Fitch Affirms Serbia at 'BB+'; Outlook Positive

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Fitch Ratings - Frankfurt am Main - 31 Jan 2025: Fitch Ratings has affirmed Serbia's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB+' with a Positive Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Credit Fundamentals: Serbia's ratings are supported by a sound policy mix, including a record of prudent fiscal management, robust economic growth outlook, strengthened international reserves and stronger GDP per capita compared with the 'BB' median. Set against these factors are Serbia's greater share of foreign-currency-denominated public debt than peer group medians, as well as a high degree of banking sector euroisation and large current account deficits.

Positive Outlook: The Positive Outlook reflects robust investment-led economic growth, underpinned by the "Leap into the Future - Serbia Expo 2027" plan, continued government debt reduction, a strengthened external position and sound management of the recent inflation shock. Solid growth has supported an almost 80% increase in GDP per capita in US dollar terms between 2018 and 2024. Fiscal policy, anchored on an IMF programme, will support further debt reduction over the medium term, amid increased capex.

Large Investment Pipeline: Short-term growth prospects are robust and will be led by public and private investment. The "Leap into the Future - Serbia Expo 2027" plan contains EUR18 billion (21.8% of 2024 GDP, to be spent over 2024-2027) allocated to 320 public investment projects centred on the Belgrade Expo 2027. The Expo itself will account for EUR1.2 billion of the total with the remaining investment directed to road and rail, industrialisation and other infrastructure projects.

Fitch has greater clarity on the fiscal implications and costs of major investment projects than at the time of its last review in August, but the precise sequencing of project implementation remains unclear. The authorities have a reasonably good record of project execution, although handling this magnitude of projects could pose challenges and we expect some under-execution of budgeted capex.

Strong Economic Growth: Fitch forecasts real GDP growth to rise from an expected 3.9% in 2024 to 4.2% in 2025 and 4.4% in 2026, with trend growth estimated at 4%. Private consumption will remain solid, supported by a robust labour market and steady inflow of remittances. Net exports will be negative given the high import bill, but new export capacities and the recovery of EU trade partners will support export growth. Successful implementation of infrastructure projects may boost productivity in the medium term.

Falling Government Debt: Fitch expects fiscal policy will be consistent with gradual debt reduction and should limit the risks of overheating, despite high investment spending. Fitch forecasts general government debt/GDP to decline to 46.6% in 2024, from 48.4% in 2023, and to below 45% by end-2027, below the current 'BB' median. The lower debt level compared with the August review reflects an upward revision of national account data. Debt reduction will be supported by strong nominal GDP growth and primary deficits averaging 0.4%.

Higher Fiscal Deficits, Investment: Fitch estimates the general government deficit was 2.1% of GDP in 2024, below the revised target of 2.7%, reflecting higher revenue from excise duties, corporate income tax, dividend payment and social contributions, and lower current expenditure.

The government revised the fiscal deficit targets for 2025-2027 to 3%, from 2.5% in 2025 and 2.3% in 2026-2027 originally. Higher deficit targets reflect increased capex, which is planned at 7.4% of GDP in 2025-2027, and higher defence expenditure. The increase in the deficit targets was agreed with the IMF under the new Policy Coordination Instrument. Given the record of budget over-performance and considering potential expenditure under-execution, Fitch expects the deficit to widen to 2.6% in 2025-2026, below the 'BB' median.

Domestic Political Uncertainty: At end-January 2025, Prime Minister Vucevic resigned, following months of protests over the accident at a railway station in Novi Sad in 2024. This has led to the collapse of the government, which had been in place since May 2024. Under the constitution, a new government needs to be appointed within a month, or the president will have to call early elections. In Fitch's view, the impact of the current political situation on the policy mix should be small but it could lead to increased spending pressures or delay in reform and project implementation.

Strengthened External Position: The external position continued to strengthen as strong net FDI and portfolio inflows more than fully covered the widening current account deficit (CAD). Balance of payments data for 11M24 show a CAD of EUR4.3 billion (5.2% of projected 2024 GDP) and net FDI inflows of EUR4.1 billion. Central bank purchases to offset exchange rate appreciation pressure reached EUR2.7 billion and a USD1.5 billion Eurobond issued in June lifted total reserves to EUR32.5 billion at end-2024, up EUR4.6 billion since end-2023.

Wider CAD: Fitch expects the investment-driven rise in the import bill will widen the CAD to 6.2% of GDP in 2025-2026, from 5.8% in 2024. Net FDI and portfolio inflows will fully cover the deficit in 2025 and 2026, allowing an increase in reserves in each year. We estimate reserve coverage peaked at 6.2 months of current external payments in 2024, above the estimate for the 'BB' median of 4.9 months, before falling to 5.9 months in 2026.

Inflation to Stay Within Target: Headline inflation averaged 4.6% in 2024. Fitch expects inflation to move within the upper range of the tolerance band (3% +/- 1.5%) in 2025 and to gradually move toward the inflation target at end-2026. We see CPI on average at 3.7% in 2025 and 3.3% in 2026, marginally above the current 'BB' median. After the National Bank of Serbia reduced rates by a cumulative 75bp to 5.75% in 2024, we expect it to remain cautious and to cut the policy rate by a total of 100bp in 2025, amid external and domestic pressures.

ESG - Governance: Serbia has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Serbia has a medium WBGI ranking at 48th percentile reflecting a moderate level of rights for participation in the political process, moderate institutional capacity, established rule of law and a moderate level of corruption.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-**Public Finances:** An increase in general government debt/GDP, for example, due to a structural fiscal loosening and/or substantial capital spending overruns.

-**Macro:** Weaker economic growth, for example, from markedly lower FDI, prolonged domestic political uncertainty and/ or increase in geopolitical risks.

-**External Finances:** An increase in external vulnerabilities, for example, from intensified financing pressures or a worsening of imbalances, leading to a sharp fall in FX reserves, or higher external debt and interest costs.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-**Public Finances:** Greater confidence in a downward trajectory of general government debt/GDP.

-**Macro:** Continued robust GDP growth that supports ongoing convergence in GDP per capita with higher rated peers, while maintaining macroeconomic stability.

- **Structural:** An improvement in governance, potentially incorporating steps that would smooth EU accession prospects.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Serbia a score equivalent to a rating of 'BB+' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Serbia is 'BBB-', 1 notch above the LTFC IDR. This reflects moderate constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of 0 notches above the IDR. Fitch's rating committee applied a +1 notch qualitative adjustment under the Long-Term Institutional Characteristics pillar reflecting the importance of FDI to Serbia's open economy and the EU accession process.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Serbia has an ESG Relevance Score of '5' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Serbia has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Serbia has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Serbia has a percentile rank below 50 for the respective Governance Indicators, this has a negative impact on the credit profile.

Serbia has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Serbia has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Serbia has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Serbia, as for all sovereigns. As Serbia has a track record of 20 years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit