment of principal or interest in respect of the Notes.

(d) ***Business Day***

In this Condition 3 (*Transfer of Notes*), "Business Day" means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the city in which the Specified Office of the relevant Registrar or, as the case may be, the Fiscal Agent is located.

(e) ***Regulations Concerning Transfer and Registration***

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes in Schedule 1 to the Fiscal Agency Agreement. The regulations may be changed by the Issuer with the approval of the Registrar.

(f) ***Authorised Holdings***

No Note may be transferred unless each of the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred is an Authorised Holding.

4. Status

The Notes constitute direct, general, unconditional and (subject to Condition 5 (*Negative Pledge*)) unsecured obligations of the Issuer and the full faith and credit of the Issuer is pledged for the due and punctual payment of principal and interest on the Notes and for the performance of all obligations of the Issuer in respect of the Notes. The Notes will at all times rank *pari passu* among themselves and at least *pari passu* in right of payment with all other present and future unsecured obligations of the Issuer.

5. Negative Pledge

So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement), the Issuer shall not create or permit to subsist any Security Interest upon the whole or any part of its present or future undertaking, assets or revenues to secure any of its Public Indebtedness or any Guarantee of any Public Indebtedness of any other Person unless the Issuer shall, in the case of the creation of any Security Interest, at the same time or prior thereto, and in any other case, promptly, procure that all amounts payable in respect of the Notes are secured equally and rateably therewith or providing such other security or other arrangement for the Notes as may be approved by an Extraordinary Resolution (as defined in Condition 14(c) (*Modifications*)).

6. Definitions

For the purposes of these Conditions:

"Guarantee" means in relation to any indebtedness, any guarantee or indemnity given by the Issuer in respect of such indebtedness or any arrangement having the same or substantially the same effect;

"Public Indebtedness" means any indebtedness which:

(a) is in the form of or represented by any bond, note, debenture, debenture stock, loan stock, certificate or other instrument;

(b) which is for the time being, or is capable of being, listed, quoted or traded on any stock exchange or in any securities market (including, without limitation, any automated trading system or over-the-counter market);

(c) has a maturity date falling more than one year after its issue date; and

(d) for the purposes only of Conditions 12(c) (*Cross-Default*) and 12(e) (*Moratorium*), is either (i) denominated or payable, or at the option of the holder thereof payable, in a currency other than the lawful currency of the Issuer (provided that, if at any time the lawful currency of the Issuer is the euro, any indebtedness otherwise falling within the other sub-paragraphs of this definition which is denominated or payable, or at the option of the holder thereof payable, in euro, shall be included in "Public Indebtedness") or (ii) denominated or payable, or at the option of the holder thereof payable, in the lawful currency of the Issuer and originally issued in a form which enables secondary market trades to be settled through one or more international clearing systems.

"Security Interest" means any mortgage, charge, pledge, lien or other security interest including, without limitation, anything having an equivalent effect to any of the foregoing under the laws of any jurisdiction.

7. Interest

(a) ***Interest Accrual***

Each Note was issued on and bears interest from 21 November 2012 (the "Issue Date") at the rate of 5.250 per cent., per annum (the "Rate of Interest") payable semi-annually in arrear on 21 May and 21 November in each year (each, an "Interest Payment Date") commencing on 21 May 2013, subject as provided in Condition 8 (*Payments*). Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date is herein called an "Interest Period".

(b) ***Cessation of Interest***

Each Note will cease to bear interest from the due date for final redemption unless, upon due surrender of the relevant Note, payment of principal is improperly withheld or refused. In such case it will continue to bear interest at such rate (after as well as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment) in accordance with Condition 15 (*Notices*).

(c) ***Calculation of Interest for an Interest Period***

The amount of interest payable in respect of each Note for any Interest Period shall be calculated by applying the Rate of Interest to the principal amount of such Note, dividing the product by two and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

(d) ***Calculation of Interest for any other period***

Where interest is to be calculated in respect of a period other than an Interest Period, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

The determination of the amount of interest payable under Conditions 7(c) (*Calculation of Interest for an Interest Period*) and Condition 7(d) (*Calculation of Interest for any other period*) by the Fiscal Agent shall, in the absence of manifest and proven error, be binding on all parties.

8. Payments

(a) ***Principal***

Payment of principal in respect of each Note and payment of interest due other than on an Interest Payment Date will be made to the Person shown in the Register at the close of business on the Record Date (as defined below) and subject to the surrender (or, in the case of part payment only, endorsement) of the relevant Definitive Note Certificate at the Specified Office of the relevant Registrar or of the Paying and Transfer Agents.

(b) ***Interest***

Payments of interest due on an Interest Payment Date will be made to the Persons shown in the Register at close of business on the Record Date.

(c) ***Record Date***

"Record Date" means the fifteenth day before the due date for the relevant payment.

(d) ***Payments***

Each payment in respect of the Notes pursuant to Conditions 8(a) (*Principal*) and (b) (*Interest*) will be made by United States dollar cheque drawn on a branch of a bank in New York mailed to the holder of the relevant Note at his address appearing in the Register. However, upon application by the holder to the Specified Office of the relevant Registrar or any Agent not less than 15 days before the due date for any payment in respect of a Note, such payment may be made by transfer to a United States dollar account maintained by the payee with a bank in the City of New York.

Where payment is to be made by cheque, the cheque will be mailed, on the business day preceding the due date for payment or, in the case of payments referred to in Condition 8(a) (*Principal*), if later, on the business day on which the relevant Definitive Note Certificate is surrendered (or endorsed as the case may be) as specified in Condition 8(a) (*Principal*) (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder).

Where payment is to be made by transfer to a United States dollar account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated, in the case of principal, on the later of the due date for payment and the day on which the relevant Definitive Note Certificate is surrendered (or, in the case of part payment only, endorsed) and, in the case of interest, on the due date for payment.

(e) ***Agents***

The names of the initial Agents and each Registrar and their Specified Offices are set out below. The Issuer reserves the right under the Fiscal Agency Agreement by giving to the relevant Agent concerned at least 60 days' prior written notice, which notice shall expire at least 30 days before or after any due date for payment in respect of the Notes, to vary or terminate the appointment of any Agent or Registrar and to appoint successor or additional Agents or Registrar, provided that it will at all times maintain:

(i) a Fiscal Agent;

(ii) a Paying and Transfer Agent with a Specified Office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; and

(iii) a Luxembourg Registrar and a U.S. Registrar.

