

SERBIA:

Recent Successes and Remaining Challenges

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16th International Conference of the Belgrade
Stock Exchange

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Outline

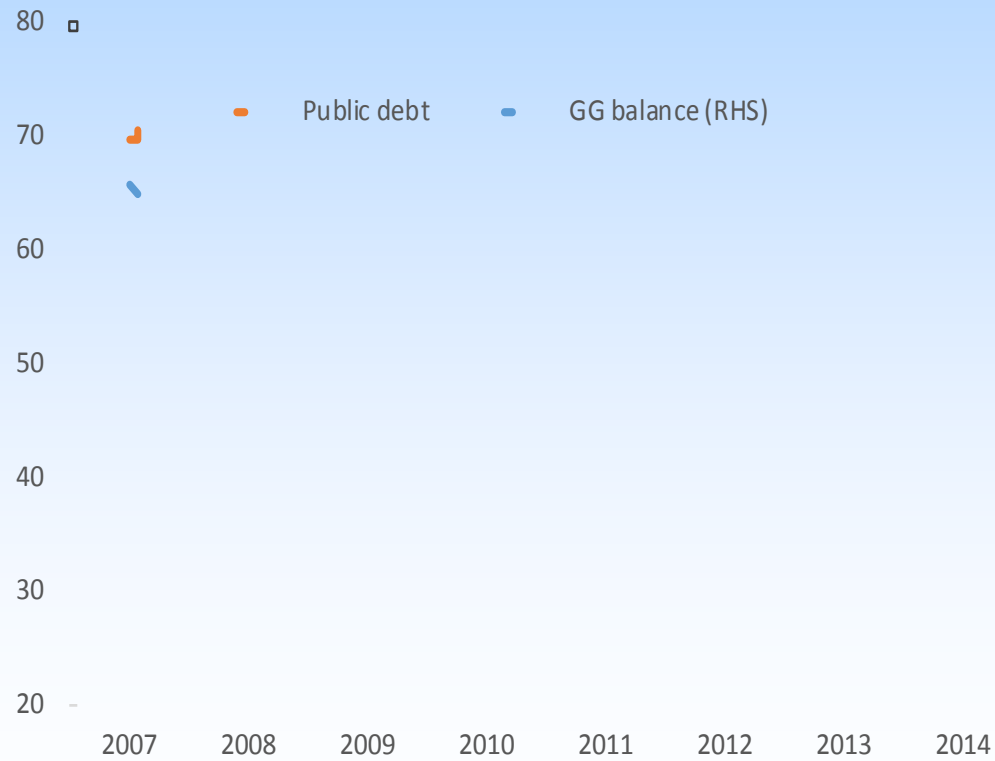
1. Serbia's IMF program: Initial context

2. Main Objectives and Results

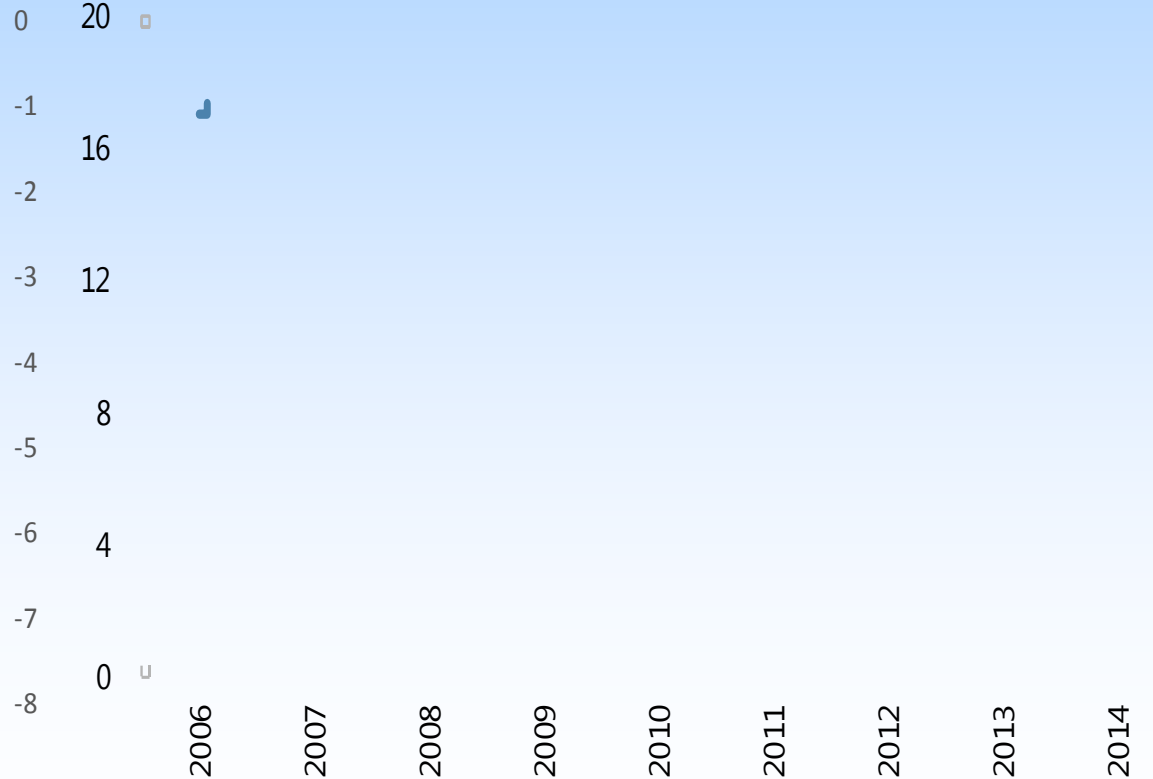
3. Key challenges ahead

Growing fiscal imbalances...

General Government Balance and Debt
(Percent of GDP)

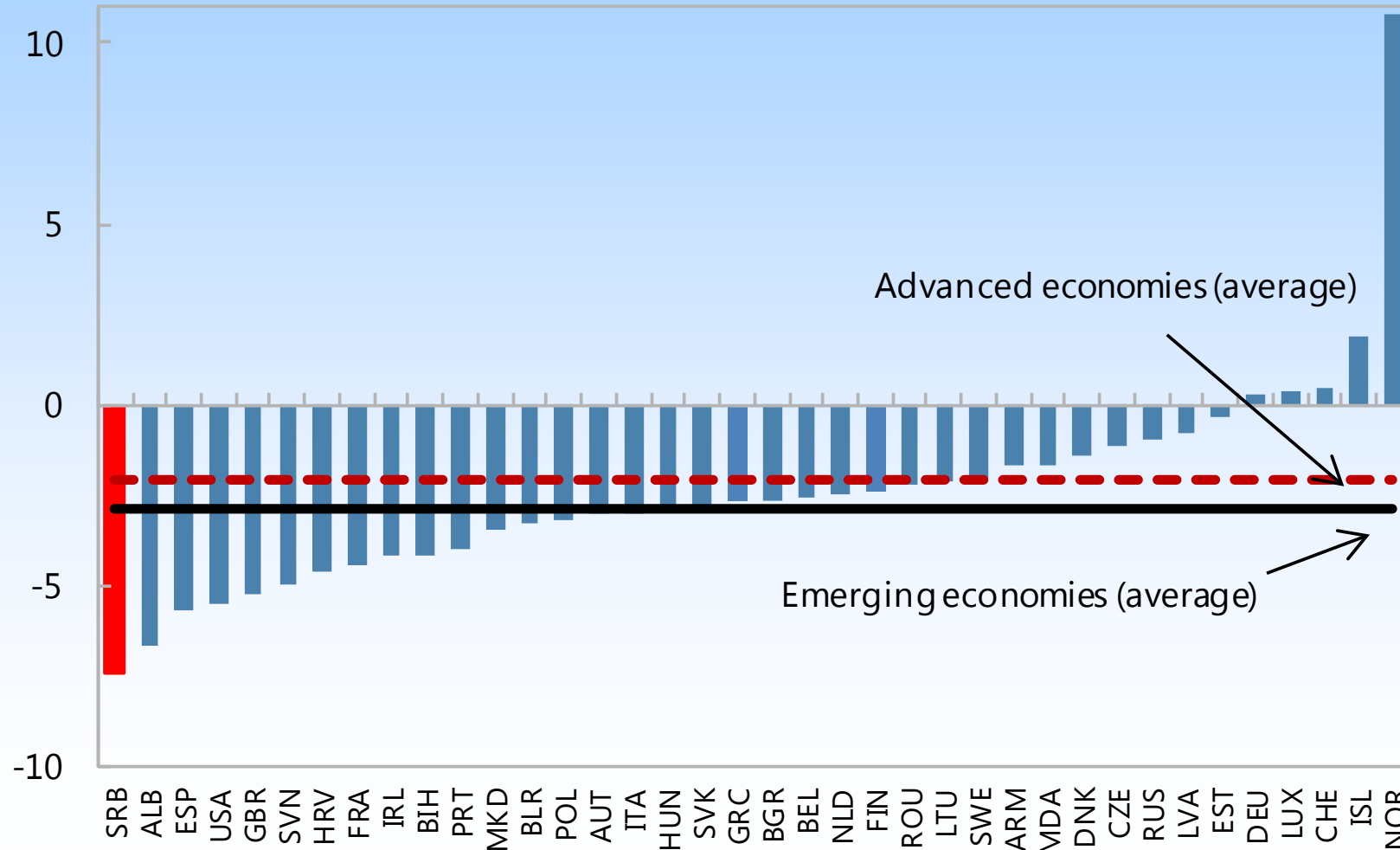


General Government Gross Financing Needs
(Percent of GDP)

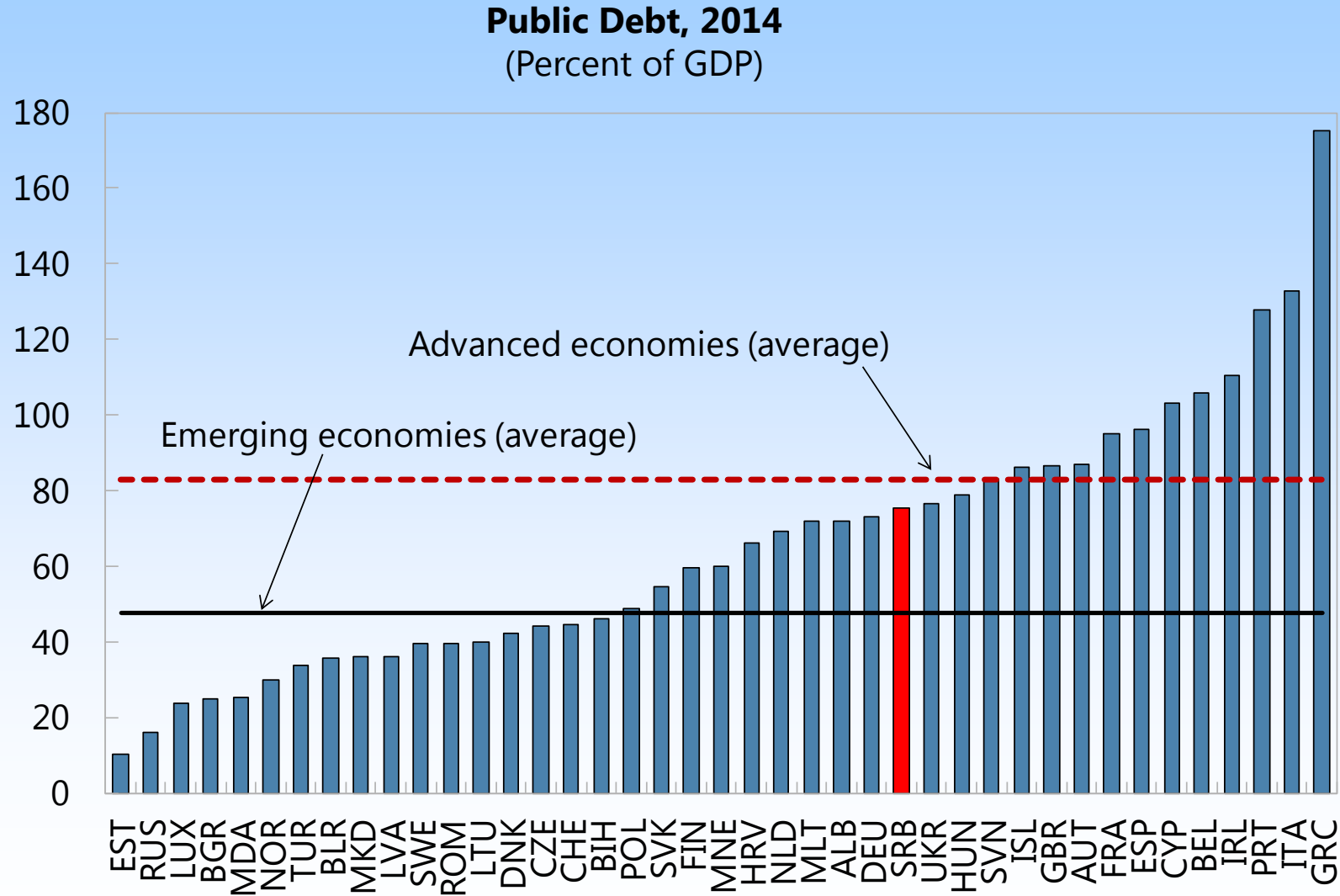


Highest fiscal deficit in Europe...

General Government Balance, 2014
(Percent of GDP)



