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June 16, 2021

Statement by Mr. Zhang and Ms. Zhao 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 statement. We take positive note that Serbia recorded one of the smallest output contractions in Europe in 2020 thanks to the authorities' swift and comprehensive fiscal, monetary, and financial sector policy measures. We commend the authorities' efforts in vaccination which is one of the most successful in Europe and has helped contain the fourth wave of infections, contributing to the upward revision of the growth forecast for 2021 from 5 percent to 6 percent, although risks are pronounced. We welcome the reform progress achieved under the previous PCIs and support the proposed successor arrangement that will help the country navigate through the crisis and lay solid foundations for economic recovery. We broadly agree with staff's appraisal and would like to limit ourselves to the following points.

On the fiscal front, we support the authorities' recent adoption of a supplementary budget to provide additional relief to households and business affected by the new waves of the pandemic. We take positive note that the country continued to take advantage of the favorable market conditions to finance the larger deficit. That said, a new fiscal rule is needed to anchor public finance once the pandemic abates. In this context, we welcome the authorities' plan to formalize a new fiscal rule framework by mid-2022 in consultation with Fund staff. The authorities' new Transformation Program Action Plan (TPAP) is a step in the right direction that will help increase tax administration and improve business environment.

On the monetary and financial policy front, we support maintaining an accommodative monetary policy to secure economic recovery as inflation remains contained. On the exchange rate strategy, while we agree with staff that a more flexible exchange rate could actually support dinarization by exposing unhedged borrowers to higher risks, we take note of the authorities' concern of not having developed a hedging market in earlier periods of exchange rate volatility. *Since a well-developed hedging market is key to benefiting from a more flexible exchange rate, could staff elaborate on the key measures needed to further develop the hedging market in Serbia?* During this process, significant preparation and careful communication with the market are needed to secure a smooth switching to a more flexible exchange rate. On the financial sector, we welcome the authorities' measures that have boosted credit growth and encouraged credit dinarization.

On the structural policy front, we commend the authorities for their adoption of a new ownership and governance strategy for SOE reforms that will help better monitor fiscal risks and enhance efficiency. In the context of the unfavorable demographic trends in EU countries, we agree with staff that greater emphasis should be put on improving productivity with the help of digitization. Given that the size of Serbia's gray economy remains high, we encourage the authorities to further reduce the informal economy including improving inspection system. We welcome Serbia's recent progress in addressing AML/CFT deficiencies and encourage the authorities to continue improving the effectiveness of its AML/CFT framework.

With these remarks, we wish the authorities every success in their policy efforts.