



Summary

The economy in Macedonia is weakening, mainly as a result of the disappointing economic performance of EU countries, Macedonia's main trade partners. Real GDP growth was lower than expected in 2011 at 3% and a further slowdown of growth to between 1% and 2% is estimated for this year. Slower growth and the easing of food and fuel prices have led to inflation falling to an estimated 3.5% in 2012. Meanwhile, the government is trying to achieve the 2.5% of GDP budget deficit target by adjusting expenditures in line with lower revenues. However, efforts to boost employment are expected to lead to the target being overshoot slightly. Although export growth has weakened, import growth weakened even more, leading to an improvement of the current account balance to between 2% and 4% in 2012. At the same time, investment and remittances inflows are suffering from the problems in the eurozone. Overall, Macedonia's external position and liquidity remain rather weak.

Things to watch:

- Impact of eurozone problems on Macedonia's economy and external account
- Progress on NATO and EU membership
- Ethnic tensions¹

Author: **Erwin Blaauw**
Country Risk Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-62648
E.R.Blaauw@rn.rabobank.nl

¹ see Rabobank Country Risk report of June 2011 for more information on this topic

Macedonia					
National facts		Social and governance indicators		rank / total	
Type of government	Parliamentary democracy	Human Development Index (rank)	78 / 187		
Capital	Skopje	Ease of doing business (rank)	22 / 183		
Surface area (thousand sq km)	26	Economic freedom index (rank)	43 / 179		
Population (millions)	2.1	Corruption perceptions index (rank)	69 / 183		
Main languages	Macedonian (official; 67%) Albanian (official; 25%)	Press freedom index (rank)	94 / 178		
Main religions	Macedonian Orthodox (65%) Muslim (33%) other Christian (0.4%)	Gini index (income distribution)	44.2		
Head of State (president)	Gjorge Ivanov	Population below \$1.25 per day (PPP)	0%		
Head of Government (prime-minister)	Nikola Gruevski	Foreign trade			
Monetary unit	Macedonian denar (MKD)	2010			
		Main export partners (%)	Main import partners (%)		
		Germany	21	Germany	11
		Serbia	13	Russia	10
		Kosovo	8	Greece	8
		Greece	7	Serbia	8
Economy		2011			
Economic size		bn USD	% world total		
Nominal GDP	10	0.01	Main export products (%)		
Nominal GDP at PPP	21	0.03	Iron & steel		
Export value of goods and services	5	0.03	Clothing		
IMF quotum (in mln SDR)	69	0.03	Petroleum & petroleum products		
Economic structure		2011	5-year av.		
Real GDP growth	3.0	3.4	Tobacco		
Agriculture (% of GDP)	11	11	Main import products (%)		
Industry (% of GDP)	28	29	Petroleum and petroleum products		
Services (% of GDP)	61	60	Road vehicles		
Standards of living		USD	% world av.		
Nominal GDP per head	5016	47	Industrial machinery		
Nominal GDP per head at PPP	10001	81	Meat and meat preparations		
Real GDP per head	3532	43	Openness of the economy		
				2011	
		Export value of G&S (% of GDP)		53	
		Import value of G&S (% of GDP)		72	
		Inward FDI (% of GDP)		4.0	

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

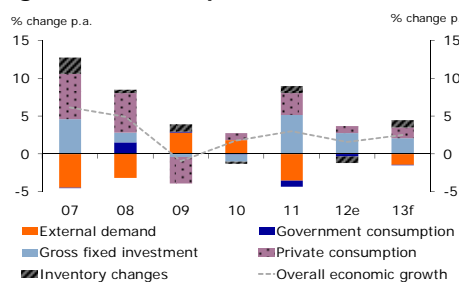
Introduction and update

Mainly as a result of the strong performance of the economy in the first half of 2011, full year GDP growth came in at a lower than expected 3% last year. However, as a result of the adverse impact of the eurozone debt crisis, on foreign investment and remittances inflows and on external demand, Macedonia's economy will slow down further in 2012. Particularly the dire situation in Greece, one of the main trade partners of Macedonia, is affecting Macedonia. In addition, the government is cutting back on investment and consumption spending, which is also negatively affecting growth. In the first quarter, real GDP contracted by 1.4% year-on-year as a result and it is likely that the second quarter, and perhaps also the third, will show continued economic weakness. Thus, while a real GDP growth rate of 3.4% was anticipated in the previous report, we now expect only between 1% and 2% growth in 2012. For next year, we expect a rebound on the back of strengthening external demand for commodities, which should propel growth to around 3% in 2013.

Although inflation was estimated at 5.1% for 2011, inflation peaked at 3.9% as growth disappointed. For this year, we estimate that consumer prices will increase by between 3% and 4%, but lower than expected food and fuel prices could push inflation back further. The favourable inflation development in combination with slower growth has prompted the National Bank to ease monetary policies somewhat this year.

