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August 24, 2020

**Statement by Mr. Palei and Mr. Potapov on Republic of Serbia
(Preliminary)
Executive Board Meeting
August 26, 2020**

1. We thank staff for the well written report and the expeditious adjustment of the PCI-supported program to the new reality created by the COVID-19 pandemic and multiple interrelated shocks. We also thank Mr. Inderbinen and Mr. Djokovic for their informative Buff statement. We support the completion of the fourth review and the modification of quantitative and reform targets.
2. Before the COVID-19 pandemic devastated the global economy, Serbia was on track in implementing its program to further build macroeconomic resilience and promote strong and sustainable growth. Real GDP growth reached 4.3 percent in 2019. External and fiscal buffers have been substantially improved over the recent years, and the financial sector has become more resilient. Formal employment and labor market participation have continued to expand, while unemployment has declined. The authorities have made important progress in strengthening the oversight of SOEs, improving revenue administration, and promoting fiscal transparency.
3. Enhanced macroeconomic resilience and fiscal prudence allowed the authorities to respond to the COVID-19 crisis with a large package of measures which have helped cushion the economic damage from the outbreak. After growth contraction in the second quarter of 2020, the recent high-frequency indicators of economic activity point to a gradual recovery. Nonetheless, the COVID-19 shock is affecting the Serbian economy through lower external demand, weaker foreign direct investment and remittances, as well disruptions in regional and global supply chains. In this context, we welcome staff's recommendations on the main contingency measures in case of downside risks' materialization (Annex I). *We note the divergence in growth projections for 2020 between the authorities and staff and would appreciate additional elaborations on the differences in reasoning and/or assumptions.*

4. We commend the authorities for their efforts to contain the virus outbreak, save human lives, and support growth and job creation. The authorities have rightly used the accumulated fiscal buffers to mitigate the shocks. Going forward, we agree with the authorities and staff that the remaining fiscal space should be used cautiously, subject to economic data and the COVID-19 developments. Monitoring of fiscal risks remains the key priority, and we encourage the authorities to request the Fund's technical assistance to further strengthen the SOE sector. We welcome the authorities' plan to increase public investments and resume work on a credible and efficient fiscal rule.

5. In the monetary area, we welcome the National Bank of Serbia's measures to support liquidity of the financial system by reducing the policy rate, expanding repo purchase auctions, and securing the euro liquidity line with the ECB. Pressures on the exchange rate have been contained, while international reserves rose to EUR 14.3 billion at the end of June, boosted by the Eurobond issuance. It is encouraging that, according to the authorities' macroprudential stress tests, the domestic banking sector is expected to remain adequately capitalized, highly liquid, and with low levels of systemic risk. While greater exchange rate flexibility will help further increase the economy's resilience to external shocks, we are sympathetic to the authorities' cautious approach in this area, especially, given the current unprecedented environment and heightened uncertainty.

6. We welcome the authorities' efforts to implement important structural reforms and complete the privatization agenda in line with the adjustment timeframes. We highlight that some flexibility should be preserved, given the reduced fiscal space to accommodate possible short-term costs of these reforms.