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Statement by Mr. von Kleist and Ms. Koh 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 the helpful Buff. We concur with staff's assessment and recommendations. We welcome the reform progress achieved under the previous PCIs and support the proposed successor arrangement.

We take positive note of the mitigating policies put forward by the authorities which helped to contain negative growth impacts resulting from the Covid-19 pandemic. With good progress on the vaccination campaign and growth expectations revised up to 6 percent for 2021 , the authorities are now increasingly focused on implementing measures to bring the debt ratio back on a downward trajectory. We welcome that the proposed reform targets (RTs) under the new PCI focus on the implementation of fiscal measures as well as growth-enhancing structural reforms.

We support staff's proposals to improve the fiscal framework and would in particular encourage further work on a fiscal rule to rebuild fiscal space and anchor public debt . We agree that the recent crisis has emphasized the general importance of sufficient fiscal space, to enable governments to swiftly and decisively act in times of crises. Therefore, the reduction of the debt-to-GDP ratio should be a priority once the recovery is firmly on the way. With fiscal room narrowing, fiscal spending should become more targeted towards the most affected and vulnerable groups. Furthermore, we encourage the authorities to continue efforts to improve public investment management. To reduce fiscal risks further, we support the ongoing reforms, supported by the proposed PCI, to increase transparency and efficiency of the SOE sector.

Regarding structural reforms, we support staff's proposal to shift the focus of the RTs towards growth enhancing measures, once the agenda to anchor public debt has

progressed. In this regard, a reduction of the informal sector, improved job opportunities and the strengthening of the social safety net should be priorities. Likewise, investments in sustainable infrastructure and fostering the green transformation will be key.

We take note that the banking system has shown to be resilient during the crisis. However, with the end of the moratoria in April 2021, the performance of loans should now be monitored closely, and the authorities should be ready to act in case NPL ratios were to rise significantly . Additionally, we note that credit supply to the private sector is expected to slow significantly in 2021 and is not expected to reach previous levels in the medium term (Table 1), even with the monetary policy stance being accommodative. *Could staff provide some information on why it does not expect to see private credit growing stronger despite expectations of a strong recovery?*

Furthermore, we welcome the efforts to further develop domestic capital markets. This can help to diversify and strengthen domestic investment opportunities and provide companies with a stable funding source. Dinarization of the economy can thereby be fostered and exchange rate risks for companies and investors should thus decrease. In the longer term, and once dinarization has proceeded, the discussion on a more flexible exchange rate regime could be more fruitful.

Regarding staff's external sector assessment, we notice the relatively large, negative EBA-lite model's current account norm of -5.9 percent of GDP (DSA). *What are the main factors that underpin this estimate and what explains the positive contributions of policy gaps?* Additionally, given the high - if largely FDI-based - negative NIIP, we would not necessarily regard an unchanged NIIP as the most relevant benchmark for external stability in the case of Serbia. *What would be the NIIP stabilizing CA balance for Serbia and how does it compare to EBA norm*?