Full Rating Report

Macedonia

Ratings

Foreign Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB+
Country Ceiling	BBB-

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Macedonia

(USDbn)	2009
GDP	9.4
GDP per head (USD 000)	4.6
Population (m)	2.0
International reserves	2.3
Net external debt (% GDP)	20.9
Central government total debt (% GDP)	24.1
CG foreign-currency debt	2.2
CG domestically issued debt (MKDbn)	30.2

Analysts

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Related Research

Applicable Criteria

- *Sovereign Rating Methodology* (August 2010)
- *Country Ceilings* (September 2008)

Other Research

- *Macro-Prudential Risk Monitor* (June 2010)
- *Global Economic Outlook* (September 2010)

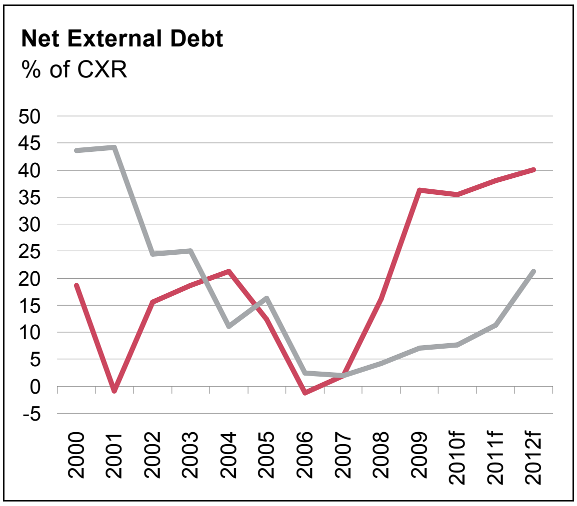
Rating Rationale

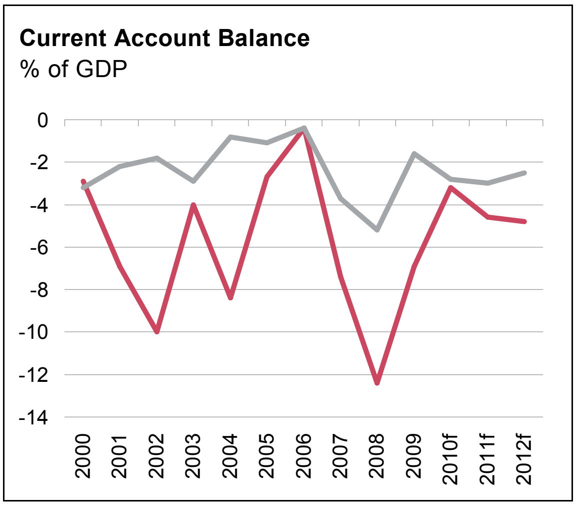
- Macedonia's 'BB+' rating reflects the country's middle-income status, a track record of structural reform, and capable fiscal and economic management. Fitch Ratings revised the Outlook on the rating from Negative to Stable on 27 October 2010 as immediate balance-of-payments risk has abated. Reserves have recovered to an adequate level following a sharp decline in 2009, and the government has had success in maintaining the fiscal deficit below 3% of GDP.
- The current account deficit (CAD) has undergone a significant correction, from 12.4% of GDP in 2008 to a forecast 3.2% in 2010, reducing Macedonia's overall external financing requirement, which is significantly lower than for peers.
- The country's net external debt stock, at 36% of external receipts in 2009 is above the rating median. Against this, international liquidity is higher than the long-term average for countries in the 'BB' category (sovereigns rated 'BB+', 'BB' and 'BB-') and 40% of the country's debt is in direct investment and trade credit, which are relatively stable.
- Public finances are a relative strength. The fiscal deficit widened only modestly to 2.6% of GDP in 2009 (a 1.7pp increase, versus 3.2pp for the region on average). As a result, the budget is in a sustainable position. Fitch expects general government debt to remain below 30% of GDP to 2012, against a 'BB'-range median of 40%.
- Political risk weighs on the rating. However, the Ohrid Agreement, which ended recent inter-ethnic conflict, has proved successful in maintaining peace and political stability. The EU and NATO accession processes are instrumental in maintaining political stability and pro-reform sentiment. However, Fitch expects little official progress towards these goals while the dispute with Greece about Macedonia's constitutional name remains unresolved.
- Governance in Macedonia is in line with 'BB'-range peers, as is income per capita (a good proxy for the country's debt tolerance). The government has legislated a raft of structural and pro-business reforms in recent years. Although the actual ease of doing business in Macedonia has not quite kept pace with the official Ease of Doing Business score, it is improving.
- The banking system, as a potential liability of the sovereign, is relatively low risk. Reliance on foreign funding is low (deposits exceed loans) and the system is well capitalised. Although Greek subsidiaries form 25% of the system by assets, these banks have little need of their parents' liquidity or capital.

