International
Credit Analysis

Macedonia (Former Yugoslav Republic of)

Ratings

Foreign Currency
Long-Term .... BB
Short-Term .... B
Outlook .... Positive
Brady Bonds .... BB

Local Currency
Long-Term .... BB
Outlook .... Positive

Country Ceiling .... BB

Peer Group

BB+	Egypt El Salvador India Panama
BB	**Macedonia** Azerbaijan Colombia Costa Rica Peru Philippines
BB-	Brazil Indonesia Lesotho Serbia Turkey Ukraine Vietnam

Ratings History

Date	LTFC	LTLC
1 Nov 2005	BB	BB

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■ Summary

Fitch Ratings has assigned a Long-term foreign currency rating of ‘BB’, with a Positive Outlook to the Republic of Macedonia. The rating is supported by a relatively high level of income and human development. GDP *per capita* was USD2,570 in 2004 at market exchange rates, above the ‘BB’ range median of USD1,775. The political situation is now stable, following an insurgency by ethnic Albanian groups in 2001. Macedonia has a Stabilisation and Association Agreement with the EU and hopes to be awarded official candidate country status this year and a start date for accession negotiations. However, the risk of shocks that could adversely affect stability is a significant constraint on the rating.

Macedonia has established macroeconomic stability: inflation has averaged 2.3% since 1996. Its key challenge is to raise the GDP growth rate, which has averaged just 2.2% over the past three years, but should be about 3.8% in 2005. The government has ambitious IMF, World Bank and EU reform programmes to address structural problems such as high unemployment, governance concerns and a weak export base. Fiscal policy is prudent: the government is targeting a deficit of just 0.8% of GDP in 2005 and 0.6% in the medium term, and its financing requirement is low. General government debt was 41% of GDP at end-2004, below the ‘BB’ range median of 49%, but some 90% is denominated in foreign currency. The current account deficit has averaged 6% over the past five years, which is a potential source of vulnerability in the context of the exchange rate peg of the denar against the euro. However, the external debt burden is moderate and although foreign reserves are quite low, so are short-term debt and debt service.

■ Credit Outlook

Structural reforms, prudent fiscal policy, signs of an economic recovery and potential progress towards EU accession point to an improving trend in creditworthiness. An upgrade would depend mainly on continuing stability and evidence that reforms were addressing structural weaknesses and raising the trend growth rate.

■ Strengths

- Track record of low inflation and macroeconomic stability
- Prudent fiscal policy, moderate public debt burden
- Moderate external debt burden, low external debt service ratio
- Relatively high income and human development for rating level
- Potential EU member state

■ Weaknesses

- Significant structural concerns: including weak export base, high unemployment and difficult business climate
- Risk of shocks to political stability
- Sizeable current account deficit, modest FDI
- High domestic interest rates and levels of euroisation
- Under-developed domestic debt market

Key Indicators for Macedonia

Population (2004): 2.0m | **Population growth rate (1999-2004):** 0.3% p.a.

GDP (2004): USD5.2bn | **GDP per head at market exchange rates (2004):** USD2570

GNI per head at purchasing power parity (2004): USD6480 (=16.3% of USA level)

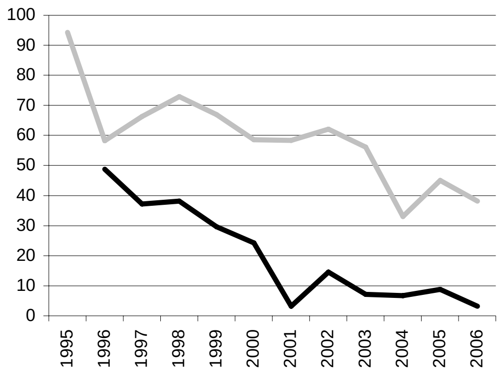
Modern sovereign rescheduling history: Former Yugoslavia: 1984, 1985, 1986, 1988 (official creditors); 1983, 1984, 1985. 1988 (commercial banks). Republic of Macedonia: Paris Club official creditors: 1995 (classic terms) and 2000 (ad hoc); London Club commercial banks: 1997.

	2001	2002	2003	2004	2005f	2006f	2007f
Domestic Economy and Finance							
Real GDP growth (%)	-4.5	0.9	2.8	2.9	3.8	4.0	4.5
Unemployment (% of labour force)	30.5	31.9	36.7	37.2	38.0	36.0	34.0
Consumer prices (annual average % change)	5.5	1.8	1.2	-0.4	0.8	2.0	2.5
Gross domestic savings (% of GDP)	5.2	0.5	3.0	3.1	3.1	3.2	3.2
Gross domestic investment (% of GDP)	19.1	20.7	20.0	20.3	20.7	21.0	21.4
Short-term interest rate (%)(1)	13.7	12.6	8.2	7.7	10.0	8.0	7.0
Broad money (% change Dec to Dec)	32.1	15.7	15.8	16.1	15.0	20.0	25.0
MKD per USD (annual average)	68.04	64.35	54.32	49.41	49.06	50.84	51.45
REER (CPI, 2000=100)	100.3	99.5	100.0	98.5	98.5	98.5	98.5
REER: % change (+ = appreciation)	0.3	-0.8	0.5	-1.5	0.0	0.0	0.0
Public Finances							
General government balance (% of GDP)	-6.3	-5.6	-0.1	0.7	-0.8	-0.6	-0.6
General government debt (% of GDP)	52.3	46.1	42.5	40.6	43.3	38.4	36.5
General government debt maturities (% of GDP)(2)	3.7	3.4	3.7	3.4	3.9	5.3	6.2
General government debt/revenue (%)	154.9	132.0	114.7	109.9	115.9	111.2	110.4
Interest payments/revenue (%)	5.5	4.2	2.8	2.4	2.5	3.0	3.1
Balance of Payments							
Current account balance (USDmn)	-244	-358	-149	-415	-291	-307	-324
Current account balance (% of GDP)	-7.1	-9.4	-3.2	-8.0	-5.3	-5.4	-5.4
Current account balance *plus* net FDI (USDmn)	197.0	-280.2	-54.7	-264.8	-141.3	193.3	-4.0
Current account balance *plus* net FDI (% of GDP)	5.7	-7.4	-1.2	-5.1	-2.6	3.4	-0.1
Gross financing requirement (% of official reserves)(3)	84.4	67.8	43.8	65.7	46.1	41.6	35.6
Current external receipts CXR (USDmn)	2178	1952	2664	3205	3763	3976	4184
Current external receipts CXR (annual % change)	-11.7	-10.4	36.5	20.3	17.4	5.7	5.2
Current external payments CXP (USDmn)	2422	2310	2813	3619	4054	4283	4508
Current external payments CXP (annual % change)	-4.6	-4.6	21.8	28.7	12.0	5.6	5.3
External Assets and Liabilities							
Gross external debt (USDmn)	1512	1635	1799	2030	2391	2381	2499
Gross external debt (% of GDP)	44.0	43.1	38.9	38.9	43.3	42.2	41.8
Gross external debt (% of CXR)	69.4	83.8	67.5	63.3	63.6	59.9	59.7
Net external debt (USDmn)	70	285	189	214	333	126	115
Net external debt (% of GDP)	2.0	7.5	4.1	4.1	6.0	2.2	1.9
Net external debt (% of CXR)	3.2	14.6	7.1	6.7	8.8	3.2	2.8
Public external debt (USDmn)	1228	1321	1473	1603	1865	1744	1747
Public external debt (% of GDP)	35.7	34.8	31.8	30.7	33.8	30.9	29.2
Net public external debt (% of CXR)	19.7	27.2	20.2	19.1	17.0	8.3	5.1
Public FC denominated & FC indexed debt (USDmn)	1772	1924	2171	2298	2302	2130	2087
Short-term external debt (% of gross external debt)	4.2	3.9	2.3	3.5	3.8	4.7	5.3
External debt service (% of CXR)	10.4	12.3	9.5	7.9	5.8	6.8	5.6
External interest service (% of CXR)	3.7	2.9	2.2	1.7	1.4	1.7	1.3
Liquidity ratio (%)(4)	321.0	475.7	424.2	542.5	621.7	568.6	653.7
Official international reserves including gold (USDmn)	799	790	935	991	1226	1415	1535
Official international reserves in months of CXP cover	4.0	4.1	4.0	3.3	3.6	4.0	4.1
Official international reserves (% of broad money)	91.5	66.3	56.7	47.6	57.3	55.9	49.0

