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June 16, 2021

Statement by Mr. Odonye and Mr. Ismail on Republic of Serbia
(Preliminary)
Executive Board Meeting
June 18, 2021

We thank staff for the informative report and Mr. Trabinski and Mr. Djokovic for their insightful Buff statement. Serbia's economy has rebounded reinforced by the authorities' decisive and sizable support measures. At the same time, effective containment measures and swift vaccine rollout of the authorities have helped rein in COVID-19 infections. This notwithstanding, the outlook is subject to significant downside risks stemming from new waves of infections and possible tightening in the global financial conditions. The pandemic has also stalled progress on implementing structural reforms and strengthening fiscal discipline under the 2018 Policy Coordination Instrument (PCI). Against this background, we broadly agree with the staff appraisal and support the authorities' request for a successor PCI to advance structural and institutional reforms, entrench macroeconomic and financial stability and pave the way for Serbia to join the EU.

We note the expansionary fiscal policy was calibrated to mitigate impact of the pandemic and minimize scarring on the economy until the recovery firms up. The supplementary budget approved in 2021 offers additional insurance against potential new waves of the pandemic. Focusing support measures on the most affected households and businesses remains crucial to provide optimum value to the targeted sectors, limit the fiscal costs, and enhance the fiscal multiplier. To this end, we encourage fiscal transparency and accountability of COVID-related spending and urge the authorities to closely monitor fiscal risks, including those stemming from the credit guarantee scheme.

Once the pandemic abates, we encourage the authorities to resume prudent fiscal policy. This would align with their intention to design and adopt a new deficit-based fiscal rule in coordination with the Fund. The framework will help place the public debt on a downward trajectory, rebuild investor confidence and enhance fiscal accountability. At the same time, the adoption of the new public wage system and employment framework provides the opportunity to reduce the recently inflated public wage bill and improve public workforce planning. The authorities' efforts to build human resource capacity and strengthen coordination across government departments constitute elevated measures to improve public investment management, which we commend. *Could staff elaborate on whether the risk in the recent personnel departures is relative to the Public Investment Management Unit or other government departments and what has been done to ensure the retention of experienced staff and new hires?* Further, we welcome the recent improvement of Serbia's debt risk profile as reflected by Moody's and the inclusion of dinar-denominated government bonds in the JP Morgan's EM Index. While welcoming the prospects of more liquidity in the economy and broadened investor base, we urge the authorities to closely monitor risks associated with the debt outlook, including contingent liabilities, slowdown in growth, and pressures on the exchange rate.

Maintaining the accommodative monetary policy stance and other support measures remain appropriate to support the recovery amidst contained inflation and negative output gap. We note that expansionary monetary and macroprudential measures have supported robust credit growth and effective FX interventions helped stabilize the exchange rate and reserve buffers. Greater exchange rate flexibility would ensure proper pricing of risks associated with unhedged FX loans and smooth the market. To this end, we encourage the authorities to develop FX hedging instruments and capital markets to support the dinarization strategy, mitigate FX risk, enhance financial stability, and foster medium-term growth.

Finally, accelerating structural reforms remains critical to support inclusive growth and advance technological and green transformation. Further improvement of the business environment is needed to attract investment through commitment to the rule of law, reformed SOE sector, modernized judicial system, and prioritized anti-corruption fight. Addressing the labor market and informality in the economy would improve the growth prospects. We commend the recent adoption of the Climate Change Law, which reflects the authorities' commitment to accelerate reforms to facilitate the transition to a greener economy with increased green infrastructure. We welcome the authorities' intention to support digitalization, which will foster the country's transition to a knowledge-and-innovation-based economy with strong growth prospects.