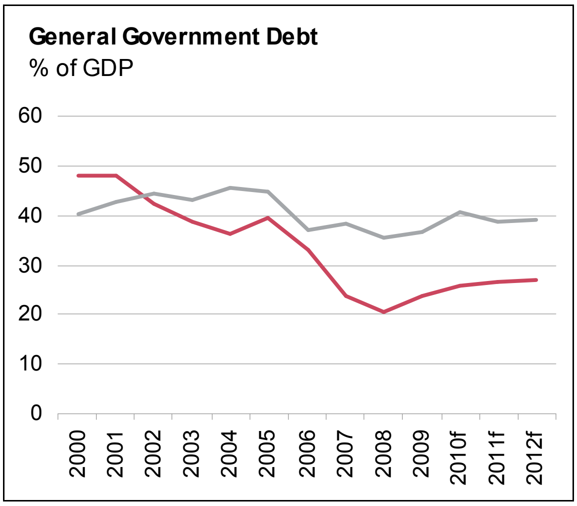
Key Rating Drivers

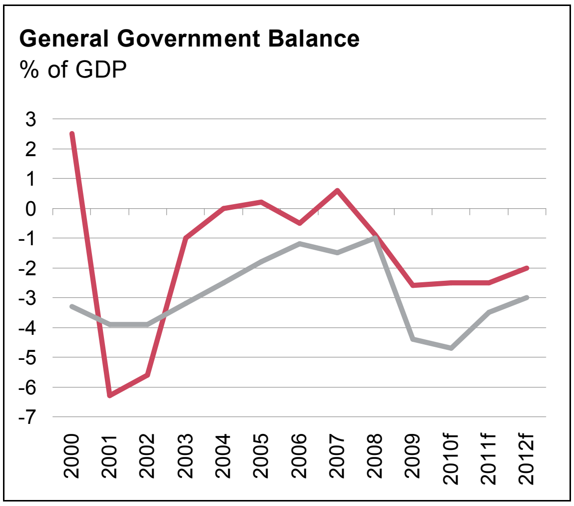
- Negative political shocks or any renewal of inter-communal conflict, although not anticipated by Fitch, would put downward pressure on the rating. Failure to resolve the "name dispute" with Greece means EU and NATO membership could be delayed indefinitely, keeping political risk elevated into the long term.
- A resumption of external financing difficulties, putting pressure on the exchange-rate peg, would threaten the rating as it would increase the risk of a disruptive balance-of-payments crisis.
- Strong and balanced economic growth over the medium term, accompanied by continued structural reforms, would put upward pressure on the rating.

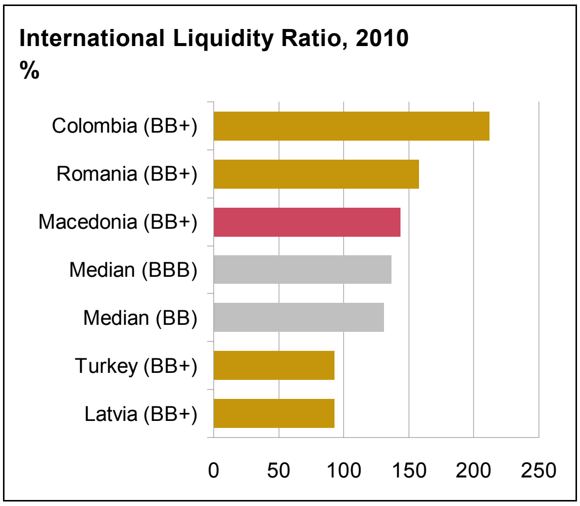
Peer Comparison

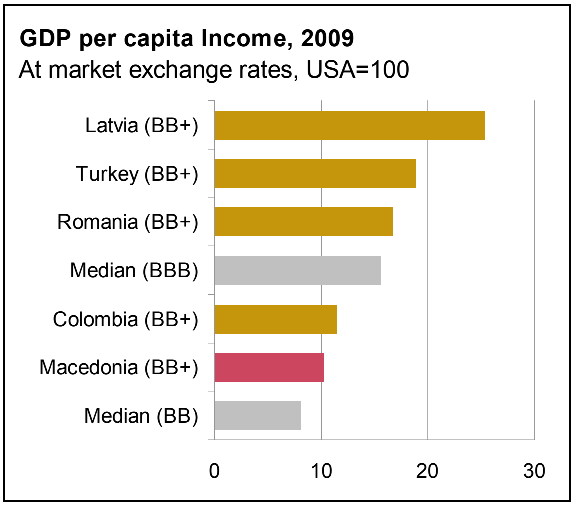












Macedonia Medians

Peer Group

Rating	Country
BBB-	Azerbaijan
	Brazil
	Bulgaria
	Croatia
	Greece
	India
	Kazakhstan
	Morocco
	Namibia
	Panama
	Peru
BB+	**Macedonia**
	Colombia
	Egypt
	Guatemala
	Iceland
	Indonesia
	Latvia
	Romania
	Turkey
BB	Costa Rica
	El Salvador
	Philippines
	Uruguay

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
13 Jun 06	BB+	BB+
01 Nov 05	BB	BB

Rating Factors

Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Structural issues	External finances	Public finances
Status	Neutral	Neutral	Neutral	Strength
Trend	Stable	Stable	Stable	Stable

Note: Relative to 'BB' category
Source: Fitch

Strengths

- The stock of government debt is relatively low, at 23.7% of GDP in 2009. Debt/revenue of 71% is far below the 'BB'-range median of 181%.
- Macedonia has traditionally run modest budget deficits, averaging 1.4% of GDP, since 2000. The deficit has not greatly increased through the global crisis (2.6% of GDP in 2009), unlike in many peer countries in the region.
- The macroeconomic environment is relatively stable, with average inflation of 2.7% since 2005, well below the peer median. This suggests the domestic policy framework has been reasonably successful. GDP contracted by a mere 0.8% in 2009, against 5.9% for central and eastern Europe as a whole.
- External debt service is low relative to 'BB'-range peers (gross external debt service was only 6.7% of external receipts in 2009). This reduces pressures on the fixed exchange-rate regime.

Weaknesses

- Government financing from the domestic market is mainly FX indexed and short term. Government financing options are constrained in the current environment.
- The country's net external debt position is higher than for most 'BB'-range peers, at 36% of external receipts (against a median of 16%).
- The long-running dispute with Greece over the name of the country is now a binding road-block to EU and NATO membership. Failure to reach an agreement with Greece risks undermining the government's reform impetus over time and keeping political risk heightened.
- Macedonia's production base is relatively undiversified and low value added. Iron, steel and clothing account for 50% of exports and are subject to volatile international prices. The country has a large trade deficit (23% of GDP in 2009).
- Unemployment is high, with the official rate at 32%, although it is declining and is probably overstated by 5-10pp.

Local Currency Rating

Macedonia's Local-Currency Long-Term IDR is 'BB+', the same as its Foreign-Currency Long-Term IDR. The central bank's capacity to generate local currency without negative economic consequences is restricted by the fixed exchange-rate regime. Furthermore, the domestic market for government securities is shallow, with the state obtaining most of its funding abroad.