Notice of any such removal or appointment and of any change in the Specified Office of any Agent or Registrar will be given to Noteholders in accordance with the provisions of the Fiscal Agency Agreement and Condition 15 (*Notices*) as soon as practicable.

(f) ***Payments subject to Fiscal Laws***

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 10 (*Taxation*). No commissions or expenses shall be charged to the Noteholders in respect of such payments.

(g) ***Delay in Payment***

Noteholders will not be entitled to any interest or other payment in respect of any delay in payment resulting from (i) the due date for payment not being a business day, (ii) a cheque mailed in accordance with this Condition 8 (*Payments*) arriving after the due date for payment or being lost in the mail, or (iii) if the holder is late in surrendering (where so required) the relevant Definitive Note Certificate.

(h) ***Business Days***

In this Condition 8 (*Payments*), "business day" means any day (other than a Saturday or Sunday) on which the commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in New York and London and, in the case of surrender of a Definitive Note Certificate, in the place of the Specified Office of the relevant Registrar or relevant Agent, to whom the relevant Definitive Note Certificate is surrendered.

9. Redemption and Purchase

(a) ***Scheduled redemption***

Unless previously purchased and cancelled as provided below, each Note will be redeemed at its principal amount on 21 November 2017, subject as provided in Condition 8 (*Payments*).

(b) ***No other redemption***

The Issuer shall not be entitled to redeem the Notes otherwise than as provided in Condition 9(a) (*Scheduled redemption*).

(c) ***Purchase***

The Issuer may at any time purchase or procure others to purchase for its account Notes in the open market or otherwise and at any price. The Notes so purchased may be held or resold (provided that such resale is outside the United States or, in the case of any Notes resold pursuant to Rule 144A, is only made to QIBs and is otherwise in compliance with all applicable laws) or surrendered for cancellation at the option of the Issuer or otherwise, as the case may be in compliance with Condition 9(d) (*Cancellation of Notes*) below. The Notes so purchased, while held by or on behalf of the Issuer, shall not entitle the holder to vote at any meeting of the Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of the Noteholders or for the purposes of Condition 14(a) (*Meetings of Noteholders*).

(d) ***Cancellation of Notes***

All Notes which are submitted for cancellation pursuant to Condition 9(c) (*Purchase*) will be cancelled and may not be reissued or resold.

10. Taxation

All payments of principal and interest in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by or within the Republic of Serbia or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note:

(i) *Other Connection*

presented for payment by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note by reason of his having some connection with the Republic of Serbia other than the mere holding of the Note;

(ii) *Presentation more than 30 days after the Relevant Date*

where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder of it would have been entitled to such additional amounts on surrendering such Definitive Note Certificate for payment on the last day of such period of 30 days;

(iii) *Payment to Individuals*

where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(iv) *Payment by another Agent*

where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by surrendering the relevant Definitive Note Certificate to another Agent in a Member State of the European Union.

In these Conditions, "Relevant Date" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent on or prior to such due date, the date on which, the full amount plus any accrued interest having been so received, notice to that effect shall have been given to the Noteholders. Any reference in these Conditions to principal and/or interest shall be deemed to include any additional amounts which may be payable under this Condition.

11. Prescription

Claims in respect of principal and interest will become void unless made within a period of 10 years in the case of principal and five years in the case of interest from the appropriate Relevant Date.

12. Events of Default

If any of the following events (each an "Event of Default") occurs and is continuing:

(a) ***Non payment***

The Issuer fails to pay any amount in respect of the Notes when the same becomes due and payable and such failure continues for a period of 15 days; or

(b) ***Breach of other obligations***

The Issuer defaults in the performance or observance of any of its other obligations under the Notes and such default is incapable of remedy or, if capable of remedy, remains unremedied for 30 days after notice of such default has been given to the Issuer (with a copy to the Fiscal Agent at its Specified Office) by any holder of Notes; or

(c) ***Cross-Default***

(i) The maturity of any Public Indebtedness of the Issuer is accelerated (other than by optional or mandatory prepayment or redemption), (ii) the Issuer defaults in the payment of any principal of or interest on any of its Public Indebtedness when and as the same shall become due and payable and such default continues for more than the grace period, if any, originally applicable thereto or, in the case of interest where such grace period does not exceed 30 days, for more than 30 days or (iii) the Issuer defaults in the payment when due and called upon of any guarantee or indemnity of the Issuer in respect of any Public Indebtedness of any other Person and such default continues for more than the grace period, if any, originally applicable thereto or, if such grace period does not exceed 30 days, for more than 30 days; provided that the aggregate amount of the relevant Public Indebtedness in respect of which one or more of the events mentioned in this sub-paragraph (c) have occurred equals or exceeds U.S.$50,000,000 or its equivalent; or

(d) ***Unenforceability***

For any reason whatsoever, any of the Issuer's obligations under the Notes are declared by a court of competent jurisdiction pursuant to a final non-appealable decision to be no longer binding or no longer enforceable against the Issuer or for any other reason any such obligation ceases to be in full force and effect; or

(e) ***Moratorium***

The Republic of Serbia shall have declared a general moratorium on the payment of principal of, or interest on, all or any part of its Public Indebtedness; or

(f) ***Validity***

The Republic of Serbia or any of its political sub-divisions (on its behalf) repudiates or contests the validity of the Notes; or

(g) ***IMF***

The Republic of Serbia ceases to be a member, or becomes ineligible to use the resources, of the International Monetary Fund,

then the holders of not less than 25 per cent., in the aggregate principal amount of the Notes may, by written notice to the Issuer (with a copy to the Fiscal Agent at its Specified Office), declare the Notes due and payable immediately. Notice of any such declaration shall promptly be given to all other Noteholders by the Issuer. Upon any declaration of acceleration, the principal, interest and all additional amounts payable on the Notes will become immediately due and payable on the date the Issuer receives written notice of the declaration. No delay or omission of any Noteholder shall impair any such right or remedy or constitute a waiver of any such Event of Default.

