FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Serbia at 'BB+'; Outlook Positive

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Fitch Ratings - Frankfurt am Main - 25 Jul 2025: Fitch Ratings has affirmed Serbia's Long-Term Foreign-Currency (LTFC) 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, strengthened international reserves and stronger GDP per capita compared with the 'BB' median. Set against these factors are the state's greater reliance on external funding than peers, which implies a high share of foreign-currency-denominated public debt, high banking sector euroisation and big current account deficits (CAD).

Positive Outlook: The Positive Outlook reflects solid, 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. However, increased domestic political uncertainty creates risks for the economic outlook, having already contributed to pressures on FX reserves in early 2025.

High Political Uncertainty: Student-led protests have continued across Serbia since the infrastructure accident in Novi Sad in November 2024 and even intensified with clashes with police at end-June. Protesters have broad demands, but these have not been formalised into a political agenda or movement. The results of June local elections indicate high social polarisation. While the ruling SNS party won the votes, the opposition achieved strong results, though it remains highly fragmented.

Presidential elections are due in spring 2027 and parliamentary elections by end-2027, but recent statements by President Vucic suggest that early elections remain a possibility. After Milos Vucevic resigned as prime minister in January, the new cabinet led by Duro Macut was appointed in April and remains committed to a sound macroeconomic and fiscal policy mix. However, domestic political considerations and the potential timing of elections could lead to additional fiscal easing.

Weaker Short-Term Growth Outlook: Fitch revised its 2025 growth forecast down to 3%, from 4.2% projected in a January review, given weaker than expected outturns, high domestic political and global trade uncertainty. In 1Q25, real GDP growth eased to 2% yoy (-0.6% qoq) on slower household spending and a decline in fixed investment. Social protests weighed on consumer and investor sentiment, amid lower remittances and FDI inflows. We expect growth to improve over the rest of the year, though downside risks persist due to the indirect effect of US tariff increases, potential sanctions on NIS, the Serbian oil company, and uncertain agriculture output.

Investment to Support Growth: Fitch projects growth to accelerate to 3.7% in 2026 and 4.2% in 2027, underpinned by a large pipeline of public and private investment, and spillovers into tourism and household spending in 2027. The 'Leap into the Future' plan includes EUR17.8 billion (20% of 2025 GDP) of public investment projects centred on the Belgrade Expo 2027, with EUR8 billion spent by the end of 2024. Despite political uncertainty, projects directly linked to the Expo site are on time, with delays for others. The authorities have a reasonably good record of project implementation, although we expect some under-execution of budgeted capex.

Larger Fiscal Deficits: Fitch expects the fiscal deficit to widen to 3% of GDP in 2025, from 2% in 2024, in line with the peer median, amid a weaker economic growth outlook. We expect the government will be able to accommodate any potential revenue shortfall, given flexibility to adjust capex. We expect the fiscal deficit to narrow to 2.7% in 2026-2027, in line with the 'BB' median, as growth picks up and we anticipate some expenditure under-execution. Capex is budgeted at 7% of GDP on average annually between 2025 and 2027.

Modest Decline in Debt: Fitch forecasts general government debt/GDP will decline to 46.1% in 2027, from 47.5% in 2024, below the 'BB' and 'BBB' medians. The debt reduction will be from a higher staring point than projected in January and will be slower due to lower nominal GDP growth and wider primary deficits averaging 0.6% of GDP.

Serbia's government is heavily reliant on external financing, which represents 71% of the debt stock and explains a high 78% share of debt in foreign currencies, though currency risk is largely mitigated by a credible, stabilised exchange rate with respect to the euro (in which most debt is denominated). Very high central government deposits (at 8.7% of GDP at end-April 2025) give Serbia flexibility to cover its financing needs.

Wider CAD, Lower FDI Inflows: Balance of payments data for 5M25 show the CAD widening relative to 2024 due to an investment-driven rise in the import bill, and net FDI inflows declining. Fitch expects the CAD to widen to 5.3% of GDP in 2025 and 5.6% in 2026, from 4.7% in 2024, before narrowing to 4.5% in 2027. We project the net FDI to average 4.3% of GDP in 2025-2027, with other financial flows covering the gap. The rising import bill means that reserves-to-current external payments will decline to 5.8 months in 2025 (versus 'BB' median at 4.8 months) and further to 5.3 months in 2027.

Inflation to Stay Within Target: Headline inflation moved within the upper range of the inflation target (a range 1.5pp either side of 3%) in 1H25 and was driven by persistent, although easing, services inflation and accelerating food prices. In the remainder of the year, food prices will continue to put upward pressure on inflation, given a likely below-average agriculture season. We see inflation on average at 4.3% in 2025, 3.5% in 2026 and 3.1% in 2027. The National Bank of Serbia has kept rates stable at 5.75% since September 2024 and we expect it to remain cautious and cut the policy rate by 25bp in 2025 and 100bp in 2026, amid external and domestic pressures.

ESG - Governance: Serbia has an ESG Relevance Score (RS) of '5' for 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 and rule of law and perception of corruption is high.

RATING SENSITIVITIES

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

- **Macro:** Weaker economic growth or macroeconomic instability, for example, from prolonged domestic political uncertainty and/or geopolitical risks

- **External Finances:** An increase in external pressures, leading to a fall in FX reserves

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

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

- **Macro:** Greater confidence that current domestic political instability will not derail the solid growth outlook or undermine 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 'BBB-' on the LTFC IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM score to arrive at the final LTFC IDR by applying its QO, relative to SRM data and output, as follows:

- Structural: -1 notch, to reflect current high level of domestic political uncertainty that may have a negative impact on the growth outlook and external finances.

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 LTFC 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-', one 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 zero 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 WBGIs 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. Political risk has increased amid ongoing social protests.

Serbia has an ESG Relevance Score of '5' for Rule of Law, Institutional and Regulatory Quality and Control of Corruption as WBGIs 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 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 WBGIs 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 track record of 20+ years without a restructuring of public debt as 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 www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Serbia	LT IDR	BB+	Affirmed	BB+
	ST IDR	B	Affirmed	B
	LC LT IDR	BB+	Affirmed	BB+
	LC ST IDR	B	Affirmed	B
	Country Ceiling	BBB-	Affirmed	BBB-
senior unsecured	LT	BB+	Affirmed	BB+
Senior Unsecured-Local currency	LT	BB+	Affirmed	BB+

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Country Ceiling Criteria (pub. 24 Jul 2023)

Sovereign Rating Criteria (pub. 24 Oct 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.3 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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