

The **National Bank of Serbia**, for the purpose of implementing Articles 3 and 10 of the Law on the National Bank of Serbia (“RS Official Gazette,” Nos. 72/2003 and 55/2004) and achieving and maintaining price stability, and the **Government of the Republic of Serbia**, for the purpose of creating a legal and institutional framework for the pursuit of monetary policy conducive to macroeconomic stability and economic growth, hereby enter into the following

A G R E E M E N T ON INFLATION TARGETING

1. The National Bank of Serbia and the Government of the Republic of Serbia (hereinafter: the Government) agree that, with a view to achieving price stability, the National Bank of Serbia shall **implement the inflation targeting regime**, the principles of which it has gradually introduced in practice pursuant to the Memorandum on the New Monetary Policy Framework adopted in August 2006. Inflation targeting regime means maintaining inflation within a defined target range, by using the key policy rate as the main instrument and other monetary policy measures when objectives cannot be achieved by means of the main instrument.

2. The National Bank of Serbia and the Government agree that the only numerical guideline for the monetary policy conducted by the National Bank of Serbia shall be defined in terms of the **annual percentage change in the consumer price index** measured and reported by the Statistical Office of the Republic of Serbia.

3. The National Bank of Serbia and the Government agree that inflation targets shall be **set by the National Bank of Serbia, in cooperation with the Government**, and shall be publicly announced by the National Bank of Serbia.

The National Bank of Serbia and the Government agree that the trajectory of inflation targets over the next few years shall be consistent with the need to achieve and maintain **medium-term price stability**, which, in view of Serbia’s medium-term ambition to converge to EU price and income levels, shall be defined as annual inflation of 2–4%.

Inflation targets for 2009 and 2010 shall be set in consistence with the already defined targets for core inflation as measured by retail prices.

The National Bank of Serbia and the Government agree that inflation targets based on the consumer price index set in the above defined manner reflect price

movements more fully and enable a clearer division of responsibilities for achieving and maintaining their stability, as well as that the announcement of such targets ensures a stronger impact on inflation expectations.

The National Bank of Serbia, in cooperation with the Government, may revise the agreed and announced inflation targets. Such revisions shall be initiated only under exceptional circumstances, and the National Bank of Serbia shall provide an adequate explanation of each such revision.

4. The National Bank of Serbia and the Government agree that, in cooperation with the National Bank of Serbia, the Government shall define and announce numeric guidelines for increase in prices of products and services under its direct or indirect regulation (the list of such products is set out in Annex 1 hereto).

In consultation with the National Bank of Serbia, the Government shall announce a single range as a numerical guideline for the increase in prices of all products in the list of products set out in Annex 1. For the purpose of setting medium-term targets and preparing inflation projections, the Government shall also communicate to the National Bank of Serbia its plans regarding any changes in prices for each individual product, together with the schedule for implementing such changes.

The Government, upon consulting with the National Bank of Serbia, may revise the agreed and published guidelines as well as the list of products set out in Annex 1, and shall provide an adequate explanation of each such revision.

5. Consistent with the agreed monetary policy framework, the Government and the National Bank of Serbia agree that the National Bank of Serbia shall implement a managed floating exchange rate regime, but that no numerical targets for the exchange rate shall be set.

6. The National Bank of Serbia shall decide on the monetary policy instruments to be used in its **pursuit of inflation targets**.

The National Bank of Serbia shall conduct its monetary policy in a sustainable, consistent and predictable manner in order to avoid any unnecessary macroeconomic fluctuations. By regularly enacting regulations, the National Bank of Serbia shall select monetary policy instruments based on its assessment of the current economic situation, current developments and the medium-term inflation projection.

The National Bank of Serbia shall be transparent and accountable to the public in pursuing the inflation targets. The National Bank of Serbia shall regularly inform the Government and the public on the achievement of its targets, factors behind economic developments and measures to be taken in order to achieve such

targets. To that end, the National Bank of Serbia shall use the quarterly inflation report as one of its key tools for communicating with the general public.

If the departure of inflation from the set target lasts for more than six consecutive months, the National Bank of Serbia shall notify the Government in writing about the reasons for such departure, measures to be taken and the time needed for inflation to return within the target range.

7. Supporting full independence of the National Bank of Serbia in its pursuit of the monetary policy aimed at achieving inflation targets, the **Government** shall:

- conduct a sustainable and predictable fiscal policy consistent with inflation targets;
- revise prices of products and services coming under its remit in compliance with the announced numerical guidelines referred to in Section 4 hereof.

The Government shall timely inform the public and the National Bank of Serbia about any changes in the economic policy that could threaten the achievement of the inflation targets, and, in particular, of any plans related to market regulation and the budget.

8. The Government and the National Bank of Serbia agree to cooperate in creating institutional preconditions necessary for effective and efficient inflation targeting by developing regulations that ensure the independence of the National Bank of Serbia and by encouraging the development of the financial market and activities relating to the strengthening of trust in the national currency.

The Government and the National Bank of Serbia agree that the conduct of monetary policy aimed at achieving the primary objective of the National Bank of Serbia as defined by the law should not have to rely solely on the funds currently available to the National Bank of Serbia for covering the costs arising from the use of monetary policy instruments.

