S&P Global
Ratings

RatingsDirect®

Research Update:

Serbia Outlook Revised To Stable From Positive On Economic Fallout Related To COVID-19; 'BB+/B' Ratings Affirmed

May 1, 2020

PRIMARY CREDIT ANALYST

Aarti Sakhuja
London
(44) 20-7176-3715
aarti.sakhuja@spglobal.com

SECONDARY CONTACT

Karen Vartapetov, PhD
Frankfurt
(49) 69-33-999-225
karen.vartapetov@spglobal.com

RESEARCH ASSISTANTS

Sarthak Maiti
Mumbai

Michelle Bozem
Frankfurt

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF@spglobal.com

Overview

- We project that restrictions imposed on peoples' movements on account of the coronavirus pandemic will cause the Serbian economy to contract by 3.5% in 2020, before it rebounds in 2021.
- Consequently, the government's fiscal and debt metrics will deteriorate this year, as will the near-term outlook for non-debt-creating investment inflows into Serbia.
- We are therefore revising the outlook on our long-term ratings on Serbia to stable from positive.

Rating Action

On May 1, 2020, S&P Global Ratings revised its outlook on Serbia to stable from positive. At the same time, we affirmed our 'BB+' long-term and 'B' short-term sovereign credit ratings on Serbia.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Serbia are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2020 EMEA Sovereign, Regional, And Local Government Rating Publication Dates," published Dec. 20, 2019, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the reason for the deviation is a significantly weaker domestic and external growth outlook. The next scheduled publication on the sovereign rating on Serbia is on June 12, 2020.

Outlook

The stable outlook balances the economic fallout from the COVID-19 pandemic--in the form of a more-adverse external finacing environment and deterioration in Serbia's growth and fiscal metrics--against the macroeconomic buffers the Serbian authorities have built up over the past half-decade, including higher foreign exchange (FX) reserves and more fiscal space.

Downward pressure could build on the ratings over the next 12 months if, contrary to our current expectations:

- We anticipated a far more significant weakening of Serbia's government finances. This could occur for instance if the growth outlook remained subdued for longer.
- Serbia became increasingly reliant on debt-creating foreign inflows to finance its external deficit.

Upward ratings pressure could build if foreign direct investment inflows continue into Serbia, supporting an improvement in its balance of payments resilience via rising export receipts and higher FX reserves.

Rationale

We project that Serbia's real GDP will contract by 3.5% in 2020 as a result of lockdown measures imposed to cope with the COVID-19 pandemic. There is a higher degree of uncertainty than usual attached to our forecasts.

Serbia has been in a state of emergency since mid-March with strict constraints on the movement of people and the closure of its international borders. A little over a month later, the authorities have started to lift some restrictions and reopen parts of the economy--for instance certain services, some retail avenues, and the construction sector--subject to social distancing norms.

Even with restrictions continuing to be gradually lifted over the next weeks, the ongoing need for individuals to maintain physical distance implies that economic output will not reach the level we previously forecast for 2021.

Moreover, Serbia's recovery will ultimately be tied to the fortunes of its key trading partners by virtue of the economy being more open than it was heading into the global financial crisis, more than a decade ago. Exports now constitute about half of overall economic output, compared to less than a third in 2007.

Foreign direct investment--predominantly in tradeables--has fully financed Serbia's wider current account deficits in recent years and lowered its reliance on debt-creating inflows. Arguably, these inflows have also aided the National Bank of Serbia's (NBS's) efforts to augment its FX reserves. Moreover, over the past decade foreign investment into Serbia's manufacturing sector has resulted in a strengthening of receipts from and diversification of the export basket. However, the nearer term outlook for foreign investment flows is fairly uncertain.

The government and the NBS have put together a package to contain the pandemic's economic fallout. The NBS cut the key policy rate by 75 basis points to 1.5% and increased the provision of liquidity to the banking sector via swap lines and repos. Of the measures announced by the government, the following will widen the fiscal deficit to nearly 7.0% of GDP in 2020 from 0.2% the year before:

- Deferrals of three months of labor taxes and social security contributions until 2021 (2.6% of GDP; this should largely reverse by 2022 given that Serbia's fiscal accounts are presented on a cash basis);
- Wage subsidies for private sector employees (1.8% of GDP);
- Cash transfers to adult citizens (1.3% of GDP);

- Wage increases for public healthcare workers, higher healthcare spending, and one-off payments to pensioners (0.6% of GDP); and
- A dividend moratorium until the end of the year (0.3% of GDP).

Other measures that will not immediately contribute to the deficit include state guarantees of about 5% of GDP for small and midsize enterprise loans via banks and Serbia's development fund. We have recorded these separately as guarantees and not included them in our projections for government debt, unlike guarantees extended to state-owned enterprises which are included in reported government debt.