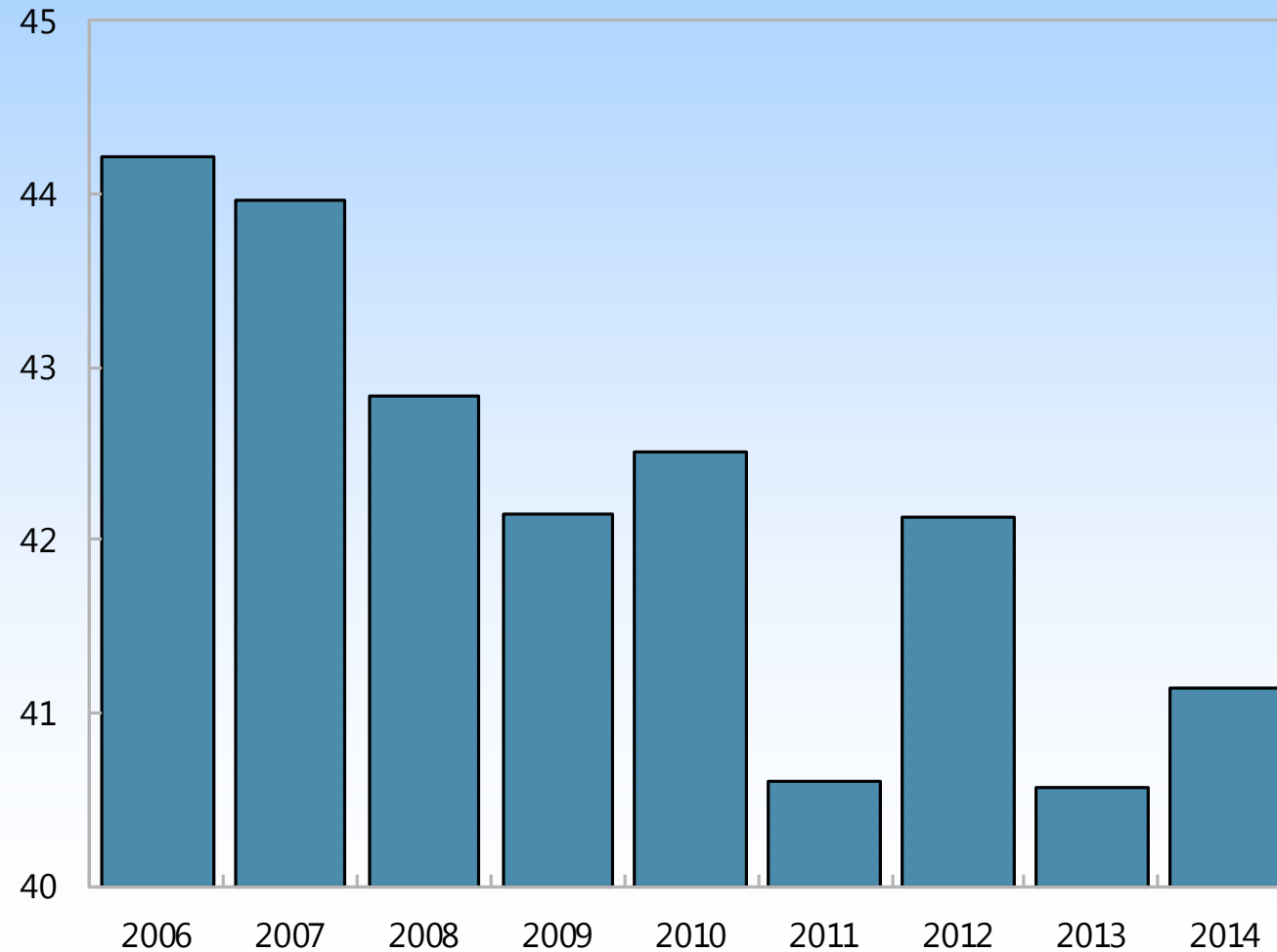
...public debt among highest across EMs



Source: WEO

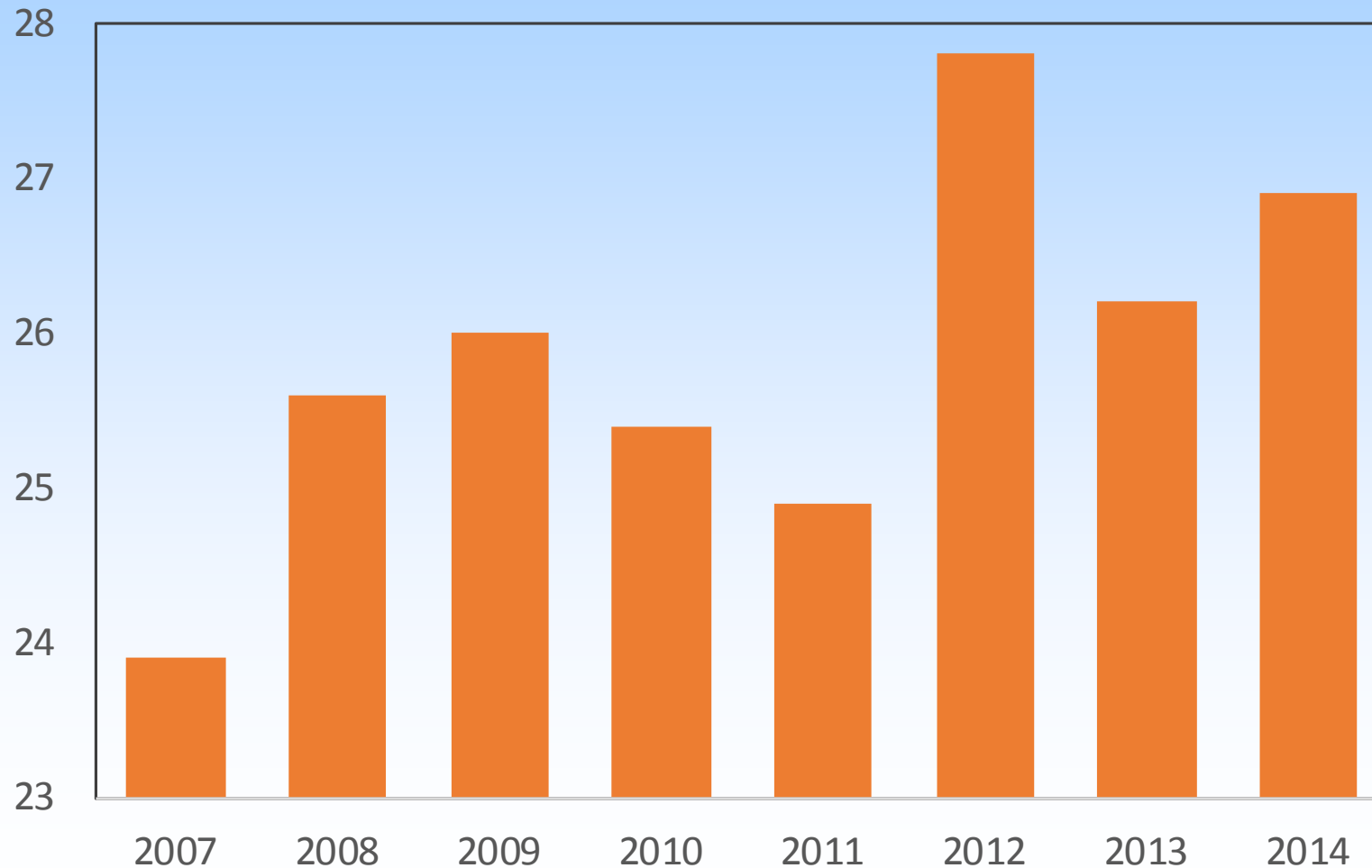
...reflecting declining public revenues

General Government Revenue
(Percent of GDP)



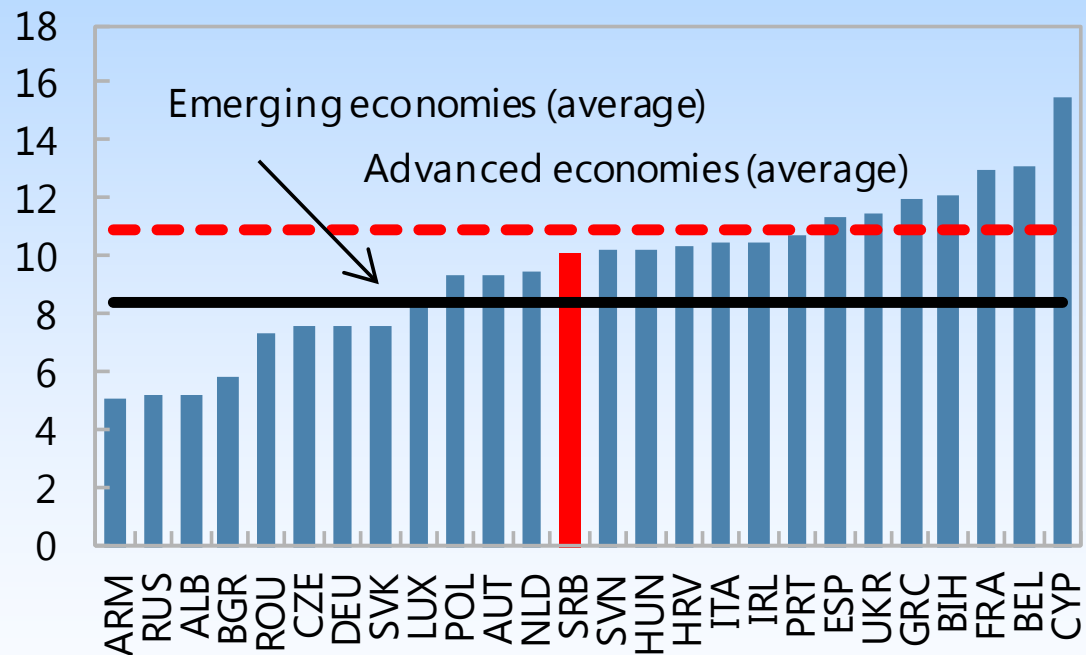
...and high (and rising) entitlement spending

Public Wages, Pensions and Subsidies
(Percent of GDP)



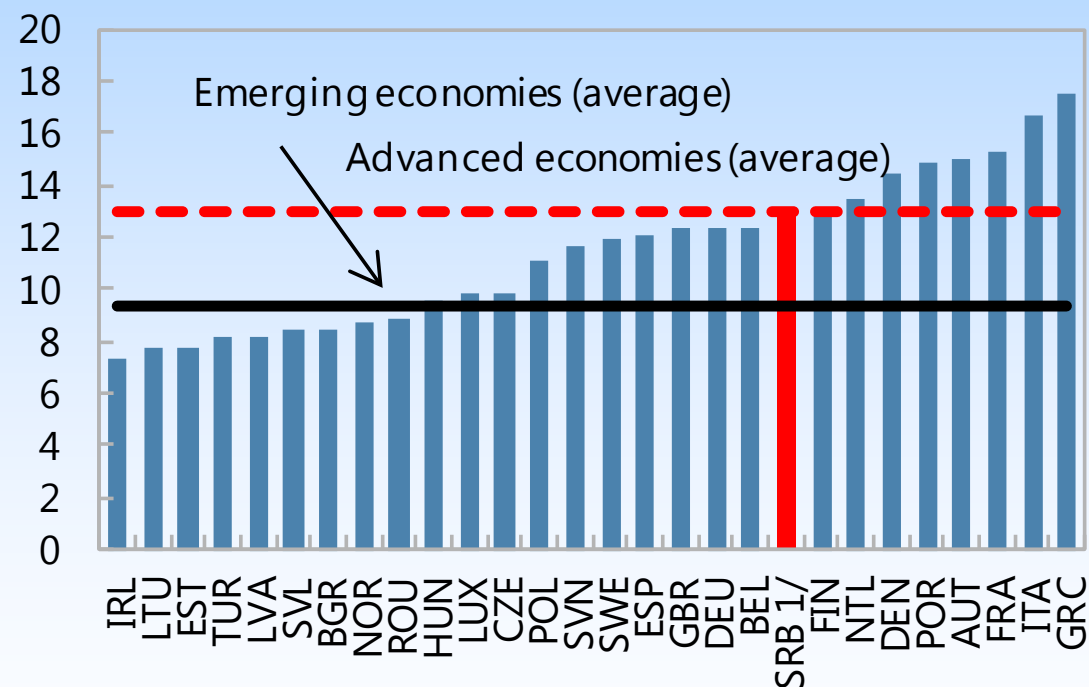
...particularly public wages and pensions

Government Wage Bill, 2013
(Percent of GDP)



Source: WEO

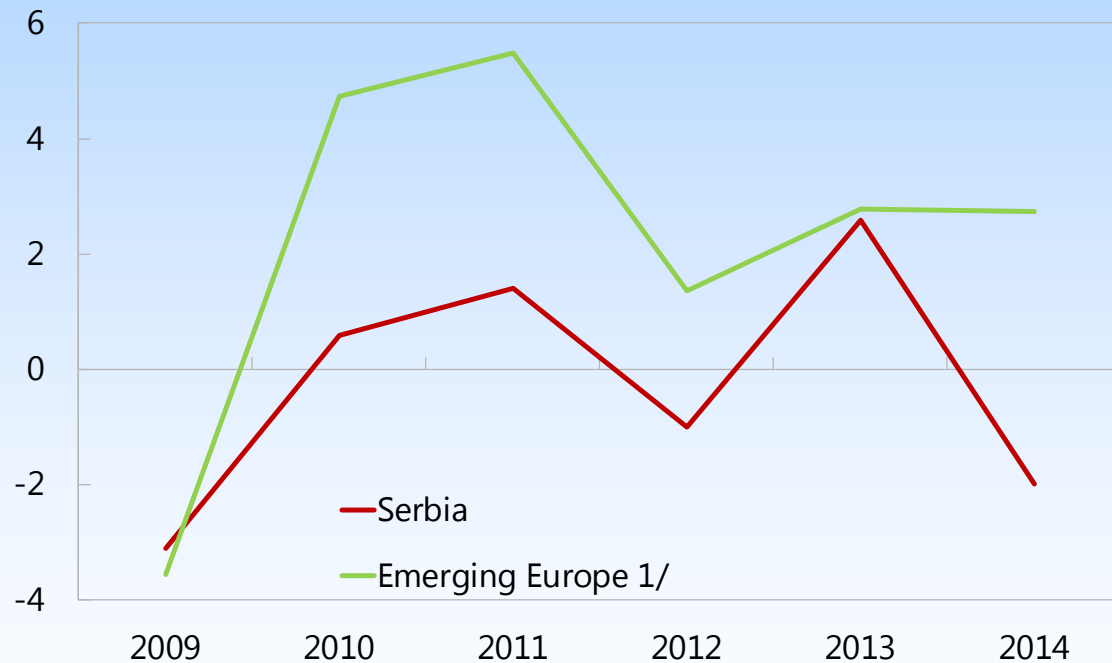
Pension Expenditure, 2013
(Percent of GDP)



Sources: Eurostat, and the Ministry of Finance .

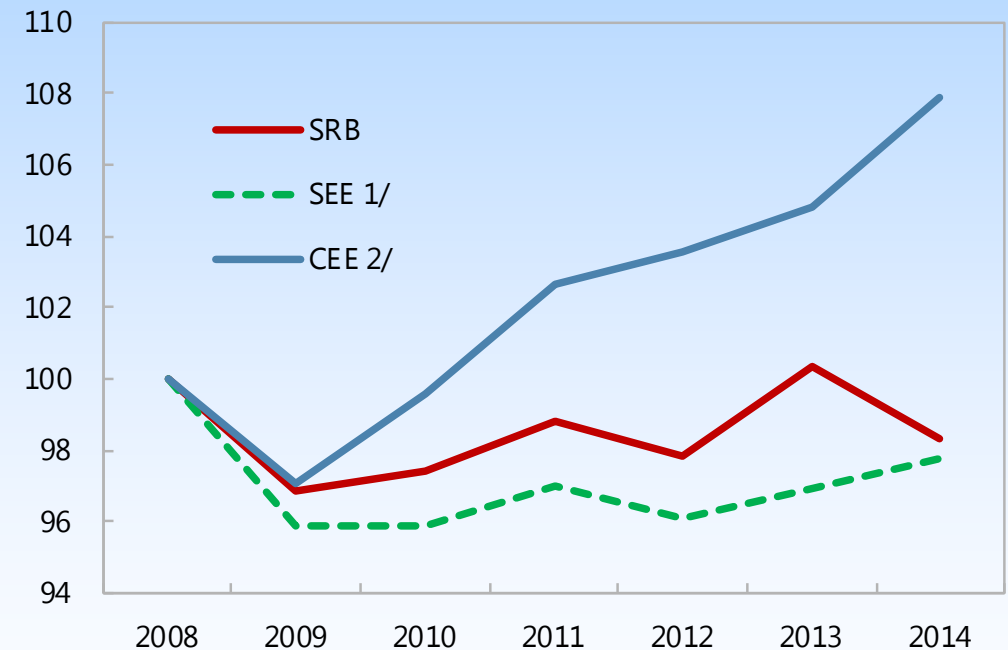
Root causes of fiscal problems include stagnant growth...

Real GDP Growth
(Percent change)



Sources: SORS; WEO; Direction of Trade Database; and IMF staff estimates.
1/ ALB, BIH, BFR, HRV, HUN, UVK, LTU, MKD, MNE, POL, ROU, SRB, and TUR.

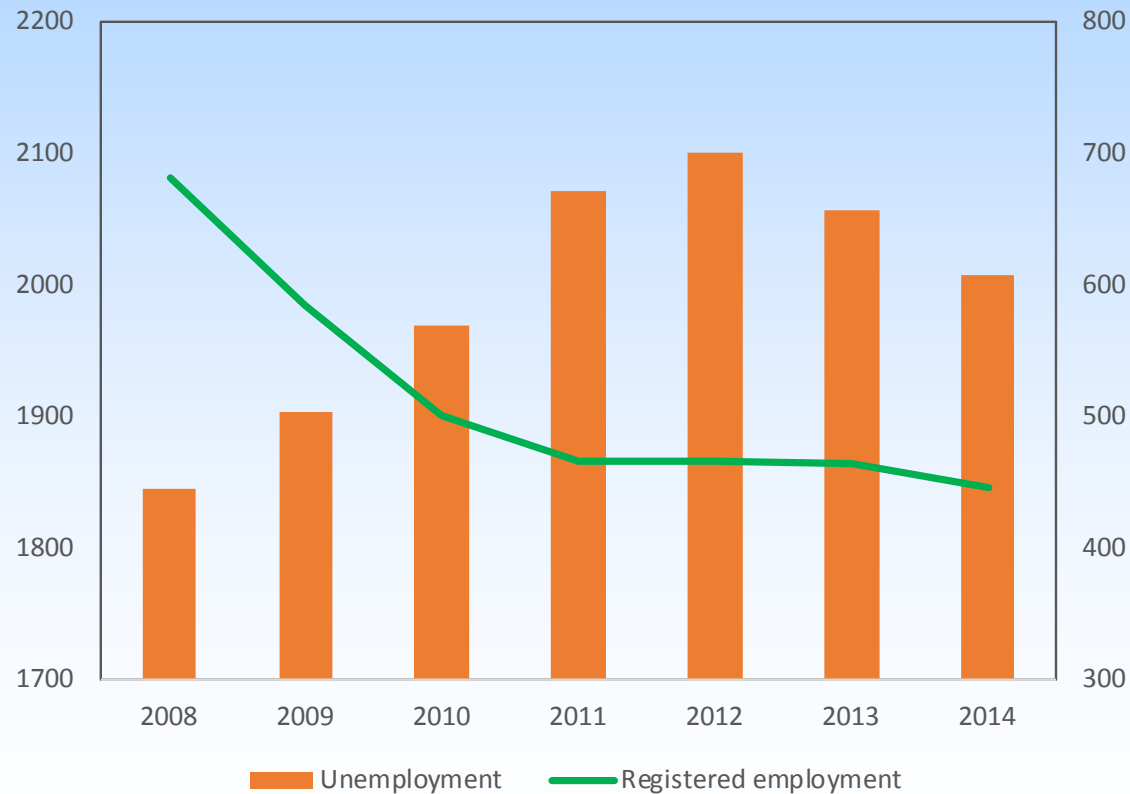
Real GDP
(Index, 2008=100)