If the Issuer receives notice in writing from holders of at least 50 per cent., in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to any above-mentioned declaration of acceleration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn, the Issuer shall give notice thereof to the Noteholders (with a copy to the Fiscal Agent at its Specified Office), whereupon the relevant declaration shall be withdrawn and shall have no further effect. No such withdrawal shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto.

13. Replacement of Notes

If any Definitive Note Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the relevant Registrar or any Agent subject to all applicable laws and stock exchange or other relevant authority requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may require (provided that the requirement is reasonable in the light of prevailing market practice). Mutilated or defaced Definitive Note Certificates must be surrendered before replacements will be issued.

14. Meetings of Noteholders and Modification

(a) ***Meetings of Noteholders***

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider any matters relating to the Notes, including the modification of any provision of these Conditions or the Fiscal Agency Agreement. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer or the Fiscal Agent at any time upon the request in writing by Noteholders holding not less than 10 per cent. in principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more Persons holding or representing at least 50 per cent. of the aggregate principal amount of the Notes for the time being outstanding, or, at any adjourned meeting, one or more Persons being or representing Noteholders holding at least 25 per cent. of the aggregate principal amount of the

Notes for the time being outstanding so held or represented; provided, however, that any proposals relating to any Reserved Matter (as defined below) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which one or more Persons holding or representing not less than 75 per cent. of the principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present at the meeting(s) or not.

(b) ***Reserved Matters***

In these Conditions, "Reserved Matter" means any proposal whereby:

(i) the principal amount of, or interest on, or other amounts in respect of the Notes is to be reduced or cancelled or the Rate of Interest on the Notes is to be reduced; or

(ii) the status of the Notes under Condition 4 (*Status*) is to be amended; or

(iii) the Events of Default set out in Condition 12 (*Events of Default*) are to be amended; or

(iv) the currency of payment of the Notes or the due date or date for any payment in respect of the Notes is to be changed; or

(v) the provisions contained in Schedule 3 (*Provisions for Meetings of Noteholders*) to the Fiscal Agency Agreement concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution or any of the definitions "Extraordinary Resolution", "Written Resolution" or "outstanding" is to be modified; or

(vi) this definition of Reserved Matter is to be amended; or

(vii) the Deed of Covenant is to be modified or cancelled.

(c) ***Modifications***

Any modification of any provision of these Conditions may be made if approved by an Extraordinary Resolution or a Written Resolution (as defined below). In these Conditions, "Extraordinary Resolution" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least:

(i) in the case of a Reserved Matter, three-quarters of the aggregate principal amount of the outstanding Notes; or

(ii) in the case of a matter other than a Reserved Matter, two-thirds of the aggregate principal amount of the outstanding Notes which are represented at that meeting.

Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and whether they voted in favour or not.

(d) ***Written resolutions***

A resolution in writing ("Written Resolution") will take effect as if it were an Extraordinary Resolution if it is signed (i) by or on behalf of all Noteholders who for the time being are entitled to receive notice of a meeting of Noteholders under the Fiscal Agency Agreement or (ii) if such Noteholders have been given at least 21 days' notice of such resolution, by or on behalf of Persons holding three quarters of the aggregate principal amount of the outstanding Notes in the case of a Reserved Matter, or two-thirds of the aggregate principal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. A Written Resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders, and the date of such resolution shall be the date of the latest such document. A Written Resolution shall be binding on all Noteholders, whether or not signed by them.

(e) ***Modification without Noteholders' consent***

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of the Notes or the Fiscal Agency Agreement which is in the opinion of the Issuer of a formal, minor or technical nature or is made to correct a manifest error. Any such modification shall be binding on the Noteholders and, if the Fiscal Agent so requires, shall be notified to the Noteholders as soon as practicable thereafter.

(f) ***Noteholders' Representative Committee***

(i) *Appointment*

The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, or by notice in writing to the Issuer (with a copy to the Fiscal Agent at its Specified Office) signed by or on behalf of the holders of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, appoint any Person or Persons as a committee (if appointed, a "Noteholders' Representative Committee") to represent the interests of the Noteholders if any of the following events shall have occurred:

(A) an Event of Default;

(B) any event or circumstance which could, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 12 (*Events of Default*) become an Event of Default; or

(C) any official public announcement by the Issuer to the effect that the Issuer is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise),

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent. of the aggregate principal amount of the outstanding Notes have either (x) objected to such appointment by notice in writing to the Issuer (with a copy to the Fiscal Agent at its Specified Office) during a specified period following notice of the appointment being given (if such notice of appointment is made by notice in writing to the Issuer) where such specified period shall be either 30 days or such other longer or shorter period as the Noteholders' Representative Committee may, acting in good faith, determine to be appropriate in the circumstances or (y) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement. Such Noteholders' Representative Committee shall, if appointed by notice in writing to the Issuer, give notice of its appointment to all Noteholders in accordance with Condition 15 (*Notices*) as soon as practicable after the notice is delivered to the Issuer.

(ii) *Powers*

Such Noteholders' Representative Committee in its discretion may, among other things, (A) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (B) adopt such rules as it considers appropriate regarding its proceedings and (C) enter into discussions with the Issuer and/or other creditors of the Issuer. The Issuer shall pay any fees and expenses which are incurred by any such Noteholders' Representative Committee (including, without limitation, the fees and expenses of the Noteholders' Representative Committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Issuer of a reasonably detailed invoice and supporting documentation.

15. Notices

Notices to Noteholders will be sent to them by mail at their respective addresses on the Register. Any such notice shall be deemed to have been given on the fourth weekday (excluding Saturday and Sunday) after the date of mailing.

So long as any of the Notes are represented by the Regulation S Global Note, notices required to be published in accordance with Condition 15 (Notices) may be given by delivery of the relevant notice to Euroclear and Clearstream, Luxembourg for communication by them to the relevant accountholders. So long as any of the Notes are represented by the Rule 144 A Global Note, notices required to be published in accordance with Condition 15 (Notices) may be given by delivery of the relevant notice to DTC for communication to the relevant accountholders.

