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FYR of Macedonia

September 2017

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SOVEREIGN RATING	Initial rating	Review	Monitoring	Review	Review	Review
Date of Rating Committee	14.09.2015	17.03.2016	14.04.2016	14.09.2016	14.03.2017	13.09.2017
Date of rating publication	18.09.2015	18.03.2016	15.04.2016	16.09.2016	17.03.2017	15.09.2017
Long-term rating:	BB- (ns)	BB- (ns)	BB- (ns)	BB- (ns)	BB- (ns)	BB- (ns)
Outlook:	Stable	Stable	Negative	Negative	Negative	Negative
Short-term rating:	B (ns)	B (ns)	B (ns)	B (ns)	B (ns)	B (ns)

● (ns) – not solicited rating

BCRA – CREDIT RATING AGENCY AD (BCRA) *is the third fully recognized rating agency in the EU, registered pursuant to Regulation No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by the BCRA are valid throughout the EU and are fully equal to those, of the other agencies, recognized by the European Securities and Markets Authorities, without any territorial or other limitations.*

"BCRA - CREDIT RATING AGENCY" AD affirms the credit rating of the FYR of Macedonia with unsolicited sovereign long-term rating BB- (ns) and short-term B (ns) with negative outlook.

BCRA's officially adopted Sovereign Rating Methodology has been applied (http://www.bcra-bg.com/files/file_330.pdf).

The report has been prepared and the rating – assigned, based on public information, made available by the National Bank of the Republic of Macedonia, the State Statistical Office, the Ministry of Finance, the World Bank, the International Monetary Fund, the European Commission, BCRA's database etc. BCRA uses sources of information, which it considers reliable, however it cannot guarantee the accuracy, adequacy and completeness of the information used.

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Political situation in Republic of Macedonia remains highly dynamic over the first eight months of 2017.

In the early parliamentary elections, held on the 11th of December 2016, VMRO-DPMNE won 38.14% of the votes and 51 mandates, followed by Social Democratic Union of Macedonia (SDSM) with 36.66% of the votes and 49 mandates. The remaining mandates were distributed among the Albanian parties.

On the 9th of January, President Ivanov gave the mandate to form a government to Nikola Gruevski, VMRO-DPMNE's leader, but Gruevski failed to form a parliamentary majority in the legally prescribed 20-day term. It took a long time for the President to decide to give the mandate to the second party, SDSM. Ivanov's reasoning included allegations of external interference in the newly-agreed coalition of the SDSM together with three of the four ethnic parties of Albanians in the parliament (the co-called "Tirana platform"). The Tirana Platform includes demands such as "recognition the genocide over the Albanians in the period 1912 -1956", adopting the Albanian language as official on an equal footing with the Macedonian, and introducing ethnic Albanian quotas at all levels of government.

All these factors intensified the crisis. One of manifestations of the latter was a mass collision between the political opponents, on the one hand, and outside protesters, on the other, in the building of national parliament at the end of April 2017. The danger of civil conflict forced the President to act by giving the mandate to the leader of SDSM' coalition, Zoran Zaev.

The Macedonian Parliament voted the government of Zoran Zaev on the 31st of March and the new cabinet took office at the end of May. Zaev promises to boost economic reforms for improving the standard of living of Macedonians.

On the 15th October, the postponed local elections will be held in Macedonia. They will represent a test for the competing parties and their results will indicate the attitudes of Macedonian society to the ongoing political controversy. At the headquarters of VMRO-DPMNE, the elections are seen as an opportunity for the party to return to the country's governing. A victory of SDSM in the local vote will stabilize the government and will give him the strength to continue their policy.

In respect to the foreign affairs, the new authorities follow a line of improving relations with Bulgaria and Greece, which is broadly appreciated by international community and paves the country's road to NATO and EU membership, accordingly. At the same time, diplomatic tensions led to worsening country's bilateral relations with Serbia in August 2017.

Therefore, the main challenges Macedonia face, include preserving the democratic principles in holding the upcoming elections as well as the further stabilization of relations among the Balkan countries.

The whole political development has left its mark on the economy, as annual GDP growth decelerates from 3.8% in 2015 to 2.4% in 2016. Negative growth of 0.9% is achieved for the first six months of 2017, driven by the significant decrease of gross capital formation. However, the constitution of a new government is expected to support an improvement in economic activity in the second half of the year. Exports continue to outperform imports since the beginning of 2017, remaining the most significant component of the GDP growth.

After the robust growth in 2016, construction activity drops by 11.6% on an annual basis during the first half of 2017. Services sector also has negative contribution to growth. Gross value added of the industry remains unchanged, compared to the same period of 2016, i.e. growth amounts to 0.0% on real basis.