Net general government debt-to-GDP, which has been on a declining trajectory since 2015, will rise to over 50% in 2020, from 45% in 2019, in line with our projections for the deficit. We flag that about 70% of Serbia's government debt is FX-denominated, making it vulnerable to exchange-rate volatility. We project that public finances will begin to consolidate in 2021 following a rebound in economic activity.

Nevertheless, Serbia is entering this crisis with significantly lower imbalances than it faced a decade ago. This is evidenced by its diminished reliance on temperamental portfolio inflows compared to the era after the global financial crisis when these flows were the dominant source of financing for its large twin deficits. Moreover, FX reserves reached a record high in January. The NBS has managed to curb inflation to under 2% over the past six years, well below the 10% average over 2003-2012. However, the restructuring of state-owned enterprises has yielded only modest success so far.

The stability of the majority foreign-owned banking sector has improved, although the euroization of deposits and loans remains high. The system's reported average capital adequacy ratio was 23.4% as of December 2019. Last year the sector was profitable and supportive of economic growth. Nonperforming loans declined to 4% of total loans from a peak of 22% in 2015, though some asset quality deterioration is likely this year. The sale of Serbia's third-largest lender, the state-owned Komercijalna Banka, to Slovenia's Nova Ljubljanska Banka is expected to be concluded by the end of this year.

Parliamentary elections, originally slated for April 2020, have been delayed until the state of emergency is lifted. Even though we expect macroeconomic policy continuity after the elections, we think the ongoing centralization of the institutional setup could undermine longer term policy predictability. This could in turn lead to flagging investor confidence. Another repercussion could be accelerated emigration of the most educated and skilled.

Our ratings on Serbia are supported by still-moderate public debt--yielding some fiscal space for the government to implement countercyclical policies--and a credible monetary policy framework. The ratings are constrained by Serbia's relatively weak institutional settings, comparatively low income and wealth levels, sizable net external liability position, and the banking sector's extensive euroization.

Environmental, social, and governance (ESG) factors relevant to the rating action:

- Health and safety

Key Statistics

Table 1

Serbia Selected Indicators

RSD. Mil.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. LC)	4,161	4,312	4,521	4,754	5,069	5,411	5,326	5,743	6,105	6,476
Nominal GDP (bil. $)	47	40	41	44	51	51	50	52	55	57
GDP per capita (000s $)	6.6	5.6	5.8	6.3	7.2	7.4	7.2	7.6	8.0	8.3
Real GDP growth	(1.6)	1.8	3.3	2.0	4.4	4.2	(3.5)	5.0	3.0	2.8
Real GDP per capita growth	(1.1)	2.3	3.9	2.6	5.0	4.7	(3.0)	5.5	3.5	3.3
Real investment growth	(3.4)	4.9	5.4	7.3	17.8	16.4	(6.0)	7.0	6.0	5.2
Investment/GDP	16.5	18.6	17.9	19.6	22.7	23.6	22.6	23.0	23.4	23.6
Savings/GDP	10.9	15.1	15.0	14.3	17.8	16.7	16.7	16.9	18.1	19.0
Exports/GDP	42.1	45.3	48.6	50.5	50.8	51.9	50.1	50.8	51.9	53.2
Real exports growth	4.3	9.4	11.9	8.2	8.3	8.5	(5.0)	5.5	5.0	5.0
Unemployment rate	19.2	17.7	15.3	13.5	12.7	10.4	12.5	12.0	10.0	9.5
External indicators (%)										
Current account balance/GDP	(5.6)	(3.5)	(2.9)	(5.3)	(4.8)	(6.9)	(5.9)	(6.1)	(5.3)	(4.6)
Current account balance/CARs	(10.7)	(6.1)	(5.0)	(8.6)	(7.8)	(11.1)	(9.8)	(10.0)	(8.5)	(7.3)
CARs/GDP	52.2	56.5	59.0	61.4	62.1	62.1	59.9	61.0	61.9	63.0
Trade balance/GDP	(11.6)	(10.2)	(8.5)	(10.2)	(11.9)	(12.2)	(10.9)	(11.3)	(11.1)	(10.8)
Net FDI/GDP	3.5	5.1	5.2	6.2	7.4	7.8	2.5	4.5	5.0	5.0
Net portfolio equity inflow/GDP	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)
Gross external financing needs/CARs plus usable reserves	101.4	100.6	98.0	103.5	103.8	107.7	101.3	100.9	100.2	98.4
Narrow net external debt/CARs	71.1	70.6	63.4	59.9	46.7	44.5	51.5	49.3	46.7	42.1
Narrow net external debt/CAPs	64.2	66.5	60.4	55.2	43.3	40.1	46.9	44.8	43.1	39.3
Net external liabilities/CARs	160.4	164.6	152.5	157.5	137.0	142.8	160.8	159.0	158.0	154.9
Net external liabilities/CAPs	144.9	155.1	145.3	145.1	127.0	128.6	146.4	144.5	145.6	144.4
Short-term external debt by remaining maturity/CARs	38.5	37.7	30.8	28.8	29.0	31.0	35.1	31.0	29.8	28.6
Usable reserves/CAPs (months)	5.1	4.9	4.4	3.6	3.5	3.4	4.7	4.3	4.2	4.3
Usable reserves (mil. $)	9,629	9,235	8,857	9,980	10,183	12,866	12,666	12,858	13,665	14,732
Fiscal indicators (general government; %)										

Table 1

Serbia Selected Indicators (cont.)

