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Statement by the Hon. **RADOVAN JELASIC,**
Governor of the Fund for the **REPUBLIC OF SERBIA**
at the Joint Annual Discussion

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Mr. Chairman, Ladies and Gentleman,

I am honored to address this high level forum. My statement will focus on the significant progress Serbia has achieved in the context of the three consecutive IMF programs after the fall of the Milosevic regime. This progress is even more noticeable having in mind the uncertain regional environment and the present challenges the country is still facing in the second phase of transition.

Serbia has implemented far reaching macroeconomic measures, with the support of the Fund, during the last five years. The result has been the decline of inflation and foreign debt and the growth of foreign exchange reserves as well as foreign direct investments. Since 2000 real GDP in USD has almost doubled, inflation has decelerated from around 120% p.a. to single digits, hopefully, at the end of this year, while external debt has declined from over 130% to below 60%. This outcome has been accomplished by both very restrictive monetary policy (as of June 30th, 2006 around 34% of the banking assets were sterilized by the National Bank of Serbia) as well as prudent fiscal policy (fiscal adjustment totaling 4% in 2 years, surplus of 2.5% of GDP at the end of 2006). Parallel to that, income policy for state owned enterprises has been also put under control. Progress has been made in implementing the structural reform agenda under the government program actively supported by the IMF and the World Bank both in terms of development and financing, although there is still more to do.

The brightest point of the whole reform process was definitely during the second half of 2001 when we closed down 66% of the banking assets in the country! With this unique and bold move, we created not a run against the banking sector but public confidence! Since then, Serbian citizens have taken money from under the mattresses and put almost USD 4bn worth of fresh savings into our banking sector! Today the banking sector of Serbia has surpassed the level of total assets and number of employees before the large scale closure, while average salaries have almost quadrupled! Unfortunately, good examples in the financial sector are not automatically copied for the rest of the economy. As the transition process matures one needs substantially more time, due to growing reform fatigue, to carry out the same number of reforms!

Despite the encouraging economic achievements, we are fully aware of the challenging reform agenda and remaining vulnerabilities ahead of us. The income gap between Serbia and the EU is still substantial, the unemployment rate is high and the progress of structural reforms in some areas, including energy and transportation sectors, is still insufficient. Our reform policy framework of those future programs will be based on three key elements. The first key element will be a monetary policy based on inflation targeting which will also change the role of the exchange rate from key policy instrument to an indicator. The second key element will be the implementation of cautious and flexible fiscal stance which has switched from high deficits to significant surpluses over the last two years. Last but not least, structural reforms must be accelerated and the state must also define its future role in the economy!

With the successful ending of the Extended Arrangement, Serbia finalized an important phase in its relations with the Fund and the Bank that was developed for post conflict and transition countries. As far as a new arrangement is concerned, since February this year, both the Serbian authorities and the Fund are following the "don't ask, don't tell policy". And although macroeconomic conditions are improving, the country still has to address not only some important macroeconomic imbalances (inflation, high current account deficit) but especially an array of structural reforms. I am confident that once some key political decisions are made in Serbia, the authorities will refocus on the second stage of reforms that are needed in order to catch up with the best performing countries of the region.

The largest enemy of Serbia is still its recent past and its own skepticism. Even today, many investors admit to being apprehensive due largely to media reports during the very unfortunate events of the nineties, However, after actually visiting Serbia, they also report that the situation is substantially more positive than they were led to expect. I am confident that the recent upgrade of Serbia's position by the World Bank's Doing

Business 2007 report, by 27 places -Serbia is the second best positioned after Slovenia among the all former republics of Yugoslavia- will further strengthen foreign investors' confidence.

In the last six years the reform momentum has received a further boost from the political side, namely through the completion of the EU's feasibility study in 2005 and the start of negotiations on accession. Although those negotiations are temporary blocked, I am confident that politicians will not risk for a second time after almost 15 years the EU future of Serbia. EU prospects will also establish a clear framework for moving ahead with the reforms. There is broad public support for EU membership and the country expects to have the candidate status in 2007.

Thank you.