16. Further Issues

The Issuer may from time to time, without notice to or the consent of the Noteholders and in accordance with the Fiscal Agency Agreement, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the date for and amount of the first payment of interest) so as to be consolidated and form a single series with the Notes ("Further Notes").

Noteholders should note that additional securities that are treated as a single series for non tax purposes may be treated as a separate series for U.S. federal income tax purposes. In such case, the new securities may be considered to have been issued with original issue discount, as defined in the U.S. Internal Revenue Code of 1986, as amended, and the U.S. Treasury regulations issued thereunder, which may affect the market value of the Notes since such additional securities may not be distinguishable from the Notes.

17. Currency Indemnity

An amount received or recovered in a currency other than U.S. dollars (the "Contractual Currency") (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction, in the liquidation of the Issuer or otherwise) by any Noteholder in respect of any sum expressed to be due to it from the Issuer will only discharge the Issuer to the extent of the Contractual Currency amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so).

If that Contractual Currency amount is less than the Contractual Currency amount expressed to be due to the relevant Noteholder pursuant to these Conditions, the Issuer will indemnify such Noteholder against any loss sustained by it as a result on the written demand of such Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the relevant Registrar or any Paying and Transfer Agent with its Specified Office in London. In any event, the Issuer will indemnify the relevant Noteholder against the cost of making any such purchase.

18. Governing Law and Jurisdiction

(a) ***Governing law***

The Notes, including any non-contractual obligations arising out of or in connection with the Notes, are governed by, and shall be construed in accordance with, English law.

(b) ***Jurisdiction***

The Issuer agrees for the benefit of the Noteholders that the courts of England shall have exclusive jurisdiction to hear and determine any suit, action or proceedings arising out of or in connection with the Notes ("Proceedings") and, for such purposes, irrevocably submits to the jurisdiction of such courts.

(c) ***Appropriate Forum***

For the purposes of Condition 18(b) (*Jurisdiction*), the Issuer has irrevocably waived any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Proceedings and agreed not to claim that any such court is not a convenient or appropriate forum.

(d) ***Service of Process***

The Issuer agrees that the process by which any Proceedings are commenced in England pursuant to Condition 18(b) (*Jurisdiction*) may be served on it by being delivered to the Ambassador of the Republic of Serbia to the Court of St. James's at 28 Belgrave Square, London SW1X 8QB. If such person is not or ceases to be effectively appointed to accept service of process on behalf of the Issuer, the Issuer shall appoint a further Person in England to accept service of process on its behalf.

(e) ***Enforcement of Judgments; Waiver of Immunity***

The Issuer agrees that any final judgment in any Proceedings commenced in a court to the jurisdiction of which the Issuer is or may be subject may be enforced in that or any other such court by appropriate proceedings and if and to the extent that the Issuer may in respect of any Proceedings be entitled to claim for itself or its assets immunity from jurisdiction, suit, execution, attachment (whether in aid of execution of a judgment, before judgment or award or otherwise) or other legal process and to the extent that in any such jurisdiction there may be attributed to itself or its assets such immunity (whether or not claimed), the Issuer irrevocably consents to the enforcement of any judgment or award and agrees not to claim and irrevocably waives such immunity to the fullest extent permitted by the laws of the jurisdiction, subject to Condition 18(f) (*Exclusions – Waiver of Immunity*).

(f) ***Exclusions – Waiver of Immunity***

Notwithstanding any of the provisions of Condition 18(e) (*Enforcement of Judgments; Waiver of Immunity*), the Issuer does not waive any immunity in respect of any present or future (i) "premises of the mission" as defined in the Vienna Convention on Diplomatic Relations signed in 1961, (ii) "consular premises" as defined in the Vienna Convention on Consular Relations signed in 1963, or (iii) military property or military assets or property or assets of the Republic of Serbia relating to any of the assets referred to in the foregoing sub-paragraphs (i) and (ii).

FORM OF THE NOTES AND TRANSFER RESTRICTIONS

Form of the Notes

All Notes will be in definitive fully registered form, without interest coupons attached. Notes offered and sold outside the United States in reliance on Regulation S will be represented by interests in the Regulation S Global Note, in definitive fully registered form, without interest coupons attached, which will be deposited on or about the Issue Date with Deutsche Bank AG, London Branch, as common depositary (the "Common Depositary") for Euroclear and Clearstream, Luxembourg, and registered in the name of a nominee for such common depositary in respect of interests held through Euroclear and Clearstream, Luxembourg.

Notes offered and sold in reliance on Rule 144A will be represented by interests in the Rule 144A Global Note, in definitive fully registered form, without interest coupons attached, which will be registered in the name of Cede & Co., as nominee for, and which will be deposited on or about the Issue Date with Cede & Co., as custodian (the "Custodian") for, DTC. The Rule 144A Global Note (and any Note Certificates (as defined below) issued in exchange therefor) will be subject to certain restrictions on transfer contained in a legend appearing on the face of each such Note as set forth under paragraph (iii) below.

The Regulation S Global Note will have an ISIN number and a Common Code and the Rule 144A Global Note will have a separate CUSIP number, ISIN number and Common Code.

For the purposes of the Rule 144A Global Note and the Regulation S Global Note, any reference in the Conditions to "Note Certificate" or "Note Certificates" shall, except where the context otherwise requires, be construed so as to include the relevant Rule 144A Global Note or, as the case may be, the relevant Regulation S Global Note and interests therein.

Transfer Restrictions

A beneficial interest in a Rule 144A Global Note may be transferred to a person who wishes to take delivery of such beneficial interest through the relevant Regulation S Global Note only upon receipt by the Registrar of a written certification from the transferor (in the form set out in the schedule to the relevant Fiscal Agency Agreement) to the effect that such transfer is being made in accordance with Regulation S or Rule 144 (if available) under the Securities Act.

Any beneficial interest in either the Rule 144A Global Note or Regulation S Global Note that is transferred to a person who takes delivery in the form of a beneficial interest in the other Global Note will, upon transfer, cease to be a beneficial interest in such Global Note and become a beneficial interest in the other Global Note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to a beneficial interest in such other Global Note for so long as such person retains such an interest.

