



SERBIA

Highlights

- **The effects of the Covid-19 pandemic are intensifying.** After a robust first quarter in 2020 (5.0 per cent growth year-on-year), GDP fell by 6.4 per cent year-on-year in the second quarter, as a consequence of the coronavirus-related lockdowns and disruptions in supply chains.
- **Work on a state-ownership policy (SOP) is advancing.** The SOP, which is designed to improve the governance of state-owned enterprises (SOEs), is expected to be adopted soon.
- **The government approved two economic support packages as a response to the pandemic.** Overall, the packages are worth around 12.5 per cent of GDP, with measures aimed primarily at preserving employment and increasing liquidity for businesses.

Key priorities for 2021

- **To ensure the sustainability of public finances, fiscal risks should be contained.** Public debt may exceed 60 per cent of GDP by the end of 2020. The government should decrease the budget deficit significantly in 2021, control wages and pensions and improve the structure of public expenditures towards more productive infrastructure investments and increase their value for money.
- **Public sector reforms need to progress.** In addition to adopting the SOP to improve the governance of SOEs and making necessary legal changes for its implementation, the government should proceed with the public administration reform, including the introduction of a new public sector pay grade system, and further professionalisation and de-politicisation of the administration.
- **Further improvements of the business environment are necessary in order to increase domestic private investments.** The focus should be on levelling the playing field for small and medium-sized enterprises (SMEs), strengthening the rule of law, implementing the legislation consistently and fighting corruption. In addition, the private sector should be properly involved in public consultations regarding new business legislation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	2.1	4.5	4.2	-3.5
Inflation (average)	1.2	3.0	2.0	1.9	1.5
Government balance/GDP	-1.1	1.4	0.8	0.0	-8.0
Current account balance/GDP	-2.9	-5.2	-4.8	-6.9	-6.5
Net FDI/GDP [neg. sign = inflows]	-5.2	-5.9	-7.3	-7.8	-5.0
External debt/GDP	72.0	65.1	62.2	61.9	n.a.
Gross reserves/GDP	27.8	25.4	26.3	29.1	n.a.
Credit to private sector/GDP	41.0	40.3	41.4	42.1	n.a.

Covid-19: macroeconomic implications

After solid growth in 2019, the economy is facing a recession in 2020. GDP expanded by 4.2 per cent in 2019, driven by domestic demand, primarily investments, among which the building of the TurkStream gas pipeline stood out. GDP also rose strongly in the first quarter of 2020, at 5.0 per cent year-on-year, driven by consumption, government expenditures (related to increased spending in the early stages of Covid-19 and a hike in wages) and investments. At the same time, exports growth slackened to 3.1 per cent year on year, which was the slowest quarterly rate since 2014. The second quarter of 2020 saw a fall in economic activity of 6.4 per cent year on year, as the impact of stringent lockdowns was felt by the economy.

Public debt has started to rise due to government measures to fight the effects of Covid-19.

According to International Monetary Fund (IMF) estimates, the budget deficit in 2020 will reach 8.6 per cent of GDP. To finance it, Serbia raised €2 billion through a seven-year Eurobond issuance in May 2020 and stepped up domestic borrowing. In June 2020 the debt stood at 58.1 per cent of GDP, around five percentage points higher than at the end of 2019, and some further rise in the ratio is expected by the end of 2020.

Inflationary pressures have remained subdued. The average inflation rate in the first seven months of 2020 was 1.5 per cent year-on-year, which is exactly at the lower bounds of the central bank's target band (3 ± 1.5 per cent). After three cuts of 25 basis points each in 2019, the central bank lowered the key policy rate by another 100 basis points between March and June 2020, to an historical low of 1.25 per cent. The latest cuts are helping to mitigate the economic effects of the pandemic. The exchange rate against the euro has remained stable. The central bank has intervened in the foreign exchange market, mainly by selling euros (€1.4 billion net in the first seven months of 2020).

A recovery is expected in 2021. Overall, GDP is expected to decline by 3.5 per cent in 2020. Although the economy is being affected through several channels (lockdown measures, disruption in supply chains, lower inflow of foreign direct investment and remittances), the contraction in 2020 is smaller than in many neighbouring countries because the structure of the economy, with production of basic products accounting for an important share, is less vulnerable to the effects of the pandemic. In addition, the government has continued capital investments throughout the crisis period. Assuming a return to normal economic activity by mid-next year, GDP growth is forecast to resume at 3.0 per cent in 2021.

Policy response to Covid-19

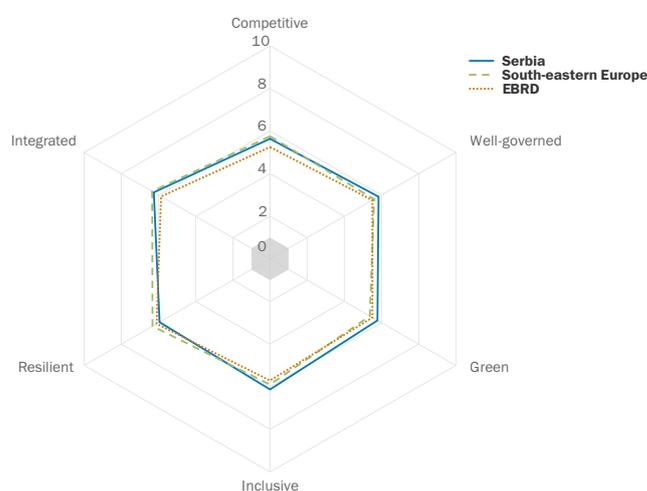
The government is implementing a large aid package to mitigate the impact of Covid-19.