The overall movement in the trade of goods during the first half of 2017 indicates a positive dynamics in nominal terms for both exports and imports. Exports of goods expand by 16.4% in relation to the same period in 2016.

The country trades most actively with the European Union. Among countries, Germany accounts for less than a half of country's exports and about 12% of country's imports in the past two years. Other EU-member countries with considerable shares in the international trade of Macedonia include Italy, Greece and Bulgaria.

The current account deficit is widening to 3.1% of GDP at the end of 2016 (2.1% in 2015). The negative balance is mostly attributable to the increased deficit on the primary income account and, to a lesser extent, to the higher deficit in the trade in goods, while services and secondary income generate surpluses.

Despite the political turmoil, FDI inflows are increasing to 5.2% of GDP at the end of 2016, mostly due to the better performance of export-oriented production, preferential treatment of free economic trade zones and presence of foreign capital in such organizations and firms.

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As of 31st of March 2017, the net international investment position of Republic of Macedonia stands negative at the value of EUR 5 933 mln or 58.1% of the projected GDP for 2017.

Inflation rate in the first half of 2017 turns positive and reaches 0.9%. Price level of the country is expected to keep the positive movement considering the expanding economic activity in Europe. Main commodities (incl. crude oil) and food prices at the international markets are also expected to moderately increase, thus, putting upward pressures on inflation.

Certain positive developments are visible in the labour market. The unemployment rate decreases to 23.7% in 2016 and shrinks even further to 22.6% in the first half of 2017 with expectations of continuing downward trend. The unemployment rate, however, remains at alarmingly high levels, much higher than representative EU-members, thus implying the presence of serious problems and obstacles the economy faces that would take time before unemployment can reach publically comfortable levels.

Central government budget has been improving over the past two years. The budget balance reaches 2.6% at the end of 2016, determined by the faster revenues' growth, compared to the increase in spending due to underexecution of capital spending.

Despite the improvement in the state budget, public debt is rising both nominally and as a ratio to GDP. At the end of 2016 public debt amounts to EUR 4 711 mln or 47.8% of GDP. State-guaranteed debt still holds a significant share of the public debt and is expected to experience a moderate increase in the period 2017-2019, as a result of new disbursement of loans under future infrastructure projects.

Public debt structure is characterised by prevalence of external over domestic debt. External debt has risen gradually in recent years, as a result of Eurobond issuances in 2014, 2015 and 2016 and public investment projects contracted with IBRD, CEDB, EBRD and EIB. In terms of currency, round 80% of the public debt is denominated in foreign currency, mainly in euros. The large amount of debt denominated in foreign currency could affect the repayment costs, however, the risk of devaluation is low, as the denar is informally pegged to the euro.

At the end of March 2017, gross external debt stands at EUR 7 780 mln or 75.7% of GDP forecasted for the year. The share of public external debt in total gross debt increases, but private external debt still prevails in the structure with 50.9%.The maturity structure remains favourable, with 73.7% of the total debt being long-term.

The sustained minimum volatility of the MKD/EUR exchange rate improves the soundness of the country's economic state, but makes it necessary for the country to maintain a high level of foreign reserves. The current level of reserves ensures over 4 months coverage over imports, enough adequate to reduce the risk of inability to respond to unexpected events occurring on international markets.

With respect to the field of banking in Macedonia as of end-2016 and Q1 2017 the turbulence from mid-2016 are generally overcome and the main quality indicators (such as non-performing loans ratio and the profitability expressed by the ROA and ROE) have reached their pre-crisis levels. Liquidity and capital adequacy are maintained at satisfactory levels ensuring stability. No significant changes are observed in the structure of the system during this period.

Preferences of depositors and borrowers towards domestic currency are restored at the beginning of 2017 as the 2016 tendencies does not undergo notable changes. The overall uncertainty in domestic political and institutional environment, however, left their mark on the dynamics of banking activities. Lending to the non-financial institutions continues to register negative growth rates in relation to the aggravated investment environment with the deposits expanding preserved for this sub-sector. Households are the most active in lending, while their savings grow moderately.

At the backdrop of this developments, banking system remains steady. It is highly profitable with increasing assets accounting for 71.5% of the country' GDP as of Q1 2017.

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Outlook:

The negative outlook of the Sovereign Rating of the FYR of Macedonia reflects the BCRA's opinion that the political situation still carries some uncertainty despite the successful formation of a new government. Other factors that affected the decision of keeping the outlook include the transmission of negative effects from the political to the real, fiscal and monetary sectors and their possible renewal in time.All listed developments are considered to have unfavourable effects on the country's general economic indicators and its creditworthiness.

BCRA would consider upgrading the Sovereign Rating and/or improving the rating Outlook for the FYR of Macedonia if further stabilization in the political situation is observed. Additional positive effects would be considered the gradual correction in economic imbalances induced by the prolonged political instability and the clearance of negative effects in the real, fiscal and monetary sector, namely – reduction in budget deficit and sovereign indebtedness and improvement in balance of payments categories.

