FitchRatings

FITCH AFFIRMS MACEDONIA AT 'BB+'; OUTLOOK STABLE

Fitch Ratings-London-15 October 2013: Fitch Ratings has affirmed Macedonia's Long-term foreign and local currency Issuer Default Ratings (IDR) and senior unsecured bond ratings at 'BB+'. The Outlook is Stable. Fitch has also affirmed Macedonia's Short-term rating at 'B' and Country Ceiling at 'BBB-'.

KEY RATING DRIVERS
The affirmation reflects the following key rating drivers:

- Improving growth prospects
After stagnating in 2012, real GDP growth grew by a strong 3.4% year on year in H113. A strong boost from construction in H1 is likely to dissipate in the remainder of 2013, but Fitch forecasts that GDP growth will average 2.7% for the whole year. The agency forecasts that growth will strengthen in 2014-15, as exports and public investment gather pace. Foreign investors in technological development zones (TDZs) already contribute over one-fifth of total export value and are likely to invest in new capacity. However, it remains questionable whether strong activity in TDZs can spill over to the rest of the economy and help to reduce the (official) unemployment rate, which despite recent improvements stood at a very high 28.8% in Q213.

- Still moderate budget deficit and debt
The (central) government budget deficit overshot slightly its target of 3.5% of GDP in 2012, coming in at 3.9%. Fitch estimates that on this basis the deficit will be broadly in line with the official target of 3.5% in 2013, but that it will not fall to 3% until 2015 as the government keeps capital expenditure high. Under Fitch's baseline scenario, Macedonia's gross general government debt (GGGD) will rise modestly to around 36% in 2015, still below the 'BB' median.

- Stable currency peg with no external imbalances
The Macedonian denar's long-standing peg to the euro is backed by international reserves at the National Bank of the Republic of Macedonia amounting to an estimated five months of current account payments. Macedonia does not suffer from major external imbalances, with the current account deficit projected to remain broadly stable over 2013-15 at below 4% of GDP, although this masks a large structural trade deficit financed primarily by current transfers. Net external debt is higher, albeit not materially, than the 'BB' median at 15% of GDP.

- Stable banking sector
Fitch does not deem the banking sector represents a significant risk of contingent liabilities to the sovereign balance sheet. The sector is well capitalised, with a Tier 1 capital adequacy ratio of 14.7% in mid-2013. Non-performing loans rose to 11.8% of the total but are fully provisioned. However, two of the three largest banks have parents domiciled in Greece and Slovenia, which may pose residual risks.

- Political risk
NATO accession and EU membership negotiations are on hold pending resolution of the "name issue" with Greece. No meaningful progress has been achieved on the issue since Fitch's last sovereign review. Relations between the Macedonian majority and the ethnic Albanian minority are stable, but Fitch cannot rule out that the continuing lack of a NATO or EU perspective could eventually lead to renewed tensions.

- Income levels and human development indicators are stronger than the 'BB' median.

RATING SENSITIVITIES
The Stable Outlook reflects Fitch's assessment that upside and downside risks to the rating are currently well balanced.

The main risk factors that, individually or collectively, could trigger a positive rating action are:
- Successful diversification of the domestic economy that leads to stronger, sustainable economic growth and continuing improvement in labour market indicators
- Resolution of disputes with neighbouring countries that clear the path towards membership of international organisations.

The main risk factors that, individually or collectively, could trigger a negative rating action are:
- A significant fiscal loosening or a crystallisation of contingent liabilities that jeopardises the stability of public finances and the currency peg.
- A sharp drop in demand for Macedonian exports in key trading partners, contributing to a prolonged domestic recession.
- A serious breakdown in ethnic relations or other political shock that leads to prolonged instability.

KEY ASSUMPTIONS

- Fitch assumes that the government will broadly meet the targets set down in its medium-term fiscal framework, which project a reduction in the budget deficit to 2.6% of GDP by 2016 and cap the GGGD ratio at 37% of GDP.

- Fitch assumes that the EU economy, Macedonia's largest trade partner, will continue to recover gradually.

- Fitch assumes that the unwinding of extraordinary global monetary stimulus will proceed in a broadly orderly fashion.

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Applicable criteria, 'Sovereign Rating Criteria' dated 13 August 2012 and 'Country Ceilings' dated 09 August 2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Sovereign Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685737
Country Ceilings
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715618