The initial package, announced at the end of March 2020, amounts to €5.1 billion (or 11 per cent of GDP). Measures include: direct private sector support (payment of three minimum wages to entrepreneurs and micro, small and medium-sized enterprises and a subsidy at 50 per cent of the minimum net wage to large businesses that had to suspend activity); fiscal measures (postponed payment of social security contributions and payroll tax; delayed advance corporate income tax payments for the second quarter of 2020); and liquidity enhancement (primarily state guarantees for €2 billion new loans). Under the second package, adopted in July 2020, the state covered 60 per cent of minimum wages for August and September, deferred payment of social security contributions and payroll tax for one month, and continued to subsidise large companies. The condition for companies to obtain state aid was not to lay off more than 10 per cent of the workforce three months after receiving the last payment. In addition, the government set aside around €22 million for farmers and approved one-off aid to pensioners of RSD 4,000 (€35), one-off assistance to all adults (€100) and a 10 per cent wage hike of health workers. In August 2020, a programme of subsidies for city hotels in difficulties was adopted. The hotels would be entitled to one-off subsidies of €350 per single bed and €150 per room.

Financial measures have also been adopted as part of the crisis response. The measures ranged from loan repayment moratoria to possible inclusion of corporate bonds into monetary operations. In mid-March 2020, the National Bank of Serbia (NBS) introduced a 90-day loan

repayment moratorium for all debtors willing to use that option, which was later extended until the end of September. In addition, the central bank provided additional local currency and foreign exchange liquidity to banks through additional foreign exchange swaps and repurchase agreement (repo) auctions. To meet possible future euro liquidity needs, it also established a €1 billion repo line with the European Central Bank, which will remain in place until at least June 2021. In May 2020, the NBS announced inclusion of corporate bonds in conducting monetary operations. The NBS can buy dinar bonds from commercial banks, issued by the end of 2020 and with a maximum maturity of five years, provided the bonds have at least a B rating assigned by the national Business Registers Agency. In June 2020, the NBS passed a regulation lowering the downpayment for first home-buyers to 10 per cent of the sought loan amount, and in August it adopted measures in support of lending. However, the latter are rather narrow in scope (targeting mostly the construction sector and housing loans) and not mandatory for banks.

Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations are advancing, albeit slowly. So far 18 chapters (out of 35) have been opened since the start of negotiations in January 2014, of which two are provisionally closed. According to the European Commission's country reports, the future speed of negotiations will depend on the pace of reforms regarding the rule of law as well as on progress in the normalisation of relations with Kosovo.

The government is taking steps to develop the capital market. In February 2020 the government announced drafting of the strategy for capital market development with the support of international institutions. At the same time, the law on capital markets was amended to allow greater availability of domestic securities for foreign investors. In May 2020 the Securities Commission enacted by-laws needed for the implementation of the law on alternative investment funds and law on open investment funds with public offerings, adopted in October 2019. The laws are intended to harmonise Serbian law with EU legislation, including on venture capital and private equity funds, and provide a more predictable environment for investors.

A new state ownership policy (SOP) is being developed. According to the IMF programme, the new policy, which should contribute to better corporate governance of SOEs, is to be adopted by the end of October 2020. The SOE sector in Serbia is relatively large and typically performs worse than it does in other countries or in the private

sector. The government agreed to adopt a SOP as part of the IMF Policy Coordination Instrument programme, and to provide a strategic vision of state ownership, including ownership objectives, financial and public policy targets, reporting and monitoring guidelines and procedural guidelines for boards of directors.

Two important state-owned companies face severe difficulties. Air Serbia, the national air carrier, is facing a major financial crisis. In August 2020 the government announced it would provide financial assistance of €56.5 million to pay off the company's debt. Meanwhile, after a series of takeovers of domestic cable operators in 2018 and 2019, the debt of the telecommunications company Telekom Srbija rose from under €400 million at the end of 2017 to €1.2 billion at the end of 2019. There are claims that the takeovers were significantly overpriced. In September 2020 the company issued €200 million worth of five-year corporate bonds, stating the need to refinance its current liabilities and advance its operations. Previous attempts by the government to sell Telekom Srbija (the last time in 2015) were unsuccessful.

The third largest bank in the country has been privatised. Following the November 2019 purchase of the 34.6 per cent stake in Komercijalna Banka from international investors, the state sold its whole share in the bank (83.2 per cent) to Slovenian bank NLB in February 2020. The transaction is expected to be closed in the last quarter of 2020.

A special law to accelerate infrastructure development may jeopardise transparency and competitive tendering. In February 2020 the government adopted a law on special procedures for implementation of linear infrastructure projects (such as highways and the underground) deemed to be of special importance for the country. This *lex specialis* allows the government to exempt "strategic" projects from the application of public procurement rules and thus might not ensure value for money.

An important step has been made in tackling air pollution. At the end of January 2020 the government adopted the country's National Emissions Reduction Plan (NERP), shortly after the Energy Community Secretariat opened a dispute settlement procedure against the country for not adopting the Plan. (The draft NERP of Serbia was approved by the Secretariat in 2016.) The adoption of the NERP is an important step in reducing emissions from large combustion plants into the air.