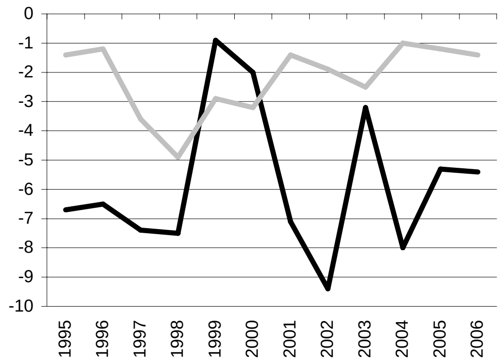
(1) 28 day CB bill rate (annual average).
(2) Maturities of medium and long-term debt during year *plus* short-term debt outstanding at the beginning of the year.
(3) Current account balance plus amortization of medium and long-term debt, over official international reserves.
(4) Official reserves incl. gold *plus* banks' foreign assets/ Debt service *plus* liquid external liabilities.

Peer Comparison

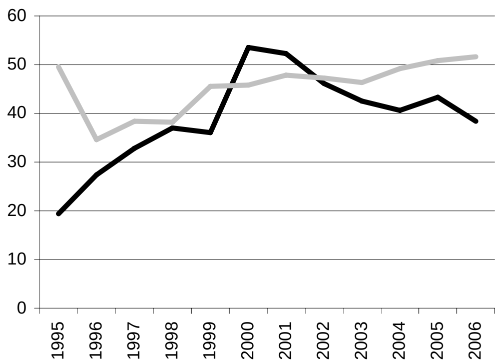
Net External Debt
% of CXR



Current Account Balance
% of GDP

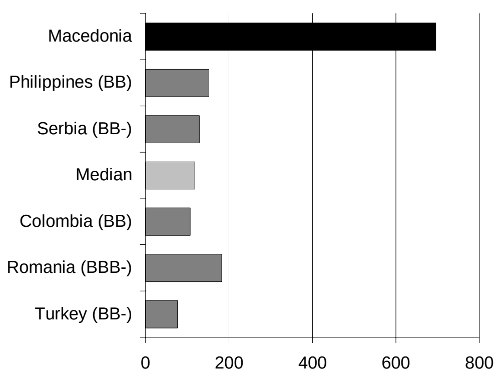


General Government Debt
% of GDP

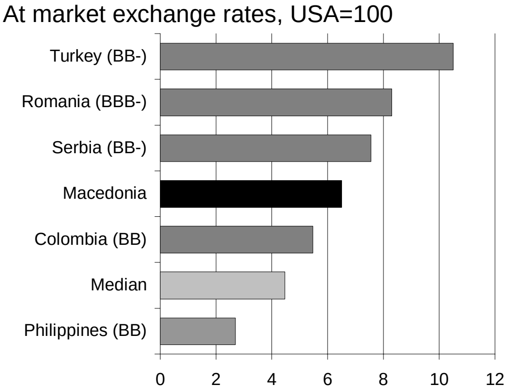


General Government Balance
% of GDP

International Liquidity Ratio, 2005
%



GDP per capita Income, 2004
At market exchange rates, USA=100



Macedonia BB Median

Source: Fitch Sovereign Comparator

Rationale

Macedonia's 'BB' rating is supported by a relatively high level of income and human development. GDP *per capita* was USD2,570 in 2004 at market exchange rates, above the 'BB' range median of USD1,775 and around 80% of the level of Bulgaria ('BBB') and Romania ('BBB-'). These fundamental credit strengths and its EU perspective give the country the potential to follow the development model of more advanced transition countries.

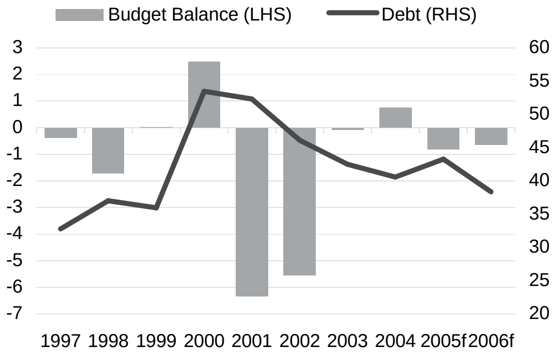
However, Macedonia's GDP growth rate has averaged just 2.2% in the past three years and raising it is a vital challenge. Encouragingly, it picked up to 2.9% in 2004 and should be about 3.8% this year. And Macedonia is undertaking ambitious structural reforms in co-operation with the IMF, World Bank and the EU. Although parliamentary elections are looming in September 2006, there appears to be a broad consensus in the country in favour of orthodox economic policies and EU accession.

Nevertheless, the rating is currently constrained by the economy's substantial structural weaknesses. Problems with corruption, bureaucracy and a dysfunctional judiciary impair the business climate. Official unemployment is a staggering 38%. A trade deficit of around 20% of GDP testifies to a narrow, and low value-added export base. Moreover, metals and clothing & textiles both account for around 30% of merchandise exports, rendering them vulnerable to shocks to commodity prices and competition.

Macedonia's rating is underpinned by sound public finances. After a small budget surplus last year, the government is targeting a deficit of just 0.8% of GDP in 2005 and 0.6% in the medium term, which should contribute to favourable debt dynamics. Fiscal decentralisation could also pose an operational risk. General government debt was 40.6% of GDP at end-2004, below the 'BB' range median of 49%; while its debt to revenue ratio was 110%, half the 'BB' range median of 240%. Moreover, taking account of its deposits at the National Bank of the Republic of Macedonia (NBRM), net government debt was 36.3% of GDP. Planned privatisation receipts of 5.5% of GDP in 2006 would further improve the government and external position, although the timing will be tight as they must be finalised in March, six months before the election.

The government's near-term financing requirement is moderate – just 6% of GDP in 2006 – owing to the long maturity of its debt. However, it needs to expand its sources of financing as amortisation steps up and official disbursements recede. It plans a debut eurobond this year to establish international market access. But the local debt market is under-developed – a rating weakness – and some 90% of public debt is denominated in foreign currency, rendering it vulnerable to exchange rate risk. Treasury bill issuance only started in 2004: the stock is just 1½% GDP, the longest maturity is 12 months and real yields are close to 10%.

General Government Finances
% GDP



Source: MoF, IMF and Fitch

Macedonia has an impressive record of price stability: consumer price inflation has averaged 2.3% since 1996, underpinned by an exchange rate peg against the euro. The denar peg has proved an effective nominal anchor and survived severe stress tests. Nevertheless, high domestic interest rates imply a risk premium and suppress investment. The extent of euroisation (over 40% of bank loans) means that currency-induced credit risk could be substantial if there were a devaluation. Credit growth is into its third year of robust expansion, but from a low base and at a more measured pace than in some regional peers. The financial sector is relatively small and well-capitalised and therefore represents only a moderate contingent risk to the sovereign.

Macedonia has a sizeable current account deficit that has averaged close to 6% of GDP over the past five years (transfers equivalent to about 15% of GDP have partially offset the trade deficit). Fitch expects it to narrow from 8% in 2004 to around 5.3% this year. Positively, the deficit is private rather than public sector driven and is natural for Macedonia's stage of development. It is lower than those of Bulgaria, Romania and Serbia ('BB-'), though so is its record of attracting FDI. Nonetheless, it is a potential source of vulnerability in the medium term, particularly in the context of the exchange rate peg.

Foreign exchange reserves (FXR) are relatively low, at 3.3 months cover of current account payments (CXP), but should increase to 4 months' cover by end-2006. However, short-term debt is low at a reported 3.5% of gross external debt (GXD) and the debt service ratio is just 6% of current account receipts (CXR) so that Fitch's liquidity ratio, which measures liquid foreign assets over liabilities falling due over the next 12 months, is 622% in 2005 – well above 129% for Serbia and 76% for Turkey ('BB-').