Country Ceiling

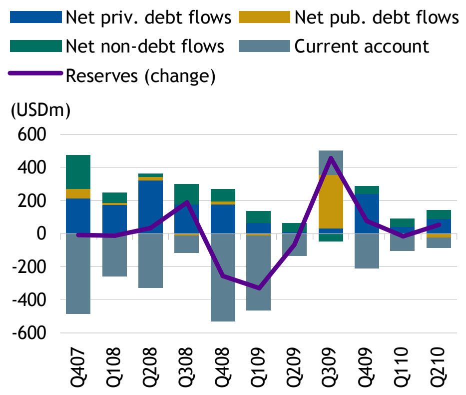
Macedonia's Country Ceiling of 'BBB–' reflects reduced transfer and convertibility risk. EU accession aspirations and the large remittances sent home by Macedonians working abroad are incentives for the government to maintain liberalised transfer and convertibility arrangements.

Outlook and Key Issues

Macedonia's 'BB+' rating has remained unchanged through the global financial crisis. The agency revised the rating Outlook to Stable (from Negative) on 27 October 2010 due to easing pressures on external finances and a relatively shallow economic contraction.

External Finances

Macedonia's balance of payments came under significant pressure from October 2008 to June 2009, with reserves falling 31% peak to trough. Recorded net capital flows slowed considerably, although they remained positive. At the same time, residents' transactions at cash-exchange houses (reflecting an increase in unrecorded "mattress money") exacerbated the rundown in reserves.



Source: IMF, NBRM, Fitch

The CAD steadily declined from 14.5% of GDP in April 2009 to 2.5% in June 2010. This has been driven by a delayed import adjustment, and a resumption of inward current transfers (from remittances and some conversion of mattress money into Macedonian denar, reflecting increased confidence in the local currency).

The government carried out most of its financing for 2009 in a single transaction, issuing a EUR175m Eurobond in July 2009 at a coupon of 9⅞. Helped by some recovery in net recorded capital inflows and a lower current financing need, this allowed reserves to recover rapidly to around their previous level.

As the country is no longer in need of immediate balance-of-payments support, the chances of an IMF stand-by arrangement in the short term have decreased compared with 2009. However, the government will need to borrow from abroad in the coming months (see *Public Finances*).

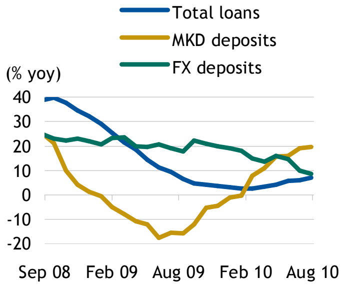
External Finances: Sources and Uses

(USDbn)	2009	2010f	2011f	2012f
Uses	**0.89**	**0.74**	**0.90**	**0.84**
Current account deficit	0.65	0.29	0.44	0.48
MLT amortisation	0.25	0.45	0.46	0.36
Sovereign	0.10	0.05	0.10	0.11
Non-sovereign	0.14	0.40	0.36	0.25
Sources	**0.89**	**0.74**	**0.90**	**0.84**
Gross MLT borrowing	0.73	0.70	0.73	0.63
Sovereign	0.20	0.19	0.27	0.27
Non-sovereign	0.53	0.50	0.46	0.35
Net foreign direct investment	0.23	0.20	0.15	0.25
Net portfolio debt	0.19	0.00	0.00	0.00
Net portfolio equity	-0.04	0.00	0.00	0.00
Other credit flows	-0.12	-0.05	-0.03	-0.03
Net errors and omissions	0.03	0.00	0.00	0.00
Change in fx reserves (- = increase)	-0.14	-0.11	0.04	-0.01

f - Forecast
Source: Fitch

At end-August 2010, reserves covered four months of expected imports or 54% of broad money liabilities, while Fitch's wider measure of international liquidity (official reserves and foreign bank assets' cover of the gross external financing need) sits in line with rating peers, at 159% for 2010. However, in light of the fixed

Deposit and Loan Growth



Source: NBRM

exchange-rate regime and significant dollarisation in the economy, higher reserves would still be desirable.

Monetary and Financial-Market Conditions

The National Bank of the Republic of Macedonia (NBRM) responded to the pressure on the currency by raising the CB-Bill rate by 200bp in April 2009 to 9%. As reserves were rebuilt and the current account adjusted, the central bank began loosening the rate in December, by a cumulative 450bp to 4.5% by September 2010. Fitch views the central bank's policy response as appropriate in light of the country's exchange-rate peg to the euro.

The banking system risk profile is low relative to regional peers. The bank's funding structure is balanced, with a loan/deposit ratio of 93% in August and a balanced external position. The total system loan book is small as a share of GDP (46%).

Non-performing loans (NPL) represented 10.1% of the total in June 2010. They are completely covered by total provisions or 70% covered by specific provisions. Although rising, this NPL level is still below that of 2005 (14.9%). Loan restructuring to avoid formal delinquency ("evergreening") is not common.

The system is 93% foreign owned. A high degree of foreign ownership of the banking system is desirable as it provides an additional capital backstop other than the sovereign if system solvency is threatened. However, 25% of the system is owned by Greek parent banks, whose risk profile has been significantly weakened since 2009.

Fitch views this Greek exposure as only a moderate source of additional risk to the local banking system. First, the Greek subsidiaries in Macedonia rely very little on their parents for funding and their liquidity management is run independently, which narrows this potential channel of contagion. Second, these subsidiaries are well capitalised, which reduces the contingent call on their parents for recapitalisation.

Nevertheless, in the event of a solvency crisis in Greece, the Macedonian authorities may well need to act to prevent a loss of confidence in Greek bank subsidiaries, drawing on international support in a worst-case scenario. Including direct lending to other resident sectors, broader cross-border claims by Greek banks totalled 25% of GDP in March 2010, according to the Bank of International Settlements.

Private-sector leverage is in line with rating peers (44% of GDP) and the lack of dependence on foreign financing reduces the risk of economically disruptive credit contraction. Credit growth slowed dramatically from a peak of 44% yoy in April 2008 to 7.7% yoy in September 2010, but remained positive throughout.

Public Finances

The central government deficit widened only slightly in 2009, despite the recession. Revenues fell by 6% yoy, prompting the government to cut back expenditure, which declined by 1% after two budgetary revisions. As a result, the deficit rose from 0.9% of GDP in 2008 to 2.6% of GDP in 2009, outperforming Fitch's expectations.

