STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

May 17, 2012

Research Update:

Republic of Macedonia Ratings Affirmed At 'BB/B'; Outlook Stable

Primary Credit Analyst:
Aarti Sakhuja, London (44) 20-7176-7111;Aarti_Sakhuja@standardandpoors.com

Secondary Contact:
Leila Butt, London (44) 20-7176-2138;Leila_Butt@standardandpoors.com

Table Of Contents

Research Update:
Republic of Macedonia Ratings Affirmed At 'BB/B'; Outlook Stable

Overview

- In our view, the Republic of Macedonia has relatively low wealth levels, limited monetary flexibility, and weak external liquidity.
- However, it has favorable fiscal and external debt stock positions and the prospect of eventual accession to the European Union acts as a policy anchor.
- We are therefore affirming our 'BB/B' long- and short-term foreign and local currency sovereign credit ratings on Macedonia.
- The stable outlook balances our view of Macedonia's structural rigidities and vulnerabilities to external shocks against its low levels of external and fiscal indebtedness.

Rating Action

On May 17, 2012, Standard & Poor's Ratings Services affirmed its 'BB/B' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Macedonia. The outlook is stable. The recovery rating is '3'. Our transfer and convertibility assessment for Macedonia is 'BB+'.

Rationale

The ratings on Macedonia balance our view of its relatively low wealth levels, limited monetary flexibility, and weak external liquidity, against its low fiscal and external debt stock positions and the prospect of EU accession in the medium term.

Following real GDP growth of 3.0% during 2011, we expect expansion to slow to 1.5% in 2012 on a likely moderation in external and domestic demand. We expect, however, that continued investment will support growth. We anticipate real GDP growth to average just below 3.0% over 2012 to 2015 supported by increased public and private sector investment in enhancing capacity across sectors, which will in turn support private consumption and exports. At the end of the forecast period, we expect per capita GDP to reach $6,000, from $4,800 expected in 2012.

The Macedonian denar is pegged against the euro, and a high percentage of loans and deposits are denominated in euros in the Macedonian banking system. These arrangements, though suitable for the nation, reduce monetary flexibility. In addition, two of the three systemically important banks have eurozone parents, which leaves the sector exposed to capital flight risk--Stopanska Banka AD's parent is Greece-based National Bank of Greece S.A. (CCC/Negative/C) and NLB Tutunska Banka AD's parent is Slovenia-based Nova

Ljubljanska banka. However, the Macedonian regulatory and supervisory framework addresses the risk of capital withdrawal by parent banks. Moreover, the banking system is well-capitalized and largely funded by domestic deposits; we do not expect Macedonian banks to rely on parental support in the near term. In addition, we do not see imbalances in the domestic banking system. In 2011, the loan-to-deposit ratio was 90%; the overall stock of domestic credit to households and nonfinancial corporations was 46% of GDP and the capital adequacy ratio was 17%. We project that the Macedonian financial system will remain in a small net external creditor position in 2012.

In 2012, we expect Macedonia's gross external financing needs to exceed 120% of current account receipts (CARs) and usable reserves. Our forecasts include a 100% roll-over rate for Macedonia's $1.8 billion stock of short-term external debt and an expectation that Macedonia will be able to finance its 2012 current account deficit and the amortization of medium-term external debt through foreign direct investment (FDI), official government financing, and increased corporate borrowing. FDI will likely be supported by government efforts to improve transportation and energy infrastructure.

Offsetting these constraints, Macedonia's stock positions look favorable, according to our criteria, although we note the positions are worsening. During 2011, gross government debt increased to 28.6% of GDP and we expect moderate increases in public debt over the coming years as the government intends to run moderate deficits. We expect general government interest expenditure as a share of revenues to remain relatively low, reflecting the still-concessional terms on much of the government debt stock. At 2.6% of GDP, the general government deficit remained broadly unchanged in 2011. However, the change in general government debt to GDP was much higher at 5%. For 2012, the government plans to maintain its fiscal deficit at 2.5% of GDP.

We believe there may be shortfalls in general government revenues over the next two years as a result of weaker economic growth. If this happens, however, we believe the government would likely postpone some capital expenditures to compensate. On the external side, we expect Macedonia's external debt net of liquid assets to rise to 25% of CARs in 2012 from 21% in 2011, a level that is still favorable for the rating level.

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 implementing the Stabilization and Association Agreement (SAA). The prospects of EU accession have acted as a policy anchor for political stability and for economic reforms. We see, however, Greece and Macedonia at an impasse over Macedonia's constitution, with a resolution unlikely any time soon. Nevertheless, we expect Macedonia will continue to make progress on the open EU accession chapters in the meantime.

Outlook

The stable outlook balances our view of Macedonia's structural rigidities and vulnerabilities to external shocks against its low levels of external and fiscal indebtedness. We could raise the rating if reforms lead to higher growth and thus greater convergence with wealth levels of higher-rated sovereigns. On the other hand, we could lower the rating if our expectations about the government's and private sector's access to international markets do not hold or if the fiscal stance weakens.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Introduction Of Sovereign Recovery Ratings, June 14, 2007

Ratings List

Ratings Affirmed

Macedonia (Republic of)	
Sovereign Credit Rating	BB/Stable/B
Transfer & Convertibility Assessment	BB+
Senior Unsecured	
Local Currency	BB
Senior Unsecured	
Foreign Currency	BB
Recovery Rating	3

Additional Contact:
Sovereign Ratings;SovereignLondon@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.