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Press Release: Rating Action

JCR affirms BB+/BBB- (FC/LC) ratings on Macedonia

Issuer: Republic of Macedonia

FC (Foreign Currency Long-Term Senior Debts):	BB+ (Stable)
LC (Local Currency Long-Term Senior Debts):	BBB-(Stable)

JCR has affirmed its BB+ rating on the foreign currency long-term senior debts and BBB-rating on the local currency long-term senior debts of the Republic of Macedonia (The Former Yugoslav Republic of Macedonia). The outlook of the ratings is stable.

The ratings are primarily supported by the country's continued efforts for various reforms with the aim of attaining EU accession, its economic and fiscal stability underpinned by the government's prudent policies and a moderate government debt despite a short-term fiscal deterioration.

On the other hand, the ratings are constrained by the fact that the country's industrial transformation has not yet reached advanced stage, with per-capita GDP (in PPP terms) estimated at 32.5％ of the EU average, its high unemployment rate in excess of 30%, a large structural trade deficit and domestic socio-political risks.

The outlook of the ratings is stable. Unlike many Central and Eastern European countries, the Macedonian economy had a rather moderate impact from the global economic and financial turmoil, due mainly to its lower dependence on external debt. The prospects of the country's EU membership became brighter as the European Commission(EC) recommends opening the accession negotiations in October 14, 2009. JCR considers that the government will continue to push ahead with reform efforts to pave the way for EU accession.

(1) The government promotes reforms geared for EU accession

Following the parliamentary election in June 2008, a coalition government formed by the center-right Internal Macedonian Revolutionary Organization-Democratic Party of Macedonian National Unity (VMRO-DPMNE) and the Albanian Democratic Union for Integration (DUI) secured a stable political base as it took control of two thirds of parliamentary seats. Its political base was further strengthened after VMRO-DPMNE won the presidential and local elections this spring. Macedonia was recognized as an EU membership candidate in December 2005 and was expected to start accession negotiations within a few years. However, the start of the negotiations has been put off after the EC pointed out in its 2008 report that the country has been making a slow progress in meeting the political criteria, given the poor conduct of its June 2008 parliamentary election. The prospects of the country's EU membership resumed progressing as the EC's 2009 report published on October 14, 2009 recommends the start of the accession negotiations based on the evaluation that the country has achieved significant progress in meeting the political criteria. JCR holds that the Macedonian government will continue to promote wide-ranging reform initiatives geared for EU accession on the back of its stable political base. With regard to its international relations, Macedonia's geopolitical risks have receded following the neighboring Kosovo's independence in February 2008 and the recent ratification of the Macedonian-Kosovo Border Demarcation Agreement. By contrast, however, the sore relationship with Greece may adversely affect the country's EU accession. Citing their long-standing dispute over the name of Macedonia, Greece vetoed the country's NATO membership in April 2008.

(2) Impact of the global economic and financial turmoil has been rather modest

Macedonia is a small and open economy, with its per-capita GDP (in PPP terms) estimated at 32.5％ of the EU average. The country's economic growth rate had inevitably remained relatively lower in comparison to the degree of its development due mainly to its lower investment and higher unemployment. However, its annual growth rate in the past three years from 2006 accelerated to over 5% on expansion of domestic demand such as stronger consumer spending spurred by increased bank loans and bigger investment boosted by substantial inflows of foreign capital. Nonetheless, the unemployment rate remained high though it improved from 35.9% at the end of 2006 to 31.8 % at the end of first half of 2009. The global economic and financial turmoil has had a relatively smaller impact on the Macedonian economy, whose expansion has been primarily supported by domestic savings. However, its real GDP growth rate contracted by around 1% year-on-year in the January-March and April-June quarters of 2009 after a 5% expansion in 2008 amid the economic recession in its major European trading partners. A negative growth seems inevitable in 2009. However, the economy is expected to resume growing in 2010 amidst the stabilized domestic demand and gradual strengthening of the export demand. The country's financial system stays relatively stable. But JCR will watch future developments as increasing volume of nonperforming loans has begun to erode the profitability in the banking sector.

(3) Government debt to stay moderate despite short-term fiscal deterioration

The central government fiscal balance has been kept almost balanced since 2004 thanks to a prudent fiscal policy, economic expansion and socio-political stability. The fiscal balance in 2008 ended with a small deficit equivalent to 0.9% of GDP. Under its medium-term fiscal plan (2009-2011), the government is seeking to increase expenditures including public spending to prompt economic expansion while keeping the fiscal deficit below 2% of GDP. The government revised its 2009 budget in September but kept its fiscal deficit target intact at 2.8% of GDP. While revenues will drop significantly amid the economic downturn, expenditures will be cut mainly through reduction of salaries for public employees and goods and services. Fiscal deterioration may inevitably increase the government debt in GDP terms, but it will be kept at moderate levels in the medium term as its ratio to GDP remained around 20% at the end of 2008. The government has been making efforts to trim its debt through efficient debt management policy. Following the buyback and write-off of its London Club debt in 2006, it completed repayment of the entire IMF and Paris Club debts and made partial repayment of the World Bank debt in 2007.

(4) Little concern over external finance due to lower dependence on external debt

The current account deficit widened to reach 13% of GDP in 2008 from 7.5% in 2007 on an increased trade deficit and a reduced transfer balance surplus. The country's structural trade deficit in excess of 20% of GDP primarily stems from its weak export base and high dependence on imports. In the past, Macedonia used to finance its current account deficit mainly with inflows of foreign direct investment. Since 2008, however, the financing has been more dependent on foreign exchange reserves. At the end of July 2009, the reserves were down more than 6% to around US$1.9 billion from the end of 2008. But they are estimated at a level enough to cover around four months of imports and more than one time of the short-term external debt. The overall external debt remained low, with its ratio to GDP staying at around 50% at the end of 2008. The current account deficit also started to narrowing.

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The primary rating methods applied to the ratings are posted on JCR's website (http://www.jcr.co.jp) "Sovereign, Public Sector Entities and Multilateral Development Bank Rating Methodology." The rating methods are subject to change or addition. However, the changes and additions including those that have been made in the past are pos ted in chronological order. Please refer to the rating methods above after checking by comparing the date of press release about the ratings with the release date of the rating methods (effective date of each of such rating metho ds).