Fitch expects the 2010 central government deficit to come in at 2.5%, in line with the official target. The government is aiming for another 2.5% deficit in 2011, falling to 2.0% in 2012. The government's recent track record suggests these targets are realistic. In contrast to most other countries in Europe, the public finances are already in a broadly sustainable position. This is a rating strength.

However, the government has come under more pressure on the financing side. The EUR175m Eurobond issued in July 2009 provided sufficient financing for the remainder of that year. During the course of H110, the stock of arrears increased, suggesting the government was facing cash-flow difficulties. Receipts have picked up in recent months, including a dividend payment of 0.5% of GDP from the state's minority stake in the telecom company MakTel. Fitch understands from the Ministry of Finance that this arrears stock had been largely unwound by end-August 2010.

In September, the IMF transferred Macedonia's General and Special SDR allocations to the government via the central bank for use in fiscal financing. This represents SDR57.2m or 1% of GDP. In 2011, the choice is likely to be between launching a new Eurobond, or applying to use the IMF's Precautionary Credit Line. Launched by the IMF in August, this is potentially available to emerging-market countries without need for balance-of-payments support but who do not qualify for the Flexible Credit Line. The World Bank will also provide USD104m in 2011-2012, of which USD30m (0.3% of GDP) in policy-based lending to the government.

Net domestic borrowing by the central government was 0.4% of GDP in 2009, bringing the stock of domestic debt to 7.3% of GDP by end-December. Net domestic borrowing in January-October 2010 has been similarly low. The government's stated intent is to borrow primarily from abroad so as not to crowd out domestic lending to the private sector. Fitch does not see crowding out as a significant risk at this stage of the cycle: demand for credit from the private sector is low and the total government borrowing requirement is small.

Public Finances: Sources and Uses

(% GDP)	2009	2010f	2011f	2012f
Uses	**5.0**	**7.4**	**8.0**	**7.5**
Budget balance	2.6	2.5	2.5	2.0
Amortisation (by place of issue)	2.4	4.9	5.5	5.5
Domestic	1.4	4.4	4.4	4.5
Foreign	1.0	0.5	1.1	1.0
Sources	**5.0**	**7.4**	**8.0**	**7.5**
Gross borrowing (by place of issue)	5.7	7.5	8.0	7.8
Domestic	1.8	5.3	5.2	5.1
Foreign	3.9	2.2	2.9	2.7
Privatisation	0.0	0.0	0.0	0.0
Change in deposits and other (- = inc.)	-0.7	-0.1	-0.1	-0.3

Source: Fitch

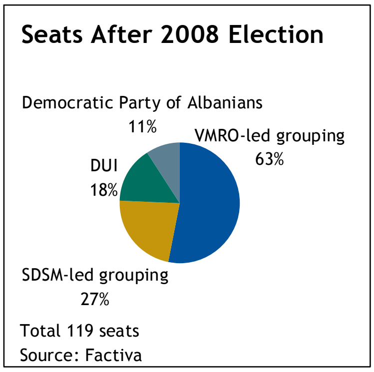
Structural Issues

An October 2009 report by the European Commission recommended opening EU membership negotiations with Macedonia, citing progress in a wide range of structural reforms and free and fair elections that year.

However, in December 2009 the Council decided to reschedule the launch date for Macedonia's EU accession talks to the first half of 2010. This decision was made to avoid an outright Greek veto of the talks. It was also intended to provide more time to resolve the dispute about Macedonia's constitutional name. With no resolution forthcoming, Macedonia was left off the agenda in the July 2010 Council summit.

It is unlikely that any official progress towards EU or NATO accession will be made until the name dispute is resolved, and the chance of an agreement in a given timeframe is highly uncertain (the dispute has dragged on since Macedonia's independence in 1991). Fitch's conservative assumption is therefore that the EU accession process will remain stalled into the medium term.

The EU accession negotiations are an important anchor for political stability (membership is a goal shared by both ethnic Macedonians and ethnic Albanians) and pro-reform sentiment in Macedonia. Fitch expects the government to continue to implement EU-required reforms in the interim. However, the agency considers it likely that the pace of reform will inevitably slow as the goal of full membership slips further into the future.



Furthermore, much more progress on both enforcement of laws and judicial reform will be needed before Macedonia's structural profile can be considered a rating strength. This will inevitably take many years, although the trend remains positive.

Despite occasional setbacks, the November 2001 Ohrid Framework Agreement, which ended inter-ethnic conflict by granting greater legal and political rights to Macedonia's ethnic Albanian and other minority communities, has worked reasonably well, often with a significant help from the international community.

The coalition government consists of the centre-right Internal Macedonian Revolutionary Organisation (VMRO) and its ethnic Albanian partner, the Democratic Union for Integration (DUI). It secured two-thirds of the parliamentary seats following the elections in June 2008 and further strengthened its position after VMRO won the presidential and local elections in early 2009.

Forecast Summary

	2006	2007	2008	2009	2010f	2011f	2012f
Macroeconomic indicators and policy							
Real GDP growth (%)	4.0	6.1	5.0	-0.8	1.0	3.0	3.5
Consumer prices (annual average % change)	3.2	2.3	8.3	-0.8	2.0	2.5	3.0
Short-term interest rate (%)[a]	6.0	5.1	6.5	8.5	7.0	6.0	5.0
General government balance (% of GDP)	-0.5	0.6	-0.9	-2.6	-2.5	-2.5	-2.0
General government debt (% of GDP)	33.0	23.9	20.4	23.7	25.5	26.6	27.3
MKD per USD (annual average)	48.8	44.7	41.9	44.1	47.0	47.7	47.7
Real effective exchange rate (2000 = 100)	96.3	96.5	101.1	100.6	100.6	100.6	100.6
External finance							
Current account balance (USDbn)	0.0	-0.6	-1.2	-0.6	-0.3	-0.4	-0.5
Current account balance (% of GDP)	-0.4	-7.4	-12.4	-6.9	-3.2	-4.6	-4.8
Current account balance plus net FDI (% of GDP)	6.2	1.2	-6.3	-4.4	-1.0	-3.0	-2.3
Net external debt (USDbn)	-0.1	0.1	1.1	2.0	2.2	2.6	3.0
Net external debt (% of GDP)	-0.8	1.4	11.1	20.9	24.3	27.3	29.3
Net external debt (% of CXR)	-1.2	2.0	16.2	36.3	35.4	38.0	40.1
Official international reserves including gold (USDbn)	1.9	2.3	2.1	2.3	2.4	2.4	2.4
Official international reserves (months of CXP cover)	5.1	4.2	3.2	4.5	4.4	3.9	3.6
External interest service (% of CXR)	2.2	2.1	1.9	2.2	2.5	2.4	2.3
Gross external financing requirement (% int. reserves)	37.6	53.8	63.6	42.2	32.3	37.3	35.3
Memo: Global forecast summary							
Real GDP growth (%)							
US	2.7	1.9	0.0	-2.6	2.7	2.5	2.6
Japan	2.0	2.4	-1.2	-5.2	3.0	1.6	1.7
Euro area	3.1	2.7	0.4	-4.1	0.9	1.5	2.0
World	3.8	3.7	1.4	-2.5	3.1	2.9	2.7
Commodities							
Oil (USD/barrel)	65.4	72.7	97.7	64.0	80.0	85.0	85.0