The Government agrees that, subject to the Law on the National Bank of Serbia, the losses recorded by the National Bank of Serbia that cannot be covered from special reserves and fixed capital of the National Bank of Serbia shall be covered by liquid assets transferred from the budget of the Republic of Serbia, including the securities issued for that purpose by the Republic of Serbia and transferred to the National Bank of Serbia. The Government and the National Bank of Serbia agree that the National Bank of Serbia may sell and effect collection in respect of the securities issued to cover the losses even prior to their maturity.

The Government and the National Bank of Serbia agree that, if the National Bank of Serbia records a positive financial result but does not have sufficient liquidity to conduct its monetary operations, the required liquid assets shall be

transferred from the budget of the Republic of Serbia to the account of the National Bank of Serbia to enable smooth conduct of monetary policy.

The Government and the National Bank of Serbia agree to regulate their mutual relations in respect of interest on government deposits held with the National Bank of Serbia depending on the financial result achieved by the National Bank and its available liquid assets.

9. The Government and the National Bank of Serbia agree to entrust the preparation of supporting materials for the implementation hereof to the working group comprising members of the Government and the National Bank of Serbia.

10. The National Bank of Serbia and the Government agree that inflation targeting is the monetary regime most conducive to the achievement of price stability, long-term sustainable growth and even development of the economy of the Republic of Serbia.

11. This Agreement is made out in four (4) identical counterparts, two (2) of which are to be kept by each party.

12. This Agreement shall be applied as of the day of its signing.

ON BEHALF OF
NATIONAL BANK OF SERBIA

ON BEHALF OF
GOVERNMENT OF THE REPUBLIC OF SERBIA

List of products and services for which price growth numerical guidelines are set by the Government of the Republic of Serbia in cooperation with the National Bank of Serbia

By implementing rules established in law or by taking economic policy measures, the Government of the Republic of Serbia regulates movements in the prices of the following products/services:

1) basic food commodities (bread made from wheat flour type 850, the so-called “common bread”) – legal basis for regulation shall be the *Law on Terms and Conditions of Commodity Trade, Provision of Related Services and Inspection Control*;

2) petroleum products (heating oil, motor fuel BMB-95, motor fuel MB-95, diesel fuel D-2, euro diesel, eco-3 diesel) – these prices are not directly regulated; the price caps are set by the *Decree on Petroleum Product Prices, and/or Rules on Producer Price Ceilings*, in line with movements in international crude oil prices ($\pm 1.5\%$ change) 15 days from the last adjustment (note that the price of pipeline transport of oil and/or petroleum products is regulated by the Energy Agency subject to the Government’s consent) – legal basis for regulation shall be the *Law on Terms and Conditions of Commodity Trade, Provision of Related Services and Inspection Control*; indirect regulation of petroleum product prices is possible through excise duties;

3) electricity: The Government of the Republic of Serbia issues consent regarding the level of electricity prices for tariff buyers, subject to positive opinion of the Energy Agency – legal basis for regulation shall be the *Law on Public Enterprises and Performance of Activities of General Interest* and the *Energy Law*;

4) natural gas (natural gas for remote heating systems and households): consent of both the Government and the Energy Agency is needed, prices are adjusted each quarter, based on a contract with the supplier and in line with the movements in prices of reference products and the US dollar selling exchange rate – legal basis for regulation shall be the *Law on Public Enterprises and Performance of Activities of General Interest* and the *Energy Law*;

5) housing and utility services (water supply for households, waste water disposal, rubbish removal services, central heating) – legal basis for regulation shall be the *Law on Public Enterprises and Performance of Activities of General Interest* and the *Decree on the Procedure of Temporary Suspension of the Transfer of Funds from the Budget of the Republic of Serbia to Local Government Units, and/or Transfer of the Appertaining Portion of Proceeds from Income Tax and Profit Tax to Autonomous Provinces*;

6) transport services (railway freight and passenger transport and toll) – legal basis for regulation shall be the *Law on Public Enterprises and Performance of Activities of General Interest*;

7) PTT services (postal services, telephone services) – prices for fixed line telephone services in domestic and international transport are under the scope of authority of the Republic Telecommunications Agency; as for postal services, consent is needed only for reserved postal services, including letters (up to a certain weight and price limit), postages (in classic or electronic form) and case documentation (court, criminal and administrative procedures);

8) TV subscription;

9) medicaments – legal basis for regulation shall be the *Law on Medicaments and Medical Devices*; medicament prices shall be set in line with the *Decree on the Price Formation Criteria for Medicaments*;

10) tobacco (cigarettes) – indirectly regulated as the product prices include excise duties;

11) social protection services (kindergarten and student/pupil residence facilities) legal basis for regulation shall be the *Decree on the Procedure of Temporary Suspension of the Transfer of Funds from the Budget of the Republic of Serbia to Local Government Units, and/or Transfer of the Appertaining Portion of Proceeds from Income Tax and Profit Tax to Autonomous Provinces*;

12) tolls – legal basis for regulation shall be the *Law on Public Enterprises and Performance of Activities of General Interest* and the *Decree on the Procedure of Temporary Suspension of the Transfer of Funds from the Budget of the Republic of Serbia to Local Government Units, and/or Transfer of the Appertaining Portion of Proceeds from Income Tax and Profit Tax to Autonomous Provinces*.