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2021 ARTICLE IV CONSULTATION AND REQUEST FOR A 30-MONTH POLICY COORDINATION INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF SERBIA

In the context of the Article IV, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 18, 2021 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 18, 2021, following discussions that ended on April 23, 2021, with the officials of Republic of Serbia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 3, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of Serbia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR21/189

IMF Executive Board Concludes 2021 Article IV Consultation with Republic of Serbia and Approves a 30-Month Policy Coordination Instrument

FOR IMMEDIATE RELEASE

- Serbia's economic recovery is expected to continue in 2021, supported by ongoing measures to boost the economy.
- Nevertheless, high uncertainty about the path of the COVID-19 pandemic persists, and accelerated structural and institutional reforms are needed to ensure more inclusive and sustainable growth over the medium term.
- The new PCI aims at supporting the authorities structural reform agenda and ongoing economic recovery, while maintaining macroeconomic and financial stability.

Washington, DC – **June 18, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Republic of Serbia and approved a new 30-month Policy Coordination Instrument (PCI).[2]

Serbia has coped well with the COVID-19 pandemic and the economic recovery is expected to continue in 2021. The economic contraction in 2020 is estimated at around 1 percent, one of the smallest in Europe. Job losses have mostly been contained to the informal sector, which could not benefit from direct policy measures. Inflation remains low, with a stable exchange rate and well-anchored inflation expectations. The banking system remains stable, liquid, and well capitalized. A supplementary budget for 2021 was adopted in April, boosting capital expenditure and extending policy support to households and corporates. The latest wave of infections is tapering and Serbia's vaccination rollout remains one of the fastest in Europe. In this context, and given the strong 1Q2021 data, real GDP growth is projected to reach 6 percent in 2021.

Over the medium-term, growth is projected to gradually converge to its potential of 4 percent, supported by strong FDI, continued high public investment, and an assumed recovery in trading partner countries. Inflation is projected to remain in the lower half of the inflation target band. The current account deficit is projected at about 5 percent of GDP and to remain fully covered by FDI.

However, high uncertainty surrounds prospects for an ongoing swift recovery. The future course of the pandemic in Serbia and its key EU trading partners remains highly uncertain. New waves of infections and new variants of the virus present a clear downside risk to the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The PCI is available to all IMF members that do not need Fund financial resources at the time of approval. It is designed for countries seeking to demonstrate commitment to a reform agenda or to unlock and coordinate financing from other official creditors or private investors.

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growth outlook and could lead to higher fiscal and external financing needs. On the other hand, building on the 1Q2021 momentum, a stronger-than-expected impact of the fast vaccine rollout in the country and globally could provide an upside risk.

The new PCI will build on the 2018 PCI successfully completed in January 2021 and aims at supporting the recovery from the pandemic, maintaining macroeconomic stability, and anchoring the medium-term fiscal policy framework, while pushing ahead with structural reforms to deliver more inclusive and sustainable growth. Program reviews will take place on a semiannual fixed schedule. While the PCI involves no use of IMF financial resources, successful completion of program reviews will help signal Serbia's commitment to continued strong macroeconomic policies and structural reforms.

Following the Executive Board's discussion on Serbia, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, issued the following statement:

"Serbia has coped relatively well with the COVID-19 pandemic. The hard-won macroeconomic stability that was achieved prior to the crisis, and the large policy support package that was deployed as the crisis hit, helped mitigate the adverse impact of the pandemic on economic activity. Nonetheless, with the uncertain future course of the pandemic, sustaining a solid economic recovery should be a policy priority.

"Fiscal policy is appropriately focused on providing support to the economy. The supplementary budget provides additional relief to households and businesses affected by the recent waves of the pandemic, while a scaling up of public investment—including in green infrastructure—should support near-term growth. Once the recovery gains momentum, it will be important to rebuild policy buffers and anchor them by a new fiscal rule.

"Monetary policy is accommodative, with inflation under control. In addition, extraordinary monetary and financial sector policy measures have supported economic activity through the pandemic. The banking system remains liquid but continued close monitoring of risks in the banking sector remains critical as crisis support measures expire.

"Further structural and institutional reforms are needed to underpin high, inclusive, and greener growth, as well as accelerate income convergence with the EU. Strengthening the governance and management of SOEs remains critical, while efforts to improve the business environment should continue to help attract investments. Developing domestic capital markets would enhance financial deepening and support medium-term growth. Finally, promoting green growth and enhancing the social safety net would support the recovery out of the crisis and ensure a more sustainable development."

Executive Board Assessment[3]

Executive Directors commended the authorities' strong policy response, which cushioned the impact of the pandemic and set the stage for an economic recovery. Continued policy support will be necessary in view of still high uncertainty, while safeguarding macroeconomic and

[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

financial stability. It will also be important to maintain reform momentum to foster stronger, more resilient, and more inclusive medium-term growth.

Directors highlighted the importance of preserving flexibility in the policy response and avoiding a premature withdrawal of support and having a contingency plan. Any additional assistance should be targeted, take into account the narrowing fiscal room, and maintain transparency and accountability. Once the recovery is fully under way, public finances should be anchored by the adoption of a new fiscal rule to help restore fiscal buffers, while prioritizing productive capital investments, moderating the growth of public wages and pensions, and further enhancing fiscal management.