[a] Central bank bill rate (annual average)
Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Macedonia

	2009						
	Colombia 'BB+'	Latvia 'BB+'	Macedonia 'BB+'	Romania 'BB+'	Turkey 'BB+'	'BB' median	'BBB' median
Real GDP (5yr average % change)	4.4	2.1	3.7	3.7	3.2	3.9	3.8
Volatility of GDP (10yr rolling SD)	2.0	9.2	3.2	4.5	5.3	3.1	3.5
Consumer prices (5yr average)	5.2	8.4	2.7	6.8	8.7	7.3	4.8
Volatility of CPI (10yr rolling SD)	1.6	4.3	2.9	13.8	20.6	3.0	2.4
Years since double-digit inflation	10.0	1.0	14.0	5.0	1.0	n.a.	n.a.
Unemployment rate	13.0	17.1	32.2	6.5	14.0	9.0	9.0
Type of exchange rate regime	Managed float	Peg (ERM2)	Peg	Managed float	Free float	n.a.	n.a.
Dollarisation ratio	0.0	84.9	60.9	53.1	31.3	53.6	26.6
REER volatility (10yr rolling SD)	8.1	11.1	2.1	8.1	9.5	8.7	5.8

Source: Fitch

Strengths

- Macedonia's macroeconomic environment is relatively stable, with low volatility of GDP growth and inflation, suggesting a reasonably successful policy framework (pegged exchange rate and broadly neutral fiscal stance).
- Despite tight monetary conditions in 2009, the economic downturn has been relatively mild in Macedonia compared with regional peers. GDP contracted by 0.8% in 2009.
- The mild recession partly reflects the relatively insulated nature of Macedonia's capital markets and banking sector. The banks are domestically funded, and most of the country's external financing takes the form of direct investment and trade credit, both of which are relatively stable. Domestic bank credit to the private sector had not contracted yoy.

Weaknesses

- Macedonia's recent economic performance, although stable, has not been dynamic. GDP growth averaged 2.6% during 2000-2009, against 3.9% for the 'BB' median.
- Official unemployment is 32% of the labour force, far higher than for most peers. However, this number is certainly overstated due to the strong incentives to register as unemployed in order to receive health insurance. Adjusting for this, the authorities estimate that the "true" rate of unemployment is closer to 25%, still high.
- The tax wedge on labour is still high, albeit declining as the government seeks to lower tax rates and broaden the tax base.

Commentary

Dollarisation is slightly higher than for most peers. Although only 22% of loans are "pure" FX denominated, this figure rises to 59% when FX-indexed loans are included. This increases the sensitivity of the real economy to currency risk. Against this, deposit dollarisation is at a similar level (61%) and the private sector is not heavily indebted. Nor is there a significant currency mismatch in the banking sector: the net open FX position was 12.8% of own funds in June 2010.

The exchange rate is not significantly misaligned. IMF research points to a currency overvaluation of 6%-11%, within the bounds of error. Fitch views the peg to the euro as appropriate in light of the small and open nature of the economy.

Fitch forecasts real GDP growth of 1% in 2010 and 3% in 2011, helped by accommodative monetary policy by the NBRM. In light of the significant dislocations caused by the global financial crisis, this forecast is subject to significant risks, both upside and downside.

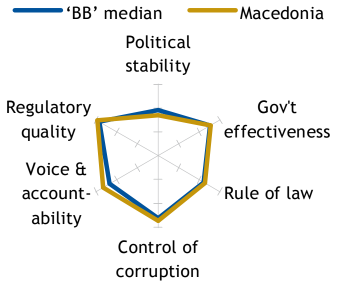
Comparative Analysis: Structural Features

Macedonia

	2009						
	Colombia 'BB+'	Latvia 'BB+'	Macedonia 'BB+'	Romania 'BB+'	Turkey 'BB+'	'BB' median	'BBB' median
GNI per capita PPP (USD, latest)	8,510	16,740	10,550	13,500	13,770	9,530	10,860
GDP per capita (USD, mkt exchange rates)	5,099	11,344	4,572	7,554	8,561	4,847	7,022
Human Development Index (percentile, latest)	58.1	74.0	60.7	65.7	56.9	56.9	59.1
Ease of Doing Business (percentile, latest)	80.3	85.8	83.0	70.4	60.5	47.3	65.2
Trade openness (CXR and CXP % GDP)	20.3	50.8	61.0	40.2	25.5	n.a.	n.a.
Gross domestic savings (% GDP)	20.5	17.4	4.0	19.1	13.7	14.7	24.1
Gross national savings (% GNP)	21.2	28.3	18.8	21.0	12.8	18.9	24.0
Gross domestic investment (% GDP)	22.5	20.4	25.4	25.1	14.9	19.8	23.6
Private credit (% GDP)	30.8	109.1	43.6	40.0	37.9	35.6	59.0
BSR indicators			n.a.			n.a.	n.a.
Bank system CAR	13.8	13.8	16.4	14.0	20.6	n.a.	n.a.
Foreign bank ownership (% assets)	16.6	60.0	93.3	87.4	16.7	n.a.	n.a.
Public bank ownership (% assets)	17.3	18.1	1.4	5.2	32.1	17.3	27.0
Default record (year cured)	-	-	1997	1984	1982	n.a.	n.a.

