

Macedonia (Republic of)

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Macedonia (Republic of)

Major Rating Factors

Strengths:

- EU candidate status provides an anchor for reforms and political stability.
- Moderate but rising government debt levels.
- Moderate, albeit rising external indebtedness.
- Narrowing current account deficit (but expected to widen again in the medium term)

Weaknesses:

- Persistent structural rigidities reflected in high unemployment, which weigh on the country's economic performance.
- Inflexible general government expenditure structure and inefficient social security system constrain the government's fiscal flexibility.
- Low level foreign currency reserves are a potential vulnerability for the long-standing currency peg to the euro.
- Residual, albeit declining, risk of interethnic tensions.

| Sovereign Credit Rating |
|---------------------------------|
| Foreign Currency BB/Stable/B |
| Local Currency BB+/Stable/B |

Rationale

The ratings on the Republic of Macedonia reflect the sovereign's moderate general government deficit targets and debt burden (although the latter is increasing); EU accession prospects that support reforms to improve economic and political stability; and moderate external indebtedness. The ratings are constrained by a weak but improving external position that could undermine the currency peg; internal structural rigidities such as high unemployment; and the potential for inter-ethnic tensions to undermine political and social stability.

We expect economic growth to be 0.9% in 2010 and 2.5% in 2011, compared with negative 0.8% in 2009, as Macedonia recovers from a relatively shallow recession. While exports are the main cause of growth, the volatility of external demand from the main trading partners remains one of the downward risks. Furthermore, we expect domestic demand to remain negative this year before recovering progressively from 2011, as unemployment remains very high and growth in domestic credit remains subdued.

We believe the government deficit will not exceed the 2.5% target this year, and will remain at that level for the next two years before lowering to 2% in 2013. The government requested a €480 million precautionary credit line (PCL) from the International Monetary Fund (IMF) as an insurance against funding risk. This should be approved by early next year and is expected to remain undrawn. After having tried to tap the markets during the spring 2010 period, the availability of this loan should improve Macedonia's ability to issue a new Eurobond in 2011, even if a high yield is to be expected. We expect the government's financing needs to be predominantly covered through external borrowing. We forecast general government deficits to increase the government's moderate net debt levels to 24% of GDP in 2013, from 17% in 2008.

The current account deficit almost halved in 2009 to 7.0% of GDP from 12.5% in 2008, reflecting an improvement in the trade balance as import demand dried up along with credit growth. In 2010, we expect the current account

deficit to narrow further to 3.6%, before starting to widen again as exports are expected to grow faster than imports.

Macedonia was granted EU candidate status in 2005, and in April 2009, the European Commission recommended opening accession negotiations, and moving to the second phase of the implementation of the Stabilisation and Association Agreement (SAA). The prospects of EU accession have acted as a policy anchor for reforms to improve economic and political stability. Nevertheless, the unresolved dispute with Greece about Macedonia's constitution remains an obstacle to EU and NATO accession, as Greece refuses to retract its veto. In our view, a quick resolution of the issue still appears unlikely. Furthermore, uncertainty remains over current EU members' appetite for further enlargement of the EU.

Outlook

The outlook is stable. We believe a renewed worsening of external liquidity indicators (due most likely to falling levels of international reserves), would intensify the risk of a disorderly exit from the fixed exchange rate regime, and would put downward pressure on the ratings. A resurgence of ethnic strife could also be negative for the ratings. Conversely, if Macedonia is able to adequately address economic imbalances and implement reforms leading to employment growth, enhancement of productivity in the tradable sector, and deepening financial markets to weaken reliance on external borrowing, this would contribute positively to Macedonia's creditworthiness. Further support could come from reforms of the social security system or the energy sector, which could eventually contribute to a return to dynamic and balanced growth.