The Notes are being offered and sold in the United States only to qualified institutional buyers within the meaning of and in reliance on Rule 144A. Because of the following restrictions, purchasers of Notes offered in the United States in reliance on Rule 144A are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of such Notes.

Each purchaser of Notes offered hereby pursuant to Rule 144A will be deemed to have represented and agreed as follows (terms used herein that are defined in Rule 144A are used herein as defined therein):

(i) (i) the purchaser (a) is a QIB within the meaning of Rule 144A, (b) is acquiring the Notes for its own account or for the account of such a qualified institutional buyer and (c) such person is aware that the sale of the Notes to it is being made in reliance on Rule 144A;

(ii) (ii) the Notes are being offered only in a transaction not involving any public offering in the United States within the meaning of the Securities Act, and the Notes offered hereby have not been and will not be registered under the Securities Act and may not be reoffered, resold, pledged, or otherwise transferred except in accordance with the legend set out below; and

(iii) the Rule 144A Global Note and any Rule 144A Note Certificates (as defined below) issued in exchange for an interest in the Rule 144A Global Note will bear a legend to the following effect, unless the Issuer determines otherwise in accordance with applicable law:

"THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER, AND WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER, THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND THE NOTES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. THE HOLDER OF THIS NOTE BY ITS ACCEPTANCE HEREOF REPRESENTS AND AGREES, FOR THE BENEFIT OF THE ISSUER, THAT (A) THIS NOTE (AND ANY INTEREST HEREIN) MAY BE RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (1) TO THE ISSUER, (2) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT OR (4) PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER, IF AVAILABLE, AND IN EACH OF SUCH CASES IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION, AND THAT (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS NOTE (OR INTEREST HEREIN) FROM IT OF THE TRANSFER RESTRICTIONS REFERRED TO IN (A) ABOVE.

THIS NOTE AND ALL RELATED DOCUMENTATION MAY BE AMENDED OR SUPPLEMENTED FROM TIME TO TIME TO MODIFY THE RESTRICTIONS ON AND PROCEDURES FOR RESALES AND OTHER TRANSFERS OF THIS NOTE TO REFLECT ANY CHANGE IN APPLICABLE LAW OR REGULATION (OR THE INTERPRETATION THEREOF) OR IN PRACTICES RELATING TO THE RESALE OR TRANSFERS OF RESTRICTED SECURITIES GENERALLY. BY THE ACCEPTANCE OF THIS NOTE, THE HOLDER HEREOF SHALL BE DEEMED TO HAVE AGREED TO ANY SUCH AMENDMENT OR SUPPLEMENT."

Each purchaser of Notes outside the United States pursuant to Regulation S will be deemed to have represented, agreed and acknowledged as follows:

(i) it is, or at the time Notes are purchased will be, the beneficial owner of such Notes and is located outside the United States (within the meaning of Regulation S);

(ii) it understands that such Notes have not been and will not be registered under the Securities Act and will not offer, sell pledge or otherwise transfer such Notes except in an offshore transactions in accordance with Rule 903 or Rule 904 of Regulation S, and in accordance with any applicable securities laws of any State of the United States; and

(iii) the Issuer, the Registrar, the Joint Lead Managers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

Exchange of Interests in Global Notes for Note Certificates

The Rule 144A Global Note will become exchangeable, free of charge to the holder, in whole but not in part, for Note Certificates in definitive form ("Rule 144A Note Certificates") if DTC (a) notifies the Issuer that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Rule 144A Global Note or ceases to be a "clearing agency" registered under the Exchange Act, or is at any time no longer eligible to act as such, and the Issuer is unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of DTC or (b) an Event of Default (as defined and set out in Condition 12 (*Events of Default*) of the Notes) occurs. In such circumstances, such Rule 144A Note Certificates shall be registered in such names as DTC shall direct in writing and the Issuer will procure that the Registrar notify the holders as soon as practicable after the occurrence of the events specified in (a) and (b).

The Regulation S Global Note will become exchangeable, free of charge to the holder, in whole but not in part, for Note Certificates in definitive form ("Regulation S Note Certificates") if (a) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of

legal holidays) or announces an intention permanently to cease business or does in fact do so or (b) an Event of Default (as defined and set out in Condition 12 (*Events of Default*) of the Notes) occurs. In such circumstances, such Regulation S Note Certificates will be registered in such names as Euroclear and Clearstream, Luxembourg shall direct in writing and the Issuer will procure that the Registrar notify the holders as soon as practicable after the occurrence of the events specified in (a) and (b).

In the event that the Rule 144A Global Note is to be exchanged for Rule 144A Note Certificates or the Regulation S Global Note is to be exchanged for Regulation S Note Certificates (together "Note Certificates") the relevant Global Note shall be exchanged in full for the relevant Note Certificates and the Issuer will, without charge to the holder or holders thereof, but against such indemnity as the Registrar may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange, cause sufficient Note Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Noteholders.

On exchange, a person having an interest in a Global Note must provide the Registrar with (i) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Note Certificates and (ii) in the case of the Rule 144A Global Note only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A. Note Certificates issued in exchange for a beneficial interest in the Rule 144A Global Note shall bear the legends applicable to transfers pursuant to Rule 144A, as set out under " – *Transfer Restrictions*", Rule 144A Note Certificates issued as described above will not be exchangeable for beneficial interests in the Regulation S Global Note and Regulation S Note Certificates issued as described above will not be exchangeable for beneficial interests in the Rule 144A Global Note.

In addition to the requirements described under " – *Transfer Restrictions*", the holder of a Note may transfer such Note only in accordance with the provisions of Condition 3 (*Transfer of Notes*) of the Notes.

Upon the transfer, exchange or replacement of a Rule 144A Note Certificate bearing the legend referred to under "*Transfer Restrictions*" above, or upon specific request for removal of the legend on a Rule 144A Note Certificate, the Issuer will deliver only Rule 144A Note Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

The Registrar will not register the transfer of any Notes or exchange of interests in a Global Note for Note Certificates for a period of 15 calendar days ending on the due date of any payment of principal or interest in respect of such Notes.