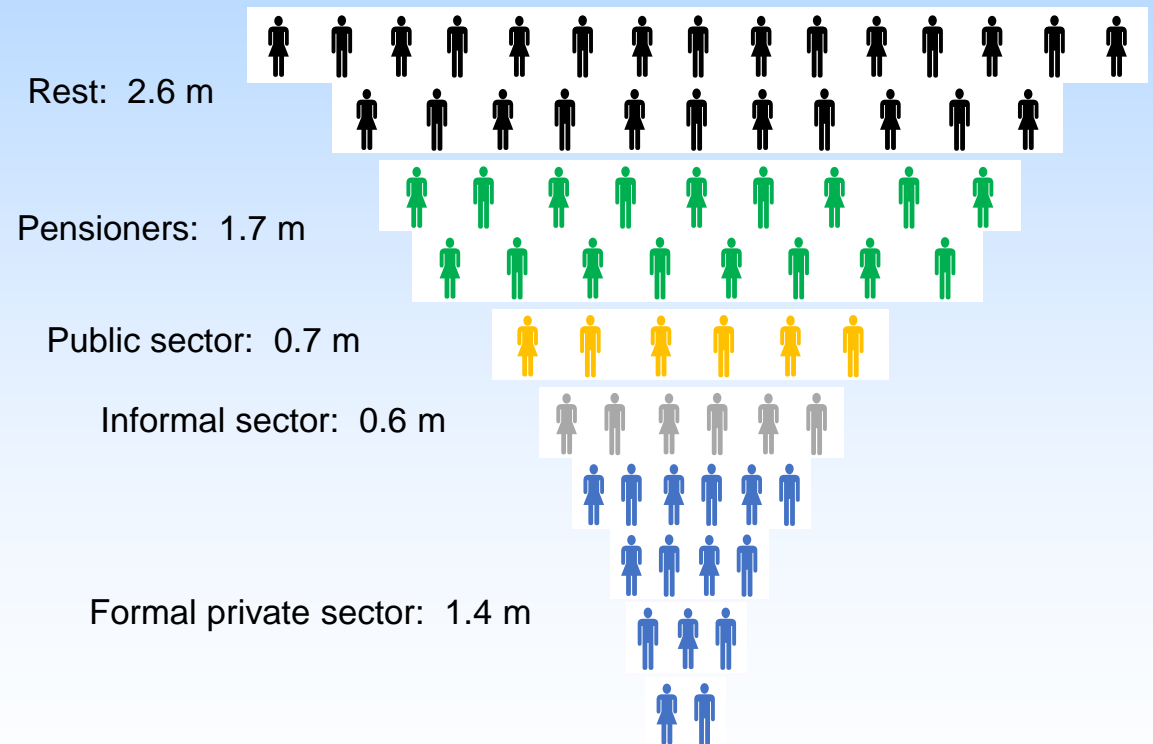
Source: Serbian Statistical Office (SORS); NBS; WEO; and IMF staff estimates.
1/ SEE includes: ALB, BIH, HRV, UVK, MKD, and MNE.
2/ CEE includes: BGR, CZE, HUN, POL, ROU, SVK, and SVN.

...weak labor market performance

Formal Employment and Unemployment
(In thousand)

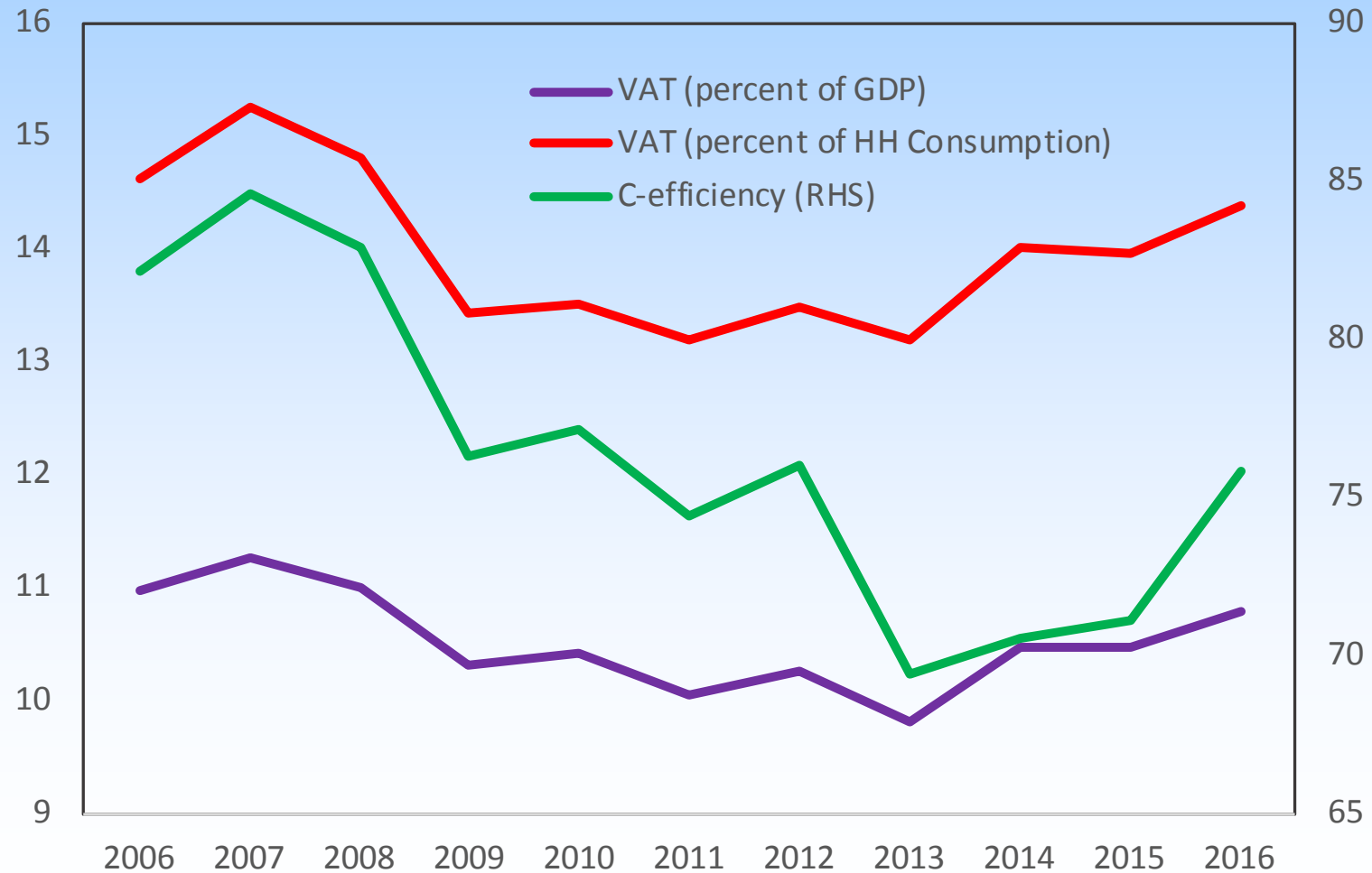


Population, 2017
(In millions)



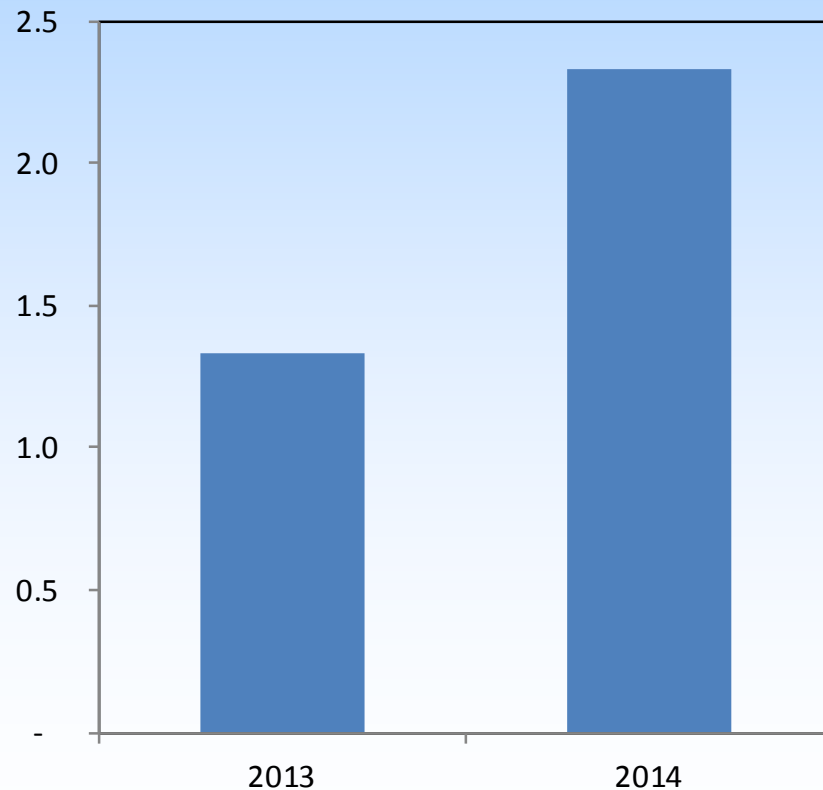
...low revenue collection efficiency

Value Added Tax (VAT) Collection
(Percent)



...and state-owned enterprises' inefficiencies

SOEs: Total subsidies, net lending and payments of called guarantees
(Percent of GDP)

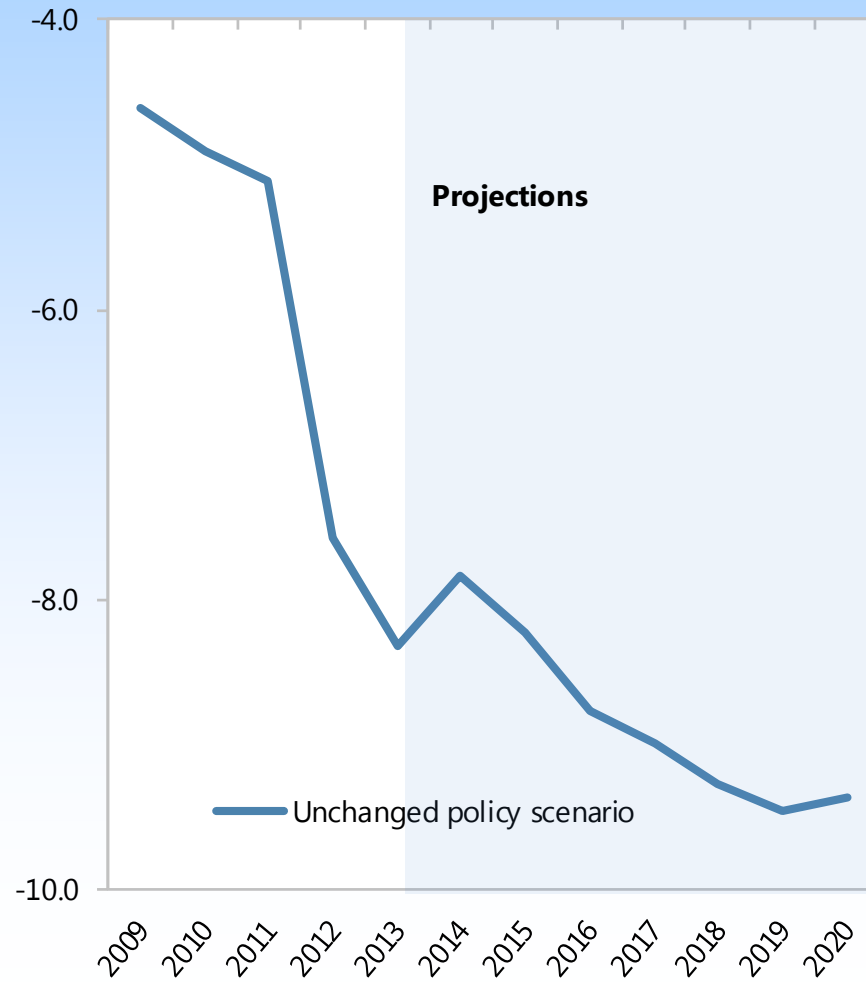


Sources: Ministry of Finance, and IMF staff calculations.

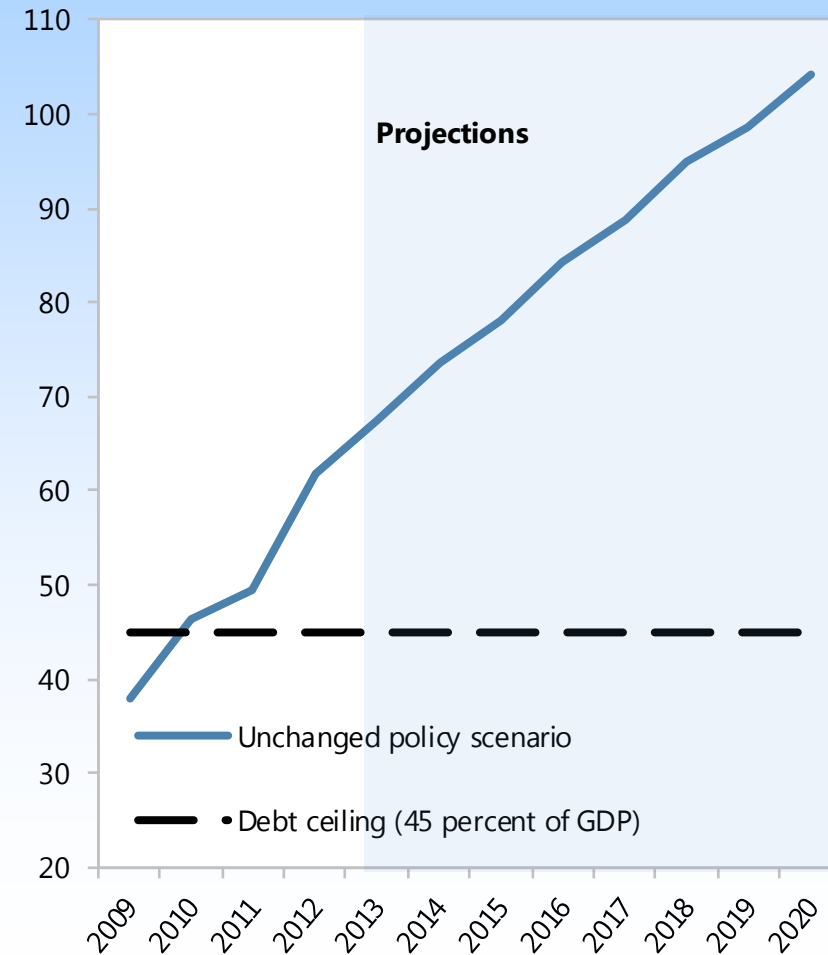
- Budget subsidies
- State guarantees for loans
- Arrears to utility companies
- Tax and SS contribution arrears

Existing policies were unsustainable

Fiscal Deficit, 2009-2020
(Percent of GDP)



Public Debt, 2009-2020
(Percent of GDP)