Macedonia's external debt burden is relatively low, a major rating strength. GXD was USD2.0bn at end-2004, equivalent to 39% of GDP and 63% of CXR. Fitch expects it to increase to around USD2.4bn by end-2005, after the eurobond issue, but then decrease relative to GDP and CXR. Net external debt (NXD) was just USD0.2bn, equivalent to 7% of CXR – well below the 'BB' range median of 33%. Overall, the structure of external debt is favourable, with a long maturity, helping make it resilient to shocks.

The political situation is an important component of the rating judgement. Macedonia has been prone to a series of negative shocks since its emergence from the wreck of Yugoslavia. In 2001 it experienced an internal armed conflict after an insurrection by ethnic Albanians. Following EU and NATO intervention, the crisis was defused by the Ohrid Framework Agreement (FA) that decentralises government and increases minority rights. The FA enjoys strong support, has survived stress tests and, Fitch believes, is likely to continue to sustain political stability.

Macedonia's goal of EU accession is a vital anchor to political stability, security, institution-building and economic reform – as in many transition countries. Its Stabilisation and Association Agreement (SAA) came into effect in April 2004. In December, it hopes to be granted official EU "candidate country status" and a start date for accession negotiations, which is likely to be after the elections at the earliest. The outcome is uncertain, though a "yes" or "yes if/when" seems more likely than an outright "no" or undefined "not yet". An answer that suggests a long or permanent delay would be a major setback.

In short, the political situation is currently stable, but the risk of shocks that could adversely affect stability is a significant constraint on the rating. Potential threats include a shock to EU ambitions, a spillover of regional instability and a flaring of ethnic tensions – the status of Kosovo is a source of uncertainty.

The country's ambitious reform programmes, prudent fiscal policy, signs of recovery in economic growth and potential progress on the road towards EU accession indicate that creditworthiness could be on an improving trend. However, an upgrade would depend mainly on the implementation of reforms and evidence that they were starting to address structural weaknesses and raising the trend growth rate.

Fitch has assigned a Long-term local currency (LTLC) rating of 'BB', the same as the foreign currency rating, as it does not currently view Macedonia as more able or willing to service one ahead of the other. The low capacity of the domestic debt market adversely affects its ability to service local currency debt. And its inflation history, moderate monetisation, prevalence of foreign currency-denominated debts and exchange regime all suggest that it would be reluctant to inflate away the real value of domestic currency obligations.

■ Political and Social Situation

Political History and the Ohrid Agreement

The Republic of Macedonia became an independent state in November 1991, after the break-up of Yugoslavia. Its origins and geographic position have led to a number of negative external shocks including the Yugoslav wars, Greek trade embargo (1994) and Kosovo crisis (1999).

In 2001 Macedonia suffered a serious, though limited, internal armed conflict after an insurrection by ethnic Albanian groups. At least 80 people are believed to have died and thousands fled their homes. Following EU and NATO intervention, the crisis was defused by the Ohrid FA, which is based on a vision of a unitary, multi-ethnic state. The FA addresses the grievances of the Albanian minority (25% of the population and are concentrated in areas) through the decentralisation of government, increasing the representation of minorities in public administration and allowance for Albanian education, language and symbols. In a key step, 84 local government entities assumed greater devolved powers in July following local elections in March.

The Ohrid FA enjoys strong domestic and international support, and Fitch believes it is likely to sustain political stability. Its implementation is anchored by the goal of EU accession, for which it is a *sine qua non* (see below). The agreement has endured some tests: the replacement of NATO troops by EU forces (2003), the death of President Trajkovski (2004), violence in Kosovo (2004) and a referendum on decentralisation (2004).

However, shocks to the *status quo* are possible. A small minority of both ethnic Macedonians and Albanians remain opposed to the settlement and there is a risk that latent ethnic tensions could be reignited at some point. The uncertain future status of Kosovo is a potential source of instability. Indeed, although the vast majority of Macedonian citizens support the territorial integrity of the country, according to one survey 76% expect a future military conflict – the highest of any country in the Balkans[1]. Small arms remain prevalent.

Government and Political Structure

Macedonia is a unicameral parliamentary democracy. Following elections in September 2002, a centrist majority coalition government was formed by the Social Democratic Union (SDSM), Liberal Democratic Party (LDP) and ethnic Albanian Democratic Union of Integration (DUI). The government has entrenched macroeconomic stability, implemented structural reforms, maintained strong relations with International Financial Institutions (IFIs) and made further progress towards EU integration. Although tensions within the coalition and shocks make early elections possible, Fitch expects the government to maintain its policy course and serve its full term to September 2006.

Parliamentary Election: Sept 2002

	No. Seats	% Seats
Government Coalition	**76**	**63.3**
Social Democratic Union (SDSM)	43	35.8
Liberal Democratic Party (LDP)	12	10.0
Other (DPT, DLB, OPRM)	5	4.2
Democratic Union for Integration (DUI)	16	13.3
Opposition	**44**	**36.7**
VMRO-DPMNE*	28	23.3
Liberal Party (LP)	5	4.2
Democratic Party for Albanians (DPA)	7	5.8
Other (PDP, NDP, SP)	4	3.3
Total	**120**	**100**

* Internal Macedonian Revolutionary Organisation-Democratic Party for Macedonian National Unity
Source: Elections Around the World

Although the make-up of the next government is uncertain, the consensus in favour of the Ohrid FA and EU accession is such that Fitch expects a broad continuity of policies, whether it is based around the current coalition, opposition or new parties. Ethnic nationalist parties opposed to the FA attract little support and there would be strong international pressure to keep them out of government. Nonetheless, in the longer term, slow dividends from or fatigue with reforms, or shocks that inflame ethnic tensions could adversely affect the composition and policies of future governments. Unemployment is high, at an official level of 38%, although the actual figure may be closer to half that. Youth unemployment among 15-24-year-olds is particularly severe, at an official level of 65%. These and other socio-economic groups that are failing to benefit from transition could prove a source of discontent.

The Road to EU and NATO Accession

The EU accession process provides a vital anchor to political, institutional and economic development and strong support to sovereign ratings, as demonstrated most recently by Bulgaria, Romania and Turkey. Arguably the EU is even more crucial in the Balkans as an "exit solution" to ethnic tensions and security threats.

Macedonia's strategic goal is to join the EU by 2010/11. It signed a SAA with the EU in April 2001, which came into force in April 2004. Under the SAA, Macedonia enjoys free trade access to the EU market for most goods and financial assistance of around EUR80m per annum. In June 2003 the EU Council reaffirmed that "the Western Balkans countries will become an integral part of the EU, once they meet the established criteria". Macedonia applied for EU membership in March 2004, and the European Commission (EC) is now preparing an "opinion" on its readiness and suitability for "candidate country status", to be published on 9 November. Areas of concern include standards of democracy (following irregularities in the local elections), judiciary, public administration and corruption.

The EC's recommendation will go to the EU Council (heads of state) for a decision in December. There are two key elements: "candidate status" and a start date for accession negotiations (as well as conditions on either). Uncertainty over the EU's appetite for further enlargement increased following the rejection of the European Constitutional Treaty, though the agreement to start accession negotiations with Turkey and Croatia, and SAA negotiations with Serbia are positive signs. And it would appear folly (and unnecessary at this stage) for the EU to turn its back on the Balkans.

The government hopes for a "yes" or at least a "yes if/when" decision on candidate status, with accession negotiations starting after the 2006 elections. A temporary delay need not be a disaster for the country, though it could be a setback for the current government. However, a "no" or undefined "not yet" that suggested a permanent change in the EU's commitment to the region would be a major shock, with adverse consequences for economic reform, growth prospects and long-term political stability.

Macedonia has also applied for membership of NATO. It had hoped for an invitation to join in 2006 and membership in 2007. However, entry before 2008 now looks unlikely.

