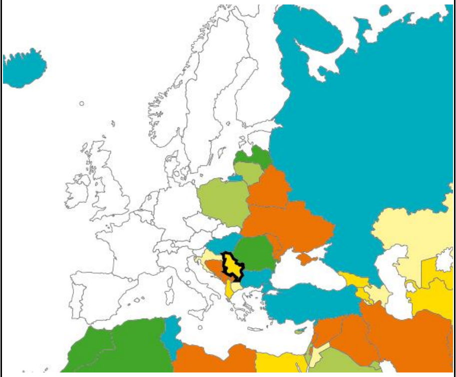
COUNTRY RISK ANALYSIS

Serbia

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

6/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 3.5 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 637 MILLION

DATE

17/3/2015

Focus on reforms in rough economy

The economic decline and the lack of reforms have led to an increase in the budget deficit and high debt for several years. Serbia opened negotiations with the EU on future membership in January 2014. The path to accession to the union is long, but provides a strong incentive for the government to step up its efforts on structural reforms that need to be implemented, with respect to both the economy and the judiciary. The government has initiated an extensive programme to strengthen the budget, reduce the debt and increase investments in the country. The leading government party garnered stronger support to continue its reform policies in a snap election in March 2014. A new three-year agreement with the IMF was negotiated in early 2015, which is a step in the right direction for Serbia. Overall, the country faces a difficult economic situation with negative GDP growth expected for the second year in a row. The government seems to have charted a course toward EU accession, but austerity is rarely easy to implement and the path will be long and bumpy.

THE COUNTRY'S STRENGHS AND WEAKNESSES

Strengths

- Opened EU membership negotiations and a new IMF agreement speeding up reforms.
- Adequate international reserves.
- Relatively rich in natural resources.

Weaknesses

- Weak competitiveness generating structural deficits in foreign trade.
- High external debt.
- Difficult business environment lowering interest in investments.

EKN'S POLICY

Unchanged policy

Serbia is in country risk category 6 – an assessment made in collaboration with the OECD. EKN has a restrictive risk assessment policy for all buyer categories except pure sovereign risks. Additional payment collateral is required for other public buyers. For bank and corporate risks, EKN particularly takes into account counterparty currency exposure. Adequate financial transparency in the form of complete, audited financial statements is also important for corporate risks.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A decrease in the budget deficit, falling debt levels and currency stabilisation.
- A substantial improvement in the business environment and structural reforms.

The policy may be made more restrictive in the event of

- A weaker currency, putting companies in a more vulnerable position.
- Suspended EU negotiations or failed economic reforms.

EKN'S EXPOSURE AND EXPERIENCE

EKN's outstanding guarantees to Serbia were SEK 640 million. EKN's guarantee exposure consists mainly of transactions in the telecom and power sectors, but the mining, machinery and transport industries are also represented. The number of guaranteed transactions is relatively low, just under ten transactions per year on average. In recent years, EKN has had payments in arrears and claims in Serbia, especially in the construction, mining and transport sectors. Recovery processes via the judiciary are slow and the outcome is uncertain. Locally registered collateral, such as in the form of liens and pledges, has proven decisive for a quick ruling in court. The enforcement of court rulings and repossession of equipment is complicated and time-consuming. In some cases, guarantee holders have had trouble bringing recovered amounts out of the country. However, EKN's payment experience in the telecom sector has been positive. EKN's claims on Serbia total SEK 100 million, mainly comprising political receivables associated with transactions entered into in the 80s and 90s. These receivables are subject to a Paris Club agreement and are being honoured according to plan. The agreement stipulates that final repayment be made in 2024.

COUNTRY ANALYST

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DISCLAIMER

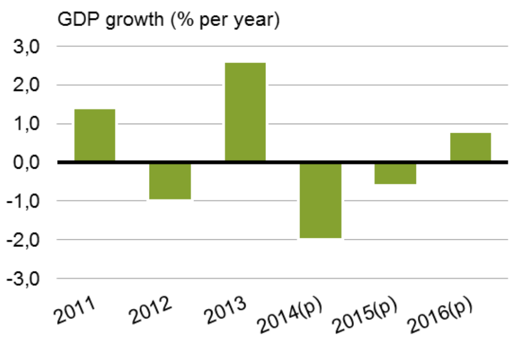
RISK DEVELOPMENT

Structural reforms required for sustainable growth

Serbia's economic problems are rooted in the national breakup, war and sanctions of the 1990s, as well as an industrial sector that is aging and lacks competitiveness. The economy is relatively diversified but inefficient. There is only small scope for measures to stimulate growth because the public finances are very strained. The IMF suspended its assistance programme for Serbia in the wake of the government passing an expansionary budget instead of necessary but unpopular budget cuts to strengthen the public finances. Loans have been raised both in the international and domestic capital markets as well as from Russia. A reform programme was initiated in 2013 and 2014 and a new election was called for March 2014 thanks to the solid poll ratings of the leading government party. The Serbian Progressive Party, SNS, came out of the elections stronger, with a stronger mandate from the voters to continue down the reform path set out. However, the large-scale flooding that impacted the Balkans in the spring of 2014 was a major setback. The costs are estimated to be EUR two billion for Serbia alone. The crucial agriculture sector was hit hard, as well as electricity production.

Serbia's Reform efforts need to be sped up as a result of the negotiations with the EU on Serbian EU membership, which were opened in early 2014. The negotiations are expected to last for several years and crucial requirements imposed on Serbia, apart from economic reforms, are reforms to the judiciary and public administration, as well as measures to combat corruption and organised crime. Perhaps the largest stumbling block will be the EU's requirement that Serbia establish normal relations with Kosovo, which thus far has led to the membership negotiations being drawn out. The immediate economic challenges together with the EU negotiations are so important for Serbia's government that reforms in the right direction will likely be implemented. The agreement between the IMF and Serbia in February 2015 is a step in the right direction. The agreement enables Serbia to borrow when needed, but more importantly, it serves as a stamp of approval, and a supervisory authority, for the government's reform programme.

GDP for 2014 and the forecast for 2015 have been adjusted down to negative growth as a result of the floods, continuing weak international economic conditions and austerity. Domestic consumption remains restrained and demand from key trade partners in Europe is weak. The national debt has gradually increased over the past years and is expected to continue rising to approximately 80% of GDP by 2016. Around 80% of the national debt is in foreign currencies, which, together with a weakened currency, adds to the government's problems. Serbia's weak current account balance is rooted in its chronic trade deficit. Exports recovered to a certain extent in 2013, mainly in the automotive industry and the agricultural sector. The deficit is expected to be approximately 6% for 2015 and 2016. The current account deficit has previously been compensated by capital inflows for investments in the country. Serbia's high external debt gives the country a very high debt service ratio, nearly 40% of exports. The Serbian dinar depreciated by 20% in 2014, which led to a further increase in the cost of the external debt and is a concern for the

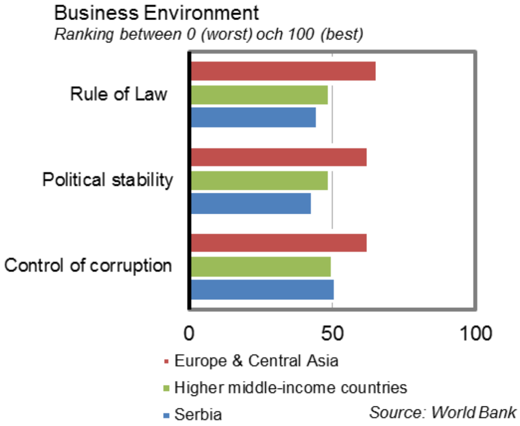


sustainability of the debt. Serbia's international reserves are at a high level, the highest in the Balkans region, and are equivalent to around seven months of imports. Without stabilising measures to boost the country's investment climate and confidence in the country's currency, the reserves will however gradually decrease. The external debt and debt service ratio will remain very high in the coming years. The large budget deficit and current account deficit, low growth and future public spending cuts with noticeable effects indicate that Serbia is in a tough situation.

BUSINESS ENVIRONMENT

Difficult business climate

The World Bank ranks Serbia in 91st place in the world in terms of its business climate, worse than the majority of its neighbours. Despite several initiatives being taken to improve the business climate, there is an extensive bureaucratic burden, which is also contributing to widespread corruption. Complicated tax laws have created a black market for goods and services. In recent years, initiatives have been taken for improvement in areas involving lending, ownership, insolvency and property tax, but the process of change is progressing slowly. Serbia is expected to continue working to improve its business climate in the coming years. For business risk assessments, special attention should be paid to corporate currency exposure, given the risks associated with a high level of borrowing in foreign currencies and a depreciating domestic currency. Three-quarters of the banking system is foreign-owned, mainly by Austrian, Italian and Greek banks. The large-scale lending in foreign currency, at about 70% of total lending, poses a risk to the banking sector and borrowers.



The bureaucracy and inefficiency of the economy is largely due to large-scale state intervention. State-owned companies have approximately 90,000 employees and subsidies and lost taxes from operations in the red are costing the government approximately EUR one billion per year. A privatisation programme was devised in 2014 where 502 state-owned companies have been identified for sale, starting in 2015. An improved business environment would strengthen the currency and increase investments, which in turn boosts the prospects for growth and creates sounder public finances. Serbia's closer relationship with the EU and the IMF points in this direction.