Outline

1. Serbia's IMF program: Initial context

2. Serbia's IMF program: Main Objectives and Results

3. Key challenges ahead

IMF-supported program: Key objectives

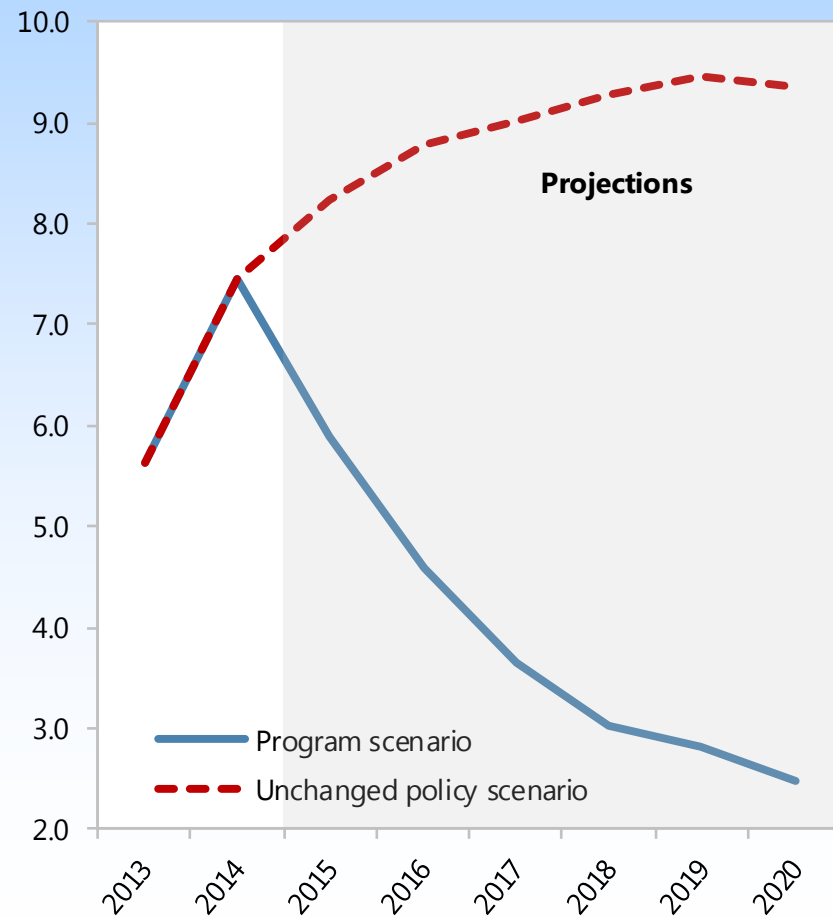
- 3-Year Stand-By Arrangement (SBA) approved on February 2015
 - Address macroeconomic imbalances and vulnerabilities, most notably by ensuring fiscal sustainability
 - Bolster resilience of the financial sector and improve its intermediation function necessary to support economic growth
 - Improve competitiveness and reduce key growth bottlenecks through vigorous implementation of comprehensive structural and SOE reforms
- Goals compatible with EU accession process, started in January 2014

Fiscal policy: Restoring sustainability

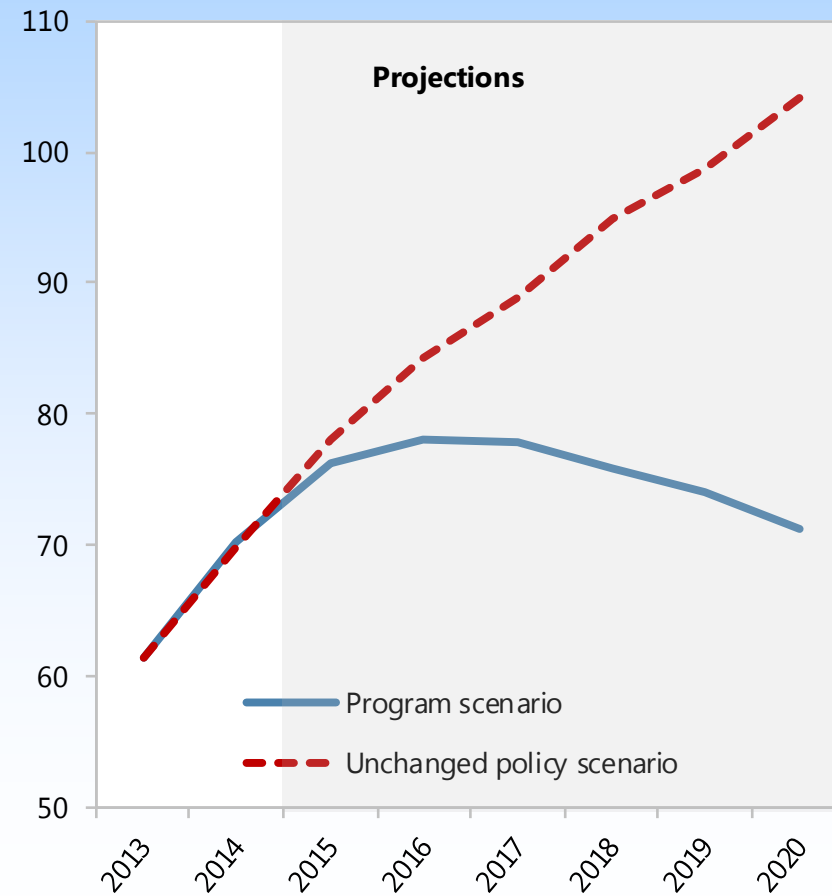
- Reverse rise of public debt and put it on a firm downward trajectory
- Structural primary adjustment of 4 percent of GDP
- Balance between credibility and growth impact
 - 50 percent of the adjustment in 1st year; protect productive spending
- Tackle unsustainable mandatory spending
 - Public wage bill reduction
 - A comprehensive public wage system reform
 - Rightsizing public employment (attrition and targeted separation)
 - Pension bill reduction
- Reduce state aid to SOEs—underpinned by SOEs reforms
- Improve fiscal institutions and PFM reform

Fiscal policy: Restoring sustainability

Fiscal Deficit, 2013-2020
(Percent of GDP)

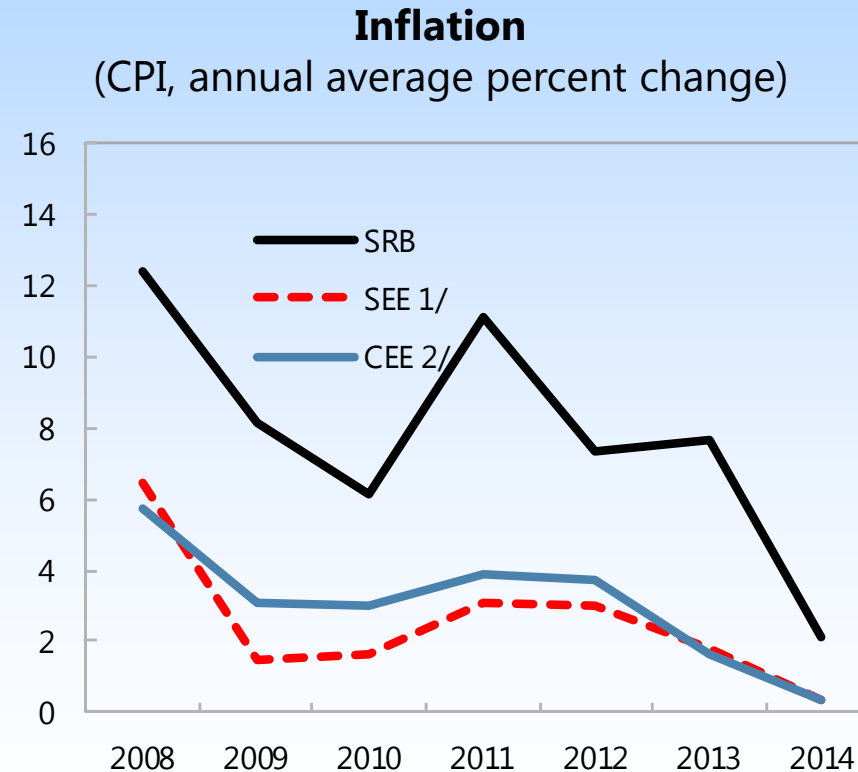


Public Debt, 2013-2020
(Percent of GDP)



Monetary and exchange rate policy: Keeping inflation under control

- Gradual monetary policy easing



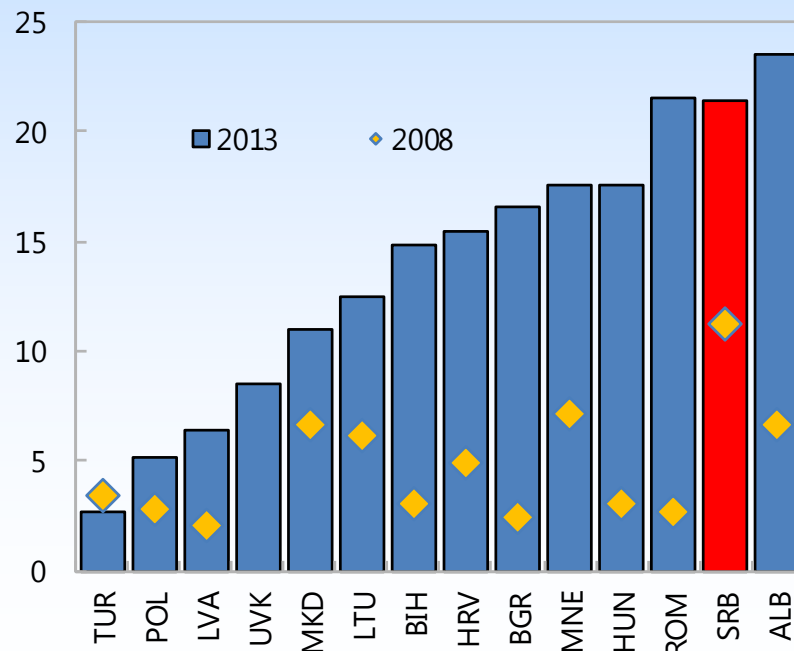
1/ SEE includes: ALB, BIH, HRV, UVK, MKD, and MNE.

2/ CEE includes: BGR, CZE, HUN, POL, ROU, SVK, and SVN.

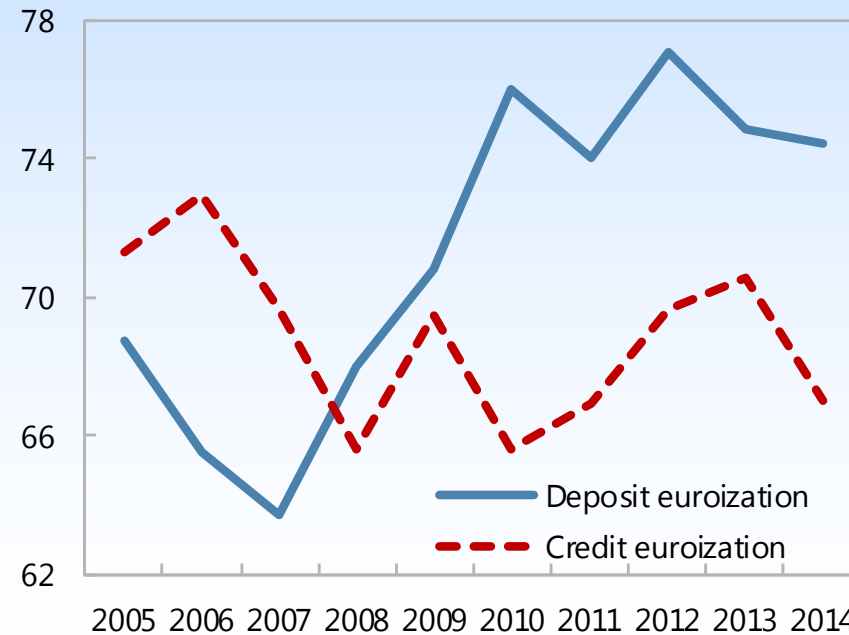
Financial sector: Preserving stability and reviving credit growth

- Strengthen the bank resolution framework
- Design and implement a comprehensive strategy for dealing with NPLs
- Increase dinarization to strengthen the monetary transmission mechanism

Non-Performing Loans
(Percent of total loans)



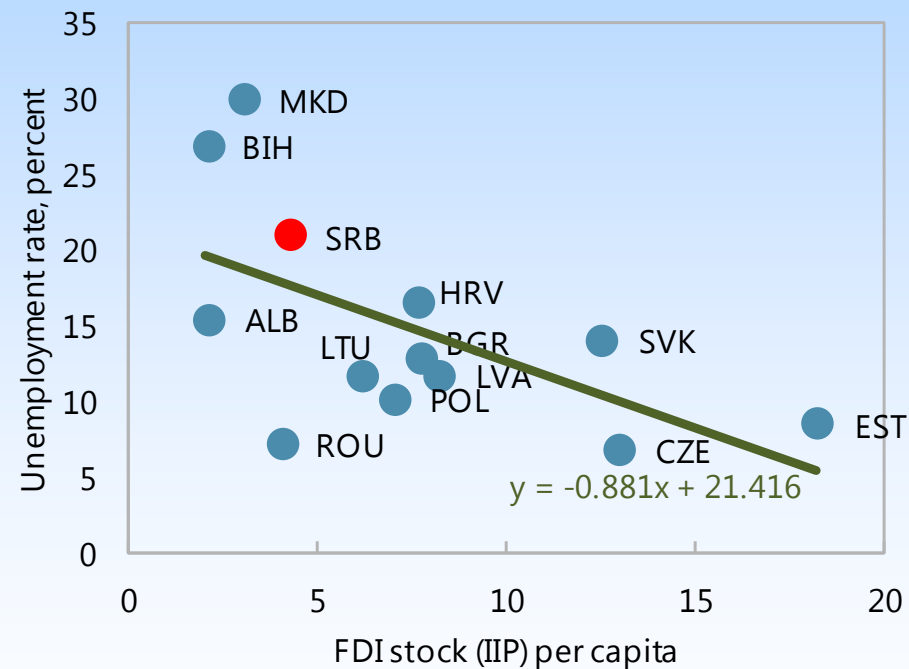
Deposit and Credit Euroization
(Percent of total)



Structural reforms: Strengthening competitiveness, employment and growth

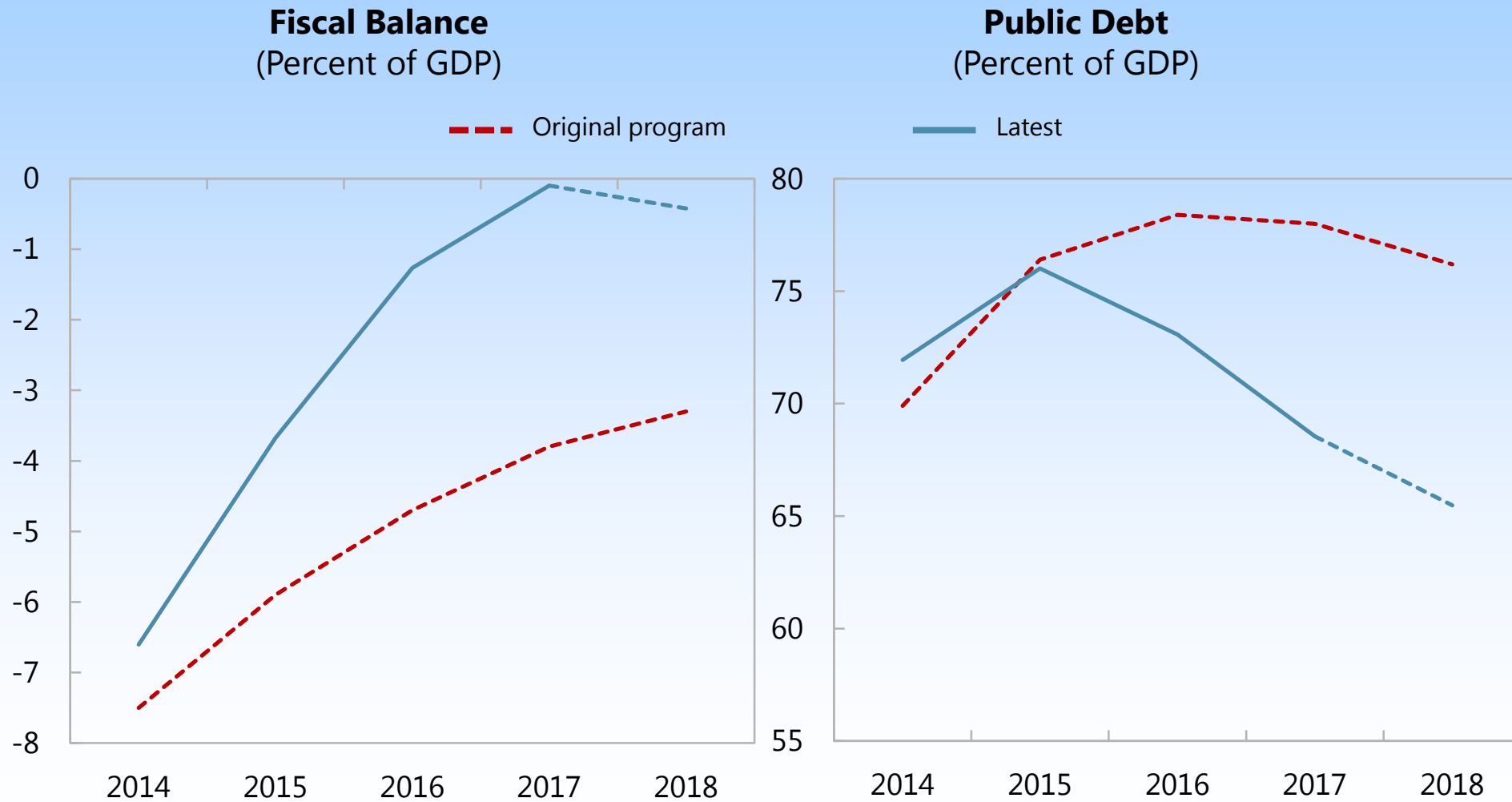
- Boost employment
- Resolve and reform SOEs
- Improve business climate

Unemployment rates vs. FDI, 2013



Sources: IFS; and WEO.