Euroclear, Clearstream, Luxembourg and DTC Arrangements

So long as DTC or its nominee or Euroclear, Clearstream, Luxembourg or the nominee of their common depositary is the registered holder of a Global Note, DTC, Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, will be considered the sole owner or holder of the Notes represented by such Global Note for all purposes under the Fiscal Agency Agreement, the Deed of Covenant and the Notes. Payments of principal, interest and additional amounts, if any, in respect of Global Notes will be made to DTC, Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, as the registered holder thereof. None of the Issuer, the Fiscal Agent, any other Agent or the Joint Lead Managers or any affiliate of any of the above or any person by whom any of the above is controlled for the purposes of the Securities Act will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the Global Notes or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Distributions of principal and interest with respect to book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by Euroclear or Clearstream, Luxembourg from an Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg customers in accordance with the relevant system's rules and procedures.

Holders of book-entry interests in the Notes through DTC will receive, to the extent received by DTC from an Agent, all distributions of principal and interest with respect to book-entry interests in the Notes from the Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

Interest on the Notes (other than interest on redemption) will be paid to the holder shown on the Register on the 15th day before the due date for such payment (the "Record Date"). Principal and interest with respect to the Rule 144A Note Certificates and the Regulation S Note Certificates on redemption will be paid to the holder shown on the Register on the Record Date upon delivery and surrender of the relevant Note Certificate. Trading between the Rule 144A Global Note and the relevant Regulation S Global Note will therefore be net of accrued interest from the relevant Record Date to the relevant Interest Payment Date.

The laws of some states of the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer interests in a Global Note to such persons will be limited. Because DTC, Euroclear and Clearstream, Luxembourg can only act on behalf of participants, who in turn act on behalf of indirect participants, the ability of a person having an interest in a Global Note to pledge such interest to persons or entities which do not participate in the relevant clearing system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

The holdings of book-entry interests in the Notes in Euroclear, Clearstream, Luxembourg and DTC will be reflected in the book-entry accounts of each such institution. As necessary, the Registrar will adjust the amounts of Notes on the Register for the accounts of the Common Depositary and Cede & Co. to reflect the amounts of Notes held through Euroclear and Clearstream, Luxembourg on the one hand and DTC, on the other. Beneficial ownership in Notes will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream, Luxembourg and DTC.

Interests in a Regulation S Global Note and the Rule 144A Global Note will be in uncertificated book-entry form.

Trading between Euroclear and/or Clearstream, Luxembourg Account Holders. Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

Trading between DTC Participants. Secondary market sales of book-entry interests in the Notes between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to United States corporate debt obligations in DTC's Same Day Funds Settlement System.

Trading between DTC Seller and Euroclear/Clearstream, Luxembourg Purchaser. When book-entry interests in Notes are to be transferred from the account of a DTC participant holding a beneficial interest in the Rule 144A Global Note to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the relevant Regulation S Global Note (subject to such certification procedures as are provided in the relevant Fiscal Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12 noon, New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg accountholder. On the settlement date, the Custodian will instruct the Registrar to (a) decrease the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note and (b) increase the amount of Notes registered in the name of the nominee of the Common Depositary and evidenced by the relevant Regulation S Global Note. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first Business Day following the settlement date. See above concerning the Record Date for payment of interest.

Trading between Euroclear/Clearstream, Luxembourg Seller and DTC Purchaser. When book-entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC participant wishing to purchase a beneficial interest in the Rule 144A Global Note (subject to such certification procedures as are provided in the relevant Fiscal Agency

Agreement), the Euroclear or Clearstream, Luxembourg participant must send to Euroclear or Clearstream, Luxembourg delivery free of payment instructions by 7:45 p.m. Brussels or Luxembourg time, one Business Day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depositary for Euroclear and Clearstream, Luxembourg and the Registrar to arrange delivery to the DTC participant on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg account holder, as the case may be. On the settlement date, the Common Depositary will (a) transmit appropriate instructions to the Custodian who will in turn deliver such book-entry interest in the Notes free of payment to the relevant account of the DTC participant and (b) instruct the Registrar to (i) decrease the amount of Notes registered in the name of the nominee of the Common Depositary and evidenced by the relevant Regulation S Global Note and (ii) increase the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note. See above concerning the Record Date for payment of interest.

Although the foregoing sets out the procedures of Euroclear, Clearstream Luxembourg and DTC in order to facilitate the transfers of interests in the Notes among participants of DTC, Clearstream Luxembourg and Euroclear, none of Euroclear, Clearstream Luxembourg or DTC is under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, the Fiscal Agent, any other Agent or any of the Joint Lead Managers or any affiliate of any of the above, or any person by whom any of the above is controlled for the purposes of the Securities Act, will have any responsibility for the performance by DTC, Euroclear and Clearstream, Luxembourg or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or for the sufficiency for any purpose of the arrangements described above.

Prescription

Claims against the Issuer in respect of principal, premium and interest on the Notes while the Notes are represented by a Global Note will become void unless it is presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 10 (*Taxation*) of the Notes).

Meetings

The holder of a Global Note will be treated at any meeting of Noteholders as having one vote in respect of each U.S.$1,000 in principal amount of Notes, for which the relevant Global Note may be exchanged.

Purchase and Cancellation

Cancellation of any Note required by the Conditions to be cancelled following its purchase will be effected by reduction in the principal amount of the relevant Global Note.

Payments

All payments in respect of Notes represented by a Global Note will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday inclusive except 25 December and 1 January.

Settlement of Pre-Issue Trades

It is expected that delivery of the Notes will be made against payment therefor on the Issue Date, which could be more than three business days following the date of pricing. Under Rule 15c6-l under the Exchange Act, trades in the United States secondary market generally are required to settle within three business days (T+3), unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Notes in the United States on the date of pricing or the next succeeding business days until three days prior to the Issue Date will be required, by virtue of the fact the Notes initially will settle beyond T+3, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Settlement procedures in other countries will vary. Purchasers of Notes may be affected by such local settlement practices and purchasers of Notes between the relevant date of pricing and the New Issue Date should consult their own advisers.