BCRA would consider downgrading the Sovereign Rating for the FYR of Macedonia if there are adverse and/or unpredictable developments in the political sector, leading to increase in instability and uncertainty, as well as further deterioration in budgetary categories, increasing indebtedness, further deceleration in economic activity and investments as well as negative shocks to the banking system.

Regulatory announcements

Rating initiative

This is an unsolicited sovereign rating. Neither the rated entity, nor a related third party has participated in the credit rating process. BCRA did not have access to the accounts, management and other relevant internal documents for the rated entity or a related third party.

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Summary of the minutes of the Rating Committee:

On the 13th of September 2017 Rating Committee of BCRA – CREDIT RATING AGECY (BCRA) had a cession, on which the **Report regarding the affirmation of an unsolicited sovereign rating of Republic of Macedonia** was discussed.

The members of the Rating Committee discussed the grades of numerous credit rating factors included in the **Model for grading** and analysed in the **Credit Rating Report** in accordance with the **Sovereign Rating Methodology**.

Current political situation was discussed. The crisis in the country' governance has been overcome with the election of a new government. This happened half a year after holding the elections and with the mandate of the Social Democratic Union of Macedonia. The two years of instability in public sphere have affected country's economic performance. There is slowdown observed in the GDP, GVA, lending and incomes in 2016, with the negative trend continuing until mid-2017. Implementation of structural reforms and accomplishing major infrastructure projects planned in the budget is highly limited without a regular government and with local authorities, which mandates has expired. In this respect, the execution of the state budget for the past year is below 100%, and there is also a reduction of the budget balance deficit.

The members of the Committee highly assessed the continued favourable development of the labour market as well as the increase in the flow of foreign direct investments in the country.

The dynamics of banking system indicators demonstrate favourable levels. In this respect the existence of sustainable mechanisms by the National Bank to deal with external shocks were also commented.

The affirmed sovereign rating and the related outlook maintenance have been determined based on the above discussion.

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Tables:

Country	*Development classification*	*Probability of default indicator*
The FYR of Macedonia	*Emerging and Developing Europe (IMF classification)*	*CDS Market Indicator Not available.*

General economy	2017 I-VI	2016 I-VI	2016	2015	2014	2013	2012
GDP (In million EUR)	**4860**	**4712**	**9861**	**9061**	**8563**	**8150**	**7585**
real growth rate (%)	-0,9	2,7	2,4	3,8	3,6	2,9	-0,5
Final consumption	4064	3894	7986	7714	7442	7275	7019
Household consumption	*3285*	*3136*	*6437*	*6202*	*5977*	*5848*	*5605*
General government consumption	*779*	*759*	*1549*	*1511*	*1465*	*1427*	*1414*
Gross capital formation	1497	1531	3310	2817	2594	2348	2194
Export of G&S	2584	2262	4856	4422	4081	3537	3442
Import of G&S	3285	2976	6291	5892	5555	5009	5070
GDP per capita (EUR) [1]	-	-	4738	4358	4122	3926	3657
Total average monthly net wage (EUR)	368	359	363	356	347	343	340
Inflation - CPI (annual average %)	0,9	-0,4	-0,2	-0,3	-0,3	2,8	3,3
Unemployment rate (in %,; 15+ y.o.)	22,6	24,0	23,7	26,1	28,0	29,0	31,0
Average exchange rate MKD/EUR	61,60	61,69	61,60	61,61	61,62	61,58	61,53
Average exchange rate MKD/USD	56,95	55,32	55,70	55,50	46,44	46,40	47,90

Balance of payments *in million EUR*	2017 I - VI	2016 I - VI	2016	2015	2014	2013	2012
Net export of goods and services	*-701*	*-713*	*-1435*	*-1470*	*-1474*	*-1472*	*-1628*
Current account	*-218*	*-278*	*-303*	*-187*	*-43*	*-134*	*-240*
as % of GDP[2]	*-4,5%*	*-5,9%*	*-3,1%*	*-2,1%*	*-0,5%*	*-1,6%*	*-3,2%*
Credit	*3414*	*3020*	*6639*	*6235*	*5921*	*5325*	*5215*
Debit	*3632*	*3298*	*6943*	*6422*	*5965*	*5459*	*5455*
Goods and services	*-716*	*-733*	*-1456*	*-1485*	*-1472*	*-1488*	*-1698*
Goods	*-901*	*-922*	*-1854*	*-1827*	*-1856*	*-1863*	*-2008*
Services	*185*	*189*	*399*	*342*	*384*	*375*	*309*
Primary income	*-209*	*-208*	*-419*	*-286*	*-161*	*-193*	*-164*
Secondary income	*707*	*663*	*1571*	*1584*	*1589*	*1547*	*1622*
Capital account	*3*	*5*	*10*	*7*	*3*	*15*	*9*
Financial account	*-231*	*-288*	*-308*	*-183*	*-27*	*-107*	*-212*

