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NEWS RELEASE

Republic of Macedonia Long-Term FC And LC Ratings Raised To 'BB+' and 'BBB-'; Outlook Stable

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Rationale

On Aug. 23, 2005, Standard & Poor's Ratings Services raised its long-term foreign and local currency sovereign credit ratings on the Republic of Macedonia to 'BB+' from 'BB', and to 'BBB-' from 'BB+', respectively, on sustained political stabilization. At the same time, the short-term local currency rating was raised to 'A-3' from 'B', and the 'B' short-term foreign currency rating was affirmed. The outlook is stable.

The upgrade reflects rapid and sustained progress toward political stability, evidenced by the successful conclusion of the Ohrid Framework Agreement in July 2005. The upgrade further reflects ongoing progress in structural reforms, macroeconomic stability, and downward trending debt levels.

The ratings on Macedonia remain constrained, however, by structural rigidities and governance issues in the economy, an inflexible government expenditure structure, and the latent risk of interethnic tensions.

Political stability in Macedonia has improved greatly since the interethnic violence of 2001. The Ohrid Framework Agreement that ended the security crisis has been successfully concluded in July 2005, despite the often politically sensitive and contentious legislation required to fulfil the terms of the Agreement. The political environment has matured and the rights of minorities have been extended, and a repeat of these events looks unlikely. This maturity is also demonstrated by a number of recent political stress tests, which Macedonia navigated well. Although the importance of interethnic relations has receded, the issue will not completely disappear. That said, the commitment of the international community to maintaining the current stability remains strong, and would have a moderating influence should tensions increase in the future.

Prudent economic policies have managed to maintain macroeconomic stability despite a multitude of shocks since independence. Inflation has remained at low single digit levels since the mid-1990s, and GDP growth is forecast to be around 4.0% between 2005 and 2008. Moreover, reforms have been undertaken or are underway to address structural rigidities and obstacles to growth in the economy such as inflexible labor markets, governance problems, and a weak judiciary.

Fiscal accounts, meanwhile, are sound. General government deficits (including grants) are forecast to average 0.7% of GDP in 2005-2008, following a slight surplus in 2004. Low net financing requirements continue to push the debt level down to 40% of GDP in 2008, from 47% in 2004. By contrast, structural rigidities on the expenditure side (where wages and transfers account for 82%), as well as an inefficient and costly social security system, pose risks to the maintenance of fiscal prudence.

Outlook

The stable outlook reflects the balanced risks to which Macedonia is exposed. Sustained and significant progress in enacting and implementing central structural reforms, anchored by the prospect of EU membership after the turn of the decade, ongoing macroeconomic and fiscal stability, and further normalization of interethnic relations could eventually lead to an upgrade of the foreign currency ratings on Macedonia to investment grade.

Looking forward, a delay in EU membership prospects as a result of the recent controversy over further expansion of the union would itself not pressure the ratings on Macedonia. On the other hand, the ratings could be lowered if the determination and consensus to pursue and implement important structural reforms and prudent macroeconomic policies were to recede, or if political stability and interethnic relations were to again come into question.

Ratings List

	To	From
Foreign currency sovereign credit ratings	BB+/Stable/B	BB/Positive/B
Local currency sovereign credit ratings	BBB-/Stable/A-3	BB+/Positive/B
Senior unsecured debt	BBB-	BB+

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