TAXATION

Serbian Taxation

The following is a general summary of the Serbian tax consequences as at the date hereof in relation to payments made under the Notes and in relation to the sale or transfer of Notes. It is not exhaustive and purchasers are urged to consult their professional advisers as to the tax consequences to them of holding or transferring Notes.

Tax Implications for Non-Residents of Serbia

Under existing Serbian laws and regulations, payments of principal and interest on the Notes to any individual or legal entity which is not resident or incorporated in Serbia will not be subject to taxation in Serbia and no withholding of any Serbian tax will be required on any such payments. In addition, Noteholders will not be subject to taxation in respect of any capital gains (determined as the difference between the sale price and the acquisition price and, in some cases, the transaction costs) realised on the transfer outside the territory of Serbia of any Notes between non-residents.

Tax Implications for Residents of Serbia

Payments of interest under the Notes to any individual (natural person) who is resident in Serbia will not be subject to taxation and any such Noteholder will also not be subject to taxation in respect of any capital gains realised on the transfer of any Notes. Similarly, Noteholders which are legal entities resident in Serbia will not be subject to taxation in respect of any capital gains realised on the transfer of any Notes.

Additional Amounts Payable under the Notes

In the event that a payment of interest in respect of the Notes is subject to withholding or deduction for any taxation pursuant to Condition 10 (*Taxation*) of the Notes, the Issuer has agreed to pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, subject only to certain exceptions set out in the relevant Condition. One such exception is that if a Noteholder is subject to Serbian taxation by reason of his having some connection with Serbia other than the mere holding of the Note, that Noteholder would not be entitled to payment of any additional amounts under the relevant Condition.

U.S. Federal Income Taxation

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, HOLDERS ARE HEREBY NOTIFIED THAT: (1) ANY DISCUSSION OF U.S. FEDERAL TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY HOLDERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON HOLDERS UNDER THE INTERNAL REVENUE CODE; (2) SUCH DISCUSSION IS INCLUDED HEREIN BY THE ISSUER IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE ISSUER OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (3) HOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of Notes by a U.S. Holder (as defined below). This summary deals only with purchasers of Notes pursuant to this offering that are U.S. Holders and that will hold the Notes as capital assets. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Notes by particular investors, and does not address state, local, foreign or other tax laws. This summary also does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as financial institutions, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other

tax-deferred accounts, tax-exempt organisations, dealers in securities or currencies, investors that will hold the Notes as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. dollar).

As used herein, the term "U.S. Holder" means a beneficial owner of Notes that is, for U.S. federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation created or organised under the laws of the United States or any State thereof, (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or the trust has elected to be treated as a domestic trust for U.S. federal income tax purposes.

The U.S. federal income tax treatment of a partner in an entity treated as a partnership for U.S. federal income tax purposes that holds Notes will depend on the status of the partner and the activities of the partnership. Prospective purchasers that are entities treated as partnerships should consult their tax advisers concerning the U.S. federal income tax consequences to their partners of the acquisition, ownership and disposition of Notes by the partnership.

The summary is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE NOTES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

Notes

Payments of Interest

Interest on a Note will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the holder's method of accounting for tax purposes. Interest paid by the Issuer on the Notes constitutes income from sources outside the United States. Prospective purchasers should consult their tax advisers concerning the applicability of the foreign tax credit and source of income rules to income attributable to the Notes.

Sale and Retirement of the Notes

A U.S. Holder will generally recognise gain or loss on the sale or retirement of a Note equal to the difference between the amount realised on the sale or retirement and the tax basis of the Note. A U.S. Holder's tax basis in a Note will generally be its U.S. dollar cost. The amount realised does not include the amount attributable to accrued but unpaid interest, which will be taxable as interest income to the extent not previously included in income.

Gain or loss recognised by a U.S. Holder on the sale or retirement of a Note will be capital gain or loss and will be long-term capital gain or loss if the Note was held by the U.S. Holder for more than one year. Gain or loss realised by a U.S. Holder on the sale or retirement of a Note generally will be U.S. source. Prospective purchasers should consult their tax advisers as to the foreign tax credit implications of the sale or retirement of Notes.

Backup Withholding and Information Reporting

Payments of principal, and interest on, and the proceeds of sale or other disposition of Notes, by a U.S. paying agent or other U.S. intermediary will be reported to the Internal Revenue Service and to the U.S. Holder as may be required under applicable regulations. Backup withholding may apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns.

Certain U.S. Holders are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Foreign Financial Asset Reporting

Recently enacted legislation imposes new reporting requirements on the holding of certain foreign financial assets, including debt of foreign entities, if the aggregate value of all of these assets exceeds U.S.$50,000 at the end of the taxable year or U.S.$75,000 at any time during the taxable year. The Notes are expected to constitute foreign financial assets subject to these requirements unless the Notes are in an account at a domestic financial institution. U.S. Holders should consult their tax advisers regarding the application of this legislation.

The above summary is not intended to constitute a complete analysis of all tax consequences relating to the ownership of Notes.

Prospective purchasers of the Notes should consult their own tax advisers concerning the tax consequences of holding Notes in light of their particular circumstances, including the application of the U.S. federal income tax considerations discussed above, as well as the application of state, local, foreign or other tax laws.

EU Directive on the Taxation of Savings Income (Directive 2003/48/EC)

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent. The transitional period is to terminate following the conclusion of certain other agreements relating to information exchange with certain other countries.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding measures) in relation to payments made by a person within their jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment is made or collected through a Member State that has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Agent (as defined in the Conditions) nor any other person is obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Under the Conditions, the Issuer is required to maintain an Agent in a Member State that would not be obliged to withhold or deduct tax pursuant to the EU Savings Directive.

SUBSCRIPTION AND SALE

Deutsche Bank AG, London Branch, HSBC Bank plc and VTB Capital plc (together, the "Joint Lead Managers") have, pursuant to a Subscription Agreement dated 19 November 2012, jointly and severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe for the Notes at 99.135 per cent. of their principal amount less a combined management, underwriting and selling commission of 0.03 per cent. of such principal amount plus accrued interest, if any. In addition, the Issuer has agreed to reimburse the Joint Lead Managers for certain of their expenses in connection with the issue of the Notes. The Subscription Agreement entitles the Joint Lead Managers to terminate it in certain circumstances prior to payment being made to the Issuer.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Joint Lead Managers have agreed, severally and not jointly, to offer the Notes for resale in the United States initially only to persons who they reasonably believe to be QIBs in reliance on Rule 144A and outside the United States in offshore transactions in reliance on Regulation S. Terms used in this paragraph have the respective meanings given to them by Regulation S.

