# SERBIA

## Highlights

- **The economy is growing strongly after a mild reduction in 2020.** Gross domestic product (GDP) fell by just 0.9 per cent in 2020, as the economy was propped up by a large fiscal package, and strong growth occurred in the first half of 2021.
- **Serbia has agreed a new non-financial and advisory deal with the International Monetary Fund (IMF).** The 30-month Policy Coordination Instrument (PCI) aims to support structural reforms and economic recovery, while maintaining macroeconomic and financial stability.
- **Progress on the green transition has been made in the past year.** New laws should help to enable large investments in renewable energy sources, as well as promote energy-saving and climate change mitigation measures.

## Key priorities for 2022

- **The green transition agenda should be accelerated.** Among other measures, the authorities should step up renewable energy auctions, energy efficiency improvements and environmental infrastructure investment.
- **The governance of state-owned enterprises (SOEs) needs to be strengthened.** SOE governance should be improved in line with the recently approved action plan for state-ownership policy.
- **Fiscal and financial sector risks should be contained after support measures expire.** To preserve fiscal sustainability, it would be prudent to adopt a new fiscal rule, prioritise productive capital investments and moderate the growth of pensions and public wages.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.1 | 4.5 | 4.3 | -0.9 | 6.5 |
| Inflation (average) | 3.0 | 2.0 | 1.7 | 1.6 | 3.0 |
| Government balance/GDP | 1.4 | 0.8 | 0.0 | -7.3 | -6.5 |
| Current account balance/GDP | -5.2 | -4.8 | -6.9 | -4.1 | -4.1 |
| Net FDI/GDP [neg. sign = inflows] | -6.2 | -7.4 | -7.7 | -6.3 | -6.0 |
| External debt/GDP | 65.1 | 62.2 | 61.4 | 65.8 | n.a. |
| Gross reserves/GDP | 25.4 | 26.3 | 29.1 | 28.8 | n.a. |
| Credit to private sector/GDP | 40.3 | 41.4 | 42.0 | 45.8 | n.a. |

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## Covid-19: macroeconomic implications

**The economy is recovering in 2021 after a modest drop in output in 2020.** The effects of the Covid-19 pandemic on the economy were moderate in 2020. The structure of the economy – a limited reliance on tourism and a relatively high share of basic goods, such as food and some chemicals in manufacturing – combined with large government aid packages and less restrictive lockdown measures for most of the year, contributed to a GDP contraction of just 0.9 per cent. In the first quarter of 2021 GDP grew by 1.8 per cent year-on-year, underpinned by a strong recovery in the construction sector, the growth of industrial output and an increase in trade, transport and tourism activities. The second quarter saw strong growth of 13.7 per cent year-on-year, reflecting the low base of last year due to Covid-19 pandemic-related restrictions.

**Inflationary pressures have increased.** The year-on-year inflation rate rose from 1.1 per cent in January 2021 to 5.7 per cent in September 2021, which is above the central bank target range (3.0 ± 1.5 per cent). The increase is primarily the result of temporary factors such as rising utilities, oil and primary commodity prices. The exchange rate against the euro has remained stable. The central bank has intervened in the foreign exchange market on both sides, but in the first seven months of 2021 it was a net buyer of euros (€700 million in total).

**Public debt has increased due to aid packages for the economy.** In July 2021 public debt stood at 55.2 per cent of GDP, around 2 percentage points below the 2020 level, but more than 3 percentage points higher than in 2019. The country placed a 12-year €1 billion Eurobond in February, while in September it issued its first ever 7-year €1 billion green bond at a record low coupon rate of 1.0 per cent, together with a 15-year €750 million Eurobond, the longest maturity Serbia has issued so far. Receipts from the green bond will be used to finance the construction of water and wastewater treatment plants, subway and modern railways, flood protection, biodiversity conservation, pollution control and prevention, waste collection, processing and recycling infrastructure, energy efficiency and renewable energy sources, and other projects from the green agenda.

**GDP will exceed its 2019 level in 2021.** Continuing expansionary fiscal policy in 2021, together with a planned significant increase in public investment and recovery in domestic and external demand, will result in GDP expanding by a projected 6.5 per cent in 2021. In 2022 a growth rate of 4.3 per cent is forecast, as the economy is expected to return to pre-pandemic growth rates amid a likely fiscal adjustment. Risks to the forecast are balanced. They relate primarily to the pace of recovery of external demand and speed of public infrastructure projects and structural reforms.

## Policy response to Covid-19

**A third package of Covid-19-response measures was approved in 2021.** The package, worth €2.2 billion (4.3 per cent of GDP), was adopted in February 2021. It included direct support to the private sector, extending the previous guarantee scheme and introducing a new one, and one-off financial assistance for adults and pensioners (€60 and €110, respectively). Direct support to the private sector comprised payments of 50 per cent of the minimum wage to all entrepreneurs and companies for three months and an additional minimum wage for employees in sectors that had been hit the hardest (catering, travel agencies, tourist guides, hotels, rental car agencies and so on). In addition, in June 2021 the state paid one-off "vaccine bonuses" of around €25 to those who had received at least one vaccine dose by the end of May.

