Country Report

Serbia

Growth momentum picks up but external vulnerabilities remain large

General Information

GDP	USD37.7bn (World ranking 89, World Bank 2016)
Population	7.1mn (World ranking 104, World Bank 2016)
Form of state	Parliamentary Republic
Head of government	Ana BRNABIC (Prime Minister)
Next elections	2020, legislative

Strengths

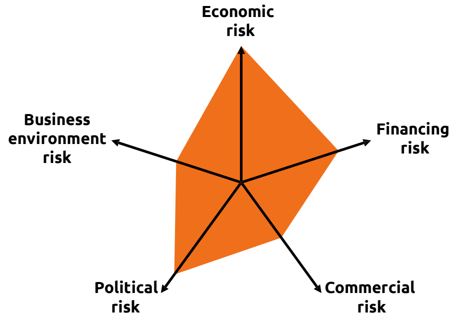
- Adequate business environment relative to regional peers, according to the World Bank's annual *Doing Business* surveys
- Comfortable level of foreign exchange reserves
- Low labor cost plus generous state subsidies for foreign companies

Weaknesses

- High systemic political risks: history of instability, weak policymaking and unresolved Kosovo conflict
- Poor macroeconomic policy track record
- High public debt
- High external financing needs and debt burden
- Exchange rate volatility and vulnerability to shocks
- Deficient infrastructure (roads, railways)
- Elevated level of perceived corruption and bureaucracy

Country Rating

D3



Source: EulerHermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Italy	15%	1	13%	Germany
Germany	13%	2	10%	Italy
Bosnia and Herzegovina	8%	3	8%	China
Romania	6%	4	8%	Russian Federation
Russian Federation	5%	5	5%	Hungary

By product (% of total)

Exports		Rank		Imports
Road vehicles	10%	1	9%	Road vehicles
Electrical machinery	8%	2	6%	Petroleum products
Vegetables and fruits	5%	3	5%	Electrical machinery
Cereals	5%	4	3%	Other industrial machinery
Power generating machinery	5%	5	3%	Pharmaceutical products

Source: Unctad (2016)

Economic Overview

Acceleration of growth ahead

Serbia's economy is expected to expand by +1.7% in 2017 before accelerating to +2.5% in the next two years. This growth will stem from strong exports due to rising foreign demand as well as the expansion of production capacities. The latter is due to the investment efforts of previous years in manufacturing and mining.

The country has benefited from steady FDI inflows, increasingly from Chinese investors which acquired, for example, Serbia's largest steel mill in 2016. The government recently adopted new regulation to attract more FDI. The expansion of investment and industrial production should accelerate over the next years, driving GDPgrowth.

Cheap labor cost and generous state subsidies for the creation of new jobs entice foreign investors to relocate facilities to Serbia. Yet, financial incentives are distributed in a non-transparent manner, which opens the door to corruption. It has become the new normal for Balkan countries to outbid one another in terms of subsidies to attract new foreign companies, despite their fiscal constraints.

Wages in Serbia are among the lowest in the Balkans, weighing on consumer spending. The government and the IMF agreed to raise public wages and pensions by 5-10% in 2018. Improving labor market conditions may lead to wage increases in the private sector, though real wage growth will be more modest due to higher inflation. This should help boost the still relatively low purchasing power.

External financing risk and debt burden

Public finances are gradually improving. Fiscal consolidation (e.g. less state involvement) has brought down the fiscal deficit to adequate levels since 2016. Yet public debt will remain high. In relation to GDP, it has risen from 32% in 2008 to currently 73%, mainly due to the continued depreciation of the RSD. Around 72% of public debt is denominated in USD or EUR. Being highly sensitive to exchange rate fluctuations, this is a source of external vulnerability, which has forced the Central Bank to be interventionist beyond its inflation mandate.

The current account deficit is set to come in at -5% of GDP in 2017 because of higher energy imports and lower agricultural commodity exports due to a bad season. Although most of the external shortfall is financed by (relatively stable) FDI inflows, the creditworthiness of Serbia remains an issue.

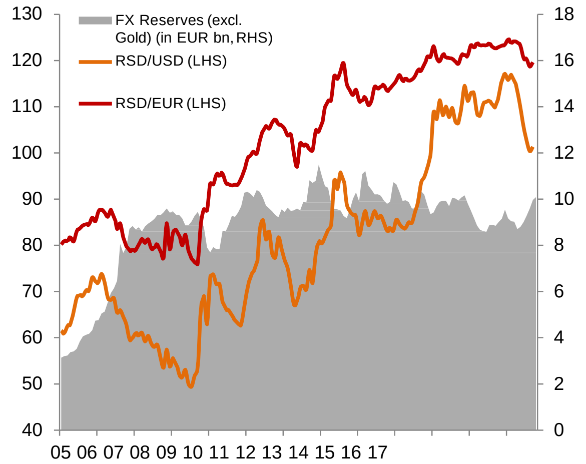
The RSD has continuously weakened since the onset of the global financial crisis and the ensuing domestic triple-dip recession. Downward pressures have been exacerbated by the high share of borrowing in foreign currency accompanied by the rise in gross external debt (77.5% of GDP in 2017).

Key economic forecasts

	2016	2017e	2018f	2019f
GDP growth (% change)	2.8	1.7	2.5	2.5
Inflation (%, yearly average)	1.1	3.1	3.3	3.5
Fiscal balance (% of GDP)	-1.4	-1.5	-1.4	-1.3
Public debt (% of GDP)	73.6	73.0	71.0	70.0
Current account (% of GDP)	-4.0	-5.0	-4.5	-4.5
External debt (% of GDP)	77.9	77.5	77.0	77.0

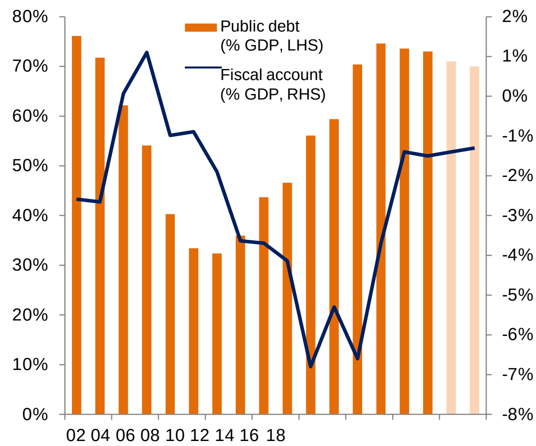
Sources: National sources, IHS, Euler Hermes

Exchange rates and FX reserves



Sources: National Bank of Serbia, Euler Hermes

Public finances (% of GDP)



Sources: IMF, Eurostat, Euler Hermes

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