Directors agreed that the accommodative monetary and financial sector policies remain appropriate. Continued oversight of risks in the banking sector will be important as the crisis measures are gradually unwound. Directors welcomed the authorities' plans to encourage dinarization and improve capital markets and access to development finance. Some Directors considered that greater exchange rate flexibility could raise awareness to the risks of unhedged FX loans, and underscored the importance of developing hedging markets. A few other Directors, however, noted the potentially limited role of a more flexible exchange rate as a shock absorber.

Directors emphasized the importance of implementing structural reforms. They welcomed the reforms to state-owned enterprises, including the new ownership and governance strategy, as well as reforms to strengthen the rule of law, improve the efficiency of the judicial system, and curb corruption. Investment in a green and digital economy can raise productivity, support job creation, and enhance economic and environmental resilience. Reforms to labor taxation and social protection will also be important.

Table 1. Serbia: Selected Economic and Social Indicators, 2018-2023

	2018	2019	2020		2021		2022		2023
			CR 21/8	Est.	CR 21/8	Proj.	CR 21/8	Proj.	Proj.
(Percent change, unless otherwise indicated)									
Real sector									
Real GDP	4.5	4.2	**-1.5**	-1.0	**5.0**	6.0	**4.5**	4.5	4.5
Real domestic demand (absorption)	6.5	6.2	**-1.7**	0.0	**6.7**	5.8	**4.6**	4.5	4.5
Consumer prices (average)	2.0	1.9	**1.7**	1.6	**1.9**	2.5	**2.3**	2.6	2.6
GDP deflator	2.0	1.9	**1.7**	1.3	**1.9**	3.0	**2.3**	2.4	2.6
Unemployment rate (in percent) 1/	2.0	2.4	**3.5**	1.8	**2.4**	2.6	**2.7**	2.9	2.9
Nominal GDP (in billions of dinars)	13.3	10.9	**…**	9.5	**…**	…	**…**	…	…
	5,073	5,418	**5,524**	5,464	**5,940**	5,942	**6,375**	6,389	6,868
(Percent of GDP)									
General government finances									
Revenue 2/	41.5	42.1	**40.3**	41.3	**40.8**	41.7	**41.3**	41.4	41.6
Expenditure 2/	40.9	42.3	**49.2**	49.4	**43.8**	48.7	**42.8**	44.4	43.1
Current 2/	36.4	36.9	**43.1**	43.1	**37.6**	40.9	**36.7**	37.2	36.5
Capital and net lending	4.1	5.1	**5.9**	6.2	**6.0**	7.6	**5.8**	6.8	6.5
Amortization of called guarantees	0.4	0.2	**0.1**	0.1	**0.2**	0.2	**0.3**	0.3	0.1
Fiscal balance 3/	0.6	-0.2	**-8.9**	-8.1	**-3.0**	-6.9	**-1.5**	-3.0	-1.5
Primary fiscal balance (cash basis)	2.8	1.8	**-6.9**	-6.1	**-1.1**	-5.0	**0.3**	-1.1	0.4
Structural primary fiscal balance 4/	2.8	1.5	**1.2**	2.0	**0.5**	-0.3	**0.4**	-1.6	0.3
Gross debt /5	54.4	52.8	**59.1**	58.4	**57.7**	60.3	**55.5**	58.9	56.0
(End of period 12-month change, percent)									
Monetary sector									
Money (M1)	20.1	16.3	**24.2**	36.3	**7.5**	11.8	**8.7**	8.4	8.0
Broad money (M2)	15.0	8.8	**12.7**	18.4	**7.1**	9.1	**7.3**	7.8	7.5
Domestic credit to non-government 6/	10.1	9.5	**10.6**	12.0	**6.5**	5.6	**7.8**	4.6	6.6
(Period average, percent)									
Interest rates (dinar)									
NBS key policy rate	3.1	2.3	**…**	1.0	**…**	…	**…**	…	…
Interest rate on new FX and FX-indexed loans	2.8	3.1	**…**	3.0	**…**	…	**…**	…	…
(Percent of GDP, unless otherwise indicated)									
Balance of payments									
Current account balance	-4.8	-6.9	**-5.7**	-4.3	**-5.8**	-5.1	**-5.6**	-5.0	-4.9
Exports of goods	35.2	35.7	**32.6**	34.5	**33.8**	39.3	**36.8**	40.3	40.8
Imports of goods	-47.1	-47.9	**-43.5**	-45.7	**-46.5**	-50.4	**-49.4**	-51.0	-51.3
Trade of goods balance	-11.9	-12.2	**-10.9**	-11.2	**-12.7**	-11.2	**-12.6**	-10.7	-10.5
Capital and financial account balance	6.7	10.6	**5.6**	5.2	**6.6**	8.4	**6.6**	6.8	6.3
External debt (percent of GDP) 7/	66.1	65.5	**67.4**	70.9	**64.3**	70.6	**61.4**	68.0	64.8
of which: Private external debt	30.9	30.8	**29.9**	34.1	**28.8**	31.8	**27.3**	30.2	28.5
Gross official reserves (in billions of euro)	11.3	13.4	**13.4**	13.5	**13.7**	15.2	**14.3**	16.1	16.9
(in months of prospective imports)	4.8	6.1	**5.5**	5.2	**5.0**	5.4	**4.7**	5.4	5.2
(percent of short-term debt)	195.3	408.9	**204.0**	412.3	**209.8**	463.6	**217.9**	493.1	516.3
(percent of broad money, M2)	52.2	57.8	**56.8**	57.7	**54.6**	60.3	**53.2**	60.1	58.7
(percent of risk-weighted metric) 8/	111.2	126.2	**122.0**	126.0	**120.7**	129.0	**119.2**	130.3	129.6
Exchange rate (dinar/euro, period average)	118.3	117.9	**…**	117.6	**…**	…	**…**	…	…
REER (annual average change, in percent; + indicates appreciation)	2.8	1.0	**…**	1.5	**…**	…	**…**	…	…
Social indicators									
Per capita GDP (in US$)	7,252	7,392	**7,723**	7,646	**8,442**	8,878	**9,653**	9,629	10,368
Real GDP per capita (percent change)	5.1	4.5	**-1.1**	-0.4	**6.4**	6.4	**4.9**	4.9	4.9
Population (in million)	7.0	7.0	**6.9**	6.9	**6.9**	6.9	**6.9**	6.9	6.8