Table 1

| Republic of Macedonia--Selected Indicators | | | | | | | | | | | |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------------|
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010e | 2011f | 2012f | 2013f | Median 'BB' 2010 |
| GDP per capita, \$US | 2,644.7 | 2,857.6 | 3,217.2 | 3,996.2 | 4,808.3 | 4,489.2 | 4,773.9 | 4,968.5 | 5,054.7 | 5,194.8 | 5,680.0 |
| Real GDP growth (%) | 4.1 | 4.1 | 4.0 | 5.9 | 4.9 | (0.8) | 0.9 | 2.5 | 3.2 | 4.0 | 3.6 |
| Real GDP per capita growth (%) | 3.8 | 3.8 | 3.8 | 5.8 | 4.7 | (1.0) | 0.7 | 2.3 | 3.0 | 3.8 | 2.1 |
| General government balance/GDP (%) | 0.0 | 0.2 | (0.5) | 0.6 | (0.9) | (2.7) | (2.5) | (2.5) | (2.5) | (2.0) | (3.7) |
| Net general government debt/GDP (%) | 31.0 | 30.3 | 20.3 | 17.7 | 16.5 | 20.1 | 22.0 | 23.2 | 24.0 | 24.2 | 26.8 |
| General government interest paid/General government revenues (%) | 2.6 | 2.6 | 3.0 | 2.4 | 1.9 | 1.9 | 2.2 | 2.0 | 2.0 | 2.0 | 8.2 |
| Domestic credit private & NFPEs/GDP (%) | 22.4 | 25.3 | 29.4 | 35.8 | 42.4 | 44.5 | 45.5 | 45.5 | 45.0 | 45.0 | 38.8 |
| CPI growth (%) | (0.4) | 0.5 | 3.2 | 2.3 | 8.3 | (0.8) | 1.4 | 2.0 | 2.5 | 2.5 | 5.2 |
| Gross external financing needs/CAR + usable reserves | 118.2 | 111.8 | 103.9 | 106.8 | 118.5 | 119.9 | 112.7 | 111.8 | 110.4 | 110.6 | 92.9 |
| Current account balance/GDP (%) | (8.4) | (2.7) | (0.9) | (7.3) | (12.5) | (7.0) | (3.6) | (4.3) | (5.0) | (5.6) | (2.8) |
| Narrow net external debt/CAR (%) | 18.6 | 14.5 | 2.6 | 5.9 | 14.4 | 23.6 | 17.7 | 16.3 | 16.0 | 17.3 | 24.0 |

NFPEs--Nonfinancial public enterprises. CPI--Consumer price index. CAR--Current account receipts. e--Estimate. f--Forecast.

Related Criteria And Research

Rating history

- Sovereign Rating And Country T&C Assessment Histories

Default history

- Sovereign Defaults And Rating Transition Data, 2009 Update
- Sovereign Defaults At 26-Year Low, To Show Little Change In 2007

Ratings Detail (As Of December 21, 2010)*

Macedonia (Republic of)

Sovereign Credit Rating

| | |
|--------------------------------------|--------------|
| <i>Foreign Currency</i> | BB/Stable/B |
| <i>Local Currency</i> | BB+/Stable/B |
| Transfer & Convertibility Assessment | BB+ |
| Senior Unsecured (2 Issues) | BB |
| Senior Unsecured (6 Issues) | BB+ |

Sovereign Credit Ratings History

| | | |
|-------------|-------------------------|-------------------|
| 21-Sep-2009 | <i>Foreign Currency</i> | BB/Stable/B |
| 30-Apr-2009 | | BB/Negative/B |
| 01-Dec-2008 | | BB+/Negative/B |
| 21-Sep-2009 | <i>Local Currency</i> | BB+/Stable/B |
| 30-Apr-2009 | | BB+/Negative/B |
| 01-Dec-2008 | | BBB-/Negative/A-3 |

Current Government

Nikola Gruevski (Internal Macedonian Revolutionary Organization-Democratic Party for Macedonian National Unity; VMRO-DPMNE) is prime minister and head of a majority coalition comprising the VMRO-DPMNE and the Democratic Union for Integration (DUI). President Gjorge Ivanov is head of state.

Election Schedule

Parliamentary Last.....June 2008 Next..... July 2012 Presidential Last.....April 2009 Next.....March 2014

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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