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IMF Executive Board Completes First Review Under Serbia's Stand-By Arrangement and Increases Financial Support to €2.9 Billion

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Serbia's performance under the Stand-By Arrangement (SBA) and increased the IMF's financial support to SDR 2.62 billion (about €2.942 billion, or about US$4 billion), equivalent to 560 percent of Serbia's quota or close to 10 percent of its GDP. The Board also extended the SBA by one year to mid-April 2011. These decisions enable the immediate release of SDR 701.55 million (about €788 million). The Board also granted a waiver of applicability for the end-March fiscal performance criterion.

The revised arrangement will support the government's economic program amid a sharper than expected impact from the global financial crisis. The original 15-month, SDR 350.8 million (about €394 million) SBA was approved on January 16, 2009 (see Press Release No. 09/12).

Since the original SBA was designed in late 2008, Serbia's external and financial environment—like in much of Eastern Europe—has deteriorated abruptly and relentlessly: Trade flows, output, domestic demand, and, especially, fiscal revenues are now lagging significantly behind initial projections. Moreover, an abrupt slowing of net capital inflows is likely to open up sizable external financing gaps in 2009–11, projected to add to about €3.5 billion (11½ percent of GDP), despite a projected rapid narrowing of the large current account deficit.

To safeguard economic stability in this markedly deteriorated environment, the authorities have revised their strategy in three key respects:

- The fiscal deficit targets for 2009–10 have been raised, but additional fiscal adjustment measures—mainly falling on recurrent spending—are also being taken;

- The main foreign parent banks have voluntarily committed to roll over their exposures to Serbia and keep their subsidiaries well capitalized;

- The authorities have requested additional financial support from International Financial Institutions and the European Union to close the projected external financing gaps in 2009–11.

Following the Executive Board's discussion on Serbia, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"The downside risks highlighted a few months ago at the start of Serbia's IMF economic program supported by a precautionary SBA are now materializing. With the global economy in recession, Serbia's exports and imports have plunged, and capital flows have largely dried up. The outlook has deteriorated markedly and remains subject to downside risks. Economic activity is likely to shrink this year, with limited prospects of recovery in 2010.

"The authorities' strengthened strategy to deal with these renewed challenges is commendable, and deserves further support from the international community. For its part, the IMF is stepping up significantly its financial assistance under the Stand-By Arrangement to help cushion the economic downturn. With strong implementation of the program by the authorities, this provides confidence that Serbia will overcome the current difficulties.

"The higher fiscal deficit targets for 2009–10 balance the goal of avoiding excessively procyclical fiscal policies with the need to start adjusting to an environment of lower revenues, as the economy rebalances over the medium term. Looking forward, many of the short-term adjustment measures will need to be replaced by permanent fiscal reforms to improve the efficiency of the public sector. Implementation of the agreed fiscal adjustment measures will be key. The authorities are encouraged to tightly manage spending commitments and cash planning to avoid a build-up of spending arrears, while protecting social spending.

"The authorities' financial sector support program should help underpin financial stability. Following a successful financial sector coordination meeting, all attending foreign parent banks provided voluntary commitments to maintain their exposure to Serbia and keep their subsidiaries well capitalized and liquid, and take part in the planned stress testing exercise. Similar commitments are expected from other banks, while domestic banks are expected to commit to facilitating the restructuring of corporate and household loans. At the same time, the plan offers incentives to participating banks.

"Monetary policy should continue to focus on inflation. Given the still high inflation rate, the authorities will need to proceed with caution to keep inflationary expectations in check.

"The long-delayed structural reforms need to be tackled. While the global financial crisis may not be conducive to privatization, particular attention should be given to preparing public enterprises for private participation and to streamlining business regulations," Mr. Portugal said.

Serbia: Selected Economic and Social Indicators, 2006–10 1/

	2006	2007	2008 Est.	2009 Proj.	2010 Proj.
	(Change in percent, unless otherwise indicated)				
Output, prices, and labor market					
Real GDP	5.2	6.9	5.4	-2.0	0.0
Real GDP excluding agricultural sector	6.0	8.8	5.0	-2.2	0.0
Real domestic demand (absorption)	6.2	11.5	5.9	-5.6	-4.6
Consumer prices (end of period) 2/	6.6	11.0	8.6	10.0	8.0
	(In percent of GDP)				
General government finances					
Revenue	43.8	42.4	40.9	39.5	38.3
Expenditure	45.4	44.2	43.4	42.5	40.9
Fiscal balance	-1.6	-1.9	-2.5	-3.0	-2.5
Gross debt	42.6	33.3	31.6	34.8	37.8
	(End of period 12-month change, in percent)				
Monetary sector					
Money (M1)	37.1	25.3	-3.8	-19.2	34.1
Broad money (M2)	38.4	44.5	9.6	0.1	19.5
Domestic credit to non-government	17.1	36.9	35.0	11.0	15.7
	(In percent of GDP, unless otherwise indicated)				
Balance of payments					
Current account balance	-10.1	-15.5	-17.1	-13.0	-10.1
Exports of goods	21.8	21.6	21.6	19.1	20.4
Imports of goods	42.9	44.1	43.9	36.6	34.8
Trade of goods balance	-21.2	-22.5	-22.3	-17.5	-14.4
Capital and financial account balance	31.7	17.9	12.4	3.2	8.1
External debt (end of period)	63.3	60.2	63.6	76.3	85.6
of which: Private external debt	36.0	39.5	45.0	47.0	52.6
Gross official reserves (in billions of euro)	8.7	9.5	8.1	7.9	8.4
(In months of prospective imports of GNFS)	6.6	6.3	7.0	6.9	7.5
Exchange rate (dinar/euro, period average)	84.2	80.0	81.5	…	…
Real effective exchange rate (annual average change, in percent; + indicates appreciation)	6.6	7.2	5.8	…	…
Social indicators					
Per capita GDP (2008): US$6,782. Poverty rate (poverty line is US$5 per day, 2007): 6.6 percent. Unemployment rate (2008): 14 percent.					

Sources: Serbian authorities; and IMF staff estimates and projections.
1/ Excluding Kosovo (with the exception of external debt).
2/ Retail prices until 2006.