[1] "*The Balkans in Europe's Future*", International Commission on the Balkans, April 2005; survey conducted in November 2004. In another question, a majority of Macedonians answered that a break-up of the country is unlikely and would be negative, while a majority of people in Kosovo and Albania answered that a break up of Macedonia was unlikely but would be positive.

Regional Relations

Macedonia enjoys good relations with its neighbours, which share its EU perspective. It has signed free trade agreements with nine countries in the region. Nevertheless, there are some issues to watch.

- **"Name issue"**: Greece continues to object to the "Republic of Macedonia", so that the country's official name remains the "Former Yugoslav Republic of Macedonia". This is a source of frustration, but not a barrier to EU accession, trade or investment.
- **Regional instability:** the Balkans' turbulent history and the unresolved status of Kosovo mean that future conflict cannot be ruled out. The provisional authority in Kosovo has yet to agree its border with Macedonia.
- **Organised crime** including trafficking in women, drugs, arms and money laundering, is rife in the Balkans.

Corruption and Governance

According to Transparency International, Macedonia was ranked 103rd (out of 158) on perceived corruption in 2005, similar to Serbia (97th) and better than higher-rated Russia ('BBB') (126th). Organised crime is prevalent. The judiciary is inefficient and potentially subject to corruption. Encouragingly major reform is under way to increase the independence, efficiency and education of judges, and constitutional amendments are expected to be passed this year. Public administration attracts similar criticism and will be tested by devolution.

Short-Term Prospects

Fitch expects GDP growth to pick up to around 3.8% in 2005, from 2.9% in 2004. The recovery mainly reflects supply-side improvements such as industrial restructuring and trade integration, coupled with strong regional growth. A number of large mines and metal smelters have resumed production after privatisation and restructuring. Industrial production was up 8.6% in the first seven months of 2005 (y-o-y), after a drop of 2.1% in 2004. Construction activity is also buoyant (growth was 8.7% in 2004).

Economic Performance and Outlook

	2004	2005f	2006f
Real GDP (%)	2.9	3.8	4.0
CPI Inflation (%, Annual Average)	-0.4	0.8	2.0
Budget Balance (% GDP)	0.7	-0.8	-0.6
Current Account (% GDP)	-8.0	-5.3	-5.4

Source: Ministry of Finance, NBRM and Fitch

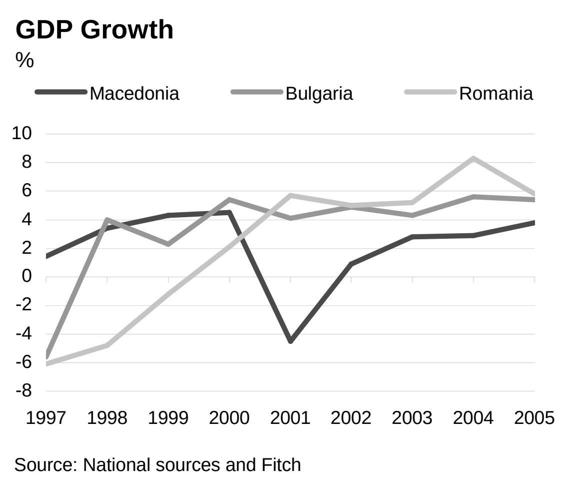
The revival in industrial output is mirrored in merchandise export growth of 32% in the first seven months of 2005 (y-o-y, in USD terms). Exports of iron and steel were up 110% in H105 (y-o-y), albeit partly owing to higher prices. Import growth was a more moderate 15%, so that net trade should make a positive contribution to GDP growth this year. Tight fiscal and monetary policy will dampen domestic demand, despite bank credit growth to the private sector of around 25%. The pace of GDP growth appears unlikely to make much of a dent in the unemployment rate. The main short-term risks to growth are from a slowdown in global activity and higher oil prices. Over the medium term, higher GDP growth will require further structural reforms.

Fitch expects inflation to remain subdued at around 0.8% this year and 2% in 2006, owing to tight macroeconomic policy, declining tariffs, a competitive global pricing environment and flat food prices. The current account deficit should narrow to around 5.3% of GDP this year.

Structural Issues

Income and Growth

Macedonia benefits from a level of income, education and human development that compares favourably with its rating peers. GDP *per capita* was USD2,570 in 2004 at market exchange rates, above the 'BB' range median of USD1,775 and not too far adrift from Bulgaria (USD3,100) and Romania (USD3,280), both rated investment grade. In terms of purchasing power parity, GNI *per capita* was USD6,480, above the 'BB' median of USD4,990 and around 80% of the level of Bulgaria and Romania. Macedonia's United Nation's Human Development Index score is the second highest in the 'BB' range.



These fundamental credit strengths, as well as its EU perspective and market access give the country the potential to follow the development path of more advanced Central and Eastern European countries

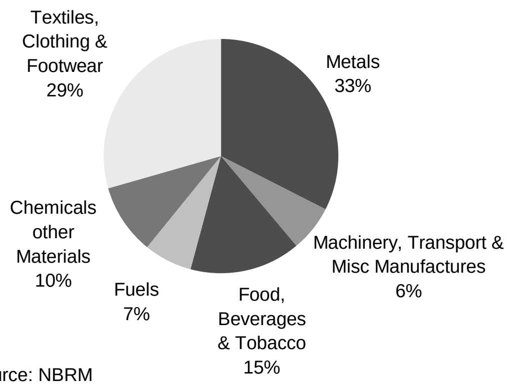
(CEEs). However, Macedonia's GDP growth rate has been disappointing, averaging just 1.3% over the past five years (albeit partly owing to the 2001 crisis), compared with 4.9% in Bulgaria, 5.3% in Romania and 4.9% in Serbia. Attaining a trend growth rate of around 5% will require structural reforms.

Trade Structure

Macedonia has a low value-added, uncompetitive and narrow export base. Its export share of world markets declined from 1996 before levelling out since 2002 (while that of its neighbours has risen) and wages are high relative to GDP per capita[2]. As a result, it has a trade deficit of about 20% of GDP. In H105, metals accounted for 33% of exports of goods, which, with other agricultural and basic materials, renders the country vulnerable to commodity price shocks. Clothing, footwear and textiles, which accounted for 29%, have held up so far this year, but face a competitive threat from China.

Merchandise Export Structure

% Total, 2005H1



Source: NBRM

Investment and the Business Climate

Macedonia has a difficult business climate. Problems include corruption, poor public and corporate governance, inefficient public institutions, a dysfunctional judiciary, high pay-roll taxes (though a low 15% profit tax rate), oppressive bureaucratic regulations, an inflexible labour market, low financial intermediation and high interest rates.

Encouragingly, the government is implementing an ambitious structural reform agenda in co-operation with the IFIs. Key measures include: World Trade Organization membership (2003) and tariff reduction (ongoing); business deregulation including a "one-stop shop" for registration (due by end-2005); law on labour relations (July); judicial reform (constitutional amendments due end-2005); new bankruptcy law (due end-2005); amendment to banking law (due end-2005); pension reform (approved in 2000, effective from 2006); health sector reforms (ongoing); and substantial public finance reforms.

Gross domestic investment is around 20% of GDP, low relative to the CEE8 median of 27%[3]. Macedonia will need to raise its investment rate if it is to grow strongly in the long term. At the same time, it will need to raise national savings to prevent a widening in the current account deficit. Domestic savings (excluding transfers from abroad) are very low, at around 3% of GDP. FDI has been moderate – a cumulative USD576 per capita from 1989-2004, according to the EBRD, compared with an average of USD2,313 for the CEE8. As a small, land-locked market, years away from EU accession, Macedonia is not an obvious location for FDI, though it has free trade agreements with larger neighbouring markets.

Unemployment and Labour Market

The official unemployment rate (International Labour Organisation) was a staggering 38.6% in Q105. Although it is clearly overstated by the extensive grey economy and an incentive to register for health benefits, it is a serious economic problem. Official employment dropped by a cumulative 13% from 2001-04 to only 33% of the labour force. Agriculture accounted for 18% of employment, and public administration, health and education for 20%.

