



## Summary

Economic growth in Macedonia is recovering from the global financial crisis and is expected to increase to around 2-3% in 2011/12. The economic downturn, combined with massive unemployment, cost the ruling party VMRO-DPMNE seats during the June parliamentary elections. Despite this, it remained the largest party and is expected to lead the coalition again. The policy direction is therefore expected to continue, with the opening of EU accession talks high on the agenda. The name dispute with Greece remains an important obstacle. The external position of Macedonia is weak. Remittances are the lifeline for the current account balance, but they are vulnerable to the situation in Greece. The current account deficit is expected to widen to around 5% of GDP – albeit much more manageable than the pre-crisis 12% of GDP. Moreover, Macedonia relies strongly on short-term debt, the external debt level increased to around 60% of GDP, the import cover is barely more than 3 months and the liquidity ratio is below 100%.

## Things to watch:

- Official results from parliamentary elections (and the response of the public)
- Widening current account deficit
- Availability of short-term foreign capital (to roll over short-term debt).

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## Country report FYR MACEDONIA

FYR Macedonia					
<b>National facts</b>		<b>Social and governance indicators</b> rank / total			
Type of government	Parliamentary democracy	Human Development Index (rank)	71 / 169		
Capital	Skopje	Ease of doing business (rank)	38 / 183		
Surface area (thousand sq km)	26	Economic freedom index (rank)	55 / 179		
Population (millions)	2.1	Corruption perceptions index (rank)	62 / 178		
Main languages	Macedonian (official; 67%)	Press freedom index (rank)	68 / 178		
Main religions	Albanian (official; 25%)	Gini index (income distribution)	42.8		
	Macedonian Orthodox (65%)	Population below \$1.25 per day (PPP)	2%		
	Muslim (33%)				
	other Christian (0.4%)	<b>Foreign trade</b> 2010			
Head of State (president)	Gjorge Ivanov	<i>Main export partners (%)</i> <i>Main import partners (%)</i>			
Head of Government (prime-minister)	Nikola Gruevski	Germany	21	Germany	11
Monetary unit	Macedonian denars (MKD)	Kosovo	13	Russia	10
		Serbia	8	Greece	8
		Greece	7	Serbia	8
<b>Economy</b> 2010		<i>Main export products (%)</i>			
<i>Economic size</i>		<i>Main import products (%)</i>			
	<i>bn USD</i>	<i>% world total</i>			
Nominal GDP	9	0.01	Iron & steel	23	
Nominal GDP at PPP	19	0.03	Clothing	17	
Export value of goods and services	4	0.02	Petroleum & petroleum products	7	
IMF quatum (in mln SDR)	69	0.03	Tobacco	4	
<i>Economic structure</i>		<i>Main import products (%)</i>			
	<i>2010</i>	<i>5-year av.</i>			
Real GDP growth	0.7	3.6	Petroleum & petroleum products	14	
Agriculture (% of GDP)	12	12	Road vehicles	7	
Industry (% of GDP)	30	29	Industrial machinery	2	
Services (% of GDP)	58	58	Meat and meat preparations	2	
<i>Standards of living</i>		<i>Openness of the economy</i>			
	<i>USD</i>	<i>% world av.</i>			
Nominal GDP per head	4442	45	Export value of G&S (% of GDP)	45	
Nominal GDP per head at PPP	9295	79	Import value of G&S (% of GDP)	66	
Real GDP per head	3227	40	Inward FDI (% of GDP)	3.2	

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

### Economic structure and growth

Macedonia is a small country in the Balkan region with only 2mln inhabitants and a total GDP of USD 19bn (PPP). The country used to be part of Yugoslavia, which is still visible in its name. The official name is Former Yugoslav Republic of (FYR) Macedonia to separate it from the Greece province of Macedonia. The name dispute is one of the most important obstacles for the opening of accession negotiations with the EU, which Macedonia hopes to start next year or so. Besides the name dispute, Macedonia also needs to address issues such as bureaucracy, corruption, weak judicial system, limited press freedom and relative low education level.

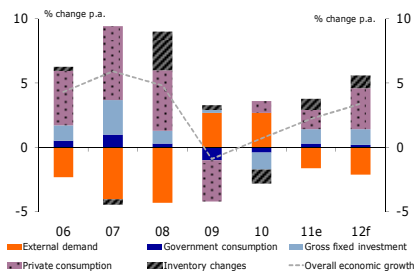
Economic growth is recovering from the downturn during the global financial crisis. Growth is expected to increase from 0.7% in 2010 to around 2% this year and 3% next year. Ample availability of (foreign) credit, external demand and remittances stimulated consumption and investment in the pre-crisis years, leading to solid growth figures. During the financial crisis, credit availability was reduced, external demand dropped and remittances suffered from the fact that many Macedonians work in Greece.

