Euler Hermes Economic Research

Country Risk Analysis

Serbia

In the midst of a double-dip recession

General Information

Form of state	USD45.8bn (World ranking 80, World Bank 2011)
Population	7.26 millions (World ranking 98, World Bank 2011)
Form of state	Republic
Head of government	Tomislav NIKOLIC
Next elections	2016, legislative

Strengths

- Foreign exchange reserves appear currently adequate (but are vulnerable to domestic and external shocks).
- Acceptable business environment.

Weaknesses

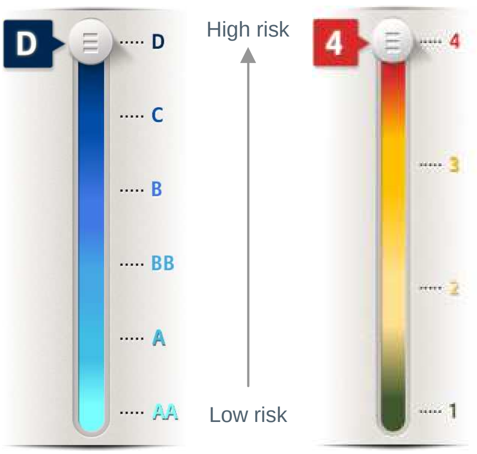
- High systemic political risks: government instability, weak policymaking, unresolved Kosovo conflict.
- Continued poor growth outlook causes high commercial risk.
- Poor economic policy track record.
- Exchange rate risk. Exchange rate volatility poses refinancing risk for Serbian businesses and raises payment default risk for exporters to Serbia.
- Ongoing large current account deficits.
- High external debt levels.

Country Rating

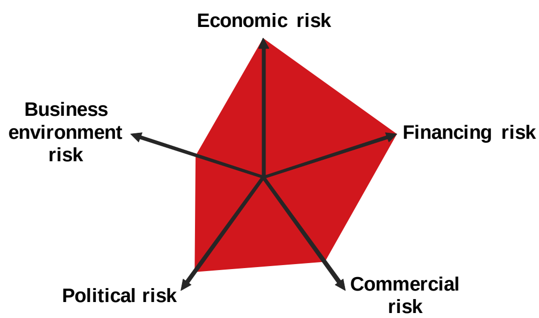
D4

Country Grade

Country Risk Level



Risk Dimensions



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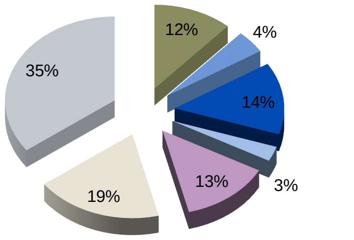
Economic Structure

GDP breakdown (% of total, 2010)



Sources: Chelem, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2010)

By destination/origin

Exports		Rank		Imports
Italy	13%	1	12%	Germany
Bosnia and Herzegovina	11%	2	9%	Russia
Germany	10%	3	9%	Italy
Russia	6%	4	5%	Hungary
Slovenia	5%	5	5%	China

By product

Exports		Rank		Imports
Iron Steel	11%	1	7%	N.E.S. Products
Non Ferrous Metals	8%	2	5%	Crude Oil
Plastic Articles	5%	3	4%	Plastic Articles
Cereals	4%	4	4%	Natural Gas
Electrical Apparatus	4%	5	4%	Refined Petroleum Products

Economic Forecasts

	Average 2000-08	2009	2010	2011	2012f	2013f	2014f
GDP growth (% change)	4.9	-3.5	1.0	1.6	-1.7	0.9	2.0
Inflation (%, end-year)	22.2	6.6	10.3	7.0	12.2	6.0	6.0
Fiscal balance (% of GDP)	-1.0	-3.7	-3.7	-4.2	-6.8	-5.9	-6.3
Public debt (% of GDP)	83.3	38.1	46.5	50.1	63.1	63.9	66.5
Current account (% of GDP)	-9.8	-7.1	-7.1	-9.5	-11.5	-10.5	-11.0
External debt (% of GDP)	70.2	82.3	85.7	72.1	86.7	97.0	92.3