Unemployment reflects the closing of loss-making state-owned enterprises (SOEs), compounded by a mismatch of skills, an inflexible labour market, the slow pace of industrial restructuring and weak GDP growth. In addition, high youth and graduate jobless rates indicate that unemployment reflects high wages, taxes, benefits and restrictive labour market practices as well as a "lost generation" of transition. The new labour law should help by reducing hiring and firing costs, liberalising part-time and fixed-term contract work and limiting the scope of collective bargaining.

Industrial Restructuring and Privatisation

The privatisation process has been largely completed, except for infrastructure companies. The EBRD estimates that the private sector accounted for 65% of GDP in 2004, greater than Croatia ('BBB-'). But many entities were sold to insiders rather than strategic investors so that improvements in efficiency, output and governance have been limited.

The national electricity company, ESM, is undergoing a restructuring process, as part of which the unbundled electricity distribution company is scheduled for privatisation by March 2006, and

[2] IMF country report, September 2005.

[3] 2003 data, deficiencies in the national account statistics raise questions over the reliability of the investment data.

generation companies following in 2007. By law, privatisations cannot take place within six months of a parliamentary election, so delay represents a risk to budget and current account financing in 2006. The government also plans to sell a chunk of its residual 47% stake in Macedonia Telecom next year.

Financial Sector

The banking sector is moderate in size with deposits of 31% and total assets of 45% of GDP. It also has a high capital adequacy ratio of 23% and so represents only a modest contingent liability to the sovereign[4]. Moreover, the system is predominantly privately owned and two of the three largest banks have foreign parent banks (Greek and Slovenian), which might provide support in the event of a crisis. The most recent Financial System Stability Assessment by the IMF and World Bank (albeit in 2003) concluded that the system was quite resilient to stress tests, mainly owing to its level of capitalisation.

Nevertheless, there are risks. Private sector credit growth was 23% in the 12 months to June 2005, the third year of brisk expansion. That said, the rate of increase is moderate by comparison with Bulgaria, 49%, Romania, 33% and Serbia, 52% (all 2004 figures) and does not raise macro-prudential concerns at this stage. Moreover, the level of lending is still low, at 24% of GDP, compared with 37% in Bulgaria and 57% in Croatia, and some deepening in financial intermediation is desirable. In addition, credit expansion is being funded organically from deposit growth, rather than external borrowing.

The banking sector has a high degree of euroisation: 62% of deposits and 41% of loans are denominated in or linked to foreign currency. The system as a whole has a small long foreign currency position and has a net external creditor position of USD750m. However, many borrowers are unhedged so that foreign currency induced credit risk would be substantial in the event of a devaluation of the denar.

The banking sector suffers from some systemic weaknesses. The lending environment is challenging, owing to a lack of credit histories, an unfavourable business climate and slow enforcement of creditor rights. The new bankruptcy law and judicial reform should be positive steps. Non-performing loans are quite high, at 9%, though down from 15% at end-2002. Credit risk is one reason for high interest rates and spreads. Yet high costs mean that profitability is low. The system is concentrated, with the top three banks accounting for 67% of assets. Nonetheless, with a total of 20 banks and 15 savings houses, the country is still probably over-banked. A deposit insurance system should guard against contagion if a smaller institution were to get into difficulties.

[4] Fitch does not currently have any public ratings of banks in Macedonia and so does not have a Bank Systemic Indicator for the country.

Key Facts: Banking System

End-2004	
M3 (% GDP)	35.5
NPL Ratio	9.0
Capital Adequacy Ratio	23.0
Private Sector Credit (% GDP)	23.8
Private Sector Credit Growth (%)	23.1
Total Bank Deposits (% GDP)	31.1
Foreign Currency Bank Deposits (% GDP)	16.9
Public Ownership, % of Assets	9.0
Foreign Ownership, % of Assets	47.5

Source: IMF, NBRM and Fitch

As the financial sector grows in size it will become more important to improve its microeconomic foundations to limit systemic risk. Amendments to the Banking Law, which is scheduled for approval by end-2005, should help to address shortcomings in the legal framework and strengthen bank supervision.

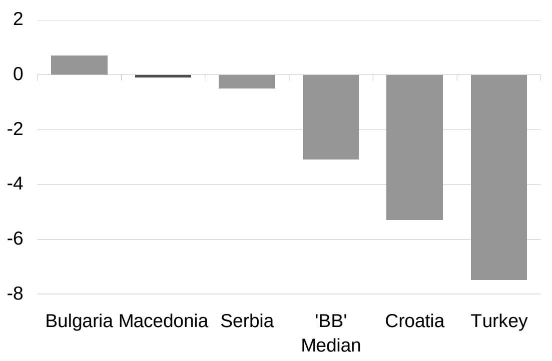
Public Finance

Macedonia’s prudent fiscal policy stance is a rating strength. The general government budget recorded a surplus of 0.7% of GDP in 2004 (counting grants as revenue). Indeed, deficits averaged just 1.4% of GDP from 1996-2004, despite widening to 6.3% in 2001 and 5.6% in 2002 related to the security crisis. For 2005, the government is targeting a deficit of 0.8% of GDP (a tightening from the original target of 1.2%), including a transfer of 0.4% of GDP to recapitalise the NBRM. Outturns so far this year indicate that the budget is on track.

Over the medium term, in accordance with Macedonia’s IMF programme, the deficit target is 0.6% of GDP, which will match borrowing from IFIs for infrastructure projects. The Stand-By Arrangement (SBA) offers an anchor to the budget ahead of the election in 2006. Fiscal policy compares favourably with that of rating peers, and should support a reduction in the public debt ratio and ease pressure on the current account deficit.

However, the structure of tax and expenditure is inflexible and underlying pressures will act to widen the deficit without further reforms. Moves to broaden the tax base and improve tax administration are positive, but high pay-roll taxes damage employment in the formal sector and tax compliance. Custom revenue is declining as tariff rates are cut, as are grants. Some 80% of spending goes on wages, social expenditure, transfers, subsidies and goods and services, though interest costs are low at about 1% of GDP. Pressure on capital expenditure is likely to rise with IFI projects and EU co-financing.

Budget Balance
2003-05 Average,% GDP



Source: Fitch

Public pensions cost about 10% of GDP and the system is running a deficit of about 3%. Reform from a pay-as-you-go to a private, fully funded scheme will strengthen the long-term solvency of public finances. But during the transition period, it will raise the budget deficit by 0.3% of GDP in 2007 and 0.5% in 2008, rising to 1% in 2015. Reforms to indexation and retirement ages and the completion this year of payments on 1994-99 arrears of 0.45% of GDP per annum also help sustainability. Healthcare expenditure is about 6% of GDP and the system has been a source of overspending, arrears and mismanagement. The government has initiated reforms to improve financial control and reporting, but faces strong vested interests.

Fiscal decentralisation could weaken public finances by "hollowing out" central government (sovereign) revenues and devolving expenditure responsibilities to 84 local authorities, which lack the efficiency and capacity of central government. Nevertheless, decentralisation will be a gradual and controlled process; local governments will be unable to borrow until July 2007 and only with restrictions thereafter.

Macedonia's fiscal transparency and architecture appear relatively strong. Fiscal data are moving towards standard IMF general government definitions and extra-budgetary funds are included in the central government budget. From 2006, parliament will approve medium-term fiscal and public debt strategies along with annual budgets. A single treasury account covers all expenditures.

The public debt burden is moderate, underpinning the sovereign rating. General government debt is expected to rise from 40.6% of GDP at end-2004 to 43.3% at end-2005, after a debut eurobond issue scheduled for Q405[5]. The IMF programme implies a eurobond of EUR150m, although actual issuance could be larger to allow for greater debt management operations. This is below the 2004 'BB' range median of 49% of GDP and above the 'BBB' range median of 36%. Macedonia's revenue base is also a rating strength. Fitch forecasts its general government debt to revenue ratio at 116% in 2005, well below the 'BB' range median of 229%.

Furthermore, the government had deposits at the NBRM of 4.3% of GDP, so its net debt was only 36.3% at end-2004. These deposits could climb to around 7% of GDP by end-2005 and 9% by end-2006, owing to the over-funding of the budget deficit – particularly given the eurobond in 2005 and privatisation receipts due in 2006.

