STANDARD
& POOR'S
RATINGS SERVICES

RatingsDirect®

Research Update:

Macedonia Long-Term Ratings Lowered To 'BB-' On Less Predictable Growth And Fiscal Policy Outcomes; Outlook Stable

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

Secondary Contact:
Frank Gill, London (44) 20-7176-7129; frank.gill@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

Macedonia Long-Term Ratings Lowered To 'BB-' On Less Predictable Growth And Fiscal Policy Outcomes; Outlook Stable

Overview

- We consider that since the onset of the global financial crisis the transparency of Macedonia's public finances has declined and growth prospects have weakened.
- In our view, Macedonia's political institutions have inadequate checks and balances, while government arrears are challenging fiscal policy outcomes.
- We are consequently lowering our long-term sovereign credit ratings on Macedonia to 'BB-' from 'BB'. We are affirming our 'B' short-term ratings.
- The stable outlook balances our view of Macedonia's structural rigidities, policy challenges, and external vulnerabilities against relatively modest indebtedness.

Rating Action

On May 24, 2013, Standard & Poor's Ratings Services lowered its long-term foreign and local currency sovereign credit ratings on the Republic of Macedonia to 'BB-' from 'BB'. We also affirmed our 'B' short-term ratings on Macedonia. The outlook is stable.

At the same time, we revised down our transfer and convertibility assessment to 'BB' from 'BB+'.

Rationale

The downgrade reflects our view of Macedonia's less predictable growth and fiscal policy outcomes owing to:
- Regional economic pressures;
- Constrained foreign parents of domestic banks;
- Difficulties in managing government arrears; and
- Recent increases in public capital expenditure on non-productive assets.

Consequently, we have revised down our expectation of annual average Macedonian GDP growth over 2013-2015 to 2%, or less than half of average growth before the 2008-2009 financial crisis. This growth rate is unlikely to generate the job creation required to markedly reduce Macedonia's reported 31% unemployment rate, and raises questions about the viability of the current policy mix.

1136650 | 301754296

We anticipate that the Macedonian economy will expand at close to 1% in 2013, with public spending providing most of the impetus, following a 0.3% contraction in 2012. In our opinion, poor external demand will dampen Macedonia's net exports, taking into account that about 60% of Macedonia's exports are directed to the EU. At the same time, we believe that constrained domestic credit conditions will limit private investment. We anticipate the current account deficit will widen to over 6% of GDP in 2014 from an estimated 5% in 2013 and will be financed by external debt accumulation, foreign direct investment inflows, and some moderate drawdowns in foreign currency reserves.

In our view, political institutions are increasingly weakened by inadequate checks and balances. This appears to be raising the hidden costs of public investment. We anticipate that investment in non-productive assets will weigh on Macedonia's potential growth prospects. We see the business environment as friendly to large foreign investors, but less encouraging to domestic small and midsize enterprises.

Between September 2012 and February 2013, the government contracted external debt in part to pay down accumulated arrears and refund value added taxes to corporate entities. In our opinion, there is a risk of budgetary revenue shortfalls during the remainder of 2013, and consequently further accumulation of government arrears later in the year, especially if there are expenditure overruns (Macedonia reports government finances on a cash basis whereas Standard & Poor's assessment is on an accrual basis). We expect general government debt to rise to 37% of GDP by the end of 2016 from about 34% currently. We further expect general government guarantees to increase from the current 4.7% of GDP in the same period.

Macedonia has been an EU candidate since 2005. A dispute with Greece over its constitutional name has hampered progress on EU entry talks. In December 2012, members of opposition parties were ousted from parliament following a debate over increased government borrowing. The European Commission has requested a Committee of Inquiry to be formed to report on this confrontation. We believe this further complicates Macedonia's prospects of eventual EU accession.

The Macedonian banking system is largely funded by domestic deposits and appears well capitalized (the reported capital adequacy ratio averaged 17.1% in December 2012). Two of the three banks that we view as systemically important in the domestic banking sector have weak foreign parents, however, exposing these subsidiaries to parent-level disruptions. Stopanska Banka AD's parent is Greece-based National Bank of Greece S.A. and NLB Tutunska Banka AD's parent is Slovenia-based Nova Ljubljanska banka. Loan growth in Macedonia decelerated to 5% in 2012, versus 31% on average between 2005 and 2008, contributing to weakening GDP growth. In our opinion, the Macedonian regulatory and supervisory framework has appropriate policies in place to address liquidity risks associated with potential withdrawals by parent banks.

Outlook

The stable outlook balances our view of Macedonia's structural and monetary rigidities and vulnerabilities to external shocks against its relatively low external and fiscal indebtedness. We could raise the ratings if reforms directed toward higher growth, were matched with increasing effectiveness and accountability of public institutions. On the other hand, we could lower the ratings if a weakening of growth, compounded by continuing government capital expenditure on non-productive assets, led to rising public and private debt.

Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Ratings List

Downgraded; Ratings Affirmed

	To	From
Macedonia (Republic of)		
Sovereign Credit Rating	BB-/Stable/B	BB/Stable/B
Transfer & Convertibility Assessment		
Local Currency	BB	BB+
Senior Unsecured	BB-	BB

Additional Contact:
SovereignEurope; SovereignEurope@standardandpoors.com

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

Copyright © 2013 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

McGRAW-HILL