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Public finance indicators

		2017 I-VI	2016 I-VI	2016	2015	2014	2013	2012
	in million EUR							
Central government budget	Revenues	*1 402*	*1 329*	*2 749*	*2 617*	*2 368*	*2 277*	*2 245*
	Expenditures	*1 537*	*1 442*	*3 010*	*2 932*	*2 727*	*2 590*	*2 533*
	Budget balance	*-135*	*-113*	*-261*	*-315*	*-359*	*-313*	*-288*
	Surplus | Deficit (% GDP)	*-1,3*	*-1,1*	*-2,6*	*-3,5*	*-4,2*	*-3,8*	*-3,8*
General government budget	Revenues	*1 499*	-	*2 950*	*2 809*	*2 543*	*2 450*	*2 432*
	Expenditures	*1 628*	-	*3 209*	*3 120*	*2 904*	*2 775*	*2 727*
	Budget balance	*-129*	-	*-259*	*-312*	*-361*	*-325*	*-296*
	Surplus | Deficit (% GDP)	*-1,3*	-	*-2,6*	*-3,4*	*-4,2*	*-4,0*	*-3,9*
Public debt	Public debt	*4708*	*4273*	*4711*	*4227*	*3921*	*3281*	*2909*
	as % of GDP	*46,1*	*43,3*	*47,8*	*46,7*	*45,8*	*40,3*	*38,3*
	External public debt	*3255*	*2876*	*3286*	*2848*	*2725*	*2079*	*1941*
	Domestic public debt	*1454*	*1397*	*1425*	*1380*	*1196*	*1203*	*968*
Reserve assets		*2 400*	*2 159*	*2 613*	*2 262*	*2 436*	*1 993*	*2 193*
as % of GDP		*0,23*	*0,22*	*0,27*	*0,25*	*0,28*	*0,24*	*0,29*
	in million EUR	**2017 Q1**	**2016 Q1**	**2016**	**2015**	**2014**	**2013**	**2012**
Gross External Debt		*7781*	*6816*	*7253*	*6291*	*5992*	*5220*	*5172*
as % of GDP		*75,7*	*69,1*	*73,5*	*69,4*	*70,0*	*64,0*	*68,2*
Net International Investment Position		*-5 933*	*-5 243*	*-5 732*	*-5 083*	*-4 549*	*-4 558*	*-4 178*
as % of GDP		*-58,1*	*-53,2*	*-58,1*	*-56,1*	*-53,1*	*-55,9*	*-55,1*

Banking sector indicators

	2017 Q1	2016 Q1	2016	2015	2014	2013	2012
Ratios							
Capital adequacy ratio (%)	15,4	15,8	15,2	15,5	15,7	16,8	17,1
Liquid assets/ Total assets (%)	27,8	28,7	28,9	28,2	29,8	31,2	32,4
Highly liquid assets/ Total assets (%)	24,2	24,8	25,7	24,3	25,5	27,3	29,4
Non-performing loans/ Total loans (%) (total loans to non-financial sector)	6,4	10,9	6,6	10,8	11,3	11,5	10,5
in billion EUR							
Total (gross) loans (to nonfinancial entities)	*4,5*	*4,5*	*4,6*	*4,5*	*4,1*	*3,7*	*3,5*
Total deposits (of nonfinancial entities)	*5,2*	*5,0*	*5,3*	*5,0*	*4,7*	*4,2*	*4,0*
Total assets	*7,1*	*6,9*	*7,2*	*6,9*	*6,5*	*6,0*	*5,7*
Financial result (net profit/ loss)	*0,027*	*0,025*	*0,103*	*0,075*	*0,051*	*0,038*	*0,024*

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* The values in EUR are calculated by using the average exchange rate of the MKD/EUR for the corresponding period

[1] The value is calculated by using the indicator GDP per capita in LCU in current prices (World Bank Database) converted in EUR by using the average exchange rate MKD/EUR for corresponding period The indicator is calculated as the sum for the period as % of GDP for the corresponding period.

[2] The indicator is calculated as the sum for the period as % of GDP for the corresponding period

[3] Pursuant to the Public Debt Law (Official Gazette, no. 145/2014), public debt is broader definition of the debt, including the government debt and the guaranteed debt of public enterprises and companies fully or dominantly owned by the state or the debt of municipalities

Sources: National Bank of Republic of Macedonia, State Statistical Office, Ministry of Finance, World Bank, Eurostat, International Monetary Fund.