General government guarantees (mainly on public enterprise external debts) were just 3.2% of GDP in 2004. But there are some other contingent liabilities. Municipalities have arrears to suppliers (but not bank or bond debt) estimated by the Ministry of Finance at MKD2.8bn (1% of GDP), though the data are incomplete. The central and local governments are negotiating with creditors to resolve these liabilities. The government will issue two denationalisation bonds, in 2006 and 2007, in compensation for property seized by the state between 1945 and 1990. The exact amounts are not yet decided but could be about EUR60m (1.3% of GDP) each.

Public Finances: Sources and Uses

% GDP	2004	2005f	2006f
Uses	**2.7**	**4.8**	**8.8**
Budget Balance	0.7	-0.8	-0.6
Amortisation	3.4	3.9	5.3
Domestic	2.2	2.7	4.0
External	1.2	1.2	1.3
Debt Pre-Payment	0.0	0.0	2.9
Sources	**2.7**	**4.8**	**8.8**
Gross Borrowing	2.0	7.8	5.6
Domestic	0.6	2.0	3.4
External	1.4	5.7	2.2
Privatisation	0.2	0.2	5.5
Change in Deposits and Other	0.4	-3.2	-2.3

Source: MoF, IMF and Fitch estimates and forecasts

Some 91% of government debt is denominated in foreign currency, leaving the burden vulnerable to exchange rate risk. It is also 56% fixed and 44% floating interest rate. But the maturity structure is favourable, since over 90% (on an original basis) involves repayment periods of 10 years or more. Government debt maturities are estimated at just 4% of GDP this year, compared with 30% for Turkey.

[5] Fitch's measure of "general government" includes NBRM debt to the IMF and its domestic securities (2.9% of GDP at end-2004). Public debt also includes public enterprise debts of 3.3% of GDP).

Debt service costs are also low, reflecting the predominance of bilateral and IFI creditors.

Modest deficits and amortisation mean that the government's near-term gross financing requirement is low. In addition, it has its liquidity deposits at the NBRM. Over the medium term, however, declining IFI and official support, rising amortisation and the completion of the privatisation process will leave the government more dependent on capital markets. The eurobond will establish international market access.

Even more important is the development of the nascent domestic debt market. The government has issued various "structural bonds" (in both EUR and MKD) since 1996, but only started selling treasury bills and bonds in January 2004. As of end-July, the stock was just 1.4% of GDP. The longest maturity is only 12 months, though a two-year bond is planned later this year. Interest rates of over 10% on T-bills testify to the low capacity of the domestic debt market, which is a rating weakness. Its development would increase the government's financing options, reduce dependence on external and foreign currency borrowing, and increase the efficiency of monetary policy and the domestic financial system.

A new public debt law was passed in July 2005, which clarifies and unifies responsibility for public debt at the Ministry of Finance. The main aims of the debt management strategy are to reduce the ratio of public debt to GDP below 40%, develop the local debt market and lower the foreign currency share of the debt. Most of the eurobond proceeds will be used for debt management operations in 2006, with just EUR10m-EUR20m being used to boost reserves. The government might buy back the (floating-rate) London Club Brady bonds, if present value gains were appealing (though they do not have collateral). The outstanding amount is about USD220m and the bonds are callable at par. It could make an offer to prepay Paris Club debt or buy back structural bonds.

Macedonia's public debt dynamics are favourable and sustainability is sufficiently robust to withstand plausible shocks. In Fitch's central scenario, based on medium-term real GDP growth of around 4.5% and budget deficits of 0.6% of GDP, the government debt ratio should decline from 43.8% of GDP at end-2005 towards 30% in 2010. Although temporary shocks could raise the debt ratio, stress tests suggest it would then be likely to decline again.

■ Monetary & Exchange Rate Policy

The NBRM enjoys *de facto* operational independence. Under the law, the prime objective of monetary policy is "price stability". This is not quantified in the law, though the NBRM published the projected rate of inflation for the following year. The main strategy underpinning price stability is a peg of the nominal denar exchange rate against the euro (previously the Deutschmark), which has been in place since 1995, with only one 15% devaluation back in 1997. The exchange rate peg has proved an effective nominal anchor that has helped to deliver price stability: annual consumer price index (CPI) inflation has averaged 2.3% since 1996.

Inflationary pressures are currently low and expected to remain so. CPI inflation was -0.4% in 2004 and is expected to be just 0.8% in 2005. It is being subdued by both macroeconomic policy: the denar peg, prudent fiscal stance, overfunding of the budget deficit and high interest rates; and microeconomic factors: declining tariff rates, global competitive pressures and declines in food prices (around 40% of the CPI basket), despite higher oil prices.

In Fitch's view, the fixed exchange rate is currently an appropriate policy framework, as Macedonia is a small open economy, with a hyper-inflation history, low domestic monetisation, an uncertain monetary transmission mechanism through the interest rate channel and shallow domestic financial markets that would constrain its ability to conduct an effective, independent monetary policy. Its uncompetitive export sector and current account deficit appear to reflect real structural rigidities rather than an overvalued nominal exchange rate. Indeed, the 1997 devaluation did not improve the current account given the absence of an adequate supply-side response and quick absorption of the initial gains in cost competitiveness. Moreover, the peg has survived stress tests such as the 2001 security crisis.

Nevertheless, the fixed exchange rate involves risks.

- It could encourage excessive unhedged borrowing in foreign currency and the under-pricing of exchange rate risk, rendering balance sheets vulnerable to a devaluation.
- An inflexible attachment to the peg could hinder a timely policy response in the event of a negative shock that might lead to a depletion of FXR and widening in the current account deficit.
- The peg itself could attract speculation that might be costly to resist. NBRM restrictions on "hot" short-term capital flows provide some insulation and non-residents do not own sizeable denar assets. But speculative pressure in autumn 2004 forced the NBRM to raise its key 28-day CB bill rate to 10% from 8% in July 2004[6].

[6] Interest rates can also vary to offset seasonal volatility in balance of payment flows and budget expenditure – illustrating the shallowness of local markets.

Exchange Rate Regimes

2005 Forecasts	Macedonia	Bulgaria	Croatia	Serbia
Exchange Rate Regime	De facto peg	Currency board	Managed float	Managed float
Change versus Euro 2000-05 (%)	-1.1	0	1.1	-32.5
CPI Inflation	0.8	4.5	2.5	16
Real Interest Rates*	9	-2.5	2	-2
FX Reserves (month CXP cover)	3.6	6.0	4.3	4.9
FX Reserves (% M2)	57.3	59.2	31.6	92.3
FX Reserves (% Short-Term Debt & MLT Debt Service)	339.5	120.4	89.4	106.6
Current Account Deficit (% GDP)	-5.3	-10.7	-5.5	-10.0

* Latest rate on securities used for open market operations or policy rate, less 2005 annual inflation
Source: IMF, National Sources and Fitch

High real interest rates on NBRM and government domestic securities partly reflect a risk premium on the denar. To bolster the credibility of the exchange rate, the authorities have agreed with the IMF to increase FXR to 4 months coverage of imports (of goods and services in 2007) by end-2006 from 3.3 months in 2004 – helped by privatisation proceeds and the eurobond issue. FXR import coverage is low relative to regional peers, but higher relative to coverage of broad money or debt service (see table).

The NBRM also has a ceiling on its net domestic assets as a performance criterion in its SBA and is likely to keep monetary policy tight. It has various instruments to sterilise excessive liquidity, including bank reserve requirements (currently 10%) and CB bills. This year it plans to introduce repos, and to start phasing out CB bills and switch to T-bills for open market operations. Interest rate differentials on domestic and foreign securities make sterilisation costly. But the recapitalisation of the NBRM was necessitated by the calling of an old guarantee to a private bank rather than current operations.