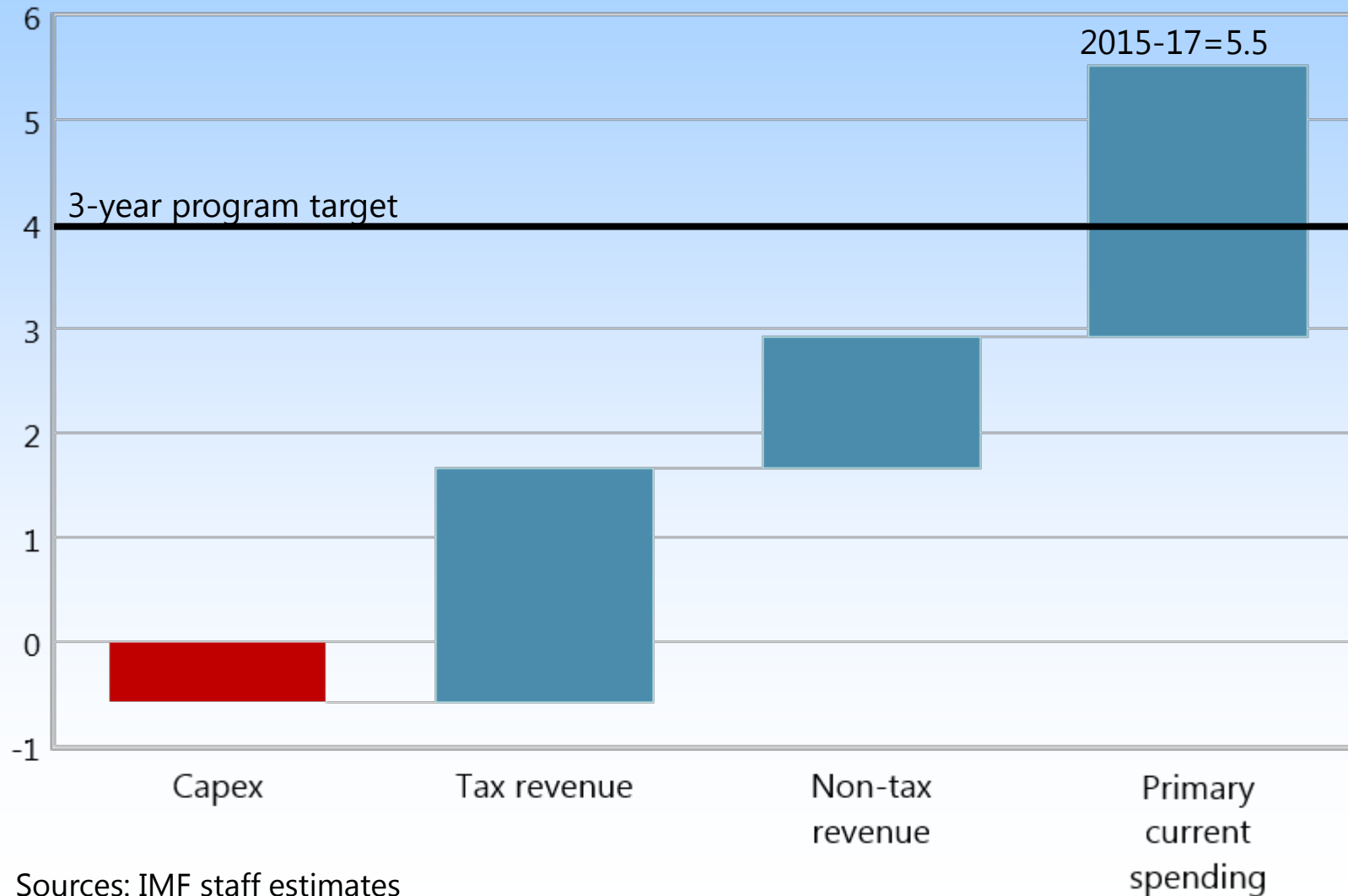
Substantial overperformance of fiscal targets



Substantial overperformance of fiscal targets

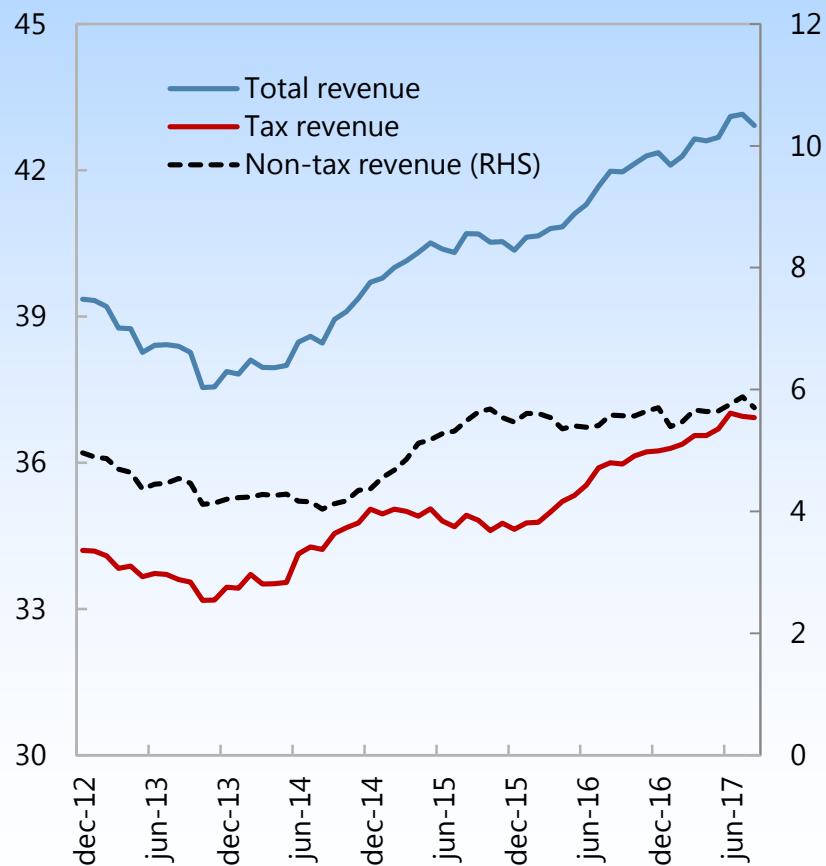
Structural Adjustment under SBA, 2015-17

(Percent of GDP)

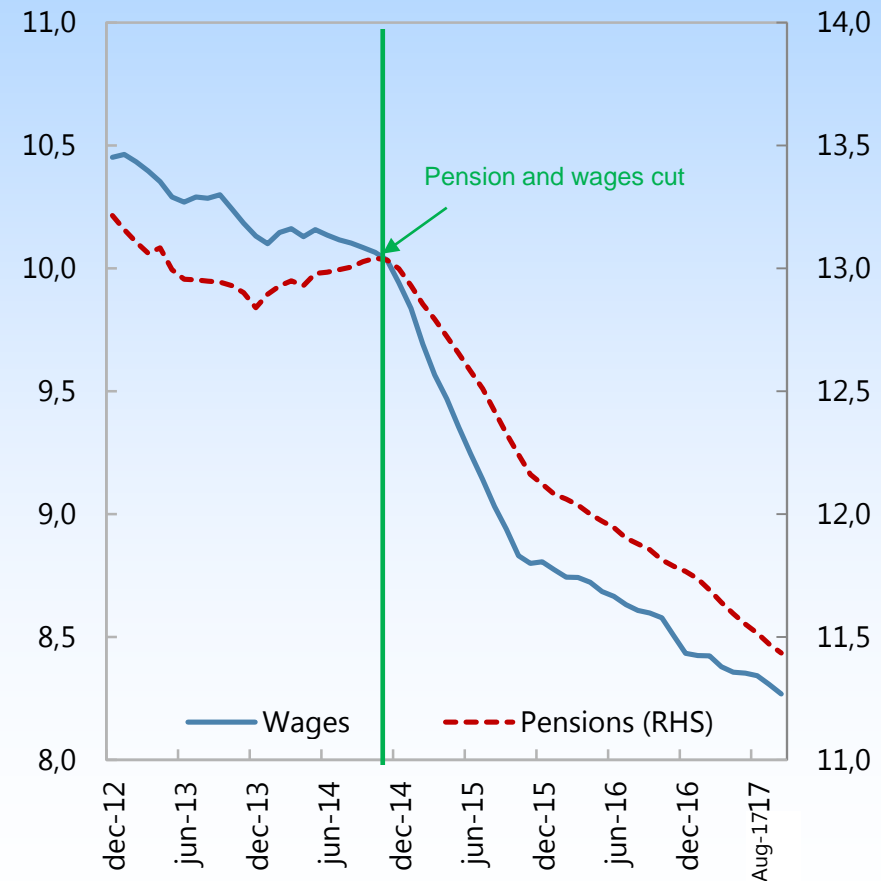


Revenues on the rise while wages and pensions falling as a share of GDP

Public Revenue
(12-month sum, percent of GDP)

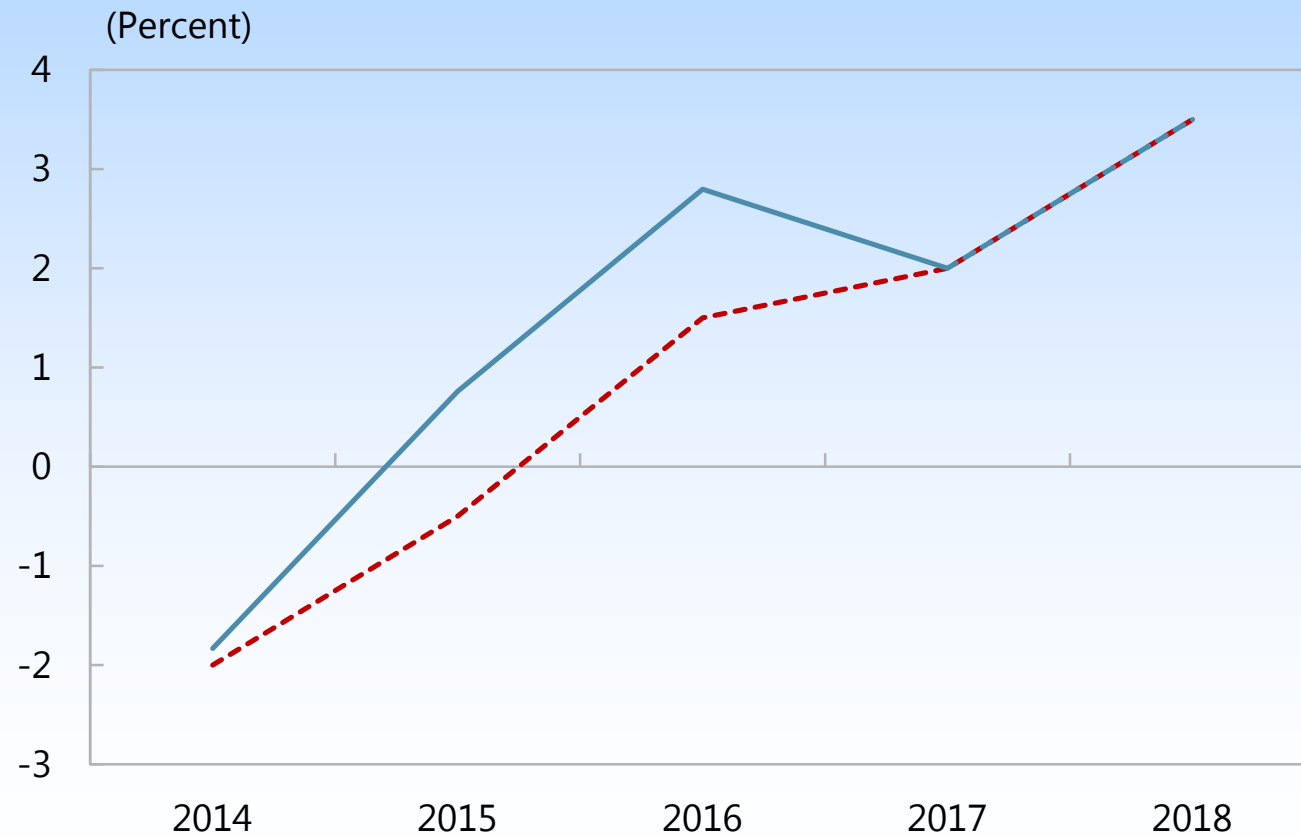


Wages and Pensions
(12-month sum, percent of GDP)