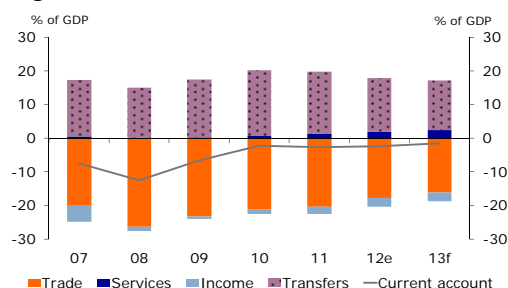
Meanwhile, as in 2011, the government has adjusted its spending plans downward in line with lower revenue projections, in response to disappointing economic growth in order to still be able to achieve the 2.5% of GDP budget deficit target in 2012. Given the still rather optimistic revenue projections for this year and the government's intention to implement measures to reduce the country's high unemployment rate (31%), the target may be overshoot slightly though. As a result of the budget deficits from 2009 onwards, public debt increased from 21% of GDP in 2008 to an estimated 26% of GDP in 2012. It was recently announced that the government has secured a foreign bank loan that will enable Macedonia to meet the remaining financing needs in 2012 and repay a bond maturing in January 2013.

Figure 1: Growth performance



Source: EIU

Figure 2: Current account



Source: EIU

Non-performing loan ratios (NPLs) are elevated at around 10%, but Macedonia's financial sector is seen as stable and well capitalized nonetheless. Provisions exceed NPLs, liquidity or solvency problems are not present and capital adequacy ratios are sound at close to 17%.

In 2011, the current account balance did not deteriorate as strongly as had been expected in the previous country risk report, dated June 2011. Although export growth was slower than anticipated due to the weakening economic environment in the EU, import growth slowed down even further due to lower oil prices and weak domestic demand. As a result, the trade deficit narrowed to 20.4% of GDP in 2011, which is still high but lower than the 22.2% estimated earlier. As a result, the current account deficit amounted to 2.7% of GDP in 2011, where a deficit of 5.5% had been estimated. This year, we expect both export and import growth to remain weak, with the trade deficit narrowing further to around 18% of GDP and the current account deficit falling to between 2% and 3% of GDP. This is expected despite the slowdown in remittances from USD 1.9bn in 2011 to an estimated USD 1.6bn this year. The eurozone issues affect the important remittances flow adversely, especially as many Macedonians work in Greece.

While the current account balance is expected to improve this year, the financial account is weakening. This is mainly the result of the economic problems in the eurozone, with FDI inflows slowing to around USD 220m this year – far lower than the USD 470m expected before. As a result of the lower than expected current account deficit, FX-reserves increased faster than anticipated, amounting to USD 2.3bn by end-2011. However, with external debt at around 66% of GDP, some 35% of which is short-term debt, and the liquidity ratio at 104%, Macedonia's external position and liquidity is rather weak.

Progress towards NATO membership

With the International Court of Justice ruling in favour of Macedonia's claim that Greece has violated the bilateral interim accord, signed in 1995, by vetoing Macedonia's access to NATO in

Country update MACEDONIA

2008, hopes of progress regarding Macedonia's NATO, and possibly even EU membership had risen. Greece is opposed to Macedonia's membership of NATO and the EU, due to a long-running dispute over FYR Macedonia's use of the name Macedonia (hence the addition of FYR to the official name). Greece claims the right of the name Macedonia, as this is also a province in the north of Greece. However, with the issue being overshadowed by Greece's economic perils, it has all but fallen off the agenda. As a result, it is unlikely to be resolved shortly, which implies that both the NATO membership and the EU membership process will suffer further delays in spite of the International Court of Justice ruling in Macedonia's favour.