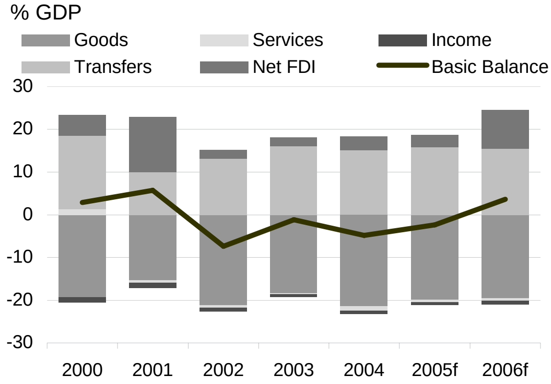
■ External Finance

Balance of Payments and Financing

Macedonia has a sizeable structural current account deficit, which has averaged 6% of GDP over the past five years and was 8% last year. Although not an immediate concern, this is a potential source of future vulnerability. The structure of the current account is unbalanced and subject to shocks, with a trade deficit of about 20% of GDP that is partly offset by transfers equivalent to some 15% of GDP[7]. Official grants are declining, but private transfers have been growing, have proved robust to shocks and now account for 91% of the total.

Encouragingly, the export recovery should help to narrow the current account deficit to around 5.3% of GDP this year, despite the impact of higher oil prices, which could add 3% of GDP to the deficit this year. The deficit reflects private sector saving and investment decisions rather than government borrowing. It is, moreover, natural for a country at Macedonia's stage of development with large investment needs and increasing access to credit. Indeed, it is lower than 2005 forecasts for Bulgaria (11% of GDP), Romania (9%) and Serbia (10%).

Current Account and FDI



Source: NBRM, IMF and Fitch

Macedonia could receive FDI of up to 9% of GDP in 2006, buoyed by privatisations. But thereafter it will need to attract more greenfield FDI to reduce dependence on debt financing. From 2002-04 its average FDI was 2.3% of GDP, compared with 6.8% in Bulgaria, 2.8% in Romania and 4.7% in Serbia.

The country's external financing position appears comfortable over the next couple of years – provided that it completes its planned privatisations. It faces external amortisation of just 3% of GDP in 2005 and a total debt service ratio of just 6% of CXR (the lowest in Europe). Despite its current account deficit, therefore, it faces a moderate gross external financing requirement of USD0.5bn (46% of gross official reserves). It should receive disbursements of at least USD55m in each of 2005 and 2006 under its World Bank programme, as well as financing from the EIB and EBRD. If necessary, Macedonia has its precautionary SBA to draw on. And the upcoming

[7] Over half of transfers are recorded from foreign exchange bureaux within the country that might be capturing other BoP flows or residents converting "mattress" savings into denars.

eurobond should establish international capital market access – increasing its financing options.

Macedonia's external liquidity position is quite strong, providing support to the rating. Fitch expects gross FXR to increase from USD1bn at end-2004 to USD1.4bn at end-2006, equivalent to four months' import cover. Fitch's liquidity ratio, which measures liquid foreign assets over liabilities falling due over the next 12 months, is a comfortable 622% in 2005 (340% excluding banks' foreign assets). This is the second highest in the 'BB' rating range and well above 168% for Croatia, 129% for Serbia and 76% for Turkey. Even if residents' foreign currency bank deposits are counted as a liability in the ratio (to simulate withdrawal in a crisis situation) the ratio would still be over 100%. In short, the threat to external financing lies more from a deterioration in the current account than in debt roll-over *per se*.

External Debt Structure

Macedonia's external debt burden is relatively low, a major rating strength. GXD was USD2.0bn at end-2004, equivalent to 39% of GDP and 63% of CXR. NXD was just USD0.2bn, equivalent to 7% of CXR – well below the 'BB' range median of 33%. Fitch expects GXD to increase to around USD2.4bn by end-2005, after the eurobond issue, but then to decline relative to GDP and CXR.

Overall, the structure of the debt is quite favourable.

- The share of short-term debt is very low at just 3.5%, though there is a risk that the official NBRM data may not capture some obligations.
- Maturity is long: on average over the next five years, amortisation is only 8% of GXD. Interest rates are also low, as most of the debt is to IFIs (52%) and bilateral creditors (12%).
- Some 79% of GXD is public sector, while 4% is owed by commercial banks and 17% by the non-bank private sector. The banking sector is a net external creditor to the tune of 14% of GDP.
- In terms of currency, 43% is in euros, 31% in US dollars and 24% in SDRs, so faces some exposure to an appreciation of the US dollar.

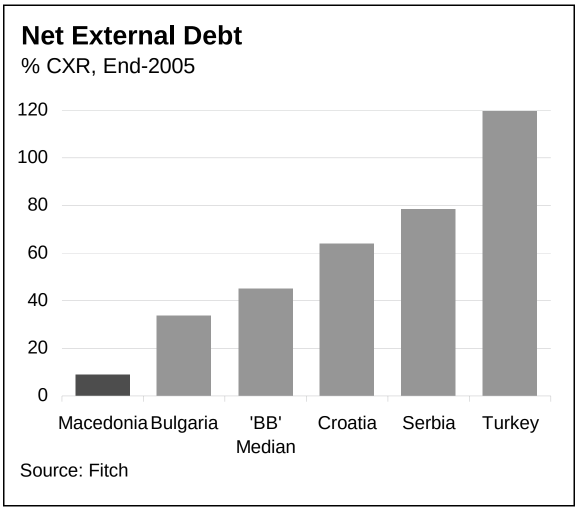
The moderate level and favourable structure of the external debt burden means that it should be sustainable and reasonably resilient to shocks. Nevertheless, Macedonia will also need to improve on its past export and GDP growth performance to validate external borrowings. A lapse in structural reforms or other negative shocks could push up the current account deficit and external borrowing needs, while weakening growth dynamics. A 25% devaluation of the exchange rate would raise the debt burden by around 10% GDP.

Like other successor states to Yugoslavia, including Slovenia ('AA-'), Croatia and Serbia, Macedonia has a modern history of Paris Club and London Club debt restructuring. Like Slovenia and Croatia, its restructurings did not involve a hair cut, and it has remained current on post-independence debt, despite the stress test of the 2001 security crisis.

External Finances: Sources and Uses

(USDbn)	2004	2005f	2006f
Uses	**614**	**457**	**674**
Current Account Balance	-415	-291	-307
MLT Amortisation	199	166	204
Public	98	91	116
Private	101	76	88
Debt Pre-Payments	0	0	163
Sources	**614**	**457**	**674**
Gross MLT Borrowing	363	508	337
Public Sector	185	342	149
Private Sector	177	166	188
FDI, Net	150	150	500
Portfolio Equity, Net	15	10	10
Net Lending Abroad	0	0	0
Capital Account	-5	0	0
Net Change in Short-Term Debt	25	20	20
Errors & Omissions	8	0	0
Change in FX Reserves (- = Increase)	58	-230	-193