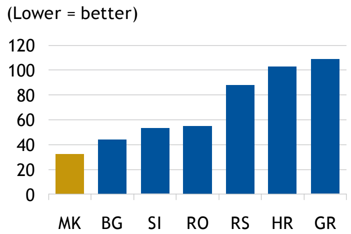
Source: Fitch and World Bank

Governance Indicators



Source: World Bank, Fitch

Ease of Doing Business Rank



Source: World Bank

Strengths

- The country outperforms 'BB' peers on the UN's Human Development index, while income per head and governance indicators are roughly in line with the rating median.
- Gross domestic investment is relatively high, increasing the productive capacity of the economy and future potential growth.
- The government's ambitions to improve the business environment have been demonstrated, albeit with mixed results. It has made a concerted effort to attract foreign investment and privatise state companies. Macedonia ranks 32 out of 183 in the World Bank's Ease of Doing Business score.
- The banking system has weathered the global crisis well. Capital adequacy was a healthy 16.5% in H110. The financing structure of the banks is relatively low risk, with little wholesale external liabilities, and loans/deposits below 100%.

Weaknesses

- Gross domestic savings are low. Domestic savings are bolstered by remittances from Macedonians working abroad. Including the latter would yield gross national savings of 19% of GDP, near the 'BB' median. However, remittances are volatile, as has been demonstrated since 2008.
- Law enforcement and judicial standards are not up to EU norms and the business climate remains opaque. The large informal sector reduces the tax base. These factors are improving.
- Political risks are a material constraint on the ratings. These consist of the ongoing name row with Greece and significant inter-communal divisions, which are blocking the EU and NATO accession processes.

Comparative Analysis: External Finances

Macedonia

	2009					Last 10 years	
	Colombia 'BB+'	Latvia 'BB+'	Macedonia 'BB+'	Romania 'BB+'	Turkey 'BB+'	'BB' median	'BBB' median
GXD (% CXR)	120.4	286.8	102.0	188.4	182.4	107.6	96.5
GXD (% GDP)	23.1	159.7	58.7	71.5	44.5	41.0	47.2
NXD (% CXR)	-0.5	104.8	36.3	83.9	72.2	16.1	17.3
NXD (% GDP)	-0.1	58.3	20.9	31.8	17.6	7.5	8.5
GSXD (% GXD)	69.1	17.2	29.4	24.2	36.4	49.0	33.8
NSXD (% CXR)	17.8	1.4	-6.4	-34.7	16.5	10.4	-8.5
NSXD (% GDP)	3.4	0.8	-3.7	-13.2	4.0	3.4	-4.9
SNFA (USDbn)	-	-0.2	0.3	19.4	-24.8	-0.2	3.1
SNFA (% GDP)	-	-0.8	3.7	12.0	-4.0	-2.2	6.5
Ext. debt service ratio (% CXR)	20.0	55.0	6.7	27.2	38.1	16.6	14.1
Ext. interest service ratio (% CXR)	6.9	8.1	2.2	4.9	5.0	5.0	3.8
Liquidity ratio (latest)	174.5	67.1	159.9	98.3	101.1	131.1	137.3
Current account balance (% GDP)	-2.2	9.8	-6.9	-4.4	-2.3	-1.9	-2.7
CAB plus net FDI (% GDP)	-0.3	10.1	-4.4	-0.4	-1.3	1.5	0.4
Commodity dependence (% CXR, latest)	45.3	18.4	11.8	15.6	13.9	32.3	20.1
Sovereign net FX debt (% GDP)	3.4	27.3	17.2	-8.8	6.3	-	-

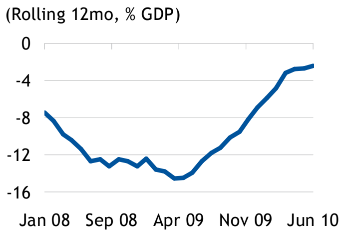
Source: Fitch

Top Five Export Markets

2009	Share of total (%)
Germany	16.7
Serbia	12.5
Kosovo	11.7
Greece	10.8
Italy	8.1

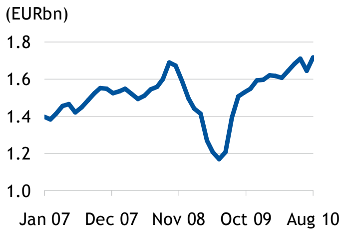
Source: IMF Direction of Trade Statistics

Current Acc't Adjustment



Source: NBRM

Official Reserves Recover



Source: NBRM

Strengths

- The sovereign is a net creditor, reflecting relatively low government debt and the central bank's foreign exchange reserves.
- Along with foreign bank assets, these reserves cover 1.5x maturing external debt in 2010. This liquidity ratio is higher than the long-term peer median.
- Macedonia's low external debt service ratio reflects a relatively high level of intercompany lending. The interest service ratio of 2.2% current external receipts is much lower than the 'BB'-range median of 5%.
- Domestic banks are not reliant on foreign financing and have a broadly balanced net external debt position. This compares favourably with many banking systems in the region.

Weaknesses

- Macedonia has run current account deficits averaging 6% of GDP since 2000. This imbalance grew to 12.4% of GDP in 2008, before shrinking to 2.4% in the year to June 2010.
- The country's net external debt position is higher than that of most 'BB'-range peers, at 36% of external receipts (against a median of 16%).
- The country's export structure remains highly concentrated on a limited range of low-value-added products, with textiles and clothing accounting for 20% of total merchandise, with iron and steel another 30%.
- Due to the country's narrow production base, a large proportion of imports cannot be substituted with domestic production. The trade deficit is large, at 23% of GDP in 2009.

Commentary

Developments in Greece affect Macedonia through trade (as well as financial) channels. Greece is a significant trading partner for Macedonia, posing a downside risk to export performance in the short term.