### Political and social situation

The June 5<sup>th</sup> parliamentary elections have likely been won by the ruling Internal Macedonian Revolutionary Organization-Democratic Party of Macedonian National Unity (VMRO-DPMNE). At the time of writing this report, the official results were not published yet, but preliminary results show that the conservative VMRO-DPMNE got almost 40% of the votes. The main opposition party, the Social Democrats, won a little over 30% and acknowledged their defeat. The VMRO-DPMNE is

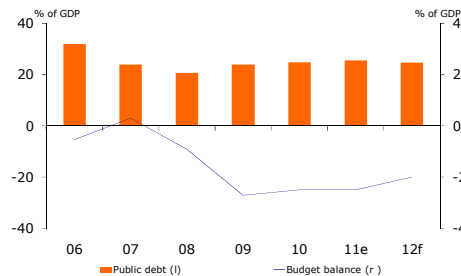
expected to form a coalition again with Democratic Union of Integration (DUI), which received 10% of the votes and represents the large Albanian minority. If the coalition is formed, this will put VMRO-DPMNE in charge for the third consecutive period. Although VMRO-DPMNE received most of the votes, it lost compared to previous elections, while the Social Democrats gained. The ruling party lost public support when it was caught in a voting scandal only weeks before the elections and because of rising public dissatisfaction with the economic situation. Economic growth is only slowly recovering and unemployment and poverty are major issues. The unemployment ratio stands at 32% and one in three Macedonians lives in poverty, based on local standards. Another important social issue is the occasional tensions between Macedonians and ethnic Albanians, which form about a quarter of the total population. In contrast to the 2008 elections, no violence was reported during the June elections. There is a small chance that the official results will trigger public protests or violence, especially if vote rigging is reported.

**Chart 1: Economic growth**



Source: EIU

**Chart 2: Fiscal deficit and public debt**



Source: EIU

**Economic policy**

The fiscal deficit increased during the global financial crisis from less than 1% of GDP in 2008 to around 2.5% of GDP in 2010. This is hardly expected to improve during 2011/12, even though the government recognizes the need for fiscal austerity to support the informal peg of the denar to the euro. Recently, Macedonia reached an agreement with the IMF for a precautionary credit line (PCL) of EUR 480mln. This will make it easier to defend the peg if necessary. Inflation is sensitive to fuel and food prices, which could push the inflation rate up to 5% this year. Next year, prices are expected to moderate to around 3%.

**Balance of Payments**

Macedonia’s main sectors are also the producers of its export products, such as steel, iron, petroleum products, tobacco, processed food, and textiles. Despite a growing export sector, the trade balance tends to have a huge deficit. The import bill shrunk during the financial crisis, but the deficit on the trade balance was still more than 20% of GDP in 2010 and is expected to stay at this level. The transfer balance, largely consisting out of remittances, shows large surpluses. With the unfolding problems in Greece, remittances are expected to slow again during 2011. On balance, the current account deficit is expected to widen from 2.8% of GDP in 2010 to around 5% of GDP in 2011/12. Despite the deterioration towards a rather substantial current account deficit, the level is much more manageable than before the crisis, when it was around 12% of GDP.

**External position**

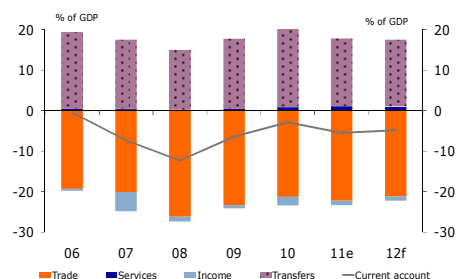
The external position of Macedonia is rather weak. The country relies on short-term debt to cover its financing needs, the external debt level increased rapidly in the past years to around 60% of GDP, the import cover is barely more than 3 months and the liquidity ratio is below 100%.



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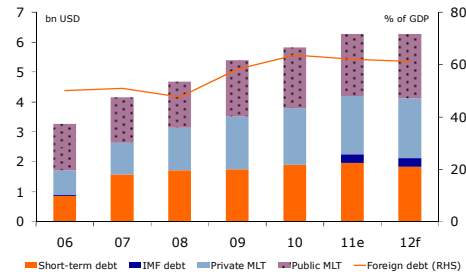
Besides the current account deficit, the external financing requirements of Macedonia are determined by interest and repayments on short and medium-to-long-term loans. Short-term debt accounts for more than 60% of Macedonia's total financing requirements. The bulk of Macedonia's external financing sources is debt financing. Only a small part is covered by foreign investment. Within the debt financing sources, short-term debt is the most-important. The large dependence on short-term foreign debt makes Macedonia's external position more vulnerable. On the back of debt financing, the level of foreign debt has been rising rapidly in the past years. It increased from USD 3.3bn (50% of GDP) in 2006 to USD 5.8bn (63.7% of GDP) in 2010. In 2011/12, foreign debt is expected to be around USD 6bn (62% of GDP).