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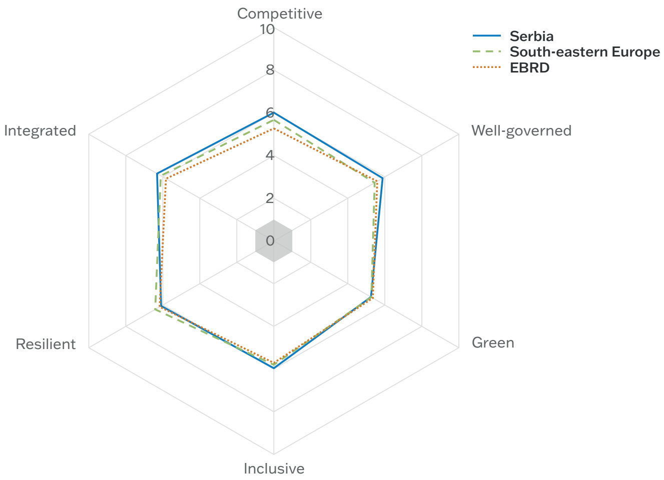
**The central bank has introduced new measures.** To support dinar liquidity, the National Bank of Serbia (NBS) introduced in November 2020 additional foreign exchange purchase swap auctions and securities purchase repo auctions, both on a weekly basis and with a three-month maturity. In December 2020 the key policy rate was lowered by 25 basis points to another historical low of 1.0 per cent. In February 2021 the NBS and the European Central Bank (ECB) agreed to prolong the duration of the precautionary repo line set in mid-2020 until March 2022. The line enables the NBS to borrow up to €1 billion from the ECB.

**Assessment of transition qualities (1-10)**




## Structural reform developments

**European Union (EU) accession negotiations are advancing, albeit slowly**. Since the start of negotiations in January 2014, 18 chapters (out of 35) of the EU *acquis* have been opened, of which two are provisionally closed. No new chapters have been opened in the past year. According to the European Commission, the future speed of negotiations will depend on, among other things, the pace of reforms regarding the rule of law as well as progress on normalising relations with Kosovo. In 2021 it was agreed to apply to Serbia the revised enhanced methodology for EU accession negotiations that was previously approved by the Council for candidate countries. This means greater leverage in preventing and addressing possible reversals in the reforms but it also presents an opportunity to accelerate the opening of new negotiation "clusters" containing several chapters.

**The IMF has approved the new 30-month PCI with Serbia.** Soon after the previous PCI had expired, the authorities launched talks with the IMF on a new one, which was approved in June 2021. The new PCI aims to support structural reforms and economic recovery, while maintaining macroeconomic and financial stability. The main pillars of the programme, which will run until the end of 2023, are: anchoring the fiscal policy framework; strengthening SOE governance; developing capital markets and further increasing dinarisation; improving the provision of social assistance; and transitioning to a green economy.

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**The country has made legislative changes that pave the way for the greening of the economy.** In March 2021 parliament adopted the Law on Climate Change, which should help establish a system for limiting greenhouse gas emissions. In April 2021 the country adopted four bills in the area of energy and mining (the Law on Energy Efficiency and Rational Energy Use, the Law on Renewable Energy Sources, and amendments to the Law on Mining and Geological Exploration and to the Law on Energy). These legal changes should enable large investments in renewable energy sources such as wind and solar, help achieve energy savings and security of energy supply, and reduce the impact of the energy sector on the environment and climate change. In addition, amendments to the Law on Energy create a legal basis for the adoption of the National Energy and Climate Plan (NECP) for 2021-30. The NECPs are the framework for EU member states to outline their climate and energy goals, policies and measures.

**Separation of electricity generation from electricity distribution has taken place.** In December 2020 the power utility Elektroprivreda Srbije (EPS) transferred its ownership of distribution system operator EPS Distribucija to the government of Serbia. The transfer of ownership is the final step in unbundling the distribution system from EPS, which began five years ago.

**The country has adopted a new state-ownership policy for 2021-27.** The policy, adopted in April 2021, should help better monitor and tackle fiscal risks and enhance the efficiency of SOEs. It identifies the rationale and objectives of state ownership and reviews the legal and regulatory framework for corporate governance of SOEs. In June 2021 the government adopted an action plan to implement the strategy for 2021-23.

**Ownership changes and acquisitions have been taking place in the banking sector.** The banking sector has remained stable, liquid and well-capitalised through the Covid-19 pandemic, with the non-performing loan ratio at 3.7 per cent in May 2021. In late 2020 Slovenia's state-owned commercial bank NLB completed the acquisition of the state-owned Komercijalna Banka, while a US investor sold its majority stake in Opportunity Bank Serbia to a group of investors. In June 2021 state-owned bank Postanska stedionica acquired MTS Banka, one of the smallest banks in the country, previously 100 per cent owned by the state-owned telecommunications company. As of early August 2021 there were 24 banks in the country and additional consolidation is under way.