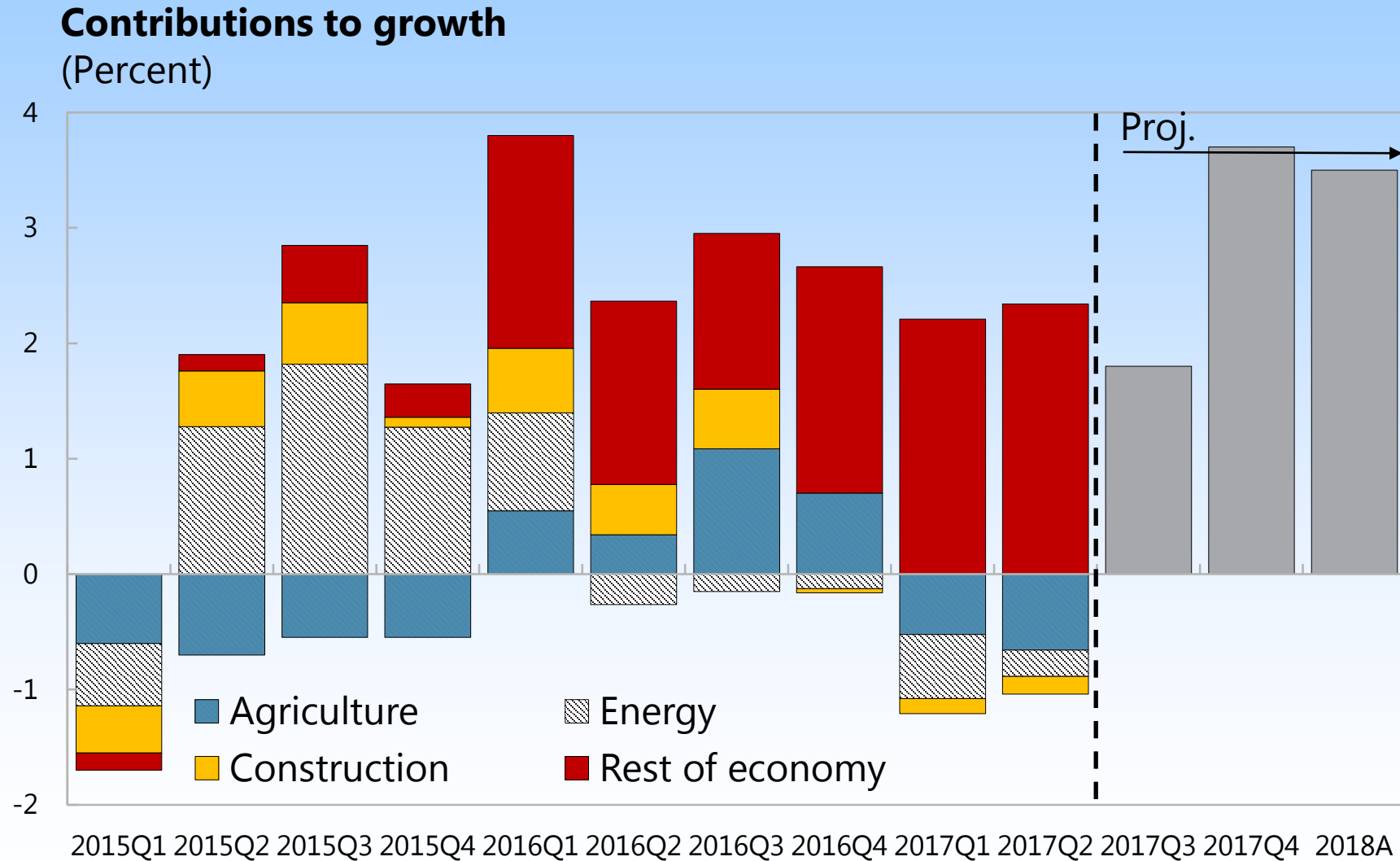


Successful consolidation has not hampered growth

GDP Growth: Original Program vs. Actual

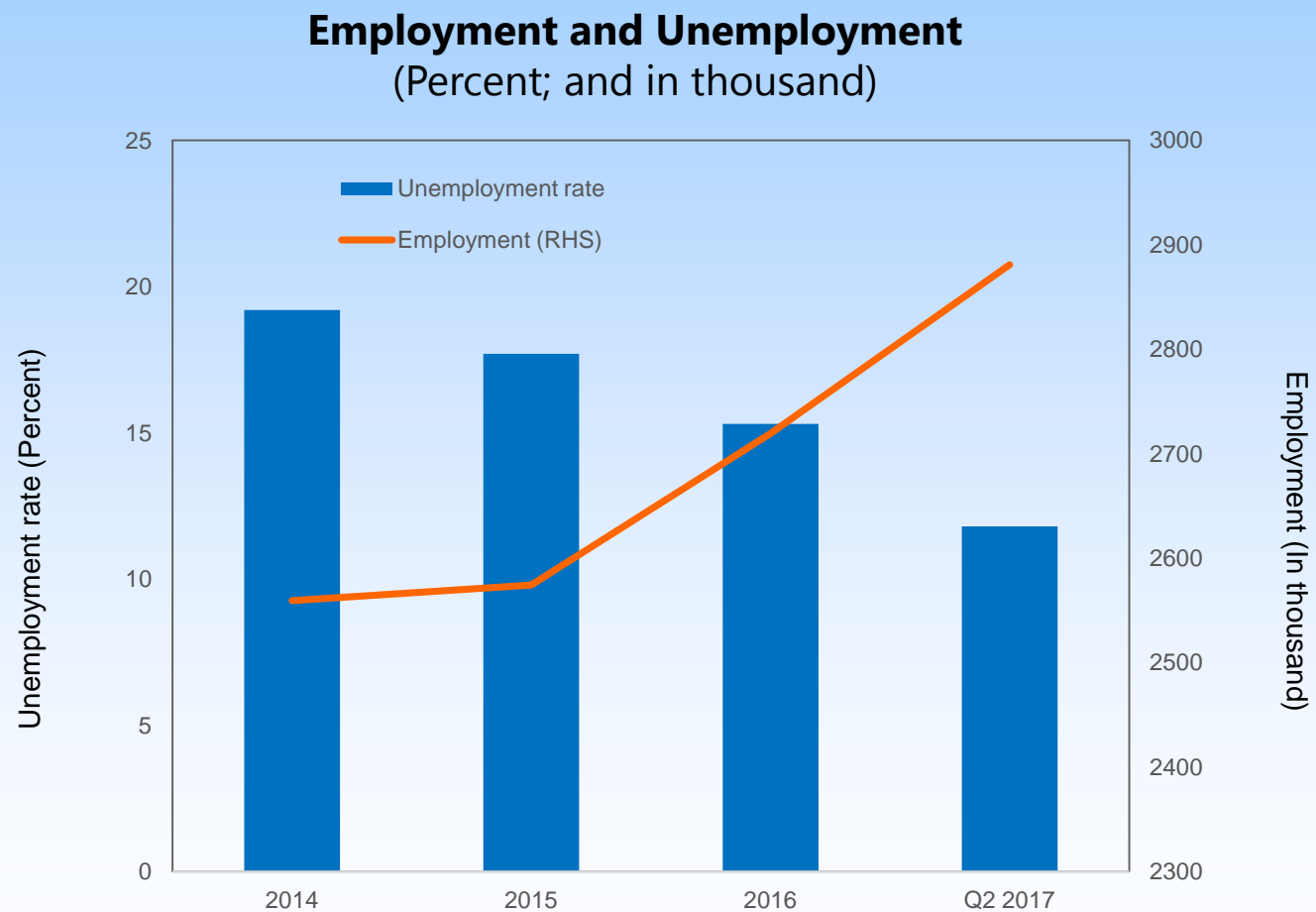


Recent slowdown reflects temporary supply-side factors



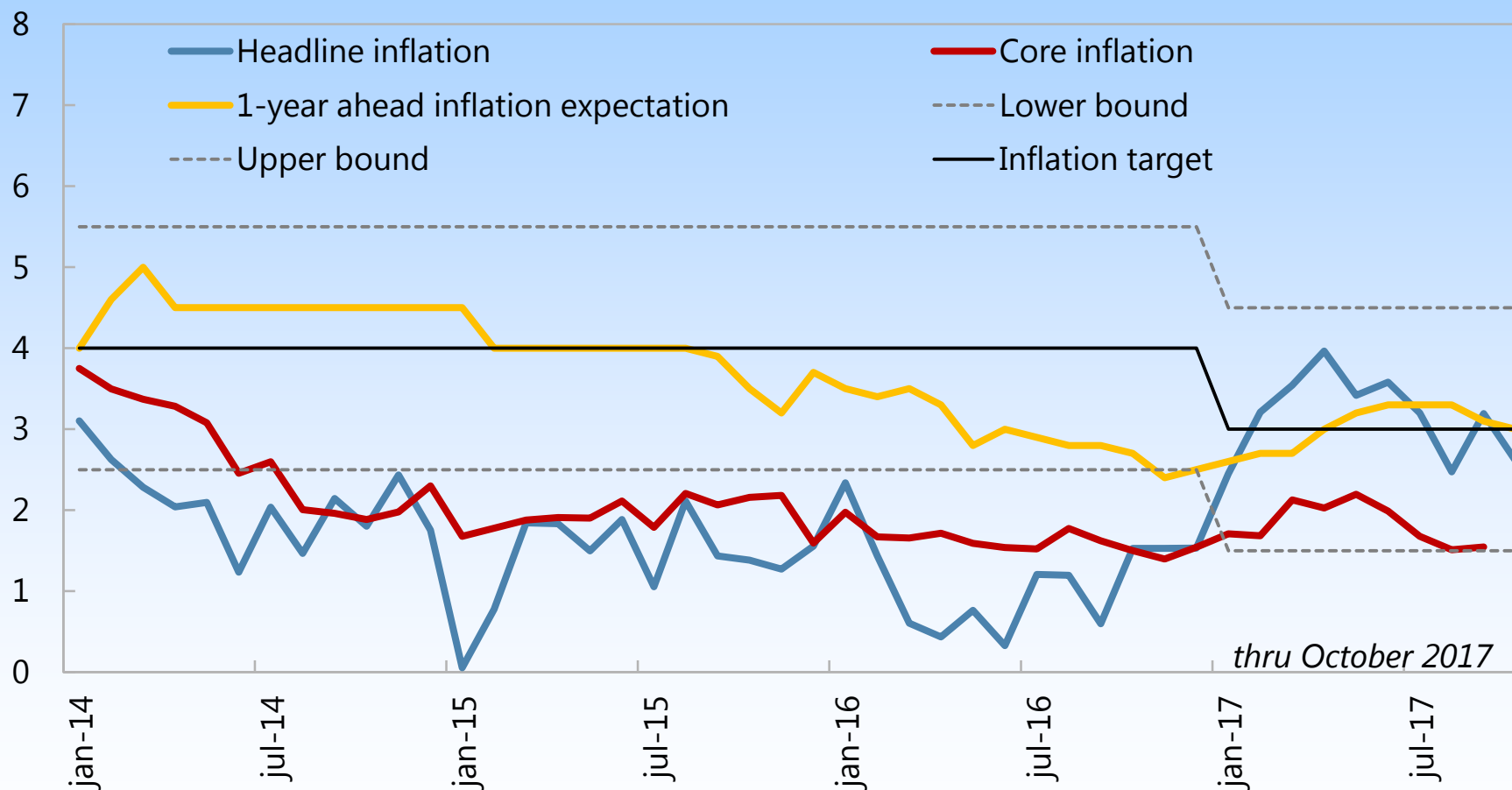
Sources: SORS; and IMF staff estimates

Labor market conditions are improving



Inflation has remained low, with anchored expectations

Serbia: Inflation
(Percent)

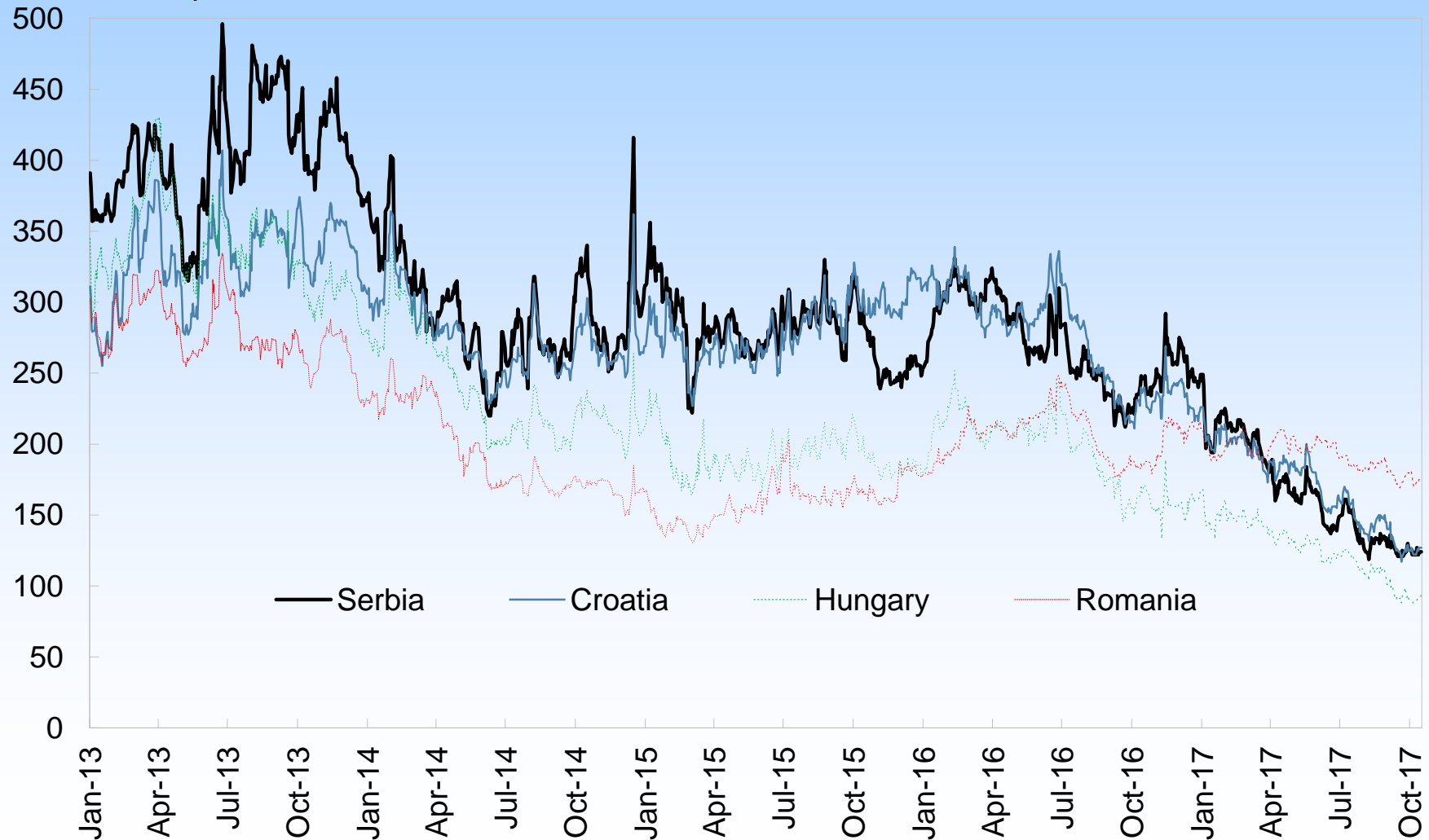


Sources: Bloomberg; National Bank of Serbia (NBS); and IMF staff estimates.

Yields on sovereign bonds have been declining

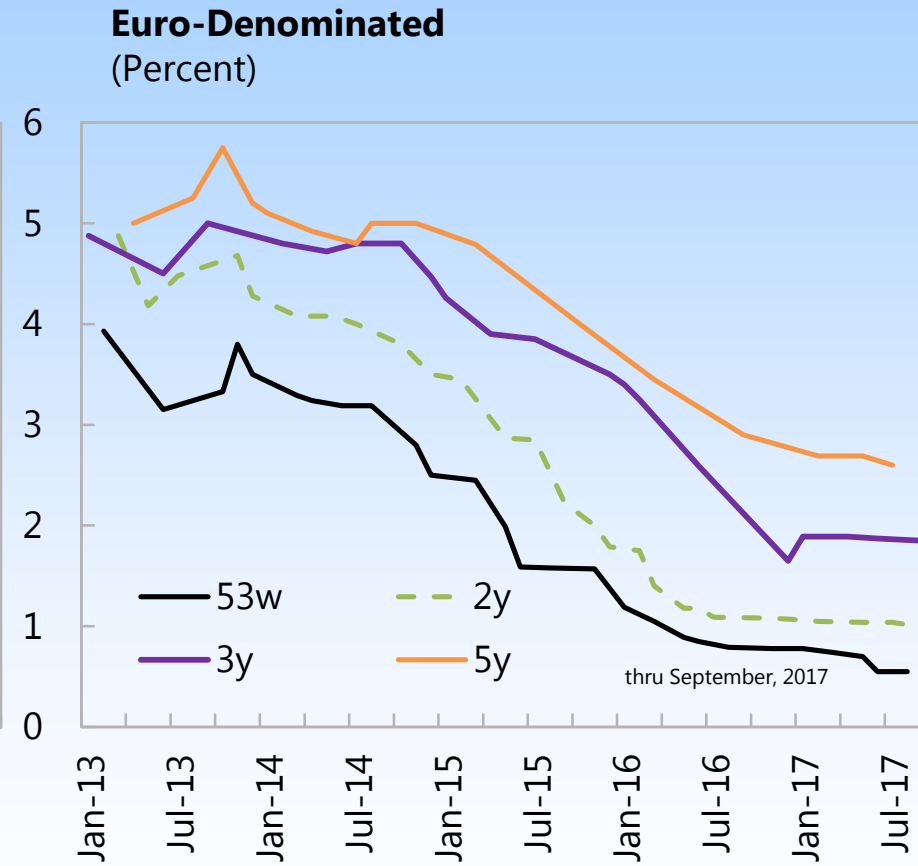
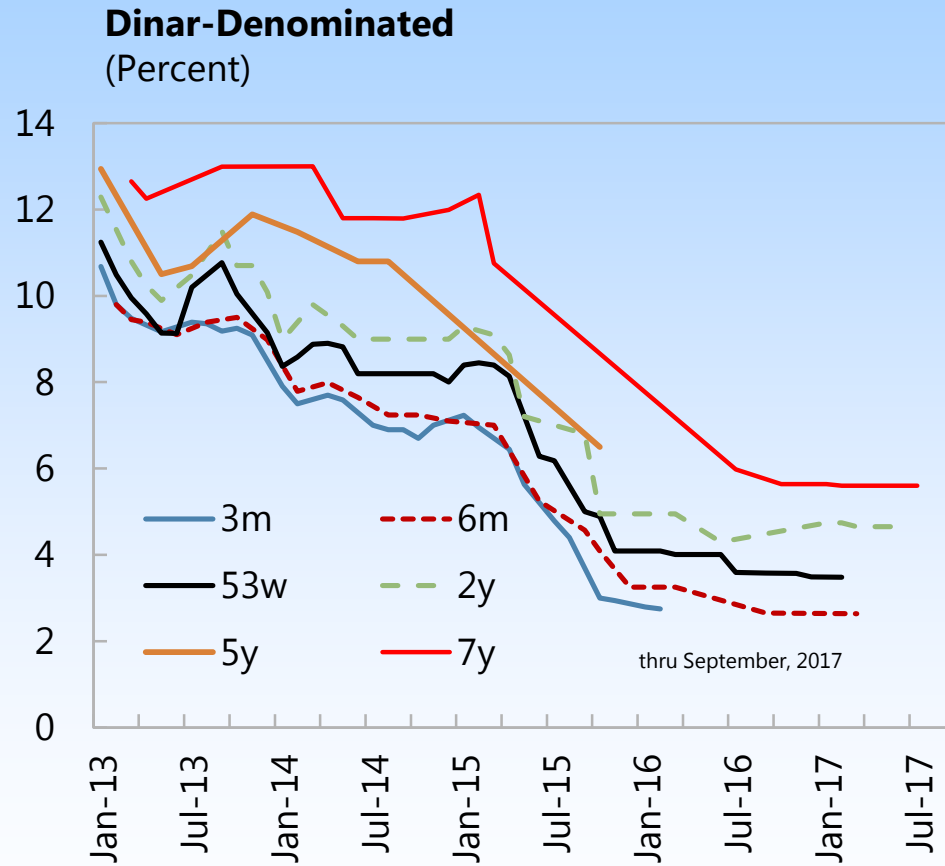
Sovereign Risk -EMBI spreads

(Basis points)