Sources: Serbian authorities; and IMF staff estimates and projections.
1/ Unemployment rate for working age population (15-64).
2/ Includes employer contributions.
3/ Includes amortization of called guarantees.
4/ Primary fiscal balance adjusted for the automatic effects of the output gap both on revenue and spending as well as one-offs.
5/ Excludes state guarantees on bank loans under the credit guarantee scheme introduced in response to the COVID-19 crisis, estimated at 0.85 percent of GDP as of end-April 2021.
6/ At constant exchange rates.
7/ After CR19/369, domestic securities held by non-residents are included in external debt. Historical data were updated since 2015.
8/ The risk-weighted metric is IMF's ARA metric for the fixed exchange rate. Serbia was reclassified as stabilized exchange rate regime in 2019.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SERBIA

June 3, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION AND REQUEST FOR A 30-MONTH POLICY COORDINATION INSTRUMENT

EXECUTIVE SUMMARY

Recent economic developments. Supported by a large policy package, Serbia's economy rebounded quickly from the initial COVID-19 shock, recording a 1 percent contraction of real GDP in 2020. Job losses have mostly been contained to the informal sector, thanks to policy measures aimed at preserving formal employment. A supplementary budget for 2021 was adopted in April boosting capital expenditure and extending policy support to households and corporates, against the background of third and fourth waves of infections and related containment measures, as well as a weaker-than-expected economic recovery in key trading partners. Inflation remains low. After rising again in late February, infections tapered, helped by new containment measures and the rapid vaccine rollout.

Fiscal policy. The latest round of fiscal support and the extension of the loan guarantee scheme will help underpin the recovery, as well as prevent bankruptcies and protect employment. Any further support should be targeted more directly at the most vulnerable households and firms and sectors most affected by the pandemic. Once the recovery is fully under way, it will be important to rebuild policy buffers and anchor them by a new fiscal rule.

Monetary and financial sector policies. Monetary policy should remain accommodative and financial sector policies supportive. While the banking system remains stable, liquid, and well capitalized, any buildup of risks should be closely monitored. Developing domestic capital markets and further encouraging dinarization would enhance financial stability and support medium-term growth.

Structural reforms. Advancing reforms of Serbia's large and inefficient state-owned enterprises (SOEs) remains critical. Improving the business environment would help attract foreign as well as domestic investment. Promoting green growth and enhancing the social safety net would support the recovery and ensure a more sustainable development.

Risks. New waves of infections in Serbia or its main trading partners present a downside risk, while a stronger-than-expected impact of the fast vaccine rollout could provide an upside risk. Tighter global financing conditions could push up the cost of borrowing and slow down the recovery.

Program discussions. The requested new PCI aims at supporting the ongoing recovery while maintaining macroeconomic and financial stability, including by anchoring the medium-term fiscal policy framework to a fiscal rule, enhancing monitoring of fiscal risks, increasing transparency and accountability of state aid, and advancing SOEs reforms.

Approved By
Jörg Decressin (EUR)
Maria Gonzalez (SPR)

Discussions were held remotely during April 12-23, 2021. The staff team comprised Jan Kees Martijn (head), Pietro Dallari, Marina Marinkov (all EUR), Sandra Lizarazo Ruiz (FAD), Marco Rodriguez Waldo (SPR), Priscilla Toffano (MCM), Sebastian Sosa (resident representative), Desanka Obradović and Marko Paunović (local economists). Vuk Djoković (OED) attended some discussions. HQ support was provided by Piotr Kopyrski and Aniko Madaraszova (both EUR).

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