**Chart 3: Current account balance**



Source: EIU

**Chart 4: Foreign debt**



Source: EIU



## Country report FYR MACEDONIA

Macedonia							
Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
<i>Key country risk indicators</i>							
GDP (% real change pa)	4.3	5.9	4.8	-0.9	0.7	2.2	3.4
Consumer prices (average % change pa)	3.2	2.3	8.3	-0.8	1.6	5.1	3.2
Current account balance (% of GDP)	-0.4	-7.4	-12.4	-6.5	-2.8	-5.5	-4.9
Total foreign exchange reserves (mln USD)	1751	2082	1920	2051	1907	2050	2090
<i>Economic growth</i>							
GDP (% real change pa)	4.3	5.9	4.8	-0.9	0.7	2.2	3.4
Gross fixed investment (% real change pa)	8.1	17.8	6.0	0.9	-7.5	6.5	7.0
Private consumption (real % change pa)	5.4	7.2	5.8	-3.9	1.1	1.9	4.0
Government consumption (% real change pa)	3.3	6.1	2.0	-6.4	-3.0	2.2	1.5
Exports of G&S (% real change pa)	9.2	11.8	7.5	-10.7	22.7	6.3	6.8
Imports of G&S (% real change pa)	10.9	15.2	11.8	-11.1	10.7	7.0	8.0
<i>Economic policy</i>							
Budget balance (% of GDP)	-0.5	0.3	-0.9	-2.7	-2.5	-2.5	-2.0
Public debt (% of GDP)	32	24	21	24	25	26	25
Money market interest rate (%)	6.0	5.1	6.5	8.5	5.8	5.3	5.3
M2 growth (% change pa)	25	28	7	4	6	10	12
Consumer prices (average % change pa)	3.2	2.3	8.3	-0.8	1.6	5.1	3.2
Exchange rate LCU to USD (average)	48.8	44.7	41.9	44.1	46.4	45.0	47.4
Recorded unemployment (%)	36.0	34.9	33.8	32.2	32.3	31.9	31.4
<i>Balance of payments (mln USD)</i>							
Current account balance	-29	-606	-1220	-600	-259	-550	-500
Trade balance	-1261	-1639	-2573	-2157	-1943	-2240	-2170
Export value of goods	2411	3392	3971	2686	3332	4180	4330
Import value of goods	3671	5030	6543	4842	5275	6430	6500
Services balance	29	34	12	40	79	110	100
Income balance	-34	-385	-115	-83	-198	-110	-110
Transfer balance	1237	1383	1456	1599	1804	1700	1680
Net direct investment flows	424	700	601	235	294	340	470
Net portfolio investment flows	92	155	-73	-99	-70	-50	-20
Net debt flows	28	726	649	722	457	470	170
Other capital flows (negative is flight)	33	-600	-112	-74	-537	-130	-70
Change in international reserves	549	375	-156	183	-115	70	40
<i>External position (mln USD)</i>							
Total foreign debt	3284	4161	4678	5405	5821	6280	6280
Short-term debt	867	1597	1729	1753	1910	1980	1850
Total debt service due, incl. short-term debt	1427	1708	2236	2365	2309	2620	2710
Total foreign exchange reserves	1751	2082	1920	2051	1907	2050	2090
International investment position	-2474	-3528	-4606	n.a.	n.a.	n.a.	n.a.
Total assets	3257	3946	3463	n.a.	n.a.	n.a.	n.a.
Total liabilities	5730	7474	8069	n.a.	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-19.2	-20.1	-26.2	-23.2	-21.3	-22.2	-21.1
Current account balance (% of GDP)	-0.4	-7.4	-12.4	-6.5	-2.8	-5.5	-4.9
Inward FDI (% of GDP)	6.5	8.6	6.0	2.7	3.2	3.5	4.7
Foreign debt (% of GDP)	50	51	48	58	64	62	61
Foreign debt (% of XGSIT)	74	70	69	100	94	88	87
International investment position (% of GDP)	-37.7	-43.2	-46.8	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	32	29	33	44	37	37	37
Interest service ratio incl. arrears (% of XGSIT)	3	3	3	3	3	3	3
FX-reserves import cover (months)	4.9	4.3	3.1	4.3	3.8	3.4	3.4
FX-reserves debt service cover (%)	123	122	86	87	83	78	77
Liquidity ratio	123	111	93	101	101	97	98

Source: EIU

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