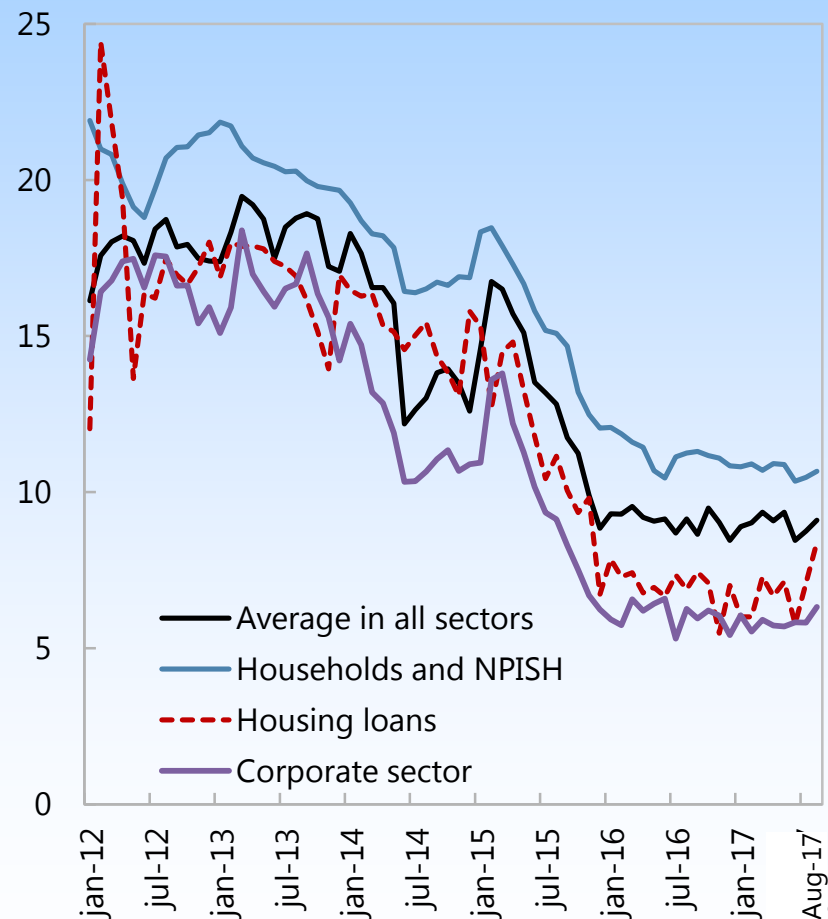
...as well as yields on domestic securities

Yields on Local Securities (Percent)

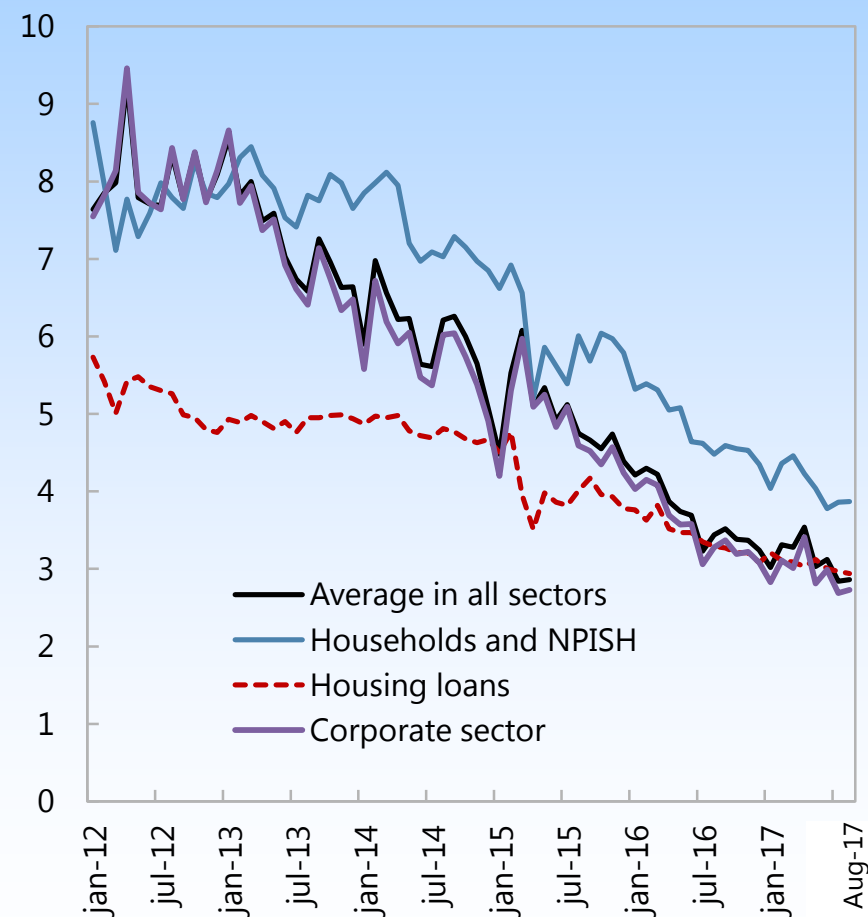


...and bank lending interest rates

Bank lending rates: RSD
(Percent)

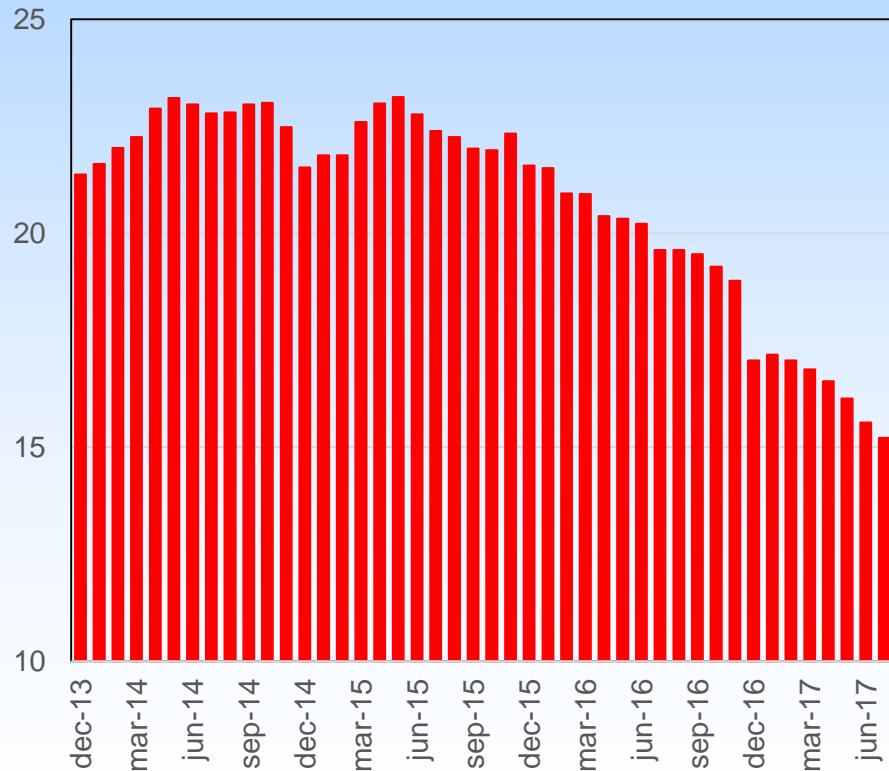


Bank lending rates: FX and FX-linked
(Percent)

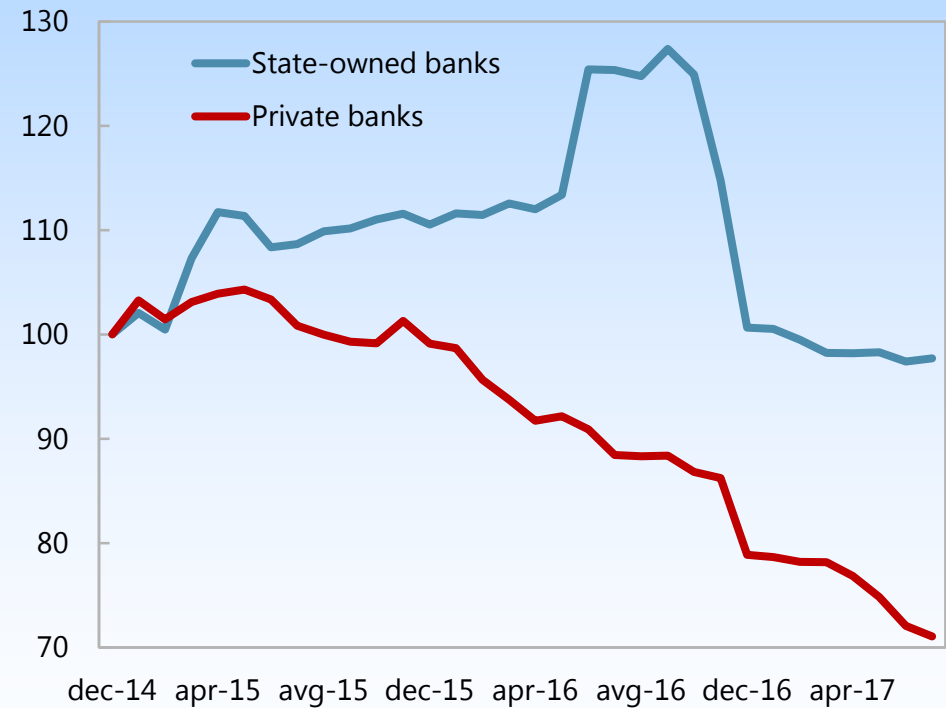


NPLs on a downward path, but still high and uneven

Non-Performing Loans
(Percent of total loans)



Change in Gross NPLs
(Index, Dec. 2014=100)



Sources: National Bank of Serbia; and IMF staff calculations.

Jul-17

Outline

1. **Serbia's IMF program: Initial context**
2. **Main Objectives and Results**
3. **Key challenges ahead**

Main challenges going forward

Sustaining macroeconomic achievements

- Enhancing fiscal rule

Preserving financial sector resilience

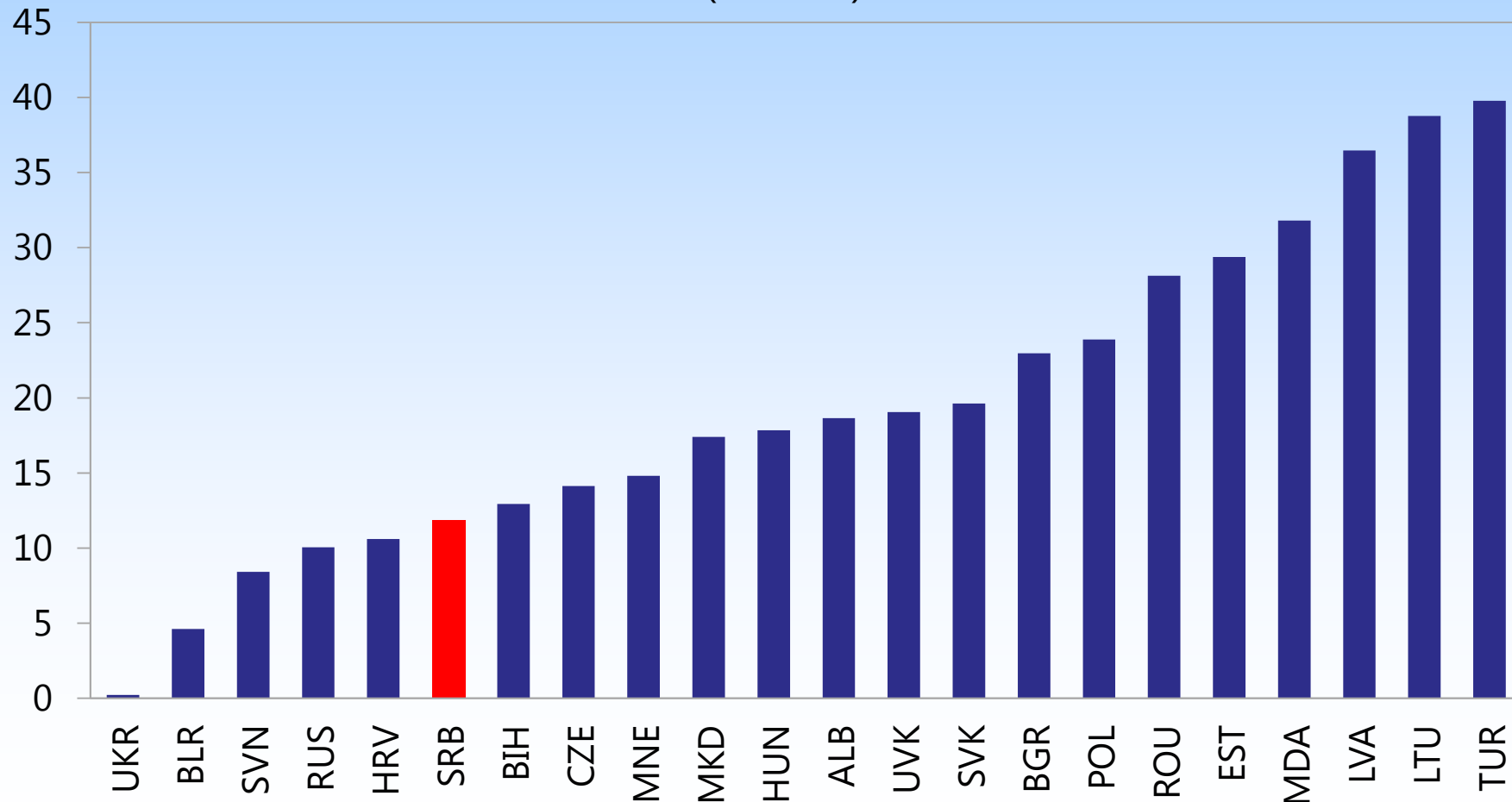
- Fully implement NPLs reduction strategy on state-owned banks
- Increase dinarization

Strengthening institutions and boosting potential (private sector-led) growth

- Completing structural reform agenda
 - Public enterprises and SOEs reforms
 - Public administration reforms
 - Reforms to improve the business climate

Since 2010, Serbia has exhibited one of the lowest growth rates across CESEE countries

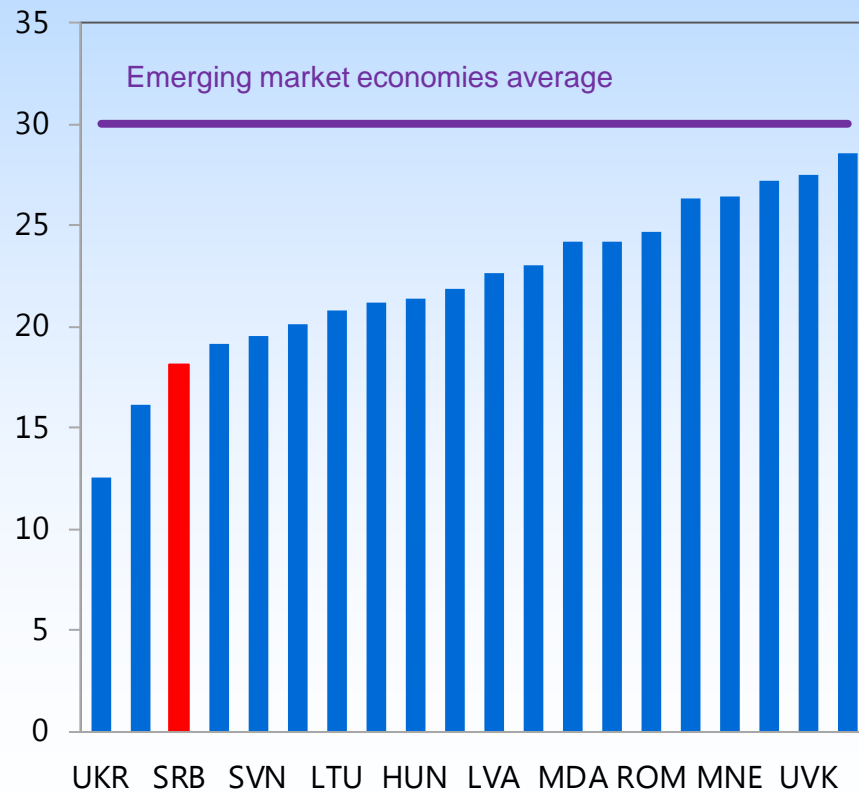
Cumulative real GDP per capita growth between 2010 and 2017
(Percent)



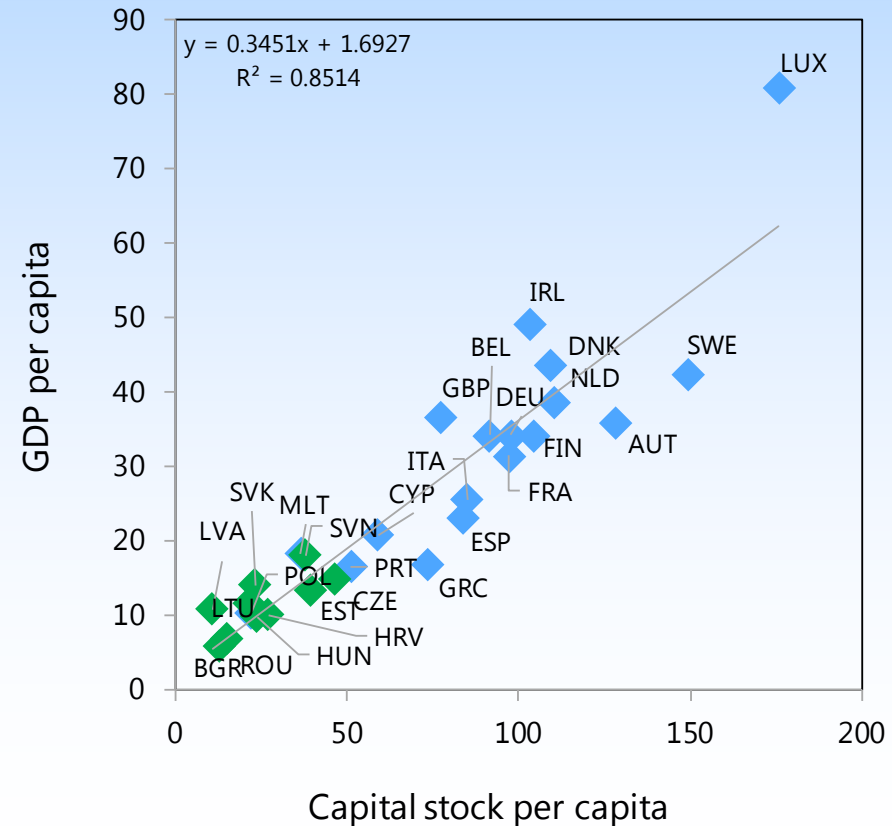
How to boost potential growth?

