BUFF/09/82

May 15, 2009

The Acting Chair's Summing Up
Republic of Serbia—First Review Under the Stand-By Arrangement and Requests for Augmentation and Extension of the Arrangement, Rephasing of Purchases, Waiver of Applicability of End-March Performance Criterion and Modification of End-June Performance Criteria, and Financing Assurances Review
Executive Board Meeting 09/49
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Executive Directors noted that the external downside risks to the Serbian economy, highlighted in the authorities' initial request for a Stand-By Arrangement, have materialized. They observed that, with the global economy in recession, Serbia's exports and imports have plunged; capital inflows have largely dried up; and foreign exchange reserves have come under pressure. Directors noted that output is likely to shrink this year, with limited prospects of recovery in 2010, and a sizeable external financing gap is likely to emerge in 2009–11. Directors also underscored that prospects for growth remain subject to considerable downside risks, and there are significant risks regarding the outlook for external debt sustainability.

Against this backdrop, Directors endorsed the authorities' revised program strategy, supported by an augmented and longer arrangement. In particular, they welcomed the strong fiscal adjustment measures in the face of sharply falling revenues; the assurances received from major foreign banks to maintain their exposures to Serbia; and the authorities' request for additional financial support from other international financial institutions and the EU to help bridge the external financing gap.

While Directors supported higher fiscal deficit targets for 2009–10, they also felt that additional adjustment is needed to maintain a sound fiscal position, and welcomed the authorities' identification of contingency measures for use in case the fiscal situation were to deteriorate. Given the large and inefficient public sector, Directors agreed that fiscal adjustment should focus mainly on recurrent spending, while maintaining an effective social safety net. Directors cautioned, however, that the authorities' strategy of relying on large across-the-board cuts in discretionary spending could prove disruptive for public service delivery or lead to build-up of spending arrears. Therefore, they encouraged the authorities to replace the temporary measures with permanent fiscal reforms that improve public expenditure efficiency and align spending with lower revenues. They also recommended that spending commitments and cash planning be tightly managed to avoid a build-up of spending arrears.

Directors supported a continued focus of monetary policy on inflation. They noted that inflation is still high. While the deepening slowdown has provided some scope to lower the policy interest rate, Directors cautioned that any further policy easing needs to be carefully calibrated to avoid undue pressure on the exchange rate and to keep Serbia's persistent inflationary expectations in check. Institutional reforms to strengthen the central bank's legal framework and independence, as well as closer policy coordination between the central bank and the government regarding adjustment of regulated prices, will also be important.

Directors welcomed the newly adopted financial sector support program. Directors were pleased that all foreign parent banks that participated in the recent financial sector coordination meeting have provided voluntary commitments to maintain their exposure to Serbia, to keep their subsidiaries adequately capitalized and liquid, and to take part in the planned stress testing exercise. Directors agreed that the support program should help underpin financial stability, while noting that past tight prudential policies have paid off in buffering the banking system against the initial financial crisis spillovers. They encouraged close monitoring and cooperation between home and host country supervisors and authorities.

Directors underscored the need to tackle long-delayed structural reforms, while acknowledging that the global financial crisis may not be conducive to pushing ahead with privatization. Particular attention should be given to streamlining business regulations and improving the effectiveness of the bankruptcy and debt restructuring framework.