The Notes are being offered and sold by the Joint Lead Managers outside the United States in accordance with Regulation S. The Subscription Agreement provides that the Joint Lead Managers may through their respective U.S. affiliates resell a portion of the Notes within the United States only to QIBs in reliance on Rule 144A.

An offer or sale of Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A, or another available exemption from registration under the Securities Act.

United Kingdom

Each Joint Lead Manager has represented, warranted and agreed that it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

General

No action has been or will be taken in any jurisdiction by the Issuer or any Joint Lead Manager that would permit a public offering of the Notes, or possession or distribution of this Prospectus or any other offering or publicity material relating to the Notes, in any country or jurisdiction where action for that purpose is required. Each Joint Lead Manager has represented, warranted and agreed that it has, to the best of its knowledge and belief, complied and will comply with all applicable laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Notes or possesses, distributes or publishes this Prospectus or any other offering material relating to the Notes. Persons into whose hands this Prospectus comes are required by the Issuer and each Joint Lead Manager to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or possess, distribute or publish this Prospectus or any other offering material relating to the Notes, in all cases at their own expense.

The Joint Lead Managers and their affiliates have from time to time provided, and expect to provide in the future, investment banking, commercial banking and other financial services to us, for which they have received and may continue to receive customary fees and commissions. The Joint Lead Managers, or their affiliates, may, from time to time, engage in transactions with and perform services for the Republic of Serbia in the ordinary course of their businesses. As a result of acting in the capacities described above, and as a result of the fact that certain of the Joint Lead Managers or their affiliates may have interests, relationships or engagements with or relating directly or indirectly to the Republic of Serbia, Serbian financial institutions or other entities and persons and bodies related to or affiliated with any of the foregoing, certain of the Joint Lead Managers or their affiliates may have interests that may not be aligned, or could potentially conflict, with investors' and with the Republic of Serbia's interests.

GENERAL INFORMATION

Authorisation

The Issuer has obtained all necessary consents, approvals and authorisations in connection with the issue and performance of its obligations under the Notes prior to the date of this Prospectus. The issue of the Notes has been duly authorised pursuant to the Decision of the Government of the Republic of Serbia dated 16 November 2012.

Listing and Admission to Trading

It is expected that listing of the Notes on the Official List and admission of the Notes to trading on the Market will be granted on or about 21 November 2012, subject only to the issue of the Global Notes. The Notes are expected to be issued on or about 21 November 2012. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. The listing of the Notes on the Official List will be expressed as a percentage of their nominal amount (exclusive of accrued interest). Transactions will normally be effected for settlement in U.S. Dollars and for delivery on the third working day after the day of the transaction. The expenses related to the admission to trading of the Notes are expected to be approximately £225.

No Significant Change

There has been no significant change in the tax and budgetary systems, gross Public Debt, foreign trade and balance of payments, foreign exchange reserves, financial position and resources and income and expenditure figures of the Issuer since 31 December 2011.

Clearing Systems

The Notes have been accepted for clearance through Euroclear, Clearstream, Luxembourg and DTC. The Common Code and ISIN for the Regulation S Notes and the Common Code, ISIN and CUSIP number for the Rule 144A Notes are as follows:

Regulation S Notes

Common Code: 085695126

ISIN: XS0856951263

Rule 144A Notes

Common Code: 085695096

ISIN: US817477AC64

CUSIP: 817477AC6

Indication of Yield

The indication of yield in relation to the Notes is 5.450 per cent. per annum. This yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

Litigation

The Issuer has not been involved in any legal, governmental or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) during the 12 months preceding the date of this Prospectus that may have, or have had in the recent past, significant effects on the Issuer's financial position.

Documents Available for Inspection

Copies of the following documents may be inspected during normal business hours at the offices of the Fiscal Agent, as set forth on the back cover of this Prospectus, for 12 months from the date of this Prospectus:

- the Budgets of Serbia, including any supplementary Budgets, for the fiscal years 2010, 2011, 2012 and 2013;
- the Fiscal Agency Agreement;
- the Deed of Covenant; and
- this Prospectus and any supplements hereto.

Third Party Information

Where information in this Prospectus has been sourced from third parties, this information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.

THE ISSUER

Republic of Serbia
(acting through the Ministry of Finance and Economy)
20 Kneza Milosa Street
11000 Belgrade
Serbia

JOINT LEAD MANAGERS

Deutsche Bank AG, London Branch
Winchester House
1 Great Winchester Street
London EC2N 2DB
United Kingdom

HSBC Bank plc
8 Canada Square
London E14 SHQ
United Kingdom

VTB Capital plc
14 Cornhill
London EC3V 3ND
United Kingdom

FISCAL AGENT AND PAYING AND TRANSFER AGENT

Deutsche Bank AG, London Branch
Winchester House
1 Great Winchester Street
London EC2N 2DB
United Kingdom

REGISTRAR AND PAYING AND TRANSFER AGENT

Deutsche Bank Luxembourg S.A.
2, Boulevard Konrad Adenauer
L-1115 Luxembourg
Luxembourg

U.S. REGISTRAR, U.S. TRANSFER AGENT AND U.S. PAYING AGENT

Deutsche Bank Trust Company Americas
60 Wall Street
New York
New York 10005
United States

LEGAL ADVISERS

To the Issuer as to English and United States law

Linklaters LLP
Linklaters LLP
One Silk Street
London EC2Y 8HQ
United Kingdom

To the Issuer as to Serbian law

Ministry of Justice and Public Administration
Nemanjina 22-26
11000 Belgrade
Serbia

To the Joint Lead Managers as to English and United States law

White & Case LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom

To the Joint Lead Managers as to Serbian law

Moravcevic Vojnovic Zdravkovic in cooperation with Schoenherr
27 Francuska St, 11000 Belgrade
Serbia

sterling 159916