Comparative Analysis: Public Finances

Macedonia

	2009					Last 10 years	
	Colombia ‘BB+’	Latvia ‘BB+’	Macedonia ‘BB+’	Romania ‘BB+’	Turkey ‘BB+’	‘BB’ median	‘BBB’ median
Budget balance (% GDP)	-2.5	-9.0	-2.6	-8.3	-6.7	-2.1	-2.4
Primary balance (% GDP)	0.6	-7.4	-2.0	-6.8	-1.5	0.8	-0.2
Revenues and grants (% GDP)	25.3	34.4	31.1	32.1	21.5	24.0	31.6
Volatility of revenues/GDP ratio	9.3	4.1	6.1	2.1	5.7	6.3	6.7
Interest payments (% revenue)	12.5	4.6	1.9	4.6	24.7	11.3	7.1
Debt (% revenue)	160.4	106.3	76.1	74.0	213.0	175.6	118.6
Debt (% GDP)	40.6	36.6	23.7	23.7	45.7	40.5	34.6
Net debt (% GDP)	38.6	26.7	22.7	20.4	41.2	35.5	28.5
FC debt (% total debt)	35.3	75.2	72.9	59.2	40.5	64.0	39.1
CG debt maturities (% GDP)	3.0	8.7	3.8	2.4	10.2	5.1	5.7
Average duration of CG debt (years)	4.2	3.1	-	-	2.0	3.3	4.3

Source: Fitch

Strengths

- Fiscal deficits have been modest in recent years. Central government revenue fell by only 6% in 2009 and two budget revisions kept the deficit under 3% that year. Fitch forecasts similar deficits over the medium term. These will pose little threat to debt sustainability.
- The stock of government debt is low in Macedonia compared with rating peers. The recession has had only a mild impact on the debt level, which Fitch expects to remain under 30% of GDP over the medium term. Wider public debt (including the central bank and public enterprises) was 32% of GDP in 2009.
- Recent reforms have helped broaden the tax base and improve tax administration, while lowering tax rates.
- The government looks likely to be eligible for the IMF’s new Precautionary Credit Line, which is aimed at countries that have sound economic fundamentals and policies and are not in need of emergency balance-of-payments support. This can be used for fiscal funding.

Weaknesses

- The government does not issue significant amounts of domestic debt. Furthermore, domestic issuance mainly takes the form of six-month FX-linked T-bills. While this is cheaper, it heightens refinancing and currency risk. Second-pillar pension funds are a growing potential buyer of longer-dated debt but so far this possibility has not been exploited.
- A temporary run-up of arrears in H110 highlights the stresses on government financing over that period. Financing conditions for the government in the foreign markets remain challenging. The government has been hesitant about launching a new Eurobond at what have been high yields (around 8%), but it will need to find additional external financing over the coming months to meet its — albeit modest — financing needs.

Commentary

Macedonia has two Eurobonds outstanding, with EUR175 maturing in 2013 and EUR150 maturing in 2015. Fitch expects further Eurobond issuance over the medium term if market conditions improve. The yields on these Eurobonds are declining (down over 50bp since end-September), increasing the likelihood of further issuance.

Fiscal Accounts Summary

(% of GDP)	2007	2008	2009	2010f	2011f	2012f
General government						
Revenue	**32.8**	**33.1**	**31.1**	**32.6**	**33.5**	**33.4**
Expenditure	**32.2**	**34.1**	**33.7**	**35.0**	**36.0**	**35.4**
O/w interest payments	0.8	0.6	0.6	0.7	0.8	0.9
Primary balance	1.4	-0.3	-2.0	-1.7	-1.7	-1.0
Overall balance	**0.6**	**-0.9**	**-2.6**	**-2.5**	**-2.5**	**-2.0**
General government debt	**23.9**	**20.4**	**24.1**	**25.5**	**26.6**	**27.3**
% of general government revenue	72.8	61.6	76.1	78.5	79.5	81.7
General government deposits	-	2.3	1.0	1.1	1.1	1.3
Net general government debt	-	18.1	23.1	24.5	25.6	26.0
Central government						
Revenue	32.8	33.1	31.1	-	-	-
O/w grants	-	-	-	-	-	-
Expenditure and net lending	32.2	34.1	33.7	-	-	-
O/w current expenditure and transfers	28.4	29.2	30.5	-	-	-
- Interest	0.8	0.6	0.6	-	-	-
O/w capital expenditure	3.8	4.9	3.2	-	-	-
Current balance	4.4	3.2	-1.3	-	-	-
Primary balance	1.4	-0.3	-2.0	-	-	-
Overall balance	0.6	-0.9	-2.6	-	-	-
Central government debt	24.0	20.7	23.6	-	-	-
% of central government revenues	73.2	62.4	76.0	-	-	-
Central government debt (MKDbn)	**87.5**	**85.2**	**97.7**	-	-	-
By residency of holder						
Domestic	-	-	-	-	-	-
Foreign	-	-	-	-	-	-
By place of issue						
Domestic	33.8	28.6	30.1	-	-	-
Foreign	53.7	56.6	67.6	-	-	-
By currency denomination						
Local currency	10.6	8.5	3.2	-	-	-
Foreign currency	76.9	76.6	94.5	-	-	-
In USD equivalent (eop exchange rate)	1.8	1.8	2.2	-	-	-
Memo						
Nominal GDP (MKDbn)	365.0	411.7	413.3	425.8	451.7	481.6