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

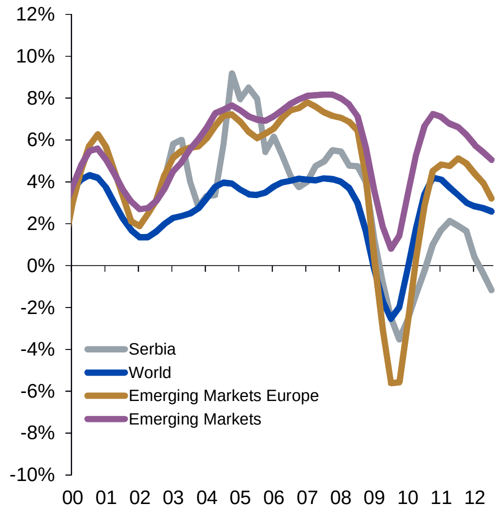
In the midst of a double-dip recession.

Following the recession in 2009, the economy grew by just +1% in 2010 and +1.6% in 2011, and shifted back into recession in 2012, contracting by an estimated -1.7%. Detailed GDP data for 2012 are not available yet, but other statistical releases indicate the drivers of the downturn. Industrial production fell by -2.9% in 2012, while real retail trade turnover dropped by -6.2%, suggesting that domestic demand has remained very weak. On the external trade front, nominal exports increased by +4.7% in EUR terms in 2012 while imports grew somewhat slower (+3.7%). Nonetheless, net exports continued to deteriorate given an unfavourable export/import ratio.

Growth in 2013 will be modest, at best.

Given very high unemployment (about 25% in 2012) and ongoing fiscal austerity, domestic demand is unlikely to recover in 2013 while external demand may gain some momentum once the recession in the eurozone gives way to modest expansion in H2 2013 (as currently expected). We forecast annual GDP to grow by just under +1% in 2013 and to pick up gradually to +2% in 2014. However, the balance of risks to this forecast is to the downside.

GDP growth (annual, %)

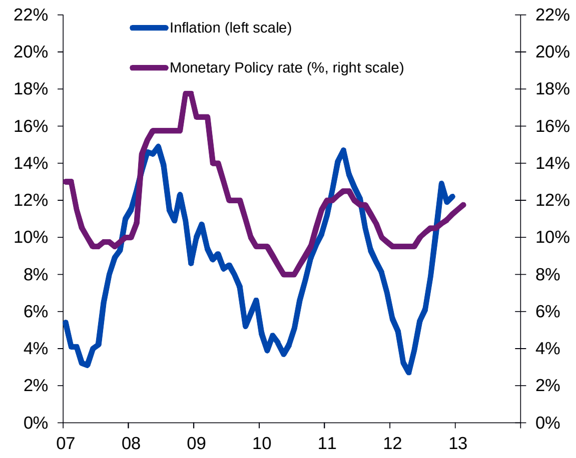


Sources: IHS Global Insight, Euler Hermes

In 2013, inflation will remain elevated ...

Inflation moderated from 7% at end-2011 to 2.7% y/y in April 2012, before accelerating again to 12.2% at end-2012 as a result of currency depreciation, increased food prices due to a poor harvest, tax rises and increasing administrative prices. As these negative impacts will wane only gradually, inflation is forecast to remain elevated for some time before falling to around 6% at end-2013. However, the balance of risks to this forecast is to the upside, especially owing to exchange rate vulnerability.

Inflation (%)



Sources: IHS Global Insight, Euler Hermes

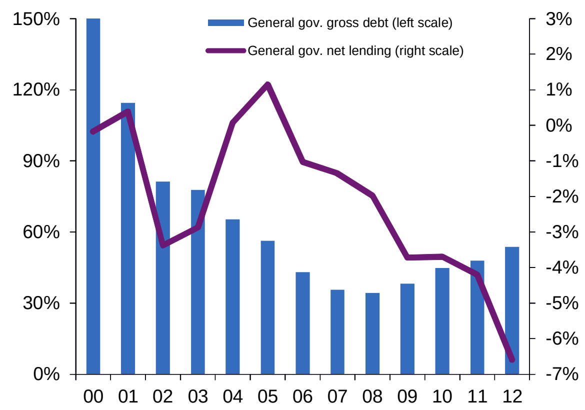
…and so will interest rates.

Between June 2013 and February 2013, the National Bank of Serbia (NBS) has raised its key policy interest rate eight times by a cumulative 325 bps to 11.75%, in a continued effort to stabilise the dinar (RSD) while keeping inflation contained. Nonetheless, the latter has overshot the 3.5–5.5% target band set by the NBS since July 2012.

