China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

November 2017

2017. No. 2 (5)

Weekly Briefing

Serbia Economy briefing:

IMF mission in Serbia

IIPE

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.
Szerkesztésért felelős személy: Chen Xin
Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.
+36 1 5858 690
office@china-cee.eu
china-cee.eu

An International Monetary Fund (IMF) mission, led by James Roaf, was in Belgrade, Serbia during October 26 – November 7, 2017. The reason was to hold discussions on the eighth and final review under Serbia's precautionary Stand-By Arrangement (SBA) with the IMF. At the end IMF mission and Serbian authorities reached staff-level agreement on policies needed to complete the eighth review under the SBA. Based on the preliminary findings IMF staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision scheduled for late December.

According to the overall IMF mission assessment all end-September 2017 performance criteria have been met, most with significant margins and implementation of structural benchmarks has continued, although with delays in some areas. The President and the Government of Serbia most emphasized the fact that the key parameters for the 2018 budget, which includes increase in salaries in the public sector and pensions starting from the next year, are agreed upon. The government plans to use part of the money from this year larger fiscal space for the payment of bonuses to pensioners, as well as for bonuses to certain categories of employees. The significance of IMF mission for ruling party in Serbia is also reflected in statement of Serbian Prime Minister Ana Brnabić that the budget proposal was delayed because a positive assessment and IMF recommendations were awaited upon. The budget for 2018, which should be adopted by December 15th, is planned based on the IMF projection that the GDP growth will be 3.5% and inflation 3%. The budget includes an increase in pensions of 5%, as well as wages in the public sector of 5-10%. A budget deficit of 0.7% of GDP is also planned, which is a level consistent with fiscal sustainability and further public debt reduction.

Even though Roaf estimated that strong economic performance of Serbia continues in 2017 this is not reflected in the standard of living, which is still low. In the first quarter of 2017, economic activities were temporarily slowed down due to droughts and interruptions in electricity supply, but remained supported by strong growth in exports, increased consumption and investment. The slowdown was caused by production factors, not because of poor demand or fiscal contraction. IMF project 2017 real GDP growth of 2%. Inflation is projected to remain close to the center of the National Bank of Serbia (NBS) target range. Given the low inflation rate, the IMF believes the monetary policy of the NBS is correct, and in the current year it notes good fiscal results, and the fiscal balance is close to a positive zero, which is better than the projected budget deficit. In September and October, NBS decided to lower the key policy rate by 0,25 pp to 3.5%.

During the multi-day meetings, they also discussed recent improvements in business survey rankings. In the World Bank's Doing Business list for 2018, Serbia ranks at 43 on the ease of doing business, compared to 47 in last year's report. In the report Serbia made greatest progress in three area: 1) Starting a Business- made starting a business easier by reducing the signature certification fee and increasing the efficiency of the registry, reducing the time for business registration. 2) Registering Property- improved the reliability of its land administration system by implementing a geographic information system. 3) Enforcing Contracts- made enforcing contracts easier by adopting a new enforcement law that broadens and clarifies the responsibilities of enforcement agents as well as the powers of the courts during the enforcement process. Over the past 15 years, Serbia has made significant progress in several Doing Business areas and implemented a total of 28 reforms, mainly in the area of Registering Property (with 6 reforms), Starting a Business and Resolving Insolvency (5 each). Serbia's progress on the World Bank's list has been widely advertised in media as a shift in the positive direction and the result of the implementation of reforms. Also, in March 2017, Moody's upgraded Serbia's sovereign credit rating from 'B1' to 'Ba3' with a stable outlook. In June 2017, S&P affirmed Serbia's 'BB-' rating with a positive outlook and Fitch affirmed its 'BB-' rating with a stable outlook. By the Serbian authorities these ratings are perceived as a very important for improving the image of Serbia in the world and attracting foreign direct investments.

Head of IMF mission states that the priority for Serbia in 2018 should be to preserve the hard-to-reach good fiscal results. It is also necessary to put further emphasis on strengthening the business environment, the reduction of business barriers, stimulating growth in which the private sector plays a leading role and employment growth. Substantial reform efforts are still needed to foster competition and reduce regulatory and administrative burden on enterprises, including modernizing tax administration and increasing transparency and predictability of public fees and charges (which are also the areas where Serbia underperforms according to the WB Doing Business list).

Salaries and pensions, at a time when the budget is being compiled, are a constant problem around the amounts that are tightened in the budget. The explanation of the Government is most often that these benefits cannot be increased due to the arrangement with the IMF. In the public, a hope is present that these benefits will increase as soon as the arrangement is over. A question that runs through the media about the lifting of the penalties for those who retired before 65 years of age is still not on the agenda, as can be seen from the limit for spending in 2018, which Minister of Finance Dusan Vujović sent to budget users these days. Ljubisav Orbović, the president of the Confederation of Autonomous Trade Unions of Serbia, who initiated the initiative, supported by the Social and Economic Council, requested that the premature pension be received by the 65th birthday, and after that full, without penalty.

In the financial sector, significant progress has been made to upgrade bank supervision and align regulations with EU standards, helping ensure financial stability. Amendments to the Law on Foreign Exchange Operations should be presented to Parliament by the end of the year, which is important for the introduction of E-commerce in Serbia. The Law on Investment Funds, amendments to the Trade Act are under preparation, and Government have completed the Law on E-Government, which is currently being harmonized. An announced privatization of *Komercijalna Banka* is the latest event that can be of great importance to the banking sector. The State is preparing for the possible privatization, but this is still not the final conclusion.

Public administration reforms should be accelerated to improve the quality of public services and reduce fiscal risks. The passage of secondary legislation for the new public wage system will be a key milestone in this regard.

Still the biggest problems in the Serbian economy that have not been resolved in the previous period are structural weaknesses in the public sector. In one hand, the financing of weak public enterprises through arrears to *Srbijagas* and *Elektroprivreda Srbije* (EPS) has been significantly reduced, reforms in railways have continued, Ironwork was sold to Chinese company *Hestee*l and pharmaceutical company *Galenika* has been privatized. However, the resolution of problems, especially in the petrochemical and mining sectors, is still pending. Serbia is running late on finding durable solutions for companies like *Azotara*, *Petrohemija* from Pančevo, *Methane-Vinegar Complex* (MSK) from Kikinda, *Mining and Smelting Combine Bor* and *Public Enterprise for Underground Exploitation of Coal Resavica*. This is a great burden on Serbian economy.

If the IMF Board gives a positive assessment of report on December it will free Serbia an additional SDR 99.14 million (€119.4 million) available to Serbia under the SBA, bringing the total funds available to SDR 871.8 million (€1,05 billion).

The Serbian authorities have decided not to withdraw on the resources available under the arrangement. After the eighth revision, program will conclude on February 23rd, 2018. Member of the Fiscal Council, Nikola Altiparmakov, evaluates that Serbia should continue the arrangement with the IMF, because the existing has given good results for the Serbian budget. There is a possibility that the newest IMF instrument (defined in July 2017) will be applied in Serbia for the first time. The Policy Coordination Instrument (PCI) is a non-financing tool open to all members of the IMF that do not need IMF financial resources at the time of approval. The PCI aims to help countries better coordinate their access to multiple layers of the global financial safety net, particularly regional financing arrangements. Serbia will probably enter into an advisory rather than a financial program with the IMF in 2018, but the final decision will be known in early 2018, after a detailed analysis of the possible negative effects of non-binding measures on further reform flows in the public and fiscal sector. The analysis will be done by Dusan Vujović and Ana Brnabić, and will also conduct consultations with President Aleksandar Vučić.