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross external debt	**1.6**	**1.7**	**1.6**	**2.3**	**2.8**	**2.9**	**3.2**	**4.0**	**4.5**	**5.5**
% of GDP	44.7	48.1	43.3	49.9	51.5	49.4	49.6	49.1	45.6	58.7
% of CXR	69.3	90.7	84.3	89.6	91.0	76.7	71.4	67.9	66.2	102.0
By maturity										
Medium- and long-term	1.4	1.4	1.6	1.9	2.2	2.3	2.4	2.7	3.2	4.0
Short-term	0.2	0.3	0.1	0.5	0.6	0.6	0.7	1.3	1.3	1.5
% of total debt	11.8	18.1	5.4	19.9	20.5	21.7	23.3	33.6	28.9	27.1
By debtor										
Monetary authorities	**0.1**	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**	**0.0**	**0.1**
General government	**1.3**	**1.4**	**1.2**	**1.4**	**1.4**	**1.6**	**1.5**	**1.3**	**1.3**	**1.6**
O/w central government	-	-	-	-	-	-	-	-	-	-
Banks	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.3**	**0.6**	**0.5**	**0.7**
Other sectors	**0.1**	**0.1**	**0.3**	**0.8**	**1.2**	**1.1**	**1.4**	**2.1**	**2.7**	**3.2**
Gross external assets (non-equity)	**1.2**	**1.7**	**1.3**	**1.8**	**2.1**	**2.4**	**3.2**	**3.9**	**3.4**	**3.5**
International reserves, incl. gold	0.5	0.8	0.8	0.9	1.0	1.3	1.9	2.3	2.1	2.3
Other sovereign assets nes	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit money banks' foreign assets	0.4	0.6	0.6	0.7	0.8	0.7	0.9	0.9	0.5	0.7
Other sector foreign assets	0.0	0.0	0.0	0.2	0.3	0.3	0.5	0.7	0.7	0.9
Net external debt	**0.4**	**0.0**	**0.3**	**0.5**	**0.6**	**0.5**	**-0.1**	**0.1**	**1.1**	**2.0**
% of GDP	12.0	-0.5	8.0	10.4	12.1	8.0	-0.8	1.4	11.1	20.9
% of CXR	18.6	-0.9	15.6	18.7	21.3	12.4	-1.2	2.0	16.2	36.3
Net sovereign external debt	0.6	0.3	0.4	0.4	0.5	0.2	-0.4	-0.9	-0.8	-0.3
% of GDP	16.1	10.0	11.0	9.0	8.5	4.0	-6.7	-11.4	-8.3	-3.7
Net bank external debt	-0.2	-0.5	-0.4	-0.5	-0.7	-0.5	-0.5	-0.4	0.0	0.0
Net other external debt	0.1	0.1	0.3	0.6	0.9	0.8	0.9	1.4	1.9	2.3
Net international investment position	**-**	**-**	**-**	**-2.0**	**-2.5**	**-2.3**	**-2.5**	**-3.5**	**-4.6**	**-6.3**
% of GDP	-	-	-	-43.2	-46.5	-40.1	-38.8	-43.2	-46.8	-67.0
Sovereign net foreign assets	**-0.6**	**-0.3**	**-0.4**	**-0.4**	**-0.5**	**-0.2**	**0.4**	**0.9**	**0.8**	**0.3**
% of GDP	-16.1	-10.0	-11.0	-9.0	-8.5	-4.0	6.7	11.4	8.3	3.7
Debt service (principal & interest)	**0.2**	**0.2**	**0.2**	**0.3**	**0.3**	**0.2**	**0.6**	**0.5**	**0.3**	**0.4**
Debt service (% of CXR)	8.8	12.4	12.3	9.9	8.4	6.5	12.9	9.1	5.1	6.7
Interest (% of CXR)	3.5	4.4	2.9	2.2	1.8	1.7	2.2	2.1	1.9	2.2
Liquidity ratio (%)	218.3	216.4	267.3	392.1	225.1	224.0	173.0	215.6	188.1	159.9
Net sovereign FX debt (% of GDP)	36.3	39.6	31.3	29.0	26.8	27.0	22.7	16.2	13.1	17.2
Memo										
Nominal GDP	3.6	3.4	3.8	4.6	5.4	5.8	6.4	8.2	9.8	9.4
Gross sovereign external debt										
Inter-company loans	-	-	-	0.1	0.3	0.2	0.3	0.5	0.8	1.2

Sources: NBRM, IMF, World Bank and Fitch estimates and forecasts

Debt Service Schedule on Medium- and Long-Term Debt at 30 June 2010

(USDm)	H2 2010	2011	2012	2013	2014	2015+
Sovereign	**45.9**	**103.2**	**105.7**	**278.4**	**97.0**	**1,074.0**
Official bilateral	6.8	12.5	12.5	10.6	9.6	130.2
O/w Paris Club	0.0	0.0	0.0	0.0	0.0	0.0
Multilateral	31.1	71.8	77.3	78.4	83.3	768.8
O/w IMF	0.0	0.0	0.0	0.0	0.0	0.0
Other	8.0	16.0	15.9	14.8	4.0	31.2
Bonds placed in foreign markets	0.0	2.9	0.0	174.6	0.0	143.8
Interest	45.6	59.6	56.9	43.1	29.2	132.8
Total sovereign debt service	**91.6**	**162.8**	**162.7**	**321.6**	**126.2**	**1,206.8**

Sources: Ministry of Finance, Central Bank and Fitch

Balance of Payments

(USDbn)	2007	2008	2009	2010f	2011f	2012f
Current account balance	**-0.6**	**-1.2**	**-0.6**	**-0.3**	**-0.4**	**-0.5**
% of GDP	-7.4	-12.4	-6.9	-3.2	-4.6	-4.8
% of CXR	-10.3	-18.0	-12.0	-4.7	-6.4	-6.5
Trade balance	**-1.6**	**-2.6**	**-2.2**	**-1.9**	**-2.3**	**-2.5**
Exports, fob	3.4	4.0	2.7	3.2	3.5	3.9
Imports, fob	5.0	6.5	4.8	5.1	5.8	6.4
Services, net	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Services, credit	0.8	1.0	0.9	0.9	1.0	1.0
Services, debit	0.8	1.0	0.8	0.9	1.0	1.0
Income, net	**-0.4**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Income, credit	0.2	0.3	0.2	0.3	0.3	0.3
Income, debit	0.6	0.4	0.3	0.4	0.4	0.4
O/w: Interest payments	0.1	0.1	0.1	0.2	0.2	0.2
Current transfers, net	**1.4**	**1.5**	**1.6**	**1.7**	**1.9**	**2.1**
Memo						
Non-debt-creating inflows (net)	0.7	0.3	0.1	0.1	0.1	0.1
O/w equity FDI	0.5	0.3	0.1	0.1	0.1	0.1
O/w portfolio equity	0.2	0.0	0.0	0.0	0.0	0.0
O/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (+= increase)	0.1	0.0	0.1	0.1	0.0	0.0
Gross external financing requirement	1.0	1.4	0.9	0.7	0.9	0.8
Stock of international reserves, incl. gold	2.3	2.1	2.3	2.4	2.4	2.4

Sources: IMF and Fitch estimates and forecasts