Exchange rate risk remains on the cards.

The RSD/EUR exchange rate has shown considerable vulnerability and high volatility over the past decade and in particular since the onset of the 2008-2009 global financial crisis. During the first eight months of 2012, the RSD fell by 13% to a record low of 118.5 against the EUR, but recovered somewhat to 113.7 at year-end (down 8.7% y/y). Prevailing weak macroeconomic fundamentals, doubts about the economic policy direction including fiscal consolidation and protracted uncertainty on global financial markets potentially will continue to put occasional downward pressure on the RSD. Any domestic or global bad news could lead to another relatively sharp drop of the exchange rate.

Fiscal balance and General government debt (% GDP)



Sources: IHS Global Insight, Euler Hermes

The fiscal position is increasingly precarious.

The fiscal deficit has steadily deteriorated in recent years and reached an unsustainably large 6.5% or so of GDP in 2012. The currently planned fiscal consolidation measures appear insufficient to reach the targeted deficit of 3.6% of GDP in 2013. We expect a deficit close to 6% of GDP. Public debt has also increased significantly in recent years and will exceed 60% of GDP in 2013.

The external position remains particularly weak, indicated by continued large current account deficits...

The current account deficit widened further to about 11.5% of GDP in 2012 from 8.9% in 2011. Particularly worrisome, net foreign direct investment inflows covered just 5% of the external deficit in the first 11 months of 2012, down from 46% in 2011. The remainder had to be financed through new external borrowing.

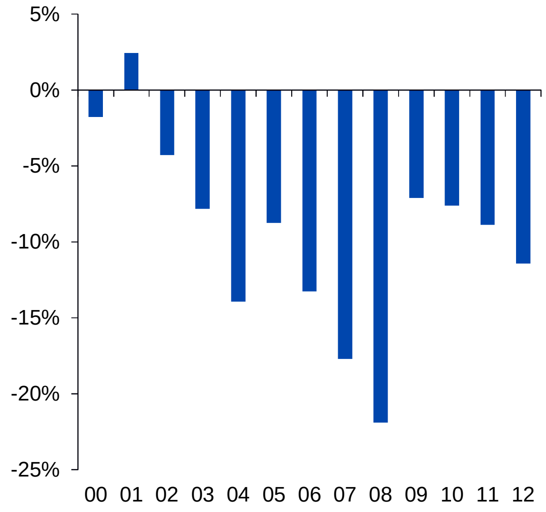
... and a very high external debt burden.

Consequently, gross external debt increased to about EUR26bn in 2012, equivalent to about 86% of GDP (77% in 2011) and 216% of annual export earnings. The annual debt service on medium- and long-term debt is forecast at a relatively high 24% of export earnings in 2013.

Foreign exchange reserves appear adequate but could erode quickly.

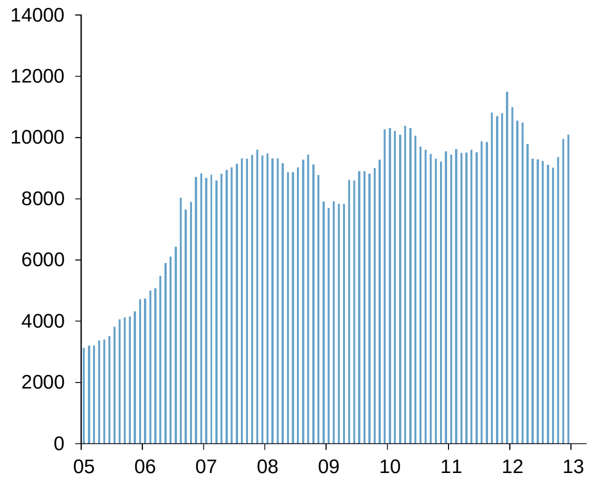
Foreign exchange (FX) reserves dropped by 22% from a peak of EUR11.5bn at end-2011 to EUR9bn in September 2012, before recovering to EUR10.1bn at end-2012 (still down 12% y/y). The current level of FX reserves is still comfortable with regard to import cover (about seven months). However, the high volatility suggests that there is a significant risk that reserves could erode rapidly should market confidence diminish once again and the central bank launch an attempt to support the RSD.

Current account balance (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (EURmn)



Sources: IHS Global Insight, Euler Hermes

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