RSD. Mil.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Balance/GDP	(6.2)	(3.5)	(1.2)	1.1	0.6	(0.2)	(6.7)	(2.8)	(1.5)	(1.0)
Change in net debt/GDP	9.4	6.6	1.2	(6.3)	(1.0)	(0.8)	6.8	3.8	1.2	0.7
Primary balance/GDP	(3.4)	(0.4)	1.7	3.6	2.8	1.8	(4.7)	(0.7)	0.6	1.0
Revenue/GDP	39.0	39.3	40.8	41.5	41.5	42.1	39.9	41.5	41.4	41.4
Expenditures/GDP	45.2	42.8	41.9	40.4	40.9	42.3	46.6	44.3	42.9	42.4
Interest/revenues	7.1	7.7	7.1	6.1	5.2	4.8	4.9	4.9	5.0	4.9
Debt/GDP	67.5	71.2	68.8	58.7	54.4	52.9	60.6	60.0	57.6	55.0
Debt/revenues	173.3	181.3	168.8	141.4	131.0	125.7	151.9	144.6	139.2	132.8
Net debt/GDP	59.4	63.9	62.1	52.8	48.5	44.6	52.1	52.1	50.2	48.0
Liquid assets/GDP	8.1	7.3	6.7	5.9	5.9	8.3	8.5	7.9	7.4	7.0
Monetary indicators (%)										
CPI growth	2.1	1.4	1.1	3.1	2.0	1.8	1.0	2.0	3.0	3.0
GDP deflator growth	2.6	1.8	1.5	3.0	2.1	2.5	2.0	2.7	3.2	3.2
Exchange rate, year-end (LC/$)	99.46	111.25	117.14	99.12	103.39	104.92	109.00	111.00	113.00	115.00
Banks' claims on resident non-gov't sector growth	3.1	3.1	2.6	2.1	9.6	9.0	0.0	5.0	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	45.3	45.1	44.1	42.9	44.1	45.0	45.7	44.5	44.4	44.3
Foreign currency share of claims by banks on residents	45.2	45.3	43.1	42.5	42.6	43.3	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	59.6	58.2	59.4	58.7	58.3	53.4	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(2.2)	(5.2)	(1.3)	3.3	3.6	(0.2)	N/A	N/A	N/A	N/A

Sources: Statistical Office of the Republic of Serbia (Economic Indicators), National Bank of Serbia (External Indicators), Ministry of Finance of the Republic of Serbia (Fiscal Indicators), and National Bank of Serbia, International Monetary Fund (Monetary Indicators).
Adjustments: Usable reserves adjusted by subtracting required bank reserves on resident foreign-currency deposits from reported international reserves.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Serbia Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	4	Reduced policy predictability resulting from increasingly centralized decision-making. Pressure on independent media suggests a certain degree of political interference in the free dissemination of information and relatively weak transparency.
Economic assessment	4	Based on GDP per capita ($) as per the Selected Indicators table above.
External assessment	4	Based on narrow net external debt and gross external financing needs as per Selected Indicators in Table 1.
		Balance of payments risks due to a potential shift in foreign direct investment flows given Serbia's large net external liability position.
Fiscal assessment: flexibility and performance	2	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
Fiscal assessment: debt burden	2	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		More than 70% of gross government debt is denominated in foreign currency.
Monetary assessment	4	The Serbian Dinar is a managed float. The central bank intervenes in the foreign exchange market to smoothen excessive exchange rate volatility and to accumulate FX reserves.
		The central bank has operational independence, uses market-based monetary instruments, and has maintaind low-single-digit inflation over the past half-decade.
		Resident deposits and loans in foreign currency exceed 50% of total.
Indicative rating	bb+	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	None
Final rating		
Foreign currency	BB+	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	BB+	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility

Assessments, May 18, 2009

Related Research

- Longer Lockdowns, Heightened Risks, April 23, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- FAQ: Sovereign Ratings And The Effects Of The COVID-19 Pandemic, April 16, 2020
- COVID-19 Credit Update: The Sudden Economic Stop Will Bring Intense Credit Pressure, March 17, 2020
- Serbia Upgraded To 'BB+' On Resilient Macroeconomic Fundamentals; Outlook Positive, Dec. 13, 2019
- Sovereign Risk Indicators, April 24, 2020. An interactive version is also available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Serbia		
Sovereign Credit Rating	BB+/Stable/B	BB+/Positive/B
Senior Unsecured	BB+	BB+
Transfer & Convertibility Assessment	BBB-	BBB-