Macedonia							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	6.2	4.9	-0.9	1.8	3.0	1.6	2.5
Consumer prices (average % change pa)	2.3	8.3	-0.8	1.6	3.9	3.5	3.1
Current account balance (% of GDP)	-7.4	-12.6	-6.5	-2.2	-2.7	-2.4	-1.5
Total foreign exchange reserves (mln USD)	2082	1920	2051	1970	2331	2450	2570
<i>Economic growth</i>							
GDP (% real change pa)	6.2	4.9	-0.9	1.8	3.0	1.6	2.5
Gross fixed investment (% real change pa)	22.2	5.4	-1.5	-3.7	22.7	9.8	7.1
Private consumption (real % change pa)	7.4	6.5	-4.2	1.1	3.7	1.1	1.8
Government consumption (% real change pa)	-0.3	10.6	0.5	-0.4	-5.5	-2.1	-0.8
Exports of G&S (% real change pa)	11.8	-6.3	-16.2	23.4	11.3	4.1	8.3
Imports of G&S (% real change pa)	16.1	0.8	-15.0	10.9	14.1	2.6	7.9
<i>Economic policy</i>							
Budget balance (% of GDP)	0.3	-0.9	-2.7	-2.5	-2.5	-2.7	-2.4
Public debt (% of GDP)	24	21	24	25	28	27	26
Money market interest rate (%)	5.1	6.5	8.5	5.7	4.0	4.8	5.6
M2 growth (% change pa)	28	7	4	8	8	4	6
Consumer prices (average % change pa)	2.3	8.3	-0.8	1.6	3.9	3.5	3.1
Exchange rate LCU to USD (average)	44.7	41.9	44.1	46.5	44.2	47.1	47.6
Recorded unemployment (%)	34.9	33.8	32.2	32.0	31.4	31.3	30.6
<i>Balance of payments (mln USD)</i>							
Current account balance	-606	-1236	-610	-200	-282	-240	-160
Trade balance	-1639	-2590	-2169	-1946	-2113	-1810	-1730
Export value of goods	3392	3983	2702	3296	4348	4450	5030
Import value of goods	5030	6573	4871	5241	6460	6270	6760
Services balance	39	16	24	64	151	200	260
Income balance	-389	-120	-67	-124	-220	-270	-270
Transfer balance	1383	1458	1602	1805	1900	1640	1580
Net direct investment flows	700	601	185	206	408	220	300
Net portfolio investment flows	155	-73	-97	-78	-45	-20	0
Net debt flows	726	567	868	277	826	670	400
Other capital flows (negative is flight)	-600	-15	-164	-218	-604	-510	-430
Change in international reserves	375	-156	183	-14	304	120	120
<i>External position (mln USD)</i>							
Total foreign debt	4161	4681	5593	5804	6609	6750	6930
Short-term debt	1597	1668	1899	2054	2132	2370	2390
Total debt service due, incl. short-term debt	1708	2219	2368	2795	2819	2850	3080
Total foreign exchange reserves	2082	1920	2051	1970	2331	2450	2570
International investment position	-3529	-4605	-5182	-4942	n.a.	n.a.	n.a.
Total assets	3946	3464	3737	3918	n.a.	n.a.	n.a.
Total liabilities	7475	8069	8919	8860	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-20.1	-26.3	-23.3	-21.2	-20.4	-17.8	-16.2
Current account balance (% of GDP)	-7.4	-12.6	-6.5	-2.2	-2.7	-2.4	-1.5
Inward FDI (% of GDP)	8.6	6.0	2.1	2.3	4.0	2.2	2.9
Foreign debt (% of GDP)	51	48	60	63	64	66	65
Foreign debt (% of XGSIT)	70	69	103	93	86	91	86
International investment position (% of GDP)	-43.2	-46.8	-55.6	-53.8	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	29	33	44	45	37	38	38
Interest service ratio incl. arrears (% of XGSIT)	3	3	4	4	3	3	3
FX-reserves import cover (months)	4.3	3.0	4.3	3.9	3.8	4.1	4.0
FX-reserves debt service cover (%)	122	87	87	70	83	86	83
Liquidity ratio	111	93	101	101	104	104	104

Source: EIU

Disclaimer

This document is issued by Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. incorporated in the Netherlands, trading as Rabobank Nederland, and regulated by the FSA. The information and opinions contained herein have been compiled or arrived at from sources believed to be reliable, but no representation or warranty, express or implied, is made as to their accuracy or completeness. It is for information purposes only and should not be construed as an offer for sale or subscription of, or solicitation of an offer to buy or subscribe for any securities or derivatives. The information contained herein is not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient. All opinions expressed herein are subject to change without notice. Neither Rabobank Nederland, nor other legal entities in the group to which it belongs accept any liability whatsoever for any direct or consequential loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith, and their directors, officers and/or employees may have had a long or short position and may have traded or acted as principal in the securities described within this report, or related securities. Further it may have or have had a relationship with or may provide or have provided corporate finance or other services to companies whose securities are described in this report, or any related investment. This document is for distribution in or from the Netherlands and the United Kingdom, and is directed only at authorised or exempted persons within the meaning of the Financial Services and Markets Act 2000 or to persons described in Part IV Article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2001, or to persons categorised as a "market counterparty or intermediate customer" in accordance with COBS 3.2.5. The document is not intended to be distributed, or passed on, directly or indirectly, to those who may not have professional experience in matters relating to investments, nor should it be relied upon by such persons. The distribution of this document in other jurisdictions may be restricted by law and recipients into whose possession this document comes from should inform themselves about, and observe any such restrictions. Neither this document nor any copy of it may be taken or transmitted, or distributed directly or indirectly into the United States, Canada, and Japan or to any US-person. This document may not be reproduced, distributed or published, in whole or in part, for any purpose, except with the prior written consent of Rabobank Nederland. By accepting this document you agree to be bound by the foregoing restrictions.