Increase investment levels...

Investment, 2016
(Percent of GDP)



Capital stock and GDP per capita, 2015
(Thousands of 2010 EUR)



...both public and private

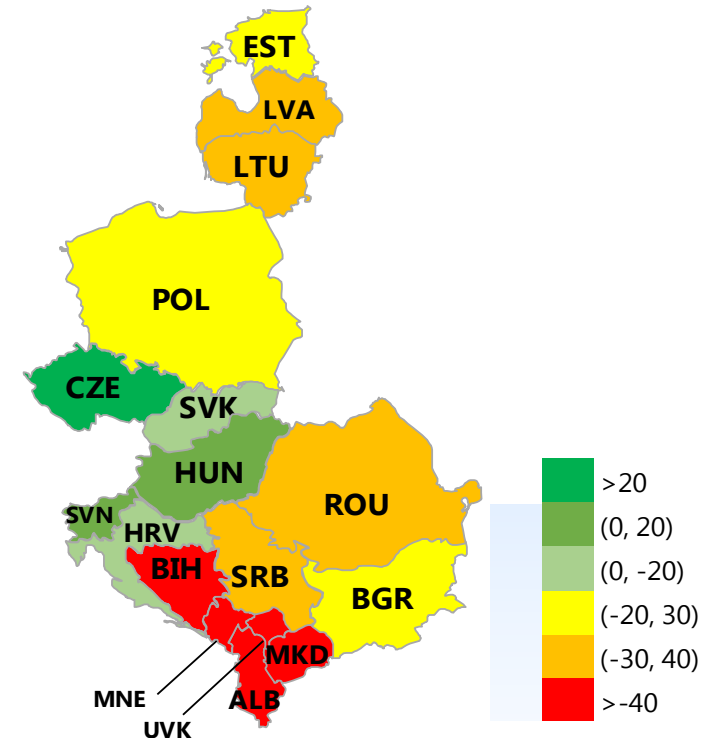
Public investment

- Reduce infrastructure gaps
- Improve public investment management

Private investment

- Investment climate
 - Rule of law
 - Efficiency of the judicial system
- Key constraint: low domestic saving

Infrastructure Gap Index

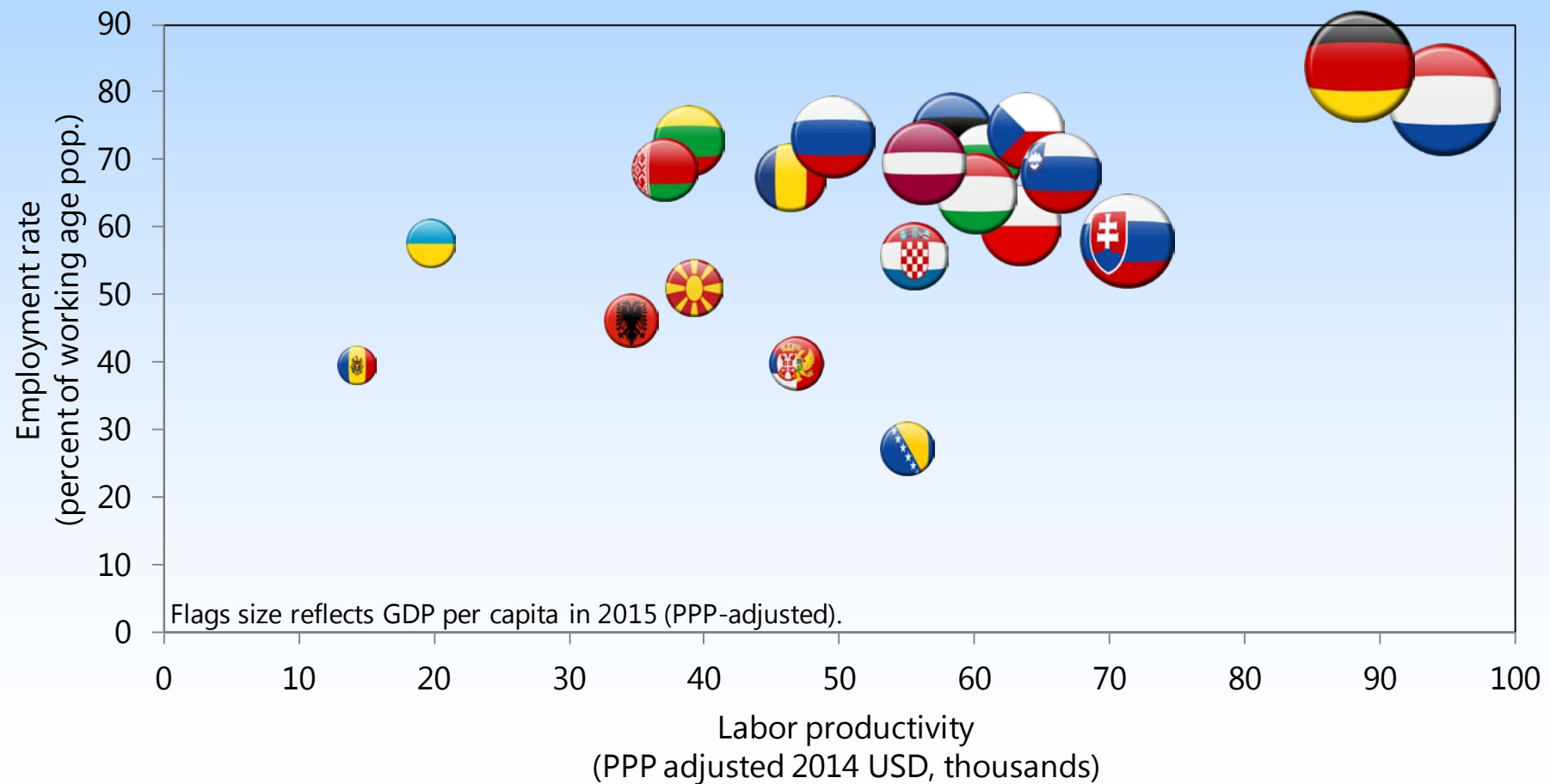


Sources: WDI, EIA, IRF, Eurostat, and IMF staff calculations.

Note: Infrastructure Gap Index calculates the gap between a country's infrastructure and that of an average EU member. In the following area's railway density, motorway density, installed capacity for power generation, phone lines and cellular subscriptions, broadband internet connections, and air transport passengers. The index value ranges between 50 to -65 with a value of zero reflecting EU-28 average.

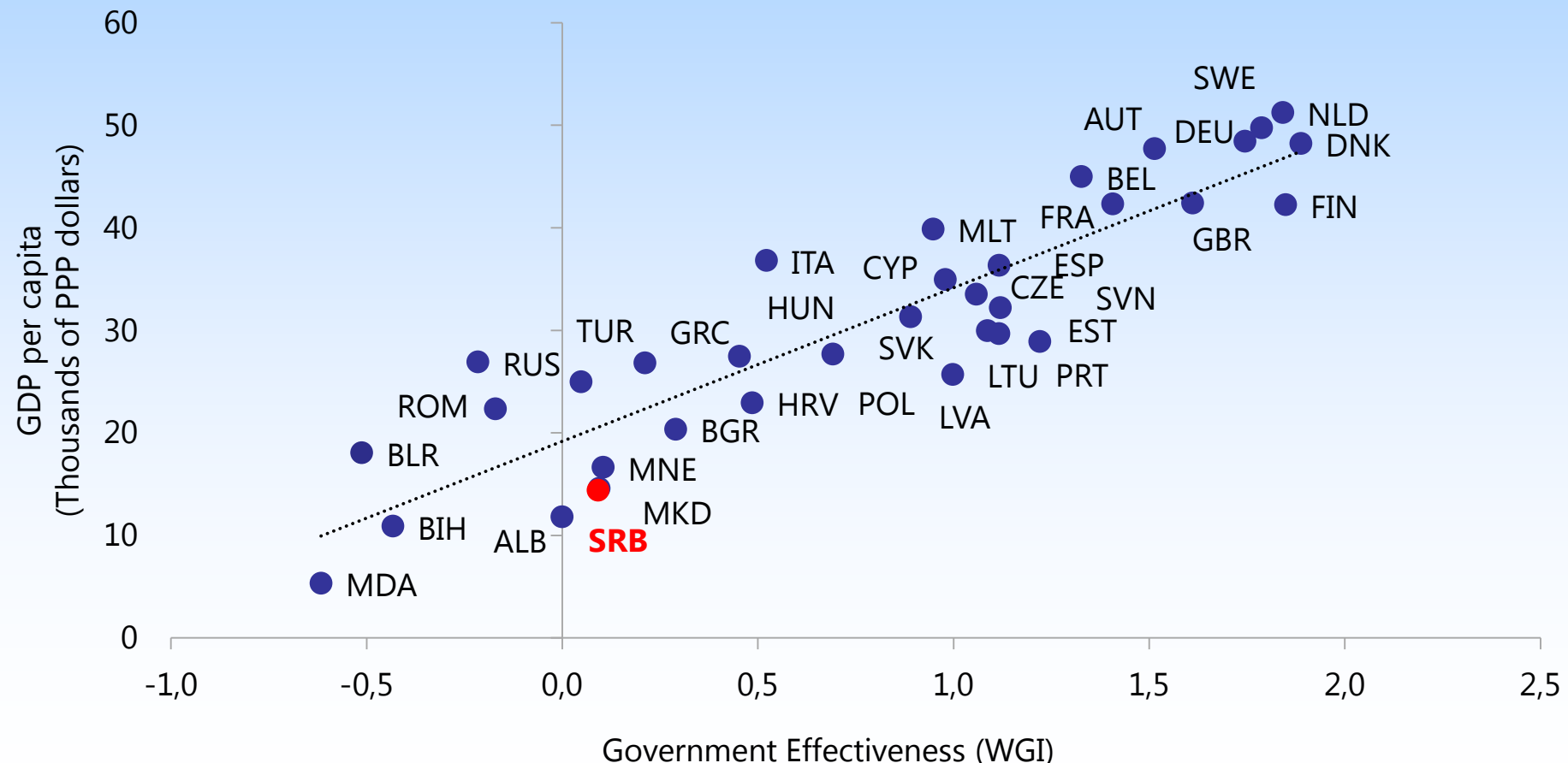
Reforms to increase productivity are critical

Labor productivity and utilization, 2015



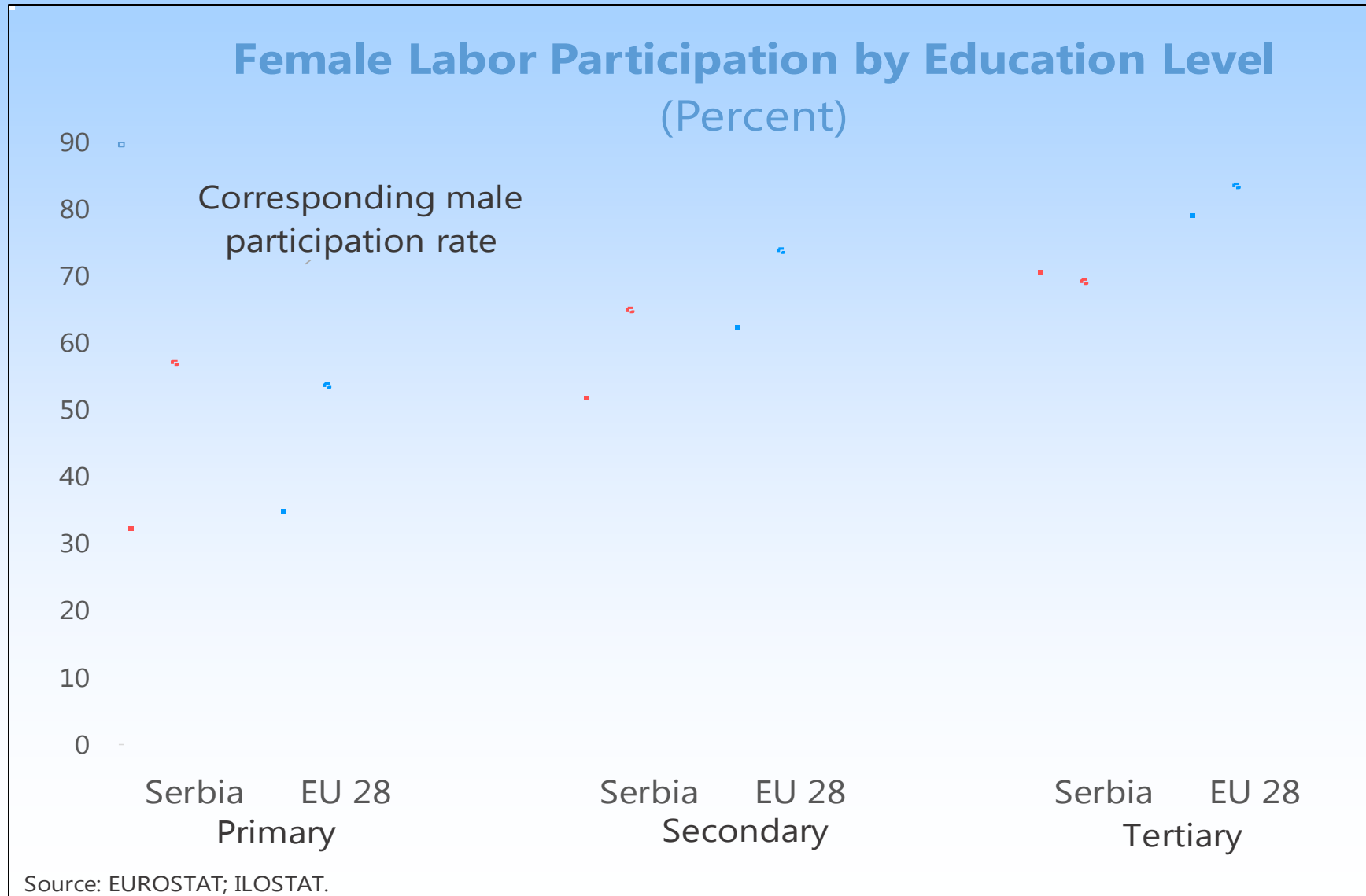
Modernizing public administration, promoting innovation, and fighting the grey economy

Government Effectiveness vs. GDP per capita, 2016



Ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance

Headwinds from demographic trends will be a challenge



Developing capital markets will critical

- Better risk sharing and a more efficient allocation of capital
- Lower financing costs
- Improved availability of long term financing
- ...allowing households and firms to better manage interest rate and maturity risk
- More companies active on capital markets implies enhanced market oversight
 - ...would increase transparency and accountability in the corporate sector
- Financing to start-ups and SMEs

Enhance savings, investment, innovation, productivity and therefore the growth potential

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