Source: NBRM, IMF and Fitch estimates and forecasts



Fiscal Accounts Summary*

% of GDP	2001	2002	2003	2004	2005f	2006f	2007f
Revenue & grants	**34.0**	**34.9**	**38.4**	**37.6**	**38.9**	**35.4**	**33.9**
o/w tax revenue	31.5	33.0	30.6	31.7	31.0	29.9	28.8
non-tax revenue	2.1	1.6	6.2	5.0	4.9	4.3	4.1
grants	0.2	0.0	1.3	0.7	1.6	0.9	0.8
Expenditure & net lending	**40.3**	**40.5**	**38.5**	**36.8**	**39.7**	**36.0**	**34.5**
o/w wages & salaries	7.2	7.8	8.5	8.5	8.6	8.3	5.5
current purchases	8.9	6.3	4.9	4.7	5.2	4.0	3.8
current transfers & subsidies	18.6	21.1	19.4	19.5	19.4	18.3	19.8
interest	1.9	1.5	1.1	0.9	1.0	1.1	1.1
capital expenditure	3.5	3.6	4.1	3.2	5.4	4.4	4.2
other	0.2	0.2	0.4	0.0	0.1	0.1	0.2
Primary balance	**-4.5**	**-4.1**	**1.0**	**1.6**	**0.2**	**0.4**	**0.5**
Overall balance	**-6.3**	**-5.6**	**-0.1**	**0.7**	**-0.8**	**-0.6**	**-0.6**
Financing:	6.3	5.6	0.1	-0.7	0.8	0.6	0.6
Domestic, net	8.2	4.8	-0.5	-0.9	-3.7	2.6	0.3
Domestic securities	-1.9	-1.7	-1.7	-1.5	-0.7	-0.6	-0.5
Bank deposits & loans	-0.5	5.9	0.9	0.4	-3.2	-2.3	-1.4
Privatisation proceeds	10.6	0.6	0.3	0.2	0.2	5.5	2.2
External, net	-1.8	0.7	0.6	0.2	4.5	-2.0	0.3
Disbursements	0.0	2.4	2.6	1.4	5.7	-0.7	1.6
Amortisation	1.8	1.7	2.0	1.2	1.2	1.3	1.3
General Government debt**	**52.3**	**46.1**	**42.5**	**40.6**	**43.3**	**38.4**	**36.5**
Domestic	19.1	17.0	16.4	15.8	14.9	13.9	13.7
External	36.4	31.9	29.1	28.1	31.7	27.8	26.0
Government debt (% of revenue)	153.9	132.0	110.7	107.9	111.3	108.5	107.7
Public enterprise debt	3.2	2.9	2.9	3.3	3.4	3.3	3.2
Public debt	55.5	49.0	45.4	43.9	46.6	41.7	39.7
Memo							
Interest service (% of revenue)	5.5	4.2	2.8	2.4	2.5	3.0	3.1
Foreign currency debt (% total public debt)	94.5	94.4	93.2	91.6	92.1	91.1	88.3
Government deposits in banking system	10.8	7.1	4.1	4.3	7.3	9.1	9.9
"Net" public debt (Debt less deposits)	44.7	41.9	41.3	39.6	39.3	32.5	29.8

* All figures refer to the consolidated general government.
** Includes NBRM debt, mainly to the IMF.
Source: Ministry of Finance, IMF and Fitch estimates and forecasts

Amortisation Schedule on Medium- and Long-Term Debt

(USDm)	2004	2005	2006	2007	2008	2009
Public sector	**98**	**91**	**116**	**126**	**132**	**153**
IMF	20	12	20	22	6	1
Other multilateral creditors	20	23	29	35	49	64
Bilateral creditors	35	36	27	27	27	27
Eurobonds	0	0	0	0	0	0
London Club	11	10	16	16	24	37
Other	13	10	24	26	26	24
Private sector	**101**	**76**	**88**	**54**	**44**	**39**
Total	**199**	**166**	**204**	**180**	**176**	**192**

Source: Ministry of Finance, National Bank of Republic of Macedonia and Fitch estimates

Balance of Payments

(USDm)	2001	2002	2003	2004	2005f	2006f	2007f
Current account balance*	**-244**	**-358**	**-149**	**-415**	**-291**	**-307**	**-324**
% of GDP	-7.1	-9.4	-3.2	-8.0	-5.3	-5.4	-5.4
% of CXR	-11.2	-18.3	-5.6	-12.9	-7.7	-7.7	-7.7
Trade balance	**-526**	**-804**	**-848**	**-1,112**	**-1,103**	**-1,105**	**-1,125**
Exports, fob	1,155	1,112	1,363	1,672	2,141	2,333	2,520
(annual % change)	-12.5	-3.7	22.5	22.7	28.0	9.0	8.0
Imports, fob	1,682	1,916	2,211	2,785	3,244	3,439	3,645
(annual % change)	-16.4	14.0	15.3	26.0	16.5	6.0	6.0
Services, net	**-19**	**-22**	**-10**	**-54**	**-28**	**-29**	**-40**
Services, credit	245	253	327	408	412	433	454
Services, debit	264	275	337	462	440	462	494
Income, net	**-41**	**-30**	**-32**	**-39**	**-35**	**-47**	**-34**
Income, credit	53	51	60	83	85	85	85
Income, debit	93	81	92	123	120	132	119
o/w: interest payments	81	56	57	56	54	66	53
Current transfers, net	**343**	**498**	**741**	**791**	**875**	**875**	**875**
Capital & financial account	**319**	**257**	**237**	**349**	**522**	**500**	**447**
Capital account	1	8	-7	-5	0	0	0
Non-debt creating flows, net	**441**	**78**	**95**	**165**	**160**	**510**	**330**
Equity Direct investment, net	441	78	94	150	150	500	320
Portfolio equity investment, net	0	0	1	15	10	10	10
External borrowing, net	**-28**	**-77**	**136**	**189**	**362**	**-10**	**117**
Debt securities	0	0	3	0	188	-163	0
General government	-65	11	28	93	60	52	18
Monetary authorities	132	-163	-5	-6	4	-19	-21
Commercial banks	-38	-5	-39	-12	10	20	20
Other private sector	-57	80	149	113	100	100	100
Net lending abroad	**-95**	**247**	**12**	**0**	**0**	**0**	**0**
Net errors and omissions	2	-19	-26	8	0	0	0
Overall balance = chg in reserves (‘-‘ = increase)	**-78**	**120**	**-62**	**58**	**-230**	**-193**	**-123**
Memo							
Current account excl official transfers (%GDP)	-8.5	-12.1	-5.5	-9.3	-6.5	-6.4	-6.2
Gross borrowing (incl. short-term)	169	170	397	430	600	286	409
Gross external financing requirement	389	542	346	614	457	511	504
Stock of International reserves, excl. gold	745	722	898	905	1,135	1,329	1,452

* Official grants included in current account
Source: IMF, National Bank of the Republic of Macedonia and Fitch estimates and forecasts

External Debt & Liquidity

(USDm)	2001	2002	2003	2004	2005f	2006f	2007f
Gross external debt	**1,512**	**1,635**	**1,799**	**2,030**	**2,391**	**2,381**	**2,499**
% of GDP	44.0	43.1	38.9	38.9	43.3	42.2	41.8
% of CXR	69.4	83.8	67.5	63.3	63.6	59.9	59.7
By maturity							
Medium- and long-term	1,449	1,571	1,757	1,958	2,299	2,269	2,367
Short -term	63	64	42	72	92	112	132
% total debt	4.2	3.9	2.3	3.5	3.8	4.7	5.3
By debtor							
Public sector	1,228	1,321	1,473	1,603	1,865	1,744	1,747
o/w General government	1,050	1,135	1,257	1,350	1,598	1,487	1,505
Monetary authority	71	67	68	63	67	48	27
Public enterprises	107	119	148	190	201	209	215
Non-bank private sector	284	314	326	427	526	638	752
Banks	187	204	240	353	442	534	628
By creditor							
IMF	71	67	68	62			
Other multilateral	617	689	858	999			
Bilateral	292	292	272	252			
Eurobonds	0	0	0	0			
London Club	262	254	234	233			
Commercial banks other	131	205	215	253			
other private creditors	63	85	137	164			
unidentified creditor	76	43	15	67			
Gross external assets*	**1,442**	**1,350**	**1,610**	**1,815**	**2,058**	**2,255**	**2,383**
International reserves, incl. gold	799	790	935	991	1,226	1,415	1,535
Deposit money banks' foreign assets	643	560	675	824	832	840	849
Net external debt	**70**	**285**	**189**	**214**	**333**	**126**	**115**
% of GDP	2.0	7.5	4.1	4.1	6.0	2.2	1.9
% of CXR	3.2	14.6	7.1	6.7	8.8	3.2	2.8
Debt service (principal & interest)	**226**	**240**	**254**	**255**	**220**	**270**	**233**
Debt service (% of CXR)	10.4	12.3	9.5	7.9	5.8	6.8	5.6
Interest service (% of CXR)	3.7	2.9	2.2	1.7	1.4	1.7	1.3
Liquidity ratio (%)	**321**	**476**	**424**	**542**	**622**	**569**	**654**
excl. banks' foreign assets	166	264	248	315	340	339	410
Memo							
Public Foreign Currency & FC indexed debt	1,772	1,924	2,171	2,298	2,302	2,130	2,087

* non-bank private sector external assets are not taken into account
Source: IMF, World Bank, National Bank of the Republic of Macedonia and Fitch estimates and forecasts